

5-STEP INVESTING

By Mark Bates, Certified Financial Technician by the International Federation of Technical Analysts.
Email: MarkJBates@bellsouth.net

Step 1 – Broad Market Trend

Primary Trend: Upward. Started March 6, 2009 at 6626.
Intermediate Trend: Upward. Started February 12, 2010 at 10012.



The Dow Jones Industrial Average (^DJI) gained 2.3% last week, finishing at 10,620.

I gave you 3 options for the broad market last week: uptrend continues, ranging market, or a slight pause followed by further downward movement. Since your first consideration is what the broad trend is doing, this decision is the most important decision. And in the last week the market has played its hand pretty tight --- it could conceivably go either of the three ways. Lets again review those 3 options:

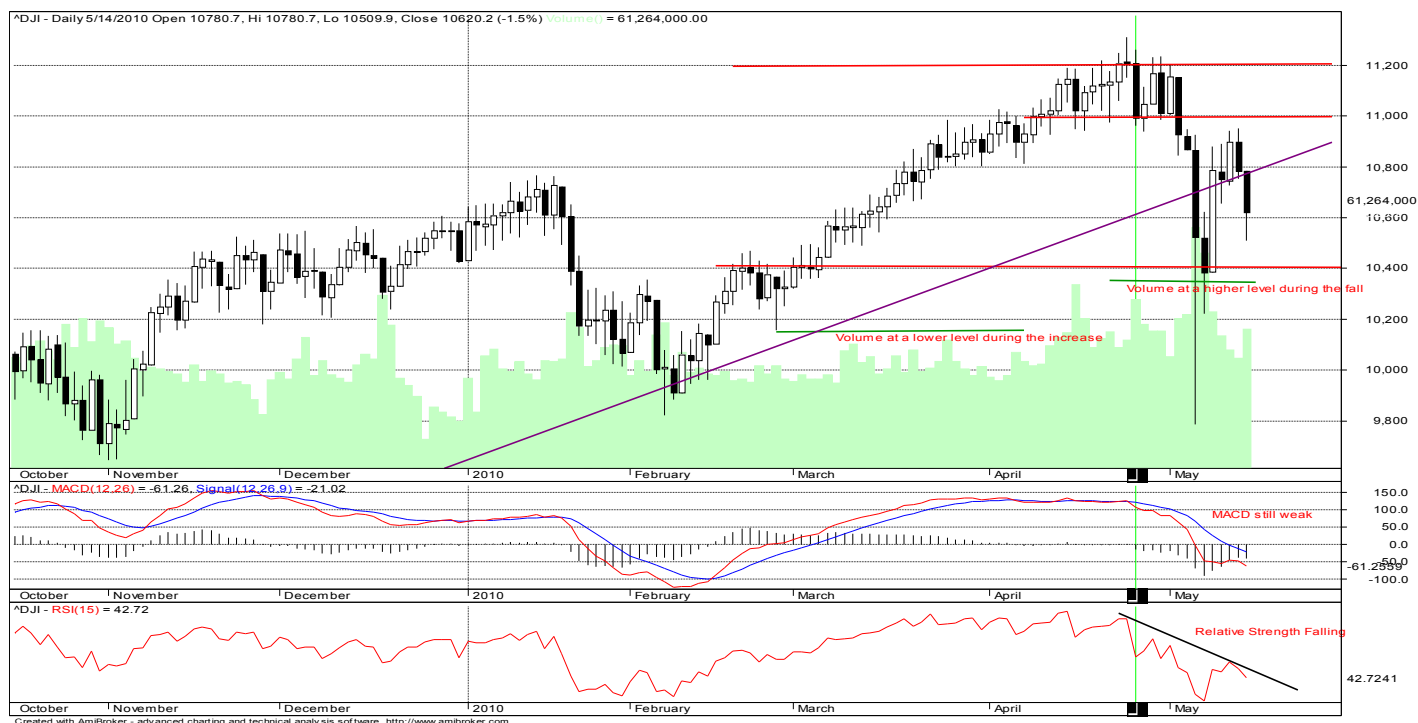
- 1) The uptrend continues. The first sign of this is that the ^DJI will gain 2.1% back up above the 10600 lower trend line and continue to a gain of 8.7% to challenge the red 11283 Fibonacci line. As I said last week, this is unlikely, and the past week seems to confirm that.
- 2) The market settles into a “ranging” market, meaning it moves sideways for awhile. At this point it would likely settle into a range between 10000 and 11283. As it closed last week at 10600, this is certainly a possible (one might say most likely) scenario.
- 3) The market rises slightly at or above the lower purple trend line, around 10700, and then dives downward below 10000. This would quantitatively establish an intermediate-term change in the market. Given the difficulty that the market had in the latter part of the week last week, this option is also on the table.

