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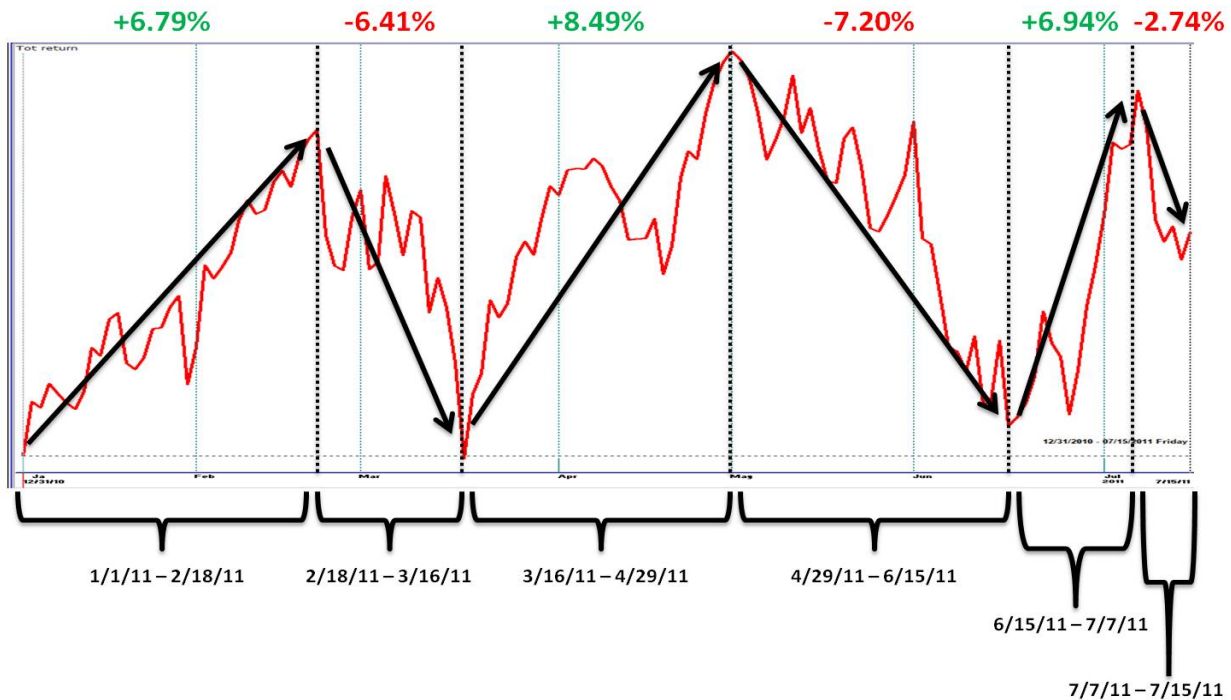
Follow-up - First Half of 2011 Looks Like 2007

08/16/11

August has given new meaning to “the dog days of summer” as the broad equity market has retracted all year-to-date gains and dropped into negative territory, all within the first couple weeks. As written in our previous [Market Commentary](#) on July 20th, our research uncovered potentially dangerous activity in the equity markets which could lead to a break and high volatility. We presented this in that [Market Commentary](#) by the chart in Figure 1 below. Using our proprietary research methodologies, we elected to make a major “Tactical” move on June 17th. That move reduced all Equity and High-Yield Bond exposure, creating 50% cash or cash equivalent allocations across all portfolios. This defensive move was shown to be prudent as volatility erupted and considerable downside was experienced in equity markets in the first week of August, as shown in Figure 2.

Figure 1.

