AIQ Opening Bell Newsletter

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Study has far-reaching implications for all investors

An Exploration of the Nature of Bull Market Tops

By Paul F. Desmond

Almost every investor harbors the secret wish of being able to sell out on the exact top day of a bull market. The bragging rights would last a lifetime. But, exactly how does an investor identify the top day? An easy answer might be that it is the highest level reached by the Dow Jones Industrial Average (DJIA) before a major market decline. This is probably a reasonably good answer for historians studying the long-term trends of the stock market, but it is not a practical, working answer for investors since it can only be known long after the top occurred.

Another answer might be that the exact top of a bull market is the point at which the vast majority of stocks reach their highest price levels for many years to come. More than a few investors would say that the first answer and the second answer are synonymous; that the majority of stocks reach their peaks at the same time as a peak of the DJIA. But, is that actually the case? Do most stocks reach their price peaks in unison, and do they do so simultaneously with the major price indexes? Does what seems so logical match actual experience?

> ***"Despite our almost total lack of understanding of the subject, the end of a bull market and the simultaneous start of a new bear market is undoubtedly one of the most important moments in time for any investor."***

There is a dearth of information about the nature of major stock market tops, and the sparse information that does exist is more theoretical than statistical. Stock market guru, Joseph Granville, once surmised that one third of stocks reach their final bull market price peaks in advance of the DJIA's peak, one third reach their price highs in unison with the DJIA's peak, and one third reach their peaks after the DJIA's peak. However, the sheer simplicity of Granville's theory suggests that it was based more on guesswork than on hard statistical analysis.

One thing that investors have known, if only in a very vague sense, is that major market tops are not the same as major market bottoms. Much more work has been done in defining the nature of major stock market bottoms than in understanding the nature of bull market tops.

A 2002 Lowry study titled *Identifying Bear Market Bottoms and New Bull Markets* (see website www.lowrysreports.com) showed that major market bottoms can often be identified by evidence of panic selling (one or more 90% Downside Days) in which investors dump stocks with abandon. Then, with the desire to sell having been exhausted, buyers suddenly rush in to snap up the bargains (and cover short positions), resulting in a 90% Upside Day. The combination of panic selling across a broad spectrum of stocks, followed quickly by broad, enthusiastic buying, produces what might be described as a classic "V" pattern of prices at major bear market bottoms.

Bull market tops, on the other hand, tend to develop gradually over a long period of time. The reasons for this gradual process are easy to understand: It is the Law of Supply and Demand at work. Just as bull markets result from strong, persistent investor demand for stocks, bull market tops evolve when investors gradually stop buying. Some investors simply run out of new money to invest. Others begin to see individual stocks as being overvalued, and begin to hold back on new purchases. Whatever the reasons, the stock market cannot continue to advance without Demand exceeding Supply.

The evolution of investor psychology from strong buying enthusiasm for stocks to passivity or complacency does not occur suddenly. Thus, bull market tops are commonly diffuse, possibly lulling most investors into inaction. Perhaps it is the slowness of the entire process that makes it difficult to recognize a bull market top.

However, beyond this vague and somewhat hypothetical supposition, little or nothing more is known about the nature of bull market tops. Despite our almost total lack of understanding of the subject, the end of a bull market and the simultaneous start of a new bear market is undoubtedly one of the most important moments in time for any investor.

Many investors have experienced the frustration and anguish of making big stock market gains in a bull market, only to watch the gains turn into big losses during the subsequent bear market. Thus, the ability to avoid capital losses is, in many ways, a more important objective for investors than making big gains.

Perhaps it is our almost total lack of understanding about the end of bull markets that is responsible for investors' almost universal inability to avoid bear markets. A greater understanding of investor psychology near bull market tops might emit warning signs in the making, and allow at least some alert investors to be able to take defensive actions in advance of the devastating losses that typically occur in the subsequent bear market.

There are several helpful tools that technical analysts have used for many decades to warn of impending stock market tops, such as the Advance-Decline Line and the number of stocks recording new 52-week Highs. History shows that these indicators often top out and begin to contract, as individual stocks fall by the wayside, months in advance of the final top in the Dow Jones Industrial Average. Therefore, it would not be a surprise to find that all stocks do not reach their peaks simultaneously or in unison

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with the DJIA. But, it is the degree and the intensity of the divergences of individual stocks from the DJIA that had never been measured before — until now.

