Stan Weinstein

In a world that is still dominated by fundamental analysts, Stan Weinstein has succeeded in gaining recognition as one of Wall Street's most respected technicians. When he speaks, people listen.

Mr. Weinstein's market initiation was not entirely different from other novices first taking the plunge. In 1961, while attending college, he invested all of his Bar Mitzvah money in the stock market. Fitting in context with his background in economics, he used fundamental analysis as the basis for his decisions. A bear market hit in 1962 and nearly wiped him out. This experience spurred him toward searching for an alternate, more profitable game plan. After reading ***Technical Analysis of Stock Trends***, he tested the precepts and found they had merit. He made the switch from fundamental analysis to technical analysis and from that point on, he has been 100% technically oriented.

Undeterred by this negative start, Mr. Weinstein headed immediately for the brokerage business after receiving his degree in economics. He was a stock broker for seven years before he began writing buy and sell orders for the now defunct Walston and Company. Earning a considerable sum of money in this position, he decided to change gears, leaving behind a sure thing and reaching toward uncertainty. In 1970, he made the transition from broker to technical editor for ***Indicator Digest***. Three years later, he left this job and joined fellow technician Justin Mamis as a partner in the ***Professional Tape Reader***, a stock market newsletter still in its infancy stage. Then in 1976, he acquired Mr. Mamis' stake in the business and focused on building his subscriber base. In a few short years, he saw his business grow from about 200 subscribers to over 10,000.

Mr. Weinstein is drawn to the market by two distinct forces, challenge and excitement. He finds the market sometimes frustrating but never boring. Technical analysis, in his opinion, is not work. It is the "ultimate fun." According to Mr. Weinstein, there are three necessary prerequisites for success in the market as well as in life—organization, discipline, and pragmatism. It is an absolute necessity to prioritize your work, segregating the urgent from the unnecessary-first things first. Do what's most important first and least important last. As he says, "If you don't have time for stochastics, you can still get by." In order to obtain a more disciplined, less emotional approach to investing, he has constructed a proprietary model containing 50 indicators which he calls "Weight of the Evidence." As the name implies, each indicator is assigned a different "weighting" or degree of importance. Though frequently pirated by other technicians, let the record show that Mr. Weinstein was the first to coin this phrase.

His workaholic lifestyle (a portion of this interview was conducted via cellular phone at Mr. Weinstein's insistence and expense) is filled with the duties of editor and publisher of the ***Professional Tape Reader***, a biweekly market newsletter. A second service is offered to institutional clients called ***Global Trend Alert***. He has offered seminars for all levels of investors on subjects ranging from simple moving averages to the virtues of capital preservation. Based on his earlier experiences with losses, he strongly advocates the use of stops and in fact, his newsletter subscribers have been spared serious losses in the past as a result of using predefined stops.

Impressed by Mr. Weinstein's technical expertise, I wrote to him in 1989 expressing an interest in working with him as an assistant. Very shortly thereafter, I received a package containing two articles- a rejection letter and a copy of his book, ***Secrets for Profiting in Bull and Bear Markets***. Inscribed within was a personalized message of hope and encouragement. This benevolent gesture is universally characteristic of Mr. Weinstein's attitude toward humanity. From among hundreds of investment books, his book was voted "Best Investment Book of the Year" by ***Stock Trader's Almanac*** and should be required reading for all market participants. I encourage you to read this premier

book for more in-depth coverage of what is discussed here, excellent guidelines on risk management, and methods for calculating price projections.

Mr. Weinstein's market views have appeared in the ***Wall Street Journal***, ***Barron's***, ***USA Today***, the ***New York Times***, and ***Investors Business Daily*** just to name a few. He has been a frequent guest on ***Wall Street Week*** and ***Nightly Business Report***, as well as many other leading financial programs.

Profiled in***Millionaire*** magazine, Mr. Weinstein's financial success confirms that his methodologies work. Over the last 17 years, with the exception of August 1985, he has correctly predicted every major bull and bear market. His prescient calls have earned him the "Stock Timer of the Year for Stocks" award presented by ***Timer Digest***.

Every technical analyst has his own distinctive style of analyzing the markets. Is there any one aspect of your analysis you deem to be unique in relation to your fellow technicians?

I would say nothing is totally unique but I feel my approach is somewhat different. One is that I truly am 100% technical. I have totally learned to put the fundamentals 100% on the side. A lot of people consider themselves technicians. I'll read their work and suddenly I will see things being thrown in like "if the Fed does this or the Fed does that." To me it is 100% supply and demand. So, I don't just talk it, I walk it. That's number one. Number two, I really do believe in sticking to my principles and keeping my analysis relatively easy. I know all the different games—candlestick charts, point and figure, bar charts, etcetera. I have tried them all but I found out that the more things you use the more you will get conflicting answers—three things are bullish, one thing is bearish. It fouls you up. I have learned to stick by my system, refine it, and basically listen to the chart itself. I very much believe in moving averages. I think they are a great help in defining trends in charts. Years ago, I developed a proprietary indicator called the NYSE Survey. It is the percentage of stocks that are technically healthy; that is, in stages I and II. From an indicator point of view it is unique. My NYSE Survey has done a great job over the years of foreshadowing important market tops. For example, in late 1972, early 1973, even though the Dow was moving to a new all-time high, this indicator was showing significant weakening. This negative pattern also appeared in late 1976 (before the 1977 bear market) and again in the summer of 1987 before the October 1987 crash. When I get past the charts of individual stocks, one thing that has helped is my proprietary "Weight of the Evidence" approach. I use 50 indicators, each singularly have a good track record. I'm not putting anybody down, because whatever works for you is terrific—this is a tough game—but I see a lot of people have a favorite two or three indicators to call the market. I listen to what the majority of my indicators are saying at any point in time. Another thing that is distinctive to my methodology is my "forest to the trees" approach. The last thing which I have always stressed and had in my book is that I think it is smart for everybody to treat their portfolio as a hedge fund. Some markets are transitional markets, not bullish or bearish, and money can be made on both sides of the tape at such times.

From an analytical point of view, do you begin with your "forest to the trees" approach?

Yes, the first thing I look at is the major trend of the market. That is the "forest." Before I pick up my Mansfield chart book, I want to know, "What is the likely trend over the next 6 to 12 months?" That is an important starting point. I try to keep it simple. If the market is real bullish I don't want to be short; I want to be a buyer. Then I work toward the trees. The trees are the sectors. I want to get into the individual groups which look best. I don't want to buy laggards, I want to buy leaders. The little leaves on the trees are individual stocks. When I am looking at individual stocks, it sounds crazy, but I really think the individual stocks are the least important of all. Going back historically, if you catch the major moves, like buying almost anything when we turned bullish in July or August of 1982 or selling almost anything when we turned bearish in August 1987, it's hard to be wrong. So the market is the most important determinant, the sectors are second, and stocks are certainly important but in a pecking order, they are the third thing I look at. Then you can say, "Okay, the market is bullish, this XYZ sector is the best sector and within the XYZ sector, this is the best stock." Conversely, when the market is turning negative, you look for the most negative sectors and then the weakest or most vulnerable stocks within that sector. Determining the trend is

the starting point but you really have to keep an open mind. I am never going to get bagged into a scenario. One of my strengths is that if I am wrong I admit it. Believe me, I have been wrong and I will be wrong again in the future. That is a part of the market. I know I am going to have interceptions but I think I am going to throw more touchdowns than most anybody else. I just want to keep the interceptions to a minimum. If I have made a mistake, I want to cut it quickly and get back into the game. After I go through my "forest to the trees" approach, even though I have a little scenario going on in my head, I let the charts talk to me. There have been a couple of times over the years where I may have been bearish but as I look through the charts, I see more and more stocks shaping up. So I simply switch gears and become more positive.

With regard to analyzing charts, is there a particular time horizon you prefer to use?

Absolutely. I don't think anybody should look at less than a one year chart. Ideally, I would like to see two years. Forget looking at a chart that is three to six months because you could be getting a break-out but if you look at the previous action, the price could be coming into supply. When I first go through the Mansfield charts I kind of feel like a major league scout looking at the guys who have been put in the minor league. After my staff and I go through thousands of Mansfield charts, we may narrow it down to something like the 100 best and the 100 worst. This is a starting point. Then on those, you look at Horsey charts (monthly charts that go back 8 to 10 years) in order to spot major support and resistance areas. Let's say I have picked out six stocks in great groups that meet all of my criteria. Then I will start playing timing games with things like stochastics, MACD, and relative strength. Of these six stocks, maybe two are overbought on a stochastic basis. They may be a good pick 30 days from now after they correct. The stochastics on the other four are oversold. So from a timeliness, trading point of view, these four would be better. You can't do this much analysis on all the charts or you'd be like Rip Van Winkle. For the average person, if they will just look at the market, then the sectors, then stocks in the sectors, this will be enough. They should use common sense. You don't buy stocks that are ridiculously far from support. I would rather miss something than pay too much for it. I am kind of neurotic this way. So if stock XYZ is breaking out at 20, I don't mind paying 20½ to 21—that's no big deal. But if stock XYZ should be bought at 20 1/8 and people are paying 26, those are the kind of people that lose a lot of money and say, "Charts don't work." You have to buy it relatively close to the ideal breakout point to keep your risk factor down.

