

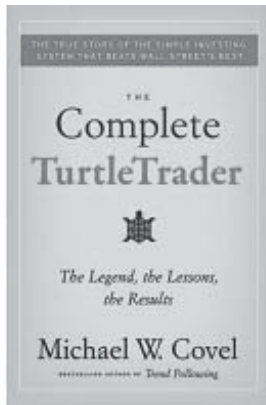
# Technically Speaking

OCTOBER 2007

The Monthly Newsletter of the Market Technicians Association, Inc. For Over 30 Years

## The Complete TurtleTrader: The Legend, the Lessons, the Results by Michael W. Covel

Reviewed by Ajay Jani



Eddie Murphy, Dan Ackroyd, and Christmas. Those three words linked together generate an almost universal association with the movie *Trading Places*. While many have enjoyed the film, few are aware that in 1983, the same year the movie was released, a real-life experiment along similar lines was carried out by legendary commodity traders Richard Dennis and William Eckhardt.

*Turtle Trader* is an inside look into the events of 25 years ago, and how they continue to influence modern markets to this day. Author Michael Covel (*Trend Following*), uses a combination of historical records and interviews with the key players involved in the experiment to tell one of the greatest market stories ever: that of Richard Dennis' "Turtles".

Richard Dennis achieved fame by turning a very small grubstake of less than \$500 into a fortune that reputedly exceeded \$200 million by the time he retired from trading for the public in the early 1990s. As Dennis' father once said, "Let's just say Rich ran that four hundred bucks up pretty good."

We are introduced to the tale with a biography of the main protagonist, Richard Dennis. Dennis grew up in a rough neighborhood on the south side of Chicago. His family did not live a life of privilege. While hampered from a lack of connections, Dennis displayed an early aptitude for thinking about odds, and was a natural poker player. After taking a summer job as runner on the Chicago Mercantile Exchange, Dennis was hooked. He wanted to trade, but at 17 did not meet the exchange's minimum age of 21. So

he had his father trade on his behalf. After finishing his degree at DePaul, he enrolled at Tulane graduate school, but quickly dropped out to return to his native Chicago to pursue his passion for trading.

The experiment was set up by Richard Dennis as a means to finally settle an age old argument that he had with his partner William Eckhardt: Nature or Nurture? Dennis contended that he could teach anyone to trade, while Eckhardt believed that Dennis had an innate gift that allowed him to profit from trading while so many others lost.

Richard Dennis was not shy of volatility. As Covel relates, "Profits...for Dennis came with heartburn. He was down \$10 million in a single day before bouncing back ... Yet Dennis cockily said that he slept like a baby during all that volatility." Most mortals would hear that description and believe that Dennis simply had risk taking hard-coded into his genome and that the best we could hope for is a ring-side seat observing greatness in action. And yet it was Dennis, trying to settle a long-time argument with his more quantitatively oriented partner Eckhardt, who decided to hire traders to prove that trading is a skill that can be taught.

In 1983, Dennis & Eckhardt taught what would be the first of 2 classes of traders their methods of trading. In exchange for signing a confidentiality agreement, those selected would be the personal money managers for Richard Dennis. The opportunity to study at the feet of widely acknowledged Masters in the world of commodity trading set off a frenzy in the industry. Of the thousands who applied, less than 50 people would be accepted during the life of the "Turtle" program.

Much of this information is already in the public domain. Where Covel excels is in bringing to light many details of the experiment that shed light on how the program operated, how money was allocated, and how the students performed while managing money for Dennis.

We learn that at least one, and perhaps several, participants who held themselves out as great traders may in fact have blown out their accounts while in the program. We learn of the jealousy and rivalries that developed as the trainees strived to prove that they were the best trader. We learn that even as Dennis was creating a legend by proving that trading could be systematized and taught, his own inner demons led him to pursue discretionary trades that would eventually terminate his career as a

manager of money for the public. We also learn of a second generation of "Turtles" that did not train directly with Dennis but studied and perhaps improved upon his methods.

Any book about the Turtles would be incomplete without a discussion of the rules that were taught in those classes nearly 15 years ago and Covel obliges our curiosity.

However, Covel saves the most important lesson for the last chapter:

"Ultimately, the path that led a regular Chicago guy to the top, that led him to teach a handful of beginners to win big and make millions like him and in many ways inspired a generation of Wall Street titans from up close and afar, is a path we can all take."

### Trading Rules

In "The Complete Turtle Trader", Covel goes through many of the rules taught by Richard Dennis. In addition, based on his study of the Turtles, Covel also offers several tips for those inclined to follow the example of successful long-term trend followers:

1. Calculate your edge for every trade that you make. It's not about the frequency of success but the magnitude of success.
2. Instead of watching TV to shape your trading decisions, use the price. Price is the purest form of information that the markets give.
3. You need to understand the concept of shorting. You must not be biased one way or the other on the market but be willing to play both sides as conditions dictate.

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# Technically Speaking

## Market Technicians Association, Inc.

61 Broadway • Suite 514  
New York, NY 10006  
Phone: 646/652-3300  
Fax: 646/652-3322  
E-mail: info@mta.org

### Technically Speaking Editor

Michael Carr, CMT  
editor@mta.org

### Technically Speaking Associate Editor

Lawrence Klamecki

## MTA Office E-mail Directory

### Inquiries Directory

General Questions	info@mta.org
Membership Information	admin@mta.org
CMT Information	cmt@mta.org
Technically Speaking	editor@mta.org
Journal of Technical Analysis	journal@mta.org
Charles Dow Award	dowaward@mta.org

### MTA Staff Directory

Philip Roth, CMT	president@mta.org
Tom Silveri (Exec. Dir.)	toms@mta.org
Elliott Capon	elliott@mta.org
Tim Licitra	tim@mta.org
Marie Penza	marie@mta.org
Cassandra Townes	cassandra@mta.org



**Market  
Technicians  
Association**

*Professionals Managing Market Risk  
Incorporated 1973*

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## A Letter from the MTA Seminar Chair

*This month, instead of A Letter from the Editor's Desk, we have decided to provide you with an update on the MTA's upcoming Mid-Winter Retreat by Seminar Chair Tim Snavelly, CFA, CMT.*



