John Magee is one of the most well-known names in the field of technical analysis and is viewed as the leading authority on classical charting. All chart readers know the phrase “Edwards and Magee,” and John Magee is rightfully famous as the co-author of Technical Analysis of Stock Trends, originally published in 1948 and now available in its 8th edition.

Magee graduated from MIT in 1923 and worked in a variety of sales and marketing jobs, including a position as a Fuller Brush salesman, until he met Robert D. Edwards in 1942. Edwards was the brother-in-law of Richard W. Schabacker, a Forbes financial editor in the 1920s and later a New York Times financial columnist. When Schabacker died in 1935, Edwards took over Schabacker’s papers and the operation of the Schabacker Institute. In 1941, Edwards moved to Springfield, Massachusetts, where Magee joined him the next year.

Schabacker was the first to apply charting methods to individual stocks and not just the market indexes. Schabacker was Edwards’ and Magee’s intellectual mentor. Between 1930 and 1934, Schabacker had written three books. The 1930 classic, Stock Market Theory and Practice, devoted 250 out of nearly 800 pages to charting. The book was so highly regarded that Graham and Dodd in their 1934 Security Analysis referred readers to Schabacker’s 1930 book for an explanation of charting, even though they saw no value in “chart reading.”

Edwards and Magee added to Schabacker’s materials and greatly expanded that work, leading to the 1948 book, today recognized as the definitive book on charting. Edwards’ and Magee’s book has two parts. Part I, Technical Theory, is based on Schabacker’s charting work, but Part II, Trading Tactics, is based on Magee’s studies and personal trading experience. Part I is Edwards’ work. Part II is truly Magee’s work. This partnership lasted less than a decade before Edwards left in 1951 to become a high school science teacher in South Carolina.

Magee maintained daily charts on almost every stock on the NYSE and AMEX. He said, “Charts are the working tools of the technical analyst.” But, he understood the limits of his craft, “A chart is not a perfect tool. It does not give all the answers quickly, easily and positively.” His understanding of the imperfect nature of charting could have resulted from his personal trading experience:

“Frankly, I haven’t done as well with my own investments, over the long haul, as I have with my recommendations to clients, but that’s because of a shaky beginning.”

In the early 1940s, he had lost $25,000 in the market.

Magee’s work focused on four basic and useful types of chart analysis:

1. Area patterns or formations of price fluctuations that indicate consolidation of strength or an impending reversal of the price trend. Formations give “get in” and “get out” signals.
2. Trend and trendline studies which supplement analysis of area patterns or formations because stock prices tend to move in trends and once established, trends continue in force.
3. Support and resistance levels which show where a move is likely to slow down or end.
4. Broad market studies such as Dow Theory.

Magee defined technical analysis as follows:

“Technical analysis is the science of recording, usually in graphic form, the actual history of trading (price changes, volume of transactions, etc.) in a certain stock or in the averages and then deducing from that picture history the probable future trend...[the real value of a share of [a stock] is determined at any given time solely, definitely and inexorably by supply and demand, which are accurately reflected in the transactions consummated on the floor of the New York Stock Exchange.”

In Magee’s opinion, supply and demand, and nothing else, moved the market. His philosophy was, “I will not be swayed or panicked by news flashes, rumors, tips or well-meant advice.” In 1958, Magee told market historian John Brooks:

“Before I came to work here, I was on my own, making my charts and operating in the market out of an office...where I had nothing but a table, a chair, a telephone, a ticker and an air-conditioning machine. I sealed up the windows with boards and putty, so there would be no outside sights and sounds to distract me. I had no fundamental information at my disposal whatever, which left me free to make up my mind solely on the basis of my charts.”

He felt that the successful analyst should be concerned with interpreting supply and demand, as shown in these two insightful quotes:

“The technical analyst’s task is to interpret the action of the market - the flux in supply and demand mirrored in the market. In this work, it doesn’t in the least matter what creates the supply and demand. The fact of their existence and the balance between them are all that count.”

“What does this action really mean in terms of supply and demand?”

Magee had a wall sign which read: “MY MIND IS MADE UP. DON’T CONFUSE ME WITH THE FACTS.” The facts were the “daily outpouring” of financial news and announcements. Except for the daily quotes, he only read two-week old Wall Street Journals. When TV arrived, his motto became, “We Follow the Tape Not the Tube.”

In later editions of his books, Magee pointed out that “the inherent nature of a competitive market does not change very much over the years, and that ‘the same old patterns’ of human behavior continue to produce much the same types of market trends and fluctuations.”

Magee enjoyed writing and teaching. He wrote two other books, The General Semantics of Wall Street and Wall Street - Main Street - And You. These books presented his market wisdom in a lighter, but educational, writing style. As for teaching, for eight years, Magee taught an investment course in the Springfield adult-education program titled “The Semantics of Wall Street.”

