WELCOME!

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NAVIGATING THE MARKETS

THE LESSONS OF HISTORY

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The Peter Dag Portfolio

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2009 Timer of the Year

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THE PETER DAG PORTFOLIO

- **TWICE A MONTH – 17-20 PAGES**
- **MARKET UPDATE (weekly)**

THE QUESTION I ASKED MYSELF

WHAT ARE THE MOST IMPORTANT LESSONS I LEARNED IN THE PAST 30+ YEARS OF MANAGING MONEY?

DOES “LONG-TERM” MEAN ANYTHING?

- THE ANSWER DRIVES MY STRATEGY
- BUSINESS CYCLE GIVES A SENSE OF “LONG TERM”
- PERFORMANCE OF ASSET CLASSES AND TIMING

FLEXIBILITY AND THE IMPORTANCE TO KEEP ASKING "WHAT IF"

THE FOCUS
OF MY RESEARCH
IN THE PAST 30+ YEARS

- **RELATIONSHIPS BETWEEN ECONOMIC AND FINANCIAL TRENDS AND INVESTMENT STRATEGY**

- **MINIMIZE THE VOLATILITY OF RETURNS**

THE OBJECTIVE

TO ESTABLISH GUIDELINES ON

- WHEN TO BUY
- WHEN TO SELL
- HOW MUCH

MAIN APPROACH

THE BUSINESS CYCLE

DRIVES

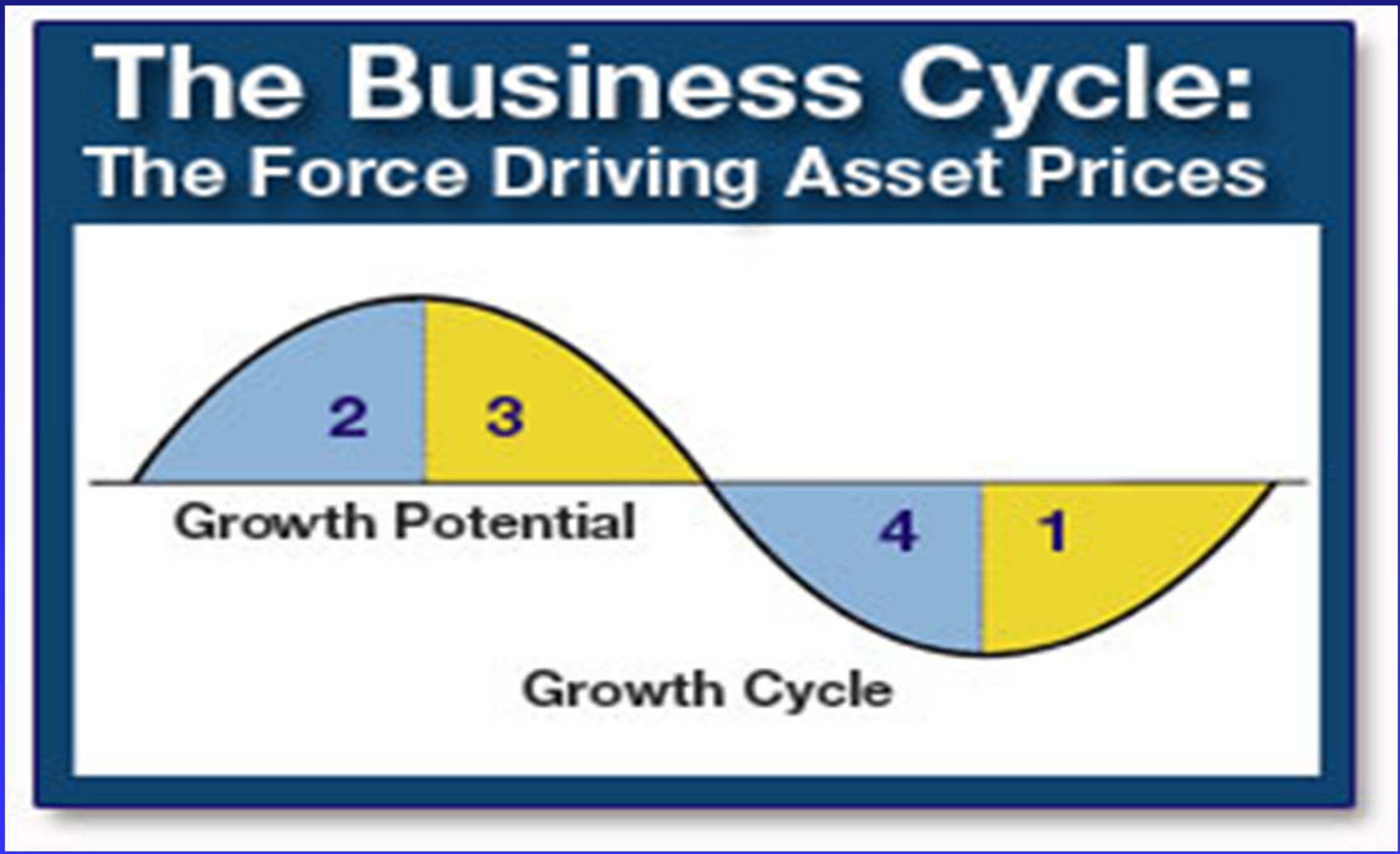
ALL ASSET PRICES

BUSINESS CYCLE

(DRIVEN BY BUSINESS DECISIONS)

ABOVE AVERAGE GROWTH OR BELOW AVERAGE GROWTH DRIVE ASSET PRICES (COMMODITIES, HARD ASSETS, INTEREST RATES, STOCK PRICES, PROFITS,CURRENCIES)

THE IMPORTANCE OF FEEDBACK



MAJOR HISTORICAL PATTERNS

WHAT HAPPENED 1969-1982

- WAR
- GREAT SOCIETY
- EASY MONEY
- LOW REAL INT. RATES
- COMMODITIES – INFLATION
- INTEREST RATES

WHAT HAPPENED 1982-1998

- LOWER INFLATION
- LOWER INTEREST RATES
- HIGH REAL INT . RATES
- BABY BOOMERS

WHAT HAPPENED 1998-2011

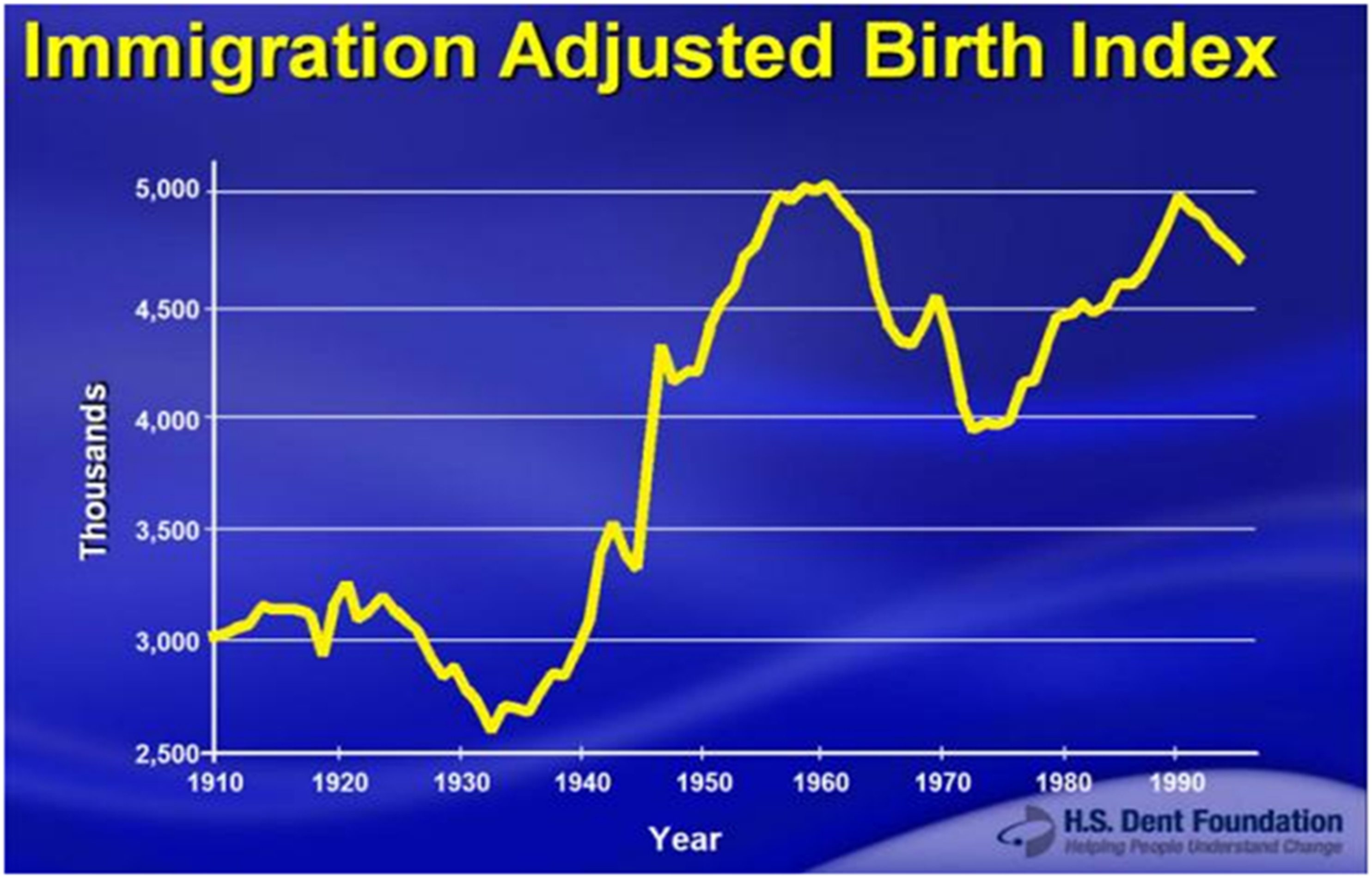
- TECH AND HOUSING BUBBLES
- AGING OF BABY BOOMERS
- LOW INTEREST RATES
- LOW REAL INT. RATES
- BOOMING COMMODITIES

DEMOGRAPHICS

- THE POLITICIANS TAKE CREDIT OF THE STRONG ECONOMY WE ENJOYED DURING 1980-2000.
- THEY COULD DO NO WRONG.
- THE BIG SPENDERS (45-50 Y/O) WERE GROWING RAPIDLY, PROPELLING THE ECONOMY.

