Perspective: The New Year, Yahoo Data, Don't Fight the Fed

The New Year Ahead
While many market pundits are doubtful that the smooth upward trajectory of the S&P500 can continue, others see the trend continuing for at least another year.

The bears say that (1) the market is well overdue for a 10% correction, (2) cyclical wave theory virtually proves another market crash is imminent, (3) the student loan debt crisis is about to implode, and (4) various Fibonacci ratios signal that a major market turning point is about to be triggered. But, the optimistic bulls point to (a) the relative fair value of the market, (b) improving employment numbers, (c) favorable consumer sentiment, (d) the reduction of energy prices, and (e) the lack of any pending destabilizing crisis.

I believe that punctuated events lead to new trends, and I don’t think a tsunami, plague, credit default, breakout of war, or statements by the Federal Reserve Chairman are controlled by Fibonacci ratios, cycle theory, or price resistance thresholds. There is nothing magic about a 10% correction — they occur in all sizes and they all test the market's perseverance. When the bears can’t get sufficient traction for a 10% correction, it doesn't mean one is overdue, it simply means the market is still stronger than they think.

I am feeling quite bullish about 2015 because I believe that the recent drop in energy prices will provide significant long-term benefits for consumers, the economy, and the markets. That said, one must keep in mind that the nature of punctuated events is to catch everyone by surprise. We all know there will be some, but hopefully they’ll continue to be rather inconsequential.

What the Charts Say Now
The chart (above right) compares three leading sector ETFs (RTH: retail, XHB: homebuilders, and XTN: transportation) to the S&P500 over the last two months. Last month I had noted that numerous Strategies began selecting transportation and retail funds, the likely beneficiaries of lower fuel prices expected to continue, measurably boosting earnings posted by airline and trucking companies and/or reducing the transportation and manufacturing cost of goods. Meanwhile, the apparent breakout of homebuilding funds to the upside after pausing for nearly two years following 2012’s explosive growth is likely a response to the recent steep decline in lumber and copper prices, and perhaps partly in response to the Federal Reserve's promise to hold interest rates low for a while longer.
Yahoo Problem: Capital Gains and Dividends Not Adjusted
I occasionally receive emails asking why SectorSurfer reports higher returns for a mutual fund than may be reported by Yahoo Finance and other services. The Yahoo Finance chart (at right) plots the transportation funds XTN and FSRFX with the S&P500, and exemplifies the problem. On the 19th of December there is a down-glitch in the red FSRFX mutual fund, but not in the green XTN ETF. The reason is because Fidelity reported capital gains distribution on that day, and while our FastTrack data correctly and immediately back adjusted the price data just as one would do for a stock split, Yahoo Finance did not. Yahoo Finance is known to take well over 30 days to properly back adjust data for capital gains distributions, and apparently never back adjusts it for dividend distributions. We tested numerous data sources long ago, and chose FastTrack data for this very reason!

Don’t Fight the Fed
I’d like to call your attention to the two ETF Strategies (posted at right) because of their inherent design for handling market crash events. They are both members of the ETF - Low Drawdown Portfolio and both use the "Painted Path" feature to produce a multi-colored equity curve so one can easily identify which fund was held by the Strategy during each period of time.

Both Strategies also incorporate UST, a 2x leveraged 7-10 Year Treasury ETF. This class of fund is fairly anti-cyclical with the US equity market, but does not have the overall negative return bias of SH (the shorted S&P500) and is also far less volatile during market crash periods when we want them to have predictable behavior.

To employ this technique, you must first enable the Advanced Features of the Strategy, and then select the Disable option for StormGuard so that it does not interfere. Keep in mind that you'll find that a set of funds with higher volatility (such as sector, country or leveraged funds) will work better with a long-term treasury fund that is correspondingly more aggressive - meaning longer term and/or leveraged. A careful examination of the Safety category of the Strategy Hall of Fame page will reveal that a great number of these very safe Strategies employ long-term treasury funds and have disabled StormGuard.

Note: Since UST data only extends back through 2010, both Strategies use the extended data version, UST-, which additionally provides data from 2004 through 2010 (extracted from another source) so that complete backtesting of the Strategy through a market crash cycle can be achieved with UST. (Other extended data symbols not yet well documented on the site include: SH-, PSQ-, EAFE-, AGG-, QLD-, UVG-, UST-, UJB-, UBT-, TLT-, JNK-, ZIV-, VXZ-, VIXY-, SVXY-, XIV-, UVXY-, VXX-, VIXM-.)

Speaking Engagement Calendar
Please come and see one of these seminar presentations if you are in the neighborhood. Alternatively, ask your AAI Chapter or Investment Group leader to schedule a presentation. Webex presentations for smaller investment clubs and groups are also possible.

Seminar Title: True Sector Rotation: Breaking Through the Efficient Frontier.
This is a fast paced detailed seminar that will cover SectorSurfer basics, Forward Walk Progressive Tuning, Strategy-of-Strategies, and how to make Low Drawdown Portfolios.
• San Jose, CA: SectorSurfer User Group - Thursday, January 15, 6:00 PM Link (adv. forum)
• San Francisco, CA: AAII Chapter - Saturday, January 17, 9:00 AM Link
• Boston, MA: AAII Chapter - Monday, January 26, 7:00 PM
• Charlotte, NC: AAII Chapter - Sunday, March 14, 10:00 AM
• Myrtle Beach, SC: AAII Chapter - Tuesday, March 17, 5:00 PM
• Calabash, NC: AAII Chapter - Tuesday, March 17, 5:00 PM (w/Myrtle Beach)
• Los Angeles, CA: AAII Chapter - Saturday, March 21, 9:00 AM (beginner & advanced sessions)
• Orange County, CA: AAII Chapter - Saturday March 21, 9:00 AM (w/ L.A. Chapter)
• Dallas, TX: MTS Group - Saturday, April 11, 9:00 AM (advanced forum)
• Dallas, TX: AAII Chapter - Wednesday, April 15, 9:00 AM
• San Antonio, TX: AAII Chapter - Friday, April 17, 5:30 PM
• Austin, TX: AAII Chapter - Monday, April 20, 7:00 PM
• Pittsburg, PA: AAII Chapter - Tuesday, May 12, 7:00 PM
• Las Vegas, NV: AAII National Conference - Saturday Nov 7
• Houston, TX: AAII Chapter - Saturday, Nov 21, 9:00 AM
• Houston, TX: HIA Houston Investors Association - stay tuned...

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Scott Juds
President & Chief SectorSurfer
SumGrowth Strategies, LLC
www.SumGrowth.com

Additional Resources

SectorSurfer University
Learn to Change the Game

Investment professional Richard Erkes created SectorSurfer University to provide everyone the opportunity to learn how to use SectorSurfer to improve investment portfolio performance while simultaneously reducing investment costs. Click HERE

SectorSurfer Users Group
Join the Conversation

The SectorSurfer Users Group is an online Google Groups Forum created by Joe Gruender of San Jose, CA to provide a platform for exchanging strategies, ideas and learning from the experience of other SectorSurfers. Click HERE