Market Bias Defense: How to Best Weather a Storm

Terry Devries

The winds of change have been blowing in 2004 as stocks fight hard to stay afloat. The key to successful money management is to ensure that the winds do not blow us too far off course. Above all, a successful manager will strive to protect a portfolio before a bear market devastates the hard earned gains.

Most market corrections are just that, corrections. They do not become full-fledged bear markets and as such the manager is wise to remain invested and add to his favorite positions on dips. When markets are weak and stocks are under pressure, a system must be in place that is disciplined and keeps the portfolio balanced in strong sectors, while raising cash in weak sectors. As markets weaken, more and more cash is raised within the portfolio allowing the manager to buy strong holdings as value presents itself.

Relative strength readings are extremely important in portfolio management and can be used to identify strong stocks as well as strong sectors.

I use point and figure charts to determine which sectors are performing the best in strong and weak markets. Systemic risk, or market risk, is identified as the unique risk that all stocks face within the market. It is a non-diversifiable risk, because when markets fall, the good go down with the bad, just not quite as fast.

The key, therefore, is to identify when market risk or intrinsic risk is high, and to stop trying to make money and focus on preserving wealth. Before I go any further, I wish to stop here and give credit where credit is due. I would like to thank Tom Dorsey for his wonderful book, Point and Figure Charting. In addition, I would like to thank everyone at Dorsey Wright and Associates for the invaluable contribution they make to the field of technical analysis, for keeping a lost art, point and figure charting, alive and well, when it risked slipping into history.

The New York Stock Exchange Bullish Percent is my favorite tool in my box for identifying market risk. Tom’s book offers an in-depth discussion of the NYSE Bullish %. There are two teams, as Dorsey puts it, an offensive team whose primary job is to make money and a defensive team, whose primary job is to keep the money. Tom uses The New York Stock Exchange Bullish Percent as his main market coach. In many ways it is a market breadth indicator, superior by far to the Advance-Decline Line, and in other ways it combines market sentiment with the overbought oversold areas of an oscillator. The NYSE Bullish Percent is currently indicating that market risk remains high; our discipline thus requires that we focus on protecting our portfolio.

A.W. Cohen of Chartcraft and Investors Intelligence, developed this indicator over fifty years ago. It is based on the point and figure methodology, developed by Charles Dow. A buy signal is generated from upturns (X’s) below 30%, and a sell signal is generated from downturns (O’s) above 70%. Michael Burke of Chartcraft and Tom Dorsey of DWA have popularized it. It is never quoted on television or in the paper, so don’t be surprised if you have never heard of it. Most people have never heard of point and figure charts either, and they have been around longer than the American bar chart by at least ten years (1886 vs. 1896), according to writings by Charles Dow.

At this time, the New York Stock Exchange Bullish Percent indicates to us that risk is high and that the market as a whole is falling. If we knew that this was the beginning of a bear market, or a continuation of the last, we would simply recommend selling, selling short, or moving the entire portfolio to cash. But we do not know where this market is headed and we must therefore manage accordingly.

Sector relative strength remains our best line of defense and our portfolio changes to reflect changes in the relative strength of the Dow Jones sectors. To calculate relative strength, we take each Dow Jones Sector and perform 90 individual relative strength calculations. For example, energy is divided by healthcare; if it is greater than one, then energy is outperforming healthcare. We then divide energy by the other nine sectors and may find that energy is outperforming every sector. We finally construct point and figure charts for each relative strength calculation. This filters out a lot of noise. If energy is outperforming every other sector, we give energy a value of 9. These calculations are then completed for the other nine Dow Jones sectors and portfolio weightings are then determined.

I use point and figure charts because I find them easier to read than other charts. They are either on a buy signal or they are not. There tends to be less disagreement between analysts. Secondly, point and figure charts, using a 3-box reversal method, cut out, to a large degree, market noise. Sector relative strength readings change more slowly using point and figure charts and signals last longer on the whole, eliminating the need for frequent changes to the portfolio. Once you have the sector relative strength calculations for each sector against the others, you can begin the process of under weighting weak sectors and over weighting strong sectors.

The last line of defense is always the chart; this is an art not a science. Don’t forget to look at the chart before determining your allocation. What you will find is that as the market weakens, cash will begin to build in the portfolio. At some time, the market will turn around and it will be time to put our cash back to work.

At that time, we will continue to put our money to work by over weighting strong sectors and under weighting weak sectors. We try to make as few changes as possible relying on long term relative performance as our guide. What is most important to the money manager is to have a system in place that looks after the downside; the upside will often take care of itself.

Terry Devries writes a weekly market commentary entitled Intramarket Analysis, where he examines the relationships between currencies, commodities, bonds and stocks at Friedberg Mercantile Group, Toronto. He may be reached at tdevries@friedberg.ca

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From the Editor’s Desk

This newsletter is a continuation of the highly successful Annual Seminar conducted in Marco Island last month. We have a summary of John Bollinger’s Keynote Address, which includes some math. John demonstrated that simple mathematical concepts can be applied to increase the credibility of technical analysis in the investment community. We also have a summary from George Schade of his comments dedicating the new Alphier Library.

