The Second Edition

Astute

Investor

Moneymaking Stock Market Advice
From the Masters

Dedication of this book is to the referenced practitioners, academics, and especially academic-practitioners who are my masters and mentors on stock market investing.

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Moneymaking Stock Market
Advice
From the Masters

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Introduction

CORRECT INVESTMENT theories, strategies and methods concisely explain how to make money in the stock market. Beginning and experienced investors alike, requiring practical knowledge to be successful when investing, find *The Astute Investor* invaluable, informative, accurate and convenient to use.

Is the stock market undervalued or overvalued? Is the market in a long-term upward trend or long-term downward trend? What stock should you buy? Monitoring interest rates will help you recognize a market top or bottom, what are they? Learn how to answer these questions correctly. This book presents new investment models and where to find data on the Internet for calculation, what the model results signify and how to use the information.

Ask fundamental questions important to stock market investors. Answer them by becoming an astute investor. From beginning investors to financial service professionals, all find the practical ten-step method for investment success instructive.

Data to run the models presented are available using specific website commands, described in detail. Learn technical analysis techniques to assist market timing. *The Astute Investor* helps individuals feel confident taking control of their investment money to build wealth and a secure future. The essential investment wisdom and moneymaking advice from thirty-seven classic investment books from the masters on investing, ensures that you learn from the best in a short period.

Stock Market Success Is Easy: Once You Know How

Most investors, unfortunately, find out about the stock market the hard way—simply by doing. Learning by doing, common in many workplaces, is expensive when learning investing. By reading this book and applying its lessons, investors avoid many pitfalls that await those who begin investing without this knowledge.

The Astute Investor is distinctive, unique and superior to any other book on investing. Learn about market valuation, trend, interest rate monitoring and calculating intrinsic value, and many more topics. Read this book to understand the following three keys to investment success: 1) using forward-looking data; 2) knowing what the political-economic conditions are; and 3) investment perspective.

U.S. political factors such as fiscal and monetary policies have a major influence on the overall market. Learn to guard against the human weaknesses of vanity, greed and the will to believe. Discover that professional traders in the market look ahead using foresight to discount the news. Contrarians recognize the importance of crowd psychology. Learn the contrarian investment method. Become an expert at performing due diligence when performing the ten-step method for investment success.

Investors learn that correct investing is not a random activity, nor mere chance or luck, but a rigorous undertaking that requires reducing risk as much as possible before the act of investing. Accomplish this by relying on proper strategy, analysis, evaluation and judgment.

The goal is to point readers toward essential investment knowledge and to what that knowledge means, transforming naïve investors into astute investors.

What Is An Astute Investor?

An astute investor has foresight and is critically discerning, shrewd, subtle, sagacious and keenly aware of what information and facts are the most significant in investing. Astute investors plan and know where to find data necessary to run appropriate investment models and how to interpret these models' results for decision making when investing. Astute investors are seekers of truth. They possess market vision, investment intelligence and practical stock market experience.

How investors implement the information presented here and the effort put forth when investing ultimately establishes how successful you will be when investing in the stock market. Understanding this book and applying it correctly, makes knowledgeable individuals investment winners versus naïve investors. The important questions concerning investing follow.

Questions Asked

Millions of Americans invest in the stock market using common stock, in mutual funds, or through self-directed retirement accounts (401(k), 403(b), IRA, or Roth IRA plans). *The Astute Investor* helps investors answer the following fundamental investment questions:

PART I

1) What investment principles and strategies are important?
2) What investment theory and practice are fundamental for investors?
3) Is the stock market currently overvalued or undervalued?
4) Is the stock market in a long-term uptrend or a long-term downtrend?
5) Why do human emotions get in the way of intelligent investing?
6) How are intrinsic, true or fair value, market value capitalization, bargain value and margin-of-safety multiple calculated and what do they mean?
7) What interest rates typically indicate a long- term stock market top?
8) Why do stock market prices often respond "illogically" to the news?
9) Being contrarian sounds simple, why is it so difficult in practice?
10) What is the practical ten-step method for investment success?

PART II

11) How can I double retirement income safely?
12) What new investment theories safeguard investment success?

Each of the chapter topics in *The Astute Investor* inform investors by helping him or her answer these fundamental investment questions for themselves.

Questions Answered

The following chapter synopses highlight the methods presented, to allow investors to answer essential investment questions, by presenting ten major investment firsts in this book, including easy to understand examples. The goal is to transform novice and experienced investors alike, into astute investors.

PART I

1) Understand investment principles and diversification versus concentration strategies. Learn the importance of investment foresight. Recognize investment pitfalls.

2) Study current stock market theory and practice of for perspective on intrinsic, true and fair value of individual companies in the marketplace. The stock market taxonomy categorizes the stock market for better communication.

3) Presenting, in chapter 3, a step-by-step discounting approach, to calculate the forward price-to-earnings (P/E) ratio and the Standard & Poor's (S&P) 500 Index Expected Fair Valuation (EFV) Model. Use S&P 500 website data to help determine whether the stock market is either overvalued or undervalued.

