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Investment Strategy
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**Investment Strategy**

## "MOOD"

**M-O-O-D:** That is the important word right here. And, what a difference a few weeks makes for last week the markets seemed to switch from the "glass being half-empty to half-full" leaving Mr. Market in a more forgiving mood. Importantly, market mood frequently sets the near-term trend. If the mood is positive, all things are possible; if it is negative, little is. To wit, consider the following excerpt on mood from the *New York Times*:

> *'Emotions are contagious,' wrote the Swiss psychoanalyst Carl Jung. His observation is now being borne out and given precision by scientific studies of the subtle interplay of moods as they are passed from person to person. . . . It is perhaps no surprise that people's moods affect how they see their futures. But psychologists point out that people are largely unaware that a good or bad mood is creating an optimistic or pessimistic outlook. . . . Research shows that moods influence people's judgments by making either positive or negative memories more readily available. Thus a rational weighing of the evidence is swayed in one direction or the other by the bias that moods introduce in what can be brought to minds.*

Obviously the mood momentum has shifted over the past few weeks and now seems to favor the bulls as indicated by +6% rally from the S&P 500's (SPX/1342.84) intraday low on June 4th (1266.74) into last Friday's intraday high of 1343.32. To be sure, the mood change has been driven by rumors out of Europe that the central banks stand ready to supply enough money to "paper over" the near-term consternations of Euroquake. Why this should come as a surprise is a mystery to me because you don't throw a trillion dollars at a problem and then just walk away if it doesn't solve the problem. We didn't do that with our financial fiasco and the Europeans won't do it with theirs. Indeed, over the past few weeks rumors have swirled that another two trillion dollars are being readied for Euroquake, and if that doesn't solve the issues I think even more money will be thrown at the situation. And, here's the twist: it is likely our Federal Reserve will have to provide a liquidity event of its own to keep the U.S. dollar from spiking higher. Clearly, that appears to be what the weakening U.S. Dollar Index seems to be sensing as can be seen in the attendant chart.

Plainly, the past two weeks' stock market action has been impressive as bad news has been ignored for the first time in two months. For example, the string of bad economic news continued last week with 10 of the 16 economic reports coming in worse than expected; four were in line, but only two came in above estimates. While that was better than the previous week's pathetic parade of releases, it is still far from being good. Nevertheless, most of the indices I monitor moved higher again last week (second week in a row). In fact, the only indexes in my universe that fell were the S&P MidCap 400 (MID/920.26) and the S&P SmallCap 600 (SML/430.25). Of the major indices the D-J Industrial Average (INDU/12767.17) faired the best by gaining 1.70% and in the process broke above its 50-day moving average (DMA) at 12752.37. This was the first close above its 50-DMA since the decline began in earnest on May 4th and should therefore be viewed constructively. It also lifted the SPX above its overhead resistance between 1335 and 1340 so often referenced in these comments. Still, to match the INDU move the SPX will have to better its respective 50-DMA at 1348.45. As for sectors, last week's most winning sectors were Telecommunication Services (+3.11%) and Energy (+2.47%). Regrettably, however, the two week rally has left no sectors currently oversold and Consumer Staples, Telecommunication Services and Utilities pretty overbought. Similarly, the NYSE McClellan Oscillator is overbought (see chart).

Since the SPX's June 4th "low" of ~1266, I have repeatedly opined that I am treating said low as a daily/intermediate-term low even though the violation of my 1290 pivot point caused me to suspend the program of recommitting some of the cash raised between February and April. As stated, "In this business it's better to lose 'face' and save 'skin'!" And clearly the decline of ~11% exceeded my expectations of a 5% - 8% affair. That's why investors need to have the discipline to adapt to whatever is happening in the various markets. But, what inevitably happens when a portfolio begins to erode, investors are told, "No one can time the market; and it is time in the market not timing the market." Or, "If you miss the 10 best days in the market, your investment returns fall significantly." Of course, investors are never told that if you miss the 10 worst days your returns swamp the return of investors who stayed the course and rode the "ups," as well as the "downs." Now I admit, n-o-b-o-d-y can consistently "time" the market on a daily or a weekly basis; yet, there are numerous indicators that tell us when we should be aggressive, and when we should be defensive. Those indicators are what caused us to raise cash every spring for the past three years. Moreover, you can pretty much count on me to sell 25% – 33% of any portfolio position if it is up 100% to rebalance that position; and, I don't really care if the gain is long-term or not. You can also count on me to take some kind of defensive action (sell, hedge, collar, etc.) when something goes against me between 15% – 20%. Indeed, avoiding the big loss is the key to better returns in the markets.

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So where does all this leave us currently? Well, plainly the markets will put rabbit ears on for the Greek elections. As I write, the polls suggest the center-right New Democracy party has a slight lead. If so, markets are likely to react positively because although this would be the same election outcome as last month, this time it should produce a stronger government coalition. However, if the left-wing Syriza party wins, the markets should react negatively as Syriza has threatened to stop all austerity programs. And when I arrived in the office at 5:30 a.m. this morning, the headline reads, "Greece's New Democracy party seeks bailout coalition." While that election is a relief, the more important election may be what happened in France where newly elected President Hollande solidified his left-wing leaning with a comfortable win by the socialists in Parliament. Then there is the election in Egypt where the Muslim Brotherhood appears to have won. Yet to me, the real surprise is likely to be our election this November.

As the astute GaveKal organization opines, "I think the surprise is going to be America and the surprise is going to be the level of productivity the U.S. is going to deliver on the back of reindustrialization, cheaper energy, and smarter policymakers and smarter policies." Indeed, history shows that you tend to get periods of governmental acrimony where nothing gets done – and we've had that. After the election, whoever gets elected, I think that a fair amount will be done to tackle the debt situation and increase the productivity of government. I love the good folks at GaveKal, as well as the way they manage money, which is why I embrace the GaveKal Platform Company Fund (GAVIX/$11.43), which is managed by my friend Steve Vannelli.

**The call for today:** The New Democracy's narrow win in yesterday's election should ease near-term worries of a Greek Gotcha'; yet, it does not take Euroquake off of the table. Moreover, the French and Egyptian elections have heightened international worries this morning leaving the preopening S&P 500 futures lower by about 5 points. Here in the U.S., investors will be listening to the Tuesday/Wednesday FOMC meeting to see if the Fed will indeed provide another liquidity event be it QE3, an extension of Operation Twist, or targeting GDP. Also on tap this week are the potentially market moving Philly Fed Index (Jun) and Leading Indicators (May) reports, not to forget the G20 meeting in Mexico. But remember, it is the stock market's reaction to the news rather than the actual news that is important. Accordingly, watch the support level now at 1330 – 1340 to see if the market continues to ignore bad news. This week should tell us if this is a "fakeout" rally or something more.

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Source: Thomson Reuters

McClellan Oscillator for NYSE

250
125
0
-125
-250
-375

1450
1400
1350
1300
1250
1200
1150
1100
1050

J AUG SEP OCT NOV DEC JAN FEB MAR APR MAY JU

S&P 500 on right scale in red

Source: Thomson Reuters

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|---|---|---|---|---|---|---|---|---|
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| **Underperform (Sell)** | 8% | 1% | 10% | 15% | 0% | 67% | 0% | 0% |

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