Letter from the Editor

The MTA Annual Award recognizes significant accomplishments in the field of technical analysis. It has been bestowed for pioneering work, an insightful innovation, or an extraordinary career. This year’s winner offers an example of an extraordinary career. Robert Peirce, the 2010 Annual Award winner is discussed briefly in this issue, and his story illustrates that technical analysis can be applied to investment management.

All too often we hear that technical analysis is not widely accepted in the finance world. Nothing could be further from the truth, and Bob Peirce is but one example among many where technical analysis was applied professionally.

One problem that does damage the reputation of professional technicians is that many people attempt to apply technical analysis without possessing great skill or applying sound techniques. The best defense against the misconceptions inspired by poor analysis is quite possibly your MTA membership. We discuss that idea elsewhere in this issue and hope that all members will let potential employers and clients know that they are bound to follow the industry’s highest professional and ethical standards. Your MTA membership is proof of professionalism.

As usual, we also offer examples of excellent analysis in Technically Speaking. Tom McClellan is advancing the work of his parents, and Sherman McClellan is another example of an individual who has enjoyed an extraordinary career in technical analysis. Their work is highlighted this month.

We hope that the articles in this issue will inspire you to achieve greatness in your career as Robert Peirce and Sherman McClellan have.

Sincerely,

Mike Carr, CMT

Robert Peirce: 2010 MTA Annual Award Winner

In the November 1987 issue of the MTA Journal, Gail Dudack wrote a short paragraph which may very well be the best description of the Award:

It is written in the constitution that one of MTA’s prime goals is to encourage high standards of professionalism and ethics among technical analysts. In the spirit of this goal, the MTA initiated an Annual Award for Outstanding Contribution to the Field of Technical Analysis in 1974. The Awards Committee, consisting of three past presidents of the MTA, has selected the following technical analysts to receive the engraved silver Revere bowl award…

Gail then listed the first winners, true pioneers in the field. Since the first Award was made in 1974, forty-one technicians have been recognized with this honor. The complete list can be found at http://www.mta.org/eweb/DynamicPage.aspx?webcode=annualawards. This year, the MTA added Robert Peirce to this distinguished list. Bob described his career with characteristic simplicity.

I was employed by the Baltimore & Ohio Railroad, which was part of Chessie Corp., now CSX Corp., when I graduated from Carnegie Tech, now Carnegie Mellon, in 1964 with a BS in Electrical
In 1970 I was hired by C.S. McKee & Co., in Pittsburgh, to provide technical analysis to clients and staff. In 1984 I formed my own company, Cookson, Peirce & Co. I will be retiring at the end of June.

The high point of my career, prior to receiving this Award, was developing and applying my Risk Adjusted Relative Strength Technique to make money for clients. The low point was realizing that it is virtually impossible to sell long term market timing. With stock selection you have 50-75 transactions a year. Any errors get lost in the noise. With long term market timing you have one decision every couple years. Clients fixate on those decisions. Since you can never be perfect, they will never be happy. There are exceptions, but you can’t plan your business around them. That could well be why most money managers have elected to stay fully invested. Nevertheless, I did continue my work in long term timing and I have made it available to those who want to use it.

From the founding of Cookson, Peirce in 1984, Bob relied on technical analysis to manage investments. His investors understand his methodology, and he achieved success by applying technical analysis in his business. It is this seemingly simple fact that places him among the list of pioneers in our field of study – Bob doesn’t just write about TA or discretely use it while relying primarily on fundamental analysis. His very successful business was built on the principles of technical analysis. When he retired, in July 2010, Cookson, Peirce was managing almost half a billion dollars using TA.

One problem with attracting institutional investors is the ‘style box’ problem. Often an institution will want to classify a manager by the market cap and investment style. Bob uses more of a ‘go anywhere’ approach and will seek profits where he thinks they are available rather than limiting himself to the confines of a single box. For those unfamiliar with the style box, it is shown in the figure below.

Bob’s approach recognizes that leadership changes in the market over time. There will be periods when growth beats value, or when one market cap leads and then lags the others, and his goal is to make money in any environment. This allows him to buy small caps when they look strong, and by following a disciplined sell methodology he may end up in large cap value stocks at a different point in the market cycle.

As he noted, the biggest disappointment of his career has been that the individual investor has not embraced long-term market timing. Bob understands that no one will ever be perfect in this endeavor. At the top, the timer will always be early if the focus is on risk or late if the timer is following the market’s action. These factors dictate the same outcome at bottoms. In addition to being unable to precisely time market turns, long-time timers will rarely take action, usually noting trend changes only every couple of years. Wrong calls are well remembered by clients, and the demand for perfect timing and accuracy make it a losing game to try to sell this service to clients.

On the other hand, applying technical analysis to individual stock selection offered a viable business model to Bob. Typical stock portfolios will consist of thirty stocks, and the portfolio may experience an annual turnover rate of more than 100%. After a year or so, Bob finds that most investors will focus on portfolio performance and

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Bob cited the Haller Theory as an important early influence on his work. The Haller Theory of Stock Market best parameter which would be found by optimization and again, may not work in the future. The whole idea is that trends have a limited life. If you wait too long to get in you should just look for something that is more timely. If you wait too long to get out, you give up too much of your gain. My work is keyed to a two-year overall period. Sometimes stocks stay strong for years, but mostly they are strong for 12-18 months.