4) The S&P 500 Index Nine-Month Moving Average (MA) Trend Line gives perspective and confirming indicators check on stage 1 through stage 4 market cycles. Know if the stock market is in either a long-term upward trend or a long-term downward trend. Discover a helpful charting website. Use the perspective of monthly S&P 500 Index trend lines, with

specific confirming indicators, to validate long-term stock market trends.

5) Basic human nature and the human mind are unchanging. Learn about symbols, herd mentality and how investors' rational, non-rational and irrational thinking and conduct undermine and even subvert the most intelligent investors' thoughts and actions.

6) The Graham-Dodd-Buffett margin-of-safety approach to value investing for all companies requires looking for and recognizing corporate bargains. Learn how to calculate intrinsic, true or fair value. Study a step-by-step real-life example of intrinsic, true or fair value using free cash flow, market value capitalization, bargain value and margin-of-safety multiple.

7) Yield curves and comparing 3-month U.S. Treasury bill interest rates with 30-year Treasury bond interest rates integrate political and economic conditions and help indicate market tops and bottoms. The spread between the Federal Reserve federal funds interest rate and the 30-year U.S. Treasury bond (T-bond) interest rate normally discounts an eventual U.S. economic recession and identifies a long-term stock market peak. Learn how to accomplish this.

8) Interpreting the news requires understanding the expected news discounting process. Learn to be skeptical of market pundits and conventional wisdom by avoiding stock tips. Avoid paying attention to news headlines. Understand why investors find the discounted news theory (DNT) important. The discounted news theory is the correct premise to explain the sophisticated methods of professional traders in the stock market and as the basis for the discounted market hypothesis (DMH).

9) Being contrarian is easy in theory but difficult to implement, and challenges the witty saying, "In theory, practice is simple." Recognize the incorrect self-selected market adviser's strategy of being contrarian is just another form of taking stock tips. Opposing the market and pride of opinion are costly if practiced by investors. Learn the correct approach to being contrarian.

10) The practical ten-step method for investment success brings together all the previously discussed points in chapters 1 through 9. And forms for the astute investor a systematic approach to evaluating the stock market and individual companies. Study real examples using S&P 500 Index data, interest rates and eBay Inc. annual report information.

PART II

11) Learn about retirement planning, using asset allocation over the super long-term and a dollar-cost-averaging buy-and-hold strategy for core investing in the S&P 500 Index versus corporate bonds. What investors learn in this chapter should double their income during retirement. Use and understand volatility tolerance for asset allocation determination in retirement planning.

12) The first time in a book on investing, learn about the discounted market hypothesis (DMH). In addition, the discounted news theory follows the expected news discounting process and supports the DMH. The new theories explain the look-ahead ability of the S&P 500 Index to predict coming political-economic conditions and long-term stock market cycles. The DMH, supported by The Life And Happiness Model, gives the theoretical foundation for why the ten-step method for investment success works in practice.

Who Should Purchase This Book

Reading, understanding and acting according to *The Astute Investor* transforms all investors into astute investors. Individuals requiring this book include:

1) Investors who want to understand a perplexing stock market, desire learning essential investment knowledge, including information from the thirty-seven classic books on investing.

2) Investors who demand more than just theory, but practical examples from real life, important website addresses and how to find data on the Internet to run these investment models.

3) Those with self-directed retirement accounts (e.g., 401(k) plans), who want to ensure a better retirement for their family

4) Financial services professionals who want to better answer client questions.

Knowing stock market results in advance is impossible. However, put probabilities in your favor by purchasing, reading and implementing the material in *The Astute Investor*.

Website Commands

Market data are essential for investors to run investment models for themselves. Therefore, bold letters identify websites with defined commands necessary to find specific current data and information. First, the website logon address. Then, as explained in the brackets, find where to look on the computer screen or where to click. Or as sometimes necessary what to type. An example follows.

Logon: http://finance.lycos.com

Where: [Where to look on the computer screen (e.g., on the top heading, along the left column, or in the main body) and the name of what to look for]
Click: [What specifically to click on the computer screen to find the next screen or the necessary data]
Type: [Sometimes necessary to type in information]

Many steps may be necessary, consequently, many **Where**, **Click** and **Type** instructions may be mandatory.

Do Not Use Bull Or Bear

Many investors know that a bull market is a stock market that is trading higher, by approximately twenty percent and bear markets trade lower, by approximately twenty percent. Wall Street and the financial media often use the terms, bull market and bear market.

Constant strings of connected mental images describe our thought process. The terms bull or bear fixates the investor's mind on either a powerful charging bull or a roaring provoked bear. Unfortunately, neither image is easy to forget. Investor emotions, discussed in chapter 5, can cloud proper action in the stock market. Because the terms bull and bear are emotionally charged words, they create in the investor's mind a mental block that works against proper analysis.

Investment poise is essential for success. Erasing emotionally charged images is beneficial. Therefore, do not use the term bull or bear to describe the stock market. Instead, describe the stock market is as being either in a long-term upward trend or in a long-term downward trend. Investors should now feel flexible in recognizing the stock market's state and their best response to it.

