Monthly Performance:

October turned out to be a rollercoaster ride with many traps for both traders and investors. It would have been easy to get carried away, however FatAlpha remained calmed and saw its portfolio reverse from a loss to a 6.2% return vs 2.3% for the S&P 500. The performance is even more remarkable if this video by Yahoo Finance is correct: http://goo.gl/5Kt7lT

Last month, I recommend that readers keep an eye on the 100-day moving average and the price action around that level. The past six times this occurred it was a buying opportunity (see http://goo.gl/2Qrm07). This time around it failed. On October 1st the market closed below the 100-day ma. On October 6th I had e-mailed two professional investors and told them that if the market closed above October 1st then I believe that would be the final confirmation for pullback no. 7. This did not occur and the market continued down to test the 200-ma. In a follow up conversation on October 21st, I stated that if the market held its gains then we can expect a new high. See the chart below:

MONTHLY PERFORMANCE		
Date	**FatAlpha**	**S&P 500**
July '12*	**2.89%**	2.13%
Aug '12	**9.12%**	1.98%
Sept '12	**3.03%**	2.42%
Oct '12	**0.66%**	-1.98%
Nov '12	**5.58%**	0.28%
Dec '12	**1.79%**	0.71%
Jan '13	**6.45%**	5.04%
Feb '13	**0.71%**	1.11%
Mar '13	**5.35%**	3.60%
Apr '13	**6.47%**	1.81%
May '13	**4.19%**	2.08%
June '13	**-0.73%**	-1.50%
July '13	**7.45%**	4.95%
Aug '13	**-1.00%**	-3.13%
Sept '13	**2.78%**	2.97%
Oct '13	**6.26%**	4.46%
Nov '13	**5.50%**	2.80%
Dec '13	**4.34%**	2.36%
Jan '14*	**-1.76%**	-3.56%
Feb '14	**7.64%**	4.31%
Mar '14	**0.91%**	0.69%
Apr '14	**5.08%**	0.62%
May '14	**0.97%**	2.10%
June '14	**0.83%**	1.91%
July '14	**3.17%**	-1.51%
Aug '14	**3.67%**	3.77%
Sept '14	**-2.39%**	-1.55%
Oct '14	**6.21%**	2.32%
2012	**25.14%**	**5.60%**
2013	**59.01%**	**29.60%**
2014	**26.59%**	**9.18%**
Since Inception	**151.91%**	**49.43%**

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Noticed how no bar closed above that of the first. Also see the buying coming in below the 200-day ma where a long tail is formed and buying continues in the next few days. The most obvious to me was the gap up and strong close of the 21st. I am no technical analysis expert and don't plan on becoming one, however price action and basic technical can be of some value. I believe investors keeping an open mind will serve them well.

There were other reasons also to be bullish. Firstly, I believed it was unlikely that we would see a shift to a bear market without us first seeing a test. Secondly, there hadn't appeared any strong enough catalysts to push the market into the bear zone. (I have to admit I was afraid of Ebola but thankfully that appears to be under some control). Thirdly, Standard & Poor's historical analysis of mid-term election years showed that the average return until April is 15% with the market advancing 94% of the time. Fourthly earnings season overall looked good to me so far based on the conference calls and earnings I saw. Combining all this and more gave me some comfort.

A friend had e-mailed me and asked me my thoughts on hedging with a short futures contact. My response was:

"Before you ask this question, the first question is what is the portfolio objective? Currently my portfolio objective is to beat the S&P with the FatAlpha strategy. The FatAlpha strategy currently does not have a sell futures strategy added to it that was studied and known to enhance the strategy. I am currently working a shorting strategy but this is still a work in progress. Now as a relative strategy, looking to beat the market, one is not too concerned with a drop in the markets. Now if the strategy was an absolute return one and the objective would be to have a positive return regardless of the S&P then that's a different story and strategy. So if one is looking for absolute return then maybe a short futures makes sense. But then that also is incorporating a market timing element. So if you are also market timing then how do you judge the correct entry and exit. What empirical evidence supports this? Little. So essentially if you are not market timing then you are shorting the futures cause you are scared of a drop, trying to protect returns. This short position could boomerang against you.

