# TRADE FOR BIG PROFITS:

## *The Top Stocks Methodology*

# Trade for Big Profits: The Top Stock Methodology

In an effort to help you make money in every market condition, I share with you how I view the market and how I use the various indicators to put together a winning trading action plan in ***Top Stocks.***

Trading will never be a science, but with this report in your hands, you will have the foundation to put my strategies to work for you. Let's get started…

First things first, when looking at the market I tend to take a top-down approach.

Most investment newsletters place great emphasis on what sort of returns you can expect or they might tell you how terrific their stock picks are with no real time providing insight. Not just to tell you what's going one, but what all of it means to you and your investments..

In this service you will not find charts of stocks explosively moving the very next day but you will find good, solid analysis of stock charts and the market.

I leave the hot stocks to *hot traders*. It is my preference to find what hasn't caught the attention of the mainstream media and traders yet. I prefer to anticipate and often that means I am early in a trend for better profit potential

The first set of indicators I look at is the shorter-term ones. This gives me a sense of what the market direction looks like in the coming week or two.

Then I look at the intermediate-term indicators. This gives me a sense of whether the short-term move I foresee is sustainable or if it's a countertrend move. Typically an intermediate term move should last at least 3-6 weeks.

When the shorter-term and intermediate-term indicators are both heading in the same direction (portending a rally or a decline), I search for stock charts that have the best chance of heading in that same direction.

**Trading Is Hard—Let Me Make It Easy!**

Helene Meisler spent more than a decade on the sell side of the financial markets as a market technician covering institutional accounts at various investment banks in New York City, including Cowen & Co. and Goldman Sachs. In addition she worked at Cargill in Minneapolis where she managed equity money for three years. She received her bachelor's degree in business from Pace University and speaks Spanish and Mandarin.

Today, you'll find Helene's most timely strategies at ***Top Stocks*** from TheStreet, where she's one of the most popular columnists on the site.

NOTE: I am a base-picker when it comes to stock charts, not a momentum player. If you want to play momentum stocks, this is not the place to look. With that in mind, let's take a closer look at some of the major indicators I follow...

so that you have a better understanding of the methodology behind ***Top Stocks.***

(Need help with the terminology? Look for the "Today's Indicator" section in each issue for the Name of the indicator and their explanations.)

## Using Shorter-and Intermediate-Term Indicators

I begin with the shorter-term indicators like the **Overbought/Oversold Oscillator.**

The Oscillator is the 10-day moving average of the net differential of the advance-decline line. It is a momentum indicator, meaning  it shows us the short-term momentum is in the market.

For example, if the market has had several down days in a row—because the oscillator is a moving average—we must assume that the market is going to replace those negative days with positive days, or at least with less-negative days. That would then make the market oversold.

When using the oscillator we also look for divergences.

For instance, at the end of a market decline and the start of a rally, the oscillator tends to give a deep oversold reading as usually there will have been many consecutive down days. That leads to an oversold rally—one that is more typified by a loss of downside momentum rather than a rally with staying power.

When that oversold rally "gives up" and comes back down, we look for a divergence.

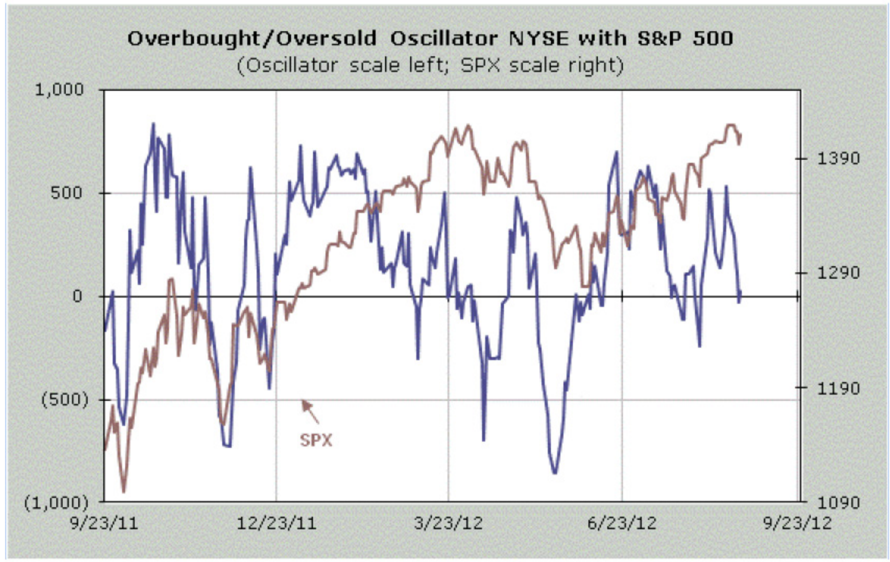
We want the underlying index average ( Dow Jones Industrial Average, S&P 500 or Nasdaq) to make a lower-low than its previous low, and when it does we look for the oscillator to make a higher-low. Why?

