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To: Bob Kargenian
Subject: TABR Monthly Update

TO: All clients and interested parties
FROM: Bob Kargenian

You may have read by now that the month of May was the second worst for equities since 1950. As in 2008, there was no place to hide, as foreign stocks (EAFE) led the way down, losing -12.1%. Other indexes were bunched, with the S&P 500 (large stocks) down -8.0% and the Russell 3000 (broad market) down -7.9%. The best of the group, the S&P Midcap 400 (midcap stocks) was down ONLY -7.2%.

Interest rates fell sharply, with the yield on the 10-year Treasury dropping from 3.66% to 3.30% and the 30-year Treasury Bond from 4.52% to 4.21%. However, the Lipper Intermediate Government Index gained just 0.1% for the month. With the weakness in equities, high yield bonds suffered, as the Lipper High Yield Fund Index fell -3.5% for the month. In the precious metals sector, the Lipper Gold Fund Index fell -3.2%.

The Evidence

The market has been trading heavy for several weeks now, with volume expanding on declining days and decreasing on up days. In technical circles, this smacks of distribution. As I have conveyed in April, the market peak was not accompanied by the normal signs of a major top, but rather the signs of an intermediate peak. Thus far, the decline of about 12-13% fits into that parameter, and it is conceivable that stocks could run back up and make new highs over the next several months. That would be the "normal" thing to do. But, as we also conveyed, there have been 3 instances since 1930 when a major peak was made in stock prices with no warnings or divergences. We won't know if this is the fourth instance until after the fact.

A lot of people want to jump on the wagon and proclaim that we are about to repeat 2008. Most of these people have no clue to what they are talking about and lack substantial credibility. There are some similarities to 2008 right now, but there are also significant differences. All we can tell you at this point is that our risk models have signaled increased risk in the past several weeks, and we have substantially reduced exposure to both equities and high yield bonds. This does not mean markets will fall apart from here. The 1040 level on the S&P 500 has become a critical level. It has been tested several times, and so far has held, and positive divergences are in place in a number of short term indicators. Despite the warnings from several of our models, it would not surprise me if stocks turned up, right here. But, our work is not making much of a bet in that direction at present, as you'll see below.

Where We Stand

This past Monday, June 7, we reduced tactical equity allocations to 40%, as presently 3 of our 5 stock market risk models are in their negative mode. Overall, equity exposure in our Moderate Allocation accounts is about 24%, which includes just over 2% in real estate and about 2.5% in gold stocks via Van Eck International Investors. Last week, one of our longer term gold stock models went on a BUY. This particular signal is one of the more reliable ones we have seen in our research, though it is not perfect. Nevertheless, we are looking to increase our exposure on weakness. Our sense from a sentiment standpoint is that there is too much belief in gold at this point, and if stocks get whacked here, gold stocks will get whacked too, creating a better entry point.

In fixed income, our high yield bond model went negative on May 7, and we cut our positions at that time by about 86%. We also cut our position in the Loomis Sayles Bond Fund by 43% when one of our models tailored to that fund went negative. Right now, corporate debt markets are on the defensive, and so are we.

For some perspective, though the Vanguard Total Stock Index fell -8% in May, and the Vanguard Total International Stock Index fell -10.77%, TABR's Moderate account dropped just -2.58%, and TABR's Conservative account was down -1.64%. These are real examples of our risk management process at work. At present, we are only a shade away from our maximum defensive position. But I should also point out the market can be very humbling, so if stocks turn tail here and start rising rapidly, we will lag in that area and look pretty stupid for a time. The most important thing to take out of this is that we are following our discipline, which is designed to protect capital in negative environments and participate reasonably well in good environments. As defined by a majority of our models, the environment has been turning more negative during the past six weeks. We are prepared for whatever outcome the market throws our way.

Best regards,

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