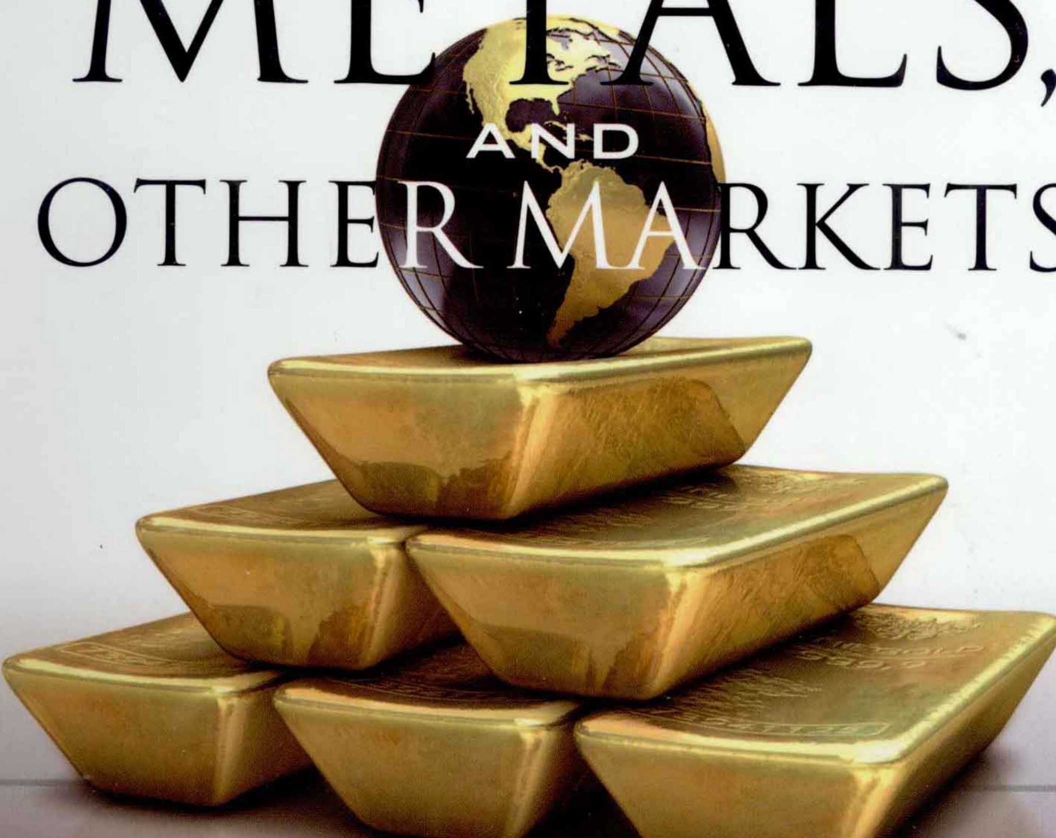
WEALTH BUILDING STRATEGIES IN ENERGY, METALS, AND OTHER MARKETS



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Wealth Building Strategies in Energy, Metals, and Other Markets

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INTRODUCTION

A Musical Rainman

"Where words fail, music speaks."

—Hans Christian Anderson

"Music was my refuge. I could crawl into the space between the notes and curl my back to loneliness."

—Maya Angelou

Like so many young people, I was captivated by music of every sort at an early age. Between the tiny grooves of vinyl records I found a gateway to a new dimension. Although outdated in the digital world, the 33 revolutions per minute of the family record player were sufficient for me to develop substantial and enduring friendships with the great classical composers. Vivaldi, Handel, Chopin, and Bach became my mentors.

Meantime, on a routine visit with a physician, I was informed that I had a rare form of eidetic memory. Dr. Bruce helped me to understand that such nearly perfect musical recall was uncommon. While eidetic mnemonics imparted flawless audio memory, it also compelled the subject to relive verbal criticisms and harsh words with DVR-like recall, indefinitely.

Still, the malady did include interesting, albeit peculiar, side effects. Whenever life's challenges seemed intolerable, a repertoire of the world's greatest musicians magically whispered in my ears. The musical genius of E. Power Biggs and the London Symphony Orchestra with Sir Neville Marriner at the helm always provided a calming panacea for a weary mind.

Internal iPod

Eventually, I was exposed to every type of modern music, including the top 40 hits. The early passion for music morphed into a mental jukebox, allowing for instant access to every song that I'd ever heard. The ability was particularly useful while attending mundane lectures in windowless, dungeon-like classrooms. Confined within appalling, windowless walls, pinned like a bull en route to the slaughterhouse, I developed a blueprint for escape. Armed with only an internal iPod I would teleport to an outdoor concert event amid lush green fields and deep blue skies. All of a sudden, boredom became musical elation. If conditions were particularly unsettling, the course of treatment included a favorite Bach fugue and toccata masterpiece or a performance written for the king of England, *Water Music* by Handel.

