Wolverton Securities

CAMERON WOODS
PORTFOLIO MANAGEMENT
Make every year count.

Have Your Cake and Eat It Too Investing

Special Report – Asset Allocation Change

By David Cameron

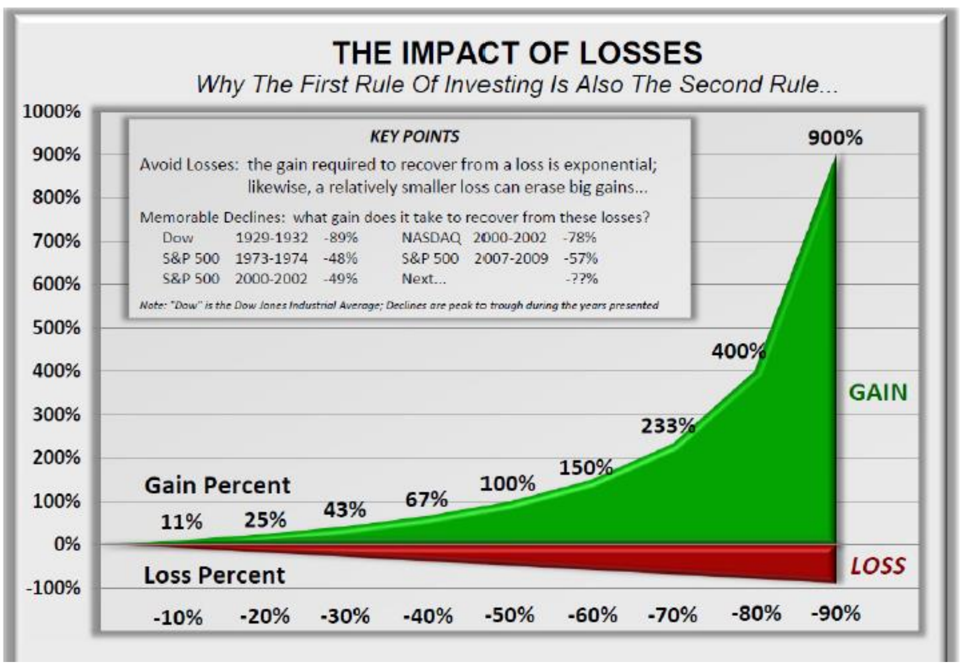
January 18th, 2016

NOTE: Based on the closing price of Markets on January 15th, 2016, a majority of our Long Term Indicators turned Negative. The odds no longer favor being invested in equities. We are moving to cash in all of our Equity Portfolios.

Why are we moving to cash?

The premise of our portfolio management process is based on cutting our losses short. The chart below illustrates why this is so important. As investment losses increase, the required gain to reach break-even exponentially increases. If we cut our losses at -10% or less we can recoup those losses with a relatively similar +11% gain - but the investor who loses -50% needs a 100% return to break-even.

There's another more important reason for cutting loses short; most people feel the stress of loss much more acutely than they do the satisfaction of achieving gains. Very few people lie awake at night because their portfolio has gone up too much. The stress of losing money and the associated feelings of discouragement, powerlessness, and anxiety can affect your relationships, your work and your health. Our efforts are focused on the wellbeing of both your money and your peace of mind, allowing you to invoke the wise words of Mr. Bobby McFerrin: "Don't worry! Be Happy!"

