alpha
INVESTMENT MANAGEMENT

Winning The Stock Market Game

BE THE CASINO

"Investment Rule #1: Don't Lose Money
Investment Rule #2: Don't Forget Rule #1"

Warren Buffet

The Alpha Difference

What sets **Alpha Investment Management** apart from other investment managers is our view that the stock market is not random. To be more precise, we believe that there are permanent cyclical factors in the investment equation which "skew" stock market returns over time. Some of these factors influence the market annually while others operate over longer time periods.

We call these factors "casino factors" because investors who are aware of them and actively exploit them cause the odds of investment success to shift dramatically in their favor. Like a casino, an investor who has the laws of probability working on his or her behalf, will emerge a consistent winner over time.

Three Casino Factors

Alpha's investment strategies exploit three primary casino factors influencing the stock market:

1. The four-year presidential election cycle.
2. The six-month annual "dead zone".
3. The dominance of small cap stocks in November and December.

These factors exert a strong influence on the market and produce statistical biases for and against specific time periods which recur cyclically over time.

Casino Factor #1 – The Presidential Election Cycle

The presidential election cycle causes a cyclical bias which has been operating in the U.S. market since the formation of the Federal Reserve in 1913. Specifically, the election cycle tends to skew returns into a 15-month period beginning with the mid-term elections. This five-quarter period beginning in the fourth quarter of the president's second year has not been down since 1931, generating an average return of 25.7% plus dividends (Dow Industrials, ending 2008). This 15-month period accounts for almost all of the total appreciation of the market since the Great Depression. The average daily return during this period is 7.6 times greater than the average daily return during all other months. We call this period the market's "political sweet spot".

The mid-term elections cause the political class to focus on the next presidential election. This shift in focus is dramatic. In the first two years of the presidential term the dominant party attempts to pass legislation with significant social importance and increased governmental activism. Such changes are generally resisted by investors, who tend to be cautious during periods of uncertainty. After the mid-term elections, however, the political class becomes less aggressive and more fiscally conservative. During this period there is no mention of higher taxes, increased regulation on businesses, or large legislative agendas. The dominant party knows that economics will play a large part in determining the presidential election and they pull out all the stops to make the U.S. economy vibrant during the election year. Naturally, this plays well on Wall Street.

PRESIDENTIAL ELECTION CYCLE
QUARTERLY % CHANGES

Dow Jones Industrials (1933 to 2009)

	Q1	Q2	Q3	Q4	Year
Post-Election	-0.4%	4.7%	-0.6%	1.3%	5.0%
Mid-Term	0.4%	0.9%	-1.4%	**7.2%**	6.7%
Pre-Election	**5.8%**	**5.5%**	**3.3%**	**1.6%**	**17.1%**
Election	0.6%	0.8%	1.1%	2.2%	4.8%

1990 – 2009

Election Cycle Sweet Spot

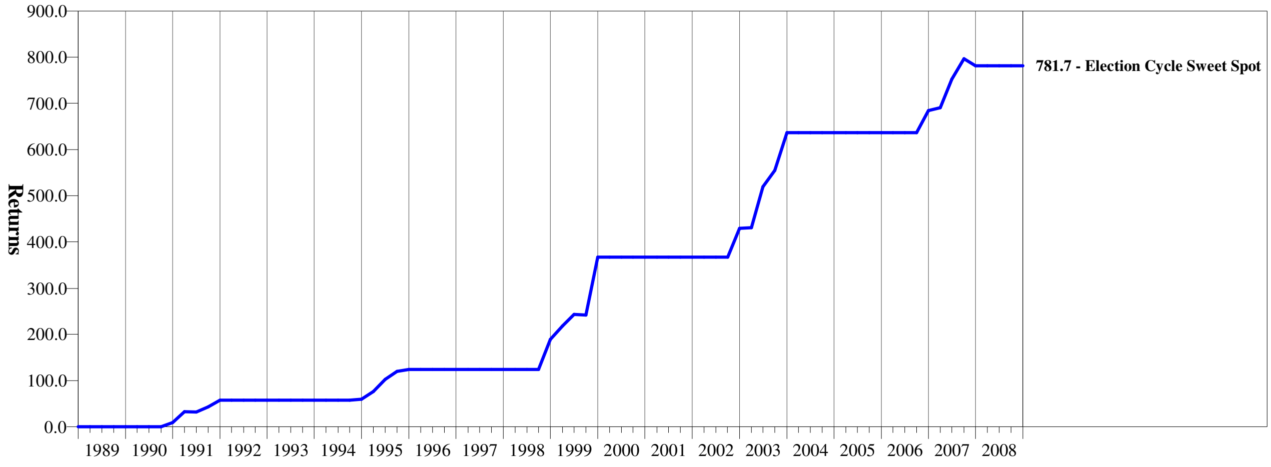
Q4 Mid-Term Year, Q1-Q4 Pre-Election Year