DEMOGRAPHICS

(Source: HS Dent)

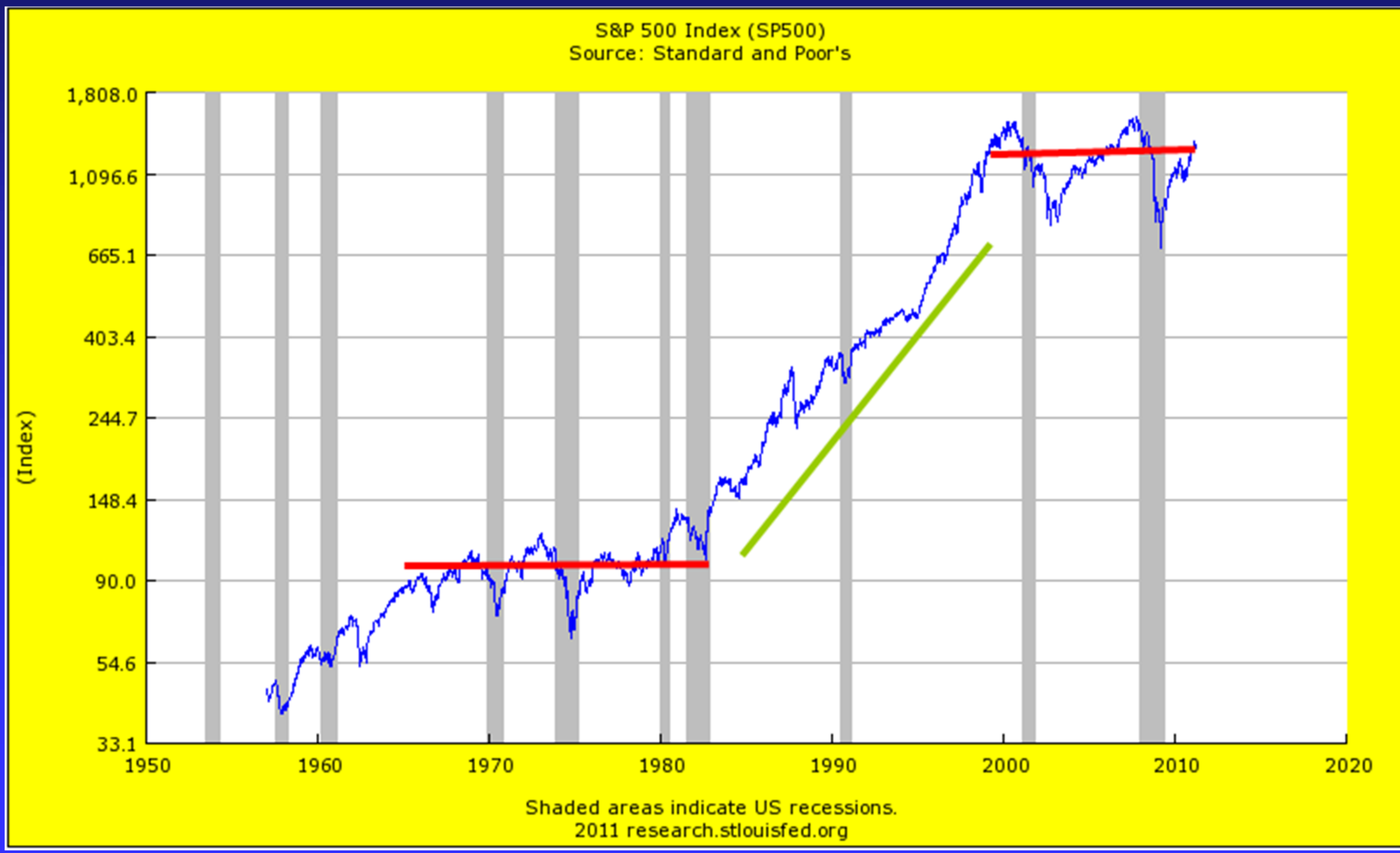


Immigration Adjusted Birth Index

CLOSE ✕

S&P 500: "LONG-TERM"

THE REAL WORLD:20 UP 23 FLAT



…. AND NOW

THE TACTICAL

FACTS

THE MOST IMPORTANT INDICATOR: SHORT-TERM INT. RATES

- I AM GOING TO DISCUSS THEIR MEANING
- WHAT DRIVES THEM
- HOW TO USE THEM TO DEVELOP AN INVESTMENT STRATEGY TO WITHSTAND MOST MARKET CONDITIONS