Founding a firm requires more than an ability to apply TA to find winning stocks. Performance alone doesn’t always attract investors. Bob teamed up with Jane Cookson to complement his skills. While he was managing money, she pursued sales. This is another example of the general approach Bob has always been known for. He understands his strengths, and recognizes his weaknesses. Bob is able to accept the fact that he won’t be right all the time, and this strong character trait contributed to his success in investing, and in business.

His programming skills allowed him to address many of the back office functions. In 1984, portfolio management software was not ubiquitous as it is today and tasks like quarterly reporting that now take moments once took weeks. The same could be said for software used to evaluate investments. Bob recalls using a programmable calculator and using removable media cards to test his ideas. The hardware limited him to the ability to review only 20 to 30 stocks with this technique, and now we can scan 8,000 or more stocks in only seconds.

Analysis tools are not the only change he has seen in the business. Early in his career, while working at Chessie in the late 1960s, it could take a couple of weeks to buy or sell a million dollar position. In today’s market, the liquidity is now deep enough to move millions of dollars in or out of a position in seconds, and often with little market impact if the market in that security is deep enough. Commissions have also fallen, by more than 95%, and are no longer a consideration to achieving successful results.

The inability to trade large positions quickly may have led to Bob’s realization that he is most comfortable as a long-term trader. This approach gave him the time to do what he really loved doing, which is researching the markets in a never ending pursuit of what forecasting tools work best. For those who are wondering, there is no Holy Grail.

Bob uses a combination of indicators. All together, he follows more than 50 indicators. Each year, he looks at which indicators have worked best over the past twenty years and uses the best 15 in his model but only for the next twelve months. He includes indicators based on cycles, sentiment, breadth, market strength, and monetary indicators. The dynamic approach to indicator selection may be unique to Bob’s analysis. He has tested indicators on 50 years of data or more, and he noticed that sometimes a great test result over that timeframe will be due to performance over a single ten year period. He recognized that markets change, to some degree and adapting his indicators to keep up with those changes would be the best way to use his model.

As an example of market change, we can think about the specialist/public short sale ratio. Bob found this indicator worked well in the 1970s. However, the markets changed. The introduction of exchange-traded options completely changed the underlying logic of this indicator. Bearish trades could then be accomplished with options rather than requiring short trades and specialists had another tool for hedging available to them.

That indicator also offers an insight into how Bob structures his research. An a priori approach requires an understanding of market structure and how the markets trade. First the knowledge is used to develop a logical expectation which is then tested. An a posteriori approach to the markets would be similar to data mining, using the past data to find something that works and may or may not be likely to work in the future. As another precaution to avoid curve fitting, Bob uses parameters that are ‘good enough’ in his indicators, not necessarily the best parameter which would be found by optimization and again, may not work in the future.

Bob cited the Haller Theory as an important early influence on his work. The Haller Theory of Stock Market Trends was published in 1965. Gilbert Haller’s work was solidly based on the use of volume and advancing-declining issues, but limited by techniques developed to fit a specific period. Inspired by this work, and typical of his usual approach, Bob modernized the indicators to track the rise and fall of markets in any time period. This attempt at a universal approach carried over to stock selection.

Another influence on Bob’s work has been Ken Tower, CMT, and now Senior Vice President at Quantitative Analysis Services. As many readers of this newsletter know, Ken is one of the foremost authorities on the use of Point-and-Figure (P&F) charting techniques. Ken’s work led Bob to study the use of percentage change P&F charts to avoid buying stocks on spikes. While Ken is well known for introducing the moving average to P&F charts, he also has highlighted the pitfalls of buying stocks that have moved a great distance from their breakout.
levels. That is a fairly important point with respect to using relative strength as a stock selection tool. Many traders attempting to apply relative strength analysis learn very quickly that what goes up all too often must come down quickly in the stock market. High relative strength stocks are notorious for delivering large losses when the momentum shifts away from them.

A great description of the basics of his stock selection strategy can be found in “A Practical Application of Alpha and Beta to Portfolio Construction,” an article Bob published in the Summer 1997 issue of the Journal of Technical Analysis. The article is available by clicking here.

In the opening paragraph we again see the central idea that defines Bob’s work, which is to look at things differently:

Alpha and Beta are products of Modern Portfolio Theory, which has been around for forty years or more. Early on, somebody developed a calculation to illustrate Alpha and Beta, and since then, the concept has been so closely associated with the calculation that most people have forgotten that the calculation is no more than a way to illustrate the concept. The calculation is not the concept.

Conceptually, Beta is a measure of how volatile a stock is compared to a universe and Alpha is a measure of how well the stock has performed after removing the effect of Beta. In other words, the Alpha of a stock is a form of volatility adjusted Relative Strength. No matter how you calculate Alpha and Beta, this basic concept remains unchanged.

The paper details the calculation and employment of risk adjusted relative strength (which should not be confused with RSI). Traditionally, relative strength is a strategy suitable for aggressive investors since the volatility of the strongest stocks can often create wide swings in the investor’s equity. By adjusting relative strength for beta, Bob expands the idea in such a way that makes it suitable as a possible investment for more conservative investors.

