MTA Annual Award

Ian Notley

Ian Notley, President of Yelton Fiscal Inc., was the winner of the 2006 MTA Annual Award, recognizing his lifetime contributions to the field of technical analysis. Yelton Fiscal was founded by Ian in 1987 and covers more than 80 global markets including equities, bonds, rates, commodities, currencies, business and credit cycle, etc. The service is designed specifically for the institutional fund manager seeking the use of a global database with a longer term outlook. The company has offices in the United States, Canada, Great Britain, Switzerland and Hong Kong.

Well known for conducting walkabouts at technical analysis seminars around the world, Ian is recognized as an expert in long-term cycles. Ian has conducted studies for over 38 years into price fluctuating phenomena. His specialty is long-term studies of secular and cyclical movements and their impact on money management style and in particular investment timelines. He has investigated most investment techniques that are present in the public domain.

His complete information system offers on-line access to a global database covering 81 different countries and 85 capital markets including equities, market indices with sector and group indices, business cycles and economic data, rates, bonds, commodities, currencies and North American real estate. The price data is supported by exceptionally long term price histories dating back 100+ years on a daily, weekly, monthly, quarterly or annual basis. Screening processes are employed to determine cyclic junctures (entry and exit points) and point-of-cycle development for all series on an absolute and/or relative basis by group, industry or country. The database contains approximately 80,000+ series with up to 2500 time points each for the daily, weekly, monthly, quarterly and annual entries.

During his productive career, Ian has worked in Toronto, Sydney, London and New York. He has fulfilled the role of Analyst, Academic Researcher, Portfolio Manager, Investment Advisor, Commodity Analyst, Market Technician and Strategist. During his earlier career, he was employed by a commodity broker, computer information service, money management group and a Canadian investment dealer and broker, with whom he spent most of his career. His academic disciplines are education and economics.

Ian’s analysis maintains a level of simplicity, in his eyes, by the use of relatively few analytical tools. All techniques focus on cyclic and linear price trends and their respective trend junctures.

• Cyclic Rotation is monitored and analyzed for individual series, groups, sectors and markets as well as for the longer term sequential relationships existing between interest rates, bonds, equity markets, currencies, commodities and the business cycle. His approach is basically a top-down approach with allowance for a bottom-up style in the case of more rotational markets.

• Trend and Cyclic commonality and variation are recorded for the cyclic waves of the dominant long term trend representing the 4 to 4½ year cycle, the intermediate, less dominant trends and the minor, more random short term trend waves. These three well-defined cyclic movements fit into each other and act together to form the cyclic model. Very long term secular trend movements are tracked, analyzed and defined by character, type, maturity and timing juncture.

• Portfolio asset mix on a country, industry, category or individual basis is provided.

Professional accomplishments include the following:

• 1985-1991 Vice President and founding director of the Canadian Society of Technical Analysts (CSTA)
• 1986-2000 Founding director of the International Federation of Technical Analysts (IFTA). Chairman of the Membership Committee and Chairman of Data Committee for IFTA.

• 1993 Awarded Life Membership to the British Society (STA) for outstanding research into security price movements.
• 1997 The MTA (Market Technicians Association of U.S.A.) awarded him with the Best of Best Award for Cycle Wave Analysis.
• 2002 He received the Frost Award from the Canadian Society of Technical Analysts (CSTA) for Outstanding Contribution and the Development to Technical Analysis.

Keith Applegate presenting the 2006 MTA Annual Award to Ian Notley

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From the Editor’s Desk

This issue focuses on the MTA Education Seminar. Attendees spent two days listening to the latest ideas on trading and learning the fundamentals of technical analysis. Some presentations are summarized in this issue; a few more will appear next month. We also hear about a recent LA chapter meeting, and we look forward to hearing about other meetings throughout the country.

The success of the Seminar demonstrates the importance of volunteers to our organization. Look over the list of committees and regions on the back page of this newsletter, and consider what you can do to help. When you have some time this month, contact a committee chairperson or a regional point of contact and talk about what you can do. The leadership of tomorrow’s MTA is working in these groups today, and you’ll be glad you became involved.

We’re also looking for someone to take on the task of newsletter editor. We’ve returned this to a volunteer position, in the spirit of every other MTA function. The editor is just another committee chairperson, soliciting help from volunteers and helping deliver incredible value for the small investment we make in our membership.

Sincerely,

Mike Carr, CMT

MTA Election Results

At the MTA Annual Meeting, held on May 21, 2006 at the MTA offices in Woodbridge, NJ, the membership voted “For” the proposed slate of officers and directors proposed by the Nominating Committee. Effective July 1, the new officers will begin their elected terms:

President: Philip J. Roth, CMT
Vice President: Larry M. Berman, CTA, CFA, CMT
Treasurer: Julia E. Bussie, CMT
Secretary: J. Timothy Snavel, CMT
Director at Large: Bruce M. Kamich, CMT
Director at Large: Sherman McClellan

Officers will serve two-year terms, and directors are elected to three-year terms.
From the President’s Desk

On behalf of all the officers and directors, I want to thank all those who voted (a little more than one third of our membership participated in the election) and supported the Nominating Committee’s slate. We have been working hard already to maintain the continuity in all the MTA’s activities. Here are some brief comments on what we have been doing so far.

The seminar in New York was a fine success. I spoke to many attendees who said they liked the program of speakers and topics, and the venue. Barry Sine was responsible for putting it together before he stepped down from the Board, leaving us with a fairly easy time of carrying it off.