In December 1984, Magee attended the MTA’s monthly meeting.

Magee’s contributions to the study of technical analysis were formally recognized by the MTA in 1978 when he was named the recipient of the prestigious annual award. He died in 1987, at the age of 86.
From the Editor’s Desk

As technicians, we identify trends in the markets and seek to profit from this insight. If “Technically Speaking” were a tradable security, I’d have to rate it a “short” in a confirmed downtrend. You hold in your hands all ten pages of the May newsletter — down from 12 pages last month and 14 pages the month before. Astute technicians can identify this trend even without a chart.

Quality is not declining. The charts provided by Alan Newman and the biography written by George Schade are outstanding submissions. John Kosar and James Bianco have submitted an objective methodology to determine the major trend in the 10-year TIPS Inflation Breakeven Rate. This very practical article has real-world trading applicability. Clay Allen reminds us of the importance of sticking to the basics — in this case, a reminder to cut losses early.

On behalf of our readers, I’d like to thank these contributors. Combined with news of the business of the MTA, they have delivered another high quality letter. Going forward, we need your input. The only way to eliminate my shameless begging from these pages is to send me something, anything at all (market.strategist@wyowbi.com). I am hoping we reach a “V” bottom and can increase the knowledge delivered to you by 40% next month.

Cordially,
Mike Carr, CMT
Editor

From the President

Greetings MTA Members and Affiliates:

I would like to comment on several key issues:

The MTA is working on various issues of importance to Technical Analysis around the world. The body of knowledge effort is discussed elsewhere, but I would like to comment on it here as well. We are going to work with the Educational Testing Service (Chaucy) to create a comprehensive Body of Knowledge to assist us in the preparation of our CMT exams, as well as for reference by the Technical Analysis community as a whole. We want wide participation, and after the preliminary work is completed, I will be asking members and affiliates for their help. Stay tuned!

Another area of interest to us is membership turnover. Every year we both lose and gain new affiliates and members. This year, we did an “exit” survey for the first time. The main point that jumped out at me was that there seemed to be demand for more educational opportunities for the membership at large, but particularly for affiliates. This is of interest to me, as I think the association could provide more in the way of educational opportunities for affiliates. I would love some feedback from affiliates here — what would they like to see, what sorts of things could we do, how can we serve them better. I believe that affiliates are our single best source of new members, and would like to see the association serve them better. Feel free to write me at fmeissner@mta.org and give me your thoughts on this.

Another area of interest for the members is our financials. Over the last year we have increased the staff and also have embarked on a public awareness program. Both of these things have cost money. While our audited results are not complete, according to preliminary numbers the financial picture is strong. Our revenues were slightly over budget, and our expenses slightly under. We appear to be healthier than last year at this time. Please e-mail me with questions on this area of the association also.

As we approach the seminar on Marco Island, the MTA looks strong. This has been a year of work, and transition, and I look forward to the next year of hard work for the MTA.

Best regards,
Fred Meissner, CMT
President
NYSE, NASD and CMT

Changes in the requirements to be called a “financial analyst” are changing and the voice your MTA is being heard.

On March 26, 2004 a conference call was conducted with the NASD and the NYSE to discuss the series 86 exam and the relationship of CMT Charter-Holders to that exam.

Participants on the call were Bob Gulick VP Education from NASD and Phil Shaikun Esq. Associate General Counsel, Regulatory Policy & Oversight and Joe Savage of NASD, and Bill Jannace and Don Van Weezel Vice President Regulatory Affairs from NYSE. Participants from the Market Technicians Association (MTA) were Ralph Acampora CMT, Bruce Kamich CMT, David Krell CMT, and Philip Roth CMT.

As a result of the call, the MTA was asked to provide a description of the CMT program to Don Van Weezel at NYSE and Phil Shaikun at NASD.

Eleven days later, on April 6, 2004, a 26-page letter was sent to comply with the request. Following are portions of that letter:

“This letter is that description. It includes the goals of the Association, the code of ethics all members abide by, the description of the CMT Program, a description of courses in Technical Analysis, and some of the instructors who teach them, the role of Educational Testing Service in the process, the history of the MTA, and finally a listing of CMT Charter-Holders from around the world.

Technical Analysis is the oldest form of financial analysis, and today it is practiced in every major country in the world. The CMT program is to Technical Analysis what the CFA program is to Fundamental Analysis.

These two forms of Financial Analysis stand on an equal footing as separate but equally rigorous approaches to financial analysis. Fundamental analysis derives decision-making from in-depth analysis of a company or industry’s ongoing and expected business. Technical analysis assumes that much of this knowledge and information is already included in the price of the asset and that price trends form as a result of gradual shifts in knowledge, not all of which is fully in the public domain.

