

FEBRUARY



Nevermind the Selling

By Victor Niederhoffer and Laurel Kenner

Columnists

02/01/2001 08:51 AM

When I put down a suggestion that seemed to me cogent and reasonable, Einstein did not in the least contest this, but he only said, "Oh, how ugly." As soon as an equation seemed to him to be ugly, he really rather lost interest in it.

H Bondi as reported in *Fearful Symmetry* by A. Zee.

Einstein liked to say that beauty was the guiding principle in the search for important results in physics. It is also often the guiding principle in the market's search for order.

One or two seconds after Doc Greenspan cut the funds rate on Jan 3, the markets moved to exactly the level they closed the month at. The rest was a mere façade to create the friction necessary to lubricate the wheels of commerce and pay for the markets' maintenance.

So the month ended as it began, with a sparkling rally in bonds, a drastic decline in the Nasdaq and a fearful but manageable fall in the S&P 500 and Dow.

The bonds ended the month about where they started, but what a triumphal road was traveled by stocks. So far this year, the Nasdaq is up 12.2%, the S&P 500 is up 3.5% and the Dow is up 0.93%.

Better yet, the prognosis is highly bullish. There is an 80% chance that the January effect will continue in the next 11 months, with an expectation of an 8% gain.

Even more magnificent, there is disappointment in the air. The Fed lowered the funds rate by half a percentage point and muttered some negative political verbiage on the economy -- exactly what the market was hoping for -- and the Dow dropped 100 points. Not only that -- but after running the stops at 1390, S&P 500 futures dropped 2% and Nasdaq 100 fell 3% in the last half hour.

Seeing Opportunity in Bearishness

"Go figure," one of our broker readers from Iowa lamented. And our nimble, gravity-defying day-trading friend from Florida confessed: "I had one of my worst days ever. I bought the highs and sold the lows."

Yes, the disappointment, the ennui, the despondency is almost palpable. If only the old-hearted correspondent at the big financial weekly were able to get connected to a communications network on his vacation. We can almost hear his exuberance.

And of course, all this is highly bullish, especially with the beginning of the month upon us.

Now that the scales have tipped to the bullish side, we plan to do lots of buying for our own account. The first thing we'll be doing is removing the hedge from our Other Worldly portfolio, leaving us with naked longs in Borland Software (BORL), Commscope (CTV), Petsmart (PETM), Techne (TECH) and Westell (WSTL).

High on Semiconductors

As for our Internet portfolio, recall that we started the year out long 15 issues and these have given us a profit of about 200%. We locked in this profit, as did many of our readers, by selling 11/12ths of the portfolio and hedging the remainder. We have no opinion on these, but Edwin Marks, the Shakespeare of markets, followed our recommendation on them and indicates that on highly speculative situations like these, he likes to take a 100% profit or so and let the rest ride for the long pull. Sounds reasonable.

We plan to wait for the next big up day and sell out another half of this portfolio. In the interim, we'll take off our hedge by covering our short of the Internet Holdr (HHH), on which, as is the norm for shorts, we lost a few percentage points.

We said Jan. 18 that we like the semiconductor industry but were going to keep our powder dry until the end of the month. We're high on semis because the industry is guaranteed to have above-average growth in the next several years. Investors tend to underestimate growth of this nature, as highlighted in our weekly piece today at [Jan. 18](#) piece for Worldly Investor still look good to us: Conexant (CNXT) and Xilinx (XLNX). They register the kinds of things we like: insider buying, a drubbing in 2000, and reasonable prospects for the future.

We intend to take all the funds we raised from selling the Internet stocks and use them to buy these two, along with the six stocks in the Other Worldly portfolio, in equal amounts.

With pessimism in the air again, it is time to reach for some good stocks.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	1.08	Up 3	0.9	2.9
S&P 500	1.50	Down 1	3.5	2.7
Nasdaq	1.27	Down 1	12	3.4
Europe STOXX-50	0.92	Up 1	0.1	0.1
Dollar/euro	1.08	Up 2	-0.9	-0.2
Nikkei	1.00	Up 1	0.4	1.3
Dollar/yen	0.79	Down 1	-2.0	1.8
Gold	0.92	Up 2	-2.3	0.9
Oil	1.00	Down 1	12	3.1
Bond Futures	0.60	Up 2	-0.5	0.00
2-Yr Note Futures	1.20	Up 2	0.7	0.3
Bund Futures	1.00	Up 5	0.4	0.2

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Honing Your Investing with Better Tools, Part II

By Victor Niederhoffer and Laurel Kenner

Columnists

02/02/2001 08:28 AM

(Brett N. Steenbarger, Ph.D. is a licensed clinical psychologist and periodic guest contributor to the Daily Speculations column. This is the second in a three-part series covering online resources and tools for active traders. Click [here](#) for Part One.)

Give a person a watch, the saying goes, and they will always have the exact time. Give them two watches and they will never know the exact time. So it is with market data. With the online revolution, information is at the fingertips of speculators to an unprecedented degree.

More Confusion than Clarity

This poses both opportunities and pitfalls, as it allows for a bewildering array of regularly updated technical, fundamental, and economic information. At some point, gathering more information is like wearing a second, third, and fourth watch. The focus on minute differences tends to obscure the larger picture, adding confusion rather than clarity.

There are psychological pitfalls to data profusion, as well, alluded to in the [first column](#) in this series. The human mind can only process a relatively small amount of information at one time. A famous study by Neal Miller estimated the capacity for short-term retention to be seven "chunks," plus or minus two, of information. Beyond this limit, adding more data without providing opportunity for rehearsal is apt to lead to forgetting.

It is important, therefore, to seek out reliable sources of the most promising information in analyzing markets and formulating trading plans. But how is one to navigate the maze of financial web sites and online data services? I turned to readers of the Daily Speculations column for their nominations of best online sources of market information and was pleasantly surprised by the enthusiastic response. Today's column will focus upon resources for stock selection.

News and Data

My first priority was to identify a resource of resources; that is, a guide to information sources available to traders. Fortunately, a recent, highly readable, and well-organized volume is available from Jon Markman, managing editor of the MSN MoneyCentral site (www.moneycentral.com). The book is the second edition of "Online Investing" (Microsoft Press, 2001), and it covers news services, sources for fundamental data, and technical analysis sites.

Markman's great strength, featured on MoneyCentral, is his creation of "models" to guide stock selection. These models address the seven plus or minus two limits of traders by synthesizing a large amount of momentum and fundamental data into screens that select promising stocks for investment. His book outlines his primary growth, value, and momentum models, including the unique HiMARQ model. This draws upon seasonal trends to select market sectors and stocks. HiMARQ can be combined with the other screens to tilt the odds in one's favor.

In response to my inquiry, Markman offered a number of promising web sites that provide information for his screening. He recommends Stockcharts (www.stockcharts.com) for well-organized data on sector performance and for the commentary offered by Richard Rhodes (The Rhodes Report). He also suggests

Briefing.com (www.briefing.com), which offers market updates free of charge and a wealth of market data for only \$10/month. Especially helpful are the daily "stock briefs" — ideas for traders—and Bob Walberg's daily column. I often rely upon Briefing.com for a view of upcoming economic data and forecasts, featuring consensus estimates and the estimates of the Briefing.com staff.

One of Markman's most interesting recommendations is Multex (www.multex.com), which offers a wealth of analyst reports on a pay-per-view basis. "A professional-level subscription to this site gives you access to the professional-level MarketGuide screening engine," Markman pointed out. "It totally rocks because you have access to 10 years of fundamental and earnings data, and a vast array of earnings-estimate data."

What Do the Funds Own?

Sites also on Markman's list that I have also found useful include Lionshares (www.lionshares.com), which is a well-organized site that summarizes the holdings of mutual funds and hedge funds. The site allows traders to follow the most successful funds and see what they are doing, both in terms of sectors and individual stock holdings. Insider Scores (www.insiderscores.com) is also a free and informative site summarizing the most recent insider trading activity for individual stocks. An especially creative feature is a rating of the past performance of insiders, which allows investors to follow the actions of insiders with particularly good track records for timing.

Mentioned by several readers was the Starmine site (www.starmine.com), which rates Wall Street's analysts for the performance of their recommendations. It highlights situations in which the "all-star" analysts are making forecasts that differ from consensus thinking. A somewhat similar concept is implemented at Validea (www.validea.com), which follows the performance of recommendations made by Wall Street gurus and commentators, such as those featured on the financial networks. Starmine breaks down analyst ratings by sectors, which is quite useful, and Validea features a number of preprogrammed screens derived from criteria set out by Wall Street authors. Both sites are a fertile source of ideas for investing.

One of the most interesting information services was suggested by reader Frank Linet. Called TV Eyes (www.tveyes.com), the site gathers all mentions of topics from television sources and mails these to subscribers. For example, if one is interested in following a particular company, it is possible to submit the name to TV Eyes and receive a regular update of every television mention of the firm. This is an excellent way to stay on top of news.

By now, you're probably noticing a theme running through many of these recommended sites. They are elaborate databases that find the best performers in a category: best performing stocks, best performing analysts, best performing insiders, etc. The idea is to sift through market data efficiently, find the cream of the crop, and follow a successful track record.

Our last column in the series will turn from stock selection to promising sources for short-term traders, including charting, news, and technical analysis sites and sites that feature promising trading ideas. Many of these feature information updated on an intraday basis organized in unique displays that facilitate trading decisions.

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Friday Was Demoralizing, but Stay Hopeful

By Victor Niederhoffer and Laurel Kenner

Columnists

02/05/2001 10:01 AM

As I watched Thompson circle those bases, I felt like going into headquarters and giving myself up. I don't think I ever felt more depressed in my life. - Willie Sutton, the notorious bank robber, on his reaction to the Giants' come-from-behind victory over the Dodgers in the 1951 playoffs

Like Willie Sutton, we felt like throwing in the towel after the drubbing the market took on Friday. The Dow, S&P 500 and Nasdaq fell 1%, 2% and 4%, respectively. Ten of the Nasdaq 100 stocks fell 10% or more on the day, and 29 stocks fell 10% or more on the week.

For the decline to come on the second trading day of the new month was particularly diabolical. Much new money comes into the market on the month's first trading day, and nothing's more discouraging than to start out with a big loss.

Friday's drop was extraordinary in more ways than one. It was the first decline of more than 10 points in S&P 500 futures since Jan. 5. This stretch of 17 trading days was the longest period without such a decline since April 16, 1997. It was also only the second time in the last six years that a decline of such a magnitude occurred on an employment day. It was only the 11th one-day decline of more than 20 points in the first five trading days of the month. And it was the first time since May 1999 that both bonds and the S&P dropped substantially in a day.

Aside from the latter, all the records are fortuitously bullish after the obligatory early margin call declines are finished today. Such a consummation is devoutly to be wished, when you're not in over your head and the cane is handy for hobbling down to the Street to follow the example of the old-timers in picking up good stocks on the cheap.

A Familiar Aspect

One regularity in the decline, from the benefit of the armchair, is that it came two days after the end of a Federal Open Market Committee meeting. On such occasions, the stock market vigilantes like to come out of their barns and threaten to lynch the powers that be unless they promise to give back the entire interest-rate increase they took during their lawless raids of the preceding 18 months. The same thing happened on Jan. 5, two days after the last meeting, when the S&P futures dropped 3.3%, and such vigilant declines are by no means atypical.

We believe that counting and testing is the key to winning the stock market battle. With the numbers highly bullish, we plan to add to our positions in our Other Worldly (non-Internet) portfolio.

We have also found two additional semiconductor stocks that fit our specifications -- deeply distressed in price, with the insiders nibbling away - Axcelis (ACLS), an equipment maker, and Viasystems (VG), a manufacturer of printed circuit boards

We bought some Axcelis on Friday and plan to buy some more today. Viasystems has massive insider buying and is selling for 10, down from a one-year high of 23. Both should benefit from the rising tide of semiconductor diffusion.

We hereby add them to our Other Worldly portfolio, which now consists of Axcelis (ACLS), Borland (BORL), Commscope (CTV), Conexant (CTXT), Petsmart (PETM), Techne (TECH), Viasystems (VG), Westell (WSTL) and Xilinx (XLNX).

Taking everything into consideration - the initial portfolios, the adds, the deletes, the four reductions in size to the Internet portfolio, the hedges - there's no good simple way to calculate a rate of return on our recommendations this year. One actuary in our employ came up with about a 150% profit to date. That seems a reasonable guesstimate to us, and is consistent with our own returns and others who have kindly told us by e-mail that they followed our recommendations.

Few Takers

Those who followed our recommendations were few and far between, because it would have required a heroic act of faith to do anything but string us up to a tree after our excessive bullishness on volatile stocks in 2000. In our defense, however, most of those sorry 2000 picks more than recouped in the first month of 2001, thereby earning us a pardon in many readers' minds and a smile in their communications.

We are similarly charitable with the mumbo-jumbo, superstitions, untested shibboleths, myths, nonsense and old wives' tales that make up the body of technical analysis. And thus, it was with great joy that we finally saw a use of technical analysis that we find totally rational and appropriate in a sector of supreme importance.

New Born Techs

This employment of technical analysis was described in a letter received over the weekend from reader Henry Carstens. We reprint it here in full: *I suppose it happens to most new parents. A case of nerves, some pre-birth jitters that sent us scrambling to the hospital a little early.*

The nurses, though, are nice, and like I said, it didn't appear we were the first to arrive slightly ahead of the nick of time. And they did graciously hook us up to a baby monitor so we could make sure Mom and baby were OK and we could watch the heartbeat and movements print out on a little ticker-like tape.

And it was in that moment that I knew I'd be OK. You see, up until I saw that little tape and its little rhythmic graphs, I'd honestly been wondering what good I'd be in the delivery room. But now I knew. I knew what I could add, what my place would be.

