STOCKS, STRATEGIES & COMMON SENSE

Third Edition

BART DILIDDO, PhD

EDITOR AND FOUNDER OF THE VECTORVEST ADVISORY

This page left blank intentionally.

VectorVest
330-867-2814, ext. 502
2650 W. Market Street, Ste #1-A
Akron, Ohio 44333

Published in association with SWC Enterprises, Inc.
4305 Mt. Pleasant St. NW, Ste 202, North Canton, Ohio 44720

Cover Design: Richard A. Fairchild II

First Printing, 1995
Second Printing, 1996
Revised and expanded, Third Printing, June 1997
Fourth Printing, April 1998
Fifth Printing, September 1998
Sixth Printing, May 1999
Seventh Printing, April 2000
Eighth Printing, February 2001
Ninth Printing, June 2001
Tenth Printing, March 2002
Eleventh Printing, November 2003
Twelfth Printing, December 2003
Thirteenth Printing, April 2004
Fourteenth Printing, September 2004
Fifteenth Printing, March 2005
Sixteenth Printing, July 2005
Seventeenth Printing, January 2006
Eighteenth Printing, May 2006
Nineteenth Printing, January 2007
Twentieth Printing, September 2007
Twenty-first Printing, March 2008
Twenty-second Printing, September 2009
Twenty-third Printing, June 2010
Twenty-fourth Printing, April 2011
Twenty-fifth Printing, September 2011
Twenty-sixth Printing, February 2012
Twenty-seventh Printing, April 2013
Third Edition, January 2022

Printed in the United States of America

Table of Contents

Preface

The purpose of this book is to help stock investors make better, more informed investment decisions.

The best opportunity many of us have of achieving financial freedom is by investing in the stock market. The barriers to entry are low, the market is liquid, profits are evident at the end of each day, and you can exit at any time. Yes, the stock market is very attractive, but you had better know what you are doing. Millions of "Know-Nothing" investors have entered the market this year. I wish them well.

When I started investing back in 1960, I was a graduate PhD from one of the finest engineering schools in the country, but I was naïve and gullible. I believed a lot of things I shouldn't have, and I didn't know a lot of things I should have. Although I read books on investing, signed-up with a top-flight Broker, attended presentations, joined a stock club, and subscribed to newsletters and magazines, I still was not successful.

It was bad enough that the DJIA cycled between 500 and 1000 and gained only 80 points in the 15 years I was in the market, I also was flummoxed by Wall Street's wily ways. Yes, there are many sly, cunning, crafty ways Brokers and others have of parting you from your money. My Broker, for example, would call me with "great buying opportunities:" Bart, he would say, "XYZ is going down in price. Now's the time to buy it." When it continued to go down, dollar-cost averaging was the name of the game. Believe me, you won't get rich buying great stocks going down in price.

I did the best I could for 15 years, but I simply was not prepared to handle three Bear Markets, Stagflation, the Cold War, the Arab Oil Embargo of 1972, and the Recession of 1973-1975, which crushed my portfolio. I sold all but my company stocks in December 1975, thinking I was done with the stock market.

A ferocious blizzard hit Northern Ohio on the night of January 26, 1978. It was called "the storm of the century." The next morning, I saw that snow covered the door of my garage. I could not go anywhere. I was snowbound with nothing to do. It felt good, I didn't have to go to work.

The morning newspaper was not available, so I picked up a copy of the January 1978 issue of Forbes Magazine. It was all about their annual review of Business & Industry. As I read it, I decided that I was going to find the ten best stocks and hold them for a year. Apparently, the stock market bug was still with me.

The Forbes information was good, but it did not tell me what I wanted to know, i.e., how to value stocks. In his classic book, "The Intelligent Investor," Professor Benjamin Graham said to favor undervalued stocks. I did not have access to the data he did, so I had saved whatever information I found on stock valuation.

The key to what I was looking for was in an article I had torn out of an old issue of Forbes Magazine. Assoc. Professor, David Dodd, co-author of "How to Analyze Stocks," said that a stock's fair value could be assessed by comparing the earnings yield of the stock to the interest yield of a bond. This comparison was the basis for a formula I crafted, called the "Quick Value Estimate." It is detailed in Chapter 4 of this book.

By the end of the day, I was comparing the value of each stock in the Dow Jones Industrial Average to its prior closing price. I finally had a way of identifying undervalued stocks.

I spent many days calculating stock values by hand, but I was finally making money with confidence. So, I bought an Apple computer and hired a programmer. This prompted a need to rank the value/price ratios of stocks. However, there were many more things I wanted to know. Consequently, "The VectorVest Stock Analysis & Portfolio Management System," was created over the next 10 years.

Chapters 3-8 provide introductory information and descriptions of the parameters and indicators of the VectorVest Stock Analysis and Portfolio Management System. Since this book will be embedded in the VectorVest 7 platform, I will be referring to it many times.

VectorVest is a unique product. It is the only system that combines the power of fundamental valuation, with the insight of technical analysis. It currently is comprised of five separate platforms which separately analyze, sort, and rank over 18,000 American, Canadian, Australian, U.K., and E.U., stocks every trading day for Value, Safety, and Timing and give a Buy, Sell, or Hold rating, Stop-Price, and a whole lot more on every stock every day. VectorVest also provides a FREE mobile app with each desktop subscription.

The VectorVest Stock Advisory was launched in January 1988 as a weekly booklet. I was beta testing it in 1987 when I began to realize it had prescient capabilities. VectorVest subscribers should read my essays of 10/17/1997, and 10/19/2007, called "Not Surprised, and Black Monday," respectively to see what I mean. If you can find better guidance anywhere, buy it.

VectorVest Electronic was released in 1991. It was a sensational, cutting-edge product with the ability to analyze, sort and rank thousands of stocks in many ways with the click of a mouse. We demonstrated it at the 1992 MoneyShow in Las Vegas, and it is remembered as the first of its kind and only survivor from that show.

VectorVest ProGraphics was released in January 1995. It opened a whole new realm of capabilities. I beta tested this product in 1994 and I felt like I went from driving a Formula One racing car to a Spaceship. I could explore the world before, now I could explore the universe.

The U.S. database currently goes back to 1995. The databases for Canada, United Kingdom, Europe, and Australia go back in time also, but not as far as 1995. The wonderful feature of these historical databases is that you can go back in time and see exactly what we did and when we did it. I like to say, **"We leave footprints." You can reap the power and efficacy of the VectorVest System for yourself. When we say we did**

something sensational, you can check it out. You can trust and verify everything that was said and done.

This is very important, because brokers, advisors and others in the stock market say and do things to deceive you. You may recall that in the Preface, I cited Wall Street's "wily ways" of parting you from your money. The "Six Greatest Stock Market Myths" are only part of the problem.

An insidious system of improper analysis and deception has developed within the stock market, which I call, "The Seven Deadly Sins of Investing." You may be the victim and perpetrator of any of these sins and be unaware of the harm they are doing to your financial success. Fortunately, VectorVest has identified and defined these sins and can defend you within the framework of its guidance. **They are identified and explained in Chapter 2.**

1

STOCKS, STRATEGIES & COMMON SENSE

The Six Greatest Stock Market Myths

Myth #1.
PRICE TO EARNINGS RATIOS TELL YOU WHETHER STOCKS ARE CHEAP OR EXPENSIVE.

P/E Ratios are easy to find. Just about every newspaper, magazine and stock report publishes P/E Ratios. Everybody seems to talk about them when discussing stocks. So, P/E Ratios must be a great way to compare stocks. Right? Wrong!

If you were told that Fly-By-Nite Industries had a P/E of 7, and Fantastic Plastics Inc. had a P/E of 14, would you buy Fly-By-Nite Industries instead of Fantastic Plastics Inc.? Only a "Know-Nothing" investor would say yes to this question. Why? Because they don't know any better. P/E Ratios do not measure value. They measure cost!

P/E Ratios are the result of transactions between sellers and buyers. Sellers set the asking price, but buyers pay a negotiated price for wide variety of reasons. Nobody knows what those reasons are except the buyers. Nevertheless, virtually all investors attribute a stock's value to its P/E Ratio because the commonly accepted formulas are complex and generally useless.

Moreover, most of the geniuses appearing on TV don't know much about the fundamentals of the stocks they talk about. However, there are money managers and newsletter writers who do know about stock fundamentals but will not help you as much as VectorVest. VectorVest provides guidance and information that you can't get anywhere else. **P/E Ratios do not tell you whether a stock is cheap or expensive.**

Myth #2.
YOU MUST ASSUME HIGH RISKS TO MAKE GOOD MONEY IN THE STOCK MARKET.

A woman recently said to me, "I'm just scared to death of stocks. I cannot afford to lose my hard-earned money." The perception of high risk in stock investing is not totally without merit. You are virtually certain to lose money if you listen to the geniuses on TV

Gullible investors get sucked into buying Meme stocks, SPACs, Cryptocurrencies, Bitcoin, and whatever could supposedly make you rich. Just the opposite is true. You do not have to assume high risk to make money in the stock market. The way to make money in the market is to buy stocks that have consistent and predictable earnings growth. **Earnings growth is the engine that pushes stock prices higher and higher.**

Here's how to make good money in stocks with low risk:

1. Buy safe, undervalued stocks.
2. Buy stocks with double digit earnings growth rates.
3. Do not put more than 10% of your money into any single stock.
4. Buy at least 10 stocks.
5. Use Stop-Loss orders to limit risk.
6. Do not own more than two stocks in the same industry.
7. Do not plunge into the market. Spread your investments over time.

Stocks with consistent, predictable earnings growth are the safest stocks you can buy. A stock portfolio with an average earnings growth rate of at least 14%/yr., has a high probability of doubling in five years. In twenty years, it can increase by 1,500 percent.

If you bought 10 stocks and limited your loss on any single stock to 10% by using Stop-Sell orders, your total portfolio risk is only 10%. Your risk on any single stock is only 1% of your total portfolio. **How many investments have the upside potential of stocks with such limited risk exposure?**

Call 1-888-658-7638 for a FREE COPY of The Guide to Worry-Free Investing.

Myth #3.
BUY STOCKS ON THE WAY DOWN AND SELL ON THE WAY UP.

It is said that the way to make money in the stock market is to buy low and to sell high. That, of course, is an irrefutable truth. The only problem is that many investors confuse this bit of conventional wisdom with the assumption that if the price of a stock is going down it is low, and if it is going up it is high. Consequently, they buy stocks on the way down and sell on the way up. There is hardly a worse thing an investor could do.

Stocks are bought on the expectation that they will go up. If a stock is going up in price, it is fulfilling that expectation. When the price is going down, it is denying that expectation. Therefore, it is logical to buy a stock when its price is going up. Moreover, one of the best times to buy a stock is when its price has broken above an old high. At this point there are no unhappy holders who are waiting to dump the stock. **If the stock is fairly valued, there should be clear sailing ahead.**

Myth #4.
STOCKS ARE A
HEDGE AGAINST INFLATION.

For many years, stockbrokers and mutual fund salesmen have been saying that stocks are a hedge against inflation. Well, stocks are and they are not. It depends on how you look at it.

A true inflation hedge is one that increases in price with higher inflation… like a house, or gold, or collectibles. The fact, however, is that **inflation is the stock market's number one enemy**. When inflation goes up, interest rates go up and two things happen. The first thing is that investors say, "Golly, I can make all that money on high interest rate bonds, so why should I invest in stocks?" So, they take their money out of the stock market, and stock prices go down. The second thing is that the cost of doing business goes up. So, corporate earnings go down, stock prices go down and a bear market is born.

So why in the world would anybody say that stocks are a hedge against inflation? It is because stock prices can go up faster than inflation. All you need to do is invest in stocks which have steady earnings growth rates higher than the sum of inflation and long-term interest rates. When you do that, the prices of your stocks will go up faster than inflation. **They will be whipping inflation by staying ahead of it.**

Myth #5.
YOUNG PEOPLE CAN AFFORD
TO TAKE HIGH RISK.

Of all the myths in the market, this may be the cruelest. Everyone knows that elderly people are not supposed to take risks. They must be very conservative because their sources of income are limited. They cannot afford to lose their money! Well, who decided that young people could afford to lose their money?

If any group needs to watch every penny, it is the young. They need money to start a family, buy a house, buy furniture, save for the future and on and on. Furthermore, young people usually are at the low end of the earnings scale. They have precious little disposable income.

Young people have an invaluable asset on their side, however: Time. They don't need to take risk. They can invest in safe, reliable stocks with above average earning growth rates that make money year-in and year-out. With a growth rate of 12% per year, their investments will double every six years. By the time their baby is off to college, that initial safe investment has increased by a factor of eight. When you have time, you can afford patience. **Patience pays off in the market**.

Myth #6
YOU CANNOT
TIME THE MARKET

Perhaps the most egregious myth is that "you cannot time the market." I hear it every day from the TV pundits, wizards selling retirement services, and everyone else who thinks they know something about the stock market. But they are all wrong! They say you cannot time the market, but every one of them thinks that they can predict the market. Can anything be any more hypocritical than this?

Over the many years that I have been an investor, I have wondered how anyone thinks they can predict the market when they cannot even time it. Timing the market is not difficult. All one needs to do is compare the daily closing prices of any of the major indexes, such as the DJIA, S&P 500, or NASDAQ, to its 65-day Moving Average to see what the market is doing. If the closing prices are above the Moving Average and going higher, the market is going up. If some of the daily closing prices are below the 65-day MA and going lower, the market is going down. It is that easy. Let the trend be your friend.

If you are interested in a precision market timing system, read Chapter 9 of this book.

2

STOCKS, STRATEGIES & COMMON SENSE

The Seven Deadly Sins of Investing

There is a big difference between a myth and a sin. A myth is a false belief based on fantasy or delusion. There is no indication of intent to mislead or deceive. A sin, however, is a highly reprehensible act against religious or moral law. Sins occur under a wide variety of circumstances. Deadly sins spur other sins.

Consequently, Deadly sins have morphed into an insidious narrative, which is being used against you and inadvertently may be used by you. Therefore, it is vital that you know what they are and how to defend yourself against them. **VectorVest has identified and defined the "Seven Deadly Sins of Investing," as follows:**

1. **HYPOCRISY...FAILING TO FOLLOW ONES OWN RULES.**
   Wall Street says you can't time the market, which is easy to do. But they say they can predict it, which is impossible.
2. **DECEIT...LYING SO SOMEONE BELIEVES A FALSEHOOD.**
   This is the most pervasive Deadly Sin of all. Brokers, Bankers, Celebrities, and many others do this in many ways. For example, they claim they can assess stock value from P/E Ratios, which is a lie.
3. **GREED...INTENSE DESIRE TO INCREASE ONE'S WEALTH.**
   Speculators are suckers of greedy venders who lie about their investment prowess. So, they buy worthless services and make huge, risky bets on low value, low safety stocks.
4. **SLOTH...LAZY, CARELESS, HALF-HEARTED BEHAVIOR.**
   Speculators and lazy investors look for an "Easy Button," where they can buy or sell anything based upon guesswork. They are surefire losers.
5. **WRATH...UNCONTROLLED FEELINGS OF ANGER, IMPATIENCE.**
   This is the result of being victimized by the above cited Deadly Sins.
6. **PRIDE...IRRATIONAL BELIEF IN ONE'S ABILITIES, REFUSES ADVICE.**
   This is the most destructive Deadly Sin. It has brought down Kings and Kingdoms. Don't allow it to bring you down. Admit your mistakes.

7. **ENVY…COVETING THE SUCCESS, STATUS, OR TRAITS OF OTHERS.**
Everyone who is in the financial world wants to be envied. Don't trust anything anybody says about their predictions, stock picking skills, investment system or past performance unless you can verify it.

Here is how VectorVest defends you from the Seven Deadly Sins:

1. **HYPOCRISY:** VectorVest times the market with a system that has never failed to call a major move, up or down. We track and report the trends of the market because market direction is the single most important thing that any investor needs to know. Market direction is headline news, Heed the Color Guard.

   I listen to the talking heads predict what is going to happen in the market every day, fortunately, I have VectorVest so I'm well aware that predictions are like assumptions, and you know how the old saying goes. Nevertheless, a time or two, I have predicted market movement, only to be disappointed by my own beliefs and expectations.

2. **DECEIT:** VectorVest doesn't use P/E ratios to value stocks, we calculate a stock's intrinsic value. VectorVest's Value is a forward-looking indicator that is calculated from forecasted earnings per share, forecasted earnings growth, profitability, interest and inflation rates. To my knowledge, VectorVest is the only service that calculates an intrinsic value and further, a value which includes the effects of interest and inflation rates.

   VectorVest's proprietary analysis is based on facts and mathematics, a proven, systematic, objective, unemotional approach that can be fact checked through the extensive historical database that's provided to every VectorVest 7 subscriber.

3. **GREED:** VectorVest teaches investors how to Manage Risk by properly sizing your portfolio and using Stop prices to mitigate losses and we provide clear Buy, Hold and Sell ratings on every stock, every day.

   The lure of fast, big wins always intrigues my greedy little mind. I've strayed from the facts that I clearly had seen in VectorVest and made risky bets on stocks that I heard others refer to as a "sure thing." This sin cost me dearly early in my investing career.

4. **SLOTH:** VectorVest does the "work" for the investor, ie., Trading System Viewer, RealTime Derby, UniSearch, BackTester.

   Over the years, I have spent a lot of time paper trading, ie., running mock portfolios and BackTests (by hand before VectorVest had tools like the ones mentioned above). It taught me a lot. Fortunately, I don't perpetrate this sin very often.

5. **WRATH:** Avoid these feelings by letting the trend be your friend, managing risk with asset allocation and Stop prices, using our unemotional, fact-based system and letting VectorVest help you do the work.

   I can recall many times in the past that I've felt anger, impatience and even disgust after making decisions based on some fly by night company I've bought because of a suggestion or my own greed.

6. **PRIDE:** Use the VectorVest proprietary indicators and Trading Systems to beat the market year in and year out.

   Speaking solely from my personal experience, pride goeth before the fall. It is so easy for me to get in the way of myself. I know better, but I don't always do better. I can go back to thinking how much smarter I am than this time-tested proven system. But when I compare my results (where my ego got in the way) to what would have happened if I had just followed the system, it definitely hurts my pride! Hahaha!

   The key is to find a plan that works for you and execute the plan over and over again until it becomes habit to do so.

