

How To Buy

**AN INSIDER'S GUIDE
TO MAKING MONEY
IN THE STOCK MARKET**

JUSTIN MAMIS

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FOREWORD

The other day, we listened to a professor being interviewed on TV about “the market.” What fascinated us was that he wasn’t talking about the market, as *we* know it. His comments centered on the Federal Reserve Board, on inflation or lack of same, on durable goods orders, and all manner of other economic factors (and from such matters he then presumed to know what stock prices were going to do). What people, in their infinite wisdom/madness, might do seemed to have nothing to do with it. That’s the opposite of how we picture “our” market of buyers and sellers: like an old-fashioned farmer’s market. Purveyors with goods to sell set up shop in the central town square (Wall Street) and put them on display (the ticker tape). Several farmers have similar-looking prosaic cabbages to sell; others have lots of different varieties of apples (big cap, small cap). At the same time, the populace wanders around to see if there is anything interesting to buy – highly desirable quality, or undiscovered bargain, or simply something they could use.

Some people will buy “at the market” right away, not wanting someone else to come along and snatch a desirable item away with a better bid; others will bide their time, hoping that by mid-afternoon the seller might reduce the price in the hopes of getting rid of his goods before the market closes for the day. That’s the market we know: made up of a variety of different buyers and sellers, a variety of different goods and choice, a variety of motivations and information (or lack of same), an on-going stream of interest and activity. With so many people with so many different styles and opinions and tastes and pocketbooks and ways and means of deciding on what they want to do, it is a psychiatrist’s dream of trying to understand it all at once ... can’t be done perfectly, but can be done relatively well.

We care about *that* market as it trades, with the fluctuating prices (and volume) telling us what’s going on, and what the underlying psychology is. In a sense, we’re trying to understand buyers and sellers, so as to be able to foretell what they might want to do next. In another sense, we’re observing who’s winning: the buyers or sellers, on the expectation that the discerned trend ought to continue. In still another sense, we are trying to establish which stocks are over-owned, and which are under-owned, and trying to

observe, in various ways, when the trend from one to another may be changing, or has gone to such an extreme that it ought to be about to change. Nor do we need to know why – just when, and how, and what! We continue to believe, in fact, in one of the first things an NYSE floor trader ever taught us: “It’s not the news that matters ... it’s how the stock reacts to the news.”

This book, and our other two volumes (*When to Sell*, and *The Nature of Risk*), describe our view of this marketplace. We’ve left untouched some of the original indicators described within, even though changing market styles have made some of them out-moded. (Odd-lot short-selling was supplanted by put and call buying, and options activity itself, in turn, has been shifted to second-tier indicator status with the advent of a vast number of new trading indexes such as QQQ for the Nasdaq 100.) You might read about those archaic indicators to get an idea of how sentiment has been measured in the past, so as to figure out how to deal with current ways sentiment is revealed ... keeping in mind that contrary opinion has been, is, and always will be the important stance.

When we opened up the original edition of *How to Buy* and saw at the outset the phrase, “the market fluctuates,” we knew that the book did not need to be rewritten. Not only does the stock market still fluctuate, but *it does so in the same manner as it ever did ...* all of the talk about volatility and all of the manic technology swings of recent years being just remarkable extensions of such fluctuations. The manner in which the market does fluctuate, and how such fluctuations should be understood, seems more timeless than we would have believed in our youth – just as valid in coping with the manic rises and subsequent bubble burstings as when the market was relatively calmer. It still takes just as long to make a top, or a bottom (*which is the basis for this book*) as it ever did.

Keep in mind, as you read these pages, that a buyable bottom can only develop when everyone who wants to sell has sold – in other words, a buying opportunity represents contrary opinion to the prevailing selling. How do we get to that point where others want to sell? Simple – there has to be bad news at a bottom, for how else would prices get driven down? Not on ‘good’ news, surely, but on bad news, and not merely on bad news but on bad news that shareholders begin to feel can only get worse, or is never going to

end. Ah, that's a buyable bottom: everyone else discouraged, scared; bad news haunting investors; and, of course, a share price that doesn't go down any more because everyone who wants to sell, or is finally scared into selling, has already done so.

In a book about *How to Buy* one needs contrary opinion to the prevailing scared sentiment in order even to start looking for a buying opportunity ... a bottom which must be contrary – can't hear the media folk on CNBC and elsewhere talking about a bottom and expect to find it at one's elbow.

Don't think a stock is attractive just because it is down so far from its high, or that it is buyable just because it has become conspicuously strong for a day or two. Patience is required. Ask yourself, Who knows what? When did they know it, and Why is the stock acting that way? Remind yourself that you're not the only person in the country who is interested in a particular stock – if it's so great, why is it still going down? If it's so crummy, why has it begun to hold and even to turn upward? Being suspicious, being cynical, is a good way to practice being contrary. A bottom will not form, a buying opportunity will not appear, if everyone believes in it – “buying when you're crying” is a floor trader expression of what one has to do to make the best bottoming purchases.