In the broad view, these are still the options. They will play out over the next several weeks.

Step 2 - Near Term Market Trend

Intermediate Trend. Upward. Started February 8, 2010 at 10195.

Short Term Trend. Downward. Started May 6, 2010 at 10520.



Last week I remarked “The overall situation is dicey”. In the last few days there have been a number of 100+ point movements both directions in the Dow Jones Industrial Average, which is an indication that the buyers and sellers are battling to see who is in control of this market.

On technical terms, it appears that the chance of a continued upside trend is small. Trading volume, as indicated by the green shaded area above, appears to spike on down days, which implies weakness because it infers that people don't want to be caught “holding the bag” if the market should continue to drop. The MACD measure on the middle chart, where the red line is well above the blue during a rise and below the blue during a fall, continues to be well below the blue line and not turning upward. This seems to indicate that a strengthening of the prices is not expected near-term. The Relative Strength of the market, which is a measure of the rate of change of the price against prior periods, shows that the price is weak and weakening.

The market closed at 10620. The first thing it has to prove is that it can rise above the purple line which is now around 10800. The likelihood at this point is that the market will move in a sideways direction between the two red lines, 10400 and 11000. If it breaks below 10400 or above 11000, we will reevaluate.

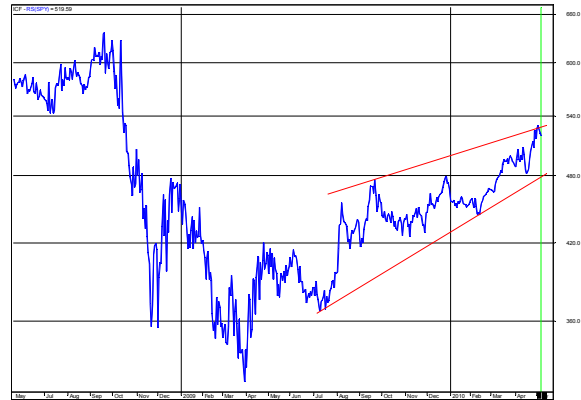
Step 3 – Asset Classes

The charts below are not the price of the security. They are the ratio of the price of certain ETFs to the value of the SPY (S&P 500 ETF).

Bonds (AGG) were proclaimed last week as “...strengthening relative to the market in general”. Then they proceeded to weaken again, making me a liar. Until that upper red trend line flattens out a bit more, I still have to admit that bonds are still weak relative to the overall market.



Real Estate (ICF) continues to outperform relative to the S&P 500. However, you must honor the BUY and SELL signals. It could outperform but just be falling slower.



Gold (GLD) continues to be strong relative to the overall market. This confirms a weakening of the overall market and a movement of monies to the safety of GLD.



Dollar (UUP) With the troubles of the Euro and general instability in world markets, the Dollar has strengthened, just as we began to see some weeks ago.



Step 4 – Current Portfolios

ETF Hedge Fund

The SPY and ICF investments were stopped out over a week ago, and that proved wise relative to the prices today.

The models are not confirming getting into SPY or its inverse, DOG. So I recommend adding no new funds.

Bond funds are still a BUY, but use the “New Position” BUY for entry and set the “New Position” SELL for your stop.