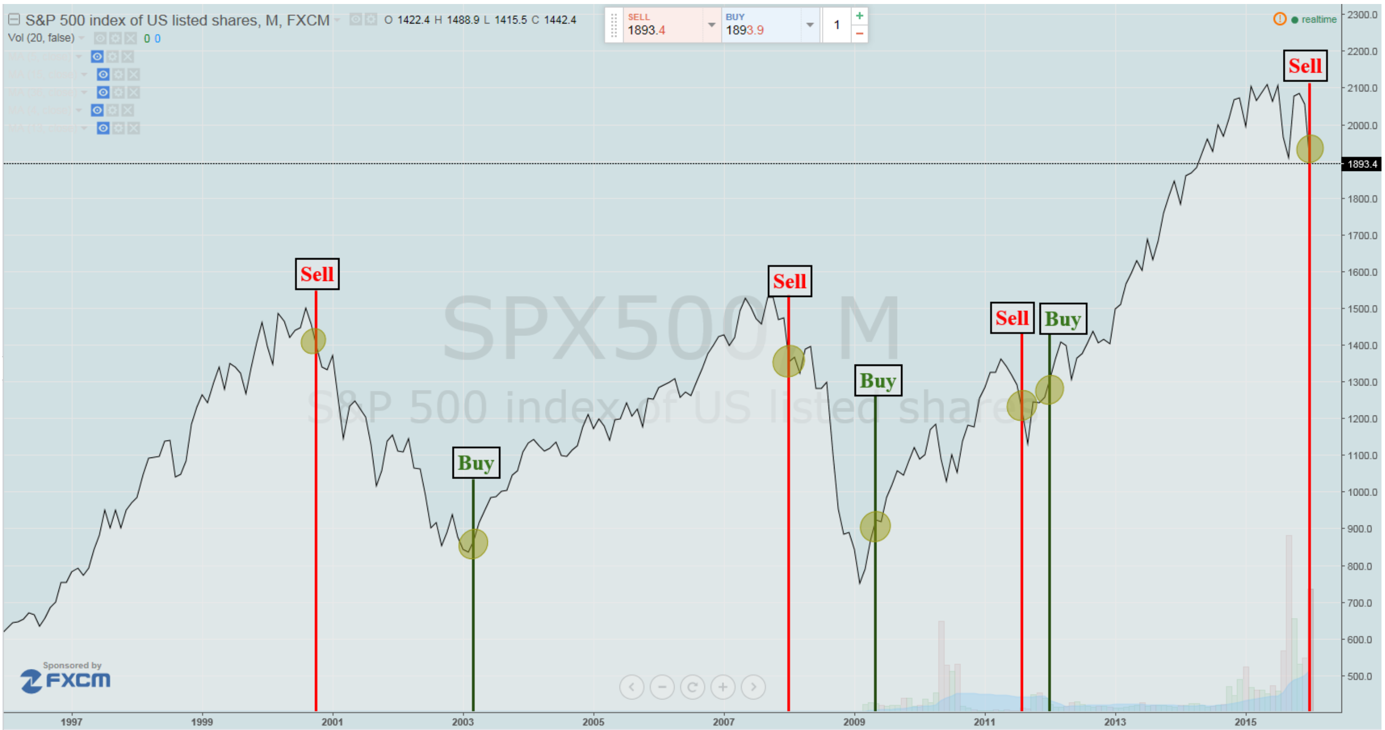


Are we predicting a Bear Market?

No.

Our decisions are based on the odds as they stand in the present. In this case, the odds have now changed such that you are more likely to lose money than make it if you stay invested in the equity markets. When the facts change, so do we.

Our long term indicators, which are measured in months and years, do not turn negative very often. The levels of support and resistance reflected in our indicators are based on years of data and, as such, are very strong. Because of this it pays to act when they break. In the last 20 years they have turned negative only 4 times, including this most recent change (as shown in the chart below). Those dates are mid October 2000, early January 2008, mid-August 2011 and mid-January 2016. An historical review of equity markets will show that the first two calls (2000 and 2008) did indeed turn out to be the beginning of significant Bear Markets. 2011 is instructive as a longer-term market collapse did not materialize at that time; we simply cannot know if ‘this time’ will turn out to be like 2011 or 2000/2008.



When and how do we get invested again?

When the odds change in favor of being invested, we will act. Our Long Term indicators went positive again as follows: mid-March 2003, mid-May 2009 and late-January 2012. All of these situations provided investors a profitable opportunity to capture the gains in the ensuing bull market rally.

The value of side-stepping the losses incurred during Bear Markets is dramatic. The peak to trough decline of the 2008/2009 Bear Market was -56.8%. A quick glance at the graphic on Page 1 shows that an investor who suffered through this would have to gain around +130% just to get back to even. If you could wish for one thing as an equity investor it should be this: wish to NOT be invested during a market collapse. If you can manage that you’ll be fine, provided you can figure out when to get in again.

There’s an old saying in money management - the amateur asks “*How much can I make?*” while the professional asks “*How much can I lose?*”

What if the market goes back up again?

It could, of course. Being wrong is a common theme when decisions are measured on their short-term results. You buy something and it goes down. You sell it and it goes up. We've all had this experience and usually more than once. It's ok to be wrong. It is NOT ok to stay wrong. If the market goes up in the next few weeks and then falls again in line with what the odds suggest, we are fine with that. If, however, the longer-term uptrend in the equity markets re-establishes itself then our indicators will turn positive (like it did in Jan '12) and we will re-establish a full equity position in our portfolios.

We have repeatedly stated that we would rather lose an opportunity than lose your money. Given the current outlook, we are comfortable with our worst case scenario – money market-like gains with no downside risk.

Don't I have to stay invested to catch those 'Best-Day' rallies?