Discoveries in science are frequently the result of happenstance rather than great scientific detective work. The discoveries to be related in this paper regarding bull market tops began in exactly that fashion. My firm, Lowry Research Corporation, had purchased rolls of microfilm of the Wall Street Journal covering the period from 1920 through 1930. Being able to step back in time, if only in recorded history, is a special experience.

The first frame to be viewed in the microfilm reader, purely out of curiosity, was the page containing the New York Stock Exchange trading of September 3, 1929 — the absolute top day for the DJIA prior to the 1929 Crash. It is ironic that 1929 is undoubtedly one of the most important dates in stock market history, and so little is known about the forces of supply and demand at

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work in the market during that period.

In simply looking around at the trading data from that day — at the many unfamiliar names of the companies traded, at the volume of trading, at the highest prices for each stock — it became apparent that some stocks had traded that day at prices below their 1929 highs. Some stocks were considerably below their yearly high. That seemed strange for a day on which the DJIA was at the absolute highest point in history and at a level that would not be seen again for the next 20 years. Upon closer examination, it was difficult to find stocks that were at their highs on that fateful day.

Intuitively, something seemed to be very wrong. On a day when common sense would dictate that most stocks should have closed at their all-time highs, it was determined that very few stocks had closed at, or even near, their 1929 highs (**Table 1**). Many stocks were down from their highs by 20% or more (Last price was lower than 1929 High price). Thus began a detailed examination of the trading of September 3, 1929. The results were most surprising.

On the day on which the Dow Jones Industrial Average reached its absolute high for the 1920s bull market, the percentage of stocks making new 1929 highs that day was not 80% or 75% or even 70%. It was 2.30%. Out of 826 stocks that were traded on the New York Stock Exchange that day, only 19 stocks made their highs. Equally surprising, only 15.62% of all issues traded on the NYSE were either at, or within 2% of their 1929 highs. In other words, about 84% of all stocks had topped out and had begun to decline at some time prior to September 3rd.

In fact, it was determined that, on the same day that the DJIA reached its all-time high, 31.84% of the stocks traded on the NYSE had already declined by 20% from their 1929 highs. 18.77% of stocks had declined by more than 30%. Stocks at, or within 2% of their highs were dwarfed by the number that had already lost 20% or more from their 1929 highs.

Thus it became apparent that the absolute top for the vast majority of stocks had probably occurred months — perhaps many months — before September 3, 1929. And yet, there had been no single, outstanding day of rally prior to September 3rd that investors could identify as the ideal point at which to shift portfolios to a more defensive composition.

The pressing question was whether the 1929 case was a total anomaly, or whether somewhat similar conditions would be found at other important bull market tops throughout history. Therefore, we expanded our study to include each of the fourteen major bull market tops, based on the Dow Jones Industrial Average, from 1929 through 2000 (see **Table 2**). Our basic assumption was that most stocks reached their highest prices in unison with the Dow Jones Industrial Average. But, our examination of each stock traded on the New York Stock Exchange, comparing their bull market highs to their closing prices on the peak days of the Dow Jones Industrial Average,

Table 1: Examination of Trading on September 3, 1929

Bull Mkt Top Day	% Stocks at New Highs	% at or <2% of New High	% Off 20% or More	% Off 30% or More
9/03/1929	2.30%	15.62%	31.84%	18.77%

Table 2: Trading at Fourteen Peaks in the DJIA

Bull Mkt Top Day	% Stocks at New Highs	% at or <2% of New High	% Off 20% or More	% Off 30% or More
09/03/1929	2.30%	15.62%	31.84%	18.77%
03/10/1937	6.05%	21.34%	5.94%	1.06%
05/29/1946	8.59%	30.44%	6.30%	0.86%
04/06/1956	5.32%	23.36%	19.92%	0.42%
01/05/1960	1.60%	5.83%	23.25%	7.67%
12/13/1961	3.56%	11.83%	25.29%	11.60%
02/09/1966	9.66%	19.04%	9.52%	2.68%
12/03/1968	9.43%	20.12%	9.51%	2.36%
01/11/1973	5.30%	11.82%	34.22%	20.51%
09/21/1976	10.97%	22.88%	21.65%	10.09%
04/27/1981	7.09%	15.18%	28.01%	9.39%
08/25/1987	6.23%	15.23%	17.37%	7.44%
07/16/1990	5.35%	18.11%	37.31%	22.74%
01/14/2000	3.54%	6.31%	55.33%	32.45%
Average	**5.98%**	**16.88%**	**21.97%**	**10.54%**

showed an unexpected picture.

