

December 21, 2010

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

This month's Commentary opens with two intriguing questions. Looking toward 2011, we will be entering the third year of our sitting President's term. First question: Since 1940, how many times has the S&P 500 gained during a U.S. Democratic President's third year in office? Answer: Every time. Second question: Since 1940, how many times has the S&P 500 gained during a U.S. Republican President's third year in office? Answer: Every time. Pretty surprising, isn't it?

How could this be? This period spans WWII, Korean, and Vietnam Wars, Cold Wars, ultra-high interest rates, inflation and income tax rates, economic expansion and contraction, political and domestic strife, earthquakes, volcanoes and hurricanes. Could this just another data-mining coincidence, or freak of financial happenstance? Absolutely not. This is but one more indisputable piece of evidence that in the financial universe things happen for reasons. While we are not blind disciples of cyclical analysis, there are many cycles that are driven by human nature. As devoted trend followers, we are absolutely students of the relatively recently-named discipline called behavioral finance.

Real people drive financial markets. Not computers, nor politicians (thank goodness, and with apologies that politicians are not real people), nor foreign interests, nor organized crime, nor governments (foreign or domestic.) Real people experience primary emotions such as fear, joy, love, sadness, surprise, and anger. Each of these primary emotions can spark secondary emotions such as anxiety, elation, attraction, despair, amazement, and bitterness. In the financial universe, these emotions express themselves in the investors' buying and selling tendencies. And as a result of those tendencies, securities prices rise and fall.

Investment professionals can analyze, compare, dissect, and extrapolate hundreds, even thousands of numbers and sets of data. We believe that the ultimate outcome of all of this analysis exemplifies itself in the actions of the investor, and the impact of those actions on the price. This is the heart of the discipline known as Trend Following. **SELECTOR**[®] Money Management is all about trend following. Our primary analysis is based on price action. Granted, there are fundamental processes that we monitor and technical analysis that we reference. Ultimately, we believe that current prices reflect the cumulative knowledge, information, and opinions on the street.

So what does this have to do with the third year of a U.S. Presidential term? Since the 1940's, American politics has been dominated by two political parties. A pendulum-like force has taken effect as these parties trade blows and promises to voters on how they are going to improve their lives, ultimately as measured by the voters' pocketbooks. Economic cycles ebb and flow with the impact of the voters'/investors' hopes and fears. In the third year of a Presidential term there has been enough hope/promise on the table for both parties, and for most voters and most investors, to result in a relatively promising immediate future. This has historically and consistently translated to positive price action and that is what we are facing in 2011. How's that for a Happy New Year's wish!

Once again, it is important to state that past performance is no guarantee of future performance. This is more than just the attorneys haranguing our optimism. There is a big difference between knowing that the seasons change and knowing exactly how and when the seasons will change. The How and When is what separates the professionals from the civilians, the successful from the frustrated. This is the work **SELECTOR**[®] Money Management does for investors.

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