There never has been, nor do we expect there ever will be, a bottom formed when buyers are enthusiastic ... an intervening bounce perhaps, sharp and short-lived, but the psychology of bottoms, and especially longer-term buying opportunities, requires “scared.” Indeed, good buying requires some nervousness that you might be wrong. What we are trying to convey in the pages of this book is various objective means – charts, indicators, sentiment analysis – to help you identify when, nervous as you may be, it is time to be the only one willing to buy at that moment. That's an exaggeration, of course, and it may happen to you only once in an entire investing career ... but it is the “buy” attitude to strive for.

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1

IT'S ONLY A GAME

I'm going to tell you things I know about the stock market that no one else knows, but what is most true about the market is something everyone knows: *it fluctuates.*

Every bit of the market's behavior, and all the information you need to deal with it, stems from that single simple fact. Yes, there are fortunes that have been made by those who got in on a stock early and stuck it out through innumerable declines and bear markets. This book is not about such rare instances. They are often offset by the stories you don't hear, of failure and mistakes in judgment. Besides, we are here not to discuss exceptions but to show you how to make money in the stock market without gimmicks, tricks, or systems, without enormous effort or time-consuming attention—solely by means of the information readily available to you.

“Can it be done?” is not the first question. Professionals do it all the time—or they wouldn't be professionals for long. Just like a rookie playing the game in the big leagues, a professional money manager or trader has got to produce or he is dropped from the team. No one fools around when capital is at stake. A pro either makes money in the market or finds a different profession.

Nor are we talking exclusively about those professionals who

have the advantage of paying much lower commission rates due to Exchange memberships. The proliferation of "discount" brokers has taken much of that sting away, and besides, some of the most successful professional traders we know gladly pay full commissions to brokers for intelligent opinions and good order executions. The trick in this business is not to make eighths and quarters but to go for the "big hits." Virtually the only extra advantage some of these professionals may have over a member of the public at large—and we're not sure this is truly an advantage—is access to "better" information (such as hot tips) a trifle faster. The batting average for hot tips proving true is dangerously low, however. More important, even when the information is accurate, it almost always can be discerned by non-professionals, too, as long as they know what clues to look for. If a stock is strong, it may signify that good news is about to be released, or merely that an institution has entered a big buy order on the Exchange floor—in which case the stock price will be vulnerable to fading as soon as that order is filled. We'll gladly show you the volume and price-action clues that can tell you, too, that "something may be going on," to help you decide whether the stock is worth buying. Remember, for someone to profit by what he knows—be it hot tip or intelligent analysis—he's got to go into the marketplace and act. This action will have an impact on the stock's price and its volume, thus creating an effect on the stock that we can perceive. This is the basis of all the information you will need to learn to make money in the stock market. If you find you are taking repeated losses instead, the problem is probably a personal (psychological) one, and you should place your money more safely elsewhere. So the question at the outset is not how you can make money but *should you be in the market at all?*

To Buy or Not to Buy

There is one reason why you shouldn't: you may not want to, or be able to, take the risk. Because the market fluctuates, your money is always being risked. Because you have to make a choice of what to buy, that risk is compounded by the added decision. This is true not only of stocks but, as so many banks, pension funds, and even

professionals have found out to their sorrow, of the bond market as well. Bonds were once thought of, with almost a religious belief, as a safe place for investments, as "sleep at night" havens for funds, but a decade of declining prices, capped by the crash of 1980-81, has, we expect, destroyed that faith with a vengeance. Those with fiduciary responsibility for "widow and orphan" funds could only shrug that they had done the prudent, the proper, thing by investing in bonds, but the losses were just as real as if they'd been speculating in cats and dogs.

Even those who shunned supposedly risky investments by tucking their money away in fluctuation-free places like savings banks have been adversely affected by the curse of inflation. Without realizing it, they were actually gambling that their dollars would buy as much when returned to them, but they, too, lost, as an inflation pace of 10 percent and more exceeded the single-digit rate banks were willing to pay. Long-term bond rates include, theoretically, a premium for the pace of inflation, but bank interest rates can't do that. The best game plan, we suppose, if you fear risk, would be to buy short-term U.S. Treasury bills, rolling them over regularly and simply accepting whatever rate of interest is being paid at the time. As long as the country is still there, you'll at least be getting your capital back and earning something on it as an investment, letting economic forces make the interest-rate decision for you. So if you don't want to take any risk at all, but have excess capital you don't know what to do with, take yourself down to the nearest Federal Reserve Bank (or get the application forms by mail) and invest in three-month or six-month Treasury bills. If that's your course, you don't need to read any further in this book.

