A Note on a Composite Commitment of Traders (COT) Model

Yngvi Hardarson

This article details what I have termed the Composite Commitment of Traders (COT) statistics and their use in providing information regarding likely price direction on the stock indices. This note considers the Composite COT statistics on the S&P 500 but a similar methodology can be employed for the Nasdaq 100.

I define the Composite COT statistics as referring to the weighed sum of the net trader futures positions on the e-mini contract and the old larger contract. Specifically, for the S&P 500 the composite for each trader group is:

\[ \text{Composite S&P500} = 0.2\text{ES} + \text{SP} \]

where ES represents open interest (O/I) for the e-mini while the SP represents the same for the older large contract. The weighting of 0.2 for the e-mini is suggested by the relative sizes of the contracts where the large contract is five times the size of the e-mini.

The net position data is derived from statistics reported by the CFTC on Friday of each week and refers to positions on the preceding Tuesday. These reports are at http://www.cftc.gov/cftc/cftecotreports.htm#CurrentReports General back-ground information on the statistics can be found at http://www.cftc.gov/opa/background/opacf596.htm The COT reports divide traders into three groups, Commercials, Non-commercial and Non-reportable. For stock indices, the Commercials are generally considered “smart money” as a group while the non-reportable group consists of small speculators that are considered “not so smart” as a group. The Non-commercial trader group, i.e. the large speculators, is somewhere in between.

The e-mini futures contract on the S&P 500 index only started trading back in September 1997 and since the COT reports are of weekly frequency there isn’t a whole lot of data available. However trading in the e-mini has grown rapidly in recent years and now the total O/I of the e-mini S&P contract has grown from just above 1% of the composite O/I in 2000 to around 20% of the composite O/I currently, after adjusting for the smaller contract size of the e-mini. The e-mini contract has an even larger impact on the composite net-trader positions as derived from the CFTC COT statistics and in fact my attention was drawn to the relative O/I size of the e-mini by some “strange” fluctuations in the large contract O/I. More recently the composite has shown an entirely different picture than the large contract with the Commercials being net short according to the Composite while they are net long on the large contract.

I assume that at least the large players have a choice of which instrument to employ, the large contract or the e-mini. On the face of it there doesn’t seem to be much that distinguishes between the contracts apart from their size. That however isn’t quite so, as the execution of the e-mini is electronic and transparent to the trader whereas the large contract is executed from the pit. There may be other reasons for the preference of one vehicle in favor of the other.

Given the O/I trends for the e-mini and the large contract, one is missing out on an increasingly large part of the picture if one chooses to exclude O/I data on the e-mini from analysis. Hence, over the longer term one might expect an added benefit in including the e-mini over and above just analyzing O/I changes for the large contract. However there is no guarantee that the derived rules are stable over time. Quite to the contrary the increasing weight of the e-mini is one additional reason that might result in the rules changing.

My analysis of the COT data has been influenced by the treatment of Murray A. Ruggiero (1997). In his book “Cybernetic Trading Strategies” (chapter 5), Ruggiero develops a trading system based on an indicator called the COT Index which has been employed by Steven Briese of Bullish Review. The COT Index is basically a Fast %K Stochastic based on the weekly net trader O/I figures with a look back period varying between 1.5 and 4 years, i.e. between 78 and 208 weeks. Ruggiero reports finding unimpressive results when employing the “classic” rules for the COT Index. These generate a buy signal when the COT Index calculated based on the Commercial net position data is above 90 and a sell signal when it’s below 10. Instead he develops rules that look promising that employ the COT Index for breakouts between 1.5 and 4 years, i.e. between 78 and 208 weeks. Ruggiero reports finding unimpressive results when employing the “classic” rules for the COT Index. 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From the Editor’s Desk

I am honored to be a part of the committee responsible for bringing you this month’s newsletter. Judging from the high quality of the articles you’ll be reading this month, it is safe to say that the new production method is working. And, I think we’ve set a standard that will be tough to match in the coming months.

You’ve already seen a fully disclosed trading system contained in the cover article. The results are promising, and enough of the logic is explained that any technician should be able to test variants of this idea. Inside this issue, there is an in-depth book review and an article on the importance of trading psychology. Finally, in between the pages detailing MTA business, there is another biographical sketch of a great technician and five actual charts for the chart readers in the crowd.

But, we are only beginning the process of delivering a timely, useful newsletter. In coming months, we need your continued generosity. Everyone uses software, and software reviews would be a great feature. Most of us read books, and we know that not every book is worth reading. A summary, of any length, would help others prioritize their reading. Even a one paragraph opinion would be considered. Summaries of presentations made at local chapters are always interesting. And, full-length feature articles on any aspect of technical analysis are welcome.

Please send your articles, ideas for articles, or feedback about what you like or don’t like to Kevin Depew or me.

Cordially,
Mike Carr, CMT

From the President

Is All Research Fundamental?

This president’s letter is concerned with some proposed NASD regulations and exams with regard to research analysts. Readers should note that we are trying to gather more information on these exams and rules, and that more current information probably will be available by the time you are reading this, than we had at the time this article was written. Please take this as a “Heads Up!” and look for more, and current, information.

There is a new NASD Rule 1050, which states that a “research analyst” shall mean an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report. To be qualified as a “research analyst” one must now pass a new set of NASD exams: Series 86 and Series 87. Series 86 consists of 100 multiple choice questions addressing primarily fundamental analysis of equity securities. Series 87 consists of 50 multiple choice questions addressing federal and industry rules and regulations.

How was it decided what was going to be included on the test? According to the NASD website, “a job analysis study was conducted to ensure a representative relationship between the contents of the examination and the job performed by research analysts. A group of research analysts and professionals who supervise research analysts identified four critical job functions.” Were any CMTs included in that group? Perhaps NOT!

The Series 7 examination is a prerequisite for taking the Series 86/87, and the Series 17, 37 or 38 may also satisfy this prerequisite. Since many firms now require research personnel to have passed the Series 7 this may not be much of a problem, but it is a requirement as far as we can tell.

A candidate who has passed CFA levels I and II may request an exemption from series 86. Applicants who do not meet these criteria may, based upon previous related employment experience, make a written request to NYSE or NASD for a WAIVER from Series 86. To amplify; it would appear that all research analysts are going to have to take the Series 87. It also appears that technical analysts may request a waiver from the Series 86.

