

WEEKEND INVESTOR

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Buy and hold gets old

Market-timing strategies score big with tense investors

By Sam Mamudi, MarketWatch

NEW YORK (MarketWatch) -- Volatile stock markets have left investor confidence in tatters. Now some say it's time to accept the turmoil and adopt more dynamic trading strategies.

Proponents of so-called trend investing -- buying and selling stocks depending on technical analysis of the market's direction -- say the tactic not only enables investors to navigate unstable markets, but also prevents big losses when prices fall.

The proactive stance is winning converts at a time when concern about the strength of the U.S. economic recovery and the future of consumer spending is running high.

Yet this technique is controversial, as it counters conventional wisdom that time in the market, not market-timing, offers individual investors their best chance for success.

To trend followers, the notion of buy-and-hold investing -- picking stocks based on fundamentals and keeping the investments for months or years -- has no place in today's market and in fact is a recipe for defeat.

"You have to understand the game you're playing -- you're playing with sharks," said Kenny Landgraf, president of Austin, Texas-based, Kenjol Capital Management. "You may believe in buy-and-hold, but there are large players out there that don't."

Time and money

Kenjol uses a proprietary formula to decide when to invest, and approaches the market using exchange-traded funds. As of this week, the firm was fully invested, having jumped back into the market mid-June.

The main advantage of trend investing is protection from heavy losses, Landgraf said.

"[After starting fully invested] you're constantly moving to a more defensive position until you just get out," he said.

The strategy has shown it can work under the most difficult circumstances. Landgraf took clients in his Sector Rotation portfolio -- his firm's all-U.S. stock offering -- out of the market in August 2008, and after "one or two false starts" didn't venture back until March 12, 2009.

This approach gave the portfolio an annualized gain of 1.53% for the two years from 2008 to 2009 -- by contrast the Standard & Poor's 500 Index (SPX) was down 10.7% over that period, and data from investment researcher Morningstar Inc. shows that less than 3% of stock mutual funds -- just 63 out of 2,301 -- were in the black.

Trend investing underpins a few specialized stock mutual-funds.

Stadion Managed Portfolio (ETFFX), for example, lost just 5.8% in 2008, according to Morningstar. The fund, which invests in an array of exchange-traded funds, pulled out its money of the market in November 2007 and didn't fully recommit until mid-April 2009. Nowadays it's completely out of the market, and has been since the beginning of May.

Stadion's approach offers investors "a much more comfortable ride" said Brad Thompson, chief investment officer at Stadion Money Management.

Hits and misses

Yet while both Stadion and Kenjol's strategies sidestepped the worst of 2008, they also missed much of the recovery the following year.

Kenjol's Sector Rotation was up 24.3% in 2009 compared to a 26.5% gain for the S&P 500, while the Stadion fund gained only 2.7%. Kenjol didn't provide returns for this year so far, but Stadion's fund was up 2.5% as of July 15, three percentage points better than the S&P 500.

Wayne Copelin, founder of Copelin Financial in Sugar Land, Texas, said two bear markets in the past decade have convinced him that buy-and-hold can't work in today's markets.

"We've heard for years from money managers the pitch that 'it's not about timing but time in the market' -- but then you notice that the ones pitching this are the ones that make money if you stay fully invested," he said.

But Stadion's Thompson still sees a place for buy-and-hold, though with caveats. "If you have the stomach for the volatility, and a long enough time horizon, then no, it isn't dead," he said.

Copelin said the securities he owns have a stop-loss order that will automatically sell if they fall by 10%.

There is also a gray area between trend followers and strict buy-and-holders. For example, Bruce Berkowitz, Morningstar's manager of the decade, fills his Fairholme Fund (FAIRX) with distressed companies that may take years to turn around but isn't wedded to his holdings and buys and sells as opportunities arise. Another investing veteran, Ken Heebner, concentrates his CGM Focus Fund (CGMFX) in areas where he has high confidence but trades frequently.

"A mutual fund manager will never tell you he's a trend follower and is timing the market," said Jonathan

Rahbar, senior fund analyst at Morningstar. "But some funds do look at both valuation and momentum."

Rahbar said fund offerings such as Legg Mason ClearBridge Aggressive Growth (SHRAX), Sequoia Fund (SEQUX) and Dodge & Cox Stock Fund (DODGX) show that buy-and-hold can still be effective.

The ClearBridge fund has a turnover ratio of 4% and 10-year annualized losses of 1.7% and five-year annualized loss of 1.6%, according to Morningstar. Sequoia Fund's annual turnover is 15%, and its five- and 10-year gains are 2.5% and 6.1%, respectively. Dodge & Cox Stock's turnover is 18%; it lost an annualized 1.5% in the past five years but is up 5.2% a year over the past decade.

Stadion Managed Portfolio is less than four years old, but Stadion's separately managed accounts, which use the same strategy as the fund, have 10-year annualized returns of 2% through June 30, said Thompson.

Kenjol's Sector Rotation portfolio returned 8.3% annualized over past five years through Dec. 31, 2009; it does not have a 10-year record.

Morningstar's Rahbar is unconvinced that trend-following is viable for most investors.

"I wouldn't follow any kind of trend-based strategy because I don't know what exactly they're investing in," he said. "I have more confidence in a strategy that makes [fundamental] investment decisions."

For those investors who think of trend-following as a way to mitigate the ups and downs of choppy markets, Rahbar has some simple advice: "Those who can't stomach market volatility should keep some of their money in cash and Treasuries."