06/30/2008 Quarterly Newsletter

Discipline is the key to success

With every approach to the stock market, bear in mind that there will always be periods of over-performance and periods of under-performance. Here at Disciplined Wealth Management (DWM), our goal is to concentrate your portfolio in the leading asset classes while avoiding the performance-sapping lagging asset classes; over the long term, our approach strives to provide you with better performance compared to the overall stock market average (the S&P 500) and with less risk. In summary – stay disciplined during times of under-performance; don't become emotional and abandon a proven long-term strategy during a usually short period of under-performance, but stick with it and let the strategy work for you. If someone says they are never wrong, they have just proven themselves otherwise.

It's that time of year again. Please take a few moments to complete the Investor Profile found in this mailing and return in the self-addressed postage paid envelope. Thanks.

General commentary –

Sell in May and go away?

You may have read that for the past 58+ years, the stock market's weakest six-month period is May through October. Numerous studies show $10,000 invested each year over the May 1st through October 31st period, starting in 1950, would only be worth $10,026 today. In comparison, that same $10,000 would have appreciated to $372,890 if it had been invested from November 1st through April 30th every year.

The bottom line is that all the significant gains of the past 58 years have been made between November and April. This is how the mantra "Sell in May and go away" began. Is this just a statistical anomaly? Probably not – 66% of the November through April periods for the last 58 years outperformed the May through October periods.

However, last year's performance was inverted. Last year, the S&P 500 gained +5.5% from May through October, and fell -9.7% from November 2007 through April 30, 2008.

Will "Sell in May and go away" work this year, or will 2008 be inverted as well?

Pro Arguments:

- The overall Market Environment Indicator remains stubbornly bearish. Even with a +2 month rally, it has not turned bullish. This situation can change on weekly basis, but for now we are still in a bearish trend.
- The rally from the March low lacked breadth and momentum compared to previous rallies from oversold extremes.
- Recession and inflation fears remain high.

Con Arguments:

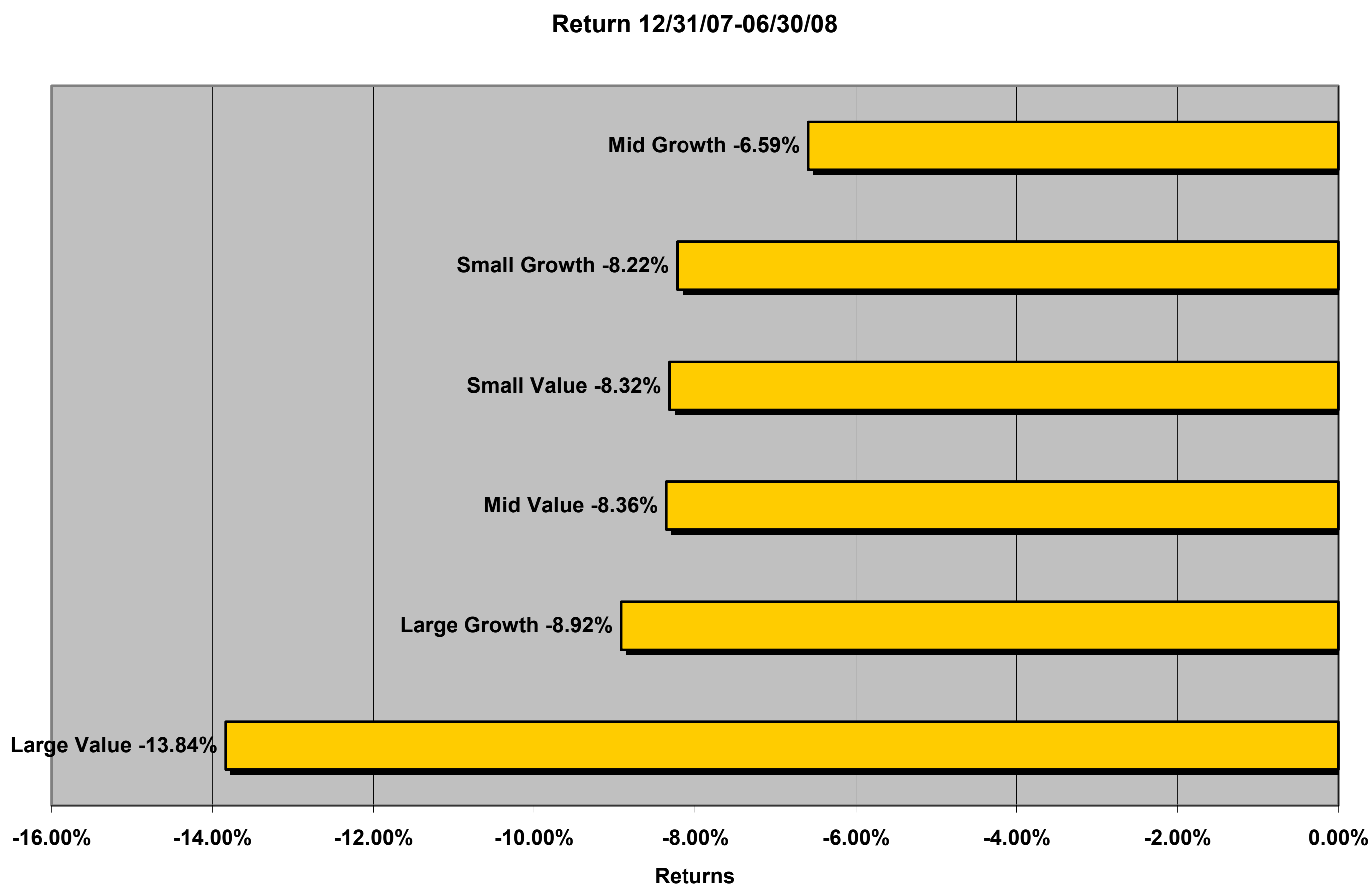
- It appears the Fed has ended its easing cycle for interest rates. Historically, that has signaled the start of a positive stock growth period.

