Robert Prechter authored the “industry standard” literature on Elliott wave theory back in 1978 and subsequently founded Elliott Wave International, which today employs 80 people in Gainesville, Georgia, providing research around the clock to subscribers throughout the world. Mr. Prechter has updated *Elliott Wave Principle* (1978/2005) to include new guidelines for each wave formation; he has also published *The Wave Principle of Human Social Behavior* (1999) and *Conquer the Crash* (2002).

Currently, Mr. Prechter is furthering his research on his theory of socionomics. He recently co-authored a paper with psychologist Wayne Parker for *The Journal of Behavioral Finance* (2007, Vol. 8, No. 2, 84-108) to illustrate the conceptual framework for examination by scholars and academics. The paper points out that traditional economic theory does not account for financial markets’ price action – which can more reliably be attributed to the new paradigm of socionomics. He has long held that events do not influence social mood, but rather social mood, which is endogenously regulated, motivates social action. The hypothesis is that humans’ unconscious impulses to herd lead to the emergence of social mood trends, which in turn shape the tone and character of social action. This perspective applies across all realms of social activity related to decision-making under uncertainty, including economic, financial, political and cultural.

NOTE: This interview is taking place as an online email exchange conducted over several days in early October 2007. Bob Prechter is in his office in Gainesville Georgia, and I’m in my office in Westport, Connecticut. This is a high-tech-world collaboration....

MS: Bob, thanks for doing this interview today. First, because this is an audience of technicians, and because you are famous for your Elliott wave work, how do you feel about the market in general right now – where do you see it in “Elliott wave” terms?

RP: It’s still in a bear market.

MS: What do you mean? The Dow is at all-time highs.

RP: In dollar terms it is, but in terms of real money and its ability to buy gold, oil and other things it’s been crashing.

MS: So how does this relate to Elliott waves?

RP: The Wave Principle explains why the latest new high is not part of the old bull market but is in fact a bear market rally. In January 2000, the Dow completed five waves up from 1932, thereby registering its “orthodox top,” the true end of the great bull market. The decline into 2002 was wave A of a bear market, and this rally is wave B. Wave C down is coming.

MS: Has this happened before?

RP: Yes, a smaller version happened from the 1970 low to the 1973 high. In 1973, the Dow and S&P made new all-time highs in nominal terms but were below their 1966 highs in terms of real money. The aftermath was a 45 percent drop in nominal terms. We face the same juncture today but on a much larger scale.

MS: As a result of inflation?

RP: No, as a result of a change in psychology. Inflation has been progressing consistently since 1933, but the market still rises and falls relative to real money, by which I mean gold. The Dow and S&P rose persistently in value relative to gold from 1980 to 1999. That was the real bull market, the biggest in history over just a two-decade period (Figure 1). Since then, investors have switched to preferring real money. These averages have lost 65 percent of their value in gold terms, and the NASDAQ even more. No one notices because optimism has yet to yield.

MS: What do you mean by “Elliott wave” terms?

RP: It’s still in a bear market.

MS: What do you mean? The Dow is at all-time highs.

RP: In dollar terms it is, but in terms of real money and its ability to buy gold, oil and other things it’s been crashing.

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MTA Membership:
This month we have a number of items on the docket...
First, I would like to wish those candidates that sat for the CMT Exam good luck. This administration, for levels 1 and 2, you will be notified of your score in 4-6 weeks. The reason for the delay is that there are several new questions added to both the CMT 1 and CMT 2 exams as a direct result of changes to the CMT 1 and CMT 2 reading assignments. To ensure that all candidates are treated fairly and in accordance with established industry practices, the CMT Accreditation Committee and Prometric will conduct an evaluation of the performance of each new question. This “psychometric” process allows us to evaluate how all CMT 1 and CMT 2 candidates performed on the new questions, thereby facilitating a determination of whether or not each question performed as expected. Moreover, this process helps to set the standard for future administrations and is strategically connected to MTA’s long term development of the certification process.

As you can see, and I’m sure you have read about it on the website and in e-mails, registration for the Mid-Winter Retreat is open. We are on pace to have a record turnout for this event. The number of hotel rooms at the discounted rate are limited, so if you are planning on attending, it is best to sign up sooner rather than later. With this great turn out, and the outstanding speaker list, there is no doubt that this is going to be the best Mid-Winter Retreat yet! If you have any questions please contact Tim Licitra at 646-652-3300.

Last but not least, is the call for Members to volunteer for the Nominating Committee. This is one of the MTA’s most important committees, in that you are responsible for selecting the slate for the Board of Directors. Please review the letter from Nominating Committee Chair, Jordan Kotick, CMT.

If there is anything you need, please contact our headquarters office. Have a great November!

Regards,

Tom Silveri
MTA Executive Director

From the Executive Director

From the Nominating Committee

Dear Members, Honorary Members and Emeritus Members,

Every year, the Nominating Committee chooses the slate for the Board of Directors that everyone eventually votes on at our MTA Annual Meeting (next Annual meeting in May-June, 2008). While thanking previously members who have served, the Committee is now totally open and I therefore need to hear from Members, Honorary Members and Emeritus Members who would like to serve on this important committee.

It is not too cumbersome a job but it is a key one since you will chose potential Board members that ultimately drive and lead the MTA in the future. For a more detailed explanation of the MTA Nominating Committee and its processes, please refer to the MTA By-Laws, Section BL 7.02 E. (Can be found in the “Mission” Section of our web-site).

I encourage all Members to apply, especially those Members outside the USA. I would really like to see this Committee reflect the diversity of the MTA membership.

Would all those interested please drop me an email with a very brief explanation of why you would like to serve and just a little about your background.

