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 *InvesTech Research* 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 bullish when everyone else was running for cover? How did we know the blocks had dropped into place for a new multi-year bull market to begin?

The secret lies in the table shown below. It identifies the most critical prerequisites –both fundamental and technical– that normally precede a new bull market. In December 1990 we published an earlier version of this table and announced that *"All criteria have been filled for one of those buying opportunities that come around only once or twice a decade."* We used the table again in November 2002 after the bursting of the technology bubble had run its course. And it proved invaluable in March 2009 as we prepared to step up our recommended invested allocation after the housing washout and resulting financial crisis led to the worst market losses of the past 80 years.

Negative (Bearish) Conditions That Precede the "Best Buy" Opportunities in Stocks

	1966	1970	1974	1980	1982	1984	1987	1990	1995	2002	2008
❶ Formal Bear Market	✓	✓	✓	-17.1%*	✓	-14.4%*	✓	✓		✓	✓
❷ >6mos. of Bear Market "DISTRIBUTION"	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓
❸ Potential "buy signal" in the Coppock Guide	✓	✓	✓		✓	✓	✓	✓	✓	✓	✓
❹ Plunge in Consumer Confidence		✓	✓	✓	✓			✓		✓	✓
❺ Contracting Manufacturing Sector	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓
❻ Recession!		✓	✓	✓	✓			✓		✓	✓

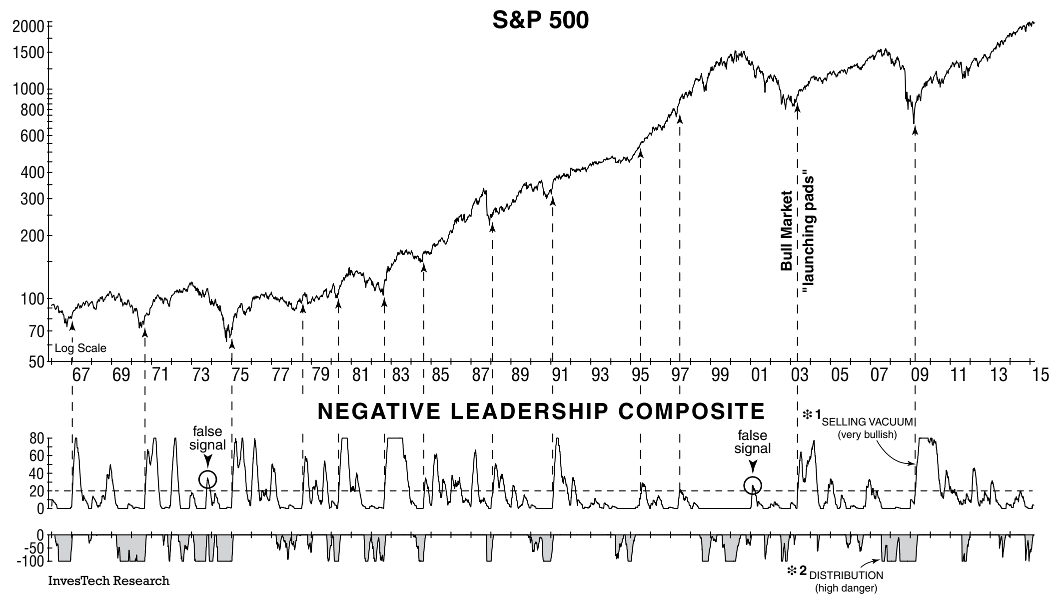
1 As signaled by over 20% decline in S&P 500 or DJIA.
2 As measured by InvesTech's Negative Leadership Composite.
3 As signaled by the Coppock Guide dropping below "0".
4 Confirmed by over a 30pt drop in Consumer Confidence.
5 Confirmed by the ISM Manufacturing Survey falling below 50.
6 Confirmed by media headlines.
* Percent decline in S&P 500.