50% S&P 500 / 50% NASDAQ 100

Q4 1990 – Q1 1992	**57.95%**
Q4 1994 – Q1 1996	**42.11%**
Q4 1998 – Q1 2000	**107.27%**
Q4 2002 – Q1 2004	**57.63%**
Q4 2006 – Q1 2008	**19.66%**
Average:	**56.92%**
Cumulative Gain:	**781.70% (as of 12/31/2008)**
Cumulative Gain S&P 500:	**404.30% (as of 12/31/2008)**

The Election Cycle Sweet Spot
50% S&P 500 / 50% NASDAQ 100

Cumulative Returns
for 20 Years Ended December 31, 2008



Last down period: 1931 (S&P 500)

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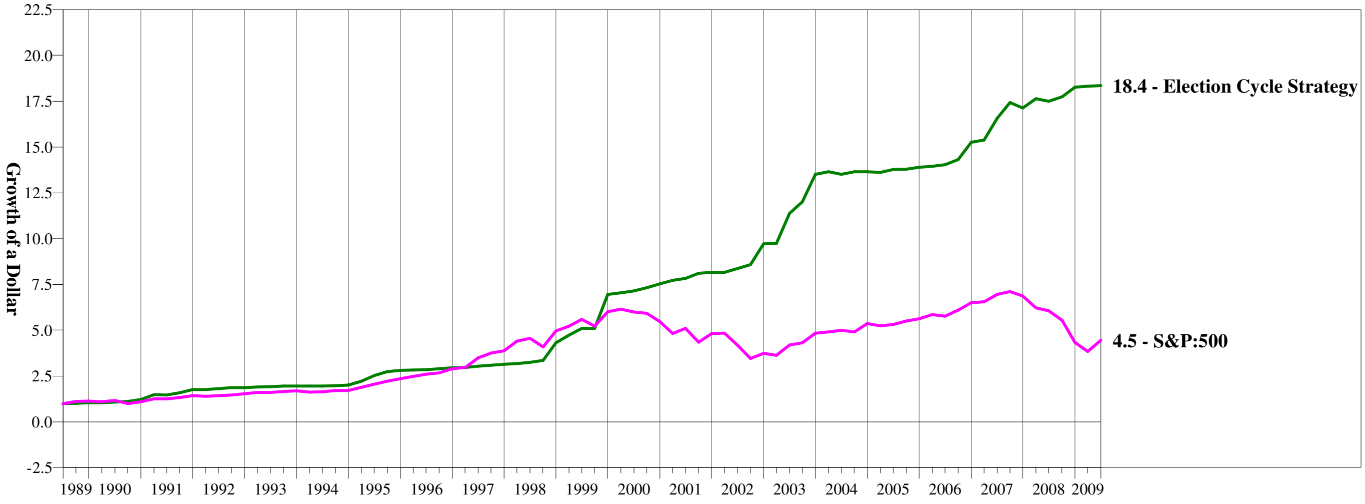
Combining the Political Sweet Spot
With Short-Term Bonds

