Lindisfarne Investments, LLC

An island of safety in a sea of risk

Market Update
June 30, 2013

I think the first illustration, courtesy of Barry Ritholtz, says it all:

World's Shortest Analyst Report

by BARRY RITHOLTZ - June 24th, 2013, 2:30pm

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June 24, 2013

C.B. Worth – "Money In Motion"

We have no new thoughts.

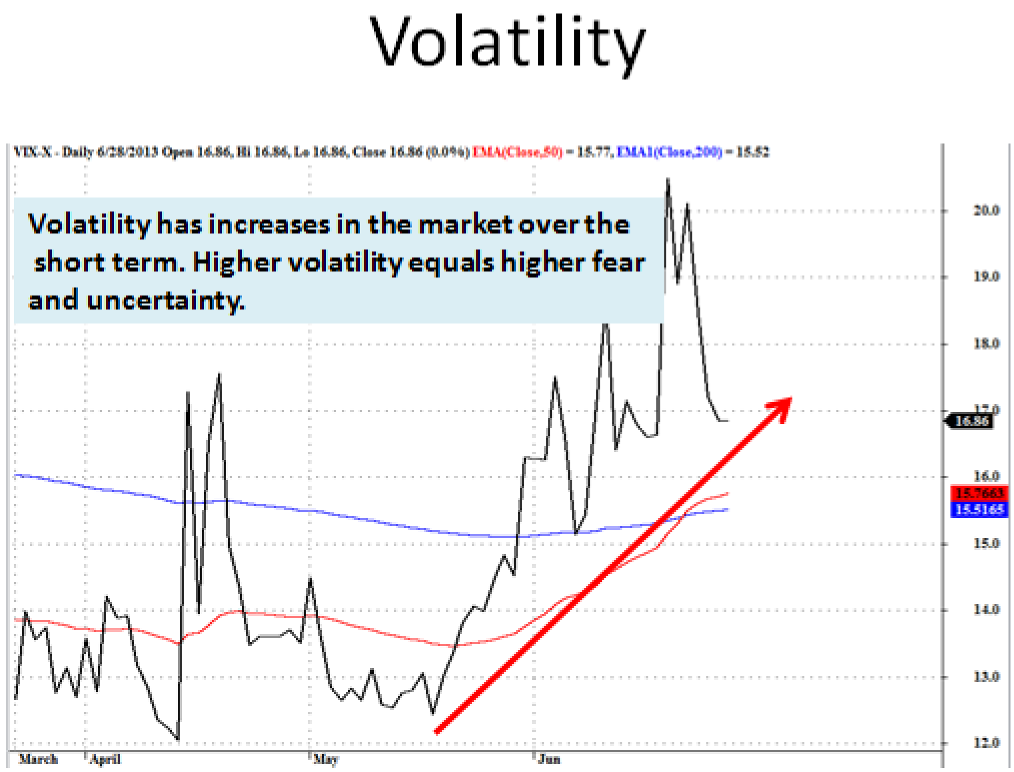
Sell.

Just for clarity, the message is "**<u>We have no new thoughts. Sell</u>**."

Since May 21st, the market has been pulling back. If you recall that was the time when Fed President Bernanke testified that the Quantitative Easing program that was pumping $85 billion a month into the economy might be tapering off in the near future. Obviously, the market reacted negatively to that possibility. Why? Because no one knows the effect of such a move. Bond yields could rise. It could be inflationary. It could stall the slowly recovering economy. It could drive us into another recession. It could, it could, it could…

Probably the best measure of uncertain and fearful periods in the market can be had by looking at the volatility of the market. When fear and uncertainty dominate, the Volatility Index rises. When comfort, a feeling of safety and complacency dominate, the Volatility Index falls.

The next chart shows that concurrent with the Fed chairman's statement, the Volatility Index has risen by about 50% to reflect the uncertainty.



