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5-Step Investing

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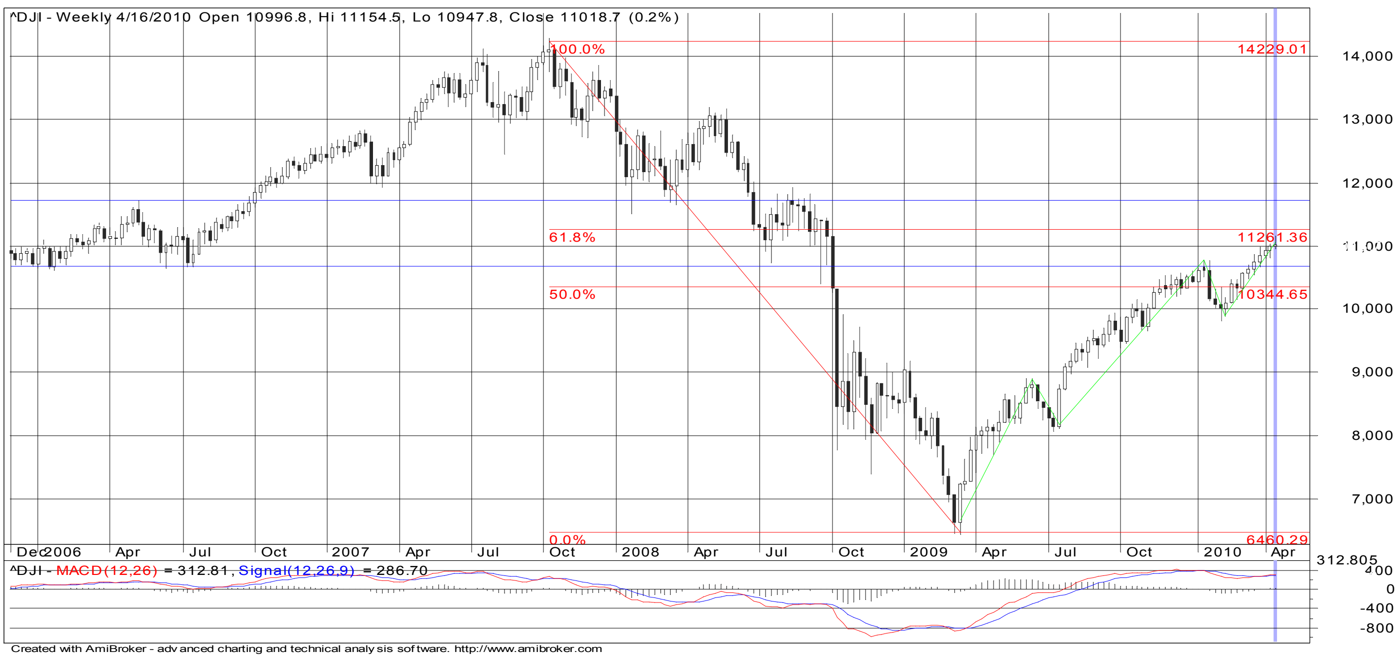
Step 1 – Broad Market Trend

Primary Trend:	Upward.	Started March 6, 2009 at 6626.
Intermediate Trend:	Upward.	Started February 12, 2010 at 10012.



