Monthly Commentary

SELECTOR
Real-Time Money Management

July 19, 2010

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

Last month we discussed the rebuilding process that equity markets needed to undertake in order to reestablish a new technical foundation. That construction/ demolition became a little too robust the last two weeks of June, with major market indexes driving down into new lows for the year. At Friday, June 18th's close the S&P 500 rested at 1117.51. On June 30th the S&P 500 closed at 1030.71, down -7.77% in just 8 trading days. This drop in prices was notable in that it included a 'pile driver day' when the index fell by -2.78% on June 29th. Over the next two weeks the S&P 500 bounced back up, closing at 1096.48 on July 15th, a respectable +6.40% move higher. The following day proved to be another 'pile driver day' with a drop of -2.92%.

'Pile driver days' can be therapeutic when they occur at market cycle bottoms. They are problematic, however, when they occur early into a cyclical decline. For those auto mechanics in the crowd, it is like an internal combustion engine that is prone to detonation, or 'spark knock.' Ideally, the spark ignites the air/fuel mixture at just the right time to propel the cylinder. When it ignites too soon, the result is a rough running engine. In equity markets, as in internal combustion engines, there can be many causes of detonation, but the bottom line is sluggish relative performance. This is one of the current problems with equity markets. They are 'out of tune' and the cyclical bottoms are sloppy.

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Since the April highs, equity markets have developed a pattern of setting lower lows followed by lower highs followed by lower lows. This has eroded away price levels that should have provided interim support. For example, in last month's Commentary we talked about potential bedrock for the Dow Jones Industrial Average at 9,800 and for the S&P 500 at 1050. During the most recent decline for three days the DJIA traded below 9,700, while the S&P 500 traded below the 1020 level. When markets reversed to the upside, they did so with only moderate volume. The message that this sends is, "Well, that's all the selling for now, but we'll be back." Conversely, with a healthy trading reversal the volume is high and the message is, "Who knows when we'll see these prices again, so buy now and don't look back!"

Needless to say, the disparity in these messages is significant, and we believe that our previous levels of caution are confirmed. From a technical perspective, the long-term trend remains positive, the intermediate-term trend is neutral to slightly negative and the short-term trend is distinctly negative. There have been negative crossovers between long-term and short-term moving averages for domestic major market indexes in the past thirty days. International major market indexes have been sending negative technical signals for months. In fact international equities may benefit from the weakness of domestic equities as institutional investors rethink and rebalance their asset allocations. We are already seeing evidence of this in the trailing 30-day data.

This naturally brings us back to the bond markets and their traditional role as defensive players. Bond prices continue to remain strong as they maintain their breakout levels, with certain bond indexes still surging higher. From a technical perspective, bonds are actually somewhat over-bought at current levels, with their short-term and long-term moving averages climbing steadily. A notable change of direction has taken place with the U.S. Dollar, however. The U.S. Dollar had retreated to its short-term moving average the end of June, but rather than retrenching it experienced its own 'pile driver decline' violating a short-term support level and an intermediate-term uptrend. It has since declined down to a long-term moving average, with a total decline from the June highs of -6.8%. This is not a problem for domestic bonds yet, but does soften a portion of their argument.

SELECTOR® asset allocations remain defensive and are poised in a Stage Yellow level. SELECTOR® Aggressive Growth model portfolios are 100% equities. SELECTOR® Growth portfolios are 80% equities/20% bonds. SELECTOR® Conservative Growth portfolios are 60% equities/40% bonds, with SELECTOR® Balanced Growth models 40% equities/60% bonds. SELECTOR® Income & Growth models are 20% equities/80% bonds.

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 Sources: Bloomberg, Marketwatch.com, StockCharts.com, Standard & Poor's, Wall Street Journal, iShares.com and Morningstar.