Another way to look at the market's health is to look at how the individual mutual funds are doing. Of the 7,651 funds that we monitor, since May 30th, only 308 have shown a positive return, or about 4% of the total. This is very narrow market participation. **Conclusion: Risk is high**. It is not easy to make money in this type of market. It's far easier to lose money.

If fact, because of this activity, our models have taken us out of our funds, one by one, as they hit their individual stops. We are now between 20% and 30% invested in our main Bond and Asset Allocation models. This reflects one of the most important elements of our models. They have us stand aside when risk grows and returns shrink.

Let's look at the market in several time periods to see if we can unravel any suggestions as to what is going on and what might come next. First, the longer term.

As you can see below, the long term trend line in green is still a valid uptrend line. In fact, we have broken above the 2000 and 2007 highs in the market that had acted as resistance. From the longer term view, these should now be support levels and contain any downward market actions.

S&P 500 Long Term Chart (5+ Yrs)

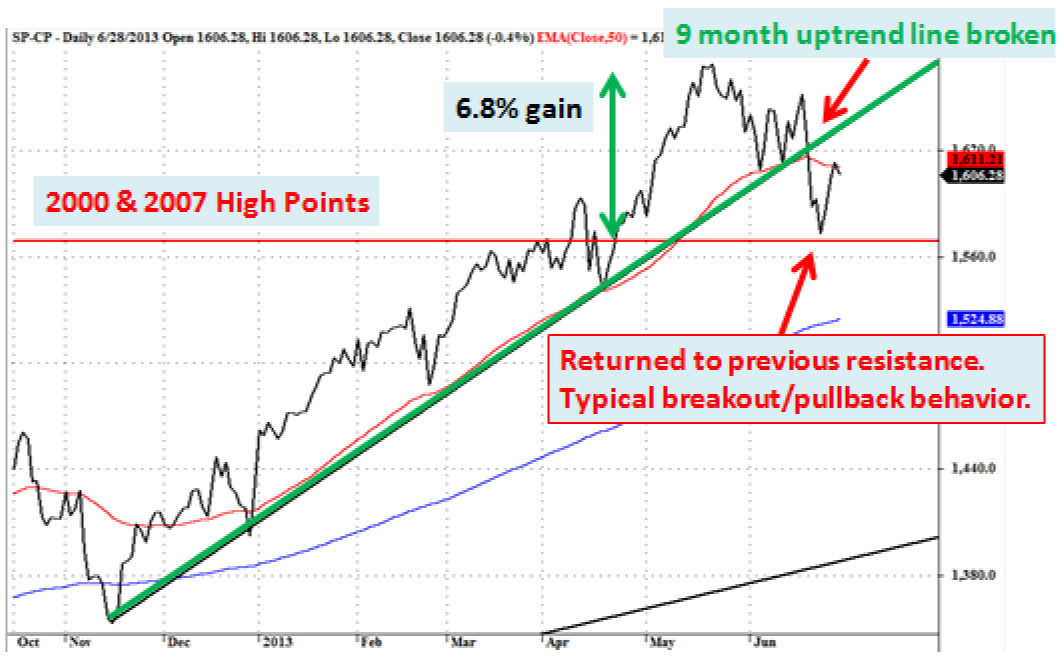
Looking next at a one year chart, we see that this trend is also up.

S&P 500 Intermediate Chart (1 Yr)

Looking shorter term, we see next that when the market broke out above the 2000/2007 highs (was resistance), it advanced about 7% to its May peak. Then, it pulled back to the 2000/2007 (now support) and has since bounced about 2% to its current levels. This breakout/pullback behavior happens often in the market.

