ASPERA BULLETIN

Intelligent, Independent Investment Management

Long-Term vs. Short-Term Holdings

Yet another quiet week in the markets. Granted, these days I consider any week to be fairly quiet if the market doesn't fall more than 10%, California doesn't slip into the sea, Warren Buffett isn't arrested on fraud charges, and Luxembourg doesn't invade one of its neighbors. Although "quiet," the week provided plenty of volatility, and we took advantage of it.

Reviewing the trading activity of this past week provides the opportunity to revisit the difference between long-term core holdings and short-term trading/opportuinistic holdings. As I regularly stress, the majority of every portfolio is focused on attractive longer-term opportunities, those I initially expect to hold for at least two years. The goal here is to buy right and be patient while monitoring developments to make sure that the initial thesis for purchasing the security hasn't changed for the worse. At the same time, these securities will be sold before anticipated if my price objective is met or if a better use of the funds surfaces.

A smaller part of the portfolio (including cash) is periodically employed to exploit shorter-term opportunities. These are investments that I expect to hold for less than one year, although most of these positions are exited much sooner than that. There is no specific portion of the portfolio that is dedicated to this purpose. Cash on hand, opportunities in the market, and investment policy constraints are the limiting factors. Still, even for my more aggressive clients, I'm unlikely to invest more than 2% of a portfolio in any one short-term idea, thereby limiting any damage if I'm wrong.

First Solar (FSLR)

With that as background, let's take a look at some trading activity this past week. On the short-term trading side, we covered our short in First Solar (FSLR). Recall, a short is a bet that a security will fall in price. We've shorted FSLR a couple of times now. The first was in October of 2008 when the stock was in the mid-$130s. We covered that position a couple of weeks later near $112 for a nice mid-teen gain in just two weeks. More recently, we shorted the stock again in mid-December near $142. This is the position we just covered at $117 this past week, generating another mid-teen gain.

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The catalyst for the recent price decline was the company's recent earnings conference call in which they lowered expectations for this year. I was expecting this given the decline in carbon-based fuel prices (the competition), the continued ramp up in solar supply, the impact of the global recession on demand and credit availability, the company's still expensive valuation, and the headwind of declining future revenue growth.

The stock fell further after we exited our position, but the goal with these short-term trades (as with the long-term investments) is not to try and time the top or bottom. In this environment, I'm more than happy to get a fairly quick 10-20% gain and book it in positions that I have no intention of holding long-term. It's best to leave a little on the table for the next guy and not get greedy.

ProShares UltraShort Real Estate (SRS)
The next short-term trade that I'd like to highlight is our sale of SRS. This is an ultrashort real estate exchange-traded fund (ETF). Let's see if I can make some sense of that. This ETF (think lower-cost mutual fund that trades like a stock) tracks 200% of the inverse performance of the Dow Jones U.S. Real Estate Index. Let's try that again. This security (that we buy) will go up by twice the amount that the Dow Jones U.S. Real Estate Index falls on any given day and vice versa. Go ahead and read that a few times.

We've been in and out of this name a couple of times. We made some money the first time last fall. This more recent time, we began buying the ETF in December and averaged in over the next few weeks following a strong rally in financial and real estate shares off of their mid-November lows. I decided to sell the position this past week following a strong 45% climb in the shares. In addition, the risk/reward trade-off on short positions is far less compelling following this recent decline in the market. Currently, we only have one outstanding short position (APOL), but I would expect to see additional shorts added when we finally do get a strong market rally.

Account performance on this SRS trade varied due to the differences in account objectives and constraints. Some accounts registered nice gains while others were closer to break-even. Although the ETF had fallen 60% when I first started nibbling, all accounts would have posted a nice gain on this trade had I only waited a couple of more weeks to pull the trigger. There's a very good chance that we'll own this position again.

ProShares Ultra Financials (UYG)
The final short-term trade that I'd like to review is UYG. This is an ultralong financial ETF. This ETF tracks twice the daily move of the Dow Jones U.S. Financial Index. As you all know, I've been no fan of the financials for many years, and avoiding them hasn't hurt performance. This recent foray into the financials was certainly not intended to be long-lived, and it wasn't.

We bought UYG on February 20th, a day marked by massive intraday declines of 20-35% for the largest banking companies. This was on top of an already horrendous performance so far this year. The substantial decline on the 20th had the feel of a panicked stampede out of financials as fears of nationalization gripped the investment community. Although I believe that nationalization (or effective nationalization) is a very likely ultimate outcome, I didn't expect an imminent announcement given the recent vague rescue plan outlined by Treasury Secretary Geithner.

This blowoff on the 20th offered an intriguing opportunity to take advantage of the panic. Rather than pick one particular company and subject us to any company-specific risk, I bought UYG (which invests in all of the large financial institutions) at an average price of $2.00 per share. We were fortunate to buy near the lows of the day and finish the day with a 10% gain as investors began taking advantage of the oversold situation. Comments from Obama the following week minimizing the chances of nationalization further buoyed the financials in the ensuing days. 6 days after buying the position, we were in "gift horse" territory and exited UYG for a gain of just over 30%. If only they all worked out this way.

Gold/Silver

On the long-term side, we recently reduced our precious metal position in a number of accounts. This is by no means an indication that my long-term bullish view on precious metals and gold mining stocks has changed. In a number of accounts, we experienced the high-class problem of having our precious metal position grow a little too big due to the recent strong performance of gold and silver prices and the continued decline in the equity markets. This was simply a rebalancing move which was expedited by the failure of gold to decisively break through the $1000/oz level. The securities we sold (SLV and DGP) subsequently fell about 10% over the next few days, so we were fortunate in our timing.

I fully anticipate rebuilding our metals position at more attractive levels. At current levels, gold mining shares are more attractive than the metal itself, so look for us to start adding soon to mining shares. These are extraordinarily volatile, but if my thesis is correct they offer tremendous upside.

Wrap Up

I don't plan to discuss every trade in the future, but I do intend to discuss some losing investments as well as some winners. If we're right more often than not and we get the really important calls correct, we're going to do well over time. That still means that we'll be wrong quite a bit, too. Examining the investments that don't work out and learning from them has always been one of the most critical components of my investment process.

Here's hoping for another "quiet" week in the markets.

Best,

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