How to Make Money in Stocks
A Winning System in Good Times or Bad

William J. O'Neil

Second Edition

McGraw-Hill, Inc.
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**Preface**

one day in October 1987, the market dropped a record 24%. Sanity and reality returned. That's the stock market. During the last 50 years, we have had twelve bull (up) markets and going up about 100% and the bear markets, on an average, declined and the classic bear market lingered only nine months. Viewed with perspective...that's a terrific deal. we have had more than 25 bear market slumps (natural, normal corrections of the previous bull market advance), and EVERY SINGLE TIME HIGH GROUND? That's fantastic.

It's one of the greatest success stories in the world—free people, in a improve their circumstances. America just keeps growing.

businesses with new products, new Services, and new inventions...and there are hundreds of them every year. The innovative entrepreneurial are always the top stock market winners.

So, why haven't more people taken advantage of these tremendous
and when you don't understand something you are unsure, maybe even afraid. I am going to solve that problem for you. This book will explain the you how to select which Stocks to buy and exactly when you should buy and when you should sell. There are two entire chapters on when to sell and nail down your profits or cut short potential mistakes. You can next twenty-five years. Our government will continue to tax you as much as it possibly can for as long as you live, your cost of living will go up substantially, and the stock market and economy will be much higher from the last one if you learn how to save and invest properly. Don't be thrown off by the swarm of gloom and doomers. In the long run, they have seldom made anyone any money or provided any real happiness. I have also never met a successful pessimist. There is one overpowering, overriding reason why there should be Marriages will be up and couples will need housing, furniture, medical care, clothing, and education for all the new children. This giant bulge income, financial independence, and security. It's a way you can "be in business for yourself," and it can be safe and sound over the long term...if you learn to correctly apply all the basic rules for making and

I have spent 35 years analyzing how the U.S. economy works. William O'Neil & Co., also built the first daily Computer data base on the stock successful companies looked like just before they became big successes. In 1970, we moved into the institutional stock research business. We institutional investors as the leader in automation in securities analysis and management. A daily chart service was also developed called Daily Graphs to which thousands of individual investors subscribe. In 1983, I designed and created the basic format for Investor's Daily, Journal. A completely separate organization was then set up to directly challenge the sacred 100-year-old east coast-based industry giant. My prime objective in writing this book is to help everyone discover how to get ahead by saving and investing.

those deeply concerned about inflation and their dwindling dollar; or silver.

or income property, and those investors who already enjoy home ownership. It is for amateur investors in the stock market, people considering an IRA (Individual Retirement Account) or a mutual fund, retired persons, teachers of Investment courses, and students attempting to learn about investments. It should be used in schools, whether grade school, should learn how the American economy and market really work and

Lastly, this book is for sophisticated professionals managing pension and stay ahead in a very complex and confusing game.

It is also for those who seek professional advice in the supervision of state and public employee funds and educational and charitable invest-

My deep appreciation and heartfelt thanks go out to those loyal hard-
typed, and retyped the endless changes made to this work. Some of those dedicated individuals are Anne Gerhard, Carolyn Hoffman, Jeannie Kihm, Jim Lan, Stanley Liu, Diane Marin, Milton Perrin, Kathy Russell, Lindee Shadrake, Kathy Sherman, Frank Spillers, and Susan Warfei. And, of course, a great amount of valuable assistance and numerous suggestions were provided by my wife Fay and Bill Sabin and the excellent McGraw-Hill staff.
How to Make Money in Stocks
PART 1

A Winning System:
C-A-N S-L-I-M


Introduction:

Winners

and mistakes. I will examine and discuss other Investments, as well.
In the past, most people who bought and sold Stocks either had mediocre results or lost money because of their clear lack of knowledge.

background, or economic position, can and definitely should own common stock. This book isn't written for an elite but for the millions of lit-

YOU CAN START SMALL beginning Investor, it doesn't take a lot of money to Start. You can begin with as little as $500 to $1000 and add to it as you earn and

of just five shares of Procter & Gamble when

You live in a fantastic time of unlimited opportunity, an era of outstanding new ideas, emerging industries, and new frontiers. But you extraordinary Situation«.

The opportunities are out there for everyone. You are now witnessing

our System of freedom and opportunity serves as a prime success model for the majority of countries in the world.
It is not enough today to just work and earn a salary. To do the things you want to do, to go the places you want to go, to have the things you

SECRET TIP #1 winners is for you to examine leading winners of the past to learn all the characteristics of the most successful Stocks. You will learn from this

price advances.

Other key factors you will uncover include what kind of Company quarterly-earnings reports were publicly known at the time, what the annual earnings histories of these organizations had been in the prior degree of relative price strength occurred in the price of the Stocks outstanding in the capitalization of each Company, how many of the greatest winners had significant new products or new management, and how many were tied to strong industry group moves caused by impor-
past successful leaders. I have already completed such a comprehensive year), spanning more than 40 years.
We call the study The Record Book of Greatest Stock Market Winners.
500 of the biggest winning companies in recent stock market history:
$250 from January 1958 through May 1960; Xerox, which escalated from $160 to the equivalent of $1340 from March 1963 to June 1966;
Limited Stores, which wildly excited lucky shareowners with a 3500% increase between 1982 and 1987; and Cisco Systems, which advanced from a split-adjusted $1.88 to $40.75 between October 1990 and March
great performers jumping twentyfold in less than 2 years from its initial
10 times from 1988 to 1992. All of these companies offered exciting
new products and concepts.
of success we discovered from this intensive study of all past glamorous
stock market leaders?
It's all in the next few chapters and in a simple easy-to-remember for-
formula we have named C-A-N S-L-I-M. Write the formula down, and
repeat it several times so you won't forget it.

chief characteristics of these great winning Stocks at their early develop-
ing stages, just before they made huge profits for their shareholders.
become part owner in the best companies in the world. So, let's get

C = Current Quarterly Earnings Per Share: How Much Is Enough?
Annual
N = New Products, New Management, New Highs: Buying at the Right Time.

I = Institutional Sponsorship: A Little Goes a Long Way.
M = Market Direction: How to Determine It?

Per Share:
How Much Is Enough?

M/A-Com Inc.
Humana Inc.

What did shares of the above-mentioned microwave component man-
From 1977 to 1981, they all posted price run-ups surpassing 900%.
also tended to shuffle around in price consolidation periods for a few
months before they broke out and soared. But one key variable stood

The common Stocks you select for purchase should show a major per-
quarter.

tant element in stock selection today.
aren't misled by comparing current earnings to nearly nonexistent earnings for the year earlier quarter, like 1 cent a share.

definitely distorted and not as meaningful as $1 versus $.50. The 100% ally low number in the year ago quarter.

I am continually amazed at how many professional pension fund managers, as well as individual investors, buy common stocks with the down. There is absolutely no reason for a stock to go anywhere if the current earnings are poor.

dply not enough of an improvement to fuel any significant upward price movement in a stock. It is also easier for a corporation currently showi

ng a mere increase of 7% or 8% to suddenly report lower earnings the next quarter.

Seek Stocks Showing Big

1953 through 1993, three out of four of these securities showed earn- quarter before the Stocks began their major price advance. The one out of four that didn't show solid current quarter increases did so in the earnings?

Our study showed that among all big gainers between 1970 and 1982, 86% reported higher earnings in their most recently published quarter, and 76% were up over 10%. The median earnings increase was 34% mean

You may find that only about 2% of all Stocks listed for trading on the New York or American stock exchanges will, at any one time, show increases of this proportion in current quarterly net income.

But, remember you want to find the exceptional Stocks rather than

ly what you're looking for. Before you Start your search for tomorrow's minut falls.

C = Current Quarterly Earnings Per Share

Watch Out for Misleading Reports of Earnings

"We had a terrible first three months. Prospects for our Company are turning down due to inefficiencies in the home office. Our competition just

Furthermore, we are losing our shirt on the new midwestern Operation, which was a real blunder on management's part."

No! Here's what you see. "Greatshakes Corporation reports record sales 31." If you own their stock, this is wonderful news. You certainly are not going to be disappointed. You think this is a fine Company (otherwise you wouldn't own its stock), and the report confirms your thinking.

pose the Company also had record earnings of $2.10 per share of stock for the quarter. Is it even better now?

the previous year? Why were sales up 20% and earnings ahead only 5%?

evaluate the Situation closely to see why the earnings increased only 5%.

Most investors are impressed with what they read, and companies love

all-time record sales, up 20%, it didn't mean much. You must be able to see through slanted published presentations if you want the vital facts.

ter the year before!

Let's say your Company discloses that sales climbed 10% and net income

because sales and total net income for the Company were up, the report

ched up only 2% or 3%.

Month Earnings into Quarterly Percentage Changes
earlier (+ 25%). Your "pet" stock inust be in great shape. You couldn't

Beware. The Company reported earnings for six months. What did
the stock earn in the last quarter, the three months ended in June?

share versus $1 (+ 60%). What does this leave for the last quarter ended
June 30? Ninety cents versus one dollar. This is a terrible report, even

If you own common stock in a Company whose earnings had been up
you had better wake up. The outfit might be deteriorating.

You can't always assume that because an earnings report appears to
be rosy, everything is fine. You have to look deeper and not accept the
reassuring manner of corporate news releases reported in your favorite
newspaper.

Many times, earnings declarations are published for the most recent
nine months. This tells you nothing, and all too often it masks serious
weakness in the numbers that really count. The first quarter may have
been up 30%, the second quarter up 10%, and the last quarter off 10%.
By always breaking down the figures to show the quarter-by-quarter
earnings, you will be able to see a completely different picture and

Omit a Company's One-Time

The last important trap the winning investor should sidestep is being
influenced by nonrecurring profits.

If an organization that manufactures Computers reports earnings for
the last quarter that include profits from the sale of real estate or a
plant, for example, that pari of the earnings should be subtracted from
the report. Those are one-time, nonrecurring earnings and are not rep-
resentative of the true, ongoing profitability of corporate operations.
Ignore them.

Set a Minimum Level for
Current Earnings Increases

As a general guide for new or experienced investors, I would suggest
you not buy any stock that doesn't show earnings per share up at last
18% or 20% in the most recent quarter versus the same quarter the

C = Current Quarterly Earnings Per Share

year before. Many successful money-makers use 25% or 30% as their
minimum earnings parameter. And make sure you calculate the per-
centage change; don't guess or assume. You will be even safer if you
insist the last two quarters each show a significant percentage increase
in earnings from year-ago quarters.

During bull markets, I prefer to concentrate in equities (common
Stocks) that show powerful current earnings leaping 40% or 50% up to

If you want to further sharpen your stock selection process, before
you buy, look ahead to the next quarter or two and check the earnings
that were reported for those same quarters the previous year. See if the

in the most recently reported quarter just because they like a Company
and think the stock's price is cheap. Usually they accept a story that
earnings will rebound strongly in the near future.

While this may be true in some cases (it frequently isn't), the main
point is that at any time in the market, you have the choice of investing
in at least 5000 or more Stocks. You don't have to accept promises of
something that may never occur when alternative investments are actu-
ally showing current earnings advancing strongly.

The Debate on Overemphasis
of Current Earnings

Recently it has been noted that Japanese firms concentrate more on
longer-term profits rather than on trying to maximize current earnings
per share.

This is a sound concept and one the better-managed organizations in
the United States (a minority of companies) also follow. That is how
well-managed entities create colossal quarterly earnings increases, by
spending several years on research, developing superior new products,
and cutting costs.

But don't be confused. You as an individual Investor can afford to wait

ings increases.
investor

the courage to change top management. Ironically, these are generally

Look for Accelerating Quarterly Earnings Growth

My studies of thousands of the most successful concerns in America proved that virtually every corporate stock with an outstanding upward price move showed accelerated quarterly earnings increases some time in the previous ten quarters before the towering price advance began.

Therefore, what is crucial is not just that earnings are up or that a certain price-to-earnings ratio (a stock's price divided by its last twelve months' earnings per share) exists; it is the change and improvement supreme price surge. Wall Street now calls these earnings surprises.

Vermilye, the former head of Citicorp's Trust Investment Division in

Investment professionals.

If a Company's earnings are up 15% a year and suddenly begin spurt-ting 40% to 50% a year, it usually creates the basic conditions for impor-

Two Quarters of Major Earnings Deceleration May Mean Trouble

Likewise, when the rate of earnings growth starts to slow and begins meaningful deceleration (for instance, a 50% rate of increase suddenly decreases to only 15% for a couple quarters), the security probably has either topped out permanently, regardless of what analysts and Wall Stree-

Consult Log Scale Weekly Graphs

security analysis is that acceleration or deceleration in the percentage rate of quarterly earnings increases can be seen very clearly on a log graph.

Log graphs show percentage changes accurately, since one inch any-change. This is not true of arithmetically scaled charts.

For example, a 100% stock price increase from $10 to $20 a share would show the same space change as a 50% increase from $20 to $30 a show the 100% increase as twice as large as the 50% increase.

understand.

ing at the wrong set of facts. A stock that earned $5 per share and expects to report $6 the next year can mislead you unless you know the previous trend in the percentage rate of earnings change.
ratio is also usually nonsense unless primary consideration has first

Perhaps this partially explains who so few public or institutional

You, as a do-it-yourself investor, can take the latest quarterly earnings

Check Other Key Stocks in
the Group

For added safety, it is wise to check the industry group of your stock.

factor. If you cannot find any other impressive stock in the group dis-

the wrong investment.

Note the date when a company expects to report its next quarterly
earnings. One to four weeks prior to the report's release, a stock fre-

Chart services published weekly also show earnings reported during

One last point to clarify: You should always compare a stock's per-

tance increase in earnings for the quarter ended December, to the

You now have the first critical rule for improving your stock selection:

(at least 20% to 50% or more) over the same quarter last year. The best ones

Where to Find Current
Corporate Earnings Reports

New quarterly corporate earnings statements are published every day in

"down" results so you can easily see who produced excellent gains.

New quarterly corporate earnings statements are published every day in
The Wall Street Journal. Investor's Business Daily separates all new

"down" results so you can easily see who produced excellent gains.

<table>
<thead>
<tr>
<th>AMERICAN TRAVELLERS CORP</th>
<th>WALL MART STORES</th>
<th>WMT 52</th>
</tr>
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<tbody>
<tr>
<td>Insurance-Ac &amp; Health</td>
<td>Retail-Discord &amp;</td>
<td></td>
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<tr>
<td>Qua: Mar 31</td>
<td>May 30</td>
<td></td>
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<tr>
<td>Sales</td>
<td>Wholesale</td>
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<td>$10,910.00</td>
<td>$10,615.00</td>
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<tr>
<td>Net Income</td>
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<tr>
<td>2,165,000</td>
<td>2,190,000</td>
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<tr>
<td>Avg Shares</td>
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<tr>
<td>135,000</td>
<td>135,000</td>
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<tr>
<td>Share Earns:</td>
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<tr>
<td>2.52</td>
<td>2.56</td>
<td></td>
</tr>
<tr>
<td>% Change</td>
<td>+10%</td>
<td>+10%</td>
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</tbody>
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| HOSPITAL MBC | NOBE 37% | UNICOR | |
|-------------|----------|--------|
| Insurer      | Realty   |       |
| Qua: Apr 30  | May 30   |       |
| Sales        | Wholesale |       |
| $4,000,000   | $4,100.00 |       |
| Net Income   |            |       |
| 2,190,000    | 2,190,000 |       |
| Avg Shares   |            |       |
| 135,000      | 135,000   |       |
| Share Earns: |            |       |
| 2.56         | 2.56      |       |
| % Change     | +10%      | +10%   |
A typical successful yearly earnings per share growth progression for a percentage; the greater the percentage, the better. However, remember estimates are opinions. Opinions may be wrong whereas actual reported earnings are facts that are ordinarily more dependable.

What Is a Normal Stock

recession or bear (down) market and eventually another bull market in common stocks.

basic industry groups such as steel, chemical, paper, rubber, and machinery are commonly more laggard followers.

Young growth stocks will usually dominate for at least two bull market cycles. Then the emphasis may change for the next cycle, or a short period, to turnaround or cyclical stocks or newly improved sectors of the market, such as consumer growth stocks, over-the-counter growth issues, or defense stocks that sat on the sidelines in the previous cycle.

turnaround opportunities led in the market waves of 1953—1955, 1963-1965, and 1974-1975. Papers, aluminums, autos, chemicals, and plastics returned to the fore in 1987. Yet, even in these periods, there were some pretty dramatic young growth stocks available. Basic industry

between 1970 and 1982, the average annual compounded earnings where you decide to buy strong turnaround situations, the annual compounded growth rate could, in many cases, be 5% to 10%.
nings recovery should put the earnings for the latest twelve months into, on a chart, the sharper the upswing the better. This will make it possible in many cases for even the "old dog" about-face stock to show some annual growth rate for the prior five-year time period. Sometimes one quarter of earnings turnaround will suffice if the earnings upswing is so dramatic that it puts the 12 months ended earnings line into new highs.

Check the Stability of a Company's Five-Year Earnings Record

The lower the figure, the more stable the past earnings record. The figures are calculated by plotting quarterly earnings for the last five years and fitting a trend line around the plot points to determine the degree of deviation from the basic earnings trend.

Growth stocks with good stability of earnings tend to show a stability cyclical and a little less dependable in their growth. All other things degree of consistency and stability in past earnings growth.

company's five-year growth rate, although most analysts and investment services do not bother to make the calculation.

<table>
<thead>
<tr>
<th>Earnings Growth Rate</th>
<th>Stability Rank</th>
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<tr>
<td>1983-87 +31%</td>
<td>(6)</td>
</tr>
<tr>
<td>1981-85 +19%</td>
<td>(8)</td>
</tr>
<tr>
<td>1979-83 +19%</td>
<td>(&quot;</td>
</tr>
</tbody>
</table>

Earning* stability rank

growth records, you avoid the hundreds of investments having erratic earnings histories or a cyclical recovery in profits that may top out as they approach earnings peaks of the prior cycle.

How to Weed Out the Losers in a Group

When you investigate a specific industry group, using the five-year growth criteria will also help you weed out 80% of the stocks in an

March 1963 to June 1966, its earnings growth rate averaged 32% per rate from 1977 to 1990 of 43% and boomed in price an incredible 11,200%. Cisco Systems growth rate in October 1990 was an enormous

The fact that an investment possesses a good five-year growth record doesn't necessarily cause it to be labeled a growth stock. Ironically, in

show slow growth.

New Cycles Create New Leaders

Each soaring new cycle in the stock market will catapult fresh leadership stocks to the attention of the market, some of which will begin to be called growth stocks. The growth record in itself, however, is only a starting point for would-be victorious investors, and it should be the

For example, companies with outstanding five-year growth records of

instances.

Current Quarterly Earnings Being Excellent

We prefer to see current quarterly earnings accelerating or at least main-
that creates a superb stock, or at least one that has a higher chance of true success.

Investor's Business Daily provides a relative earnings ranking (based on earnings reports) for all common stocks shown in the daily NYSE, AMEX, and NASDAQ lists.

More than 6000 stocks are compared against each other and ranked on a scale from 1 to 99. An 80 earnings per share rank means a company's earnings per share are 80% of the median earnings per share for all companies.

Arc Price-Earnings Ratios Important?

Rent quarterly earnings record and annual earnings increases in the last five years, you may be wondering about a stock's price-to-earnings (P/E) ratio. How important is it in selecting stocks? Prepare yourself for a bubble-bursting surprise.

A tool in deciding if a stock is undervalued (has a low P/E) and have very little to do with whether a stock should be bought or not. A successful stock moves.

Jones Industrial's P/E at the same time averaged 15. While advancing, of P/E ratio).

Fabulous Stocks!

growth stocks in the 40 years through 1993, you automatically eliminated most of the best investments available!

P/Es were higher on average from 1953 to 1970 and lower between 1970 and 1982. From 1974 through 1982, the average beginning P/E was 15 and expanded to 31 at the stock's top. P/Es of winning stocks during this period tended to be only slightly higher than the general market.

High P/Es were found to occur because of bull markets. With the markets. Some OTC growth stocks may also display lower P/Es if the stocks are not yet widely owned by institutional investors.

Don't buy a stock solely because the P/E ratio looks cheap. There usually are good reasons why it is cheap, and there is no golden rule in the marketplace that a stock which sells at eight or ten times earnings cannot eventually sell at four or five times earnings. Many years ago, when I was first beginning to study the market, I bought Northrop at times earnings.

Are Misused

Many Wall Street analysts inspect the historical high and low price-earnings ratio, to drop, because then the P/E declines and the stock appears to be a bargain.
faulty method of selecting stock investments based chiefly on low P/E ratios and go wrong more often than not.

People, the general market may have topped out, in which case all stocks are earnings. The market break of 1987 hurt many value buyers.

The Wrong Way to Analyze Companies in an Industry

and professionals alike is to evaluate the stocks in an industry and company with the most ghastly earnings record, and that's precisely why it sells at the lowest P/E. The simple truth is that stocks at any one time usually sell near their current value. So the stock which sells at 20 times earnings is there for one set of reasons, and the stock that trades for 15 times earnings is there for other reasons the market already has analyzed. The one self-deficient. Everything sells for about what it is worth at the time. If a company's price level and price-earnings ratio changes in the near future, it is because conditions, events, psychology, and earnings

Eventually a stock's P/E will reach its ultimate high point, but this normally is because the general market averages are peaking and start-earns growth.

high-tech area. The price of a high P/E stock can also get temporarily ahead of itself, but so can the price of low P/E stocks.

Some High P/Es That Were Cheap

growth situations that have revolutionary new product breakthroughs,

over-the-counter market in early November 1985, and it bolted 300% in the next five months. All had fantastic new products.

Don't Sell High P/E Stocks Short

Beverly Hills investor barged into the office of a broker friend of mine was selling for 50 times earnings. He sold 2000 shares short at $88. After he sold short this "obviously overpriced stock," it immediately adjusting for stock splits. So much for amateur opinions about P/E ratios being too high. Investors' personal opinions are generally wrong;

Some institutional research firms in recent years published services and analyses based on the principle of relative P/E ratios for companies, compared to individual company earnings growth rates. Our be misleading and of little practical value. The conclusion we have reached from years of in-depth research into P/E ratio. At any rate, it may be easier to spot emerging new trends than to accurately assess correct valuation levels.

In summary: Concentrate on stocks with a proven record of significant annual earnings growth in the last five years. Don't accept excuses;
N = New Products, New Management, New Highs: Buying at the Right Time

It takes something new to produce a startling advance in the price of a stock.

This something new can be an important new product or service, selling rapidly and causing earnings to accelerate above previous rates of increase. It could also be new top management in a company during the last couple of years. A new broom sweeps clean, or at least may bring inspiring ideas and vigor to the ball game.

Or the new event could be substantial changes within the company's industry. Industrywide shortages, price increases, or new technology could affect almost all members of the industry group in a positive way.

Super Successes

1. Neutrogena's stock to $50 a share, from $16.

2. Thiokol in 1957-1959 came out with new rocket fuels for missiles.

3. Syntex, in 1963, marketed the oral contraceptive pill. In six months the stock soared from $100 to $550.

4. McDonald's, in 1967-1971, with low-priced fast food franchising, snowballed into an 1100% profit for stockholders.

5. Levitz Furniture stock increased 600% in 1970-1971, with the pop-

6. Houston Oil & Gas, in 1972-1973, with a major new oil field ran up

7. Computervision stock advanced 1235% in 1978-1980, with the introduction of new Cad-Cam factory automation equipment.

8. The Thiokol stock advanced in 1980, when the company acquired an engineering company that made equipment for intercontinental missiles, and the stock raced ahead from 60% in 1990 to the equivalent of 460% in January 1992.


10. Amgen developed two successful new biotech drugs, Epogen and Neupogen, and the stock raced ahead from 60% in 1990 to the equivalent of 460% in January 1992.

11. International Game Technology rose an astounding 1600% in

American industry either had a major new product or service, new management, or an important change for the better in the conditions of their particular industry.

The Stock Market's Great Paradox

...
I have provided extensive research for over 600 institutional investors in the United States. It is my experience that most institutional money managers are also bottom buyers—they, too, feel safer buying stocks that look cheap because they’re either down a lot in price or selling near their lows.

The hard-to-accept great paradox in the stock market is that what seems too high and risky to the majority usually goes higher and what seems low and cheap usually goes lower. Haven’t you seen this happen before?

In case you find this supposed "high-altitude" method a little difficult to boldly act upon, let me cite another study we conducted. An analysis was made of the daily newspapers’ new-high and new-low stock lists dur-

Put another way, a stock listed in the financial section’s new-low list of

before it appears on the new-low list.

You may have guessed by now what the last intriguing new realization is that I promised to disclose to you earlier. So here are the three stocks you had to choose among on the previous page, Stock A, Stock B, and Stock C. Which one did you pick? Stock A (Syntex Corp, see below) was the right one to buy. The small arrow pointing down above the weekly prices in July 1963 shows the same buy point at the end of Stock A in July on the previous page. Stock B and Stock C both declined.

**Syntex Corp (SYN)**

+400% in six months* from July 1963
When to Correctly Begin
Buying a Stock

undergoing a price correction and consolidation. The consolidation
or eight weeks up to fifteen months.
As the stock emerges from its price adjustment phase, slowly resumes
an uptrend, and is approaching new high ground, this is, believe it or
not, the correct time to consider buying. The stock should be bought
just as it's starting to break out of its price base.

You must avoid buying once the stock is extended more than 5% or

$50 to $100?

As a final appeal to your trusty common sense and judgment, it should
be stated that if a security has traded between $40 and $50 a share over
many months and is now selling at $50 and is going to double in price,
it positively must first go through $51, $52, $53, $54, $55, and the like,
before it can reach $100.

and finally begins to look attractive to some of those same investors.
or service, new management, or changes in conditions in their industry. And most importantly, companies whose stocks are emerging from
highs in price are usually your best buy candidates. There will always be
panies—a bundle of future, potential big winners.