It also appears that there will be a one year grace period for complying with this regulation, providing that the member, or member organization that employs the candidate files a Form U-4 with the Central Registration Depository. I urge all who may be affected by this to check with their firm’s compliance department regarding this requirement. It is unclear whether an amendment to an already filed U-4 is allowed.
FCH and MIP and CMT

Financial Career Headquarters (FCH) and the MTA Insurance Program (MIP) have been launched. CMT exams are planned for May 22 and November 20, 2004.

More than 50 of our members and affiliates have posted their résumé on FCH. Your information is totally confidential. If you are interested, please go to the MTA website and post yours today.

On February 5, 2004 we got our first job posting. We have done a direct mail piece that has gone out to 4,622 employers in our field. Our ads are appearing in Barron’s, Traders Magazine and the Journal of Financial Planning. For your reference, those ads are published in this newsletter – the Barron’s ad is to the right and the direct mail piece (which is the same copy and layout for the ads for Traders and JFP) are on the next page.

Within the next month Tom MacMahon will be calling on 5-10 larger employers in the NYC area to gauge their interest. The President of Boxwood Technology’s, career counseling division, our partner in FCH will have a spot on the program at the seminar in Marco Island, Florida in May to address those interested in career planning advice.

If it is okay for us to solicit your employer, PLEASE LET US KNOW. If you can give us the name to whom we may direct our solicitation for job postings that would be most helpful. The list of 4,622 personnel directors was purchased from their association. We will not use your personal employment information without permission.

We have had many compliments about FCH and a few questions. Most people seem to think this is a very valuable service, and our promotion of MTA as a source for the best Market Analysts will be helpful to them. A few people have said that while they appreciate the fact that resume postings are FREE, they think that job postings should be FREE for members as well. We have explained that is how the bills get paid, and unfortunately that cannot be changed at this time. Most have understood and agreed with this explanation. Please let me know your concerns.

This is our first effort in this area, and we want to be a responsive as possible. Marie Penza, our Administration Coordinator, is our in-house expert on FCH. Please contact Marie if you have any difficulty with the new service.

The MTA insurance program, MIP, is now available. This is the benefit that 30% of our members and affiliates answering this year’s member survey indicated that they would like to have.

The application process for the various insurance programs are quite detailed because they vary by state. However, Mr. Mike Crifasi, our broker, assures us that he will get us the best quotes possible in each area. Please let us know your thoughts on this new service.

FYI, all three levels of the CMT exams are being given in May and November this year. You will be receiving a post card with John Bollinger’s handsome face on it this time. If you are already in the program, please pass the card along to a friend. Thank you.

Sincerely,

John Kirby, Executive Director
The Market Technicians Association is pleased to announce the launch of the FIRST online job board exclusively for the market analyst profession.

Start posting your requirements for technical analysts, portfolio managers, hedge fund managers, traders, investment advisors, market letter writers, and others involved in all aspects of equities, futures, options, fixed income securities, currencies, international markets and derivatives.

Visit us today: www.mta.org/fch
tics. This led me to test a strategy resembling Ruggiero’s system but instead of employing the COT Index I decided to employ moving average crossover rules. I tested several MA types, including simple, exponential, weighted and double simple (i.e. triangular). The crossover rules employed were as follows:

- For a Long position the Composite Commercial net O/I of LAST week must be above its MA while the Composite Small Speculator net O/I must be below its MA.

- For a Short position the Composite Commercial net O/I of LAST week must be below its MA while the Composite Small Speculator net O/I must be above its MA.

If the condition for a Long position holds, then a Long position is assumed to be taken on the Open NEXT week; conversely, if the condition for a Short position holds then a Short position is assumed to be taken on the Open NEXT week. These rules result in a reversal system with no stops being employed for the purposes of the testing. The set of rules implies almost a two-week time lag from the net O/I measurement until a position is assumed. This lag seems optimal as assuming a trade at the end of the CURRENT week or at the open of the WEEK AFTER NEXT results in lower net gains.

A range of MA lengths varying between 5 weeks and 50 weeks was tested with a 13-period double simple MA (25-period triangular MA) turning out as a near top performer. This is in line with the results of the Spectral Analysis with the MA being half the length of the assumed cycle. I therefore adopted the 13-period double simple MA. The results of this backtest are shown in Table 1. A cost of 0.05% was assumed for each trade, on entry and again for exits, somewhat on the low side if only because of potential slippage. There are 32 closed trades and an open position. Table 1 depicts the main results of the backtest.

Table 1. Backtest Results

<table>
<thead>
<tr>
<th>Item</th>
<th>Value</th>
<th>Item</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total net profit (log)</td>
<td>1.3615</td>
<td>Open position value (log)</td>
<td>-0.0607</td>
</tr>
<tr>
<td>Current position</td>
<td>Short</td>
<td>Date position entered</td>
<td>5/9/03</td>
</tr>
<tr>
<td>Buy/Hold profit</td>
<td>0.1068</td>
<td>Days in test</td>
<td>2171</td>
</tr>
<tr>
<td>Total closed trades</td>
<td>32</td>
<td>Commissions paid (log)</td>
<td>0.0325</td>
</tr>
<tr>
<td>Avg profit per trade (log)</td>
<td>0.0444</td>
<td>Avg Win/Avg Loss ratio</td>
<td>1.79</td>
</tr>
<tr>
<td>Total long trades</td>
<td>16</td>
<td>Total short trades</td>
<td>16</td>
</tr>
<tr>
<td>Winning long trades</td>
<td>13</td>
<td>Winning short trades</td>
<td>11</td>
</tr>
<tr>
<td>Total winning trades</td>
<td>24</td>
<td>Total losing trades</td>
<td>8</td>
</tr>
<tr>
<td>Amount of winning trades (log)</td>
<td>1.7468</td>
<td>Amount of losing trades (log)</td>
<td>-0.3246</td>
</tr>
<tr>
<td>Average win (log)</td>
<td>0.0728</td>
<td>Average loss (log)</td>
<td>-0.0406</td>
</tr>
<tr>
<td>Largest win (log)</td>
<td>0.2124</td>
<td>Largest loss (log)</td>
<td>-0.091</td>
</tr>
<tr>
<td>Average length of win</td>
<td>9.54</td>
<td>Average length of loss</td>
<td>10.13</td>
</tr>
<tr>
<td>Longest winning trade</td>
<td>25</td>
<td>Longest losing trade</td>
<td>22</td>
</tr>
<tr>
<td>Most consecutive wins</td>
<td>7</td>
<td>Most consecutive losses</td>
<td>2</td>
</tr>
</tbody>
</table>

Week ending 4/7/1997-week ending 13/6/2003

Here we have 32 closed trades and an open position at the end of last week. The last trade assumed on May 9th shows more than a 6% loss.