The S&P 500 Index As A Proxy

The Standard & Poor's (S&P) 500 Index is the recommended average and proxy for the overall stock market in *The Astute Investor*. Other averages, such as the Dow Jones Industrial Average (DJIA), the NASDAQ Composite, the NASDAQ-100 (NDX), the Russell 2000, or the Wilshire 5000 do not work or not nearly as well as the S&P 500 Index.

The Wilshire 5000 includes all equities on the NYSE Euronext [Deutsche Boerse merges with the NYSE in February 2011, the new company is yet unnamed], NASDAQ and the NYSE Amex Equities exchanges. Nevertheless, it does not work as well as the S&P 500 Index in this book's approach. Perhaps because the Wilshire 5000 includes smaller more volatile companies in its average than the S&P 500 Index.

Technical Analysis

Use technical analysis on the overall stock market, as represented by the S&P 500 Index. For example, look at S&P 500 Index double tops and bottoms, head and shoulders tops and bottoms and outside reversal days to help when identifying changes in long-term stock market trends. In addition, learn about the S&P 500 Index Nine-Month Moving Average (MA) Trend Line and confirming indicators such as the S&P 500 Index Two-Month MA Trend Line, the Moving Average Convergence Divergence (MACD), higher-highs and higher-lows, in chapter 4.

Technical analysis for an astute investor is recommended for the S&P 500 Index using monthly data. Please do not use any other stock market average or on any individual corporate stock. Do not assume other technical analysis techniques work for the S&P 500 Index method, such as flags, pennants or price gaps. Also, do not use technical analysis for an industry index, such as the semiconductor index (SOX).

Bibliography

The Astute Investor incorporates the essential investment wisdom and moneymaking advice from thirty-seven classic investment books from the masters on investing, presented in the bibliography section. Individuals study from the best and save considerable time learning how to invest. The glossary contains a financial dictionary of investment words. Investment principles and strategies are next, in Part I – chapter 1.

Glossary

FINANCIAL AND INVESTMENT word definitions are found at www.investorwords.com, www.trading-glossary.com, or by using the referenced dictionary by Barbara J. Etzel.

Astute Investor. A person who has foresight and is critically discerning, shrewd, subtle, sagacious and keenly aware of what information and facts are the most significant in investing. An investor who plans and knows where to find website data necessary to run appropriate investment models and how to interpret these models' results for decision making when investing. A seeker of the truth who possesses market vision, investment intelligence and stock market experience while using the practical **ten-step method for investment success**.

Bargain Value Calculation. Comparing the **intrinsic, true or fair value** for a corporation to the **market value capitalization** to calculate its bargain value using a systemic valuation method. If the intrinsic, true or fair value is greater than the market value capitalization, then the bargain value is positive. A positive bargain value signifies an undervalued company and a negative bargain value signifies an overvalued company. Rank order the calculated **margin-of-safety multiple** and bargain value for each corporation, highest to lowest values, for comparison to invest in based on the **margin-of-safety** principle.

Basic Net Earnings Per Share (EPS). The Basic EPS figure is a fundamental measure of corporate valuation. Ratio of net income (less preferred stock dividends) divided by total shares outstanding. The EPS figure appears after net income on the income statement [See **Diluted Net Earnings Per Share (DEPS)**]

Basis Points. Indicates the different yields available on individual bonds. 100 basis points equal 1 percent.

Buy-and-Hold Strategy. Once purchasing securities, during an investor's working career, hold them at least until retirement. Used with **dollar-cost-averaging** and the core retirement account strategy to save for retirement over the **super-long-term**.

Capital Asset Pricing Model (CAPM). A market portfolio theory, which explains that proper market pricing is based on relative security risk to the risk-free rate of return. The model rewards only systemic risk or **market risk** associated with the marketplace and not unsystemic risk, which is related to a specific company. Beta, a measure of market risk, is a result of the model. In efficient markets, the expected risk premium is directly proportional to beta.

Cash Flow Statement (CFS). Tracks money flow in time through the corporation. The CFS has the following three sections: 1) Cash from Operating Activities; 2) Cash from Investing Activities; and 3) Cash from Financing Activities.

Confirming Indicators. To determine the **long-term** trend in the U.S. stock market, follow the **S&P 500 Index Nine-Month Moving Average (MA) Trend Line**. Confirming indicators, although not all required, help substantiate the stage 1 through stage 4 **market cycles**.

Contrarian, Being. An investor who desires, at the correct time, not to invest with the crowd by purchasing good common stock when prices are low and selling common stock when prices are high. Investors should not use a **self-selected market adviser's strategy** to being contrarian, which is just another form of taking stock tips. Instead, use the practical **ten-step method for investment success.**

Corporate Bonds, Callable. Bonds redeemable by the issuing corporation whenever interest rates decline, before the maturity date.

Current Ratio. Total current assets divided by total current liabilities from a corporation's balance sheet. As a general guideline, the current ratio should be greater than two.

Debt-to-Equity Ratio. A measure of the capitalization structure of a corporation and whether the corporation is using debt wisely. Total liabilities divided by total stockholder's equity, which are both available on the balance sheet. A general guideline is—although this may change with financial institutions or utilities—most companies should stay below a debt to equity ratio of 1.00.

