The Q3 2012 Mark(et) Rush Report

By

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Preface

Once again, it is time for my quarterly market review, where I examine world events and attempt to understand their implications on the markets. This is my time to reflect on current events, portfolio performance, and event scenarios, and their subsequent implication on world equity markets and my investment strategies.

It is my goal in life to have my money working for me instead of me working for my money.

Please keep in mind that I am an *amateur* investor and this document is a *hobby* for me. Any thoughts and concepts should be treated as such. Please consult a professional financial advisor before you make any investment decisions regarding your investment ideas, goals, and strategies. Continue reading this document at your own risk…

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In plain English, I am NOT giving you investment, tax, or legal advice.

Regards,

Mark Rush
http://traderwasteland.wordpress.com/

Introduction

Not a lot has changed in last quarter on the macroeconomic front, Europe is still a basket case and China has continued to stumble. But what is on the radar this quarter is the upcoming Presidential election, both sides would have you believe that we are at a major cross roads and the other guy is going to destroy the country. In reality, the economic impact of any one person, including the POTUS, is slightly less onerous.

I will be briefly be talking about market impact regarding the two candidates, before I everyone gets in an uproar, remember this is investment newsletter where I look at how things realistic behave and this report is not a dreamy document opining on how the world "should" work. My hard earned money is nonpartisan.

Regarding the portfolio, last quarter I announced that I had sold in May (and went away) and was 75% in US dollars (USD). Shortly after writing the last report, I started to nibble and became nearly fully invested by the end of August. At that point I started to thin out the portfolio again at the end of September after the market ran up and I can once again proudly say that I am 80% in USD once again. I apparently made an entire round trip in the market over the last 3 months. Now I am back to where I was at the last report but with a little more spending money in my pocket.

I suspect I will be getting back into the market sometime late this month or early next month. I am anticipating a market pullback shortly and I believe that this should (hopefully) set things up as a buying opportunity. If we don't get a pullback I will be forced into buying the market at higher (riskier) levels. I believe this bull market is not dead yet although getting somewhat riskier.

I am waiting for the election to make some final life decisions regarding where to live and if I am going to stay independent (stay off the corporate treadmill), but we will save those discussions for next report (after the election). But there seems to be a 66% chance that I am going to stay independent and completing my move to Galt's Gulch, Colorado. West Virginia has served me well for the last few years but I believe it's time to move up in life, at least 7,000 ft. up.

Regards,

-Mark

You can follow my latest shenanigans at http://traderwasteland.wordpress.com/

Chapter 1
Considerations

US Presidential election

Normally I try to avoid politics in this report as much as possible except its impact on my investments but I believe that this year's elections will have an impact the US economic philosophies for the next 4 years. I suspect Obama will win the election although the Electoral College shows a closer race but that is still leaning toward Obama. http://www.270towin.com/

The real influence on the economy, by whoever becomes President, is vastly overstated… The latest official Rush Report market poll (Intrade) has Obama at 66% chance of winning albeit his ability to get anything "new" done will be mostly blocked by the Tea Party wing of the Republican Party in the House. My guess is that the Republican's will control the House but not Senate although neither party will have the critical 60% control in the Senate. The only real debate will be the fiscal cliff…

If Romney were to win, I personally think the economy would be slightly better off with a more pro-business and pro-energy administration. But realistically his win would likely only increase GDP by 1/10% in the last few years of his first term. If Romney were to win I would aggressively shift all my capital to banking stocks and energy stocks, since this would be the area of greatest positive impact. Rates would tend to stay lower and the value of the US dollar would like not deteriorate as fast. A full recovery of the economy may be slightly faster under Romney but will still likely to take the entire 4 years to achieve. Romney would likely have a more aggressive stance with the Federal Reserve's "easy money" policy; the dollar would likely deteriorate slower.

With an Obama win, we are likely to see more of the status quo. My investment thesis wouldn't change (it is the base case) but it would tend to be slightly more toward investments overseas and precious metals to compensate for a likely continued decline in value of the US dollar. I would also put a little more money into healthcare since we will be pumping additional billions more dollars into that industry. The probability of a debt spiral increases slightly near the end of his term if unemployment remains high.

Real Probability of Systemic Risk from Europe (update)

Same as it ever was… same as it ever was…

There are only two realistic ways out of the dilemma in the short term; an explicit default or a stealth default. I seriously doubt Europe has the intestinal fortitude to admit that the Euro Zone was a bad idea, so the only practical solution left is denial; therefore they will eventually execute the stealth default. The best way to implement a stealth default is to simply have the European Central Bank (ECB) print money. In the old day before the Euro countries could simply devalue their own currency but now since there is a single currency individual countries have no control over the printing presses. I suspect that

Europe will come to the precipice and right before they go over the edge (a collapse of the Euro Zone) they will finally "monetize the debt" and print their woes away.

