Market Timing FOR DUMMIES®

by Joe Duarte, MD

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About the Author

Dr. Joe Duarte (`www.joe-duarte.com`) is best known for his candid, no-nonsense, and prescient expert commentary on the financial and commodity markets, such as his on-the-money call on CNBC, June 4, 2008, when he correctly noted that oil had made a top and that a fall below $110 would take prices to $100 or less. By September 2008, oil had broken below $100. He is a widely read analyst and writer and an active trader. His daily Market IQ column is read by thousands of investors, market timers, and professional traders around the world.

Dr. Duarte is the author *Futures & Options For Dummies, Trading Futures For Dummies, Successful Biotech Investing,* and *Successful Energy Sector Investing.*

His combined expertise in health care, energy, and the effects of politics and global intelligence on the financial markets offers a unique blend of insight and information to thousands of active investors and political and intelligence aficionados around the world on a daily basis.

Dr. Duarte's Market Moves column is syndicated to a global audience through FinancialWire, a leading independent syndicate of financial information. He is also a featured columnist on the popular investor Web site Stockhouse.com.

Dr. Duarte is a frequent guest on CNBC and is an original CNBC Market Maven. He is a regular guest on the *Financial Sense Newshour with Jim Puplava* radio show, where he comments on the energy markets and geopolitics.

Dr. Duarte has been writing about the financial markets since 1990. His articles and commentary have been featured on Marketwatch.com and in *Barron's, Smart Money, Medical Economics,* and *Technical Analysis of Stocks and Commodities* magazines. He has been quoted in the Associated Press, CNN.com, *The Wall Street Journal, Smart Money Magazine,* and *Investor's Business Daily.*

In 2003, Dr. Duarte received second place in the professional section of the Medical Economics Investment Challenge with a 12-month return of 42 percent.

Dr. Duarte published the critically acclaimed market-timing newsletter "The Wall Street Detective" from 1990–1998, when it became an exclusively electronic publication. It later was converted to Joe-Duarte.com. His daily market commentary "Joe Knows" appeared on Financialweb.com from 1998–2000. Dr. Duarte served as senior columnist for Investorlinks.com from 1998-2001. He is a registered investment advisor and president of River Willow Capital Management.

He lives in Dallas, Texas, plays a Gibson ES-135, and loves his vintage Völkl tennis racket.

Dedication

To family, friends, and market timers around the universe.

Acknowledgments

Writing a book is a unique, lonely, and personal experience, and very few but the author, the editor(s), and those who share the space-time continuum with them can understand this. During this one, I had my share of ups and downs as well as rewards. So I can't complain. Still, I couldn't have done it without the usual gang that helps me on a daily basis. So here's a big thanks to:

My family, my office staffs from my other life, the Wiley editorial staff, especially Stacy and Traci who helped shepherd me to the final goal, nearly on time for once.

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Frank "the master of all things Web-related," without whom there would be no Joe-Duarte.com. Too bad you couldn't come along on this little expedition.

To Stone Barrington, Michelle Maxwell, and Sean King, Gabriel Allon, Oliver Stone (the literary character, not the movie director), and other inhabitants of pages and audio books that help me stay sane as I work and travel.

As always coffee, tea, vitamins, sports drinks, nutrition bars, and the game of tennis also help.

Special thanks to those who read my books, subscribe to my Web site and have kept this thing going for 18 years. Who'd've thunk it?

And also to two longtime friends, John and Greg, whose interactions with me always prove to be worthwhile and interesting, to say the least.

My patients who so graciously come back the next day even if I've had to run out of the office in a hurry to be on CNBC.

If I've forgotten to mention anyone, it wasn't intentional. I'm not as young as I used to be.

Publisher's Acknowledgments

We're proud of this book; please send us your comments through our Dummies online registration form located at `www.dummies.com/register/`.

Some of the people who helped bring this book to market include the following:

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Contents at a Glance

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Introduction

When I started trading, I had no idea that I was a market timer. The whole concept that you could actually maximize your gains and avoid major losses by managing your portfolio was foreign to me, given the fact that Wall Street's buy-and-hold mantra is the first thing that anyone ever hears about. But after nearly 20 years in the business, every time there's a bear market or a market crash, I'm glad that I took it upon myself to learn the craft.

