



Monthly Commentary

May 20, 2010

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

The month of May has brought an end to the market rally that began back on the 9th of February and had carried the S&P 500 +14.84% higher by April 23rd. A long-awaited and overdue market correction went very wrong, however, on the afternoon of May 6th. In the space of several minutes equity prices plunged. The S&P 500 fell -8.51% before rallying back to close down -3.09% for the day. This is being referred to as the ‘Flash Crash’ because it occurred so quickly. This rapid market drop is now being investigated and possible remedies being discussed to slow down equity markets during periods of rapidly changing buy or sell activity. It is thought that stock exchanges became overwhelmed by the size and breadth of certain computer-generated sell programs, with disruptive consequences.

Even though equity markets initially rebounded from the Flash Crash, equity markets returned to an environment that is still involved with a correction. One of the latent problems associated with the sudden drop was that although a large number of trades were determined to be incorrect and prices were adjusted accordingly, the technical ‘roadmap’ became very distorted. This distortion can tend to exaggerate the short-term perspective at the expense of the intermediate and long-term perspective. Additionally, market volatility, which had been quite subdued over the previous 10 weeks, suddenly shot through the roof. The market volatility and price action was so dramatic that equity markets actually went from being overbought to being oversold in a matter of just hours.

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SELECTOR[®] Money Management had been building bond positions over the past few months as we took profits in emerging markets and international equities, as well as energy and basic materials equities. As the Flash Crash occurred these bond positions worked to reduce portfolio volatility. A week later, as equity markets dipped back towards the 150-day moving average, we sought to take advantage of the lower prices in equities and the higher prices in bonds to reposition portfolios. A portion of the managed portfolio’s bond positions were sold and the proceeds reallocated towards small cap value equities. Additionally, technology positions were replaced with real estate securities, where available.

Repositioning portfolios during market dips can be the most rewarding or most frustrating of experiences. On one hand, it is satisfying to buy at better/lower prices. In the past week we started to buy equities at lower prices then had been available for over eight weeks, and selling bonds near their highs for the year. The frustrations settle in when prices get even better after you are finished trading. Realistically, we anticipate that prices may move a few percentage points through our trades. However, today’s market action was excessively volatile, with major market indexes falling by as much -4%. The 20/20 hindsight can be blinding and maddening. Even for experienced investors it can be frustrating.

The bad news bears have had plenty to discuss, most notably European equities and energy. The Euro-nations are being challenged as their weakest members, known as the PIIGS and including the countries of Portugal, Italy, Ireland, Greece, and Spain threaten the value of the Euro as they struggle with their economic problems. International equities had declined sharply even before the recent correction. Closer to home, as the still-uncontained Gulf oil leak continues to threaten coastal habitats, oil prices have fallen by as much as 25% in the past three weeks. Energy-related equities have also declined dramatically. Since February, SELECTOR[®] managed portfolios have held no international nor energy equities. Sometimes you are thankful for the equities you own. Sometimes you are thankful for those you don’t own.

While SELECTOR[®] asset allocations continue to be somewhat conservative, with this recent reallocation we have reduced bond positions and added to equity positions. SELECTOR[®] model portfolios currently emphasize small cap and mid cap equities. Positions have been added in the real estate equities and financial equities sectors. SELECTOR[®] Aggressive Growth model portfolios are now 100% equities, while 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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