50% S&P 500 / 50% NASDAQ 100
Invested During Sweet Spots
+
Barclays Capital 1-3 Year Treasury Index
Invested Between Sweet Spots

Growth of a Dollar
for 20 Years Ended June 30, 2009



Annual Returns for Calendar Years
20 Years Ended June 30, 2009

	2 Qtrs. 2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991	1990
Election Cycle Strategy	0.47	6.62	12.34	9.80	1.71	1.08	39.06	19.05	8.50	8.16	61.55	36.83	6.64	5.08	40.28	1.81	5.37	6.24	44.93	15.84

A simple investment strategy is to own stocks (50% S&P 500/ 50% NASDAQ 100) during the sweet spot, and conservative short-term government bonds for the time periods between. The chart above shows the result of this strategy over a ten-year bullish period and a ten-year bearish period. The Election Cycle strategy produced a twenty-year average return of 15.7%, with no down years.

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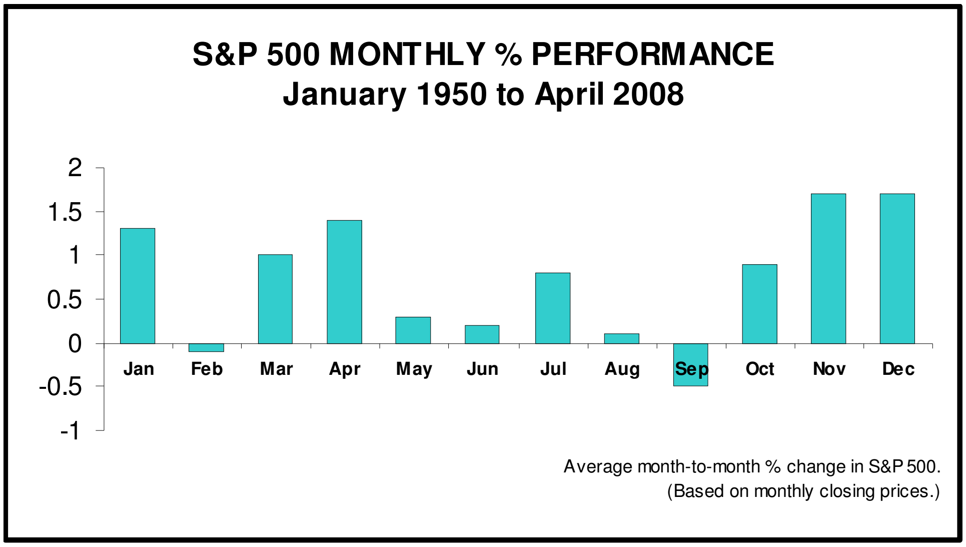
Casino Factor #2 – Six-Month Annual "Dead Zone"

Since World War II all of the aggregate gains of the stock market have been contained in the six months beginning in November and ending in early May. The period from early May to late October we call the market's "dead zone". Since 1949, this six-month period has been down 45% of the time, with the brunt of all bear markets occurring within its time span. The other six months, from November 1 to May 1, have enjoyed an average daily return 27.5 times greater than the days in the "dead zone". To be sure, the "dead zone" is up 55% of the time, often spectacularly, but these gains have been offset by even larger losses, thereby giving the period a negative bias. Alpha avoids this period, except during the third year of the election cycle – the "political sweet spot".



S&P 500 MONTHLY % PERFORMANCE
January 1950 to April 2008

Average month-to-month % change in S&P 500.
(Based on monthly closing prices.)

The "dead zone" is a global phenomenon. It shows up in 36 developed countries world-wide, often more dramatically than in the U.S. While its causes are not completely understood, the negative effect on the stock market is indisputable, as the next table demonstrates.

