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Is 50% Always Good?

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As usual, I have a lot of topics to cover and never enough time. Let's begin with some comments I received the other week when I spoke to a group of individual investors. I was invited to give a brief talk on managing expectations in a volatile market.

My opening comments focused on the use of words to describe the climate. It seems to me that when stocks go up, especially sharply, everyone is calling it a rally or bull market. People are happy and sometimes giddy.

Yet isn't it amazing that when stocks down hard, we hear about "volatile" times or "unusual market volatility". It's almost as if people are in denial that stocks can go down! So during my talk, I told the group that accepting the good with the bad is one trait that all successful investors possess.

I went on to explain that everyone should evaluate performance on an ongoing basis and understand what is successful and what is not. Investors need to either measure themselves against a benchmark, like the S&P 500 or on an absolute basis.

For example, if your bench is the S&P 500 and you consistently beat that index, guess what? You are doing an outstanding job! Now, if you are an absolute return investor, your goal is to make money each and every year, regardless of what the stock market does. That includes the year when you make 8% and the Nasdaq soars 50%!

Anyway, most of the group was nodding their heads in agreement when I showed the
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famous chart of the Dow since 1900. Remember, I said; the stock market has rallied about 9% a year for the past 100 years. That sounds fine to most people, until they live through 2000 - 2002 or the 1970s and see their investments plummet 30, 40, 50 or even 70%!

At that point, a middle aged man raised his hand and asked how good I was. Uncomfortably, I half smirked as I dropped my eyebrows and told him that was for my clients to judge not me, hoping to end the discussion. But no, he pressed on, asking me to discuss and evaluate performance of my strategies.

As I began to talk about what we do and how we do it, he once again jumped in and demanded to only hear facts and figures. As a speaker, I knew he was trying to take control of the group and eventually push some agenda. He then blatantly blurted that he only wanted to know which investment program made the most money.

At that point, I offered him our Short Term Nasdaq Program, which was up about 12% for 2007 on that date. He immediately scoffed. Then I followed up with it's 15 month performance of roughly 50%! Yes, you read that right, 50% since the summer of 2006.

He said nothing. I asked for a show of hands of who would be happy with a 50% rise in their account in 15 months. All hands went up, except his, of course. I asked what would please him, knowing that I was risking giving him the floor to spew garbage. Instead of answering with a firm number, he launched into a 5 minute diatribe about, of all things, real estate!

After the first 30 seconds, watching the audience's reaction, I let him finish since I knew his investing acumen was not even on par with my 2 year old son, who, by the way, is up about 50% in his short investing career!

After the man was done, I repeated my question to the audience about being happy with 50% over 15 months. There were no changed in answers. I shook my head in disbelief as not one single person questioned me about the strategy and how we got there.

Since we were having a discussion about evaluating performance, shouldn't they have asked how aggressive that strategy was? Wasn't anyone curious if it made it a lot of money early and then lost money continually to the end? What if the account went up 100% or 200% and then collapsed to "only" be up 50% after 15 months?

These are all questions that intelligent and successful investors should ask. 50% is good. It's actually great, but everyone should evaluate how to get there. It's an aggressive strategy, so that makes the pool of potential investors much smaller. It can lose 10-15% in a given week. How would you feel then?

Everyone needs to properly evaluate performance. There are mathematical measures to help you, like volatility, Sharpe and Sortino ratios. It's not simply what makes the most money, but the ups and downs along the way.

Lastly, I know some of you love to chase performance. Each quarter when I publish numbers, which I will do next week, I get emails and calls to move money from an underperforming strategy to a leading one. Or new clients will immediately want to hottest one.

Folks, I BEG you to find strategies that fit your investment criteria. Be comfortable enough to add money when it has a bad month or quarter. When people ask me about the Short-Term Nasdaq Program, my immediate comment is that it's very aggressive and that if you can't tolerate your investment losing 15% right out of the box, you should look at another strategy, even though it's made so much money.

No more preaching today! Thanks for indulging me!!

