Course Schedule

PART 1- The Base. What does intermediate-term momentum trading mean and how does it differ from the short- and long-term? What does it take to excel as a momentum trader?

PART 2- How to Buy. Learn the very best chart patterns that most consistently lead to big winners, as well as how best to choose an entry point. You'll also learn about proper money management principles in detail: Learn how to jump-start your results with an understanding of position size, position risk, and proper use of margin.

PART 3- When to Sell. The sell decision is many times more important than the buy decision. Greg and Kevin will show you when to hold 'em and when to fold 'em.

PART 4- The Market. Learn exactly how to interpret the only two market indicators that are necessary to know: the action of the major stock averages and the behavior of the market's leading stocks. Additionally, investor sentiment is a prime driver of what goes on in the intermediate term. From the heap of sentiment indicators that abound, Greg and Kevin discuss the few that make the most sense from the standpoint of the intermediate-term trader.

PART 5- Putting it All Together (Section 1). Greg walks you through a step-by-step analysis of why he became very bullish in October 1999 despite the prominent bearish overtones of the day. He shows you how to combine an analysis of the market with a study of individual stocks so you won't miss the signposts of the next big bull move.

PART 6- Putting it All Together (Section 2). Kevin explains why he turned bullish in early-February 2000 and how he took advantage of the market's change in dynamics. He'll show you what stocks he bought, as well as his reasons for buying them.

Dear Fellow Trader:

Welcome to the Kuhn/Marder Intermediate-Term Momentum Stock Trading Course!

Over the next couple of months, our goal is to provide you with an understanding of what it takes to become a successful intermediate-term stock trader -- as well as the exact techniques that we use to take money out of the market. Like many of you, over the years we've studied numerous methods and indicators, bought countless books and software packages, subscribed to various newsletters and attended investment conferences -- all in the search for the proverbial Holy Grail.

What we've learned is that there is no such thing as the Holy Grail -- that elusive indicator or system that magically delivers fat profits every day to your portfolio. Thus, we won't promise you that this course will turn you into an investment phenom overnight. What we will deliver, however, is a course that emphasizes a methodology used by *many of this era's most outstanding money managers and traders.*

The emphasis of our course will be on "meat" -- not theory. This is because we're keenly aware that what makes a trader money is an understanding of *what* happens in the stock market -- not *why*.

Due to heavy demand for this course, it's simply not possible for us to answer all individual questions you may have. However, we will do our best to get to a number of them via the upcoming release of TradingMarkets.com's Community section.

Enjoy the course and Trade *Hard* !

Sincerely,

Gregory J. Kuhn Kevin N. Marder

WEEK ONE — THE BASE

Giving Credit Where Credit Is Due (aka The O'Neil Factor)

Kevin N. Marder: Rather than bury this somewhere in the back of the course, I'd like to start by saying that Greg Kuhn and I have both been heavily influenced by Bill O'Neil, the founder and chairman of Investor's Business Daily. We owe Bill a tremendous debt, as do many of this era's most outstanding traders.

Over the years, I've added my own wrinkles to O'Neil's basic strategy of buying high relative-strength growth stocks as they emerge from sound technical chart patterns.

Many moons ago, when I learned how to play guitar, I studied the style of Eric Clapton. Although I was greatly influenced by him, playing the guitar, like trading stocks, ultimately comes down to developing your own style. That's because, as human beings, we're all different. In the stock market, each player will necessarily play the game from a different vantage point so as to complement his/her unique risk tolerance level, personality, experience, and ego.

Thus, there are certainly things that I do that Bill O'Neil might roll his eyes at as I'm sure there are things that I do that Greg would never do. Nevertheless, Greg and I see eye-to-eye on more things having to do with the market than practically anyone else I've met.

Gregory J. Kuhn: For many years I tried to improve upon the basic principles that O'Neil laid out. I added all of the usual canned indicators into the mix to better time my purchases. I also tried adding in some of the commercial timing products that were coming into great vogue in the early 90s. Why did I do this? Because I didn't fully grasp all of O'Neil's principles right away. I was trying to cut corners. It took some time, several years actually, but after continuing my study of his principles I found the answer right under my nose - stick to his principles and don't add or subtract anything. They work over and over again.

I got to the point where I wanted to trade exactly as he would - and still do to this day. Look at the market through his eyes. As an institutional client of his firm, I've seen first- hand how really great he is in the market. I don't believe there is anyone as good in the stock market. And, if you ask him, he's still learning.

So, it is with his absolute principles in mind, that I will educate you on what I believe to be the best way to approach the market for maximum profit. As you will find as the course progresses, every nook and cranny, from holding on as long as you can to a big-winner in your portfolio, to getting out of the market completely, is covered in this methodology. No rock has gone unturned. There are rules for entry, rules for exiting. Slowly or quickly. Bottom line; if you follow the principles laid out in this course you will never miss an important move in the market. If you are relatively new to investing in the stock market grasping everything will take time. Years, in fact. But if you constantly go back and honestly analyze all of your mistakes in real-time, you will some day look back and wonder at what point did it all come together.

If you have a system that you can trade with great confidence, you will never need to fall victim to the latest fad of "Trading Coaches".

The 101 Ways

Kevin N. Marder: A word to the wise -- As there are 101 different ways to skin a cat, there are 101 different ways to make money in the stock market. By no means are Greg and I suggesting that this is the only strategy you should play. That is for you to decide. In general, your level of success in employing the techniques that we'll begin covering in Part II of the course is a function of five things:

1. your risk tolerance level
2. your personality
3. your experience level
4. the time you have to spend on research

5. your ego

Gregory J. Kuhn: There may not be 101 ways to use O'Neil's principles, but there certainly are many. I know traders using these principles that basically just trade the pattern breakouts - some for a day, others over a few days. There are ways to exit a successful position in the midst of a longer-term advance, and re-enter to catch the next big wave. Then there are ways to screw that up entirely. There isn't always an easy spot for re-entry.

The whole idea with this method is to identify the truly best stocks and ride them as far as you can. Kick out the ones not performing and add to the ones that are. In practice, however, this approach can be extremely difficult - been there, done that, got the t-shirt. There are definitely different ways to play this method. As a strong move develops in the market, you will typically see many, many stocks breaking out from basing patterns for months. Some traders will just keep flipping these breakouts, so to speak, and make money. Yes, you can do that, but I'm not advising it. If you want to learn how to buy and ride some of the market's biggest winning stocks this course is for you. It's also a great refresher for me. Following these concepts is something I work on, and strive to get better at, every day.

I once read where an extremely successful trader was asked why he was teaching his system to so many people. Wouldn't that affect his ability to use the system himself? His response was a flat out "no," adding that "Human beings, being what they are, will try to add their own little quirks to the system, ultimately changing the whole system to suit their personality."

I even had a discussion about this with Bill O'Neil and he shared the same sentiments.

A word from the wise.

Your risk tolerance level

Kevin N. Marder: The strategy outlined in this course works best with growth stocks, or issues of companies that are growing their earnings at a pace faster than the overall market and with little exposure to the whims of the economic cycle. Companies with annual earnings growth of 25% or more are the ones that we target. This compares with the average company in the Standard & Poor's 500 Index, which grows earnings at about 7% a year. However, our favorite stocks are those with earnings growth of at least 50% a year. They make up the fertile ground where the most outstanding winners are found.

Reward goes hand-in-hand with risk, however, and all things being equal, the higher a company's growth rate, the more volatile its shares.

Some investors aren't comfortable with the *potential* for increased volatility. Through proper money management principles, we will show you ways to alleviate much of the stress in one's daily market activity. However, the *potential* for higher volatility won't go away. Moreover, there is no such thing as a low risk, high return investment. If there was, many investors would stream into this vehicle, driving up its price and reducing its return.

In short, your risk tolerance level is something that only you can address.

Gregory J. Kuhn: Risk will always be available in the market. You can have as much as you want. But even if you buy a stock at any old price, as long as you use some kind of stop-loss point (the point at which you admit you are wrong and sell at a lower price) you've just eliminated some of the risk. There really isn't any level, or degree, of risk. Either you're in the market taking a risk or you're not. You buy a stock and set your exit point.

The whole idea is to minimize risk, not by purchasing some so-called low-risk stock, but by having an exit strategy. All stocks are rife with risk, regardless of their supposed status or quality. Just take a look at J.C. Penney over the past 12 months. I guess if you want to totally eliminate risk you can buy Eastman Kodak. Now there's a stock that's gone nowhere over the past 13 years. I'm being facetious of course, but what's reward without risk?

Kevin and I will show you how to properly set up a strategy with a minimum 3:1 risk/reward ratio. Meaning, say, for every 7% you risk on any one position your potential gain is 21% or more. If you consistently stick to this approach you will make money over time. You will make a lot of money, even with a 50-50 batting average on your picks. Now there's risk I can tolerate.

Your personality

Kevin N. Marder: Since all of us live in an era of unprecedented technological change, we are constantly bombarded with new products and services that can dramatically change the way we live our lives. I've always been intrigued by new things, whether they be related to cars, fashion, musical styles, companies, or a host of other things. Operating in the aggressive growth sector allows me the chance to watch first-hand the progress of many companies on the cutting edge of innovation. This emphasis on "the new" suits my personality and allows me to adapt well to the changes going on in the growth sector.

Are you this sort of person? Or do you prefer to go with the old, the tried-and-true? If you consider yourself among the latter, will you be apprehensive about taking positions in stocks that are on the cutting edge of technology, healthcare, retailing or any other pocket of innovation in our economy? These are the names that will crank out the heftiest advances in the years ahead.

At TradingMarkets.com, we understand that each trader is different. What's short-term to one trader might be long-term to another. Nevertheless, it's important to play the game within a time frame that fits your lifestyle and personality. Someone who's on the road a lot during market hours might find it difficult to trade within the short-term time frame. On the other hand, someone else might desire the more active approach associated with day trading. At TradingMarkets.com, this is how we define the various timeframes:

- Day -- Holding a position for a fraction of a day, with no overnight positions
- Short-term--Holding a position for a few days to a few weeks
- Intermediate-term--Holding a position for a few weeks to a few months

Our course is for intermediate-term traders.

Gregory J. Kuhn: Personality is a foreign concept to me when it comes to investing in the market. Either you want to make as much money in the market as you can or you don't. Does this sound arrogant? Perhaps. This course is not about finding the best Utility stock with the best dividend yield. It's about digging around, over and over again, to find the truly best stocks in the newest, most dynamic industries. However, in that search comes a lot of potential aggravation. Many of these stocks carry high price-earnings multiples and are certainly vulnerable to the slightest negative change in the company's future earnings outlook. It might be because of increased competition or maybe because of poor management. But Kevin and I will share with you techniques for avoiding all of the pitfalls of being involved in a bad situation. I've been trading the stock market for 12 years now and have never, in following these principles, been caught flat-footed in a stock that I couldn't get out of for anything more than a small loss.

If you don't already have one, you must develop a very thick skin if you want to be rewarded in the market. The timid get crushed. A crude statement, yes, but too true to fool with. If you want to be rewarded you have to stick your nose out there. I realize I've been taking the hard-line approach over the past several paragraphs, but if there is one thing I've learned in the market there is no escape from risk. Just like in life, there is no freedom from pain and there is no freedom from disappointments. However, there is freedom in accepting all of these things as part of life. The personality you need to be successful in the market is one of perpetual humility.

Your experience level and ego

Kevin N. Marder: Especially if you're new to trading, this course presents concepts that might make you shudder. "No, I can't do that," you might say. Like the old dog who had a hard time learning a new trick, the people that have the most investment experience will probably find it the most difficult to grasp this material and run with it. This is because deeply-ingrained habits, some of them bad, are often hard to change overnight, if at all.

I've only taught two other people the contents of this course. Both had no prior trading experience. But both took what I taught them and did exceedingly well in their first years as traders. They never once questioned why this should be done or that should be done. They just followed the rules and did it. I should be honest here and say that one of them was a chess master. He once put on an exhibition in which he played 32 games *simultaneously*. Following this, he played four games simultaneously blindfolded (there is a syntax involved so that each opponent communicates the positions to him). As such, he had a well-developed sense of the importance of risk.

The top traders become successful by putting their personal opinions aside and listening to the market's message. In fact, keeping one's ego in check is one of the most important aspects of trading. This becomes particularly difficult when someone who is a success in another field, say medicine, law, business, or sports, believes his success will translate to a superb trading career. The problem is that the market doesn't know who you are, doesn't know how bright you are, and doesn't know what great college you attended. It simply doesn't care. So the highly successful lawyer walks into the game expecting to clean up. Often, he is the one that gets cleaned.

Gregory J. Kuhn: I can remember vividly the paint-by-number painting of *The Last Supper.* My brothers and sisters and I used to work on this as kids. Pretty simple. All of the No. 12 areas were to be painted blue, or something like that.

The beauty of the method Kevin and I are about to share with you is that it's systematic completeness. It's a very structured approach to systematically pulling money from the market. If trading the market is considered by some to be an art form, then I like to call this method "painting by numbers*."*

It may not be as easy as a paint-by-number painting, but relative to all of the information thrown at us each day, it provides the same walk-through sequence in selecting stocks at the exact right time. How easy will the concepts come to you? If you're used to buying stocks that are down-and-out, if you're more experienced with stocks that essentially do nothing more than mark time, this method will require a total 180- degree turn on your part. The stocks Kevin and I search for are the kind that whiz to withering heights. You know, the stocks you see skyrocketing on the evening business news. The real horses.

If you have the aptitude to concentrate, can ferret only the most salient information available, and stick to the rules we lay down, time will be your best experience.

The time you have to spend on research

Kevin N. Marder: We've all heard the phrases "*you get out of something what you put into it*" and "*practice makes perfect*."

This certainly applies to the stock market. Some people have 20 minutes to devote to their investments each week, while others can devote nearly every waking hour of every day. The strategy that Greg and I will be showing you requires a few hours of study each weekend, in addition to 20 minutes or so each weeknight. Although sacrificing a few precious weekend hours may seem like a lot, proper preparation is crucial. After all, would you go into battle without a knowledge of the probabilities of you're winning?

The upside of this methodology is that there is no need to do extensive study of company financial statements, analyst reports, etc. during the week. Twenty minutes a night should be adequate to monitor your positions and your Watch List.

And once you get the hang of it, the few hours of weekend study may even turn out to be some of your favorite hours of the week.

Gregory J. Kuhn: Speaking of time, how long should it take to follow this system? As a hedge-fund manager with a lot more money on the line, not to mention my livelihood, it takes me many hours a day - just as it would to succeed in your profession.

Kevin and I will show you how to narrow the time that's required to follow this system to literally 20 minutes a day, and no more than a few hours over the weekend. I will share with you the necessary resources of information to best utilize your time. Like anything worthwhile in life, though, you get out of something what you put into it. If you have a tremendous passion for the market, then time won't even be an issue.

"To each his own," said the lady as she kissed the cow

Kevin N. Marder: There are a lot of very bright people operating in the U.S. market. Try as they might, most underperform the S&P 500 Index (the most widely-used proxy for the U.S. stock market) in the long term. According to Morningstar, about 70% of all actively-managed mutual funds underperformed the S&P 500 in the three-year period ended Jan. 31, 2000. And Morningstar also tells us that a full 80% of all actively-managed funds couldn't keep pace with the S&P over the past 10 years.

These numbers are quite revealing. They tell us that most mutual fund investors should either find a better fund or throw in the towel and "become the market" by buying shares in a fund that mirrors the S&P 500.

As for investors in individual stocks, most underperform the S&P 500. I believe the main reason for this is a lack of knowledge of how the market really works. Whereas the primary disadvantages of mutual funds are their size, their need to maintain cash reserves to meet redemptions, and their need to hold a large number of stocks, the individual investor doesn't have these problems. He may enter and exit positions in a relatively effortless manner, can toggle between being fully invested and being in a 100% cash position, and can concentrate his account in fewer names. Further, once he/she develops a successful strategy, a strategy using margin is an option to boost returns. These are all advantages which greatly outweigh a fund manager's ability to leverage a relationship with a CEO into

The key point to understand here is that the only way to gain an edge over your competition in the market, i.e. everyone else, is to do things differently. Mimicking what everyone else does is the surest ticket to mediocrity -- and worse -- in the stock market.

Along these lines, perhaps some of the old market saws, such as "*don't buy stocks with sky-high price-earnings ratios*," "*don't buy stocks as they hit 52-week price highs*," "*buy more of your losers so that your average cost drops*" (after all, the market will always come back), "*you'll never go broke taking a (quick) profit*," etc. should be discarded.

In this course, there will be plenty of things that will make some of you squirm in your chairs -- things that are diametrically opposed to the way you currently play the market. Just remember one thing as you squirm: You've got to do things differently to make big money in the stock market.

Perhaps the lady that kissed the cow knew a good thing. Of course, we'll never know, will we?

The Holy Grail

Kevin N. Marder: In the parlance of the stock market, the "Holy Grail" is that elusive indicator or trading system that will lead us to the doorstep of riches, the thing that can make all of our trading dreams come true. Any of us that has spent any time researching the market (or spending lots of money on books, software, etc.) knows just how intense the search for the Holy Grail can be. It's out there, it's out there somewhere. If only we can find it.

Really?

Our take is that there is no such thing as the Holy Grail. The successful traders in the world succeed because they possess something that gives them an edge in the market. That edge, when combined with sound money management principles, is enough to vault them into the winner's circle.

Lastly, as there are 101 different ways to skin a cat, there are 101 different ways to make money in the stock market. Certainly, there are quant players and value players and contrarian types that are quite successful. Greg and I wholeheartedly agree that each investor or trader must find his or her own calling. However, we firmly believe that the methodology outlined in this course represents the finest way to attack the stock market from the standpoint of rolling up fat gains within the intermediate time frame.

