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Letter from the Editor

In this month’s issue of Technically Speaking, we offer several short articles that could stimulate some fresh thoughts on the markets.

John R. McGinley, CMT, offers details on a reliable January indicator. What is interesting about his work is that he includes a test of statistical significance, a step lacking in most articles written about technical indicators. We are also reprinting a very readable explanation of the chi squared test written John’s friend and mentor, the late Arthur Merrill, CMT.

We follow this with some very specific trading lessons. Mike Moody, CMT, quantifies how much following a disciplined approach can be worth in “The $ Value of Patience.” Ken Winans, CMT, contributes an article which shows that simple strategies can work very well. David Penn of TradingMarkets.com also explains a specific trading strategy. Bob Palmerton, CMT, provides details on a disciplined way to look at the markets each day.

Finally, we have some reviews of trading tools developed by MTA members. We are always happy to bring your work to the attention of others. Books can be reviewed as Adobe files so that the article can be published at the time the book is being formally released. Please email us at editor@mta.org to arrange for a review, or to contribute an article that will be read by thousands of MTA members and affiliates around the world.

Sincerely,

Mike Carr, CMT

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World’s Best January Indicator

By John R. McGinley, CMT

(If the 1st five days are net up, the year will be up. If down, no prediction, a coin-toss)

This is hands-down THE best of the January Indicators. This year for only the second time in six years, the first five trading days of January were up (1.8%); therefore we have a buy signal for the year as a whole. We record a buy signal only when the first five days are up. There are no sell signals because when the first five days are down, the record amounts to a coin-toss. The same applies to the month of January as a whole (i.e. do not use the down months), but the record is not as great as for the first five; further, waiting until Feb 1 to buy can amount to missing as much as 15% of a year’s move. The extraordinary statistics of this indicator are found below. We count from the 6th day to the year-end. If the first five days are up 4% or greater, the year as a whole has always been up.

<table>
<thead>
<tr>
<th>Signal Strength</th>
<th>Dow Jones Industrial Average</th>
<th>S &amp; P 500</th>
</tr>
</thead>
<tbody>
<tr>
<td>No signal</td>
<td>24</td>
<td>32</td>
</tr>
<tr>
<td>Correct signals</td>
<td>35</td>
<td>82.1</td>
</tr>
<tr>
<td>Number wrong</td>
<td>8*</td>
<td>7**</td>
</tr>
<tr>
<td>Percentage right</td>
<td>81.4!</td>
<td>15.7</td>
</tr>
</tbody>
</table>

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Chi Squared (highly significant #)
Chi Squared

By Arthur Merrill, CMT

Editor’s Note: Arthur Merrill, CMT, was a leading advocate of the need to apply statistical rigor to technical analysis methods. He frequently employed the Chi squared test to assess the validity of his backtested results. This difficult concept is usually explained over the course of several dozen pages in college-level statistics textbooks. Demonstrating his extraordinary ability to make the complex simple, Art published this concise and understandable explanation in his newsletter in August 1986:

If, in the past, the records show that the market behavior exhibited more rises than declines at a certain time, could it have been by chance? Yes. If a medication produced cures more often than average, could it have been luck? Yes.

If so, how meaningful is the record?

To be helpful, statisticians set up “confidence levels.” If the result could have occurred by chance once in twenty repetitions of the record, you can have 95% confidence that the result isn’t just luck. This level has been called “probably significant.”

If the result could be expected by chance once in a hundred repetitions, you can have 99% confidence; this level has been called “significant.”

If the expectation is once in a thousand repetitions, you can have 99.9% confidence that the result wasn’t a lucky record. This level has been called “highly significant.”

If your statistics are a simple two way (yes-no; rises vs declines; heads-tails; right-wrong), you can easily determine the confidence level with a simple statistical test. It may be simple but it has a formidable name: Chi Squared with Yates Correction, one degree of freedom!

Here is the formula:

\[ \chi^2 = \frac{(D - 0.5)^2}{E_1} + \frac{(D - 0.5)^2}{E_2} \]

Where \( D = O_1 - E_1 \) (If this is negative, reverse the sign; \( D \) must always be positive)

\( O_1 = \) number of one outcome in the test

\( E_1 = \) expectation of this outcome

\( O_2 = \) number of the other outcome

\( E_2 = \) expectation of this outcome

\( \chi^2 = \) Chi squared

If above 10.83, confidence level is 99.9%
If above 6.64, confidence level is 99%
If above 3.84, confidence level is 95%
An example may clear up any questions:

\[ R = \text{number of times the day was a rising day in the period 1952 - 1983} \]
\[ D = \text{number of times it was a declining day} \]
\[ T = \text{total days} \]
\[ \% = \text{percent} \]
\[ ER = \text{Expected rising days} \]
\[ ED = \text{Expected declining days} \]

Overall, there were more rising days than declining days, so that the expectation isn't even money. Rising days were 52.1% of the total, so the expectation for rising days in each day of the week is 52.1% of the total for each day. Similarly, \( ED = 47.9\% \) of \( T \).

