Monthly Commentary

November 20, 2010

SELECTOR
Real-Time Money Management

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

The past month has been a tale of two markets. The last two weeks of October were extremely quiet, with the Dow Jones Industrial Average closing a mere -0.22% lower and the S&P 500 finishing with a change of just -0.12%. Then in November the fireworks started. Equity markets rose by over +3% the first five days, including a dramatic +1.9% surge on November 4th that took major market equities to levels not seen in over two years. Then, just as dramatically, markets declined for five of the next six days, falling by almost -4%, before stopping on a dime and then rallying the next three days for a +2% gain as of Friday, November 19th. So far in November, the Dow Jones Industrial average has traveled up then down then up for a total of 958 points to close 85 points higher.

During periods of high short-term volatility it is important to take a step back for perspective. Why the sudden reversals? Are markets bouncing off a bottom, trapped in a range, or breaking through a ceiling? In our opinion we are seeing equity markets break through a ceiling that has contained prices since April of 2010. Equities made a pronounced run from the March 2009 lows to the April 2010 highs that defined the new long-term Bull Market. Equity prices then consolidated back into a trading range for the next five months. When major markets rallied out of that range in September the surge had enough power to push back to the penthouse of the three tier trading range. Equity prices are now hitting on all cylinders, even with the pullback last week.

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Bond markets charts are telling a whole different story. Major bond indexes rallied strongly from April to September before settling into their own trading range. Some of the major bond indexes, such as the Barclays Aggregate Bond Index and the intermediate-term corporate bond indexes, remain in their trading ranges. But there have been notable technical breakdowns in the past month for long-term and intermediate term government bonds. These weakened sectors had been significantly over-bought in recent months. It remains to be seen if this weakness spreads to other bond sectors, but it appears that the pendulum may be shifting between the bond market performance and equity market performance.

Even with the recent pullbacks, bond returns for 2010 continue to be good. The Barclays Capital U.S. 20+ Year Treasury Bond Index is now up +10.19%, the Barclays Capital U.S. Credit Bond Index is up +9.33%, the Barclays Capital U.S. TIPS Index is up +7.72%, and the Barclays Capital High Yield Bond Index is up +13.34%. With their strong performances the past month, equity indexes have finally surpassed the performances of the bond markets. Year-to-date, the S&P 500 is now up +9.53%, the S&P 400 MidCap 400 Index up +18.49% and the Russell 2000 Index is +17.06%. Sector leadership remains with real estate securities, with energy and basic materials equities stepping into leadership positions. The Dow Jones U.S. Real Estate Index is up +20.72%, the Dow Jones U.S. Basic Materials Index is up +20.34%, and the Dow Jones U.S. Oil & Gas Index is up +11.64%. Despite Ireland's credit issues, international equities are holding gains with the S&P Europe 350 up +2.53% and the MSCI Emerging Markets Index up +14.67% YTD. Financial services, utilities, and clean energy equities remain at the bottom of the performance charts for the year.

The recent breakout in equity markets have prompted us to upgrade our allocation models from Stage Yellow to Stage Green. Accordingly, we have recently changed portfolio allocations by increasing equity versus bond ratios by an additional 20%. All SELECTOR® models are now fully invested in equities in a manner consistent with the specific style of management. SELECTOR® Aggressive Growth and SELECTOR® Growth models are 100% equities. SELECTOR® Conservative Growth models are now 80% equities/20% bonds, with SELECTOR® Balanced Growth models 60% equities/40% bonds. SELECTOR® Income & Growth models are 40% equities/60% bonds. SELECTOR® Income models remain 100% invested in bonds. Portfolios remain over weighted in mid cap and small cap equities. New additions to the portfolios include energy and basic materials equities. Real estate and emerging markets equities continue to hold their positions. As bond allocations were adjusted we focused on reducing exposure to government bonds while holding high yield and intermediate-term investment grade corporate bonds.

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Sources: Bloomberg, iShares.com, Marketwatch.com, Stock Trader's Almanac 2010, Standard & Poor's, StockCharts.com.