Please contact me at nominations@mta.org

Thank you,

Jordan Kotick, CMT
Nominating Committee Chair & Board Member

“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.

• “An American Hedge Fund: How I Made $2 Million as a Stock Operator & Created a Hedge Fund” by Timothy Sykes
• “Your Money & Your Brain” by Jason Zweig
• “The Psychology of Risk: Mastering Market Uncertainty” by Ari Kiev
MTA Mid-Winter Retreat 2008
SIGN UP NOW!!

Registration for the upcoming Mid-Winter Retreat is now open. It will be held January 25 - 26, 2008, at the beautiful Don CeSar Beach Resort at St. Pete Beach (outside Tampa, FL.). The theme of this event is “Technical Analysis Applied.” MTA membership registration fee is only $450!

For more information, or if you wish to register over the phone, please contact Tim Licitra at 646-652-3300.

Event Agenda

Thursday, January 24th. 2008
7:00 - 8:00 PM: Registration Reception

Friday, January 25, 2008 - Day 1
7:00 - 8:00 AM: Breakfast
9:00 - 10:00 AM: Jordan Kotick, CMT - “Forget the Textbooks: Technical Analysis that’s Relevant”
10:30 - 11:30 AM: Frank Teixeira, CMT, CFA - “Integrating Technical Analysis in Portfolio Management”
12:00 - 1:00 PM: Luncheon - Awards Presentation
2:00 - 4:00 PM: Market Forecast Panel Discussion Featuring: Jeff deGraaf, Phil Roth, Rick Bensignor and more!
6:00 - 7:00 PM: Cocktail Hour
7:00 - 9:00 PM: Outdoor BBQ

Saturday, January 26, 2008 - Day 2
7:30 - 9:00 AM: Breakfast
9:15 - 10:15 AM: Ned Davis - “Applying Sentiment”
10:30 - 11:30 AM: Hank Pruden - “The Three Skills of Top Trading”
12:00 - 1:00 PM: Luncheon - John Bollinger, CFA, CMT - “Yesterday Plus Today Equals Tomorrow”
1:30 - 3:30 PM: Rotating Roundtable Discussions - “Meet the Experts” Our current discussion moderators are: Ned Davis, Phil Roth, Sherman McClellan, Frank Teixeira, Jeff deGraaf, Hank Pruden, and John Bollinger.

Current Attendees*

- Acampora, Ralph
- Adams, Gregory
- Arbeiter, Mark
- Athanassie, Steve
- Berry, Harry
- Bollinger, John
- Carson, Edward
- Coradi, Richard
- Corbitt, Wayne (+1)
- Crutchfield, Tamalyn
- Davis, Ned
- deGraaf, Jeff
- Detrick, Ryan
- Epstein, Mike (+1)
- Geisdorf, William
- Giannini, Christina
- Gilchrest, Emerson
- Greenspan, Cary
- Hale, Samuel (+1)
- Henze, Neil
- Hetzer, Kristin
- Hunziker, Frank
- Hyde, Sean
- Jani, Ajay
- Jensen, Joni
- Jimenez, Raul
- Kahn, Michael
- Karaali, Orhan
- Kotick, Jordan
- Kerns, Lane
- Krebs, Cory
- Ladd, Michael
- Lauderdale, Patrick
- Licitra, Tim
- Livesey, William
- Martin, Peter
- McClellan, Sherman
- Meissner, Fred
- Messina, Sebastian (+1)
- Neunkirchner, Christian
- Nipper, Richard
- Powell, Robert
- Pruden, Hank
- Regan, Vincent
- Riger, Michael
- Roth, Phil
- Rueda, Adolfo
- Ryley, Robert
- Schuster, Robert
- Silveri, Tom
- Snively, Tim
- Sokoloff, Kim
- Teixeira, Frank
- Thomson, Dale
- Townshend, Katherine
- West, Timothy
- White, Clare
- Winer, Lawrence
- Wymes, Robert

Event Sponsors

* As of 10/25/07
In Depth With Robert R. Prechter, Jr.

continued from page 1

MS: That sounds bearish.
RP: You don’t know the half of it. Sustained optimism has created the greatest credit bubble in history. Credit and leverage have financed the bull market. But leverage works both ways. When the trend changes toward pessimism, the result will be something to see.

MS: When will wave C begin?
RP: The “when” of the collapse in dollar terms has eluded me. As a student of history, I have relied upon past extremes in trend, sentiment and valuation as a guide to indicating a major top. To give you some perspective, stocks rose by six times in the Roaring ’Twenties and ten times from 1942 to 1966, in terms of both dollars and gold. Those were big moves. But from 1980 to 1999, the Dow rose an amazing 32 times in terms of gold, and as of today it’s up 24 times in dollar terms since 1974. In 1929, the dividend yield for the Dow fell below 3 percent for a couple of months, and the market crashed. In 1992, the dividend yield fell below 3 percent and has stayed there ever since, for 15 years. In 2000 it was as low as 1.5 percent, half the level of 1929. And there have been more bulls than bears among advisors in 457 out of the past 466 weeks—a nine-year stretch. The percentage of bearish weeks over this period is below the average by a factor of ten, producing the most topsided ratio ever. So this period of optimism and overvaluation has dwarfed all others in extent and duration, by many multiples.

MS: I can see where that might throw you off.
RP: At least my short term skills have been intact lately. Each time the market made an intermediate peak in the past three years, I saw the signs and said so. But these historic extremes in valuation and optimism convinced me that each peak was the last, and the market has continually recovered. Yet the piper always gets paid, and when payment is delayed he generally charges you more. So I expect a long, deep price collapse, and the longer it takes to arrive the worse it will be.

