

The Astute Speculator

*Moneymaking Stock
Market Trading 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 speculation.

The Astute Speculator

*Moneymaking Stock
Market Trading Advice
From the Masters*

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Introduction

EARNING +33 PERCENT PER YEAR speculating in the stock market, in both good times and bad, and retaining the profits once earned are challenging but realistic goals and the focus of this book. Trying to beat the stock market with what is learned in other professions and a smattering of Wall Street lore is almost certain to fail, as approximately 95 percent of beginning speculators discover.

Few gain correct speculative awareness before trading. Novice traders use trial and error, and experience becomes the initial teacher. Speculating in the stock market without the necessary understanding and practice is often a harsh, confusing and expensive way to learn.

Learn eleven key scientific speculative factors, three speculative arts and ten speculative bylaws necessary for correct stock market speculation. Success when speculating is best achieved by first becoming a knowledgeable stock trader, then practicing using simulator trading, next performing odd-lot trading with limited funds and only then graduating to trading in round lots.

The Astute Speculator

The essential trading wisdom and moneymaking advice from forty-five classic books and articles from the masters on stock market speculating, ensures that you learn from the best in a short period.

Speculative Experience

Most speculators find out about the stock market the hard way, simply by doing. Learning by doing, common when starting out in other businesses, is an expensive way to acquire the skills of a successful stock market speculator. By reading this book and applying its lessons well, novice speculators avoid many ruinous pitfalls that await those who begin speculating without first learning how.

Experience by itself does not inform on the lessons learned. Events merely appear without a frame of reference. Unaware speculators, during a stressful trading experience, do not recognize the important trading signs appearing right before their eyes, even though they think they see what is happening. Important data and information significance hides among the thousands of distracting facts and opinions.

Some will say, “Yes but, experience is the best teacher and he or she will do much better next time.” Nevertheless, if the bad experience traumatizes the losing novice speculator so they never want to see or hear about the stock market again, this cancels a good learning experience.

Learn First, Before Doing

The man or woman who masters the knowledge of stock market speculation, as presented in this book, is exceptional because few accomplish this task before they begin trading. Speculators should take a pledge to shun Wall Street until knowing they are doing the “right thing” and the “thing right.” Before speculating in the stock market, first learn about one of the most all-encompassing, strategic, fast paced and complex professions in the world.

Perhaps in no other professional activity will correct understanding pay higher dividends than learning beforehand how to trade properly in the stock market. Correct speculative theories, strategies and methods presented in this book succinctly explain how to make money in the stock market.

Introduction

A positive approach in this book explains stock market speculation. The goal is to point speculators to essential speculating knowledge and to what that knowledge means. The stock market is a mental game— next.

Mental Game

Stock market buying and selling is a mental game based upon the perceptions of participating traders. Taking advantage of market inefficiencies and winning on Wall Street is the province of those with the correct knowledge, foresight, patience, humility, iron nerve, discipline, judgment and having the courage to take proper action.

Albert Einstein (1879-1955) says, “The definition of insanity is doing the same thing over and over again and expecting a different result.” Do not be delusional. Failure in the stock market, as in business, is thinking in an intellectual rut. Only after losing most or all their money do speculators finally realize they have to think differently to be a success when trading common stock. Therefore, losing speculators should change their beliefs, desires, decisions and actions to achieve speculative success.

Beginning speculators should develop a reference for both understanding and feeling comfortable trading common stock. *The Astute Speculator* helps speculators feel confident in taking control of their money when speculating.

Speculative Overview

Stock market speculation is both an art and a science. The study of eleven key scientific speculative factors include what stage the market is in, the market’s trend, whether the market is undervalued or overvalued and how to calculate a corporation’s margin-of-safety multiple. The three speculative arts are: 1) how to time stock buying or short selling over the intermediate-term using turning points and trigger points; 2) how to sell or cover a stock position by taking the emotion out when using stop-loss orders and money management rules; and 3) knowing yourself and what approach will work best for you based on your character, personality and lifestyle.

Successful speculators master the art of short selling, which is not “un-American.” Making a purchase commitment on a stock is difficult

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but less emotional than concluding it. Learn how best to accomplish both. Recognize that sectors and industries have a major influence on how a stock within that industry behaves, over the intermediate term.

Price action indicates but is secondary in importance to trading volume, which validates the stock market's buy-side advance or sell-side decline. Learn how to use tape reading to recognize trigger points to capitalize on market turning points. Use the speculative bylaws and money management rules to become a successful speculator. Speculative strategies have to fit the speculator's character, personality and lifestyle to be effective—learn how to accomplish this.

Stock market speculating is a first-class profession. You require no outside office, no employees nor clients. Connect your computer to the Internet and live anywhere in the world. Many want to enter this unsurpassed speculative profession but few take the time to properly learn and practice before beginning, and predictably, they fail.

Speculative Goals

Challenging but reasonable goals when speculating are to earn three times the average super long-term S&P 500 Index return of approximately +11 percent per year, i.e., +33 percent per year. Then, retain profits, which is the real endgame. The most significant goal in stock market speculation is to have money available at the end of your trading career for a new life interest, leisure, or for a comfortable retirement.

Do Not Force The Stock Market

Do not try to force the stock market to fit your needs. Those who want the stock market to pay their weekly bills by trying to scalp full-or-half point moves in a stock will fail. Trying to make the stock market pay for an expense or a particular bill is futile. Unfailingly, the timing is wrong resulting in impulsive or unreasoning trades.

Astute speculators should take what the market gives them on the market's terms. Think of determining the objective truths of "what, when, who and where" of stock speculation as detective work and going on a journey of discovery.

How To Succeed On Wall Street

There is a saying on Wall Street, “Persons who act like stock market speculation is the road to riches, frequently go broke; however, persons only wanting a reasonable profit on their money, have the best chance of becoming rich.”

Speculators learn that correct trading is not a random activity, nor mere chance or luck; but a rigorous undertaking that requires eliminating risk as much as possible before taking a stock position. Accomplish this by relying on a suitable approach to the speculator, calculation, analysis, evaluation, good judgment and the courage to act properly.