Those of us who want more, however, and are willing to take a risk to get more, must understand the nature of the risk. We're going to discuss later how to limit your risks by buying intelligently in terms of both timing and stock selection, but first you have to confront the nature of the marketplace. As long as there is fluctuation—whether you're dealing with bonds or stocks—there are choices to be made: what to do, and when to do it. It seems to us that what we are really talking about (with due apology to all those men in three-piece business suits with plush carpeted offices) is *playing* the market. That is, the market is a game.

Again, this is as true for bonds (or paintings, antiques, diamonds, real estate, for that matter), within their much more limited sphere, as it is for stocks. What we are describing is a form of gambling. *You are placing a bet on your judgment.* The odds may be good—and we'll try to make them better for you—but that doesn't take away the nature of what you are doing. There is a playing field—the market itself—and there are choices to be made, just as in roulette or at the race track. There are long shots, and safer (less volatile) alternatives that will yield less potential reward for your risk. There is the tension and anxiety that any gambler feels—and enjoys, once the bet is down and he can watch the ball spinning, or the horse sprinting down the home stretch, or the ticker tape running. Even someone who does no more than read the market results in the newspaper can't deny the rush of anticipation he feels as his eye runs down the column looking for Digital Equipment or Halliburton, or, when he sees a plus or minus sign, the elation or disappointment that follows. There is the cursing, or kissing, Lady Luck. There is the high of being a winner, the depression of being "down" via the stock's drop, and there is the frustration of having made no tactical mistake and still losing—for even professionals don't profit on every trade. The times when you'll buy because you think the market is going up, and then see the averages leap without your stock selections participating, can be the most aggravating of all. The market as a place to gamble can bring on even more anxiety than the track or the casino in the sense that, with a horse race or roulette wheel, a finite time—mere seconds or minutes—elapses and then you get a definitive answer as to whether you've won or lost, whereas the market goes on and on and on, constantly fluctuating and thus constantly changing your chances of winning or losing, and constantly creating the need to make yet another decision.

Make no mistake about it: every decision to buy, sell, hold; to pick stocks or bonds or real estate; to choose Digital or Halliburton or Verbatim, is a bet. You are gambling, whether you think of yourself as a long-term investor or a short-term speculator, or a broker convinces you that the stock market is a "nice" place for an American to invest in for retirement. Those concepts merely

define the kind of gambler you are. Thus, if you are willing to assume some degree of risk, and understand that you are taking a gamble when you do, the next question becomes: Why the stock market?

Why Stocks?

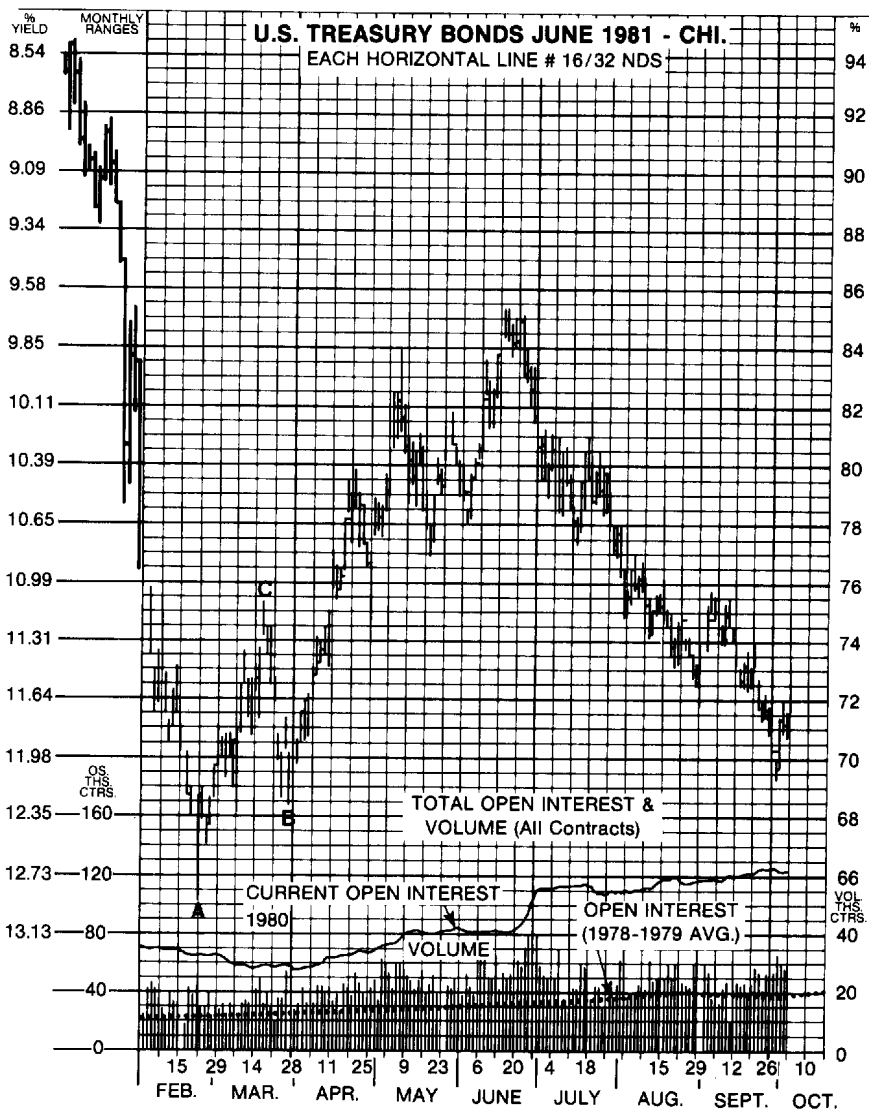
This is America; there are a wide variety of investment choices and there is no need to bother with the stock market at all. You can go through life contentedly without buying a single share. So let's briefly consider some alternatives.

