

**CORNERSTONE**  
Investment Services, LLC

Cornerstone Investment Services LLC Money Managers

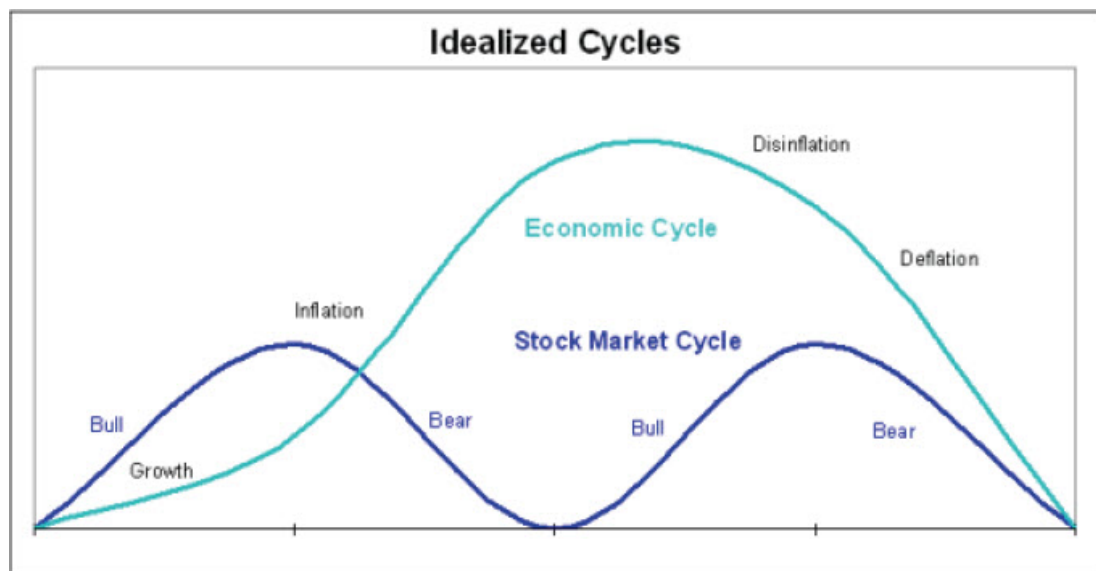
# LONG TERM CYCLES/ASSET ALLOCATION

*Be Prepared, Not Surprised!*

## UNDERSTANDING THE MACRO-CYCLES

The first thing that needs to be done is understand the macro-economic cycle and how it affects the market cycle. This is done by reviewing various economic statistics and seeing how they have progressed over time. With this information we are able to determine approximately where in the cycle the economy currently is.

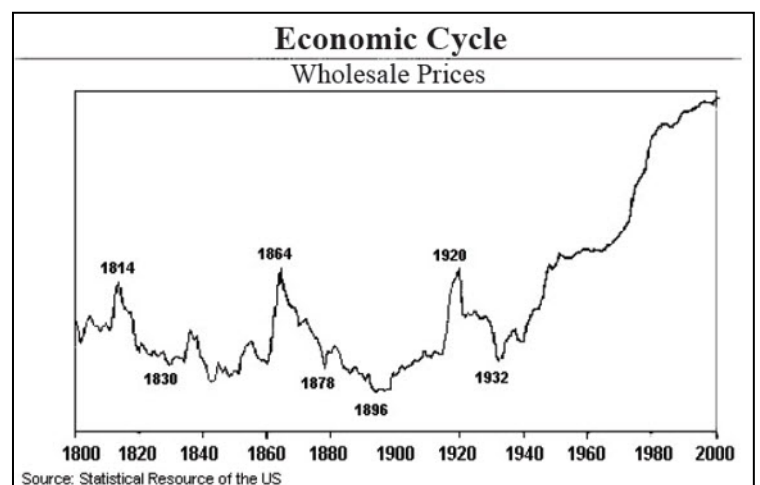
This is an economic overview, or top down approach. Macro-economic trends are the "big picture" if you will, and indicate what sectors of the economy and industries will do well and which will have a downturn. A solidly built economic view will insulate the investor from playing the "number of the day" game that causes so much volatility in the markets today. Once the economic overview is in place, the sectors of the economy and industries that will benefit from this view will become evident.



## IDEALIZED AND ACTUAL CYCLES

The chart above is "idealized". It does not show the actual movements and shapes of the cycles. But it does give a good indication of the relationship between macro economic trends and macro stock market cycles.

