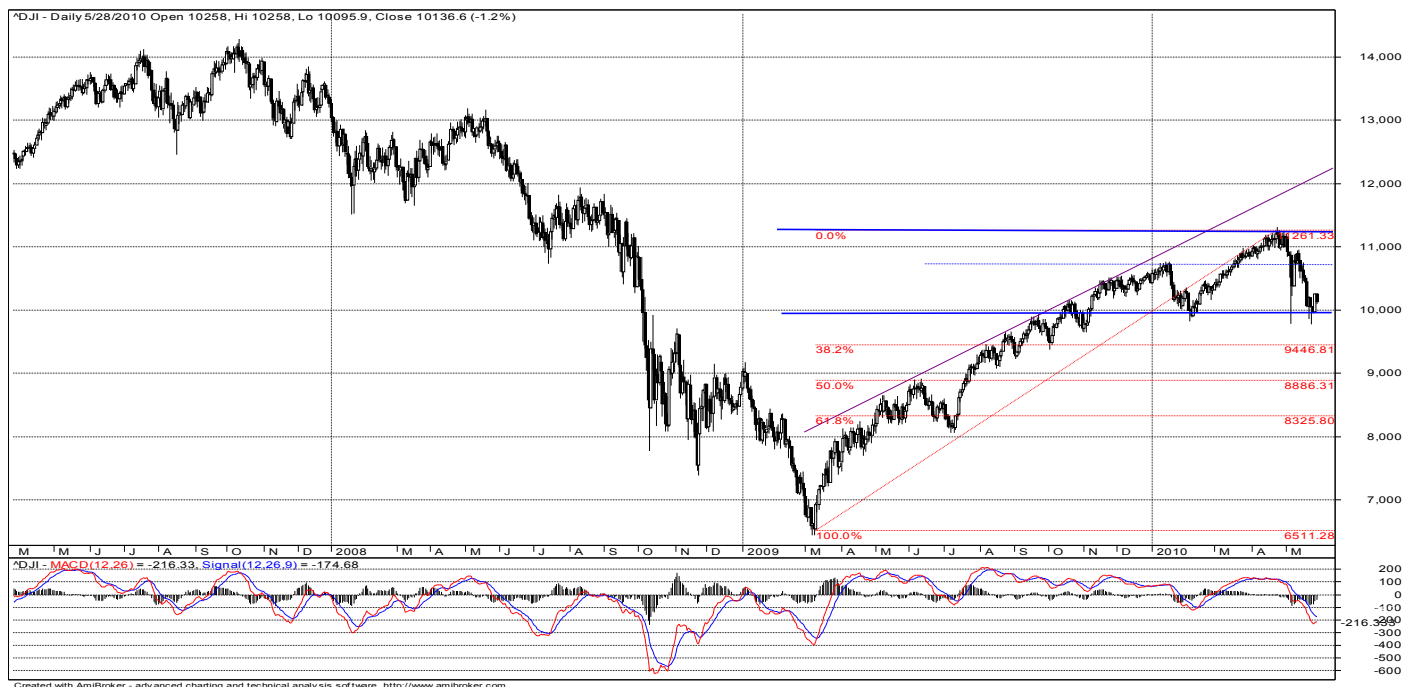


# 5-STEP INVESTING

By Mark Bates, Certified Financial Technician by the International Federation of Technical Analysts.  
Email: [MarkJBates@bellsouth.net](mailto: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) lost 1.2% last week, finishing at 10,136.