The technical discipline attempts to measure real time changes in supply and demand in the trading marketplace; to determine what this may indicate about shifts in knowledge and changes in trend before they become fully articulated in the information marketplace. One looks at what a company says and does; the other, at what investors know and do.

The practice of Technical Analysis is vital to managing financial market risk. The 1998-2003 bubble and post-bubble period is a classic example of when traditional fundamental valuation methods would not have led to involvement in leading groups while momentum was strong, nor a timely exit when momentum turned weak. The CMT Charter-Holder is the recognized expert in this field.

... We thank you for your time and kind consideration. While there are more than 65,000 CFAs today, there are only several hundred CMTs. This elite group, although small in number, is critical to solid financial analysis, and deserves your recognition.”

If you would like a full copy of the text, please let me know. I will email it to you. This effort is being followed up with personal meetings by David Krell and Ralph Acampora with the officials at NYSE and NASD to carry our case forward.

Thoughts and suggestions of all members and affiliates are appreciated.

Sincerely,

John R. Kirby
Executive Director

CMT Exam May 22 – Updates from MTA

Shelley Lebeck

To May 22, 2004 CMT Candidates:

Exam site details have been posted in the CMT program section of your personal home page www.mta.org/membership/cmt/

Report time for all locations (exception noted within site address) is 8:30 a.m. local time Saturday May 22, meaning you are at the site at that time. You MUST be at the exam site by the report time, or you might not be allowed to take the exam. The exam will start shortly after everyone is settled and instructions have been read, so the start time of the exam depends on how many people are at your site.

You will be sent in the postal mail an exam site ticket that you need to bring with you to the exam along with PHOTO ID. When the tickets have been mailed, we will let you know. If you are not going to be at your postal mailing address in the next 30 days to receive the ticket, please let MTA office know that as well to arrange alternate delivery address or send via e-mail. Any questions on this, contact MTA office — cmt@mta.org

Water will be allowed into the exam sites, but no other liquids and no food. Simple calculators – battery operated, hand-held, no printing, no memory – will be allowed.

Please check your emails and personal home page frequently in the next 30+ days for any updates regarding the CMT exam. Thanks

The CMT 1 exam is multiple choice, 120 questions and you have two hours to complete the exam. Please bring 2 pencils for the answer sheet.

The CMT 2 exam is all multiple choice, 150 questions and you have four hours to complete the exam. Please bring 2 pencils for the answer sheet.

The CMT 3 exam is all essay format, and you have four hours to complete the exam. Please bring pens to write your answers (no pencils).

HELP WANTED

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This job is ideal for people that presently trade from home and are interested in taking their trading career to the next level as well as for people that traded in the past and are looking to get back into the market. Resumes can be sent to carol@trendfund.com
Factors That Influence 10-Year Treasury Inflation Protected Securities’ (TIPS) Breakeven Inflation Rate

By John J. Kosar, CMT and James A. Bianco, CMT

This model was originally published by Bianco Research, LLC, as a Special Report to their subscribers. It allows investors to determine the expected trend in the 10-year TIPS breakeven inflation rate.

A TIPS security pays a yield and the inflation rate to its holder. The inflation rate is measured using the non-seasonally adjusted Consumer Price Index - All Urban Consumers (CPI-nsa) and is paid on a two month lag due to reporting/timing delays. By subtracting the yield of the 10-year TIPS security from the yield of the 10-year Treasury Note (the “nominal”), one can derive a “breakeven inflation rate.” That is, the inflation rate the holder of a TIPS security must receive in order to collect the same income as the holder of a 10-year “nominal” Treasury note. (Note: this breakeven inflation rate is the market’s assessment of the 10-year annualized inflation rate, not the upcoming year-over-year rate as is commonly mistaken).

We use the breakeven inflation rate because we felt it would have the additional benefit of being useful to non-TIPS investors since it is also a gauge for changing inflation expectations.

The chart below shows the 10-year breakeven inflation rate back to the first 10-year TIPS auction in 1998.

Chart 1 - A Four-Part Model

How can we objectively determine the trend of this rate? More importantly, how can we determine when the trend changes? In order to answer these questions, we’ve built a model that incorporates the following components:

- The level of the breakeven rate itself
- The price of crude oil
- The Leuthold Inflation Beneficiaries Stock Index
- The yield curve

The Level Of The Spread

First we “smoothed out” some of the erratic day-to-day price fluctuations to improve the reliability of any signals produced by our model. We accomplished this by using a 1-week moving average of the breakeven inflation rate rather than the “raw” rate itself.