DWM's bottom line is as follows: Trust the overall Market Environment Indicator. The indicator motivated us to participate in the bull market rally last year and avoid the bear market decline of last November. 2008 may match the "Sell in May and go away" strategy, but if that is the case, it will be based on current market readings, which we prefer.

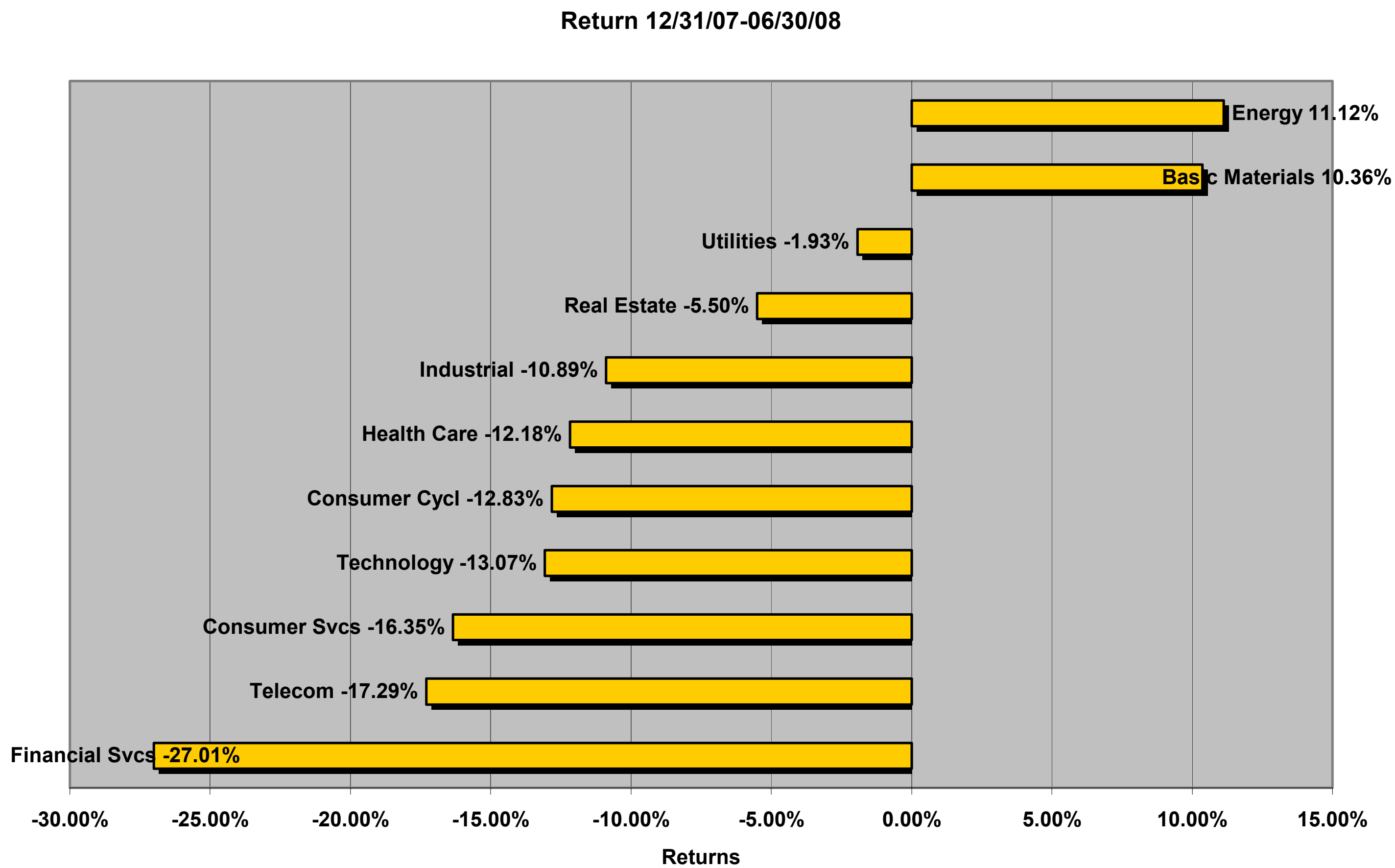
As we go to press, the overall market environment indicator remains Bearish. We will continue to monitor this indicator and make the necessary adjustments.

Please note that, in the following pages, the performance charts for certain asset classes are for illustrative purposes only, and do not reflect the ranking system utilized by DWM.

