

## Model #3 - Market Segments

“Three models, one portfolio.” Rather than relying on one model, our new Tactical Allocation Portfolio incorporates three of our best growth models. As the name implies, the portfolio overweights specific areas in the market. Sector fund rotation is especially important but country, commodity and inverse funds also play a role.

Even the best models have bad periods. With our “three models, one portfolio” approach, there are checks and balances. Rather than relying on one sector rotation model, our strategy is applied to two sets of sector funds. Rather than relying on one market timing model, our approach applies two independent models to reduce drawdowns during bear markets. Rather than viewing a possible portfolio change every other week, the three models are evaluated at different times for rotation. These checks and balances lead to more consistent returns while keeping the high profit potential.

### **Model #3**

In his 2011 book, *Exchange Traded Profits*, David Vomund presents a model that rotates to different market segments, including commodity and inverse exchange-traded funds (ETFs). Our model is a variation from what appears in the book, but it is still an “all weather” approach that has the ability to make money in any market environment.

This third model represents approximately 25% of the entire Tactical Allocation Portfolio and it serves as a good hedge during bear markets. When the model goes net short it hedges the risk of other long positions that may exist elsewhere in the portfolio.

Here are the ETFs that we follow in this model.

<b><u>ETF</u></b>	<b><u>Market Segment</u></b>
iShares S&P 500 (IVV)	Large-Cap Equity
PowerShares Nasdaq 100 (QQQQ)	Large-Cap Growth
iShares Emerging Markets (EEM)	Int'l Emerging Markets
PowerShares Commodity Index	Commodity
iShares Treasury Bond	20+ Year T-Bonds
ProShares Short S&P 500	Inverse S&P 500

In a nutshell, we run a relative strength report that overweights recent activity on this list of ETFs and buy the best performer. The model holds one ETF. When this holding falls below the top two positions on the relative strength report then it is sold and is replaced by the best performer. The relative strength report is evaluated every other week for possible rotation.

In a prolonged bear market the Short S&P 500 and T-Bond ETF should rise to the top of the rankings, warranting a sell on any of the other positions. When holding the Short S&P 500 ETF, this model can increase in value during a bear market.

## *Performance Research*

The percentage returns represent a back-tested paper portfolio instead of real money. Past performance does not guarantee future results. See Back-testing Assumptions for more details.

<u>Year</u>	<u>ETF Trading</u>	<u>S&amp;P 500 Index</u>
2002	0.99	-23.37
2003	50.43	26.38
2004	17.09	8.99
2005	31.04	3.00
2006	6.95	13.62
2007	31.49	3.53
2008	6.66 *	-38.49
2009	54.38	23.45
2010	<u>1.03</u>	<u>12.78</u>
Avg.	20.74	1.02

3 round trip trades per year with an average holding period of 125 days.

### *Back-Testing Assumptions*

Our back-test was not intended to indicate the returns of an actual portfolio. The back-test assumed the portfolio was always fully invested. Some of the ETFs were not yet available to purchase at the beginning date of the back-test. When the ETF wasn't available, the back-test used the ETF's benchmark index as a substitute. The back-test used price data from the actual ETF once it became available. Studies show a high, but not exact, correlation between the benchmark indexes and the ETFs.

For inverse ETF data, we inverted the daily percentage change figures from the S&P 500 index to create our own inverse data. Needless to say, the price data from an inverse ETF would be different. We used actual inverse ETF data once it became available.

The percentage returns represent a hypothetical back-test instead of actual performance. The back-test's returns and other figures have not been audited but are based upon information obtained from public sources believed to be reliable. Since no funds were managed using the strategies during this period, the impact that economic and market factors might have had on the trading cannot be represented.

The strategy was run with a view toward capital appreciation with risk levels far higher than the S&P 500. Because of turnover rates, portfolios are subject to higher tax costs than portfolios with lesser turnover.

Dividends and interest payments were excluded from the data. Trades were placed on Friday's closing prices, even though a real portfolio would place trades on the following Monday. Slippage and our management fees were not included. A \$17 commission was factored in.

**As with any strategy, past performance does not guarantee future results or that losses will not occur.**

## ***Back-Test Trade Details***

<b><u>Ticker</u></b>	<b><u>ETF</u></b>	<b><u>Buy Date</u></b>	<b><u>Sell Date</u></b>	<b><u>% Change</u></b>	<b><u>Days Held</u></b>
EEM	Emerging Markets	12/31/2001	6/7/2002	7.48	158
SH	Inverse S&P 500	6/7/2002	8/30/2002	9.14	84
DBC	Commodities	8/30/2002	10/11/2002	0.35	42
SH	Inverse S&P 500	10/11/2002	11/22/2002	-10.94	42
QQQQ	Nasdaq 100	11/22/2002	12/6/2002	-4.51	14
TLT	T-bonds	12/6/2002	12/20/2002	1.40	14
DBC	Commodities	12/20/2002	3/28/2003	3.65	98
QQQQ	Nasdaq 100	3/28/2003	5/9/2003	8.93	42
EEM	Emerging Markets	5/9/2003	5/23/2003	0.66	14
DBC	Commodities	5/23/2003	6/20/2003	1.49	28
EEM	Emerging Markets	6/20/2003	5/7/2004	28.08	322
DBC	Commodities	5/7/2004	11/5/2004	13.11	182
EEM	Emerging Markets	11/5/2004	6/16/2006	43.68	588
DBC	Commodities	6/16/2006	8/25/2006	2.92	70
EEM	Emerging Markets	8/25/2006	9/8/2006	0.03	14
DBC	Commodities	9/8/2006	9/22/2006	-5.31	14
TLT	T-bonds	9/22/2006	10/6/2006	-1.50	14
IVV	S&P 500	10/6/2006	11/3/2006	1.12	28
EEM	Emerging Markets	11/3/2006	1/11/2008	42.35	434
DBC	Commodities	1/11/2008	8/8/2008	15.87	210
QQQQ	Nasdaq 100	8/8/2008	9/19/2008	-9.34	42
SH	Inverse S&P 500	9/19/2008	4/3/2009	6.32	196 *
EEM	Emerging Markets	4/3/2009	1/22/2010	44.83	294
QQQQ	Nasdaq 100	1/22/2010	5/28/2010	3.26	126
TLT	T-bonds	5/28/2010	10/15/2010	3.91	140
EEM	Emerging Markets	10/15/2010	11/26/2010	-4.11	42
QQQQ	Nasdaq 100	11/26/2010			

\*Does not factor in a \$11.98/share distribution. in SH on 12/23/08.

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