Dialectic Theory. The theory presented by the German philosopher G.W.F. Hegel (1770-1831). In Hegel's system, a thesis starts the discussion, then an opposing antithesis statement follows and finally a synthesis develops that resolves both the thesis and antithesis and settles the conflict. The process then repeats with the synthesis becoming the new thesis. This process expected scheduled news makes in the marketplace and describes the **expected news discounting process.** Which is a continuous and ongoing progression of news expectation, then the reality of the news, leading to a revised news expectation by professional stock traders.

Diluted Net Earnings Per Share (DEPS). The denominator expands for the **basic EPS** to include all convertible bonds, convertible preferred stock, warrants and stock options. When exercised, these shares will dilute the basic EPS figure. This is a caution for investors for that possible eventuality.

Discounted Market Hypothesis (DMH). The discounted market hypothesis (DMH) has the strongest form of market effectiveness. Security prices indicate all past prices, all published information and all the information available to investors anywhere. All expected scheduled news is discounted and unexpected news that affects the stock market has already been partially discounted by the marketplace. The **Life And Happiness Model** supports the DMH, all investors' actions and non-actions are in the marketplace. All objective and subjective truths, beliefs, values, everything that is possible to know and everything expected to be known about **political-economic conditions** are now included in the stock market. The discounted market hypothesis uses the **discounted news theory (DNT),** which incorporates the **expected news discounting process**. Emphasizing the premises of **discounting the news** and stock **market cycles** over the **long-term**.

Discounted News Theory (DNT). A stock's price movement before an expected scheduled news occurrence is referred to as **discounting**

the news. This explains how the stock market looks ahead to predict coming **political-economic conditions** using the **expected news discounting process**. All news, whether expected or unexpected, is discounted at least partially by the stock market, by investors' actions and/or non-actions. The discounted news theory supports the **discounted market hypothesis.**

Discounting. The premise is the stock market is a "discounting mechanism." Stock markets look ahead to what will happen in the future—at a stock market top, as much as the next six to twelve months—and reacts based on investor expectations. The discounting premise supports **discounting the news**.

Discounting The News. A prior bidding up or selling down of stock prices by professional stock traders, usually over the short or intermediate term, expecting either good or bad news about a company, economic factors, or political conditions. Discounting the news occurs when predicting government pronouncements, actions, or any other expected occurrence, which affects the stock market. Discounting the news is the premise for the **expected news discounting process,** which supports the **discounted news theory**.

Discount Rate, Risk-Free. The rate at which the expected future **free cash flow** is discounted to calculate the corporation's present-worth or **intrinsic, true or fair value**. Use the 30-year Treasury bond (T-bond) interest rate as the risk-free discount rate, because the 30-year T-bond is free of credit risk, is liquid and extends over the super long-term planning horizon.

Dollar-Cost Averaging. Contributing a fixed dollar amount automatically each month to purchase securities. This strategy should never change, regardless of market conditions. Used with a **buy-and-hold strategy** for retirement savings accounts over the **super long-term**.

Double Top or Bottom Reversal Pattern. At a market top, two peaks occur on a monthly chart at two separate points in time that look like a upside-down letter W—normally two to six months apart. On a stock chart with almost the same intraday price highs, double tops happen when the S&P 500 Index is rolling over at a long-term market high. At a long-term market bottom, a double bottom occurs on a monthly chart when two troughs that look like the letter W happen on two separate occasions—usually two to six months apart. On a chart with almost the same intraday price lows, double bottoms occur as the S&P 500

Index is forming a base and beginning a overall market upturn. Both are **confirming indicators** to the **S&P 500 Index Nine-Month Moving Average Trend Line**.

Due Diligence. Expect investors to consider properly and thoroughly all possible factors to determine an investment's suitability immediately before the outlay being made. This includes investigating the **political-economic conditions** in the stock market, including a company's **intrinsic, true or fair value**, its **market value capitalization, bargain value and margin-of-safety multiple**. Judge all **investment** information and data for accuracy, omissions and misstatements.

Efficient Market Hypothesis (EMH). The theory of the efficient capital market to describe the overall stock market that relies on the **random walk theory (RWT)** as a way to represent seemingly random daily movements of individual stock prices. The stock market, say the efficient market hypothesis theorists, is efficient because so many skilled participants who possess a collection of all relevant information are setting prices. Because the participants, as a whole know, all the relevant information then the market is competitive and true stock market values always prevail. Consequently, attempting to identify undervalued common stock is pointless because the market has previously priced in information making beating the marketplace unachievable. Results will be as good if common stock for purchase are decided upon randomly, hence the dependence on the RWT. Three versions of market efficiency, weak form, semi-strong form and strong form of the marketplace are offered with assumptions.

Electronic tape. A scrolling display, through the trading day, of corporate stock symbols, transaction prices and volume of shares changing hands during the transaction. The scrolling electronic tape display is usually available at stockbrokerage offices, on cable television and on stock market Internet websites. Also, *tape.*

Expected News. All scheduled news from corporations, from governments, or their agencies. For all expected scheduled news, professional stock traders use the expected news discounting process when discounting either meeting or not meeting expectations that affects the stock market.