The problem is with this strategy is that, in my opinion, long- term you cannot solve a *fiscal problem* with a *monetary response*! In other words, in the long run you cannot solve the problem of giving away too many goods and services (redistributing too much wealth) by simply printing more money. This is the current world strategy to solve these kinds of problems; it will not work long term. Remember, money is nothing more than an accounting scheme to track the goods and services that we produce; it in itself has no real value. Producing more money does NOT produce more goods and services. This is a very important point that too many very smart people miss. Money is not wealth!!

Weakness or soft landing in China and India

The Chinese and India stock market has gotten punished this year and I am fearful it could get worst, for the past few years the world economy has depended these engines to fuel world growth. If Europe starts to fall apart, these markets will get hit harder than most (high beta). After Europe, this is what I will be watching this year.

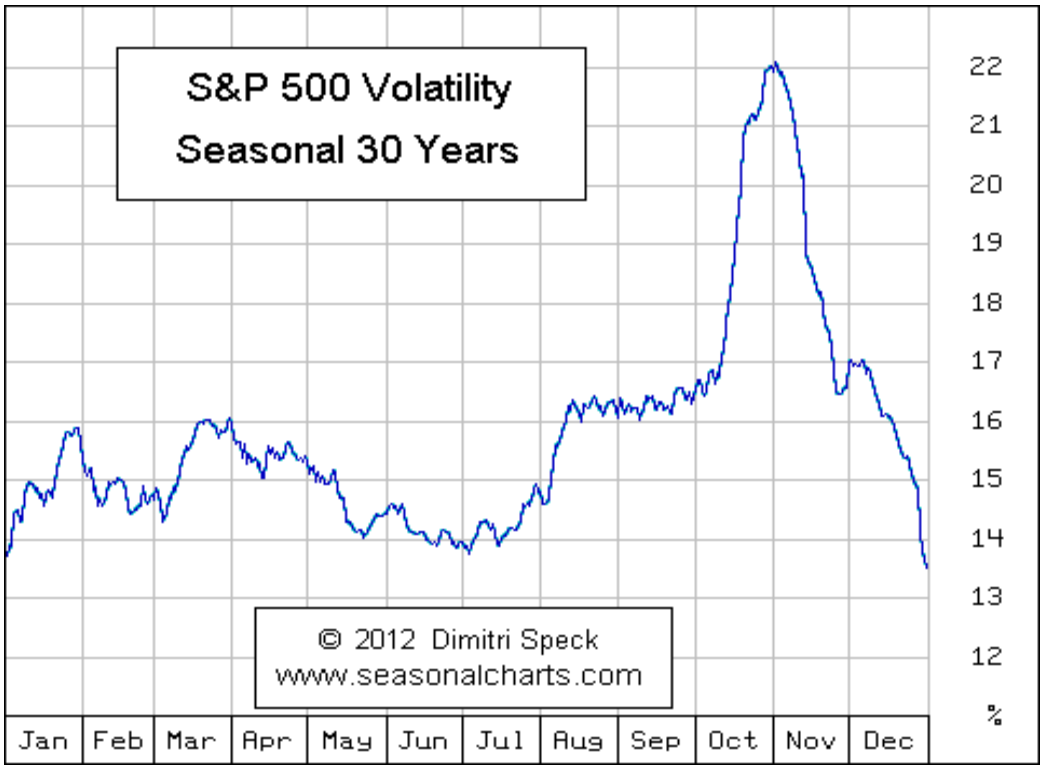
Stock Market Cycles

The market tends to tank this time of year then rebound sharply next month. I don't fully understand the psychology of this phenomenon but it seems to be well established and markets tend to go up November through April. I plan to follow this plan and be underinvested this month and look to be a buyer in November (after the election).

I have included a few seasonal charts that I look at to determine what time of year to invest. From these charts it seems that buying in November and selling in August is the way to go.

Same ideas in this chart but this time it is broken down into a 5, 10 and 15 year history. This is actually the chart that I use to make my seasonal decisions. This one tends to tell me to buy mid-November and sell January then buy in March then sell in May (and go away).

Since I trade a lot of options, I like this chart. When Volatility is high the market tends to be going down. Think of this chart as a chart of the amount of risk in the market.



Fiscal cliff

Now considering how the market took the last time we had fiscal debates and considering the potential for political grand standing, things could be worse this time around. I plan to be ready for another shaking of confidence of our financial system by both parties.

Changes in taxes at the end of the year

Below is a list of the taxes that are set to change at the end of this year.

- Top marginal personal tax rate rises to 39.6% from 35% at the end of 2012.
- Limits on itemized deductions will effectively add 1.2% to the top rate.
- The new 0.9% Medicare tax for those over $200k single or $250k joint.
- Top 15% rate on long-term capital gains rises to 20%.
- Dividends will be taxed at ordinary rates — 39.6% max rate up from 15%.
- The new 3.8% Obama-care tax on investment income over $200k/$250k
- Estate tax rate goes from 35% to 55% (60% in some cases).
- The estate tax exemption falls from $5 million to $1 million
- Forty-one other separate tax provisions expire this year

QE3

Quantitative Easing Round 3 – The Federal Reserve announced last quarter that it was going to inject yet another ½ Trillion dollars into the economy targeting Mortgage Backed Securities. What this means is the Federal Reserve is going to be buying mortgages from Freddie and Fannie Mae. This should make more money available to this now failed publicly owned institution to make more housing loans (isn't this how we got here?). The net effect of this is it "should" lower mortgage rates even more in the near future with the goal of forcing a housing market recovery. All in all it sounds like a laudable goal.

