Global Tactical Asset Allocation – Q3 2011
(Mutual fund investment strategy)

Friday's close marked the end of the third quarter of 2011; a quarter in which substantial daily swings became common place. Volatility increased and the trade of the quarter involved selling anything to reduce risk. The S&P 500 was down 13.87% and was the worst return for this index since Q4 2008 and the 23rd worst quarter since 1926. It also marks the fourth straight year with at least one quarter having double digit losses. Global equity markets fared worse than our domestic market. In U.S. dollar terms, EAFE shed 19% and emerging markets gave back 22.5%. In fixed income markets, high credit quality bonds (AAA treasuries and government agencies) rallied significantly while lower credit bonds lost a significant portion in value with credit spreads widening considerably.

Because of the increasing volatility and declining asset valuations, our GTAA model signaled us and pointed us to de-risk the GTAA portfolio considerably since the ongoing Euro-zone saga entered its next chapter back in late July. Since then, credit spreads on fixed income investments have "widened out" substantially. This is why we sold off our high yield positions and are now sitting in cash with the proceeds. We have now built in a liquidity premium (close to 20% cash in GTAA accounts). About 52% of the current portfolio is either in cash or in "defensive" equities such as consumer products, utilities, gold, or investment grade sovereign debt positions. GTAA MODERATE accounts have about 40% less equity exposure and about an additional 30% in cash or money market. We believe this negative market situation will present a tremendous "buying opportunity" somewhere in the near future; and we aim to take advantage of it when the "uncertainty" is greatly reduced through government and central bank intervention. As long as "the can is just kicked down the road" we will be focused on preservation or return of principal as well as return on principal.
Specifically, mid and small cap exposure was reduced from almost 30% at the end of June to its current weighting of less than 14%, direct energy exposure was sold as were industrials (both being very economically sensitive). Our model also led us to sell our REIT position; and in early August, we sold our healthcare position along with just about all high yield bond funds. Not all of the cash went to the sidelines. Our model showed money flowing into consumer products (staples) and utilities. Over the course of Q3, we added approximately 10% positions in each of these sectors. Recent changes include a swap of a new technology fund in lieu of a small cap fund (again because of money flows and relative outperformance) and a recent addition of about a 5% position in a retailing fund.

GTAA is positioned for the near future, meaning we are hedged to both protect should the market continue to decline; and also to participate should the market advance. There has been increased talk in the media of late about a growing fear of recession on which investors can rely on three different sources of information: forecasts, sentiment, and facts. Currently, forecasts and sentiment are decidedly negative, but the facts say otherwise. The economy is not contracting; it is just expanding at a very low rate. Fact: initial unemployment claims fell 37,000 last week to 391,000 (which is still a big number); however, it is the lowest level in six months. Same-store chain store sales are up year over year, rail traffic is up year over year, and so is hotel occupancy. None of these numbers are typically associated with a recession. An accommodative FED is not the friend of a recession, unless it comes to a panic. As I mentioned earlier, when central bank and government market intervention to shore up the current debt crises prevail, market uncertainty will lift and so will asset prices – the only question remains in the timing. If timing gets delayed because of political lack of will, our model will signal us to get even more defensive. If the politicians and central bankers become market "leaders" and "do the right thing – rather than doing things right", then our model will position us to take advantage of the best performing funds of a rising market. Either way we should be in a better place than we have found ourselves at the end of September 2011.

I would be remiss if I did not express my sincere and heartfelt gratitude to Rudy Polanski, who created and perfected the GTAA models over his18 year career at WRM. It has been an honor and a privilege to train and work beside Rudy for the past ten months or so. Although Rudy won't be in the office daily in the future, he will still be making a positive contribution to GTAA by counseling and advising me and WRM on a regular basis through the end of June 2013. Rudy, as you glide into retirement: may your life be full of years; and may your years be full of life!

I want to thank all of you for your continued confidence in allowing us to manage your investment assets and welcome any questions you may have.

Sincerely,

Ted Strathdee

Ted Strathdee
Portfolio Manager