SELECT ONE manager's report

Fourth Quarter 2011

MARKET REVIEW

After surviving a very bad period in August and September, the market rebounded with a very strong rally in October to kick off the fourth quarter. The S&P 500 index (“SPX”) moved up from a close of 1123.95 on October 4 to a close of 1285.08 on October 28, a move of over 14%. It was the strongest October rally in decades. But then, after repeatedly failing to make new highs during November and December, the index swung back and forth, forming a bullish medium-term chart pattern in the process. For those Clients who want to know how the clock is built as well as what time it is, details are shown in Enclosure One.

For the entire 2011 calendar year, the SPX lost a whopping three one-hundredths of a point. But that tiny move lower brought market makers and professional money managers to their knees unlike almost any other year. During August and September, in a news-driven market focused on the financial panic in Europe, there were multiple two to four percent daily moves up or down making it nearly impossible to get a handle on the underlying market direction. But then, on the day before the big October rally began, there was a large intraday move to the downside before a sharp rally into the close. That cleared the air and the market moved up from there.

Bottom line, at the end of an extremely volatile year, the stock market would up flat. The question now becomes, will it be able to move on up from here, and if so, when?

PERSPECTIVE

The phrase that best describes the market's action during 2011 is a "flight to safety". And the best word to describe our market strategy was "defensive". Defensive sectors wound up as the best performing groups, but the rotation by the traders from one sector to another made all market sectors extremely volatile.

The continuing move to safety allowed the Dow Jones Industrial Average (“Dow”) to lead the major indices higher in December, gaining 1.43% while the NASDAQ, by comparison, dropped 0.58%. However, although the Dow wound up slightly profitable for the year, the SPX is a far better indicator of broad market action.

The “raw” SPX (without dividends reinvested) wound up down 0.003%. And as shown in the attached performance report, the secondary indexes were down for the year. For the quarter, our five models gained from 4.08% to 5.62%, for an average of 4.9%. We paid the price for remaining defensive by lagging the equity indexes with which we compete for the quarter. However, for the year our performance was competitive.

After see-sawing back and forth throughout the year, the U.S. dollar finished almost exactly where it started. While plenty of questions remain about our economy and the politicians seem no closer to resolving our debt crisis and fiscal issues, buying the dollar was the obvious choice over other currencies. Once again, this is a clear sign that traders sought safety throughout 2011.

As the dollar rallied late in the year, the "gold rush" finally derailed. Gold, which reached approximately $1925 per ounce in August, closed the year at just $1565 per ounce, a 19% fall from its intra-year high.

STRATEGY

Since we never reached a bear market extreme during the summer weakness—the major indexes never closed down more that 20% from a previous high—we left the core holdings of our portfolio models intact, trading only as necessary to upgrade our holdings. In the satellite positions, we avoided sector funds because of their extreme volatility as the trading elements rotated from one sector to another to scalp profits. We held some non-correlated (with the stock market) assets in some of the satellite positions but held cash in the other positions.

