

Laurel Kenner and Victor Niederhoffer
Columnists

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Even Genius Fails: Book Review Part II

By Victor Niederhoffer and Laurel Kenner

Columnists

12/01/2000 10:30 AM

(Editor's Note: This is Part II of a two-part book review of Roger Lowenstein's, When Genius Failed, by bond expert Paul DeRosa, Ph.D. [Click Here for Part I.](#)

DeRosa was formerly head of proprietary bond trading at Citibank and helped establish Eastbridge Holdings, a bond and currency trading company in New York. He has also worked as a staff economist at the Federal Reserve Bank of New York.)

Once the bailout fund for Long Term Capital Management was in place, the crisis was over and for all intents and purposes, LTCM entered history -- 100% of its capital gone and its managers disgraced.

Was the world endangered by its failure? Probably not. The gathering at the New York Fed represented organizations with collective stockholder equity of some \$400 billion and market capitalization of twice that amount. It takes a romantic imagination to envision a problem that could be solved for \$4 billion seriously challenging that amount of muscle.

It is quite possible, however, that individual firms could have been badly damaged. Given the success of LTCM over the years, one suspects it had more than a few emulators. Lowenstein mentions several rumors of firms trading against the LTCM positions, but it is far more likely that their competitors had been cloning LTCM trades on their own books. The bankruptcy of Drexel Burnham never threatened the banking system, but it closed the junk bond market for a few months and left several wounded camp followers in its wake. No one can predict how events would have played out, but by giving LTCM time to liquidate, the banks probably saved themselves some money. Since the year 1998 was already a drain, it was money they would have just as soon not lost.

Extended Coda

If Lowenstein had confined himself to a lively description of the rise and fall of Long-Term Capital Management, he would have produced a creditable piece of financial journalism. Unfortunately, his work is deformed by an extended coda in which he attempts to allocate blame for the LTCM failure and to lament the ease with which the putatively guilty parties escaped. He also advocates increased regulation of hedge funds and for more financial regulation in general. As if those 3,000 lawyers at the SEC were not enough.

Lowenstein's position is captured more or less by his statement that "Greenspan's more serious and longer-running error has been to consistently shrug off the need for regulation and better disclosure with regard to derivative products. Deluded as to the banks' ability to police themselves before the crisis, Greenspan called for a less burdensome regulatory regime barely six months after it." Judging from this statement and others within the text of *When Genius Failed*, one could conclude that Lowenstein believes the failure of LTCM to have been a consequence of regulatory leniency rather than the vagaries of finance, and that a regulatory regime stringent enough to have prevented LTCM's collapse would be more desirable than the one in place.

If this is his position, he's wrong on both counts, or at least the failure of LTCM is insufficient evidence to make him right. His problem is philosophical. A terrible event took place; it must have had a cause.

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Surveying the landscape after the fact, he observes what looks like a large amount of reckless borrowing and declares that to have been the problem. He might be correct, but only to the extent that all financial blow-ups have a proximate cause. At Bank of America it was loans in the oil patch; for Citibank it was real estate; for Continental Illinois it was something else. It's always something.

Like these other organizations, Long-Term Capital Management was a financial intermediary with fixed liabilities and assets that fluctuate with the market. For such businesses, the threat of bankruptcy is always present, even for those that are competently managed. Financial intermediaries are not unlike a person in a game of coin tossing, where with skill and practice a few people might become expert to the extent of raising the probability of a winning head on any toss to 55%, leaving only a 45% probability of throwing a losing tail. Such an expert might well enjoy a long, profitable career tossing coins, but if someone engaged in as many as 1,250 tosses (roughly the number of business days LTCM was in business) the probability of at least one run of a dozen consecutive tails (roughly the number of adverse trading days suffered by LTCM in September 1998) is not trivial. It is 8.2%.

Trouble Assured

This number is not shockingly large, but it's large enough to assure that slightly less than one coin tosser in 10 will run into financial trouble every few years, despite having started with a significant edge. And when they do, doubtless someone will be able to identify mistakes they made in the last few losing tosses.

The experience of the United States prior to FDIC insurance was both that periodically the unpredictable nature of events overcame management efforts and banks failed, and that some banks were run so fraudulently that their failure was preordained. Since economic growth requires risk-bearing intermediaries, little was done to prevent failures until the problem became so great as to inhibit growth. The government took steps to reduce the rate of failure by raising the capital required to enter the industry, but even then regulatory intervention was restricted to commercial banks. It could have reduced the failure rate further by requiring even more capital and extending regulation to non-bank intermediaries. Such a regime, however, might also have discouraged intermediation to a point at which economic growth would have suffered, in which case the cure would have superseded the problem. For all we know they may already have gone too far.

Lowenstein, for all his effort to sound hardnosed, was beguiled by the glamour of Long-Term Capital Management into elevating its demise into a cause of financial turmoil rather than a consequence of turmoil. Meriwether's firm was an intermediary twice removed from the payment system. Its failure preoccupied regulatory officials for a brief time, but no one beyond its investors lost any money. It created a problem that required a bit of Fed-assisted market fixing to repair, but in the end the system worked. Roger Lowenstein's book describes exactly how that system worked in this case. If you are the type of reader who is upset by events like this, you might still enjoy *When Genius Failed*, but you'd better brace yourself; LTCM won't be the last financial horror story.

Paul DeRosa began his career in the securities industry as the money market economist in Citibank's bond trading division. He later became the bank's chief proprietary bond trader and subsequently was named head of Citibank's financial derivative and capital markets businesses in North America. In 1986, Mr. DeRosa joined E.F. Hutton Co. as co-head of bond trading with particular responsibility for mortgage trading and finance. In 1989, Mr. DeRosa helped to establish Eastbridge Holdings Inc., a bond and currency trading company in New York, where he eventually served as CEO.

Speculator's Scorecard			
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Dow	1.04	Down 1	-9.4	-2.3
S&P 500	0.88	Down 1	-11	-4.2
Nasdaq	0.96	Down 4	-36	-14
Europe STOXX-50	1.06	Down 3	-2.3	-4.8
Dollar/euro	0.83	Up 4	-16	2.3
Nikkei	0.77	Up 1	-23	0.4
Dollar/yen	0.98	Up 1	-13	-1.5
Gold	0.71	Up 1	-6.1	1.5
Oil	1.32	Down 1	86	-1.9
Bond Futures	1.20	Up 3	13	1.9
2-Yr Note Futures	1.08	Up 3	1.5	0.4
Bund Futures	1.12	Up 5	4.8	1.5

Mr. DeRosa holds a Ph.D. in economics from Columbia and has served as a staff economist for the Federal Reserve Bank of New York.

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Specs Seek Shelter from the Storm

By Victor Niederhoffer and Laurel Kenner

Columnists

12/04/2000 10:05 AM

Welcome to the 453rd edition of Stock Talk! We have moved from the sunny climes of Florida to wintry upstate New York for a Grand Rounds presentation at the State University of New York's Upstate Medical Center in Syracuse. *Daily Speculations* consulting psychologist Brett Steenbarger has prepared a talk on behavioral finance for an enthusiastic group of psychiatrists, psychologists, medical students, doctoral interns, and psychiatric residents.

The topic du jour, understandably, is the recent swoon in the Nasdaq market (\$COMPX), which essentially halved the value of stocks on the most widely traded exchange in America.

We may find some shelter from the storm during 2001, however. Members of the New York Stock Exchange have been net buyers of stocks for the past seven weeks and 11 of the last 14 weeks. Indeed, the detrended measure of net member buying followed by Carl Swenlin at www.decisionpoint.com has reached its highest level in six years. This has been a useful measure in the past, hitting lows in early 1998 and late 1999 prior to market corrections. It suggests that savvy members are gobbling up bargains.

Our first question comes from Twinkle Patel, a Research Technician at SUNY:

Patel: What are the causes for the market's current downtrend?

Steenbarger: In times of confusion, the late novelist and philosopher Ayn Rand advised people: "Check your premises!" It is good investment advice as well.

Your question contains two hidden premises:

- 1) There is an entity called "the" market, and
- 2) This market has been in a downturn.

Let's look at these.

From March 23 to the present, the Dow Jones Industrial Average (\$INDU) has moved from 11,119.86 to 10,373.54, a decline of less than 7%. During that same time, the Nasdaq 100 Index (\$NDX) has fallen by roughly 50%. If we look at the components of the Dow and remove the influences of Microsoft (MSFT) and Intel (INTC), which were added to the index in November of 1999, we find something interesting.