As useful and entertaining as a powerful memory proved to be, it was destined to remain little more than a diversion. The ability offered little in the way of monetary rewards. I found the prospect of becoming a starving artist somewhat less than appealing. Millions of gifted artists will gladly attest to the fact, that without a source of income, all the talent in the world will not satiate a landlord's appetite for monthly rent payments.

The Rhythmical Economist

Just as the language of music is applied to a canvas-like score, one brush stroke at a time Wall Street carries on its discourse with investors via individual stock quotes. The striking visual and mathematical relationship between stock charts and musical arrangements first became apparent to me while away at school. Ergo, a degree in economics seemed the ideal transition from a potential life of penury into the more practical and promising field of investing.

My education in the challenging world of finance began at the library. Anxious to obtain the latest copy of the *Wall Street Journal,* before daily lectures, I'd dash from the student center with a freshly grilled Philly steak sandwich and side of French fries. Sitting comfortably in the library periodical reading room, I occasionally turned my attention away from the *Journal* to survey the remarkable campus. The view was filled with tall Georgia pines, majestic magnolia blossoms, and the pale blue southern skyline.

Meanwhile, the front page of the investing section provided the object of my obsession—a chart of the Dow Jones Industrial Average. Like the intense yet sublime melody of Vivaldi's *Four Seasons*, the Dow Jones prices seemed to adhere to a divine governing rhythm. Suddenly, a beguiling question struck me. Just as the human mind is capable of anticipating the next few notes of a musical performance—was it possible to profit from the basic melodies hidden within market prices? Answering the perplexing question became a personal quest.

Super Dome of Finance

The decision crystallized within me to pursue a degree in economics and finance. No longer was my career path to be dominated by music. While enjoying Christmas break, my resolve was further emboldened by a visit to the Chicago Mercantile Exchange. A close family friend and former member of the exchange invited my family on a tour of the vast trading floor. While strolling around the huge complex, I found the energy level and the roar of the adrenaline-filled traders to be intoxicating.

Afterwards, a new question entered my mind. Should a starving college student pursue a summer internship as a runner on the exchange floor? Unfortunately, the campus was nearly 700 miles away from the super dome–sized temple of finance.

Moreover, most if not all the brokerage positions required unpaid internships, endless cold calling, and boiler room–like conditions. Undeterred, I eventually secured a position as an industry analyst at the nation's largest law firm. Compared with the jobs I'd held while working my way through school, I found, for the most part, that lawyers enjoyed far more reasonable working hours.

My new office home from 9 to 5 P.M. towered 500 feet above the sprawling metropolis. The executive suite was lined with huge windows, which framed a breathtaking scene of the city skyline. Local news helicopters whirled through the city, sometimes several stories below eye level.

Meantime, I settled into a surprisingly comfortable leather office chair behind an impressive executive desk and began analyzing economic conditions for the firm's partners. I'd been hired with the understanding that I should expect large blocks of time, sometimes days, without steady projects. The work was challenging, albeit sporadic. Waiting for new projects to descend the imposing office hierarchy left considerable time for my market investigations. I found that my passion for the markets hadn't disappeared, but merely lain dormant.

Nonetheless, 500 feet below my office the shelves of a nearby bookstore held copies of the latest investing periodicals. During lunch hour I'd pass through the air-conditioned sky tunnels, which connected the marble tower to a shopping venue.

Similar to my daily visits to the university library reading room, my search now focused upon the latest issue of *Stocks & Commodities* magazine. I devoured each article with as much fervor as lunch—sometimes losing track of time in the process. As a typical neophyte, my quest for the holy grail of investing began with the field of technical analysis, that is, repeating rhythmic price patterns. Terms such as *stochastic, relative strength index, trend lines, Fibonacci* and *parabolic stop,* and *reverse systems* entered my vocabulary.

By 1998 the Internet stock market boom was front-page news. Trading opportunities seemed so boundless that I decided to pursue independent investing as a full-time career. My house was the first in the neighborhood to "jack-in" to the newly available broadband Internet technology. With blazingly fast cable modem wind in my computer's sails, I attempted to seize the unique trading opportunities offered by instantaneous market quotes.

