PREDICTABLE INVESTING

January 2007

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HISTORY LESSON – January 2007.
WHY THE PREDICTABLE INVESTING SYSTEM WORKS.

1.0 Introduction: Many of our readers are puzzled as to why the simple long-term market-timing system used in Predictable Investing should work at all. The data from the last 12 years shows that the PI portfolio has very handily beaten the S&P500 index. Since most professional fund managers cannot even match the S&P500, our simple system has also beaten most of these very highly-paid advisers.

These readers are even more disconcerted to learn that the portfolio consists of only one very widely diversified low-expense ratio mutual fund, the Vanguard Index 500 Fund (VFINX), and that there has been only one sell and one buy signal during the entire 12 year period. How is this possible?

2.0 Performance Data: Just how well has the PI portfolio done over the last 12 years? The S&P500 index has grown 9.86% annually, while the PI portfolio has grown by 13.55% each year. This means that we have beaten the index by a huge 37.42% per year, over this entire period.

This data is summarized in the table below.

	Start Value	At Market Peak	At Market Bottom	Today's Value
Date	1/3/1995	3/20/2000	3/3/2003	12/29/2006
SP500-AnnualReturn%	0	25.95	7.51	9.86
PI-PortfolioAnnualRet%	0	25.58	15.30	13.55
% Advantage for PI	0	-1.43	103.73	37.42

(a) From the start of the portfolio on Jan 3, 1995 to the peak of the market on March 20, 2000, the PI portfolio trailed the S&P500 index by 1.43%.

(b) During the bear market that followed that ended on March 3, 2003, the annualized return of the S&P500 fell to 7.51%, while the PI portfolio returned 15.3%, thus beating the index by 103.73%.

(c) During the entire 12 year period of Jan 3, 1995 to the present, the S&P500 has returned 9.86% annually, while the PI Portfolio has grown 13.55% each year, thus beating the index by 37.42%.

3.0 The Predictable Investing System Review: The PI model predicts those long time periods when the stock market is in a favorable environment and rising stock prices are likely (bull market). The model also forecasts those sustained long-term periods when stocks are likely to fall (bear market). The portfolio is managed depending on whether the market is BULLISH or BEARISH. This information is posted weekly on the CURRENT OUTLOOK Page.

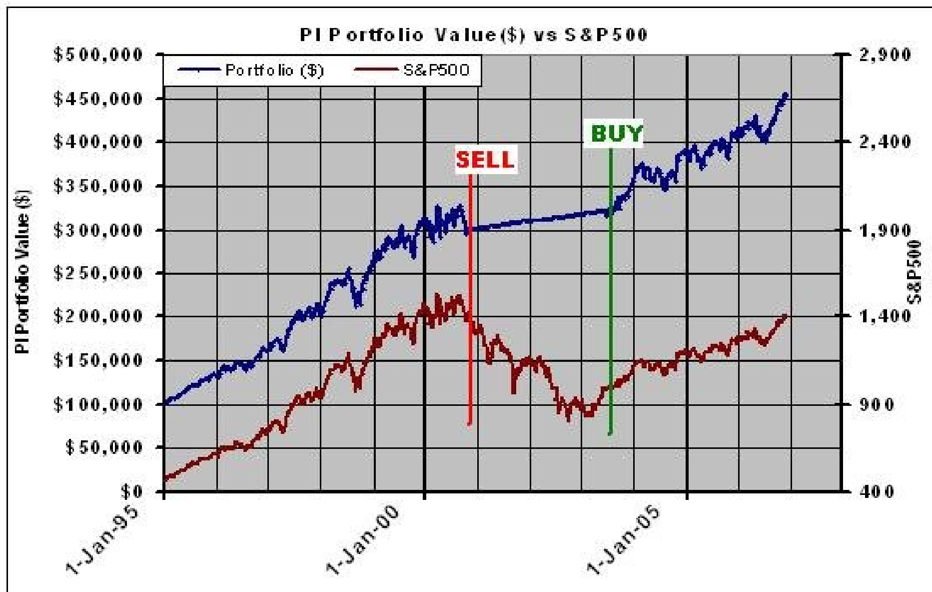
(a) When the model switches from a BUY to a SELL, we sell all stock mutual funds and place the proceeds in a money-market fund. When this happened in Oct 2000, the

stock mutual fund VFINX was sold, and the proceeds placed in the Vanguard Money Market Prime Fund (VMMXX).
(b) When the model switches from a SELL to a BUY, we use all the cash in the money market fund, including the accumulated interest, and buy the stock mutual fund. This happened in June 2003, and all the money in VMMXX was used to re-purchase the stock fund VFINX.
Details of these transactions over the last 12 years are described on the PORTFOLIO Page, and also shown below.
Flowcharts of how to manage your portfolio using our principles can be found in part 2 of the USER MANUAL page.

Buy Date	Fund Symbol	Price ($/shr)	VALUE($)	Sell Date	Price ($/shr)	VALUE($)	Gain
01/03/95	VFINX	42.96	100,000	10/24/00	129.1	300,512	301%
10/24/00	VMMXX	1.00	300512	06/06/03	1.00	321,548	7.0%
06/06/03	VFINX	91.46	321,548	none	still invested		

We are still fully invested in the Vanguard 500 Index Fund, VFINX. The price as of 12/29/2006 is $130.59 per share, and the portfolio value is $459,118.23.
The PI portfolio has therefore grown to 4.59 times the starting value in the last 12 years.

4.0 Why the PI system beats the Markets: Figure 1 below shows the value of the portfolio over the last 12 years, and that of the unmanaged S&P500 Index.



During BULLISH periods, we are invested in VFINX, which tracks the S&P500 Index faithfully, but has a 0.18% lower annual return. This 0.18% is the amount of the expense ratio charged by Vanguard to manage this fund, which is therefore subtracted from the annual return. So during the entire bullish period when we are invested in the market, our portfolio grows at almost exactly the same rate as the S&P500.

However we are completely out of the stock market during a BEARISH period, and are earning a small but steady amount of interest from the money market fund. During this period the S&P500 is falling steadily and sometimes drastically.

Figure 1 shows that the S&P500 dropped almost 46% between the SELL signal of Oct 2000 and the BUY signal of June 2003. Investors who remained in the market lost almost half their portfolio value, and have not yet recovered the prior highs that were reached in early 2000. Our portfolio was out of the market during this vicious decline and in the safety money market funds, which earned a positive 7% return. This means that instead of losing money during this 2.5 year bear market, we made a small positive return and outperformed the S&P500 by a whopping 53%.

5.0 Why the PI Portfolio has less risk than the market. The History Lesson for June 2006 entitled "Asset Allocation" (see ARCHIVE Page) showed that "Risk" of a mutual fund is measured by the standard deviation (also called "sigma") of the weekly gains of the fund price. The higher the standard deviation, the larger is the daily fluctuation in the price of the fund.
During the BULLISH periods when we are fully invested in VFINX, our portfolio sigma is the same as the S&P500. During the BEARISH periods when we are out of the market and in money market funds, our portfolio sigma is zero. Since we have been BULLISH for 9.41 out of the last 12 years, our portfolio risk is 78.4% of that of the S&P500.

Therefore, over the last 12 years, not only has the PI portfolio beaten the market by 37.4%, but it has done so with 21.6% lower risk.

6.0 SUMMARY:

In summary, the Predictable Investing system works because during bull markets we match the growth of the S&P500, but during bear markets we do not suffer the huge losses experienced by the index. ***Our entire excess performance comes as the result of being out of the market during the huge bear market declines***. Therefore the entire and single-minded focus of our model is to accurately identify the start and end of long-term bull and bear markets.