About 60% of the Dow's decline since March is attributable to those two Nasdaq stocks. Had the composition of the Dow remained limited to New York Stock Exchange-listed issues, there would be no "market downtrend" in that index. Indeed, financial (\$NF), consumer (\$CMR), health insurance (\$HMO), and utility (\$UTIL) stocks have been in uptrends during this time!

The moral of the story is to beware of generalizations about "the" market. Within the universe of stocks are many industry sectors that can move surprisingly independent of one another. The Nasdaq is not "the

market".

Steven Batki, MD: Should I sell Treasuries and buy the Nasdaq 100 stock (QQQ), with the Nasdaq so low? I'm a long-term investor.

Steenbarger: I want to thank Dr. Batki for organizing this Grand Rounds presentation. We know the Nasdaq has been weak. The question is whether or not we're near a point of maximum bleakness

One way of doing that is to examine the number of stocks that have made new annual lows on a given day. At important market bottoms, we typically see a large expansion of stocks making new lows followed by a series of strong rebound days that pull most stocks off those lows. This is a reliable sequence that can be observed over a period of years: panic selling by unsophisticated traders followed by vigorous buying among savvy speculators who have taken out their canes and hobbled down to Wall Street in pursuit of bargains.

Observe that on November 30, nearly 16% of all Nasdaq issues traded made new annual lows. That is the 14th highest percentage of new lows since 1978. The other time periods in which at least 15% of traded stocks made new lows reads like a veritable hall of fame of market bottoms: late October, 1987; late September, 1981; early October and late August, 1998; late August, 1990; and late March, 1980.

On many of these occasions, the market averages made lower lows even after the number of stocks making 52 week lows had crested. In retrospect, however, these turned out to be profitable opportunities to add to positions. It is certainly possible that we will see lower prices for the Nasdaq averages in coming weeks. I cannot find a single time in the past 22 years, however, when the market was not significantly higher 12-18 months following a day when at least 15% of traded Nasdaq stocks made annual lows.

Laurel Kenner: We think we're seeing a bottom. The 30-year bond yields are at the lowest levels of the year. S&P 500 futures have been down four days in a row. And a canny friend, Marc Strausberg, founder of Edgar Online Inc. (EDGR), tells us that for the first time in five years, he owns a few stocks in addition to his 20% ownership in his company.

His method: find the worst disasters; make a judgment on whether they'll be standing at the end of the day, and then check to see if any mutual funds held significant shares in the third quarter. "No fund wants to show that they ended the year holding a stock like Globix (GBIX)," he notes. But Globix's price last week (\$2.50) creates a \$60 million market cap for a company with \$300 million plus in cash. Marc expects fourfold returns in the first quarter from Globix and another downtrodden Internet publisher, Marketwatch.com (MKTW).

Paula Trief, Ph.D.: Is it generally wise or foolish to buy a solid stock right after it has split?

Victor Niederhoffer: A classic study of stock splits by Jensen and Scholes found that stocks tend to rise after an announcement of splits. This is because there is an informational impact with regard to the increased likelihood of future dividend increases. After the effective date, however, the effect wears off. The book *Stock Split Secrets* by Darlene and Miles Nelson lacks hard evidence, but contains one or two hints. They point out that stocks that split tend to rise on the announcement. They also tend to rise on the day or two before the announcement and then fall thereafter.

If you see a company announcing a meeting of the board or requesting a vote to increase the authorized shares by a multiple of 100% of outstanding shares, that's grist for the mill that there is going to be a

split.

Laurel Kenner: We looked at the split-related performance of the 20 largest stocks in the S&P 100 by market value, and included the eight that had a split this year so as not to exclude from the results one of the poorest years on record. The eight were: GE (GE), Cisco (CSCO), Intel (INTC), AIG (AIG), Citicorp (C), EMC (EMC), Oracle (ORCL) and Nortel (NT). We included one previous split.

The average move three days after the split announcement was down 1.8%. Three months later, the stocks were on average 4.9% higher. The results this year were slightly worse for three-day performance (-2.9% vs.1.1%), and slightly better for a three-month holding period (5.8% vs.3.9%).

Andrew Pellicchia: Why does the market seem to stumble greatest in October?

Roger Greenberg, Ph.D.: Are there relationships between stock market changes and indices of mental health, such as rates of hospitalization or suicide?

Steenbarger: These questions may seem unrelated, but perhaps not. We know that there are seasonal patterns to suicide attempts, with colder months showing the greatest prevalence. Similarly, we are accustomed to the notion of summer rallies in the stock market and fall declines.

Interestingly, the phenomenon of seasonal affective disorder is said to be significantly more prevalent in regions that have limited sunlight in winter—such as Russia and Scandinavia—than in tropical areas drenched in sunlight. Could there be a link between mood and market performance?

It's possible, but note that September is an even crueler month than October, with many wonderful buying opportunities emerging in the fall. This occurred in 1978, 1979, 1987, 1990, 1998, and 1999. Do also recall the year-end effect, in which small capitalization stocks have tended to outperform larger ones. The lesson, perhaps, is to buy when those around you are most depressed!

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S&P 500	0.89	Up 1	-10	-3.8
Nasdaq	0.97	Up 1	-35	-13
Europe STOXX-50	1.07	Up 1	-1.0	-3.2
Dollar/euro	0.84	Up 5	-15	3.6
Nikkei	0.78	Up 2	-22	2.0
Dollar/yen	0.97	Down 1	-13	-2.4
Gold	0.70	Down 1	-6.5	1.4
Oil	1.31	Down 2	76	-8.6
Bond Futures	1.19	Down 1	13	1.7
2-Yr Note Futures	1.07	Down 1	1.4	0.4
Bund Futures	1.11	Down 1	4.8	1.5

Brett N. Steenbarger, Ph.D. is a licensed clinical psychologist and Assistant Professor of Psychiatry and Behavioral Sciences at the SUNY Upstate Medical University in Syracuse, NY. His primary research interest is multivariate behavioral modeling of the stock market. He welcomes comments and questions

at steenbab@aol.com. He does not hold a position in any of the stocks discussed in this column. Positions may change at any time.

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*.*

Laurel Kenner is a financial writer in New York City. Formerly head of US stock market coverage at Bloomberg News, she previously reported on police, politics and aerospace during her 17-year news career.

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Market Symmetry Calls for Prodigious Rise

By Victor Niederhoffer and Laurel Kenner

Columnists

12/05/2000 10:09 AM

The extent to which symmetries pervade the universe is remarkable.

-- Ian Stewart and Martin Golubitsky, *Fearful Symmetry*

There is a beautiful symmetry in starfish, snowflakes, splashes and markets.

One month ago, at 2 a.m. on the day after the election, overnight futures spiked up on the announcement that Bush had won. The S&P 500 contract hovered at 1,455, and the Nasdaq 100 was on the verge of rising above 3,400.

Since that time, the market has been in steady decline, with each step down corresponding almost one for one with bits of news on Bush setbacks or prolonged litigation. On the day after the election, the Nasdaq fell a fast 8%, and the S&P was headed down for 1,400. By Monday's close, the S&P 500 had dropped 8.6%, while the Nasdaq 100 lost 24%.

What a tremendous destruction of value. Measured by the Wilshire Index, \$1.5 trillion has evaporated from the US stock market since the high on Nov. 7.

Rebound Opportunity

What an outcry would have ensued if the Republicans had caused this by their repeated challenges to the election decision. And what an opportunity is provided by yesterday's post-close rulings by the US Supreme Court and Judge N. Sanders Sauls. After all, if the Nasdaq could fall some 25% on prospects of a Republican defeat, it's a good working hypothesis that it will rise by the same amount on the relative certainty of a Republican increase.

The game isn't over yet. Gore is likely to win a case in Seminole County, Florida, that would throw out 15,000 absentee ballots and cost Bush 4,800 votes. Republicans had asked the judge in the case, Nikki Ann Clark, to recuse herself because Bush's brother, Gov. Jeb Bush, had passed her over for an appellate court appointment. Clark refused.

But we doubt that Ms. Clark's likely ruling will decide the election, since the Republican-controlled Florida legislature is in the wings if the legal cases are unresolved by the Dec. 12 deadline for appointing electors.

Quitting While He's Ahead

Ms. Clark's insistence on staying on the case contrasts with the decision by James Cramer to leave his hedge fund at its peak. Quitting at the top is hard to do, because that's when you can make the most money. Most people have rules to quit when they're behind, but not when ahead. We admire him for overcoming the natural impulse of greed.

A strange aspect of quantitative analysis of stock patterns is that often the expectations are in line with qualitative factors that retrospectively tend to explain the quantitative numbers. For example, the overwhelming bullishness of the patterns over the last week for stocks in retrospect seems to be due to the excessive pessimism that was encapsulated in the past performance of stocks relative to the

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prospects for Bush to ultimately prevail.