Next, we added a 3-month moving average of the breakeven inflation rate as a way to measure the significance of movement in the 1-week moving average. Three months was chosen as our long-term time frame because most managers are focused on quarterly performance.

A widening bias is signaled when the 1-week moving average moves above the 3-month moving average. A tightening bias is signaled when the 1-week moves below the 3-month.

**Crude Oil**

We used cash crude oil prices (Cushing) rather than nearby futures to avoid any artificial price movement due to contract rollover.

Again, we used a 1-week moving average of price in an attempt to smooth out any erratic day-to-day movements in the price of crude oil. We then added a 2-month moving average of the price of crude oil for comparison with the 1-week average. We chose a 2-month moving average (rather than a 3-month as used for the price of the spread) to align this inflation measure with the payout of TIPS securities as explained above. We wanted to measure the movement in this inflation measure since the last “CPI payout” (or accretion, as it’s called).

Once again we used a 1-week average to smooth out the day-to-day fluctuations in price, and a 2-month average for a benchmark to measure the movements in the shorter moving average against.

We selected the 2-month time frame for the longer moving average for the same reason we did in crude oil: to align our benchmark with the 2-month lag in the TIPS payout of CPI-nsa.

A widening (inflationary) bias is signaled when the 1-week moving average moves above the 2-month moving average. A tightening bias is signaled when the 1-week moves below the 2-month.

**The Yield Curve**

We used the 10-year/3-month yield curve for our model because it’s the same one used by the Index of Leading Economic Indicators (LEI). This is the yield curve that is supposed to lead economic activity. To remain consistent with the other inflation measures*, first we smoothed the data with a 1-week moving average, and then measured it against a 2-month moving average.

A widening (inflationary) bias is signaled when the 1-week moving average moves above the 2-month moving average. A tightening bias is signaled when the 1-week moves below the 2-month.

**Putting The Model Together**

For each of the four components we assign a “+1” when the indicator is signaling a widening trend and a “-1” if it’s signaling a tightening trend. There is no neutral signal - it is either one or the other, depending on the 1-week moving average of that particular component’s position relative to its longer moving average.

Chart 3 shows the results of this model. The
top panel shows the breakeven inflation rate. The bottom panel shows the model’s signals. The widening signals are highlighted with arrows pointing up when the bottom panel hits +4 (meaning all four of the components discussed above are signaling a widening). The tightening signals are highlighted with arrows pointing down when the bottom panel hits -4 (meaning all four components are signaling a tightening).

Like the individual components themselves, this model is always “in the market” as it moves from signaling a widening trend (when it reaches +4) to signaling a tightening trend (when it reaches -4).

Close inspection of the chart shows signals have been successful at defining the trend during both widening and tightening periods.

Table 2 shows the results of following this model over a five-year period. The highlights of the table are as follows:

- 73% of all signals were profitable.
- The model yielded +314 bps from March 1988 through April 2003, versus -9 bps using a buy and hold strategy.
- Tightening and widening signals have been equally successful: +152 bps during widening trend, +163 during tightening trends.
- Profitable signals were in the market almost twice as long as unprofitable signals.

<table>
<thead>
<tr>
<th>Summary Signals</th>
<th>Widening</th>
<th>Tightening</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Signals</td>
<td>6</td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td>Number of Winning Signals</td>
<td>3</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>Percentage of Winning Signals</td>
<td>60%</td>
<td>83%</td>
<td>73%</td>
</tr>
<tr>
<td>Number of Losing Signals</td>
<td>2</td>
<td>1</td>
<td>3</td>
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<tr>
<td>Percentage of Losing Signal</td>
<td>40%</td>
<td>17%</td>
<td>27%</td>
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<tr>
<td>Average Profitable Signal Length (days)</td>
<td>135</td>
<td>128</td>
<td>131</td>
</tr>
<tr>
<td>Average Unprofitable Signal Length (days)</td>
<td>90</td>
<td>38</td>
<td>72</td>
</tr>
<tr>
<td>Biggest Win (bps)</td>
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<td>81</td>
</tr>
<tr>
<td>Biggest Loss (bps)</td>
<td>6</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Cumulative Gains (bps)</td>
<td>145</td>
<td>163</td>
<td>308</td>
</tr>
</tbody>
</table>

Conclusion
When we put this model together we asked ourselves the question, “What factors do managers look at when investing in TIPS?” We initially considered a dozen factors including:

- 10-year Treasury yields
- the yield curve
- the level of the spread itself
- the CRB Index, (an index of 17 commodity futures prices)
- the price of crude oil
- the S&P 500
- the Volatility Index (VIX)
- inflation-sensitive stocks
- the MOVE Index (a volatility index of the bond market)
- CPI-nsa momentum
- ECFI (Economic Cycle Research Index) Leading Inflation Index
- Non-Seasonally Adjusted CPI - All Urban Consumers

After testing these indicators individually and in combination with each other, we found that most did not work as trend indicators of the breakeven spread. However, four of these indicators did work:

- the level of the spread itself
- crude oil
- inflation-sensitive stocks
- the yield curve

And interestingly, these four worked better in concert with one another than they did individually. For example, the yield curve component avoided some unprofitable signals by not allowing the model to go into a widening signal during the February-December 2000 period when the curve was inverted.

