

Sir John Templeton – 1985, Union League, Philadelphia, PA

“Buy when everyone one else is selling and sell when everyone else is buying. It is the single most important piece of advice I can give you yet it will be the most difficult thing for you to do.”

I was a young Merrill Lynch broker in 1985, cramped in a small cubicle, loaded with some leads, a phone, and quotron machine. One morning, my manager walked around the office to gather as many of the 40+ brokers he could to listen to Sir John Templeton. I had no idea who this man was, but along with four other young rookies I jumped at the opportunity for a free lunch (the older established brokers had little time for the distraction).

In a packed room with nearly 200 people, I listened disinterested as Sir John began to speak. He began his presentation and offered that he would share with us the single most important piece of advice - the reason for his great success over many years. He said that most people will never be able to do it yet if you could you will be amongst the elite brokers in the business. As silverware clattered in the room, I stood straight up in my seat and zeroed in on what this man was saying. Of course, I wanted to be the best.

How easy I thought – “buy when everyone is selling and sell when everyone is buying”. I can do this, I said to myself, I can do this.

I look back today, wiser, more balanced, and certainly humbled as I have been nicked along the way. I reflect on what Sir John shared with us in that room and often smile at the simplicity of his advice and also how difficult it is to do in real life.

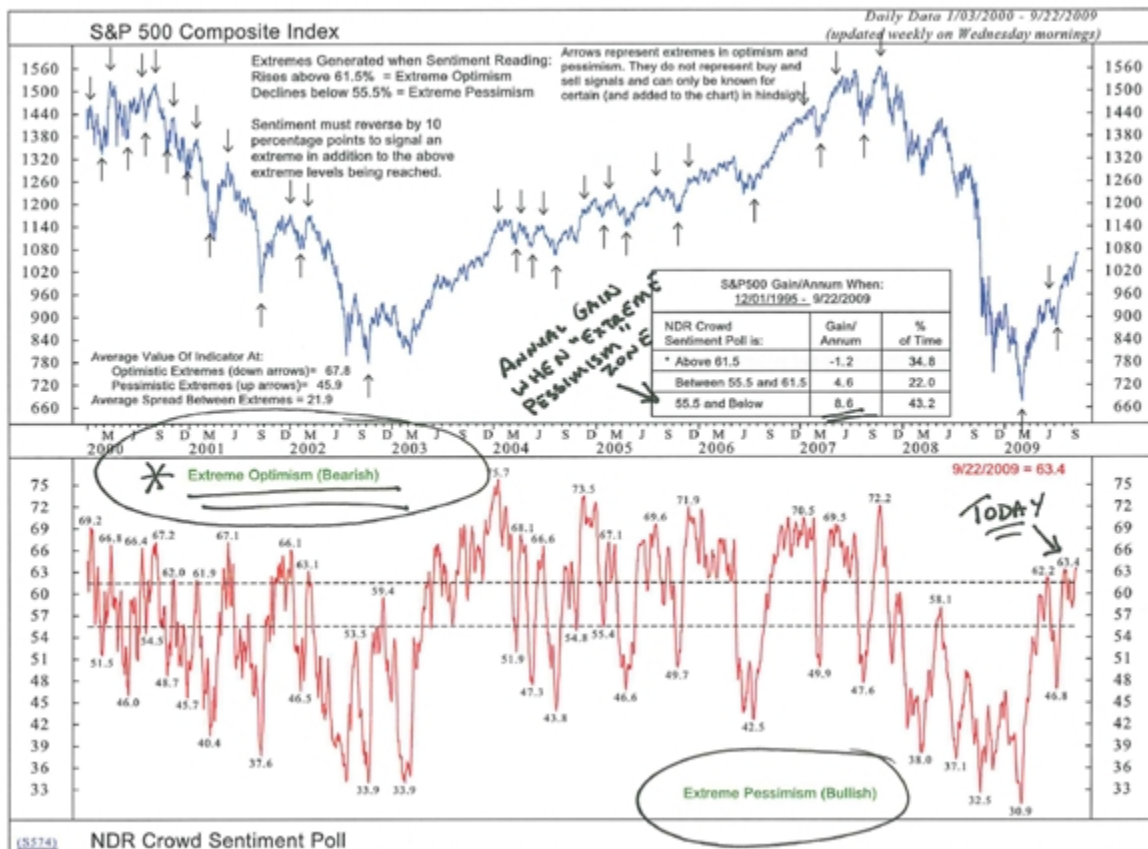
As I look at the market today, I thought I'd share with you what I'm seeing, how investors are behaving, and why it is so difficult to apply Sir John's simple advice. In December 2008, I put out a piece saying “Be Patient, You'll Get That Chance”. It was a 'don't panic in the midst of the storm' email (buy when everyone else is selling or at the very least don't panic-sell now). I believed we would see a very strong recovery bounce (similar to other post crash periods). I suggested investors set a plan in place to exit on the recovery move (target S&P 500 Index between 1000-1200 depending on needs, risks, goals, etc.) and, importantly, to be prepared to execute on that plan as bigger problems remain in the system.