Expected News Discounting Process. Explains how investors with foresight in the stock market constantly look ahead to predict political-economic conditions. This process explains how the stock market operates as a **discounting** mechanism. The recurring scheduled ongoing process of news expectation, news reality, and updated news expectation follows Hegel's **Dialectic Theory**. Expected scheduled news does not startle the stock market or professional stock traders because it is discounted.

Exploring-Compensating Condition. Stock traders, to check on whether the stock market is at intrinsic, true or fair value, use the exploring-compensating condition technique. Investors in the stock market are not always confident of the rightness in the current direction the overall stock market is taking. Investors explore by inquiring, studying, experimenting and examining the best fit between current market pricing and **political-economic conditions**. Millions of stock market participants diligently search for and intensively pursue the market direction that conforms correctly to political-economic conditions.

Federal Reserve. The U.S. central bank, which manages monetary policy, "to promote effectively the goals of maximum employment, stable prices and moderate long-term interest rates." Creating or withdrawing reserves by the Federal Reserve (Fed) influences the supply and demand of Federal Reserve Bank balances, which adjusts the federal funds interest rate. The Fed uses quantitative easing to affect **political-economic conditions**.

Fixed-Income Annuity. Policies offered by insurance companies paying a lifetime of fixed monthly income. Payments to beneficiaries are based on interest rates at the time monthly payments begin, and then remain constant for the life of the policy.

Forward Price-to-Earnings (P/E) Ratio. Current per-share price divided by the corporation's estimated earnings for the next twelve months. Foreseeing the future is the stock market's function and that is what investors with foresight and vision are striving to predict and estimate. Consequently, the forward P/E ratio is more appropriate for use than the **price-to-earnings (P/E) ratio**.

Forward Price-to-Earnings-to-Growth (FPEG) Ratio. FPEG is the forward P/E (diluted) ratio divided by the diluted net earnings per share (DEPS) growth rate per year. An FPEG ratio above 1.00 is poor, below

1.00 is good and below 0.50 is outstanding. When dividends are considerable, add the dividend yield to the DEPS growth rate.

401(k) Plan. A defined contribution, self-directed employee plan set up by corporations to invest tax-deferred income in their employee's retirement account. 401(k) plans are portable and follow employees from job-to-job. Certain 401(k) plans allow the corporation to match employees' contributions to their retirement plans. Employees pay taxes at withdrawal during retirement.

Free Cash Flow. Free cash flow (FCF), calculate by adding the normally negative **total capital expenditures** derived from the cash flows from the investment activities portion of the cash flow statement for the year, to the expected positive cash from operating activities for the year on the **cash flow statement (CFS).** Consider positive free cash flow (FCF) a benefit for a corporation's stock price because management has the option of increasing dividends, buying back their stock, developing promising new products/markets, or meeting competitive challenges—all without the need to raise additional money from outside sources.

Head and Shoulders Top or Bottom Reversal Pattern. This monthly chart pattern gets its name because at a market top it looks like the head and shoulders of a person's outline on a graph. Three distinctive market peaks, during a market top, are in evidence. The head is the middle and highest intraday price peak while the left and right shoulders have prices that are approximately equal, but slightly lower in value. For a market bottom, turn the price pattern upside down. The market bottom head intraday low price trough is the lowest while the left and right shoulder trough price values are approximately equal and not as low as the head's value. Both are **confirming indicators** to the **S&P 500 Index Nine-Month Moving Average Trend Line**.

Higher-Highs and Higher-Lows. When the **long-term** trend line is pointing upward, during Stage 3: Mark-Up - Uptrend; (see Graph 3 - 3), each wave up on the monthly chart depicts successively higher-highs and higher-low prices until Stage 4: Distribution - Topping occurs. This occurrence is a **confirming indicator** for an up trending **S&P 500 Index Nine-Month Moving Average Trend Line**.

Initial Public Offering (IPO). A company's initial stock sale to the public in the primary market, normally using an underwriter known as an investment banker—such as Merrill Lynch, Solomon Smith Barney, Morgan Stanley Dean Witter, or Goldman Sachs—as a manager. The **Securities and Exchange Commission (SEC)** approves and regulates all proceedings of the IPO.

Intrinsic, true or Fair Value. An intrinsic, true or fair value calculation for a company is instrumental for the **margin-of-safety** concept and **value investing**. Future yearly expected corporate **free cash flow** (FCF) values are discounted by the 30-year U.S. Treasury bond risk-free interest rate of return, which determines the corporation's present-worth or intrinsic, true or fair value.

Investing. Proper investing requires **investment foresight** and the most beneficial strategies and analysis leading to suitable evaluation and judgment for purchasing or selling common stock or fixed-income securities for either capital appreciation and/or predictable income over a long planning horizon. Investors should prefer high quality securities at proper or reasonable prices, which match the investor's scheduled needs. Investors should believe that all relevant factors are favorable before making an investment because the power to decline an investment is his or her most cherished advantage. Use **Due diligence** and follow the practical **ten-step method for investment success**.

