**An Overview of the Sherman Strategy**

The Sherman Strategy is built on 3 fundamental principles:

1. Bull Markets and Bear Markets - which can last from months to years - are identifiable at an early stage, allowing for timely adjustment of tactics.
2. Intermediate-term trends - which can last from weeks to months - are identifiable at an early stage, and provide continuous profit opportunities.
3. The relative strength of individual equities, mutual funds and ETFs is persistent; therefore, portfolios should be constructed only of the candidates exhibiting the best relative strength.

The Sherman Strategy is a systematic method of buying low and selling high, further enhanced by a superior portfolio-selection method, which combine to take maximum advantage of market opportunities.

The Sherman Strategy can be implemented in almost any client account, and the Sherman Sheet daily publication provides easy-to-follow guidance specifically intended for the time-pressed advisor.

Intermediate-term trends are identified at an early stage. By definition, uptrends begin at the conclusion of downtrends, and downtrends begin at the conclusion of uptrends. Therefore, buying at the beginning of an intermediate-term uptrend is "buying low", and selling at the beginning of an intermediate-term downtrend is "selling high".

Whether in Bull Market or Bear Market, intermediate-term trends form the bulk of all tradeable market activity.

**Bull Market and Bear Market Determination**

The Sherman Strategy employs several longer-term measurements in determining the infrequent changes from a Bull Market to a Bear Market, or vice versa. When the momentum of the prior longer-term trend is exhausted, and a series of meaningful prior highs and lows are violated in the opposite direction, a major trend shift has occurred. The Sherman Strategy uses a somewhat different set of tactics in Bull vs Bear, as explained below. Advisors can also use this timely information to shift more conservative client accounts to heavier fixed-income weightings when a new Bear Market is identified, and back to more aggressive equity weightings when a new Bull Market is identified.

**The Shermanator - the Key to Intermediate-Term Trend Identification**

The Sherman Strategy uses the Shermanator to identify the emergence of intermediate-term trends, and establishes market positions accordingly - Long, Short or Cash.

The Shermanator is a measure of the expansion and contraction of buying in the US stock market, measured in units of market sectors. There are 36 sectors which form the universe upon which daily measurements are taken. These 36 sectors cover all of the US stock market except for those uncorrelated parts, which are intentionally excluded (the excluded sectors are typically hard-assets, such as Precious Metals and Oil).

The Shermanator measures whether buying or selling are the dominant recent activity in each of the 36 sectors, assigns a "1" to those sectors experiencing recent net buying, assigns a "0" to those sectors experiencing recent net selling, and sums them. Therefore, the total range in which the Shermanator travels is 0 to 36 (i.e., 0 = no sectors are undergoing recent net buying, and 36 = all sectors are undergoing recent buying).

The US stock market tends to oscillate in intermediate-term uptrends and downtrends, lasting weeks to months, during both Bull Markets and Bear Markets.

Uptrends begin when downtrends are exhausted and then reverse. Downtrends begin when uptrends are exhausted and then reverse. In fact, the stock market can be thought of as a never-ending continuous series of intermediate-term uptrends and downtrends.
The Sherman Strategy in Detail

The Sherman Strategy uses the Shermanator to accurately identify the exhaustion-and-reversal point when an intermediate-term trend ends and another, in the opposite direction, begins.

The accurate identification of the exhaustion-and-reversal of a downtrend allows the Sherman Strategy to "buy low," since the endpoint of a downtrend is by definition at the lowest point of the trend.

Conversely the accurate identification of the exhaustion-and-reversal of an uptrend allows the Sherman Strategy to "sell high," since the endpoint of an uptrend is by definition at the highest point of the trend.

Both uptrends and downtrends usually end after the number of sectors undergoing recent buying has reached a level near the extremes of the 0-36 range. Uptrends usually end after the number of sectors undergoing recent buying has reached a level of 30 or higher (see the Bear Market exception further below), and downtrends usually end after the number of sectors undergoing buying has declined to a level of 10 or fewer.

How the Sherman Strategy uses the Shermanator

The Sherman Strategy establishes Long positions in the market after the Shermanator has declined to a level of 10 or lower, and then ticks up by one or more. For example, if the Shermanator declines to a level of 4, and then ticks up to 5, the Sherman Strategy initiates a Long position. Waiting for an uptick is important, as the uptick is a sign of buying returning to the market at the end of a decline.

