Technically Speaking

Market Technicians Association
MAY 2012
LETTER FROM THE EDITOR

As an organization, the MTA has a strong sense of history. One of the ways the MTA chronicles the history of technical analysis and the organization is through its Annual Awards program. Individuals from the past who have made contributions to the field are honored at the Annual Symposium. This year, six individuals were commended for their work and we present small summaries of their accomplishments.

We also include history in this newsletter as often as possible. This month, we conclude with a summary of the Darvas Box, a trading technique developed by Nicolas Darvas. Although better known as a dancer than a market analyst, Darvas wrote a New York Times Best Seller in the late 1950s that highlighted the value of technical analysis to the public. Technicians working with screening software can easily automate his approach instead of relying on weekly issues of Barron’s as Darvas did more than fifty years ago.

This issue also offers an extract of a recent academic paper that discusses some of the topics that are explained poorly in finance textbooks. This material could help some who are trying to explain the benefits of technical analysis to academics. Beta and the equity risk premium may be ill defined, yet cornerstones of pricing theories. Technical analysis offers an adaptive approach to investment theory and could be more useful in real-world trading than concepts like that.

As always, we enjoy learning what you think about Technically Speaking. Please email us at editor@mta.org.

Michael Carr
MTA RECOGNIZES SIX WITH AWARDS
BY MIKE CARR, CMT

At the recent Annual Symposium, the MTA recognized six individuals for their contributions to the field of technical analysis and the MTA. Three individuals – Dr. Martin Zweig, Steven C. Leuthold, and Ned Davis - were honored for their life-long outstanding contribution to the development and widespread acceptance of technical analysis by institutional practitioners and individual investors. Edward C. Johnson III was the Recognition Award recipient. The Service Award was presented to Marie Penza (MTA Member Services Director) and the Memorial Award recipient was George Lane.

The Annual Award is issued to a person(s) who made an outstanding contribution to the field of technical analysis.

Dr. Martin Zweig

Martin Zweig contributed to the acceptance of market timing in the 1980s. He achieved success with an advisory service and managing money in private accounts and closed end mutual funds. His award recognizes that, “He was one of the first practitioners of technical analysis to validate his research with solid statistical evaluation and subject his work to the rigors of academic challenge and debate. His testing work set the rigorous standard that we now employ in evaluating papers for the Journal and the Charles H. Dow Award.”

Dr. Zweig completed his bachelor’s degree at University of Pennsylvania's Wharton School of Finance and then earned an MBA at the University of Miami before completing a Ph.D. in finance at Michigan State University. His doctoral thesis, written in the late 1960s, was on relative strength.

In the early 1970s, Dr. Zweig wrote several articles for Barron’s and made a number of successful market predictions. He also began publishing The Zweig Forecast, an investment newsletter which was highly ranked by The Hulbert Digest as one of the best performing newsletters of the 1980s and early 1990s. The newsletter delivered an average annual gain of 16% from 1980 to 1995, outperforming all other market advisory services during that time. He was also a regular guest on PBS's popular Wall Street Week and he predicted the stock market crash of October 1987 in an appearance on that show the weekend before the crash.

Dr. Zweig also wrote a book, Winning on Wall Street (1986), which provided detailed insight into his methods. In the book, Zweig presents a number of monetary indicators that he monitors, along with technical and fundamental indicators. He combines the various indicators into a model that assesses market risk and invests in equities when risk is relatively low.

In looking at monetary indicators, Dr. Zweig reviews the prime rate to assess the impact of interest rates on businesses. Installment debt is monitored to determine the impact of debt on consumer spending. His Fed indicator
follows the Federal Reserve’s discount rate and the central bank’s reserve requirements.

Market momentum is also important to consider. Zweig Breadth Thrusts are often found at market bottoms. The Advance/Decline Line can be expressed as a ratio. When this ratio moves from below 40% to above 61.5% within ten days, it gives a buy signal. This indicator was written about in the 1980s and correctly forecast the market bottom in March 2009.

Dr. Zweig also studied up volume as a ratio of total trading volume and found that when 90 percent of the volume is upward, a significant, bullish market move should be expected.