Tim Snavelly

### MTA Membership:

I am pleased to invite you to join us this year for our 2008 MTA Mid-Winter Retreat - a high quality, advanced topics, learning and networking event set on the gorgeous Florida Gulf Coast. This year's Retreat will be held January 25th and 26th at the fabulous Don CeSar, a Loew's Hotel, and it will feature:

- An MTA Market Forecast Panel, featuring expert ideas, outlooks, and forecasts for 2008!
- Presentations from renowned experts including John Bollinger, Ned Davis, Jeff deGraaf, Jordan Kotick, Hank Pruden, Phil Roth and more!
- A networking-oriented Rotating Round table discussion enabling attendees to strengthen relationships and share market insights with our attending experts.
- An Awards Luncheon. One of the MTA's finest traditions is recognizing the important contributions of members of our community - and it's fun!
- An outdoor evening reception and BBQ to soak in the Florida sun and spend time with your friends and colleagues in the industry.
- A low priced Spouse/Guest Rate, with some spouse - and guest-friendly meals so that everyone can join in the fun.
- This year's Retreat promises to be the best ever! Accommodations and arrangements at the Don CeSar are possibly the best any where on the Gulf, and the program is designed to balance market insights with networking and time for fun in the sun.

Please stay tuned for more information, and be sure to review the itinerary. There is no better place to be this January 25th and 26th than St. Pete Beach, Florida - so plan ahead and act now to take advantage of this opportunity, and the low pre-registration rate available for only a short time.

For more information or to register, go to [www.mta.org](http://www.mta.org), or contact Tim Licitra, MTA Marketing Services Coordinator, at (646) 652-3300.

Sincerely,

Tim Snavelly, CFA, CMT  
MTA Board Member & Seminar Chair

## From the Executive Director



Tom Silveri

### MTA Membership:

This is a very busy, and exciting, time of the year for the MTA and its membership. As we are wrapping up registration for the fall CMT Exams, we have just opened registration for our 2008 Mid-Winter Retreat. The CMT Institute (CMTi) is also underway, along with the opening of new chapters in Baltimore and Charlotte.

For those of you who have already registered for the fall CMT Exams, I want to wish you all the best of luck. As you all know, registration ends on October 19th for Levels 1 and 2 (Level 3 closed September 30th), so there is still time left if you would like to take the Exam this fall. If anyone has to reschedule their exam, or if you have any questions at all, please contact Marie Penza at [marie@mta.org](mailto:marie@mta.org) or 646-652-3300.

As seen on the next page, in the letter from the Seminar Chair, the website, and our e-mails, we have opened registration for the 2008 Mid-Winter Retreat. This is really shaping up to be our best Retreat yet. The list of speakers is outstanding, the resort is beautiful, and where else would you rather be in the middle of the Winter! Also, what better way to start off 2008 than a Market Forecast Panel with some of the leading and most renowned experts in the field today. I hope you all consider attending.

The CMT Institute (CMTi) is in full swing. I hope all of you that are taking these classes (90 in total!) get a lot out of it, and that it prepares you well for the exam. I would also like to thank Chris Ruspi, MacNeil Curry, and Jeff Lay for giving up their time in order to prepare those that are taking these courses.

In our efforts to continue to grow and spread the outreach of technical analysis, we have opened two new chapters, Baltimore and Charlotte. I would like to urge those in the area to contact Matthew Trump (Baltimore Chapter Chair) or Carson Dahlberg (Charlotte Chapter Chair) for more information on their respected chapter. Thank you Matt and Carson for volunteering and helping to grow the MTA.

In this busy and exciting time I would like to wish those participating in the Exam this fall good luck, and hopefully I will see many of you in Florida come January.

Regards,

Tom Silveri  
MTA Executive Director

# MTA Mid-Winter Retreat 2008

**SIGN UP NOW!!**



**DATE:** January 25 - 26, 2008

**THEME:** "Technical Analysis Applied"

**SPEAKERS:** John Bollinger, CFA, CMT - Bollinger Capital Management, Inc.  
Ned Davis - Ned Davis Research, Inc.  
Jeffrey S. deGraaf, CMT - ISI Group  
Jordan Kotick, CMT - Barclays Bank  
Hank Pruden - Golden Gate University  
Philip Roth, CMT - Miller Tabak + Co.  
(More To Come!!)

**LOCATION:** Don CeSar  
3400 Gulf Boulevard  
St. Pete Beach, FL 33706  
1-800-282-1116

**PRICE:** Member Price - *ONLY \$450*  
Non-Member Price - \$600  
Guest Fee - \$250

For more information, or if you wish to register over the phone, please contact Tim Licitra at 646-652-3300.

*Don't miss out on our best Mid-Winter Retreat yet!!*



## The Complete Turtle Trader

continued from page 1

4. Use a software program to test your systems and get a better feel for the performance of your methodology.
5. Be flexible on the parameters you use for your breakout systems. Test different parameters to find what you are comfortable with.
6. Stop worrying about how you enter a trade and focus on the exits. Plan ahead of time where you will be wrong and get out of the position.
7. Calculate the volatility of the instrument you are trading using the Average True Range calculation. Many software programs have this indicator already coded into the package.
8. Risk no more than 2% of your account on a given trade.
9. Vary your position size based on the volatility of the instrument. Larger position sizes for less volatile instruments and vice versa for higher volatility instruments.
10. If you want to make Turtle-type returns, you need to get comfortable with leverage and pyramiding winners.
11. There is no fixed portfolio of markets or set account balance that you need to trade. Each trader is different and should develop their plan according to their temperament and capitalization.

