

The Geometry of Stock Market Profits

**A Guide to Professional
Trading For a Living**

by
Michael S. Jenkins



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**Biographical Sketch
of**

Michael S. Jenkins

Michael S. Jenkins was born in Schenectady, New York on March 12, 1949. From earliest childhood he was fascinated with the stock market and studied every book and publication he could find regarding the subject. He studied Economics and Business Administration at Washington & Lee University and graduated with a B.S. in Commerce in 1971. In 1975 he received an MBA from George Mason University.

Mr. Jenkins held positions at various bank trust departments from 1971-75 and in 1976 was appointed portfolio manager for three mutual funds in Washington D.C.

In 1984 Mr. Jenkins moved to New York City to become a professional trader for a number of specialist firms on the NYSE. In 1985 he founded the investment newsletter *Stock Cycles Forecast*. Because of the widespread notoriety this letter received in precisely predicting the final stock market high in August 1987 and specifically calling for a 500 point drop in the Dow that would end by October 19th of that year, Mr. Jenkins has become a frequent commentator on television and often the subject of numerous popular financial magazine and newspaper articles.

Nearly every major high and low of significance in the past several years has been successfully forecasted in the *Stock Cycles Forecast* newsletter, many down to the exact day and in a few cases the exact hour on those dates! Mr. Jenkins is considered an authority on cycles in the financial markets and often lectures on this subject as well as providing investment seminars where his proprietary trading methods are taught. This book is an attempt to provide the investing public with a basic reference work to learn the art of market forecasting and professional trading for a living.

Preface

As I look back over 42 years of life I vividly recall 33 years of interest in the stock market. I was 9 years old when I first learned about stocks. I had been watching a television program with my parents and one of the actors mentioned that someone had made a million dollars in the stock market. I recall commenting to my parents that this must be a mistake since nobody made money since the 1929 stock market crash. I had often heard this from my grandparents and associated the stock market and millionaires with days long gone by and it seemed inconceivable that a fairly modern day play would have people who were millionaires in the stock market.

My father pointed out to me that this was indeed the case and that the stock market was alive and well and that he himself bought stocks all the time. He opened a newspaper that was lying next to him and pointed out the tables of stocks. As I looked down through the stocks I noted one or two names that were very familiar to me.

One in particular was RCA. It was the very same RCA with the famous dog listening to the sound of his master's voice on the old victrola speaker. I was quite familiar with their logo and knew that this was a major company, but the number next to RCA was the number 9. This number seemed totally inconceivable when my father told me that it meant \$9.00 per share. That is, you could buy RCA stock and become an owner of RCA for only \$9.00.

I immediately assumed that my father had been mistaken since parents often do make mistakes, especially when you are 9 years old. I was convinced that he was wrong, it could not have been \$9.00, it must have been nine million dollars. Over the next several days, I proceeded to scan the newspaper columns and footnotes to see if this was not indeed the case.

After a number of inquiries of my father, and his insistence that this certainly was \$9.00 and not \$9,000,000, he showed me that he had been buying stocks that sold at \$5, \$10, \$15, and had even set up an account for me, under the Uniform Gifts to Minors Act and had been buying stocks for myself and my sisters. This immediately picked up my interest and I set about formulating a plan to buy some stocks for myself.

Over the next few years as I earned money, either through mowing lawns, or working odd jobs, I bought my first stocks which set me on the long road toward losses and disappointments that almost all investors go through when they initially learn to trade in the stock market.

My initial purchase was a cheap stock which was all I could afford. As I look back now over the years, especially that early 10 to 15 years of investing, I can clearly see the most common mistake that everybody makes in buying cheap stocks. Cheap stocks are cheap for a very good reason. If I could impress on everyone, **never, never under any circumstances buy a stock that sells for less than \$10.00. for** chances of that stock going anywhere are substantially lower than a stock that sells in the mid ranges.

Regardless of early setbacks, I struggled through for a number of years with an average track record. Early on, my father gave me a book or two from his library on the stock market. This set me on a course of going to the library each week and reading every book I could get my hands on. By the time I had entered high school I had read hundreds of books on the stock market, investing, and technical analysis.

My father was a banker and taught me analytical methods such as credit, debt, balance sheets and general fundamental research. Throughout high school and college I was a fundamentalist. In college I studied both economics and business. I later went on to get a masters degree in business. I passed the uniform CPA exam. I was taking the CFA exams and I started doing fundamental research on the stock market and investing like most fundamentalists.

My first jobs out of college were in bank trust departments, where I learned to invest for widows and orphans, trusts and estates: good, fundamental research, sound practices, typical of most big banks in this country. This was a real eye-opening experience.

One of the fast banks I worked for was a famous old trust department in Washington, D.C. It had as clients many of the original founding families in America, whose names still exist as corporate entities today. As I read through the trust documents I saw how year after year the portfolio managers bought growth stocks and diversified the various portfolios, however, I was shocked to learn that in a large trust department with a dozen or so portfolio managers, the bank did not even possess a single quote machine. I was told that it was totally irrelevant to what we did, to know what the stock market or what the prices of the stocks were doing. That was for day traders and scalpers and long term fundamental investing had nothing to do with current activities in the stock market.

At this time I started reading more and more books on technical analysis as my fundamental investments did not actually perform very well. I knew how to read a balance sheet better than anyone. It was my whole objective in getting undergraduate and graduate degrees in business and accounting to be able to decipher the finest little minute details of balance sheets. To be able to predict precisely each earnings per share adjustment of every company, and with this certain knowledge of being able to predict their earnings, I would be a success at investing in the stock market.

It was only after years of doing this with great precision, and having mediocre results, that I came to believe that fundamental investing had very little to do with making money. It was then that I tamed and devoted my full time to technical analysis and the study of cycles.

This book is the outcome of the last twenty to thirty years of my research in these areas. The orientation of this book is purely technical. That is, "fundamental investing" has to do with the earnings of individual companies, economic conditions of the country, Gross National Product, etc., under the belief that if economic conditions are improving, or the earnings of a company are improving, the price of the stock will go up.

"Technical" analysis as opposed to fundamental analysis has to do with supply and demand factors.

The price of the stock the volume of the shares trading, whether this forms a pattern of **accumulation** or buying the stock over periods of time, or the process of **distribution**, selling the stock.

Cycles are a particular subset of technical analysis. It is through the use of cycles that we can pinpoint possible highs and lows in the stock market, well ahead of time, rather than waiting for past history to confirm that we were right. In conventional technical analysis it is the breaking of a trendline or a moving average that tells us something has changed. But in theory, the breaking of a moving average, whether it be 3 days, 5 days or 200 days is based on events that have gone by and you can never predict the final high or the low day with conventional technical analysis.

By definition of what a high or low is, no human being looking through human emotional eyes will see the high day. On the high day even the bears who think the market will go down believe there is yet another day where it could go higher and they don't sell. The bulls don't sell because they think it will go higher also. It is only the next day, when mysteriously the stock market opens unchanged or down, that we have any evidence at all that the market has indeed topped on a given day, a given hour. Through the study of cycles we can know ahead of time with very high probability, that a top or bottom will be seen, and then fine tune our technical tools such as breadth, volume, price patterns and momentum. We watch closely various technical tools on that day to see if they justify our taking a position in the stock market.

If our technical tools indicate that a cycle is possible turning we can clearly define our risk. We can take a position by selling the high or buying the low and use a very close stop loss both in terms of price level and in terms of time before we find out if we are wrong. It is a tremendous advantage in trading to limit our losses quickly and to confine them to small amounts of money. This is the beauty of cyclical analysis. What you will learn in this book should teach you how to become independently wealthy and successful while gauging the amount of risk you wish to undertake in improving your rates of return substantially.

After concluding a number of jobs, in various bank trust departments doing fundamental analysis, I moved to a major mutual fund complex. I was chief accountant there for a number of years and eventually I became a portfolio manager. It was during this time period when I got to know the side of the street known as the "buy side." I was a portfolio manager in charge of several medium size mutual funds aggregating over \$100,000,000. I was quite successful at this, having had one fund that was up over 50% two years consecutively. This was quite an accomplishment if you understand that with a diversified portfolio of 40 or 50 different stocks, in order to have an overall rate of return of over 50% you might need 10 or 12 of those stocks to triple or quadruple to offset the other stocks that go nowhere and the few that go down. My success at trading as a portfolio manager was due to my switch out of fundamental analysis and into technical analysis. It was during this time that I learned many of the ideas and techniques of mathematics, numerology and time cycles that are discussed in this book which have been refined subsequently over the following 15 years.

After becoming fairly successful as a portfolio manager I made a major career move in late 1983 and decided to retire, at least in regard to working for other people. I moved to New York City to become

a professional trader. One of the lessons I learned was that to feel completely financially secure in life one must be able to take on a job that was totally financially insecure. In other words, security is not to be found in having a secure job with set hours and benefits. **Security can only be found by having absolute knowledge of what you are doing and the strength of conviction that only comes from within.**

So I became a professional trader. A job that on the surface had no draw, no salary, no benefits, and the only money I would ever receive would come from capital gains. It literally forced me to try to make money day in and day out, week after week month after month, to have a positive cash flow to pay the bills. It was this arena of professional day trading that was my best teacher.

Casual investing in the stock market, long term investing over years hoping to get annual rates of return of 15% to 20% a year is for the idle rich or people who do not plan to be successful. It is easy under these circumstances to make excuses for our failures and to wait for the next trade over several months or years to bail us out. The approach I took in becoming a professional day trader literally forced me for my very survival, to learn as fast as I could not to be biased in any manner as to what was the appropriate manner of trading.

The tuition I paid for this education was extreme. Fortunately, in those early years it was with other peoples' money. Whether they were the bank trust department customers, mutual funds or my various employers, early mistakes probably cost millions of dollars. However, soon I made more money than I lost and millions of dollars were made. But each of those prior losses was a tremendous learning experience.

The tuition I paid for learning how to trade the S&P futures was one of my most startling learning lessons. I remember very well my first experience in trading S&P's. On the ticker tape they looked just like stocks only they moved more rapidly. After getting permission from my business partners to trade up to 15 of these contracts a day I started trading with gusto. The first day I made \$8,000. A day or two later I made \$20,000 in a single day. The next day I made another \$2,000 or \$3,000. But, on the 4th or 5th day I lost over \$40,000, and I suddenly found out that they were a little different than stocks.

I immediately jumped into bond futures thinking they might be easier but the overnight gaps up and down were quite unfamiliar to me. I did not know that bonds literally traded round the clock around the world and that the markets were continuous even though futures stopped trading in Chicago at 2:00 PM. To make a long story short my initial 2 or 3 months tuition was close to \$500,000 for both S&P's and bonds combined. Fortunately, my profits in day trading stocks was about the same amount of money. However, the biggest lesson I learned from all this was that if one could master short term day trading, through the use of leverage it could be a spectacularly rewarding career.

I have been privileged over the years to know some of the world's greatest, most successful, professional traders. Many of whom use very esoteric techniques and are of strange and different personalities. What I have learned from all these various sources I now wish to share with you in this introductory book on Professional Trading.

Please keep in mind, while reading this book that my perspective has changed dramatically over the years. Starting as a fundamentalist, like most people, and ending up with a very rare, unique perception as to what drives the markets.

I have come to appreciate the fact that market movements day to day are not random. Market movements day to day have nothing whatsoever to do with economic statistics, fundamentals, politics, or any of the things that professional portfolio managers, bankers, mutual funds, or managers of brokerage firms tell you what the stock market is all about. I have come to the conclusion that the vast majority of books written on technical analysis and fundamental analysis are totally worthless.

In the stock market, price is reality. It is the only reality. The techniques that I use have to do with determining the price level and the direction of the price level and investing accordingly. Techniques in this book are based on explicit assumptions that there are immutable laws of nature, unseen forces that are known as "cycles." It is these cycles of which we can never know what causes them or where they come from, but it is these cycles that literally predetermine the stock trading price levels on a day to day basis.

This can be conclusively proven with the techniques in this book for forecasting, and by the time you get to the end of this book you should be able to forecast well out into the future with high reliability, at least as to the turning point days, when major turns in the market are almost certain to materialize. You may not know the direction of that turn ahead of time but you will be able to predict when you get to that point in time, that a major change of significance will take place in the market and you will be able to exploit that opportunity. None of these prediction methods would be possible if news items or fundamentals had anything to do with the stock market.

This book, as much as it is about making money in the stock market, is a book about philosophy. It is a philosophy about life, about the human condition, about the limited perceptions that human beings have, and about the distortions that are picked up through those perceptions. It is the pure reality of price in the stock market that is the truth that burns through these human perceptions and illusions.

Hopefully by the time you have finished this book you will come to the same conclusions I have, as to what it takes to make money in the stock market, especially the lesson that you must be extremely disciplined, have no subjective judgment and be very objective about taking losses. I have said over and over again, and I sincerely mean it, **the only thing easier than making money in the stock market is losing money**, and the one thing all professional traders abhor is losses.

To become a professional trader you must learn to cut your losses quickly and at reasonable levels without guilt as to whether you were right or wrong. **There is no right or wrong in the stock market...there is only the reality of price and profit or loss.**

There will be many people who will read this book and not believe it at all. They will not believe these techniques work because their minds will be so closed and so subjective based on their backgrounds, their perceptions and their upbringing. They will look at many successful multimillionaires from the

Wall Street community who will swear that these things do not exist, that the only way to make money is to invest on good fundamentals.

I will tell you from my viewpoint there are a great many people who are quite successful, but whose reasons and perceptions as to why they are successful are completely wrong. That either their gut instincts, their innate abilities, their own clairvoyance, or sixth sense allowed them to be in the right place at the right time, and their rational reasons for why they made money are not valid.

The hypothesis put forward in this book is that the market can be predicted. The tools described in this work are predictive tools that work. They work all the time, there are no exceptions. If you practice with the techniques in this book you will see that they work and you will also see there is no other logical conclusion if they do work, and they do forecast future price levels, than to say that cycles exist regardless of whether or not intelligent people perceive those cycles.

The market is a zero sum game, in that on each side of a transaction there is a buyer and a seller. One side has to win and one side has to lose. But what is not readily realized is usually that on one of those sides there is one infinitely intelligent wealthy person on the winning side of the transaction and on the losing side of the transaction there are thousands of little, uneducated, misguided people.

The purpose of this book is to put YOU on the winning side of each trade with almost certain knowledge and confidence that you will make a success in speculation.

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Chapter #1

Introduction to Cycles

“With all of these (cyclical) findings, why is it so hard for man to believe that perhaps his buying and selling of stocks and bonds may not be rational behavior after all?”

Since the beginnings of recorded history, mankind has debated the ageless philosophical questions of destiny and fatalism, and man's supposed free will to create his own individual life cycle. Natural catastrophes and large scale warfare have often been the philosophical catalysts in forming this debate of whether man actually has free will in determining his destiny.

In the natural realm, animal life was long known to exhibit life cycles of consistent regularity, and fisherman and fur trappers often recounted the years of abundance or scarcity in their harvests. Cycles of draughts and famines are well known to all farmers and workers of the land and weather prediction has become a modern day scientific marvel. Prior to the founding of the Federal Reserve System and centralized banking in this country, financial booms and busts were regular recurring phenomenon for over a century. The Rothschilds of Europe for years made use of the recurring economic cycle of 41 months to buy and sell, and were held in awe by the less cyclically educated because of their seemingly uncanny ability to pick the highs and lows of the economic cycle.

In the ancient world, fascination with the heavenly bodies at least made the masses aware of possible cyclical influences in their lives, although fatalism and superstition prevented any real serious study except on a limited scale. Religious bias and persecution often hindered the study of cyclical determinants of human behavior especially when recurring crop failures and droughts could be of better use to politicians within the religious governing bodies. Almost all rulers both secular and religious had appointed soothsayers and astrologers to provide official explanations for cyclical events that might rouse up the masses. Even in the more modern age, perhaps the greatest mental giant that ever walked the earth, Sir Isaac Newton was the official court astrologer and personally defended the practice with great zeal.

In the modern age rigid political and academic ideologies constantly persecute cyclists and fatalists in order to maintain their power structures even in the face of modern scientific evidence of an overwhelming magnitude. Tacit acknowledgment of the cyclical nature of the economy is the underlying principle of *Keynesian* economic planning, whereby the politicians decide to spend more money in bad times to stimulate the economy when the natural consumer cycle is sluggish. It is a shame that the

politicians seem to think that everyday things are bad enough to need their omniscient stimulation.

Wall Street, although one of the last bastions of real freedom and economic choice, has had a hard time dealing with the rise of "cyclical investing methodologies" since these do not intellectually lend themselves to generating ever more sales commissions on a daily basis. Who wants, or needs a Wall Street stock analyst if the cycles say stocks will decline for the next year or even more?

In the final analysis, the human being is primarily a *rational* being. At least he Thinks he is. Objective observation of human behavior would seem to indicate, however, that he is largely *emotional* by nature, and the more emotional he is the less it has to do with rationality.

Modern science has discovered biological clocks, circadian rhythms, estrogen and endocrine rhythms, sleep cycles, sunspot cycles, blood chemical cycles, cosmic rhythms and a multitude of others too numerous to even mention. Most of these are what we would term external determinants, even though they are found often internally, as opposed to rational thinking determinants. With all of these findings, why is it so hard for man to believe that perhaps his buying and selling of stocks and bonds may not be rational behavior after all?

Over the years I have come to the conclusion that there are only four major motivating influences in the world. These are money, sex, power, and religion. The perfect example of all of these is the U.S. Congress. Often all four will be excessively exhibited by individual members of Congress.

The stock market of course has to do with money and I would hypothesize that the smartest minds in the world that are motivated by money either are found on Wall Street or in Las Vegas. Why is it, that many of these great minds are not so successful in cracking the secret of stock price movements? I firmly believe it has to do with rational minds trying to battle emotional problems. What people buy and sell has very little to do with what they say they are doing (rationalizing) but more with what they feel. My work conclusively shows that these feelings are **CYCLICAL**.

The intellectuals have been attacking the problem with a rational understanding which is bound to fail. The problem is akin to the millions of people who go on diets to lose weight. Billions of dollars have been made by selling books on diet fads, vitamins, and exercise, and knowledge about losing weight is readily obtainable by everyone. But who actually loses weight and keeps it off? The answer lies in emotional behavior not rational knowledge.

The solution to the stock market mystery is to use our rational mind to develop a rational plan to control our emotions in buying and selling. **CYCLES ARE THE KEY**. If one merely believes in external cycles controlling our behavior, and uses a rational game plan to invest with that cycle, he will become a success. Notice that it is not necessary to prove that cycles even exist for this to work. This is merely a mental construct that will conveniently allow us, as rational beings, with tremendous perceptual blockages, to battle our emotions effectively when buying and selling.

It is not my purpose to tell you the **CAUSE** of cycles in this book. My approach is only to give you techniques to discover cycle rhythms and patterns, so you can gain mastery over the most difficult part

of professional trading for a living... pulling the trigger with a cool head and extreme confidence. As you go through this book, please remember that cycles do exist, and if we do not cloud our understanding with needless rational "reasons" why such and such a stock must go up or down, we will be much better off. I will feel that my efforts were successful if at the end of reading this book and practicing these techniques, you throw away your newspapers and analytical reports that serve as your rational crutches for your emotional behavior, and you find yourself slightly humbled, being merely an emotional human creature and not so smart after all.

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Chapter #2

Why Technical Analysis?

"All losses in the market are entire attributable to not investing with the primary trend."

For many years market observers have argued over the merits of various approaches to investing in the market. The two most widely accepted schools existing are the fundamental and the technical.

The fundamental approach utilizes an analysis of broad economic factors, so called "fundamentals," in an effort to predict the earnings growth and industry trends for stocks, in the belief that a rising earnings trend in a generally improving economic situation, to which the stock belongs, will sooner or later result in a rising price for that stock. Practitioners of this form of investing will tell you that the stock market cannot be predicted, except within a general trend of economic events. These fundamentalists usually detest technicians.

Many of the most successful stock investors of the past fifty years have been fundamentalists, who believed in a buy and hold strategy of investing in common stocks. This strategy worked well as the U.S. economy and the stock market grew secularly and dominated the world economic scene. I have serious doubts that the next fifty years will show a continuation of this same American secular growth. In retrospect those buy and hold players may have been simply lucky that the long term trend was up. The approach I favor to investing in the market, and what I believe to be the only valid intellectually sound method, is the technical approach.

The technical approaches' basic philosophy is that all economic, fundamental news of any significance is always reflected in the price and volume characteristics of a stock long before the economic improvement or deterioration is known to the general public.

Intellectually this has to be, since at the most basic level of the company, the chairman of the board and members of the board of directors, all know the outlook for the industry and their stock in particular, long before objective public evidence is available. These people are lifetime specialists in their field and must have information far better than any Wall Street analyst. Therefore, when a significant economic event occurs, these insiders know immediately whether their stock is relatively cheap or dear, and buy and sell it accordingly to the utmost available amount of their resources. It is their buying and selling that leaves its tell tale tracks on the ticker tape for the technical analyst to spot and to evaluate. No stock makes any significant rise or fall overnight, only through the day after day accumulation or distribution of shares in the open market.

Assuming for the moment, that even the board of directors of a company are completely unaware of a fortuitous event in the company, and an outside fundamental analyst has correctly evaluated the situation, the technical approach is still the only valid intellectual approach for investing for the following reasons:

- It is buying and selling of a stock which makes it go up or down and gives it any economic value for the investor. Earnings may skyrocket, a company may strike oil or gold, buy if someone, somewhere, with money, does not bid up the price of the stock, then such fundamental developments are of little worth to the capital gains stock investor.
- The technical approach will always reveal the direction of a stocks' movement from the very first instant of its move, and the able technician will always be long a rising stock and short a falling stock, before the reason for its rise or fall becomes apparent.

The secret to stock market investing was once stated by Will Roger when he said, "*One should buy good stocks that go up and if they don't go up, don't buy them.*"

Although this quote is somewhat facetious, in logic, it is exactly what the technical approach is all about, identifying stocks that are going up or ones that are going down. All losses in the market are entirely attributable to not investing with the primary trend. This should be our only goal as speculators or investors--identifying the primary trend.

Now let us review the basic cycle of a stock's rise and fall. At the end of a Bear Market or economic recession, stocks sell at very cheap, low levels since most people have sold out and no longer anticipate any favorable news from the company. If the company is not going bankrupt, but continues in business there will come a point when the daily volume of transactions will dry up to practically nothing, at a price low enough that all reasonable long term investors think is fair value, and at a level that the insiders consider cheap, relative to the future outlook of the company.

Executives who plan to spend their whole working lives in a particular venture, usually know when conditions are at rock bottom and can only improve. It is at this point that the process known as "**accumulation**" starts to take place. Day after day the insiders, their relatives, their families and a few outside analysts start to buy the stock.

At first, the stock will only move an eighth or so, as there are usually many sellers until around at slightly higher prices. But after a period of weeks, even months, most of the overhead supply of stock for sale has been accumulated by these long term insiders.

This class of investor is very long term by nature, thinking in terms of the industry economic cycle. They do not plan on selling the stock bought today for a few dollars more when it will be higher next week or next month, but rather several years down the road, at retirement, or when the economic cycle seems to have peaked and the stock has very likely doubled or tripled.

Since these long term investors have accumulated the available supply of stock for sale, effectively taking it off the market for several years, only new sellers coming into the market will be able to make the stock decline in price.

As this process of accumulation ages, the price of the stock, which at first creeps higher with small gains, then begins to fluctuate much more violently, and finally, literally explodes upwards from the day after day buying when fewer and fewer shares are available for sale.

Near the top of the cycle, after the stock has been rising for quite some time, the stock becomes very thin and a very small amount of buying can greatly move the price of the stock upwards. This is a natural, psychological phenomena. At that point, all holders of the stock have a profit on their position, and psychologically feel that they have been right all along and that the stock will go higher.

Naturally, feeling this way, they do not want to sell the stock now, even more than before. Soon the natural forces of greed take hold and these investors, who feel that they are "so right", increase their buying to include bank borrowing and margin purchases. At the top of the cycle this reaches an extreme, and the original insiders decide to sell some of their holdings.

This at first merely checks the rise of the stock but does not send it down. Only later when the margin interest expenses pile up and the stock stops moving do others start to sell and the "distribution phase" now begins.

Often the insiders will not only sell their own holdings, but since they feel the economic cycle for that company is near a peak, they will sell more company stock to the public in an effort to capitalize on easy money financing for the future. As soon as the stock becomes "waterlogged," it begins to go down and each successive lower break brings in more selling.

As in the Bible, the phrase "like begets like" applies equally well to the market, as buying will attract more buying and selling will attract more selling. (Specialists on the floor of the exchange know this well and raise and lower their quotes all day long according to this principle). On the way down, the stock also becomes thin, as the general consensus is reached where most people have become bearish sellers and the buyers are price cautious.

Near the lows, the volume increases until the price reaches a value level that the original insiders feel represents true value, and then step in and buy all the stock being sold. After this, the volume dries up and the stock goes dormant, awaiting the next anticipated upturn in the economic cycle.

It is the tools of technical analysis which identify the various phases of the accumulation, distribution life cycle and allows the speculator to capitalize on these movements. Remember we are talking cycles here, and our emphasis will be on identifying where we are in the cycle, so that we can determine the main trend and invest accordingly.

It should be noted however, that the average time for the accumulation, distribution cycle can be as short as a year or in some cases extend upwards or downwards to ten years and in some cases even thirty years.

In those situations it is accomplished within the frame work of what we call a "**Bull Market**" for the accumulation phase, and a "**Bear Market**" for the distribution phase. Most Bull Markets this century have lasted 3 to 5 years with Bear Markets 1 1/4 to 3 years. It is to be emphasized that the Bull or Bear Market characterization applies to psychological processes or emotional cycles and not just periods of time when prices rise and fall. It is these psychological processes that help us identify what cycle really is operating. There are many elements of each cycle and they are not of utmost importance in a work as technical as this but here are a few.

In the "**Bull Market**" expect to find easy credit, increasing margin buying, increasing public participation and rapid and easy upward price movement. Bad news is ignored and corrections against the primary trend seldom last more than six weeks. The economic backdrop is coming out of a recession with strong economic growth, and the economy is throwing off lots of excess cash flow from business profits to fuel the ever higher price movements. People are still used to the past, tough economic times, and this usually creates the "wall of worry" of stock prices.

In the "**Bear Market**" phase we find that confidence is still high from the Bull Market excesses and the attitude of "**buy the dip**" is prevalent. Economic statistics deteriorate, but most analysts call for a reversal any day now. Margin is being liquidated, credit is tight, rallies are short lived but very powerful, and the economy is "**sucking**" cash out of the system to finance inventories, debt etc.

In cycle analysis, we must remember to try and get a "**feel**" for the cycle, and the above general characteristics, although somewhat subjective, will at least point us in the right direction. In final analysis, only one consideration is of importance--if the stock goes up or down.

If one were to describe in simple terms how a rising stock behaves, one would see that in order to maintain an uptrend, a stock must over time, reach higher price levels both on each rally and on each subsequent decline. Each low for the correction would be higher than the previous correction low. This is referred to as making "**higher tops and higher bottoms.**" The same is true in reverse for declining stock patterns. For a stock to show a down trend it would make a series of lower lows and lower highs.

In evaluating the strength and duration of a move, one must keep his investing horizon in perspective.

- Long term investors - will only be concerned with correction lows that hold above long term prior lows, such as the prior year's low,

the prior quarter's low or the previous month's low.

- **Short term investors** - will pay close attention to the prior weeks' lows, to watch for violations.

- **Aggressive day traders** - will watch each daily high and low but usually the past three days' trading range is most important.

In analyzing this, please keep in mind the natural rhythm of the movement. Price patterns represent the over abundance of either buyers or sellers on a daily, weekly, monthly, etc. basis, and these forces react on a ticker tape much like the natural force of the tide at the beach. The following analogy should be studied until it is firmly understood.

The first time beach visitor is not usually aware of the tide but only notices the boundary line of the waves pounding on the shore. After a while, he would notice that some waves are more powerful than others and subsequent reach further inland.

If he gets a chair and sits just past the waters edge, he would notice over the next few hours that the general line of demarcation between the shore and water, moves inland or recedes further out towards the sea.

If our first time beach visitor is observant enough to time the rising tide patterns, he would see the ever increasing inland penetration of water. He may now become alarmed, thinking that eventually the tide will swallow up the beach, threaten the local beach houses and eventually the town.

Our nervous beach visitor may now try to measure the rate of advance between each thrust of the waves, by marking the extreme penetration with perhaps a rock or stick and thereby begin to calculate the time when the water will reach the adjoining houses. He would note, that eventually the tide stops advancing, stays level at a certain marker, and then starts to withdraw. At first, this would seem like an anomaly which would grant a short reprieve to the beach front property owners, and our observer would still assume that the next wave, or perhaps one or two after that, would yet go further inland.

After spending more time observing, our visitor would begin to see that the tide is leaving, and never having experienced that before, may now conclude just the opposite, that the beach will be getting permanently larger and larger.

This analogy with tides and stock market movements is very close, and has fascinated market technicians for generations. The wave patterns of buying and selling stock seems to indicate a human psychological tide of emotion, that varies in amplitude and intensity, manifesting as greed and fear.

This pattern of stock prices can then be analyzed to one's financial betterment, if one is only willing to make the assumption that this analogy is true and invests accordingly, without inferring subconscious fear, or intellectual bias in the process.

If this analogy holds, we should be able to benefit by making observations as to each wave thrust, how high it goes and the resulting pullback. Then we anticipate the next thrust by buying on the receding pullback and seeing our stock surge ahead almost immediately, rewarding our scientific methodology with a better rate of return over time.

Whether or not this analogy is true is irrelevant, because no stock can go up without making higher highs and higher lows, and such analysis will always keep one out of trouble, as it is losses that are the problem in investing. So determining the main trend is the only thing.

It is the tools of technical analysis that help us to measure these trends. The long term fundamental investor invests with the rising tide, but there is nothing to enhance his position throughout the entire movement and he must wait to sell at the end. The technical trader, on the other hand, can achieve much greater results by selling at each extreme thrust, and reentering on each receding decline and picking up a few extra dollars on each attempt.

I equate the fundamental approach to that of a blind man at the beach. He hears the tide and makes a general observation about its direction and movement, but he cannot spot each little thrust and recession and be able to time the next movement. A sharp-eyed scientist on the beach would be able to measure quickly and get a sense of the rhythm of each internal movement, in addition to the rhythm of the large crashes heard by the blind man.

Only now do we see that the definition of the main trend of higher highs and higher lows for advancing prices, and lower highs and lower lows for declining trends, will keep the observing technician invested with the main trend of the market.

Like the analogy of the blind man at the beach and the scientific visitor with sight, investors cannot possibly hope to accurately discern patterns of accumulation and distribution of stocks, unless one has in his possession a chart or graph of the stocks' activity over time.

Remember, it is the daily buying and selling, the price levels and volume fluctuations, that subtly reveal the sophisticated operations of insiders and large institutional investors whose immense power make the stocks rise and fall.

Investing without a record of the price and volume, is investing on hope, and one who invests solely on hope is bound to be disappointed before too long. Most investors can readily obtain weekly charts and subscription services at reasonable prices. However, for the casual investor who only trades five or six issues, he should be able to construct and maintain his own charts within a few minutes each day.

Although, I personally prefer charts because one can easily discern simple patterns and thus project future price movement, based on the symmetrical patterns of the past, one need not use pattern recognition to invest successfully. The basic necessity, is simply a log of each price swing high and the preceding and subsequent price lows, along with the daily volume. The investor then merely sells out whenever a prior low is broken and remains long as long as those lows hold.

A breakout to a new high would indicate that a move up to even higher highs is likely. This method has been used successfully for generations, and even the famous Jesse Livermore used such a rudimentary log of price levels to keep track of the main trend.

A log is necessary because memory is short and often a stock can remain dormant within a trading price range until most investor forget the stock. It is then very important to have a record of prior highs and lows so as to know when the main trend will be resumed or reversed.

Our next chapter will discuss the various charts one should keep and why.

Chapter #3

Charts

"All buying and selling is reflected in the history of prices volume and dates of such movement."

Basic Charts are of several types:

1. **Bar Chart** - the normal chart, where each price is graphed with price on the vertical column and time across the bottom. Volume is usually indicated by vertical lines along the base time line.
2. **Point and Figure Charts** - no time or volume is recorded. Point and figure charts presume that only price is important since that is what determines gain or loss.

Point and figure charts record reversal in price, usually with a series of X's, one on top of the preceding, as long as the price of each high exceeds the preceding high, and during declining periods a series of vertical declining O's are started.

The chart reader can instantly see if the rising X's are greater and more numerous than the declining O's and then see if the trend is rising or falling. Since these patterns say nothing about time, they can often wear out the patience of investors who see the stock in an up trend, since no low has been broken, but the stock may trade sideways for years and still appear to be in a rising trend.

It is therefore hard to compare relative performance of one issue verses another, since the investor's primary interest is in rate of return over time annualized and not just absolute return.

A stock that goes up 50% in 50 years is not the same as one that goes up 50% in 50 days, and yet the point and figure charts could look the same. Point and figure charts are **good when making an initial analysis** in picking stocks as its history is easily summarized.

3. **Logarithmic Charts** - charts drawn with prices over time but the vertical price scale part of the chart is graded logarithmically. This means, that each grid up on the scale is not an equal dollar price, but an equal percentage move from the last base price.

These charts are helpful in that a trendline drawn on such a chart connecting lows will show a growth rate such as 20% a year compounded since each move up is an equal percentage of the last. If the same slope trendline plotted on a long term logarithmic chart was drawn on a regular

normal chart with equal price increments, it would appear to be an upward parabolic growth curve.

Since we are investing for rate of return, these charts are excellent in comparing various stocks that trade at different price levels. For example, to compare a \$15 stock with an \$80 one, trendlines of the same slope will show the same rate of return.

Investors can be easily deceived into thinking that an \$80 stock going up \$10 to \$90 is better than a \$15 stock going up to \$18. When in reality, the first is returning a 12 1/2% yield and the second, a 20% yield. On a logarithmic chart the 20% return would easily be seen as a steeper slope trendline.

4. Hybrid Price Volume Charts (Equal Volume charts)- these are various charts that encompass the volume traded each day with the price movement so as to make a visible interpretation of volume price relationships easier.

For example, volume chart users use a very fat bar on a day when volume is large, and a thin bar when the volume is small. The height of the bar would be the same, the price range fluctuation would be identical, only the volume would be different.

In theory, accumulation patterns show volume rising with prices rising and volumes falling as prices ease into the correction period. Distribution patterns, selling or declining, show volume increasing on down days with light volume on rally days.

5. Japanese Candlestick Charts - these charts have been around in the East for hundreds of years. They try to visually relate the relationship of the opening high, low, and daily range with the closing level. For many people, these colored bars are easier to notice when changes are developing. The patterns can be quite complex and I would recommend that you get a good book on the subject if you are just learning. However, your effort will prove to be quite rewarding.

I usually recommend that traders use normal charts with price, time, and volume since other charts can be derived from the information therein. Serious students can reconstruct the patterns on one chart into all the other kinds of charts visually in their heads.

So now, with our preliminary starting point of the natural wave trend analogy and the belief that all buying and selling, regardless of nature or reason thereof, is reflected in the history of price, volume and dates of such movement, and with our charts showing such history, we are now ready to develop an objective, scientific analysis of stock prices to see how money can be made with such knowledge and losses avoided.

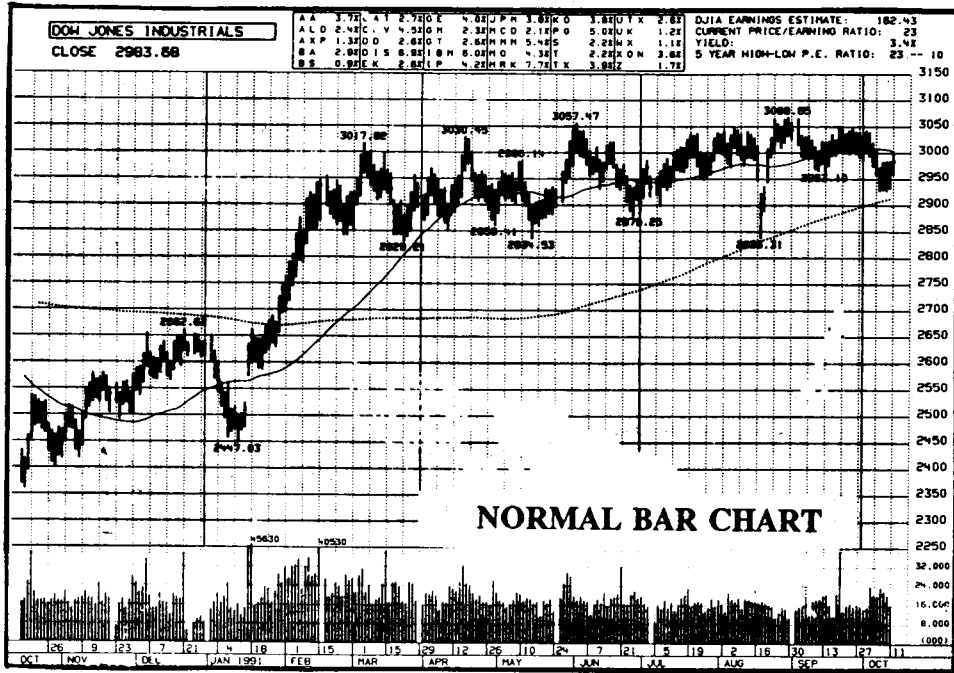


Chart Courtesy of
Daily Graphs
Los Angeles, California

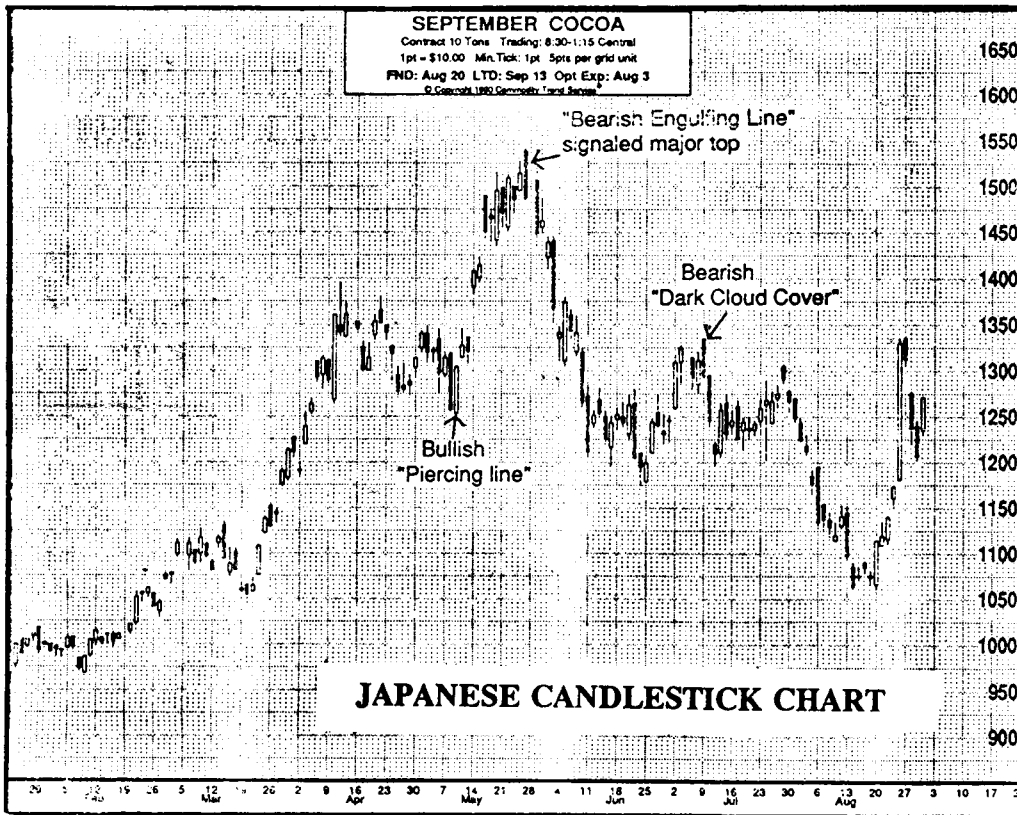


Chart courtesy of
Commodity Trend Service
Palm Beach, Florida

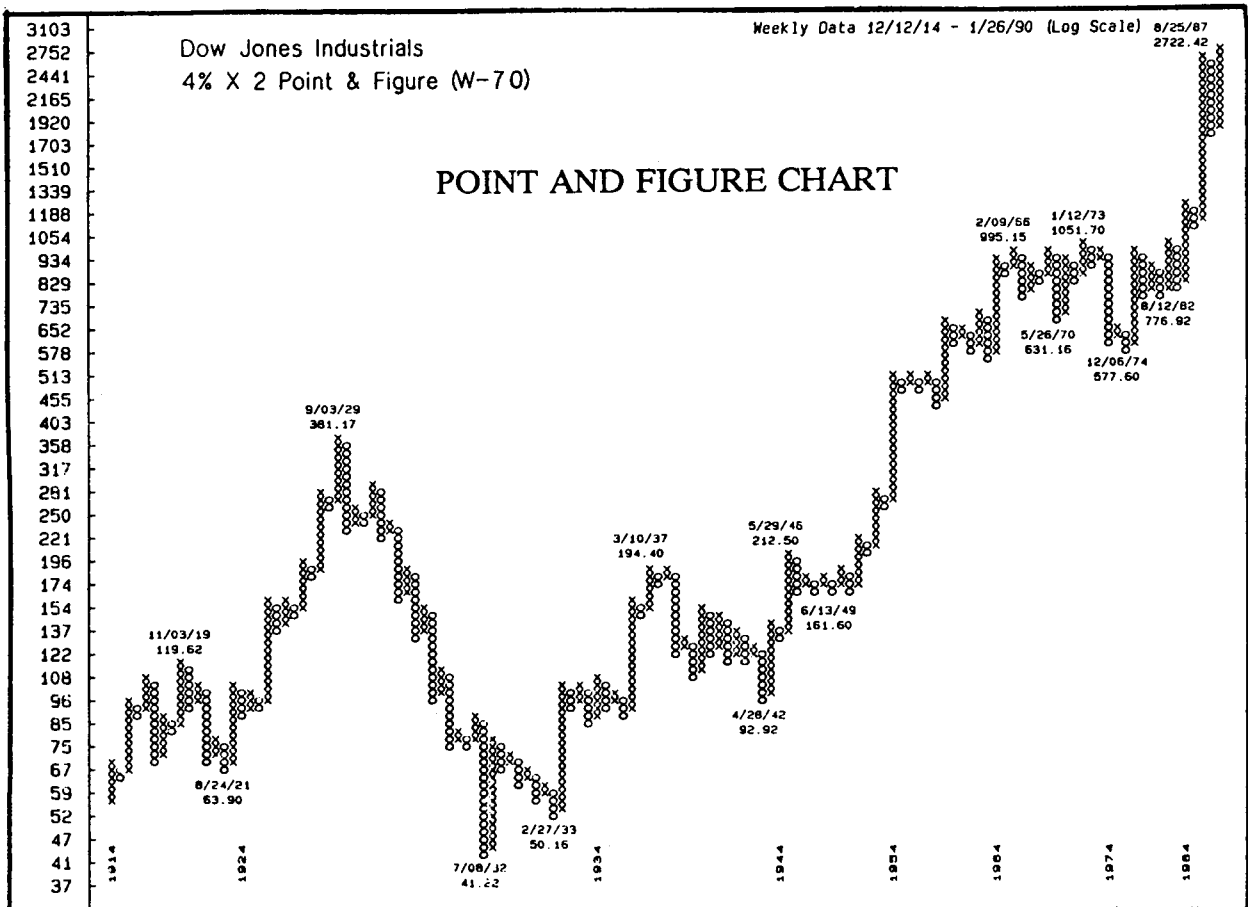


Chart courtesy of
Ned Davis Research Inc.
Atlanta, Georgia

"SEMI-LOGARITHMIC CHART"

The charted trends reflect relative, or percentage changes. Thus, in this scale, the vertical linear distance for a 100% move is the same any place on the chart irrespective of whether the rise is from \$5 to \$10, \$20 to \$40 etc. This permits an accurate comparison from one chart to any other.

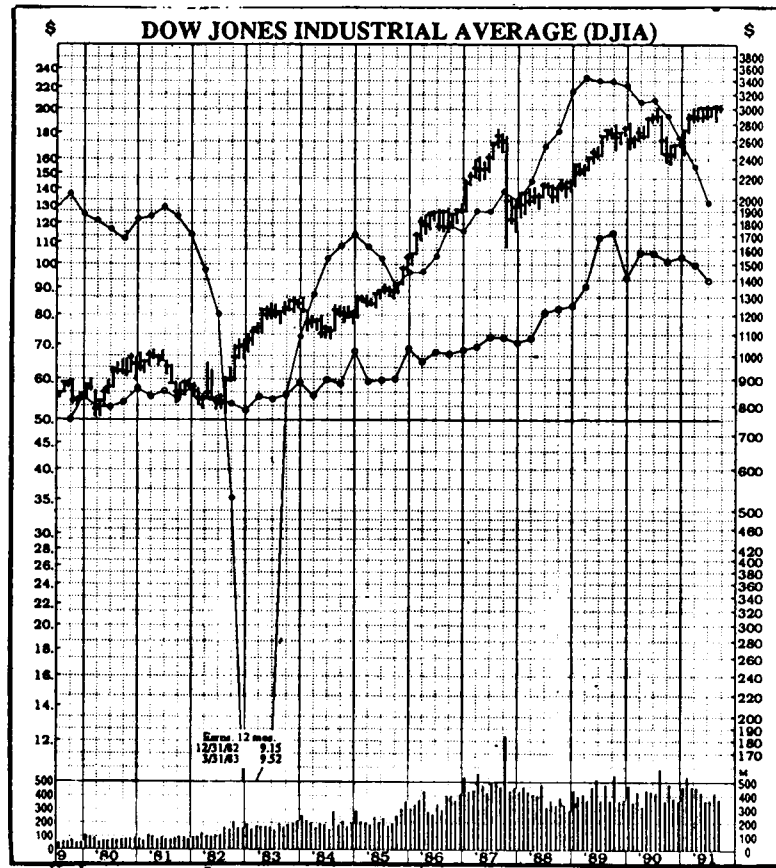


Chart courtesy of
 Securities Research Company
 Wellesley Hills, Massachusetts

Chapter #4

Theory of Geometry

"The solution to the stock market enigma is nothing more than keeping track of all the fluctuations of the past."

The concepts in this book may seem unusual from a rational, logical point of view, but trading is an emotional, not a rational experience. Our strategy therefore, must be a rational approach to conquering emotionalism.

In the twentieth century, one of the greatest frauds ever perpetrated on this planet was the blind acceptance of the science of economics. Although, great in theory, in practice, no economist, to my knowledge, was ever able to forecast anything but past events.

The reason for this dismal failure lies in the crude assumption of behavior on the part of the consumer. Given limited wealth and scarce resources, a consumer is supposed to rationally choose the best alternative to get the most for his money. This sounds great to academics, but in the real world it is totally devoid of any real meaning, because the assumption of the consumer's rational behavior is in error.

I maintain that not one major decision in life is decided rationally, but emotionally. Examples of this are when you get married or divorced, quit your job, tell your boss to shove-it because your raise wasn't big enough, or when you buy that \$50,000 red sports car. These are emotional reactions that we rationalize, in order to make us feel good about the decision we make. Even the seemingly, most rational decision we think we make, voting for the U.S. President, has bloodied many a nose, when the candidate's name was mentioned in the wrong bar.

The stock market is the perfect economic environment, where we see emotionalism at the extreme. Simple fear and greed drive the markets and people simply rationalize the events that they respond to emotionally.

After waking up and emotionally wanting to buy or sell, the masses search newspapers, television, or business analysts to find reasons to support their feelings and to allow them to be at peace when investing their life savings by the "*seat of the pants.*"

The proof of this is why technical analysis works. Predictions can be made months and years ahead of

time with technical analysis, even when the media reporters say that particular outcome is impossible.

Markets as a whole are great statistical laboratories for measuring mass emotions of fear and greed. Although, we know there are economic and fundamental reasons why the economy improves or deteriorates, it is clear that it is human beings that are buying and selling stocks. It is this human behavior of buying and selling that is accentuated by the amount of leverage in the buying and selling.

In the speculative markets, especially commodity markets or in the stock market, with the use of futures or options, where there is tremendous risk involved, emotionalism is at an extreme. Since these markets consist of millions of people all around the world, the emotions that are exhibited give us very reliable, predictable, mathematical certainties as to the timing and magnitude and duration of these basic human emotions.

In theory, if you examine the market from the last six months to two years, the same types of people are in the market, there are no new investors. In the last sixteen to eighteen months all players are essentially the same, but over fifty or sixty years the makeup of the investment community changes.

If we were to measure the extremes of emotions during those last eighteen months, such as fear of going to war or a current news item, every time that fear manifested itself, emotions would run to certain extremes. Perhaps the market would drop seven days in a row 100 points and then exhaust itself. Perhaps if there was a major financial crisis, the market would go down seven weeks in a row and several hundred dollars, and then exhaust itself.

We know from psychiatry and studying the behavior of animals under stressful situations in cages, that when under extreme pressure they will either adapt or break down totally and exhibit all kinds of nervous disorders and mental breakdowns. In the stock market, it is impossible to have a total nervous breakdown. What happens is that we have financial panics and the stock market collapses.

In reviewing the history of the financial market during the last two hundred years, we find that at recurring periodic intervals major crises occur. These crises cause people around the world to react in similar patterns, as they have done in the past, because the basic human emotion, fear, always manifests itself in the same manner.

The price levels may be different, the amount of volume that trades hands may be different, the leverage in the market may be different, but the amount of time it takes for a human being to go through a fear cycle, and have the fear exhaust itself, is usually the same. In most cases during the last century, normal panics run about seven weeks from the high to the low, or about 49 days, but we have seen extremes, where it can last 9 weeks, 13 weeks, a full quarter, sometimes even six months.

If we examine the history of the stock market for major events, major bullish events, sudden unexpected good news or major bearish events, such as the collapse of a major institution or the death of a famous person or of a president, we will have a pretty good idea of the extremes that emotions can run. In measuring these extremes, we can estimate the time it will take from a high to a low, and the magnitude of that particular drop, or advance, if it is a Bull Market.

There seems to be a unique life cycle to the emotions that feed fear and greed. In the early bullish phase of the market, some sudden, unexpected news, takes place and the market quickly rallies. At first, people are still a little suspicious, but the initial excitement is enough to get the market going.

After a modest pull back, another advance takes place, and people get more excited. This takes a course from being cautious and conservative, to more aggressive, outright speculative buying, and finally hysteria, with extreme bullishness at the top, and wild swings of the market.