Because I could read the tape.

I could predict the contractions.

I could see the ever-changing cycles.

I could forecast the next event.

LoBagola entered, and was quickly swept from, my mind. I talk less of elephants these days.

The nurse assured me I was 'helping' and I knew that fate had sealed my part and that it was a weight I could carry. I would read the charts. When the time came, I would help.

I would be there to spot the head and shoulders.

After Willie Sutton adjusted to the Dodgers' loss, he was able to stay out of prison for a number of years by taking a job as an orderly in a Staten Island hospital. Mr. Carstens' hospital dispatch fills us with similar hope for all those who watch the charts.

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In addition to owning most of the Internet stocks recommended in our previous columns, albeit at drastically reduced levels, Vic is long Axcelis, Conexant and Xilinx. Laurel owns Conexant, Viasystems and Xilinx.

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The Latest Market Mystery: Chip Stocks

By Victor Niederhoffer and Laurel Kenner

Columnists

02/06/2001 10:34 AM

The market tried but couldn't quite close the Pandora's box of woes opened in Friday's decline. The Dow and the S&P 500 rose 0.9% and 0.4%, but the Nasdaq fell 0.7% as semiconductors continued to register a strong current of panic, fear and dismay.

Pandora, the Greeks said, was created because Zeus wanted to bring humans down a notch after Prometheus stole fire from the gods. After January's rise in growth stocks, a similar move to squelch the creative fire in the market was inevitable.

The drop followed a Semiconductor Industry Association report projecting a 10% rise in chip sales this year, less than half of what SIA had predicted. Robertson Stephens & Co. advised clients to expect slowing, "given weak PC sales coupled with higher inventories of communications-related components."

As usual, the Street is behind the form.

Chip stocks fell last year as one analyst after another said warnings from companies like Cisco (CSCO) and Intel (INTC) indicated continuing weakness in demand. After chip stocks proceeded to go up almost 30% in the first month of 2001, the analysts began hauling out reasons why the gains couldn't last in a slowing economy.

But how to explain the surging demand at Taiwan Semiconductor Manufacturing (TSM), the largest maker of custom chips? TSM said overnight that fourth-quarter profit more than doubled as US companies farmed out chip production to concentrate on design. The growth came from all areas: computers, telecom equipment and consumer electronics.

Sales for the industry as a whole are expected to rebound in the second quarter, according SIA. We are therefore not about to throw in the towel on our own semiconductor picks. In addition to Viasystems (VG) and Axcelis (ACLS), which we recommended yesterday, we have been buying Conexant (CNXT) and Xilinx (XLNX).

(We recommend the sale of USinternetworking (USIX), as the insider transactions that prompted our recommendation last week appear to have been options-related.)

As for the market today, our crystal cloud is cloudy.

The one lesson we've learned in our combined 60 years of business and writing is that in both fields, customers determine success.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	1.00	Up 2	0.9	2.1

S&P 500	1.67	Up 2	4.0	3.5
Nasdaq	1.40	Up 3	15	8.4
Europe STOXX-50	0.85	Down 1	-0.3	2.3
Dollar/euro	1.00	Up 1	-1.6	-1.6
Nikkei	0.92	Down 1	0.3	1.8
Dollar/yen	0.85	Up 2	-1.5	1.1
Gold	0.85	Up 1	-2.3	0.9
Oil	1.09	UnChg	13	2.0
Bond Futures	0.53	Up 1	-1.1	0.3
2-Yr Note Futures	1.10	Up 1	0.5	0.2
Bund Futures	0.92	Up 4	0.3	0.4

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Serendipity, Baby!

By Victor Niederhoffer and Laurel Kenner

Columnists

02/07/2001 09:49 AM

(To the tune of *Stouthearted Men*, from *The New Moon*, music by Sigmund Romberg, original lyrics by Frank Mandel and Oscar Hammerstein II)

*Give me some men who are stout-hearted men who will buy stock the funds all abhor
Priced below 10, paying no dividend, warned on earnings and who knows what more?
Value Line ranks it a 2 and a slew of insiders have come to the fore
Time to buy a stock is when it lacks a crowd of fans
When stout-hearted men can stick together man to man!*

One of the most amazing anomalies in stock prices is the continued ability of the Value Line timeliness rankings to differentiate between above-average and below-average performing stocks.

If \$100 had been invested in 1965, with rebalancing every six months, here is how it would have grown by year-end 2000:

Group 1: \$15,923

Group 2: \$7,430

Group 3: \$2,743

Group 4: \$959

Group 5: \$151

The results for Value Line's technical analysis rankings are similarly alluring and non-random. The only problem we have with using the timeliness and technical rankings is that stocks in the most favored groups often had superior price performance in the last 12 months.

For example, in a screen we ran for this column, we uncovered 12 stocks currently ranked in Group 1 for timeliness that had insider buying in the last three months. Their average performance in 2000 was up 107%.

Similarly, we found 58 Group 2 stocks with insider buying in the past three months. Their average performance in 2000 was up 44%. Unfortunately, the five stocks that declined last year are all up substantially in 2001, as follows:

Abercrombie & Fitch (ANF): 52%

Brown Shoe (BWS): 24%

CIT Group (CIT): 17%

Tech Data (TECD): 36%

Western Digital (WDC): 88%

We're Human

We are psychologically incapable of buying a stock that has risen more than 50% in any recent period, and are seeking a referral to Dr. Brett, the Daily Speculations consulting psychologist at SUNY Syracuse, for treatment.

In the interim, we are relying on serendipity. Responsible for discoveries as sublime and wide-ranging as gravitation, penicillin and rubber, serendipity is also on occasion the source of the discovery of something as humdrum as an undervalued stock.

The humdrum issue under consideration today is Chart Industries (CTI), that is our kind of stock for many, many reasons:

- It's ranked 2 for timeliness by Value Line, although the firm cautions that only the stout-hearted should consider buying shares.
- It sells below \$5, down from a 1998 high of \$23.29.
- Mr. Don A. Baines, a certified public bean counter who serves as Chart's chief financial officer and treasurer, has been buying shares for at least the past year, at prices starting at \$3.75.
- Best of all, the company recently eliminated its dividend, and is struggling under a massive debt burden of some four times net equity.

Oh, yes, it makes cryogenic equipment such as heat exchangers, vacuum pumps and storage containers used by the chemical industry.

We uncovered Chart Industries when we ran a screen looking for Value Line stocks ranked high for timeliness with recent insider buying. The serendipity was that it happened to be selling for less than \$5 -- a class of stocks that goes up, on average, more than 50% a year.

Chart Industries looks so risky and out of favor that we are adding it to our recommend list. For the stout-hearted only.

End Note: Today's nice down open, after a nice down day, continues the recent pattern of backing and filling without a major run of moves in the same direction. We anticipate continued backing and filling with a nice positive drift to the upside, starting today.

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Nikkei	0.75	Down 4	-3.7	-5.1
Dollar/yen	0.93	Up 2	-0.7	1.8
Gold	0.71	Down 3	-3.1	-1.1
Oil	1.00	Down 2	18	2.6
Bond Futures	0.65	Down 1	-0.3	1.7
2-Yr Note Futures	1.00	Down 3	0.5	0.08
Bund Futures	1.15	Down 1	0.7	0.7

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It's All Greek to Us

By Victor Niederhoffer and Laurel Kenner

Columnists

02/08/2001 09:51 AM

Sisyphus, the tale goes, was the technology king. He used his cunning to get the river god to give Corinth a fresh-water spring, doubtless with the idea of making silicon chips for all of Greece.

But before Sisyphus could carry out his plan, Hades hauled him off to the other world and condemned him to spend eternity pushing a boulder up a hill. Every time he was about to reach the top, the boulder, repulsed by a terrible force, rolled all the way to the bottom.

Next to Sisyphus was Tantalus, standing up to his chin in a pool of water. He suffered from burning thirst, but whenever he lowered his head to take a drink the water receded. Above him stood pomegranate, apple and pear trees, but whenever he tried to reach up for them, the winds blew the branches above his reach.

The myths are elegant and sage, invented apparently in allusion to the inability of the Nasdaq and S&P 500 to make serious progress in the new millennium.

After rising 16% through Jan. 23, Nasdaq 100 futures fell back yesterday to below their year-end level. S&P 500 futures fell below their Dec. 28 price, after rising to up 4% on the year on Jan. 3 .

Texas Magic

At the height of the agony, one man stood stalwart. A hedge fund manager from Austin, Texas, sent us this e-mail:

"Having broken through NDX 2550, now is the second zone to establish positions around NDX 2350. I think this one will hold. We broke through the downtrend line (drawn from Sept. 1 highs on daily chart) and this is a test of that line from above. That said, position sizing is what counts, so play accordingly. Be careful, there is danger above and below."

Ordinarily, we would promptly denounce something like this as a prime example of that popular mystical form of analysis, innocent of scientific testing, which cloaks itself with Delphic ambiguity consistent with all future events and is therefore predictive of none. Our interest, though, was much enhanced by the fact that the author of this e-mail has not had a losing month in two years, and has been garnering a 10% monthly return for his clients. We only wish we could use voodoo as effectively as this.

We therefore appealed to our list of savants to get their books on technical analysis out from under the coffee-table legs where they serve as balances, and help us interpret.

From the Land of Lakes

Program developer John Lamberg from Minnesota stepped up to the plate, helping to assuage our torture with this incisive missive.

"After reviewing my books," Mr. Lamberg wrote, "I can comment. Yes, NDX did break above the downtrend line, but then it dipped below it. So I would argue this is a false breakout and we need to re-

establish the downtrend line using the 1/24/01 high. But, I do see the point about 2350 as that level appears to be a 61.8% Fibonacci retracement from the 1/97 highs (re-tested in the fourth quarter of '97 and first quarter of '98) to the 2000 highs.

"If the 2350 support level does not hold, I would like to point out that the 1/2/01 low held at the 200-week simple moving average of typical price, 2114 (that's 200-week, not 200-day moving average -- I'm a long-term investor, so I use long-term moving averages). So, I concur on the 2350 call. If that failed, then I would look to 2114 and wait for a re-test before establishing positions."

Glad to have that straightened out.

Not Unscathed

Unfortunately, yesterday's torments did not leave our own recommended portfolio untouched.

Axcelis (ACLS): -0.6%
 Borland (BORL): -1.1%
 Conexant (CNXT): -2.6%
 Commscope (CTV): -1.1%
 Chart Industries (CTI): -4.4%
 Petsmart (PETM): -1.8%
 Techne (TECH): -2.0%
 Viasystems (VG): -5.4%
 Westell (WSTL): 1.2%
 Xilinx (XLNX): -5.0%

Dolly Parting

Yesterday, we received lyrics, sung to the tune of *Hello, Dolly*, from Jim Holub, a professor in the math department at Virginia Tech. We think the words capture the spirit of the market's trials:

GOODBYE, RALLY

*Goodbye, rally,
 Well, goodbye, rally,
 It was nice to have you back in town again.
 You looked so swell, rally,
 I could tell, rally,
 You were glowin', you were growin'
 You were goin' strong.*

*And all the talking heads said so,
 And the guests that were on their show,
 All said the market's giving stocks away,
 Soooo...!, get your cash out,
 And take it from an honest tout,
 Rally's on a streak
 That's here to stay...,
 Yeah!
 Rally's never going away,
 Rally's never goin' away,
 Rally's never goin' away again!*

*But now the room's strangely swayin',
And the band's stopped playin'
That old song "Buy the Dips"
We loved so well, soooo...
Golly gee, fellahs,
Better buy some puts with me, fellahs,
Rally's makin' moves to go awaaay,
Yes, rally's makin' moves to go,
Rally's makin' moves to go,
Rally's makin moves to go awaaay.*

Mistress' Mercy?

Fortunately, the Daily Spec computers are telling us that the mistress of the market is ready to end the torture. For the first time since the beginning of the year, she gave the bulls a firm ledge to stand on, by sending S&P 500 futures down two days in a row.

Bulls able to maintain their footing are scheduled to be nourished with an up opening. And after the evil one tries to take away this proffer with his evil margin calls early in the day, there should be ample food for them the rest of the week.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	1.00	Down 2	1.5	2.8
S&P 500	1.31	Down 2	1.6	-1.7
Nasdaq	1.14	Down 1	5.6	-8.8
Europe STOXX-50	0.88	Down 1	-2.7	-2.6
Dollar/euro	1.14	Up 1	-1.2	0.8
Nikkei	0.81	Up 1	-3.0	-3.8
Dollar/yen	0.88	Down 1	-2.0	1.3
Gold	0.67	Down 4	-3.3	-0.5
Oil	1.07	Up 1	22	7.6
Bond Futures	0.65	UnChg	-0.3	1.9
2-Yr Note Futures	1.08	Up 1	0.5	0.1
Bund Futures	1.23	Up 1	0.8	1.0

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*, which is available [here](#).*

Laurel Kenner is a financial writer in New York City. Formerly head of US stock market coverage at Bloomberg News, she previously reported on police, politics and aerospace during her 17-year news career.



Reinventing Good Moves

By Victor Niederhoffer and Laurel Kenner

Columnists

02/09/2001 09:19 AM

(Editor's Note: David Ciocca is a hedge fund manager, wrestling coach and periodic contributor to the Daily Speculations column.)

Study the games of the old masters, and your game will keep young.

--Tom Wiswell, world checkers champion for 25 years.

About six years ago, I had the pleasure of coaching the best wrestler of my career. He was a sophomore transferring from Purdue University, where he had been a National Tournament qualifier as a freshman. Needless to say, I was excited to have a chance to work with such a talented wrestler.

