

October 3, 2007



Clients,

After the second quarter of unsustainable high returns, this quarter saw a major dip in the markets. We ended the quarter up an annual rate of 8% compared to 4% for the Russell 3000 and -13% for the Russell 2000. There was more variation between portfolios. More diversified accounts typically saw performance extremes between different portfolios; less diversified accounts were more likely to be up or down (see page on Client Performance Variation). All accounts saw a big dip and a dramatic recovery. The overall annual rate of return since August 16 has been 229%. So it seems to be turning out well. How do we cope beforehand when that is not so obvious?

The question I ask is "Is this to be a drop within trend, is it likely to be a more severe but short-term correction, or is it likely to be the start of a secular bear market?". While the changes in market breadth and smaller caps lagging the market were reasons for concern, there is too much corporate cash chasing a diminishing supply of stocks impacted by corporate buybacks. A bear market usually follows a series of lower highs or a rolling top in the charts; this decline was abrupt and fed by a lot of fear hype. And my expert, James Paulsen, Ph.D, the economist at www.wellscap.com, has been very positive on the economic forecast. If I'm fairly comfortable that this is not a long-term decline, I tend to not watch and analyze too closely for fear of getting an itchy trigger finger.

On the timing portfolios, I did go in too soon. So we rode it down and rode it up again; I didn't want to get out and miss the bounce and was quite confident that a month would see higher prices. The primary lesson I take from the experience is that we can ride these out.

Those of us holding the Uranium portfolios have seen a serious decline up until a month ago, and very strong returns since then. That seems to be driven by the speculators getting margin calls with the credit crunch, as well as seasonal variations as nuclear power plants prepare for the winter season (Energy output is lowest in the Spring and Fall.) In addition to Sean Broderick who gave the original recommendations, Nicolas Vardy has been recommending uranium.

I'm doing some research on returns by time length of holding the position. If I'm right that we do better the first year, I will do more selling of older positions, especially in IRA accounts. The older positions appear to be less reliable, either going way up or way down, especially in the Statistical Strategy.

An alternative to mutual funds.

I read two excellent books on critical thinking this past quarter, [The Only Three Questions that Count](#) by Ken Fisher and [Don't Believe Everything You Think: The Six Basic Mistakes We Make in Thinking](#) by Thomas Kida. They are both very readable, practical and have much to offer even if I don't buy Kida's assertion that one cannot beat the market. An aeronautical engineer concluded that it was impossible for a bumble bee to fly; fortunately no one told the bumble bee. It seems that no matter how excellent the talent in professional sports teams, the league has trouble producing a win rate more than 50%. The academics who grade on the curve end up with the student average being average. Ken Fisher was proud of beating the benchmark by 1.7% over several years; after almost six years we are above the benchmark about 9% when including cash, less 2% for fees gives about 7%. Fisher's strategy is not to go for returns, but to safely beat the market by just enough to keep his 16 billion in accounts. His business has more to lose from scared clients than he has to gain from strong returns. I sat here and typed detailed notes and reactions to both books, which I would be happy to e-mail upon request.

I'm taking a challenging class online in data mining. It is giving me new tools and statistical understanding to help with our Statistical Strategy.

And finally, what are good ways to work with your money manager? Some of you read the reports (which is a good idea since I work hard on them), and I rarely hear from you. That is fine with me, as long as I don't get any surprises from you. With some of you I meet regularly for lunch, which I always enjoy (Call). Some of you call with an occasional question. With a few of you, I have helped do some long-range probability projections which has helped give a sense of financial security. My original concept was that I would offer strategy and portfolio options for you to select, and I would then pick the positions. While with new clients we often pick the portfolios together, most of you leave it to me to balance out the strategies, portfolios and positions based upon my informal understanding of your situation and the changing promise of different approaches. While I post the overall performance of each current portfolio option on my website each month and used to mail out a copy each quarter, I have yet to have anyone review the data and come back to me wanting to make a switch. So I take that as an implied consent, and thank you for the trust.

Lee Wenzel
(952) 944-2699
Lee@WenzelAnalytics.com
www.WenzelAnalytics.com

Wenzel Analytics, Inc.
Registered Investment Advisor
8666 Westwind Circle
Eden Prairie, MN 55344