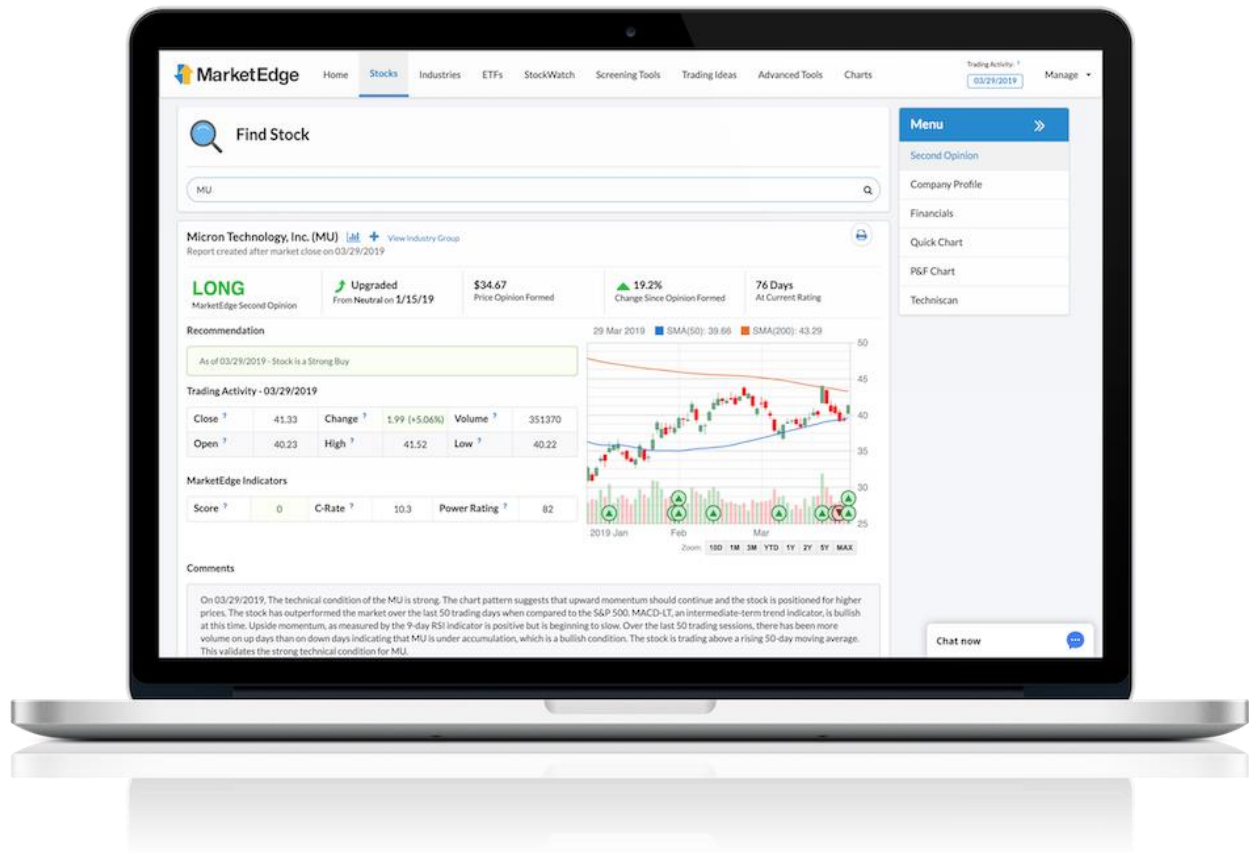


The MarketEdge Way

Level the Playing Field with the Big Boys on Wall Street



By Tom Ventresca – Founder Computrade Systems Inc. / MarketEdge

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Introduction

Investing in the stock market can be an intimidating experience for the individual investor when you consider that you are a small fish in an ocean dominated by whales. The institutions are armed with the latest and greatest computer wizardry. They are on top of the game and can move in an instant, leaving people like us in the dust. But, this doesn't have to be the case anymore. The information age is upon us. Institutional research, which was once reserved for only the elite Wall Street money managers, is now available to individual investors for pennies a day.

Now, the problem is what to do with all of the available information. Contrary to what you may believe, successful investing in the stock market does not require a great deal of time or tons of market information. What is needed is an understanding of what makes the market tick, a consistent, disciplined approach and proper money management. 'The MarketEdge Way' details a comprehensive approach to investing in the stock market that covers these basics by utilizing the computer power contained in MarketEdge.

There are many approaches to investing in the stock market. Most will produce decent results, simply because the stock market is a favorable game. Unfortunately, most investors approach the market without any idea of how it works, a lousy game plan and no idea of what money management is all about. As a result, their returns are far from what they expect.

The flamboyant Joe Granville often said that, "The stock market is like a Shakespearian Play. The play is always the same, but the actors are different." He was right on. The market is a big time 'play,' and it usually operates in the same manner. What is different are the 'actors,' which are the outside influences that have dramatic effects on stock prices. Here is what usually happens. At market bottoms, the majority of investors run for the hills, convinced that the world is ending once again. Conversely, at major tops, the greed factor takes over and investors can't get enough of it, rationalizing that stock prices are going to the moon. In both situations, the results are usually the same. Stocks rally big time off of bear market bottoms when everything looks horrible, and they fall off bull market tops when everything is rosy. In both instances, most individuals are left out to dry and can't figure out what happened. Well, it doesn't have to be like that anymore.

Introducing 'MarketEdge' - a dynamite website that takes the output from very sophisticated computer applications and reduces it into *finished, stock market research* that anyone can use. For the most part, the investment approach described in 'The MarketEdge Way' is probably contrarian to what you have come to believe. Therefore, it will probably take some time for you to become familiar with the methodology and develop the confidence needed to put it to work in real-time situations. The good news is that MarketEdge does most of the work for you. There is no need to spend hours studying complicated strategies, etc. The market is not going to go away any time soon, and since it doesn't matter whether it is going up or down, you have plenty of time to become comfortable with this approach. In most cases, you should be ready to roll in less than thirty-days.

1. The MarketEdge Approach

There are two basic approaches to the stock market. The most common is called fundamental analysis, which deals with a company's earnings expectations, their management, product life and other economic considerations. The second is called technical analysis, which is one of the most misunderstood applications on the planet. Technical analysis deals with price trends, chart formations and an array of supply/demand indicators to forecast a stock's future direction.

Odds are your stock market experience has been confined to some form of fundamental analysis since, on the surface, it seems to make a lot of sense. A company makes a lot of money therefore its stock should go up- right? Wrong! The fact of life is that the only factor that causes a stock price to go up is if the buyers are willing to pay higher prices for a stock than the sellers are willing to accept, i.e. demand outstrips supply. Granted, when good things are happening to a company, an imbalance of buyers vs. sellers will develop, which

usually causes the stock price to appreciate. The problem is that what is happening inside a company today is usually inconsequential. What is important is the public's perception of what will be happening six-months from now. In most cases, it is unusual for the public to know this information. It is for this reason why a rigid fundamental approach is flawed.

In practically every market scenario, there is **smart money** and the **general public** which influence the price of a stock by their buying and selling activities. The smart, or informed, money crowd has a good idea of what will occur in the future and express their convictions through their trading activities. It is this activity that causes a stock to go up or down. Therefore, by monitoring trading activity, one can detect what the smart money is doing and act accordingly. This is the basis of technical analysis. The technician's tools of the trade are charts and various indicators that interpret price and volume characteristics. Technical analysis works simply because it is impossible to conceal trading activity since all trades are reported to the exchanges and are available for all to examine.

Technical analysis has long been viewed by most Wall Street guys as some sort of voodoo - mumbo jumbo that had little if any predictive power and was not to be trusted. Brokerage firms have traditionally proclaimed their research expertise in deploying fundamental analysis to uncover tomorrow's big movers. Nothing could be further from the truth. The fact is that technical analysis is a superior form of analysis that you can trust and with the right tools, it is not too difficult to understand.

Think of it in these terms. Imagine that you are playing blackjack in a casino. Skilled blackjack players have the ability to count the cards that are dealt and determine when the deck is favorable to the player, i.e. an abnormal number of 10's and face cards remain in the deck. When this occurs, they bet more money in anticipation of the dealer, who has to hit on 16 or lower, dealing himself a 10 and busting out. Imagine that you are in a game and the count is very favorable, meaning that there are twenty cards remaining in the deck of which sixteen are 10's, there are no aces and the dealer has 15. You would bet the ranch in anticipation of the dealer, who has to hit his hand busting out. Now at the same time, news comes across the ticker tape that the Federal Reserve Board has raised interest rates, Iran has bombed Iraq and unemployment has shot up during the previous month. Would you change your betting strategy? Of course not. It doesn't have anything to do with the game you are playing.

The same is true in the stock market, and it is the hardest thing for investors to understand. The stock market is a barometer, not a thermometer. A barometer measures barometric pressure that changes prior to changes in temperature while a thermometer measures the current temperature. The stock market measures economic conditions six to nine months in the future. It is not a gauge of what is happening now but of what will likely occur in the future. The only way for an investor to anticipate what will happen to a company's stock in the future is to know what the smart money crowd is doing today.

Let's say your neighbor is the president of XYZ corporation and he tells you that XYZ has made a major oil find that won't be disclosed until further testing is done to determine the richness of the find. Would you wait six months before you bought the stock? Of course not. You would start buying today in anticipation of the news. Depending on how many people had knowledge of the find, the stock's price would begin moving up as demand outpaced supply. The company's fundamentals would not appear to have changed, but the technician would recognize that something good was about to happen.

Another dilemma is that the majority of individual investors lack a sound strategy when it comes to the stock selection process. Everyone is looking for the next home run, which typically leads them to small stocks that have a great story, are heavily promoted, but in reality, have a 100-1 shot of ever fulfilling the promise. Traders that look to short stocks are typically drawn to the high-flyers that are making new highs every day, assuming that they will have to fall back to earth one of these days. Both of these mind sets will usually lead to lousy results. It is important to understand that making money in the market is largely dependent on not losing money. If you lose 40% on a stock, you have to make 67% on the next one just to get even. Dropping 40% in a bear market is easy. Making 67% in any market environment is unusual.

'The MarketEdge Way' utilizes computer generated, technical analysis to formulate a disciplined, consistent approach to investing in the stock market. This manual breaks down the process into four segments: 1) Market Timing 2) Stock Selection 3) Portfolio Management and 4) The Rest of the Stuff. Each of these topics are described in full. The Rest of the Stuff section covers chart formations, reliable technical indicators, short-term trading systems and a description of classic market situations that will keep you ahead of the crowd. The best part is that MarketEdge provides ***finished technical research***, meaning that all of the work is done for you. While all of this may sound to be complicated at first take, with a little bit of effort you should be up and running in a relatively short period of time.

Quick Start

Before you get bogged down with all of the features of MarketEdge, do yourself a favor and get acquainted with the two primary modules, ***Second Opinion*** and ***StockWatch***. There are two videos in the Help Section that walk you through these core components so that you can be operating in no time. Click on the Manage button in the upper right-hand corner of the Home Page and then on Help Center, followed by Video Tutorials. While you're there, go ahead and check out the MarketEdge Overview video. Sit back and take it all in. You will be glad you did.

Section I: Market Timing

Timing is everything. This is especially true when investing in the stock market. While the market can experience periods of extreme volatility, the reality is that around 70% of the time it remains in a trading range. It is the 30% of the time that the market experiences significant moves, whether up or down, where opportunity lies.

Identifying the market's intermediate-term trend is first and foremost to any investment approach. The stock market is like the ocean. When the tide comes in, most of the boats will rise with the tide. Such is the case with the stock market. When the market is in an uptrend, a large majority of stocks will follow the trend and move higher. Stronger stocks will obviously outperform the weaker ones, but even the dogs will usually go up. Conversely, when the market heads south, few are spared the ensuing carnage with the fundamentally weak stocks seeing the brunt of the damage. If you don't believe me, check out the number of advancing issues versus declining issues on the NYSE over a thirty-day period when the market, as measured by Dow Jones Industrial Average (DJIA) experiences either a 10% up or down move. What you will typically see is a large majority of the issues performing in line with the DJIA.

2. Market Timing Models

If one can accurately time the major moves in the market, most of the battle is over. Not only would bad stock selections be buffeted from major declines but by simply avoiding bear markets, long-term performance would be greatly enhanced. Add to this the capability to play the market on the short side during bear phases, and the game gets even better.

Most will tell you that it is impossible to accurately time the market. Surprise! It just isn't true. Granted, it is tough to forecast every blip, but it is not impossible to identify when the market is either favorable or to be avoided and to identify when the prevalent trend is changing. MarketEdge combines the output from three, market timing models into 'The Market Posture'. These models include the Cyclical Trend Index, the Momentum Index and the Sentiment Index. These models generate an intermediate-term forecast for the market, as measured by the DJIA on a weekly basis. This forecast has consistently projected the intermediate-term direction of the market with better than 70% accuracy.

The Cyclical Trend Index (CTI)

The Cyclical Trend Index (CTI) is the cornerstone of the MarketEdge market timing model. The underlying principle of the CTI is that the market, as measured by the Dow Jones Industrial Average (DJIA), tends to move in cycles that often resemble sine waves, a basic cycle which determines much of the motion in the universe. The utilization of sine waves in market forecasting is based on studies that demonstrate that stocks, and in particular the DJIA, tend to experience price reversals at anticipated time intervals. These intervals, referred to as cycles, consist of the price movement of the DJIA from a significant low to an identifiable high, followed by a retreat to a recognizable low over a predetermined time frame. There are five identifiable cycles, each with different time durations at work in the market at all times. Cyclical analysis systematically determines the beginning and ending points of these cycles, so as to accurately time purchases and sales for maximum profit.

To picture how these cycles influence price direction, visualize the stock market as a piece of elastic that is constantly subjected to positive or negative forces exerting pressure in either the same or opposite direction. These forces are the five cycles that are incorporated in the CTI. The cycles vary in duration with the shortest being only 6 weeks and the longest lasting 4 to 4 ½ years, which coincides with a typical business cycle. The following table categorizes each cycle by the average time duration that it experiences from a significant low to a high and back to either a higher low or new, lower low.

CYCLE	AVERAGE TIME DURATION
A	6 weeks (+or-) 1 week
B	18 weeks (+or-) 2 weeks
C	36 weeks (+or-) 4 weeks
D	72 weeks (+or-) 7 weeks
E	216 weeks (+or-) 20 weeks

Theoretically, each of the above cycles exerts upward pressure at the beginning of its time frame and continues to do so until it is one-half completed. At this point, the process is reversed, resulting in negative pressures being applied to the DJIA. Life would be simple if only one of these cycles were factored into the equation. However, when dealing with five cycles, the picture can become confusing. For example, two of the cycles may be pointing up while one is flat and the remaining two are pointing down- suggesting a market influx. Maybe yes, maybe no!

In order to get a complete picture of the cyclical status of the market, the positive and negative forces need to be combined into a single indicator that has predictive value. To accomplish this goal, each of the cycles is assigned a numerical value based on the amount of time that has lapsed since its previous, cyclical low. Values are positive in the early stages of the designated time frame and begin to decline as time goes on, becoming negative toward the end of the period. The shorter cycles receive higher values since they are more dominant. The total of these values is called the CTI, and it is a very powerful tool in forecasting the intermediate term direction of the DJIA. CTI readings of +1 and higher indicate a bullish trend in the market, whereas a 0 to a negative 15 value signals a downward, bearish scenario.

The chart below shows the DJIA over a one-year period. Four of the cycles (B, C, D & E) are plotted on the chart. Cycle A is not included because of its short length (6 +or- 1 week). As can be seen from the graph below, all of the cycles bottomed the week ending 3/14, signaling the end of a bear market. Cycle B (18 +or- 2 weeks) bottomed on 08/15 and again on 11/28. Cycle C (36 +or- 4 weeks) bottomed in harmony with Cycle B on 11/28. Neither Cycle D (72 +or- 7 weeks) nor Cycle E (216 +or- 20 weeks) posted a new bottom over this period.



There is one problem that crops up when determining the starting point for each of the cycles. The rule is that when the count for a cycle nears the end of its pre-determined time period, the DJIA must post a higher intra-week low when compared to the previous week's low. This will cause a reset of that particular cycle's count to week #1. The problem arises when during the week following a reset a lower intra-week low occurs which aborts the reset and can have a negative effect on the CTI.

