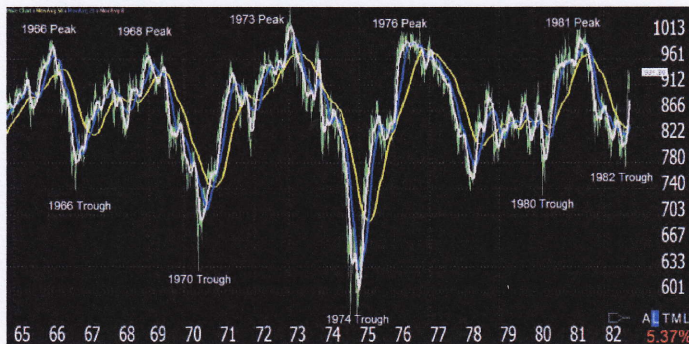


## Identifying Stock Market Turns – The Key to Successful Investing

by IMCZ Treasurer John Henry Smith

### Buy-and-hold versus timing strategies

Many investors buy equities with a view to holding them for the long term in the expectation that their value will appreciate considerably without any intervention on their part. However, a long-term buy-and-hold approach strategy may not bring the expected performance in view of the cyclical nature of the economy. Although the Dow Jones Industrial Average (DJIA) failed to record a net advance between 1966 and 1981, the period did in fact include five major advances totaling over 1500 Dow points. A long-term cyclical investor selling at the 5 tops in 1966, 1968, 1973, 1977, and 1981 and



reinvesting the money at the troughs of 1966, 1970, 1974, 1980 and 1982 would have seen the total investment grow from a theoretical \$1,000 in 1966 to over \$10,000 by October 1983. In contrast, a buy-and-hold investor would have profited a mere \$250.

Similarly, if you had bought cash-rich Microsoft on January 2, 2002, for \$30.08 and held it till December 30, 2005, when it closed at \$26.15 your investment would have declined 13 percent even though the fundamentals of Microsoft have always been very strong. On the other hand, if you had taken advantage of Microsoft's intermediate trend reversals you could have theoretically made an 85 percent profit as the following table shows:

Bought	Buy Price	Sold	Sell Price	Profit/Loss
Jan 02, 02	30.08	Mar 11, 02	28.86	(1.22)
Jul 25, 02	19.21	Nov 22, 02	26.12	6.91
Mar 11, 03	20.45	Sep 19, 03	26.88	6.43
Mar 23, 04	21.67	Nov 15, 04	27.39	5.72
Mar 29, 05	23.92	Aug 05, 05	27.76	3.84
Oct 12, 05	24.30	Nov 21, 05	28.16	3.86
				25.54
				84.91%

These examples illustrate the potential benefits of exploiting market reversals vis-à-vis a buy-and-hold strategy. The techniques used to determine these market turns come into their own for two reasons. Firstly, because they lock in profits or at least reduces losses, and secondly they provide a new opportunity for profit at the next upward stage of the market.

### Timing Investor Psychology

Since the capital markets are predicated on crowd psychology oscillating between panic, fear and pessimism on the one hand and confidence, excessive exuberance, and greed on the other, timing techniques are concerned with identifying those shifts in technical conditions that lead to key market reversals of sentiment before other investors are able to react. Although it must be said that this is hardly

realizable with unexpected breaking news, it is achievable with primary and intermediate market trends.

### Trend Indicators Measure Changes in Investor Psychology

Stock price trends are determined by investors' reactions to a plethora of economic, monetary, political and psychological forces. Studying these trends enables technically-oriented investors and traders to buy and sell stocks with a degree of confidence based on the principle that once a trend is set in motion it will have momentum until market psychology changes. Trend indicators monitor price momentum, market breadth, volume, and so on in order to evaluate the health of the prevailing trend using moving averages, peak-and-trough analysis, price patterns, and oscillators. Most of the time, these indicators rise and fall together, but towards the end of the market movements, the paths of many of them diverge from the price. Such divergences offer signs of technical deterioration during advances, and technical strength following declines.