When I first saw him wrestle in our practice room, he was working on a series of pinning combinations that had been considered obsolete since the 1970s. My initial thought was that he was just messing around.

He wasn't.

Over the next three years, this young man won three consecutive NCAA National Championships, and was voted the outstanding wrestler in the nation in his last two seasons.

What was so compelling about this wrestler was that he was able to master a series of moves that had been previously considered antiquated. None of his opponents could defend this series of moves, as they didn't know what to expect -- what it actually felt like to try to counter his pinning series. In fact, many opponents actually feared his "unknown" techniques.

The Market's Old Movers

The market as well often gives us opportunities to reinvent "moves" that most investors, even the top performers, have written off. Consider a couple of examples from the recent past.

In late 1999 and early 2000, many legal and financial pundits wrote off Phillip Morris (MO) as a litigation nightmare with little hope for survival, much less gains for investors. By year-end 2000, this "dinosaur" had returned over 100%.

Or consider software behemoth Microsoft (MSFT). A year 2000 of antitrust misery culminated with a high-profile profit warning at year-end. In the month or so since, the stock is up over 50%.

It was a similar story for Dell Computer (DELL). Computers are a relic, the sages said at the end of 2000. Then, in January, the computer makers posted their best month in years. Dell was up 50% in the month.

Perhaps the recent carnage in telecommunications and networking stocks, caused by the Cisco (CSCO) earnings miss and subsequent lambasting from the financial gurus, might provide similar opportunities.

Companies of the Future?

Consider the following companies as candidates to catch the next move up, as they've been left for dead in the past few days.

JDS Uniphase (JDSU) -- This previous high-flyer has fallen on hard times of late, down 70% from its 52-week high. This year's expected slowdown (30 to 40% growth) notwithstanding, the company expects earnings growth approaching 50% annually for the next five years.

Teradyne (TER) -- A member of the beaten-down semiconductor equipment group, Teradyne is also 70% off its 52-week high. After slower growth of 20% to 25% in 2001, Teradyne expects growth of 40% in 2002, and 25% over the next five years. The company said Thursday at the Banc of America Technology Week conference that it outspends all other companies in its industry.

Nortel Networks (NT) -- This one is pretty straightforward. Growth of 25% to 30% for the next five years. Significant insider buying over the past several months. Down 60% from the high.

Now, all of these companies have taken a good beating lately, particularly in the past week. Qualitatively, that makes them all the more attractive, as the bottom could come when bullish stories start reappearing. These stocks might be good choices for the reinvention of obsolete "moves."

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	0.94	Down 3	0.9	1.4
S&P 500	1.21	Down 3	0.9	-1.8
Nasdaq	1.07	Down 2	3.7	-7.0
Europe STOXX-50	0.94	Up 1	-2.6	-2.8
Dollar/euro	1.07	Down 1	-2.6	-0.4
Nikkei	0.76	Down 1	-4.7	-4.8
Dollar/yen	0.82	Down 2	-2.3	-0.3
Gold	0.63	Down 5	-4.3	-1.6
Oil	1.14	Up 2	23	7.6
Bond Futures	0.65	UnChg	-0.3	1.4
2-Yr Note Futures	1.00	Down 1	0.5	0.08
Bund Futures	1.14	Down 1	0.5	0.6

David Ciocca is president of DLC Capital Management, Inc., a Rochester, N.Y.,-based Registered Investment Advisor. He holds, either directly or in client accounts, some of the stocks mentioned in this article. Positions can change at any time. He coaches wrestling at Rochester Institute of Technology. He welcomes your comments at daveciocca@yahoo.com.

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worldlyinvestor.com

From the Ego Alley Tropical Bar and Grill: Stock Talk!

By Victor Niederhoffer and Laurel Kenner

Columnists

02/12/2001 10:29 AM

*Red sky at morning, sailors take warning**Red sky at night, sailor's delight.*

The 447th edition of Stock Talk! was held at the Ego Alley Tropical Bar and Grill on City Dock in Annapolis, Md., after the Speculative Duo took a crowd of speculators out sailing in Chesapeake Bay on their sailboat, "Risk."

Laurel: Tim Melvin recommends the martinis here. He says the food is great, and there's also a good wine list. Those of you with daughters, keep an eye on them; the place is full of sailors.

Vic: That was a rough ride. Good thing we decided not to put the jenny up.

Laurel: Yes, it seemed like a good time to run before the wind, but when the breezes picked up we could have capsized. Reminds me of the market last week. But as they say, Red ink Friday night, investor's delight.

Vic: Excuse me, I'm getting something on the wireless from the Daily Spec computers. (Reads) The computers are showing rainbows in the sky, and we should have some good sailing going forward. The alignments of bonds, the S&P and Nasdaq is highly unusual, of the kind that has come perhaps once every two months during the last seven years. Looking at the 40 most similar events, we find the expectations are for about a 2% rise in the S&P 500 over the next week, with an 80% chance of a rise and an average variability of three times that level.

Laurel: Tim Melvin, you're not only a local here in Annapolis, you're a vice president of investments at Ferris Baker Watts. We came down here to talk to you about your stock-picking techniques. You sent us some very interesting suggestions, which we'll talk about later. It's unusual for a broker to have such a quantitative frame of mind.

Tim: I got into this business about 12 years ago and was fortunate enough to be exposed to a broker who was a huge Ben Graham and Marty Whitman fan, working in bankruptcies and undervalued situations. He taught me a lot about valuing stocks, and more importantly gave me mindset that has lasted for a number of years.

As to the quantitative screening, I have just picked that up over the years. I have noticed that winning stocks seem to have certain characteristics. Like you, I can't buy stocks at the high. So I started looking for patterns that fit my make-up. Two years ago I wrote an educational program for the US Junior Chamber that ended up being called the US Junior Chamber Value Investing course.

The program drew heavily on the works of Graham and research provided by Chris Brown at Tweedy Brown as to the characteristics. Once you have a set of characteristics that have worked over time, it just makes sense to screen for those. Insider buying and large drops in price showed up over and over as I worked through the research.

Laurel: Tell us about some of your screens.

Tim: One of the things I do is look for stocks with high short interest and recent strong insider buying. The latest list is fascinating. Several arbitrage situations pop up, as is to be expected, but once those are removed you have a list of stocks where the Street and the insiders clearly and strongly disagree about the future of the company.

In some cases, the shorts have forced the shares down to a bargain-basement level, and will cover soon. There's nothing like a good short squeeze in a company whose fundamentals are improving to get the blood racing and the profits climbing

The names included Primedia (PRM), Tejon Ranch Co. (TRC), Nucentrix Broadband Networks (NCNX) and Storage Technology (STK). I personally own Storage Technology.

Vic: The academic studies show insider buying is a good rudder for the stock picker, consistently giving a few extra percentage points over the market. And we've found you can do even better by narrowing down the initial list of candidates.

For example, at year-end, we screened a list of "Mostly Likely to Succeed" Internet stocks for insider buying. We came up with 15 stocks that doubled in less than a month.

Dr. Brett, did I hear you say you've been experimenting with combination screens?

Brett Steenbarger: Your Vic & Laurel specials -- down big with insider buying -- are one example of combination screens. One thing every defunct company shares in common: At one time they were down 80%. That's why I like your use of the insider buying as one screen for the companies that are massively down.

I am in the process of working out a rating scale for hedge/institutional/mutual funds that identifies "all-star" funds for stock picking. I then comb through the filings required of the funds and find the positions they are adding big time.

There is a lag involved in this process as well, but so far it's worked well in real time. The stock I selected for Laurel and Vic's recent contest, Fair Isaac (FIC), was chosen by scouring the filings. If two or more all-star funds take an oversized position in a stock and are adding to that position in the latest reporting position, that says a lot.

Laurel: Your pick is up 45% since the contest began Dec. 1, Dr. Brett, and definitely in the running for the top spot when the competition ends May 31. Do you have any names from more recent screens?

Brett: The latest screen came up with GenStar Therapeutics (GNT).

Laurel: We'll look forward to hearing more about that all-star screen.

As for us, we checked for insider buying in a list of 20 "best-managed, fastest-growing technology companies" in the latest issue of *Forbes*, and found three -- Netro (NTRO), WebEx (WEBX) and Vyyo (VYYO) -- that have insider buying.

Vic: Tim, you also like corporate liquidations.

Tim: My battered, beaten, well-read, more-than-dog-eared copy of Ben Graham's classic, *The Intelligent Investor*, tells me that corporate liquidations were one of the most prevalent investment operations for Graham's firm. His criteria for investing are the same ones I use today:

- A. A calculated annual return of 20% or more, and
- B. Our judgment that the chances of a successful outcome are at least four out of five.

Right now, Musicmaker.com (HITS) appears to have some value. It's trading above 5 now, and is worth a buy on any price pullback near 4. Salient Communications (STCIA) has a definable time and price that is a more-than-worthwhile return. In real estate, Philips International Realty (PHR) and Burnham Pacific Properties (BPP) offer value. I'd wait for a bit of a pullback on Burnham. Genesee Corp. (GENBB) is a layup here at 34, with my estimate of payout over 43 a share.

Laurel: (Takes a bottle from the waiter.) Why look, here's a bottle with a paper inside. It's from the mysterious Mr. X! (Reads):

*Weakness, weakness, everywhere and not a sign of strength
The U.S. has nobody to sell to, though it go to any length.
The market will rise on Tuesday, but then decline still more.
A hard economic landing is unfortunately in store*

Vic: (Scribbles something on a piece of paper, puts it inside the bottle and throws it over the railing into the harbor.)

Laurel: What was that, Vic?

Vic: Some buy orders. Laurel is expert at reading all instruments and can tell us just where we stand.

Laurel: A week ago Friday, \$100 invested at year-end in our picks would have grown to \$250. Our Internet portfolio, which we have reduced to 1/24th the initial investment, fell 17%, while the Other Worldly portfolio lost 5%. I'm calling it a 5% loss, on balance, so we're up 137% for the year.

Vic: With the Daily Spec computers showing rainbows in the sky, we're planning to add 25% to our holdings by going on margin with our \$237 of funds. We'll have \$296 invested. Our recommendations should be charted accordingly.

But do leave a stop, in case the portfolio slips from \$237 to below \$170. It's much more terrible to give back profits than not to make them at all, according to psychologists who study this under the rubric of loss aversion or regret theory.

Keep in mind this scientific reminder from William G. Van Dorn in *Oceanography and Seamanship*: "Freak waves three or four times the average height (and freak hollows, equally deep) can occur in any random seaway, and under marginal conditions, a constant watch is necessary to meet them head on."

Thanks to all for tuning in. See you at our next edition of Stock Talk!

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S&P 500	1.13	Down 4	-0.4	-3.0
Nasdaq	1.00	Down 3	0.0	-11
Europe STOXX-50	0.88	Down 1	-4.0	-4.0
Dollar/euro	1.13	Up 1	-1.7	0.2
Nikkei	0.82	Up 1	-2.6	-2.0
Dollar/yen	0.78	Down 3	-3.1	-0.4
Gold	0.63	UnChg	-4.3	-0.9
Oil	1.07	Down 1	21	4.2
Bond Futures	0.71	Up 1	0.4	2.2
2-Yr Note Futures	1.07	Up 1	0.6	0.2
Bund Futures	1.21	Up 1	0.8	1.0

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Say Die or Roll the Die?

By Victor Niederhoffer and Laurel Kenner

Columnists

02/13/2001 10:19 AM

No matter what turned up, he is always ready to alter his plans and make fresh ones, and in the meantime laughs, jokes and enjoys a joke with anyone, and in this way keeps everyone's spirits up.
--Walter How, seaman and sail maker, of the explorer Sir Ernest Shackleton.

The subject of risk is on everyone's mind as we anxiously await the market's reaction to Doc Alan Greenspan's Humphrey-Hawkins testimony today.

Amid all the uncertainty, the markets are strangely close to where they began the year. The S&P 500 and Nasdaq are up 0.8%, and the Dow is up 1.5%. The VIX, the average implied volatility of near-term stock market index options, hovers at 24.5%, almost exactly between the bullish 30% and bearish 20% levels.

The delicate balance between a peaceful present and a highly uncertain future brings to mind the "vista of ice" of the Antarctic. The region abounds with tales of survival and death, yet visitors invariably write about the enveloping tranquility.

"Clouds of ice crystals thinly veiled the sun as in a glittering, tenuous garment reflecting its rays, so that the whole arch of the heavens was traced with circles and lines of brilliant prisms of white light," wrote Louis Bernacchi, the physicist on Sir Ernest Shackleton's 1901-1904 expedition.

In 1914, Shackleton drew a line between survival and success, risk and reward when he abandoned a quest to the South Pole -- just 97 miles away from his goal -- so he could save all his men. He is lionized now as perhaps the greatest leader of an expedition ever.

Slap on the Risk

The question of when to draw the line confronts all of us in life and speculation. How much risk should we take in achieving our goals, and when should we turn back? The subject is so vast that books are written supporting completely different answers to the question.

For example, *The High-Risk Society* by Michael Mandel argues that we take far too little risk in our society. He argues that we should buy a much higher proportion of stocks for our portfolios than we do, and strive for jobs in the riskiest sectors. Mandel places great emphasis on a series of psychological experiments designed by Daniel Kahneman and Amos Tversky showing that people don't make rational decisions regarding risk, and that they are much too concerned about avoiding the uncertainty of loss.

Psychologists studying risk have found two main principles:

1. People have a benchmark set of expectations.
2. Relative to those expectations, perceived losses are much more painful than foregone gains.