Compounding the problem is the fact that the cycles are harmonic, meaning that they exist within each other. For example, within Cycle E (216 weeks) there are three Cycle D's (72 weeks), six Cycle C's (36 weeks), twelve Cycle B's (18 weeks) and thirty-six Cycle A's (6 weeks). Cycle D encompasses two Cycle C's, four Cycle B's and so on. Since the CTI is the total of the various cycle's values, an aborted reset can change the CTI. Fortunately, this only occurs once a year when Cycle A, B and C are simultaneously reset, once every 1½ years when Cycle A, B, C & D are reset and once every 4 to 4 1/2 years when all of the cycles are reset.

The CTI is a unique market timing tool in that it is a trend forecaster, not a trend following indicator, such as moving average crosses or MACD. Assuming that the projected starting points for the various counts are correct, an extended forecast can be made with a high degree of certainty. Such a forecast is made every week and is presented in 'The Market Letter,' which is located on the Home page. The forecast projects periods of strength and weakness for the DJIA based on the projected CTI readings.

The Momentum Index

The Momentum Index is designed to measure market divergence by comparing the performance of nine, broad market indexes to that of the Dow Jones Industrial Average (DJIA). Divergence is a technician's term that describes whether the DJIA is performing better or worse than the majority of the broader, market indexes. Whenever the DJIA goes its own way or diverges from these indexes, whether up or down for a period of time, a market turn is usually at hand. Typically, negative divergence, DJIA is up while broader indexes are trending lower exists at significant market tops, while positive divergence, DJIA is down while broader indexes are trending up occurs at major market bottoms. In order to spot market divergences, the following indexes are followed on a daily basis:

Dow Jones Industrial Average (DJIA)
Dow Jones Transportation Index (DJTA)
S&P 500 (S&P)
NYSE Advances & Declines (A/D)
NYSE New Highs & New Lows (H/L)

NASDAQ Composite (NASDAQ)
Dow Jones Utilities Index (DJUI)
New York Stock Exchange Index (NYSE)
NYSE Advance & Decline Line (A/D Line)
American Stock Exchange (AMEX) or the Russell 2000

The Momentum Index is updated every week and is located in the 'Market Letter' on the left side of the Home page. It is a numerical value that can range from -10 to +10. When new highs are being recorded by a majority of the market indexes and the DJIA is not, positive (bullish) divergence exists, and the Momentum Index will be +4 or higher- which is regarded as bullish. A bearish momentum setup would occur if the opposite scenario existed, i.e. the DJIA records a series of new highs while the majority of the other indexes do not- creating a negative (bearish) scenario and a Momentum Index of -4 or lower. When the DJIA makes a new high and the **majority** of the other market indexes are doing the same, the DJIA's move is said to be confirmed. Conversely, a new DJIA low which is accompanied by diverse moves from the **majority** of the other indexes is referred to as a non-confirmed move.

Typically, you will see a series of confirmed highs (bullish) or lows (bearish) over an extended period of time that can last for several months. When this occurs, the Momentum Index is telling you that the market is in a long-term bullish or bearish configuration. When divergences do occur, the Momentum Index is sending a signal that a change in the prevailing trend is in the making.

Why does the Momentum Index have predictive value? The Dow Jones Industrial Average (DJIA) is a weighted average of thirty blue-chip stocks. It is the most widely followed equity index in the world and has over the decades become the standard measurement of the health of the U.S. equities markets. Since the DJIA only contains thirty stocks, its performance can mask the underlying strength or weakness of the market as a whole. Look at it this way. The market tends to act much like the weather in that trends develop and tend to remain intact until they change.

The market is either in an uptrend, a downtrend or a consolidation phase. Similarly, the weather is either warming (uptrend), cooling (downtrend) or stuck in a holding pattern (consolidation). Weather trends change very slowly, creating the four seasons. Likewise, changes in major market trends occur over an extended period of time. Seldom is it the case that the DJIA turns on a dime and reverses its prior trend. Usually what happens is that during a bull phase, the DJIA makes a series of new highs, corrects and then continues on its merry way, posting another series of new highs. Throughout most of the move, **demand** (money) exceeds **supply** (stock). At some point, the scenario reverses with **supply** (stock) out-stripping **demand** (money) and the trend reverses as a bear phase takes hold.

During a bull to bear transition, the DJIA remains robust giving the appearance that the market is healthy, and the trend is intact. However, underneath the hood, the broader based indexes are beginning to deteriorate. The phrase "when the generals walk alone" describes this negative divergence as the Dow's generals march to new highs while the broader market indexes begin to falter. Of particular importance at this juncture, is the action of the NYSE Advance/Decline Line and the number of NYSE New Highs/Lows. If the DJIA is making new highs while the A/D Line is declining, the number of NYSE New Highs is shrinking and the number of New Lows is increasing, you are witnessing the setup for a significant reversal of the market's trend. Conversely, at major market bottoms, the broader based indexes will begin to show signs of improvement long before the beaten down DJIA perks up. Again, improving action of the A/D Line and the number of NYSE New Highs/Lows are significant tell-tale indicators at this crossroad.

The Sentiment Index

Bull markets climb a wall of worry. They start when things look terrible. Usually the market has been in a long down trend, economic conditions are horrible, and the public could care less about the stock market. Conversely, bear markets typically start when things look great. The market has been in an extended uptrend, economic conditions are great, and the public can't get enough of Wall Street.

The Sentiment Index measures the market's bullish or bearish sentiment and is an important tool when determining the market's future direction. The following is a description of the indicators that are included in the Sentiment Index, which is updated on a weekly basis, and is posted in 'The Market Letter.'

- 1) Fear-Greed Index (5 Day Avg): Measures prevalent fear or greed in the marketplace. Excessive fear

(readings below 25) is bullish for stocks while too much greed (readings above 75) is a bearish condition. The index is composed of seven indicators which are tracked on a daily basis. Indicators include stock price momentum, the number of NYSE new 52-week highs and lows, market breadth, the put/call ratio, the spread between yields on investment grade bonds and junk bonds, VIX and the difference in returns for stocks versus treasuries. The Fear-Greed Index is a 5-day moving average of the daily total.

- 2) Shares Sold Short NYSE- Monthly: The number of shares sold short on the NYSE. Increasing amounts are regarded as Bullish while declining totals are Bearish.
- 3) NYSE Short Interest Ratio: The number of shares sold short on the NYSE divided by the average monthly trading volume: 3.5 to 9.0 is Bullish, 3.0 to 3.5 is Neutral and 0 to 3.0 is Bearish.
- 4) Shares Sold Short NASDAQ – Monthly: The number of shares sold short on the NASDAQ. Increasing amounts are regarded as Bullish while declining totals are Bearish.
- 5) NASDAQ Short Interest Ratio: The number of shares sold short on the NYSE divided by the average monthly trading volume: 3.5 to 9.0 is Bullish, 3.0 to 3.5 is Neutral and 0 to 3.0 is Bearish.
- 6) AAIL Bull-Bear Ratio: The AAIL Bull-Bear Ratio is a sentiment indicator created using the American Association of Individual Investors (AAIL) sentiment survey. Every week, the (AAIL) asks its members about their view on the direction of the stock market in the near term. Using the percentage of members who are bullish and the percentage of members who are bearish, this sentiment indicator tells us whether the general market sentiment is overly optimistic or pessimistic. A high AAIL Bull-Bear Ratio number indicates that there are more bullish than bearish traders, while a low AAIL Bull-Bear Ratio number indicates that there are more bearish than bullish traders. The ratio can be used as a contrarian indicator, which means that a high or low number is a sign that a market turn is near, and that stock market direction is likely to change or reverse in the coming days.
- 7) Put/Call Ratio (5 Day Avg.- All Equity Options): A five-day moving average of the number of CBOE Index put options divided by the number of index call options: 70% and higher is Bullish, 41% to 69% is Neutral and 0% to 40% is Bearish.
- 8) NAAIM Exposure Index: The NAAIM Exposure Index represents the average exposure to U.S. Equity markets reported by their members. As a contrarian indicator, when active investment managers are overly exposed and leveraged in equities, it's a bearish condition. Likewise, leveraged short positions would be regarded as bullish.
- 9) Bullish Investment Advisors: The percentage of newsletter writers who are Bullish on the prospects for the market as measured by Investors Intelligence: 0% to 35% is Bullish, 36% to 54% is Neutral 55% to 99% is Bearish.
- 10) Bearish Investment Advisors: The percentage of newsletter writers who are Bearish on the prospects for the market as measured by Investors Intelligence. 50% to 99% is Bullish, 21% to 49% is Neutral, and 0% to 25% is Bearish.
- 11) Bullish/Bearish Investment Advisor Ratio: The bull/bear ratio indicates overall investor sentiment in the market by comparing the number of bullish and bearish investor. This market indicator is calculated and published weekly by the Investors Intelligence Sentiment Survey. The ratio is a contrarian indicator, interpreted as follows: a high bull/bear ratio (greater than 3) indicates that there are too many bulls in the market, and you should take a bearish stance; a low bull/bear ratio (less than 1) indicates that there are too many bears in the market, and you should take a bullish stance.
- 12) VIX (CBOE Volatility Index): A measurement of the premiums of index puts and calls. Range can vary from 0 to 100. Readings under 20 are regarded as bearish as option premiums shrink and as

complacency takes over the market. Readings over 30 are bullish, reflecting an increase in put option premiums as an aurora of fear permeates the landscape.

Strength Indexes

The Strength Indexes measure accumulation and distribution in the stocks that make up the three major market indexes: The DJIA, NASDAQ and the S&P 500. The values represent the percentage of the stocks in each index that are under accumulation based on the MarketEdge proprietary Up/Down Volume indicator. Values over 50.0 are regarded as Positive while less than 50.0 is Negative.

	<u>Current Reading</u>	<u>Prior Week</u>	<u>Connotation</u>
Strength Index - DJIA (DIA):	72.4	65.5	Positive
Strength Index - NASDAQ 100 (QQQ):	57.1	55.1	Positive
Strength Index - S&P 100 (OEX):	69.5	57.9	Positive

The Market Posture

The Market Posture sums up the status of all three of the market timing models into an intermediate-term forecast for the market, as measured by the DJIA. The beauty of the market timing models is that, for the most part, they are computer generated based on conditions and indicators that historically have had significance in forecasting the market's direction. Again, think of it as a similar exercise which is used by your friendly weatherman who interprets the output from several computer models and comes up with a forecast. It's the same deal.

The Market Posture is either Bullish, Bearish or when things get whacked out, it can be Neutral. There will be times when there are conflicting signals from either the Momentum or Sentiment Indexes. Seldom is the case when **all** of the indicators will be in sync, i.e. all bullish or bearish. The fact is that most technical indicators are not very reliable on their own. However, when the **majority** are either bullish or bearish, the odds are good that the forecast will be accurate. The Market Posture is not designed to catch every wiggle in the market but rather to determine when conditions are either favorable (Bullish) or unfavorable (Bearish). Typically, the Market Posture will change three to four times a year, and it has a good record of getting it right with about 70% accuracy since 1978.

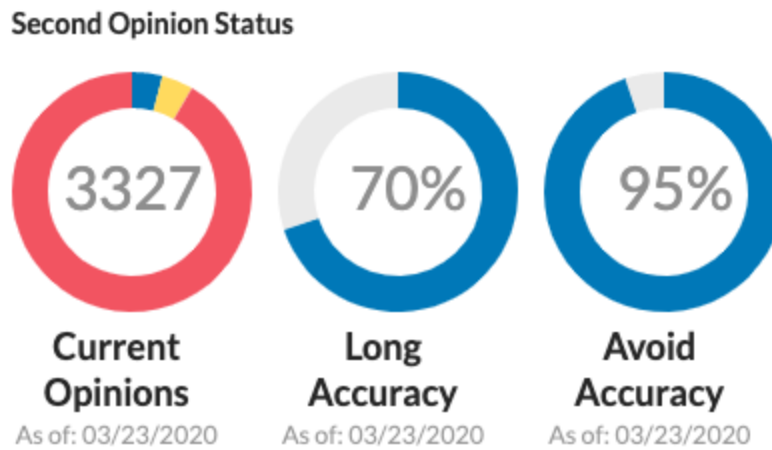
3. Additional Short-Term Market Timing Tools

The S&P Oscillator

The S&P Short-Range Oscillator is a market measure which takes a number of related variables of trading data into account, tracks development according to several moving averages, and results in an average numeric value which may be either positive or negative. Historically, the expression of this result has been viewed as symbolic of the condition of the market. An Oscillator value of 50% is considered "par." When the Oscillator reaches a value of "+4%" (meaning 4% above par, or 54%), the market is technically said to be in an "overbought" position. Markets in this standing may be considered as being poised for a downward correction. By contrast, Oscillator values falling to levels below 50% may be indicative of a trend in the opposite direction. An Oscillator value reaching "-4%" (meaning 4% below par, or 46%) is a technical indication of an "oversold" market, which may set the stage for a rally.

The MarketEdge 'Market Barometer'

The daily percentage of stocks that has a MarketEdge 'Long Opinion' is a number that is published every day on the Second Opinion status page along with the number of upgrades and downgrades. You can find the details on the Status page that is linked from the Second Opinion Status summary on the Home page.



Each day, we check the percentage of stocks in each category, and over time when we see the LONG ratio increase, we know that the market is getting stronger. When the ratio decreases, we know that the market is getting weaker. The trend of the number over time is what matters as an indicator, as the static number on any given day does not tell you very much.

For example, if 50% of the ratings of MarketEdge stocks are LONG, does that indicate the market is strong or weak? You cannot know. But, if it is 50% today and last week it was 40%, the market is getting stronger because 10% more stocks are rated LONG. If the number is 50% and last week it was 60%, the market is getting weaker.

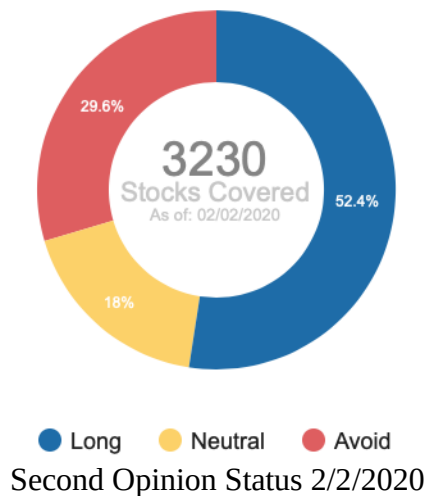
The MarketEdge Second Opinion rating uses technical analysis to figure out what the Smart Money is doing with each individual stock that we follow. The Second Opinion rating does not care what the guests on CNBC are saying about the stock or the latest analyst write up in Barron's or what the experts on Wall Street are publishing for next quarter's earnings estimates. It only cares about how people are actually trading the stock.

The theory behind using this statistic is that you can see which way the overall market is headed because we calculate LONG, NEUTRAL and AVOID opinions for all 3200+ stocks in our universe each day. If, over time, the number of LONG ratings is going down, then the market is weakening. If it is going up, then the market is getting stronger.

Because we are doing detailed technical analysis on each of the of the individual stocks we follow and not simply looking at an analysis of the market as a single entity (just the DJIA or S&P 500), you will be getting a better indication to the true well-being of the market. The strength of each of the individual stocks is what provides the strength of the overall market. The market as a whole can seem strong, but if a majority the individual stocks are showing signs of weakness, then the market is not nearly as strong as it appears.

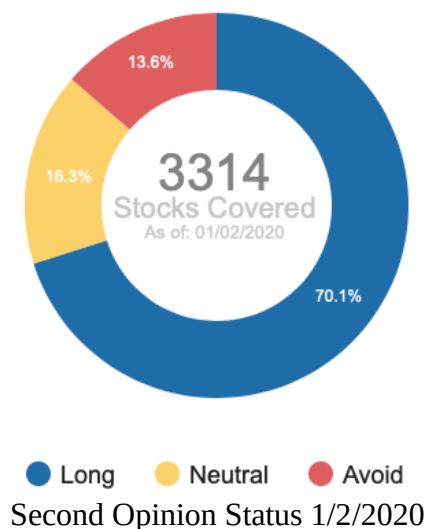
The Market Barometer in Action

Let's look at how this worked during the first three months of 2020. On 02/02/20, there were 3230 stocks in the MarketEdge Universe. Of those, 52.4% had a LONG Rating.