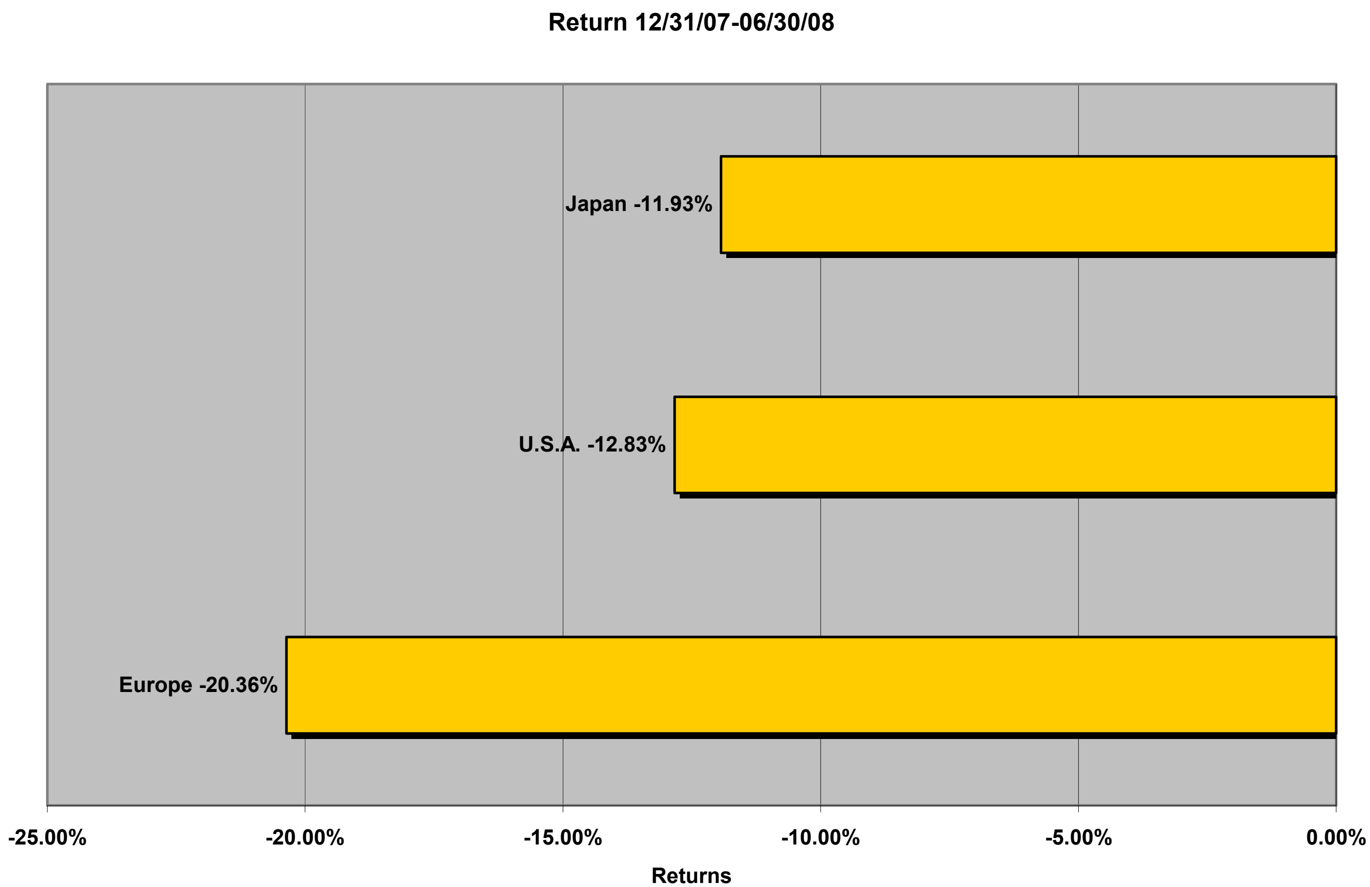
Style boxes – Surprisingly, Mid-Cap Growth claimed the number one position from Large Cap Growth in my relative strength ranks. But should it come as a surprise? According to a study performed by Ned Davis Research, the answer is “No.” Historically, a small-stock rally during an economic slowdown has often foreshadowed better times ahead. Ned Davis Research of Venice, Fla., studied economic downturns since the end of World War II and found that large-cap stocks tend to lose their momentum to smaller stocks six months after the start of an official recession. The typical recession lasts about 10 months, so these reversals often take place during the economic slump — not afterwards. To be sure, no official recession has yet been declared at this time. But if, as some economists believe, a recession began in December, it wouldn’t be surprising that small stocks have begun to excel. Maybe this is why Mid-Cap has recently become the front runner. Although no recession has officially been declared, many investors are waiting for it to become official, and may be parking their assets between Large and Small Caps in preparation. As usual, we will continue to rely upon our time-tested relative-strength analysis to guide our investments in Style Boxes.