Now you may ask yourself, "Where did the Federal Reserve get all this money" to help out us poor want-to-be homeowners. That is a good question, the answer is well… nowhere! They simply willed the money into existence. So, this is where the big rub is, the Central bank simply "creates" this money to buy these mortgages and if you are in the market to buy a house this is a good thing *for you*. The down side is, under normal circumstances this tends to cause inflation or stagflation. The Fed is "hoping" that inflation doesn't occur, and I use hope here because they really don't know for sure, this is one massive experiment with our monetary system and the phase "unintended consequences" often comes to mind.

So far there hasn't been a huge amount of inflation in the general economy but you can see the effects of all the money that has been created, as of now only the raw commodities have seen inflation such as oil, grains, gold, metals. We have not yet hit an "inflation spiral". To be fair I think QE1 was necessary but I disagree with #2 and #3.

If you refinance a house or in the market to buy a house QE3 will benefit you, if you own gold, silver or platinum this will sort of benefit you, also if you own an oil well or copper mine this will also benefit you. But on the other hand if you have a savings account, live on a fixed income, work for minimum wage, or are part of a pension plan this will hurt you. Over all savers will be hurt and debtors will benefit and after all isn't this want we want from a truly great society, to subsidize debt at the expense of savers? This has worked so well these days in Europe, just ask Greece and Spain…

Now as far of how this affects my investments, I will avoid having any cash since you get nothing for savings and prices keep creeping up. I also believe QE is a primary driving force for the current stock market gains. So, I invest in things that will likely go up as the dollar goes down, such as oil, gold, and Australian dollars. Owning companies is also a good thing since the value of these companies are more or less fixed but as the paper money falls in value it will appear to most that they have become more valuable.

Another problem is the Fed isn't the only central bank that is doing it. European Central Bank (ECB), Bank of England, Bank of Japan and other are all creating money out of thin air "solve" the current bad economy. Money is nothing more than an accounting method used to track wealth creation and destruction. Creating more zeros at the end of the day only creates more zeros and does not create any more real good and services. If QE really worked Zimbabwe would have the world strongest economy right now.

http://en.wikipedia.org/wiki/Hyperinflation_in_Zimbabwe

Roth IRA Conversion

I have decided to convert a small part of my IRA to a Roth IRA this year but I needed to consider the potential tax consequences for this year and next. With taxes likely to rise next year, I decided it was time to consider a Roth IRA conversion. Unless Congress acts, income tax rates will go up on January 1, 2013 so a conversion is "cheaper" this year.

Also some people may have to consider that next year the new 3.8% Medicare surtax takes effect for married couples filing jointly with modified adjusted gross income (MAGI) of more than $250,000 ($125,000 per person for couples filing separately), and for individual filers with MAGI greater than $200,000. The new surtax applies to whichever is *less*: net investment income (such as interest, dividends, capital gains, annuities, rents, and royalties) or the amount that exceeds the MAGI income thresholds. Since any amount that someone converts to a Roth IRA in 2013 would be included in your MAGI, a Roth conversion could trigger the 3.8% Medicare surtax on any investment income next year—thus increasing the net cost of a conversion.

A full blown conversation was likely to push me up a couple of tax brackets so my solution is to only convert part of my IRA and continue to do each year for the foreseeable future so I will stay under my threshold of pain on my taxes. Unfortunately, I am getting good at calculating an estimated tax liability several times a year.

Chapter 2
Fundamental and Technical Indicators

Economic Projections

It is time to review world events applying my "opinion" based on absolutely nothing other than my limited understanding of how the world works. Headline predictions are made at the beginning of the year and may have changed materially since then.

US Economic Indicators (my forecast)

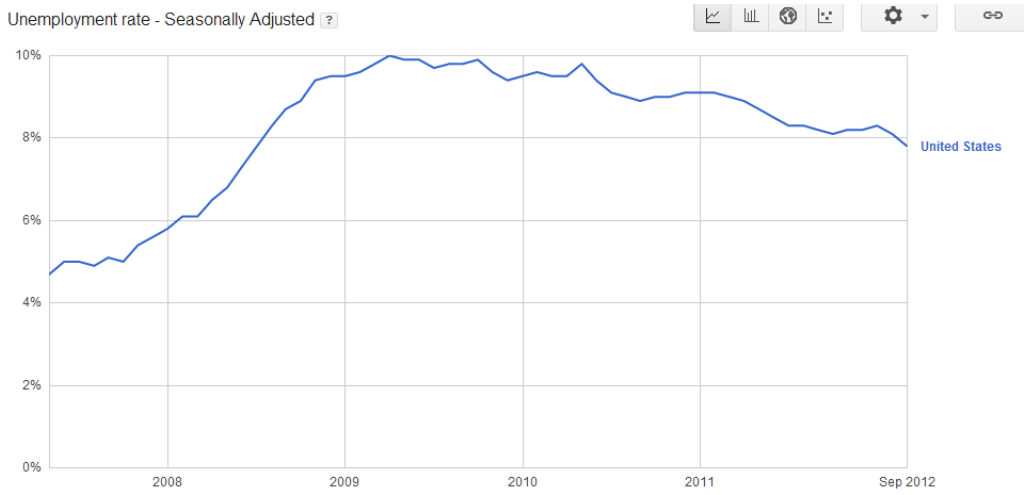
US Gross National Product (GDP) Growth > +2.5 % for 2012

