



## THE FOXHALL GLOBAL OUTLOOK



MAY 7, 2010

PAGE -1-



Dear Paul,

**Are the stock market declines over the past two weeks the beginning of a major stock market correction?**

I have been warning in these FOXHALL GLOBAL OUTLOOK newsletters since last November that we were historically due for a significant stock market correction.

WARREN BUFFETT, America's richest and most successful investor has said that in the short run, the stock market's movement can seem as random as a "SLOT MACHINE." But in the long run, the stock market is like a "WEIGHING MACHINE," in that IT ALWAYS TRACKS THE LONG-TERM DIRECTION OF THE UNDERLYING ECONOMY.

### THE U.S. STOCK MARKET IS OUT OF SYNC WITH THE U.S. ECONOMY

That is the problem investors' face right now. The U.S. stock market is completely OUT OF SYNC with the underlying U.S. economy.

Make no mistake about it, the U.S. economy is growing and expanding—but at a very mediocre rate of about 3% this year.

At the same time the U.S. stock market has shot up over the past year, without a major correction. We haven't seen such a long and sharp upward movement in the stock market after a severe recession since the 1930's and the correction that followed that post-recession bull run was not pretty.

The laws of statistics state that whenever two trends diverge they must always "REGRESS TO THE MEAN" of their underlying fundamentals—which is the basic U.S. economy.

### HOW MUCH IS THE STOCK MARKET OVERVALUED?

Some analysts believe a stock market correction of 10% to 15% would be extremely beneficial and would bring the market and the economy back into some rough balance.

However, Professor and Yale economist Robert Shiller has developed a method of calculating the stock market's historic PRICE/PRICE EARNINGS RATIO that has been uncanny in predicting overvaluations in the stock market.

HIS CALCULATIONS NOW SHOW THE U.S. STOCK MARKET IS OVERVALUED BY AS MUCH AS 30%! That means we may eventually see a larger drop in the stock market to bring it back to some fair value.

I know investors hate corrections or any stock market drop. But in the long run it is far more healthy and stable in the long-term to have a stock market that is running in tandem with the fundamentals of the economy.

Whenever the stock market is OUT OF SYNC with the underlying economy, large institutional investors become nervous -and nervous institutional investors result in increased volatility.

With instantaneous computer trading by these huge institutional investors, we saw on May 6<sup>th</sup> that they can drive the Dow down almost 1000 points during a single day.

During two days on May 4<sup>th</sup> and May 6<sup>th</sup> we saw the sixth most volatile two days in U.S. market history. In fact, in November last year and January and February of this year we saw huge spikes in volatility.

Volatility is a measure of the stress in the market caused by a stock market and underlying economy out of balance with each other.

**OVER THE NEXT FEW MONTHS,**

**I BELIEVE WE MAY SEE**

**CONTINUED TURMOIL IN THE**

**STOCK MARKET AS THE STOCK**

**MARKET AND ECONOMY TRY**

**TO FIND SOME EQUILIBRIUM.**

**AGAIN, OVER THE LONG-TERM**

**THIS IS A HEALTHY PROCESS.**

### HOW FOXHALL PROTECTS CLIENT'S PORTFOLIOS

This volatility is the primary reason Foxhall Capital has maintained fairly significant positions in cash and U.S. Treasury Bonds in most of our client's portfolios over the past six months.

This conservative risk management technique really helped Foxhall clients on May 6<sup>th</sup> when the Dow had an intra-day loss of almost 1000 points and ended the day down over 300 points. FOXHALL ETF ACCOUNTS WERE DOWN SIGNIFICANTLY LESS THAN THE MARKET AS A WHOLE!

### AT FOXHALL CAPITAL RISK MANAGEMENT IS EVERYTHING!

Over the next few months, I believe we may see continued turmoil in the stock market as the stock market and economy try to find some equilibrium. Again, over the long-term this is a healthy process.

But in the short-term, this turmoil and transition may be unpleasant.



## THE FOXHALL GLOBAL OUTLOOK

MAY 7, 2010

PAGE -2-

### **SO HOW WILL FOXHALL MANAGE YOUR INVESTMENTS DURING THIS PERIOD?**

I've always believed that the true measure of an investment manager is how high a priority they place on risk management and rigidly limiting client portfolio losses.

As active investment managers, our primary function at FOXHALL CAPITAL is to manage the down-side risk of our client's portfolios.