On the other hand, books like *Mean Genes* by Terry Burnham and Jay Phelan argue that our thrill-seeking genes, developed in a past era so that we could thrive and migrate, make us accept too much risk

than is good for us. Our genes fool some of us into taking sucker's odds in lotteries and driving cars too quickly, by triggering a biochemical reward system involving the production of dopamines that make us feel good.

This is so because we are the great-great grandchildren of humans who placed risky bets. Imagine two kinds of humans: those who cowered in their caves, and those who explored new areas. The ones with risk-taking genes gambled, and populated the globe. We are their descendants. But those same genes can lead us astray in our society of great material abundance, programming us to take undue risks.

Specs Nix Risk

Our own take on the debate is that as far as stock market investment goes, we take much too little risk. The proportion of assets we invest in the market is much too small relative to the returns that have been achieved. We are much too averse to investing in technology, which has the greatest rate of change and the longest lead times between investment and return. We outlined some of these arguments in a Feb. 8 article for MSN MoneyCentral, "Roll the Dice on a Money-Losing Company."

In fact, our own recommended portfolio is built upon a judgment that people avoid risk to such a great extent that the stocks with the greatest degree of perceived risk are systematically undervalued.

So far, so good. The portfolio rose 1.5% yesterday, and with the recommended increase in margin is up 139% so far this year.

Our thinking is that the perception of risk is too great, and the swoon in the Nasdaq has been too great for Doc Greenspan to fool around with his usual Delphic pronouncements. We think he will dust off his pro-growth, pro-productivity, pro-innovation speech when he talks before the Senate Banking Committee today. Because he caused the market to dive the last few times he has been in the news, he will strive mightily today to say something bullish.

Losses and Wider Losses

After the usual tribute to loss aversion and regret, we can expect the market to continue higher. It's a roll of the dice in the short term. We do best to keep in mind Sir. Shackleton's motto: Prospice (look forward).

End Note: The current standings in our second Reader Picks Contest clearly show the line between risk and reward. The longs are down an average of 2%, while the readers are down an average of 4% on their shorts. The competition began Nov. 30 and ends May 31.

In the lead as of Monday night:

- No. 1: Roy H. Webb with Laser-Pacific Media Corp. (LPAC), up 71%.
- No. 2: Scott L. Burson's Varian Semiconductor (VSEA), up 62%.
- No. 3: Frank ("patents, patience, profits") Linet with Genelabs (GNLB), up 57%.
- No. 4: Our own Daily Speculations market psychologist, Dr. Brett, and daughter Devon, with Fair Isaac (FIC), up 45%.
- No. 5: Peter W. Portlas, with Integrated Device Technology (IDTI), up 33%.

On the short side:

- No. 1: Mr. Linet, again, with Emulex (EMLX), down 31%.
- No. 2: Mike Ott, a chemistry student who has enlightened us on the subject many times, with Incyte

(INCY), down 22%.

No. 3: Mr. Portlas, again, with Handspring (HAND), down 22%.

No. 4: Mike Mackenzie with Siebel Systems (SEBL), down 17%.

No. 5: J. Bernstein with Talbot's (TLB), down 4%.

Speculator's Scorecard				
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Dow	0.94	Up 1	1.5	2.3
S&P 500	1.20	Up 1	0.8	-2.5
Nasdaq	1.06	Up 1	0.8	-12
Europe STOXX-50	0.94	Up 1	-3.3	-3.6
Dollar/euro	1.20	Up 2	-1.1	1.4
Nikkei	Mkt Closed	Mkt Closed	Mkt Closed	Mkt Closed
Dollar/yen	0.78	UnChg	-3.1	-0.9
Gold	0.68	Up 1	-4.0	-0.6
Oil	1.00	Down 2	19	5.0
Bond Futures	0.67	Down 1	-0.2	1.9
2-Yr Note Futures	1.00	Down 1	0.6	0.1
Bund Futures	1.13	Down 1	0.8	0.8

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No Love Lost for Greenspan

By Victor Niederhoffer and Laurel Kenner

Columnists

02/14/2001 10:01 AM

What a difference when I measured my physical and moral existence of that first period with that of my later. I could hardly recognize myself as the same man.

--Casanova's Memoirs (1832)

Like Casanova, who used up his creative energies in ephemeral activities, Doc Greenspan has lost his ability to talk the market to where he wants it to go.

The market delivered its votaries a reverse Valentine's pattern yesterday, showing an inverted "V" during the last three days: down strongly on Friday, up strongly on Monday and down strongly on Tuesday.

Regrettably, after such a reversion, the Spec computers don't turn bullish until the end of the day.

Weak Evaluation of Economic Factors

The proverb, "If you sow the wind, you will reap the whirlwind" seems to cover the loss of credibility that Doc Greenspan has achieved. He listed a hornet's nest of reasons for the economy's weakness over the past year: consumer confidence, higher oil prices, weather.

But somehow missing in the self-evaluation was the Fed's raising of rates to unholy levels during 2000. As if a prime rate of 9.5% with inflation running along at 3.5% is not a damper on the economy. Even the perennially optimistic finance professor Dr. Mark M. McNabb was ready to throw in the towel.

"Seems the market distrusts an optimist, be it CEO or Fed chair," Dr. McNabb wrote from Blacksburg, Va., in a wireless transmission from his GMC pickup town car with the BMW seats. "If this market were a horse, it would stumble."

Based on the lessons of Casanova, we would advise the Doc to turn his attention back to the joys of the saxophone and clarinet, where he will be able to communicate inwardly and outwardly in the language of music rather than in the Delphic utterances he has grown accustomed to.

While this advice is different from the hagiographic idolatry accorded him at every turn by the Doc's biographers and the servile members of Congress, we are confident that in the long run, the satisfaction he and the market receives from it will be much more rewarding than the present course of dusting off the "Productivity is Good" mantra when the market is bad and "The Fed is the Silent Arbiter" speech when the market is good.

Too Tired to Tango

Like the Doc, Casanova, who among his other accomplishments founded the French lottery and developed the first fixed-income derivatives, ultimately blew his wad.

"I could not commit all the follies which she would, for I was no longer at the age of miracles," he admitted vis-à-vis an assignation with the beautiful Italian ballet dancer Nina Bergonzi, late in his life.

At this stage of his career, Casanova turned his attention to publishing a literary magazine, translating the Iliad into Italian, and conducting mathematical investigations into the duplication of the cube.

"It is while descending that the man who has passed his life among pleasures of the world is obsessed with dark reflections," he wrote in the memoirs. "Imagine, dear reader, what must be those which obsess me today, now that I am alone, despised, impotent and poor."

Of course, even at this stage Casanova was not immune to the strong emotions that romance aroused in him, and in the financial field he was still able to cause a general rise in the bourse with his purchases and information.

"Physician heal thyself" is another proverb that comes to mind. "Tell us," our readers often say, "more about how to profit from individual stocks right now" -- and less about Casanova, Cervantes, Cobb, Darwin, Einstein, Ewing, Fleming, Galton, Kipling, Melville, Rand, Shackleton and Shakespeare. (Although, to be fair to ourselves in one of our patented self-congratulatory reports, we note that for every demand for more pragmatism we receive a dozen communications lauding us for providing meals for a lifetime rather than a fish for a day.)

XOXO on Valentine's Day

Along these lines, we have examined the barren wasteland of insider buying in Nasdaq 100 stocks. Regrettably, well over 90% of the transactions in these stocks have been on the sell side. But one stock, XO Communications (XOXO), selling for 18 3/4, down from a March 2000 high of 66, has a massive preponderance of insider buying.

Directors Craig McCaw, Dennis Weibling, officer Nancy Goff and 10% beneficial owner Theodore Forstmann have within the last two months quietly accumulated some 645,000 shares. Better yet, XO, formerly NextLink, a purveyor of telecom services over fiber-optic lines, is our kind of stock. It lost \$1 billion in 2000 and is forecasted by Value Line to lose more than \$2 billion in 2001.

Our studies have shown that this class of stock has a highly superior return to the market. As with most such companies in the sweet spot of industry, whose revenue is generally expected to grow by a few hundred percent a year for the foreseeable future, the key query is whether it will run out of cash in the process.

Our confidence that they will land safely is increased by the indicia of commitment from the aforementioned eminent insiders.

Don't be surprised if, before long, we add this issue to our recommended portfolio, which sadly declined 0.5% yesterday, reducing our year-to-date profit to 138%.

Casanova often found it useful in his speculations to take quill to paper. "Beautiful Lia," he wrote in one of his later amorous adventures, "I am going to buy the horse (from her father) only to make you a present of him. If you do not accept, I leave. I place no other condition on my gift than the pleasure of riding with you when I wish."

In a similar vein, our former esteemed partner Mr. Wiz often finds it useful to leaven the cares of the speculative fray by addressing haiku to his brokers.

*Prices meander
But not to where you filled me*

I say "Time and Sales"

Speculator's Scorecard				
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Dow	0.89	Down 1	1.1	0.2
S&P 500	1.12	Down 1	-0.1	-4.0
Nasdaq	1.00	Down 1	-1.7	-14
Europe STOXX-50	1.00	Up 2	-3.0	-2.7
Dollar/euro	1.12	Down 1	-2.3	-0.7
Nikkei	0.78	Down 1	-3.7	-4.0
Dollar/yen	0.83	Up 1	-2.3	-0.8
Gold	0.65	Down 1	-4.1	-1.8
Oil	0.94	Down 3	18	4.5
Bond Futures	0.63	Down 2	-0.4	0.7
2-Yr Note Futures	0.94	Down 2	0.5	-0.07
Bund Futures	1.06	Down 2	0.6	0.3

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A Paradox? Get Papa

By Victor Niederhoffer and Laurel Kenner

Columnists

02/15/2001 10:03 AM

*A paradox, a most ingenious paradox.
We've quips and quibbles heard in flocks,
But none to beat this paradox.
A paradox, a paradox,
Ha, ha, ha, that paradox.
--Gilbert & Sullivan, The Pirates of Penzance*

In one of the most exciting, heartening and paradoxical days ever, the Nasdaq whirled around like a Wudan swordsman in the afternoon, running up walls and flying over roofs, after plummeting to new lows in the morning.

By the end of the day, Nasdaq 100 futures had risen 6% from their low to close up 4% on the day, the S&P had risen 1% from its low to close slightly down. The Dow was left defeated near its low, down 1% on the day.

And now, the paradox.

On one hand, the Spec computers are bearish. It was only the sixth time ever that the Nasdaq managed to rise more than 50 points while the S&P fell by a comparable amount. All six of the events occurred last year, and on five of those occasions, both indexes declined substantially in the next five days.

On the other hand, the Spec computers are bullish. On days where the market rebounds at the close from an earlier strong decline, the averages have a strong tendency to go up at the beginning of the day, meander around and then rise to much higher levels.

Plot Thickens

The paradox deepens because each result is highly significant in the statistical sense.

As to how to reconcile seemingly opposite forecasts of this nature, only a W.S. Gilbert would have the answer. Or Vic's brother, Roy. On such occasions, he would ask Vic whether he felt bullish or bearish. And then he would have the computer search through billions of events to pick out at least 50 that were bullish or bearish at the one-in-1,000 level, according to Vic's state of mind.

Under the circumstances, we turn to the timeless wisdom of the great American sages Ernest Hemingway for guidance as to the character necessary to confront vicissitudes. In a modern version of the Casanova-type personality we alluded to in our Valentine's piece yesterday, Hemingway gave this classic description of the successful risk-taker:

He had been admirably endowed for a speculative career because he had possessed extraordinary sexual vitality that gave him the confidence to gamble well; common sense, an excellent mathematical brain, a permanent but controlled skepticism; a skepticism that was as sensitive to impending disaster as an accurate aneroid barometer to atmospheric pressure; and a valid time sense that kept him from trying to hit tops or bottoms.

--Ernest Hemingway, *To Have and Have Not*

Previous Suggestions

On Jan. 18, we said we liked the semiconductor industry because of growth will be above average for the next several years. On Feb. 1, we recommended Conexant (CNXT) and Xilinx (XLNX), and on Feb. 5, we added Axcelis (ACLS) and Viasystems (VG) to our list. The four rose an average of 7% yesterday.

We now advise the sale of Usinternetworking (USIX), which gained 38% yesterday. The insider buying that contributed to our recommendation of it earlier this month turns out to have been options-related, and we see no reason to hold on.

Our portfolio now consists of the four semiconductor stocks mentioned above, and Borland (BORL), Chart Industries (CTI), Commscope (CTV), Petsmart (PETM), Techne (TECH) and Westell Technologies (WSTL).

How quickly the complexion of the market can change. At the lows yesterday, the Nasdaq and other markets looked like they were going to Davy Jones' locker, a most pleasing prospect for the old-hearted, whether in Nebraska or at the helm of the media.

By today's opening, the Nasdaq was about unchanged for the year. Semiconductors are soaring on the wings of Morgan Stanley's bullish guidance. Birds are singing and soaring on air currents outside the windows for the first time in three months. The market air smells of roses. And the market day by day sings its joyous roundelay, to paraphrase Gilbert.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	0.84	Down 2	0.1	-0.8
S&P 500	1.06	Down 2	-0.3	-3.7
Nasdaq	1.06	Up 1	0.8	-10
Europe STOXX-50	0.94	Down 1	-4.3	-4.4
Dollar/euro	1.06	Down 2	-2.5	-1.6
Nikkei	0.83	Up 1	-3.6	-4.0
Dollar/yen	0.89	Up 2	-2.2	-0.2
Gold	0.62	Down 2	-4.6	-2.3
Oil	0.89	Down 4	16	3.7
Bond Futures	0.60	Down 3	-0.6	-0.03
2-Yr Note Futures	0.88	Down 3	0.3	-0.4
Bund Futures	1.00	Down 3	0.5	0.1

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*, which is available [here](#).*

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Honing Your Investing With Better Tools, Part III

By Victor Niederhoffer and Laurel Kenner

Columnists

02/16/2001 10:14 AM

Brett N. Steenbarger, Ph.D. is a licensed clinical psychologist and periodic guest contributor to the Daily Speculations column. This is the third in a three-part series covering online resources and tools for active traders. This is the second in a three-part series covering online resources and tools for active traders. Click [here](#) for Part One. Click [here](#) for Part Two.)