With so many momentum players in the game today, do you buy a stock immediately as it is breaking out or do you wait for it to pull back?

I do both. I mention this in my book. If you are a trader, I think you should go for it but if you are an investor, which most people are, I think the smartest thing to do is to buy half a position on the breakout and the other half on the pullback. If 20 1/8 is a breakout and the stock closes at 19½, forget it. But if it closes at the end of the day at 20¼ on a valid breakout and the volume has picked up, I would buy half of a position on the breakout and then when it gets a good distance away, say 22 or 23 and pulls back and holds at 20¼ or 20½, I would buy the other half. That is a good one-two punch. If you strictly buy only the pullback, which is safer, you are going to miss too many good

stocks because when the momentum players start taking stock away from you, you'll never get any. The reality is that if momentum players are going to be making the charts you have to adjust to what's going on. Over the years, the market "gets" all of the different types of market players. In one cycle, it will be technicians while at another time the market will level the buy and hold people. Right now, momentum players have been the heroes over the last three to four years. If I'm right, over the next year or so they are going to get it. When they go out of style that will help us to be able to buy stocks more easily.

You mentioned that you looked for areas of support and resistance on 8 to 10 year charts. Realistically, how viable are old levels of support and resistance?

A lot of people think after a year or two resistance is not there but I disagree. I definitely factor in resistance back 6 to 12 months. You don't have to be a genius to know that nearby resistance is far more potent then resistance 10 years ago but I will go back on the charts up to 10 years. Resistance is resistance. I think you should know it's there. It becomes less and less important because a lot of people have already taken losses. To give you an example, a stock breaks out at 20 and gets really extended and goes to 32. I say, "Where is it likely to stop?" I'll take a look at the Horsey charts and see that seven years ago it had a high of 34. You figure nobody is still in it from seven years ago. You know what? It stops at 33½. It's amazing, so I still respect old resistance levels but you have to know that resistance dissipates in strength as time goes by. Twelve month resistance is very potent.

Do you have any specific techniques for constructing a trendline?

First know that I think trendlines are less important than moving averages. I am probably disagreeing with a lot of other technicians but I use trendlines and I use moving averages. Of the two, I think moving averages are more important. You can take any two points and you have a trendline but if you are using a two point reversal trendline, they better have been good sharp rallies off of those two bottoms. Connect intraday lows rather than closes. The intraday price to me is much more important. Make sure the two points you are connecting are good, valid points, reasonably far apart, ideally at least two weeks apart and maybe even a couple of months apart. In an ideal world, if I can lay my ruler on a chart and find three points on a chart over 3 to 5 months that it hits, I know I am dealing with an important trendline. When you extend that trendline out into the future, it's amazing what happens. I remember in my book I had Skyline as an example. I think it hit the trendline six times over a year and a half. I bring common sense into the equation. I look at some people's charts and they look like spider webs. I can't even read the charts because there are so many lines. You'll go nuts with all those conflicting signals. It should be obvious—this is a good chart, that's a bad chart. Probably one of the greatest mistakes that I have seen over the years is that people overwhelm themselves with trying to do too much. Try to keep things simple and pick one really clear line that has been hit 3 or 4 times over the last couple of months. The other thing is don't be silly. Sometimes I see people drawing trendlines that go up at a 60 degree angle. If a slope is real sharp, you can break a trendline easily. I would say the trendline should usually be under 45 degrees to be meaningful. The flatter the trendline, the more meaningful the break. Just realize that if you have a very steep trendline it is only showing a slowing down of momentum, it's not a bear signal.

I thought a steeply sloped trendline was exhibiting powerful momentum?

It does. I am talking about a break in a steeply sloped trendline. The fact that it has a sharp, rising slope showed it was a very aggressive upmove and after the break maybe it will now rise at a slower rate of ascent. Picture this. Let's say a stock or the market is going up at a 60 degree angle and it breaks the trendline. That doesn't necessarily mean it's a sell. Maybe now it will start moving up at a 40 degree angle instead of a 60 degree angle. There is no doubt that it is showing a slowing down of momentum. The closer you get to a horizontal line, the more serious it is. If you have a line that is rising at only 10 or 15 degrees, and it has been hit a couple of times and then you break below it, that's not just a slowing down. I think you are ready to head south.

Earlier, you mentioned your preference for moving averages. Let's delve into this subject a bit deeper.

The two moving averages that I have found historically to be the most helpful are the 10 week and 30 week moving averages. Plenty of chart services use 40 week moving averages. I have tried 40 week, 30 week, and 20 week. I have found that the 20 week moving average is nice and early but you get a tremendous amount of whipsaws. The 40 week moving average, which the great preponderance of Wall Street uses, has minimum whipsaws but you are late. I try to be a real world person. I realize life isn't perfect and the stock market isn't perfect and the technicals aren't perfect. I try to see what works most of the time and come down the middle. The 30 week moving average comes down the middle very nicely. You get minimum whipsaws, not a whole lot more than the 40 week, and it turns earlier. It is amazing how many times I will put out a buy/sell signal and I will see 4 to 8 weeks later market advisory services using a 40 week moving average jump on board. I think the 30 week moving average is very important for investors. The 10 week moving average, while it is not real important for the investor, is absolutely crucial for traders. I think investors and traders should learn to use both the 10 week and the 30 week moving averages. I strongly believe in bringing common sense to this equation. It is a mistake for people to lock themselves into "I'm an investor" or "I'm a trader." Even an investor should learn if stock XYZ has had a tremendous run from 10 to 30 and then even though it is longterm bullish, if the 30 week moving average is say at 15 and you have doubled the longterm moving average, you don't have to be a genius to know you have a correction coming. If you start breaking below the 10 week, which is perhaps say at 28, I would certainly never tell them to blow the whole position but I think even the longterm investor should shave the position a little—take a few chips off the board. Profit taking is not a dirty word. You see that within the last year, the markets have developed incredible volatility. I think this is one of the things that my institutional clients, even the fundamentalists have learned. You've got to have a little bit of trading aspect to you. I'm not talking shortterm but intermediate-term—two to three months. If something is real extended, I think investors should take some profits when you break the 10 week moving average. A trader's case is another thing. They should sell more aggressively.

Does the market have to be in a clear cut uptrend or downtrend for the moving averages to be useful?

Useful is the wrong word. The moving average is always useful even if it's to tell you that you are in a whipsaw environment. To be really "profitable" you need a strong trend—not even a question. The moving averages are most helpful in a market that has a clear cut trend. For example, a lot of charts broke down below their 10 week and 30 week moving average lines in May and early June 1996. Then you had that tremendous sell-off into mid-July. In early August, a lot of stocks started moving back above their 10 week moving averages. When you are oversold and start moving above the 10 week moving averages, you want to be less short. In some cases stocks moved above their 30 week moving averages. It was a better rally than we expected so we quickly made adjustments. The most profitable times are when you are coming out of a longterm bear market, like 1982 to late 1983. All of the stocks were above their moving averages for about a year and a half. Same thing coming off of late 1994. For all of 1995 and in most cases, the first half of 1996, all were very bullish. Conversely, if you go back in history and study 1973-1974, in many cases stocks stayed below their moving averages for close to two years. It is more profitable and easier to trade when you have a trend behind you. This environment that we are in is very difficult because you are getting a lot of whipsaws. People put down moving averages saying they can lead to whipsaws. Even though it's annoying to get whipsawed, I think it is a small price to pay so that you don't ever get killed. I would rather have 3 or 4 whipsaws in a row than to hold onto something, having no idea where the hell to get out, and get bombed on the long or short side.

So this is a stage when the phrase "when in doubt, stay out" becomes applicable?

I love it. "The bigger the top the bigger the drop." Those are good phrases and we are putting in some pretty big tops here. You don't have to bet on every race. Right now, this is not a real high probability bet. I think we are in a very toppy, whippy phase. In my fax to institutional clients—I was kidding around but somewhat serious—I said, "It almost makes you a believer in random walk." When the market is so trendless as this, trades don't work very well. The trend will become definable again. I may see a couple of interesting things but I definitely wouldn't be betting as heavily as in January through May of 1996. To me that was a slam dunk on the long side. June and July were a slam dunk on the short side. There is nothing wrong with saying, "I'm not going to play, I'm going to take it easy." There are some races that are better to bet on than others.

What are your thoughts on the spreads between 10 week and 30 week moving average lines?

