Lindisfarne Investments, LLC

An island of safety in a sea of risk

Market Update
November 16, 2012

First and foremost, I would like to wish everyone a wonderful and safe Thanksgiving holiday. It is a great time to get together with family and friends and that is what we in the Barack clan will be doing. For the first time in 10 years, our entire family will gather together and catch up on all that has been happening. My parents, 90 and 88 years old, will be in demand for their stories and photo-ops with the 3 generations of descendants that will be joining them. I am really looking forward to our get-together.

General Market Conditions

Thanksgiving week is a short trading week. Of course, the markets are closed on Thursday and many of the movers and shakers on Wall Street will be absent on Friday (if not all week), so treat any major moves as suspect. Volume is usually light around the holiday, but we often do see a recovery of sorts that may or may not stand the following week.

Lately, it seems that we work our way through one set of uncertainties (Wall Street doesn't like unknowns) when another quickly takes its place. The election was no soon over than the "fiscal cliff" fears returned to haunt discussions about the future of our economy.

At first, the legislators were "making nice" about the prospects for agreement, which fast returned to the rigid talking points of old, only to be followed by Friday's meeting between Congressional leaders and President Obama. This ended with positive statements about the possibility of compromise coming from both parties. This type of market moving news will most likely continue until an agreement is reached.

There was a lot of work being done behind the scenes, even during the race to the election. Rest assured that whatever the final agreement becomes, we will be paying higher taxes and seeing new restrictions and lower budgets for some government programs. Whether or not this includes Obama-care, social security, Medicare, defense spending or (fill in the name of your favorite government funded program) remains to be seen.

The chart below shows some of the tax changes that are being discussed. Review the list and see how many would affect you.

Ways and means

Proposal	Revenue raised 2013-22 $bn	Revenue raised 2013-22 % of GDP
Reinstate 35% and 39.6% upper-income taxpayer rates	442	0.2
Tax dividends & capital gains as ordinary income for upper-income taxpayers*	242	0.1
Reinstate limitation on itemised deductions/phase out personal exemption for upper-income taxpayers*	165	0.1
Limit deductions to 28% of income for upper-income taxpayers*	584	0.3
Raise estate tax to 45% from 35%, reduce exemption to $3.5m from $10m*	119	0.1
Tax carried (profits) interest as ordinary income*	13	0
Remove tax break for corporate jets	2	0
Repeal all itemised deductions	2,200	1.1
Cap itemised deductions at $25,000	1,177	0.6
Cap itemised deductions at $50,000	749	0.4
Cap itemised deduction tax savings at 2% of income	2,000	1.0
10-year budget deficit†	**9,974**	**4.9**

Sources: US Treasury; Tax Policy Centre; Martin Feldstein; Congressional Budget Office

