SPECIAL REPORT

"BEST BUY" OPPORTUNITIES IN STOCKS

... and the conditions that precede them

InvesTech Research

As any contrarian knows, bear markets lead to great buying opportunities… the challenge is identifying the right time to step in.

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It was January 4, 1991… the same week that President Bush formally announced the country was heading into a recession. Wall Street was tumbling with the DJIA at 2566. Analysts and economists alike were mired in a bog of universal gloom. Yet InvesTech subscribers received a special bullish issue of the *InvesTech Market Analyst* titled ***"TORO… TORO… "***

A short two weeks after that issue, which declared *"the balance [of technical and monetary evidence] is rapidly shifting to the bullish side,"* the stock market blasted off on one of the biggest bull markets of the century. What did InvesTech see that others didn't? Why did we turn so aggressively bullish when everyone else was running for cover? How did we know the blocks had dropped into place for a new multi-year mega-bull market to begin?

The secret lies in the table shown here, which is an updated version of one we were tracking at that time. It identifies the most critical prerequisites that normally precede a new bull market. In December 1990 we published a copy of this table and announced that *"All criteria have been filled for one of those buying opportunities that comes around only once or twice a decade."* It was this checklist –based on objective analysis– that convinced us the tide was turning and that formed the primary basis for our bullish stance on January 4, 1991.

6 Conditions That Preceded the "Best Buy" Opportunities in Stocks

	1966	1970	1974	1980	1982	1984	1987	1990	1995	2002
❶ Positive shift in monetary policy[*1]	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
❷ Reversal in Bear Market leadership[*2]	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
❸ Coppock Guide "low-risk" confirmation[*3]	✓	✓	✓		✓	✓	✓	✓	✓	✓
❹ Plunge in Consumer Confidence	✓	✓	✓		✓		✓	✓		✓
❺ "Formal" recession	✓	✓	✓	✓	✓			✓		✓
❻ >20% decline in DJIA or S&P 500		✓	✓	✓	✓			✓		✓

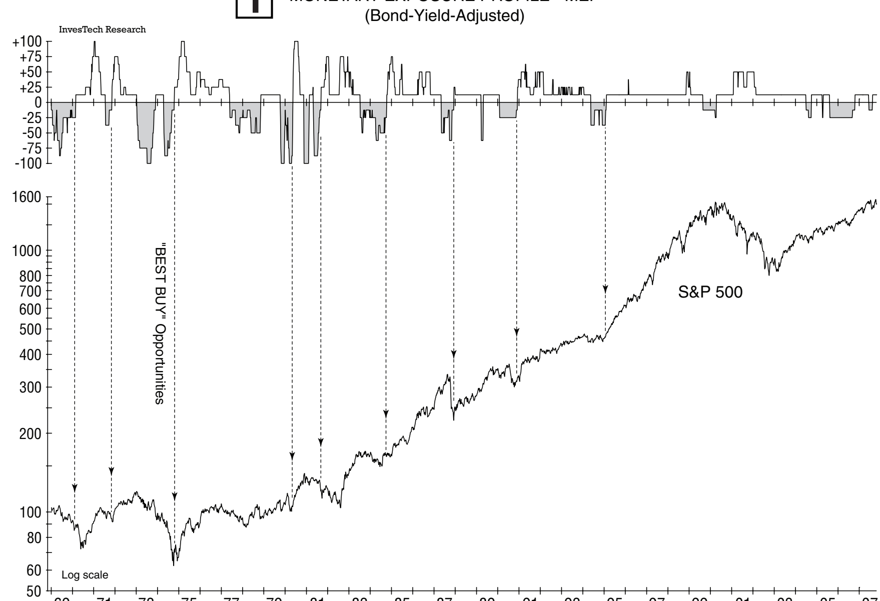
[*1] As signaled by a strong upward move in InvesTech's MEP Monetary Model.
[*2] As signaled by InvesTech's Negative Leadership Composite which monitors 'downside' leadership.
[*3] As signaled by the Coppock Guide turning upward from near or below "0".

As a bear market unfolds, the task is clear cut… remain objective, avoid the emotional traps set by short-term rallies and look for the conditions that mark a major turning point. Here are some of the criteria to watch that will point to a "BEST BUY" opportunity and the start of a new bull market:

❶ **Positive Shift in Monetary Policy –** confirmed by a sharp upward swing in our Monetary Exposure Profile (MEP) [1]. Over the years, our MEP has earned a cornerstone position as the primary monetary model used by InvesTech to determine whether the monetary environment is favorable or unfavorable for the stock market. As the MEP climbs above the neutral axis (0), it usually indicates an ideal environment for investing in stocks or a stock mutual fund… a reading above +25 is often a precursor of an "explosive" new bull market. This, quite simply, is when new bull markets are born.

Past bullish triggers in the MEP are shown by the dashed lines in this figure. This model has been in real-time use for over 20 years by InvesTech, with an uncanny ability to signal the start *(and warn of the end)* of past bull markets.