This is a little bit subjective because the more volatile a stock is the wider the spread. Cisco Systems is going to have a much bigger spread than say a stock like General Motors. A person should just use common sense. Look at a chart over a two to three year period and you can gauge what the average spread is for different stocks. You will see that historically every time it gets to say 5 or 6 points away from its moving average line, that turns out to be an overbought or oversold signal. Conversely, a very volatile four letter aggressive stock might be 15 or 20 points away from its moving average line. The bottom line is that this is all pattern development. It's kind of like kids have personalities—charts have

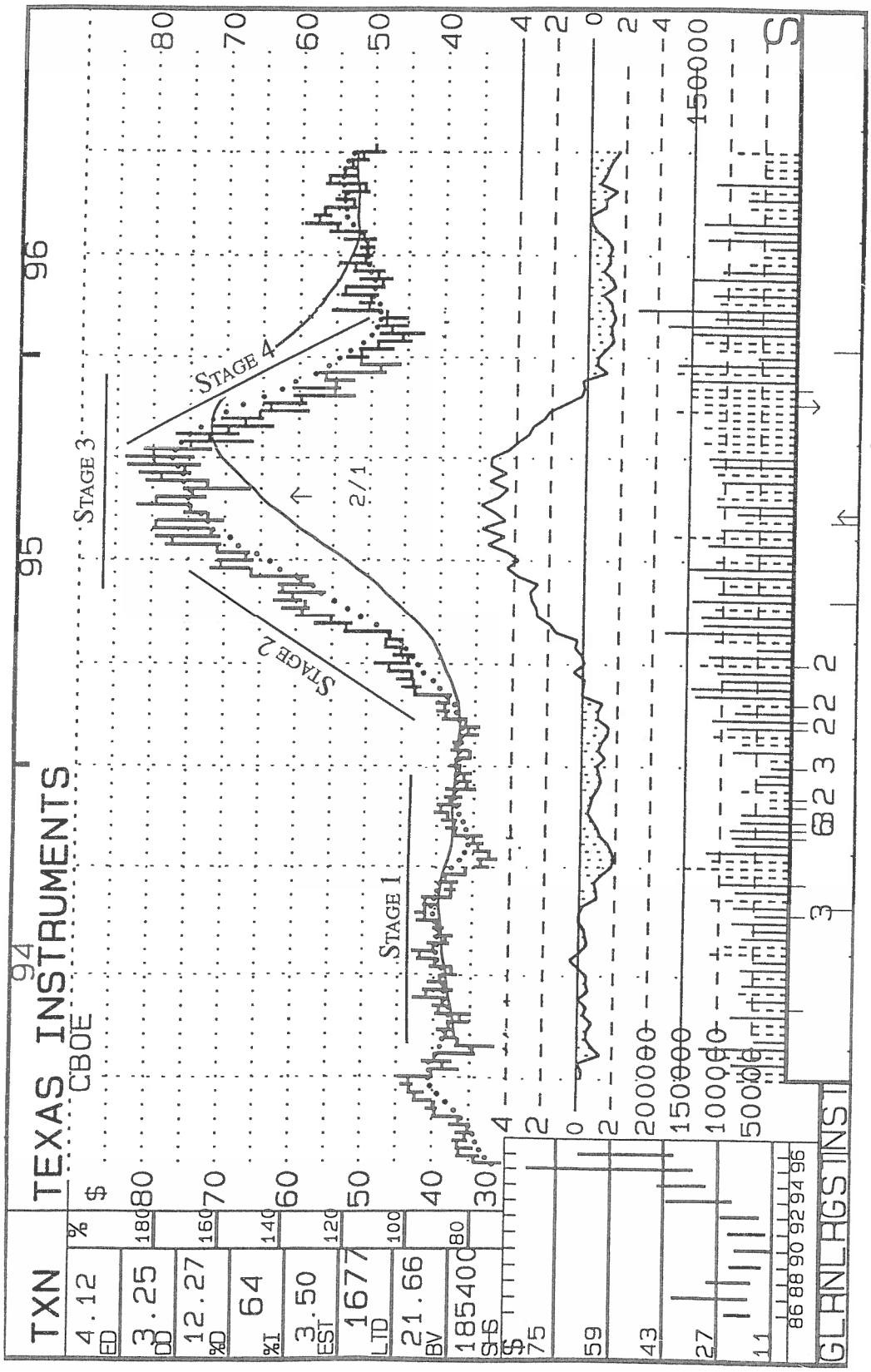
personalities. I wouldn't act strictly off of this but when you put the whole deal together, it works.

Don't you categorize market indexes and individual stocks in four distinct stages—I, II, III, and IV?

Right, and I'll quickly define the stages. Stage I is the basing phase while Stage II is the exciting, advancing phase. Eventually, after an upmove, a stock moves into Stage III, which is the topping phase and once it breaks down from support and starts trending lower it is in the destructive Stage IV declining phase. To illustrate with numbers, let's say stock XYZ has fallen from 20 down to 8. As long as a stock is below its 30 week moving average you are in stage IV. Then let's say it moves between 8 and 10 and starts to form a constructive base. If the 30 week moving average is still far away, say at 15, I still consider it late stage IV. It is a little bit subjective but if we continue building this base and the 30 week moving average drops down to 10½, that is, if it gets within spitting distance of the price, I will say we are early in a stage I base. You know for sure that you are in late stage I when the stock physically moves above the 30 week moving average or the 30 week moving average stops declining or becomes almost flat. Once you move above the 30 week moving average, even if a stock hasn't broken out of a valid base, you are in stage I. Now let's say you are in stage I and the stock goes between 8 and 10. Eventually, maybe six months after this sideways base movement, you break out above resistance at 10½ and it breaks above its 30 week moving average, now you are in stage II. That is the momentum phase. Go for it. I don't care what the fundamentals are saying, I want you to be bullish on the stock. While you are in stage II, longterm investors should just stay with the stock. There will be plenty of corrections along the way but they all happen above rising 30 week moving averages. Forget the trading aspect and just ride it. Let's say a year later the stock price is up to 22 and it starts going sideways, whipping a little below the 30 week moving average which is flattening out. You are now in a stage III distributional top. Traders blow it out. Investors should lighten up, selling maybe a quarter to a third of a position. When you break below the bottom of the trading channel, let's say it's 20, that is stage III turning into stage IV. When it breaks below 20, you are in stage IV. Nobody should be holding a stage IV stock. We all know that you get the heck out and stay out of the way. I would like to stress that before a person becomes a winner, they have to eradicate the most losing techniques. I have said this for years in my speeches and I believe it sincerely. So the first thing that you should do is never hold a stage IV stock. If you can get everybody to do this they will be well on their way to success. When I give speeches I kid around by saying, "Today's going to be like an AA meeting, you are going to take the oath—we are never going to hold or average down in another stage IV stock." If what I have just said can be eradicated, I think even some of the crummiest market players will take a quantum leap forward.

Get rid of the bad habits.

Absolutely. Everyone has bad habits but they spend time blaming everyone else. It's the broker's fault or the news media's fault or the market letter writer's fault. Some people are confirmed losers. They will lose no matter who they follow. If somebody comes up and says, "Stan, I don't have time to go through all this analysis, give me your best stock that's going to double in the next thirty days," I know that person is a loser because he's not ready to do serious work.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When you spot a stock breaking out of a base and moving from stage I to stage II, how do you distinguish between a stock making a false breakout and the start of a true, legitimate uptrend?

First of all, you really can't totally until after the fact but we can at least have a hint into which one is more likely. If the volume doesn't pick up considerably, you have a big chance of a false breakout.

Should we expect average daily volume to double?

At minimum a double. Historically, if you go back the big winners have at least triple volume on the daily charts. I would say you are very unlikely to get a false breakout if you have double volume on a weekly chart and triple on a daily chart. The other thing that will help keep the false breakouts down is to make it close above the breakout. If you can give me these two things at the end of the day it would cut down the chance of a false breakout. Let's say a stock broke out at 20 1/8, went up to 20½ and closed at 19 7/8 and the volume didn't pick up. The odds, and that's all we are dealing with is probabilities, are that this could be a false breakout if you get this type of thing. I don't like to buy a stock at 9:42 in the morning. I like to see how it's going to close at the end of the day.

So you want a stock to close at its intraday high when it breaks out?

It doesn't necessarily have to close at its daily high but it has to close above the breakout. If the breakout was at 20 1/8, it should close above that. The higher in the day the better.

Let's say you sit down with your new Mansfield chartbook in an attempt to find a stock candidate for purchase. What major characteristics would you look for?

I do it instinctively. It's almost like Gestalt where you are not even thinking about it. It's the sum total of all you have been trained to see but let me try to break it down. First of all, I do my group work. I'm going to be paying attention to stocks that are in strong groups. The second thing I want to look for is a good chart pattern I want something that preferably hasn't broken out or has recently broken out and is about to pull back. I don't want a stock that is like "mission impossible"—20 points away from the break-out and real extended. I want timeliness. I want something that can soon pull back to the breakout or it is about to breakout. When it does breakout, I don't want to have a lot of resistance nearby. If it is going to break out at 20 1/8 and at 22 I have supply, that is not going to thrill me. But if I see one that breaks out into virgin territory and it's at a new all time high, that turns me on a lot. New all time highs tingle me. I like this situation better because there is no theoretical supply. Nobody has a loss in the stock and has to get out. Another big factor is risk:reward. I want a stock where I can see that the risk:reward is in my favor. Let's say the stock broke out at 20 1/8 and it's at 22. Then I say, "If it breaks back below 19 or 18 7/8 I'm going to lose 3 points but if it works, it's going to go to 30." At least I can see some risk:reward in my favor. I like 3:1 as my risk:reward ratio—3:1 if I'm right versus I'm wrong. I want to have 3 points up for every one point down. Let's hypothesize that it could go to 29. It's now at 22. It probably has 7 points to the upside and I could lose three before I get stopped out. That is a little better than 2:1. I don't love it. I find another stock that is at 22. There is no supply and I think it could go to 32 and I can get stopped out at 20 7/8 because there is a prior bottom there. I might have

a risk:reward of 5:1 in my favor. When I first go through my charts, I make a mental calculation of risk to reward. I don't do all of the mathematics. When I look at a chart for the first time I am just making a list—here are good stocks in good groups. Let's say I have 20 stocks from certain groups. Then I start to whittle them down and say, "If I get stopped out with this one I am going to lose 4 points and maybe I am only going to make 8 points, it's 2:1—fair." This one is 3:1—very good. Then I start looking at other factors. All things being equal, I like bigger bases because I believe bigger accumulations lead to bigger moves. I like very little or no overhead supply nearby. I like good relative strength, and obviously if I see volume building up even before the breakout, that's usually a tell-tale sign strength is sneaking in. I like to see some volume characteristics and volume confirmation.