These findings defy the conventional wisdom about the nature of stock market tops. In each case, 11% or less of stocks (average 5.98%) were making new highs along with the new high in the DJIA — a generally accepted proxy for the broad list of stocks. Further, in 9 of the 14 cases covered in this study, a significant number of NYSE-listed stocks (average 21.97%) had already dropped in price by 20% or more before the DJIA had reached its bull market peak.

The primary conclusion to be drawn from these fourteen cases is that the vast majority of stocks reached their bull market highs well before the peak of the Dow Jones Industrial Average. If a portfolio manager had somehow been able to sell out on the absolute top day of the DJIA in each of the fourteen cases studied here, in most instances the portfolios would have already lost a considerable amount of value by that time. Investors who may have thought themselves lucky enough to sell all of their stock on the exact top day of the DJIA could have actually suffered significant losses.

The amazing similarity of the statistics in these fourteen cases suggests a pattern of deterioration at major market tops that investors cannot afford to ignore. In searching for a way to describe this phenomenon of market deterioration — the gradual process of hundreds of individual stocks rolling over into their own bear markets, one by one, over a period of many months — the picture of a feather emerged. We think that image is just about right.

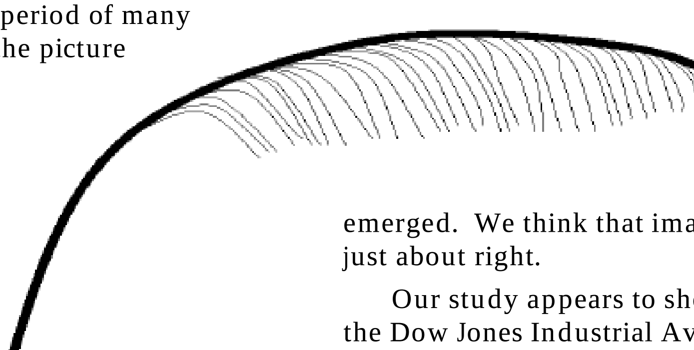

Table 3: The DJIA components as of September 3, 1929

DJIA Components	1929 High	Sept. 3, 1929 Close
Allied Chemical	354 ¾	354
American Can	184 ½	181
American Smelting	129	128 ⅛
American Sugar	94 ¾	81 ¾
American Tobacco	205	200
Atlantic Refining	77 ⅞	65 ⅝
Bethlehem Steel	140 ¾	136 ¾
Chrysler	135	71 ⅞
Curtis Wright	30 ⅛	29
General Electric	403	391
General Foods	81 ¾	71 ⅞
General Motors	91 ¾	71 ¾
General Railway Signal	126 ½	123 ½
Goodrich	105 ¾	73
International Harvester	142	140
International Nickel	72 ¾	54 ½
Mack Trucks	114 ¾	97
Nash Motors	118 ⅞	84 ⅝
National Cash Register	148 ¾	125 ¾
North American	186 ¾	184 ⅛
Paramount	74	72
Radio Corp.	114	98 ⅛
Sears Roebuck	181	171
Standard Oil N.J.	73 ⅞	70 ¾
Texas Corp.	71 ¾	68 ½
Texas Gulf Sulphur	85 ¼	72
Union Carbide	137 ⅞	135 ¾
U.S. Steel	261 ¾	257 ⅝
Westinghouse	295 ⅝	285 ⅞
Woolworth	100 ⅞	99

Our study appears to show that the Dow Jones Industrial Average is a less than ideal proxy for the broad list of stocks. For example, as shown in **Table 3**, in the 1929 case, none of the thirty component stocks were making new highs along with the Industrial Average on September 3, 1929. This is due to a large extent to the reporting of closing numbers for the Average on a theoretical basis.

The study also suggests that, even at that early time in the history of the 30-stock Average, the price weighting of the components was producing an undue influence on the movements of the DJIA. However, the bigger issue is that the evidence drawn from all fourteen cases suggests that the highest price levels for the vast majority of New York Stock Exchange listed stocks have tended to occur well before the final peak in the DJIA.

