Scotty C. George
Chief Investment Strategist

December 22, 2014

Market Outlook:

Whiplash

The exhilaration of watching your portfolio rise in value mid week last week pales in comparison to the depths of anguish and despair you felt when five to seven percent of your market value was erased such as in the weeks prior. Because zenith valuations are not finite, but fluid, one rationalizes that he hasn't *really* lost anything when the account value goes "down"....it always "comes back" over time. But seriously, who swallows that sort of justification when the monthly statement comes in the mail showing portfolio valuations minus several tens of thousands of dollars?

For that reason alone, I am loathe to accede to client demands that we go *"all in",* or *"stop playing it so cautiously".* As I said last week, recovering from portfolio draw down is a most difficult task statistically and psychologically. I must never forget that these are my clients' monies, not mine, and that I serve as steward to their financial objectives. The markets are a tough place, and not for the faint of heart.

Uppermost, we must remember that investing involves time, process, methodology, risk, and patience. There are no guarantees about return on equity, but there are rewards usually for those who don't panic.

Thus, a steady deterioration during the past several weeks in portfolio values, and the global bourses themselves, should not have been unexpected. A decline in energy prices might have caught the "experts" off guard, but the potential for a market capitulation, even a big one, has been something my quantitative integers have been indicating for several months. October's decline was swift and difficult to take. December seems to have its own agenda for swoons and gains.

One reason why sector allocation is more important than stock picking is that *indiscriminate* over weighted concentrations of underperforming stocks can have a deleterious impact upon portfolios, whereas, in the right proportions, even bad stocks within specific groups might not have a correlated impact upon portfolio performance relative to the benchmarks.

In addition, one's timeline of expectations is critical to the analysis. We should know by now that it is impossible to guess correctly every short term swing in prices of stocks and bonds. Instead, rather than "timing" trades, it is better to focus upon demographics and secular shifts in culture, population, social trends, geography, politics, and money flow (fiscal and monetary policy). From there, it is more likely to make educated decisions, even if they are unique to each investor, about how money can be put to work to achieve your growth aspirations for the longer term. I favor Technology, Industrials, Cyclicals, alternative Energy, Biosciences, Agriculture, and Basic Materials for those tasks.

While I view economic data as becoming decidedly more positive, my concern is the unusual volatility of short cycles and emotional responses which can interrupt the strength of our portfolio building. Indeed, as mentioned earlier, it is no fun seeing five percent or more in portfolio losses in one month through no "fault" of our own, except for manic mood and price swings in one or two sectors.

Support

Do we thus conclude that investing is all for naught, a big waste of time? Absolutely not. Our discipline and processes are oriented specifically towards balancing risk during the kind of volatility that we are experiencing now. For example, prior to the dot.com debacle in 1999-2000 clients may recall that we had begun to shift our asset allocation away from technology shares because (1) valuations had become unsustainable and excessive and (2) there were few real earnings-driven companies in that space at that time. In 2008, as the run up in credit deconstruction was occurring, we were devoid of any Financial shares and had already pared down our exposures to lengthy bond maturities in our balanced portfolios because our screening tools had flashed warning signs about excessive borrowing in the global marketplace. While I might be sitting with "too much" cash today, the parallels to an unsustainable valuation rally and a decline in relative strength integers is uncanny, a situation which has persisted since April of 2013!!

If we wind up missing the targeted benchmark return, so be it. The reward is avoidance of a flash-point decline that can do serious harm.

We will continue to be invested, in the proportions we deem appropriate to our client's risk/reward tolerances, and to do so with a respect for our client's families and long term objectives.

(Our next posting will be the Quarterly Commentary: January 1, 2015)

Happy Holidays!!

Arlington Econometrics is a quantitative market tool. Utilizing proprietary algorithmic equations, AE offers solutions for market-timing, asset allocation, and macro economic analysis. Using historical time-series measurements, Arlington Econometrics optimizes the analytical process and forecasting coefficients to make economic forecasting more objective.

The information contained herein has been obtained from sources believed to be reliable, but is not necessarily complete and its accuracy cannot be guaranteed. This report is not to be construed as an offer to sell or solicitation to buy any security. It is intended for private information purposes only. Any opinions expressed are subject to change without notice. Alexander Capital and its affiliated companies and/or individuals may from time to time own or have positions in the securities or contrary to the recommendations discussed herein. Neither Alexander Capital, LP nor any of its affiliates (collectively, "Alexander Capital, LP") is responsible for any recommendation, solicitation, offer or agreement or any information about any transaction, security, customer account, or account activity in this communication.