The Four Percent Model is a simple trend following tool that Dr. Zweig presented. He applied the model to the Value Line Composite Index although it can be used with any index. Variants of the indicator are also popular. Using the weekly close of the Value Line Index, a buy signal is given when the index rises 4% or more from its previous low. A trend reversal of 4% from a previous peak is a sell signal. In an update to his original book, Dr. Zweig provided results that showed from 1966 through 1993, the Four Percent long/short trading strategy delivered a 12.6% annualized return, compared to a 2.7% gain for the Value Line Index.

On a fundamental basis, Dr. Zweig wrote that he liked to buy stocks of companies that have reported earnings growth in at least four of the last five years and show earnings growth year-over-year in the most recent quarter. He also looks for sales growth over those time frames. He then filters stocks based on the price-to-earnings (P/E) ratio. Dr. Zweig follows a philosophy that has become known as growth at a reasonable price (GARP). He is looking for stocks where the P/E ratio is less than the earnings growth rate. The P/E ratio of a company he is looking at buying should also be in line with the P/E ratio for the stock’s sector. For buys, he sets a minimum P/E ratio of 5 since stocks with ratios less than that are prone to having operational or financial problems.

Technical analysis is also applied to the trading decisions. Dr. Zweig likes stocks that are outperforming the market and he prefers buying breakouts from basing patterns.

Dr. Zweig has been credited with developing a number of technical tools, including the puts/call ratio, a well-known sentiment indicator.

Editor’s note: The biographical information and photo for this article are from www.martinzweig.org, a site that is not affiliated with Dr. Zweig.

**Steven C. Leuthold**

Steve Leuthold is the Founder and Board Member of The Leuthold Group, an investment management and institutional research firm. Steve also serves as a Director of the Leuthold Funds Board of Directors. His MTA award notes that, “Steve has been a stalwart of the MTA Organization nearly since its founding in the early 1970s. He established his
presence first at Piper Jaffray in Minneapolis as their Chief Technical Analyst, then at this own firm and most recently with Weeden His contribution to the field centers on very long-term cyclical analysis (typically 50 years or more) of a wide variety of technical indicators of major indices, but of also sub-sectors and specific technical measures of investor sentiment.

His work remains fresh, innovative and highly respected. Steve has demonstrated the value of the profession in the professional management of various funds over the last 20 years that validates the utility of technical research in the investment process, perhaps putting together the longest buyside performance benchmark of a manager using a suite of technical tools. Steve has been a respected contributor to the financial media uplifting the reputation of the profession. His contribution to the MTA via Committee Chairs including editing the MTA Journal for several years lifted the quality of that publication to new standards in which the entire profession can be proud.”

Prior to founding The Leuthold Group, Steve was an Officer and Portfolio Manager of two mutual funds for Criterion Investment Management; and from 1969 to 1977, he was an Officer and Investment Strategist at Piper, Jaffray & Hopwood. Steve has also previously served on the Board of Directors of Weeden & Co., L.P., an institutional equity trading firm.

Steve’s work includes co-authorship with Eric Bjorgen of the 1999 Dow Award winning paper, “Corporate Insiders’ Big Block Transactions.” In this study, the authors studied insider activity from 1982 to 1999. They found that the 10-week average of dollar volume of net insider selling seemed to work well as a market timing tool. They normalized the selling by dividing the raw value by the stock market capitalization. High levels of net selling (greater than 0.07% when normalized) tend to precede lower than average returns in the stock market. Low levels (less than 0.01%) are associated with reliable buying opportunities.

Editor’s note: The biographical information and photo for this article are from http://www.leutholdfunds.com/steve-leuthold.

### Ned Davis

Ned Davis, Senior Investment Strategist, founded Ned Davis Research Group (NDRG), in 1980. His award notes that, “Under his direction and with his encouragement, Ned Davis Research has become a wonderful training ground for quantitative technical analysts. Ned has been a tireless contributor to the profession and MTA through his participation as a speaker at many MTA programs and conferences over a career that now spans nearly 40 years.”