Accordingly, lightning-fast Internet access and free real-time index charts did culminate with a significant breakthrough. I discovered that the underlying futures contract always changed direction before the NASDAQ at important market tops and bottoms. Although the brief glimpse into the future dissipated eventually, a million-dollar seat on the NYSE wasn't required to recognize the potential arbitrage opportunities. Armed with the latest technological marvels and a zealous lust for success, I found that providence favored the prepared mind. Trading losses eventually yielded to profits, albeit humble.

Moreover, as with so many endeavors in life, just when the riddle of the markets seemed to be solved, a fundamental shift occurred and everything changed. On March 9, 2000, the NASDAQ index climbed above 5,000 for the first time in history. Pundits proclaimed that the market ascent would continue, perpetually.

The Dow Jones Industrial Average gained more than 1,300 percent during the great bull market of 1982–2000. James K. Glassman and Kevin A. Hassett's book, *DOW 36,000*, forever captured the extraordinary hyperbole of the period. Many book titles were to follow, such as *DOW 40,000* by David Elias. But the crown and scepter of one-upmanship remains justly and firmly in the possession of Charles W. Kadlec. The title of his work, *DOW 100,000*, was the piece de resistance. Yet the additional 1,000 percent in gains required for Kadlec's *Dow 100,000* penultimate forecast to come to pass, never materialized. Kadlec's prediction was a contrarian wake-up call to liquidate stocks and diversify into Treasuries and commodities.

Dot.com—Dot.bomb

In the late 1990s, many executives desperately sought to secure their claim in the Internet Gold Rush. For a very brief moment in time, adding a simple web page and dot.com to the corporate logo worked wonders for share prices. But before long the Internet stock flash in the pan came to an abrupt halt. By the end of 2000, the market selloff seemed as harrowing to the legion of inexperienced investors as the tribulations of Job.

In Chapter 1, verse 21 of the Book of Job, the troubled protagonist says, "Naked came I out of my mother's womb, and naked shall I return thither: the Lord gave, and the Lord hath taken away." In similar fashion, just as the market had granted sizable profits during the late 1990s bull market, now that the stock market peak had passed, a scourge of losses promptly followed. As suddenly as the IPO phase of the bull market had arrived, it evaporated. Gone were the profitable days of investing in dot.com stocks. Just as Job was engulfed by his misfortunes, bullish investors suddenly faced a formidable bear market.

Correspondingly, by September 11, 2001, investing capital was dwindling as rapidly as market prices. In order to retain what little remained of an initial grubstake, a self-imposed trading hiatus was necessary. During the break, I began an exhaustive search for a solution to the bear market dilemma. The renewed quest for an investing holy grail included Metastock, a computer-based trading system platform.

During business hours, I designed and tested mechanical trading systems. In the evenings, my reading list included books covering the mathematical underpinnings of rules-based investing, such as system expectancy, risk-reward ratio, win-loss and Sharp ratio, and so on.

Accordingly, the due diligence process led to an epiphany. No matter what time frame I examined, whether it was tick by tick, five, 15 or 60 minutes, daily, weekly, or quarterly, one commonality always held true. Eventually, a lengthy/profitable trend emerged. Finally, the breakthrough arrived and persistence yielded dividends. An adaptive and robust trend-based system was to be my portfolio's savior. The faithful Job-like neophyte investor had escaped the clutches of financial capital punishment by carefully scrutinizing the markets.

The leap of understanding shares similarities with Euclid's five postulates. In his magnum opus, *Elements*, the Greek mathematician and founder of modern geometry provided mathematical proofs that, even 2,300 years later, form the support of every conceivable engineering wonder. In like manner, the realization that regardless of the time frame observed, all markets eventually establish a profitable trend was a career-changing insight. Suddenly price prediction seemed a wasteful, even futile, endeavor.

Moreover, as the seductive sea siren of Greek mythology and wailing banshee from Gaelic folklore lured seafarers toward the reef, so the promise of prediction draws the unsuspecting market mariner to his ultimate demise. Calm market conditions more often than not conceal a tempest of price complexity. As soon as an over-optimized system is exposed to actual data, it invariably crashes into the unyielding reef below, covering the sea floor with the contents of the portfolio treasure chest. The solution is simple. Investors must leave forecasting to the weatherman and instead concentrate on wealth building strategies that entail a portfolio rich in energy and precious metals investments.

The focus of Part I of this text is wealth building strategies in stocks and commodities. Relevant historical anecdotes add greater substance to the material and better illustrate the challenges facing the modern investor. For instance, stock market bubbles and panics are neither new nor rare occurrences. Extreme price volatility is actually the norm. From the South Sea Bubble all the way to the more recent 1929, 1987, and 2000 market implosions, former manias provide an excellent vantage point from which to investigate the recent 2008 credit crisis.