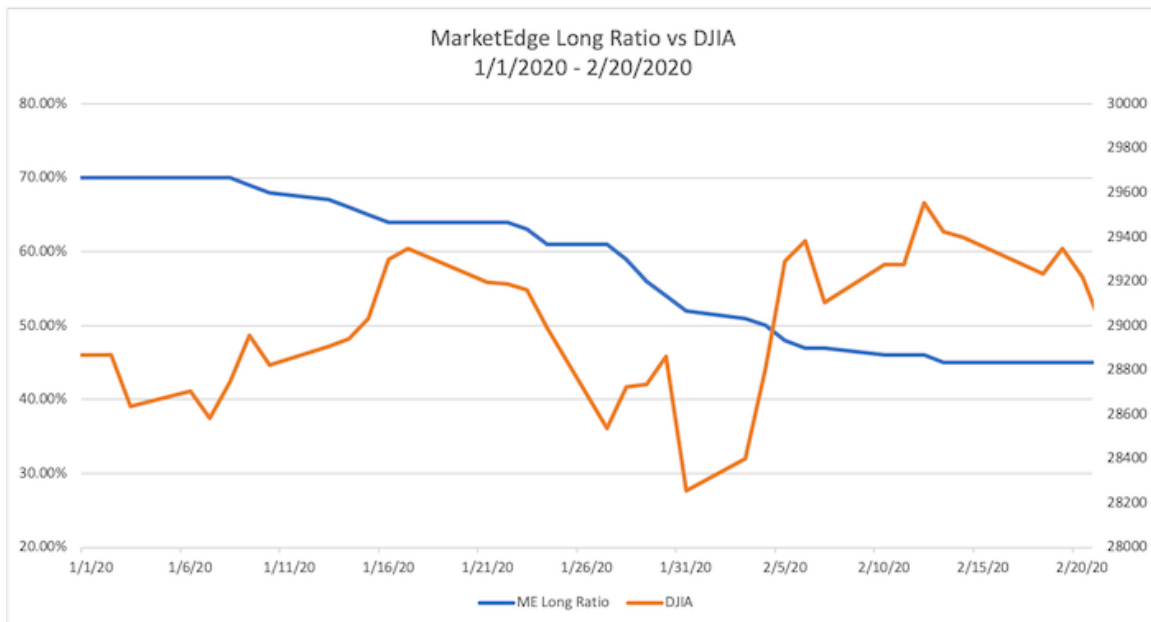
That number in and of itself would seem to indicate a decent market, after all, we are talking about a period of record highs for many stocks, the DJIA and the S&P 500. Additionally, every place you turned, the experts were talking about the strong economy and the general feeling was that everything was great. What could possibly go wrong?

But remember, we need to look at this number over time so we will go back thirty-days to 01/02/20 to see what was happening. On 01/02/20, the LONG ratio was 70.1%.



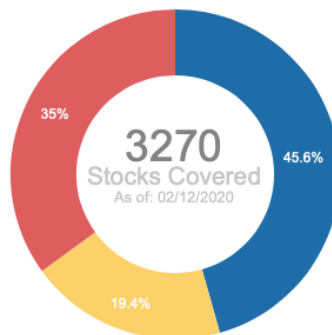
Wait a minute. That 52.4% on Feb 2 looks pretty BAD now. That is an **18% drop** in just thirty-days. If you were to look at each day over the period from January 2nd to February 2nd you would see that there were more downgrades than upgrades. Even though the market was making record highs, the MarketEdge Long Ratio was steadily eroding, indicating that something was happening underneath what appeared to be a very strong market.

So, what have we got going on here? First of all, MarketEdge downgraded over **600** stocks during that period- indicating a strong negative rotation. If you had these stocks in your Stock Watch List, you would have received email notices each night when they were downgraded and probably looked at them kind of funny because the experts were saying you should buy this pull back. After all, we were poised for Dow 30,000.



MarketEdge Long Ratio and the DJIA Jan 1, 2020- Feb 20, 2020

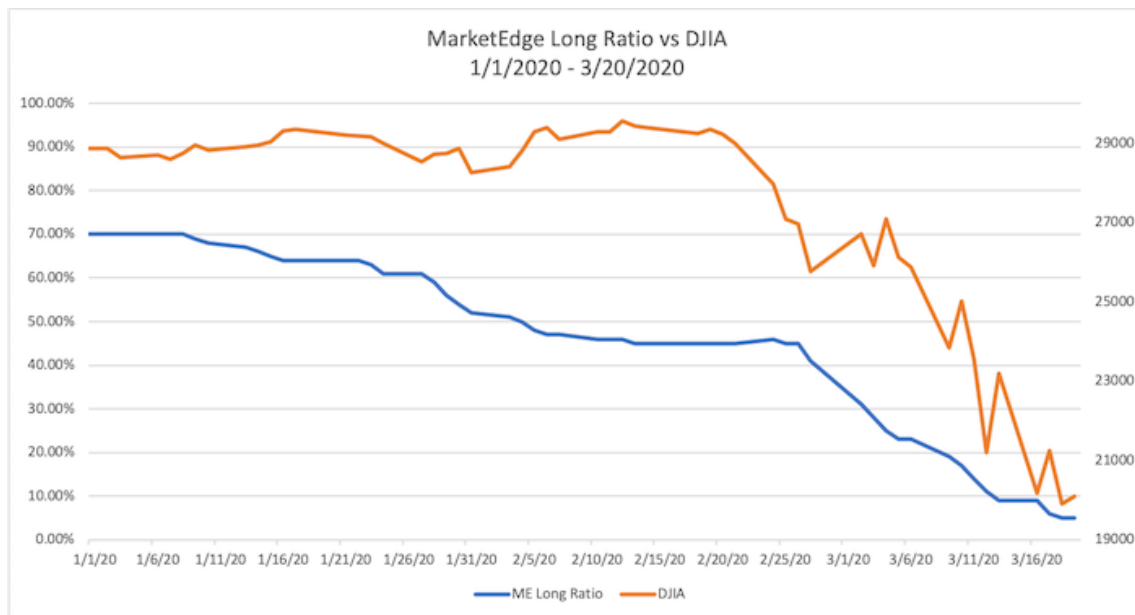
But, the Second Opinion report does not watch CNBC or “*feel*” that a company is doing great. It looks at the hard data of how the stock is trading each and every day and from that data, MarketEdge could see that the Smart Money was quietly heading for the exits. ***Not on a few stocks but on over 600 of them.***



● Long ● Neutral ● Avoid

Second Opinion Status – Feb 12, 2020

On 02/02/20, the market was again at all-time highs, but the ratio had dropped from 52.5% to 45.6%. The market was doing extremely well, but the MarketEdge Long Ratio was still falling. It should have been pretty obvious that something was very wrong with those record highs. Over the course of the next four weeks, the ratio sharply decreased, including through the bounce at the beginning of March. During that bounce, there were many very smart people encouraging you to jump into the market, buy the dip and grab some bargains, but the MarketEdge Ratio was telling you that the Smart Money was still running for the exits. The Ratio continued to drop by huge percentages each day. By 03/06/20, there were only 22.5% of the stocks in the universe with a Long Opinion and that continued to fall to below 5% on 3/20/20. What a ride!



Second Opinion Status – March 22, 2020

The S&P Oscillator and the MarketEdge Barometer are located on the right side of the Home page, along with the other Market Timing Models, Status Report, Market Recap, Market at a Glance, Industry Groups and Your Upgrades and Downgrades. What a design.

Market Recap

Market Recap is an across-the-board view of the market in action. It contains sixteen daily charts and graphs of the major market indexes and technical indicators. The result is a complete picture of the market and its components in motion that can be a valuable tool in determining the future direction of the DJIA. The Market Recap is located on the right-hand side of the Home page. To view the charts, click on 'Market at a Glance' located at the bottom of the Recap section.

The following is a list of the indexes and indicators that are included in the Market Recap section.

Dow Jones Industrial Average (DJIA)	Russell 2000
Dow Jones Transportation Index (DJTA)	U.S. Equity Mutual Fund Cash Inflows
Dow Jones Utilities	CBOE, Index Put/Call Ratio
NASDAQ New High/Low Line	NYSE Advance & Decline Line
NASDAQ Composite (NASDAQ)	CBOE Volatility Index (VIX)
NASDAQ Advance/Decline Line	Margin Debt
S&P 500 (SP-500)	% Bullish Investment Advisors
NYSE New High/New Low Line	% Bearish Investment Advisors

All of the components listed above are included in either the Momentum or Sentiment Indexes and are used in conjunction with the Cyclical Trend Index (CTI) to form the Market Posture.

Comparing the charts of the major market indexes (DJTA, SP-500, NYSE, NASDAQ, Russell 2000) to the chart of the DJIA provides confirmation or non-confirmation of a DJIA move, whether up or down. A confirmed move by the DJIA would result in similar looking charts of the majority of the other indexes. Conversely, a non-confirmed move by the DJIA would show a lack of participation by the other averages. When the Dow 'Walks Alone', meaning that the bluest of blue-chip stocks are making new highs while the broader based indexes are not, a major reversal is usually in the cards. On the other hand, when the DJIA records a series of new lows, which aren't accompanied by similar movement of the broader indexes, a reversal to the upside is imminent. Typically, the market will experience a series of confirmed highs or lows over an extended period of time. When this occurs, the market is telling you that it is in either a long-term

bullish or bearish trend. When non-confirmed moves begin to develop, the market is sending a signal that a change in the prevailing trend is in the making.

In addition to the market averages, there are eight technical and breadth indicators plotted for similar analysis. The breadth indicators include the NYSE and NASDAQ Advance/Decline Lines and the NYSE and NASDAQ High/Low Lines. Breadth indicators measure the broadness of the market's participation in either an up or down move. Both of these indicators are constructed in the same manner. The A/D Line is a running total of the number of advancing issues minus the number of declining issues. The High/Low Line is a cumulative total of the number of stocks making new 52-week highs less those making new 52-week lows.

When analyzing breadth indicators, once again it is all about positive and negative divergence. Negative divergence occurs when the DJIA is performing worse than the breadth indicators. This is easy to spot on the charts, as the DJIA would be trending up while the breadth indicators are turning down. This typically occurs at significant market tops. Positive divergence is the opposite situation. The DJIA is in a downtrend while the breadth indicators begin to turn up. This situation usually occurs at major market bottoms. The remaining four indicators measure the market's sentiment. These are contrarian indicators, meaning what appears to be positive is actually negative for the market.

The sentiment indicators include CBOE - VIX, the Put/Call Ratio, % Bullish - Bearish Investment Advisors, U.S. Equity Mutual Fund Cash Flows and the Dollar Amount of Margin Debt. The theory behind sentiment indicators is simple. When market participants become either extremely bullish or bearish, the odds are that the market will go in the opposite direction. If the majority of traders are bullish, theoretically they have expressed their opinion by putting all of their money to work in the market thus leaving little cash available to fuel the fire. Conversely, when sentiment is very negative, traders have liquidated their positions, which eliminates the supply of stock for sale. This lack of potential selling pressure coupled with a build-up of cash creates a perfect scenario for a significant rally to develop.

The majority of the time, these sentiment indicators are flashing neutral readings. However, when market sentiment swings dramatically to either the bullish or bearish camp, these indicators will signal that a market reversal is at hand. Each indicator has a range of values, which are listed below along with the extreme bullish and bearish levels for each indicator.

1) **CBOE Volatility Index (VIX):** A measurement of the premiums of index puts and calls. Range can vary from 0 to 100. Readings under 20 are regarded as bearish as option premiums shrink and as complacency takes over the market. Readings over 30 are bullish, reflecting an increase in put option premiums as an aura of fear permeates the landscape.

2) **Index Put/Call Ratio:** A five-day average ratio of the number of the Index put options divided by the number of call options traded on a daily basis. The range for this ratio typically varies from .70 to 2.50. Readings over 1.70 are regarded as bullish; reflecting a very high number of puts being purchased versus calls. Less than 1.00 is bearish since it indicates that either an equal amount of puts and calls are being bought or more calls than puts are being purchased.

3) **Percentage of Bullish & Bearish Investment Advisors:** on a weekly basis, Investors Intelligence, Inc. reports the percentage of newsletter writers who are bullish, bearish or see a correction for the market over the intermediate term time frame. Typically, the percentage of advisors with a bullish outlook ranges from 30% to 70%. Readings under 40% are regarded as bullish while those over 55% are bearish. Readings for the Percentage of Bearish Advisors are less than 21% is bearish while greater than 50% is bullish.

4) **U.S. Equity Mutual Fund Cash:** Money makes the market 'go round and round.' Monitoring the amount of cash that is either coming in or going out of U.S. equity funds is a good measurement of investor's sentiment. When outflows approach record levels, a market bottom is in the offing. Conversely, when money is pouring into equity funds for a sustained period, a major top is imminent.

5) **The Dollar Amount of Margin Debt:** Rising amounts of margin debt is considered to be bearish while low levels are bullish.

Tech Talk Tuesday

Every Tuesday we publish an informative thirty-minute video on MarketEdge and the market by one of MarketEdge's technical analysts. Topics vary each week but usually include the status of the market based on the Market Timing Models as well as segments on how to use a specific feature of MarketEdge and answers to questions sent in by subscribers. Check out the video each week and you can review past videos in the archive.

4.The Market Letter & Daily Market Comment

While all of this sounds good, you have to be wondering how you are going to stay on top of it all. Not to worry. It is all done for you. Every week after the market closes, the 'Market Letter' is posted on the site, and it is also e-mailed to you. It contains the status of the three market timing models, the Strength Indexes, and last week's performance of the DJIA, the S&P 500 and the NASDAQ Composite. In addition, there is a weekly review of the market, a ranking of Industry Groups and ETF's, plus important 'Numbers to Watch' for the upcoming week.

<u>Market Timing Models</u>	<u>Current Reading</u>	<u>Prior Week</u>	<u>Connotation</u>
Cyclical Trend Index (CTI):	3	3	Positive
Momentum Index:	2	0	Neutral
Sentiment Index:	4	6	Positive
Strength Index - DJIA (DIA):	72.4	65.5	Positive
Strength Index - NASDAQ 100 (QQQ):	53.1	55.1	Positive
Strength Index - S&P 100 (OEX):	69.5	57.9	Positive
Dow Jones Industrial Average (DJIA):	24242.49	23719.37	2.2%
S&P 500 Index:	2874.56	2789.82	3.0%
NASDAQ Composite Index:	8650.14	8153.58	6.1%

Daily Market Comment

Every night after the close, the day's trading activity is reviewed and published in the 'Daily Market Comment.' Unlike most market commentary, the Daily Comment contains valuable market statistics and technical information, which can be a precursor to upcoming market action. Like the example below, the Daily Market Comment is located on the Home page.

[Daily Market Comment](#)

[Stocks Rebound on Stable Oil Pricing](#)

[Wednesday, April 22nd, 2020, 5:59 pm](#)

[Global stock markets posted strong rebounds today as crude oil prices stabilized. US equities got an extra boost from the Senate passing a \\$484 billion spending package to help small businesses...](#)

That's all there is to it. But wait, it gets even better. Everything described above is displayed on the MarketEdge Home page along with up-to-date market statistics, a current Status Report and the Market Recap (Market at a Glance). Lastly, the Upgrades and Downgrades are listed for the stocks that you have in your Watch Lists. Is that slick or what?