In June 2009, with the S&P just above 900, I sent out an updated piece entitled “Watch out for the Left Hook”. It was an update on the recovery and it expressed my view that we'd see the first recovery target of 1000 in the S&P 500 Index in very short order. We have hit that target. So here we are today at 1070. Just a few good up days away from my personal 1122 trading target. For me, I just don't think the potential of gaining

another 10% above 1122 is worth the 30% downside risk I see ahead. And of course, there is no guarantee we hit my target.

Sir John would advise to “sell when everyone else is buying”. Today there are a number of ways to measure this – we call it Investor Sentiment (various charts/services measure the number of bulls vs. number of bears). The following chart from NDR is one of my favorites. It reflects that professional investor sentiment is in the Extreme Optimism zone which gives me great caution today. Individual investors are not yet as bullish - I’m watching closely.

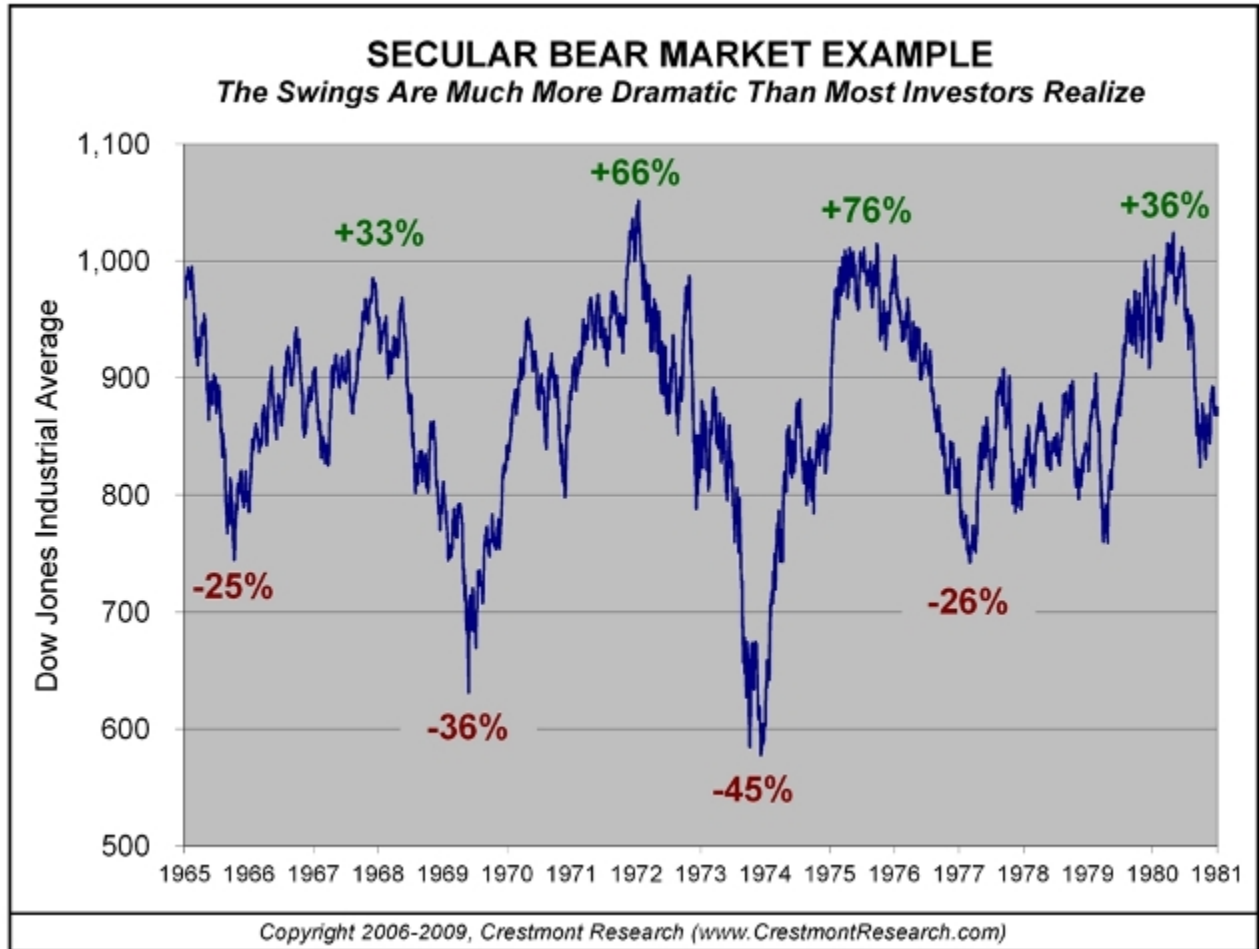
NDR CROWD SENTIMENT POLL



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Sell when everyone else is buying. It sounds so easy. Psychologically, it is a process of managing our fear and greed. We know from many industry studies that investors in large buy at the top and sell at the bottom. If they could only train themselves to buy when they are in a place of most internal fear and sell when everything feels so good, I believe they would find much greater long-term investment success. So that’s Sir John’s point; in real life executing his simple plan is not so easy to do. Today, we are again seeing investors lose discipline, fail to have a plan, and feel the confidence to jump back into the market – they are buying when everyone else is buying.

Following is a chart of the 1966-1981 secular bear market. Note the sharp rallies and the sharp declines that made for a very challenging buy-and-hold investment environment. One needed to trade the market to survive.



If we are in a similar long-term bear market, I think it makes sense to adhere to Sir John Templeton's advice and look to "sell when everyone else is buying and buy when everyone else is selling". Be careful today – this is the single greatest move since 1930.

What are investors to do? Here is my advice:

Take a step back from all of the day-to-day market noise and ask yourself the following questions:

What is my one year, three year, and five year investment plan? Where do I think the market is going? What are my investment goals and income needs? What level of portfolio risk am I prepared to take on? How is my portfolio currently allocated?

If we are in a long-term secular bear (similar to the '66-'81 cycle) and the short-term bull move is nearing completion, then I'd look to continue to trade my long equity allocations

tactically, look at some attractive tax-frees for the fixed income element of my portfolio (shorter term maturity focus), and have a significant allocation to absolute return trading strategies.

I believe our strategies are appropriate for a piece of an investors' overall portfolio. We are part of a broader portfolio plan and I feel we should be a piece of your absolute return portfolio allocation. Instead of the old way of thinking (60% stocks and 40% bonds - that mix won't work in a long-term secular bear market with high valuations, structural deleveraging and a maxed-out consumer), consider perhaps 30+% to the absolute return investment category and a smaller allocation to stocks and bonds. A more balanced portfolio in this environment might be 33% absolute return strategies, 33% stocks (but traded more tactically with Sir John's advice) and 33% bonds (with a shorter term fixed income portfolio as the risk of higher rates over the next five years is significant). Of course, this is in no way a specific recommendation for you as your needs and investment goals may differ.

