Monthly Commentary

June 20, 2011

SELECTOR Real-Time Money Management

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

After setting yearly highs the first of May, equity markets retreated for six straight weeks. That was the longest retreat of the year, with the other significant decline being the three weeks following the Japan earthquake and tsunami. Take into context that we are now twenty-five weeks into the year and have only had two meaningful pullbacks. There is little cause for alarm. However, bad news sells more than good news, and occasionally we are still surprised by how quickly negative sentiment takes center stage.

The long-term trend remains positive, while the intermediate-term trend has turned neutral as equities settle into trading ranges. With the six-week decline at its back, the short-term trend is negative. As we discussed last month, trading range markets are quite common, especially as they coincide with the Summer season. Those long, dog days of Summer have lulled many a bull market to sleep. But we have rarely seen dramatic, long-term market reversals during these trading range time-outs.

Like Summer thunderstorms, it's common to see lots of thunder and lightening as the cold, (bearish) fronts push through the warm, moist (bullish) pockets of air. One of the natural ways of the world is that things fall faster than they rise, and equity markets are no exception to that rule. Toss in the 'media effect' and you can have quite the Midsummer Night's Dream, where little is as it seems. Just as "The course of true love never did run smooth," neither does the course of a bull market. The cautionary note is to avoid taking too seriously this Summer silliness, lest we become the subject of Puck's famous observation, "Lord, what fools these mortals be!"

Healthcare is still the best performing sector for the year, with the Dow Jones U.S. Healthcare Index up +12.36%. Real estate securities also continue to shine with the Dow Jones U.S. Real Estate Index up +8.64%, while the Dow Jones U.S. Oil & Gas Index is up +6.48% year-to-date. In spite of all the saber rattling about Greece, Europe is also holding onto gains, as the S&P Europe 350 Index is +5.29%. The broader MSCI EAFE Index is much more muted, up by only 0.69%, and the MSCI Emerging Markets Index is down by -2.98% for the year. Latin American equity markets are struggling and down -8.36%, and Japan remains under water down -8.88%. Domestically, the S&P 500 Index is up +2.58%, the S&P MidCap 400 Index is up +4.28%, and the Russell 2000 Small Cap Index is up +0.26%.

The real beneficiaries of that six-week decline in the equity market were bond markets. Their returns for 2011 year-to-date best many of the equity indexes. The Barclays Capital U.S. 10-20 Year Treasury Bond Index is up a strong +5.47%, with the Barclays Capital U.S. TIPS Index up +5.46%. The S&P National Municipal Bond Index is up +5.14%, and the Barclays Capital U.S. Aggregate Bond Index is up +3.30%. High yield bond markets retreated with equity markets from the highs, but still remain steady with the iBoxx $ Liquid High Yield Index up +3.49%. In fact, every one of the thirty-six bond indexes that we follow are in positive territory.

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We have been making some tactical adjustments to equity allocations recently. These adjustments have been minor as we work to recognize the relative strength of international equities, healthcare, and utilities sectors. The relative weakness in certain sectors such as technology and small cap equity make them candidates for replacement, or reduction in size depending on overriding portfolio factors. However, we are not seeking to be overly dramatic. Every equity sector we follow has its own trading range and is moving freely within it.

SELECTOR® Aggressive Growth and **SELECTOR®** Growth models are 100% invested in equities. **SELECTOR®** Conservative Growth models are 80% equities/20% bonds. **SELECTOR®** Balanced Growth models are 60% equities/40% bonds while **SELECTOR®** Income & Growth models are 40% equities/60% bonds. **SELECTOR®** Income models remain 100% invested in bonds.

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Sources: Barrons, Bloomberg, iShares.com, Marketwatch.com, Stock Trader's Almanac 2010, StockCharts.com.