

The MoniResearch Newsletter[®]

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Performance Rankings of Active Money Managers Since 1981

Issue # 102

NOTICE

This issue is printed on white paper, signifying it is devoted to Rydex and ProFunds timers and "classic market timers."

A companion MoniResearch publication, printed on ivory paper, is devoted to dynamic asset allocators.

Classic market timers use only domestic equity mutual funds plus, of course, a money fund during defensive periods.

Dynamic asset allocators also practice market timing, but use multiple asset classes such as international equities, bonds, gold.

There are other differences, as well. These are more fully explained in material sent to all new subscribers. To obtain a free copy, contact us at the address below and ask for "green sheet."

Steve Shellans, Editor

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Highlights

Their colorful name notwithstanding, **Scarecrow Trading's** one year performance for the year ended 9/30/2004 is remarkable: 64.92%. We are pleased to introduce Scarecrow in the column at the right: **P. 1**

We present our acclaimed **risk-return chart** based on the Ulcer Index, a measure of risk. The great majority of the firms we track outperformed the S&P 500 and the NASDAQ. A few firms are outstanding. **P. 2**

For years, rumors have circulated that much of **the nation's gold in Ft. Knox may be missing**. We take a critical look at the possible truth of this rumor. While Ft. Knox conducts a yearly audit of its holdings, we find two gaping loopholes in its procedure. While this country is no longer on the gold standard, its absence would be a blow to the credibility of the government and the currency: **P. 4**

Changes in **the Roster** **P. 4**

◆ **ERRATA**. Please see page 5 for corrections regarding:

- **Atlas Capital Mgmt**
- **Lancaster County Financial**
- **Witter & Lester** **P. 5**

◆ An update on credit card debt and why it signals danger for the economy: **P. 6**

◆ **"Turk" Teragliafera at CM Capital Mgmt** is excited about a new Rydex program he has started. Backtesting showed an initial investment of \$1000 growing to \$50,000 in six years: **P. 7**

Rydex performance table **P. 10**

Classic Performance Tables **P. 14**

Administrative Information **P. 17**

Scarecrow Trading, Inc.

When I first heard the name "Scarecrow Trading," I promised myself, "That's a firm I *have to* track in the newsletter, almost regardless of their performance." Let's face it: the material in a newsletter such as this tends to be a little drab at times, and so I become alert when I spy a bit of 'color' in a story. But as it turns out, I need not have been concerned about their performance — Scarecrow has produced a compound annualized rate of return of 64.92% (audited and net of fees) for the year ended September 30. Later in this article I'll explain the origin of the name "Scarecrow" and how Len Fox, it's founder and principal, came to choose it.

When I asked Fox to fill me in on his career and background, his story brought to mind the quintessential Hollywood flick: "Mailroom Boy Makes Good In Corporate America." Let me explain.

When Fox graduated from a Denver high school in 1972 at age 17, he did not know what he wanted to do with his life, but college was certainly **not** a prominent possibility in his mind. He enlisted in the army, figuring that the three-year hitch might help clarify his thoughts and goals. Fox also explains that the Viet Nam war was cooking at that time, and he felt a sense of responsibility to serve his country by being involved. Fox was posted to the Signal Corps at Ft. Bragg, North Carolina.

After his term of service was complete, Fox returned to Denver where he had been a bag boy at Safeway during high school. I could hear the gratitude in Fox's voice when he described his treatment at Safeway when he asked for his old job back: "They treated my