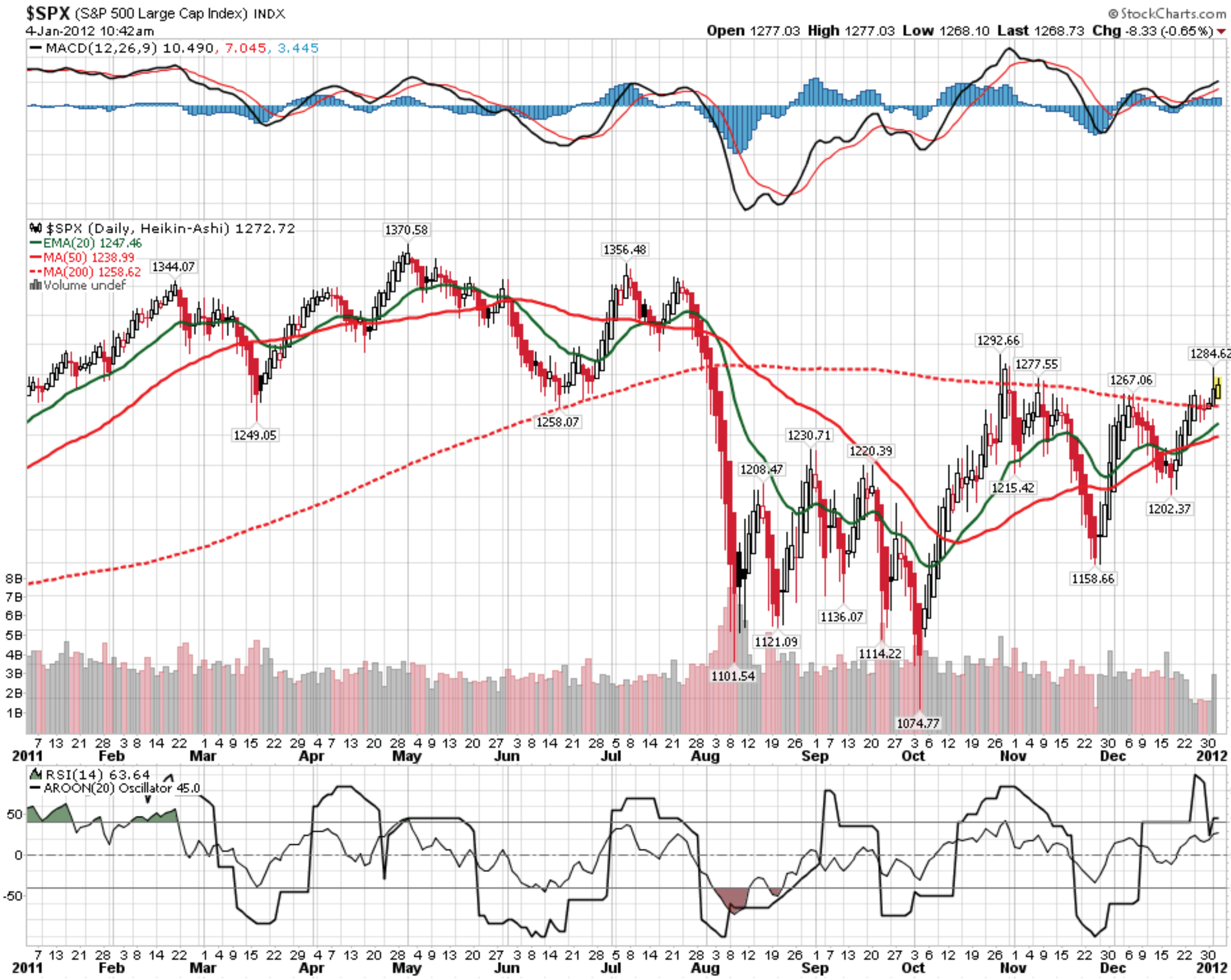
The bond market was the big surprise during the year. In the “risk-off” environment, investors kept dumping money into very low-yielding U.S. Treasury bonds, thereby taking on bond-market risk in return for very low yields. Viewing this as imprudent, we favored other types of bond funds in our more conservative models. Throughout the year, we remained fully invested in the income-oriented bond and hybrid slots in our portfolio models. We held our cash balances in money-market funds to retain our flexibility while avoiding bond market risk.

When bull market conditions return and the high volatility subsides, we’ll gradually become fully invested. However, in an election year, with political and fiscal gridlock in Fort Fumble (Washington, D.C.), in an economy that is sluggish at best, with problems overseas overhanging the market, the normal bullish implications of the fourth-year of the Presidential Election Cycle are open to question.

Bottom line, we’ll remain defensive until in our view the stock market has shaped up.

$$$$$$$

PHILIP S. KELLEY, CFS
SENIOR PORTFOLIO STRATEGIST
Portfolio Design Advisors
A Registered Investment Advisor



Market Comments

This chart shows just how volatile the stock market was during 2011. The market was mainly dominated by the short-term trading elements, Institutional investors mainly sat on their hands, with the exception of August and September, when they dumped stocks indiscriminately driving the volume much higher,. (We use two-day price bars to better show the trends, with selloffs shown in red and rallies in black.)

The indicators above and below the price bars also illustrate the extreme volatility. The Aroon indicator below the price/volume bars shows that after the market hit its intra-year high in March, it made five trips across a very broad trading range. (When this heavy black line was above 70, the market was bullish; but below 30 it was bearish.) The MACD indicator above the price bars is shorter-term in nature, but basically sends the same message.

The action of the market relative to its 200-day moving average shown by the dotted red line is critical. Note that after several attempts to move significantly above this line, the SPX is trying once again to “break out” to the upside. This process requires that the index move above the 200-day line, and hold above it on the inevitable retest of the 200-day support. A further move above the 1292.66 close at the top of the October rally should complete the turnaround process. Until that happens, we remain mired in a sideways, volatile market.

Enclosure One