THE RUDD COMMENTARY

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We are excited to publish this edition of *The Rudd Commentary*, which is a periodic publication designed to bring you a professional opinion on the current investment environment and some developing trends. Please feel free to forward *The Rudd Commentary* to family, friends, and business associates who might find this information valuable.

TOO MUCH INFORMATION

As they say in Hollywood, "let's cut right to the chase." The third quarter of 2011 was a difficult time to hold equity investments of all kinds. The S&P 500 Index gave up 13.9% for the three months ending September 30th, 2011 and 8.7% for the year.[1] Most other equity asset classes followed suit declining without hesitation, including commodities, real estate and international stocks. To the contrary, highly rated domestic bonds posted gains as investors poured into treasuries, municipals and corporate bonds in search of a fixed (albeit low) level of income. It is clear that fear and distrust are dominating investors minds at present. Historically, these are signs of great opportunities for those who gather the relevant facts, assess the situation dispassionately and choose to take risk.

As I look forward into the fourth quarter and the conclusion of 2011, I am beginning to see less negatives and even some encouraging signs that things many not be quite as bad as investors currently perceive. First, our economy in the U.S. is still grinding forward and the prospects of another recession seem less likely. Second, corporations are currently posting solid earnings and currently hold high levels of cash on their balance sheets. And while our banks are not perceived as the bulwarks they once were, they are well capitalized and in a better position than their counterparts across the pond.

If economic data is showing some positive signs, why are the financial markets reacting like a campaigning politician with a bipolar disorder? Let's take a look at two things that I believe will shed some light on the seemingly manic depressive moves in the markets and their extreme intensity.

LUDICROUS SPEED »

Leaps in technology and innovation have a habit of leveling the playing field between the haves and have nots. History has shown us that a period of volatility often follows these leaps as those that were previously without the new technology exert (or over exert) their new found power in society. When I came into the world of finance in the 1990's, I was introduced to a technological leap that would have a profound influence over how the world perceives risk. This great advancement was the computer spreadsheet, Microsoft Excel to most of us. Technology had reached a point where anyone with a basic understanding of mathematics and computers could perform complicated data analysis in customized or prepackaged spreadsheet models. This new analytical capacity was quickly followed by an ever-increasing supply of data that continues today. I would now estimate that individual investors have access to as much real-time data free on the internet as the major brokerage house trading desks did a few years ago. Also consider that America's top business schools have filled the ranks of virtually all the world's major financial institutions with MBAs that bleed spreadsheet dependent arrogance. For many, "Risk" has become a program, model, or metric in Microsoft excel; something that can be modeled away in a Monte Carlo simulation. As we have quickly began to realize, this mindset has suddenly revealed an environment with high destructive potential hidden in the tails of the normal distribution (bell curve).

The recent volatility in the last decade is a manifestation of this technology advancement and data deluge. For $100 a month, an individual investor can now reach beyond the speed of relevant real-time information. Suddenly, what has been regarded as immaterial or even ludicrous is now being featured and subscribed to in the latest trading schemes sold on television. Ironically, this ravenous desire for real-time information and the inability to separate the material from the immaterial, promotes the very market volatility that users are seeking to avoid. The risks that led to the financial markets crises in 2008-2009 were modeled in spreadsheets, but were labeled "outliers" as complicated spreadsheet simulations hid the true value at risk. As the nations of the world are now sober to, finan-

[1] All data represents cumulative total return obtained from J.P. Morgan Asset Management: Guide to the Markets, 4Q 2011

cial risk still depends on emotional human choices, which do not always turn out as expected in a spreadsheet.

TECHNICAL MUMBO-JUMBO »

Along with the internet and data revolution has come a period of great interest in Wall Street jargon. As a professional money manager, I have always been amazed by the general public's desire to become Wall Street experts in their spare time. This phenomenon is not limited to my industry. I often hear psychologists say that they are reluctant to share their profession at social events (my wife gets angry when I simply respond "I am a consultant" and quickly change the subject) due to the very long and inescapable conversations that tend to result. In my experience, these encounters rarely focus on the merits or fundamentals of investing. Instead, I am usually asked to comment on some obscure penny stock and hear phrases like "200 day moving average", "head and shoulders", "option spread", and my personal favorite, "Fibonacci retracement pattern". Penny stock strategies and technical analysis can be profitable to some in the short-term...as can blackjack. However, luck is usually mistaken for skill and like Las Vegas, the large "houses" have an consistent and overwhelming advantage.

Casting the company fundamentals aside and trading on technical analysis may lead to some short term gains, but is not a viable long term strategy for most investors. Ultimately, assets will be held by investors based on their ability to produce adequate returns on invested capital over a long period of time. This can happen through the payments of dividends now or the potential of earnings growth in the future (i.e. future dividends). The word "earnings" gives us a clue as to what are the

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fundamentally important variables to investing success. The ability to "earn" lasting positive results, be it financial, improved health, or deeper personal relationships, rarely rely on short-term investments. Lasting returns that produce joy and happiness require investments of pain, suffering and a little patience.

NO CAPTAIN KIRK WITHOUT MR. SPOCK »

The ease, speed and quantity of available information combined with our ravenous desire to over analyze, have contributed to an environment that is characterized by nervousness, volatility, and distrust. While this can offer opportunities for investors with the emotional intelligence and patience to take advantage of mispriced assets, it is not the ideal environment for investors trying to minimize the month to month volatility on their investment statements. While we hope investors will adapt to these great leaps in technology over time, the journey may prove to be unsettling. Until we have adapted to this new environment, a dispassionate and discriminating perspective is recommended. An experienced, competent and trusted advisor can keep the fundamentals front and center and help investors sort through their emotions and discern between the relevant and irrelevant. Once the clutter and tears are swept away, risks can be seen clearly, and the opportunities exploited.

Invest Long & Prosper,

Josh Rudd

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