"The final days of a bull market are substantially different than the final days of a bear market. At most bear market lows…the vast majority of stocks tend to bottom in unison. At most bull market tops…the vast majority of stocks seem to top out on an individual basis."

The final days of a bull market are substantially different than the final days of a bear market. At most bear market lows, because fear and panic are the dominant emotional drivers, the vast majority of stocks tend to bottom in unison. At most bull market tops, where investors have been lulled into complacency, the vast majority of stocks seem to top out on an individual basis.

This is not much different than observing that a farmer usually plants all of his seeds at the same time in the Spring. However, not all of the fruit reaches the point of peak ripeness at the same time. The ripe fruit must be picked individually, rather than all at once. In the same way, investors must commit to buying stocks quickly after a major market bottom, but must sell stocks one by one, as they reach their individual peaks.

This simple study of bull market tops should have far-reaching implications for all investors. The conventional wisdom of what a major market top looks like must be completely revised. Every portfolio manager must create a new strategic plan as to how and when to take defensive action. And, new indicators must be devised to eliminate the current guesswork of where individual stocks are within the primary trend. Investors must be able to see, and have time to react to, the gradual deterioration of market breadth that precedes periods of substantial stock market losses.

We will leave it to other researchers and analysts to determine all of the various reasons why so few stocks have reached their bull market highs in unison with the Dow Jones Industrial Average. Our principal concern, at this point, is to alert investors to the conditions that have consistently occurred at important stock market tops. Future studies will address the need to develop new indicators and a new portfolio management strategy to deal with the challenging conditions revealed in this study.

You can visit Lowry's Reports online at www.lowrysreports.com.

An Exploration of the Nature of Bull Market Tops is reprinted from a study published by *Lowry's Reports, Inc.*

Coming in March

In the March issue of the Opening Bell, David Vomund will show you how to apply Paul Desmond's market top analysis using AIQ TradingExpert Pro's new Market Breadth Builder.

STOCK DATA MAINTENANCE

The following table shows stock splits and other changes:

Stock	Ticker	Split	Approx. Date
Lundin Mining	LMC	3:1	02/06/07
Preferred Bk Los Angeles	PFBC	3:2	02/07/07
Jacobs Engineering Group	JEC	2:1	02/16/07
Markwest Energy Partners	MWE	2:1	02/23/07
Harsco Corp.	HSC	2:1	03/01/07

Trading Suspended:
Aleris Int'l (ARS), American Italian Pasta (PLB), BellSouth (BLS), CNS, Inc. (CNXS), Dialog Semiconductor (DLGS), E*Trade (ET), Global Signal (GSL), Symbol Technologies (SBL), Veritas DGC (VTS)

Name Changes:
Apple Computer (AAPL) to Apple (AAPL)
Hyper-Space Communications (HCO) to MPC (MPZ)
ITLA Capital (ITLA) to ITLA Capital (IMP)
Lexington Cpro. Properties Trust (LXP) to Lexington Realty Trust (LXP)
netGuru (NGRUD) to BPO Management Services (BPOM)
Serono S.A. (SRA) to Merck Serono S.A. (SRA)

Market Review

Was It a Very Volatile January? Not at All

As the year began, the Dow Industrials soared 117 points in the first few hours, then word came that the Fed at the December meeting was still focused on inflation, not growth. Suddenly, the Dow was down 58 points. Then on the last day of the month the market soared because the Fed was less hawkish on its public statement.

It sounds like the market was very volatile but it is actually showing record low volatility levels. In last month's Market Review we showed the S&P 500 along with a 2% Zig-Zag indicator. This indicator showed the S&P 500 hadn't had a 2% pullback since mid-July. January has come and gone and still no 2% pullback.

For the month, the S&P 500 gained 1.4% while the Nasdaq Composite gained 2%. The leading market segment is mid-cap, with the S&P 400 Mid-Cap index gaining 3.5%.

Fundamental analysts are in one of two camps. Some see a soft landing for the economy, lower interest rates ahead, and slowing inflation. Others say the soft landing ended, growth is picking up, inflation will remain too high and interest rates, rather than falling, could very well rise again later this year.