Small Capitalization
Plus Big Volume Demand

The law of supply and demand determines the price of almost every-
thing in your daily life. When you go to the grocery store and buy fresh
lettuce, tomatoes, eggs, or beef, supply and demand affects the price.
The law of supply and demand even impacted the price of food and
where these state-owned items were always in short supply and frequently
available only to the privileged class of higher officials in the bureaucracy
or in the black market to comrades who could pay exorbitant prices.

of supply and demand is more important than all the analyst opinions

Big Is Not Always Better

hard to budge up because of the large supply of stock available. A
tremendous volume of buying (demand) is needed to create a rousing
price increase.
On the other hand, if a company has only 2 or 3 million shares of
the stock up rapidly because of the small available supply.

shares outstanding and the other with 60 million, the smaller one will
pany's capital structure represents the potential amount of stock avail-

The stock's "floating supply" is also frequently considered by market
by company management. Stocks that have a large percentage of owner-
that companies with large capitalizations (number of shares outstanding) as a rule produce dreadful price appreciation results in the stock market. The companies themselves are simply too big and sluggish.

**Pick Entrepreneurial**

**Caretakers**

defect large companies should attempt to correct.

from what's really going on out in the field at the customer level. And

Times are changing at a quickening pace. A corporation with a fast-
selling, hot new product today will find sales slipping within three years
if it doesn't continue to have important new products coming to market.

Most of today's inventions and exciting new products and services are
nies with entrepreneurial-type management. As a result, these organiz-
Americans. This is where the great future growth of America lies. Many
of these companies will be in the services or technology industries.

If a mammoth-sized company occasionally creates an important new
product, it still may not materially help the company's stock because
drop in a bucket that's just too big.

**Big Cap Handicap**

Many large institutional investors create a serious disadvantage for
themselves because they incorrectly believe that due to their size they
practically guarantees inadequate performance because these investors
may restrict their selections mainly to slowly decaying, inefficient, fully
most outstanding, small- to medium-sized growth companies than 50 to

If you desire clear-cut factual evidence, the 40 year study of the greatest stock market winners indicated *more than 95% of the companies had fewer than 25 million shares in their capitalization when they had their greatest period of earnings improvement and stock market performance*. The average capitalization of top-performing listed stocks from 1970 through 1982 was 118 million shares. The median stock exhibited

**Foolish Stock Splits Can Hurt**

Corporate management at times makes the mistake of excessively split-
ing its company's stock. This is sometimes done based upon question-

In my opinion, it is usually better for a company to split its shares 2-
sell for half the price.)

Overabundant stock splits create a substantially larger supply and may
put a company in the more lethargic performance, or "big cap," status sooner.

a bull market or in the early stage of a bear market. Yet this is exactly
price per share. This may occur, but may have the opposite result the
years. Knowledgeable professionals and a few shrewd traders will probably use the oversized split as an opportunity to sell into the obvious

Many splits. However, in the year preceding great price advances of the leading stocks, in performance, only 18% had splits.
Large holders who are thinking of selling might feel it easier to sell

infinitesimal group) pick on stocks that are beginning to falter after enormous price runups—three-, five-, and ten-fold increases—and
able stock split, find the number of their shares tripled, thereby dramatically increasing the potential number of shares for sale.

Look for Companies Buying
Their Own Stock in the

nies, is for the concern to be acquiring its own stock in the open market-

Total company earnings will, as a result, usually be divided among a smaller number of shares, which will automatically increase the earnings per share. And as we've discussed, the percentage increase in earnings per share is one of the principal driving forces behind outstanding stocks.
Tandy Corp., Teledyne, and Metromedia are three organizations that

stock.
and 1983. Teledyne stock zoomed from $8 to $190 in the thirteen years prior to June 1984, and Metromedia's stock price soared to $560 from $30 in the six years beginning in 1977. Teledyne shrunk its capitalization-
its earnings from $0.61 a share to nearly $20 per share with eight different huvbacks.

Alter you have picked a stock with a small or reasonable number of shares in its capitalization, it pays to check the percentage of the

Earnings per share of companies with high debt-to-equity ratios can
leveraged companies generally are deemed to be of poorer quality and
over the last two or three years is well worth considering. If nothing else, the company's interest expense will be materially reduced and

The presence of convertible bonds in a concern's capital structure
into shares of common stock.
It should be understood that smaller capitalization stocks are less liq-
uid, are substantially more volatile, and will tend to go up and down

nity. There are, however, definite ways of minimizing your risks, which
will be discussed in Chapter 9.
Lower-priced stocks with thin (small) capitalization and no institu-
tional sponsorship or ownership should be avoided, since they have
demand. Trading volume should dry up on corrections and increase significantly on rallies. As a stock's price breaks out of a sound and proper base structure, its volume should increase at least 50% above normal. In many cases, it can increase 100% or more.

shares outstanding will, other things being equal, usually outperform
older, large capitalization companies.
Which Is Your Stock?

about, or stocks they feel comfortable with, like an old friend, old shoes, or an old dog. These securities are frequently sentimental, drag-market.

down the most in price, because you feel safer with them and think you're getting a real bargain, you're probably buying the sleepy losers of the group. Don't dabble in stocks. Dig in and do some detective work.

Three Stocks in a Group

In 1979 and 1980, Wang Labs, Prime Computer, Datapoint, Rolm

cycle, IBM finally sprang to life and produced excellent results. Home

Hechinger, the laggards, clearly underperformed.

Avoid Sympathy Stock Moves

There is very little that's really new in the stock market. History just afterwards advanced 400%. Yet most people would not buy it then because it had just made a new high in price at $100 and its P/E ratio,

Several investment firms recommended G. D. Searle, a sympathy play, which at the same time looked much cheaper in price and had a similar product to Syntex's. But Searle failed to produce stock market results.

ones showing a more mediocre record and weaker price performance.

business.

Many people bought Wickes instead of Levitz because it was cheaper in price. Wickes never performed. It ultimately got into financial trouble, whereas Levitz increased 900% before it finally topped. As Andrew Carnegie, the steel industry pioneer, said in his autobiography, "The first man gets the oyster; the second, the shell."

Is the Stock's Relative Price

Here is a simple, easy-to-remember measure that will help tell you if a security is a leader or a laggard. If the stock's relative price strength, on a scale from 1 to 99, is below 70, it's lagging the better-performing stocks in the overall market. That doesn't mean it can't go up in price, it just means if it goes up, it will probably rise a more inconsequential amount.

mance to the price action of a general market average like the Standard & Poor's (S&P) Index, or in some cases, all other stocks. A relative
or twelve months.

**rule is: Avoid laggard stocks and avoid sympathy movements. Look for**

Most of the better investment services show both a relative strength line and a relative strength number and update these every week for a list of thousands of stocks.

Relative strength numbers are shown each day for all stocks listed in the *Investor's Business Daily* NYSE, AMEX, and NASDAQ price tables. Updated relative strength numbers are also shown in Daily Graphs charting service each week.

**Pick 80s and 90s That Are in**

If you want to upgrade your stock selection and concentrate on the best a relative strength rank of 80 or higher. Establish some definite discipline and rules for yourself.

(proper sideways price consolidation pattern) and that the stock is not extended (up) more than 5% or 10% above this base pattern. This will prevent you from chasing stocks that have raced up in price too rapidly should not be purchased more than 5% or 10% above $29.

**more, or if the line has an abnormally sharp decline for four months or**

glimpse drearily behind a laige number of other, better-acting securities rating at a relative strength line or number.

prolonged downtrends in relative strength. I do not like to buy stocks in an overall downtrend.

first or second base structure. A potential winning stock's relative strength should be the same as a major league pitcher's fast ball. The average big league fast ball is clocked about 86 miles per hour and the outstanding pitchers throw "heat" in the 90s.

need to sterilize their instruments before each operation. So they kept killing off excessive numbers of their patients until surgeons finally and begrudgingly accepted studies by a young French chemist named Louis Pasteur on the need for sterilization.

It isn't very rewarding to make questionable decisions in any arena. And in evaluating the American economy, investors should zero in on sound new market leaders and avoid anemic-performance investments.

**Always Sell Your Worst Stock First**

If you own a portfolio of equities, you must learn to sell your worst-performing stocks first and keep your best-acting investments a little longer. In other words, sell your cats and dogs, your losers and mistakes, new leaders if you know what to look for. The more desirable growth stocks normally correct 1½ to 2/2 times the general market averages.

stocks that plummet the most are your weakest choices.

falloff, three successful growth securities could drop 15%, 20%, and 30%. The ones down only 15% or 20% are likely to be your best investments after they recover. Of course, a stock sliding 35% to 40% in a and you should, in many cases, steer clear of such an uncertain actor.

**Pros Make Mistakes Too**

buying stocks that have just suffered unusually large price drops. In
June 1972, a normally capable, leading institutional investor in Maryland bought Levitz Furniture after its first abnormal price break in one week from $60 to around $40. The stock rallied for a few weeks, rolled over, and broke to $18.

when it had its first unusual price break. It later plunged.

Certain money managers in New York bought Dome Petroleum in cheap and there was a favorable story going around Wall Street on the stock. Months later Dome sold for $1, and the street talk was that the company might be in financial difficulties.

the normal price declines and the highly abnormal corrections that were a sign of potential disaster in this stock.

Of course, the real problem was that these expert investors all relied solely on fundamental analysis (and stories) and their personal opinion of value (lower P/E ratios), with a complete disregard for what market action could have told them was really going on. **Those who ignore what the marketplace is saying usually suffer some heavy losses.**

Once a general market decline is definitely over, the first stocks that or so, with many stocks recovering and making new highs. To be a truly astute professional or individual investor you must learn to recognize the difference between normal price action and abnormal activity. When you understand how to do this well, people will say you have "a good feel for the market."

**Strength in a Weak Market**

During a trip to New York in April 1967, I remember walking through a broker's office on one day when the Dow Jones Industrial Average was down over twelve points. When I looked up at the electronic ticker tape showing prices moving across the wall, Control Data was trading in heavy volume at $62, up 3 1/2 points for the day. I immediately bought the stock at the market, because I knew Control Data well, and this was abnormal strength in the face of a weak overall market. The stock subsequently reached $150.

In April 1981, just as the 1981 bear market was commencing, MCI Communications, a Washington, D.C.-based telecommunications stock trading in the over-the-counter market, broke out of a price base at $15. It advanced to the equivalent of $90 in the following 21 months.

So don't forget: **It seldom pays to invest in laggard performing stocks even if they look tantalizingly cheap. Look for the market leader.**
6

A Little Goes A Long Way

It takes big demand to move supply up, and the largest source of
money. More recently, numerous new "entrepreneurial type" investment
counseling firms have been organized to manage institutional monies.

Performance figures for the latest 12 months plus the last three- to
change significantly as key portfolio managers leave one money man-
tually rotate and change.

For example, Security Pacific Bank (now merged into Bank America)
had somewhat modest performance in its trust investment division up
to 1981. But with the addition of new management and more realistic
concepts in the investment area, it polished up its act to the point that
it ranked at the very top in performance in 1982. In 1984, the top man-
Applegate of San Diego.

mance will be more run-of-the-mill. The odds are that at least several of
the more than 1000 institutional investors have looked at the stock and

your investment. If there is no sponsorship and you try to sell your stock
in a poor market, you may have problems finding someone to buy it.

Daily marketability is one of the great advantages of owning stock.
(Real estate is far less liquid and commissions and fees are much high-
er.) Institutional sponsorship helps provide continuous marketability
and liquidity.

Is It "Overowned" by
Institutions?

stock whose institutional ownership had become excessive. In any case,
excessive sponsorship can be adverse since it merely represents large
potential selling if anything goes wrong in the company or the general

The "favorite 50" and other lists of the most widely owned institu-
tional stocks can be rather poor, and potentially risky, prospect lists. By
stock, it is probably too late. The heart is already out of the watermelon.
In June 1974, we put Xerox on our institutional sell list at $115. We received unbelievable flack because Xerox was then one of the most that point. However, our research indicated it had topped and was headed down in price. year. Of course that didn't stop it from tumbling in price. What it did steadily in spite of such buying. The episode did bring us our first large

They had been buying Xerox on the way down in the $80s until we persuaded them they should be selling instead of buying.

**Famous Last Words— "We'll**

investment organization pounding the table and saying, "We'll never mistakes and incur losses. In many ways, some institutions are like the 

It is, therefore, not always as crucial to know how many institutions own a stock as it is to know which of the better ones own or have purchased a particular stock in the last quarter. The only important thing trend. Is the number of sponsors increasing or decreasing?

**Note New Stock Positions**

'S'-- hold for some time. Many investors feel disclosures of a fund's new commitments are published after the fact, too late to be of any real value. This is riot true.

These reports are available publicly about six weeks after the end of a of charts.

Additionally, half of all institutional buying that shows up on the New 

ly informed institutional buying from the poor, faulty buying. Though difficult, this will become easier as you learn to apply and follow the shares or more. Institutional buying and selling accounts for more than 80% or 90% of the important price movements of stocks on the New York Stock Exchange are caused by institutional orders.

moment philosophy and techniques used by certain funds. For example, Pioneer Fund in Boston has always emphasized buying supposedly larger number of OTC stocks. A chartist probably would not buy many sound, small companies.

Jim Stower's Twentieth Century Ultra and his Growth Investors funds use computer screening to buy volatile, aggressive stocks that show the greatest percentage increase in recent sales and earnings.

early on every new concept or story in a stock. Some other manage-

Thomson, Brandywine, Berger, and CGM. Some funds buy on new highs, others try to buy around lows and may sell on new highs.
7

M = Market Direction: How to Determine It

You can be right on every one of the factors in the first six chapters; and you will lose money. Therefore, you need in your analytical tool kit a simple reliable method to determine if you're in a bull (up) market or it weak and acting badly or is it merely going through a normal decline? in the country, or is it doing something abnormally strong or weak?

market is to follow and understand every day what the general market

The Vital Importance of Daily

market average to study. The S&P 500 can also be used; however, it is broader, more modern and representative average consisting of 500 Daily 6000 market value-weighted index, which covers all New York Stock Exchange, American Stock Exchange, and NASDAQ common stocks over 6000 equities in the overall market.

fish. His scholars went to the library, read books about fish, and then wrote their expositions. The students were shocked when, after turning in their papers, the professor tore them up and threw them in the waste basket. When they asked what was wrong with the reports, the professor said, "If you want to learn anything about fish, sit in front of a fish bowl and look at fish." He then made his students sit and look at fish for hours. studying the object itself.

The daily Dow Jones Industrial Average represents an average of thir-want to observe arid study carefully.
The difficult-to-recognize but meaningful changes in the behavior of the market averages at important turning points are the best indicators of the condition of the whole market.

Chart Every Day

The general market should be studied closely every day, since reverses rather than that of interpreting other subsidiary indicators that are sup-to the many stock market letter writers or technical analysts that pore over twenty indicators and tell you what they think the market should confusion in an investor's mind. Markets tend to go up when people are skeptical and disbelieving.

Learn to interpret a daily price and volume chart of the general market averages. If you do, you can't get too far off the track. You really won't need much else unless you want to argue with the trend of the market.
Experience teaches you that continually arguing with the market can

How You Can Identify Stock Market Tops
in the price of your stocks will cause you to lose 40% of your money.
Don’t wait around after the first few definite indications of a general market top. Sell quickly before real weakness develops.
Napoleon once wrote that he never hesitated in the battlefield and quick and there are the dead!

before a cave-in. In most cases, distribution or selling in individual market break. Use of individual stock selling rules, which we will discuss in the next two chapters, should lead you to sell one or two of your stocks on the way up just prior to the general market peak.

After the top, poor market rallies and rally failures in the averages failures are recognized.
If you miss the S&P or Dow Jones topping signals, which is exceeding on the direction of the market and wrong on almost everything you do.

the whole complicated ball game. It is also the key investing skill that

You can also try to plan ahead and write down on charts, based on the market’s historical precedent, where you expect the Dow to go and when the rally or decline might end. But it is best to watch the market, as it will eventually tell you when the correction or uptrend is finally completed.

stock graphs. Every four or five years, like in 1986, Congress makes purely political decisions to sometimes raise or do away with capital in Congress have not yet been able to figure out. They incorrectly view the capital gains tax solely as a plum to the rich. Some day, proven competence and professional understanding may become an important prerequisite for obtaining high political office. Both Presidents John F. Kennedy and Ronald Reagan believed in lowering everyone’s tax rates. usually try to raise your tax rates so they can have more money to spend for their inefficient programs.

Study

Historically, intermediate term distribution tops and reversals in the further upward price progress on the Dow Jones Industrials, followed with a wide price spread from the day’s low to its high, followed the next day by increased volume, with the Dow Jones average closing down in price, and three days later, increased New York Stock Exchange vol-


several tops that happened between 1973 and 1994.

Congress Lacks Real Economic Knowledge
It is unfortunate that many in Congress have a deficient understanding
Market tops, whether intermediate (usually 8% to 12% declines) or primary bull market peaks, occasionally occur six to seven months after the last major buy point in leading stocks and in the averages.

into new high ground and during their third to ninth day of rally. The new highs were off small chart bases. The conditions under which the tops occurred all appeared similar.
Watch for Heavy Volume

Progress Up
What signs should you look for to detect a market top? On one of the

prior few days. The spread from the daily high to the daily low of the market index may be a little larger than on earlier days. The market average does not

making it much easier to recognize the distribution as professional investors sell or liquidate stock.

Normal liquidation near the market peak will only occur on one or two days, which are part of the uptrend. The stock market comes under distribution while it is advancing! This is one reason so few people know how to recognize distribution (selling).

where volume may subside and the market averages will sell off for perhaps four days. The second and probably the last early chance to recognize a top reversal is when the market attempts its first rally, which it will always do after a number of days down from its highest point.

Three Ways the First Rally Attempt Can Fail
If this first attempted bounce back follows through on the third, fourth, or fifth rally day either on decreased volume from the day before, if it shows poor net price progress as compared to the progress the day before, or if the market average overall recovers less than half of the initial back is feeble and sputtering when it should be getting strong.

Be Prepared for Abrupt Rally Failures
Frequently, the first stock market rally during a beginning downtrend will fail abruptly. After the first day's resurgence, the second day will open down. The abrupt failure of the market to follow through on its first recovery attempt should probably be met by further selling on your part.

The Initial Market Decline Can Be on Lower Volume
Most stock market technicians are fooled by the initial market decline way up around the top.

Volume begins to pick up on the downside, days or weeks later, when it becomes obvious to more investors. But as in anything else, if you wait until it becomes obvious to most people, it is going to cost you more.

Similar top indications can be seen on the S&P 500, New York Stock Exchange Composite, or even on occasion an index of the current

The speculative, or swinger-type, stock index is occasionally significant because market movements are almost always led by a few aggressive heels first. Therefore, a speculative index may highlight the one-day price reversal or stalling action on increased volume. I term this "heavy or increased volume without further price progress on the upside."

At sensitive potential turning points, an active market operator can watch hour-by-hour market index price changes and hourly NYSE volume as compared with volume the same hour the prior day.

A good time to watch hourly volume figures is during the first attempted rally following the initial decline off the market peak. You should be able to see if volume is dull and dries up on the rally. Plus you can recognize the first hour that the rally starts to fade, with volume picking up on the downside.
that support area. What you want to determine is the degree of pickup in selling that occurs as the market is collapsing into new low ground. Does the hourly volume pick up dramatically or only a small amount? After a few days of undercutting of previous lows on only mildly increased volume, do you get one or two days of increased volume with-area ready for an upturn. This occurred on April 23 and 24, 1990.

the market averages and volume on an hourly basis every day.

**Look for Divergence of Key**

are significant divergences. For example, if the Dow Jones was up 10 the S&P, being a broader index, would indicate the rally was not as broad and strong as it would appear on the surface.

age into the Dow Jones Industrials'. This figure can then be multiplied by the change in the S&P to convert it into numbers comparable to the Dow Jones movement for the day.

at 125, the 1000 Dow would be eight times the S&P index of 125. Therefore, if the Dow, on a particular day, is up 10 points and the S&P is up .60, you can multiply the .60 by 8 and find that the S&P was only up the equivalent of 4.80 on the Dow Jones.

**A 33% Drop Requires a 50% Rise to Break Even**

even. Therefore, it is essential to try to preserve as much of the profit

I generally have not had much problem recognizing and acting upon 1976, and 1981. However, between 1962 and 1981, I twice made the sad mistake of buying back too early. When you make a mistake in the stock market, the only sound thing to do is correct it. Pride doesn't pay. separate phases, or legs, of decline interrupted by a couple of rallies

ing stocks off the bottom and help make the rally convincing enough to

of a bear market.

**FRB Discount Rate Changes Are Influential**

The Federal Reserve Board discount rate and stock margin level

Interest rates, as a rule, provide the best confirmation of changing basic conditions. Changes in the Federal Reserve Board's discount rate are by far the most reliable market measurement. The Alan Greenspan Federal Reserve Board discount rate increase to 6% in September 1987 led to the severe stock market break of October 1987.
in succession, and it usually signaled the end of a bear market when the

The Fed Kills the 1981
Economy

The bear market and the costly and protracted recession that began in
1981, for example, was created solely because the Federal Reserve
Board increased the discount rate in rapid succession on September 26,
1980; November 17, 1980; and December 5, 1980.

important market turns that the discount rate did not help predict, one
of the more noteworthy being in 1962.

Washington Causes the 1962

Nothing was wrong with the economy in the spring of 1962, but the
(SEC) announced it planned a major investigation of the stock market.
50%. A new bull market sprang to life following the Cuban missile
showdown with the Russians in October. All this happened with no
change in the discount rate.
Also there are situations where the discount rate was lowered six

Other Key Market Factors to
Recognize and Use

and acted upon, the market that is starting to top out will mechanically

which you will immediately sell to cut a loss.
If, on the other hand, you can't watch your stocks closely or you are
your distance or indecisiveness.

errors can cost you money.
One of the biggest faults investors have is that it takes time to reverse
points, you will automatically be forced into selling as a general market

A sophisticated investor who uses charts and understands market
gard stocks to show strength at this stage. Seeing a number of sluggish
A peculiar tendency during a bear market is for certain leading stocks to resist the decline and hold up in price, creating the impression of true strength. This is almost always false and simply postpones the inevitable collapse. When they raid the house, they usually get everyone.

**How to Interpret the Advance-Decline Line**

which are cumulative statistics on the total number of New York Stock market. In other words, a market keeps advancing toward higher fail to break through prior resistance areas on the upside. This, in to be rallying strongly, the broad cross section of the market remains just a few leaders to make a new bull market.

**Forecasting the Powerful January 1985 Rally**

second week of January 1985 was clearly and easily forecast by the advance-decline line three weeks earlier. The NYSE advance-decline line broke above immediately prior peaks three times while the *Investor's Business Daily* stock index moved sideways and the Dow Jones Industrials actually took a nosedive.

Market tops usually occur with odd lot (less than 100-share transactions), short-interest, relatively low (1% or less of total odd-lot selling activity), and, at a peak, in short-term, overbought, oversold indexes
top, there will be either a poor rally in the market averages, rally failure, or both. You should learn in detail exactly what signals you are looking for, and you should remain unbiased with no opinion about the market. Let the daily Dow tell you what the market has been doing and is doing. You do not need to know what the market is going to do! All you need to know is what the market has actually done! This is the key! Think

Follow the Leaders for Market Clues

After the daily general market averages, I would say the second most important indicator of primary changes in stock market direction is simply the way leading stocks act.

After an advance in stocks for a couple of years or more, if the majority of the original price leaders top, you can be fairly sure the overall

ings, the big question is how long you should remain on the sidelines. If you plunge back in the market too soon, the apparent rally may fade and you'll lose money. But if you hesitate at the brink of a roaring recovery, opportunities will pass you by.

where from its third to tenth day of recovery. The first and second days of an attempted improvement can't tell you if the market has really turned, so I ignore them and concentrate on the follow-through days of the rally. The type of action to be looked for after the first few days of revival is an increase in total market volume from day before, with substantial net price progress for die day up 1% or more on the Dow Jones or S&P Index.

furious volume, normally the next day.

Just because the market corrects the day after a follow-through, however, does not mean the upward follow-through was false. When the

if these pullbacks or tests hold up at least a little above the absolute intraday lows made recently in the market averages.

Wait for a Second Confirmation at Market Bottoms

confirmation of the turn before buying heavily. The bottom day in the first indication of a possible bottom. A good follow-through, with the Dow Jones up 18 or 20 points or more (if the Dow is in the 1800 area) and accompanied by an increase in daily volume from the day

Follow-throughs after the tenth day indicate weakness.
if the first, second, and third day are all very powerful, for example, each day being up 15 or 20 points on the Dow with large increased vol-
that is strong, decisive, and conclusive, not begrudging and on the fence, up only a marginal eight or nine points. Following are examples

Is the Dow Theory Useful?
The Dow Theory is another method used by some to predict the beginning of a new bull market. I do not recommend its use because it is just

too late and obsolete to be of practical use in today's modern market. The Dow Theory, it must be remembered, was created around the turn of the century when the railroad industry was a booming growth sector.

The theory simply states that you must always analyze the industrial and railroad averages together. If, after a prolonged bear market, the industrial average breaks out into new territory, you must wait for the rails to also blast out and confirm the movement of the industrials.
The rail average was changed several years ago to include airlines and

For investors interested in pursuing the matter in more detail, William Peter Hamilton, in 1922, published the classical work entitled *The Stock Market Barometer*. Robert Rhea, in 1932, wrote an updated treatise on the subject, entitled *The Dow Theory*.

**General Philosophy and Observations**

To many people, it seems prudent or fashionable to say or believe they

nonmovement in several relatively mild bear markets that decline 20% right devastating.

The problem is always at the beginning when you first start to sense

bear markets typically averaged only nine months in duration with a 26% market downturn.

**1973-1974: The Worst**

Watergate hearings and the 1974 oil embargo by OPEC combined to

the average stock plummeted over 70%. This was a complete disaster for stockholders and was almost as severe as the approximately 90% correction (million of that period's population were unemployed.)

exchange might not survive as a viable institution.

At that time, the head of a large brokerage firm lobbied two years in

kners to provide markets in NYSE stocks upstairs within their own organizations and among their own customers.