Chart 1 depicts all 33 signals on the log cash S&P 500 index and the log equity curve.

Chart 1. Signals and Equity Curve

Table 2 details a trade-by-trade summary. Note that the date of entry for the first trade is January 9th 1998. The rightmost column of the table shows Maximum Adverse Excursion in log (percentage) terms.

Table 2. A Trade by Trade Summary

<table>
<thead>
<tr>
<th>Trade #</th>
<th>Trade Type</th>
<th>Entry Date</th>
<th>Close Date</th>
<th>Profit (log)</th>
<th>MAE (log)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Out</td>
<td>7/4/97</td>
<td>1/9/98</td>
<td>0.0000</td>
<td>0.0000</td>
</tr>
<tr>
<td>2</td>
<td>Short</td>
<td>1/9/98</td>
<td>1/30/98</td>
<td>0.0171</td>
<td>0.0036</td>
</tr>
<tr>
<td>3</td>
<td>Long</td>
<td>1/30/98</td>
<td>2/27/98</td>
<td>0.0760</td>
<td>0.0000</td>
</tr>
<tr>
<td>4</td>
<td>Short</td>
<td>2/27/98</td>
<td>3/13/98</td>
<td>-0.0216</td>
<td>0.0206</td>
</tr>
<tr>
<td>5</td>
<td>Long</td>
<td>3/13/98</td>
<td>3/27/98</td>
<td>0.0394</td>
<td>0.0000</td>
</tr>
<tr>
<td>6</td>
<td>Short</td>
<td>3/27/98</td>
<td>5/15/98</td>
<td>-0.0091</td>
<td>0.0030</td>
</tr>
<tr>
<td>7</td>
<td>Long</td>
<td>5/15/98</td>
<td>7/17/98</td>
<td>0.0485</td>
<td>0.0309</td>
</tr>
<tr>
<td>8</td>
<td>Short</td>
<td>7/17/98</td>
<td>8/21/98</td>
<td>0.0903</td>
<td>0.0223</td>
</tr>
<tr>
<td>9</td>
<td>Long</td>
<td>8/21/98</td>
<td>11/27/98</td>
<td>0.0896</td>
<td>0.1406</td>
</tr>
<tr>
<td>10</td>
<td>Short</td>
<td>11/27/98</td>
<td>2/29/99</td>
<td>-0.0640</td>
<td>0.0893</td>
</tr>
<tr>
<td>11</td>
<td>Long</td>
<td>2/29/99</td>
<td>3/12/99</td>
<td>0.0278</td>
<td>0.0189</td>
</tr>
<tr>
<td>12</td>
<td>Short</td>
<td>3/12/99</td>
<td>4/9/99</td>
<td>-0.0152</td>
<td>0.0372</td>
</tr>
<tr>
<td>13</td>
<td>Long</td>
<td>4/9/99</td>
<td>7/16/99</td>
<td>0.0903</td>
<td>0.0128</td>
</tr>
<tr>
<td>14</td>
<td>Short</td>
<td>7/16/99</td>
<td>8/20/99</td>
<td>0.0544</td>
<td>0.0121</td>
</tr>
<tr>
<td>15</td>
<td>Long</td>
<td>8/20/99</td>
<td>9/24/99</td>
<td>0.0048</td>
<td>0.0211</td>
</tr>
<tr>
<td>16</td>
<td>Short</td>
<td>9/24/99</td>
<td>10/8/99</td>
<td>0.0392</td>
<td>0.0000</td>
</tr>
<tr>
<td>17</td>
<td>Long</td>
<td>10/8/99</td>
<td>11/9/99</td>
<td>0.0836</td>
<td>0.0390</td>
</tr>
<tr>
<td>18</td>
<td>Short</td>
<td>11/9/99</td>
<td>3/31/00</td>
<td>-0.0910</td>
<td>0.1066</td>
</tr>
<tr>
<td>19</td>
<td>Long</td>
<td>3/31/00</td>
<td>5/5/00</td>
<td>-0.0514</td>
<td>0.1314</td>
</tr>
<tr>
<td>20</td>
<td>Short</td>
<td>5/5/00</td>
<td>5/19/00</td>
<td>0.0209</td>
<td>0.0000</td>
</tr>
<tr>
<td>21</td>
<td>Long</td>
<td>5/19/00</td>
<td>6/9/00</td>
<td>0.0379</td>
<td>0.0430</td>
</tr>
<tr>
<td>22</td>
<td>Short</td>
<td>6/9/00</td>
<td>10/13/00</td>
<td>0.0463</td>
<td>0.0351</td>
</tr>
<tr>
<td>23</td>
<td>Long</td>
<td>10/13/00</td>
<td>10/27/00</td>
<td>-0.0096</td>
<td>0.0761</td>
</tr>
<tr>
<td>24</td>
<td>Short</td>
<td>10/27/00</td>
<td>4/13/01</td>
<td>0.2124</td>
<td>0.0293</td>
</tr>
<tr>
<td>25</td>
<td>Long</td>
<td>4/13/01</td>
<td>7/20/01</td>
<td>0.0735</td>
<td>0.0000</td>
</tr>
<tr>
<td>26</td>
<td>Short</td>
<td>7/20/01</td>
<td>10/5/01</td>
<td>0.1571</td>
<td>0.0087</td>
</tr>
<tr>
<td>27</td>
<td>Long</td>
<td>10/5/01</td>
<td>12/14/01</td>
<td>0.1037</td>
<td>0.0000</td>
</tr>
<tr>
<td>28</td>
<td>Short</td>
<td>12/14/01</td>
<td>2/8/02</td>
<td>0.0283</td>
<td>0.0211</td>
</tr>
<tr>
<td>29</td>
<td>Long</td>
<td>2/8/02</td>
<td>3/15/02</td>
<td>0.0383</td>
<td>0.0399</td>
</tr>
<tr>
<td>30</td>
<td>Short</td>
<td>3/15/02</td>
<td>7/5/02</td>
<td>0.1611</td>
<td>0.0085</td>
</tr>
<tr>
<td>31</td>
<td>Long</td>
<td>7/5/02</td>
<td>11/29/02</td>
<td>-0.0627</td>
<td>0.2529</td>
</tr>
<tr>
<td>32</td>
<td>Short</td>
<td>11/29/02</td>
<td>2/21/03</td>
<td>0.1075</td>
<td>0.0252</td>
</tr>
<tr>
<td>33</td>
<td>Long</td>
<td>2/21/03</td>
<td>5/9/03</td>
<td>0.1070</td>
<td>0.0567</td>
</tr>
<tr>
<td></td>
<td>Open Short</td>
<td>5/9/03</td>
<td>6/13/03</td>
<td>-0.0607</td>
<td>0.0801</td>
</tr>
</tbody>
</table>