*Ajay Jani has been in the investment business since 1989, and is currently advising a hedge fund investing in Emerging Markets. He is an MTA affiliate and has completed levels I & II of the CMT.*

### Turtle Historical Track Records

<b>Mike Carr*</b>	
1984	24.09%
1985	45.78%
1986	77.98%
1987	49.06%
Apr-88	-19.80%
<b>Mike Cavallo</b>	
1984	-14.50%
1985	100.72%
1986	33.62%

1987	111.25%
Apr-88	-7.41%
<b>Liz Cheval</b>	
1984	-20.98%
1985	51.65%
1986	134.68%
1987	178.02%
Apr-88	-13.02%
<b>Jeff Gordan</b>	
1984	31.74%
1985	82.05%
1986	50.85%
1987	11.49%
Apr-88	3.45%
<b>Jim Melnick</b>	
1984	102.33%
1985	42.18%
1986	160.47%
1987	45.71%
Apr-88	4.19%
<b>Stig Ostgaard</b>	
1984	20.03%
1985	296.56%
1986	108.21%
1987	87.77%
Apr-88	-23.85%
<b>Howard Seidler</b>	
1984	15.91%
1985	100.16%
1986	95.98%
1987	79.52%
Jan-88	-5.84%
<b>Jerry Parker</b>	
1984	-10.04%
1985	128.87%
1986	124.74%
1987	36.76%
Jan-88	-20.81%

<b>Jim DiMana</b>	
1985	71.12%
1986	131.68%
1987	96.74%
Apr-88	-20.62%
<b>Philip Lu</b>	
1985	132.25%
19856	128.80%
1987	77.58%
Apr-88	7.62%
<b>Mark Walsh</b>	
1985	99.46%
1986	135.86%
1987	78.35%
Apr-88	-30.82%
<b>Brian Proctor</b>	
1985	54.82%
1986	116.17%
1987	185.10%
Apr-88	7.85%
<b>Paul Rabar</b>	
1985	91.72%
1986	125.86%
1987	78.19%
Apr-88	-8.80%
<b>Tom Shanks</b>	
1985	18.10%
1986	169.53%
1987	146.49%
Apr-88	-36.58%

\* Please note that this is not the editor of this Newsletter\*

## Advertising

If you are interested in advertising in the MTA's monthly newsletter or journal, you can find a listing of our advertising rates on our website.

Please e-mail Tim Licitra at: [Tim@mta.org](mailto:Tim@mta.org) if you wish to submit an advertisement or have any questions.

## Fusing Catalysts Together for Greater Returns

By Todd Campbell,  
President, E. B. Capital Markets, LLC

The average technician scours thousands of charts daily looking for the perfect storm. Whether it be uncovering rocks in search of gold nuggets, or catching lightning in a bottle, the task is daunting.



Ten years ago I began my career off Wall Street, providing independent research to money managers. In 2003, I took the path less traveled and founded E.B. Capital Markets, LLC. My goal was simple. Find an easier way to find the best names at the right time. I spent over 1,000 hours - much to the chagrin of family and friends - working through the key drivers of price and in the process fusing together technical, fundamental and seasonality research.

As members of the MTA, technicians recognize the value of listening to markets and not fighting the tape. Sometimes, however, financial success is more difficult than finding the perfect chart.

Technicians know price history shows market sentiment better than other methods. We recognize billions of dollars follow technical analysis, impacting demand and price direction. Choosing to ignore the market impact of technicals is perilous to returns.

Likewise, ignoring other disciplines and their affect on supply and demand is folly. It is one reason fusion style research has been gaining popularity and why many market-moving institutions embrace our research.

In building the model driving our research, I incorporated key catalysts for price action across various styles and approaches.

The first consideration is supply and demand. Stocks with rising volume on up days indicates institutional buying while stocks with rising

volume on down days indicates institutional selling. Evaluating price and volume over a period of time shows whether buyer and seller enthusiasm or pessimism is building or waning. It is the embodiment of "don't fight the tape". Our price volume work considers the most recent week versus the previous months averages, and the previous months averages to the prior three-month average. Price action, alongside daily volume, provides an easy-to-digest snapshot of sentiment and improves the success rate of choices.

Price and volume provides an excellent launch point. However, with thousands of stocks we need to narrow our focus to get an actionable list. Unfortunately, narrowing increases the risk of discarding a winner and choosing a loser. Since most investors don't have the luxury of buying thousands of stocks, we need to focus on names most likely to win. We do this by integrating fundamental and seasonal metrics into our methodology.

While traditional fundamental research involves channel checks and meeting management, I came to the conclusion the best, unbiased way to identify good management is to rate their ability to execute.

First, investors embrace stocks beating Street estimates and discard those failing to beat. The ability to consistently beat analyst forecasts suggests management teams understand how Wall Street rewards and punishes stock. These management teams "get it". They know to control Street enthusiasm, or risk paying a long-term price for a short-term gain. As a result, solid management teams consistently exceeding analysts are rewarded - and those consistently failing, are punished. We measure the ability to beat Street expectations over a rolling four-quarter period.

Secondly, Wall Street rewards management teams aligned with shareholders. Shareholder friendly management teams want their shares to trade higher, and are willing to put their own wealth at risk in the process. Insider at-the-market buys by key executives, especially those with access to the big picture of sales and expenses, can drive additional institutional demand for shares as investors seek to ride alongside the CEO to profits. Insider holdings can provide key insight into upcoming news. For example, we were early buyers of Playtex prior to a 63% move because we viewed actions by management as shareholder friendly and likely precursors to M&A. Further, by considering insider buying we were able to reinforce our bullish stance on American Eagle Outfitters in September of 2005. Following a 33% drop in market cap the CEO purchased 1 million shares of stock at market prices. A year later the stock had doubled. We reward stocks with insider buying over a rolling six-month period.

We also determined, over time, the amount investors are willing to pay for a stock is geared toward the company's ability to generate earnings, and grow those earnings.

Investors are willing to pay a higher premium for the rate of growth in earnings, and in the case of stable growth companies, pay a particular range for each dollar of earnings. By analyzing the historical PE ratio over the past five years, and considering the future earnings projections, investors can see whether shares are trading at a discounted valuation to the historical norm, or are expensive. This metric is particularly helpful alongside the company's history of beating expectations - suggesting forward estimates are conservative and don't accurately reflect potential upside.

