How They Do It

By Matthew Caruso

Recently, a member suggested that we feature interviews with successful technical analysis practitioners on how they apply technical analysis to make money in the real world. MTA affiliate Matt Caruso agreed to conduct interviews and prepare this feature. MTA President Phil Roth took some time to talk about his day job in late December. Part II of this interview will be published next month.

Philip J. Roth, a Chartered Market Technician (CMT), joined Miller Tabak + Co., LLC in 2002 as Chief Technical Market Analyst after a long distinguished career at Morgan Stanley. He came to Morgan Stanley through Dean Witter Reynolds which he joined in October, 1989. Philip Roth has 39 years experience, including E.F. Hutton (from 1979 until 1987) and then, Shearson when it merged with Hutton. Prior to 1979, Roth was a market analyst for Merrill Lynch and for Loeb Rhoades. A former Director of the New York Society of Security Analysts and current President and long time Board Member of the Market Technicians Association, Roth was among the first recipients of the Chartered Market Technician designation. He was voted No. 1 in Charting and Technical Analysis in the 2001 Reuters survey. He earned a Bachelor’s degree in economics from the University of Notre Dame and did graduate work in economics at Rutgers. He is a frequent market commentator in the printed media and on CNBC.

He has been teaching a graduate level course in Technical Analysis at Fordham University for more than five years and has lectured at Rutgers, Cornell, University of Richmond, Baruch, Howard and Tulane.

Matt Caruso: What is your professional job description?

Phil Roth: Well I’ve been an analyst my whole career, this is my 41st year right now. I’ve been on the sell side with major brokerage firms for most of my career; 11 years at Merrill Lynch, more than 11 years with the E. F. Hutton/Shearson combination, more than 11 years at Dean Witter/Morgan Stanley, and now I’m with an institutional firm and all we do here, is institutional research. So I have a much smaller audience, but an institutional audience. My job is three fold: to have a market view and make stock suggestions to our own people; try to bring in some business from my old contacts at previous firms; and try to increase business with the firm’s present customers by adding technical research.

M.C.: Do you work only with stocks, or also futures or options?

P.R.: Our business here is equities and options. What I follow and I’ve always followed primarily is the equity market and I make my suggestion strictly in equities, both long and short ideas. I follow all the markets though to do my analysis of the equity market. I follow bonds, commodities, and currency but I only provide ideas in equities. Our people on the desks, since we have very astute option people here at Miller Tabak, they often translate my ideas into some kind of options strategy.

M.C.: How pronounced do you find the effect from the futures and currency markets is on your equity predictions? Do you find those markets to have a large affect on your analysis?

P.R.: Well I do a top-down versus bottom-up kind of analysis, so intermarket analysis is part of the top-down. For example, if interest rates are rising and oil prices are rising, I probably want to suggest oil stocks and not utility stocks. So I start with a top-down, the top-down tells me what kinds of stocks make sense, the top-down tells me about how attractive stocks are relative to other forms of investments like bonds. Then I look at as many individual chart patterns as I can as often as I can, I guess I monitor about a thousand stocks every week, to see if I’m getting the same message or a different message. Sometimes I will see changes starting from the macro, sometimes I will see it starting from the micro. I always compare one to the other to make my judgment. Commodities and bond are very important because there are stocks that are commodity sensitive and stocks that are interest rate sensitive. The currency situation is different obviously; you can have a strong market with a week currency and a strong market with a strong currency. It’s a little harder to incorporate, but international flows are huge these days by the standards of what they were 10 or 20 years ago. Therefore you try to have some judgment about foreigners’ attitudes towards the US - do they want to buy U.S. financial assets or not. Right now for example I think we’ve had a weak dollar and it’s at least as far as domestic US investors go they’ve interpreted it as sort of a positive, a mild positive, it’s certainly a positive in some multinational earnings. But if the dollar got weaker and you had more emotional markets, foreigners might perceive the currency risk as too great and might dump it. You certainly have to watch it and I think an aceleration of dollar weakness could be an important negative if it happens and it’s possible.

M.C.: What specific technical tools do you apply when looking at your charts and making your analysis?

P.R.: I follow four kinds of indicators. The first kinds are trend and momentum indicators. This is sort of traditional stuff so I'm looking at the price indexes, breadth, volume, and relative strength. I usually do my trend and momentum work from inspection of bar charts. In other words, I do not really use tools like stochastics, and MACD and RSI and all of those momentum tools. I do that by inspection. I look for changes in intra-day volatility and changes in volume to make my judgment about the strength or weakness of a trend. Moving averages I use as kind of guides, but again it is primarily from my subjective evaluation of changes in volatility and changes in volume. That’s the first kind of indicators, trend and momentum. Those kinds of indicators tell you the direction the markets are moving and the force behind the move, is it accelerating or is it decelerating?

