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On The Mark Investing

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Broad Market Trend using Weekly Data

The Dow Jones Industrial Average (^DJI) gained 4.2% in the last 6 trading days, finishing at 10,525.

Last week I noted “If the ending value next week significantly exceeds 10300 then I’ll have to revise the theory of a slow drift downward.” The recent close this afternoon at 10,525 is clear cause for reevaluation.

There is a theory called the Elliott Wave Theory which may give insight into what is going on. In brief, major movements in the market consist of upward and downward thrusts called “waves”. The movement downward from its top in 2007 consists of 9 steps --- 5 larger down steps and 4 smaller up steps. This is consistent with the wave theory in that the down steps are bigger because we were in a down trend, and they were sharper because drops typically occur faster and steeper than rises in price.

Then notice the market rise starting in March, 2009. There were 5 steps – 3 larger up steps and 2 smaller down steps. Again, this is consistent with wave theory in that the up steps are bigger because we were in an uptrend, and they were less dramatic than the drops in price because rises typically are more gradual than falls in price. This movement is consistent with Elliott wave theory. The number of steps is usually 5 but can be extended to odd number beyond that.

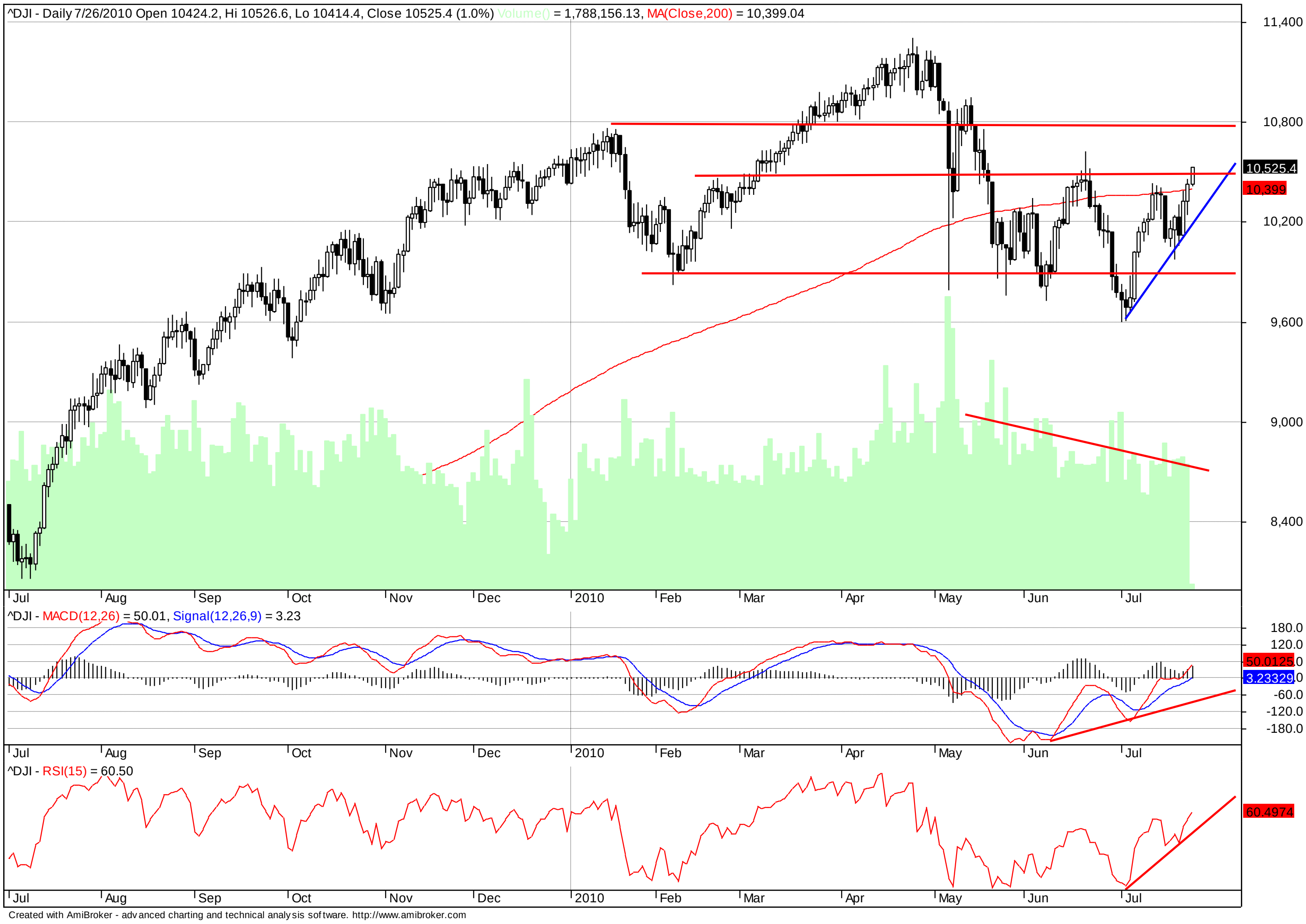
So that brings us to the recent market movement since April of this year. When the Dow dropped below 10000, you can see that rather than extending the upward rise and another Elliott wave, it created what appeared to be the first Elliott down wave. So one could easily imagine that this was a first step in a 5 step move downward. But then to complicate matters, the market has risen in recent days to now close at 10525. So what next?

