

August 15, 2011

“Good investors gather information, put that information into current and historical context, then make sound decisions.”

The story of the last 30 days is embodied in the drama that unfolded last week. Over a period of four consecutive days, equity indices made enormous moves in opposite directions. Specifically, the S&P 500 was down -6.5% on Monday, up +6.4% on Tuesday, down -4.5% on Wednesday, and up +4.5% on Thursday. Leading into these markets gyrations, equities had declined for 9 of the previous 10 days, with the S&P 500 dropping from 1345.02 on Friday, July 21st to 1199.38 on Friday, August 5th, a total of -10.83%. That officially qualifies on its own as a moderate correction. Then the fireworks really let loose. In my thirty plus years in this industry I have never witnessed the volatility that shook equity markets last week. It was exhilarating!

Why exhilarating and not terrifying or disturbing or distressing? Because it was a rollercoaster ride, not a plunge into an abyss. No lives were lost, just numbers tossed. And on Wednesday, we took advantage of the opportunities at hand and made calculated moves back into equities at very favorable prices. Remember, equities had been trading within a range for six months and we had raised cash at the top of that trading range in June and July, so we had money to reinvest at better prices. And oh my goodness did we ever get those better prices in a hurry!

Bond prices simply soared higher last week, especially U.S. Government bonds. In fact, this was one of the clues that a reversal was at hand. There was a lot of news last week about the Standard & Poor's downgrade of the U.S. credit rating from AAA to AA+ and many attributed the equity market action to that downgrade. But if institutional investors were losing confidence in U.S. Government bonds, why was so much money pouring into them during the equity market decline? The U.S.'s debt situation has been widely publicized for months, even years. Was the Standard & Poor's Corporation's decision to lower the credit rating such a big surprise? Hardly. The money that was flowing out of equities during the correction was flowing into U.S. Government bonds because they are safe, but mostly because they are so liquid. These means that institutions could easily buy them one day and sell them the next day so they could pour money back into equities. And that is just what the institutions did, in such volume and with such power as had never been seen.

Granted, equities are still experiencing a correction within the context of a Bull Market. This correction graduated from a moderate to a severe correction in the

course of just a few hours. But the move off those lows, known as a reversal, occurred with such energy that by today's market close, equities were right back to where they closed back on August 5th. Equities are still 10% lower than those July levels, but what a demonstration of buying power!

There is still work to be done once equities are back inside their old trading range, which we shall refer to as the chicken coop. The direction and degree of the equity market's movement when that range was broken surprised most, including us. That impression will not be easily forgotten and will color our decisions going forward. It will be interesting to see how market volatility is affected once prices are once again safe inside the familiar range. One thing is for certain, this a market that is best suited for professionals, not amateurs.

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Following our buying during the ‘blue light special’ last week, we are now more fully invested. In certain Aggressive Growth and Growth models we still carry an extra 10% in money markets. Last week we increased equity exposure by adding Small Cap Growth and Mid Cap Growth equities to most portfolios. Additionally, European equities were increased in certain Aggressive Growth portfolios. Conservative Growth, Balanced Growth, and Income & Growth models now fully invested in equities within their respective asset class constraints. SELECTOR[®] Aggressive Growth and SELECTOR[®] Growth models are 90-100% equities, with 10% balances in money markets with certain portfolios. SELECTOR[®] Conservative Growth models are 80% equities/20% bonds, and SELECTOR[®] Balanced Growth models are 60% equities/40% bonds. SELECTOR[®] Income & Growth models are 40% equities/60% bonds, with SELECTOR[®] Income models 100% invested in bonds.

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