STREETSMART GUIDE TO

Timing the Stock Market

When to Buy, Sell, and Sell Short

Discover the Secrets of Successful Futures Traders

Colin Alexander

The Streetsmart Guide to

Timing the Stock Market

When To Buy, Sell, and Sell Short

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Colin Alexander

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PART ONE

The Case for Timing

CHAPTER 1

The Secret of Timing

What and When to Buy and Sell

The timing techniques in this book come from technical analysis. If the word *technical* sounds forbidding, don't be alarmed. In this context, technical does not mean complicated. This book is for all investors. It is for those already familiar with technical analysis as well as for those who know nothing about it but want to learn which stocks to buy and when, and when to sell.

Technical analysis tells you when to buy or sell a stock on the basis of what its price action says about it. It can complement fundamental analysis, which suggests which stocks to buy on the basis of financial statements and assumptions about business prospects.

From this book you will learn, step-by-step, how to use specific timing techniques to buy and sell stocks. In doing that, it discards what you do not need to know, for there are few areas of greater knowledge overload than the stock market. This book comprises, with modifications and additions, a straightforward and easy-to-learn system that works in futures markets and which is described in my book, *Five Star Futures Trades.*

A computer program developed from *Five Star* by Pierre Fichaud in Montreal delivers consistently profitable results in all financial futures markets traded in North America. He has proven with this program that this methodology works in all financial futures markets and in all market conditions over the long term. The results for stock indexes, although deriving only from data during a major long-term bull market, show profitable trades exceeding losers by more than two to one, and profits exceeding losses by almost four to one.

When technical analysis and fundamental analysis support the same conclusions, the results are likely to be spectacular. However, fundamental analysis on its own does not necessarily lead to stocks where the action is. A stock might look wonderful on the basis of its fundamentals but in the real world more people may want to sell than buy it. So the stock goes down, not up. On the other hand, when there are strong technical buy signals, it will likely be more rewarding to buy a stock about which you know little or nothing than to buy a blue chip with poor price action.

You can tell from technical analysis when an individual stock, or the market generally, is in an uptrend or a downtrend, or when the trend is sideways and ambiguous. Within that framework, the timing techniques described in this book tell when the balance of the evidence favors buying, holding a stock, selling, selling short, or doing nothing. In simple terms, that means buying a stock already showing, by going up, that it can continue to move up, and vice versa when selling or selling short in a bear market.

As long as the technical indicators remain favorable, you can let profits run for a long time, occasionally for many years. When the balance of technical evidence turns against a stock, it is time to bank a profit or prevent a loss from getting bigger. Over the years it may be appropriate to buy and sell a stock several times. Since you can never tell beforehand how far down a stock might go once it starts going down, you must also be prepared to sell as well as buy. Even the greatest stock can fade and, in extreme cases, go down to nothing. You must avoid the tragedy of losing your life savings in a major bear market.

Contrary to what many people believe, timing is not about picking exact market tops, either in the market generally or for an individual stock. That cannot be done with acceptable consistency, and there is no point in trying.

Extremely good profits should come some of the time, and you should avoid devastating losses at any time. It is certain that you will sometimes misinterpret signals. Remarkably, you might think, you have to be right less than the 50 percent of the time. When you are really right, you may succeed in buying a stock that goes up by ten times or more. That, in essence, is the secret of timing.

The Difference Between Two Stocks

Price charts and chart-based technical indicators show you what is happening. The challenge of buying the best stocks and of not buying poor ones is illustrated by comparing the monthly chart for General Motors (Figure 1-1) with the one for General Electric (Figure 1-2).

Everyone knows GM. It is a household name, so it would be natural to think of it as a solid and reliable company and of its stock as a great one to own. In the 1920s the stock was the equivalent, for its time, of Microsoft, multiplying in price by 150 times. In 1989 you could have bought GM at $50. At one point in 1998 the stock made it to $76, for a

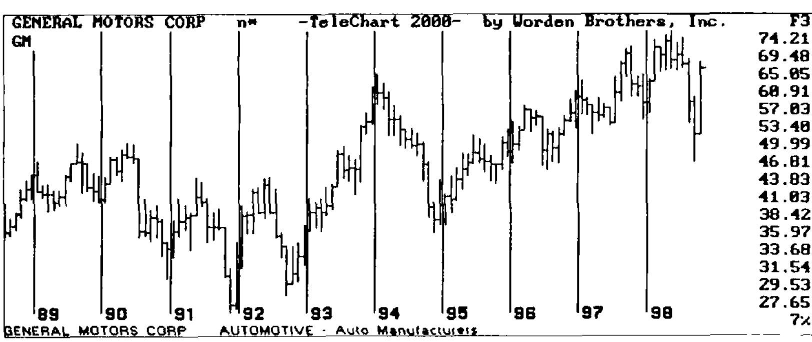

FIGURE 1-1. Monthly Chart for General Motors.

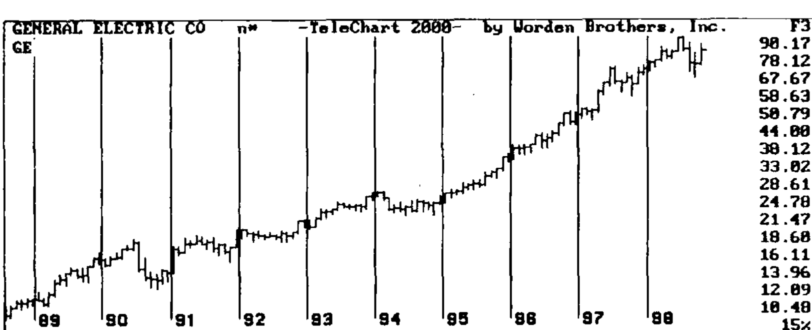

FIGURE 1-2. Monthly Chart for General Electric.

profit of about 50 percent. However, in October 1998 the stock fell to $47, to where it was almost ten years before. Meanwhile, many stocks went up by five and ten times between 1989 and 1998.

Instead of buying GM, you could have bought General Electric. At the beginning of 1989 you might have paid $12 for the stock, or you might have paid $18 at the high in 1990. Assuming that you held the stock until 1998, it would matter little how much you paid. At the 1998 top, you made between five and eight times what you invested in 1989 or 1990. When the stock fell back to $69 at the low for the decline in October 1998, you still had several times what you paid for it in 1989 or 1990.

As we shall see later, there were sometimes better times to buy GE, when the near-term prospect of gain was greater, and the near-term risk of loss lower.

What You Need

This book, a computer with charting software, and a source of end-of-day stock prices provide the tools you need to be successful. You also need to make a commitment to set aside a moderate amount of time for homework to review your current investments and potential new ones. Investing should be stimulating and rewarding in every sense, although it has to be approached responsibly and in an organized manner, as you would approach any business.

For illustration, this book uses stock charts generated by the Worden Brothers' *TC 2000* software. There are many good software programs but it is hard to beat *TC 2000* for cost and data management. Even if you have a small portfolio, you must have a package that permits unlimited access to long-term historical data. It is essential for long-term investing with the system described in this book to look at the charts for several years of market action.

The *TC 2000* software includes two excellent technical indicators not discussed in this book. They are the Cumulative MoneyStream and Balance of Power. Developed by Don Worden, one of the pioneers of volume and money-flow analysis, these indicators show buying and selling pressure. The software comes with a booklet explaining these indicators. This book uses, in new ways, the similar On Balance Volume indicator, which can also be used with other software.