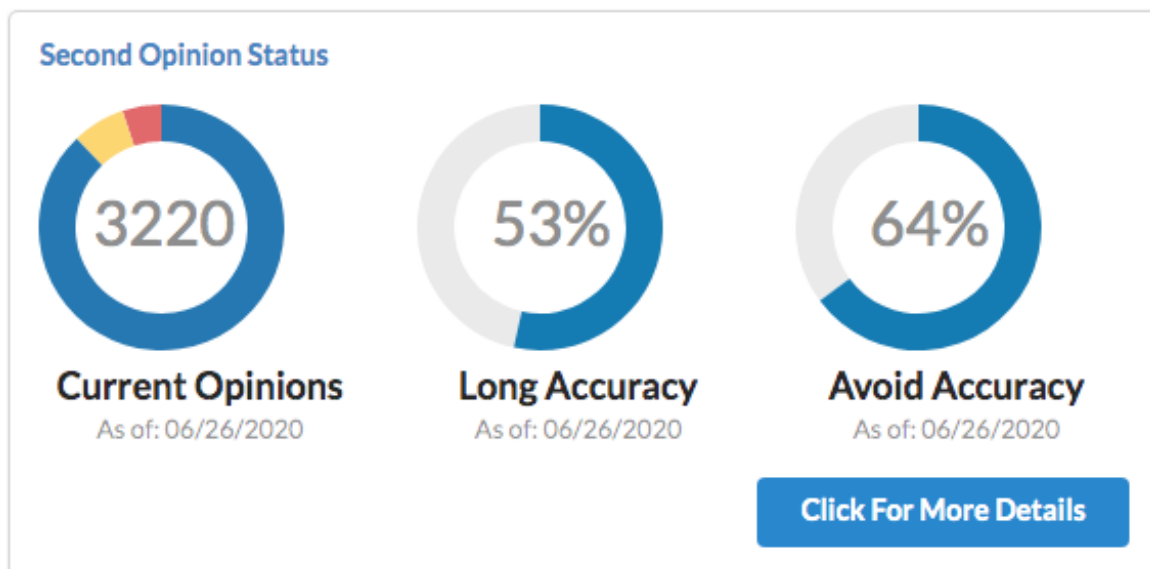
Section II: Stock Analysis

5. The Second Opinion Report

The most important part of investing in stocks is to know **when** to buy, not **what** to buy and more important, **when** to sell. Enter the Second Opinion Report, which is the core of the MarketEdge web site.

Second Opinion is a computer-generated report, which list the technical status of thirty-seven technical indicators and studies along with their Bullish (BL) or Bearish (BR) connotations. In addition, current and historical prices for the stocks are listed along with the MarketEdge 'Opinion'. Opinions are either Long (Buy) Neutral (Hold) or Avoid (Sell or Sell Short). These Opinions have an historical average record of forecasting price direction with around 70% accuracy with the winners outperforming the losers by a 3:1 ratio. A sample Status Report created on 06/29/20 which details the Opinion's performance follows:

Second Opinion Performance ?



As can be seen from the report, of the 3,220 stocks in the MarketEdge universe, 2,829 had a Long Opinion while 166 were rated as an Avoid. Of the 2,829 stocks with a Long Opinion, 1,505 (53%) were up in price (Winners) since the upgrade to Long. Of the 166 stocks with an Avoid Opinion, 107 (64%) were down in price (Winners) since the downgrade to Avoid.

An example of the Second Opinion report can be seen below of Tesla, Inc. (TSLA).



LONG

MarketEdge Second Opinion

 **Upgraded**
From Neutral on 5/28/20

\$820.23
Price At Upgrade

 **17.0%**
Change Since Upgrade

32 Days
At Current Rating

Recommendation

As of 06/26/2020 - Stock shows Mildly Deteriorating Conditions. SCORE = -1
If you are Long, hold current position. Do not initiate new position.
Stock is Not a Short Sale Candidate.

Trading Activity - 06/26/2020

Close ?	959.74	Change ?	-26.24 (-2.66%)	Volume ?	83609
Open ?	994.55	High ?	995.00	Low ?	954.87

MarketEdge Indicators

Score ?	-1	C-Rate ?	13.6	Power Rating ?	71
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Comments

On 06/26/2020, The current technical condition for TSLA is strong and the chart pattern suggests that upward momentum should continue. The stock has outperformed the market over the last 50 trading days when compared to the S&P 500. MACD-LT, an intermediate-term trend indicator, is bullish at this time. Chart formation indicates a strong rising trend. Upside momentum, as measured by the 9-day RSI indicator is beginning to show signs of strength. Over the last 50 trading sessions, there has been more volume on down days than on up days indicating that TSLA is under distribution, which is a bearish condition. The stock is trading above a rising 50-day moving average. This validates the strong technical condition for TSLA. The stock is above its 200-day moving average which is pointed up indicating that the intermediate term trend is bullish.

26 Jun 2020  SMA(50): 851.95  SMA(200): 557.69



Price Analysis

Yr. High ?	1027.48
Yr. Low ?	211.00
MO Chg.(%) ?	14.9
Trend Line Resistance ?	0.00
Trend Line Support ?	0.00
Resistance Range ?	995.00-1012.00
Support Range ?	937.15-954.87
Sell Stop ?	899.54
Volatility(%) ?	4.1
Position ?	61
ADX ?	29

Volume Analysis

Avg Volume(00) ?	112426
MO Chg.(%) ?	-16.4
U/D Ratio ?	1.0
U/D Slope ?	Down
On Balance Volume ?	Bearish
Positive OBV ?	Bullish
Negative OBV ?	Bullish
Money Flow (MF) ?	58
MF Slope ?	Bearish

Technical Analysis

Alpha ?	0.66
Beta ?	1.10
MACD ST ?	Bearish
MACD LT ?	Bullish
STO(Fast %K) ?	30
STO(Slow %K) ?	36
50-Day R.S. ?	1.20
Wilder's RSI ?	39
OBOS ?	1
B.Bands ?	16
RSV ?	99

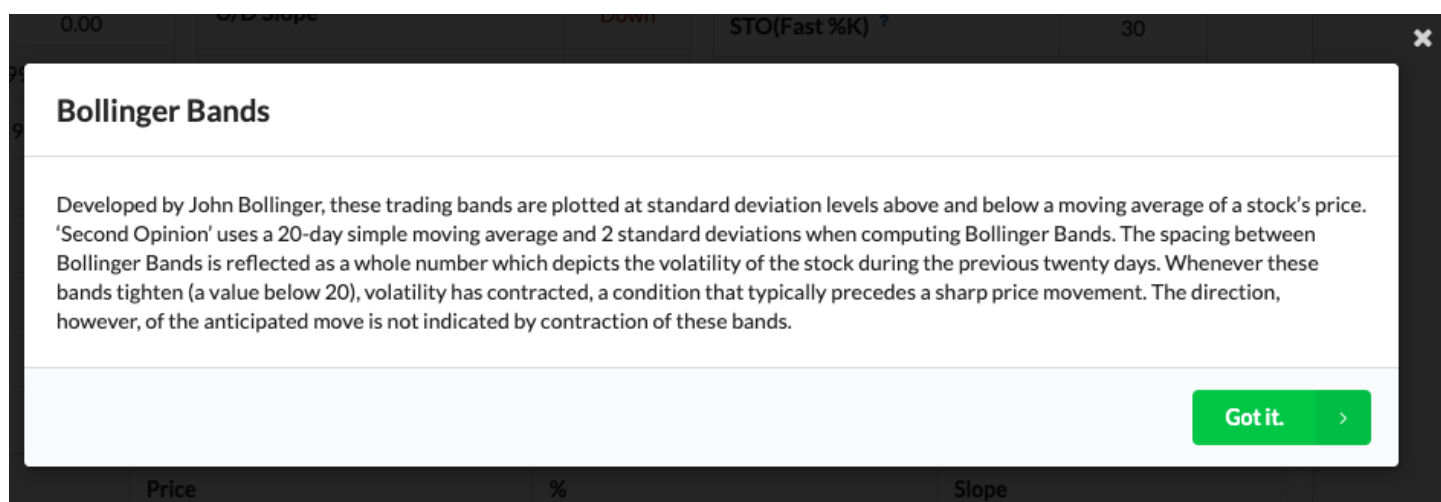
Moving Average

MA	Price	%	Slope
10 Day	987.23	97.00	UP
21 Day	949.70	101.00	UP
50 Day	851.95	113.00	UP
200 Day	556.85	172.00	UP

As can be seen from the report, the Opinion for Tesla was upgraded from Neutral to Long on 05/28/20 when the stock closed at \$820.23. Since the upgrade, the stock gained 17%. Next is the Daily Recommendation, followed by the prior day's trading activity and several MarketEdge indicators. The proprietary MarketEdge indicators are the Score, C-Rate and Power Rating, which are the most important numbers on the report.

The Score ranges from 0 to -4 for stocks with a Long or Neutral from Long Opinion and denote the degree of any technical deterioration in the stock. For stocks with an Avoid or Neutral from Avoid Opinion, the Score will range from 0 to +4 indicating the extent of technical improvement. The C-Rate is a percentage projection of future price. The Power Rating is the deal. It is a compilation of the numerical values assigned to several technical indicators and studies. The Power Rating can range from -70 to +90. When the Power Rating crosses above +59, a Long Opinion is generated. Conversely, when it declines below -27, an Avoid Opinion is created. Neutral Opinions are formed when it crosses above or below 0. Lastly is the Comment, which is a daily, computer generated report that analysis all of the pertinent indicators and studies on the Second Opinion report and produces a comprehensive description of the technical condition of the stock.

The Second Opinion report also contains the status of over thirty technical indicators and studies. As with everything on the MarketEdge site, you don't have to know anything about these indicators since they are listed along with either a Bullish (BL) or Bearish (BR) connotation. To retrieve a description of any of the indicators, go to the Glossary section of the Help Center by clicking "Manage" at the upper right-hand side of the page. Each definition can also be accessed by simply clicking on the small, "question mark" symbol next to each indicator on the Second Opinion report, as seen below for Bollinger Bands.

A screenshot of a tooltip window titled "Bollinger Bands" with a close button (X) in the top right corner. The text inside the tooltip explains that Bollinger Bands are trading bands plotted at standard deviation levels above and below a moving average. It specifies that 'Second Opinion' uses a 20-day simple moving average and 2 standard deviations. It also notes that the spacing between the bands is reflected as a whole number depicting volatility, and that tightening bands (value below 20) typically precede a sharp price movement. At the bottom right of the tooltip is a green button labeled "Got it" with a right-pointing arrow. The background of the screenshot shows a dark interface with some text like "STO(Fast %K)" and "30" visible.

There you have it. Second Opinion is like having your very own technical analyst by your side providing complete, unbiased, consistent analysis for over 3,000 stocks on a daily basis.

6. Determining Price Projections and Protective Stops

When investing in the stock market, there are times when you should be long, times when you should be short and times when you should 'go fishing'. In Chapter 2, the market timing models were introduced that identify favorable or unfavorable market conditions. But, that is only half the problem. You still have to figure out which stocks you either want to buy or sell short.

When selecting stocks, you want to determine if the potential is there for good price movement. If price potential anticipated to be limited, you are staring at a lousy risk-reward ratio. The MarketEdge Confidence Rating (C-Rate) helps solve this problem. In addition, there are several techniques listed below which can help you determine both short and intermediate term price projections for individual stocks.

Moving Averages: One of the most reliable price projection techniques is obtained by analyzing the ten-week simple moving average (SMA) of the closing prices of a particular stock. When the moving average turns up, note the closing price of the stock. Now count back five weeks and note the closing price. Take the difference between the two closes and add it to the most recent close. The total, +/- 10% of the difference is the preliminary target which should be achieved over the next five-six weeks.



To illustrate how this works, refer to the weekly chart for Apple Computer (AAPL) located above. A ten-week simple moving average has been overlaid on the chart. Apple put in a double bottom in late June 2013 and began to move higher. On 08/02/13, its ten-week moving average turned up when the stock closed at \$66.14. To determine the intermediate term target, count back five weeks to 06/28/13 and note the close for that week (\$56.70). Subtract \$56.70 from \$66.14 (\$9.44) and add the difference to \$66.14. The result is a price projection of \$75.58, +/- 10% (\$0.94 points) or \$74.64 - \$76.52 over the next five-six weeks. As it turned out, AAPL traded above the high end of the range the week ending 11/1/13 (\$77.11). Note that the rally did not end once the target was achieved. AAPL continued upward and topped out on 12/06/13 at \$82.25. This will occur on many occasions and shouldn't be of concern. The initial projection was based on a five to six-week time frame. In this example, it

took almost twelve weeks to hit the high end of the projected range.

Reverse the process when looking to short a stock or index. When the simple moving average turns down, note the closing price for the stock. Count back five weeks and note the closing price. Take the difference between the two closes, +/- 10%, and subtract it from the most recent close. That is your preliminary target that should be achieved over the next five-six weeks.

Computing targets in this manner gives you another tool when narrowing your stock selections. Using the ten-week moving average is measuring the stock's short-term momentum. A large projected gain simply means that the stock has been experiencing a powerful move over the past five weeks, a move that is likely to continue. When selecting stocks, you obviously would rather buy one that has a 25% price potential versus one with only a 5% projection. It should be noted that the price target generated via this technique is only the initial forecast. It is not to be construed as the ultimate top in the stock's move.

So, when should you sell? The answer is whenever you want to. Sound strategies include selling when the stock reaches its target, if the stock falls below the protective stop, or when your stomach can't handle it anymore. Whatever you do, once you're gone don't go back. When you decided to get into the stock, conditions were favorable. When you sell, conditions have changed. The only time that you should reenter the stock is after a correction of some sort and favorable conditions are once again prevalent. It is important not to get emotional about a stock. This is 'strictly business'. Never look back is usually good advice, and never get married to a stock.

Head and Shoulder Formations: Although seldom seen, Head & Shoulder formations are very powerful chart patterns that can signal major structural changes in the trend of a stock or index. The significance of a Head & Shoulder formation is when there is penetration of the neckline. Once this occurs, a drop in price is usually in the cards. To determine the first price objective, measure the distance from the center of the head to the neckline and subtract it from the neckline value located at the center of the head. This will give you the first price projection. Usually this level will be achieved rather quickly with more downside to follow.

The chart for Twitter (TWTR) located below shows a Head & Shoulder pattern which was formed from August 2019 through mid-December 2019. The neckline, which connects the bottom of the left and right shoulders, was around \$39. The head was formed on 09/09/19 when the stock topped \$46. The difference between the neckline and the head of the formation was six points. Subtracting six from the neckline produced a price projection of \$34 which was achieved on 10/24/19. This same technique works when a Reverse Head & Shoulder formation develops. Simply reverse the procedure to determine the preliminary price projection to the upside.



The 50% Principle: When a stock or index declines for a period of time and then begins to rally, note the number of points that the stock has lost from its previous peak to the most recent bottom. If the stock rallies back more than 50% of the previous decline, the odds are good that it will recover the entire loss. The faster the 50% retracement occurs, the higher the probabilities are that a complete retracement will occur.

American Airlines (AA) experienced a 50% retracement over the June – October 2014 time frame. As can be seen from the chart below, the stock got slammed from \$44.88 to \$28.10, a 16.75-point loss, over a four-week period beginning in late June 2014. Then, the stock began to rally. The 50% principle was activated as the stock crossed \$36.50 on 10/21/14 pointing to a complete retracement of the previous decline. By mid-November, the entire loss was recovered as AA traded through the \$45 area.



Extended Chart Base Formations: Often, a stock will sell off and the price will remain depressed for an extended period of time. At some point, one of two scenarios is likely to develop. Usually, the fundamental reason behind the sell-off gets resolved, and the stock, after having traded in a narrow range for a long period, will begin to recover. When the stock breaks out of the basing pattern, measure with a ruler the distance on the chart from the beginning of the base to the spot where the stock broke out of the basing pattern. Place the ruler on a forty-five-degree angle with the left edge of the ruler at the breakout point in the center of the trading range. Where the right edge of the ruler lays on the chart is the price projection for the stock.

The DJ Utility Index (DJUI) remained in a narrow trading range from July 2013 until February 2014 between 471 and 510. The index broke out of the trading range in mid-February. As can be seen from the chart below, the forty-five degree line at the time of the breakout forecasted a move to the 565 area by September 2014. The DJUI surpassed 565 in late June, corrected and then rallied back to the target area in mid-September 2014, right on schedule.



Placing Protective Stops: By developing a systematic, disciplined approach to investing in the market, you will greatly reduce the probability of losing money. One of the most important tools in your arsenal should be the use of properly placed Stop loss orders. Selling a stock at a loss is probably the hardest thing for an investor to stomach. Understand that a loss is a loss whether you realize it or not. When the ship is sinking, don't pray – jump! Turning a small loss into a large loss is the worst thing that you can do. Not only will it hinder your overall performance, it will wear on your confidence. By using Stop loss orders, you will be forced to do the right thing at the right time. Accept the fact that if a Stop loss order is properly placed, a penetration of that price point is telling you that a significant support or resistance (short sales) area has been broken and the odds favor a reversal of the trend.