We`ll see you next week,

Gregory J. Kuhn Kevin N. Marder

WEEK TWO **HOW TO BUY**

Kevin N. Marder: When I began trading this strategy some years ago, I looked at a bunch of fundamental and technical characteristics as part of my buy decision. Since then, I've pared my list of "must-haves" down to just a few. They involve one fundamental measure and two technical measures.

Earnings, Earnings, Earnings

The only fundamental characteristic that matters to me is earnings growth. Some of us know that in real estate a property's value relative to other properties is largely a function of three things: location, location, and location. In the stock market, a stock's value relative to other issues also boils down to three things: earnings, earnings, and earnings. Over the truly long-term, say 10 years, a stock's price will tend to rise in tandem with its rate of earnings growth, all things being equal. Exogenous factors, such as the interest rate environment, will also play a major role, but these tend to impact investor appetite for stocks *as a whole*, and not on a relative basis.

Is the importance of earnings growth in stock selection a fad that's destined to someday go the way of the hula hoop? No. As long as earnings are transferred from a company's income statement to the equity section of the company's balance sheet, thereby increasing the equity of shareholders, this relationship isn't in danger of going the way of the dinosaur.

So earnings growth is where we start. Historically, we know that the average company in the Standard & Poor's 500 Index has grown earnings at 7% a year. What I'm looking for are companies that are growing profits at a minimum of 30% a year. This is the absolute minimum, however. What I'm really on the lookout for are companies boasting at least 40% growth. In fact, the faster the growth, the better. My favorite buy targets are those companies that are growing earnings by 60%, 80%, even 100% or more per year. Back in the '80s, when I first started getting serious about investing, I favored companies with steady 20%-25% growth, like Waste Management, Wal-Mart, Coca-Cola, Merck, etc. The most aggressive growers simply scared me, what with their volatility. I quickly learned, though, that the really big profits in the market are made by focusing on stocks of companies with greater-than-40% earnings growth. Later in the course, Greg and I will show you how to deal with the higher rate of volatility associated with these names.

So my initial screen quickly limits my search to those companies that are among the most aggressive growers. These are companies that are offering a product or service that's so popular that customers are beating a path to their doorstep. Microsoft grew its earnings at a 50%-a-year pace in its early years as people gobbled up its state-of-the-art software products. In the late '80s and early '90s, Home Depot experienced blistering growth by coming out with a chain of innovative home improvement stores offering discount prices. Cisco Systems became an earnings juggernaut by developing technology used to link groups of individual computers together. In each case, these companies carved out a whole new market for themselves by developing something new.

There are various ways to measure earnings growth. The five-year annually compounded rate of growth, the three-year annually compounded rate of growth, and the most recent two quarters of year-over-year growth can be used. As one example of the latter, you're comparing the third quarter of '99 with the third quarter of '98 and Q4 of '99 with Q4 of '98. Many companies experience some sort of seasonal bias to their business. Comparing year-over-year quarterly earnings data, then, removes this bias versus merely comparing 1999Q4 earnings with 1999Q3 earnings. And when I speak of "earnings," I'm referring to earnings per share -- not net income, which is the so-called bottom line of an income statement. Earnings per share equals net income divided by total shares outstanding.

How do I measure earnings? *Specifically, I'm interested in the next one to two fiscal years of earnings estimates provided by Wall Street analysts*. Since the market is a discounting mechanism, or a forward-looking animal, it doesn't care about yesterday, or even today. All that matters is the expectation of what tomorrow will bring. This is why I limit my earnings screen to the next two years of estimates. By just looking at past earnings performance one can miss out on a turnaround situation within a company. I should point out, though, that Wall Street's accuracy in forecasting a company's future earnings stream often leaves much to be desired. No one said this business of speculating was easy, however!

There are two exceptions to my emphasis on future earnings:

- When a company is not expected to become profitable in the next two fiscal years, I specifically look at *sequential revenue growth over the past one to three quarters*. In this instance, the term "sequential" means "from one quarter to the next." So I would be looking to see how much 1999Q3 revenues grew over those of 1999Q2, and then how much 1999Q4 revenues grew over those of 1999Q3. Indeed, since profitless companies are some of the biggest winners in the stock market, it would be foolhardy to overlook them entirely. The obvious example in 1999's U.S. market was the Internet group. You would have missed some fat moves had you ignored companies like Ariba, Commerce One, E Piphany, and Juniper Networks. Here's what I've found: The biggest winners among profitless companies are growing revenues at 33% or more sequentially.

- When a company is not expected to become profitable in the next two fiscal years and sequential revenue growth over the past one to three quarters is unimpressive or even downright stagnant, I'll look at *whether the stock is part of an industry group that's exhibiting outstanding tape action.* The obvious recent example is the biotech group, especially the genomics segment. Many of these companies are development stage outfits. They're doing research on new gene-based products and services that have yet to develop into revenue-generating -- let alone profit-making -- entities. Yet when an entire group runs up in such a bullish manner as did the genomics in December 1999-February 2000, I sit up and pay attention. The odds of hooking a big winner increase materially when a stock is part of a group that's trampling other groups in terms of relative strength.

Those investors and traders that question the wisdom of buying stocks of companies with no earnings would certainly object to buying stocks of companies with no revenue growth. But my goal in the stock market is to make big money. And whatever the market is interested in kiting to the sky, I'm interested in. This last sentence should tell you where I place my highest priority: *Above all else, the tape matters most*.

Gregory J. Kuhn: Kevin hit the nail on the head, so I'll just simply walk you through the process I use in narrowing down my stock selections on the fundamental side.

There are many different earnings growth combinations I look for. One combination is no more important than the other. It's just that different stocks will be in different phases of their growth period at different times. However, there is only one particular thing I look for in revenue growth - it must simply be there in conjunction with a company's bottom line growth. Specifically, revenue (or sales) growth should increase by at least 25% for the past two quarters on a year-over-year basis. Earnings growth with negative revenue growth, or high earnings growth with very low revenue growth, will eventually lead to trouble at a company's bottom line. If a company has good earnings growth and poor revenue growth it typically indicates the company is now growing earnings through accounting tricks, which won't last. One example would be where a company keeps earnings growth afloat through a lower tax rate. If a company isn't growing earnings because of its product line, the growth simply won't last. Revenue growth is the first line of fundamental analysis I use in screening for stocks.

Once I've identified that a company has sufficient revenue growth (absolute revenues should be greater than $3 million in the most recent quarter as well), I then turn to the bottom line.

Like Kevin, at a minimum I'm searching for companies with quarterly earnings growth on a year-over-year basis of at least 30% for the past two quarters. But, again like Kevin, I'm really looking for companies with the highest rate of quarterly earnings growth. I mean, the whole idea is to find and buy the very best merchandise. Moreover, provided the company has shown earnings for the past five years, I'm looking for an annual growth rate of at least 30% as well. Again, this is the minimum, as most of history's biggest winning stocks have had annual growth rates well in excess of this rate of growth *before* they launched their tremendous runs.

But let's say a company is relatively new in a hot, new, dynamic industry, or is a new company that's developed a better product in an older industry and doesn't have a five-year, or even a three-year, growth record. We then want to defer and put all of our emphasis on the quarterly growth rate - more importantly, the past two quarters. Now, let's say a company has a hot, new product in a hot, new industry like in the case of the recent induction of the Internet sector. Well, as many of us have learned over the past three years, the emphasis has fallen to top-line growth, or growth in revenues. The companies that have been rewarded the most in this industry over the past few years have had very strong quarterly revenue growth *sans* any earnings - typically in excess of 100% or 200%. Rule of thumb; the bigger the better. Take one look at Amazon.Com [AMZN|AMZN]. As we all know, ad nauseum, the company has no earnings to this day. However, throughout its tremendous run from Sept. 1997 through Jan. 1999, Amazon sported quarterly revenue growth in excess of 300%.

The following is a very useful earnings matrix to help you narrow down your selections to the very best:

<u>EARNINGS MATRIX</u> (use with companies that have a five-year growth rate)

Quarterly Growth	100%	50-100%	25-50%
Annual Growth			
50%	1	2	3
25-50%	4	5	6
15-20%	7	8	9

Try and get as many of your picks as possible in box No.1 -- quarterly growth in excess of 100% and five-year growth in excess of 50% - and work down from there.

Beyond the next quarter's earnings estimate I don't use analysts' consensus earnings projections as part of my selection process. When it comes to growth stocks, especially newer companies, it's been my vast experience that analysts consistently underestimate a company's growth potential. For that, I leave future growth prospects to expanding ROE, after-tax profit margins, and most important, how the stock acts technically.

Relative Strength

Kevin N. Marder: It's all fine and well if Wall Street expects a company to post powerful earnings growth over the next fiscal year or two. But there is another component other than earnings growth that drives the relative value of one stock versus another. And that's investor psychology, which is comprised of numerous things. There are a few gauges that track investor psychology as it relates to the general market. Greg and I will discuss these in Part IV of this course. But suffice to say, investor psychology is hard to measure on a stock-by-stock basis -- that is, unless we look at how a stock is performing *vis à vis* the rest of the market. The handiest tool for doing this is an indicator called the relative strength line. The RS line is not to be confused with the relative strength index (RSI), which is an oscillator used to determine when an index, sector, group, or individual security becomes "overbought or oversold."

On a chart containing price and volume bars, the RS line is plotted directly underneath the price bars and above the volume bars. Ignore the numerical scale that's associated with the RS line and which appears on the vertical axis of a price chart. It's meaningless. What's important is the slope of the RS line. This tells us whether the stock is outperforming a benchmark, be it the S&P 500 index or the index of a group or sector. The RS line that I use compares a stock's performance with the S&P 500. If the line is upward sloping, the stock has outperformed the S&P 500 over this period. If the line is downward sloping, the stock has underperformed the S&P 500 over this stretch.

Like most tools that are powerful, this one can easily be misused. For example, a stock could be outperforming the market but might be beginning to show signs of weakness that appear on its price and volume bars. *Specifically, I look for a stock to show a rising RS line over the past eight to 13 weeks.* This tells me that the market -- which is all that really matters -- likes a stock more than it does the average stock. Why does the market like a stock more than most others? Usually, it has to do with earnings growth being above average. But I don't spend much time caring about what the fundamental reasons are. All that matters is that they *are*.

Gregory J. Kuhn: For years, academicians have run studies on high relative-strength stocks to show how a strategy of buying such high-flyers would have yielded negative investment results on balance. Unfortunately, these ivory-tower pundits would randomly select a period in the market for their studies. But like anything, all tools must be used within the context of other complementary tools to yield good results. Picking something on its arbitrary merits is a quick way to the poor-house. I wouldn't dare buy a stock because its earnings growth was great unless I saw that the market agreed.

As the saying goes in the market, the whole idea isn't to pick which girl *you* think will win the beauty contest, it's to pick the girl you think the judges will pick.

There are two aspects to relative strength I look for in a stock. One measures the stock's performance against the S&P 500, or relative to the general market. The other measures a stock's weighted 12-month price performance relative to a total database of stocks. For the latter, I use Bill O'Neil's RS rank formula, which measures a stock's price performance against his company's database of some 7,000 stocks, laid out each day in Investor's Business Daily.

Basically, a stock's relative strength line, the line that measures a stock's performance against the S&P 500, should either lead a stock into new high ground or accompany it into new high ground as the stock breaks out of a basing pattern. Additionally, I want to screen for stocks with an RS rank of at least 83, but the higher the better. Period!

Like O'Neil's RS ranking system I also tie in his EPS rank, which is related to the first section on earnings growth. The following is an EPS/RS combination I have found to work well over the years as part of my screening process.

EPS/RS Combos

1) Best - RS and EPS rank both 99......naturally.

2) Minimum - RS and EPS rank both >84.

3) If EPS is 97-99, then RS can be as low as 83.

4) If EPS 76-83, then RS >89.

5) If EPS <76, then >RS 94.

The EPS/RS combination is certainly not set in stone. However, if you were to begin your screening process using these parameters you will automatically be in touch with most of the market's best stocks.

One additional note: With the advent of Internet stocks in recent years, you can substitute No. 5 with >RS 90 for this sector. Before that, No. 5 was used to identify those stocks without a five-year growth rate, but had solid quarterly earnings over several quarters. Since the EPS rank takes the five-year growth rate into account as part of its calculation, stocks without an annual earnings growth rate would be penalized with a lower EPS rank. Nonetheless, the very high RS rank indicated the market believed earnings were right around the corner, if it didn't have any, or that what was in place on a quarterly basis would continue.

Chart Patterns

Kevin N. Marder: The third characteristic I look at is a stock's chart pattern. *Specifically, I'm looking for a stock that's emerging from a base*, or an area of sideways movement lasting from a few weeks to a number of months. A base acts as support for a stock in the event a breakout fails. A breakout may fail due to a fundamental event at the company, such as a negative earnings surprise, or it may fail due to weakness in the general market. By buying a stock that's breaking out of a base on volume that's 40%-50% greater than its 50-day average, you're insisting that a surfeit of other buyers agrees with you. By contrast, low-volume breakouts are prone to failure and should be avoided. This is easier said than done, and you'll probably end up learning this lesson through experience.

We'll go over three types of bases: the cup-with-handle, the flat base, and the double bottom.

Cup-With-Handle Base

Gregory J. Kuhn: The cup-with-handle basing pattern was popularized by Bill O'Neil, founder and chairman of *Investor's Business Daily*. The pattern takes its name from a resemblance to the profile of a coffee cup. The cup of the pattern typically forms during intermediate-term market corrections and is usually three to six months in duration but can be as long as 15 months during bear markets or as short as seven weeks during bull markets. The left side of the cup is a downtrend correcting the previous uptrend, from which the prior advance should be at least 30% to indicate the stock is already on the move. The stock price bottoms and begins to advance, forming the right side of the cup.

During the formation of the cup's right side, the stock becomes subject to profit-taking at its old highs (the beginning of the cup formation) from sellers who bought at the cup's bottom. Additionally, investors who bought near the old highs on the left side of the cup are anxious to sell; the anticipated selling is referred to as "overhead resistance." Since the stock has already worked its way up through most of this supply, the remaining supply waiting at the higher price level has minimal impact but should stall the stock's rise near the old high. The stock's price should then consolidate, forming the handle of the pattern.

The handle of the cup is usually more than one or two weeks long and should drift down on very low volume and form in the upper half of the pattern, preferably the upper third. A handle that drifts lower rather than higher is important because it indicates that enough disbelievers are still active at that point.

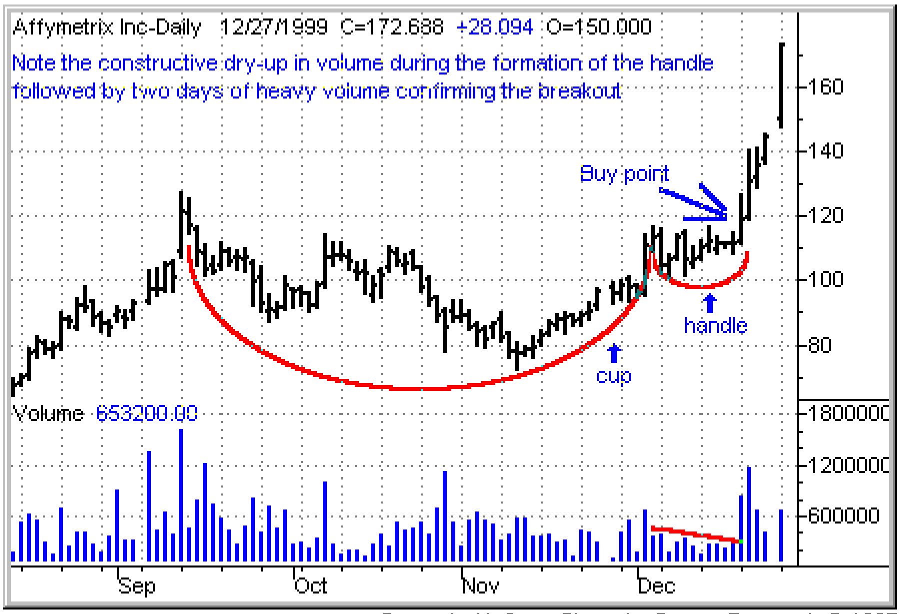
The handle sets the stage for the stock's breakout to new highs. At this point, the daily trading volume should be light, indicating a lack of selling pressure. During the formation of the handle, new buyers step in and eager institutional investors add to their positions. When the stock breaks out from its handle, volume must surge by at least 40% above its 50-day average volume to confirm that enough demand is present at the stock's earliest emerging point.

In some unusual cases, the handle may form slightly into new high territory if the right side of the cup overshoots the left side on the upside. Generally speaking, this "high" handle shouldn't form more than about 10-12% above the high on the left side of the cup.

Here's a general, extent/duration guide of a sound cup-with-handle basing pattern:

Base depth (%)	*Duration (weeks)*
12-20	7-13
21-35	13-26

The depths of a cup can be as deep as 50% in a bear market, though, and some very volatile leaders can also swoon this much during a bull market correction and still be okay - provided the deep dip is correcting a fairly healthy advance. The entire cup formation should take on the look of a rounding bottom at its depths and not appear to be "V" shaped. V-shaped patterns are faulty and failure-prone.