Real Estate and Gold are also a BUY, but as above use the “New Position” BUY and SELL points.

Using the “New Position” BUY and SELL points as you add up to 12% of your investing position allows you to confirm an uptrend, and then protect your downside in case the uptrend is transient in this particular market.

Security	Long-Term	Med- Term	Short Term	Price	Current Position Stop Loss	New Position Stop Losses	
					SELL	BUY	SELL
SPY (S&P 500 ETF)	BUY (May 6) (112.94)	BUY (May 6) (112.94)	SELL (May 4) (116.92)	\$113.89	\$108.69		
AGG (Bond ETF)	BUY (Apr 30) (104.89)	BUY (Apr 29) (104.44)	BUY (Apr 15) (104.26)	\$105.21	\$103.22	\$105.75	\$103.76
ICF (REIT ETF)	BUY (May 10) (61.93)	BUY (May 14) (60.03)	BUY (May 11) (62.10)	\$60.03	\$56.78	\$63.50	\$60.25
GLD (Gold ETF)	BUY (Jan 29) (105.96)	BUY (Apr 23) (113.19)	BUY (Mar 30) (107.97)	\$120.37	\$115.65	\$122.50	\$117.78
UUP (Dollar ETF)		BUY (Dec 18) (23.01)		\$25.19	\$24.50	\$25.50	\$24.81
DOG (S&P Inverse)	SELL (June 30) (66.50)	BUY (May 7) (50.63)	SELL (July 16) (64.27)	\$50.23	\$48.79		
MUB (Tax Advantaged Bond)	BUY (Mar 18) (103.49)	BUY (Mar 18) (103.49)	BUY (Apr 16) (103.48)	\$104.05	\$103.12	\$104.50	\$103.57

Recommended Weights for Portfolios

	Conservative	Aggressive
S&P 500	0%	0%
Bonds/Cash	84%	84%
Real Estate	6%	6%
Gold	6%	6%

Step 4 – Current Portfolios

401K Mutual Fund Portfolios

This is a new section in the newsletter this week. I will begin to give you asset-class-specific guidance on the timing of allocations in your 401K Mutual Fund portfolios. For many of you this is where the plurality of your wealth exists, and the simple buy-and-hold return of a typical target fund will expose you to downward rides that can be avoided through fairly straightforward technical analysis. This section is designed to avoid over-trading, and to keep you on the right side of major trends. We will use SPY as the proxy for all Equity Mutual Funds, and AGG as the proxy for all Bond Mutual Funds. The charts of these two ETFs are highly correlated to respective-class mutual funds.

Security	Recommendation	Current Price of Proxy	Guidance
Equity Mutual Funds (SPY as a proxy)	(May 16) BUY per recommended weight below	\$113.89	Shift monies from Equity Mutual Funds to Bond Mutual Funds when the price of SPY drops below \$110.00 for 3 days
Bond Mutual Funds (AGG as a proxy)	(May 16) BUY per recommended weight below	\$105.21	Shift monies from Bond Mutual Funds to Money Market Funds when the price of AGG drops below \$102.11 for 3 days
Money Market	Do not hold cash	N/A	

Recommended Weights for Portfolios

	Conservative	Aggressive
Equity	50%	70%
Bond	50%	30%
Money Market	0%	0%

Rules for 401K Mutual Fund Portfolios

Segment your 401K portfolio offerings into Equity, Bond, and Money Market. Most equity funds (Large Cap, Small Cap, International, Growth, Value) are very tightly correlated and should be considered as a single asset class. Of these, if you have an S&P Index fund, choose this as your Equity fund. Most bond funds (government, mortgage) are tightly correlated. Of these, if you have a government bond fund, choose this as your Bond fund. You typically will not have a Real Estate or Gold option for 401K portfolios.

Step 5 – New Ideas

None this week.

The Final Word

This week's Final Word comes from Dan Miley, a previous contributor and Fundamental investor.