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From the Executive’s Desk

Tom Silveri

The month of January traditionally sees the start of many initiatives as attention turns to the New Year. The MTA is no different. This past month saw the culmination of several initiatives that was in process and the start of some exciting new initiatives. Let me describe them for you.

On the completed side

• In Mid-January we held our Mid-Winter Retreat in Miami Beach, Florida. Over 125 seminar attendees, speakers, guests and staff were in attendance. By all accounts this retreat was certainly one of our very best. Over 10 well-known and highly regarded speakers provided a learning environment which allowed for the passing of ideas in a relaxed networking environment. Our Awards dinner continued our time-honored tradition of recognizing our exemplary performers. Please read about the retreat in the following pages and don’t forget that our May Educational Seminar is right around the corner (May 18th-19th) in NYC. I hope to see you there.

• By the time you read this newsletter, the MTA headquarters staff will be set up in our new Headquarters facility at 61 Broadway, 5th floor, in NYC. We will slowly transfer phone lines, computers and library materials so we are still reachable. This move is an exciting new initiative. We will have an “Open House” at the facility in the beginning of March, 2007 and if you are in the area, please stop by. We will provide a learning environment which allowed for the passing of ideas in a relaxed networking environment. Our Awards dinner continued our time-honored tradition of recognizing our exemplary performers. Please read about the retreat in the following pages and don’t forget that our May Educational Seminar is right around the corner (May 18th-19th) in NYC. I hope to see you there.

On the Horizon

• We have recently opened registration for the Spring CMT test. Our window for the examination will be April 26th to May 5th, 2007. We urge you to register early for your exam to ensure the best time and location. You can register on-line or contact Marie Penza at Marie@mta.org for any questions you may have. For this examination, we are planning on providing:
  - A free internet web-cast, led by Chris Ruspi, CMT, on the overall test process, materials for study and best practices to the exam taking, to be held on Feb 17.
  - A free internet web-cast on the CMT Ethics which is, of course, part of the examination process.

Be on the lookout for announcements on these sessions and please sign-up early.

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• We will provide, as in the past, an internet based tutorial for all parts of the examination (Levels I-III) through our CMT Institute. Our experience in this format continues to grow and gain acceptance by the participants. In addition to the instructor led sessions, we will provide a free web-cast on the technology behind these sessions to ensure that the technology is familiar to you BEFORE the sessions start. See the announcement on the CMTi in this newsletter (see page 4) which includes some testimonials from previous participants.

Be on the lookout for announcements on these sessions as well and again, please sign-up early.

Sincerely,

Tom Silveri
MTA Executive Director
John Bollinger, CFA, CMT

On behalf of the MTA Awards Committee I recently had the honor of presenting Service Awards to Shelley Lebeck and Mike Epstein and the MTA Award to David Krell. The presentations were made at the Saturday night Awards Banquet at the 2007 Winter Retreat.

Shelley’s award recognized her long-term service to the MTA and its members. Most importantly, it recognized her vital role in the growth of the MTA, nurturing it from a nascent organization to the international powerhouse it is today. Mike Epstein, Sam Hale, Ralph Acampora and Ken Tower spoke for her. Anyone who has met and or worked with Shelley will know how richly deserved this award was. Shelley’s husband, Tom MacMahon, who has also done a lot for the society, accompanied her.

Mike Epstein was recognized for his long service to the MTA and his work with the Education Foundation. The focus of the award was the role Mike has played as a human bridge to the quantitative and academic communities, an effort that continues today via his position at MIT. Unfortunately Mike was not able to be in Miami to accept, so Tim Licita’s cell phone intervened, teleporting Mike to the banquet.

David Krell was honored both as a technician and for his long-term role in the society. Always a friend to technicians, he was cited for his role in helping the MTA transition from its original format as a club of Wall Street wire-house market-letter writers to the modern, dynamic organization it is today. More importantly, David was acknowledged for his recent efforts in assembling the team that convinced the NASD and the SEC to waive the Series 86 and 87 exam requirements for technicians holding the CMT designation, placing the CMT on par with the CFA for this purpose. David’s parents, who live in Florida, were able to attend and were rightfully bursting with pride.

The committee is working on writing and gathering biographies of all the past MTA Award winners for a new awards section on the MTA web site. If you have any material that might be of interest in this regard or would like to write up a biographic sketch of your favorite award winner please let us know.

Finally, we are accepting nominations for awards. There are three award categories, The MTA Award, Service Awards and Recognition Awards. The general guidelines are that the MTA Award is for outstanding work in technical analysis, the Service Award recognizes those members who have contributed to the society in some extraordinary manner and the Recognition Award is to recognize those who have contributed to technical analysis but may not be technicians themselves. Nominators should be prepared to sponsor their nominees.

You can reach us through our MTA office liaison, Marie Penza, marie@mta.org, or by email to BBands@BollingerBands.com.

