

January 3, 2011



Clients,

Wenzel Analytics has now completed nine years of managing other people's money (OPM). I appreciate the challenge, the autonomy and the sense of serving each of you. I can't imagine any reason to not continue doing what I am doing. I'm sometimes surprised at how little has changed over the years in the strategies for how I invest or in my business model.

Performance Summary

I have included with this mailing the Wenzel Analytics book-of-business Performance Summary. It amazes me how few of my competitors publish their performance. It amazes me even more when people I thought were sane hire them as their money manager because they represent a big organization.

As I have said before, in evaluating past performance you need to study your individual reports. For projecting future performance, the book-of business results is likely to be more predictive. The Summary provides additional overall perspective and may be a useful referent for comparing your portfolio results. If you look through it and want to shift your portfolio allocation, let me know. It is also a good piece to give to a friend, neighbor or relative who might want to explore becoming a client.

Markets

As for clouds on the horizon, Jason Goepfert in his every morning *Sentimentrader* e-mails has been reporting that 79% of the dumb money is bullish and 29% of the smart money is bullish, a near record contrast. (The dumb and smart is determined by the size of trades.) He also has lists of indicators or studies that are at extremes of being bearish or bullish for the market. Recently it has been running twenty or so bearish and either none or one bullish. The domestic market has not been pausing for its normal corrections, while most international markets have. My sense is that the market has been running on exogenous artificial stimulus in the form of fiscal and monetary policy or news and views about policy. I'm expecting a false break-out up, and then a moderate correction in the next month.

In this context I decided that rather than move wholesale to cash, it would be prudent to take a short-term stake in a possible correction. On December 23rd I put almost all of you 5% in SDS which is an ETF that is ultra (double) short the S&P 500.

For the year as a whole I remain very optimistic about stocks, especially stocks that are mid-cap and smaller, as well as international offerings.

I am less optimistic about bonds, or about employment levels. It seems to me that as we use human and financial capital to make both stuff and services available ever more cheaply, we need fewer and fewer employees. Our economic challenge is not with production or supply, but with demand. Visit a lights-out factory that runs 24-7 and you get a feeling for the issue. If we don't need people for production, how are we going to distribute the fruits of all the machines, automated factories and business processes? One answer: it will increasingly come from ownership or entitlements, and less from wages. Being able to live off of investments (capital) is going to become ever more important. Marx didn't have it all right, but he didn't have it all wrong either. Such beliefs are how I make myself feel important in the work I do for you!

An alternative to mutual funds.

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Research and Resources

I completed an extensive data mining project this quarter on eight years of monthly data. I also ran tests on screens that I had discovered in the past but then discontinued. I find it is particularly difficult to find screens that hold up in all market conditions. This is particularly difficult if the screen contains any variables related to momentum or price variation. I am now eager to broadly implement one screen first developed in 2005 and another that best passed my tests this quarter.

On December I presented to our Twin Cities Chapter of AAI the highlights of a paper on how to make sizeable gifts to non-profits at no after-tax cost to the donor. In brief, if someone is at a 33% state and federal tax bracket and gifts a stock that has tripled, it is possible to have the tax deduction cover all of the original cost. The paper is at www.WenzelAnalytics.com. Alert me to not sell highly appreciated positions if you have an interest in gifting appreciated stock.

I'm reading a good book about business and economic cycles including the history and intricacies of inter-country economics and currency valuations. I particularly like the historical examples and stories given in *The Road from Ruin* by Matthew Bishop and Michael Green.

While recently replacing some basement sheetrock, I finished listening to the CDs of a course on economics by Timothy Taylor and produced by The Teaching Company. Initially I was struck by how little the concepts of economics have changed in the fifty years since I took Principles of Economics and read the classic Samuelson text. There again, the nature of money and of currency exchange was the most interesting. Let me know if you want to borrow the set.

While talking about resources, more and more I'm using www.freestockcharts.com. It is a very intuitive site with real-time charts. If you have a Worden subscription, the advertising on the right drops off.

Enclosed Reports

There are many steps in assembling your reports and lots of opportunity for error. I try to be careful and check, but I have found out-dated charts and such after the mailings have gone out. If you find something omitted or that doesn't add up, please let me know.

For those of you with taxable accounts, if it would be easier to cut and paste from an Excel copy of the Capital Gains reports for Schedule D, let me know.

I always welcome opportunities to sit down with you and review what I'm thinking and doing on your accounts, as well as to hear about your goals and concerns.

Best wishes for a happy and prosperous new year!

Lee