The economy is growing slower than I predicted at only 2.1%, this isn't great but at least it is a positive number.

The economy seems to be weak buy growing

Unemployment of falls to < 7.5% by the end of 2012

The economy needs to retool itself before the unemployment rate will fall. The trend seems to be positive. We can debate if it is real jobs or people dropping out workforce.

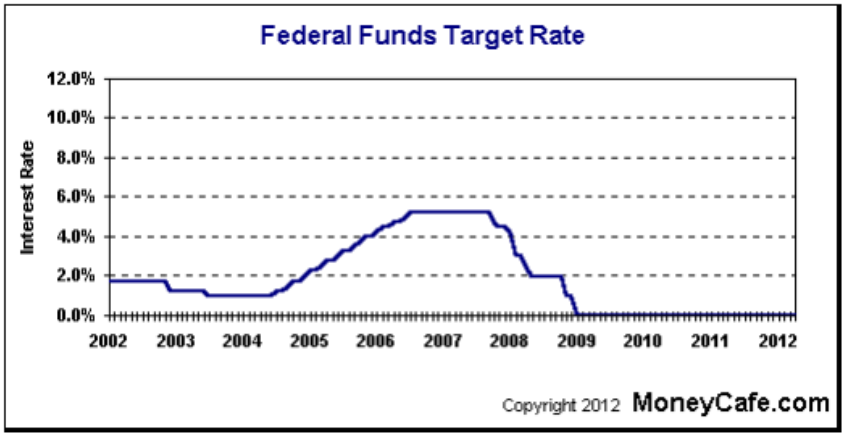


The latest number (Sept) was 7.8%

Unemployment is very high but falling

Federal Reserve keeps interest rates steady in 2012

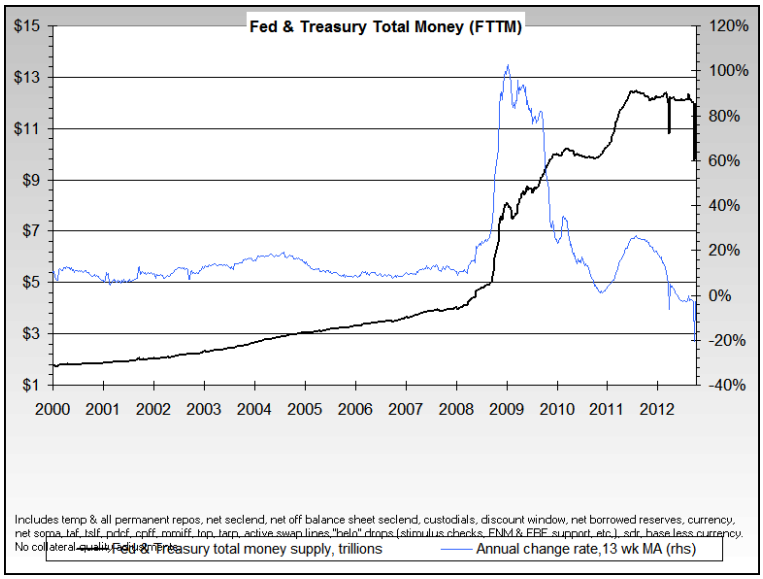
The Fed has stated it will keep rates low until at least mid-2015.



Low rates are good for the market…

Inflation > 3.5% in 2012

The money supply continues to grow (black line)… The FTTM money supply has gone from $2T in 2000 to almost $13T today with a 600% increase. The rate of money creation has slowed and should stabilize the dollar. QE3 should start to increase this number once again.



Currently we are not experiencing inflation but there is a slight bias of inflation