MS: How does socionomics fit into this?
RP: Among many other things, socionomics explains why the market reaches valuations that later generations describe as absurdly low or absurdly high, like today.

MS: But that’s not so unusual.
RP: That’s exactly the point. It’s normal for financial markets to careen wildly from overvaluation to undervaluation. But can you recall this kind of thing happening in markets for sandwiches or lawnmowers?
MS: Well, Starbucks is expensive.
RP: So is everything else, thanks to inflation. But the price of a cup of coffee is not volatile, either over time or relative to other things, such as fried eggs and toast. Investment prices leap and fall continually, over time and relative to each other. But in the market for goods and services, prices are relatively stable. You don’t see the price of pistachio at the Westport ice cream shop soaring and crashing every few days or months. You pretty much know what the price of a scoop will be before you walk in.

MS: I wouldn’t buy pistachio if it were twenty dollars a scoop. I’d buy something else. But if it were a nickel, I’d stock the freezer.
RP: Precisely. In the marketplace for goods and services you use your reasoning power to decide whether a purchase is a good use of your money. This is called “maximizing the utility of your resources.” When steak gets too pricey, you buy chicken, and vice versa. When there’s a sale on, you rush out to buy more. But—and this is crucial—when prices go down in the stock market—in other words, when there’s a sale—almost everyone wants to own fewer shares. And when prices go up, investors buy more. See the difference? Theoreticians either ignore this fact or call buying high and selling low a “temporary anomaly,” but it is the rule in financial markets. And it’s the opposite of the rule that holds in economic markets. This is a fundamental difference between the two.

MS: O.K., so that’s why your paper is titled “The Financial/Economic Dichotomy.”
RP: Right. And in the world of financial theory, this is a radical idea. For half a century the reigning model, called the Efficient Market Hypothesis, has said that financial markets are just like economic markets: People take all information into account and buy or sell according to what’s reasonable. But if they did that, they would buy more when prices were low and less when prices were high, wouldn’t they? But they don’t.

MS: Is that the only thing wrong with the old theory?
RP: Oh, no. It’s full of errors.

MS: Like what?
RP: Economic theory says that prices seek equilibrium. It says they are random. It says they are objectively determined. It says they are completely unpredictable. None of this is true. So the old theory is broken. We need a new theory.

MS: Which is…?
RP: My colleague Wayne Parker and I call it the socionicomic theory of finance, or STF. Under our model, prices are dynamic, not stable; they are subjectively, not objectively, determined; they are not random but patterned; they do not seek equilibrium but instead conform to the Wave Principle; and they are probabilistically predictable because herding is patterned. We have a table (Table 1) expressing ten stark theoretical differences between STF and traditional theory.

<table>
<thead>
<tr>
<th>Efficient Market Hypothesis (EMH)</th>
<th>Socionomic Theory of Finance (STF)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Objective, conscious, rational decisions to maximize utility determine financial values.</td>
<td>1. Subjective, unconscious, prerotational impulses to herd determine financial values.</td>
</tr>
<tr>
<td>2. Financial markets tend toward equilibrium and revert to the mean.</td>
<td>2. Financial markets are dynamic and do not revert to anything.</td>
</tr>
<tr>
<td>3. Investors in financial markets typically use information to reason.</td>
<td>3. Investors in financial markets typically use information to rationalize mood-induced imperatives.</td>
</tr>
<tr>
<td>4. Investor decisions are based on knowledge and certainty.</td>
<td>4. Investor decisions are fraught with ignorance and uncertainty.</td>
</tr>
<tr>
<td>5. Exogenous variables determine most financial decisions.</td>
<td>5. Endogenous social processes determine most financial decisions.</td>
</tr>
<tr>
<td>6. Financial prices derive from individual decisions about value.</td>
<td>6. Financial prices derive from trends in social mood.</td>
</tr>
<tr>
<td>7. Financial prices are random.</td>
<td>7. Financial prices adhere to an organizing principle at the aggregate level.</td>
</tr>
</tbody>
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Table 1. Contrasting Models of Finance

MS: That’s a lot of differences. And what’s this about the law of supply and demand not pertaining? That sounds really radical.
RP: No kidding. But the law of supply and demand is irrelevant to financial markets. There are no producers and consumers in financial markets, just investors. So there are no balancing forces on price. The law of supply and demand reigns at the shopping mall because consumers are pretty
In Depth With Robert R. Prechter, Jr.
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certain of their needs and resources, so they can reason their way through the decision process. But investors are uncertain because they have no basis to decide a fair price. In the financial context, knowing what you think is not enough; you have to try to guess what everyone else will think. It’s not easy to use reason to figure that out. When everyone faces this dilemma, the result is herding. Herding is an unconscious impulse, not a reasoned response to prices and values. So financial markets follow a different law. We say that economic prices conform to the law of supply and demand but financial prices conform to a law of patterned herding.

**MS:** Then what makes prices fluctuate?

**RP:** The herd has little basis to judge what others will think about values in the future, so the main determinant of aggregate prices is the mood of the crowd, the social mood, whether it is optimistic or pessimistic, hopeful or fearful. Social mood has a fractal structure, little waves inside bigger waves, which accounts for the fluctuations in the market of all different sizes.

**MS:** What do you mean when you say that social mood is “endogenously regulated”?

**RP:** Social mood does not react to current events, as most people think. Its fluctuations result from the internal mental processes of members of the herd.

**MS:** I thought events like wars and scandals affected social mood.

**RP:** Everyone thinks that. When the Enron scandal hit, the media all said it was affecting investors’ mood negatively. But I did a study showing beyond question that the Enron scandal did not have a negative effect on investors’ mood, which in fact got more positive throughout the whole episode. There is no correlation between wars and the direction of social mood as recorded by stock prices, either. Sometimes it’s up, sometimes down and sometimes net sideways. But there is a great correlation in the other direction. When the social mood gets more negative, it triggers scandals and wars.

