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Heading to the Beach

August Market Review From Your Portfolio Management Team—September 12, 2011

In the Washington DC area, August is the month when many people take their vacations. Congress is usually in recess, so it is a quiet time in the city. Dinner reservations are easy to come by, and the traffic is lighter. For many families, getting away means heading for the beach, and spending some time enjoying the sun, sand and surf.

For clients of FSA, heading to the beach carries a different connotation. It means we are putting the portfolios into a defensive position because the stocks and/or bond markets have gotten more volatile. It comes from our oft-used analogy of describing our investment process as cautiously wading into the ocean waters once the surf has calmed down, first wading to our ankles, then our waist, and then finally venturing out in deeper waters. When we see signs of rougher seas and stronger current, we begin to move back closer to the safety of the shore (money markets or bonds).

Even the casual observer knows the seas have gotten pretty rough recently, with high waves and a rip tide. The headline on Yahoo Finance's website a few weeks ago said, "Wall Street Sees Worst Four-Week Drop Since March 2009." The first week in August saw four consecutive 400-point swings on the Dow Jones Industrial Average (an index of 30 large U.S. companies). For FSA, that type of activity in the market is a sign for us to start moving to shore.

Fortunately, we were heavily weighted towards bond funds, so we have been relatively insulated from much of the turmoil in the stock market. Nevertheless, as you have probably noticed, we have increased our activity level over the past month as most of our stock funds tripped through their safety nets. The table below shows how we are allocated as we begin the month of September. As you can see, we have only modest allocations (if any) to stock funds. In addition, we have radically trimmed back (either by outright selling or by hedging with an inverse fund) our allocation to high yield bond funds, which have turned down along with the stock market. The high quality bond funds continue to perform well, and in most cases, are at or near all time high levels in price.

Strategy	Stock Funds	HY Bonds	Inverse HY	Quality Bonds	Money Markets
Tactical Growth	10%	20%	15%	0%	55%
Core Equity	5%	15%	10%	5%	65%
Conservative Growth	0%	5%	0%	45%	50%
Income & Growth	10%	0%		65%	25%
Income	--	0%	0%	55%	45%

Note: Allocation percentages are as of August 31, 2011 and are an average of all accounts within the objective. Individual account allocations may differ from these averages. Inverse HY Bonds are bonds designed to move in the opposite direction as traditional HY bond funds.

As late as August 22nd, the S&P 500 index was down 13% for the month (and down 18% from its peak on April 29). Only a furious 7 day rally prevented the broad stock market from having a very ugly month. For the month of August, the S&P index finished down less than 6%. The FSA strategies, on average, were down about half that amount, with the more aggressive strategies, like Core Equity and Tactical Growth, down more than the average, while the more conservative strategies, like Income & Growth and Income, were down less than the average.

With most stocks trading below their 200-day moving averages, and the averages themselves beginning to trend lower, we will continue to avoid that asset class for now. Quality bond funds, however, continue to attract investor interest, so we maintain those holdings in our portfolios. Until the market can establish a solid bottom and rebuild momentum to the upside, we will remain close to the safety of the shore. Only when volatility settles down and stocks get back on an upward track will we venture back into deeper waters.