The numbers today tell a similar story. As we write, the Nasdaq is up 4% in overnight trading, close to where it was before Thanksgiving. It is rare for there to be large rises on a Monday followed by a large rise at the open as is on tap today. We find only three comparable cases over the last seven years.

Regrettably, two of those cases worked their way substantially lower by the end of the week. This would be in line with a decision by Judge Clark to bring the initiative back to the Democrats.

A Pick That Hasn't Panned Out

Two out of three snow flurries does not make a ski season, nor a stock market decline to hang one's hat on. But it's a caution nonetheless.

On Nov. 20, we recommended Antec (ANTC), based on late-October buying by insiders. The stock has since fallen 28%. AT&T (T), which accounts for 40% of Antec's sales, said Nov. 24 it would suspend buying equipment to upgrade cable TV systems for phone service through the end of the year. Antec was one of several companies affected. The problem promises to be temporary -- and since Antec's CEO was buying at 13, we think it's a good buy now, at 8 11/16.

Stock Contest Winner

The final winner in our stock-picking contest is Jack Tierney, who chose Fiserve (FISV). Mr. Tierney was the only one in his group to pick a stock that gained in the six months ended Nov. 23. To collect his fish dinner, Mr. Tierney is asked to e-mail ltkennner@yahoo.com.

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Oil	1.30	Down 3	72	-11
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Charting a Course After a Banner Day

By Victor Niederhoffer and Laurel Kenner

Columnists

12/06/2000 10:03 AM

The Nasdaq registered the greatest rise in history yesterday, on the fourth anniversary of the destructive "irrational exuberance" speech of Doc Greenspan.

Bonds closed at their highest level since April 29, 1999, crude oil ended at the lowest since Aug. 18, the euro closed to a three-month high and the yen at the lowest since February.

All of this was triggered by two events: the courageous but futile decision by Judge Sauls that the votes should not be recounted, and the Doc's speech to the America's Community Bankers Conference, in which he said the "wealth effect" from stock gains is diminishing and that weakening financial markets could be signaling or bringing on an "excessive softening in household and business spending."

Where to Now?

These events were beautiful, complex and interrelated. But where are we going? Certainly, it's as clear as the Atlantic in the Caymans that Judge Clark is preparing to throw out several thousand votes for Bush.

How will it all work out? How will all these linked but separate forces, seemingly as diverse as the world itself, ultimately affect the markets?

To start, we turned to our trusty Daily Spec computers. These have increased in trustworthiness with the long overdue move of yesterday, and have now been taken out of the closet, where they were buried as they repeatedly called for a vigorous post-Thanksgiving rally despite the market's insouciant refusal to oblige.

The Daily Spec computers noted 15 days on which the S&P has risen 40 or more points in the last six years. Happily the S&P was higher on 12 of those occasions five days later -- the expected move of 1.5% bordering on the levels of statistical significance conventionally accepted for differentiating true relations from random ones.

Regrettably, after the eight similar occasions where two nice days of rallies have occurred, the market tended to back and fill for the next two days. And this would be in line with the all-but-foregone outcome of Judge Clark's adjudication.

Finally, the computers noted four occasions when a big rally of this magnitude followed on the heels of a big decline. Regrettably, also, we must report that three of the four occasions showed a considerable decline before plowing on ahead to stellar uncharted territory on the upside. But of course, four swallows is not enough for a statistical spring.

Our Market Counselor

We turn instead to our consulting market psychologist, Dr. Brett Steenbarger, who is equally at home turning his bank of computers to counting spectacular rallies as he is at allaying the fears of doctors concerning an imminent collapse in the Nasdaq, or ministering his one-minute cure for any and all emotional problems thrown at him during his 30 hours a week of psychological practice at SUNY

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Syracuse. He reports:

"While fear and greed take top billing as behavioral variables influencing trading decisions, I find regret to be every bit as powerful. After a large move such as today's, the normal human tendency among those who did not participate is to hope and wait for a pullback. Regretting having missed 'the bottom,' they cannot accept the new, higher level of valuation and hope the market will get them in at better prices. Rarely does the market accommodate.

"What is the likelihood of a continued market downtrend given the vigorous rise? Not great. I could only find 15 occasions since 1965 in which the S&P had risen over 38% in a single day. When this had occurred, the market was higher 120 days later 14 out of the 15 times by an eye-opening 14.63%. In other words, the best was yet to come and waiting for the prior lows was a losing bet."

Advancing stocks on the NYSE exceeded declining stocks by a margin of more than 35% yesterday, Dr. Brett added. "This has occurred 439 times since 1965, or about once a month. There are favorable expectations going forward over every time frame from the next day to 120 days out once this has occurred. When the rising tide is lifting all boats, the rise tends to have some persistence.

"I also note that many of the previous rises of this magnitude came at important market lows, including May 1970, October 1974, August 1982, November 1982, October 1987, September 1998, October 1998 and March 2000. Markets seem to be like rocket ships: A strong upthrust can overtake gravity and produce an impressive rising trajectory."

Summed up the barbecue-loving finance professor Mark McNabb: "In other words, escape velocity from the bears requires a +X% day of some volume shortly after a capitulation event. Hence we talk of markets that ramp, take off, blast off, rock, rocket, etc."

End With a Song

We conclude with a song from a South African correspondent, Adam Rosner, to be sung to the tune of Mack the Knife:

*Oh the market has its ways, dear
It will take away your stock
So be careful to buy the bottom
and sell always at the top*

*Now those Net stocks have big growth, dear
At least that's what they all say
But be careful when they miss earnings
'Cause you'll be sorry for what you paid.*

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Golden Means and Magic Numbers

By Victor Niederhoffer and Laurel Kenner

Columnists

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"The Golden Mean is best."

-Mirror Magazine, 1850

The 40-point rise in S&P futures on Tuesday followed by a 20-point decline yesterday brings us back to Greek days where the focus was on Golden Numbers, Golden Ratios, Golden Angles, Golden Sections and Golden Means.

Ian Stuart believes that placing reliance on non-existent patterns in numbers of this nature is a breed of mumbo-jumbo. He states in *Fearful Symmetry* that, "A whole breed of financial analysts currently attempts to predict the behavior of the stock market by applying a range of 'patterns,' either geometrical or numerological. Whose basis is - to say the least - dubious. The sensible ones make money by teaching the system to everybody else."

Nevertheless, our calling is to deflate ballyhoo and the best way to do so is to test, rather than attempt to stride upon Mount Olympus with a pronouncement. In this regard we have temporarily removed the Daily Speculations computers, which were prematurely bullish, from the woodshed as they have recently been generating their usual accurate predictions.

They now reveal that in situations like the present, where the market registered a nice daily decline but yet is still up over the previous two days, the moves are highly bullish following a down open. In fact, from the open to the close three days later the market is up 85% of the time with an average rise of 1.5%.

This would be consistent with a bullish employment number to be reported tomorrow. As is well known, the employment number is the most bullish number of all of the 20 or so major monthly releases of economic statistics. This would also be consistent with "Doc" Greenspan's report on Tuesday that he is watching signs of "excessive softening in household and business spending". We have found that much of the Doc's forecasting tends to be consistent with economic numbers to be released (and presumably already vetted by him) in the near future.

Inspired by golden talk and magical numbers, we turn to a magic stock and a magic number: IBM (IBM) and 100. We believe that the number 100 exerts a gravitational impact on stock prices. It tends to be a goal of longs when a stock is trading below and it tends to be the cutoff point "just sell everything" when the stock is trading above.

One example of how to profit from this is to buy IBM at the close on the first day it closes below 100 when the preceding day's close was above 100 and similarly to sell IBM at the close on the first day that it closes above 100 after the previous close was below 100. By following this system one would buy IBM at $96 \frac{3}{4}$ as of Wednesday's close since its previous close on Tuesday was $103 \frac{3}{8}$. Following such a system since Oct. 17 when IBM fell below 100 on the announcement of dismal third-quarter sales would have yielded six consecutive profits totaling \$26.55 as follows:

Trade Date.....Buy.....Sell.....Profit

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Oct. 18.....	\$95.50	
Nov. 2	\$102.00.....	\$6.50
Nov. 9.....	\$99.50.....	\$2.50
Nov. 17.....	\$102.00.....	\$2.50
Nov. 21.....	\$98.50.....	\$3.50
Dec. 5.....	\$103.40.....	\$4.90
Dec. 6.....	\$96.75.....	\$6.65
Profit.....		\$26.55

Twenty-six percent over a two-month period is not a paltry return for a stock of IBM's caliber.