Technicians are also willing to short stocks. We've found following trends can help make money in the short term. However, short sellers are often forced to cover. The resulting short squeeze drives stocks higher and seriously damages returns. We discovered stocks are squeezed when they have high short interest coupled with positive results on our other metrics. For example, short sellers will cover positions in companies where earnings are growing, estimates are being beaten, insiders are buying and institutional volumes are rising on up days. While you don't want to be first to the party, you don't want to be last to the dance. As a result, we use short interest as a contra indicator. Alongside our other metrics, it allows us to anticipate which stocks are mostly likely to be squeezed.

Finally, our model incorporates seasonality.

Our seasonality research is unique. There are few others providing seasonality to institutional clients, and invariably our clients find the historical trends of individual stocks and sectors enlightening and profitable.

Empirically, investors realize cold winter weather boosts demand for coats. Similarly, hot summers drive sales at ice cream vendors. While some seasonal plays are similarly easy to find - others are less identifiable - making them even more valuable to clients.

Most stocks have an identifiable history of strength or weakness at a particular time of year. It may be due to corporate budget calendars. It may be due to shopping habits. Regardless, trends in historical seasonality can be exploited for upside, and used in conjunction with our other components, to find winners at the right time.

While quant models provide consistent idea generation, many models suffered this summer. Investors can't operate within a bubble, and research must consider the world outside of number crunching. I learned long ago to trust

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## Fusing Catalysts Together for Greater Returns

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markets and pay attention to the macro catalysts likely to continue to push or pull at stocks. As a result, our approach doesn't stop at generating actionable lists.

Once our model is run we are tasked with selecting a handful of winners. To do this we look at historical market seasonality, industry or sector seasonality and global news.

Our goal is to find names with the fewest headwinds and the greatest chance for success. In keeping an open mind, and considering the broader market, we were able to tell clients to buy the Feb 28th sell-off ([www.ebcapitalmarkets.com](http://www.ebcapitalmarkets.com)) and sell Q2 leaders by mid July – ahead of the correction. Considering macro catalysts also helps in deciding which individual stocks with great charts and metrics to own. For example, keeping clients focused on names where stories back technical and fundamental metrics, like owning the best looking aerospace suppliers because China's burgeoning middle class is driving deliveries. Or, owning great looking agriculture suppliers because higher corn planting in the grain belt is resulting in greater Brazilian soybean planting.

Investing starts with good-looking charts. However, there are thousands of stocks trading and continued market globalization means more investment choices are coming daily. Investors need to consider as much information as possible without causing analysis paralysis. The goal of our firm, to find the best names at the *right* time, drove us to identify the key price drivers and consider the reasons stocks trade up or down. The result, a process which helps investors find good charts in stocks with talented management teams, trading

at discounted valuations, with overly pessimistic shorts and where seasonality suggests stock investors are willing to buy.



Todd can be reached at [campbell@ebcapitalmarkets.com](mailto:campbell@ebcapitalmarkets.com).

## Technically Speaking Opt-Out

For those of you who wish to read this monthly publication online only (from the newsletter archive section of the website and e-mail), please e-mail Tim Licitra at [tim@mta.org](mailto:tim@mta.org).

He can remove you from this mailing list and make sure that you only receive the e-mail notification that it has been posted to the website.

## CMT Exam

### Registration for Fall 2007

## Don't Miss Out!!

The Exams will be given between October 25th and November 3rd, 2007. Sign up now, time is running out!

If you have any questions regarding the CMT Exam, please contact Marie Penza at [marie@mta.org](mailto:marie@mta.org) or 646-652-3300.

The CMT is the only Technical Analysis designation that is recognized by the NYSE and NASD. It is also the only designation for Technical Analysts that qualifies as a Series 86 exemption.

Please note the change to the Levels I and II recommended reading list



## A Smarter Look at Put/Call Ratios

ISE's put/call value provides a more accurate measure of true investor sentiment than the traditional put/call ratio by using only customer trades to calculate bullish/bearish market direction.

**ISE Sentiment Index® (ISEE)®** for overall market direction  
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**ISEE Select<sup>SM</sup>** for individual securities' market direction  
Sign up for a free 14-day trial at [www.ise.com/iseeselect](http://www.ise.com/iseeselect)



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## Fusion Analysis

4-6 November 2007, Kuwait

Also, other planned courses for 2008 in GCC countries (Enhance Training and Development) and in New York and Beijing

### EQUITY PORTFOLIO MANAGER INVESTMENT FUND SELECTION TECHNICAL ANALYSIS CMT 1

#### INTRODUCTION TO STEALTH TRADING USING FUSION, ALGORITHMS, AND DERIVATIVES FOR PROFESSIONALS

- Taught by John Palicka CFA CMT -

#### FUSION ANALYSIS:

This is a must attend workshop that blends fundamental, technical, behavioral and quant strategies to exploit profitable opportunities in market investing by both investors and traders. Whilst the course focuses on US equities, fixed income, commodities and GCC stocks will also be considered as the techniques can be applied to other markets and asset classes. Given the plethora of strategies, the workshop will help create focused approaches to meet specific investment objectives. Fusion Analysis can create: **“The better approach to investing”**

#### EQUITY PORTFOLIO MANAGER:

Serious managers will utilize this course to analyze leading Wall Street valuation models and investment strategies for equities using fundamental, behavioral/technical and quant approaches, and then study how these are modified by the best performing equity portfolio managers to produce risk-adjusted excess returns. Also reviewed are: accounting and cash flow tricks that are sidestepped by professional investors, but punish many investors; various trading strategies, incorporating algorithms, hyper-trading, dark pools, and derivatives; new reporting requirements for regulatory considerations, consultants and clients as well as fund marketing techniques; and career advice to get the big bonus checks. An interactive investment workshop reinforces these skills when participants get to select stocks, choose a performance measurement method and then determine a marketing style and vehicle to create an investment approach producing excess returns. Case studies examining the investment approaches of leading versus average performing portfolio managers are also included. This intensive course goes beyond basics into the sophisticated and subtle strategies that can help achieve: **“Top Quartile Manager”**

#### INVESTMENT FUND SELECTION:

This is a must attend course for all professionals involved in the selection and management of third-party investment managers. Investment Fund Selection offers an insiders perspective into the various challenges in determining the most appropriate fund structure, managerial style and fund value-added performance of third-party investment managers in order to achieve individual investment objectives.