Trick Or Treat For The Stock Market

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Turning to the stock market, we've seen behavior very consistent with the past following the Fed's decision to begin a rate cut cycle. I use the word "cycle" since that group has never had a "one and done" position. They usually move in intermediate-term cycles, although it doesn't mean they have to cut at each and every meeting.

Once Bernanke & Co. cut the Discount rate in August and then the Fed Funds rate last month, they essentially insulated the market from anything dramatic on the downside for a good 4-8 weeks. That rendered my 1946, 1987 and 1998 comparisons null and void. DOD... Dead on delivery.

While I am not shocked the stock market rallied, I am surprised at the vertical nature of it without any meaningful pullback. What's most eye-opening is the total lack of volume since the August bottom.

Yes, I know the last two weeks of August usually see light volume, and that spills into Labor Day week. But once the Jewish holidays were done, volume was supopsed to return with a vengeance. This has not happened and I really cannot explain it! It is without precedent in a bull market.

Certainly, the rally has caused a number of short sellers to cover and run for the hills, but where's all the big money? It almost seems like a total lack of sellers once Bernanke cut the Discount rate in August. No one wants try to run into a headwind until that euphoric sense dissipates.

With the markets very quiet over the past few weeks, I sense some more turbulent
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times are not far off. The employment report is tomorrow at 8:30am. Earnings season begins next week and lasts a solid month. Bernanke & Co. have a two day meeting to end October. All of this spells opportunity!

Now that September, traditionally the worst month of the year, is out of the way, the stock market should go straight up to year-end, right? Not in my opinion, although I do think we will only see one more meaningful decline this year and much higher prices after that and into 2008. It is funny though, that the past four Septembers have all been UP!

Normally at this time, we see the media dig up all of the horrid collapses we've seen in October. The Great Crash of 1929. 1987 Crash. 1989 Crashette. 1990 Iraq in Kuwait. 1997 Asian Contagion. 1998 Long Term Capital. 2000 Tech Collapse. 2002 Corporate Malfeasonace.

I haven't seen or heard much this year. Have you? While September was an almost straight up affair for the bulls, I doubt October will be similar. Don't get me wrong. Stocks can certainly end the month higher, but I do not think it will be the same as last month. The longer it stays on the quiet side, the more ups and downs we will eventually see.

I have seen a number of folks online talk about the "7" curse, something I mentioned earlier in the year. In almost all cases except 1947, we have seen a dramatic fourth quarter decline in years ending in "7", usually in October. I don't have strong conviction yet for this trend to continue, but I will certainly keep you informed if things change.

How Can They Call ME Stubborn?

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People who know me very well sometimes say that I am headstrong. If that's true, we definitely have like father like daughter since my four year old can be so tough. I happen to think she takes after her paternal grand mother, but that's a whole other story!

For years, clients have asked me to develop an international strategy. I have always said that unless I feel I have a solid edge over the masses, I would rather refer people to professionals I believe have that skill.

As you know, we formally launched Developed Markets and Emerging Markets strategies in July, giving us a moderate and an aggressive option for folks wanting international exposure. If we haven't spoken about these, I urge you to contact me directly to do so.
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This week, after years of resistance, we formally launched a High Yield Bond strategy to the delight of many clients and prospects. Similar to international, my thinking was that unless I had something unique, I would rather leave that space to other folks.

After exhaustive research, I am very proud of what we created and confident in the power of the model. My goal was to wait until the High Yield sector had one of its routine collapses before accepting client money and we saw debacle over the summer.

I will talk more about High Yield in upcoming issues, but if you are looking for an income generating strategy without the risk of the stock market, I invite you to explore this further. Hit "reply" right now or pick up the phone and contact me at 203.389.3553 for a more detailed discussion.

As we've done with both new international strategies, our fees are waived through December 31, 2007 as an additional enticement.

That's it from here. I am off to Buffalo, Rochester and Syracuse for some golf, wings and fun. The drive is painful, especially with my brother in the car, but it's all worthwhile when I get my first plate of wings at the Anchor Bar or Duff's. Hard to believe it's going to be in the upper 80s! And I was packing fleece!!

Enjoy the rest of the week and have a safe weekend!

I'll be back to you next week.

To Your Financial Success,

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