Martin Zweig, a legendary money manager from the 1980s, changed the way I looked at investing when he promoted his book *Winning on Wall Street* (Grand Central Publishing) in the early days of financial television. The phrases "don't fight the Fed" and "don't fight market momentum" were so intriguing that I bought the book and became a market timer.

With this book, I hope to humbly contribute to opening more readers' eyes to a new reality — that of being able to avoid catastrophic losses and to maximize stock market gains by actively managing their portfolios.

About This Book

Market timing is the most essential aspect of all trading and investing endeavors. If you think about it, timing is the key to success in many things you do. Try to hit a tennis ball without timing your stroke. Or try to run a yellow light before that camera goes off behind you without timing.

So why is it that if you're talking about getting married or buying a house, people say that "timing is everything," but when you talk about market timing, people roll their eyes and tell you that it's impossible? In fact, market timing isn't just possible; it's central to successful trading because whenever you mistime an entry or an exit to any trading or investing position, you run the risk of reducing your profits or losing money outright.

Indeed, because market timing is so misunderstood and maligned, it's still an area of trading that few people practice — openly, anyway. Its shady reputation gives the successful timer an advantage over the financial planner, the retail broker, their unsuspecting clients, and their buy-and-hold strategy. As others hold on to falling stocks through bear markets and see their assets dwindle, you'll be able to make money or preserve more of your bull market gains by applying the market timing techniques in this book.

Am I guaranteeing you gains? Of course not; you don't get guarantees on anything in life. You wouldn't stay on a sinking ship in the middle of a hurricane, yet millions of investors decide to ride out massive bear markets and stock market corrections, pinning their hopes and their retirements on that old adage "the long-term trend is up."

Being different could make you money if you consider market timing a viable alternative to the old Wall Street "buy and hold" swindle. If you have any doubts about considering market timing, remember that Wall Street has also given us things like portfolio insurance, the savings and loan crisis, the Internet bubble, and most recently the subprime mortgage crisis. Each of these little gifts from the guys who tell you that holding stocks for the long term is the only way to fly has also led to major bear markets where investors have lost billions by holding on to their investments too long.

Sure, the market came back. But in many if not all cases, the best that most buy-and-hold investors got was all their money back. Those who sold early in the start of the down trend had more money to invest when the market turned up. Better, those who sold the market short actually made money when the market fell. And because of new products, such as exchange-traded mutual funds (ETFs), short selling is as easy as buying shares of stock through your online broker with one click of the mouse.

This book is about staying with the overall market trend. It's about knowing when to get in and out of your trading or investment positions with enough time to preserve more of your hard-earned money. Accomplish that, and when things turn around, you can start in a better place than someone who rode the bear market all the way down to the bottom and is only likely to get her money back — if she's lucky enough and has enough time.

Conventions Used in This Book

To assist your navigation of this book, I've established the following conventions:

- I use *italic* for emphasis and to highlight new words or terms that I define.
- I use `monofont` for Web addresses.
- Sidebars, which are shaded boxes of text, consist of information that's interesting but not necessarily critical to your understanding of the topic.

If the book seems to be a little heavy on jargon, it's because there is no other way of saying what I'm trying to say. Believe me, this book was heavily edited, and carefully combed through in order to make it as accessible as possible to you.

Foolish Assumptions

In order to write this book, I had to make assumptions about who you might be. Market timing isn't rocket science, but it's not for preschoolers, either, and I have done my level best to walk the line between basic and technical information that gives readers what they need to go forth and confidently time the markets. As I did that, I assumed that you

- Know something about trading and have some experience. (I'm actually hoping that you have more than a little experience; this topic is difficult for beginning investors and may be a fairly risky practice for those with little savvy.)
- Don't mind working hard and spending time analyzing the markets on a regular — even daily — basis in order to be successful.
- Will set time aside on a regular basis to develop your trading skills, and will run your trading as a business, keeping accurate records of your trades, both winning and losing, and reviewing them on regular basis.
- Are well financed enough to be able to take some risks with your money without impairing your long-term finances or your family's well being.
- Are interested in trading with the prevailing trend of the stock market but not quite interested in day trading.
- Are tired of missing opportunities and waiting too long to take profits and so would like to improve your ability to enter and exit markets.
- Would like to expand your trading beyond the stock market but are more interested in trading commodities and futures through exchange-traded funds than in trading futures or options directly.