7. **ENVY:** Buy safe, undervalued stocks that are rising in price and sell unsafe, overvalued stocks falling in price. There is no guesswork involved when it comes to the VectorVest system. And you can verify everything!

   Everybody wanted Bernie Madoff to invest their money. Everybody envied his so-called results and track record. There was no way to verify anything that he did, he even fooled the SEC. His results sounded too good to be true, because they were.

3

STOCKS, STRATEGIES & COMMON SENSE

How to Pick Stocks

Visit the business section of any decent library. You will find shelves full of books on how to pick stocks. I have read many of them over the last sixty years, and some are very good. Most are not. It is not easy but sorting the good stuff from the not-so-good is necessary. Anyone who has read John Rothchild's, *"A Fool and His Money"* knows what I mean.

The biggest obstacle to finding winning stocks is that no stock picking system works every time. Even the great Warren Buffett picks bummers once-in-a-while. Nevertheless, there are some simple, common-sense rules that can improve anyone's stock picking skills regardless of the system they use. Here they are:

Rule I: Favor Undervalued Stocks. The first step in picking stocks is to favor stocks of companies that are making money, lots of money. Favor stocks of companies with double-digit earnings growth rates. Choose stocks of companies that consistently make more money quarter after quarter, year after year.

The only way to know if a stock is undervalued, is to know its intrinsic value. I calculate a stock's intrinsic value from its earnings growth rate, profitability, and other fundamentals. **My formulas for calculating value are described in Chapter 4 of this book, *"How to Value Stocks."*** If a stock's Value is more than its Price, the stock is undervalued. It is a candidate for selection.

Undervalued stocks offer lower downside risk and higher probability of achieving gains. Undervalued stocks also decrease the risk of losing money and increase the rewards for winning. So, favor undervalued stocks.

Rule II: Favor Safe Stocks. Have you ever noticed that the prices of stocks like Sherwin Williams, SHW, and AutoZone, AZO, never seem to cause any excitement, yet go up year after year? Stocks like Beyond Meat, BYND, are always in the news because these stocks go up and down, like a yo-yo. There is a very simple reason for this contrast. The former stocks have track records of steady earnings performance, while the latter has an erratic earnings record. Price volatility reflects fear and uncertainty.

Price volatility and risk arise from many sources...rumors, political assassinations, earthquakes and so on. Shareholders with little confidence in the company's performance tend to overreact to rumors and bad news. So, the stock prices of companies with erratic earnings performance suffer more when unfortunate things happen. Stocks of companies with steady, predictable earnings can weather nearly any storm.

Obviously, there is less risk in holding stocks of financially stable companies. Consequently, I analyze the risk factors of stocks very carefully before buying. A discussion of how I assess risk is given in Chapter 7, ***"Stock Safety: The Missing Link."*** The second key factor in picking stocks is to favor safe stocks.

Rule III: Favor Stocks with Rising Prices. The hardest thing for most investors to do is buy a stock while its price is rising. Most of us have been taught to wait for a stock to go down before buying it. The idea of buying stock at a lower price makes sense but is fallacious.

First, you will miss a lot of good opportunities. Really good stocks usually don't look back once they have started moving upward. Witness the hundreds of stocks that have doubled and tripled over the last few years with nary a downturn. To find these stocks in VectorVest 7, all you need to do is sort the Stock Viewer by Comfort Index, CI.

Buying stocks on the way down is a sucker's game. Just review Myth #3 in Chapter 1. Most of us dream of buying a stock at its low point and riding it to the moon. It is a great dream, but the chances of doing so are virtually nil. The low points on good stocks don't last long. You must be very lucky to bag a bottom.

Picking stocks with rising prices not only obviates the problems cited above but offers several advantages. First, a stock that is rising in price is already doing what you want it to do. (You don't have to break a rising stock of a bad habit.)

Buying stocks with rising prices does not preclude the idea of buying them right after they hit bottom. So how does one know when a stock has hit bottom? The easy way to tell is that they started going up. Alright wise guy, how does one know when stocks have started going up? That is a wonderful question. We answer it in **Chapter 17, *Bottom Fishing: The Art of Buying Low and Selling High***. Owning stocks with rising prices is the surest way to the bank. So, pick stocks with rising prices.

Rule of Rules: Pick Safe, Undervalued Stocks, Rising in Price.

4

STOCKS, STRATEGIES & COMMON SENSE

How to Value Stocks

"How do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decades?"

These words, spoken on the evening of December 5, 1996 by Dr. Alan Greenspan, former Chairman of the Federal Reserve Board, unleashed a selling frenzy that ripped around the world. Prices plunged in Asia, Europe and England. The mighty Dow Jones Industrial Average fell 145 points in America the next morning and were down 55.16 points for the day.

Indeed, how do we know when stock prices are too high? All serious investors are asking this question. Surely, the Wizards of Wall Street must have the answer. Why, then, was Dr. Greenspan, America's most powerful financial person at that time, posing the question? Our guess is that Dr. Greenspan was sending a message, but stock valuation remains a mystery to even the most prestigious members of the financial community.

The theory of stock valuation is relatively simple but is terribly difficult to apply. It is described best by the classic *"Dividend Discount Model"* which is theoretically elegant, but not practical. This model is based on assumptions regarding cashflow, dividend payments, growth rates, and other risk factors that are little more than guesswork and give answers that are usually worthless. **How can we get realistic valuations of stocks based upon facts rather than assumptions?**

Let us examine the way the stock and bond markets work. Investors pour money into stocks when the economy is strong and corporate earnings are going up, and they sell stocks and buy bonds when they are fearful of a weak economy and decreasing corporate earnings.

Given this scenario, investors are constantly seeking to maximize their returns, i.e., they get greedy and buy stocks when they think the total return would be more than that of buying bonds. They buy bonds when they are fearful and think bonds would provide a safer return on their investments.

In the case of bonds, it's easy to know exactly what one would pay, BP, to receive a given return. Simply divide the annual interest payment, IP, by the interest yield, IY. This is calculated as follows:

$$BP = 100*(IP/IY) \qquad \text{Eq. (4.1)}$$

Where: BP = Bond Price in $/Share
IP = Annual Interest Payment in $
IY = Interest Yield in Percent

For example: The price of a bond paying an annual interest payment of $8.00 and yielding 6.25% would be $128.00.

$$\begin{aligned} BP &= 100*(8.00/6.25) \qquad \text{Eq. (4.1)} \\ &= 100*(1.28) \\ &= \$128.00 \end{aligned}$$

With stocks, however, there is far less certainty regarding the returns one might receive. Even after a buyer and seller have negotiated a stock's price, neither party knows whether, when or how long the stock will pay any dividends. **In their book, "*Security Analysis,*" Professor Benjamin Graham and Associate Professor David Dodd said that investors purchased stocks in the early 1900s primarily to receive the income from dividend payments**.

Since the purchase of stocks was riskier than the purchase of bonds, the dividend payments from stocks were expected to be higher than the interest payments from bonds. Since dividend payments come from a company's earnings, the place to start in assessing the price one should pay for a stock is from its Earnings Yield, EY.

We can find a stock's Earnings Yield by looking at its Price to Earnings ratio, i.e., P/E Ratio. Thus,

$$EY = 100*[1/(P/E)] \qquad \text{Eq. (4.2)}$$

Where EY = Earnings Yield in Percent
P = Stock Price in $/Share
E = Earnings Per Share in $/Share

For example: The Earnings Yield of a stock with a P/E ratio of 10 would be 10%.

$$\begin{aligned} EY &= 100*[1/(10)] \qquad \text{Eq. (4.2)} \\ &= 100*(0.01) \\ &= 10\% \end{aligned}$$

The relationship between EY of a stock and IY of a bond lays the foundation for establishing reasonable P/E Ratios of stocks. In the early 1900s a typical investor would have expected that a stock with an EY of 10% would have its earnings allocated as follows: $6.25 would match the interest payment of the bond, IP, plus $0.75 for a Yield Premium, YP, to compensate for the risk of the stock and $3.00 of the earnings would be retained by the company for reinvestment into the company. Therefore,

$$EY = IY + YP \qquad \text{Eq. (4.3)}$$

In summary, a stock with a P/E Ratio of 10 would be considered a fair trade to a $128 bond with an IY of 6.25% and a YP of 0.75%. A stock with these characteristics would be called a VALUE stock. As time went by, it became evident that stocks with consistently growing earnings deserved higher P/E Ratios. These stocks were called GROWTH stocks. Since their level of current earnings were typically lower than those of VALUE stocks, they were considered speculative because investors were betting on future earnings performance rather than past earnings performance.

This early standard for assessing stock value was that sufficient earnings would have been made to pay for the price of a VALUE stock in 10 years or sufficient earnings of a GROWTH stock would have to be made in a number of years equal to its P/E Ratio. For example, a fairly valued GROWTH stock would have a P/E Ratio of 20 if its earnings growth rate were 20% per year.

Thus, the concept of the PEG ratio, (P/E)G, was created and would be equal to 1.00. Stocks with PEG ratios greater than 1.00 were considered OVERVALUED and stocks with PEG ratios less than 1.00 were considered UNDERVALUED.

As a new investor, I was fascinated by this concept because it was a metric that could be used to easily judge the intrinsic value of a stock. Unfortunately, it was not accurate. I needed something better than this crude approach to assessing stock value.

As noted above, the relationship EY = IY + YP, lays the foundation for stock valuation

If $\quad EY = IY + YP \quad$ Eq. (4.3)

Then: $\quad 100 \times (E/P) = IY + YP$

If we substitute P, a stock's market Price, with V, its intrinsic value, we obtain:

$$100 \times (E/V) = (IY + YP) \qquad \text{Eq. (4.4)}$$

Solving for V gives us:

$$V = 100 \times [E/(IY + YP)] \qquad \text{Eq. (4.5)}$$

Where: V = Value of a Stock in $/share
E = Earnings per share
(IY + YP) = Interest Yield + Yield Premium

This equation is called our "Quick Value Estimate." Let us see what the "Quick Value Estimate" of Sherwin-Williams, SHW, would be as of June 30, 2021. VectorVest's 12-month earnings forecast of SHW was $9.40 per share. As a matter of fact, the average (IY + YP) of all the stocks in the S&P 500 was 3.86 on June 30, 2021. **It represented the actual IY+YP that existed at that time and was not an assumption or a guess.**

Inserting these figures into Eq. (4.5) gives us:

$$V = 100*9.40/(3.86) \qquad \text{Eq. (4.5)}$$
$$V = 243.52 \text{ \$/share}$$

SHW's actual closing price on June 30, 2021 was $272.45 per share. So, our quick value estimate is 10.62% below SHW's actual closing price. It is not bad for a calculation you can practically do in your head.

Equation 4.5 tells us that SHW's stock was worth at least $243.52 per share based upon earnings and investors' perceived risk. The critical factors of profitability, earnings growth, and inflation still need to be considered. Let us do this now.

The key measure of operating performance is return on capital employed. We measure profitability by using Return on Total Capital, (ROTC). (Total Capital is defined as equity plus long-term debt.) If a company's ROTC is higher than the IY+YP, its stock's Value should go up, and vice-versa. So, let us include profitability into our equation for Value.

We have found that the effect of profitability is non-linear and reflects reality as shown in the following equations:

R = (IY+YP) *SQR(ROTC/(IY+YP) Eq. (4.6)

Where: R = Profitability Factor

ROTC = 20.18

IY + YP = 3.86

Using Eq. (4.6):

R = 3.86*SQR(20.18/3.86) Eq. (4.6)

R = 3.86*SQR(5.83)

R = 8.83

Adjusting stock Value for Profitability:

V = 100*(E/(IY+YP))*SQR(R/(IY+YP)) Eq. (4.7)

Substituting all the numbers into Eq. (4.7) gives:

V = 100*(9.40/3.86)*SQR(8.83/3.86) Eq. (4.7)

V = 100*(2.44)*SQR(2.29)

V = 369.04 $/Share

Due to SHW's extraordinarily good ROTC, its stock Value received quite a boost. Let us proceed.

Earnings growth is the key factor in perceiving future expectations. We need to compare earnings growth to inflation in the same way we compared profitability to (IY+IP). If a company's earnings growth rate does not exceed the current rate of inflation, it is falling behind the devastating effects of inflation and its stock Value should go down. We will also link earnings growth to profitability since profitability determines a company's internal growth rate.

Here is how it is done:

V = 100*(E/(IY+YP))*SQR[((R+G)/2)/((IY+YP)+F)]   Eq. (4.8)

Where V = Stock Value in $/Share

E = Earnings Per Share in $/Share

IY+YP = Interest Yield + Yield Premium

SQR = Square Root

R = Profitability Factor

G = Annual Earnings Growth Rate in %/yr.

F = Inflation Rate in %/yr

Note that the factor, SQR[((R+G)/2)/((IY+YP)+F)], is a performance measure of the company's ability to increase shareholder value. If this factor is less than 1.00, the company is losing out to interest and inflation and should be viewed as a questionable investment prospect.

Using Eq. (4.8), where:

E = 9.40

(IY+IP) = 3.86

R = 8.83

G = 16.0

F = 5.0

Thus:

V = 100*(9.40/3.86)*SQR[((8.83+16.0)/2)/(3.86+5.0)]

V = 100*(2.44)*SQR(12.415/8.86)

V = 100*(2.44)*1.18

V = 287.92 $/Share.

So, the quick value estimate of $243.52 per share for SHW was below the closing price of $272.45, and the final estimate, $287.92, was above SHW's closing price. Which value is the better answer? **We should opt for the value obtained using Eq. (4.8), $287.92, because it is the result of a more comprehensive assessment.**

Now, let us see how Equation (4.8) works for the 30 stocks in the DJIA. In Table I, we listed all the stock-specific data we needed to use Equation (4.8) as of 02/13/2015 and have also converted the sum of the Values into the VV-DJIA using a divisor of 0.1557159, which we obtained from the *Wall Street Journal*.

Table I. Realistic Value Estimate of the Dow Jones Industrial Average
As of February 13, 2015. (IY + YP) = 5.17%, F = 0.80%

Stock	Price	EPS	ROTC	GRT	Value
3M Co	$165.94	8.34	24.9	9	$172.46
A T & T Inc	$34.66	2.24	3.8	-2	$25.55
Amer Express	$78.08	6.11	8.2	11	$119.93
Boeing Co	$149.73	8.43	32.2	14	$191.94
Caterpillar	$85.13	5.89	8.3	0	$67.45
Chevron Corp	$112.78	8.67	12.6	-6	$95.39
Cisco Systems	$29.43	1.94	10.2	3	$31.60
Coca Cola	$41.99	2.04	16.3	-4	$31.70
Disney (Walt)	$104.17	4.98	12.3	15	$112.26
DuPont*	$76.18	4.33	15.9	16	$81.84
Exxon Mobile	$93.37	6.57	17.4	-5	$88.02
Gen'l Electrc	$25.15	1.73	3.8	2	$18.81
Goldman Sachs	$189.00	18.25	3.1	8	$214.57
Home Depot	$111.89	4.84	19.8	14	$110.07
Intel	$34.36	2.48	17.0	12	$49.88
Int'l BusMach	$160.40	16.5	29.5	0	$209.17
J P Morgan Chs	$59.67	5.94	4.1	15	$82.62
Johnson & Jhsn	$99.62	6.25	15.8	10	$134.13
McDonalds	$95.65	5.25	18.5	-5	$89.24
Merck & Co	$58.81	3.04	6.0	5	$52.44
Microsoft	$43.87	2.78	20.0	4	$56.76
Nike Inc. B	$92.04	3.79	22.3	14	$91.22
Pfizer Inc	$34.64	1.93	10.6	1	$28.72
Proctor & Gmbl	$85.90	4.09	12.6	0	$63.81
Travelers Comp	$108.00	10.07	12.0	9	$160.95
United Tech*	$121.25	7.39	12.3	9	$160.95
UnitedHlth Grp	$109.44	6.42	11.7	7	$139.54
Verizon Comm	$49.31	3.45	7.7	8	$59.56
Visa Inc	$269.63	10.6	19.8	14	$217.85
Wal-Mart Strs	$85.81	5.02	23.6	0	$72.92

As shown in the Valuation Section of the VectorVest Views on February 13, 2015, The Dow Jones Industrial Average closed at 18,019.35 and the VectorVest Industrial Average, VVIA was computed to be 19,728.00, which is only 9.48% higher than the actual DJIA. The DJIA and VVIA comparison is reported each week in VectorVest Views each Friday.

An examination of the stocks in Table I. shows that the following stocks, AT&T, Chevron, Exxon, General Electric and IBM, all had low a GRT. Every one of these stocks went down in price from 02/13/2015 to 06/30/2021. Here again, the ultimate effect of earnings growth on price is demonstrated.

*DuPont merged with Dow Chemical and now functions as a subsidiary of Dow Chemical. United Tech merged with Raytheon and was removed shortly thereafter and replaced by Honeywell.

5

STOCKS, STRATEGIES & COMMON SENSE

Earnings Growth:
The Golden Touch

Your job as an investor is to preserve and increase your net worth. Your enemies are spending, taxes and inflation. Spending can be controlled. Taxes may be deferred, sheltered and avoided, but not evaded. Inflation cannot be deferred or evaded, but it can be overcome. One of the surest ways of defeating these enemies is to have a portfolio of solid growth stocks.

SETTING INVESTMENT OBJECTIVES. The rate of return needed to cope with taxes, overcome inflation and provide current income varies with economic conditions and your personal circumstances. Only you can decide how much cash you need for spending. Beyond the need for current income, the minimum rate of return you should aim to achieve is equal to the sum of the CPI inflation rate plus the yield on 10 Yr-AAA Bonds. In the early 1980's, this sum was about 20 percent per year. With inflation currently at five percent and AAA Corporate Bonds yielding less than two percent, your hurdle rate is now less than seven percent per year. But it won't stay this way forever, so don't forget what must be done.

Stocks have appreciated historically at an average rate of nine percent per year. The average earnings growth rate for American companies has also been about nine percent per year. This is not a coincidence. Earnings growth is the engine that drives stock prices higher and higher.

The earnings growth rate of your stocks must be consistent with your investment objectives. If you want to double your money every five years, you should have a portfolio of solid stocks growing at least 14 percent per year. When inflation and interest rates increase, it's necessary to adjust your investment objectives accordingly. A thorough understanding of the role of earnings growth, how growth rates are estimated and the appropriate use of growth estimates will help you select the right stocks.