Because that shows a market that is tired of going down, in other words it's a market that has lost all downside momentum and  is ready to rally.

Obviously, the reverse is true at tops: We get a maximum overbought reading, and...

*"I believe Helene Meisler is one of the world's finest technicians."*

***– Jim Cramer***



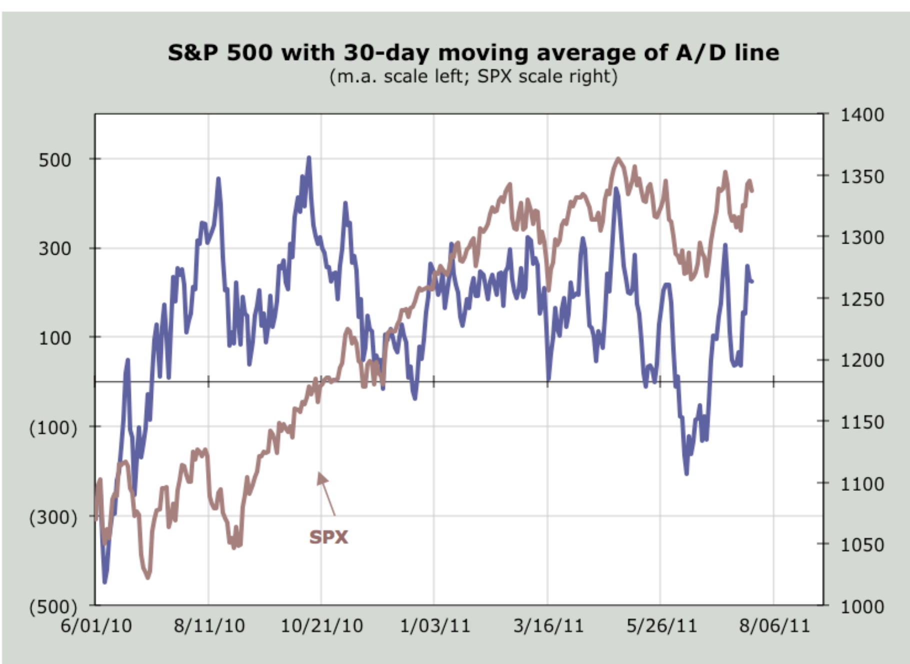

the market backs off and then rallies again. But if that rally takes the underlying average to a higher-high and the oscillator to a lower-high, we would then look for a market that is ready to fall.

Using the same statistics, the **Advance-Decline Line**, I also then calculate the 30-day moving average. This is an intermediate-term oscillator.

When this indicator is oversold, it tends to be supportive of the market; and if it's rising, err on the side of looking for a rally, as declines tend to be contained in that scenario.

Staying with the Advance-Decline Line, I also use the **McClellan Summation Index.**

NOTE: *Please reread that carefully as <u>I do not use</u> the McClellan Oscillator, I use the Summation Index.* The Summation Index is a complicated calculation so rather than go through the calculation, let us just think of it as a very smooth version of the advance-decline line.