Martin Pring was recognized at the Annual Seminar as the 2004 Annual Award Winner. The newsletter includes some information on his contributions to technical analysis, an explanation of one of the indicators he developed (KST) and some charts applying KST to the current market.

Sherman and Marian McClellan were recognized with a Lifetime Achievement award, and we are honored to include a description of the indicator they developed (the McClellan Oscillator) written by their son, Tom.

George Schade also contributed a biography of Abe Cohen, developer of the three-point P&F technique. Terry DeVries builds on that by applying one of Cohen’s tools, the New York Stock Exchange Bullish Percent indicator, to today’s market.

We hope you find this newsletter useful and practical. Please send your feedback and contributions to me at any time.

Cordially,
Mike Carr, CMT
Technically Speaking Editor

From the President

Greetings MTA Members and Affiliates:

As I write this letter, the kudos to Dave Clemens and the Marco Island seminar committee continue to come in. Many attendees have said that this was one of the best seminars, both in terms of content, and camaraderie, that has been held in recent years. My hat is off to the guys who organized this, as well as Barbara, Shelley, Tom and the entire MTA staff for their hard work on this event. We have been taking some surveys to determine the sorts of seminars the membership would like to see, and we will have some ideas for you as the year progresses. Stay tuned!

One thing, which made a real impression on me, was Sherman McClellan’s presentation on Technical Analysis in the 1960s and 1970s in Los Angeles, as well as his skillful “re-living” of the crash of 1987. This was interesting not only because of the material, and my own memories, but also because there were many in the audience who had not seen such a presentation, and who had little knowledge of the important work being done in Los Angeles during this time. For instance, Channel 22 had the first live stock tape on TV, and the first major charting TV show (Gene Morgan’s “Charting the Market”) in the US.

The MTA is starting to go through a generation change. New faces are coming to the profession, and some of the older stalwarts are beginning to retire. One challenge the board faces is to preserve the historical knowledge of the people, and the traditions of the organization, while making room for the new ideas and concepts that are coming. One only need look at John Bollinger’s presentation on Statistics and Technical Analysis to see just one of these new directions. We can see, in Richard Russell’s DVD presentation at the IFTA conference, a way to preserve the history, through the flavor of the personalities involved. We will make more DVD’s of this type in the months ahead!

This looks to be a banner year for the association, and the profession. I am privileged to serve as your President during this time. Remember that I am always accessible at fmeissner@mta.org or 404/875-3733.

Best regards,
Fred Meissner, CMT
President
NYSE Discussion Update

Last month in this space, we talked about the changing NASD-NYSE requirements to be called a “financial analyst” and what your MTA is doing about it.

As you may recall, there was a conference call on March 26, 2004, and a letter written to the officials involved at NASD and NYSE on April 6, 2004. In that article, we offered copies of the full letter to anyone requesting it and requested comments. I’m please to say, we got many requests for the full text of the letter and many comments and suggestions. Thank you all for your kind interest and attention to this very important subject.

Since that letter much has happened. Ralph Acampora and David Krell had a personal meeting with the top officials NYSE on May 10, 2004 to outline the case for the MTA.

They were very cordially received, and out of that meeting came a request from the NYSE for more information on the history and development of the CMT.

On June 8, 2004 an all day meeting is being held in Princeton, New Jersey with Linda Montgomery, Ph.D. of the Chauncey division of Educational Testing Service. Attending this meeting, in addition to Mr. Acampora and Mr. Krell, will be Jordan Kotick, (soon to be installed as VP of the MTA), Ken Tower (current Board member), Brad Herndon (of our accreditation committee) Barry Sine, Larry Berman, Shelley Lebeck and me. Mr. Herndon, Mr. Sine and Mr. Berman are all CFA/CMTs.

The purpose of this meeting will be to finalize the MTA strategy and further response to the NYSE. In the meantime, as most of you know the study guide for the new Series 86 and 87 is published on the NASD website. Please be assured that your MTA is on the job working hard for the membership and the future of the CMT.

Thoughts and suggestions of all members and affiliates are appreciated.

Sincerely,

John R. Kirby
Executive Director

Just in Time for Summer - MTA Online Store has New Apparel

T-Shirt
Heather Grey 100% cotton (Large and Extra Large) 100% heavyweight cotton jersey. Embroidered with red MTA logo and grey wording on left sleeve. $23

Ballcap
Brushed twill cap with velcro closure. Black with red logo and grey wording (as modeled by our own Connie Brown) $17

Polo shirt
Heather Grey 100% cotton (Large and Extra Large) 100% cotton extra heavyweight pique knit sport shirt with a welt collar and cuffs and 3 buttons. Embroidered red MTA logo and grey wording on left sleeve $33

Laptop Case
Black (16” L, 12” H or 4” W) Multi-function organizer with PDA, phone and pen holders. Padded computer compartment. Debossed logo on front panel. $46

To order, go to: www.mta.org log on to your home page and click on Electric Books.

All prices include domestic shipping and handling. Overseas products will be sent priority mail or DHL (your choice) - price will be determined with each overseas order.

