



Wenzel
Analytics
Inc

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Clients,

To the impatience of some of some of you, I continue to be swayed by a fear of repeating a ride down with a serious market correction such as I allowed in 2008. I personally can't afford a 30% correction, and project the same for most of you. The fear derives in large part from the influence of fractal analysis, and David Nichols in particular, who writes with such certainty and supporting data. Fractal patterns are good at predicting whether an up or down trend will continue. It is not very good at predicting whether a breakout from a lateral pattern will be up or down. We have been in a lateral topping pattern for some time, with an exploratory blip down in October and another smaller one in December.

How I Invest

Feeling somewhat under duress in anticipating a market downturn that has not materialized, I'm re-forming and reiterating the rules and strategies by which I invest. I find it rather insidious how when I have a pattern in my head or gestalt of expectations, events which support the pattern are acknowledged and events which do not are discounted. The new set of rules or guidelines spelled out below pulls from some of the experiments and experiences of the last year.

Some of you want to have better returns than the overall market or returns from a broad market Exchange Traded Fund. That has been the business premise for my value-add, and has been achieved over the long term but not recently. Others of you are not so concerned about beating the market as by being relatively comfortable knowing that real returns will meet your retirement income needs. Those wanting relative returns will be invested heavily in stocks with strong potential for capital gains. Those wanting real or absolute returns will be invested heavily in income producing investments. In the past I have sometimes gotten mixed signals from clients, such as not wanting a decline in "principal" but then being dissatisfied when returns did not match the market or their expectations.

I will continue to make timing judgments at both an aggregate overall allocation level, as well as at the level of each position to be purchased or to continue to be held. If I judge it appropriate to be fully invested in the market, clients for whom I manage over a million dollars will generally have funds allocated according to Table 1.

An alternative to mutual funds.

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Table 1.		
Rationale		
	Gold and Silver	I'm expecting a strong uptrend in the next quarter. If prices fall below current levels, or continue to base, this will be abandoned.
	Resource Scarcity	Positions will be in uranium, stocks that can rebound with increases in the prices of oil and gas, or have potential related to export of Liquid Natural Gas (LNG) such as terminals.
	Timing	This is where I have gotten carried away by a perceived threat of a 30% downturn. The December downturn was 5%, the October one 10%. Less money will be moved in and out, particularly prior to a 10% correction.
Statistical		
	Piotroski Relative Strength (PRS)	I discovered this screen nine years ago and have yet to find a better one in my data mining research. It mostly combines strong financials (Piotroski scale from AAll Stock Investor Pro) with relative strength. It is volatile.
	SectorSurfer	Scott Juds has a website with statistical and fractal tools and findings (www.sumgrowth.com). The methodology recommends one position at any one time from a set of ten positions. I'm using up to four of these sets. It works.
Tested Source		
	Income	Most of the high income positions (>6.5%) are derived from preferred stocks as screened by Doug K. Le Du at www.CDx3investor.com . REITS are more volatile. Still more volatile and used even less frequently are business development corporations and master limited partnerships.
	O'Shaughnessy	These value screens have the best returns that I have found verified over long time periods. The screens research is in a book, <i>What Works on Wall Street</i> , and the screens derived from a keynote at the AAll national convention and then published in the AAll Journal of March 2014.
	Investment Advisory Service	Doug Gerlach publishes this newsletter through IClub Central, which sponsors invest clubs and is the principal alternative to AAll in investment education. Its returns are rated very highly by Hulbert's Financial Digest.
	Shadow Stocks	This portfolio of micro-cap stocks is published by AAll and James B. Cloonan, AAll's founder. It has a good track record but is very volatile, even when holding ten or twenty positions.
	Buyback Index	David Fried writes this newsletter for Forbes. He has excellent long-term results. The impact of buybacks has accelerated. Apart from his selections, he publishes a good composite index indicating whether the market is overbought or oversold. (Currently it is in a topping pattern.)
	Motley Fool Stock Advisor	David and Tom Gardner have a very credible newsletter and returns. They are buy and hold investors. They are next on the list, but I'm not using them currently.

The above list is of equities, even if the preferred stocks are very similar to fixed income. I'm experimenting with Funding Circle, an online service that offers small business loans with a much faster approval process than banks and a more accurate quantitative means for evaluating or scoring the loans. Accredited investors can buy all or portions of these loans, or automatically allocate by risk rating. Funding Circle has made 7,000 such loans. Investor returns are above 10%. Liquidity may take five years and the loans are not SEC registered.

I take the recommendations from the above portfolios spelled out in Table 1 and where appropriate, further screen each stock held or considered for purchase using a scoring system.

Table 2.	
Screen Criteria	Explanation
Piotroski f-score	Nine indicators of quality financials published by Stock Investor Pro of AAIL.
Nav-Grades	Qualitative and quantitative scores published by Louis Navellier at navelliergrowth.investorplace.com/portfolio-grader .
StopBuyingTheBull	Ratings of buy, sell or potential signal change. Published by Gary Falber at www.stopbuyingthebull.com
Fractal Dimension Indicators	I use a combination of four of these FDI's derived from Matt Trivisonno, David Nichols, XLQ's formula which I submitted, and charted coefficients of variation.
Moving Average Rollovers	These are based on statistical work I have done in the past.
Technical review	Pretty basic analysis of support and resistance lines.

For accounts of less than \$100k I've learned that it is very difficult to diversify enough to produce consistent, market-beating returns. Clients who say they want more aggressive portfolios generally leave when the volatility turns against them, as it naturally will at times with those kinds of portfolios. Consequently, overall returns for my overall practice are impacted by funds being pulled at the wrong times. As I note in the quarterly general performance report, this accounts for clients' return on investment over the thirteen years being only half of the Time Weighted Returns (TWR). Time Weighted Returns is the methodology used by mutual funds and is not affected by the timing of deposits and withdrawals. It more accurately measures the investment decisions over which I have control. Generally, the best portfolio for almost all of these smaller accounts is the high income portfolio heavily weighted to preferred stocks.

Clients for whom I manage between \$100k and \$1,000k, which is most of you, will have some combination of some of the above portfolios, depending upon your risk appetite and possible designated portfolio selections.

In terms of where I'm at, I'm less interested in researching and finding new approaches and more interested in executing well using the above resources and approach. If you want to ride with me, I appreciate that. If you don't, that's fine too.

The Market

Stock prices are influenced by many dynamics. At the present time, the U.S. economy looks stronger than most anywhere else, attracting funds from around the world and bidding up stock prices, particularly large cap stocks that have the liquidity required by huge sovereign wealth funds, speculative hedge funds, our own central bank, and other central banks. Japan recently issued a large amount of currency. How much of that bid up the value of the dollar and consequently bought and bid up U.S. stocks?

Perceived economic strength affects stock prices, as do relative returns from other kinds of investments. The games played by intermediators such as High Frequency Traders impacts returns. And lastly the merits of individual companies might impact their stock prices. While these fundamental or technical patterns may carry weight over the longer term, for eighty percent of the stocks eighty percent of the time, I suspect the merits of individual companies is over-rated.

The common perspective is that these myriad forces shape and determine stock prices, as if there are all these causes and the market is the effect or dependent variable. Increasingly, it appears that the market is both cause and effect, both the dependent and independent variable. It chases its own tail in a reflexive, fractal pattern.

Having said all that, the market is long-in-the-tooth. It may go higher, although as I edit this after seeing the precipitous fall of the market on December 31, I suspect it may drop significantly.

Sincerely,

Lee