It should be mentioned that a backtest for a period of four years, i.e. the week ending July 4th 1997 through the week ending July 6th 2001, resulted in a simple 13-week double simple MA being superior to the 13-period double simple MA. That strategy resulted in 24 closed trades and an open position. As to be expected the performance of that rule dropped for the period week ending July 6th 2001 through the week ending June 13th 2003. The signals pro-

Newsletter Submissions

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duced by that strategy are similar to the double simple MA strategy with the
difference being a much larger loss from a long trade going into the
July 2002 low. Chart 2 shows the difference in equity curves for the two
strategies.

Chart 2. Equity Curve Comparison – Double vs. Simple MA Rule

To conclude there are indications that the Composite COT data contains
predictive information regarding market direction including a useful lead
time. However one must emphasize some caution in employing the results
as optimization was involved, mainly regarding the type of moving average
employed. Optimization runs as regards MA length, however, should be
regarded more as a sensitivity test as the sample “optimal” parameter was
not adopted.

It must also be pointed out that the available data horizon is relatively
short and does not permit proper out-of-sample validation of the strategy
being tested. Observation of actual out-of-sample performance of these rules
is recommended for validation purposes. Furthermore, no stops were em-
ployed for the testing as the purpose of the exercise was primarily to inves-
tigate the potential information content of the Composite COT data. Event-
ual trading rules would require price feedback, i.e. some sort of trend con-
firmation rules possibly employing daily frequency data as well as a solid
trading rules would require price feedback, i.e. some sort of trend con-
firmation rules possibly employing daily frequency data as well as a solid
stop-loss strategy and would be expected to improve on the results presented
here.

Yngvi Hardarson is a founding partner of Economic Consulting and
Forecasting Ltd., the only company in Iceland specializing in independent
financial consulting and advisory information services. Based in Reykjavik,
his company also publishes FX-mail, a daily newsletter that covers global
monetary and currency markets. The client list includes some of the largest
financial institutions. He may be reached at hardy@consulting.is

MTA Calendar of Events

March 8       New York Chapter Meeting
Contact: Cassandra Townes, admin@mta.org
March 9       Boston Chapter Meeting
Contact: Chuck Dukas, chuck@trendadvisor.com
March 10      Technically Speaking submissions due to
              market.strategist@bresnan.net
March 17      Chicago Chapter Meeting
Group Discussion: Reversal Patterns
Contact: Ross Leinweber, releinweber@lakeshoretrading.com
March 18      Atlanta Chapter Meeting
Speaker: CyberTrader Chief Market Technician, Ken Tower, CMT
Contact: Tim Snavel, tim_snavely@thco.com

Review of John Murphy’s Intermarket Analysis
Matt Blackman

Some things about the markets are intuitive. Most are not. The relation-
ships between asset classes and global markets fall into the second category.
Who would ever believe that what happens in one market and asset class has
a strong influence on others around the world without exhaustive study of
them all?

Most traders and analysts are guilty of being unable to see the forest for
the trees. They are so focused on their own area of expertise that they don’t
have time to consider the much larger global picture. However, this clois-
tered isolationist approach continues to lose disciples as global markets evolve
and merge into an intricate tapestry of complex cause and effect relationships
in the twenty-first century.

John Murphy’s new book entitled Intermarket Analysis was written for
the express purpose helping traders and investors make this transition while
learning how to recognize the intermarket trends and signals for themselves.
Does the book achieve this lofty goal?

An Idea Germinates

A long tradition of blindered single market focus may explain why so few
were aware of these interrelationships when John Murphy first stumbled
upon them in the 1980s. He had begun his career more than a decade before
as a stock analyst. By the 1970s he began getting interested in commodities
and it was where he was to spend the next 15 years of his professional life.

It was during this time that the commodities markets went through a rapid
evolution from an exclusive focus on hard commodities such as grain and
corns to the introduction of contracts on currencies and treasury bonds. In the
early 1980s, stock index futures were born, rounding out the commodities
arena to include the four major asset classes.

While the investment world concentrated on Wall Street stocks, Murphy
was looking at all assets: stocks, bonds, commodities and currencies. But it
would take one more pivotal event in his career to fully enlighten him to the
various interrelationships that existed and put them in perspective.

He began working for the Commodity Research Bureau as a consultant
and when the New York Futures Exchange launched a futures contract on the
CRB Index in the mid 1980s, he had access to all research available. That
research contained early discussions of the correlation between stocks and
bonds.

Next, he began to examine the relationship between commodities (CRB
Index) and bond yields. Noticing that the two moved together, the realization
of the importance of his discovery dawned after watching it in action. Rising
commodity prices resulted in inflation, which brought rising bond yields
(interest rates). It all made perfect sense and he was hooked.

Intermarket Technical Analysis, his first book on the topic, was published
in 1991. Like most revolutionary ideas, the technical analysis community
that until that time had been solely focused on single market price and vol-
ume analysis initially rejected it. Looking at global markets was economics
not technical analysis, his critics claimed. Murphy can laugh about it today
but it didn’t seem funny at the time. If intermarket study wasn’t technical
analysis, then what was it? It is a question the author continues to wrestle
with and why his new book no longer includes the word ‘technical’ in the
title.

But when it comes to making money in markets, how much do semantics
really matter? If it works, who cares what you call it?

