

Asset Returns

December 31, 2006	2006	2005	2004	10 Year	20 Year
Domestic stocks					
Large	15.7	4.8	10.7	10.7	13.2
Large Value	22.0	6.9	16.1	11.9	13.6
Large Growth	8.9	5.1	6.1	9.6	12.6
Small	18.2	4.5	18.2	10.7	11.8
Small Value	23.2	4.4	22.1	14.4	14.1
Small Growth	13.1	4.0	14.1	7.4	9.5
Micro Cap	16.2	5.7	18.4	15.4	14.5
International stocks					
Large	26.0	13.3	19.0	7.9	12.2
Large Value	30.0	14.4	24.9	10.2	14.5
Large Growth	21.9	13.6	16.5	5.6	10.0
Small	24.9	22.0	30.9	11.5	-
Small Value	28.4	23.2	34.8	12.5	-
Emerg. Mkts.	30.7	32.6	24.6	11.3	-
EM Small	37.3	25.8	28.9	-	-
EM Value	37.9	30.8	39.5	-	-
Sectors					
U.S. REITs	35.5	8.9	30.2	16.7	12.3
Energy	18.4	40.2	33.9	16.8	14.9
Bonds					
Short Term	4.8	2.3	0.9	4.3	4.6
Five Year	3.9	1.7	2.9	6.2	7.5
Long Bond	1.7	6.6	7.1	7.9	10.3
Total Market	4.3	2.4	4.3	6.2	8.0
Other					
Inflation	-	3.4	3.3	2.5	3.0
Comm. RE	-	14.5	16.1	11.8	8.0
Residential RE	-	8.3	13.5	6.6	5.5
Hedge Funds	-	2.7	2.7	9.9	-
Commodities	-	18.9	12.5	5.6	5.9

SOURCES:

Large Cap data is based on S&P 500 returns.
 Large Value and Growth returns are based on Russell 1000 Value and Growth data.
 Small Cap, Small Value & Small Growth are based on Russell 2000, R2000 Value and R2000 Growth data.
 Micro Cap returns are based on the CRSP 9-10 index of the smallest publicly traded stocks.
 Int'l Large, Large Value and Large Growth are based on MSCI's EAFE Indexes.
 International Small & Small Value returns are based on small company data in developed markets from DFA.
 Emerging Markets data is from MSCI's Emerging Market.
 Emerging Market Value and Small Cap data is based on Indexes maintained by DFA.
 REITs are based on the Wilshire REIT index.
 Energy data is from S&P's energy index.
 Short term bonds are represented by Lehman's index.
 Five year bonds are five year treasury returns and long term bonds are 20 year treasuries.
 Total Bond market is the Lehman Aggregate Index.
 Other data comes from the Federal Reserve, National Association of Realtors, HFRI & the CRB.

PAST PERFORMANCE IS NOT A GUARANTEE OF FUTURE RESULTS. INVESTMENT OBJECTIVES, RISKS, CHARGES, EXPENSES AND OTHER IMPORTANT INFORMATION ABOUT A FUND ARE CONTAINED IN THE PROSPECTUS; READ AND CONSIDER IT CAREFULLY BEFORE INVESTING. PROSPECTUSES ARE AVAILABLE ON COMPANY WEBSITES OR FROM TSI.

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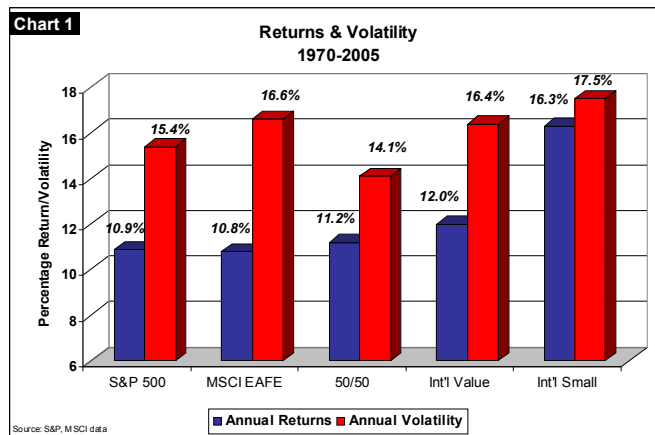
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International Investing (Part 2)

Last month I reviewed the economic case for international investing. Basically, the U.S. is becoming a smaller part of the world economy. By investing outside the domestic markets, investors have the opportunity to diversify among different economies and gain exposure to countries with faster growth rates than our domestic economy. I also discussed some of the incremental risks associated with investing abroad. These include a lack of long-term market history, political instability, transparency, and exchange rate fluctuations. This month I will review the history of risk and return, discuss size and value effects, and review historic portfolio impacts of international diversification for developed and emerging markets.

