The Power of Compounding
ETF Market-Timed Trading

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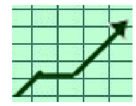

While there are thousands of ways to construct a financial portfolio, and the best fit model can be designed for each individual with the help of their personal financial advisor, in this article I would like to present one idea, a scenario that can be considered, with particular attention to one of its key segments.

In this portfolio model, the strategy of portfolio management chooses to allocate 75 to 80 percent of the entire portfolio in very conservative instruments such as FDIC insured cash, short-term U.S. Treasuries and precious metals (segment # 1). Then in segment # 2, another 5 to 10 percent of the portfolio is allocated to a market timing trading program using Exchange Traded Funds to play rising and declining short-term market trends. Then, lastly, in segment # 3, another 5 to 10 percent is allocated in a speculative program such as the trading of Put and Call Options, Long, on Exchange Traded Funds. These last two segment allocations are where this portfolio model aims to generate profits that lift the return for the entire portfolio above what average ultra conservative investment returns can be expected to generate. The net result of this strategy is our portfolio as constructed has adequate liquid, with the vast majority of assets held in safe conservative investments, yet with about 20 percent available to be actively managed to provide overall returns that are superior to fixed income securities, and either keep pace or exceed stock market returns without all the risk.

For this article, let's focus on the 10 percent allocated to trading in market-timed Exchange Traded Funds. While an argument certainly can be made that there remains a place for speculative options trading, which is the third allocation segment, a market timing ETF trading program other than Options offers a unique, lower risk alternative for generating wealth building.

The idea here for an Exchange Traded Funds market-timed actively traded program is to trade both rising and declining trends. This is in contrast to a strategy where we would time our trading in an “on” / “off” scenario, in other words getting in and out, only investing when markets are likely to rise. By playing both up and down trends, it gives us the potential to generate profits substantially above the S&P 500, which is a buy and hold, hope it goes up, strategy. There are ETFs that play markets to rise and other Inverse ETFs that play markets to decline. It is important we carefully research which ETFs correlate well with the underlying market moves we intend to play, and which ETFs are liquid (high volume traded), and well managed. Our intention is this portion of the portfolio’s management is to play major ETFs that play major markets such as the Dow Industrials, S&P 500, NASDAQ 100, Russell 2000, Gold, Silver, Mining Stocks, the U.S. Dollar, and the U.S. Treasury Bond as an example.

But the real power here for the 10% of our portfolio we are going to trade with market timing ETFs is the compounding effect, the mathematics of reinvesting net profits year after year. Richard Russell, for those of you who loved reading his stuff as I did before he passed away a few years ago, was a huge proponent of compounding. But we don’t have to settle for compounding meager interest income returns from fixed income securities. Rather, with a market timed ETF program we can compound profits that substantially exceed interest income. That plus *the mathematics of compounding creates powerful wealth building potential*.

It is important to have the correct time horizon perspective for the full benefit of compound returns from an ETF trading program. While this can be a very powerful wealth building tool, realistically it needs a 5 to 10-year time horizon for it to achieve its ultimate aim. Further, the miracle of compounding ETF trading profits depends upon making the profits. If the profits are there, the math works beautifully.

Now this is a key point: For the compounding wealth-building power of market-timed ETF trades to work, *we have to have very good, time tested, trading indicators for entry and exit.* Also, we have to be disciplined. We have to be prudent with the amount invested, diversify, and accept small losses if trends go sideways or reverse course quickly, yet we want to remain in trends that last long periods of time. That's it. That's all we need for success. Of course, this assumes the derivatives ETF market does not experience a catastrophic implosion. But, again, that is why we have 80 percent of our portfolio in safe, conservative assets, to protect us from such a bizarre event. This 80 percent rock solid portfolio segment gives us the freedom to be aggressive with the other 20 percent.

In considering this other 20 percent, let's compare an ETF trading program with an Options trading program. It takes a certain risk appetite and experience level to trade Options that may not be a perfect fit for many traders and investors, however trading the Exchange Traded Funds (ETFs) directly may be a good fit. It is simpler. Buy ETF shares and sell them. Simple.

Here is an example of how an ETF Trading Program can work:

Let's assume we have a total financial portfolio of $1.0 million. In this case, conservatively, let's start with $50,000, five percent of our portfolio, and trade ETFs using key trading indicators that we have found and are confident in to tell us when there are high probability tradable trends, when to enter and when to exit. While returns in this program will not likely be as strong as if trading Options, let's set a goal, in this example, **our goal is to double our initial $50,000 portfolio dedicated to this trading program in one year.** No guarantees but that is our goal. **We anticipate doing 25 to 50 trades per year buying shares of ETFs that track the major Stock, Bond, Oil, Currency and Precious Metals markets directly or inversely, and in some cases with a multiple correlation, moving 2 or 3 times what the underlying market moves.** We will carve out pieces from this $50,000 portfolio for each trade. At times, we may only invest $5,000 or $10,000 in a particular trade with the remainder of the $50,000 portfolio sitting in cash. At other times, we may have 5 or 6 trades going on simultaneously in different markets, and have $30,000 or more of our $50,000 portfolio invested in what our trade indicators are telling us are high probability market timed tradable trends.