The Sherman Strategy supports two methods of handling intermediate-term downtrends: Cash and Short. The former is known as "Long/Cash" and the latter as "Long/Short."

The Sherman Strategy establishes Short or Cash positions after the Shermanator has risen to a level of 30 or higher, and then falls to a level of 29 or lower. This is different than the interpretation of the Shermanator at the lower extreme (see above). Instead, the Shermanator is allowed to move up and down as much as it wants in the range of 30 to 36, and no action is taken. Action is then taken only upon a decline that pierces the 30 level and drops to 29 or lower. This is a recognition of the reality of the market - the market can stay "fully bought up" for a long time before finally breaking down (look at the attached chart for 2003 for an example of the Shermanator staying in the 30+ area for seven months). However, markets rarely linger at the lower extreme once an uptick occurs, so taking action at that first uptick is warranted.

During Bear Markets, an additional simple rule is activated. Because uptrends in Bear Markets cannot be expected to run all the way to a Shermanator level of 30 or more every time, if the Shermanator turns down within the range of 20 to 29, a Short or Cash position is initiated. But if the Shermanator reaches the level of 30 without turning down, the same rule applies as in Bull Markets: the Shermanator is allowed to move up and down within the range of 30 to 36, and action is taken when the Shermanator drops out of that range to a level of 29 or lower.

Portfolio Selection

The maximum benefit from an intermediate-term uptrend can be achieved by allocating investment dollars to those candidate equities which are ranked in the highest grouping on a relative-strength scale. The Sherman Strategy uses a best-to-worst ranking method that includes the Russell 3000 broad-market index, and divides the ranked candidates into two groups: those that are above the Russell 3000 broad-market index in their relative-strength ranking, and those that are below. The final portfolio selection is made from among the top candidates in the above-average group.

During intermediate-term downtrends, the Long/Short version uses a 100% short S&P 500 position, while the Long/Cash version uses a Money Market fund.

The charts and performance data presented below for the Long/Cash and Long/Short models of The Sherman Strategy are based on the the ProFunds family of mutual funds.
Historical Performance

Important Disclaimer: The Shermanator and the Sherman Strategy were both introduced in early 2004. The construction of the Shermanator has not changed since introduction. However, the Sherman Strategy has been improved numerous times over the years, as recently as mid-year 2008. These changes include improvements in the interpretation of the Shermanator, as well as improvements in portfolio construction. Therefore, even though the Shermanator itself has been calculated in real time since its introduction, please consider all of the returns shown in the tables and charts to be hypothetical, as they are the result of applying the current Sherman Strategy to all prior years. See full disclaimer at the end of this document.

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<th>2000</th>
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<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010*</th>
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<td>28.9%</td>
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Annual Charts

Ten charts are appended to this document, one for each of the years 2000 to 2009.

The Shermanator is displayed across the top of each chart (see the illustration below), followed from top to bottom by the Sherman Sheet’s Long/Cash portfolio, then the Sherman Sheet’s Long/Short portfolio, and finally the S&P 500 Cash Index. Each chart is plotted in alternating green and red, signifying periods of Long positions (green) and Short/Cash positions (red) as dictated by the rules for interpreting the Shermanator. Horizontal dashed lines on the Shermanator chart denote the important Shermanator levels of 10 and 30 (and, during Bear Markets, the Shermanator level of 20). Finally, the percent return for each of the years is noted at the right edge of each of the plots. The disclaimers contained in this document also apply to the charts.

To see current 2010 year-to-date performance results for these model portfolios, please visit www.theshermansheet.com.
2001 Performance Charts

The Shermanator

Bear Market Rules in effect all year

The Sherman Sheet Long/Cash
Low-Activity Model Portfolio

+28.9%

The Sherman Sheet Long/Short
Low-Activity Model Portfolio

+63.8%

S&P 500 Cash Index (unmanaged)

-13.0%
2009 Performance Charts

Green = In the Market
Red = Cash or Short

Bull Market Rules go into effect 5/15/2009

The Shermanator

The Sherman Sheet Long/Cash Low-Activity Model Portfolio

The Sherman Sheet Long/Short Low-Activity Model Portfolio

S&P 500 Cash Index (unmanaged)

+48.0%

+64.6%

+23.5%
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