In addition to being a talented technician, Bob demonstrated an expertise in running his own business as well. His retirement plan unfolded over ten years, and he unlocked the value of his firm by selling the business to several key members of his staff. The details offer, once again, an insight into Bob’s detailed thought process. In December 2001, the founding partners of Cookson, Peirce entered into an earnout agreement, a plan that allowed several key employees to use some of their share of the company’s profits to buy all of the stock in the company. To ease into the slower pace of retirement, the original parents cut their work week by one day every two years, giving a larger share of the operating profits to the designated buyers.

Bob’s long and memorable professional life can serve as a model and inspiration for technicians today. Many analysts want a job on Wall Street, being paid to provide opinions. Those jobs have been disappearing in recent years. But it is still possible to start your own firm and manage money with technical analysis. It is certainly not easy to do so, but success is within reach for those willing to study the markets, work hard, and find others to work with who can help them grow a profitable company by sharing the workload. Bob proved it can be done, and this Award recognized his perseverance and contributions to the field of technical analysis. One of his greatest contributions may very well have been to demonstrate the possibilities available to motivated technicians.

In the introduction to Long-Term Secrets to Short-Term Trading, Larry Williams wrote:

This book is not the product of research—it is the culmination of a career that has included a great deal of research, personal introspection, and, along the way, some personal growth.

That sentence sums up a conversation with Bob Peirce. His career represents not a single product as much as a process of developing a model, adapting the model to an ever changing market while remaining true to the basic guiding principles he originally developed, and applying technical analysis to build a career. The Annual Award does not recognize a single accomplishment but rather acknowledges a career that included a great deal of research and undoubtedly some personal growth. This Annual Award should inspire many – Robert Peirce has completed a career which shows that doing the basics very well can lead to extraordinary success in our field.
“I have heard about the “Coppock Curve” but I cannot find it on my charting program. Do you know how it is calculated?”

The Coppock Curve was developed in the 1960s by the late E.S.C. (Sedge) Coppock. He called it his Very Long Term (VLT) Momentum Index.

It is calculated by finding the 11-month and 14-month rates of change (ROC) of the DJIA, adding them together, and then calculating a 10-month weighted moving average (WMA) of the result. It is effectively a really long term price oscillator, since it first uses monthly closes for the DJIA, or for any other index, and since it uses a long lookback period.

Coppock used the 11-month and 14-month periods because he had once been told by an Episcopal priest that the typical period during which a person grieves over the loss of a loved one is 11 to 14 months. Coppock hypothesized that human psychology related to investment losses was similar to the grieving process, and so he sought to use that time period in creating an indicator that would help him find the really important long term price bottoms.

You can download an Excel spreadsheet file (Editor’s note: the hyperlink is available online and the spreadsheet provides data back to 1912) to help you calculate the level of the Coppock Curve for the DJIA on an ongoing basis, including a calculation of the DJIA level at which the Coppock Curve would change direction (Coppock Unchanged).

The Volatility of Volatility (this article was originally published on February 05, 2010 at http://www.mcoscillator.com/learning_center/weekly_chart/the_volatility_of_volatility/)
The CBOE Volatility Index (VIX) is one of the favorite tools of technical analysts. It measures the "implied volatility" that is priced into SP500 options. Put simply, implied volatility means how much extra premium is priced into the cost of an option, over and above that option’s inherent value plus the time value of money. As such, it reflects a sort of "insurance" cost. In the same way that earthquake insurance typically costs more in California than in Nebraska, volatility insurance in the stock market tends to cost more during wild price movements than during periods of calm.

The numerical value of the VIX itself can be a useful sentiment indicator, especially when compared to recent values. Comparatively high VIX readings are reliably associated with important bottoms for stock prices, because those high VIX values say that fear is at a maximum. Very low VIX readings show complacency, which can be indicative of a price top for stocks. In every issue of our twice monthly newsletter, we show the VIX compared to its 50-day moving average, with 1-sigma Bollinger Bands to help gauge where "high" and "low" levels are.

In addition to the raw VIX level, we can also gain interesting information about the market by observing the way that the VIX moves around. This week's chart looks at a very simple indicator used on the VIX, the percent rate of change (%ROC). It simply measures how far the VIX has moved from the value 7 trading days ago. The VIX will understandably move up and down as prices change, but sometimes the movements of the VIX can be extreme. Saying it another way, sometimes options traders overshoot in their short term adjustments to options pricing.

To continue reading, please go to:
http://www.mcoscillator.com/learning_center/weekly_chart/the_volatility_of_volatility/

Proof The Double-Dip is Coming (this article was originally published on June 11, 2010 at http://www.mcoscillator.com)

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I keep hearing the question offered in the financial media about the possibility of a "double-dip" recession, and so far the answer to that question by the "experts" is nearly uniform. The consensus seems to be that we will not see a double-dip recession.

As an aside, we have collectively lost some accuracy in our economic terminology. 100 years ago, it was proper to refer to any economic slowdown as a "depression", much as one would describe a low point in the ground. A depression consists of 3 parts: the recession (going down), the bottom, and the recovery (going up). Thus, the economy can be in recovery mode, and still be in a depression, much like climbing uphill but still being in a valley.