As long positions are opened, you should immediately enter GTC (Good to Cancel), Sell Stop orders. The best way to determine your Stop loss levels is derived from a form of analysis called 'Cyclical Analysis'. This is how it works. Locate the most recent identifiable, cyclical low prior to when the position is opened and deduct 1/2 of a point from that low. That is your original Stop price. The Stop should remain unchanged if the price of the stock moves adversely from its opening price. The Stop should change if the price of the stock moves favorably in which case it would be adjusted up with the stock. The following chart for Big Lots shows proper adjusted Sell Stops as the stock moves up in price.



The opposite is true for short sales. Locate the most recent cyclical high prior to when the short is opened and add 1/2 of a point to that high to produce a protective Buy Stop. The Stop should remain unchanged if the price of the stock moves adversely from its opening price. The Stop should be adjusted downward if the price of the stock moves favorably. The following chart below shows proper downward adjusted Buy Stops for Blackrock Energy (BGR) as it moved down in price from \$21.50 in late April 2015 to below \$14.00 in August 2015.



7. Power House Chart Formations

The bar chart is the most common type of a chart associated with stocks. A bar chart consists of a series of Open, High, Low and Close prices plotted on a series of vertical lines with ticks to the right and left representing the open and closing prices. There are several formations that you need to be aware of because they can be very reliable in predicting future price direction.

Head and Shoulder Formation: As noted in Chapter 6, a head and shoulder pattern is a very strong trend reversal formation. The pattern consists of a left shoulder, the head and the right shoulder. Typically, the stock will rally to a peak (left shoulder), correct and then rally to a higher peak (head), correct and rally again to a lower peak than the head and often lower than the left shoulder (right shoulder). When this pattern develops, the chartist draws a line known as the 'neckline' which connects the valleys or bottoms created during the correction phases of the left shoulder and the head. If the right shoulder corrects and penetrates the neckline to the downside, a trend reversal is highly probable. If the neckline is not penetrated, a significant price rise is very likely. To determine the first price objective, measure the distance from the center of the head to the neckline and subtract it from the neckline value at the center of the head. This will give you the initial price projection. Usually once this level is reached, more downside will follow, as shown below.



Reverse Head and Shoulder Formation: A reverse head and shoulder pattern usually occurs at significant bottoms and as is the case outlined above, it is a very strong, trend reversal formation. The pattern consists of a left shoulder, the head and the right shoulder. Typically, the stock will decline to a low (left shoulder), rally and then decline to a lower low (head), rally and decline again to a higher low than the head and often higher than the left shoulder (right shoulder). When this pattern develops, the chartist draws the neckline which connects the peaks or highs created during the rally phases of the left shoulder and the head. If the right shoulder rallies and penetrates the neckline to the upside, a trend reversal is highly probable. If the neckline is not penetrated, a significant price decline is very likely. To determine the first price objective, measure the distance from the center of the head to the neckline and subtract it from the neckline value at the center of the head. This will give you the first price projection. The chart below shows the penetration of the neckline on 12/16/14 when Central Garden & Pet (CENTA) traded above \$8.50. The difference between the head of the formation (\$6.95) and the neckline (\$8.80) is 1.85 points which when added to the value of the neckline produces a price target around \$10.65 which was reached on 01/13/15.



Cup and Handle Formation: A cup and handle is a classic bullish formation that occurs when there has been a significant price decline followed by a long, base building period in which there is little price movement. This base building phase is followed by a sharp price rise, a small correction and then another price rise. The Buy signal is given after the correction and the breakout of the previous rally. The chart below is an example of a Cup & Handle formation.



Pennant Formations: Pennant formations are very common and can be either bullish or bearish depending on how the formation is formed. A pennant, or triangle, resembles a flag with the pole being on the left side of the formation created by either a sharp rise in the stock's price or a big decline. The flag or pennant is formed as the

stock trades in an increasingly narrow range. The longer that the flag process takes, the larger the ensuing move will usually be.

Typically, the stock will come out of the flag formation in the same direction that it came in. If a pennant is formed after a sharp rise, the odds favor a resumption of the advance once the stock breaks out to the upside. Conversely, a pennant formation formed after a sharp decline will usually see lower prices once the flag is broken to the downside.

The reason for this phenomenon is simple. Whatever caused the sharp rise or decline creating the "pole" was due to some change in the company's fundamentals such as an earnings surprise or an unexpected news release. The flag is formed as the event is disseminated and new opinions are formed. Usually, whatever caused the spike (pole) is resolved in favor of the event and price continues in the same direction. However, sometimes the opposite occurs, as can be seen in the example below.



Up and Down Price Gap Formations: An Up Price Gap occurs when a stock's opening price is higher than the previous day's high. In order for an Up Gap to occur, an abnormal influx of buy orders exceeding the available number of shares for sale must occur as demand exceeds supply, a bullish condition. A Down Gap (bearish) occurs when the stock's opening price is lower than the previous day's low. In order for a Down Gap to occur, an abnormal influx of sell orders exceeding the available number of shares to be bought must exist- indicating that supply exceeds demand, a bearish condition. The chart below shows the Up Gap for Disney (DIS) on 04/11/19.



The chart below shows the Down Gap for the NASDAQ.



Point & Figure Chart Formations

Point & Figure charting dates back to the inception of modern market analysis and is unique in that it is only concerned with price movement. The significance of Point & Figure patterns lies in identifying price trends and reversals. The user unfamiliar with Point and Figure Charting techniques is referred to the Chartcraft publication, *Three Point Reversal Method of Point and Figure Stock Trading*, published by Chartcraft, Inc., Larchmont, N.Y.

Typically Point & Figure charts are constructed using boxes that represent a stock's price movement either up (X's) and down (O's). A box size equals 3% of the closing price of the stock. For a reversal to occur, a 3-point move in the opposite direction is necessary. Therefore, a stock that closes at 100 would require a 3-point move to earn either an X or an O designation. Stocks that close at 20 need only a 1/2 point move on a daily basis to generate either an X or O entry. So that there is a time reference on the chart, X's and O's are replaced by numbers and letters that represent the months of the year. Number 1-9 indicate January (1) through September (9). The letters A, B & C are inserted for October, November and December. The most popular and profitable Point & Figure chart formations are the Double, Triple and Quadruple Top and Bottom formations.

Double Top/Bottom Formations

Double Top Formation: The most recent column is an X. This X column exceeds the previous O column.

Double Bottom Formation: The most recent column is an O. This O column exceeds the previous X column.

Point & Figure Chart - (GPC) Double Top Formation-Bullish



Point & Figure Chart - (CYH) Double Bottom Formation-Bearish



Triple Top/Bottom Formations

Triple Top Formation: The most recent column is an X. This X column exceeds the previous O column and the other two previous X columns.

Triple Bottom Formation: The most recent column is an O. This O column exceeds the previous X column and other two previous O columns.

Point & Figure Chart - Triple Top Formation-Bullish



Point & Figure Chart - Triple Bottom Formation-Bearish



Quadruple Top/Bottom Formations

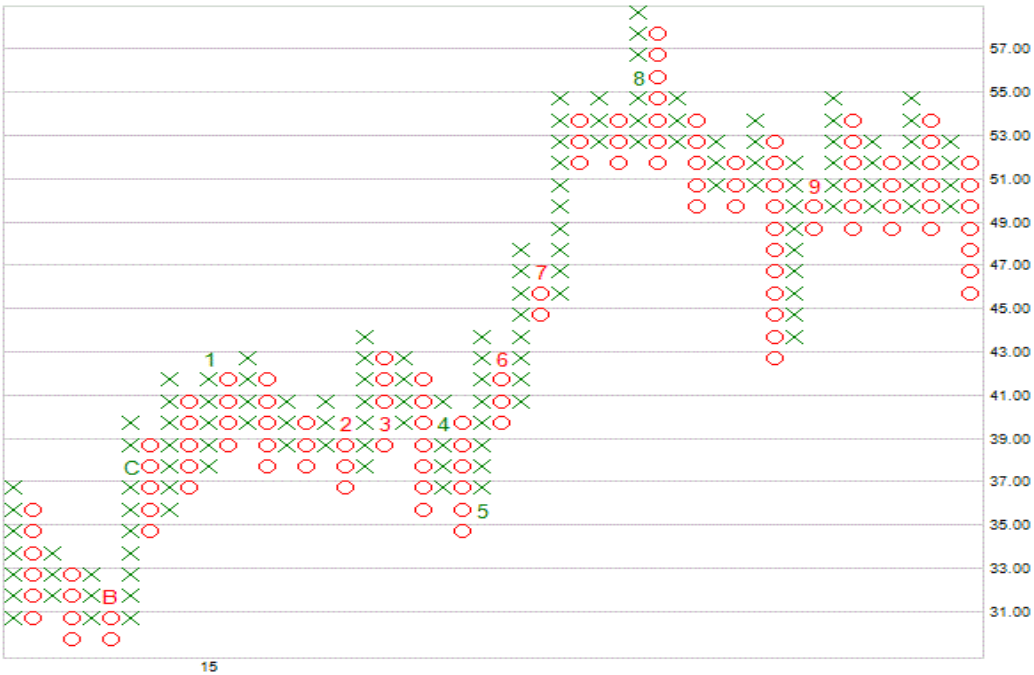
Quadruple Top Formation: The most recent column is an X. This X column exceeds the previous O column and the other three previous X columns.

Quadruple Bottom Formation: The most recent column is an O. This O column exceeds the previous O column and the other three previous O columns.

Point & Figure Chart - Quadruple Top Formation-Bullish



Point & Figure Chart - Quadruple Bottom Formation-Bearish



Section III: Portfolio Management

8. Stock Watch

The Stock Watch module is designed to handle an important part of the investing process, portfolio management. Just like a successful thoroughbred horse trainer, you need to create a *stable* of stocks that you follow on a regular basis. In Stock Watch, you can create up to fifty lists of stocks with a maximum of two hundred stocks in each list. In addition, you can customize your reports to include up to fifty of your favorite technical indicators and studies which will automatically be updated on a daily basis. To see how to create a list, go to Stock Watch, click on the Manage button in the upper right-hand corner of the page and then on Manage Reports. Click on Video Tutorials and then on the Stock Watch video.

Your *stable* of stocks should include liquid stocks with average daily volume, of at least 200,000 shares per day, in the \$10 - \$200 price range and preferably have listed options. The liquidity requirements assure that you will be able to get in and out of positions without getting killed by slippage. Stocks that trade 200,000 or more shares per day typically trade in narrow spreads and can absorb your buy or sell orders without disturbing the market. Stocks that have listed options are preferred since in some instances, you will want to write (sell) options against your existing positions or use them to hedge your positions.

Creating Your Lists

You will want to create two lists of stocks in the Stock Watch module. The first list would be your Buy Candidates – 'Watch List'. In addition, if you like, create a Short-Sale 'Watch List'. Each list should contain between 10 to 50 stocks that you consider to be good candidates. There are numerous sources that you can access to build this list, and the best part is that they are mostly free. Check out the resources included in MarketEdge, which are listed in Chapter 9. The second list is your 'Position List'. This list contains the stocks that you either buy or sell short.

When creating your Watch Lists, try to include stocks that you are familiar with to some extent. When setting up the Report Format for your lists, you want to include items which will give you a daily snapshot of the technical condition of the stocks in your list. The following are the indicators that you should include: Close, Stop, Opinion, Opinion Date, Power Rating, Score, U/D Volume Ratio Slope, Fast %K and Slow %K Stochastic and the Strength Rating.

To set up a report format, click on the Manage button in the upper right corner of the page and then on Manage Reports. There you can either Edit or Add a New Report. To edit a report, click on the pencil next to the list. To add a new report, click on the + sign next to Add a New Report. When finished adding your report items, click on Create Report.

Pulling the Trigger

Once you have created your Watch Lists, you will need to develop a method for determining when to 'pull the trigger' and open either a long or short sale position. There are several techniques and indicators that you can use to identify good entry points.

The stochastic oscillator is an indicator that identifies overbought and oversold conditions and is a good tool when identifying entry points. The stochastic oscillator compares where a stock's price closed relative to its trading range over x-time periods. Values range from 0 to 100. Readings over 80 signal an overbought (Sell) condition, while readings below 20 are regarded as an oversold (Buy) situation. There are two stochastic indicators, Slow (Slow %K) and Fast (Fast %K). The difference between the two is that Slow %K is a smoothed version of Fast %K, typically with a 3-day moving average and is therefore less erratic.

As you accumulate Buy candidates in your Watch List, monitor them on a daily basis by checking for either Fast %K or the Slow %K stochastic oscillator to fall to around 20, signaling an oversold (Buy) condition.

The chart below shows both Fast %K and Slow %K plotted on the bottom of the General Motors (GM) chart. As can be seen from the graph, both Fast %K and Slow %K generated Buy signals on 10/15/14 (\$29.69) and again on 12/16/14 (\$30.73).



Selling Stocks Short

When the Market Posture is Bearish, you may want to create a Short Sale Candidates - Watch List. For whatever reason, most investors seldom short stocks. It could be that they feel that there is an unlimited risk when shorting stocks or it is just a non-American thing to do. It is true that when you short a stock, your potential loss could be unlimited. A stock sold short at \$20 could go to \$200 but any sane person should use Buy Stop orders when initiating short sales to prevent such a disaster. The fact is that shorting stocks can be very profitable, it is cheaper than buying stocks on margin and when right, can generate profits at a much faster clip than most long positions. It is no secret that most things, including stocks, go down a lot faster than they go up. If you don't believe this phenomenon, see how long it takes you to climb up the stairs of the Empire State Building. Then jump!

You will want to use the same set of technical indicators when looking for short sale candidates as outlined above, but they should have a weak technical condition and thus a high probability of going down in price. What you are looking for are stocks whose Relative Strength is less than .95, the Up/Down Volume Ratio is down (BR) indicating that the stock is under distribution, the 50-day simple moving average is pointed down, signifying that a down trend is in place and is likely to continue and the MACD directional line has crossed below the signal Line from above. Again, use the stochastic oscillators to identify an overbought condition (readings over 80) which would signal a favorable entry point for short sales.

Initiating a short sale is not the same process as opening a long position. First of all, you have to get permission from your broker to short the stock so your broker can borrow the shares that you are selling but don't own for delivery to the buyer. Here is what happens. Your broker contacts his stock loan department to see if the stock is long in the firm's vault, meaning that other customers are long the stock in margin accounts and have had them held at the firm instead of taking delivery. Whenever you open a margin account, a line in the margin agreement allows the brokerage firm to loan your stock at their discretion. If the brokerage firm doesn't have any stock, they call other firm's stock loan departments and try to borrow the stock from them. If your broker tells you that you can't short the stock because there is none to borrow, breathe a sigh of relief and walk away. Don't even

think about buying put options as an alternative. Here is why. If there is no stock to loan, this tells you that there is a big time short position in the stock which could come back to haunt you.

Remember, if you are short a stock, some day you will have to cover the position by buying back the stock. If there is a substantial short position, the potential exists for a short squeeze whereby everyone that is short rushes to buy back the shares causing a big run to the upside, something that you don't want to experience. Remember, you always want the odds in your favor and shorting a stock that has a large short interest ratio (# of shares sold short / the average daily trading volume) is like spitting in the wind.

A short position will be placed in a segregated short account. Your short account will receive a credit, but it will not earn any interest unless you can negotiate a deal with your broker. You are liable for any dividends that the company pays out while the short position is open and are subject to margin and maintenance requirements, as with long positions.

9. Creating Watch Lists

As discussed in Chapter 8, you are going to want to create a couple of Watch Lists in the Stock Watch module. A buy candidate Watch List should contain stocks that have good fundamentals or a good story or both. The list will provide you with desirable buy candidates when MarketEdge says it's time to pull the trigger. Your short list will have stocks with the opposite characteristics. Remember, it's not so much **what** you buy or short that's important. It's **when** you buy or short the stock that matters the most.

There are numerous sources from which to draw from when compiling list of potential **buy** candidates. The following is a brief description of the MarketEdge resources that will provide you with candidates on a regular basis. If you like a stock, put it in your Watch List and wait for MarketEdge to upgrade the Opinion to either Long or for it to become an Early-Entry Buy candidate, and then track the stochastic readings for your entry point.

Dr. MarketEdge Talks Stocks - Stocks in the News

This is great resource for finding potential buy candidates. Every week on Tuesday, Dr. MarketEdge reviews up to three stocks which have recently been featured in the media by one or more of Wall Street's major brokerage firms. There is a brief summary of their analysis at the top of the article followed by the MarketEdge Second Opinion report, a current Smart Chart and the good Doctor's Summary outlook. What more could you want? Top-notch fundamental research (I hope) coupled with the Doc's opinion. Best yet, these reports are archived on the site, so at some later time you want to refresh your memory as to why you bought this puppy, you can retrieve the report. The Doc's weekly stock reports are located in the lower left area of the Home page.