Know the proper trading principles and follow the ten speculative bylaws for speculative success. Know yourself, do not overreach, and practice first using simulator trading. Start trading initially using odd-lot trades with limited funds and only then graduate to regular round-lot trading. Do not take unduly large risks in the stock market.

The purpose of this book is to point readers toward essential speculating knowledge and to what that knowledge means, transforming novice speculators into astute speculators—as described next.

What Is An Astute Speculator?

An astute speculator has foresight, a cool temperament, a clear mind, patience, iron nerve, discipline, is shrewd, and humble. She or he is keenly aware of what information and data are the most significant in stock market speculation, with the courage to act on that information.

Astute speculators plan and know where to find data necessary to perform calculations and how to interpret these results for proper decision-making. Astute speculators are seekers of truth, possess market vision, speculative intelligence and can take appropriate action based on practical stock market experience.

How To Become An Astute Speculator

The best stock market speculators are continuously learning how to trade. Speculators should ask themselves if market or stock price movements

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excite them. If speculators cannot wait to understand why price movements are occurring, these persons should delight in speculating.

To become a speculative professional and make a living from the stock market, it is imperative that traders take their calling seriously. Success in the stock market entails earnest, exhaustive study and only then taking proper action.

Trading stock looks deceptively easy to the uninformed. However, speculation can be especially trying. The axiom is, “One gets out of life an equal measure put into it.” Since the goal is to make outsized profits in the stock market by having money work extra hard, this requires speculators to work especially hard because no one earns something for nothing in life.

How speculators implement the information presented and the effort put forth when speculating ultimately establishes how successful they become when trading. Knowing what is in this book and applying it correctly, compared to others, makes these knowledgeable individuals speculative winners. To be an expert stock market speculator requires first being an expert investor, as described next.

Be An Expert Investor First

First, become an expert investor before attempting stock market speculation. An outstanding investor knows whether the overall stock market is undervalued or overvalued, if the market is in a long-term upward trend or long-term downward trend, what the most promising stock to buy is and what interest rates to monitor.

Astute investors use investment models, know where to find data on the Internet to perform calculations, understand what the results signify, can properly take action and are familiar with the following concepts.

1. Understands the difference between systemic risk and unsystemic risk.
2. Knows how the stock market acts as a discounting mechanism.
3. Fully understands diversification versus concentration of a stock portfolio.
4. Knows whether the overall stock market is either undervalued or overvalued.

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5. Knows how the rational, non-rational and irrational behavior of stock traders affect their actions.
6. Can determine the four stock market stages and how that affects speculating strategy.
7. Understands corporate intrinsic value, market value capitalization, bargain values and how to use margin-of-safety multiples to evaluate common stock.
8. Knows the political-economic conditions and how they affect the stock market.
9. Can determine interest rate spreads and how yield curves affect the stock market.
10. Understands the use of expected and unexpected news in the stock market.
11. Knows and can apply the contrarian method.
12. Can implement the practical ten-step method for investment success.

After feeling comfortable deciding and performing properly on diversified portfolios over the long term of 1, 2, 3, 4, 5 years or more, novice speculators may make judgments and perform successfully on concentrated portfolios over the intermediate term of 1, 2, 3, 4, 5 months or more. For those new to stock trading or for those who would like an investment refresher course, please use *The Astute Investor*, Prentis (2012)—see the bibliography for the specific reference.

Stock Market Stages

Correctly identifying with 95 percent certainty which of four stages the stock market is in is fundamental to good speculating. Understand the following four stock market stages referenced throughout this book:

Stage 1: Mark-Down – Downtrend

Stage 2: Accumulation – Bottoming

Stage 3: Mark-Up – Uptrend

Stage 4: Distribution – Topping or Rounding Over

Use the S&P 500 Index Nine Month Moving Average Trend Line with confirming indicators, as discussed in chapter 4 of *The Astute Investor*, to help determine the four stock market stages.

Do Not Rely On Luck

Speculators learn that correct speculating is not mere chance or luck but an activity relying on proper policy, analysis, foresight, patience, character, discipline, good judgment and timely action. Astute speculators have the advantage when competing against persons who do rely on luck.

Study the practical day-to-day solutions to the problems of speculating and Internet websites on where to find the appropriate data for speculators to calculate models for themselves. Ask the following fundamental speculative questions that are important to stock market traders.

Speculative Questions

Stressing only the answers to stock market speculation is unwise. Speculators repeatedly find it more instructive to learn the correct questions they should ask rather than a momentary correct answer, such as in a **monthly** market newsletter. Correct answers are for a specific time and place. Correct questions and solution methodologies transcend both and are universal.

The Astute Speculator helps speculators answer, for themselves, the following fundamental speculative questions:

- 1) What speculative principles are important?
- 2) Why is being a good short seller important? What are trigger points?
- 3) Why is the buy decision complex and timing critical?
- 4) Why is the sell or covering decision emotional, and how to complete trades successfully?
- 5) What aspects of trading volume are important when identifying turning points?
- 6) How can sectors and industries help recognize intermediate- term speculative momentum?
- 7) What character traits do winning speculators have and what are the ten speculative bylaws for trading success?
- 8) What money management rules reduce risk and ensure a profitable retirement?

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9) Each speculator's character, personality and lifestyle have to match their speculative strategy, why?

10) What are the strengths and weaknesses of participating in the futures and options markets?

Each of the chapter topics in *The Astute Speculator* support speculators by helping him or her answer these fundamental speculative questions for themselves, next.

Speculative Questions Answered

The following chapter synopses highlight the solution methodologies presented to allow speculators to answer these ten speculative questions.

1) Speculative principles cover both the art and a science of speculation. Use the eleven key scientific speculative factors and the three speculative arts and techniques for solution. Theory calls the stock market the “unbeatable game,” learn how to beat it. The stock market taxonomy categorizes the stock market for better communication and understanding.

2) Most speculators trade on the long side of the market. Astute speculators trade on the short side of the market, as well. Learn how to sell stock short using trigger points.