CQG Workshop

Learn to Trade Supply/Demand Imbalances

Speaker: Bell Curve Trading
Presentation will be followed by Q&A and a cocktail reception

Thursday, July 1
3:00 - 6:00
The Union League Club
65 West Jackson Boulevard, Chicago

Please RSVP by June 25th to Neisha Johnson at 1-800-525-7082
Hurry, seating is limited!
http://www.cqg.com/forum/seminars.cfm

In Memoriam

Elli Gifford
July 1944 - April 2004
Ann Whitby

Elli Gifford, Fellow of the Society of Technical Analysts (UK), passed away on 15 April 2004. Elli first became known at the MTA when she was working for Investment Research (IR) in Cambridge, England in the 1970s and started attending the MTA annual seminars. Her mission was twofold: to hear the ideas being put forward by the speakers, then to persuade those speakers to come to England and speak at IR’s annual conferences, held in September each year. She was very successful in that persuasion, encouraging top class US speakers to cross the Atlantic and help to contribute to the enormous success of those IR conferences.

As an early member of MTA, and one of the few non-Americans in those days, Elli continued to attend the MTA Seminars during her career at Rudolph Wolf and then back at Investment Research of Cambridge. She also introduced other UK analysts to the MTA and its May Seminars.

Apart from this association with the MTA, Elli was regarded as one of the top UK Technical Analysts, particularly in the field of Commodity markets, which were her speciality. Her opinions were widely read in the IR Commodity and Futures publication, and disseminated to the Metals industry during her time at Rudolf Wolf. She continued to write about the metals for a US company, and speak at their conferences, until quite recently.

Elli did not, however, attend conferences merely as a delegate. She was a much sought after speaker, talking about her methods and market views at venues all round the world. Conferences she addressed included the STA and IFTA, amongst many others, usually on her favourite subject of commodities & futures.

In addition, Elli was an active teacher of technical analysis, both in the UK and elsewhere in Europe. Many people have contacted us at the STA to say that she ‘opened the TA door’ for them. There have also been comments about how talking to her, or listening to her views on the markets, helped to increase their interest. Both for her TA skills, and for her views on the markets, helped to increase her standing with the top TA people. She contributed to the enormous success of those IR conferences.

Those who knew Elli will also remember her whole hearted approach to life, her slim tall figure, always elegantly clothed, and her immense sense of fun. Technical analysis, particularly in the UK, has lost one of its stars, and a well-loved one. She will be sadly missed.
Abe Cohen
George A. Schade, Jr., CMT

Abraham W. Cohen, who received the MTA Annual Award in 1986, was a significant contributor to the development of point and figure charting. Prior to entering the investment field, he was a lawyer, a graduate of Harvard Law School. In 1947, he wrote a book on point and figure (P&F) charting entitled Stock Market Timing. The following year, he founded the Chartcraft Weekly Service, and Chartcraft began publishing Cohen’s book. Cohen was the first editor of Chartcraft, and his work is still carried on by Chartcraft/Investor’s Intelligence. (www.chartcraft.com)

In 1968, Cohen authored How to Use the Three-Point Reversal Method of Point and Figure Stock Market Trading, the original and authoritative book on the three-box reversal method of P&F charting. In 1990, Michael Burke, successor editor of Chartcraft, updated Cohen’s book.

Cohen’s landmark contribution to point and figure charting was simple – he created a method that uses the high and low prices, available in daily newspapers, that can be maintained without relying on the continuous charting of all price moves, which is the basis of the traditional one-box reversal method.

Classical P&F charting recorded all one-point changes – including intraday as they occurred. The best evidence is that P&F charts were being kept as early as 1885. But as Garfield Drew wrote (in 1941): “One writer outlined this theory in detail in 1904, and it has merely been repeated rather than improved since.” Cohen improved it.

Cohen used a three-box reversal - the unit used for measuring price changes has to rise or drop at least three squares from the previous spot. Only the high and low prices, which are readily available, are used.

The three-box reversal method was intended for intermediate trend analysis. By simplifying P&F charting, Cohen made the technique accessible to the average investor.

Cohen wrote: “The basic premise of Point and Figure Charting and trading is that the Law of Supply and Demand, and nothing else, governs the price of a stock... The Point and Figure chart is, therefore, a pictorial record of the contest between the forces of Supply and Demand.”

“Each pattern gives us a definite buy or sell signal.” There are 16 price patterns most common to the three-box reversal method – 8 buy signals and 8 sell signals. These patterns have been tested, and the results have been very positive.

Trendlines are very important in P&F charting, and they augment the three-box reversal method. The trendlines are drawn at 45 degree angles and are designated the bullish support line and the bearish resistance line.

Chartcraft’s most trusted indicator is the NYSE Bullish Percent Index. Mike Burke said that if only one market indicator was available, this one would be his choice. For Tom Dorsey, who authored a book on the three-box reversal method of point and figure, this is the “mainstay” of his market indicators, his “long-term coach.”

Cohen created the indicator in 1955, and later Earl Blumenthal (interestingly, another lawyer) redefined its interpretation. Cohen was trying to create a market indicator that was bullish at the bottom and bearish at the top. The NYSE Bullish Percent is a compilation of the percent of NYSE stocks showing P&F buy signals. The calculation is: total number of stocks on P&F buy signals ÷ total number of stocks evaluated.