THE ROLE OF EARNINGS GROWTH. Companies must grow to stay alive. They cannot stand still. Spending, taxes and inflation erode a company's wealth, just as they do yours. If a company fails to grow fast enough to stay ahead of these common enemies, it will eventually die. On the other hand, a company will prosper if its earnings grow steadily at a robust rate. Earnings growth is a manifestation of a company's health and prospects. It is also a key indicator of your portfolio's health and potential.

ESTIMATING GROWTH RATES. The concept of earnings growth is very simple, yet estimating growth rates can be terribly difficult. It is like computing the gas mileage of your car, calculating the MPG on a single tank of gas is very simple, but it can also be very misleading. Obviously, your average miles per gallon varies widely depending upon driving conditions and other circumstances. Companies like Sherwin Williams and Nike grow earnings at a nice steady pace, so there's very little problem estimating their growth rates. Other companies are like stop and go drivers. Their earnings go up and down in a hopelessly random fashion. Although it is virtually impossible to predict the earnings of these erratic performers, you still need to have an idea of their earnings growth prospects.

Given the variety of factors and circumstances affecting earnings performance, a system of estimating earnings growth is required that virtually tailors growth estimates for each company. Take, for example, the simple step of selecting a time period for computing a growth rate. When should the period begin? Five, ten, fifteen years ago? When should it end? One, three or ten years from now? This single decision makes a major difference in the estimated growth rate you would obtain. Other critical issues like handling negative numbers and dividing by zero make it easy to see why many growth rate estimates may be totally erroneous.

One of the worst examples of misleading growth rates used to appear in a popular financial magazine which published monthly lists of "America's Fastest Growing Companies." These companies were defined as "showing at least a 200% gain in quarterly earnings." Sure, a company's quarterly earnings may increase from one cent to three cents for a 200% gain, but does that mean it is one of America's Fastest Growing Companies? Give me a break!

How does one arrive at these outlandish figures? Simple third grade arithmetic? Brokers merely compare last year's earnings per share with the leading 12-month earnings forecast. The result is misleading and essentially useless information for investors. As a matter of fact, VectorVest provides an update of earnings every week based on data received from FactSet, the gold standard for providing financial data. As of June 25, 2021, FactSet claims that the estimated earnings growth for the S&P500 for Q2 should be a healthy 61.9%. This statement is ridiculous!

Comparing historical point to point earnings data is a common mistake that is made throughout the industry, but VectorVest does not buy it. Statistical analysis of historical data is required to properly determine earnings growth performance. Earnings performance data may be obtained from a company's annual reports or various financial services. Historical data is necessary, but not sufficient. It only reflects the past. The stock market anticipates the future. **Extrapolating the past to estimate future growth is a common and foolish mistake. You need forecasted growth rates to know where a company is heading.**

VectorVest provides estimated growth rates for over 18,000 stocks every day. It statistically analyzes historical sales and earnings performance; it also accounts for current quarter-to-quarter changes in sales and earnings and uses forecasted earnings to target future growth. VectorVest analyzes both sales and earnings data because they are linked in the long-term. Sales growth without accompanying increases in earnings growth reflects a loss of margin...a bad sign. Earnings growth without equivalent sales growth reflects cost cutting, productivity improvements, and so on. These are good things, but they cannot last forever. Clearly, there is much more to estimating earnings growth than meets the eye.

USING GROWTH FORECASTS. Even a perfect growth estimate reflects conditions at a single moment in time. Therefore, it is necessary to use these estimates with three considerations in mind. These are:

1. Sustainability
2. Trends
3. Variability

SUSTAINABILITY. The mark of a great growth company is the ability to continue growing at a steady, predictable pace. The law of large numbers, however, dictates that extremely high earnings growth rates cannot be sustained. Think Cisco Systems, CSCO. It went public on February 16, 1990 and was growing at a fantastic triple digit rate. Its price was skyrocketing. Consequently, it split 9 times, providing 288:1 shares, prior to closing at an all-time high of $79.38 per share on March 24, 2000.

At that point in time, VectorVest gave CSCO a Value of $14.80 per share. Was VectorVest crazy? Not necessarily. VectorVest gave a Confirmed Down, C/Dn,Signal on March 14, 2000, and CSCO's price was going down with the market. Subsequently, CSCO's price fell below the VectorVest Value of $20.82 per share on March 12, 2001. CSCO hit a lower low of $10.32 per share on October 7, 2002, which was also below VectorVest's Value of $13.12. Its Earnings Growth Rate was 19% per year, a far cry from plus 100% per year. On 06/30/2021, CSCO closed at $53.00/share with a GRT of 8%/yr. Although its performance has improved, its days of glory are long gone.

A great story of sustained growth is that of Apple Computer. Steve Jobs became the interim CEO of Apple on July 4, 1997. AAPL was in dire financial straits. Its EPS was essentially zero and its growth rate was minus 5% per year. In less than a year, Mr. Jobs' magic was taking effect: AAPL's EPS was $0.01 and its GRT was 15%.

As time went by, Mr. Jobs transformed Apple Computer into an innovative growth company introducing totally new products, which created new markets. AAPL's GRT continued to move higher under Mr. Jobs stewardship, and it split 2:1 on June 21, 2000. It split 2:1 again on February 28, 2005. It split again, 7:1, on June 9, 2014, and it split 4:1 on August 31, 2020. **Had you purchased 100 shares of AAPL for $1,369 when Mr. Jobs rejoined Apple Computer on July 3, 1997, and held them until June 30, 2021, you would now have 11,200 shares worth $1,533,952.**

Obviously, Apple Computer is the all-time Super Star of stocks. Its growth rate peaked at 44% per year in May of 2005, but its EPS has continued to rise higher and higher. Although Mr. Jobs passed away on October 5, 2011, he was replaced by Mr. Tim Cook who has maintained the culture and standards of the company. AAPL's forecasted earnings per share, EPS, was $4.55 per share as of June 30, 2021, while the growth rate was 25% per year.

About 3,000 stocks in the VectorVest US database are currently estimated to grow at or above 14 percent per year. Many will still be growing rapidly ten years from now. Others will not. It takes phenomenal products, customer service and management to grow at double digit rates for years on end. Apple, Starbucks and Microsoft are prime examples of such great companies. They are literal money machines.

TRENDS. The transition from high growth to sustainable growth is a scary experience that usually causes considerable anxiety among investors. The slightest hint of an earnings slowdown causes a stock's price to fall.

A failure to meet forecasted earnings by as little as one cent often results in a 30 percent drop in price. No one knows for sure what a company's sustainable growth rate will be or when it will be over. Therefore, VectorVest updates its earnings estimates each week for every stock. I believe that VectorVest is the only service which allows you to see these trends on a chart.

We have found that long-term earnings growth trends provide excellent leading indicators of a stock's price performance. Intel is a great company. It was a high growth stock, and its price went higher and higher. Intel's GRT began a cycle in 2000. Its stock price peaked in August 2000, when its growth rate began to trend downward. Over the years its growth rate has fluctuated, and its price performance has suffered since then. No one knows whether its sustainable growth rate is 20 or 2 percent per year. Until this has been determined, Intel's stock price will lag the market.

Tracking growth trends may also reveal spectacular turnaround situations before they are generally recognized by the public. An unexpected increase in earnings performance often causes a stock's price to soar. This can happen even if a company loses less money than it did the year before. So, a reduction in negative growth can be just as important as an increase in positive growth.

VARIABILITY. The third important consideration in using growth rates is variability. Premier growth companies have a history of consistent, predictable financial performance. It is very easy to estimate the growth rates of companies like AAPL and Starbucks. These companies are called "Ruler Stocks," because their quarter-to-quarter earnings increase at a constant rate. You can lay a ruler along a plot of this data. Estimating that these companies will grow as they have in the past entails very little uncertainty.

The way to judge the variability, i.e., risk of a growth forecast, is to examine VectorVest's Relative Safety ratings. Stocks with Relative Safety ratings above 1.00 on a scale of 0.00 to 2.00 have above average financial performance. They also have less variability in their growth forecasts. Less than 12 percent of the stocks in our database have growth rates greater than or equal to 14 percent per year and Relative Safety ratings of 1.00 or over. Your chances of finding a "Ruler Stock" are even less. Let us see how this information can be used to build a variety of growth portfolios.

HIGH GROWTH STOCKS. Aggressive investors must deal with high growth stocks. The risks are high, but so are the potential rewards. **If you deal with high growth stocks, make certain that the Sales GRT exceeds the Earnings GRT. Sales growth is the fuel for the engine the drives stock prices higher and higher.**

GROWTH & INCOME STOCKS. Conservative investors usually prefer to achieve their target level of total return by combining earnings growth with dividend payout. It is OK to do this, but don't take it too far. High yield without earnings growth is a loser's game. I suggest that the earnings growth rate of your stocks be at least double the dividend yield. For example, a portfolio offering a 12 percent total return would have stocks with at least eight percent growth and four percent yield. In most cases, I tend to favor stocks with higher growth and less yield.

RULER STOCKS. As noted above, the consistency and predictability of the earnings performance of "Ruler Stocks" is so good, that you can draw a straight line through their quarter-to-quarter twelve months earnings performance. They're easy to find with VectorVest. We simply use VectorVest's 'Ruler Stocks' search to instantly identify stocks having an RS>=1.40 and GRT>=14.

Note that these phenomenal stocks are ranked by RS * GRT. (Only VectorVest can perform this search for you). Also note only one of the five stocks is selling at a premium Price compared to Value and the remaining four are well below their Value. Why are they worth buying? See Chapter 6, “High Growth vs. Low P/E Stocks.” All these stocks have favorable upside potential compared to an investment in AAA Corporate Bonds. **Imagine growing your money 28.4% a year with stocks of America’s best managed companies!**

PREMIER GROWTH STOCKS. Prudent investors want the best of all worlds...high growth and low risk. This marvelous combination can be found in premier growth stocks. These companies have exemplary records of above average, consistent, predictable earnings growth. Some pay dividends, some do not.

Premier growth stocks have a Price greater than Value. That is why we call them “Premium Growth Stocks.” Investors are willing to pay a premium price for these stocks because of their rare combination of high growth and outstanding financial performance. None of these stocks pay a dividend. They are relatively young companies and are focused on using every cent of capital at their disposal on growth. This “Premier Growth Stock” list has an average growth rate of 27.2%/year and has a good chance of doubling in three years. That is not a bad deal when you consider the relatively low risk of owning them. Each is a leader in its field.

Coming up with lists such as this is easy with VectorVest, but it is the result of a lot of hard work. Fortunately, VectorVest has done the work. All I had to do was ask VectorVest.

When it comes to preserving and increasing your wealth, go with consistent, predictable growth. It is the Golden Touch.

6
STOCKS, STRATEGIES & COMMON SENSE

High Growth vs. Low P/E Stocks

High growth stocks offer the promise of the future. Low P/E stocks provide the certainty of today. There are strong arguments for and against buying either type of stock. Which stocks are best for you?

Many successful investors, including the legendary Peter Lynch, said a growth stock is fairly valued when its earnings growth rate is greater than its P/E Ratio. David Dreman, the high priest of low P/E stocks, said that low P/E stocks provide better profits with less risk. These views are very interesting, but how can we tell which choice is best?

Consider the following questions:

A. If someone were to offer you $500 now or $1,000 in three years, which would you take?

B. If someone offered to sell you a $1,000 note payable in three years, how much would you pay for it?

Regarding question (A), a lot of people would take the $500 now even though receiving an additional $500 in three years is very attractive. For whatever reason, $1,000 three years hence is deemed by these people to have a Present Value of only $500. Do they know that $500 would have to grow at a compounded rate of 26% per year to become $1000 in three years? Maybe, but they want the money now. They are the kind of people that buy low P/E Stocks.

About question (B), most people would gladly pay $500 to receive $1,000 in three years. Compounding money at 26 percent per year is not chopped liver. That's what buying high growth stocks is all about.

Ah, but what about risk? Doesn't it play a role in making these decisions? Of course, it does. It plays a very important role. That's why buying a stock simply because it has a high earnings growth rate or a low P/E Ratio is naive. Unless one has a way of taking risk into account, they will never know how to make the best investment decisions. Discounted cash flow analysis provides the tools for doing this. It allows us to:

1. Calculate exactly how much money we should be willing to accept now (Present Value) in lieu of a future payment (Future Value) depending upon our desired rate of return and risk premium (Discount Rate),
2. Determine how much an investment should be worth in the future, and
3. Compute the Discount Rate for an investment, given its Present and Future Values.

Let's apply these concepts to stock analysis.

When buying a stock, one should know if its future value is worth the stock's current price.

Here is how to get the answer:

I. **COMPARE PRICE TO VALUE.** In Chapter 4, we learned how to calculate the value of stocks. This calculation did not take risk into account or attempt to determine a stock's future worth. However, it provided the necessary starting point for assessing a stock's price appreciation potential.

Five years ago, one of the most speculative, high growth stocks on the market was Tesla Motors, (TSLA). As the name implies, Tesla Motors makes electric cars. Although several electric cars have been put on the market by a variety of manufacturers, none has captured the imagination of investors like Tesla did.

VectorVest began tracking TSLA on July 01, 2010. A VectorVest Simple Graph, showing End-of-Day data, shows that it plugged along until 03/26/2012, until it rose to $7.48 and got its first Buy rating. Its sales growth was 9%/yr., earnings growth was 22 %/yr., forecasted earnings were -$0.08/share, and its current Value was calculated to be $0.71/share, with a Relative Value, RV, of 0.41.

On the strength of increasingly bullish sales and EPS forecasts, TSLA's price embarked upon a long, see-saw journey to an all-time high of $864.16 on January 27, 2021. Tesla had a GRT of 52%/yr., and closed on June 30, 2021, at $679.70 a share with a "Buy" rating, and a current Value of $177.59 per share. Why were investors chasing the stock?

Tesla Motors is an exciting company that produces premium electric cars. It is making a huge bet on the future and the potential rewards are enormous. **Was it worth $679.70 per share to buy TSLA's stock when it was valued at $177.59? Let's see.**

II. ASSIGN RISK. VectorVest performs a complete risk analysis on over 18,000 stocks each day, and Tesla got a Relative Safety, RS, rating of 1.40 on June 30, 2021. This rating is well above average. Therefore, TSLA's price was deemed to have low probability of moving lower in any given year.

III. APPLY RISK ADJUSTED EARNINGS GROWTH TO PRICE APPRECIATION. We assume that a stock's price appreciation will be consistent with its earnings growth and RS rating over the long-term. For Tesla, the forecasted risk adjusted Price Appreciation as of June 30, 2021, was calculated to be $2,153.90.

IV. COMPUTE RISK ADJUSTED FUTURE VALUE. Given a risk adjusted earnings growth rate and RS, of 1.40, the risk adjusted Value of Tesla's stock three years hence was calculated to be $1,173.28.

V. DISCOUNT FUTURE VALUE TO A NET PRESENT VALUE. This computation results in a number called Relative Value, RV. This term was used because Relative Value compares the price appreciation in Tesla's stock, ($2,153.11 per share in three years), to the gain one would obtain from Tesla's Future Value discounted by AAA Corporate Bonds yielding 2.08%, i.e., our Discount Rate.

Since an investment in AAA Corporate Bonds would appreciate 1.0637% in three years, the Relative Value, RV, of Tesla's stock as of June 30, 2021, was: (($2,153.110) / (1,173.28)/1.0637) = 1.73.

An RV of 1.73 indicates that an investment in Tesla's stock, with a forecasted growth rate of 52%/yr., RS of 1.40 and P/E Ratio of 154.13 would appreciate 73% more in three years than its future value discounted at a AAA Corporate Bond interest rate of 2.08%.

Note that Tesla failed both Mr. Lynch's valuation test with a PEG ratio > 1.00, and Mr. Dreman's test by having a P/E ratio >10.0.

Stocks with RV ratings above 1.00 have favorable price appreciation potential. Those with RV values below 1.00 are either glamour stocks selling at a premium, overpriced stocks, having low or no earnings, and/or low growth rates.

If you want to have some fun and improve your profits, buy beaten-down stocks with RVs >= 1.50 using a VectorVest search called, "New Hold, Old Sell." It's a "no guesswork" way to buy great stocks with high upside potential.

7

STOCKS, STRATEGIES & COMMON SENSE

Stock Safety: The Missing Link

Several years ago, I received a thing in the mail called the "Hot Stocks Review." Phrases like "may even double again in the next twelve months," and "could have you crowing all the way to the bank" riveted my greedy eyes. Never one to pass up great investment opportunities, I decided to examine these "Hot Stocks." The blurb gave an 800 number to call for more information, but I prefer to do my own research.

The first thing I did was check my VectorVest database. Only two of the 29 stocks recommended by the "Hot Stocks Review" were covered by VectorVest. This was not too surprising since only eight of the 29 stocks are traded on American exchanges. Both stocks covered by VectorVest had a below average Safety rating. Neither had a Buy recommendation.

I checked Standard & Poor's Stock Guide, which covers more than 8,800 stocks, and found only one stock named in the "Hot Stocks Review." It was not ranked in terms of earnings and/or dividend quality.

Obviously, if one were to invest in any of those stocks, one would have to believe the promotional material touting the stocks, or use the information sent by the companies. There are two problems here. First, it takes a lot of time and effort to analyze a company's financial statement, and I certainly did not want to do that. Secondly, the investment caveats cited in company literature and prospectuses were designed to protect the seller, not the buyer.

Of course, the publication featuring the "Hot Stocks Review" included the usual disclaimers that "all investments carry risks," and made it clear that "the publisher nor anyone else involved would be liable for any investment decision resulting from their recommendations." That is fine, but how does one get a handle on finding out how risky a stock is, anyway?

Risk has two parts:

a. The probability of an unfavorable outcome, and

b. The consequences derived from that unfavorable outcome.

Simply put, investment risk entails the probability of losing money, and the pain associated with the loss.

Each of us needs to know how much money we can afford to lose on any single investment. Even though the risk is extremely high, we may be very comfortable with buying a lottery ticket because we can afford the loss. Buying stocks, however, is a lot different. We are using serious money when investing in the market...money that can make a difference in the way we live. Once we have established our "tolerance for risk," we can focus on assessing the risks involved with individual stocks.

Good information on stock safety is hard to find. Maybe that is because it's the last thing anybody wants to think about. Even the few credible sources that provide some form of risk analysis, do so subjectively. Consequently, most investors do little more than plug intuition into their investment decisions. It is the Missing Link in assessing stocks.