**MS:** Does research back this up?

**RP:** In our paper we cite research showing that humans herd, that they are under the influence of powerful unconscious motivations, and that outside events have at most transient effects on stock prices. I’ve done a lot of correlation studies, but as yet they are not peer-reviewed.

**MS:** Are you saying that news doesn’t matter to stock prices at all?

**RP:** We have to be careful to distinguish between social mood, which is endogenously regulated, and emotions, which are transient, usually conscious, reactions to outside stimuli. Dramatic news can affect market prices for a few minutes or a day because they temporarily trigger emotional reactions. But news—no matter how dramatic—doesn’t change social mood. People have said, “Come on, Bob, what if a nuclear war broke out?” But the answer is the same. People never seem to ask where the war would come from in the first place. War doesn’t happen by chance but as a result of a trend toward negative social mood. So you can use social mood to predict social events but not the other way around. Even if you knew every news event in advance, you couldn’t predict the stock market. This is a counter-intuitive claim, because we hear about supposed news causality all day long on financial TV and in newspapers.

**MS:** It seems a lot of thought goes into all those explanations.

**RP:** Which brings up another aspect of STF. We argue that most of the talk about where stock prices are going is rationalization. People have no idea where prices are going, so to satisfy the reasoning portions of their brains, they make up reasons to justify their buying and selling actions, which are in fact motivated unconsciously by social-mood herding.

**MS:** Are you saying all that talk is just air? So much of it seems to be high-level reasoning.

**RP:** The lack of proper reasoning is palpable. When markets are hot, commentators can talk all day long about reasons to own investments. But when stocks are cheap, almost no one talks about the stock market; they talk about something else. Is that high-level reasoning? But it’s more serious than that. We have graphed the market relative to all kinds of causal claims, such as that stocks respond to economic figures, political trends, peace and war, trade deficits, federal spending, scandals, demographics, you name it, and there is no consistent causal relationship between any of these outside factors and the future course of stock prices. None of it affects how investors really behave.

**MS:** So there is no correlation at all?

**RP:** On the contrary, there is an excellent correlation! But it is in the opposite direction of what everyone thinks. Stock price changes precede changes in economic production, election results and peace and war. They also coincide with changes in fads and fashions. All of these correlations show that social mood, which propels stock prices, is also manifest in many other areas of human expression. Economic and political trends lag the stock market because it takes time for people’s decisions to affect those areas. So again, social mood is primary; it determines social actions.

**MS:** What does all of this mean for technicians?

**RP:** It’s the basis for the whole profession.

**MS:** What do you mean?

**RP:** Economists have long judged technicalicians as delusional. And if economic theory pertained to finance, they would be! Think of it this way: Wouldn’t it be crazy to study past prices of shoes as if they meant anything about the future prices of shoes? That’s how economists view technicians studying patterns of prices and other investor behavior. And their view logically follows for economists, because their premise is that stock prices are no different from shoe prices: economics and finance are the same. But the socionomic theory of finance erases such objections and justifies technicians’ pursuits. Investors are not reasoning but unconsciously herding, and unconscious processes aren’t random; they proceed according to mental constructs. That’s why financial markets display patterns such as persistent trends, head and shoulders formations, trend channels, Elliott waves, and so on. Of course, it is also possible to perceive patterns that don’t exist, but economists are hardly immune from that problem.

**MS:** So it’s really economists trying to explain stock price movements in terms of outside causes who are delusional?

**RP:** Well, I would say they are laboring under a misconception. Let’s look at some examples, and you can decide. Economists have repeatedly stated that expanding trade deficits are bearish. But a graph of the U.S. trade deficit shows that for 30 years a widening trade deficit has coincided with a stock market boom and an expanding economy. Still, economists keep making statements contrary to the evidence. Why? Because their argument seems logical — to hell with the data. The same thing is going on right now with respect to the Fed’s latest discount-rate cut. Economists quoted in the news say that such a cut is a stimulus and is therefore bullish. But falling interest rates throughout the early 1990s didn’t stop the Japanese stock market from having its biggest decline ever, did it? Interest rates fell throughout the bear market of 2000-2002, but that didn’t stop the S&P from sliding 50 percent, in nominal terms, mind you, despite continuing inflation. And rising rates have accompanied the stock market recovery since 2003. If you were to look at only these data, and if you had no idea what they represented and had no prejudicial beliefs about causality, you would conclude that stocks tend to fall as long as the interest-rate line falls, and stocks tend to go up as long as the interest-rate line rises. The last time the Fed surprised the market with an interest-rate cut was January 2001. The S&P had one of its biggest one-day rallies ever. Then it immediately turned down and fell in the biggest decline in over 60 years as rates fell all the while. None of this fits the “stimulus” theory of falling rates. Chartists tend to be empiricists. They look at data, which puts them way ahead of the game. Traditional economic theorists ignore a lot of data. They have to in order to keep believing in their model of outside causality. So who are more useful, economists who
In Depth With Robert R. Prechter, Jr.
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devise theories of external causality or the chartists who study history?

MS: But economists know a lot about their subject.
RP: Yes, they do. But again, that’s the point of our paper: Economics and finance are completely different fields. Economists are highly useful in their own field, where the law of supply and demand rules. But in the field of finance, where the law of patterned herding rules, they are lost.