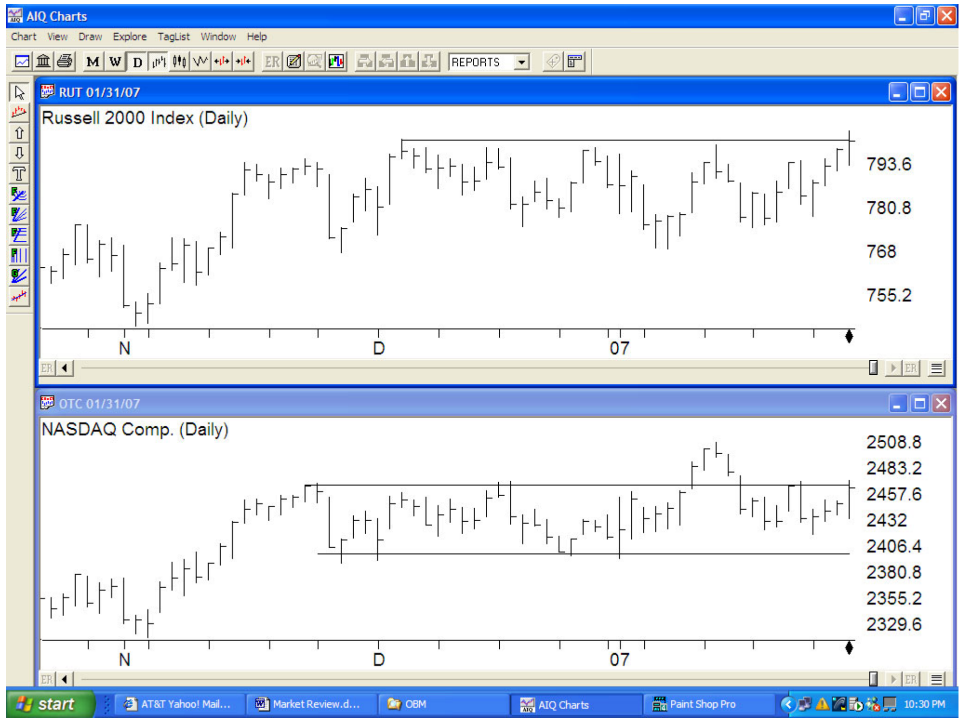

Figure 1. Chart comparing price action of Russell 2000 and Nasdaq Composite.

Technicians don't worry about such things, preferring to study the charts. At month's end, the S&P 500 was right at its January 24 high. The Nasdaq Composite was right against a strong 2470 resistance level. This level acted as resistance in November, December, and January. A move above this level would be constructive. The Russell 2000 is against resistance as well (**Figure 1**).

Although the market averages are near their highs, the percentage of S&P 500 stocks giving unconfirmed AIQ buy versus sell signals is close to even.

Looking at individual sectors, Real Estate was the top performer gaining 10%. Defense & Aerospace rose 6%. The two worst performers were Financial Services and Energy, each losing about 3%.

S&P 500 Changes

Changes to the S&P 500 Index and Industry Groups:

AvalonBay Communities Inc. (AVB) replaces Symbol Technologies (SBL). AVB is added to the Residential REITs (REITRES) group.

Ensco International (ESV) replaces BellSouth (BLS). ESV is added to the Oil & Gas Drilling (OIL&GASD) group.

Spectra Energy (SE) replaces Parametric Technology (PMTC). SE is added to the Oil & Gas Storage & Transportation (OILGAST).

Terex Corp. (TEX) replaces Navistar (NAV). TEX is added to the Construction & Farm Machinery & Heavy Trucks (CNSTFARM).

AIQ Opening Bell Newsletter

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Welcome to a revolutionary new service from AIQ in conjunction with Dale Wheatley.

Dale Wheatley - The Options Hunter

Dale Wheatley is a full-time professional trader and AIQ user, who has achieved financial independence. He exclusively trades options based on an MACDI strategy and a list of tickers based around AIQ's group / Sector structure. His unique disciplined approach, together with the power of compounding, results in a system that's both profitable, and fun to trade, without the need to trade frequently. **Better yet Dale has been trading with this system for over 15 years.**

Learning from the Options Hunter

Dale has taught his strategy to hundreds of people, all over the world, but does training sessions usually by select invitation only.

Now you can learn how to trade like the Options Hunter with this new and unique subscription service. delivered weekly as a web broadcast.