3) The ability to “say no” to a stock purchase is key. Learn whether to buy now or later, what stock to buy and at what price. Patience is necessary when making the buy or short sale decision, learn why. Making a purchase commitment is difficult but less emotional than concluding it. Learn why keeping a cash reserve is imperative.

4) Learn how best to sell or cover stock. Selling stock, both for amateurs and professionals, is emotionally difficult. The stop-loss order is certain protection against a speculator's human weakness when it comes time to sell or cover. Understand the effect use of stop-loss orders.

5) Price action indicates, whereas trading volume validates. Learn how to read the tape. Identify trend changes by using price and volume transactions that show up on the tape. Turning points indicate a stock market losing intermediate-term momentum, either up or down. First, recognize the turning point and then speculate on the correct side of the market.

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6) Momentum speculating is different from momentum investing. Sectors and industries typically either lead, lag or are coincident with the overall stock market's long-term trend. Consequently, determine the intermediate-term momentum of a stock. Industries high and low rankings help specify the leading stock within that industry for purchase or the lagging stock to sell short.

7) Learn the character traits of the best speculators. Astute speculators should follow the speculative bylaws when trading. Use simulator trading is a good first step when practicing. Start with limited funds to reduce emotional stress when trading with money, only when successful, graduate to trading in round lots.

8) Money management issues force speculators to prepare for possible trading losses. Money management rules focus on position size or determining how many shares to acquire, to the total amount of risk capital available to the speculator. Money management is about determining the risk of the trade based upon the percentage of the total risk capital put into each trade. Understand focus speculating, drawdown, emotional trading zone and calculating the reward-to-risk ratio.

9) How each speculator responds to the pressures of trading in a volatile stock market is unique. Therefore, each speculator must devise a speculative plan that works best for their character, personality and lifestyle. The three strategies presented are: 1) panic or contrarian specialist; 2) box theory; and 3) tandem trading. Select one of these strategies to implement, or combine different aspects for an approach that works best for you.

10) Study futures and options exchanges. Use different call and put strategies. Learn the good options strategies with the possibility for unlimited gain and limited loss. Understand why the futures and options markets are problematic for astute speculators.

Purchase This Book

Purchase this book because:

1) Speculators who need to understand a seemingly confusing and mysterious stock market. In addition, those who desire gaining essential trading knowledge grounded in the science of speculation.

Introduction

2) Those who desire a systematic approach to stock market speculation that includes becoming an expert investor first. Speculators learn important website addresses and how to find current data on the Internet to do the necessary model calculations for themselves.

3) Speculators who demand more than just description and theory; but, also how best to gain practical experience.

4) Financial services professionals who need to fully comprehend and explain the stock market to their clients.

Knowing exactly what the stock market will do is impossible. However, speculators have probabilities in their favor by purchasing, reading and correctly implementing the presented material in *The Astute Speculator*.

Website Commands

Current market data are necessary for speculators to run speculative models for themselves. Therefore, identifying websites with defined commands necessary to find specific current data and information are in bold letters. First, find the website logon address. Inside the brackets is where to look on the computer screen, what to click on or what information 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: [Necessary to type in information]

Many steps may be necessary, requiring various **Where**, **Click** and **Type** instructions.

Bibliography & Glossary

The Astute Speculator incorporates the essential speculative wisdom and moneymaking advice from forty-five classic books and articles from the masters on stock market speculating, presented in the bibliography section. Individuals study from the best and save considerable time learning how to trade. The glossary contains a financial dictionary of speculative words. Chapter 1 discusses speculative principles, next.

Glossary

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

Accounts Receivable. Customers who purchase goods or services using credit have their payment due amounts recorded in accounts receivable under current assets on a corporation's balance sheet. Accounts receivable become cash when customers pay their bills.

Algorithms. For **program trading**, optimally solves a mathematical model representing a large trading problem by using a goal seeking objective function and a progressive or iterative problem-solving solution method. Relying on computers to calculate algorithms designed by human beings, making possible quick decisions to take advantage of the fast changing stock and derivative markets. HFT uses algorithms.

Amateur Speculator. Amateur speculators trade based upon incorrect theories or principles that are at odds with demonstrated successful practice and scientific study. Amateur speculators do not take the time to weigh facts, learn conditions, or think through the

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consequences of their actions. Amateur speculators typically sell stock too soon, capitulate and repurchase the same stock at a higher price, buy additional stock as the price sinks during a market downturn and finally lose money by selling everything on an impulse at a market bottom. Amateur speculators believe that luck or tips dominate activity in the stock market, willingly overtrade on margin with inadequate capital, take profits too early, trade impulsively and become **chronic traders**. A major difference between amateur speculators and professional speculators is that when conditions are right to sell, professional speculators act while amateurs waver.

Astute Investor. A person who has foresight and is critically discerning, shrewd, intelligent, knowledgeable and keenly aware of what information and facts are the most significant in investing. An investor who plans and knows where to locate website data necessary to run appropriate investment models and how to interpret these models' results for decision making when investing over the **long term**. 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**.

Astute Speculator. First and foremost, a person who is an **astute investor**. A speculator in common stock over the **intermediate term**, trading either long or short, who understands the eleven key scientific speculative factors for success and excels at the three **speculative arts**. An astute speculator has foresight, a cool temperament, a clear mind, patience, iron nerve, discipline, is shrewd, humble, and keenly aware of what information is the most significant in stock market speculation and has the courage to act properly. Astute speculators plan, schedule, work hard and know where to find data necessary to make necessary calculations and how to interpret model results for proper decision-making. Astute speculators are seekers of truth, possess market vision, speculative intelligence, have practical stock market experience and can take appropriate action. Astute speculators recognize the importance of leading, coincident and lagging **sectors** and **industry group** rankings when identifying leading stock for purchase or lagging stock to sell short. Astute speculators follow **speculative bylaws**, use **money or risk management rules**, trade on **turning points** and **trigger points**, perform **tape reading** and realize that price action indicates, whereas, trading volume validates.

