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A Grain of Salt

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President

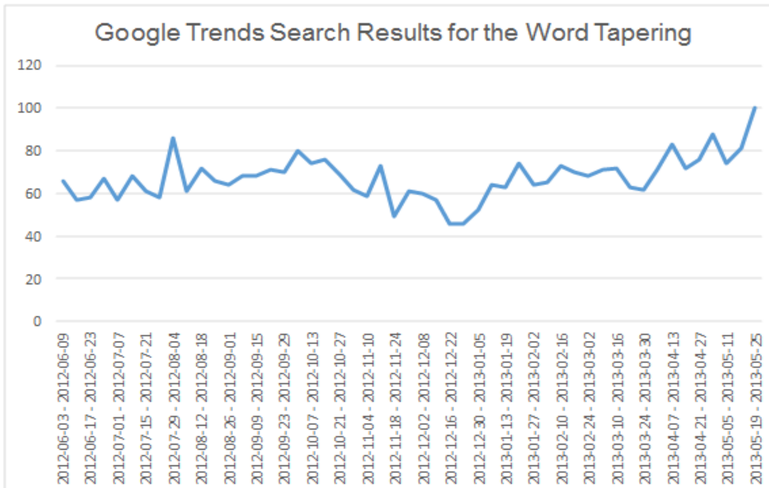
Last week only had four trading days because of Memorial day, but that does not mean that there was not a lot of price movement. The markets fell the most in quite some time, but the exact reason for the decline is complex and unclear. However, the word tapering has been coming up quite a bit in the financial news, with headlines like: *US dollar slides as soft data offsets Fed taper talk*, *Stocks Plummet on Fed Tapering Fears,* and *Turkey's Lira Latest Casualty of Fed Tapering Fears*. I underlined the word taper because it has risen in popularity as recently as you can see from the 'google trends' chart on the right (A score of 100 represents the highest number of Google searches and Headlines). Buzzwords are very common amongst traders and the financial media, and often oversimplify complex concepts into actionable 1-dimensional strategies. This week I will examine some popular investing phrases and buzzwords.

Weekly Changes

S&P 500 Index
-18.86 **-1.14%**

Dow Jones Industrial Average
-187.53 **-1.23%**

NASDAQ Composite
-3.23 **-0.09%**



What Tapering?

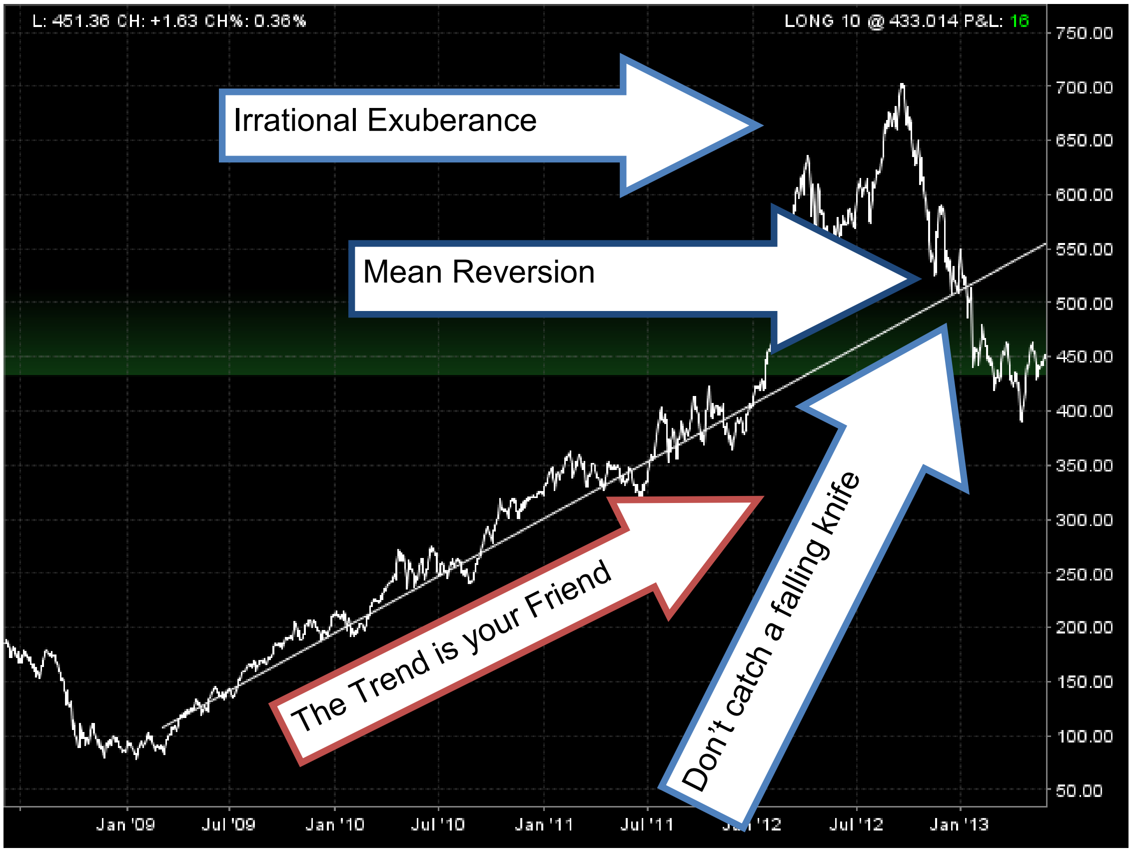
The word tapering refers to the possibility that the Federal Reserve may slow the rate of quantitative easing going forward. Although the word tapering never came up during Ben Bernanke's testimony the financial media read between the lines and began using the word taper to describe the possibility that the Fed may begin to slow quantitative easing. The financial media then began repeating the term in their own echo chamber, which can be quite misleading to the average investor. Here is the official statement: "With unemployment well above normal levels and inflation subdued, fostering our congressionally mandated objectives of maximum employment and price stability requires a highly accommodative monetary policy." Ben Bernanke has consistently stated that the Fed will keep rates low as long as unemployment is above 6.5% and inflation is below 2.5%. Since neither of these conditions have been met, the Fed has not deviated from its zero-interest rate policy. The market has reacted to this paradigm for the last several years and the investment strategy was summed up nicely by our next phrase.

