

## Client Forum—Answers to Your Questions

It was a quite volatile and vicious three months for stock markets around the globe. Unlike the spring/summer 2010 correction where we successfully sidestepped much of the volatility, we did not foresee this year's severe market decline coming. The summer rally we expected in June lasted only six weeks before abruptly ending in early August. Financial markets were roiled by political bickering around the debt ceiling faceoff and further by the Eurozone politicians wrangling over solutions to their sovereign debt crisis. In any case, there is no sugar coating it, performance this past quarter was bad. Since then and through the October 19<sup>th</sup> publish date for this letter a substantial rally has recouped much of the decline. As we point out below, any signs of progress toward addressing world debt problems would help relieve investor anxiety and, as we expect, sustain a strong rally.

In discussions with a number of clients, several common questions and concerns have come up. We take this opportunity to use a question and answer format to address your foremost concerns.

**Q: In the past you have anticipated and sidestepped significant market declines quite well. How did you miss this one?**

**A:** Simply put, we were caught off guard at this particular turning point and leaning in the wrong direction. Much of our disciplined decision-making process is based upon 150 years of historical and sequential financial market relationships directly related to the business cycle. The vast majority of the time the sequence works smoothly and we effectively anticipate important turning points. This particular time the sequence shifted out of order and early warnings did not register. For instance, even today the nation's Leading Economic Indicators (LEIs) are still achieving new recovery highs. In every instance since the development of the LEI's in the 1950's, the leading indicators declined for a minimum of 5 to 7 months *ahead* of a recession—so this reliable advance warning still has not flashed an economic red light. Even more unusual is to have commodity prices, such as oil, copper, and other basic materials turn down *ahead* of an economic slowdown or stock market decline. Historically, commodities lag and turn down *after* the economy does. We positioned portfolios for a continuation of economic expansion because evidence did not point to the cycle ending. However, recent data is softening and portfolio adjustments are forthcoming.

**Q: After the rough quarter, what is the outlook for the near future?**

**A:** The vicious two month market decline has left the market in a position where the psychology of most individual investors and even professionals is extremely pessimistic and fearful. From a contrary viewpoint this is a good sign as excessive pessimism is always found near important low points. Many of our psychological or sentiment indicators that measure "fear or greed" are at elevated fear levels that typically trigger a dynamic multi-week/month rally. The last two week's strong rally has kicked off in earnest and shows promise of further follow-through. As we have witnessed many times before, investor psychology can change on a dime. Any positive news can quickly move investors away from their worst fears toward a little more optimism and carry the rally further.

**Q: What are your portfolio tactics moving forward?**

**A:** As we point out with the previous answer, the likely scenario is a strong rally that pushes the stock market up for the next few weeks/months. A substantial rally will be a breath of fresh air. We will use the opportunity to partially reposition away from cyclically sensitive areas to essential consumer staple sectors. Longer-term, the cyclical financial landscape is shifting and our tactics call to use market strength to become overall more defensive. Bottom line, we *expect* a continued upswing, but are *prepared* to take more defensive steps if the rally fails to sustain upside momentum.

**Q: All of this stock market volatility makes me very nervous, why is this happening?**

**A:** It is not your imagination. The stock market had 9 swings averaging 7 ½% *up and down* in just the past 30 trading days. If you feel a sense of stock market whiplash, it is justified. Several structural changes in the way trades are executed on the exchanges have moved markets toward this more volatile state. Most significantly, the advent of computerized or *high frequency trading* explains much of the exaggerated price swings *both up and down*. It is little wonder investors are feeling the whiplash effect of volatile market gyrations these days. Regulators are investigating this questionable activity and are beginning to understand that containing *high frequency trading* (HFT) would be a giant step toward restoring investors' confidence in Wall Street. In the meantime, the situation is what it is and as your investment advisor we have to adjust portfolio tactics to manage around this increased market volatility.

**Q: Are we back in a recession?**

**A:** As far as the economy is concerned, it is slowing down but we maintain the economy is not *yet* in a recession. However, Euro-zone debt problems among many other potential problems have led to falling consumer confidence and could easily drag the U.S. economy into recession. The important observation is the recent stock market decline has already discounted another serious recession. If one does not materialize soon the market has room to rally even higher. We will evaluate the evidence one day at a time.

**Q: I'm concerned the next recession will be a repeat or worse than the 2008-2009 Great Recession. What is your opinion?**

**A:** The so-called "Great Recession" was triggered by the enormous once in a generation excess in real estate speculation. The bigger the party, the bigger the hangover. Since the financial meltdown in 2007-09, there has been significant improvement in the nation's financial health. First, overall the banking system today is in much better shape than going into the last slowdown. Second, corporations from a balance sheet perspective have never been stronger or better prepared for a recession. Third, households have been retrenching for 3-4 years and are also in better financial position for a slowdown. Finally, housing the poster child for causing and exacerbating the last recession has been in repair mode for four years now. Much of the prior economic excesses have been purged with corporations and the housing industry running lean and mean. While unemployment will rise in the next recession additional massive layoffs will not be a factor. For these and other reasons, we expect the next recession will be much less severe and shorter than the last "Great Recession".

**Conclusion**

Amazingly, the quarter finished with major market indexes ending at levels first crossed in 1998—in other words the stock market has made virtually no net progress in thirteen years! In comparison, long-term Pring Turner clients can say they reached new high levels of wealth in 11 of those 13 years including earlier this year. Pring Turner looks forward to the challenge of doing even better in the next 13 years. However, today's focus is on the task at hand—diligently seeking fresh opportunities for tomorrow's profits. Fully acknowledging being caught off guard recently, we are working long hours to improve and adapt to the changing investment climate. We are confident having the right tools, experience and decision-making process will enable us to achieve new high levels in your wealth. As usual, please feel free to contact us with any questions regarding your portfolio.

## Activity Update

*The next few months are shaping up to be another busy time period for Pring Turner.*

*Tom has once again been invited to present Pring Turner's market outlook to the [San Francisco Chapter of the American Association of Individual Investors](#) on Saturday November 19<sup>th</sup> at His Lordships restaurant on the Berkeley Marina. The AAI is a leading non-profit organization dedicated to investment education for more than 150,000 members nationwide.*

*In October, Martin traveled to Las Vegas to present at a training conference for users of MetaStock, a prominent provider of investment software. Next week he travels overseas to present Pring Turner research to investors at one of Indonesia's leading financial services firms.*

*The Pring Turner team is co-authoring a new book to be published by McGraw Hill in 2012 entitled, "How to Survive and Prosper in the Second Lost Decade." This practical guide for all investors will explain our outlook for the secular investment environment and the risk management tools Pring Turner utilizes to manage conservative portfolios.*

*We are pleased and proud to report that Jim (Tom's son) successfully completed Level 2 of the Chartered Financial Analyst (CFA) coursework and exam. This prestigious designation is earned by passing three rigorous levels of study. Jim plans on completing the third and final level next year. In addition to being deeply involved with our research and back office operations, Jim brings a high level of enthusiasm and technology skill to the firm.*

*In September after extensive testing, Dow Jones Indexes, a leading global index provider, and Pring Research [announced](#) they are teaming up to develop a business cycle index that follows the Pring Turner "Six-Stage" business cycle investment strategy. The planned index will be a dynamic rules-based tool designed to determine the asset allocation classes and sectors that perform well in the various business cycle stages. The new index is designed to help investors successfully navigate through the inevitable boom and bust periods that lie ahead. We look forward to future announcements regarding this relationship with Dow Jones Indexes.*

Stay up to date with our latest observations at [www.pringturner.com/blog](http://www.pringturner.com/blog)

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