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5-Step Investing

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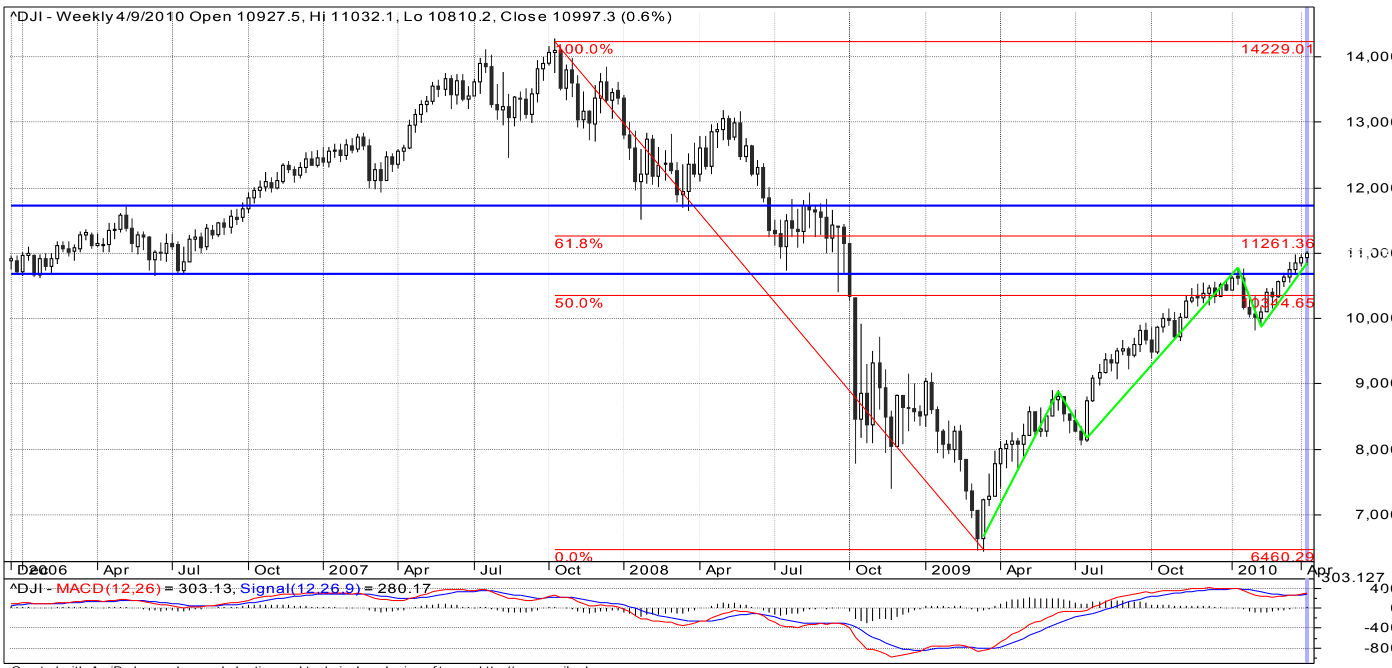
Step 1 – Broad Market Trend

Primary Trend:	Upward.	Started March 6, 2009 at 6626.
Intermediate Trend:	Upward.	Started February 12, 2010 at 10012.