Exchange's ability to conduct an auction market and could have resulted in the industry leaders' sharply cutting prices and driving many smaller competitors out of business. Thereafter, the leader could theoretically

powers in Washington at the time didn't trust the self-serving nature of the pleas. Fortunately, I had known Harold Williams, then chairman of the

Business School. My firm had provided a few scholarships to students, so we used to go to lunch on occasion, where we usually discussed the economy.

So I made a trip to Washington and discussed what I believed was going on. A few days later the SEC began a policy change away from

tating the New York Stock Exchange market making function, putting smaller organizations out of business and maybe opening the door to more monopolistic control for the industry's largest firm.

the press by a particular senator for dragging its feet on vitally needed

**Industry Action That Led**

**Firms**
ed to replace fixed rates, the end result was as follows: Many smaller industry giants, commissions to institutions were immediately cut in

Other Bear Market Warnings

lier, is when the original bull market leaders falter and a number of forgotten old dogs begin to bark and raise up out of the grave and leg. Watch out.

a matter of weak leadership trying to command the market. If the best ones can't lead the market, the worst ones certainly aren't going to for very long.

At other times, when the market begins an important top, it will recov-high ground for a few days before it breaks down in earnest. This character-

ly the right time. In 1994 the NASDAQ topped weeks after the Dow.

In the stock market, the majority will be fooled first. This goes for
stocks back during the strong rally. This is an example of how tricky and

The new high by the Dow in January 1984 was accompanied by a diver-
gence in the broader-based and more significant S&P 500. It did not hit a

new high. This is the reason most professionals plot the indexes togeth-

ly get at least two or three pullbacks to fake out or shake out the few can be run in or run out throws in the towel and acts, there isn't anyone

and begin a whole new trend.

traps. In fact, in my experience a person's years and quality of education have very little to do with making big money investing in the market.

The more intelligent people are, the more they tend to think they know what they are doing—and the more they will have to learn the
ket. The few people I have known over the years who have been unques-
ing individuals without huge egos.

The market has a simple way of whittling all excessive pride and

than try to prove that the thing you said or did yesterday or six weeks ago was right. The fastest way to take a bath in the stock market or go

new bear market begins. That is to have the sense to sell and get out or go short. When you get out, you should stay out until the bear market is over. This usually means nine months, and in the prolonged, problem-ridden 1969-1970 and 1973-1974 periods, it meant two years.

Selling short can be profitable, but it is a difficult, highly specialized subject and short selling should only be attempted during bear markets. Chapter 11 discusses short selling in more detail.

Psychological Market Indicators Can Help

There are several other indicators which may provide further data about the trend of the general market. The percentage of invest-

mentology. Near bear market bottoms, the great majority of advisory let-
investment advisors were bearish that the next time the advisors' index
one of the great problems with indexes that move counter to the

Overbought/Oversold: Two
Risky Words

by some public investors, is a 10-day moving average of advances and
declines in the market. Caution: Sometimes in the beginning of a new
bull market the index will become substantially overbought because it has
stocks. A similar occurrence can happen in the early stage or first leg of a

everything told me the market was beginning to get into serious trouble
date stocks and raise large amounts of cash, he was telling them that it
was too late to sell because his overbought/oversold indicator said the
market was already very oversold.
You guessed it, the market split wide open after the index was over-
sold and really started to decline.

ator. Sometimes, the more widely quoted and accepted the market or eco-
nomic expert, the more trouble you might, on occasion, get yourself into.

insisted that government borrowing was going to crowd out the private

The exact opposite happened; inflation broke and interest rates came
crashing down. Conventional wisdom is rarely right in the market.

Cycle

The winning investor should understand how a normal business cycle
unfolds and the duration of these periods, paying particular attention to

never, bull markets frequently top out and turn down before economic
cession begins.
Therefore, using economic indicators to tell you when to buy or sell
firms have people trying to do this very thing.
It's a somewhat ridiculous approach, but it does seem to make those
who don't understand the stock market very well feel better.
Ironically, economists also have a rather faulty record of predicting
the economy. A few of our U.S. presidents, themselves lacking sufficient
understanding of the American economy, have had to learn this lesson
the slow, hard way. Around the beginning of 1983, just as the economy

Council of Economic Advisors was a little concerned because the capital
this particular advisor might not be as thoroughly sound as he should

when American plants were operating at a low percentage of capacity.
You should check earlier cycles to learn the sequence of industry
equipment, machinery, and other capital goods industries are late
movers in a business or stock market cycle. This knowledge can help
you determine what stage of the current market period you are in.
When these groups start running up, you know you're near the tail end.
Two Years
Almost always, the really big money is made in the first one or two years of a normal new bull market's upward movement. This, then, is the recognize upon while the golden opportunity is there.
The remainder of the up cycle usually consists of back and forth movement in the market averages, followed by a bear market. The year of a new cycle was caused by the advent of the Vietnam war.

intermediate-term declines in the market averages, usually lasting a cou-
15%. After several sharp downward adjustments of this nature, and ther upside progress in the daily market averages could indicate the

Since the market is made up of supply and demand, you can decipher a chart of the general market averages almost the same as you read the chart of an individual stock. The better publications display the Dow

They should show the high and low and close of the market averages day by day for the prior year, together with the daily New York Stock Exchange volume in millions of shares traded.

ations and events in the country and let the general market tell its own attempting to tell you.

The Effect of News Events on the Market

extremely valuable, particularly if you retain and review old back copies. er with important news events that may have influenced the market's direction in the past.

History can repeat itself. If you have solid information about how

and price controls, discount rate changes by the Federal Reserve Board, or "panic" news circumstances.

Indicators
moving average which relates trading volume in stocks that close up in show divergence at some intermediate turning points in the market. ages, the averages may continue to penetrate into new low ground for downside volume may be subsiding.

changes, together with daily volume on the NYSE, you'll pick up these

New York Stock Exchange, expressed as a percentage of total NYSE lators in the market. The May-June 1994 rally was a short squeeze rally.
increased short selling) in this index along bear market bottoms. There is no positive rule governing how high the index should go, but you can study past general market bottoms to review what has happened to the

The odd-lot-balance index is a ratio between the total buying and selling of odd loiters. Odd loiters are individual investors that buy or sell in less than round lots (100 shares). The theory behind this index is that the less-informed crowd tends to be wrong at important turning points, misunderstood and misinterpreted. It is not critical that the index show net buying or net selling. What is important is the trend of activity. If odd loiters have been buying, on balance, and trend toward buying less, it means they are becoming more cautious. Odd-lot theory suggests their caution could turn out to be wrong.

If odd loiters have been selling steadily, the point to watch for is less or transition toward buying. If they are beginning to sell less, the significant top.

Caution: There is confusing dislocation in the odd-lot figures in
lios for year-end tax benefits. Odd-lot figures also have seemed to be of less importance in recent periods.

The **odd-lot, short-sales index**, which measures the percent of total odd-lot sales that are short sales, is one constructive measurement of crowd psychology and often has signaled the bottoms of bear markets. When you reach a point where numerous small investors conclude the only way to make money is to sell short, you are very late in the down short-sales index increases. It can build up to a series of peaks over sev-

![Graph: ODD LOT SHORT SALES AS % OF ODD LOT SALES](image)

Although not watched as frequently at tops, this index is usually around its low point at major bull market tops. Researchers can note the extreme low point reached at the peak at the end of December 1976.

Of all the many general market indicators, the odd-lot, short-sales index historically has been one of the more reliable confirming indexes. Odd-lot figures are shown in the financial section of most daily news-

will see that in almost every case there was a substantial increase in emo-

The odd-lot, short-sales index is valid because it tends to represent

*Stock Market*, written in 1948, provides statistics on odd-lot sales over

the past, and human nature and mass psychology haven't changed much.

Now that speculation in put and call options is the get-rich-quick

Another favorite indicator many investors watch is the **specialist**

rally in the market that places huge demands upon their market-making index is overused, overrated, not properly understood, and frequently misinterpreted.

Market conditions change, and influences upon the market change as specialists as well as other speculators.

The specialist short-selling index may, on occasion, be valuable as

comparison.

**Mutual fund sales and redemptions** (excluding money market funds) are important indicators because mutual funds, although not as large as banks, are active investors and impact the stock market. If mutual fund support for the market.

market funds) and the **cash position of pension funds** is an important indicator of future market trends.

Ironically, major bull markets begin when institutional cash positions are higher than normal, and bull markets usually top out when cash positions are lower than normal.

| MUTUAL FUNDS CASH POSITION - HIGH/(6/82) 12.2% LOW/(1/84) 8.0% |
|--------------------|---------------|-----------------|
| OCTOBER 1988       | 10.0%         | APRIL 1989      | 8.8%            |
| NOVEMBER 1988      | 9.7%          | MAY 1989        | 9.2%            |
| DECEMBER 1988      | 9.4%          | JUNE 1989       | 9.2%            |
| JANUARY 1989       | 9.4%          | JULY 1989       | 9.3%            |
| FEBRUARY 1989      | 9.0%          | AUGUST 1989     | 10.2%           |
| MARCH 1989         | 8.7%          | SEPTEMBER 1989  | 10.2%           |

**Mutual funds cash position**

reasons for the unbelievable bull market stampede on the upside that followed. A record number of mutual funds had 30% to 50% cash posi-

positions at the 1982 bottom, and they were dead wrong.
When you are wrong in the market, sooner or later you are forced back into the market to correct your untenable position.

Some services measure the percentage of new money flowing into corporate pension funds that is invested in common stocks and the amount invested in cash equivalents or bonds. This, too, provides a measure of institutional investor psychology.

For many years the composite strategy of institutional investors near market tops and bottoms invariably has been wrong. As did the odd letters of old, when the majority of institutions decide it is time to keep more of their investments in cash or bonds, it is generally time for a roaring advance in the prices of common stocks.

In the stock market, majority (crowdlike) thinking is rarely right even

A decline in the average price of the most active stocks daily is an indication of impending trouble during the summer of 1983 when OTC volume reached the level of NYSE volume. When a trend persists, indicating wild, rampant speculation,

This measure provided a helpful tip-off of impending trouble during the summer of 1983 when OTC volume reached the level of NYSE volume. When a trend persists, indicating wild, rampant speculation,

The unweighted stock index shows the true picture of the average as a whole by eliminating any possible bias due to weighting of individual companies. In some markets, the weighted averages such as the S&P 500 may overstate the actual strength of the market.

The glamour index is composed of speculative or aggressive-type stocks. This index attempts to measure the demand for such stocks, thereby indicating investor sentiment toward the market. A strong

Some publications show a long-term, inflation-adjusted market index. This is an academic economist's concoction and is of no real value to

A defensive stock index is composed of defensive (more stable and supposedly safer) stocks, such as utilities, tobaccos, foods, and soaps. conditions may indicate "smart money" slipping into defensive positions and a weaker general market ahead.
Another possible indicator you should be aware of in evaluating the list that could be categorized as either defensive, low-priced, laggard, or of concern with weakness in the market because of the number of new new-high list has shown that when a high number of preferred or defensive stocks appear, it has frequently signaled a bear market environment. A little surface knowledge can hurt you in the stock market.

**Indicators**

several industry groups, is often affected by changes in interest rates.

reserve requirements for member banks, the M1 and M2 money supply percent rate of change, federal funds rate, consumer price index, member bank reserves, ratio of government securities holdings to bank loans, 90-day Treasury Bill yields, and U.S. Treasury Bond prices.

These monetary indicators might help you anticipate future government policy decisions and their effects on the stock market, individual stocks, and the American economy.

Funds rate sometimes help predict impending discount rate changes.

Don't be discouraged if the subject of monetary indicators seems complex; it is. Few economists, few presidents, virtually no one in Congress, and even few people at the Federal Reserve, including some heads of the Fed, understand it as well as they should.

remain relatively independent and not subject to political control or extreme pressure from the Congress. It might, however, be constructive skill and timing, but one possible effect for some managers may be to

More and more funds operate under a plan of very wide diversifica-

most managers have difficulty in getting out and into cash at the right time and, most importantly, then getting back in fast enough to participate in the initial powerful rebound off the ultimate bottom.

**Is C-A-N S-L-I-M Momentum Investing?**

No, C-A-N S-L-I-M has absolutely nothing to do with momentum investing. In fact, I'm not even sure what momentum investing is. Some analysts and reporters, who have no idea at all how we invest, have referred buying the stocks that have gone up the most and that have the strongest relative price strength. No one in their right mind invests that way.

That is not what we're doing. We're buying companies with strong fundamentals, large sales and earnings increases resulting from unique new products or services and trying to time the purchases at a correct point as the company emerges from consolidation periods and before the stock runs up dramatically in price.

To summarize this vitally important and rather complex subject, learn to interpret the daily general market indexes and action of the individ-

stop listening to all the uninformed, costly, personal market opinions from amateurs and professionals alike.

**How to Remember and Use What You've Read So Far**

apply a simple-two word phrase—C-A-N S-L-I-M.
do selecting winning stocks. So each letter in the C-A-N S-L-I-M slogan stands for one of the seven basic fundamentals of selecting outstanding

\[ C = \text{Current quarterly earnings per share. They must be up at least } 20\%. \]

\[ N = \text{New. Buy companies with new products, new management, or significant as they initially make new highs in price. (Forget cheap stocks; they are} \]

\[ S = \text{Supply and Demand. There should be a small or reasonable number of shares outstanding, not large capitalization, older companies. And look sors with better than average recent performance records.} \]

interpret the daily general market indexes (price and volume changes) and action of the individual market leaders to determine the overall mar-
to Buy Stocks

**Branch offices** of most New York Stock Exchange firms have a broker of the day. He or she will probably be called a **registered representative**.

This is the person you will likely talk to if you visit a broker's office look-

How do you find a competent stockbroker? I suggest you follow a slightly different procedure.

Go to the office of the firm you choose and ask to see the office man-

manager. Say you are considering opening a new account but would like to deal with a broker that has definitely been successful at making money in his or her own personal account and for most customers' accounts.

middle-aged, or older. Age or years of experience is certainly no sign

Did you ever hear the story about the schoolteacher who had 25 years' experience but was turned down for a job by a new principal? one year's experience 25 times over.

**Ask Questions....It's Your Money**

questions. It's your money.

or she has read? If the broker can't easily name a few, then maybe you should be a little cautious.

for ideas, information, and reports, you may be better off visiting with a few other brokerage firms before you decide where to open your account.

to a chart service or *Investor's Business Daily* on their own, and will

Following brokerage firm research department reports is not neces-

Brokers that have attended *Investor's Business Daily* all-day workshops

**Should You Have Several Brokerage Accounts?**

most cases such a practice is silly, since your account won't be as impor-

activity with the best stockbroker you can find. If this doesn't work well after a year or two, change and find another broker.

If you are more accomplished and make your own buy-and-sell deci-

ions, you might want to consider a discount broker. You could save as

have grown and increased their share of the retail securities business
If you don’t know the name or location of a stock brokerage firm that is
Exchange firm is that NYSE membership in the securities industry is a lit-
tle like the Good Housekeeping seal of approval. It certainly doesn’t guar-
tantee you will make money; however, you will be dealing with a more sub-
stantial organization. Members usually pay several hundred thousand

Stock exchange firms also have many rules and regulations to which
they must adhere. And they are subject to surprise audits and annual
examinations from the stock exchange.

Conversely, some firms that are only members of the NASD, the
ness. They may not be backed up with as substantial a capital base.

If you’ve never opened an account with a brokerage firm, don’t be
timid or reluctant to visit one. It’s simple and easy, just like opening an
out and sign new account papers before you will be able to buy or sell
ences, such as your bank. All brokerage firms have a regular commis-
sion schedule which they should be able to show you. The commission
generally averages from 1% to 2% to buy or sell a stock.

When you buy or sell stock, you will receive a confirmation in the
mail (a small slip of paper) which will show what stock you bought or
sold, the price paid or received, the commission paid, and the total dol-
lar amount you owe or will receive if you sold a stock. It will also show
the settlement date by which the transaction must be settled.

It’s best to pay these bills immediately on receipt since they will be due
ly endorsed without delay when you wish to sell a stock, otherwise the
endorsements) can be signed and mailed separately to your broker.

It is usually more convenient for both you and the NYSE firm to hold
your stock certificates in street name (the brokerage company name),
where they are held in safekeeping for you by the brokerage firm. All
accounts are insured to $500,000 by the Securities Investor Protection
Corporation, and additional insurance is carried by most firms.

The largest retail brokerage firms in the United States are: Merrill
- * Paine, Webber, J. Smith, Dean Witter Reynolds; Prudential

Securities; Paine Webber; A.G. Edwards & Sons; Kidder, Peabody & Co.;
Smith Barney Shearson, Inc.; Bear, Stearns & Co.; First Boston; Goldman,
Sachs & Co.; Morgan Stanley & Co.; and Salomon Brothers. Charles
larger discount firms.

All of the above brokerage organizations are substantial and experi-
Prudential is a member of the giant Prudential Insurance Company fami-
count retail brokerage firms that are New York Stock Exchange members.
An exceptionally able broker can be almost as important to you as a

**Why You Should Have an Individual Retirement Account (IRA)**

Why are so many people investing in IRA accounts, as they are com-
monly known?

U.S. law allows working individuals to invest any amount up to $2000
every year in a tax-deferred IRA account if the company they work for
does not have a qualified retirement plan. This can be an enormous tax
advantage, and every American should consider taking advantage of it.

First, you may be able to deduct the $2000 investment from your tax-
able income and not have to pay income tax on that part of your earn-
ings. And you can do this every year that you invest in an IRA, until you
are 70 years old. If married and both of you are working, you can invest
any amount up to $4000 every year.

The second advantage of an IRA is that the profits, dividends, or
tax-deferred. These earnings compound tax-free for the many years until
you retire and begin taking distributions.

Do you have any idea what $4000 invested tax-free every year, earning
and compounding at an average rate of 12% per year, would be worth

IRA plans allow you to begin withdrawals (of course subject to regular
income tax rates at the time of withdrawal) at age 59½, but you must
begin by age 70½. If you are disabled, you can withdraw early; otherwise
early withdrawal is subject to a 10% penalty plus the regular income tax.

You don’t have to wait till age 59½ to benefit from the plan, however; if
you withdraw funds after five or six years and pay the penalty, you are still
taxes and saving for your retirement. Be determined and stick with it.
Withdrawal, after age 59½, can be in a lump sum or spread in install-

Most families in America should budget carefully their monthly and
annual expenses and make sure they save enough of their hard-earned
You can open an IRA account at any bank or stock brokerage firm. IRA
accounts cannot be margined.
of deposits, mutual funds, or self-directed accounts in common stocks
maximum hedge against inflation.
Keogh plans are similar to IRAs except they are only for self-employed
20% of a person's annual salary or up to $30,000. Another form of a
contributions.
to invest, on a tax-deferred basis, larger amounts than are allowable in

In 1982, approximately 60 million American households were eligible
important than Social Security. This will mean a large increase in the
If you only have $500 or $1000 to invest each year, that's okay. You
maximum dollar amount required to begin an IRA.
If you opt for an IRA, then you had better start learning about invest-
every few years to help you keep on target. Why? Because, if you invest
$2000 each year, in only four or five years you are going to have $10,000
ments properly.

**When to Sell if Your Selection or Timing Might Be Wrong**

*Sometimes* the best offense is a great defense. Now that you've

Angeles Dodgers, and before that the Brooklyn Dodgers, have generally

In the stock market, you absolutely can't win either unless you have a
strong predetermined defense to protect yourself against large losses. This

These poor decisions will lead to losses, some of which can become
believe your information or analysis is, you simply are not going to be

**Bernard Baruch's Secret Market Method**

Bernard Baruch, a famous market operator on Wall Street and trusted
advisor to U.S. presidents said, *“If a speculator is correct half of the
time, he is hitting a good average. Even being right three or four times
out of 10 should yield a person a fortune if he has the sense to cut his*
This point of Baruch’s was proven to my satisfaction in the case of an account I managed many years ago. In 1962, the general market took a 29% nosedive and we were right in only 33% of the commitments made year because the average profit on the 33% correct decisions was over

The whole secret to winning in the stock market is to lose the least amount possible when you’re not right. In other words, in order to win you’ve got to recognize when you may be wrong and sell without hesitation to cut short your loss.

But how can you tell when you may be wrong? That’s easy. The price
bility that you are mistaken, as well as the price you are going to pay for

or Always Right?

People think a successful person is either lucky or right most of the
cesses are a result of hard work rather than their being lucky. They suc-

In search of a filament for his electric lamp, Edison carbonized and tried 6000 different specimens of bamboo. Three of them worked. chicken feathers.

England before they finally made it.

I have found over the years that only one or two stocks out of every 10 I bought turned out to be truly outstanding and capable of making sub-

down substantial gains in stocks like Brunswick and Great Western
Fairchild Camera and Polaroid in 1965, Control Data in 1967, Levilz
Technology in 1991-1993. These stocks dazzled the market with gains ranging from 100% to more than 1000%.

Are You a Speculator or an Investor?

Before we delve further into the intriguing shell game of when to sell,
investor.

Bernard Baruch interpreted speculator as follows: "The word specula-
tor comes from the Latin 'speculari' which means to spy and observe. A
comes."

investor this way: "Investors are the big gamblers. They make a bet, stay
with it, and if it goes wrong, they lose it all."

These definitions are a bit different than those you will read in
Webster's Dictionary. But we know Baruch and Livermore on occasion
made millions of dollars in the stock market. We're not sure about
Webster.

investment ideas, beliefs, and methods you have heard about or used in
the past.

The amount of erroneous information and ignorance about how the

How the Normal Investor
Thinks

Let's examine how the normal investor thinks and makes decisions. If

<table>
<thead>
<tr>
<th>Buys</th>
<th>Cost</th>
<th>Current price</th>
</tr>
</thead>
<tbody>
<tr>
<td>100 Navistar</td>
<td>$27</td>
<td>$23</td>
</tr>
<tr>
<td>100 Luby's Cafeterias</td>
<td>20</td>
<td>30</td>
</tr>
<tr>
<td>100 Toys R Us</td>
<td>76</td>
<td>74</td>
</tr>
<tr>
<td>100 Storage Technology</td>
<td>30</td>
<td>48</td>
</tr>
<tr>
<td>100 H.J. Heinz</td>
<td>31</td>
<td>37</td>
</tr>
<tr>
<td>60 Wal-Mart Stores</td>
<td>55</td>
<td>61</td>
</tr>
</tbody>
</table>

To see what price you paid for the stock, don’t you? If you have a profit, you may sell; if you have a loss, you will wait rather than take the loss.

So, in this example, you may decide to sell your Luby's Cafeterias or Wal-Mart Stores stock because they show a profit. But these are the stocks you should consider keeping. Instead, you should probably sell

If you’re the type of person who would have been inclined to sell the "price-paid bias" which 95% of investors have.

Suppose you paid $30 for a stock two years ago. Today it is $34. You may sell it because you've made a profit. But what does the price you

whether it should be held or sold now?

Suppose you paid $40 for the same stock six months earlier and, therefore, have a loss today. Does this change its future potential? Probably not! What you paid for a stock years ago or whether you have a

### Loss?

When you say, "I can't sell a stock because I don't want to take a loss," the stock does not know who you are, and it doesn't care what you hope or want.

The loss, but selling doesn't give you the loss; you already have it. If you think a loss is not incurred until you sell the stock, you may be kid-

For example, if you paid $40 per share for 100 shares of Ace Chemical, and it's currently worth $28 per share, you have $2800 worth

vert it to cash or hold the stock, it is only worth $2800.

You took your loss as this stock dropped in price even though you didn't sell; now you will probably be better off selling the stock and going back to a cash position. You can think more objectively with cash in your stock account than you can if you're worrying about a stock that has lost money for you. Anyway, there are other securities where your chance of recouping your loss could be far greater.

Here's another suggestion that may help you decide whether or not to sell. Pretend you don't own the stock and you have $2800 in the

### Records

ent method of keeping records. At the end of each quarter, figure the value of each stock position you own by multiplying the current market price of the stock by the number of shares you own.

Compute the percentage change in price of each stock from the last

Let's say your Tektronix is down 8%, your Exxon is unchanged, and Exxon and Tektronix.

At the end of the following quarter, do the same thing. After a few reviews, you will easily recognize the holdings that are not doing well. They will be at the bottom of the list, and the ones that performed best will be at the top.

This method, while not foolproof, does force you to focus your atten-

of your portfolio.

Eliminating the price-paid bias can be profitable and rewarding. If you price because you do not want to accept the fact you have made an impru-
dent selection and lost money, you are making decisions exactly the opposite of those you would make if you were running your own business.

Investing is a business and should be operated just like a business.

bought and stocked women's dresses in three colors—yellow, green, and red. The red dresses are quickly sold out, the green ones are half

Do you go to your buyer and say, "The red dresses are all sold out. more of them anyway"?

Certainly not!
The clever merchandiser who survives in the retail business eyes this predicament objectively and says, "We sure made a mistake. We'd better eliminate the yellow dresses. Mark them down 10%. Let's have a sale. If they don't sell at that price, mark them down 20%. Get our money out of those 'old dogs,' and put it in more of the hot-moving red dresses that are in demand." This is common sense in a retail business. Do you do this with your investments? Why not?

Everyone will make buying errors. The buyers for department stores are professional buyers and even they make mistakes. When you do slip up, as to be correct on all your investment decisions to make a net profit.

80%, would you? But how do you know this is not the situation when you buy a stock if you do not attempt to define these factors and operate according to well-thought-out selling rules? Do you have any specific selling rules, or are you flying blindly?

I suggest you consider writing down the price at which you expect to securities you purchase. By writing it down, you will focus your atten-

8% of Your Cost

the loss on initial invested capital in each stock to an absolute maximum of 7% or 8%. Because of position size problems and broad diversification which lessen risk, most institutional investors do not usually follow

vidual investor, have over the institution, so use it.

price you paid. Once you are ahead and have a good profit, you can afford to, and should, allow the stock more than 7% or 8% room for normal fluctuations in price. Do not sell a stock just because it's off 7%

asked him if he followed the 10% loss policy himself. He said, "I would hope to be out long before they ever reach 10%.