David Krell, CMT

It is with great pride and humility that I accepted the MTA Annual Award on January 20, 2007 in Miami Beach. The MTA Annual Award has been granted in the past to very talented and dedicated technical analysts and it is an honor and a privilege to have been selected to join this distinguished group of prior recipients.

Receiving the MTA Annual Award was very special for me. It was granted by an association that I love and where I’ve made many life-long friends. It was also very special because it came from my peers- the individuals best positioned to evaluate my work and contribution and who are the world experts in their profession.

As a long-term member of the Market Technicians Association, as well as a past-president, I am very confident that the MTA has a great future ahead of it. When I helped craft the original MTA Mission Statement at the first long-term strategic planning session in 1987, I could not have imagined how the MTA would thrive, grow and become the national organization representing technical analysts of every genre. Moreover, who would have forecasted the importance and desirability of the CMT designation. I am very proud to have participated in the first group to take the CMT examination and to have been awarded the CMT designation nearly 20 years ago. It is the dedication of the many volunteer members of MTA to continuously update and upgrade the quality of the exam as well as to create a comprehensive body-of-knowledge that has resulted in the CMT exam becoming the standard for the technical analyst certification.

I thank John Bollinger and the Award Committee for selecting me as the 2007 recipient of the MTA Annual Award. This is an honor that I will cherish forever.

Shelley Lebeck

My journey to Miami to accept this award began, not on Thursday when I flew here, but nearly 30 years ago in 1978 when I moved to New York City. My first job there was working at Smith Barney with Ralph Acampora, who was a founder of the MTA, so naturally I helped Ralph out on MTA work. He and I moved to Kidder Peabody, and I got even more involved in MTA administrative work. By 1988 it had started to be so much time working for MTA and shortchanging Kidder, that a decision had to be made and I chose working for MTA full time. It wasn’t full time at first but quickly became that within a couple of years. The MTA did not have office space so I worked from my apartment for six years. In 1994 the MTA moved up in the world and got space at the World Trade Center c/o New York Society of Security Analysts. We had a great seven years there until 9/11/01 changed everything for everybody. After that we picked up the pieces and relocated to Woodbridge, New Jersey. Several years later, in June 2005, I left the MTA after 17 official years of employment but 27 years of involvement. And so this journey is one that covers over half of my life. I have met so many, many wonderful people over these years, and I am grateful for that. You can’t hang around with a group of people for that many years and not have it shape your life. But at the same time, it means that I shaped the MTA for many years of its life, and I will always be proud of the work I did for those years. Thank you all very much for this award; I appreciate your good thoughts and wishes.

Mike Epstein

I am honored and pleased that my efforts, in some small way, have helped to broaden and further the professional and academic efforts of our organization. My award is really an award to all members of the MTA who have contributed to this evolution. We can hopefully look forward to even greater progress in the next 30 years.

All pictures taken by Tom MacMahon
Technically Speaking

February 2007

www.mta.org

CMT Institute

Registration Is Open!

The following are testimonials from those that have recently taken the CMT Institute

“The classes were fantastic and very helpful. I reviewed the recordings a number of times to grasp concepts I was not comfortable with and that was invaluable. Jeff was great and kept the class interesting and on its toes. I would recommend the classes to any CMT candidates.”
- Konstantinos Piskopanis, Sprint

“The weekly online course was great. I passed the exam and learned more material than required for the Exam...a double hit”
- Andrew Hill, Comerica Bank

“The classes were fantastic and very helpful. I reviewed the recordings a number of times to grasp concepts I was not comfortable with and that was invaluable. Jeff was great and kept the class interesting and on its toes. I would recommend the classes to any CMT candidates.”
- Konstantinos Piskopanis, Sprint

“I participated in the Spring Level II session and I found it helpful in understanding some of the more difficult concepts. I appreciate the instructors’ willingness to answer our questions during and after the sessions. In addition, I enjoyed the live discussions on the application of the various techniques on the current markets.”
- Sam Chan CFA, CFP, FCSI, STI

“After taking the CMT Level 1 prep course, I felt that it greatly helped me pass Level 1. Both Jeff and Chris were very effective in presenting the related materials and were very knowledgeable in answering participants questions. In addition to the live online training session, being able to go back and view previous classes on my own schedule was very convenient and proved to be very valuable.”
- Anthony Zmuda, Knight Capital Group

To register, or for more information, please visit our website at www.mta.org, or you can contact Tim Licitra at tim@mta.org.

EXAM DATES

CMT Levels 1, 2, and 3: April 26, 2007 to May 5, 2007

Registration for Levels 1 and 2 ends March 30, 2007 with registration for Level 3 ending April 20, 2007
MTA MOVES BACK TO NEW YORK

As many members and affiliates will remember, the MTA had its global headquarters in the World Trade Center in downtown New York City until the tragic date of September 11, 2001. Shortly thereafter, the staff and facilities were relocated to nearby Woodbridge, New Jersey—an inauspicious location for an Association with ties to Wall Street and the international financial markets.