Once we get to the top, we often see spike emotional tops. The market pulls back, people get a little cautious, but they are still wildly speculative, they buy every dip. A little while later, they start to lose by buying dips and become a little more conservative, and we start to see the emotions switch.

As the stock market continues to deteriorate, and they lose more money, they get downright cautious, and then slightly fearful, and then stop investing. As the market continues to go down, the people who are still long and losing money, become afraid and fear starts to manifest. It starts to turn into hysteria, and as it snowballs people sell and sell at any price, and we start to see the extreme measurement of fear.

An impartial observer can get a good understanding of this type of sentiment by reading headlines in the newspapers. He would see, if the behavior of people buying and selling was actually rational, or if they were doing crazy things, like selling at any price or buying at any price, being so confident or afraid, that they have lost all sense of reality.

Many successful investors over the years have used these "sentiment" measures, and there are many technical tools to gage sentiment. Different indicators can measure how overbought the market has been by how many days in a row it goes up, or how oversold it is, or the advance-decline line breadth deferential, but these are still approximations and are averages of the past.

My work proves conclusively that these things do not have to be approximations. They are exact, very precise and very mathematically defined, as you will see in the coming chapters when we deal exclusively with the geometry of the market and how we define these emotions.

Now, let us assume that the market is exhibiting the emotional behavior of fear and greed. We may not know the actual underlining connection between the emotionalism in the market, as exhibited in price fluctuations, or what causes that emotionalism. Many causes have been assumed, but I am not talking about fundamental economics, I am talking about the external causation of cyclic human behavior.

For instance, it could be the weather cycle, it could be barometric pressure, it could be tidal forces, it could be precipitation, wetness or dryness, it could be cosmic influences, electromagnetic radiation from outer space, it could be any of these things. However, for our purposes, it is irrelevant as to what the actual cause might be. What we need to do is to find a system that will identify these particular patterns and precisely measure the influence of these causes on the market. Then we need to find out when the cycle will reverse itself, and when these emotions will subside.

This is what separates my work from other great investors over the past years, who measured the sentiments of fear by some kind of gut feeling or intuitive knowledge or just practical hard experience. All great successful people in the market have had this ability to calculate these emotions, but it was not very objective and they could not communicate it to other people.

The mathematical approach, in particular, in the use of geometry and other mathematical formulas we get from physics, like vectors, define these emotions much more precisely, and can be communicated to anyone in a very objective fashion.

The overall philosophical underlying belief seems to be that on a subconscious psychic basis, mankind is connected. This may very well be associated with Jung's belief, of the collective unconscious, for we know that the mass's buying and selling in the stock market, with the tide of emotionalism, can be timed very precisely.

There seems to be a connection between the subconscious emotion and the movement of prices on a day to day basis. If we track the day to day price movements, and apply mathematical models to them, we can identify underlining currents of greed to fear and back to greed, thereby, timing the highs and lows in the market.

Some of these methods have been used by a number of others for several hundred years, but most are my own proprietary discoveries, and although they may appear illogical at times, I can assure you, that in over twenty years of actual experience with them, they have always worked to my extreme satisfaction.

The basic underlying premise was stated by Pythagoras, a few thousand years ago, in that "**Time and Space are connected by numbers.**" The angle or the angular momentum of the stock's initial rise has within it the ability to forecast the magnitude and duration of the movement, both in terms of the final price, and the approximate number of days or weeks until exhaustion of that particular movement.

It is similar to artillery gunnery calculations. There we put a projectile, with a specific charge of powder, into a cannon and fire it out several hundred yards into the distance. Instead of varying the amount of powder behind the bullet, we need only change the slope, or how high we tilt the barrel of the cannon. If we tilt it straight up, we find that the bullet will go straight up and come down and land a few feet from us. If we tilt it at a 45 degree angle, we find that it will go the furthest. If we tilt it less, say 30 degrees, we find that it will have the same effect as tilting it straight up, that is, it will land shorter, closer to us.

The initial thrust in the stock market, of stocks coming off the low prices or on a breakdown from the top prices, are what we term "**impulse waves.**" They are a lot like the trajectories out of these cannons, whereby, we can take measurements on these trajectories and forecast where they are going to go.

With this as a backdrop, we return to the theory that the subconscious mind of man is connected with

the price level of stocks, on a day to day basis, which has something to do with time cycles that are influencing human beings and their behavior, so we can make the following conclusion:

The price level at which a stock trades tells us something about its own internal time cycle. **This is the major secret key to the stock market!** That is, if a stock goes up to \$50 and it tops out, and then goes down, we can say that the \$50 price is more than just price, for price also has an intricate connection with the time cycle.

Indeed, the time cycle has a mathematical numerological equivalent of 50, just like the price of \$50, and we will find turning points in the future of that stock at units of 50 time periods. These units can be 50 minutes, 50 hours, 50 days, 50 weeks, 50 months, 50 years, but all the units of 50 from that high price will be evident in future cyclical behavior.

This can be proven conclusively to anyone by looking at any chart, whether it be stocks, commodities or even the prices of used cars. (*See Figure 1*)

One takes the high price, takes that time unit and measures over in days, week, months. The unit you want to use, should be applicable to the trading horizon. If you are a long term investor, you would use weeks and months. If you are a short term investor, you might want to use weeks and hours. However we measure it, we will find the turning point in harmonics (fractional mathematical parts) of the major high or low.

Now, when that stock at \$50 goes down and makes a new low, say \$30, and it turns up, we now have the same effect from the lows. The \$30 low will spin out time cycles, based on 30, not 50, but every 30 units over, and these will have a tendency to be lows to lows or highs to highs. For instance, the \$50 price might spin out a high every 50 time cycles, and the \$30 low might spin out lows every 30 time cycles.

What we find, is that the solution to the stock market enigma is nothing more than keeping track of all the fluctuations of the past. All the day to day highs and lows, are spinning out these future cycles, based on those highs and lows of past history. This is very similar to throwing a handful of pebbles in a pond. We know if we throw in one big boulder we get a giant wave, and if we throw in a little pebble, we get little tiny ripples.

These are a lot like the price levels of stocks. The great big boulder might be an all time high or low, the little tiny pebble, might be a recent high or low that might only last for a couple of weeks. The ripples in the pond, that spin out from these prices, give us our cycles. Remember, we are trading for profit here, so we are not concerned with what caused that pebble or boulder to be thrown in, just the fact that we can calculate its effect. The actual reasons and nature of the cause is a subject that I truly do not believe can be addressed in a book of general circulation to the masses at this time.

Now, if we study the physics of light optics or waves of sound, we know there are interference patterns. These waves will come together at some point, at a common denominator, and change the

pattern, making a much larger wave or entirely eliminating the wave completely. What we find, is that each individual high and low, in the history of the stock market ten years ago, a hundred years ago, two hundred years ago, six years ago, are spinning out their own eternal cycle, and we find time periods in the future, where all these cycles come together, creating major market movements (interference patterns), the end of Bull Markets, and the beginning of Bear Markets. The birth of newborn Bull Markets are nothing more than innumerable cycles all coming out at the same time.

The mathematics of this is fairly simple, although depending on how many highs and lows we want to use, it may get a little complex. However, with modern day computers it becomes relatively simple to program in two or three hundred observations of highs and lows over the last hundred years, and spin out these cycles, and let the computer tell us when they are all coming out together.

For instance, when a stock has a high at \$20 and a low at \$10, we know that at every twenty weeks there will be a major high, and at every ten weeks there will be a major low. Now, we would note that every other low of ten weeks would also be twenty weeks, so that a high and a low would come out together, reinforcing the cycle, making it even stronger, and this is where cycles can change on us.

If we have a common denominator cycle, that has a rhythm of 10 and 20, they will often come together at a new price. Let us say, the day that both cycles came together, the stock was at \$17. At that point forward we may very well generate a new cycle which eliminates the past highs and lows of 10 and 20, and make a whole new cycle of 17 units.

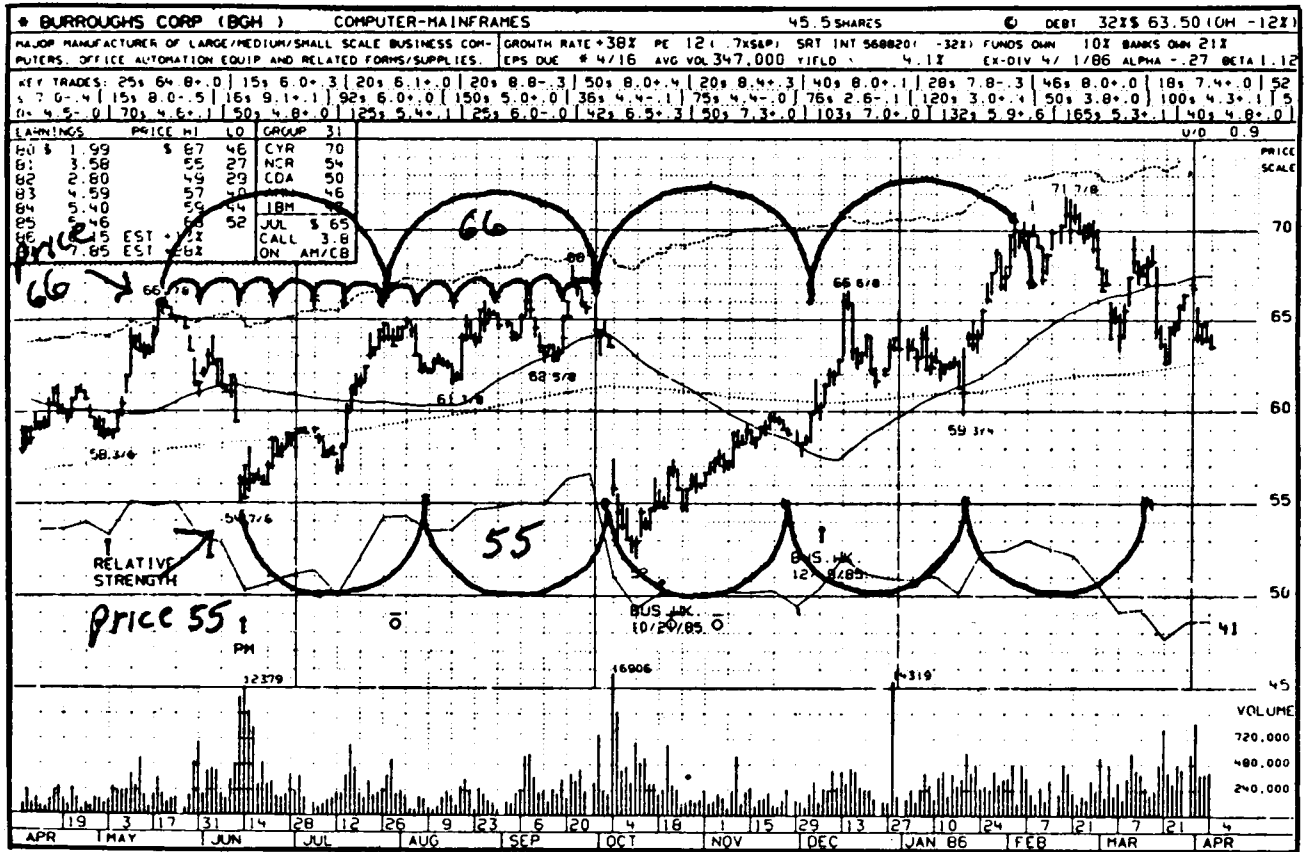


Figure 1

The above chart of Burroughs Corporation from 1985 shows a top cycle of 66 days spinning out from a high of 66 1/8.

Also shown are very small top cycles at 66 hours from that first top. The inner half shows low cycles of 55 days being spun out from the low of 54 7/8.

TIME AND PRICE SQUARES

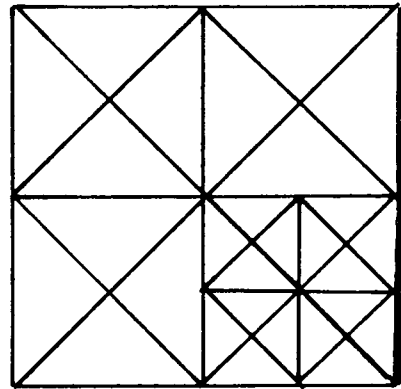
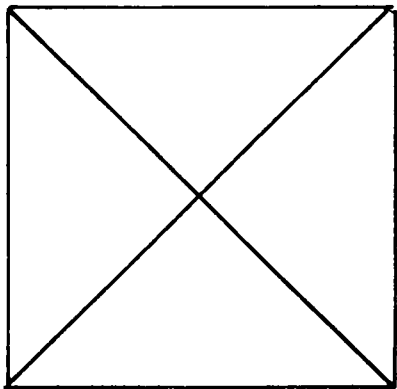
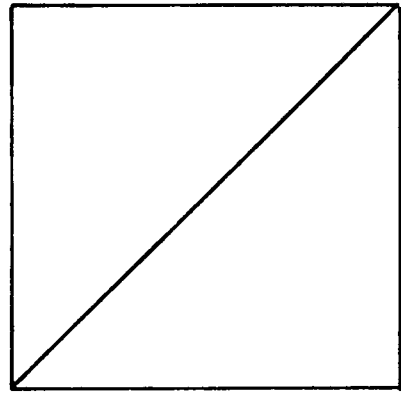
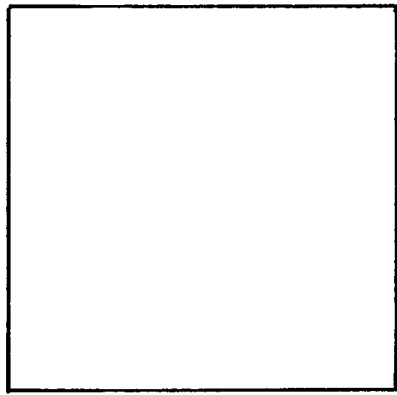


Figure 2

ORIGIN OF TREND LINES

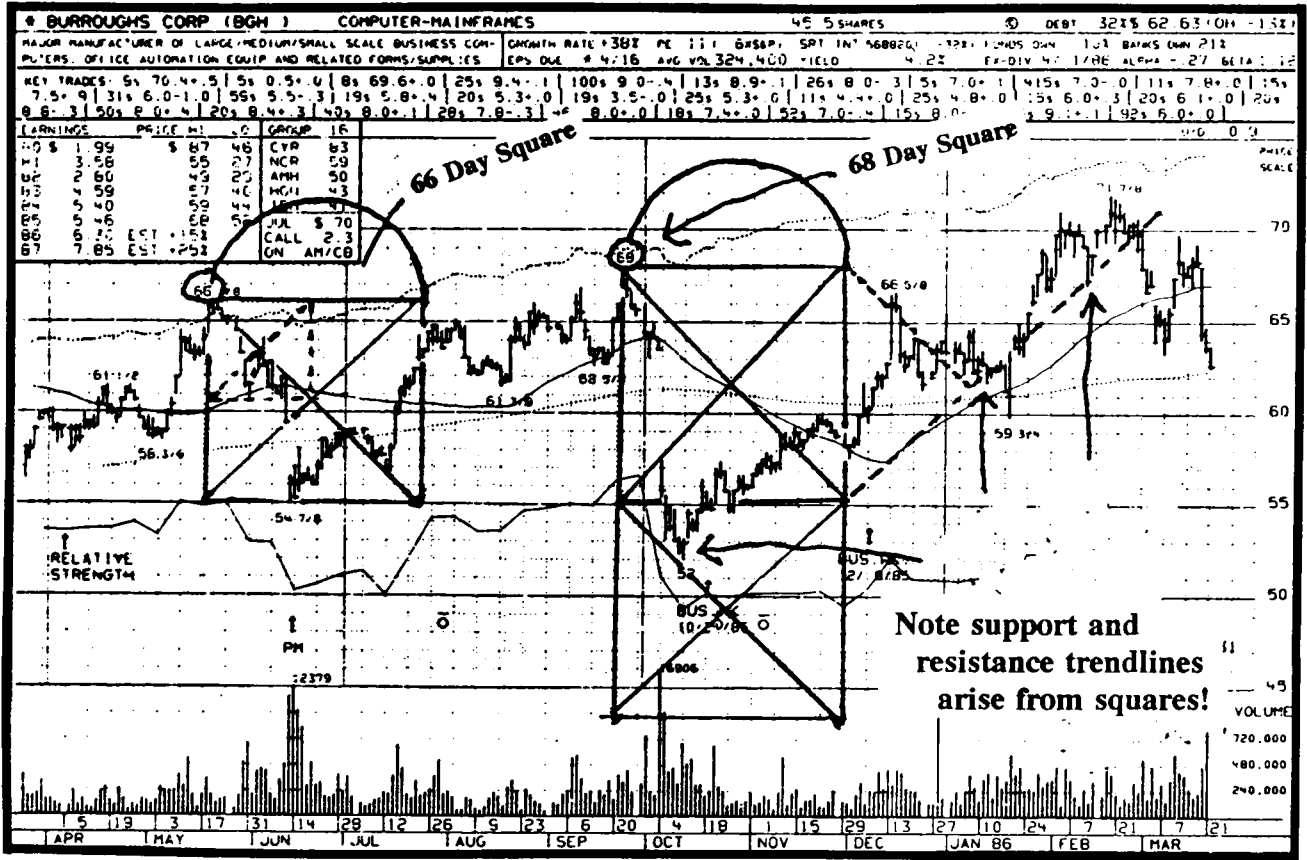


Figure 2A

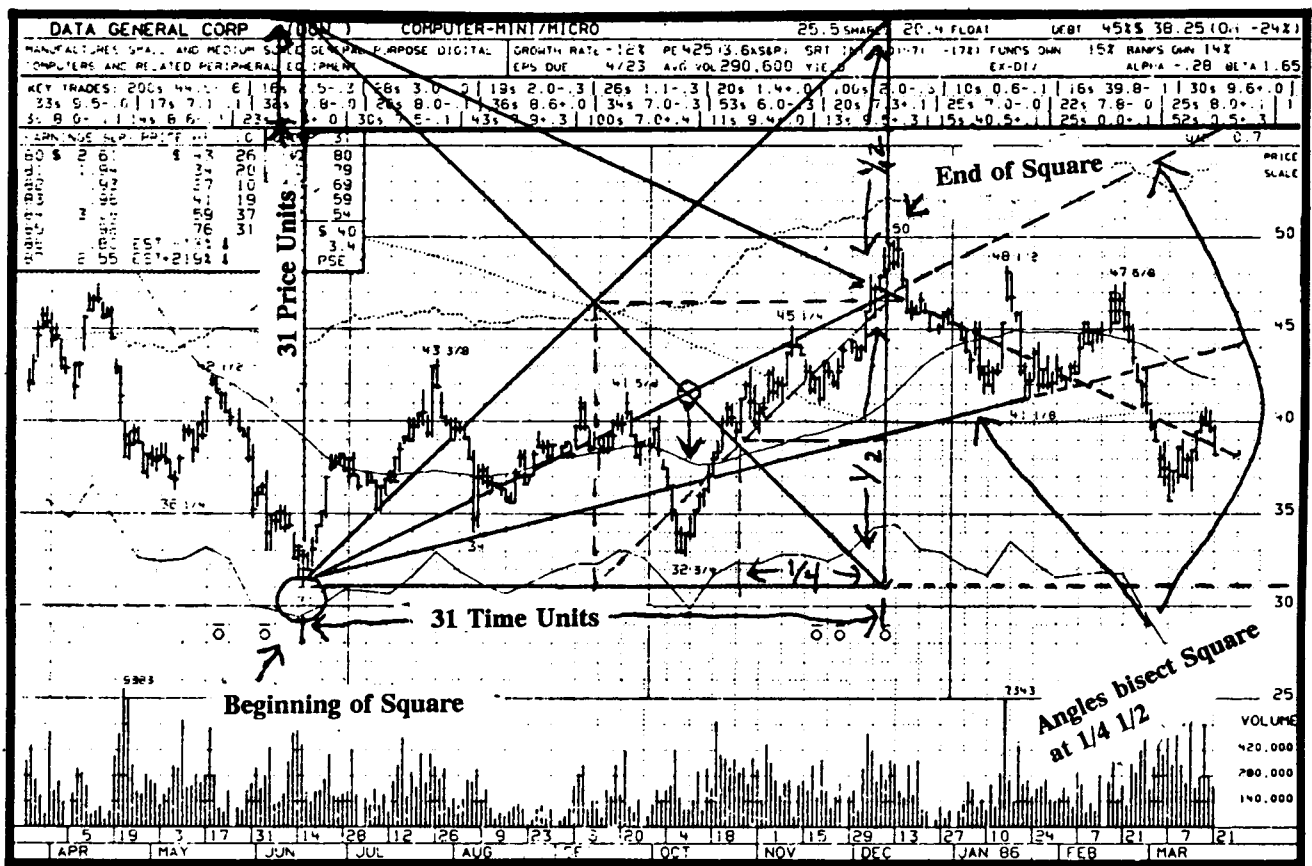


Figure 2B

INTERSECTING LATTICES CREATE CYCLICAL CHANGE

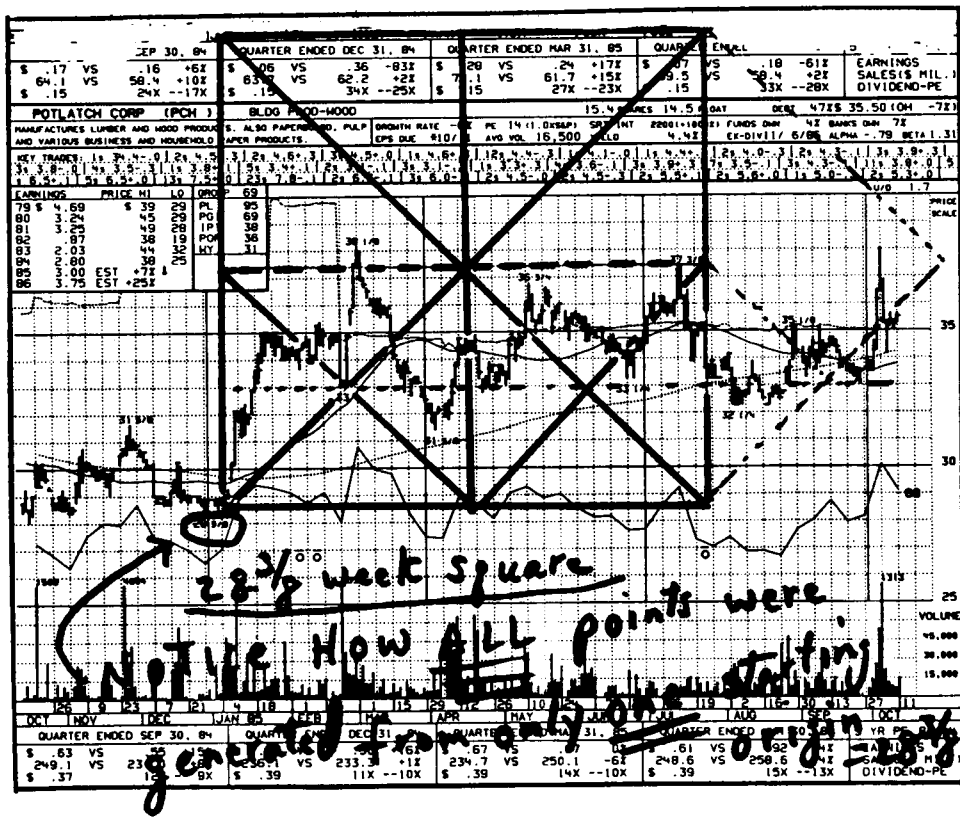
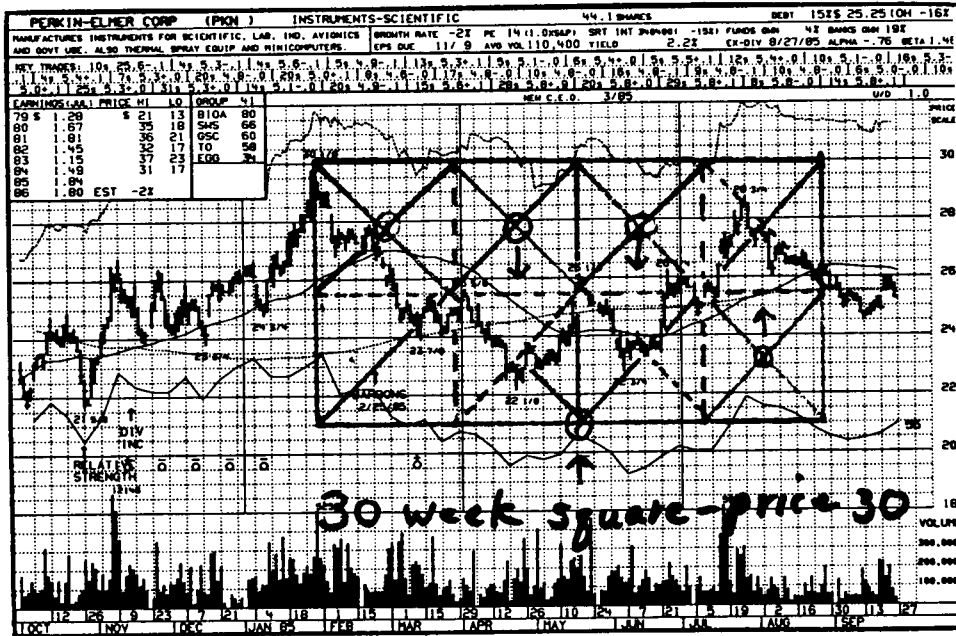


Figure 3

A similar thing would be, if we had a high at \$20 and a low at \$10, and then another price at \$12. We would merely look at the common denominator of these. We know that there would be a common denominator of $20 \times 10 \times 12$ (2,400) for a very big cycle, but we can also reduce to the common denominator by dividing each by 2. For example, 10 divided by 2 gives us 5. 20 divided by 2 gives us 10 and 12 gives us 6. If we multiply the least common denominators $6 \times 5 \times 10$ we will find a shorter time period (300) where these big cycles will come out. This is the theory, and we keep track of it through geometry, through the concept known as, "*time and price squaring.*"

Time and price are the same thing. By this, we mean, the price of \$50 on the stock, generates time cycles of 50 that are interchangeable for most purposes, and because they are the same thing, we can construct a geometric "square" around the price of \$50. If you were to take a ruler, and on your graph paper when the stock hits \$50 as a high, measure 50 weeks, or 50 days, whatever you want to try, draw a straight line horizontally across your paper from the \$50 high, and we would have our timing of 50 units measured out horizontally.

To square time and price we construct a square. We have the horizontal unit of the square. Now, we merely measure down and make a vertical unit of a square, which gives us a little geometric square of 50 units. (*See Figure 2 and 2A*)

To further complicate things, and yet make them easier, we do not necessarily have to use 50 units of time, in terms of days, weeks or months. On our graph we can also use 50 price units, by measuring how far 50 price units are vertically, on the particular graph we are using. Once we have made that measurement with a ruler, we can turn the ruler horizontally, and see what the measurement equals in terms of time periods. (*See Figure 2B*)

For example, you may find on the particular graph you are using, that our unit of \$50 may equate to 217 days, an unusual unit, and yet, since we know that units of time and price are the same thing, we can still construct a little square and achieve very accurate results.

So the initial step is to construct the square based on the high price. However, if you wanted to construct a square up from the low, you can take the low price and measure up and construct a square. This of course is very basic. Please try and keep an open mind until you grasp all of this, for the implications are staggering, and our minds are rigid through years of erroneous thinking. Trust me, the effort will be worthwhile! Besides, we are not trading for fun and profit, but only for profit. Let's not get biased by thinking too hard at this stage of the game.

The next step is to divide the square. We draw a diagonal line through the square, which will subdivide our square. As we subdivide the square diagonally, we would then have two halves of the square.

We then draw a vertical line through the middle of the diagonals, making it into two halves. Within each of the four quarters of the square, we can draw diagonals, making eighths, and then subdivide these little eighth divisions within each quarter.

As we continue the process of drawing diagonals within squares, within smaller squares, within smaller squares yet, we see that these diagonals are actually the trendlines that mysteriously appear from nowhere. We can now see conclusively, on our chart, the origin of all trendlines, how these trendlines arise from the mathematics of the high and low prices, and the square units that are spun out from these highs and lows. (See *Figure 2A*)

One of the reasons, in theory, as to why this all works, comes back to the original statement of Pythagoras, **“UNITS IN CIRCLE OR IN A SQUARE ARE RELATED TO EACH OTHER IN TERMS OF PRICE AND TIME AT SPECIFIC POINTS.”**

Let us, for example, put a series of random dots on a piece of paper. There is nothing that relates those dots to each other. Now, if we draw a square on a piece of paper we can easily see that the dots that make up the lines or the sides of the square. The dots are related to each other in a very specific mathematical fashion, for they make up the sides of the square. On a truly innate level, human beings recognize the geometric shapes apart from randomness, so we must accept the interconnectedness of points that fall on the axis lines of these very special shapes. (Did you ever wonder why humans see shapes?)

So it is the same with any other geometrical shape, a circle, a triangle, whatever else, they are not just random dots. What we are seeing by joining these squares around the price levels of stocks are unifying cyclical influences.

Keep in mind that on a subconscious, psyche level, people are exhibiting emotional behavior caused by external cycles, that are influencing them to sell the stock at \$50. What our square shows, as it is broken down into little diagonals and sub-diagonals, is the minute subconscious emotional facets of the cycle that is currently operating.

We can, therefore, conclude that the masses as a whole will exhibit major cyclical behavior at the end of the big square of 50, say 50 weeks later. At the end of that point, time and price will be at a major mathematical point that ties in the original starting point of that cycle high. If there are indeed external cycles, and all the evidence points to such, this method is a way of subtly capturing all these subconscious, subcycles, of greed and fear that manifest in the market.

What we find is that when we take these squares and subdivide them, when we put diagonals in the squares, and when we subdivide them into quarters, and then into 8ths, and then into 16ths, and continue to subdivide the square down into trendlines, the stock appears to trade within these subdivisions.

It is these diagonals within a square, the subdivisions of an emotional cycle, which are the well known trendlines in technical analysis. The reason these trendlines work has to do with the origin point of the cycle.

Note that the random dots on a piece of paper have nothing in common, but dots that fall on the param-

eter of a square are connected. So when the price of a stock goes down from \$50 and hits one of these intersecting diagonals or trendlines, it is somehow mathematically, harmonically, related to the origin point, because we have a geometric shape, a structure, a square, a diagonal, that is mathematically connected.

We, therefore, have something that ties in our cycle and the force of the cycle can now be measured in a mathematical, very precise objective fashion. Remember the rule, when a stock price hits a trendline a change in trend will take place. For instance, if a stock declines, and hits a trendline, it will often bounce off that trendline. This is considered a change in direction. Sometimes though, a change in trend is a change in momentum or acceleration such as a stock going down to a trendline, and when it hits it, accelerates and collapses, bursting through the trendline. This too, is a change in trend, but not a change in direction, for the trend has changed to an acceleration of the existing trend.

Within a square, or geometric shape, the intersection of various trendlines, such as the center of the square, where two diagonals cross, represents a kind of a forcefield vector, where extreme emotionalism comes together. It is at this intersection or intersecting lattices, within the square, that we find major changes of a cyclical nature. (See *Figure 3*)

This is apparent in a chart where we have constructed a square over the price action. At these intersecting points you will find the stock will change direction or accelerate, and we will see an evidence of change brought about from a cyclical nature. Many of these changes are obviously insignificant and not worth trading as they are minor fluctuations. Therefore, when we are really investing off this cyclical methodology, we must keep track of major changes.

For instance, a major square of 50 years from a price of \$50, would have the diagonal intersecting at the midpoint, which would be 25 years later and we would expect to see a very major change at 25 years. Also, on a 50 week cycle, every 25 weeks we would expect a major change. Obviously, these changes would be much bigger than if we had a 25 minute chart or a 50 minute chart with the diagonals intersecting every 25 minutes. There would be a change there too, but it might be for 50 cents, whereas the one for 25 weeks might give you a \$10 fluctuation.

The theoretical implications of this are staggering. In my research of many years I have made some major conclusions from studying these things. Many of these are proprietary and I choose not to reveal them at this time, however those of you who grasp the basic fundamental truth as to how this works, can easily derive many of these concepts for yourself.

Now, let us see how this is used in a normal trading situation. The first thing we would want to do is go back over 10, 20, 30 years of stock market history data of a particular stock and find the highest price it ever sold at in history. Maybe the stock at one point sold over \$100, and today it is only trading at \$30. We would know that that was a major cyclical high.

For example, let us say that our stock topped at \$120. We would want to keep track in a tickler file, or

on a calendar, this cycle origin point. If the \$120 price was made on January 1, 1973, we would want to keep track of 120 weeks, especially 120 months, which would be 10 years later, January 1, 1983, or 120 quarters or 120 years.

First we need to get the really big cycles down. We know by subdividing these squares into halves, quarters and thirds, we would see that the simple division of the square, is what really gives us the well known technical observation of proportion and harmony in the price of the stock. If the stock's high was \$120, we know that 50% of that high is \$60, and we all know the 50% principle...when a stock pulls back to half of its all time high, it finds major supports. It finds major supports simply because of these diagonals coming up from the low, under this giant square, and at the midpoint all angles intersect at the 50% midpoint. This is why the strongest point on any movement is the 50% retracement point, whether the stock is going down and bouncing back from the 50%, or is going up from a correction low to the 50% point.

There are many logical conclusions to be made from an analysis of squares, or various methods of time and price squared. Since every high and low is connected with previous highs and lows, it stands to reason that a price of \$50 at a high, is really stopping at \$50, because of some unit in the past that has spun out these squares and circles into the future. Perhaps there was a square of 100 many years ago. As the stock currently goes up to \$50 it hits that midpoint of the giant square and stops at 50. If there had been a low of \$25 many years ago, we would have two squares on top of each other. A square of 25 units up from that low, would also come out at 50, and the stock would top at 50. We may not be able to identify the origin point of where the squares are coming from, but because of the theory of the square, we know that we can take the high price of 50 and draw a 45 degree diagonal line up and down from that price, and start a brand new square. This is why in most technical courses, people use 45 degree angles. For it is the 45 degree angle that neatly subdivides each square.

Because, the 45 degree angle is the intricate unit of the square, we can see, that we do not need to know where the actual time cycle began, because all the future highs and lows, all the current highs and lows, are bouncing around within these fractional diagonal points of various squares. Therefore, when we draw our 45 degree angles down, we are assuming there was a square with a diagonal coming down that caused the stock to top out. To find out if there was a diagonal coming up from a low that caused that price, we should draw a 45 degree diagonal down and to the left to see if it hits a lower price.

One useful means of doing this is known as, "squaring the range." The range of a stock, is defined as the price levels between a high and a low. For instance, if a stock trades over several weeks or several months, at a price range of \$25 to \$50, and back again, what we would do is to take the high price and draw a 45 degree diagonal down, until that diagonal intersects the low price, which would be \$25 in this case.

At that intersection point, the 45 degree timing line would square, or make equal the high price of \$50 and the low price of \$25. At that point, we should turn the "timing line" up again, and draw from the \$25 low, up at a 45 degree angle, to where it intersects \$50. We would continue doing this as a timing

mechanism with a zig zag up and down, back and forth between \$25 and \$50, until the stock breaks out of that trading range. You might want to draw a big square of \$50 at the high, and draw the 45 degree diagonal down to where it intersects with zero, as the intersection of zero price is the end of the square.

Instead of actually constructing a square geometrically on a piece of paper around that high price of \$50, the 45 degree diagonal neatly does it for us, because when it gets down to zero, we know it has divided a square with \$50 up at the top left hand corner, and the zero at the far right bottom corner. So, without actually constructing the square, we know when the end of that time cycle comes out, simply by drawing an angle.

We would also find, when half that time cycle comes out by drawing an angle down from \$50 to \$25. Again, we know that when the 45 degree angle comes down from the \$50 price, and intersects the price of \$25, we are at the midpoint of a giant square. Likewise, if we draw a line from \$50 down to \$37.50, which is the midpoint between \$25 and \$50, we would find that we are at the 3/4 point of the square.

So you can see, without actually constructing these squares, that we can **find all our cycle turns by constructing a simple timing line of 45 degrees and watching where that timing line intersects a proportionate part of the price level.** This is the same thing, as actually constructing a square with all the diagonals, only it is much faster and much easier. (*See Figure 4*)

It makes our analysis much easier to start with any stock and instantly draw a 45 degree angle up, or a 45 degree angle down, and start to get these turning points. For instance, if we have a \$25 low price on a stock, but did not know exactly what the high was, we could just draw an angle up 45 degrees, and when it intersected harmonic fractional parts of \$25 we would get turns. Remember, half of \$25 is \$12.50, so as the angle goes up from \$25 to \$37.50, we would know that it was a potential top, as it would be 50% higher.

We can continue this diagonal up through \$50 for a double, through \$75 for a triple and through \$100 for four times. The squares would get larger, and larger, and larger, and we would be able calculate these turning points from one simple 45 degree diagonal.

I apologize for repeating all this 45 degree angle stuff so much, but it is absolutely imperative that you learn this as second nature before we go on to the more complicated angles, as fractional parts of the analysis. The 45 degree angles are easy, because they represent one unit of time and price. Later you will use 30 degree angles, 60 degree angles, and a host of other angles that are just as important for determining trend, but which are more difficult to keep track of mentally, unless we understand this intersecting lattice groundwork.

45 DEGREE TIMING LINE INTERSECTING PROPORTIONAL PRICE LEVELS

SECRET OF THE 45 DEGREE ANGLE

A 45 degree diagonal line evenly divides a square. Since we consider time and price on a chart to equate to the bottom and side of a square, the 45 degree diagonal becomes a timing line or moving average that equates one unit of time with one unit of price.

It additionally keeps track of mathematical relationships between time and price from any past high or low. So when a stock hits the line it again is in exact mathematical relationship to the original price and must change direction or accelerate the existing trend.

This is why trendlines work-- because they equate, at that exact timing point, a fractional harmonic of both the passage of time and price with the original high or low from which the angle is drawn. Since this is so, we can deduce the following:

- When a timing line (45 degree) intersects major price harmonics of the original high or low - **change will occur!** i.e. 1/8, 1/4, 1/3, 1/2, etc.
- Major "square outs" occur with 100% movements of price intersection, i.e. from top down to zero, or zero up to top (forms a square) hence, "square out".

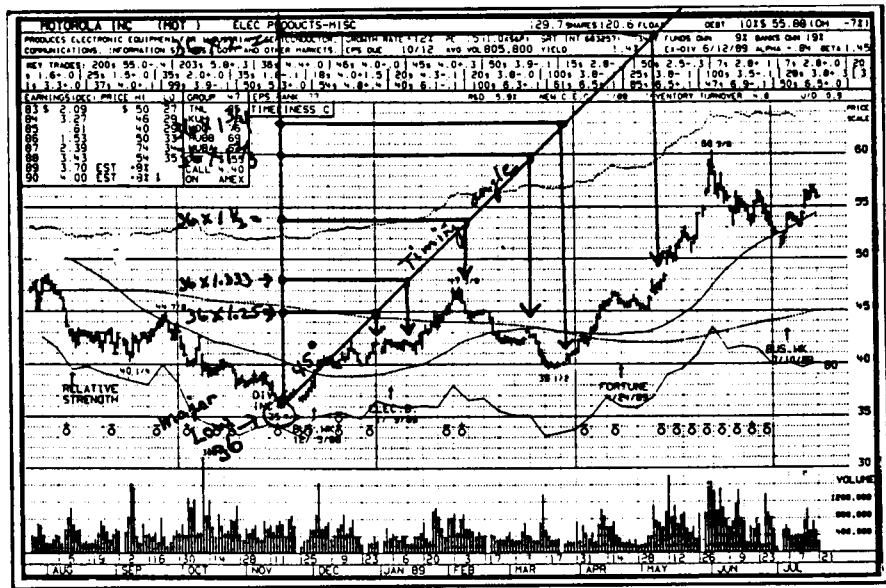
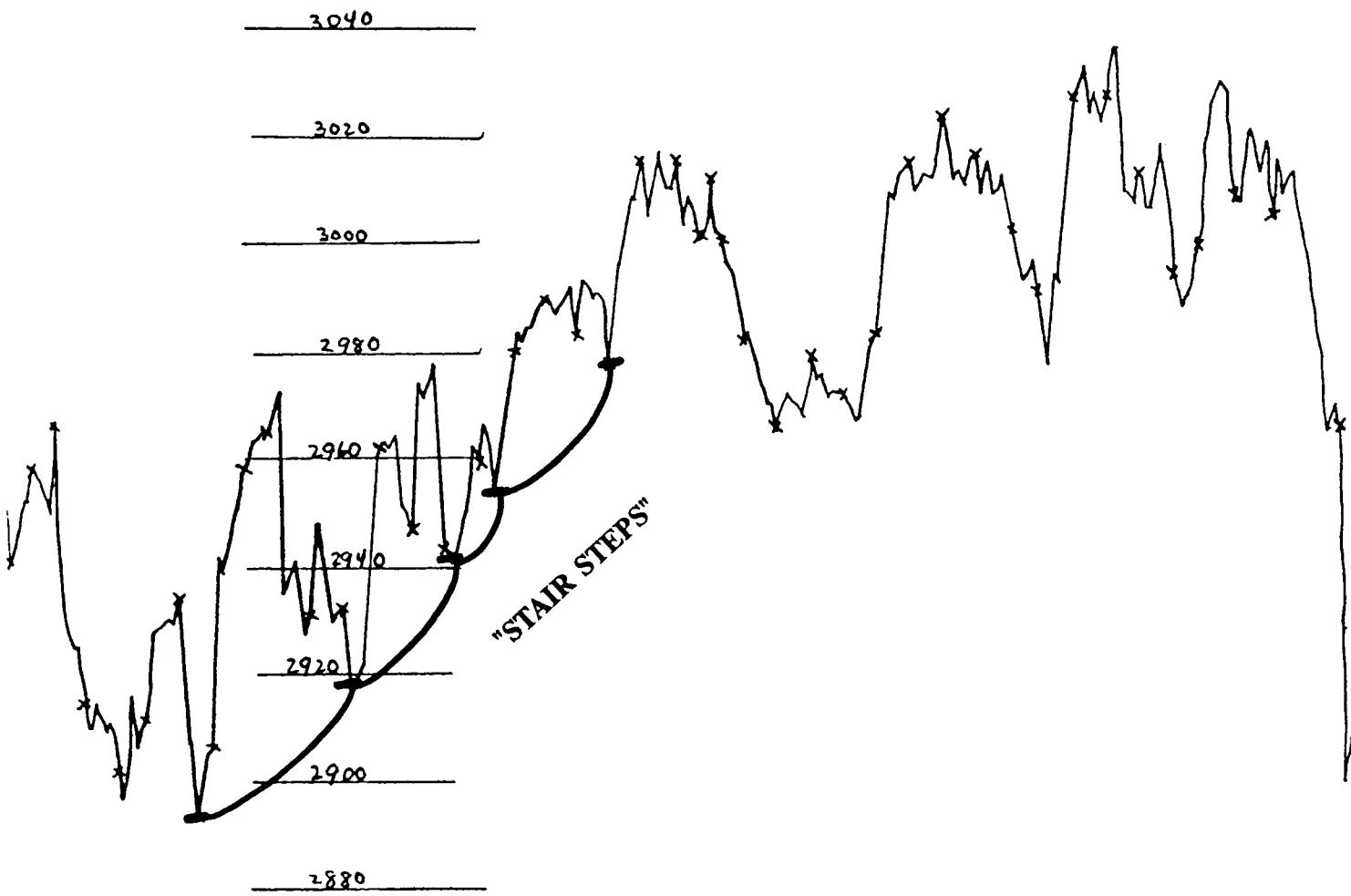


Figure 4



TYPICAL HOURLY CHART

20|21|24|25|26|27|28| 1|2|3|5|8|9|10|11|12|15|16|17|18|19| 22|23|24|25|26|29|30|31| 1|2|5|6|7|8|9|12|13|14|15|16|19
 June July August

Figure 5

Chapter #5

The Hourly Chart

"An Hourly Chart is our primary indicator of major turns."

The very first place to start our practice of professional trading is with the corner piece of all professional trading, the hourly chart. This is the smallest chart, for practical purposes, one should maintain. Obviously, if one uses an hourly chart we are talking about short term trading that is good for three days to three weeks at a time. If you must trade for three months to a year at a time we are really talking daily or weekly charts. However, for most trading activity in the speculative markets, especially commodity markets, S&P futures, bond futures, gold, wheat, soybeans, stocks and certainly all options, we want to stick to trends that last 3 days to 6 days to 2 weeks. We will be using options and futures where we can make 50% to 100% on our money in just a few days.

A properly drawn hourly chart can forecast price events several months into the future as well as each minute hour to hour fluctuation each day. Hourly charts are better than daily charts, in that there are many waves or patterns that develop within the market, day to day and week to week, that are only observable on an hour to hour basis. These are easily identified by their shape and pattern but these patterns are only visible if one has an hourly chart. It is one of the best kept secrets I know, but I will tell you that you will NEVER understand the market until you see and use an hourly chart. It is only with the hourly chart that you will see the patterns that repeat over and over in the course of several months, that are the key to the market. Daily and weekly charts are good but rarely show the common key patterns that clearly identify the market's activity. We therefore start our professional trading career with the hourly chart.

It is my practice to use 6 hours in a day, 11:00 AM being the first hour. There are many reasons for this. One reason is numerological, in that the number 6 is the basis of a great many structures in mathematics, including the cube. God also created the world in 6 days.

There are many more reasons why the number 6 is important, but I shall not go into them at this time. I shall leave that important investigation to you. The 6 hours of a day will be labeled 11:00 AM, 12:00 PM, 1:00 PM, 2:00 PM, 3:00 PM and 4:00 PM which is the close. We need only to keep *a line drawing* which is merely drawing a dot at each hourly price and connecting the dots with a straight line. (See Figure 5)

It is usually best to use an "X" for the close at 4:00 PM each day, so when going over our series of line drawings we will see little "X's" that designate one day from the next.

The hourly chart that I use, and I have had twenty years experience practicing with it, is 6 hours in a day starting with 11:00 AM as the very first hour. I do not consider the 10:00 AM print a full hour, even though it is an hour on the clock. The market opens at 9:30 AM, so the 10:00 AM print is a half hour of time. It has been demonstrated, absolutely to my satisfaction, that **human beings are incapable of being totally committed** to the market without at least 45 minutes to an hour of actual trading. Therefore, most of the days' opening levels, if recorded, using the 10:00 A.M. print will often be erroneous.

If the market had been going down from 3:00 PM to 4:00 PM the preceding day, often the 10:00 AM print will be up \$3 or \$4 and by 11:00 AM the market will be right back down on the day. A line connecting the 3:00 PM or 4:00 PM reading of the previous day before, will show a smooth transition to the 11:00 AM reading and the 10:00 AM reading will not.

Now, obviously the chart you use should have a good correlation between the time period you trade and the trading hours in the day. So many people use the **theoretically perfect chart**, which is the 1/2 hour chart, because in each day you actually have 6.5 hours, from 9:30 AM to 4:00 PM. At least those are full units of 1/2 hrs or 6 1/2 hrs in a day, whereas the six hour chart I use is a little less than what is really going on. However, what most people use in the hourly chart with their 10:00 AM reading is a 7 hour chart and that is too many hours in a day.

I have found after years and years of study, if you are going to use an hourly chart rather than the superior 1/2 hr chart, the six hour chart will give better results than the 7 hr chart. Therefore I use 11:00 AM everyday as my first hourly reading, and that is the first little dot I put on my chart following the 4:00 PM close of the previous day. I have made many proprietary computer studies doing calculations of thousands of trading hours on both a seven hour basis and a six hour basis.

After tens of thousands of hours, the calculations on the six hour chart always work, but the seven hour yields only partial results which are unacceptable for my kind of work. I know all this six, seven hour discussion sounds repetitious, but the vast majority of traders in the world use seven hour charts and my proprietary cycles say those charts will just not work as well.

The reason hourly charts are so beneficial, is that within the hourly patterns of each day, there are many little corrective thrusts, retracements, impulse waves and all sorts of little wiggles that can help one discern the pattern of the market. These trends only go 2 to 3 hrs at a time, before there is a slight 1 or 2 hr pullback, which creates the little wiggles that we can measure quite accurately on an hourly chart, which **do not show up** on the daily chart.

On the daily chart we may have three days in a row straight up, but within those three days we are talking about a time period of 20 hrs or more. Within these hours there are many little wiggles, such as an impulse wave that lasts 6 hrs straight up, a pull back of 2 or 3 hrs, then another three hour advance and then a pull back for 3 or 4 hours. There could be many different combinations, but **it is the shape of these waves** that form a pattern. We will find through study that there are a number of set patterns that repeat over and over again.

Now, I have not cataloged every major pattern there is, but in my 20 years of experience in using hourly charts, I would say that there are probably 12 very reliable patterns that repeat over and over again, and that there are probably only five or six patterns that repeat 70% to 80% of the time.

If one maintains an hourly chart over a couple of years, he would see almost every single known pattern. There would be slight subtle innuendoes in changes to these patterns, but most of the patterns you would ever see could be found in an hourly chart. A brief analysis of the hourly chart also provides much more data to study, and can literally save you years of looking at daily data before you could see the same patterns and learn from them. The only thing different would be the major waves present. When the market is going through financial panics or major booms the hourly patterns are exaggerated. The shape is still the same, but the magnitude of these impulse waves and the retracement correction percentages have been exaggerated. The shape is still there to guide you to the number of "stair steps" up or down as before, until the final high or low is reached.

One trick that I have learned, and one I always use in determining the main trend, is that for an hourly chart to show an uptrend it is always best to wait until there are at least five easily identifiable bottoms in place. For instance, if the market is going down and plunges to a vicious low and spikes up, that low is the first little bottom. There is then a pull back that results in a higher bottom, then an advance, then another pullback, which is a third higher bottom. At this point you can still have a bearish pattern that fails and goes all the way down to new lows. This frequently happens, but if you then have a fourth higher bottom and a space for a fifth higher bottom, at least at this point you would probably be 80% to 90% certain that the trend has changed from being a down trend to an up trend. Note that I emphasize higher bottoms, not just five bottoms. Each of the five bottom probes must be higher than the preceding one.

Since we are dealing with hourly charts this gives us a big advantage, in that these five higher bottoms can be seen within only a two or three day observation period. Whereas, if we are dealing with a weekly or daily chart, and the trend is down, it may take several days to a week or more, before these respective chart patterns show any sequence of higher bottoms.

So the hourly chart is our primary indicator of major turns, even if we are long term oriented and we trade off of a weekly chart. If we are in an area where our time count is such that we expect the weekly charts to make a reversal or we have a major move in terms of where the average time to correction has run its course, we may want to switch our attention to the hourly chart to see if this is the beginning of a new trend.