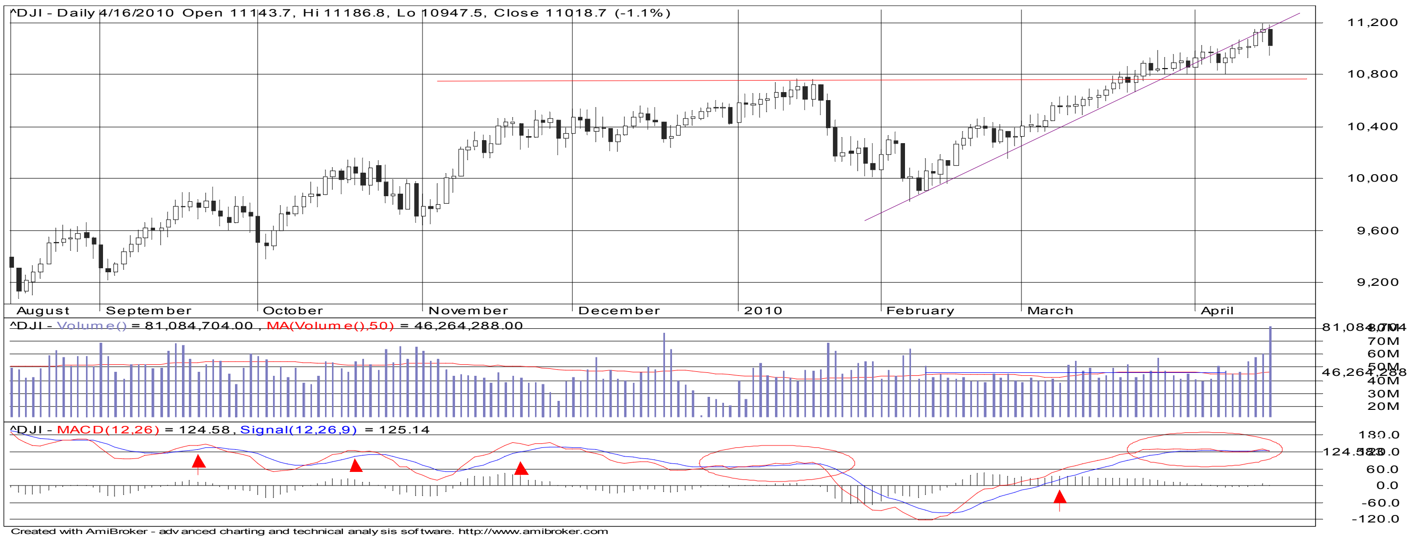
The Dow Jones Industrial Average (^DJI) advanced 0.2% last week, finishing at 11,018. As I mentioned last week, the next point of interest is the 11261 Fibonacci line, which is a 2.2% gain away. Following that, there is potential resistance at the upper Blue line at 11711, which is a 6.3% gain away.

I said last week, “So while we might have a few more weeks to go in this upward rally, in the broad view the signs are set for a slowing and eventual pullback in the growth of this market”. There are plenty of “contrarian” indicators (Put/Call Ratio (see Balbino Vazquez' article in this newsletter 3 weeks ago), media buzz, various oscillators) that suggest a correction in the air.

The Dow could drop as much as 9.2% from here (down to the early February low of around 10000) before it would suggest an intermediate change in direction away from the present uptrend. So keep that in mind --- we are going to set our stop losses, let the market drop below them, and then re-buy when the correction has completed and the next leg begins. Don't be shocked at a drop of 7-9% over a several week period. It is all part of the normal zig zag cycle of an active market.

Step 2 – Near Term Market Trend

Intermediate Trend. Upward. Started February 8, 2010 at 10195.
Short Term Trend. Upward. Started March 1, 2010 at 10337.



Last week I remarked "As you can see above, during the past week the 45 degree trend line that was established back in February and was in force through April was breached last week. So it is certainly possible that the market is getting set for a short-term downward pause, which is not unexpected given that the current short term rally has been underway since early March".

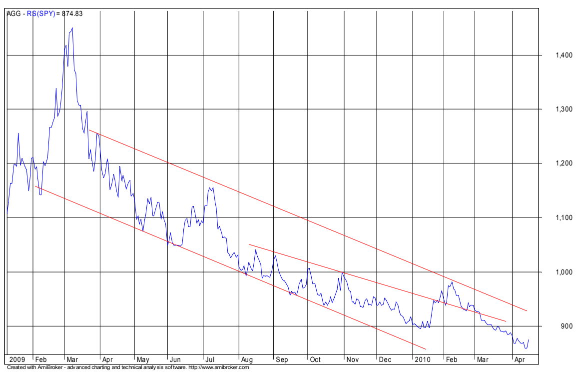
The common thinking about trend lines is that they offer support (prop up the price) when it is above the trend line, and they offer resistance (a ceiling on the price) when the price is below it. Looking at this daily chart you can see that our trend line has turned into a resistance line. This would suggest that the market is changing its tone. I also would point out the MACD lines again. Note that when the blue MACD line and the red signal line spend weeks without much separation, a change in direction is often indicated. Given the history of this indicator, it would appear that the movement is going to be down. Finally, note that volume picked up on the days when the market dropped. That would indicate a bearish tone in the confidence of the traders.