For an example of the calculation of \( \chi^2 \), using the data for Monday:

\[ O_1 = 669 \]
\[ E_1 = 799 \]
\[ O_2 = 865 \]
\[ E_2 = 735 \]
\[ D = 669 - 799 = -130 \text{ (reverse the sign to make } D \text{ positive)} \]
\[ \chi^2 = \frac{(130 - 0.5)^2}{799} + \frac{(130 - 0.5)^2}{735} \]
\[ = 43.8 \text{, a highly significant figure; confidence level is above 99.9\%} \]

If expectation seems to be even money in your test, such as right/wrong), the formula is simplified:

\[ \chi^2 = \frac{(C - 1)^2}{(O_1 + O_2)} \]

Where:

\[ \chi^2 = \text{Chi squared} \]
\[ C = O_1 - O_2 \text{ (If this is negative, reverse the sign, since } C \text{ must always be positive)} \]
\[ O_1 = \text{number of one outcome in the test} \]
\[ O_2 = \text{number of the other outcome}. \]

[Chi squared is not always the correct statistical tool. When the number of observations is less than 30, Art used a test based upon the T-table statistic:]

The problem: In a situation with two solutions, with an expected 50/50 outcome (heads and tails, red and black in roulette, stock market rises and declines, etc.) are the results of a test significantly different from 50/50?

Call the frequency of one of the outcomes \( a \), the frequency of the other \( b \). Use \( a \) for the smaller of the two and \( b \) for the larger. Look for \( a \) in the left hand column of the table below. If \( b \) exceeds the corresponding number in the 5% column, the difference from 50/50 is “probably significant”; the odds of it happening by chance are one in twenty. If \( b \) exceeds the number in the 1% column, the difference can be considered “significant”; the odds are one in a hundred. If \( b \) exceeds the numbers in the 0.2% (one in five hundred) or 0.1% (one in a thousand), the difference is “highly significant.” Note that the actual number must be used for \( a \) and \( b \), not the percentages.

Example: In the last 88 years, on the trading day before the July Fourth holiday, the stock market went up 67 times and declined 21 times. Is this significant? On the day following the holiday, the market went up 52 times and declined 36 times. Significant?

For the day before the holiday, \( a = 21 \) and \( b = 67 \). Find 21 in the left hand column of the table; note that 67 far exceeds the benchmark numbers 37, 43, 48, and 50. This means that there is a significantly bullish bias in the market on the day before the July Fourth holiday.

For the day following the holiday, \( a = 36 \) and \( b = 52 \). Find 36 in the table. The minimum requirement for \( b \) is 56; 52 falls short, so that no significant bias is indicated.

Table for Significance of Deviation from a 50/50 Proportion: \( a + (b) = (n) \)

This is essentially the T-table statistic. It should be used instead of Chi Squared when the number of observations is less than 30.
The $ Value of Patience

By Mike Moody, CMT

This article was originally published at Systemic Relative Strength, the official blog of Dorsey Wright Money.
The annals of investor behavior make for some pretty scary reading. Yet this story from the Wall Street Journal may take the cake. It is an article about the top-performing mutual fund of the decade and it shows with remarkable clarity how badly investors butcher their long-term returns. The article hits the premise right up front:

Meet the decade's best-performing U.S. diversified stock mutual fund: Ken Heebner's $3.7 billion CGM Focus Fund, which rose more than 18% annually and outpaced its closest rival by more than three percentage points. Too bad investors weren't around to enjoy much of those gains. The typical CGM Focus shareholder lost 11% annually in the 10 years ending Nov. 30, according to investment research firm Morningstar Inc.

It's hard to know whether to laugh or cry. In a brutal decade, Mr. Heebner did a remarkable job, gaining 18% per year for his investors. The only investment acumen required to reap this 18% return was leaving the fund alone.

Yet in the single best stock fund of the decade investors managed to misbehave and actually lose substantial amounts of money—11% annually.

Even Morningstar is not sure what to do with Mr. Heebner:
The fund, a highly concentrated portfolio typically holding fewer than 25 large-company stocks, offers "a really potent investment style, but it's really hard for investors to use well," says Christopher Davis, senior fund analyst at Morningstar.

I beg to differ. It's really hard to use well?? What does that even mean? If it is, it's only in the sense that a pet rock is really hard to care for.

Investor note: actively managed or adaptive products need to be left alone! The whole idea of an active or adaptive product is that the manager will handle things for you, instead of you having to do it yourself.

Unfortunately, there is an implicit belief among investors—and their advisors—that they can do a better job than the professionals running the funds, but every single study shows that belief to be false. There is not one study of which I am aware that shows retail investors (or retail investors assisted by advisors) outperforming professional investors. So where does that widespread belief come from?

From the biggest bogeyman in behavioral finance: overconfidence. Confidence is a wonderful trait in human beings. It gets us to attempt new things and to grow. From an evolutionary point of view, it is probably quite adaptive. In the financial arena, it's a killer. Like high blood pressure, it's a silent killer too, because no one ever believes they are overconfident.

