

# **MDP ASSOCIATES LLC**

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## **INTERIM NEWSLETTER #3**

August 10, 2007

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### **Living with highly volatile markets**

I am in Branson, Missouri, near the end of a trip with my wife that has taken us to the national parks and other attractions in the western parts of the Dakotas. One effect of my travels is that this interim newsletter is later than it would have been if I were at home, and it may be shorter. On the other hand, being away from my computer and enjoying what this area of the country has to offer has the benefit of not paying attention to the violent fluctuations we have been seeing for the past couple of weeks. I think that is the best way to deal with these markets—don't get very worked up one way or another.

It seems that almost every day now the Dow moves at least 100 points, and often a lot more, in one direction or the other. The market seems like a manic depressive as it is worried about the effects of subprime mortgage defaults one day or giddy about the basic strength of the economy on others. It is helpful to keep things in perspective and not focus on the day-to-day movements. For example, as I write this on Friday morning, the Dow is down about 60 points, which is less than half a percent, for the week. Yesterday's 380 point drop wiped out most, but not all, of the gains the first three days of the week.

The Dow is down 6-7% from its high just above 14,000 in mid-July, but that is hardly a reason to get excited. Until recently, the markets have been less volatile than is typical as they have moved steadily upwards with the exception of a brief pullback in late February. As most talking heads point out, it takes a 10% drop to qualify as a "correction." In this case, they have the right idea.

I suspect that the volatility will continue. It shows that a lot of institutional investors are nervous and will make moves in either direction to avoid not being in synch with their peers. It is the old analogy of a herd of elephants trying to squeeze through a door at the same time. Fortunately, we don't have to be part of that herd. Also, it seems that the herd can't seem to figure out which side of the door they should be on, so they keep going through it one way and then the other.

My “solution” is to manage accounts and make investment decisions based on well researched formulas. I see nothing in the recent action to indicate that the formulas should not be followed because there has been an earthshaking change in the way markets and those who trade them operate.

There are three models I pay serious attention to when evaluating the markets in general, and I use two of them most often to manage accounts. Two are broad market indicators, and the other is designed to trade high technology indices such as the Nasdaq 100. One of the broad market models, Triple-40, gave a sell signal based on last Friday’s closing data, and I sold holdings in broad market funds on Monday. The other broad market model, Pentad, gives signals far less frequently—it has been on a buy signal for almost three years, so I tend not to apply it to managed accounts. It is also a weekly model, and it weakened last week and could give a sell signal this week. The model for trading the Nasdaq 100 index and related funds, called RutVol, gave a sell signal in July. All told, that means that accounts that trade other than sector funds or precious metals funds are on the sidelines now.

As far as sector fund trading goes, holdings depend on how aggressive the account is. The most conservative sector trading managed accounts, those in STAR (Sector Trading Adverse to Risk) which trades Rydex sector funds, have been totally in money market since late July. On the other hand, the ART (Aggressive Rydex Trading) accounts have remained fully invested in one fund at a time. Those accounts have held up well. The approach of buying a recently weak fund in anticipation of at least a brief recovery has worked well with the violent bounces the market has been taking.

My other sector trading uses the Fidelity Select funds. The more conservative accounts are now about half in cash as they sold one of the two funds they owned, Automotive, on Monday. They continue to hold Wireless as do the more aggressive accounts that are entirely in that fund. Until yesterday Wireless had not dropped very much from its peak a few weeks ago. However, it is now approaching the point where I may sell it using a trailing stop tactic.

In summary, I think your best course of action is not to pay much attention to the daily market fluctuations and find fun things to do. I will be seeing a couple of shows here in Branson later today.

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