Of course, the stock price should be positioned above its moving average lines.

That goes without saying. If all of this is going on below a declining 30 week moving average line, I am not going to be paying attention to it. The moving average has to be right. In an ideal world, the best scenario would be a stock that was breaking out with no supply, it's near or above the 10 week moving average, and the breakout will also take the stock above its 30 week moving average. That is really a kind of super proposition.

In other words, when you see a stock getting ready to move above its 10 and 30 week moving average, that is a pretty good buy signal even though there might be some resistance overhead?

Sure. But I am making this first run through and will get a whole bunch of stocks. Then I narrow them down by saying, "This is an A-, this one is a B+, here's an A+." In an ideal world I'd like minimum or no resistance but maybe there is no such animal in this batch. I'd like to be very close to the break-out and I'd like to have a relatively close stop point. If the stop point is going to be like 20% away, forget it.

So you make a general list of stocks and then cull the least attractive candidates?

Yes. That's the way you should do it. It can make you nuts if you try to do it right the first time. The first time should really be instinctive.

Just a quick visual interpretation?

You should just look for basically good patterns. On the first run through you cut down, say 1,000 charts, to 20 or 30. On the second run through you should really start to sweat it a little, thinking about risk:reward and playing all the games I have just alluded to. When I get excited about a chart it should just pop out. I think, "Wow, that's a Picasso," then I can start quantifying it later.

You stressed that moving averages, pattern recognition, and group strength are your primary technical tools with regard to culling a large groups of stocks. Let's say you have narrowed the list of twenty stocks down to four. You can only buy one. Moving in order from most impor-

tant to least important, what other indicators would you use to make your final decision?

When you are fine tuning your work I would say resistance is the next important thing. You have to look at longterm charts and see where the resistance is. Let's say you have four A+s here and to make it easy, make believe they are all at $12.00 but one of them is in virgin territory and another one has resistance at 14. We know we are going to throw out the one with nearby resistance at 14 and concentrate on the one that has no overhead supply. Whenever you break down below a support level that you think is important and then boom, you move back above it, or you break out of a top congestion area and then you move back below it; that is how tops and bottoms start to form.

When you say longterm, is a three year chart sufficient?

Yes, that would be fine but, I look at Horsey's 10 year charts. The minimum chart investors should look at would be 3 or 4 years. Longterm resistance still counts. I can't tell you how many times I have looked at longterm charts and seen a stock approaching a high from 10 or 12 years ago. It's almost like looking for an excuse to stop and it stops near there. It is really good if people do look at longterm charts to get an idea of where they could run into trouble.

What else do you use in your final analysis?

You should also look at relative strength. All things being equal, one has neutral relative strength, another looks like it has much stronger relative strength. Another important factor I use to make my cuts is risk:reward. I think too many times people only look at the upside potential of a stock. To keep it simple, let's say you have narrowed it down to two stocks. Both are in virgin territory, they both look great, and they have good relative strength. How do I choose between these two? One of them is at 12 and it has support at 8. The stop you can realistically put at 7. I will end up taking a 40% loss if I am wrong. The other stock is at 12 and support is at 11. I can put a meaningful stop at 10 3/8. It's a no brainer—I'll go with the second stock. Too many people only look at the fact that the pattern is good and that's great but you have to look at your risk:reward because once in a while we all know we are going to be wrong. I don't want any one stock to hurt me. I would never pick a stock where the stop is more than 15% away and ideally I would really like it to be 10% or less away. If you can show me a stock with a 10% stop, close to support, no resistance, and good relative strength—go for it.

Mansfield collates their individual stock charts by group or industry. Separately, they also print charts showing the performance of particular groups. When you weed out the weak and strong groups, do you look first at the group charts or individual charts within a group?

For the average person, if they look at the group charts in the front of Mansfield that really is a tremendous help. But I do a second thing. If you have the time, looking at the individual charts within a group can raise you to a higher level. Sometimes groups are very narrowly defined, that is, some of those groups represent only 3 or 4 stocks. If one stock is a takeover or something like that, it totally distorts the group. In the old days, I didn't understand this. I would say, "This group looks great" and then I would go through Mansfield and see 22 charts within that group and only one

looked good. The group didn't look that good. When I go through my work I like to take a naive approach. I forget what I previously thought about groups and focus on today—what looks problematic and what looks good? I like to see the charts individually pop up with no prejudice. I like to see agreement between the groups and individual charts. So that's the second thing. Here's a good case. When we put out the buy recommendation several months ago on the banks, the S&P bank group on a relative basis looked okay but it wasn't that super. But a lot of individual stocks like Bank of America, Nation's Bank, looked very, very good. I think there was a lot of junk in the group but the leaders were breaking out and going topside. I think that the individual stocks were ahead of the group at that point. I remember when I did my work that night, that suddenly I had 22 buys and 11 of them were banks. Even though the group had only been so-so you didn't have to be a genius to say, "Hey this is looking very good." The same thing happened recently with drugs where the group itself looked just okay but I saw Warner-Lambert shaping up and Abbott breaking out. A lot of individual drug stocks were looking very good. Individual charts and groups should agree and when they don't, something is usually wrong.

If groups and individual charts disagree, would you pay more attention to the individual chart?

Without question, I would definitely pay more attention to the individual chart. But I pick stocks more in terms of where they both agree. For example, the bank charts shouldn't be giving a sell signal as a group and then a stock like Bank America is heading topside. That would bother me. If a bank group chart is just okay, like a B but not an A, and I see a lot of A+'s in the individual charts, that's okay with me. Of the two, you are recommending a stock, not the group. For the average person, if they can do only one, I think if they use the groups probably 80% of the time it's going to give them almost the same answer.

What are you thoughts on buying or shorting stocks that buck the major, overall market trend?

I think that it is great. Some people can't do this. For those people who have the temperament and are really serious, I think that it's a good discipline if everybody runs their own hedge fund. I do this a lot of times myself. We all get sloppy and say, "Ah, it's a bull market" and you only look at the good stocks and you can miss some very good moves on the downside. For example, I put out a sell signal in August/September of 1995 on the technology sector and I actually had bigger profits on the short side with sells. In the middle of the bull market, we recommended shorting Micron Technology. So I think that everybody should treat their accounts as a hedge fund. If things are very bullish, there is nothing wrong with saying, "I'm 98% bullish and I have only one short so I'm 2% short." Conversely, it's good discipline not to be 100% short in a bear market so you don't become too prejudiced and root against the market when it starts turning up. A hedge fund helps you move with the market flow. For example, 3 or 4 months ago, the hedge fund should perhaps have been 95% long and 5% short. As you moved into June, I would have dropped to 65% long and 35% short. If I were running a true hedge fund tonight, I think there would be nothing wrong with being 50% long, 50% short. I think you could make money on both sides. My 50% long would be the nifty-fifty big cap stocks and the 50% short position would be four and five letter OTC stocks. I disagree with those people who are bullish on Monday and suddenly turn bearish on Tuesday. If

you are doing this right, and you go back over the month, you are 90% bullish, you are 80%, you are 70% and so on. As more charts keep breaking down or going "topside," you keep moving in the proper direction so that you are in position before the official signal is given.

In other words, you are staying with the trend but your asset allocation is shifting?

Right. We are actually going with the trend. It is nice and easy when you know what the trend is. For example, coming off of a bottom like 1982, you obviously know what the trend is. Coming off a big decline like 1962 or 1973-1974, you know what the trend is. But right now, what is the trend? It's up in terms of the averages. Individually, more stocks are down than up. The drugs and the banks can be making the S&P look much more bullish while individual stocks are blowing up in your face. Right now I think there is a lot of distribution going on under the cover of Dow strength. I think a lot of people are going to be deluded on the downside when this whole thing rolls over and turns bearish. In this kind of market it would be crazy to be 100% long. This is why I like my NYSE Survey. When the NYSE Survey is very bullish and I see five stocks breaking out for every one breaking down, I know where my slant should be but I should still look at the one that is breaking down because in a bull market, there is something wrong there. When you are in a bull/bear environment, I think it's really great to have longs and shorts. If you do this right, anyone who looks at a broad spectrum of charts should move incrementally rather than making a big judgment.

