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A black box gets 25% return on Treasuries

Lara Group program yields stocklike gains

By Sarah O'Brien

When a government bond portfolio posts a 25.14% annual return, you know something screwy is going on with the market.

Either that or Ron Lara's top-secret mathematical model is telling you when to buy a certain kind of bond and when to follow a self-imposed, ironclad rule to sell.

The Lara Group in Vienna, Va., where Mr. Lara is a vice president, offers a program that invests exclusively in U.S. government-backed bonds.

But having the bonds guaranteed by the government is where the safety ends.

Mr. Lara's investment method relies heavily on zero-coupon bonds, called strips, which essentially are bonds that come only with the guarantee that they will be worth full face value at maturity.

Unlike other types of government bonds, no interest payments are attached. Because payment is deferred until maturity, they are the most volatile kind of bond.

"If you buy and hold these until maturity, you can know with certainty how much you'll have at the end," says Eric Jacobson, an analyst at Morningstar Inc. in Chicago.

"But if you buy and sell these bonds, you're basically buying and selling something that can be as volatile as stocks," he says.

Money is made trading strips only when interest rates fall.

In other words, say you pay $210,000 for a $1 million zero-coupon bond that matures to face value in 20 years. To get to full value, it is growing at an annual rate of 6.5%.

Then, suppose interest rates drop to 6% a year later. The bond you're holding is more valuable because it is maturing at a higher rate than a new $1 million bond maturing at just 6%.

Get the timing right and you can start making some real money.

But because predicting interest rate moves in the long term is difficult, you buy that $1 million bond on the faith that rates will go down soon.

But rates could also go up, dashing profits from the bond's sale.

That's where Mr. Lara relies on his mathematical model, which he says he shows to no one. He plugs in certain variables, and then the model spits out the ideal time to buy 20- to 22-year strips.

Then, without fail, he sells them when there's a half-percentage-point drop in interest rates.

"There aren't too many money managers out there that are good at predicting the direction of interest rates," says Mr. Jacobson. "But [Mr. Lara] did well in years that were horrible for others."

Indeed, just three mutual funds that invest in those bonds outperformed his portfolio last year.

The top performer, the $543 million American Century Target Maturity 2025 Fund, boasted a return of 32.1% in 2000. But in 1999, it lost 20.9%.

The Lara program, by contrast, lost just 0.5% in 1999. And that year it still beat the benchmark Lehman Brothers Long Treasury Bond Index, which lost 8.74%.

The Lara Group posted another strong year in 1996, when the bond portfolio gained 15.46%, and the Lehman index lost 0.87%.

Overall, the Lara portfolio had an average annual return of 12.36% over the past five years and an 11.4% return over the past 10.

Mr. Lara says his clients — which have $20 million in the program collectively — aren't complaining.

"I don't want to brag too much, but a 12% average return with Treasuries?" he asks. "My clients love it."