- Want to be able to make money when the market enters a down trend but don't really want to go through the hassle of opening a margin account or a futures account.
- Have or would like to develop the market analysis skills that enable you to be patient in order to recognize outstanding opportunities and don't mind some break-even, lose-a-little, or gain-a-little trades along the way.
- Recognize that this is a global marketplace in which futures, stocks, bonds, and currencies influence each other and that you need to be well versed in the vagaries of international markets in order to maximize your profit potential.
- Have access to top-of-the-line computing equipment, an online trading account, and a high-speed Internet connection, as well as the ability to check your trades when you're not in front of your trading station.

How This Book Is Organized

To make this book easy to navigate, I've organized it into five parts. The following sections give you a quick rundown of what you find in each.

Part I: Stepping Into the World of Market Timing

In this part, I ease you into the wide world of market timing, introducing you to its basic tenets and showing you the tools you use to time the markets. You find out about the principles that market timers use, and the charts they use to get the timing job done. Read this part to stock up on the raw materials of market timing.

Part II: Market Timing's Methods and Strategies

Here you get into the meat of timing. I tell you how to prepare for and decipher the economic reports that matter. Believe it or not, timing in January can be different from timing in July, and in this part I introduce you to some of the seasonal and cyclical patterns you find in the markets.

Your primary directive as a timer is finding the prevailing trend in the markets and making trades according to that trend. But the market reacts not just to facts and realities but to how traders, financial experts, and consumers *feel* about those trends, and I tell you about how to assess the sentiment as well as the trend.

Part III: Applying Timing to the Markets

What happens when the all the timing principles I cover in Parts I and II come together in a trade? I kick off this part of the book by taking you through every step of my actions and thinking as I executed a real trade. Your mileage may vary, but glimpsing the way the parts come together gives you great insight into the planning and evaluation that are timing's hallmark.

The later chapters run through the various markets you might want to dip your toes into, from the stock market you probably already know and trade to the specifics of currency, commodity, and many more markets.

Part IV: Timing the Sectors

Opportunities run through the stock market all the time; your job is to find them, and in this part I take you on a tour of some of the major divisions within the market. You find out about timing technology stocks, for example, as well as the energy, financial, and health care sectors. This part is one of my favorite sections of the book, as I get into the very specific characteristics of each of these very profitable sections of the stock market.

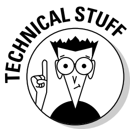
Part V: The Part of Tens

In every *For Dummies* book, you find chapters that give you quick tips for the topic at hand, and right here is where you find them. In this part, I give you a rundown of many more than ten resources that I turn to most often as well as ten ways to keep your timing practice on track without losing your shirt or your sanity.

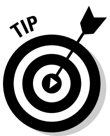
Icons Used in This Book

I use icons to emphasize and reinforce information throughout the book. Here's a list of the icons you find and what you can expect from the text they highlight.

When I present a concept that is important for you to keep in mind as you read, I include this icon beside it. This icon directs you to bits that enable you put together key concepts.



Feel free to skip over information highlighted with this icon. I use it to point you toward information that goes deeper than you need. You might find these advanced tidbits interesting, but you can come away with a complete understanding of market timing without them.



A tip is something that you can use right away in your trading practice. Tips save you time or money and give you the benefit of my many years of trading experience.

This bomb icon reminds me of funny old cartoons and the Pink Panther movies, but its message is hugely important. I use this icon to identify practices or notions that could cause damage to you or your trading accounts.