While arguing that forecasting reliably (“Being Right”) is impossibly difficult, he espouses a philosophy that he feels can consistently win (“Make Money”) through a disciplined strategy of following the weight of objective indicator evidence. Because he also believes flexibility (ability to adapt) is crucial, Ned Davis Research Group also produces many sentiment indicators warning investors to be wary at crowd extremes, and helping them to be
open-minded about potential trend changes. A self-proclaimed risk manager, Ned dedicates his research to avoiding major mistakes, cutting losses short, and letting profits run.

Ned is the author of *Being Right or Making Money* and *The Triumph of Contrarian Investing*. He has been the subject of numerous featured interviews in *Barron’s*, and has been a featured guest many times on the late Lou Rukeyser’s *Wall Street Week*. NDRG is widely quoted by various media and Wall Street sources.

The firm combines macro, technical, and fundamental research into what they call fusion research. Using more than 200 data vendors, NDR has access to more than 10 million data series and over 10,000 visually rich charts and graphs to help clients understand macro environments and execute asset allocation strategies.

Ned Davis Research charts are a model of clarity and usefulness. Examples are plentiful. Below is a chart taken from “Using IPOs to Identify Sector Opportunities,” the 2009 Charles H. Dow Award winning paper written by Kevin Lapham, CMT. Kevin is a Data Integrity manager at NDRG and his work is an example of the inspiration that Ned Davis provides.

In the paper, Kevin applies the number of initial public offerings (IPOs), a well-known, long-term stock market indicator, to market timing. With the popularity of sector investing and the increased use of exchange traded funds, it would be advantageous to employ a new IPO-based indicator to assess sector health, improving upon available technical market measures.

This study will examine how the number of IPOs within the ten market sectors can be used to help identify overbought or oversold conditions in each respective sector.

This chart shows how that indicator could be applied to the Industrials sector. It presents clear buy and sell signals, explains the performance of the indicator in a box that is easily understood, and shows the indicator with key levels in the bottom of the chart. All of the work inspired by Ned Davis is similar in that it is innovative and well presented.

**Editor’s note:** The biographical information and photo for this article are from [http://www.ndr.com/marketing/bios/ned_bio.pdf](http://www.ndr.com/marketing/bios/ned_bio.pdf).
Edward C. Johnson, III

The MTA recognized Edward Johnson, noting, “A lawyer by trade, Edward C. Johnson III built Fidelity with the mindset that price action was predictable. As a result, the company has stressed the importance of technical analysis as part of the normal course of business consistently maintaining a highly regarded department dedicated to the practice.”

Along with daughter Abigail Johnson, Edward Johnson owns and runs Fidelity Investments and Fidelity International. After graduating with a Bachelor’s degree from Harvard College in 1954, Mr. Johnson served in the US Army, before becoming a research analyst at Fidelity Investments in 1957, a company founded by his father Edward C. Johnson II in 1949. He became the portfolio manager for the Fidelity Trend Fund in 1960 and ran the famous Fidelity Magellan Fund from 1963 until 1977. He became president of the company in 1972 and chairman and CEO in 1977.

Among his many industry accomplishments, he started the practice of permitting check writing on money market funds. Under his leadership, Fidelity was among the first to sell discount brokerage services to banks, insurance companies and consumers.

Mr. Johnson’s father was the recipient of the third MTA Annual Award recognizing his lifetime of accomplishment in 1976. The senior Mr. Johnson died in 1984, at the age of 86.

Marie Penza

Marie is “A longtime member of the MTA staff, [who] has gone beyond professional service. As Member Services Director the organization is fortunate to have a detail-oriented, gracious person as a first/on-going point of contact for its members. In addition, as support to various committees and groups within the organization, her patience and agility in making things happen are also appreciated.”

Marie has been with the MTA since 2003. As the Member Services Director, she is responsible for the administration and scheduling of the CMT Program. Additionally, Marie handles administrative duties for the MTA Board of Directors, coordination of the Dow & Annual Awards, and general membership inquiries.

George Lane

Summarizing a successful career, the MTA Memorial Award states, “George Lane developed the widely followed stochastics oscillator to address problems encountered when data was dropped from a series as you move forward in time. His double-smoothing

Editor’s note: The biographical information and photo for this article are from Forbes.
process to normalize the data has been referenced by many different practitioners along the way. Mr. Lane focused on the commodities markets and traveled throughout the Midwest teaching his techniques, which require experience and judgment, to farmers.”