We now cannot easily assume we are in a downwards market --- we are back to the old hypothesis that this is a sideways market. Your important Dow Jones Average numbers are these:

- The market is at 10525. If it rises and stays above 10750 (2.1% gain) for several days then you can assume that the downward market is cancelled, this is a sideways move, and we'll be waiting for the next step up or down.
- The next step in that instance is 11263 (7.0% gain from today). If the market passes that point, we can assume that the sideways market is cancelled, and that we are in another period of uptrend in the market. A likely extension of the Elliot wave to a 7th leg up.
- If however the market drops down below 9632 (9.3% drop from today), we could expect a continued fall as this would the third leg of an Elliott down or correction wave.

From a broad market perspective the movement is sideways. There are opportunities within that, as will be discussed in the Near-Term analysis below. But in the Broad we are still in a sideways market. It is worth noting that the Stochastics and MACD above show that the RED line is crossing above the BLUE signal line. In both cases the technical indicators are Bullish, indicating a particular preference for continued upward movement.

Near-Term Market Trend using Daily data



Last week I noted: “We should conservatively see sideways movement between the two RED lines above, therefore movement between 9700 and 10400. If the broader but slow downward trend persists, we’ll see movement between 9400 and 10300.”

The Dow closed today at 10525. So what gives?

Near-term traditional trailing technical indicators look favorable for the near-term. That squirrelly red line above is the 200 day moving average, which is a traditional bullish/bearish indicator --- if the market closes above that value it is deemed a bullish market. That has excited market technicians. So have the favorable MACD and RSI values in the above graphs, as well as the nice blue up-sloping line that the market trend has honored to this point.

The only rain on this parade, and it is a bit of a thunderstorm, is volume. The GREEN volume area has continued to fall. This rise in the market in July has happened with little investor participation. And when THAT happens, market moves of size can move and in effect “sucker in” people who think all is going to be fine and dandy, until the selling starts and it comes with abandon. So what to do at this point?

You are in a sideways market. In the near term it appears that it could rise up to the RED line at 10784, and it may see downside protection at the BLUE line around 10250. The technical indicators say that it is more likely to continue to go up than it is to go down. If you trade daily you may in fact be safe to make that market-general SPY investment as long as you keep your stop loss in play.

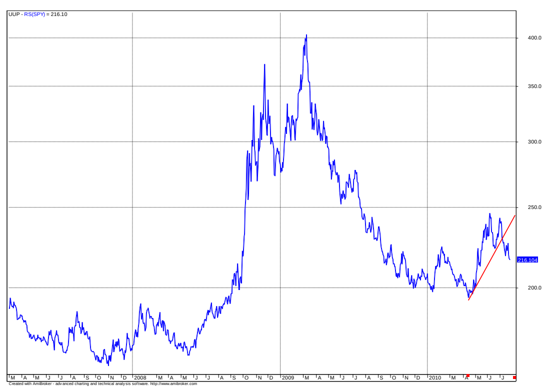
I am concerned enough about volume not to recommend movements of monies out of your 401K mutual funds into equities yet. This market is up on fumes, and still trying to find its feet.

