Sunday June 27, 2010
Volume 2, Issue 25

On The Mark Investing

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Broad Market Trend using Weekly Data

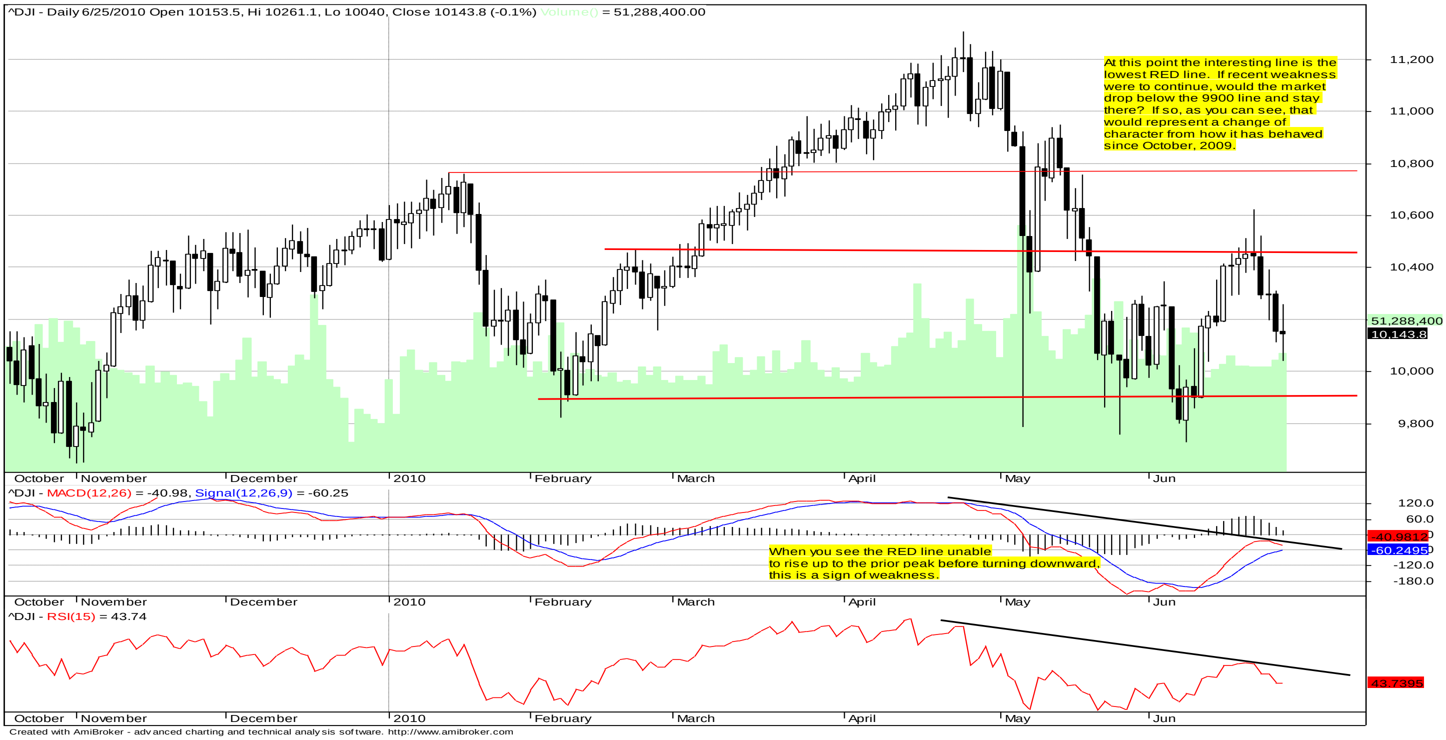
The Dow Jones Industrial Average (^DJI) lost 2.9% last week, finishing at 10,143.

Last week I noted "…the working assumption at this point is that we are in a sideways market, unless the ^DJI takes out the 11283 on the high side or the 10000 on the low side. I would further refine the high point with the 10700 blue line above --- that is a near term point of resistance."

The MACD graph above, which I have included for multiple weeks now, is a record of the difference between a short and a longer term moving average of weekly prices. When the RED MACD line moves up, it indicates that the short term moving average is increasing faster than the long term moving average. This is another way of saying that the short term price movement is moving upward faster than it had been in the longer term. This would be a bullish sign for the market. Technical aspects aside, if you just look at the MACD lines, you can see that the RED line is generally above the BLUE signal line when the market is moving upward. The reverse is also true. So our present situation, where the RED MACD line is below the BLUE signal line and falling, is a technical indication of weakness in the market and some indication that it will move sideways at best.