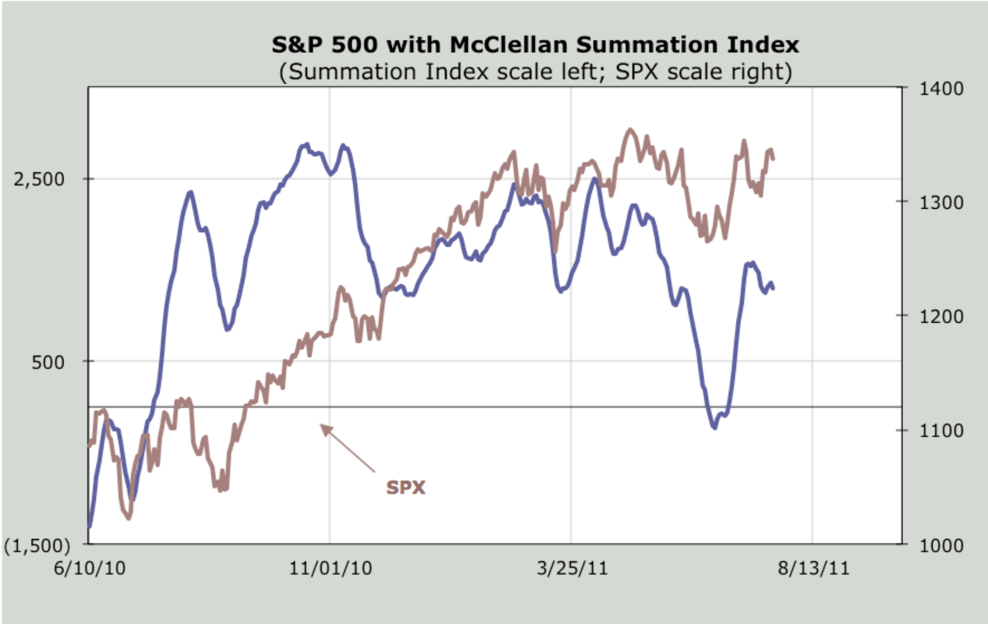



This indicator moves slowly and does not swing much. We want to err on following its direction. For example, if it's rising, we want to be on the bull-side of the market. If it's falling, we should be looking for shorts, not longs.

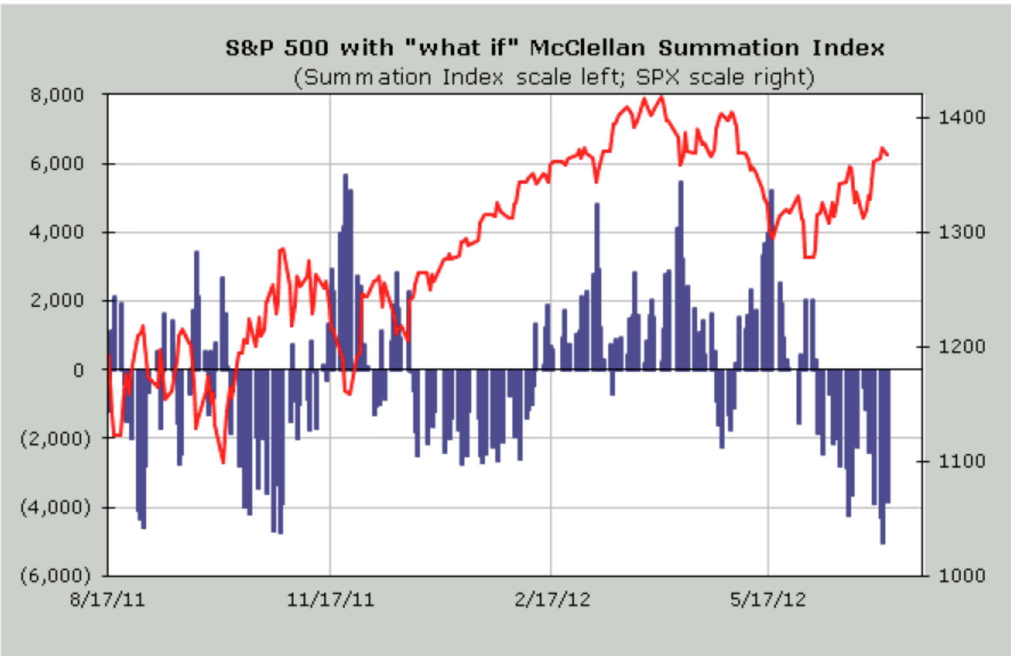
Recently I have begun to calculate 'what-ifs' based on the McClellan Summation Index to determine what it will take to turn this indicator from up to down or down to up.

I have learned that when the...

market gets to the point where it requires more than +/-4000 issues to turn, we are overbought or oversold. Meaning, if it requires a net differential of -4000 advancers minus decliners on the NYSE we are overbought. For oversold readings we use +4000.