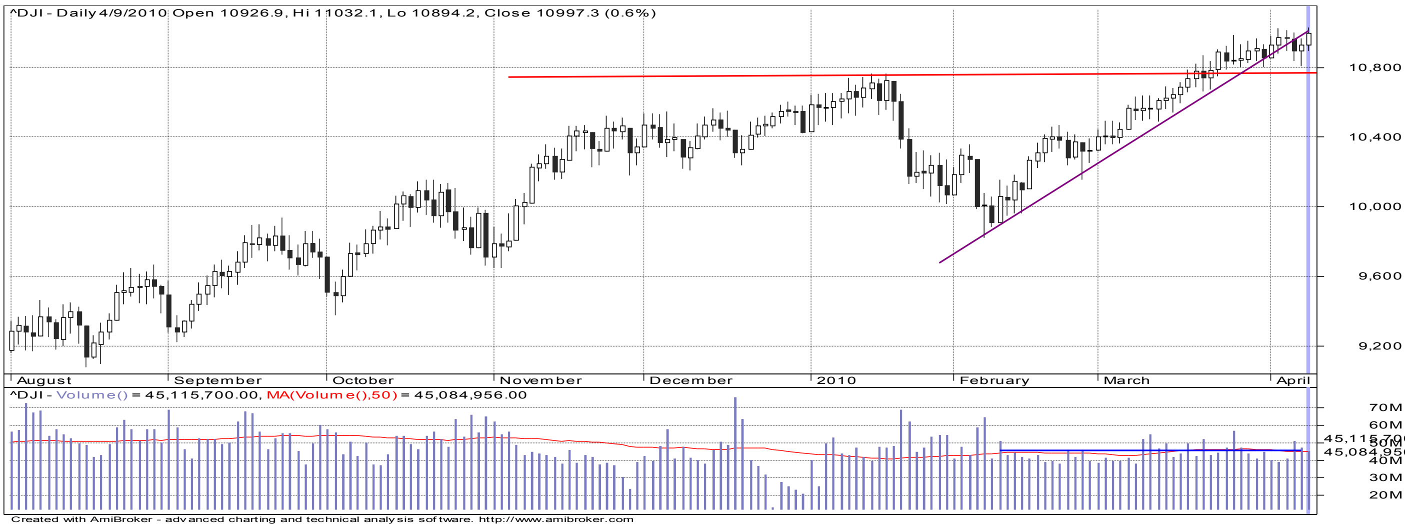
The Dow Jones Industrial Average (^DJI) advanced 0.6% last week, finishing at 10,997. As I mentioned last week, the next point of interest is the 11261 Fibonacci line, which is a 2.4% gain away. Following that, there is potential resistance at the upper Blue line at 11711, which is a 6.5% gain away.

Again on technical terms alone it looks like the broad market is in an upward trend which if it continues can be anticipated to gain at least 2.4% more. If it falls, support is at the Blue 10669 line that is 3.0% away. Note that in the bottom chart, the red MACD line, which had crossed below its blue signal line as an alert to a possible change in direction, has crossed back above the blue line. If you look in the past, that is usually an indication of a positive trend in price. But if you look back in time, the red MACD line, which is presently at 303, has never rebounded back to 400 after falling from that point. There has always been a subsequent extended lateral or downward movement in the market. In practical terms, this is saying that growth that has been this strong for this long eventually takes a break. And the MACD pattern that is there today has, in the past, always indicated an upcoming end to the present upward trend.

So while we might have a few more weeks to go in this upward rally, in the broad view the signs are set for a slowing and eventual pullback in the growth of this market.

Step 2 – Near Term Market Trend

Intermediate Trend. Upward. Started February 8, 2010 at 10195.
Short Term Trend. Upward. Started March 1, 2010 at 10337.



Last week I remarked "When this (45 degree) trend line is breached then our concern should heighten". Also "...volume is not growing even through the growth period of February through early April".

As you can see above, during the past week the 45 degree trend line that was established back in February and was in force through April was breached last week. So it is certainly possible that the market is getting set for a short-term downward pause, which is not unexpected given that the current short term rally has been underway since early March.

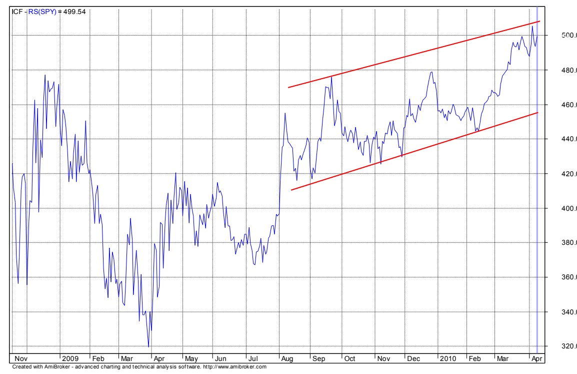
Given that the market went up 0.6% last week, and that this newsletter is based on an intermediate-term view of the markets, it is too early to consider anything defensive. Time to watch what this is going to do. Again, keep your stop loss levels up to date, as a 2.1% move downward to the red line (10768) or below would not be an unusual correction for this market.

Step 3 – Asset Classes

The charts below are not the price of the security. They are the ratio of the price of certain ETFs to the value of the SPY (S&P 500 ETF).

Bonds (AGG) continue to under-perform relative to the S&P 500. It should be underweight in your portfolio. No sign of need to shift to this safer asset class.