### Classification of Price Movements

Price movements may be classified as primary, intermediate, and short-term. Major movements, sometimes called primary or cyclical, typically work themselves out in a period of about two years from trough to peak and are a reflection of investors' attitudes toward the business cycle. Intermediate movements usually develop over a period of 6 weeks to nine months. These are significant in that they are of sufficient magnitude for the investor to exploit as is shown in the Microsoft example. It is also clearly important to distinguish between an intermediate reaction in a bull market and the first down-leg of a bear market, for example. Short-term movements, which last less than 6 weeks, tend to be random in nature, and are characterized by emotional over and under-reactions.

### The Discounting Mechanism of the Market

The capital markets are constantly evaluating future corporate earnings, which are discounted back to their net present value stock prices, at least theoretically. Such estimations of fair value are continuously being revised in the light of new economic and geo-political developments and cause stock prices to be in a constant state of flux as investors try to position themselves to liquidate their positions profitably. The maxim 'sell on good news' applies when the news just meets expectations that were previously factored into the stock price. The process explains the paradox of equity markets peaking when economic conditions are strong, as we have seen in the 1st quarter of 2006 earnings season in the U.S., when the market was more pre-occupied with inflation and fears of further interest rate rises, the course of the war in Iraq, rising oil prices, and the expectation that 2nd quarter earnings would not exceed those of the 1st quarter. On the other hand, if news is better than expected, the surprise is likely to trigger accumulation, since it would be seen to positively impact future earnings.

### Technical Analysis and Trend Determination

A study of market character is a cornerstone of technical analysis, since reversals of price trends are almost always preceded by latent strength or weakness in the market structure. Just as a careful driver does not judge the performance of a car from the speedometer alone, so technical analysis does not look to one single indicator to confirm stock market behavior! Time measures the recurrence and length of cycles in investor psychology. Changes in confidence go through distinct cycles, some long and some short, as investors swing from excesses of optimism toward deep pessimism. The degree of price movement in the market is usually a function of the time element.



The longer it takes for investors to move from a bullish to a bearish extreme the greater the ensuring price change is likely to be. Volume reflects the intensity of changes in investor attitudes. For example, the level of enthusiasm implied by a price rise on low volume is not nearly as strong as that implied by a similar price advance accompanied by very high volume. Breadth measures the extent of investor sentiment. This is important because as long stocks are advancing on a broad front, the trend in favorable emotion is dispersed among most stocks and industries, indicating a healthy and broad economic development and a widely favorable attitude toward stocks in particular. In contrast, when interest has narrowed to a few blue-chip stocks, the quality of the trend has deteriorated, and a continuation of the bull market is highly suspect.

## Conclusion

Financial markets move in trends caused by the changing attitudes and expectations of investors with regard to the business cycle. In today's volatile markets, more than ever investors need to employ timing strategies to take advantage of the peaks and troughs that are caused by investors responses to the roller coaster phenomena of macro-economic activity. Even major corporations hesitate to give the markets long-term guidance, since predictability becomes more uncertain the further out the time horizon is. If this is true for them, how much more is it true for private investors pursuing a buy-and-hold strategy? No single technical indicator can ever be expected to signal all trend reversals, so it is essential to use a number of them together to re-confirm turning points.

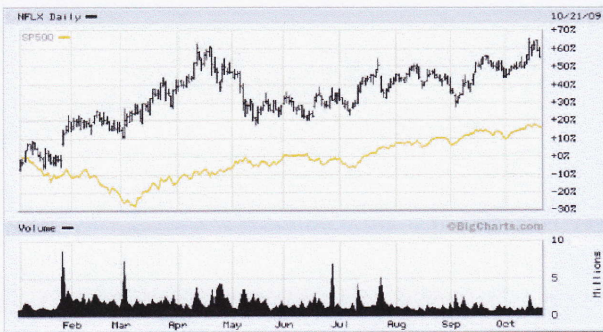
# Investment Corner

by IMCZ Treasurer John Henry Smith

As there are several categories of investment styles, each Grail stock will be analyzed in accordance with a stated style or strategy, e.g., Momentum Investor, Value Investor, etc.

