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The Industry Selector

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Over the years we've advocated using the futures markets to make inferences about market expectations. To determine which industry groups will benefit from our economic forecast, we apply, in an ongoing process, our Selector Methodology. We attempt to select industries that are likely to outperform in the near term. Our statistical procedure attempts to estimate industry responsiveness to the economic cycle. In effect, we estimate an average response over previous cycles. Our estimates are dependent on the availability of quarterly historical data. The length and quality of that data affect the reliability of our forecasts. The shorter the horizon, the less history we have. Thus, the more volatile the earnings history, the less reliable the estimates produced by our model.

Looking forward to the first quarter of 2002, our Industry Selector favors: **Aerospace/Defense, Auto Parts & Equipment, Communication-Equip/Mfrs., Distributors, Electronics (Semiconductors), Electric Companies, Electrical Equipment, Equipment (Semiconductors), Financial (Diversified), Foods, Footwear, Health Care (Drugs), Insurance Brokers, Insurance (Life/Health), Publishing (Newspapers), Retail Stores (Dept.), Retail Stores (Drug).**

To keep track of our recommendations, we build a model portfolio based on our industry selections. The first step in the process is to identify all the stocks in the industries selected. Next, we weight each of the stocks in direct proportion to their market capitalization. One implication of this weighting scheme is that larger companies will have a significant influence on the portfolio. During the fourth quarter, our model portfolio included fourteen industry groups – Banks (Major Regional), Beverages (Non-Alcoholic), Electric Companies, Electronics (Defense), Equipment (Semiconductor), Foods, Health Care Diversified, Housewares, Insurance Brokers, Insurance (Life/Health), Publishing (Newspapers), Retail Stores (Dept.), Retail Stores (Drug), Retail Stores (Food).

As a result of the cap-weighting, we pay attention to the possibility of a heavy concentration in a few stocks. During the fourth quarter the four largest holding were: Intel (8.91%), Johnson & Johnson (6.89%) , Coca Cola (5.07%) and Bristol Myers (4.59%). It is fairly obvious that these four stocks would influence the portfolio performance. Unfortunately, only Intel outperformed the S&P 500 during the quarter, the remaining three stocks under-performed with Bristol Myers producing negative returns. However the Intel performance more than overshadowed the lackluster performance of the next three largest holdings. Intel accounted for nearly 40% of the portfolio returns.

The Fourth Quarter and Year 2001 Performance. The model portfolio has gained 12.78% during the fourth quarter versus a 10.42% gain for the S&P500 (Table 1). While the market has not delivered positive returns for the year, we are happy to point out that the Industry Selector is in positive territory as the year comes to an end. The year to date gain of 1.12% is leading the benchmark by 1407 basis points.

Table 1

Performance of the S&P 500 and LJE Industry Selector

	2001.1	2001.2	2001.3	2001.4	2001(ytd)*
S&P 500	-10.46%	5.60%	-17.01%	10.42%	-12.95%
LJE Performance	-9.52	7.77	-6.35	12.78	1.12

*as of Dec 26, 2001

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