<u>Conventional wisdom.</u> **Indexation**. What a marvelous investment strategy. A giant in the mutual fund industry sold us the concept. An easy formula based on the fact that you cannot outperform the averages. Therefore, forget about volatility and risk management and invest in an average.

Recent market history has shattered all these easy investment rules. Because of the strength of the technology groups, all indexes have included a large amount of these stocks. The outcome has been a sharp decline in the averages because of the collapse of the technology group.

The market declined close to 17% this year, while the majority of stocks rose. The advance-decline line has been in a solid up trend since late 2000. (The graph of the advance-decline line is shown on the Internet version of this advisory, free for our subscribers.) This trend has been confirmed by the gains of many mutual funds emphasizing value strategy.

Another formula-based way of investing is "**averaging down**". The idea behind it is to keep investing money as the market or stocks decline. I am sure that those who were heavily invested in technology in the past two years found out that this strategy was a license to go bankrupt. Besides, where could you find the money to invest when stocks decline more than 50%?

"Yes, what you are saying is right, but I am a **long-term investor**". This is another great idea. It is based on the fact that the market produced a return of close to 7% in capital gains and 3% in dividend yield – 10% total return. The problem with this formula is that the market rose 20% half of the time since the beginning of this century. The other half showed little or no gains. The average of these two periods has been 10%. (Please see my book for more statistics on this subject).

The main issue for investors is to determine in which one of the two periods we are now. Being a long-term investor was not a great strategy from 1968 to 1982 because the market was absolutely flat during those years.

My point is that there is no easy formula. They eventually fail. I believe investors need to adopt a **flexible investment approach** based on the fact that **market risk** changes. By adapting the investment portfolio to the level of risk it becomes easier to manage the **volatility of returns**. Flexibility implies to be open-minded and accept the fact that no sector can outperform the rest of the market over the long term. This market has also taught that **value** eventually prevails.

This advisory attempts to implement these concepts. The fact that Hulbert singles us out as having a **low risk** money management style suggests we are successful in our endeavor.

10-29-01