



Capital Markets Observations

MAY 2010

Will the Real Stock Market Please Stand Up: “To Tell the Truth” is a famous game show that was one of only three game shows in the United States to have aired at least one episode in at least six consecutive decades. The show consisted of four celebrity panelists who tried to correctly identify a described contestant who had an unusual occupation or experience. The central character was joined by two imposters who pretended to be the actual character. Each episode ended with the host asking “will the real [central character’s name], please stand up”. There were many notable contestants over the years including the infamous John E. DuPont, heir of the DuPont fortune, Orville Redenbacher, later of popcorn fame and in 2001, Sergey Brin, co-founder of Google. Currently, we seem to have an equity market that is hiding its true identity and often changing personalities on a daily basis.

It wasn’t too long ago, when investors couldn’t get enough of the stock market. The U.S. equity market bottomed on February 5th and then embarked on a meteoric rise that didn’t see much more than a hiccup. March 2010 went down as the most consistently positive month since April 2007 and one of the best months since 1900. The Dow Jones Industrial Average traded higher on 18 of the 23 trading days during the month. Finally, the market didn’t have a pullback of over 1% for 44 straight days through April 15th. When the music finally ended on April 26th, the trough to peak gain from early February registered nearly 17%. Near the April top, advisor sentiment was at the most bullish level since late 2007, coincidentally the all time peak in stock prices. According to Investors Intelligence, 54% of advisors were bullish while only 18.7% were bearish (as of April 27, 2010).

Here we are a scant seven weeks later and not only have all of the year’s gains been wiped out but many advisors seem to be throwing in the towel. From the April peak through yesterday’s close, the S&P 500 has declined 13%. Bullish sentiment has been dropping faster than stock prices with Investors Intelligence reporting today that the number of bulls dropped for the fifth straight week to 38.5%. The number of bears rose to 31.9%, nearly double their level when the S&P 500 hit 1219 in April. Currently, both bullish and bearish figures are at extremes not seen since July 2009, just before a major three month rally in equities.

So which market is telling the truth or is the “true” character actually Sybil with multiple personalities? Regardless, it appears that direction affects sentiment which in turn is a testament to the inability of most advisors to adhere to an outlook or discipline. It is also reflective of the continued herd mentality that has consistently ruined most investors’ portfolio returns. Being bullish at market peaks and bearish at bottoms is not a good recipe for making money. We believe that gathering current information and data is important. However, it is much more critical to arrive at an independent conclusion driven by the ability to use all the tools at your disposal.

Asset Class Index	Month to Date	Quarter to Date	Year to Date	Last 12 Months	Annualized Return	Standard Deviation
Russell 3000 Index	-7.90%	-5.91%	-0.32%	23.20%	-8.24%	21.32%
MSCI All-Country World Ex-US	-10.91%	-12.16%	-10.91%	7.96%	-11.70%	25.20%
Dow Jones UBS Commodity Index	-6.92%	-5.12%	-9.89%	0.47%	-8.88%	23.93%
Barclays Aggregate Bond Index	0.84%	1.89%	3.71%	8.42%	6.89%	4.11%
HFRI Fund Weighted Hedge Fund Index	-2.26%	-2.25%	-2.22%	-2.13%	-0.74%	1.31%

Sources: Zephyr Associates, Inc. and Hedge Fund Research, Inc. Annualized return and standard deviation are for the trailing 36-month period. Data as of 4/30/2010.

Market Update & Outlook: We were not surprised by the recent sell-off and in fact we expected it to come sooner. Our portfolios have carried short term hedges since late last year and in recent weeks we have been rolling these hedges out longer term. In addition, we have been adding non-correlated strategies to portfolios as well as minimizing broad market exposure. Our contrarian nature provides an opportunity to take positions on our terms rather than selling into panic or buying into euphoria. *June 9, 2010*