*Revenue based on increased tax rates
†If current policies continue

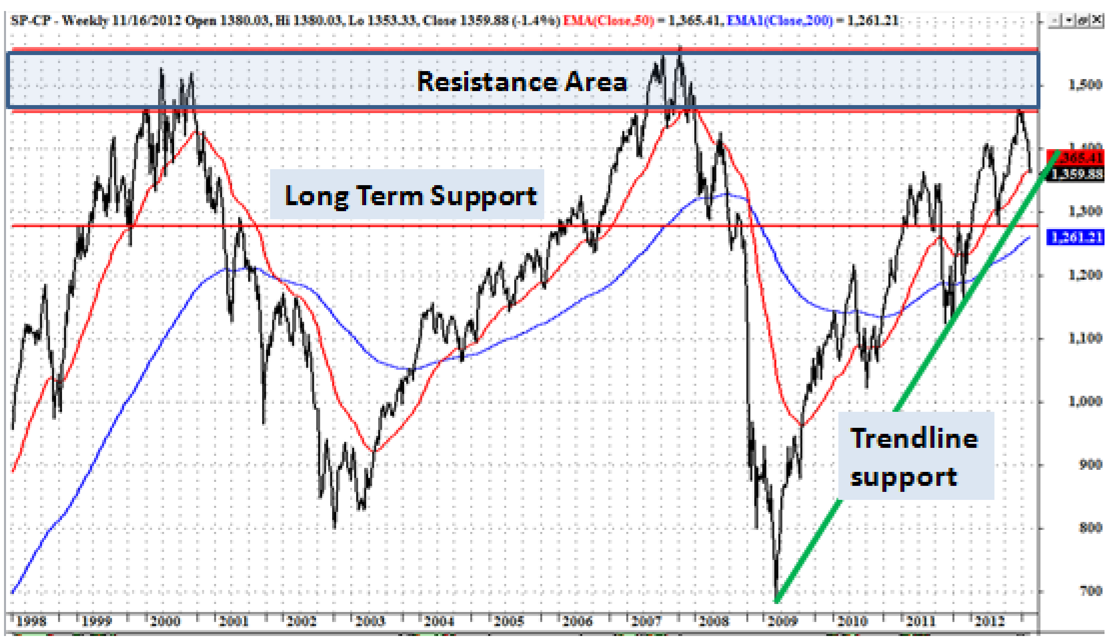
And just to complete the picture, Morgan Stanley's chief economist, Vincent Reinhart, is predicting a "Patch and Promise" followed by a "Plan". This would be a stop-gap legislation that would extend most features of the current system (taxes and budget) to be followed by the promise (should I say re-promise) of a significant budget reduction plan to be agreed to sometime in 2013. Tongue in cheek, this implies that the solution to the 2012 Fiscal Cliff will be a 2013 Fiscal Cliff (recall that the 2012 Fiscal Cliff is what resulted from the 2011 debt ceiling negotiations and the 2010 expiration negotiations of the Bush tax cuts). It's not "Patch and Promise", rather it's "Extend and Pretend". Don't you just love politics?

What the Charts Are Saying

The S&P 500 large cap index, currently at 1360, is stuck between a rising trendline support and an overhead resistance area. To clear overhead resistance, the market needs to move above the 1565 (+15.1%) level. Further downside is probable if the market breaks the trendline support at around 1300 (-4.5%). As long as the index remains between these two areas, any day to day movement is just noise.

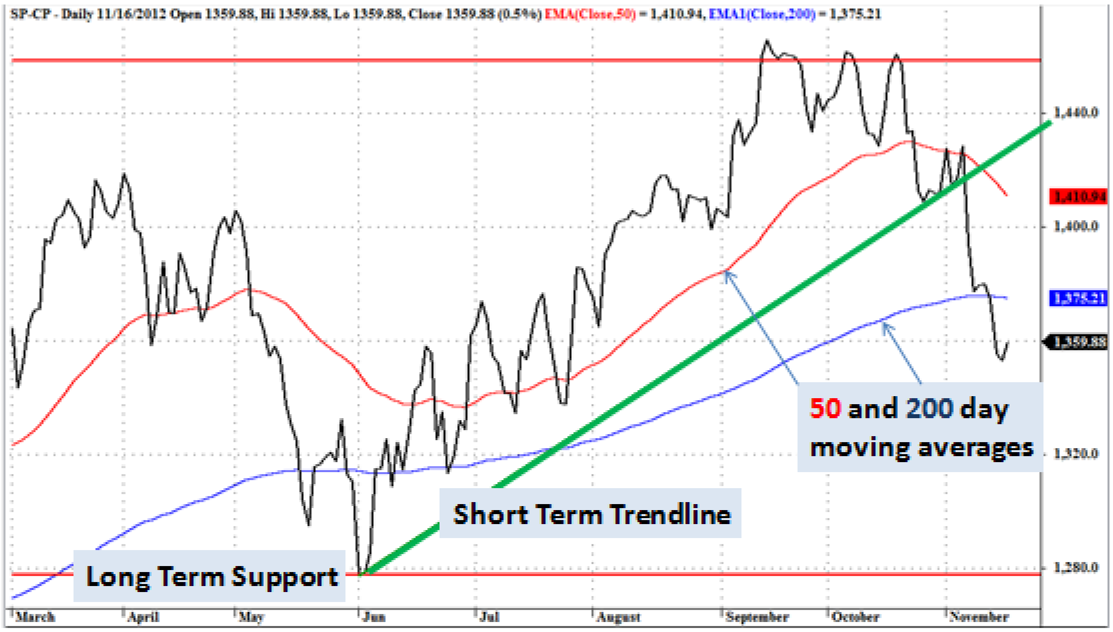
Below that, the next support levels are at 1277 (-6.1%) and then 1143 (-16.0%).

