

# Questions & Answers

CLIENT UPDATE

November 15, 2010

**Q: From your perspective, what's the latest outlook for gold?**

**A: Gold will go up if it doesn't go down.**

That may sound like a trite answer, but it isn't intended to be. For background considerations, please reread two recent Q&A newsletters posted on [www.selectone.us/communications](http://www.selectone.us/communications). The first one (09/01/10) was posted in the midst of a recurring media advertising barrage trying to convince everyone to buy precious metals. It explained how difficult it is to figure out what is driving gold up or down at a particular time or to trade it successfully without professional help. The second one (10/20/10) discussed gold as part of a discussion of investment bubbles. We think the private investor investing on his or her own would be well advised to steer clear of gold. But if they insist on participating, we suggest they avoid over-reacting to the "doom and gloom" scenarios featured on the media ads by limiting their position to a small percentage of their invested assets.

**The question now becomes "is the bubble bursting?"** We doubt it just yet, but after moving to new all-time high ground recently, precious metals, including gold, got hit hard on last Friday. Prices fell by double digits. Volatility, anyone? However, we point out that, despite Friday's setback, the long-term trend is still clearly to the upside. Our "gut feel" is that it might pull back to the recent support in the 1315-1326 area before it reverses to the upside again. But if it breaks below that support level and/or its 50-day moving average (shown in blue), it could move much lower.



**Q: The seasonal pattern discussed in your Q&A newsletter (07/05/10) misfired this year. Is it still valid for the long-term?**

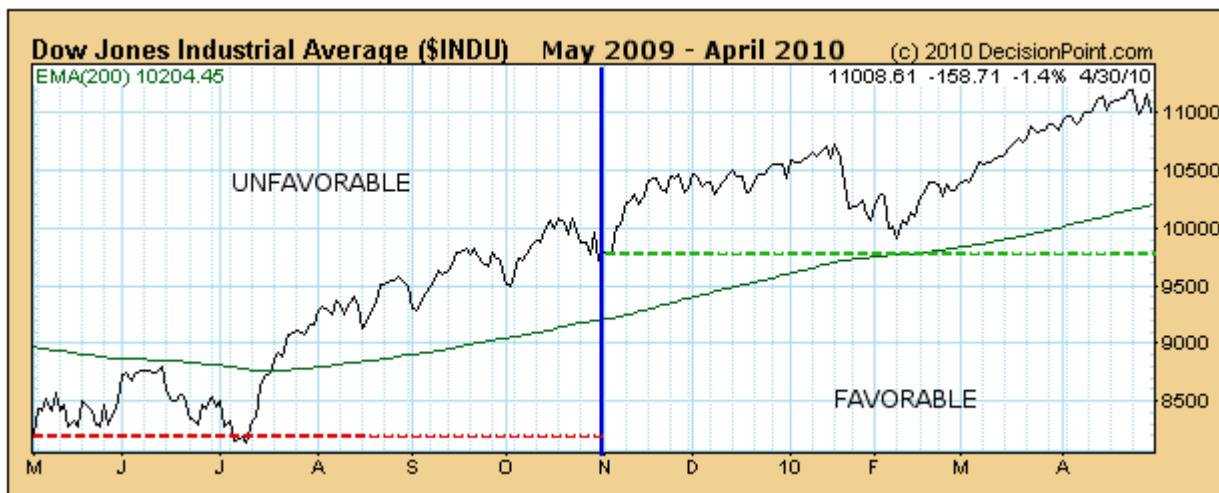
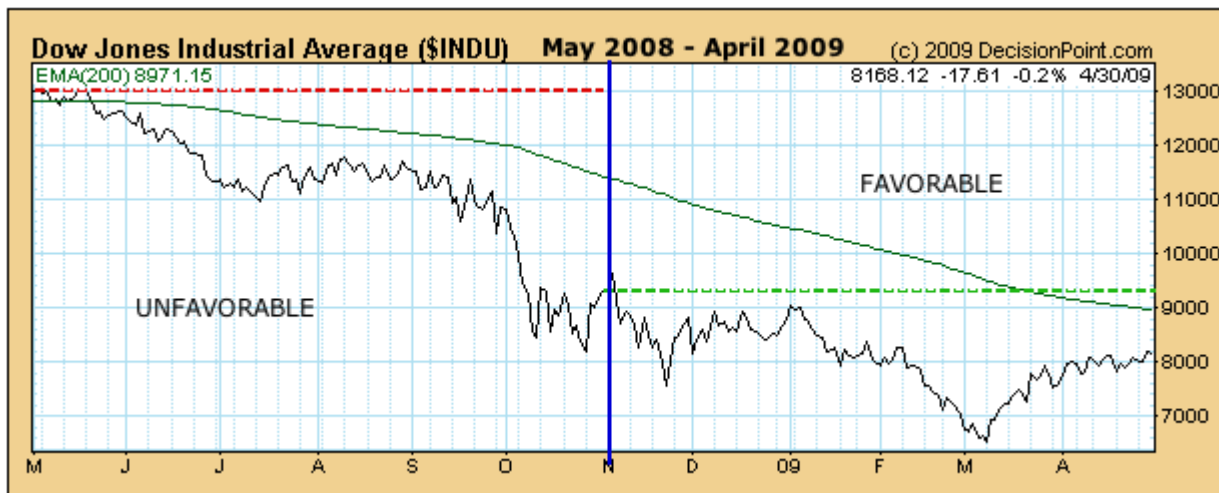
**A: That's doubtful. As the following discussion and charts show, it has misfired badly during the last few years.**

Perhaps when the market returns to "normal," it might get back on track. But under the "new normal," one probably should be aware of it but not be guided by it. Even those who have championed the "sell in May and go away" strategy for decades are now using other technical indicators to determine exactly when to get in and get out instead of blindly selling on May 1<sup>st</sup> and buying on November 1<sup>st</sup>.