The indicator is charted on the basis of a 2% move per box, so a three-box reversal would require a 6% move in either direction.

Cohen interpreted the indicator to mean that if the index is rising in a column of X’s and is above the 50% level, the market is bullish. If the index is declining in a column of O’s and is below the 50% level, the market is bearish.

There are several interesting facts associated with the NYSE Bullish Percent Index, according to Tom Dorsey (www.dorseywright.com):

A. A sell signal was given in September 1987.
B. A buy signal was given in November 1987.
C. Signals are infrequent – during the past 25 years on average about 3 per year.
D. Up moves reach overbought levels when the index rises above 70%.
E. Down moves reach oversold levels when the index falls below 30%.

Mike Burke applied the bullish percent concept to industry sectors. Dorsey agrees that the concept has worked very well with industry sectors.

Abe Cohen died in 1984 at the age of 80.

How It Came to Be – The Arrival of the Alphier Library
Dedicated May 15, 2004 at the 28th Annual Market Technicians Association Seminar, Marco Island, FL
George A. Schade, Jr., CMT

The journey that brings us to this dedication began shortly after Jim Alphier passed away in September 1990. Long time MTA members who had known Jim knew that he had spent a professional lifetime collecting and accumulating a significant and eclectic collection of materials covering the breadth of technical analysis. Jim had the highest respect for the classic techniques of those he called the “old masters,” the founders of technical analysis. He loved history. He loved markets. He loved preserving knowledge.

For a variety of reasons, the initial efforts to obtain Jim’s library were not fruitful. The timing was not good. In November 2002, spurred by an online conversation, I sought to rekindle those efforts and locate Jim’s widow. With pieces of information provided by Sam Hale, Ian McAvity, Mike Moody, A. C. Moore and John Bollinger, I found Mrs. Stephanie Ellen Alphier residing in Santa Barbara, California. When I called to ask if she would consider donating her late husband’s library to the MTA, she answered that I should call back in four months. Again the timing was not right.

In March 2003, I called Stephanie to reiterate the interest of the Market Technicians Association Educational Foundation to obtain all or part of Jim’s library. Timing was good. Stephanie agreed to donate the library to the Foundation.

Meantime, I had asked John Bollinger if he would appraise the collection. Paul Desmond had suggested John for this work. We considered John’s high standing within the professional community of market technicians and his knowledge and interest in the subject. Without hesitation, John agreed to appraise Jim’s library. The proximity of Stephanie in Santa Barbara to John’s office in Manhattan Beach was fortunate as we found out.

On April 19, 2003, John and I traveled to Santa Barbara. We found a garage filled to the max. After almost two hours, we were able to open twelve huge metal fireproof cabinets. They seemed immovable. Their contents were intact. We found over 800 books, many being first editions of classic works; series of market letters by leading analysts; reports; pamphlets; correspondence; tapes;
On Saturday evening, May 15th, the MTA proudly honored Martin J. Pring with its annual award for his original contribution to technical analysis. John Bollinger, CFA, CMT presented his friend and colleague with the silver bowl. This award has been presented annually since 1974. The previous recipients are listed in the grey box below.

Martin Pring entered the financial markets in 1969 and has grown to become a leader in the global investment community. In 1981, he founded the International Institute for Economic Research, and began providing research for financial institutions and individual investors around the world. Since 1984, he has published a monthly market review offering a long-term synopsis of the world’s major financial markets. Demanded as a speaker worldwide, he is the author of several outstanding books including, Introduction to Technical Analysis, Martin Pring on Market Momentum and Technical Analysis Explained, now in its fourth edition. Since this unique book first appeared in 1979, Technical Analysis Explained has established itself as the number one guide of its kind. It is used by several international technical societies for training and is one of the three main books for Level 1 CMT certification for the Market Technicians Association. Translated into over 10 languages, the book is, as quoted in Forbes, “widely regarded as the standard work for this generation of chartists.” According to Futures Magazine “it is one of the best books on technical analysis to come out since Edwards & Magee’s classic text in 1948...belongs on the shelf of every serious trader and technical analyst.” It has become the text on which other works in the field have been based. In 2002 McGraw-Hill released six of Martin’s books, Technician’s Guide to Day and Swing Trading, Breaking the Black Box, Introduction on Candlestick Charting, How to Select Stocks and the two-volume set, Momentum Explained.

Described by Barron’s as a “technician’s technician,” Martin’s articles have been featured in Barron’s, and he has been quoted in The Wall Street Journal, International Herald Tribune, The New York Post and Los Angeles Times newspapers and the National Review. He is currently writing a monthly educational column on the basics of technical analysis for Stocks and Commodities Magazine. Over the past 34 years, his research has led to the development of reliable financial and economic indicators for timely and effective forecasting. Martin’s personal Barometers for the Bond, Stock and Commodity markets have identified major turning points since the 1950s on a timely basis and have outperformed the buy/hold approach by a wide margin.

