

Three Quarters, Three Gains

The third quarter, and the year so far

The New York Times ran its quarterly look at fund returns on Friday, and the winner was energy, in a year when the easy pick was technology. The average energy fund gained 11.6% percent in the three months through September, the average technology fund lost 1.4% percent, and the average U.S. stock fund and the average bond fund each lost about 2% percent. The war with Iran did it, by driving up the price of oil and fuel and pushing interest rates higher, and when rates rise the bonds people already own fall in price. The columnist admitted that in January he would have picked technology to lead, and most of us would have said the same.

I gave up trying to pick the winning sector a long time ago, which is why the strategy can own all eleven sectors of the stock market in equal amounts. Energy is one-eleventh of the portfolio, the same as technology, and it stays for as long as it trades above its trend line, which is its average closing price over the past 200 trading days. Energy was above that line every day of the quarter, so the strategy held it the whole way, and the energy fund it owns (XLE) gained 16.5% percent. The Times figure is an average of every energy fund out there, which is why it is lower.

The same rule that kept energy told the strategy when to leave other sectors. Utilities closed more than 1% percent below their trend line on July 31, so the strategy sold at the next morning's open and moved the money to cash (U.S. Treasury bills or a money market fund), and the utilities fund dropped another 10.2% percent by the end of September. Five more sectors slipped below their lines in September, and the quarter ended with seven of the eleven positions sitting in cash and earning interest. The rule gets one wrong now and then, and this quarter it was consumer discretionary, which the strategy bought in early August and sold four weeks later about 3% percent lower. I accept small losses like that one as the price of missing the large ones.

The strategy gained almost 1% percent for the quarter (0.99%), which turned \$100,000 on June 30 into \$100,992 on September 30. I judge a quarter by a simple question: if you had put your money in at the start of the quarter, how far under water were you at the worst moment? The answer this time was 0.15% percent, about \$150 on that \$100,000, and it came on July 1, the very first trading day. The portfolio closed above its starting value every day after that.

Many of you may own a 60/40 portfolio, meaning 60% percent stocks and 40% percent bonds, with the bonds there to steady the ride when stocks fall, and this quarter the bonds fell right along with them. The Vanguard Balanced Index Fund (VBINX), the standard example, lost 0.57% percent, was down 2.06% percent at its worst, and spent 25 trading days below where it started.

I view this primarily as an absolute-return strategy, which means the aim is to grow your money and keep the declines shallow whatever the market is doing, and the table at the bottom of the page shows how that has gone this year. The strategy and the 60/40 fund have ended up in nearly the same place, up 6.52% percent and 6.30% percent, and they took very different roads to get there. The strategy gained in all three quarters, between 0.99% percent and 2.84% percent each time, while the 60/40 fund went down 2.44% percent, up 9.58% percent and down 0.57% percent. Reaching the same place with three steady gains and no losing quarter is what an absolute-return strategy is built to do. That steadiness cost something in the second quarter, when the strategy trailed the fund by about 7 points in a strong rally, which is the trade I described in my note *Warned in Advance*. The strategy will have lagging quarters of its own.

So I will go on examining all eleven and letting each trend line decide whether to own it. Four sectors are held as the fourth quarter begins: technology (XLK), financials (XLF), health care (XLV) and energy (XLE).

John

2026 through Sept. 30	Q1	Q2	Q3	Year to date	Up quarters
The strategy	+2.84%	+2.56%	+0.99%	+6.52%	3 of 3
60/40 fund (VBINX)	-2.44%	+9.58%	-0.57%	+6.30%	1 of 3

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