Tactical Update

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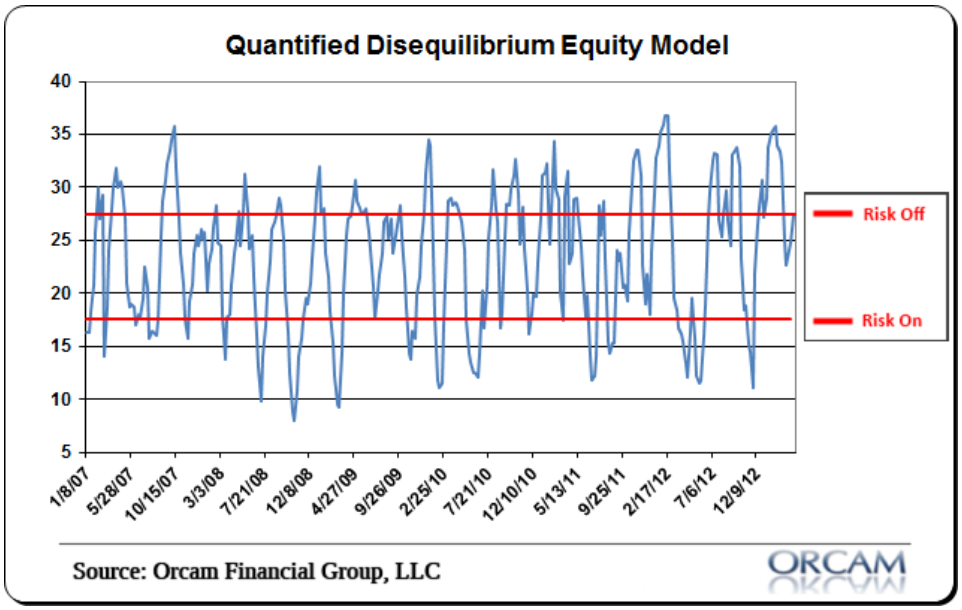
What to do, what to do?

It feels like forever ago that I was discussing how to respond to a market that just won't go down. Actually, it was only about a month ago, but this mini bull run is one of the longest in history. In fact, at 80 sessions long, the current rally without a –5% correction puts it at the second longest streak during the 2009-2013 bull market.

> **"Risk is not knowing what you're doing."**
>
> **Warren Buffett**

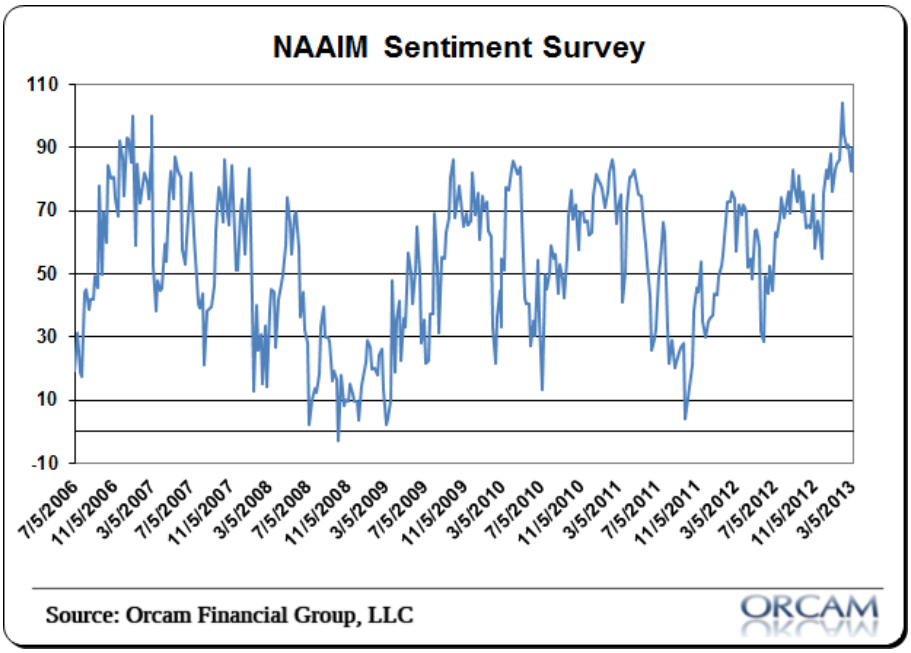
The market has a very bubbly sort of feel to it here, but the market can certainly remain irrational longer than we can remain solvent. So we must be careful with how we approach the tactical piece of the portfolio. Obviously, after a nice streak of good tactical buy/sell moves last year and into the beginning of this year, our tactical model has fallen out of bed while the strategic model has remained correct. Obviously, I need a new crystal ball so if you have a spare one I'd appreciate you sending it my way.



Obviously, being wrong is not unexpected at times, but it doesn't make it any easier to swallow not being 100% right. Then again, the point of running the tactical/strategic approach is to hedge against the reality that we won't ALWAYS be right. Still, I owe you a mea culpa for the recent tactical positioning.

Interestingly, as you can see on the previous page, my equity model is right back into the risk off mode after having never given a buy signal. That's a highly unusual occurrence, but not surprising given the fact that the S&P 500 has rallied 15% in a straight line off the November lows and is already up 9% in the first 2.5 months of the year. That 43% annualized return trajectory is the sort of return that my approach will NEVER outperform and is not designed to outperform. When the market soars 10% we should hope to capture 5-7% of it through the combination of the tactical/strategic approach and when the market crumbles 10% we should hope to only be involved in 5-7% of the downside. We aren't in the "beat the market" game. We are in the "maintain purchasing power, avoid permanent loss and beat the market on a risk adjusted return basis" game. That said, I remain cautious from the tactical position and still favor selling equity positions into market strength. I won't make excuses about how that tactical positioning has clearly been wrong, but I do not think it has been imprudent by any means when considered as a whole with the strategic approach.

The euphoria of the market appears almost unbreakable at this point and "new record highs" seem inevitable on a daily basis, but that is precisely the type of noise we should be hedging against. We can't be sucked into the euphoria of a market rise and feel like we are losing just because we are not fully invested in the market's every twist and turn.



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Speaking of euphoria, it's interesting to note that the market is showing severe signs of complacency from the perspective of money managers. Money mangers dominate the movements of the markets due to such vast asset control and they're currently just slightly less bullish than the record high set earlier in the year. In fact, the current reading (see the chart on page 2) is higher than any point in the last 5 years if we exclude the recent data. When sentiment and my algorithmic tactical model align it usually means something very unusual is occurring in the markets. I can't be certain that Fed optimism is purely driving equities or what, but it certainly appears to be a heavy dose of optimism. And while Mr. Market may appear optimistic today he can turn on a dime. The tactical approach, though obviously wrong at times, is designed to hedge against the risk of just that sort of occurrence.

I'll keep you updated just in case the market ever decides that it might fall again. Until then, stay bullish on a cyclical basis, risk off on a tactical basis and be careful putting all your eggs in one basket in this type of environment. There's an eerie almost disconcerting confidence in the market right now….

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