The slowdown episode in the 1930s was tagged as the "Great Depression". That term was coined during a period when "The Great..." was a modifier that got applied to lots of different things. WWI was "The Great War", F. Scott Fitzgerald wrote "The Great Gatsby", and author Jack London coined the term "The Great White Hope" which referred to a boxer who whites hoped would finally defeat boxer Jack Johnson, a black man who was the heavyweight champion from 1908-1915. In the years that followed The Great Depression, no one wanted to conjure up the mental images of something as bad as that 1930s period, so economic slowdowns were just referred to as "recessions". Some in the media have even taken to referring to the economic slowdown of 2007-10 as "The Great Recession".

Back to the double-dip. Most economic indicators are now showing growth in the U.S. and worldwide economies, and short term interest rates are starting to rise again. The 6-month LIBOR (London Interbank Offered Rate) had gotten down to as low 0.34% on February 17, 2010, and it is now back up to 0.76%. I have found that lumber futures prices give a great leading indication of where short term interest rates are headed, and thus of future economic activity. Turning to this week’s chart, the plot of lumber prices is shifted forward by a year to reveal this lead-lag relationship. Interest rates follow the same dance steps, with admittedly less volatility, about a year after those movements are seen in lumber prices.
To continue reading, please go to: http://www.mcoscillator.com/learning_center/weekly_chart proof_the_double-dip_is_coming/

The McClellans – Innovative Market Timers

The McClellan Market Report and its companion Daily Edition are produced by Sherman McClellan and Tom McClellan. Both are technical analysts and educators whose innovative insights have helped countless investors succeed.

The McClellans’ work has been repeatedly quoted in Barron’s, and their market timing signals have ranked them in the top ten timers for both intermediate and long term by Timer Digest.

Tom McClellan

Sherman and Marian’s son Tom McClellan has done extensive analytical spreadsheet development for the stock and commodities markets, including the synthesizing of the four-year Presidential Cycle Pattern. He has fine tuned the rules for interrelationships between financial markets to provide leading indications for important market and economic data.

Tom is a graduate of the U.S. Military Academy at West Point where he studied aerospace engineering, and he served as an Army helicopter pilot for 11 years. He began his own study of market technical analysis while still in the Army, and discovered ways to expand the use of his parents’ indicators to forecast future market turning points. Tom views the movements of prices in the financial market through the eyes of an engineer, which allows him to focus on what the data really say rather than interpreting events according to the same “conventional wisdom” used by other analysts. In 1993, he left the Army to join his father in pursuing a new career doing this type of analysis. Tom and Sherman spent the next 2 years refining their analysis techniques and laying groundwork.

In April 1995 they launched their newsletter, The McClellan Market Report, an 8 page report covering the stock, bond, and gold markets, which is published twice a month. They utilize the unique indicators they have developed to present their view of the market’s structure as well as their forecasts for future trend direction and the timing of turning points. A Daily Edition was added in February 1998 to give subscribers daily updates on their indicators and also provide market position indications for stocks, bonds and gold. Their subscribers range from individual investors to professional fund managers. Tom serves as editor of both publications, and runs the newsletter business from its location in Lakewood, WA.

Sherman McClellan

Sherman earned a degree in business administration and economics from Claremont Men’s College (now Claremont McKenna College), but found out after graduation that the standard types of fundamental analysis taught in school did not provide enough of the answers concerning why and when stock market prices moved.

Dissatisfaction with a number of methods for technical analysis led him to develop new techniques for assessing market conditions. Sherman and his mathematician wife Marian developed the McClellan Oscillator and Summation Index in 1969. It took their combined talents to do the work then, in a day when computers were unavailable, and when charts had to be drawn by hand.

Sherman brought these indicators to the public during guest appearances on Charting The Market, a technical analysis television program hosted by Gene Morgan which aired on KWHY in Los Angeles. As a result of these appearances, public interest in Sherman and Marian McClellan’s new indicators increased. They were invited by the late Mr. P. N. Haurian, publisher of the Trade Levels Report newsletter, to publish a book detailing their research. The book Patterns For Profit was the result of this effort.

Development of the McClellan Oscillator and Summation Index took place before access to computers was widely available. The first edition of their book included 8 years of data on the Oscillator and Summation Index portrayed in comparison to the NYSE Composite Index, and all data points were computed and plotted manually. For the purpose of verifying the signals given from NYSE data, they also calculated and graphed Oscillators and Summation Indices using AMEX advance/decline data and NYSE and AMEX up-volume/down-volume. This was before the Nasdaq even became a market.

The amount of work required to perform the calculations this way limited the further development of market timing tools using these techniques. The development of personal computers opened up new capabilities for using the trend analysis techniques which are part of the McClellan Oscillator. Several popular market analysis software packages now include versions of the McClellan Oscillator and Summation Index. An updated edition of Patterns for Profit with 40 years of computer generated chart data is available from McClellan Financial Publications, Inc.