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Dow Performance

November 1 through Third Trading Day of May
versus
Fourth Trading Day of May through October 31
1949 - 2009

Start Bullish Period (Nov)	Percentage Gain	$1,000	Start Bearish Period (May)	Percentage Gain	$1,000
1949	14.1	1,141	1950	4.0	1,040
1950	16.9	1,334	1951	(0.3)	1,037
1951	(0.7)	1,325	1952	3.3	1,072
1952	3.3	1,369	1953	(0.9)	1,063
1953	15.3	1,578	1954	10.8	1,177
1954	20.0	1,894	1955	7.7	1,267
1955	13.0	2,140	1956	(6.6)	1,183
1956	3.7	2,219	1957	(11.4)	1,048
1957	4.6	2,320	1958	17.8	1,235
1958	15.2	2,674	1959	3.3	1,276
1959	(5.5)	2,526	1960	(5.0)	1,212
1960	18.7	2,999	1961	2.2	1,238
1961	(4.0)	2,878	1962	(12.7)	1,081
1962	21.8	3,504	1963	5.2	1,137
1963	9.5	3,835	1964	5.6	1,201
1964	6.8	4,095	1965	3.1	1,238
1965	(4.8)	3,899	1966	(11.8)	1,092
1966	11.1	4,332	1967	(1.9)	1,071
1967	4.5	4,527	1968	3.6	1,110
1968	0.7	4,558	1969	(10.7)	991
1969	(17.1)	3,779	1970	6.5	1,055
1970	24.1	4,688	1971	(10.5)	944
1971	11.3	5,216	1972	2.4	967
1972	(0.2)	5,207	1973	0.3	969
1973	(11.6)	4,605	1974	(21.3)	763
1974	28.6	5,920	1975	(2.3)	745
1975	18.0	6,985	1976	(2.2)	729
1976	(2.5)	6,809	1977	(13.0)	634
1977	1.3	6,897	1978	(4.4)	606
1978	8.2	7,464	1979	(4.9)	577

Start Bullish Period (Nov)	Percentage Gain	$1,000	Start Bearish Period (May)	Percentage Gain	$1,000
1979	0.1	7,469	1980	13.3	653
1980	5.2	7,856	1981	(12.3)	573
1981	0.2	7,874	1982	16.1	665
1982	22.3	9,628	1983	1.0	671
1983	(3.6)	9,285	1984	2.2	686
1984	3.3	9,591	1985	10.2	756
1985	30.5	12,519	1986	4.7	791
1986	24.5	15,588	1987	(14.7)	675
1987	2.1	15,923	1988	5.5	712
1988	11.4	17,739	1989	10.5	787
1989	1.9	18,081	1990	(9.4)	713
1990	20.3	21,757	1991	4.4	744
1991	9.5	23,815	1992	(4.0)	715
1992	6.9	25,460	1993	6.7	763
1993	0.5	25,578	1994	5.7	806
1994	11.9	28,622	1995	8.7	877
1995	15.2	32,971	1996	10.1	965
1996	19.6	39,447	1997	3.2	995
1997	22.9	48,487	1998	(6.1)	935
1998	27.5	61,823	1999	(2.1)	916
1999	(2.3)	60,384	2000	4.7	959
2000	(1.6)	59,424	2001	(15.9)	806
2001	10.3	65,523	2002	(16.1)	676
2002	1.6	66,573	2003	14.9	777
2003	5.2	70,036	2004	(2.7)	755
2004	3.6	72,531	2005	0.5	759
2005	9.2	79,202	2006	6.0	805
2006	9.6	89,811	2007	5.2	847
2007	(4.8)	82,666	2008	(28.5)	605

(Source: Jay Kaeppel, Seasonal Stock Market Trends, Wiley, 2008)

Sell in May – the "Dead Zone"

- The average daily gain from November to May was 27.4 times higher than the average daily gain of all other days.
- The annualized return of the best six months was 17.1%.
- The Dow posted a gain 81% of the time between November and May.
- The Dow posted a gain 55% of the time between May and November.
- A $1,000 investment only during the November-to-May period grew to $82,666.
- A $1,000 investment only during the May-to-October period shrank to $605.