Those who were reluctant to accept the benefits of intermarket analysis
after reading Intermarket Technical Analysis will find making the paradigm
shift much easier after reading his latest book. Murphy has the benefit of
some monumental market events in the last three decades to demonstrate his
case and he uses them to great effect. As Conan-Doyle’s most famous literary
creation would say to his well-proboscis endowed understudy after looking
at the evidence, ‘Why it’s as plain as the nose on your face, my dear Watson!’

Taking Root

The first real test of John Murphy’s acumen in the field of intermarket
analysis came in 1987 while he was working on Wall Street. It was the year,
he claims, that made him a true believer. Earlier in the year, the dollar started
to plummet but stocks were still locked in a strong bull with commodities. But bonds were dropping as well. Using the traditional well-worn approach of looking solely at stock market internals, the vast majority of analysts did not see the October crash coming.

Murphy remembers writing and giving speeches that the situation with the dollar and bonds was very bearish for stocks but no one listened. When it ultimately came, most blamed it on program trading. They missed the real reasons even after the fact.

Next came the Japanese stock market meltdown in 1989. Coincidentally, Murphy was putting the finishing touches on his first intermarket book at the time and had written a chapter on Japan. Like the U.S. crash, everyone in Japan used program trading as the scapegoat. They ignored the fact that the yen had begun to collapse and bonds had dropped severely beforehand. Both are signs of a market top and traders ignore them at their peril.

Then in 1990 on the eve of the first Gulf War, oil prices spiked to $40 dollars a barrel. As large oil importers, Japan was more vulnerable but as he mentions in the book, when the price of crude gets into the vicinity of $40/barrel, recession surely follows in Japan as well as the US. It is an historical fact. It was also another nail in the coffin of the Japanese economy.

Fast forward to 1997. While the book documents the intermarket situations that shaped outcomes from 1981 to late 2003, it was the events from the Asian currencies crashes and forward that set the stage for the stock market crashes in North America and Europe in 2000. The book contains numerous examples of warnings that were visible to the intermarket strategist.

The first casualty of the Pacific Rim currency crashes was commodity prices. The CRB index hit a new two-year low in 1997, then proceeded to hit a series of lower highs and lower lows for the next two years in a strong downtrend.

It was in 1998 that another key relationship changed. The normal chain of events in the business cycle is that bonds lead stocks in a recovery followed by commodities. As the recovery begins to wane, bonds turn down first, then stocks, then commodities as the economy slows and a recession approaches. At least this is what had happened historically. But in 1998, bonds and stocks decoupled due to the deflationary pressures brought about in Asia the year before. Stocks moved up when bonds moved down and vice-versa.

The last time this situation had occurred was in the 1930s. In early 2004, the situation persisted. Intermarket analysts will be watching for the old relationship to return for it will mean that deflation is no longer a threat and the economy is truly on the mend.

**Doing the Topic Justice**

As John pointed out in an interview for *Stocks & Commodities* magazine with the author in December 2003, it was his original goal to write the quintessential intermarket book but then found the topic so involved that each chapter could have become a book. There is just so much to discuss. Attempting to cover anything but a small snippet in a review is sheer folly. It is also impossible to do the book justice.

One technical analyst sent this author an e-mail recently saying that she considered Murphy’s first book on the subject, *Intermarket Technical Analysis*, to be one of the top three books on technical analysis. Those who liked his first book will absolutely love this one. This reviewer considers it to be one of his top three current technical analysis/markets reference books.

Murphy is perhaps the only man alive today that could have written Intermarket Analysis with such conviction. As he mentions early in the book, anyone with the benefit of hindsight can choose what indicators would have worked best. There is no skill in that. What gives him the credibility to analyze what was happening at the time is that he was doing it daily for his subscribers to the MurphyMorris Market Message Newsletter online and much of the book is documented with excerpts and detailed charts written at the time the events were unfolding.

The book is well written and very readable with plenty of examples to demonstrate each key point. The business cycle and all important market cycles are discussed from the seasonal best time to be in the market (November through January) to the 54-year Kondratieff Long Wave Theory. It will be a book that one will read repeatedly as well as an essential reference to come back to time and again as new market events unfold.

There is also little doubt that this book will become a market best seller. But it will not become the sole domain of the technical analyst and trading community. Everyone who plays the markets will want to read it. It is not simply about trading or technical analysis, but about markets and how to operate within a global framework in the four asset classes and effectively gather crucial up-to-the-minute intelligence to make the best-informed decisions.

Murphy makes one fact crystal clear. There are a number of essential intermarket relationships of which to be aware, any one of which could save your financial bacon at the right time. The implied corollary is that ignorance of any one of them could prove fiscally catastrophic.

Markets have become so interdependent in the last decade, a correlation that continues to strengthen with time. If those who suffered financial ruin between 2000 and 2002 had read his first book, how many of them could have avoided huge losses and even profited from what occurred? We will never know for sure but is it a risk that anyone can afford to take, especially when considering that the cost of avoidance (cost of the book) is less than $50?

**Suggested Reading**

- Murphy, John [2004] “Intermarket Analysis,” John Wiley & Sons
- The Murphy Market Message Newsletter, [http://www.stockcharts.com](http://www.stockcharts.com)

Matt Blackman is a technical trader, author, reviewer, keynote speaker and regular contributor to a number of trading publications and investment/trading websites in North America and Europe. He can be reached at matt@ tradingsystemguru.com

This article is republished with permission from [www.traders-mag.com](http://www.traders-mag.com).
Charts of the Month

Over the very long-term, seasonal factors tend to have less predictive value.

Charts: Compliments of Ron Greiss - The Chart Store (www.thechartstore.com)
Using Questions to Improve Trading

Ruth Barons Roosevelt

"Asking a question is the simplest way of focusing thinking... asking the right question may be the most important part of thinking." Edward de Bono

Your internal questions direct the flow of your thinking. If you’re not making money through your trading, you are probably not asking the right questions. Questions are vitally important because they establish focus, effect feelings, and ultimately direct your actions.

Answers give you facts, but questions set up the foundation for those facts. Questions create the architecture of your thinking and establish your direction. You will follow in the path of your questions, so it imperative that you ask the questions that will take you where you want to go.

There are questions that empower and questions that debilitate. “Why do I always lose?” sets you up to lose some more. It presumes that if you have lost in the past, you will lose now and in the future. Perhaps most dangerous of all, it establishes your identity as a loser. “How can I increase the probabilities of winning?” assumes that you can create an edge to change your trading in the future. It creates a potential for becoming a winner and identifying yourself as a winner.

