

PORTFOLIO WATCH



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Fee **FO** Only

Making Sense of Market Behavior

As the market crashed last year, a lot of people claimed that stock prices didn't make sense. Prices have certainly recovered impressively, but the second rule of investing is "the market is never wrong" (you'll need to call if you want the first rule). There is a logical reason why prices go up or down, even when a company releases record earnings and the stock price drops. Understanding the reason forms the basis of my investment strategy, so I tend to think it's pretty important.

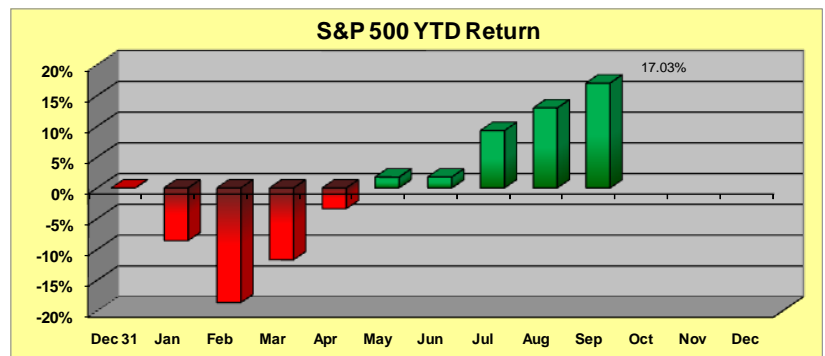
The Secret of Market Behavior

One of my favorite sayings is "There's a fine line between an 'ah-ha' and a 'duh'". This one may fall closer to the "duh" side, but the secret of market behavior is supply and demand. For any stock at any given price, there is a certain number (which could be zero) of shares that people want to buy (demand), and a number of shares people are willing to sell (supply). When the supply of shares at a certain price is exhausted while there are still people who want to buy, the price moves up until it reaches the point that someone wants to sell again. If people are jumping up and down to sell when there are no buyers at a certain price, the price moves down until some demand is found. This back and forth movement happens all day, every day, and is the only reason for price movements.

Support and Resistance

At times, it seems that a stock (or the market) just cannot seem to break through a certain price. Let's say the price is \$50. Every time the price goes up to that level, it falls back down. This is "resistance", and it exists because, for whatever reason, a bunch of people want to sell at \$50. In fact, there are more people waiting to sell at \$50 than there are people wanting to buy at \$50. This often happens at a stock's previous high point, because many people probably

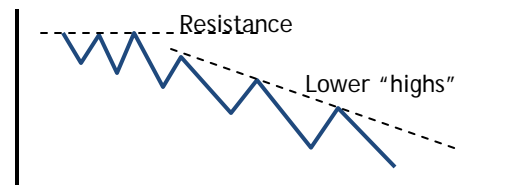
2006 return: 13.62% 2008 return: -38.49%
 2007 return: 3.53%



bought at that point and lost money. When they are finally able to get their money back, they sell, and the price falls a little bit. This may happen several times until, eventually, all of the supply at that particular price has been used up and the stock is free to go higher. This same thing happens, only in the opposite direction, when a lot of people are waiting to buy at a particular price.