Brief therapy is the art and science of helping people change problem patterns in a relatively short period of time. Unlike traditional psychotherapy, which may take months or even years to explore problems and their origins, brief therapy is highly focused and action-oriented.

Good brief therapists do not talk about problems with clients. Rather, they actively trigger those problems within sessions, giving people an immediate and powerful opportunity to face and change their patterns in real time.

Checking Yourself

Brief therapy is not unlike short-term trading. Both require the ability to detect and exploit subtle shifts in real time. Both draw upon the rapid processing of information under emotional circumstances. And both are skills that cannot be honed under time-unlimited conditions.

The worst way to become a good brief therapist (a good trader) is to learn long-term therapy (investing). If you have ever tried your hand at lightning chess after learning the game without time limits, you know the difference that time can make.

A number of online tools are available to assist short-term traders in rapid decision-making. Many are sophisticated databases and charting programs that attempt to organize large amounts of data into an actionable format.

As a short-term trader, it is nice to have institutional activity on your side. It is difficult, however, to evaluate the minute-to-minute activity of institutions across a universe of stocks. The Thomson I-Watch service (www.thomsonfn.com) addresses this need by continuously monitoring the buy and sell feelers put out by institutions. Significant activity is marked on a stock chart with blue (buy) or red (sell) arrows. Larger arrows denoted more significant buying or selling interest. The site identifies stocks showing the greatest interest each day and offers a sector-based view of where money is flowing on a short-term basis.

If, on the other hand, your desire is to determine where the herd is moving in the short-term, Ameritrade (www.ameritradeindex.com) maintains a daily index of the buying and selling activities of its traders. Jon Hoenig of Capitalist Pig fame (www.capitalistpig.com) uses this as a contrary indicator, much as one might analyze a put-call ratio. The site also identifies the stocks attracting the greatest buying and selling activity, allowing users to see where speculative activity is centered.

Those put-call ratios, by the way, are updated every half hour on the CBOE website (<http://www.cboe.com/Volumes/ViewHalfHourlyUpdate.htm>). I have found extreme intraday values for the equity options to be especially helpful in identifying short-term turning points. Values nearer the

mean appear to have less predictive significance.

Involuntary Actions

Several readers make use of the Ivolatility Web site (www.ivolatility.com), which monitors implied and historical volatility for major stocks. These volatility figures often spike during sell offs, signaling potential trading opportunities. Periods of waning volatility are often associated with intermediate-term market tops, as signaled by the site in October.

Daily Speculations reader Peter Daniels heartily recommends The Financial Café (www.thefinancialcafe.com) as a tool for honing one's daytrading skills. The site does not charge a commission for trades, allowing Daniels to trade as little as one share of stock at a time. This creates an affordable simulation, with greater emotional immediacy than simple papertrading.

A reader near to this author's heart, father Jack Steenbarger, reports success using the Vector Vest program (www.vectorvest.com) to aid in short-term stock selection. The program computes relative value, safety, and timing ratings for stocks and compiles the ratings into overall guidance for the broad market. Steenbarger indicates that "the benefits of this approach are that you are dealing with quality and taking advantage of momentum." He reports a 25% average return per year, while remaining in the market less than half of the time.

Interestingly, the Value Line service (www.valueline.com) can be utilized in a similar way, combining the well-known performance ratings with the lesser-known technical ratings. Founder and research director Samuel Eisenstadt points to the long-term track record of both rating systems, which attempt to place traders in the best fundamental stocks at the most favorable technical times.

Daytripping on the Web

Several readers, including Chris Guida, wax enthusiastic about the 3D Stock Charts site (www.3dstockcharts.com), which is a useful tool for daytraders. The site creates three-dimensional charts of the order books of ECNs, updating these each second. Another innovative charting display, the Market Carpet, is mentioned by Jon Markman. Available on the StockCharts.com site, it represents sectors and stocks as rectangles in a checkerboard display. These are color-coded to identify advancing and declining action, providing a vivid, shifting image of market strength and weakness.

Guida also recommends StockSmart (www.stocksmart.com) as a useful site for sector and industry research data, as well as information on individual companies.

Two innovative sites for short-term traders with a quantitative bent are the Market History site (www.markethistory.com) and Traderbot (www.traderbot.com). Market History employs a large database for data mining, identifying patterns in stocks that have been profitable in the past. Daily recommendations are highlighted as actionable ideas for trading. Traderbot describes itself as a kind of search engine for trading patterns, including many intraday patterns utilized by daytraders and swing traders. The program allows you to define your own patterns and then perform a screening search to identify all stocks meeting your criteria. Some of these patterns are quite fine, as in unusually wide bid-ask spreads.

It is likely that future online services will collate even greater amounts of information and package these in user-friendly ways. One reader calls attention to Codexa (www.codexa.com), which compiles online information on firms and markets and delivers these to fund managers and other sophisticated traders. Such programs can allow users to quickly summarize trends on message boards to determine speculative interest among active traders, follow news developments as they are breaking, and keep a finger on the

pulse of the online community.

The risk inherent in these sites is that traders can become data rich and information poor. The successful brief therapist is not the one who collects the most background on his or her clients. Rather, success derives from the ability to rapidly synthesize relevant information into meaningful patterns, a skill that comes from long-term immersion in one's craft.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	0.89	Up 1	1.0	-0.8
S&P 500	1.12	Up 1	0.5	-3.4
Nasdaq	1.12	Up 2	3.3	-8.3
Europe STOXX-50	1.00	Up 1	-3.1	-1.7
Dollar/euro	1.00	Down 3	-4.1	-4.1
Nikkei	0.89	Up 2	-3.3	-3.3
Dollar/yen	0.94	Up 3	-1.6	-0.1
Gold	0.59	Down 3	-6.0	-4.8
Oil	0.84	Down 5	12	-3.3
Bond Futures	0.57	Down 4	-1.3	-1.8
2-Yr Note Futures	0.83	Down 4	0.2	-0.6
Bund Futures	0.94	Down 4	0.1	-0.3

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Roll Out the Red Carpet for the Broken-Hearted

By Victor Niederhoffer and Laurel Kenner

Columnists

02/20/2001 09:31 AM

The 5% decline in the Nasdaq on Friday broke the hearts of many remaining tech bulls.

This was the sixth Friday out of the last seven that the Nasdaq got killed at the end of the week, and it made for a particularly discouraging remembrance over the weekend as the vivid decline cast a pall over all thoughts of innovation, research and growth.

And yet, as our readers know, this is just what the mistress of markets loves to do just before she rolls out the red carpet.

Friday Is Anyone's Game

Almost all the events similar to this one during the last six years were greeted with a nice opening the next day, a gut-wrenching decline to the middle of the day and then a beatific move back by the end, followed by grinding and a grudging climb back up the ladder to Thursday's close. By Friday, it will be anyone's game again.

Thus, there should be some great opportunity for the bulls to take out the canes and hobble down to Wall Street to make some profits during the recapitulation of the decline that's statistically in store for today.

The one caveat we would offer is that the variability of the expected moves over the next four days appears to be about 10 times the edge on the bullish side. In other words, there is a risk of serious injury to those trying to win the race at all costs after a week like this.

Stocks and Stock Cars

As we mourn the death at 49 of Dale Earnhardt, the greatest stock-car racer of his time, who did not heed this advice and tried to pass on the block of the curve of the last turn, it is appropriate to be mindful of the possibility of disaster for those who try to swing too high, whether in stock cars or the stock market.

With disaster and risk weighing heavily upon us, we revisited a lecture that our friend Ken Rendell delivered at the 125th anniversary dinner of the Appalachian Mountain Club. Ken contrasted the wisdom of Ernest Shackleton, who put survival above everything and ended with the greatest rescue voyage of all time, with George Mallory, the greatest climber of his day, who risked everything on a chancy ascent of Mount Everest in 1924 and died with his inexperienced partner, Sandy Irvine.

"If one should ask me what use there was in climbing, or attempting to climb the world's highest peak, I would be compelled to answer 'None,'" Mallory once told a newspaper interviewer. "There is no scientific end to be served, simply the gratification of the impulse of achievement, the indomitable desire to see what lies beyond that ever beats within the heart of man."

What a good thing to "copper," to go against, in one's market climbs. If you have an edge, a valid *idée fixe*, then the best thing by far is survival. Why risk everything without being prepared, when the mountain of the market will always be there for another chance?

Perception and Deception

"Best free advice I have ever read: 'Never, never bet the house,'" said Shawn Andrews, one of the greatest hedge-fund operators of our day, immediately weighed in from Vegas, where he manages the portfolios of many of the owners and major entertainers there. "Every time you think your perception of the market is reality," he added, "remember the cybernetic definition of an illusion: any observation or observations in which the observed has no doubt that his/her perceptions represent reality."

Under the circumstances, we are not going to recommend an increase in the margin of our portfolio from its present level of 125% of net worth. Our own recommended portfolio is up 3.5% since Feb. 13, including a 4% drop on Friday, bringing the total profit year to date to 141%.

However, XO Communications (XOXO), which we were eyeing last week "because it was there" with massive insider buying and an 80% swoon from its high, is too rewarding for us to pass up. And we hereby recommend climbing the summit to 8,000 feet by adding it to the portfolio, rebalancing within the existing supplies.

With the thought of George ("higher in the sky than imagination had dreamed, the top of Everest appeared") Mallory in mind, we will refrain from recommending two issues brought to our attention by intrepid Baltimore stockbroker Tim Melvin, Prime Retail (PRT) and Galey & Lord (GNL). Both of these are our type of stock.

Hopefully, our readers have for us the same "hope in their hearts and trust" that Shackleton's men accorded to him during his life. Whatever regrets our readers may have from not attempting to reach the pole or the mountaintop, the first prerequisite is not to lose life. However, do watch them closely for a change in the weather.

Taking one consideration with another, the best advice is to leave yourself a safety net.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	0.85	Down 1	0.1	-0.6
S&P 500	1.06	Down 1	-1.4	-3.6
Nasdaq	1.06	Down 1	-1.8	-8.8
Europe STOXX-50	0.95	Down 1	-5.5	-3.8
Dollar/euro	1.06	Up 1	-2.8	-2.0
Nikkei	0.84	Down 1	-4.4	-3.9
Dollar/yen	1.00	Up 4	-1.5	0.0
Gold	0.64	Up 1	-4.9	-3.2
Oil	0.89	Up 1	14	-6.6
Bond Futures	0.62	Up 1	-0.8	-0.6
2-Yr Note Futures	0.89	Up 1	0.5	-0.1
Bund Futures	1.00	Up 1	0.3	-0.2

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*, which is available [here](#).*



A Little Symphony for Net Investors

By Victor Niederhoffer and Laurel Kenner

Columnists

02/21/2001 09:59 AM

What is the nature of the heroic experience represented in Beethoven's music? The short answer usually invokes the necessity of struggle and eventual triumph as an index of man's greatness, his heroic potential.

--Scott Burnham, "Beethoven Hero"

The market, like one of those heroic Beethoven symphonies that dramatize the human experience, was beset by *leidensnotwendigkeit* (the necessity of suffering) yesterday, and today is ready for *uberwindung* (overcoming) after a severe down open.

The suffering was great. The Nasdaq 100 fell 5% yesterday, bringing the loss from Thursday's close to 10% in just two trading days. Twenty of the Nasdaq 100 stocks declined wider than 10% yesterday, with Qlogic (QLGC) bringing up the rear with an 18% loss.

Weak Internet Index

The Philadelphia Semiconductor Index lost 7% for a second consecutive day, after VLSI Research changed its forecast for 2001 chip sales to just 1.2%. The original estimate was for 11%, and VLSI cut that to 5% just last month.

In the Internet sector, Covad (COVD) -- a digital subscriber line company that last year sold as high as 66 -- yesterday declined 43% to 1 5/8. Its market value stands at \$290 million, down from almost \$10 billion last year, providing an object lesson in the dangers of unbridled enthusiasm.

The Interactive Week Internet Index, which was up 47% on the year on Jan. 24, is now down 15% for the year.

Thank goodness we sold 94% of our Internet holdings last month near their highs of up 80% on the year, and recommended that readers do the same. If we hadn't, we might not have the luxury of reporting that our portfolio of recommended stocks lost 4% yesterday, bringing the gain to date for the first two months of this year down to 136% when taking account of the recommended margin.

Fortunately, we also have the luxury of looking forward and forecasting, rather than describing from the armchair what happened yesterday or trotting out some mediocre mutual fund manager to declaim on why the expectations concerning earnings were too high when the market goes down.

Fine Finn Friends

We would prefer to point to the 38% decline in Finland year to date to assuage *Schadenfreude*, the unholy joy that Europeans of an envious nature take in the fall of the mighty regardless of how it affects them.

We do not have to turn to a mutual fund manager for an explanation either, but can resort to the only newspaper that Vic reads, the *National Enquirer*. The current issue reports that in Finland, the penalty for a speeding ticket is based upon income. A wealthy motorist recently was fined \$40,000 for a speeding ticket there.

Extending the reasoning, we believe that excessive tightening by the Fed last year, and the refusal of the vox populi to rebel against the excessive amount of chips absorbed from their lives by governments, is the main cause of the current market decline.