Some questions are virtually unanswerable, and become unimpeachable statements. “Why am I such a loser?” is a simple condemnation and presumes the truth of the content. It is not answerable. “How can I make this better? How can I begin to win?” presents you with possibility and demands an answer. The first question focuses on the problem and places you permanently there. You remain stuck in the past. The second and third questions focus on the solution and presume that there is a way out of the dilemma. You move into the future with possibility.

Curiosity moves you away from stuck states and into a new future. Some people hesitate to ask questions because they are not comfortable with not knowing. They feel they have to have clear answers all the time. Trading is all about the unknown. If you have to know in advance, you really can’t trade.

Courage lies at the heart of creative questioning (and trading) because it requires the willingness to ask questions that might have no answer or might challenge your current position or way of thinking and perceiving. With a vibrant and easy curiosity, you will automatically ask questions when confronted with a difficult, confusing, or new situation.

Questions are powerful because they presuppose their own authenticity. They presume their inherent truth. The question sets up a gestalt that ultimately engineers an answer. Wrong question: wrong answer. Right question: possible answer. The answer seems as believable as the question.

Sometimes we’re not even aware of the questions we’re asking. A simple statement or thought often has a silent or implicit question behind it. “I could lose.” is often asking “What if I lose?” This what if question leads you into negative worry.

You begin to imagine losing. With that in mind, you may fail to pull the trigger even if you’re determined to take every signal your system offers you.

Imagination is stronger than will power. Imagining loss is sufficient to keep anybody out of a trade. Opportunity passes like a cloud. The greendrums of the trader is that he must preserve his capital, and still he must pursue profitable opportunity. “What if I win?” is the retort that will lead you into the trade.

At any time when your trading is not going well, ask yourself, “What questions am I asking myself? Am I asking the right questions? What is the question I need to ask right now?” Questions are the answer. They lead us out of a morass. They lead us where we want to go.

It’s important to make a distinction between the questions that are helpful to ask while researching and the questions to ask while trading. Trading and research are two quite distinct activities and roles. Researching involves thinking and exploring and checking and rechecking, creating methods and verifying them. Trading involves doing: perceiving and acting in a timely manner. Trading is simply applying your methods to the market. Because these two aspects are so different, they require a different type of attitude and a different type of questioning.

Some helpful questions to ask while researching might include the following:

- What is the trend?
- What does the market want?
- What are the probabilities?
- How much can I make?

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Ruth Barons Roosevelt

Some helpful questions to ask while researching might include the following:

- What is the trend?
- What does the market want?
- What are the probabilities?
- How much can I make?

Some unhelpful questions to ask while trading would include the following:

- What if I lose?
- What if I’m wrong?
- What if I can’t succeed as a trader?
- What will my broker—my wife—my boss think?
- Why is it always so hard?
- How can I make this trade work out? (You’re already wrong: get out.)

Remember, there are questions that illuminate; and there are questions that destroy or confuse and stagnate. You have the power to construct the questions that will move your trading forward. Whenever you’re in a quandary or things aren’t going well, ask yourself, “What is the question I need to ask right now?” What if you could learn to ask yourself questions that will make you a winner over time?

Ruth Barons Roosevelt is a psychological trading coach, working with traders around the world. She can be reached at her Wall Street office, 165 William Street, New York, NY 10038, 800-692-0080 or on the web at http://www.RuthRoosevelt.com

Related Reading


Did you know... William Peter Hamilton replaced Charles Dow as editor of The Wall Street Journal after Charles Dow’s death in 1902. He held this position until December 1929.

During this time, he wrote 255 articles making clear market forecasts. He made 90 position changes, switching from stocks to cash or vice versa. Of these, 45 were correct according to a 1933 Cowles Commission study, “Can Stock Market Forecasters Forecast?” (http://www.technicalanalysis.org.uk/history/Cowl33.pdf)
In 1991, in Santa Barbara, CA, the MTA bestowed its Annual Award upon George Lindsay, in recognition of the outstanding contributions he made to the field of technical analysis. Lindsay began writing about the markets in 1950 with the publication of an original theory of price movements. In 1951, in response to investor inquiries, he founded his advisory service, George Lindsay’s Opinion. Lindsay brought to his analysis a deep interest in history, which contributed to the manner in which he saw the markets. His original desire to study the stock market resulted from hearing stories of the enormous losses people had suffered in the 1929 crash. He began to study markets and investments while stationed abroad during World War II.

Upon completing military service, Lindsay pursued a career as a commercial artist in New York City. He would spend most of his life in the City, specifically in Greenwich Village. But, fortunately for all of us, Lindsay experienced a desire to make money in the stock market and began trading for his own account.

Lindsay was especially noted for long-term timing studies. The successor editor of George Lindsay’s Opinion wrote in 1991 (4 years after Lindsay’s death at age 85) that Lindsay’s studies called for an important market top in the Fall of 1997 (DJIA 8,000 was surpassed), and a second, possibly superior high in 1999 (DJIA 11,000 surpassed).

The Three Peaks and the Domed House Formations

Lindsay is best known for identifying Three Peaks and the Domed House while studying market action from 1893-1895 and 1910-1912. The two formations have appeared at major tops in the DJIA at least 55 times since 1885. The formations have been found in the DJIA, Treasury bond markets, NASDAQ Composite, NYSE Composite, Russell 2000, NASDAQ 100 30-minute charts, and in the Hong Kong Index.

Source: http://www.sandspring.com/graphs/threepeaks.jpg

Construction of Formations

In simplest terms, the Three Peaks represent a flat shape with three tops in the same general price range. A Separating Decline separates the Three Peaks from the Domed House.

The Separating Decline is divided into two selling waves. The lowest point of the Separating Decline is always lower than the two prior lows of the Three Peaks. Some type of base formation marks the bottom of the Separating Decline, but there must be two dips.

There must be two tests of the lowest point before a Domed House begins. A fast advance follows, forming the Wall of the First Story. The Roof of the First Story consists of five reversals. Then, an advance forms the Wall of the Second Story, followed by a Cupola or Small Dome at the top, hence, the name of the formation. The Roof of Second Story is an abrupt decline, which is followed by a recovery, but the downward trend is inevitable.