S-T INTEREST RATES

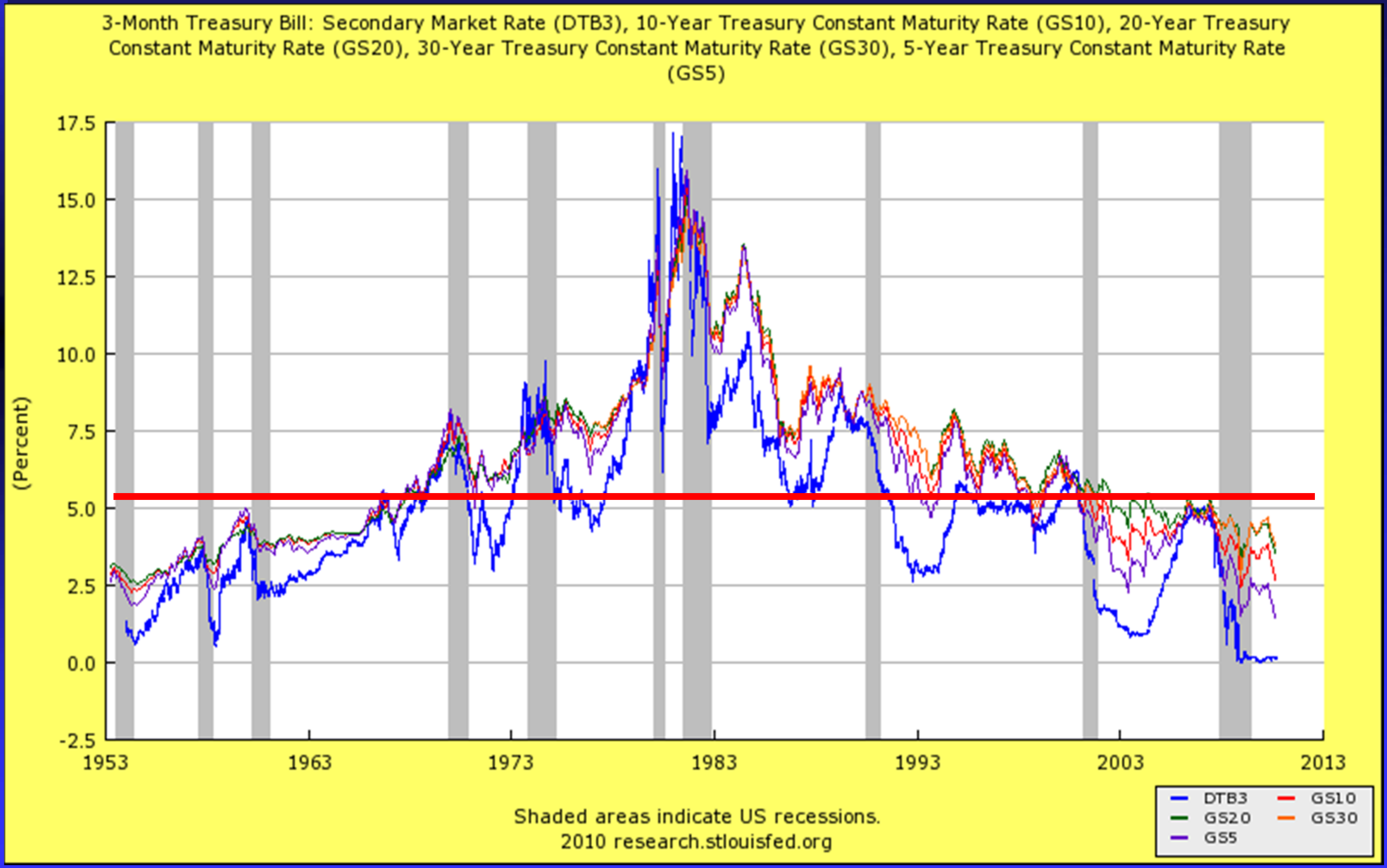
- INTEREST RATES ARE THE FEVER CHART OF ANY ECONOMY
- 5% IS THE GOLDEN MEAN

SHORT-TERM INTEREST RATES

THE MOST IMPORTANT INDICATOR

BECAUSE THEY TELL YOU ABOUT RISK AND WHICH ASSETS YOU SHOULD USE TO MAKE MONEY

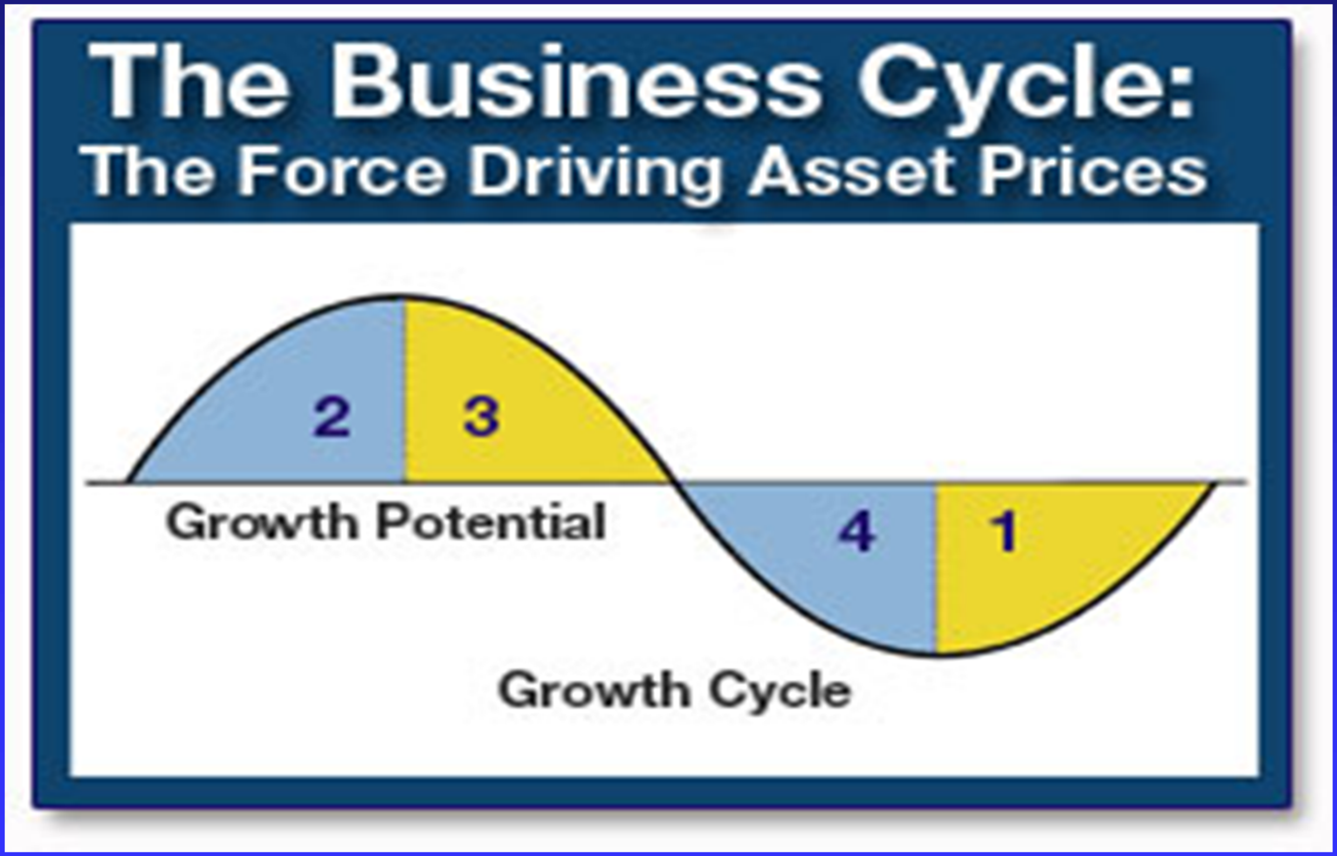
INTEREST RATES



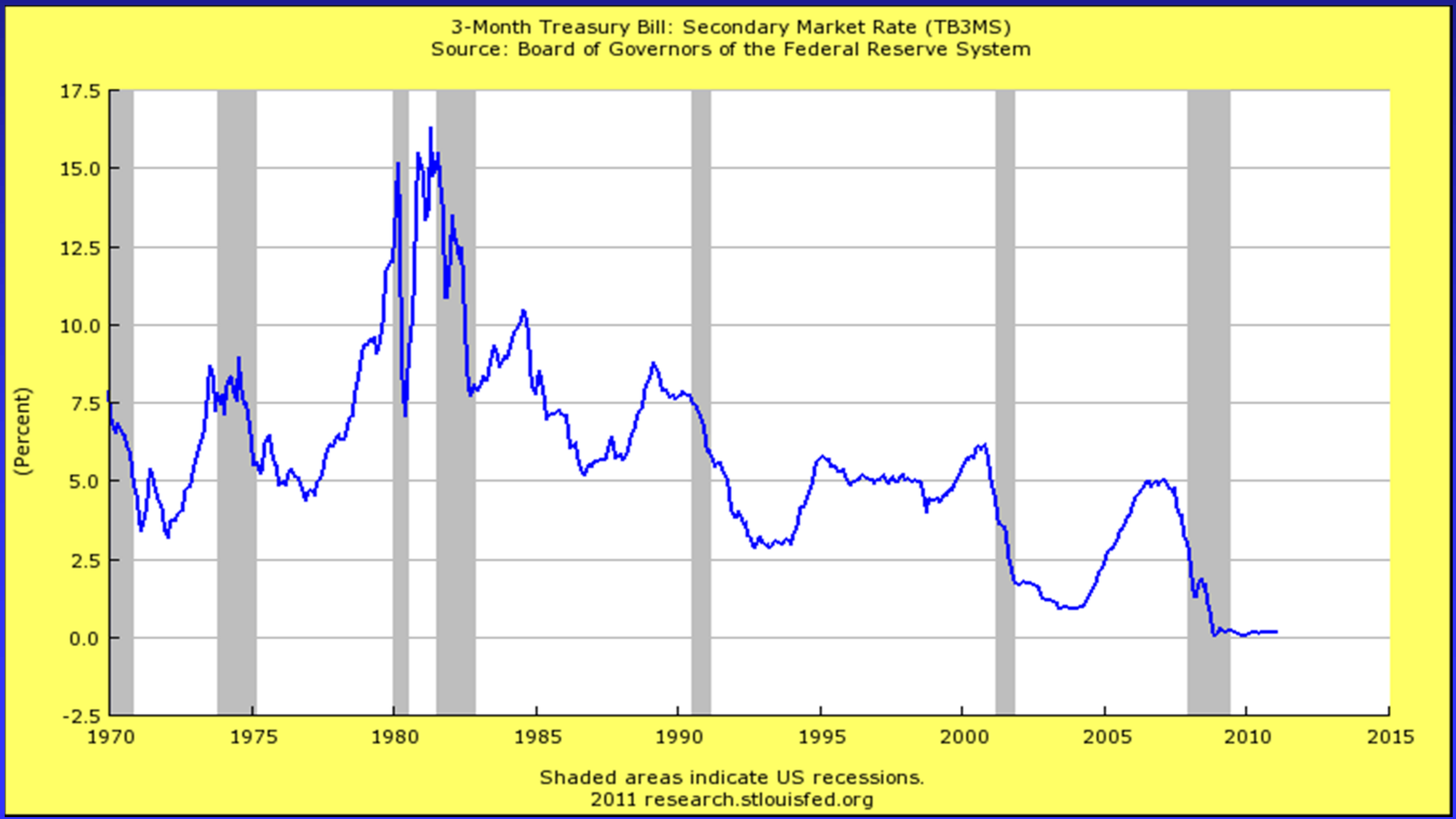
COMPARE SHORT-TERM INTEREST RATES TO …

- …BUSINESS CYCLE