Don't Fight the Fed

The phrase "don't fight the fed" is used to highlight the futility of taking positions that are contrary to the stated objectives of the Fed. The Fed has been taking measures to stimulate the economy and lower interest rates for years. You would have lost a lot of money if you bet that the fed would fail in it's objectives. While you may disagree with the long run efficacy of the policy, the real world implications of a multi-billion dollar policy to buy bonds will create a huge premium.

However, it is dangerous to blindly follow the fed or market trends in general even if the gains seem limitless.

Animal Spirits



Animal spirits was a term coined by the famed economist John Maynard Keynes to describe human emotions such as fear and greed. These spirits can keep investors from behaving rationally and will cause greedy investors overextend themselves when times are good and can also lead to panic selling when fear of loss takes over. Examples of this behavior can be seen clearly in hindsight by examining events like the dot com bubble and the housing bubble. Former Fed chairman Alan Greenspan used the term “irrational exuberance” to refer to these types of asset bubbles. There is a saying in trading culture that can help protect you against animal spirits if you are willing to heed it’s advice, “Bulls make money, bears make money, pigs get slaughtered.”

Contradictions

There are many classic stock market phrases that can seem contradictory such as “the trend is your friend” and “mean reversion”. “The trend is your friend” means that if a particular stock has been going up it is likely to keep going up, while mean reversion means that if it has greatly overshot its long term moving average price it will eventually come back down to that average. However, in the process of reverting to it’s mean a stock will often overcorrect to the downside, which leads to another popular phrase, “don’t try to catch a falling knife”. Many of these phrases are somewhat graphic which is likely a byproduct of the machismo wall street culture that has existed for many years.

Conclusion

Stock market phrases can be useful tools to help traders keep a cool head, or to simplify complex concepts, but it is important to remember that they are imperfect and subject to manipulation. That is why the best phrase one can use when relying on stock market phrases for investment decisions is...“take them with a grain of salt”.

Strategic Allocation

Conserva- Aggressive

RISK SCORE	1	2	3	4	5	6	7	8	9	10
Debt	66	54	48	40	33	27	19	15	8	8
Short Term	28	21	19	16	14	10	7	5	3	3
intermediate term	20	21	20	15	13	11	7	5	3	3
long term	9	7	7	7	4	4	4	4	2	2
floating	9	5	2	2	2	2	1	1	0	0
Equities	18	27	33	41	47	51	59	64	71	71
small cap	3	4	8	8	13	14	17	21	27	32
mid cap	3	5	9	14	14	17	23	24	26	28
large cap	12	18	16	19	20	20	19	19	18	11
Other	16	19	19	19	20	22	22	21	21	21
Reits	8	10	10	10	10	11	11	10	9	8
Commodities	5	6	6	6	7	8	8	8	9	10
currency	3	3	3	3	3	3	3	3	3	3
total	100	100	100	100	100	100	100	100	100	100

The Strategic allocation represents what should be the long term average of a portfolio. That is, the average allocation of the portfolio should adhere to these risk allocations. Different asset classes will outperform during different market conditions. This allocation will change slowly as new information comes to light that will affect the long term performance of certain asset classes. We expect that portfolios that are more aggressive will outperform conservative portfolios over a longer period of time, but will experience a greater amount of volatility.

Overweight short term debt, particularly for more conservative clients. This sector should reduce interest rate risk as well as market risk in the portfolio.

Neutral intermediate term debt, we prefer higher quality corporate bonds to replace treasury exposure.

Neutral Long Term Debt, Long term debt has substantial risk if interest rates rise, but can still help alleviate losses in the event of a rapid stock market selloff.

Overweight on floating rate debt, we are expecting slow and steady appreciation on floating rate notes.

Neutral Small Capitalization Stocks, we are recommending a neutral holding of smaller companies with strong balance sheets and little need for short term debt financing.

Neutral Mid-Cap Stocks, we apply the same logic to this asset class as to small cap stocks.

Underweight Large Cap Stocks, We are more selective with large cap stocks, and will try to avoid those companies with a larger exposure to the Chinese economy.

Neutral REITs, we will look to add to our position in REITs during periods of deflation, we are now underweight leveraged mortgage REIT's as interest rate risk is substantial in these products.

Neutral Commodities, we believe that much of the correction has already occurred in commodities and while they may remain low for quite some time, they should slowly recover once inflation begins to return.

Currency - We are underweight the Euro. We continue to recommend protecting any exposure to the yen. We are currently holding higher levels of cash generally.