This week is end of the second financial quarter. There may be a slight upward movement in the market this week since the market is short-term oversold and financial managers are buying and selling positions ahead of quarterly reporting.

Near-Term Market Trend using Daily data



Last week I noted "There are a number of interesting short-term things happening, but most are not of interest to intermediate-term investors."

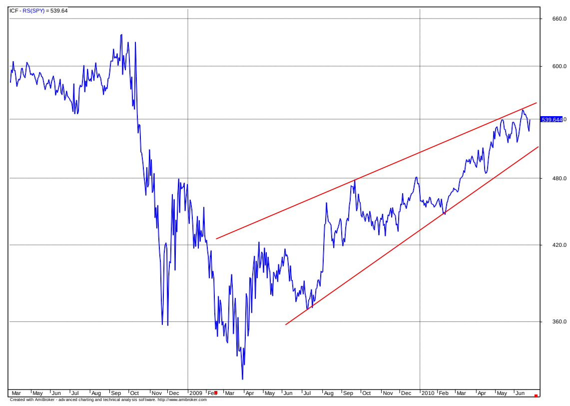
This is a ranging market, comprised of generally low-volume days and not much in the way of trend momentum. There is an old saying about the summer months – "sell in May and walk away".

Percentage-wise the market spends at least 30% of its time ranging from side to side. If you are an active trader in this market, you need a short timeframe since you'll buy on intra-day and intra-week price swings. If you are an intermediate term investor, you will want to generally hold sensible fixed income securities, and wait for the market to signal a trend of consequence.

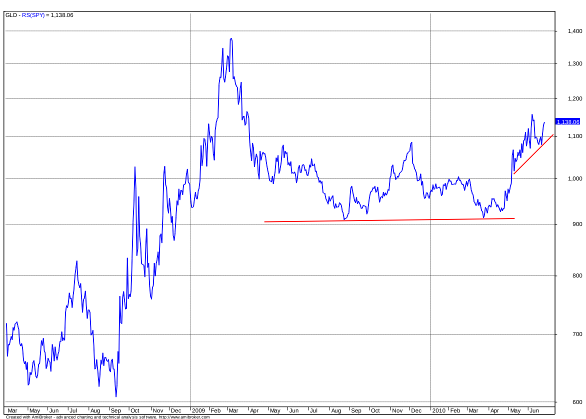
<u>Asset Class Behaviors</u>

The charts below are <u>not</u> 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) have had recent strength against the broad market. They are still the better bet in a sideways market.



Real Estate (ICF) continues to outperform relative to the S&P 500. But it too is stuck in a sideways price pattern.



Gold (GLD) continues to be strong relative to the overall market in the short term and intermediate term. This confirms a weakening of the overall market and a movement of monies to the safety of GLD.

Dollar (UUP) With the troubles of the Euro and general instability in world markets, the Dollar has strengthened, just as we began to see some weeks ago.