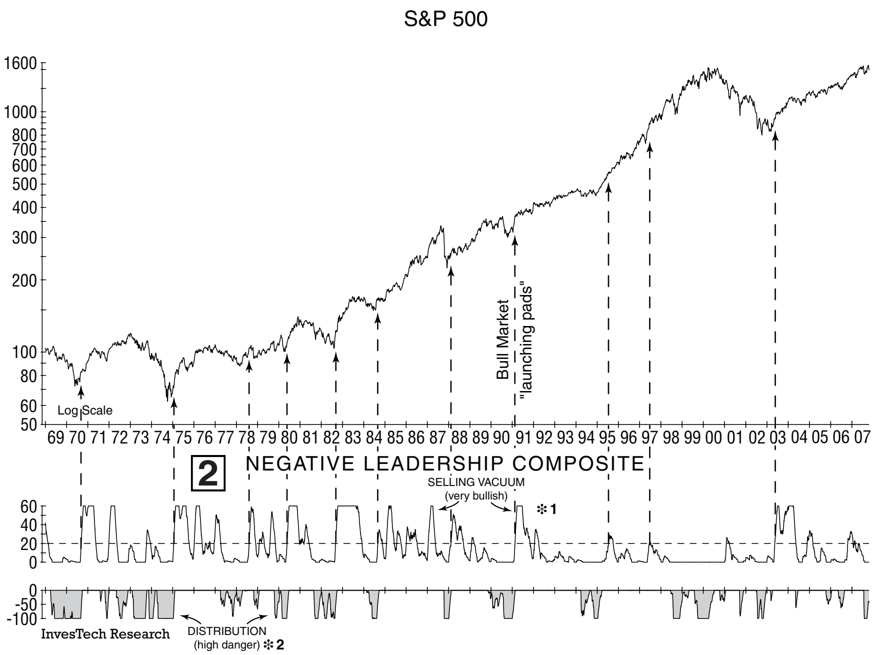
[1] MONETARY EXPOSURE PROFILE - MEP
(Bond-Yield-Adjusted)



One cautionary note: Monetary models can be misleading or give a rare false signal by turning positive too early in a DEflationary bear market. A perfect example was the popping of the Internet and high-tech bubble on Wall Street in 2000. Even with aggressive Fed easing, almost $7 trillion was wiped out as technology stocks came crashing down, bringing the rest of the market with it. Fortunately, such deflationary bear markets are a rarity; and even in this case, the MEP was positive and did confirm a "Best Buy" opportunity when the remainder of the Conditions dropped into place near the final market bottom in October 2002.

❷ **Reversal in Bear Market Leadership –** from InvesTech's Negative Leadership Composite (NLC) 2. This gauge, also used by InvesTech for many years, measures downside leadership or selling pressure in the market based on the number of stocks hitting new yearly lows. The NLC warns of bear market "DISTRIBUTION" ✻2 by falling into the negative (shaded) region of the graph early in a major decline. It typically requires <u>at least</u> 6 months of this DISTRIBUTION before a "Best Buy" opportunity will appear in stocks.

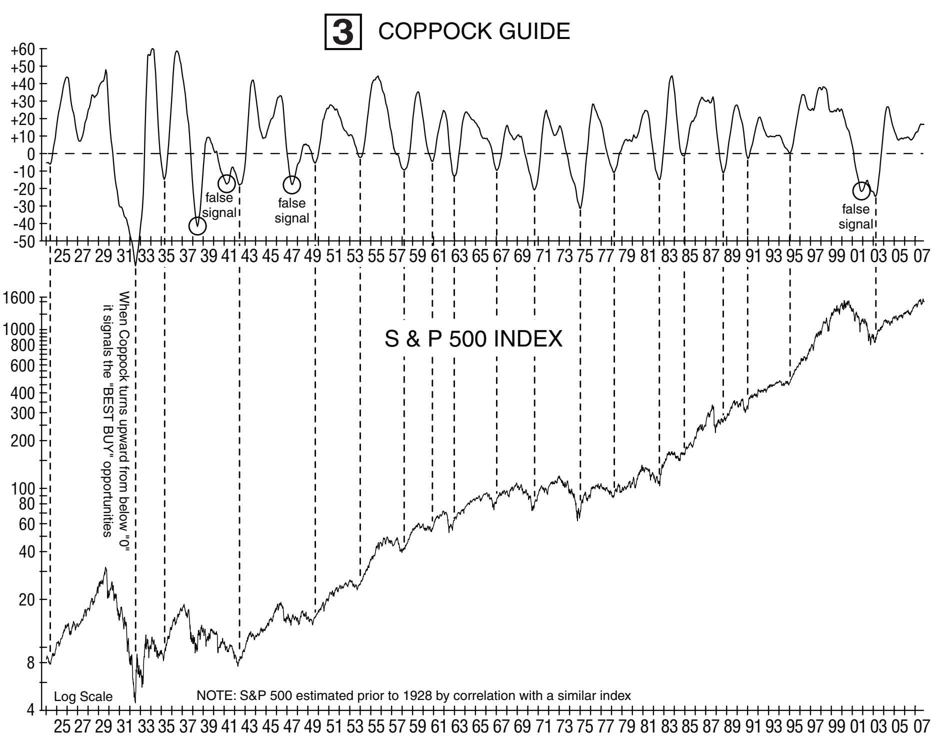
Ultimately, this will be followed by a bullish "SELLING VACUUM" ✻1. This happens when the top half of the NLC climbs to a reading of +20 or higher. Technically, it signals that downside leadership has dried up – resulting in an absence of selling pressure. When this SELLING VACUUM appears (especially after 6 months of DISTRIBUTION), it's time to jump on a new bull market. Note in our "6 Conditions" table that –like our MEP– this Negative Leadership Composite has confirmed every best buy opportunity of the past 40 years.