Sherman’s years of experience at tracking the movements of the financial markets enable him to interpret current market events in the context of similar events seen in many other market cycles. He now uses several new indicating tools which are more complex and more powerful for short term trading than the Oscillator and Summation Index alone. These new tools are also based upon exponential moving averages of data from advances and declines, up and down volume, and price movements.
Sherman served on the board of directors of the Market Technicians Association from 2006-2009, and has conducted a number of seminars on the McClellan Oscillator and Summation Index for investor groups around the country. Under the auspices of Sherman McClellan & Associates, he provides market timing advisory service to selected institutional clients. From 1976 to 2003, he and his family also owned and operated Admiral Plastics Corp., a custom plastic injection molding company in Los Angeles.

Reprinted from http://www.mcoscillator.com/about_us/
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 many specialized topics. Whilst the course focuses on US equities, other markets including GCC stocks, commodities, and real estate will also be explored. An optional 1-day session entirely dedicated to exploring trading opportunities for US and GCC equities, FX, commodities and bonds using technical analysis. Prior workshops correctly called turns in the US market, collapse of real estate, 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, such as, algorithmic models to meet various investment goals. The objective of this course is to give the student an introduction to the mathematical challenges of creating algos and, utilizing various trading strategies that can achieve best execution. This course should help achieve: “Best Execution.”

**ADVANCED CAPITAL MARKETS ANALYSIS**

Spot, forwards, futures, swaps, options, and statistical issues are discussed in dynamic capital market strategies. This course was first introduced to a top Ivy Business School. Solving the course problems and cases has brought angst to MBA and CFA candidates. Still, the topics are the food for advanced hedge fund techniques.

**STRATEGIC GOLD INVESTING**

Gold has been one of the very few assets to have created wealth in the past several years. Gold offers investment opportunities for investors, traders, and financial engineers.Erroneously, some feel that one must only speculate on rising or falling gold prices to make money. In fact, there are strategies other than pure directional ones that may also offer investment opportunities. Preconceived notions on gold may soon be giving in to today’s global economic challenges. This course is for believers and non-believers in gold. Gold offers hedges against both inflation and fear. Portfolio strategies can also benefit from owning gold. Bull and bear traders can profit by using unique strategies to capitalize from gold’s fluctuations. These strategies include the use of complex technical analysis, behavioral, economic, and algo models. Financial engineers may also be interested in replicating or enhancing traditional investment strategies with gold. This course should help answer: “Is gold the future global currency or the future paperweight”.

**GLOBAL SMALL CAP INVESTING**

Global small cap stocks offer investors the ability to participate in the world’s future big winners. Certain trends have made this exciting area more attractive. These trends include more common product standards and consumer expectations, as well as freer capital and financial information flows. It is more likely that innovations will be produced globally rather than in traditional countries. Despite the attractive nature of this investment universe, it holds many traps and challenges for the stock analyst and portfolio manager. Therefore, the typical global small-cap manager has not produced an alpha. This course also explores alternatives in venture, emerging, frontier, BRIC, and financially engineered companies. This course covers fundamental, technical, behavioral and quant approaches to investing in global small-cap stocks. Global small-cap investing will help answer: “Now why didn’t I invest in that company?”

Instructor John Palicka CFA CMT is a top-ranked portfolio manager of Global Emerging Growth Capital (WWW.GLGEGC.COM) with over 30 years experience of managing $ billions. He has doubled client money, on average, every 4 1/2 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 and consulting contracts that parallel the learning topics. John has an MBA from Columbia University and also teaches these courses for leading training institutions, including The New York Institute of Finance (WWW.NYIF.COM).

To find out more about these courses in GCC locations, please call Esam Hassanyeh + 9714 391 0234 or visit his website: www.enhance.ae. * Past performance is no guarantee of future results.
In May 2007, Katie offered MTA Symposium attendees a short tutorial on applying relative strength. The complete presentation can be seen by clicking here.

The MTA Video Archive contains a number of valuable presentations like this one. While they may seem dated, and some may in fact be out of date, this one is a timeless example of how to analyze the markets. In addition, Katie provides a lot of detail on how she does her job, and seeing how a successful technician works is valuable for newcomers to the business as well as experienced technicians who benefit from seeing what others are looking at.

Beginning with a definition of relative strength, Katie walked through how she uses relative strength and other indicators and wrapped up by giving her current views of the markets. In the first few slides, she demonstrated the diversity of relative strength analysis, which can be used in a number of ways, to evaluate breakouts & reversals and to identify shifts in market leadership.

Relative strength offers a number of advantages, in particular:

- It’s a time-tested & widely used concept. Technicians have used relative strength for decades, and it can be used for analyzing anything that has a price. Within her presentation, she demonstrated techniques to apply the analysis to global markets and interest rates.
- The simplicity of the calculation makes it easy to understand, an advantage for technicians selling their analysis to skeptics.
- The calculation is readily available on almost any software platform.
- Reveals inter-market relationships that can help develop long-term trading strategies.
- Relative strength offers a visual gauge of performance, making it possible to analyze a large number of charts in a short time.
- It’s useful in pairs trading, and in fact forms the basis of this trading strategy.
- There is a broad appeal to relative strength, and Katie noted that it’s not just for technicians. It can be applied in economic analysis just as easily and is a concept that fundamental analysts can accept.

