Monthly Commentary

May 21, 2012

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

Since May 1st, the Dow Jones Industrial Average (DJIA) declined 12 of the next 13 days for a total of 948 points, or -7.1%. In spite of that, the DJIA remains up +4.99% for the year at today's close. This is the second correction we have seen in 2012 after a steady increase in prices during the first quarter. The first correction started on April 1st and lasted a mere week, with the S&P 500 declining a mild -3.80%. Equity indexes then climbed back to their first quarter highs the last two weeks of April. When the second current correction in equities began, major market indexes were in a trading range within the context of a long-term uptrend. The first week of this correction was contained within that trading range. Last week's consistent selling pushed equity indexes below the lower boundary of that trading range.

This selling may sound reminiscent of last Augusts' price action but there is a significant difference. In August the correction was accompanied by high frequency, high volume, high volatility algo-trading. In sharp contrast, this May's correction has been just the opposite. While prices were declining day to day, almost all of the negative days had less than 1% moves. For the S&P 500 only two of the down days exceeded 1% and none were over 2%. Market volume was not remarkable. This correction was more of a soft slide than the violent shakedown that equity indexes endured in 2011.

Today, May 21st, equity indexes prices had a strong, broad rebound rally. Yes, it was just one day. Yes, it will take time to rebuild after the short-term technical damage inflicted on long-term trendlines and moving averages. Today's rally was singular in that it was so very broad. Every major capitalization weighted index we follow was up. Every sector weighted index we follow except for utilities, gold, and silver was up today. The NASDAQ led the pack with its biggest single-day advance of 2012. There were no real heroics, just a very determined reversal. And it was actually quite complimentary to the dignified retreat of the first three weeks of May. It will be interesting to see if equity markets can retain their composure over the next few weeks as they work off a deeply oversold condition.

Bond markets have continued to be steady winners in 2012. In fact, bond investors probably have been wondering what all the fuss has been about. After bond markets completed their own healthy correction back in March, they have demonstrated excellent resilience. The steadiest performance year-to-date has been in TIPS bonds, with the Barclays U.S. TIPS Index now up +4.22%. Municipal bonds have also performed well, with the S&P National Municipal Bond Index up +3.80%. The Barclays U.S. Credit Bond Index is up +3.43% and the iBoxx $ Liquid High Yield Index is up a comfortable +3.27% even after correcting with equity markets in May.

As for the equity market leaders, mid cap and large cap equities are leading the way. After today's action the S&P MidCap 400 Index is up +5.83% with the S&P 500 up +5.53% YTD. The Russell 2000 Small Cap Index is up +1.34%. The strongest sector performers continue to be in technology, real estate and health care. The Dow Jones U.S. Technology Index is up +10.88%, the Dow Jones U.S. Real Estate Index is up +8.69%, and the Dow Jones US. Health Care Index is up +6.75%. The recent correction had the biggest impact on the energy sector and on international equities. The Dow Jones U.S. Oil & Gas Index is now down -4.61%, with the MSCI EAFE Index down -1.65%.

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There are several interesting stories developing. International and emerging markets equities are now back at prices that attracted considerable institutional attention at the start of the year. Even if they become trading-range-bound those ranges are wide enough to attract trading interest. Declining oil prices have created deeply oversold situations for energy securities that are now as much as 15% off their March highs. The once-sharply overbought technology and healthcare equities are now back in focus after healthy price corrections. It remains a target rich environment for equities.

SELECTOR® Aggressive Growth and Growth models are currently 100% invested in domestic and international equities. **SELECTOR®** Conservative Growth models are now 80% equities/20% bonds, and **SELECTOR®** Balanced Growth models are now 60% domestic and international equities/40% bonds. **SELECTOR®** Income & Growth is 40% equities with 60% bonds, and **SELECTOR®** Income models are 100% invested in bonds.

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

Sources: Barrons, Bloomberg, iShares.com, Marketwatch.com, Stock Trader's Almanac 2011, StockCharts.com.