- … INFLATION
- … BONDS
- … COMMODITIES
- … EARNINGS
- … STOCKS

BUSINESS CYCLE



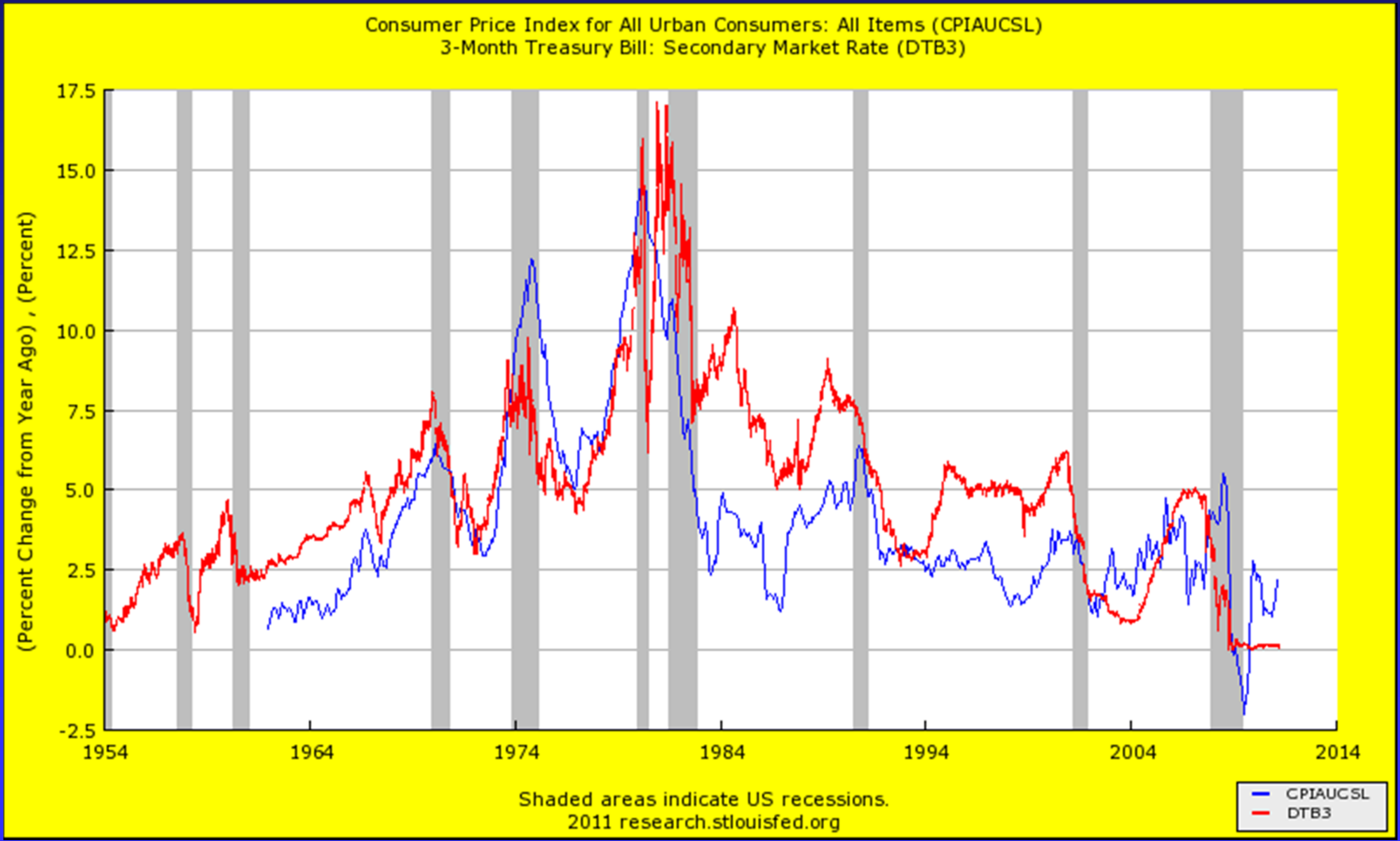
SHORT-TERM INTEREST RATES AND THE BUSINESS CYCLE



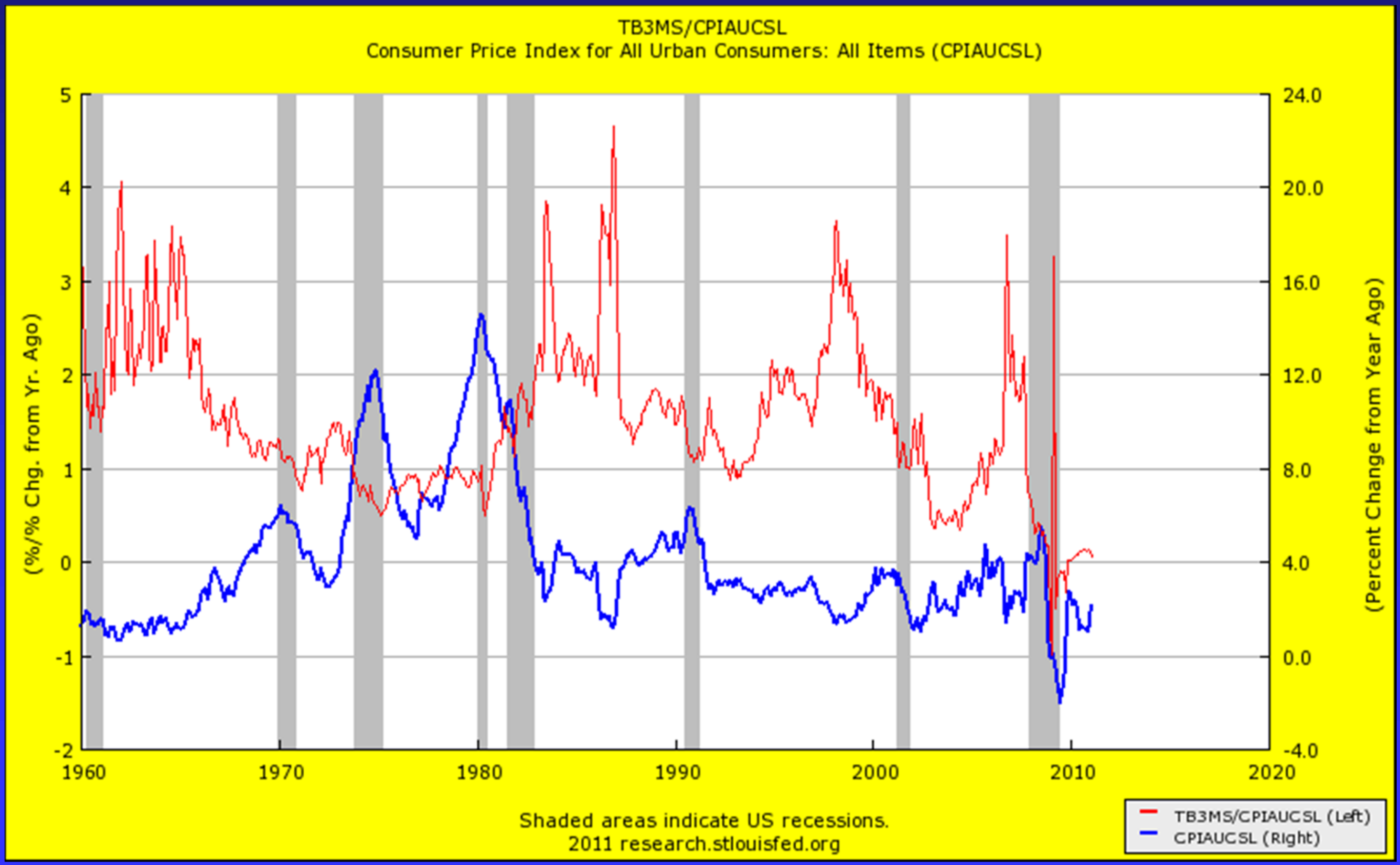
S-T INTEREST RATES AND INFLATION

- INTEREST RATES/INFLATION RISE AFTER A PERIOD OF STRONGER ECONOMIC GROWTH
- INTEREST RATES/INFLATION DECLINE AFTER A PERIOD OF SLOWER ECONOMIC GROWTH
- LOW REAL INTEREST RATES ARE INFLATIONARY