Since the Daily Spec computers are highly bullish following the open today we are recommending the application of this system for IBM only on the long side. Be aware, however, that a system like this that is profitable close to 100% of the time is exposed to large unrealized losses that can try one's patience and net worth. Buying IBM at times like this has the virtue of putting you ahead of the stampede of the bulls when the market swings positive. But in the event of an October 1987 or a miserable earnings report from IBM, be prepared for the worst.

Another stock that we are recommending is Cree Inc. (CREE), a developer and manufacturer of semiconductor materials such as blue and green light emitting diodes.

Cree is the archetypical Nasdaq company, with sales growing by 100% a year from its current level of \$100 million, a market value of some \$2 billion, and a price that has receded some 60% from its previous high of 168 to its current level of 68.

In this case the stock is recommended by Mr. X, the plugged-in researcher and intelligencer whose track record is sterling. He reports: "The reason I love Cree is because it has such a reliable earnings visibility for the next few years...It is sold out on its inventory for a year. In 2001 the great companies like GE will be able to produce great earnings despite the slowdown. Cree can do it because its products are sold out."

How golden we all will be feeling in the next several days will be determined by the employment numbers and the election outcome. Let us hope for a harmonious resolution.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	1.04	Down 1	-7.2	2.5
S&P 500	0.90	Down 1	-8.0	2.2
Nasdaq	0.96	Down 1	-31	1.5
Europe STOXX-50	1.06	Down 1	-0.4	0.9
Dollar/euro	0.85	Up 1	-14	5.4
Nikkei	0.79	Up 1	-21	4.1
Dollar/yen	0.98	Up 1	-13	-0.3
Gold	0.71	Up 1	-4.6	3.1
Oil	1.29	Up 1	64	-16
Bond Futures	1.19	Up 2	14	1.7
2-Yr Note Futures	1.10	Up 3	1.8	0.6
Bund Futures	1.13	Up 3	5.3	1.5

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Laurel Kenner is a financial writer in New York City. Formerly head of US stock market coverage at Bloomberg News, she previously reported on police, politics and aerospace during her 17-year news career.

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Looking for Meaning in a Mean Market

By Victor Niederhoffer and Laurel Kenner

Columnists

12/08/2000 08:58 AM

(Editor's note: Brett N. Steenbarger, Ph.D. is a licensed clinical psychologist and periodic guest contributor to the Daily Speculations column. This is the first article in a two-part series examining cognitive aspects of trading.)

With the intensity of selling reaching a zenith not seen since late 1998, according to the open 10-day short-term trading index developed by Richard Arms, the market staged a furious rally on Tuesday only to see a good share of those gains eroded on Wednesday and Thursday.

The market's underlying strength was in evidence in those last two days as new annual highs on the New York Stock Exchange outnumbered new annual lows. This bodes well on a day when the market will cope with an Intel (INTC) earnings warning, an unemployment report, and quite likely one or more Florida court rulings.

"Stock prices do not follow random walks," asserts a well-known research study by Lo and MacKinlay. Indeed, research evidence strongly suggests that stocks follow non-random patterns of momentum, seasonality, and response to earnings surprises. How can speculators hope to benefit from such patterns?

The cognitive tradition in psychology, beginning with Jean Piaget and continuing with the therapeutic work of Aaron Beck, emphasizes that human thought is distinguished by its meaning making. We are driven to make sense of the world, to capture the unknown in the terms of what we understand.

Mental Plans

One way we accomplish such meaning making is through the creation of mental representations called schemas. A schema can be regarded as an internal map, a model that we build of the world around us. Both Piaget and Beck regard the human being as a kind of scientist, forever creating hypotheses and theories about the world, testing these through experience, and modifying their models in the light of non-confirming evidence.

Unfortunately, people can be highly biased in their model building, causing them to react in distorted ways. I sometimes ask people in an audience to compare themselves to the average person on such traits as caring and honesty. Routinely, 80% to 90% of participants rate themselves above average! Social psychologists call this a "positive attributional bias," a tendency to attribute favorable traits to ourselves even in the light of disconfirming evidence.

Investors model the markets much as they create models of self, careers, and relationships. These models help make sense of a complex reality, guiding action and imparting a sense of mastery. Alas, our model building of markets is also prone to information processing biases. Researchers in behavioral finance refer to our informal models as heuristics. They note that we tend to restrict our heuristics to immediately available information, thereby limiting our ability to predict and understand markets.

Good Predictors and Bad

A good example of the overuse of availability heuristics can be found among hiring practices in the business world. When we look to hire a person for a position, we model our candidates based upon such

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factors as interview performance, letters of recommendation, and resumes. A wealth of research, however, suggests that these methods are almost completely unreliable and lacking in validity. If we want to identify good candidates for a position, we need to observe them performing tasks similar to those demanded by the job. Interviewing a candidate salesman about his career goals is far less effective than showing him a Waterman writing instrument and saying, "Sell me this pen!"

In understanding markets, we also have candidates that vie for the position of predictors. These candidates may include such variables as interest rate changes, volume shifts, price momentum, and earnings. We could rely upon readily available heuristics derived from market bar charts or the pronouncements of media pundits, but this would be prone to unreliability and inaccuracy. A more promising approach would be to see how markets actually behaved in the past when faced with a given configuration of interest rates, volume, momentum, and earnings. We could even test this model on fresh data to ensure that it is valid and not just the result of overfitting.

David Aronson, professional trader and analyst at the options division of Spear, Leeds, and Kellogg, offers the following analogy:

Suppose we are trying to describe the topography of the state of Colorado. This would be nearly impossible to accomplish in a series of sentences. If, however, we could assemble a gigantic wire mesh grid and place it over the state, we would find that the resulting imprint would be a reasonable approximation to the state's topographic features. A good model is one capable of capturing the complexities of its subject matter. When the subject matter is highly complex, as in the case of financial markets, the models generally take a mathematical form to overcome the limits of our ability to visualize and verbalize intricate relationships.

The Simplify Trap

This brings us to one of the great challenges of behavioral finance. It is human nature to simplify our meaning making in the face of threat and uncertainty, in order to facilitate action. Much emotional dysfunction has its roots in such simplification. The paranoid person reduces his world to black and white to ward off threats; the person with an eating disorder oscillates between self-starvation and binge eating to regulate her feelings about herself.

Traders similarly fall back on simplified models when faced with roller coaster markets. Instead of rationally weighing candidate predictors tested for validity, they impulsively follow trendlines, news items, and arcane numerological nostrums. Just when they need to account for complexity, they find themselves emotionally tugged into simple, available heuristics. Freud referred to this tendency as regression: the impulse to return to earlier developmental modes of coping under emotional stress.

I recently asked John Wolberg, author of the book *Expert Trading Systems* (Wiley, 2000) and a specialist in financial data modeling at the Technion-Israel Institute of Technology in Haifa, how one can begin to develop more sophisticated models of the market. He responded:

The Right Model

There are many simple modeling tools available. One good place to start looking is at kdnuggets.com. This site contains links to innumerable data mining tools of all types and is not limited to just tools for financial market modeling. Whether or not these general purpose-modeling tools can be applied to developing successful market models is another story. The markets are probably the most difficult modeling problem that one can face.

In the second article in this series, we will consult with Dr. Wolberg about the challenge of modeling the

markets and explore ways of maintaining cognitive balance during turbulent market times. In replacing psychological regression with statistical regression, we may go a long way toward maintaining contact with ever-changing market realities.

Speculator's Scorecard				
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Dow	1.03	Down 2	-7.7	1.7
S&P 500	0.89	Down 2	-8.6	0.9
Nasdaq	0.95	Down 2	-32	-2.7
Europe STOXX-50	1.07	Up 1	-0.4	-0.5
Dollar/euro	0.84	Down 1	-14	5.4
Nikkei	0.78	Down 1	-22	2.9
Dollar/yen	0.98	Down 1	-13	0.0
Gold	0.71	Down 1	-4.9	3.0
Oil	1.28	Down 1	62	-17
Bond Futures	1.20	Up 3	14	2.0
2-Yr Note Futures	1.09	Down 1	1.8	0.6
Bund Futures	1.12	Down 1	5.1	1.3

Brett N. Steenbarger, Ph.D. is a licensed clinical psychologist and Assistant Professor of Psychiatry and Behavioral Sciences at the SUNY Upstate Medical University in Syracuse, NY. His primary research interest is multivariate behavioral modeling of the stock market. He welcomes comments and questions at steenbab@aol.com. He does not hold a position in any of the stocks discussed in this column. Positions may change at any time.