I would like to emphasize that it is imperative that one draw an hourly chart by hand and not use a computer. Although in my trading I have several computers, that simultaneously draw all kinds of 5 minute, 15 minute, hourly, daily, and 1/2 hour charts, I always maintain at least one hand drawn hourly chart on the market averages.

I believe that the reason why this works, has to do with our subconscious mind. It is a well known fact that under hypnosis we can recall all kinds of elaborate details from our subconscious mind from

years ago, and that our subconscious mind is much more aware of what is going on than we realize.

When we actually sit down and draw an hourly chart on a piece of paper by hand, what we are actually doing is integrating our conscious, rational mind, with our subconscious mind, and as we draw these various price levels, you instinctively have a much better feel for the market when reversals take place. It will be much easier to recall where these highs and lows are placed, than with a chart book publication or a computer printout that we just have a cursory look at.

Keep in mind, when we are trading, *that these impulse waves, patterns and cycles are used to develop a trading strategy* of whether or not we want to be bullish or bearish. If we want to be bullish and the main trend is up, we want to buy every dip and scale out of our positions on rallies. If we are in a long term bearish trend we want to sell short all the advancing rallies and cover on the dips.

These cycles and the *forecast* of the probable price trend is only used to set our *trading strategy*. When we actually make a trade, there are hard and fast trading rules that we utilize to make money-- not predictions of probable future outcomes. For instance, once we have a pattern of 5 higher bottoms and we believe that the long term trend is up, we can make a "measured move" with a ruler on a piece of paper of what the average duration of the most previous advances has been. We can take a proportionate measurement of these impulse waves and make an approximation of where it is going and the average time period it will take for the move to be completed. We can also count our waves to find out where we are in a wave count.

However, these are just entry and exit points. The forecast at this point is discarded and our trading rules take over to insure that we put money in the bank at the end of the trade no matter what we hypothesize about its future forecasted course.

Once we have a main trend, we will buy the dips as they make a higher bottom, using a stop loss at the previous low. The safer thing to do is to buy a dip on an hourly chart and put our stop loss at two lows back. The rule being **you can usually break the immediate preceding low, but you will not break the second preceding low back** if the trend is legitimately up.

If you start to break the second low back and especially the third low back, the odds increase dramatically that the trend has indeed changed. If we assume that the main trend is up with five higher bottoms, by the time we start to break back through 2, 3, or 4 of the previous lows, we are creating a sequence of highs and lows that indicate we are making multiple lower tops and lower lows and that the trend is probably changing to the downside.

Trading comes down to simple probabilities:

- **Waiting to find a clearly identifiable uptrend.**
- **Waiting for a pullback for a higher bottom entry point.**
- **Placing a stop loss at the previous or the second previous back stopout point.**

- Gauging the magnitude of risk that we want to take.

Keep in mind too, that the number of "stair steps" up also determines the probability of being stopped out. If it is early in the movement and we have 4 or 5 higher bottoms, the movement is strong enough that we can still probably use our trend stop loss of the most immediate past bottom. If our advance already has 6, 7, 8 or 9 higher bottoms or little stair steps to it, we had better use the second bottom back for our stop loss, because at this point there will be many more "headfake" corrections down, even if the trend has not changed. Anyway, the odds are increasing that the trend is changing, so the probability of our success is not that great. Risk adverse traders will not bother trading at these "extended" time periods, but wait for the opportunity to establish a short position when the trend reverses. (See Figure 6)

In constructing the hourly chart, it is important that time and price are related to the same scale. That is, on a piece of graph paper **one hour in time should be equated to \$1 in price**. In a box with 10 squares we should have \$10 of price movement, versus 10 hours of time movement. This simplifies our calculations and it equates time and price to the same unit.

We now need data to make some projections. Start with any major high or low of a swing nature, such as the highest high or the lowest low, in the last 3 months. The data is readily obtained from daily newspapers in the public library and the hourly chart can be maintained in only 2 to 3 minutes a day.

Once we have several weeks, to a month and a half of data, we will see many minute wave patterns forming. We will also have a good idea of **the approximate average movement between reversals** that the market exhibits. It is only by maintaining hourly charts over several years that we will get to **measure the extremes** we can expect. However, in just 1 to 3 months of charting data hour to hour we can see 80% of all the normal fluctuation ranges. These we use to make estimates at each reversal point, as to approximately how far the move will go in both time and price.

Our calculating tools for cycles are our geometric angles. From any major high coming down off the top we draw a 45 degree angle as our primary tool. The 45 degree angle is equivalent to over 1 and down 1. **1 unit of time is equal to 1 unit of price and it is our master calculator.**

Therefore, we know that if there was a market fluctuation where the market averages moved from a low to a high of 50 points and at the high we drew an angle down at a 45 degree angle, we would know that it would intersect that low 50 hours later. We need only visually look at the angle coming off the top, intersecting the low point, to make that calculation. We need not count with our fingers and toes 50 individual hours. Likewise, we will want to draw angles twice as steep and four times as steep. Instead of over 1, down 1, we want to go over 1, down 2. This is an angle twice as steep as the 45 degree.

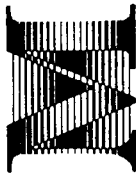
In theory, geometric angles are angles that are constructed from geometric figures, such as a square. The diagonal of the square from one low corner to the high corner is the 45 degree angle. If we then put a dot in the midside of the square and connect the lower corner with a line to the right midside, we will have an angle that is half as steep as the 45 degree angle. If we then put a dot on that right hand side, at the 1/4 point and draw our angle from the lower left hand corner to the right 1/4 up, we will have an angle that is 1/4 as great as our 45 degree angle. (*See Figure 10, Page 46*)

These angles are drawn both up and down, over the market averages to calculate time periods. We can also use standard angles such as 30 degrees and 60 degrees. Even though these are not geometric, they are natural angles and give us quite reliable results. Natural movements often follow along these angles.

Our basic methodology must consist of some method of keeping track of time. Especially time from the extreme high and the extreme low. We want to have some system of numbering on our chart, the number of hours going horizontally across our page after each major high and low. You can number every single hour, 1 through several thousand and have a special "tick" mark on certain numerological hours, such as at Fibonacci ratios and the Fibonacci absolute numbers 1, 3, 5, 8, 13, 21, 34, 55, etc. It is also good practice to make a "tick" mark on the natural square numbers. For instance, 2 squared is 4, 3 squared is 9, 4 squared is 16,...25, 36, 49, 64, etc. These natural squares have very strong support and resistance influences on the market.

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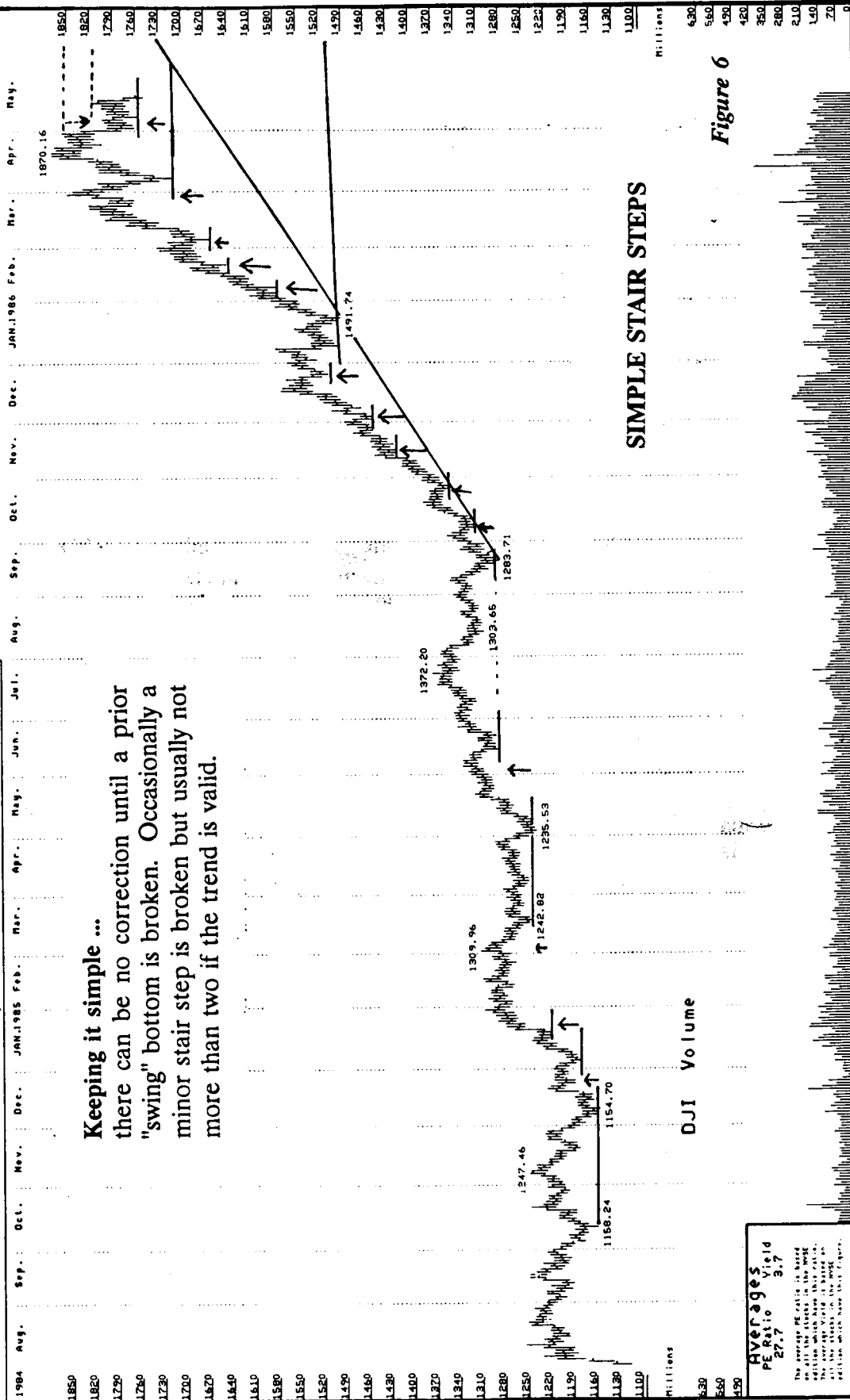
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Dow Jones Industrial Averages				
	HIGH	LOW	CLOSE	CHANGE
MON	1804.32	1774.80	1787.33	-2.10
TUE	1804.07	1772.32	1785.34	-1.99
WED	1815.23	1775.55	1808.28	22.94
THU	1808.78	1766.99	1774.68	-33.60
FRI	1775.67	1749.88	1759.79	-14.89

CLOSE = 1759.79



SIMPLE STAIR STEPS

Figure 6

Keeping it simple ...
there can be no correction until a prior "swing" bottom is broken. Occasionally a minor stair step is broken but usually not more than two if the trend is valid.

DJI Volume

Averages	
PE Ratio	27.7
Yield	3.7

The average PE ratio is the average price per share divided by the average earnings per share. The average yield is the average dividend per share divided by the average price per share.

When we do this procedure from each high and low in sequence and extend out our time cycles into the future, we will instantly see *cluster points*, where there are common denominator hour numbers of various highs and lows that come out within an hour or two of each other on certain dates in the future.

For instance, 55 Fibonacci hours from a major top may also coincide with 34 Fibonacci hours from a subsequent low. The fact that both of these come out at about the same time period, identifies for us, a potential turn, well ahead of the time where the market may change direction.

It is not uncommon to have a large hourly chart with 8, 10 or 15 different coincident turns within an hour or two projected several weeks into the future. These are the surest signs of major, significant market culminations. When trading off hourly charts, it is amazing to see the exactness of the market turns on each and every hour and the forecasting results that one can obtain using a good hourly chart.

For example, if the market tops out at 1:00 PM one afternoon, we can apply the simple Fibonacci sequence of numbers, in terms of hours. That sequence being 1, 3, 5, 8, 13, 21, 34, 55, etc. It is a sequence of numbers where each number is added to the previous number to get the next. So 1 and 2 are added together to get 3, 3 and 2 are added together to get 5, 5 and 3 are added together to get 8, 8 and 5 are added together to get 13, etc.

If we take these numbers and apply them in terms of hours, what usually happens is if the market topped out at 1:00 PM, we would have a decline that would last maybe 3 hrs, 5 hrs, 8 hrs, 13 hrs or 21 hrs downward. Within those downward time periods we would see our little waves developing and could count our little stair steps and patterns of those waves. The longer the advance, the more likely that the correction would be a little bit longer than with shorter advances. What happens is that the vast majority of market movements usually consists of hourly patterns of 8 hours, 13 hours or 21 hours and occasionally a long movement will go 21 hours, 34 hrs or 55 hours. But for most day to day markets, 8 hours, 13 hours and 21 hours are the keys.

If we had an advance that went approximately 21 hours and then topped out, it would be foolish to expect a low at the next hour or even the second hour. We would probably need a correction of 5 hours, 8 hours or 13 hours. If the market went down 5 hours and it looked like it started to rally, we may very well go long on the 5th hour, using the price level of the **5th hour** down from the top as our stop out point.

On the other hand, if it failed there and went down for a 6th hour, the odds would be very good that the trend would continue on down at least until the 8th hour, the next number in sequence, or if it didn't stop at the 8th hour, the 13th hour.

So if we have hour number 6 off the top we have valuable information. We know that even if we are looking for a reversal, and may be nervous about our short position, there is no need to be overly concerned until we go another two full trading hours to hour number 8, because markets do have a tendency to turn on these Fibonacci numbers. This is not only a natural tendency in the market, to run

in Fibonacci hours, but a great many professionals trade off these patterns, and in today's world with the advent of numerous computer trading systems, it becomes a self-fulfilling phenomenon.

Now, for these hourly turns to become even more reliable in our work, we should observe a series of highs and lows over the last several weeks. If we find that several days ago at 2:00 PM the market had a bottom, we may want to note over the next four or five weeks these Fibonacci hours, counting out 13, 21, 34, 55, 89, 144 and put a little "tick" mark on our paper, making a horizontal line of these "tick" marks. We would do this in sequence with all of our highs and lows of significant moves.

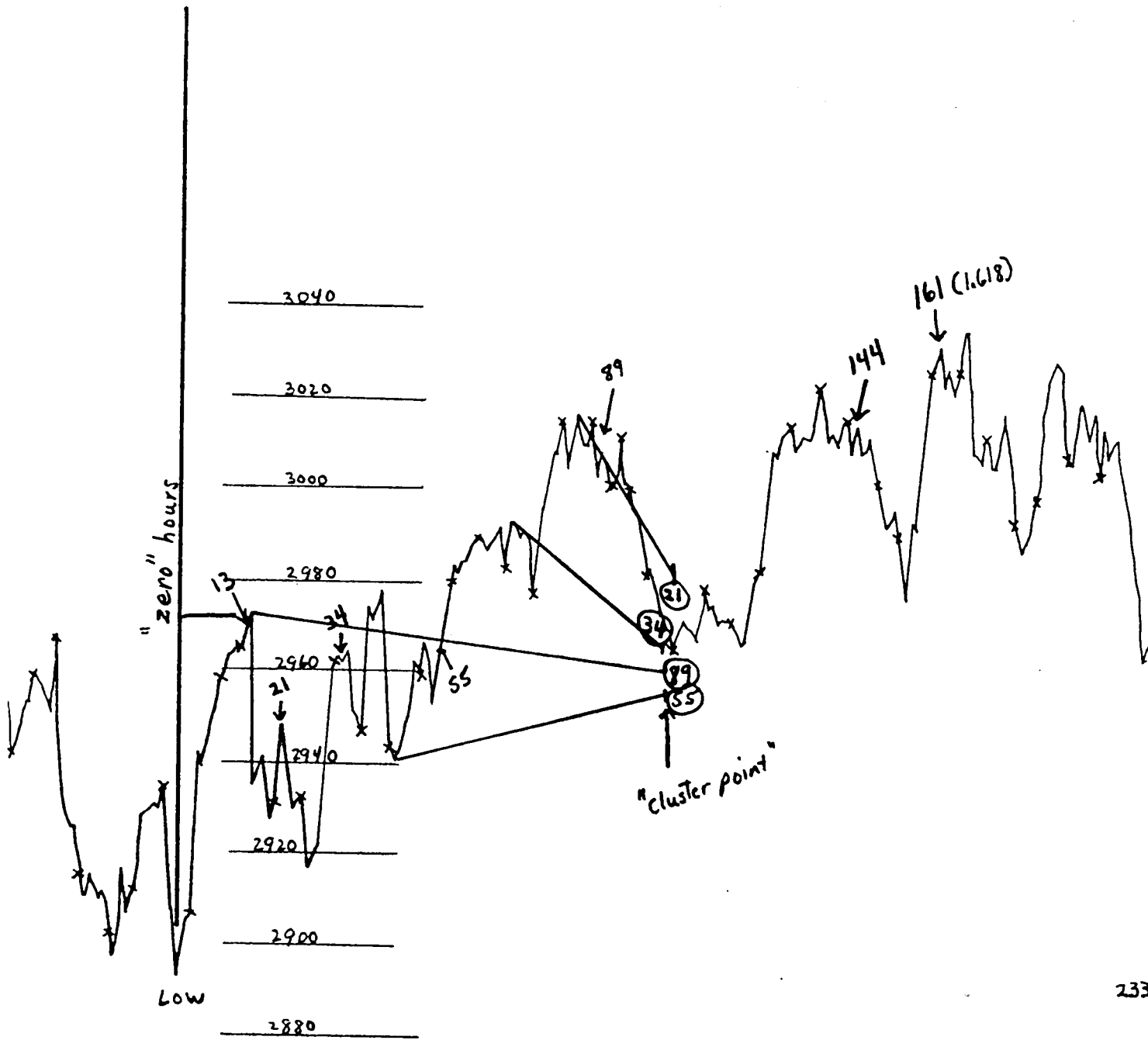
(See Figure 7)

One thing you will find by doing this, is that there will come a time in the future where there will be a whole cluster of Fibonacci numbers spun out from these various highs and lows, and they would fall within 1 or 2 hours of each other. For instance, we may have a time period two weeks from now that turns out to be 13 hours from the recent high, 144 hours from a low several weeks ago, 89 hours from some high or low, maybe 233 hours from a turn a long time back. We would find that all these highs and lows have a common denominator coming in Fibonacci time periods right about now. This immediately gets our attention that there is a significant cycle coming due within an hour or two.

During this hour or two we want to pay very close attention to our hourly chart, to see if it is trending down or if it is trending up and if we have 8, 9, 10, 12 or more stair step patterns up. If indeed, it has already had 12 or 13 upward stairstep patterns, then we are nearing some kind of probable top reversal in trend. With all these Fibonacci hours coming out, it would appear with almost certainty, that the market is going to top out and change direction, and we can anticipate that top and buy some very cheap put options.

Actually, even in guessing, with a close stop loss based on a number of hours rather than a point count, if the market continued to go through our Fibonacci time cycle period, and there was still no change, then something would be wrong and we would close out our position. But the odds would be very good that the market would indeed turn during one of these time periods.

You will find as we start to use our mathematical set of tools, our arsenal of counting waves, counting stairs steps, using Fibonacci numbers, using proportionate parts of the impulse waves identified on our hourly charts, we get into highly probable scenarios of what the direction is, how long it is going to go in that direction, and where the change will take place.



FIBONACCI HOURS

June 20 | 21 | 24 | 25 | 26 | 27 | 28 | 1 | 2 | 3 | 5 | 8 | 9 | 10 | 11 | 12 | 15 | 16 | 17 | 18 | 19 | 22 | 23 | 24 | 25 | 26 | 29 | 30 | 31 | 1 | 2 | 5 | 6 | 7 | 8 | 9 | 12 | 13 | 14 | 15 | 16 |

July

August

Figure 7

If one uses a simple hourly chart like this, has extreme discipline and does not override the very objective facts and figures of these numbers of hours from the highs and lows, and uses these angles with cold, hard logic to mechanically trade off them, then one can be extremely successful in the market. So much so, that you will probably be right 80% of the time since you have a clearly defined stop out point. Let us say you buy an option at \$3 and you are 80% right, your average gain might be a double, a \$3 profit. Your average loss, since we have a clearly defined stop out point, might only be \$1. Now, if you are right 8 out of 10 and you are making a \$3 profit and 2 out of 10 you are losing \$1, you will see that you will be quite wealthy indeed, before very long.

Remember these Fibonacci numbers when you make an initial trade, especially with options. If there is a reversal at one of these number periods in the market, as things in the market are not random, there is evidence that cycles exist.

If the patterns show us that there is a reversal in trend, we have high reliability that these reversals in trend will persist, being cyclical in nature, in the new direction for a set number of hours. In normal movements, Fibonacci hours run to 8, 13, 21 most of the time.

So, if we were to buy a call option at \$3 and were lucky enough to define the low fairly precisely, one would not have to be nervous and quickly sell one hour later when the option went up to \$3.50 and have only a \$.50 profit. We could calmly sit back and say, "wait a minute, this movement will probably last 8 or 13 trading hours at a minimum." Keeping in mind there is only 6.50 hours in a day, an 8 hour movement on an hourly chart, will get us well through the whole trading day and into the next trading day. A 13 hour movement will last 2 full days before we even have to think about selling.

Now, during this time period, if the market does a truly spectacular move, our \$3 call option may very well go to \$8, \$10, \$15 or more, and we would have an enormous reward and it would be based on scientific trading and not guessing.

The only reason we want to close out our option, after we have a winning trade, is that the probabilities are going against us or we have been stopped out through cold hard discipline. There are many times we will be whipped-sawed and we will be stopped out even though we are right, but we still must maintain the discipline and stop ourselves out if the option goes much against us.

If the hourly chart turns down again and we try to buy a low and it violates that low, we are probably wrong and a downtrend is continuing. We must watch our entry and exist points, for our biggest risk will always be clearly defined but also be for a very short time period.

We need only to watch the market for an hour or two if we have done our homework, and during that hour or two, we are most vulnerable and we must keep our closest stop loss. After that, it should be very obvious that we are right or wrong with the trade.

Another good rule that I use, is that after we have done our homework, taken our position and are expecting a major turn to develop and nothing happens, we never want to carry options for more than 3 days at the most. Sometimes, if you carry an option for more than 5 or 6 trading hours, there is no need to carry it. You should close it out, scratch the trade at a small profit or a small loss and *reduce your risk*.

It is not that we are wrong, and it is not that we will not be proved right a day or two later, but **it is not professional to guess** when we do not have to guess at all. We are investing with the trend and if there is no trend, why risk our money, why take on risk? The professional trader is totally risk adverse. It is a lot like a professional gambler, but the element of chance is so reduced that we have stacked the odds at 80% to 90% in our favor and we know how much money we can afford to lose ahead of time.

This is what professional trading is all about. Not guessing, not hoping, not reading the newspaper, not believing in our company, but looking at the technical patterns of our charts. After having done the time count, having measured the waves, having some angles come up from the bottom for support or angles come down from the top for resistance, or having done a percentage retracement or a proportionate advance of an impulse wave, then you can make a cold, hard, mechanical entry point.

We have many, many tools in our arsenal now, to clearly define support and resistance in time cycles turns. We should now step up and make a commitment with a stop loss. Once we have made that commitment with a stop loss, the trade becomes very, very, easy.

Chapter #6

Proportion and Harmony

"Most of the highs and lows of history have been near exact proportions of prior highs and lows in the past."

All nature, art, music, and human behavior as reflected in stock prices, consists of mathematically defined proportion in harmonious arrangement. It would take several books just to begin to reveal such proportions.

However, in this book, we will just be concerned with simple mathematical ratios and their use in forecasting future support and resistance, and the estimate of the time period covered by such proportional ratios.

A proportion is simply the division of the whole into its respective parts. The starting point of life at the biological level, is the whole divided by two or 50%. If each of these halves are divided we get 1/4 (25%). The sequence goes something like 1, 1/2, 1/2 over 2 = 1/4, 1/4 over 2 = 1/8, 1/8 over 2 = 1/16 or 1/2, 1/4, 1/8, 1/16, 1/32, 1/64, etc. This is one starting point. Another starting point is to divide by 3. Then we have 1, 1 over 3 = 1/3, 1/3 over 3 = 1/9 or 1/3, 1/9, 1/27, etc. The natural sequence derives from this simple dividing by 2 and 3.

In the stock market, the major divisions of the 1/8 and 1/6 level are usually sufficient for all calculations, or 1, 7/8, 3/4, 2/3, 5/8, 1/2, 1/3, 3/8, 1/4, 1/8. Stock prices will gravitate towards these percentages of their prior highest or lowest price and will find support or meet resistance there.

A fundamental rule in investing is **always observe the 50% point**. From a low to a high, the subsequent pull back or counter trend decline, will almost always find major support at 50% of the range of the move. This is true of both time and price (i.e. the time duration of a reaction often approximates 50% or one half the length of time involved in the preceding advance).

For example, a stock that goes from \$50 to \$100 will usually retrace 50% to \$75 in a good correction, and in terms of time, if the advance lasted for twelve weeks the decline might take six weeks. The 50% point is the strongest support, but in strong moves the correction will rarely correct even that much. **Usually 1/4 to 1/3 retracements are the norm for strong trending markets.**

Retracements for more than 50% often show complete failure, especially if 2 prior lows are broken

and a move back to the starting point of the advance is likely.

The theoretical underpinnings of the 50% rule **go back to the basic diagram of the square**. In the division of a square along the diagonal, the diagonal or 45 degree angle evenly divides the square into two equal halves. It is this natural 45 degree slope which equates time and price with 50% of the high and low, since the 45 degree angle evenly divides any size square. Obviously, the use of the 50% rule is for entry and exit of our trades.

If we buy a double bottom and assume the trend is up, anytime the stock starts to decline from its highest advancing point, we must measure and keep track of the range from the double bottom to the high and calculate the 50% point of the move (remember a 45 degree timing line does this 50% calculation for us). Our sell stop point should be placed just under that point assuring a profit on the trade.

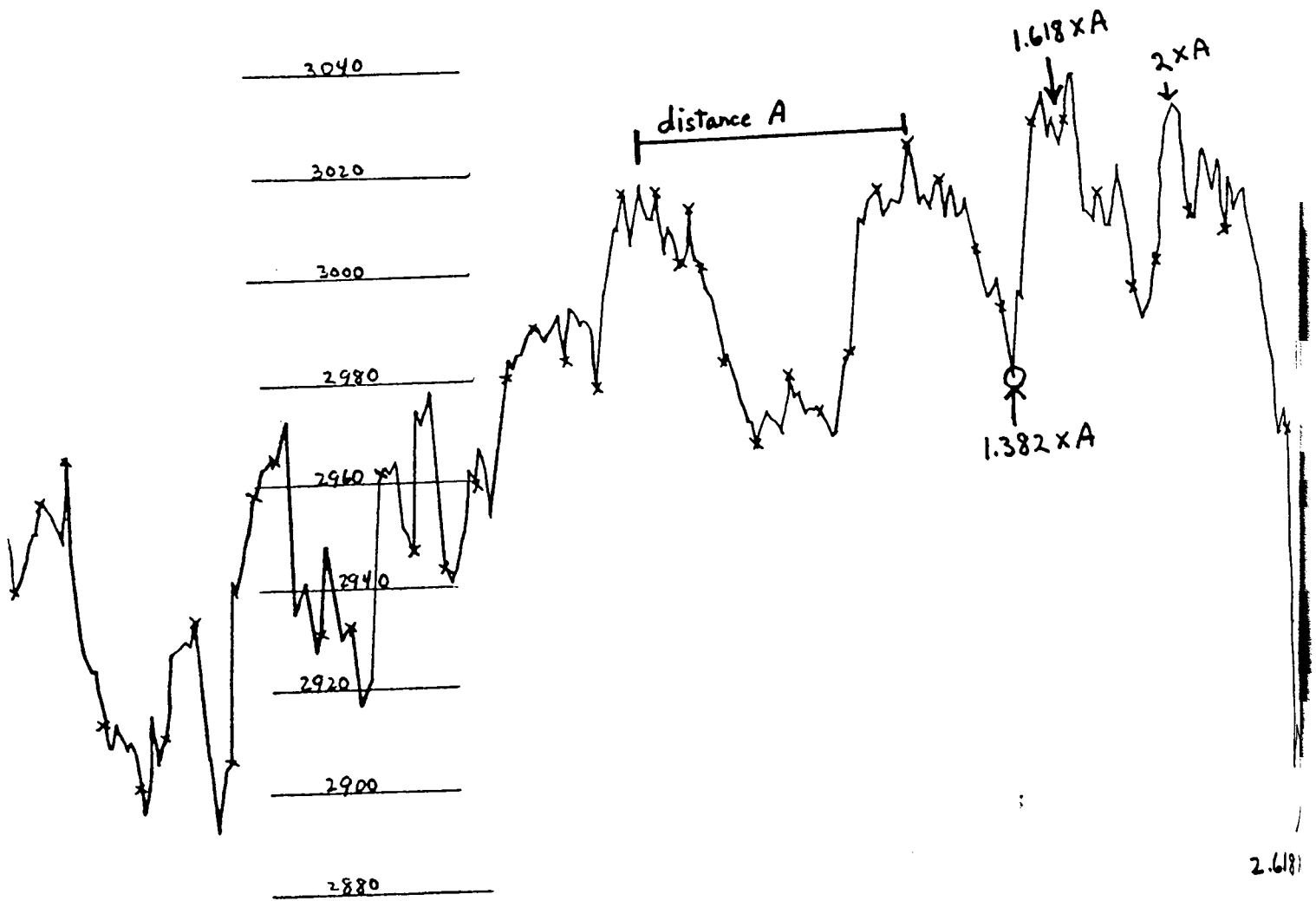
The market averages as a whole also reflect proportionate movements, and most of the highs and lows of history have been near exact proportions of prior highs and lows in the past. We have all noticed the fact that most stocks meet strong resistance when they double or meet the one hundred percent proportion. Since these proportions relate to time as well as price we can theorize about basic cycle origins.

If a stock tops at \$50, the major harmonic or proportion of this will also be 50 time units. Whether they be 50 days, 50 weeks, 50 months, etc. In terms of days, we would witness cyclical behavior at intervals of 50, 100, 150, 200, 250, etc. days from that high. We would also see cycles of 50% of 50 or 25, such as $50 + 25 = 75$ days, 100, 125, 150, 175, 200, 225, etc. The day to day fluctuations in the market are nothing more than these interrelating cycle proportions of past high and lows coming out. Large movements occur when numerous harmonics of past highs and lows are near the same date.

It is important to note that this theory implies connection between price and time. As a consequence, proportional harmonics such as $1/2$, $1/3$, $1/4$, etc. relate to both time and price, and you will usually find that a **time cycle** from a price, such as \$100, might end on the 50% or $1/2$ point 50 days later, and **on that date the price** will be 75% or $3/4$ of \$100. In this way, time and price work out in independent proportions. Since this is a natural phenomena we can use the mathematics of physics to measure forces and vectors on stock price graphs.

More interesting, however, from a philosophical point of view, is the interrelationship to the mathematics of stock prices and the harmonic mathematical structure of music. Rhythms in music, pleasing to the ear, show up in stock price patterns that are pleasing to the eye. In music, a halving of the length of a string doubles the frequency and in mathematical terms this interplay between addition and multiplication takes form in the logarithmic function.

A useful mathematical relationship of stock prices and nature, relating to this interplay between addition and multiplication, is the Fibonacci sequence. As mentioned previously, this sequence is an additive sequence, where each number in the series is added to its neighbor to get the next number in the series. More important than the absolute number values themselves, however, is their relationship to every other number in the series. This proportion of each number divided by any other approaches



PROPORTIONAL RATIO TOPS EXPANSION

| 20 | 21 | 24 | 25 | 26 | 27 | 28 | 1 | 2 | 3 | 5 | 8 | 9 | 10 | 11 | 12 | 15 | 16 | 17 | 18 | 19 | 22 | 23 | 24 | 25 | 26 | 29 | 30 | 31 | 1 | 2 | 5 | 6 | 7 | 8 | 9 | 12 | 13 | 14 | 15 | 16 |

June July August

Figure 8

the "golden ratio" of 1.618, which is a constant. Most markets and individual stocks will be observed to begin and end their movements at these ratios.

This topic is of the utmost importance, but a simple work such as this cannot give it justice. Again I will have to leave this exploration to those of you who wish to master these secrets as opposed to the vast majority of casual readers (see chapter 8 on Impulse Waves). I would add, that the complete Fibonacci series is quickly obtained with a pocket calculator and the function $Y=(1.618)^X$ to the "X" power. That power "X" can be positive or negative, such as the range -5 to +5. What this has to do with harmony and proportion in the market, is that we simply take our hourly chart and apply these proportional ratios (.382, .618, 1, 1.618, 4.236, etc.) to each high and low both to the price levels and the time periods of each advance or decline. For instance, if the market tops at a price of 1000 we would look for price support and resistance at 1000 plus or minus 382, 618, etc. We would also watch for hourly time counts at these time periods from the high or low hour. Additionally, if two tops occurred 100 hours apart, we would look for the next top in sequence 162 (100×1.618) hours later and the top after that, at 262 (162×1.618) hours. (See Figure 8)

What we are really dealing with, in discussing harmony and proportion in the stock market, would be better classified as "Progressions," since we want to predict the next time or price event in a series. These are properly classified as the Arithmetic, Geometric, and the Harmonic Progressions.

The Arithmetic Progression - yields a difference between terms of equality, or a set number value between each term such as 1, 2, 3, 4, 5, 6, etc. This would be as found in normal set cycle lengths like 100, 200, 300 hours, days, weeks etc. where the set number value is added to each term to get the next term.

The Geometric Progression - instead of adding a set term to each number, we multiply a set term as in the doubling process of multiplying by a factor of 2 as 1, 2, 4, 8, 16, 32, 64, etc. Here we have a set constant ratio between adjacent terms.

The Harmonic Progression - consists of the reciprocals of the arithmetical series or a series of fractions with the same numerator while the neighboring denominators share the same difference. Here we have $1/2, 1/3, 1/4, 1/5, 1/6$.

These three progressions give us all the mathematics we will ever need to measure cycles in the market. Note that the Fibonacci ratio or series is both Arithmetic, as each number adds to get the next, Geometric as each number is a multiple of the prior by .618, and finally Harmonic, as each reciprocal of the series yields another number in the series.

A potential solution to our problem of forecasting is to use a computer to apply these above mentioned progressions to our series of hourly highs and lows to try and find where we presently are in the cycle. Once we have the progression key we will be able to accurately forecast for long periods into the future. For example, in my newsletter, *Stock Cycles Forecast*, I boldly predicted the final high as

August 24, 1987 (actual top 11 AM August 25th) because of a unique diminishing Fibonacci cycle series counting down backwards yearly, monthly, and weekly to August 1987! Count backwards from August 1987 by years 1, 3, 5, 8, 13, etc. to see this harmonic for yourself.

The more common technique on hourly charts is to simply use a premarked tape measure with all the important ratio hours in progression and just move this tape backwards and forwards over your charts, until you get a match of multiple highs and lows coinciding with the tape tick marks. Then simply complete the series on your chart for any desirable time period into the future.

One final hint before leaving proportion. Since these patterns on our charts are harmonic and proportional, we can use what architects use to keep track of symmetry -- **regulating lines**. These are merely lines that go from top to bottom of our chart, at preset angles, that reflect the proportion we are dealing with. These **angles** can be Geometric, Fibonacci, or Esoteric. *I leave the experiments to you...* words to the wise are sufficient!

Chapter #7

Trading Basics

"We want to invest only on a rising tide, not high tide or a declining tide or even low tide."

Our approach to trading must be one that is objective, simple and reliable. Obviously, the first three are prerequisites for a system of determining the main trend, which is our objective.

The concept of the main trend was touched upon in the prior section of the tide analogy, which relates each rising wave at the beach to each higher price that a stock trades during each "*swing*" period. I use the term "*swing*" to mark each beginning and end of a price movement.

For example, a stock that starts at 10 and goes to 20 and then 15 and then 18 would have the first swing low of 10, first swing top at 20, with another swing low at 15, etc. In trading, we wish to identify the point of each swing for our entry and exit point for each trade, as well as determining probable duration for each swing and estimate the time period and price movement so as to avoid minor and inconsequential movements that simply increase our trading costs.

Cyclical analysis presumes that history repeats and stocks behave in the future much like they did in the past. We must therefore become a market historian, an expert in the past history of a particular stock we wish to trade. To paraphrase one of my favorite quotes from the Bible:

"The thing that hath been, it is that which shall be; and that which is done is that which shall be done: and there is no new thing under the sun." Ecclesiastes, Chapter 1, 9. (i.e. history repeats)

Various stocks, like people, have specific personalities and certain types of investors seem to only trade in certain groups of issues. Just as the personality of a movie actress is different from the personality of a chemical engineer, so is the trading personality of IBM quite different from the trading personality of General Motors. The differences are much greater than the mere fact that these two groups differ in their response to different economic fundamentals.

When you look at the group patterns of all stocks, i.e., the automobile group or the computer group, you find that in tracking the group average, each individual issue that has movement, has a particular characteristic which identifies it from the group.

One quickly sees the subtle ways that different stock personalities make bottoms or tops. Some make a rounded bottom trading at near the same low price for several days to weeks before inching up, while others spike down on one low day reversing and dramatically advance.

The trading personality also has a timing rhythm that is peculiar. Some issues move in straight line movements lasting months without reversing, while others exhibit sudden, dramatic, up and down reversals almost weekly. Although much could be said, suffice it to say, you must complete a thorough analysis of a stock's history before investing.

If our trading method is to be of practical worth we must be overly concerned with losses. In the stock market anyone can make money, it's easy. In fact the only thing easier is to lose money.

One of my favorite sayings is, "*The quickest way to make a small fortune in the stock market is to start with a large one.*" Every losing trade that an investor makes is almost always, a function of deliberately looking the other way while the stock declines, because one is rationalizing why the decline is only temporary, and to sell out merely to buy back very shortly is a waste of time.

In this past century, psychiatrists have become wealthy describing persons who are *masochistic*, wanting to hurt themselves, *egocentric*, who are always right, no matter what the circumstance or suffering from *grandiose delusions* about the nature of reality. In the stock market the only truth is price. If you buy something and it goes down you are wrong, it does not matter how smart, wise or powerful you are...you are wrong!

Successful traders are people who recognize when they are wrong and are not inhibited by psychological factors in doing something about being wrong. The good trader and technician uses objective measures, to quantify the degree of error. He is willing to assume risk and then live by predefined rules. This is known as a "stop loss discipline." It can be a simple rule, such as using a 10% loss to sell, a \$3 loss or simply a time period, i.e., if you have not made money on the trade in three days or three weeks, sell and go to something else.

These rules work because stocks that are truly in an uptrend rarely go down much or rarely go sideways for too long a time period before resuming the uptrend by making a new high.

Remember the analogy of the tide...we want to only invest on a rising tide, not high tide or a declining tide or even low tide, since we can not afford to have our money tied up, not getting a rate of return when an alternative investment is working.

In my years on Wall Street, I have seen many successful business men make lots of money in Bull Markets and give it all back in Bear Markets. Most of the time this occurs because of one of two personality defects:

The First Personality Defect - the positive thinking executive type who believes in the force of his will and that his analysis will ultimately be right. He will hold on for months and years because he is right.

These people point out that many of today's fabulous, wealthy investors got their money just through such a buy and hold strategy. Having invested a small amount thirty years ago and never having sold.

Although it is quite true, statistics are deceiving. For every individual who bought IBM or Xerox or any other big winner and made millions by sitting tight there are probably five to ten million others who sat tight for thirty years and either lost everything, broke even or made what they would have made at a bank at 5% interest compounded. Unfortunately, books written about these not so famous people don't sell very well.

You do not have to believe that your stock will go up if you are a technician, you see it. Every stock that became a big winner in the market should have been purchased by technicians, since by definition, it was making patterns of higher highs and higher lows. If one has the attitude that a certain stock will go up indefinitely, there is no harm in trading it when using technical analysis tools. Since one would always buy it back when it made a higher high or would have bought it back when it made a minor higher low. Often times, a long term winner will consolidate for months or even years without going up or down and thereby tie up valuable capital that could be earning a return elsewhere.

The Second Personality Defect - is the person who does all the ground work conscientiously and then buys a stock only to see it go down.

In this case it is hard to admit being wrong because it seems psychologically unfair since all that work was done. It is easy to rationalize a decision of "let's wait and see, perhaps I'm not wrong, just early!" On Wall Street, the amount of work that you do has nothing to do with the rewards you reap, although usually hard work pays off.

The reality of Wall Street is price. Because of the reality of price, one could merely flip a coin and buy on heads and sell on tails to enter a trade. A good trader and successful speculator **knows what to do after he is in the trade**. If the trend goes against him, he merely doubles up and goes in the opposite direction. Since the main trend tends to persist over time, such a simple coin flipping methodology will work if one's stop loss discipline is vigorously followed.

For example, if the probability of a stock going up or down is 50/50 then the practice of selling at a \$1 loss and selling at a \$3 gain will always make money, assuming the trend persists for at least \$3 and it usually does.

Even better, is a system of selling at \$1 losses and using a rising sell stop point for the gain. If the stock runs up many points over several weeks, a rising sell stop point just under each swing low will keep you in most of the bigger moves. Hence, the old saying, "***Cut your losses and let your profits run.***" The good trader is not afraid to take a loss but also is not afraid to take a big unlimited gain over time as long as the trend is up.

What you try and not develop are preconceived ideas about how much money you will make. Otherwise, once or twice in a lifetime big winners will always get away because the investor grabs a quick

profit and indiscriminately sells without any technical sign of deterioration.

One standard psychological excuse for avoiding technical analysis and utilizing buy and hold long term strategy, is the old fear of paying taxes on short term gains. Although tax rates have varied over the years and long term capital gain rates are usually much smaller than short term income rates, I continually find that the people who are most concerned with paying taxes on short term gains of 30% to 40% usually end up getting a 5% to 8% taxable rate of return on bank CD's or even a non-taxable 6% on municipal bonds.

In almost all cases the 30% trading return will always yield more after tax dollars. However, its biggest advantage, I believe, is a psychological one. The annual paying of taxes on capital gains forces one to be liquid and not get trapped into holding a stock which is obviously going down, just because you have a low tax basis in the stock.

I have seen many wealthy investors suffer for years because their long term family heirloom stock is declining 50% and they can't sell because their cost is \$2 a share and the stock is currently \$80. The fear of paying the tax allows them to psychologically stand by helplessly watching their stock go from \$80 to \$50 and back to \$80. If they had paid taxes annually they would probably be better off.

Although many people are aware that stocks fluctuate 20% to 30% per year from high to low, many do not realize that these 20% to 30% swings sometimes occur two to three times over any given year. A trading philosophy allows one to be better prepared psychologically for opportunities in the market.

Most people know that compounding rates of return can add up to substantial amounts of money over time and recent advertisements for IRA and KEOH retirement accounts demonstrate this very well. However, many people are completely unaware of the truly speculative returns available through compounding. In today's speculative market, options and futures often fluctuate by 20% to 30% per day and options doubling or tripling over a few days, are likely, of course along with the commensurate risk.

My point is simply this, a speculative trading strategy combined with a vigorous stop loss discipline can yield phenomenal results. For example, if you start with a reasonable sum of \$10,000 and get 10% a month you will be a millionaire in only four years, ignoring taxes and losses. However, this is not so far fetched since many times you are making 30% or 40% or even a double in an exceptional month. The reason options appeal to all of us is that almost everyone who has ever bought them has at one time or another doubled or tripled his money. Obviously, since everyone is not a multimillionaire the *real secret* is not the doubling or tripling, but the NOT LOSING! Professionals trade entirely with this loss fear as the foundation of their operations.

We must develop a method to stop losses or limit our risk without unduly increasing our trading costs or frequency of turnover in commissions. My approach, being one of the better solutions, is to seek low risk entry points, where a \$1 or \$2 stop loss can be used. Most traders buy a prior swing low using those lows as a stop, or buy when the stock pulls back to a trendline and place a sell stop under that trendline. It is not glamorous or particularly hard, but the objective here is money and risk man-

agement. Remember, we are not trading for fun and profit, just profit! As is often said on Wall Street, *"happiness cannot buy money."*

I like to combine these rules with a timing entry point based on cyclic characteristics of the stock, whereby, you enter a trade after a stock has been declining and is just turning up, making it much more unlikely that your stop point will be hit. Determining those cyclic time periods is a function of the historical analysis of the chart, noting the probability of past time cycle patterns and trading off of them.

By the end of this book you should be able to find a good combination of stop loss and sell points based on trendlines, swing points and cycle turns, but for now we must concentrate on the basic trendlines.

As I mentioned previously, for a stock to show an uptrend, it must make a series of higher highs and higher lows. This is not always readily apparent from a casual glance at a chart. Most people therefore, draw trendlines.

Trendlines are simply lines that connect each rising successive low point to show uptrend and connect each declining top point to indicate a declining trend. Here again, the investment time horizon is of paramount importance.

Trendlines connecting each daily price will be much steeper than trendlines connecting weekly or monthly points and also will be violated much more frequently.

Trendlines are very useful tools in battling the traders worst enemy, his psychological propensity to become involved in a trade in an emotional way, thereby becoming biased as to the stocks trend.

Trendlines keep one honest. If the trendline is broken, so is the trend. The reality of price says that when the trend changes you will lose money unless you go with the new trend.

Trendlines are really a form of moving average. The slope of the trendline shows the rate of change, of price over time. The steeper the slope the greater the change.

Trendlines can also be considered good psychological measures of emotional sentiment by the masses. Stocks that are in favor exhibit steeper and longer uninterrupted trendlines than those less popular issues.

The rate of change in public acceptance can usually be measured along a series of ever increasing trendlines, starting with the steep weekly trend, which in turn becomes a steeper monthly trendline, and finally a steeper yearly change. As the accumulation process takes place, an investor examining the continuous chart over several years, will see a gradual, but ever increasing rate of change in the trendline slope up until the moment of the final top.

The long term chart's rate of change takes the visual form of a curve rather than a straight line, and this curve can be plotted mathematically to help predict the final point of emotional exhaustion, with the start of the beginning of the distribution and the declining phase. I might add, **the study of circular arcs is a science in itself and one I would recommend to everyone.** I do not have time in this simple work to discuss the theoretical ramifications of arcs but, suffice it to say, they lie at the heart of my personal proprietary methods. Arcs are the **ONLY** form of trendline that will conclusively show you where tops will appear. The end of all Bull Markets occur at the resolution of long term parabolic arcs. (See *Figure 9*)

The most important use and application of trendlines is through geometric charting or using **geometric angles** for trendlines. By this, I simply mean to change the slope of the trendline by proportionate divisions of the whole such as 1/2, 1/3, 1/4.

Example: A normal 45% diagonal line divides a square into 2 or a 1/2 division. This basic slope equates one unit of price with one unit of time. As from our school days, slope is equal to "over one and up one."

As we go over one time unit horizontally, we move up one price unit on a stock chart. A 1/4 division of a square gives us another slope half as great as the first. This would be over 2 units and up 1 unit, or a 1 by 2 angle. 1 unit price by 2 units of time. Similarly a 1 by 3 angle would be over three time periods, up 1 unit of price.

When slopes are more than the normal 45 degree angle for steeper or greater momentum moves, we use 2 by 1, or 3 by 1, or 4 by 1 angles where the price unit is raised a multiple amount for each time unit, as in a 3 by 1 angle up \$3 and over one time period. Time periods on your chart will be hourly, daily, weekly or monthly. These are natural slopes and most stocks tend to follow one or all of these division slopes at different times. To find a unique, natural slope for your particular stock we simply apply the same principal of fractional division.

1. First we connect the trendline by drawing a straight line between consecutive lows for an uptrend example.
2. Then we subdivide this natural angle to measure off an arbitrary horizontal amount on our time scale with "tick" marks every 1/2".
3. Note where the natural trendline intersects a particular price level at the first "tick" mark. Now at the same price we put a dot above each of our 1/2" increments.
4. We now merely draw slope angles from the original low price through each of our price dots. These slopes will give us natural 1 by 2, 1 by 3, 1 by 4, 1 by 5, etc. trendlines.