Once we settled on this group of factors that worked well, we then tried to put them together in such a way that would produce an objective conclusion regarding the spread’s direction that was free from emotion and other extraneous factors.

We chose time frames that are consistent with the reporting of Leading Economic Indicators and the spread’s direction that was considered a dozen factors including:

| Members on the Move |

Mark Eidem, Internship Chair, has a new address/phone:
2133 Stockton Street #B206
San Francisco, CA 94133
phone: 415/296-7831
email: alaska trader78@yahoo.com

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email: alaska trader78@yahoo.com

Have you been quoted in the press?
The MTA PR department wants to know. Please contact Bgomperts@aol.com with the information.
Dr. Alexander Elder, spoke at the New York monthly educational meeting on December 15, 2003. He presented an overview of his decision making process and briefly discussed the importance of money management.

In his first book, “Trading for a Living,” Elder defined his Triple Screen Trading System. Under this method, the timeframe the trader targets becomes the intermediate timeframe. The longer-term timeframe is one order of magnitude greater while the shorter-term timeframe is one order of magnitude less. For example, an intermediate term trader would use daily charts with weekly charts being the longer-term timeframe and hourly charts the shorter-term.

The trader begins by looking at the long term and identifies the direction of the trend on that chart. Any trend following indicator can be used for this analysis. Elder showed that a trader could use the slope of the two most recent bars on a MACD histogram to determine the trend. The second screen is used to identify trade entry points in the direction of the longer-term trend. For this screen oscillator divergences are used to buy short-term weakness in uptrends, or to sell short-term strength in downtrends. The third screen is used to time the trade entry. When the first screen shows that the weekly trend is down and the second screen shows that the daily trend is down, the third screen is used to place a buy stop order to catch an upside breakout by buying at the previous day’s high. If the weekly trend is down and the daily trend is up, a sell stop order is placed at the previous day’s low.

Although any trend following indicator, such as a stochastic, can be employed in the second screen, Elder introduced several indicators in his book “Trading for a Living” that should be considered by traders:

- Elder Ray consists of two measures - Bull Power and Bear Power. Bull Power is calculated by subtracting a 13-day EMA of closing prices from the daily high of a stock, index or commodity. Bear Power subtracts the 13-day EMA from the day’s low price. Both are plotted as histograms. To buy using these indicators:
  1. The trend must be up, as indicated by the closing price being above the 13-day EMA.
  2. Bear Power should be negative, but rising. The best signals occur when Bear Power sets up a bullish divergence with price.
  3. Ideally, Bull Power is reaching a new high, compared to its previous peak.

This trade would be closed when Bull Power does not confirm a new price high. A stop loss should be entered when the trade is initiated to preserve capital. That order could be placed at the previous day’s low.

Sell signals are generated when:

1. The trend is down, as indicated by price being below the 13-day EMA.
2. Bull Power is positive but declining. A bearish divergence creates the best shorting opportunity.
3. Ideally, Bear Power is reaching a new low.

Covering shorts on a bullish divergence in Bear Power is recommended. A stop loss order could be entered at the previous day’s high.

- Force Index is calculated by subtracting yesterday’s close from today’s close and multiplying that by today’s volume. If the close is higher today than yesterday, the force is positive. If the closing price is lower than yesterday’s, the force is negative. This number is then smoothed with a 2-day EMA for short-term traders, or a 13-day EMA for intermediate-term positions. To trade using this oscillator, go long if the Force Index is below zero and there is a bullish divergence. Shorts can be initiated if the Force Index is above zero and a bearish divergence occurs.

In his latest book, “Come into my Trading Room,” Elder introduces the Impulse System. His charts show each bar with a different color—red, blue, or green. If a fast moving average and the slope of the MACD histogram are moving upwards, the bar would be green. If both are sloping downward, the bar is red. If the direction of the slopes is mixed, the bar is blue. This serves as a visual means of ensuring he is trading in the direction of the trend.

In his presentation, Elder demonstrated the Impulse System using a 13-day EMA and an 11, 25, 8-day MACD. His experience shows that these values work for his trading style. Other successful traders may modify the periods used in the indicators, or may rely on different indicators. Trading system development is a personal endeavor, and Elder urged the audience to use his models as a point of departure for their own testing.