At times like these, our readers are much more interested in a meal for a day than a meal for a lifetime. We will therefore avoid theoretical discussion, and merely advise buying some more beaten-down stocks like those in our recommended portfolio. The Spec computers are declaring that after two large declines of the nature just witnessed, the market is ready for some serious *uberwindung*.

We note that the balance of insider transactions in Xilinx (XLNX) has shifted to the sell side, removing one of the reasons we recommended buying the stock. We therefore advise selling it.

Can't Beat Beethoven

The suffering and overcoming theme that most clearly resembles the present came out on Jan. 3, the first trading day of the New Year. The market dropped some 35 S&P points that day, following an 18-point drop on the last day of 2000, with proportionately greater swings in the Nasdaq. The move the next day, up 59 points in the S&P, the greatest of all time, is quite in line with the expectations of the Spec computers.

Looking at the 15 most similar examples of *leidensnotwendigkeit*, the SP overcame and was in the black on 14 of these 15 occasions six days later, with an expectation of 4%, with a variability of half that amount.

We recommend listening to the Third Symphony of Beethoven as a backdrop for trading today.

Unfortunately, days like Oct. 27, 1997, when the market got killed, also cropped up on the printouts. Under the circumstances, prudence is called for, and it would be well to heed the lessons in survival from the expeditions of Shackleton and Mallory reported yesterday.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	0.85	Down 2	-0.52	-2.1
S&P 500	1.06	Down 2	-3.2	-5.5
Nasdaq	1.06	Down 2	-6.1	-12.8
Europe STOXX-50	0.95	Down 3	-8.5	-6.8
Dollar/euro	1.06	Up 1	-2.9	-2.1
Nikkei	0.84	Down 1	-4.9	-1.3
Dollar/yen	1.00	Down 2	-2.5	1.8
Gold	0.64	Up 1	-5.6	-2.2
Oil	0.89	Down 1	12.9	-4.6
Bond Futures	0.62	Down 1	-0.9	-0.7
2-Yr Note Futures	0.89	Up 1	0.5	unch
Bund Futures	1.00	Down 2	0.2	-0.2

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Market Rolls Over Instead of Beethoven

By Victor Niederhoffer and Laurel Kenner

Columnists

02/22/2001 09:52 AM ·

The market played Beethoven's Third Symphony yesterday, but got caught in the Funeral March of the Second Movement on the way from suffering to overcoming.

The S&P 500 and Nasdaq 100 futures sank to two-year lows. S&P 500 futures dropped 2.2%, bringing their loss over the past three days to 6%, and are now at October 1998 levels on an adjusted, continuous contract basis. Nasdaq futures fell 2.8%, and their three-day loss comes to 12%.

All the better time for the triumphant Third Movement to come. After three consecutive declines of this magnitude, the odds are vastly in favor of a triumphant finish to the week.

The fate of Ciena (CIEN), last year's best Nasdaq 100 performer, illustrates the horror of the three-day decline. A week ago, Ciena raised its estimate for 2001 sales, a rarity in the Internet-equipment industry these days. Ciena's gear works in both old and new networks and so is in demand despite the economy's slowdown. Better still, Ciena is said to be gaining an edge in the market for optical switches, the next phase of telecom technology.

If ever there were a growth stock to be long in, Ciena would have seemed to be it. Unfortunately, the market mistress put it on her short list. After gaining 28% on Tuesday and Wednesday, Ciena proceeded to drop 20% in the last three days. One moral: Never buy a stock that is already up more than 20%.

We are partial to growth stocks like Ciena, but only after they've been knocked down so far that even the insiders are starting to buy them. So we are relatively pleased to report that our own recommended portfolio didn't fall as wide as the market in general yesterday. A 1% loss, at 25% margin, brings our year-to-date return to 135%. (We removed Xilinx (XLNX) and added XO Communications (XOXO) as of yesterday's close, as recommended in [yesterday's column](#).)

The Bright Side of a Panic

One of the virtues of a market panic like we have witnessed during the last three days, besides the opportunity to listen to the heroic symphonies of Beethoven for moral and artistic sustenance, is the decline of many good stocks. We are partial to Value Line Group 2 stocks that have insider buying and are selling for less than \$10 a share.

This class of stocks, according to our preliminary estimates, shows an average return of some 10 percentage points a year above that of the average stock. Three of the stocks on our current recommend list -- Chart Industries (CTI), Petsmart (PETM) and Westell Technologies (WSTL) were selected according to these criteria.

The problem with most of the companies in this class this year is that they have already appreciated to an extraordinary degree.

However, one stock, Aviall (AVL), currently selling at 7.21, is our type of stock. It sold for as much as 9.44 in 2000, 19 in 1999, 16 in 1998 and 17 in 1997. It has nice insider buying, and it's ranked Group 2 in timeliness by Value Line.

Oh, yes, it's the world's leading distributor of aviation parts and supplies, with some 42 million items in an Internet-based procurement system for its customers. Earnings are projected to grow by some 20% this year.

The last insider transaction reported was the purchase by director Bruce Whitman of 5,000 shares on Dec. 8 at a price of 5 1/8. (How do they always seem to know?)

Aviall has one other thing going for it. Through a wide range of plant and animal species, there is a constant ratio of such early tells as age of weaning to ultimate life expectancy, or weight at birth to ultimate weight. We apply this reasoning to the administration of W.

If, within his first two months in office we have already bombed Iraq for warning and retaliation, think of the likely number of such sallies that we can expect for the entire term. And with the public's love and unilateral support for all such maneuvers, we might anticipate projecting this number over an eight-year time period, rather than a mere four.

All things considered, we're putting Aviall on our watch list. Another buck or so down, and don't be surprised to see it added to our recommended list.

Follow the Insiders

Along these lines, we were pleased to note that Mr. John Seazholtz, a director of Westell Technologies (WSTL), bought an additional 2,000 Westell shares on Jan. 2, bringing his holdings up to 7,000 shares. Our admiration, but not our joy, was increased, however, when we noted that he bought those 2,000 shares at a price of 3.32, just 20 cents above its all-time low of 3. We can only hope that Mr. Seazholtz's prescience in giving advice to the company is matched by his acumen in purchasing its stock. Westell currently sells for a bit under 5.

It's true that there have been only 15 occasions during the last three years where the market has declined 10 S&P points three days in a row, and that the market was up seven days later on 13 of these occasions. It's also true that there have been only three times when the market declined 15 or more S&P points on three consecutive days, and the market was up substantially a week later, with the expected move 7%.

But we are mindful of the lessons to be learned from the life of Shackleton, enumerated in our [Feb. 20 column](#), as well as those from the recent death of racecar driver Dale Earnhardt, reported below.

Thus, just when we should be throwing caution to the winds and doubling up, we're going to maintain our recommended exposure at a mere 25% above equity. We suggest a stop loss if the portfolio value, currently at 235, should fall below 180.

We believe we have an edge. And as our mentor Irving Redel likes to say, "The market will always be around another day. Survival is key."

Therefore, in light of the uncertainty embedded in all such predictions, and particularly after the extraordinary string of declines seen the past three days, we find it appropriate to share reader Tim Melvin's thoughts on lessons from Earnhardt:

Even the greatest can be wiped out in the blink of an eye. No matter how good or great you are at your sport, be it racing or trading, the next wipeout is always seconds away.

Enjoy each victory, each competition, each day. . . life ends suddenly.

It is a game of inches sometimes. A six-inch change in the angle, he would have gone into the wall, had a headache and walked away.

And a final one: chase your dreams as hard as you can as long as you can. Think about Earnhardt, an eighth-grade dropout in a Carolina mill town, and a recipe for trailer trash if there ever was one. But he was great at one thing: building and racing cars. He focused on that and was the best he could be at what he chose. He didn't worry about what he couldn't do, but focused on what he could do. He worked at it, was single-minded about it, took huge risks to achieve his dreams and when he died the President called his family to express condolences. Earnhardt had created a multimillion-dollar business that he passes to his son. Not bad.

A beautiful post that should be framed and on every trader's desk.

As we have been much occupied with the subject of risk lately, we were glad to receive this perceptive query from a reader, particularly because he was kind enough to compliment our work:

Having recently discovered your postings both on Worldly Investor and MSN, I have been busy reading all of your past columns with the overriding sensation of fresh air and pure, clean water amid the usual offering of dreck that so proliferates Internet financial journalism.

I read somewhere in your musings that you believe risk is underrated and underused by investors and something about the aversion to risk being a handicap, not a safety net. Maybe you can expound on that in a future column, as I have often felt that way myself, but have no empirical evidence to back it up and in fact, have always felt my affection for risk in portfolio management was a remnant of the debauchery years of an earlier life.

Since you seem to advocate only strategies which are backed by some objective proof in their making, your dealing with investment risk as something other than merely another four-letter word would make a fascinating foil against the backdrop of a Nasdaq sinking into an abyss of great opportunity.

Allan P. Harris

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	0.77	Down 3	-2.4	-3.8
S&P 500	0.95	Down 3	-4.9	-6.4
Nasdaq	0.95	Down 3	-8.2	-13
Europe STOXX-50	0.82	Down 4	-8.1	-5.5
Dollar/euro	0.95	Down 2	-3.6	-2.5
Nikkei	0.81	Down 1	-5.0	-2.0
Dollar/yen	0.90	Down 2	-2.5	-0.5
Gold	0.70	Up 1	-5.0	-1.8
Oil	0.81	Down 2	12	-8.4
Bond Futures	0.64	Down 1	-1.2	-1.0
2-Yr Note Futures	0.94	Up 1	0.5	-0.04
Bund Futures	0.95	Down 2	0.05	-0.8

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*, which is available [here](#).*

Laurel Kenner is a financial writer in New York City. Formerly head of US stock market coverage at Bloomberg News, she previously reported on police, politics and aerospace during her 17-year news career.

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Book Leaves More Q's Than A's About "Q"

By Victor Niederhoffer and Laurel Kenner

Columnists

02/23/2001 10:08 AM

(Editor's Note: Filling in for the Speculators today is bond expert Paul DeRosa, Ph.D., with a review of Valuing Wall Street, a new book by Andrew Smithers and Stephen Wright.)

In the mid 1960s, James Tobin and his colleagues at Yale tried to develop a body of research on the role of the capital markets in the US economy, a surprisingly underdeveloped subject at the time. It was Tobin's essential premise that the capital markets are, in effect, a large price-discovery device continuously dedicated to putting a dollar value on the nation's stock of physical capital.

Tobin extended this thought into a theory of capital investment by amplifying a more or less off-hand comment of J.M. Keynes, to the effect that if corporate managers could add capital equipment to their business at a price less than that for which they could sell it to the investing public, they could increase the wealth of their existing shareholders by doing it.

Tobin derived a general arbitrage theory of capital investment. He assumed the best available valuations of businesses were those made by free markets, and when the market value of all claims on the earnings of a business -- essentially its stocks and bonds -- exceeded the cost of building that same business from scratch, its managers had an incentive to expand and would invest. Tobin formalized his theory to the extent of defining a ratio of the market value of capital to its reproduction cost and calling that ratio "q."

Practice Doesn't Make Perfect

Tobin himself never did much to test his theory against the data, but several of his students and other economists did. In general, they found that despite its many attractive properties, the q-theory didn't explain the cyclical pattern of capital investment particularly well.

In practice, q had several measurement problems. Only a fraction of American business enterprises are publicly traded, and it isn't clear that the valuable components of every business can be expanded upon demand. After a flurry of research activity in the early 1970s, interest in q waned, and it assumed something of the status of a siren, always compelling but never delivering.

Most recently, the economists Andrew Smithers and Stephen Wright have rejuvenated interest in q by inverting Tobin's thinking in an interesting way. Where Tobin used the capital markets to place a value on the capital stock, Smithers and Wright, in their book, *Valuing Wall Street*, claim the capital stock can be used to evaluate the stock market.

Their argument rests on a body of recently developed evidence revealing that the q ratio has fluctuated around a stable average for the past 100 years. This observation establishes q as a mean reverting series -- movements well above or below the average are inevitably followed by a return toward the average, and the central tendency of q is more or less the same from one decade to the next.

Adjustment Issues

Moreover, the observation that capital investment is not powerfully motivated by q suggests that the denominator of the ratio -- the capital stock valued at its cost of construction -- is relatively stable. It must therefore be the numerator, which is dominated by the value of the stock market, that does most of

the adjusting when q reverts to its mean.

If true, these observations are a fountain of wisdom, and stock-market investors can materially improve investment returns by following q , which is now computed and published by the Federal Reserve. When the ratio is well above its average, stocks are too expensive and should be avoided. The reverse is true when q is below average.

Smith and Wright sell their argument by demonstrating that investors, using trading rules based on q , would have outperformed a buy-and-hold strategy by several percentage points over long periods of time. They outline their entire strategy and present the supporting evidence in the first 120 pages of the book. The remainder they dedicate to attacking buy and hold, principally by revealing the risks it holds for the average investor, and to arguing that their approach is not just sound but also consistent with a properly nuanced understanding of market efficiency.

Through this combination of deductive reasoning and scientifically organized evidence, Smithers and Wright have produced a book that represents a minor landmark in the popular investment literature: two economists who understand and are sympathetic to efficient markets are offering a systematic assault on the random walk theory of security price movements and on its corollary, the buy and hold investment strategy.

Some Convincing to Do

Whether they are, in fact, correct is another matter. Their evidence isn't very impressive, and their arguments for the plausibility of q are less than convincing.

Yet the case argued by Smithers and Wright has enough weight to cause many investors to reconsider their allegiance to buy and hold. At the same time they provide a first-rate survey of the best of modern finance theory as well as a wealth of empirical evidence regarding the outcome of various investing strategies. It would be a rare reader who didn't find something of value in their book.