Averaging Down. Continuing to add to a losing stock position by naively buying more stock as the stock's price declines, to lower the average price of a stock previously purchased. Avoid averaging down.

Bargain Value Calculation. Compare the **intrinsic, true, or fair value** for a corporation to the **market value capitalization** to calculate its bargain value using a systematic valuation method. If the intrinsic, true, or fair value is more 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. Calculate **margin-of-safety multiples**. Rank in order the bargain value for each corporation, highest to lowest values, for comparison to make investments 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. Find the EPS figure after net income on the income statement [See **Diluted Net Earnings Per Share (DEPS)**]

Basis. The relative difference between spot or cash prices and futures price movements over the term of the futures contract. A perfect hedge has a constant basis.

Bulge. A fast run-up in the price of the stock market, an individual stock price, or a **futures contract** price.

Business Speculation. Because the business endeavor is new, it may seem hazardous. However, the general expectation is the product or service is either necessary or wanted and has the probability of an outsized profit. Systematically analyze and determine a new product, process, market and financial conditions are beneficial to the speculator.

Buy Ins. The brokerage firm informs the short seller of required higher fees to remain in the current short position or warns that a "buy in" is now possible. Unless the short seller can locate stock to borrow on their own, the brokerage house covers the stock on the short seller's behalf in the open market without the short sellers knowing about the transaction until the next business day.

Buy-Limit Order. An order to the brokerage firm that the customer's transaction occurs at a specified price or better. Set the limit order

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to buy at a price below the current market price, purchasing all shares are at that limit price or a lower price.

Cash Flow Statement (CFS). Tracks the 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.

Castle-In-The-Air Theory of Speculation. Expression coined by John Maynard Keynes (1883-1946) to describe how optimistic speculators behave in driving up a stock's price. Regardless of what reality is or expected to be twenty years from now, realize that a company's stock price can veer far from its **intrinsic, true, or fair value**. Keynes' sophisticated speculative strategy is subtle. That is, think about what the average investor will think about the average investor or crowd's assessment of market or stock expectations and trade with that determination.

Chart Patterns. Traders' human nature does not materially change through time. While traders do change, how traders act and react because of worry, hope, greed, fear and ignorance remain constant. This common reaction to trader's emotions produces recurring shapes or price patterns that constantly repeat themselves when viewed on stock charts or graphs, e.g., a **double top or bottom reversal pattern**.

Chronic Traders. Speculators who feel they have to trade constantly. **Amateur speculators** are obsessed with the idea of having all their money working all the time. It is futile to try to force the market to produce profits through chronic trading. Instead, only buy into an expected large stock gain. The money made and kept determines stock market success, not how often one trades. To trade stock just because cash is available is an inexcusable blunder.

Clearinghouse Corporation. A clearinghouse corporation assists in trade executions by conveying money, handing deliveries and certifying the accomplishment of all contracts for members on a **futures exchange** or **options exchange**. Each clearinghouse corporation assumes the responsibility for all trades made on their member's exchange.

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 trends**.

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Contingency Orders. Allows a stock or futures speculator to put in multiple orders that are dependent upon one another. If one order goes through then the other orders are canceled automatically, a.k.a., “if-then orders.”

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, but instead use the practical **ten-step method for investment success**.

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 higher than two.

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

Delta. Specifies how much call options will either increase or decrease in value when the underlying stock changes by one point in price, a.k.a., the “hedge ratio.”

Diluted Net Earnings Per Share (DEPS). The denominator for the **basic EPS** is expanded to include all convertible bonds, convertible preferred stock, warrants and stock options. When exercising these shares, they 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 encompass 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 is partially discounted by the marketplace.

Discounted News Theory (DNT). The movement of a stock’s price prior to an expected scheduled news occurrence is **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 at least partially discounted 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, in expectation of either good or bad news about a company, economic factors, or political conditions. Discounting the news also occurs when anticipating government pronouncements, actions or any other expected occurrence that affects the stock market. Discounting the news is the premise for the **expected news discounting process** that 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, exceptionally liquid and extends over the super-long-term planning horizon.

Double Top or Bottom Reversal Pattern. At a market top, a two-peak **chart pattern** occurs on a monthly graph at two separate points in time that looks like a upside-down letter W—normally two to six months apart. On a stock chart/graph 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 the same intraday price lows, double bottoms occur as the S&P 500 Index is forming a base and beginning an overall market upturn. Both are **confirming indicators** to the **S&P 500 Index Nine Month Moving Average Trend Line**.

Drawdown. The probable amount of money lost, as a percentage of total risk capital, during trading to achieve the expected returns.

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Drawdown increases as the percentage amount of risk capital committed to any one trade is increased.

Due Diligence. Investors should consider properly and thoroughly all possible factors to determine whether an investment or speculative position is suitable immediately before making the outlay. This requires investigating the **political-economic conditions**, **yield curve** and **industry group ranking** in the stock market, including a company's **intrinsic, true, or fair value**, its **market value capitalization**, **bargain value** and **margin-of-safety multiple**. All information and data used for **investing** and **speculating** should be judged for accuracy, omissions and misstatements.

Efficient Market Hypothesis (EMH). The theory of the efficient capital market to describe the overall stock market, which 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.

8-K. A report filed with the **Securities and Exchange Commission (SEC)** by a public corporation when a material corporate event that significantly affects the financial condition of the firm occurs.

Equivalent Stock Position. Translate call or put option positions into the equivalent number of shares owned of the underlying common stock, either net-long or net-short. The equivalent stock position (ESP) equation is equal to the number of option contracts, times **delta**, times the number of shares per option.

Expected News. All scheduled news from corporations, from governments, or their agencies. All expected scheduled news, whether meeting or not meeting expectations that affects the stock market has been fully

discounted by professional stock traders using the **expected news discounting process**.

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, leading to updated news expectation uses Hegel's Dialectic Theory. Expected scheduled news does not startle the stock market or professional stock traders because it is discounted.

Fair Value. The fair price for purchasing or selling a stock, option, or futures contract. Find fair value for stock by calculating its **intrinsic, true, or fair value**. Specify futures, options and options on futures fair values using specific mathematical valuation models.