Georgia, suggests a minor revision of the 10% loss-cutting plan. He feels

To preserve your hard-earned money, I think 7% or 8% should be the limit. Your overall average of all losses should be less, perhaps 5% or 6% if you are strict and fast on your feet.

There is no rule that says you have to wait until every single loss reach-
ket or your stock isn't acting right or that you are starting off amiss. Then you can cut the loss sooner, when a stock may be down only one or two points.

ALSO, 7% TO 8% BELOW YOUR PURCHASE PRICE IS THE ABSOLU-
TATE LIMIT. Once you get to that point, you can no longer hesitate. You can't think about it or wait a few more days to see what might hap-

immediately at the market. The fact that you are down 7% or 8% below

At this time nothing else should have a bearing on the situation.
Cutting Losses Is like Buying an Insurance Policy

Granted, many, many times the stock you sell will immediately turn around and go up. You will probably get very perturbed and think you

ance this year? Of course you are!

home did not burn down last year, are you upset because you made a bad financial decision?

You don't buy fire insurance because you know your house is going to

investor who cuts losses quickly and closely; he or she wants to protect against the possible chance of a larger potentially devastating loss from

I know a stockbroker who bought Brunswick in 1961 at $60. When it

course. Never argue with the market—your health and peace of mind are always more important than any stock!

your money to try again for a winner in another stock.

If you can keep the average of all your mistakes and losses to 5% or 6%, you will be like the professional football team that opponents can never score yardage on. If you don't give up many first downs, how can they ever beat you?

Take Your Losses Quickly and

smallest loss. In my view, the way to make investment decisions is to take your losses quickly and your profits slowly. Yet most investors get emo-

we sit with stocks rather than selling and taking a loss? How about unusual

Does this loss-cutting procedure apply all the time, or are there excep-

Letting your losses run is the most serious mistake made by almost all investors! You positively must accept that mistakes in either timing or selection of stocks are going to be made by even the most professional investors. In fact, I would go so far as to say if you aren't willing to cut short and take your losses, then you probably should not buy stocks.

Speculative

their name, quality, or purported blue chip status.

Every 50% loss began as a 10% or 20% loss. Having the raw courage to sell and cheerfully take your loss is the only way you can protect your-

be instantaneous and simultaneous. To be a winner, you have to learn to make decisions.

If a stock gets away from you and the loss becomes larger than 10% or 15%, which can occasionally happen to anyone, the stock normally

than normal losses are usually the really awful selections that must be sold. It is wise to remind yourself, "If I let a stock drop 50%, I must

buy stocks that double?"

It is a dangerous fallacy to assume that because a stock goes down, it has to come back up. Many don't, and some take years to recover.

"I'm A Long-Term Investor; I'm Not Worried; I'm Still Getting My Dividends"

Another risky statement is to say to yourself, "I'm not worried about my stocks being down because they are good stocks, and I'm still getting my dividends." This is naive because good stocks can go down as much as
might not be good stocks in the first place. It may be just your personal opinion that they are good stocks.

absurd to say you're all right because you are getting a 4% yield? A 25%
loss plus a 4% income gain makes a big fat 21% net loss.

If you aspire to be a successful investor, you must face facts—most of
the reactions you have about taking losses are rationalizations, because
no one wants to take losses. You have to do many things you don't want
to do to increase your chances of success in the stock market. You must
develop exact rules and tough-minded selling disciplines.

Should You Average Down in
Price?

One of the worst mistakes I have seen some stockbrokers make is to be

help and reassurance. To shirk duty in the difficult periods is not very
professional and shows a lack of courage, or "guts," under pressure.

the hook by advising customers to average down and buy more of the

Everyone loves to buy stocks; no one loves to sell stocks. As long as
you hold a stock, you still have hope it might come back up at least

accept the cold reality of defeat. Investors are always hoping rather than
being realistic. You just can't afford to have a love affair with any stock.

Let's see where the real problem lies. Does the fact that you want a

The stock market only obeys the law of supply and demand. So try to

A little boy was walking down the road when he came upon an old
contrivance consisting of a big box with the door hinged at the top.

This door was kept open by a prop to which was tied a piece of twine
leading back a hundred feet or more to the operator. A thin trail of
corn scattered along a path lured turkeys to the box. Once inside the
turkeys found an even more plentiful supply of corn. When enough
turkeys had wandered inside the box, the old man would jerk away the
prop and let the door fall shut. Having once shut the door, he couldn't
open it again without going up to the box and this would scare away any

One day he had a dozen turkeys in his box. Then one sauntered out,
leaving 11. "Gosh, I wish I had pulled the string when all 12 were
there," said the old man. "I'll wait a minute and maybe the other one
will go back."

But while he waited for the twelfth turkey to return, two more walked
out on him. "I should have been satisfied with 11," the trapper said.
"Just as soon as I get one more back, I'll pull the string."

But three more walked out. Still the man waited. Having once had 12
turkeys, he disliked going home with less than eight. He couldn't give

ly only one turkey was left in the trap, he said, "I'll wait until he walks
out or another goes in, and then I'll quit." The solitary turkey went to
join the others, and the man returned empty-handed.

The analogy to the psychology of the normal investor is amazingly close.

Never Lose Your Confidence

genuinely hurt you is that you must never lose your self-confidence and

If you don't sell to curtail your losses when you begin to get into trou-
ble, you can easily lose your confidence to act and make buy decisions in
the future. In my book, the first and most important rule for beginners or
experienced investors in the stock market is to trim all losses quickly.

early October 1987 before Black Monday's 500-point break in mid-

stocks properly and make a net profit is always a complicated affair.
And human nature being what it is, 90% of the people in the stock market haven't really studied the problem to find out what they are doing right and wrong, and they haven't studied in enough detail to understand what makes a successful stock go up and down. There is no luck to it; it's not a total mystery, and it's certainly not a matter of random walk, like some inexperienced university professors believe.

The fascinating point is that investors can be good at stock selection and experience, but they can also be ignorant about how and why and when to sell their stocks.

Very few people sell well. Selling a stock correctly is the toughest job and the one least understood by everyone. The next chapter will discuss when to sell and take your profits.

In short, if you want to make money in the stock market, you need a good business decisions without wavering.

profit. You, as the merchant, must sell your merchandise in order to realize a profit. It is best to learn to sell on the way up while your stock periodically in market leaders and cause great downside portfolio volatility.

It is far better to sell early. If you are not early, you will be late; you'll and not get excited, optimistic, or greedy as a stock's price advance gets stronger! The old saying is, "Bulls make money and bears make money,

Bernard Baruch, the financier who built a fortune in the stock market, said, "Repeatedly...I have sold a stock while it still was rising—and that has been one reason why I have held onto my fortune. Many a

lapsed."

When asked if there was a technique for making money on the stock

the bottom and I always sell too soon."
Joe Kennedy's Stock Market Secret

Wall Street speculator and the father of former President John F. Kennedy. The object is to get out while a stock is up, before it has a chance to break. Gerald M. Loeb states, "Once the price has risen into estimated normal or overvaluation areas, the amount held should be

market one good profit in hand is worth two on paper.

Develop a Profit-and-Loss Plan

If you want to be a big success investing or trading in the stock market, I believe you must operate with a set of rules and a profit-and-loss plan. I'm going to share with you the rules and plan I devised when I was between 26 and 28 years old and had been a stockbroker with Hayden,

ing in depth the three best-performing mutual funds of the prior two years. The Dreyfus Fund, from 1957-1959, led in performance and in

So I got copies of every Dreyfus quarterly report and prospectus for that time period and calculated the average cost of each new stock posi-

new stock Dreyfus had bought, I marked in red ink on the chart the average price they paid during the quarter the new position was purchased.

bought over several years, I made quite a stunning surprise discovery.

had sold for in the past year. In other words, if a stock bounced from

Jack Dreyfus Was a Chartist

Jack Dreyfus was a chartist and a tape reader. He bought all his stocks based on market action, and he only bought when the price broke into new high ground. He was also beating the pants off every one of his competitors that depended solely on fundamental analytical opinions

Jack's research department in those early big-performance days prior

They posted to large oversized charts the day's price and volume action on hundreds of listed stocks.

doing the same thing. They also produced superior results. Almost all the stocks these three funds bought also had strong increases in their quarterly earnings reports.

My first rules were as follows:

1. Concentrate on listed stocks that sell for over $20 a share and that have at least some institutional acceptance.
2. The company's earnings per share should have increased in each of the past five years, and the current quarterly earnings must be up at least 20%.
3. Timing-wise, the stock should be about to make a new high in price after emerging from a sound correction and price consolidation

The first stock I bought under this set of rules was Universal Match in February 1960, and it was fantastic. It doubled in only 16 weeks, but I failed to make much because I didn't have much money to invest then.

Procter & Gamble, Reynolds Tobacco, and MGM, all of which over the next year had outstanding moves. However, my problem was still that I was relatively young, just getting started, didn't have many customers, and had very little money of my own to invest.
About this time, I was accepted to the Harvard Business School via

**Jesse Livermore and Pyramiding**

At the business school, in my extra time, I read a number of business and investment books in the library. The best one was called *How to objective in the market was not to be right but to make big money when you were right.*

I adopted his method of averaging up, or pyramiding, when a stock moved up after purchase. This helped to concentrate my buying when I seemed to be right. If I was wrong and the stock dropped a certain amount below my cost, I sold the stock to cut short the loss.

In the first half of 1961 my rules and plan worked great. Some of the mer, all was not well.

mided with additional buys so I had good positions and profits. But for over a year and just broke even.

**My Failures**

I was so mad that I spent the last six months of 1961 carefully analyzing every transaction made during the prior year. Much like the medical profession and the Civil Aeronautics Board conduct postmortem operations and postcrash investigations, I marked with a red pen on charts had no rules, no plans, and no idea about when to sell and take a profit.

**My Mistakes in Certain-teed**

There was one stock I handled particularly poorly. I bought Certain-teed in the low $20s and sold it for a two- or three-point gain because I

gonize what I had and failed to capitalize on this phenomenal situation.

**A Revised Profit-and-Loss Plan**

to 25% and then decline, build a new base, and in some cases resume pivot buy point, not pyramid more than 5% past the buy point and

The Certain-teed case had been so powerful, however, that it had

Therefore, one important exception was made in the "sell at + 20% analyzed to see if the stock should be held for a possible six-month, long-term capital gain (six months was the capital gains period at that time). If stocks declined below their purchase price by 8%, they would be sold and

In summary, here was the revised profit-and-loss plan: Take 20% prof-

and cut losses at 8%. The plan had several enormous advantages. You could be wrong twice and right once and still not get into financial trouble. When you were right and wanted to follow up with another buy in the same stock a few
was force-fed into the best investments.

year equaled a 40% annual rate of return, and if you were using 50%

Market System
I made one other profitable observation from analyzing all of my dumb mistakes. Most stocks that topped had done so because the general mar-

market averages to establish the true trend and crucial changes in direction of the overall market.

of every stock. I was 100% in cash, with no idea the market was headed

Operator by LeFevre and was struck by the parallel between the 1907 stock market panic, which was discussed in detail, and what seemed to

Since I was 100% in cash and my daily Dow analysis said the market was weak at that point, I began to sell short stocks like Certain-teed and

just recommended Certain-teed as a buy, and I was going around telling

Later in the year Korvette was sold short over $40. The profits from the short sales were fairly substantial.

By October 1962 and the Cuban crisis, I was again in cash. A day or

worked so well that the worst performing account I managed in 1963

was up 115%. It was a cash account. Other accounts were up several
were usually small, averaging 5% to 6%, and the profits were awesome pyramiding.

back-to-back big winners—Korvette on the short side in late 1962, 40%, short-term gains were building, and I decided to play this power-

By the fall of 1963, the profits were over $200,000 and I decided to
tell you it can't be done!

Many long evenings of study at last led to rules, disciplines, and a plan that finally worked. Luck had nothing to do with it; it was persist-
ence and hard work. You cannot expect to watch television or drink stock market or the American economy.

get discouraged, go back and put in some detailed "extra effort" and

Friday that ultimately makes the difference.

Other Prime Selling Pointers
result of the six-month intensive analysis of my past ignorant selling mis-
takes. Following is a list and explanation of many of them:

do not chase or pyramid a stock when it is extended in price too

. normal corrections in the price of your stock. Winning stocks sel-

emotional, uninformed, temporary, or not as large, relative to past volume, as it appears. The best of stocks can have sharp sell-offs for
overall perspective to avoid getting scared or shaken out in what may just be a normal pullback.

closes for a larger increase than on any previous up days, watch out! This move usually occurs at or very close to a stock's peak.

beginning of the advance.
5. Sell if a stock advance gets so active that it has a rapid price runup for two or three weeks (eight to twelve days). This is called climax (blow-off) top activity.

+ 25% or + 30% and, in a few rare instances, + 50%). If a stock's many instances the stock should be sold.

released.

9. After an advance, heavy volume without further upside price

10. Tops will show arrows pointing down on a stock's daily chart (closing at lows of the daily price range on several days—in other words, full retracement of a day's advance).

higher, sell, because it is too late! Jack Dreyfus said, "Sell when there is an overabundance of optimism. When everyone is bubbling optimism and running around trying to get everyone else to buy, they are fully invested. At this point, all they can do is talk. They that." Buy when you are scared to death and others are unsure. Wait until you are happy and tickled to death to sell.

12. If a stock that has been advancing rapidly is extended from its base and opens on a gap up in price, the advance is probably near its peak. A two-point gap in a stock's price would occur if it closed at its high of $50 for the day and the next morning opened at $52

13. Sell if a stock's price breaks badly for several days and does not rally.
14. Consider selling if a stock takes off for a good advance over several

15. When quarterly earnings increases slow materially or earnings actu-

18. Try to avoid selling on shakeouts (below major price-support areas).

the way down from the peak. After the first break, some stocks may once pull back up in price.

nation of the previous runup, the top, and the decline may help determine if the advance may be over or if a normal 8% to 12% correction is in progress. You may occasionally want to sell if a makes its greatest one-day price drop since the beginning of the move, consider selling, but only if confirmed by other signals.

22. When you see initial heavy selling near the top, the next recovery trend lines and support areas are broken.

uptrend line or breaks a key price-support area on overwhelming volume.

24. The number of down days in price versus up days in price will change after a stock starts down.
25. Wait for a second confirmation of major changes in the general be bought cheaper.
26. Learn from your past selling mistakes. Do your own post-analysis by plotting on charts your past buy-and-sell points.
27. Sell quickly before it becomes completely clear that a stock should
could be a poor decision because the stock could pull back after
28. Always project the week you can expect capital-gains selling by
those who bought in volume at the original breakout point from a
base. (This applies only if current tax laws favor capital gains.)
29. In a few cases, you should sell if a stock hits its upper channel line.
(Channel lines are drawn to connect the lows and connect the
channel lines should normally be sold.
30. Sell when your stock makes a new high in price if it's off a third- or
ket. It has become too obvious and almost everyone sees it.
31. Sell on new price highs off a wide-and-loose, erratic chart price for-
32. Sell on new highs if a stock has a weak base with much of the price
work in the lower half of the base or below its 200-day moving aver-

ume in its prior five years.
34. Some stocks can be sold when they are 70% to 100% above their
200-day moving average price line.
of its price turns into a downtrend, consider selling the stock.
selling when a stock's relative strength on a scale from 1 to 99 drops below 70.

Before going to the next subject, a few words or rules should be suggest-
ed on the question of when to be patient and hold a stock. The decision
to sit tight is important and closely related to making selling decisions.

and Hold a Stock

weekly graph at the precise price level where you will sell and cut

your loss. In the first 1½ to 2 years of a new bull market, you may
want to give stocks this much room on the downside and hold until

The defensive, loss-cutting sell line may in some instances be raised
purchase. If you raise your sell point, don't move it too close to the
current price, because any normal little weakness will shake you out of
your stock. If your stock increases 15% or more after a correct pur-

I do not think you should continue to follow a stock up by raising
inevitable, natural correction. Once your stock is 15% above your pur-
chase price, you can begin to concentrate on the definite price where
you will sell on the way up to nail down your short-term profit.
2. Your objective is to buy the best stock with the best earnings at exact-

after your first purchase week before you conclude that a stock that
hasn't moved is a dull, faulty selection. This, of course, applies only
if the stock did not reach your defensive sell price first.

back into the loss column. For example, if you buy a stock at $50
and it shoots up to $60 (+20%) and you don't take the profit when
raised, ridiculous, and not too bright buying at $50, watching it hit
$60, and then selling at $50 to $51, but you've already made the mis-
letting it develop into a loss.

chases when the market averages are topping and beginning to
bought. (Most breakouts will fail.)

5. Major advances require time to complete. Don't take profits during
the first eight weeks of a move unless the stock gets into serious trou-le or is having a two- or three-week "climax" rapid runup on a stock
split. Stocks that show a 20% profit in less than eight weeks should
be held through the eight weeks unless they are of poor quality with-
cases, dramatic stocks advancing 20% or more in only four or five
6. If you own a dynamic leader or a stock belonging to a leading group, 

7. If possible, try to hold through the stock's first short-term correction once you already have a profit.
8. Holding for a long-term gain during the early stage of a new bull enough to make a big gain. Remember, the object is not to be right, 

money, it's the sitting." Investors who can be right and sit tight are uncommon. It takes time for a stock to make a large gain. The first two 
pany and its products well, you will have the additional confidence and patience.

You've just read one of the most valuable chapters in this book. It Money in Stocks—if you will review and understand what you've read and adopt a disciplined profit-and-loss plan for your own investments. 

Do you remember when Mobil diversified into the retail business by none is seldom a dramatic success in any field.
The best example of diversification in the corporate world is the conglomerate. Most are not real winners. They are too big, too inefficient, too spread out, and are involved in so many businesses they have trouble concentrating and creating profitable growth.
Would you like to go to a dentist who spent part of his time doing engi-

The more you diversify, the less you know about any one area. Many investors overdiversify. The best results are achieved through concentration: putting all your eggs in just a few baskets that you know a great 

more stocks you own, the slower you may be to react and take selling action to raise sufficient cash when the next serious bear market begins.
**How Many Stocks Should You Own?**

An individual investor with even a large portfolio of a million dollars investment. If you have a total of $5000 to $20,000 to invest, three

them. It's a little like the starry-eyed fellow who made money in his
quite a bit more to handle and found the additional outlets caused
more problems and losses than he had anticipated.
You can also diversify your purchases over a period of time. When I
more than 100 different days. It was spread out over a period of time
and add-on buys were only made when there was a significant cushion

things aren't working out as expected.

**winners rather than dozens of very small profits.** It is much better to
have a number of small losses and a few very big profits.
One way to maneuver your portfolio toward concentrated positions is
to follow up and make one or two smaller additional buys in stocks that
have advanced 2% to 3% or so above your original or last purchase
price. At the same time, sell and eliminate those that start to show loss-
owned a smaller number of shares of it than you had in other more
uneventfully performing stocks? Using this follow-up purchasing pro-
cedure, in time, should result in your having more of your money stashed
in just a few of your best stock investments. While no system is perfect,

**Long Pull, or Trade?**

If you decide to concentrate, should you invest for the long pull, or
trade? The time period is not the main issue. Buying the right stock —
is time to sell. This time period could either be short-term or long-term.
each stock.
If you do this, some of your winners will be held for three months,
Most of your losses will be held for a shorter time period, normally from

**No well-run portfolio should ever have losses that have been carried
for six months or more.** Keep your portfolio clean and in touch with

**Do Not Day Trade**

One type of stock trading you definitely do not want to engage in is day

fluctuations which are much harder to determine than are basic trends.

mentioned before, you also should not follow a program of taking short,
two-point profits, because again your margin of profit is too small to off-

**Should You Use Margin?**

buy stocks on a cash basis only?
In the first year or two while an investor is learning, it is much safer to
restrict activities to a cash basis. However, with a few years' experience,
(using borrowed money from your stockbrokerage firm), particularly if
It is absolutely essential that you understand that when the general market declines and your stocks start sinking in price, you will lose your a cash basis. This dictates that you cut losses quickly and get yourself off of margin when major general market deterioration begins. A margin account should not be fully margined all the time. At times be invested on a cash basis. At other points you will be using a small part of your margin buying power, and in a few instances, where you are making

The margin interest expense, depending on current laws which constantly change, might be tax deductible. However, in certain periods, margin interest rates can become so high that the probability of substantial success may be more restricted. The best time to use margin is usually during the first two years of a new bull market. Once you recognize a new bear market, you should are unquestionably active and more seasoned, you may consider limited short selling.

**What to Do about a Margin Call**

One last bit of wisdom. **Never answer a margin call.** If the stocks you have in your margin account collapse in value to a point where your stockbroker issues a margin call for you to put up money or sell stock, are on the wrong path and things aren't working. So sell and cut back

To buy on margin you will need to sign a margin agreement with your (the brokerage company name). As long as you're dealing with an estab- avoids tremendous paperwork and time on your part that would other- forth to your broker each time you conduct a transaction. And it averts problems and notorious delays with transfer agents, whose work it is to statements of your account, provided by most brokers, will also give you

**Should You Sell Short?**

The years on the subject of short selling. It is a topic few investors understand, and in which even fewer succeed. Why would you ever want to sell short? If you think the market is going to decline substantially or a certain stock is ready to cave in, you could sell the stock short even though you don't own it by borrowing you can buy it at a lower price (this is called covering your short position) and pocket the difference in price as your profit.

Of course, it seldom works out so well. Usually the stock you sell short expecting a colossal price break will do the most unexpected thing—it will immediately begin creeping up in price.

When it goes up you will lose money; therefore, my first rule is don't sell anything short during a bull market. Why fight the general tide? Remember this, because sooner or later you may try it and will have to find out the hard way, just like you learned that signs saying "wet paint" usually mean what they say. Save the short selling for bear markets. Your

The second rule is never sell short a thinly capitalized (small number of shares outstanding) stock; it's too easy for the stock to be run up on you (that's called a short squeeze, and it doesn't feel very good when you are in one). a general market decline and short off the behavior of the daily market mining general market direction, and the ability to select stocks that have had a tremendous runup and have definitely topped out. Flawless timing is the whole game. You can be right but too early and be forced to cover at a loss. Don't kid yourself, you have to take and cut when you buy stocks. Otherwise, the sky is the limit, and a short-selling

The two best chart price patterns for selling short are:

1. The head and shoulders top. The right shoulder should be slightly third upward pullback in price in the right shoulder is about over. In former big leaders, the several upward pullbacks can be 20% or stock's quarterly earnings showing substantial decleration in
rate of increase or have turned down. Furthermore, the stock's rela-
months or longer so you can be more confident that the security has

2. Third or fourth stage cup with handle or other similar patterns that
have definitely failed after an attempted breakout. The stock should
be just picking up trading volume and starting to break down below

Chapter 14.

stocks drop. If you begin by shorting 200 shares, any follow-up at lower
prices should be in smaller quantities and you should carefully limit
how far down in price you will continue to sell short.

Since you have to get an uptick from the previous trade before your

\[ \frac{1}{4} \]

stock could trade down a point or more without having an uptick.

You'll have to short in a margin account, and you had better check
with your broker first to see if you can borrow the stock you want to sell
short. Also, if the stock pays a dividend while you are short, you will

stock you sold. (So don't short big dividend paying stocks.)

The whole matter of short selling is quite treacherous, even for pro-
essionals, and only the more able, daring, and successful investors
should probably venture into this puzzling territory. One last absolute
warning: Don't short an advancing stock just because its price seems too
high to you. You could be "taken to the cleaners."

well-selected stocks, and let the market help determine how long stocks
should be held. Using margins is okay if you are experienced, but it
involves extra risk.

Should You Buy Options, OTC Stocks, New Issues...?

I do not think most investors should buy or sell options. Options are
ty than do common stocks. Winning investors should first learn how to
son has proven he or she is able to make money in common stocks and
the limited use of options might be intelligently considered.

Limit Your Dollar Commitment to Options

When and if you do consider options, you should positively limit the
to 15% is a prudent limit.

Options are like making all or nothing bets. If you buy a three-month
call option on General Motors, that gives you the right to purchase 100
shares of General Motors at a certain price anytime over the next three
months; the option could expire worthless at the end of three months if

Short-Term Options Are More Risky

If you buy options, you are better off buying longer time period
options—six months, or so. This will minimize the chance your option
will run out of time before your stock has had a chance to perform. Now that I've told you this, what do you think most investors do?

You will then lose on all your options because of the general market. This is also a reason why you want to spread your option buying and

I also prefer buying options on the most aggressive and outstanding stocks, ones where the premium you have to pay for the option is high-

You should also adopt some rule about where you intend to cut and

fluctuates three times as rapidly as its underlying stock, then perhaps 20% consider adopting a rule that you'll take many of your gains when they

75%.

Keep Option Trading Simple

simple as possible. Don't let someone talk you into getting fancy and speculating in strips, straddles, and spreads.

puts on the same security at the same exercise price with the same expiration date. The premium is less than it would be if the option were

purchased separately.

A straddle is either long or short. A long straddle is a long call and a

It is difficult enough to just pick a stock or an option that is going up. If you confuse the issue and start hedging (being both long and short at the same time), you could, believe it or not, wind up losing on both sides.

If you think a stock is going up and it is the right time to buy, buy it or purchase a long-term option and put your order in at the market. If it's

way orders on the options exchanges are executed is even different.

orders. Once they form the bad habit of placing limits, they are forever difficult to maintain sound judgment and perspective when you worry about changing your limits by 1/6, 4, and 1/2 points. In the end, you'll get

When you finally pick the big winner for the year, the one that will

You never make big money in the stock market by eighths and quart-
you fail to sell and get out because you put a price limit on your sell fluctuations.

the underlying stock. Therefore, you should apply your C-A-N S-L-I-M formula and select the best possible stock at the best possible time. If except the option should move up much faster due to the leverage.