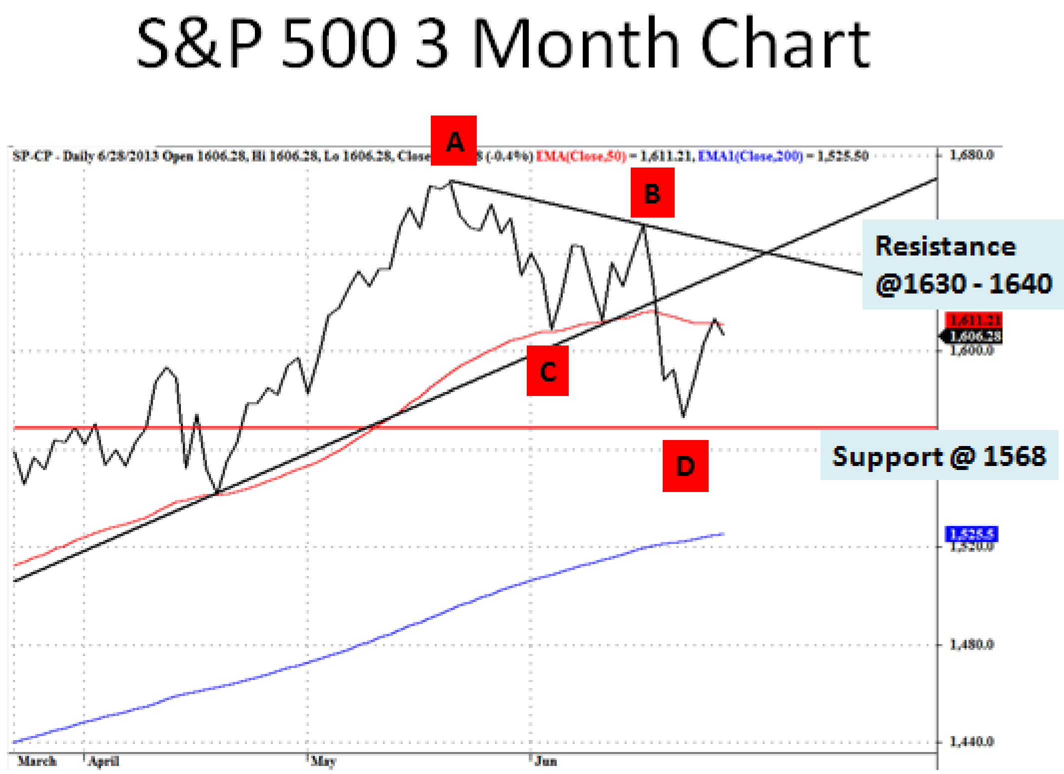
The short term trend is still up.

S&P 500 Short Term Chart



Very short term – next chart – details what has happened since May 21st. The market has made lower highs (points A & B) and lower lows (points C & D). This type of stair stepping down is the hallmark of a downtrend. While it is encouraging that the market bounced at point D (2000/2007 highs forming support), it needs to make at least a higher high and a higher low to reverse the very short term down trend.

Very short term trend … down.



So, what should we look for? A break above the downtrend line formed by point A & B (1630 – 1640 on the S&P 500) would be the earliest sign of a reversal to an uptrend – it would be very aggressive to invest at this point.

Second would be a high forming above point B and a new low forming above point D. This is still somewhat aggressive.

The most conservative would be to wait until the market closes above point A (1670 on the S&P 500).

On the downside, if the market would break support at the 1568 level, it could signal more down side ahead. (Notice that a close below 1568 would give us another lower low, continuing the stair step down trend.)

How long before we get an answer to the question of which direction are we going to go? It could happen at any time. For example, an improved unemployment report this Wednesday, a better jobs report on Friday, the Fed announcing that QE III will not taper in the near future could all boost the market higher.

Or, look at the triangle formed by points A & B and the red 2000/2007 support line. The corner to this wedge is about 3 months out. That takes us to September, a usually bad month for the market. This is about the longest that this "wedge" uncertainty can last. At that point, we will either have broken above the down trend line or violated the support. And the market could always morph into a longer term trading range between points A & D.

It could be a long summer.

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 .

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