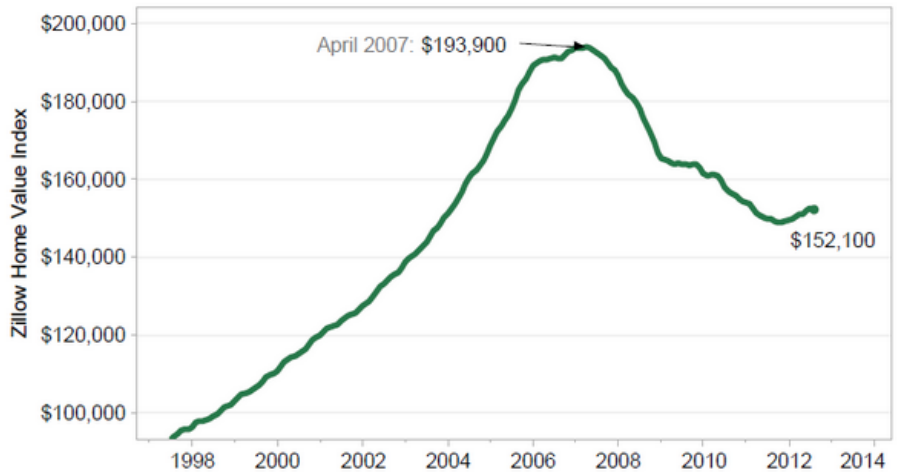
S&P 500 index >1425 at the end of 2012

Corporations were financially stronger coming out of this downturn (except financial institutions) compared to other recessions. We have nearly hit my target for the year in the first quarter. Too bad it has dropped since that… We have exceeded this goal.

Stable Real Estate prices (ave home >150k) in 2012

The 30 year mortgage rate is at 3.25%%. I expect as rates to remain low for at least 18 more months. Real estate will probably never be cheaper and rates will never be lower. Home "affordability" is currently extremely high as long as you can get a loan.

National average House Values



National average Mortgage Rates

Housing prices are stabilizing; interest rates are low

<$1.10 Trillion Dollars budget deficit for FY 2012 (US FY ends in Oct)

Latest estimates are $1.1 Trillion http://www.usdebtclock.org/

I believe thoughtless government overspending is harmful in the long run

Technical Indicators

Technical analysis is the attempt to forecast the future direction of prices through the study of past market data. I use Barchart (http://www.barchart.com/) to come up with a final "objective" opinion of an investment. Its primary ability (flaw) is that it tries to predict the future by interpolating from the past performance. One phrase does come to mind, "Past performance is not an indication of future results".

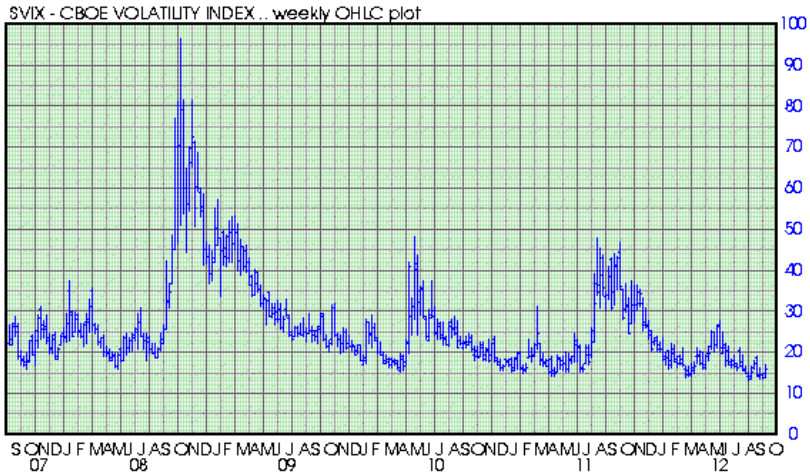
Model Portfolio and other technical indicators (+100% = strong buy; -100% = strong sell)

US Stock	3/30/12	7/3/12	10/1/12	Link
SPY	+72%	+48%	+8%	http://www.barchart.com/opinions/etf/SPY
QQQQ	+88%	+48%	+8%	http://www.barchart.com/opinions/etf/QQQ
IWM	+56%	+56%	+8%	http://www.barchart.com/opinions/etf/IWM
International				
EFA	+56%	+32%	+8%	http://www.barchart.com/opinions/etf/EFA
EEM	-16%	+24%	+56%	http://www.barchart.com/opinions/etf/EEM

Bonds	3/30/12	7/3/12	10/1/12	Link
TLT	-72%	+32%	-16%	http://www.barchart.com/opinions/etf/TLT
SHY	-16%	-48%	+80%	http://www.barchart.com/opinions/etf/SHY
Gold/Oil/Dollar Index/Euro/Yen				
GLD	-40%	+8%	+64%	http://www.barchart.com/opinions/etf/GLD
USO	-16%	-8%	-16%	http://www.barchart.com/opinions/etf/USO
UUP	-56%	+16%	-48%	http://www.barchart.com/opinions/etf/UUP
FXE	+56%	-16%	+32%	http://www.barchart.com/opinions/etf/FXE
FXY	-40%	-8%	+56%	http://www.barchart.com/opinions/etf/FXY
Volatility Index				
VIX index	-80%	-64%	-16%	http://www.barchart.com/opinions/stocks/$VIX

Volatility increases in 2012

Volatility Chart (market fear index)



The Volatility index (VIX) can be thought of as the US stock market fear indicator and the lower it is the lower the fear in the market. This indicator is one of the more valuable tools to evaluate what implied risk is in the market at any given point in time. It is showing that fear in the market has fallen back to near pre-crisis levels. It is for us to determine if this is warranted or simply complacency. I am voting for complacency.

Ted Spread…

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This is the Bond market fear index; it has been falling all year.