He showed an example of one of his most profitable trades during 2003. He had bought Ishares on the Japanese stock market near the low. Although all his technical indicators were bullish, he also liked the fundamentals of Japan and he felt sentiment had reached a bearish extreme. Elder stressed the importance of using all available information to make a trading decision, and not blindly follow any single indicator.

Elder reminded the audience that without sound money management, any system will eventually fail. Two simple rules he uses are to risk no more than 2% of an account on any single trade and to stop trading for the month if he loses 6% of his equity during the month. Following these guidelines ensures that he will always be able to survive the inevitable drawdown periods.

He also recognized the fact that emotions play a large role in trading. That is why he believes paper trading does not reflect actual performance that should be expected. Without real money at risk, there is no emotion. And, paper traders often allow trades that would be stopped at a loss with real money to become profitable. He likens paper trading to watching a show such as “Who Wants to be a Millionaire.” While playing at home may make you smarter, there is no way of knowing how you will actually perform until you are sitting in the light under the glare of the audience. With commissions as low as they are now, Elder saw no reason a trading system could not be tested with real money.

More information on these trading techniques may be found at www.elder.com

**NY Regional Chapter Monthly Meeting Review**

**The Decision-Making Tree: Beyond Technical Analysis**

Newsletter Submissions

Changing jobs? Have an idea for a story? An anecdote to share? Advice for other MTA members and affiliates? We’d love to read them!

Remember the MTA newsletter is for you! Help us make *Technically Speaking* an indispensable part of your membership in the MTA. Please send submissions and ideas to editor@mta.org

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What Does A Portfolio Manager Manage?
W. Clay Allen, CFA

Portfolios heavy with underperforming stocks almost never outperform the market, or, to paraphrase Peter Lynch, “You should water the flowers and pull the weeds.”

To many professional investors, the role of a portfolio manager is simply to pick stocks for the portfolio. If we could accurately predict the future of the economy or a business, then stock selection would be all that would be required to be a successful portfolio manager. Since our abilities to predict the future of the economy or a business falls far short of perfect, the portfolio manager’s primary role is to deal with the stocks that don’t work out as hoped. Before a stock is purchased for the portfolio we usually develop expectations about how we think the stock will perform in the future. Once the stock has been purchased, the portfolio manager must measure the performance of the stock to verify that the expectations about performance are working out as planned. The market behavior that is being recorded acts as a check on the projections of financial performance that motivated the purchase of the stock in the first place. It seems, therefore, that the primary responsibility of a portfolio manager is to identify and eliminate poorly performing stocks from the portfolio.

The question now becomes: How best to measure a stock’s performance and what constitutes unacceptable market performance?

An investor’s time horizon is much longer than that of a short-term trader so the performance must be measured around a long-term time frame. It is also important to remove the effects of short-term market noise.

The three box, point and figure charting system provides a technique that removes the short-term noise from the data and the trend indications are drawn from the alignment of at least six columns of price movement that usually take months to form. The PnF approach also converts the chart into a format that records price change vs. risk and that is far superior to price change vs. time.

The second major influence on market performance is the movement of the market itself. The influence of the market is removed by converting the price change to relative price change by dividing the stock’s price by a measure of the market-usually a major market index such as the S&P 500. This conversion process is usually referred to as relative strength. It must be emphasized that relative strength is not presented as a ranking index and that it is the trend of relative strength that is important. Stocks that persistently show downward trends on the PnF relative strength charts, such as Deutsche Telecom in the chart, are stocks that should be removed from the portfolio.

Stocks that show upward movement, to the right, on the chart can be retrained in the portfolio for as long as the up trend lasts. The chart of Coach presents an example of this. This tool allows the portfolio manager to identify the stocks that are not performing as hoped.

This does not involve a prediction of the future behavior of the stock other than a belief that persistently poor market performance reflects long-term forces that can reasonably be expected to continue to affect the stock negatively in the future.

W. Clay Allen, CFA, has operated Market Dynamics since June 1998. He applies his PnF relative strength methodology to long-term investment decisions. More information can be found at www.clayallen.com

MTA Calendar of Events

May 10
Technically Speaking submissions due to market.strategist@bresnan.net

May 10: New York Chapter Meeting
Kenneth Safian, Safian Investment Research Inc. Contact: Cassandra Townes, admin@mta.org

May 11: Denver Chapter Meeting
John Bollinger, Bollinger Capital Management, Contact: Lyle Dokken, klyledokken@yahoo.com

May 13-16: Annual MTA Seminar
Marco Island, Florida

May 27: Atlanta Chapter Meeting
Adrienne Toghaie, Trader’s Coach, will talk about the disciplines and habits of successful traders and her experiences working with some of the best. Contact: Tim Snively, tim_snively@rhco.com

May 19: Chicago Chapter Meeting
Group Discussion: Trader Psychology
Contact: Ross Leinweber, rleinweber@lakeshore trading.com

Did you know...

