

## **FORCED SELLING**

When I wrote my last market commentary, I didn't think that I would be writing another one so soon. In any event, market turmoil persists and may continue. Many are asking why, and there are a number of opinions, but I believe that it stems from Forced Selling. Forced Selling occurs when mutual funds and hedge funds are receiving more redemption requests from investors than what the funds have available in cash and/or new inflows. To raise the cash to pay the investor, they have to sell assets (stocks) that are liquid; hence, we get extreme volatility in both good and bad stocks. It is important to understand that good stocks are equally, if not more affected by forced selling. Good stocks tend to have more liquidity, meaning they are easier to buy/sell than bad stocks. This pattern feeds on itself, and more stocks are sold to meet more redemptions, etc., and so on, until it finally stops. When that is, I do not know. I do know it will end, and there will be opportunities. The economy was showing continued strength, other and than housing sectors, but now it appears that not only housing may bring down the economy, but systemic risk in structured products (forced selling) may do it as well. The Fed has added liquidity to the markets which it is supposed to do, and as I have said before will ultimately cut rates aggressively to keep the economy out of recession. As in the past Federal Reserves will be a little late to the game, and rather than have a smooth transition it will be choppy and abrupt. Patience is mandated here.

### **What we have done:**

As you know, from past commentary, we have been defensive, or at least thought we were. We had increased exposure to the Schwab Hedged Equity Fund, believing it would provide downside protection. But the fund got caught up in the Quant debacle and did not provide the protection to the extent we thought it would, therefore we have liquidated that position and are in cash.

Several weeks ago when the market began to show weakness and increased volatility we actively placed stops on portions of our equity holdings. We did this for several reasons. First, if the market sold off (which it did) we were in a position to protect capital. If we were wrong and the market went up, we would only have missed a small run-up. More importantly, we wanted to reduce volatility in the portfolios.

### **What we will do:**

We have looked to enter some short positions, but with the market turmoil, we have taken the position to stand aside. We continue to monitor positions, and seek entry points. You may see more trading, as we are continuing to set rather tight stops on some investments.

As always we are seeking to preserve capital, and look for opportunities with the least risk.