

INVESTMENT SIG

STRATEGIC STOCK SELECTION

March 10, 2011

- **The material in this presentation is primarily based on the book: “Strategic Stock Trading” by Michael Swanson**
- Swanson was a Hedge Fund Manager from 2003 to 2006 with a performance return of 78%. His fund was in the top 35 of several thousand funds ranked by HedgeFund.net He now runs his own investment website:
WallStreetWindow.com
- I have been on his email distribution list for a couple of years and found to my surprise that his short term predictions using technical analysis have been correct about 75% of the time. (I’ve not been a big fan of technical Analysis.)
- Most of the techniques used in this methodology are related to Technical or Chartist Analyses

INVESTMENT SIG

STRATEGIC STOCK SELECTION

His approach or methodology to selecting stocks is summarized below:

OVERVIEW

1. Identify the sectors that are leading the market
2. Analyze the technical stage of the market that the sector is in
3. Find the individual stocks that are best performing in the sector for your purpose (long or short)
4. Find the best time for the stock transaction using technical analysis of the charts

INVESTMENT SIG

STRATEGIC STOCK SELECTION

After this overview,

1. I will show the steps in more detail
2. Demonstrate them with an example

INVESTMENT SIG

STRATEGIC STOCK SELECTION

1. Sector Selection

Identify the leading sectors and do a relative strength analysis.

- Sources: Fidelity.com gives the basic 10 sectors (free)
Morningstar.com gives the 10 sectors (free)
Worden.com is used by Swanson & gives 250 sectors (it is a paid site)
Trendfollowing.com is an (expensive) paid site that offers a system of selecting securities by trend analysis
- For each bull market there is normally a different sector that leads the market vs. the prior bull market. There will be several that are ahead of the group.
- Fidelity also provides recommendations of which Sector(s) to use
- With in the Sector, there are Industry recommendations, a further subdivision, also shown by Fidelity

INVESTMENT SIG

STRATEGIC STOCK SELECTION

1. Sector Selection (continued)

Identify the leading sectors and do a relative strength analysis.

- The theory here is that while individual stocks are subject to major abrupt changes, sectors tend to have a continuation of the a trend for many months.

- The trend can be your friend:
 - Invest long on bull markets
 - Invest short on bear markets

INVESTMENT SIG

STRATEGIC STOCK SELECTION

2. Determine the **stage of the market cycle** that the sector is in.

- Swanson uses the standard 4 stage market cycle chart with 150 and 200 Day moving average

<F:\2011 SIG MONTHLY INVESTMENT MEETINGS\Ca Hyperlinks Mar 10 Mtg\4 stages of stock cycle.tif>

INVESTMENT SIG

STRATEGIC STOCK SELECTION

3. **Identify individual stocks** that are leading the market or are best buys in the sector via:
 - Stock screens
 - Fidelity
 - Morningstar
 - Vanguard
 - Many others

 - Fundamental analysis using standard measures such as
 - Price/Earnings; Price to Book; Free Cash Flow; Moat width; Debt load; market position; etc

 - These measures are shown in most financial web sites and newspapers

INVESTMENT SIG

STRATEGIC STOCK SELECTION

4. Determine when is the **correct time to purchase** the stock using technical analysis.

He purchases when the daily price line crosses the 200 day moving average line—with some variation according to his knowledge of the Market's general psychology

He cautions to avoid responding to news on CNBC, many times there are market manipulators, especially on very low priced stocks, who plant stories so they can profit from the masses of public investors following the crowd

INVESTMENT SIG STRATEGIC STOCK SELECTION

Demonstration example using the process:

1. **Identify the best performing sectors**

**Criteria: Percent improvement in price—Plus other factors such as expectations of future performance
(Note: Fidelity takes this into account and gives weighting recommendations)**

..\Ca Hyperlinks Mar 10 Mtg\Fidelity.com.mht

..\Ca HyperLinks Mar 10\Fidelity Investments Research Sectors.mht

INVESTMENT SIG

STRATEGIC STOCK SELECTION

Demonstration example using the process:

1. Identify the best sectors (Using Vanguard ETF's as a proxy since they mostly duplicate the stocks in the sector)

■	<u>ConsumerDiscretionary</u>	VCR 4.25%	
■	<u>ConsumerStaples</u>	VDC 0.95%	
■	<u>Energy</u>	VDE 12.86%	1st
■	<u>Financials</u>	VFH 5.03%	3rd
■	<u>HealthCare</u>	VHT 4.58%	
■	<u>Industrials</u>	VIS 6.43%	2nd
■	<u>Information Technology</u>	VGT 4.97%	
■	<u>Materials</u>	VAW .68%	
■	<u>Telecommunication Services</u>	VOX-1.94%	
■	<u>Utilities</u>	VPU 2.75%	

INVESTMENT SIG

STRATEGIC STOCK SELECTION

Demonstration example using the process:

2. Analyze the technical stage of the market for the sectors:

Energy (VDE)

Industrials (VIS)

Financials (VFH)

[..\Ca HyperLinks Mar 10\Yahoo Finance Home page.mht](#)

INVESTMENT SIG

STRATEGIC STOCK SELECTION

Demonstration example using the process:

3. Find the individual best performing stocks in the sector:

C:\Documents and Settings\Larry G McKee\My Documents\2011 SIG MONTHLY INVESTMENT MEETINGS\Ca HyperLinks Mar 10\Morningstar home page, Mutual Fund, Hedge Fund, ETF Investment Research.mht

INVESTMENT SIG

STRATEGIC STOCK SELECTION

Demonstration example using the process:

4. Find the best time to purchase the stock

[..\Ca HyperLinks Mar 10\Yahoo Finance Home page.mht](#)

INVESTMENT SIG STRATEGIC STOCK SELECTION

Demonstration example using the process:

Note: Swanson uses the same technique to identify securities to sell short during a bear market cycle.

I will not demonstrate this in an example, but I think with some study, a person can apply this system satisfactorily

INVESTMENT SIG

STRATEGIC STOCK SELECTION

- **Swanson's advice on portfolio management**
- **While he is not a buy and hold indefinitely investor, he does not trade in and out on the ups and downs.**
- **He follows the long term trend for the duration of a bull market and trades when the daily line crosses the moving average or moves below a support line—or when there is some major market mover for the individual stock**
- **He charts weekly each stock and subscribes to alerts for news about them**
- **He only buys what he can monitor properly, about 20 stocks.**
- **He only puts a maximum of 20% in any one stock**
- **He will invest in several sectors**

INVESTMENT SIG

STRATEGIC STOCK SELECTION

- **My variation of his approach:**
- Purchase Sector ETF's instead of individual stocks
iShares or Vanguard
- The likelihood of very, very high gains is small
- The likelihood of a precipitous drop in value because of such things as a company scandal, an accident, or management error is also much smaller

INVESTMENT SIG

STRATEGIC STOCK SELECTION

Correlating Advice

There is a educational selection on Fidelity.Com that has similar information and explanations—with some variations though

[..\Ca Hyperlinks Mar 10 Mtg\Fidelity.com.mht](#)

[..\Ca HyperLinks Mar 10\Fidelity Investments Research Sectors.mht](#)

INVESTMENT SIG STRATEGIC STOCK SELECTION

Reference:

Swanson's book can be obtained at [Amazon.com](https://www.amazon.com) for \$10.82. Its 127 pages are a quick, easy read.

INVESTMENT SIG
STRATEGIC STOCK SELECTION

The End