Investment Foresight. Foresight for investors requires them to envision or imagine what will happen in the future based on all the necessary information available to them and then to adequately prepare and properly position themselves for the expected consequences. Use **Discounting the news** and an awareness of **political-economic conditions**.

Japanese Candlestick Charting Technique. The open, high, low and closing values form the candlestick. Solid candlestick bodies show the close lower than the open. White candlestick bodies depict the close higher than the open. The thin lines above and below the solid-or-white candlestick bodies are upper-and-lower shadows and indicate the high and low price range. Candlesticks are figurative and make stock chart illustrations attractive and easy to understand in one glance.

Laddered-Bond Portfolio. The rungs of a ladder represents each year when a portion of the notes or bonds in a portfolio mature. An equal amount of bonds are purchased with a spread-out maturity risk because of varying interest rates over the **long term**. As notes or bonds come due, they are rolled over to the next free rung on the bond ladder. Scheduling notes to mature each year during retirement dampens out interest rate fluctuations.

Life And Happiness Model. Defined by individuals' objective and subjective thinking and beliefs, plus desires, that supports decisions, leading to actions and or non-actions in pursuit of life's happiness. Define the "what, who, where and when" of thought and action as technically provable by **objective truths,** which are external to an individual. Define the fundamentally different "how and why" of thought and action as **subjective truths** which are internal to an individual. Subjective truths, thoughts, beliefs and values within individuals are positive subjective truths or negative subjective truths, beliefs, or thoughts. The Life And Happiness Model uses feedback, based on human beings' survival instincts, to demonstrate how individuals determine the best solutions to make them the happiest. Use the Life And Happiness Model to explain the **discounted market hypothesis.**

Long-Term. In the stock market—time lasting one, two, three, four, five years or longer.

Lower-Highs and Lower-Lows. When the **long-term** trend line is pointing down during Stage 1: Mark-Down - Downtrend (see Graph 3 - 1), each wave down on the monthly chart depicts successively lower-highs and lower-low prices until Stage 2: Accumulation - Bottoming is reached. This occurrence is a **confirming indicator** to a down trending **S&P 500 Index Nine-Month Moving Average Trend Line**.

Map. The map (abstraction) should conform to the **territory** (reality) to be a legitimate map. All maps need constant verification to confirm their validity and to retain legitimacy. Maps should be necessary and sufficient to meet its function and application. The symbolic representation of reality using maps, models, words, or numbers are never the objects and events (i.e., territories). Investors routinely use maps (financial statements, etc.) or **maps-of-maps** (opinions from experts) on investing, but should always be aware these are not the real territories and may not be legitimate.

Maps-of-Maps. Mapmakers should have direct knowledge of their **territory** (reality) and decide to make a legitimate **map**. If a second mapmaker makes a different map based on the original map, this is making maps-of-maps or an abstraction from an abstraction. Maps-of-maps making does not use direct knowledge and in addition may be either legitimate or illegitimate. Maps-of-maps creators include **market pundits**.

Margin-of-Safety. The Graham-Dodd-Buffett strategy for their prudent **value investment** style. Purchasing stock at suitable prices, as determined by this sound method, should triumph over market adversity in the **long-term**. A positive corporate **bargain value** indicates a stock that is undervalued. A company's stock whose **intrinsic, true or fair value** is at least twice its market value capitalization has a large enough **margin-of-safety multiple** and is a deserving candidate for purchase based on the **margin-of-safety** concept.

Margin-of-Safety Multiple. A company's stock whose **intrinsic, true or fair value** is at least twice its **market value capitalization** has a large enough margin-of-safety multiple and is a deserving candidate for purchase based on the **margin-of-safety** concept. Rank order margin-of-safety multiples from highest to lowest, with their **bargain values,** to select the most deserving corporate stock for investment.

Market Cycles. There are four main stages in a market cycle over the **long-term**: Stage 1: Mark-Down - Downtrend; Stage 2: Accumulation - Bottoming; Stage 3: Mark-Up - Uptrend; and Stage 4: Distribution - Topping or Rounding Over. Stock markets in the long-term move slowly, monthly data and the **S&P 500 Index Nine-Month MA Trend Line** gives the best perspective needed to observe **long-term** stock market trends.

Market Pundit. A so-called expert or investment guru on the stock market or an individual stock who readily offers rationalizations for common stock being either under or overvalued, all supported by proffered economic justifications using **maps-of-maps**. A stock market sophist, known more for plausible but specious arguments then for being correct. In limited instances—a seeming authority figure making true but nonetheless unprincipled public statements in an effort to manipulate the investing public to go one-way, while the market pundit or his associates are doing something else, all motivated by their expected financial gain.

Market Risk. Systemic risk factors of **political- economic conditions** that determine overall stock prices. Market risk uncertainties have a tendency to move most stock prices together. Thus, diversifying market risk is impossible regardless of the number of companies or types of stock in an investment portfolio. Well-diversified portfolios eliminate all unsystemic risks associated with individual companies. Market risk is systemic risk.

