By Philip C. Henry, ChFS, CFS
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Philip C. Henry, ChFC, CFS is the President of Henry Wealth Management, LLC, an independent financial planning firm located at 1370 Washington Pike, Bridgeville, PA. He offers Securities and Investment-Advisory Services through a non-affiliated firm, NFP Securities, Inc., a Broker/Dealer, Member FINRA/SIPC, and Federally Registered Investment Advisor.

The Odd Couple and Investing

Why Felix and Oscar-like uncorrelated investments are desirable in a portfolio

You've heard that opposites attract, right? Consider how The Odd Couple became attractive to each other. Recall that Felix Unger was a neurotic neat-freak. Thrown out by his wife, he moved in with Oscar Madison, his unkempt, slovenly friend. Though they had different personalities, they shared one important attribute: the desire to reduce living expenses, since both were paying alimony.

In the fictional world of The Odd Couple, putting opposites together made for good comedy. In the very real world of investing, different kinds of investments are often highly desirable in financial portfolios, the goal being to obtain good long-term performance while reducing portfolio volatility. This can be done by diversifying*.

Two Very Different Types of Stocks
Consider one of the best-known stock market indexes: the Standard & Poors 500 (S&P 500). This collection of 500 domestic stocks is meant to reflect the risk/return characteristics of the large-cap universe. As of December 31, 2006, the largest company in the S & P 500 was Exxon Mobile. Let's call it Oscar.

And then, let's consider Felix. The MSCI EMF-Latin America Index (EMF-LA) is quite different than the S&P 500. This index is designed to measure equity market performance of emerging Latin American countries. As of June 2006, the EMF-LA consisted of the following six country indices: Argentina, Brazil, Chile, Colombia, Mexico, and Peru. The S & P 500 and the EMF-LA are often considered extreme investment opposites.

Nine Very Different Years
Let's examine the calendar year performances of the S&P 500, the EMF-LA, and then a 70-30 blend of the two, for the last nine years.

Remember that this is just an example. I'm not advocating either a sole approach or a blend as an appropriate investment choice, since I believe in diversifying into many more than just two asset classes. All indexes are unmanaged, have limitations and cannot be directly invested in. Also, indexes have no fees. Historical performances for investment indexes generally do not reflect the deduction of transaction and/or custodial charges or the deduction of management fees. If they did, the

Henry Wealth Management, LLC
1370 Washington Pike, Sute 403
Bridgeville, PA 15017
Phone: 412.838.0200
Fax: 412.838.0204
E-mail: Admin@HenryWealth.com
Www.HenryWealth.com

historical performance would be lower. Past performance of an index does not guarantee future results. Nonetheless, it is enlightening to consider the comparisons.

Year	OSCAR: S & P 500 Index Calendar year returns	FELIX: MSCI EMF Latin America Index-Calendar year returns	THE ODD COUPLE 70% S&P 500 30% MSCI EMF Blended Calendar year returns
1998	28.58	-35.11	-7.37
1999	21.04	58.89	36.01
2000	-9.11	-16.57	-12.55
2001	-11.88	-0.39	-6.82
2002	-22.10	-22.45	-22.27
2003	28.68	73.66	49.82
2004	10.88	39.62	26.54
2005	4.91	50.42	32.27
2006	15.79	43.48	34.72
Annualized Return	**13.47**	**23.51**	**17.88**

Source: Zephyr StyleADVISOR

Notice that the "highs and lows" of the S&P 500, 28.68% in 2003 and -22.10 in 2002, are far less dramatic than of the EMF-LA, at 73.66% in 2003 and -35.11% in 1998. Its extremes seem to mirror the highly-emotional TV persona that was Felix.

International investing does present certain risks not associated with investing solely in the United States. These include, for instance, risks related to fluctuations in the value of the U.S. dollar relative to the value of other currencies, the custody arrangements made for the fund's foreign holdings, political risks, differences in accounting procedures and the lesser degree of public information required to be provided by non-U.S companies. However, I believe that from an asset allocation/diversification perspective, multiple asset classes are usually desirable.

Note the result of mixing 70% of the S & P 500 with 30% of the EMF-LA, as compared to the standalone S & P 500. One could argue that despite Felix's volatility, Oscar was still better off having Felix around. It is also important to note that a percentage mixture other than 70-30, for example, 50-50 or 20-80, would produce different results.

When it comes to the world of asset management, having an "Odd Couple" portfolio consisting of even more than two asset classes, may be more beneficial and might have you smiling… all the way to the bank!

** Diversification does not protect against the loss of principal due to fluctuating market conditions and using diversification as your strategy does not guarantee better results.*

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Bridgeville, PA 15017
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Fax: 412.838.0204
E-mail: Admin@HenryWealth.com
Www.HenryWealth.com