At a Harvard conference on behavioral finance, I heard Nobel Prize winner Daniel Kahneman talk about the best way to combat overconfidence. He suggested intentionally taking what he called an "outside view." Instead of placing yourself—with all of your incredible and unique talents and abilities—in the midst of the situation, he proposed using an outside individual, like your neighbor, for instance. Instead of asking, "What are the odds that I can quit my day job and open a top-performing hedge fund or play in the NBA?" ask instead, "What are the odds that my neighbor (the plumber, or the realtor, or the unemployed MBA) can quit his day job and open a top performing hedge fund or play in the NBA?" When you put things in an outside context like that, they always seem a lot less likely according to Kahneman. We all think of ourselves as special; in reality, we're pretty much like everyone else.

Why, then, are investors so quick to bail out on everyone else? Overconfidence again. Our generally mistaken belief that we are special makes everyone else not quite as special as us. Overconfidence and belief in our own specialness makes us frame things completely differently: when we have a bad quarter, it was probably bad luck on a couple of stock picks; if Bill Miller (to choose a recent example) has a bad quarter, it's probably because he's lost his marbles and his investment process is irretrievably broken. We'd better bail out, fast. (A lot of people came to that conclusion over the past couple of years. In 2009, Legg Mason Value Trust was +40.6%, more than 14% ahead of its category peers.)

Think about an adaptive Dorsey, Wright Research model like DALI. As conditions change, it attempts to adapt by changing its holdings. Does it make sense to jump in and out of DALI depending on what happened last quarter or last year? Of course not. You either buy into the tactical approach or you don’t. Once you decide to buy into—presumably because you agree with the general premise—a managed mutual fund, a managed account, or an active index, for goodness sakes, leave it alone.

In financial markets, overconfidence is the enemy of patience. Overconfidence is expensive; patience with managed products can be quite rewarding. In the example of the CGM Focus Fund, Mr. Heebner grew $10,000 into $61,444 over the course of the last ten years. Investors in the fund, compounding at -11% annually, turned $10,000 into $3,118. The difference of $58,326 is the dollar value of patience in black and white.

Mike Moody is a Senior Portfolio Manager at Dorsey, Wright Money Management on January 6, 2010. It is reprinted here with permission. Additional articles can be found at http://systematicrelativestrength.com/
Management. He joined the firm in 1994. Prior to Dorsey Wright, he worked for Smith Barney and Merrill Lynch. Mr. Moody has been a speaker on the subject of technical analysis and has provided commentary for national media such as Investor's Business Daily and Financial News Network/CNBC. He has served on the board of the Market Technicians Association and is the former editor of the Journal of Technical Analysis. He has also authored several original research papers on the subject of technical analysis. Mr. Moody holds a BA from Pitzer College with a dual degree in Psychology and English, where he graduated summa cum laude.

Dorsey Wright & Associates is an independent and privately owned registered investment advisory firm. Relative Strength is the cornerstone of their investment process. High relative strength stocks have historically provided high returns, but they often do not correlate very well with the broad market. For that reason, high relative strength stocks frequently appear to act like a separate asset class. From an asset allocation perspective, there is significant value in a high-return asset class that is uncorrelated with most other stocks and bonds. Non-correlated performance can help smooth out the returns in a diversified portfolio. For more information on Dorsey Wright Money Management, go to www.dorseywrightmm.com.
An optional and practical one-day investment fund selection workshop will also include various fund 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 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 algs 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.
Buy and Hold Investing: Bonds-Yes & Stocks-No!

By Winans International

Every bull market produces its fair share of “proven” investment strategies that promise easy riches.

During the “Roaring 1920’s”, buying equities with high levels of margin debt was the norm among everyday investors. During the mega bull market from 1982 – 2000, it was the notion of buying & holding equity index funds at all times that became the cornerstone strategy for many investors, big and small alike. Unfortunately, both strategies led investors off a financial cliff during the next bear market.

In the following table, Winans International completed a study that compared 3 different equity investment strategies using S&P 500 Index funds from 1988 to 2009. Two different scenarios were analyzed. One in which all capital was invested at once (i.e., beginning lump sum investment), and the other of building up a portfolio gradually by investing $500 per month (i.e., dollar cost averaging). 90-day Tbills and corporate bond investments with laddered maturities were also included in the study.

Passive vs. Active Investment Strategies

<table>
<thead>
<tr>
<th>Market</th>
<th>90 Day T-Bills</th>
<th>Dow Jones Corp Bond Index</th>
<th>Buy &amp; Hold S&amp;P 500 Index Funds: 200-day Moving Average</th>
<th>January Barometer</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rolled Laddered</td>
<td>BLS</td>
<td>DCA</td>
<td>BLS</td>
</tr>
<tr>
<td>1990</td>
<td>22%</td>
<td>34%</td>
<td>23%</td>
<td>5%</td>
</tr>
<tr>
<td>1999</td>
<td>63%</td>
<td>114%</td>
<td>321%</td>
<td>186%</td>
</tr>
<tr>
<td>2002</td>
<td>72%</td>
<td>136%</td>
<td>130%</td>
<td>49%</td>
</tr>
<tr>
<td>2007</td>
<td>88%</td>
<td>167%</td>
<td>225%</td>
<td>110%</td>
</tr>
<tr>
<td>2008</td>
<td>89%</td>
<td>173%</td>
<td>92%</td>
<td>25%</td>
</tr>
<tr>
<td>Annualized Returns</td>
<td>4.0%</td>
<td>8.1%</td>
<td>6.0%</td>
<td>2.4%</td>
</tr>
</tbody>
</table>