The CMT tests have been given and graded. While candidates seemed to have a harder time than usual with CMT 1, the success rate for CMT 2 was one of the highest. As I write this, the final results for CMT 3 are not in, but when they are we will find that more than half our members will have their CMT certifications.

The Search Committee for a new Executive Director has conducted the first round of interviews with a half dozen strong candidates. The second round is coming up. The committee has been quite encouraged by the number of people interested in working for the Market Technicians Association and the experience and quality of those people. We hope to have a new Executive Director on board sometime in the summer.

As you know, we are planning to move the offices of the MTA back into New York City. The process has turned out more difficult than we thought it would be. But it will happen. I will be turning that job over to the new ED.

We have our winter getaway meeting in Miami coming up. To ensure its success, I encourage members to send any thoughts they have for topics to the MTA office. When we have a good idea what members want to talk about, it will facilitate getting the appropriate moderators.

Those are the highlights of our recent work. Of course, I am omitting a host of important issues on educational matters, including the work of the MTA Educational Foundation, and our monthly meetings, here in New York, and around the country. I encourage you to contact me with suggestions and comments. The Board needs to know what you think about how we are doing and how we can do better.

Sincerely,
Phil Roth, CMT
President

Commodities and the Fed Funds Rate

By Blethyn Hulton, CMT

Amidst the comments, actions, and retractions of the Bernanke Fed over the past month, market participants face greater uncertainty over the direction of interest rates than at any time since the start of the tightening cycle in 2004.

To reduce the uncertainty, this article argues for the use of commodity-prices as a meaningful indicator of Fed policy. Granted, commodity prices may not be appropriate for the FOMC, whose decisions take several months to fully impact the economy. However, traders and investors have the luxury of being able to effect their decisions more quickly than the central bank; and so trends in commodity prices are practically as well as theoretically useful.

First, whether or not the FOMC raises the Funds rate in June, I argue that it is the start of an “easing cycle,” not the end of a “tightening cycle” that produces the beneficial effects of a relaxed Fed policy. Either pausing or ending the tightening cycle leaves the anchor Fed Funds rate in place, and the economic impact of any real rate-level is not likely to lessen over time. Over the past two decades, the Fed Committee, in its eight meetings per year, has at times left rates unchanged for months. If the Fed is going to wait for more economic data to guide policy, it is reasonable to expect that the Fed Funds rate could stay at 5%-plus to the end of the year, with all other, longer-term rates spreading up as much as two percentage points from there.

The argument favoring the use of commodity prices to indicate the start of an easing-cycle is one of intermarket analysis - the sequential, laggard impact of the U.S. Dollar on commodities, commodities on bonds, and bonds on stocks. The indirect link between commodity prices and the Fed Funds rate runs through 3-month T-Bill rate. A Fed paper (see link below) suggests that the Fed-controlled Funds rate is the “tail” wagged by the market-controlled “dog” of the 3-month Treasury-bill rate. Specifically, the paper found that from 1974 to 1999 the Fed Funds rate reacted more quickly than the T-Bill rate when the two deviated from their average 65-basis-point premium of Funds over T-Bill. The paper offered the explanation that the T-Bill rate consistently and accurately prices in the future Fed Funds rate and so does not need to be adjusted so quickly. I would like to add that the Federal Reserve may use the Fed Funds rate to temporarily serve priorities other than its premium to the T-Bill rate, bringing the two rates briefly out of line.

Putting aside the rationale, the link between Fed Funds and T-bills is important because of the link between T-bills and commodity prices, which intermarket analysts such as Murphy and Pring have demonstrated. The logic behind this link is that in the short-term Treasury market, where default- and reinvestment-risks are zero, money is a commodity; and so money competes for speculative capital alongside oil, copper, gold, etc.

In conclusion, barring a reversal in commodity-price trends, the bullish development of a Fed Funds easing-cycle looks to be delayed for several months. Until that time, I expect Fed policy to remain bearishly “uncertain;” and until the return of greater certainty in Fed policy, I think commodity prices will be the most useful gauge of all interest rates, including those set by Bernanke’s FOMC.


Blethyn Hulton, CMT has been a member of the MTA since 1995 and can be reached at blethyn@cloud9.net.

NYSE Offers New Data Service

Prior to touring the New York Stock Exchange, MTA Seminar attendees learned about a new data service being offered by the Exchange. NYSE InfoTools™ offers more granular information about NYSE trading with minimum latency. There are currently four different products available:

1. Real-Time Datafeed - ReTrac SM is a real-time datafeed that allows investors to identify retail trading behaviors by monitoring the retail share volume as it is executed. Immediately upon execution, the Symbol, Volume, and Time of each retail execution will be disseminated as a realtime message.

2. End-of-Day File - ReTrac EOD SM At approximately 8:00PM each day, a file will be made available that contains a summary of the ReTrac activity during the day for each stock and identifies the volume of retail buy and sell shares executed on the NYSE. The file will be made available to recipients of the ReTrac datafeed (at no additional charge) or as a stand-alone product. Shares will be totaled for each symbol in separate buy and sell quantities.

Program Trading Activity

3. Real-Time Datafeed - ProTrac SM is a real-time datafeed that provides investors the ability to identify program trading executions at the NYSE by monitoring the program share volume for each stock as it is executed. Upon execution, the Symbol, Volume, and Time of Execution will be disseminated as a real-time message.

continued on page 7
Fred Schutzman, CMT, “Mechanical Trading Strategies”  
Summarized by Mike Carr, CMT

Fred has a relatively simple approach to the markets; he believes that objective, disciplined trading and a strict risk management policy are the keys to success. His firm has more than $80 million under management, and he employs mechanical systems to achieve steady returns with low drawdowns. Fred has followed the same general techniques for more than fifteen years, and finds the best way to improve performance is to refine his exit techniques and strictly adhere to his money management disciplines.

