Lindisfarne Investments, LLC

An island of safety in a sea of risk

Market Update
August 26, 2012

General Market Conditions

Recent market activity has been, in a word, bi-polar. There have been 4 to 5 weeks of consecutive positive weekly gains as well as multiple weeks of consecutive weekly losses. It's as though the market swings between bouts of optimism and pessimism.

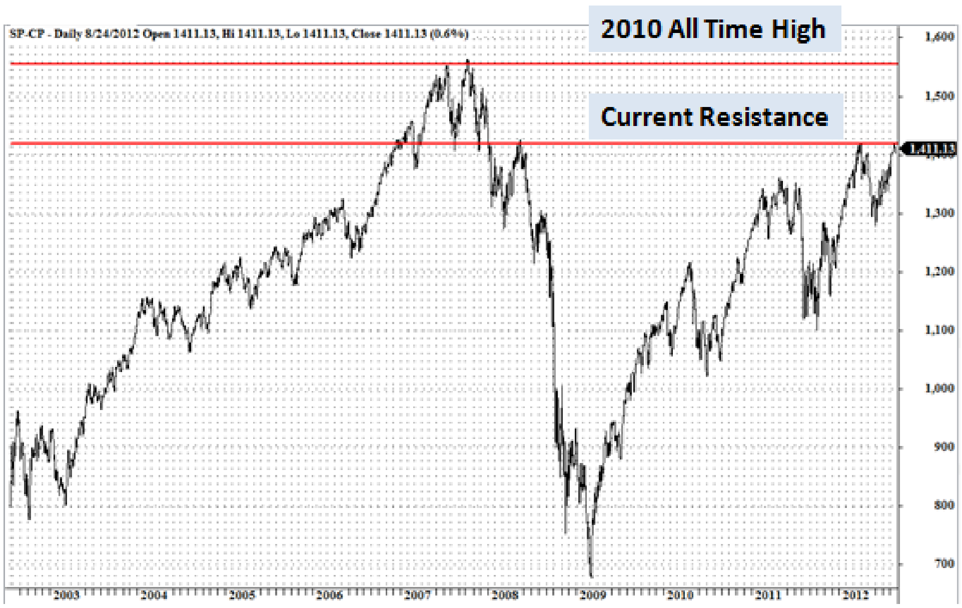
Looking at the first chart, we can see that the market is at resistance. Easier to see on the second chart is the fact that we have touched this resistance twice. If you recall, we have been in an uptrend since March of 2009 with the latest up-leg beginning in early June of this year. This has been, in part, due to expectations that the Federal Reserve will announce some form of QE 3 (the third Quantitative Easing) where they will essentially pump more money into the economy. Since this money has to go somewhere, much of it finds its way into the stock market where it leads to an increase in prices.

The Fed has three scheduled meetings left this year. Those are on September 12-13, October 23-24, and December 11-12. They are usually very careful not to make any moves near election time since they do not want to appear to favor one political party over the other. So, I am surprised that they have not announced a move yet, assuming that an easing is in their near term plans. To me, that leaves the December meeting as the most likely for any announcement, followed by September's meeting. I think a change in October is a virtual impossibility.

What does this lead to? We are likely to stay stalled at or below what is marked at current resistance on the charts. Of course, a pick-up in the economy or a Euro-zone resolution could make this discussion mute.

The other factor that could lead to a near term increase in volatility and therefore, prices moves, in the market is the political conventions. The Republican convention in Tampa (barring hurricane Isaac ruining the party) is this week. This is followed by the Democratic convention on September 3rd through the 6th in Charlotte, N.C. I would expect both to fuel optimism/pessimism which could leak into the market and affect prices near term. View any market moves over the next several weeks with a degree of skepticism.

S&P 500: 10 Year Chart



S&P 500: 5 Year Chart

Our equity models have recently indicated that we could begin to move back into stock funds, but with the market at resistance, the safer course of action is to wait for the market to either break that resistance or begin a decline from that area. So we are deferring action and waiting at this point for the market to establish its next direction.

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There has been a recent increase in the press casting doubts on the ability of the Bond Market to continue its recent positive performance. This type of news usually leads to a short term rise in interest rates along with a corresponding decrease in bond prices. Since late July, 10 year Treasury Yields have moved between 1.43% and 1.83% before retreating to the current 1.68%.

But the next chart shows that this recent move has not invalidated the longer term downtrend in yields that started in June of 2007 (before the current financial crisis became common knowledge).

10 Year Treasury Yields: 10 Year Chart

As the next chart shows, this recent action has been well behaved, simply retracing to recent lows in the yield curve that were set at the end of 2011.

Since yields often precede any major move in the markets, we keep a close eye on them to see if they are foreshadowing a change in market direction. Meantime, we remain fully invested in our bond model portfolios. Hi-yield, emerging market, municipal and mortgage backed bond funds continue to post positive gains.

10 Year Treasury Yields: 5 Year Chart

The World of ETFs, Agricultural Funds

The three main grain stocks in the U.S. are wheat, soybeans and corn. Until recently, one needed a commodity trading account to participate in these markets. But with the ETF companies ever expanding their offerings, we can now participate in these areas with our regular and IRA brokerage accounts.

The table below lists one ETF for each of these grains. As you can see, there is almost one year of history in the wheat and soybean ETF price action and over two years in corn.

Given the drought that is plaguing the farming heartland of the U.S., all of these securities have put in substantial gains to date. The key question you must answer before investing in any of these is “Will the estimates of and actual crop yields continue to fall?” So far, the FDA is predicting only a modest inflation of food prices (2.5% to 3.5%) because of the current drought. But they are “retaining the right” to adjust these estimates as conditions unfold.

Commodity ETF Summary Sheet

Commodity	Symbol	8/24/12 Price	Avg Vol (3 months)	Start Date	Gain Since 6/15/12
Wheat	WEAT	$24.31	10,000	9/21/11	+29%
Soybeans	SOYB	$27.96	45,000	9/21/11	+22%
Corn	CORN	$51.21	214,000	6/9/10	+44%

To complete the current picture, the next three charts show the recent price action of these ETFs. The highlights for me are that:

- Wheat's up-move has stalled. If I were to take a position here, I would wait for a pull back to support near $24.
- Soybean's uptrend is intact. Buying near the current trendline support of $27 would be the safer move.
- Corn has broken above last year's high which now should serve as support. $50 to $51 is a potential buying zone.

But if you do decide to invest in any of these funds, you must watch them closely. And they should be considered a part of the speculative portion of your portfolio with attendant smaller size orders.

Wheat ... WEAT

Soybeans ... SOYB

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Corn ...CORN

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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