Beginning Lump Sum (BLS); Dollar Costs Averaging (DCA)

The results:

1) While buying and holding S&P 500 Index funds worked very well during the great bull market run of the 1990’s, the strategy quickly gave up its gains during the two significant stock market declines that followed. In other words, passively managed equity index portfolios went through a 22-year roller coaster ride that barely outperformed Tbills.

2) It was a different story for investors who bought & held corporate bonds. The components of the Dow Jones Corporate Bonds Index (laddered for 10 years) greatly outperformed the passively managed equity portfolio (8.1% versus 6.0%) over 22 years studied.

3) The last 22 years was a very profitable time for actively managed portfolios that switched from equities to cash during the 11 times when the S&P 500 Index traded below its 200-day moving average for at least one month, or the 5 separate occasions when the index posted negative results in January. Both active portfolios posted annualized returns at least twice at high as the passively managed portfolio and significantly outperformed the laddered corporate bond portfolio. The reason: The portfolios that used these time-tested tools posted solid annualized returns during market advances and protected portfolios during bear markets.

“Winans International has successfully managed client assets by using these technical indicators to navigate the equity markets and laddering bond portfolios since 1992. With many corporate bond funds consistently having high trading turnover and many of the largest mutual funds indexed to the stock market, it seems like the mutual fund industry has done it completely backwards, and investors have suffered for it. I think it is fair to say that the idea of 100% invested, 100% of the time in stocks will end up in history’s ash heap of flawed financial logic.” Says Ken Winans, President & Founder of Winans International and author of the award-winning book “Investment Atlas”.

Since 1900, the U.S. equity markets have posted negative returns 29% of the time. This historical fact means that a successful investment strategy must incorporate a policy for reducing investment risks during bear markets. In sporting events and military operations, overall victory only comes from executing a good offense.
AND an effective defense. The same is true of investing.

This report was prepared by Winans International. More information can be found at http://www.winansintl.com & www.investmentatlas.com & www.wimutualfunds.com. The firm operates under the leadership of Kenneth G. Winans. Ken has more than 24 years of industry experience. He has conducted “ground breaking” investment analyses and designed innovative investment models and strategies. He is a regular guest on various TV and radio shows and has had much of his investment research published by leading magazines and newspapers.

The Winans International Preferred Stock Index (WIPSI)™ and the Winans International Real Estate Index (patent pending) (WIREI)™ are considered leading market benchmarks and are used by major financial and academic institutions.

Ken is also a member of the Chartered Financial Analyst (CFA) Institute and has served on several committees for the San Francisco Chapter. Ken and his wife, Debbie, are long-time residents of Marin County and are active in industry and community groups. In 2002, they founded The W Foundation, a non-profit organization dedicated to the public education of the history and future benefits of space exploration. He also serves on the board of the Chabot Space Science Center. In his spare time, Ken ski races in the U.S. Ski Association’s Masters Program and is a renowned collector of artifacts from space exploration as well as antique financial documents. Many pieces of his collection are on display at leading museums coast to coast.

Moving Averages: ETF Strategies for Short Term Traders

By David Penn, www.tradingmarkets.com

What are the two most important moving averages for short-term, high probability ETF traders?

Moving averages are a very popular tool, and are a key ingredient in many trading strategies. Moving averages are typically trend-following tools that help traders determine what kind of trend, if any, a given market has developed.

One problem with moving averages is that many of the uses of moving averages have not been quantified – especially for short term traders in stocks and ETFs. As a result, a number of short term trading strategies for stock and ETFs that rely on moving averages or even multiple moving averages, have often underperformed.

Our research into short term price behavior – in both stocks and ETFs – has found two key roles for moving averages in our trading strategies. These roles enable us to use moving averages for what they are best equipped to do – at least from the perspective of a short-term, high probability trade designed to last 5-7 days. Here, we will take a look at those two roles and which two moving averages have been quantified to fit the bill.

Only Buy Above the 200-Day

The most important moving average in our research, the one that is most important to our high probability ETF trading strategies, is the 200-day moving average. While we have developed a few trading strategies that are “moving average agnostic”, the vast majority of our high probability trading strategies call for buying above the 200-day moving average.
The green highlighted sections show when the SDPR S&P 500 ETF [SPY] was trading above its 200-day moving average. The red highlighted section shows when the SPY was trading below its 200-day moving average.

If you examine a large set of data, you will notice that markets that are above the 200-day moving average tend to recover after short-term pullbacks. At the same time, you will also notice that markets that are trading below the 200-day moving average tend to resume their downtrends after temporary bounces.