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Casino Factor #3 – End-of-the-Year Effect on Small-Cap Stocks

The months of November and December are the best months of the year for the stock market. This is due, in part, to the market's recovery from the "dead zone". In addition, Wall Street is pumping out the usual optimistic forecasts for the new year, which causes investors to perk up and invest in more speculative stocks, mostly smaller companies. In December, the Russell 2000 small-cap index averages a return of 2.8% (since 1979) vs. a 1.5% average return for the S&P 500. During this year-end period, there are three sub-periods – which we call "power periods" – when the Russell 2000 is consistently and powerfully profitable. Using special 1.5 beta index funds with no transaction charges, Alpha exploits these sub-periods which have been up about 90% of the time since the creation of the small-cap index in 1979.

Russell 2000
Fourth Quarter Power Periods

Power Period One = Last two days of October, first two days of November
Power Period Two = Last six days of November, first three days of December
Power Period Three = Last seven days of December

Year	Power Period One	Power Period Two	Power Period Three	Total Return	Total Return With 1.5 Beta
1979	2.37%	6.05%	1.85%	11.06%	16.60%
1980	1.33%	0.12%	2.16%	3.06%	5.40%
1981	3.11%	2.18%	0.12%	5.48%	8.40%
1982	2.72%	2.64%	2.30%	7.85%	12.00%
1983	-0.91%	0.73%	1.36%	1.17%	1.80%
1984	0.53%	-2.26%	0.79%	-1.00%	-1.50%
1985	1.02%	3.27%	1.58%	5.97%	9.20%
1986	1.18%	3.00%	-1.38%	2.77%	4.20%
1987	10.80%	-5.20%	0.49%	5.55%	8.40%
1988	0.21%	2.48%	1.98%	4.73%	7.20%
1989	0.17%	1.08%	3.33%	4.62%	7.10%
1990	0.55%	5.26%	1.24%	7.15%	11.00%
1991	1.08%	-0.17%	7.56%	8.53%	13.40%
1992	0.92%	2.89%	2.79%	6.73%	10.30%
1993	1.64%	1.16%	3.19%	6.09%	9.30%
1994	0.60%	-1.55%	3.99%	2.99%	4.60%
1995	2.17%	3.92%	3.22%	9.59%	15.00%
1996	0.55%	3.01%	1.82%	5.46%	8.40%
1997	1.73%	0.75%	3.99%	6.58%	10.00%
1998	4.27%	0.18%	4.93%	9.61%	14.90%
1999	3.70%	0.75%	5.95%	10.69%	16.70%
2000	5.58%	1.20%	5.48%	12.70%	18.70%
2001	0.88%	5.93%	1.37%	8.32%	12.90%
2002	4.91%	0.58%	-0.06%	5.45%	11.00%
2003	1.34%	3.72%	1.85%	7.05%	10.70%
2004	-0.29%	4.61%	0.84%	5.18%	8.00%
2005	5.21%	1.15%	0.09%	6.51%	9.90%
2006	-2.05%	0.72%	0.73%	-0.60%	-1.10%
2007	-2.86%	3.52%	1.39%	1.95%	2.30%
2008	10.86%	11.34%	5.13%	29.76%	38.60%

1.5 BETA STATISTICS

Total Quarters = 30	Average Quarter Return = 9.7%
Losing Quarters = 2	Market Exposure = 8%
Win Rate = 93.3%	Total Return = 1580%
Largest Quarter Loss (1984) = -1.5%	R2000 B+H = 1162%
Largest Quarter Gain (2008) = 38.6%	Average Gain Per Trade = 3.26%

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1989 – 2009

Fourth Quarter Returns of Three "Power Periods"