Bonds are a cousin of stocks. We've been picking on them as a supposedly safe investment in order to emphasize that everything contains a risk. As it happened, everyone who bought bonds for safety over the past decade and more had suffered a loss by mid-1981. It does no good to say it was just a paper loss; the loss was real, since, if the money had been invested otherwise (Treasury bills, for example), it could have been growing instead. And yet, even within this great bear market in bonds, there was a terrific trade to be made from the March 1980 lows well into June—with the proper timing.

Following is a chart of Treasury Bond futures, a relatively new commodity-like trading tool. While the financial futures market is a highly specialized and sophisticated game, you don't need to speculate in the futures but instead can use the chart to help gauge the potential direction for interest rates. At those times when there is intense concern about interest rates, the action in the financial futures market serves as an indicator for the stock market as well as the bond market. Note the huge price slide, so costly to supposedly conservative investors; the low in February (A); and the successful test of that low on March 28, 1980 (B).

This chart of the financial futures market showed a base similar to those you would see in stocks. This bullish action took place even as open-market interest rates were still rising, and at a time when conventional, professional, and published opinion insisted that rates were going higher instead. While deciding to act in the face of such widespread bearishness may have been difficult, the

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choice itself was an easy "Should I, or shouldn't I?" That's the primary advantage of playing the bond market: you make your decision based on only one factor—which way interest rates will go. And the only thing you have to keep in mind is that because your decision is a bet on that direction, it is not without risk.

There used to be a belief on Wall Street that what was good for bonds was bad for stocks. That no longer seems to be true, although such a fashion, as with clothing, may come back into favor in the future. But increasing institutional sophistication, a devastating bear market in bonds, and a need for common stocks in a more balanced portfolio have changed the philosophy. Of late, easy money has led to rising bond prices as well as a favorable stock-market climate, while tight money has had negative effects on both sectors. There may be a time (as in late May 1981) when bonds are a good trade, but more often, given a choice of trading vehicles, it makes more sense to shoot for the potentially greater rewards stocks can offer. Note that if in March 1980 you had bought two-year Treasury notes yielding 15 percent, you would have snared a fine yield in a relatively riskless instrument, and could even have made a short-term capital gain within a month. But approximately three weeks later, from virtually the same type of chart formation (see page 134) in the Dow Industrial Average, you could have bought stocks at the right juncture for an ensuing 250-point rise.

On the other hand, during periods when interest rates are trending higher, you don't really want to own either bonds or stocks. These bearish times can be so destructive that all you ought to be concentrating on is preserving your capital so you can enter the game again at a later, less risky time. That means tucking your money into short-term, readily accessible top-quality havens such as Treasury bills. Even better, of course, for those willing to take the risk and play the game from every angle, would be to sell stocks short during such major bear trends. Your basic purpose is, first, to preserve capital and, second, to make it grow. That means betting when the risk is least, and not betting when the climate is dangerous, be it stocks or bonds, or both.

In sum, bonds and stocks often have become buyable at approximately the same time. Because the risks of holding bonds in an inflationary era have been proven to be as great as the risks of

playing the stock market, we'd rather take our chances with stocks. If you can catch a significant price bottom, and *want* bonds for their yield, it pays to watch for such stand-out opportunities. (Some of the conditions we'll discuss later as associated with stock bottoms, such as panic, a market in disarray, and pronounced skepticism after a successful test of the low, can be applied to bonds with equal validity.) Certainly there are investors who have a need for such an assured income; you should see to it, though, that you are not lulled by the holding thereafter. Remember that you are playing a game; if you win one bet, don't lose the next. The smart thing to do in 1980, for example, would have been to buy equities a few weeks after the successful test of the low, in April, using bonds as just a short-term haven rather than as the conventional long-term "safe" investment.