This tendency has been uncovered time and time again in our testing of both stocks and exchange-traded funds (ETFs). And while there have been few, specific exceptions, our backtesting confirms that for the vast majority of the time and for the vast majority of traders, the 200-day moving average is a critical technical indicator to help traders do the right thing on the right side of the market.

The 5-Day Moving Average Exit

The other moving average that has withstood our testing (testing which has included thousands of stocks since the early 1990s and hundreds of exchange-traded funds since inception) is the 5-day moving average.

What do we use the 5-day moving average for? Our testing has shown that for short term trading strategies that are based on buying after pullbacks (“buying the selling”) exiting the trade after the market closes above its 5-day moving average is a simple and effective trading strategy for exiting high probability trades (“selling the buying”).
Exiting trades after they close above their 5-day moving average is one excellent and quantified strategy to “sell the buying” and take profits from high probability trades.

A close above the 5-day moving average is a sign that the market is gaining strength. Remember that the 5-day moving average takes the average of the five most recent closing prices of the market. When a market closes above the average of its recent closes, it is a quantified show of strength that high probability traders can rely on when looking for the requisite “strength” into which to exit high probability trades.

One last note: when we use moving averages in our testing and our trading strategies, we use the simple moving average rather than any of the more exotic varieties. We have found that we gain no significant edge in our testing by substituting more complex moving averages when basic, easy-to-calculate moving averages like the simple moving average is available.

David Penn is Senior Editor at TradingMarkets.com.

Baseline Analytics’ Market Tour

By Robert F. Palmerton, Jr., CMT

At the close of each trading day, Baseline Analytics conducts a streamlined yet comprehensive review of the financial markets. To short-cut the time spent reviewing the markets without compromising the key market indicators we have found to be most important to arrive at a trading strategy, Baseline Analytics has devised a daily “Market Tour” consisting of about 30 charts made public and maintained on Stockcharts.com. These charts are organized into several categories:

- Index reviews
- Market Breadth
- Sentiment
- Sector relative strength
- Intermarket (bonds, commodities, stocks)
- Style (small cap, large cap, value and growth)

The charts are annotated with comments and colored based on bullish perspective (green), bearish (red), and neutral (black). Here is how our daily Market Tour begins:
Index Reviews: The Big Picture:

Our nightly tour starts with a price review of the major indices (the focus is on one daily and weekly chart each of the S&P500 and the Nasdaq); observing price behavior relative to trendlines (with a preference for a 34-day exponential moving average), confirmation and divergence using RSI and OBV, and volume and candle patterns.

We also look at moving average slopes for consistent direction, and a chart showing the percentage of stocks in these respective indices above or below their 50-day moving averages.

Breadth Indicators: the Market’s Internal Strength

Next is a tour of various breadth indicators. Charts of the NASDAQ and NYSE advance-decline data are reviewed using a moving average of the data to remove the daily noise. Overbought and oversold points on the breadth charts are compared to points on a chart of the respective index that have coincided with market trend changes.
We find the NYSE McClellan Oscillator to be key indicator of internal market strength. We look for NYMO to exceed zero to confirm the equity market’s bullish tone. Alternatively, NYMO crossing its 20-day EMA (and an uptrending EMA) supports the bullish case.

Relative Strength: Where is the Money Flowing?

The next stage of our daily market tour is to assess how the various sectors performed relative to SPX. This is particularly helpful in gauging the stage of the economic cycle. The sectors we focus on include financials, discretionary stocks, staples and technology. Watching financials underperform for most of November and into December, for example, is a cause for concern and has tempered our bullish stance, even though the indices are generally following an uptrend. We also believe that NASDAQ (technology) leadership is important.
Watching staples vs. discretionary stocks gives us a sense of the strength or weakness of consumer spending and expectations toward economic growth.

Finally, we like to keep Dow Theory in view, so we add a simple daily chart depicting the Dow Jones Industrial Average with the Transportation Index as we look for consistent performance between the two indices.

Sentiment: Gauging Fear and Complacency
The next phase of our Market Tour is sentiment. We review VIX relative to the S&P500 and its own trendlines, moving averages and RSI (we use the 50-line on RSI to assess whether VIX is bullish for equities (RSI below 50) or bearish (above 50). Extreme VIX readings relative to its EMA 34 raise the prospect of a short-term trend change.

Put/Call is reviewed to identify whether it has hit an extreme high or low value where market turning points have been experienced in the past.

Intermarket Tour: Confirming relationships between Commodities, Bonds and the Dollar

The Market Tour proceeds to review intermarket relationships among commodities, the dollar and bonds. Signs of divergence and trend exhaustion and sought, as well as evidence to either support or challenge positions in the equity markets.
Industrial Metals (copper)/Bonds ratio since early this year's recent consolidation. Bonds took a hit with rising rates, helping this ratio climb.

CRB consolidates as gold corrects. A strengthening dollar could put CRB bulls at risk.

Dollar weakness based on a broader and potential reversal. Note the jump in the 1Yr US Treasury Yield, which maintains a strong correlation with the dollar.
Style: What’s in Fashion?