Technical summary…

The markets are neutral for most stock investments and positive for all other currencies (negative for US dollar), gold and emerging markets. I am not sure what to make of this since there are significant risks in the markets right now but the market seems to be blowing them off or is bored of Europe.

Chapter 3
Value Stocks

Here is a quick list of the *some* stocks that I follow that I think are "value". I show the expected yield in '13, its current stock price verses *expected* earning in '13 (price/earnings), and stock price to book value in percentage. Regarding book value 100% = current stock price is equal to book value, below 100% indicates the stock is selling below book value. This is my shopping list for individual stocks when it is time to buy.

Stock	Symbol	Yield	Est. '13 P/E	Price to Book
Apple	AAPL	0.0%	12.5	560%
Barrick Gold Corp	ABX	1.9%	8.5	170%
American Capital Agency	AGNC	14.3%	9.7	120%
Bank of America	BAC	0.4%	9.7	50%
Barclays	BCS	1.8%	5.6	50%
BP	BP	4.5%	7.9	120%
Citigroup	C	0.1%	7.7	56%
Caterpillar	CAT	2.4%	8.4	350%
Cisco Systems	CSCO	3.0%	9.0	190%
Chevron	CVX	3.1%	9.4	180%
Deutsche Bank	DB	1.6%	6.5	50%
Facebook	FB	0.0%	35.0	350%
Google	GOOG	0.0%	15.4	390%
Goldman Sachs	GS	1.6%	9.6	88%
ING Groep	ING	0.0%	4.7	50%
JP Morgan Chase	JPM	2.9%	8.0	86%
KKR Financial Holdings	KFN	8.4%	6.7	100%
Morgan Stanley	MS	1.2%	8.9	56%
Arcelor Mittal	MT	4.4%	7.6	42%
Annaly Capital	NLY	11.8%	8.8	93%
Rio Tinto	RIO	3.1%	6.4	160%
China Petroleum	SNP	3.0%	6.5	110%
Toyota	TM	1.8%	9.7	93%
Total S.A.	TOT	4.7%	6.9	120%
Vale S.A.	VALE	6.5%	6.3	120%

The list is not all inclusive and I tend to track large companies (for liquidity and options) but notice that big discounts tend to be in financial firms, oil companies, raw materials, and drugs. Yes, I think Facebook is a value play based on next year's earning estimate considering its growth rate, I don't own any now but it's on my tech list of things to buy on a dip. If the economy gets better this stock will do well long term.

Chapter 4
Mark's Model ETF Portfolio

Asset reallocation

General profile for a several diversified portfolios

	Risk Adverse	Balanced	Growth	Aggressive
US Large Cap:	20%	30%	40%	30%
US Small Cap:	10%	10%	20%	30%
International:	10%	20%	30%	40%
Fixed Income:	50%	35%	10%	0%
Cash:	10%	5%	0%	0%

US Large Cap:
SPDR S&P Depository Receipts (SPY) 33%
NASDAQ 100 Trust Shares (QQQQ) 33%
Vanguard Value VIPERs (VTV) 33%

US Small Cap:
iShares Russell 2000 Index (IWM) 100%

International:
iShares MSCI "EAFA" Europe, Australia and Far East Index Fund (EFA) 50%
iShares MSCI Emerging Markets Index (EEM) 50%

Fixed Income (Bonds):
iShares Lehman 20+ Year Treasury Bond (TLT) 25%
iShares Lehman 7-10 Year Treasury Bond (IEF) 25%
iShares Lehman Aggregate Bond (AGG) 25%
iShares GS $ InvesTop Corp Bond (LQD) 25%

Cash:
iShares Lehman 1-3 Year Treasury bond (SHY) 100%

Year to Date Returns

Name	Symbol	12/31/11 Price	6/30/12 Price	YTD Gain % w/o Div	YTD Gain % w/ Div
SPDR S&P Depository Receipts	SPY	$125.50	$144.50	15.14%	16.80%
NASDAQ 100 Trust Shares	QQQ	$55.83	$68.57	22.82%	23.64%
DIAMONDS Trust	DIA	$121.85	$134.05	10.01%	11.97%
Vanguard Value VIPERs	VTV	$52.49	$58.72	11.87%	14.00%
iShares Russell 2000 Index	IWM	$73.75	$83.44	13.14%	14.44%
iShares MSCI "EAFA"	EFA	$49.53	$53.00	7.01%	9.33%
iShares MSCI Emerging Markets	EEM	$37.94	$41.33	8.94%	10.17%
iShares Lehman 20+ Year Treasury	TLT	$121.25	$124.22	2.45%	4.24%
iShares Lehman 7-10 Year Treasury	IEF	$105.57	$108.46	2.74%	4.00%
iShares Lehman Aggregate Bond	AGG	$110.25	$112.45	2.00%	3.72%
iShares GS $ InvesTop Corp	LQD	$113.76	$121.77	7.04%	9.80%
iShares Lehman 1-3 Year Treasury	SHY	$84.50	$84.50	0.00%	0.27%