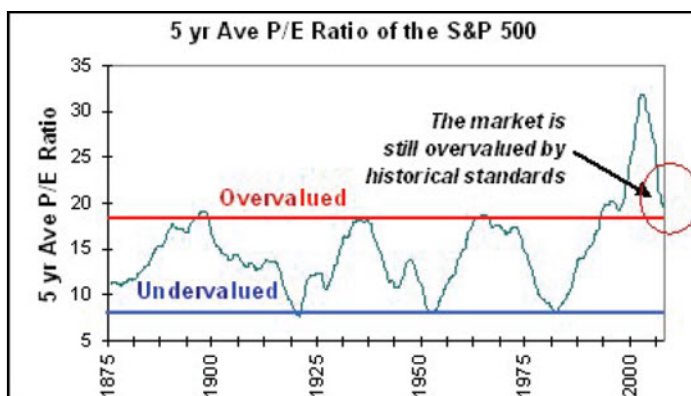
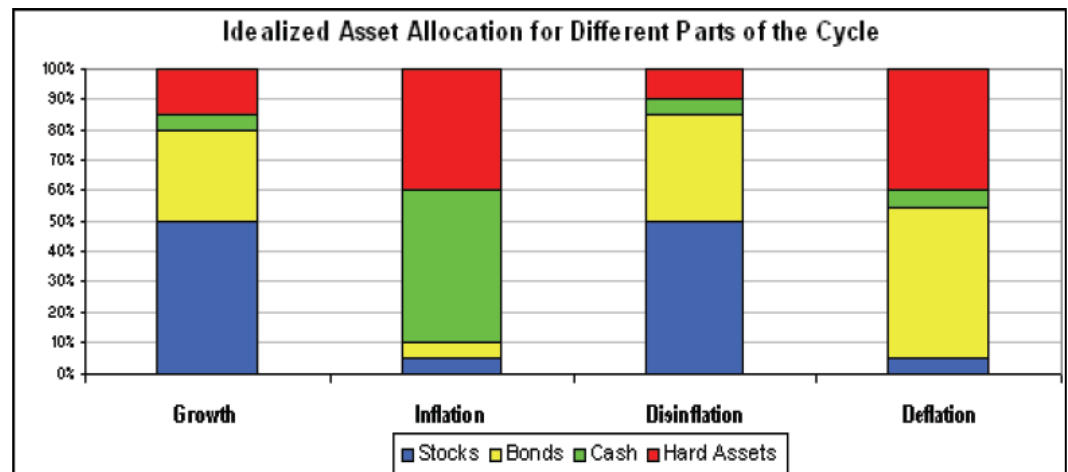
To the right are the actual cycles. While not as smooth as the idealized charts, the cycles are clear. The Economic Cycle chart shows the ebb and flow of inflation to deflation.



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The chart below shows the Market Cycle. It shows the true measurement of value in the market, the P/E ratio. We averaged the P/E ratios over a 5 year time frame. The peaks and valleys of the cycle are obvious. The P/E ratio peaked a few years ago and we are now heading into the declining part of the cycle. Normally, the 5 year average P/E ratio doesn't bottom until it hits single digits. This would be a decline of 50% in the current S&P 500, or a doubling of earnings. In the current economy, which is more likely?



None of the cycles were exactly the same as the previous one, but they had the same characteristics. The specific causes of the recoveries and downturns were all different, but the effects were the same.

Excessive debt was usually the main cause of deflationary downturns. It is the same today in Japan and in the US.

## ASSET ALLOCATION

The market cycle and economic cycle determine asset allocation. Asset allocation is the key to investment success. We at Cornerstone have determined the appropriate mix of assets for various economic and market conditions based on a thorough study of market history and application. An idealized allocation model has been developed for each part of the market cycle. Cornerstone has developed a model portfolio that fine tunes the allocation for today's markets. (The allocations are not meant to be static, since within each cycle there are counter trends that have to be managed with allocations increasing and decreasing.)

Diversification does not ensure a profit or guarantee against a loss. There is no assurance that any investment strategy will be successful. Investing involves risk and you may incur a profit or a loss.

Fee based money management and Financial Planning offered through Cornerstone Investment Services, LLC's RIA Accounts are carried by National Financial Services Corporation, Member NYSE/SIPC

Past performance is no guarantee of future results

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