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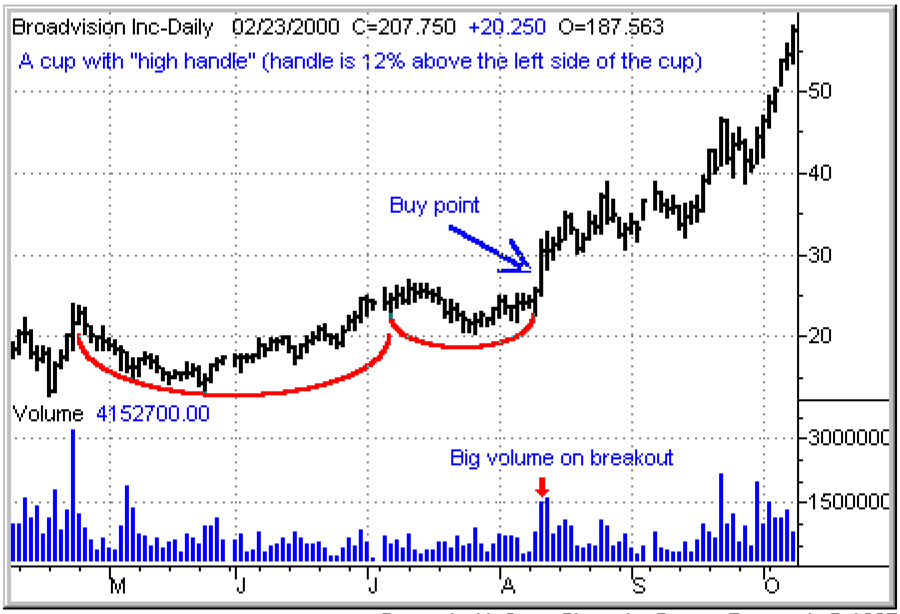

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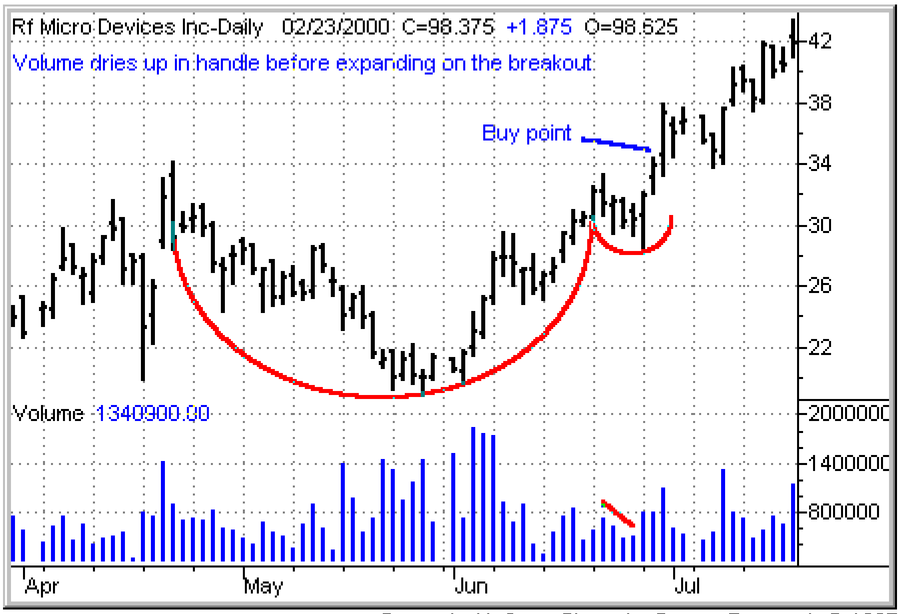

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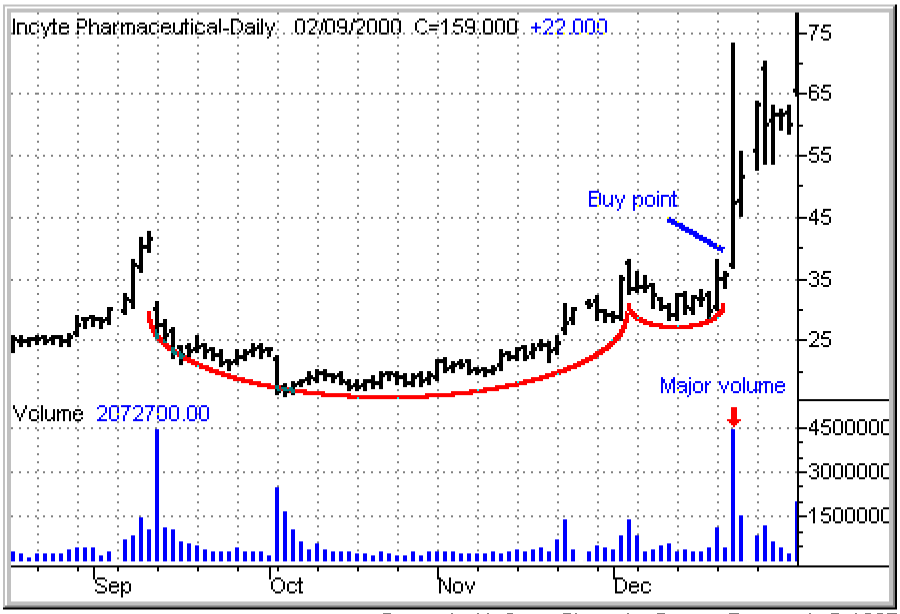

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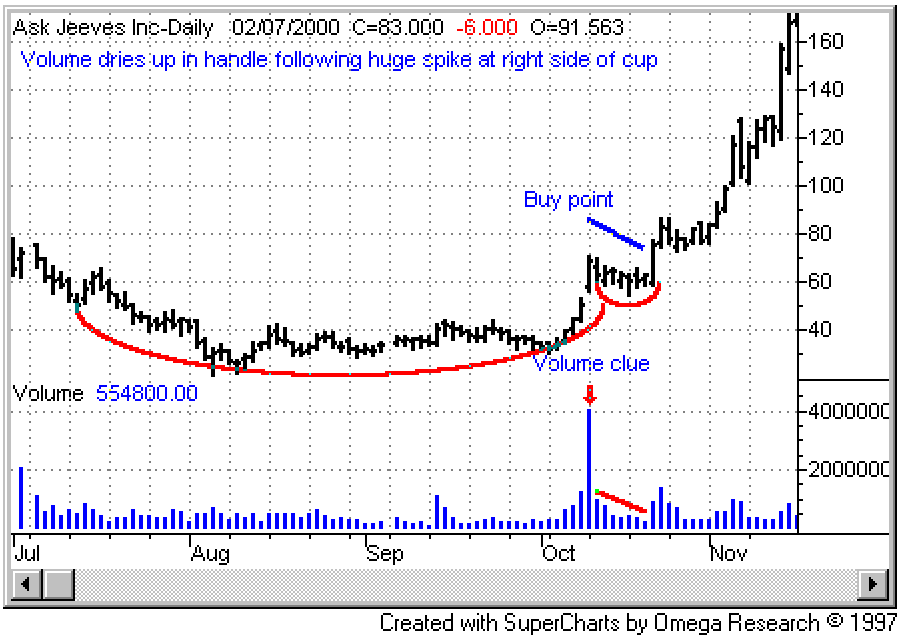
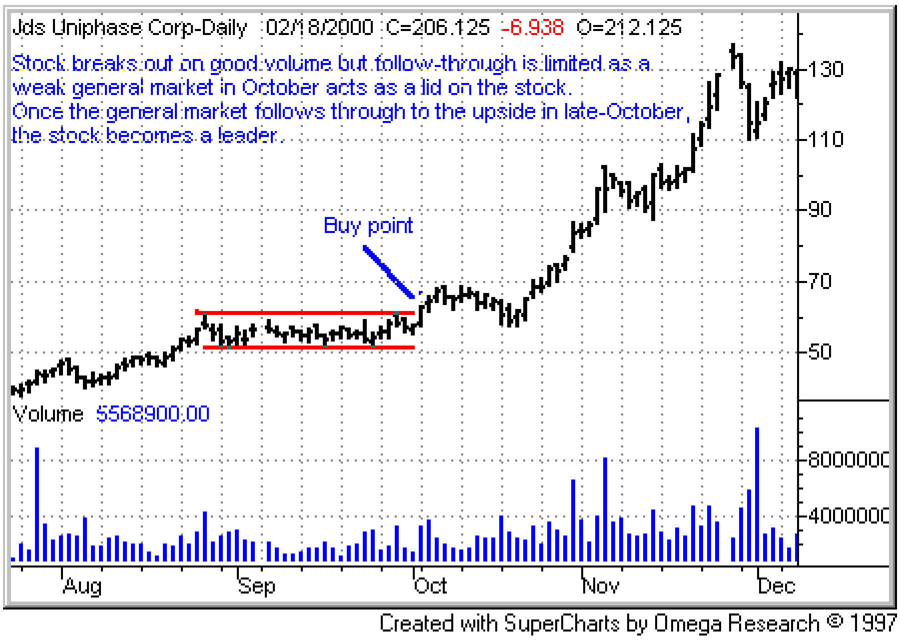
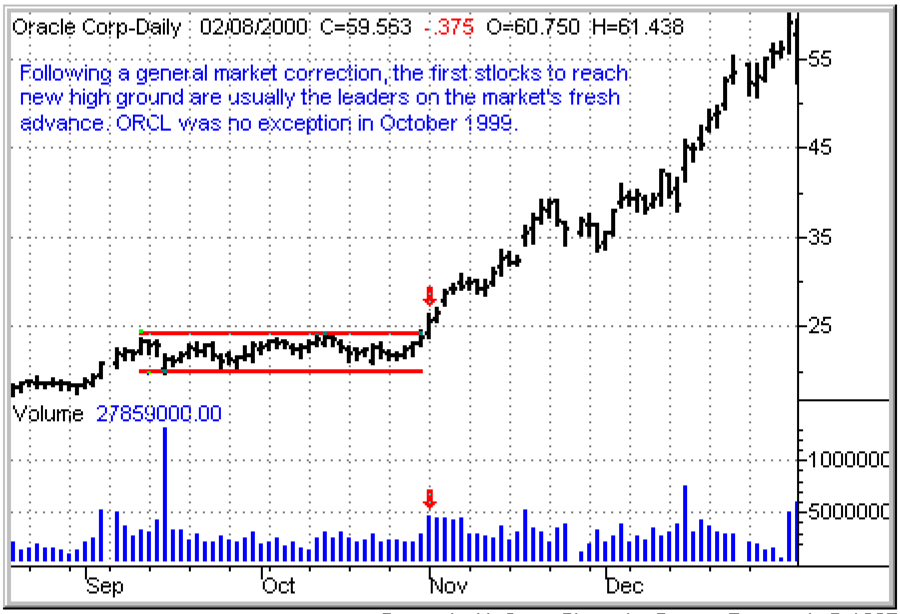


The Flat Base

Kevin N. Marder: The flat base is a fairly tight sideways range that develops over a period of at least five weeks. Ideally, the distance from the base's peak to trough should be no more than 10%-15%, but in the volatile environment of the past two years, many leading stocks trace out flat bases of 20% in depth. Watch for big volume spikes as the base is developing to see if they correlate with updays in price. Unless you're dealing with a smaller-cap stock, this is evidence of institutional investors accumulating positions. The flat base will often develop after a stock has broken out from a cup-with-handle base and run up substantially. It's critical to see if volume dries up as the base forms; this indicates profit-taking is minimal. Conversely, when a stock advances substantially and experiences big volume during the formation of a flat base, it's an indication of extensive profit-taking. Be alert when you see this. The buy point would be 1/8- or 1/4-point above the absolute peak of the base, as long as volume appears as though it's going to be at least 40%-50% greater than average by day's end.

Example: A stock's average daily volume is 500,000 shares. At 12:30 p.m. ET, the stock breaks out of a flat base and you notice that volume for the day is 400,000 shares. Since the day is one-half over, you could double the 400,000 shares and deduce that the stock might finish the day with volume of 800,000 shares. Since 800,000 is 60% above the daily average of 500,000, your volume requirement is met. Remember that this is just a quick and dirty way of determining what the approximate volume level for the entire day *might* be.





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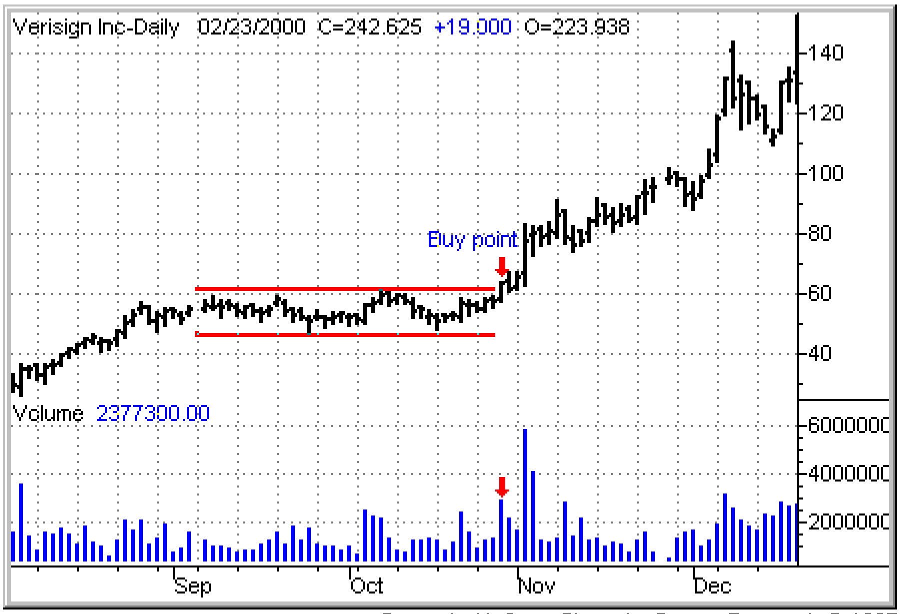

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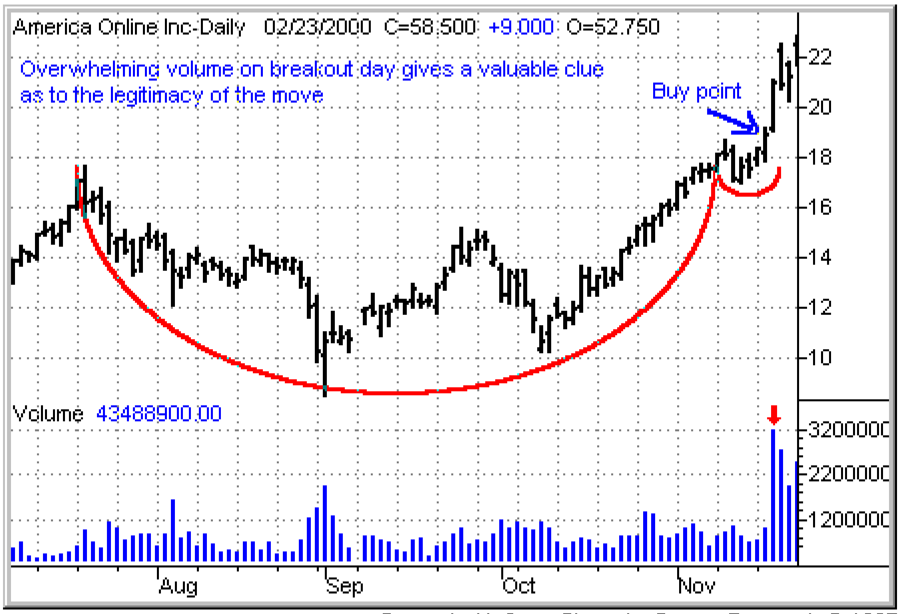
Double Bottom

Gregory J. Kuhn: Like the cup-with-handle, the double bottom formation takes on a very recognizable form that looks like a "W". Although this pattern doesn't appear as much as the cup-with-handle, it has many of the same attributes and can easily be mistaken for a cup-with-handle because, in most cases, it will also form a handle. The main difference is that the double bottom will appear more jagged around its bottom as opposed to the cup-with-handle which will appear more rounded. Moreover, it's best that the second bottom in the "W" touches or even undercuts the first bottom to create a shakeout of weak holders. However, a double bottom won't always form a handle, so the midpoint in the pattern, or the mid-peak of the "W", becomes your pivot-point or buy price as it breaks though it on the upside on big volume.



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One final note on buying base breakouts. It is absolutely essential to limit your buy "window" to no more than 5-7% above the stock's breakout point. As you will see under the next section covering money management, if you set a fairly tight stop-loss, say 7%, you want to avoid being stopped out of your position on a normal price pullback in a stock. Some stocks will break out from their basing patterns, run 10%-15%, and then pull back right to the top of the base, or breakout point. If you bought the stock in excess of 10% above its base breakout, a normal pullback to test the breakout point will "whip" you out of an otherwise sound position in many cases.

Money Management

Kevin N. Marder: Money management is one of those topics that's often given short shrift by traders. Yet many of the most successful traders and money managers point to proper money management principles as actually being more instrumental to their success than their basic strategy. In fact Mark Boucher, in his trading course, calls money management the "real Holy Grail." That's enough for me, seeing as how Nelson's ranked Mark's hedge fund No. 1 in the world over a recent five-year time period.

The two areas that I'll cover are risk control and pyramiding.

Risk Control

Rule No. 1 for this entire trading strategy is to admit when you're wrong and cut a loss before it becomes a big loss. This is very difficult for many investors to do when they want to make the jump from investing to trading. I've read a large number of books on trading, encompassing many different strategies. The one common thread that ran through the best of them was the familiar "cut your losses, let your profits run."