MS: But technicians are often lost, too.
RP: Sure they are! I’ve proved that one myself. But socionomic theory properly elucidates the problems we face as analysts and investors. Herding is non-rational, which means it has its own curious illogic. Our minds are well suited to work out logical problems, but it is poorly trained in guessing the future course of crowds. Our brains are designed to participate in crowds, not analyze them. And the herding impulse is also immensely powerful. So it’s nearly impossible for an analyst of any type—economic, fundamental or technical—to overcome his own impulses to herd and just perform cold, impassionate analysis. The socionomic theory of finance explains why most investors lose money over the long run: They are herding, so they buy high and sell low along with the crowd.

MS: But doesn’t traditional theory account for this by saying no one can beat the market?
RP: Yes, the random walk and unpatterned multifractal models also account for the failure of most investors to succeed, but they do not explain why a tiny handful of investors gets super-rich. Our theory allows for the success of a few investors, namely, those who learn a lot about market behavior and who can also overcome their own herding impulses to some degree. It’s a rare combination, but it exists.

MS: Technicians, and even the Graham-and-Dodd fundamentalists, have always operated under the belief that random walk is wrong. They both believe that the market provides buying and selling opportunities.
RP: Yes, and now they have a theory of market behavior to back them up.

MS: Do you think more universities will teach technical analysis?
RP: Academics and practitioners seem to be coming closer together, and the field of socionomics provides a new basis for understanding finance and therefore a scholarly basis for teaching technical analysis.

MS: Maybe someday the herd will get it.
RP: The herd never gets it, but a thoughtful individual can always learn something new.

MS: Where can readers get a copy of “The Financial/Economic Dichotomy”? RP: The Journal of Behavioral Finance wants a few bucks for it, but the price is reasonable; after all, it’s an economic market! To order it, just go to http://www.leaonline.com/toc/jpfm/8/2.

You can email Prechter at bobp@elliottwave.com

Molly Schilling is an independent trader and freelance writer.

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EQUITY PORTFOLIO MANAGER

INVESTMENT FUND SELECTION

TECHNICAL ANALYSIS CMT 1

INTRODUCTION TO STEALTH TRADING USING FUSION, ALGORITHMS, AND DERIVATIVES FOR PROFESSIONALS

- Taught by John Palicka CFA CMT -

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”

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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?”

TECHNICAL ANALYSIS CMT 1:

A must attend 4-day course for investment professionals wishing to pass the CMT Level I professional examination in Technical Analysis from the Market Technicians Association (MTA). Using real-life charts, participants learn traditional technical tools of charting and some more specialized 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”

INTRODUCTION TO STEALTH TRADING USING FUSION, ALGORITHMS, AND DERIVATIVES FOR PROFESSIONALS:

Today, portfolio managers increasingly must use stealth trading in order to disguise their intentions and thus benefit from best execution. The old ways of staring at a Bloomberg to get bid/ask quotes and transacting an order is gradually being supplemented by more sophisticated strategies to meet various investment goals. The objective of this course is to give the student an introduction to various trading strategies that can achieve best execution. This course should help achieve: “Best Execution.”

Instructor John Palicka CFA CMT is a top-ranked portfolio manager of Global Emerging Growth Capital (WWW.GLEGEC.COM) with over 25 years experience of managing $ billions and, he has doubled client money, on average, 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 in GGC locations, please call Esam Hassanyeh + 9714 391 0234 or visit his website: www.enhance.ae. John also teaches these courses in New York at the New York Institute of Finance, website: WWW.NYIF.COM

* Past performance is no guarantee of future results.
US Oil Consumption and the Needs of the Military

By Molly Schilling

Ed Note: While not strictly technical analysis, Molly considers supply and demand from a unique perspective and her article highlights the value of analyzing the news from this viewpoint.

In 1911, Winston Churchill, then First Lord of the Admiralty, converted the British fleet from Welsh coal to foreign oil. The resulting gain in speed, and decrease in logistics burden, gave the British navy a decisive advantage over Germany’s Bismarck. This shift toward a foreign source of energy catalyzed what now has become a century-long geopolitical scramble—of major economic powers continuing to seek and secure oil. (1)

Astute traders have likely eyed the unending upward momentum of crude oil over the last year and wondered what pattern will finally present itself as a reversal, and what kind of duration that pattern will signal and entail. As Technical Analysts, we look for continuations and reversals—after all, Dow himself counseled that any tide that comes in will eventually go out. And some of us have wondered how much the ongoing price of oil is related to our Military activity in Iraq (and elsewhere), and if US oil demand—as well as price—may de-escalate once our war strategy is altered (for whatever reason). A new study shines a light, so to speak, on the dilemma of scarcity and dependence, and detailing the nature of a “Herculean” transition from traditional energy sources to new and alternative sources. We thought it might be helpful if we brought some of the detail of this important study to the attention of our traders:

“Over the past several decades, the United States has become increasingly reliant on imported energy, primarily from petroleum. The Energy Information Agency (EIA) forecasts that US dependence on petroleum imports will increase to 68% by 2025. DoD, the largest US consumer of energy, also relies on foreign supplies of crude oil and the finished transportation fuels (such as military jet fuel) that are derived from it. Fuel represents more than half of the DoD logistics tonnage and more than 70% of the tonnage required to put the US Army into position for battle. The Navy uses millions of gallons of fuel every day to operate around the globe, and the Air Force—the largest DoD consumer of fuel—uses even more.” (2)

The Pentagon Office of Force Transformation and Resources, which is responsible for addressing future security challenges, commissioned LIM, a government consulting firm, to produce a report called “Transforming the Way DoD Looks at Energy.” The Study is intended to be a potential blueprint for a new military energy strategy, and includes a detailed survey of potential alternatives to oil—including synthetic fuels, renewable biofuels, ethanol, and biodiesel fuel as well as solar and wind power, among many others. (3)