In mid-1983 commodities trader Richard Dennis was having an ongoing dispute with long-time friend Bill Eckhardt about whether great traders were born or made. Richard believed that he could teach people to become great traders. Bill thought that genetics was the determining factor. To settle the matter, Richard suggested they recruit and train some traders and give them actual accounts to trade to see who was correct. Thirteen students were trained for two weeks at the end of December 1983. They began trading the next month. The Turtles became the most famous experiment in trading history and over the next four years, they earned an average annual compound rate of return of 80%. The complete set of the rules that Richard Dennis taught his trainees can be downloaded at http://originalturtles.org/docs/turtlerules.pdf

MTA Library Activity

Cassandra Townes

I am very pleased to report that more and more people are using the MTA library. We sent out approximately 180 books in the first 3 months of this year, compared to 170 last year this time.

With the addition of our new Alphier collection, people have started borrowing those books as well. Please visit your MTA library today from your member home page.

Did you know...

The MTA Web Site includes streaming video archives of past New York monthly educational meetings. Go to the video archive link at http://www.mta.org/membership/video/ to see presentations given since August 2003.

May 10, 2004
Technically Speaking submissions due to market.strategist@bresnan.net

M A Y   2 0 0 4
The surge in Bulletin Board volume clearly shows that speculative activity is what forms the backbone of the U.S. stock market. Although one can easily make the case that Bulletin Board volume does not characterize the overall U.S. market, I believe it does! You are not going to have a speculative blowoff in garbage issues like those on the Bulletin Board unless you are already in a grossly speculative phase across the entire spectrum of the broader averages. This is noteworthy when you consider that P/E ratios are still extremely high by historical standards and yields are still at extremely low levels.

The very low cash-to-assets ratio of mutual funds is incontrovertible evidence that speculation rules the U.S. stock market, where index funds and ETFs have made such gigantic inroads that active managers are too afraid to keep any substantial amounts of cash. Case in point, at the end of February, Fidelity Magellan, the largest actively managed fund of them all (with $67 billion in assets) was down to a piddling 1.4% cash at the end of February, furiously trying the catch the tail of the index dogs.

The speculative nature of the U.S. market is perhaps driven home best by the realization that insiders want no part of the shares of the companies they manage. If there were legitimate prospects for these companies at the prices the shares were trading at, there simply would have to be less insider selling. In fact, the picture shown is only the number of insider buys (5) and sells (254) and does not show the amount of shares purchased and sold. What you do not see is the worst ratio of shares sold (70.6 million) to shares bought (8000) that have taken place since I began tracking this measurement (8830:1) several years ago. For every hour of every trading day over the last six months, the insiders of these ten companies have dumped an average of 86,255 shares - this is the mark of a highly speculative market!

Lastly, we must consider that seasonality will soon turn unfavorable. The last chart illustrates the net inflows into equity mutual funds broken down by month through the end of 2003. April has been the strongest month for many years, probably due in part to IRA contributions. The seasonal influence is about to turn negative in an extremely speculative environment, a double whammy.

Although most technicians are quick to call the environment a new bull market or a “cyclical” bull market within a secular bear market, my opinion is that the definitions do not match the environment. From 1997 to date, we have seen circumstances unlike any seen before in our lifetimes. Much of what we have seen can only be explained by the supposition that a veritable stock market mania is still in force and only took a time out from the 2000 peak to the 2002 lows.

Alan M. Newman, Editor, Longboat Global Advisors Crosscurrents

www.cross-currents.net
MTA Annual Membership Meeting
Sunday, MAY 16, 2004 - Marco Island, FL
Election of Officers and Directors

In accordance with the MTA Constitution (2003), the MTA Nominating Committee has presented the following slate of candidates for officers for terms of two (2) years.

President — M. Frederick Meissner, Jr., CMT has been in the investment business from 1983 to the present, working as a broker and technical analyst. Fred was the lead technical analyst for the Robinson Humphrey Co. for 10 years from 1989 to 1999. He has been an MTA member since 1993. He started in membership and then moved to regions. He helped establish chapters around the US. He has served as Vice President and is the current President. Fred now works for Yelton Fiscal, one of the premier data base and cycles-oriented companies in the world.

Vice President — Jordan Kotick, CMT, is Vice President, Technical Strategist for JPMorgan Chase in New York. Prior to this, he worked for three years at Elliott Wave International as a senior interest analyst and before that, was employed at CIBC World Markets as a technical analyst on the research, strategy and trading desk and a government bond trader. He is the past president of the Canadian Society of Technical Analysts and currently the IFTA liaison for the MTA. Jordan holds an honors BA with a double major in Philosophy and Economics and a MA in Philosophy.