INTEREST RATES, INFLATION, AND ECONOMIC GROWTH



SHORT-TERM INTEREST RATES AND INFLATION



REAL INTEREST RATES

HIGH INFLATION

RELATIVE TO S-T INTEREST RATES

IS A SIGN OF

CHEAP MONEY AND

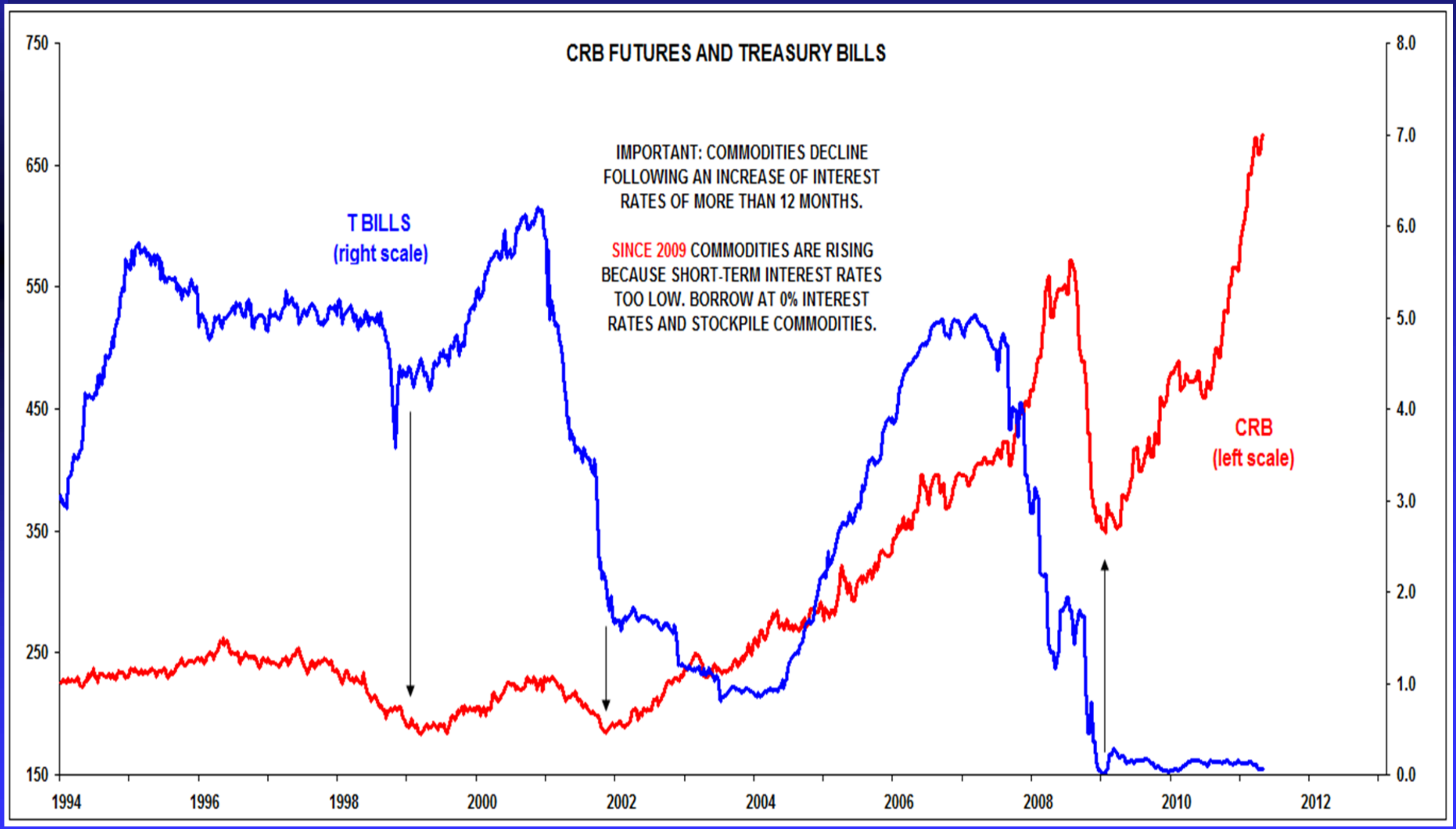
INFLATIONARY

SHORT-TERM INTEREST RATES AND COMMODITIES

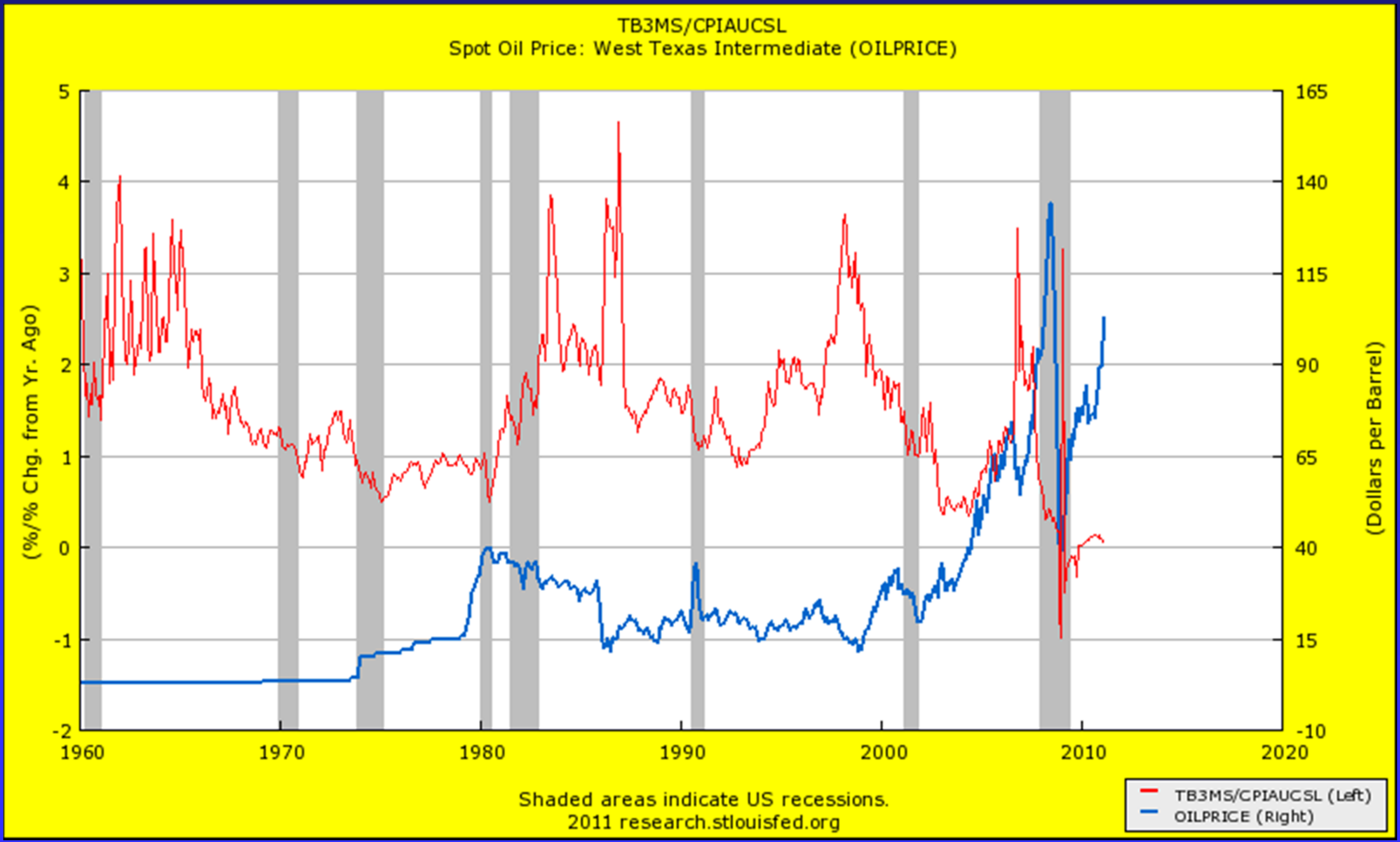
- **COMMODITIES RISE AFTER A LONG DECLINE IN INTEREST RATES**
- **A LONG RISE IN INTEREST RATES ANTICIPATE A PEAK IN COMMODITIES**

ASSUMPTION: COMMODITIES RESPOND TO LEVELS AND TREND OF S-T INTEREST RATES

SHORT-TERM INTEREST RATES AND COMMODITIES



REAL INTEREST RATES AND COMMODITIES



BONDS

YOU BUY BONDS FOR CAPITAL APPRECIATION NOT FOR INCOME

BONDS
THIS IS HOW IT WORKS

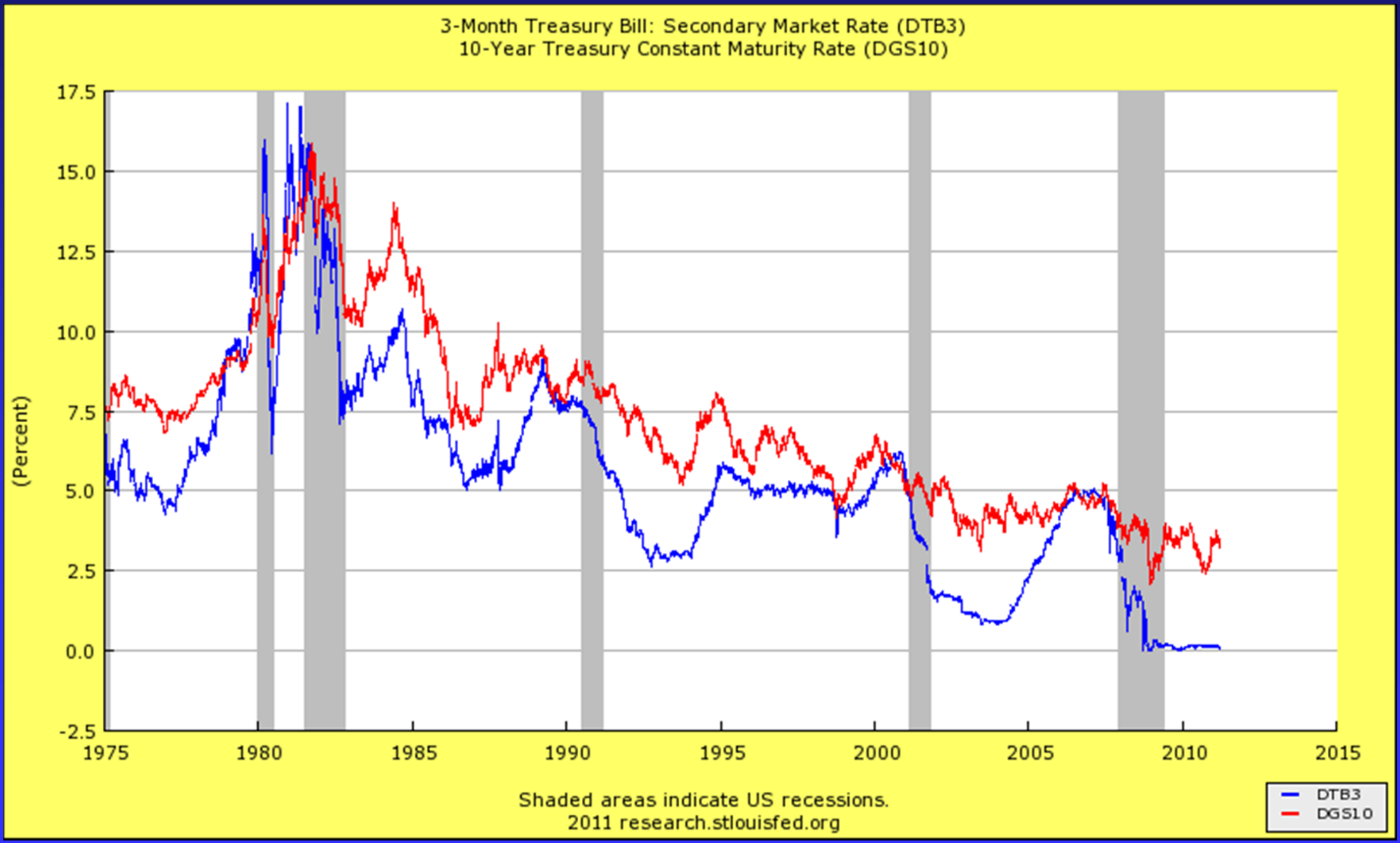
- INTEREST RATES: 2.5%
- $100 BOND HAS TO HAVE COUPON OF $2.5
- INTEREST RATES DECLINE TO 2.0%
- NEW BOND PRICE: $125 ($2.5/$125=2.0%)
- GAIN: 25% + COMPOUNDING INTEREST OF BOND

