



THE FOXHALL GLOBAL OUTLOOK



NOVEMBER 3, 2011

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HOW LONG COULD IT TAKE TO RECOVER PORTFOLIO DECLINES FROM OVER THE PAST FEW MONTHS?

I know when the stock market is going down, everyone gets very anxious and I understand investors' concern and worry over recent portfolio declines.

I have been managing money for almost 25 years and as I look at the history of the US stock market, the one thing I can tell you is that no investment manager or investment strategy is going to be right in every market situation or in every stock market cycle.

If there were a perfect system, everyone would use it—but the hard truth is, there is not one perfect system to manage investments.

Warren Buffett is generally considered the best and smartest investor in the United States. His company, BERKSHIRE HATHAWAY, lost almost 45% of its value between December 2007 and February 2009. One can only imagine how his investors felt during that downturn in their portfolios.

This simply goes to prove that even the best investment strategies suffer significant downturns in some stock market cycles.

WHAT IS A STOCK MARKET CORRECTION?

It is also helpful to remember that stock market corrections of between 15% and 20% DURING BULL MARKETS are extremely common. They can, and often do, happen once or twice a year during long-term bull markets.

FOR EXAMPLE, last year between late April 2010 and late June 2010, the S&P 500 INDEX declined -16% and then recovered over +19% in the following 4 months and recovered almost another +10% in the next four months. This is how

corrections in bull markets often work. LAST SUMMER IN 2010 THE MARKET WENT DOWN -16% IN THE SPRING AND THEN THE STOCK MARKET REBOUNDED BY OVER +30% OVER THE NEXT 8 MONTHS.

It is hard to recover from bear market losses, but, historically, most CORRECTIONS WITHIN A LONG-TERM BULL MARKET recover and move higher within 8 to 10 months after a correction bottom. I expect the same pattern to track during this cycle, once this correction is finally over.

WHY DIDN'T FOXHALL SELL OUT OF THE MARKET SOONER?

Our system is designed to identify LONG-TERM BEAR MARKETS and then move portfolios to cash and patiently wait out the bear market until our signals tell us that we are re-entering a LONG-TERM BULL MARKET.

In every one of my speeches I always mention, "FOXHALL is always a little bit late getting out of a bear market and always a little bit late getting back in." I always mention the history of our signals in that they usually take 3 to 4 months AFTER A BULL MARKET HIGH to signal that we are entering into a long-term bear market and, conversely, they almost always take 3 to 4 months AFTER A BEAR MARKET BOTTOM to signal that a long-term bull market is beginning. That is how the system has worked in the past.

During this current stock market cycle, the system worked, as it should. HOWEVER, THE RESULTS IN TERMS OF SHORT-TERM PERFORMANCE LEFT A LOT TO BE DESIRED.

But from a RISK MANAGEMENT PERSPECTIVE the issue is not so clear. If the European debt crisis did blow up and we had a new global financial crisis (which many analysts predicted could happen) and the stock market went down over 50% like it did after the LEHMAN BROTHERS default, then we would all be breathing a sigh of relief and happy that the system saved us from an even larger decline.

Over the past few months we HAVE NOT experienced a LONG-TERM BEAR MARKET. We have, however, experienced A SEVERE CORRECTION WITHIN AN OVERALL BULL MARKET.

The reason we know this is that our FOXHALL system DID NOT signal that we were entering into a LONG-TERM BEAR



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MARKET and the recent economic data confirms that the economy grew over 2% in the last quarter and so we are clearly not in a bear market or a recession using our FOXHALL signal's definition of those terms.

WHAT CAUSED FOXHALL TO MOVE TO CASH?

One of the other RISK MANAGEMENT TOOLS that we use at FOXHALL, and a tool used by almost all investment managers is a STOP-LOSS TRIGGER. We have a computer program that looks at past historical volatility of a particular security or index and when that security or index breaks below their historical volatility band, we sell the security or index.

As I mentioned before, the stock market regularly goes down 15% to 20% during BULL MARKET CORRECTIONS and that means that most of our stop-loss triggers are also set slightly outside of the 15% to 20% range depending on the security or index.

The reason for the stop-loss trigger is that when a security or index declines below its historical volatility band that usually means something is very wrong. As risk managers, we sell and sit in cash or US treasury bonds.

If a security can decline below its historical average, then there is always the possibility that the decline can be much more serious. Remember General Motors or AIG? We will not take that chance for our clients.

One of the reasons clients hire FOXHALL is to manage risk. IT DOESN'T MEAN WE WILL ALWAYS BE RIGHT, but it does mean we try to ERROR ON THE SIDE OF CAUTION.

Normally, this works to the clients benefit, but over the past few months our stop-loss triggers were slowly getting us out of the market during the recent down turn and the day after the last stop-loss triggered the market shot up over 10% in less than 10 days. That is just the way things work sometime. We don't have a crystal ball.

WHAT IS FOXHALL'S STRATEGY GOING FORWARD?

Since coming out of the 2009 bottom, we have made some changes to our SECURITY SELECTION PROCESS. Within our various strategies we believe that once this current correction is over and there is a sustained upward trend in the stock market that our new security selections process could outperform the stock market and I hope this will help mitigate recent portfolio declines.

WHEN WILL THIS CORRECTION END?

IT ISN'T OVER YET!!!

It now seems we may have to wait until the first week of December for the EUROPEAN DEBT CRISIS to be over—one way or another. That is the week Greece votes in a referendum to support the European bailout and austerity plan for that country.

In the end, I believe the Greeks will vote in favor of the bailout. The current austerity plan will be painful, but the alternative of leaving the Euro Zone will be so draconian that Greece could once again become a



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third-world country. No one in Greece wants to see that.

GOING FORWARD...

Over the past 3 weeks FOXHALL has been cautiously moving back into the stock market while maintaining significant positions in cash to help cushion the volatility in a stock market that seems to move up or down 2% to 3% almost every day.

Investors in Variable Annuities will see a cautious re-entry of some positions in the next few days. Most Variable Annuities have special trading restrictions set by the insurance companies that sometimes limit Foxhall's ability to move securities quickly.

As I have mentioned before, historically, when stock markets have been negatively impacted by political events like the European Debt Crisis, the stock market recovery after a political resolution of the issue has usually been sharp and quick.

When this political resolution occurs, FOXHALL will fully re-enter the stock market very quickly.

I believe once a resolution occurs, that over the next eight months or so, we will be back above the last high in the stock market and we most likely will have recovered a significant portion of recent portfolio declines.

But until early December, it could be another roller coaster ride.

Until then...

Patience!

—Paul Dietrich
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