What Makes a Trend?

May Market Review From Your Portfolio Management Team—June 12, 2015

At FSA we often talk about following the trends of the stock and/or bond markets. While it can be interesting to follow and talk about GDP growth, inflation, or unemployment rates, at the end of the day, it's the price trends of the markets or the other specific funds in your account that dictate when we buy or sell. Over our 30-year history, we have learned that directly tracking and responding to movements in the funds themselves represents the best way to participate in the growth of the stock or bond markets, as well as to protect the accounts when those trends turn down.

The challenge is how to identify a trend. Sometimes, a security may look positive or negative just based on the time frame one is using. For example, look at the following charts of a popular Real Estate ETF:

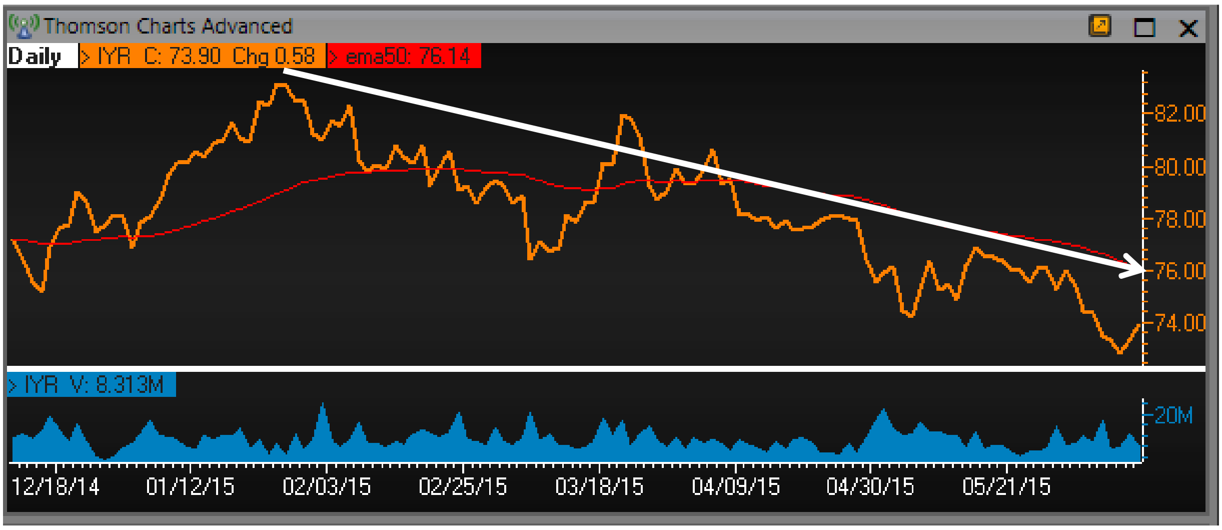

Chart 1: Short-term chart (6 months)

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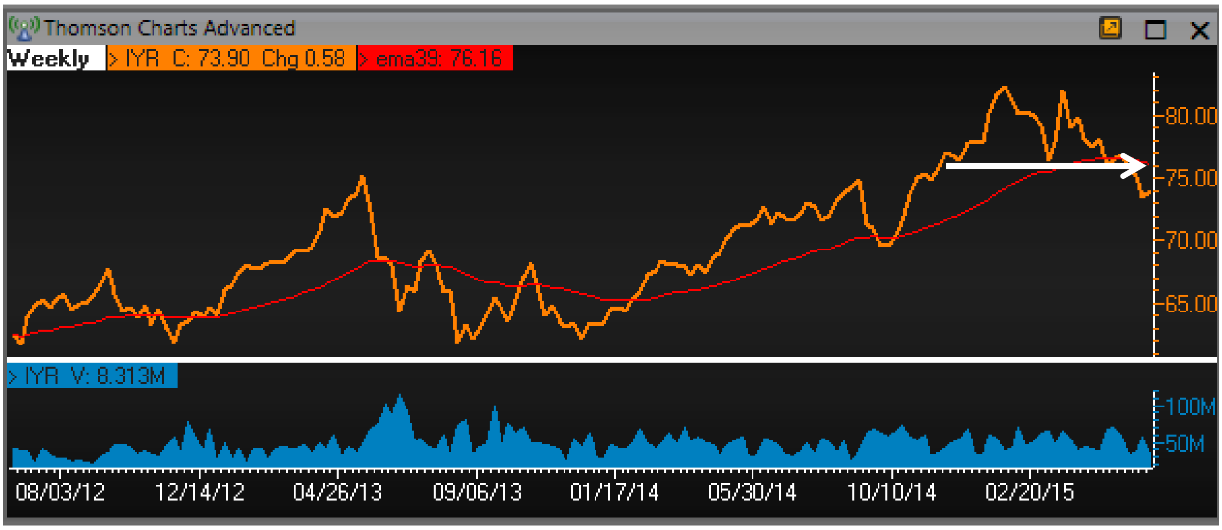

Chart 2: Intermediate-term chart (3 years)

Chart 3: Long-term chart (10 years)

All three charts show the price action of the same Real Estate ETF; the only difference is the time frame. By looking at the first chart (short-term view), one might see a negative price trend and want to avoid or sell the ETF. The second chart (intermediate-term view) shows a choppy or mixed trend. In the third chart (long-term view), the price trend still looks positive and the recent pullback looks similar to other declines along the six-year uptrend.

So, trends depend upon perspective…how short-term or long-term is one's viewpoint? At FSA, we may use all three vantage points along the way. The shorter the time period, the more sensitive one can be to trend reversals and thus protect capital by reacting more quickly. Unfortunately, shorter term perspectives can also create more frequent trading, as well as possibly missing the bigger trend by focusing on shorter term movements.

At FSA, we have to balance our need to protect our clients' portfolios from sustained losses with our desire to keep the trading frequency to a moderate level. That balance will tend to have us focus on a more intermediate-term perspective. Nevertheless, we may take a short-term perspective to reduce a position, while we take the intermediate-term view to exit the remaining position. The same logic could also apply if the security was in an uptrend. The long-term perspective is a good sanity check to add further evidence that a current trend is still on track or is beginning to roll over.

Our primary job in managing the FSA portfolios is to stay on the right side of the prevailing trends, either by being invested in stocks and/or bonds, or by retreating to the relative safety of money market funds in times of market stress. While the different perspectives can create uncertainty at times in identifying the true underlying trend, we will use those different perspectives to more effectively manage the FSA portfolios to stay on the right side of the prevailing trend. Hopefully, our daily monitoring of these trends will allow our clients to sleep at night.

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