CIRCULAR ARCS TIME MARKET TOPS

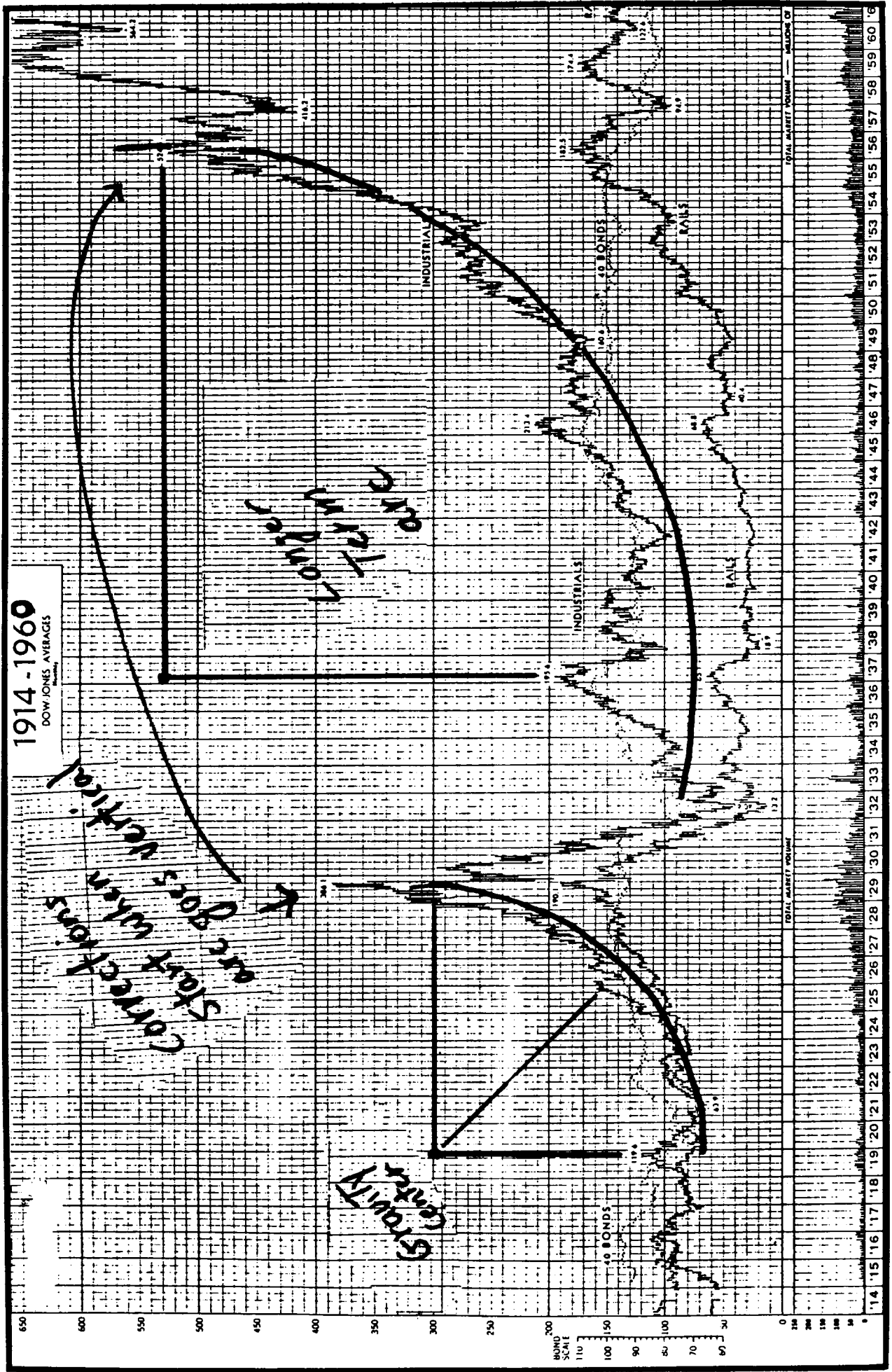
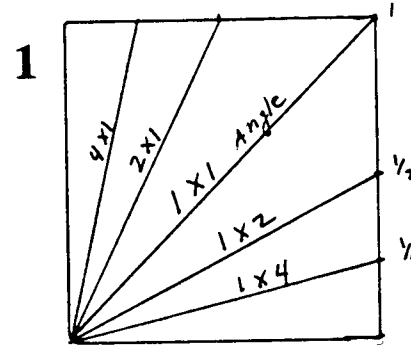
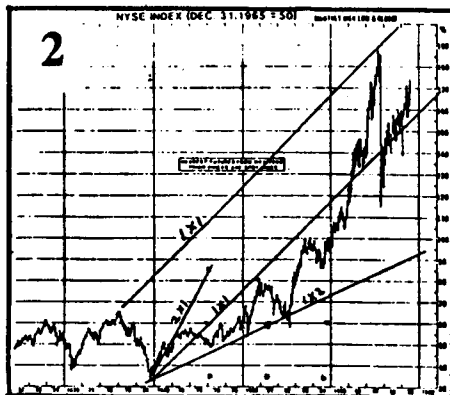


Figure 9

TRADING WITH ANGLES

- 1- Angles are types of moving averages and tell you much more about sentiment and true market power than any oscillator or percentage bands.
- 2- They evenly divide time and price with space movements - thus you can forecast future price levels at time periods commensurate with the slope of the impulse angle.
- 3- When you break an angle you will always drop to the next angle down or go sideways until it catches up with you.

72



or: Draw set of fixed dots

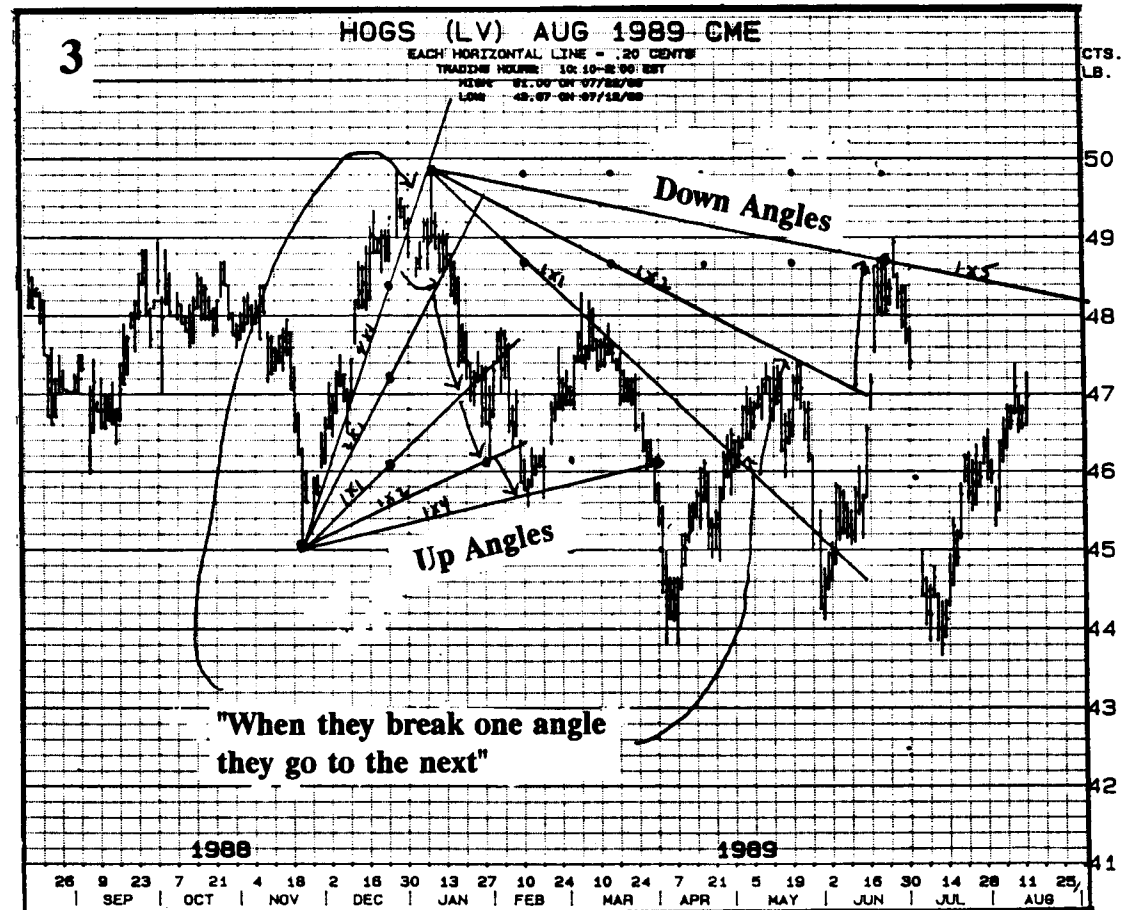
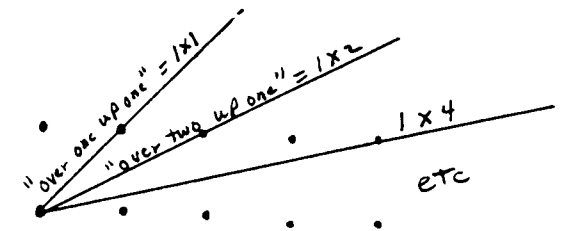


Figure 10

So why bother? My work shows conclusively that price movement in stock patterns are inextricably related in an exact mathematical relationship to time periods.

Furthermore, this implies of course, that in the masses, human greed and fear, as exhibited in the buying and selling of stocks, takes on mathematical predictability to a degree of exactness not even dreamed of by the common man. Utilizing some basic mathematical concepts and plotting trendlines will therefore give us vastly improved results in timing and trend analysis **if those trendlines are drawn correctly**. Once we have trendlines we can use a wonderful rule that is highly reliable and valuable for trading purposes if believed in and always followed. This rule can be simply stated as follows:

"A stock's price will follow a geometrical trendline angle and when it breaks it can never regain that specific angle and must fall or will not advance until it touches the geometrical trendline below it"

It is very important to know that since we are dealing with trendlines or slopes, we are not saying the price must fall if the trendline is violated. We are talking about rates of change. It is usually the case however, that when a trendline breaks a new direction is indicated. For example, if we are following a stock that is advancing along a trendline which is increasing at a rate of \$1 each week, the first time that trendline is broken does not tell us that the stock is going down or even that it has stopped advancing. It does tell us however, that it will not be \$1 higher next week as it can never regain its original trendline.

It also tells us that the stock will drift sideways or down or slightly up until at a later date it hits the next lower trendline which would be an angle advancing at a rate of \$.50 per week. If the beginning point of our original trendline was ten weeks and \$10 ago, the second angle would currently provide support \$5 lower today (1/2 per week) or at the same level in ten weeks as it catches up in the future. This is valuable information and we may want to invest our money elsewhere while we are waiting for the stock to consolidate or decline to find support. More importantly, we would certainly not want to own call options on that stock, but we may consider writing naked calls or covered calls at that point.

Likewise, in using such analysis in trading the overall market, there comes a time just after a top is reached and a trendline is broken, that the market cannot go higher but it may not go lower immediately. At these times a professional trader is just wasting his or her time in trying to trade stocks. For me, these are vacation periods or long weekends off.

When using these rules and trendlines you must always remember that these slopes of advance in prices or declines are reflections of mass psychology. In the masses as a whole, greed and fear manifest in the buying and selling of stocks and like any physical phenomena, waves of bullish or bearish sentiment will follow a natural course till exhaustion develops and arrests the trend.

We can track the development of these waves by noticing the relative slope of angles. Since success in the market and trading is dependent on getting a rate of return over time, the trendline slope defines this rate of return, i.e. slope equals price divided by time or the change in price related to the change in time. The steepest trendlines are the ones that interest us.

Stocks that are the most popular will always have steeper trendline rates of return. Please remember, that when I use the word popular, I am referring to the action of much more buying than selling. In pluralistic democracy, the rule is one man, one vote. In pluralistic capitalism, as in the stock market, it is \$1 one vote. This is why there are few very successful investors and many unsuccessful losers.

Now that we have a better appreciation for the value of trendlines to gauge the direction of the trend and its momentum, we now need to address the question of time. Although trendlines may break, we have noticed that this does not mean that the price will fall as the upward rate of momentum is slowing. In order to show a change in trend, we must now see successively lower lows and lower highs in order for the trend to have changed from upward to downwards.

The first thing we must do is keep a grasp on the big picture, the long term trend. A violation of a daily trendline, or a weekly trendline, does not necessarily mean that the longer trend, the monthly trend is down. Perhaps we have entered a consolidation period or sideways trading range. To see if the longer term picture is deteriorating, we need not resort to dozens of charts, but merely note the last major swing low on the longer term chart. For this purpose it would be convenient to maintain a log book of the highest price for the month and the lowest price for the month.

As long as the decline does not go lower than the low reached in the prior month, the trend cannot be down since any line drawn between the prior month's low and this month's higher low would still be an upward slope. A price decline to the same price level would show a horizontal slope.

We usually refer to these types of lows, as double bottoms or triple bottoms in the case of a decline, rally and another decline into the same price area. The general trading rule which is quite reliable, is to **buy at double and triple bottoms**, but to watch for a breakdown on any test of those lows after that 4th bottom or more. It will still be helpful to picture the rising tide analogy:

When the tide reaches its highest or lowest point, there will be several waves reaching to a certain point without exceeding that point. Eventually the new direction penetrates this point as the tide advances or recedes as the case may be.

In the stock market this change in tidal direction of buying and selling may take a long period of time to complete, say several weeks or months, before decisively reversing. So a strategically placed purchase or sale, at a prior swing price, will almost always result in immediate gain as the stock or market reverses to test again its prior direction.

At this point the trade is questionable, as the trader does not know if the bounce off of the prior price level, is the beginning of an eventual breakdown to new lows or merely only the test of a major support area prior to a much bigger advance. Chapter 6 on Proportion and Harmony deals with possible methods to resolve this issue.

We should mention a few more words on support and resistance areas. These are as follows:

- **Support area** is an area which has horizontally stopped many previous declines and resulted in subsequent price advances.

- **Resistance area** is a price range that has historically resisted any further advance and has resulted in a reversal of trend to the downside.

These historical time and price periods can be anywhere from the past few weeks, or to old highs or lows made at those price levels years ago.

Just like the tide analogy of small waves within bigger ones, **time is a function of the individuals perception. price is the reality.** A long term rising trend, i.e., IBM over the past 30 years will have within that trend many declining years and even within those declining years, weeks to months of advancing prices. So we might see an example of a minor decline on a monthly basis to a certain price level, a bounce off that level, giving rise to a three or four week rally, another failure to test that level, then a 3 year advance to new highs and then years later, a one or two year decline, all the way back to the original levels. Then support levels form double, triple or multiple bottoms on various charts.

In our historical analysis of a stock, before trading it, we should carefully note all these support and resistance areas. From a rational perspective, for those of you who need to grasp logical truths before you invest, support and resistance levels are psychological buy and sell points that last for long periods of time and they usually form at physiological, emotional times in the market.

Long term investors always remember where they bought or sold their positions and what their cost basis was. So when a stock finally returns to those same levels after long time periods, those same investors either add to their positions or eliminate them. In our theory of time squares, you will find these support and resistance areas at time and price proportional points. We can then see how big or important the square is, and thereby, get a feel for whether the pivot point will hold or how a consolidation should take.

Chapter #8

Impulse Waves

"The real value of impulse waves is that they do accurately predict the length and price targets of the entire movement from the very first fluctuations."

We have made the analogy that the stock market consists of emotional, psychological waves of fear and greed. This analogy likens the waves at the beach or the waves of sound striking the ear, or the waves of light striking the eye to the price levels in the market. Many of the known laws of physics and mathematics that we use to identify waves in the physical world, apply to measuring movements of emotional waves in the stock market.

The first place to start is at the beginning of the wave. These initial thrusts are called impulse waves that occur at the end of the prior movement and the start of a new trend. This idea of an impulse wave, as a start of a trend, is also helpful in identifying the main trend when the price pattern is choppy. **The rule is to go with the direction of the obvious impulse waves.**

For instance, a new Bull Market starts at the end of a Bear Market when the market stops going down and it gets dull and quiet. There does not seem to be any activity and then suddenly an impulse wave hits and the market goes up dramatically.

This initial surge is what we define as the impulse wave and is usually measured from the first day the trend reversal starts, to the time that the first minor correction sets in. This can be a couple of days to several weeks later and may amount to a few points on an individual stock, whereas, on the Dow Jones Averages it may amount to several hundred points of an advance before the first significant correction sets in.

What we want to do is make measurements of the **time duration of this impulse wave and the price distance** it travels during that time, to get an idea as to the strength and probable time period to exhaustion of this move. To do this, we must define a series of expanding number cycles and apply them to the initial magnitude of the impulse wave.

Keep in mind the analogy of our main trend which consists of a series of stair step higher highs and higher bottoms. Each of these little stair steps is a type of impulse wave and each are related to the very first impulse of the whole movement.

It has been shown historically that there are expansion multiples of exact proportions of the initial impulse wave that calculate each of the subsequent waves. For instance, if the first wave measured 100 dow points we could say that this was unit 1. We might say that our second wave might be a proportionate part of that, such as 1 1/2 times or 2 or 3 times the first wave. If we apply these fractional proportions to the initial wave it will give us some guesstimate as to its probable time duration and price level.

After each impulse a correction follows. The correction retraces a percentage of that initial impulse advance, but the correction is not usually 100 percent of the advance, otherwise, we would not have one of these stair step patterns. Usually it is a proportionate part not more than 1/2 or 1/3 of the distance back.

As we recall from our 50% rule, the 45 degree diagonal line coming off of a low intersects a square at the 50% point. So after an initial impulse wave a 45 degree diagonal line coming up off the initial low would provide *major support* any time the corrective wave came down and touched it.

There are a number of ways of calculating the correction percentage after the initial impulse wave. We can use our standard mathematical angles of 30 degrees, 45 degrees or 60 degrees. Each of these may be less or more steep than the other, but each of these provide good support for a correction.

We could also take a percentage retracement like 25%, 1/3, 1/2, etc. of the initial impulse. When we see the correction "*losing momentum*" or "*running out of velocity*," at one of these price levels, we can assume that the movement is just about finished and that our next impulse wave is about to begin. This next impulse wave will be proportionately related to the first one.

Now, there are many other ways of looking at impulse waves and measuring them. Most of these are called **Pattern Recognition Systems** and are the most accurate ways of forecasting stock price movements.

The Elliott Wave System is the most popular by far. Here the market is seen as a series of waves in units of 3, 5 and 8. The primary trend consists of 5 waves up with a counter trend of 3 waves down. If you have 5 waves up, the count would be 3 impulse waves and 2 corrective waves. So the first impulse would be 1, the corrective wave down would be 2 and another bigger impulse wave 3 with a corrective wave 4 and then a big finishing impulse wave labeled 5. This 5 wave sequence is really only 3 impulses up and 2 that are corrective waves.

After that sequence is complete, a major down trend ensues which consists of 5 waves down. An initial thrust down, a counter rally back, another big thrust down, a counter rally back and then a final thrust down. You would have 3 thrusts down and 2 little counter waves that would complete the down wave.

As often as the Elliott System works, I have found it to be perhaps no more than 70% accurate.

There are many other wave pattern systems that I find to be more reliable. Some of these patterns instead of consisting of 3, 5 and 8 waves, consist of 7 or 12 waves, or even equal proportions of 2 and 2.

I do not think it is particularly relevant to rely exclusively on any one of these particular recognition systems. However, it is important when we examine our historical record of data, **to see if there is a particular wave that is unique to that particular market** or stock we are trading and thereby, make some measurements to see how many waves it usually follows. Each of these waves of course are percentage proportionate parts of the preceding waves.

The Elliott Wave school of thought has popularized the so called "*Fibonacci sequence*." The Fibonacci sequence is the approximate ratios of .382, .618, 1, 1.618, 2.618, 4.236, etc. This is also known as the golden proportion, the golden ratio or golden spiral and it is the **logarithmic growth curve of almost everything in life** and in the great galaxy itself. It is a natural, proportionate, mathematical sequence which adapts itself quite readily to stock market movements. This is an additive series that starts by adding each number to its neighbor, so 1 plus 1 = 2, 2 plus 1 = 3, 3 plus 2 = 5, 5 plus 3 = 8, etc. until we have the series 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, etc. The numbers are not absolute so much as the ratios between them are constants. All other additive number series also eventually meld into these ratios and they, therefore, become quite useful.

For instance, if the initial impulse wave is considered unit 1, even though it was \$5, \$7.50 or \$12, we would multiply that one unit by 1.618 and we would get an expected expansion on the next impulse wave of something like a fractional part of that, like .382, 1.618, 2.618, 4.236, would be an expansion of that initial impulse. However, the Fibonacci ratio is not the only expansion numerical series that applies to the stock market, so feel free to experiment.

I might add, that when there is difficulty in determining the main trend, and we invest only with the main trend, and not the counter movements, sometimes it is easy to identify the main trend by watching for impulse waves. Over a series of months if the market is trading in a big flat and we are not certain whether it is going up or down, every few weeks or every few months, there will usually be a big spike impulse wave that occurs in the direction of the main trend.

For instance, if we are in a flat and suddenly one day the stock shoots up \$2 on heavy volume and a couple days later trades right back down into the base and then two weeks later there is another big spike of \$3 or \$4 upwards and then trades down, we can assume these impulse waves are accumulation patterns and are precursors to a major breakout.

Likewise, if there is a drifting pattern downward, but the stock keeps coming back to where it was and we see a sudden thrust to the downside, these too, are impulse waves, as they clearly show that the impulse is to the downside and we can expect that the main trend will resume in that direction fairly soon.

We also want to pay close attention to the number of impulses within the wave. The more there are, the

more likely it is that the wave is coming to an end. As previously mentioned, the Elliott Wave movement consists of 3, 5 and 8 wave movements which are quite common.

In a little "stair step" pattern where you have an impulse up, a little corrective to a "higher stair step", then another impulse to a "higher stair step," each of these higher lows in an uptrend can be numbered 1, 2, 3, 4, 5. You will find that in almost all markets when you get to 7, 8, 9 higher lows we are running out of time and the odds overwhelmingly favor that a counter trend movement of significance is about to start.

Usually five higher bottoms is about the minimum, although occasionally in dull markets only three will appear. Five higher is a normal movement, but the 7th, 8th, 9th is the danger point. If the impulses go past 9 they will usually complete 12 or 13 little movements. However, by the time we get to 12 or 13 movements one should basically be out of longs or using very close stop losses because the trend almost always reverses.

Of course the reason for this, as we know, is that the market is following a natural cycle. We do not know what these cycles are, whether they be weather patterns, biorhythms, cosmic radiation or whatever, but we do know there are natural cycles that repeat. History has shown time and time again that these impulse waves just do not go up forever, but they are a series of impulses and then they reverse.

Remember, when trading we want to enter and exit our trade at low risk points that are clearly defined. Where we can define both probable direction of the movement and be able to reverse and get out when we make a mistake with the smallest loss. Obviously, if a stock had a corrective low of \$30 and shot up to \$36 and we blindly buy at \$36 there would be no justification for putting a stop loss of \$35. Since the last low was \$30, the stock could decline all the way to 30 again and still find major support.

So, what we would want to do is to buy the stock on a pull back towards \$30 **anytime it made a higher bottom from \$30**, and then we would use \$30 as our stop out point. If we were to buy the stock at \$32 we would only have a \$2 risk before if it actually broke that \$30 support level. So a professional trader, even though the main trend may be up, would not necessarily take a trade at \$35 or \$36 simply because there is no clearly identified exit at that point. He would just have to wait until the next correction low even if it took three weeks.

If he finds out that this low is only \$34 and then advances, he could then buy it with \$34 as a stop loss and have an identifiable stop out point. Keep in mind that **when the \$34 point is established**, if it is the 7th, 8th, 9th higher bottom, so far the odds are pretty good that we are going to get stopped out and we may not want to make that trade.

The real value of impulse waves is that they do accurately predict the length and price targets of the entire movement from the very first fluctuations. What I do is initially construct a box or "Gann Square" around the initial low to high sequence and expand these boxes by various ratios. For instance, if the initial thrust was \$10 for a stock and it lasted 50 days, we could expect a maximum expansion of 4.236 $[(1.618)^3]$ times 10 or \$42.36 as a target price with a time horizon of possibly 212 days (4.236 x 50).

Basically, one would start two expansion series. The first, would be simple linear boxes of equal size as the first thrust, and the other would be growth expansion such as with the Fibonacci sequence. Other sequences could be the square root series, such as the roots of 2, 3, 4, 5, 6 multiplied by the initial box size, or the use of universal constants such as pi (3.14159). We would keep expanding these box size squares until it eventually became obvious that the major trend had changed. Here again our historical examination of extreme measurements will give us good approximations as to what to look for.

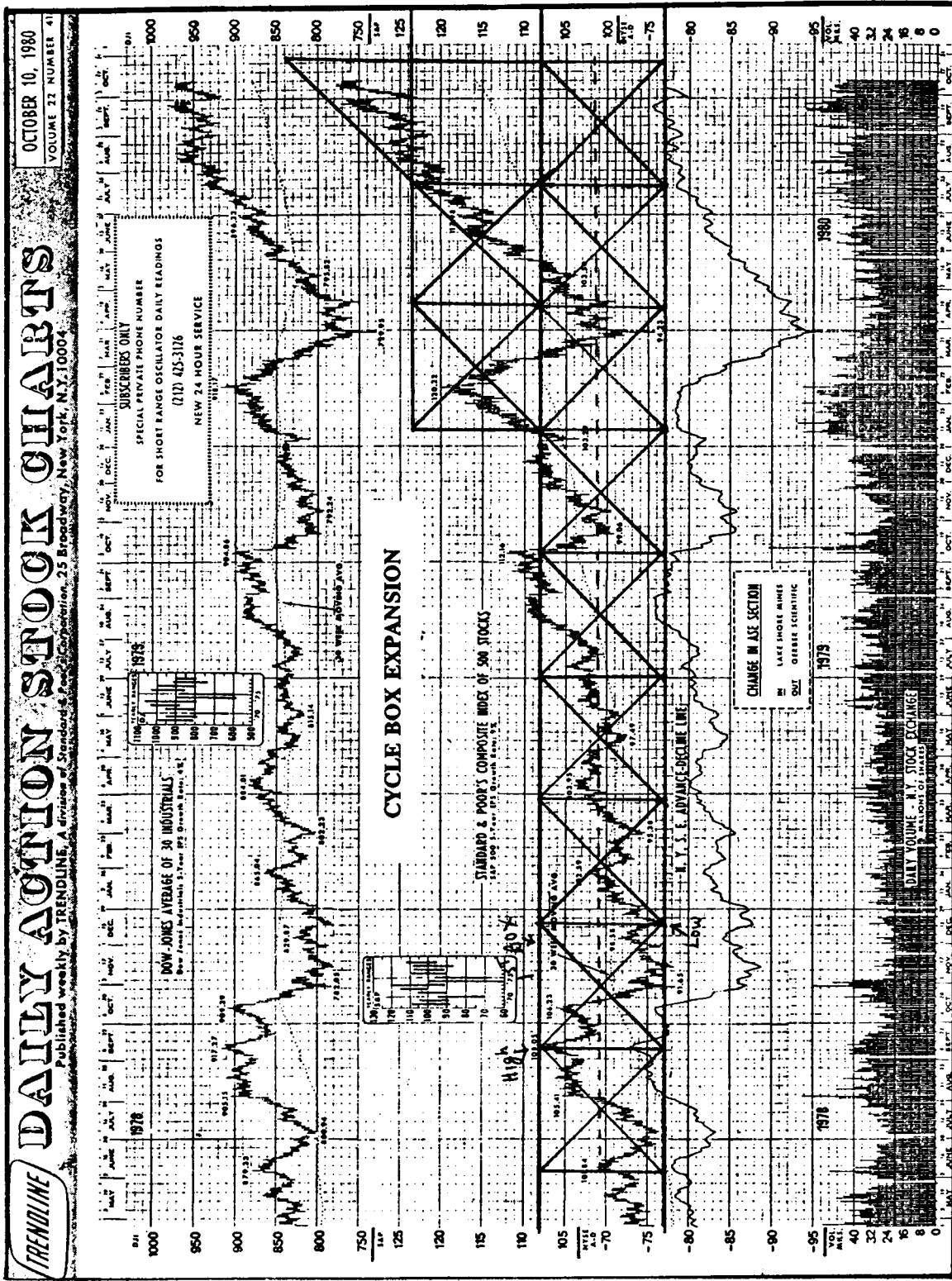


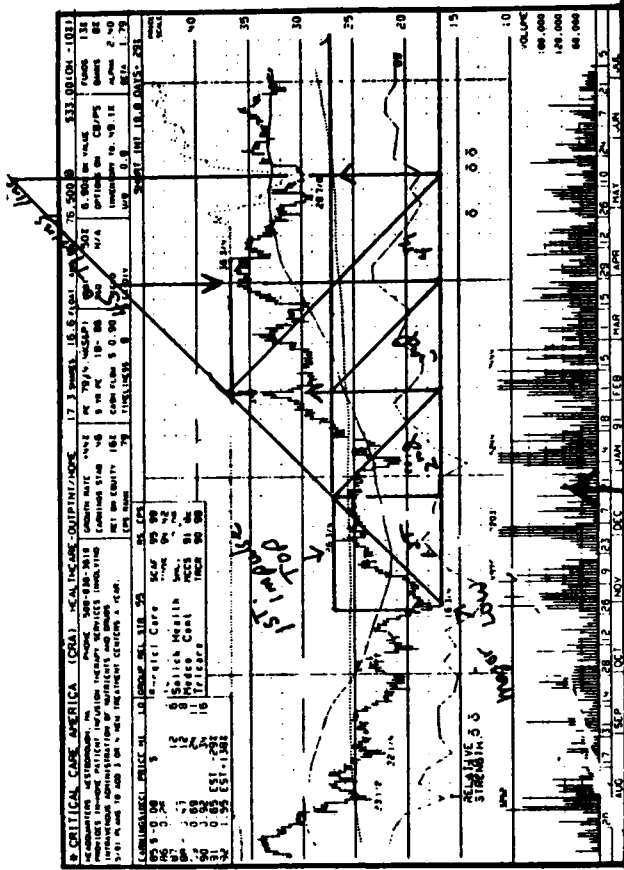
Figure 11

CALCULATING IMPULSE WAVES

The initial "impulse" wave of any move is most important. All future moves are spawned from this initial movement. An easy way to keep track of these cycles is as follows:

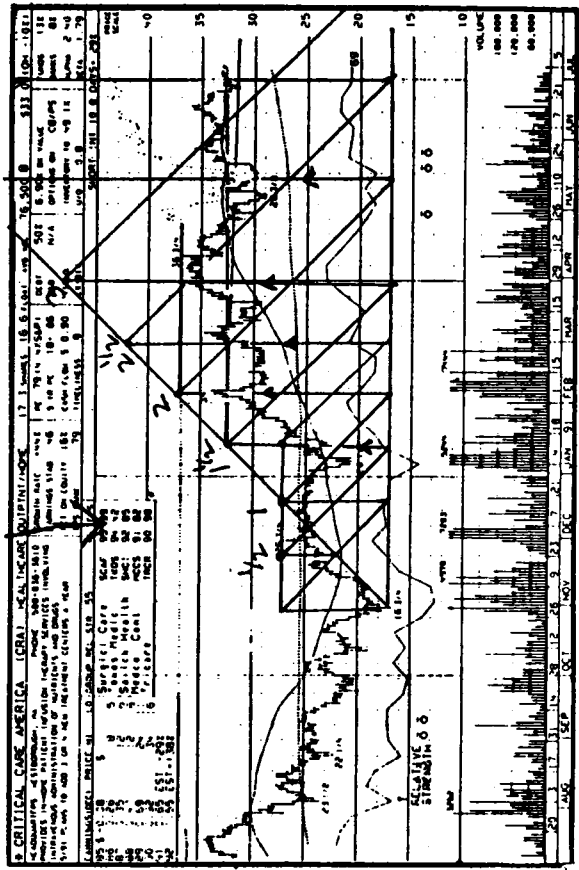
- 1 - "Box" in initial impulse with a 45 degree diagonal.
- 2 - Make multiple boxes by drawing 45 degree "tic tacs" from end of first box.
- 3 - Note that these boxes not only delineate time but also horizontal price resistance.
- 4 - To get smaller harmonic (fractional) divisions, tic tac from mid-point.

Figure 12



Whole Impulse Waves

Whole + 1/2 Waves



Chapter #9

Trading Options

"Just because a market maker has to sell you an option, doesn't mean he has to sell it to you at a price so that you will make money."

Trading Options is a little bit different than trading stocks. Stocks are longer term investments where we can use trend stop losses. An average stock may fluctuate only \$.25 to \$.50 a day and we take a position and hold it maybe 3 to 6 weeks at a time and try and make 10% or more on our money during that 3 to 6 weeks. We may even hold it for months and months as long as the trend continues up week after week. When we are trading options, it is a different environment in that we are buying options from the market maker, an option specialist, so to speak, on the floor of the Exchange.

This man is selling directly to and in competition with us. For when you go down to the option floor to buy an option, you are usually buying it from a professional who is shorting it to you (or a group of professionals as at the CBOE). They can read the tape every bit as well as you can and probably better, for they have been on the floor of the Exchange for years and make their living selling options everyday. Therefore, they have priced the option accordingly so you will lose money and they won't.

If the market is up 20 points and booming and you want to buy a call option, be aware that the call option you are buying assumes that trend will persist and the market will probably travel another 20 points tomorrow, because that is the normal expectation.

So if you expect to buy a breakout you had better have in your calculations a movement of the market that goes 3 or 4 days or 100 Dow points in a certain direction. For when that market maker shorts that option to you, the very next day if we go up 20 points or only 5 or 6 more and pulls back, the option will drop immediately, and perhaps get cut in half because the premium of that amount was already factored in the price. I can't tell you how many times I could predict exactly the next day's movement but still had no investment vehicle to trade because the expectations were already built in. Professionals learn to skip those overpriced option situations. The public has to buy them and is always shocked to be right and still lose money. Just because a market maker has to sell you an option, doesn't mean he has to sell it to you at a price so that you will make money!

This is why it is imperative to know the main trend when investing in options. For you see, if the main trend is up you can afford to buy **down** days, when other people are afraid the downtrend is going to continue and they are selling out their call options and the market makers themselves are uncertain of the trend.

So if you buy with the full realization that the main trend is up and that it is a temporary dip, that will stop at a higher level than the previous dip, and you have entered the market at a point slightly higher than the previous dip, aware that the market will probably stop dead in its tracks, you will have a tremendous advantage over the market maker and you will buy cheap calls.

When the market does indeed stop and reverse, and the next day it goes up 20 points and everybody else rushes in to buy the calls, you have the flexibility at that point to sell the calls back at a huge profit. Often times the option itself will have doubled by that point. The significance of trading with the main trend is that you will get cheap premium. You will be able to take advantage of the specialist and if you are investing with the main trend you will trade out of your position within a few hours to a day or two, and you will have a reasonable stop loss exit point.

I might add another unique trading tip about options that I have found. It has been well stated that a professional trader is not afraid to take a huge unlimited profit. Meaning, that if a Bull Market starts and goes up and up, you just do not arbitrarily sell your stocks because you have a \$1 gain, when if you just sit on them, they will go higher and higher every day. However, in many cases **taking small gains is a superior strategy.**

Sometimes in the option market, with these speculative instruments that are fluctuating 30%, 40% or more per day, you do not want to become the long ball hitter, looking for home runs in options, where you buy an option for \$1 and expect to get \$6, \$8, \$10 for it. That is for the public who do not know what they are doing, who are just gambling. Remember, 70% of all options expire worthless.

Many people have the attitude that this is a high risk venture. They will take their \$1 premium and either get a huge score or be completely wiped out. Since 7 out of 10 get wiped out the other 3 might break even or the other 3 might make 6 times their money and still might come out ahead. There is no need for this kind of investing when you can use "scientific" technical analysis.

In **scientific technical analysis**, as I have been describing, we can easily define our risk, the probable direction of the market, the number of hours of persistence of that trend, whether they be Fibonacci 8, 13, 21, 34 number counts or natural squares, and support and resistance calculations. If we use this, we can frequently buy options at \$1 and sell them \$.50 higher for a 50% return on our money and do that almost every single day rather than waiting for one option to go to 6 or 10 times our money over an entire month.

The professional trader wants to make money all the time, small, steady amounts of money. In trading options, I have usually found it better not to go for the big unlimited reward that sometimes is technically available and is a better strategy for investing in stocks, where we would just buy a stock and

use a trailing stop loss, that as long as the stock went higher and higher and higher we would just raise our stop and carry the stock for years. With options the better strategy is to bank the gains quickly and frequently.

Options actually expire, they have a set time period and they have premium. The market makers are setting the premium levels to expectations. Every time there is a little dip in the market, the premium expectations will expand and contract as the market makers adjust prices according to expectations. Therefore, it is usually best to trade options. As soon as we have our entry, this is where we have our biggest risk, the 1 or 2 hours when we make our trade, the approximately 10 point trading range within the "stair steps" on the Dow Jones hourly chart.

Let us say we make our trade and bought our option at \$1. It is usually wise to immediately offer it back and put it on the books at 1 5/8 or 1 3/4 or even maybe \$2, if we are looking for a big explosive move, and often we will find that in the very next hour or two, a sudden reversal occurs and the market is up as we expected. The calls easily double as the market makers adjust the premium. They sling shot through our price level and we are sold out immediately for a wonderful profit in a very short period of time. Within a couple of hours, when we have a normal little counter move, the options come plunging right back to what we paid for them, only a little bit more.

Perhaps we can buy the same option back at 1 1/4 this time and since we are still bullish on the long term trend, we offer our option, let us say at 1 3/4 and are sold out. We turn right around and bid for them back at 1 1/4, 1 3/8. A few hours later, if there is a dip, there is a very good chance that our order will be filled at 1 3/8. Then we can turn around and offer them this time at 2 1/4. This way we can get several good, consecutive trades of 30%, 50% or 100% on our money.

Believe me, several trades at 50% or 100% on your money will always be more superior than one trade at 6 to 10 times your money, that only comes once a month and has **a probability of being totally wiped-out** once a month. Remember the beauty of compound interest, especially with options. Options fluctuate at least 20% to 30% a day and often times double or triple in a day.

The world's greatest *investors* frequently have long term track records in stocks of making 25% per year. Very good stock *traders* make 70% per year or more and very good commodity traders might make 300% per year. However, with options that fluctuate by 30%, 50% or double everyday, why are these people not all infinitely wealthy?

The truth is, trading opportunities for big gains with limited risk is not the same everyday. We have seen from counting our numbers of hours from a high or low and counting our impulse waves and counting our main trend that there are patterns within the market. If we are only trading options, we want to be in a pattern that not only is 80% probable of being **right in terms of the direction** we are going, **but also a pattern that gives us the biggest reward over the shortest time period.**

This is a very important theoretical point for many people make the mistake of buying puts and calls in a basing pattern. After a long term decline the market is quite scary, especially when it is making a bottom. The market will go up and down, and up and down, often over a week or two weeks at the lows.

Now, from our time cycle analysis or some other technique, we know the market has stopped going down, but **just because it has stopped going down does not mean it is time to buy** call options expecting it to go up. The market will usually decline, base, oscillate back and forth in a trading range, and then break out to the upside and have an extended move of 1, 2, 3, 4, days in a row up. It is during that 3 or 4 days in a row, when it is going up, that we are going to have our biggest winnings in the option market.

Historically, these moves come maybe once every two weeks. However, maybe once a week there is a trade where you can easily double your money in options, but it does not come every day. If you are going to trade options every single day, your probability of success is going to be more like 50/50 rather than 80%. You will be subject to the daily fluctuations of plus or minus 20%, 30% in the option's price, rather than probabilities where your option will double and triple and quadruple because the market is going up 50 points.

This is universally what separates the professional trader from the public. The public does not realize that **each day's trading has different probabilities of success**. There are many days during the week when the market is caught in a consolidation band of plus or minus 10 on the Dow Jones Averages, maybe because there is news that people are apprehensive about, or some unexpected event that just happened, or maybe the market is getting ready to reverse.

The professional trader sees and realizes that we are in a consolidation band of plus or minus 10 points and that it is not worth trading options. He therefore, does nothing but watch the ticker tape and be prepared for evidence of when there is a breakout of that trading band.

Practicing with an hourly chart and observing these patterns gives one confidence from observation of past historical breakout points. When the market breaks out after a basing period it usually advances 3 or 4 days in a row and extends upwards, maybe 100 Dow points in a straight line. Once you start to oscillate from the top, you have entered a topping pattern and it is inappropriate to own calls at that point.

The first time the market goes down you can buy a dip if the market has advanced 100 points, but if it suddenly pulls back 20 or more it is likely that that is the final top and calls would be inappropriate. Now you would wait for a topping action over several days before it would be appropriate to think about puts for the breakdown. Catching the final high or low is a sign of trading inexperience. Although, the final high or low can often be forecast right down to the hour, the public and the vast majority of investors, will never see it. As a result, the options at the final reversal point are always too expensive. It is only after the first minor correction that the premiums collapse, making them a bargain, because it is then that most people think the main movement is resuming and throw their options out the window.

Options - What They Mean

Professionals use options not in the normal sense that public speculators do. Professional trading is often a game of strategy and thinking and the use of options is not simply to gain leverage.

Options are a very important tool in today's market in judging what the market will do. Although we have great legislative bodies, such as the SEC and the various stock exchange organizations policing what is going on, in reality it has always been the case that there is tremendous inside information on Wall Street.

To the poor and the man on the street, acquiring information about a merger or a takeover is a rare event. If he has a friend, who is an attorney, who happens to be writing a proposal for a takeover, it is a rare opportunity. However, to the rich, the super-rich, the knowledgeable people, the heads of Wall Street brokerage firms, accounting firms, and law firms, it is a way of life. It is not inside information at all to go to cocktail parties and discuss nothing but inside information.

In theory this is illegal. In reality, it is a way of life if all your friends are on the board of directors of various companies or are high ranking attorneys at major, exclusive, law firms. Of course on Wall Street, when you have a wired hand or a guaranteed knowledge of an event, such as a takeover of a stock going to be shortly announced, the natural greed being what it is, forces the individuals involved to put as much money on that speculation as they can. If they know a stock is going to be bought out at \$50 and is currently selling at \$30, not only will they try to beg, borrow or steal all the money they can to invest in it, they will almost always use as much leverage as they can because there is no risk to the insider who has secret information.

This is what options trading is really all about. **Option premiums will always reflect inside information that is not available to the general public.** This is a very important point to be considered not only in terms of illegal information, but in terms of legal information that is of a very grey area, such as major basket programs, or major pension fund liquidations or buy programs that are operating in the market. At the major firms of Wall Street, where they have sizable, multimillion dollar buy and sell programs, they will not only race the tape to protect themselves and buy lots of call or put options before that program hits, but also as part of that program, they will buy thousands of puts and calls to hedge themselves and to protect their customer from unusual market fluctuations until that program is completed.

These movements of tremendous amounts of money into options are instantly reflected in the option premiums. The average retail investor who has learned to use a "Black-Scholes" options model or some kind of theoretical options premium model, that says what the fair value of options are, entirely misses the point. He will end up looking for **cheap options** that the theoretical model says are cheap, that will go to their natural price.

What he should be looking for are options that **are ridiculously expensive**. Premiums that are outrageous, premiums that are selling for prices far more than the theoretical models say they should be selling for. This is always a tip off to a major trading opportunity.

For instance, on individual stocks that are takeover candidates, if, on a stock selling for \$40, one were to look at the out of the money 45 call options whose normal theoretical value might be \$.50 and suddenly find that 1,000 options have traded at \$1.50 and yet the stock is lifeless on the tape, with

low volume and small range, this would give you an immediate tipoff. The tape is being raced for a certain transaction that will transpire sometime in the future and the insiders know about it.

Whether it is illegal because of a takeover, or legal as part of a basket program, or a forthcoming recommendation by a famous analyst, we will never know until after the fact. However, the fact remains, when big money has a sure thing they use lots of leverage and they use options.

In today's markets that are so influenced with basket programs, buy-write programs and pension fund investing, the OEX, and XMI puts and call options are dead giveaways as to what the major players are doing.

I cannot tell you how many times I have seen at 11:00 AM or 12:00 PM a major transaction of 2000, 5000, or 10,000 puts or calls cross up \$.50 from the last trade. Inquiries result only with names of the brokers who traded them and no indication on the tape of any kind of unusual activity in the market whatsoever. Seemingly a random transaction and yet three hours later out of the blue, massive buy or sell programs hit the tape going in the direction of those puts or calls that were bought or sold by the major brokerage house. Further inquiries indicate, the same broker did the program who did the options earlier that day.

The professional is keenly aware to watch for not only the premium levels themselves for the tip off, but more important, the time and the price level the trade went on. Major arbitrage activity may last in the market for several hours to several days. If one notes the time and price the options were traded and notes that they do not trade under that price again, it is very likely the conditions in the market will last until the options move back under the price level where the original trade was made. Sometimes that can be three days later and 60 points on the market averages.

Another thing to know about option premium levels in gauging the strength of the market and its direction, is relative strength. No matter what you think about the tape, remember there are insiders at major brokerage firms who have guaranteed information. If a multimillion dollar sell program is around, no matter how bullish the tape looks, it will not be able to go up because they will be feeding out stock every twenty or thirty minutes to check the rise of the market.

The telltale sign of this, is when the out of the money call options in a bullish rising market are flat or down on the day. Typical, would be a market that may be 12 or 15 dollars up on the day, looking quite bullish and yet the \$5 above strike options just above the market are down 3/8 to 1/2 on the day from the previous night's close.

Out of the money puts and calls, tell you a great deal about what the leverage players are doing. People who have absolutely guaranteed information do not pay large premiums and get near money strikes and pay \$6, \$8, \$10 premiums. They will get fairly out of the money premiums because they know exactly what is going to happen within fair tolerances. Likewise, in a Bull Market this is not just illegal inside information, but the overall total amount of investing by the public. When a large cycle is present in a Bull Market for instance, a sudden plunge of \$15 or \$20 in the market is often accompanied by out of the money puts being completely unchanged to down on the day with the market down

\$20. When you see something that looks like the market is breaking down, and is down, and yet no one who owned puts overnight, who should have taken advantage of that, has made any money, it virtually tells you that the tape action is an illusion, that it is a temporary blowoff and the market makers know it. They are flooding the market with put options that they are selling naked because there is no way the market can go down.

Even more guaranteed is the situation where the market is down, the puts are down and the call options are being bid up. When you see that, it does not pay to fight that kind of information, even though the trend is down and the stocks are down on the day. As a professional, you cannot trade against the premiums.

Also be aware that **options themselves influence the market** tremendously. Large insurance companies have multibillion dollar positions in the stock market. Most of these companies are long term passive investors who collect dividends and do what is known as **buy-writes**.

They will buy hundreds of thousands of shares of stock because they think the trend is up and will catch the dividends and sell call options to collect premiums. This gives them attractive annual rates of return of 15 to 20 to per year with little risk. This being the case, they will always commit their money to stocks that have seemingly unusually large option premiums.

In the last several years we have seen potential takeover stocks literally become self-fulfilling rumor stocks that go higher and higher and higher with little substance to the rumor. This is the effect of the tail wagging the dog. The more the rumors spread the more the speculators bid up the call premiums. The theoretical value of the premium based on the stock's history might be small, but the prospect of the stock suddenly being bought up \$30, \$40, \$50 higher makes the premium level 3 or 4 times what it should normally be.

Insurance companies see that premium and are forced to do **buy writes**. They come into the market and buy 100 to 500 thousand shares of stock to sell those premiums and get that juicy annualized return. They do not care if it is a true rumor and if it is bought out or not. If it is bought out they will still be exercised at the higher strike price, thus getting a capital gain and the premium, so they will be happy.

What happens in the short run, is that it is almost guaranteed that a large option premium will attract buyers. The buyers will push the stock up. The stock going up will expand the option premium and the process will feed on itself until all players who do buy-writes have exhausted their pool of money and have their positions. At which point, after 3, 4, 5 days to sometimes several weeks, the stocks go right back where they came from, the premiums collapse and the insurance companies close out their positions by buying back the options that they wrote at \$3, \$4, \$5. They buy them back at 1/8 or 1/4 and they sell out the underlining stock...and we are back to where we started.

To the professional, those heavy premiums with little activity in the underlying stock is a dead **give-away** as to what to do. The professional will always buy those stocks, knowing they will be attracted to the higher strike price, because of the premium. He may also set up a spread where he may buy the

way out of the money calls for a fraction and buy the stock. As the stock starts to go up, sell it out and sell the deep in the money calls against his out of the money hedge position.

With the advent of computers in the home, there are tens of thousands of investors who now have the ability to scan option activity every day. **Be aware that these large premiums on individual stocks have important information as to the direction of individual stocks and the market averages.** This is a very important professional point which needs much consideration.

While discussing options, I might reflect back on some basic misconceptions the public has concerning options. That is the basic creation of options. There are hundreds of books written about the risks of options, or how one purchases and sells them. I assume you know that much. However, what a lot of people do not understand is that when you buy a call option on a stock, somebody actually sold that call option to you.

Even though there are market makers quite willing to sell these call options naked, without the underlining stock behind it, most transactions are covered transactions. That is, if you buy a call option, on the other side of the equation somebody bought stock and sold the call to you. That is why if you ever decide to exercise your call, they will have the stock and they will be exercised out and the stock will go to you. That would be a covered write.

Now, on the put side of the equation, if the speculator wishes to buy a put, although a market maker may sell a put naked to him, he often likes to be covered on a position. A covered writer of puts is a person who sells short the underlining stock and then sells the put. That way, if the person who buys the put ever exercised it (and you buy it because you think the stock is going down) he probably already owns the stock. If you buy a put to protect yourself and the stock should collapse, you would exercise the put, forcing the person who sold you the put to buy your stock.

That is why a covered writer of puts, is a person who shorts the stock ahead of time, with the expectation of being exercised at a later date, and forced to buy the stock to cover his short. Naturally, he would not be forced to buy the stock unless the stock went down, so his only consideration is being short the stock if it goes up. As long as the stock goes up and he sold the put, the put is worthless. He has no risk and he can cover his short. However, as long as the stock is below the strike price he will usually be hedged against the put by being short.

What I am explaining is what causes the major movements around the options expiration dates. Over a three or four week period the public as a whole is Bullish or Bearish. They accumulate, let us say a large put position, because they are Bearish on the market. What they do not realize, is that over the course of time, as they are buying puts on their favorite stocks, market makers are selling short these stocks to accommodate them and write the puts.

The public has no intention of exercising the puts because they do not usually own the stock, they are just speculators. Their intention, as we get closer to option expiration, is to sell the put at a profit. The natural effect of this, as they go to sell the put, is that the market maker on the floor buys the put

back. He has not extinguished his liability from when he initially wrote the put, days, weeks, months ago and since he was short stock when he wrote it, he now has no need to be short stock and he buys back the stock.

The net effect is that the speculator who sells out a put position, forces someone to buy stock. Groups of people who, very quickly on news items, or trendline breakouts, or for any other reasons, are forced into simultaneously selling large amounts of puts, create massive buying in the stock market. The more the massive buying hits the stock market and stocks go up, the more the people who own other puts, see their profits evaporate and are forced to sell. The more they sell, the more the buying ensues.

This is a double-edged sword, in that the more the buying ensues the more other speculators want to buy calls. As those speculators come in and buy calls it forces market makers to also buy stocks and sell the calls. So you have a double effect, people selling puts which causes buying of stocks, and people buying calls which forces buying of stocks. This happens until the market gets saturated and stops going up. At which point people take their profits.

Now the people who have call options start to sell. As they sell out, the person who originally wrote the call and had bought stock, buys back their call options and no longer needs the stock and sells out the stock. The selling of the stock forces the market down. The forcing of the market down, forces more people who have calls and see their money evaporating to sell the calls even faster. The more they sell the calls faster, the more the stocks go down.

Now as the stocks go down, speculators want to profit and they buy puts on the market. As they buy puts on the market, the market maker shorts stocks, forcing them to go even lower...and we have a vicious cycle that oscillates back and forth. This is why on the option expiration days, we see the market gyrate up 10 points, down 10, up 20 or 30, seemingly random, but what you are seeing is massive buying and selling that reaches saturation due entirely to put and call transactions.

In analyzing the stock market, one must be cognizant of these types of fluctuations as you get closer and closer to option expiration, because there you have the combined buying and selling of the last several days, several weeks, maybe months, coming to an end where there is a legal deadline in a matter of days or hours, and thousands of people have to make up their minds simultaneously to do something about their positions.

It is during these times that it is very important to watch outstanding interests in the puts and calls listed in the newspaper. If there is a huge position in outstanding puts, there is a maximum floor under the market, which no matter what kind of selling pressure it has, will not go through. If those puts are stampeded, if they are in the money puts of any value, it will force the stock market higher as those speculators sell the puts.

In recent years when the market had a bearish bias from '89 through '90 and beyond, we frequently saw a phenomenon where most people had puts. Going into option expiration, the market always rallied up forcing them out of their puts, leaving them high and dry at a loss on option expiration date,

not wanting to pay the very large premiums for a whole new month of trading activity.