Knowing how safe (or risky) a stock is can make the difference between making money or losing money as an investor. Here are the key factors used by VectorVest in assessing stock safety.

EARNINGS CONSISTENCY. The largest risk that shareholders have is that the company fails to meet earnings expectations. Experienced investors know that the moment of truth comes each quarter for every company traded on American stock exchanges. If a company fails to meet analysts' earnings estimates, its stock's price often drops 30% in a single day. Therefore, the single most important factor in assessing stock safety lies in quantifying the probability that quarterly earnings will meet investor's expectations. If a company has a well-established record of consistent, predictable earnings performance, it is much more likely to meet the market's expectations.

Companies like Alphabet (GOOGL) and Old Dominion Freight (ODFL), with predictable performance have high safety ratings.

COMPANY SIZE. It is true that the stocks of large companies generally are safer than those of smaller companies. Many fund managers are forbidden to invest in companies with less than a billion dollars in annual sales. Obviously, larger-sized companies are not going to disappear overnight. Investors should not assume, however, that the shares of a company are safe just because they belong to big companies.

Size is not nearly as important as knowing where the company's earnings are heading. It is virtually impossible to forecast the earnings of companies in cyclical industries with any degree of accuracy. Therefore, the VectorVest safety ratings of their stocks are usually below average.

PRICE BEHAVIOR. The classic measure of price volatility is given by "Beta." Beta reflects the statistical movement of a stock price compared to that of the market. If a stock's price moves up and down exactly in sync with the market, it will have a Beta of 1.00. If a stock's price consistently moves up 10% more than the market and down 10% more than the market, it is more volatile than the market, and it has a Beta of 1.10.

Fair enough. High Beta stocks are more volatile than the market and less predictable. Therefore, they are riskier than the market. Ironically, they are not necessarily riskier than some low Beta stocks. Certain stocks, such as gold stocks, are very volatile, but tend to move counter to the market. These stocks may have low or even negative Betas. Given this dilemma, I use Betas with a grain of salt. I prefer to analyze absolute price behavior to measure risk.

Absolute price behavior not only provides an unequivocal measure of volatility, but it allows one to assess risk in relation to the stock's price history. Since all things tend to move toward a mean, stocks which are well above their price moving averages are more likely to move down, and stocks which are well below their price moving averages are more likely to move up. This phenomenon is called reversion to the mean. Therefore, a stock which has moved well above its price moving average is riskier than one which has moved well below its price moving average.

LONGEVITY. It is better to deal with the devil you know, than with the one you do not. All other factors being equal, there is less risk in dealing with a company with a long track record than one which is brand new. Young companies offer some of the best investment opportunities, but they also bear potential pitfalls that could be fatal. Regardless of how good a stock looks, it is risky if it has not been traded for at least five years.

DIVIDEND HISTORY. When a company pays a dividend, it is perceived that the company has at least a good financial track record. Therefore, it is also perceived that dividend paying stocks are safer than stocks without a dividend payment. A company does not have to pay a dividend to have a safe stock. But if it does pay a dividend, it must maintain or increase the dividend without exception. A cut in dividend is a black eye for any company and reflects poorly on its management and stock safety.

DEBT/EQUITY RATIO. The US government allows companies to deduct interest payments as a business expense. That is nice, but some companies overdo a good thing. They load up on debt beyond the point of being able to report any net earnings. Such companies may have good businesses, but their financial performance is a mess. Their Relative Safety ratings in the VectorVest system would be below 1.00 on a scale of 0.00 to 2.00.

Beware of companies with excessive debt. Do not be fooled by the line about valuing a company based upon its cash flow. A company that cannot report positive earnings after interest and tax payments is in big trouble no matter how you slice it. Safe stocks belong to companies with low debt/equity ratios.

OTHER FACTORS. The items cited above are only a short list of the many things that may be considered in assessing stock safety. Anyone who has studied accounting or read Benjamin Graham's book, "The Intelligent Investor," knows that there are many other things to look for. Regardless of how one might assess stock safety, it is important to do it systematically. Services such as VectorVest, Value Line and Standard and Poor's use systematic approaches to assessing stock safety. Investors should always factor risk into their investment decisions.

USING STOCK SAFETY. Mr. Graham spends a lot of time in his book, "The Intelligent Investor," discussing the difference between investing and speculating. Basically, this difference is a matter of using knowledge to reduce risk to the point where the odds of winning are in your favor. Mr. Graham approaches the reduction of risk by advocating the purchase of undervalued stocks.

I approach valuation and safety as separate issues; then tie them together. In the previous chapter, High Growth vs. Low P/E stocks, I showed how valuation and stock safety are linked together in assessing a stock's long term investment potential. Both factors also play key roles in establishing Buy, Sell, Hold recommendations. Intelligent investment decisions cannot be made without including an assessment of stock safety. **Do not let stock safety be your Missing Link.**

8

STOCKS, STRATEGIES & COMMON SENSE

Timing: The Ultimate Weapon

"Desert Storm" was a piece of cake. By the time the Allied attack on Iraq was launched in February 1991, American reconnaissance had sliced and diced Iraq 80 ways to Sunday. Every significant target was identified and programmed into computers. The attack was spearheaded by "smart bombs." These guided missiles knew where to go and what to do. They epitomized the Allied force's supremacy in planning and running a high-tech war.

The first truly successful smart bomb was an air-to-air missile called the "Sidewinder." It homed in on a heat source such as the exhaust of an airplane engine and pursued it relentlessly. Very few targets escaped its destructive intent. For a while, it was the ultimate air combat weapon.

Just as military strategists search for weapons that can reliably seek and destroy enemy targets, investors look for sure-proof methods of buying and selling stocks. Many investors apply the concepts of fundamental analysis. They analyze a company's business, its financial data, the economy and other factors. When they are convinced, they pull the trigger and buy the stock. These investors are called "Fundamentalists" or "Value" investors. They believe that undervalued stocks will ultimately be recognized by higher prices, and they are willing to wait a long time to be proven right.

Other investors are far less patient. They do not care a whit about a company's fundamentals or holding a stock for the long-term. They just want to buy low and sell high. They want to buy when a stock's price is about to go up and sell when it is about to go down. How can they possibly expect to do this?

By using the "Near Perfect Indicator, NPI." The NPI is the Brainchild of Mr. Stan Heller, Managing Director of VectorVest Canada. He noted that a stocks' Price is rising when the 5-Day Moving Average of RT is higher than the 40-Day MA of RT and vice-versa. It works like a charm and allows you to consistently buy low and sell high with confidence.

The NPI makes the practice of analyzing charts of price formations and patterns obsolete. A perfect timing system does not exist. But this is not to say that technical analysis is without merit. Quite to the contrary, technical analysis plays a larger role in short-term stock market movements than fundamental analysis.

I have discussed the role of fundamental analysis in stock valuation and stock safety in prior chapters. So far, however, I have not mentioned technical analysis. While an understanding of stock value and safety are vital for appropriate stock selection, a knowledge of technical analysis and timing is essential for knowing when to buy and when to sell.

Designing a stock timing system is quite the same as designing a smart bomb. You need an analytical device that recognizes its target and a decisional mechanism to trigger an output. A stock timing system's analytical device, such as a chart, must recognize certain pricing patterns, and its decisional mechanism must produce an output signal to indicate whether the stock's price is rising or falling.

Exactly how one interprets historical price data and produces an indicator depends upon their buy/sell philosophy. My philosophy is to buy a stock when it is going up in price and sell when it is going down. It is consistent with the buying patterns of most investors...they flock to the market when it is going up and they shy away when it is going down. Favoring stocks going up in price is also inherent in the "Relative Strength" approach to timing.

Relative Strength is the measure of a stock's price performance compared to other stocks. High Relative Strength stocks are those which are outperforming the market. Many extremely successful investors use Relative Strength as their primary timing system for selecting stocks to buy or sell. **VectorVest provides an indicator called the "Comfort Index," which is on a scale of 0.00-2.00, and allows users to rank the relative performance of stocks with a click of the mouse.**

The trick with all timing systems is in knowing when a stock's price is going up or down. One of the simplest ways to analyze a stock's price behavior is to compare its price pattern to a moving average of its previous prices. If a stock's price is above its moving average price, and is moving away from the moving average, the stock is in an uptrend. The reverse is also true. VectorVest provides charting and moving average capabilities on over 9,100 U.S. stocks.

Investors who use moving averages to time their buy and sell transactions can do very well. However, they will never "get in at the exact bottom," or "get out at the exact top" because of the characteristic of "lag" of moving averages. On the other hand, good chartists can capture a higher percentage of a move and avoid disastrous losses.

VectorVest computes (13-week) moving average prices for over 9,100 stocks each day. It publishes a Stop-Price for each stock based upon its moving average. Thus, if one sees that a stock's price which is above the VectorVest Stop- Price in a dataset, they would not be able to tell whether the stock is in an up or down price trend unless they use a graph.

VectorVest solves this problem with an indicator called, "Relative Timing, RT." This indicator analyzes the direction, magnitude and dynamics of a stock's price movement. It is reported on a scale of 0.00 to 2.00. When RT is above 1.00, the stock's price is in an uptrend. When RT is below 1.00, the stock's price is in a down-trend.

RT has all the characteristics of a guided missile system. It is extraordinarily fast. Once it locks in on a stock, it tracks the stock relentlessly. It explodes upward from bottoms and dives from tops. It can see things not visible to the naked eye and automatically returns to 1.00 when a stock's price flattens out.

Since RT works within a framework of 0.00 to 2.00, the price direction of all stocks may be searched, sorted, screened and ranked on a consistent basis. Day-to-day or week-to-week comparisons of RT are easily done with VectorVest's UniSearch tool, helping investors discover many great winners just as they are beginning big moves.

No level of fundamental analysis could find these stocks at the critical point of eruption. They need not necessarily be undervalued or of low risk. Investors must employ technical analysis and timing to complete their stock selection arsenal. **Timing: It is the ultimate weapon.**

9

STOCKS, STRATEGIES & COMMON SENSE

Timing the Market: A System that has Never Failed

Being on the wrong side of the market is the worst thing that can happen to an investor. It does not have to happen to you.

Old Joe Granville always said the market tells its own story. All you have to do is read what it is saying. Unfortunately for him, he didn't take his own advice.

Joe Granville was one of the pioneers of technical analysis. He used several novel methods of "reading the market." The most popular of which is "On Balance Volume." Initially, he was quite successful and became the market "Guru" of the early 1980's. He was so influential, that his forecasts became self-fulfilling prophecies.

Then, he missed the call on the great Bull market of the 1980s and '90s. On August 16, 1982, the market broke out of a steep slump and Joe Granville said it was a folly. He said that it was a Bull trap, rising stock prices were like balloons that were about to burst. He remained a Bear for over 14 years while the market soared. What went wrong?

Mr. Granville's fatal error is that he went from timing the market to forecasting it. There is an enormous difference between the two. Market timers are messengers. They study indicators of market activity to determine whether it is rising or falling and communicate their conclusions on market direction. Forecasters consider economic factors and whatever else they think is important to predict what the market will do. **Market timers need never fail. All forecasters will fail eventually.**

Theoretically, forecasting the market is far more powerful than timing. Everyone would like to know what the market is going to do, when it will happen and by how much. In the real world, however, nobody has a crystal ball. Forecasting deals with the unknown and eventually, error is certain. The landscape is full of forecasters who have gone wrong. Their stories are well documented. They were viewed as stars when they were right. They are viewed as losers when the crystal ball is broken.

The first Hot Shot was Joe Granville. He was great until he was not anymore. I was subscribing to his newsletter in 1987 when the stock market crashed on October 19. He could not accept that fact and said that the market would recover soon. It did not. And neither did Joe.

The next Wall Street Wizard was Elaine Garzarelli. She was a stock market analyst working for Shearson Lehman in 1987 when she correctly anticipated a market down-turn and was given credit for predicting the stock market crash of October 19th. She became famous and subsequently started her own business in 1995. When I signed up for her newsletter, it promised that her subscribers would be the first to learn about her next major prediction when one was made.

On July 23, 1996, Ms. Garzarelli predicted that the market would drop between 15 and 25% soon. I was miffed because I learned about this prediction from the general news. Moreover, our Market Timing system indicated that the overall market, as represented by the VectorVest Composite, was completing a downturn and we had advised our subscribers to go Bottom-Fishing and Bargain Hunting.

Ms. Garzarelli and her publisher suffered badly from her call and the VectorVest Composite rose nicely from a level of $19.50 on July 26, 1996 to $21.90 on February 14, 1997, a gain of 12.31%.

The last and final prophet I dealt with was Robert Prechter, editor of the Elliot Wave Theory. I subscribed to his newsletter in 1987 when he was forecasting that the Dow would close at around 2,700 in 1987 and 3,600 in 1988. I paid extra for his telephone service that would advise me of any changes to these forecasts.

I did not receive a telephone call from him in 1987, and we know what happened on October 19, 1987. He claims he called all his telephone subscribers. He did not, as far as I'm concerned. He became a perma-bear after 1987, and we do not hear much about him anymore. So much for prognosticators.

It is ironic that literally everyone on Wall Street says, "you can't time the market," but they all try to predict it. This chapter is not about predicting the market. It's about timing, i.e., reading our indicators and letting them tell us when the market is rising or falling. It's about sensing turning points and knowing when to invest aggressively and when to take defensive actions. We want to buy within five percent of a bottom and sell within five percent of a top. Can we do it? It's really very simple.

The market timing system described below was discovered in March 1995 and depends upon two key indicators:

1. The Price of the VectorVest Composite, and
2. The VectorVest Buy/Sell Ratio.

Both indicators were developed by VectorVest, a stock analysis system which analyzes over 18,000 stocks each day for Value, Safety and Timing and gives a Buy, Sell or Hold recommendation on each stock each day.

The Price of the VectorVest Composite, VVC, an arithmetic indexed average of all the stock prices in the database, is the most important indicator used in timing the market. When the Price of the VVC has moved two weeks either up or down, you can bet that the market has moved in the same direction.

The VectorVest Buy/Sell Ratio, BSR, is the second most important indicator used in timing the market. It responds to the directional movement of the Price of the VVC and increases as the market moves higher and decreases as stock prices move lower. This indicator is amazingly sensitive to the inner movements of the market. When the ratio of Buys to Sells is above 1.00, the market is robust. Correspondingly, the market is weak when the Buy to Sell Ratio is below 1.00.

Since VectorVest gives buy ratings to stocks moving higher in price and sell ratings to stocks falling below their Stop Price, we knew from the very beginning that the Buy/Sell Ratio was an excellent indicator for measuring the health of the market. But it was not until March of 1995, that I discovered that the Price of the VVC replicated the direction of the overall market. I examined our data back to April 1991 (the time when we first began computing the VVC) and found that tracking the direction of the market with the Price of the VectorVest Composite was incredibly simple and reliable. **Here's how the system works:**

If the Price of the VVC moved up or down over a five-day trading period, it gave a preliminary signal of the market's direction, up or down. This signal is called the **Primary Wave**. If the Primary Wave is followed by another five trading-day move in the same direction, the preliminary signal was reinforced, but not confirmed. We must turn to the BSR for confirmation of the market's direction.

A Confirmed Up, C/Up, is given when the Price of the VVC has gone up for two consecutive five trading day periods, closes higher than the previous day and the BSR is above 1.00.

A Confirmed Dn, C/Dn, signal is given when the Price of the VVC has gone down for two consecutive five trading day periods, closes lower than the previous day and the BSR is below 1.00.

Although we discovered this timing technique in March 1995, the first major C/Dn signal given in "real time" did not occur until 09/22/95. The market had just completed a marvelous Bull rally, lasting 39 weeks. Signs of weakness had begun to appear in July, but the market did not peak until 09/08/95. Two weeks later, we got the C/Dn signal. Here's what we said on 09/22/95: "The Price of the VVC has now gone down for the second week without an intermediate up move. Our studies have shown that this event signals a market correction. The still favorable investment climate suggests, however, that it will be only a mild correction."

From September 22, 1995, on, we tracked the "mild correction" week-by-week, until it bottomed on January 12, 1996. Two weeks later, we said, "The Price of our VectorVest Composite rose for the second week in a row, signaling that the market's correction is over. Although the green light has not been confirmed by the BSR, it's OK to buy high VST-Vector "B" rated stocks."

As luck would have it, buying high VST-Vector "B" rated stocks rising from a C/DN bottom was not the best advice. We eventually learned that high VST-Vector "B" rated stocks were being out-performed by beaten down "S" rated stocks during the rallies coming after C/DN bottoms. **Learn more by reading our Special Report "Bottom-Fishing: The Art of Buying Low and Selling High," in VectorVest 7 U.S.**

You might believe that the market moves in a random fashion. It does not. While there are periods where the market moves up and down from week to week, it always happens within the framework of an underlying trend. **The VectorVest system of timing the market has never failed to signal a major move...and it never will.**

Big moves start with little moves. Since we keep track of every little move the market makes, we will never miss a big move. Even the apparently abrupt crash of October 1987 occurred nearly two months after the market peaked in late August 1987.

We warned our readers to take profits at the very top of the bull market on March 10, 2000, to go long at the beginning of a new bull market on March 21, 2003, and we issued a strong warning at the onset of the bear market on November 2, 2007. We also nailed the beginning of the long bull market at the very bottom on March 6, 2009. **All of this can be verified within the VectorVest 7 U.S. database.**

The drama of the market's moves is vividly displayed on the Home Page of the VectorVest software in a clear, easy to understand tool called, "The Color Guard." There's no guesswork. Green means the market is Bullish. Red means the market is Bearish and Yellow means the market is in transition.

See it for yourself. Call **1-888-658-7638** or log on to **www.vectorvest.com** to order a Special 30-day Trial to VectorVest. Databases are available for the following markets: United States, Canada, United Kingdom, the Euro Zone, and Australia. You will receive FREE technical support during the Trial Period.

10

STOCKS, STRATEGIES & COMMON SENSE

Bull and Bear Market Scenarios

There is a terrific battle raging on Wall Street. The Bulls are looking for new highs. The Bears are saying the party's over. Both camps are making their point with a plethora of facts, fiction, and fluff. How can we cut through the noise and focus on what is really happening?

We must focus on the primary forces driving the market and not get bogged down or misdirected by an endless parade of useless headlines. **Astute investors know that three powerful forces drive the stock market.** They are known to everyone but are usually misunderstood. They are related, but independent. They are measurable, but controversial. They convey the effects of all that happens and ultimately determine the fate of the market.