Winners of the MTA Annual Award

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<tr>
<th>Year</th>
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Martin pioneered the introduction of videos as an educational tool for technical analysis in 1987, and was the first to introduce educational, interactive CDs in this field. His latest releases include Technician’s Guide to Day Trading, the Introduction to Technical Analysis, an 8-hr CD-ROM/ book course for the beginning to intermediate technician, and Breaking the Black Box, a no-nonsense guide to creating and testing mechanical trading systems. His latest book is Martin Pring on Price Patterns due in August complete with 1-hour DVD presentation in the back.

For many years, Martin’s primary interest has been educating students of technical analysis in the basic and finer points of this art. He enjoys mentoring students of technical analysis from the college level to professionals already in the field, sharing the wealth of knowledge he has gained through his own experience and research. In this regard, he has spoken on technical analysis to the Darden Business School, Golden Gate University, and University of Richmond, VA.

In 2000 Martin received the CSTA’s Annual A.J. Frost Memorial Award for outstanding contribution to the development of technical analysis.

This article is based upon research done by George A. Schade, Jr., CMT. He can be reached at aljschade@aol.com

Dow Award Process Reopened

Because there wasn’t a winner for the 2004 Charles H. Dow award, the process will be reopened on June 1. Those wishing to submit papers can download revised guidelines from the MTA website after June 1: www.mta.org
If you’re driving a car in a strange city and need to get directions, it’s easy to stop at a gas station and buy a map. Wouldn’t it be great if you could also buy an investment map pinpointing the market’s proximity to major tops and bottoms? Well, you can!

The KST Market Cycle Model, a new analytical approach, can help you just like a map. Developed by Martin J. Pring, author of the widely acclaimed Technical Analysis Explained and editor of the InterMarket Review, the KST Market Cycle Model is used by many technical experts.

Of course, no system is perfect, but the KST approach has been proven dependable to help put the odds in your favor. How does the KST System fit into the bull and bear cycle?

Both the chart and figure show a typical market cycle. The thick line in Figure 1 represents the primary trend, more commonly referred to as “bull” or “bear” markets.

They typically extend over a one- to two-year time frame. Primary trends are not usually straight line affairs, but are interrupted by counter-cyclical price movements known as “intermediate” trends or “secondary” corrections.

This is depicted by the thin, solid line. These last anywhere from three weeks to many months and retrace between one-third to two-thirds of the previous primary movement. Secondary corrections usually develop because of a temporary change in the perceptions of investors towards the economic or financial outlook.

In turn, intermediate trends are interrupted by even smaller ones lasting from a few days to as long as three weeks. These short-term price movements (the dashed line) are usually caused by random reactions which have little or no bearing on the business cycle.

From an investment point of view, the best time to buy is when all three trends are bottoming. Conversely, the most risky point occurs when the news is good and confidence is highest.

The KST Market Cycle Model consists of three oscillators which reflect the primary, intermediate- and short-term time frames, shown in Chart 1. These are no ordinary oscillators, but have been specially constructed to take into account the fact that price trends are influenced by the simultaneous operation of many different time cycles. Moving average crossovers by the KST indicators generate timely signals of short-, intermediate- and long-term trend reversals, but keep whipsaws, or false signals, to a minimum.

The direction of the Long-term KST tells us whether the primary trend is up or down and the degree of its maturity. Maximum profit opportunities occur when the Long-term KST reverses to the upside from below zero.

The most important thing to bear in mind is the direction and maturity of the primary trend. Short- and intermediate signals which are triggered in the same direction as the main trend result in the strongest rallies. Signals which go against the main trend generally give false indications.

The KST Market Cycle Model can be constructed for any financial market influenced by the business cycle and also is a very effective tool for relative strength analysis.

For more information, go to www.primp.com
McClellan Oscillator Calculation

Tom McClellan

The standard McClellan Oscillator is calculated as follows: First calculate the daily breadth, which is the difference between the number of advances and the number of declines:

\[(A-D) = \text{Advances} - \text{Declines}\]

Then calculate two separate exponential moving averages (EMAs), known as the 10% Trend and the 5% Trend (so named because of the smoothing constants used in their calculation).

\[
\begin{align*}
(10\% \text{ Trend})_{\text{TODAY}} &= 0.10 \times (A-D) + 0.90 \times (10\% \text{ Trend})_{\text{YESTERDAY}} \\
(5\% \text{ Trend})_{\text{TODAY}} &= 0.05 \times (A-D) + 0.95 \times (5\% \text{ Trend})_{\text{YESTERDAY}}
\end{align*}
\]

The McClellan Oscillator is calculated as the difference between these two exponential moving averages.

\[
\text{McOsc} = 10\% \text{ Trend} - 5\% \text{ Trend}
\]

Many of the current technical analysis software packages contain pre-built modules for calculating the McClellan Oscillator. It is also very easy to build in any spreadsheet program. A copy of one such spreadsheet file in Excel format is available at http://www.mcoscillator.com/user/OSC-DATA.xls

Ratio-Adjusted Oscillator Calculation

The number of stocks traded on the NYSE is constantly changing, and this can affect the amplitudes of indicators that are tied to the number of issues traded, such as the McClellan Oscillator.