Here are consumption statistics from 2005: “In FY05, the United States (overall) consumed about 20 million barrels per day. Although the entire federal government consumed 1.9% of the 20 million barrels, the Department of Defense (DoD) -- consumed more than 90% of the 1.9% -- or let’s say it consumed 1.65%. (4)

More recently, the Air Force has spent about $5 billion a year on fuel, mostly to support flight operations. The Navy and Army are close behind. Of all the cargo the military transports, more than half consists of fuel. About 80% of all material transported on the battlefield is fuel. The Military’s energy consumption has steadily grown as its arsenal has become more mechanized and as US forces have had to travel farther distances. (5)

In World War II, the United States consumed about a gallon of fuel per soldier per day, according to the report. In the 1990-91 Persian Gulf War, about 4 gallons of fuel per soldier was consumed per day. In 2006, the US operations in Iraq and Afghanistan burned about 16 gallons of fuel per soldier on average per day, almost twice as much as the year before. (6)

Further, the present Iraqi Surge, beginning in April 2007, pushed about 21,000 more troops into theater, increasing US Military oil demand by 333,600 bbl/day -- while refinery maintenance was taking supply offline (by approximately 6% of US refining capacity). With total troop strength of about 150,000 in Iraq and another 18,000 in Afghanistan, that puts war demand at 2,688,000 bbl/day. Current total US consumption is about 20.8 million bbl/day on average.* That puts the Surge at an increase of 1.6% and total war use at 2.9% of US consumption.

Simply put, our present need for oil for Military operations far exceeds what we needed in the past—even what we needed one year ago; and part of the dilemma is that moving to alternative energy sources on a large scale would “challenge some of the department’s most deeply held assumptions, interests, and processes,” the Report suggests. (7)

Weaning the Military from fossil fuels will be a Herculean task—because the bulk of the US arsenal -- the world’s most advanced -- is dependent on fossil fuels and those military systems have been designed to remain in service for at least several decades. (8)

To further complicate the situation, the DoD -- although highly dependent on supply and the single largest user -- cannot by itself, drive the market. Therefore, the DoD’s operations (the capabilities, costs, and the strategy that define them) rely heavily on the petroleum market—making it vulnerable to the price and supply fluctuations affecting all of us. (9)

On the other hand, the US Military leads as an influence in the broader national effort to reduce dependency on foreign oil; and “The Pentagon’s efforts in this area (developing alternative fuel sources for new weapon systems designed for alternative fuels) would have a huge impact on the rest of the country” says Milton R. Copulos, National Defense Council Foundation President and an authority on the Military’s energy needs. “We are at the edge of a precipice and we have one foot over the edge…The only way forward is to move aggressively with alternative fuels. Just cutting back won’t work.” (10)

Military Needs Going Forward

The report admonishes that a continued US Military reliance on fossil fuel poses a serious far-reaching risk to national security.

“Despite the apparent near-term availability of oil supply, or perhaps associated with the caveats related to stable and functioning markets, competition for world energy supplies appears to be increasing. All over the world, importers are increasingly finding themselves in direct competition over sources and strategic shipping routes. Japan and China are continually trading diplomatic blows and threats over off-shore petroleum reserves south of Japan. In 2003, China’s President Hu Jintao also expressed concern over the “Malacca Dilemma,” the reputed US ability to control the Straits of Malacca, through which much of China’s energy flows. As a result, China has taken a “string of pearls” approach to develop bases and military relationships that will improve the security of its oil supplies and transit lanes. China has also embarked on a strategy to secure oil equity interests in Latin American, Canada, Russia and Africa. (11)

What this means, essentially, is that the rising cost and dwindling supply of oil -- the lifeblood continued on page 9
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of fighter jets, warships, and tanks -- will make ultimately make the US Military’s ability to respond to hot spots around the world -- which is part of their post-cold war objective -- “unsustainable in the long term.” (12)

The US Military has changed its posture in recent years: during the Cold War, US forces were deployed across numerous bases all over the world; since then, we’ve downsized our force and closed many of our former bases in Asia and Europe. (13)

The Pentagon’s current strategy, however, places great emphasis on being able to deploy forces quickly around the world -- now from bases here in the United States. The anticipated missions call for an increased US Military presence around the globe to combat international terrorist groups and to respond to humanitarian and security crises.

These are mission specific deployments which will involve high costs. Aviation fuel consumption alone, for example, has increased 6% over the last decade, and the report predicts that this trend will continue. (14)

“The US Military will have to be even more energy intense -- locate quickly in more regions of the world, employ new technologies, and manage a more complex logistics system.” According to the report, “Simply put, more miles will be traveled, both by combat units and the supply units that sustain them, which will result in increased energy consumption.” (15)

Broadly speaking, energy costs have doubled since the terrorist attacks of September 11, 2001. The cost of conducting these new and complex operations could become so expensive in the future that the Military may find itself unable to pay for some of its new weapon systems. (16)

Foreign Policy Considerations

Ensuring access to dwindling oil supplies not only carries a big price tag -- it points to the rather terrible irony of our national security dilemma:

“The dependence on and competition for world energy supplies constrain the foreign policy and national security objectives of oil importers. The United States has long taken an energy-based security interest in the Middle East even though the US receives on 17% of its oil from the region (and spends 44 billion each year safeguarding oil supplies in the Persian Gulf). Meanwhile, net exporters -- such as Russia, Iran, Sudan, the Central Asian republics, Venezuela, and even Saudi Arabia -- are emboimded to leverage energy sources to achieve political gains that are usually inimical to many of the oil-importing states. Examples include Russia’s restricting natural gas to former republics (and Europe), Iran’s development of nuclear capability, Sudan’s actions in Darfur, and Saudi Arabia’s weak support for human rights.”

