NOTTINGHAM ADVISORS
ASSET MANAGEMENT

Why <u>Real</u> Returns Matter

Let's face it, portfolio return measurement is a big part of the investment management game we all play. While everyone's return bogey tends to be a little different – some chase after the S&P 500 return, while other pursue returns based on fixed-income benchmarks like the Barclays Aggregate Bond Index – we all tend to take periodic stock of where we stand financially. It's important, however, to always understand just what those return numbers mean – and what they don't mean.

We all live in a world of **nominal** returns. Remember, however:

Nominal returns = Real returns + Inflation

During the spring of 1980, an investor could have bought a 10-year risk-free US Treasury note yielding better than 12% per annum! Inflation, however, as measured by the YoY change in the Consumer Price Index (CPI), came in at 14.8%. So, based on the simple formula above, that investor recognized a real return of -2.8%. <u>They actually lost purchasing power</u> even though their investment earned 12%!

Inflation is public enemy #1 for most fixed income investors. Given the 35-year period of disinflation (disinflation is a declining rate of inflation) that we have experience since the early '80's, it's understandable that many investors may simply ignore inflation measures today. However, it doesn't take much of an increase in prices to wipe out the meager yields available in today's market.

Having a hedge for fixed income portfolios seems to make a lot of sense to us at Nottingham Advisors. That's where our Real Return strategy comes in. Designed and first implemented four years ago, this strategy has proven itself valuable in mitigating some of the ravaging affects that inflation can play on traditional fixed income portfolios.

The Nottingham Advisors Real Return strategy combines four distinct asset classes, each with a proven track record of generating real inflation-adjusted returns. These four asset classes - Equites, Commodities, Fixed Income & Alternatives - are equally weighted and rebalanced annually. The sub-sectors within each asset classes are carefully monitored to ensure sufficient diversification and positive correlations with inflation.

Our equity allocation, utilizing liquid and low-cost exchange-traded funds (ETF's), emphasizes high quality companies with a long history of consistently growing their dividends. Along with dividend growth companies, we also focus on businesses in the infrastructure space. Industry centered around toll roads, utilities and airports, to name a few, involve long-lived assets and a degree of pricing power which allows for incremental costs to be passed on to users of the assets.

Commodities have a long history of increasing in value during periods of rising inflation. Along with positions in gold and silver, we invest in companies involved in agribusiness as well as the energy space. Energy prices have historically made up a big component of CPI and companies involved in this space provide something of a natural hedge against higher energy prices.

The Real Return strategy's Fixed Income allocation is comprised of adjustable-rate and inflation-protected ETF's. These contain securities that allow for future price adjustments based upon the published rate of inflation in the US economy, such as TIPS, as well as securities with variable or floating-rate coupons.

Lastly, we have an allocation to the so-called Alternative space that is may consist of real-estate ETF's, currency exposures or other certain inflation-sensitive positions. These positions are monitored and adjusted over time, with all sectors subject to rebalancing annually.

For more information about Nottingham Advisors Real Return Strategy, please call our office.

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