Reviewing different fund structures, such as mutual funds, private equity and hedge funds, participants explore regulatory, audit, established and recent portfolio performance measures and behavioral finance issues and, learn about subtle tricks that some funds can use to “dress up” performance records and charge unwarranted fees.

A practical one-day investment fund selection workshop will also include various case studies and exercises to reinforce the definitive selection techniques learnt. Participants get to perform an investment fund selection role-play in order to evaluate and screen funds for specific investment criteria and answer the question: **“Is my fund manager giving me my money’s worth?”**

#### TECHNICAL ANALYSIS CMT 1:

A must attend 4-day course for investment professionals wishing to gain the CMT Level I professional qualification in Technical Analysis from the Market Technicians Association (MTA). Using real-life charts, participants learn traditional technical tools of charting and some more specialized topics. Whilst the course focuses on US equities, other markets including GCC stocks (Saudi, Kuwait & U.A.E etc.) and real estate will also be explored. An optional 1-day session entirely dedicated to exploring trading opportunities for US and GCC equities (Saudi, Kuwait, U.A.E etc), FX, commodities and bonds using technical analysis. *Prior workshops correctly called the rise of the US market and the decline of the Saudi market by blending technical indicators.* This course should help answer the question: **“Buy or Sell and When”**

#### INTRODUCTION TO STEALTH TRADING USING FUSION, ALGORITHMS, AND DERIVATIVES FOR PROFESSIONALS:

Today, portfolio managers increasingly must use stealth trading in order to disguise their intentions and thus benefit from best execution. The old ways of staring at a Bloomberg to get bid/ask quotes and transacting an order is gradually being supplemented by more sophisticated strategies to meet various investment goals. The objective of this course is to give the student an introduction to various trading strategies that can achieve best execution. This course should help achieve: **“Best Execution.”**

*Instructor John Palicka CFA CMT is a top-ranked portfolio manager of Global Emerging Growth Capital (WWW.GLGEGC.COM) with over 25 years experience of managing \$ billions and, he has doubled client money, on average, every four years since 1980\*. His high course ratings from major investment firms reflect clear interpretations and practical applications of complex topics; knowledge applied to examples and cases found in the current worldwide and GGC marketplace; his experience with specific situations actually encountered in his career that parallel the learning topics.*

*To find out more about these cutting-edge courses in GGC locations, please call Esam Hassanyeh + 9714 391 0234 or visit his website: [www.enhance.ae](http://www.enhance.ae). John also teaches these courses in New York at the New York Institute of Finance, website: [WWW.NYIF.COM](http://WWW.NYIF.COM)*

\* Past performance is no guarantee of future results.

## An In-Depth Interview

By Molly Schilling



Josh Rosen, CMT  
Senior Domestic Trader  
*Driehaus Capital Management and Driehaus Securities*

*Last year at this time, I interviewed Josh in his position at the New York Stock Exchange where he had been working for many years as a Senior Specialist for Kellogg Group. He has since taken a position in Chicago where we meet up again – this year -- to do a follow-up interview.*

**Molly Schilling [MS]:** Josh and I are enjoying a beautiful evening here in Chicago at the Park Hyatt Lounge overlooking Michigan Avenue and the lake. I'm so happy to see you again – it has been one year since we last met at Bobby Van's down on Wall Street, and you were a Senior Specialist on the floor of the New York Stock Exchange – and you've had a lot of changes since that time.

**Josh Rosen [JR]:** Yes, last October I was a Senior Specialist for Kellogg. But I had been thinking about expanding upon my experience and my writing (I used to write an on-line technical piece) -- and the perfect opportunity came along -- I took a position as a Senior Domestic Trader at a long-only money manager with Driehaus Securities, a unit of Driehaus Capital Management LLC here in Chicago -- right in the heart of downtown Chicago. My wife and I live very close to work -- there's a lot going on here -- but compared to NYC, it's very calm and mellow.

**MS:** What's your working environment like?

**JR:** Driehaus is in a landmark Chicago mansion. Richard Driehaus, who owns the company, is a prolific collector of architecture and art, especially Tiffany stained glass – I think he has the largest personal collection in the world. It is a museum within a money management operation. I first learned about Richard Driehaus when he was profiled by Jack Schwager in *Market Wizards*. He is known as the father of momentum investing and as well as having an aggressive growth

approach to investing, he truly believes in the art of technical analysis.

**MS:** So, what is your day like?

**JR:** As a trader for Driehaus Securities, our client is Driehaus Capital – but our portfolio managers' clients are institutions, pension funds, and high net worth clientele. So my job is to trade the capital at the portfolio managers' direction, in the best way I can. So, I buy and sell, add to positions, create new positions, or liquidate old positions. Each portfolio manager has a different personality, and they have a different needs, so you really have to create a relationship with each manager, and understand what they want out of their trader. Some are extremely involved in the trading process; others are not as involved and are more interested in the bottom line at the end of the day than they are in the minute by minute trading.

We traders understand how to execute those orders, and we communicate with the portfolio manager as we're trading -- but our primary job is best execution, getting in and out of the market without leaving a big footprint that could roil a stock or a sector.

**MS:** What does that entail?

**JR:** I have to pay close attention to volume, to price action, and the impact that it might have if we try to get an order done all in one day. So there's a lot that goes into each trading decision -- everything from liquidity, technical analysis, overall analysis in the market, sector analysis. You don't want to come in there like the bull in the china shop.

**MS:** How do you do it without leaving a footprint?

**JR:** One of the most important jobs of a trader is to understand how to access the liquidity that's out there. The fact of the matter is that almost nobody shows their hand -- there are always sellers and buyers, you just have to find out where they are. The NYSE hybrid system was supposed to reward liquidity and transparency – and NMS was supposed to create a more liquid transparent market place –

**MS:** NMS?

**JR:** NMS, the new National Market System, which was actually initiated on August 19th. The market has been through the trial phase with about 250 stocks, and now we're going to go full blown -- the main goal of this is to reward liquidity and transparency so that everybody can trade in an easier fashion. It was also designed to protect the small retail investor from the large blocks that trade through them. Of course, that's not going to work (the goal of adding more transparency) because this is not a business where everybody's going to just start showing everything they have. And it's probably not a smart thing to do, because if you start putting all of your offers and bids out there, people are going to jump in front, and it can

become a very difficult, cumbersome task to get anything done.