Continued on page 12

	Fund Family Used			Style	Performance					Ulcer Index (Risk)	Notes
					Annualized			Actual			
	Rydex	ProFunds	Potomac Funds	L=long, Sh=Short, Sc=Sectors, B=Bonds, G=Gold	5-yr	3-yr	2-yr	1-yr	3Q 2004		
Flexible Plan Investments / Classic	✓			L, Sh, B	-11.7	1.4	27.0	11.7	-5.4	171	
Flexible Plan Inv. / VR Aggres Growth	✓			All	5.1	-0.1	-1.8	-4.9	-2.5	10	8
Global Invest. Solutions / McClellan	✓			L, Sh	-1.7	0.2	2.3	-9.9	-3.0	34	
Index Asset Mgmt	✓			L, Sh	-7.9	-12.2	3.1	11.9	-4.5	124	
Key Market Research / Classic Index		✓		L, Sh		-4.0	-0.2	2.2	1.7	58	3, 9
Key Market Research / Sectors	✓			Sc		0.6	6.0	16.4	0.9	27	3
Landis Financial & Inv. / Long Index	✓			L		10.5	5.9	6.8	-3.5	11	3
Landis Financial & Inv. / Sector	✓			L, Sh, B, Sc,G		10.4	2.0	2.4	0.2	14	3
Marathon / Gold	✓			G			-1.9	-10.1	3.8	21	3, 4
Marathon / Sector Rotation	✓			L, Sh, Sc	4.3	-1.2	-5.1	2.1	2.9	49	
National Invest. Adv. / Insured OTC	✓			L	2.4	-6.7	-4.4	-10.5	-12.2	82	2
Potomac / Bull & Bear	✓			L, Sh		8.5	15.4	17.6	0.3	18	3
QMA Invest. Mgmt. / QMA Rydex Funds	✓			L, Sc, G		16.3	8.1	0.1	-3.4	13	3
Scarecrow Trading	✓			L, Sh				64.9★	12.4★	0★	3
Spartan Everest Capital Mgmt, LLC	Name	change.	See	Climo Capital	Mgmt						
Spectrum Financial / Sector	✓			Sc, Sh	4.3	-1.8	7.2	0.3	-2.7	90	
Spectrum Finan. / Short term	✓			L	-4.4	14.6	37.5★	16.9	1.5	157	
Stanford Global Capital, LLC	✓			L, Sh, Sc, G		-3.5	-23.7	-30.2	-1.3	64	3, 9
Third Day Advisors, LLC / Aggressive	✓			L, Sh		21.9★	19.7	19.5	3.0	1	3

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★ Leader for this time period

Numbered notes to above table:

1. On March 1, 2002, the model was changed to allow short positions. Therefore past results may not be representative of future results.
2. Insurance against loss of principal available.
3. For programs with much less than a 5-year track record, the Ulcer Index may not be reliable.
4. The figure shown in the 2-year column is actually for 1.75 years.
5. The figure shown in the 5-year column is actually for 4.5 years.
7. The figure shown in the 3-year column is actually for 2.5 years.
8. The figure shown in the 5-year column is actually for 4.75 years.
9. The figure shown in the 3-year column is actually for 2.75 years.
10. Dave Kern at Advantage Financial Planning has temporarily closed his gold timing program.
11. FGCM's "AM Ryder" program may be structured — at the client's direction — for different levels of aggressiveness ranging from 25% to 100%. The figures shown in the table are for the least aggressive 25% option.

General notes to above table:

- ◆ All figures shown are net of management fees.
- ◆ All programs were audited unless otherwise noted.

Scarecrow Trading — continued from page 1

three years in the army as if I had continued to be employed at the store. They gave me a good raise and increased responsibility."

Fox stayed with Safeway for another four years, but his mother perceived that her son's future was limited as a supermarket stock clerk. At the time, she was employed by Western Electric and strongly suggested to her son that he apply there for employment and pursue a career in industry. At his mother's urging, he did so, was accepted, and was given a job running one of the company's large Xerox copiers. As time moved on, Fox moved to the factory floor where he spent the next 10 years.

But there came a time when Fox realized that the people he observed advancing in the company all had college degrees, and that the highly placed people in the organization held advanced management degrees. Under the G.I. Bill, fox was entitled to educational benefits which would cover some college costs. He approached Western Electric and found they were willing to help with the balance. While continuing his employment during the day, Fox attended Regis University in Denver for 12 years at night, earning first a B.S. degree and then an MBA.

Fox reports that with these degrees in hand, "life changed" for him. At that point he was working in Sales for AT&T, the parent company of Western Electric. He was promoted into a management position and during the next ten years held the titles of Sales Manager, Technical Manager, and Business Development Manager.