SHORT-TERM INTEREST RATES AND BOND YIELDS

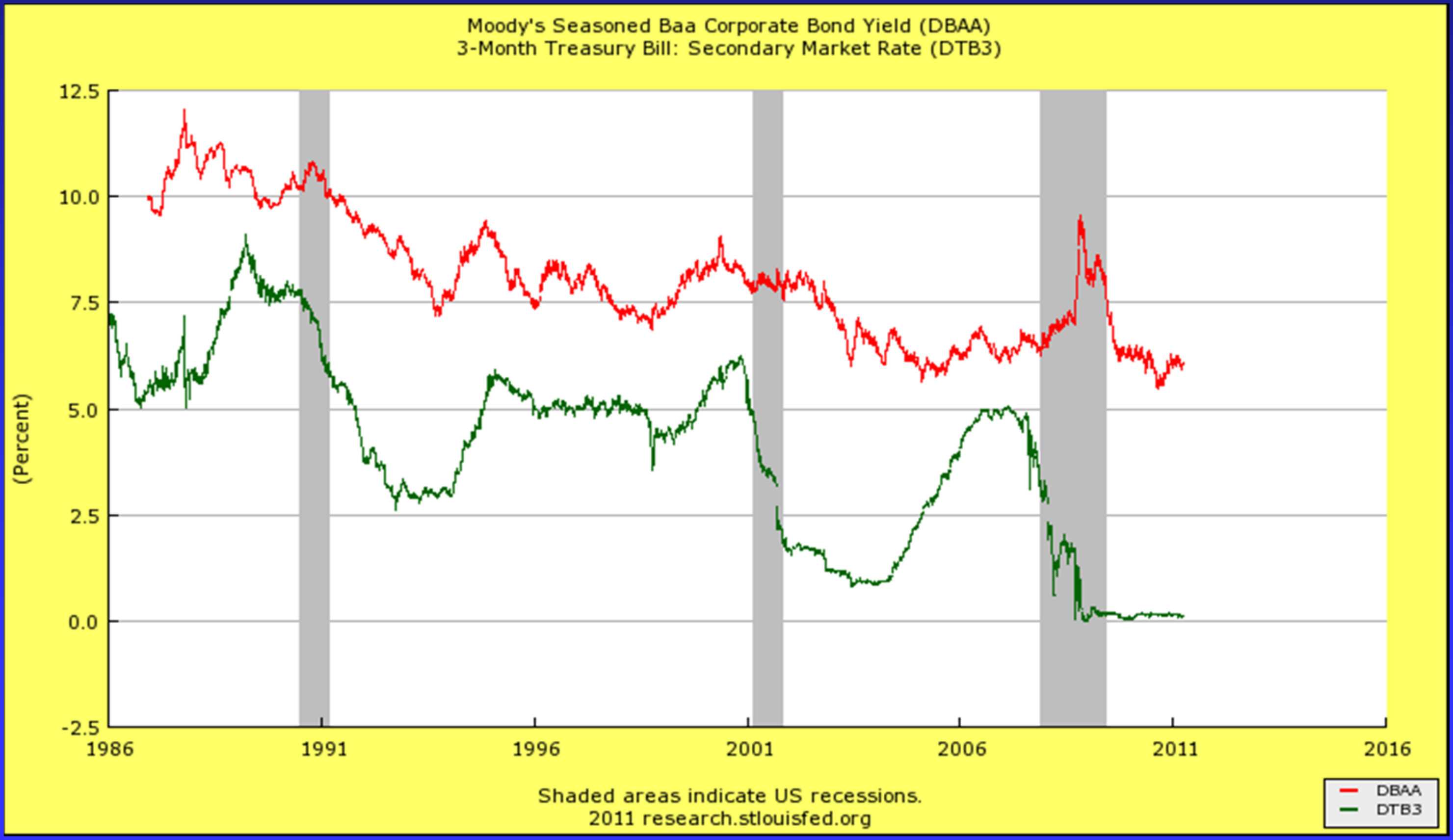
- **BOND YIELDS RISE WHEN S.T. INTEREST RATES RISE**
- **BOND YIELDS DECLINE WHEN S.T. INTEREST RATES DECLINE**

PS. BONDS RETURNS CHANGE WITH DURATION, QUALITY, AND LIQUIDITY (CHAPTER 9 MY BOOK)

SHORT-TERM INTEREST RATES AND TREASURIES



SHORT-TERM INTEREST RATES AND CORPORATE BOND YIELDS



SHORT-TERM INTEREST RATES AND CORPORATE BOND YIELDS

- FROM 1983 TO 2010 AAA YIELDS DROPPED FROM 12.5% TO 5.0%.
- NEW BOND PRICE: $250 (ASSUME PRICE OF $100 IN 1983)
- ADD COMPOUNDING INTEREST FOR 27 YEARS

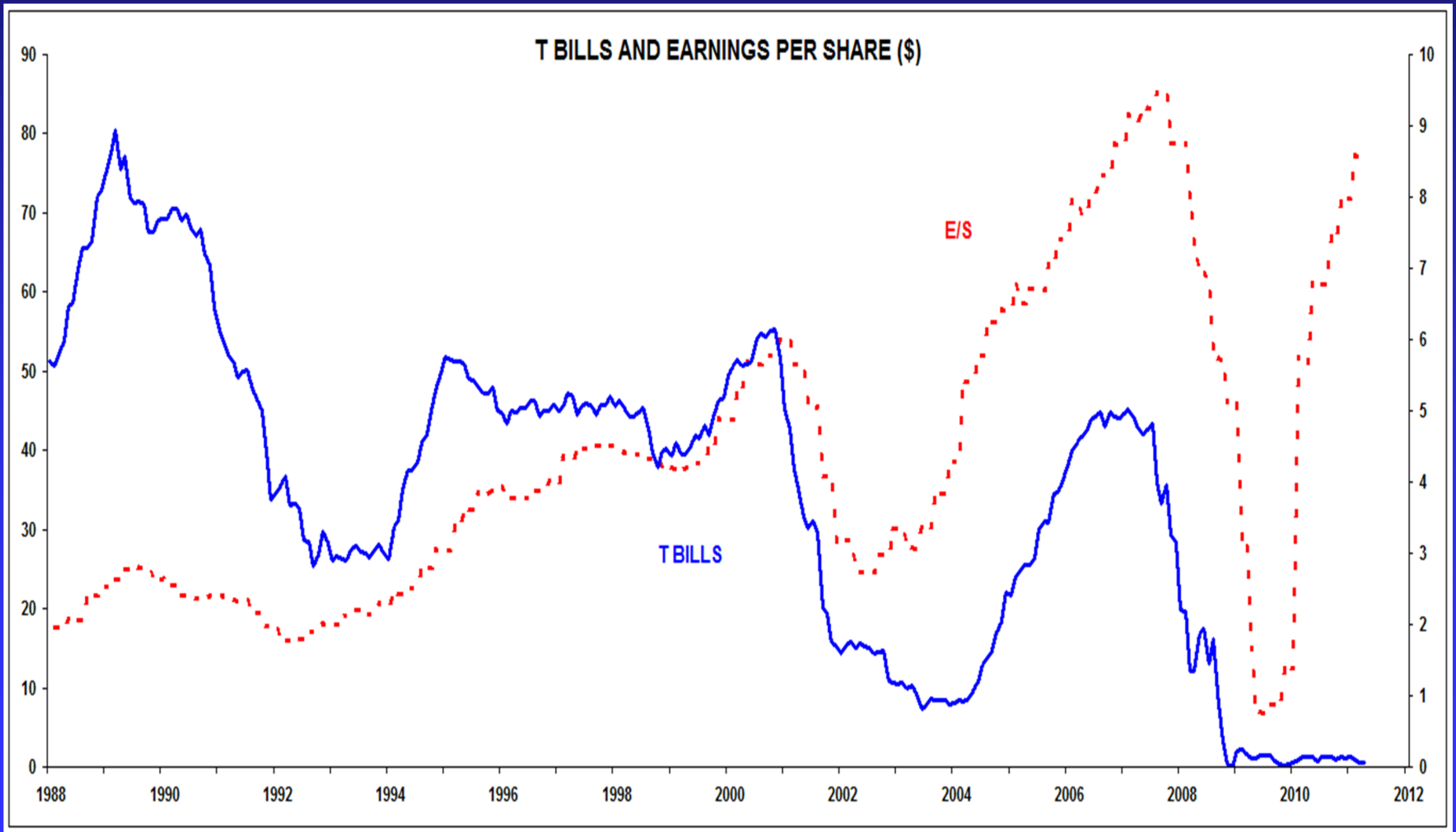
EARNINGS PER SHARE ARE CLOSELY RELATED TO …