S&P 500: January 1, 2011 – July 15, 2011

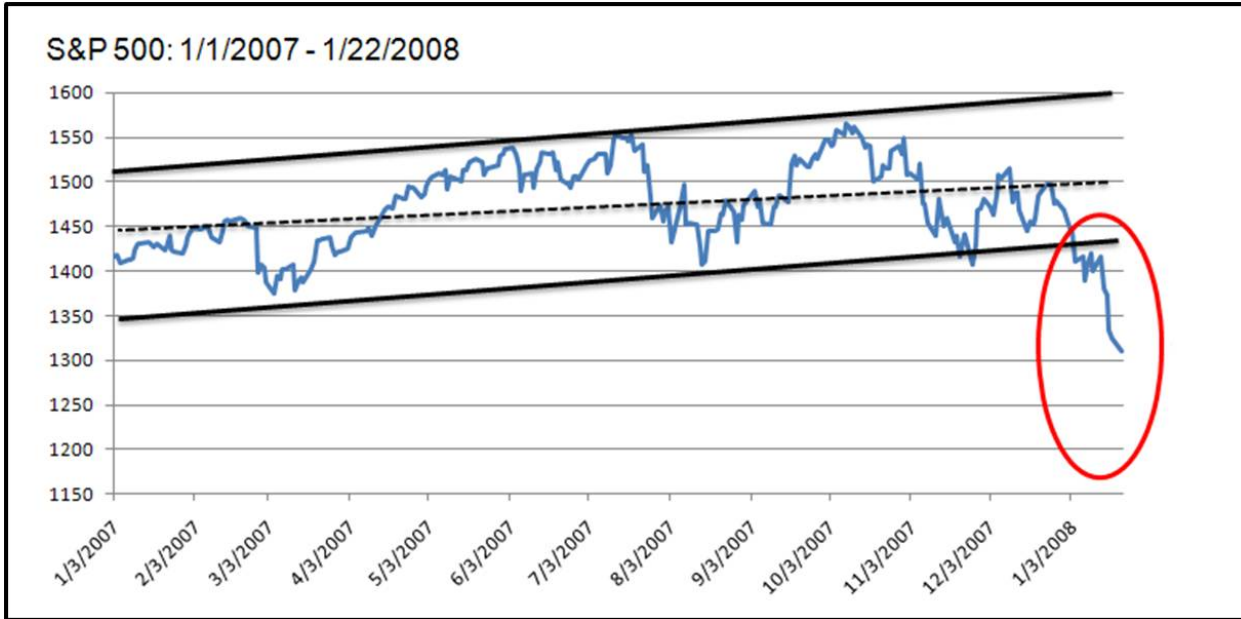


Source: FastTrack



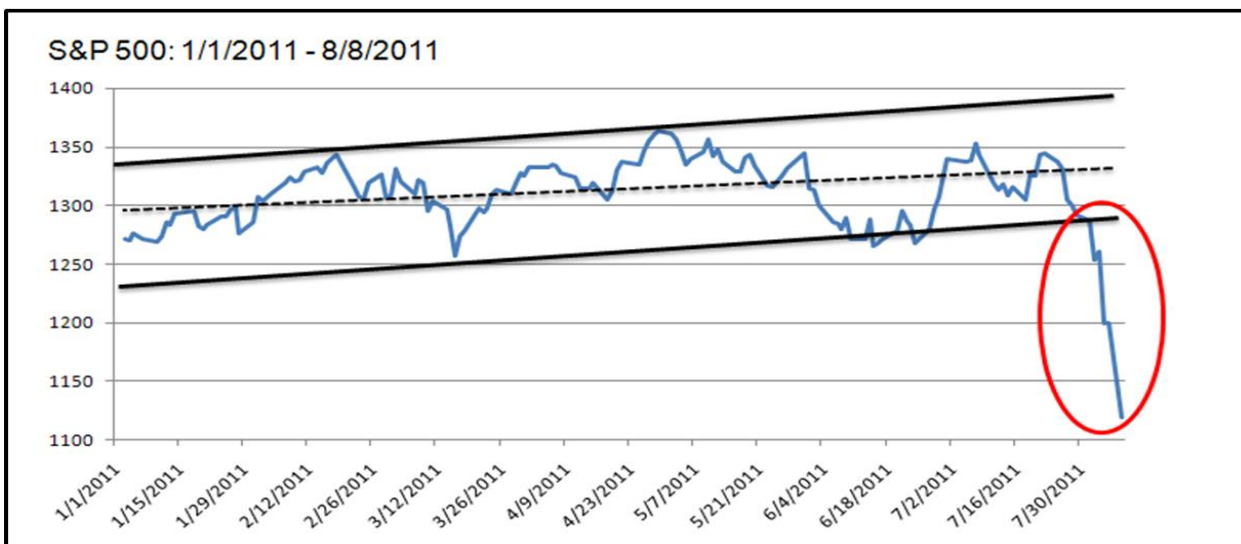
With this heightened volatility, we were observant that this market behavior was eerily similar to market conditions in 2007. To elaborate on this point, let's compare the S&P 500 Index for 2007 vs. the first seven months of 2011. As you can see below in Figure 2, 2007 experienced high volatility yet remained range-bound in an upward trend (represented by the overlaid black bands).

Figure 2.



This whipsaw movement extended throughout 2007 until finally breaking sharply to the downside in January 2008. This pattern may seem familiar to you... take a look at the first 7 months of 2011 below in Figure 3 and the subsequent break to the downside.

Figure 3.



The first half of 2011 maintained a range-bound upward trend until finally breaking sharply to the downside in the first week of August.

Of course now everyone wants to know what happens next? Our research has no special predictive power of what may happen now that the “trend” has been broken. Instead, what our research is telling us, and what we are doing for client portfolios here, is remaining extremely cautious at this time. We have since moved client portfolios to almost 100% money markets and/or cash equivalents in all accounts. We do maintain some high quality bond positions.

You may think “But I can’t make any money in money markets, they pay nothing these days!” True enough, but there are many times in one’s investing lifetime where the best investment is to simply maintain principal. That principal amount will be able to potentially purchase more in the not too distant future.

A simple example is stocks. On April 29 of this year, \$1,340 purchased the equivalent of one S&P 500 Index share. Today, to own those same companies that make up the S&P 500 Index, the cost is below \$1,200, yet the same amount of dividends is being received. In this period preserving principal has resulted in increased “investment” purchasing power, income and potentially increased return.

Thank you for the opportunity to be of service.

Thank you,



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