

# S & P 500 GPS

*Independent Research for  
Investment Advisors and  
Professional Investors*

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**SPECIAL MARKET KEY EDITION**

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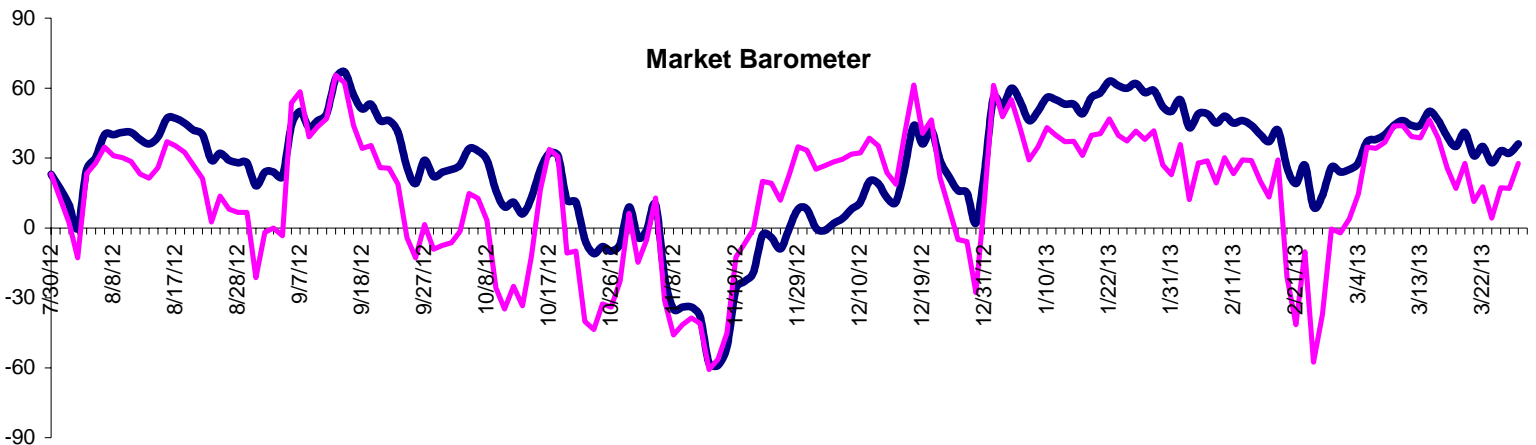
Histogram Sept 14<sup>th</sup>, 2012

On September 14<sup>th</sup>, 2012 our Market Barometer topped out with Cumulative Breadth flattening soon thereafter. Both market measures entered bearish territory in late October culminating with a market sell-off in November. Stocks in the SP500 fell 6.4% on average over the time period with the Market Barometer going from Zone 6 to Zone 1. Zone 6 stocks with high Implied Risk fell 7.3% while Zone 1 thru 3 stocks with lower Implied Risk fell only 4.5%. Overall 390 stocks were down during the same time period with 105 up and several unchanged which begs the question — When the Market Barometer is in high risk territory and Cumulative Breadth confirms institutions are selling, do you feel lucky enough to pick the few stocks which will show a gain or are you more likely to be holding the 80% or so which will be down ? Should you heed the warning signals and use prudent portfolio risk management? Our TradeWind indicator was also a useful tool. Stocks with positive TW rose +2.3% on average while TW-1 fell 5.7%, TW-2 -7.0%, TW-3 -9.2%, TW-4 -12.1%, TW-5 -14.4% and TW-6 fell 20.3% so we saw a high correlation between degrees of negative TradeWind and % return for the time period.

Histogram November 15<sup>th</sup>, 2012

On November 15<sup>th</sup> the Market Barometer bottomed out in Zone 1 as politicians wrangled over the fiscal cliff. We expect a Zone 1 reading about once every 24 to 36 months which historically is a major market bottom. In poker a Market in Zone 1 is like being dealt two Aces making this an "all in" buy with your chances of winning extremely high. Since the big buy signal on November 15<sup>th</sup> 471 of SP500 stocks are up, 27 down and a handful unchanged with an average gain of 20.5%. The strongest stocks, those above Zone 6 in November, are up 37% while the weakest stocks below Zone 1 in November are up only 15.6%. TradeWind is just as correlated to price action on the upside as it was on the downside with TW+5 stocks up 36% , TW 3 and 4 up 24.6%, TW 1 and 2 up 19.6%, and negative TW up only 10% since November.