Asset Class Behaviors

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) are becoming unstable against the overall market. A widening triangle as drawn indicates volatility. Likely, the strength is coming to an end.

Real Estate (ICF) is still in a near term broadening pattern, strengthening against the market. Bias has reversed to neutral and perhaps positive.



Gold (GLD) has continued to slow against the market. This is a confirming indication that the present market is in a sideways movement and investor concerns about the market in general have eased a bit.

Dollar (UUP) is weakening relative to the market. It has broken a 3 month trend to the downside.

ETF Hedge Fund – Description

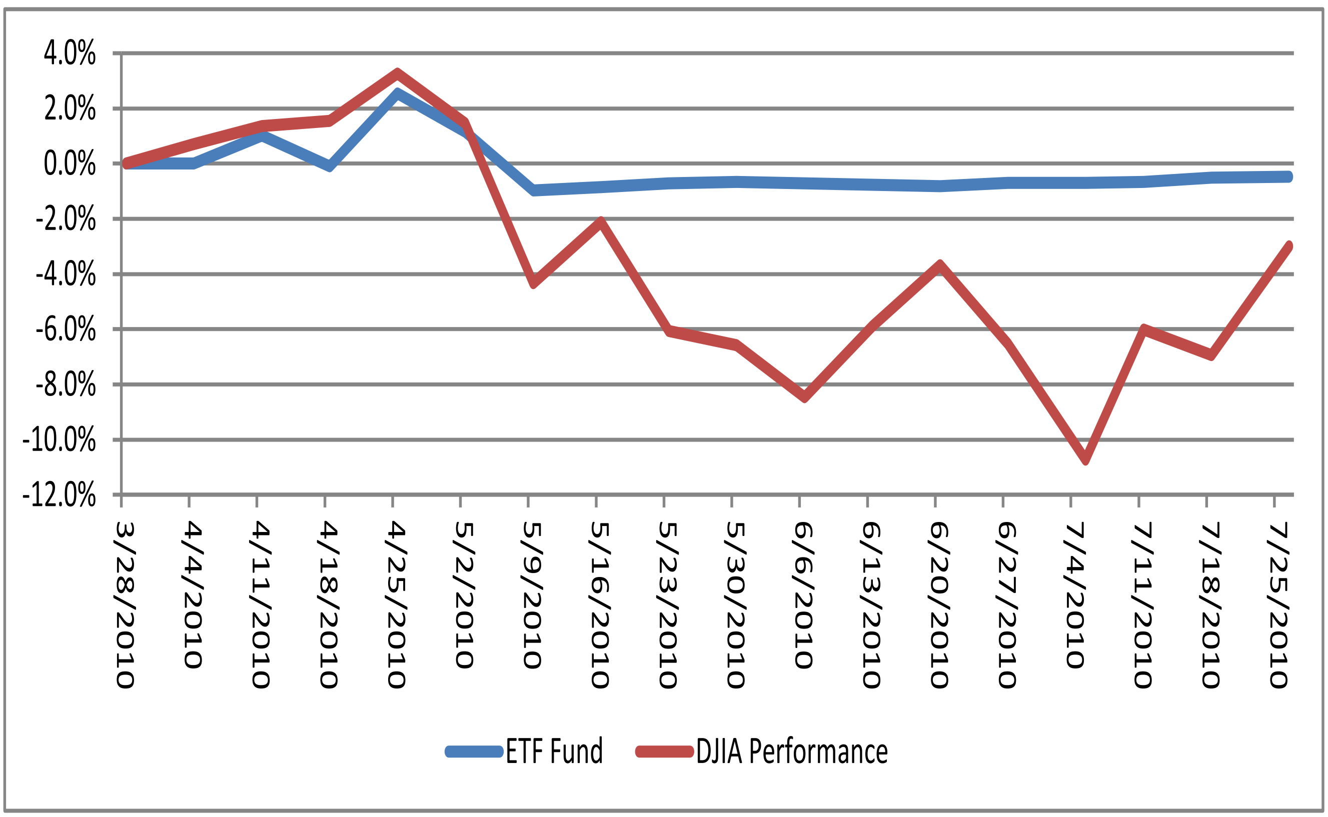
The ETF Hedge Fund consists of a set of loosely-correlated ETFs (Exchange Traded Funds). It is aimed at the conservative investor who is looking to preserve capital, avoid major market downturns, and ride market upturns. Trading occurs no frequently than weekly, and the ETF Hedge Fund has a bias toward conservative money management. ETFs can be bought just like stocks using Schwab, TDAmeritrade, Etrade, or any other electronic brokerage.