Warren Buffett's mentor and Columbia University professor, Benjamin Graham once wrote, "The essence of investment management is the management of RISKS, not the management of RETURNS." He said, "Well-managed portfolios start with this precept."

At FOXHALL CAPITAL, our PRIMARY OBJECTIVE is first and foremost RISK MANAGEMENT. That means that our PRIMARY OBJECTIVE is to try to make sure that none of our clients experience any significant loss of principal in their investment accounts. Our next, but SECONDARY OBJECTIVE is to increase the value of our client's accounts. BUT RISK MANAGEMENT IS ALWAYS OUR PRIMARY OBJECTIVE.

Our FOXHALL CAPITAL RULE #1 is, "ALWAYS PROTECT THE DOWNSIDE." We always try to "LOOK" DOWN before looking UP in an attempt to manage risk in our client's retirement accounts.

### **WHAT DOES FOXHALL DO TO SPECIFICALLY MANAGE RISK?**

THIS FOXHALL CAPITAL "PRESERVE, DEFEND & PROTECT" RISK MANAGEMENT STRATEGY also provides ANOTHER LEVEL OF RISK MANAGEMENT in bull markets. When volatility in the stock market goes up, FOXHALL CAPITAL automatically increases the allocation to money market and U.S. government bonds in our client's investment accounts. This is our "volatility suppression technology" at work.

This tool helped FOXHALL clients buffer the stock market turndown over the past few months.

SECOND, we maintain a "trailing sell price" on the overall client portfolio. If a PORTFOLIO STOP-LOSS is triggered, we will move the entire portfolio to money market or U.S. Treasury Bonds.

THIRD, we maintain a stop-loss on all of the key indexes we follow. That means if the stop-loss on the S&P 500 INDEX for the U.S., the EAFE INDEX for other developed markets, the EMERGING MARKETS INDEX or the COMMODITIES INDEX is triggered on one or more of these indexes, FOXHALL will sell out of those positions representing these indexes.

Our theory is that whichever of these stop-losses hit first, we will start reducing our client's exposure to the market.

LAST, we monitor U.S. and global markets every day. Because of the crisis in Greece, which may spread to Spain, Portugal and Ireland in the coming months, FOXHALL has held little exposure to positions in Europe over the past few months.

While we remain invested in Asia, because of the housing bubble in China, we have significantly reduced our exposure to Chinese stock markets.



## THE FOXHALL GLOBAL OUTLOOK

MAY 7, 2010

PAGE -3-

### WHERE DO WE GO FROM HERE?

Whether we like it or not the global markets are now all INTERCONNECTED. That means when there is a debt crisis in Europe or a housing bubble in Asia—IT WILL NEGATIVELY AFFECT THE U.S. STOCK MARKET.

HERE IS THE BOTTOM LINE! FOXHALL CAPITAL will use all of its “PRESERVE, DEFEND & PROTECT” RISK MANAGEMENT STRATEGIES to limit our client’s portfolios to any significant loss.

We also must remember that this is a CORRECTION within a LONG-TERM BULL MARKET. The definition of a long-term bull market is everything is broadly going up over a five to eight year period. That is why investors don’t want to completely exit the stock market unless all our stop-losses are triggered.

If the portfolio stop-loss is triggered, we will exit the markets, but during bull market corrections, it is more likely that FOXHALL will manage risk by increasing money market and U.S. Treasury Bonds while volatility in the market remains high.

Even though this correction that may play out over the next few months, may feel unpleasant, this is something fundamentally very healthy.

The stock market and the economy have to return to some balance and I don’t know how that can happen without a correction.

But once we go through this period, I can see a sustainable bull market this fall.

### THE DIFFERENCE BETWEEN A CUSTOMER AND A CLIENT

According to MERRIAM-WEBSTER’S DICTIONARY, the definition of a “CUSTOMER” is “one that purchases a commodity or service.” The definition of a “CLIENT” is “one that is under the protection of another.”

FOXHALL KNOWS THE DIFFERENCE! Our FOXHALL TREND RECOGNITION TECHNOLOGY™ protected our clients at a time when they needed it most. Now, that same FOXHALL TREND RECOGNITION TECHNOLOGY™ will help them navigate into the next opportunity for growth.

That’s ACTIVE INVESTMENT MANAGEMENT. That’s FOXHALL CAPITAL. That’s the FOXHALL DIFFERENCE!

### UNTIL THEN!

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