On or around July 16th, 1996, a large majority of stocks broke below both their 10 and 30 week moving averages and then quickly reversed above them. A novice thinking that a break below the 30 week moving average line signaled stage IV would have sold out and been whipsawed.

If a stock breaks below the 30 week moving average, if the 30 week moving average is still rising, it is more likely that it is in stage III than if you break below a horizontal or a declining 30 week moving average. That is number one. Number two is a little bit subjective. If the stock breaks its 30 week moving average and in addition, it also breaks below an area of congestion, whether I get whipsawed or not, I have to put that in stage IV. Let's say you have been going between 23 and 26 and the 30 week moving average line is flat and at 24. You break 24 and then you break below 23, which has been support for the last 3 or 4 months, that is stage IV. If a stock was recently at a new high, went below its 30 week moving average which may even still be rising, and then moved back above it—unless it goes to new highs, a big stage III top is being built. Maybe it even holds up for a couple of more months thereafter. If you go back and look at the charts in 1973, you had a lot of stocks that broke below moving averages and whipped several times back and forth but they never really went topside above that range. The whole thing was part of a stage III top which is the most difficult part of the cycle to handle. "Whipping" comes during transitional periods, usually between a stage I and stage III. It doesn't take a genius to figure out that this isn't a stage I bottom we are experiencing here. As long as you haven't violated an actual area and you haven't broken below a clear cut range and if the moving average is still rising, we have to assume it is probably stage III.

A "warning sign" for impending stage III tops seems like a good explanation for this type of behavior.

Yes, it's a warning sign. This is where a lot of people screw up technicals—they expect it to be like surgery. Even surgery in the real world isn't perfect. Doctors kill people. Life isn't perfect. There are going to be whipsaws. That is part of the game. You can't be looking for an excuse to put down technical analysis. Don't think that just because the price broke below the 30 week moving average one time and then went back that the game is nonsense. You have to accept that this is a very valid tool but be warned that this tool isn't perfect. If you come in with a fair and open mind and learn how to use it properly, it will work probably 80% of the time. A break in the 30 week moving average line is a warning and that warning should be respected.

Are moving average crossovers used for shortterm signals?

No, the exact opposite. This may be contradictory from what other people say but as I see it crossovers (for example 10 week moving averages moving above or below the stock's 30 week moving average) are a longer term confirmation or reinforcement of a major trend. Some people trade strictly off of this. I am not saying you can't do it but I find it a very slow, lagging indicator and it is going to be late. There are ways of being much earlier. For a person looking for a 6 to 12 month kind of move and is already in the stock, you can press your bet when the crossing happens. But to first wait until that point to make the bet, I think you are already in the fifth inning of the game. When you really turn out to be right it's just good money management to press your bet. It is the same thing as in Black Jack. When you are on a roll, bet more aggressively than when you are cold. So when you have a good pattern working your way, it's a good thing to press the bet.

How do you interpret moving average crossovers?

It will be late but it is a confirming signal that a major, major turn is taking place when the 10 week moving average crosses the 30 week moving average. This is the sequence: a terrific stock starts going into a stage III top. It breaks below the 10 week moving average and then eventually breaks below the 30 week. Maybe the 10 week moving average is still above the 30 week moving average. You had the sharp drop and then it rallies back. The 10 week breaks the 30 week and they often stall at that point where they are converging. If you get it, this is a good point to do some short selling. Again, I wait for this signal and when you see that, it is a very strong confirmation. The flip on the bottom is good too for a bullish signal. Let's say a stock breaks out at 15, goes up to 20, and pulls back to 15 or 16. You have already bought some of your initial position. The 10 week moving average is coming underneath and up through the 30 week moving average. That is a bullish confirmation and makes me feel even stronger that I want to add to the position. I don't think it is a good idea to initiate trades off of crossovers but I do think it is a good longer term confirmation of major trend changes up and down so I use it for confirmation and to add to positions.

Which crossover is more significant—the 10 week moving above or below the 30 week or the 30 week moving average moving above and below the 10 week?

I see the 10 week moving average coming through the 30 week moving average up and down as more significant. The 10 week moving average turns quicker than the 30 week. The two most meaningful for me are—if the 10 week moving average has been below the 30 week moving average for a long time and it moves above it—good positive confirmation. You will notice that it is usually going to be accompanying a pullback. Conversely, when the 10 week has been above the 30 week for a long time and then the 10 week starts breaking below the 30 week, that's a good negative confirmation. You have already had other signals and patterns that probably came along before this which have made you feel bullish or bearish. I see a crossover as a confirming kind of deal that your formation was correct.

You follow the differences in stocks making new highs versus lows on both a daily and a weekly basis. Will the daily differential generate a trend reversal first?

Absolutely, not even a question. By definition, the daily will generate it first but know that each one has a plus or minus. Over the longer range, the daily will more likely give you a couple of whipsaws. The weekly is not as likely to whipsaw so that is more meaningful. The daily will generate a reversal first and then if it is a real good signal, maybe three or four weeks later, the weekly should be confirming it. Even though the daily has a shorter term feel to it and it is definitely a tremendous necessity for traders, the daily can even be used on a longer term basis. You can look back on a chart, like we have had in this case over the past year and a half, and you will see lower peaks on the daily even though the Dow has gone higher. You can see that pattern forming. The weekly has some longterm advantages but the daily serves its purpose for shorter trading. I think both of them should be used.

Your proprietary indicator, the NYSE Survey, allows you to ascertain the overall health of the market by categorizing individual stocks within four stages based on the stock's price in relation to it's 30 week moving average line. How well does your indicator correlate with Investor's Intelligence percentage of NYSE stocks above their moving average line?

I would think that there is a definite correlation but it is not a one to one correlation. I would say it is about a 75 to 80% correlation. But you are not going to see the NYSE getting super bullish and the other indicator very bearish. I think my gauge is finer tuned because we put patterns in there along with the moving averages. If you use just the moving averages, you could theoretically break below a moving average and it immediately becomes negative. So it's not perfect. The other indicator doesn't make a differentiation between whether the moving average is rising, not rising, falling or whatever. I think that is where my indicator has an advantage.

There will be a lot of people who won't have the time or inclination to go through hundreds of individual charts.

There is no question that the average person is not going to have time to look at each chart individually. If they are not going to make the wise choice to subscribe to the ***Professional Tape Reader*** and we can't rectify that error, then I think failing that, they should definitely look at the percentage of stocks above or below their moving average line.

You created the "eleven o'clock" and "last hour" indicator. Can you tell me about these and what is significant about those time periods?

First we started out with the last hour indicator. Understand that I always work in reverse. A lot of people think, "Hey this seems to make sense" and then they try to prove the point. I think that is backwards. I just take a look at all these different indicators and patterns and as I see what works, then I start reflecting. You might ask me, "What is the theory behind this?" To be perfectly honest, I don't give a hoot why things work—it's just that they do work. I am the ultimate pragmatist. The reality is that we charted all the different hours and the first one that I saw that had a really good correlation was the last hour, between 3:00 p.m. and 4:00 p.m. That was easy to justify because people I knew on the floor of the exchange would tell me how specialists in the last hour often adjust their books before they go home for the day. Also, a lot of shortterm traders want to be flat for the night and then they will come in trading again for the next day. So how they position themselves in the last hour is very important. It made sense intellectually but it also worked on a longterm basis. Then we tried it for all other hourly time frames. Eleven o'clock to noon turned out to be very interesting. In some respects, the more work I did I found that the eleven o'clock indicator was even better than the last hour. That really surprised me because I really thought the last hour would be the best tip-off. For whatever reason, I found that the 11:00 a.m. to 12:00 p.m. time frame seems a tad more longer term oriented while the last hour I found better for the intermediate-term. There is usually a reason for things but I just don't care too much about it. I started talking with a lot of people on the floor who told me that both of these time periods really make sense. The reason for the 11:00 a.m. to noon hour is: Let's face it, when the market opens I don't want to be in there because there are a lot of overnight orders, odd-lots, foreign orders—things like that. It usually takes an hour to an hour and a half before that stuff blows itself out. About 10:30 a.m. or 11:00 a.m., traders often start putting on positions after they see the fluff is out of the way. Then, at noon, people are taking time out for lunch—the ones that aren't drinking Maalox. So I think that between 11:00 a.m. and noon you are getting a snapshot of where they are initiating trades of the day. Between 3:00 p.m. and 4:00 p.m. you are certainly getting an insight and a snapshot into how they are feeling at the end of the day, initiating or closing out positions. Those two things are symmetrical in some respects. The two together, especially when they are both moving in the same direction, are very helpful indicators.

If readers wanted to start charting these two indicators, could they just jump right in or would they have to collect some back data?

They can get started very easily. Just like with an advance/decline line, as long as you scale it off, net up or net down, you can start at any point in time. It's not like you have to go back a year before. This will start working for you after a few months of history. Obviously, the more data you have, the better off you are.

To calculate the indicators, do you just subtract the 11:00 a.m. level of the DJIA from the noon level and the 3 p.m. level from the 4 p.m. level?

It's so easy. Take the differential between the two times periods for the DJIA, obviously plus or minus. It's cumulative so each day add on or subtract off the current numbers from the previous total.