It has always been the intent of the Boards of Directors for the last five years to move the MTA back “home” to New York. By the time most of our readers receive this newsletter, such a move will either have been completed or will be in the final stages of completion.

In early February, the MTA headquarters, staff, and full facilities will be moving to 61 Broadway, Suite 514, New York, NY 10006-2701 (diagonally opposite the corner of Broadway and Wall Street). The new phone numbers are not ready as of the date we go to press, but they will be posted on the website. Calls to our existing phone number will re-direct you to the new number. Our e-mails will still function normally.

The staff asks for your indulgence and understanding during this physical move. We intend the transition to our new location to go smoothly, but by definition the unforeseen cannot be predicted. We remain dedicated to prompt and professional service to our members and affiliates, and look forward to serving you better from our new office.

MTA members and affiliates who happen to be in the Wall Street area are of course always welcome to stop in for a visit, a chat, or a look at our expanding library.

See you in New York!

Correlation Behavior Between Single Name CDS and Common Stock News: 3 Case Studies

By Lawrence H. Klamecki, MBA, JD

Introduction

The global credit derivatives market has grown dramatically in recent years. One of the reasons for this dramatic growth is the belief that credit derivative prices are non-correlated to other asset classes, and thus offer portfolio diversification and volatility reduction benefits not available from other instruments. The purpose of this article is to analyze single name CDS spreads in relation to the common stock of three major U.S. listed companies following the recent release of negative company news. I focus on short term price correlation behavior, with the intent to provide some real-world perspective to investors and traders involved in the U.S. CDS market.

There is substantial debate whether buying credit default swaps (CDS) or shorting common stocks are effective hedges against bond defaults. Recent events in May 2005 surrounding the downgrade of GM and Ford bonds to junk status indicate that presumed correlation behavior between CDS, bonds, and common stock may prove invalid shortly after news of a company’s potential credit default. Contrary to expectations, after GM’s downgrade and subsequent revelations that GM might be responsible for billions in Delphi pension obligations, GM bond prices actually increased. CDS protection sellers rushed to accumulate sufficient bond inventory for delivery to bondholders, causing a run on the supply of defaulted bonds. Kirk Kirkorian’s accumulation of GM stock after May 2005 and his potential takeover triggered a short squeeze that drove GM stock up and caused substantial losses to shorts who had used the stock to hedge their GM bonds. Hedge funds lost billions as a result of stock vs. bond vs. CDS correlation trades gone bad.

In GM’s case, shorting common stock to hedge against bond default backfired. But was this simply a unique situation caused by the entry of a major acquirer buying up the common stock? What about situations where a company releases bad news, its stock price falls dramatically, default probabilities increase, but there is no major acquirer hanging in the wings waiting to buy up the company’s shares?

It is commonly believed that spread prices on single name credit default swaps (CDS) are negatively correlated to the common stock of their reference company. Common sense says that bad news that increases bond default probability (but not sufficient to cause an actual default) should result in the following price behavior:

1) Common stock prices drop rapidly (gap down) as the company’s forward-looking earnings and cash flow prospects fall and large institutional sell orders are distributed across major exchanges. Equity prices are the “canary in the coal mine”, responding to negative news quickly due to high liquidity provided by exchanges. Presumed correlation to CDS = negative.

2) Bond prices drop rapidly (gap down) as the company’s future ability to repay its debts becomes questionable. Mutual funds, pensions, and hedge funds attempt to liquidate their positions in the institutional markets. Price adjustment typically occurs at a slower rate than the company’s common stock, as many fixed income investors may respond to delayed credit downgrades as the primary sell trigger. Presumed correlation to CDS = negative.

3) CDS spreads rise rapidly (gap up) as the probability of default rises. Liquidity is a potential issue as this market is strictly over the counter, price visibility is less than optimal, and bid/ask spreads are wide.

Testing the CDS / Common Stock Correlation Presumption

The purpose of this article is to show real-world correlation behavior between CDS spread prices and prices of a company’s common stock in the first two months following negative market news. “Market news” in this case means news sufficient to increase the probability of credit default and cause a significant stock price drop, but not an event that would trigger a legal default event as defined by ISDA (bankruptcy, failure to pay, restructuring, etc.) The three cases studied are very recent – the latter half of 2006 – during a significant run up in the U.S. stock market. These conditions are unique and may not represent future periods. While these case studies shed light on interesting CDS/common stock correlation dynamics, care should be taken in deducing future behavior.

The data compares correlation between the common stock of each company with its 3-, 5, and 10-year single name CDS contracts. The closing stock price data is from Yahoo! Finance. The CDS spread price data is dealer reported OTC CDS trade prices from Markit.