A popular and persistent myth for the "Buy-and-Hold" crowd is the 'Best-Days' argument. The idea is that the market moves in fits and starts. In order to maximize your gains over time you must stay invested lest you miss those best days. You'll find variations on this argument of Best 10, Best 25, Best 100, etc… This hypothesis doesn't stand up to scrutiny however (we have a detailed report on this - ask if you'd like a copy). Over the last 15 years the facts are as follows: the 100 'best days' are completely offset by the 100 'worst days' (+377.1% for the best days, -376.0% for the worst days). Best and worst days occur at about the same frequency and at about the same size. So, in order to get the best 100 days you have to be invested during the worst 100 days … effectively netting you nothing.

The 100 Best and Worst Market Days

S&P 500 Jan. 1, 2000 through Mar. 31, 2015

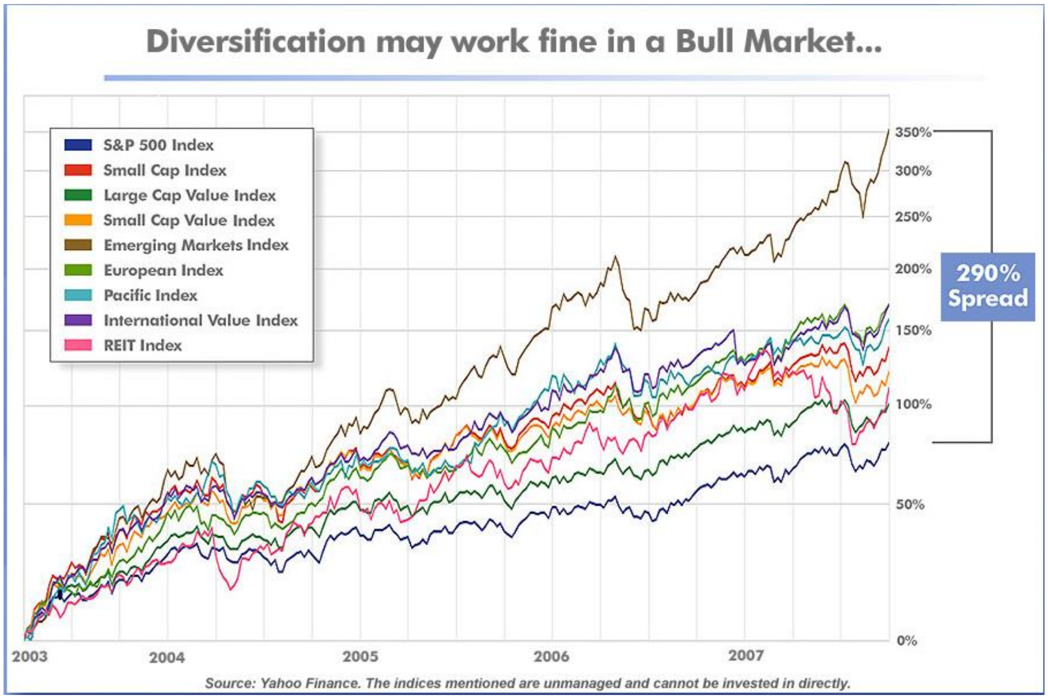
Best 100 Days Net Results	
Best 100 Days Net Percent Gain	377.08%
Best-100 Gains in Bear Markets	**290.53%**
Best-100 Gains in Bull Markets	86.55%
Bear Market share of all Best-100:	77.05%

Worst 100 Days Net Results	
Worst 100 Days Net Percent Loss	-376.00%
Worst-100 Losses in Bear Markets	-275.20%
Worst-100 Losses in Bull Markets	-100.80%
Bear Market share of all Worst-100:	73.20%