S&P 500 ... 14 Year Chart



If we look at the 9 month chart below, we can see that a shorter term trendline has already been broken. Of further concern is that the current price is below both the 50 day and the 200 day moving averages. This is not a bull market!

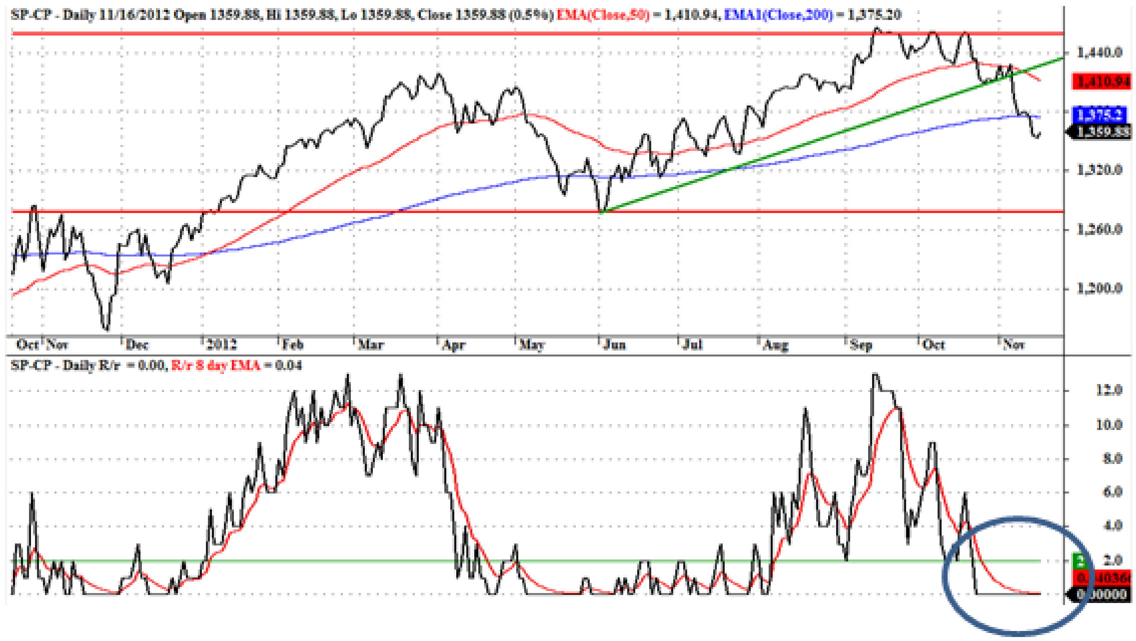
S&P 500 … 9 Month Chart



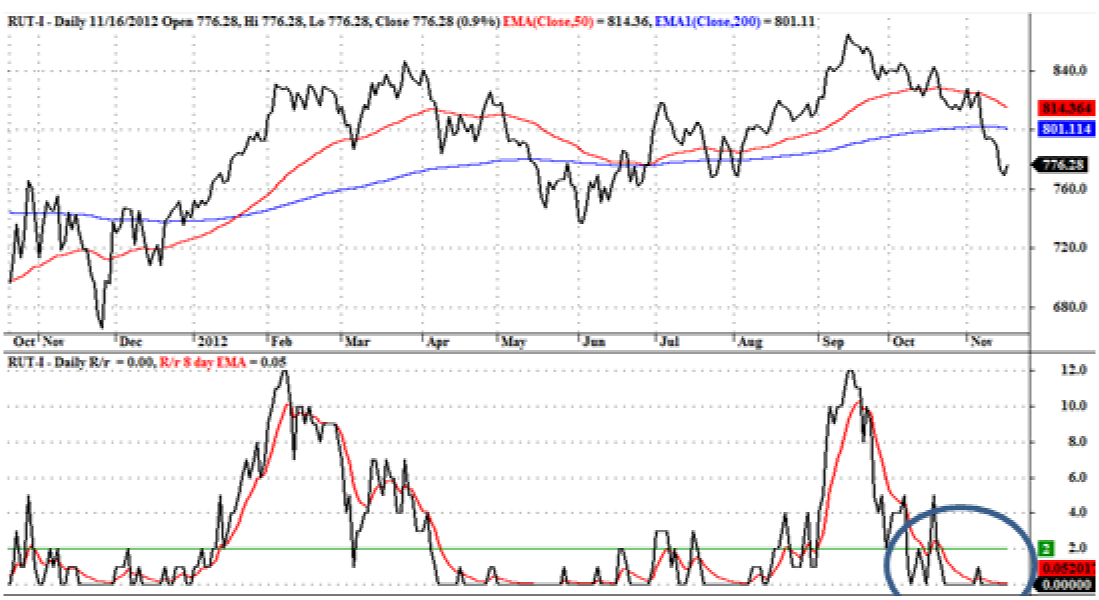
Another way to look at the market is to look at our R/r (Reward/resistance) indicator. This is shown below for the S&P 500 large caps, the Russell 2000 small caps and the NASDAQ 100 technology segments of the market. In these charts, the price action is shown in the top pane while the rolling R/r indicator is shown in the bottom pane. Please note the green horizontal line at the 2 level on the R/r pane. When the R/r is less than the green line, the market is generally moving sideways or down.

Disturbingly, all three major US market segments are now below this level and have been for about 1 ½ months. The last time we were less than 2, the market spent about 5 months moving sideways.

R/r ... S&P 500 (Large Cap)



R/r ... Russell 2000 (Small Cap)



R/r ... Nasdaq (Technology)

Another way to use the R/r values is to look at the various economic groups and see what percentage have a one month value greater than 1. This is where you are at least getting a unit of return for each unit of risk that you are taking. The next chart shows that only 4 out of 53 sectors (8%) are doing well. Percentages less than 20% are dangerous times to be in the market.

