Monthly Commentary

January 18, 2011

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

The 2011 starting gate is open and the good news is that almost all equities are running in the right direction. Several of the early leaders were relative laggards in 2010, an indication of portfolio rebalancing more than longer-term changes in market leadership. Examples of this early leadership include the financial services, technology, and European equities. This is mirrored by the relative weakness in several of the market leadership sectors that had paved the road into year-end. This group includes real estate securities, basic materials, and emerging markets equities. Rebalancing activity rarely disturbs longer-term trends and we expect to see market leadership revert back to those sectors that brought us to the dance as we move further into the first quarter of the year.

The historically strong November-December-January period for equities did nothing to tarnish its reputation. The S&P 500 has gained +10.73% over the trailing 3 months and is up +2.90% YTD. Even stronger performances took place in the domestic mid cap and small cap market sectors. The S&P 400 Mid Cap Index has gained +14.12% the last 3 months and is up +2.66% YTD. The Russell 2000 Small Cap Index rose +14.93% the last 3 months and is up +3.08% YTD. We still have a couple of weeks to maneuver in January. But rising trendlines and moving averages, accompanied by the previous trading range resistance, now support, should provide ample cushioning for a consolidation at current levels.

Domestic and international equity markets completed and confirmed their breakout to the upside in November and December. While equities have traveled a good distance from the bottom of the previous trading range, in our opinion their upside potential is significant. Trading range breakouts like those of the past 60 days are frequently followed by price action that works to establish a new trading range. A rule of thumb for estimating the new trading range is to extrapolate the previous trading range above the breakout level. For the S&P 500, the previous trading range was defined by 1040 at the bottom and 1220 at the top, a 16% range. A 16% move from the breakout level of 1220 projects an S&P 500 price of 1415, 12% higher than last Friday's closing price of 1257.64. We expect variations in volatility as our current positive trend extends and becomes more developed.

Bond markets are involved in their own delicate ballet. Over the trailing 3 months, only high yield bonds experienced marked price appreciation. Short-term investment grade and U.S. Treasury bonds, as well as TIPS bonds, broke even for the period on price alone. The remainder of the bond indexes that we follow took losses the past 3 months, most notably long-term U.S. Treasury bonds and municipal bonds. The Barclays Capital U.S. 20+ Year Treasury Bond Index lost -8.82% over that period, with the S&P National Municipal Bond Index falling -7.15%. The ballet is evolving with those indexes that have already established technical support and are beginning to track higher. The broader Barclays Capital U.S. Aggregate Bond Index, which had also declined -1.54% in the last 3 months, has found support. Bond prices are pirouetting around current levels, being led by high quality short-intermediate term corporate bonds.

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A brief recap of the E-I-E-I-O for financial markets is in order. The **E**conomy is continuing to slowly expand. **I**nterest rates remain near record low levels. Corporate **E**arnings will start being announced the next couple of weeks and early estimates are positive. **I**nflation is still not threatening, beyond the monetary inflation associated with burgeoning levels of government debt. And finally **O**il prices are at higher than acceptable levels, as are most commodity prices, which is being interpreted as an indication of future international growth and economic recovery.

Our primary market evaluation for equity markets is Stage Green and all SELECTOR® models are fully invested in equities in manners consistent with the specific styles of management. SELECTOR® Aggressive Growth and SELECTOR® Growth models are 100% equities. SELECTOR® Conservative Growth models are now 80% equities/20% bonds, with SELECTOR® Balanced Growth models 60% equities/40% bonds. SELECTOR® Income & Growth models are 40% equities/60% bonds. SELECTOR® Income models remain 100% invested in bonds.

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Sources: Bloomberg, iShares.com, Marketwatch.com, Stock Trader's Almanac 2010, Standard & Poor's, StockCharts.com.