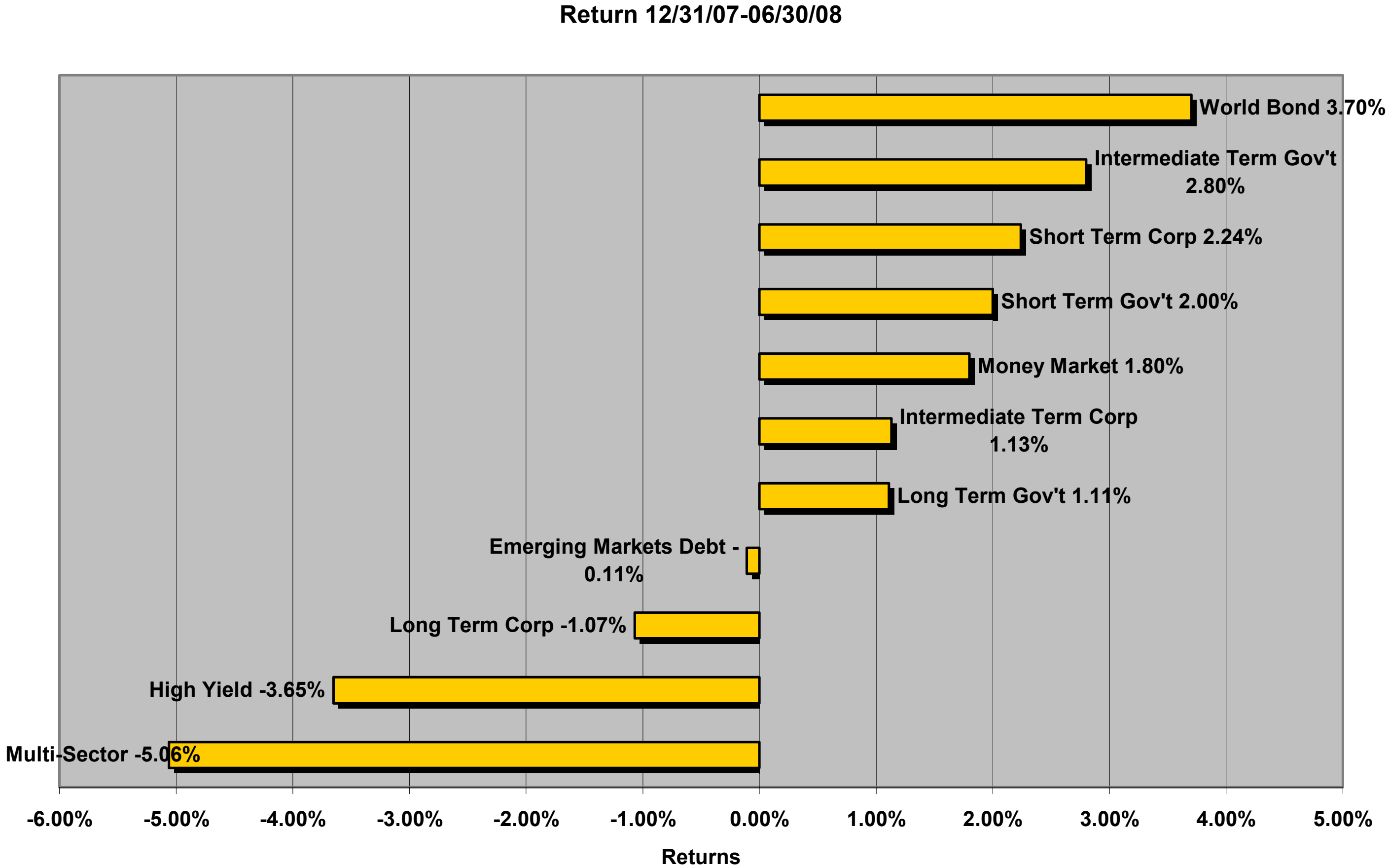
Sectors – Energy seems to have claimed a majority of the headlines recently so that's going to be the main focus of this newsletter. Economics 101 would tell us that there should be elastic demand for oil and that given a certain price point buyers would begin to temper their usage. Demand in the U.S. is, in fact, likely to moderate as industrial production stalls and aggregate growth remains sluggish for the foreseeable future. Demand from China and other emerging markets will more than make-up for the U.S. shortfall, however. Including geopolitical risks and supply concerns to the equation might mean that oil prices remain high, even if short-term interest rates in the U.S. are pushed higher. Supply issues related to attacks on Nigerian pipelines, turmoil in Iraq, nationalist fervor in Venezuela and slower production in Russia all point to a higher risk premium in the price of oil for the foreseeable future. These factors build a great fundamental case for energy. I will always rely on my time-tested relative-strength analysis to guide our investments and will make changes accordingly, no matter how strong or weak the current fundamental case might be. Currently, my relative-strength analysis favors energy.



