

Disciplined Wealth Management

12/31/2011 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.

General commentary –

National Association of Realtors – “DOH” Moment

If you follow the housing market, 12/21/2011 news was a “DOH” moment. The good news? Existing home sales rose in November to a ten-month high. Unfortunately, the bottom from which the bounce is measured was “revised” considerably downward.

What happened? The National Association of Realtors said the sales figures it has reported since 2007 were too high by an average of 14%. A divergence with similar data collected by the Census Bureau forced the real estate lobby to “rebenchmark” its numbers. Nevertheless, home prices do seem to be finding some kind of bottom. Working off the housing inventory will still take time, particularly since growth is now concentrated in multi-family dwellings.

While the American Santa Claus tries to decide which chimneys to ignore, imposters at the European Central Bank delivered a 439 billion-euro gift to the continent’s financial sector. The three-year, low-interest loans added up to almost two-thirds of next year’s maturing bank debt. This may stave off a liquidity crisis, especially since a similar auction is scheduled for February. The debt burden is far from eliminated, however.

The fact that Europe’s banks took far more loans than analysts had anticipated provoked some uncomfortable questions. Borrowing from central banks is something private bankers have historically shunned lest they look “unstable,” which is why the Federal Reserve went to great lengths to hide its actions in 2008-2009. Either European bankers seem less concerned about appearances, or they are in even worse trouble than we thought.

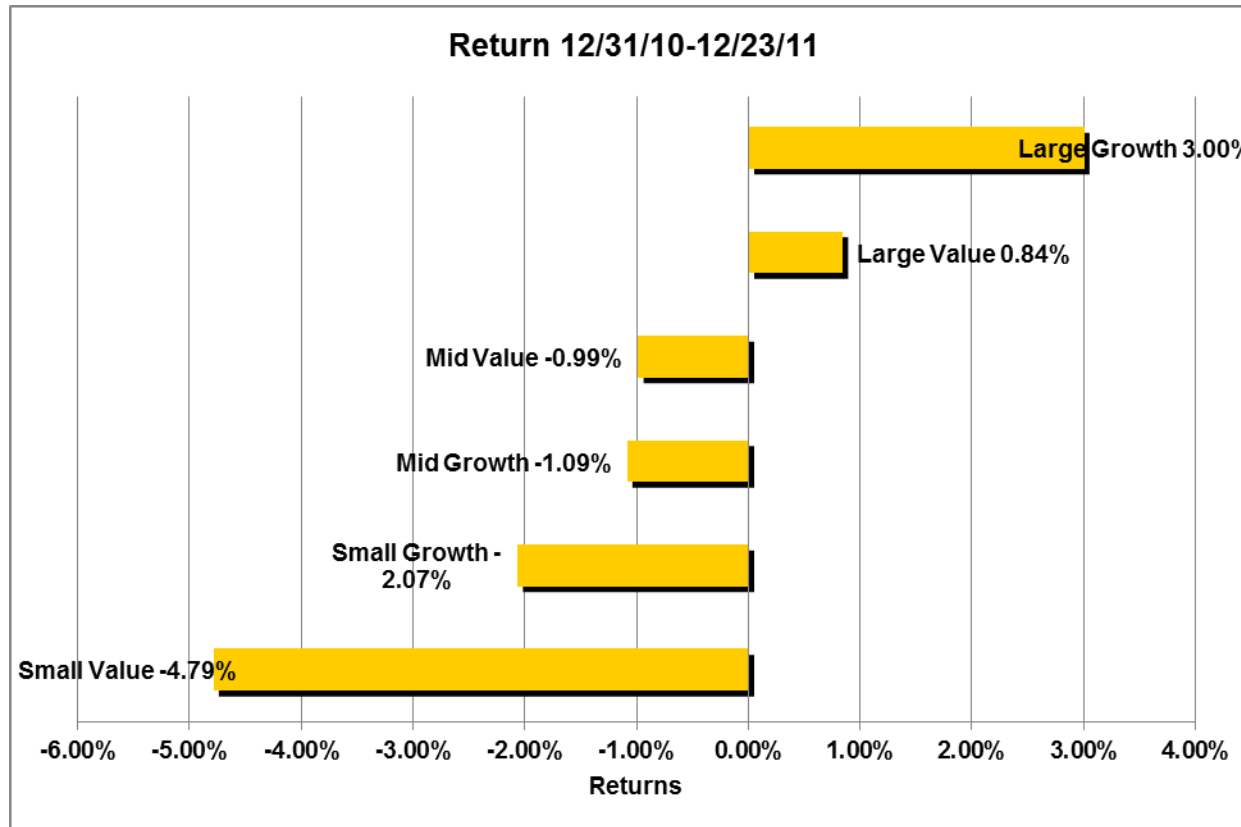
The European mess, combined with a few bad earnings reports, prevented U.S. stocks from a meaningful follow-through of Tuesday’s 12/20/2011 sharp gains. The S&P 500 stands about 8% below this year’s high and will be lucky to end 2011 with a small gain.