Momentum – When Investors Get Trendy

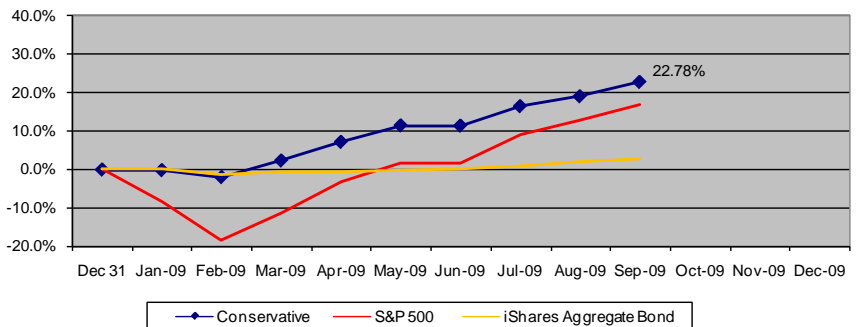
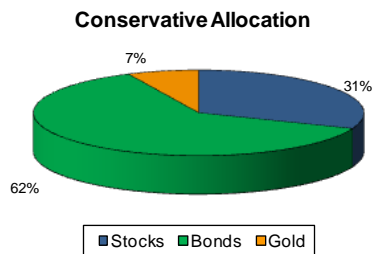
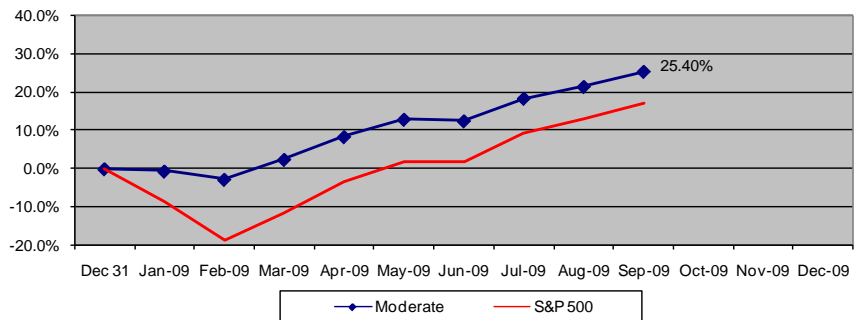
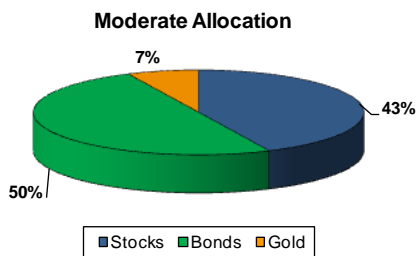
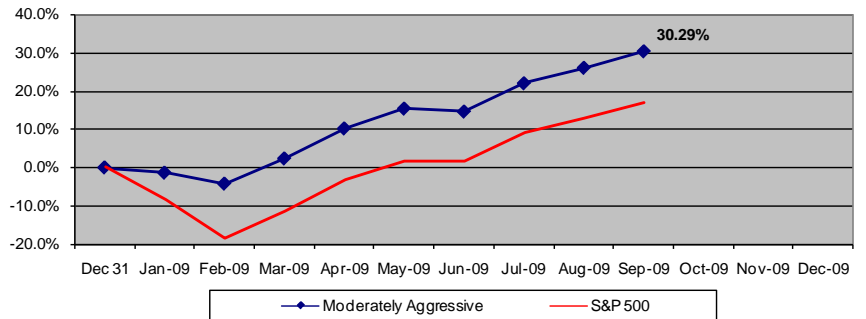
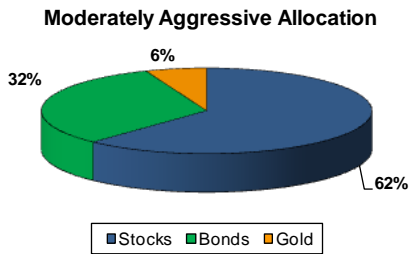
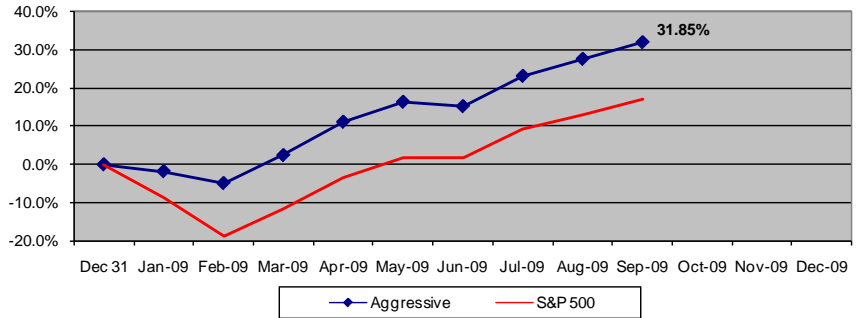
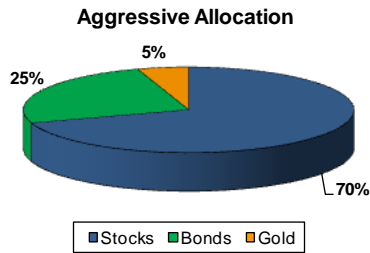
Burton Malkiel, author of "A Random Walk Down Wall Street", once said that a blindfolded monkey throwing darts at the financial section could do as well picking stocks as a financial expert. However, even Malkiel admits that the market isn't completely random because it often follows trends. When a lot of investors decide to sell and no one wants to buy, the price has to fall. Eventually, some suckers buyers will be found and the price will start to move up again. However, if the market or the stock is in a downtrend, the price will not be able to get back up to its previous high price before there are no buyers left and the price heads back down. The pattern ends up looking like this:

