PROTECTING YOUR FUNDS

"Safety First, Market Timing for the Conservative Mutual Fund Investor"

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INVESTMENT PSYCHOLOGY AND LONG TERM PERFORMANCE

The conservative municipal bond market as measured by the bond buyers municipal bond index has lost over 19% this year. The typical government or high yield fund is down 12 to 13% and some stock funds have lost as much 35%. As “buy-and-hold” mutual fund investors begin to realize the extent of their losses, fear sets in causing them to sell. Newspaper stories, such as the Orange County bankruptcy, fuel their fear and push the markets lower. The old stock brokerage adage states **“When the markets go high, they want to buy. When it makes a new low, they let them go."** The “they” in the rhyme are the small investor, the investing public.

Investment success is earned by consistently buying low and selling higher. Yet, there is a natural tendency for the small investor to do the opposite by selling at the bottom and clambering to buy as the market reaches its peak. The surpression of these natural emotions is one of the hardest disciplines for an investor to master. So hard, that the markets have even developed measures to indicate what the small investors (Odd lotters, as they are affectionately referred, because of their tendency to buy less than 100 shares of a stock) are doing and then to do the opposite. Sad, a little bit scary, but not suprising, is the fact that this indicator works on mutual fund managers as well. Both the Odd lotter and mutual funds managers are notoriously wrong at major market turning points. An extreme example occured in 1987. These two groups measured their highest optimism the week before the crash. Switched to highest level of pessimism the week after the crash. Their peak in pessimism coincided perfectly with the beginning of a 16% rally that ran through the first of the new year. As usual, just when these two groups agree and believe the market will go to zero the market turns and produces a substantial rally. As of the end of last week, both odd lotters and fund manager were at the most pessimistic levels since after the crash in 1987. **This clearly indicates that some sort of market bottom should be forming.**

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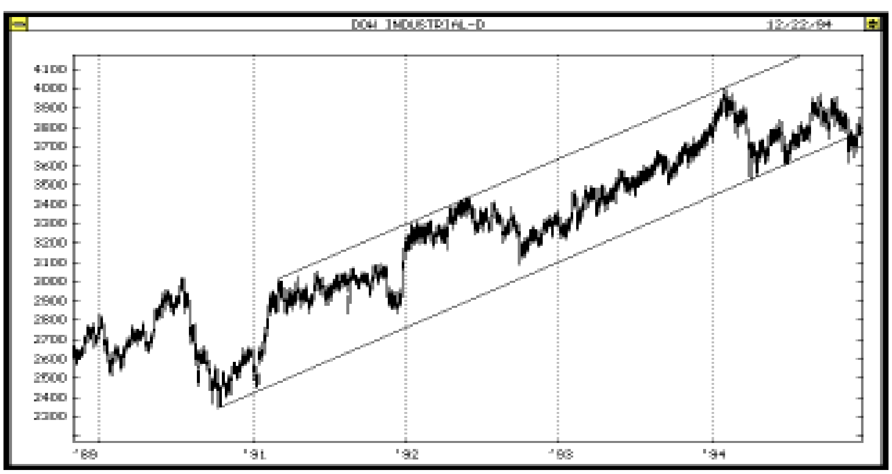
FUNDS IN THE SPOTLIGHT



FUNDS IN THE SPOTLIGHT

In this month’s Funds in the spotlight I want to discuss the Dow Jones Industrial Average. Although it is not a fund, it is probably the most watched market indicator in the world.

The chart below shows a longer term perspective of the Dow. This graph covers from 1990 to the present. Here, we can see the beginning of the rally as the the economy and the Dow grew out of the recession. But, we can also see a clearly defined channel that has contained the entire up move. The channel is confined between a 9 point lower trend line and a 10 point upper line. Remember, the more points where a trend line can hold off challenges and the longer

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MANAGED ACCOUNT PERFORMANCE

Account Type	Year to date Returns	1993 returns
Managed Income	4.8	18.1
Managed Tax-Free	1.1	8.1
Domestic Growth	-7.3	8.9
International Growth	5.3	20.4

*Returns achieved through 12/16/94 with approximately one half the risk of a buy-and-hold strategy.

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Status of Tumming Models

Managed Income	Sell	(11/23/94)
Managed Tax-free...	Sell	(12/14/94)
Conservative Growth...	Sell	(12/09/94)
International Growth...	Sell	(09/16/94)

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The market is a measure (in dollars) of mass psychology. Measures of this psychology give an informed investor an edge over the uninformed. Many investors react to these losses by returning to the safe haven of the Certificate of Deposit. CDs look good; but, they are only a quick fix; not a lasting investment plan. As interest rates continue to climb, so do the rates the banks pay on CDs. But, the conservative long term investor must look at why the rates are climbing. Rates climb to counter or slow the onset of inflation. The very safety investors look for in CDs is the ultimate undoing of their investment plan and standard of living. When downside fluctuation (losses) enters the market, investors change from a motive of greed to a motive of fear. They look for the security of principal protection. By now, I hope you know that I am all for principal protection. Principal protection is what market timing is all about. However, by locking into CDs, instead of a liquid money market fund (where we are also earning 5%), they are out of the fluctuating markets. This means they give up the growth of principal offered by the long term markets. They are betting that the 5 or 6 percent they have locked into will be better than the market returns over the next two years. Statistically, the odds are stacked against them. And with out a doubt, these CD investors are insuring that taxes and inflation will beat them over the long run.