Where to Go from Here

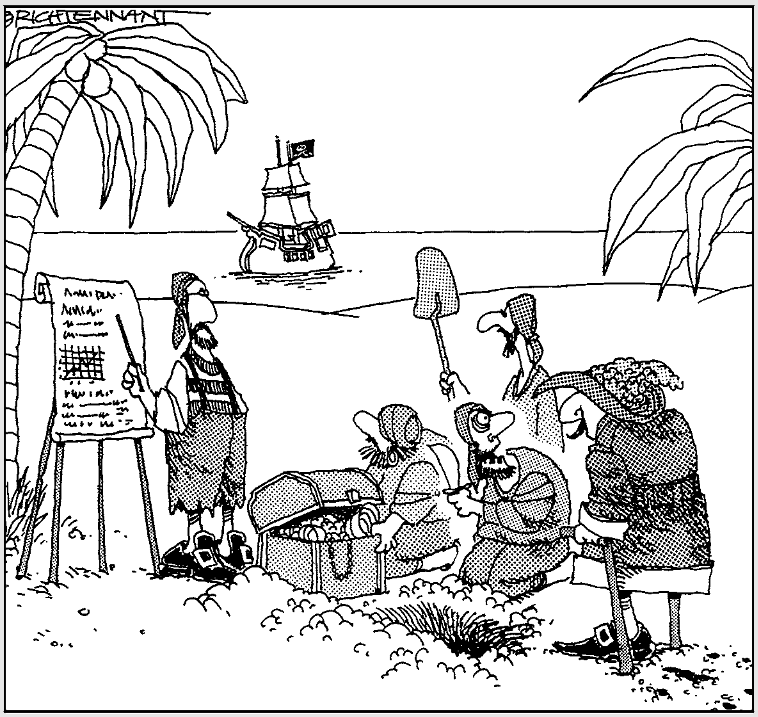
In short: Anywhere you want. *For Dummies* books are written so that you can jump in at any point that interests you. Want to find out how presidential elections affect your investments? Head straight to Chapter 6. Interested in browsing the various market sectors? Part IV has what you want. If you're brand-new to market timing or just an overachiever, turn to Chapter 1 and don't stop reading until you get to the index.

I've been a market timer for 20-plus years and have found the concepts that I've put forth in this book quite useful. I hope that you do, too.

Part I

Stepping into the World of Market Timing

The 5th Wave   By Rich Tennant



"Volatility bands? Trend reversals? I say we stick the money in the ground like always, and then feed this guy to the sharks."

In this part . . .

New to market timing? This part of the book takes you through the basics you need to get started. In it, I show you how to think like a market timer and how to use the tools that lead to successful timing. You get a good view of the work required to anticipate timing situations and an insider's view about what to expect in this often misunderstood world of trading.

Chapter 1

Becoming a Market Timer

In This Chapter

- Understanding market timing
- Getting a handle on timing's jargon
- Glimpsing the importance of technique
- Finding the whys of market timing
- Getting ready and diving in
- Keeping your expectations reasonable
- Enjoying the process — and the results

An old market cliché says "there's always a bull market." In other words, if you look hard enough you can find a market that is trending, up or down, and that you use to make money.

Because there's always a bull market, market timing may be the trading method of the 21st century, given the potential for volatility in the world and the markets, and the change that's likely to follow as humanity progresses toward its next stage of development.

Although the topic may seem daunting, you have plenty of reasons to consider adding it to your investing arsenal, given what may lie ahead. For one thing, the world is moving from a North American and Eurocentric focus to one that includes Asia and the emerging economies of South America, specifically, China, India, and Brazil. Resource-rich nations such as Russia and Venezuela are also participating in the mainstream markets.

That change alone — the spreading of power and influence to more places around the globe — is enough to create opportunity for market timers, who now operate in a world where money travels at the speed of light and the 24-hour news cycle has created a world where information is available at any time to anyone who has access to a computer and an Internet connection.

The bottom line is that buy-and-hold investing, the more traditional method for everyday folks to increase their wealth, is losing its appeal as the ability to move faster in and out of trading positions, and to trade markets that are rising or falling profitably, is increasingly important to long-term investors. The net effect is that investors who can adapt to this new world are the ones who will have the best chance of success.

But don't let all that stuff about change get you down. With this book, you can find out how to profit from the market's perception of and reaction to events by timing the markets. In this chapter, I introduce you to the world of market timing and show you how you can be in control of your investment results.

Defining Market Timing

Market timing is the act of entering and exiting trades (buying and selling at the most opportune time) in any market, whether, stocks, bonds, futures, or options. When timing the markets your goals are to

- **Decrease your exposure to risk.** As a market timer you want to stay with the dominant trend, whether up or down; you want to swim with the tide by buying stocks in a rising market, and selling or selling short in a falling market.
- **Maximize your profit potential.** If you can make money when the market goes up and when the market goes down, you have twice the opportunity to make money, and you decrease your chances of losing money when the trend goes against you.
- **Increase the consistency of your results.** Non-timers confuse consistency with frequency of trading. Market timing isn't day trading. It's about recognizing opportunities early, moving into positions using well-planned strategies, and monitoring the process on a daily or more frequent basis. It's about doing your homework, being prepared, and setting exit strategies before entering any position. And it's about recognizing when you've made a mistake early so that you can exit a position with as much capital as possible so that you can trade again.
- **Avoid heartburn and feelings of misery.** Anyone who's ever sat through a three-year bear market, such as the 2000–2003 implosion of the dot-com boom, knows that holding on to your favorite stocks during such a period is a sure recipe for heartburn and high blood pressure. If you had followed sound market timing techniques during that time, your losses would almost certainly have been less than if you held your positions during that period.