The world of academic finance has for some time been a source of cognitive dissonance. While the professional journals were filled with articles on the random nature of asset prices, several of the more able people in the field were drifting away into asset management. Smithers and Wright reconcile this contradiction by laying out the accumulated evidence against random walk. Most of it is not original to them, but it previously had been accessible only to readers with a fluency in mathematics.

Smithers and Wright also contribute, indirectly, to the debate over privatization of Social Security by modeling the returns available to participants in a systematic savings plan.

Wall Street has sold buy-and-hold by emphasizing the stability of long-term returns, but very few investors have horizons of the required length. As Smithers and Wright point out, even the natives who sold Manhattan for \$24 could have bought it back at a profit had they been able to buy equities and leave them untouched for three-and-a-half centuries -- but they couldn't.

Lumped Together

A more realistic program might be one in which participants invested a given amount into equities for each of, say, 30 years and then retired on the lump sum. It turns out that returns to such a program have been far from stable, fluctuating between 1.3 times the value of aggregate contributions and five times contributions. The unlucky savers who retired in 1974 saw the inflation-adjusted value of their accumulated saving fall by 58% in the last two years of their program, while the lucky bird who retired in 1964 had five times his contributions.

These figures might dismay advocates of Social Security privatization, who point to the apparent stability of equity returns as the solution to the pension crisis. They can take some heart, however, in observing that Social Security is such a bad investment for all but the lowest wage earners, most retirees would have been better off in equities in all but the worst years.

Regardless of its interesting elements, *Valuing Wall Street* must ultimately be judged on whether or not q is a reliable guide to valuing equities. Here, unfortunately, it fails on both the empirical and the theoretical levels. Regarding the empirical evidence, the data presented by Smithers and Wright show that investors who strictly followed q and owned equities when q was beneath its long-term average, and therefore indicated stocks were undervalued, and who held cash when q was above its average, over the course of the last century, did about as well as the buy and hold investor.

The q -investor would have been safely in cash during some of the century's worst bear markets, like 1929-30 and 1973-74, but he would have had his nose against the pane throughout the bull market of the 1990s. He might also have experienced somewhat less volatile returns, but it isn't clear by how much.

Cobbling a Pair Together

Smithers and Wright improve upon this performance by cobbling together a pair of trading rules based on q . These rules do produce materially better results, but they are poorly motivated and have the feel of arbitrary data mining.

On the theoretical level, a skeptic might fairly ask that if q is truly a measure of value, how does a market as efficient and competitive as the equity market ever wander as far from fair value as the q time series suggests?

Smithers and Wright attempt to address this problem by arguing, convincingly, that markets are efficiently priced because speculators keep them that way, and the degree of remorselessness with which speculators perform this function depends upon the uncertainty involved in valuing the underlying asset.

In forward foreign-exchange markets, the equilibrium spread between spot and forward rates can be calculated with perfect certainty to the fifth decimal place. As a result, deviations from perfect pricing of more than a fraction of a mil are never observed. In the mortgage market, on the other hand, the value of 6% FNMA versus 7% FNMA, or of 7% GNMA versus the five-year Treasury is probabilistic at best.

Speculation involves greater risk and speculators proceed with greater circumspection. In noisy markets, valuations can get bumped substantially out of shape before enough speculative interest is aroused to put them back into line.

Piggybacking to the Piggy Bank

Smithers and Wright argue that the equity market is incomplete because it lacks stabilizing speculators. They claim the natural players of that role are the managers of the large mutual and endowment funds, but these managers have an economic incentive that deflects them from providing the service.

The fund managers are personally paid on the basis of performance relative to the market, which arrangement, according to Smithers and Wright, transforms them into piggyback speculators instead of stabilizing ones. Rather than damp the market's fluctuations, they aggravate them. This arrangement leads to an equity market that can depart from fair value and stay there for surprisingly long periods. The heart of Smithers and Wright's advice to investors is that by following q they can profit from dislocations caused by fund managers. They will buy cheaply, sell dear and live happily ever after.

The weakness in Smithers and Wright's case is found in the range over which the q ratio has fluctuated. According to the data in *Valuing Wall Street*, equities have spent several years undervalued or overvalued by as much as 70%, without attracting hordes of speculators from outside the ranks of fund managers. Such a situation is not so much impossible as it is implausible. Anyone familiar with the world of high-octane investing knows there are large, mobile pools of capital searching the globe for mispriced markets, and they don't need five years to find one that truly is worth 30 cents on the dollar.

An alternative explanation is that speculators see these opportunities but are unwilling to commit enough capital to restore proper valuation because trading against the market involves risk. Aggressive investors who calculated their q-ratio in 1997 and sold equities short were probably bankrupt by the end of 1999.

They might have been mildly gratified by the knowledge that q was twice its equilibrium value, but in the end that knowledge wasn't worth much. Less aggressive investors who didn't short the market but simply went to cash did not confront bankruptcy but did endure a long period of poor performance.

The fact that q is a mean reverting series suggests these investors will eventually be vindicated, but the operative word here is eventually. Thoughts such as these as well as other observations from within *Valuing Wall Street* suggest q has a measurement problem, which causes it to signal greater deviations from fair value than in fact occur.

Whether or not the problem is surmountable is something for future research to decide. One suspects there will be a good deal of work on this subject in the next couple of years. Smithers and Wright have produced a provocative new approach, which will almost certainly be followed by others.

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Nikkei	0.77	Down 2	-5.2	-0.5
Dollar/yen	0.95	Up 1	-2.4	0.0
Gold	0.74	Up 2	-4.8	-0.6
Oil	0.86	Up 1	13	-8.4
Bond Futures	0.61	Down 2	-1.3	-1.1
2-Yr Note Futures	1.00	Up 2	0.6	0.1
Bund Futures	0.90	Down 3	-0.02	-0.5

(Paul DeRosa began his career in the securities industry as the money market economist in Citibank's bond trading division. He later became the bank's chief proprietary bond trader and subsequent was named head of Citibank's financial derivative and capital markets businesses in North America. In 1986, Dr. DeRosa joined E.F. Hutton Co. as co-head of bond trading with particularly responsibility for mortgage trading and finance. In 1989, Dr. DeRosa helped to establish Eastbridge Holdings Inc., a bond and currency trading company in New York, where he eventually served as CEO. Dr. DeRosa holds a Ph.D. in economics from Columbia and has served as a staff economist for the Federal Reserve

Bank of New York.)

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The Old Man and the Market

By Victor Niederhoffer and Laurel Kenner

Columnists

02/26/2001 09:21 AM

This is what we waited for, so now let us take it.
Ernest Hemingway, *The Old Man and the Sea*

The old man woke at 2:30 a.m. on Friday and turned on the screen. "Hades," he said. "The NASDAQ is down again. It has fallen five days in a row, and is already down 7% for the week. Why did Sun (SUNW) have to warn when I am long?"

Far away, the waves crashed. He had been dreaming of the young bulls on the beach again. They swam in from the water and played along the sand, splendid and strong.

"It is seven Fridays now that the market has been down, and it looks like it will open down again," he said aloud. "I hope that the Motorola (MOT) forecast is good. After this much of a decline, there will be many weak longs, and if the Motorola call is bad, the market will be limit down and that will cause liquidation."

The old man pulled on one of his socks.

"I wish Laurel were here," he thought. "She has a portfolio of good stocks and is not on margin. She is never bothered by a market decline because she buys for the long term. I do not feel like writing when the market is down this much in a week, and she could write the column herself. But she is asleep in New York."

The old man watched the screen until Germany and France opened. "Good. They are opening strong. Now the S&P and the Nasdaq are up. Perhaps it will not be a bad day after all. The S&P has already gone down 10% from its high this week, and that is enough."

He tapped a few keys on the computer keyboard. "Half of the companies on the Nasdaq 100 have declined more than 60% of their high of the last year. There is no need for any further declines. But the market is going down."

He watched the headline as it crossed the screen. "Motorola Business in Free-Fall, President Says."

The overnight market heaved lower like a ship run aground. The old man watched the monitor. "Now they are running the stops before the market opens. If they keep this up it will go below the lows of yesterday when the S&P fell to 1230 and then rallied. Don't go down any further," he told the market. "Hold the lows and steady the course."

He remembered the time the market went down on Friday, Oct. 16, 1987, when he had been long. In the afternoon, there had been a rally, and he had sold out.

"I hope this isn't the killer," he said. "No, it's bullish when the market has three big down days in a row, like it was on Wednesday."

But Thursday was a rise, he recalled. Why did Thursday have to be an up day?

"If you were going to be up on Thursday, why did you only rise 1 point?" he said to the screen. "But you were still down from the open on Thursday. Maybe Thursday should be counted as a down day."

The light began to come in through the windows. "I can hope it is oversold," he said to himself. "Many times the market opens down on Friday and then goes straight up. It went down early Thursday, and it looked like the end. But then it rallied. The small traders will be afraid to buy at the open on Friday, thinking it will be like Thursday, and then the market will go up."

Thank goodness I can rely on psychology and counting to help me decide what to do, he told himself. "Else I would be easy prey for the sharks, who smell when you are bloody."

Laurel called at 7:30 a.m. "I will finish the column," she said. "You will need to watch your positions. Trade, old man."

"Yes," he said. He looked at the screen. The line representing the cumulative orders of 100,000 traders lit up and began working its way down.

"I'll play it for a rally," he said. "Good. The NASDAQ is rising to almost unchanged. I'll place a few limits at 2031. They have risen to that level twice and then failed. The round number will not hold. Yes. Take it, it's good."

The wire rang. His broker confirmed a sale.

"I have now sold 125 NASDAQ. Now you can do whatever you want, NASDAQ, because I am not long, and you cannot hurt me."

I should sell the S&P, he thought. Too late, now it's going down. It looks like it will hit limit down again. If it rallies, I will buy some puts and sell some futures to balance my position. Here it goes: 1230, 1235, 1240.

The old man picked up the phone. "Buy some December puts," he said. "Put out a line of sales in the minis."

They will not know it is me selling there, he said to himself. At least they cannot refuse to trade with me there when I am first, and they cannot take down any prices if they do not like the fill. No one can say that he was offering below me there.

The broker called again with confirmations.

"Now I am short," he said. "Go down, market. You cannot hurt me any more. And when you come back up, I will not let you throw me over."

At 1:30 p.m. it looked like the end. Stocks went down just like they did in Oct. 16, 1987, and April 14, 2000. S&P futures fell 40 points to 1217. The old man opened an e-mail from his broker. "I had a nightmare that the market was down 10% and the exchanges closed," it said. "Keep me posted on what you are doing."

"It must be a bottom," the old man thought. "But I am short."

Just then a 5-foot Angell fish jumped out from his cubbyhole at a large firm. The fish said the Fed would probably cut rates next week.

The market began to rise. "But it couldn't do what it did on Thursday and rally 35 points," the old man told himself. "I better put out some more short lines just in case."

The market rallied 20 points. And then another 20. Again and again it cut through the old man's short lines.

"Market, you are doing the right thing at the wrong time. Please go down so that I will not lose what I caught early in the day."

When futures and options trading closed at 4:15 p.m., the old man kept watching the screen for a moment. The sharks had come and feasted on his catch. He was exhausted and hungry, but alive.

He slept for three days. When he woke up, he said, "They beat me, Laurel. The market truly beat me."

"The market didn't beat you, Vic. You did what you had to do to survive."

"The market is very big and hard to guess. How did you do?"

"I bought at the bottom, Vic. I picked up some U.S. Steel (X) and Stillwell Financial (SV) and Lucent (LU). The banks would not lend to Lucent unless it had a good plan."

"Very good. I should pay more attention to what you do."

"Tomorrow will be another day. The market is opening very high, and it will fill the gap of the previous open and then the gaps before that."

"Bring me the computer output so that I can tell the readers which way the market will go," he said.

"Yes, it is bullish when it does that after a big down week."

"You must not be too hard on yourself. You are there for other times."

As Laurel left to study risk for a Tuesday column, the old man was sleeping. He was dreaming about the bulls that would be coming soon.

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Nikkei	0.82	Up 1	-3.9	-1.3
Dollar/yen	1.00	Up 2	-1.8	1.4
Gold	0.78	Up 3	-3.9	0.3
Oil	0.90	Up 2	14	-6.0

Bond Futures	0.65	Up 1	-0.8	-1.2
2-Yr Note Futures	1.06	Up 3	0.7	0.1
Bund Futures	0.95	Up 1	0.2	-0.6

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*, which is available [here](#).*

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Good Rallies Aren't Built in a Day

By Victor Niederhoffer and Laurel Kenner

Columnists

02/27/2001 09:19 AM

*Still have I borne it with a patient shrug
For sufferance is the badge of all our tribe.
--Shakespeare, The Merchant of Venice.*

Following a hiatus of almost two months after the spectacular rally of Jan. 3, the market finally registered a strong, sustained move up yesterday. The Nasdaq rose 2% to 2,100, up almost 10% from its low on Friday. The S&P 500 rose 26 points. The Dow rose 200.

The advance was broad and dynamic. Some 13% of the Nasdaq 100 rose more than 10%, led by such former giants as Abgenix (ABGX), up 24%; i2 Technologies (ITWO), up 20%; and Millennium Pharmaceuticals, up 17%. The leader in the Dow, Home Depot (HD), rose 9%, followed by the venerable duo of DuPont (DD), up 6%; and Microsoft (MSFT), up 5%.

Our own recommended portfolio did not stay aground in the lifting tide. Two of our stocks, Axcelis Technologies (ACLS) and Techne (TECH) rose more than 10%. The portfolio rose 3.6% on the day, and is up 0.6% since we last reported it on Wednesday, with a year-to-date gain of 136%.