To factor out the effect that a changing number of issues has on values of the McClellan Oscillator, we divide the daily breadth number \((A-D)\) by the total of advances plus declines \((A+D)\) to come up with a ratio instead of a raw number. We ignore the number of unchanged issues. We then go to the extra step of multiplying this ratio by 1000 to get it back up out of the realm of tiny decimals and into the range of “normal” numbers. In effect, this mathematical step pretends that there are always exactly 1000 stocks traded on the exchange. In a formula, it looks like this:

\[
\text{Ratio-Adjusted A-D} = \frac{(A-D)}{(A+D)} \times 1000
\]

Once this number is obtained, the rest of the calculations for the EMAs and the Ratio-Adjusted McClellan Oscillator proceed in the same way as for the standard version.

Summation Index

When Sherman and Marian McClellan were first working with the McClellan Oscillator, it occurred to Marian that the “area under the curve” was an additional important feature of this indicator. This stemmed from Marian’s background as a mathematician, familiar with the techniques of differential calculus.

To calculate the undulating amount of this area, they added each day’s value of the Oscillator to a running total of all previous Oscillator values and in the process they created the Summation Index. This indicator changes each day by the value of the Oscillator, and protracted conditions of either a positive or negative Oscillator result in an extended value for the Summation Index. The first chart below shows the Oscillator and Summation Index together and compared to the Dow Jones Industrial Average. When the DJIA is trending upward, we typically see positive Oscillator values and so therefore a rising Summation Index. When the Summation Index reaches a high value, it is normal for it to fall back downward as the market consolidates, the better to set up the market for the next leg of the move.

During their early work with the Summation Index, Sherman and Marian McClellan noticed that this indicator had a total amplitude of about 2000 points. Since all calculations were done manually at the time, and since some users had difficulty with adding and subtracting negative numbers, the McClellans artificially adjusted the values of the Summation Index upward by 1000 points so that its neutral level would be at +1,000. This way, it would oscillate between 0 and +2,000 under normal conditions, and any rare negative readings would be a sign that a truly unique and extreme condition in the market was being exhibited. The +1,000 neutral level for the normal McClellan Summation Index remains the standard to this day.

What was not contemplated in 1970 was the large increase in the number of issues traded on the NYSE, and this increase has led to an increase in the amplitudes of both the Oscillator and the Summation Index. To deal with this issue, one must make an adjustment to the values of the Summation Index. This can either be done mentally, with a subjective factoring of changes in chart amplitudes, or computationally by using Ratio Adjusted values for the Oscillator and Summation Index (see above).

The Ratio-Adjusted Summation Index (RASI) is still calculated as a running total of all previous Oscillator values, but in the case of the RASI we are calculating a total of Ratio-Adjusted Oscillator values. Rather than the artificial neutral level of +1000 introduced for the conventional Oscillator in 1970, we employ the more standard value of zero as the neutral value.

One of the great benefits of the RASI is that it gives us intermediate term (several months) overbought and oversold values. It also tells us when to expect further strength in the major averages, and when to expect weakness. If the RASI is able to move from an oversold reading to above +500, it promises us higher highs. The market may undergo a routine correction, but higher highs should ensue once the correction is done. When the RASI fails to get above +500, as shown in the circled instances in the chart above, it says that further weakness should be expected on the ensuing downtrend.

This article has been excerpted from booklet prepared by Tom McClellan, who is the editor of The McClellan Market Report and the son of Sherman and Marian McClellan to honor his parents upon their selection to receive the 2004 MTA Lifetime Achievement Award. To review the booklet in its entirety, or for more information, visit www.mcoscillator.com
Favorite TA Websites

A few months ago John Greeley came up with the idea of asking MTA members/affiliates and IFTA colleagues to send in three of their favorite websites — regardless of price — and he would categorize and present them in a workshop at the MTA seminar in Marco Island. John promised that we would publish the listing in the newsletter and all the links would be available on the MTA website at http://www.mta.org/talinks/

The following is the listing that John put together and presented in his workshop. The numbers in red indicate how many people submitted the same site. A special thank you to John Greeley for all his hard work. Enjoy!

TRADING

NEWS

MARKET ECONOMIC COMMENTARY

TECHNICAL (SPECIAL)

CHARTS

CHARTS (SPECIAL)

MEDIA

MARKET LETTERS

EXCHANGE - GOVERNMENT DATA

FUTURES

TECHNICAL SERVICES

TECHNICAL/FUNDAMENTAL

SCREENER

COMMODITIES

BROKERS - MUTUAL FUNDS
www.agedwards.com  www.Fidelity.com

FOREX

FOREIGN

OPTIONS

SPECIALTY

OTHER
**NY Chapter Monthly Meeting Review**

**A Systematic Approach To Trading Decisions**

Don Wilcox, principal of Helia Asset Management, LLC, spoke at the New York monthly educational meeting on March 8, 2004. He presented an overview of system development theory. Wilcox follows a simple five-step process:

1. Come up with a trading theory. Do this by observing a price/indicator relationship. The objective is to state the theory as simply as possible. He opined that if Einstein could capture the essence of quantum physics with $E=mc^2$, you should be able to succinctly express a trading theory.