While it is nice to have a recent example of a major market bottom, normally stocks rotate through Implied Risk Zones with varying degrees of TradeWind highlighted in Red, Yellow or Green. Each week the SP500 Histogram report brings to our attention stocks on the move via top and bottom Action, Implied Risk and TradeWind. The Histogram further highlights movement between Zones and overall market risk bringing stocks to our attention for further review. Simply put the SP500 report shows What stocks are on the move? How risky is the stock and market at current prices and which direction are they headed? Used hand in hand with fundamental research portfolio managers find these risk-return measurements to be an invaluable tool.



### **Terminology Definition Key:**

**1 WK Chg** - Change in closing price over five days.

**Implied Risk ( IR)** - The expected range of a stock expressed in % overbought or oversold as compared to the current trend and underlying volatility. This is the markets forecast of expected return and allows comparison of a less volatile utility stock to a highly volatile tech stock.

**Action** - Change in the IR from one day to the next which highlights a stocks movement amongst the entire stock universe.

**TradeWind** - The trend and momentum of a stock expressed as a number generally between +4 and -4 with greater numbers in extreme circumstances.

**Low & High Limits** -Short term estimates of a stock's low and high price targets which are often good buy and sell points.

**Where is my Stock Symbol?** - In Adobe Reader use Control+F or select "Find" from the "Edit" pull down menu to open the search window and enter the symbol or name.

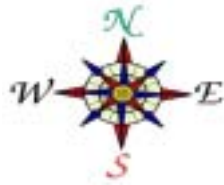
The Zone system is simply another way of looking at the market and the Histogram allows a unique view of the overall Market and individual stocks. Over time every stock will visit every Zone and the Histogram provides an objective view of a stocks current price, be it low or high relative to future volatility estimates and expected returns making the histogram essentially a GPS for the stock market. Because the other name for 'volatility' is 'risk' Implied Risk scores enhance fundamental research balancing fundamental opinions with an objective risk assessment and price expectation.

In the SP500 Histogram below stocks are placed into Zones based on the Implied Risk score and colored by the TradeWind or trend in an attempt to show where the stock is and in which direction it is moving. When a stock declines into Zone 1 and the TradeWind flattens (Yellow) or turns positive (Green) the probability of advance is high, assuming there are no fundamental 'surprises' with the company. Likewise when a stock is in Zone 6 and TradeWind flattens (Yellow) or reverses course (Red) one should consider taking profits or at least writing a Covered Call to mitigate a price reversal down to the mean price estimate. The Zone system may be compared to a road map. While a map may be of significant benefit in determining where you are going, its most important contribution is telling you where you are. If you don't know your current location, it is impossible to find the path to your desired destination. Likewise knowing the current Implied Risk or GPS reading enables the buy, sell or hold decision when compared to your fundamental opinion of future price movement.

When the stock Zone list or Histogram is viewed in total the picture presented is another view of overall market risk. Under normal conditions we would expect about two-thirds of the stocks to be in the middle Zones with a small number in the extreme Zones. When the list is skewed in one direction or the other it is an indication of an "overbought" or "oversold" market. Over time the Histogram will normalize either via stock price action or a longer term change in price expectations – a bull or bear market.