When 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 **Formal Bear Market –** confirmed by a greater than 20% decline in the DJIA or S&P 500. This does not mean start buying as soon as these blue chip indexes lose 20%. But the "Best Buy" opportunities on Wall Street usually come from the most oversold levels, and a drop of that size implies an eventual washout in investor psychology lies ahead. When a formal bear market is triggered, it's time to keep a close eye on the other prerequisites listed here.

❷ **Over 6 months of Bear Market "DISTRIBUTION" –** from InvesTech's Negative Leadership Composite (NLC) (see graph at top of next page). This gauge, 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 early in a major decline. It typically requires <u>at least</u> 6 months of this DISTRIBUTION before a "Best Buy" opportunity in stocks will appear.

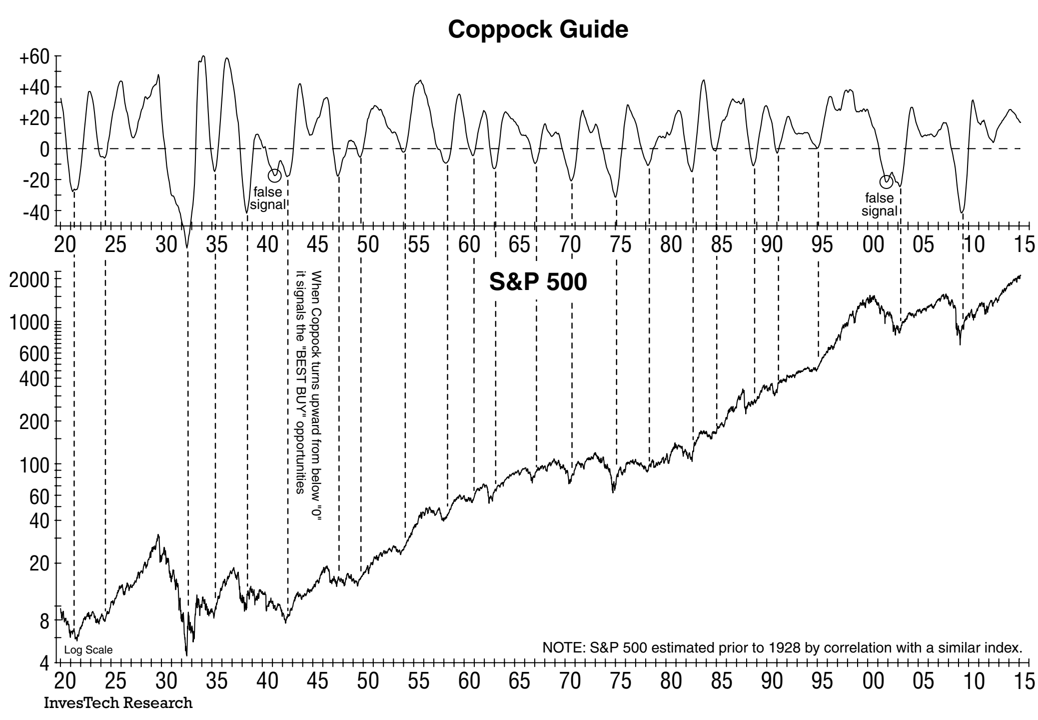
Ultimately, this will be followed by a bullish "SELLING VACUUM" [✻1], which develops when the top half of the NLC climbs to a reading of +20 or higher. Technically, it signals that downside leadership has dried up – resulting in an absence of selling pressure. When this SELLING VACUUM appears (especially after 6 months of DISTRIBUTION), it's time to jump on a new bull market. Note in the graph below that this Negative Leadership Composite has confirmed every "Best Buy" opportunity of the past 50 years.