2. Translate the theory into trade entry and trade exit criteria. When developing exits, identify a method to take profits and a way to control the risk of the trade.

3. Convert the trading rules into computer code.

4. Ensure you have adequately addressed risk control. Stop losses are an essential component of any trading system.

5. Apply the code to backtest and evaluate the trading rules. If the system performance is significantly less than expectations, assume that something went wrong and carefully check the theory, the rules and the code. But, if system performance greatly exceeds expectations, you should also assume that something went wrong and check all aspects of the system.

When evaluating system performance, Wilcox looks at the maximum drawdown, maximum number of losers in a row and the largest loss. It is important to know these statistics to ensure that you can stick with the system during the bad times. He also calculates that average winning trade, average losing trade and ensures that the largest winning trade does not account for a disproportionate share of the profits.

In his trading, Wilcox uses a research tool based on Dow Theory, but adapted for commodity markets, such as gold and currencies. His models attempt to identify emerging trending trades in various time frames (5 minute, 60 minute, 4 hour and daily). Although his models are proprietary, several general principles can be derived from them:

- Periods of strong agreement across time frames are the precursor of a strong signal.
- Taken on its own, the 5-minute model is an excellent timeframe for active traders.
- The hourly model seeks “swing” trades that can have a holding period of 1-3 days.
- Daily signals are trend following in nature, and these signal are intended to identify trades that can last up to a month. These longer-term signals occur infrequently, an average of 17 times a year for each currency pair.
- Multiple signals can be used to set up trades with smaller profit objectives since the expectation of being right is higher.
- All trades should be set up with profit objectives three times the amount to be risked.

Donald C. Wilcox is a 17-year Wall Street veteran. Mr. Wilcox has extensive experience in foreign currency trading. He was first exposed to the FX market during an internship at Paine Webber; this led to other positions in the firm’s FX area. Mr. Wilcox established corporate currency trading at Oppenheimer and Company in 1991. His next assignment was at the New York branch of the Bank of Yokohama, where he was the senior proprietary foreign currency dealer. In 1999 Mr. Wilcox helped found MatchbookFX - the world’s first Internet-based foreign currency matching engine. He is the Principal of Helia Asset Management www.heliaassetmgmt.com/index.html

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**Denver Chapter Monthly Meeting Review**

**Rigorous Technical Analysis**

More than 100 Denver-area technicians packed into the regal University Club on May 11th to hear John Bollinger address the newly reorganized Rocky Mountain Chapter. John didn’t disappoint the largest audience to attend such an event as he offered a preview of what would be his Keynote speech to the annual seminar in Marco Island a few nights later.

Like most technicians, Bollinger has grown tired of the Art vs. Science debate surrounding technical analysis. However, he sees this debate as an opportunity to better define what we do, rather than as a rift within the community. The simple answer is that our discipline combines some art with some science.

He feels that all analysis techniques can be found somewhere along the curve between art and science, and he reminded the audience that success can be found at any point along that curve. In his opinion, very few technicians are relying on 100% art or 100% science to achieve the goal of profitable analysis of the markets.

Technical analysis is, and always will be, part art because markets are resistant to a completely rigorous approach. Market dynamics change, and as this never-ending process occurs, system performance must also change. Since market dynamics are dependent upon investor psychology, market-place technological changes, and the regulatory environment, among other things, models should eventually break down and system performance is likely to change over time.

Bollinger subtitled his talk “How relatively simple statistical procedures can help us improve our credibility and improve our image.” Specifically, he had two tools in mind to stimulate thinking that evening.

In December 2003, he published a study using volatility to forecast prices. Volatility, measured with VXO, was assigned to deciles based upon the relationship of the current value to the six-month range of VXO. The deciles were then compared to price changes, also assigned to deciles, one, three and six months in the future. The findings were then analyzed with the Spearman Rank Correlation Coefficient. The Spearman Rank Correlation Coefficient is used to discover the strength of a link between two sets of data, expressed as a value from 0 to 1. When written in mathematical notation the Spearman Rank formula looks like this:

$$ (R^2) = 1 - \frac{6 \sum d^2}{n^3 - n} $$

In the volatility study, Bollinger found a strong link between the current volatility and future prices:

**The conclusion of this work, supported by statistical testing, is that higher volatility, relative to the six-month range, leads to higher returns over the next six months.**

The second tool that Bollinger demonstrated was Chi-Squared, a concept familiar to most technicians. Using Arthur Merrill’s “Day of the Week” study, Bollinger explained that Merrill found statistical significance in the conclusion that Mondays were the weakest day of the week and Fridays the strongest. Merrill used data for the Dow Jones Industrial Average from 1952 through 1983 in his study. Bollinger updated the study, using Dow data from June 1998 through April 2004. The updated results showed no tradable tendencies with statistical significance for any day of the week.

In conclusion, Bollinger noted that applying these two relatively easy to use tools would greatly benefit traders. Learning that a high degree of statistical significance is associated with a system will give the trader the confidence to stick with that system during the inevitable drawdowns. It will also improve the credibility of technical analysis to the investment community at large.