An interesting application which she demonstrated was using relative strength to confirm breakouts from support and resistance levels. Katie notes that relative strength and support and resistance are among the tools that she finds most useful in her analysis. That is actually a valuable insight that many may have overlooked. Relative strength can precede a price move, and a breakout through resistance or a bounce off of support is logically more likely to follow through with higher prices if the relative strength is in an uptrend. Likewise, a relative strength divergence as prices move through resistance is probably indicating that this would not be a great trade on the long side. The final conclusion from her insight is that a downward trend in relative strength with prices at support levels is likely to be bearish.

Welles Wilder demonstrated that charts patterns and trend lines work very well with indicator analysis. Katie offers several examples that you can see in the video of traditional Edwards and Magee chart patterns forming on relative strength charts. This can be a confirmation of price action or may actually be a leading indicator in some examples. In either case, it is valuable information for the technician to have.

Katie demonstrated the use of other indicators along with relative strength. In particular, stochastics and MACD, along with Rick Bensingor’s TMAP, an indicator combining three moving averages, help her to refine her analysis. There is a danger in relying on only a single indicator, but many beginning technicians suffer from trying to look at too many. Each slide that she presents shows a clear analysis, and the video demonstrates simple ways to look at the charts to form clear conclusions.

Another unique part of her presentation included a list and discussion of the drawbacks of relative strength analysis. Many speakers rely on the well-selected example to make their point, and avoid discussion of what can go wrong. Every experienced trader knows that the market involves a great deal of uncertainty and successful traders take time to consider what can go wrong. Her list included:

- Secondary indicator based on price
- Risks of long-term analysis
- Tech bubble (there were no negative divergences to warn of the crash)
- Choosing comps can be difficult
- Confused with Relative Strength Index (RSI)

In the video, each of these points is explained in detail. The fact that she acknowledged and skillfully discusses potential pitfalls proves that she works in the real world and this is not a theoretical discussion but instead is offering the audience the benefit of experience. It is often said that experience is the best teacher, but it is also usually the most expensive. This slide can help save thoughtful analysts a great deal of time by highlighting what they need to pay attention to in the real-time pursuit of profits.

It’s interesting to see an analysis of the markets at such a critical time. Katie noted a large number of relative strength divergences and called for investors to be selective in banks and real estate, among other sectors. The fact that she made a number of very good calls is less important than the opportunity to see the thought process that was applied at that time. Technicians trade on the right side of the chart (the present time) and her analysis was done along that right edge. With the benefit of hindsight, we know what she got right and wrong, but this
video offers a valuable approach to analysis. Even if you don’t use relative strength, you can see an analytical process that can be applied to any indicator.

Katie Townshend Stockton, CMT, Managing Director/Chief Market Technician, joined MKM Partners, LLC in August 2004 as Chief Market Technician. Prior to joining MKM, Mrs. Stockton worked as a trader for New York-based hedge fund and was a publishing analyst for Morgan Stanley’s technical strategy group. From 1997 to 2001 she worked as a technical analyst in San Francisco, including two years with Wit SoundView (formerly E*OFFERING). Mrs. Stockton received her Chartered Market Technician (CMT) designation in 2001, and graduated magna cum laude with a BSBA from the University of Richmond. She is a frequent guest on CNBC and Bloomberg Television, and is often quoted in the Wall Street Journal, Barron’s, and financial newswires.

For more detail on her work, please visit http://www.mkmpartners.com/technical.html.

Efficient Market Hypothesis’ False Reign Over Financial Markets

By David Waggoner, CMT

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American academic institutions of higher learning expelled technical analysis from school and labeled it heresy in the 1970s based on the Efficient Market Hypothesis (or EMH).

EMH is the cornerstone of modern finance. Ironically, this slayer of technical analysis shares a philosophical base with it. Efficient Market Hypothesis asserts “that market prices fully reflect all information contained in the historical sequence of prices.” This sounds a lot like Dow’s basic tenet that price discounts everything.

Charles Dow organized stocks into indexes and provided tenets for interpreting the price movement of those indexes through a series of articles in the Wall Street Journal in the late 1800s to early 1900s. He believed the sum total of all causal factors, including “acts of God” were already included in the price of the market (market discounts everything) and a person could forecast business and the economy through observation of the indexes and application of his tenets. In addition to the belief that (1) the market discounts everything, the other tenets of Dow that remain the philosophical pillars of technical analysis today are (2) that prices move in trends and (3) market history repeats itself.

EMH concludes, however, “that past prices contain no information which can be used to predict next period values,” which is diametrically opposed to the second and third tenets of Dow’s theory that price trends and history repeats.

The Efficient Market Hypothesis is attributed to Professor Eugene Fama at the University of Chicago’s Booth School of Business, through his published Ph.D. thesis in the 1960s. The idea was first expressed by Louis Bachelier, a French mathematician, in his 1900 dissertation, “The Theory of Speculation.” (The timing of Bachelier’s paper with Dow’s published tenets in the Wall Street Journal is an interesting coincidence.)