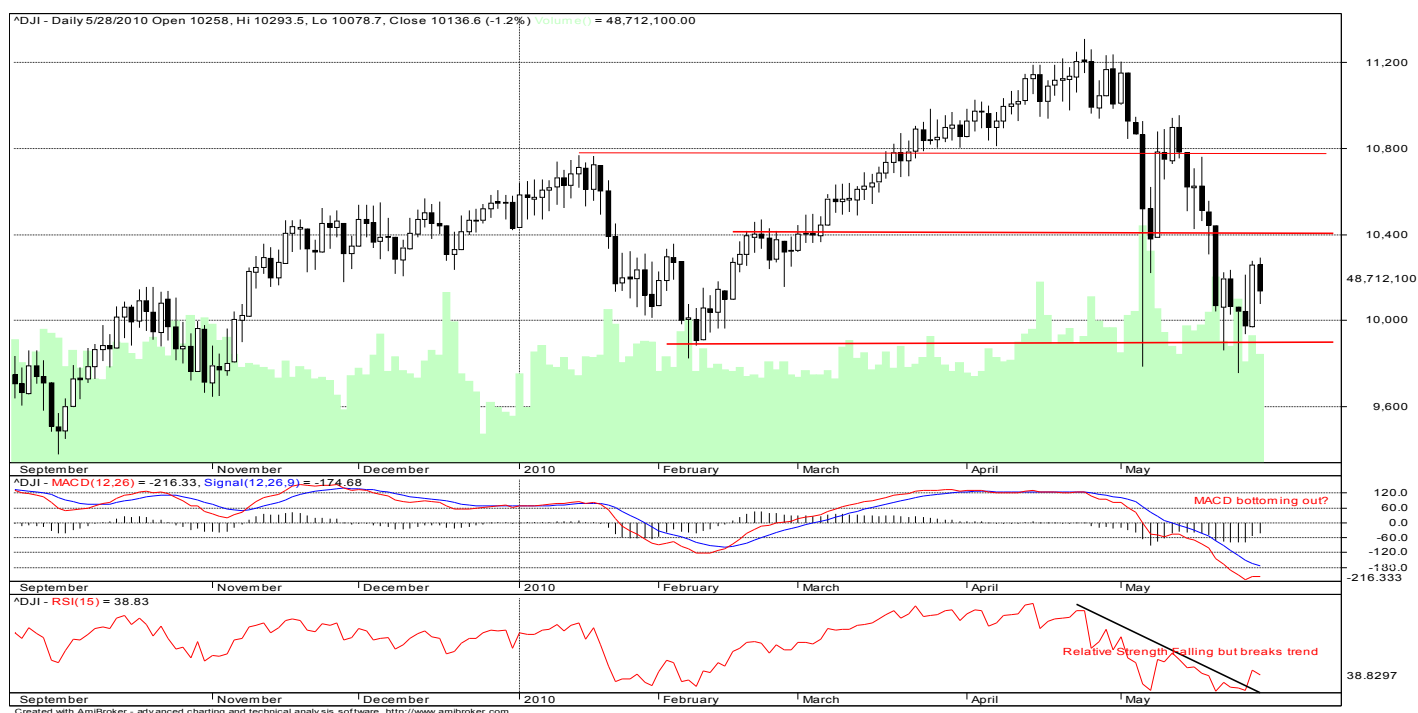
I gave you 3 options for the broad market several weeks ago: uptrend continues, ranging market, or a slight pause followed by further downward movement. In particular one of the options was that “The market settles into a “ranging” market, meaning it moves sideways for awhile. At this point it would likely settle into a range between 10000 and 11283.” It would appear that this is what we are dealing with for the time being. The near term range is probably between 10000 (the lower blue line) and the 10700 line (the middle blue line). The upper range, technically, is still the prior top at 11283.

What would be important here is if the market drops below 10000 for a period of days and does not rise back above 10000. You can look at that lower MACD graph and see that the red line is below the blue signal line and falling. Until that red line clearly begins to go back up, there is the kind of weakness here that could lead to a further decline in what is a very volatile market. You can also see that given the rise starting back in March, 2009, a fall of 38% or so, which would be a reasonable Fibonacci retracement, puts the Dow at 9446. So it would not be unusual to see a drop below 10000 although it has not yet occurred.

So for the time being, as long as the the ^DJI does not drop and stay below 10000 or above 11283, we are going to assume that it is going to move sideways for a while.

## 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.



Two weeks ago I remarked “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...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”.

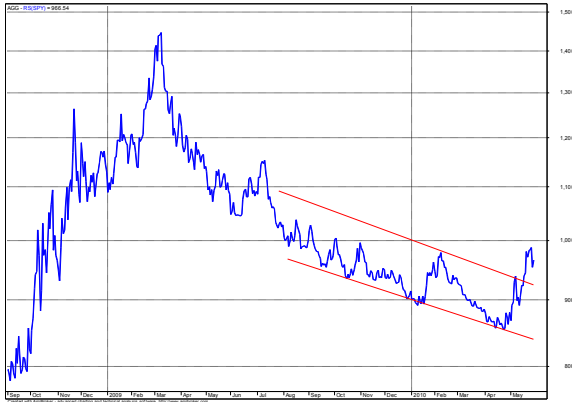
The market continues to be very volatile. You can see that by noticing the length of the individual daily bars on this chart (vertically) they represent the daily range, compared to the last couple of months of last year or the period from March to May of this year. Sellers are still in control --- volume is still high particularly on down days, and technical indicators that might indicate a reversal are weak or simply unreliable due to recent volatility.

The short term trend in this market is down, and as an intermediate investor you don't want to fight the general trend. There have been recent days (May 27) where the market has gone up nearly 3% in one day, and you may ask yourself why you are not fully invested in this market. But as a conservative, intermediate-term investor, you would be advised to keep your powder dry until the sideways trend resolves itself.