George humbly attributed his success to being "in the right place at the right time" to grow with the industry. He was a professional trader for more than 50 years and is well known as the originator of the widely used stochastics indicator.

During his career, George was a floor Broker for 10 years and a member of three Exchanges. He served on the Board of Directors of Mid-America Commodity Exchange in 1965. He also owned a regional brokerage firm with 41 branch offices and served as Research Director/Economist for two other brokerage firms.

George wrote a daily market letter with a hot line for 16 years and authored four courses for commodities education and an additional course for stock market traders. Among all of his accomplishments, he probably enjoyed training thousands of farm families, ranchers, and producers in other industries, along with their brokers and bankers, how to hedge the risk of production in the futures market.

Since 1953, has taught thousands of market analysts, money managers and individual investors in more than thirty states and abroad how to use technical analysis to trade the markets more effectively. In 2004, George passed away at the age of 83.

A detailed discussion of George Lane’s life and work, prepared by George Schade, CMT, was presented in a recent issue of Technically Speaking and can be read at [http://go.mta.org/282](http://go.mta.org/282).

Editor’s note: The biographical information and photo for this article are from [http://www.lanestochastics.com/George%20Lane's%20Bio.htm](http://www.lanestochastics.com/George%20Lane's%20Bio.htm).

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MTAEF SPRING 2012 FUNDRAISER:
TAKE AN ANALYST TO LUNCH AUCTION
BY BRUCE KAMICH, CMT

The Market Technicians Association Educational Foundation (MTAEF) is holding an auction to raise funds for the mission of identifying and supporting educational programs in the field of technical analysis.

The auction will run from May 1st - 11th, and gives participants the opportunity to take a renowned technician to lunch. This is a great chance to get access to some of the top market minds, and the format of taking the expert to lunch (or a 45 minute phone call) will enable bidders to participate regardless of geographic location.

How do I meet my technician?

Winning bidders will be contacted by a member of the MTAEF staff after they have successfully won and paid for their technician. They will be provided with the contact information of the technician, who will also be given the name of the winning bidder.

How long do I have to carry out my lunch or phone meeting?

Winning bidders will have one year from the date of the close of the auction to arrange a meeting with their technician.

How can I pay for my winning bid?

The MTAEF accepts Paypal payments, credit card payments, or check payments.

For complete details, visit http://www.mtaef.org

This year’s participants include:

- Rick Bensignor – New York, NY
- Marc Chaikin – Philadelphia, PA
- Jeff Cooper – Malibu, CA
- Tony Crescenzi – Orange County, CA
- Thomas Dorsey - Richmond, VA
- David Fuller – London, England
- Jeff Greenblatt - Phoenix, AZ
- Todd Harrison – New York, NY
- David Keller – Boston, MA
- Jeff Kennedy – Atlanta, GA
- Walter Murphy – New York, NY
- Jon Najarian – Chicago, IL
- Mark Newton – New York, NY
- Jim Rogers – Singapore
- Linda Bradford Raschke – Chicago, IL
- Phil Roth – New York, NY
- Vic Sperandeo – Dallas, TX
- Katie Stockton – Greenwich, CT
- Frank Teixeira – Boston, MA
- Larry Williams – St. Croix, US Virgin Islands
- Louise Yamada – New York, NY
- Dan Zanger – Miami Beach, FL
INTERVIEW WITH RALPH ACAMPORA, CMT
BY AMBER HESTLA-BARNHART

How would you describe your job?

My ‘job’ is as Partner of a company called Altaira. We are a small wealth management company that has a set of outside managers who run separate portfolios. I am part of the investment committee that allocates the assets between these products. For example, we have many Middle-Eastern clients and we created an Islamic High Dividend Fund. We also have a relationship with an Emerging Markets Fund (ETFs), etc...

I am still a ‘stock jockey’ but since we started this firm in 2008, I have spent most of my time looking at Exchange Traded Funds

Do you look at any fundamental or economic inputs to develop your opinions?

We call our research: “Fusion Analysis” – meaning that we incorporate fundamentals, economic, and other inputs and, of course, we time everything technically.

Can you share any longer term market opinions?