The last time the S&P had managed to rise even 10 points was on Feb. 15. Thus, five long trading days had gone by without a drink. Such lapses are always highly bullish, and during such times it is always good to remember that patience is a virtue.

Bring On the Computers

Of course, there's nothing as terrible as subjecting a nice plausible theory to a test with data. For the benefit of those readers who are interested in a meal for a lifetime rather than a meal for a day, we hauled the Spec computers out from the woodshed, where they always end up after a sustained decline.

We posed this query: If the market has spent five or more days without going up more than 10 S&P points, what is the expectation, O Computer?

It answered in a synthetic voice: "Master, the expectation is that it will go up 3 points a day, with a 60% chance of a rise, and an average variability of about seven times that level. Remember that Rome was not built in a day."

After we promised to remember Rome, the computer added that the market has managed to show great strength three days in a row in the afternoon as hopes of a Fed rate reduction fanned through the grandstands.

"Be wary that this hope does not lead to excessive enthusiasm," it said, "especially during the last two trading days of the month, as the Fed likes to pretend it is independent of the stock market."

Patience is a Lamberg

In line with our theme of patience, we turned to a naturally patient man, John Lamberg, who lives in

Minnesota, land of 10,000 frozen lakes. As he is one of those who is a natural for markets as well as his own field of communications, where he holds some eight patents, we asked him to educate us.

Mr. Lamberg was equal to the task, having been studying up on ice safety as he, with everyone else in Minnesota, waits for that glorious May day when fishing season opens again. Inspired by our column yesterday on The Old Man and the Market, he assured us that ice lore holds lessons for market fisherman as the thaw at the Fed proceeds.

At the moment, the lake ice is treacherous. Minnesotans who venture out on the lake in snowmobiles or cars know survival depends on knowing the hidden properties of ice. Even if ice is a foot thick, for example, it can be one inch thick just a few yards away. "It's impossible to judge the strength of ice by its appearance," a safety expert warns.

Just so, the market can't be fathomed by looking at charts and trend lines.

The strength of ice depends on a combination of factors: the depth and chemistry of the water, the size of the lake, the currents, and the distribution of the load on the ice. Snowmobiles need 5 inches of good, clear ice.

A Necessary Quotient

And so it is with the market. If you invest in size, you need underlying liquidity.

It's possible to drive a light truck out on the lake, if the ice is at least 8 inches thick. But safety experts say it's important to keep the windows rolled down, just in case a quick escape is called for. A plunge into icy water will take the breath away, and become painful in less than two minutes.

Fortunes have been lost in less time. It's therefore wise to have an escape plan.

But winter ice does not last forever. Fishing season will begin again. We began this column with a quote on patience from Shakespeare, the wisest man who ever lived, and we'll close with one from Ed Marks, whose decades of successful investing make him the Shakespeare of markets: "Patience, ah, patience does it."

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Dollar/yen	0.95	Down 1	-2.5	0.7
Gold	0.83	Up 4	-2.1	2.0
Oil	0.86	Down 1	11	-6.5
Bond Futures	0.70	Up 2	-0.3	-0.1
2-Yr Note Futures	1.11	Up 4	0.9	0.3
Bund Futures	0.91	Down 1	0.2	-0.6

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Making a Case for Buy and Hold

By Victor Niederhoffer and Laurel Kenner

Columnists

02/28/2001 09:36 AM

We recently received a letter from Jonathan Hoenig, a man of great intelligence and one of the most respected commentators today. Though still in his 20s, he runs his own hedge fund, and has been on the cover of Institutional Investor. We are inclined to treat his comments, especially since he's our friend, with great respect and reverence.

We shared his ideas with our circle of acquaintances. They registered great admiration and approval. Mr. Hoenig's logic seemed sound as a nut. Yet we reflected that he is still a young man, and does not have as many years as we do in the market and we could not resist subjecting his comments to some scrutiny.

Mr. Hoenig's theme, published in a Feb. 22 piece for smartmoney.com, was that buy-and-hold investors are kidding themselves. "So-called prudent investors have been misled by believing that stocks return about 12% a year. But that oft-quoted statistics actually represents a 72-year average, and I for one am uncomfortable waiting around that long to see if history repeats itself," he wrote. "The long haul is what prompts people to buy XYZ at 100 expecting it will go to 120. But when it slides to 50, they wait and wait and hope and wait, because we've been told that most stocks eventually go up and hey, we're in it for the long term."

Nothing that Mr. Hoenig says would tend to override the most important empirical result in stock prices in investments of all time, nor, as far as we can see, has Mr. Hoenig actually represented the true variation of such returns from investment.

Read It Here

The fundamental baseline of the rising trend of stock prices over the last 200 years is well covered in such books as *How to Buy Stocks* by Louis Engel, *Corporate Finance* by Ross by Westerfield and Jaffe, and *Stocks for the Long Run* by Jeremy Siegel. We have updated the figures reported in these books, the most recent of which ends in 1997, with calculations and estimates of our own; since then, the return has been about 15% a year. Here are the facts:

1. The arithmetic average of the 75 annual returns for the S&P 500 from 1926 to 2000 is 13%, including dividends.
2. The standard deviation of these 75 annual returns is 20%.
3. These annual returns may be expected with a 68% confidence level to range between a 7% loss and a 33% gain.
4. The mean of the 54 annual returns from 1871 to 1925 was 8.5%.
5. Taking every New York Stock Exchange stock into consideration, of the 2,850 year-to-year combinations possible between year-end 1925 and year-end 2000, there were only 73 with negative returns.
6. Results for a single year vary widely, and include losses of 46% in 1938, 20% in 1969, 29% in 1973, 26% in 1974 and 17% in 1990.
7. Of the 2,200 10-year comparisons possible over the period (which is relevant for retirement and college planning), more than 95% show an annual compounded return above 9%.
8. The only bad period during the entire 75 years covered for long-term investors was the one ending in 1974. For that year, the long-term returns averaged only 5%. But for 1974 and for all other years, those

able to hold on for another few years without getting out would have seen a marked improvement in their returns.

The question then emerges as to whether this time is different. Is there a reason to believe that returns for the next 75 years will vary much from the past?

We turn to the dynamics of the economy for an answer. The main reason that stocks have gone up is that corporate sales and profits grow. Their growth in the main is determined by innovation, especially in general-purpose technologies like printing, writing, telegraphs, electricity, materials, lasers, semiconductors, the Internet and genetic engineering. Why should the growth from such innovations be any less in the future than in the past?

Science, if anything, is growing much more rapidly. And the public from Chile to China to Connecticut is becoming more accepting of these trends through investing in stocks.

Can forces such as privatization of Social Security, growing interest in common stocks among the Chinese and new technologies -- especially those that will prolong life -- be overridden by trading rules that would have you selling whenever a trader feels bearish or his straight lines between two points slope downward, or his comparison of the current price to 20 days ago be up or down?

We don't think so.

According to Mr. Hoenig, a smart investor will be flexible enough to admit that at some point we might want to trade one position for another. "For example, Microsoft (MSFT) has now been dead money for two years, Lucent (LU) for four, Motorola (MOT) for seven, Apple (AAPL) for 14. Xerox (XRX) for ... well, you get the picture."

The question is, at what point is it time to trade one position for another? Five percent down? Ten percent down? Twenty percent? Forty percent?

The Circle Weighs In

Mark Hulbert, who has studied this field much more thoroughly than anyone else, has found no evidence that any technical forecasting has validity. (Even our own Spec computers are from time to time retired to the woodshed.)

Mr. John Lamberg, an engineer with a financial turn of mind, ran a few numbers to illustrate that AOL was dead money many times during the 34,500% ascent from its first day of trading. "A long-term investor had to withstand the following foolish roller-coaster ride:

03/10/93 was a HIGH at 15/64 followed by a 3/32 (40.83%) decline.
 04/20/93 was a LOW at 9/64 followed by a 37/64 (418.32%) rise.
 03/24/94 was a HIGH at 23/32 followed by a 21/64 (45.38%) decline.
 04/21/94 was a LOW at 25/64 followed by a 4 3/64 (1,030.37%) rise.
 05/07/96 was a HIGH at 4 7/16 followed by a 2 29/32 (65.49%) decline.
 07/24/96 was a LOW at 1 17/32 followed by a 16 1/32 (1,046.94%) rise.
 07/21/98 was a HIGH at 17 9/16 followed by an 8 15/16 (50.89%) decline.
 09/01/98 was a LOW at 8 5/8 followed by a 79 1/8 (917.39%) rise.
 04/06/99 was a HIGH at 87 3/4 followed by a 43 (49.00%) decline.
 06/15/99 was a LOW at 44 3/4 followed by a 19 7/8 (44.41%) rise.
 07/09/99 was a HIGH at 64 5/8 followed by a 26 5/32 (40.47%) decline.

08/05/99 was a LOW at 38 15/32 followed by a 69 17/32 (180.75%) rise.
 12/10/99 was a HIGH at 108 followed by a 59 13/16 (55.38%) decline.
 02/22/00 was a LOW at 48 3/16 followed by a 26 7/16 (54.86%) rise.
 03/27/00 was a HIGH at 74 5/8 followed by a 37 5/8 (50.42%) decline.
 10/18/00 was a LOW at 37 followed by a 21 1/2 (58.11%) rise.
 11/08/00 was a HIGH at 58 1/2 followed by a 26 27/32 (45.88%) decline.
 01/02/01 was a LOW at 31 21/32 followed by a 25 7/16 (80.35%) rise.

"You can stomach that? OK then, 50% swings:

05/07/96 was a HIGH at 4 7/16 followed by a 2 29/32 (65.49%) decline.
 07/24/96 was a LOW at 1 17/32 followed by a 16 1/32 (1,046.94%) rise.
 07/21/98 was a HIGH at 17 9/16 followed by an 8 15/16 (50.89%) decline.
 09/01/98 was a LOW at 8 5/8 followed by a 79 1/8 (917.39%) rise.
 04/06/99 was a HIGH at 87 3/4 followed by a 49 9/32 (56.16%) decline.
 08/05/99 was a LOW at 38 15/32 followed by a 69 17/32 (180.75%) rise.
 12/10/99 was a HIGH at 108 followed by a 59 13/16 (55.38%) decline.
 02/22/00 was a LOW at 48 3/16 followed by a 26 7/16 (54.86%) rise.
 03/27/00 was a HIGH at 74 5/8 followed by a 37 5/8 (50.42%) decline.
 10/18/00 was a LOW at 37 followed by a 21 1/2 (58.11%) rise.

"Do I hear 60% swings?

05/07/96 was a HIGH at 4 7/16 followed by a 3 3/64 (68.49%) decline.
 10/15/96 was a LOW at 1 25/64 followed by a 106 39/64 (7,622.95%) rise.
 12/10/99 was a HIGH at 108 followed by a 76 11/32 (70.69%) decline.
 01/02/01 was a LOW at 31 21/32 followed by a 25 7/16 (80.35%) rise.

Mr. Lamberg acknowledges that he could just as easily go back into his database and find a stock that would have ground a buy and hold-at-any-cost investor into dust. But that's a reason for owning a basket of stocks, not an argument against holding for the long haul.

The market's climb is like a current carrying along an investor's boat. As another financial columnist friend of ours, David DeRosa, puts it: "Because of the drift you cannot be permanently 'long and wrong.'"

Talk the Talk, Walk the Walk

All that being said, we are not averse to putting the money where the mouth is. Today marks the end of the month. That's always a particularly chancy day, especially during the last few hours. But the beginning of the month is by far the most bullish period of all. We are therefore going to advise going on full margin as of the end of today's trading on the 11 stocks that we have recommended (assuming the S&P 500 futures are not up more than 1% today). In other words, we are recommending buying stocks to a level of 200% of the equity in the account at present, up from the 125% level recommended previously -- i.e., using a full 50% margin.

Our recommended list follows:

Axcelis (ACLS)
 Borland (BOR)
 Conexant (CNXT)

Chart Industries (CTI)
 Commscope (CTV)
 Ivax (IVX)
 Petsmart (PETM)
 Techne (TECH)
 Viasystems (VG)
 Westell Technologies (WSTL)
 XO Communications (XOXO)

Thus, we expose our 136% year-to-date profit to the winds of chance, based on a buy-and-hold strategy. However, with the lessons of Sir Ernest Shackleton, Will Shakespeare and Ed Marks (see [our column](#) yesterday) in mind, we are going to put a stop on the portfolio should it decline by one-third from the close today. Such a loss would bring our portfolio to about even for the year.

Of course, these statistics at present are of small consolation to those who invested in Nasdaq stocks last March. Fifty-five of the Nasdaq 100 are down more than 60% from their one-year high. Long-term holding of a basket of 10 such issues, however, can be expected to duplicate the results reported above.

Hope is recommended.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	0.79	Down 1	-1.4	-2.4
S&P 500	0.87	Down 1	-4.7	-4.6
Nasdaq	0.95	Down 1	-11	-9.1
Europe STOXX-50	0.83	Up 2	-9.4	-6.6
Dollar/euro	0.95	Up 1	-2.7	-0.4
Nikkei	0.75	Down 2	-5.3	-1.6
Dollar/yen	1.00	Up 1	-2.3	0.0
Gold	0.87	Up 5	-1.5	2.8
Oil	0.83	Down 2	10	-6.9
Bond Futures	0.74	Up 3	0.8	1.2
2-Yr Note Futures	1.17	Up 5	0.9	0.4
Bund Futures	0.95	Up 1	0.7	0.1

Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling [The Education of a Speculator](#), which is available [here](#).

Laurel Kenner is a financial writer in New York City. Formerly head of US stock market coverage at Bloomberg News, she previously reported on police, politics and aerospace during her 17-year news career.