“Because small changes in supply or demand can have large price impacts, the dependence on oil to fuel the global economy will continue to have negative implications for our national and economic security. The Council on Foreign Relations Energy Security Task Force estimates that a 1% change in supply (or demand) can have a 5% to 10% impact on price. As long as our global economic partners remain significant oil consumers, the United States would still feel oil price shocks even if it could achieve energy “independence.” This shock would come in the form of higher finished good prices from our fastest growing trade partner, and potential geopolitical competitor; China. Also, our European partners, who are more reliant on Middle Eastern and Russian oil than we are, would likely suffer an economic downturn that would limit their purchase of our products.”

“In short, oil considerations are a key component of our economic security and a significant driver of our national security posture. As former Secretary of State George Schultz noted: “Once more we face the vulnerability of our oil supply to political disturbances. Three times in the past thirty years (1973, 1978, and 1990) oil price spikes caused by Middle East crises helped throw the US economy into recession. Coincident disruption in Venezuela and Russia adds to unease, let alone prices, in 2004. And the surging economies of China and India are contributing significantly to demand. But the problem far transcends economic security and involves our national security. How many more times must we be hit on the head by a two-by-four before we do something decisive about this acute problem?” (17)

Some policy observers believe competition for energy sources may lead to conflict. Others, however, believe this outcome can be avoided through the development and eventual deployment of alternative weaponry, alternative energy sources, enhanced energy efficiency and demand reduction, as well, of course, as increased cooperation to ensure the security and efficiency of international oil markets. However, as the report points out, Herculean tasks don’t happen quickly.

The Report goes into great detail regarding the potential alternatives for systems as well as energy sources that could be developed by the Military. For this detail, go directly to the website.

Footnotes:


Pentagon Study Says Oil Reliance Strains Military: Urges Development of Alternative Fuels. By Bryan Bender. The Boston Globe. May 1, 2007 (Bender@Globe.com)

Sources and direct quotes for (3), (5), (6), (7), (8), (9), (10), (12), (13), (14), (15), (16).

Globalization makes it possible for large traders to profit from the best opportunities around the world. Hedge funds employing these strategies make large bets based upon macroeconomics and are run by traders such as George Soros. Although the extensive research capability required to be successful in the global marketplace alongside great traders has prevented the small investor from participating in markets beyond their borders, here is a product the narrows the gap.

VectorVest Europe, an innovative new product from VectorVest, has dissolved this barrier between small investors regarding countries in Europe, allowing for technical and fundamental evaluation of companies trading in Amsterdam, Vienna, Brussels, Paris, Xetra, Berlin, Madrid, Irish, Milan and Lisbon, a total of ten exchanges in a single software platform.

VectorVest has long offered similar products for the United States and Canadian markets, and more recently the United Kingdom and the European version brings the same capabilities found in those softwares. Those packages were detailed in “The Fusion Trader’s Secret Weapon, A Review of VectorVest Online Software” by Matt Blackman in the December 2006 issue of Traders magazine. That review concluded:

“VectorVest is a useful tool for the fusion trader or investor. Like all great players before them, the best of tomorrow will be those who realize that the key to success in the market is finding and using anything that works in keeping them one step ahead of the competition.”

VectorVest Europe offers the opportunity for small traders to identify the best investment within an entire continent rather than in just a single country. Can small traders benefit from having access to screening tools that let them invest beyond borders and act more like hedge funds? VectorVest Europe provides investors and traders alike with an answer to this question.

Getting Started

Users will need an account to install the software. A low-cost, five-week trial is available at www.vectorvest.com. After logging in, users will immediately access an overview of the European markets (Figure 1) and the full functionality of the software will be available after an automatic download and installation which takes place during the new user’s first visit. In moments, traders can access complete analysis on more than

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1,800 stocks, 160 different Industry groups, and 39 Business Sectors.

Using the system

In the center of the home page, the Color Guard provides an immediate and simple to understand guide to current market conditions. Green indicates bullishness, yellow suggests traders should consider a cautious approach towards the markets, and red signifies the short-term market outlook is bearish. The market is defined as the VectorVest Composite Europe (VVC/EU), the average price of all stocks in the database. In mid-May 2007, the indicator was green, somewhat bullish as defined by the underlying indicators. With a quick glance, traders can see the daily change in nine European market indexes on the left side of the screen, and several unique market timing indicators are just below the Color Guard.

Each stock in the database is rated a buy, sell or hold. The determination of the ranking is completely objective, and relies in part upon the relationship of price to a modified 13-week moving average. The percentages of stocks in each category, along with the buy-sell ratio are updated daily.

Here is a summary of some of the indicators available in the program.

RT (Relative Timing) is a proprietary indicator that quantifies a stock’s price trend. It’s a modified relative strength calculation, incorporating an analysis of directional movement, range, and stability of a stock’s price action over varying time frames from one day through one year. RT is designed to be sensitive to price changes so that it will move rapidly upward from bottoms and quickly reverse lower from top formations. VectorVest recommends that stocks have an RT value of at least 1.0 on a 0.00 to 2.00 scale before they are considered for purchase.

Market Timing Indicator (MTI) is designed by VectorVest to represent the overall direction and strength of the market in a single indicator. It combines the other indicators on this page into a single indicator, again ranging from 0.00 to 2.00, with readings above 1.00 meaning the market is bullish. The values of this indicator for the past six months are shown in the graph on the right side of the screen. This indicator has a long, well documented history of reliability, and profitability in the U.S. markets. The real-time track record for the VVC/EU dates back only two years, but has outperformed the buy-and-hold investor by about 1.5% over that time with less risk. The MTI and RT indicators are shown in Figure 2, and their performance is better than a simple moving average system.