In the end, a trader needs to use many different tools to find liquidity by really understanding the markets that you're trading in, and the equities that you're trading. You have a job, and the job is to get the best execution and to complete orders.

**MS:** Now we're meeting on Friday afternoon at the end of one of the most turbulent weeks we've seen in the market in a long time (August 17). How did you manage last week during this upheaval? Was it more difficult?

**JR:** Well it definitely *wasn't* business as usual. The level of intensity was much higher; the emotions that were flowing were more intense. We were trading many more orders. There was a lot more to take in, and when you're trading that many more orders, it's that much more difficult to make sure that you do the best you can on each one. So absolutely, I felt it. It was different, it was exciting. I mean, it's why we trade.

**MS:** An exciting challenge?

**JR:** It's a challenge -- you could feel it. Closing volume levels on the NYSE and the NASDAQ were higher than they've ever been in the history of trading. So it was definitely an exciting time.

**MS:** What is your assessment of the market – broadly speaking?

**JR:** I've seen the market starting to break down for a while now. I keep a careful diary, a trading notebook, of the market, and I make a point of reviewing it seriously every Sunday night. I look at the Dow, the S&P, the NASDAQ, the transports, homebuilders, brokers; I look at advance/decline lines, sentiment indicators, some new highs, new lows, trends, moving averages, point and figure, where we're at in that. I look at monthly, weekly, and daily time frames on all these. Then I look at any trading patterns, any interesting volume, a couple of oscillators, most likely a MACD, but sometimes an RSI on top of that, any major divergences, candlesticks, anything that's really jumping out to me.

So I have my own carefully documented timeline. I can look at the larger picture, and work to the smaller -- starting with the major indexes, then looking at some of the more important, or what I think are the more important internal indexes, like financials, housing, drugs, so you can get a really good look at the entire market.

Then, the last thing I do is look at relative strength. What's outperforming, what's really underperforming? So by the end, and this takes no more than about 30 minutes since I have it fairly streamlined, I can come up with a score for the market. And so over the last few weeks my score for the market has been neutral, at best, if not a little bit cautious.

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## An In-Depth Interview

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**MS:** You've developed your own comprehensive system to guide your decisions?

**JR:** Right -- here are some notes on oscillators (showing me his notebook), you know, huge volume on down. There was evidently a bear trap in the daily of the Dow Jones Industrial. On the S&P -- resistance but the trends are still positive, and the moving average is still positive on the monthly. As you move down the line, what you'll see is, the monthly looks pretty good. The weekly Industrials still look good, the S&P I did not like -- under distribution, divergence, candlesticks, and a couple of other things I felt were turning negative. On the NASDAQ -- monthly's look good, weekly's are still holding but they are under-distribution. And lastly, I look at the dailies.

I had already assessed that a market correction was in the wind on 8/6. You know, the next week things weren't getting too much better.

The Russell 2000 had a dead cross on their moving averages, as well as the small cap index. Housing and brokers, as far as I am concerned, are dead right now -- in the shorter term, and longer term, forget about them.

**MS:** You have little hope, even in the long run, for housing and financials?

**JR:** I hate to get emotional about them, but I wouldn't buy them with my enemies' money. I don't bottom feed. It's not part of my nature as a trader, or an investor. And they've broken long-term trend lines as well as short-term trend lines.

The home builders chart, has retraced, or had retraced .682 of its entire move up from 2002. It has now since broken that level and traded down quite a bit. Any retracing that we're seeing in the homebuilders and brokers right now looks to me like a little retest of their 200-day moving average.

These indexes, if you look at the stocks within them, even the greatest financial stock of all time, Goldman Sachs, looks like it's a rounding top. If you go with the idea that great stocks that go up 20, 30, 50, 500%, come out of bases -- sound bases, and are in up trends, are above their moving averages, and are breaking out on great volume -- then these are not them right now. Could they form great bases, and could I be proven wrong? Hopefully I'll notice that on the charts, but right now, I don't believe that that's the sector to be involved in. Not only is it not a necessary sector to be involved in, but quite frankly, they couldn't be underperforming the market any worse.

**MS:** What about value investors?

**JR:** There are value investors out there that I'm sure have a horizon of 5-10 years, that might think this is a great time to start adding to those

positions, and they might be very right. That would not be something that I'd be comfortable with because that's not how I see it. I'd be much more comfortable with growth metrics and the technicals showing me that there's a future. Right now, even with a strong move up, there's so much overhang resistance -- all of those people that got caught buying on the way down, you know, that might be looking for a spot to revisit the situation, and get out. So no, I'm not comfortable with those gains.

**MS:** Are there any traders or teachers who have inspired you along your way...

**JR:** Bill Shrire who used to be at Citigroup was one of my first teachers in the technical field. I tried to get into Ralph Acampora's class, *An Introduction to Technical Analysis*, and I couldn't. So I ended up taking a class at Smith Barney through the New York Institute of Finance with Bill Shrire, and one of the things he used to always say was, "Housing and financials lead bull markets. They've got to be rocking and rolling for everything else to be doing well." So, if you believe in that wisdom, as I do, and if those sectors are breaking down and going down. That's a concern for me.

**MS:** Let's go back to your Sunday night analysis and method. You're very methodical, you take notes, use the notebook, you digest it thoughtfully every week, you look back from week to week to see what you've written before, so you really chronicle your perceptions over a period of time?

**JR:** It took a very long time for me to get to this point where it really works because it is a lot of work to do it. It's one thing to be looking at your screens and charts, and having an idea -- it's another thing to write it down on paper and to follow a set of rules. In that same notebook I have a list of 30 rules that I've written down, and that I should be following every week. And yes I do the diary every week, every Sunday night, but I'm constantly following things midweek as well. And I also write a couple of technical pieces each week, which I keep in chronological order and publish in-house. And I keep a hard copy for myself. So on top of the diary I go back and look at each one of these. There's nothing like putting it down on paper.