Corporate earnings are the first and most powerful force driving the stock market. When a major event such as a product introduction, an earthquake or assassination occurs, investors instinctively speculate on whether it will help or hurt corporate earnings. If the event seems likely to help earnings, the perception of stock value rises, so prices rise. Conversely, prices fall when the news is perceived to be harmful to earnings.

Inflation is the second powerful force driving the stock market. Inflation is a fearsome threat to a strong economy and the Devil that constantly haunts the market. It causes raw materials, labor, and service costs to rise. Unless a company cuts costs by increasing productivity and maintains its margins by raising prices, corporate earnings go down. When corporate earnings go down, stock prices go down.

Inflation lessens the value of financial assets, but it also erodes the purchasing power of consumers. Left unchecked, inflation destroys monetary stability and leads to a weak economy. The Federal Reserve Board (The Fed) is charged with the responsibility of maintaining monetary stability. It fulfills this task by controlling the money supply. When the Fed sees inflation increasing, it tightens the money supply and interest rates go up.

The third powerful force driving the stock market is rising interest rates. Rising interest rates raise costs and ultimately weaken the economy. **Fear of inflation always causes the Federal Reserve to raise interest rates to the point where a Bear market is born.**

As we have seen, stock value is driven primarily by earnings, inflation, and interest rates. The level and dynamics of each of these factors are fully documented and discussed in VectorVest's weekly **Investment Climate Report** cited in the Views section of VectorVest 7.

The Investment Climate Report, shown below, tracks and documents two measures of inflation, three measures of interest rates, three measures of market performance, and one measure of Bullish Advisors Sentiment.

The current level of each Indicator is documented every week and the dynamics of each Indicator are shown on a scale of 0.00–2.00. Levels above 1.00 are Bullish and levels below 1.00 are Bearish.

The Investment Climate Report

Indicator	Current Level	05/28/2021	06/04/2021	06/11/2021	06/18/2021	06/25/2021
CPI Inflation %	5.00	0.53	0.53	0.49	0.49	0.49
CRB Inflation	210.42	0.61	0.59	0.61	0.67	0.64
90 Day T-Bills %	0.06	2.00	1.13	0.33	0.14	0.04
10 Yr T-Notes %	1.54	0.36	0.37	0.47	0.43	0.41
10 Yr.+ AAABonds %	2.08	0.74	0.71	0.86	0.80	0.80
S&P 500 Earnings	7.29	1.08	1.09	1.10	1.10	1.11
S&P500 Index	4280.70	1.17	1.10	1.12	1.07	1.07
NYSE Adv/Decl	592752.00	1.00	1.01	1.01	1.00	1.01
% Bullish Advisors	54.10	0.88	0.96	0.90	0.88	0.89
Composite	....	0.93	0.85	0.80	0.78	0.77

"The Truth Chart," makes it extraordinarily easy to know when the market is in a Bull Market Scenario or in a Bear Market Scenario. Note that all the Bullish Scenarios prevail when earnings are rising, and all the Bearish Scenarios prevail when earnings are falling. The various Cases are as shown below:

Case	Earnings	Inflation	Interest	Prices	Comments
1.	Up	Up	Down	Up	Bull Market Begins
2.	Up	Down	Down	Up	Bull Market Thrives
3.	Up	Down	Up	Up	Rarely Happens
4.	Up	Up	Up	Up	Bull Market Ends
5.	Down	Up	Up	Down	Bear Market Begins
6.	Down	Down	Up	Down	Rarely Happens
7.	Down	Down	Down	Down	Bear Market Prevails
8.	Down	Up	Down	Down	Bear Market Ends

Case (1). Bull markets begin when earnings and inflation go Up, and interest rates are still going Down.

Case (2). Bull markets thrive when earnings are going Up, and both inflation and interest rates are going Down.

Case (3). Rarely happens because inflation rarely goes Down while interest rates are barely going Up.

Case (4). Bull market ends while earnings, inflation, and interest rates are going Up.

Case (5). Bear markets begin when earnings are going Down, and inflation and interest rates are going Up.

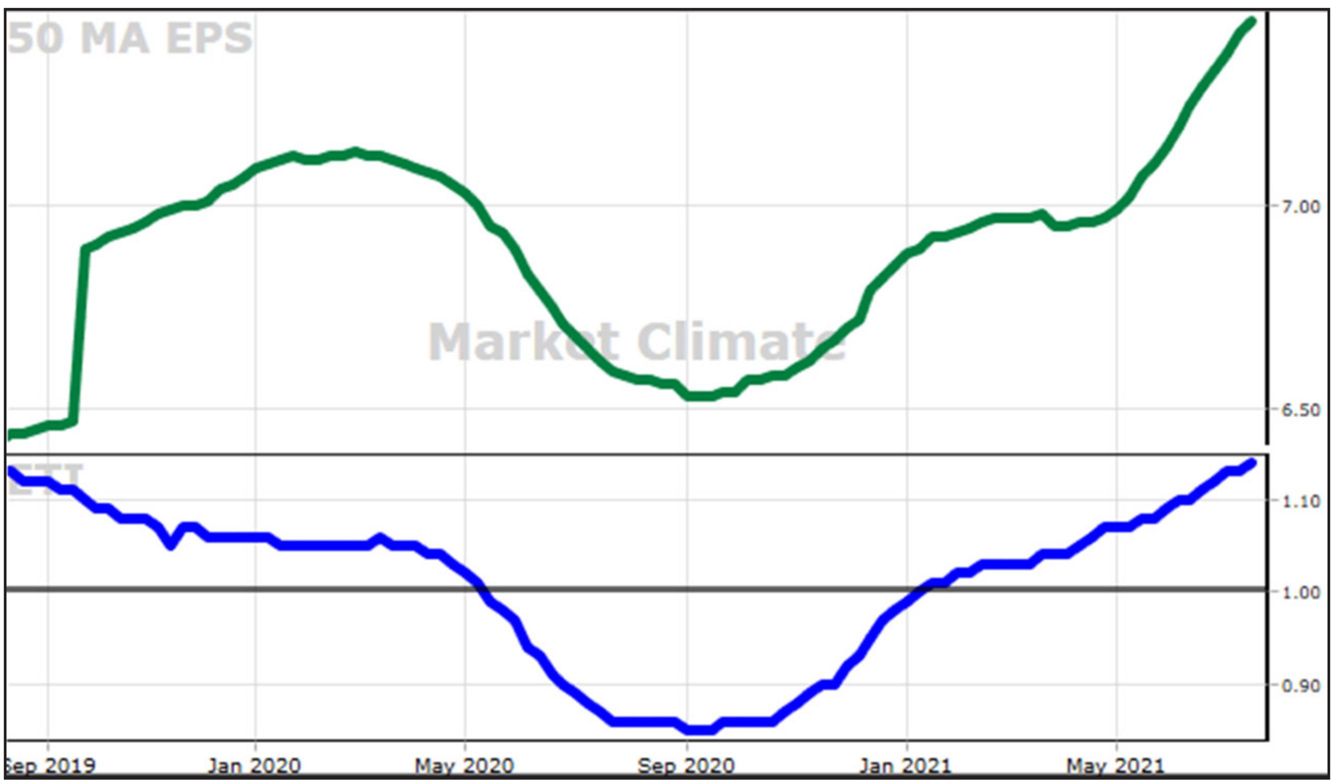
Case (6). Rarely happens because inflation rarely goes Down while interest rates are barely going Up.

Case (7). Bear markets prevail when earnings, inflation, and interest rates are going Down.

Case (8). Bear markets end while earnings go Down, inflation goes Up, and interest rates go Down.

VectorVest identifies whether the earnings are rising or falling by using an **Earnings Trend Indicator, ETI**. The ETI is comparable to our Relative Timing indicator, RT, and tracks the direction of a 50-day Moving Average of S&P 500 forecasted Earnings Per Share, EPS.

The **Market Climate Graph** allows one to see the relationship between S&P 500 forecasted earnings per share and the ETI. It may be accessed in VectorVest by clicking on the Graphs Tab, clicking on the Drop-Down Arrow located in the upper left-hand corner of your screen, and selecting Market Climate Graph. This graph is discussed weekly in the VectorVest Views.



Weekly Earnings Report as of June 25, 2021

As of tonight, our Market Climate Graph shows that the 50-Day MA of the VV S&P500 WatchList Average EPS, rose $0.03 to $7.45 per share, while forecasted average earnings growth remained at 14%/yr. The Market Climate Graph shows that the Earnings Trend Indicator, ETI, also rose 0.01 point to a level of 1.14. Since it is above 1.00, the market is in a Bull Market Scenario. Stay tuned for our next Earnings Update.

11

STOCKS, STRATEGIES & COMMON SENSE

Stock Valuation and Stock Market Cycles

The Efficient Market Theory states that it is impossible to "beat the market" because share prices always incorporate and reflect all **relevant information** as soon as it becomes available. Implicit in this theory is the condition that all market participants receive and act on all relevant information **at the same time**. Of course, this notion is silly and is not true.

The reality is that market participants certainly would like to be among the first to receive all relevant information, but only a few have the wherewithal to do it. The Pros and high frequency traders can do it, but most of us are among the last to hear of any market moving news until it's old hat. So, how can we deal with this disadvantage?

Retail investors must understand what drives stock prices up and down. What is relevant information and what is not? In other words, what are the key factors that drive stock prices higher or lower? These factors are identified in the stock valuation formula published in Chapter 4. This formula is the only relationship which ties these powerful forces together. For your convenience, this relationship is shown as follows:

V = 100*(E/(IY+YP))*SQR[((R+G)/2)/((IY+YP)+F)] Eq. (4.8)

Where:
V = Stock Value in $/Share
E = Earnings Per Share in $/Share
IY = AAA Corp. Bond Rate in Percent
YP = Yield Premium
SQR = Square Root
ROTC = Return on Total Capital in Percent
R = Profitability Factor
G = Annual earnings growth rate in %/yr.
F = CPI inflation rate in %/yr.

Our Market Climate Graph presents a historical record of all the factors shown above. This graph may be seen by accessing VectorVest 7, clicking on the Graphs tab, clicking on the Drop-Down Arrow shown in the upper left-hand portion of the header bar of your screen, and selecting Market Climate.

Bear markets are born when the economy is strong, as it was in 1999. The Dot Com bubble and Bio Tech bubble were about to burst. Notice that the S&P 500 Index was moving higher until March 10, 2000. The CPI inflation rate and the AAA Corporate Bond Interest Rate were also rising. This phenomenon is typical for the end of the Bull market cycle and the beginning of a Bear market.

Bull markets are born when the economy is very weak, and there is a hint of hope that better days lie ahead. Consider the recent cycle following the brutal Bear market of 2008. The February jobs report, released on March 6, 2009, was dismal and earnings were falling. It showed that another 651,000 non-farm jobs were lost in February. Moreover, downward revisions of an additional 161,000 losses were made for December and January. The unemployment rate hit 8.1%, yet stocks prices opened to the upside. Why in the world would that happen? The reason was that the news was not as bad as investors thought it would be and they were itching to buy stocks.

On the morning of Monday, March 10, 2009, it was reported that Citigroup made money in the first quarter. This was the kind of news that investors were praying for, and it sparked a tremendous rally which continued to June 30, 2021. Yes, the economy was still very weak, but the prospect of combining rising earnings, with beaten down stock prices created the buying opportunity of a lifetime.

Obviously, when both interest and inflation rates were very low, the market had extraordinary lifting power. This is exactly what happened in late 2008 and throughout 2009. It was the interest-sensitive phase of the Bull market. Stocks of all stripes soared. Helped by a very accommodating Fed, the economy began improving in 2009 and earnings began to rise. Inflation and interest rates continued to stay low, and the Bull market was in full swing. Stocks in housing, furniture, appliance, and other associated industries were on fire. It was the best of all worlds.

The role of Dr. Ben Bernanke, Chairman of the Federal Reserve, during this critical period must be recognized. He lowered interest rates to historic low levels and flooded the world with dollars to avoid a global economic meltdown. While the global meltdown was avoided, the strong economic recovery he hoped for was not achieved. While stock prices had recovered to all-time highs by 2014, inflation and interest rates were held to low levels.

The economy improved dramatically after Mr. Donald Trump was elected President in November 2016, but it was shut down in the Spring of 2020 by the devastating effects of the COVID-19 Pandemic. As of June 30, 2021, Mr. Trump is no longer President, but the worst effects of the pandemic seemed to be behind us. Although the economy has improved somewhat, inflation has reared its ugly head again.

The Fed continues to maintain its policy of low interest rates and says that the spike in inflation is temporary. Meanwhile stock prices have continued to soar. Many analysts believe the Fed will begin to raise interest rates sometime in mid-2022.

As of June 30, 2021, the average Price of the stocks in our S&P500 Watchlist was 15.0% higher than the average Value. Therefore, VectorVest indicates that stocks are overvalued, but earnings growth continues to be robust, at 13%/year. Price volatility has increased, and the expectation of the next Bear market is increasing rapidly. Nevertheless, the Bull Scenario will continue if the Earnings Trend Indicator remains above 1.0.

Since the Market Climate is a strategic issue and Timing the Market is a tactical issue, all investors should manage their portfolios according to the guidance in the Color Guard.

12

STOCKS, STRATEGIES & COMMON SENSE

Investment Styles & Strategies

Every investor needs to define a realistic set of goals, the amount of risk they can handle and a feasible investment plan. In my case, I wanted to double my money every five years, I was willing to accept modest losses and I was going to invest in quality growth stocks.

Every investor has an intuitive sense of their own risk/reward profile. They feel it in their bones, and it should dictate their investment style. Speculators and traders thrive on volatility and savor the thrill of making a fast buck. Conservative investors cringe at the thought of a capital loss and patiently reap small rewards.

Without knowing it, each of us has an investment style which is distinctly our own. A key to becoming a successful investor is in recognizing your investment style and buying stocks which are consistent with that style.

The VectorVest system of stock analysis identifies four basic investment styles. These are arranged in the following Strategic Investment Matrix:

STRATEGIC INVESTMENT MATRIX

REWARD			
	High	Prudent	Aggressive
	Low	Conservative	Speculative
		Low	High
		RISK	

PRUDENT INVESTOR. Prudent investors want the best of all worlds: High reward and low risk. They are interested in outperforming the market over the long-term and achieving annual returns greater than the sum of long-term interest and inflation rates. The best way to meet these stringent requirements is to buy undervalued stocks with consistent, predictable earnings. How can we find them?

In the VectorVest system, these stocks are characterized by high Relative Value (RV), high Relative Safety (RS), and double-digit Growth Rates, (GRTs). All stocks in the VectorVest system are rated on a scale of 0.00 to 2.00. Investors buying high RV, high RS stocks are virtually certain of making money and outperforming the market in the long-term.

You can prove this to yourself by using the UniSearch tool and the QuickTest tool. Here's how:

1. Access VectorVest 7. Click on the UniSearch tab and click on the Searches-Prudent Folder shown on the left-hand side of the screen. You will be presented with a list of searches, all of which incorporate the criteria, RV>=1.00 and RS>=1.00.
2. Click on the Search identified as Prudent Stocks. Set the search date in the Drop-Down Calendar, located in the upper left-hand corner of your screen, to May 10, 1996. This is the date VectorVest became a daily service. Note that the Sort criteria, located above the Drop-Down Calendar, is identified as VST DESC, Symbol ASC. Click on the Run Search tab. Note that all the stocks which are returned have RV>=1.00 and RS>=1.00, and the stocks are sorted by our master indicator, VST-Vector.
3. The QuickTest Tool allows you to see the performance of these stocks by any start date to any finish date. Simply click on the QuickTest tab and the performance results will be returned immediately. **For example, QuickTest shows that the top 20 Prudent stocks sorted by VST DESC returned on May 10, 1996, gained 1,302.01% with 20 winners and 0 losers as of June 30, 2021.**

AGGRESSIVE INVESTOR. Aggressive investors want high performance, e.g., capital appreciation of greater than 20 percent per year and are willing to take substantial risk to achieve it. They are looking for big gainers and stocks with high upside potential. They typically like high growth stocks that are skyrocketing in price. These stocks are characterized by high Relative Value (RV), low Relative Safety (RS) and high Relative Timing (RT). Aggressive Investors are often associated with the "momentum" style of investing. Due to the volatility of high RV, low RS stocks, Aggressive Investors may substantially outperform the market over the long-term.

1. Click on the Search identified as Aggressive Stocks. Set the search date in the Drop-Down Calendar, located in the upper left-hand corner of your screen, to May 10, 1996. This is the date VectorVest became a daily service. Note that the Sort criteria, located above the Drop-Down Calendar, is identified as VST DESC, Symbol ASC. Click on the Run Search tab. Note that the stocks which are returned all have RV>=1.00 and RS<=1.00, and the stocks are sorted by our master indicator, VST-Vector.

You can prove this to yourself by using the UniSearch tool and the QuickTest tool as described above. Simply follow the steps outlined above. **For example, QuickTest shows that the top 20 Aggressive stocks sorted by VST DESC returned on May 10, 1996, gained 2,108.63% with 18 winners and 2 losers as of June 30, 2021.**

CONSERVATIVE INVESTOR. Conservative investors buy stocks, but do not like to take much risk. They are primarily interested in capital preservation and are delighted to settle for average market returns. They typically buy low growth, steady performers, which pay solid dividends. These stocks are characterized by low

Relative Value (RV) and high Relative Safety (RS). Conservative Investors are virtually certain to make money over the long-term, but they may not outperform the market.

1. Click on the Search identified as Conservative Stocks. Set the search date in the Drop-Down Calendar, located in the upper left-hand corner of your screen, to May 10, 1996. This is the date VectorVest became a daily service. Note that the Sort criteria, located above the Drop-Down Calendar, is identified as VST DESC, Symbol ASC. Click on the Run Search tab. Note that the stocks which are returned all have RV<=1.00 and RS>=1.00, and the stocks are sorted by our master indicator, VST-Vector.
2. You can prove this to yourself by using the UniSearch tool and the QuickTest tool. Simply follow the steps outlined on the previous page. **For example, QuickTest shows that the top 20 Conservative stocks sorted by VST DESC returned on May 10, 1996, gained 288.12% with 16 winners and 4 losers as of June 30, 2021.**

SPECULATIVE INVESTOR. Speculative investors are looking for big gains without regard to risk. The fundamentals of value and safety mean nothing to them. They buy stocks on hype and rumor and are excited by price activity and volatility. Stocks with low Relative Value (RV) and low Relative Safety (RS) are unpredictable and volatile. Many of them are priced under $10. Nimble investors can make high profits in these stocks if they pay close attention to Relative Timing (RT) and Stop-Prices. Without a keen sense of when to buy and sell, most speculators lose money over the long-term.

