KAM COMMENTS

KRUSE ASSET MANAGEMENT, LLC

SELL IN MAY AND GO AWAY?

For our Q3, 2011 newsletter, I wrote about “Sell in May and Go Away.” At that time, the market had rallied in the 1st quarter, peaked in mid-April and then come off its highs (down over 20%) by October. This Wall Street axiom would suggest that traders should now be ready to re-enter the market. (Incidentally, this is a similar pattern that happened in 2010.)

Since those lows October lows, the S&P has rallied 28% — 12% in Q1, 2012 — but has since started a pull-back again, 9.5% so far. So, is it time to “Sell in May…,” again?

The question is are you an investor or are you a trader? An investor:

- Does not make short-term decisions based on non-fundamental data — anything less than 3 years should be considered short-term.
- Does not have to make two correct decisions: when to get out, and also, when to get back in.
- Tends to do better than those who try to “time” the markets.
- Expects that there will be market pull-backs along the way — it happens just about every year, so it shouldn’t be a surprise or even frightening to anyone.
- Allocates their portfolio so that they can withstand these anticipated slides.

That said, if you could miss a 20% slide in the market, wouldn’t that be the best of both worlds? Yes, which is why Kruse Asset Management has been doing some promising macroeconomic research that looks for leading economic indicators that could point to turbulent markets. While this research is not completed, initial indicators would point to an up-market a year from now.

Be on the lookout for future development of these models that will continue to help slant that odds in your favor.

- JSK, CFA

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May 15th, 2012

Did you know?

* 10.5% is the average percent of household income that it takes to afford a house today — the lowest in over 35 years.
* Unemployment for college grads or greater is around 4.2% (less than high school is 12.9%).
* 18% of the world’s oil supply goes through The Strait of Hormuz (Iran).
* The U.S. produces 11% of the world’s oil (topped only by Russia and Saudi Arabia both at 12%).

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Principles that Outperform!

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Make it a Great Year!

Q1, 2012 FIXED INCOME RECAP

The headlines during the first quarter of the year were more and more equity related as the stock markets continue to move higher. Within the fixed income market, rates witnessed modest movement but ended up mostly unchanged. Two notable items which quietly occurred I will briefly touch on: Supply and High Yield Bonds.

First we had an avalanche of supply come into the corporate bond sector. As more and more investors clamored for high quality paper and better returns then current United Stated Treasuries, the corporate sector awoke. With companies now once again willing and able to sell bonds and with the historically low yields in the market place, corporations ran to the markets to refinance old debt or to issue new debt, at these once in a life time levels. The investing community's appetite was there and the market never once flinched. With Europe in turmoil and U.S. Government Debt issues, bond funds, investors and pension funds all gobbled up this supply, leaving the corporate balance sheets even stronger. This has narrowed the spread between corporate bonds and U.S. treasuries to historically narrow level s.

The last item I will mention is the continuing rally in the high yield sector. As the economy continued to improve and the equity markets rallied we continued to see the B-BB paper move higher. Finally reaching a point now where a majority of this paper is at or near their call levels. The two advantages to owning this paper in the past were the high coupons and also the potential for capital gains as the paper was generally trading at a discount to par and/or call levels. We are at a point now where a majority of these issues now don't have the capital gain potential as before, since they have reached their bond call levels but still have the advantage of higher rates. Being at, or near, these levels won't mean these bonds will be called (remember these still are companies on credit alert and will need their cash). Calling their paper and issuing new paper at market price, isn't a viable option right now; however, bonds generally won't trade much higher than their call level no matter where rates go. Good for investor already involved in this asset class, but not so for new investors.

Where does this lead us for the next few quarters? If we follow the trend of the past few years, the first quarters have seen a pullback in rates followed by rallies entering the spring/summer. With Europe still in a mess, the need for safety will remain. U.S. treasuries still see demand every time there is a pullback in rates. This shouldn't change. A ten year in the 2.25% range still is attractive to institutions for liquidity and safety concerns. Without any inflation premium priced into U.S. Bonds, one will have to watch their duration exposure very closely, if and when inflation takes a hold. Be nimble and careful at these interest rate levels; Europe's situation will still be a major concern.

— Matt Kraus