Using the Russell 2000 Index Raised to 1.5 Beta

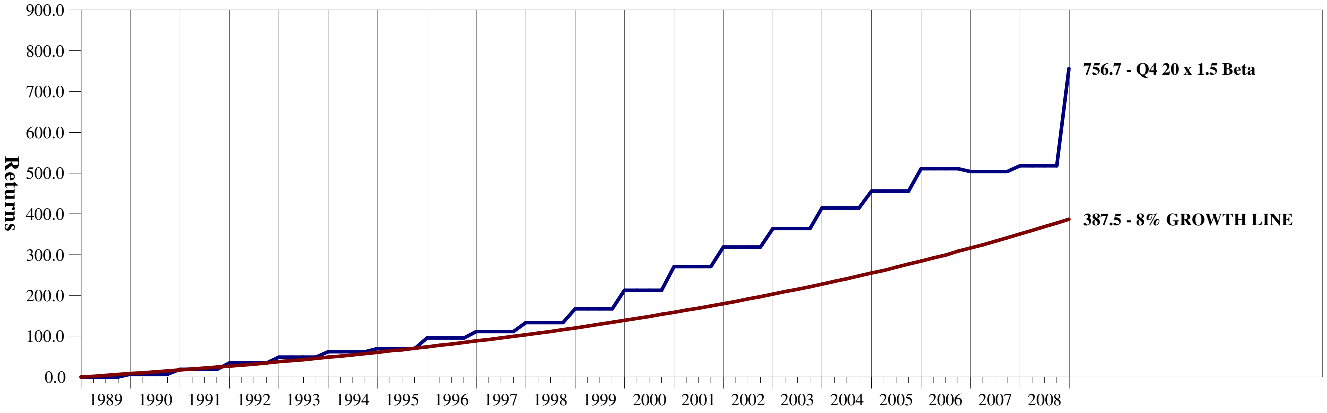
Power Period #1: Last two days of October, first two days of November
Power Period #2: Last six days of November, first three days of December
Power Period #3: Last seven days of December

1989: 7.10%	**1994: 4.60%**	**1999: 16.70%**	**2004: 8.00%**
1990: 11.00%	**1995: 15.00%**	**2000: 18.70%**	**2005: 9.90%**
1991: 13.40%	**1996: 8.40%**	**2001: 12.90%**	**2006: (1.10%)**
1992: 10.30%	**1997: 10.00%**	**2002: 11.00%**	**2007: 2.30%**
1993: 9.30%	**1998: 14.90%**	**2003: 10.70%**	**2008: 38.60%**

Total Return: 756.7%
S&P 500 Total Return: 404.3%

Three Fourth Quarter Power Periods x 1.5 Beta

Cumulative Returns
for 20 Years Ended December 31, 2008



Over the past 20 years, the strategy of raising the beta of each power period to 1.5 has resulted in a return of 11.3% annually, without interest earned in the interim periods. Over the same period, the S&P 500 returned 7.3% annually.

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Long-Term Investment Success

Alpha's investment objective is to grow capital smoothly and consistently over time without large losses. Specifically, we seek positive returns every year and long-term returns above 10% annually. To achieve these goals, we cannot be continuously invested in the stock market. A fully-invested continuous exposure to the stock market virtually guarantees large losses periodically, with no assurance of timely recovery of such losses.

By concentrating our strategies' equity exposure to those periods of time favored by these casino factors, and avoiding time periods with a negative or neutral bias, we minimize the risk of loss and maximize the probability of gains over time. By systematically taking the "good bets" and avoiding the "bad bets" we bring the law of probability to work on our clients' behalf, just as the casino operator does.

Of course, this type of investment method means that we will miss out on some periods when the market goes up. This is inevitable. Our casino factors set the "climate" for the market, they do not predict the "weather".

Since our objective is to make gains every year in the belief that this will eventually pay off in more substantial long-term returns than a buy-and-hold approach, sitting on the sidelines during these counter-trend market moves is simply the price that must be paid for the smooth, consistent growth of capital.

Alpha's strategies are carried out using no-load mutual funds and institutional index funds which have no transaction costs. When the odds of success are strongly in our favor, we accept risk in the stock market. When the casino factors skew the odds against the market, we withdraw to the relative safety of bonds, using no-load, top-ranked fixed-income funds.

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Published 09/09 – Second Edition