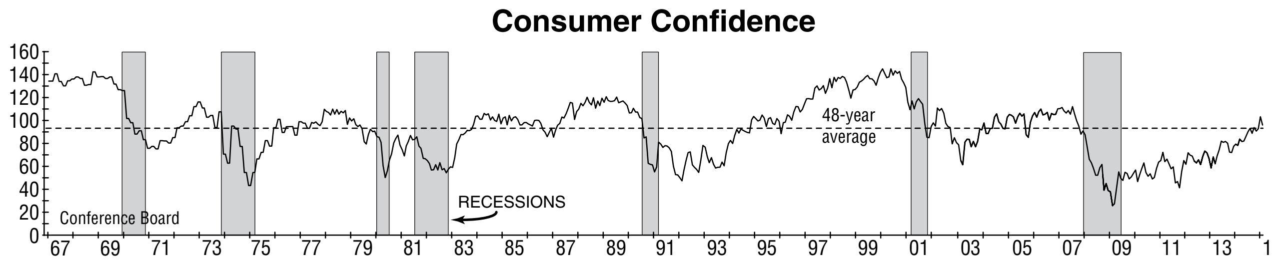
✻1 SELLING VACUUM [-BULLISH-]: This confirms the absence of negative or downside leadership. It is normally a very bullish signal since a stock market without any downside leadership is destined to move much higher.

✻2 DISTRIBUTION [-BEARISH-]: This signals that investors are anxious to sell stocks regardless of whether their position is at a loss, or the stock market is tumbling to new lows. It carries bearish implications as it suggests investors will use any rallies to get out of the market.

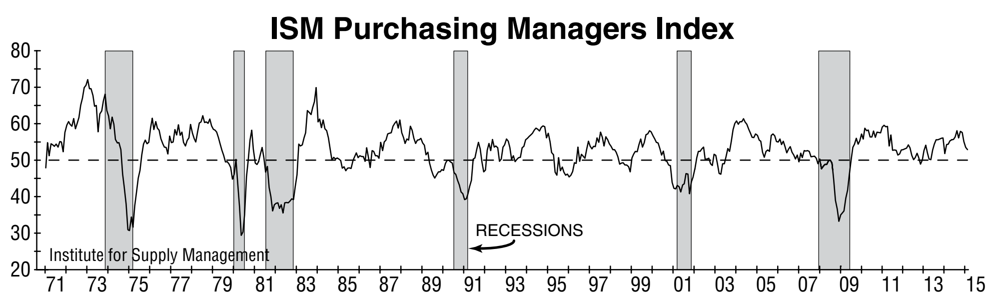
❸ **Potential "buy signal" in the Coppock Guide –** This little-known technical tool was originally developed in 1962 by Edwin S. Coppock. By calculation, the Coppock Guide (or Curve) is a momentum oscillator; but in simple terms, it's described as *"a barometer of the market's emotional state."* In other words, when investor sentiment begins to change, the Coppock Guide 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 signals the start of a new bull market. Note by the dashed lines, that an upturn in this Coppock Guide (from "0" or below) has confirmed every significant buying opportunity of the past 95 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 7 recessions, the Conference Board's Consumer Confidence Index 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.



❺ **Contracting Manufacturing Sector –** Likewise, when it comes to the economy, bad news is often good news for the market. The ISM Purchasing Managers Index from the Institute for Supply Management is based on data compiled from purchasing and supply managers nationwide. The Index is reported monthly and reflects changing trends in a number of indicators, such as new orders, backlog, production and employment. When the ISM Index shows that manufacturing is contracting (a level below 50), the economy is usually in a slowdown. If it drops below 45, the slowdown most often ends in a recession, and that generally leads to a buying opportunity in the stock market.



❻ **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!" confirmed in the media headlines, it's a pretty strong indication that Wall Street is approaching a "Best Buy" opportunity. Remember, the stock market typically leads the economy by at least 6-12 months. Case in point: the 2007-09 recession was formally acknowledged by the NBER (National Bureau for Economic Research) in December 2008. The final bear market low was in place 3 months later in March 2009.

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 the 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.