Should You be Panic Selling on Bad News? No!

A StormGuard Perspective April, 19th 2011

This article is based on an email sent to SectorSurfers regarding questions about how StormGuard was responding to the pull-back associated with Standard & Poors' downgraded market outlook statement in view of US government debt.

Dear SectorSurfer,

The sharp market pull-back today triggered by a market-downgrade statement issued by Standard & Poor's Financial Services today generated some jitters among a few who are wondering just when StormGuard will kick in and tell them to go to $CASH. Certainly the market reaction indicates immanent doom ahead, right?

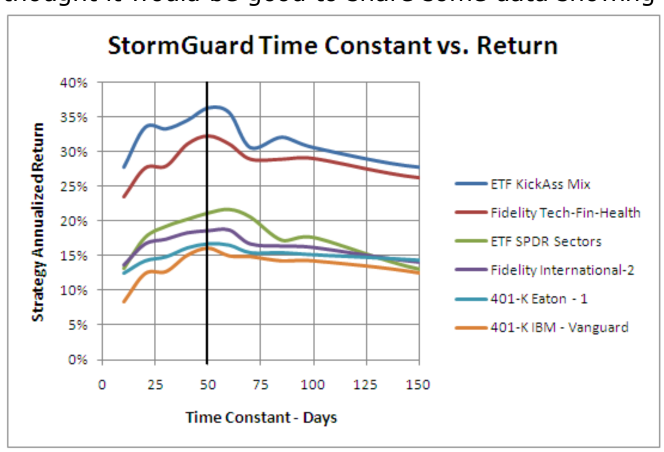
First, let me remind you that "If economists were laid end-to-end, they would point in all directions." And they do. There's also no shortage of optimistic talking heads on CNBC. You can pick your expert, but at the risk of picking the wrong expert. Or, you can listen to the data – "The trend is your friend." It's SectorSurfer's job to dig trend signals out of the market noise as reliably as possible. So, let's take a look.

Just a month ago there was a market pull-back associated with the late February Middle East protests and riots for democracy, and the mid March Japanese earthquake and tsunami disaster. Many were similarly worried about the market and whether StormGuard would wake up in time to save them. The DJIA (Dow Jones Industrial Average) chart of March 16, 2011 was as shown on the right.

We argued that (1) the cause of the pull-back was not systemic in nature and amounted to a knee-jerk reaction to world events, (2) that selling would likely result in whip-saw losses, and (3) that StormGuard had been optimized to find a balance that is slow enough to minimize whip-saw losses, but fast enough to exit before a real systemic market storm.

The DJIA chart of today, April 19, 2011, bears out that it was wise to ride out the market pull-back last month. Furthermore, looking at this chart, it is pretty difficult to make any argument that the market today shows any sign of being in decline. In fact, the pull-back today is smaller than that of a month ago.

Because this is such an important topic for everyone, I thought it would be good to share some data showing the effects on Strategy return from changing StormGuard's time constant. The chart to the right shows the annualized return for six Strategies plotted against a range of constants for controlling StormGuard's reaction response. The Strategies were selected to include a sampling of different fund characteristics.



As can be seen, all of them have a peak around 50 days – the value used by StormGuard. To react to current events would require a time constant much shorter than 50 days. Perhaps even 10 days is not short enough. Clearly, whip-saw losses for such short time constants would be quite punishing to Strategy annualized return performance. Thus, patience is a virtue here.

I would also like to share some excerpts from one of Jim Cramer's recent Mad Money shows from TheStreet, by Scott Rutt, 04/15/2011, entitled "Cramer's 'Mad Money' Recap: Timing Is Everything"

> NEW YORK (TheStreet) -- "Timing is everything," Jim Cramer told the viewers of his "Mad Money" TV show Friday, as he dedicated the entire show to helping home-gamers become better investors.
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> Cramer said whether it was the crash of 1987, the event surrounding 9/11 or the recent earthquake and tsunami in Japan, panic selling has never been the right strategy. In fact, Cramer said in his 30-year career on Wall Street, there's only been a single time when selling into a panic was justified, and that was in October, 2008.
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> Cramer said investors should never panic and never sell in the midst of an awful decline. "Not every sell-off is the end of the world," Cramer told viewers, "don't trade like it is." Just in the last year alone we've seen market scares about Egypt, Libya, the Grecian debt crisis, troubles in Portugal, the death of the euro and of course, the tsunami in Japan. During all of these events the markets have sold off, but should investors have followed suit?
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> What do Egypt, Libya, Italy, Ireland, Greece, Spain, Portugal and Japan have in common? None of them caused the end of the world as we know it, even though each one rocked the stock market at the time. Cramer said in the middle of the debt crises for Ireland, Greece and Spain money managers all felt that it was the end of the world once again for the banking stocks, all of which sold off hard. But in reality, banks were better capitalized than people thought, and the issues all resolved themselves. In Egypt, investors asked how a regime change in that country could not be bad for stocks? The unfolding events once gain sent investors heading for the hills. But in reality, no U.S. companies were significantly impacted by the protests.
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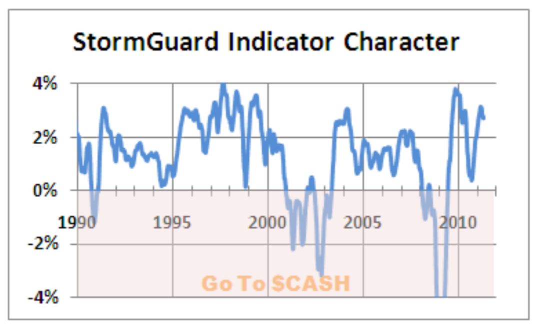
> Cramer said events like these should prove to investors that not everything signals the end of the world. In the case of Japan, which was indeed a horrific event, the outcome will be a positive one, as the country gets to rebuild itself better and stronger than before. Cramer said the market always manages to survive catastrophic events, which is why they're a time to buy and not sell and are definitely not a time to panic.

Finally, the StormGuard Indicator Character chart to the right shows how StormGuard has changed over time. In particular, note that it dipped near the thresholod for going to cash in the summer of 2010. The charts near the top of this document show that the market then experienced about a 12% pull-back followed by a slow rough climb back up. While it was close to being a Market Storm, it did only amount to a market correction. The summer of 2010 thus makes a good reference point in time to understand what constitutes the threshold at which StormGuard decides it is time to go to $CASH.



To learn more about the StormGuard indicator, [click this link.]()

Surf Well,

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