Market Value Capitalization. Calculated by multiplying the corporation's total number of diluted shares outstanding times the current per share stock price. Used with **intrinsic, true or fair value** to calculate **bargain value**.

Moving Average Convergence Divergence (MACD). The MACD for the S&P 500 Index displays two crossing moving averages, the MACD (12,26) line and the MACD EMA (9) line. The monthly MACD is effective as a long-term indicator. Watch it closely at the beginning of each month. Use the monthly MACD as a confirming indicator for the **S&P 500 Index Nine-Month MA Trend Line**.

Objective Truths. Truths external to the individual and answer the questions of "what, who, where and when" of thought and action. Provable facts or truths are from the territory or reality that can be tested and found to be true. Objective truths are provable and consequently individuals hold these beliefs with assurance they are true. Use objective truths to explain the **Life And Happiness Model**.

Outside Reversal Day (ORD). At a stock market bottom, the **S&P 500 Index** makes a new intraday low for the current move and then closes above the intraday high of the previous day on extraordinarily high share-trading volume. At a stock market top, the S&P 500 Index makes a new intraday high for the current move and then closes below the intraday low of the previous day on extraordinarily high share-trading volume. This confirms a double top, on the second peak, or double-bottom, on the second trough, of the S&P 500 Index graph pattern. The ORD is a **confirming indicator** for the **S&P 500 Index Nine-Month MA Trend Line**.

Political-Economic Conditions. The long-term stock **market cycles** parallel political-economic conditions. These conditions occur because of long-term business and political conditions that are not random but irregularly cyclical in nature. The stock market is a representation of not only the real corporate economy, but also everything that impacts on the real economy. For example, political action by the federal, state and local governments and agencies that include: the decision to go to war; the policies on fiscal deficits and taxes; currency values; inflation rates; trade laws; decision on the federal funds interest rate and quantitative easing; **yield curves**; immigration policy; natural events (earthquakes, hurricanes, a pandemic disease); world conditions. The ultimate discovery that most investors make in the stock market is they must examine political-economic conditions and be able to interpret them to help determine and foresee investment probabilities. Stock market price action discounts **market risk** or systemic political-economic conditions because collectively the millions of investors see more clearly into the future. Political-economic conditions correspond to **long-term** stock market stages and are instrumental for the practical **ten-step method for investment success**.

Price-to-Earnings (P/E) Ratio. Current per share price divided by the corporation's **basic EPS** for a prior period. P/E ratios are actual or trailing twelve-month earnings per share divided into the stock price and are usually reported by the financial media. A stock with a high P/E ratio may signify a faster growing company resulting in the investor's willingness to buy at higher prices the same annual earnings. Also *Actual P/E Ratio*.

Random Walk Process. The financial research literature describes movement of a corporation's stock price as that of one aimlessly wandering through time as if someone drew by chance a plus or minus number and added that number onto the previous day's closing price. Day-to-day company stock price movements are seemingly independent from one another and are as random as the flipping of a coin or much like a pure gambling game such as American roulette. Each daily price series for a company's stock acts like a random walk process—no cycles are in evidence. The random walk process supports the **random walk theory**.

Random Walk Theory (RWT). The Random Walk Theory (RWT) states that corporate stock prices move randomly, either up or down and the prediction of a company's stock price is impossible. The RWT uses the premise of the **random walk process**. The RWT assumes that prices are based on random breaking news information that is unpredictable. Because unpredictable news information comes into the marketplace randomly—it is fully expected that prices respond randomly to this news. The Random Walk Theory supports and is the premise for the **efficient market hypothesis.**

Return-on-Equity (ROE) Ratio. Calculated by taking the annual net income (less dividends on preferred stock) found on the income statement, divided by total shareholder's equity from the balance sheet. Investors want ROE to be a high percentage and improving yearly. Monitor ROE, an important measure of management's performance when using **value investing**.

Roth IRA. Pay taxes on the income and the money going into a Roth IRA. However, at retirement, withdraw all the capital appreciation gained in the Roth IRA tax-free at retirement. Some income limits apply.

Securities and Exchange Commission (SEC). The federal government board created by the Securities and Exchange Act of 1934, which has regulatory responsibility for the securities industry.

Self-Selected Market Adviser's Strategy. This is the incorrect method for implementing the contrarian approach to investing. Believing the market is now undervalued or overvalued, based on a financial expert or market adviser's scintillating reasoning (see **maps-of-maps**), the investor decides now is the time to be contrarian and go against the crowd and takes a contrary position in the market. If, as likely, the market moves against the investor, he or she decides to hold on until the "market comes to its senses" and begins to correctly reflect the investor's "rational opinion." Predictably, this experiment in being contrarian goes awry. Guard against two human behavioral traits, opposing the market and pride of opinion, when attempting to be contrarian.

Standard & Poor's 500 (S&P 500) Index. Includes 500 public corporations selected in proportion to their **market value capitalization**, for their common stock trading liquidity and industry representation. The S&P 500 Index represents approximately 75 percent of the overall U.S. stock market value capitalization of U.S. equities on the NYSE, the NASDAQ and the NYSE Amex Equities stock exchanges. Use the S&P 500 Index as a benchmark to compare the total returns of other investments and is a good proxy representation of the overall U.S. stock market.