I remember in 1991 receiving a phone call from a lawyer friend. He wanted to know if I thought IBM was a good buy given the company's just-announced pact with Apple Computer. At the time, IBM was lagging the rest of the market as it grappled with slowing earnings growth. My advice was to stick with stocks of companies with solid earnings growth and suggested Home Depot, which was tacking up big earnings numbers quarter after quarter and was one of the real leaders in the '90-'91 advance. Can you guess which stock my lawyer friend bought? Of course, it was IBM. When my friend had lost 50% on his position, he phoned me, asking for advice. My advice hadn't changed.

There are two problems with hanging onto losers. First, you can exact a potentially devastating hit to your account if you allow a small loss to grow into a big one. Second, the opportunity cost of tying up your money in a laggard stock can be quite large in a bull market. In the example, my lawyer friend had part of his portfolio weighed down by a losing position in IBM, while other stocks with great earnings and relative strength, like Home Depot, were doubling and tripling in price and leading the entire market higher

In terms of risk control, I never want to lose more than 8% on a position. But that's just a maximum. My actual target is 5%-7% below my entry point, with my average loss coming in between 5% and 5.5%. My initial position in a stock will usually represent 10%-15% of my account. But I'll vary the risk of my "hand" depending on the general market's health and the stock in question. For example, if the general market is just beginning to take off on a fresh intermediate advance, and if I have an exceptionally high level of confidence in a stock, my opening position will be 20%. Conversely, if my confidence in the general market/individual stock is less than ideal, my opening position might only be 8%.

For newcomers to this strategy, I would recommend taking smaller positions at first, at least until you can put together a track record that's good enough to give you confidence in the approach. Confidence is important since there will come a time when you strike out several times or more in succession. This happens to everyone at some point. Having the confidence necessary to ride out the rough patches is vital in order to prevent you from chucking an otherwise-sound plan at the first sign of weakness.

Once you get the feel for this strategy, you can jump-start your results by taking concentrated positions in fewer issues and by using margin. But it should be strongly emphasized that *concentrated position sizes and use of margin elevate your risk level*. Remember: Higher return goes hand-in-hand with higher risk!

Gregory J. Kuhn: Our first line of defense in any decision we make in the market is a sound stop-loss plan. The price where, just after we bought a stock, we cry "uncle" and get out. But buying a stock at any old price and setting a stop-loss at any old price is not what we're after. The whole idea is to set a stop price at the point where we have the highest probability of being correct in parting ways with our position. In other words, this is the point at which we have the least chance of being "whip-sawed" out of our position only to watch the stock immediately do a "180" and rocket without being aboard. In other words, we want to get stopped out and watch the stock crumble further, proving us right in getting out. Most winning stocks won't fall back into their base and stop you out for a 7%-8% loss and then recover. Sometimes this might happen either because the stock is all wrong, or the market is beginning to get into trouble. From here, the stock will either build a whole new base and set up again when the market recovers, or eventually fall apart.

Following my purchase of a stock, I immediately calculate where I'm going to get out if the stock drops below my purchase price. I initially set my stop loss 7% below my purchase price, but am really looking to get out somewhere between 5% and 10% below purchase price. Ten percent is the maximum. As your feel for the market and how stocks act around breakout levels improves you'll learn to cut your loss before your stop is even hit in many cases.

There are computer programs that attempt to calculate a stock's volatility in setting the best stop price. But my attitude is to keep it simple. You can try and make the market as scientific as you want, but then you can also drive yourself to the nut house in the process. What you want to do in making money in the market is to find trades with a 3:1 risk/reward ratio. By utilizing the parameters Kevin and I have set forth in buying stocks properly, you'll easily catch a stock for a 21% gain. Even if you're only right 50% of the time on your purchases, a 21% profit vs. a 7% loss yields a ratio of 3:1. Compound that over time and you're talking some real nice money.

Another aspect to money management is determining what kind of size to take on per position. I use a 6% position in the fund I manage (15 positions to get fully invested), however for individual investors I suggest at least twice that percentage per position. You want to put as many of the factors Kevin and I have illustrated in your favor and really concentrate your portfolio. If you have $20,000-$100,000 to invest in the market I would use maybe three to five equally-weighted positions. If you have a $200,000-$500,000 account, I would use five to seven positions, and I'd use seven to 10 positions for a $1 million account.

Pyramiding

Kevin N. Marder: Pyramiding refers to buying more shares in one of your winners, or "averaging up." I do this in two different ways. In the first case, when I buy a stock and it acts well coming out of a base on strong volume, I'll sometimes buy a second position that's one-half or two-thirds the size of my original position. I will only purchase the second position within 5% of the correct buy point, or pivot point, of my original entry. I sometimes will buy a third position that usually is one-half the size of my second position.

Example: The general market is emerging from a correction of at least 8%-12% in the major averages while scores of growth stocks are forming sound bases and breaking out on powerful volume. I put 2 + 2 together and surmise that this is one of maybe two especially good buying opportunities that present themselves each year. If I calculate the pivot point on a stock to be $100, and I put 20% of my account in the stock at $101, I might add on another 10% of my account at a point no higher than $105. I then have about 30% of my account stashed in what I believe might be one of the outstanding winners in the fresh intermediate-term market advance. If the stock runs up at least 20%-30% and then forms a base, I will often add a third position equal to 5% of my account if it convincingly breaks out of that second base.

In the second case, I'll add a second position in a stock after it forms and then breaks out of a second base.

Example: I put 15% of my account in a stock as it emerges from a base. It runs up 30% and forms another base. I decide to play the stock out for a bigger gain and I sit through the second base. As the stock breaks out from the second base, I put another 10% of my account in the stock.

In the above examples, I would play each of the positions separately in terms of a stop-loss limit. The difference is that my loss limit on an "add-on" position is usually 3% instead of the 5%-7% I normally use.

I make liberal use of margin when the general market appears ripe for continued gains. The combination of concentrated positions, pyramiding, and margin can take this strategy to a whole different level in terms of performance. But like any other weapon, these three can easily be misused. Use caution with these, and only use them once you've got some experience under your belt with this strategy and can show a good profit. As well, everyone has his or her own comfort level when it comes to risk. Some traders never feel comfortable using concentrated positions, pyramiding, and margin, just as I would never feel comfortable using this strategy with just four stocks in a fully-margined account, as some traders do with phenomenal success.

We hope you've gleaned something of value from Part II of our course! We hope you'll join us for Part III.

WEEK THREE — WHEN TO SELL

Kevin N. Marder: The sell decision is many times more difficult than the buy decision. We'll break selling down into two types, one having to do with cutting a loss and the other having to do with taking a profit.

Selling to Cut a Loss

Gregory J. Kuhn: Okay, you've spent weeks searching for a good, sound stock to buy with a bright future. It has all the right fundamental characteristics and, just as important, the proper technical setup. You've done your homework and you've watched the stock set up in what you think is a solid basing pattern. As the stock puts the finishing touches on its launching pad, or base formation, you're ready to fire on all cylinders. The stock breaks out on huge volume and you're all over it. Within a few days, the stock's up 10% from where you bought it. Feeling good? You bet.

But then the unexpected happens. Before you know it, your little brainchild is crumbling and the stock is now trading a bit below your cost. No fear, it'll come back. Just a little profit-taking. Then it moves a bit lower. How could you be wrong? You've put too much time in to this one for it fail. Now the stock is 7% below your cost.

If you have any respect for the market, you have to know when to say, "I got this one wrong." Whether it's the wrong stock, whether your timing was wrong, or whether the market is beginning to weigh on your position, you have to just let it go and move on to the next one.

The most important thing about trading stocks is to understand this one simple rule and to believe in it religiously: Most big losses begin as small ones. PERIOD! You must obey this rule knowing that you may even be selling your position at the bottom tick of a "whipsaw" situation, from which the stock will immediately recover and move demonstrably higher. Cutting a loss quickly is the insurance you must pay to protect capital at all costs. Investing in the stock market isn't an exact science. It's a game of probabilities. Utilizing a high degree of risk control is just part of the game. A sound stop-loss plan should always be your first line of defense. While your offense will help you win, your defense will keep you in the game long enough to reap the rewards of investing in the stock market.

The best strategy for playing the market over the intermediate term is to look for trades carrying a risk/reward ratio of at least 3:1. As I've pointed out before, even with a 50-50 win-loss ratio, this r/r ratio will yield consistent returns over the long run. If you follow the steps Kevin Marder and I spelled out in Part II of this course, you will easily find stocks that have the potential to rise at least 21%. Therefore, I use an initial stop-loss of 7% (21/7 = 3:1) on all of my trades. If you use this strategy with a seven-position max. in your portfolio, you're only risking 1% of your account equity per position.

After a stock breaks out from its basing pattern, though, I will raise my stop-loss at certain breakpoints. Following a 20% move above my purchase price, I raise my stop-loss point to 4-5% below my cost. Once the stock increases in excess of 25%, I raise my stop to my cost. I never want to let a profitable position of this magnitude turn into a loss.

Kevin N. Marder: Rule No. 1 of this strategy, and indeed of any trading strategy, is to admit when you're wrong, sell a losing position, and step aside. Yet the very failure to abide by this rule is easily the biggest reason why traders fail. It's kind of like your physical health: If you don't have that, everything else is a moot point. And if you can't preserve your capital to play the game again, a great strategy is worth nothing.

Selling to cut a loss involves tossing our own ego into the trash can. For some of us, this is very difficult. I've seen a number of people who have been quite successful in other careers attempt to duplicate their success in trading, but to no avail. The problem in every situation? These traders thought they were smarter than the market. What they didn't fully comprehend is that what a trader thinks about a stock doesn't matter. The market doesn't know who we are, or how educated we are, or how smart we are, or what a success we've been in another career.

The bottom line here is that *I've never met a successful trader that wasn't religious about cutting losses*.

As Bill O'Neil likes to point out, the mathematics are against you when you let a small loss grow into a big loss. For example, a 33% loss requires a 50% gain just to break even on a trade, while a 50% loss requires a 100% gain. And that's just to break even. Too, if we're in a bull market, the opportunity cost of having money tied up in a loser can be major (the prior example of my lawyer friend holding onto IBM in 1991 applies).

The good news is that selling to cut a loss removes quite a bit of the stress associated with trading. As well, it is, by factors, an easier decision than that of nailing down a profit. Most of the time, I use a stop loss level that equates to 5%-7% below my entry point. This level does not necessarily correspond with some area of support, though at times I do set my stop just below a "shelf," or support level.

Of course, there are exceptions to every rule. Situations in which I deviate from the 5%-7% level, and instead set my risk at 3%-5%:

- In the case of stocks that sell for more than $150. With a $150 stock, I usually don't need more than a 7-point cushion (4.7% below the entry point) to prove myself wrong.

- When a stock breaks out of a brief consolidation area of less than four weeks. This especially applies to stocks that I buy that pull back for just a couple of days. For those just starting out with this strategy, I *strongly* urge you to concentrate your buys on those stocks forming bases of at least five to six weeks. All other things being equal, a breakout from a proper six-week base has substantially higher odds of succeeding than a stock emerging from a consolidation of less than four weeks. Prove to yourself that this strategy works with proper bases before you start taking on higher-risk trades. The danger is that you'll buy stocks coming out of brief, two-week pullbacks, they'll fail, and you'll end up chucking the whole game plan before you give it a legitimate chance to work. Of course, paper trading for a while is one way to build your confidence.

- When I pyramid a position. I will usually set a stop of about 3%-3.5% on any add-on buy.

- When the general market's health is marginal.

The last three exceptions listed above involve higher risk, hence the tighter stop level.

For newcomers to trading, there will be many times in which you'll sell to cut a loss, only to have the stock come right back in your face and break to the upside. You may even develop an inferiority complex as you sell at the bottom tick of the day. Nonsense! This happens to all traders. If you look on this business of cutting a loss as merely an insurance policy, you'll better appreciate its importance -- not to mention the reduction in stress that it brings.

Selling to Take a Profit

Gregory J. Kuhn: Your first line of analysis after you buy a stock breaking out of a proper basing pattern is to watch the stock's daily price-and-volume action. Ideally, a stock should advance daily on increased volume and pullback on light volume throughout the entirety of its fresh, new upward trend. Each day I compare the stock's price action and daily trading volume to the day before to detect any hints of distribution, which is characterized by a down day on increased volume from the day before. However, although a stock can experience a day or two of distributive activity during its advance, it must be used in conjunction with several other factors in truly determining whether the position should be held or punted.

If you're new to intermediate-term investing, if you're new to technical analysis, or even if you're just new to the investment approach Kevin and I have laid out thus far, I urge you to set up your own checklist of sell rules to follow. The idea is to run each stock through this checklist each night to see if any of the sell rules have been triggered. You want to make your stock jump through all of these hoops in determining whether or not it merits you sticking with the position.

Although almost half of my decision-making process in buying a stock is based on a company's fundamentals - namely earnings and revenue growth - my rule-based strategy for selling is purely technical. The only exception is when a company's quarterly, year-over-year earnings growth decelerates by more than two-thirds over two consecutive quarters. However, I must say, I've only seen this occur with a stock still materially in its upward trend on rare occasions. The majority of times, a stock will have already peaked and headed into a downward trend in advance of any fundamental deterioration in the company's growth. Therefore, I put almost all of the weight in selling a stock on the technical side.

You buy fundamentally, but sell technically.

Bear in mind, one or more of the sell rules laid out below will trigger when a stock's trend is over or about to end. These rules are not devised to get you out of the stock at the top tick. They're here to help you hold onto a stock for the majority of its move. Nothing more, nothing less.

Volume

As discussed above, my first line of analysis is to watch a stock's price-and-volume action -- just as I do with the market. I will sell all or part of my position if I see:

1) *New highs on decreasing volume or low volume over several days without an increase in volume*. This will typically occur well into a stock's advance as it runs out of fresh, institutional interest.

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2) *Heavy volume without the stock moving one way or the other*. The stock may even be up during the day only to close lower, called a price reversal. For example, let's say a stock has made a nice advance, of say, 75%, over a couple of months on healthy turnover. All of a sudden the stock stops dead in its tracks for a day on very heavy volume, perhaps the heaviest volume day in weeks. This is called distribution as bulls and bears fight it out. Well, they can have their fight. This action will typically occur at or near the end of a move.

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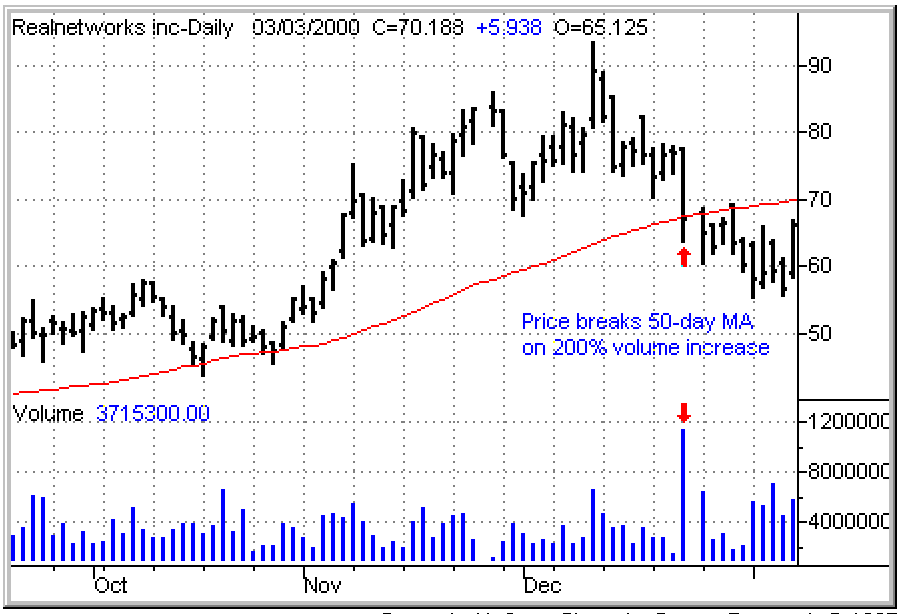
When heavy selling pressure appears near a stock's peak, the next recovery will either follow through on weaker volume or show poor price recovery (see above chart). Sell on the second or third day of the poor rally attempt.

3) *If a stock breaks and closes below its 50-day price moving average on a 200% increase in volume or breaks down on a 300% increase on volume,* I'm a seller. Again, I will sell the position in either part or whole depending on where the stock is in its overall upward trend.



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There is one caveat to the volume sell signals, however. Beware of stocks showing distribution (reversal day on heavy volume) after a stock advances 10%-25% from its base breakout within eight weeks of the breakout. It may only signal a pause in the stock's advance. As long as the market is still in good shape, a stock can recover from this condition without much of a subsequent sell-off.

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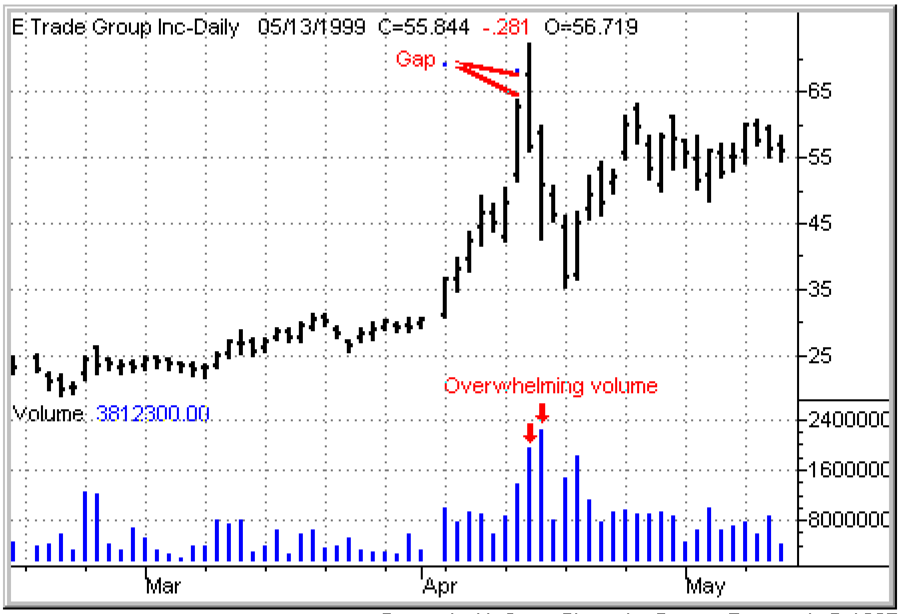
Price

After a stock has advanced over several months, if none of the above volume sell rules have been triggered, some stocks will go into what's referred to as a climax run over a two-to-three-week period. This is also referred to as "going parabolic," which appears as a sloped upward trend on a price chart that ends by moving straight up. If the stock is materially extended from its most recent base breakout, you want to sell right into this. Most professionals will use this opportunity to feed stock out to the masses coming on board late into a stock's trend.