In a major bear market, you might consider buying put options on certain individual stocks or on the S&P index, along with selling short shares of common stock. You don't have to get an uptick in the trading of the stock when you buy put options. Sometimes the uptick rule for short-selling stocks listed on an exchange or the inability of your broker to borrow stock may make selling short more difficult than buying a put.
ing someone else (the buyer) the right to "call" away and buy the stock from the writer at a specified price, up to a certain date. In a bull mar-

The writer of calls pockets a small fee and is, in effect, locked in for the time period of the call. What if the stock gets into trouble and maneuver the writer can take, such as buying a put to hedge and cover oneself, but then the problem gets too complicated and the writer could get whipsawed back and forth.

take risks in stocks for only skimpy gains and no chance for large gains? most investors or brokers. But then again, what most people are saying

Writing naked calls is even more foolish, in my opinion. Naked writ-
are unprotected if the stock moves against them.
returns on their portfolio may find some minor added value in writing, they feel are overpriced. However, I am always somewhat skeptical of new methods of making money that seem so easy. There are few free

**NASDAQ Stocks**

ed through over-the-counter dealers. The over-the-counter market is a specialized field, usually of younger, less-established companies. There are hundreds of intriguing new growth stocks in the NASDAQ market; however, you may want to learn to first make money buying and have a record of some success, then the exploration of the over-

ket and a record of some success, then the exploration of the over-

the-counter stock market should positively be considered.

to no more than 25% to 50% of your total stock portfolio. For maxi-

Subject investments. Sometimes over-the-counter securities may prove to be less liquid in

ary investment data. So don't overlook the NASDAQ market.

Many NASDAQ stocks are frequently available at lower P/E ratios because they may not have received wide recognition and strong institu-

and $10) that have no institutional sponsorship.

The over-the-counter market is a very large marketplace. There were days in the 1990s when trading volume on the OTC market was larger than that on the New York Stock Exchange. *Value Line, Standard & Poor's, Daily Graphs, Long Term Values, Quote Digest, and Mansfield all

In 1983 and again in 1993, more than 800 companies went public by selling stock in their enterprises. Almost all of these youthful and inno-

are definitely outstanding companies, more than have been seen in generations, and many will emerge as leaders in future market cycles.

**Winners on the American Stock Exchange**

The AMEX, as it is referred to, lists companies that are typically younger or smaller in size than those on the NYSE. Trading on the AMEX is therefore much more speculative and volatile.

However, for skillful investors who follow a sound plan of operation, tremendous possibilities. Following is a list of some of the unbelievable price moves with all stock splits considered that occurred on the

Chilton Corporation—July 1982 to September 1983, $10 to $78
Commodore Int'l. Ltd.—June 1978 to July 1983, $22 to $1215
Should You Own Convertible Bonds?

I do not recommend that the average investor buy convertible bonds. Sometimes investors are attracted to this medium because they can borrow heavily and leverage their commitment. This simply increases your risk. Excessive leverage can be dangerous.

common stock rises, but the convertible bond will decline less during downturns. As it goes with most theories, the reality may be quite different. There is also a liquidity question to consider, since many convert-

How about Tax-Free

Should you consider tax-free securities and tax shelters? No, I don’t

People seeking too many tax benefits frequently end up investing in

be considered first and tax considerations made a distant second.

bracket. One of the greatest tax advantages during the early 1980s was to make long-term capital gains at the lower capital gains tax rates.

Overconcern about taxes can seriously confuse and cloud your normally sound investment judgment. Common sense should also tell you if you invest in tax shelters, there is a much greater chance the IRS may decide to audit your tax return.

lent promotions. Time magazine on December 5, 1983, discussed the charge of a federal grand jury in New York City that Sentinel Government

fraud in U.S. history. Hollywood leftist Norman Lear was apparently taken for $1.8 million, according to the article.

This is America, where anyone who really works at it can be success-
it, rather than complaining about having to pay tax because you made a profit. Would you rather have a loss so you have no tax to pay?

Recognize at the start that Uncle Sam is always your partner and he will

me free to concentrate on finding the best investments possible. On occasion when these investments worked out I paid my taxes on them
just like everybody else. The United States’ system of freedom and

**Recommended?**

investor about owning Continental Illinois Bank in 1984 when the stock plunged from $25 to $2, or any of the electrical utilities caught up in

**yield available.** That will probably entail greater risk and lower quality. Trying to get an extra 2% or 3% yield can expose your capital to larger losses. **Dividends can also be cut if they are not being adequately cov-**

If you need income, my advice is to buy the very best stocks you can find and simply withdraw 6% or 7% of your investment each year for liv-

$1\frac{1}{2}\%$

time they could lead to possible depletion of your principal.

**Are Warrants Safe Investments?**

date. Many warrants are cheap in price and, therefore, seem appealing. The real question comes down to whether the common stock is correct

**Should You Buy New Stock Issues?**

First, the few outstanding new issues are going to be in such hot
you may only be able to buy a tiny allotment. If you can acquire all the

new underwritings can occasionally be overpriced, and since they have

no well-established market, you cannot be sure whether they are over-

priced or not. This speculative area should, in most cases, be left to
to experienced institutional investors who can afford the necessary in-
depth research and who are able to spread their new issue risks among

many different equities.

Larger individual investors who can afford several expensive and var-

ied services may want to consider Value Line’s New Issue Service.

Initially filed with the SEC may not actually come public. The **IPO**

**Reporter,** a Florida-based service, also provides information on new

issues.

Once an initial public offering has been trading in the marketplace

price and volume action data on which to judge the situation. Stocks

**Merger Candidates Can Be Erratic**

**Should the individual investor speculate in merger candidates? No, not**

S-L-I-M evaluation, than to try to guess whether or not a company will

be sold.
deal falls through or other unforeseen circumstances occur. In other words, it can be a risky, volatile business and in most instances should be left to experienced professionals.

**Should You Buy Foreign Stocks?**

but I don’t advise individual investors to waste much time investing in foreign stocks. The potential profit should be two or three times as large as that in a standout U.S. company to justify the additional risk of owning a foreign stock. For example, the player in foreign securities country involved. Sudden changes in the country’s interest rates, currency, or governmental policy could, in one sweeping action, make your

It is not really necessary for individuals to find foreign stocks when Foreign stocks should probably be left to professionals who specialize in

In 1982, some of our large banks learned the hard way the substantial countries.

**Avoid Penny Stocks**

The Canadian and Denver markets list many stocks you can buy for only cheap merchandise is that everything sells for about what it’s worth. You get what you pay for.

quality. The risk with them is higher than with better-quality, higher-promotional practices is also greater. I do not like to buy any common stock that sells below $10 or $12 a share. If you want to fly, why not go first class?

**Do You Belong in Futures?**

Commodity futures are extremely volatile and much more speculative or small investor unless you want to gamble or lose money quickly.

However, once an investor has four or five years’ experience and has unquestionably proven his or her ability to make money in common

In commodities it is even more important to be able to read and interpret charts. The chart price patterns in commodity prices are similar to those in individual stocks. Being aware of futures charts can also help stock investors evaluate changing basic economic conditions in the country.

There are a relatively small number of futures in which you can trade. Therefore, astute speculators can concentrate their analyses. The rules greater, so investors should definitely limit the proportion of invest-
sell and cut a loss. Futures can be treacherous and devastating.

Most futures fall under the group categories of grains, precious met-
als, industrial metals, foods, meats, oils, woods and fibers, financial issues, and stock indexes. The financial group includes government securities such as T-bills and bonds, plus foreign currencies. One of the market for "hedging." Hershey, for example, might lock in a current price by temporarily purchasing cocoa beans in May for December delivery, while arranging for a deal in the cash market.

**or Diamonds?**

Should you invest in gold, silver, diamonds, or other precious metals or stones? Some investors have lost a great deal of money investing in such commodities.

with little protection afforded the small investor. There was no SEC to protect against exaggerated, or possibly fraudulent, claims made by some dealers in precious metals. Many books were written boldly pre-
dieting gold would bolt to several thousand dollars and our country would go down the drain.

ties. In recent years, they became highly speculative commodities.

The dealer's profit markup in these investments was excessive in some cases. Furthermore, these investments did not pay interest or dividends during a period of very high interest rates.

Gold, silver, and diamonds all made very major long-term tops in 1980. At some point these commodities will rally back to a degree. However, due to the wild speculative furor that occurred, there is no way to know how much time must pass to completely clean out past excesses.

There will be periodic short, quick runups in gold, caused by fears or panics regarding potential problems in certain foreign countries. But, movements create recurring pressures for them to sell gold, oil, and other unable to successfully and efficiently produce. This does not add to 

Arab world during the inflationary period when the price of oil was of excessive oil prices in the 1970s and early 1980s, the long-term world

To prevent excessive dependence on imported oil from OPEC and press hard to open the deep interior of Alaska for oil drilling. I spent a few years stationed in Alaska while in the Air Force and can say that only where the temperature falls to 70 degrees below zero in the winter. It should be developed for the benefit of 250 million human beings.

and films that no longer use silver.

Diamonds were hawked to the public with almost fraudulent sales pitches, claiming diamonds are guaranteed to go up every year in price diamond-market price is totally controlled and set by DeBeers.

Many investors were surprised to learn, as prices collapsed during 1980, that the law of supply and demand also works for diamonds. New such items will become timely and reasonable. However, even in this

**Estate?**

**I am completely convinced that every able-bodied citizen should work**

The typical equity in a home in 1984 was $40,000. Even most insurance companies have made more from their big real estate equity investments than they have from bond and stock investing. That is in part

Home ownership has always been a goal of Americans. Their ability to obtain long-term borrowed money through mortgages and the like,

Time and leverage have usually paid off. However, this has not always been true. People can and do lose money in real estate if:

1. They buy in an area that is slowly deteriorating or is not growing.

    severe economic setbacks in the economy or in the particular geographic area where they own real estate. This might occur if there are major industry layoffs or the closing of an aircraft or steel plant

    elements that are too high, and their source of income is reduced by property.
4. They make a poor initial selection, the area deteriorates, or they're

   They say there are three golden rules to buying real estate—location, 
   location, and location!

will occur.

   Southern California, Arizona, Texas, Nevada, and Florida are the 
   fastest growing Sunbelt locations. California is already the largest state in 
   the union, with 33 million in population and good year-round weather.

dependent on the oil industry. In early 1983, the unemployment rate in 

Florida has been known for past real estate booms followed by occasional busts when the speculative fever got too hot. Florida will continue to develop rapidly, and light industry should evolve.

Your own home is probably the first real estate investment you will make. Location is key here also. However, timing and financing are now 

up to your ears in payments. Your risk-reward ratio has to increase. If 

you use creative financing that could force you to refinance in three to 

five years, your risks materially increase because you don't know what 

loan conditions may be like in the future.

   There will be many other forms of imaginative financing. These 

could force you, the buyer, to assume greater risks or payments down 

the road.

   Remember, it is definitely possible to lose money in real estate or to 

lose your house if you can't under any and all future circumstances contin-

ually meet the payments. I would also shun the widely promoted,

Real Estate Questions for You
to Ask

self some questions. What are the better areas? Quality usually holds up best in the long run.

good schools and shopping areas? How easy would this house be to 

   Where are the main traffic arteries or freeways, and do you have rea-

sonable access to them? How long will it take you to get to and from 

   Then there are questions of a different type. Could there be any pos-

sible problems in the future, like a new freeway a half block away; new 

   assessments for streets, sewers or lights; or a worn plumbing or heating 

   Then you come to the financing. What will your total monthly pay-

ments be? Can they escalate and if so, how much? Will you be able to 

   handle the increases? Are you sticking your neck out a little or a great 

   deal? What are all the hidden costs, taxes and insurance, "points" 

   up with in addition to the down payment? Can you positively get a clear 

   title? Are there unreasonable prepayment penalties in the lender's 

   make sure you know exactly what you are doing. Two twin opportuni-

   that real estate offers are tax advantages (depreciation and tax deduc-

   tor who greedily overexpanded, so beware of trying to use leverage to 

acquire too many pieces of property. That's dangerous. You could be 

building a house of cards that will be blown down in the next healthy 

change.
You should, furthermore, be careful of putting too large a down pay-
be able to get all your cash out. You will probably have to take back a
large amount of paper in the form of a second mortgage. And remem-
to substantial discounts when you try to sell and convert them to cash.

because you will, in effect, own an apartment without much land.
Frequently, land appreciates more over the years than does the structure.

A friend of mine who was in charge of real estate investments for the
advice: "In office buildings or apartments, location and economic fac-
tors that will affect the area in the future are key. Is the area dependent
on one industry? What is the unemployment rate? Is this the type of
per square foot units and you build for $25, you'll have trouble. Or if
you will get hurt." These factors, he feels, are more important than the

ing angle to land: they aren't making any more of it.

13

How You Could

Owning Mutual Funds

 Mutual funds are outstanding investment vehicles after you learn how
understanding or conviction about mutual funds.

The first absolutely essential point to understand is that the big money
in mutual funds is always made by sitting through several business cycles.

In other words, to reap large returns from funds, you have to have the
strong belief and patience to sit tight for 10 or 15 years or longer. It's
impatient or shortsighted and sell out after only three or four years. It

Investors in open-end investment companies, as mutual funds are
sometimes called, tend to buy the best-performing fund after it has had

Sometimes shareholders will switch to another fund that someone
convinces them is much safer (usually at exactly the wrong time) or has
a "hotter" recent performance record. Switching breaks up your long-
range holding plan. I suppose you should switch if you have a really bad
fund or the wrong type, like an income or industry fund when you

are going to be a successful long-pull investor in funds, you'll need to
acquire the courage and perspective to live through numerous discourag-
ing bear markets. Have the vision to build yourself a great long-term
growth program, and stick to it.

I have sold mutual funds, known many top fund portfolio managers,
provided research to hundreds of mutual funds, managed two mutual
one of the funds was up over 10%, when the Dow was down 23% in a
bear market. The other fund set a performance record for diversified
growth funds of +116% in the following year. A huge number of
stocks in its portfolio doubled. We had even planned that our goal at
the beginning of the year was to be the number one fund for the year.

assets under management in the fund and individual accounts
increased dramatically. We also owned too many thin, volatile holdings,
as we had just invented Datagraphs in January 1968 and, for the first
time, had information on microfilm of several thousand smaller-com-
panies no one had ever seen before.

year, but most were unaware that twice before, in 1963 and 1965, we
had also made 100% or more in many individual accounts.

In 1963, the lowest-performing individual account I managed was up
115%. It was a cash account. From its inception, the fund ranked in the
top 22% of all common stock funds until the day it was sold to another
investment organization. This is an important fact most media people
overlooked. An even more important point is that those original share-
holders who held onto their shares as they were merged into the new
company had a total increase of over 1,100%, which is the vital point
compounding over a span of years. Funds should be an investment for
your mutual funds. So buy right and sit tight, period!

How to Become a
Millionaire the Easy Way

five years. It will probably have averaged an annual rate of return of about
20%. The fund should also have a better-than-average record in the latest
12 months when compared to other domestic growth stock funds.

Steer away from funds that concentrate in only one industry or one
to give you an excellent profit over 10 to 15 years.

The fund can be either a no-load, with no commission, or load, or
one where a sales commission is charged. If you buy a fund with a sales
charge, discounts are offered according to the amount you invest and
some funds have back-end loads which you may want to check. The

When you purchase a mutual fund, you are hiring professional man-
stocks. A stock may decline and never come back in price. That's why
the loss-cutting policy is necessary.

However, a well-selected fund run by an established management
organization will, in time, almost always recover from the steep correc-
because mutual funds are broadly diversified and should participate in
each recovery cycle in the American economy.

Therefore, I believe an extraordinarily different strategy should be
employed with mutual funds. Each time you get into the thick of an
economic recession and the newspapers and TV tell you how terrible
peak price. It might even be a possible time to borrow a little money

Remember, you're going to hold through many economic cycles, so
why not be smart and add to your investment during each bear market?
You can also reinvest your dividends and capital gains distributions and
benefit from compounding over the years. When you buy your growth
mutual fund, you should make up your mind at the outset that you are
positively going to sit through the next three or four bear markets or
make really big money.

How about Income Funds?
If you need income, you may find it more advantageous not to buy an
income fund. Instead, you could select the best possible fund available
per year. Part of the withdrawal would come from dividend income
How Many Funds Should You Own?

begin accumulating in another long-term program. If so, do it. At the end of 10 or 15 years, you might own a worthwhile amount of two or overdo it. Those rare individuals with multimillion-dollar portfolios could spread out in more funds which would allow them to place almost

If you own a growth fund which, by definition, invests in more aggressive growth stocks, it should go up more in bull-market years and fall off more in price than the general market in some bear market years. This lios, so don't get alarmed and panic out at the wrong time. During the a Fund?

Any time is the best time. You'll never know when the perfect time is and waiting will usually result in your paying a higher price.

Should You Buy a Global or International Fund?

Hou You Could Make a Million Owning Mutual Funds

investments. International funds can, after a period of good perfor-

Funds

Asset size is a problem with most funds. If a specific fund has billions of funds. However, if you have a fund that has performed well for you over the years and it has now grown large but still performs reasonably well,

Checking Management Fees and Turnover Rates

Some investors try to evaluate the management fees and portfolio higher turnover rates. The Fidelity Magellan Fund, during its three biggest performance years, averaged an annual turnover rate of over a turnover rate of 272% and 226% in 1990 and 1991 respectively and was the top-performing fund from 1989 to 1994. You can't be active and on top of the market and do nothing. A good fund manager will sell stocks when he or she is worried about the overall market or a specific tuitional commission rates that funds pay are extremely low, only a few cents per share of stocks bought or sold.

for You?

I do not generally favor monthly investment plans, where an investor adds $100 or so every month to a fund program. My reason is practical. Most with such plans. If, on the other hand, you can have money automatically
also do not think people should make long-term investments in bond or preferred funds. Common stocks perform better.

If you want to check performance records, most magazines produce services such as Arthur Weisenberger or the Lipper service. Investor's Business Daily rates the prior 3-year record and shows the

ment activities.

An open-end fund continually issues new shares when people want to buy

A closed-end fund issues a fixed number of shares. Generally, shares are not redeemable at the option of a shareholder. Redemption takes shares are listed for trading on exchanges. There are ordinarily better long-term opportunities found in open-end mutual fund investing than

attempt to trade no-load funds, because mistakes would probably be made in timing of buy and sell points. Get aboard for the long pull.

Finally, some individual or professional stock traders use growth stock

Money in Top-Performing Funds

Believe it or not, half of the people invested in some of the best-per-

two when performance is slower or down. Why not buy and sit tight for the rest of your life and make a big fortune?

The Five Dumbest Mistakes

Make

1. Failing to sit tight for an absolute minimum of 10 to 15 years.

3. Being affected by news in the market when you're supposed to be

5. Being impatient and losing confidence too soon.

Here are some strategies from a few of the smartest and best mutual fund portfolio managers in the business:

AIM Aggressive Growth Fund's Harry Hutzler and Jonathan Schoolar emphasize companies with a small market capitalization of $200 to $300 having a bomb detonate in the portfolio if they had 4% or 5% in any one stock. They like stocks posting accelerating and better than expect-

orously. Earnings reports are "where the rubber hits the road." Hutzler and Schoolar do not visit companies and will sell when earnings start decelerating or come in below expectations. They stay glued to the news wires for indications that earnings will be a lot higher or lower investment process is based on the theory of positive momentum- posi-
tive surprises, which asserts that a good company doing better than generally expected will experience a rise in its stock price. Conversely, a

try level including capacity utilization rate. They break down every industry and company to their bellwether indicators that will signal sur-

prises. They closely watch about 12 areas of a company's business.

Twentieth Century Ultra's forte is picking the very best growth stocks
growth. Their policy of remaining heavily invested at all times does,
growth as well as current business conditions. Then, within roughly the
appreciation using a bottom-up approach. Generally, DiCarlo looks for

To summarize, the way to make a fortune in mutual funds is almost always by your long-term sitting, not your thinking. If you purchase $10,000 of a diversified domestic growth stock fund that is able to average about 15% a year over a period of many years, here is what could occur, compliments of the magic of compounding and time:

<table>
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<th>Years</th>
<th>Investment</th>
<th>Final Value</th>
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<tr>
<td>First five</td>
<td>$10,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Next five</td>
<td>$20,000</td>
<td>$40,000</td>
</tr>
<tr>
<td></td>
<td>$80,000</td>
<td>$160,000</td>
</tr>
<tr>
<td>Next five</td>
<td>$640,000</td>
<td>$1.28 million</td>
</tr>
</tbody>
</table>

during each bear market while the fund was temporarily down from its peak 25%. What do you think you'd be worth?

there are always taxes, the example above is somewhat close to what's been happening with the better growth mutual funds over the last 50 years and the American Stock Market has been growing since 1790. (See the chart on page xiv at the front of this book.) So, in my opinion, faith and confidence in America's long-term future is a very shrewd and

Now that you've previewed C-A-N S-L-I-M and know when to sell and cut a loss or nail down a profit, I should mention that a number of the models can't, either teach or write"? Well, we did the work, produced the results and now, afterwards, have put it down in writing to, we hope, help you.

Account

gang, and filing and paying taxes each year. I got the easy job of managing the money.

It is an interesting account to study because it proves you can start very small and still beat the game if you stick with sound methods and are some of the actual buy-and-sell records to illustrate in vivid detail the "..."•••• have discussed up to this point.

<table>
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<th>SHARES</th>
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<th>DATE BOUGHT</th>
<th>PRICE PAID</th>
<th>DATE SOLD</th>
<th>PRICE SOLD</th>
<th>GAIN OR LOSS</th>
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<td>烬shwick</td>
<td>2/21/61</td>
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<td>3/10/61</td>
<td>68½/2</td>
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<td>Certain-peed</td>
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<td>42½/2</td>
<td>4/13/61</td>
<td>39½/2</td>
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<td>17½/2</td>
<td>102.96</td>
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<td>47½/2</td>
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<tr>
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<td>Corvette</td>
<td>4/5/62</td>
<td>52½/2</td>
<td>4/13/62</td>
<td>54½/2</td>
<td>183.96</td>
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<td>(81.02)</td>
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<td>1/15/63</td>
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<td>62½/2</td>
<td>2/28/63</td>
<td>62½/2</td>
<td></td>
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<tr>
<td>25</td>
<td>RCA</td>
<td>2/28/63</td>
<td>31½/2</td>
<td>3/31/63</td>
<td>32½/2</td>
<td>(8.46)</td>
</tr>
<tr>
<td>14</td>
<td>Chrysler</td>
<td>2/27/63</td>
<td>92½/2</td>
<td>4/16/63</td>
<td>109½/2</td>
<td>300.03</td>
</tr>
<tr>
<td>8</td>
<td>Chrysler</td>
<td>3/14/63</td>
<td>93½/2</td>
<td>4/16/63</td>
<td>109½/2</td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>Control Data</td>
<td>4/23/63</td>
<td>44½/2</td>
<td>5/13/63</td>
<td>49½/2</td>
<td>102.55</td>
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<td>52½/2</td>
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<td>22</td>
<td>Chrysler</td>
<td>5/13/63</td>
<td>54½/2</td>
<td>6/10/63</td>
<td>61½/2</td>
<td></td>
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<tr>
<td>25</td>
<td>Chrysler</td>
<td>5/17/63</td>
<td>55½/2</td>
<td>6/10/63</td>
<td>61½/2</td>
<td></td>
</tr>
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<td>6/11/63</td>
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<td>146½/2</td>
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<td>149½/2</td>
<td>10/22/63</td>
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<tr>
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<td>7/17/63</td>
<td>67½/2</td>
<td>(59.62)</td>
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<tr>
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<td>RCA</td>
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<td>102½/2</td>
<td>2/11/64</td>
<td>105½/2</td>
<td></td>
</tr>
<tr>
<td>15</td>
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<td>106½/2</td>
<td>2/11/64</td>
<td>105½/2</td>
<td>(8.49)</td>
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<tr>
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<td>RCA</td>
<td>1/10/64</td>
<td>107½/2</td>
<td>2/11/64</td>
<td>105½/2</td>
<td>(25.54)</td>
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<tr>
<td>20</td>
<td>RCA</td>
<td>2/17/64</td>
<td>65½/3</td>
<td>3/9/64</td>
<td>68½/3</td>
<td></td>
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<tr>
<td>50</td>
<td>RCA</td>
<td>2/17/64</td>
<td>65½/3</td>
<td>3/9/64</td>
<td>68½/3</td>
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1964, around 20% and the average loss, about 7%. If losses had not been cut in Standard Kollman, Brunswick, and a few others, later price drops would have caused much larger losses. This small cash account concen-

The account made no progress in 1962, a bad market year, but was

By the end of 1963, the gain had swelled up to 474% on the original

The 1964 year was a struggling, lackluster year with no real gain.

showed further progress, but there were net losses in 1969 and 1974.

Another period of interesting progress started in 1978 with the purchase of Dome Petroleum. All decisions beginning with Dome are

A valuable lesson can be learned about why most stocks sooner or

Note also that the account was worn out of Pic'N'Save on July 6, 1982, at $15, but we bought it back at $18 and $19, even though it was at a higher price, and made a large gain by doing so.

Another engaging example of the C-A-N S-L-I-M principles being

118%.

2. Median EPS percentage increase, current quarter, 34%.
3. Average P/E, 15.
4. Average Relative Strength, 85.
5. Relative Strength line up an average of 6.5 months.
6. Median shares outstanding, 4.6 million.

8. Median industry group strength, top 30%.


Another associate, Lee Freestone, participated in the U.S. Investing Championship in 1991 when he was just 24 years old. Using the C-A-N S-L-I-M techniques, he came in second for the year with a result of 279%. In 1992, he gained a 120% return and again came in second.

Real money is used and actual transactions are made in the market.