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Market's Short-Term Future Sits with Supreme Court

By Victor Niederhoffer and Laurel Kenner

Columnists

12/11/2000 09:03 AM

In cunning, fraud and wily tricks He was master of infernal politics
 --A. Oakley Hall, from *The Downfall of Tammany Hall No Fall at All* (1871)

Welcome to the 454th consecutive edition of Stock Talk! We're coming to you today from the old site of Tammany Hall, the Wigwam, on Nassau and Frankfort streets next to Maitland's Tavern.

We chose the location because of the mottos of William M. Tweed, Tammany chief and sachem: "In counting votes there is strength," and "If I count the votes, what are you going to do about it?" We were also enchanted by A. Oakley Hall's 1871 cartoon of Boss Tweed, wearing a feathered hat, astride a balance labeled "The Ballot."

Founded just after the Revolutionary War as a patriotic society named after an Indian chief, Tammany was just as adept in using political maneuvers for financial advantage as certain modern cattle futures traders.

This meeting was run by the anonymous fund manager Mr. X, whose Tammany lineage, contemporary connections and daily perusal of 900 online publications has helped him attain extraordinary politico-market intelligence. Mr. X's great-grandfather was a grand sachem of Tammany as well as a leading member of the Governor Flower ring, which bulled stocks up when warranted by political events such as the election of a president.

Mr. X's great-grandfather had a brother who was chief of the New York Supreme Court. "Even then," noted Mr. X, "the Democrats knew the importance of having a friend in court."

Representatives of the 13 Tammany tribes, dressed in buckskin and moccasins, attended the meeting and fired a number of politico-stock market questions at Vic and Laurel, who by a special dispensation from the male-only organization was allowed a place on the dais due to her great sagacity and beauty.

Question Laurel, the market has been subjected to virulent attacks interspersed with days of great elation ever since the election. What's going to happen next?

Laurel: Regrettably, the market continues to be totally dependent on election news. Take a look at what happened to S&P 500 futures after last week's important headlines:

Monday, Dec. 4, 11:43

***U.S. SUPREME COURT ASKS FLORIDA HIGH COURT FOR CLARIFICATION
 Futures rise 19 points in four minutes (1335.50 to 1354.)**

Dec. 4, 16:50

***GORE DENIED REQUEST FOR HAND RECOUNT IN RULING BY JUDGE SAULS
 Futures open 14 points higher the next morning, close up 43 points, or 3.9%, at 1374.**

Dec. 8, 14:22

***FLORIDA JUDGES REFUSE TO BAR ABSENTEE BALLOTS IN TWO COUNTIES
Futures jump 14 points in one minute (1371 to 1385).**

Dec. 8, 16:02

***FLORIDA HIGH COURT SIDES WITH GORE, ORDERS RECOUNT OF BALLOTS
Futures drop 40 points in three minutes (1370 to 1330).**

Dec. 9, 13:00

**U.S. Supreme Court Requires Halt to Florida Ballot Recounts
Overnight futures were up 33 points as of late Sunday evening. (1357 to 1390.)**

The U.S. Supreme Court will be hearing arguments on Bush's appeal at 11 a.m. today. The market will swing up or down a few percent, depending on whether the decision favors the Republicans or the Democrats.

Vic: And after an appropriate period of brooding and digestion, the market will inevitably rally with renewed vigor.

Question. Why are you so sure of a rise?

Vic: The interest-rate environment is highly favorable. Bond yields are near two-year lows. Short-term rates have been higher than long-term rates, an inversion that's always bad for stocks – but that situation is rapidly changing for the better.

Not least, Doc Greenspan is on watch to assure that whichever party takes the White House, his prospects to stay chairman will be enhanced by a good year-end stock market environment so that people will feel good with the new president as the New Year approaches.

Question Mr. X, what's your take on this election?

Mr. X: Clinton has the spirit of Tammany and Boss Tweed in his blood. Gore doesn't. That's why he's losing.

Q. Vic, I read that one of your first big trading successes came through purchasing stocks with insider buying. I'd like to pick up some Nasdaq stocks now, since they've fallen so much. Are there any you'd recommend based on that strategy?

Vic: Among the 20 worst Nasdaq performers year to date, six had insider buying in the last couple of months. Craig McCaw bought 600,000 shares of XO Communications (XOXO), at the end of November, paying around \$14.38 a share for the company he founded. XO, formerly known as Nextlink, rose 34% to 16 11/16 on Friday.

Our insider buying screens also turned up KLA-Tencor (KLAC), Worldcom (WCOM), Apple (AAPL), Dell (DELL) and Conexant (CNXT). Note that Conexant fell from 132 ½, above the round number of 100, to 19 5/8 at the end of November and is now back to 28 11/16.

Q. What happened to Boss Tweed?

Vic: He had stolen millions of dollars in municipal funds, and the stock market panic of 1873 led to his

imprisonment because the people couldn't afford him any more.

Grand Sachem Mr. X concluded the meeting by warning that the election contest is by no means over. "In Tammany politics, the most unusual outcome always ultimately transpired. The Seminole County suit over military ballots has been quietly taken up by the Florida Supreme Court for a Tuesday hearing. Beware. Also, George W. should remember the fate of Alexander Hamilton, who lost New York to Thomas Jefferson in 1800 after a frontal attack by then-Tammany leader Aaron Burr, one of the ablest leaders that Tammany ever had."

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S&P 500	0.90	Up 1	-6.8	2.1
Nasdaq	0.96	Up 1	-28	0.4
Europe STOXX-50	1.08	Up 2	0.0	-1.7
Dollar/euro	0.83	Down 2	-14	5.0
Nikkei	0.78	Down 2	-22	2.7
Dollar/yen	0.97	Down 2	-13	-0.2
Gold	0.70	Down 2	-5.3	2.4
Oil	1.27	Down 2	57	-20
Bond Futures	1.19	Down 1	14	1.8
2-Yr Note Futures	1.08	Down 2	1.7	0.6
Bund Futures	1.11	Down 2	4.9	1.1

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So Many Signs of the Bull

By Victor Niederhoffer and Laurel Kenner

Columnists

12/12/2000 09:49 AM

Nasdaq futures yesterday registered their third significant daily rise in a week Monday, and are now up 22% from their low just seven trading days ago. And sure as night follows day, the professional stock market analysts are lining up to jump on the Nasdaq bandwagon.

The venerable Barton Biggs, chief global strategist at Morgan Stanley, an expert repeatedly cited by the old-hearted columnist at the nation's largest financial weekly, is Exhibit No. 1. After being bearish for the greater part of 10 years while his plumber and others have seen Nasdaq rally from 400 to 3000, he now sees a 25% rise.

Exhibit No. 2 is the spate of analysts who yesterday joined the bullish camp. Edward Kerschner of UBS, ranked as the best investment strategist by Institutional Investor, now sees in stocks "one of the five most attractive opportunities of the past 20 years."

Exhibit No. 3 is the current cover of *Business Week*: "The Tech Slump." As our reader, the eminent insurance analyst Mr. G. W. Truck, puts it: "Editors are people too, and as with most of the public late to the party and late to the funeral. This would indicate the funeral is over."

Yes, we agree. It was over right before Thanksgiving, when stocks like Aether Systems (AETH) and the chip stocks were selling at below their cash value. Value managers were coming into ascendancy, and the old-hearted were predicting a Nasdaq 1500 without a demurrer in the house except for ours.

Contrarian Indicators

While it's scary to see all these trend followers throwing in the bearish towel – indeed, when the old-hearted columnist turns bullish on Nasdaq, we are going to sell everything – we believe they are right.

The reason is twofold. For one, the period from Dec. 10, Vic's birthday (he's 100 this year), to the end of the year has been quite bullish for the past decade. S&P futures have registered only three declines, each less than 1.5%, while the average move was up 2.5%. The average move for the Nasdaq Composite was a nice 3.7% rise.

General Electric (GE), which we chose as a bellwether since it seems to be the archetypal S&P 500 stock these days, has done even better in end-of-year runs. The average move from Dec. 10 through year-end: 5.4%. The news that GE will take a \$4 billion pretax charge and that analysts are downgrading the stock provides a nice opportunity to nibble away at a down opening today.

GE

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1999: 5%

1998: 15%

1997: -0.5%

1996: 0.9%

1995: 2%

1994: 8%

1993: 3%
 1992: 2%
 1991: 18%
 1990: 0.7%

The other major reason that we feel the market has a long way to go is that bond prices continue near two-year highs. Particularly noteworthy is that they managed to lose only two ticks yesterday to close at 103 10/32, while the Nasdaq and S&P soared. The gain in bonds thus provided a refutation of the hypothesis that stocks are the opposite of bonds and that one has to seesaw up while the other seesaws down.