Make a daily graph. A lot of times you get thrown off by keeping a table with a couple of good or bad days. Start charting it because you will start to see a trend and it is very helpful. For example, the 11:00 a.m. was fantastically bullish from late in 1994 until about May 1995. It has been weak the last couple of months. Even now, with the slight little bounce up it had, it really isn't coming back commensurate with the market which reinforces that there is a tremendous disparity in this rally. Over the past year and a half, all the other rallies were good. This time it is rallying but rallying poorly which makes me feel like we are topping out. You can do this with stocks too. If somebody is really serious and they have a few pet stocks, I have found this to be fantastically helpful with individual stocks. It's really laborious but if you have the time to do it, it works well.

You keep two separate charts on these?

Keep two separate charts because from time to time they tell you something very different which is currently happening. The ideal is when the two of them are in gear. That is a slam dunk. For all of 1995, the two of them were clearly in gear together. They started splitting off in either April or May. Now you are starting to get a divergence where the last hour is still favorable but the eleven o'clock isn't terrific. It is getting a shortterm rally within a longterm negative pattern and it is well below it's prior peak. The eleven o'clock indicator is usually earlier turning than the last hour.

Would it be helpful to compute a ratio dividing the volume for each of these hourly periods by the total day's volume?

I shouldn't talk because I haven't done it. If you haven't done it, you are just giving your own two cents. Somebody could try that but I would think that volume might be less helpful than the price. I think price is the most important thing. I use volume to confirm price. You can get thrown off a lot if you just look at volume and chart the volume. You don't know if it was an up or down day. I don't think the pattern is going to be as helpful. When you do the price you know, "that was down big, they were really scared" or "that was up big, they really got excited." I am not going to be dogmatic about this but my gut instinct says that it is not going to be nearly as helpful.

On a shortterm basis, what other indicators would you use to judge the trend of the overall market?

One should definitely use the call/put ratio. It's the same thing as the put/call ratio, it's just the inverse.

Why do you invert the ratio?

I started doing it that way years ago. I'm just used to it. One way is not any better than the other. However you use it, just make sure you interpret it properly. I like the call/put ratio because it is very easy for the average person to understand. The relevant numbers for me are: at 3.00 and higher you have to start looking for shortterm tops. Start looking for shortterm bottoms at 2.00 and lower, especially below 2.00. Anything in between is neutral. In July, when you put in that important intermediate bottom, you had approximately 1.4 calls for every one put being purchased. That was very low. That is almost

equal and historically you rarely have them equal. That showed a lot of pessimism. When you go back to May, before the decline, the ratio got to an exceedingly high 4 to 1. That was a lot of optimism. There were four calls being purchased to every one put. That was one of the highest readings I have seen in years. The call/put ratio told you that there was way too much optimism in May and way too much pessimism in July. In late August, early September, the market had that sell-off going from about 5700 down to 5560. The pessimism built up incredibly fast. The call/put ratio dropped down to 1.9. This was the little kicker that told me the Dow was probably going to break out to new highs even though a lot of the other averages wouldn't confirm.

Regarding the call/put ratios, do you look at the equities, indexes, or both?

First of all, I am not calculating it myself anymore. I used to do it out of ***Barron's***. ***Barron's*** has the C.B.O.E. and other exchanges and I used to average them together. Now I use the one on my Bridge system and they are doing it off of the equity. I think the equities are far more meaningful than the indexes.

The C.B.O.E. has a toll free number available to get the put/call data on the hour and half-hour from that exchange only. The equity put/call ratio is actually pre-calculated.

That's fantastic. It's ridiculous to spend two hours doing eighteen different things to one indicator. I really believe in the acronym KISS, "keep it simple stupid." I have found that with a lot of indicators, once you track them for a while you will start to see where the turns occur. My call/put numbers may be say 3.00 and 2.00 and the C.B.O.E. may be 2.8 and 1.8. The exact numbers I use may be off by magnitude a little bit but they can use the C.B.O.E. and it will correlate. If people can call in and get the numbers without a lot of calculation, they should do it and keep it simple.

After all, the objective is to spot the extreme readings.

That's right. The extremes are what they really want to spot and also unusual patterns. Sometimes you are not at an extreme. The top and bottom extremes were obvious in May and July. In late August, early September, there wasn't a wild extreme but the fact that the Dow was so near the high and you had a lot of pessimism, that was a shortterm bell ringer telling you that you were probably going to break out and go topside. If the call/put ratio drops from 3.00 to 2.00 and the market has had only a very small fall, the pessimism is coming in too quickly and that I think is more meaningful than if it had dropped 500 points. If the market dropped this much I would expect to see the ratio drop to 2.00. Sure, you will probably get an oversold bounce. If you look at the extremes, you will be 1000% right for sure but the numbers in relation to what's happening in the market are also important. If the ratio changes too quickly on either side, that is very meaningful. The call/put is especially good for the intermediate-term and isn't as good for the short-term.

What other indicators do you look at on a shortterm basis?

The percentage of bearish advisors. The fact that this indicator got up to 45% to 46%, the highest in a year and a half, confirmed what we saw in July with the call/put ratio. They dovetailed nicely. Also, I like the Investor's Intelligence overbought/oversold oscillator—the number of stocks above or below their 10

week moving averages. That also got wildly oversold in mid to late July.

What are the parameters of the Investor's Intelligence overbought/oversold oscillator?

I would say 70% becomes overbought and 30% is oversold. You can't be totally mechanical about these things. You have to tie it in with what the market it doing. If you have a market that is very strong and you have reached 70% but the charts aren't showing any signs that the rally is ending-fine—it's a little overbought but I am not going to take that too seriously. That is a real early signal. Conversely you've had a big rally and you start to see signs of churning. If that number gets above 70% and then starts to dip down, I might take some chips off the table. Every 70% isn't the same. Part of their rule is if it gets above a number then you want to see at least one week where it flags a little lower. It could be 75 one week, 72 the next, then 70 the next. You want to know that this indicator is starting to top out. It is a three part deal. First you want to get close to plus or minus 70. Secondly, you want to see if the rally is showing signs of at least getting tired and then the third part is that you want to see this indicator come down. To put it together, let's say you went up to 71% last week and the market is starting to get a little churny. The next week it is 69%. You don't bet the whole ranch on it but that's telling me that it's an overbought reading. That is one thought. A second thought is that you have to be a little more aggressive for the oversold number. I have seen the overbought number lead by a good several weeks. There are a lot of cases where you get above 70% but the market doesn't go down for another six to eight weeks. The oversold number usually correlates more closely with actual turns. When you get an oversold reading you will usually be within a week or two of an important short to intermediate bottom. That is another little subtlety of their indicator. I think it is a big mistake for people to become totally mechanical. You have to develop a feel in technical analysis. Some 70% readings lead to a B minus decline, some lead to an A+ correction. Same thing happens with stochastics. If you sell your stock on every overbought signal you are going to get whipsawed. When it fits in with the other things we talked about it is a good fine tuning indicator. Another good indicator is the 10 day and 30 day moving averages of the advance/decline line (A/D). When the 10 day A/D line gets extremely overbought, above plus 300, or oversold, below minus 300, and the 10 day A/D moving average line crosses above or below the 30 day A/D, that is a confirming deal. If the market gets really oversold like it did in July 1996 dropping 600 points and then if the 10 day A/D moving average line crosses and moves up through the 30 day A/D line, that is a very good bullish confirmation. It doesn't happen too often. Conversely, if the 10 day A/D is like +400 and the 10 day A/D moving average breaks down below the 30 day A/D moving average line, that is a good confirmation that you are going to get a correction.

Would you explain your overbought/oversold readings on the 10 day advance/decline in a little more detail?

It's an oscillator. All you are doing is taking the net differential of advances minus declines for 10 straight days. Let's say today you have 1,000 advances and 700 declines. That's plus 300. You can keep a running total of the net difference for 10 straight days or you divide the total by 10 and make it a moving average. You can do it either way as long as you are consistent. When you get to plus 300 or 400, or in the case of the total, plus 3,000 to plus 4,000, that is historically overbought.

Conversely minus 300 to minus 400 is oversold. For those you want to be a bit more sophisticated, there is another little game that you can play. Let's say one week an overbought signal gets to +380. You say, "Fine, I will take a few chips off the table because the market is extended." Two weeks later the 10 day A/D moving average starts heading down and breaks below the 30 day moving average of advance/declines. Let's hypothesize that the 30 day moving average is at +200 and the 10 day moving average drops below the 30 day moving average at +200. This is a very important short to intermediate-term sell signal. When the 10 day moving average violates the 30 day moving average, that usually leads to a decline for a good couple of weeks. Conversely, on the bottom, let's say you have been down to -320. It's oversold so you are covering a few shorts. The 10 day moving average moves above the 30 day which we'll guess is at -200. That is telling you that the rally is going to be a little bit better than you expected so you had better cover some more shorts. That is a good short to intermediate term confirming indicator. Anytime the 10 day A/D moving average breaks above or below the 30 day it has meaning and is important but if you look back historically, the most significant corrections or rallies are signaled by the 30 day being far away from the zero line of the oscillator. The higher the 30 day is when the break comes the more meaningful it is. This is another subtlety. Just to make this clear, let's say the 10 day A/D is at + 400 and the 30 day is near the zero line and the 10 day A/D breaks below the zero line. There's going to be a little decline but it's not as serious as if the 30 day A/D moving average line had been higher on the oscillator chart. If the 30 day is at least in the +150 or +200 zone when the break occurs, that will produce a more meaningful sell-off then if it is near the zero line. For example, let's say the 10 day A/D moving average has been well above the 30 day moving average and then it breaks below it at a point where the 30 day is well above the zero line, say as high as +200, you will have a more meaningful sell-off. Conversely, if you get the reverse signal at a market bottom, that is, an oversold signal with the 30 day at -150 to -200 and then the 10 day A/D moving average crosses above it, that will give a more meaningful rally signal than if the 10 day crosses up through the 30 day when the 30 day is near zero.

