

December 19, 2011

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

The month of November gave equity markets the pullback they needed, followed by a very nice, albeit very short rally the final week of the month. That late rally failed to set higher highs, so we are once again looking at a trading range market. We are also on the doorstep of the Holiday Season, which is historically accompanied by low trading volume and limited price action. As of last Friday's close the S&P 500 was trading at 1,219.76. It started the year at 1,257, and gets a little help from dividends, so its total return for the year is down -1.05%. Today's price action was poor, further raising the hurdle for year's end. Those of us keeping score on that 70-year old tradition of the S&P 500 gaining in the third year of a U.S. Presidency recognize that it may require a Hail Mary pass to the end zone in these final days of 2011 to keep that string intact. But this is the 'Year of the Tebow' so anything is possible.

As for the broader markets, 2011 has been a very difficult year, especially for international equity markets. Emerging markets have had the roughest time. Year-to-date, the MSCI Emerging Markets Index has fallen by -19.54%, and the S&P Latin America 40 Index is down -20.36%. The highly publicized financial problems of Europe have also taken their toll, with the S&P Europe 350 Index down -14.37%, and the MSCI Europe Financials Index down -29.20%. The broader international equity benchmark, the MSCI EAFE Index, is down -14.79% as of last Friday, the 16th.

Bond markets are enjoying a much better year. The Barclays Capital U.S. Aggregate Bond Index is up +7.72% as of last Friday. The Barclays Capital U.S. 20+ Year Treasury Bond Index is up a whopping +34.59%, and the Barclays Capital U.S. 7-10 Year Treasury Bond Index is up +15.74%, even with single-digit interest rates. The S&P National Municipal Bond Index is up +10.56%, and the Barclays Capital U.S. Treasury Inflation Protected Securities (TIPS) Index is up +13.78%. Conversely, international bond markets have suffered with their currencies, with the S&P/Citigroup International Treasury Bond Index Ex-U.S. down a total of -2.89% for the year.

For diversified asset allocation investors, 2011 has been a year where the negatives have outweighed the positives. While a diversified investment approach may result in negative total return numbers, the benefits of being diversified continue to outweigh the less manageable risks associated with concentrated portfolios. High volatility is a vexation for investors, even when employing long-term trend-following techniques, as we do at **SELECTOR**[®] Money Management. Dramatic price shifts make it difficult to secure efficient trading executions, and can dramatically 'rock the boat' with respects to asset allocation modeling. Despite this, we remain confident that diversified asset allocations provide us with the best tool set/rule set for long-term investors.

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Despite their tepid results for the year, domestic equities look pretty good compared to their international cousins. Large cap equities have weathered the high volatility better than midcap or small cap equities, as evidenced by the S&P 500 Index, down a mere -1.05% YTD. The S&P MidCap 400 Index is down -4.14%, and the Russell 2000 Small Cap Index is down -6.71% YTD. The best performing domestic equity sectors this year have been the pharmaceutical and utilities sector. The Dow Jones U.S. Select Pharmaceuticals Index is up +18.17% and the Dow Jones U.S. Utilities Index is +14.53%. The worst performing domestic equity sectors have been the Dow Jones U.S. Financial Services Index, down -22.84%, and the Dow Jones U.S. Basic Materials Index down -16.88%.

SELECTOR[®] Aggressive Growth and Growth models include 20% bond allocations, with either TIPS bonds or high quality short-intermediate term corporate bonds. **SELECTOR**[®] Conservative Growth models include 40% bonds. **SELECTOR**[®] Balanced Growth models are now 60% bonds, and **SELECTOR**[®] Income & Growth models include 80% bond allocations. **SELECTOR**[®] Income models remain 100% invested in bonds. We continue to hold relatively high money market balances as we evaluate opportunities in both bond and equity markets.

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