A related hypothesis was that Bush is bad for bonds. This idea had considerable negative impact, as it provided negative feedback in the stock market. When stocks went up on signs that Bush's fortunes were improving, bonds went down, and this led to erosion in stocks, creating a countervailing force to the rallies.

Another part of the breakdown of this destructive hypothesis is the avalanche of business economists now forecasting a recession. All the major gurus now see the chance for a decline in economic activity as 50-50, where just a month or two ago, inflation was the mantra.

Look to the Ponies

We will eschew a philosophical analysis of why it is that the dominoes start falling like this except to relate some wisdom from Robert L. Bacon, who has more insight in his left pinkie on this subject than all the academics in the world. "Keep out of those switches," he writes in chapter 4 of his classic, "Secrets of Professional Turf Betting." "It's the switches and not the races that beat the public play."

Bacon continues: "Here are a few that professionals take good care to avoid. First there is the switch of position. The professional bets straight to win, only because there is the least unfavorable take against the straight position. The amateur bets to win, only to have the horse run third. He bets for third – but the horse runs second. He bets for second, only to have it run third. Then when he switches back to third again, the horse wins and pays \$28.70 straight, \$7.90 place but only \$3.80 for show. The first wrong switch breeds a fear of wrong switches, which automatically puts the player into an endless chain of unfortunate decision..."

To descend from the sublimity of Bacon to the devil's pit of politics, the market's move the next few days will depend on the end game played by the various Supremes, legislatures and Tammanys.

Consequently, we will turn off the juice to the Daily Spec computers except to say that any nice down is a great buying opportunity for GE and all our other favorite growth issues, particularly the techs.

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Nasdaq	0.97	Up 2	-26	4.7
Europe STOXX-50	1.08	Up 3	2.3	0.4
Dollar/euro	0.83	Down 3	-15	2.9
Nikkei	0.78	Up 1	-21	2.0

Dollar/yen	0.98	Up 1	-13	-0.4
Gold	0.70	Down 3	-6.0	0.2
Oil	1.28	Up 1	63	-17
Bond Futures	1.18	Down 2	14	2.0
2-Yr Note Futures	1.07	Down 3	1.6	0.5
Bund Futures	1.11	UnChg	4.9	1.0

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Back to An Uncertain Grind

By Victor Niederhoffer and Laurel Kenner

Columnists

12/13/2000 10:34 AM

Stocks traded in the narrowest range in a month yesterday as they waited for the Supreme Court ruling. As usual, when the decision came, the move was diametrically opposed to the expectation.

Instead of the massive anticipated rally associated with all the other increases in the chance of a Bush presidency, the open today is a mere molecule away from unchanged.

Particularly noteworthy in the backdrop is the switch in the ideas that have been moving the market. In previous days, 5% declines in the Nasdaq were common as sparrows in the park -- a state of affairs that assuaged the envy of all the old-hearted who missed the 10-fold increase over the previous decade.

Nowadays, after the Nasdaq's rally since its Nov. 30 low, any decline at all is newsworthy. Any Nasdaq slack, the mantra now says, is merely a ripple in the tide of inevitable ascent.

Weeble Stocks

One of the most heartening recent developments has been the reaction of stocks of companies that issue earnings warnings. Before this month, an earnings warning was good for a 20% drop -- recall the reactions to Intel (INTC), which fell 22% on Sept. 22; Dell (DELL), down 19% on Nov. 10; Novell (NOVL), lower 19% on Nov. 22; and Gateway (GTW), down 36% on Nov. 30.

But stocks have now been beaten down so much that in some cases, earnings warnings have been producing spiky gains. Kodak (EK) and DoubleClick (DCLK) cut estimates yesterday, and their shares rose 4% and 16%, respectively. Intel started the trend last Friday when it rose 5% on a warning.

Last night, Compaq Computer (CPQ) came out with a warning. CMGI (CMGI) and FuelCell Energy (FCEL) are scheduled to report today; their stocks are down 53% and 34%, respectively, since the end of September. Comtech Telecommunications (CMTL) just reported earnings that matched expectations. Given the bullish sentiment prevailing relative to expectations, it would not be surprising if these stocks rose from the open today.

The Creamy Middles

On the other side of the spectrum, Interstate Bakeries (IBC), one of the most traditional companies of all, fell a nice 24% when it reported disappointing profits and warned that things wouldn't soon improve.

Interstate Bakeries, maker of Wonder Bread and Twinkies, is just the kind of brand-name company that the Sage of Nebraska loves, an untouchable comparable to the candy, brick, shoe and carpet makers that he can understand and thus feels appropriate to buy.

Recall that it was Mr. Buffett who figured prominently in setting the stage for the Nasdaq's battering this year by saying he would have been doing a favor to the world by shooting Orville Wright, since the invention of the airplane had resulted in a competitive industry in which many companies had gone out of business. He thereby cleared the way for Judge Penfield Jackson to bash Microsoft (MSFT) with impunity.

The Odd Couple

How ironic that the two richest men in the world are bridge, burger and travel buddies. And yet the ideas of the one, if brought to their natural extension, would lead to the ruination of the other. The importance of a rudder of philosophical belief to insulate one from the minutiae of the daily fray is underlined, not only for running a business but also for investment itself.

While we are averse to recommending the shorting of a stock, we cannot resist noting that the Sage's investment company, Berkshire Hathaway (BRK/A), is up 27% this year, a high for the year and within 15% of its all-time high in 1998. To us, Berkshire consists of a fine insurance company responsible for all its success, and a ragtag collection of old economy companies and holdings in makers of good brands of the kind that your average mediocre mutual fund is laden with.

We can't resist recording our impression that Berkshire would be a great candidate for those famous short-long pair investments that the Harvard University investment managers are so partial to, offset by the purchase of a good financial stock like Goldman Sachs & Co. (GS) or Morgan Stanley Dean Witter & Co. (MWD).

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S&P 500	0.90	Down 1	-6.7	2.6
Nasdaq	0.96	Down 1	-28	7.2
Europe STOXX-50	1.08	Down 1	2.0	1.8
Dollar/euro	0.84	Up 1	-15	2.7
Nikkei	0.79	Up 2	-20	3.1
Dollar/yen	0.97	Down 1	-13	-1.4
Gold	0.70	Up 1	-5.9	0.5
Oil	1.29	Up 2	64	-13
Bond Futures	1.19	Up 1	14	1.8
2-Yr Note Futures	1.07	UnChg	1.6	0.4
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A Sliver of Light in a Calm, Dark Market

By Victor Niederhoffer and Laurel Kenner

Columnists

12/14/2000 10:14 AM

The market was relatively calm on the surface yesterday. The Dow closed little changed, the S&P 500 fell less than 1% and the Nasdaq lost 4%. But those placid numbers hid an iceberg of great power and danger.

The market opened strong on the winds of the news that the US Supreme Court had halted the hand rechecking of ballots in Florida. But by the close, the S&P futures had fallen 2% and the Nasdaq 100 managed to lose 6%

Despite last night's sportsmanlike concession speech by Al Gore, with poetic allusions to his service from Vietnam to the vice presidency, the market is set to open down half a percent at the open.

What a world of disappointment is submerged in this reaction to the news that the market had seemed to hope for the most.

Even worse, Germany's DAX is down 1% this morning, trading just a stone's throw away from its low for the year -- down 18% for the year in dollar terms. Japan's Nikkei is down 28% in dollars and the yen is at a one-year low.

"If the Nikkei falls down past 14,500, it could be the start of something terrible," said our Vegas correspondent "boyplunger," equally adroit at gambling, Maori dancing and yen trades.

(Laurel's note: Vic has momentarily left the room, and I cannot resist noting the negative gravitational impact of Asia-Pacific market declines. South Korea, down 50%; Taiwan, down 40%; New Zealand, down 30%; Indonesia, down 53%; the Philippines, down 47%. And -- as I look around three times to make sure Vic hasn't returned -- Thailand is down 51%. Under the circumstances, the 20% declines in India, Singapore, Mexico and Brazil, and the 30% decline in the Nasdaq Composite, look positively benign. Oops, got to go; he's back, and I had to put the S&Ps back on my monitor.)

Charlie Says

Most distressing of all are the actions of the one man whom the Sage of Nebraska clearly values as the most astute investor he knows, the man who persuaded the Sage not to invest himself into oblivion with small farm equipment makers, noncompetitive steel distributors, decaying regional department stores and other below-book-value "values" that could never be sold. The very man, as Mary Buffett writes in Buffettology, who persuaded him to "focus on the more sophisticated philosophy of purchasing excellent businesses at prices that made business sense, instead of seeking only Graham-type bargains."