An ETF is a commonly traded security that represents a published proportion of underlying securities. For example, the ETF going by the ticker symbol "SPY" consists of a basket of stocks matching the proportion used in the S&P 500 index. ETFs have the advantage of being liquid, traded like stocks, and diversified like a mutual fund since they consist of so many underlying securities.

ETF Hedge Fund – Performance

Performance from inception, 03/28/2010 to Current

The ETF Hedge Fund is down -0.5% before dividends. The DJIA is down -3.0% in the same period.



You can see the moderating effect that properly using uncorrelated assets can have on overall return. Note that in the April timeframe, as the market was moving upward, we took advantage of the trend. In the last 3 months, we are positioned to retain our gains as the inevitable corrections occur.

Were dividend income to be included in the overall results, the ETF Hedge Fund would be positive for the year.

Assumptions in the above chart:

1) You followed all BUY/SELL/STOP LOSS instructions for the security since March 28, 2010
2) Equal amounts were invested each time the security was purchased
3) All shares were sold at the time of the SELL order
4) No commission or transaction fees are included
5) No dividends or capital gain disbursements are included

ETF Hedge Fund – Security Detail

	The BUY/SELL notes below are from mechanical models and used as a reference. Please see notes directly below this table for further clarification and direction.				Current Position Stop Loss	New Position Stop Losses	
Security	Long-Term	Med- Term	Short Term	Price	SELL	BUY	SELL
SPY (S&P 500 ETF)	SELL (Jun 30) (103.22)	SELL (May 20) (107.54)	BUY (Jul 9) (107.96)	$111.56			
AGG (Bond ETF)	BUY (Apr 30) (104.89)	BUY (Apr 29) (104.44)	BUY (Apr 15) (104.26)	$107.41	$106.44	$104.75	$104.00
ICF (REIT ETF)	BUY (Jul 7) (55.30)	SELL (Jul 2) (53.66)	BUY (Jul 13) (58.38)	$60.97			
GLD (Gold ETF)	BUY (May 24) (116.84)	BUY (May 24) (116.84)	SELL (Jul 1) (117.04)	$115.52			
UUP (Dollar ETF)	BUY (Jul 14) (24.25)	SELL (Jul 14) (24.30)	SELL (Jun 17) (24.95)	$23.86			
DOG (S&P Inverse)	SELL (Jun '09) (66.50)	BUY (Jul 14) (50.80)	SELL (Jul '09) (64.27)	$50.82			
MUB (Tax Advantaged Bond)	BUY (Mar 18) (103.49)	BUY (Mar 18) (103.49)	BUY (Apr 16) (103.48)	$104.89	$104.12	$103.40	$102.75

Three comments from last week are generally still true:

1) **We only BUY when all three models are in sync and suggest BUY.**
2) General equities (SPY, ICF, DOG) are not suggested by the models, and the market is in a general downward or sideways trend. So as an intermediate-term investor you should not be in equities.
3) 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.
4) Gold and the US Dollar are both beginning technical correction cycles and are not good BUY at this point.

Remember to set the stop loss as indicated.