# 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) have strengthened materially relative to the overall market. This justifies the shift into bonds that started several weeks ago.



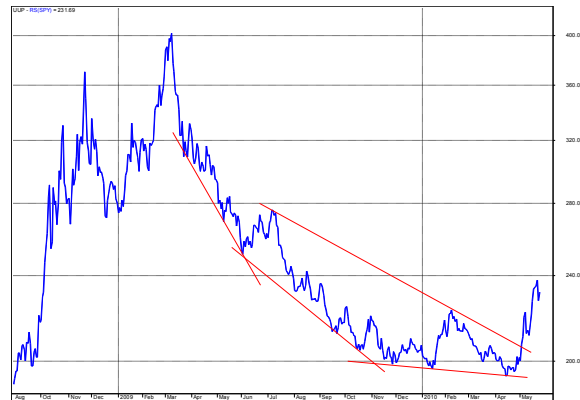
Real Estate (ICF) continues to outperform relative to the S&P 500. But be careful, as real estate as a whole is down relative to where it started the year.



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

At this point two things are true:

- 1) General equities (SPY, ICF, DOG) are not suggested by the models, and the market is in a general downward trend. So you should not be in equities.
- 2) Bond funds (AGG, MUB) have been bid up such that they are very expensive. You should wait to “buy on the dips” so to speak. So you will see that even though the models say they are BUY, you should wait until the price drops before adding to your holdings.
- 3) Gold and the US Dollar are both strong but are also expensive at this point and due for a technical correction.

As we are in a trending, sideways market, we will buy when the prices hit the lower end of expectations and sell when they reach the higher end of expectations.

					Current Position Stop Loss	New Position Stop Losses	
Security	Long-Term	Med- Term	Short Term	Price	SELL	BUY	SELL
SPY (S&P 500 ETF)	BUY (May 21) (109.11)	SELL (May 20) (107.54)	SELL (May 4) (116.92)	\$109.37			
AGG (Bond ETF)	BUY (Apr 30) (104.89)	BUY (Apr 29) (104.44)	BUY (Apr 15) (104.26)	\$105.71	\$104.77	\$104.00	\$103.50
ICF (REIT ETF)	BUY (May 21) (56.95)	BUY (May 14) (60.03)	SELL (May 20) (55.13)	\$58.43			
GLD (Gold ETF)	BUY (May 24) (116.84)	BUY (May 24) (116.84)	SELL (May 21) (115.22)	\$118.88			
UUP (Dollar ETF)		BUY (Dec 18) (23.01)		\$25.34	\$24.70		
DOG (S&P Inverse)	SELL (June 30) (66.50)	BUY (May 7) (50.63)	SELL (July 16) (64.27)	\$52.43	\$50.14		
MUB (Tax Advantaged Bond)	BUY (Mar 18) (103.49)	BUY (Mar 18) (103.49)	BUY (Apr 16) (103.48)	\$104.69	\$103.73	\$103.40	\$102.75

### Recommended Weights for Portfolios

	Conservative	Aggressive
S&P 500	0%	0%
Bonds/Cash	100%	100%
Real Estate	0%	0%
Gold	0%	0%

## Step 4 – Current Portfolios

### 401K Mutual Fund Portfolios

Security	Recommendation	Current Price of Proxy	Guidance
Equity Mutual Funds (SPY as a proxy)	(May 24) SELL when SPY was below 110 for 3 days. (\$107.71)	\$109.36	You should be out of equity funds for the time being.
Bond Mutual Funds (AGG as a proxy)	(May 16) BUY per recommended weight below	\$105.71	Shift monies from Bond Mutual Funds to Money Market Funds when the price of AGG drops below \$103.80 for 3 days
Money Market	Do not hold cash	N/A	

### Recommended Weights for Portfolios

	Conservative	Aggressive
Equity	0%	0%
Bond	100%	100%
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

Bonds will not always be a safe haven. Should the economy begin to improve enough, and consumer confidence improve enough, two things will start to happen:

- 1) money that is “scared” and money that has been sitting on the sidelines waiting for the next “bull” market will start to be invested in equities. That will cause money to shift out of bonds, and that will drive the price of bonds downward, since they will not be in such demand.
- 2) the Fed will ultimately begin to raise interest rates. At that time, you will see bonds additionally lowered in value, since inflation has the effect of dropping the value of bonds.

Shortly I will be adding additional investment options that offer protection to your principal in times of inflation. We will shift into these investments over time as the inflation threat arises.

### 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.