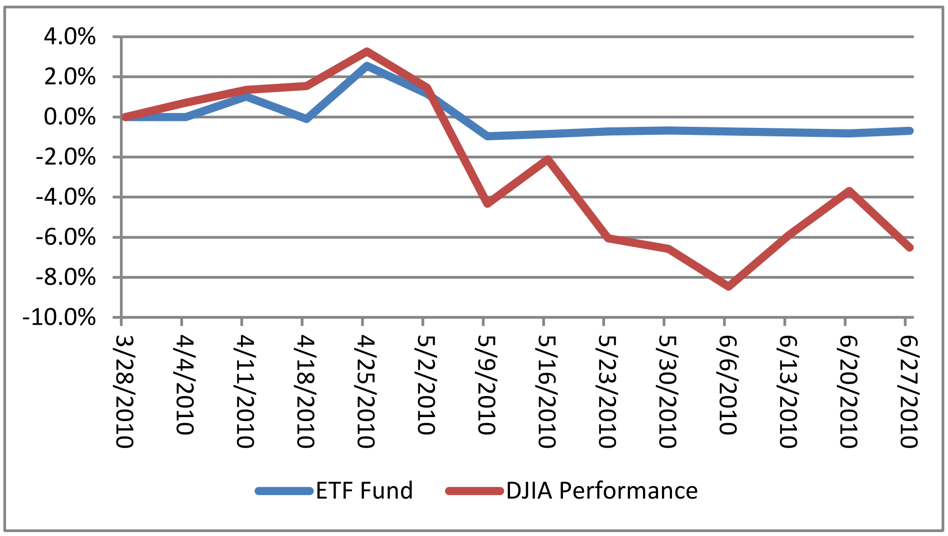
ETF Hedge Fund – Description

The ETF Hedge Fund consists of a set of loosely-correlated ETFs (Exchange Traded Funds). It is aimed at the conservative investor who is looking to preserve capital, avoid major market downturns, and ride market upturns. Trading occurs no frequently than weekly, and the ETF Hedge Fund has a bias toward conservative money management. ETFs can be bought just like stocks using Schwab, TDAmeritrade, Etrade, or any other electronic brokerage.

An ETF is a commonly traded security that represents a published proportion of underlying securities. For example, the ETF going by the ticker symbol "SPY" consists of a basket of stocks matching the proportion used in the S&P 500 index. ETFs have the advantage of being liquid, traded like stocks, and diversified like a mutual fund since they consist of so many underlying securities.

ETF Hedge Fund – Performance

Performance from inception, 03/28/2010 to Current



You can see the moderating effect that properly using uncorrelated assets can have on overall return. Note that in the April timeframe, as the market was moving upward, we took advantage of the trend. In the last 2 months, we are positioned to retain our gains as the inevitable corrections occur.

Were dividend income to be included in the overall results, it is likely that the ETF Hedge Fund would be positive for the year.

Assumptions in the above chart:

1) You followed all BUY/SELL/STOP LOSS instructions for the security since March 28, 2010
2) Equal amounts were invested each time the security was purchased
3) All shares were sold at the time of the SELL order
4) No commission or transaction fees are included
5) No dividends or capital gain disbursements are included

ETF Hedge Fund – Security Detail

					Current Position Stop Loss	New Position Stop Losses	
Security	Long-Term	Med- Term	Short Term	Price	SELL	BUY	SELL
SPY (S&P 500 ETF)	BUY (May 21) (109.11)	SELL (May 20) (107.54)	BUY (Jun 10) (109.15)	107.87			
AGG (Bond ETF)	BUY (Apr 30) (104.89)	BUY (Apr 29) (104.44)	BUY (Apr 15) (104.26)	$106.72	$105.48	$104.50	$104.00
ICF (REIT ETF)	BUY (May 21) (56.95)	BUY(May 14) (60.03)	SELL (Jun 24) (56.64)	$58.21			
GLD (Gold ETF)	BUY (May 24) (116.84)	BUY (May 24) (116.84)	BUY (Jun 7) (121.49)	$122.76	116.71		
UUP (Dollar ETF)	BUY (Jun 18) (24.94)	BUY (Jun 18) (24.94)	SELL (Jun 17) (24.95)	$24.83			
DOG (S&P Inverse)	SELL (6/30/09) (66.50)	BUY (May 7) (50.63)	SELL (7/16/09) (64.27)	$50.58			
MUB (Tax Advantaged Bond)	BUY (Mar 18) (103.49)	BUY (Mar 18) (103.49)	BUY (Apr 16) (103.48)	$103.83	$103.42	$103.40	$102.75

Three comments from last week are generally still true:

1) We only BUY when all three models are in sync and suggest BUY.
2) General equities (SPY, ICF, DOG) are not suggested by the models, and the market is in a general downward trend. So you should not be in equities.
3) Bond funds (AGG, MUB) have been bid up such that they are very expensive. You should wait to “buy on the dips” so to speak. So you will see that even though the models say they are BUY, you should wait until the price drops before adding to your holdings.
4) Gold and the US Dollar are both strong but are also expensive at this point and due for a technical correction.

Remember to set the stop loss as indicated.

Mutual Fund Guidance

Security	Recommendation	Current Price of Proxy	Guidance
Equity Mutual Funds (SPY as a proxy)	(May 24) SELL when SPY was below 110 for 3 days. ($107.71)	$107.87	You should be out of equity funds until this lateral market resolves into a trend.
Bond Mutual Funds (AGG as a proxy)	(May 16) BUY per recommended weight below	$106.72	Shift monies from Bond Mutual Funds to Money Market Funds when the price of AGG drops below $103.80 for 3 days
Money Market	Do not hold cash	N/A	You should be in fully in bond mutual funds at this point.