Case Study #1: Ford

From early 2005 to present, the prospects for Ford Motor Company (F) have been bleak. Ford’s debt was downgraded to junk status in May 2005, and mounting pension obligations, loss of market share, departures of key employees, and plant closures haunt the company’s future. The stock rebounded from a low of $6 to a high of $9.25 from August through September 2006, pushed by the overall market and strength of the economy. However, on September 14, 2006 the
company announced it expected increased losses for the year and offered to buy out 75,000 hourly workers. The stock tumbled to $7.70 over the course of three days. It then recovered over the next three months. (Figure 1)

Figure 1 shows Ford’s CDS spreads over the ensuing three months. As expected, CDS spreads rose rapidly in the three days following the negative news. As the stock recovered in the next three months, CDS spreads fell again. (Figure 2)

However, looking at actual statistical rolling 10 day correlations (using Excel function CORREL) between the stock price and CDS spreads shows an interesting dynamic. (Figure 3)

Up to and immediately following Ford’s release of further bad news, the CDS contracts were almost perfectly negatively correlated (~0.8 to -0.9) to Ford stock price. However, around the end of September, the rolling CDS/stock correlation dramatically increased, peaking at +0.7 on October 17. After that, correlation dropped again deep into negative territory as Ford’s stock price headed north and CDS spreads fell again.

Case Study #2: Caterpillar

Caterpillar (CAT) is a different story than Ford, with the company generally in good financial health. The CDS market has assigned CAT low default probability spreads of less than 0.5%, much lower than Ford’s 4-8% probability. However, on October 19, 2006 the company announced a sharply lower full year forecast due to a slowdown in U.S. housing and legal costs associated with a dispute with Navistar. The stock tumbled 12%. (Figure 4)

As CAT’s stock price fell (and stayed lower), the 3-, 5-, and 10-year CDS spreads also fell. This is contrary to general expectations, since negative earnings news and a bleaker outlook should increase the potential for default and result in rising CDS spreads. (Figure 5)

As the chart below shows, CAT’s rolling CDS/stock correlations increased significantly after the negative market news and stock price drop. While the pattern is not as orderly as in Ford’s case, the dynamic is fairly obvious. (Figure 6)
Case Study #3: Tenet Healthcare
Tenet Healthcare (THT) falls somewhere in-between the Ford and Caterpillar cases. The company has a history of earnings restatements, overly aggressive billing practices, and narrow margins in the healthcare delivery space. Tenet has been in the midst of a turnaround effort for the last 2 years, but has not had the extreme financial difficulties of Ford. Following a fall to $5.75 in August 2006, the stock had rallied to above $8.50 until October 27, when the price dropped from $8.35 to $6.75 in only 7 days on news that it was facing a bad debt crisis, slowing volume growth, and Deutsche Bank’s downgrade from Hold to Sell. (Figure 7)

Tenet’s CDS spreads have been between 2% and 6% in the 3 to 10-year segment, basically hovering in a flat pattern until the announcement. On the day of the announcement, CDS spreads increased somewhat, but inexplicably declined over the ensuing three weeks. (Figure 8)

As the chart below shows, Tenet’s CDS/stock correlations rose significantly after the announcement. This is contrary to expectations of increased default probability after negative news. Leading up to the announcement, CDS/stock correlations were highly negative. (Figure 9)

Possible Explanations for Correlation Behavior
After a major negative earnings announcement (Ford), core market slowdown (CAT), or investment bank downgrade (Tenet Healthcare), one would expect default probabilities to rise and be reflected in higher spreads in the company’s CDS contracts. This appears to be the case in the several days immediately following bad news. However, in our three cases CDS spreads became significantly more correlated with stock prices over the following month. This is both counter-intuitive and troubling from a portfolio hedging perspective.

Without further supporting data which is difficult to acquire, it is nevertheless possible to advance several potential explanations for this correlation behavior:

1) Market makers, CDOs, hedge funds, and other players have been aggressively selling default risk, driving down CDS spreads which are now at historical lows. Falling CDS spreads after bad company news may simply be a result of shorting spread peaks amidst a skewed supply/demand situation.

2) “What doesn’t kill you only makes you stronger.” Bad news which doesn’t cause a company to default may reduce the perceived likelihood of future default. If the likelihood of default drops, a CDS contract would become less valuable and tend to track the stock’s downward bias.
Correlation Behavior Between Single Name CDS and Common Stock After Bad Corporate News: 3 Case Studies
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3) Bad news may have already been factored into CDS spreads prior to these announcements – thus causing a “sell the good news” effect with CDS buyers selling out to capture short term profits. In Ford’s case, this could be true as the company had plenty of pre-announcement woes. In Tenet’s case, this may also be true as the entire healthcare industry had issues with bad debt and thin margins before Tenet’s bad news. This may also be true for Caterpillar, as a housing slowdown was widely anticipated.

4) “When the s**t hits the fan, everything becomes perfectly correlated.” As we have seen from major past market collapses, the flight to cash and gold causes all other asset classes to become highly correlated. However, the three cases studied here do not encompass a major market crash, so this seems an implausible explanation.