EMH was combined with Random Walk Theory (or RWT), popularized in the 1973 book A Random Walk Down Wall Street, by Burton G. Malkiel, a Princeton economics professor. RWT postulated that stock-market prices were completely random, and debunked both fundamental and technical reasons for buying stocks. However, his sensationalized coin-flip test was more of a black eye to technical analysis. His students were given a hypothetical stock that was initially worth $50. The closing stock price for each day was determined by a coin flip. If the result was heads, the price would close a half point higher, but if the result was tails, it would close a half point lower. Over time, cycle and trend data were plotted from the test and taken to a technical analyst in chart form. The analyst told them they should buy the stock.

Technical analysis was further attacked by the scientific testing of mechanical “technical” systems that used volume, advance-decline, odd-lot statistics, and short interest data to forecast future market direction on the basis of historical data. The test results found no positive correlation. It was footnoted that the study wasn’t conducted by practitioners.

The combined theory of EMH/RWT was latched onto by academia as groundbreaking “hard science” for finance. It was heavily hyped and spread like wildfire. Backed by “empirical” statistical studies, it grew unchecked as the scientific basis for the quadrillion dollars of financial derivatives now circling the globe, as well as the Black-Scholes option pricing formula.

Over the course of the next decade, subsequent academic studies revealed numerous statistical anomalies in the
Waggoner lives in San Diego, California, with his family. He spends his free time in the desert with a motorcycle.

David Waggoner, CMT, is the founder of TheMarketDetective.com and uses the Elliott wave principle and Fibonacci ratio analysis to uncover clues about the direction of the market. He then uses other forms of technical analysis to corroborate his findings in such a way as to assign a probability factor to them.

Waggoner has been a trader/investor full-time since 2000. He manages personal equity and provides professional market opinion to private and commercial clients. Prior work history includes a successful career in information technology with AOL, KPMG, and the USMC.

Waggoner lives in San Diego, California, with his family. He spends his free time in the desert with a motorcycle.
Can Anyone be a Technical Analyst?

By Mike Carr, CMT

Sadly, the answer to that question is yes. All it seems to take is the time to create a blog account before some writers claim that they are providing market insights and analysis. The rapid and easy dissemination of information is an advantage of the internet, and at the same time creates a junkyard of market analysis.

This problem is not just limited to technical analysis. Sloppy fundamental analysis and incoherent economic analysis can also be found on blogs and sites that will even sell you their flawed analysis for as little as $29.95, and yes, there is usually a bonus for acting right now — often you can get twice as much of the most worthless analysis by subscribing for two years at half price.

Amidst the chaos of the internet and the plethora of pundits, the Market Technicians Association offers its Members the chance to stand out and have their work recognized. Our organization has a Code of Ethics which was written many years ago but has withstood the test of time. The Code reads as though it was written to prevent some of the worst abuses that can be found on blogs. It is well worth repeating the Code in its entirety here to highlight its clarity and applicability to everything we do as professional technicians and to make it easy to reread and think about.

The Market Technicians Association has established ethical standards of professional conduct which every Member and Affiliate shall maintain. The Ethical Standards set forth in 1 through 9 serve as a guide of professional responsibility and as a benchmark for ethical judgment.

1. MTA Members and Affiliates shall maintain at all times the highest standards of professional competence, integrity and judgment. Said standards should be maintained, and Members and affiliates should act with dignity and in an ethical manner when dealing with the public, clients, prospects, employees, fellow Members, and Affiliates and business associates.

This ethical standard requires strict compliance with the applicable laws and regulations of any government, governmental agency and regulatory organization which has jurisdiction over the professional activities of Members and Affiliates.

This same ethical standard requires that Members and Affiliates abide by the Constitution and By-Laws of the Association, and all rules promulgated by its Board of Directors. Members and Affiliates shall not unduly exploit their relationship with the Association for commercial purposes, nor use, or permit others to use, Association mailing lists for other than Association purposes.

2. Members and Affiliates shall not publish or make statements which they know or have reason to believe are inaccurate or misleading. Members and Affiliates shall avoid leading others to believe that their technically-derived views of future security price behavior reflect foreknowledge rather than estimates and projections subject to reexamination and, as events may dictate, to change.

3. Members and Affiliates shall not publish or make statements concerning the technical position of a security, a market or any of its components or aspects unless such statements are reasonable and consistent in light of the available evidence and of the accumulated knowledge in the field of financial technical analysis. New methods of technical analysis and modifications of existing concepts and techniques shall be fully documented as to procedure and rationale. Proprietary methods shall not be infringed, but this standard shall be a guide in the creation of proprietary products.

4. Members and Affiliates shall not publish or make statements which indefensibly disparage and discredit the analytical work of others

5. Members and Affiliates shall not seek, disseminate or act on the basis of material, non-public (inside) information, if to do so would violate the laws and regulations of any government, governmental agency or regulatory organization relating to the use of inside information.

6. Members and Affiliates shall keep in confidence knowledge concerning the lawful private affairs of both past and present clients, employers, and employer’s clients.

7. When a Member or Affiliate recommends that a security ought to be bought, sold or held, adequate opportunity to act on such a recommendation shall be given to the Member’s or Affiliate’s clients, employer, and the employer’s clients before acting on behalf of either the Member’s or Affiliate’s own account or the accounts of immediate family Members.