Here are the Advantages of this Market Timing ETF Trading Approach versus Options trading:

1. Exchange Traded Funds do not have an expiration date, therefore **there is no need for doing any rollovers. Time is not an issue**. For

those with limited trading funds, this is more appealing since rollovers require more capital to be added to an Options trade position to buy more time for the trend to do its work.

2. ETFs on major market indices typically do not experience as much price volatility as Options do, which means if the market takes an unexpected move in the opposite direction of our play, **the deterioration in the value of our position is significantly smaller than with Options**. For those with lower risk appetite, this should be appealing.

3. By trading ETFs using our key trading indicators, **we can hold an open position for almost the entire period of a trend. This allows us to continue to stick with a trend if a trend lasts a long time and extends price, allowing us to maximize the profit potential of a trend**. There is no need to get out early as would be the case trading Options. One of the frustrations with Options trading is that because there is so much risk of price volatility, once we see substantial profits in our position, it is very difficult to hold that position for the full duration of the tradable trend. For example, if we see a 50% profit early in a trend, it may be tempting to take that profit and exit our position because of the risk that our profits could evaporate very quickly for several reasons, including time premium expiration risk, corrective price reversals within a larger trend we are playing, delta risk, and volatility premium change risk. There is a lot to consider when deciding when to exit a profit position in an open Options position. Our experience with Options trading is, if we see a profit we like, take it. Don't get greedy. Bears win, Bulls win, Pigs lose. Now, **with this new ETF trading program, we can hold our position until our trading indicators reverse, telling us the trend is most likely over and a new trend in the opposite direction is starting.** This is a luxury that prudent Options trading may not allow.

4. In our ETF Trading Program, we will be taking more frequent (but probably relatively small) losses during sideways whipsawing market environments than we typically take with Options trading, since we will not be doing rollovers to extend the life of our position. Our plan is to exit out of positions when we get new short-term trend reversal signals from our trading indicators. But **this tactic will keep us out of major underwater positions**. **Even better, we will remain in strong powerful trends almost to their conclusion,** which opens up a huge new opportunity for profits that optimal (risk managed) Options trading

does not necessarily permit. **Being able to stick with a trend, both up and down, for longer durations will be one of the exciting key profit generators for this ETF Trading Program**.

Now, if our goal of doubling our money every year is achieved, this is not a small achievement. **This approach can build an enormous nest egg through the power of compounding, a very powerful financial tool**.

For example, if we start with $50,000 and can generate a 100% return on our portfolio every year, if we can double it every year, after taxes, we can turn **an initial $50,000 portfolio into one worth $25,600,000 in just ten years!** That is not a typo. Or, another scenario is, if we start with $50,000 and can generate a 50% return on our portfolio every year, we can turn an initial $50,000 portfolio into one worth $1,922,000 in ten years. Or, even more conservative, if we start with $50,000 and can generate a 25% return on our portfolio every year, we can turn an initial $50,000 portfolio into one worth $372,500 in ten years. These scenarios would assume the entire portfolio is traded every year for ten years, and the profits of the prior year are reinvested or traded. Maybe we will choose not to do that. It will depend upon our risk appetite as the portfolio grows, or other opportunities outside financial trading that come along for the use of that money. **So, while initial returns may not have the glamor of the returns we get from Options trading, which have the potential to generate returns such as 25 to 100 percent or more in a few weeks, the end results could be fantastic. Kind of the tortoise versus the Hair approach**. Again, no guarantees, but this is the goal line.

Now, no investment strategy is right for everyone. It is imperative that an investor fully discuss all strategies with their financial advisor before conducting trades. Overall financial objectives, experience, age, risk appetite, etc... are critical decision factors in developing the right program for each individual. However, for some, the above ETF market timed trading approach with the power of compounding juicing long term returns may be an interesting idea.

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Dr. McHugh's book, "The Coming Economic Ice Age, Five Steps to Survive and Prosper," is available at amazon.com at http://tinyurl.com/lypv47v

"Jesus said to them, "I am the bread of life; he who comes to Me shall not hunger, and he who believes in Me shall never thirst.
For I have come down from heaven,
For this is the will of My Father, that everyone who beholds the Son and believes in Him, may have eternal life;
and I Myself will raise him up on the last day."

John 6: 35, 38, 40