DSA Communiqué

December 2011

Since the inception of our firm in 1994, our goal has always been the same – *meeting your objectives and exceeding your expectations*. Droms Strauss is committed to providing you with the highest level of investment management and financial planning services. Our quarterly Communiqués are one part of our continuing efforts to effectively communicate to you what we're thinking about investments, financial planning issues, the economy, and maybe, even the political landscape. We also intend to use this communiqué to keep you posted on what's going on at Droms Strauss as we continue to grow and enhance the level of services we provide for you. We welcome your questions, comments and feedback; please feel free to contact us at any time.

As we close the door on a relatively moribund world economy in 2011, we are looking forward to what we expect will be a continued slow rebound from the 2008–09 recession and what we expect will be better equity market returns over the next few years. One of the key investment areas where we expect to see a rebound in 2012 is the global real estate investment trust (REIT) sector. Based on our recent discussions with Bob Steers (co-founder and co-chairman of the Cohen and Steers mutual fund family), we think values in the commercial real estate market right now are very attractive and provide an important avenue for diversifying our portfolios. We therefore want to use this month's Communiqué to review the investment outlook for the REIT sector.

Why we own REIT (Real Estate Investment Trust) Funds

DSA has owned REIT funds, Cohen & Steers, in particular, since 1996 and over the course of the past 15 years we periodically are asked why we maintain our long-term commitment to REITs. The answer is this: we believe that REITs offer three important attributes that are appealing to long-term investors.

First, over most long periods of time, REIT returns have been superior to other equity return classes and also have been less volatile. For the ten years ended 2011, for example, the average annual compound return on the S&P 500 Index is a rather anemic 2.9% per year while the Dow Jones Real Estate index had a compound average return of 10.2% per year. Measuring risk by the conventional volatility measure of standard deviation of return shows that REITs provided returns at much lower risk levels, providing 0.40% units of return for every unit of risk (standard deviation = 25.2%) while the S&P 500 returned only 0.14% units of return per unit risk (standard deviation = 20.5%).

Second, for us, a big attraction of REITs is that REIT returns have fairly low correlations with stock market returns and nearly zero correlations with bond market returns. Correlation measures the extents to which two return time series move together – the low correlation of REITs tell us that REIT returns are relatively independent of returns in the stock and bond markets. This provides a valuable diversification benefit because a year of low or negative stock returns does not necessarily imply that REIT returns will also be low. An excellent example of this was 2002: the S&P 500 Index lost 22% while the Dow Jones REIT Index gained 3.6%. Unfortunately, things do not always work out this way, and we probably all remember the 2008 crash when all boats sunk with the falling tide and REITs dropped right along with stocks. However, over the course of the last 15 years that we've owned REIT funds, the REIT returns have been fairly independent of stock returns.

Third, REITs throw off a much higher dividend yield than we see in the overall stock market or the interest yields in the bond market. This is particularly helpful to a balanced portfolio in times like now when most equity returns are expected to be somewhat anemic and when fixed income returns are at historically low levels. At a time when the dividend yield on the S&P 500 sits at about 2% and the 10-year Treasury bond interest yield is less than 2%, the dividend yield on the Dow Jones REIT average is just over 4%. This higher cash yield makes a significant contribution to total return from a REIT investment.

A logical follow-up question might be "how have REITs worked out for us over the past several years and what do we see looking forward?" Looking back is always the easiest question to answer so we'll answer that one first.

As mentioned earlier, over the ten years ending December 31, 2011, U.S. REITs returned an average rate of return of 10.2% as measured by the Dow Jones Real Estate Index. Cohen & Steers Realty Shares (mostly U.S. REITs) returned 11.4%. U.S. REIT returns compare favorably to the U.S. stock market which returned 2.9% as measured by the S&P 500 Index.

Looking forward to 2012 and beyond, the REIT outlook is reasonably optimistic. As we explained in our January 2011 White Paper, one of the major tactical changes we made in investment management this past year was to move to a "global mandate" in our REIT investments by combining our domestic and international REIT positions into the Cohen & Steers Global REIT fund. This move relies on the worldwide analysts and portfolio managers at Cohen and Steers to manage the country weighting of the portfolio rather than manage the country weights by setting a predetermined mix of international and U.S. REIT funds. Over the long run, we expect the global mandate to enhance the performance of our REIT investment.

We recently had the opportunity to sit down and talk with Bob Steers, Co-Chairman of Cohen and Steers. Bob explained that their view is that the global macro outlook has turned more positive due to monetary easing in the Asia Pacific region and in emerging markets as well as slow but positive economic growth in the United States. C&S expects Europe to continue to be a trouble spot and the Cohen and Steers Global portfolio is therefore underweighted in European REITs. However, C&S does believe there are "pockets of opportunity" in Europe, including prime office and retail markets in London and the relatively healthy economies in Germany and Scandinavia where the fund has continued to invest. The portfolio also is underweight in Japan but overweight in the Asia Pacific Region ex-Japan. Back in the U.S., the portfolio is overweight in the U.S. REIT market, where slow but steady GDP growth is expected to lead to gradually improving fundamentals for commercial real estate.

In 2011 U.S. REIT returns were very solid with the Dow Jones REIT Index returning 9.0% (the S&P 500 Index returned 2.11%). Unfortunately, the international markets were hammered by all of the uncertainly in Europe and slowing growth rates in China. As a result, international REITs produced losses of just over 15% in 2011 (as compared to the MS-EAFE Index which lost 12.1%). On the plus side, quality properties in the international markets continue to trade at attractive valuation levels, and 2012 may well turn out to be a significant opportunity for global REIT investment. Of course, no one can predict when or if he turnaround will come, but portfolios need to be positioned in advance to take advantage of improving returns.

And another very Happy New Year…

As we begin another new year, we reminded ourselves that we each have much to be thankful for, our health, our families and for 2011, an improving economy, albeit, slowly. We want to take this opportunity to wish each of you our very best wishes for a healthy, happy and prosperous New Year and our hope that the economies of the U.S. and the world continue to recover.

What's happening at DSA

Droms Strauss continues to grow, and we'd like to take this opportunity to thank all of you for your continued trust and confidence. It's been particularly rewarding for us that we received more referrals this year from our clients than any previous year and we hope that's a sign that you recognize how important it has always been for us to provide you with the best advice we can, and guide you through what have certainly been turbulent times.

As we've said before, our goal is to provide you and every DSA client the highest level of service. With five investment professionals we are in an excellent position to expand without compromise to relationships.

Referrals

Please take a moment to recommend us or share contact information for an individual, family or a business colleague you think could benefit from working with us. Be assured that we will regard your friends, family and business colleagues with the highest level of consideration.

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