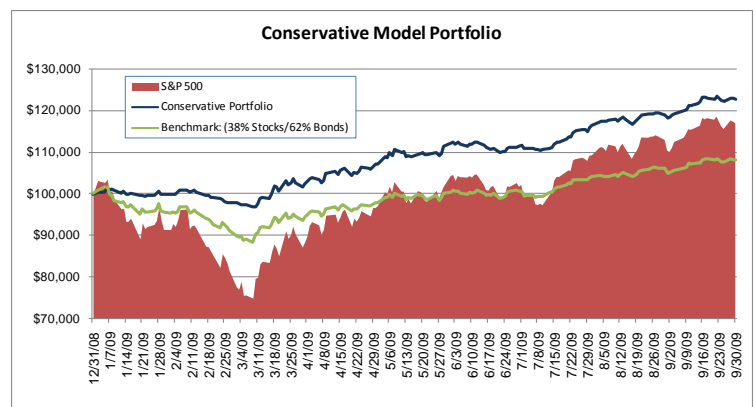
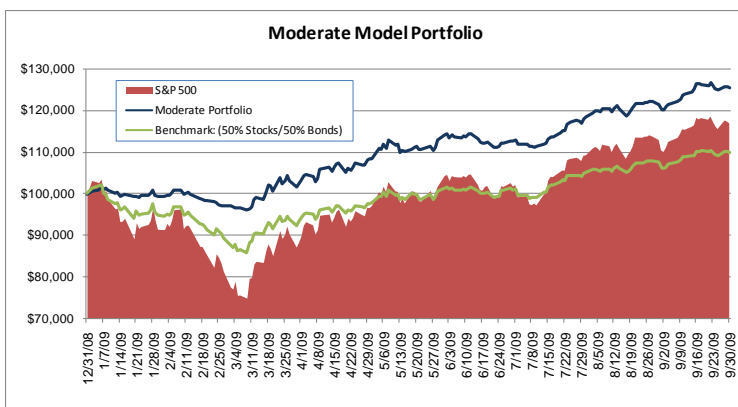
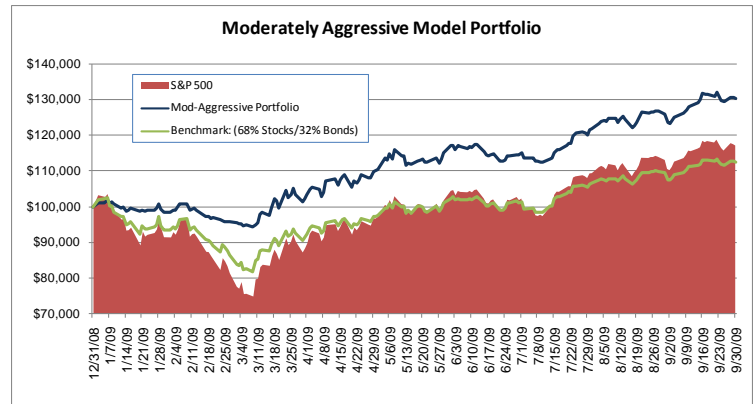
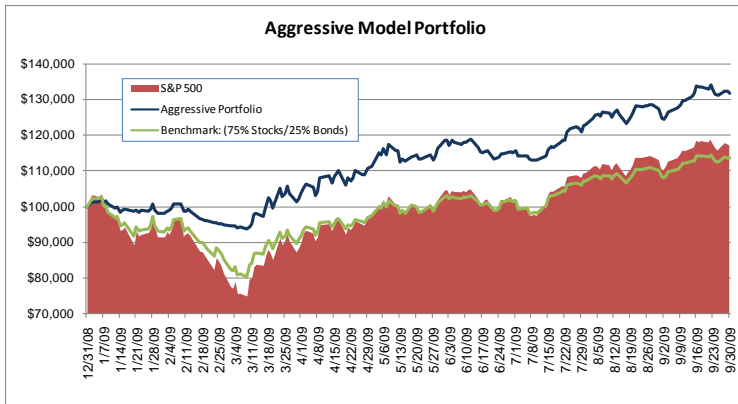


