

October 19, 2010

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

The last thirty days have been very, very good for equities and quite nice for bonds. A surprisingly strong September has carried through into October. These subsequent advances have allowed equity markets to make broad moves back towards their April, pre-‘flash crash’ levels. It is notable that the collective follow-through was not accompanied by an increase in market volatility. Rather, the progress was made in very level, measured steps. Since the September 1st surge in the S&P 500, it has risen by an additional +9.26%. That run listed three days when the S&P 500 advanced by an average of 1.01%. The remainder of the advance included smaller, but very deliberate upward moves. As we stated last month, this continues to provide evidence of an institutional power play, rather than a clever trader’s ruse.

Long-term U.S. government bonds continued to work off their overbought condition, declining as the major equity markets advanced and underscoring the institutional sector rotations. On the other hand, high quality corporate bonds, TIPS bonds, municipal bonds and high yield bonds all carried yearly highs in October, albeit in a less robust fashion than equities. None of the thirty-two bond indexes that we follow are in negative territory year-to-date and many are carrying gains that would turn the heads of most equity managers. Year-to-date, the Barclays Capital U.S. 20+ Year Treasury Bond Index is now up +14.83%, the Barclays Capital U.S. Credit Bond Index is up +10.12%, the Barclays Capital U.S. TIPS Index is up +9.55%, and the Barclays Capital High Yield Bond Index is up +13.39%.

Most all equity indexes have successfully established themselves above resistance that had held prices back since mid-May. Additionally, most of these indexes have also reclaimed their longer-term 150-day and 200-day moving averages and their shorter-term 50-day moving averages, which are all trending higher. This may provide additional support to current prices, even in the event of a well-deserved pullback. Year-to-date, the S&P 500 is now up +7.93%, while the Dow Jones Industrials Average is up +6.87%. MidCap and SmallCap equities have regained their leadership positions, with the S&P 400 MidCap 400 Index up +14.74% and the Russell 2000 Index is +13.52%.

On the international front, the S&P Europe 350 is now up +3.63% and the the MSCI Emerging Markets Index is up +14.62% YTD. The persistent weakness of the U.S. Dollar is now fanning the flames of nearly all international equities and bond markets, while the strength in oil and

gold prices also continue to support international positions. The U.S. Dollar has now surrendered all of its gains for the year. A particularly strong beneficiary of this weakness in the U.S. Dollar has been the emerging markets bond markets. The JPMorgan USD Emerging Markets Bond Index is the top performing fixed income index we are following, up +16.83% YTD.

Of particular note and of ongoing interest to us are those sectors which have recently and decidedly broken out above their April highs. They include high yield bonds, real estate securities, and emerging markets. Standing alone, this is a rather eclectic group. But when included within the context of a diversified portfolio, the investment potentials are intriguing. Early in October, SELECTOR[®] Money Management made portfolio adjustments designed to take advantage of this potential. We also continued to include mid cap and small cap equities. The addition of high yield bonds replaced previous positions in investment grade bonds. Should major domestic equities markets continue to rally to levels that would top the April 2010 highs, we would be compelled to reexamine our overall market staging for a possible upgrade.

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Until that time, the equity market rallies that we have enjoyed since September 1st continue to be regarded within the context of a contained, sideways trending market. Even with the sector reallocations affected earlier this month, SELECTOR[®] asset allocations remain allocated to Stage Yellow levels. SELECTOR[®] Aggressive Growth models are 100% equities. SELECTOR[®] Growth models are 80% equities/20% bonds. SELECTOR[®] Conservative Growth models are 60% equities/40% bonds, with SELECTOR[®] Balanced Growth models 40% equities/60% bonds. SELECTOR[®] Income & Growth models are 20% equities/80% bonds, and SELECTOR[®] Income models are 100% bonds.

Edward D. Foy
Manager, SELECTOR[®] Money Management
www.selectoronline.com, Ed@selectoronline.com
(800) 456-4380