These indicators all use the advance-decline figures, which are also known as **market breadth.**




Another form of market breadth is the number of stocks hitting new highs and new lows each day. We use these readings for confirmation or divergence.

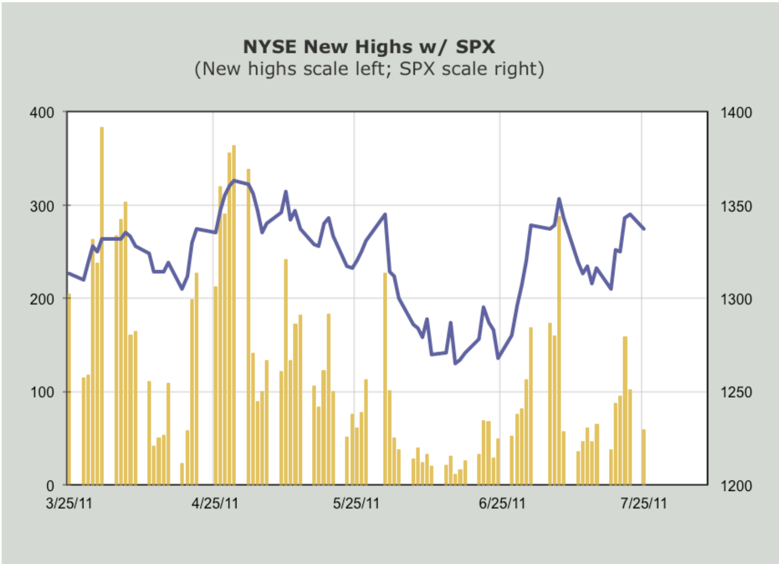
In a market rally we see the number of stocks making new highs increase. If individual stocks are doing well, the market averages will do well and the rally ought to continue.

But if the number of stocks making new highs begins to contract instead of expand, it is an early warning sign the rally may be getting tired.

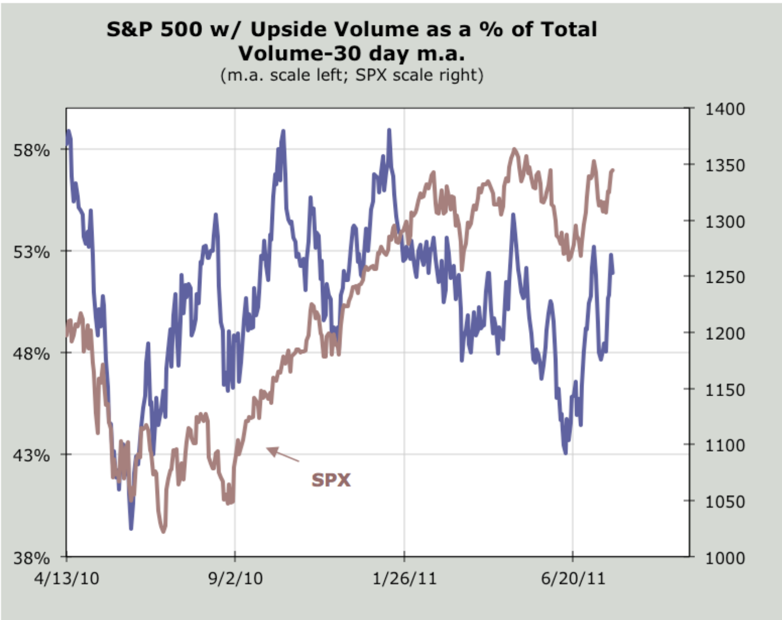
In a downtrend we typically see the number of stocks making new lows expand. If we are looking for...

a change in trend, we pay attention to this reading.

Most often the market index make a lower-low and the number of stocks making new lows stops expanding and begins to contract. That tells us stocks are tired of going down and we should start preparing for a potential rally.




## Volume: The Big Difference Between Highs and Lows




Another aspect of market breadth is volume.

As it is an important factor in the markets, I monitor many aspects of volume, but the indicator I find most useful for an intermediate-term move in the markets is derived by taking the percentage of upside volume plotted on a **30-day Moving Average.**

When this indicator gets down to the low 40% area, the market tends to be closer to a bottom than a top.