Federal Reserve. The U.S. central bank, which manages the following 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 influences the supply and demand of Federal Reserve Bank balances, which adjusts the federal funds interest rate that directly affects **political-economic conditions**. The Federal Reserve sets a target for the federal funds interest rate.

Fill-or-Kill (FOK) Order. Directs the floor broker, a.k.a the pit broker, to attempt to fill the order three times at a specified price. Afterwards, the order is killed or canceled when not successful.

Float. Float represents the number of shares in the investing public's hands available for trading. The higher the float the better the stock's liquidity and ease of shorting. A company with a large percentage of shares held by management or owners reduces float because they are less likely to trade their shares. Also, stockholders with brokerage cash accounts may not allow shorting their shares by removing them from the street name of their broker's borrowing account, which further reduces float. **Buy ins** and **short squeezes** are the reason that short sellers should know the float, **short interest, short-interest-to-float** and **short-interest ratio** before **short selling** a stock.

Focus Speculating. Thoroughly knowing and understanding the few companies that are being speculated in, rather than taking a less

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knowledgeable statistical diversification approach. Relying on sound fundamental analysis for selecting undervalued stock to purchase or overvalued stock to sell short. The recommended number of companies that astute speculators should trade in at any one time is three, each representing 25 percent of total risk capital. This leaves 25 percent of total risk capital as a cash reserve. Use approximately 15-targeted trades to earn the astute speculative goal of +33 percent per year.

Free Cash Flow. Calculate free cash flow (FCF) 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 hopefully positive cash from operating activities for the year on the **cash flow statement (CFS)**. Positive free cash flow (FCF) is a benefit for a corporation's stock price because management then has the option of increasing dividends, buying back their own stock, developing promising new products/markets, or meeting competitive challenges—all without the need to raise additional money from outside sources.

Futures Contracts. Hedgers (producers and end users) and speculators in the futures market attempt to forecast, for successive months over the next twelve months for most futures contracts, the price of soft commodities (agricultural and food), physical commodities (energy and metals) and financial futures (equity, foreign currency, and interest rate indexes). Standardized contracts for each commodity traded on the **futures exchange** entails quantity, quality, destination and expiration date. Standardization encourages futures trading and, therefore, market liquidity. Both the buyer and seller have to satisfy the terms of the futures contract on its final settlement date.

Futures Exchange. Its function is to bring buyers and sellers together when trading **futures contracts**—whether they are hedgers (producers and end users) or speculators. The four main attributes of the futures exchange are: 1) price settlement; 2) contract standardization; 3) buying and selling liquidity; and 4) the transfer of risk.

Futures Price Spread Strategies. At certain times of the year, based on commodity seasonality, futures price spreads between different futures contract expiration dates fluctuate. Prices may not change in an identical fashion on different **futures exchanges**. Therefore, use price spread strategies profitably. Example futures price spread

strategies for commodities include: intra-commodity spread, inter-commodity spread and straddles.

Good Till Canceled (GTC). An open buy or sell order in force now and in the future in the brokerage's system, that sets a priority for sale. The GTC order remains in effect either until the customer cancels or executes the order.

Head and Shoulders Top or Bottom Reversal Pattern. This **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/chart. 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**.

Hedge Fund. Open-ended investments company that large institutions and high net-worth individuals may make an investment. Hedge funds are speculative enterprises whose objective is to earn above market returns and/or to reduce risk. They may invest in the stock, bond, commodities, or foreign exchange markets. Typically, the hedge fund manager may borrow money, buy long or sell short and use derivatives such as futures, options and options on futures—all concurrently.

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 event is a **confirming indicator** for an up trending **S&P 500 Index Nine Month Moving Average Trend Line**.

Index Arbitrage. The most used strategy of **program trading** and involves identifying price inconsistencies among stock baskets, indexes and futures & options contracts on different exchanges. Advanced HFT computer **algorithms** hedge equity positions.

Industry Group. Companies are grouped into twelve **sectors** and further sorted into anywhere from 100-200 industry groups. The primary business pursuit of the corporation determines how to sort companies

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into industry groups. Industries display momentum and high or low industry rankings help identify corporate leaders or laggards to either purchase or sell short.

Industry Subgroups. Large **industry groups** may include as many as 100 public corporations and, consequently, have subgroups of companies that represent a niche within its industry group.

Initial Public Offering (IPO). A company's initial stock sale in the primary market, normally using an underwriter as a manager known as an investment banker—such as Morgan Stanley, Goldman Sachs, JPMorgan Chase, Citigroup and ING Group. The **Securities and Exchange Commission (SEC)** approves and regulates all proceedings of the IPO.

Intermediate Term. In the stock market, a period of time lasting 1, 2, 3, 4, 5 months or longer.

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 that 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 many year planning horizon. Investors should prefer high quality securities at proper or reasonable prices that 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. Perform **due diligence** by following 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.

Law of Compensation. Dualism takes place in nature and is the condition of man. Every gain causes a loss; every loss a gain. Look for the silver lining in every dark cloud and the downside that always accompanies an upside experience. That is, do not let life blind-side you at an inopportune time.

Long Term. In the stock market, a period lasting 1, 2, 3, 4, 5 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 reaching Stage 2: Accumulation - Bottoming. This occurrence is a **confirming indicator** to a down trending **S&P 500 Index Nine Month Moving Average Trend Line**.

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. Margin-of-safety multiples may be rank ordered from highest to lowest, with their **bargain values**, to select the most deserving corporate stock for investments.

Market If Touched (MIT) Order. Specifies a set purchase price only if the current price drops to the lower set price.

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 than 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 take action while the market pundit or his associates are on the other side of the trade, all motivated by an expected financial gain.

Market Risk. Risk associated with systemic factors of **political-economic conditions** that determine overall stock prices. Market risk uncertainties have a tendency to move most stock prices together. Thus, you cannot diversify away market risk regardless of the number of companies or types of stock in an investment portfolio. Adequate diversification eliminates almost all unsystemic risks associated with individual companies. Market risk is systemic risk.