Recently we have raised some cash because we anticipate a market correction; we are slowly starting to put money back to work in the emerging markets area, mainly Eastern Asia. I am in the camp of those who believe that we are in a major long-term bull market – currently, the USA is the most interesting area in the world for investing in equities. Any corrections are deemed long-term buying opportunities.

What advice would you have for someone starting in the business today?

Starting in the business today reminds me very much of the time when I was a young analyst starting my career in Wall Street in the 1970s. Like the 1970s, the market today is going to remain very choppy and the lack of volume underscores the fact that, like in the 1970s, we again lost a generation of investors. This lack of volume continue to negatively affect the trading firms and the major brokerage companies because investors (the Baby Boomer generation) are totally risk adverse because they are approaching retirement and the last thing they want to do is take a risk on some stock idea. Unlike the 1970s the growth in research departments is now on the buy-side of the Street and not the sell-side when I began my career. Thus, I would encourage a young person start looking for a position on the buy-side.

The more professional accreditations one can get the better – therefore, I would recommend that one acquire both CFA and CMT charters. The field of ETFs is still in its early stages – I would recommend that one get a better understanding of all the intricacies of ETFs. Of course, the biggest change in our field is the fact that the world is indeed ‘global’ - international investing is growing with more and more emphasis on markets outside of the USA. We technicians are very fortunate because our discipline is indeed ‘international,’ supply and demand are forces that are universal and thus can be followed by those who are technically oriented.
Ralph Acampora, CMT is Senior Managing Director, Altaira Investment Solutions LLC. Ralph is a pioneer in the development of market analytics and has a global reputation as a market historian and a technical analyst. He is the former Director of Technical Research at Kidder Peabody and Prudential Securities, a published author, popular lecturer and a leading international expert, consulted by prominent financial experts and journalists worldwide.

These questions and answers have been compiled by Amber Hestla-Barnhart, an independent market researcher. If you’d like to participate in a future interview, please contact her at amzhondacbr@yahoo.com.
TEN BADLY EXPLAINED TOPICS IN MOST CORPORATE FINANCE BOOKS
BY PABLO FERNÁNDEZ

Editor’s Note: This is an extract of the paper. The full paper is available at http://go.mta.org/285 and portions are reprinted here with the permission of the author. Technical analysts focused on risk may find the information about equity premiums useful. Those interested on relative strength strategies may find the discussion on beta to be useful.

Abstract: This paper addresses 10 corporate finance topics that are not well treated (or not treated at all) in many Corporate Finance Books. The topics are: 1. Where does the WACC equation come from? 2. The WACC is not a cost. 3. How is the WACC equation when the value of the debt is not equal to its nominal value? 4. Textbooks differ a lot on their recommendations regarding the equity premium. 5. The term equity premium is used to designate four different concepts. 6. Which Equity Premium is used by professors, analysts and practitioners? 7. Calculated (historical) betas change dramatically from one day to the next. 8. Why many professors still use calculated (historical) betas in class? 9. EVA does not measure Shareholder value creation. 10. The relationship between the WACC and the value of the tax shields (VTS)

Textbooks differ a lot on their recommendations regarding the equity Premium.
For example, Brealey and Myers considered until 1996 that \( \text{REP} = \text{EEP} = \text{arithmetic HEP over T-Bills} \) according to Ibbotson: 8.3% in 1984 and 8.4% in 1988, 1991 and 1996. But in 2000 and 2003, they stated that “Brealey and Myers have no official position on the exact market risk premium, but we believe a range of 6 to 8.5% is reasonable for the United States.” In 2005, they increased that range to “5 to 8 percent.”

Copeland et al. (1990 and 1995), authors of the McKinsey book on valuation, advised using a \( \text{REP} = \text{geometric HEP versus Government T-Bonds} \), which were 6% and 5.5% respectively. However, in 2000 and 2005 they changed criteria and advised using the arithmetic HEP of 2-year returns versus Government T-Bonds reduced by a survivorship bias. In 2000 they recommended 4.5-5% and in 2005 they used a REP of 4.8% because “we believe that the market risk premium as of year-end 2003 was just under 5%.”