Assessments and Analysis based on October 22, 2009 close price: \$49.63

Analysis of: Netflix, Inc. (NFLX)  
 Industry Sub-Sector: Music & Video Stores  
 Strategy: Momentum Investor  
 YTD Performance: +66%  
 SP 500 YTD Performance: +21%



## COMPANY DESCRIPTION

Netflix, Inc. provides online movie rental subscription service in the United States to approximately 10 million subscribers. The Company offers a variety of plans and provides subscribers access to over 100,000 digital versatile disc (DVD) and Blu-ray titles plus more than 12,000 streaming content choices. Subscribers select titles at the Company's Website aided by its recommendation service and merchandising tools. Subscribers receive DVDs by United States mail and return them to the Company at their convenience using its prepaid mailers. After a DVD has been returned, The Company mails the next available DVD in a subscriber's queue. It also offers certain titles through its instant-watching feature. Subscribers can watch streaming content without commercial interruption on personal computers, Intel-based Macintosh computers (Macs) and televisions.

CATEGORY	CRITERIA OF A MOMENTUM INVESTOR	SCORE	REPORT CARD
Current quarter vs. same quarter last year:	Current EPS growth 18% better than the same quarter last year	EPS is <b>58%</b> higher than the same quarter last year	<b>PASS</b>
Annual earnings growth:	Annual earnings growth above 18%	Annual earnings rate over the past 5 years is <b>66%</b>	<b>PASS</b>
Earnings consistency:	Year on year earnings growth should be higher than the previous one, allowing for one dip.	Annual EPS before extraordinary items for the last 5 years of <b>0.33, 0.64, 0.71, 0.97, 1.32</b>	<b>PASS</b>
Current price level:	Should be within 15% of its 52-week high	The current stock price of \$49.63 is 2 cents above its last 52-week high of <b>\$49.61</b>	<b>PASS</b>
4 month S&P relative strength line:	A general upward trend in the stock's weekly relative strength compared to the SP500	NFLX's relative strength trend has been increasing over the last 4 months	<b>PASS</b>
Price performance compared to all other stocks:	A stock's price performance, or weighted relative strength, compared to the SP500 over the past year should be no less than 80	The relative strength is <b>92</b>	<b>PASS</b>
Confirm at least one other leading stock in the industry:	Confirm the industry's attractiveness by citing at least one stock that has a relative strength of at least 80.	NFLX's industry sector has <b>4</b> other companies that have a relative strength of over 80	<b>PASS</b>
Look for leading industries:	The number of companies in the industry with a weighted relative strength above 80, or look for industries with the most stocks making new 52-week highs	NFLX's industry sector is currently in position 20 out of 269 of the Morning Star industry groups and thus one of the top performing industries	<b>PASS</b>
Decreasing long-term debt/equity	A debt/equity ratio less than 2, or the company has consistently cut debt over the last 3 years	The debt/equity ratio of this company is <b>0.16</b>	<b>PASS</b>
Return on equity:	A Return on Equity of at least 17%	ROE is <b>38.7%</b>	<b>PASS</b>
Shares outstanding:	Shares outstanding less than 30 million.	Total shares outstanding are <b>58</b> million	<b>MODERATE FAIL</b>
Insider ownership:	Insider ownership of 15% or more	Insiders own <b>19%</b> of the stock	<b>PASS</b>
Institutional ownership:	Some institutional ownership is preferred	Institutions own <b>95%</b>	<b>PASS</b>

**DISCLAIMER:** The above financial data is for informational purposes only, and is explicitly not a recommendation made by IMCZ, which cannot be held liable for its accuracy and that any purchase and/or sale of securities in whatever form based on this information is entirely at the reader's own risk.