Examples of Great Winners to Guide You

A selected group of the greatest stock market winners are presented them carefully, and refer to them often, because they are examples of what you must look for and learn to spot in the future. The thin line
150


TOYS R US

GLOBAL MARINE INC

INTL DAIRY QUEEN INC

LIMITED INC

2200% increase in 51 months

775% increase in 22 months

G C A CORPORATION

WESTERN CO OF NO AMER

LIZ CLAIBORNE INC

PULTe HOME Corp

983% increase in 22 months

500% increase in 21 months

650% increase in 10 months

IMPELL CORP

WAL-MART STORES

FORD MOTOR

HASBRO INC

445% increase in 23 months

7250% increase in 131 months

879% increase in 60 months

900% increase in 35 months

PANDICK PRESS INC

MARION LABORATORIES INC

CONAIR CORP

3960% increase in 23 months

1800% increase in 59 months

1840% increase in 59 months

725% increase in 12 months
Investing like a Professional

Sell or Short-selling Models

GULF OIL CORP

BOEING CO

SCHLUMBERGER LTD

COMPUTERVISION CORP

BOMBAY CO INC

NEWBRIDGE NETWORKS CORP

MARVEL ENTERTAINMENT GRP

COLECO INDUSTRIES INC

MC I COMMUNICATIONS

TANDON CORP

SENSOROMATIC ELECTRONICS

FINANCIAL CORP AMER

PULTTE HOME CORP

Investing like a Professional

stock's chart pattern just before the point where you want to take action. For example, the first model in this series of charts, Lorillard, broke out of its five-week sideways price base from $24 to $27 the very next week in November. If you bought as it traded at $27, Lorillard ing pictures of the most outstanding price accumulation patterns just before enormous price moves began.
X-rays and brain scans are "pictures" doctors study to diagnose what is happening to the human heart. Maps are plotted and set to scale to help people tell exactly where they are and how to get where they want. Structures or patterns seem most likely to contain oil. Economic indicators are con
tinue if a stock is strong and healthy or if it is weak and behaving in an abnormal fashion.

highly organized, time-saving way. You can subscribe to any one of the on that you can't easily get any other way. That's why doctors study X-rays to understand and interpret charts.

largest auction marketplace in the world. Facts on markets are much

Milton and Rose Friedrnan, distinguished economists, devoted the power of the marketplace and the unique ability of prices to transmit important and accurate information to decision makers.

Those investors who train themselves to properly decode price move
tments have an enormous advantage over those who are either too lazy or too ignorant to learn about such seemingly irrelevant hocus-pocus. Reading charts is easy to learn if you will take a little time.

I have seen many high-level investment professionals ultimately lose their jobs because they didn't know very much about market action.

Learn to Use Historical Precedents

consolidation structures that stocks form are repeated over and over Therefore, price patterns taken from successful stocks in the past few years should definitely be used as models or precedents for future precedents; why shouldn't you do the same? Our record book of Greatest Stock Market Winners was compiled to searching for successful stocks.

price consolidation structures is to diagnose if the price and volume move
ments are normal or, instead, signal significant weakness or distribution.

structures and completely obvious patterns that everyone sees bring failure. Price patterns are certainly not Ouija-board magic fakery. Fortunes are

such important tools are openly confessing their total ignorance of the use of modern highly sophisticated measurement and timing mechanisms.
Search for Cup-with-a-Handle Price Patterns

usually three to six months). The usual percentage correction from the 33%.

It is normal for growth stocks to create a cup pattern during intermediate general market declines and correct 1 ½ to 2 times the market averages, sometimes up to 2 ½ times. However, stock downturns exceeding
terms that deteriorate the least during an intermediate market decline.

market. Base patterns correcting over this amount while in bull markets resume their advance. The reason is that a downswing over 50% from a peak to a low means the stock must increase 100% from its low to get back to its old high. Many stocks making new price highs after such a huge move may fail 5% to 15% beyond their breakout price.

Here is one glowing exception. Sea Containers descended about 50% during a sharp intermediate decline in the 1975 bull market. It then formed a perfectly shaped cup-with-handle price structure and proceeded ~½ in the next 101 weeks. I presented this stock, with its 54% annual-earnings growth rate and its latest quarterly earnings up 192%, along with several other equities to Fidelity Research & Management in Boston during a monthly consulting meeting in early June 1975. One of the portfolio managers became instantly interested in the stock upon seeing such big numbers.

Coming out of a major bear market, some patterns that have decreased 50% to 60% or more can succeed. The percent decline is, in of the stock’s prior price runup.
The bottom part of a cup pattern should be rounded and give the other speculators’ attention away from the stock. A sounder foundation of strong owners who are much less apt to sell during the next advance

Basic Characteristics of Handle Areas

price drops below a prior low point made a few weeks earlier) near the end of its down-drifting movement. Extreme trading volume dry ups will
Cups without handles have a somewhat higher failure rate, although
forming a handle.
When handles do occur, they should form in the upper half of the
cup. This should be above the stock's 200-day moving average price
line. Handles forming in the lower half of a base or completely below
the stock's 200-day line are weak, failure-prone price structures.

Stocks have a higher probability of failing when they break out into new
highs. This wedging-upward characteristic along low points in the hand-
out after having advanced from the low of the base into the upper half
third- or fourth-stage bases, laggard stock bases, or very active market
age during bull markets look wide and erratic and are, in most cases,
improper, excessive, and risky.

**Tight Price Areas**

Accumulation. Tightness in this sense means small price variations from
or remarkably near to the previous week's close in price.

**Find Pivot Points and Watch**

*"Volume % Change"

When a stock charges through an upside buy point, which Livermore
referred to as "the pivot point or line of least resistance," the day's vol-
during a major breakout.
The winning individual investor can afford to wait and begin buying
the exciting action originates. If you try to buy before this point, you
will be premature and in many cases the stock will never get to its buy
point. If you buy more than 5% to 10% past the point, you are late.
to begin buying at exactly the right time. This means you have to learn
to wait for a stock to move up and trade at your buy point before mak-
ing an initial commitment.
Pivot buy points are not necessarily at a stock's old high; many occur
5% to 10% below a stock's former high point. Sometimes you can get a
slight head start by drawing a down trendline across certain peak points
in the stock's price pattern and begin your purchase as the trendline is
broken. However, you have to be right in your chart and stock analysis
to get away with this.

**How to Spot a Saucer-with-Handle Price Pattern**

A saucer with a handle is a price pattern similar to the cup with a han-
dle except the "saucer" part tends to be longer and more shallow. If
using the name "cup with handle" or "saucer" sounds unusual, consider

A strong price pattern of any type should always have a definite price
a minimum of a 30% increase in price in the prior uptrend, together
with improving relative strength and a very substantial increase in volume.
**Price Pattern**

A double-bottom price pattern looks like the letter "W." This pattern does not occur as often as does the cup price structure. It is usually the first bottom or, as in most cases, undercut it by one or two points, thereby creating a shakeout.

proper cup with a handle, since to make the double bottom, the stock Petroleum below for outstanding examples of double-bottom price pat-

![Double-bottom price pattern](image1.png)

![Flat base price patterns](image2.png)

**Structure**

A flat base is another rewarding price structure. It is usually a second-stage base that occurs after a stock has advanced off of a cup-with-handle, saucer, or double-bottom pattern. The flat base moves straight side-

not correct more than 10% to 15%. Standard Oil of Ohio in May 1979 Boys in March of 1981 formed a longer flat base.

A high, tight flag price pattern is rare and occurs no more than once or twice a year. It begins by moving approximately 100% to 120% in a very short period of time (four to eight weeks) and then corrects sideways, usually in three, four, or five weeks, no more than 10% to 20%. It is the
gnize or interpret. Many stocks can skyrocket 200% or more off this Syntex, July 1963; Rollins, July 1964.)

provided a perfect precedent or model for the Certain-Teed advance which occurred in 1961, and Certain-Teed in turn became a model for
Deciphering a Shakeout-Plus-Three-Points Situation

If a stock drops below its low price while it is in a base-building period, the security will probably be one of the first to race into new high ground depressed and held down by the pressure of a heavy object. Once the

security will probably be one of the first to race into new high ground depressed and held down by the pressure of a heavy object. Once the

What Is a Base on Top of a Base?

During the latter stages of a bear market, in a few stocks a contrary condition occurs that can result in aggressive new leaders in the market. I

ket begins another leg down. The stock, therefore, builds a second price-consolidation area just on top of its previous base while the general market keeps making new lows.

recommendations made just before we placed a full-page "bullish ad" in The Wall Street Journal on March 29, 1978. Both had a base-on-top-of-a-for-
Wide-and-Loose Price Structures are "Failure Prone"

Another interesting price phenomenon is the one we label wide-and-
although some of them may later tighten up their price structure and

New England Nuclear and Houston Oil & Minerals are two cases of

both of them at the time. It is always wise to review big winners you
decreasing trend of its relative strength line throughout the false struc-

drifting down or having a shakeout.

However, if you tried to buy at point G, you were wrong again. It was

a steep decline. The rise straight up from the bottom at point F to its

bogus breakout point G was too fast and erratic, covering only three

seventeen months of decline in relative strength was not sufficient to

turn the previous poor trend into a positive one.

if you bought at point I on the breakout attempt, the stock failed again.

to J to K and 15 weeks later, at K, broke out of a very tight sound base

right and wrong time to buy a stock. But it's demanding.
Houston Oil & Minerals
Pattern Tightens Up

years of poor price structures and toppy earnings that my mind was slow
to change when the stock suddenly changed its behavior in only nine
weeks. I was also probably intimidated by the tremendous price increase

Once again, this just proves that opinions are frequently wrong but mar-
ket seldom are.

tree down quarters didn't even change my incorrect bearish view of

Patterns and Base Structures

Schabacker, a financial editor of Forbes, wrote a book entitled Stock
Market Theory and Practice. In it, he discussed many patterns, such as
triangles, coils, and pennants. Our detailed model building and investiga-
tions of price structure over the years have shown the patterns he dis-

part of the "roaring 20s" when any and every old thing ran up in a wild,

Our studies show that, with the exception of high, tight flags, which
to eight weeks of price consolidation. Most coils, triangles, and pen-
nants are simply weak foundations without sufficient time or price cor-

John McGee and Robert D. Edwards wrote a book in 1948 called
"An Analysis of Stock Trends" The book is fairly expensive and

appears to have copied many of the same faulty patterns presented in
Schabacker's earlier book.

Help You in the Stock Market, which explains many of the correct prin-
ciples behind technical analysis. However it, too, seems to have ronrin-
failure-prone price patterns.

Triple bottoms and head-and-shoulder bottoms are also structures widely mentioned in several books on technical analysis. These we have found to be weaker structures. A head-and-shoulders bottom may suc-

have claimed, head-and-shoulder top price structures are one of the more reliable price patterns signifying a top in a stock. But be careful—with just a little knowledge of charts, you can misinterpret what is a correct head-and-shoulders top. Many professionals do not properly inter-

than a double bottom because the stock corrects and falls back sharply to its absolute low three different times rather than twice, as with a dou-

Near Lows of a Price Pattern

Nearly all proper bases will show a dramatic volume dry up for one or two weeks along the very low of the base pattern and in the low area of no more stock coming into the marketplace. Healthy stocks under accum-

ulation almost always show this symptom. The combination of tight-
and dried-up volume is generally quite constructive.

How to Use Relative Strength Correctly

Many fundamental security analysts think technical analysis means buying stocks with the strongest relative strength.

You do not buy stocks that show the highest relative price strength on some list of best performers. You buy stocks that are performing relatively stronger than the general market just as they are beginning to emerge from a sound base-building period. The time to begin selling is base, and is showing extremely high relative strength.

Analysts have a great deal to learn if they believe all that technical research

A critically important concept to learn in analyzing price movements is advances from $25 to $40, then declines back to $30, most of the people unless they were quick to sell and cut their loss (which most people don’t or $40 area, all the investors that had losses can now get out even.

mal that a number of these people will sell when they see a chance to get their money back after having been down a significant amount.

Good chartists (a typically tiny group of investors) know how to rec-
ognize the price areas that represent heavy overhead supply. They will never make the fatal mistake of buying a stock that has a large recent amount of overhead supply. This is one type of serious mistake many

overhead supply, it may be safer to buy even though the price is a little higher because the stock proved itself to have sufficient demand to absorb the concentrated supply zone. Of course, a stock that has just supply to contend with, which adds to its appeal.
Excellent Opportunities in Unfamiliar Newer Stocks

Alert winning investors should have a way to track every week all of the new stock listings and new issues that have emerged on the scene during these newer and younger companies will be among the stupendous performers of the next year or two. A newspaper's OTC section can possibly help you stay on top of the myriad of new companies.

Commonly, some new issues move up a small amount and then retreat to new price lows during a bear market. This creates a rather forgotten newcomers will, unnoticed, sneak back up, form a base pattern, and suddenly take off and double or triple in price.

Following Chart books each week can help you spot these unfamiliar, newer companies. It also is essential for a chart service to follow a large number of stocks so you don't miss a big new leader simply because the stock didn't appear in the service.

Levitz Furniture, Rite Aid, and National Chemsearch in 1970, and Toys R Us in 1978 are a few examples of the situation mentioned above.

Valuable

Big daily and weekly volume provides another extraordinarily valuable tip-off to a trained chart reader looking for potentially large winners. Fannie Mae in May 1988, Software Toolworks in September 1989, and indication immediately before tremendous price increases.

Huge volume weeks with price advancing, followed by extreme volume dry ups in other weeks, illustrates a picture of maximum contrast conjunction with weekly basis graphs can frequently let you see unusual volume activity that happened on only one particular day.

Analysis of volume, or the number of shares of stock being traded, is a subject worth careful study. It can certainly help you recognize if a you won't have to rely as much on the personal opinions of analysts and experts. Big volume at major points is indispensable.
sponsorship, two vital ingredients in successful stock analysis. Perhaps you may want to consider getting a chart book and starting to learn how ing buys at the wrong time, or worse, buying stocks that are not under accumulation or have unsound price structures.

Let me offer one last bit of judicious guidance. If you are new to the stock market or the strategies outlined in this book, or more importantly, you are reading this book for the first time near the beginning or middle of a bear market, do not expect the presumed buy patterns to work. Most will be defective.

bottom of a base into new highs, without any handle area forming. The patterns can show laggard stocks with puny relative strength.

It isn’t that bases, breakouts, or the method isn’t working any more, it’s that the time and the stocks are simply wrong. The price and volume patterns are phony, faulty, and unsound. The general market isn’t right. It is selling time. Even a skunk isn’t going to make a cent.

Be patient, keep doing your studying, and be 100% prepared. At spring to life. The practical techniques and disciplines discussed

trates what a cup-with-handle-pattern looks like on a daily chart.

To summarize: Learn to read and use charts if you want to improve your stock selection and timing. It’s easier than you think to scan a daily chart book once a week, so don’t pass up this gold mine of opportunities.
articles strikes their fancy. To further save you time, all front page fea-

Page 4 is usually the Executive Update section. Frequently you'll find arti-
cles here on the latest high-tech and computer systems. The New America

Next, many investors read the daily stock market column. It tells the
important "goings on" in the market the day before highlighting stocks
jumping all around or starting toward the rear of the paper, to check
the stock tables. New York Stock Exchange prices are printed up front
their papers. There has been little change in this basic information pro-
vided to the public for 50 years or more. For example, they show the
yield, P/E, high, low, closing price, net price change for the day, and
most investors see, but it does not give you the complete picture.
Specifically, four critical additional news items are provided every day
in the Investor's Business Daily New York Stock Exchange, AMEX, and
NASDAQ tables, items that cannot be found in your local paper or in
The Wall Street Journal.

Earning per Share Rank

Relative Earnings Growth

The first "additional" news item in Investor's Business Daily is the earnings
ings per share over the last five years and the stability of that growth. A
recent quarters, versus the same quarters a year ago, is combined and
then averaged with its five years' earnings growth record. The result is
a scale from 1 to 99, with 99 being the highest. An 80 EPS rank means that
particular company's bottom-line earnings results are in the top 20% of
the more than 7000 corporations being measured.
This, of course, could be crucial intelligence because it gives an

type ahead of the rest.

of a firm’s success, EPS rank should be invaluable for screening the
ture leaders from the poorly managed, deficient, and lackluster lag-
Earnings rank may be more meaningful than the widely followed Fortune

Corporate size rarely guarantees growth, innovation, profitability, or an increasing number of jobs for workers.
opinions and are sometimes inaccurate, whereas reported earnings are actual reported facts.

Relative Strength Rank

shows how a stock's price

formance during the last 12 months. Relative strength measures the

theoretical value of the company or its past popularity, name, and image.

running 12 months’ performance is updated daily, compared to all
other stocks, and then placed on the same easy-to-use 1 to 99 scale.

An 80 relative strength rank means the stock, pricewise, outperformed 80% of all other common stocks in the last year. During good
markets, the potential implication of these two basic news measure-

poor markets, relative strength measures that break below 70 might

strength is shown each Monday. Investor's Business Daily shows a list

at the end of the NYSE tables of stocks that just fell below 70, 50, or 30 in

relative price strength. These are generally companies to avoid.

Most of the superior stocks available for investment will usually rank

rent record can’t suddenly start to turn sour. That's why you should

always have and use some type of loss-cutting strategy. Additionally,
daily or weekly chart to see if it is currently in a base (sideways area of
price consolidation) or is extended in price above its base. Then study
an S&P stock report tear sheet or a Value Line report to learn more

about the company’s basic business and new products.

companies, over a 40-year period, showed that the previous five years’

earnings was the most important fundamental common characteristic in

the majority of excellent-performing companies. These successful mod-

point, when they broke out of their first price-consolidation basing
area, prior to their substantial price advance.
there are dozens of first-rate choices with higher rankings? Companies with poor ratings can perform, but there are more disappointments in these lower categories. Also, even when a low-ranked company has a decent price move, one of the better-ranked stocks in the same industry probably advanced percentagewise much more. These combined measurements, in a way, are similar to the A.C. Neilson's TV viewer ratings especially poor ratings?

available at a cheaper price, but how many ball games would you win with nine players in your lineup averaging .200?

When the bases are loaded in the ninth inning and the score is tied, who would you rather march to the plate: a .200 hitter or a .300 hitter? How often does an established .200 hitter blossom into a batting champion? Not often.

It's no different selecting and managing your portfolio of stocks. To

areas of our older basic industries, these practical, no-nonsense measurements have helped wake up corporate boards of directors. They usually producing pathetic second division results. Alert, responsible directors need to be aware of these longer-term company relative performance rankings.

Accumulation/Distribution

This proprietary measurement is based on price and volume change and tells you if your stock is under accumulation (professional buying) or "B" ranked companies and temporarily avoid the "D" and "E" ranked

Volume % Change Tracks Big Money Flow

The fourth valuable news measurement is volume % change. Most news-change goes one giant revealing step further by keeping track of what the normal trading level for every company is during the prior three ing 10,000 shares a day, another 100,000 shares a day, and still another

If a 10,000-share trader suddenly transacts 70,000 today, and its price jumps one point, the stock has popped up on a 600% increase in vol-

demand for every stock."

Is this essential data for you to know? Imagine if your largest stock holding was down two points yesterday and the volume % change col-

Wouldn't you want to be aware of that fact?

New York Stock Exchange and most professional portfolio managers, as well as many savvy public investors, read the Investor's Business Daily stock tables.

This data allows them to scrutinize the flow of money into and out of stocks. Many sophisticated investors and experienced or larger-producing stockbrokers also widely utilize this more advanced news dissemination.

stocks up one point or more or those hitting new price highs are print-
ed in large boldface type. Stocks down one point or more or making

To further save readers time in today's fast-paced business world, the remaining print is easy to read, companies are spelled out more completely, and preferred stocks are displayed in a separate area.

Have you ever tried to find a common stock in the price tables and and you weren't sure which one was your stock? Old tables that show a can add to the delay and confusion in locating your common stocks.
Additionally, each Tuesday the stock tables show every company's P.E. ratio and Wednesday's tables give you the sponsorship rank. management, and Friday's edition tells you the % dividend yield.

when taken together, are far more important for getting better invest-

Greatest % Change in Volume

orities like IBM, AT&T, or General Motors, which each normally trade more than a million shares a day. Investor's Business Daily, on the other their own last 50 days of average daily trading volume.

small- and medium-sized, innovative, entrepreneurial organizations that may have a 500% increase in trading volume but never reach a total volume figure large enough to make the more commonly followed "Most Active" lists. These sophisticated screens may not appear in other publications. Pay close attention to the boldfaced stocks on the list.

price. This list is almost universally worthless because it will show a $2 stock up 1/4% of a point as stock up in price the greatest percent. They also show preferred stocks in the list. Low-priced stocks and preferred prospecting in the junk pile.

Eliminating the cheaper, less relevant, low-quality stocks, plus the more significant securities $12 or higher is more useful. Stocks in this list that have options listed show a small "o" after the company's name

Most newspapers typically provide a small block, "How to Read the Daily Stock Tables." Be absolutely sure to read these instructions as you facts that will save you money.

**Trading Volume**

otions omit volume data. Volume helps measure liquidity and the amount

New Highs Daily (Graphically Displayed)

Another helpful feature is 30 graphic displays shown every day of stocks in the news on each of the New York and NASDAQ markets. If a stock makes a new price high for the year, a weekly graph of its high, low, closing price, and volume is shown covering the past 12 months. If rank are pictured. If there are less than 30, the remainder of the list is trading volume.

This display is like a computerized tool for bringing to the surface all particularly in the over-the-counter market, because the stocks are not widely known. These unrecognized, unfamiliar companies frequently blast off and become the new outstanding big winners of the year.
NASDAQ Stocks In The News

Lists are provided for all NYSE, AMEX, and OTC stocks hitting new price highs or new lows. Initial new highs could be worth checking up on, especially in the OTC market, since few publications provide new high lists for over-the-counter securities. New high lists are uniquely shown by industry groups and they show the stock symbol and closing market averages.

Investor's Business Daily provides you with the Dow Jones 30 Industrials, two broader indexes, the S&P 500 index and Investor's Business American, and over-the-counter common stocks, and is the broadest

The NYSE daily advance-decline line, which measures cumulatively the number of stocks on the New York Stock Exchange advancing in price together and paralleling exactly the same current nine-month period. At most major market tops and bottoms, subtle divergences occur between the various market averages.

As mentioned in Chapter 7 on general market direction, in

ing light" alert that the broad market was getting stronger, while the indication of the market's condition.

21 and December 21 of 1984. These interest-rate changes were shown stunning rally quickly ensued.

cent company debt, group relative strength, stock relative strength line and number, average daily trading volume, price-earnings ratio, current quarterly earnings, high and low prices for the prior two years and if

In June of 1986, I picked a June 1985 paper at random and checked News" section. In the one year up to June 1986, 27 of the 30 had advanced in price and three had declined. In this instance the overall increase of all 30 stocks averaged 75%, while the general market averages for the same time period increased 25%. That certainly doesn't
below one of its important earlier price support zones and the Investor's Business Daily stock index, which represents the entire market, may by flashing a positive sign. These are refinements you need to recognize on a day-to-day basis.

occur on one specific day, and it's important to spot them when they only once a week?

**Indicators Are Important**

sales (the higher the percentage of short selling by small investors, the more positive it should be for the stock market), and cash positions of

**Let You Hone In**

Nine different major market sector graphs appear daily at the bottom of the general market indicators' page. The economy is divided into broad economic sectors. You can rapidly monitor every significant sector such securities, and even a new issue index.

The percentage change in each index is quoted every day in a small composite, the Dow Jones Transportation, arid the utilities index are ing world of emerging growth opportunities.
During early 1994, using data in the market sector box, you could easily see that the high-tech sector was the leading market segment performancewise, with junior growth stocks next in strength, and the utility

Observe Prices of 197

Newspapers generally show stock tables containing the prices of individual stocks. But it is also possible to see the price changes every market day for 197 industries.

week's price performance of each industry. The top 10 industries are shown in boldface print.

produced the best price performance since the beginning of the year. each industry's performance and ranking.
Investing like a Professional

How to Make Money Reading the Daily Financial News Pages

Leading Industry

presented of a top industry in the market. Under that is a list of the companies within that particular industry group. People find this screen worthwhile, so they cut it out to save for future research reference. The typical Investor’s Business Daily is kept 13 days.

The number of companies in a leading industry can be extensive since the newspaper has exclusive contractual access to a proprietary relative-strength rank. Generally the top 20% of this list represent the

Companies In A Leading Industry

The Medical-Health Maint Group ranked in top 30 prior six months
15 stocks are shown by total of EPS Rank and Relative Price Strength

<table>
<thead>
<tr>
<th>Rank</th>
<th>Stock</th>
<th>Trade Symbol</th>
<th>STR Rank</th>
<th>EPS</th>
<th>REL Atr</th>
<th>Recent PE</th>
<th>High Price</th>
<th>Syr PE</th>
<th>I/O</th>
<th>Sent</th>
<th>(m$m)</th>
<th>Avg. Or</th>
<th>Last Qu</th>
<th>Last Qt.</th>
<th>PE</th>
<th>% Profit Margin</th>
<th>Return on Equity (%)</th>
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<td>1</td>
<td>Mid Atlantic Med Inc</td>
<td>MAMS</td>
<td>99 95 A</td>
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<td>35</td>
<td>7</td>
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<td>2</td>
<td>Oxford Health Plans Corp</td>
<td>OHP</td>
<td>99 96 A</td>
<td>68.00</td>
<td>84</td>
<td>23</td>
<td>15.1</td>
<td>30091</td>
<td>79</td>
<td>106</td>
<td>5</td>
<td>8.4</td>
<td>433</td>
<td>95</td>
<td>14</td>
<td>0.29</td>
<td></td>
<td></td>
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<tr>
<td>3</td>
<td>Intergroup Healthcare</td>
<td>IDG</td>
<td>96 64 A</td>
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<td>8</td>
<td>20</td>
<td>9.8</td>
<td>433</td>
<td>30</td>
<td>95</td>
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<td>119</td>
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<td>15</td>
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<td>First Amer Health Care</td>
<td>FAMC</td>
<td>92 97 A</td>
<td>9.50</td>
<td>30</td>
<td>40</td>
<td>2.4</td>
<td>79</td>
<td>125</td>
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<tr>
<td>5</td>
<td>Physician Corp Of Amer</td>
<td>PCAM</td>
<td>91 98 A</td>
<td>29.50</td>
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<td>29</td>
<td>8.7</td>
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<td>0.96</td>
<td></td>
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The Economy Page

The entire front page of the second section is devoted to coverage of the U.S. and the world economy. Breaking news, as well as a regular economics column entitled “Perspective,” is provided daily.