For information about regional MTA events in the Denver area, contact Clare White at cwhite@invelocity.com
The Market Technicians Association introduced a new member benefit earlier this year in February... the MTA Insurance Program (MIP). John Kirby, Executive Director pushed to get the program going and worked together with Mike Crifasi, CFP®, Program Manager to implement it. According to John, “Working with the Crifasi organization has been a pleasure. They have terrific experience with non-profits such as ourselves, and they did not hesitate to tailor the program to our needs.” The program offers group insurance products specially priced for MTA members and offers discounts on most individual insurance products as well. Interest in the program is high and Mike Crifasi, CFP®, Program Manager, and his organization; have helped many members to find quality insurance at excellent rates.

The MTA itself was one of the program’s first clients. John Kirby purchased a group health insurance policy for MTA employees. John Kirby says of this experience, “Their service was quick and professional. Thanks, Mike.”

The hottest topic with MTA members is health insurance. If you are in the market for health insurance, you should be aware of Health Savings Accounts (HSAs). HSAs are the newest type of health plan, and are a tremendous advance in the concept of personal health insurance for everyone. With an HAS, for the first time, all taxpayers can have them available. There will be even more new that many insurance companies don’t yet have them available. There will be even more reason to pay attention to HSAs if legislation, which is supported by President Bush, is passed this summer. That bill would allow purchasers of these plans to deduct 100% of their premiums from federal income taxation.

MTA Calendar of Events

June 10
Technically Speaking submissions due to market.strategist@wyowbi.com

June 14: New York Chapter Meeting
John J. Murphy, Stockcharts.com Contact: Cassandra Townes, admin@mta.org

June 16: Chicago Chapter Meeting
Speaker Presentation: Eddie Toppel “Why trading is the Hardest Way to make money?” Contact: Ross Leinweber, rleinweber@lakeshoretrading.com

June 24: Atlanta Chapter Meeting
Eric Davidson, Pristine Capital, discussing market indicators and trading setups. Contact: Tim Snavely, tim_snavely@rhco.com

November 4-6: IFTA Annual Conference
Are You Ready for the Next Bull Market? Intercontinental Castellana Hotel, Madrid, Spain. For complete details, log on to the IFTA website: http://ifta.org/events/next.html or the AEAT http://www.aeatonline.com/events.html

For the latest information on chapter meeting times and locations, log into http://www.mta.org/membership/meetings/

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 by the 10th of each month to editor@mta.org

An Exciting Addition to the Financial Career Headquarters

Now MTA members and their families can enjoy an added benefit from the Financial Career Headquarters service. Discounted test prep services are now available in the Career Development program.

From now until June 30th, MTA members, affiliates and their families can receive a $50 discount off the Princeton Review Test Prep Course through our FCH Program to help them succeed professionally from graduation to retirement.

Our Career Development Program enables any member, affiliate or their family members to effectively prepare for standardized admissions test such as the SAT, ACT, LSAT, MCAT, GRE and GMATS.

You can find out more on our Financial Career Headquarters on our website, www.mta.org

FCH Update
Marie Penza, Administrative Coordinator

We now have had seven jobs posted. The employment agency Management Recruiters International is becoming an account and will be posting numerous jobs.

Please visit the site at www.mta.org/fch for the new listings and to post your resume.

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

Take Advantage of the New MTA Insurance Program

The hottest topic with MTA members is health insurance. If you are in the market for health insurance, you should be aware of Health Savings Accounts (HSAs). HSAs are the newest type of health plan, and are a tremendous advance in the concept of personal health insurance for everyone. With an HAS, for the first time, all taxpayers can have them available. There will be even more new that many insurance companies don’t yet have them available. There will be even more reason to pay attention to HSAs if legislation, which is supported by President Bush, is passed this summer. That bill would allow purchasers of these plans to deduct 100% of their premiums from federal income taxation.

HSAs are available for anyone who has an approved high deductible health plan (HDHP) as their only health care plan. (Individuals must have an annual deductible of at least $1,000 with an out of pocket maximum up to $5,000; and, families must have an annual deductible at least $2,000 with an out of pocket maximum up to $10,000). In 2004, up to $2,600 of eligible cash deposited into a HSA is deductible for individuals and up to $5,150 for families. In 2004, individuals over the age of 55 can contribute an additional $500, increasing by $100/year until it reaches $1,000 in 2009. The funds in the HSA can be used to pay for deductible health care expenses with tax-free dollars. The Medical Savings Plan (MSA) was replaced by the HSA in 2004 and may be converted to an HSA.

Whether you need health insurance for yourself, your family, your small business, or your large business, Mike Crifasi’s organization can find a plan that will work well for your situation.

It’s obvious from the member inquiries into the various products available, that MTA members need the full array of insurance products being offered through this program:

- Health Care Insurance
- Short-Term Disability
- Long-Term Disability
- Long-Term Care
- Life
- Fidelity & Surety Bonds
- Professional Liability
- Media/Publication Liability
- Property/Casualty
- Directors’ & Officers’

In the coming month or so, you can expect to receive a special offer for group Long-Term Disability. This offer will provide a significant price advantage over other similar products. In the meantime, if you would like more information on any of the products offered, please take advantage of the MTA Insurance Program by visiting the MIP Web site.
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