Conclusion
Our three case studies involving Ford, Caterpillar, and Tenet Healthcare show that CDS/stock prices are generally highly non-correlated up to and including negative company news. However, within a short period thereafter, CDS spreads and stock prices can become highly correlated for several weeks or months. This dynamic could prove problematic from a portfolio diversification standpoint. In a nutshell, the three cases studied here show that buying CDS contracts to hedge a portfolio of U.S. common stocks may actually add to losses after bad corporate news, rather than reducing them.

Lawrence H. Klamecki is a derivatives analyst at Summit Systems / Misys Banking Systems in New York City, and Associate Editor of Technically Speaking. He is an independent trader of equities, futures, and options, employing both rule-based trading systems and visual technical analysis strategies. Lawrence at LHKlamecki@hotmail.com or 646-918-0690.
How They Do It
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But those kinds of indicators don’t necessarily tell you very well where you are in a trend. To get some handle on that I look at many sentiment and supply/demand indicators. That’s really my love, my love is markets psychology and trying to analyze how bullish and how bearish the different market participants are. The most important technical precept to me is that investors make bottom and traders make tops. I mean that investors, people that are motivated by price and value, are the kind of people that are likely to buy in a weak market or in adverse conditions because they have a long term view, they look beyond the short term uncertainty. Traders on the other hand are motivated by the trend and they’re bearish if the trend is weak and bullish if the trend is strong. So what tends to happen is that at turning points it takes traders an amount of time to change their opinion because nobody recognizes the change in trend immediately, trends don’t change immediately. So as a trend goes from up to neutral to down, it tends to catch the traders bullish a little too long. The same thing is true on the downside, it takes them a while to recognize a turn from down to up and so they tend to be bearish at bottoms.

So I’m looking for indicators that measure the attitudes of investors and indicators that measure the attitudes of traders. When looking at traders I look at options data, put/call ratios, put/call ratios on volume, put/call ratios on premiums. For short selling indicators I look at polls; Consensus, Inc. polls, Investor’s Intelligence polls. Those polls are basically traders polls, and all those kinds of indicators tend to be reasonable good contrary indicators.

For investment attitudes, there are people with long term horizons. Normally when I say that people think I am talking about the institutional money manager, but I am not. I believe institutional money managers have a relatively short term horizon. People with long term horizons are corporations themselves, so if corporations are buying back more stock then they are issuing, that is very bullish for me because that means the supply of stock is actually contracting and it means corporations think their stock is cheap and they obviously have a very long term view. Insiders have a good record of buying their stocks when their stocks are cheap. So I pay attention to the relationship between corporate buy backs and new equity financing, and I pay attention to insider activity. Those are the kind of indicators that are in that sentiment and supply/demand category which are the second and third kinds of indicators I follow.

The fourth kind which we touched on at the beginning is intermarket analysis. The change in valuation of any alternative to equity will affect the supply and demand for equity. If bonds go up and down in price it changes the supply/demand picture for stocks. As commodities go up and down it changes the supply/demand picture for stocks. I follow them in the order in which I mentioned and the importance is in the order in which I mentioned them. The most important thing is trend and momentum, then sentiment and supply/demand, and then intermarket analysis.

One observation I would make is that a lot of people try to analyze market psychology and make a market judgment based on that alone and I think that is a terrible trap because indicators of sentiment and supply/demand are only important insofar as they occur against a certain trend backdrop. In other words, it is a mistake to say that everyone is bullish therefore I’m bearish, and you hear that all the time. Well that’s nonsense because during a strong trend everybody gets the idea and everybody is right for a while. It’s when the trend falters and the traders stay bullish that you get an important message. So you cannot use sentiment and supply/demand indicators for that matter inter-market analysis in isolation. You must start with an assessment of the trend.

M.C.: Very interesting. You also mentioned that you use subjective analysis. Is there any mechanical system you use as well as a filter in your work, or are you purely subjective?

P.R.: The only thing that is mechanical is how I get some of my ideas. I need to figure out what the strong stocks are and what the weak stocks are, and you can’t look at everything everyday. So I do look at the new high list and the new low list, I want to know where the relative strength and relative weakness is. That doesn’t mean that I want to buy a stock simply because it’s on the new high list but I’m probably going to be bullish rather than bearish on such a stock. That’s how I get some ideas. However, I do not have any mechanical buy or sell signals. I think if I were a trader rather than an analyst I would apply more systems like that but since I am an analyst and I do not manage a portfolio or manage money I can afford to be more subjective in how I do things. I am concerned with the relationship between risk and reward when I make a recommendation. If I am suggesting something for a short term trade, what I mean by that is a couple of months horizon, I’m always looking for at least a 2:1 profit-to-risk profile and I’m looking for more than 10% profit potential. Let’s say I’m looking for a 15% potential. I want to control my risk to half of that, 7%. On an investment basis, if I’m suggesting something for a longer term, six months or more, then I’m looking for at least a 3:1 profit to risk profile and I’m looking for a bigger return. I’m looking for 40 or 50% and I’m willing to take a 10-15% risk. Those are some of the parameters I’m using. Also, the risk levels always come from some chart point. If I can’t identify the risk clearly from some chart point, or there is no reasonably close risk level, I don’t use the stock. I’m not going to buy something simple because I think the trend is up. I have to be able to quantify what the risk is and it has to be from some reasonable point on the chart, a support level or a trendline or something like that.