Real Estate (ICF) continues to outperform relative to the S&P 500. It should be overweight in your portfolio.



Gold (GLD) has weakened relative to the S&P 500. It should be under-weight in your portfolio. Confirms that there is no need to shift to GLD for safety.

Step 4 – Current Portfolios

ETF Hedge Fund

There is no indication that you should prepare to hedge for a downside intermediate term correction yet, although in the near term a short pullback in prices is to be expected after the present run-up. While there are questions regarding the length and duration of the existing uptrend, there is no reason to disregard the model recommendations at this point. When securities hit the stop loss the monies should go into cash until the next weekly investment cycle. Remember to update your stop loss levels every week.

Security	Weight	Long-Term	Medium Term	Short Term	Price Now	Stop Loss
SPY (S&P5 ETF)	Overweight	BUY (Jan 25) (109.77)	BUY (Mar 19) (115.97)	BUY (Feb 11) (108.13)	119.55	114.65
AGG (Bond ETF)	Out	Put this component into cash for the time being.				
ICF (REIT ETF)	Overweight	BUY (Jan 25) (50.15)	BUY (Mar 5) (54.36)	BUY (Feb 16) (50.30)	59.72	56.21
GLD (Gold ETF)	Underweight	BUY (Feb 1) (108.35)	SELL (Jan 29) (105.96)	BUY (Apr 1) (110.26)	113.64	108.4

<u>Current Recommended weights for portfolios:</u>
Conservative: Bonds/Cash 30%; S&P 55%; Real Estate 15%; Gold 0%
Aggressive: Bonds/Cash 5%; S&P 60%; Real Estate 35%; Gold 0%

<u>Base weights for portfolios:</u>
Conservative: Bonds/Cash 50%; S&P 30%; Real Estate 10%; Gold 10%
Aggressive: Bonds/Cash 25%; S&P 25%; Real Estate 25%; Gold 25%

Rules for Adding New Money to Existing Portfolios or Building from Scratch

1) Only add new monies to securities with BUY in Long-Term, Medium Term and Short Term. Otherwise, keep the money in a money market fund.
2) Do not increase the overall size of the portfolio more than 12% a week, in order to limit market risk.
3) Always enter the noted stop loss amount with each investment. Do not enter a purchase without an associated stop loss amount.

Rules for 401K Portfolios

1) Segment your 401K portfolio offerings into Equity, Bond, and Money Market. Most equity funds (Large Cap, Small Cap, International, Growth, Value) are very tightly correlated and should be considered as a single asset class. Of these, if you have an S&P Index fund, choose this as your Equity fund. Most bond funds (government, mortgage) are tightly correlated. Of these, if you have a government bond fund, choose this as your Bond fund. You typically will not have a Real Estate or Gold option for 401K portfolios.
2) Apply the Medium Term recommendations above to these two fund options by using the Bonds recommendation for the Bond fund, and the S&P recommendation for the Equity fund. Calculate the percent allocation for the equity fund as the sum of the S&P, Real Estate, and Gold recommendations.
3) Remember that most 401K options have limitations on the frequency with which you can trade the funds or other fund-specific limitations.
4) Avoid using the “target date” funds, as they remain invested in the market at a 65-80% level regardless of market

Step 5 – New Ideas

I will be publishing on this in the next few weeks for those of you interested in tax-sensitive and non-tax-sensitive investing ideas.

The Final Word

This week's final word comes from the book "Technical Analyst of the Financial Markets" by John J. Murphy. This book is considered one of the classic texts of technical investing. Murphy suggests these money management and trading tactics, many of which apply to all investors, casual or otherwise. I happen to follow many of his "rules" in the development of this newsletter. Enjoy.

1) Trade in the direction of the intermediate trend.
2) In uptrends buy the dips; in downtrends, sell bounces.
3) Let profits run, and cut losses short.
4) Use stop losses to limit losses.
5) Don't trade impulsively. Have a plan.
6) Plan your work and work your plan.
7) Use money management principles (like entering the market 12% at a time...).
8) Diversify, but don't overdo it.
9) Employ at least a 3:1 reward ratio.
10) Close out losing positions before closing out winning positions.
11) Work from the long term view to the short term view.
12) Ignore conventional wisdom and don't take what you hear on TV too seriously.
13) Learn to be comfortable in the minority. If you are right on the market, most people will disagree with you.
14) Keep it simple. More complicated isn't always better.