As for other forms of investment, they have a laundry list of disadvantages. Such games as real estate, diamonds, antiques, paintings, etc., (1) are not liquid; (2) require special knowledge; (3) include steep dealer or middleman costs; (4) must be ferreted out before they become overly popular, thus increasing the speculative risk; and (5) are far less easy to establish a "right" price for. Consider, for example, that while an art dealer may put all his eggs into the art basket and never own a share of stock, his oft-repeated advice to the public is to buy only a painting you like—i.e., if you're wrong on the investment value, at least you'll have something pleasant to live with. But in the stock market you always know what someone is willing to pay for your shares, or what you will have to pay for something you want. You'll *always* have—and this is perhaps the most important advantage of stock trading—a readily liquid market. Stocks can be sold quickly, at a price close to the previous price, if you decide you don't want them any more.

Indeed, that is the best reason of all for gambling in stocks. Like those superhighway roadside restaurant signs, call it "Easy in, Easy out." You can get in the moment you decide you want to play, and out, if need be, as soon as you realize you were wrong or have enough of a profit. Or perhaps that's not the best reason after all. There is a lot to be said for—although few on Wall Street are willing to admit it—the excitement and fun of the gamble itself.

And while you are enjoying yourself, it's a sound bet for many reasons. The odds are relatively good, for example. Ten- or twenty-to-one payouts are rare, of course, but compare betting on a long shot at the track versus the favorite. The long shot would pay such high odds precisely because of the little likelihood of victory, whereas in the market the same analytical approach and judgment can be applied to Recognition Equipment as to IBM—and if REC looks like a good bet, it has just as much chance of being a winner as IBM. Nor does it have to be an all-out winner, as a long-shot horse has to be; as long as it racks up a decent profit, you'll be satisfied. What's more, because the stock market is a liquid arena, if you're wrong you can get out of your bet not only readily but with the bulk of your capital intact, unlike having only your losing long-shot ticket to show for your efforts after the race.

In addition, in the market it is possible to forecast tops and bottoms with reasonable accuracy. We've found—and we'll show you what to look for—that it is even easier to catch an important market bottom than a top, and that goes for timing individual stocks, too. The readily available information is much more consistently useful than the performance charts relied on for handicapping horses. Thus, the bet has a good deal of substance to it. It won't be flawless, and you'll have hot and cold streaks just like any other gambler, and you won't buy at the bottom eighth more than once in a lifetime, because that's pure luck. But as a place to bet your surplus money, stocks are relatively easy to understand, requiring some attention, but not all day every day. Anyone can learn to play the game reasonably well, and the monetary rewards are well worth it.

Playing the Market

Why have we argued in favor of playing the market when, if you've bought this book, you are undoubtedly already "in the market"? The answer is, we want you to feel comfortable with the game. Any of the conventional attitudes—such as the "own your own share of American business" basis for investing—will cause, and probably already has caused, losses. So too will guilt, suspicion, fear,

anxiety, greed, and other emotions, while setting up the true playing field for you will make it easier to understand our point of view and to profit from it.

So let's define "playing the market" as using the stock market as the proper place to put your excess funds at the proper moment. That is, you begin with an absolutely free choice. You can enter the market whenever you feel the timing is right, and can withdraw or change your choices at any time. Even if you are truly a gambler at heart, and enjoy the fun of betting and the tensions of the game, you should always remember that *doing nothing is also a betting choice*. Too much money is lost unnecessarily by those gamblers who compulsively need to play something, anything, all the time.

The stock market is challenging, readily accessible, and easy to play—an ideal gambler's table at which you are pitted against a collective mind that often seems uncannily human. Playing the market is better than other gambles because it is far less subject to chance. The favorite wins only about a third of all races; the roulette ball falls we know not where; cards, too, are random. But the stock market, as we'll show you, has specific discernible features. That is, there are things to "know" about the market and about individual stocks that can shift the odds in your favor and help make them better bets. The main disadvantages are, as we've said, that it goes on and on and on, so that there is never a definitive moment when you know whether you are right or not, and there are times when you'll be a loser without making a tactical mistake. A good decision, it can be said, is not the same as a good outcome. You can act on what looks like a sensible bet at the time, only to see the evidence change on you. But at least you can change your bet, even if at a loss; try doing that when your horse stumbles out of the starting gate. There is, indeed, ample evidence out there to be seen and used; that's why we play the market.

