

EPIC ADVISORS, LLC

Weekly Market Commentary

April 22, 2008

Sean Hannon, CFA, CFP

“There are only two emotions in the market, hope and fear. The only problem is you hope when you should fear and fear when you should hope” -Jesse Livermore

I wrote my last market commentary on April 8th. On that day, the Dow Jones Industrial Average (DJIA) closed at 12,576. Yesterday the DJIA closed at 12,825. The net result is a two week gain of just under 2%. However, the underlying story of this 2% move tells more about how an investor’s emotions can overwhelm logic and lead to inopportune decisions.

From the April 8th close, we saw the DJIA dive over 250 points lower, briefly flirt with 12,300 and then stage two different gains of over 200 points that pushed the index above the top of a 4-month trading range. Within this violent action, breadth began deteriorating, my timing model has been breaking down and volume has remained light. Given the variety of warning signs, most investors were not prepared for the dramatic moves and are now left questioning what the next step will be.

This brings us to investor’s emotions and the effect they have on decision making. As the quote above describes, fear and hope are two competing factors that drive our thought process. Unfortunately, most fail to apply these emotions correctly and make inopportune decisions. As the market approached 12,300 last week, many investors went to cash and began increasing short positions. Since these actions had been successful over the prior days, the decision appeared reasonable. However, as the market rallied, fear that we have moved too far too quickly prevents these same people from increasing their exposure. At some point, this fear will evaporate, the hope of catching a rally will emerge and sidelined investors will pour into this market. From there, we will hit a peak and begin selling lower. It is a matter of when, not if.

Knowing that emotion can lead to faulty decisions, what can we do to protect ourselves? As always, we must think of both the long-term future of the market and what opportunities short-term volatility provides. My approach has been to combine the two time periods to develop a portfolio of strong companies as long-term holdings and then to adjust my net equity exposure for short-term movements. Within a well diversified portfolio of excellent companies, I seek limited downside risk, strong profit potential and an above average dividend yield. By spending the time needed to fully understand each company and the value placed upon it by the market, I have strong conviction about what I own and why I own it. Doing so eliminates the daily noise the market produces and allows me to focus on the business prospects of the companies I own. As mentioned earlier, the 2% move over the

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past few weeks would not cause anyone to alter their long-term investment stance while the massive volatility that drove us to this point left many behind.

On a short-term basis, I maintain a net equity exposure that ranges between 50-120% long. When I think markets are in for trouble, I gravitate to the lower end of the range. If I think we are heading higher, I buy more stock and approach the higher end of that range. For the past few months I have been between 60-75% long. For me, this represents a neutral stance. By being short of weak companies and long of strong companies, I participated in rallies and profited during downturns. As this market has moved higher, I will begin to drift longer and expect my accounts to approach an 80-85% long exposure. While there are many factors that worry me about the current market environment, I am inclined to become longer in order to profit from any future rallies.

For the past few months I have stated that we are long-term investors who pick stocks to own. This allowed me to remain invested as the market bounced. Knowing that certain sectors of the market will always be out of favor, I focus upon companies who are mispriced and build my portfolio accordingly. Since my job is to help my clients compound wealth over time, we stay invested, diversify our risk and look for opportunities. While this approach does not allow us to maximize every sharp market rally, it achieves our objective of profiting when markets go up, down or sideways. The ability to generate positive return regardless of market direction will allow us to steadily increase wealth over long periods of time.