S&P 500 Index Expected Fair Valuation (EFV) Model. Divide the next twelve months of estimated reported earnings for the S&P 500 Index companies by the S&P 500 Index price resulting in a "S&P 500 Index estimated reported earnings yield." Next, divide the 10-year U.S. Treasury note interest rate by the "S&P 500 Index estimated reported earnings yield" resulting in a S&P 500 Index Value Factor. Calculate an expected fair valuation for the S&P 500 Index by dividing the current S&P 500 Index price by the S&P 500 Index Value Factor. While S&P 500 Index EFV Model is not precise, it gives the astute investor approximate correct forward-looking valuations.

S&P 500 Index Nine-Month Moving Average (MA) Trend Line. For the **S&P 500 Index**, the monthly trend line gives perspective to identify **long-term** trends in the stock market. Because the stock market, over the long-term, moves slowly, the perspective of monthly data are most appropriate to analyzing long-term trends associated with **market cycles**.

S&P 500 Index Two-Month Moving Average Trend Line. Helps identify long-term trends in the marketplace. Used as a **confirming indicator** for the **S&P 500 Index Nine-Month MA Trend Line** in the stock market.

Subjective Truths. Truths internal to the individual that have no objective criteria for judgment. Subjective truths are beliefs and values about concepts and answer the questions of "how and why." Prioritizing objective truths or facts ultimately makes all objective truths subjective truths since some objective truths may now be overshadowed or even ignored if they do not fit one's concepts. Subjective truths, thoughts, beliefs and values within individuals may be further divided into positive subjective truths and negative subjective truths to determine "how events are either occurring or *not* occurring in one's life" to make us happy. Use subjective truths to explain the **Life And Happiness Model**.

Super Long-Term. Twenty years, two decades, or more in the stock market.

Ten-Step Method for Investment Success. The method is practical and includes: 1) selecting the correct goal and strategy; 2) identifying **political-economic conditions**; 3) calculating the **S&P 500 Index Expected Fair Valuation Model**; 4) identifying the **S&P 500 Index Nine-Month MA Trend Line** using perspective and stock market stages; 5) rational anxiety, non-rational emotions and irrational influences all to be counteracted by proper investment character traits; 6) Graham-Dodd-Buffett **value investing** with **intrinsic, true or fair**

value, **market value capitalization**, **bargain values and margin-of-safety multiples**; 7) **yield curve** and interest rate monitoring to identify long-term market tops; 8) news evaluation, **discounting the news**, **discounted news theory,** being skeptical of **market pundits** and shunning stock tips; 9) avoiding the "**self-selected market adviser's strategy**" to being **contrarian** and being skeptical of conventional wisdom; 10) investors pull all the information together from steps 1 through 9, to make their **due diligence** judgments and arrive at their investment decisions.

Territory. The real world, as one experiences it using sight and other senses, is the real territory of external reality. Represent real world experiences symbolically on a **map**. However, never confuse maps and or **maps-of-maps** with the real world territory.

Total Capital Expenditures. Determine total capital expenditures by subtracting the purchase of property and equipment (sometimes-called capital expenditures), the acquisition/disposition costs or gains from the purchase or sale of subsidiaries, plus any proceeds from the sale of assets. Find these accounts on the cash flows from investment activities portion of the **cash flow statement (CFS).** Total capital expenditures are important when calculating **free cash flow (FCF).**

Unexpected News. Unexpected news is nonscheduled news with only the likelihood of "what, who, where and when" the imagined event may take place. The imagined "what, who, where and when" of unexpected news events cause some investors to modify both their actions and/or non- actions in the stock market. Everything that investors can imagine, which affect the stock market are partially discounted in the marketplace.

Value Investing. Expect buying good securities at a significant discount is the best strategy over the long-term. Investors should prefer high quality securities at proper or reasonable prices, which match their scheduled needs. **Intrinsic, true or fair value** is a good method for determining a company's present worth, compared with its **market value capitalization. Margin-of-safety multiples** and **bargain values** for each stock are rank ordered to identify possible candidates for stock purchase based on the **margin-of-safety** concept. Value investing is similar to comparison shopping and looking for outstanding stock market bargains.

Yield Curve. The yield curve is a result of monetary and fiscal policies affecting **political-economic conditions,** over time. A normal yield curve, for federal funds, T-bill, T-note and T-bond maturities, occurs during standard economic growth conditions. An inverted yield curve comes about when both money and credit are restrictive and is a good indicator of a U.S. economic downturn. If the federal funds target interest rate exceeds the 30-year T-bond rate, this indicates the overall stock market may begin to discount a slowdown in the U.S. economy and be peaking.

Zero-Coupon Treasury Bonds (Zeros). Purchase Zero-coupon Treasury bonds at a discount. The U.S. government pays no interest, but they are redeemable at par value at maturity. The benefit is that all interest is reinvested so Zeros sell at a deep discount to par value. There is a disadvantage to Zeros, however. The federal government requires a fixed proportion of the taxes paid annually, as if the U.S. government were paying interest.

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