As long as we're going to play, we need to define the game and its rules. Such guidelines are the basis for eliminating as many psychological impediments as possible, so as to reduce losses. Thus, the second important thing we have to say about the market is that, as long as it is going to fluctuate on us, *we need to distinguish between what is knowable and what is hope* or dream, or, at best, expectation.

Relying on the Facts

Time and time again, when we are asked for our advice on the market, people want to know "What's going to happen?"—where's the market going to go? how far? how long?—and while we could chat for hours about possibilities, probabilities, and even likelihoods, and yet not be sure, we can invariably answer a different question with ease: "What should I do today?" In other words, "How should I play the game right now?"—buy on a dip, sell into strength, stand pat, buy Du Pont, sell Motorola, etc. The actual betting decisions, in short, are much clearer than anything the crystal ball will show.

Amateurs believe in the market—that it is a "nice" place to make money grow—while professionals believe in the game. Foremost in this category are those who trade for their own, or their firm's account, either on the Exchange floor or from the firm's office (known as "upstairs" traders or, more formally, as Member Traders). These are pros who spend all day every day buying and selling; there may be as many different styles for such trading as there are traders, but in every instance the game they play is the same: buying a particular combination of letters (the ticker symbol) at a certain number (the price) in the expectation that they'll eventually be able to sell that same combination of letters at a higher number. Even the most virginal stock-market investor, strolling into a Merrill Lynch office for the first time, is doing exactly the same thing, even though he doesn't realize it, when he takes the broker's advice to buy American Telephone. True, he is buying a share in that company, and will have the voting rights to prove it as well as a dividend check as his share of its earnings, but he is actually placing a bet on the market action of T at the same time. The risk is that T's price may drop, creating a capital loss greater than the dividend received; the hope is that it will go higher. It may be a conservative bet, but a bet it is.

The professional may make his decision based on any number of factors, ranging from sheer tape-reading instinct to a hot tip from a friend; indeed, he may even buy something based on a conventional brokerage-house report extolling a particular stock. And while he may be unwilling to admit that he is gambling, he

would probably recognize that his decisions are made within the context of a game, with profits and losses denoting whether he has won or lost. Nor does the time span matter. Whether it's the in-and-out activity of a floor trader or the longer-term orientation of a professional mutual-fund money manager, all either is trying to do is play the fluctuations for profit.

Obviously, since so many people lose so much money in the stock market, it isn't an easy game to play. You can't just stick a pin in the stock tables and be right often enough to stake real money on such a "system," nor should you play such an amateurish game as walking into a brokerage firm's office and buying whatever the salesman is peddling that day. There are dozens of different ways to play the game, but no matter what the style, it should be rooted in what is knowable, and not what can only be guessed at, or hoped for.

We hesitate to call what is knowable "facts" because the interpretation of those facts is always so quick to follow, but at least they start out by being specific and irrefutable—Halliburton closed on Friday at 100 $\frac{1}{2}$, up 2 $\frac{3}{8}$ from the previous day's closing price; the Odd-Lot Short-Sales Ratio for yesterday's trading was 1.40, and that was the highest in over five weeks; the daily bar chart of IBM shows that a budding, albeit small, head-and-shoulders bottom formation would be completed if the stock price crossed the "neckline" at 56; Digital Equipment pays no dividend; the latest quarterly earnings report for Inland Steel was \$1.28 per share vs. \$1.18 a year ago; the Federal Reserve Board's latest report showed Net Borrowed Reserves at \$657 million; the Index of Leading Economic Indicators for May showed a record decline of 4.8 percent; and so on. All these are clear, factual items; the waters muddy only as interpretation of their significance begins.

Notice that there are, generally speaking, three categories of "facts." First, there are those that relate directly and exclusively to action within the stock market itself; these are known as technical data. Second, there are those that relate directly to the company and only indirectly to the stock market. Some investors use such corporate data to make buy-or-sell decisions; this is the fundamentalist approach. And third, there are those which pertain to the overall economy; while they are basically fundamental in nature,