As we go to press, the overall Market Environment Indicator (MEI) remains bullish. We will continue to monitor this indicator and make the necessary adjustments.

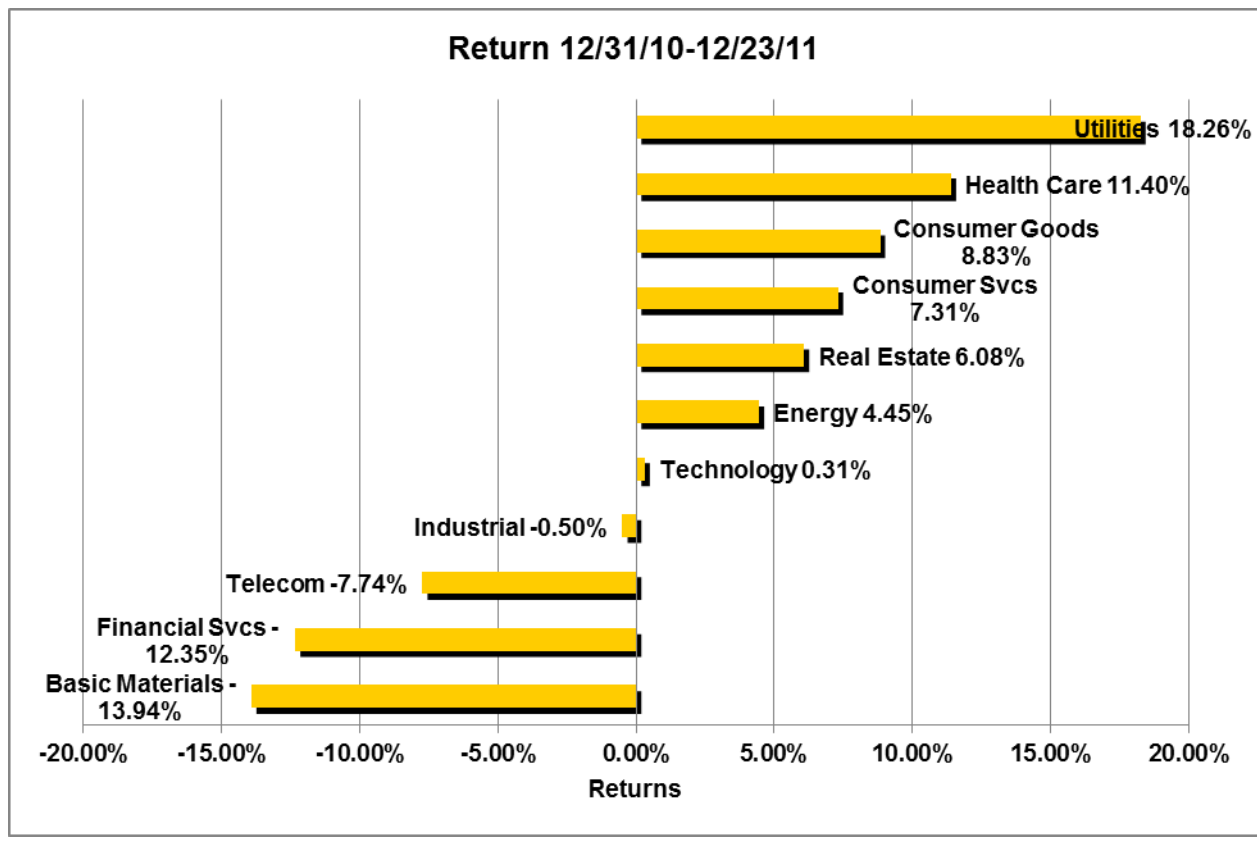
For an individual performance review please call 303-471-5189.

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.