Now how would I look/justify a shorting futures or stocks or put options. a) As part of a strategy outlined above (work in progress), and/or b) Based on a shift in the market from a bull market to a bear market. In this case, the inverse of my value model aka the most overvalued stocks will most of the time drop more in a bear market and can be shorted to take advantage of the FatAlpha method. On the other hand if it is not a bear market then this short could again hurt the portfolio. Now we can judge a bull and bear market based on this article I wrote for seeking alpha.

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So far we only had a pullback which did violate the 100-day and continued, unlike the last 6 pullbacks but did find support under the 200-day ma. So while we had a pullback, in the bigger picture we are still trending up both on the daily and monthly chart.

As investors we can't be scared by minor rocking of the boat. We don't care about flat years and small negative years as we will outperform and make money most of the time. We should focus our fear on the big bear markets. This keeps us in the market longer and makes us more money.

This is a short answer :)"

I truly meant it when I said it was a short answer. During the month of October, I attended the European Investment Conference in London organized by the CFA Institute. There I got the chance to speak with James Montier (author of the excellent and highly recommended "Value Investing: Tools & Techniques for Intelligent Investment"). From our conversation I understood that James believes the market is expensive and has increased his cash position. James is a much smart man than I, with research under his belt that can blow you away, however the market is not only science. The Cyclically adjusted P/E may be higher than normal but that doesn't mean that a) the market can't go higher, b) earnings may rise and reduce it, c) some have made some strong arguments against the use of CAPE and d) there are always new opportunities. The market has a tendency to rotate from one extreme to the other. Personally, I believe if I don't see bubbles in every direction than I'm still ok. Those who watched the market in 1999 know what I mean. Yes we do have some crazy valuations in biotech and some internet darlings but it's nothing compared to 1999. Just look at King Digital (KING), the creator of Candy Crush. The company went public at the end of March and the market has already punished it as it worries it's a 1-trick pony. KING trades at 6x earnings. How about Amazon? Investors have taken the stock down to $300 from $400 at the beginning of the year. 3D Systems (DDD), the 3D printer manufacturer is down from almost $100 to $40. All this, while the market just made a new high. So while references to 1999 make good press, market activity is nothing like 1999. There is a selection process, and companies do get punished for not producing. Finally, quantitative value models I have tested underperformed in 1999 as investors focused on the high flying loss making companies. These same models have helped push FatAlpha to a 17% outperformance so far.

Some investors are worried about the rate hike. But still that does not mean that we will shift to a bear market. Firstly, in the past the market has risen with rate hikes, and secondly the rate hikes will most likely come later than expected. So staying out of the market while global central banks continue pumping is very costly.

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So the plan is simple. Keep doing what we are doing until there is a significant shift in both fundamentals and technicals. By being invested we take advantage of the natural direction of the market which is up.

Transaction History by Date:

Date: **October 30th, 2014**
Ticker: NSIT
Name: Insight Enterprises
Transaction: Bought
Price: $22.40
Size: New position

Note:
Added to NSIT position at $22.40. The move down is exaggerated and we should see a correction (similar to what happened to XRX) and most of the loss should be recovered. The trigger was a reduction in yr-end guidance from 2.02-2.10 to 1.99-2.05. That's only reason I found. Margins are a bit lower this qtr too. But sales are up and operating profit even. EPS up on lower share count and higher net income.

Date: **October 13th, 2014**
Ticker: PETM
Name: Petsmart
Transaction: Sold
Price: $64.97
Size: Reducing

Note:
Sold 1/2 of current position in Petsmart (PETM) at $64.97. The stock has been supported since early July when activists announced they were involved in the stock. In the last trading session however the stock closed below the 200-ma and clear below the support area from July. In addition, no news regarding any corporate action. The stock is not cheap (which I believe is the main obstacle to a deal) and I only hold on to a quarter of the position in case there is a big announcement. If there is further weakness then I will reassess.

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