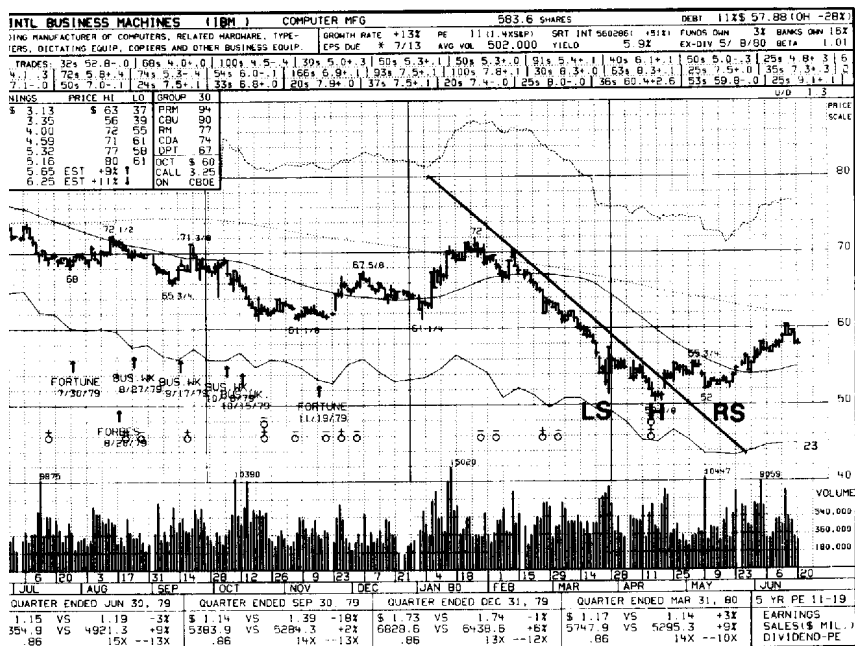
some, particularly the monetary data, have been adopted by technicians as useful indicators, too.

It is often said, by suspicious investors, that what is wrong with the technical view of the market—the notion that market behavior itself tells the story—is that all it has to go by is what's already happened. This, of course, is true. Technical analysis is based entirely on what is knowable: yesterday's price, not a hunch of tomorrow's. Any prediction is the analyst's opinion. The fundamentalists, however, disdaining the technical approach, feel more comfortable with earnings forecasts and economic predictions, because they believe that somehow in their analysis they are anticipating the future in a concrete way, apart from the vagaries of the market, by concentrating on the company instead. Saying that IBM should be bought if it crosses the neckline sounds more like hocus-pocus than saying IBM should be bought because, even though 1980 earnings will be up only 6 percent, the forecast is for a 23 percent gain in 1981. The problem with this apparently dignified approach is that it is both one step removed from the factual—based on future-earnings estimates rather than the already known earnings—and one step removed from the marketplace—based on the company rather than the stock.

Not only do such earnings estimates get “nickel and dimed” by the industry analysts—shaded this way and that as each quarter's actual report comes out—but fundamentalists also have to decide what buyers and sellers are going to do with the forecast once it becomes actualized. All sorts of should's and ought to's are used: IBM should earn \$6.70 per share; IBM should sell this year at the same 11-times earnings it is currently selling at; IBM ought to sell at a higher price/earnings ratio next year because its earnings will then be rising rapidly again; and so on. Unfortunately, the market is not so obliging. Any number of things can go askew: the earnings forecast may be off by as little as a dime, surely accurate enough for a financial forecast, and yet the collective disappointment may produce a rush to sell; the earnings forecast may be on the money when reported, but no one may care, for those who did care have already bought on the forecast, or the market collectively believes that 10 times such earnings is ample enough, so the stock price goes nowhere; the earnings report may be a nickel better than expected,

but just as the good news is released, the market has come under heavy selling pressure due to an international crisis, so IBM sells down regardless. In sum, the attempt to translate corporate matters into stock-market action is for the most part imprecise, because it fails to take into account other influencing factors. Many fundamentalists take refuge in the corporate world because the stock-market game continuously frustrates them. They can't deal with the market's fluctuations, so they end up buying shares in the company just because they like the company—and to hell with the market.

What we are seeing is that, at the root of it, the fundamentalists' shares are subject to technical factors regardless of their views. To be sure, they've played it safe by buying according to their theories; the investment committee can't criticize them for buying IBM even if it goes down, but they've risked their money by exposing it to technical factors without taking these factors into consideration when placing their bet. Consider, instead, the technical data: it's simple, even if our decisions about what to do with this data are not so easy. A look at the daily action chart as of Memorial Day 1980 shows that IBM has already broken a steep downtrend line and has been going sideways instead; if it can cross 56, it will complete a small head-and-shoulders bottom formation, and by reaching a price *higher* than the last previous rally high (at 55 3/4), it will inaugurate an uptrend instead. We don't know *why* sufficient buying has come in to improve the stock's technical picture—perhaps it is that earnings forecast; perhaps it's that the market itself has been quite strong for the two days prior, so that IBM begins to look like a “nice” stock still close enough to its low to seem “cheap”; or perhaps it's merely that traders think it is finally time for IBM to participate in the rally. But we don't know if we should try to anticipate that breakout (after all, the market, having already rallied sharply, is getting overbought), if we should actually wait until the breakout to buy, or if, instead, we should make the stock prove itself on the move, and then buy on a pullback. We do know that if IBM, as a market leader, looks increasingly positive—especially if similar improvement can be seen in several other blue-chip stocks—it is a healthy sign for the market's longer-term course, suggesting that any overbought condition will be tempo-



rare; but we still don't know whether to buy, or wait, or buy something else that may look even stronger. That is, the game isn't necessarily made easier by what we know. We still have risky decisions to make with our capital, but at least we are able to focus on what our choices are by sticking to what is readily knowable from the ticker tape and the newspaper.