Results for the various "autopilot" portfolios

	Risk Adverse	Balanced	Growth	Aggressive
'12 Return	8.49%	10.29%	13.00%	13.21%
'11 Return	7.02%	3.30%	-2.52%	-6.51%
'10 Return	11.17%	12.45%	15.53%	16.91%
'09 Return	11.14%	19.65%	31.48%	36.54%
'08 Return	-8.18%	-18.66%	-33.90%	-39.60%
'07 Return	7.82%	9.40%	10.04%	10.45%
'06 Return	9.72%	13.63%	19.09%	21.83%
'05 Return	5.49%	7.55%	9.73%	11.77%
Total return since inception	64.38%	66.69%	59.04%	53.47%

Despite the recent pullback in the market all strategies are doing reasonably well this year. I still believe in 2013 the "Aggressive" portfolio will outperform the "Risk Adverse" portfolio.

Chapter 5
My Plan

Every trader reserves the right to make a more intelligent decision today than he made yesterday. - Sheldon Natenberg

Considerations
Election cycle – Weak before election, strong after??
European sovereign debt – Pretend and extend???
China – Hard/soft landing?
Market Seasonality – tuning negative but then then very positive for 2nd half of quarter
Taxes – 2013 increases and/or fiscal cliff… I will need to play this as it develops.
QE3 – It is foolish to own any paper money or bonds for any extended period of time

US Economy

The US economy is weak but stable and it is likely to remain that way through mid-2013. I expect unemployment to continue to improve slightly over the next few months. I don't expect to make any real progress anytime soon in the Euro zone and a sudden meltdown in Europe would hit the US economy.

There are many headwinds for investors right now but it appears the US economy is the sexiest girl at Wal-Mart tonight. US companies have their collective acts together. QE3 pushes me to toward large US based multinationals that have pricing power.

Inflation

I only expect modest price increases for the next 9 months with acceleration of inflation late next year or early 2014. I plan to bias my portfolio toward inflation plays such as gold, energy, stocks, real estate, and commodities.

Europe

Things in Europe still look weak and will remain so for the foreseeable future. I will tend avoid any new investments in Europe but may start looking for "cheap" stocks there. Europe is starting to interest me and I may dabble a little this winter.

The Dollar and US Bonds

I do not own any US bonds because yields are too low and they are going to stay low for the foreseeable future. I do not understand why anyone would invest in this sector, although I have to admit those who have over the past couple of year have been rewarded handsomely.

If you twisted my arm and forced me to buy bonds I would only consider TIPS…

Muni bonds

The yields here are higher than US Treasuries and tax free. I could understand why someone might be tempted to buy ***selected*** muni bonds that have a low potential for default. I personally will not be looking in this area.

I still believe that high dividend stocks are still a better bet than muni's until 2013 when dividends get taxed at the normal income rate. Muni bonds may make a comeback in the 4th quarter of this year when the tax rates are scheduled to go up. I will not invest in Muni bonds due to my current distain for *any* type of fixed income.

I do not own any muni bonds nor will I ever purchase any.

Corporate Bonds

Corporate bonds have a higher yield than Government bonds but I am still shying away from all types of "fixed" income assets. Something I am had considered is acquiring corporate bonds and selling (shorting) Treasuries. This would offer some protection from inflation and likely to yield a decent return under most circumstances.

I don't own corporate bonds and unlikely to purchase any bulk in the near future. If forced to buy bonds this is where I would go.

Financial stocks

I own some Bank of America Jan '14 options as a speculative play. I have my eye on a few more bank names this year if the economy continues to recover. This sector will make or break me next year. I am pondering buying some BCS and/or buying call options on the XLF (financial ETF) as a speculative play.

If the economy holds/improves banks stocks have the potential to outperform. I like bank stocks!!

Real Estate

I think we may be near a bottom and I am shopping for a house in CO. When I approved for a loan I was shocked how low my monthly mortgage would be. The trick for most people is getting a loan and coming up with that pesky down payment. I believe a fixed rate loan is the only way to go. If inflation creeps up in the next 3-5 year, the long term the value of the house will go up and the burden of the loan will go down. Win win…

Oil/Energy

I like oil for next 5 years. I like BP, Total, and China Petroleum. I will be investing in these names later this year or early next. I also like Chevron with its low P/E and high dividend but do not own any yet. I also own Transocean (RIG) via options and outright stock. I like energy and will be buying more after the election. If Romney wins the election I will be buying much more in this space.

Domestic Stocks

Many US stocks are still cheap right now but they are not as cheap as they were in last year. Selected stocks are still very attractive considering the alternatives (bonds).

Chinese and Emerging markets

I am still a believer that these markets will drive the world economy over the next 50 years. I will be investing there based upon these beliefs but just not right now. I am waiting for things to sell off a bit more before I get into this arena again.

Options

Volatility seems to be extremely cheap right now but it keeps getting cheaper. I looked at my portfolio and had a few out of the money call options and I attempted to buy some of them back and I bought some "protection" by owning some put options on the S&P 500 ETF (SPY) and potentially I will buy some call options on the volatility index (VIX).