Yes, Charlie Munger himself has recently expressed his own views on the market. From Nov. 10 through Nov. 15, he sold \$19 million of Berkshire Hathaway (BRK/A) shares. Doubtless for estate planning only.

All this would be truly discouraging if it weren't for one overriding fact. The interest-rate environment is extraordinarily favorable. Bonds rose almost one point yesterday, and are at their highest level since October 1998, when the Fed cut rates after the near-collapse of Long-Term Capital Management.

(Where were they one year earlier, when Vic was in Thailand?)

The feedback effect on stocks is extraordinarily favorable. Indeed, we have just plugged in the Spec computers, and they indicate that on the 25 most similar occasions to the current one vis-à-vis the recent moves in stocks and bonds, the S&P 500 has been up seven days later 100% of the time, with the average move four or five days later being a pleasant 3%.

We are also happy to report that down moves at the open similar to the current on a PPI reporting day are extraordinarily bullish, with the moves seven or eight days later averaging up about 4.5%.

Inside Insider Trades

With that in mind, we looked through the latest insider filings for possible buys. We found buying in Pinnacle Holdings (BIGT), a real-estate investment trust (REIT) that rents space to wireless communication providers. Pinnacle's stock is down 77% this year, giving the company a market value of about \$460 million.

There has also been buying in Transmeta (TMTA), down 38% from the high it set Nov. 7, the day of its IPO. The company, valued at \$4 billion, makes chips for laptops and mobile Internet computers.

We also spotted a 1,000-share purchase by the chairman of XOMA Ltd. (XOMA), a biotech that's developing a psoriasis drug with Genentech (DNA). Frank Linet, our biotech-research correspondent, says the company is well-managed and has a rich pipeline.

A few days ago, we reported that Craig McCaw bought 600,000 shares of XO Communications (XOXO). Turns out he wasn't the only one. Buyout billionaire Theodore J. Forstmann, who already owns more than 10% of the broadband communications-services company, bought 150,000 shares between \$14.88 and \$19.63 on Nov. 21 and Nov. 22. XO rose 83% in the past four days, so we don't advise buying right now.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	1.07	Up 4	-6.1	1.6
S&P 500	0.89	Down 2	-7.4	1.3
Nasdaq	0.95	Down 2	-31	4.3
Europe STOXX-50	1.07	Down 2	1.6	1.7
Dollar/euro	0.83	Down 1	-15	2.0
Nikkei	0.80	Up 3	-20	4.6
Dollar/yen	0.96	Down 2	-14	-1.3
Gold	0.70	Down 1	-6.6	0.9
Oil	1.28	Down 1	58	-17
Bond Futures	1.20	Up 2	15	2.2
2-Yr Note Futures	1.08	Up 1	1.8	0.4
Bund Futures	1.11	Up 1	5.2	1.0

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*.*

Laurel Kenner is a financial writer in New York City. Formerly head of US stock market coverage at Bloomberg News, she previously reported on police, politics and aerospace during her 17-year news career.

Laurel has a long position in Transmeta. Positions can change at any time.

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In an Uncertain Market, Some Guarantees

By Victor Niederhoffer and Laurel Kenner

Columnists

12/15/2000 09:08 AM

After penetrating 3,000 on Monday, Nasdaq 100 futures have fallen 4% a day. On Thursday, they closed at 2627, just 3% above their low for the year.

With the expiration of options today as well as the announcement of Consumer Price Index figures, the market should be particularly volatile.

During 40 years of trading commodities, bonds and stocks, Vic has recorded hundreds of observations on the market's vicissitudes that seem "guaranteed to happen". Today we present a few of them as a respite from the ups and downs.

Since we began writing together in January this year, we've become ever more convinced that no one or two speculators can embrace the total knowledge of the market. To the contrary, we are ever more impressed by the scope and depth of our readers' insights and know-hows. We therefore encourage everyone to send "Guaranteed to Happen" observations to Laurel. We'll reprint the ones that strike a chord and reward the best with canes for hobbling down to Wall Street in times of panic, as speculators have always done.

Guaranteed to Happen:

The market will try to scare you out before going in your favor.

When a broker receives orders to "sell at any price," he will quietly start buying for his mistress's account.

If a stock keeps going up after seemingly terrible news, a big advance in price or an acquisition at a rich premium is probably in the cards.

When an executive sells half of his stock after a 300% run-up, he will answer a reporter's query as follows: "My reason for selling had nothing to do with the company's prospects; it was merely related to estate planning/an alimony settlement/my children's education."

When the first companies start issuing warnings in the last month of each quarter, the market will jerk down drastically, regardless of the fact that earnings for the overall economy will come up 20% for the quarter.

A company that's late in reporting quarterly earnings will disclose an unpleasant surprise.

Junk bonds that take a quarter of an hour to acquire will take more than a lifetime to sell.

After the Nasdaq suffers a 5% drop during the week, the old-hearted gurus and columnists who missed the 10-fold appreciation will warn of an imminent 50% decline.

The morning after the S&P takes more than a 30-point decline, chances are two in three that Abby Cohen will issue a bullish forecast predicting that the market will end up 10% on the year.

The implied volatility of index options will rise three points in the 15 minutes before a star Nasdaq 100 company issues an earnings warning.

When a high-flying stock is down more than 90% for the year and the last 10 insider trades were sells, that stock is down for the count.

After a big decline in the Nasdaq 100, you will receive three calls from the restaurants for which you're on the waiting list, saying they can fit you in tonight.

The day after the market takes a horrible decline, it likes to register a nice open, shoot down to the previous day's lows and then close at the highs.

The leading business magazine's cover will be "The End of Tech" just before the absolute bottom.

People who can see the trends in technology will make the most money in the market.

When Thailand goes down overnight after seemingly bullish earnings news in the U.S., fasten your seatbelt.

On days the DAX is up more than 2% by 8 a.m. New York time, bulls can rub their hands and start counting their winnings. When the DAX and the bunds get killed before the New York open, look out in San Jose.

The best tell that the dot-com bubble was about to burst was a cover story in Fortune on the \$250,000 starting salaries of Stanford MBAs joining the hot venture capital companies.

The performance of stocks is directly proportional to the number of stories in the prior month that contain the word "correction" and inversely proportional to the number that contain the word "surge."

You'll cut your face when you shave in the morning of the day that the Dow declines more than 300 bucks.

The year after a company is named one of the 10 best-managed in the U.S., it will suffer at least a 50% decline.

If any market has suffered a correction, the pundits, shaking their heads, will note that more than half of all stocks are down more than one-third from their highs.

A mutual fund manager in the bottom half will point out that except for the three largest gainers in the Dow, the average would actually be down for the year.

One day after the market receives the news it was hoping for the most, it will start a vicious decline.

The professional investor you know with the worst record of all will get very upset if you reveal his picks to your friends.

Immediately after you place a large sell order, your broker will call you, "Goldman offering 1,000 ahead

of you."

When you place an order in the futures pit and it does not immediately move 1% against you, your broker will call you to say: "Locals only; very quiet."

The consensus of bullish investment advisers is correlated 99% with the move in the market the previous two weeks.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	1.06	Down 1	-7.2	2.5
S&P 500	0.89	Down 3	-8.7	2.0
Nasdaq	0.95	Down 3	-33	5.0
Europe STOXX-50	1.06	Down 3	-0.6	1.7
Dollar/euro	0.84	Up 1	-14	1.9
Nikkei	0.79	Down 1	-21	1.9
Dollar/yen	0.97	Up 1	-14	-2.0
Gold	0.71	Up 1	-6.3	-0.2
Oil	1.26	Down 2	53	-18
Bond Futures	1.21	Up 3	15	1.9
2-Yr Note Futures	1.09	Up 2	1.9	0.4
Bund Futures	1.12	Up 2	5.3	0.5

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Bullish Speculators as Battered as the Knicks

By Victor Niederhoffer and Laurel Kenner

Columnists

12/18/2000 08:44 AM

Welcome to the 455th consecutive edition of Stock Talk! This weekend's session was held at Madison Square Garden on Friday, when the Knicks scored their lowest point total since 1992.

We had no idea when we chose the venue how appropriate it would be. That afternoon, the S&P had closed at its lowest level since Oct. 28, 1999.

There was great depression among the spectators that the Utah Jazz, led by Karl "The Mailman" Malone and John Starks -- two guys approaching 40, with a total age rivaling Vic and Laurel's combined -- could humiliate the Knicks with an 89-58 game.