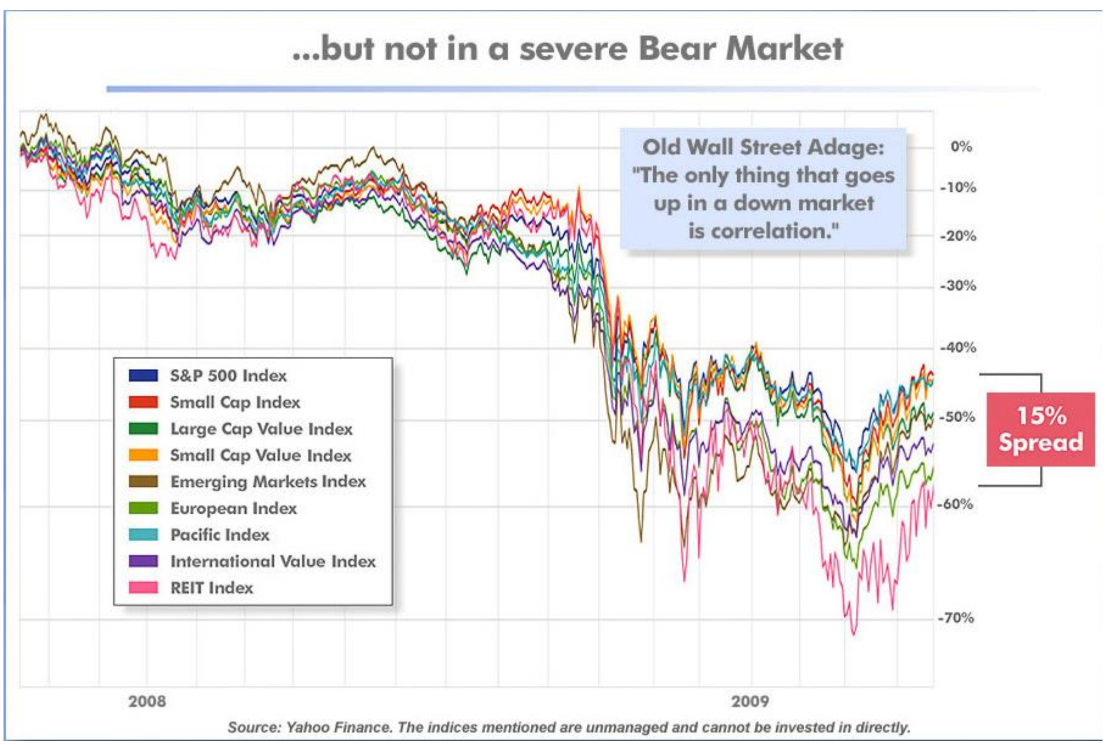
An interesting anecdote to this study is the following fact about the 100 Best/Worst Days: they are overwhelmingly more likely (77% for Best Days and 73.2% for Worst Days) to occur during Bear Markets. We suggest that instead of worrying about missing the 'best days', focus on the fact that the dominant trend in most stocks within the market is *down*!

Why isn't the diversification in my portfolio enough to protect me in down market?

A key benefit of Relative Strength investing is that it allows us, during a Bull Market, to identify and invest in the stocks, sectors, countries, etc… that are showing consistent relative outperformance. Even if everything is going up there is a significant difference between what is going up the most and what is going up the least. The chart at the top of the following page demonstrates this:



In a Bear Market, however, the spread among different assets utterly collapses leaving you nowhere to hide. Even if you stick with relative strength investing strategies you still end up with nothing more that the best of the worst. You can see this in the chart below as the spread between the best and worst asset classes drops from nearly 300% to 15%.



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Is there anything you can do in the current market environment besides stay in cash?

As a matter of fact there is. We are focusing on three strategies:

A) Bond Market: Bonds remain in a Bull Market as per our indicators and analysis. Therefore, there are no changes to our Bond ETF Portfolio or the bond allocations in our balanced portfolios. In select ETF Equity Portfolios, where permitted by our Investment Policy Statements, we are implementing a reasonable facsimile of our Bond Portfolio to increase yield and generate gains.

B) Calendar Effects: This is the name given by academics and researchers to the long-established and statistically-validated tendencies of the stock market to produce higher than average returns during certain calendar periods. This strategy works particularly well during Bear Markets. It works well during Bear Markets because of the Best 100 Days argument. You'll recall that 77% of the Best 100 Days happen during Bear Markets. The Calendar Effects strategy identifies the most likely timing of those Best Days while avoiding the Worst Days. To learn more about how we are applying this strategy to your benefit give us a call.

C) Bear Market Strategies Portfolio - Under Construction - : We are currently working to create a new Bear Market Strategies Portfolio. It stands to reason that if our process identifies what is most in demand then it will also identify that which is most in supply (i.e. not in demand). There are investment vehicles which allow us to profit when markets fall. These are generally referred to as Inverse Exchange Traded Funds (ETFs). If the market drops 10% then the ETF will go up 10% (and vice versa). Careful, process driven use of these types of investment vehicles during Bear Markets combined with the aforementioned Calendar Effects process should result in positive gains through a full Bear Market Cycle. This is not something we will be implementing within any of the current Cameron Woods Investment Portfolios, but within a new Bear Market Strategies Investment model currently being constructed. Stay tuned for more information on the availability of this Portfolio.

Questions, Comments, or Concerns

Depending on your own unique situation we may be talking to you about one or more of these strategies. We continue to strive to make every year count regardless of market conditions.

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