A climax run may also occur just after a stock split or announcement of a split. If the stock advances 25%-30% (sometimes 50%) over a one-to-two-week period after a split, use this strength to sell.

Another price-based rule can be triggered if a stock is extended from its basing pattern, advances very rapidly (goes parabolic), and gaps up in price. Again, many professional investors who move a lot of stock and can materially affect a stock's trend will sell right into this excitement. This action will normally appear near the end of a trend. Although the stock may move higher, if you've captured the majority of the move your work is done. Don't ever expect to sell at the top tick. If you did, you got lucky.



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Also, sell a stock that just breaks down considerably in price right in the midst of an advance, especially if it breaks and closes below a major trendline or moving average. Conversely, if a stock has maintained a well-defined trend channel during its advance and suddenly surges above the upper trendline the stock can be sold. This will most often occur in conjunction with some of the other price-based sell rules, such as a climax run.

Moving Averages

One aspect of a stock's technical condition I'm always aware of is how the stock is interacting with several moving averages. Mainly I use a 21-day and 50-day moving average in my trading. I also may look at a an eight-day moving average for very early warning signs of lost momentum:

1) Short-term warning: eight-day moving average crosses below 21-day moving average.

2) Intermediate-term warning: eight-day and 21-day moving averages cross below 50-day.

3) Moving average early-warning combo: Be prepared to sell when a stock is:

a) >125% from its recent base low, and

b) > 70% above its 200-day moving average, and

c) > 25% above its 50-day moving average.

If all of the above criteria to No. 3 are met, a stock may correct by 15-25% from this point.

Bear in mind, though, No. 3 doesn't apply to Internet stocks. Many of this sector's big winners will blow right through these parameters. The same can be said for both the biotechs and semi manufacturers of late.

Relative Strength

While most of the stocks I buy carry an O'Neil relative strength (RS) ranking 90 of or above, I will always sell a stock if its RS rank drops below 80. No questions. However, I truly can't remember the last time this situation came up. I'm typically out of the position well before I even have to concern myself with this criterion.

Slowing earnings growth

Kevin N. Marder: One reason to take a profit comes when a company's earnings growth slows. More often than not, however, the market will get wind of this months before the actual slowdown. As one example, all it takes is for one Street analyst to find out from a company's head of marketing that product order growth is slowing. That analyst might have an avid following with three institutional investors. As the institutions begin to sell the stock in earnest over the next few weeks, the downward price pressure concerns other big investors, who trim their own positions. Next, the momentum crowd starts to dump positions, and pretty soon you see the stock stumble 20% over a week or two or three. And therein lies the difficulty for any individual investor pursuing a value-oriented strategy. For although the Internet has greatly narrowed the information edge that an institutional investor holds over an individual investor, there's no substitute for contacts at a company -- contacts that most individual investors simply don't have, let alone the time needed to do the research.

When I begin to see earnings estimates lowered so that the earnings growth rate is expected to be 20% versus the 40% that I require on most positions, my finger gets closer to the sell button.

Deteriorating relative strength

When a stock begins to show flagging performance versus the S&P 500 Index even though it continues to rise in price, think about selling. This often happens early in a brand new bull market, when market breadth is good, with many stocks participating in the advance. Though participation is excellent, there are naturally some stocks that will lag the S&P 500 Index. The RS line will tell you which ones are beginning to underperform.

Runaways

When a stock explodes for a huge gain in a short period of time, for example an 80% move in just four days, some traders of this strategy will sell into the move. This means the stock will be sold as it rises. There are a few tip-offs to be on the lookout for when you hold a stock that explodes over a short period of time.

- Does the stock put in the widest-range day since it began its advance? Since most runaways top on a day with a very wide range, this could be a sign that the move is nearing an end. I say "could" because trading a discretionary strategy such as this one is an art, not a science.

- Does volume spike to a level *significantly* greater than on any day since the stock began its advance? A buying climax normally occurs on such a day.

- Does the stock gap up at the open, stage a ferocious run-up on heavy volume, but then close at or near its session low? This is called a "tail," and is a loud sign of distribution, or professional selling, especially when it comes on heavier volume than the prior day. This behavior often signifies the buying climax, or top.

I do things a little differently than some traders in the event of a runaway. As a general rule of thumb, I will usually wait until the stock comes off its high by 20% before I sell, and even then, it will often be just one-half of my position. So if a stock runs up 100% over a week-long span, I will sell one-half or all of my position after it drops by 20% from its intraday high. This 20% rule lets me give the stock plenty of breathing room, which most big winners need, yet lets me lock in 80% of the gain. The only way to learn how to deal with runaways is by experience. Fortunately, they're a nice problem to have to deal with.

Many traders like to take quick profits of 10%-20% once they have them. This is great for short-term players that hold positions for a few days to a few weeks. But this is not what intermediate-term trading is all about -- at least this is not the way that Greg and I play the game.

A Better Opportunity

If I'm 195% long (100% of the cash portion of my account is invested and 95% of the margin portion of my account is invested), I will sometimes sell a stock to make room for another that's acting better. The better actor could be a fresh buy or it could be a stock I already own that I wish to pyramid into.

A Breakdown

The most common reason to sell a stock is simply when it breaks down technically. Although volume plays a key role in any decision when using this strategy, price is the bottom line. And when price breaks down even when volume is thin, it's still time to pull up stakes and move on to another opportunity. If you consider that there are at least 9,000 U.S. stocks, it makes little sense to tie one's hopes to a stock's fundamental prospects while its technicals are screaming "sell!" When a stock breaks down, I look at a few different things:

- Is the stock making a lower high and lower low? For example, I buy a stock at $100 as it clears a proper base. The stock then advances 30% to $130. Profit-taking sets in, and the stock falls 10% from its intraday high of $130 to $117. Over the next two weeks, it then rises back up to $126, but then falls again past its most recent low of $117. I would likely sell the stock, since it made a lower high (at $126) and a lower low (below $117), which signifies a downtrend. The exception here would be if, instead of rising 30% and then correcting, the stock rocketed, say, 100% before correcting and it was early in a brand new bull market. I would consider holding the stock and playing it out for a much bigger gain if I felt it had good institutional sponsorship and was a dynamic market leader.

- Is the stock breaking a prior support level? Some traders use the bottom of a prior base as a natural level of support. I'm a bit more aggressive and use the top of a prior base as a support point. Example: A stock rocks back and forth between $112 and $100 for six weeks before breaking out on dense volume. I buy the stock and it moves up 10% to $123. It then comes back down to the top of the previous base between $100 and $112. Rather than wait for the stock to break $100, I will sell after it breaks below the $112 level by a point or so.

- Is the stock experiencing abnormal distribution (much higher volume than the prior day) on several days as it pulls back? Seeing this would prompt me to tighten my sell stop.

In essence, my decision to sell on a technical breakdown is based on either a break of support and/or a certain percentage decline off a stock's high. The less of a gain I have in the stock, the less I will allow a stock to drop off its high before I sell. Of note: The monster moves of 1998-2000 notwithstanding, big gains often take time to make. Therefore, I will give a stock plenty of breathing room once I've got a nice profit cushion.

Selling is an exercise that every practitioner of this strategy will do a little bit differently and no one will do perfectly. Like anything else in life, practice and experience will reap their own rewards.

Letting Profits Run

Gregory J. Kuhn: Intermediate-term advances in a stock need time. So while I have a plan for deciding when to sell a stock I also need one to aid me in sticking with a position long enough to make a worthwhile gain.

After you purchase a stock breaking out from a proper basing pattern, you should give your position a few months to work for you. Depending on market conditions, some stocks may break out and they're off to the races, like we saw during the fourth quarter of 1999. However, my personal experience over the years has been vastly different.

If after a few months your stock is ahead by less than 25%, you can sell this outright in most situations. For whatever reason, the stock just isn't moving along and has become stale. But give it this amount of time. Over the years, I've seen stocks break out, advance 15%-20% very quickly, then sit there for weeks on end. Lo and behold, though, just about three months following its breakout, the stock continues its upward trend in earnest. Please don't be carried away by what's been going in the Nasdaq Composite over the past several months. Unless this trend continues ad infinitum, most situations in the future will revert back to sticking to this rule.

A stock that advances more than 20% in less than eight weeks from its breakout point should be held through the eighth week, unless the position gets into serious trouble and breaks badly in price. This little nugget is one of Bill O'Neil's rules and I've witnessed first hand over the years just how important it is.

Again, these rules are instituted to force you to hold onto a position long enough to make your buy decision as profitable as possible.

Finally, always try and hold through a stock's first short-term correction following a successful breakout. Many of history's greatest winning stocks have experienced sharp sell-offs for a few days or a week after a breakout. Often, a successful stock will break out on strong volume, run up for several days, pull back for a day or two, pop back to a new high for a day, then sell off hard over several days, often times breaking below the low of the first pullback day. If this sharp pullback occurs on light volume and holds well above the breakout point, get ready. The stock may be prepping to take off to the upside soon thereafter. This is a pattern I've detected over the past couple of years in many Internet stocks that have blasted off to the moon after this little "Texas two-step."

See you in Part IV, when we talk about the General Market.

Market Bottoms

The O'Neil Follow-Through Day Concept: Where Real Money Is Made

Gregory J. Kuhn: The true mark of a great athlete is when his opponent knows exactly what the great athlete is going to do, but is unable to stop him anyway. The same goes for the stock market.

The true mark of a meaningful turn in the market is when you think the market should be going down and does the exact opposite. You just can't stop it! However, if you stick to this one simple, iron-clad rule, you'll never miss another meaningful advance in the market -- ever!

It's called the O'Neil Follow-Through Day.

After years of examining many market bottoms, Bill O'Neil identified the single most important factor that kicked off all intermediate- and long-term advances. What he found was quite simple - a true market bottom has always been marked by a strong, one-day advance on increased volume within days of an exact low in the market.

Specifically, an O'Neil follow-through day occurs when one or more major indices advances by 1% or more on increased volume from the previous day within four to 10 days off a closing low. The strongest signals typically occur within four to seven days, however. Historically, this bottom-finding indicator has been correct roughly 80% of the time. But what about the other 20% of the time? Herein lies the beauty of the indicator. Typically, a failed signal will occur within a few days of the follow-through day, characterized by an abrupt downturn in the market. So, if you began to buy stocks breaking out of base formations following the signal, it won't be long before you even have a chance to risk much of your hard-earned money.

This single indicator is so important to keep your eye out for because it usually arises at a time when a lot of the news emanating from the press is poor or downright ugly. Somewhere along the line, all of this bad news is already factored into the market and most of those investors who wanted to sell are out of the market, clearing the way for a fresh, upward trend. That's what the follow-through attempts to detect. For a major index to advance 1% or more on increased volume in a single day suggests that the prior selling pressure has been alleviated. But you want to ignore the first three days of the market's attempted rally, unless all three days are up 1% or more on successively higher volume, because what we're looking for is "follow through" of the initial rally off the low. Obviously, the indicator was not devised to identify the exact low in the market. Who needs that? Wall Street's graveyard is littered with guys and gals trying to pinpoint market bottoms. What we want to do is utilize a highly predictable indicator to identify a fresh, upward trend early enough to greatly profit from it.

Okay, so we found the market's bottom a week or so after the fact. Now what do we do? How do we make money from this? That's the first question I ask anyone trying to tell me what they think the market is going to do. What good is it to predict where the Dow will be at the end of the year? What good is it to predict to what level the Dow will reach at any point? DOW 12,000.....DOW 15,000? How in the world do I make money with this information? I mean *real* money! The kind that makes taking risks in the market very worthwhile. Tell me, how does predicting where the Dow will go help anyone?

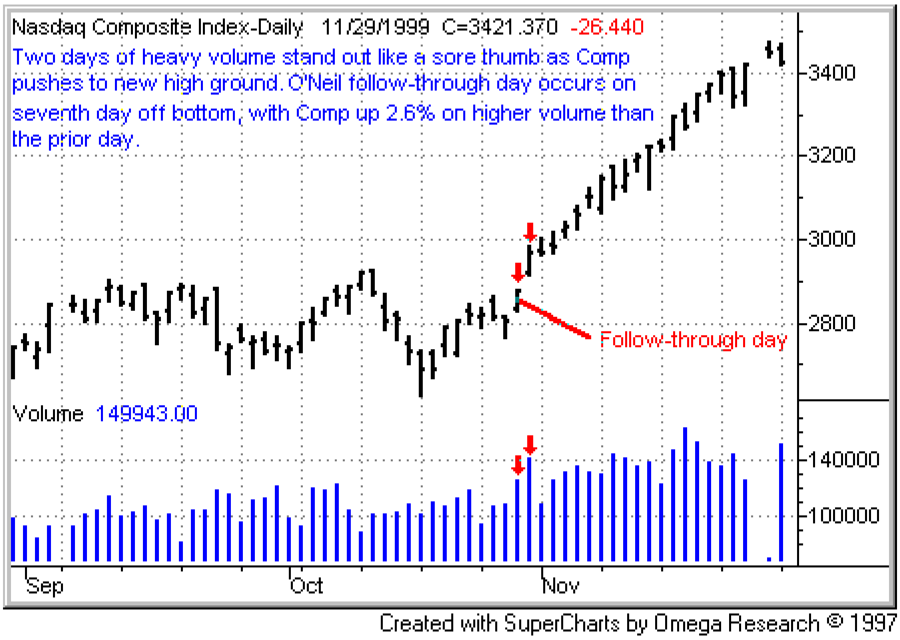
No, what helps you make money in the market is staying flexible. Neither bull, nor bear, but opportunist. How do you become an opportunist? Not by predicting the future, but by understanding the past and correctly interpreting the present. Measuring the market's condition day to day. That's what the follow-through day will do for you. It's an indicator that's worked in the vast majority of cases over the years and, if correctly interpreted in the present, will make you a lot of money today.

Now, provided you've been maintaining a list of stocks potentially forming bases throughout any downturn in the market, you'll be absolutely prepared to pounce on their breakout moves when the follow-through signal rings. Bear in mind, though, some follow-through signals will be met with some, many, or no stocks ripe for purchase. If the latter, you just stand by and wait.

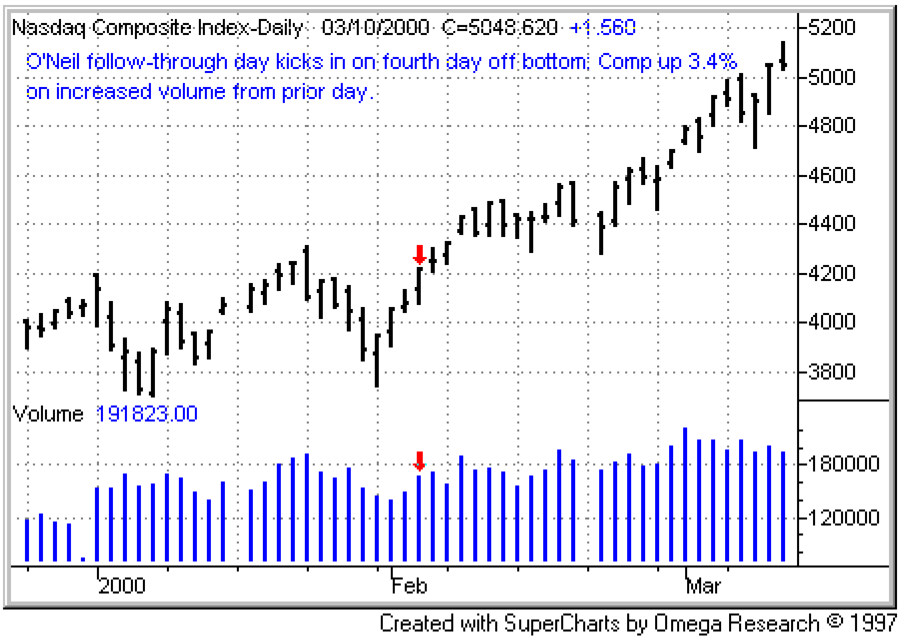
The O'Neil Follow-Through Day Concept: Where Real Money Is Made (Cont`d)

Take the recent case on Feb. 3, 2000 in the Nasdaq Composite. The Composite recorded a follow-through day buy signal, but there weren't many stocks quite ripe for purchase. However, if you had hung in there for several days, as the Composite moved even higher, high, relative-strength stock after high, relative-strength stock began to emerge from sound basing patterns. In the fund I manage, I went from a 10% invested position to 100% within two weeks of the follow-through day by just letting the market bring me back into the market. Remember, though, most of the market's leading stocks will emerge almost immediately, so you can't vacillate.

