

Q: What's Your Strategy For The Market Pullback?

Infrequently Asked Questions

"More than any other time in history, mankind faces a crossroads: One path leads to despair and hopelessness, and the other to total extinction. Let us pray we have the wisdom to choose correctly."

Woody Allen

I won't single anyone out, but one of you summed it up well in an email to me on Thursday afternoon. It simply read, "Don't take vacation ever again." I had hoped for a quiet week in the markets during my vacation but instead ended up with one of the most volatile weeks in the last couple of years. I am almost 100% certain that the market decline and my decision to finally take a vacation were completely unconnected. I am back in town now, so if we experience a strong rally (anything is possible) this upcoming week, I may have to reevaluate future vacation plans or at least massively short the market before I next vacation. In the meantime, please keep your thoughts of shackling me to my desk to yourself.

As I'm sure you all are aware, volatility is at long last picking up once again in the financial markets. You've all been conditioned by me not to panic when the markets get dicey or to become exuberant when big rallies occur, so I'm sure you don't need me to rock you gently and reassure you that everything is going to be ok. Don't get me wrong. I'm willing to do it, but my fee will double.

Nevertheless, I thought I'd send a quick note out discussing how our portfolios are doing during this turmoil and what to expect going forward. Consider this a general outline of my plan of attack in the days and weeks ahead. None of what follows should be terribly surprising. Many of the events that are now spooking the markets are issues we've been discussing for months and years. In addition, you should find the following very consistent with my investment philosophy and discipline. Still, this seems like a good time to beat it into you one more time.

Aspera Performance

The U.S. stock market has fallen 10% this quarter, much of it in just the past week. Our portfolios are fairly flat over this period. It was precisely in anticipation of recent events (U.S. debt/deficit issue, European debt and bailout failure, competitive currency devaluation, weak developed-world economies, Chinese and Australian real estate bubbles, etc.) and our view that many financial markets were not attractively valued that we've had a conservative bias to all of our portfolios for some time. There is nothing that is occurring right now that we haven't discussed over the past few years, so we're hardly being caught flat-footed.

We've weathered the storm well so far, but that doesn't mean we won't incur some decent losses moving forward. If we see a true panic and investors start dumping everything, our precious metals names will not be spared. We saw this last Thursday. Our portfolios performed well through Wednesday, but on Thursday it was risk-off across the board, and even gold was jettisoned. If irrationality and panic occur, we will most likely suffer to some degree. I'm not predicting this, but it's certainly possible. You've been warned. More broadly, I've stressed repeatedly that our current conservative bias will lead to us underperform the market somewhat during strong rallies but decline less during significant market drops. I would still expect that to hold true moving forward until we shift from wealth preservation mode to a growth focus.

Strategy Should a Serious Decline Occur

Importantly, we have plenty of dry powder in the form of cash, bonds, and other stable investments that can be put to work in the event of a severe market drop. As I said in the July 30th piece, "We should all be rooting for a big sell-off." Any near-term losses in our portfolios will be well worth it if we're able to add securities to our portfolios that have attractive future expected returns. For what it's worth, I am beginning to find more names (and not just precious metals names) that are at attractive levels. How much more attractive they get is an open question.

Let me be clear. I don't know where the market will bottom near-term or ultimately. Frankly, I don't worry about that. I'm looking for attractive securities, sectors, countries, and asset classes. I'm not trying to time the market. We will likely be putting some toes in the water if the sell-off continues. Any purchases we make are very likely to be a bit early. We will continue to add risk exposure, and we will add it more aggressively, the further the market falls. These purchases will likely hurt our performance in the short-term, but they will sow the seeds of solid future returns.

You know the drill by now. We buy low and sell high. We don't panic. You pay me to take the emotion out of this and make prudent long-term decisions with our money. For what it's worth, I'm not worried about what's transpiring. Actually, I'm excited about it. I've been patiently waiting for a good opportunity to add more diversified risk, and we MAY get that chance.

So, if we do see a serious sell-off in the days and weeks ahead, you should expect to see us gradually reducing our conservative positions and gradually putting that money to work. We reduced our TIPs (Treasury Inflation-Protected securities) position last week in a number of overweight accounts, and we've sold out of many of our money market mutual funds, so the process has begun. Next, you'll likely see me adding to names we already own that have fallen as well as adding some new securities, most likely U.S. and foreign equities as well as commodities.

Current Portfolio Expectations

Let's turn our attention to our current holdings. We have a few key components to our portfolios currently. The following looks at each of these and provides some thoughts as to what you should expect.

- Gold looks very good still. Everything that is happening is bullish for the metal. Still, there will be pullbacks from time to time, particularly during panics.
- Silver looks good too, but it does have industrial applications and is more subject to manipulation. It will be very volatile, but the ultimate outlook for silver is even brighter than gold.
- The miners will be even more volatile. Unfortunately, for the time being, they're more likely to track the stock market than the price of gold and silver. This could hurt us near-term, but I expect us to look back a few years out and find our biggest winners in this group.
- Our cash, bonds, and other conservative positions will be just fine. These serve as a source of funds to rotate into attractive risky positions if global markets keeps falling.
- We have a number of non-fixed income securities that provide a healthy yield. These are our limited partnership positions and a number of our dividend-yielding equities. These names include AMJ, EPD, RDSA, BP, DO, MSFT, NLY, NAT, and SLE. These names will largely trade with the equity market, but I view these more as inflation-protected bond positions. We own them primarily for the yield. As I've warned in the past, do not get overly excited when they appreciate, and do not get overly concerned when they fall in price. My concern with these names is that they will be able to generate the necessary cash from operations to fund their dividends/distributions. Do not obsess about the price fluctuation of these securities.

Hopefully this has given you some sense as to how we've been doing and what to expect going forward. While many investors are worried and panicking over recent developments, I'm excited by the opportunities that may be created. Volatility is a friend to us but not to those who use leverage or target short-term performance. Rest assured that I'm on top of developments and actively looking to exploit any long-term and tactical opportunities that this volatile period offers.

As always, feel free to contact me with questions. Given current developments, you probably won't hear back from me until after the market closes, but I'll return calls and emails as soon as possible.

Best,

Ken Bell, CFA, CFP
President
Aspera Financial, LLC

08/06/11

This article reflects the views of the author as of the date or dates cited and may change at any time. The information should not be construed as investment advice. No representation is made concerning the accuracy of cited data, nor is there any guarantee that any projection, forecast, or opinion will be realized.

References to stocks, securities, or investments should not be considered recommendations to buy or sell. Past performance is not a guide to future performance. Securities that are referenced may be held in portfolios managed by Aspera Financial, LLC or by its principal, and such references should not be deemed as an understanding of any future position, buying or selling, that may be taken by Aspera. We will periodically reprint charts or quotes from articles published by other sources. When we do, we will provide appropriate source information. Their reproduction in no way implies that we endorse any part of the material or investment recommendations published on those sites.