



Clients First      Transparent      Accessible

# Mid-Month Market Cycle Monitor

Volume IV, Issue X      October 2011



## Rollercoaster

The path of the business cycle follows a regular pattern. However, the timing, extent, and duration of each cycle can vary widely.

From September 14th to October 14th, the S&P 500 Index rose 3.0%. However, that 4 week return hides quite a bit of volatility.

From September 20 to 22 the index fell 6%

From the 22nd to the 27th the index rose 4%

From the 27th to October 3rd the index fell 6.5%

From the 3rd to the 14th the index rose 11.4%

Many individual stocks experienced even greater volatility.

Much of the **shorter-term**, intraday and day to day **volatility is due to short-term traders**, often speculating (or reacting) on leverage to price movements precipitated by the intraday news flow and order flow. The majority of short-term traders **over time do not achieve consistently positive results**.

**Consistently positive results become more probable as one's time frame expands**. Nevertheless, good timing will improve results, while bad timing will hurt results. One would prefer to purchase after a 6% decline (given a subsequent advance) or sell after a 6% rise rather than the other way around. And while such a statement may seem logically simple, various natural human psychological tendencies coupled with the limitations of short-term forecasting can confound the execution of a simple logical plan.

Typically, in an economic expansion, the news flow is generally positive and the market can shrug off an occasional disappointment. During an economic downturn, the news flow is generally negative and the market can ignore pieces of good news. **Currently**, the environment is mixed with the most probable outcome of **slow growth** but with a majority of economists forecasting a double dip recession as well as a **low degree of future visibility**. Therefore, we should not be surprised as the news flow is better than expected one day, and worse than expected on another, resulting in volatile markets.

Looking out 3 to 9 months:

We continue to expect that **China will not experience a "hard landing"** (which is defined as less than 5% growth in GDP).

We expect that Europe will not have an unmitigated default, but instead will have a number of iterations of marking down debt and raising capital (in order to afford the next mark down in debt) until all the losses are absorbed over a number of years. In the meantime, periodic challenges leading to fears of a potential systemic collapse will be met in an untimely fashion by a policy response to prevent a collapse.

The U.S. economy will struggle with high unemployment and a depressed housing market, however, many companies will grow earnings. **The Federal Reserve will continue to implement accommodative monetary policy**, which provides a **tailwind for stocks**, and a **headwind for the U.S. dollar**, even if the effect on the economy is limited.

Millions of consumers will rise out of poverty and into the middle class in emerging markets providing the marginal demand in a slowly growing global economy.

**We continue to reposition into investments that look attractive for this environment** while taking advantage of market volatility the best we can.

**ASSET MIX:** We are **underweighting bonds**. We are **maintaining** the allocation to equities. We are utilizing cash as a strategic asset class, raising cash after a market advance in order to reinvest into stocks after a market decline.

*Grace Y. Lau, CFA*

*Elliot C. Kauffman, CFA*

## Professional Staff



*Grace Y. Lau, CFA*  
Chief Executive Officer



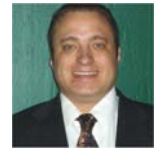
*Carter A. Pearl, CFA*  
Senior Portfolio Manager



*Elliot C. Kauffman, CFA*  
Senior Portfolio Manager



*Daniel S. Flack, CFP, CFA*  
Portfolio Manager



*Brian Metke*  
Operations Specialist

*PacWest Financial Management*  
1643 E. Bethany Home Road  
Phoenix, AZ 85016

*Tel: (602) 997-8882*

*Toll Free: (888) 997-8882*

*Fax (602) 997-8887*