Remember that all applicable information of any sort, whether it be the best earnings estimate or inside information on a takeover bid, must be translated into a money decision—whether to buy or hold or sell—in order for the possessor of that information to profit from it, and that action must take place in the market where we can see it. And since it seems reasonable that so-called big money is either smarter, or has access to better information, or both, the action to look for first is what big money decides to do. You may know nothing about the company itself, it may be just a ticker symbol to you, but market action—both volume and price change—can call your attention to the stock as a potential buy candidate.

At this point, if you want to, you can do all the fundamental analysis your conservative heart desires, but it is the technical analysis that has shifted the betting odds greatly in your favor.

Minimizing Your Risk

All we want to do, you see, is minimize the risk. As an astute floor trader once told us: "It's how much you don't lose, not how much you make" that determines stock-market success. Of course, the proper use of stop-loss orders (as discussed in detail in *When to Sell*) will get you out of a position that has turned out to be, to put it bluntly, wrong, but here we are primarily concerned about taking the least risk by making the best bet available to us at any given moment. In this instance all we know, based on the available evidence on that specific day, is that IBM is a potential place for betting money.

Obviously, someone is buying it. Here comes IBM across the tape in streams of activity: 55 1/4 1/4 1/4 1/4, now 55 3/8, back to 1/4, then 3/8 and—wow!—50,000 shares at 55 1/2. The temptation to jump on board is powerful; we sit on the edge of the chair. Imagine the pressure that would come across the phone line from a broker talking to a potential customer; reading the ticker tape while even innocently trying to entice the client into a commission-reaping purchase creates enormous tension to act before it is too late. (That, incidently, is how so many people manage to buy at the high for the day . . . and think they are personally jinxed.) IBM ticks back to 3/8, seems to be stuck there. Ah, we think, more hopefully than practically, it'll stop here and back off where we'll surely purchase it; we should have bought it last week, we berate ourself, when we spotted that head-and-shoulders bottom formation developing.

Of course, if we were dealing with, say, Recognition Equipment, we wouldn't mind missing it as much. There'll be other low-priced flyers. But IBM! We search the market for signs that the short-term rally is tired: TICK is faltering, but TRIN remains robust. Other leading issues are also stuck, but, damn, here come the oils, giving the action a new burst of life. IBM whacks away at 55 1/2, and now it begins to trade at 5/8. We sit back forlornly. The hell with it,

we think, as if it has personally insulted us by going up before we bought it. If it won't cooperate by dipping, we'll wait for the upside breakout signal at 56. Hah, we don't even have to do that, we reason; since we are convinced that the overall market is getting overbought and will experience a correction, we'll damn well wait for the pullback after the breakout before buying. Except that—look at how impressive it is on the tape!—maybe we should buy a little now just to have it, and buy more on that by now ephemeral dip. Damn! then we should have done that back at 3/8, not now.

On and on our thoughts race, in rhythm to the clack of the ticker tape. We've become completely caught up in our emotions and our need to be perfect. Not only can we no longer make a simple decision about IBM, we've managed to miss the bullish action in REC, which we also wanted to buy, and, worse, we were so busy concentrating on buying—on being bullish—that we missed the chance to cash in our profit on Weyerhaeuser, which was on the top of our list to sell. Well, we "reason," if IBM stays strong, it'll carry the market with it, and we'll get a second chance to get out of WY. Thus, we've begun to compound our tactical errors; our emotional involvement has carried the day.

It can be even worse, as we've noted, if you are on the other end of the phone with a similarly emotional broker who not only wants to convey the flavor of the action to you but wants an order, too. And, perhaps worse yet, if you are out of touch and open the newspaper the next morning to see what has already become market history, the air will be full of curses of "should have" and "ought to have."

No, thanks.

It is to avoid these potentially destructive mind-churning effects that we've set out our three basic concepts. First, we've given you the playing field—a fluctuating marketplace—so that you can time your buying better and have the patience to wait, comfortable in the knowledge that the market game goes on and on. (IBM, for example, did indeed cross 56, but then it was again readily buyable under 55 as the market experienced its expected correction.) Second, we've introduced a playing style based on what is readily knowable—the "facts"—and while these "facts" may be in conflict (an increasingly overbought climate vs. the emergence of IBM as

a buy candidate), you at least have the tools with which to make your decision. And third, by insisting that all market decisions have as their primary intent the reduction of risk, we can get rid of as many of our dangerous emotions as possible. After all, it's just a game. Let's enjoy it, not torture ourselves.