Key Futures Graphs for Traders and for Economic Perspective

form. This is helpful not only to commodity traders but to corporate off-crude oil may influence inflation rates, as well as the price of airline stocks; lumber prices give a hint of the building industry's health. Today's savvy business people are interested in currency futures as well as in corn, cattle, and coffee prices. Spot (cash) and future price tables are also furnished for a wide variety of commodities. A special daily futures column is provided and all charts show stochastic price momentum lines.
Check Up Versus Down Corporate Earnings Reports Daily

When corporations announce their quarterly earnings results, the reports closing price, EPS and Relative Strength rank, plus industry group is provid-

Performance

you make sounder evaluations, because they show each fund’s year-to-date total return plus the prior three years ranking of total results. Investor’s Business Daily was the first newspaper to show performance data in its mutual fund table. Six different graphs are also shown each day of outstanding funds and their most recent publicly available stock buyys. The 10% which gained the most for the day are boldfaced in the tables.
Last, a growth-fund index is graphically presented together with 50- and 200-day moving average price lines. The index can be used as another general market indicator, since it is made up of the combined performance of twenty growth funds, or a tool for those who use mov-

**Performance of World Stock Markets Are Charted**

Of course for some people, investing is a global affair, so daily world-markets graphs portray how stock markets in 12 other countries are doing. Prices of selected foreign stocks are also listed.

**New Issues, Corporate Offerings, and New Listings**

Pending new corporate underwriting and other financing are listed showing you the dollar amount, indicated price, type of security firm’s name.

**Yield-Curve Graphic Display Plus Selected Interest Rates**

Interest rates are important to everyone. The Fed Funds rate, FRB Discount rate, rate of three-month Treasury Bills, the prime rate, rates of 30-year Treasury Bonds and tax-exempt bonds, rate of Moody’s AA utilities, and 90 CDs’ interest rates are graphed every day. A yield curve
Investing like a Professional

The information about U.S. Treasury issues is also available daily. These important rates should help you better plan your business financing, personal financing, and investing.
Convertibles are shown in their own table with valuable data such as S&P ratings, yield to maturity, volume, conversion price, and premium or discount calculated and provided in order to save you time.

**New Ideas from the**

Some of America's most dynamic, growing companies are spotlighted every day on the "Companies in the News" section near the back of Section II. (See page 203.) The companies surveyed on this page coming the previous six months. The high-ranked companies in that industry are profiled, by an experienced business reporter who reviews each

Along with in-depth editorial coverage, there are also three graphs have a way to make better-informed financial decisions. Incidentally,

December, 1990 to August, 1992 while it was a young, new company, before it was covered in another national newspaper.

**Be a Visitor to the New York Analysts' Meetings**

York Society of Security Analysts. The presidents and chief executive officers of leading corporations appear before the New York analysts to analysts. In fact, these sessions are so well regarded that some investors pay important sums for transcripts of what transpires.

Reporters attend analysts' meetings not only for the company appearing at the New York analysts', but also for important analysts' meetings panies, are presented regularly. Here is one great example you missed if
you weren't reading the paper on February 11, 1988. L. A. Gear jumped from $14 to an equivalent of $175 before it topped out.

began the first of four consecutive discount rate cuts during the subse-

following page, we received a short, to-the-point letter from Don Regan, then Chief of Staff to the President. The letter said, "...rest assured this will get to all the right places and something will be done about it." The
The Art of Tape Reading: Analyzing and Reacting to News

Tape reading is like seeing the Super Bowl football game live from the 50-yard line rather than reading about it in the paper the next day. You see all the grand action, you feel the electricity in the air, and you experience the overpowering emotion and excitement.

A tape reader is an investor or speculator who spends time watching both individual stock transactions as they are reported on the stock exchange ticker tapes and absorbing news as it flows over the news wires. A good tape examiner acquires a feel for the market and can tell you whether stocks are behaving normally or not. Naturally, the number of them do well, but you often hear them brag about their favorite

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How to Utilize the News

2. Use the new low list in conjunction with the stock tables to show a

AMEX, and OTC market. There will be fewer stocks making new

ly if they are not extended too far below price-basing patterns.
4. Notice if there is a shift to defensive securities such as Foods,

general market indicators page.
5. What are the weakest industry groups and the former leading

groups?
6. Are more stocks consistently underlined in the price tables than

are boldfaced?

stock positions that may need to be sold.
8. Check price tables for companies with relative strength breaking

beginning of the next bull market. Observe the Mutual Fund Index

and performance of foreign market averages for further clues. Is the

Fund Index persistently below its 200-day moving average line?
10. Watch for special news items daily on companies, industries, or the

economy. And be sure to check the NASDAQ chart.
11. Track weakening stocks that perhaps should be sold.
13. Save and study the New America page to get ready for the next bull

market.
tapes put in every office in his accounting department. If he happened to leave his desk to go into the accounting area, he didn’t want to risk

Jesse Livermore and Gerald Loeb of E. F. Hutton always watched the tape. And of course, specialists on the floor of the New York Stock

All transactions are supposed to be flashed on the ticker tape about three minutes after the trade actually occurs on the floor of the stock exchange. Sometimes, however, the volume of trading is so heavy even time to buy or sell because it is sometimes harder to know what the actual prices are on the floor at the time you enter your orders.

Separating Leaders from Laggards, via the Tape

Competent, experienced tape readers can weed out the stock leaders from the feeble, laggard stocks in the market. How is this done?

After declining for several weeks, a market will finally turn and start to rebound. The observant tape reader will notice which stocks are the first ones to begin the rally.

quantity of buying, in terms of the size and volume of transactions. He

the market.

Other stocks that are the last to respond in a rally, or stocks that only

watch for stocks that for some reason persistently resist selling off along

The tape analyst looks for a sudden pickup in volume and activity in a

The best tape readers are concerned more with volume in a stock than with just watching the price. Several 20,000-share trades in a com-

It Isn’t Your Aunt Sue Buying

For one thing, a 20,000-share trade in a $50 stock on a 1/8-point uptick (20,000 X $50). The assumption is that some buyer is willing to pay up three-eighths of a point to buy the stock. Because of the size you can also be pretty certain it isn’t your Aunt Sue down the street buying, but probably a more informed buyer.

hardly ever works in the stock market. Experienced professionals know investors are influenced by big trades appearing on upticks, so don’t get

The real problem with tape analysis is the tape reflects all trading, correct buying. Professionals who deal in big blocks buy a large number of mediocre or poor stocks, or good stocks at the wrong time. So, it becomes a question of sifting the white elephants from the smart buying. Market manipulation by program traders also distorts prices.

Tape Reading Is Too Exciting and Emotional

emotional. It requires constant discipline to avoid being swept along

vinced it’s going to go ”straight through the roof.”

everyone

est to see the trees. And above all, the most important things a winner

Is the Stock in a Base or Is It Extended?

There is an easy, effective way to periodically read the tape and exercise strong discipline. Whenever you see tape activity that impresses you,
refer to the stock's chart to see if the stock is in a base-building period or if it is extended from a base. If it is extended in price, leave it alone.

If the stock is in a base (sideways price-consolidation area), then a meaningful amount? Is the five-year earnings record good?

More than half the stocks that look inviting on the tape will fail to become investments. However, sooner or later convincing tape action will point you to a golden opportunity that passes all your criteria and could become a star performer.

Scan Chart Books Weekly and List Buy Prices

Another way to use the tape productively is to review a comprehensive graph book every week and make a list of stocks that meet your technical plus fundamental selection criteria.

Then jot down the pivot price where you would consider buying. Also write down the average daily volume for each stock on your prospect list.

when you are watching the ticker tape or the market. In time, one or two and will approach your buy point. This is the time to get ready to make a possible buy decision—if the stock trades at your buy price and you conclude the day's volume will be up at least 50% above average. Generally, the more demand for a stock at the buy point, the better.

Look for a Shift in Quality Around the Top

After a short-term rally, or near a market top, a tape reader can frequently discern a shift in the quality of the tape. The top-notch leading stocks no longer lead the market up. Lower quality laggards and cheap-

around the next corner.

Stocks Begin to Appear

After an extended rally in the market, a tape reader may notice more

There are other little symptoms and market habits the tape observer will recognize. Some stocks have delayed openings other stocks will stop trading during the day. At certain times activity will become so numbers left off certain prices and volumes.

At other periods stocks may rally in rapid fashion, which creates the of the market may become very slow. In these lulls, the ticker is known as a "quiet or dull tape." Some traders say "don't sell a dull market."

moving alerted the tape reader to a pickup or slowdown in the pace of overall market activity. Now we have modern electronic tapes, which move without a whisper.

reflect a slow, steady pace of quiet, subtle accumulation. Sometimes on the day before a long holiday weekend, those on the job are quietly and weekend and miss what's transpiring.

Tape readers expect the pace of activity to slow down around lunch time in New York (12:00 p.m. to 1:00 p.m., New York time, or 9:00 a.m. to 10:00 a.m., Los Angeles time). They also know the market frequently closing strong, or suddenly weakening and failing to hold gains established early in the day.

The careful eye can also spot a stock "churning" on the ticker tape. This happens when a great deal of trading volume occurs but poor

In 1961, years before Bunker Hunt got involved in his silver fiasco, he phoned me one day and said he had just come from lunch at a downtown Dallas hotel. The rumor, he said, was that Glint Murchison was going to buy control of a particular company that sold at about $16 on the New York Stock Exchange.

He suggested buying the stock, and as he was talking, I watched the stock trade in unbelievable reams on the ticker tape. However, most of
the prices were unchanged and the price was not making any real progress overall. I told Bunker to wait a few days. Something didn't make sense to me, because if these rumors were true, why was the stock

Two days later, the news filtered out that Murchison had acquired control of a block of stock outside the marketplace and had been selling short in the market the day Bunker Hunt telephoned. The stock sold off on this surprising news. Now you have a firsthand example of why tips and rumors are dangerous and can get you into trouble.

Rumors

I never buy stocks on tips, rumors, or inside information. It simply is an extremely unsound investment practice. Of course, tips, rumors, or inside what most people believe and do in the market doesn't work; so beware!

Certain advisory services and some daily business newspapers carry regular columns fed by Street gossip, rumors, tips, and planted personal opinions or inside information. This, in my opinion, is not the most professional approach, nor is it too sophisticated. There are far sounder and safer methods of investing in the stock market.

Bernard Baruch emphasized the importance of separating the facts of a situation from tips, inside "dope," or wishful thinking. One of his rules was to beware of barbers, beauticians, waiters—of anyone bringing

Big Block Trades Represent Institutions

In today's institutionally dominated markets, large numbers of big blocks of stock trade every day. Many of these blocks of 10,000 to 500,000 shares or more are crossed by block houses (institutional brokerage firms specializing in large transactions). Sometimes they represent both sides of the order, acting as broker for both the buyer and seller. In certain of these cases it may be of value to know if a stock exchange specialist has taken any stock in position on the block trade.

Block houses positioning (buying for their own trading account) a block that trades on a big down tick from the prior trade will try to dispose of their stock as soon as possible over the next few trading days.

Block trades unchanged or only $1/4$ of a point above or below the prior trade are confusing and misleading to the public and are sucker bait for the uninformed. Arbitrage and deliberate painting of the tape by crossing blocks that are being sold on $1/8$ of a point upticks complicate the

Brothers also being a giant factor in this specialty. Block firms take large risks and at times may run their block operations as a loss leader to attract greater syndicate, bond, or other commission business.

Learning Ticker Tape Stock Symbols

A good tape reader should learn the stock symbols of most of the leading stocks. All stocks have an abbreviated ticker symbol, such as GM for General Motors, T for American Telephone, and XON for Exxon.

Symbols are easy to learn. However, there are many newly listed stocks each year, so you have to keep abreast of new symbols. Some new listings, particularly on the American Stock Exchange or NASDAQ market, can become exciting growth leaders in certain types of market cycles where the AMEX or NASDAQ is in favor.

Below is an example of the New York Stock Exchange ticker tape. This sample shows a 10,000-share block of IBM which traded at 154$1/2$ (the first two digits, I and 5, are deleted) as well as 100-share trades in General Electric, J.P. Morgan, Hewlett Packard, American Express, and Merrill Lynch. A big block of 1,500 American Telephone and Telegraph traded at 34$1/2$.

<table>
<thead>
<tr>
<th>IBM</th>
<th>10,000x4%</th>
<th>GE</th>
<th>JPM</th>
<th>HWP</th>
<th>AXP</th>
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</table>

Sample NYSE ticker tape

Since many equities tend to move in industry groups, a seasoned tape reader will usually look for confirmation of strength in at least one other important stock in the same group. For example, if Aluminum Co. of America shows unusual strength in the market, you would expect either Alcan Aluminum, Reynolds Metals, or Kaiser Aluminum to also show strong price and volume action.
Don't Buy into Overhead Supply
Last, a professional tape reader always avoids buying securities as they stock is able to break through its recent overhead supply zone before considering purchase.

Many amateur and even professional investors do not understand the rance they make poor stock selections. Ignorance in the stock market always costs money.

Around Year's End
A certain amount of distortion can occur in the activity in optionable stocks around option expiration dates. There is also a significant amount of year-end distortion in stocks during December and some-

The year's end is a topsy-turvy, tricky time for anyone to buy stock since a new year, which further adds to the difficulty. Fake-out action can occur with one big "up" day followed by a big "down" day, only to be fol-
just as soon take a vacation in January.

which continually provides company news and comments from around

Analyze Upticks and Down Ticks
One helpful tool in judging overall performance is to analyze a stock's upticks and down ticks. The total blocks over a period of time that $\frac{1}{4}$ $\frac{1}{4}$ point

the top 50 stocks in the overall market for the past week in terms of net plus ticks shown on the stock exchange ticker tape. A separate list of the significant in picking up net accumulation or distribution in stocks. But

An active do-it-yourself investor with enough study might, in time, tern. The institutional buyer usually feels a need to start a little earlier, due to its size disadvantage.

overhanging the market is out of the way, a stock customarily will finally rally. Specialists that take blocks on big down ticks will usually try to

Some tape detectives feel specific stocks are predictive of the entire mar-
et. The saying used to be, "As General Motors goes, so goes the mar-
et." This is not necessarily always true. However, at times certain key fashion. Many professional traders feel if Merrill Lynch stock gets some, but not all, cases.

had led its industry into new highs in the last year or two fails to lead its

control, learning to read the ticker tape properly could be a useful tool to add to other investment skills.
Interpret and React to Major News

government, foreign countries, or international events, the capable good or bad than they are in analyzing the news effect on the market. For example, if the market yawns at national news that appears to be

stocks give ground slightly, the tape analyst might conclude the underpinnings of the market are weaker than previously believed. The essential point is not always whether the news is good or bad but how the

Sometimes the market overreacts or even counteracts favorable items or

full page ad in The Wall Street Journal predicting rampant inflation and another 1929 depression. The ad appeared during the middle of an intermediate correction in the market. Its warnings were so overboard and advance and the beginning of a rally that lasted for several days.

explain, and one which slumps noticeably on no apparent news at all.

actions such as wage and price controls, U.S. flagging of Kuwait oil

Old News versus New News

Both good and bad news becomes old news after being repeated several times, and it will frequently have the opposite effect on the stock market—of how propaganda and disinformation work in totalitarian countries—the more a lie or distortion is repeated to the masses, the more it comes to be accepted as a truth. When a news item has become widely known or anticipated, it is usually discounted by experienced individuals in the marketplace, blunting the effect of its release.

News can also be very paradoxical and confusing to the market neophyte. For example, a company can have a bad quarterly earnings report released and the stock may go up in price when the news is

tions at a difficult time.

There are several excellent books written on the subject of analyzing national news. Humphrey Neill, author of the 1931 classic Tape Reading and Market Tactics, also wrote The Art of Contrary Opinion, which differently in the various cities' newspaper headlines, and how that can be misleading to stock owners.

His contrary opinion investment theory is developed by illustrating how frequently conventional wisdom or accepted consensus opinion expressed entitled The Gods of Antenna. It specifically tells how our national TV news can manipulate and bias the news to influence and help form pub-


The most outstanding study on the subject was published in 1986 by Adler & Adler, 4550 Montgomery Avenue, Bethesda, Maryland, entitled, The Washington Post, and Time, Newsweek, and U.S. News & World conservative right. Eighty-five percent of the top national journalists were

How the national news is edited and presented does dramatically affect economy, our government, our President, and the stock market.

to learn to separate with better insight and perspective the relevant agenda,
18

and Market Sectors

Common stocks, like people, tend to move in groups. Each market stocks may be the leading groups, and in another period, retail or price movement is due to subgroup influence and 12% to major group influence. Normally the leading industry throughout one bull market will not come back and lead in the next cycle, although there are some irregul- now and again are early enough in their own stage of improvement to weather a bear market and resume advancing to set the pace in the next

In our institutional service every week the computer arranges each of the 200 groups in order of their group relative-price strength for the prospecting in Volume II.

more interested in companies in Volume I of the institutional service.

each stock's big price increases began.

Why Track 200 Industry Categories?

new segments to every industry. We call them subgroups.
For example, in the 1970 market, if economic research told you to cycle, what stocks would have been included in your definition of the
Rather than one building group, there were actually 10 different sub-10 different ways you could have played the building boom.
You could have invested in gypsum stocks, the lumber and plywood mobile homes or low-cost housing, building material retailers and whole-insurance group (MGIC), the air-conditioning group, the carpet industry,

Guess where the traditional building stocks were during 1971? That's right; they were buried deep in the back of Volume II (the weakest sec- tion) of the institutional database service all year, while newer subgroup

In the 1978 to 1981 market sequence, the computer industry was one considered the industry to consist of IBM, Burroughs, Sperry Rand, and turers. They failed to perform during that cycle, while the many subdivi-

the microcomputer family (small home computers, such as Commodore International), the graphics group (which included cad-

(Cullinane Database), or the time-sharing industry. These winners
Industries of the Future or Past?

or two, exciting new subgroups to monitor will be added to our database. Change and new technology are occurring in the United States at

After all, we are in the computer, communications, and space age.

rior products and services. Space research should be promoted.

one. Industries of the past, while at times quite interesting, may present

Here are a few older industries whose greatest growth was possibly in

1. Steel
2. Copper
3. Aluminum
4. Gold
5. Silver
6. Oil
7. Textile
8. Chemical
9. Paper
10. Railroad
11. Railroad equipment
12. Utilities
13. Tobacco
14. Airlines
15. Old-line department stores

3. Electronics
4. Communications
5. New concepts in retailing
6. Space exploration and research

A Stock's Weakness Can Spill Over to the Group

Displaying and monitoring stocks by industry groups can also help get

usually wash over into the remaining issues in that field, sooner or later.

Weakness in several principal building stocks was the paramount indi-

to that date resisted the failure of sister stocks.

At that time there was unanimous agreement by fundamental research firms that MGIC had a 50% annual increase in earnings locked

later collapsed along with the rest of the deteriorating group.

In February 1973, ITT traded between $50 and $60 while every other

been in long declines. The two central points overlooked by four lead-

Top in 1980-1981

This same "wash-over effect" within groups was seen in 1980-1981 after a

long period of advance in oil and oil service stocks, when our early warn-
ing criteria caused us to put stocks like Standard Oil of Indiana, 

Therefore, we put equities like Hughes Tool, Western Co. of North on the sell side even though the stocks were making new price highs. These moves baffled many experienced professionals on Wall Street. However, we had documented and studied the historical precedence of these and facts that had worked over decades, rather than on personal opinions of analysts or one-sided information from company officials. Professional money managers slowly realized that once the price of oil had topped and the major oil stocks were under liquidation, it would be

This single decision to advise clients to sell oil and oil service stocks from November 1980 to June 1981 was perhaps one of our more valuable calls. We even told a Houston seminar audience at The Galleria

We were not aware at the time, or even in the several months following, that the board on the energy and related drilling-and-service sec-

magazine, energy analysts at eight of the largest and most respected brokerage firms took a highly positive view and advised purchasing these securities, as their price peak. This is just another example of how opinions, even if they come from the very highest places, are frequently wrong when it comes to making or preserving money in the stock market. The behavior of markets is usually right. Analysts that do not understand this are destined to cause some substantial losses for their clients. Decisions like the above are one of the rea-

Has the Stock Market Really Changed?

Many inexperienced investors somehow think the market today is very different from the past. They feel, so attempts at stock selection are destined to fail. I was astonished to read as late as the early 1980s that some respected publications still repeated such academic nonsense.

restricted by the SEC or the Stock Exchange. (The 50-point rule helps.) The simultaneous execution and ganging up on a broad list of 150 blue old things happen in the market, cycle after cycle; it's just that the players are different. I'll give you an example to illustrate what happened in and affecting the rest of die flock, happened years earlier in 1961.

The Bowling Boom Tops

Throughout Brunswick's tremendous move that began in 1958 until its

Brunswick peaked in March 1961, it rallied back from $50 to $65. But for the first time, AMF did not recover with Brunswick. This was the stock should be sold—the entire group had made a long-term top. Information of its strength and attractiveness by at least one other important missing should be in stocks you can classify as totally unique companies. Walt Disney should have been classified at points in the past as a unique entertainment company, rather than just a company in the unsteady movie group.

Through our building of historical models in the stock market, there the "follow-on group effect."
The "Follow-On Group Effect"

When efficient new jet aircraft took to the skies in 1963 through 1965, airline stocks also flew. As a result of materially increased air travel, the hotel stocks had a tremendous bull market beginning in 1967. Loews on effect caused by the large increase in air travel.

When the price of oil grew dear in the late 1970s, oil companies began drilling like mad for the pricey substance. As a follow-on result, stocks in 1979, but oil service stocks gushed the next year as oil companies aggressively stepped up exploration.

The roaring sales success of small- and medium-sized computer manufacturers during the 1978-1981 bull market created the "follow-on" demand for computer service, software, and peripheral products in the market resurgence of late 1982.

Use the Cousin Stock Theory

doing exceptionally well, there may be a distinctive supplier company that is also enjoying expanding sales.

In 1965, Boeing was selling many new jet airliners as a result of escalating airline demand. A cousin stock to Boeing was Monogram Industries which, of all things, supplied chemical toilets for all the new jets. Monogram earnings increased 200%, and this little gem had a 1000% advance.

In 1983, Fleetwood, a leading manufacturer of recreational vehicles, because it supplied vinyl-clad paneling and hollow-core cabinet doors to recreational vehicles and mobile home companies.

Basic Conditions Change in an Industry

conditions in an industry. For example, in 1953 aluminum and building stocks had a powerful bull market due to the pent-up demand for housing that was the follow-on aftermath of war. There was such a shortage of gypsum board that gypsum salespeople were offered new Cadillacs by some contractors just to let builders buy a carload of wallboard.

or more, created a solid demand for electronics. Companies such as

Scan Measures of an

Industry group-strength ratings are published by many services. On the only which groups are currently strongest, but which groups have just moved into the top 100. This could be an early indication of possible new group leadership when confirmed by other fundamental economic checks.

On August 14, 1970, the mobile home sector crossed into the top 100 groups and remained in the top 100 until February 12, 1971. The group returned to the top 100 on May 14, 1971, and fell into the bottom half groups in December 1967 and dropped to the bottom half in 1969. The price advances of mobile home stocks were spellbinding during these positive periods.

Fidelity Funds of Boston also shows more than 25 industry mutual funds whose recent performance can be checked to spot the best-acting industry sectors.

from 1953 through early 1994.

<table>
<thead>
<tr>
<th>Year</th>
<th>Industry Sectors</th>
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<tbody>
<tr>
<td>1958</td>
<td>Bowling, electronics, publishing</td>
</tr>
<tr>
<td>1959</td>
<td>Vending machines</td>
</tr>
<tr>
<td>1960</td>
<td>Foods, savings &amp; loan, tobacco</td>
</tr>
<tr>
<td>1963</td>
<td>Airlines</td>
</tr>
<tr>
<td>1965</td>
<td>Aerospace, color television, semiconductors</td>
</tr>
<tr>
<td>1968</td>
<td>Mobile homes</td>
</tr>
<tr>
<td>1971</td>
<td>Mobile homes</td>
</tr>
<tr>
<td>1973</td>
<td>Gold, silver</td>
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<tr>
<td>1974</td>
<td>Coal</td>
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<tr>
<td>1975</td>
<td>Catalog showrooms, oil</td>
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<td>1976</td>
<td>Hospitals, pollution, nursing homes, oil</td>
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<td>1978</td>
<td>Electronics, oil, small computers</td>
</tr>
<tr>
<td>1979</td>
<td>Oil, oil service, small computers</td>
</tr>
</tbody>
</table>
1982 electronics, mobile homes, retail apparel, toys
1984-1987 Generic drugs, foods, confectionery and bakery, supermar-
1988-1990 Shops, sugar, cable TV, computer software, jewelry stores,
1990-1994 semiconductors, telecommunications, generic drugs, cable TV

the three or four individual stocks that lead each group. *Investor's Business Daily* also publishes wall charts covering 50 years of news events and key economic and market indicators.

<table>
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<tr>
<th>INDUSTRY</th>
<th>THIS WEEK</th>
<th>LAST WEEK</th>
<th>4 WEEKS ABD</th>
<th>8 WEEKS ABD</th>
<th>3 MONTHS ABD</th>
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</tbody>
</table>

The Importance of Tracking Thousands of OTCs

Early tip-offs of groups that will emerge as leaders in a new bull market cycle can, at times, be found by observing unusual strength in one or two over-the-counter issues and relating that strength to similar power attention to a category, but confirmation by one or two kindred over-the-counter companies can quickly steer you to a new industry recovery in development. To do this, it is necessary to actively follow several

1. Centex Corporation's relative strength in the prior year was strong
2. Note accelerating earnings, +50%, during the June 1970 quarter.
3. In March-September 1970, the stock was selling near an all-time high at the bottom of a bear market.
4. A strong Centex (OTC) base coincided with the base in Kaufman & Broad (NYSE).

### Groups

In July 1982, we sent a wall chart to institutional accounts. It displayed
dict moves in the stock market, there are, on occasion, some extremely profitable exceptions when you analyze specific industries. The unprecedented move in oil service stocks in 1980 was clearly forecast by industry employment statistics.