Cash and its proxies

With QE3 and Europe likely to QE also, all paper currencies are suspect. Earlier this year I was keeping about 20% of my portfolio in Australian dollars (FXA) due to its high yield ~4+%, currently I am in USD but will likely return to my "not printing" friend $AU. The $AU is very volatile but the monthly checks were very nice. I need to think of a leveraged way to short USD and buy $AU and collect the carry.

Gold/Platinum/Silver

I sold all my Gold and Platinum a few months ago but for a few weeks this past quarter ~15% of the portfolio was in Silver (SLV). I will likely buy more silver in a few weeks if we get the pullback I am expecting. For most of 2013 I will not hold USD in my portfolio instead I will hold these metals as a proxy for cash since I am bearish of USD and all major currencies due to bad monetary and fiscal policies. I like shiny metals!!

Long Term Macroeconomic Trends

Longer term we cannot overlook the wealth effect that is going on globally. Three billion or so poor people are moving up the wealth latter and their diets are shifting to higher quality protein and upscale brands are increasing in sales. Farming and its derivatives will benefits in the upcoming decades along with aspirational items.

People with more disposable incomes will want more cars and general use more energy. Oil use and energy infrastructure will continue to grow for remainder of the decade. These people are going to also want newer and larger houses therefore lumber, copper, and all the other raw materials will be benefiting over the next couple of decades.

I believe in long-term raw materials, food, energy, and health care are strong foundation to my investment thesis. Add to this the world wide easy money policy and this doubles my reasons to own raw material for the foreseeable future.

Summary of Mark(et) Economic Indicators

GDP Growth – Stable
Unemployment – Unemployment is very high but falling
Federal Reserve Bias – Low rates are good for the market bad for USD…
Inflation – Currently we are not experiencing inflation
Corporate profits – Estimates for next year are falling due in part to Europe
Real Estate Market – Housing prices are stabilizing; interest rates are low
Budget Deficit – Improving?
Dollar – QE3 (good for stocks)
Volatility Index – Low
Technical Indicators – neutral
Liquidity – Improving

So… What is the Plan?

Historically, for whatever reason, October tends to be a bad month for the market therefore I have already sold most of my portfolio and I am currently ~80% in cash (USD). Long term I still think that investing is the market is the only option available with yields on bonds so low. I am over 80% cash in outright USD; this is an extremely poor place to be invested for any length of time!

My current strategy is based on a win for Obama in the upcoming Presidential election; I am going to start by selectively investing a week or two before the election or on any sharp market selloff. After the election I will become more aggressive on my investments and hope to be at least 80% invested within 2 weeks after the election. If Romney wins, I will move into the market much more aggressively especially into energy, pipeline, and banks. The bottom line is that it really doesn't matter much who wins the election, I will still want to be 80%+ invested in the market within a couple of weeks after the election.

QE3, when the Fed creates more money the value of that money falls, when the value of money decreases it makes other things looks like they are going to go up in price. I will be investing heavily over the next 6 months due to this phenomenon. This is biggest reason why to be in the market now. If the market tanks, they will print more…

I *still* need some exposure to drugs or healthcare. I need to look at the Health Care Select Sector ETF (XLV) such as the XLV and/or the Nasdaq Biotechnology ETF (IBB).

Currently my major holdings, in no particular order, are Cash (US$), BAC, RIG. SDS, WFT, ABX, CHN, GDX, IGE, AGC, AGNC, HPT, IRE, KFN, KKR, MUX, NLY, PDS, and SNP. SDS is an inverse ETF used to offset my other positions.

When the time comes I will be investing heavily in Banks/Financials, Oil companies, commodities plays, gold/silver, and possibly the Australian dollar again. By being in cash right now I am have already missed a big market move up and if the pullback doesn't occur I have lost out on a significant amount of upside to the portfolio. The trick is to know when to jump in gangnam style… Oop oop…

Chapter 6
Final Thoughts

The Good

- Interest rates are low and will stay low until at least 2015
- World economic growth is weak but growing
- World GDP is projected to be positive in 2013
- New innovations and new efficiencies are creating new real wealth daily
- US company's balance sheets are strong, stock market valuations are good

The Bad

- High unemployment
- Upcoming fiscal cliff debate and likely political impasse
- Higher US taxes in 2013 on capital/production to subsidize consumption
- Borrowing and spending is not the cure for too much borrowing and spending
- 2013 S&P earnings estimates are falling
- China/India growth???

The Ugly

- The European sovereign debt spiral is still in play, it has not gone away!
- *Exploding* US budget deficit/national debt due to increased spending
- We may be seeing the beginnings of a US Government debt spiral
- Unfunded Social Security along with State and local pension time bomb
- Governance that confuses redistribution for wealth creation
- Attempts to solve *fiscal & structural problems* with a *monetary responses*

Final thoughts:

QE3… China… Election… Thousand points of light…

This is the conclusion of my report; I hope to get my next report the year-end special edition out by January 7th, 2013 from Colorado. Please send any questions, comments or topic ideas for future issues to me. GOOD LUCK!!!

Regards,

Mark Rush