1. Click on the Search identified as Speculative Stocks. Set the search date in the Drop-Down Calendar, located in the upper left-hand corner of your screen, to May 10, 1996. This is the date VectorVest became a daily service. Note that the Sort criteria, located above the Drop-Down Calendar, is identified as VST DESC, Symbol ASC. Click on the Run Search tab. Note that the stocks which are returned all have RV<=1.00 and RS<=1.00, and the stocks are sorted by our master indicator, VST-Vector.
2. You can prove this to yourself by using the UniSearch tool and the QuickTest tool. Simply follow the steps outlined above. **For example, QuickTest shows that the top 20 Speculative stocks sorted by VST DESC returned on May 10, 1996, gained 938.22% with 13 winners and 7 losers as of June 30, 2021.**

In summary, the four investment styles produce the following results from May 10,1996 to June 30, 2021:

Prudent–1,302.01%
Aggressive–2,108.63%
Conservative–288.12%
Speculative–938.22%

Prudent, Aggressive, Conservative, Speculative? Which of these investment styles rings your bell? **Are your stocks consistent with your investment style and strategy?**

P.S. Note that VectorVest is the only service that allows you to verify everything we say.

13

STOCKS, STRATEGIES & COMMON SENSE

Managing Your Portfolio

The players make the game. Everyone knows it...the owners, the players and the fans. Baseball is a good example.

Regardless of how good managers are, they are not able to cause mediocre teams to perform like champions. The best that managers can do is to help their teams fulfill their potential. Even with genuine major leaguers, most managers fall far short of achieving championship status because of poor execution and bad decisions. In the end, the managers are no better than the players.

For the same reason, many stock investors fail to achieve their goals. They buy losers, sell winners, make small profits and suffer large losses. And they constantly underperform the market. How can we avoid these pitfalls, and make higher profits with lower risk?

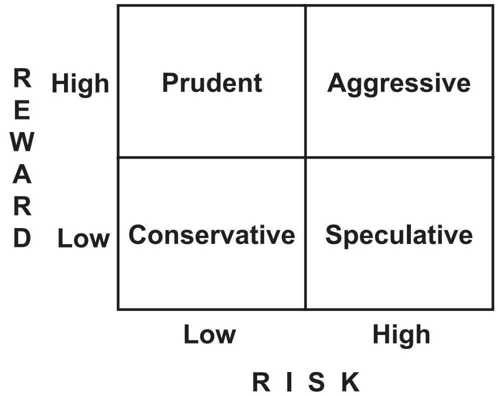
STOCK SELECTION and TRADING TACTICS. Good portfolio management starts with selecting the right stocks. Just as major league scouts look for the best talent for their teams, investors should select the best stocks for their portfolios. The type of stocks you buy will dictate the way you must manage your portfolio.

You cannot expect to outperform the market with conservative, overvalued stocks. Nor can you practice a “Buy and Hold” strategy with speculative, volatile stocks. The compatibility of your stocks with your management style is crucial to your long-term success. It is described best by using our Strategic Investment Matrix.

If you are a new subscriber to VectorVest, click on the Welcome tab in VectorVest, click on the Training tab and click on the **Successful Investing Quick Start Course**.

If you are a new investor, the main thing you want to do is conserve your capital and you do not want to lay awake at night worrying about your portfolio. Therefore, I suggest you read our Special Report, ***“The Guide to Worry-Free Investing.”***

STRATEGIC INVESTMENT MATRIX



This **matrix** was discussed at some length in the last chapter, "Investment Styles and Strategies."

The Reward/Risk coordinates of the matrix are defined quantitatively by VectorVest's Relative Value and Relative Safety indicators. Relative Value relates to Reward by indicating a stock's long-term price appreciation potential and Relative Safety relates to Risk by reflecting the consistency and predictability of a company's financial performance. These indicators were also described in chapters 6 and 7.

For a variety of reasons, most investors prefer to "Buy and Hold" stocks for the long-term. Some of the advantages of holding stocks for the long-term include lower commission costs and fewer tax consequences. However, it is not always the best thing to do. Bear markets are inevitable and even the best stocks go down in price. Nevertheless, the best stocks i.e., those with consistent earnings growth, do recover and go higher as the market starts going up again. Perhaps some stocks in your portfolio should have never been purchased and should be sold. Hopefully, your Stop Prices signaled a Sell for those stocks. How can we select stocks that can be held for the long-term?

Identify companies that do well in good times and bad. These companies have long records of consistent, predictable financial performance, low debt, high profitability, and solid earnings growth. Because of these characteristics, their stocks are very stable. These stocks all have high Relative Safety, RS, ratings in the VectorVest system of analysis. As shown in Table I., Relative Safety provides a key to how long one might expect to hold a stock.

Table I. Portfolio Turnover Rate in Percent per Year as a Function of Relative Safety.

Percent Turnover	**Relative Safety**
200	0.50
100	0.75
50	1.00
25	1.25
10	1.50

Investors dealing in speculative, highly volatile stocks with low Relative Safety ratings should expect to experience turnover rates well over 100 percent per year. Those investors buying low-risk, high Relative Safety stocks will have very low turnover rates. Let's look further into the relationships of stock selection and trading tactics.

CONSERVATIVE STOCKS. Stocks falling into the Conservative quadrant of our Strategic Investment Matrix are ideally suited for cautious “Buy and Hold” investors. These investors are more concerned with capital preservation than they are with capital appreciation. They have below average Relative Value ratings, and they usually pay well protected dividends.

All you have to do to find these stocks in VectorVest is to click on the UniSearch tab, click on the Searches-Conservative Folder shown on the left-hand side of the screen, click on the Conservative Stocks search and click on Run Search. You will be presented with a list of stocks, all of which incorporate the criteria, RV<=1.00 and RS>=1.00.

Look at 5-year graphs of the top 20 stocks. Note that every one of them has gone up in price over the last 5 years. These steady, predictable stocks seldom receive a Sell rating. Investors buying Conservative stocks will experience low turnover and low commission costs. Generally, however, they will also experience modest portfolio performance.

PRUDENT STOCKS. Prudent stocks offer above average capital appreciation potential, along with above average safety. Investors buying Prudent stocks tend to hold them for the long-term, but also sell lackluster performers to improve profits. Therefore, their turnover is somewhat higher than that of Conservative investors, but their portfolio’s performance is usually much better.

All you have to do to find these stocks in VectorVest is to click on the UniSearch tab, click on the Searches-Prudent Folder shown on the left-hand side of the screen, click on the Prudent Stocks search and click on Run Search. You will be presented with a list of stocks, all of which incorporate the criteria, RV>=1.00 and RS>=1.00.

AGGRESSIVE STOCKS. Aggressive stocks have high upside price appreciation potential but tend to be volatile. Investors dealing with these stocks must be willing to Sell when necessary to protect profits and/or minimize losses. The use of Stop-Sell prices is advocated strongly when managing stocks with Relative Safety ratings of less than 1.00. Portfolio turnover and commission costs can be substantial, but so can the profits.

All you have to do to find these stocks is to click on the UniSearch tab in VectorVest, and click on the Searches-Aggressive Folder shown on the left-hand side of the screen, click on the Aggressive Stocks search and click on Run Search. You will be presented with a list of stocks, all of which incorporate the criteria, RV>=1.00 and RS<=1.00.

SPECULATIVE STOCKS. These stocks are extremely volatile and demand close attention and frequent trading. In my view, the use of Stop-Sell prices is mandatory when dealing with Speculative stocks. Turnover and commission costs will be high for traders, but losses can be very high if one is unable to sell when necessary.

All you have to do to find these stocks is to click on the UniSearch tab in VectorVest, and click on the Searches-Speculative Folder shown on the left-hand side of the screen, click on the Speculative Stocks search and click on Run Search. You will be presented with a list of stocks, all of which incorporate the criteria, RV<=1.00 and RS<=1.00.

DIVERSIFICATION and INVESTMENT TACTICS. It makes no sense for the average investor to try putting their eggs in one basket and watching them carefully. There are just too many uncontrolled variables in the stock market. Moreover, the average investor is normally the last to hear about bad news when it happens. I recommend that investors reduce risk by diversifying. This may be done by investing in a variety of different stocks in different industries and by investing over a matter of time. Don't plunge into the market all at one time. It pays to diversify.

The amount of money to put into any single stock depends, of course, upon your personal circumstances. As a rule of thumb, I like to see at least twenty stocks in a portfolio. Invest equal dollar amounts into each of the stocks you buy. This is called "dollar weighting." It ties in with reducing risk by diversifying. Set your Stop Price at 20%, so that your portfolio will go down only 1% for each stock that is stopped out. While diversification is good, too much diversification will dilute the portfolio's performance and add to commission costs.

Do not be afraid to use margin. When used with safe reliable stocks, margin can increase the profitability of your portfolio substantially. If one used prudent stock selection and effective trading tactics, the use of margin should not pose a problem.

THE BEST STRATEGIES. When one considers the difficulty of picking winners, commission costs and tax consequences, the best strategy for the average investor is to create a diversified portfolio of high Relative Safety stocks with double digit growth rates. These stocks combine the best of all worlds, above average rewards and below average risk.

Consider the following list of searches:

1. Money Makers, sorted by RS*GRT
2. America's Safest Most Reliable Stocks, ASMRS, sorted by RS*GRT*MC
3. SuperStars CP

14
STOCKS, STRATEGIES & COMMON SENSE

Stop-Prices: Are They For You?

Stop Price is like a pane of glass. Once it gets hit, it is broken. The use of Stop-Prices is one of the most controversial and misunderstood methods of selling stocks. Stop-Prices are double-edged swords. They can cut losses and protect profits or result in high turnover and lost opportunities. Are they for you?

Selling is the most difficult part of successful investing. Yet, it is avoided like the plague. The reasons are clear. Buying a stock is fun, a positive event. It is the beginning of a hopeful relationship. Selling is a negative experience, the end of the relationship. Hope of future profits is gone, and losses become reality. Tax consequences must be addressed, and the proceeds need to be re-deployed. Selling is not fun, but it must be done.

While there are no hard and fast rules for selling stocks, each investor eventually must make decisions to sell. You cannot spend paper profits. The need for cash money, tax considerations and a myriad of other factors enter these decisions. Whatever the reasons, the primary purposes of selling are to protect profits and to control losses. Stop-Prices are ideally suited to do both.

STOP-PRICES. The term "Stop-Price" comes from the practice of selling stocks falling to specified prices. For example, if one of your stocks were at $27 a share, and you were concerned that it was going to go down in price, you could place a "stop-loss" order to sell the stock at a specified price, say $25. In this case, the Stop-Price is 25. Your broker would enter a "stop-loss" order to sell the stock if it fell to $25.

A "stop-loss" order does not guarantee that your order will be executed at the Stop-Price. The price at which your stock is sold depends upon market conditions. In severe downturns, stocks may be sold well below Stop-Prices. However, you may enter a "limit" order which tells your brokers not to sell it unless you get the Stop-Price or a better price.

It is also important to know that "stop-loss" orders can be executed on exchange-traded stocks, e.g., New York and American stock exchanges but may or may not be executed on over the counter (OTC) stocks, depending upon your broker.

Many advisors suggest that Stop-Prices be set at 10% below purchase prices. I have found that the Stop- Price of a stock should be based upon its safety, fundamentals and price trend. Safe stocks with solid fundamentals should have “looser” Stop-Prices than those with weak fundamentals. These considerations allow investors to stay with solid stocks longer and get out of weak stocks sooner. VectorVest is the only service that provides dynamic Stop-Prices on every stock, every minute of every day, at no extra charge.

One of the major arguments against using Stop-Prices is that they result in excessive trading and expose one’s positions to “whip-sawing.” The likelihood of experiencing these events depends upon the integrity of the broker and the type of stocks one owns. Safe, steady performers rarely hit their Stop-Prices, while risky, highly volatile stocks often break their Stops.

Table I. shows the relationship between Portfolio Turnover Rate in Percent and Relative Safety.

Percent Turnover	**Relative Safety**
10	1.50
25	1.25
50	1.00
100	0.75
200	0.50

In the VectorVest system of analysis, stocks with a Relative Safety rating of 1.00 or higher are above average in safety. Prudent and Conservative investors dealing in safe stocks would experience lower turnover, while Aggressive and Speculative investors would have much higher turnover rates.

A stock’s price behavior and future performance can become vividly clear by observing the difference between a stock’s price and its Stop-Price. If a stock’s price is above its Stop-Price, and the price difference is getting wider on a day-to-day or week-to-week basis, the stock is behaving favorably and will likely continue to perform well. If the reverse is true, the stock is heading for trouble. This is when you need to be on guard.

VectorVest alerts its users to these conditions by adjusting its Buy, Sell, Hold ratings in the following manner:

- A stock gets a “B” or an “H” rating if its price is above its Stop-Price and it gets an “S” rating if its price is below its Stop-Price.

- The distinction between a “B” and “H” rating is made on the basis of safety, fundamentals and price trend. Strong stocks receive “B” ratings much more readily than weak stocks.

With this background in mind, let’s see how Stop-Prices can be used to control losses and protect profits.

USING STOP-PRICES TO CONTROL LOSSES. The cardinal rule of investing is to let your profits run and keep your losses small. This goal may be achieved by virtue of the stock market’s tremendous liquidity. It allows investors to specify both a buying price and a selling price at the same time. The best time to make these decisions is before buying a stock.

Investors should be aware that it will always cost money to make a trade. Even if you have a **Zero Commission** Broker, they will sell your trade to another broker in an action called “Order Flow.” The broker who purchased the trade supposedly looks for the best price to buy or sell the stock you wish to trade. What they really do is raise the asking price when you buy and lower the bid price when you sell, so they make money on the spread between the bid and asking price. Zero Commissions **are not** cheap.

USING STOP-PRICES TO PROTECT PROFITS. As the price of a stock rises or falls, VectorVest automatically raises or lowers its Stop-Price. This is called a "Trailing Stop," and it is commonly used to protect profits in a variety of ways.

1. THE RATCHET STOP. The most conservative and, perhaps, the most common use of Stop-Prices, is to raise the Stop-Price as the price of a stock goes up. If one never lowers the Stop-Price, it moves only in one direction like a Ratchet. This system ensures that most of the profits gained from a price rise will be captured. It is, however, susceptible to premature selling and "whip-sawing." Consequently, the "Ratchet System" of using Stop-Prices does not necessarily lead to the best overall profit performance. This is the price one pays for reducing risk.

2. THE TRAILING STOP. A slightly less conservative method of using Stop-Prices is that of allowing the Stop-Price to float up and down as the price of the stock fluctuates. This is very easy to do with VectorVest since new Stop-Prices are calculated every day. While this approach allows a Stop-Price to drift downward, it reduces turnover, commission costs, and the probability of getting "whip-sawed." While it may or may not provide higher profit performance than the Ratchet-Stop System, I prefer this method of using Stop-Prices.

When using the Trailing Stop, one should never let the Stop-Price go below their purchase price once it has gone above the purchase price. Why risk encountering a loss when you had a profit?

3. THE GUIDANCE SYSTEM. Many investors prefer to use Stop-Prices as a guide rather than a trigger for selling. They feel that Stop-Prices are too mechanical. It's OK, if you have nothing better to do with your time, but investors who work full-time or are traveling, however, are vulnerable to bad news. In today's age of instantaneous communication and electronic trading, a stock may drop 30% in an afternoon. The guidance system of using Stops is the least conservative method of managing one's portfolio. If you buy safe reliable stocks with double digit growth rates, it may be the most profitable because you don't need to trade them very often.

4. USING MENTAL STOP-PRICES. Many investors use Stop-Prices, but do not use stop-loss orders. They want more control over deciding when a stock is sold. For example, an investor with a ten-stock portfolio may use a 10% stop-loss. This way a 10% loss on a single stock amounts to a 1% loss on the total portfolio. Money managers typically have 20 or more stocks in a portfolio and use a 20% stop-loss system. In this manner, the stock has more room to fall without increasing the risk to the portfolio, since a 20% loss on a single stock would amount only to a 1% stop-loss on the portfolio.

5. THE CASE FOR NOT USING STOP-PRICES. Just to be fair, I must tell you that there are many successful investors who do not use Stop-Prices. The theory is that if you buy safe, undervalued stocks rising in price, which make more money year after year, through good times and bad, they will go up in price over time.

For example, Mr. Warren Buffett, an extremely successful investor, does not use Stop-Prices. He says it's too short-term focused and does not reflect his buy and hold philosophy. He maintains that it is impossible to time the market and views price drops as opportunities to buy at discounted prices. Moreover, he is alleged to have said, "Investors should be greedy when everyone is fearful, and be fearful when everyone is greedy."

This system is perfectly fine if you buy the right stocks i.e., safe reliable stocks, have a cast iron stomach, have faith in your decisions, and have a lot of patience. A further benefit is that unrealized gains, i.e., "paper profits," are not taxed, while realized gains are taxed. **Stop-Prices: Are they for you?**

15

STOCKS, STRATEGIES & COMMON SENSE

America's Safest Growth and Income Stocks

Bull markets do not last forever. As the market changes with the economic cycle, investors constantly adjust their focus on how the primary forces of earnings, interest rates and inflation affect stock prices. When favorable interest rates and inflation turn sour, investors tend to dump growth stocks and buy value stocks with low, but consistent, earnings growth and dividends.

Ironically, the market performs best after the economic climate is at its worst. Consider the market's performance from 1990-1991. The S&P 500 fell 6.50% in 1990 and rose 26.31% in 1991. The weak economy in late 1990 and all of 1991 alleviated inflationary pressures and allowed the Federal Reserve Board to lower interest rates. This caused money to flow from fixed income securities and saving accounts into stocks. Investors were anticipating, i.e., discounting, the arrival of better earnings. Stock prices soared. **This was the "Discounting" phase of the Bull market. It lasted from October 1990 to February 1992.**

Once the economy began to improve, investors became more selective. They began turning away from consistent, predictable stocks such as foods and beverages to cyclical stocks that would see tremendous earnings gains. This marked a change in investor's stock choices and was called **the "Transition Phase." It lasted until February 1993.**

The final phase of the Bull market was the "Capital Goods Phase." This occurred when the economy was gaining a full head of steam. The housing and automotive industries were running flat-out and corporate earnings were soaring. It ended when everything looked great...on February 4, 1994.