Consequently, no one had any puts on the close of business on options expiration and the following Monday the market opened down 50 to 70 points. This gets the juices flowing on the Bears. They rush to buy their puts anyway and by Tuesday morning or Wednesday morning the stock market stops going down from the short selling, as everybody has bought puts and then it starts to creep back up again. The puts start to lose their value, people start to sell their puts and it creates buying, and the market comes right back to where it was.

These are natural cycles. If you look at every single option expiration, you can see where the masses, as a whole, had either a net bullish or bearish bias. This can be a good sentiment indicator. It is no accident that almost all of the big "crashes" in recent years occurred during option expiration.

Another thing to keep in mind, is that although there is a legal deadline for option expiration of the third Friday of every month, during the last several years, the legal, practical deadline has slipped into Monday, not Friday. This has come about because in many firms trades in margin accounts are considered day trades without money having to be put up to pay for them on exercises of options.

Therefore, if a speculator owns options and they are going out worthless Friday afternoon by selling for 1/16th and he has strong conviction that the trend will reverse on the following Monday, and he will actually make money, he will frequently exercise the call into a stock position. Since the exercise notice is not received until Monday morning, as long as he sells the stock out by Monday's close, he does not get a margin call for that transaction. So many investors have taken advantage of this to get a free ride over the weekend on lots of stocks.

Market makers in particular, who used to arbitrage by selling naked puts and calls at the strike price, straddling both the calls and puts right down to the index strike price, used to cover themselves by buying baskets of stocks. Now they do not bother until the Monday afterwards. They prefer to capture all the premium, close the OEX and XMI on the exact strike levels and if it requires them buying odd amounts of stock on Monday, they will do that rather than destroy the chance of getting all the premium on each side of the strike price. It is not an accident or a coincidence that every option expiration the OEX and the XMI's close exactly at the strike levels.

Several years ago, it also was no coincidence either, that all the underlining component stocks also closed exactly at the strike levels. However, in today's market, apparently greed has gotten to such an extreme that the market makers no longer buy the individual stocks and many individual stocks that weigh heavily in the indexes no longer close at their strike price until the following Monday. They want the indexes to be exactly at the strike so they get all the premium and after the indexes expire worthless Friday, they will buy the one or two individual stocks they need in that basket on Monday to force it to the index strike.

The net result of all this, especially because of the speculators who get a free ride on Monday, is that after the option expiration the stocks have a tendency to have severe gyrations from 2 PM to 4 PM on Monday afternoon, very often in a completely opposite direction to which the day had been going.

What happens, is that somebody who exercises a call on IBM, because he thinks it will go up on Monday, is exercised into the stock at the same strike price it was Friday afternoon. He hangs on all Monday afternoon hoping the stock will go up and sell at a profit, but the market makers know he does not have the capital to pay for the stock and must sell it by the close. So they will start a drive in the market to lower the bids and in the afternoon, sure enough, IBM will start to sink.

Alluding to the poor, undercapitalized speculator, who knows he has to sell it by the close anyway, he will be forced out on the very first dip, usually at 2:00 PM to 3:00 PM and be certainly out of the position by the close. The net result is that the market makers scoop up cheap stocks at 4:00 PM and the **Tuesday** following the option expiration, we are off to the races.

All the big, big winners in the last five years have usually exploded on Tuesday, following the Monday after option expiration. It does not pay as a professional trader to gamble on that Friday or Monday unless you are a short term scalper and you have very strong convictions. Watching the market trend emerge on Tuesday or Wednesday, following option expiration, is often a very profitable endeavor.

The public should also be aware, especially during the weeks surrounding option expiration, against trying to read the tape. In my opinion during everyday of the week, at least 30% if not 60% of all transactions on the floor of the New York Stock Exchange are now option related.

To most people this sounds ridiculous and is very hard to prove, but many people who are buying, for example, IBM, are buying it under some type of option strategy. If not individual options on IBM, they would be buying IBM or selling it, because it is part of the Dow Jones Averages, the OEX, the S&P 100 largest big cap stocks or the XMI, the twenty big cap stocks. People buying puts or calls on the XMI, on the OEX, the S&P futures will be affecting the price of IBM. Someone recently mentioned to me that for every listed stock, there were now up to seven individual derivative option listings on each.

It is almost impossible to differentiate all the different players in the market, all their reasons, the amount of money each has and the influence that a few small highly leveraged players have to more than compensate for large legitimate fully paid for stock buyers. This is why the influence of stock option activity is so high.

The problem with reading the ticker tape around the option expiration is this influence. I have often seen brokers say, "There is a big buyer of such and such a stock" and I say, "It is probably option related," and the broker says "No! I have the account right here, they are just buying stock." What that broker does not realize is that big institutions have a dozen accounts all over the street and they keep all of the accounts guessing, because they do their options at one place and their stocks at the other and do not tell either side that they are the same guy down on the floor.

Often times, after completion of buying 100,000 shares of stock on the NYSE, you will see in Chicago 1,000 calls trade and the 1,000 calls that represent 100,000 shares are probably connected and being crossed in some kind of an option related transaction.

Around option expiration, when people have puts or calls and have made large amounts of money, let us say, they bought a put at \$2 and the market broke, the stock went down and the put is now selling for \$16, the public loves to call up the broker and tell him to sell their \$16 puts. In reality, on the last day of trading and the day before, no market maker wants to invest all his capital in expensive \$16 puts. The only way you will ever find a willing buyer of those puts is through an arbitrage transaction. Remember, the person who originally wrote a put is short stock.

The transaction that takes place in order to extinguish a liability is that a market maker will first buy stock. He will buy the puts, exercise the puts and through the exercise of the puts will sell his stock to the person who originally wrote the puts. For instance, if the put strike price was \$100 for IBM and IBM is now selling at \$90, the put is worth \$10. For that market maker to pay \$10 for the put, he would buy stock at parity with the put. In other words, buy stock at \$90, no less, no more, then buy the put at \$10, exercise the put which forces whoever originally issued the put, to buy stock at \$100 from him at the strike price.

The specialist owns the stock at \$90, (he just bought it) and sells it to the original buyer at \$100 making a \$10 gain, but the specialist bought the puts for \$10 and that offsets the gain on the stock. The net effect to the specialist is zero, no gain or loss but he will make a commission on the trade and the speculator will sell his puts.

What this is all about, is that when you look at the tape on option expiration, you will see unusual orders of 20,000, 50,000 shares of stock being bid for or being offered. This does not mean that there are actual sellers or buyers for your stock and that it is going up or down. These are arbitrage orders and are limited to a price. The reason they are limited is that on the other side of the equation there is somebody trying to sell a put or a call. So he is patiently hoping that the market maker can either short that many number of shares or buy that many number of shares at that exact price so his in the money puts or calls can be traded.

Often you get a sense of this by watching the option activity throughout the day, especially deep in the money puts and calls. Every twenty or thirty minutes you will see some trade and then you will know what is going on, on the floor. I have seen many naive investors see a 100,000 share bid for stock on the floor and think that it would force the stock up.

In reality that 100,000 bid does not even exist, except only at that price, because somebody is trying to get out of a deep in the money option transaction. So there is no need for the bid to leap frog and force the stock higher and higher as normally would be the competitive position if there was a 100,000 share buyer of stock around. In this case the 100,000 share buyer of stock is a neutral trade, is exercising put options at the same price he is buying the stock and the net effect is usually no effect on the stock.

Similar to this, is the public's misconception of the market on close orders. Market makers and arbitragers who have bought and sold for weeks at a time, going into option expiration, try to extinguish their positions. However, as you get down to the last day they frequently do not trade every

minute each day, for they are totally hedged. The only time they are unhedged is when the options expire at 4:00 PM on the close of business on option expiration and at that point they are either long or short stock and no longer have an adequate hedge in puts or calls.

This is why they close out their positions when the market closes, on the last trade of the day. At that point, it does not matter if they pay up for the stock or down because the offsetting put or call market index goes exactly with the stock and their offsetting transaction will settle in cash with the cash index. They do not care that on the last transaction of the day IBM may go up \$3 from 4:00 PM to 3 minutes after 4:00 PM. They do not care because they may have OEX or XMI puts or calls and they may have to pay more for IBM increasing their cost. However, if they have the puts or calls on the index, it will go up that exact same amount because IBM is in the index and by definition, as IBM goes up, the index goes up. It is completely offset.

The public assumes when they get information about option expiration that the market makers have stock to buy, that the market makers are just going to walk into the market all day long and buy IBM right up to the buzzer. So the public rushes in during the morning and they buy IBM all day and nothing happens. As the day goes on, one by one they get frustrated. As IBM starts to go down and down and down and they start to lose their money and they sell their IBM at a loss and they all wonder, "I thought the market makers were going to buy the stocks!"

In reality, the market makers do have stock to buy. They may have 1,000,000 shares of IBM to buy, but they do not have to buy it until 4:01 PM. when the market is closed on the last transaction of the day. So, for professional option traders, the best trade on option expiration is to go counter to the trend in existence at 11:00 AM in the morning because it is always going to be the public invested in the wrong direction. Then make your maximum bet at 5 minutes of 4:00 PM in the afternoon. At that point all of the premium in the puts and calls has been rung out of the market and you are truly paying for the speculative possibility of the market going up or down in the last few minutes of trading. **Those are by far the most profitable trades if you are unwise enough to trade at all in the gambling casino of option expiration.**

One other professional observation I might make about options for the professional trader, is that these days there are so many highbred types of arbitrage transactions, that one must be particularly careful not to go by just one indicator, such as premium level on options related to the market. Over an average period of time for instance, expansion of call option premium usually means the stock market is going up.

It is usually true, that either there are inside information buyers around or just pressure on the call options to go up which attracts buyers. However, there are unusual times when the premiums go just the opposite to what you would expect. When the market is plunging, the call option premiums go up.

This type of market always fools the trader into thinking that there is a short term low in the market and that something has happened to end the sell program and the option premium expanding means that the market is about to reverse.

Many times this is true, but I have also seen a number of arbitrage situations recently where the professionals are shorting S&P's and buy OEX call options. They are completely hedged. If the market goes down they make money on the S&P future shorts, if it goes up they make money on the call options. Depending on the degree of leverage and the degree of bullish or bearishness they want, they will either buy calls and sell S&P's or they will buy puts and go long S&P's. This usually happens when major moves are under way and people are using maximum amounts of leverage.

During these times the premium levels will give you almost backwards readings from what is normally expected. It is important during these times to use some common sense and see what the direction of the overall tape action is. If the market is very strong down on heavy volume, big leadership on the downside, I would not expect premium level expansion in call options to be a good indicator. But in dull, quiet, everyday type of trading activity, with the market in a normal trading range, call option premiums are quite valid as to what they actually mean.

I might mention one other phenomenon that has occurred quite frequently in the last several years. Professional traders and professional hedge fund managers usually do not buy put options when they think the market is going down as you are paying too big a price. Puts and calls have always had premium levels worth about 12 to 20 points on the Dow Jones in the direction they anticipate. If you think the market is going down and you buy an out of the money put for a couple of dollars, unless the market goes down more than let's say, 20 or 25 points, in theory you are not going to make any money anyway.

So what the professional does when he expects the market to go down 20 or 30 points is to sell calls naked, rather than buy puts. As the market goes down the call premiums collapse point for point with the market, especially if they are deep in the money calls and the professional merely covers his short, buys back his call option and collects the full amount of the premium. Whereas if he had bought a put for \$2 and the market went down 25 points his \$2 put may only go to 2 5/8 or \$3. If he sells a \$10 OEX call naked it would go from \$10, maybe down to \$6 or \$7, he would get the full effect of the drop in the indexes.

What this does, and the reason they do it, is that a professional can usually tell by reading the tape if the market is going up. If he is short calls it is rare that the market ever explodes in such a rapid fashion that he cannot buy his calls back at parity with the market averages. If the market averages open up one day and surprise him they usually only open up 8 to 12 points. It is rare that the market opens up 20 points. However, there are times when there are unusual news items where the market literally gaps open from 18 to 20 points and suddenly call premiums explode. When you see this activity you know that the short call players are trapped.

What we have seen in recent years when this occurs, and it only occurs when the market gaps up through a strike price, because it is the near money strike price where these people are short, is that people start to lose money. Rather than be in a desperate bind to buy the calls back they will merely sell more naked calls of the higher strike, assuming that the market will fail when it gaps open points.

As the day goes on the market does not come down at all. Later in the afternoon it goes from plus 20 to plus 35 points. At this time they must buy back the calls they sold the day before, and they have compounded things by selling new calls at the higher strike, but they are still essentially even. What they have lost on the calls they were naked the night before, they now figure they will make on the next dip having sold calls at a higher price.

What usually happens is that this trend feeds on itself, the market never does dip at 3:00 PM and at 3:15 PM it is up 40 points and by 4:00 PM it is up 45 or 50 points. This forces the market makers again to roll up to the next higher strike, buy back the calls they sold naked at the lower strike and roll up to a higher strike and sell the calls naked.

Statistically, this has given us many three day moves of 30 or more points each day with a Dow Jones movement of about 100 points before all these players are exhausted and they stop selling the naked calls. If you see this pattern on the tape, you usually know it does not last just one day. It will usually last a good three days and a good 100 points or more.

The same thing happens on the down side when the puts get out of control and a few big players, especially in the Bull Market, who instead of buying call options on the way up, sell the deep in the money naked put options. As the market starts to rally they sell naked puts, collapsing the premium, hoping to buy them back at the end of the day. Sometimes they get caught when the market gaps down on them and they have to buy back their deep in the money puts they sold naked and so they sell the next strike down naked. They keep doing this until the market stops going down.

The 1987 crash proved to many people that it was very unwise, indeed, to sell naked puts because of the severity of the declines and the unlimited liability. Now, the only time most market makers will sell naked puts is when there is a very strong trending market that is up on the day, and as long as it is getting stronger and stronger they will continually sell the puts naked right up to 4:00 PM when they usually buy them back as a day trade.

Chapter #10

Cycles

"I cannot emphasize enough how very valuable such knowledge is of the long term trend and how profitable it can be to you to trade with that certain knowledge."

The major cycles consist of the 100 year cycle, the 90 year, the 60 year, the 50 year, the 30 year cycle, the 20 year cycle, the 10 year cycle, the 7 year cycle, the 5 year cycle, the 3 year cycle and the cycle of 1 year.

Most of these cycles as you see are in harmonic relationships to each other. For instance, the 20 year cycle and the 40 year cycle are probably related and the 10 year cycle and the 20 and 30 year cycles may be related. We also know that these are complete cycles in that highs to highs and lows to lows come out on these dates, very similar to prior highs and lows.

There are complete cycles of these lengths. We also know that there are harmonic sub-cycles of shorter divisions. For instance, a cycle of 20 years might give us 1/4 turn movements of 5 years or 1/2 movements of ten years, 3/4 of the cycle every 15 years, and 20 years for the full cycle. It has often been supposed that the 20 year and the 10 year cycles are the ones that give rise to the famous decennial pattern, or the 10 year cycle in that the starting point would be at year 1 up to the opposition point at year 10 and then back down to your 20th year for the next low. This is why we see a 10 and 20 year pattern that seems to repeat over and over again in the stock market.

Basic analysis must start with the historical record of the individual stock, commodity or market average. Because of the lengths of these cycles the more data we have for analysis, the better. Obviously everybody cannot get 100 year old data but there are some charts around if you search that will show graphic representations of the market averages for more than 100 years.

There are also chart books such as the SRC's (Security Research Corporation in Boston) on individual stocks covering 35 years. The Horsey Chart Book Service in Salisbury, Maryland, also covers 5, 10, 20, to even 30 years of activity on selected issues.

In public libraries you will often find the New York Stock Exchange record service, which has a day to day record of each stock listed on the New York Stock Exchange. Depending on the library you might have volumes of these going back 20 or 30 years.

Once we have the data, we can then make a cursory examination of the highest highs and lowest lows to find out if any cycles are obviously present. We should, for instance, see highs to highs every 10 years or every 5 years if those cycles are present in the data. Keeping in mind the theoretical basis of cycles is that time is of a cyclical nature and prices on stocks respond to cycles. Therefore, when a cycle returns to the same place it was, the price levels of individual stocks should likewise return to their exact same trading levels unless there has been a change in the outlook of the company or growth. Under these circumstances, which is the usual, we find that as a cycle returns to its same time period location, it also returns at an exact proportional multiple of that prior price level.

For instance, in 1966 when the Dow hit 1,000 for the first time, we would expect if there was a cycle of 10 years, that 10 years later the Dow might hit 1,000 again or be at a multiple of that price. We clearly see this from 1976 when the Dow hit 1,000 some 34 different times over the course of the year (10 years from the first 1000 in 1966). When we compare this with a cycle of 15 years length, hitting in 1991, we see that the Dow got seesawed above 3,000 (3 x 1000) for most of the year. We can also see a comparison with 1986 and 1991, the five year cycle, only this time at a Fibonacci ratio of 1.618 times the 1986 price. This is the effect of numbers tying in with cycles.

What our analysis hopes to find, is the beginning and ending points of the cycle and the number and the proportions of these numbers that tie in with those beginning and ending points. Once we have this we can make some good assumptions about how long the current trend in effect will last and what price multiple it will expand or contract to based on the prior cycle. It is truly amazing to see long term cycles repeat almost in an exact fashion.

For example, as I write this book in 1991, one of the dominant cycles is the 90 year cycle from 1901. One of the interesting things I noted this year was that the company U.S. Steel, letter X on the New York Stock Exchange, was listed for the very first time in history on the Exchange in the spring of 1901. In the past several years U.S Steel changed its name to USX Corp, but in the spring of this year, within a few weeks of its first day of listing, 90 years later, it changed its name back to U.S. Steel again and was relisted under the letter X under the name U.S. Steel, just like it was 90 years ago.

Another obvious example was the recent tearing down of the Berlin Wall, almost exactly 45 years from its erection (1/2 of 90 years). This type of information, though rather subjective, gives us a good idea as to identifying which cycles are operative. As we look through our historical record and see price patterns that may appear to the eye to be similar to what is currently happening, we can look at some of the individual sociological events of the day from newspaper clippings and find out if those events are repeating in similar fashion. For instance, there may be a problem with the president's health, there may be a sociological clash with women or with groups of minorities in society, there may be cultural changes. Whatever we notice helps our analysis to determine which is the exact cycle we are dealing with.

If cycles were of fixed lengths, that is, if a 10 year cycle ran exactly 10 years to the day, it would be easy. However, cycles expand and they contract, they breathe out, they breathe in, so we have at best a subjective analysis of the cycle. To keep track of the overall period of time, let us say a 10 year

cycle, our turning points may be off by 1 to 3 months compared with what happened 10 years ago. We must be prepared for some flexibility in our analysis.

The first way to start is to pinpoint the low day 10 years ago, if we are using a 10 year cycle. Knowing that natural minor cycles exist in the stock market of 3 to 4 weeks and 6 1/2 weeks duration, we will often find that these small cycles give us the break points in the larger cycles. So if there was a major low on March 1st, 10 years ago and we expected a minimum 3 1/4 week cycle, (that is what happened 10 years ago) we would look to see if there was a top around March 22nd, 23rd, ten years ago. What we want to do this year, 10 years later, is look anywhere from the middle of February through the middle of March to find an identifiable low point that could have been our low point on March 1st 10 years ago followed by a top 3 1/4 weeks later.

Once we have that identifiable low point on our chart, we can then count our number of days up to our high. It does not have to be the natural cycles of 3 1/4, 6 1/2 weeks, but they work most of the time. What we would actually want to do is count the exact number of days the market advanced 10 years ago from our low.

Most people in starting the analysis make the mistake of going 10 years to 10 years on anniversary dates. They will pick the low on March 1st, assume there is a low this year on March 1st, and if the market back then did not top out until the middle of April, they will forecast that the market will not top out this year until the middle of April.

The problem here, is that if our cycle does not bottom exactly on March 1st this year, but let's say it bottomed the last week in February, the cycle of the same number of days from 10 years ago would no longer top out at the middle of April, but would be short of that by a week or two. So we want to keep track of the number of days up or the number of days down from our identifiable high or low point on our cycle 10 years back.

Having the harmonics of these cycles with the fractional components to break them down is a function of our Gann Square Analysis. Starting with a high, let's say we are dealing with a 10 year cycle, we draw our angles down from the high price at 1 point per day, or a larger square of 1 point per week, or 1 point per month. When these angles go down at those rates they will eventually get down to the zero point based on how many days, weeks or months they are from the all time high. If the price of a stock was \$50, 50 days later, 50 weeks later or 50 months later, our first Gann square of 50 time units would come out.

It is nice to try and find a square that ties in with the overall natural time cycle. For instance a 10 year time cycle might require a 120 month Gann square because this is the normal, natural number of months in the time cycle. So if the market averages were 800, 900, 1000, or 2000 ten years ago it does not matter. We may want try a cycle of 120 or its multiples until we find one very similar to the price level.

Any experimentation with drawing a few squares and subdividing them, and subdividing them, and subdividing them, will show us very quickly if this type of analysis applies to our particular cycle. If

the midpoint of our square seems to hit a major inflection point on the market averages it is reliable. If the 3/4 point hits it again it is even more reliable. If we divide it into 1/8's and we find that all the 1/8's point turns hit, then we know we have a grid that fits the cycle very closely.

At this point we at least have a rough time table based on the subdivisions of our square, as to give us a point when to expect major harmonic turns in our cycle. Remember that these break points will not exactly repeat from the past, but will correspond to highs and lows of the past somewhere near the turning point we have predicted in this time frame.

We now want to go back and check the exact number of days again, keeping track also of the total number of days from the extreme high or low. Even if we are looking for a little rally from a short term low, that might have run 30 days, we will also want to know where that short term low started from in terms of where the final high or low was, which could have been 200 days earlier. In a 10 year cycle, do not forget we are dealing with 1 to 10 years of data. So from each high and low we want to keep track of such counts as how many days they were from the original high or low. This seems like a lot of work, but actually it is quite simple to do and of course with today's personal computers it is no work at all.

Added confirmation of our cyclical turns on the 10 year cycle is given by looking at the price levels at each important high or low. As I mentioned, when the cycle comes back to its origination point each time, the price levels will be mathematical proportionate parts of the prior price level. So if we are dealing with a cycle, let's say 100 years ago, when the Dow Jones sold at 80 or 90, we might very well find a multiple of 10 times that with the Dow Jones Average selling at 800 or 900.

Throughout the 1960's and 1970's the Dow Jones sold at an even multiple of 10 times the prior sixty year cycle price. In 1966 the market hit 1000 and in 1906, 60 years earlier, the market hit 100. That master cycle of 60 years basically followed, true to form, from 1966 all the way into the late 1980's at a 10 multiple of what the price level was. If we find a visible high or low in our cycle, to identify where we are in the cycle, and find that the price level at that time is an exact, proportionate multiple of the high or low in the prior time cycle, then we can make a good forecast as to how long the trend will last and on the expected turning point date what the price level will actually be.

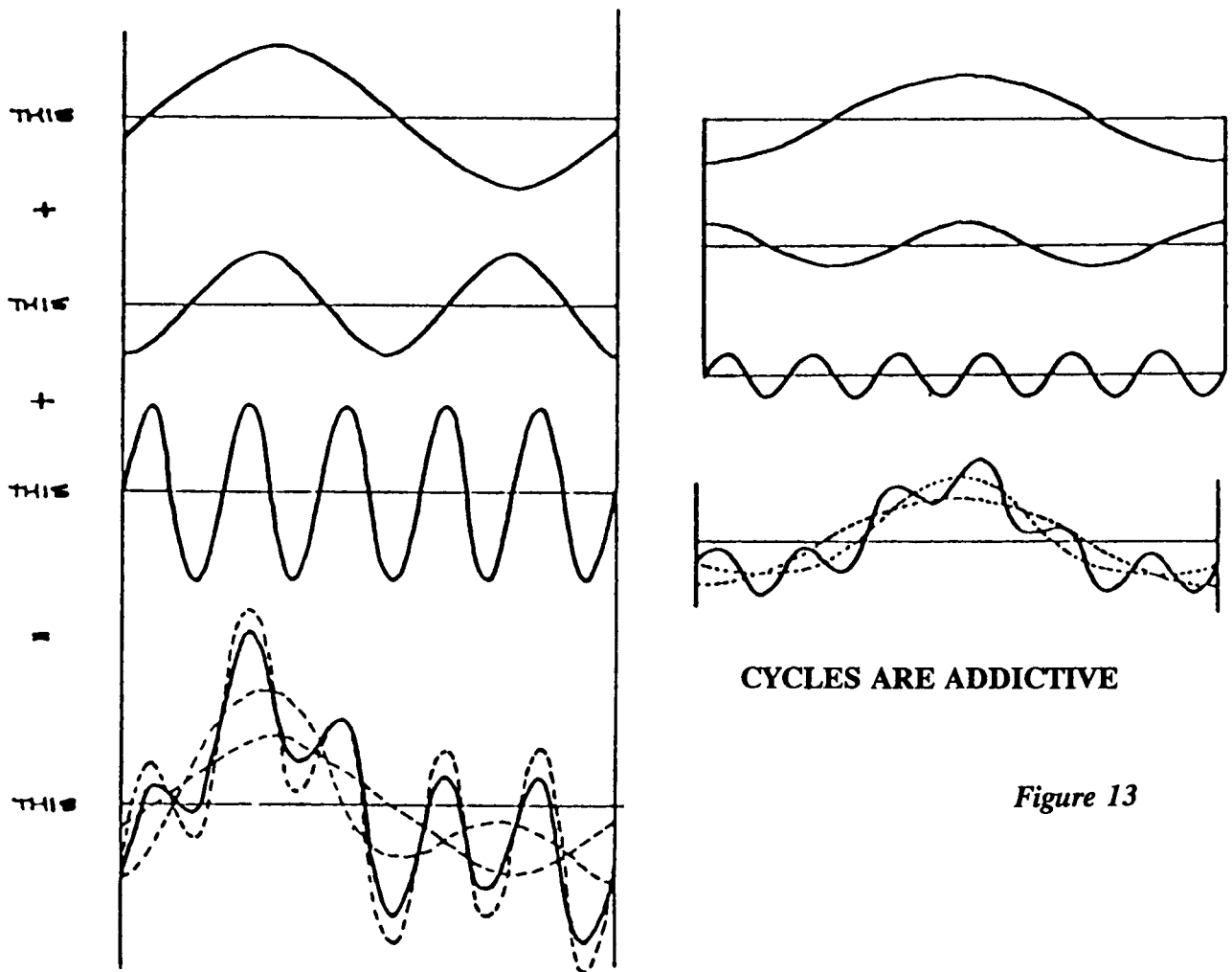
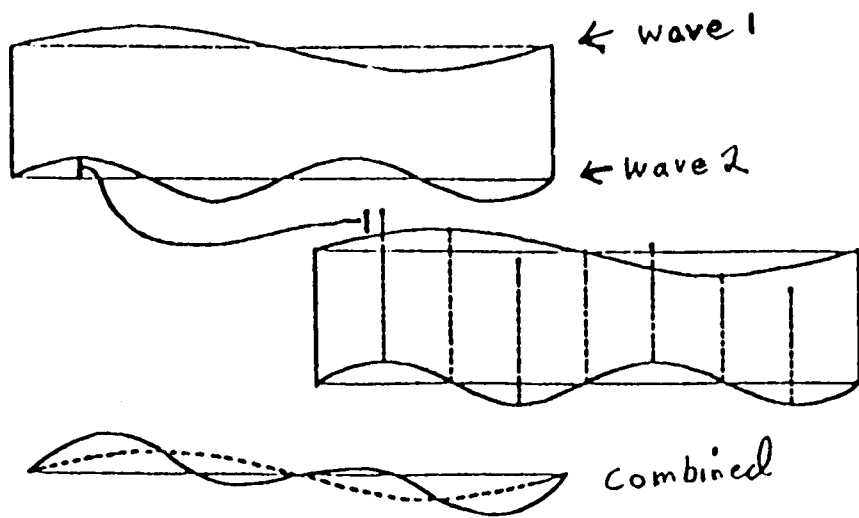
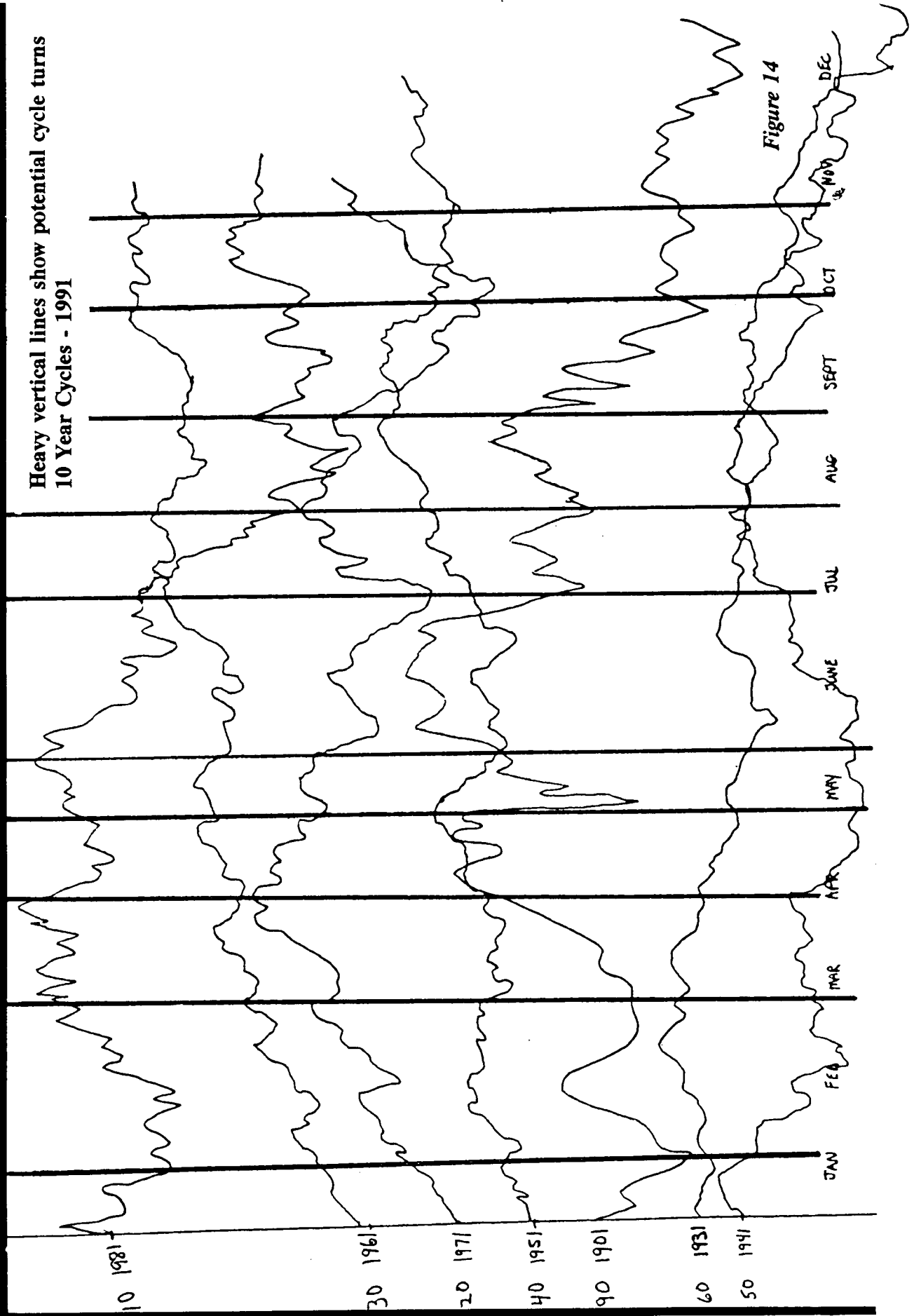


Figure 13

STICK FIGURE CYCLE FORECAST



When we combine this type of analysis with our trendlines, our Gann analysis, our Fibonacci numbers, and our hourly chart wave patterns, we find that we can get some very, very accurate projections. When we do our cycle analysis, the first thing we must remember is that cycles are additive. That is, if we have a 10 year cycle that is going up for 3 months, but we have a 50 year cycle that is going down for 3 months, it is very likely our expected outcome will be a flat, sideways movement for 3 months. (See *Figure 13*)

Whereas, if we had three well known cycles, a 10 year, 20 year and a 50 year, all going down at the same time for three months, not only would our forecast be that the cycle was down for three months but it might be a tremendous down, as all three of the downward cycles add to give their impetus to the movement.

This is indeed what happened in October of 1987. In early October of 1987 I had 12 different cycles going in different directions. As we got into the middle of the month all 12 of them simultaneously went down for periods of 1 week, 2 weeks, 3 weeks and after that short 3 week period, when all of my cycles had been turning down, many of them started turning back up, some continued to go down, some went sideways. What we saw was that the combined influence of all of these cycles going down for a short period of 1 or 2 weeks combined to bring about a devastating waterfall liquidation.

Obviously, those of you who are mathematicians and scientists will want to track and computerize all these cycles and add them up on the computer and get composite cycles. This is very good and will give you a very good composite drawing of what to expect if the cycles you are dealing with are the right cycles for that time period. However, for the average person this is not even necessary. We are just doing a cursory exam of cycles to get a rough idea of how to forecast the coming year. This can easily be done in a matter of minutes on a simple piece of graph paper by just merely going from point to point and marking the visible highs and lows on each of our cycles.

For instance, on a vertical column on your graph paper list your cycles, 5 years, 7 years, 10 years, 20 years, 30 years, 40 years, 50 years, 60 years, 90 years, 100 years and whatever other cycles you think are significant. Then go to your 10 year cycle, say you look at the month of January, if it basically goes down all month draw a general down trending line for the month of January. If it stops at the middle of the month and turns up, make a little "V" pattern.

Then trace out the 10 year pattern in kind of a "*stickfigure*" on your graph paper month by month. There are usually not more than one or two inflection points a month at most, so it might only take us 30 seconds to a minute to quickly draw out the general direction of stock prices on the 10 year chart. (See *Figure 14*)

We do this for each of our cycles in turn. When we are done with this analysis we can easily see the time periods that have simultaneous turns in the market. We may find for instance, that in the month of February all major cycles make a turn. Let's say, we are dealing with ten cycles, 8 of them have major lows and then go up the next three months. What I often do is draw a red vertical line down through the whole series, the 10, 20, 30, 40, 50, right down through that inflection point to let me know that coming up in the middle or end of a certain month there is a high probability that there will be a major change in direction.

This is also the point in time each year when we want to revise our forecast. If our 10 year cycle has been tracking very closely, if there is going to be an aberration and the cycle is going to jump from a ten year, being the dominant cycle, to the 60 year, it is at these inflection points where the cycles jump.

This is another basic fact that is often overlooked by people when they first learn about cycles. When you are forecasting a major turn in the market, based on a cycle from the past, two things could happen. Either the current cycle will change from the existing cycle ten years ago or the turn ten years ago was an aberration of the true ten year cycle. If we went back ten years prior to that, we would not find the turn on that date going in the same direction. It may have been what we call a cycle inversion. That is, a turn in the cycle in the opposite direction of what is predicted or the opposite direction of what it did in the past cycle.

These happen frequently and play havoc with our long term forecast. However, when we get to that pivot point since we know it is a pivot point, there is no need to make a mistake as to which way it is going. If we find that we get to our turning point date and the market starts going in the opposite direction, we have to assume that from that pivot point, until the next forecasted pivot on our model, the trend in effect will be in the same direction. Even though it might be exactly backwards from the direction that occurred on the prior, let us say ten year pattern. If we have a cycle inversion, we must be aware that there will probably be another inversion in the not too distant future, that will flip the pattern back for the major cycle.

Cycle inversions only occur in short periods of time, 3 to 6 weeks in short cycles and maybe 3 or 4 months in a long cycle. Since long term patterns, like 10 year, 20 year and 60 year patterns work over and over and the highs and lows in the stock market follow these long term patterns, you cannot have one of these cycles invert forever. The inversion is some minor cycle that will drop out, and it will be over and done usually within a 3 to 6 week natural cycle. Then we will find ourselves getting back on track, getting caught up with the original projection.

Keep in mind when using our graph paper technique, of adding up the sums of the directions of the various market cycles, that we are not doing this mathematically precise, we are just visually looking at all the cycles and summing them up in our head. This is all that is really necessary because when we trade, we do not trade off of a specific forecast, we use the forecast to plot our trading strategy, **not to trade**. If the forecast says that the market is going up the next three months, we do not blindly just buy and go away for three months and assume we have made money.

What we do, when we forecast the market will go up for three months, is to look at the ticker tape, using our technical analysis tools, such as trendlines, overbought, oversold oscillators, and whatever tools we are using, to give a valid technical buy or sell signal. If we get our technical buy signal and it goes with the forecast, we develop our strategy to buy all the dips and assume the forecast will work, ever keeping in mind a stop loss discipline if the trend actually starts to deviate from the forecast. Because of this, it is not that necessary to have a detailed, minute to minute forecast of our cycles. These are just stop signs along the road of our game plan to investing.

For many years, a famous technician, George Lindsey, whom I had the privilege of knowing until his death in 1987, developed a technique called Mirror Image Forecasting. Although, he is widely cred-

ited for developing this and practicing it to a high art for over a 30 year period, and writing a newsletter and making incredible predictions, there were many others who used this technique all the way back into the 1800's. What this technique involves is very similar to what we have talked about in our cursory graph presentation of cycle analysis.

From every major high and low in market history, we record on a piece of graph paper the direction the market went from each of these highs and lows. What the mirror image fold back pattern tells us is that time goes both forward and backward. So for example, if the bull market in 1980 went from the low in March up until year end, and then went down again, at some point in the future this cycle of going up that many months would fold back and go down the same number of months.

What the actual analysis consists of, is that on January 1st of this year we are "X" number of days from the all time market low of December 1974. We would calculate the exact number of calendar days we are from the low in 1974, and that would equate to January 1st of this year. We now want to graph a visible pattern that occurred prior to the low in 1974, the **same exact number of days** that we are today (January 1st), but going **backwards in time** from that point on a day to day fashion. Whatever the market did in a backwards graphic fashion we would expect to happen from January 1st of this year on.

We do this for several historical observations. Taking all the major Bull and Bear Market highs and lows, we keep track up to January 1st of every year, the exact number of days we are from each of these highs or lows. The initial graph paper might require a lot of work but maintaining it year to year is quite simple. Even if we have 20 or 30 different observations of major all time highs or lows, we know as of January 1st of each year, the exact number of days we are from each of those highs and lows and the next year when we do our projection we need only add 365 days. (See Figures 20, 20A)

The essence of the analysis is that we will end up with 15 or 20 observations. We will draw on our graph paper from January through December of this year, a little stick figure representation of what the market averages did backwards from these points so many years ago. We then visibly look up and down, in a vertical fashion, the month of January, February, March, April on our comprehensive graph sheet to see if we can find common inflection points.

This technique actually works very, very accurately. George Lindsey was able, years ahead of time, to forecast the market averages within a day or two of major turns and predict which direction the turns would go and exactly how many days it would last. This was possible because of cycles.

Now in the actual mirror image fold back technique we don't have to address cycles *per se*. We are just using the numbers of the days of the week and the patterns themselves. Remember that these patterns are a form of cycle.

Today, an easy way of doing this is to use Xerox transparencies. If you have a Xerox machine that takes plastic transparencies, you can simply photograph backwards your chart pattern. Xerox the Dow Jones averages over the last five or ten years and then turn your transparency backwards. You will have a beautiful graphic representation of a mirror image fold back.

If you take this transparency approach with ten different market years, and line them all up vertically, you will see at a glance 4 or 5 major pivot points over the course of the year. We can then look at our normal forward moving cycles, like the 10 year, the 20 year, the 30 year and see which of those patterns give us a pivot point at approximately the same date, and will help us on the direction of the move coming out of that pivot point.

For years I was able to make accurate, long term predictions on the stock market based on these rough graphic sketches, whether they be 10 year, 20 year, 30 year composite pictures, or the mirror image fold backs. One thing which is very good about this analysis is that once you have one of these cycles that is working, they have a tendency to persist for long periods of time before you have to make an adjustment to the forecast.

On long term cycles of 10 or 20 years, it is often the case that a trend in effect will last for at least three to six months, sometimes nine months. So during that time period you will have a very accurate forecast and be right on the market with all of your trading, whether you buy every single dip or short every single rally.

I cannot emphasize enough to you how very, very valuable such knowledge is of the long term trend and how profitable it can be to you to trade with that certain knowledge.

I might allude to one important cyclic point at this time to motivate you into further research. Although many people believe the BIBLE is a document of many things, I can assure you that you will find the keys to all major cyclic themes in life hidden in this work. One example is sufficient. The key prophetic cycle is 360 days, and 360 years equal to the 360 degrees of the circle. Although we use 365.2422 days to the astronomic year, this is not so in prophecy, which is 360 days to the year. For example, Abraham Lincoln was assassinated on April 14, 1865. John Kennedy was assassinated on November 22, 1963. The time period between these dates is 98.608 years by our counting, but the actual days are $365.2422 \times 98.608 = 36016$, or if we divide by the prophetic year of 360 days we get 100.04, only two weeks off from a perfect 100 year cycle! You might want to check some stock market cycles for this adjustment factor. It might also not be a bad idea to read the Bible!

THE TEN YEAR DECENIAL PATTERN

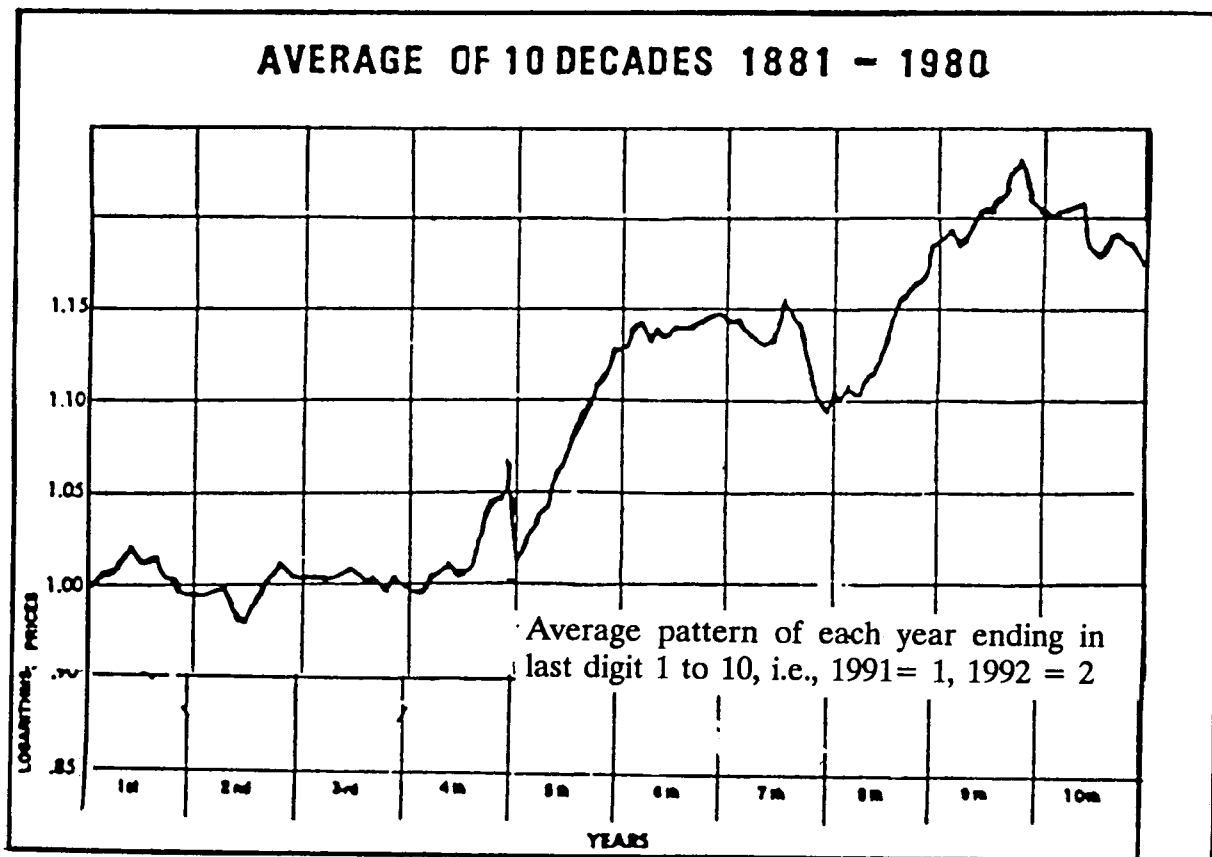


Chart courtesy of
Arthur Merrill, Technical Trends
P.O. Box 792, Wilton, CT

Chapter #11

What is a Professional?

"Professional traders are merely odds makers who speculate when the odds are all in their favor."

You will find that professional trading encompasses more than just business organization. First, there is an attitude towards speculation that it is a business, not a gamble, not a crap shoot. More important, it is a belief that it is a legitimate business, a profitable business, where money can be made month after month, year after year consistently, in good times and bad. Much of this has to do with what I call a professional attitude toward investing.

This attitude is exclusively risk oriented. The professional trader has to make money. He cannot be subjectively biased by his belief, by his value system, newspaper articles or peer pressure. He must have an overriding concern for losses and being wrong on the direction of the market movements. Making money is never a problem, taking profits is not a problem, but a true professional especially knows how and when to take losses.

A professional also trades slightly different than the average retail brokerage firm customer. Often the word "professional trader," designates people who either own seats on the various stock exchanges, or have agreements with business partners who own such seats. The advantage, of course, of owning a seat on the stock exchange is that you do not have to pay commissions. However, there are usually minor service charges, called clearing charges that must be paid for clerks to process the order, write up the tickets, and submit them to the computerized clearing firms, but these are token charges.

For instance, if you buy 1000 shares of IBM, you may have a ticket charge of between \$2 to \$3, to maybe as high as \$15 in total. This would be the same charge, whether you bought 1000 shares or 10,000 shares. Because of this low overhead, without commissions, professionals, who have a business do have an advantage over the public. Buying 1000 shares of IBM and seeing it go up 1/8 of a dollar, which is a \$125 profit, a professional is free to sell the stock, and with very small ticket charges realize almost the entire gain. The average person who uses a broker, might have to pay 10, 15, maybe 20 cents a share, each side of the buy and sell in commissions. He is literally incapable of making a profit on only a 1/8 fluctuation.

Nowadays, with the advent of discount brokers and deep discount brokers, much of this has been eliminated. There are many brokers, who advertise in newspapers on a nationwide basis stock com-

missions as low as 1 or 2 pennies per share, and most will certainly do business at 7 to 10 cents per share. So the professional trading advantage that insiders and members of the stock exchange used to possess, has largely been eliminated, as a barrier to professional trading for a living.

There are other advantages professionals have, such as capital requirements. In many cases, owning a seat on the stock exchange floor allows you different margin requirements than the average public. Sometimes becoming registered as a market maker allows you even more privileges.

By and large, what this book is about **is professional trading techniques and secrets as to entry and exit points into profitable trades.** For most purposes, commissions are no longer a consideration, nor is leverage. The public can often times use options or financial futures and acquire leveraged positions for as little as 10 percent down or less.

In professional trading, time horizons are much shorter. To a professional, every month is like a year, every week is like a quarter, every day is like a week. A professional will almost always make money every month. He will have an occasional losing week and he could have several losing days, but by and large if a professional starts to lose money he will stop trading. He will cut down on his trading size until he becomes profitable.

I have often seen professionals who trade 1000 to 5000 shares of stock a day, who, if they start to lose money, will cut their trading in half. One professional I know, who trades often up to 5000 shares a day, if after 2 or 3 days of losing money, will cut down his positions to as small as 100 to 500 shares until he consistently starts to make money again.

This is a good principle to follow, as often our own internal cycles are detrimental to our own profitability. It is then that our rigid discipline, our technical tools and our professional attitude towards losses, saves us.

Professional traders are merely odds makers. You can never be absolutely certain, but you can speculate when the odds are all in your favor. This is the big difference between gambling at Atlantic City Casinos, and trading in the speculative markets. In gambling, you are taking a risk, in the stock market you are also taking a risk, but you are taking a risk when all the odds are in your favor. You are free to pick and choose what the trades will be, and how you want to stack the odds.

Do you want to wait for a near certain trade, a 90% probability, or are you willing to take a small probability of only being right 60%? The best trades have the probability as high as 90% of being right on the main trend, and also have a high probability that the direction and momentum of the movement will be so extreme that the profits will be large. It is one thing to be 80% right on a trade, and only having the prospect of making \$1 on an individual stock, and another being 80% right on the direction of the trade and having an 80% probability that the stock will go \$10 to \$30 in that direction.

The professional spends most of his time setting the odds on how he will play. He does not allow

news events or peer pressure or other items to set the odds or the rules of the game for him.

When you are consistently around Wall Street, employed as a professional, day in and day out, there are many fringe benefits. The most obvious, and the one overlooked by the public is the opportunity benefit. There are times over the course of the year by just having the right of being at the Stock Exchange when an explosive move in the market gets under way, that people connected with the market will make unlimited amounts of money in a short period of time. Those people who happen to be school teachers or construction workers or in other areas of life, do not have that opportunity. They can only read in the papers several days later that the market was active.

A professional trader learns to recognize opportunity. When opportunity presents itself a professional will act. It is a crime to be a professional trader and see a major move underway and not do anything about it because of fear of taking a loss. A professional, usually follows the trend quite quickly and is quite happy to be stopped out of the trade at a small loss, if he is wrong.

Another characteristic of professionals is that they employ strategy. Most of the public being fundamentalists, have no strategy at all. They merely think something is going to go up over time because of some fundamental development, and everything is thrown into the pot known as long term investing. The professional trades all the time and only short term. He never trades for long term capital gains, and he is never concerned about tax consequences. Money is money, profits are profits, and whether you pay 10% tax or 90% tax, if you have a profit, you have more than you had the day before.

Therefore, the consideration that the professional has is how best to exploit the opportunities that present themselves. Does he want to be a Bull or a Bear? Does he want to buy the dips or sell the rallies? What is the best way and the best vehicle to employ such a strategy? Does he want to use leverage, options, futures? Does he want to pyramid? What are the active markets, stocks or commodities? A professional cannot afford to tie up his money in idle stocks or commodities that are not moving. His cash flow must pay his bills. He cannot buy a great quality stock that is just lying dormant. He must restrict his investment activities to big movers.

Because of this, the professional has no need to catch the high or low "tick". He is merely interested in making a consistent profit in the middle. Although the techniques in this book teach you how to find the high day and the low day and to predict the cyclical changes in the market, these forecasting tools are of use only for setting your trading strategy. Professional trading itself is a highly specialized, disciplined activity and forecasting has nothing to do with it.