Secretary — David Clemens, CMT joined the MTA in 1999 and is a CMT. He works for Legg Mason in Williamsburg, VA. Dave is currently the Chair of the Seminar Committee.

Treasurer — John J. Kosar, CMT started his career on the trading floor of the Chicago Mercantile Exchange in 1980, where he immediately became interested in technical analysis. He worked on the floor for 15 years, primarily as an analyst and broker for two major investment banks and a primary dealer. He left the floor in the late 1990s to work for Bridge Information Systems as a technical analyst. He stayed at Bridge until they went out of business in 2000. Since then he has been employed as Senior Research Analyst for Bianco Research, LLC in Chicago.

He has been an MTA member since the late 1980s. During that time, along with a few others, he helped establish the Chicago Chapter of the MTA. They started the Chapter by organizing downtown meetings, with well-known speakers from all over the country, at the old Midland Hotel in The Loop. Later, he worked on the Newsletter Committee with Michael Kahn, reinstated and chaired the Internship Committee, and most recently has been MTA Secretary for the past two years.

In accordance with the MTA Constitution (2003), the MTA Nominating Committee has presented the following candidates for directors-at-large for terms of three (3) years. There are two (2) Director-at-large seats to fill.

Director — J. Duke Jones, CMT, is a portfolio manager for Longboat Global Advisors, LLC. Duke manages the Sector Rotation Hedge fund and individual accounts. Duke is a former Vice President-Portfolio Manager of Frost National Bank (Cullen-Frost CFR-NYSE). While at Frost he served as Chair of the investment strategy and performance committee, which consisted of 28 portfolio managers and analysts that oversaw asset allocation and equity selection for over $12 billion in trust and agency assets. Duke researched and developed a proprietary sector and industry classification pyramid and model, which is now used by mutual fund organizations, hedge funds and investment advisors through the INSYNC trading platform. This quantitative model fundamentally and technically ranks industry groups and their constituents used in the asset management process. Duke has been quoted in Barron’s, The Wall Street Journal, Bloomberg and the local press.

Currently he serves as Chair of the MTA annual award committee, which selects those who have made outstanding contributions to the field of technical analysis. He also serves on this year’s MTA seminar committee. Duke is a member of the MTA and a CMT. He is also a member of the Association of Investment Management and Research, AIMR.

Director — Michael Kahn, a graduate of Brandeis University and the holder of an MBA from New York University, has been involved in the investment community for many years. Formerly Chief Technical Analyst at Bridge News, he is now an independent consultant and writer. He is a regular columnist for Barron’s Online. He joined the MTA in 1994, served as the editor of the newsletter, and is currently the Chair of the Marketing Committee.

Résumé Assistance for MTA Members and Affiliates
Take advantage of the Professional Résumé Writing Services at our Financial Career Headquarters. To register for this service (fee applicable) go to www.mta.org/fch

FCH Update
Marie Penza, Administrative Coordinator

The Financial Career Headquarters has been operating very well. I find myself learning along with you. Thank you for your kind comments.

Six jobs have been posted since the site was established and we are working closely with Kristen Corbett of Boxwood to help generate more traffic on our site. She has been sent a list of employers to be contacted.

Peter Goodman, Director of Business Development at Boxwood will be speaking at our annual seminar on Effective Interviewing and Navigating Salary Negotiations Through Annual Reviews.

This new member benefit has generated great interest among our members and eighty-nine resumes have been posted.

To sign up today, go to www.mta.org/fch

To E-Mail or Not to E-Mail
Shelley Lebeck

About 50% of you are receiving the MTA newsletter Technically Speaking via postal mail. While we will not completely give up on postal mail, we would like to increase that number of e-mail deliveries.

If you want to receive the newsletter via email instead of postal mail, please go to your personal home page and make the change [View Personal Record, Update Personal Record] look for:

E-mail/Postal Delivery
Send publications (i.e. newsletter) and other correspondence (i.e. meeting notices) via:

E-mail/Postal Mail and change to e-mail.
Or contact the MTA office — admin@mta.org — and we will change it for you. Thanks

The Alphier Collection
Wylkiri Bosques, Library Production

The MTA Library continues to expand with the addition of an entire new collection donated by the estate of Mr. Jim Alphier. There are over 1,000 books and journals of which, 959 have already been documented, tagged and placed in the Woodbridge library shelves.

As well, every one of these books and journals are now available to members and affiliates through our On-line Library in the members’ and affiliates’ personal home pages. These books are already being requested and loaned out. We look forward to continued growth in both the quantity and quality of the MTA Library.
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