**MS:** When you have to digest your impulses sufficiently so that you can write about them, that really does process your thinking doesn't it?

**JR:** Right, I get it down on paper and if I had to pick one word that matters more than anything else in investing, it's *discipline*. And it took a long time for me to learn it, but part of the discipline is writing down what you need to do, the rules you need to follow, and the things that you might need to change, or learn more about, and keeping it on a piece of paper. It's almost like writing down goals and checking them off one by one. It's easier said than done. It takes discipline to get it down on paper, and follow those rules. And if you've broken them, to make sure you know why.

**MS:** Gives you a sense of structure and security.

**JR:** Yeah, it gives me a sense that -- if I am wrong, I can know why. It's written down. If I'm wrong I can even know that it's because of one of two things: either I'm not following my rules (which would be a real shame, and maybe I'm not in the right profession) or I'm not following the *right* analysis because I'm not listening to what I wrote... or I'm lazy. Or, my rules are wrong, which is fine. Everything in life, or at least I believe this, are a work in progress, and there's nothing more dynamic than being a trader or investor. By writing down the rules -- if you're wrong, if you're following them -- maybe your rules are wrong.

One great thing that somebody said about emotions, I'm sure I've said this before because it's one of my favorite ideas -- it's that you *don't* want to learn how to trade *without* your emotions, you just want to know that they're there. You need to understand that idea. Meaning that you are going to be emotional, just understand that that's part of the fact, don't try to overcome it. You are going to get fearful and greedy, and panicky, but if you know that going into it, and you know that that's part of it, you're in a much better position. So it's not trying to erase them, it's just trying to understand that they're there.

Another great thing -- and I was talking about discipline and how important I think that is in trading, there was a study done, and I believe it was by Bob Prechter, who is a market technician, and an incredible sociologist -- he says that some of the best traders out there, the top performers, were ex-armed forces -- Marines and Navy men. It was that type of lifestyle, he believed, that was instilled in them, and they transferred that sense of discipline over to their trading life. That discipline is key in what you do, it is key in the armed forces, and I believe it is a huge key in trading as well.

You know there are guys that say they trade by their gut -- that might be true but I don't believe that that's some "unknown factor". What I believe is that someone who's been in the market for 20, 30 or 40 years, and has seen something over and over again, those guys that have that gut, have a perception that's probably better than a lot of other people, so when they see something, or something happening on the charts, or in a fundamental way, they may not know why they're getting the feeling, but it's only because they've seen it time and time again, and they've been able to internalize that.

**MS:** So, great traders -- traders who have developed a "gut" sense of the market -- come out of discipline too?

**JR:** I would imagine that they started out being *very* disciplined -- you know, concentration is one of the hardest things in the world to do. To really be in the moment, not to have your mind going other places, if you're really in that moment you're doing it correctly. It's called being in the zone. It's not

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magic; it's just not allowing anything to be going on in your world except for what you're doing. That's discipline.

**MS:** What do you think when you look back at the New York Stock Exchange?

**JR:** It's obvious that the specialist system, that specialists for the most part, are making less money, or losing money. I mean, look at LaBranche, they're the only publicly traded specialists out there, and you can tell by the action in their stock that it's been tough for them down there.

Specialists at the New York Stock Exchange had the opportunity to both add value, and to make money. The truth is, there were guys down there that just took advantage of the system. And what I mean by taking advantage was, there were, and these are the stories that everybody's read, a few people manipulating the system so that it was just almost impossible for them to lose money; they also got in the way of smaller investors and institutions, and it created a feeling on the entire street, and I mean institutions, hedge funds, where it wasn't a good idea to be on the floor. You always got screwed by the specialist. He was always out to get you.

A lot of the rules, granted, have been changed now with the hybrid system. But you're trading risk capital now, whereas in the past, your risk reward was always a known because the specialist companies provided liquidity. And all of that has changed. Nobody's leaving large orders on the floor now. Everything's fragmented. Market places are fragmented no matter where you are. And that's part of the job of finding that liquidity out there. But originally as a specialist, your edge was that you had all the orders. You never got too far away from a level of comfort because you had a lot of orders. You had a lot of order flow. Order flow is king. You'd know where the buyers are, you'd know where the sellers are, you'd know where you can comfortably add a little bit of value on the downside and add value on the upside. Keep it nice and tight. Fill in when there's no buyers there, because maybe they'll be back, and the stock is moving up. And fill in when there were no sellers there. And that has gone away now. And so it's going to be very difficult for specialists moving forward in this environment.

The specialists used to have to pay huge fees to work as a specialist on the floor, and I think a lot of those fees are going away, because if they didn't there'd be no specialists at this point at all.

I want to make sure that I leave you with the impression that I do believe in the specialists system. I also believe in technology as well. You don't want to have a system where it's all technological and then banks are charged with the duty of adding risk and capital to the market, because that is not their job. Banks were never organized to be "the other side" of all these trades. That's what specialists do. And without them, I

believe that we're going to see a lot more volatility, and a lot more illiquid situations.

**MS:** Because there's no capital.

**JR:** There's no capital there and without specialists and market-makers there will be a less orderly marketplace, a fragmented marketplace.

**MS:** Are there any particular indicators you use?

**JR:** I try to learn new indicators all the time, but for the most part, I use a small tool box of indicators that are fairly simple, that I could explain and understand in a flash, and that keep everything very neat for me. The problem is when you start using too many indicators; it becomes very difficult to get a clean sense of what's going on because you can have different indicators telling you different things about the market. I always go back to what I learned when I first started in technical analysis, which is that price is what matters, volume is secondary, and everything else is tertiary.

My most important tools are what most technical analysts learn when they read *Technical Analysis of Stock Trends*, which was written by Edwards and Magee. A lot has been added since then, and I include a lot of those tools, but I always focus on those beginnings - trendlines, point and figure charts. And, I use candle charts.