Once you make a trade, and you are in it, profit and loss is the only consideration, not the forecast. The forecast is used to set your strategy, of being a Bull or a Bear; setting the odds as to the probabilities of success, the magnitude of the success, and watching the tape activity based on that forecast, to see if the technical conditions and the tape validate the strategy.

Professional trading strategy is a lot like poker playing. Professionals are constantly watching the other players in the market, be it mutual funds, the public, well known television commentators, or

any other force that has an influence on the market. Themes and group cyclical activity must be considered. If one group is showing weak earnings reports, professionals will develop a strategy to short the stocks prior to earnings announcements. If the market is mesmerized by economic statistics being released at recurring intervals, professionals will not trade around those intervals where there is little likelihood of major movement, until the figures are released.

A professional will usually let the market tell him when it is time to change. He will exploit a specific strategy until he loses money. That is, he will buy a dip, day after day, after day, as long as it is profitable, and the first time he starts to lose money he will change his strategy. On the Bear side, he will short a rally. The public on the other hand will often buy a dip once, take a quick profit, and immediately start shorting rallies. They will get confused as to the long term trend direction.

A professional trader knows that making a living in the stock market is hard work. That in reality, it is like a game, and that you must know the rules of the game. The rules are not variables. The rules say, buy or sell, you win or you lose. The idea of the game is to lose as little as possible, not to make as much as you can. If you try and make as much as you can, you are going to have large wins and large losses. The rules say, **lose as little as possible and you will win consistently.**

The public does not know such rules exist. The public invests for long periods of time under the accepted notion, that it is okay to lose money. It is okay to lose 20%, 30%, 40% over six months, because in the long run, the market always comes back. This is absolutely ridiculous. There is no such thing as investing over the long term unless it is profitable positions day after day, week after week, that are making money. Simply investing and holding stocks in a losing position, is just plain stupid.

I learned a great lesson starting off in bank trust departments. I had first hand experience in looking at very wealthy people's accounts over 20, 30, 40 year periods and seeing that often, people owned a stock that went from \$10 to \$200, \$300 to \$400 dollars, and split many times, and made them infinitely wealthy. However, as time went on they could do nothing about their holdings, but watch them go up and down 20%, 30%, 40% every couple of years, because of the huge and steep, onerous tax burdens. Many people had an adjusted tax basis of a fraction of a dollar.

In the final analysis, it was always that they could not sell because they would have to pay 20 or 30% of the stock's value in taxes, and unless the market was going down 20 or 30% it made no sense to sell. The lesson from this is, pay your taxes currently. If you want to keep a position over 20, 30, 40 years, buy every dip every time it breaks out, make certain you buy your position back but do not blindly buy and hold and be afraid to sell because of the tax consequences. People can get guaranteed income of 7 to 9 percent on a long bond. What is wrong with short term trading profits of 40%, 80%, 100% per year and paying taxes on them?

Professional trading is a humbling experience. You must be capable of trading without personal pride, dignity, inability to admit defeat. Being wrong is part of the game and being wrong many, times is expected. No one can be a successful trader unless they have taken many, many losses. It is the magnitude of the losses and how quickly they are taken, which is important.

The professional trader, more than anyone else, learns from his losses, his mistakes, not his winning trades. The public only looks at their winning trades, and how successful they were, and ignore their losses out of shame. The professional studies his losses and vows never to have them repeated.

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Chapter #12

Professional Trading

"You must be 80-90% right on the primary direction but also 80-90% right that your sale at a specific profit goes off."

Professional trading differs from investing in many regards. To the professional trader the most important consideration is not profit or how to make money, but losses and how to avoid losing money. As I have said before, the only thing easier than making money in the stock market is losing it.

From the professional standpoint, the trader does not care how big his gain will be, or how long it takes to get it, or if he is right or wrong. His only consideration is not losing money. To the professional trader opportunities come every day of the week. The professional is a technical trader. He knows how to read the tape, he knows how to pick stocks and there are thousands of opportunities to choose from. He is somewhat similar to a professional odds-maker in gambling. It has often been said, that the difference between gambling and speculation is that in the case of speculation, you are taking a **risk** when the **odds are entirely in your favor**.

Being a professional odds-maker, a professional trader only takes those trades when, in his judgment and assessment, the market conditions, fundamental, technical and all the tools of his trade, show the odds are probably 80% to 90% he is right in the direction of the market and the trade. However, more important, if he makes the trade, what kind of risk is involved and when he can get out of it if he is wrong, and how much money will he lose if he is wrong.

There are many times when the professional trader knows exactly what the market is going to do and will refuse to make a trade. He may know the market is going up another twenty points to an all time high. However, if the assessment is such that in that final twenty points something could go wrong, and the market could suddenly reverse on him, the risk factor involved in being wrong or having an accident happen is far too great to make a trade, so he will let the trade go by and not trade at all. This is a consideration that entirely escapes the average person who is not used to making money on a professional basis. The average person has been duped by the large brokerage firms into **accepting losses**, in the belief in some distant, "**long term**", investing horizon, where all investments eventually workout fine.

Remember, the professional trader makes a living exclusively from capital gains month in, month out. He must make money every single month that he trades. He may occasionally lose money on a day to

day basis, a few times a year lose money on a weekly basis, but he will rarely lose money on a monthly basis. This is due to his ability to weed out the bad trades and only trade with all the factors in his favor. More importantly, he has an exit point that is clearly defined as to degree of risk, amount of money, and amount of time it takes him **to find out if he is wrong**. This is **all done before he makes the trade**. Many good professional traders I know will often watch the ticker tape all day long, for days on end and never make a single trade. **Learning how to do nothing is a very important trait. Knowing when not to trade is often much more important than knowing when to trade.**

For instance, when the market is in a trading zone bound by heavy resistance just above, and major support just below, and is neither going to break out to the upside nor break down dramatically to the down side, and there is significant economic news that is being released within a day or so, such as a GNP report, trade balances, options expiration, or Presidential speeches or trips, trading would be curtailed significantly rather than gamble.

During these times the professional trader knows that the opportunities for a major move in the stock market are quite limited. Therefore, trades made during this time period are subject to frequent whipsaws, small gains and lots of random noise. If one decides to trade in such an environment he must adapt his strategy to very short term scalping. Buying on the bid side, immediately offering it for sale 1/4 point higher, not expecting \$2, \$3, \$4, on some big move.

Often times the technical analysis will tell us what these opportunities are. If we are near a major trendline we know that we are probably not going to go through that trendline, and if the **market is just too overbought or oversold to penetrate** that trendline in the other direction, or bounce off it, then the probabilities are not good in making the trade.

Another factor in assessing risk versus reward is that a professional understands the amount of leverage to take on any one trade. When there is significant potential in the stock market, such as a major basing period over weeks and months, or economic conditions have suddenly changed unexpectedly to the better and the stock market breaks out of a trading range, then more leverage would be considered. This type of opportunity is immediately seized by the professional, where not only are the probabilities good for trading with the primary trend but one may use leverage, such as options and financial futures to double and triple one's normal position and get a very large profit with a reasonable amount of risk.

Most other times when trading probabilities do not exist, leverage may be totally inappropriate to the professional trader who must be 80% right on the trades he picks. Being right 80% of the time, as to the direction of the market, is not an advantage if you use leverage inappropriately. A highly leveraged position that goes against you 20% of the time when you are wrong on the direction, can still destroy your overall performance over the course of a year.

To a real professional trader it is usually discovered that his true rate of return is made in three or four spectacular trades during the year, when the stock market spends six weeks going in one direction, i.e. 200 points. The rest of the year is spent entirely keeping out of trouble, breaking even, and a lot of small scalping trades.

The opportunities for large money rewards and the use of leverage do not exist everyday. This too is a distinguishing characteristic that the professional knows how to assess but which the average public investor has no conception of. To them, the equal probability of the market going up or down any one day is the same. **They do not know that major moves only happen 2, 3, 4 times a year at most, and they do not know how to recognize major moves.**

The professional knows that when a major move exists, and he recognizes it, he must do something about it. For that is what being professional is all about...**seizing the opportunity when it happens.** This is where our knowledge of historical measured moves comes in and **what is normal market action and what constitutes abnormal moves.**

Since there are so many opportunities in the stock market to make money, the professional trader is never emotionally attached to any one trading vehicle or stock. He learns to risk his capital in the most attractive markets. When stocks are dull and there is no hope for a major turnaround, his attention might be focused on soybeans, gold, foreign currencies or bonds, but he will always try and keep his capital employed in the most active tradeable markets and avoid the quiet ones.

He tries not to have a personal, subjective bias to any one particular trading vehicle, such as gold. Even though he may think the long term outlook is very clear, if there is no volatility on the tape, he learns not to waste his time and his capital trading it now. The big money is made investing with the main trend, well off the lows and well before the highs. That is where most of the easy money is made by the professional.

Professionals treat stocks, commodities, options like a grocer would heads of lettuce. The produce truck comes almost every day and dumps off a major shipment. If you buy a head of lettuce, let us say for \$1, you are not looking to sell it for \$1.30 or \$1.50, you are looking to sell it for \$1.10 or \$1.15 and to sell quite a few. The professional trader treats stocks this way. 1000 shares of IBM bought in the morning up 3/8 is \$375. A professional might make that single trade 3, 4, 5 times in a single day, trying to scalp out 1/4, 3/8, 1/2 and maybe net out \$500 to \$1000 every day on a 1000 share position.

I have known many option players, who only trade 20 or 30 options, which is the equivalent of 2000 or 3000 shares. They buy the options at \$1 and no matter what they think about the prospects for doubling, tripling, quadrupling their money, they offer it for sale at 1 3/8 of a dollar. The **probability of being successful** in that trade is very great.

Professionals can usually tell the direction of the market and if the stock will go up \$1 or \$2. If they don't try and get the maximum out, they will probably be 95% right and they can get a minimum fluctuation of a 1/4 or 3/8. If you buy 30 calls, (3000 shares) and make 3/8 on it, you are making \$1000 a pop. If you can further be 90% to 95% right when you do that...it does not take a rocket scientist to figure out that your money adds up very quickly!

That is not to say that the professional will deliberately turn down a much larger profit if trading conditions warrant. In a major blast off of a new Bull Market, where the breadth is spectacular and the

market is going up 50, 60 points per day, and the average glamour stock is going to be up \$2 or \$3 at the end of the day, it is not reasonable for a professional to look for 1/4 or 3/8. A professional at that point would buy 100 call options (10,000 shares) and sit on them for up to three days and get \$2, \$3, \$5. However, those opportunities do not come everyday.

For the day to day opportunities, it is always a function of the highest percentage batting average, trying to get wins of 90%, 95%. Even though they are small wins, small percentages add up tremendously when you have many, many trades. Just like the grocer who sells truckloads of lettuce, marked up at only pennies, it adds up to big money when done in volume. In the final analysis, the professional trader/odds maker has two probabilities to calculate:

- 1 - The probability of direction.
- 2 - The probability of making x amount on the vehicle he has chosen to trade the trend with.

In other words, you must be 80-90% right on the primary direction but also 80-90% right that your sale at a specific profit goes off. Being right on the move but never realizing the profit because the move wasn't big enough can be a real disaster. This is another very important distinguishing characteristic that separates the professional from the public...**knowing that banking a successful trade is more important than being right!** Strategy is used to fix the odds that put the most winning trades in the bank.

Remember, once you are in a winning trade with a profit, your odds automatically start to decline from 90% to only 50-50% after the run. You must have a strategy to bank the profit before that 90% trade becomes a badly executed nightmare. Because of this, almost all traders have a rule, to use a stop loss but never a stop loss that results in a loss after a profit has already been achieved. If you lose on a trade, it should only be because it went against you from inception and you were stopped out at your predetermined risk level, not at a loss after a good profit run that was not taken!

Chapter #13

Common Sense Trading Rules

“A good way to identify new leadership in the stock market is to daily observe individual stocks when the market makes a new move either up or down and see if they are following the move of the averages”

Division of Capital is the most important trading rule. A professional trader never employs all of his trading capital on any one trade. A large fund manager may diversify his portfolio and have a great many stocks at one time, and thereby diversify his capital, but in the usual case the professional trader puts most of his eggs in one basket or very few baskets and watches them very closely.

However, in those few baskets he does not employ all of his capital. Most frequently great traders will tell you they only put 3%, 5%, 10% of their capital on any one trade, especially when using leverage such as options or futures, where you are only putting 10 to 30% down. In these cases the profit is most likely a double, triple or quadruple and even though it is only a small fractional part of your total capital, the rate of return is substantial and quickly builds up.

If one were to use a 10th division of his capital he could afford to lose 10 times in a row before he was out of business. Most professionals have a batting average of 60-80% right, and when they are wrong they stop themselves out for small losses. It is the **compounding of many small profits** that add up in professional trading. Therefore, the professional trader only uses a fractional part of his capital in his trade. It is not uncommon to find the largest proportion of capital unutilized, sitting in cash or in T-bills as a reserve.

Trade with the Main Trend is the second most important trading rule. A trend that has a daily, weekly, monthly, higher bottoms formation is the bull trend and the “*stair step*” lower highs and lower lows is the bear trend. Trading with the main trend is the objective. The old saying applies “***When in doubt, get out.***” If you do not know what the trend is do not trade.

In regard to the trend, stocks that hit new highs for the year are strong stocks by definition and you should never try to short new high stocks. In theory, a stock that hits a new high is the strongest stock there is and you **should buy breakouts to new highs**. If you are going to sell short you should not sell short new highs but you **should sell short new lows**. New lows for the year are made by stocks that are in trends that are very weak.

The average person's classic mistake is trying to short high price stocks and trying to catch the final high. In a long term bull trend, new highs are made every several days and each one of those cannot be the final high. Only one day can be the final high and that long term trend may last for years with many, many individual days of new highs. It is insane to try and short stocks that go to new highs. The trading strategy should be to buy on dips stocks that have recently gone to new highs and to sell short stocks on rallies that have recently hit new lows for the year.

This brings up the concept of **relative strength**. All stocks are not created equal, some stocks are stronger than others. The professional trader should seek out stocks that are stronger than other stocks. He should be long the stronger stocks and short the weakest stocks. **The steepness of the trendline angle tells you the strength of the individual stock.**

A stock's strength can be relative to its own recent past history, such as its 10 day, 30 day, 50 day moving average, or it can be relative compared with other individual issues. When compared to other issues, the relative strength stock is first compared to the market average. If the market average goes up a certain percent, the relative strength stock should go up during that time period a greater percent.

A good way to identify new leadership in the stock market is to daily observe individual stocks when the market makes a new move either up or down, and see if they are following the move of the averages. For instance, if the Dow Jones has a break and drops a significant amount, lets say 5% over 3 weeks, and the individual stock you are watching goes sideways over that 3 weeks, you would want to make a list of such stocks to see that on the next Dow Jones advance if those individual stocks advance. If they do, having not first declined, it is a sign of great relative strength and a sign that they will far out perform the market averages and all other stocks on the ensuing move. Those are the stocks that should be bought.

Another technique to keep in mind, is at major impulse wave breakouts of market averages, such as the beginning of new Bull Markets, you should keep a list the first week or two of the greatest dollar gainers, stocks that to up \$3, \$4, \$5 in a single day. These stocks should be bought, they should not be avoided because they seem expensive. They are only expensive because they are on everybody's buy list and are the relative strength stocks.

Every fundamental analyst in the country has his private list of what stocks to buy when the market moves and these are the ones the big money will power into. You can usually identify these popular stocks on the initial impulse wave only. After the first few weeks of the rally the rest of the market averages go up and down and rotate. You will usually find that the stocks that go up the greatest amount the first few days of the move are the ones that are on everybody's shopping list, and will continue to go up week after week, month after month for quite some time into the future.

There are a number of price patterns that are quite common in professional trading and useful to know. The most important is the **daily and weekly patterns** in Bull Markets and Bear Markets.

In Bull Markets - the beginning of the week, Monday, opens strong and follows into Tuesday.

Then a counter decline sets in, a correction, with a weak Tuesday afternoon, correcting into Wednesday and then by Thursday the market is in a strong up trend and on Friday, closes the week at the extreme high of the week. This strength follows through again for Monday. This is the classic **Bull Market pattern strong on Monday into Tuesday afternoon, pullback Wednesday, into Thursday; Friday Monday strength.**

In Bear Markets - expect just the opposite - weakness on Monday into Tuesday, midweek counter cyclical rallies, failures on Thursday with a weak close on Friday followed by a weak Monday.

These patterns are quite reliable and one should adjust their trading strategy on a weekly basis, to buy on the dip on Tuesday or Wednesday midweek and sell into the strength on Friday afternoon or Monday on a Bull Market pattern. On the Bear Market pattern you want to short the rallies on Tuesday, Wednesday and cover on the decline Friday afternoon and Monday.

Short Term Daily Pattern - each and every day is a reflection of the larger weekly pattern with each hour during the day being likened to each day of the week. Therefore, the first hour, which I usually use 11:00 AM rather than 10:00 AM, is 1 1/2 hours. The first hour into 11:00 AM is equivalent to a Monday.

In a bull trend you would expect a strong opening up until 11:00 AM or 12:00 PM, a midday pullback from noon to 1:30 PM to as late as 2:45 PM, strength in the afternoon with a strong close from 3:00 PM to 4:00 PM to follow through the next day. This is your typical strong day Bull Market pattern. Note the emphasis on the first hour strength and the last hour strength and in the weekly charts the Monday strength and the Friday strength. Strength early and late in bull trends, weakness in bear trends.

In the bear trend the daily pattern is just the opposite. Down hard into 11:00 AM, counter rally mid day and then after 2:30 PM weak finishes with weak openings next day. Individual stocks are traded the exact same way on these patterns. Stock that are often strong and break out do so around 2:00 PM in the afternoon with a strong finish and usually top after the opening the following morning. Then they have an intraday correction, where they pull back to just above where they came from yesterday and then close strong again.

It is often good to find stocks that are in long term up trends and look for the dips intraday. If you find a stock that has been down all morning, strengthens around 2:00 PM in the afternoon there is a good chance that it will close strong, reversing the trend and carry through that strength for the next several days. Likewise, in Bear Market patterns, shorting should be done on any strong movement but more than likely midday rallies from noon to 3:00 PM, expecting the failure to occur 3:00 PM to 4:00 PM and covering on the close or the opening plunge the following day.

Opening and Closing Patterns - are of key importance, even more so, than the daily patterns, especially in the financial futures. These are known as **opening bulges** and in the financial

futures markets, the professionals who really know what they are doing, use a lot of leverage. They are **almost always right on the main trend** of the market.

However, because of the leverage they use and the risk avoidance of the professional trading mind, they do not like to carry positions overnight. This gives one a distinctive advantage in watching these opening and closing bulges. If the S&P Futures or the Bond Futures gap open quite strong everyday, even though they seem to be fading at mid day, the opening bulge usually shows you that the professionals are committed to the long side of the market and the daily trend and the weekly trend is probably up. Therefore, any pullback intra day should be bought and right on the close, which will be strong, there will be a sell off. That sell off in the case of financial futures is not necessarily indicative of a reversal in trend but just the day traders liquidating.

Likewise, in bear trends the opening bulge is to the downside, where the professionals go short as soon as the market opens and very late in the afternoon cover shorts to put them out again the next day.

In terms of statistics, 70% to 80% of the time the **extreme high or low for the entire trading day** is usually made in the **first 20 minutes** of trading in the financial futures. Therefore, if they open up and go up dramatically in the first 20 minutes and then in the ensuing next hour are still up on the day, the chances are overwhelming that the **extreme high or low** was the opening **low**. That being the extreme you would want to buy pull backs during the day, expecting the market to close at the extreme high.

If the opening bulge is to the downside, you could have the extreme high of the day being the opening quote. If the opening quote is never regained after the first 20 minutes, then any rally in the day should be shorted with an expectation of an extreme weak close. If the financial futures gap down big and after the first 20 or 30 minutes come back and start to close the gap and **never approach** the opening low, then one can assume that the **extreme low** was made for the day and any **dip intraday** that does not take out that opening low, **should be bought** with the expectation of a firm close near the high of the trading range.

Financial Stocks - professionals watch the financial stocks, particularly the banks, and the go-go over-the-counter glamour stocks. Prior to every big Bull Market move there will be strength in the bank stocks and over-the-counter stocks. The bank stocks always show strength because there is a high correlation between confidence in the financial system and low interest rates and good banking conditions. In the over-the-counter market there is strength because over the counter stocks are always heavily shorted.

Because of the fact that the trading rules allow over-the-counter stocks to be shorted, **without regard to the up tick rule** that was established by the SEC on the New York Stock Exchange, that requires a short to only short a stock at a "zero plus tick," or only short a stock that did not go down on the previous tick, this has the effect of eliminating a lot of short sales on the New York Stock Exchange when the market is quite weak. Those who wish to short stock must wait for legitimate strength in order to get a short off.

In the over-the-counter market, no such rule exists (although changing this rule is in discussion at the time of this writing); anyone who likes to short stocks may simply sell at the bid side of the market, thereby guaranteeing getting a short off. Inexperienced traders who are greedy and impatient, will not wait to get their short off on the New York Stock Exchange, but will pick on over-the-counter stocks and indiscriminately hit the bids. Therefore, when the market is prepared to rally, the first group that feels the pressure are the most heavily shorted stocks. These will always be the over-the-counter stocks.

So when one sees a firming of the market, with both the over-the-counter stocks all nudging up and the bank stocks firm, it is almost always a certain sign that a major move is about to take place to the upside.

Divergences - watch for cycles that exist in the market that appear simultaneously in similar groups. That is to say, in a bull trend, bonds and interest sensitive vehicles show strength and the market shows strength likewise. One should be cautious though, when one market diverges from the other, such as bonds down on the day, but stocks up or bonds up and stocks down. This may be the beginning of a change in trend, and unless one has real conviction he should limit his trading to smaller positions until the condition cleans itself up.

A trader will always be long in the market when the S&P stocks are up, the financial futures are up, the stock market is up and the bonds and the bond futures are up. When there is across the board strength there is a high probability that that is indeed the main trend.

Along with bonds, as relative strength vehicles, one might also watch the U.S. Dollar. There is usually a good correlation between the strength of the U.S. Dollar, the strength in our bonds, and the strength in our stocks. The stronger the dollar the more attractive it is to invest in U.S. equities, in U.S. denominated assets by foreigners.

Likewise, almost all financial panics start with weakness in the dollar, followed by weakness in bonds and then weakness in stocks. Divergences can also appear within various market averages. One would like to keep track of the Value Line, the S&P, Utilities, the Transports and the Industrials. If all those indexes are all going together the primary trend is well defined. The primary trend may be undergoing a change or be questionable when several of the various market averages start to diverge. Especially when making new highs, one must be on the lookout for one or more of the market averages, to not go to a new high in unison with the others. This will be your first warning that after a technical pull back and then another rally there may be many more diversions and that second rally may be the final top.

A primary consideration in looking at the divergences is breadth divergences with the market averages. During the course of the day the advance/decline line should have a healthy plurality of advancing stocks over declining stocks if the trend is up and the market averages are up.

In such a situation you would be long the market. You would take a cautious stance however, if the

breadth was even or negative and the market averages were up due to strength in a few selected glammers. Such a circumstance of diverging breadth with the leadership confined to a few individual stocks is a real sign of danger.

One rule I follow, that is helpful in defining the trend, especially in regards to relative strength and divergences, is to watch opening bulges in the market averages, such as a market that opens up 12 to 18 Dow points or opens down sharply 12 to 18. **The character of the makeup of that point count in the Dow Jones averages is very important.** For instance, in a Bull Market trend where the market opens up strongly 15 or more, there should be at least 1/2 dozen to 1 dozen of the glamour stocks that are up 7/8 to 15/8 in the first half hour of trading.

One merely looks up the biggest advancing stocks. Ideally if you have a computerized system and you can scan the top 10, 20, 30, 50, or 100 stocks, so much the better but you should look for big price movements, price movements of 7/8 of \$1 or more to legitimize the trend.

In **false trends** where the market opens up 15 and it consists of the top 10 or 20 stocks simultaneously, being up 3/8 to 5/8 of a dollar and **no one issue** being up as much as \$1, it is almost a certain sign that this is a specialist markup opening that should be shorted and a reversal will shortly follow.

Markets that go up 20, 30, 40, 50 or more in a day almost always have several dozen stocks up at least \$1 or more by 11:00 AM. Markets that go up for 1 hour and reverse and close weak almost always have **high average point counts**, but very few participating individual issues that are up more than \$1.

This is also true in the opposite. On a big down day you should look for many stocks down 7/8 to 15/8. If they are all down, but only 3/8 or 5/8 of \$1, this is a sign of tremendous strength and the market averages will shortly reverse as each of these individual stocks reverse their trends. Keep in mind that this principle is based on the fact that there are cyclical influences in the market. True cyclical influences show up in broad based statistics, such as breadth and price movement. If you see an opening bulge in the market and the breadth is strong and it follows through in every average, every vehicle such as bonds, stocks, futures, foreign markets, one can be assured that this is of a **cyclical** nature and that the primary trend has emerged.

News item bulges and random events due to basket programs often take place within diverging backgrounds. Foreign markets up or down, individual commodities up or down, breadth so-so and price structure modestly higher or lower. In these types of trading patterns there is no clear trend and there is no trade to be made until the trend emerges.

One should also consider the correlation between volume and price action. Ideally a rising stock should have rising volume or accumulation. This is a general principle, it does not apply late in the rally phase or late in the Bull Market. If it is late in a rally phase, after several days or weeks of advances, and then volume comes into a stock, it is almost certainly indicative of a top and distribution.

Likewise, in the last several years, whenever the Dow Jones Averages hit 200 million shares or more after a prolonged period of average trading volume of 130, 160 million shares, the high volume always marked the top day or the top was one day later. Also in a bull trend, a decline that results in lower and lower trading volume usually shows a heavy volume reversal day, and if one charts volume and price action and sees a consistent pattern of declining volume on a declining market and then a reversal pattern day with an up market on heavy volume, one can be certain that the trend has changed to the upside.

The biggest generalization I hear all the time, that I consider false, is that volume is bullish. It is only after a liquidating market has been declining for quite some time that big volume comes into the market on advances and is quite bullish. Most of the time however, unusually large **volume is always indicative of an approaching top**. Resistance is being met and many transactions are taking place because there are sellers and buyers equally matched. You can have many extended moves on very light volume either up or down without changing the trend, but when large volume transactions come in, in a rising market, it usually checks the rise and there will be a sign of a top.

Another time tested saying is that **distribution is done after the top is in**. This is why volume is usually Bearish. Let's say the market breaks big and starts to rally back in a few days. Many financial commentators see the large volume on the rally and say it is bullish. The truth is that the large pension funds and mutual funds that have multimillion share positions must wait for the bargain hunters to show up to sell into them. This is most clearly seen in individual issues that have broken down. The only way to know for sure is to watch the issue several days later after the large volume rally day to see if the stock is then lower in price. If it is it is almost certainly being distributed and should be shorted or avoided.

Chapter #14

Ten Trading Tips to Make You Rich

TRADING TIP NO. 1 - BASIC TRADING CYCLES

The most fundamentally basic trading cycles in the stock market are the 3 1/4 week and 6 1/2 week cycles. This is based on the fact that the natural year has 52 weeks and the primary divisions of 52 weeks are 1/8th and 1/16th (52 weeks divided by 8 = 6 1/2 weeks, 52 weeks divided by 16 = 3 1/4 weeks). (See *Figure 15*)

All longer term movements in the market are just these basic cycles strung together. You should start your count of the cycle from any major high or low on the stock that you are following. Take the high and low price and measure over 3 1/4 weeks and see if the market reverses. If the market continues strong into the 4th week be assured that it will continue in that direction until at least the 6 1/2 week cycle.

At 6 1/2 weeks, look again to see if you might have an extension of another 3 1/4 weeks, but by and large almost all trading stocks either go 3 1/4 weeks or 6 1/2 weeks from high to low. Consequently there is no such thing as a 2, 4 or 5 week cycle.

TRADING TIP NO. 2 - BUY AND SELL REVERSAL BAR SIGNALS

On any standard bar chart where you are charting price action, there is a range on the daily bar chart. These could be hourly charts, 15 minute charts, daily charts, weekly charts. It does not matter, for as long as it is a typical bar chart there is a range. A line is drawn from the low of the day to the high of the day which creates our bar.

A trend, such as an uptrend, is usually defined by each of our bars where each day the high of today's bar is higher than the preceding day's high, and the low on today's bar is higher than the preceding day's low. A series of bars like this is an uptrend.

The buy, sell signal occurs when we have a trend, such as an uptrend, and on the highest day we note the low of that high bar. The signal does not come until at least the next day. The next day after the top

will be indicated by a new bar that **does not have a higher high** than the preceding day. It must also have a **lower low**. The sell signal occurs when that bar or the subsequent bar goes **lower than the low of the highest bar recorded** in the move so far.

For example, let's say the market has gone up six days in a row and on the 6th day you have a range bar. On the 7th day the market goes sideways, it does not exceed the high of that bar on the 6th day but it does not break the low of that bar either. On the next day the market goes down and breaks underneath the low of that 6th day high bar.

At that point you get your trading sell signal. That is the point you sell out your longs, go short the market and put a stop loss in at the highest reading on the high bar, but usually it is safe enough to use 50% of the range of the highest bar or in many cases you can probably get away with using the low of the high bar which is where the sell signal was generated. (See Figure 16)

Often times after a sell signal is generated in this fashion, and the market declines for several days, it will rally up and fail exactly at the price which was the low of the highest bar, where the **sell signal was generated**.

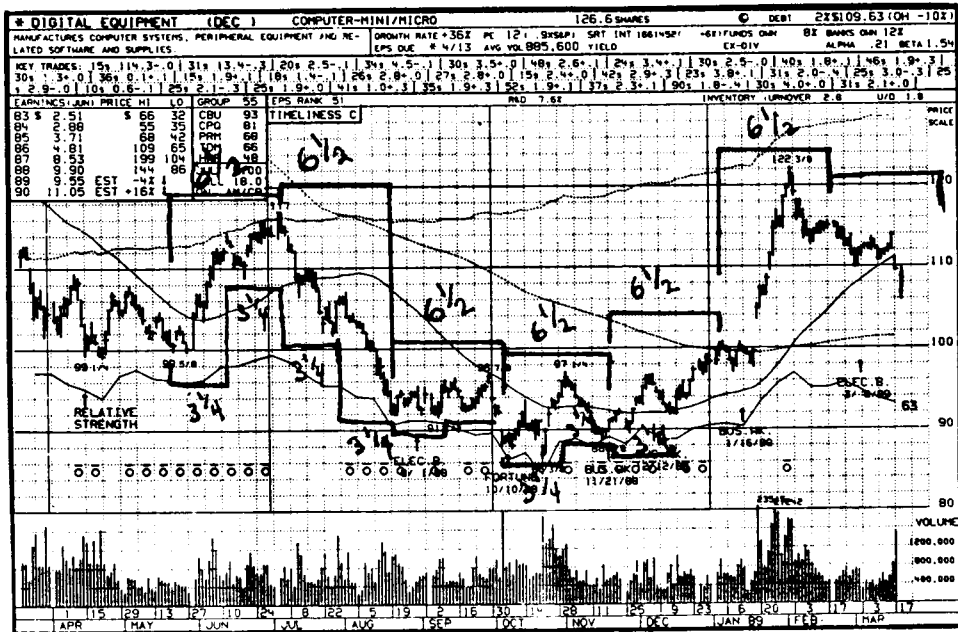
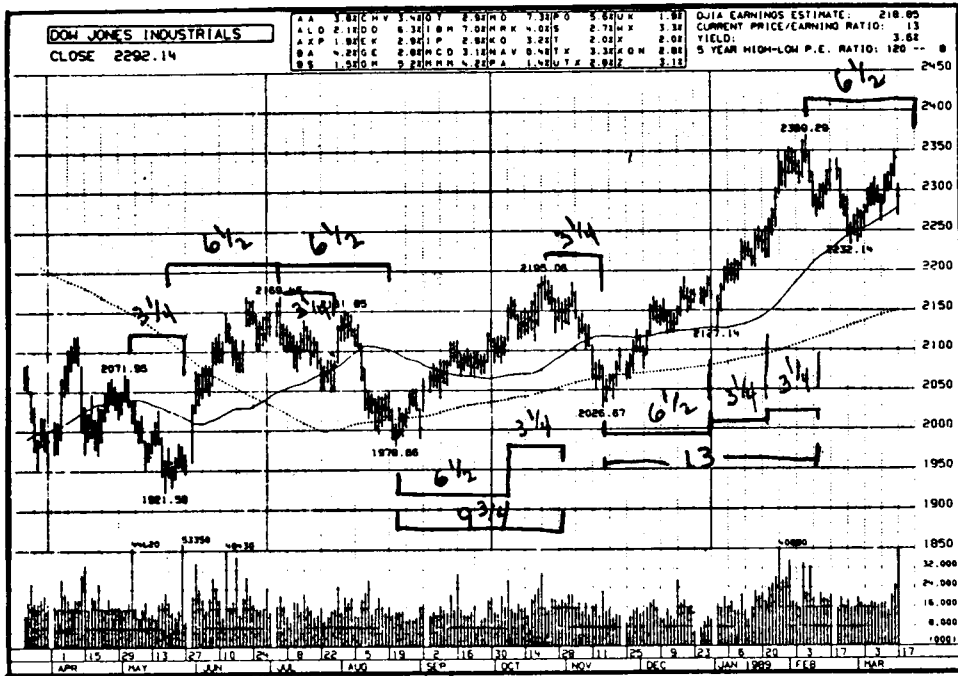
Buy signals are just the opposite. If the market has been declining and each day's bar on your chart gives you a lower low reading and a lower high between the vertical bars and you get to an extreme low, (a new low for the move one day and the next day you do not go to a new lower low) and the high for the next day is higher than the high was on the day when the final low was made, when you go **higher than the high on the lowest bar day, the buy signal is generated**.

This is when you go long the market using the extreme low as your stop out point if the market should reverse and go back down. Here too it is helpful to note that after a buy signal is generated there is usually a secondary test of that low in a few days to a week or two. On that subsequent decline, if it is successful, it will almost always stop dead in its tracks right at the **high price level of the lowest bar of the day of the move**.

These reversal bar signals are very important in the market. By themselves, they can reverse on you quite a bit and are not that helpful. However, if always watched they will at least keep you within the main trend for 5, 6, 7 days in a row before there is a chance of reversal. Likewise, if we use our trading tip No. 1, (3 1/4 weeks cycles), we can often find at the end of our 3 1/4 or 6 1/2 weeks cycle a high or low bar reversal signal. At that point it becomes much more valid and we can take the signal with confidence that the market will go 3 1/4 weeks in the opposite direction before we have to look for a sell signal.

The same principle of the reversal bar applies to any type of chart. That is hourly charts, 15 minute charts, daily charts, weekly, monthly, etc. Obviously it is important to look for long term reversals on daily, weekly and monthly charts. On a weekly chart for instance, when a bar is reversed after a great many weeks up, it usually indicates declines of several months, so weekly chart bar reversals are very important.

TRADING TIP NO. 1 - BASIC TRADING CYCLES



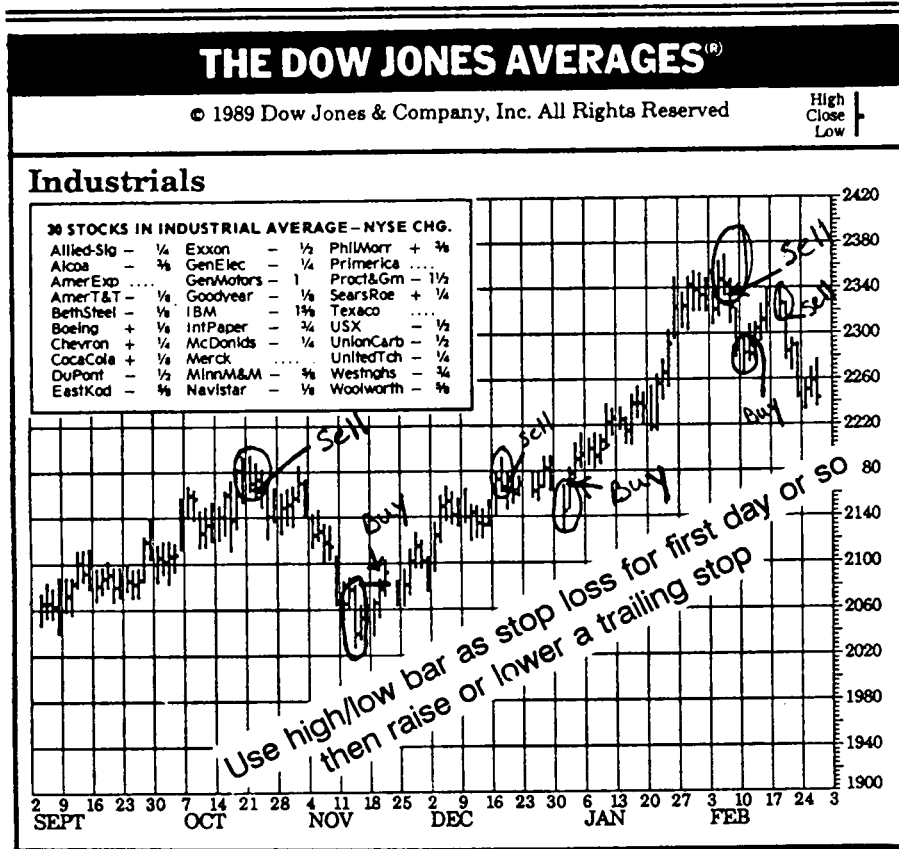
All stocks trade in cycles relating to the natural year of 52 weeks.
 The primary divisions are 1/8 and 1/16
 ($\frac{52}{8} = 6 \frac{1}{2}$ weeks, $\frac{52}{16} = 3 \frac{1}{4}$ weeks).

Longer term movements are just these basic cycles strung together.
 Begin your count from any major high or low.

Figure 15

TRADING TIP NO. 2 - BUY AND SELL REVERSAL BAR SIGNALS

This same principle applies to any type of chart i.e. daily, weekly, hourly, etc.



The market generates a buy or sell signal when the daily range on the highest or lowest day is exceeded on the following day. For example:

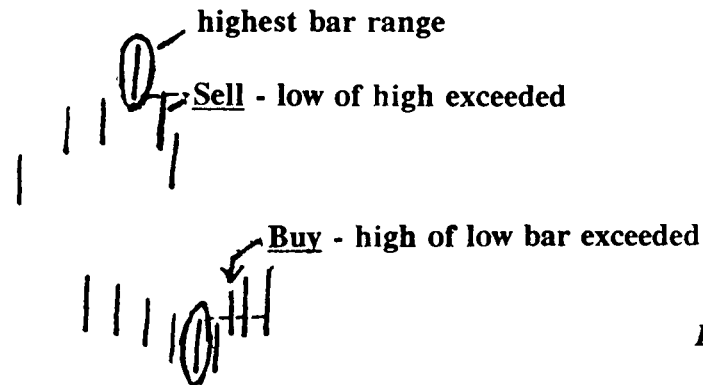
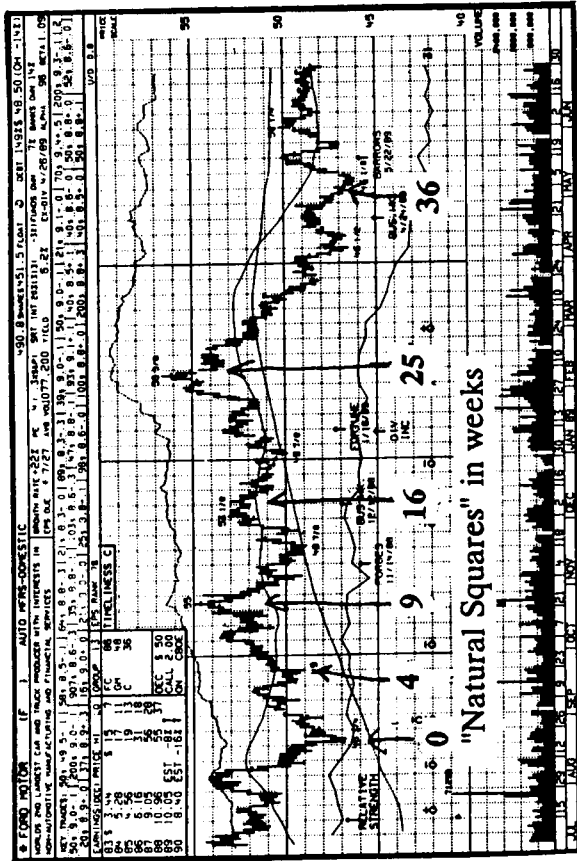


Figure 16

TRADING TIP NO. 3 - NATURAL SQUARES AND 45 DEGREE DIAGONAL SQUAREOUTS



"Natural Squares" in weeks

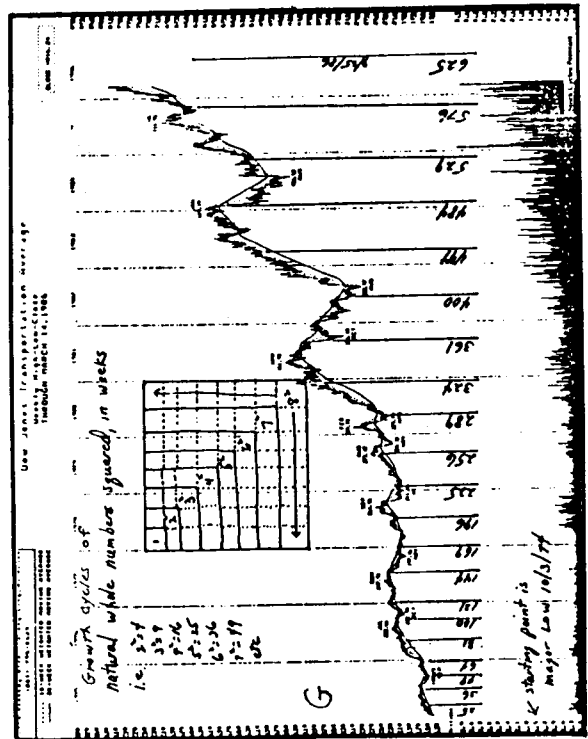


Figure 17

45 Degree Diagonal Squareouts
How easy can it be!

TRADING TIP NO. 3 - NATURAL SQUARES AND 45 DEGREE DIAGONAL SQUARE OUTS

As has been noted previously, numbers themselves spin out cycles that are harmonic lengths of the numbers. In addition to this, there are natural cycles of whole numbers squared. What I mean by this, is that the whole number 2 squared is equal to 4; 3 squared is equal to 9; 4 squared is equal to 16 and 5 squared is equal to 25. These are the natural squares, 4, 9, 16, 25, 36, 49, etc. These natural squares apply to days, weeks and months. (*See Figure 17*)

If you take a chart and start with a major high or low, making "tick" marks on your chart on every 4, 9, 16, 25, 36 days, weeks and months, you will be prepared to see most of the major highs and lows come out on those dates. As you get further into the squares these often last into the hundreds of numbers. For instance, the square of 25 is equal to 625 weeks or nearly twelve years. Cycles of this length still come out almost to the day and often it is important to look at the midpoint between these long term squares. Often this will fill in some data and give you some better turning points.

Beside these natural number squares we also want to keep track of our normal counting cycles using our 45 degree triangle. Draw a 45 degree angle off of any major high on a stock or market average until it intersects the next major low horizontally. This will give you a major turn in the market.

For example, on the Dow Jones Chart in 1966 when it hit 1000 for the first time, the 45 degree angle coming down intersected the low at 736 which was in late 1966. The 45 degree angle off that top did not intersect the low price until 1969. In 1969 the market hit 1000 for a second time and was the beginning of another major Bear Market, three years later. We therefore want to keep track of using a 45 degree angle off every major high until it intersects every major low after that high. The intersection of those angles off the top and the sideways horizontal price level always gives us a guaranteed turn.

Here again, on weekly, monthly and yearly charts, these square outs are very big and can lead to trend changes of weeks to months. They are very easy to keep track of and there is no excuse not to. The little turns on hourly and daily charts also produce trend changes but they are not as important.

TRADING TIP NO. 4 - NUMEROLOGICAL 360 DEGREE SUPPORT AND RESISTANCE NUMBERS

Support and resistance in the stock market are merely places where stocks stop their rise or descent and find strong resistance to the trend.

In terms of natural price levels, the divisions of the master circle of 360 degrees create natural support and resistance. These natural numbers come from the divisions of the circle by 3 and by 2. That is, 360 divided by 3 is equal to 120. We then divide that 1/3 of the circle by 2 to get the fractional part of the 3rd. So 120 divided by 2 is equal to 60. 60 divided by 2 is equal to 30. 30 divided by 2 is equal to 15. 15 divided by 2 is equal to 7.5. These are the thirds or 360 divided by 3.

Next we take 360 and divide by 2 which is equal to 180. 180 divided by 2 is equal to 90. 90 divided by 2 is equal to 45. 45 divided by 2 is equal to 22 1/2. 22 1/2 divided by 2 is equal to 11 1/4. 11 1/4 divided by 2 is equal to 5 5/8. (*See Figure 18*)

What we find when we complete this process is a series of numbers that are natural support and resistance in **both time and price**. We all have noticed in trading stocks that when a stock, for example, goes up to 90, it will top and reverse because 90 is a strong support and resistance number. After it gets above 90 and goes to 98 it may pull back and rest on 90. Likewise, the numbers 45, 30, 60 are all natural trading numbers. Less familiar are the 7 1/2, 15, 11 1/4, but these are also strong numbers. What really happens on smaller price stocks is that **these are additional incremental units**.

For instance, if the stock that you are trading has a low at \$14, we know that if we add 7 1/2 on top of that we get \$21.50, and that will be the **natural resistance of 7 1/2 units** on top of a \$14 low. After that the natural resistance of 11 1/4 would give us the price of \$25.25. Keeping in mind too, that the natural square of 25 would also provide resistance.

This is how we trade stocks off natural support and resistance. Take any major high or low and add or subtract to it this series of numerological numbers, and you will see that 80 to 90% of the time the stocks will stop right at those numbers and consolidate for several weeks before they advance again or decline. These numbers 7 1/2, 11 1/4, 15, 22 1/2, 30, etc. **also apply to time** in days, weeks and months from highs and lows.

In terms of the Dow Jones Averages, it is interesting to note that the whole part of 360 has often been important in market movements. The all time high in 1929 was 386, which was a bit above the 360, and twice 360 or 720 was an important low area throughout all the 70's and into 1980. Those lows in the stock market were consistently down around the 720 level. Add another 360 to 720 and you get 1080 which was the 1984 bear market low.

**TRADING TIP NO. 4 - NUMEROLOGICAL 360 DEGREE
SUPPORT AND RESISTANCE NUMBERS**

All stocks and market averages trade off natural support and resistance numbers that are divisions of the master cycle or circle of 360 degrees. All division and numbers come from 3 and 2 harmonics:

$$\frac{360}{3} = \frac{120}{2} = \frac{60}{2} = \frac{30}{2} = 15$$

$$\frac{360}{2} = \frac{180}{2} = \frac{90}{2} = \frac{45}{2} = 22 \frac{1}{2}$$

DOW JONES

Natural Number Support & Resistance

		<u>3</u>	<u>Both</u>	<u>2</u>
	360 = 386 1929 high	7.5		11.25
+360		15		
	720 1978, 1980, 1982 lows		22.5	
+360		30		33.75
	1080 1984 low	37.5		
+			45	
+	1800	52.5		56.25
+		60		
360	2160		67.5	
+		75		78.75
180	2340	82.5		
+			90	
180	2700	97.5		101.25
+		105		
45	<u>2745</u>		112.5	
	'87 top	120		123.75
		127		
			135	
		142.5		146.25
		150		
			157.5	
		165	2	168.75
		172.5		
			180	
			360	

Figure 18

TRADING TIP NO. 5 - THE ZERO ANGLE

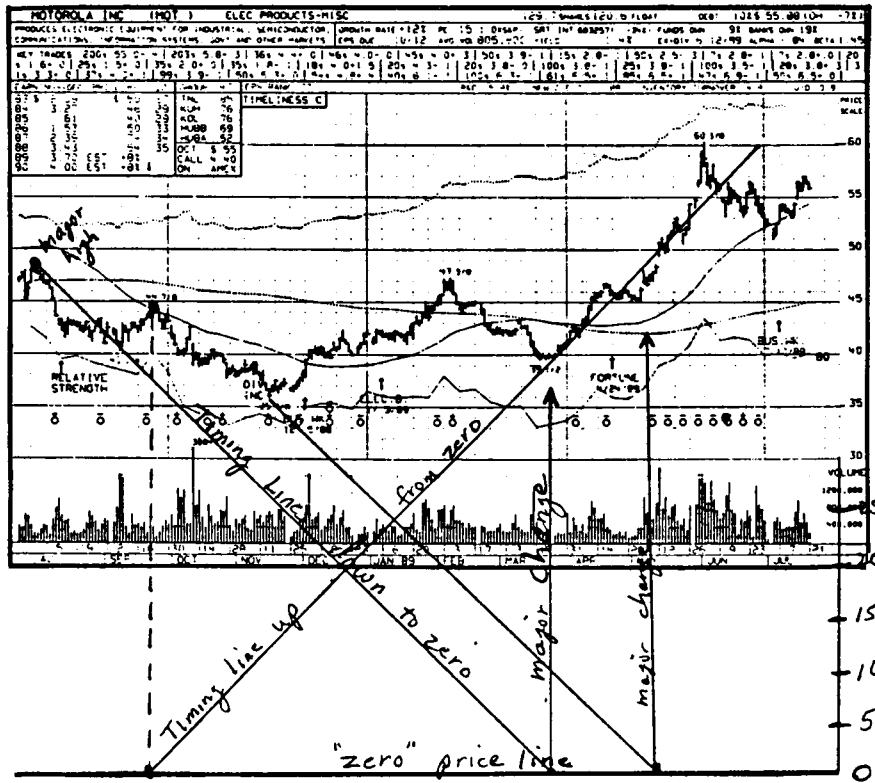


Figure 19

If we keep adding 360 all the way above, we find numbers like 2160, 2520, 2880, and 3240, as we get higher and higher. We can also break down 360 into 180. The top in 1987 was roughly 2745. So it is half of 90, which is 45, added to our price of 2700 even, which was 2520 plus 180. So natural support and resistance on the Dow Jones usually runs in the bigger multiples, 45, 90, 180 and 360 points up or down for major support.

Remember to always count days, weeks, and months in these special time units from any major high or low to see if a change in trend is warranted. Usually the simple 30, 60, 90, and 120 day count produces good turns for active trading and should always be kept track of.