The market has been doing exactly the opposite since early March, and is up about 56% since then. However, over the last couple of weeks, it has hit resistance, with the down days being higher volume than up days. As I've mentioned before, when the market goes into a downtrend, I see no reason to wait around to see how much money will be lost.

Model Portfolio Performance

The following allocation models and Year-To-Date performance graphs represent the preferred investments in Veripax Financial Management's target portfolios. Investment allocation for each model is determined based on time horizon and risk tolerance. In most cases, individual client portfolios will contain slightly different investments and allocation mixes based on individual financial goals, investment priorities, and tax considerations. The Model Portfolios invest primarily in Exchange Traded Funds and no-load bond funds.





Benchmarks: The Benchmark for each of the above graphs utilizes the Russell 1000 Index for stocks and Total Bond Market Index for bonds. The ratio of stocks and bonds in each Benchmark matches the ratio of the associated VFM model portfolio.

Portfolio Construction: Each Model Portfolio consists of up to 8 stock sectors, 7 bond sectors and gold. Buy/Sell decisions are based on VFM's proprietary algorithm and are consistent across all portfolios. Each Model Portfolio and the associated Benchmark are rebalanced quarterly.

Portfolio Comments

The market is still marching up, with the S&P 500 now up 17% for the year, and an amazing 56.2% since the low on March 9. With unemployment rates slowing but still increasing, this recovery is an indication of just how panicked investors were earlier in the year. The technology-heavy NASDAQ is leading all of the major indices with a 34.5% gain for the year.

Most major investors are still waiting for a substantial pullback, and the market refuses to give them one. Once again, I'm fine with that. All of the portfolios beat their benchmarks last month, and the more aggressive portfolios only lost a fraction of a percent to the S&P 500. This is impressive given that stocks have been ripping higher and the Aggressive portfolio only has a 75% allocation of stocks (compared to 100% for the S&P 500).

For the third straight month, every sector posted a gain. Energy, Real Estate, Small Caps and Gold were all in the 5%-6% range for the month, but the leader was High-Yield Bonds (again). This brings High-Yield bonds to a 49.82% gain for the year. I had a feeling they were beaten down a little too far, but there is no way I would have predicted a 50% gain. I continue to be nervous about a sharp pullback, and there are some technical signals that indicate some sectors may be stalling. Given this, I moved Financials and Real Estate to cash about a week before the end of the month in preparation for a rebalance. This locked in about a 43% gain for Real Estate since it was purchased several months ago, and removed some risk from the portfolios.

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