Monthly Commentary

January 16, 2013

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

The year 2013 is off to a good start for equities. Domestic equity markets benefitted from a substantial rise in prices the first couple of days in the new year, as markets cheered Congress' decision to address the 'fiscal cliff.' But it didn't stop there, and the past couple of weeks have continued to be profitable ones. International equity markets have also seen continued progress through December and into January, though with less drama and flourish than domestic markets.

We are happy to say that we have been participating in this progress. Over the past year, we have been working on identifying specific indicators that coincided with significant market reversals. As trend followers, we have always been working to recognize dominant and persistent trends in financial markets. The excessive volatility that first exposed itself in the 'Flash Crash' of May, 2010, and again in the second half of 2011, brought us to the realization that we needed to identify specific market indicators that would allow us to better protect ourselves during turbulent markets.

This work has proven to be worthwhile. We have identified market oscillators that when presenting themselves in pairs over relatively close time frames provide invaluable indications of pending and imminent market reversals. These market reversal signals can be positive or negative. We regard a positive market reversal as a Buy Signal, while we consider a negative market reversal as a Sell Signal. We have tested these Buy and Sell Signals over some of our most volatile recent equity markets and their consistency is impressive. The bottom line is that we now have a very specific indicator which should assist us in determining our exposure to equity markets and bond markets, both offensively and defensively. The name of this indicator is the SELECTOR® Trend Reversal Indicator. It generates both Buy Signals and Sell Signals for a wide variety of market indexes, including both equity indexes, bond indexes, mutual funds, individual equities, and volatility indexes such as the VIX.

We are currently observing equity markets that are operating within a Buy Signal that was generated in late November. Since that time we have seen significant advances in a wide variety of equity market indexes including large cap, mid cap, and small cap. Individual sectors have also participated including health care, consumer discretionary, and financials. Developed international and emerging markets have been strong.

As we have stated in previous Monthly Commentaries, equity markets are far more predictable than most people would have you believe, especially during the November-December-January period. These seasonal tendencies are significantly more important than the 'dramas de jour' which this past season included both a Presidential and Congressional elections, and Congress' responses to the 'fiscal cliff' deadlines, all of which proved to be real yawners. Equity markets historically have had a tendency to 'rise on the rumor and to sell on then news,' but in 2012, the news was so predictable and anticlimactic. The cyclical and seasonal rally sequences had little difficulty overcoming the tears and fears of those who were predicting another apocalypse.

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Bond markets have been more sedate so far in 2013 after enjoying a prosperous 2012. Broad corporate bond indexes have been tracking sideways since October, while high yield bonds have continued to track the progress of equity markets. The weakest bond sectors continue to be intermediate and long-term U.S. Government bonds. TIPs bonds have pulled back from their December highs but continue to demonstrate the resilience we have seen all of last year.

For the past twelve months we have been developing a new set of indicators to help us identify primary changes in market trends. We believe that it is critical to recognize the signals that are present when major shifts in trends are taking place. The timely identification of these reversals in market trends can be a valuable tool for managing account drawdown, as well as for taking better advantage of favorable market conditions. We have tested these new indicators for the very volatile period of 2007-2011, as well as during 2012, and our confidence in the conclusions, as well as the potential benefits of buying and selling as these signals are being generated, is very high. We received positive signals in November on most all of the 64 equity indexes that we monitor. The 36 bond indexes we follow have been positive all year.

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Sources: Bloomberg, iShares.com, Marketwatch.com, Stock Trader's Almanac 2012, StockCharts.com.