Traders don’t have to enter a market, but once they do, they must make an exit decision at some point. To Fred, exits are more difficult and more important than entries. He likes to use the same technique across many markets, demonstrating in his mind that the exit is based upon a good concept. Initially, he employs a money management stop, risking something such as 0.2% of account capital on each trade. This allows him to determine whether or not to take a trade, and if he does, it allows him to determine the number of contracts to trade.

Research is a crucial component of his trading enterprise. He begins this process by thoroughly testing a trading idea across multiple markets, time frames and parameters to determine its validity. In his current model, he trades three systems across twenty different futures markets. Risk controls protect investor’s capital through analysis and rules-based decision-making. These measures include stop losses for each trade based on a percent of capital and Fred applies the principles of technical analysis to his equity curve.

Mechanical systems represent an objective approach to the markets, in Fred’s opinion. He identified three major benefits of a mechanical approach:
1. The ability to backtest ideas before trading them.
2. Human emotion is minimized.
3. More markets can be covered, especially with a computer.

Fred tests any idea that can be coded into TradeStation, and in his experience 95-98% of these ideas lose money. Even profitable ideas usually lose money when commissions and slippage are added. All testing involves a five-step approach:

A. Start with a concept. This can be done by looking at charts to identify what precedes major moves, reading about technical strategies to see what others have done, or in any other manner traders can derive information from the markets. Fred noted that most of the successful trading strategies are trend-following. Along this line are moving average systems, Donchian’s weekly rule and volatility breakout systems. Price patterns (visual or statistical) and divergences also represent useful starting concepts.

B. Transform the concept into a trading strategy by expressing the idea as objective rules. While Fred uses TradeStation, there are many other software packages available that allow traders to accomplish this.

C. Visually check the trading signals on a price chart. This step ensures that the coded rules are doing what you intend them to do.

D. Backtest the rules. This is one of the biggest advantages mechanical systems offer. Backtesting should be thorough, covering several markets, different time periods including both bull and bear markets and should include trending and non-trending markets.

E. Evaluate the results. Fred analyzes the equity curve, looking for steady gains with manageable drawdowns. He also evaluates the strategy on a trade-by-trade basis, looking at each signal to see that losses and gains are properly handled. Key statistics he looks at are profit factor, average trade, return on account and the maximum intraday drawdown (differentiating between starting trade drawdown and drawdown from the equity peak).

Finally, diversification across markets, systems, and timeframes helps Fred to achieve steady gains with limited drawdowns. It seems logical that trend-following systems will underperform when countertrend systems are performing well. Pattern recognition systems may be traded infrequently, but offer additional upside when losses are strictly managed. In combination, the result is a smooth equity curve.

Fred Schutzman heads Briarwood Capital Management’s research and development team. He is also responsible for all programming of their proprietary trading systems. Fred has developed his research and programming expertise over 19 years of experience. He has designed over 100 proprietary profitable mechanical trading systems since 1988 and has actively refined these models with real-time experience since 1996. The Briarwood Capital Management Diversified Trading Program is a synthesis of Fred and Paul DeMarco’s most innovative and profitable trading ideas.

Fred has been a member of the Market Technicians Association since 1985. He is a former Omega Research™ Solution Provider and an EasyLanguage™ Consultant. Fred is a contributing author to well known technical analyst John J. Murphy’s book Technical Analysis of the Financial Markets as well as a world lecturer on the subject of technical analysis of the commodities markets. He graduated Valedictorian and Summa Cum Laude from The College of Insurance (now The School of Risk Management at St. John’s University) in 1986.

V. John Palicka, CFA, CMT, “Fusion Analysis in Small-Cap Investing”  
Summarized by Mike Carr, CMT

Technical analysis has played an important role in small-cap investing for John since 1980. However, he has found that above average performance requires more than technicals. He combines fundamental analysis and behavioral finance with technicals to form a quantitative model which has been the backbone of his success.

In his opinion, an increasing number of portfolio managers have realized that fundamental analysis alone does not deliver the best investment returns. Distrust of corporate accounting and other fundamental issues has led more investors to explore the opportunities available in technical analysis. At the same time, increasing academic evidence supports the use of technical analysis, and
V. John Palicka, CFA, CMT, “Fusion Analysis in Small-Cap Investing”
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A recent Nobel Prize in Economics recognized the contributions to the field of behavioral finance. John has observed that these events have driven portfolio managers to increasingly consider the benefits of technical analysis along with behavioral finance as these two fields intersect each other due to their interrelationship. He noted that this popular trend is being called “fusion analysis” by market participants.

To illustrate fusion analysis, John explored the technical, fundamental and behavioral aspects of a selling climax. He expects this pattern to be common over the next decade as investors and traders continue to “shoot first and ask questions later.”

From a technical perspective, a selling climax is well defined by John Murphy, CMT, in his 1999 book, Technical Analysis of the Financial Markets. Murphy says that a selling climax is a significant reversal occurring at a chart bottom. It is “…usually a dramatic turnaround at the bottom of a down move where all the discouraged longs have finally been forced out of the market on heavy volume.” Murphy continues, “The subsequent absence of selling pressures creates a vacuum over the market, which prices quickly rally to fill.” And, Murphy notes, “…while it may not mark the final bottom of a falling market, it usually signals that a significant low has been seen.”