The market topped on that day in February and a new reality began to set in. As the Federal Reserve Board tightened money supply, investors could no longer count on lower interest rates to inflate stock prices. Just any old stock was not going to make it anymore. As interest rates increased, it became increasingly difficult to find stocks that would hold up in the new environment. What kind of stocks performed best in the 1994 environment?

Studies have shown that undervalued stocks with solid dividends hold up best in down markets. Over the long-term, dividends account for over 50 percent of the profits made in the stock market. Shrewd investors know that re-investing dividends is a sure way to accumulate wealth in the long run. (See "Why Dividends Matter" by Mortimer and Page, Fund Co-Managers, GUINNESS ATKINSON Funds.)

The best of all worlds...collecting dividend checks while the prices of your stocks go up, comes from finding solid growth stocks that pay dividends. VectorVest is ideally suited to find these babies. VectorVest analyzes and ranks over 9,100 U.S. stocks for Value, Safety, and Timing and gives a Buy, Sell, or Hold rating on every stock every day.

VectorVest's proprietary dividend analysis and retirement scans are of primary interest to investors seeking current income and long-term profits. Stocks with the highest YSG-Vector ratings are deemed to have the best combinations of dividend Yield, Safety and Growth.

VectorVest ties these indicators together via our UniSearch scanning tool so that any of the above parameters can be used to screen, sort and rank stocks. We used it to find the safest, growth and income stocks in our database.

We asked UniSearch to find stocks with the following characteristics:

Relative Safety >= 1.40
Dividend Yield >= 1.00
Earnings Growth >= 10
Dividend Growth >= 10

In the VectorVest system, stocks with Relative Safety ratings of at least 1.40 on a scale of 0.00 to 2.00 have outstanding financial performance. A Dividend Yield of at least 1.00 percent was selected to eliminate stocks with only token dividend payments. Earnings growth of at least 10 percent per year would usually keep you well ahead of the sum of inflation and interest rates, and finally, we wanted dividend growth to be at least equal to earnings growth.

We also asked UniSearch to rank these stocks by the sum of VST-Vector + YSG-Vector. Stocks with the highest VST-Vector have the best combinations of Value, Safety and Timing. Stocks with the highest YSG-Vector have the best combinations of dividend Yield, Safety and Growth. Stocks with the highest total VST-Vector + YSG-Vector should give us the best of both worlds. The top 10 stocks found by VectorVest as of February 13, 2015, are shown in Table I.

Table I. America's Safest Growth & Income Stocks
Ranked by VST-Vector + YSG-Vector

Company Name	Symbol	Price	Value	%DY	VST	YSG
Hilltop Hldgs	HTH	36.40	50.48	1.32	1.38	1.33
Cigna Corp.	CI	237.07	341.53	1.69	1.29	1.38
Lennar Corp. B	LENB	81.45	113.32	1.23	1.36	1.31
Allstate Corp.	ALL	130.44	181.83	2.48	1.34	1.30
Skyworks Soltn	SWKS	191.74	265.47	1.04	1.45	1.19
Lennar Corp. A	LEN	99.35	141.79	1.01	1.33	1.30
Fidelity Nat'l	FNF	43.46	65.14	3.31	1.30	1.32
Price TR GRP	TROW	197.97	277.26	2.18	1.39	1.21
Medifast Inc	MED	282.98	379.60	2.01	1.39	1.20
Regions FinlCp	RF	20.18	29.82	3.07	1.29	1.28

Price = Closing Price as of 06/30/21.

Value = Intrinsic Value in $/Share.
%DY = Dividend Yield in percent.
VST = VST-Vector (Rating above 1.00 is good).
YSG = YSG-Vector (Rating above 1.00 is good).

Some highlights regarding the stocks in Table I. are as follows:

- All of the ten stocks listed above are currently undervalued.
- Dividend Yield is good. The average DY of 1.934 percent is above the S&P500's average yield of 0.97 percent.
- Average earnings growth is forecast to be 23.2%/yr.
- Dividend Growth is outstanding with an average DG of 19.3%/yr.
- The earnings pay-out is less than 50%.

In summary, this portfolio provides an enticing combination of low risk stocks with above average earnings growth, dividend yield, dividend safety and dividend growth. **In our book, it represents a fine list of America's Safest Growth and Income Stocks.**

As a matter of updating this book, we ran a QuickTest from 02/13/2015 to 06/30/2021 on the same list of stocks. The results are shown below (Please note that AAPL and SBUX had split adjustments of 4:1 and 2:1, respectfully between 2/13/15 and 06/30/21):

16

STOCKS, STRATEGIES & COMMON SENSE

Super Star Stocks

What does it take to be a Super Star? Performance. Outstanding performance. Not for a day, a week or a year, but over a period of years.

Everyone knows that Michael Jordan, Jack Nicklaus, and Tom Brady are Super Stars. Their performances were visible and well documented. Keeping score in the world of sports is straightforward, but it is not so easy with stocks. There are accepted standards for measuring stock performance, but they are complex and hard to understand. So, how should we identify Super Star Stocks?

One might be tempted to use price performance as the only characteristic of a Super Star Stock. But I have seen too many miserable stocks get pushed up by hype and fluff to be impressed only by price performance. So, let us go behind the scenes and look at the bottom line.

In the world of business, making money is the key measure of performance. Making money is the difference between winning and losing, struggling or surviving. But making money is not enough to spawn a Super Star. A company must make more money quarter after quarter for a long time. Companies which consistently generate higher and higher earnings at tremendous rates create Super Star Stocks.

It is terribly difficult to grow earnings at high rates over a long period of years. It requires a rare combination of superb management, quality products and exceptional services. Consider the following story.

In Chapter 5, “Earnings Growth: The Golden Touch,” I wrote about Mr. Steve Jobs and how he transformed Apple Computer with his imagination, desire or quality, and perfection. As a reminder, the following was taken from Chapter 5.

Another great story of sustained growth is that of Apple Computer. Steve Jobs became the interim CEO of Apple on July 4, 1997. AAPL was in dire financial straits. Its EPS was zero and its growth rate was minus 5%

per year. In less than a year, Mr. Jobs' magic was taking effect. On November 4th, 1997, AAPL's EPS was $0.01, but its GRT was minus 5%.

Not to worry, AAPL split 2:1 on June 21, 2000, it split again 2:1 on February 28, 2005, it split 7:1 on June 9, 2014 and it split 4:1 on August 31, 2020. Had you bought one share of AAPL when Mr. Jobs rejoined Apple at a split adjusted price of $0.123 per share, you would now own one share worth $136.96, for a gain of 111,249.6% gain. How about that!

As time went by, Mr. Jobs transformed Apple Computer into an innovative growth company introducing totally new products, which created new markets. AAPL's GRT peaked at 44% per year in May of 2005, but its EPS has continued to rise higher and higher. Although Mr. Jobs passed away on October 5, 2011, his culture and standards remain with the company due to the able management of Mr. Tim Cook. As of June 30, 2021, AAPL's forecasted earnings per share, EPS, was $4.55 per share, while the growth rate was 25% per year.

VectorVest helped me find stocks having a Relative Safety of 1.20 or more and above average GRT and at least a 10-year track record as of June 30, 2021. This is a very select group and was Cherry Picked by me. Table I. below shows all fourteen Super Star stocks ranked by 10-year performance as of 06/30/2021.

Each of the companies listed in Table I has strong upside price appreciation potential, as reflected in the high RV values and double digit GRT's. They have extraordinary long-term records of financial performance, as shown by the RS values above 1.20.

Table I. Super Stars WatchList as of June 30, 2021

VST DESC, Symbol ASC | Top (All) | 15 Found | Find Symbol(s) | Clear | QuickTest All | Grap

6/30/2021 | Stream | Add Symbol(s) | Add | Delete | TRADENOW

Company	Symbol	Exch.	Price	Value	RV	RS	RT	VST	CI	REC	Stop	GRT
NVIDIA (	NVDA	xO	200.025	116.91	1.53	1.46	1.71	1.58	1.72	B	168.84	33
Applied I	AMAT	xO	142.40	179.49	1.58	1.43	1.46	1.48	1.80	B	129.49	25
Target C	TGT	xN	241.74	266.39	1.50	1.35	1.33	1.39	1.77	B	217.20	24
Alphabet	GOOGL	xO	2441.79	2550.74	1.50	1.49	1.08	1.35	1.61	B	2224.76	24
Schwab	SCHW	xN	72.81	70.39	1.41	1.40	1.21	1.34	1.73	B	67.82	20
UnitedHl	UNH	xN	400.44	524.19	1.47	1.47	1.08	1.33	1.40	H	377.31	15
Shopify I	SHOP	xN	1460.98	197.55	1.37	1.27	1.33	1.32	1.35	B	1252.83	44
Apple In	AAPL	xO	136.96	131.93	1.45	1.32	1.08	1.28	1.34	B	123.75	25
AutoZon	AZO	xN	1492.22	2081.19	1.48	1.27	0.99	1.24	1.23	H	1373.17	19
Dominos	DPZ	xN	466.49	395.30	1.25	1.22	1.24	1.24	0.75	B	417.45	17
Microsoft	MSFT	xO	270.90	197.42	1.32	1.37	1.06	1.24	1.29	B	242.35	20
Intuitive	ISRG	xO	919.64	397.75	0.98	1.40	1.19	1.21	1.40	B	816.21	16
Fiserv In	FISV	xO	106.89	144.69	1.43	1.36	0.81	1.20	1.09	H	105.41	14
Medtroni	MDT	xN	124.13	119.18	1.22	1.34	0.90	1.15	1.34	H	116.82	12
Starbuck	SBUX	xO	111.81	58.82	1.04	1.30	0.93	1.10	1.47	H	105.08	14

Table II. Super Stars 10-Year QuickTest

QuickTest - Super Stars CP

6/30/2011 - 6/30/2021 Stream Run Test Reset Sort

Record Count - 14 (14 Winners, 0 Losers, 0 Even)

Symbol	Begin Price	End Price	% Price C	Total ARR
NVDA	3.984	200.025	4,920.71%	492.00%
DPZ	25.24	466.49	1,748.22%	174.80%
AAPL	11.988	136.96	1,042.48%	104.23%
AMAT	13.01	142.40	994.54%	99.44%
MSFT	26.00	270.90	941.92%	94.18%
GOOGL	253.443	2441.79	863.45%	86.33%
UNH	51.58	400.44	676.35%	67.63%
ISRG	124.037	919.64	641.42%	64.13%
FISV	15.658	106.89	582.65%	58.26%
SBUX	19.745	111.81	466.27%	46.62%
TGT	46.91	241.74	415.33%	41.53%
AZO	294.85	1492.22	406.09%	40.60%
SCHW	16.45	72.81	342.61%	34.26%
MDT	38.53	124.13	222.16%	22.21%
Average:	**$67.2446**	**$509.1604**	**1018.87%**	**101.87%**

Compare To: SPX

Symbol	Begin Price	End Price	% Price Cha	Total ARR
SPX	1320.64	4297.50	225.41%	22.54%

17

STOCKS, STRATEGIES & COMMON SENSE

Bottom Fishing: The Art Of Buying Low and Selling High

Most investors are disappointed when the stock market falls in price. But I am like Dr. Strange Love, who learned to stop worrying and love the bomb, i.e., the nuclear bomb. That sounds strange, doesn't it? That is why Dr. Strangelove is named the way he is.

Seriously, when stock prices fall, the opportunity to buy low and sell high is created. This is what Bottom Fishing is all about. It is a great way to get rich. Why isn't everybody doing it?

Buying low and selling high is not as easy as it sounds. No one knows for sure which stocks are "low," and which are "high." A stock that seems "low," may go lower. One that seems "high," may go higher. How can we tell which is likely to do what?

Clearly, history can be our guide. **A stock whose price has fallen from a peak is "low" relative to that peak.** A peak may reflect the highest price a stock has ever attained, or it may reflect an intermediate high over the last 52 or 13 weeks.

Ideally, one would like to buy good stocks that have been beaten down in price and are poised to rise. But that is not what happens. When the market starts heading down, Money Managers start buying stocks with the best fundamentals and pay dividends. They are trying to protect their performance. **At the same time, stocks with the worst fundamentals go down the fastest and the furthest. Fortunately, VectorVest has a simple way of finding these stocks. Here is how it is done.**

I. IDENTIFY STOCKS THAT ARE "LOW" IN PRICE. The best way to find these stocks is to use the VectorVest Relative Timing, RT, indicator. VectorVest allows you to force rank thousands of stocks by RT with a single click of a mouse. The stocks with the lowest RT values have been beaten down the most in Price, they could be taken for dead. But, they are like zombies and invariably rise up in price when the market rises from a bottom.

II. SELECT STOCKS MOST LIKELY TO REBOUND. The key to successful Bottom Fishing is to find stocks with good fundamentals and low RT's and "S" ratings. These are the stocks which have been beaten down to bargain prices.

VectorVest has a unique combination of indicators that make it extraordinarily easy to find stocks with the best fundamentals. One of our favorite sorts is VST/RT. This sort ranks stocks with the highest Value-Safety-Timing Vector, VST ratings, and lowest RT at the top of the list. **"Jail Break," one of VectorVest's most popular bottom-fishing searches, produced a stunning return of 1,108% gain from March 6, 2009 to February 13, 2015.**

The lesson here is clear: Beaten down stocks with good fundamentals, i.e., high RV and high RS, go up sooner, faster, and longer than stocks with weak fundamentals. I, personally, used the "Jail Break" search, to go bottom fishing on the morning of March 10, 2009. And our subscribers did too. This was not a stroke of luck. **On Friday, March 6, 2009, I wrote an essay entitled, "Itching to Rally."** (See VectorVest Views.) We said an explosive rally was imminent and gave our subscribers six bottom-fishing searches to choose from. The explosive rally I anticipated began on March 10, 2009. All six searches produced fantastic gains.

III. BUY STOCKS THAT ARE RISING IN PRICE. Never buy stocks on the way down! Nobody knows how low they will go or how long they will stay down. So, how can we tell when a stock has stopped going down in price? Simple. Wait until it starts going up… that's not a joke. You may not be able to see it with the naked eye, but a graph of Price and RT will show you when downward Price momentum has dissipated and when Price has begun to go up.

One would love, of course, to buy stocks at exact bottoms. VectorVest has come close to doing it on many occasions and we did it on March 10, 2009. This was not a stroke of luck, and we do not predict the market. **Our market timing system is explained in Chapter 9 and it is, perhaps, the most important factor in making money in stocks.**

Everything begins with market direction. Consider the following sequence: On November 2, 2007, I warned our subscribers that "The Confirmed Down signal that we received yesterday could be the entrée to a long Bear market," and I advised them to buy Contra ETFs. Those who heeded my guidance made money and/or avoided losing their money in the severe bear market of 2008 and bought stocks, in the opportunity of a lifetime, on March 10, 2009. That experience reflects the art of bottom-fishing at its best.

Do not despair, bottom fishing opportunities appear regularly. Let us consider a recent opportunity. It occurred on Monday, March 23, 2020. On that date, the Timing section of VectorVest Views presented a gloomy picture of market direction. The Color Guard shows that the price of the VectorVest Composite, VVC, was $34.00 per share, RT was very low at 0.44, the BSR was at a rock bottom of 0.02. These were perfect conditions for a rebound.

On Tuesday, 03/24/2020, the Color Guard shows that the Price of the VVC rose to $36.62 per share, RT rose to 0.57, and the BSR remained at 0.02. So, the market had gone up, but the Buy-Sell Ratio, BSR did not change. The reason is that stock prices were so low that they did not rise enough to reduce the number of "S" rated stocks in the database.

However, the VectorVest Real-Time Derby results, shown below, showed that the Top Derby Winners were all Bullish with fantastic price gains. Indicating that Aggressive investors were Bottom Fishing and Bargain Hunting. **But it was not too late to join the party because the Buy-Sell Ratio was still at 0.02.**

On Tuesday, 03/11/2009 the Derby Winners the top five, ten-stock portfolios having with the highest 1-Day percent price gains were:

Bullish: AC's Percent Price Poppers - RT Asc...............31.96% Total % Gain
Bullish: The Comeback Kids - DR. ....26.40% Total % Gain
Bullish: Bottom Fishing in Rising Industries .... 25.76% Total % Gain
Bullish: Russell 2000/RT...24.13% Total % Gain
Bullish: S&P500/RT ....23.00% Total % Gain

The Derby's top five Winners, with the highest percent price gains over the **last five trading days** were:

Bullish: Silber's Singles/BMB .... 53.59% Total % Gain
Bullish: Russell 2000/RT..53.57% Total % Gain
Bullish: S&P600 SmallCap/RT .... 53.43% Total % Gain
Bullish: AC's Percent Price Poppers - RT Asc.............. 52.52% Total % Gain
Bullish: S&P400 MidCap/RT.......................................50.16% Total % Gain

The guidance given in the Daily Color Guard Report said it was time to go Bottom Fishing and Bargain Hunting, but do not buy anything unless there was follow through the following day.

On Wednesday, 03/25/2020, the Color Guard showed that the Price of the VVC rose to $37.30, RT rose to 0.63, but the BSR was still 0.02! **It still was not too late to join the party because the Buy-Sell Ratio was still at 0.02.**

Wednesday's 1-Day Derby Winners showed the following incredible results:
Bullish: Blyar's Bottom Feeders/BMB..........................21.23% Total % Gain
Bullish: Bottoms Up..21.01% Total % Gain
Bullish: S&P600 SmallCap/RT ....17.73% Total % Gain
Bullish: Pirates - Long ....17.39% Total % Gain
Bullish: Bottom Fishing in Rising Industries ....15.85% Total % Gain

Wednesday's 5-Day Derby Winners showed the following incredible results.
Bullish: AC's Percent Price Poppers - RT Asc............. 92.63% Total % Gain
Bullish: Bottoms Up... 88.79% Total % Gain
Bullish: Russell 2000/RT... 87.44% Total % Gain
Bullish: Silber's Singles/BMB .... 87.22% Total % Gain
Bullish: S&P600 SmallCap/RT .... 86.14% Total % Gain

On Thursday, 03/26/2020, the Color Guard showed that the Price of the VVC rose to $39.11, RT rose to 0.73, and the BSR rose to 0.03! **It still was not too late to join the party, but we now needed to watch out for follow through on the next day.**

Thursday's 1-Day Derby Winners showed the following incredible results:
Bullish: Blyar's Bottom Feeders/BMB .... 46.55% Total % Gain
Bullish: S&P600 SmallCap/RT .... 39.45% Total % Gain
Bullish: Russell 2000/RT... 36.03% Total % Gain
Bullish: Bottom Fishing in Rising Industrie .... 35.90% Total % Gain
Bullish: AC's Percent Price Poppers - RT Asc ....31.89% Total % Gain

Today's 5-Day Derby Winners showed the following incredible results.
Bullish: Silber's Singles/BMB .... 106.94% Total % Gain
Bullish: AC's Percent Price Poppers - RT Asc ....100.86% Total % Gain
Bullish: Russell 2000/RT..94.21% Total % Gain
Bullish: Bottom Fishing in Rising Industries .... 92.99% Total % Gain
Bullish: Jail Break - No Contra ETFs .... 87.20% Total % Gain

The question here is how long can this go on? The Market Timing Graph shows that the BSR went above 1.00 on May 18, 2020. The Bottom Fishing experience was not over. The BSR went on to hit a high of 12.81 on June 9, 2020, and that is when the fat lady sang.

