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## The Death Of Buy And Hold

By Carl Gutierrez

Value investors like Warren Buffett love to hear about how the latest investment strategy will out-perform their tried and true methodology of buy-and-hold. And in principal that method makes sense because people are irrational and the markets are volatile.

But as the last ten years have demonstrated, buy-and-hold may be logically sound, but it may no longer be a viable investment strategy. Between June of 2005 and June 2010 the S&P 500 index dropped 10.4%, and between June of 2000 and June of 2010 the index tumbled 26.0%.

Howard Present, president and chief executive officer off F-Squared Investments, said that he thinks there's a better way. "We formally believe that buy-and-hold is a flawed strategy, and today's markets are proving why," says Present.

As Present argued, buy-and-hold or index funds require full participation in every down market. "The last decade proves why that's flawed, not because the market never went up, but because the market also collapsed and never gave investors back their value."

Like value investors, Present's investment strategy extols the value of simplicity. "The single most positive strategy in creating wealth is be in the market when it's heading up, and out when it's heading down," he said.

Present and his firm are also 100% quantitative in their decision making, and only uses

sector SPDR exchange-traded funds. "When we make a decision to sell we actually eliminate a sector entirely," he said. "It's a decision of conviction if you will. The key decision is we sell when we feel the data is telling us that the probability of the sector to lose money is greater than its ability to make money."

There are three primary factors in his decision making. The first is historical prices. Present tracks the daily price of three-years-plus for each ETF, and follows the rolling moving average as a means to evaluate the momentum of the price move.

Present said that he then takes into account the volatility of each sector, and specifically the inter-day volatility rather than the closing price. "As you can imagine the inter-day volatility now has been high," he said.

Finally, Present factors in the change in volatility. "Volatility being high is one thing, but getting higher is worse," he said.

The worst case scenario is an accelerating negative trend with increasing volatility.

To be sure, Present said that he does not day trade or market time. "Our trading patterns can be fairly long-term in nature," he said. "Our leading portfolio did not have a single trade for six months."

That hasn't been the case recently. At the end of March all nine sectors appeared reasonably to fairly healthy. "None indicated imminent signs to approach sale trigger point," Present said.

Fast-forward to late-April and early-May, and for the first time in a year Present said that he saw broad-based weakness, with more than half of the sectors reaching a point of concern.

By mid-May, Present said that he sold the materials sector, the first sector his firm sold in six months, and now four in total have been taken out of his portfolio. "Of the five left consumer discretionary is the strongest, while the ones showing the most signs of difficulty are technology and financials, though they are still active," he said.

Present said that the four lost represent roughly just under 30% of the S&P 500 from a market value perspective, but if the two sectors showing bearish signs—technology and financials—were to go would mean two-thirds of the market would have gone negative, and at that point Present would begin building a cash position. "We're not there yet, and we're not saying that's going to happen next week, but 30% has already been turned off, and roughly 35% is on our watch list, and if that were to go it would obviously be very significant," he said.

When the market is going down, Present begins building a cash position, and has gone all-cash, like in March 2009. Because he only invests in ETFs, his version of cash is the SPDR Barclays Capital 1-3 moth T-Bill ETF.

"In severe bear markets there is no safe haven," he said. "We want to take clients' risk off the table and the only way to do that is through cash."

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