Fundamental Analysis – Company Profile & Financials

At this stage of the game, you have probably concluded that MarketEdge is all about technical analysis and nothing else. Right? Wrong. Check this out. From the Stocks tab, enter a symbol in Second Opinion and choose either Company Profile or Financials posted on the Menu section, which is located in the upper right-hand corner of the page. Here you find just about everything you need to know about the company- plus a ton of fundamental data. Do your analysis, and if you find a stock that you like, click on the + sign next to the symbol on the Second Opinion report to import it into your Watch List.

ETFs And Mutual Funds

Let's say you're a mutual fund guy and have never bought an individual stock. Does that mean MarketEdge is not for you? Nope. MarketEdge has you covered so that can have a disciplined, unbiased approach as to when to buy and more importantly, when to sell your funds.

MarketEdge has an ETF Center which is located on the main tool bar under ETFs. The main screen shows forty-six ETF categories, which contain over 600 individual ETFs. These categories are much like

industry groups. You can rank these categories based on the MarketEdge 'Condition,' which range from Strong to Weak, Improving to Deteriorating and Upgraded or Downgraded. Once you rank the categories, you can view the individual ETFs, order them based on the thirteen headers and retrieve the Second Opinion report by clicking on the symbol. Order the ETFs by Opinion and check out those that have a 'Neutral' Opinion. These ETFs are good buy candidates once their Opinion is either upgraded to Long or if they become an Early-Entry Buy candidate. Further selection criteria would be to check the Strength Rating, which can be either Outperform, Perform or Underperform. The best selections will have a 'Neutral' Opinion and an 'Outperform' Strength Rating.

Strength Ratings are designed to identify ETF categories or individual ETFs that have a high probability of outperforming the market, as measured by the S&P 500. The Strength Ratings are created by tracking the ETF's Relative Strength (RS), which is a measurement of an ETF's performance over a specific period of time—usually 50-days vs. the performance of a market index, typically the S&P 500.

Relative Strength is calculated as a percentage with 1.00 representing an equal performance between the S&P 500 and a particular ETF. Values over 1.00, i.e. 1.06 indicate that the ETFs has outperformed the S&P 500 by 6% over the last 50-day period while a reading of 0.93 would reflect under performance of 7%. While a Relative Strength reading over 100 is positive, it is where the Relative Strength figure has come from which is more significant. At first glance, an ETF with Relative Strength of 0.96 looks to be a laggard and would be under the radar of traders looking for an outperforming ETF. However, if the ETF's Relative Strength was 0.79 three weeks ago and it is now 0.96, there has been a significant momentum shift which is likely to continue. Strength Ratings for ETFs can be either Perform, Outperform or Underperform. To add an ETF to your Watch List, click on the + sign next to the symbol.

If you are dealing with a 401-K or some other type of retirement account, the process to find the strongest mutual funds offered by the plan is much the same. In this instance, you are interested in the ETF categories, not the individual ETFs. The MarketEdge category titles should be similar but not necessarily identical to the names of the various mutual funds provided by your retirement plan. From the main screen, order the categories by the MarketEdge Condition, which is either Strong, Improving, Deteriorating or Weak. The Condition is based on the category's Strength Rating described above. Select your plan's mutual funds based on this rating. Now all you have to do is check the category's condition on a weekly basis to see if it has been downgraded. If so, sell the fund and reinvest in one that has a Strong or Improving rating.

Industry Group Analysis

Click on Industries on the MarketEdge tool bar to retrieve the MarketEdge Industry Group analysis page. This is a great place to find stocks for your Watch Lists. Here you will find ninety-one industry groups, which can be ranked by their Condition in the same way as described in the ETF Center above. Click on the Condition header to sort the list from Strong to Weak. For a Buy 'Watch List', click on Strong under the Menu section located in the upper right-hand section of the page. Check out the stocks in the Strong groups with good Relative Strength, a Long Opinion and the Score equals 0. Click on a stock's symbol to retrieve the Second Opinion report. To add the stock to your Buy 'Watch List', click on the + sign next to the symbol. If you are creating a Short Sale 'Watch List', do the reverse. Click on the Condition header to sort the list from Weak to Strong. Check out the stocks in the Weak groups with poor Relative Strength, an Avoid Opinion and the Score equals 0. Click on a stock's symbol to retrieve the Second Opinion report. To add the stock to your Short Sale 'Watch List', click on the + sign next to the symbol.

For a video demonstration of how to use both the ETF Center and Industries, click on the Manage button located in the upper right-hand section of every page, then on Help Center, and then on Video Tutorials.

If all else fails and you are still at lost for stock ideas, there is always the media. Those guys always have a ton of opinions to share with you. A word of caution. It is not what a company does or is planning to do that's the most important part of investing in stocks. We're not interested in buying companies, but rather **when** it's the right time to buy or sell a company's stock. That's what MarketEdge is all about, and as we progress, you will see that it is very good at doing its job.

10. Money Management

Another important part of your overall game plan is the development of a properly structured money management strategy. The secret to making a lot of money in the stock market is proper capital allotment and compounding returns. With the advent of internet brokerage accounts in the mid 1990's, the cost of transactions is practically zero. With the cost of trading no longer an issue, a major roadblock has been removed from the decision-making process.

Percentage Allotments

A good premise of a sound money management plan is to invest the same percentage of your investment capital in each of your stock selections. Depending on the size of your bankroll, percentage allocations should vary between 5%-20%. This would translate into a portfolio consisting of five to twenty stocks when 100% invested. Using the approach that has been outlined so far, you should be right on your market calls around 70% of the time. Your stocks should also make money 70% of the time with your winning trades outperforming your losers by a 2 to 1 ratio.

Let's assume that you apply 10% allocation with a bankroll of \$100,000. You would invest \$10,000 in ten different stocks. Suppose that seven of these stocks (70%) result in an average gain of 20% for a gain of \$14,000. Three result in an average loss of 10% or \$3,000 resulting in a gain of \$11,000. Commissions at your friendly, online brokerage firm should be no more than \$8 per trade or \$16 round turn (\$160) leaving you with a net gain of \$10,840.

Typically, the stock market experiences three significant moves a year. These patterns are either an up-down-up scenario or a down-up-down pattern. This type of market activity should provide you with at least three opportunities to turn your portfolio a year. By duplicating the above example, you would realize a net gain of \$32,500 or 32.5% per year. If you leverage your account to the hilt, \$32,500 would turn into a net gain of \$65,000 or 65.0% year. Margin interest charged in a leveraged account should be reduced by dividend income.

Compounding Returns

If you compound your returns, the picture gets even rosier. The first swing, you invest \$100,000 and return \$10,840 (10.84%). Round two you would invest \$110,840 and net \$12,015. Round three you would invest \$122,855 and net \$13,317 for a total gain of \$36,173 for the year (36.1%).

While these results are big time over a one-year time frame, things really start to balloon if you carry the exercise out over a five-year period. Your original bankroll would grow to \$468,218 in a cash account which works out to be a gain of 368.2% (cash account).

I think by now you get the picture. Compounding profits can greatly increase your returns. In the real world, the duplication of this scenario is highly unlikely. Somewhere along the road you will find yourself in a market environment that makes no sense. Remember, leverage is a two-edged sword. When the wheels come off and you experience a string of losing trades, your bankroll will not grow on a linear basis and your overall results will be greatly reduced.

11. Putting It All Together

There you have it. The MarketEdge Way, a consistent, disciplined approach to investing in the stock market in any kind of market environment. Sounds like a lot of stuff, but it is not very complicated since MarketEdge does most of the work for you. Let's review.

Get on the right side of the Market

First and foremost is to be on the right side of the market. You want to be long stocks when the market

is favorable and either out and in cash or short stocks when the market is in a bear phase. Identifying the market's projected status is done for you in a couple of ways.

Check the Market Letter on a weekly basis and trade in accordance with the 'Market Posture'. Typically, dating back to 1978, the Market Posture changes from Bullish to Bearish and vice versa about three to four times a year with around 70% accuracy in forecasting the intermediate-term direction of the market, as measured by the DJIA. Occasionally, the Market Posture will be Neutral, which suggests that the indicators and studies are in flux. In addition, check the 'Market Barometer'. This timing model is updated daily and will provide confirmation to the Market Posture. Lastly, for very short-term market timing, i.e. entering or exiting positions, stay on top of the S&P Oscillator which is posted on the Home page every Friday. A *daily* subscription to the Oscillator is additional but worth every penny.

Set Up Your Watch Lists

Once you have a handle on the market, it's time to buy and sell some stocks. The primary way to go about this is to constantly update your 'Watch Lists' with both buy and short-sale candidates. You can check the status of your 'Watch Lists' every day in about one minute. Simply, click on the list and check for stocks which have been upgraded to Long or are Early Entry Buy candidates. MarketEdge will e-mail you any stocks in your 'Watch Lists' that have been Upgraded or Downgraded every night. When a stock is upgraded, check the Smart Chart to make sure something crazy isn't going on. Remember, all of this information is computer generated, and although MarketEdge is a very smart computer system, strange things can happen.

Build a Position List

If all is good, buy or short the selected stocks and then put them in your 'Position List' by clicking on the + sign next to the stock's symbol. Now you need to stay on top of your holdings, so you know **when** it is the right time to close a position. You will want to check your 'Position List' every day. Simply access the list and check out the Opinion and the Score. It is a good idea to close long positions when the Opinion is downgraded, or the Score drops to -3. For short sales, cover the position if the Opinion is upgraded or the Score improves to +3. Again, it's always a good idea to take a look at the chart.

Section VI: The Rest of the Stuff

MarketEdge has numerous features that will satisfy practically any investor/trader's needs. These include a slew of technical indicators, short-term trading strategies, sophisticated charting capabilities, detailed fundamental data, recommended stock selections based on a combination of fundamental and technical research and much more. The following section describes these features and provides tips on how to put them to use in your everyday endeavors.

12. Technical Indicators in Action

The following is a description of some popular technical indicators and an explanation of how to put them to use. Most charting software allows you to construct the majority of the indicators that are listed below. As you might expect, the MarketEdge 'Smart Charts' will also get the job done for you.

Technical Indicators

ADX: J. Wells Wilder's Average Directional Movement Rating. This indicator was designed to measure the intensity of a stock's trend. Readings over 20 suggest that a stock is experiencing a trending movement while readings under 20 suggest that the stock is in a trading range. The higher the ADXR reading, the stronger the magnitude of the trend. ADXR does not indicate the direction of the trend, only its intensity.

Beta: Beta is a measurement of a stock's volatility as compared to that of the S&P 500. Readings greater than 1.00 denote stocks that have demonstrated a greater degree of volatility than the S&P 500 during the previous year. Stocks with a Beta of .99 or less have demonstrated less volatility than the S&P during the same period. Traders who desire above average volatility should choose stocks with a Beta of 1.2 or higher. Conversely, conservative traders should only select stocks with a Beta less than 1.00.

Bollinger Bands: Developed by John Bollinger, these trading bands are plotted at standard deviation levels above and below a moving average of a stock's price. Use a 20-day simple moving average and two standard deviations when computing Bollinger Bands. The spacing between Bollinger Bands is reflected as a number that varies between 0 and 100 and depicts the volatility of the stock during the previous twenty days. Whenever these bands tighten (a value below 20), volatility has contracted- a condition that typically precedes a sharp price movement. The direction, however, of the anticipated move is not indicated by contraction of these bands.

Linear Regression Line (LRL): Linear regression lines are unique, straight lines that best approximate the points being observed. For example, LRL can identify the direction that an indicator like 'On Balance Volume' (OBV) is pointed. While the OBV total is a valuable indicator, it is the direction or slope of the least square fit of the OBV total that forewarns of a change in a stock's trend. When a stock is under accumulation, the LRL for OBV will be +1. Conversely, the stock is being distributed when the OBV LRL is -1.

RSV (Relative Strength Value): Relative Strength Value differs from 50-Day Relative Strength (50- Day R.S.) in that it is not a measurement of a stock's performance as compared to a market index. Relative Strength Value is the percentage price change of a stock during the preceding twelve months or 250 trading days. The calculation is weighted, with the most recent three months assigned a 40% weight, while the previous nine months receive a 60% weight. All of the stocks in the database are then arranged in order of price change and ranked with a value of 99 to 1. A Relative strength rating of 92 would indicate that the stock has outperformed 92% of all other stocks in the database.

Moving Averages: Moving averages are a popular tool in identifying a stock's trend. Moving averages come in three flavors. The most popular is the simple moving average, which is the average of a stock's closing prices over an x period of time. An exponential moving average is a more complex calculation that gives more weight to the most recent closing prices than to earlier ones. Moving averages are typically constructed using 10, 21, 50- and 200-day time periods.

10-Day Simple Moving Average



21-Day Simple Moving Average



50-Day Simple Moving Average



200-Day Simple Moving Average



Stochastic (Slow %K & Fast %K): Stochastic oscillators are designed to identify overbought and oversold conditions by comparing today's price to a present window of high and low prices. The stochastic oscillator compares where a stock's price closed relative to its trading range over x-time periods. Stochastic oscillators can either be Fast or Slow. Slow %K is the same as Fast %K except that it is smoothed with a simple moving average to make it less erratic.

Stochastic-Slow %K



Stochastic values range between 0 and 100. Readings of 20 or less denote an Oversold (bullish) condition while values of 80 or greater signal an Overbought (bearish) scenario. Overbought and Oversold conditions typically resolve themselves by the stock trading sideways for a couple of days or a price reversal. Looking at the chart for American Airlines (AAL) located above you will see that a Slow %K buy signal was generated on 07/01/15 when the stock closed at \$38.80 and Slow %K was under 20. On 07/15/15, AAL closed at \$41.54. A sell or short sale signal was created on 04/22/15 when the stock closed at \$51.40 and Slow %K was 97. On 05/06/15, the stock closed at \$47.04.

Stochastic-Fast %K



The chart located above is also for American Airlines (AAL) over the same time period. The difference is that Fast %K is plotted below the stock's chart. In this example, a Fast %K buy signal was generated on 07/24/15 when the stock closed at \$39.63 and Slow % K was under 20. On 08/04/15, AAL closed at \$42.71 when Fast %K was 98. A sell or short-sale signal was created on 08/17/15 when the stock closed at \$43.95 and Fast %K was 98. On 08/21/15, the stock closed at \$39.75 as Fast %K fell to 7.

Support/Resistance Trend Lines: Trend line analysis is an important tool in determining potential trend reversals as well as pin-pointing entry and exit points. Support/resistance trend lines are constructed by connecting either the most recent, significant lows (support) or highs (resistance) on a stock's chart. To have a valid support trend line, the slope of the line should be pointed **Up**. Conversely, a valid resistance trend line should be pointed **Down**. You should construct as many trend lines as possible in the same fashion. Initially, the trend line that you are interested in is the one that is farthest away from the closing price of the stock. As the stock moves more than 20% away from either the support or resistance trend line, focus on the next trend line for areas of support and resistance. Penetration of these trend lines is a warning that the prevailing trend is waning, and a reversal is highly probable.

Support Trend Lines



Resistance Trend Lines



Wilder's RSI (Wilder's 9-Day RSI Value): J. Welles Wilder's RSI indicator detects overbought and oversold conditions. The Index is comprised of three variables: 1) the average of all up closes during a given period, 2) the average of all down closes during the same period, and 3) the length of the period in days over which these averages are taken. RSI measures the degree of strength left in a price trend. If price has been declining and RSI drops to 30 or lower, traders should be alerted to a probable reversal of the downtrend, since momentum would

appear to be losing its strength. If RSI moves above 70 as price rises, an intermediate top is usually imminent. The standard time period when computing RSI is 9-days.



In the above example, RSI crosses above 92 on 04/24/15 when American Airlines closed at \$52.71 setting up a good short sale entry point. Six days later (04/30/15), AAL had fallen to \$48.28- a decline of 4.43 points as RSI fell to 50.50. On 08/24/15, RSI was 18 when AAL closed at \$37.62 setting up an oversold buy point. On 09/02/15, AAL closed at \$41.51, a gain of 3.89 points.