Nevertheless, there's far more to financial success than merely solid investments in stocks and commodities. At the end of the trading session, every investor must find someplace to call home. Yet the challenges facing homeowners today are overwhelming. During the past three years, securing a reasonably priced house has become a far more complex proposition. Currently more than 11 million families own homes worth less than their mortgages. Part II investigates the housing crash and provides an easy-to-follow roadmap to real estate bargains. Armed with three simple rules of thumb, readers will never again fall prey to high-pressure sales tactics. Instead, they'll know how to avoid the lemons and secure their dream home. Once the housing market fully stabilizes, most likely in 2012–2013, the reader will be prepared to purchase a safe and affordable house at a reasonable price.

Furthermore, until recently, domestic bank runs/banking holidays were rare occurrences. That all changed in 2008 when hundreds of IndyMac bank accounts were frozen and seized by the FDIC. With numerous banks expected to file for bankruptcy, would you know what to do if your lender suddenly closed its doors? Part III guides investors through the land mine–laden banking sector with practical procedures to protect the accumulated profits earned from the methods outlined in Part I and Part II.

In addition, over the course of five years in the field of business talk radio, I've answered thousands of thought-provoking questions. One universal theme remains constant throughout the stacks of letters and phone calls: Millions of real people are desperately seeking simple answers to tough financial questions. Thus, each chapter includes a Q&A section with inquiries from actual Goldseek.com radio listeners. Plus chapters wrap up with a Key Point summary of the most significant topics. So insert your ear buds and enjoy your favorite iPod tunes. You are embarking upon a unique and entertaining financial enterprise!

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PART I

SUCCESSFUL INVESTING

CHAPTER 1

Winning Formula

THE INVESTING HOLY GRAIL

"October: This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February."

—Mark Twain

Welcome to the exciting world of personal finance. Written within the pages of this book are the keys to unlocking incalculable riches. The first step to financial success is a unique understanding of price behavior. This chapter begins a thorough investigation into trend investing, arguably the most profound breakthrough in finance since the first exchange opened for trade over 400 years ago. By examining market manias and the people who traded them, the reader will gain priceless insights into market dynamics including how and why securities enter protracted trends.

The Market Trend Enigma

For hundreds of years, the secrets to investing success were hidden away from the masses. Even the prodigious mind of Sir Isaac Newton was perplexed by market dynamics. When asked about the South Sea Bubble, the greatest scientist of the last millennia replied, "I can calculate the movement of the stars, but not the madness of men." His investing woes were further chronicled and corroborated by comments from his niece, "(Uncle Isaac) lost twenty thousand pounds (millions of dollars). Of this, however, he never much liked to hear." (See Figure 1.1.) Judging by the nearly vertical crash that followed the speculative mania, it's easy to understand why Newton was so mystified by market mechanics (see Figure 1.2).

Yet by the twentieth century the investing riddle was solved. The astonishing market operations of two great traders, Jesse Livermore and Richard Dennis, contained the blueprints for a trend investing revolution. Rumors persist to this day that Livermore, the boy plunger as he liked to be called, reaped $100 million in profits by correctly gauging the 1929 market crash and the subsequent downtrend that followed. (See Figure 1.3.)

In similar fashion, the Prince of the Commodities Pit, Richard Dennis, reportedly transformed a meager $400 of borrowed funds into $200 million by adhering to market trends. What Livermore and Dennis had independently discovered was a financial El Dorado that had eluded even Isaac Newton. The intrepid pair ignited an investing gold rush of riches beyond the dreams of avarice, available to everyone armed with the proper skill set.

So just what exactly is the enigmatic market trend? A trend is merely an unusually long price advance or decline that results from a powerful new cycle in a higher time frame. For instance, a powerful new upswing in the weekly stock price oftentimes results with a lengthy uptrend within daily prices. Examples of extraordinary trends that remained unbroken for decades include the U.S. stock market and the residential real estate market. Both trended higher for decades. (See Figures 1.4 and 1.5.)

Trends do not always follow a northerly pathway; at times prices decline for extended periods. For example, from 1980 to 2000 lower prices (a downtrend), dominated the gold market. The yellow metal subsequently reversed course in 2001, beginning a decade-long advance (uptrend). (See Figure 1.6.)

Simply Unpredictable

Thousands of investors have subsequently followed in the footsteps of Livermore and Dennis, embracing the trend investing methodology. Yet despite the fact that trend investing is profoundly profitable, it runs contrary to currently accepted industry and academic

Figure 1.1 South Sea Bubble