Fundamentally, a selling climax may reflect earnings outlook disappointments based on a corporate announcement. Analysts and investors are then forced to scale down their optimistic price projections based upon Price/Earning Growth (PEG) and Discounted Dividend Models (DDM). Selling ensues, and at the new, lower price levels, the stock should show more attractive valuations evidenced by relatively lower price/book value and a smaller market cap size. Lower valuations are supportive of outperformance, as demonstrated in the work of Eugene Fama and Kenneth French (“The Cross Section of Expected Stock Returns,” Journal of Finance 47 (June 1992), pp 427-465).

Another leading expert, James Montier, has commented in Behavioral Finance (Wiley, 2002), that “…if a stock price drops, then in theory if the analyst were correct in their initial price target, it should become even more attractive to buy. However, in practice, analysts actually reduce their target prices in response to a drop in the current market price.”

Another behavioral consideration that John Palicka noted is representativeness. This is defined as a tendency to evaluate how likely something is with reference to how closely it resembles something rather than using probabilities. As an example, John noted that some investors looked at the initial accounting scandals at Tyco as similar to those of Enron, even though subsequent events showed that they were vastly different.

To put it all together, John explained that a simple quantitative screen can be used to identify trading opportunities from selling climaxes. He begins by looking for stocks making a large percentage down move on very heavy volume. This criterion employs technical analysis. Using fundamental databases, he then screens for optimal valuation levels. He is looking for stocks that are in the lower half of the market for market capitalization and price/book ratios. Behavioral opportunities are identified by insider activity. Looking at large holders in SEC filings or at Yahoo! Finance, John likes to find stocks heavily owned by large, action-oriented mutual funds and portfolio managers. These investors will likely sell immediately, creating a support level under the stock since other managers, such as index funds, will not be selling at the lower price.

To implement the strategy, a trader can simply buy the stock. Alternatively, more complex strategies can be employed. A level of price protection can be obtained by buying the stock while buying a put option. John also demonstrated that traders can execute a “spread” trade on an intermarket basis. For example, if the a housing stock sold off because of a sharp rise in interest rates, traders can evaluate which area (bonds, the stock, or an ETF) overdid the sell-off, and try to position a spread trade. Using this strategy, the trader may try to buy the cheaper security, say the housing stock, from the proceeds of a short on the more expensive asset, which could be TLT (an ETF on 20-year government bonds). Profits are generated as the spread narrows.

John Palicka, CFA, CMT, has over 25 years of experience in researching and managing money in global, emerging, and US small-cap stocks. He is currently in his 16th year as President and Chief Portfolio Manager at Global Emerging Growth Capital, where he is responsible for a global small cap fund that has been ranked consistently in the upper quartile by consultants and reporting agencies such as Russell, Nelson, PSN and MMR. John has an MBA from Columbia University.

Summarized by Mike Carr, CMT

William O’Neil’s CANSLIM stock selection methodology is very well known and widely followed by readers of Investor’s Business Daily. Bob has employed this strategy since the early 1970’s and provided Seminar attendees with unique insights into using this technique.

Bob began his presentation with a short summary of CANSLIM:

C = Current earnings per share should be up 25% or more and in many cases accelerating in recent quarters. Quarterly sales should also be up 25% or more or accelerating over prior quarters.

A = Annual earnings should be up 25% or more in each of the last three years. Annual return on equity should be 17% or more.

N = A company should have a new product or service that’s fueling earnings growth. The stock should be emerging from a proper chart pattern and about to make a new high in price.

S = Supply and demand. Shares outstanding can be large or small, but trading volume should be big as the stock price increases.

L = Leader or Laggard? Buy the leading stock in an industry. A stock’s Relative Strength Rating should be 80 or higher.

I = Institutional sponsorship should be increasing. Invest in stocks showing increasing ownership by mutual funds in recent quarters.

M = The market indexes, the Dow, S&P 500 and NASDAQ, should be in a confirmed up trend since three out of four stocks follow the market’s overall trend.

Under Current earnings and Annual earnings are two recent additions to the rules. Bob noted that requiring quarterly sales to be up 25% or more or accelerating over prior quarters and annual return on equity (ROE) to be at least 17% will prevent traders from buying into a mania. History has shown that in the late stages of a bull market, companies often pay a high price for acquisitions and lower their ROE. These additions to the system reduce risk by ensuring the companies have solid business plans.

He also expanded on the “M” by noting that tops are often accompanied by distribution day clusters. continued on page 6

These days are a signal of broad selling by mutual funds and other institutions that dominate the daily trading action of the stock market. A distribution day occurs when a key index declines on higher trading volume than the prior session. At bottoms, investors should look for a follow-through day as confirmation that the market is turning higher. According to Investor’s Business Daily website, www. investors.com, if a rally is genuine, four to seven days into the advance, one of the senior averages should post a one-day gain of 1.7% or more on an increase in trading activity over the previous trading day. Follow-throughs after the 10th day indicate that a rally may be weak. According to the website, follow-through days are among the most reliable indicators of a fresh uptrend, claiming that no major uptrend has occurred without one.

Adding detail to the basic rules, Bob offered several insights:

• Price without volume is meaningless data. Breakouts must be confirmed by volume. While a breakout to a new high in price is a significant event, it must be legitimized with a volume spike of at least 50-100% more than the usual volume.

• Relative strength often breaks out to a new high along with price.

• While the cup-and-handle is the classic IBD chart pattern, breakouts from any basing pattern confirmed by volume offer trading opportunities.