Developed Markets

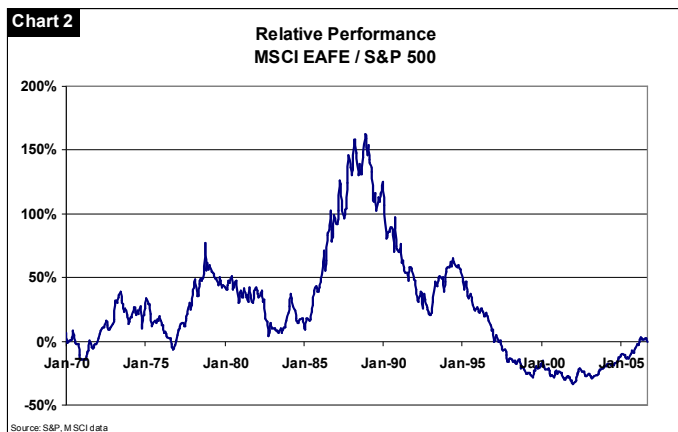
We have good data on U.S. market returns back to the early 1900s. However, broad-based international market information isn't available prior to 1970, when the Morgan Stanley Capital International (MSCI) Europe, Australia and the Far East (EAFE) index began. A few markets (i.e. Great Britain) have market history going back to the early 1900s. However markets like Japan and Germany started from scratch after World War II and 1970 was only 25 years after the close of the war. Chart 1 shows the returns and volatility for the S&P 500 and the MSCI EAFE from 1970 to 2005. Additionally, it shows the performance of a combined index with 50% domestic and 50% international stocks. Since 1970, domestic and international stocks have had almost the same compound annual return, 10.9% and 10.8% (in U.S. dollar terms) respectively. Over the same period, a combined portfolio of 50% domestic and 50% international would have produced slightly higher returns and lower volatility than either index individually. This outcome supports a central tenet of Modern Portfolio Theory; diversification can lower volatility and increase returns (when executed properly).



So far, so good, international stocks from developed markets have performed generally inline with U.S. stocks over time and their inclusion in a portfolio can increase returns and lower volatility. However, Chart 2 illustrates a potential problem for investors. Domestic and international stocks

have long periods of varying performance. From 1985 to 1990, international stocks climbed over 100% relative to domestic stocks. However, from 1990 to 2002, they steadily trailed domestic stocks. Investors who held international stocks endured 12 years of under-performance from their foreign holdings. Much of this under-performance was driven by the prolonged bear market in Japan (the second largest equity market). Just the opposite was true over the last four years, as the EAFE has outperformed the S&P 500 by over 30%.

In the past, I've discussed the impact of valuation and company size on returns for domestic stocks, pointing out that value stocks have generally produced higher returns



than more expensive growth stocks. Additionally, small company stocks have outperformed large company stocks over time. Of course, the higher returns have come with higher volatility, but investors can construct portfolios that attempt to capture these structural aspects of the equity markets. Chart 1 shows the same valuation and size effects are present in international markets. From this chart, you can see that investors who take on international exposure would have benefited from exposure to value stocks and small caps.