Market Timing. Expecting to purchase common stock at the precise bottom price and to sell at the exact top price on any intermediate or long-term move. **Astute investors and speculators** do not assume perfection and believe being close enough by attaining the more secure middle two-thirds in any market move is the better strategy.

Market Trends. Four main stages defining the market trend over the **long-term** are: 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** help in determining market stages and trends.

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**.

Momentum Speculating. Used to identify intermediate-term industry trends by looking at industry rankings and additional fundamental corporate factors. Stock momentum may be either positive or negative

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depending on intermediate industry and long-term stock market trends, the market stage and **industry group** rankings. Use **Trigger points** to help identify momentum speculating **turning points**.

Money Management Goals. The three goals of money management are:

1) never put one's way of life at risk; 2) only risk as much money on one trade that will keep the mind clear; and 3) be able to keep the money once earned.

Money Management Rules. Money or risk management focuses upon position size, or how many stock shares to acquire, to the total amount of risk capital available to the speculator. And upon the risk of stock trading where speculators plan for the possibility of trading losses by using risk-reduction strategies. Money management rules are important because it is not how much money speculators earn that is most important, instead, it is how much traders do not lose that determines speculative success. Speculative money management rules include: 1) save half the profits; 2) have patience, keep cash reserves and have the capability to "say no"; 3) protect capital; 4) use **focus speculating**; and 5) staying with winners.

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**.

Moving Average (MA) Trend Line. Gives the best perspective needed to observe **long-term** stock market trends.

Naked-Short Position. During a naked-short transaction, one or more of the following **SEC** requirements are deficient: 1) the order must inform the exchange handling the trade it is a short sale; and 2) the broker handling the sale must have borrowed the stock to make delivery before the sale. Also, a non-hedged stock position.

Not-Held Order. The brokerage firm is instructed to use their discretion on the timing and/or price when executing either a market or limit order. Expect the floor broker to have a better feel for whether stock prices should rise or fall. The not-held order does not guarantee filling the customer's order.

Options. A holder of a stock option has the right but not the obligation to either purchase or sell a stock at a predetermined price over a specified period. A call option allows the holder to buy the underlying stock at a specific price, called the strike price, and the put option allows the holder to sell the underlying stock at the strike price. Both the call and put options may trade until the options expiration date.

Options Exchanges. Where common stock options and equity, industry, foreign currency and interest rate index options occurs. Listed **options** require five pieces of descriptive information, i.e., the basis of the option (whether a common stock option or equity, industry, foreign currency or interest rate index option), if it is a call or put option, the number of options contracts, strike price and expiration date.

Options On Futures. Derivatives on derivatives twice removed from the underlying spot or cash market. First, is the spot or cash market. Second is futures on the spot or cash market. Third is the options on the futures on the spot or cash market. Cash-based options on futures, as opposed to commodity based futures options, have no material commodities as a basis for the options contract.

Options Strategies. Call and put options strategies include: call buying, covered and uncovered call writing, put buying, put writing, protected short sale, reverse hedge, and straddle buying, ratio writing, ratio call spreads, vertical, horizontal and diagonal spread strategies, and collars. Recommend good options strategies, with the possibility for a large or unlimited gain or a limited loss: i.e., call buying, put buying, protected short sale, reverse hedge and straddle buying.

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**.

Pivot Points. Price support and resistance levels define pivot points used with the tandem trading strategy. Reversal pivot points mark the end

of a long-term trend for a stock or the stock market, either upward or downward. The reversal pivot point is the ideal psychological time to begin the “long-pull” trade to take advantage of the new major long-term trend in the market. Continuation pivot points are intermediate-term trend reversal points that signify that a countertrend is ending and the intermediate-term trend will now track with the market’s long-term trend.

Political-Economic Conditions. The long-term stock **market trends** correspond to political-economic conditions. These conditions are mainly by long-term business and political conditions that are not random but irregularly cyclical in nature. The stock market is a symbolic representation of not only the real corporate economy, but also everything that affects 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; **yield curves**; immigration policy; natural events (e.g., earthquakes, hurricanes, a pandemic disease, etc.); world conditions; etc. The ultimate discovery that most investors make in the stock market is that 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 systematic political-economic conditions because collectively the millions and millions of investors see more clearly into the future than any one person possibly can. Political-economic conditions correspond to **long-term** stock market stages and are instrumental for the practical **ten-step method for investment success**.

Premium. The price difference in points/dollars, whether positive or negative, between the S&P 500 Index futures contract price and the spot or cash price of the underlying stock in the S&P 500 Index. Determine market momentum, either up-or-down, by knowing “the premium.”

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 trailing twelve-month earnings per share divided into the stock price and reported on by the financial media. A stock with a high P/ E ratio may signify a faster growing company resulting in the investor’s

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willingness to buy at higher prices the same amount of annual earnings. Also *Actual P/E Ratio*.

Program Trading. An arbitrage strategy for inter-market price variations based only on market divergences rather than stock fundamentals. Program trading accounts for almost 70 percent of the trading on the NYSE and utilizes HFT computer **algorithms** to implement the following strategies: 1) investment objectives; 2) duration averaging; 3) portfolio insurance; and 4) **index arbitrage**.

Progressive or Trailing Stop-Loss Orders. Once the trade is profitable, either long or short, move the **stop-loss order** so you sustain no loss on the trade. As the stock price continues to move in the speculator's favor, continually move the stop-loss order up if long and down if short, at a measured distance from the stock's current price. Thus assuring a larger-and-larger profit if the stock price should then move against the speculator—resulting in the progressive stop-loss order automatically closing out the profitable position.

Proxy Statement. Required SEC material sent to existing shareholders, before the annual meeting with management that lists corporate issues for voting—including directorships, the auditing firm, salaries of top officers and major corporate resolutions.

Put/Call Ratio. Tracks speculator sentiment and calculated by dividing the number of put options contracts traded per day by the number of call option contracts traded on the same day. A put/call ratio (PCR) less than one means speculators are optimistic and expect stock prices to increase. A PCR over one signifies pessimistic options traders who expect a price decline.