8. Members and Affiliates shall not copy or deliberately use substantially the same language or analysis contained in reports, studies or writings prepared by any author unless permission to do so is received, in advance, from the author. In the event the original author is deceased, or is otherwise unavailable to grant such permission, Members and Affiliates must ensure that the original author receives prominent and adequate credit for the original work.

9. Members who have earned the CMT designation shall use CMT after their name whenever and
wherever appropriate.

Basically, we, as Members of the MTA, are required to complete work that is based on sound research. We should be prepared to defend our methods when asked to and avoid being negative about the work of others unless there is strong evidence that the person is deliberately misleading or inaccurate. After all, there can be differences of opinions when applying the same theory to the same facts, and that is really why markets exist. If I see a sell signal while you see a buy, we can each trade our opinions but it is also very likely we can each defend our opinion based upon the preponderance of the evidence. That’s all the Code of Ethics requires.

These standards only apply to Members of the MTA, and other professional organizations have similar standards. However, many of the opinions on the internet do not adhere to even the lowest standards of common sense. It is easy to find examples of work that is deeply flawed and that disparages the sound analysis of some of our Members. In fact, what prompted this article was an incredibly sloppy analysis of the McClellan Oscillator that I spotted on a web site. It included scatter diagrams of irrelevant data and looked impressive to those without an understanding of backtesting or the indicator. In the text, the author admitted that he used incomplete advance-decline data to develop his opinions. Good data does cost money and many internet analysts rely solely on free resources, forever wondering why they can't find a winning trading idea. Looking at the site, I found other Members had been subjected to the same level of irresponsible analytical scrutiny. While this clearly violates the MTA Code of Ethics, it is protected by the First Amendment to the US Constitution as free speech.

Therein lies our opportunity – the MTA stands for something. We are held to the highest standards in our research. This separates us from the amateur and adds credibility to your analysis. Whenever you publish, it's worthwhile noting your MTA Membership.

To me, it seems appropriate to say to potential employers and clients that "As a Member of the MTA, I am committed to the highest ethical standards." It separates our work from the readily available drivel.

MTA Announcements

MTA Press and Media Center - New Page on MTA.org!

The MTA is pleased to announce the launch the new Press & Media Center page on our website. This page will showcase all MTA Press Releases as well as a new feature called the MTA Newswire. The MTA Newswire is a new, automated service that scans the internet for articles relating to technical analysis, the Market Technicians Association, the Chartered Market Technician designation, and other relevant member-related stories. For those members that are writing articles online, this service will display your article on the mta.org website if it mentions technical analysis, the MTA, or if you use the CMT designation after your name.

MTA Knowledge Base - Recent Additions!

The MTA would like to announce that the following resources have been added to the MTA Knowledge Base.

- Directional Movement Indicator (DMI) and Average Directional Index (ADX) - (Knowledge Base ID: 10.2.1.08)
- Performance Cycles (Video) - (Knowledge Base ID: 4.3.15)

If you are interested in volunteering to help the MTA continue to build and add resources to the Knowledge Base, please email Tim Licitra at tim@mta.org.

Volunteers - Thank You!

The MTA would like to thank all of those that submitted their name as someone willing to volunteer and help fill open positions on the Admissions and Finance Committees. The Finance Committee is pleased to welcome Philip Breeding, CMT, CFP, CRPC, Jeff Cheah, CMT, and William Guthrie, CFA, CFP, and would like to thank departing Finance Committee members Tom McClellan and Harold Parker, CMT for their efforts. The Admissions Committee is pleased to welcome Robert Palmerton, CMT and Michael Sacchitello, CMT, and thank departing Admissions Committee members Andrew Bekoff and Ken Tower, CMT for their efforts.

The MTA is always looking for volunteers to help populate the Knowledge Base with technical analysis information. If you are interested in volunteering, please email Tim Licitra at tim@mta.org.

CMT Institute (CMT) - Registration Open!

Sign up today to start viewing these archives and begin your study process now! We are
pleased to announce the opening of the Fall 2010 session of the CMTi, to help you prepare and do your best for your respective exams. As we have done in previous administrations, upon registering for the CMTi, you are given instant access to recent, relevant, archived presentations. To register for one of the CMTi courses, please click here, or call Cassandra Townes at 646-652-3300.

MTA Regional Seminars/Meetings - Don't Miss Out On A Meeting Near You!

The MTA is pleased to announce that the agendas for all four FREE events listed below are now available.

- August 9th - United Kingdom Initial Event (London)
- August 10th - Netherlands Initial Event (Amsterdam)
- September 18th - US West Coast Regional Seminar (San Francisco, CA)
- October 1st - US Mid-West Regional Seminar (Columbus, OH)

Registration is now open. Sign up early! For more information on these FREE events, including agendas, speakers, and registration instructions, please click here.

MTA Membership Dues - Summer Renewals!

Approximately 30% of our membership has dues expiring in the summer months (June, July and August). CLICK HERE to visit your My Transactions page where you can go to find out when your membership expires and to renew your dues. On that page, you will see a RED renew button to process your payment online. If you would prefer, you can call the MTA Headquarters at 646-652-3300 and renew over the telephone with any of the MTA Staff members. It is important that you renew in a timely fashion to ensure there is no disruption in your MTA services.

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