Is this the extent of your trend following indicators?

I will give you one more helpful indicator—the TRIN gauge. Keep it simple. Don't do it intraday. Do a 10 day moving average of the closing TRIN. If you drop to .80 or lower, you are usually overbought. Conversely, if you go to 1.20 or higher, that is oversold. Look at the TRIN in relation to what the market is doing for subtleties. In late August, early September period in 1996, the TRIN didn't quite make 1.20 to get fully oversold. It got to about 1.16. This was very unusual because the market was still near the top so that was a sign that a lot of individual stocks were building up bearishness even though the whole market didn't. That is another sign of extreme pessimism and coming at too soon a point. It's not like the oversold reading was coming after a 500 point fall. If an indicator doesn't get to 1.20, that is, if it only gets to 1.10 and there is not a big sell-off, that is meaningful. If investors follow these indicators they will be pretty well tuned in.

To bring things together, would you classify your overbought and oversold indicators according to shortterm or intermediate-term?

There is a difference between the indicators I use for the stock market and for individual stocks. For the market in general, the 10 day A/D is very good as an intermediate-term indicator. For those

who are more sophisticated and have their own computer systems, I think MACD and stochastics are as good as it gets shortterm. The stochastics turn earlier than the MACD but give you more whipsaws. The MACD has less whipsaws and is a little bit later. Again, we are talking very shortterm. When you use the two together I think they are very good for both the market and individual stocks. Using 10 day moving average line crossovers of the A/D line is very good shortterm work to confirm your opinion. For the intermediate-term I think the TRIN and the call/put ratio are excellent but people need to separate these indicators. When people get confused sometimes they will say something is very oversold because the 10 day A/D is oversold. They don't realize that the TRIN or the call/put ratio is not so oversold. I have seen the A/D oversold for a long time. When you get the really meaningful bounces, you are going to first get the shortterm indicators oversold and then you get the intermediate ones oversold. Like in July 1996, they all came together—the TRIN, the call/put, and your shortterm indicators like the 10 day A/D. When they all coalesce, that really gives you something.

So it is perhaps better, especially for the inexperienced, to wait until they all simultaneously give the same signal?

I think so. It's one thing if you have a lot of experience, then you can do it sequentially. But for the average person, they are going to start seeing oversold levels and it will be like "there is a communist under every bed." I see this all the time. I think beginners should move incrementally on a learning curve. You don't want to bet every race. Initially, just do the big easy bets. Then as you become a little sharper, you can trade around that. There are usually only a couple of extremes a year. In 1996, where did these indicators all come together? They all came together at the May top and at the July bottom.

Which indicators do you use to measure momentum?

I would say you measure momentum by looking at where the market and the averages are in relation to their 30 week moving average. How far is the stock above its 30 week moving average? Obviously, if you start getting pretty far above it, you have built up a lot of momentum. When an individual stock is getting too far above its 30 week moving average and especially its 10 week, it's showing good positive momentum longterm. Each stock has its own historical characteristic. When you start getting to a certain point on the chart, like doubling the moving average or something, even though that is showing tremendous momentum, it is also overbought shortterm. Another good momentum gauge is stochastics because it is a rate of change and that is a perfect measure of momentum. It's even better than MACD. For individual stocks, I think you should use stochastics and MACD to measure momentum.

MACD and stochastics are primarily shortterm, right?

Stochastics and MACD are not strictly scalping tools. They are shortterm but depending on the computer system, you can adjust them and the same concept can be used on a weekly chart. I use the intermediate-term MACD and stochastics on weekly charts. When you are using 6 day and 12 day stochastics, that is obviously shortterm. But then when you start doing it on a weekly basis, 6

weeks and 12 weeks on weekly charts, the intermediate term signals are very meaningful. Those signals are giving you moves that often last 3 to 6 months. The last thing I use to measure momentum is relative strength. Especially with individual stocks, I think this is outstanding.

Are you talking about the relative strength index?

Yes. I would suggest using the relative strength index two ways. Use the shorter term relative strength index for daily charts and then there is a weekly relative strength index which is definitely important for intermediate to longterm. At extremes it can also be used as a trading tool. When it gets up as high as it can get, you know it's a top or if it is down to 10%, it's very oversold. The relative strength index and stochastics both tend to be early. Mansfield charts have a different way of weighting relative strength. When relative strength starts increasing and going above the Mansfield zero line, I have found that to be meaningful. The relative strength index is a shorter term measure of momentum, more for trading, whereas the relative strength line has a longer term orientation.

When you are trying to judge the overall market trend, on which major indexes do you keep tabs?

Those people who are only going to look at the Dow— forget it. If you look at the Dow, the S&P 500, the NASDAQ composite, the Dow Transportations, the Dow Utilities, and the A/D line you will be in great shape. Through almost all of 1995, all of those were in gear on the upside. When they are in gear don't argue, just go with it. Conversely, if you take a look you will see since late May, early June 1996, you are getting a lot of disparity. Some are going to new highs, some aren't going to new highs. That is a sign that you are putting a top in here. When they are all in gear, don't worry about whether they are too high or too low, just go with the trend. When you start to see things getting out of gear, that is a sign of a trend reversal. The sequence usually goes in this order— first you have the utilities go. Then usually you start to usually see the Transportations go. The A/D line should come next. Then the speculative issues should top out. The last thing to top out are usually the blue chip averages. Usually at the end, investors go to quality because they don't have a lot of confidence. When these are out of gear you can make money but you have to play it carefully because that means something.

How do you measure speculation?

An easy measure is what I call my "speculation index." This is so easy to calculate. You can get the numbers from ***Barron's*** every week. It is the weekly volume for NASDAQ divided by the weekly volume of NYSE. Historically, you get more NYSE volume than OTC volume. When the OTC volume gets very low, like 70% or 75% of NYSE volume, that is usually an important sign that nobody wants to speculate. That is near a bottom. That happened in late 1994. Conversely, when it gets high and you start getting above 1.20 and 1.30 showing that for every one share traded on the NYSE you are trading 1.20 or 1.30 shares on NASDAQ, then you are starting to get speculation. In late May of 1996, when I really turned negative on the aggressive stocks, we set a new all time high. I think the number was something like 1.80. You got almost two shares of OTC stock traded for every one share on the NYSE and that said it all. I don't care how high the Dow goes, I think

you will see that the speculative stocks topped out in late May, very coincident with this speculation index. Now this is a good longterm speculation gauge. A good shortterm measure of speculation is the call/put ratio.

You spend a lot of time with industry groups. Have you observed a definable sequence regarding group rotation at market tops and market bottoms?

I would say that historically, starting a move, investors usually go first to quality—good blue chips-and then will fan out to the wildly speculative stocks, the $1.00 and $2.00 OTC stocks. At the end of the game it becomes wildly blue-chip again. This to me is a clearer sign than saying, "When Group A moves that's the start and when Group B moves that's the end." Historically, copper or the oils move at the end but it doesn't always turn out to be true. These kinds of things can be a claptrap. People are going to decide that this is the rule and in the next cycle suddenly they will see the mobile homes leading first. Every cycle is somewhat different. These things change like fads. What is most likely to hold true is at first, when investors are not sure if this is the real deal, they go into the blue chips. Then as they start to become more emboldened, they invest more aggressively in OTC speculative stocks. At the end when you see the speculative issues starting to lag and top out while the Dow makes a new high, that to me is a pretty clear sign that you can take it to the bank. That is more important than my telling you, "Because copper has moved, sell stocks." I don't believe in that so much.

Bonds and financial stocks usually move in the same direction but there were occasions during 1996 when the two diverged. Is this a rare occurrence?

Yes, but here is where a lot of people have all these rules etched; "if bonds are good then gold has to be bad" or "if bonds are good, bank stocks have to be good" etcetera, etcetera. Yes, those things usually hold but there are times they diverge. The bottom line is that it happens rarely but it is happening now. People say, "Stan, how can you be at all concerned about the market when historically we know if the financials are okay the market is usually okay." My answer is that maybe this is one of the few times it can uncouple. I always go back and say, "Is there a time it was like this?" If you go back to 1962, the bond market was just fine and they crashed the stock market. 1977 wasn't as fine but bonds weren't a problem and interest rates were benign. The stock market had a bear market. The same thing happened in 1990 when you had that junior bear market in stocks and bonds were again benign. So it is certainly not without precedent. Too many times people learn the rules so to speak. The rules might work 75% of the time, but if you are getting a divergent answer, you have to be open and accept that this might be the 25% of the time it's not working. That is one of the things that I find so annoying about Wall Street. They always know the "answer." If the Fed does this, the market can't possibly do that. It is ridiculous. If it were that easy, we would all make a million tomorrow.