Emerging Markets

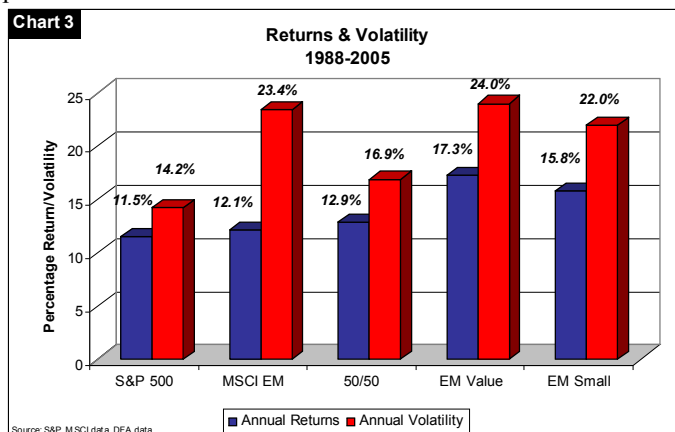
The first emerging market's index was the MSCI Emerging Markets (EM) index, which started in 1988. The index's top 10 market weights are:

EM Index Holdings	
1. South Korea	16.5%
2. Taiwan	10.7%
3. Brazil	10.2%
4. Russia	9.9%
5. China	9.8%
6. South Africa	9.2%
7. Mexico	7.6%
8. India	5.5%
9. Isreal	4.0%
10. Indonesia	2.7%

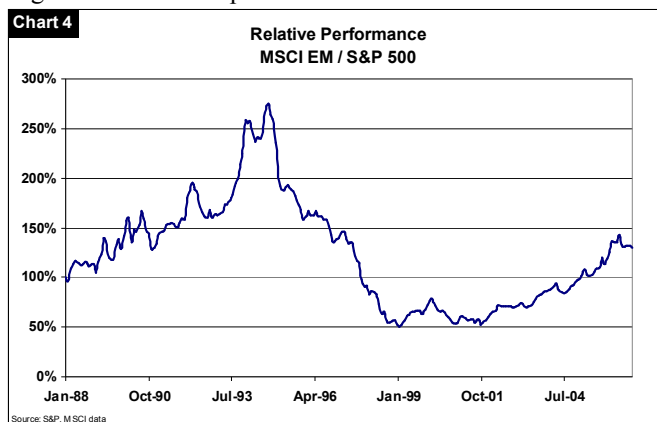
China and India represent almost 40% of the world population, but they are only 15% of the MSCI EM index due to their relatively recent experiment with capitalism. However, South Korea, with four decades of free market growth is well represented by companies like Samsung and Korea Electric. Taiwan, with 23 million people, has a representation larger than mainland China's (1.1 billion people.) Although there are a handful of international industrial powers (i.e. Samsung, Taiwan Semiconductor), most of the companies in the index are related to basic industries like oil & gas, mining, communications, and utilities. Since the index is capitalization weighted, the country and industry weights will change over time as these "emerging markets" become more developed. Consequently, China and India will likely increase their share of the index in coming years.

Theoretically, emerging market returns should be higher than U.S. returns and also more volatile. Because the economies are relatively small and more uncertain, the companies in those economies will also be relatively small and should trade at a discount to a similar company in the developed world. Chart 3 shows the performance of the MSCI EM, S&P 500, a combined portfolio, EM value stocks and EM small stocks since 1988. EM returns have been higher than domestic

returns and much more volatile. Within emerging markets, value stocks and small stocks have outperformed their larger peers.



At first glance, it doesn't look like the higher EM returns are justified by their 65% increase in volatility. A review of EM history helps put the volatility and returns in context. Chart 4 shows the relative returns of the EM index to the S&P 500. Similar to the developed markets index, there were periods of sustained over and under performance. However, the period from 1994 to 1999 saw three crises that drove EM underperformance. First, Mexico devalued its currency in 1995. This caused severe problems in Mexico and other Latin American countries. Next, the "Asian Tigers" experienced economic problems in 1997 due to currency speculation and devaluation. Finally, Russia defaulted on its debt in 1998, causing the collapse of Long Term Capital. These successive crises are responsible for the relative underperformance. Since early 1999, the MSCI EM is up almost 300% versus a 15% increase for the S&P 500. Based on the potential for higher returns in the future, I would argue investors can benefit from limited exposure to emerging markets. Additionally, volatility could decline as the markets become larger and more transparent.



Summary

Modern Portfolio Theory states investors should diversify among different asset classes with the hope of reducing volatility and improving returns. International exposure can improve portfolio risk and return characteristics. Additionally, value and small cap stocks have shown strong performance relative to large caps in both developed and emerging markets. A balanced portfolio can include several asset classes within both the developed and developing markets.