Navigating the End of the World….

Fair enough, the "End of the World" is perhaps a bit of an overstatement, but should we allow our emotions to follow suit with the general media accounts of the present economic derby, the "End of the World" does seem to be at least among the horses in this economic race. We are hearing the term "Double Dip" tossed around a bit more casually of late and currently it is mentioned with data points that previously were not part of the discussion. In other words, the reality of a second recession following hard upon the last is something that is being forced into the frontal lobe of the market, and quite frankly, is unsettling to the nth degree for many investors.

"How are you going to get my account through the "End of the World?"

This is the question we have been asked too many times to count over the last 3 weeks. The answer is:

- **Relative Strength Matters…..**

  This is kind of important, so follow along.
  One of the measures we use to manage your investments is something called relative strength. Relative strength is merely a way of ranking stocks, ETFs, asset classes, etc. The premise behind relative strength is very similar to ranking your favorite sports team. The more your team wins, i.e. is stronger than its opposing teams, the higher in ranking it goes. The same can be said in the investment markets. The stronger an investment, the higher in ranking it goes. We measure "wins" by performance relative to other securities. What's interesting is that investors want to buy the teams ranked at the bottom of the pack in hopes that one day they will win. This would be akin to picking the Carolina Panthers to win the Super Bowl in 2011. Sure, there is a possibility they could win, but the probability is very low considering they only won 2 games last year. A much better bet would be to the pick the Pittsburgh Steelers or Green Bay Packers. That doesn't mean the Packers will win the Super Bowl again, but they have a good probability of at least making it to the playoffs.

  We want to hang onto the investments with the **BEST** relative strength. When the market gets sloppy, the investments that hang in a little better are those with good relative strength.

  

  Finally, before we put an asset into our portfolio, the asset has to pass one final hurdle. Can the asset win an arm wrestling match versus cash? If the asset class is unable to outperform cash, then cash wins.

- **What is Relative Strength telling us now?**
  Currently, relative strength is telling us that Domestic Stocks and Commodities are better places to be than Fixed Income or International Stocks. **But…..**Relative Strength is also telling us Domestic Stocks and International Stocks cannot win the arm wrestling match versus cash.

What Does all of this Mean?

As these relative strength signals started to change on August 2, we started to change the investments we own. Our current portfolio is quite defensive with approximately 40% in short term bonds/cash, 10% precious metals and 0% in international holdings. With the real possibility of recession, we have also improved the credit quality of our fixed income holdings.

As the "windsock" changes, we change.

As you know, we do not have a crystal ball here in our office; we simply rely on the old adage "what is, is". Relative strength serves as a "Windsock" for the prevailing currents and crosswinds of the market and embraces the concept of reacting to changing trends, for better or worse, in a disciplined way. This allows us to eliminate the human or "gut feel" decisions and gives us a game plan to manage risk in a portfolio in an unemotional way.

The Investment Management Process:

"The essence of investment management is the management of risks, not the management of returns. Well-managed portfolios start with this precept" -Benjamin Graham

As always, if you have any specific questions, please give us a call.

Relative Strength (RS) is a historical measurement of price performance and trend, and is calculated by dividing the price performance of a stock by the price performance of a suitable index for the same time period. Past performance does not guarantee future results. There is no assurance these trends will continue. Investing involves risk and you may incur a profit or a loss. Commodities are generally considered speculative because of the significant potential for investment loss. Commodities are volatile investments and should only form a small part of a diversified portfolio. There may be sharp price fluctuations even during periods when prices overall are rising. Certified Financial Planner Board of Standards Inc. owns the certification marks CFP®, CERTIFIED FINANCIAL PLANNER™ and federally registered CFP (with flame logo), which it awards to individuals who successfully complete initial and ongoing certification requirements.