For more information on these and other indicators and fundamental criteria provided by the program, please see http://www.VectorVest.com/definitions

These market timing tools are a valuable part of the VectorVest service. Most traders want to get in close to the bottom, maximizing gains in bull markets. Looking deeper at what VectorVest offers, the buy-sell ratio seems like it would work well as a market breadth indicator. Visually, Figure 3 shows that this indicator holds promise as a buy signal. When the indicator crosses above 1.0 from below, traders can safely enter the markets, usually ahead of moving average signals or the signals generated by other indicators. Using the longer history available in the U.S. markets confirms this idea. Unfortunately, it’s tougher to spot sells with this approach since overbought markets can become overextended before pulling back, and strong breadth readings can indicate sustainable moves.

Again applying insights from VectorVest’s U.S. market data, spotting a bottom can be fine-tuned even more by using the actual percentages of VectorVest’s buy, sell and hold rankings to reliably call bottoms within days. Historically, oversold markets show a large percentage of sell recommendations which means a large number of stocks are trading below their 13-week moving averages. When the price of the VVC/EU is trading below its 13-week moving average, waiting until the number of sells is greater than 40% and then buying after the percentage of sells decreases identified major market bottoms within a week of the actual low. This indicator, along with the VVC/EU is shown in Figure 4. Only one signal was generated with this approach over the past two years, timing the bottom to within one week. There are more signals, equally reliable, using the U.S. data.

Given these market timing tools, aggressive traders can base their leverage on the market climate, enjoying the rapid gains often enjoyed after a bottom is confirmed alongside successful hedge funds who are certainly participating. Conservative investors can move to cash based upon the MTI or RT alone, and buy into markets again when these indicators provide a margin of safety. VectorVest will help traders of any temperament select the right stocks at the right time. Determining what to buy is also easy with VectorVest. Looking again at Figure 1, the home page provides a list of purchase candidates based on value, safety and timing rankings.

For each stock in their database, VectorVest calculates a series of ranking stock indicators in a number of ways. Among these tools, Relative Value (RV), Relative Safety (RS), and Relative Timing (RT) are combined into a single indicator, VST, which is then scaled from 0.00 to 2.00, as are all of their proprietary indicators. RV compares the long-term potential for capital gains to the yield available on long-term corporate notes. RS looks at the company’s size and record of financial performance, rewarding the stocks of companies with low debt to equity ratios, above average price stability, and a propensity to rise in price with high RS values. RT for individual stocks is similar to the RT indicator for the overall market. It provides an indication of the expected direction of price movement in the short-term. The highlighted list on the home page represents the top five buy candidates from all the European markets, an incredibly efficient way for small traders to scan multiple markets for trading ideas.

Also on that information-rich home page are a list of leading industries and sectors. Clicking on one of these groups will bring up a list of stocks within that group, across all the exchanges, sortable by a variety of user preferences. Complete fundamental and technical data can be accessed by clicking on any symbol from that list. Additional links provide access to recent headlines about the stock, and charting capabilities to gauge the technical pattern of the equity.

Detailed stock analysis and a wide array of pre-built searches are available from the menus. These capabilities are impressive, and provide more tools than most traders will ever need to use.

Figure 1 - VectorVest Europe Home Page. Chart by www.VectorVest.com

Technically Speaking

www.mta.org

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Figure 1 - VectorVest Europe Home Page. Chart by www.VectorVest.com
These features were very well explained in the December 2006 review reference earlier, which can be accessed online at http://www.traders-mag.co.uk/medien/heft0612a0012.pdf (free registration required). By providing so much, VectorVest is certain to meet the needs of the trader and longer-term investor alike.

**Other Features**

Daily updates are available by 18:30 Greenwich Mean Time, allowing even part-time traders ample time to review the markets, review some trading ideas and place their orders before the next day’s trading gets underway. For the full-time trader who wishes to conduct a more indepth examination of stock candidates, VectorVest provides a detailed commentary on the day’s market action and the Unisearch tool includes a collection of long and short stock scans to search for more ideas. Users can also create custom scans using Unisearch to identify stocks based upon combination of criteria in the database.

Online help includes VectorVest University, a useful collection of videos that help the user get started, and help the experienced user implement new ideas. A weekly service, VectorVest Views presents a detailed summary of the past week, allowing those who want to learn more to study the report for insights into indicator behavior. This service also provides a weekly update on economic conditions within the European Community, collecting data from the various markets into single indicators. In some ways, it’s like having an independent economist report provided on a weekly basis.

**Conclusion**

Time required to conduct research and availability of data for foreign exchanges has long hindered the performance of the individual trader. This product specifically designed for those trading European markets effectively removes this barrier.

Affordable multi-market analysis has been beyond the grasp of individuals for years. VectorVest Europe is a giant leap in capability for individuals, putting them a step closer to the depth and quality of institutional information systems, at less than one-tenth the cost. With market timing tools and in-depth stock analysis, traders have virtually everything they need in a single package. This product has the potential to put traders one giant step ahead of the competition.


Matt Blackman, the host of www.TradeSystem-Guru.com a website devoted to educating traders and investors on finding the best tools and resources available, is a technical trader, author and keynote speaker whose work has appeared in a number of major financial publications, websites and newsletters. He is a member of the Market Technicians Association (MTA) and Technical Securities Analysts Association (TSA).

Mike Carr, CMT is a private trader. He holds the Chartered Market Technician designation, is a member of the Market Technician’s Association and editor of the MTA newsletter Technically Speaking.

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