Here are some recent examples of what a follow-through day looks like:



Referring to the above chart, following the Nasdaq Composite's 10% correction from Oct. 11, 1999 through the intraday low of Oct. 18, 1999 the Composite advanced 2.6% on Oct. 28, 1999 on 1.25 billion shares -- higher volume than the day before. This follow-through day on Oct. 28, 1999 was seven days off the closing low of the correction on Oct. 19, 1999. And, if there was any doubt, the Composite advanced 3.6% the following day on even stronger volume to the tune of 1.44 billion shares.



Following the Nasdaq Composite's six-day correction of 8.5% from Jan. 24, 2000 through Jan. 31, 2000 (see above chart), the Composite advanced 3.4% on increased volume from the day before -- a follow-through buy signal. This was an all-clear to begin a new buying campaign -- the Composite was now on solid footing. And the further it moved away from the follow-through signal in days, the less chance of a failed signal. So, as each day

The Action of the Leading Stocks

Kevin N. Marder: Following a selloff in the major averages of at least 8%-10%, recognizing an O'Neil follow-through day in one or more of the major indices is Step One in recognizing a bottom.

Step Two is an analysis of the market's leadership. Analyzing the leading names, then, serves two purposes. First, knowing what's in vogue is instrumental to my stock selection process since I limit my purchases to the leaders -- it gives me a shopping list to focus on. Second, a market's character can easily be ascertained by an analysis of its leadership.

The most bullish thing a market can do is feature scores of growth stocks building, and then breaking out of, well-formed bases on explosive volume. When you see this behavior occur at about the same time as a follow-through day signal in an average or averages, you've just been given that much more proof that the recent bottom was indeed a durable one for the intermediate-term.

There will be some cases in which a number of growth stocks begin breaking out of bases prior to a follow-through day. One such example was the Nasdaq follow-through day of June 23, 1998. Some Internet issues broke out in advance of this follow-through day by one to two weeks. Had you waited for the follow-through day, you would have missed America Online's June 17, 1998 breakout (which saw it run up 51% over the next four weeks), Amazon.com's June 9, 1998 breakout (which led to a 200% run over the next four weeks), and Yahoo's June 17, 1998 breakout (which saw it escalate 73% over the next three weeks).

Market Tops

Distribution in the Major Averages: The Look Of Institutional Investors Exiting The Market

Gregory J. Kuhn: While the follow-through day tells us to step on the gas pedal and buy stocks, searching for the subtle clues that major investment managers leave behind when they've collectively begun to exit the market can help us determine when to lighten up or exit the market altogether.

An important market peak is typically led by several days or weeks when one or more major indices fails to advance on increased volume from the previous day. It can be quite subtle because the market may not drop very much -- it'll just stall out. But the key is the volume. Does the market fail to make any upside progress on increased volume? If the market stalls on lighter volume than the prior day, that's okay. It's when the market stalls out or actually declines on increased volume on three to five days within a two- or three-week period that we need to be concerned. So, in addition to watching for distributive activity in the stocks we own, as stressed in Part III of this course, we must also be cognizant of this condition in the market averages. Even if some of the positions I'm holding in my portfolio haven't given me a clear-cut sell signal, several days of churning action in the market within a relatively short period of time is usually enough for me to begin exiting at least part of my positions.

Here are some recent examples of what an impending market top will look like:

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Distribution in the Major Averages: The Look Of Institutional Investors Exiting The Market (Cont`d)

For those holding cyclical stocks at the turn of the new year, the distribution days clustered above were a clear warning that all was not well with the Dow. Four distribution days occurred within eight days of the Dow's all-time high on Jan. 14, 2000. Moreover, from the point the Nasdaq Composite recorded its successful follow-through day on Feb. 3, the Dow dropped another 1,000 points over the next three weeks:

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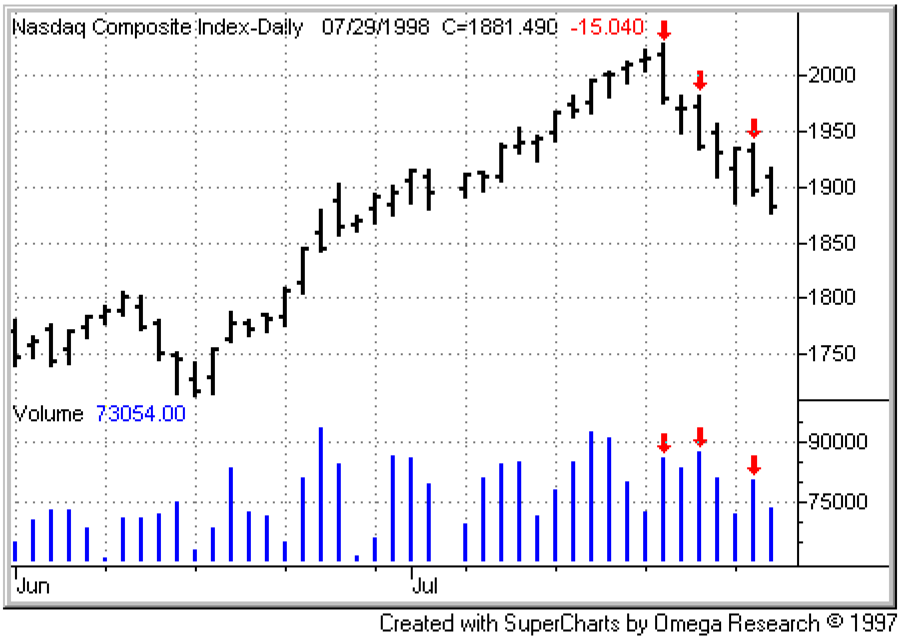
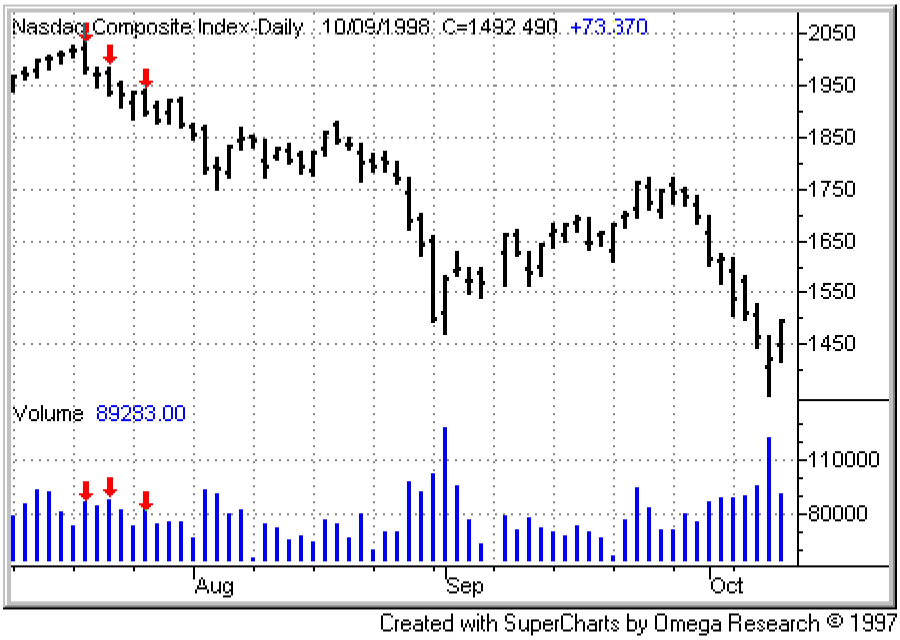
Following the Nasdaq Composite's all-time high recorded on July 7, 1998, three distribution days occurred within five days of the high -- a clear sign to begin exiting that market:



From the closing low of the third distribution day on July 28, 1998, the Composite fell another 28.5% over the next 2 1/2 months:



Unlike the clear-cut follow-through signal, properly detecting real distribution in the market takes a lot of practice. Moreover, here's something I picked up from my friend Gil Morales at William O'Neil + Co.: It's now important to look at the ratio of upside volume to downside volume when a supposed distribution day arises on the Nasdaq Composite. Because the Nasdaq Composite is a cap-weighted index, sometimes the index gets weighed down by heavy selling in its biggest stocks, like Microsoft or Dell Computer. If a distribution day appears on the Composite but upside volume exceeds

Breakdowns in the Leading Stocks

Kevin N. Marder: When you see a number of the market's leaders encounter distribution in tandem with distribution days in one or more of the averages, a yellow flag should go up in your head. Common sense should tell you that the market might be heading for trouble if its leaders can't lead!

This business of watching for breakdowns in the leaders can be tricky, however. During a general market correction, institutional investors tend to cling to their "sacred cows," or favorite holdings, the longest. One example was during the July 17, 1998-Sept. 1, 1998 bear market. Dell Computer, a leader if there ever was one in 1998, peaked on Aug. 26, just four days before the end of the bear market. In those last four days, Dell sank 28% on an intraday basis. The same thing happened with Cisco Systems, another sacred cow: It also peaked Aug. 26, then retreated 23% over the next three days on an intraday basis.

To compensate for the "sacred cow factor," I like to examine a cross-section of leaders that run the gamut from emerging growth types to institutional favorites. And since the strategy outlined in this course is all about trading *aggressive growth* stocks, your sell discipline will see you shift to the sidelines and into a 100% cash position when the leaders break down in earnest.

Another example of breakdowns in the market's leadership occurred in August 1987 when Gap and Limited both peaked. The Dow topped a couple of weeks later and then staged a weak, last-gasp rally from Sept. 21 to Oct. 2. At the close of Oct. 2, Gap had tumbled 50% from its peak and Limited had given back 32%. The blatant technical failure of these two leaders was telling if you were there to listen. The rest is history, as the Dow unraveled to the tune of 34% on a closing basis from Oct. 2 to Oct. 19.

Sentiment

Put/Call Ratios: When To Part Ways With The Crowd

Gregory J. Kuhn: In addition to following the market's price-and-volume action in determining the health of the market's prevailing trend, I also keep an eye on the various CBOE put/call ratios. If there was ever a group of traders that were notoriously wrong at an important turning points in the market, it's the options crowd.

When options players become wildly bullish on the market, the volume in call options relative to the volume of put options will rise markedly. Or, the volume of put options will just drop off significantly to call option volume, resulting in a low puts-to-calls ratio. Conversely, when put volume rises to a high level relative to call volume, options players as a crowd are expecting more downside in the market. When this level reaches an extreme the market is now ready to reverse course and head higher.

But how does one measure for extreme readings? This is the tricky part. Over the years, the put/call ratio has tended to expand and contract from a high, or bullish, level of .75 to 1.00 several years ago to where extreme readings are considered now, anything north of, say, 70. However, the past two market bottoms in October 1998 and October 1999 were immediately preceded by a one-day, put/call ratio spike of 1.00 and .90, respectively. Conversely, a low, or bearish, level used to be considered any reading below .60, to where a low reading is now considered to be anything south of .40. Bear in mind, these are general levels.

The put/call ratio can measured in several different ways, from a 10-, 15-, or 30-day moving average basis - take your pick. I just like to track the one-day, total CBOE put/call ratio carried daily in Investor's Business Daily.

In addition to watching for extreme readings, I really like to look for those periods when the ratio has been trending in one direction, or even moving sideways, then suddenly does something out of character to its prior trend. For instance, moving sideways around the low, bearish level of .45 or .40 for weeks, then suddenly drops below 35 for a day. Once this spike occurs, the market is typically near an important top. This is what happened recently, just as the DJIA, S&P 500 and NYSE Composite peaked in early January. But, of course, the Nasdaq Composite soon thereafter was off to the races again. This is why the market's own price-and-volume action is our first consideration.

Because of its high accuracy in identifying important inflection points in the market, the put/call ratio, or any sentiment indicator for that matter, may seem like the Holy Grail at times. But sometimes bullish or bearish attitudes toward the market can persist into an upward or downward trend in the market for a time. Although the put/call ratio's main purpose is as an early warning indicator, the ultimate arbiter in the market is the market itself. Therefore, I always defer to the follow-through and distribution signals in the market. It's what's really going on in the market that counts.

Investor's Intelligence Survey/NYSE Upstairs Members/VIX

Kevin N. Marder: I also keep an eye on the CBOE put/call ratio and have found that readings of 1.00 or greater often coincide with intermediate-term bottoms.

Another survey is the much-watched Investor's Intelligence Survey. When the percent of bullish investment letter writers exceeds 60%, the market has generally been on weak footing.

Another gauge I watch is the ratio of buying versus selling that so-called upstairs members engage in at the New York Stock Exchange. Upstairs members, sometimes referred to as the "smart money," hold onto positions longer than other members of the NYSE, such as specialists and floor traders. Thus, their behavior, especially when they're bullish, is something to note. The data on this indicator are released two weeks in arrears, and can be found in Barron's each week. Specifically, when the amount of weekly buying exceeds the amount of weekly selling by 20 million shares or more for three or more consecutive weeks, it has often led to a significant intermediate-term advance. One such example was in the fall of 1990.

Any discussion of sentiment would be remiss without mentioning the VIX, however I defer to the Connors/Boucher Market and Mutual Fund Timing course for a thorough explanation of this indicator.

Lastly, I must admit that although I follow the above sentiment indicators, when push comes to shove, I only "worship" those indicators that I trade off of. And for general market direction, I only trade off of my analysis of the price/volume behavior of the major averages as well as the action of the leading stocks. These two are enough for me!

In closing Part IV of our course, I would like to share with you the most meaningful information I've ever come across when it comes to general market direction. Although it may seem simplistic, the more experience you get as an intermediate-term trader, the more you will realize the value of this information, which is actually a quote. In fact I have chosen to make this the only boldfaced text in this entire course as a means of highlighting its importance:

"You do not need to know what the market is going to do! All you need to know is what the market has actually done! This is the key! Think about it for a minute. There is a fortune in this paragraph."

--from Bill O'Neil's *How To Make Money In Stocks*

WEEK FIVE Putting it All Together - Section 1

A few years ago there was a television commercial in the U.S. about the horrors of illegal drug abuse. A frying pan, stove, a narrator's voice and an egg was all there was in the picture. While the frying pan heated up on the stove the narrator's voice said; "okay, last time....this is drugs". Then a hand broke the egg on the side of the frying pan and dropped it into the hot pan as the egg sizzled fiercely. Then the narrator's voice, again: "This is your brains on drugs.....any questions?"

Simple, yet extremely effective.

Like the commercial, the methodology I'm about to share with you is simple, extremely effective, and never changes. Only the symbols of the market's biggest winning stocks do.

Flexibility Is Imperative

Throughout the third quarter of 1999 I was absolutely convinced the market was heading for a serious decline. The Federal Reserve reversed its easing mode from the fall of 1998 and began to raise short-term rates in a preemptive strike against potential inflationary pressures. Companies like Nokia reported better-than-expected earnings, only to have their stocks crater from all-time highs. And, by every indication, the distribution of stocks by institutional investors was becoming almost a daily occurrence, as the market slid lower into October. Market breadth had already been quite poor, as the daily NYSE advance/decline moved endlessly lower. And there I was on the world's most-widely watched financial television station calling for the market's head. But I soon began to question my own market call as evidence of a bottom began to mount.

Being Right or Making Money

Every important market bottom I've ever studied from the past, or been involved in since I began actively trading in 1988, had just two important elements - extreme pessimism and a strong rebound in price and volume within days of the absolute bottom.

When these two elements came together in late-October 1999 I couldn't believe my eyes. But there they were, nonetheless. I *was* looking for a temporary bottom because sentiment had become so pessimistic, but not the kind of price strength that followed. It was time to abandon what I'd thought the market was going to do and time to buy stocks. In managing my hedge fund, nobody pays me to predict the market's future. What my investors pay me to do is correctly interpret the present, get in line with the path of least resistance, and make them money.

The most interesting aspect of this analysis is that it had absolutely no basis in the fundamentals of the market. What with valuations so stretched in relation to history, especially the Nasdaq's tech issues, how could the market possibly move any higher? Nonetheless, it was these very overpriced Nasdaq tech issues that led the charge during the final quarter of 1999. And the stocks that made significant advances during the quarter had no business doing what they did if you were obsessed with their astronomic P/E multiples.

The Setup

As I watched the market slide lower and lower during the third quarter I couldn't understand why it wouldn't just finally break wide open. I was short the SPDR contract on the S&P 500 but not making any money whatsoever. Then there was the Nasdaq 100 Tracking Stock (QQQ), affectionately referred to as the "trip Q's." With everything else moving lower, I reasoned that the big Nasdaq stocks would eventually fall apart as well. But in a grave attempt to sell short the trip Q's I couldn't build enough of a position before getting stopped out on each rally within its tight trading range.