• There’s symmetry in the marketplace – the bigger the base, the bigger the potential price move after a breakout.

• Rising from the bottom of the basing pattern to the upper limits of the price range requires a lot of buying power. After the rally from the bottom, weak holders will exit during a consolidation, the handle in a cup-and-handle. It is very important to see a consolidation in the basing pattern.

• Because breakouts tend to run up 20%, it is important to limit buy points to within 5-10% of the breakout price.

• Stocks should be held for a minimum of 8 weeks.

• Traders should pyramid up, and never add to losing positions. Bob follows the O’Neil principle of limiting losses to 8% of the initial buy price.

• Second level breakouts are those which occur after an initial price run-up and subsequent consolidation. These are equivalent to Elliott Wave 3, and offer the greatest potential return to the trader.

• Third and fourth level breakouts have a high degree of failure. A third level breakout can be thought of as a fifth wave in Elliott wave analysis.

Sell side discipline is what separates good investors from average investors, in Bob’s opinion. In addition to the 8% initial stop, Bob sells if the chart indicates a price breakdown, especially when the price action is confirmed by volume. He summarized his sell philosophy with a baseball analogy, “three strikes and you’re out.” Strikes include breaks of long-term trendlines; breakdowns through important support zones; and below the 200-day moving average, especially if the moving average is sloping downward.

Robert Rossetti is a portfolio manager for Morgan Stanley on the Asset Allocation team, focusing on the Total Return Trust. He joined Morgan Stanley in 1995 and has over 34 years of investment experience. Prior to joining the firm, Bob was a Supervisory Analyst in Merrill Lynch’s Research Compliance Department. Previously, he managed individual portfolios at Prudential Securities and managed the U.S. equity assets of the Swiss Reinsurance Company.

Rick Martin, CFP, CAIA, CMT, “Portfolio Simulation to Optimize Trading Systems” Summarized by Mike Carr, CMT

Rick began his presentation by exploring some traders’ myths:

• “I have found the holy grail of indicators. They work great when I overlay them on a chart.” Unfortunately, he pointed out, weaknesses with this indicator will show up when it is tested under different market conditions.

• “I have been trading this system for a year and it is profitable...it can’t lose.” He explained that market conditions change with time, and a year is not long enough to adequately assess the long-term performance of any system.

• “I have optimized a new entry system that will improve my results.” It is his opinion, which was shared by several other speakers, that we all spend too much time trying to find the perfect entry technique. Exit strategies are more important to returns, as illustrated by the old market adage, “cut your losses and let your profits run.”

• “Only systems with more winning trades than losers will be profitable in the long run.” Rick demonstrated that long run profitability is determined by mathematical expectancy. Expectation is defined as (Pw * Aw) – (Pl * Al), where Pw is the probability of a winning trade; Aw is the average dollar amount of a winning trade; Pl is the probability of a losing trade; and Al is the average amount lost on a losing trade. Many profitable systems will only have 40%, or less, winning trades, but by letting profits run and cutting losses, the system is profitable.

Moving beyond myths to identify factors critical to success, Rick demonstrated the importance of simulating system results at the portfolio level. At the portfolio level, traders get the truest insight into drawdowns and performance. They can also properly assess trade frequency and portfolio level. At the portfolio level, traders get the truest insight into drawdowns and performance. They can also properly assess trade frequency and equity curve reliability. This level of simulation will demonstrate whether or not the system suits the trader’s personality.

To illustrate his points, Rick showed the results of three systems available in MetaStock along with the returns of three proprietary systems his firm has developed. The MACD Crossover works very well in bull markets, but is extremely volatile and prone to large drawdowns. The well-known Turtle Breakout strategy is also profitable over the long-term, but had sustained a three-year drawdown which makes it difficult for most traders to stick with the strategy. The best performer of these systems was a random entry with a Bollinger Band exit, showing profitability with limited drawdowns. To Rick, the fact that this system tests so well demonstrates the importance

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Rick Martin, CFP, CAIA, CMT, “Portfolio Simulation to Optimize Trading Systems” continued from page 6

of exits to system performance.

For his own trading, Rick combines momentum with trend-following to attain the best risk/reward ratio. He also finds that limiting leverage to about 125% within his fund achieves the greatest return while minimizing risk. To determine the size of each trade, he relies on volatility, trading larger amounts in low volatility securities and smaller amounts as volatility increases.

Rick Martin is Managing Director and Director of Research at Ryan Beck & Co. and the principal of Ryan Beck Kronos Fund, LP. He was previously the co-founder and primary portfolio manager of Denver-based Geronimo Partners Asset Management, LLC, a hedge fund management firm. Rick is the past Director of Research and Board member of Tucker Anthony Sutro Capital Markets (TASCAM), and Managing Partner of TASCAM Investment Partners. Prior to joining TASCAM, Rick had been Director of Research and Co-Head of Investment Banking for Advest, Director of Research for Swiss Bank, Director of Research for the Chicago Corporation, and an Institutional Investor All Star technology analyst.

George Senge followed this with a presentation entitled “The True Strength Index (TSI) and The Price Oscillator.” The TSI was developed by William Blau and is designed to determine both trend and overbought/oversold conditions; the TSI is applicable to intraday time frames as well as long term trading. TSI helps traders determine overbought and oversold conditions of a security by incorporating the short-term purchasing momentum of the market with the lagging benefits of moving averages. George explained that the serial composition of the TSI (a version of Wilder’s Relative Strength Index) can also be expressed as a parallel composition which is related to the Price Oscillator.