Delivering education and trading idea each week, subscribers will gain powerful insights into the trading strategy that has earned Dale a unique reputation and helped him achieve financial independence.

Find out more about this service at www.aiqsystems.com/optionshunter.htm

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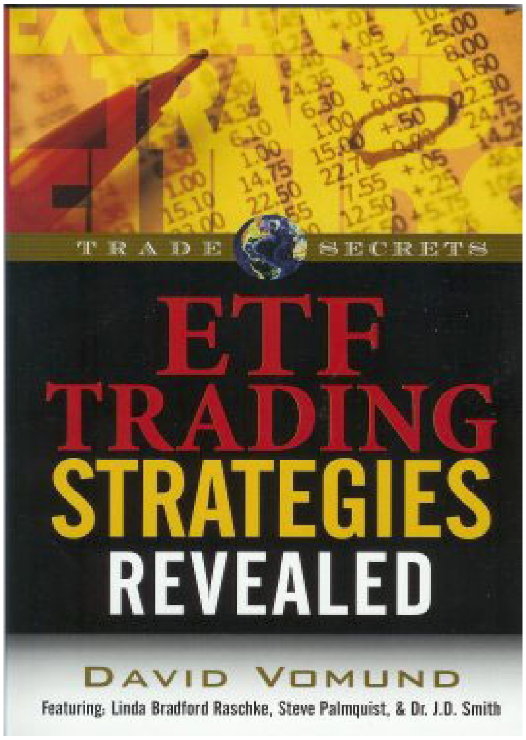
New AIQ correlated CP Group/Sector Structure

The CP Group/Sector Structure is a highly correlated AIQ Group / Sector Structure containing ***20 Sectors, 102 Groups and nearly 2000 U.S. Stocks***. Stocks were screened for inclusion using Market Cap, Price and Industry Correlation. More than 95% of SP500 stocks and 90% of Russell 1000 stocks are included.

The CP Group/Sector Structure follows the concept pioneered by the DowJones / FTSE Industry Classification Benchmark (ICB). The ICB Industry Structure was introduced in 2005.

Find out more about this new Group/Sector structure at www.aiqsystems.com/CPgroupsector.htm

ETF Trading Strategies Revealed



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Want to know how to trade the hottest new investment vehicle?

In his new book, David Vomund, AIQ's Chief Analyst reveals the secrets of profiting from a new and growing investment vehicle - the Exchange Traded Fund. Pulling from experts in the field like Linda Bradford Raschke and Steve Palmquist, this book has all the information you need to begin trading ETF's for profit.

- Learn the basics of ETFs; how they work, why they're growing in popularity, and how you can get your share of the profits.
- Discover the way to apply classic techniques to leverage your ETF investments for both the short-term and long-term.
- Study simple but highly effective mechanical ETF rotation techniques (style, sector, and international) that are now available to the individual investor.

ETF Trading Strategies Revealed doesn't end there. Learn from long-time trader and founder of AIQ Systems, Dr J.D. Smith, what it takes to mentally be the best. When you have the emotional discipline to follow his technique, you'll find increased profits aren't far behind.

"Finally... a comprehensive book on Exchange Traded Funds! I have always enjoyed reading David Vomund's insights on the markets and his interviews with other successful traders, and I know you will prosper from the wealth of information contained in this ground-breaking book." **Price Headley, CFA, CMT**

Don't miss these 2 FREE David Vomund events at the World MoneyShow in Orlando Feb 7-10, 2007 register at http://www.worldmoneyshow.com/twms/orlando/main.asp

Market Truths

Friday, Feb 9, 10:15-10:45
Stage Presentation in
the Exhibit Hall

Drawing on his 20 years experience as an analyst, investor and money manager, David will reveal the **TRUTHS** that can help you succeed in today's **MARKETS**.

ETF Trading Strategies Revealed

Saturday, Feb 10, 10:40-11:25 Osceola 5-6

In this session David Vomund, Chief Analyst at AIQ Systems and author of the best-selling book ETF Trading Strategies Revealed will discuss his successful Market Rotation Strategy. Which segment of the market should you be in - growth, small-cap, large cap or value? Using ETFs to track major market indices, David will show you how to be in the right segment at the right time. David will also share with us his sector rotation strategy using ETFs to track industry sectors.