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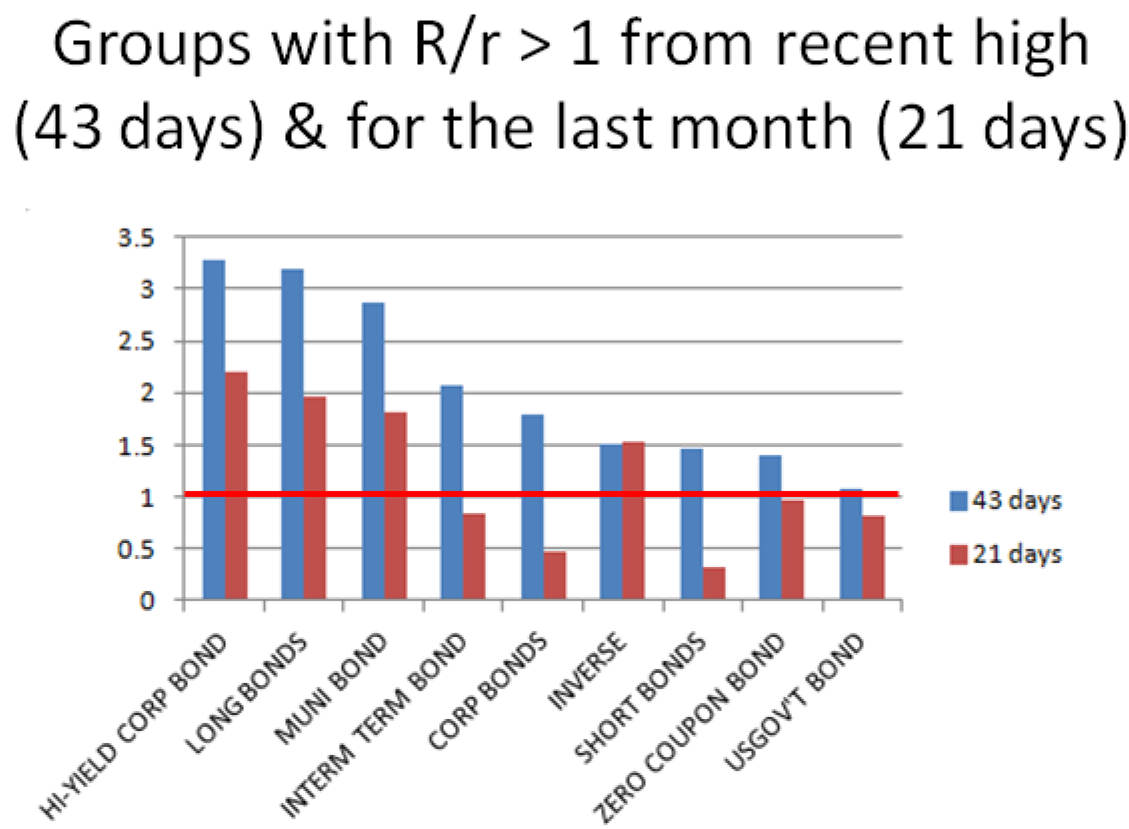
Rather than looking only at the one month value, let's compare the group behavior from the most recent market high (43 days ago) to the one month (21 days ago). As you can see we have deteriorated from 9 groups (in blue) to the current 4 groups (in red). Once again, bond related funds are the only groups that are performing but the market is getting narrower and narrower in its sector participation. High participation indicates a broad, robust economy while narrow participation shows a poor health. Conclusion: the market is becoming more and more dangerous to be in.



We Are We Invested

We remain invested in the safer sectors of the market, e.g. bonds. The gains are not of the late 1990s variety, but in this type of market, risk control is of paramount importance. As the sage once said "This is a time to be less concerned about the return on our capital but to be concerned about the return of our capital".

All this negative activity is necessary. It is setting up the next major bull market. Our only unknown is when it will begin.

Of course, the market can always change its nature tomorrow. For example, our High Yield bond holdings are close to giving us a sell signal. If it comes, we will lighten our holdings there. And we, as always, will continue to monitor our other investments for any sell signals and take the necessary actions.

Barack Capital Management Transition

I would like to thank all who have returned the contract assignment document that moves control of their accounts to Lindisfarne Investments from Barack Capital Management. For those who have not yet done so, please sign it and send it to me. If there are any questions or concerns, please call me so I can go into more detail with you.

Through the vagaries of life, I ended up with two distinct Registered Investment Advisory firms, Lindisfarne and Barack Capital Management. Rather than continue with both, I decided that it was time to roll them both into one. Selfishly, this saves two annual registration fees with the government and twice as many audits of my business practices which is a major time sink of preparation.

Simplification of my life has been one of my New Year's resolutions. This is a part of it.

Please feel free to pass this update on to anyone that you think might be interested in it. If they wish to be on the mailing list or would like more information about the services of Lindisfarne Investments, we can be contacted by phone at (440) 623-0775 or by email at bill@lindisfarneinvestments.com .