Random Walk Process. The financial research literature describes movement of a corporation's stock price in the stock market as 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** of stock prices.

Random Walk Theory (RWT). The Random Walk Theory (RWT) states that corporate stock prices move randomly, either up or down and that

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the prediction of a company's stock price is impossible. The premise of the **random walk process** supports the RWT, which assumes that unpredicted random breaking news information determines market prices. Because unpredictable news information comes into the marketplace randomly—stock prices respond randomly to this news. The Random Walk Theory supports and is the premise for the **efficient market hypothesis**.

Reaction. A quick dip in price for the stock market, an individual stock price, or a **futures contract** price.

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. Closely monitor ROE as an important measure of management's performance when using **value investing**.

Reward-to-Risk Ratio. If setting the stop-loss order two points/dollars below an average priced stock, the expected profits should be at least eight points to consider this a good trade. **Astute speculators** should expect to earn at least four times the possible loss on the stop-loss order. Assuming a speculator wins 60 percent of the time and loses 40 percent of the time, the probabilities are now in the speculator's favor—expect total returns to be a positive 30 percent over ten trades, less commissions. Probabilities are now in the speculator's favor, not requiring trading perfection.

Robust or Appropriate Method. Perfection and trying to find the optimal market solution model is counterproductive. Riches and perfection do not go together in the stock market because performing flawlessness in the stock market is impossible. Instead, look for the most robust method and stock market models proven capable in practice.

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.

Scale In-or-Out Orders. An order issued to a brokerage company to execute either the buying or selling of a set number of shares of the same equity at varying prices. The price points are typically set at half-point intervals, either up or down.

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Sectors. A stock market sector is a large grouping of corporations with shared business characteristics. Sort companies on the different exchanges such as the NYSE, NYSE Amex Equities and the NASDAQ into twelve sectors. Sectors lead, lag or are coincident with the overall stock market. Further sort companies within sectors into smaller **industry groups**.

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.

Selling Climax Day. Signifies a market capitulation and occurs at a long-term or intermediate-term support **turning point**. The market opens weak and plunges straight down on heavy volume. Selling climax volume at a long-term turning point is normally 1.5 times average NYSE volume during a day where stock prices drop precipitously for the S&P 500 Index in a broad market decline. The selling climax day normally coincides with bad news that causes the investing public and **amateur speculators** to dump their stockholdings at distressed prices. Buyers that are more knowledgeable have already discounted the news. They now buy the excess supply, resulting in higher closing stock prices. A selling climax day turns around the technical condition of the market, which changes it from being long or intermediate-term weak to now being a strong market. Also the “clean out day.”

Semi-Investor. A person who keeps four separate financial accounts and makes a transition from investing to speculating. He or she wants to purchase stock bargains in three leading, high-quality companies with stellar records of accomplishment at a long-term market bottom.

Shares Outstanding. The number of shares of common and preferred stock issued by the public corporation, less the stock later repurchased by the company and held as treasury stock or retired. Outstanding capital stock available for trading.

Short Interest. The total number of a company’s shares or positions on the futures exchange sold short. The higher the short interest the more pessimistic traders are on the common stock or futures position.

Short-Interest-to-Float. The **short interest** divided by the stock’s **float**. A high short-interest-to-float percentage is dangerous for short sellers when **short selling** because it shows that a large short position is already

in the stock. When putting on a short sale, short sellers prefer not to have too much short-sale company.

Short-Interest Ratio. The **short interest** divided by the stock's average daily trading volume indicates how many days are necessary to cover all short-sale shares. When **short selling**, high short-interest ratio stock are more hazardous to sell short because the short position may be too crowded.

Short-Sale Uptick Rule. (Rescinded in 2007) Assuming one can borrow the stock shares, the **Securities and Exchange Commission (SEC)** uptick rule 10a-1 of the Securities Exchange Act required the short sale to take place on a plus tick (increase in price) or zero-plus tick (unchanged price) from a prior transaction price.

Short Selling. First selling the common stock or futures contract first without benefit of ownership. "Sell high, buy low," describes the procedure when short selling. As the stock or futures price declines, cover the short position at a profit. The speculator, on the short side of the market, is planning to profit from the drop in the price of a stock, commodity, or financial index.

Short Squeeze. A rapidly rising stock or **futures contract** price has the effect of pressuring those in short positions to cover which further increases prices—forcing even more shorts to cover. Examples of events that can cause short squeezes are brokerage house upgrades, buyout or merger Wall Street rumors, intermediate-term swings in the market that go against the short's position and companies that get proactive in trying to squeeze short sellers.

Simulator Or Paper Trading. Simulator trading, paper trading, or virtual trading is a replicated process where speculators practice trading and gain real world experience without risking money. Because there is no risk of loss involved, simulator trading can be an empty exercise if not conducted properly.

Speculating. Stock market speculation is both an art and a science. Understand and master eleven scientific speculative factors and three **speculative arts**. Speculators follow **speculative bylaws**, use **money management rules**, trade at **turning points**, use **trigger points**, perform **tape reading** and realize that price action indicates, whereas, trading volume validates.

Speculative Arts. Include: 1) how to time stock buying or short selling over the intermediate-term using **turning points** and **trigger points**; 2) how to sell or cover a stock position by taking the emotion out when using **stop-loss orders** and **money management rules**; and 3) knowing yourself and what scheme will work best for you based on your character, personality and lifestyle.

Speculative Bylaws. Bylaws are necessary because stock market speculation looks relatively easy to **amateur speculators** who incorrectly think of speculation as simply gambling in a large casino called the stock market. Instead, proper knowledge and following tested bylaws are essential to reducing risk and achieving market success.

Speculative Goals. Earning +33 percent per year speculating in the stock market, in both good times and bad, and then retaining the profits, which is the real endgame.

Standard & Poor's 500 (S&P 500) Index. Includes 500 public corporations selected for market capitalization size, common stock trading liquidity and broad industry group representation. The S&P 500 is a value-weighted index and 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 with which to compare the total returns of other investments and is a good proxy representative of the overall U.S. stock market.