When to Sell...and when not to

I am sure that many of you have been following recent events and were probably tempted to sell everything. I hope that you were not. However, there are times when you *should* sell a stock. Selling an individual stock should be based on individual analysis, and, in general, unrelated to external events. So let's examine on my strategy for selling Providence Service Corp (PRSC) - yes, the stock that I recently recommended.

I detailed my reasons for buying PRSC last time and I think that it is a buy today. But I do plan on selling it above \$23. Why? I calculate PRSC to be fairly valued at around \$21, based on their current earnings of \$21.1 million, projected earnings growth of 13% per-annum, accounting for long term debt of 186 million, and discounting these earnings against a "risky" stock rate of 15%. So at anywhere north of \$21, the stock has moved into overvalued territory and should be sold. The important thing to remember here is to establish a target selling price for a stock and sell at or near that price, regardless of day to day market issues, no matter how frightening those issues may be. Also, it is important to do not get greedy and stay too long, especially with a small cap, high beta stock like PRSC.

Some stocks, like PRSC, are good stocks to buy and sell after making a decent profit. Other stocks, especially strong dividend payers, will stay in my portfolio perpetually. Here are some high quality dividend payers that I highly recommend as core holdings:

1. Altria (MO), dividend yield is 6.74%, and like it or not, people will continue smoke.
2. Phillip Morris International (PM), dividend yield is 5%, same comment as for MO.
3. Verizon (VZ), dividend yield is 6.74%, and I believe that their investment in fiber optics will pay off.
4. Kraft (KFT), dividend yield is 3.86%, and I believe that management has turned the corner with the acquisition of Cadbury.
5. Coca Cola (KO), dividend yield is 3.34%, and market for bottled waters and energy drinks is growing.
6. International Business Machines (IBM), dividend yield is 2.13%, and their market for consulting services is growing to replace the stagnant mainframe business.
7. Intel (INTC), dividend yield is 2.96%, and I believe the "tech refresh" is just starting.
8. Exxon Mobil (XOM), dividend yield is 2.8%, and unlike BP, is run by extremely competent managers.
9. Johnson & Johnson (JNJ), dividend yield is 3.4%, and just about everyone uses at least one of its products
10. Pfizer (PFE), dividend yield is 4.4%, and I think that they will eventually develop a gene therapy drug that will outsell Lipitor.

Legal:

First, among the positions that I hold positions are AGG, MUB, and UUP.

Second, the information contained herein is based on sources that I deem to be reliable but is neither all-inclusive nor guaranteed for accuracy by me and may be incomplete or condensed. The information and its opinions are subject to change without notice and are for general information only. Past performance is not a guide or guarantee of future performance. The information contained in this report may not be published, broadcast, rewritten or otherwise distributed without my consent. Pursuant to the provisions of Rule 206(4)-1 of the Investment Advisers Act of 1940, all readers are advised that they should not assume that all recommendations made in the future will equal that referred to in this material. Investing in securities involves risks, including the possibility of loss.

Appendix: Important Details

Rules for Placing Trades

- 1) When you place a BUY order, you will also place an associated SELL order for the same security. This is designed to keep you free of constantly checking progress of the trade, and it is designed to build the discipline of always having a set of stops in place to control downside risk. This can be automated on TD Ameritrade by using what are referred to as “Conditional Orders”. On Schwab these are referred to as “Bracket Orders”. Lacking these automated tools, once you execute the BUY order you can go in the day after the BUY and manually place the protective stop.
- 2) All of your orders (BUY and SELL) will be done using Stop Market orders. That is, on a BUY order the market price must rise to a particular price before you BUY. This gives you initial confirmation that the market price is moving in the expected direction. On a SELL order the market price must fall to a particular price before you SELL.

Rules for Adding New Money to Existing Portfolios or Building from Scratch

- 1) Only add new monies to securities with BUY in Long-Term, Medium Term and Short Term. Otherwise, keep the money in a money market fund.
- 2) Do not increase the overall size of the portfolio more than 12% a week, in order to limit market risk.
- 3) Always enter the noted stop loss amount with each investment. Do not enter a purchase without an associated stop loss amount.