TRADING TIP NO. 5 - THE ZERO ANGLE

Keeping track of time cycles through the use of angles is fairly easy. However, knowing where the major turns are can be difficult at times. One of the most important tools is the use of the zero angle. The zero angle is the angle we construct starting at the zero price scale underneath our major high or major low. On most chart services the scale does not extend all the way down to zero especially if it is a \$50 or \$60 stock. The relevant price range might only be \$40 to \$80 so it is not on your chart. (*See Figure 19*)

What you must do is very carefully with a compass and a ruler, measure down on the scale of your chart from the existing price grid, down so many inches below the chart to where the zero point would be. At that zero point you put a dot and a horizontal line for zero price. Under each major high and low we draw our natural angles of 45 degrees, also 30 degrees and 60 degrees up from zero.

What we will find as the stock goes up and down horizontally across the page, is that as it hits these powerful angles up from zero, these major support angles will cause it to bounce off these angles every time. The strength of the stock's movement is often indicated by how it bounces off these angles.

If it barely has a little blip for a day or two, and breaks under the angle, we know the trend is weakening even though it may still be in an uptrend. What usually happens is that the first time the stock goes sideways enough to hit the powerful 45 degree angle it will have another tremendous impulse wave starting at that exact point that will catapult the stock much higher.

This is one of the major points of using angles. It is one thing to use angles off of the prices themselves and intersect highs and lows for little square outs, but all major support and resistance and major cycle turns come when the zero angle up from underneath the major high and the major low on whatever chart you are following is hit by the current price. When that zero angle comes up and the individual stock price hits it, how it reacts tells us a lot about the strength of the market, and whether it is going up or down. It also gives us an ideal buy point if the market has been declining down to that angle, knowing that it will bounce off it, using that zero angle as our sell stop point if it subsequently breaks the angle and comes down through it.

TRADING TIP NO. 6 - MIRROR IMAGE FOLDBACK PATTERNS

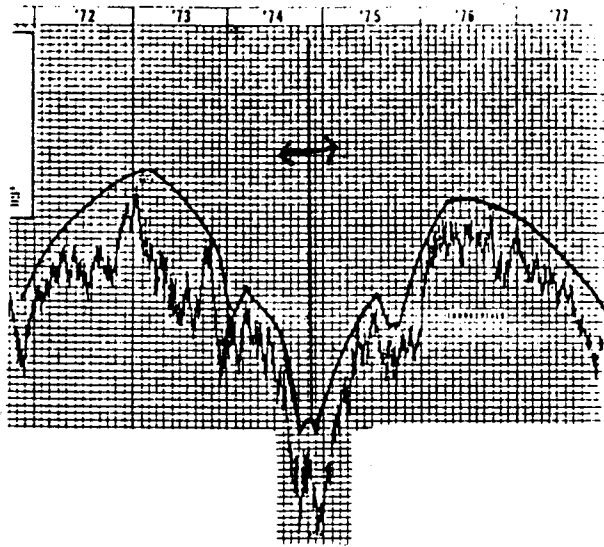
In theory, time moves both forwards and backwards. The word cycle implies that time returns again to a starting point. This means time does indeed go both forwards and backwards. This is a difficult concept for human beings but philosophers have debated it for years and found that it is possibly true. Einstein's Theory of Relativity hypothesizes that time most certainly is a variable depending on the speed or relative motion of the observer.

So, it is not unusual to think that human beings, who have internal biological clock mechanisms, and also being on a planet that is constantly turning on its axis being subject to different velocities, really do not have a conception of time. However, inanimate stocks that are traded with human emotions and graphed on pieces of paper often reveal to us where these pivots in time occur and the fact that time does indeed go backwards.

The implications are such that when a stock goes from a low to a high, time is in one direction. When you have a high and the market goes down it is basically following that same pattern backwards. Just as the stock rose to a high, it declines, going down the same way it came up. The theory of mirror image foldback forecasting states, "*At every major high and low the price patterns folds backwards in a similar fashion to the prior price pattern just before the high or low.*" Many times this time period is symmetrical, it is identical. So that ten weeks before a turn will show the same pattern ten weeks after the turn. However, in reality these time movements can speed up or slow down. Often we will find an advance of 9 or 10 weeks, but a decline of maybe only 7 weeks and yet the **pattern and shape** might be of the same magnitude. (See Figure 20)

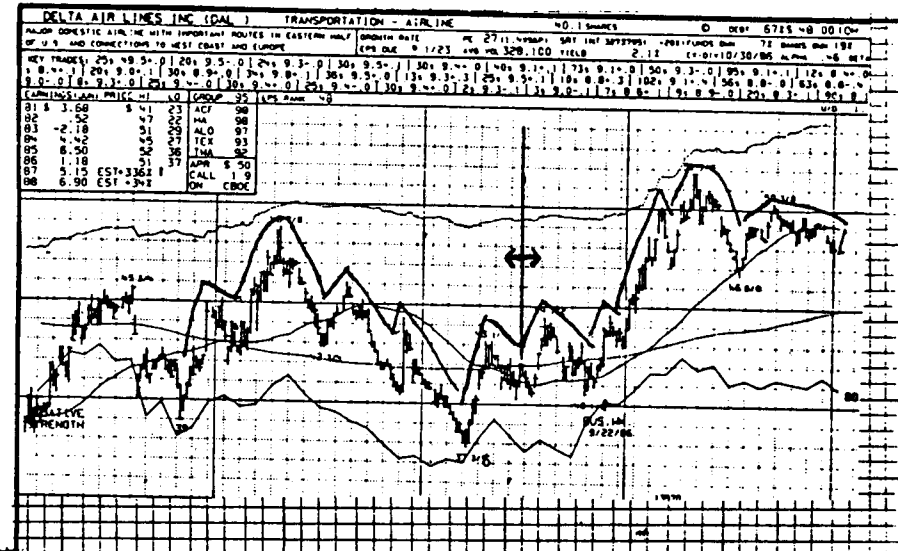
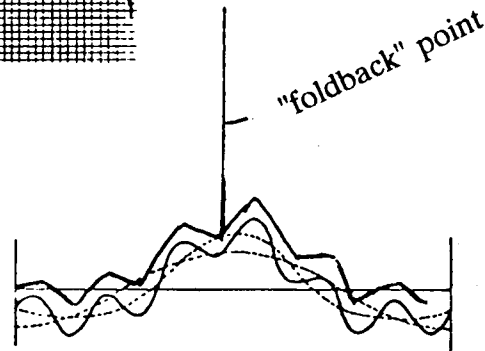
A use of this in forecasting is that we can draw a vertical up and down line through each of our major highs and lows. Measuring how far to the right of that vertical line we are, we then go to the left of that vertical line, that same distance, and see what happened in the market. If the market changes direction and goes for many weeks in a different direction, we can now forecast that our market too is going to change direction and go for that same number of weeks or roughly that amount in that new direction.

Many wonderful, long term forecasts in the market have been made by using mirror image reversal patterns. I use them all the time and they are by far the most accurate forecasting method that I know. **Do not underestimate their power.** The difficulty arises in that it is fairly subjective, in that the left side of the fold back and the right side will visibly look quite similar in shape, yet there are some individuals that do not possess the ability to visually recognize those shapes. If one leg was only 6 or 8 weeks and the other leg is 5 weeks, they do not see that they are both the same legs. So there are some drawbacks. However, if you are one of those lucky few who can see these foldback patterns and you keep track of them on a piece of paper, especially all the major highs and lows in the stock market, you will find that your long term forecasting of direction for 3, 6, 9 months or more will improve dramatically.



TRADING TIP NO. 6 - MIRROR IMAGE FOLD BACK PATTERNS

SYMMETRY AND PROPORTION



"MIRROR IMAGE" FOLDBACK PATTERNS

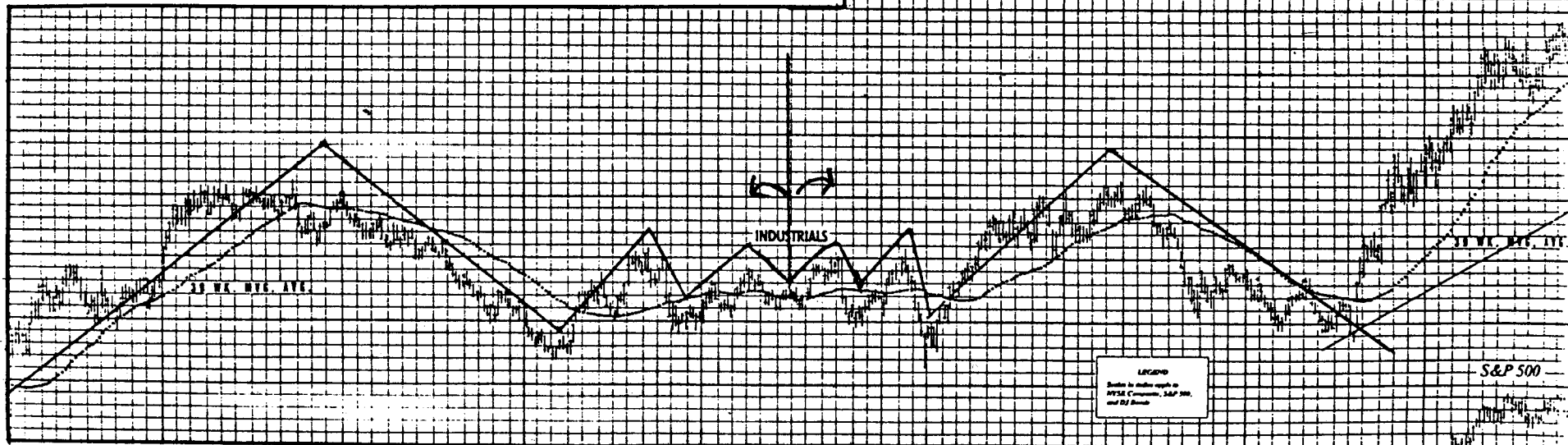


Figure 20

MIRROR IMAGE FOLDBACKS (continued)

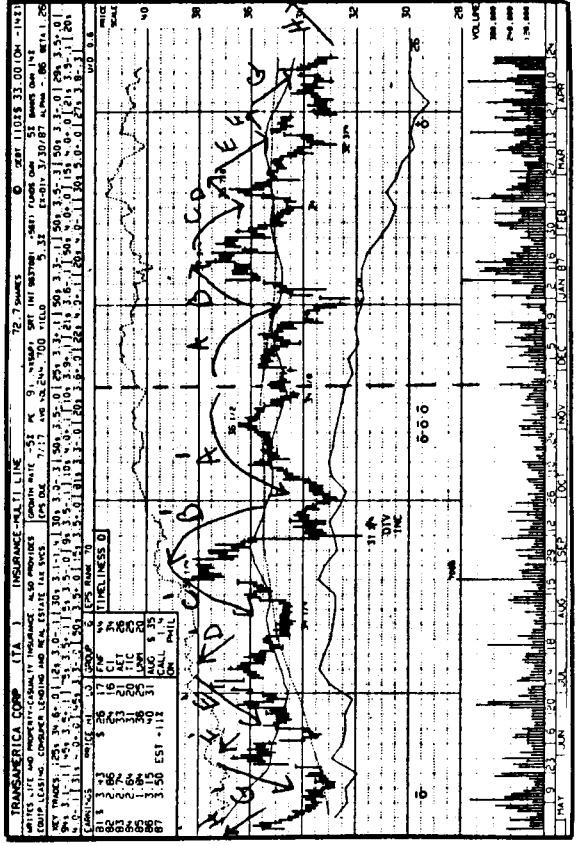
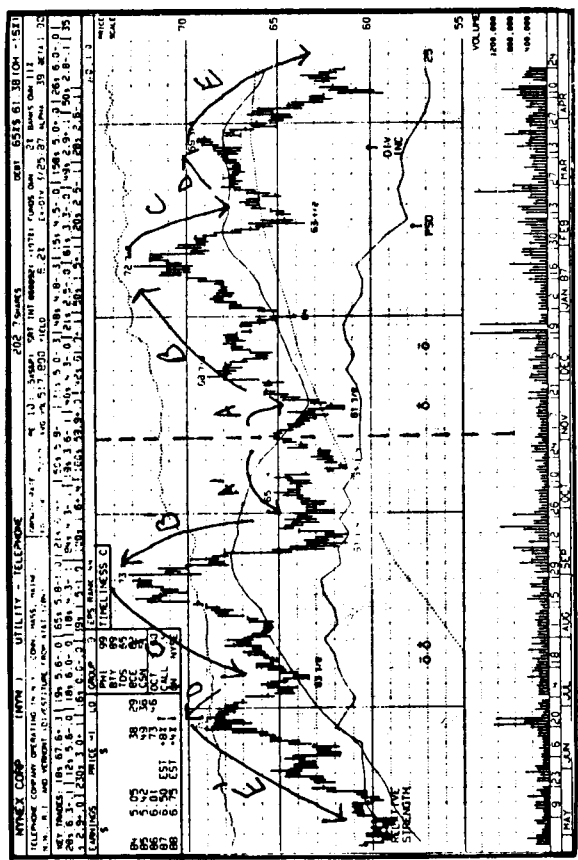
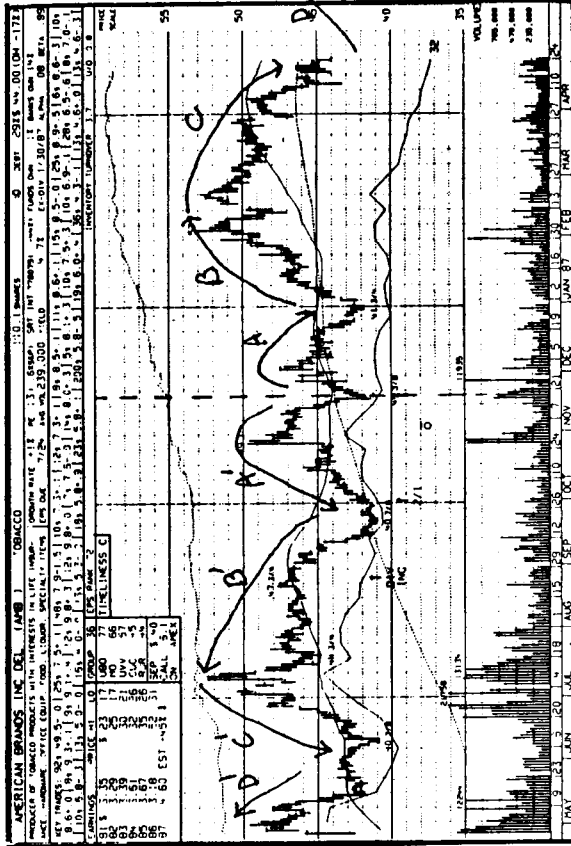
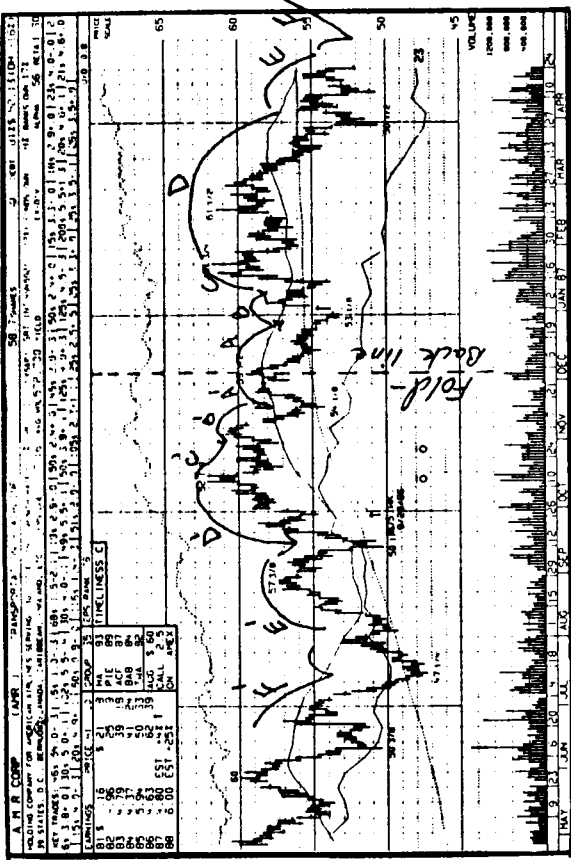


Figure 204

TRADING TIP NO. 7 - MEASURED MOVES

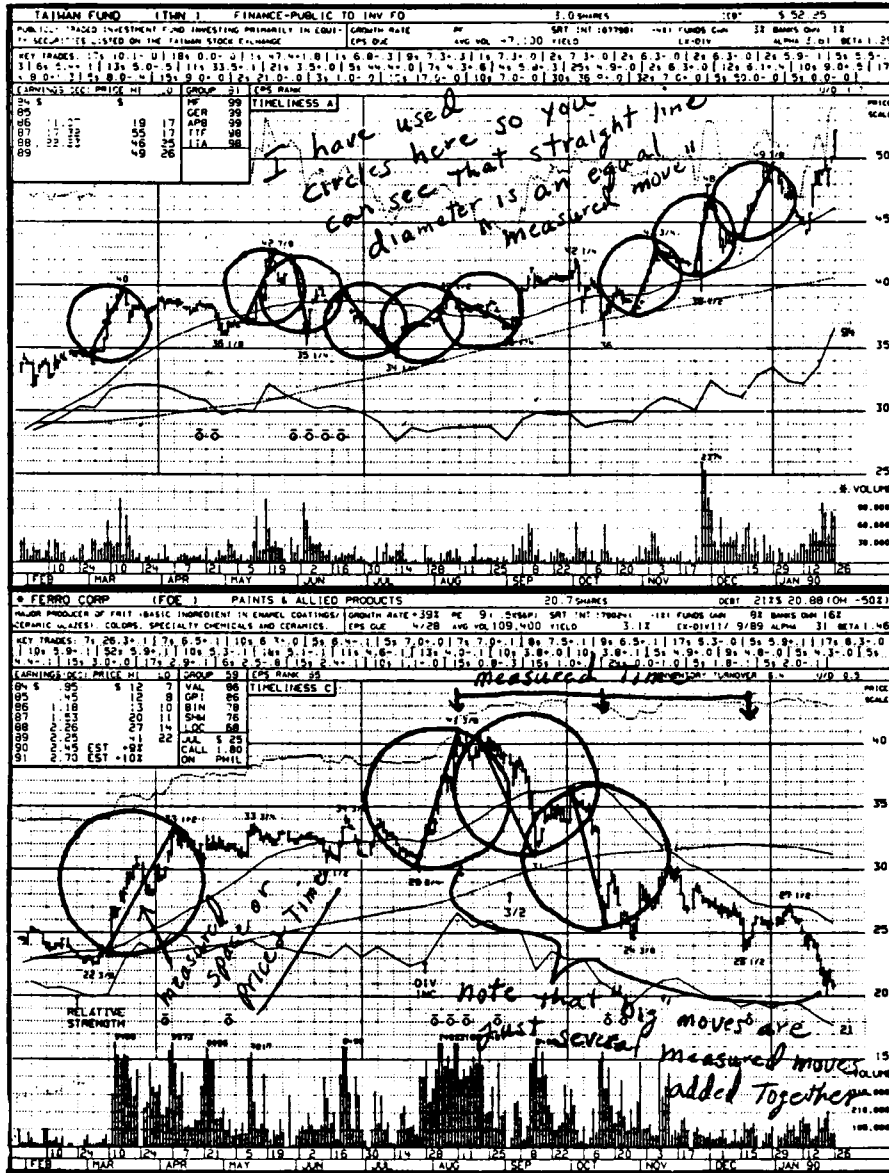


Figure 21

Human beings are very predictable, **emotional** creatures. They buy and sell emotionally and the length and strength of the emotions are **caused** by **cycles of time**. To project turns and price levels we need only study the history of similar emotional situations and make "measurements" of the time and price fluctuations. As we are dealing with **emotions, time and price are the same thing (!)** Since emotions change as prices reach expected levels **or** time passes **or** a combination of **time and price** movements occurs, by "measuring" in **any direction** these time and price vectors, we can predict when a change in trend will take place.

TRADING TIP NO. 7 - MEASURED MOVES

Human beings are very predictable, emotional creatures. That is why stock market prediction is easy at times. People buy and sell emotionally and the length and strength of the emotions are caused by cycles of time.

To project turns and price levels we need only study the history of similar emotional situations and make measurements of the time and price fluctuations. Since we are dealing with emotions, time and price graphed on a chart paper are the same thing. Emotions change as prices reach expected levels or the time period passes or a combination of time and price movement occurs. We find that measured moves, that is movements of a certain magnitude in any direction, calculate for us similar turns. (*See Figure 21*)

By measuring in any direction (in circular motion) these time and price patterns, we can predict when a change in trend will take place. Remember that in theory, participants in the stock market do not really change over relatively short periods of time. Let us say that over the 1 to 3 year period immediately past, there may be some subtle changes in the economies of the world, but by and large, the same number of individuals, the same number of institutions, the same glamour stocks all are participating in the same fashion.

If we want to see the strength of emotions of human beings, we can take a survey of the last several years and readily measure the movements in the Dow Jones Averages and see **what the average, and the extreme periods** of bullishness and bearishness were. For instance, rats in a cage subject to electric shock any time they get food will become neurotic, break down and die. But human beings, as a whole, trading stocks can only exhibit such emotional neurotic behavior for set limits of time before that emotion is exhausted.

In this century, most financial panics have lasted seven to nine weeks, with some as much as thirteen. However, as a general rule after seven weeks, financial panics burn themselves out. The theory of the measured move is just this. That if we examine our market data by measuring it with a compass from high to low we will get a vector distance. This vector distance accurately reflects the total emotionalism over time. Whereas you would think if the market went sideways nothing had happened, but there is actually emotionalism being exhibited in a sideways fashion.

Similarly, if the market collapses in a straight line there is extreme emotionalism over a short period of time. If the market declines at a 45 degree angle, there is a direct relationship of one to one of emotionalism per price and per time period. If we make these vector movements and measure from any low in a circle the average movement the market has exhibited over the last several months, we will have a very high probability forecast of where to expect changes in trend.

If the market rallies up to the circular boundary of the average vector measured move, and does not stop, the odds are overwhelming that it will go exactly two or more exact whole units of the measured

move. If you measured accurately over the last several months you can usually **find the fundamental unit**, and in the **extremes it will be 2 or 3 fundamental units** and the market will almost always stop exactly at the end of one of these measured moves.

If you use any kind of chart, especially with hourly charts in trading options, and you have these measured moves, you will find that you can often reverse your trade within \$1 of the Dow Jones exact stopping point and within an hour or so of when to expect the turn. This is a very valuable and yet easy trading rule to apply.

TRADING TIP NO. 8 - BASIC TREND DETERMINATION

In the final analysis, trading with the main trend is everything. It does not matter about cycles, it does not matter about projections, it does not matter about fundamentals, if you know the main trend direction of the market you will make money.

Hence, all the old reliable trading saws say, "***Trade with the main trend, don't trade too often, stay with the main trend, let your profits run but cut your losses.***" This assumes you are with the main trend which persists for long periods of time, sometimes for many years. How do we tell what the main trend is? This is the hardest thing and yet in many cases the simplest in technical analysis.

The following is what my definition of the main trend is from a technical viewpoint. It is a very helpful tip and will clear up a lot of misunderstanding.

In a **Bullish trend**, an upward trending market, there is only one significant thing to look for and that is a pattern of higher bottoms. That is, after each several days of up movement, the market has a little correction down. That correction down must always end at a higher price level than the prior correction down, several days or several weeks earlier. As long as this pattern continues several days up, a couple days down, several days up, a couple days down, and each of the down days are in turn higher than they were on the previous down days, higher than the previous weeks, higher than the previous months corrections, the long term trend is up. (See Figure 22)

TRADING TIP NO. 8 - BASIC TREND DETERMINATION

At a minimum watch your Stocks/Mutual Funds on a weekly basis to see that the Low each week is higher than prior week low if you are long - and lower highs and lower lows if you are short

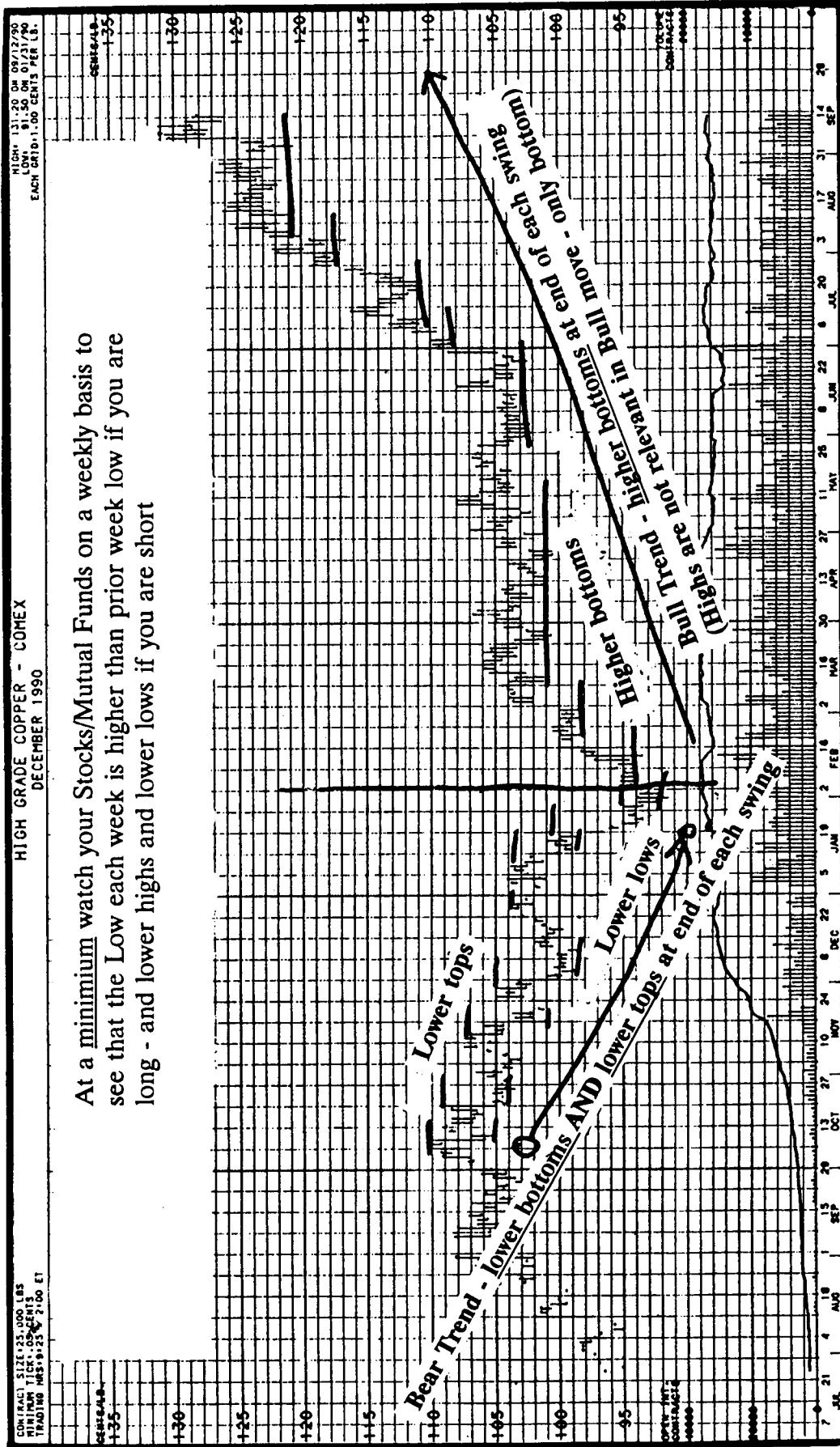


Figure 22

IMPULSE WAVE TIME AND PRICE PROJECTIONS

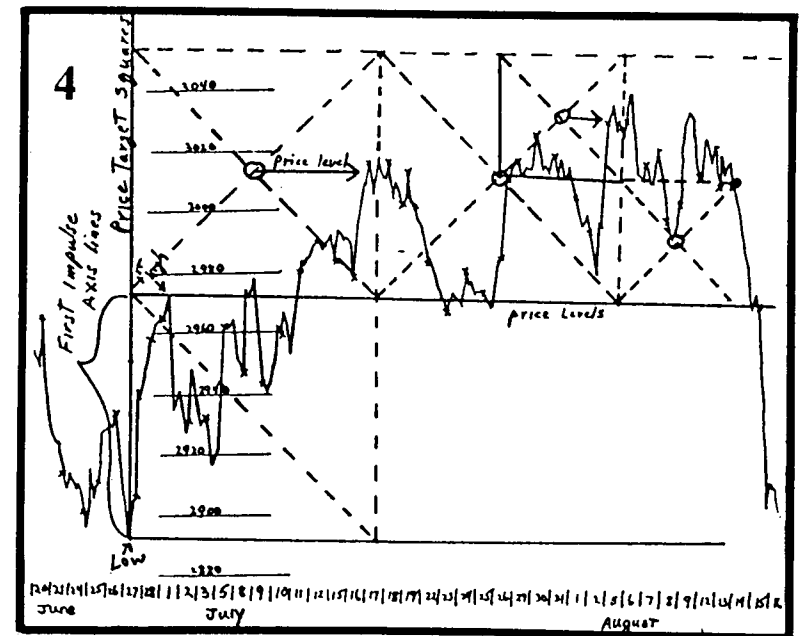
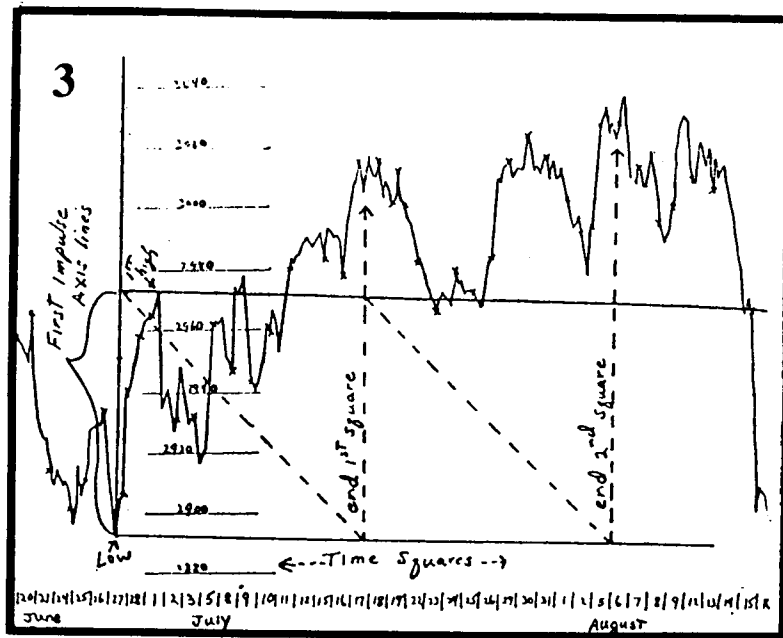
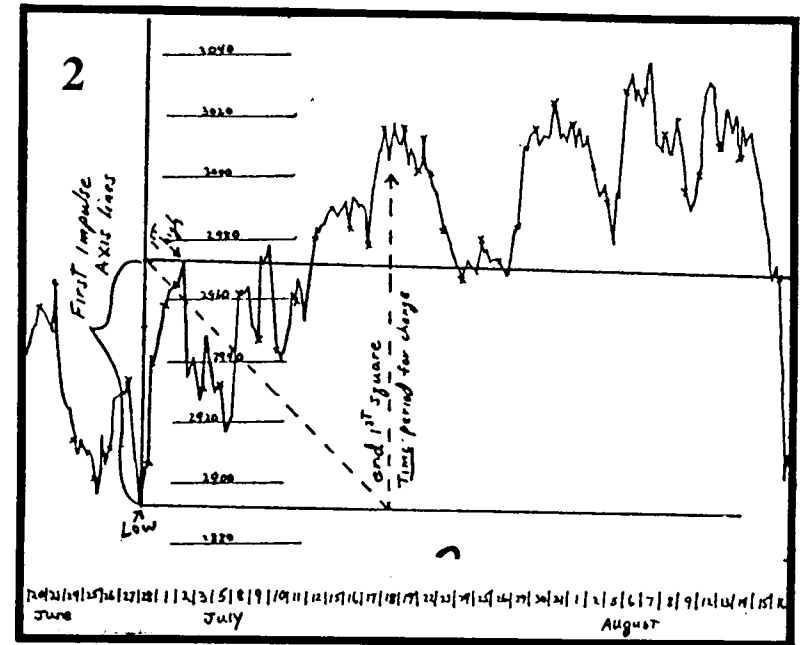
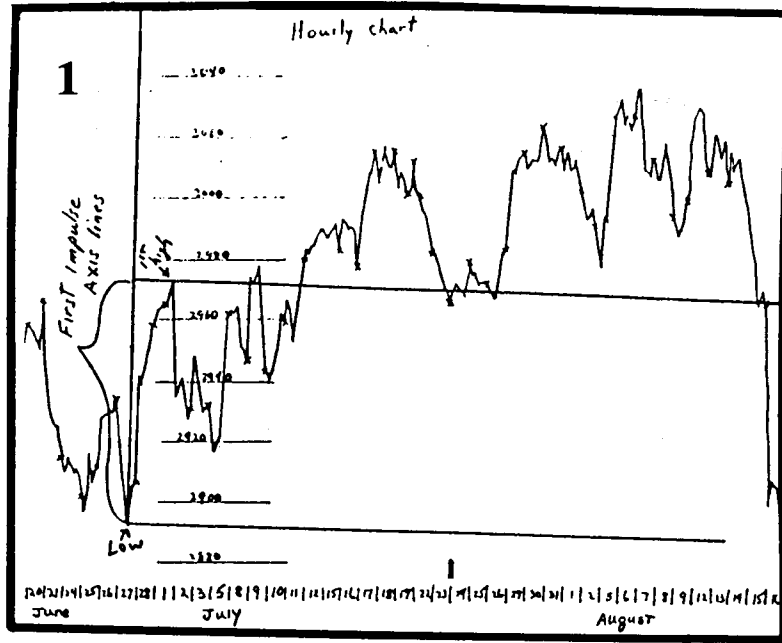


Figure 22A

For mutual fund investors I have often given the advice to leave the trading to a professional money manager, but to watch the price of your mutual fund on a week to week basis and note the low of each and every week. As long as the low of each week is higher than the preceding week you are in an uptrend. To be extra safe you may want to use the monthly low. As long as you never break a monthly low on a month to month basis it is all right to hold your position.

What frequently happens in Bull moves, is that the market is very volatile and we often find the stock market going up 20, 30, 40 points or more in a single day. At the end of the day with the market up 20 or 30 the Bears give in and many Bulls who forgot to get invested rush in and buy stocks indiscriminately with the averages up 20 or 30. The very next day the market plunges 10 or 15 and all these people have losses and they panic and sell. And yet the plunge of 10 or 15 points results in a much higher low than the previous day when the market was up 20 or 30.

If you were keeping track of the trend and lows each and every day, instead of selling out and panicking on that \$15 plunge, you would have the confidence to buy into the dip as long as that dip resulted in a higher bottom than the previous day or the previous two or three days. There is a natural emotional inclination to look for a top in a Bull trend. This is why people are fooled when a 20 dollar up day suddenly plunges and only closes up a few dollars. As long as the day is still up it is better than yesterday and the dips should be bought.

This is a big advantage in trading options. To be able to buy call options when the market is down on the day, knowing that by definition of the main trend within a day or so it will reverse back up and go to a new high.

Obviously, if you are not trading with the main trend it is the quickest way to disaster and bankruptcy. That is why it is imperative to watch a pattern of higher bottoms and invest on those higher bottoms.

Now the **Bear trend** requires two distinct determinations. It needs a pattern of **lower bottoms AND lower tops** at the end of each little swing. If you were to draw a chart of it, you would see a pattern of beautiful lower lows, a little rally up that does not go as high as the preceding rally, then a failure that goes to lower lows than the preceding low, then another rally that rallies but does not get as high as the preceding high. You would see a series of "stair steps" where lines connecting to the tops of each of the rallies would ever be going lower and lower and lower and lines connecting the bottoms of each of the declines go lower, and lower and lower. Once you see that pattern, and **this is a pattern**, you can be assured that the main trend is down and you should be shorting the rallies and covering shorts on the dips. This is the main trend in a Bear Market.

TRADING TIP NO. 9 - IMPULSE WAVES

Impulse waves are the initial price thrust movements that start a primary long term move (*See Figure 12 & 22A*). These initial waves contain a wealth of information regarding the potential price objectives for the move and the potential time target to exhaustion. Although there are many methods of measuring such waves, simple proportional parts of the initial thrust is usually sufficient.

Remember to measure these proportional parts both in price and time. When a time objective and a price target come together big movements begin or end. Watch the numerology of the waves, such as the Fibonacci sequence 1, 3, 5, 8, 13, 21... or simple proportions, one times the initial thrust, 1 1/2 times it, 2 times it, 2 1/2 times it, 3 times it, etc.

The actual method consists of measuring on your graph paper from the initial final low up to the first wave top. On many short term charts this may only be 4, 5 days of trading to 2 to 3 weeks. On a longer term chart, such as weekly or monthly, it might be the end of a six week rally. You draw a vertical line straight up measuring the distance in price from the low to the very high.

Once you have made that vertical price measurement you then take proportionate parts of that price unit. Say that the first initial thrust is value 1, even though it may be 10 or 20 points on a stock or 100 points on the market averages. That is one unit. Now take proportionate increases of 1 1/4, 1 1/2, 1 3/4, 2 or Fibonacci ratios, 1, 1.382, 1.618, 2.618, etc. These should be measured on a vertical scale, but most importantly, and most often overlooked, on the time horizontal scale. When you measure up the initial thrust of one, turn your measured move horizontally, sideways, that same amount and that will give you a natural impulse wave time period.

Do the same thing with your vertical proportionate parts, 1 1/4, 1 1/2, 2, turn those sideways and what you will find is a series of overlapping growth squares. Now, at the end of each square the top will be a price composite and the sideways, horizontal vertical vector will be a time unit. This is where all subsequent highs and lows will occur on these proportional parts.

This is the finest method of making large amounts of money in a short period of time through options. Waiting until a major proportional measurement of a primary impulse wave runs its course and the next impulse wave is starting. These are where secondary impulse waves begin or the final top is reached and the market changes direction. At these points it is imperative that you watch the market closely and trade with the trend that emerges.

TRADING TIP NO. 10 - PLACING STOPS, ENTRY AND EXIT POINTS

Professional traders trade only to make money, not to work out psychological problems or for ego gratification. Therefore, they only trade when they have a clearly defined entry point and a very close exit point whose violation would indicate that they are wrong on the trend. These exit points are where they place sell stop orders. (*See Figure 23*)

Remember, to the professional, stocks are merely heads of lettuce that you buy at 99 cents and sell at \$1.05 many times. You do not buy at 99 cents and expect \$1.50. If you cannot buy at 99 cents you do not buy at all. On Wall Street, the delivery truck stops everyday with new produce.

In an uptrend you buy on dips and use as your stop point the second prior swing low. Remember the main trend determiner is the series of higher bottoms that gives rise to an uptrend. Obviously, when you break a prior bottom the trend might be changing but often times in the short run you can break one minor bottom. However, 80% of the time you will not break the second prior swing low bottom unless it is a significant correction or the trend is starting to turn down.

Therefore, the safest stop is close to the current price level on a dip, but back at the second prior swing low. After you have your entry point and you have bought your stock or option, you place your stop at the second prior swing low. It is then okay to allow your profits to run, but as the profits and the market move up in your favor, you raise your sell stop order to the next higher correction low. So each time the market has a correction low and advances, you raise your stop up to the next higher stopout point. This way you can let the main trend run for weeks, months and even years, without being stopped out of a primary trend.

When shorting a downtrend, I usually use the same procedure. Remember a downtrend consists of two things: both lower tops and lower lows in a pattern. You short the rallies as they fail at a lower high level and you cover on the dips.

On longer term trends you short the rallies and place your stop loss two prior swing highs back. This gives you a good safe point in case you should have a tremendous short squeeze that goes past the most immediate prior swing high, but the vast majority of times it will fail before it gets past the second swing high.

A professional trader, even though he may have a very strong opinion about the direction of the overall market, if he cannot enter a trade near a low risk entry or exit point he will prefer to miss the trade entirely than gamble with his money. If he misses the trade and let's say, the market goes up \$20 on the day and he wanted to be a buyer, if he were forced into the market at up \$20, he might have to suffer through a full day or a day and a half correction down, almost the entire \$20, before he could validate that the trend had indeed turned because it would have to break at least the low of that current day.

That is usually too much risk and too much heartburn for the professional trader to make such a trade. Since opportunities are innumerable on Wall Street you want to have all the probabilities in your favor and only take those opportunities that give you clearly defined, low risk, very low loss of capital stop out points.

If you use the tips in this book, you will probably be right on the main trend 70% to 80% of the time and the losses that you sustain will be very small while gains will be quite sizable.

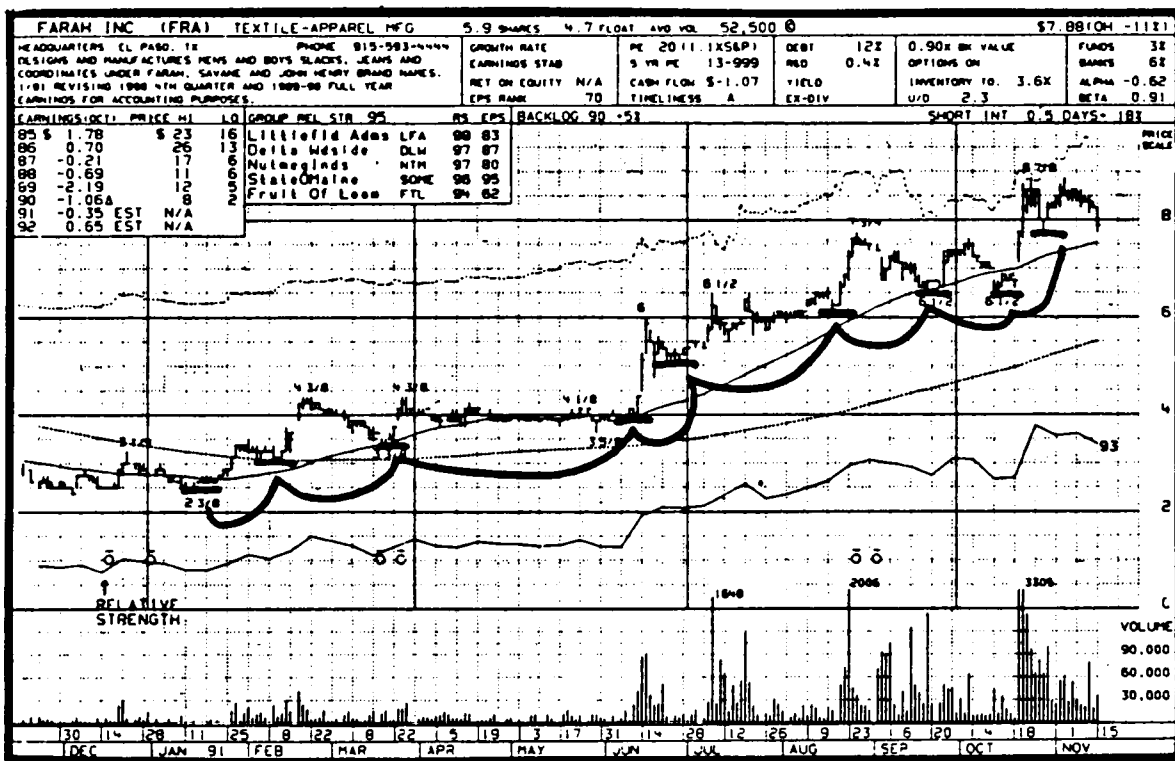
In many cases, people recommend using actual stop losses on the books of the specialist rather than what is known as mental stop losses. In my opinion, this is solely up to the trader. You must ask your-

self if there has ever been a time where if you had not put a stop loss on the books, that you were mentally strong enough to eliminate the trade, when it went through your stop out point? If you cannot answer yes, to that, then you probably need to put stops on the books to mechanically force you out of the trade.

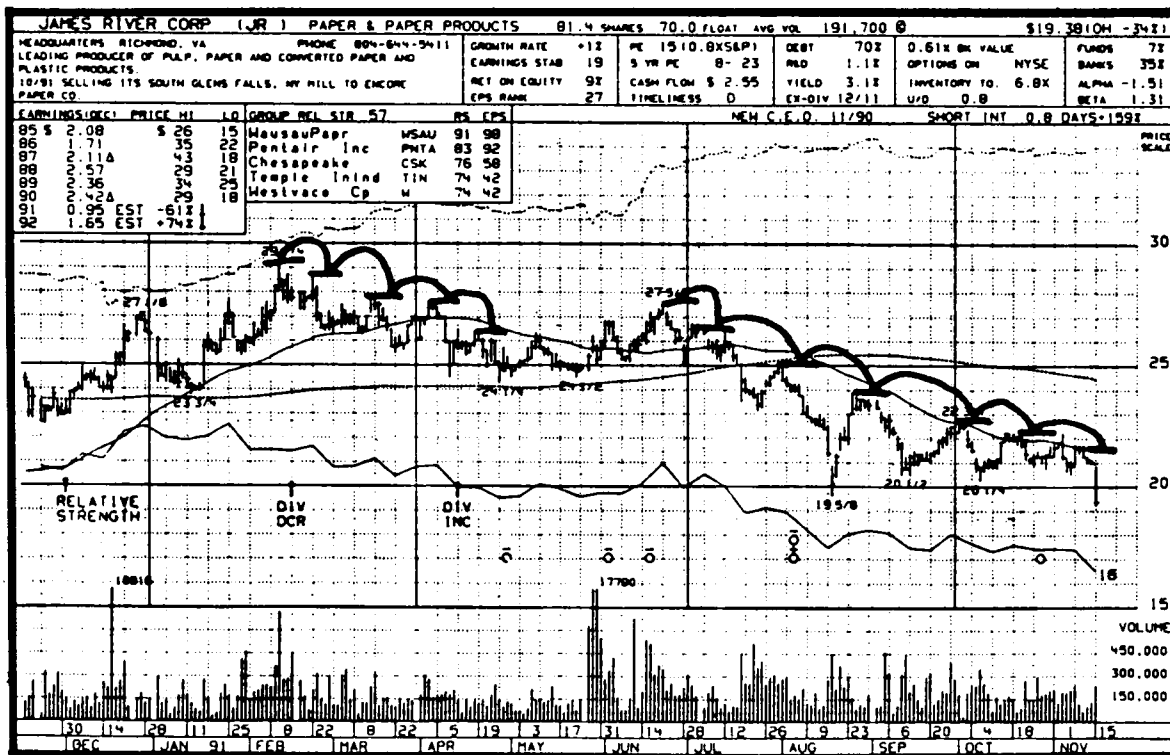
I can not emphasize enough that trading is an emotional experience and the smart rational people in the market use their rational minds to combat their emotional weakness. Do not waste your rational mind calculating earnings per share and rational reasons for the newspaper items. Use your rational mind to fight your emotionalism. The best way to do this is through stop losses, trendlines and rigid discipline about rules, especially rules about taking losses.

The only thing easier than making money in the stock market is losing money. So you should start on your very first trade, with not only knowing when to get in, what your objectives are, but before you make the trade to determine where you get out and at what loss point.

TRADING TIP NO. 10 - PLACING STOPS, ENTRY AND EXIT POINTS



SELL STOP POINTS



BUY STOP POINTS

Figure 23

Chapter #15

Comments about Fundamentals and Economics

"Fundamentals and economics per se, do not play that big of a role for the trader-scalper professional."

Many professional traders utilize fundamental analysis and economic statistics to decide their strategy. As you can tell the primary basis of this book is quite technical in approach and cyclical.

In dealing with cycles our philosophy is very fatalistic. The rise and fall of stock prices are much like the waves at the beach. There are immutable forces that cause the rise and fall of stock prices which consist of large waves of human emotion.

The seemingly random news items that hit the newspaper headlines or the television announcer's desk have really no effect on anything. The perception is that they are the cause of the movements.

However, a rigid analytical analysis of stock prices and volume and trendlines and cycles show that long before the news item is known, the stock or market average has anticipated it. This is not because of illegal inside information, but the natural total unconscious psyche of mankind investing in the market.

Believe it or not, even natural catastrophes, like earthquakes, volcanoes or presidential assassinations are forecasted in the stock prices shortly before the events take place, sometimes many days before. There is something in the collective unconsciousness of mankind that reflects these things and they can be picked up analytically through a study of price patterns.

As a result of this philosophical viewpoint and perception, I do not pay attention in large scale to the so called economic statistics that come out week after week. However, as a trading professional one must be constantly aware of **managing risk** and if there is a widely disseminated statistic due out, such as GNP, employment statistics or any other statistics of significance, one usually likes to reduce his exposure to unexpected events by reducing the amount of leverage through options or futures and the overall size of positions until the news breaks.

Economic statistics in particular, are not even as valid as they used to be. If used in your work you should apply the technical and cyclical tools in this book to analyze those very same statistics. On a weekly, or monthly basis, charts laid out based on the economic statistics will show cyclical character-

istics that will have good forecasting reliability. However, day to day blips do not necessarily show a trend.

Remember, the long term trend showing rising bottoms and rising tops or lower bottoms and lower tops will apply to economic statistics just as they do to stock prices. Once these patterns are discerned their use has much more reliability as to the long term effect of the true economic experience.

Fundamentals and economics *per se* do not play that big of a role for the trader-scalper professional. Whether General Motors sells at \$20 a share or \$200 a share has only a general connection with its underlying fundamentals. Most good analysts can forecast earnings and increasing car sales, but the fluctuations in General Motor's stock has much more to do with emotionalism. What the fundamentalists like to think are fundamentals-- PE ratios, dividend yields, other normal valuation standards, are really quite subjective, emotional fluctuation extremes.

I find it hilarious that many fundamentalists justify their positions of being bullish or bearish by redoing their fundamental benchmarks at emotional extremes. The reality is that they are emotional and when the trend is up they want reasons to buy stocks and so they invent reasons, such as lower inflation with commensurate higher expansion of PE's or lower interest rates and lowered dividend expectation yields, to justify further investment in higher stock prices.

On Wall Street, up until 1985 and 1986, many firms did not even have full time technical analysts, and the few that did, did not pay too much attention to them. They were always considered a weird group of people who were near occultists. However, after the Dow Jones Averages breached 1400, 1500, 1600 on the Dow, the normal equations that the fundamentalists used for the last twenty years in regards to PE ratios, dividend yields, earnings per share multiples were all violated and the fundamentalists were either going to be left in the dust or they were going to have to revise their thinking. The fundamentalist's choice was clear--more commissions meant changing the rules!

Suddenly by 1986 and early 1987 everybody had technical analysts as advisors. There were not only innumerable technical analysts and cyclists around, but we saw the beginning of artificial intelligence trading mechanisms and computerized programs that had nothing to do with fundamentals or economics on a large scale.