In summary, the Bottom Fishing experience began when the BSR fell below 0.20 and bottomed out at 0.02. At this point, we began looking or an opportunity to begin buying low and selling high. The Color Guard made it easy to determine what the market was doing, and The Real-Time Derby gave us factual evidence of which Bottom Fishing searches were working the best and when to trade.

The Market Timing Graph gives us a bird's eye view of what the market is doing, and we could read the VectorVest Views and listen to the Enhanced Daily Color Guard Report for guidance. **What more could we ask for?**

.

18

STOCKS, STRATEGIES & COMMON SENSE

Teeny Boppers: Low Price Stocks with Explosive Price Appreciation Potential

On January 20, 1995, I published a list of 50 Buy rated stocks called "High Performers." This list included **Micron Technology**, which went from $22.63 to $94.75; **US Robotics**, from $23.50 to $179; and **Ascend Communications**, from $6 to $62. My favorite, however, is **Iomega,** which went from a split adjusted $1.69 to $66, up a fantastic 3,800 percent! How did I find these stocks?

The same way I find similar stocks today. I was tracking stocks that were hitting new 52 week highs and ranking them according to a certain system I have. Before getting into that, however, let's step back a minute.

Why was I tracking stocks that were hitting 52 week highs? In the last chapter on "Bottom Fishing," I extolled the virtues of buying low and selling high and suggested the idea of tracking stocks that were getting beaten down in price. Now, I'm saying the opposite. Have I lost my marbles?

Not really. The approach we described works very well, but it's not the only way to make money in the stock market. In fact, the method of finding low-priced stocks having explosive price appreciation potential described in this chapter has a lot in common with the last chapter.

In both cases, we're tracking stocks which are deviating significantly from their normal patterns, i.e., they're making new 52 week lows or 52 week highs. These stocks are screaming for attention. They're telling us that something significant, good or bad, is happening. We ought to be able to take advantage of these situations.

Another common point, and a very important one I might add, is that I advocate buying stocks that are rising in price whether you are bottom fishing or not. A critical key to successful Bottom Fishing is buying these stocks AFTER they have stopped going down. I never buy a stock on the way down. If you're good, you can catch depressed stocks just as they have started going up...usually within 5-15 percent of their lows.

An easier game to play, however, is buying stocks that are hitting new highs. Think of this: **Iomega** didn't go from $1.69 to $66 without hitting new highs, time after time. It was screaming for attention. All we had to do was listen to it.

Many studies show that one of the surest ways of making money in the stock market is to buy stocks hitting new highs. A lot of people, however, don't like to do this because they think these stocks are "over-bought" or "over-extended." Nonsense. I've seen too many stocks take-off and never return to their so called buying ranges. I especially like to buy low-priced stocks with the potential to become 10-baggers, i.e., go up 1,000%. I call these stocks "Teeny Boppers."

Teeny Boppers remind me of teenagers. They are full of energy, vigor and ambition. They have new ideas and different ways of doing things. They represent the wave of the future, but are untested. They're risky and many fail to fulfill their promise. But, many succeed. When they do, they become our new leaders. **Iomega** was a classic Teeny Bopper. Here's how to find the next **Iomega**.

I. FIND LOW-PRICED STOCKS HITTING NEW HIGHS. There are no hard and fast rules for defining low-priced stocks, but let's restrict our discussion to stocks under $5.00. These stocks can easily be found by using the Teeny Bopper search in VectorVest. This search is located in the Price-Volume folder in the UniSearch tool and finds stocks between $1.00 and $5.00 per share that are hitting new 26-week highs with a 50-day average daily volume > 25,000 shares per day. It sorts the stocks by VST/Actual Price Desc.

On January 17, 2003, I wrote an essay called, "Hard to Beat." It was meant to show that VectorVest's Stop-Prices are, in fact, very good. So, I ran a series of five back-tests, each with a different exit signal, using the Teeny Boppers search, week-to-week, from 01/05/96 to 01/10/03. The results were incredible, producing gains of 436%, 648%, 2,150%, 4,083% and 4,596%. The largest gain was obtained when I used VectorVest's Stop-Prices to exit my positions, but the exit criterion wasn't the only important factor in achieving these gains.

The Teeny Boppers search itself was an extremely important factor! It found China Yuchai, CYD, on 05/24/02 at $3.40/share and it closed at $36.45 on 11/07/03. On 06/28/02, it found Sohu.com, SOHU, at $1.70/share and Sina Inc., SINA, at $1.75/share. SOHU closed at $42.68 on 07/14/03 and SINA closed at $48.25 on 01/26/04. Subsequently they went on to hit new highs again and again and again. As you go through a weekly routine of running the Teeny Boppers search, you'll notice that many of these stocks will appear a second, third or more times. It is not necessary for a stock to hit new highs in consecutive weeks, but once a stock has hit a new high several times, give it a shot.

II. ANALYZE YOUR SELECTIONS AND MAKE YOUR FINAL CHOICES. In order to select the most promising stocks, it pays to study their graphs. Look for steady price patterns. I especially like to see a stock flat-line; then breakout on high volume. Don't underestimate the importance of high volume. It reflects the conviction of the buyers who are driving the stock's price higher and higher. You have to recognize that they probably know something you don't. Therein lies your risk. Analyzing low-priced stocks on the basis of fundamentals is usually an exercise of faith. Most low-priced stocks have very weak fundamentals. So, try to learn all you can about the stocks you select.

VectorVest makes it quite easy to get scads of data on every stock it analyzes. All you have to do is right click on the stock from any Viewer, and click on "View Stock News." This will take you to the research section of a Yahoo! Finance, Financial Times, or Reuters website. VectorVest allows you to select the website of your choice. **You may also access VectorVest's full stock analysis report from the right click menu.**

The clearest and most important information you'll ever receive about Teeny Bopper stocks comes from the market. **Iomega** was still losing money long after it had doubled, tripled and quadrupled in price. But its new Zip drives were flying off the shelves. Informed investors knew that. They knew that big profits were just around the corner and were pushing **Iomega's** price higher and higher. So, if a Teeny Bopper's price keeps going higher and higher over a period of months, check its sales growth, it's the fuel that feeds the tank of the engine that drives earnings growth higher and higher. It is as evident as the nose on your face.

Another Teeny Bopper, screaming for attention back in 2004, was **Nutri System**, NTRI. Our Teeny Boppers search, sorted by VST Desc., found it on 12/02/04 at $2.79/share. It found it again on 12/03/04 and 12/06/04. It found NTRI 14 more times in January 2005 and five more times in February, before it went above five dollars per share. It closed at an all-time high of $74.86 on 05/11/06.

It's not hard to find these stocks and it doesn't take a long time to do. I simply run the Teeny Boppers search at the end of each week and graph the top 100 candidates, if there are that many. I look for a long consolidation period; then a break-out on high volume. When I see a chart pattern I like, I put it into WatchList via the right click button. **A good example of a recent winner is Enphase, ENPH. I found it on 11/13/2017 at $2.32/ share. It has made a reasonably smooth climb since then and hit an all-time closing high of $197.87 on 02/08/2021 for a gain of 8,428.88%.**

III. MANAGING YOUR PORTFOLIO. Let there be no mistake, dealing with Teeny Boppers is a high-risk strategy. One way to mitigate this risk is to spread your bets in equal dollar amounts over at least 10 stocks. With this many stocks, you can begin to tolerate the wild price swings that are normal for Teeny Boppers. High volatility is the blessing and the curse of Teeny Bopper stocks. You have to be willing to accept rapid price swings of 20 to 30 percent with these stocks, but you also need to know when to get out. Normally, one would exit a stock that drops 10 percent, but that would get you whipsawed over and over again. I would suggest that you use the VectorVest Stop-Price as your first line of defense. Sell the stock when you get an "S" rating; then buy it back when it hits a new high.

Take **Sina, Inc.**, for example. You could have bought it at $1.75/share on 06/28/02. It rose to $10.38 by 01/24/03. Then it dropped rapidly over the next 13 trading days to $6.32 and it got an "S" rating on 02/12/03. Two months and two weeks later, it closed at a new high of $10.88 on 04/21/03. Thereafter, it rose to a high of $43.57 on 10/28/03 and corrected to $35.26 and got an "S" rating on 11/11/03. You could have bought and sold this stock all the way up to **Sina's** all-time closing high of $142.83 set on 04/20/11. The same technique could have been used with **Sohu.com**. It closed at an all-time high of $106.28 on 04/28/11.

The name of the game with Teeny Boppers is to keep plugging. Although you may find that many of your selections lose money, one ten-bagger will more than make up for a lot of little losses. That's the beauty of buying low-priced stocks with explosive price appreciation potential.

19

STOCKS, STRATEGIES & COMMON SENSE

The Election Cycle

Earnings are the single most powerful factor affecting the stock market. As sure as the moon causes ocean tides to rise and fall, earnings cause stock prices to do the same. Stock prices go up when earnings go up and fall when earnings go down.

There is another powerful force, however, that comes along every four years that overrules earnings. It's The Presidential Cycle. It doesn't matter whether earnings are rising or falling, the stock market usually goes up during the last two years of a presidential administration.

This phenomenon is neither coincidental nor accidental. It is the result of political forces striving to boost the economy. A prosperous economy and a booming stock market virtually guarantee reelection of an incumbent administration.

According to Jeffery Hirsch, Editor of the 2021 Stock Trader's Almanac, "the last two years of the 45 administrations since 1833 produced a total net market gain of 764.8% compared with a 326.6% gain of the first two years of these administrations. The average gains were 16.2% and 6.7%, respectively."

Clearly, incumbent administrations not only strive to look good in the last two years in office, but they make the hard decisions, such as raising taxes, during the first two years.

Consequently, the first year of a presidency has shown the worst performance with an average gain of 3.0%, as measured by the Dow Jones Industrial Average and the second-year performance has also been relatively weak, with an average gain of 4.0%.

As campaign spending and re-election promises take form, investors sense that better days lie ahead, so it's not surprising that third year performance showed the best results, with an average gain of 10.4%. Fourth year showed the second-best result with an average gain of 6.0%.

Contrary to historical precedent, the worst performance for any year, -52.7%, came in 1929 during Herbert Hoover's third year in office. The best performance for any year, 66.7%, came in 1930 during Franklin Delano Roosevelt's first year in office.

In his book, "*Strategic Investment Timing*," Mr. Dick A. Stoken states that, **"The really juicy part of the election cycle is the fifteen-month period beginning in early October, two years before the election, and lasting until early January of the election year."** In other words, the juicy part of the 2024 election cycle will start early in October 2022 and end early in January 2024.

While studying historical phenomenon such as The Presidential Cycle is fun, one would be better served by staying with fundamentals. That is exactly what VectorVest does. We track and analyze two measures of inflation, three measures of interest rates and the 50-day moving average of forecasted S&P 500 earnings each week, as well as document the data in our Investment Climate Report. As usual, we analyze the data and determine whether the stock market is bullish or bearish. This information is published in our Truth Chart which recognizes bullish and bearish stock market scenarios based on our fantastic Earnings Trend Indicator (ETI). The ETI was instrumental in alerting our subscribers on November 2, 2007 of the possible onset of a long bear market. Here's what we said:

A WORD TO NEW SUBSCRIBERS

"The Confirmed Down signal that we received yesterday could be the entrée to a long Bear market. We aren't there yet because earnings are still rising according to our method of analysis. Yet, we no longer appear to have the support of an accommodative Fed and that can make things very bad for the stock market. So don't be deceived by the endless parade of experts who will appear on TV and other places telling you to buy stocks. This is not the time to buy stocks. Just follow our Market Timing System and it will tell us when to go long again. At that time, we should be getting some wonderful bargains."

The most interesting thing about this call is that we saw it coming and it happened in the third year of President George W. Bush's second term...just as we were completing the "juicy part" of the 2008 Presidential Election Cycle.

20

STOCKS, STRATEGIES & COMMON SENSE

Knowledgeable Investors

Knowledge is power. Power is the ability to get things done. Knowledgeable investors have the power to know when to buy, what to buy and when to sell. They keep risk under control and manage their portfolios for consistent profits.

Knowledge comes from experience and information. Experience cannot be purchased. There's a price to pay for experience, however, and it does not come cheaply. The price we pay is time and the agony of learning from our failures. Experience comes only from one's personal involvement.

Information, on the other hand, can be purchased: it comes from others. Herein lies a problem. What we take as information may or may not be valid. Information is often misrepresented... especially in the stock market. Investors are often fooled into thinking they have purchased information when they have purchased fluff and hype based on data, not information. Data and information are distinctly different. Data is a commodity, a mute documentation of the past. Information is a value-added product. It speaks to the future.

Information comes from the analysis of data and is only as good as the data and the analysis from which it came. A thousand investors may read the same annual report. Each will analyze the report and draw a different conclusion, depending upon their intentions. Bullish investors are more likely to believe a company's performance is favorable. The reverse is true with bearish investors. However, brokers and those workers on the sell side of the market, typically advise investors to buy, buy, buy whether the market is bullish or bearish. Those with greater experience, special skills or training are more likely to make a proper assessment of the data/information. The others are more likely to be wrong in their assessments and make unfortunate decisions.

Investors are starved for information. They read books, magazines, and newspapers, watch TV, attend seminars and belong to investor groups to learn as much as they can. It seems that the world is awash in information. But good information is hard to find.

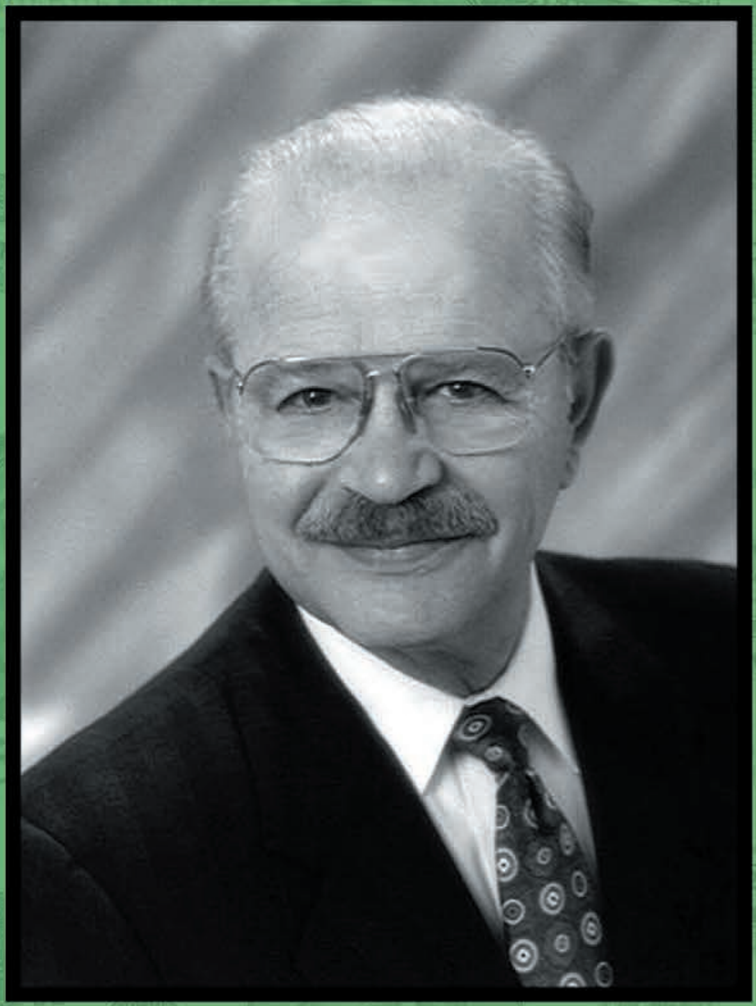
Knowledgeable investors know that information is unlikely to be reliable unless the cause-and-effect relationships within the data have been tested and verified. Statistical analysis is a powerful tool for analyzing data. But it's not the only one. Common sense is your most important asset.

Most of what we receive as information in the stock market is not reliable. This so called "information" is flawed, either by improper or insufficient analysis, or by deliberate design to separate you from your hard-earned money. Buyer beware holds especially true in the financial markets.

In selecting stocks, your primary job is that of assessing information. Many investors, however, do not feel qualified to analyze data and prefer to speculate. Knowledgeable investors can save time and get excellent results by asking the right questions. Can you answer the following questions about the stocks in your portfolio?

* Is the company making money?
* What is the stock really worth?
* Is the stock over or undervalued?
* How safe is the stock?
* Is its price rising or falling?
* What are its forecast earnings per share?
* What is its estimated earnings growth rate?
* What is its growth to P/E ratio?
* What are its dividends per share?
* How safe are the dividends?
* How fast are dividends growing?
* Does this stock meet my risk/reward objectives?
* Should I buy it now?
* When should I sell it?

VectorVest answers all these questions systematically, objectively and unemotionally. Compare these answers with those of other reliable sources if you can find any. It's the right thing to do. When you combine experience with good information, you'll have what it takes to join that elite class of Knowledgeable Investors.



Bart A. DiLiddo, PhD, has over forty years of experience as an engineer, business executive and investor. Bart was Executive Vice President of a Fortune 500 company, and graduated from MIT's Sloan School of Management.

Dr. DiLiddo was a winner in the Wall Street Journal's "Dart Board" stock selection contest, speaks regularly at investor forums, and writes a monthly article for the Investors Alliance Investors Journal.