M.C.: Do you apply fundamental or economic factors?

P.R.: Only in one sense - I am always interested in seeing if there is some consensus about the fundamentals because then we can see how the market reacts to that. If there is some consensus and we can get a good sense that there is a consensus, then that notion is probably discounted in the market and I’ll be looking for the opposite to pan out. But, no, I do not apply fundamentals at all. We have fundamental research here and my job is not to bump heads with the fundamental analysts. So I’m not going to emphasize stocks we have a different opinion on simply because it would be stupid from a standpoint of trying to do something business. I try to support the fundamental analyst. That doesn’t mean I’m going to prostitute myself, if I have a different opinion I say it. But I’m always going to try to emphasize the points of agreement just from the standpoint of doing business.

M.C.: As you said earlier, you really love the sentiment and supply/data figures because you like analyzing market psychology. Do you find that your own psychology or your own emotions at times affect your analysis?

P.R.: Absolutely. It’s the hardest thing for an analyst to do in my opinion is to stay objective. I don’t even manage my own money for that reason. I want to stay as objective as possible so my own money is managed. I have found that I make the most mistakes, or the biggest mistakes, when I think I know why something is happening. If I’m making my judgments strictly from the chart and am paying no attention to why a stock or the market is going up or down, I’m going to perform relatively well. If I think I know why for example, interest rates are behaving well I may want to buy stocks. Well if interest rates start performing poorly and then the market keeps going up, you’re saying, “What the heck is going on?” So staying objective is very important and it’s difficult and I think the biggest problem I have is everyday taking a look at things and everyday making a new judgment and trying not to be influenced by my own opinion. The hardest thing for anybody in making money in the markets is to admit you’re wrong and it’s the thing you have to do all the time. I make lots of mistakes and as long as they’re little, that’s no problem. Everyday you have to say, that stock I suggested yesterday, if I hadn’t suggested it yesterday, would I want to suggest it today? Everyday you want to force yourself to take a fresh look at things and not be affected by your previous opinion. It’s difficult but that’s what I try to do.

Matthew Caruso is an experienced independent trader. He recently passed his level 3 CMT exam and is currently an active trader and analyst for www.analyzingmarkets.com.
Equity Portfolio Manager:

Serious managers will utilize this course to analyze leading Wall Street valuation models and investment strategies for equities using fundamental, behavioral/technical and quant approaches, and then study how these are modified by the best performing equity portfolio managers to produce risk-adjusted excess returns. Also reviewed are: accounting and cash flow tricks that are sidestepped by professional investors, but punish many investors; various trading strategies, incorporating algorithms, hyper-trading, dark pools, and derivatives; new reporting requirements for regulatory considerations, consultants and clients as well as fund marketing techniques; and career advice to get the big bonus checks. An interactive investment workshop reinforces these skills when participants get to select stocks, choose a performance measurement method and then determine a marketing style and vehicle to create an investment approach producing excess returns. Case studies examining the investment approaches of leading versus average performing portfolio managers are also included. This intensive course goes beyond basics into the sophisticated and subtle strategies that can help achieve: “Top Quartile Manager”

Investment Fund Selection:

This is a must attend course for all professionals involved in the selection and management of third-party investment managers. Investment Fund Selection offers an insiders perspective into the various challenges in determining the most appropriate fund structure, managerial style and fund value-added performance of third-party investment managers in order to achieve individual investment objectives.

Reviewing different fund structures, such as mutual funds, private equity and hedge funds, participants explore regulatory, audit, established and recent portfolio performance measures and behavioral finance issues and learn about subtle tricks that some funds can use to “dress up” performance records and charge unwarranted fees.

A practical one-day investment fund selection workshop will also include various case studies and exercises to reinforce the definitive selection techniques learnt. Participants get to perform an investment fund selection role-play in order to evaluate and screen funds for specific investment criteria and answer the question: “Is my fund manager giving me my money’s worth?”

