

“Expecting is the greatest impediment to living. In anticipation of tomorrow, today is lost.”

—Lucius Annaeus Seneca

The 2nd quarter brought with it the volatility that we all had been anticipating — the first quarter was just too easy. The S&P 500 fell -11% at one point from its April 2nd high of 1,422 to its 1,266 low on June 4th. That low point found good support, however, as a healthy, volume-supported rise in prices ensued and closed the quarter at 1,362. In the end, it was a ho-hum result as the index declined -2.9% for the quarter.

The CAN SLIM® Investment Program declined -4.6% in the quarter steadily raising cash as sell stops were triggered during the decline. The portfolio started the quarter at 95% invested and finished at 55% with our investors well protected. Such reaction is normal during market swoons like this; the portfolio now sits postured to take advantage of new stocks that break out of the current malaise.

Interestingly, for the year, the portfolio sits at +5.4% net of fees. Rather healthy. Cash investors, on the other hand (and there are millions of them right now), earned virtually 0%. In fact, they really lost about -1% due to inflation. We speak with many investors and in our estimation, those in cash are suffering terribly from a combination of fear and paralysis — a position they have been in since 2009.

Supporting this viewpoint, the Harrison Group and American Express Publishing released their 2012 Survey of Affluence and Wealth in America. It’s a sobering document. While the report studies all affluent households earning more than \$100,000 year, it also clearly zeros in on the top 1%, 390 of the 1,268 surveyed had more than \$450,000 in annual income.

What’s sad about the Amex-Harrison report? High-net worth investors who were hurt in the financial markets are now hoarding cash and avoiding almost all risk. In 2007, the “One Percent” had a savings rate of 12%; in 2011, that savings rate had jumped to 34%. Their savings doubled between 2007 and 2011, from \$250 billion a year to \$550 billion a year. The percentage of those savings going into “personal savings and money markets,” earning next to nothing but relatively safe, has jumped from 24% to 54%. Conversely the rate invested in “financial products and markets” has plummeted from 76% to 46%.

The stomach is the key organ here — not the brain. Of the four major asset classes (cash, bonds, real estate, and stocks), stocks are the most attractive in our estimation and will benefit in the years to come as other crowded positions, cash and treasuries in particular, unwind. With hindsight, dot-com busts and real estate tops are easy to see, and in a few years we think that same retrospection will make a bond top clear to the benefit of equity investors. With each passing month, the millions of high-net worth investors sitting in cash will find that position increasingly untenable. Eventually they will be supporting the equity market of the future.

Alas, we don’t live in the future and must manage the market today. The future is unknowable, and though this plausible outcome seems likely, who knows when it begins. This is why we leave anticipation for others and live for today — the CAN SLIM® System adjusts to conditions daily. If the market straightens out, we will make new investments in high quality growth stocks. If the market doesn’t, we will hold more cash and wait for a better entry which, due to the above, doesn’t seem that far away.



“How much money does it hold?”

Cash Scaling: downside protection during uncertain markets

The “M” in the CAN SLIM® System stands for the stock market, and for more than fifty years William J. O’Neil has taught investors about the merits of paying attention to what the market is doing. There are times to be in the market and times to wait on the sidelines and hold cash. Even the best stock picking can’t dodge a bear market, and good long-term track records are more often built by avoiding losses as opposed to booking big gains . . . just ask some recent falling stars such as Ken Heebner, Bill Miller, or Bruce Berkowitz.

For 25 years, NorthCoast has been mindful of that principle. In every year since our founding in 1988, we have offered tactical investment portfolios that move to cash in an effort to avoid steep losses. It was this belief coupled with our long-term performance that attracted Investor’s Business Daily (IBD) to partner with us in January 2006, and we began offering an institutional caliber separate account to the public exclusively branded with their CAN SLIM® trademark. After six years together, our relationship has strengthened and our investment portfolios have grown in both size and stature.

The mechanism we have used to preserve capital during down markets is to “scale to cash”. For years we have used a methodology based on market technicals (20-day price and volume patterns complemented with IBD’s classic confirmation/distribution day count) to indicate when we should progressively invest in leading CAN SLIM® stocks during rising markets and sell stocks in declining markets. The success of this strategy has proven itself during past bear markets such as 2001-2002 and 2008-2009 and avoided undue investment volatility and devastating losses to our clients.

Investment products are never “done” however. Just because something worked in the past doesn’t guarantee its success in the future. Markets evolve, and the most successful portfolio managers are the ones who can distinguish between noise and change and then adapt to a real evolution. We base these decisions on data and fact, not emotion or opinion. When asked in 2006 why we didn’t simply use IBD’s day count approach to time our investments we explained that it doesn’t work as well as a cash scaling technique that smoothes the signals. We did the homework and can answer such questions because we have the data and the unique ability (in the investment world) to scientifically approach and test hypotheses.

We believe the time has come to again refine our cash-scaling methodology. Evidence exists that a Technicals-only approach is not as robust as one grounded in technicals and complemented with valuation, sentiment and macroeconomic factors. After a thorough analysis of over 140 factors with decades of history, we believe that the time has come to introduce new data elements into our cash scaling strategy. In our estimation, this change, though only a slight modification on a day-to-day basis, will yield enormous benefits to our clients over the years. Our Technicals-only strategies has served us well in the past and our clients have fared far better than most buy-and-hold approaches during the last two decades. As we look ahead, we are optimistic that the future is brighter. Our enhanced methodology will most often agree with our old technical indicators but at times will diverge at some key inflection points — divest or invest earlier or even hold the course and continue investing during mild setbacks where attractive entry points can lead to better returns in the future. This change continues a long legacy at NorthCoast of building the best investment products we can for our clients and furthers our belief that simple strategies — rigorously researched and consistently applied — will outperform over time.

The analysis and results from the research referred to above has been published in a whitepaper and is available to all clients who desire more detail. Please call 203-532-7003 if you care to receive by email or mail. For instant download, please go to www.ncamadvisors.com/whitepaper.pdf. As always, we thank you for your business and look forward to discussing with you any additional questions or comments.