Generally a 25-day exponential moving average (EMA) is applied to the difference between two share prices, and then a 13-day EMA is applied to the result, making the indicator more sensitive to prevailing market conditions. After the data is smoothed, some calculations are done to make the indicator fall in a range from +100 to -100, or from +1 to -1. A signal line (7-day EMA) is usually added - as it is to the MACD indicator - to help identify reversals. In addition, values of -25 and +25, like the levels of 30 and 70 used with RSI, can also be used to identify levels where a security is overbought or oversold. Many in attendance did not remember the exact definition of polynomials; however, we all gained an appreciation of the mathematical calculations that are required for the construction of these indicators. We caught a glimpse into the world of “black box” arbitrage.

The remainder of our meeting was devoted to our semi-annual Roundtable event. Bob Kargenian, CMT, of TABR Capital, discussed indicators he follows as well as mandatory risk management strategies, imperative at this juncture of the financial markets. Stan Harley, Harley Capital Management, presented his current cycle work, “The Case for a Market Top.” Sherman McClellan of S. McClellan & Assoc. discussed his work regarding the correlation between Gold and Oil with charts showing their relationship back to 1981. Steve Todd of the Todd Market Forecast discussed his key indicators and outlook for the next 6 months. Don Coyne overlaid the NASDAQ Composite with the Dow 1930-1939 charts and discussed his observations regarding similarities and differences. We had a stimulating evening of passionate conversation regarding the financial markets only surpassed by the quality of our market technicians in attendance. The meeting ended with a market poll predicting where the broad market would be 6 months from now, with approximately 85% of attendees believing the market will be lower in November, compared to the closing valuations on May 9, 2006.

Our next meeting will be held in September at El Moro Restaurant in West LA. The Guest Speaker will be announced later.

(Contact Kristin Hetzer CMT, khetzer@royalpalmscapital.com regarding upcoming meeting information or volunteer with the LA Chapter of the MTA.)

NYSE Offers New Data Service continued from page 3

4. End-of-Day File - ProTrac EODSM At approximately 8:00PM each day, a file will be made available that includes a summary of all program trading activity for each stock and identified the amount that was executed for all non-index arbitrage program trading. The file will be made available to recipients of the ProTrac datafeed (at no additional charge) or separately as a stand alone product. Shares will be totaled for each symbol in separate Index Arbitrage and Non-Index Arbitrage quantities.

Free Trial Introduction

For a limited time, all NYSE InfoTools products will be available at no charge for evaluation and redistribution until at least the end of June 2006. This trial will include a six-month historical database. To participate in the free trial, register at www.nysedata.com. Feedback on the products can be provided to Mark Schaedel at (212) 656-5418.

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Please e-mail Tim Licitra at: Tim@mta.org if you wish to submit an advertisement or have any questions.

Los Angeles Area Regional Chapter Meeting

The LA Regional Chapter of the MTA held their quarterly meeting May 9th at Spaghetti’s Bar & Grill in Seal Beach. We had 21 members, affiliates and guests in attendance. To begin the meeting, Julia Bussie gave an overview of the upcoming election and the successful transition the new slate of officers had recently completed.

Slide #22 From Rick’s Presentation

George explained that the serial composition of the TSI (a version of Wilder’s Relative Strength Index) can also be expressed as a parallel composition which is related to the Price Oscillator.

Generally a 25-day exponential moving average (EMA) is applied to the difference between two share prices, and then a 13-day EMA is applied to the result, making the indicator more sensitive to prevailing market conditions. After the data is smoothed, some calculations are done to make the indicator fall in a range from +100 to -100, or from +1 to -1. A signal line (7-day EMA) is usually added - as it is to the MACD indicator - to help identify reversals. In addition, values of -25 and +25, like the levels of 30 and 70 used with RSI, can also be used to identify levels where a security is overbought or oversold. Many in attendance did not remember the exact definition of polynomials; however, we all gained an appreciation of the mathematical calculations that are required for the construction of these indicators. We caught a glimpse into the world of “black box” arbitrage.

The remainder of our meeting was devoted to our semi-annual Roundtable event. Bob Kargenian, CMT, of TABR Capital, discussed indicators he follows as well as mandatory risk management strategies, imperative at this juncture of the financial markets. Stan Harley, Harley Capital Management, presented his current cycle work, “The Case for a Market Top.” Sherman McClellan of S. McClellan & Assoc. discussed his work regarding the correlation between Gold and Oil with charts showing their relationship back to 1981. Steve Todd of the Todd Market Forecast discussed his key indicators and outlook for the next 6 months. Don Coyne overlaid the NASDAQ Composite with the Dow 1930-1939 charts and discussed his observations regarding similarities and differences. We had a stimulating evening of passionate conversation regarding the financial markets only surpassed by the quality of our market technicians in attendance. The meeting ended with a market poll predicting where the broad market would be 6 months from now, with approximately 85% of attendees believing the market will be lower in November, compared to the closing valuations on May 9, 2006.

Our next meeting will be held in September at El Moro Restaurant in West LA. The Guest Speaker will be announced later. (Contact Kristin Hetzer CMT, khetzer@royalpalmscapital.com regarding upcoming meeting information or volunteer with the LA Chapter of the MTA.)

NYSE Offers New Data Service continued from page 3

4. End-of-Day File - ProTrac EODSM At approximately 8:00PM each day, a file will be made available that includes a summary of all program trading activity for each stock and identified the amount that was executed for all non-index arbitrage program trading. The file will be made available to recipients of the ProTrac datafeed (at no additional charge) or separately as a stand alone product. Shares will be totaled for each symbol in separate Index Arbitrage and Non-Index Arbitrage quantities.