The daily Market Tour is wrapped up with a review of style, looking at small caps vs. large caps, growth vs. value. Value stocks excelled following the 2000 peak, which reversed in mid-2003 when growth returned to favor. These charts help define the secular trend and the risk-reward of the various market sectors. Looking at style helps choose which areas to participate in the equity markets when the intermarket relationships, indices, sentiment and breadth align favorably to support building equity exposure.

Baseline Analytics’ daily review is accomplished with under 30 charts on Stockcharts.com. The green (bullish), red (bearish) and black (neutral) ratings are collectively assessed to arrive at position on the various markets. Baseline Analytics will hold long and short positions and hedge accordingly, given its overall assessment resulting from its Market Tour. Perspective is always tempered with a focus on price (which is of primary importance, as the indicators are secondary, supporting tools); our preference is to define the intermediate-term trend as exhibited by price and its relationship to its EMA 34.

Baseline Analytics’ Market Tour is updated weekly on Stockcharts.com.

About Baseline Analytics

Baseline Analytics, based in Ann Arbor, MI., develops trading and investment strategies utilizing a combination of technical, fundamental and macro-economic research. Robert Palmerton, CMT, founded Baseline Analytics in October, 2005. Bob received his MBA in Finance from the University of Michigan, a BA in Economics summa cum laude at Fordham University in New York, and is a Member of the Market Technician’s Association (MTA) in New York City, where he earned the Chartered Market Technician (CMT) designation. Bob is also a member of the Detroit Chapter of the MTA, the Technical Securities Analysts Association (TSAA) and the Detroit Metastock User’s Group.

Fibozachi – Taking the Trading World by Storm

By Deberah Bringelson

The first thing you’ll want to know is were the name comes from. Fibozachi is a combination of the words Fibonacci and Zachary. Fibozachi.com is the creation of two brothers who combined overlapping expertise in the field of technical analysis. One brother is a portfolio manager with a macro outlook and the other is a trader with a micro outlook. One has a BA in Economic History and a Concentration in Economic Game Theory from the University of Pennsylvania, while the other has a BA in Psychology from the University of Colorado at Boulder; each is a candidate for Level III of the Chartered Market Technician designation.

Bursting onto the trading scene in early - 2009; Fibozachi, with its highly accurate and innovative indicators is taking the trading world by storm. The Brothers Fibozachi; Zachary and Brandon have combined extremely high level fractals and mathematical formulas and the harmonic rhythms of Fibonacci sequencing with real life, practical trading experience to create comprehensive packages of trading indicators that are sure to add to your portfolio.

Master any of the 35 Fibozachi indicators, paint bars and radar screens and new and experienced traders alike will find profits soaring.
Easy To Use

Long-time traders will recognize slightly updated names that take the best of the best and make them even better. For example, Bollinger Bands become Inflection Bands (FIBs) which identifies high probability breakouts, while at the same time, defining support and resistance. Dramatically improving on BBs, FIBs don’t just average the closing price, but more accurately indicate the stocks true movement by averaging the open, high, low, and close, producing smoother bands and a more accurate reflection of price action.

And, combining FIBs with Trend-Traffic Lights, which provide trend change alerts, helps even the novice trader isolate breakouts.

Riding the wave of a trend is certainly the best and easiest way to make money in the market. But knowing when to catch a breaking wave can be tricky. Not with the Fibozachi Trend –Traffic Package.

But, as we all know, not all trends are equal. A breakout on low volume may mean a head fake and result in hefty losses. The Vol.T Trigger, Oscillator and Paint Bar solve the problem by alerting traders to exactly when and where buying pressure, selling pressure and profit taking are taking place.

Out With The Old – In With Profits

What makes the Fibozachi indicators so successful is the fact that they are both unique and cutting edge. With extensive training in mathematics, economics and game theory and 12 years trading experience, the Fibozachi Team has embraced both tried and true trading indicators (e.g. Fibonacci sequencing) and new-style electronic and mechanical trading.

Gently weaving these together, Fibozachi has created new indicators that leave the old in the dust.

Just three examples are the Fibozachi SuperRSI, SuperDMI, and SuperMACD, which have made the "old" versions effectively obsolete.

Many traders use the "old RSI" to predict when a stock is in overbought or oversold territory. And, we’ve all experienced the whipsaws that occur when the "old RSI" gives false signals. Fibozachi’s “SuperRSI” solves that problem by modifying the way "price" is calculated. Rather than only using the closing price in its calculations as the "old RSI" does, SuperRSI modifies the way price is calculated by incorporating a number of highly complex averaging techniques, which gives you the trader a clearer, smoother, highly sophisticated indicator.

You - In Control

Fibozachi’s “SuperRSI”, “SuperMACD”, and “SuperDMI” all put you in control. While the old versions use only simple moving averages and always calculates price based only on the close, SuperRSI allows for powerful customization to best fit your trading needs. By giving you the trader a choice between Simple, Exponential, Double Exponential, Triple Exponential, Weighted, Triangular, Hull, Gaussian, and Adaptive Moving Average methodologies, SuperRSI, SuperMACD and SuperDMI each open up a whole new world of profit possibilities.