But in the summer of 2003, Fox was laid off along with hundreds of other employees at all levels within AT&T. It was time for a career change and Fox decided that his hobby would henceforth fill this role. In the early 1990s, while working a trade show for AT&T, Fox became acquainted with someone who was trading the market over the internet. Fox became fascinated with this new world. He subscribed to Investors Business Daily

and avidly studied the books and tapes provided by IBD. Using a simplistic relative-strength model, Fox began trading in the stocks he saw listed in IBD. But results were disappointing. Fox laments: "We were going into a little bit of a bear market at that time. I lost on everything I did. I was confused; I didn't understand what was happening. And so I retreated to a buy-and-hold strategy in mutual funds."

Eventually, Fox got his courage up and re-entered the stock-trading arena. He admits: "I was nervous. I stumbled around with no real strategy. But we were in a bull market then [1997-98] and I became pretty impressed with the money I was making."

But Fox's wife evidently had a different perspective on these events. Just as Fox's mother had been instrumental in changing the direction of his career 20 years earlier, his wife now played that role: "One night when I came home from work, my wife said she had seen me struggling with investment strategies and had signed me up for an adult-education course in investing. I said to her: 'I have a Masters in Business Administration; I don't need it.' But she sweet-talked me into it and it opened new doors for me. One of the most valuable was a book entitled: 'When to Sell' by Justin Mamis. I realized then that I had read lots of books on buying, but I had no strategy for selling. Within two weeks of reading the book, I was out of every stock I owned!"

"It was then that I realized I had gotten my butt kicked twice in a decade. I knew I needed to understand the market better, not just individual stocks. I read everything I could about active trading. I tried all the programs, systems, and models on the internet. This was a two-year process and I didn't have much to show for it."

"But then I came across one system that resonated with me. It was pretty effective. It cost only \$100 and I bought it. There are many people who say you can't find good models on the internet, and for

the most part it is true. But it is not 100% true. I altered the system I had bought and tweaked the algorithms. I have been running it in real time now for 14 months and I think that – by any measure – it has been highly successful."

Indeed. Fox trades using only the Rydex Velocity and Venture Funds. These mimic the NASDAQ, long and short, and incorporate leverage of 2:1. Scarecrow's compound annualized rate of return (net of fees) for the year ended September 30 is 64.92%. Quarterly performance statistics:

September 2003	2.90% (gross)
4Q2003	17.69%
1Q2004	0.34%
2Q2004	24.26%
3Q2004	12.38%

The Model

I asked Fox about the nature of the Scarecrow model. He reports that it is a momentum-based model that incorporates an overbought/oversold indicator. The model's time-span is short-term — of the four moving averages, the longest is about 25 days.

Although Rydex offers holders of its Venture and Velocity funds the opportunity to trade twice a day (once in the morning and once shortly before the market close), Fox seldom uses the morning opportunity. He explains that he uses this flexibility only to accomplish a "correction." That is, if late trading the previous day changes the signal (or the lack thereof) that occurred at yesterday's cutoff time, he will take corrective action the next morning.

Fees

Fox is not a registered investment advisor with the SEC. (Nor does not need to be, based on his present circumstances, according to Fox.) This gives him certain freedoms and at the same time imposes certain constraints. For example, Fox

states he is able to charge a performance fee while SEC-registered advisors can do this only under limited circumstances. But at the same time, Scarecrow is constrained by SEC regulations to have no more than 15 clients. At the present time, Scarecrow has only five clients and \$1.2 million under management.

I pointed out to Fox that as a result of this article he could easily fill the remaining 10 open client slots. I inquired what he would do at that juncture. He is unsure at this time. He mentioned as possibilities:

- ◆ Getting registered with the SEC. However, he dislikes this option because it imposes constraints on the fees he can charge.
- ◆ Licensing his model to others
- ◆ Identifying a close family member to replicate what he has done.

If Scarecrow's performance continues, I predict that Fox will be making this decision 'PDQ.'

Origin of "Scarecrow"

And finally we close with the *pièce de résistance* — why "Scarecrow?"

One of Fox's five children is 10-year-old Ben. Ben had shown a keen interest in Fox's work with the stock market. One day at Ben's school, the class was asked to write an essay. This was the essence of Ben's story.

- ◆ Once there was a scarecrow standing in a cornfield.
- ◆ All the crows flying around said he was dumb.
- ◆ But the scarecrow actually had a brain. In fact, he was so smart he learned to trade the stock market.
- ◆ He made a million dollars and didn't have to work anymore.
- ◆ And after that, the crows didn't call him dumb anymore. ■