Free Trial Introduction

For a limited time, all NYSE InfoTools products will be available at no charge for evaluation and redistribution until at least the end of June 2006. This trial will include a six-month historical database. To participate in the free trial, register at www.nysedata.com. Feedback on the products can be provided to Mark Schaedel at (212) 656-5418.

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The 20-week cycle is a half-period harmonic of the more dominant 40-week cycle, sometimes called a 9-month cycle. I currently track the actual length of that 40-week cycle at 185 trading days, which is about 38.5 weeks, but the phrase “40-week cycle” rolls off the tongue more easily. So far as I know, no one has come up with a reasonable explanation for WHY the 40-week cycle exists, since it does not comport well enough to fiscal or earnings cycles. Some people claim its length is related to the human gestation period, but I don’t place a lot of faith in that explanation. The existence of half-period harmonics of this and other cycles is an easier concept to understand, as harmonics is a phenomenon which exists in physics.

The lows of the 40-week cycle are pretty punctual, far more reliable in their timing than the 20-week cycle, and this is perhaps the factor which frustrates most of the people who try to use the 20-week cycle. In my view, the 20-week cycle is simply not reliable enough in the timing of its arrival to use for calendar planning purposes. But by no means do I wish to imply that it is without value. The “20-week” bottoms are pretty easy to locate in hindsight, and they definitely do occur. You just cannot set your watch by them.

Our schedule has the last 40-week bottom due Feb. 13, and it was a very quiet one. Muted 40-week cycle bottoms occur usually every 3rd or 4th iteration, and the prior muted one was late November 2003. The next 40-week cycle bottom is ideally due Nov. 3, 2006. Splitting the difference between Feb. 13 and Nov. 3 puts the 20-week cycle low as ideally due June 24, but as I mentioned above, this cycle is horrible in its habits of punctuality. The actual 20-week bottom can arrive plus or minus a month from that date, and still be considered within the normal behavior parameters.

But if we accept the idea that there is indeed a bottom which we might refer to as the 20-week bottom, and if we can accept that it ought to arrive sometime within that broad time window somewhere in the middle between the more punctual 40-week bottoms, then we can move forward toward hunting for that 20-week bottom using tools other than the calendar. One of the best ways to do this is to use a stochastic oscillator set to half of the period of the cycle you are hunting for.

In the weekly chart of the S&P 500, I have included a 10-week stochastic. Its lows generally coincide with the 20-week lows (and the 40-week lows also). The trick is to first understand the aforementioned phenomenon of the 40-week cycle skipping a beat every 3 or 4 iterations, and then next to understand that the 20-week cycle lows are not going to be particularly punctual. With those two points established, you can then free your mind to see what is actually there, and how the stochastic oscillator helps to identify those lows. On that basis, the current oversold condition qualifies as a likely 20-week cycle low coming early. But as we saw in early 2004, it is possible for the 20-week cycle low to undergo a bit of mitosis (or is it meiosis) and split itself into two lows, the center of mass of which is on schedule. Frustrating, I know, but how else can one describe it?

If this is the 20-week cycle low arriving a bit earlier than the ideal due date in late June, then that is not very good news for the bullish case. Uptrending markets tend to see the 20-week cycle arrive late, and also the high which follows that 20-week cycle low should be higher than the high preceding the 20-week cycle low. If the SP500 fails to exceed the May 5 closing high of 1325.76 this summer, then the decline into the 40-week low this fall should be uglier than it might otherwise need to be.
The MTA Education seminar kicked off on May 18th with a Market Forecast Panel at the Bloomberg World Headquarters in New York.

The moderator was Vincent Catalano. Panelists were Gail Dudack, Michael Kahn, John Kosar, and Louise Yamada.

**Vincent Catalano, CFA**

Vincent Catalano, CFA, is president and founder of iViewResearch, a research and consulting firm, and Get Smart Quick, a contract research company. Mr. Catalano is a past president of the New York Society of Security Analysts (NYSSA) and served as a board member from 1991 to 2005.

**Gail Dudack, CMT**

Gail Dudack, CMT is co-partner of Dudack Research Group LLC (DRG), an investment research firm that provides economic, fundamental, quantitative and technical strategy and tools for institutional money managers. Prior to DRG, Ms. Dudack was the Managing Director of Research and the Chief Investment Strategist for SunGard Institutional Brokerage Inc. Earlier, she was the Chief U.S. Investment Strategist for UBS AG and was chief technical analyst for BridgeNews.

**Michael Kahn**

Michael Kahn writes the twice-weekly “Getting Technical” column for Barron’s Online (www.barrons.com), and the daily “Quick Takes Pro” technical newsletter (www.MidnightTrader.com). Mr. Kahn is the author of two books on technical analysis, most recently Technical Analysis: Plain and Simple, is a frequent contributor to SFO Magazine and was chief technical analyst for BridgeNews.

**John Kosar, CMT**

John Kosar, CMT is the Director of Research at Asbury Research LLC, which provides financial research to investment professionals. John has been in the financial business since 1980, and spent the first half of his career on the trading floors of the Chicago Mercantile Exchange and Chicago Board of Trade. Prior to founding Asbury Research, John was Senior Research Analyst for Bianco Research.