✻1 A SELLING VACUUM is the complete absence of negative or downside leadership. And a stock market without any downside leadership is destined to move higher.

✻2 DISTRIBUTION occurs when investors decide to sell stocks for only one reason – to get out of the market, regardless of whether their position is at a loss or the stock is tumbling to new lows.

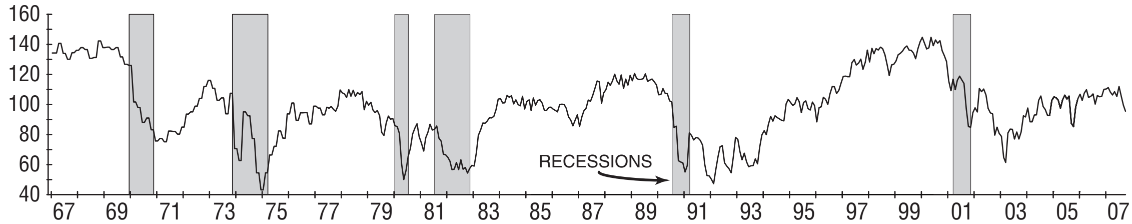
❸ **Coppock Guide "Low-Risk" Confirmation**. This little-known technical tool was originally developed in 1962 by Edwin S. Coppock. By calculation, the Coppock Guide (or Curve) is a momentum oscillator; but in simple terms, it's described as *"a barometer of the market's emotional state."* In other words, when investor sentiment begins to change, the Coppock Guide 3 reverses direction. Its historical value lies in identifying market bottoms (it's usually too early to signal market tops). While calculation of the Coppock is



complicated, understanding it is not. Once it drops to "0", the next upward reversal almost always marks the start of a new bull market. Note by the dashed lines, that an upturn in this Coppock Guide (from "0" or below) has signaled every significant buying opportunity of the past 85 years!

❹ **Plunge in Consumer Confidence –** marked by a drop of 35 points or more. This index is reported monthly by The Conference Board and is based on a representative sampling of 5,000 U.S. households. It's calculated as a weighted average composed of 40% current and 60% future expectations and is commonly used to predict the future health of the U.S. economy. For investors, it can also provide a valuable clue to identifying the "Best Buy" opportunities on Wall Street. Logically, such opportunities seldom occur in the late stages of a bull market when consumer optimism is already frolicking at lofty levels. Instead, the time to start shopping for stock market bargains is after confidence has plummeted and gloom is widespread. In each of the past 6 recessions, the Conference Board's Consumer Confidence Index 4 has tumbled over 35 points before a new bull market was born. Watch for a similar drop that might help to confirm the next true low-risk buying opportunity.

4 CONSUMER CONFIDENCE



Source: Conference Board

❺ **"Formal" Recession –** confirmed (not just feared or debated) by media headlines. Once again, this reveals the importance of being a contrarian investor… buying when no one else wants to. Historically, when you see "RECESSION!" in the media headlines, it has often been the time to back up the truck to start loading up on stocks. Remember, the stock market typically leads the economy by at least 6-12 months. Case in point: President Bush first uttered the word "recession" in the first week of January 1991 – just 2 weeks before the blast-off of the biggest bull market in 50 years.

❻ **Over 20% Decline in DJIA or S&P 500.** This does not mean start buying as soon as the DJIA or S&P 500 loses 20%. But the best buying opportunities on Wall Street often come from the most oversold levels. And a drop of that size implies an eventual washout in investor psychology lies ahead. When triggered, it's time to keep a close eye on the other prerequisites listed here.

It's important to remember that true low-risk "Best Buy" opportunities usually come around only once or twice a decade. Preparing for them requires both patience and a healthy respect for risk. The patience is necessary to avoid the lemming-like stampedes that greet every bear market rally. The historic risk is that many conservative portfolios have still been decimated simply by jumping into the middle of a severe, prolonged bear market. *The solution is discipline.*

Only by adopting a bear market strategy can investors protect their portfolios. Part of that strategy is knowing what conditions will inevitably lead to the next bull market. Among the most reliable prerequisites are those discussed in this special report. Of course, not all will drop into place every time. And the decision to buy must be based on weight-of-the-evidence. Yet in the end, when the time is right… when pessimism prevails on Wall Street… when portfolios have been crushed and frightened investors are scrambling for cover… these guidelines should provide the confidence and discipline to step up and take advantage of the next "Best Buy" opportunity of the decade.