So in situations where there are divergences, you fall back on the tape for the answer?

Absolutely. At the top of my newsletter I have the logo, "the tape tells all." I really believe this.

When I think back, the times when all of us make mistakes is when we don't listen to the tape. Over the years, I have had myself hit over the head enough times to know the market is smarter than I.

I certainly can relate to those experiences.

All of us can. I'm sure if you are honest with yourself the times you were most wrong was when you thought something out intellectually. This is where the charts can help you the most, when they diverge from what everybody is thinking. There are times when I have made up great stories in my head— "this should happen, that should happen" and it blows up in my face unless the chart agrees with me. The technicals are not Nancy Reagan astrology. When a doctor looks at a cardiogram, if he has never met you or me, he can make a certain guesstimate about our health or lack thereof. The same thing with blood testing. That is what we are doing with charts—running cardiograms of the market, which is supply and demand. And if you will learn to listen to the cardiograms, you will have a much better chance of being right then selling yourself on an intellectual proposition.

It's difficult not to anticipate the resolution of a chart pattern rather than letting the chart tell us what it is doing.

That is what we all have to learn. Most people don't even get to chart patterns. They read something in the paper that says XYZ has good earnings so the stock should go up. If you look at the chart, that stock's pattern is a horror show. That is why I became a technician. I started out getting a degree in economics and saying, "Now this is the way the market should act." It never worked that way and I lost a lot of money. I decided there had to be a better way. Some people aren't open. They continue to hit their head against the wall and they don't understand why the wall doesn't move. I know if something isn't working there has to be a better way so I start looking.

You follow roughly 50 indicators in your "Weight of the Evidence" approach. Are these indicators equally weighted?

Definitely not. I think that certain indicators are more important than others. I always kid around and say that if I were stuck on a desert island and could only have two indicators, I think the two I would want would be my NYSE Survey and the advance/decline line. A third indicator would be the Dow with some other average in relation to its 30 week moving average. I will definitely weight these much higher because I think they are more important. Forget weightings. I think it is more important for people to separate what is an early warning indicator and what is a confirming indicator, that is, coincident with what's going on. I think this is where people foul up. For arguments sake, right now if you take a look, new highs are improving. Well, they should. The stock market is going up. But conversely, if you take a look at the NYSE Survey, which is usually early, it is not showing as much strength as it should on this rally. Anytime you see that you have a problem 3 to 4 months out. Divergences can be wildly early. Rather than be worried about weighting, I think people should start putting. We know tops are the toughest times in the cycle. We are making a stage III top which is a transitional stage. It is not obvious in the Dow but it is obvious in a lot of stocks. So how should a top form? First, you should have the bonds and the utilities top out well ahead of the market. They topped out in January/February 1996. They are usually very early by

6 to 9 months. Then you should have a speculative top next. The speculation index reached its highest point in May. When we had the June/July sell-off, they should have killed the "specs" and they did. The Dow was down only 10% and the OTC Composite was down 25%. Boom, that did it. Then after you put in a bottom in July and started coming back up, there should be less confidence. They shouldn't go right back to the specs, it should become nifty-fiftyish. Well, it is. A lot of OTC four and five letter stocks under $20.00 that were the big leaders up until May aren't lifting with almost a 600 point Dow rally. The A/D should top out ahead of the Dow. I think it has. That was one of the things that was wrong with the May top. There were no divergences in May in the A/D line. Everything was pretty confirmed then but now you are getting a lot of divergences—classic things where the Dow is at a new high and the Transportations are not. All these things are really coming to the fore the way they should when you are putting in a top. Sometimes it can be fast like 1987, other times it can go on for a year like 1972. When you are putting in a top and all the things are happening in textbook fashion the way they should, it just takes a long time and you get a lot of false moves and it is very annoying. This is one of the most complex tops I have seen in my 35 years in the market but I think if we step back, most of the things that are supposed to happen, which we just outlined, are sequentially happening.

What was the most painful lesson the market taught you and what did you learn from it?

The market has taught me a lot of painful lessons. First of all, no matter how sure you are of something, never bet the whole ranch. The first lesson I learned was back in late 1961—early 1962. At that time, I was in school getting my economics degree. I was believing in the fundamentals. I was getting a lot of fundamental stock services telling me about all these great stocks. I bet my whole Bar Mitzvah money on the stock market and the 1962 crash came along and it wiped out all of my money. At that time, it was a lot of money to me. The lesson I learned was that fundamentals don't work, at least fundamentals by themselves. Fundamentals are important when you are putting them together with the chart. That was lesson number one and that is really what propelled me to become a technician. After that, I remember going to the school library and getting Edwards and Magee's book ***Technical Analysis of Stock Trends*** and saying, "What the heck is all this?" I started doing some charting. I am not going to say I made money right away but I lost less. I found that there was really something to technical analysis and it was interesting. I saved up the next little bit of money and started out the second time and got much better. The second lesson I learned was not having stop losses. In 1962, stocks came down so much that I sold at the bottom because it looked like they were going to go down forever. When I look back, they were good companies. Some of them had tremendous falls. I didn't realize first starting out that good companies could get whacked. When I started looking at charts, I realized that no stock should ever fall by half and lose that much money. Remember I told you to look at two charts and see which one has less risk? Going back to that initial experience, I am very risk averse. We never get past those experiences. It's like people who were tainted by the depression. Before I look at how much I can make, I first say, "How much can I lose?" I think that is important. You realize that once you learn this game you can have a lot of small losses and still come back to fight another day but when you are on margin and you take a big hit like I did in 1962, it takes a long time until you put the money together and come back. It was a painful lesson but it was a good thing. I always believe that something positive can come out of something negative. That did it. I'm a technician today and I learned to always cut my losses.

That experience was your tuition for learning.

I agree. I don't think most people who become successful in the market can just walk into the market and become successful anymore than somebody can walk onto a tennis court and start whacking the ball. You really have to pay some dues. Some people have a faster learning curve than others. Some people go through life and never learn. They blame their brokers or their stock market letter writers. You have to pay your tuition.

What are the most essential psychological traits for successful investing?

I think the first thing is to admit to yourself that you are emotional and then to be able to put your emotions on the side. That is another reason I use stop losses. I can be as emotional as the next person. We all believe when a stock is rocketing it is going to 100 and when it starts down it's going to zero. That is the nature of human beings. When you learn how to properly use stop losses and to move the stops, they insulate your emotions from your stock market decisions. Discipline is one of my strong traits. When something goes against me I say, "I was wrong" and that's it. If you can see your emotions for what they are and say, "How am I going to handle this?" I am going to be disciplined. I am going to follow my stop losses. I am not going to guess, "This time it's different." I wrote in my book and I believe it—those people who learn how to properly take a loss can become the biggest winners. One of the most crippling traits that I have seen in people is—I'll wait for a stock to come back to get out even. People who can't take losses, who pull their stops, or don't want to put stops in—they are going to get whacked. It's just a matter of when and in what market. They are going to get killed because the stock is going to go against them and at some point it has gone too far against them and they are finished. Can you take a loss? Can you be disciplined? Can you say, "Fine, I'm going to be whipsawed now and then but that's better than losing 50% or 60% in a stock?"

When your forecasts don't materialize, do you ever go back and analyze the situation?

I do, absolutely—it's painful but very important. I always try to figure out what went wrong. For example, I stuck my neck out when the market topped out in May 1996 and said that was going to be the high initially for the Dow and all the averages. At 5180 I covered shorts and called for the rally but I only called for 5600. I didn't call for 6500 so I amended that in August saying I thought the Dow could make a marginal new high. When I looked back, you know what was wrong there? There were no divergences. We have had only two or three cases in the whole 20th century where a market has topped out with no divergences. I had just looked at so many bearish charts that I said, "This is it." I really didn't pay enough attention to the fact that the odds were that we were not going to end without divergences. That is why I feel better about this second rally as a double top is forming. This fits in more with classical theory of divergences. In the old days, I used to keep a dairy of what I thought the mistake was. I think everybody should keep a diary and you will soon see a pattern develop. Everybody has patterns. Some people's pattern will be that they take profits too quickly. Another person's pattern may be that they never take losses. You will see what your pattern is and then you have to learn to deal with it. I guarantee you that if a person is losing a lot after they get good technical skills, they have a character thing to deal with. They should find out what their pattern is because it is correctable. Sometimes you will take a look and say if you

had to do it over again, I'd do it. It's a perfect call, it just didn't work. If it's that I would just forget about it. It's just a cost of doing business.

Do you have any favorite quotes?

"The tape tells all" and "Don't bet every race." A lot of times people say to me, "This time the market is wrong." I have always come back with, "The market is never wrong. The market is the ultimate reality. We are wrong." Another thing I have said is, "It's not un-American to sell short." I think everybody should learn to sell short. In essence, not being willing to sell short is kind of like driving a car with no reverse on it.