Alpha Power Indexes

Alpha Power Indexes represent one of the most efficient uses of equity capital over a full market cycle. Since 1949, the U.S. stock market has exhibited a persistent tendency to "skew" returns into the six-to-seven month period from November to May (June). Statistically, for the Dow Industrials and the S&P 500, the period from May 1 to November 1 has produced no gains over the 59-year period ending in 2008. Virtually all of the appreciation of the broad market has transpired in the favorable six months (the "power zone") from November to May. Small cap stocks have exhibited a tendency to extend this "power zone" into late June.

The unfavorable period – the "dead zone" – has tended to coincide with the bulk of bear markets and market crashes. This almost 60-year pattern occurs in many developed foreign markets as well. Indeed, in some foreign markets the phenomenon is more dramatic than in the U.S.

Power indexes eliminate "dead zone" equity exposure and replace it with exposure to short to intermediate government bonds. This raises the probability of positive returns during the unfavorable seasonal periods by a significant factor. By earning positive returns during periods when the market is declining (which tends to be a relatively high percentage of the time during the "dead zone") power index returns steadily overwhelm traditional index performance over time.

Long-term investors who have equity exposure over one or more market cycles (4-10 years) would have added an annual return premium of 2% - 5% by using power indexes instead of traditional indexes over the past 30 years and longer. Over time, power indexes produce total returns that can be several multiples of value higher than traditional index investments.

In addition, the last 20 years has produced voluminous research which converges to the same conclusion: actively managed portfolios, including mutual funds, systematically underperform their benchmark indexes over the long-term. It is also well established that investors attempting to "pick" the best funds and managers increase their long-term deficit to index performance due to their propensity to select the funds or managers which have the best recent performance. This focus on recent performance virtually guarantees poor relative returns over the next market cycle.

The argument for constructing portfolios which replicate power indexes is simple and compelling. As you will see in the data which follows, holding equities during the "dead zone" is a long-term losing proposition. Power indexes replace high risk investment instruments with low risk investment instruments during periods when the <u>average</u> risk-return profile for equities is poor. This achieves a <u>weighted average return per unit of risk</u> that significantly exceeds a passive, continuously invested equity index.

Dow Performance

November 1 through Third Trading Day of May
versus
Fourth Trading Day of May through October 31

1949 - 2009

Start Bullish Period (Nov)	Percentage Gain	$1,000	Start Bearish Period (May)	Percentage Gain	$1,000
1949	14.1	1,141	1950	4.0	1,040
1950	16.9	1,334	1951	(0.3)	1,037
1951	(0.7)	1,325	1952	3.3	1,072
1952	3.3	1,369	1953	(0.9)	1,063
1953	15.3	1,578	1954	10.8	1,177
1954	20.0	1,894	1955	7.7	1,267
1955	13.0	2,140	1956	(6.6)	1,183
1956	3.7	2,219	1957	(11.4)	1,048
1957	4.6	2,320	1958	17.8	1,235
1958	15.2	2,674	1959	3.3	1,276
1959	(5.5)	2,526	1960	(5.0)	1,212
1960	18.7	2,999	1961	2.2	1,238
1961	(4.0)	2,878	1962	(12.7)	1,081
1962	21.8	3,504	1963	5.2	1,137
1963	9.5	3,835	1964	5.6	1,201
1964	6.8	4,095	1965	3.1	1,238
1965	(4.8)	3,899	1966	(11.8)	1,092
1966	11.1	4,332	1967	(1.9)	1,071
1967	4.5	4,527	1968	3.6	1,110
1968	0.7	4,558	1969	(10.7)	991
1969	(17.1)	3,779	1970	6.5	1,055
1970	24.1	4,688	1971	(10.5)	944
1971	11.3	5,216	1972	2.4	967
1972	(0.2)	5,207	1973	0.3	969
1973	(11.6)	4,605	1974	(21.3)	763
1974	28.6	5,920	1975	(2.3)	745
1975	18.0	6,985	1976	(2.2)	729
1976	(2.5)	6,809	1977	(13.0)	634
1977	1.3	6,897	1978	(4.4)	606
1978	8.2	7,464	1979	(4.9)	577

Start Bullish Period (Nov)	Percentage Gain	$1,000	Start Bearish Period (May)	Percentage Gain	$1,000
1979	0.1	7,469	1980	13.3	653
1980	5.2	7,856	1981	(12.3)	573
1981	0.2	7,874	1982	16.1	665
1982	22.3	9,628	1983	1.0	671
1983	(3.6)	9,285	1984	2.2	686
1984	3.3	9,591	1985	10.2	756
1985	30.5	12,519	1986	4.7	791
1986	24.5	15,588	1987	(14.7)	675
1987	2.1	15,923	1988	5.5	712
1988	11.4	17,739	1989	10.5	787
1989	1.9	18,081	1990	(9.4)	713
1990	20.3	21,757	1991	4.4	744
1991	9.5	23,815	1992	(4.0)	715
1992	6.9	25,460	1993	6.7	763
1993	0.5	25,578	1994	5.7	806
1994	11.9	28,622	1995	8.7	877
1995	15.2	32,971	1996	10.1	965
1996	19.6	39,447	1997	3.2	995
1997	22.9	48,487	1998	(6.1)	935
1998	27.5	61,823	1999	(2.1)	916
1999	(2.3)	60,384	2000	4.7	959
2000	(1.6)	59,424	2001	(15.9)	806
2001	10.3	65,523	2002	(16.1)	676
2002	1.6	66,573	2003	14.9	777
2003	5.2	70,036	2004	(2.7)	755
2004	3.6	72,531	2005	0.5	759
2005	9.2	79,202	2006	6.0	805
2006	9.6	89,811	2007	5.2	847
2007	(4.8)	82,666	2008	(28.5)	605

(Source: Jay Kaeppel, Seasonal Stock Market Trends, Wiley, 2008)

Sell in May – the "Dead Zone"

- **The average daily gain from November to May was 27.4 times higher than the average daily gain of all other days.**
- **The annualized return of the best six months was 17.1%.**
- **The Dow posted a gain 81% of the time between November and May.**
- **The Dow posted a gain 55% of the time between May and November.**
- **A $1,000 investment only during the November-to-May period grew to $82,666.**
- **A $1,000 investment only during the May-to-November period shrank to $605.**