As inflation increases, interest rates rise. Inflation is the monster that eats away your standard of living. Here's an example: An investor has $50,000 invested in the markets. Because of market fluctuation through out the year, it drops to $48,000 or a loss of 4%. Not wanting it to drop any farther, a natural reaction, the investor sells the investment at the price lows and places in a bank or credit union where they can collect 5 percent. When we consider taxes at 28% (ignoring state taxes) the investor will net 3.60%. If real inflation is running around 4 to 4.5%, then their standard of living will slowly erode over the years. However, if inflation heats up or if the goods they buy, like food and fuels, increase faster than the average rate of inflation, then they are in big trouble. Again, this is the exact reason why 50% of the retirees at age 75 or over live under the poverty line. They didn't retire that way; but, their investments failed to keep up with rising prices. Inspite of the fact that they had CDs at 16% years ago; because then inflation was at 20%. While they may still have their principal intact, **it did not grow!** We all know that $50,000 will not buy what it did 15 or 20 years ago. Well, neither will the meager 5% or 10% interest earned on the $50,000. If the prices of the items they purchase increases faster than their net earning, their living standard slowly slips away.

If investors don't stay with the grow potential markets then they are locking in inflation losses. Obviously, this may seem better than the fear of losing some your principal; but, in the long run even the "buy-and-hold" stock fund investor will out perform inflation and the CDs. Additionally, market timing can reduce the pain, anguish, and long periods of poor performance caused by the "buy and hold" through bear market fluctuations.

Market timing is not a panacea. Our managed portfolio returns may seem lack luster (see Managed Account Performance). However, compared to the losses throughout the markets, we have had a very good year. We are still 10 to 15% ahead of the pack. Our key to superior long term investment results is to minimize losses caused by the occasional bear (declining) market. This year the bear reared it's ugly head and the markets dropped on average 20%. We managed to produce profits in all of our accounts with the exception of the domestic growth account, where our losses are 1/3 of the typical fund. Yes, you may have done better in a CD in 1994 , but, that's hindsight and hindsight is always obvious. Remember though, that a two year CD purchased in January would have yielded 4% and we have matched that with more opportunity and liquidity.

We have protected and maintained our principal throughout this bear market. More important, we are still in position to reap the growth of the markets. If you want to stay ahead of inflation, your investments must return 10% or better. This goal requires investments with exposure to market fluctuations. We can not make the markets grow. Some years, every thing goes down together. **We minimize the down side fluctuation.** Therefore, we can quickly profit compared to the 'buy-and-hold investor", who needs to make up their 10 to 35 percent losses before gains can be acheived.

Yes, there are some "buy and hold" investments that have come close to our performance; but, by side stepping the majority of any major down move, timing also lowers the risk associated with investing. Our timing models cut the risk exposure in half verses the buy-and-hold approach. When our returns are measured with this in mind, there is not an investment strategy that has been able to match us. This does not say that we will always beat a buy-and-hold strategy every year. But, market timing has proven to consistently outperform the "buy-and-hold" and the CD on a risk adjusted basis over a typical market cycle (5 to 6 years).

CURRENT OUTLOOK

For stocks and bonds much of what needs to be said is already written. This month's cover story and Funds in the Spotlight cover my ideas and direction. Never-the-less, I will give additional thoughts and reasons briefly.

The bond markets, both taxable and tax-free have a supportable bottom in place and have rallied off the most recent lows. I expect to get a new buy signal as early as tomorrow and this growth to continue, but not for long. As I predicted last month, the Federal Reserve did not raise interest rates in December. This has given the badly beaten bond market a need rest. However, I suspect that "round 7" is right around the corner. January or at the latest February should see the Fed. tightening again. Believe me, I would love to be wrong.

In the international funds, we are starting to see some upward action. If you take a look at the U.S. Dollar index with a Stochastics Oscillator. You will see that the move up is starting to tire. It will not drop right away due to the high level achieved. More likely, it will make one more small move up before heading south to test support. A dropping dollar will give added growth to the international investments. But, like the bonds, this window of opportunity will be short lived; as the dollar finds support from our own rising interest rates.

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the time span it stays in force, then the higher the significance as a support or resistance line for price movements the trend line becomes. These two trend lines are very old and powerful indeed.

Ten times the price approached the upper boundary, but could not exceed it. Nine times the price approached the lower trend line, but could not break through it. That is, until November of this year. The break through in November cast a dark cloud on the prospects for the market. When the price breaks through an existing trend line, then that trend lines dimensions of support or resistance become new dimensions but the opposite in nature. This means that the lower support line became a powerful resistance above the market once it was broken. Ten times the market attempted to push prices above the line; but, it could not. That is, until last week.

The graph above shows a closeup of the Dow, covering the price action in 1994. The '91 trend lines are contiuned from the graph on page 1. Just as the breakthrough to the downside cast a cloud on the market, this most recent breakthrough to the upside shows great promise. Now that prices have moved up above the lower trend line, a move towards the center of the channel and ultimately to the top is expected. This channel has a 500 point spread between it upper and lower boundaries. With the current lower limit at 3800, 500 point up is a 4300 Dow or 13%. As you can see, the upward sloping nature of the trend lines suggests that the upper limit will ultimately be much higher than 4300. I don't know for sure if or how long it will take the Dow to reach the upper limit. However, even if it takes two years, that projects the Dow to top 5000, **a whopping 31.5% gain**. Sure beats a 6% CD.