**MS:** Japanese candlesticks are interesting sentiment indicators.

**JR:** Absolutely, you get sentiment and you get some great leading indicators as well, especially when you're able to use candlesticks with other confirming indicators, like oscillators, trend lines, moving averages, and so forth.

**MS:** Are there any particular candlestick patterns that you are attuned to?

**JR:** Those that occur at resistance and support areas. I always look for engulfing patterns, or what a traditional Western analyst would call an "outside day". Morning stars and evening stars are also great patterns. I like hammers and shooting stars, but with the morning star and the evening star, you get a real full candle pattern and if you're lucky, an island - it's something that you can hold onto and work with. And if the pattern is going to fail, you'll know by a new high or a new low that breaks the formation.

One thing Steve Nison always says is that these patterns, these bearish and bullish patterns, just call for a *stall* in the current pattern, and you want to watch for a confirmation of a reversal using other indicators. It's very easy to get ahead of yourself when you see a hammer, and you really want to think it's time to buy. And that's not always the case. So, I like to see another couple of confirming indicators along with it.

**MS:** I have a particular love for the candlestick patterns. They're historic, and are embedded with great Japanese philosophy. Sometimes I spot a

pattern forming and I allow it to build itself until it resolves into something that I expected or that surprises me. In other words, I see that there may be a morning star setting up, or you may get suddenly, a deep and extended shadow, and then you think, "okay let's see. Let's see if this happens, will it develop?" Generally speaking, when there is a significant shadow for a morning star or a significant shadow for an evening star, that's a big indicator to me. I'm watching. I'm tuned in to a reversal.

**JR:** Absolutely.

**MS:** There's always a follow through at some point. It may be a week later, it may be two weeks later, but I've at least been given a signal that there's a shift in the wind.

**JR:** And as you said, I love candlesticks because of the stories. You can really understand what they mean. If you read a little story about the history of the candles, and what has happened time and time again after they developed, and how the names evolved within the traditional Japanese trading culture, you can really start to understand what the formations means. And I'm a true believer in the psychology of trading and the emotions that we all put into our trades, and the emotions that amass. Candlesticks speak to that to help clarify what's going on.

**MS:** We've covered a lot of territory, and I'm so happy we've had this opportunity a year later, to come back and visit, and to learn about all your new experiences. This has been an enlightening interview and I am honored, and I look forward to visiting with you again next year.

**JR:** Thank you very much. It was a pleasure talking to you again and I love doing this, so I look forward to it too.

**MS:** Thanks, Josh.



*Molly Schilling is an independent trader and freelance writer.*

## Submitting an Article

If you are interested in submitting an article in the MTA's monthly newsletter, please e-mail the editor Michael Carr, CMT at: [editor@mta.org](mailto:editor@mta.org)

If you have any questions about Technically Speaking please contact Tim Licitra at: [tim@mta.org](mailto:tim@mta.org)

## MTA Quarterly Announcement

Once a quarter the MTA would like to recognize those that have been granted Member Status and the CMT designation. During this time period, July '07 - September '07, the new Members and CMT charter holders are as follows:

### New Members

Peter Austin, NJ, USA  
 James Bartelloni, VA, USA  
 Ulrich Bender, Switzerland  
 Curtis A. Butler, MA, USA  
 Ryan Campbell, UT, USA  
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 Mark Cison, IL, USA  
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 Eric Bielefeld, KY, USA  
 Curtis Butler, MA, USA  
 Ryan Campbell, UT, USA  
 Samuel S. C. Chan, Canada

George Davis, Canada  
 Robert C. Dufour, NY, USA  
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 Brad Wishak, Canada

## Stairstops: Using Basing Points to Ratchet Stops in Bull or Bear Markets by W. H. C. Bassetti

Reviewed by Mike Carr, CMT

W. H. C. Bassetti recently updated and revised *Technical Analysis of Stock Trends* by Robert D. Edwards and John Magee. Chapter 28 of the ninth edition of that classic is titled, "What is a Bottom -- What is a Top?" and contains what Bassetti considers to be one of Magee's most important contributions to traders, the concept of basing points. Prices never move in a straight line up or down, instead advancing or declining in waves, as described by Charles Dow or R. N. Elliott. Magee took a simpler and practical approach in his writing and saw the extreme points in a wave as a good location for stops. *Stairstops: Using Basing Points to Ratchet Stops in Bull or Bear Markets* expands and clarifies this concept into a complete system for setting stops to protect profits and limit losses.

During an uptrend, prices make higher highs and higher lows. Basing points are the higher lows in an uptrend and form the basis for a disciplined approach to stop placement that lets winners run and cuts losses early. The same concepts apply in downtrends where traders would use the lower highs to chart basing points. In this short e-book, Bassetti presents examples from Magee's original work in the 1940's, along with examples from the recent bull market. He presents precise rules for stop placement, allowing readers to program the rules into any software package. The book concludes with exercises, and the annotated charts allow readers to verify that they understand the concepts.

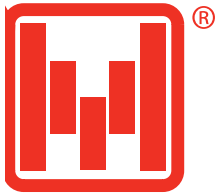
Given that exits represent the most difficult decision some traders face, this book offers a graduate level course in getting out of trades. By addressing good and bad trades, the simple strategy presented can be used by traders to ensure that they don't allow hope or fear to triumph over logic.

This e-book is available at [www.edwards-magee.com](http://www.edwards-magee.com). Additional information may be obtained from the author at [bassetti@edwards-magee.com](mailto:bassetti@edwards-magee.com).

## "What's Hot" The MTA Library Announces...

The MTA Library would like to announce that the following books have been added to our Library. Go to our website at [www.mta.org](http://www.mta.org) and visit our Library to check out your copy today.

- *"Breakthroughs in Technical Analysis: New Thinking from the World's Top Minds"* by David Keller, CMT
- *"Candlesticks Explained 1st Edition"* by Martin Pring
- *"The Psychology of Investing"* by John Nofsinger
- *"Elliott Wave Simplified"* by Cliff Droke
- *"FOREX Patterns & Probabilities: Trading Strategies for the Trending & Range Bound Markets"* by Edward Ponsi



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