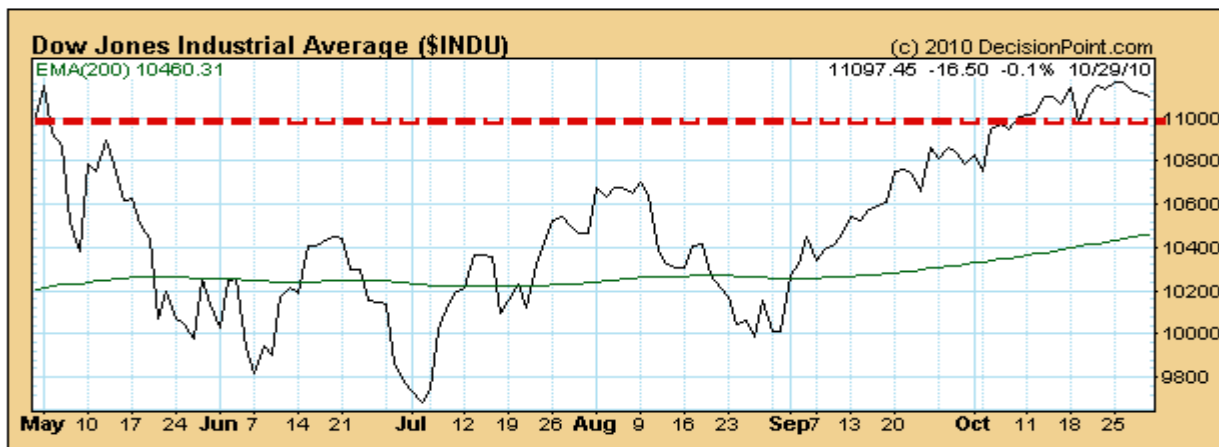
**The theory:** Research published by Yale Hirsch in the *Trader's Almanac* shows that the market year is broken into two six-month seasonality periods. May 1 through October 31 is seasonally unfavorable, and November 1 through April 30 is seasonally favorable. Statistical average results for these two periods are quite compelling, but capturing these results is not always as easy as it sounds.

Below are two one-year charts that begin on May 1, and end on April 30 showing the unfavorable period on the left and the favorable period on the right. The green line shows the beginning of the favorable period and the red line the beginning of the unfavorable period. As you can see, regardless of how the market performs on average, every year is different and presents its own challenges, and there is no guarantee that any given period will conform to the average. In fact, it is obvious, at least in the last few years, that bull and bear market pressures will override seasonal tendencies more often than not.

The first chart shows a snapshot of part of the last bear market, and both periods were unfavorable. The second chart shows that the current bull market began shortly before the unfavorable period, and, as a result, the entire year was favorable.



The final chart is the recently ended May - October 2010 period, supposed to be unfavorable, but wasn't. Part of the correction from the April top occurred in the first third of the period, but the ensuing rally made up for the losses and the Dow recently pushed above its starting point. Note that the historically horrible months of September and October beat the averages and were positive.



**Conclusion: Be aware of current seasonal tendencies, but first and foremost follow the primary trend.**

**Q: What is QE2 and what will its effect likely to be on the bond market and the U. S. dollar.**

**A: Quantitative Easing (“QE”) is a process by which the Fed buys Treasury bonds, with the aim of lowering borrowing costs.**

The Fed’s QE2 plan is the second such effort since the recession began. The program began last week. But so far it isn’t working. Bill Gross, manager of the world’s largest bond fund, had warned that the Fed’s plan could have the opposite result, driving bond yields higher (bond prices lower). And indeed, bond yields have been rising and prices falling since early September when the Fed first hinted of providing the stimulus.

The rise in borrowing costs could have a negative effect on the economy rather than the positive stimulus effect the Fed anticipated. For example, it could increase mortgage rates, instead of lowering them. It was also expected that QE2, with the Fed printing billions of dollars to finance its big bond purchases, would result in the dollar extending its decline against global currencies. That was expected to be another positive for the U.S. economy, making U.S. exports to other countries less expensive and prices of imports from other countries more expensive.

And indeed, the initial reaction to the Fed’s announcement a couple of weeks ago was an immediate resumption of the dollar’s decline, the dollar reaching a new low. However, the downside reaction so far has been short-lived, at least short-term, with the dollar having rallied off that low.

So, we have bonds and the dollar defying the Fed’s QE2 intentions, neither moving in the direction the Fed intended to provide additional stimulus for the economy. The saving grace may be that recent economic reports indicate the economic recovery may be getting back on track on its own and may not need more stimuli.

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