Histogram  
Sorted by quarterly Implied Risk Zones.  
Red/Yellow/Green indicates direction of **Trade Wind**

S & P 500

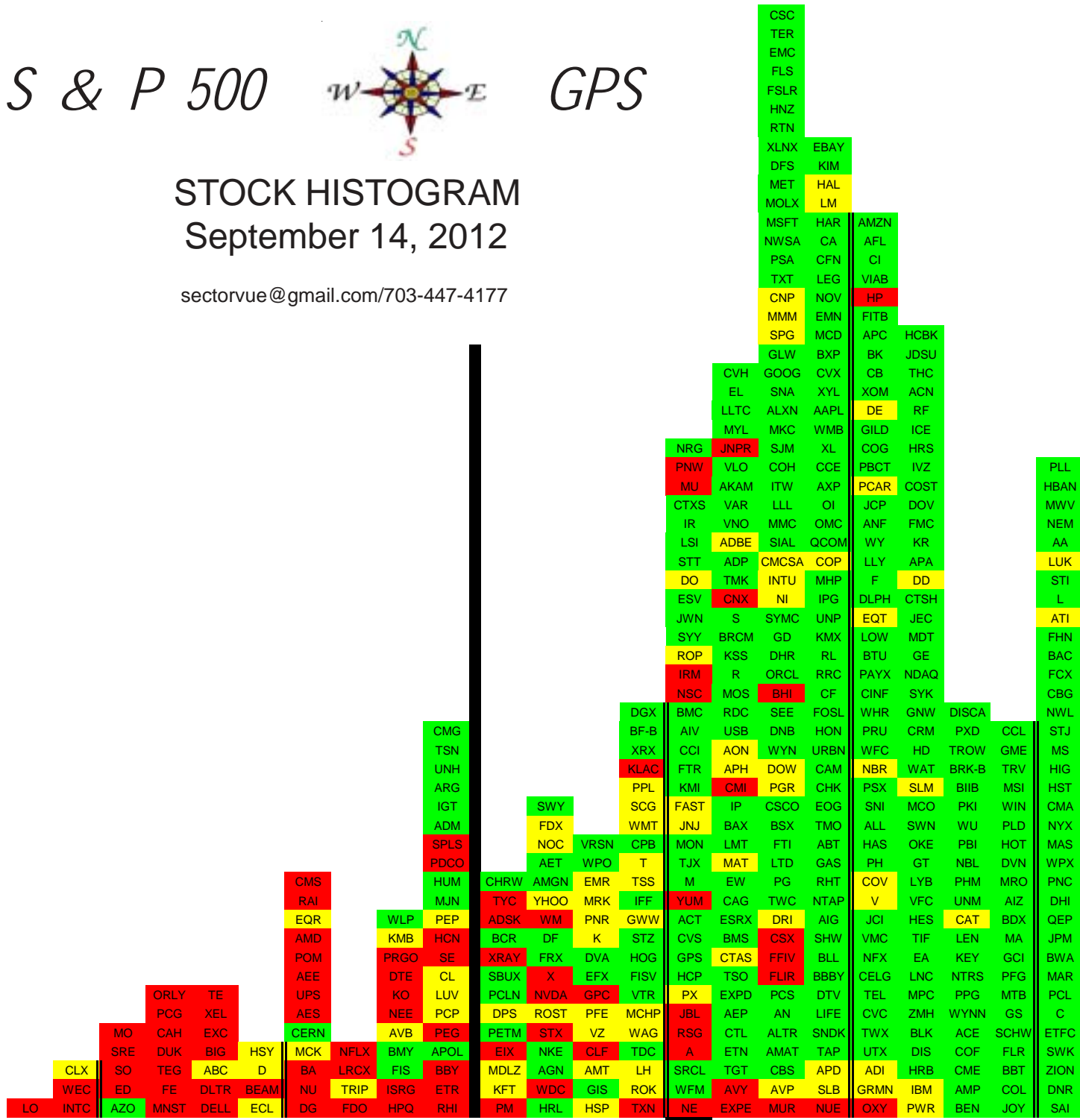


GPS

# STOCK HISTOGRAM

## September 14, 2012

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4 Stocks      23 Stocks      49 Stocks      66 Stocks      187 Stocks      133 Stocks

Zone 1      Zone 2      Zone 3      Zone 4      Zone 5      Zone 6

<-100   -99   -91   -83   -75   -66   -58   -50   -42   -33   -25   -17   -9   9   17   25   33   43   50   58   66   75   83   91   99   >+100

Implied Risk

# S & P 500



# GPS

## STOCK HISTOGRAM November 15, 2012

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