And that’s not all. Take for example SuperRSI, which also includes incredible, proprietary “buy/sell” signals that are based on a secret formula only revealed to users. The “Slope Trigger” Bullish/Bearish “Dot”, signals when the SuperRSI reverses its direction/slope while in the overbought/oversold thresholds. And “Crossover
Triggers” - Bullish / Bearish “Dot” signals are generated when the Super RSI crosses above or below the overbought/oversold thresholds.

Stepping up to the plate next is the highly sophisticated SuperMACD, which not only gives you the option of customizing moving averages as in the SuperRSI and SuperDMI; but further refines signals by actually changing the calculations within the indicator’s formula when the MAs are changed.

Adding to SuperMACD’s usability is the option to modify just “how” price is calculated. While the “old” MACD uses the “close” of each bar for its calculations often resulting in erratic movement and false signals, SuperMACD kicks it up several notches by giving traders the option customize further by using the “average close” of the last “N” amount of bars for its calculations!

Next Generation Trading

Along with SuperMACD and SuperRSI, the Fibozachi SuperDMI truly takes trading to the next level. We all know that we only make money when the market or a stock is moving. But all too often stocks get caught in a sideways dance, which cost you money. SuperDMI dramatically smoothes bearish and bullish signals to get you in at the beginning of the trend and out when it’s over. By giving traders the option of smoothing any of the eight Moving Average options, as well as smoothing price calculations, the jagged, frequent false signal crossovers common to the “old DMI” are virtually eliminated.

And with both visual and audio alerts, Fibozachi indicators let you know exactly when to enter and exit winning trades.

Roadmap To Success

One of the best things about all of the Fibozachi products is how easy they are to read. Is the stock breaking out, breaking down, trending sideways? Take the Fibozachi ZMA. During a hectic trading day, often a quick glance at the screen tells you exactly what you need to know. Having used the Fibozachi indicators for several months, this trader finds them both easy to read and fun to use. Just three of my personal favorites, the Spectra-Trader Paint Bar, ZMA, and Dynamic Trailing Stop, all provide an easy to read road map to buying and selling entrance and exit points.

As the stock crosses the Dynamic Trailing Stop (DTS) white line it gives a buy sell signal. ZMA provides instant Bullish or Bearish trend direction. And, confirming the DTS line cross with the analysis of the Spectra-Trader paint bar means that trades are made with confidence. Spectra-Trader Paint diagnoses the strength and the direction of a trend and tells traders if the stock is bullish, slightly bullish, slightly bearish or bearish. Personally, Spectra-Trader Paint Bar goes on every chart I use.

Customized to Fit All Trading Styles

Are you a long-term investor? Day trader? Scalper? Stocks? Options? Futures? Fibozachi indicators work for you. And with trial programs available now to NinjaTrader and soon for TradeStation customers, taking Fibozachi for a test drive is well worth a trader’s time.

My personal experience is that customer support is highly responsive, friendly and helpful. Detailed user guides are provided with all indicator packages. And, training videos and “Designer Tip” videos will be out in early 2010.
The FOG Index: Recognizing Extremes of Fear and Greed in the Financial Markets by Jeff Cheah, CMT, and Russel D. Ogden

Reviewed by Mike Carr, CMT

In a short book about 80 pages in length, Cheah and Ogden introduce the FOG Index, an indicator offered exclusively to subscribers of Thomson Reuters' DataStream and 3000 Xtra products. However, the book is far from being a marketing brochure for a proprietary technical tool. It is an interesting and instructive look at how many other technical indicators can be evaluated. In less than an hour, readers will understand that there may be more information in the first derivative of an oscillator than in the oscillator itself. With this inspiration, some readers may find success by applying the general principles that the authors detail in The FOG Index.

The authors explain that, “The FOG Index is a tool to help market participants recognize extremes of fear or greed in the financial markets. It helps to spot the early warning signs of euphoria heading toward panic, as well as the early signals that pessimism and complacency are turning toward rational optimism. Simply, the FOG Index helps to understand risk from a market sentiment perspective.”

Market action over the past ten years offered many examples where the indicator showed the possibility of extreme risk or potentially extreme rewards. In the chart below, we show an example from the relatively calm stock market of the 1990s.

Source: Thomson Reuters DataStream

The index itself is derived from ten indicators:

1. TED Spread
1. LIBOR
2. US T-Bills
The book includes a detailed discussion of each indicator. Rather than focusing on the absolute level of each indicator, Cheah and Ogden evaluate the velocity of the indicator and its relative position when studied in the context of recent market action. This technique can be applied to any market analysis.

From high school physics, many market technicians will recall that velocity is the first derivative of distance with respect to time. Acceleration is the second derivative. While Cheah and Ogden don’t delve into high school science and math, astute technicians will see the application of these ideas in The FOG Index. Applying that insight could lead to a number of testable trading ideas, and may even form the basis of a profitable strategy.

What the authors do is present a quantitative model of emotions in the markets. “Today’s markets are increasingly speculative and prone to the changing moods in herd behavior...