- **Make responsible investment decisions.** Some investors watch every single tick of a trade and sweat the details constantly, compounding their mistakes and increasing their suffering as their trade turns against them and the losses mount. Finally, when they can't stand it any more, they sell in a panic and remain miserable for months after their experience when they have no one to blame but themselves.

  Timing is about seeing the intermediate-term trend, which lasts for weeks or months, and staying with a position as long as it meets the criteria that you've set forth in your trading plan. It's also about getting out of your position when your goals are met or when your exit strategy is triggered.

- **Diversify your opportunities.** What makes timing one of the most useful trading methods is that you can use the techniques to time stocks, bonds, mutual funds, futures, options, and exchange-traded funds, which means that there is one or more timing vehicles for every possible personality, level of expertise, or risk profile in the investment universe.

REMEMBER

Timing is as much a state of mind as a combination of trading methods, and it requires knowledge of fundamentals and technical analysis, the latter being as much as 80 percent of what will help you pull the trigger consistently and become successful.

Terms of Engagement for Timing

I use a lot of terms in this book that sound jargony (and *man,* do *For Dummies* editors hate that). These terms are at the heart of market timing, though, so you might as well get used to them. You encounter more terms (defined wherever they first appear) throughout the book, but this small list of critical lingo gets you started:

- **Going long:** Buying assets, be they stocks, bonds, or futures, in hopes that they will rise in price.

- **Selling short:** Borrowing stocks (usually from a broker's stocks) in hope that the stocks will fall in price, at which time the short seller buys the stock back and returns the stock to the lender. The short seller pockets the profits gained from the stock having fallen in price. In turn, the lender receives dividends accrued by the stock during the time the stock is being sold short.

  WARNING!

  Short selling is very risky: Any time the stock rises, the short seller loses money. And stocks can fall only to zero, but they can theoretically rise forever.

- **Bull markets:** Markets that are rising.
- **Bear markets:** The opposites of bull markets; the tendency of prices during these periods is for markets to fall.
- **Leverage:** The practice used by traders in which less than the full amounts of money let them participate in the full price action of the underlying contract. Leverage is similar to credit. And like credit, it can be very detrimental when it goes against you.
- **Margin:** In the stock market, margin is like a down payment on buying stocks. In futures, it's more like a good-faith deposit. In all cases, margin is a form of leverage that lets traders buy larger positions without putting up the entire price.
- **Futures contracts:** Contracts between buyers and sellers that specify how much of an underlying asset will be delivered to the buyer at a certain time in the future.
- **Options:** Contracts that give those who possess them the option to buy or sell an asset at a certain time in the future. I don't go into great detail about futures and options in this book, but I do mention them when the time is right. You can get *Trading Futures For Dummies* (by yours truly) and George A. Fontanills's book *Trading Options For Dummies* for the full details.
- **Market sectors:** A specific area of the market, such as technology or health care. Market timing of individual sectors of the market is essential in both bull and bear markets and can be very profitable. See Part IV for more details on sector investing.
- **Trends:** Time periods in the markets where prices head primarily in one direction for a period of time. The **dominant trend** refers to the one direction in which the market heads over a very long time, even though it includes periods where it heads in the opposite direction. See Chapter 4 for more about trends and how to time them.
- **Sell stops:** Price limits that you specify to your broker when you buy a stock. You use sell stops to decrease losses by selling your shares when they hit the price that you specified as the stop. Sell stops are an important part of market timing, and I discuss them throughout the book.
- **Buy stops:** Price limits used to limit losses when you're selling stocks short. Sell stops are limits placed below the price of the stock you own. Buy stops instruct your broker to buy back the stock you sold short at a price above the price of the stock. You should adjust your buy and sell stops as the trade develops.