At that point start focusing on when the oscillator will next be oversold, and...

looking for stock charts that should be bought for the upcoming rally. When this volume indicator gets over 55%, the market tends to be close to the end of a rally.

This is a good point to point out that there is a big difference between market highs and lows.

It is human nature to want to buy, not sell; therefore bottoms can form in a day, but most often it takes tops significantly longer to form.

So when I tell my readers "we are late in the rally," it means I no longer want to be buying stocks.

First the indicators stall out; and then at some point, after these indicators stop going up, all these indicators will start rolling over with stock charts following. That will be the point I want to start shorting.

## Monitoring Market Sentiment: The Best and Then the Rest

This brings us to a discussion of sentiment. I put a lot of emphasis on sentiment in my market outlook. I am a strong believer in contrary investing. When there are too many bulls, I wonder who is left to buy. When there are too many bears, I wonder who is left to sell.

Granted, there are long periods of time when the trend is your friend and it does not pay to be contrary. But when the sentiment indicators are at or near extreme readings and the other indicators are lining up with them, the market is gearing up for a turn.

On a daily basis I follow the **Put/Call Ratio.**

My thought process is that folks who are bearish buy puts and folks who are bullish buy calls. So a low put/call ratio means there are too many call buyers vs. put buyers, and is considered bearish. Because you cannot judge a whole market on a one-day reading, though, I will tend to smooth this indicator out and plot it on a 10-day moving average.

When this moving average rises to the top of the chart (there is no definitive level, but it becomes obvious on the chart), there are too many bears. When it falls to the bottom of the page, there are too many bulls.

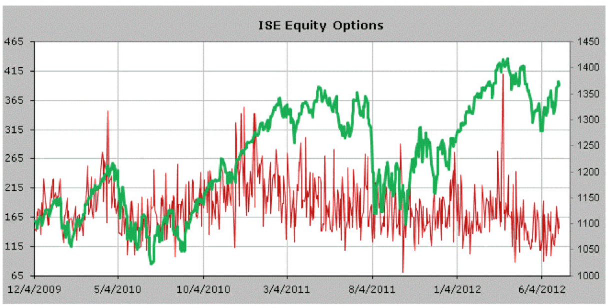
The **Investor's Intelligence** readings are weekly. There are many market participants who complain that this sentiment indicator is no longer useful because so many watch it. My answer to that is Investor's Intelligence is one of the oldest sentiment indicators out there — it's been around since the 1960s– and I have rarely seen a market bottom or top where this indicator hasn't given us a signal. There are too many bulls at the highs and too many bears at the lows.

Another weekly sentiment indicator is the **American Association of Individual Investors.**

I have found this indicator useful at times, but my big pet peeve is that these folks call themselves...

investors yet they jump around from bull to bear in the course of a few days! Therefore this indicator needs to get to a major extreme and needs to be confirmed by at least one other sentiment indicator for me to make a big fuss over it.

The **Market Vane Bullish Consensus** is a survey of traders. Readings in the 70% range should be considered too bullish and are warnings we should no longer be chasing rallies. The lower end, however, is not as easy to interpret as it once was. There was a time when a reading under 20% meant it was time to buy, but we haven't seen a reading under 20% in years.




The **ISE Sentiment** readings are also options ratios but they are calculated differently than the CBOE's put/call ratio.

A reading under 100% tells us folks are leaning too bearishly, so a contrarian would consider that bullish. When the Equity ISE reading gets into the high 200s or low 300s, it is time to exercise caution in the markets.

Over time there will be other indicators I discuss that are not listed here. However in general these are the indicators I use most frequently in ***Top Stocks.***

## No Stone Unturned

The key to my successful ***Top Stocks*** strategy is that I obsessively analyze every scrap of data I can get my hands on and look  for stocks that are about to make a move in the next week to month, so I am not day-traders.

At ***Top Stocks*** we look for quick moves, so if we don't get the kind of bounce (or drop) we're looking for, we move on to better opportunities; we use stop losses to get us out quickly if the unexpected happens or the move I'm expecting doesn't materialize.

And after more than 20 years of successful trading, I have dozens of tricks that help you boost returns and cut risk in almost every trade I recommend.

See for yourself, in real-time, how successful you can be with highly-accurate technical trades in ***Top Stocks***.

As my friend, Jim Cramer would say, "There is a bull market out there somewhere. Let's go find it together!"