While our average blend is up 9 to 10% net of fees through the end of August, we are flat to down over the last few months and we are beginning to see a small number of clients pull out and transfer their money right back into the stock market. Many of those accounts have been with us less than ninety days.

Investing is about discipline. It takes discipline to have a plan and discipline to execute that plan. Be balanced. Sometimes you'll be so smart with your decisions and you might feel all too empowered (don't get too crazy about yourself) and sometimes you'll regret a decision and think that your approach is broken (don't get too down on yourself). Investing is about probabilities. The idea is to have more winning trades than losing trades, keep balanced in your approach and stick with your plan over a one year, three year and five year basis.

Our strategies are absolute return focused trading strategies. Many have a long-term win rate of 7 out of 10 trades. Sometimes those strategies win 9 out of the last 10 trades and sometimes they win 4 out of the last 10 trades. If the process is sound, the strategy is no better at a 90% short-term win rate vs. a 40% win rate. Much like Sir John's advice, I believe the smartest investors are able to add when a strategy is out of favor and rebalance with other strategies when the win rate is above the norm. This approach has served me well over many years. Not perfect but a good disciplined approach. I'm not thrilled when Scotia, or any other strategy, is in a drawdown, but there is not one trading approach that is designed to win in all periods. There is no perfect investment strategy – there is no holy grail. My personal investment portfolio is 100% focused on absolute return trading strategies and I'm tactically trading my 401k (as there are limits to what funds are available to me). I like to add to a proven strategy especially when it is in a drawdown and, most importantly, I focus on correlation diversification between multiple strategies.

With nearly 2000 individual client relationships, I hear from a number of clients from time to time. Sometimes the emails express that we are the greatest and sometimes they

express how bad we are and sometimes I get both opinions on the same day. After 25+ years in this business, I have learned to stay balanced and stay neutral. If we are doing our job well, hopefully we are encouraging you to have a plan in place, to follow that plan, and to invest with discipline. Our strategies are a piece of your investment portfolio. They should be used in conjunction with your other fixed income and equity allocations.

These are difficult times to say the least. Investing is confusing to so many. You may feel that as soon as you invest in something it goes down. It is a common sentiment and leaves investors frustrated. Consider Sir John's advice, "buy when everyone else is selling and sell when everyone else is buying".

As always, please feel free to call us if you have any questions.

With kind regards,
Steve

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