Rules of Interpretation

1. Look for the formations whenever markets are moving sideways.
2. The entire gain in a Domed House formation is eventually canceled. The average drops down to the level from which it began or even lower. There has never been an exception to this rule.
3. Movements never last very long. There are few explosive moves. The market spends most of the time backing and filling in a comparatively narrow range.
4. Once either formation is under way, it normally lasts a long time, hence its predictive value.
5. The formations are mainly proportional with respect to time duration. Lindsay believed time is more important than price for market forecasts:
   “All of my original methods are based on a single observation. Throughout market history, the length of time that advances and declines last has been much more nearly uniform and symmetrical than the number of points the averages gain or lose. Thus, time is more important than price when we try to estimate what will happen in the distant future.”
6. The formations appear in both macro and micro sizes.

Longtime member Philip R. Covato, who is the foremost student of Lindsay’s work, nominated Lindsay for the MTA Award. Covato and Lindsay exchanged opinions and forecasts for almost 20 years beginning in the mid-1970s. While Lindsay was not a particularly good writer, maybe because he explored and discussed many themes at the same time, he was an outstanding technician. Covato found that Lindsay was more visual than expressive. According to Covato, Lindsay was “a very sharing person” – “not secretive about his work” – “nothing proprietary about his work” – “always willing to discuss ideas and forecasts” – “willing to admit being incorrect.” George Lindsay personified the values of the MTA.

This article is based upon research done by George A. Schade, Jr., CMT.
2004 Charles H. Dow Award Guidelines

Each year, Market technicians are invited to submit a paper and application for the Charles H. Dow Award for excellence and creativity in technical analysis. The Charles H. Dow Award is sponsored by the Market Technicians Association, Inc. (MTA) and Dow Jones Newswires and will be given to the work that breaks new ground or makes innovative use of established techniques in the spirit of pioneering market technician Charles H. Dow.

This year’s Charles H. Dow Award will be presented at the MTA Annual Seminar in Marco Island, Florida in May 2004. The winning author may receive a personal award and be invited to discuss the paper at the MTA Seminar (Marco Island) or at a monthly meeting of a MTA regional chapter. A perpetual plaque including the author’s name with those of previous recipients of the Charles H. Dow Award will reside at the MTA office in New Jersey.

The publication or a summary of it may be published in the MTA’s Journal of Technical Analysis, the MTA newsletter, Technically Speaking, and the MTA website. Additionally, Dow Jones Newswires will make the paper available to the public through various media. At the discretion of the judges, the authors of runner-up papers will receive personal awards. No cash award will be given to any award winner or runner up.

Submission Deadline: Wednesday, March 15, 2004

Guidelines

1. Standards of Judgment
   A submitted or nominated work will be judged according to the following:
   a. The work is based upon the concepts of technical analysis.
   b. The work is either original or is a significant extension of an established work of technical analysis.
   c. The subject matter is substantive. Solid research and analysis are imperative.
   d. The work is practical and enhances the understanding of market action.
      A market forecast will not, by itself, be considered for the Award. The presentation of an analytical method or trading system is expected to include the results of applying the technique to specific past data according to generally accepted standards of testing.
   e. The strength and clarity of writing are superior.

2. Submissions of Papers
   Papers written especially for the Award or works published between March 15, 2003 and March 15, 2004 may be submitted. There is no fee for submissions.

   Preferred Format – PDF: Submissions should be sent to the Dow Award Chairman, Ross Leinweber at dowaward@mta.org All references to the author’s name should be removed from the paper’s content – the title page should contain the paper’s title ONLY. In the e-mail message, please give the Dow Award Chair all the important information: author’s name, contact information AND the title of the paper. Papers not following this guideline will not be accepted.

   Alternate Format – Hard Copies: There must be seven (7) hard copies sent to Ross Leinweber, Charles H. Dow Award, Lakeshore Trading, 550 Frontage Road, Suite 3400, Northfield, IL 60093. All references to the author’s name must be removed from the paper’s content. In addition, two title pages should be submitted: the first should list the title of the paper and all of the author’s contact information; the second title page should only include the title of the paper. Papers not following this guideline will not be accepted.

3. Style
   The text must be a succinct and conclusive presentation of the subject. The charts, tables, and figures should be used to exemplify or to supplement the text and should not be the primary means of conveying the writers’ points.

   The paper must not contain less than 1,500 or more than 4,000 words. A paper shall not contain more than 10 charts, tables, or figures total. Charts, tables and figures should be placed in appropriate sections of the text. When it is not possible to do so, they must be presented as appendices to the submission. Charts, tables, and figures must be individually labeled in numerical sequence.

4. Deadline
   The last day for submitting publications is Wednesday, March 15, 2004. Entries received after that date may be accepted at the discretion of the judging panel.

5. Judging Panel
   The judging panel will consist of seven (7) voting members and be selected from the following sources: prior winners of the Charles H. Dow Award, full members of the MTA and representatives of sponsoring organizations. Members of the Board of Directors of the MTA, excepting the editorial board of the MTA’s Journal of Technical Analysis, shall not be eligible for the judging panel. The chairman of the Award Committee will be a non-voting member of the judging panel. No author shall ask for or receive assistance of any kind from a member of the judging panel.

6. Decisions of the Judging Panel
   Decisions of the judging panel will be made in the best interest of technical analysis. The judging panel’s selection and acceptance of a work will be final and without recourse for reconsideration either by the judging panel, sponsoring organizations, or the MTA.

7. Post-Award Publicity
   Dow Jones Newswires and the MTA may publicize the award, its recipients’ names (but not necessarily their places of employment) and all or part of the winning publication or of runner-up publications. Recipients of the Award and runners-up may publicize their awards in an appropriate manner without undue enhancement.

8. Authors’ Copyright and Permission to Produce Copies
   The author of the winning paper and the papers that may be awarded certificates shall retain the copyrights to the papers, but the authors shall permit Dow Jones Newswires to produce and distribute copies in any medium of all or part of each paper. Dow Jones Newswires will bear the expenses of copy and distribution but will not remunerate the author.

9. Invitations for Submissions
   Award guidelines, including invitations for submissions, shall be published in the MTA newsletter, Technically Speaking, prior to the annual deadline. The guidelines shall be placed concurrently on the MTA website. Invitations may be publicized in any other manner chosen by Dow Jones Newswires, the MTA or other sponsoring organizations. Invitations shall be publicized in order to reach the largest number of potentially interested people.