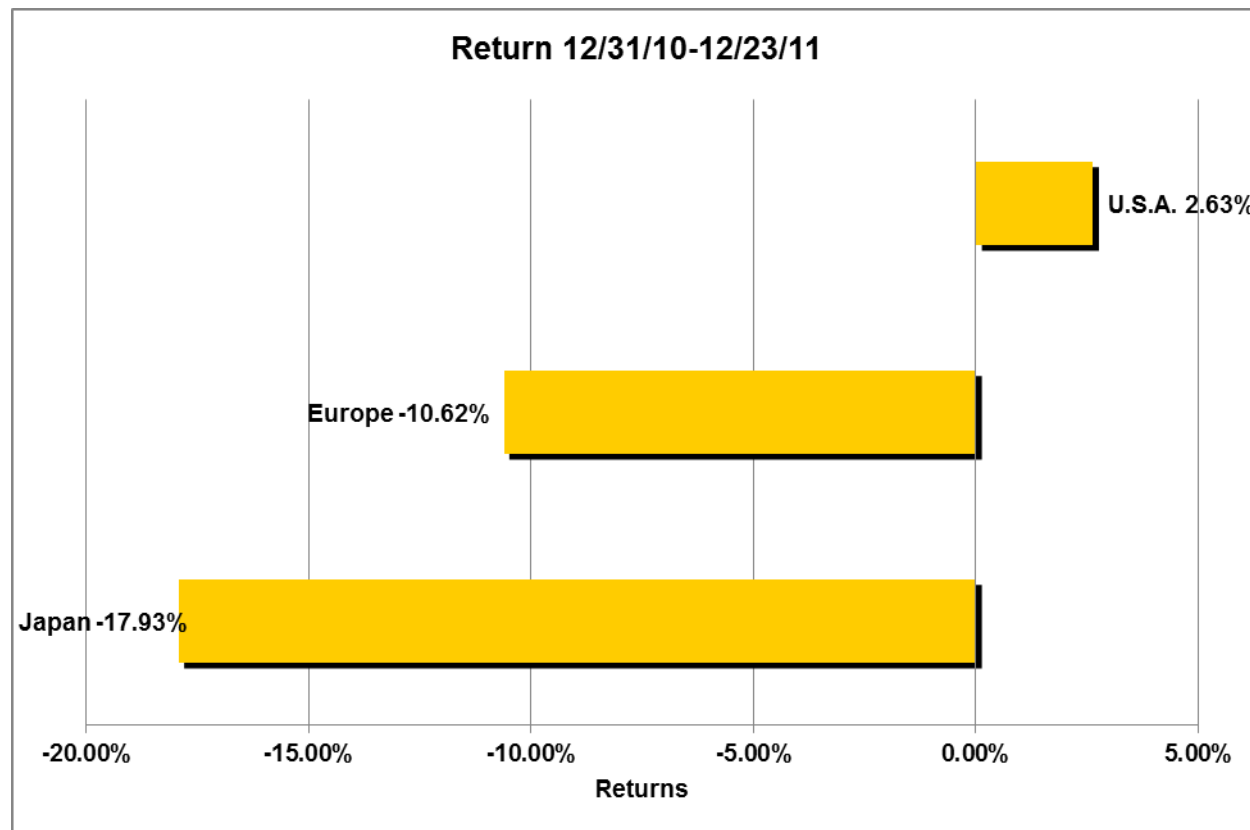
Style Boxes – As of 12/23/2011, the style rankings are so compressed that drawing conclusions about relative strength has been tough this year. There really are no discernible patterns. Large Growth and Large Value continue their strong holds on the number one and number two positions in my relative strength work. Mid Value jumped one spot from my last rankings to claim the number three position. Small Value had the largest jump of two spots to claim the fourth position. Mid Growth did the exact opposite of Small Value, falling two spots to end the year's rankings at number five. As usual, we will continue to rely upon our time-tested relative-strength analysis to guide our investments in Style Boxes.