The near term market conditions certainly seem to also indicate a correction or lateral movement in the air.

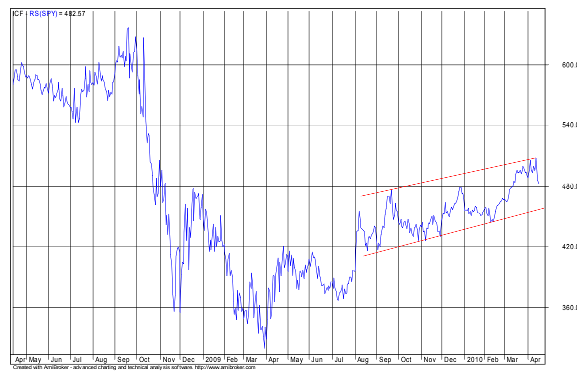
Step 3 – Asset Classes

The charts below are not the price of the security. They are the ratio of the price of certain ETFs to the value of the SPY (S&P 500 ETF).

Bonds (AGG) continue to under-perform relative to the S&P 500. It should be underweight in your portfolio. No sign of need to shift to this safer asset class.

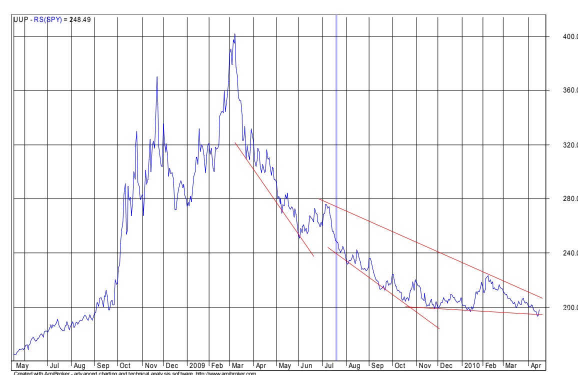


Real Estate (ICF) continues to outperform relative to the S&P 500. It should be overweight in your portfolio.



Gold (GLD) has weakened relative to the S&P 500. There may be a breakout soon in the price of GLD relative to the S&P 500, as the price will move either above or below the apex of this triangle.

Dollar (UUP) has moderated in strength against the S&P 500. It is at the apex of a descending triangle, so in technical terms we might soon see it break sharply in one direction or the other.



Step 4 – Current Portfolios

ETF Hedge Fund

I have added two additional ETF options to the ETF Hedge Fund. UUP is US Dollar ETF that moves upward as the US Dollar moves upward against other major world currencies (Euro, Yen, British Pound, and others). It has a narrow bid/ask spread (so you are not paying too much to the market maker) and it regularly trades over a million shares in a day, so it is very liquid. Most importantly, the US Dollar moves in a non-correlated way against the overall market, making this an interesting investment to diversify your portfolio. I have in the past owned UUP in my portfolio.

DOG is a high-volume INVERSE ETF, meaning that it is designed to trade exactly opposite as the Dow Jones Industrial Average. Rather than move monies out of SPY when it flashes SELL, you can get a larger return by selling SPY and buying DOG, in effect "shorting" the market.

If the AGG Bond ETF is a part of your core, long-term holding, it should again be purchased up to the recommended weight. The price is sitting in the middle of an expected band of $102 - $106 per share. It is yielding 3.81% with an expense ratio of 0.24%, so it remains a well positioned ETF as part of the core holding and should help diversify holdings appropriately.