The term equity premium is used to designate four different concepts:

1. Historical equity premium (HEP): historical differential return of the stock market over treasuries.
2. Expected equity premium (EEP): expected differential return of the stock market over treasuries.
3. Required equity premium (REP): incremental return of a diversified portfolio (the market) over the risk-free rate required by an investor. It is used for calculating the required return to equity.
4. Implied equity premium (IEP): the required equity premium that arises from assuming that the market price is correct.

The equity premium designates four different concepts: Historical Equity Premium (HEP); Expected Equity Premium (EEP); Required Equity Premium (REP); and Implied Equity Premium (IEP). Although the HEP is equal for all investors, the REP, the EEP and the IEP are different for different investors.

There is a kind of schizophrenic approach to valuation: while all authors admit different expectations of equity cash flows, most authors look for a unique discount rate. It seems as if the expectations of equity cash flows are formed in a democratic regime, while the discount rate is determined in a dictatorship.
A unique IEP requires assuming homogeneous expectations for the expected growth \((g)\), but we show that there are several pairs \((\text{IEP}, g)\) that satisfy current prices. We claim that different investors have different REPs and that it is impossible to determine the REP for the market as a whole, because it does not exist. 129 of the 150 books identify Expected and Required equity premium and 82 identify Expected and Historical equity premium.

This is explained in the article “Equity Premium: Historical, Expected, Required and Implied”, downloadable at http://go.mta.org/287.

Which Equity Premium do professors, analysts and practitioners use?

A survey (http://go.mta.org/288) shows that the average Market Risk Premium (MRP) used in 2011 by professors for the USA (5.7%) is higher than the one used by analysts (5.0%) and companies (5.6%). The standard deviation of the MRP used in 2011 by analysts (1.1%) is lower than the ones of companies (2.0%) and professors (1.6%).

Figure 3 shows the dispersion of the MRP used:

Calculated (historical) betas change dramatically from one day to the next.
Figure 3 shows the historical betas of AT&T, Boeing and Coca-Cola in the two-month period of December 2001 and January 2002 with respect to the S&P 500. It may be seen that the beta of AT&T varies from 0.32 (January 14, 2002) to 1.02 (December 27, 2001), the beta of Boeing varies from 0.57 (January 30, 2002) to 1.22 (January 20, 2002), and the beta of Coca-Cola varies from 0.55 (December 28, 2001) to 1.11 (January 15, 2002). A closer look at the data shows that the beta of AT&T is higher than the beta of Boeing 32% of the days, and is higher than the beta of Coca-Cola 50% of the days. The beta of Boeing is higher than the beta of Coca-Cola 76% of the days. AT&T has the maximum beta (of the three companies) 29% of the days and the minimum beta 47% of the days. Boeing has the maximum beta (of the three companies) 58% of the days and the minimum beta 15% of the days. Coca-Cola has the maximum beta (of the three companies) 13% of the days and the minimum beta 38% of the days.

This is explained in the article “Are Calculated Betas Worth for Anything?” downloadable at [http://go.mta.org/289](http://go.mta.org/289).

The article provides additional information about the 62 calculated betas of 3,813 companies with respect to the S&P 500 in the two-month period of December 2001 and January 2002:

- 2,927 companies (77%) had, in the sample period, a maximum beta more than two times bigger than their minimum beta.
- Only 2,780 companies (73%) had positive betas on the 62 consecutive days.
- 52% of companies in the S&P 500 had a maximum beta more than two times bigger than their minimum beta.
- The median of the difference between the maximum and the minimum of the 62 betas calculated for each company was 0.88 for the 3,813 companies in our full sample, 0.63 for the 450 companies in the S&P 500.

Looking at industry betas, 25% of the industries had a maximum beta more than two times bigger than their minimum beta.

It seems that it can be an enormous error to use the historical beta as a proxy for the expected beta. First, because it is almost impossible to calculate a meaningful beta because historical betas change dramatically from one day to the next; second, because very often we cannot say with a relevant statistical confidence that the beta of one company is smaller or bigger than the beta of another; third, because historical betas do not make
much sense in many cases: high-risk companies very often have smaller historical betas than low-risk companies; fourth, because historical betas depend very much on which index we use to calculate them.