13. Advanced Tools for Experienced Investors and Traders

Traders and investors can access stocks which have experienced either bullish or bearish technical events or formed relevant chart patterns during the prior day's trading activity. These technical events have good historical records of forecasting short-term price movements. A detailed description of each of the technical indicators and chart formations are listed below and are included the Glossary, located in the Help section under the Manage button.

Advanced Tools

- 1) Point & Figure Chart - Top and Bottom Breakouts. Stocks that have broken out of one of the following Point & Figure Chart formations:
 - a) Double Top – Double Bottom
 - b) Triple Top – Triple Bottom
 - c) Quadruple Top – Quadruple Bottom

Stocks in these groups are listed with the P&F chart formation and the MarketEdge Opinion. Click on the chart formation to retrieve the P&F chart. For a description of P&F chart formations, click on the Menu button and then on Glossary.

- 2) Point & Figure Chart - Early Alert Buy and Sell Signals. This is a special feature which includes stocks that are in the process of forming a significant Point & Figure chart formation and are close to breaking out of the formation. Like above, the P&F formation is listed along with the MarketEdge Opinion, and the Breakout Price that must be breached for a breakout to occur. Talk about being ahead of the game.
- 3) Trading Ideas - Long and Short. Stocks that have experienced one of the following technical events during the prior day's trading activity. For a description of the various setups, click on the Menu button and then on Glossary. In addition, there are explanations and charts for several of the setups located in Chapter 12.

Near 10-Day Moving Average/
Near 21-Day Moving Average/
10 Day/21Day Cross/
21 Day/50Day Cross/
50 Day/200 Day Cross/
MACD-LT Cross

OBV Price Divergence
Relative Strength Divergence
Stochastic Cross
Wilder's RSI Cross
Commodity Channel Index
Chakin Oscillator

Screening Capabilities

If for some reason you aren't satisfied with all of the MarketEdge indicators, studies, and time-tested trading systems, and still want to do your own thing, then this is the place for you. Click on the Screening Tools tab on the MarketEdge toolbar and get ready to go wild. But wait- before you start screening for everything under the sun, check out the Default Filters. Click on the Menu button and then on Default Filters. Here you will find six, preset setups that will in all likelihood guide you to what you are looking for. They include Bullish (BL) Bottom Fishing candidates, Bullish (BL) Short Term Plays, Bullish (BL) Strong Momentum Stocks, Bearish (BR) Potential Disasters, Bearish (BR) Selling Tops and Bearish (BR) Short-Term Sells (shorts).

Under the screen title are the adjustable variables that are used in the setups. You can delete any of the criteria by clicking on the red "x". Then, go to the variables screen on the left side of the page and make any additions that you would like to include in the setup. The standard criteria for the individual setups are described in the Glossary. When finished, click on Reset and then on Run. If you like the results, click on the Save button and name the setup.

You can also add any number of the variables that are located on the left side of the screen. If you don't get any selections, you have probably over-loaded your screen with too many items. Delete one or more until you get some results. As always, click on the + sign next to the symbol of a stock that you like to import it into a Stock Watch List.

14. Smart Charts

If a picture is worth a thousand words, then a stock chart is worth a thousand dollars. Never has this been truer than what you see when you retrieve a MarketEdge 'Smart Chart'. I doubt if you have ever seen anything like this before. Everything that you could possibly want to know about the technical condition of a stock is displayed in an easy-to-read format. **In addition, you can customize your charts so that your favorite indicators and studies will automatically be displayed for any stock that you choose.** Simply click on the Charts tab located on the MarketEdge tool bar and you will be off and running.

Proprietary MarketEdge indicators, studies and features available in Smart Chart are listed below.

- 1) MarketEdge Opinion.

- 2) Date the Opinion was formed.
- 3) Closing price when the Opinion was formed.
- 4) The Score.
- 5) Green (Bullish) and Red (Bearish) arrows pointing to the date and type of a technical event including Point & Figure chart breakouts.
- 6) Four different chart types.
- 7) Nine technical indicators.
- 8) Customized simple and exponential moving averages.
- 9) Eight preset time frames.
- 10) Detailed display information dropdown for each data point on the chart.

Check out the chart for Qualcomm (QCOM) located below to see all of this in action.



From the information detailed on the chart above, you can make the following observations:

1. The technical condition for Qualcomm (QCOM) is improving with nine of the last eleven events since March 2020 being bullish.
2. Significant positive developments include reliable trend following indicators: MACD-ST and MACD-LT turning bullish on 3/26/20 and 4/16/20, while the Up/Down Volume Ratio turned up on 4/08/20.
3. Relative Strength turned bullish.
4. The stock had a Point & Figure Double Top breakout on 4/29/20. Currently (at the date that this book was published), MarketEdge maintains its Neutral Opinion but recommends it an Early-Entry Buy candidate. With momentum at its sails, Qualcomm looks to be all set to make a run to CFRA's \$100 long-term price target.

15. Classic Situations

The stock market is constantly dealing with conflicting forces. Typically, there is an imbalance one way or the other, resulting in either a bullish or bearish trend. Whenever the imbalance intensifies, situations set up that usually identify either the end of a major move or a resumption of an existing trend. These situations repeat over and over again and can provide great trading opportunities.

Blow Off Tops

Often bull to bear market reversals follow what is referred to as a 'Blow Off Top'. While a Blow Off Top isn't a must for a major reversal to happen, it is important that you are aware of their existence and act accordingly. A Blow Off Top usually takes place during the final phase of a bullish move. This can occur with market indexes as well as with individual stocks. Typically, the stock or index will have been in an uptrend for a long period of time. The blow off top sees the stock surge to the upside on very high volume, reverse course to the downside and either closes down for the day or opens lower the following day. In the below example, ABB Ltd. surged on 06/04/15 on twice its average volume while closing at \$23.66, up 1.32 points for the day. This was followed by a down price gap the following day as the stock closed at \$22.80. As is usually the case, the blow off marked the beginning of a significant decline as ABB Ltd. dropped to \$18 by late August.



Selling Climaxes

Frequently, bear to bull market transitions follow what is referred to as a 'Selling Climax'. A Selling Climax usually occurs in the final phase of a bearish move but can also happen following a short-term correction. Typically, a stock or market index will have been in a long downtrend. The reversal takes place on very high volume as the stock collapses to the downside, reverses to the upside and closes up for the day. Selling Climaxes are the opposite of a Blow Off Top, as investors throw in the towel, convinced that everything is going to zero. Since this usually occurs after a sustained sell off, there is a lot of cash around providing the fuel necessary to launch a new bull phase. The chart of the DJIA located below shows a good example of the Selling Climax that occurred on 08/24/15.



Reflex Rallies

Reflex Rallies, also known as counter trend, moves or dead cat bounces can provide excellent opportunities to initiate new short positions. The rally usually occurs after a stock gets hammered over a short period of time. Not to be confused with Selling Climaxes, Reflex Rallies lack the convolutions and volume expansion that happens during a Selling Climax. To the contrary, the rally usually develops over several days after an extended decline that sees volume dry up as the rally progresses. While initiating a short sale during a reflex rally can be profitable, it can also be tricky business. Usually a Reflex Rally will carry the stock back up to a declining 50-day simple moving average. This is a good entry point for a short sale. The reason this occurs is that the 50-day moving average represents the average price that investors have paid for the stock over the last 50-days. Since everyone has a losing position, the tendency is to sell the stock and try to get even. The supply of stock for sale at this point is usually sufficient to squash the Reflex Rally.

The chart below for Applied Industries (AIT) shows a typical Reflex Rally which occurred in mid-November 2014. After topping on 11/12/14 at \$49.69, AIT traded down to \$42.93 on 12/17/14. From there, the stock rallied back (Reflex Rally) to within one point of its 50-day moving average (\$47.07) closing on 12/29/14 at \$46.43 before trending lower to below \$40 by mid-January 2015.



Last Hour Trading

There is an old saying on Wall Street that states that "All that matters are the first and last hours of trading- the rest is just noise." There are a lot of sayings on Wall Street, but this one has some merit. You should be aware of the direction the market moves during this time. There are four scenarios that can occur:

- 1) The market is down all-day and then rallies during the last hour. This is regarded as a bullish condition and is typical when the market is in a bull phase.
- 2) The market is up all day and then declines during the last hour. This is regarded as a bearish condition and is typical when the market is in a bear phase.
- 3) The market is up all day and then rallies further during the last hour. This has little significance, as does the fourth scenario.
- 4) The market is down all day and declines further during the last hour.

The main reason why it is advisable to stay abreast of the last hour's trading activity is to confirm the 'Market Posture'. Conflicting last hour trading signals should alert you to a potential change developing in the market forecast. Conversely, confirmed last hour activity would add confirmation to the current 'Market Posture'.

Volume Traps

Volume is the weapon of the bulls and should be monitored on any rally to confirm its validity and strength. Be suspect of any rally by the major averages that develop when the daily volume doesn't equal or surpass the previous, twenty-day average volume. Typically, a volume trap takes place in the early stages of a bear market as the die-hard bulls view market setbacks as 'buying opportunities'. Usually, the market will experience a setback as the bear market begins. The 'buy on the dip' traders move into the market thinking that the correction is another buying opportunity. The market rallies, but the volume is well below the average volume that existed during the bull phase. This type of rally usually tops out at lower highs, confirming the fact that a bear market is underway.

16. Stuff You Need to Know

The following are some general conditions and terminology that you need to be aware of. As time goes on, you will probably be confronted with some or all of these situations. By following the guidance listed below,

you should be in a position to profit when these events occur and more importantly not lose money by making incorrect moves.

General Conditions

The indicators incorporated into the Sentiment Index are *hard figures* that are generated on a daily or weekly basis. They can be quantified and are included in the model. However, attention needs to be paid to what I refer to as *general conditions* that cannot be quantified but usually exist at major bull market tops or bear market bottoms. These conditions are contrarian in nature, as they measure investor's emotions at these major turning points. Always remember that the market does not move in step with the economy- it leads the economy. By the time the good news comes out, the market has already moved up in anticipation of that news. By being aware of what is going on, you will know when the crowd has become either extremely bullish or bearish and you can act accordingly.

Market Tops

- 1) Everything looks great. The financial media continue to report that economic conditions are great and that's good for the stock market. Unemployment is low, interest rates are low, inflation is non-existent and corporate profits are soaring.
- 2) The market has been in a long, extended bull phase, typically between 32 - 36 months.
- 3) The 'It's Different This Time' theory is promoted by the financial geniuses who continue to rationalize that despite stocks surpassing historical benchmarks, the market will continue to roll this time around.
- 4) Major bullish headlines appear in the media. Remember when gold was approaching \$1,000/ounce in late 1970 and oil was heading to \$150 a barrel in 2005? Bullish forecasts for both commodities appeared on the covers of Time and Newsweek magazines. Both commodities topped out days after following these publications. Moral of the story: by the time the media guys figure out that something is red hot, the party is usually over.
- 5) Consumer confidence approaches record highs. People are not optimistic because they are going to buy stocks, they are optimistic because they already have bought stocks, typically at very high prices.

Market Bottoms

- 1) Everything looks terrible. The financial publications paint a gloomy picture. Unemployment is high, interest rates are high, bankruptcies are soaring, and corporate profits are tanking.
- 2) The market has been in a long, extended bear phase, typically between 12 - 16 months.
- 3) The 'It's Different This Time' theory is promoted by the financial geniuses who rationalize that despite stocks sinking to record lows, the market will continue to head lower.
- 4) Major bearish headlines appear in the media. Remember when inflation was running at 18% - 20% in 1981 - 1982 and interest rates were going through the roof. Had you believed the media, you would have concluded that there was no way out of that mess.
- 5) Consumer confidence approaches record lows. People are not pessimistic because they are going to sell stocks. They are pessimistic because they already have sold stocks, typically with large losses.

Know What You are Talking About

Wall Street can be a very confusing place. There are numerous terms, sayings and expressions that are unique to the securities industry that you need to understand- so as to avoid any nasty surprises.

- 1) Margin: Borrowing money from your brokerage firm to purchase securities. The percentage that is available to borrow differs between stocks and bonds. Stocks typically require 50% margin while bonds require 20%. Therefore, if you wanted to Buy 1000 shares of a \$20 stock, you would be required to put up 50% or \$10,000, and you would be charged margin interest on the \$10,000 balance. Options cannot be bought on margin.
- 2) Short sale: Selling a stock that you don't own in anticipation that the stock will decline. When placing a short sale order, you must get permission from your broker. The position will be segregated in a short account. The margin requirement for a short sale is usually 50%. You are not charged margin interest since your short account will show a credit balance. Unless you have a lot of clout with your broker, you will not earn interest on the credit balance. In lieu of cash, you can also deposit other securities, such as T-bills to meet the margin requirements.
- 3) Options: A call option gives the holder the right to Buy 100 shares of stock at a specific price (strike price) by a certain date (expiration date). A put option gives the holder the right to Sell 100 shares of stock at a specific price (strike price) by a certain date (expiration date). You cannot buy options on margin.
- 4) Stop Market Orders: Orders that are entered to close out an existing position if a certain price is obtained. Stop orders can be either a Sell Stop, which is used to protect a current Long position from further loss due to a decline in the stock, or a Buy Stop, which is used to protect a current short sale position from further loss due to a rise in the stock. In either scenario, the order is executed on the next trade once the price has been reached.
- 5) Stop Limit Orders: Orders that are entered to close out an existing position if a certain price is obtained. As above, Stop orders can be either a Sell Stop or a Buy Stop. In either scenario, the order is executed once the specified limit price is reached and *then only if the trade can be executed at or better than the specified limit price*. If the stock tanks, odds are you're going to tank with it- defeating the whole purpose of a protective Stop.
- 6) Market Orders: Buy or sell orders that are not limited to a specific price. When the order reaches the floor, the order will be filled at the prevailing market price.
- 7) Limit Orders: Buy or sell orders that are limited to a specific price. If the price is obtained, the order will be filled at the specified price or better.
- 8) Arbitrage: A sophisticated trading strategy whereby a simultaneous long and short position is initiated to try to capture a spread or profit regardless of what the stock does in the future.
- 9) Short Against the Box: A tax strategy whereby you have a Long position that you don't want to sell for tax purposes, but you are afraid that your gains may evaporate. In a short account, the same number of shares is shorted leaving the account both long and short the same stock.
- 10) Ex-dividend: A stock trades ex-dividend on the date that the dividend is declared, not necessarily paid. The stock's price is marked down on the opening the amount of the dividend. For example, if a stock closes at 30, has declared a \$0.50 dividend and goes ex-dividend on Monday, the stock will open down 1/2 point to reflect the distribution. Don't think that you can buy a stock the day before it goes ex-dividend and make any money.
- 11) Ex-date: The date that the stock will begin trading without dividend rights to the new owner, and its price is adjusted downward on the opening to reflect the distribution.
- 12) Record date: The last date of ownership to be eligible for a dividend.
- 13) Divergence: Indicators, markets, etc. are said to diverge when one makes a significant new high or low while the other does not. This is very important in market timing techniques- especially when the DJIA is making new highs or lows, and the majority of the other market indexes are not.

- 14) Call Feature: The call feature entitles the issuer of corporate and municipal bonds to call in the bond prior to maturity, typically at a slight premium to the initial offering price. If there is a decline in interest rates, the issuer will call in the higher interest-bearing securities and issue new bonds at a lower rate. U.S. Treasury bonds don't have call features.
- 15) Option Premium: The price of a call or put option. Option premiums are the result of a stock's price in relationship to the strike price, the time remaining until the option expires, interest rates and the volatility of the underlying security.
- 16) P/E Ratio: A ratio calculated by taking a company's annual earnings per share divided by the stock's current price.
- 17) Splits: A tactic whereby a company reduces the price of its stock by a set ratio while increasing the number of shares outstanding in order to make the stock attractive to a broader group of investors. Typical ratios are 2/1, 3/1, 4/1, 3/2. A reverse split occurs when the company does the opposite, which raises the price of the shares by decreasing the number of shares outstanding.
- 18) Breadth: A gauge of the market's strength or weakness measured by monitoring the number of new highs/lows and the number of advancing/declining issues.
- 19) Breakout: The point when a stock's price or market index moves out of a trading range.
- 20) MOC (Market on Close): An order that is to be filled at the closing price of the day.
- 21) Fill or Kill: An order to either execute the order immediately at the market or cancel.
- 22) GTC (Good till Cancelled): A limit order that stays on the books until it is either filled or cancelled.
- 23) Good for the Day: An order that is entered for the day only. If it is not executed during the day that it was entered, it is cancelled. Unless specified as a GTC order, it is usually assumed that the order is for only the remaining part of the day.
- 24) All or None: An order that stipulates that the entire order must be filled or none at all. This type of order is placed in conjunction with a limit order whereby you have placed a price limitation on the Buy/Sell order.