10. Chartered Market Technician (CMT) Papers
    A paper submitted to the MTA to fulfill the requirements of the Chartered Market Technician program shall not be eligible for the Charles H. Dow Award unless the paper has already been accepted by the MTA as a CMT paper prior to its submission for the Award.
2004 Seminar Schedule - Preliminary as of February 10

Thursday, May 13
7:30 Golfer’s Breakfast
9:00 MTA Annual Golf Tournament (Advanced reservations required)
12:00 Seminar Registration opens
3:00 Hotel Registration
6:00 Reception/Buffet Dinner
8:00 Greetings/Introductions/Dessert
Keynote Speaker
Presentation of the Charles Dow Award

Friday, May 14
7:00 Breakfast
8:00 Interest Session 1
  Tract 1: Welcome to the MTA - new members/affiliates
  Tract 2: Business Planning
  Tract 3: Innovative Strategies in System Development
9:15 Interest Session 2
  Tract 1: CMT Level 1, 2, 3 Q&A
  Tract 2: Business Planning
  Tract 3: Advanced Money Management Principles
10:25 Break
10:45 Interest Session 3
  Tract 1: CMT Level 1, 2, 3 Q&A
  Tract 2: MTAEF Update
  Tract 3: Hedge funds and pair trading
12:00 Lunch (on own)
1:30 Presentation - 2004 Dow Award winner
2:45 Presentation
3:30 Break
3:45 Presentation
6:00 Beach Party
7:00 Tacky Tourist party and BBQ by the Pool

Saturday, May 15
7:00 Breakfast
8:00 Presentation
9:15 Presentation
10:30 Break
11:00 Presentation
12:15 Lunch
1:30 Presentation
2:45 Presentation
3:15 Break
3:30 Presentation
6:00 Cocktail Reception
7:00 Dinner and MTA Annual Award

Sunday, May 16
7:30 Breakfast
9:00 Annual Meeting
12:00 Hotel checkout

Speakers
Tom Dorsey, Dorsey Wright & Associates
John Greeley, Hedge Funds/Pair Trading panel moderator
Jordan Kotick, CMT, JPMorgan Chase
Peter Mauthe, SAAFTI, Spectrum Financial
Linda Raschke, LBR Capital
Bernie Schaeffer, SchaeffersResearch.com
Jeff Weiss, Jesup & Lamont
Jeanette Young, CFP, CMT, SG Martin Securities, Option Queen Letter
MTA Business

Electric Books... the MTA Bookstore Opens at www.mta.org

The all new MTA Electric Books product store is now open for browsing!

For years the MTA has made a tremendous effort to preserve as many original presentations as possible. Unfortunately we lost a lot of irreplaceable archives in the World Trade Center disaster of September 11, 2001. This spurred on efforts to save the remaining archives for posterity. This process will be on-going as we add newer presentations. Presently we have 42 items which have been preserved for use by MTA members and affiliates. We are offering these items on a cost-recovery basis. Members and affiliates receive a 20% discount.

Visit our new Electric Books store where you can find some terrific items such as:

- A DVD of John Bollinger, President of Bollinger Bands.com, talking about volume indicators as they relate to price line activity. (A DVD unit that can play DVD-Rs is required).
- A CD of Bob Prechter, President of Elliott Wave International, discusses trading and the long-term situation of the market as seen through the perspective of the Elliott Wave principle.
- Economic History Illustrated, a compendium of over 300 10" X 16" charts of prices, indices, data series and rates, stretching as far back as 1720! Areas covered include stock prices, interest rates, foreign exchange, economic data, commodity prices: metals, grains, oil, seeds, meats, energy, natural resources, food and fiber. This keynote work represents the culmination of over 50 years of painstaking cycle research.
- A CD of Alan Shaw, past president of the MTA, sharing 35 years of his experience with fellow technicians. This is a goldmine of wisdom and insight into both the market and technical interpretation of trends.
- A CD of Ralph Acampora, past president of the MTA, explaining the most logical approaches to the market based on solid technical analysis. This is an audio CD.
- The 2004 Market Forecast – This timely event offers an end-of-year panel featuring four of the best market analysts in the industry: John Murphy, John Bollinger, Alan Shaw and Richard Bernstein. Under the expert monitoring of Vincent Catalano, each panelist presents his views on where the market is headed in 2004 as well as answering questions from the audience.
- Plus much, much more!

For years the MTA has made a tremendous effort to preserve as many original presentations as possible.

We are calling upon our members and affiliates to help us make the 2004 Marco Island seminar a great success. Every year we try to have a solid roster of vendors exhibit their wares in the tradeshow part of the seminar. This year we would like to improve our chances at getting products and services which attendees would find interesting and valuable. Therefore we are asking everyone who reads this article to help us by answering the following questions:

1. Name 3 or more suppliers or companies with which you, as a technical analyst have done business in the last year and/or -
2. Name 3 or more suppliers or companies you would like to see as exhibitors at our annual seminar and/or -
3. Name 3 or more suppliers or companies from which you would like us to negotiate discount and/or -
4. Name 3 or more suppliers or companies which you feel would provide terrific value to the practice of technical analysis.

We will take your suggestions and tally the counts against each vendor name. Our exhibition sales team will then approach these people and indicate we have membership interest in their products or services. This can help us entice them to come to Marco Island and show their wares. As well they may also offer their service or product at a discount to MTA membership and we would certainly add that vendor to the numerous others on our website benefits page.

We thank you in advance for your help in making Marco Island the best event ever!

Please send your responses to tom@mta.org

2004 CMT Exams Registration Now Open!!

CMT exams, all 3 levels, will be given next on Saturday, May 22, 2004. Registration for all 3 levels of the exam is open NOW – registration deadline is Friday, April 2.

CMT exams, all 3 levels, will now be given twice a year going forward. Next date after May is Saturday, November 20, 2004.

To register for the May exams, please log in to your personal home page of the MTA website, click on CMT program from the left hand menu and you will find appropriate message of whether you need to take CMT Levels 1, 2 or 3. Register for the exam by picking a site, optional study group, then paying with credit card online.

Just remember, you are not automatically registered for the next exam. Also keep in mind that CMT exam fees do not carry over to the next exam and are not refundable once you have registered.