**Why do many professors continue using calculated (historical) betas in class?**

A survey (http://go.mta.org/290) done in 2009 reports 2,510 answers from professors from 65 countries and 934 institutions. 1,791 respondents use betas, but 107 of them do not justify the betas they use.

97.3% of the professors that justify the betas use regressions, webs, databases, textbooks or papers (the paper specifies which ones), although many of them state that calculated betas “are poorly measured and have many problems”.

Only 0.9% of the professors justify the beta using exclusively personal judgment (named qualitative, common sense, intuitive, and logical magnitude betas by different professors).

All professors admit that different investors may have different expected cash flows, but many of us affirm that the required return should be equal for everybody: That is a kind of schizophrenic approach to valuation. Most professors teach that the expected cash flows should be computed using common sense and good judgment about the company, its industry, the national economies… However, many professors teach a formula to calculate the discount rate (instead of using again common sense).

The paper includes interesting comments such as:

- I justify the betas by computing them and proving that they are right. References are also made to financial webs.
- I always emphasize that beta calculations have to be taken with some leeway.
- I use betas... but I use all metrics that are available.
- I do not have much confidence in beta but we don't seem to have any easy substitute.
- It is poorly measured, but no substitution so far.
- I justify the betas if the published betas are "abnormal" (i.e., negative when you would expect it to be positive)
- The model has received a Nobel Prize in Economics and while not perfect is used extensively in practice.
- If you don’t use betas, how do you adjust for risk? Almost every practitioner book uses betas such as the McKinsey publications.
- I use whatever is suggested in the teaching note.
- Beta is a simple method and it is used in the "real world." It is really not so helpful, although easy to use.
- I use beta in my valuations. In consulting, it is essential to fully support your estimates.
- Referees want to see them as the underlying model. I need a model anyway, and these are the safe bets that referees will not challenge.
- Students tend to see CAPM as just one recipe from a cook book.
- I do not use betas except for teaching purposes. I researched the predictability for stock returns. I found worse out of sample
predictive power for future returns using betas than when the market average return is used.

- We justify use of betas through underlying theory and students get convinced. I found that students are quite excited about betas.

Pablo Fernández is Professor of Financial Management PricewaterhouseCoopers Chair of Corporate Finance / Nissan Chair of Corporate Strategy and International Competitiveness Finance at IESE Business School in Madrid, Spain. Prof. Fernández was awarded his Ph.D. and M.A. in business economics from Harvard University. He also holds an M.B.A. from IESE and a degree in industrial engineering from the University of Navarra in San Sebastian. Before embarking on a career in academia, Prof. Fernández was the financial analyst and financial coordinator of Pepsi Cola for the south of Europe (Portugal, Spain, Italy, Libya and Malta) in Spain, a position he also held in Rome where he simultaneously took up the financial management for the Mediterranean Region (Egypt, Turkey, Lebanon and Jordan) and Sudan. He can be reached at fernandezpa@iese.edu.
GLOBAL EMERGING GROWTH CAPITAL

**Investment Courses For Professionals**

A sample of a growing list of fundamental and technical courses is shown below. The courses are associated with global destinations and dates, both for open and private client formats. They are produced by various knowledge vendors throughout the world. Details can be provided by contacting NYIF.COM, or John Palicka (palicka@pipeline.com).

*Taught by John Palicka CFA CMT*

**FUSION ANALYSIS**
This is a professional approach that blends fundamental, technical, behavioral and quant strategies.

**EQUITY PORTFOLIO MANAGER**
Serious managers will utilize this course to analyze leading Wall Street valuation models and investment strategies for equities using fundamental, behavioral/technical and quant approaches, and then study how these are modified by the best performing equity portfolio managers to produce risk-adjusted excess returns.

**INVESTMENT FUND SELECTION**
This is a must attend course for all professionals involved in the selection and management of third-party investment managers.

**TECHNICAL ANALYSIS CMT 1**
A must attend course for investment professionals wishing to gain the CMT Level I professional qualification in Technical Analysis from the Market Technicians Association (MTA).

**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.

**ADVANCED CAPITAL MARKETS ANALYSIS**
Spot, forwards, futures, swaps, options, and statistical issues are discussed in dynamic capital market strategies.