Rules for 401K Mutual Fund Portfolios

Segment your 401K portfolio offerings into Equity, Bond, and Money Market. Most equity funds (Large Cap, Small Cap, International, Growth, Value) are very tightly correlated and should be considered as a single asset class. Of these, if you have an S&P Index fund, choose this as your Equity fund. Most bond funds (government, mortgage) are tightly correlated. Of these, if you have a government bond fund, choose this as your Bond fund. You typically will not have a Real Estate or Gold option for 401K portfolios.

New Ideas

For more aggressive investors, I will have some news in the next week or so.

The Final Word

(Today's Final Word comes from Charles Kirk and his June 2nd posting at www.thekirkreport.com. As you focus a bit of time every week on the market and on your investing, you will become more confident in market direction, more experienced in market ups and downs, and better prepared and better able to take advantage of market conditions.)

It is often said that markets hate uncertainty and it is true. We do live and trade in uncertain times. But, as traders and investors, we must all learn to love and appreciate uncertainty. **With uncertainty, also brings opportunity**. Understanding this concept is so very important and learning how to profit from uncertainty consistently is going to make a critical difference between your success and failure.

Traders learn through experience the importance of examining and evaluating the markets through placing percentages on various future market scenarios. For example, at the hedge fund I worked at last week, every morning traders assemble for a 30 minute premarket meeting where everyone at the firm works closely together to outline the various potential scenarios for the market that day and then place specific odds on what they think is most likely to occur and why. One trader every day is in charge of diagramming out the different market scenarios on a whiteboard which resembles a flow chart so that the firm has a structured and easy to follow game plan. That game plan is also copied and stored so that the firm can later review it to learn and prepare in future days. In fact, at the end of every trading day they have another meeting to review the game plan and what went right and wrong and why.

By having the plan in place with various market scenarios outlined and positions to profit from those scenarios, **uncertainty is no longer a factor**. In fact, traders learn to love uncertainty because uncertain market conditions tend to favor those who are the most prepared to handle anything and everything Mr. Market could throw their way.

When the market does something outside of that original plan (it doesn't happen as often as you might think), there is always a Plan B, Plan C, and so on with a number of preconfigured trading ideas to profit if the market moved in a specific manner different than the most likely scenario. By having this planned structure in place, everyone can then focus on price action and trading setups as they occur instead of flying by the seat of their pants or, even worse, finding themselves held hostage or paralyzed by the ticker.

I had the distinct privilege of looking through the archive of firm's game plans for the past year and was amazed by how well the firm positioned itself according to the plan AND more importantly how it handled itself when the market did something unusual. In fact, just reviewing past game plans would be incredibly useful as a teaching mechanism for new traders who have little understanding of how the pros plan their work and work their plan. If you're like me, you'll begin to respect the other side of the trade much more than you probably do already.

As you might imagine, the process of formulating a game plan based on setting percentage odds for various scenarios was very interesting and useful for me to watch and participate in. It also stressed how important it is to have a plan, but at the same time be flexible enough to adjust as market conditions change. I usually spend at least an hour of prep time before every trading day, but after last week's experience, I will be doing more prep than before. That's how important I think this kind of exercise can be!

So, the question becomes, are you adequately prepared every trading day? In working with many traders over the years, most are not as prepared as I saw with my very own eyes last week. In fact, given the firm's results compared with other traders I know, I have good reason to think that kind of high-level preparation frequently can separate the winners from the losers.

Yes, it is true that we call can get lucky (every trade in theory has a 50% chance of working out, correct?), but over time the market will remove that luck factor and your success will be determined primarily on consistency and how you plan and deal with uncertainty in the markets. If you spend time every morning engaged in developing your own plan, I think you're bound to see steady and significant improvement. As Sun Tzu once said, *"every battle is won before it is ever fought"* and that's true for those who engage in doing battle with the market in such uncertain times.

Appendix – Important Details

Rules for Placing Trades

1) When you place a BUY order, you will also place an associated SELL order for the same security. This is designed to keep you free of constantly checking progress of the trade, and it is designed to build the discipline of always having a set of stops in place to control downside risk. This can be automated on TD Ameritrade by using what are referred to as "Conditional Orders". On Schwab these are referred to as "Bracket Orders". Lacking these automated tools, once you execute the BUY order you can go in the day after the BUY and manually place the protective stop.
2) All of your orders (BUY and SELL) will be done using Stop Market orders. That is, on a BUY order the market price must rise to a particular price before you BUY. This gives you initial confirmation that the market price is moving in the expected direction. On a SELL order the market price must fall to a particular price before you SELL.

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.

Things to be Aware Of….

First, among the positions that I hold positions are AGG, MUB, and UUP.

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