- BUSINESS CYCLE
- S-T INTEREST RATES
- COMMODITIES
- … AND STOCK PRICES

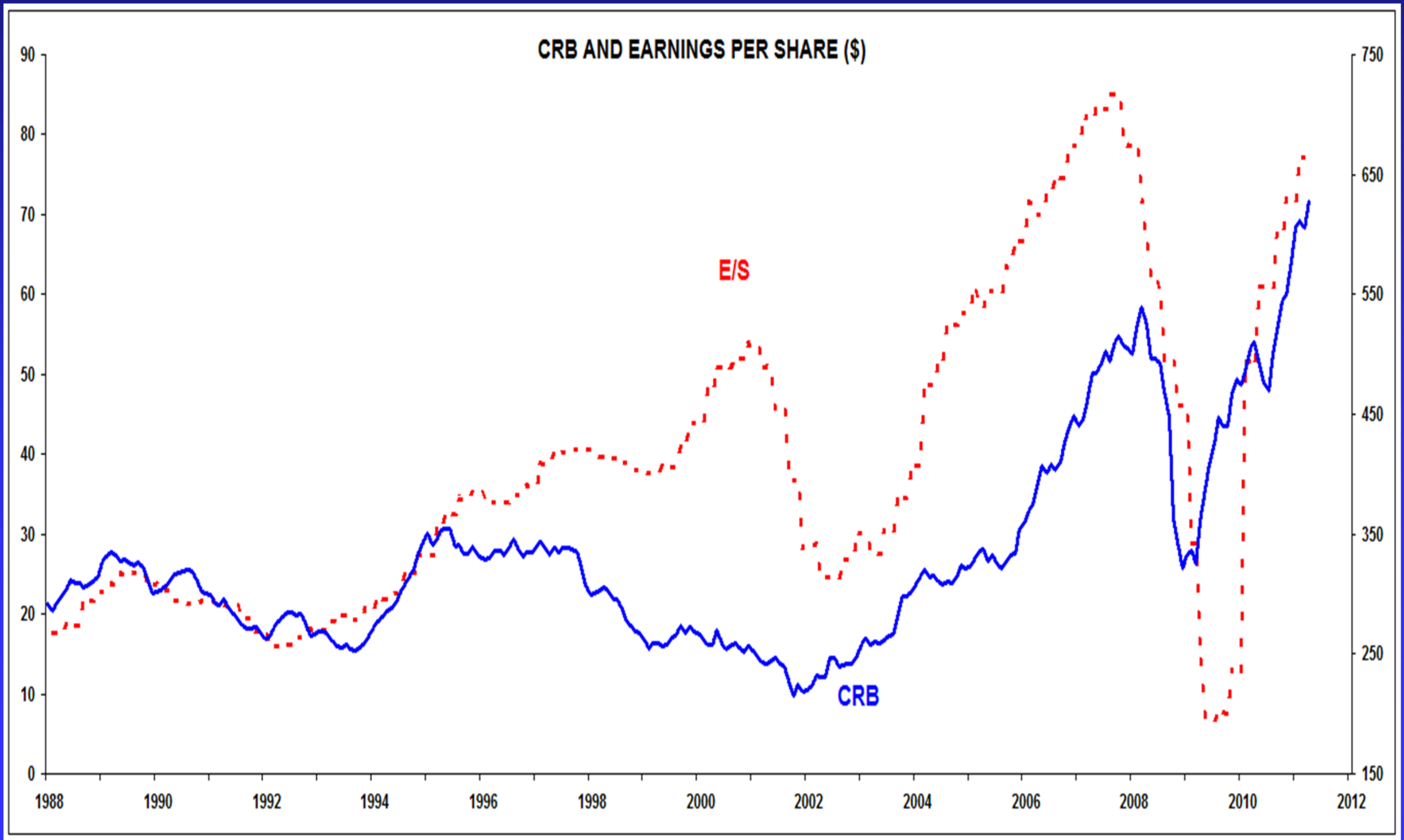
EARNINGS PER SHARE AND BUSINESS CYCLE

- E/S RISE FASTER WHEN THE ECONOMY STRENGTHENS
- E/S SLOW DOWN WHEN THE ECONOMY SLOWS DOWN

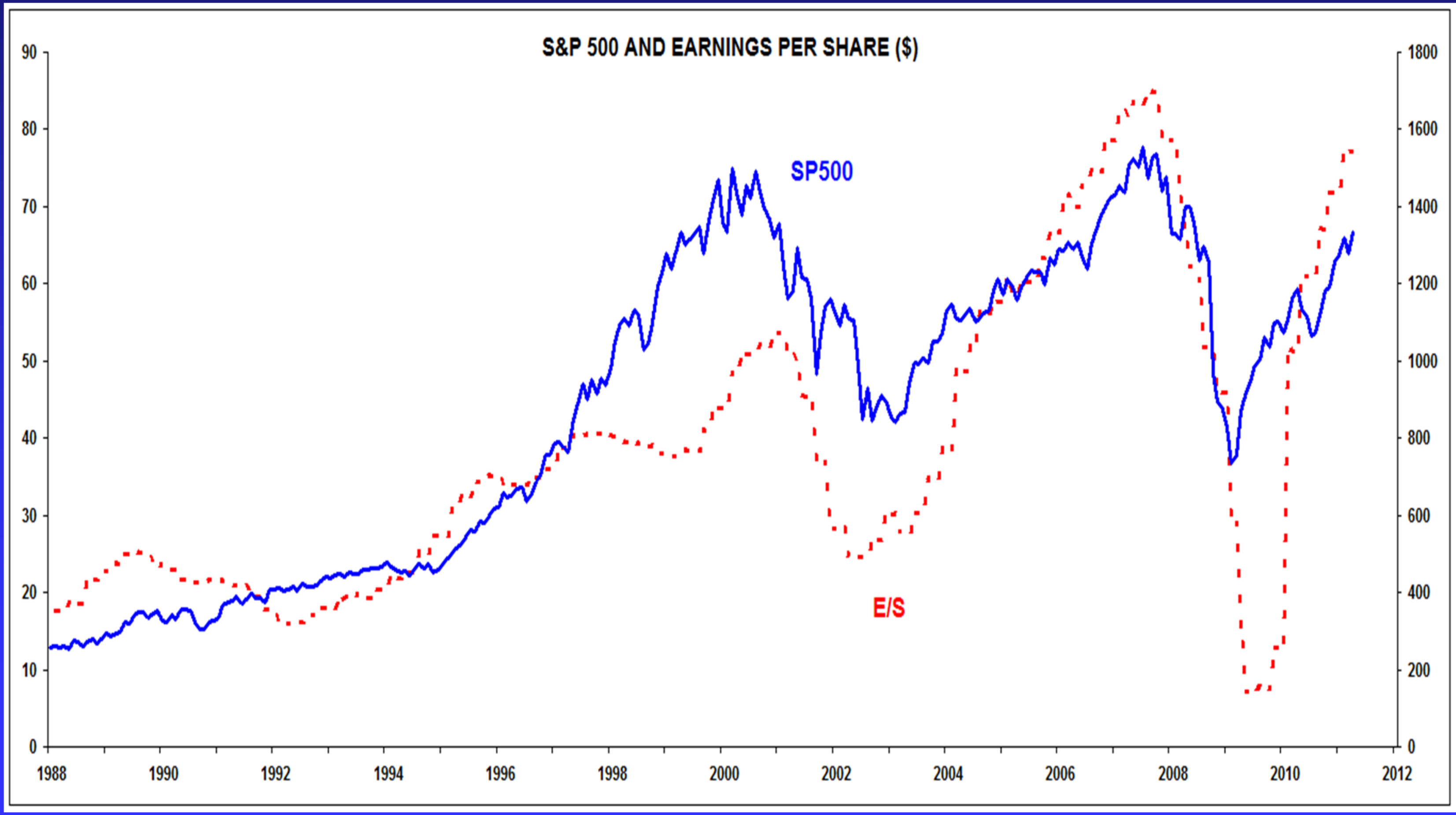
S-T INT. RATES AND E/S



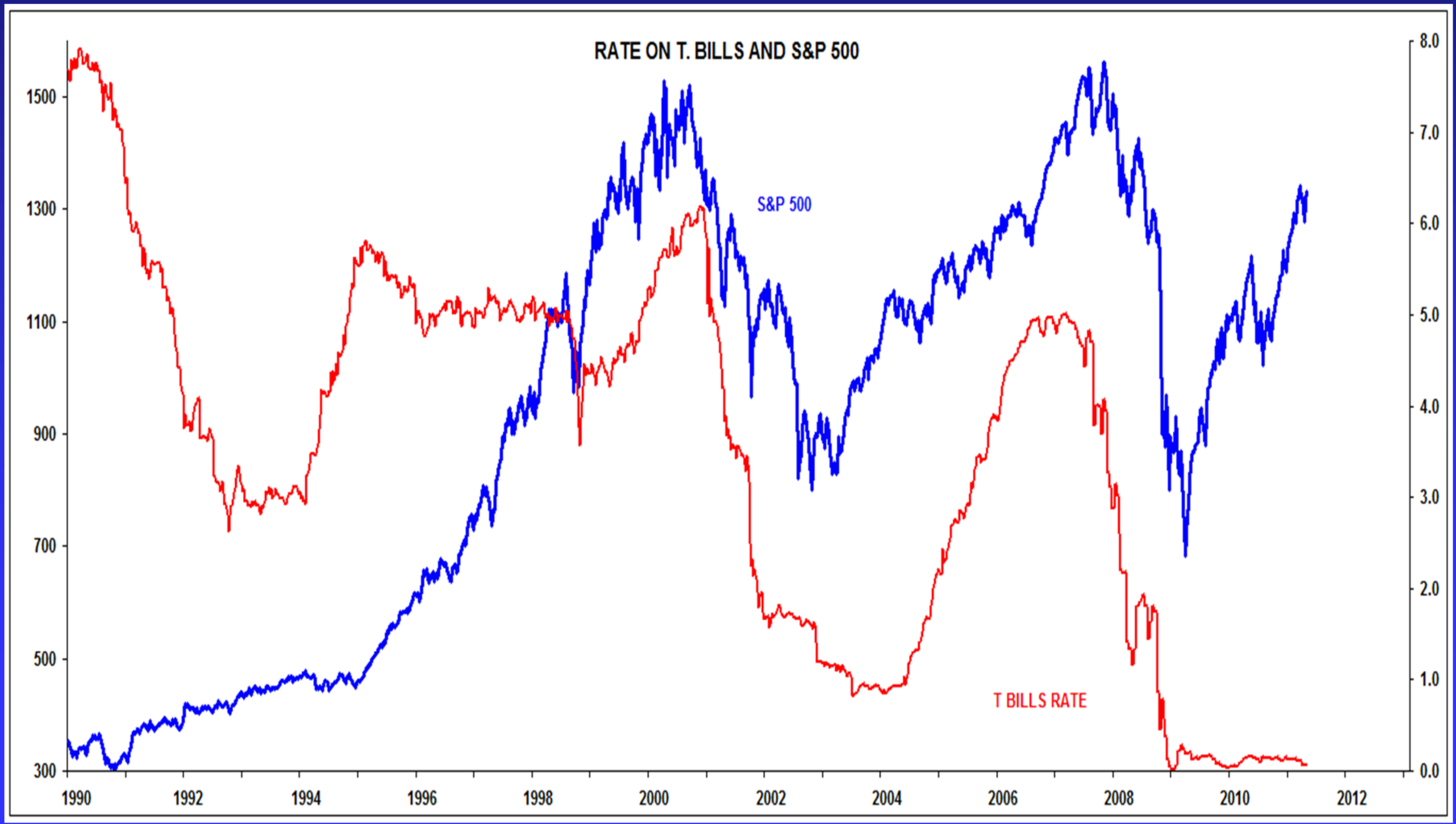
E/S AND COMMODITIES



E/S AND STOCK PRICES



SHORT-TERM INTEREST RATES AND STOCK PRICES



SHORT-TERM INTEREST RATES AND STOCK PRICES

- **STOCKS PEAK FOLLOWING A RISE IN S-T INTEREST RATES**
- **STOCKS BOTTOM FOLLOWING A DECLINE IN S-T INTEREST RATES**

INTERESTING

BUSINESS CYCLES,

SHORT-TERM INTEREST RATES,

BOND PRICES,

COMMODITIES,

STOCKS

ARE ALL TIED TOGETHER

THE PROCESS

- SLOWDOWN
- LOWER IN.RATES, COMMODITIES, INFLATION, PROFITS
- PROFITS, PURCHASING POWER IMPROVE
- SPENDING, INT. RATE, COMMODITIES, STABILIZES
- ECONOMY STRENGTHENS
- RISING INTEREST RATES , COMMODITIES, INFLATION
- DECLINING PURCHASING POWER, PROFITS ………..SLOWDOWN

THE BUSINESS CYCLE TIES THESE IDEAS TOGETHER
(WITH LEAD/LAGS)

- **STRONGER ECONOMY: RISING INTEREST RATES, COMMODITIES, E/S, INFLATION, …**
- **WEAKER ECONOMY: DECLINING INTEREST RATES, COMMODITES, E/S, INFLATION….**

SECTORS FOR A WEAK ECONOMY AND BEATING THE S&P 500

- HEALTH SERVICES
- INSURANCE
- BANKS, REGIONALS
- BROKERS
- REAL ESTATE/REITs/TRUSTS
- PRIVATE EQUITY
- DEFENSE

SECTORS FOR A STRONG ECONOMY AND BEATING THE S&P 500

- METALS AND MINING
- ENERGY
- MACHINERY
- ELECTRONICS, INTERNET
- COMPUTER SOFTWARE & SERVICES
- CONGLOMERATES

ETF SECTORS

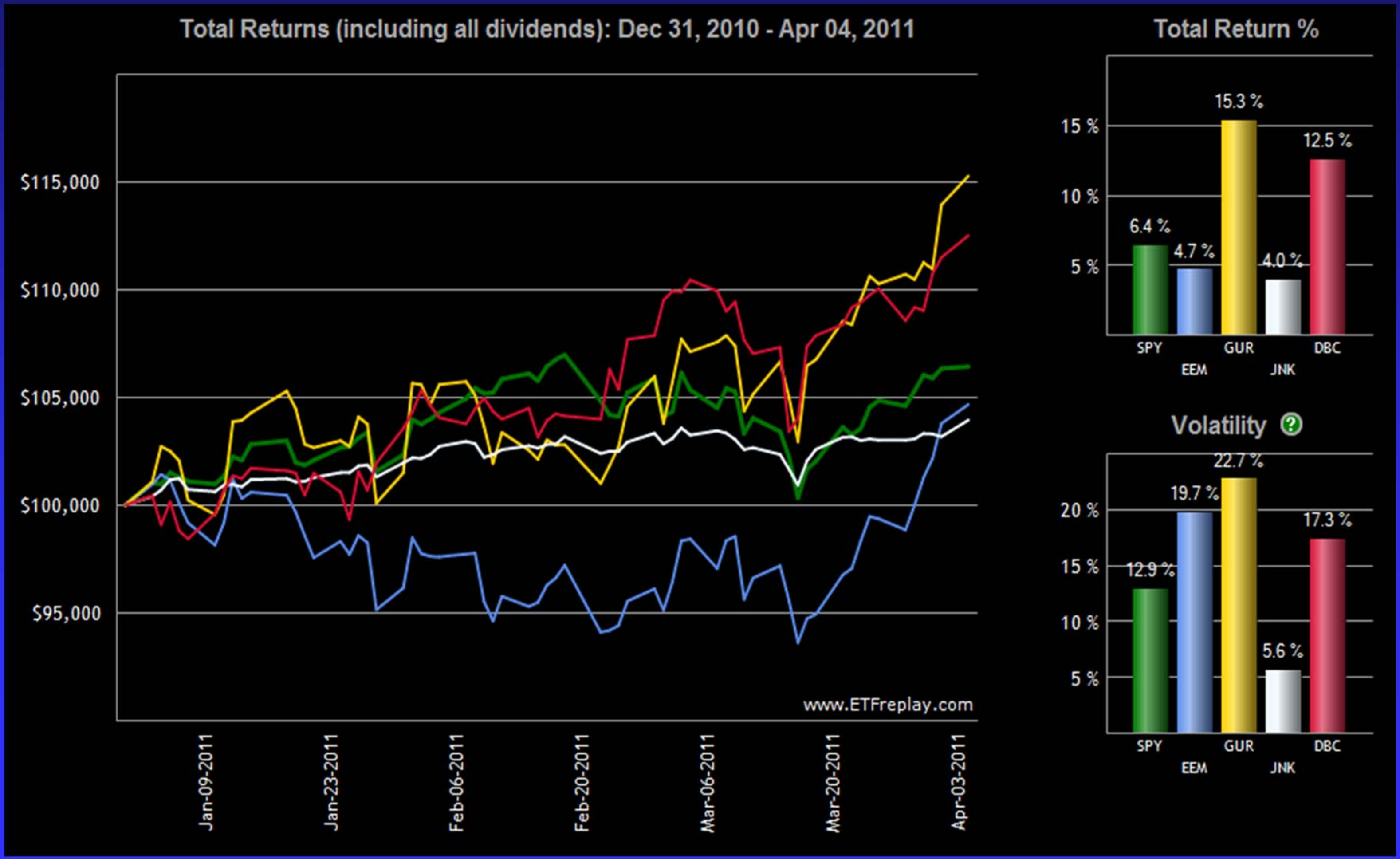
- <u>FINANCIALS</u> (WEAK ECONOMY)

-- XLF, KRE, IYR, KIE, PSP, PPA, JNK, LQD