**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.

**GLOBAL SMALL CAP INVESTING**
Global small cap stocks offer investors the ability to participate in the world’s future big winners.

**PORTABLE WEALTH INVESTING**
Portable Wealth (PW) management offers investment opportunities for wealthy investors and their advisors. PW can generate attractive risk-adjusted excess returns to traditional and alternative investments.

*Instructor John Palicka CFA CMT is a top-ranked portfolio manager of Global Emerging Growth Capital ([WWW.GLGEGC.COM](http://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](http://WWW.NYIF.COM)).

*Past performance is no guarantee of future results.*
THE ORIGINAL TREND-FOLLOWER: 
NICOLAS DARVAS 
BY MIKE CARR, CMT

In 1960, Nicolas Darvas published, How I Made $2,000,000 in the Stock Market, a book in which he described the Darvas Box trading method, a strategy based on weekly charts and trend following. As interesting as the method is, Darvas’ life is probably even more interesting.

As he explains in the book, by the late 1950’s, Darvas was part of the highest paid dance team in show business and on a worldwide tour, performing in front of sold out audiences. Every week, he was also using Barron’s to find winning stocks and sending telegrams to his broker as he grew his investment account from $36,000 to more than $2.2 million in about three years.

Darvas studied economics at the University of Budapest in his native Hungary. He fled the ravages of World War II in 1943 and made his way across Europe. Eventually he was reunited with history and they began dancing professionally as a team. His dance credits include appearances with Bob Hope and Judy Garland. While touring, Darvas used his travel time to read about the stock market. The two books he found most useful were The Battle for Investment Survival, written by Gerald M. Loeb and published in 1935 and the 1931 classic Tape Reading and Market Tactics, by Humphrey Bancroft Neill.

Darvas developed a techno-fundamental theory of investing. His initial filter was to industries that he expected to profit over the next 20 years. In the 1950s, this included electronics and rocket companies.

In the book, he notes that companies with the greatest potential will be in the industries with the greatest potential. This is similar to part of William O’Neil’s CAN SLIM methodology where the N stands for ‘new industries.’ O’Neil also credits Loeb’s Battle for Investment Survival as an influence on his work.

Darvas then selected a few of the leading companies from the leading industries and put them on his watch list. He considered an increase in volume to be an indicator that the price was setting up for a big move. Then he turned to the charts and looked for stocks that were trading within a narrow range. The top of the range could be defined as a high that held for at least three days and the bottom of the range would be a low that a low that stopped a decline for at least three days.

He bought with a limit order near the top of the range and used a stop loss near the bottom of the range. He found that boxes “piled up” which meant that trends would lead to new ranges at higher levels and new breakouts would continue the pattern. Whenever a new box formed on the chart, he adjusted his stops.
In general terms, this idea is illustrated below:

In specific terms, we can review a specific trade in Texas Instruments (TXN) that Darvas highlighted.

Source: http://www.nicolasdarvas.org/apendix_charts.php

Near the end of 1958, TXN was trading near the top of a range and showed a large increase in volume at the point marked (A). Darvas watched the stock from that point and bought about six months later, at the point marked (B). He added to his position at (C) and (D). He continuing raising his stop and eventually sold at a price near (E).
This approach can still work. High volume breakouts are easily scanned for and other criteria can be added to duplicate Darvas’ technique.

An interesting footnote to this story (http://go.mta.org/284) is that after the book became a bestseller with more than 120,000 copies sold, the New York Attorney General alleged that the his story was 'unqualifiedly false' and reported that its investigators could find 'ascertainable' profits of only $216,000. This action was among the first that the state would take under a state law that banned fraud or misrepresentation in investment advice.

Later, Time magazine reported that courts stopped the Attorney General’s investigation, calling it an 'unwarranted invasion of the free press.' State investigators also admitted they had not been able to track down all of Darvas’ brokerage accounts and Darvas was reported to have called the charges false, a "cynically irresponsible action, book burning by publicity."

This struggle may have been another contribution Darvas made to the investment community. Investment newsletters and books have since been found to be protected under the laws that guarantee a free press. Few writers have had to endure the process that Darvas was subjected to of having to prove their truthfulness.

Photo of Nicolas Darvas from DarvasTrader.com