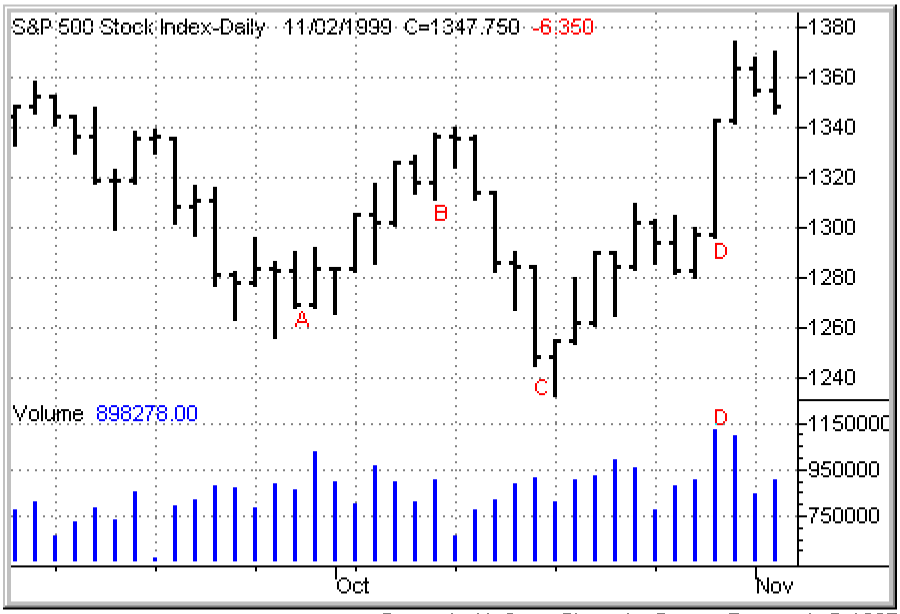
Sentiment grew more and more pessimistic as each week passed in October. One of my favorite sentiment gauges is the CBOE 15-day Equity Put/Call ratio because of its accurate history of forewarning impending market turns. With more than 75% of NYSE stocks trading below their 10-week moving averages, this sentiment gauge remained steadfastly in its too-much-pessimism zone for weeks. Every time this bullish combination occurred in the previous three years the market eventually bottomed and turned higher into at least a six-week rally phase. Nonetheless, even if a near-term rally occurred I figured the market's extreme overvaluation would limit its upside.

Despite my concerns over the market's valuation and a tightening Fed, history told me to remain as flexible as possible, waiting and watching for a sign that an important market turn was unfolding. With sentiment now deep into its pessimistic mode it was time to be on alert for an O'Neil follow-through-day buy signal.

O'Neil Follow-Through Day

To review, an O'Neil follow-through-day occurs when a major index advances by more than 1% within four to 10 days of a closing low on increased volume from the prior trading session. The first three days of the rally are ignored, unless the first three days are all up more than 1% on successively higher volume. We're trying to distinguish between just a short-lived bounce and a genuine market turn. The time to really look for this is following an intermediate-term correction of, say, 7%-10% or more. The most powerful signals actually occur within four to seven days off the closing low, while signals occurring more than 10 days off the closing low are failure prone. It's that simple, but requires absolute flexibility and a ton of patience.

Interestingly, the first attempt at an O'Neil follow-through-day actually failed.



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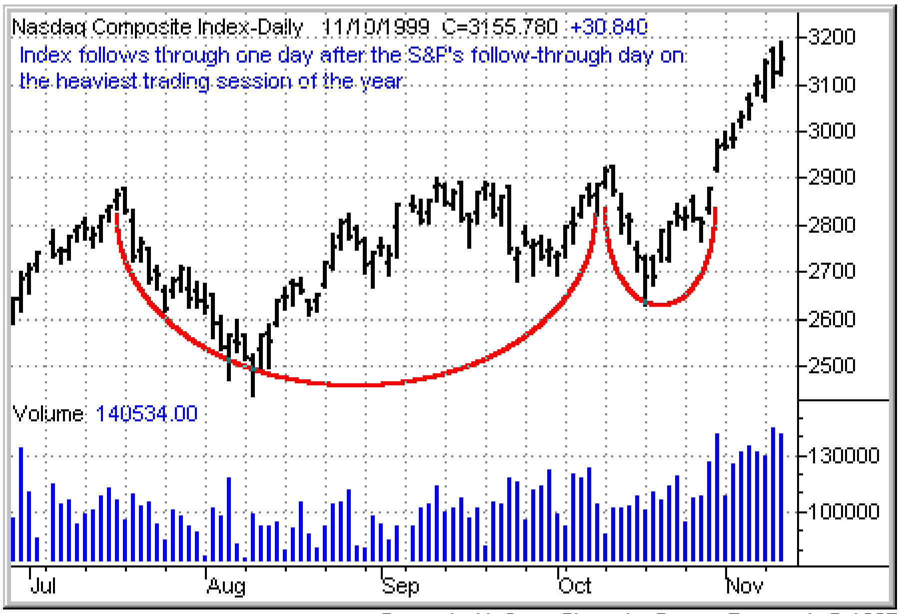
Using the S&P 500, the first follow-through attempt on Oct. 8, 1999 (B) occurred on the seventh trading day from the Sept. 29 closing low (A). However, the market's rally attempt failed abruptly three days later on its way to test the lows. And therein lies the beauty of this signal: Failed signals will typically occur within one to three days of the signal, with an abrupt downside price reversal.

Within a few weeks, though, a second follow-through session resulted on Oct. 28, 1999 (D). This occurred on huge volume nine trading days from the Oct. 15 closing low (C), as several market leaders began to breakout from long basing patterns. There was no mistaking this signal. Volume swelled significantly and breadth was strongly positive, for a change. All major indices had a follow-through signal that day. In fact, the Nasdaq Composite broke out to all-time highs the day after on the heaviest volume day of the year. It was time to begin buying the stocks breaking out from sound basing patterns.



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Again, here's the beauty of following the indicator. Although many big winning stocks will begin to emerge from basing patterns on that very day, even a few days before, many other leading stocks are actually still completing sound basing structures. So you're not yet fully invested. You're going to let further upward progress in the market guide you into stocks as the potential of a failed follow-through signal fades. In fact, leading stocks will break out of basing patterns for up to 13 weeks after the follow-through day signal. Time is on your side. Nonetheless, you really want to catch many of the first ones out of the shoot.

The Buying Campaign

One of things that seemed odd throughout the market's third-quarter decline was that some stocks meeting my strict buying criteria were actually breaking out to new highs from good base formations. But I just couldn't bring myself to buy them with the market acting so lousy. Though most of these issues struggled to move higher during this period, enough of them remained well above their breakout points. In hindsight, their constructive action was a hint the market would eventually turn. So, I tucked that information away in my head until further evidence presented itself.

Nokia was the first stock I purchased as the market began its second rally attempt in late-October, but before the *real* follow-through day. It broke out from a 14-week, cup-with-handle base on huge volume. Though I was still waiting for a confirmed follow-through signal before getting more aggressive, the huge-volume breakout on a better-than-expected earnings report was too bullish to pass up. I bought it in anticipation of a follow-through signal which came through five days later. Now, other stocks on my buy list were emerging to new highs on confirmed volume. It was time to go for it.

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RealNetworks and VerticalNet were two of the first set of stocks I purchased right out of the shoot. Both had already traced out well-defined, cup-with-handle bases over several months and were ready to break out. I bought RealNetworks at 113 on Nov. 3 as it began to emerge from the completed "handle" portion of its cup-with-handle basing structure. By the close of that day, volume confirmed the breakout, increasing some 60% above average volume. VerticalNet was bought at 64 1/2 the same day, as it emerged from its technical base on heavy volume. As you can see on the graphs, both issues immediately followed through to higher levels in subsequent days which indicated I was on the right track.

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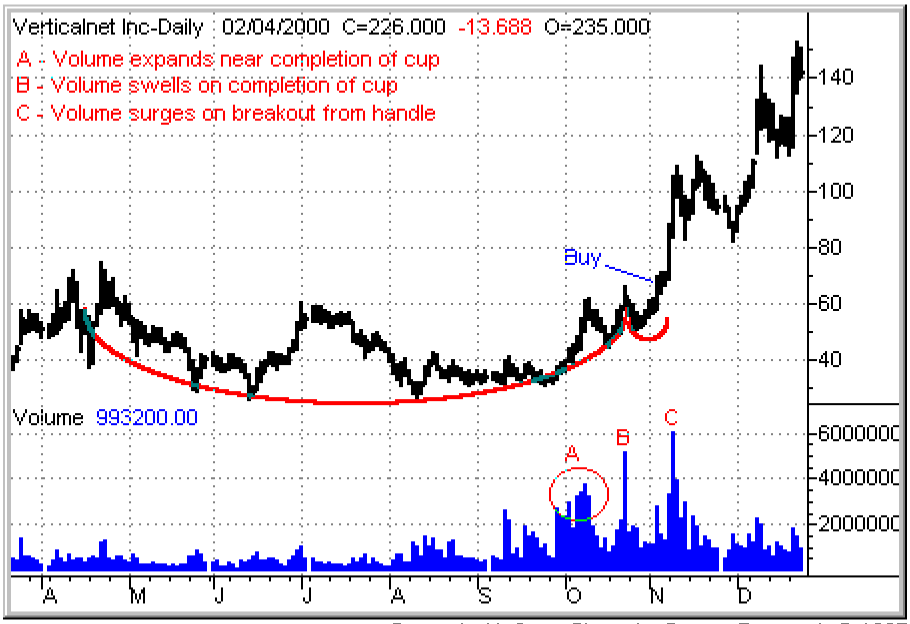

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As the market kept proving me right, it was on to buying more stocks.

Yahoo! was next in line, among others. Wait a minute. Wasn't this stock too overpriced to make a meaningful advance? Not quite. There it was, in all of its glory. What a base. Yahoo! was purchased at 195 as it emerged from its 31-week, cup-with-handle basing pattern on Nov. 8.

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Infospace was next out of the shoot and was bought on its gap-up open on Nov. 15 at 67, as it broke out from a long, 28-week cup-with-handle base on huge volume.

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By now, more and more stocks began to break out from long basing patterns, many of which were Internet-related - a sector that was doomed to failure by most market prognosticators. But there they were. Ripe for the picking. All of the examples above were part of the same leading Internet subgroup, ISP/Content Providers, and all had O'Neil Relative Strength (RS) rankings of 90 or above at the time of purchase., along with large increases in year-over-year earnings or revenues in the quarter immediately preceding their breakout moves. (O'Neil's RS rankings are available in Investor's Business Daily, Daily Graphs Online and Daily Graphs.) There were so many I couldn't buy all of them. Their bullish action indicated something positive was going on. The market was now on solid ground. Selective market or not, the stocks that were working *were* the market and ruled the major indices.

Conclusion

Being right or making money? The latter is all that matters. You must remain absolutely flexible in your daily assessment of market conditions if you ever expect to make money in the market on a consistent basis.

If you are new to investing in stocks, don't expect to understand everything you need to know to make money consistently right away. It takes a lot of sweat equity before it all comes together. It literally took me more than five years of constant study and many, many errors in judgment before I could do it. Add to that the psychological aspect of successful investing and you learn over time that the only magic pill to success in the market is perseverance.

WEEK SIX Putting it All Together - Section 2

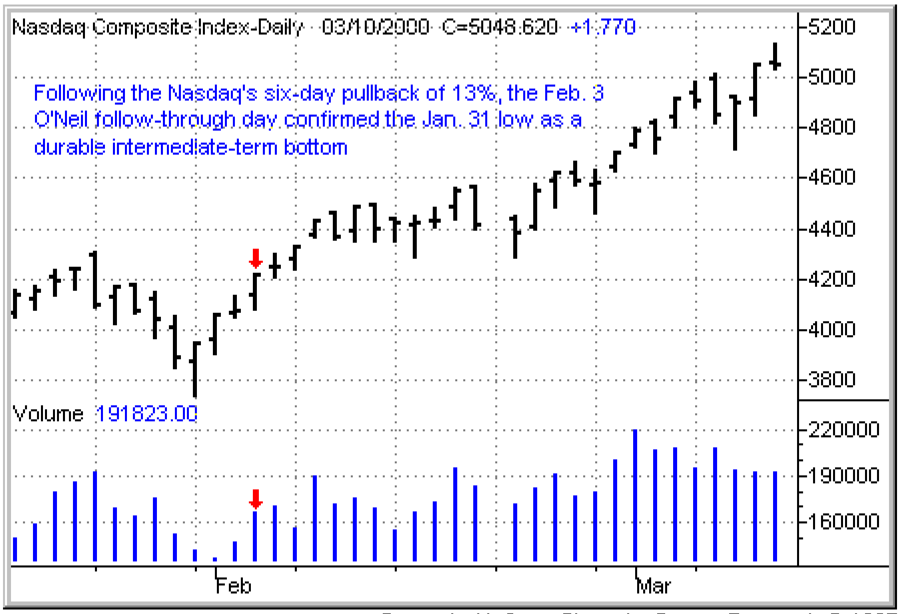
Part VI -- Putting It All Together (aka Putting Your Money Where Your Mouth Is)

Kevin N. Marder: In this section, I'll show you how I applied the concepts outlined in this course to the February-March growth stock advance. There are a few losers interspersed with the winners.

Feb. 1: I write an article in my "Marder On The Market" column for TradingMarkets.com entitled "Cash Is King." My money is where my mouth is -- in a 100% cash position. Unbeknownst to me, however, the Nasdaq Composite had bottomed the day before. At all times, even when the major averages are in a vicious downtrend, I want to keep tabs on the outperformers, the stocks that are in fashion, the vogue names. The stocks that hold up best by giving back the least amount of ground in a market correction are usually your leaders in the ensuing market advance. So even though the Nasdaq was in a downtrend, I had compiled a "watch list" of names that were building bases.

Feb. 2: In "Marder On The Market," I write: *The picture for equities usually isn't too impressive following four Fed rate hoists. For the intermediate-term player, however, what's important is keeping his/her eye on the ball. That means watching the big averages for any follow-through action to the upside as well as keeping an eye on the individual leaders.*

Feb. 3: The Nasdaq Composite surges 3.4% on higher turnover than the day before. Since this represents the fourth day off the Jan. 31 low, the session qualifies as an O'Neil follow-through day. I begin to see a number of aggressive growth names set up for breakouts. In "Marder On The Market," I write: *The upshot of the day's action: It's safe again for the intermediate-term trader to wade back into growth/aggressive growth names*.



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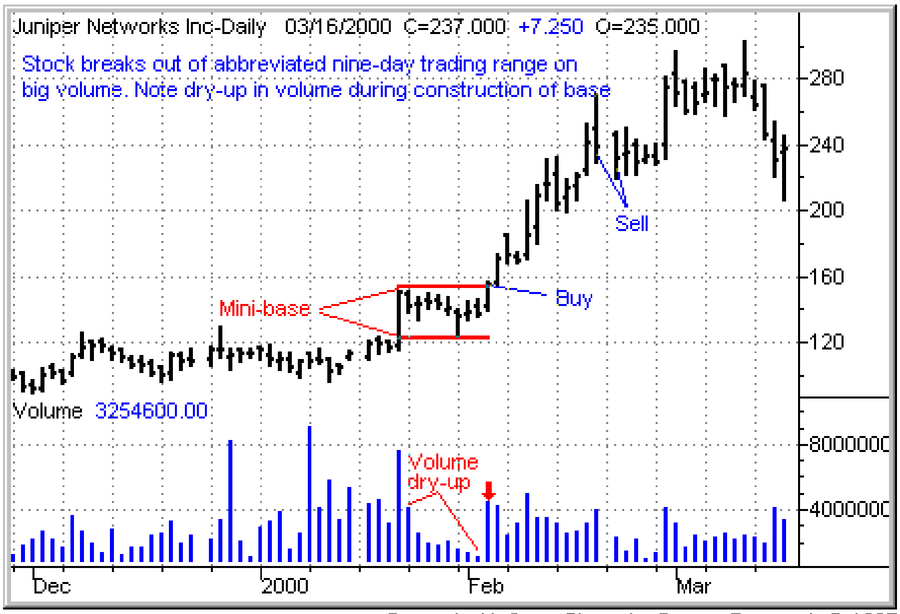
Probably the biggest mistake that beginning traders make is to think that they know more than the market knows. By contrast, the most outstanding traders know that being humble when dealing with the market is always the best policy. And so it was easy for me to turn bullish on Feb. 3 -- just two days after my Feb. 1 column entitled "Cash Is King." In trading, flexibility rules and pride means little! After all, which is better, to be right or to make money?

The first stock I buy is Juniper Networks (JNPR), breaking out of a nine-day trading range on big volume. Fundamentally, the company lost 7 cents a share in '99, is forecast to earn 15 cents in '00 and 25 cents in '01. The relative strength line (not shown on these charts due to a lack of space) indicates the stock had outperformed the S&P over the prior nine-week period. Moreover, the stock is in the Internet Network Solutions group, a leading market segment. Although it's not absolutely mandatory, I much prefer to buy a stock that's in a leading group.

Elsewhere in this course, I've stressed the need for beginners to this strategy to focus on stocks with bases of at least five to six weeks in length. Often, a big winner will break out from a so-called first-stage base, run up, and then pause for a week or two. If volume dries up significantly during this abbreviated one-to-two-week period, I'll buy the stock as it clears this brief range. The odds of success are different, however, should a stock clear a one-to-two-week zone after first tripling in price. In this case, I won't chase the stock.

In Juniper's case, the stock broke out of a six-week base while I was in a 100% cash position due to my lack of confidence in the general market. However, JNPR held in very nicely over the next nine days and, based on the very bullish dry-up in volume, I entered on the day it cleared the top of this range. The dry-up in volume during this nine-day period told me profit-takers were scarce despite the stock exploding for a 54% gain on an intraday basis over the prior six days.

When a stock acts exceedingly well in the first day or two after purchase, I often add to the position, especially during the early stages of what I believe is a fresh intermediate-term market advance. I did so with Juniper, buying the stock a total of three times on the breakout day of Feb. 3. The size of the second and third buys were each one-half of my normal opening position in a stock, and the third buy was entered at a point less than 4% past the entry point of my first buy.