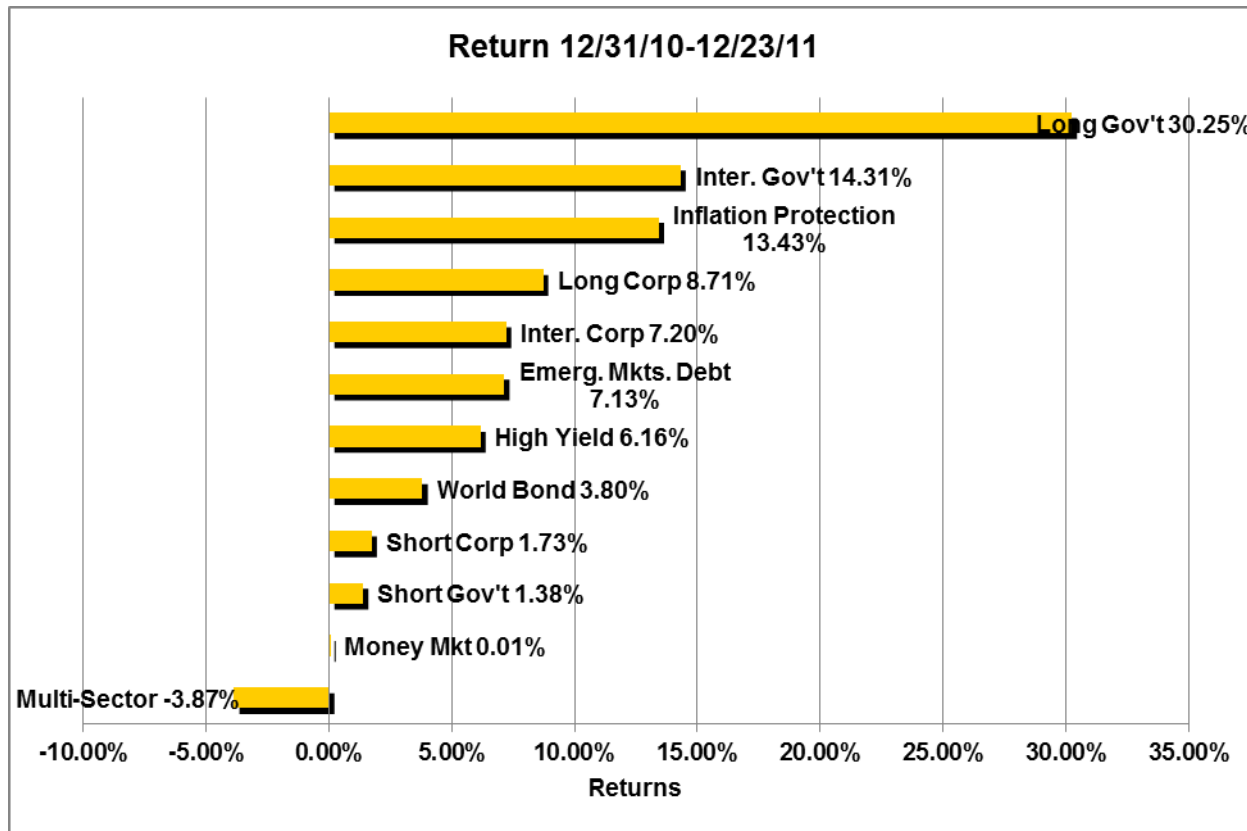
Sectors – As of 12/23/2011, the stock market’s massive rally on 12/20/2011 didn’t change the appearance of our sector rankings. Defensive sectors hold the top three spots. Utilities are still number one, followed closely by Consumer Goods. Rising volatility in Utilities seems not to be deterring yield-hungry dividend investors. Consumer Services jumped one spot to claim the number three position in my ranks. Technology surprisingly jumped one spot to round out the top four; with the earnings warning by Oracle (ORCL) I was under the impression Technology would have lost momentum and slipped in my relative strength work. Energy experienced the largest jump in my ranks, adding three positions, as Telecom did the exact opposite, falling three spots. Basic Materials remains at the bottom of my ranks. As usual, we will continue to rely upon our time-tested relative-strength analysis to guide our investments in Sectors.



Internationals – As of 12/23/2011, the USA as we see it is “a small speck of green in an otherwise red global sea.” The color has not yet changed, but you will need a very high-resolution monitor to see any green. Green stands for positive and red stands for negative. Only a surge in dollar strength kept our domestic benchmark in the lead. The European market remained in second place and should be able to stay above average if the pound can hold on to its recent rally. Japan remains at the bottom of my ranks. As usual, we will continue to rely upon our time-tested relative-strength analysis to guide our investments in Internationals.



Bonds – As of 12/23/2011, the same bonds hold the top three spots from my last relative strength rankings. Long Gov't has a stranglehold on the number one spot (I don't see this changing anytime soon). Intermediate Gov't and Inflation Protection Bonds are close in my ranks, claiming the number two and three spots. Long Corp jumped one spot and claimed the fourth and final spot from Intermediate Corp in my ranks. High Yield Bonds experienced the largest move up, jumping four spots from eleventh position to seventh. World Bond fell the most in my ranks, dropping five spots to the eleventh spot. Multi-Sector Bonds remain at the bottom of my ranks. As usual, we will continue to rely upon our time-tested relative-strength analysis to guide our investments in bonds.



Forecast –

+1260 on S&P Key

For the past five months the 200-day moving average has represented a level of overhead resistance for the S&P 500 and many other indexes. That represents ninety-nine trading days, where only on two days, 10/27 & 10/28, was the market able to trade above the 200-day moving average before falling back.

A decisive move above 1260 on the S&P 500, less than a 1% move (as of 12/22/2011), or 765 on the Russell 2000, a +3% move (as of 12/22/2011), or 2660 for the NASDAQ, also a +3% move (as of 12/22/2011), would finally confirm that the markets are ready to move for a retest of the April 2011 highs.

Every year or market cycle, investors will receive a lot of data, some positive and some negative. For the bulk of this year the market has been reacting to many of the negatives and has ignored the bulk of the good news. This has driven equities to some of the lowest valuations in decades.

As an example, the current spread (as of 12/22/2011) between an 8% S&P 500 earnings yield, which is the inverse of the P/E ratio, and a 2% Ten Year Treasury yield is at levels that have preceded big rallies in equities.

Will this be the case? 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 = i-Shares Russell Indexes. Source: 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.