

September 19, 2010

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

September arrived with a ‘bang’ as the S&P 500 jumped higher by +2.95%, the Dow Jones Industrial Average climbed +2.55%, and the Russell 2000 shot up +3.87% on the first trading day of the month. These moves were significant in several ways. First, the markets vaulted higher at the opening and closed on their highs. This is a strong indication of institutional buying activity, as opposed to short covering by hedge funds and traders. Second, several major market indexes ‘gapped open’ higher, which means their opening prices were significantly higher than their previous day closing prices. This is indicative of strong, preplanned institutional buy programs, rather than closing hour tactical rallies. Third, and most significantly, markets were kicking higher at the bottom of a cyclical ‘stroke’, rather than misfiring halfway up or down. This is a sign that equity markets are once again firing in sync, and that their ‘detonation’ problems may be behind them, at least for a period of time.

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Equally impressive was the fact that on this same first day in September, long term Treasury bonds experienced a very sharp sell-off. The Barclays 20+ Year Treasury Bond Index fell -2.07% on September 1st after spiking into new highs the end of August. It takes a tremendous amount of selling pressure to drive a bond market that huge, and that liquid, down that much. Once again, this type of activity had institutional fingerprints all over it, and foretold more rotation from high quality bonds to equities over the next several weeks. This is exactly what occurred. At this writing, the Barclays 20+ Year Treasury Bond Index had fallen from highs of 108.24 on August 31st to a low of 101.67 on September 17th, a -6.07% decline in just over two weeks.

Equity markets, as well as bond markets, are at critical junctures at this time. For equity markets, they are now resting just below resistance levels that have effectively contained prices since mid-May. Should these levels be penetrated to the upside, the next significant resistance should be the April 2010 highs. For the S&P 500 those

highs were at 1220, +8.44% higher than last Friday’s close. For the Dow Jones Industrial Average, the April highs were seen on April 26th at 11,205.03, almost 600 points higher than Friday’s close of 10,607.85. The 2010 highs for the Russell 2000 Index were also seen on April 26th, +12.88% higher than Friday’s close. As intriguing as those possibilities are, should equities fail to breach those resistance levels in the next few days, an equally weighted possibility is that they may once again test their 2010 lows. This action is tempered somewhat by the fact that September’s strong advance did push most major market indexes back on top of their 150-day and 200-day moving averages, which may give them support and a springboard back to assault those resistance levels.

Equity markets also have contrarian, political, and cyclical winds forming at their back. The month of September had been heavily identified as being stricken by poor historical market performance by the press. August’s very poor performance may have very well absorbed a bulk of selling preempting September, which has thus far has been quite productive, pleasing contrarians everywhere. From a political perspective, historically, equity markets have been fairly good at ‘pricing’ into markets the outcome of the November elections in preceding months. A perception of Republican gains in November helping capital markets, and perhaps easing some of the fiscal burdens that have smothered markets in the future, may provide fuel for the Bulls in September and October. During 18 of the 25 mid-term election years since 1914, markets have found bottoms and moved higher. Finally, from a cyclical calendar perspective, fourth quarters have historically provided investors with the best quarterly returns, especially during midterm election years.

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, as always.

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