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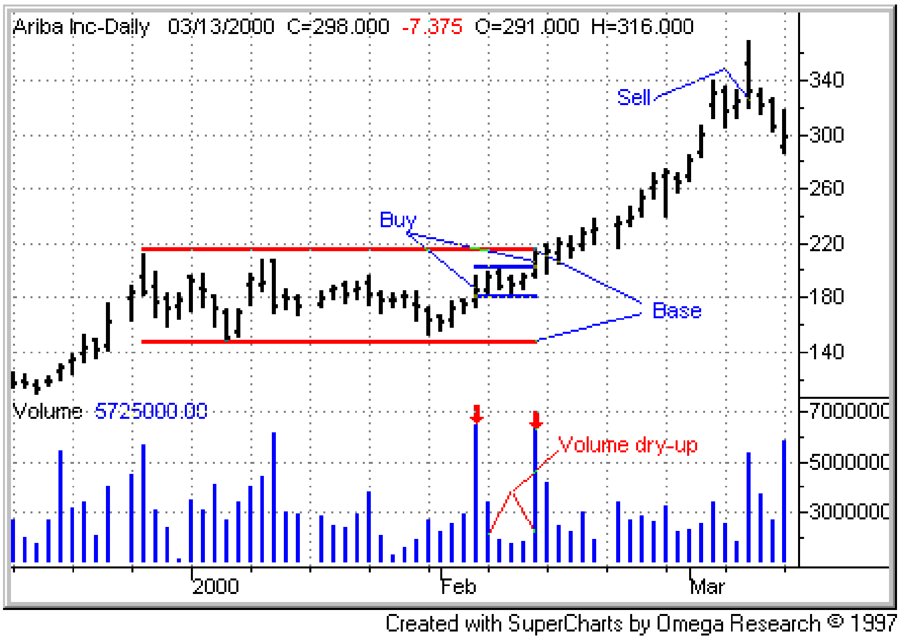
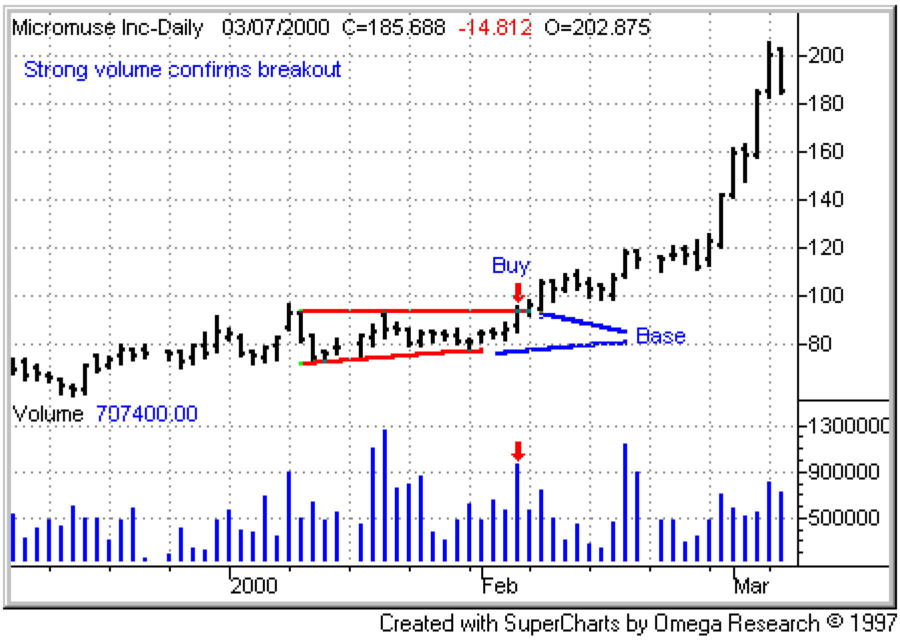
I sell part of my position on Feb. 18 at 233 (the first day of distribution since entry) and the other part on Feb. 22 at 222.

Feb. 4: I "cheat" by buying Ariba (ARBA) before it actually clears its six-week base. Cheating is a riskier play and should only be attempted by experienced traders of this strategy. But it pays off big if done early in a fresh intermediate-term market advance. As mentioned earlier in the course, my usual 5%-7% stop loss point is reduced to 3% or so when I'm dealing with a higher-risk situation or an "add-on position." I then add to the initial ARBA position later the same day as well as a week later on Feb. 11 as the stock formally breaks out of its seven-week base. Once again, note the bullish volume dry-up right after my initial buy. Fundamentally, ARBA is forecast to lose money in '00 and '01. In profitless cases such as this, I look at sequential revenue growth over the past quarter or two. The figures are 44% and 37%, respectively, indicating rapid growth. A look at the relative strength line tells me the stock has outperformed the S&P over the past four months. Additionally, the stock is in the Internet Software group, a leader.



On March 8, I sell my position at 322, 12% off the stock's high for the move.

Feb. 4: I buy Micromuse (MUSE) as it clears a four-week base on big volume. Fundamentally, earnings are forecast by Wall Street to grow 56% in '00 and 43% in '01, meeting my growth test. The issue's relative strength line also checks out, telling me the stock has outperformed the S&P over the previous four months. As well, MUSE is a member of the enterprise software group, a leader.

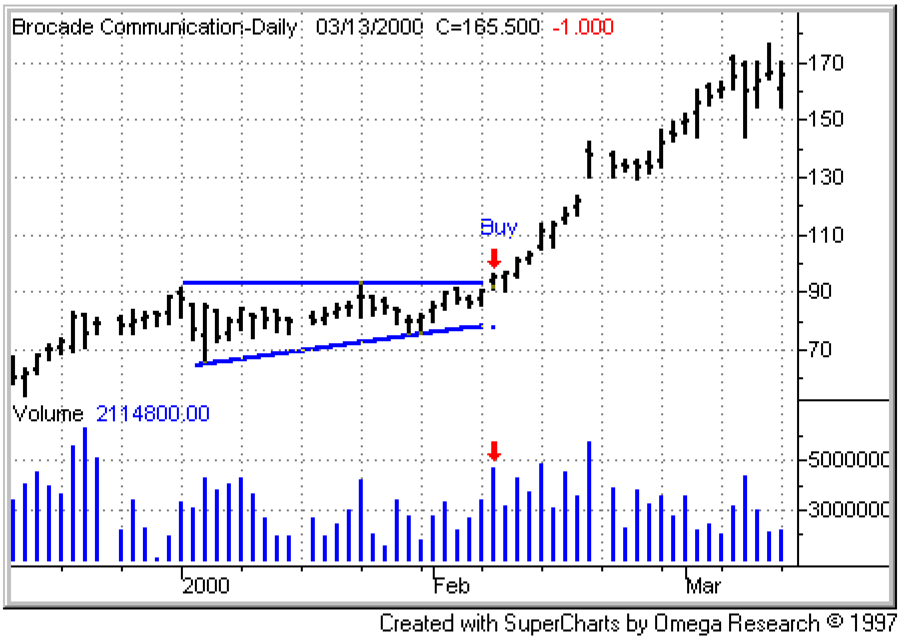


On March 8, I sell my position at 177, 14% off the stock's high for the move.

Feb. 7: I buy Ciena (CIEN) as it breaks out of an eight-week cup-with-handle base. This is a riskier play due to the lack of heavy volume on the breakout day. Since I always cut my losses when I'm wrong, I'll sometimes buy a stock even though volume isn't especially strong. The worst case scenario is that I'm stopped out for a small loss if the stock doesn't follow through over the ensuing few days. In this case, I took the trade because it was early in what I believed was a new intermediate bull leg in the market. Beginners, however, should insist on volume on the breakout day being at least 50% above the stock's 50-day average of volume. Fundamentally, the Street expects earnings to grow 900% in '00 and 93% in '01. The RS line has been rising over the past four weeks, less than the 8-12 weeks I ideally like to see. The stock is in the telecommunications equipment group, a leader.

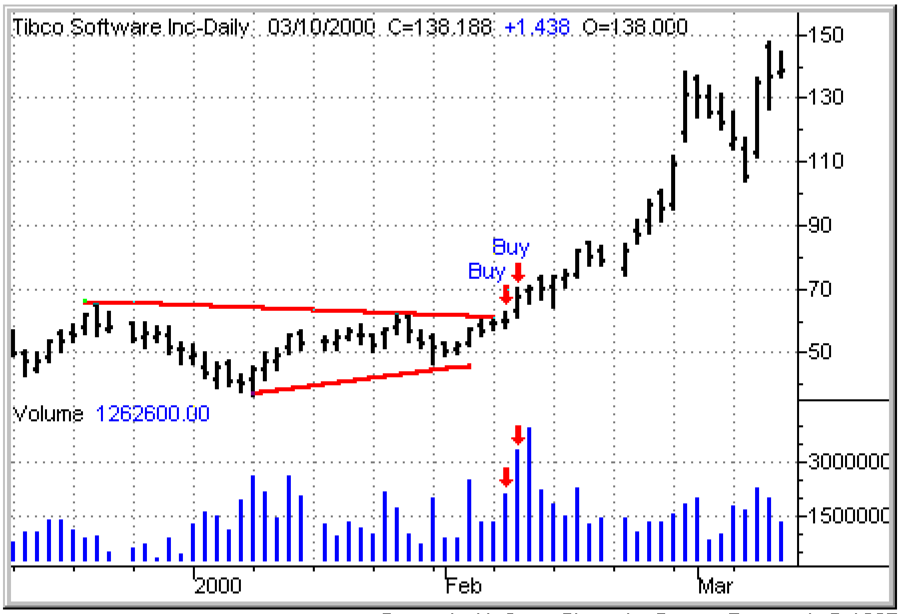
On March 8, the third day of distribution in five days, I sell my position at 158, 16% off the stock's high for the move.

Feb. 8: I buy Brocade (BRCD) as it emerges from a five-week base on heavy volume. Fundamentally, analysts expect earnings to grow 300% in '00 and 75% in '01. Meanwhile the relative strength line has been rising over the past eight weeks. Brocade is in the computer networking group, a leader.



On March 8, I sell my position at 289 on the first day of distribution since entry, 16% off the stock's high for the move.

Feb. 8: I buy Tibco Software (TIBX) as it comes out of a seven-week base on decent, but not heavy, volume. I then add to my position on the following day as volume picks up. Fundamentally, the company lost 14 cents in '99, is projected to lose 5 cents in '00, and is expected to earn 26 cents in '01. No problem with growth here. A rising RS line over the past three months tells me the market likes this stock more than the average issue.



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On March 7, the fifth down day in a row for TIBX, I sell my position at 112, 18% off the stock's high for the move.

Feb. 10: I buy China.com (CHINA), choosing not to wait for it to form any sort of handle. Fundamentally, the company is expected to lose money in '00 and '01. Sequential revenue growth has been 125% and 99% over the past two quarters -- hard to beat. The RS line tells me that the stock has outperformed over the past three months.

As is sometimes the case, a stock will complete the right side of a cup-like base and move into new high ground -- only to back off as it builds a handle. I chose to lock in a minor profit as the stock pulled back the day after I bought it. Two days later, I re-enter as the stock advances out of the handle and rises about 22% over the next four days. Note how volume was "okay" on the breakout, but nothing to write home about. After peaking, the stock drifts back for a few days and I sell it over two different sessions for a minor profit.

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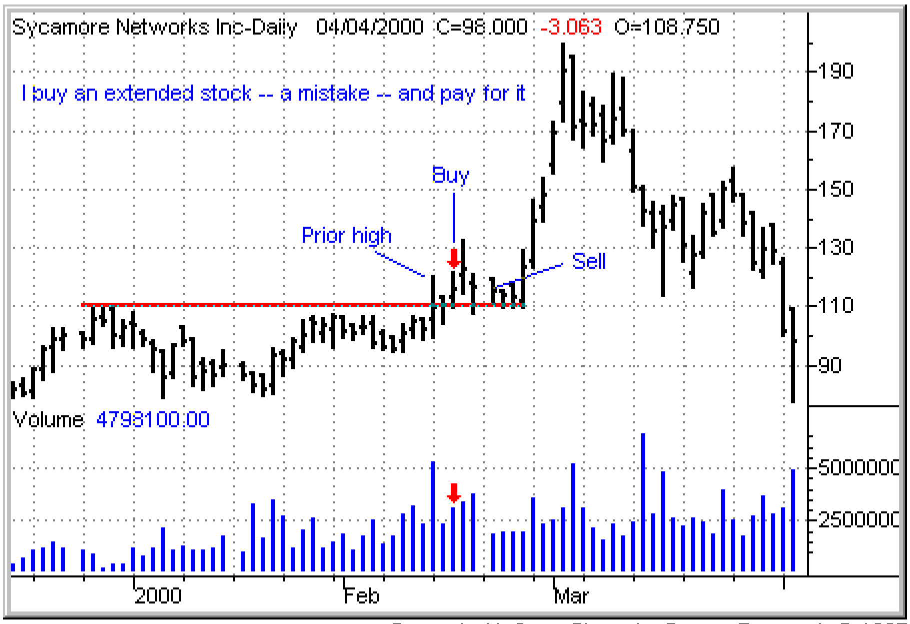
Feb. 16: I buy Sycamore Networks (SCMR) as it moves above its prior high of Feb. 14. Fundamentally, SCMR lost 21 cents a share in '99 and is expected to earn 5 cents in both '00 and '01. I look at sequential revenue growth and notice that it's been 73% and 49%, respectively, over the past two quarters. The RS line is upward sloping over the past 11 weeks. The company is in the ultra-hot optical networking segment of the telecommunications equipment group, a leading area.

Buying Sycamore was a clear mistake. The obvious entry point was two days earlier when price broke out of a seven-week cup-with-handle base on major volume. Instead, I bought the stock two days later as it cleared that prior high. I was then stopped out with a 4.5% loss. Note that if I had bought the stock properly, I would not have been stopped out when it pulled back, since the stock came back as far as the breakout point before running up about 80% over the next five days. Right stock, wrong timing.



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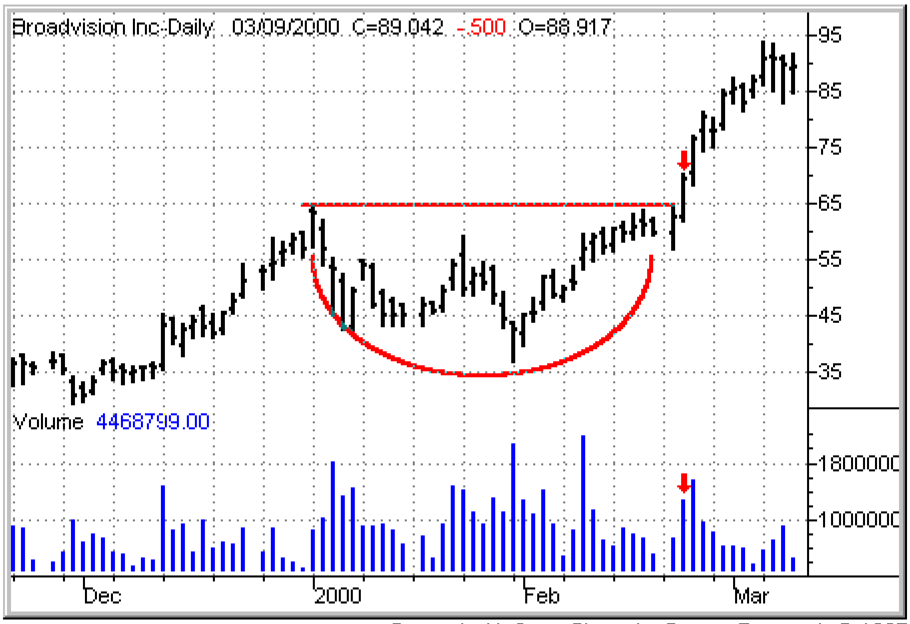
Feb. 23: I buy Broadvision (BVSN) coming out of a seven-week base on solid, but not heavy, volume. I add a second position later that day. Fundamentally, the Street forecasts earnings growth of 36% and 50%, respectively, over the next two years. A rising RS line reflects outperformance over the prior four months. Finally, the stock is a component of the Internet Software group, a high relative strength group.



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On March 8, the second straight day of distribution, I sell my position at 250, 10% off the stock's high for the move.

March 9: I buy E Piphany (EPNY) as it emerges from an 11-week cup-with-handle base. Fundamentally, the company is forecast to lose money in '00 and '01. On a sequential basis, revenues have grown 65% and 63% over the past two quarters, respectively. The stock has an upward sloping RS line over the past eight weeks. EPNY is a member of the enterprise software group, a market-leading segment.

The timing of my purchase couldn't have been much worse, since the stock peaked the next day along with the Nasdaq Comp. Since volume was low on the breakout day, I kept my risk to an absolute minimum and was stopped out the next day with a 3% loss. To review, I normally limit my losses to between 5% and 7% unless I'm faced with a higher-risk entry. If so, my losses are capped between 3% and 5%.

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March 14: I move my account to a 100% cash position.

March 15: In "Marder On The Market," I write: *I moved my account to a 100% cash position Tuesday a.m...I did this not because I felt the Nasdaq would necessarily come undone, but rather because each of my stocks violated stop-loss levels...As I had recently mentioned, I sometimes use a 20%-drop-off-a-high as a trigger to sell one-half or all of a winning position...given the lightning runups in numerous leaders since early February, my stops were tighter this time around...*

Indeed, most of my sell-to-nail-down-a-profit decisions were based on either one or more days of distribution in a stock or a percentage decline off a stock's peak.

With liberal use of margin and a religious approach to cutting losses, my account was up 110.4% during the month of February 2000. In the past few years, on average there have been two propitious times each year to buy growth stocks similar to the month of February 2000. Thus, this type of opportunity in the growth sector will present itself in the future no matter how bleak the market may look at times. Just when you think things will never improve, a fresh crop of dynamic growth names will assert themselves by building bases and then breaking out on dense volume.

A final word to the wise: *February 2000 was not a normal month for me.* Temper your expectations of what this strategy can yield. If need be, paper trade it for a while to build your confidence before you put your hard-earned money to work.

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Greg and I will end this course the way we began it -- with a nod to Bill O'Neil: "You're the man, Bill."