67% of Winners Are Part of Group Moves

In addition to narrow industry categories, there are broad general areas concentrated in Dallas, Texas, and other key growth or technology centers in

Shrewd investors should also be aware of projected growth rates over the next few years for various age groups in America. From such data it is possible to predict potential future growth for certain industries. Because of the upsurge of women in the workplace and the gush of baby boomers during the 1980s, the women's apparel group, led by Limited Inc. and Dress Barn Inc., soared straight out of sight between 1982-1983 and 1986.

It is also important for market buffs to know the defensive stock groups.

only two small, light-trading companies make up a sector, it may not be enough to call a group. On the other hand, there are industries with supply does not add to their attractiveness unless some extremely unusual changes occur in their industry conditions.

of Its Own Group?

stocks in the top half of their own group are better investments in a comparable basis, a manager or analyst can quickly screen every alternative in a group by comparing 120 basic factors of one stock to another. In 15 minutes, an experienced professional can pinpoint the two or research. The remaining stocks that do not measure up should be elimi-

expenses and substantially increase efficiency and performance of pen-

result, achieved relatively undistinguished results.

Anyone ferreting out such information received the first crystal clear warning of the worst market upheaval that has occurred since 1929.

So, if you want to produce superior results in the stock market, you

and subgroups.
of Pension and Institutional Portfolios

If you own a mutual fund or your employer has a company pension fund, it is quartered by an institutional money manager and you, as an individual investor, have a vested interest in knowing that he or she is doing the job professionally.

Today's markets are dominated by institutional investors. That's perhaps good, because investing in the market can be a full-time business.

Technologies, Inc., of Rockville, MD, performed substantially better than average during the 5-year period that ended April 30, 1990. Professional

<table>
<thead>
<tr>
<th>Years Ended 4/30/90</th>
<th>Armualized rate of return</th>
</tr>
</thead>
<tbody>
<tr>
<td>NCNB</td>
<td>31.0%</td>
</tr>
<tr>
<td>Sun Bank, N.A.</td>
<td>24.4%</td>
</tr>
<tr>
<td>Fidelity Management</td>
<td>22.6%</td>
</tr>
<tr>
<td>State Street Bank &amp; Trust Co.</td>
<td>21.5%</td>
</tr>
</tbody>
</table>

Financial Strategical Portfolios-Health Sciences | 24.0% |
20th Century Gift Trust | 22.9% |
Hartwell Emerging Growth | 20.9% |
AIM Constellation | 20.7% |

investors do not panic as easily on the downside as the public on occasion the way down.

funds overall could increase by as much as 15% per year in the future. margin, money used, so this builds a far sounder foundation for your kets. (In 1929, the public was heavily involved in the stock market, speculating with 10% cash and 90% margin.) There is so much competition

The problems the stock market encountered from 1969 to 1982 were politicians in Washington, B.C., not by institutional or public investors. The stock market is like a giant mirror that merely reflects basic condi-

Having managed individual accounts, pension funds, mutual funds, having supervised research analysts and dealt closely with many top institutional money managers, I have a few observations about some of the more difficult or debatable areas of professional money management.

over the years; that's how all of us learn and, hopefully, become wiser. through many economic cycles will make a few of these attempts at con-

structive suggestions valuable.

If you are an individual investor, extra insight into the subject of the are the enormous force behind 80% of the important price moves in formula, and they exert far greater influence upon stock prices than specialists do.

equipment known as a high-speed microfilm plotter.
At the time, this costly computer machinery was so new no one knew how to get a picture of graphs out of it. Once this barrier was cracked, it

26 technical essential facts about a company. The same 120 variables can compare any company to any other company either in the same industry or in the entire database.

**Interpreting Dome Petroleum's Datagraph**

The Datagraph of Dome Petroleum on the facing page has been

stock ourselves. Dome Petroleum became one of our biggest winners of how it is actually done.

**The Pic'n'Save Story**

Another stock we recommended in July 1977 that no institution would originally buy was Pic'n'Save. Most felt the company was too small

eral months later. We had historical models of K-Mart when it traded when it traded 500 a day.

Both of these retailers grew into tremendous winners after they were discovered. Average daily trading volume of these issues, as a result, steadily increased. Historical precedence was on our side.

I've always thought of finding an outstanding stock and buying it every point on the way up. That is almost what happened with Pic'n'Save. We bought it every point or two on the way up for several
This little, unknown company headquartered in Carson, California, turned in a steady and remarkable performance for seven or eight earnings growth rate, and debt-to-equity ratio were at that time superior was purchased on 285 different days and held for a period of $7\frac{1}{2}$ years. Sometimes it seemed that if it wasn't Chock Full O'Nuts (located in

Radio Shack's Charles Tandy
I ran into this same phenomenon in 1967 when we first uncovered that time. Among the reasons given for not buying were that Charles
to be an outstanding salesman (a combination seldom found).
Tandy had innovative incentives, departmental financial statements, and highly detailed computer reports on the sales of every item in every store by merchandise type, price, and category. His automated invento-
existence, and a few research reports started coming out noting what an undervalued situation Tandy was. Isn't it strange how far some stocks have to go up before they begin to look cheap to everyone?

forget is that you want to buy a stock when it is not completely obvious the very best stock ideas. When several reports show up, it's time to sell.

Management
ficulty is size. Because they manage billions in assets, there never seem big

Size is a realistic problem. It's easier to manage $10 million than $100 million and simpler to manage $100 million than $1 billion, and $1 bil-
$30 billion. The size handicap simply means it is hard to buy or get rid of a huge stock holding in a small- or medium-sized company.

large capitalization companies. There aren't enough outstanding large capitalization companies in the first place. Why buy a slow-performing stock just because you can easily acquire a lot of it?
From 1981 through 1987, during the Reagan administration, for the public offerings of stock. Many of these small- to medium-sized entre-
significant crossing of blocks occurs between institutions.

The institutional asset manager who professionally manages billions

This is preferable to restricting activities to the same limited, approved list of only a few hundred large, well-known or legal list-type companies. The research department of one of the largest banks in the United

A sizable institution would likely be better off owning 500 companies of all sizes than 100 large, mature, slow-moving companies.

Size Is Not the Key Problem
one trouble is the investment philosophy and particular investment methods utilized by some money management operations.

economists’ top-down predictions of the broad sectors that ought to do well. We believe working from the bottom up produces better results.

Many decisions had to be approved by investment committees. Committees make pitifully poor decisions in the stock market!
some institutions are restricted from buying stocks that do not pay a dividend. This limitation seems in the dark ages because many outstanding

Other restrictions mandate that half or more of the portfolio be invested in bonds. Most bond portfolios have produced weak results over the accounting that did not mark their portfolio to current market prices.

In these few situations, reporting of bond portfolio results is too infrequent and the true overall performance is unclear. Too much emphasis is on yield and not enough is on the increase or decrease in market value of the assets in the portfolio.

**Bottom Buyers' Bliss**

as bottom guessers. This is, in some instances, not the best way to produce a superior performance record. It can place decision makers in the position of buying a stock that is slowly deteriorating.

and restrict their investments to stocks in the lower end of past P/E ranges.

While this approach definitely works for a few unusually capable con-
does not produce truly superior results for the typical institution or have continually lagged in performance due to utilizing this approach.

**Usually Lag**

undervalued method lost a huge account in 1983 due to steady under-

performance.

I have witnessed hundreds of institutions and every type of invest-
ment philosophy imaginable over the last quarter century, and most of those that concentrate on the undervalued theory of stock selection

invariably lag in the results produced when compared to the better money managers today. Sometimes these undervalued situations get more undervalued or trail the market for a considerable time.

**Comparing Growth versus Value Results**

Over the previous 10 business cycles, it has been my experience that the

The best undervalued type managers in the same period averaged 15% to 20%, with a few a little over 20%. Of course, the best were defi-

most individual investors haven't prepared themselves well enough to

**Undervalued System**

rating stocks based on earnings increases and relative market action.

able for corporations or individuals to choose from. But today there is a

which they insist their analysts continually follow and update, an analyst might be to a year or more (or never) in getting all the interesting new

overused stale names. This too little-too late method should be reap-

praised.
Overweighting and Underweighting to the S&P

Many institutions invest primarily in stocks in the S&P 500 and try to overweight or underweight positions in certain sectors. This practice assures they will never do much better or worse than the S&P average.

1½

Weaknesses of the Industry-Analysts System

to have a huge number of analysts with their responsibilities for compa-

For example, the classical securities research department has an auto-

on and on. The problem with this method is its tremendous inefficiency

an analyst assigned two or three out-of-favor groups do? Recommend to

the analyst.

three good winners? When the oil stocks boomed in 1979 and 1980, all of

them doubled or tripled. The best ones shot up five times or more. The

hire a chemist from a chemical company to be their chemical analyst and

their industry but in some cases have a dubious understanding of the

course, it is stocks and the stock market that determine how successful

your investments will be. (Incidentally, do you know what makes a stock

go up? A stock generally goes up because it has fewer buyers. They just

Firms also like to advertise they have more analysts, the largest
department, or more top-ranked "all star" analysts. I would rather have
five good analysts who are generalists than 30, 40, or 50 who are con-

more analysts who are all outstanding at making money in the stock

Financial World's Startling Survey of Top Analysts

A Financial World magazine article dated November 1, 1980, found that

averages. They also seldom provided sell recommendations, limiting

most of their advice to buy or hold. Investment banking creates conflicts.

The Financial World study confirmed research we performed in the

eyear 1970s. In that study, we found that only the minority of Wall Street

recommendations were successful. We also concluded that in a period

every ten reports made sell suggestions.

One of the unsolved problems is that 80% of the research in Wall

Street today is written on the wrong companies. Every industry analyst

has to turn out a certain amount of product. Buy only a few industry

groups lead a typical market cycle. There is insufficient front-end

which current reports should actually be written.

The Daily Pile of Research Reports

reports a foot or so high. It's a great waste of time trudging through

these trying to find a good stock to buy. If you are lucky you may spot

one company out of twenty that is right to buy.

Efficiency

With massive automation we rapidly screen through over 8000 compa-

nies in our database. If we become interested in the defense industry,
the defense area, whereas the typical institution might look at the stand-
ing back for a number of years, as well as the ability to display these vari-
oustanding characteristics worthy of more detailed research.
The remaining companies, because they showed deficiencies on
standard characteristics uncovered in the initial screening. In other
words, you can generally help tell an institution’s analysts where they
should spend their time more productively. Yet, few research depart-
ments are organized to take advantage of such advanced and disci-
plined procedures.

stitutional service called New Stock Market Ideas and Past Leaders to
Avoid. It is published every week, and its documented 16-year perfor-
mance record is shown on the following page (+7126%).

Buy selections outperformed avoid suggestions more than 20 to 1,

We provide institutional investors with computerized quarterly
years of varied business experience before coming to us.

We like to send two analysts on all company visits. However, we do

Also, this method has the advantage of not being gullibly dependent
age money for others, so those areas of potential bias are nonexistent.

to institutional investors who subscribed to our consulting service. In no
case was it necessary for us to have inside information or talk to the

It is naive to believe companies are going to tell you when they are start-
ing to have problems. By using our own data and research, we also thor-
Is In-House Pension Fund Management the Answer?

A few corporations that become disillusioned with their pension fund performance decide to move their money in-house. I doubt that going in-house provides any serious advantage because the problem is still the same: they are doing and are able to produce excellent performance? Another growing trend is the number of new investment counseling organizations. Only a small list of a few of these enterprising organizations:

- Clement Capital, Inc.—New York, NY
- Essex Investment Management Co., Inc.—Boston, MA
- Jundt/Capen Associates—Minneapolis, MN
- Railing Capital Management—Chicago, IL
- Kunath, Karren, Rinne & Atkin, Inc.—Seattle, WA
- Nicholas-Applegate Capital Mgmt., Inc.—San Diego, CA
- Southeastern Asset Management, Inc.—Memphis, TN

On a different subject, certain institutions may allow some of their some attorneys are so cautious or adamant they may prevent realistic some brokerage firms that will execute at the very cheapest prices, but again, always buying the cheapest execution and the cheapest available research can substantially hurt your long-term performance.

dilutes the real value and impact of those few good ones. The confusion firms at critical junctures can be exceptionally expensive.

The 1982 and 1978 Full-Page Bullish Ads

Let me provide you with an example. We placed a full-page ad in The Wall Street Journal early in 1982 stating that the back of inflation had been broken and we believed the important stocks had already made their lows. In May 1982, we mailed out wall charts showing 20 consumer believed might be attractive for the bull market ahead.

and contact several large institutions. In these meetings we stated a bull-

The stance we took was diametrically opposed to the position of most institutional research firms at that point and to the negative flood of judgments frightened large institutional investors so much they hesitated and could not fully capitalize on the fact that the two leading groups for the newly evolving bull market that was quickly to follow had already surfaced and had been identified.

It appeared professional managers had been bombarded with so

mer of 1982, we internally produced the largest performance in the firm investment account in any year since the beginning of the firm. This account had a twenty-fold increase in profits from 1978 to 1991. Events such as this make us believe it is an advantage not to be head-
DON'T LET THE GLOOM BUGS FOOL YOU... INFLATION'S BACK IS BROKEN AND IT'S TIME TO INVEST FOR THE RECOVERY AHEAD

February 1982 bull market ad
The savvy individual investor has a gigantic advantage in not having to listen to 50 different strongly held opinions. Perhaps the common-
that majority opinions seldom work in the stock market and stocks seem to require a wall of worry, doubt, and disbelief to climb. Fear is proba-

We generally do not attempt to call every short-term or intermediate correction, as sometimes this could be a little foolish and shortsighted for the institutional investor. Primary concentration is on recognizing and acting upon the early stage of a new bull market and on the early beginning phase of each new bear market. This focus includes searching for the market sectors and groups that should be bought and those what our position was at that juncture so there could be no question

The time when an institutional research firm can be of inestimable
ries, information, and overconfidence.
If you don’t think fear and emotion can ride high among profession-
al investors, it can. I remember meeting with a group of the top three
ordinary stock in the market was off 75%.)
I recall seeing another prime manager about that same time who was
looked as if he had been run over by a freight train! Of course, all of that is preferable to what happened in 1929, when a few people jumped out of office buildings.
accounts in the United States and around the world that receive our be in process.

right and sometimes they are not. This one gave institutions ten weeks of rally to sell into before the market topped in late January 1994. Of course, almost all institutions either were unsure, argued with the con-
cash in April 1994 than they had in November 1993.

TO: Institutional Clients
FR: William O’Neil
RE: November 19, 1993 Market Memo

Newbridge, Nextel, Qualcomm, Tellabs, etc. These stocks are different
of the year. If you combine this with noticeable weakness in the banks,

Here are a few other pertinent facts: the general market (S&P arid DHA) on Tuesday, Wednesday, and Thursday, November 2-4, came suffered its sharpest two-day drop in two years and was unable to rally back. The IBD Mutual Fund Index also had its sharpest two-day break, as did the NASDAQ average. We believe that the NASDAQ and AMEX average had a speculative price climax on heavy volume four weeks earlier

Investor's Business Daily broke below its support low of four weeks ago on been down. Last month was an all-time record for new issues and both

on a yield and PE basis has been in overvalued territory for some time
believe a stock like Intel is a value simply because it sells for nine times earnings. We expect an earnings slow-down over the next several quarters
Many of President Clinton's proposals appear to us to be unsound, particularly in the healthcare area. Our estimate is that 10 years from now, new program. Price controls along with government management could lead to other difficulties. There also seems to be a credibility problem.

Inflation risk in aggressive stocks and groups. We do not, however, expect any bear market correction that might occur to be of a substantial nature (when compared to historical bear markets). Perhaps 15% might cushion any adjustment. We are also in a low interest rate, low

How High-Techs Topped
At the opposite end of the pole, I remember a high-tech seminar given presentation to a bank in another large city. The bank brought in all of its analysts. Close to 20 people were sitting around an impressive table in the

ever seen, and I've never seen it since. Needless to say, this institution consistently performed in the lower quartiles when compared to its more alive

Years ago, one medium-sized bank for which we did consulting work their approved list which met our qualifications for buying, we had to

laggard performance for the past several years.

investment department and trot outside for a successor who invests in pretty

much the same way. Naturally, this does not solve the problem of deficient investment methods and philosophy that continues to be perpetuated.

July 1981, it made a change in its top investment management, but it brought in an individual with a completely different approach and superior investment philosophy, as well as an outstanding performance the country.

At still another midwestern institution we provided consulting recommenda- tions but they were of doubtful value because the institution was wedded to the cast-in-concrete belief that any potential investment must

Clearly the best investments rarely show up on any undervalued model. There is no way this institution ever produce a first-rate result until it changes its philosophy and throws out its undervalued model. This is exceedingly hard for large organizations to do. It's per-

become a Catholic or vice-versa.

Foolish
Some corporations place entirely too much emphasis on saving management fees, particularly when they have giant funds to be managed. Usually an actuary convinces them of the tremendous dollars their pension fund can save by shaving the management fee just one-eighth of 1%.

If companies have billions of dollars to be managed, they should

slock market. If you were going to have open heart surgery, would you select the doctor who would do it for the absolutely cheapest fee?

Recommended
As discussed earlier, modern portfolio theory, a strictly theoretical
This effort has proven to be almost a complete waste of time, since its theories were built on assumptions that were not true. One of the reasons that it gained acceptance was many institutions did not understand professors.

Of course, most of the university professors who devised these new answers to the stock market had very limited understanding of, or real success with, the stock market. Every study we have conducted and virtually every organization utilizing these statistical methods has shown the concept to be inferior to that used by today's more successful money-management organizations.

All the random-walk theories, to me, are like the experts who years ago claimed a baseball didn't curve, that it was just an optical illusion. experts is that they certainly never had to stand at home plate and have a pitcher fire a pitch right at their head before curving a foot and a half from a world of poorly conceived dividend discount models, it will be

it should not be taught in business schools, and it should not be forced upon young analysts studying to pass CFA examinations. It is, in my view, a tremendous misuse of valuable time.

How to Select and Measure Money Managers Properly

In general, managers should be given a complete cycle before you managers—from the peak of one bull market period to the peak of another cycle or the trough of one cycle to the trough of another. This

At the end of this period, the bottom 20% or so of the managers in total overall performance should then be replaced. Thereafter, every year or two the bottom 5% or 10% of managers over the immediately prior three- or four-year period should be eliminated.

a short period of a few quarters or in any one year. Given time, this process will automatically lead to a positively outstanding group of have a sound, longer-term, self-correcting mechanism, and you won't suddenly replace managers.

In your selection of managers, consideration could be given to their recent period. Diversification should be considered among the types, styles, and locations of managers. The search should be widespread and managers.
The corporate or pension fund client with money to be managed has to also be especially careful not to interfere at critical junctures—for valued stocks should be emphasized.

should go or by directing that executions be given to whoever will pro-

vide the cheapest executions. The latter, while a well-meaning attempt to save money, commonly results in forcing upon a money manager someone that provides poorer executions or no research input of real value. This handicap costs the portfolio money as it pays 1/3, 1/4, or 1/2

Meddling corporate sponsors usually think they are saving money.

never be able to buy the "best market brains" at the cheapest price.

State and Educational Funds Could Do Better

could be improved. Some employ fairly deficient methods of stock selection. Once these so-so investment decisions are made, the decision makers tend to ride through the years with losing investments.
Taxpayers normally have to ante up when these funds have mediocre performance. In some cases, states might be better off turning their investment portfolio over to several professional money managers rather than having it run by state employees.

Is an Index Fund the Way to Go?

One last thought about the indexing of equity portfolios. A key fallacy

For example, if we were to go through another 1929, and the general market indexes were to decline 90% in value, no intelligent trustee
of its value. Positively no one would be happy just because they achieved their target of matching the market indexes’ disastrous performance.
I actually saw a version of this happen in 1974. I was called in to evaluate a fund that lost exactly 50% of its assets because it was managed by an organization that specialized in and promoted index funds. The
rendous losses, but of course this sort of bad performance by an index fund was hushed up and never allowed to be publicized in the press. It was an embarrassment to the company.

index they were supposed to match. Once this occurred, the master planners went back to the drawing board and came up with new versions of indexing which injected more human judgment into formulas. This human analysis and personal analytical opinion contradicted the

average or mediocre job, any more than the majority of musicians, ball

fields might be a slightly subpar performer.
The answer in money management is the same as in other occupations—to get above-average results, you have to go out of your way to find

securities successfully because all information is already known and

Value Line’s rating system since 1965 is ample evidence that stocks can be selected which materially outperform the market. Our top
ages over the 30 years from 1964 through 1993.
Professor Marc Reinganum of the University of Iowa, during a University of Chicago sabbatical produced an independent research study entitled “Selecting Superior Securities.” He selected nine variables compa-
result 36.7 percentage points greater than the S&P 500.
The stock market is neither efficient nor a random walk simply
because there are too many poorly conceived opinions, too many incorrect interpretations, and too many emotions such as pride, doubt, fear,ous complex variables, and fast-changing events which analysts do not properly weight even when they possess all relevant information, which is the exception rather than the rule. And finally, there are just too
many poor fundamental and technical research reports always recom-
dations are few and far between at the beginning of each bear market

fund.

about this retailer that illustrates how large older companies react to managed companies react.
The head of investments for this large retailer was visiting with me in Los Angeles. I took him out to Colton, California and showed him the first Price Club warehouse store that had just opened in the Los

He replied that it looked a little like one of their warehouses in Chicago. At a later board meeting, I’m told he presented the idea to top management and was laughed out of the place.

Saul Price and went through one of their stores. That night when he returned to Bentonville, Arkansas, his architects were up all night draw-

I know we were pleased with Price Co. since we discovered it early on and held their stock for 3½ years while it was performing well during the early 1980s. Institutional investors might do well to emphasize
20

18 Common Mistakes Most Investors Make

"The way to succeed is to build up your weaknesses until they become
embarrassing results is because they simply make too many mistakes.

Over a period of 35 years, I have dealt with or known thousands of
individual risk takers, all the way from green beginners and amateurs to
the most knowledgeable and successful professionals. Following are the
mistakes I have noticed made most frequently by individual investors

1. Most investors never get past the starting gate because they do not use good selection criteria. They do not know what to look for to
find a successful stock. Therefore, they buy fourth-rate "nothing-to-
write-home-about" stocks that are riot acting particularly well in the

2. A good way to ensure miserable results is to buy on the way down
than it was a few months earlier. For example, an acquaintance of mine
down in price sharply and seemed a great bargain. This was his first
near its low for the year. As it turned out, the company was in serious

3. An even worse habit is to average down in your buying, rather
than up. If you buy a stock at $40 and then buy more at $30 and average
out your cost at $35, you are following up your losers and mistakes by

4. Too many investors don't pay attention to price-earnings ratios. Dividends are not as important as earnings per share; in fact the more a company pays in dividends, the weaker the
replenish internally needed funds that were paid out in the form of div-

5. First-time speculators want to make a killing in the market. They
want too much, too fast, without doing the necessary study and prepara-

6. Mainstream America delights in buying on tips, rumors, stories,
and advisory service recommendations. In other words, they are willing

putting good money after bad. This amateur strategy can produce seri-

higher-priced, sounder companies. You must think in terms of the num-
ber of dollars you are investing, not the number of shares you can buy.
By the best merchandise available, not the poorest. The appeal of a $2,

anything else. You can't buy the best quality at the cheapest price!
It usually costs more in commissions and markups to buy low-priced
faster than most higher-priced stocks. Professionals and institutions will
not normally buy the $5 and $10 stocks, so you have a much poorer-

5. First-time speculators want to make a killing in the market. They
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and advisory service recommendations. In other words, they are willing

price-earnings ratios. Dividends are not as important as earnings per share; in fact the more a company pays in dividends, the weaker the
replenish internally needed funds that were paid out in the form of div-

8. People buy company names they are familiar with, names they
know. Just because you used to work for General Motors doesn't make
General Motors necessarily a good stock to buy. Many of the best invest-

9. Most investors are not able to find good information and advice. average friend, stockbroker, or advisory service could be a source of losing advice. It is always the exceedingly small minority of your friends, brokers, or advisory services that are successful enough in the market themselves to merit your consideration. Outstanding stockbrokers or advisory services are no more frequent than are outstanding doctors, sign professional contracts ever make it to the big leagues. And, of course, the majority of ball players that graduate from college are not even good enough to sign a professional contract.

10. Over 98% of the masses are afraid to buy a stock that is beginning to go into new high ground, price wise. It just seems too high to them. Personal feelings and opinions are far less accurate than markets. losses when the losses are small and reasonable. They could get out cheaply, but being emotionally involved and human, they keep waiting and hoping until their loss gets much bigger and costs them dearly.

12. In a similar vein, investors cash in small, easy-to-take profits and hold their losers. This tactic is exactly the opposite of correct invest-

sions. Your key objective should be to first make a net profit. Excessive worrying about taxes usually leads to unsound investments in the hope of achieving a tax shelter. At other times in the past, investors lost a good profit by holding on too long, trying to get a long-term capital gain. Some investors, even erroneously, convince themselves they can't concentrate entirely in shorter-term, lower-priced options that involve price period works against short-term option holders. Many options speculators also write what is referred to as "naked options," which are nothing but taking a great risk for a potentially small reward and, therefore, a relatively unsound investment procedure.

15. Novice investors like to put price limits on their buy-and-sell orders. They rarely place market orders. This procedure is poor because the investor is quibbling for eightths and quarters of a point, rather than emphasizing the more important and larger overall move-

market and not getting out of stocks that should be sold to avoid sub-

stantial losses.

16. Some investors have trouble making decisions to buy or sell. In other words, they vacillate and can't make up their minds. They are unsure because they really don't know what they are doing. They do not have a plan, a set of principles, or rules, to guide them and, therefore, are uncertain of what they should be doing.

opinions rather than paying attention to the opinion of the market-

place, which is more frequently right.

If you hunger to become a winning investor, read the above items

How many of the habits mentioned above describe your investment

Poor principles and poor methods will yield poor results. Sound principles and sound methods will, in time, create sound results.

give up. Great opportunities occur every year in America. Get yourself
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