S&P 500 Index Expected Fair Valuation (EFV) Model. The next twelve months of estimated reported earnings for the S&P 500 Index companies are divided by the S&P 500 Index price resulting in a "S&P 500 Index estimated reported earnings yield." Next, the 10-year U.S. Treasury note interest rate is divided 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 S&P 500 Index 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 **market trends**.

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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.

Stock Journal. Speculators should study market behavior for stock indexes, **industry groups** and specific common stock by keeping accurate daily journal records. Record significant events, i.e., the daily opening, high, low and closing price data, trading volume data, and why you entered the trade and why it worked or did not work in practice.

Stop-Loss Orders. Preset instructions to take a trader out of a current long or short position at a small loss when the stock's price moves to a set price level. A sell stop-loss order for a long position automatically activates when the stock's price reaches a lower price than it is trading. A buy stop-loss order for a short position automatically activates when the stock's price attains a higher price than it is trading. The stop-loss order may be in place for one-day, a longer-term period or **good until canceled (GTC)**. A defensive technique to conclude an emotionally charged transaction decision.

Strong Hands. Coming off a long-term market low during Stage 2: Accumulation, the technical position is strong as strong-hand professional speculators accumulate stock from the “**weak hands**” of the investing public. A strong technical position is in effect at a long-term market bottom because professionals gradually purchase common stock at low prices from the fearful investing public.

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

Supply And Demand, Current. Stock price purchase and trading volume figures reported on the tape that indicates the existing supply and demand condition in the stock market. Either buyers or sellers dominate in the market resulting in an upward or downward trend.

Supply And Demand, Potential. Stock prices over the intermediate and long-term move in trends. Looking at a chart/graph, supply and demand points are support and resistance levels. A support level is the price where sizeable new buying demand takes place and may keep the price from falling below this point. A resistance level is the price where substantial new selling supply takes place and may keep the price from rising above this level.

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

Tape Reading. Foreseeing stock price changes based on price and volume transactions that show up on the electronic **tape**. This requires forecasting stock trends and **turning points** by understanding the consequences of how past price and volume transactions affect future price movements.

10-K. The **Securities and Exchange Commission (SEC)** requires public corporations to file financial information on the firm's operations called 10-K reports. Annual reports going to stockholders are more visually appealing while 10-K reports going to the SEC have more financial detail and incorporate information on management compensation and report on any legal proceedings. Ninety days after the close of the corporation's fiscal year, they should file their 10-K report.

10-Q. The **Securities and Exchange Commission (SEC)** requires public corporations to file quarterly unaudited financial information on the firm's operations called 10-Q reports. The 10-Q report is a less comprehensive but more regularly filed version of the **10-K** report. Forty-five days after the close of the corporation's quarter, they should file their 10-Q report.

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

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wisdom; 10) investors pull all the information together from steps 1 through 9, to make their own **due diligence** judgments and arrive at their own investment decisions.

Time Stops. Capital is the lifeblood of trading; therefore, it is imperative that risk capital always be in effective circulation. If a stock does not perform as expected, close the position after only a few weeks. Better to wait patiently in a neutral cash position for the next superb trading opportunity than have cash locked in a listless stock drifter going nowhere.

Time Value Premium. When a call is out-of-the-money, the call time value premium equals the option premium. The equation is—call time value premium equals call option premium less intrinsic value. The intrinsic value is equal to the stock price, less the strike price. When a call option is out-of-the-money, the intrinsic value is equal to zero.

Timing. On Wall Street, timing is the primary **speculative art** or “art of arts.” The primary concern for speculators is always “when.” The “what” to buy or sell short is always of secondary importance. The stock’s price or “how much” to pay or initially receive for the shares sold short is only number three in significance.

Total Capital Expenditures. Determine total capital expenditures by subtracting the purchase of property and equipment (sometimes capital expenditures), the acquisition/disposition costs or gains from the purchase or sale of subsidiaries, plus the addition of 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)**.

Trader’s Market. No well-defined upward or downward long-term trend is in evidence during a trader’s market during two distinct market phases: Stage 2: Accumulation - Bottoming and Stage 4: Distribution - Topping or Rounding Over. A trader’s market is also in evidence during one or more intermediate-term moves that run counter to the overall long-term movement during a Stage 3: Mark-Up – Uptrend long-term advance and during a Stage 1: Mark-Down - Downtrend long-term decline.

Trigger Points. Perception of what is hoped for takes on the guise of reality. It is human nature to desire wealth and in the stock market, this occurs when dreaming about the future. A speculator’s perception is

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often better than reality and a stock's price reaches its highest level when trader's expectations are the highest and not when reality is at its highest point. A trigger point for an overvalued or undervalued stock is typically fulfilling expectations, used in **momentum speculating**.

Turning Points. The stock market loses momentum over the long or intermediate-term, either up or down, at turning points. Momentarily, supply and demand are in balance and the market is in equilibrium, however, markets do not stay in equilibrium for long. Turning points typically occur on heavy volume but no headway in price. The **momentum speculating** goal is to make the trade close to the exact turning point when the market then starts going the opposite direction.

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 can be imagined by investors, which are determined to affect the stock market are partially discounted by the marketplace.

Value Investing. Buying good securities at a significant discount is the strategy expected to triumph over the long-term. Investors should prefer high quality securities at proper or reasonable prices that match their scheduled needs. **Intrinsic, true, or fair value** is a good method for determining a company's present worth and is compared with its **market value capitalization**. Rank in order **margin-of-safety multiples** and **bargain values** for each stock to identify possible candidates for stock purchase based on the **margin-of-safety** concept. Value investing is like comparison shopping and looking for stock market bargains.

Wasting Asset. Purchased options are a wasting asset of the “**time value premium**.”

Weak Hands. A market in a weak technical position. At a long-term market peak during Stage 4: Distribution - Topping or Rounding Over when stock is being gradually distributed over many months from “**strong hands**” to the investing public's “weak hands.”

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

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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 is a harbinger the overall stock market may begin to discount a slowdown in the U.S. economy and be close to peaking.

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