- <u>CYCLICALS</u> (STRONG ECONOMY)

-- XLI, XME, XLB, XLE, XLK, GLD

EMERGING MARKETS



WHY MOMENTUM WORKS

- MOMENTUM REFLECTS CHANGES IN THE ECONOMY, MANAGEMENT, MARKET.
- THESE CHANGES LAST FOR A LONG TIME
- BUT YOU HAVE TO WATCH FOR THE LOSS OF MOMEMTUM
- HORSE RACE

THE FOLLOWING THOUGHTS ARE PROBABLY THE MOST IMPORTANT LESSONS I LEARNED IN 30+ YEARS IN THIS BUSINESS

THOUGHTS #1

- IS YOUR PORTFOLIO INCREASING IN VALUE?
- IS YOUR CHOICE OF SECTORS THE CORRECT ONE?
- NO? START REDUCING EXPOSURE TO WORST PERFOMING POSITIONS AND ADD TO THE BEST PERFORMING ONES
- USE FAN CHARTS AND 40-WEEK M.A. TO COMPARE PERFORMANCE/SELLING

THOUGHTS #2

- AVOID ASSET CLASSES NOT IN TUNE WITH THE BUSINESS CYCLE
- DIVERSIFICATION = INDEXATION = AVEARAGING DOWN = LONG-TERM=NONSENSE
- ONCE YOU LOSE, YOUR MONEY IS GONE. CONCENTRATE ON WHAT TO DO NEXT.

THOUGHTS #3

- USE TIMING TOOLS TO KEEP FOCUSED
- MANAGE THE MARKET VALUE OF YOUR PORTFOLIO, NOT EACH POSITION
- MOMENTUM WORKS - SELL WEAK & BUY STRONG POSITIONS (GRADUALLY)
- USE HEDGING TECHNIQUES ("SH" INSTEAD OF CASH)

THOUGHTS #4

- NOONE KNOWS THE OUTCOME OF POLITICAL, SOCIAL, ECONOMIC DECISIONS.
- HISTORY IS RANDOM – THIS IS THE REASON WE SEEM TO REPEAT THE SAME MISTAKES.
- GOVERNMENTS SHOULD SET THE RULES OF THE GAME AND NOT BE A PLAYER.

THOUGHTS #5

- ALL THE PHDs, NOBEL PRIZES, AND SO CALLED EXPERTS IN WASHINGTON---YET THIS CENTURY HAS BEEN PLASTERED WITH DEPRESSIONS(1930s), RECESSION & INFLATIONARY PERIODS (1970s), WARS (1910-2010), AND BUBBLES OF ALL TYPES (2000s). WHY DO WE NEED THEM?
- RELY ONLY IN YOURSELF

THOUGHTS #6

POWER AND WEALTH
ARE THE ULTIMATE OBJECTIVE
OF THE GAME

THANK YOU!

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