Let’s be clear: The FOG Index cannot predict the next financial event. There will be another crisis event in the future. The FOG Index is not a timing indicator. It cannot tell you with absolute precision when to buy or sell securities in the market. In fact, daily observation of the FOG Index is meaningless. The FOG Index is, however, an indicator that can capture the behavior of excessive risk-taking or risk-averse conditions in the financial markets. Extreme market sentiment conditions (especially of the financial bubble types) can stay inflated for a long time. It is usually after the fact that we come to recognize that market conditions were indeed bubble-like.

The FOG Index captures moments when fear and greed become rampant in the marketplace. When the FOG Index is showing extreme levels, this is a signal that market conditions warrant closer scrutiny because turning points are just around the corner.

Unlike a thermometer that can show a freezing or boiling point, the FOG Index cannot offer a precise measure for when fear or greed reach extreme levels. Instead, it relies on a standard deviation analysis to ascertain when financial market conditions are touching extreme points. The upper and lower Bollinger Bands are +/- 2 standard deviations. The moving average is part of the Bollinger Band calculation, and in our FOG example, it merely serves as a reference guide.”

The concepts presented are universal and can be applied in the FOG framework or on a standalone basis.

The book is available for US$17 directly from the authors. For more information on the FOG Index, contact Jeff Cheah CMT, Chief Technical Analyst, Thomson Reuters, at jeff.cheah@thomsonreuters.com or (416) 941-8166.

Jeff Cheah is Chief Technical Analyst at Thomson Reuters Americas, in Toronto. Jeff has more than 20 years experience in market analysis, including Senior Analyst at the Bank of Canada, Market Strategist, Standard & Poor’s, Foreign Exchange Trader, Bank of America, and Derivatives and Money Market Trader at the New Zealand Investment Bank in Singapore.

Russel Ogden is a sociologist at Kwantlen Polytechnic University, Surrey, British Columbia.

MTA Announcements

MTA Website Orientation Video - New!

Over the course of the last month the MTA has gone through the process of creating an orientation video for our mta.org website. The purpose of this video is to provide new and prospective members with a tutorial that explains and describes how to access all the member services that are offered through our website. As an existing member, if you are unsure or would like a “refresher” on what is available through our website, this video might be of value to you. Click here to view this new orientation video.

MTA Board of Directors Nominations
For the fiscal year commencing July 1, 2010, four (4) Officer positions are up for consideration for a 2-year term, and two (2) At-large Board positions are up for consideration for a 3-year term. Over the next two months, we are encouraging any Member, Honorary Member or Emeritus Member in good standing to submit your name for consideration to nominations@mta.org. The nominating committee will then seek out your completion of a tailored questionnaire as part of its review process. In addition, if you do not wish to serve but have suggestions on who might be willing/able to do so, we would encourage you to write us on that as well. Nominations may also be made by petition signed by not fewer than ten (10) percent of the Members, Honorary Members and/or Emeritus Members in good standing. For complete details on the Nominating Process, please visit section C5.04 of the MTA Constitution.

MTA Educational Web Series - Upcoming Schedule and New Addition!

Registration is now open for the following upcoming presentations of the FREE MTA Educational Web Series.

- **Sign Up Now** - Wednesday, February 3rd, Joseph Mertes, Managing Partner at Joseph James Consulting, LLC, will present "Auction Market Theory" at 12:00 PM EST. Register for this webcast. *(Please note that this event was originally scheduled for Feb. 24th, but subsequently has been changed.)*

- **Sign Up Now** - Tuesday, February 9th, Steve Nison, CMT, renowned author and speaker, Candlecharts.com, will present "Candle Charting Essentials and Beyond" at 12:00 PM EST. Register for this webcast.

**New Addition to the Schedule** - The MTA is pleased to announce the following presentation has been added to the Educational Web Series schedule:

- Thursday, March 11 - Jeremy du Plessis, CMT, FSTA, Head of Technical Analysis and Product Development with Updata PLC. Jeremy will be presenting "Understanding and Using Point and Figure Charts" at 12 PM EST.

View the entire schedule of upcoming webcasts...

CMT Institute (CMTi) - Registration Open!

We are pleased to announce the opening of the Spring 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. Sign up today to start viewing these archives and begin your study process now. To register for one of the CMTi courses, please click here, or call Cassandra Townes at 646-652-3300. Click here to read a letter from the CMTi Director, Carson Dahlberg, CMT.

Spring 2010 CMT Registration - Open for All Levels!

Registration for all levels of the Spring 2010 CMT Exam Administration is **NOW OPEN!** Sign up today to ensure your preferred time, date, and location! Contact Marie Penza, 646-652-3300, for information on the CMT Program and/or if you are having trouble scheduling your exam with Prometric. For detailed instructions on how you can register online, please click here.

Upon entering the CMT Program, you will automatically receive the electronic CMT Newsletter. The purpose of the CMT Newsletter is to share with CMT Program candidates important information regarding the requirements, recommended readings, changes and overall administration. Click here to view the most recent issue, and the archives.