Fusion Analysis:

This is a must attend workshop that blends fundamental, technical, behavioral and quant strategies to exploit profitable opportunities in market investing by both investors and traders. Whilst the course focuses on US equities, fixed income, commodities and GCC stocks will also be considered as the techniques can be applied to other markets and asset classes. Given the plethora of strategies, the workshop will help create focused approaches to meet specific investment objectives. Fusion Analysis can create: “The better approach to investing”

Technical Analysis CMT 1:

A must attend 4-day course for investment professionals wishing to gain the CMT Level I professional qualification in Technical Analysis from the Market Technicians Association (MTA). Using real-life charts, participants learn traditional technical tools of charting and some more specialised topics. Whilst the course focuses on US equities, other markets including GCC stocks (Saudi, Kuwait & U.A.E etc.) and real estate will also be explored. An optional 1-day session entirely dedicated to exploring trading opportunities for US and GCC equities (Saudi, Kuwait, U.A.E etc), FX, commodities and bonds using technical analysis. Prior workshops correctly called the rise of the US market and the decline of the Saudi market by blending technical indicators. This course should help answer the question: “Buy or Sell and When”

Instructor John Palicka CFA CMT is the top-ranked portfolio manager with over 25 years experience of managing $ billions and he has doubled client money every four years since 1980*. His high course ratings from major investment firms reflect clear interpretations and practical applications of complex topics; knowledge applied to examples and cases found in the current worldwide and GCC marketplace; his experience with specific situations actually encountered in his career that parallel the learning topics.

To find out more about these cutting-edge courses, please call Esam Hassanyeh + 9714 391 0234 or visit our website: www.enhance.ae/opencourse.htm

* Past performance is no guarantee of future results *
MTA Board of Directors
Call for Nominations – 2007 Election

In May 2007, the members of the MTA will be asked to vote for two Directors, filling the positions currently held by Michael Kahn and Bradley J. Herndon, CFA, CMT. This year, those are the only vacancies on the Board. The following information, extracted from the Constitution is provided to help members identify nominees for these positions:

- Directors are elected for three year terms (Section C6.02)
- Section C6.05 defines the duties of the Board of Directors:
  A) The Board of Directors shall be responsible for the oversight and policy of the affairs of the Association.
  B) The Board shall be responsible for the final adjudication of all matters relating to the acceptance of new Members, the granting of professional resignations, all matters relating to professional ethics, and the censure, suspension or expulsion of Members or Affiliates.
  C) The Board shall be responsible for instituting a set of By-Laws under this Constitution, to govern the operation of the Association. Such By-Laws shall be subordinate to the Constitution and shall be adopted, or modified, in accordance with Section C15 of this Constitution.

The Nominating Committee requests nominees for these positions in accordance with BL7.02. Names may be submitted to Jordan Kotick, CMT, at jkotick@gmail.com no later than Feb 28, 2007 for consideration by the committee. As an alternative, Members may submit nominees directly by petition to the Secretary of the MTA. Nomination of a candidate for Director may be made in writing by a petition with at least ten percent (10%) of the Members, Honorary Members, and/or Emeritus Members in good standing with the Association. This will require about 65 names. Petitions for nomination, containing the original signature of each petitioner, together with the nominee’s written consent, shall be presented to the Secretary no later than March 30, 2007. E-mail signatures are acceptable provided they originate from the Member’s e-mail as listed in the official member directory and are subject to verification by the Secretary.

“What’s Hot”
The MTA Library Announces...

The MTA Library would like to announce that the following books have been added to our Library. Go to our website at www.mta.org and visit our Library to check out your copy today.

- “21 Candlesticks Every Trader Should Know” by Melvin Pasternak
- “Getting Started In ETFs” by Todd Lofton

The MTA would also like to thank those that have recently donated books to our library.

- Mebane T. Faber, CMT

Submitting an Article

If you are interested in submitting an article in the MTA’s monthly newsletter, please e-mail the editor Michael Carr, CMT at: editor@mta.org

If you have any questions about Technically Speaking please contact Tim Licitra at: tim@mta.org

New MTA Undertaking:
We Need Your Input

By M. Frederick Meissner, Jr., CMT

When I was President of the MTA, I started thinking about a project that would video some of the older, retired (or still practicing!) Technicians to create an “Oral History” of our craft. Like many ideas we have had over the years, other tasks seemed more important and this kept getting pushed back. The death of Kennedy Gammage, publisher of The Richland Report, on January 3, 2007, has given new impetus to this project (More about Kennedy and his career in the next newsletter). As a young Technician in Los Angeles in the 1980’s, Kennedy was one of my first mentors. Indeed, the first “real live” Technicians I met at the start of my career were Kennedy Gammage and Gene Morgan.

I would like the membership’s help in coming up with two lists. The first is a list of prospective interview questions. The idea is to ask each Technician the same questions so there is some commonality in the interviews. The second list is a list of Technicians to be interviewed. We will look at any suggestions you make and come up with a plan of attack. Please e-mail any comments and suggestions to Marie Penza at Marie@mta.org.

We have had some wonderful characters as well as some brilliant analysts in our profession. I want to be sure that, generations from now, people can get a sense of what our profession was like. Imagine seeing a live interview with Ralph Nelson Elliott, or W.D. Gann would be like for us today, and you will see what I am trying to accomplish.

February 2007