Security	Weight	Long-Term	Medium Term	Short Term	Price Now	Stop Loss
SPY (S&P 500 ETF)	Overweight	BUY (Jan 25) (109.77)	BUY (Mar 19) (115.97)	BUY (Feb 11) (108.13)	119.36	116.87
AGG (Bond ETF)	At weight	HOLD	HOLD	BUY (Apr 13) (104.19)	104.42	103.35
ICF (REIT ETF)	Overweight	BUY (Jan 25) (50.15)	BUY (Mar 5) (54.36)	BUY (Feb 16) (50.30)	57.6	57.11
GLD (Gold ETF)	Underweight	BUY (Feb 1) (108.35)	SELL (Jan 29) (105.96)	BUY (Apr 1) (110.26)	111.24	108.52
UUP (Dollar ETF)	None yet	Consider buying at $24 per share. Current price is $23.65.				
DOG (S&P Inverse)	None yet	SELL (Jun 30) (66.50)	SELL (Feb 17) (52.47)	SELL (Feb 16) (52.75)	48.81	N/A

Current Recommended weights for portfolios:
Conservative: Bonds/Cash 30%; S&P 55%; Real Estate 15%; Gold 0%
Aggressive: Bonds/Cash 5%; S&P 60%; Real Estate 35%; Gold 0%

Base weights for portfolios:
Conservative: Bonds/Cash 50%; S&P 30%; Real Estate 10%; Gold 10%
Aggressive: Bonds/Cash 25%; S&P 25%; Real Estate 25%; Gold 25%

Rules for Adding New Money to Existing Portfolios or Building from Scratch

1) Only add new monies to securities with BUY in Long-Term, Medium Term and Short Term. Otherwise, keep the money in a money market fund.
2) Do not increase the overall size of the portfolio more than 12% a week, in order to limit market risk.
3) Always enter the noted stop loss amount with each investment. Do not enter a purchase without an associated stop loss amount.

Step 5 – New Ideas

Tax-Advantaged ETF Options

I will be including an additional set of investing options in this newsletter, starting this week with Tax Advantaged options. This week, a discussion of MUB.

The iShares S&P National AMT-Free Muni Bond ETF (MUB) has a capitalization of $1.8 billion, yields 3.6% and has an expense ratio of 0.25%. It carries municipal bonds with an average duration of 7.4 years and an average rating of AA. The fact that the 3.6% yield is generally free of Federal taxes including the AMT means that it is equivalent to a pre-tax yield of 5.5% for someone in a 35% Federal tax bracket.

The price of MUB has ranged from $98.22 to 107.80 in the past 52 weeks, and is currently at $103.48. If you have a long-term (3-5 years say) need for a tax-advantaged stream of dividend income with little or no capital gains, this should be a consideration. I hold MUB in my personal account.

The Final Word

Today's Final Word comes from the April, 2010 AAII Journal (Journal of the American Association of Independent Investors). It is from an article on beginning investing --- how to get started being in charge of your own investment decision-making. AAII suggests that you create a plan to follow. Know what you want to accomplish and the steps you are going to take to get there. The following should be in your plan:

1) <u>Financial Goals</u>: write down each goal, # of years to the goal, and financial target
2) <u>Risk Tolerance</u>: how much risk can you stand and still sleep at night. Be honest with yourself.
3) <u>Personal Involvement</u>: how interested are you in selecting, analyzing, tracking your investments? Do you have the time to do so?

Risk tolerance is dictated by the amount of wealth that you have and the time that you have until you need to tap into that wealth. And this may be counter-intuitive. The longer the period of time before you need to depend on your portfolio for cash withdrawals and the greater your current wealth (or ability to add to your savings), the <u>higher</u> your risk tolerance should be. Conversely, the shorter the period of time and the lower your wealth is, the lower your risk tolerance should be. After you determine your level of risk tolerance, you can begin to figure out an asset allocation scheme that properly diversifies and gets you the highest level of return for that assumed risk.

Legal:

First, I presently hold positions in SPY, AGG, MUB, and IHF.