Internationals – Global markets continue to be extremely volatile as fears concerning continued fallout from the credit-market turmoil, the falling dollar and the prospects of a weakening global economy, are offset by the world's monetary authorities' injections of liquidity. However, there were some shining stars in the first half of 2008, and all of them came from the same area – Latin America. According to the I-shares Exchange Traded Fund (ETF) symbol EWZ, Brazil was up over 11%. Latin America, as measured by the I-shares ETF symbol ILF, was up just under 12%. Mexico, measured by the I-shares ETF symbol EWW, was up just under 3%. I realize these gains are not huge on an absolute basis, but when measured on a relative basis to the U.S. market, the gains were substantial. The U.S., as measured by the S&P 500, dropped nearly 10% over the same time period. The driving force behind Latin America's gains is, of course, energy. Many Latin American markets have over 50% exposure to energy and materials, while Emerging Market funds have closer to 35% exposure. Energy is the leading sector within the global boom, due largely to India and China's growth of vast commodity-hungry economies. Will this trend continue? No one knows for sure – only time will tell. As usual, we will continue to rely upon our time-tested relative-strength analysis to guide our international investments.



Bonds – On Thursday June 19th, Moody's Investor Service stripped the insurance arms of Ambac Financial Group and MBIA of their triple-A ratings. That same day, Standard & Poor's said it may cut automaker ratings, putting General Motors, Ford Motor and Chrysler ratings on watch. With this type of turmoil surrounding bonds, it's not surprising that the Money Markets are climbing in my ranks as one of the better and safer bond positions as Money Markets claim the third place spot in my relative strength ranking. As usual, we will continue to rely upon our time-tested relative-strength analysis to guide our bond investments.



Forecast –

20% drop in the S&P?

The Royal Bank of Scotland has joined the swelling chorus, which predicts an approaching disastrous downturn in global equity markets. RBS analysts believe that the S&P 500 will plummet 300 points, or 22%, by September, and that credit markets will be just as vulnerable.

RBS thinks that, as the effects of the stimulus package begin to diminish and inflation continues to soar, the economy will show signs of real deterioration. The Fed, meanwhile, will be hamstrung by high inflation, and will be unable to provide the necessary relief: The authorities cannot respond with easy money, because oil and food costs continue to push headline inflation to levels that are unsettling the markets. "The ugly spoiler is that we may need to see much lower global growth in order to get lower inflation," he said. "The Fed is in panic mode. The massive credibility chasms down which the Fed, and maybe even the ECB, will plummet when they fail to hike rates in the face of higher inflation, which will combine to give us a big sell-off in risky assets," he said.

Will the Royal Bank be right-on or way off the mark? What we do know is that an uncertain market requires that we stick with sound trading rules. All of DWM's strategies are based on unemotional quantitative mathematical models. In other words, we take the emotion out of investing. Our goal is to stay in tune with the market; we invest in market leaders, avoid market laggards, and operate defensively during market declines. Our Year-to-Date performance supports our disciplined approach.

Currently, DWM is operating defensively. The S&P 500 has fallen more than 13% since our November 5th sell signal in the Market Environment Indicator, and remains in bearish territory.

Will the S&P 500 drop another 20% from current levels? No one knows for sure and only time will tell. DWM, for one, will continue to rely upon its tactical tools to stay in line with the market's fluctuations. Always remember: the key to investment success is to stay disciplined and flexible in an ever-changing market environment. The moment you start to second-guess your decisions is usually when you shouldn't.

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Sources:
Style box data = Russell Indexes. Source: www.russell.com and Investors FastTrack.
Sector data = DJ US Sector Indexes via I-Shares. Source: Investors FastTrack.
International data = EuroTop 100 Index for Europe, Tokyo Nikkei Index for Japan, S&P 500 Index for U.S.A. Source: Investors FastTrack.
Bond data = Various bond mutual funds and exchange traded funds (ETF). Source: Investors FastTrack.