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Ellumination Newsletter

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Approaching a Critical Juncture

June 30, 2010

Equity markets continue to weaken around the world. We can make all the fundamental arguments we want about how cheap stocks appear to us, but it doesn't matter. The markets are in retreat. In fact all of Europe's major stock averages have already experienced the same technical sell signal that caused 5T to go entirely to cash in late 2007.

The Dow Jones Utility Average got the signal six week ago, and until yesterday was the only U.S. stock average on the sell signal. It triggered for the NYSE Composite Average yesterday.

If you are a client you have probably noticed that we have been net sellers of stocks in the past few days as this signal appears to be imminent for all U.S. stock averages.

Most of the major averages are now threatening to get the signal. This includes the S&P 500, Dow Jones Industrial Average, Dow Jones Transportation Average, Wilshire 5000, S&P Mid Cap 400, Russell 2000, the Nasdaq 100 and the Nasdaq Composite.

Here is a simple chart of the S&P 500. You can see the red arrow pointing to the signal in late 2007. That was the sell signal we used to go to cash and preserve a lot of money in 2008. We also show you the buy signal (blue arrow) that was triggered during the summer of 2009. We are now threatened with a potential sell signal again.

Should this signal trigger for the S&P 500, and the other averages listed above, we will either short them or buy inverse exchange traded funds (ETF) that benefit from them going down. We will not be establishing short positions as hedges, as we sometimes do in daily trading. We will be recognizing that a major trend change is occurring.

We did not rely on this particular trading signal when we started 5T, but over years of practical experience and through additional back testing (for decades) we have come to realize that the 13-34 EMA crossover on a weekly chart is simply one of the most reliable trading signal there is.

You can see for yourself that it doesn't get you out precisely at the top. Nor does it get you back in right at the bottom. But it does allow an investor or trader to capture much of the major trend in either direction. It allows you to own what is going up and to get out of what is going down-a favored concept here at 5T.

We have learned that this signal is reliable regardless of what market it is applied to, i.e., stocks, bonds, gold, agricultural commodities-you name it-the signal is reliable.

In 2007 we chose to go to cash when the signal triggered. Had we actually used it to short the market we would have made money for our models all the way down in 2008 and into 2009. That would be our goal this time. We prefer this time not to retreat from the market but to try to profit from the downtrend. That is why we will use this signal to establish longer term short positions instead of just going to cash.

With the caveat that "no one knows for sure" it now looks pretty likely to us that the 1040 level on the S&P 500 will break. That level has been the "support" that has been probed 4 times now. If it breaks most technicians we respect are looking at levels like 990, 950 and 880 as next key levels. A break of the 1040 level would also trigger our sell signal. We don't want to stick around for more of a ride down, and we suspect you would agree with us.

Here is another chart of the S&P 500 that also gives us pause. It is a monthly chart. Each bar represents one month's price movement of the index. We are wondering if we are seeing the same topping pattern that happened in 2007. Is this déjà vu?

We commented in our last letter that the technical condition of equity markets deteriorated very quickly after reaching highs in April. That deterioration seems to be accelerating. It would not surprise us if this signal is confirmed on all major averages very soon.

All the best,

Paul

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Disclosure and Disclaimer - Updated last on August 13, 2007 by Paul Krsek:
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The investment portfolio models or management services mentioned in ELLUMINATION may or may not be available in some states, and they may not be suitable for all types of investors.

5T WEALTH MANAGEMENT manages accounts with various histories and investment objectives. Various accounts may be managed differently from time to time.

Krsek makes frequent reference to the model portfolios called Hatteras, Mendocino, Halifax, Bonavista, Fresnel and The New World. During 2005 Paul Krsek was appointed Chief Investment Officer of 5T WEALTH MANAGEMENT, and as such is responsible to make all trading and management decisions for all client accounts which are being managed according to a specific portfolio model. A description of each of our models can be found on our website at http://www.kaassets.com/choices.htm.

Not all accounts managed by 5T WEALTH MANAGEMENT are "modeled" accounts. We strongly urge our clients to understand which model, if any, are being used to manage their accounts.

As of July 3, 2007 Lee O'Dwyer joined 5T WEALTH MANAGEMENT as a portfolio manager. Paul Krsek and Lee O'Dwyer frequently discuss investment ideas, model portfolio strategies and the investment policies of 5T WEALTH MANAGEMENT. But when it comes to the implementation of those polices Krsek is primarily responsible to manage the accounts that fit into each model portfolio description. He generally makes all final investment and trading decisions relative to those accounts that are considered to be "modeled." However, in Krsek's absence O'Dwyer does have the authority to trade all client accounts. He has been actively trading accounts in the various models since joining 5T WEALTH MANAGEMENT.

From time to time 5T WEALTH MANAGEMENT receives requests from clients to purchase securities that are not included in the model portfolio to which they are assigned. Effective May 24, 2006, 5T WEALTH MANAGEMENT has encouraged clients to hold such securities in a separate account for the client. Because 5T WEALTH MANAGEMENT is a "fee only" registered investment advisor" it charges its normal management fee for monitoring such securities in the separate accounts in which they are held.

5T WEALTH MANAGEMENT makes every effort to exclude securities that are 'requested by the client' from the modeled portfolio accounts.

The investment objectives of various accounts and models may be substantially different from one another. Therefore topics or investments mentioned in E-Ellumination may or may not apply to specific managed accounts and/or models.

Trades or adjustments to accounts mentioned in ELLUMINATION may or may not happen in every account managed by portfolio managers at 5T WEALTH MANAGEMENT.

If you are not satisfied with the investment results in your account it is your responsibility to inform Krsek or O'Dwyer and to discuss possible changes that can be made to the account to accommodate and satisfy your needs.

The assets held in managed accounts at 5T WEALTH MANAGEMENT may include stocks, bonds, cash, commodities, foreign exchange or mutual funds or exchange traded funds (ETF's), money market accounts or limited partnerships that represent the same. They are subject to market fluctuation and the potential for losses. The assets are not insured. The value and income produced by these investment products may fluctuate, so that an investor may get back less than they initially invested.

The portfolio managers at 5T WEALTH MANAGEMENT do not guarantee results.

Past performance should not be considered an indicator of potential future performance. If you do not consider yourself suitable, either emotionally or financially, to experience volatility and/or losses in financial markets, you should not invest.

From time to time Krsek lists the simple annual returns of the six model accounts in this newsletter. These accounts are "models" and do not represent the actual results accruing to individual accounts. Simple annual return does not represent "time weighted return" as reported individually to clients in their quarterly reports prepared using Centerpiece.

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