SectorSurfer
Change the Game

Shoot The Curl
Monthly Perspective

Perspective: The June Market Dip Rebound

July 4, 2013

Dear Scott,

Month in Perspective: The V-Notch Story

Near the end of June, we were sitting at the bottom of the v-notch you see in the S&P500 chart to the right. After a few days of big market selloffs many investors were saying "OMG, I gotta get out!" This was the sentiment on CNBC, and in my received emails, one of which was from a SectorSurfer who added a money market fund to his Strategies to be "for sure for sure." If your mind was drifting in this direction, check out The Faster Response False Dilemma.

3-Months

The longer view, shown in the 5-Year chart, provides a different perspective. It is common for the market to rise with a little excess enthusiasm followed by a little excess pessimism, which creates those moderate sized bumps in the chart as the market rises. Human mood swings create boom and bust cycles not only in the financial markets, but also in fashion, politics and other aspects of our lives.

5-Years

The market is both visceral and numerical. On the way to determining the right price, the news of the day plays into the fear and greed tug of war. The early part of June was all about worries that Ben Bernanke, Chairman of the Federal Reserve, was going to take his foot off the economic stimulus pedal, and that China was not going to help matters with its new fiscal policies. But then on June 25th we got real economic numbers about employment and consumer sentiment showing stronger growth continues to take root. Fear subsided, greed kicked in, and the market quickly bounced back 3%.

For now, all is well in the markets - and it's time to celebrate the 4th of July. In spite of all the economic troubles we believe we may have, the sentiment among most investment professionals is that the US still has the strongest and most reliable economy and is the best place to invest your dollar. That's an achievement worth recognizing and celebrating!

Learn More About StormGuard

Just the FAQs:
Why Not Include a Money Market Fund?

First, let's be clear that there is nothing inherently wrong with including a money market fund as one of your Strategy funds to make sure that the algorithm will always have at least one non-sinking fund to choose from during a market decline. Preventing loss not only directly addresses risk reduction, but can also be a comparatively easy way to improve long-term portfolio returns.

Although the most important thing for risk reduction is to have at least one method in place to escape the ravages of a down-market, the second most important thing is to optimize your method of escape. Thus,

the operative question here is whether including a money market fund among your Strategy funds is the optimum method for risk reduction. **SectorSurfer provides 4 methods for escaping a down-market.**

1.) Include a Money Market Fund. While the method of including a money market fund generally works, it's effectiveness depends on the character of the other funds and whether StormGuard is enabled, as demonstrated in the video How to Make Great Strategies. The primary reason why adding a money market fund conterintuitively often increases risk and reduces return is because of whipsaw losses. By reacting too quickly you are more likely to lock in the current loss than to successfully avoid further loss in a true market crash. Small market shocks with rebounds are much more common than true market crashes. See evidence in The Faster Response False Dilemma. Furthermore, because money market funds do not share the daily market movement in common with other funds, the decision to move to or from cash should be treated differently as described here: Common Mode Noise Reduction.

2.) StormGuard-Std. StormGuard is designed to signal a move to cash when markets aren't safe. Its algorithm determines the optimum balance between reacting fast enough to prevent serious loss in a true market crash yet reacting slow enough to avoid whipsaw losses from reacting to short term makert spikes. It is the optimal balance of reaction time that produces both the lowest risk and highest return for the Strategy. StormGuard is more fully described here. The back tested value of the balanced optimization is detailed in the article Should You be Panic Selling on Bad News? When StormGuard is enabled, both money market funds and ordinary bond funds are generally counterproductive additions.

3.) StormGuard-AQR. StormGuard-AQR (asymmetric quick response) is a more aggressive StormGuard that (a) ''comes out of the hole'' sooner following a market selloff, (b) triggers sooner by not adhering to month-end trading rules, and (c) does not honor fund-specific trade hold rules. Money market funds and bond funds can significantly reduce the intended benefits during market recovery. See more on StormGuard-AQR here.

4.) Inversely Correlated Funds. Turning off StormGuard makes it possible to use funds that are inversely correlated with the market to do well during down-markets. These funds include so-called inherently shorted inverse funds, such as PSQ and SH, and generally includes long-term treasury funds, such as FLBAX, VUSTX, TLT, and UBT which are commonly found in the Safety category of the Strategies Hall of Fame.

Celebrate the 4th of July and surf well,

Scott Juds
President & Chief SectorSurfer
SumGrowth Strategies, LLC
www.SumGrowth.com

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