Mutual Fund Guidance

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)	$111.56	You should be out of equity funds until this lateral market resolves into a trend.
Bond Mutual Funds (AGG as a proxy)	(May 16) BUY	$107.41	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	You should be in fully in bond mutual funds at this point.

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.

New Investing Suggestions

None this week. However, as I noted last week, I will be distributing information on a new Mechanized Hedge Fund in the next few weeks.

The Final Word

(Today's Final Word comes from Dan Miley, an accomplished investor friend of mine who has a Fundamental investing perspective.)

Well, it's that time of the week again, and I have three new picks for your consideration. But before that, I would still like you to consider (or reconsider) two stocks I recommended in prior newsletters.

The first former recommendation I would like to highlight is Provident Service (**PRSC**). Since I recommended PRSC at around $15 about a month and a half ago, it fell to as low as $12, but is back on the upswing at $14. I still think that stock will hit $22 within year - a potential 57% gain.

The second former recommendation I would like to highlight is First Cash Financial Services (**FCFS**). Since I recommended FCFS about a month ago at $21, the stock has risen to about $24 - a 14% gain. But I still think that FCFS has room to grow as I see FCFS growing to around $30 within a year - a potential 25% return.

And now to my new picks. The first stock I would like you to consider is a little company called Apple (**AAPL**). Obviously, AAPL is no longer a small company, with a market cap rivaling Microsoft. It is hard to believe that AAPL was close to being irrelevant in 1998 but now is preeminent with its dominance of premium computers, iPhones, iPads and the ubiquitous iPods. With that being said, why I would I still buy AAPL at the lofty price of around $260? With a five year revenue growth rate of 39%, an EPS growth rate of 93%, a ROE of 35% and EPS long term growth rate of 17%, I see the stock reaching 350 dollars within a year - a potential 35% gain. And if analysts most optimistic 5 year earnings predictions of 20% per year turn out to be true, the stock could grow to $880 - a potential 338% gain in 5 years.

The second stock I would like you to review is a lot more prosaic pick than Apple - it is the Ensign Group (**ENSG**). The company offers nursing and assisted living services; physical, occupational, and speech therapies; and other rehabilitative and healthcare services for long-term residents and short-stay rehabilitation patients in California, Arizona, Texas, Washington, Utah, Colorado, and Idaho. The stock currently sells for around 18 dollars. With an aging population, a company like this has good potential for growth. And its numbers bear that out with a 5 year revenue growth of 17%, 5 year EPS growth of 23%, ROE of 19% and EPS long term growth of 15%. Applying these growth rates and accounting for long term debt, I see this stock as undervalued with an intrinsic value of about $31, so I would definitely consider purchasing this stock.

The third stock and final stock I would like you to consider is Almost Family (**AFAM**). Almost Family provides visiting nurse and personal care services to clients in Florida, Kentucky, Connecticut, New Jersey, Ohio, Massachusetts, Alabama, Missouri, Illinois, Pennsylvania, and Indiana. Again, as with ENSG, with our aging population, this stock has great potential for growth. Its numbers are actually better than ENSG: revenue growth of 35%, EPS growth of 54%, ROE of 21%, and EPS long term estimated growth of 16%. The stock currently sells for around 25 dollars. Applying these growth rates and accounting for long term debt, I see this stock as grossly undervalued with an intrinsic value of $ 74. However, be *very cautious* before investing in this stock, as the company is currently under investigation by federal investigators for Medicare reimbursement issues. Personally, I think that the company will end paying a fine without admitting any guilt and this issue will blow over but there are no guarantees. Therefore, this stock should be considered by those with a strong tolerance for risk.

As always, the opinions expressed above are clearly my own, and you should do your research before investing in stocks. And I would also advise sell covered calls or buying protective puts as a hedge.

Thanks for interest, happy investing, and good luck!

Fair disclosure: Dan owns positions in PRSC and AAPL. He doesn't currently own FCFS, ENSG, or AFAM. He may increase or decrease positions in these securities this week.

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.

Things to be Aware Of….

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

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.