Do's and Don'ts

There are several things that you need to keep in the back of your mind when trading stocks. These suggestions are not based on technical or fundamental conditions, but they will save you a lot of money in the long run if they become part of your arsenal.

Do's

- 1) If a company reports bad news and the stock rallies, *Buy* the stock.
- 2) If company reports good news and the stock declines, *Sell* the stock.
- 3) Invest the same percentage of your investment capital in each stock selection.
- 4) When the ship is sinking, jump- don't pray. Recognize the fact that you aren't going to be right 100% of the time. If you were that good, you would own the NYSE exchange.
- 5) Be suspect of any rallies that aren't accompanied by rising volume.

Don'ts

- 1) If a company reports bad news and the stock rallies, don't sell the stock.
- 2) If company reports good news and the stock declines, don't buy the stock.
- 3) Shorting stocks in a dull market environment is not a good idea.
- 4) Never reverse a position in a stock from long to short or vice versa.
- 5) Don't sell naked options.
- 6) Don't trade against the prevailing trend of a stock or the market.
- 7) Don't invest more money in one stock versus another because it looks exceptionally strong. Your dollar commitments should always be a fixed percentage allocation.

This and That

- 1) Timing the stock market is very important to your investing approach, and it can be done with a reasonable degree of dependability. You are not going to catch every wiggle, but it is possible to identify most intermediate-term trends.
- 2) A good way to make a lot of money in the stock market is to compound your returns.
- 3) There is nothing wrong with trading on margin- provided that you use protective stops. Trading on margin increases your leverage. However, leverage can be a two-edged sword if not properly managed. By using stops, the risk is lowered during adverse times.
- 4) A stock's movement is dependent on the perception of what the company earnings will be, not necessarily on what the company actually reports. When the company reports their quarterly earnings, things can really start happening- especially when growth stocks miss the mark. The problem with growth stocks is that their prices are heavily predicated on a combination of earnings and the perceived growth rate of their earnings. Traders don't forgive even an insignificant earnings disappointment, since it destroys their estimates and they dump the stock on the spot. This can wreak havoc for the stock- especially if it is thinly traded. The moral of the story is that growth stocks can be great on the way up but a rough go when the party is over.
- 5) Shorting stocks should be a part of your investment strategy. In a bear market, shorting stocks can be a very profitable endeavor. Story, or rumored stocks, are the work of promoters/bucket shops and should be avoided. Odds are that the story stock is basically worthless and is trading at artificial, inflated prices. Once the boys have ran up the price to a desired level, they unload their stock and leave guys like you holding the bag.
- 6) Despite the fact that the stock market is a favorable game, you are not going to double your money every year. Remember, historical returns from the stock market have averaged less than 10% a year. The majority of money managers never beat the market averages, so don't expect miraculous returns.
- 7) A loss is a loss, whether you realize it or not. I have heard individuals say over and over again that despite the fact that a stock they own is down 20%, they don't have a loss until they sell it. When a stock is moving against you, odds are your analysis is wrong and you should get out. Remember, when the ship is sinking, jump- don't pray. I have nothing against praying, but if it worked in the stock market, everyone would be rich.
- 8) The stock market is probably one of the straightest games in the world. Although funny things happen

at times, the game is not fixed. Stay with liquid stocks, no penny issues and reputable brokerage firms.

- 9) The stock market doesn't always go up. Down years will and do occur and can be devastating to a portfolio. Those that think they can't lose by buying market dips or corrections will get their heads handed to them when a severe bear market develops.
- 10) The market is not necessarily a good hedge against inflation. If you had bought all of the DJIA stocks at the bottom of the 1929-1932 disastrous bear market when the DJIA was 32 and sold those stocks in the fall of 1982 when the DJIA was 800 (a 50-year period), adjusted for inflation, you would have broken even.
- 11) Stocks and bonds don't always move in concert with each other. Decoupling of the two securities usually occur during periods of explosive economic growth- which historically is a prelude to inflation, a no-no for bonds. The best example of this happened in 1987, as the yield on the 30-year Treasury Bond soared from 7% to 10% between February and August. The stock market continued to make new highs during this period, topped out in late August and then crashed in October.
- 12) Neither seasonality nor the Super Bowl winner has anything to do with the direction of the stock market. The media makes a big deal of year end rallies, favorable months of the year, etc., but the facts don't support the argument.

17. MarketEdge Weekly

Most of the online brokerage firms offer a free service from Computrade Systems, Inc. called MarketEdge Weekly (MEW), which is a reduced version of MarketEdge. MEW uses weekly, instead of daily data, and is updated only once a week after Friday's close.

It Ain't the Same Thing

MarketEdge Weekly has the weekly version of the Second Opinion report, but it doesn't have any of the other components included in the daily product. Since the algorithms use **weekly** instead of **daily** data, the information on the Second Opinion report may differ slightly and is not as timely as what you will find on the regular Second Opinion report. Also, from time to time, the Opinions may not be the same. While it is still good stuff, it is not anywhere near what you get with a MarketEdge daily subscription.

18. Managing Your MarketEdge Site

Click on the Manage button located in the upper right corner of the Home page to activate this section of the site. Here you can select from the following topics: Account Center, Manage Reports, Help Center and Logout. Following is a brief description of the functions which are included in this section:

Getting Started

Several articles which will provide you with an in-depth understanding of the market timing models, charting features, technical indicators, trading techniques, user tips and many other items used by successful investors.

Message Center

Receive e-mails and notices from the guys at MarketEdge.

Manage Account

Lists the information that MarketEdge has for your account. If you have any questions or would like to make any changes to your account, email them at support@marketedge.com

Video Tutorials

A series of video tutorials to help you navigate the various modules on the MarketEdge site. These tutorials will explain how to interpret a Second Opinion report, set up your Stock Watch Lists, find daily trading ideas, use Smart Charts to determine trends and resistance and support levels, and how to use the ETF and Industry Group modules.

Glossary

A description of all of the MarketEdge terms are listed here. Every technical indicator and study are included along with their bullish or bearish limits. In addition, popular chart formations, trading system setups and terms used in the fundamental analysis area can be found here.

Manage Reports

Allows you to edit or add to your report formats. To edit an existing format, click on the pencil icon next to your list and add or delete any of the fifty items located here. To delete a list, click on the red "x." To add a list and indicators, click on "+ Add A New Report."

19. Appendix

Sentiment Indicators

The following is a description of the technical indicators included in MarketEdge 'Sentiment Index'.

- 1) Fear-Greed Index (5Day Avg): Measures prevalent fear or greed in the marketplace. Excessive fear readings below 25 are regarded as bullish for stocks while a reading above 75 is a bearish condition. The index is composed of seven indicators, which are tracked on a daily basis. Indicators include stock price momentum, the number of NYSE new 52-week highs and lows, market breadth, the put/call ratio, the spread between yields on investment grade bonds and junk bonds, VIX and the difference in returns for stocks versus treasuries. The Fear-Greed Index is a 5-day moving average of the daily total.
- 2) Shares Sold Short NYSE - Monthly: The number of shares sold short on the NYSE. Increasing amounts are regarded as bullish while declining totals are bearish.
- 3) NYSE Short Interest Ratio: The number of shares sold short on the NYSE divided by the average monthly trading volume: 3.5 to 9.0 is bullish, 3.0 to 3.5 is neutral and 0 to 3.0 is bearish.
- 4) Shares Sold Short NASDAQ – Monthly: The number of shares sold short on the NASDAQ. Increasing amounts are regarded as bullish while declining totals are bearish.
- 5) NASDAQ Short Interest Ratio: The number of shares sold short on the NYSE divided by the average monthly trading volume: 3.5 to 9.0 is bullish, 3.0 to 3.5 is neutral and 0 to 3.0 is bearish.
- 6) AAI Bull-Bear Ratio: The AAI Bull-Bear Ratio is a sentiment indicator created using the American Association of Individual Investors (AAII) sentiment survey. Every week, the (AAII) asks its members about their view on the direction of the stock market over the near term. Using the percentage of members who are bullish and the percentage of members who are bearish, this indicator tells us whether the general market sentiment is overly optimistic or pessimistic. A high AAI Bull-Bear Ratio number indicates that there are more bullish than bearish traders, while a low AAI Bull-Bear Ratio number indicates that there are more bearish than bullish traders. The ratio is used as a contrarian indicator, which means that a high or low number is a sign that a market turn is near and that the stock market's direction is likely to change in the coming days.
- 7) Put/Call Ratio (5-Day Avg.- All Equity Options): A five-day moving average of the number of CBOE Index put options divided by the number of index call options: 70% and higher is bullish, 41% to 69% is neutral while 0% to 40% is bearish.

- 8) **NAAIM Exposure Index:** The NAAIM Exposure Index represents the average exposure to U.S. Equity markets reported by their members. It is a contrarian indicator, which measures when active investment managers are overly exposed and leveraged in equities. This is a bearish condition. Likewise, leveraged short positions are regarded as bullish.
- 9) **Bullish Investment Advisors:** The percentage of newsletter writers who are bullish on the prospects for the market as measured by Investors Intelligence: 0% to 35% is bullish, 36% to 54% is neutral 55% to 99% is bearish.
- 10) **Bearish Investment Advisors:** The percentage of newsletter writers who are bearish on the prospects for the market as measured by Investors Intelligence: 50% to 99% is bullish, 21% to 49% is neutral, and 0% to 25% is bearish.
- 11) **Bullish – Bearish Investment Advisor Ratio:** The bull/bear ratio indicates overall investor sentiment in the market by comparing the number of bullish and bearish investors. This market indicator is calculated and published weekly by the Investors Intelligence Sentiment Survey. The ratio is a contrarian indicator, interpreted as follows: a high bull/bear ratio (greater than 3) indicates that there are too many bulls in the market, and you should take a bearish stance; a low bull/bear ratio (less than 1) indicates that there are too many bears in the market, and you should take a bullish stance.
- 12) **VIX (CBOE Volatility Index):** A measurement of the premiums of index puts and calls. Range can vary from 0 to 100. Readings under 20 are regarded as bearish, as option premiums shrink and as complacency takes over the market. Readings over 30 are bullish, reflecting an increase in put option premiums, as an aura of fear permeates the landscape.

Favorite Technical Indicators

There are several technical indicators that have a good history of identifying stocks that have a good probability of going up or down in price. These indicators have been around for decades and are the favorites of most market pros. All are included on the MarketEdge Second Opinion report and most can be charted in the Smart Charts module. The following is a brief description of these indicators and an explanation of why they are important tools when identifying good buy and short-sale candidates.

Relative Strength: Relative Strength is a measurement of a stock's performance versus the performance of the S&P 500 index. To calculate this ratio, take the stock's closing price minus the price of the stock 50 days ago, and divide that number by the closing price from 50 days ago to get a percentage increase or decrease for the period. Do the same with the S&P 500. Now, divide the stock's percentage change by the percentage change of the S&P 500. This is the 50-day Relative Strength for the stock. Relative Strength ratings of 1.01 or higher identify stocks that have outperformed the S&P 500 over the last 50 days. Readings of .99 or less identify those stocks that have underperformed the S&P 500. Stocks being considered for Long positions should possess Relative Strength ratings of 1.05 and higher, while Short-Sale candidates should have ratings of .95 or less. This can be found at the bottom of every stock's TechniScan report on MarketEdge. As seen below, the line located at the bottom of Amazon's chart is the 50-day Relative Strength.



On-Balance-Volume: Joseph Granville developed the original theory of On-Balance-Volume (OBV). The basic assumption underlying this technique is that the market is divided between "Smart Money" and the "General Public." Smart money accumulates stocks at low prices and distributes it to the general public at higher levels. By tracking a stock's OBV, you can detect the smart money's accumulation or distribution activities before significant price moves occur.

OBV is computed in the following manner. If a stock closes up for the day, the total volume for that day is considered to have been buying induced, and therefore the stock is under accumulation. Conversely, if a stock closes down for the day, the total volume is regarded as having been selling induced and the trading activity is considered to have been a day of distribution. The volume on up days is totaled against the volume traded on down days. The net is a running total of OBV and is either a positive or negative number.

OBV totals are based on trading activity during the preceding forty days. Bullish conditions exist when a stock's OBV total is increasing- indicating that the stock is under accumulation. The best scenario is when a stock's OBV is at a higher level than it was when the stock was previously at the same price level. This set up suggests that smart buying is happening by informed money and is usually a prelude to an advance in the stock. United Parcel Service (UPS) forty-day OBV total is plotted at the bottom of the chart located below. Compare where OBV was in late September 2014 when the stock was trading around \$95.00 and then in early August 2015 when UPS approached \$95.00 again. This type of positive divergence identifies major accumulation that typically results in a significant move to the upside.



50-Day Simple Moving Average (SMA): Add the closing prices of the stock over the previous 50 days and divide the total by 50. This is the stock's 50-day simple moving average (SMA). When the 50-day moving average turns up, the odds are in your favor that a tradable trend is in place and is likely to continue for a minimum of twenty-five days. The chart below shows that the 50-day SMA for Boeing (BA) turned up in at the beginning of February 2019 when the stock was around \$336 and trended higher as the stock moved nearly into the \$400's by early April 2019.



Moving Average Convergence Divergence (MACD): MACD is an advanced technical indicator developed by Gerald Appel. MACD incorporates three exponential moving averages of price into an indicator that gives Buy and Sell signals based on crossovers of the various averages. A standard MACD setup consists of a signal line, which is the difference between the 12 and 26-day exponential moving averages, and the directional line, which is the 9-day exponential average of the signal line. MACD buy signals occur when the directional line crosses the signal line from below. Sell signals are generated when the reverse occurs.

The MACD indicator is displayed on the bottom of Boeing's chart displayed below. The signal line crossed the directional line from below on 12/30/14 (\$131.83), producing a buy signal. A sell signal occurred on 03/24/15 (\$151.65) when the signal line crossed the directional line from above.



Options

Options can be a good tool when hedging positions, protecting your portfolio from disasters and increasing your overall returns. This can be accomplished by implementing the following strategies:

Selling Covered Calls: A covered call is a call option sold against an existing long position. As long as you sell the same number of call options, one contract per 100 shares of stock, there are no additional margin requirements and you keep the premium from the sale. The risk is that if the stock trades above the strike price, your stock will be called away and any further gains will be lost. Another problem that can arise is that if you get stopped out of a position, you will have to immediately buy back the option. This is not something that you will want to do for every position, simply because the option's premium may not be large enough to warrant the risk.

Selling Covered Puts: The same strategy as outlined above but employed with put options against short sale positions.

Buying Puts Against a Long Position: Instead of using stop loss orders, put options can be used to protect a

long position from a decline. The advantage to this strategy is that you don't have to liquidate your position until the option expires at which time you would sell both positions.

Buying Calls Against a Short Position: The same strategy as outlined above but used with call options against short sale positions.

Buying Index Calls & Puts (Portfolio Insurance): There are several index ETFs that have listed options, which can be used to protect a portfolio against adverse market moves. OEX is the symbol for the S&P 100 Index, DIA, the symbol for the Dow Jones Industrial Average and SPY for the S&P 500. These ETFs trade in conjuncture with their respective index. Index options are good vehicles to hedge a portfolio that is either net long or short. Let's assume that you have a \$100,000 portfolio that is invested on the long side. If the market took a 10% hit, odds are that most of your positions would be stopped out resulting in a 10% loss or \$10,000. Buying DIA index puts in the proper ratio would lessen the blow.

About the Author



Tom Ventresca received his B.A. degree from Penn State University in 1968. He began his career in the securities industry in 1977. He spent fifteen years in the industry, which included positions as a retail broker, bond trader, office manager, technical analyst and money manager. In 1990, Tom founded Computrade Systems, Inc., the developer of the MarketEdge website. MarketEdge has been used by individuals, brokers and money managers around the world since 1992. Tom remains active at Computrade Systems Inc. where he is the Managing Director in charge of research. He currently lives in St. Augustine, Florida.