**Louise Yamada, CMT**

Louise Yamada, CMT, formed Louise Yamada Technical Research Advisors, LLC with Ron Daino after 24 years at Smith Barney (Citigroup). Ms. Yamada was Managing Director and Head of Technical Research for Smith Barney. She is a perennial leader in the Institutional Investor poll, and was the top-ranked market technician in 2001, 2002, 2003 and 2004.

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**Volunteers Needed**

Volunteers are needed for the seminar committee. If you are interested please contact Tim Licitra at (732) 596-9399 or by email at tim@mta.org.

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**Question:** What is the state of the market?

**Yamada:** The market has started a corrective trend. It is due for a rest. She expects a new low but not lower than the 2002 low. Metals, materials, and industrials are in a bull market driven by international expansions, similar to the U.S. expansion in the early 1940’s.

**Dudack:** Reporters say this sell-off is due to the CPI data but she doesn’t believe it. She thinks it is related to a liquidity crisis somewhere in the world, similar to the October 2005 rapid drop caused by Refco. It could be the “fast money” that had moved into hedge funds, international markets, and commodities unwinding positions. Last Friday (May 12) everything went down, indicating that people were moving into cash. Someone big is selling.

She thinks this is a good buying opportunity, that the fundamentals are still strong. She quoted someone at Merrill Lynch saying this should be a fast correction on the way to 12,400: 12,600 on the Dow. Leadership will be in industrial and health-related sectors, which will grow faster over the next decade.

**Kosar:** He expects a 10-12% correction. When the Nasdaq is under-performing the S&P 500, as it is now, it is bad news and it has been seen in several structural breakdowns. Lots of things are at their 200-day moving averages now, so the markets are at a critical juncture. VIX has recently spiked up, so he expects to see a recovery in late Q4.

**Yamada:** DELL, MSFT, INTC are weak but they are becoming old tech. Many of the new tech sectors are doing fine. Money is moving out of old tech into new tech.

**Kahn:** Things are not looking good. He doesn’t want to be in stocks now. Stocks will be a lot lower in six months. Gold is too high, should drop back to 550-600 range, where it would be a good buy since the long-term trend is up.

**Kosar:** Long-term rates have broken a well established down trend line and are headed up, after a rally in bonds over the next few months.

**Dudack:** The rapid decline of the dollar followed an international economic summit meeting and could have been part of some plan. She is long-term bullish on the dollar and sees a 30% gain vs. the Euro. Technically, she sees a head and shoulders bottom. But the dollar could remain weak vs. the Asian currencies.

Long-term rates may come down some now, but the long-term trend is up. Rates have been artificially low for several years. One cause was the 2003 tax package, which required pension...
funds to match durations of holding vs. durations of obligations. This increased demand for long bonds. 30 & 50 year bonds are very popular. Real returns on bonds, after inflation, should be 2%. They have been well below that.

Yamada: International markets are now like the U.S. in the early 1940s, driven by growth. U.S. markets are under-performing international markets. This is bad for the dollar. She sees the dollar at a long-term support level of 80 and expects that it will go lower. She thinks the dollar may be losing its place as the world’s reserve currency for a couple of reasons, “Lots of people now hate us as a result of our policies. We have become an economy driven by consumption and government spending.”

Traditionally, economies driven by growth, like China currently, tend to have stronger currencies. Economies driven by consumption and government spending have tended to have weaker currencies. As an example, she pointed to England early in the last century.

Question: What do you love and hate now:

Dudack: Loves stocks with increasing dividends over the last ten years, low PE ratios, and 3.5% yields. Hates commodities short-term.

Kosar: Loves the long bond, utility stocks, and financials after a short pause. Hates commodities, tech, CRB, speculative bubbles.

Yamada: Loves cash in foreign currencies like the Canadian dollar. Loves materials and gold after a pullback. Hates bonds and the dollar.

Kahn: Loves bonds for a while. Sees consumer stocks faltering, while industrials will be strong.

Question: When do you think we will see the bottom?

Kahn: About the end of the year when we see the breadth improving.

Yamada: After we see a new low, then a test of that low to confirm the uptrend.

Kosar: When sentiment is more bearish and techs start out-performing again.

Dudack: When we see another 90% down day (of stocks) then a 90% up day.

Summary comments:

Dudack: The Nasdaq has changed: now too much hot money in QQQQs. The importance of the Nasdaq was a 90’s view. Tech is under-performing this year because they have to start expensing options. This depresses earnings. So money flow is out of tech now.

The dollar is too low. Europeans came here last Christmas to do their Christmas shopping. New York is flooded with foreign tourists.

Yamada: The market is now very stock-specific. Look at the major trends and enter on pullbacks. Gold and oil are in a structural bull market (after a pullback). Bonds and commodities are in a trend reversal. Midcap was strong, may be less so going forward. The dollar is breaking down.

Dudack: Use technical analysis in a broader perspective. Ask who has the money and what do they own. Recently hedge funds have had the money and it tends to be hot money, moving around rapidly. With ETFs and all the derivatives, the market has changed. Look at price and volume. Look at sentiment indicators (she likes the AAII sentiment indicator). She thinks tracking the assets in Rydex funds (suggested by Kosar) is a good idea.
## Upcoming MTA Regional Chapter Events

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<td>New York City</td>
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## MTA Regional Chapter Contact Information

If you are visiting any of these chapter areas over the next several months and might be willing to make a presentation to the local group, please contact the regional chapter chair as noted to work something out. Some are long-standing chapters, some are trying to get started, but ALL of them are in need of speakers now and then.

<table>
<thead>
<tr>
<th>REGIONAL CHAPTER</th>
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