



## May '06 – The Best Predictor of Market Direction

A difficult and serious problem for investors today is that there is entirely too much free information, hype, promotion and personal opinion about the stock market. You get it from friends, co-workers, TV, stock brokers, the Internet and various other sources. Much of this information can be risky and potentially dangerous to your portfolio. To be successful, it is my assessment, we need to limit ourselves to a few sources of relevant facts and data and a sound system that has proven to be accurate and profitable over time. Facts are almost always better than personal opinions. Do not take information at face value; think carefully about how it is being presented to you. Especially from pundits on TV who may have an agenda when they are giving us their expert opinion. For instance, they may be telling you about how much they like a particular stock because they want to sell it and needs buyers!

From my years of study with accomplished investors, it is my assessment, the best predictor of market direction is to follow, interpret and understand what the general market averages are doing every day. It might sound overwhelming at first but with practice and patience, you too can be analyzing the market like a pro!

Where is the big money flowing? According to William O'Neil, founder of Investors Business Daily, Institutional investors (mutual funds, pension funds, etc.) account for 80% of the markets direction...and 3 of 4 stocks follow the general market direction. When these extremely large money managers get in or out of the market (buy and sell stocks), they cannot hide and the market moves on above average volume.

- High volume up days in the markets = institutional buying
- High volume down days in the markets = institutional selling

We want to be on the same side as the institutions. Buy when they are buying and sell when they are selling. It does not matter what our personal opinions may be - it does not pay to argue with market. Experience teaches us that fighting the market can be a very expensive lesson.

Many investors describe themselves as "long-term investors." Often times they may get away with staying invested through relatively mild (20% or less) bear markets but many bear markets are not mild. This is what happened to the NASDAQ\* in the bear market of 2000-2002 when it went down 77.8%. This loss requires over a 300% gain to breakeven! This is why investors portfolios were hurt so bad from this 2 ½ year period in the markets.

The importance of knowing the direction of the general market cannot be over emphasized. We will never be able to pick the market tops or bottoms but we may be able to limit losses. Learning to determine the overall market direction by accurately interpreting the daily market indices' price and volume movements may determine whether you win big or lose.

Dave

\* The NASDAQ index is a measure of the combined value of roughly 5,000 stocks traded on the National Association of Securities Dealers Exchange. Past performance is not indicative of future results.