Historically, the commodity markets were always prone to reality. They were highly leveraged markets where technical analysis was supreme. There were major players who made money on the fundamental size of the wheat crop, but price reality rules a highly leveraged market. If the price of wheat went down you either went bankrupt or you sold out. So technical analysis was much more important in trading commodities than in trading stocks. In recent years with the high volatility, the high beta movement and the higher priced market averages, technical analysis has become a dominant force in the stock market. So much so that on the popular TV programs the average man in the street now is quite familiar with the word oscillator, stochastic and moving averages. The future of technical analysis can only be brightening.

Epilogue

In a short book such as this my intention was to only scratch the surface of philosophical geometrical trading, in an attempt to change your distorted perspective of how to make money in the stock market. Your mind is your worst enemy, if you use it in the wrong fashion. Price is the reality filtered through the enormous perceptual handicap of human emotions, especially fear and greed. Success is solely dependent upon recognizing the facts and behaving in a non-emotional fashion. Reading the newspaper or listening to TV broadcasters or brokerage house spokespersons is a deception.

For thousands of years, knowledge has been passed down to us in the form of geometry and numerology. Sages of the ancient world probably knew more about reality and the patterns of life than any modern day scientist. If you would be truly informed about the great truths of existence you must work in the realm of symbolism. As much as the high I.Q. genius is above the ordinary man, the next level higher, that of the prophet and all higher realms of intelligence, operate not on the plane of language and verbiage, but symbolism. The stock market patterns of price and time created through the buying and selling of human emotions creates a symbolic story that is an open book for those who know the key. We have always had the clues, but they were never really taught us in school.

From time immemorial the ancients have coded the needed symbols for our future use. If you would know their teachings I refer you to books on architecture, philosophical or sacred geometry, numerology, astrology, freemasonry, the great pyramid, and of course the master hidden code book, the bible.

The lessons written here are not for everyone, and are therefore coded to remain hidden to the masses. Likewise, this book contains much information especially in the chart exhibits that if followed to logical conclusions would yield infinite rewards.

The beauty of mathematics is that we can start with a series of assumptions and build elaborate logical extensions that lead to rules, axioms, and principles that provide us with answers not readily apparent from the initial facts. The use of mathematics, especially geometry in our stock market chart patterns, gives us similar results. For the price of a book as reasonable as this I cannot specifically point out the real hidden truths behind these chart exhibits, but I encourage you to finish the work yourself by extending the concepts to all of their logical conclusions and **PROVING** them to yourself on your own charts. Nothing I have stated in this book cannot be proven with the geometry of circles, squares, and triangles on your own charts! If you apply the teachings in this book to your trading **you will become financially independent**. If you apply the concepts of perceptual distortion to your life you will become emotionally, and intellectually independent and free.

Appendix

Trader's Checklist

_____ 1. What is the main trend?

Higher bottoms (up), or lower tops and lower bottoms (down)?

What time perspective are these trends? (Hourly, Daily, Weekly, Monthly?)

_____ 2. How long has this trend been in effect? (Are cycles ready to turn?)

How many days, weeks, months, 3 1/4 weeks, 6 1/2 weeks from last low, (high)?

Should I go with the current trend or wait for an expected reversal trend?

_____ 3. What vehicle should I use to exploit this trend?

Stocks - buy dips on stocks making new highs.

- sell rallies short on stocks hitting new lows.

Options - buy options only on ACTIVE LEADERS with volatility.

- Are options over/undervalued?

Futures - is the trend so sure that I can use real leverage and get out with a reasonable stop?

_____ 4. Where do I put my stop loss?

Price level - last swing or trendline.

Time period stop - sell if no profit within reasonable time.

Are these stops mental or mechanical? (actually put on the specialists books).

Trader's Daily Worksheet

Date of last low (high) _____

Price of last low (high) _____

Today is _____

Number of Trading Hours since last low (high) _____

Number of Trading Days since last low (high) _____

Number of Calendar days since last low (high) _____

Number of Weeks since last low (high) _____

Number of Months since last low (high) _____

Check these periods for known cycle lengths, numerology, or Fibonacci numbers (i.e. 30, 45, 60, 90, 120 etc., or 3, 5, 8, 13, 21, 34, 55 etc., or 9, 16, 25, 36, 49, 64.....)

Check for price square outs such as 100 days from a price of 100.

Price Angles today: Number of days since last swing, multiplied by 2, 4, 8, etc. and added to swing low or subtracted from swing high to get today's geometric equivalent of Gann's 1 x 1, 2 x 1, 4 x 1 angles. (example - 100 days from last low of 3000 Dow. 100×2 plus low = 3200 or 100×4 plus low = 3400 etc., or $3000 - 100 = 2900$ or $3000 - 400 = 2600$). Also, do this hourly, weekly, and monthly.

1 x 1 _____

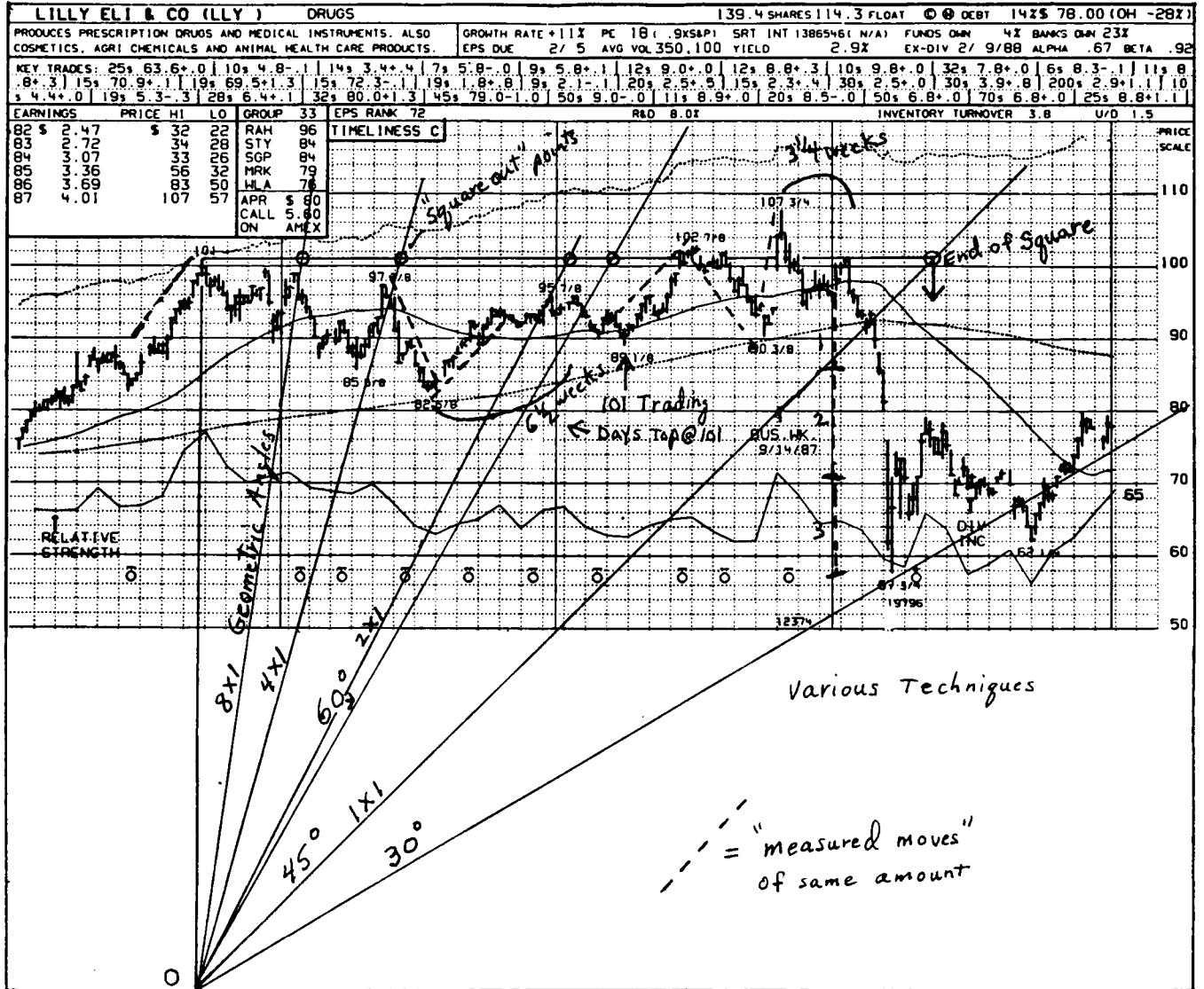
1 x 2 _____

1 x 4 _____

1 x 8 _____

Exhibits

On the following pages exhibits have been reproduced from
Mr. Jenkins' Stock Cycles Forecast Newsletter.



Follow UP STOCK

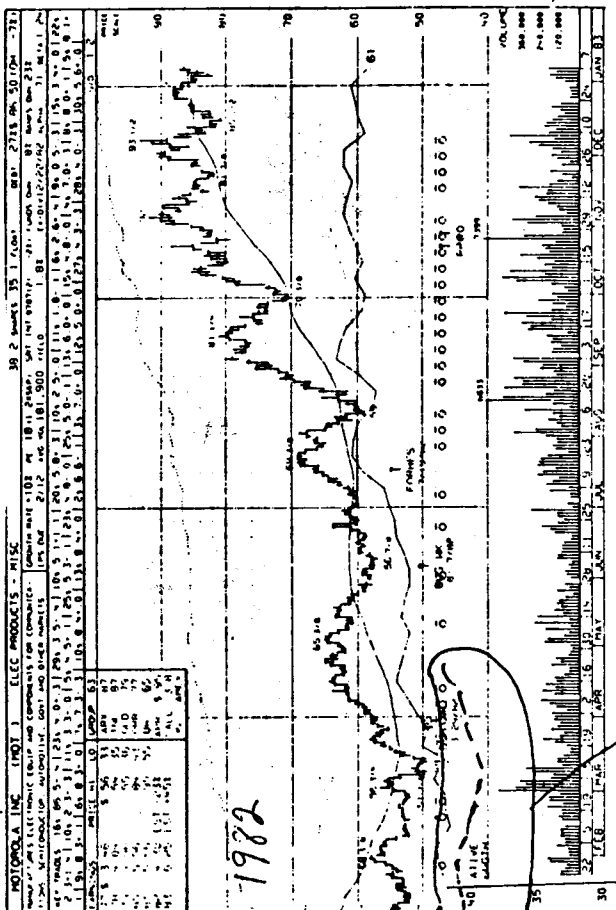
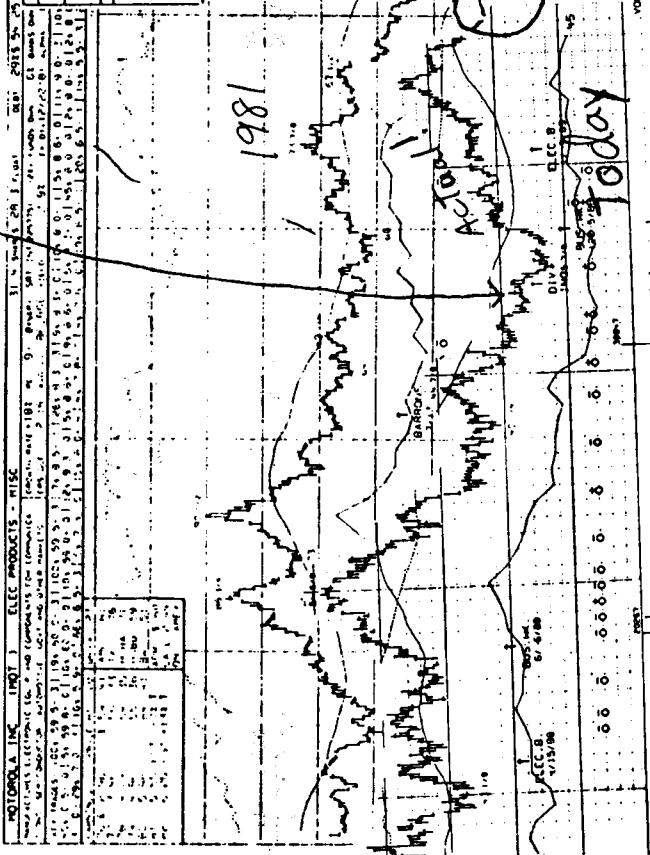
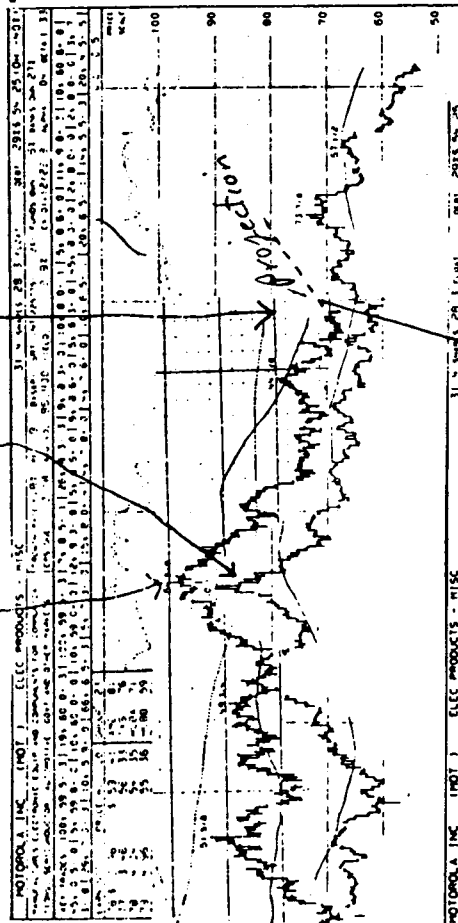
Remember this projection from issue #8 in October '88?

most semiconductors and computers seem to be on this cycle from 7 years ago - looks like a low due this week with a 2 week rally before last decline.

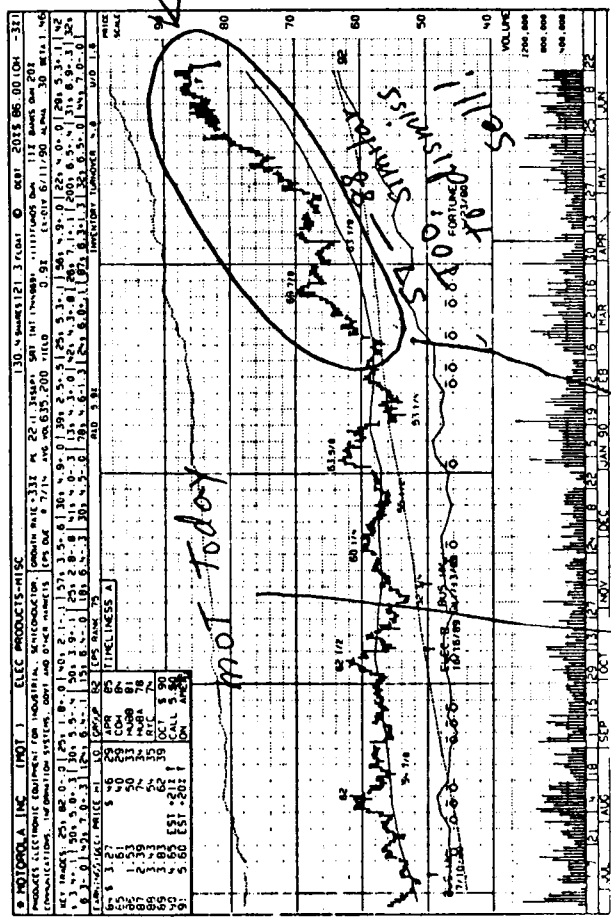
Looks like a rally coming!

7 yrs ago 1981

Today 1988

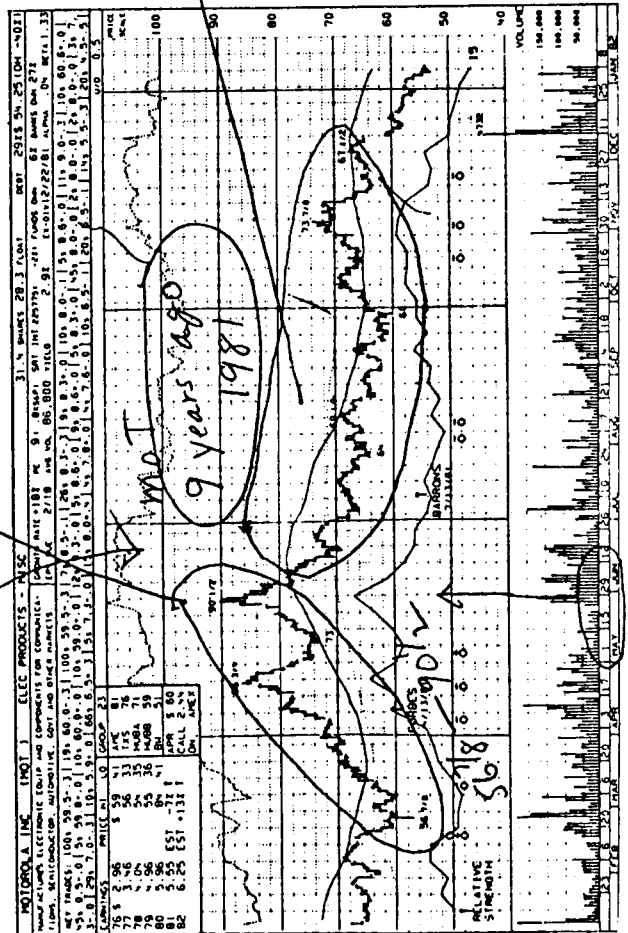
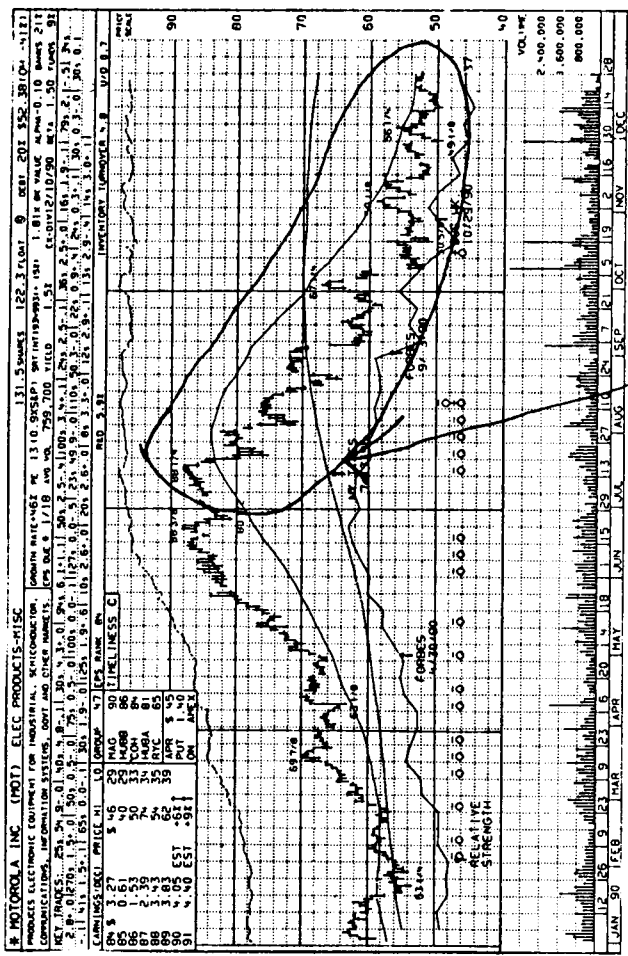


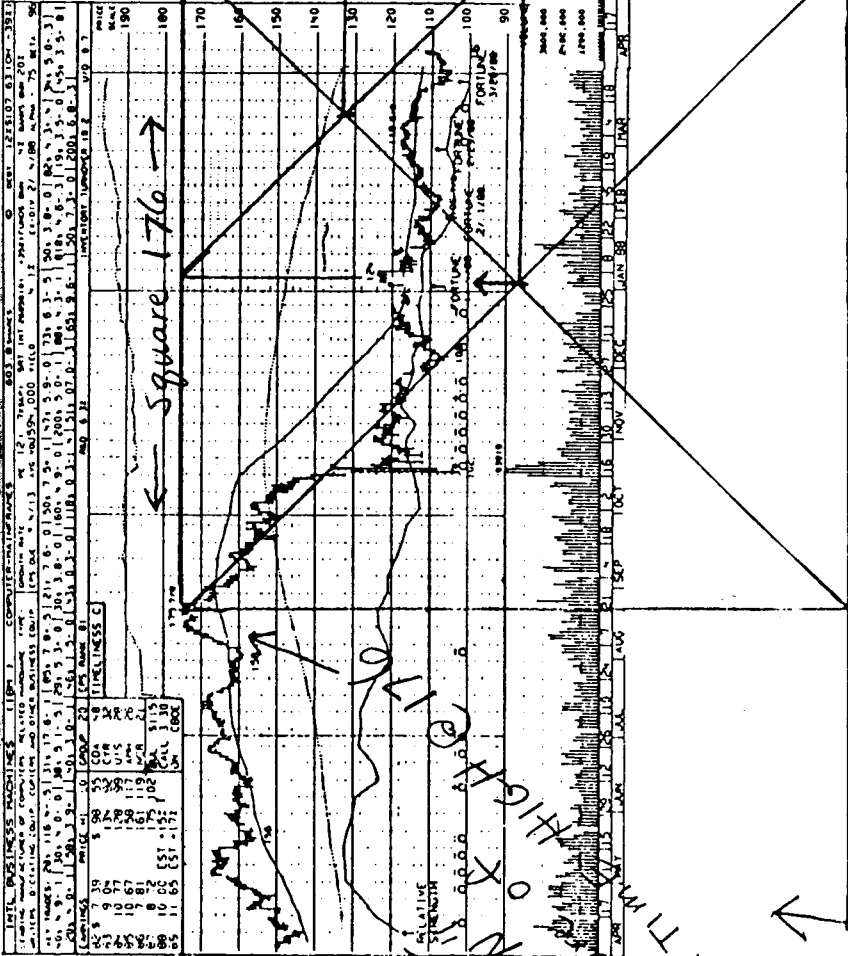
This looks like our projected Dow low, late April pattern just before big leg up to 2700 by August!



Vol 6 Issue 2
June 28, 1990

Cycle Top Projected



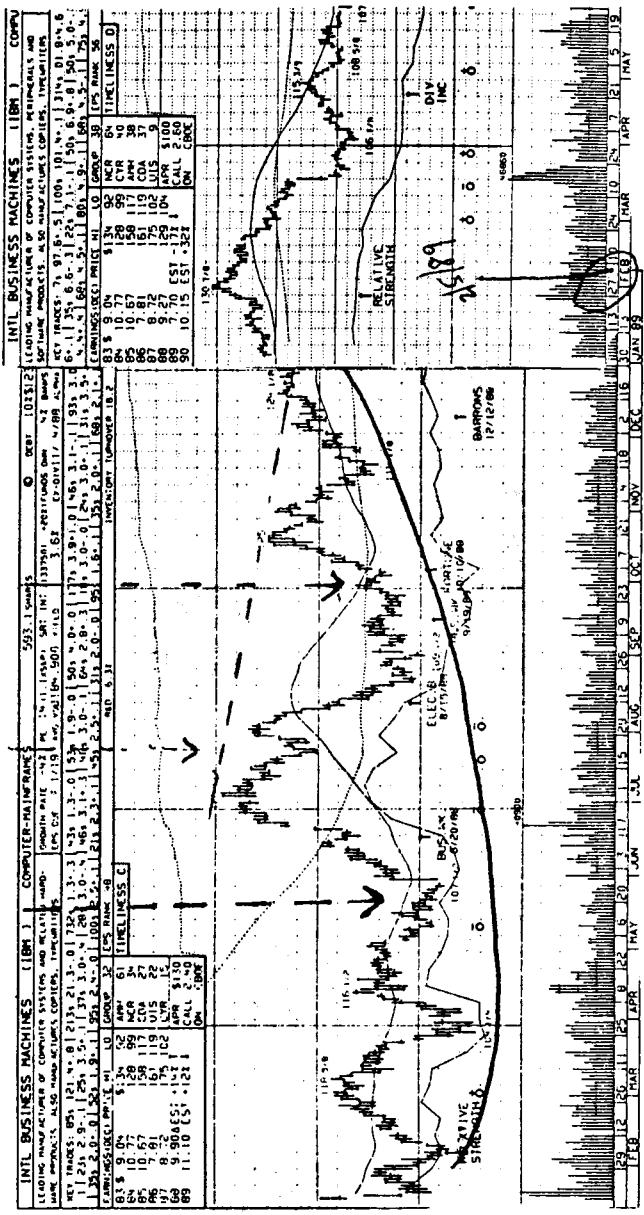


End 1st major square
may 15? ± 1mk

← Square 176 →

ALL TIME HIGH @ 11/10
Square 176

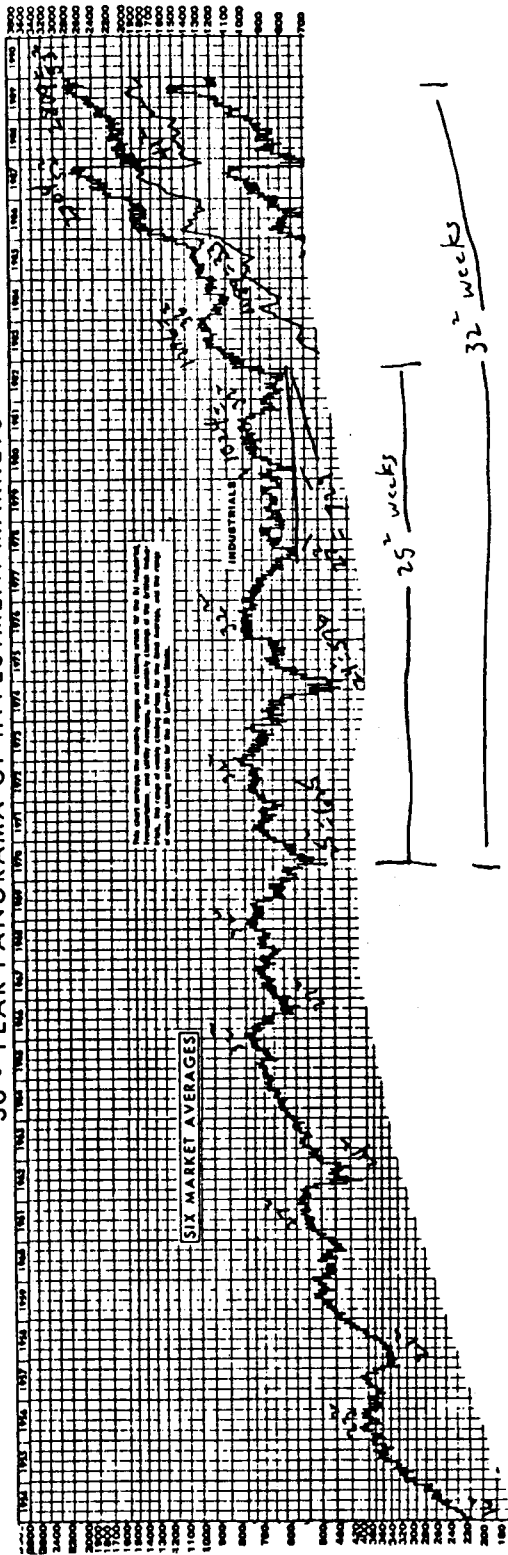
Feb 5, 1989



This is a reproduction of a handout for a speech I gave in April 1988. Note the symmetry of the Low into the end of the first square near may 15th projecting a High at the end of the second square near Feb 5, 1989!

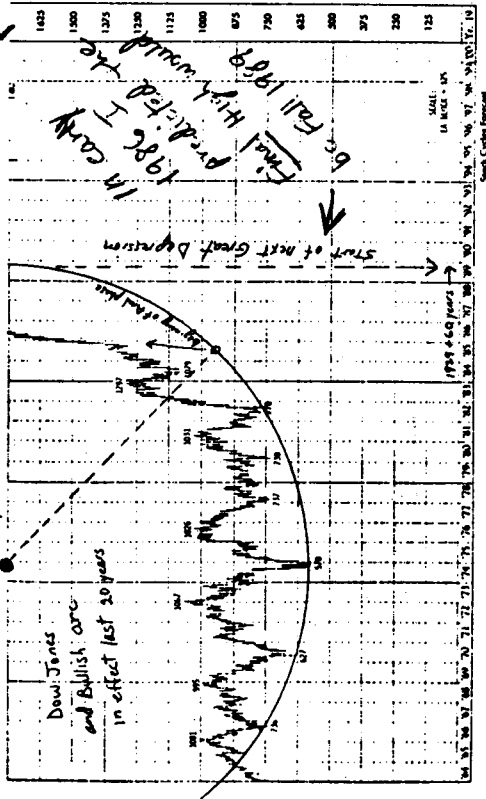
Traders' Tip:
Secret of the Natural Square

36 - YEAR PANORAMA OF INVESTMENT MARKETS



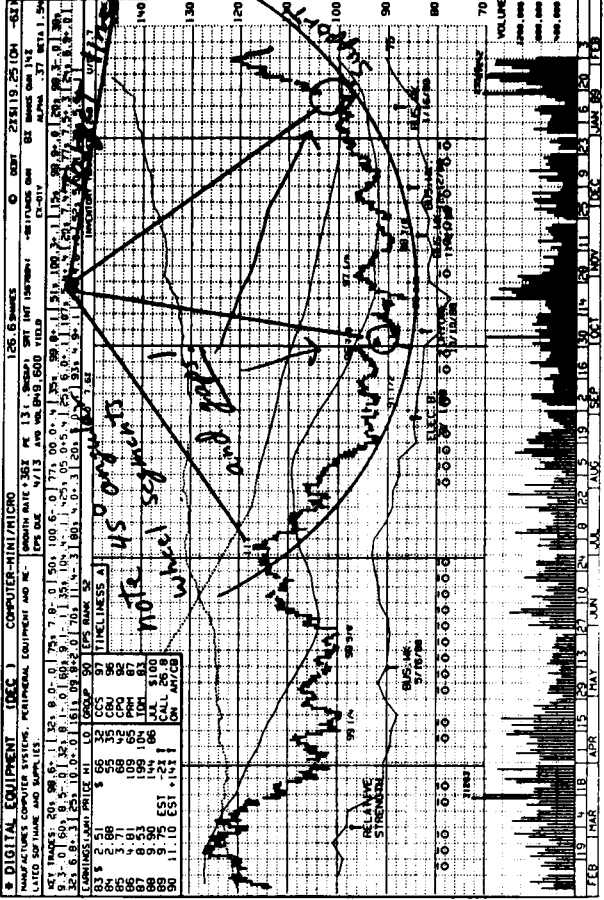
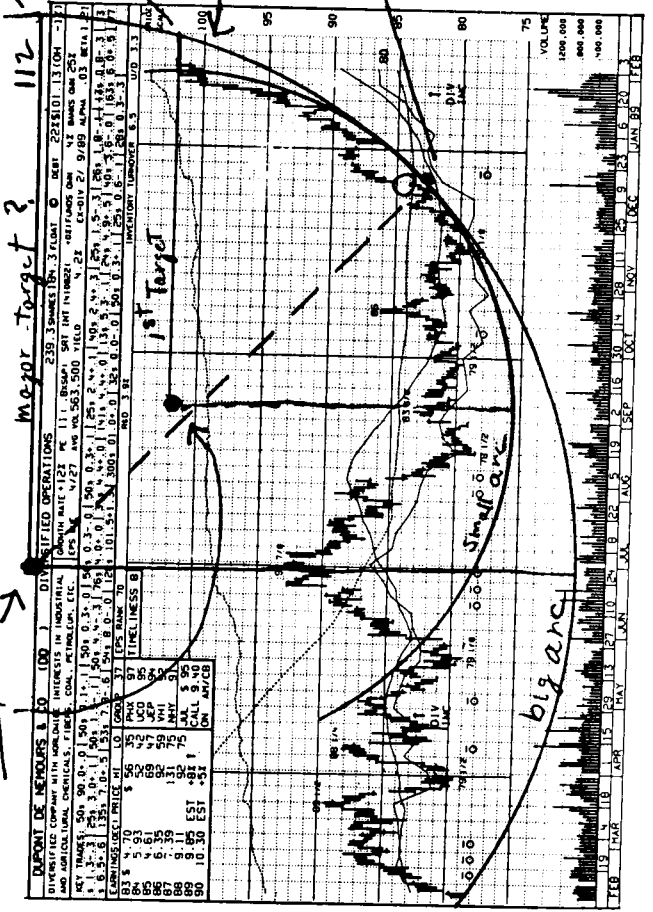
All final highs & lows of all stocks & commodities begin and end with the Natural Squares of numbers. There is a very simple reason why this has to occur, but I am not disposed to reveal it to the public at this time or my competition. In any event, $2809 = 53^2$ and is a potential top, but the Bulls are looking for $55^2 = 3025$, $57^2 = 3249$ or $60^2 = 3600$! ALSO these squares apply to Time so that low in mid 1970 at 25^2 gives rise to low in mid 1982 25 weeks later!
 ALSO mid 1970 low is 32^2 weeks from 1-15-90 so about 1-15-90 we will either end the Bull market (1970 low to 1990 high) OR start major blast off to 55^2 or 57^2 - IT should be easy to see which!

Geometry of the market



Typical Dow stock and why market could yet see 2700 - 2930

"Trade secret"
"Gravity center of arc defines resistance & Target"



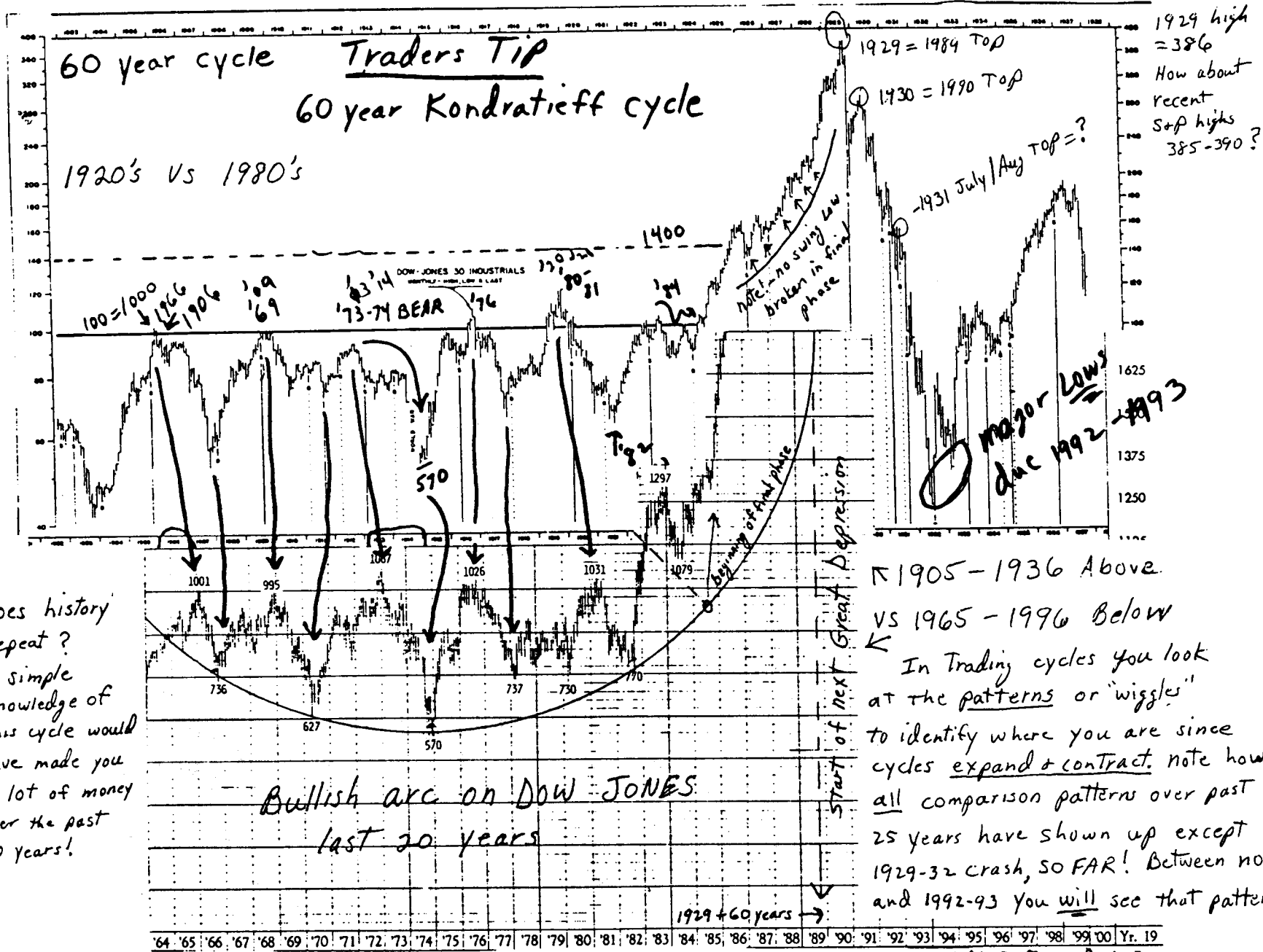
Circular arc patterns are usually rare except at the end of very big cycles. While in effect corrections are short and shallow and when over, the collapse is devastating!
In Terms of Time, decline will last 15 years i.e. from '74-89 → 2004 Low

most Dow stocks @ 2550-2400 have hit 1st Target @ 2200 otherwise a break of this arc signifies minor counter 45° from "blastoff" defines

Vol 4 Issue 13
February 9, 1989

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Vol 7 Issues 3
August 20, 1991



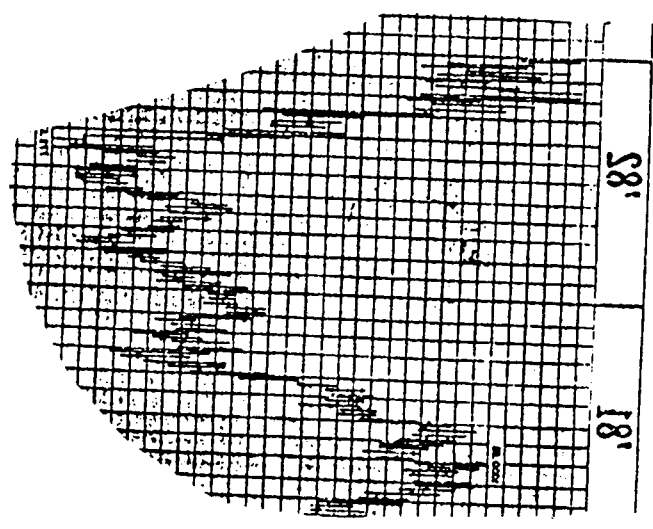
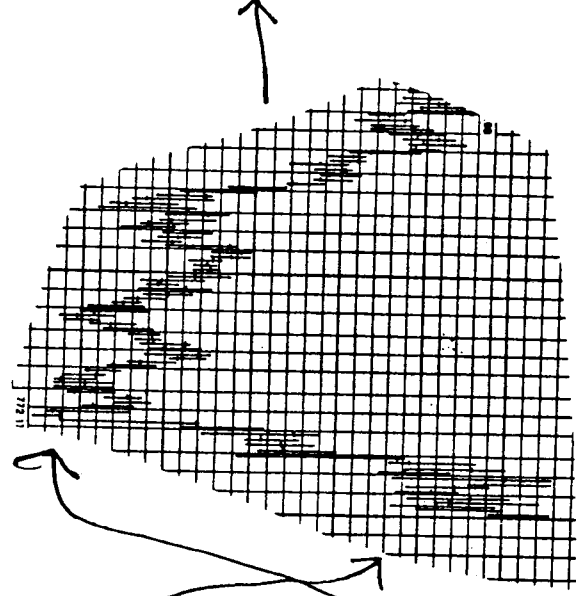
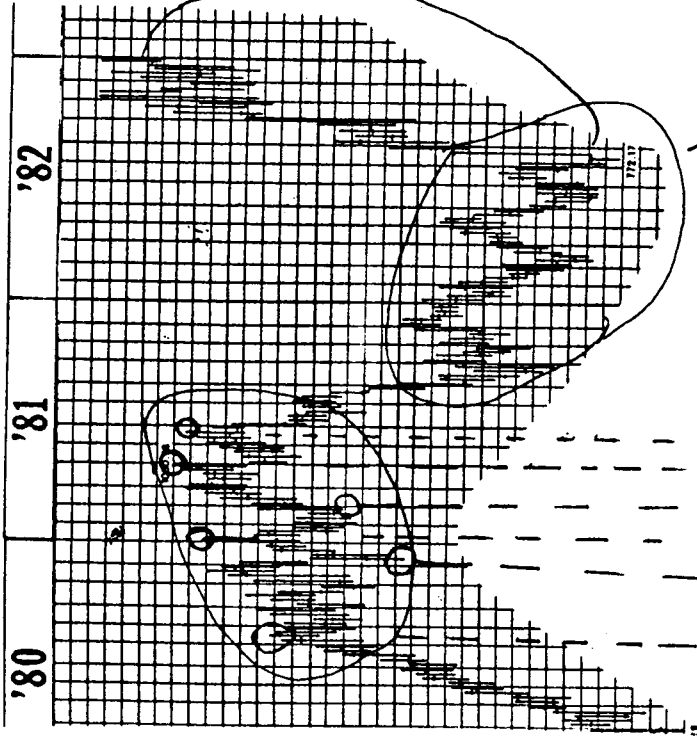
Does history repeat?
a simple knowledge of this cycle would have made you a lot of money over the past 20 years!

Bullish arc on Dow Jones last 20 years

1905-1936 Above
VS 1965-1996 Below
In Trading cycles you look at the patterns or "wiggles" to identify where you are since cycles expand & contract. note how all comparison patterns over past 25 years have shown up except 1929-32 crash, SO FAR! Between now and 1992-93 you will see that pattern.

In 1929 the U.S. was the dominant market - in 1989 - JAPAN.
Japan broke 50% in 1990 went sideways 6 months (like rally 6 mos into 1930) and is now breaking again. Look for JAPAN TO Lose 70%-90% by 1992-93 and U.S. only 40-50%

STOCK CYCLES FORECAST



1st Transformation "flip"
 Take bottom,
 upsidedown

2nd Transformation
 Take reverse negative
 (this is a xerox
 "thru the back side"
 of the copy)

Proof that emotions of Greed at Top, and Fear
at bottom are reflections -

TOP
 recreated
 i.e. bottom is
 reflection of top

Mirror image / Ying-Yang = The top reflects
 the bottom

1981 Top pattern creates 1982 bottom

STOCK CYCLES FORECAST

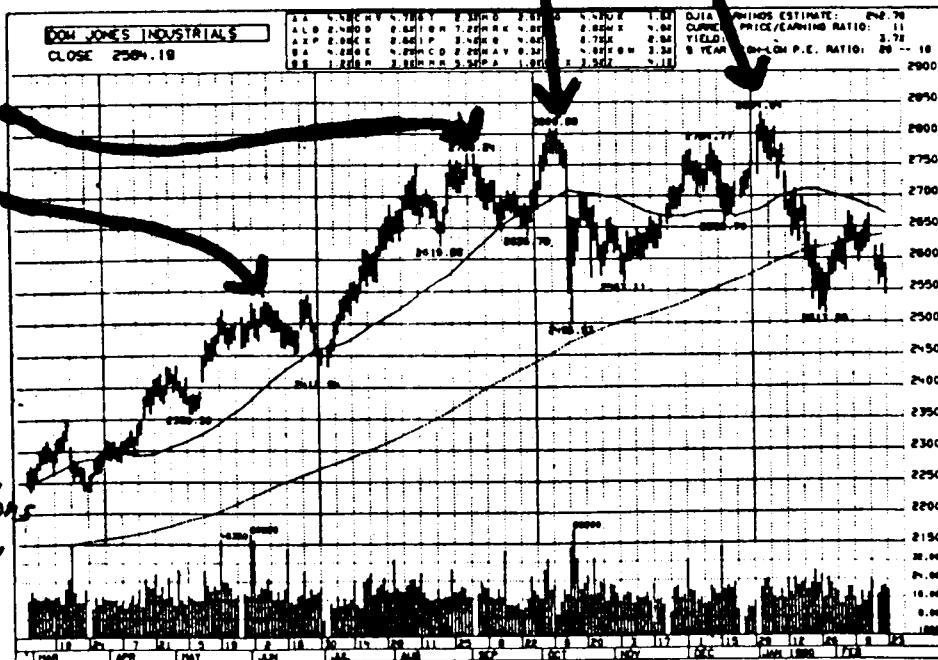
160 Broadway, East Bldg., 7th Floor, New York, N.Y. 10038, Telephone: (212) 285-0050 Volume 5, Issue 2

June 14, 1989

Dow 2503

As of today's date the market has still not exceeded my resistance number of 2520 mentioned in the last report. If we exceed it in the next few days we will probably go to 2580 for the top, otherwise the correction will start when we break 2480 and take us down to perhaps 2371, the gravity center and pivot of this years' move. The correction should take three weeks to complete. Should we start the correction from the higher level the low will be 2442. Please remember that if we are in a truly gigantic big up move to 2800 to 3200 we may not see a correction at all, so don't jump the gun unless we break at least 40 Dow points from any extreme high price reached.

From a cycles perspective I can now give you some valuable information as to the most probable outcome for the rest of the year. First, IF we get into the second week of July AND we get to or are above 2500, the odds overwhelmingly favor the FINAL TOP being made August 31, 1989 or September 5th, with a price of at least 2800. Second, a crash like 1987 will again take place in October and not bottom until the second week of November. Third, another important top and the last place to get out on before the massive liquidation begins will be January 1990. This top in January could be a double top all the way back to the highs.



Other than Nostradamus, has any person ever made such a series of consecutive accurate predictions as these? →



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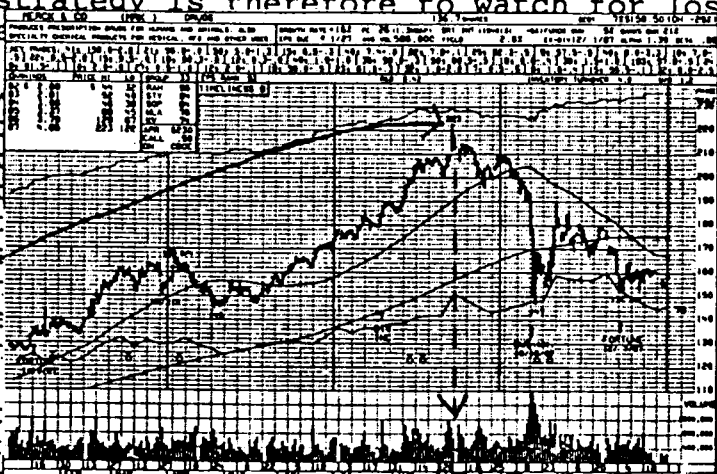
STOCK CYCLES FORECAST

160 Broadway, East Bldg., 7th Floor, New York, N.Y. 10038, Telephone: (212) 285-0050 Volume 3, Issue

August 12, 1987

Dow 2670

★ The massive blast off to new highs predicted in the last issue is now well underway and only a short time remains for safe trading. The momentum of the move should buy at least three weeks of time and perhaps more, but this is one top I want to be out of early rather than late. Watch for major moves near my millennium date of August 19th and especially the 24th. I sense almost complete bullish consensus that the market will trade up into year end and close at the highs, and many of my cycles are near maximum peaks over the next thirty days and then down hard. September is shaping up as a real potential disaster so avoid the rush and lighten up into Labor Day. It is important to remember that all of the charts are now in the near vertical parabolic phase that always leads to a blow-off after a substantial run. The strategy is therefore to watch for loss of momentum before the point Dow decline (within 3 to 6 months) so stop point the market weekly close is at least



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 issues. By the
 way, for those of you who are owed fortunes having shorted Merck during the run from 40 to 200 in the past two years, I calculate the final Bull Market high for this stock to be the first week of September 1987!

From a trading perspective, the best emerging groups to buy are insurance, banks, and brokers. Watch for a good shorting opportunity in the XMI stocks particularly MO, MMM, MRK, PG, DD, and GE at the end of the current run. Price targets for the current move are 2725, 2765, and 2850.

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STOCK CYCLES FORECAST

160 Broadway, East Bldg., 7th Floor, New York, N.Y. 10038, Telephone: (212) 285-0050 Volume 3, Issue

October 15, 1987

Dow 2355

A major crossroads is now at hand. If the market cannot stage a significant rally of at least 150 Dow points within the next two weeks, the Bull market will be over. Should the market continue to plunge and break 2290, watch for an immediate crash to 1850. If the Dow regains 2520 it will possibly go to 2610 for the final high into the second week of November. In any event, all cycles point down hard after mid-November and won't even remotely rally at all until early March 1988.

2355
1850 *
505
expected
drop
into
October 19th

Although a major time cycle low is possibly near, I find it difficult to believe that the recent drop could have happened if the underlying technicals were really strong enough to support a rally to new highs later this year. It seems much more likely that the 50 year cycle mentioned in previous issues has hit and we will now enter a one year Bear Market prior to any further major advance. I think it will be easy to know the outcome anytime after October 20th, as the enclosed activity calendar seems extraordinarily bullish, but could also be a bearish cycle inversion with every day down if further lows are made after the 20th. In terms of cash available the market is very liquid; in terms of psychology, it is totally illiquid and quite dangerous. As of today the Transports and Industrials have both broken to new lows and thus rendered a "Dow Theory" Bear Market sell signal. This should give one concern, however, I am still skeptical because we have just reached the 200 day moving average which almost always gives rise to a good rally, and additionally the market was so high above this average during this tremendous move and the violation of prior lows in the averages may not be as significant as experienced in prior less parabolic Bull markets.

Since it is still theoretically possible for the market to yet go to new highs starting next week, the jury is out until we either break 2300 downside or 2500 topside. I would suggest selling out and only buying again if the market holds for three full days without making a new low, and we get a rally with breadth of at least 1100 stocks up on the day. Important cycle turns seem to be near October 19-20th, 22nd, 27th, and November 5th. Odds favor a good low October 19th ✓ * and a major top by November 5 but certainly no later than the 20th.

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SECRET OF FRACTIONAL HARMONIC TRENDLINES

(Gann's secret of why Time and Price are the same thing!)

This chart clearly demonstrates better than words the helplessness of the human condition and why people lose in the markets - **Reality** is completely different than **perceptions** - i.e. news items, brokerage recommendations, etc. have no bearing on stock price movement.

See how the top near \$100 spins out support and resistance angles at 1/8 increments. The intersections of these angles (down and up) give rise to **all** reversals in the price pattern and cannot possibly be related to random news or recommendations.