As Troubled as the Knicks

Truth be told, the Speculative Duo were feeling some empathy for the Knicks. After all, Vic and Laurel have been touting the growth stocks all year as great ways to invest in the future, and their friends know not to mention that the S&P Barra Growth Index is down 20% this year, vs. a 2% gain with reinvested dividends for the Value Index.

We overheard a few snatches of their conversation as they sat at the edge of the court:

"Laurel, I'm beginning to feel like the old-hearted columnist at the leading financial weekly who was bearish for 10 years and talked such a good game that he kept enormous numbers of good people out of the market."

"Don't talk like that, Vic. Nobody who knows you thinks you're old-hearted."

"But our \$5 companies are down, and we've told people far too often this year to take out the canes and hobble down to Wall Street."

"Even I am beginning to have doubts, Vic. The economy is slowing, profits are diminishing, people who got blown out of the market aren't going to be spending as much."

"I'm bullish, Laurel."

"Oh, Vic, not again! Are you sure?"

"Yes. Remember last week the market fell from the open almost every day, and how it loves to confound as many people as possible by doing the opposite of what's most vivid in their memories. And stocks have a 75% chance of a rise on the Monday and Tuesday of a Federal Open Market Committee meeting week, with an average change of up 2%. The long bond is yielding 5.41%, the lowest all year. My computers say there's an expectation of a 3% to 5% gain over the next 10 days. Trust me, things are different this time."

"Well, maybe ease in gradually?"

couldn't you tell him to at least throw some economic numbers in those patterns? It would make me feel better for your sake.

As for me, I'm buying Apple (AAPL). The semiannual Mac World conference is in January, and Apple keeps good news secret to announce then. If you look at what happened from Dec. 15 through Jan. 31, you'll see that the stock has gained 11 of 15 times. Since Steve Jobs returned to head the company in 1997, the effect has been 3 for 3. Jobs is quite a showman.

1999: 48 ½ to 52

1998: 17 to 20 ½

1997: 7 to 9

1996: 11 to 8

1995: 17 ½ to 14

1994: 18 ½ to 20

1993: 15 to 16

1992: 28 ½ to 30

1991: 25 to 32

1990: 20 to 27

1989: 17 to 17

1988: 17 to 20

1987: 19 to 21

1986: 11 to 14

1985: 5 to 5

A fisherman must learn to be very patient, and I've been biding my time waiting to see you since our last dinner engagement when you hurriedly left to write your column. To put the fish right out on the table, Laurel, I'm ready to pack up the nets and hooks and be your collaborator in writing and stocks, now that the tide has changed. If I'm right, on Tuesday you'll see Doc Greenspan taking your advice and issue a loosening directive that will make stocks soar.

Can we talk things over at a fish dinner at Lundy's next Friday at the 456th Stock Talk!?

Yours truly,
Fish

For now, Trader Vic is back in Laurel's good graces along with the Knicks after they beat Milwaukee 100-97 on Sunday night. The Knicks went from down seven in the first quarter to up 16 in the third to down 10 in the fourth with 2 minutes and 47 seconds remaining, then won the game. As Vic observed: "Just like the market."

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	1.05	Down 2	-9.2	0.6
S&P 500	0.88	Down 4	-11	-0.2
Nasdaq	0.94	Down 4	-35	0.3
Europe STOXX-50	1.05	Down 4	-2.5	-1.5
Dollar/euro	0.84	Up 2	-13	1.9
Nikkei	0.79	Down 2	-23	-1.9

Some members of the audience recognized Vic and Laurel, and sent along notes. We reprint them here.

The first was a poem from a Daily Speculations reader in South Africa that seemed to be a hint:

*Down wind
Out of sight
Crafting patience
Eyes of bear observe
Walrus bathing on rocks of prosperity
Ravenous bear
Barely visible
Swims in Arctic
Walrus in panic
Circled by cunning
Pouncing predator
Fleshly feast
-- Jason S. Sweidan*

Next, there was a note from Fisherman Vic, whose letters to Laurel we reprinted here a few months ago. It seems he has been on a long trip to the West Coast and beyond, and now wishes to renew his acquaintance with Laurel, who left him during the dessert course during an interview so she could finish writing the next day's column.

Dear Laurel:

Forgive this intrusion, but you look so beautiful and have had such presence and grace in this down market that I mustered up the courage to write to you.

You see, I've been reading your columns by our Internet satellite hookup on the fishing boat, and you've been so good at assuaging the fears of readers. But when are you going to get rid of that collaborator of yours, Trader Vic? He's been calling for a rise in the Nasdaq and S&P ever since April. He keeps saying that low bond yields are bullish for stocks, but frankly, Laurel, the guys on my fishing boats are saying that line has a sinker at the end of it.

I didn't go to Harvard like Trader Vic, but I knew the jig was up early this year when all those Stanford MBA students started hiring out our boats for one-night charter parties at \$100,000 a pop. That's when I started shorting the Nasdaq. Now the Stanford students are back, but this time they're asking for jobs as cooks or fishermen.

Laurel, admit it. You're getting impatient with patterns and forecasts that are based on a handful of observations. In my business, we don't bring in the boat until we have a hold full of fish. You should tell your collaborator that luck is involved in most patterns, and that the luck part isn't repetitive, only the skill part.

Don't you realize that it's natural for things to end up at extremes at the close of the year? It's quite likely that bonds will end at a high and stocks at a low, just the reverse of last year when stocks were at a high and bonds at a low.

Of course Trader Vic is the best when it comes to trading futures every day. The boys and I have actually made a lot of money out there on the boat by trading on his short-term bearish calls. But

Dollar/yen	0.96	Down 1	-14	-1.3
Gold	0.71	Up 2	-5.9	0.6
Oil	1.27	Up 1	57	-11
Bond Futures	1.22	Up 4	16	2.6
2-Yr Note Futures	1.10	Up 3	1.9	0.5
Bund Futures	1.13	Up 3	5.7	0.9

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Speculators Still Betting on Year-End Surge

By Victor Niederhoffer and Laurel Kenner

Columnists

12/19/2000 09:24 AM

Like an embryo during gestation, the market yesterday recapitulated its development during the year. The Nasdaq opened with a 2% surge only to close down 1% on the day and within 1.5% of its low for the year. Ontogeny recapitulates phylogeny, as a biologist would put it.

At the close, the Nasdaq was down 35% for the year, and down 48% from its March 10 high. The Dow, for its part, closed up 2% for the day, a mere 9% from its all-time high.

Thus, as the first year of the new century wends its way to a close, all eyes are on the architecture of the market: the divergence between the worlds of value and growth, the superior performance of the financial stocks vs. the crash of the dot-coms.

We are still going with our forecast of a surge for the end of the year. The seasonals, the pessimism and the low level of interest rates all argue for this.

Remember that the first move by the Federal Open Market Committee is followed on average by a run of 10 consecutive moves in the same direction. Thus, the information content of the first qualitative change is extraordinarily high.

The always-political Doc Greenspan has been making noises about an easing, and he knows which side his bread is buttered on, especially after eating breakfast with the president-elect yesterday.

Lastly, European markets are way up as we go to press. FOMC meeting days are usually bullish, especially up to 2 p.m.

The qualitative take on today's FOMC meeting was well summarized by William Haynes, a humble, young-hearted senior who is our chief Fed analyst because of his expertise in plane design, aeronautics, biotechnology and the forces that keep humans young in spirit and vital in wealth.

After all, aside from the rulings by the Judge Penfield Jackson federal court, the main drag on the technology sector this year has been the aftermath of the slowing of the economy engineered by the Fed with its six consecutive raisings of the federal funds rate since June 1999.

Mr. Haynes' brief on the likely decision of the Fed and its 74-year-old, old-hearted chairman is incisive and forward-looking in the best tradition of the objectivity and hypothesis-generating analysis of the curious scientist. We report it here in full:

I'm betting on a quarter-point lowering. My arguments:

- No significant sign of inflation.
- Unemployment still very low but up a tenth last report.
- Numerous downsizings, and not just dot-coms.
- Venture capital drying up.
- Numerous earning reports down, and from top companies.

- Pre-Christmas sales reports disappointing.
 - Automobile sales down.
 - Geo. W. and Alan had breakfast together today, and
 - 1) The President-elect is sticking to his \$1.3 trillion, with a "T", tax reduction plan.
 - 2) That won't help liquidity until at least April 2002, even if passed this coming summer.
 - 3) Geo. W. must be highly motivated to avoid a "Bush Recession" in his first year, leading up to congressional elections of 2002.
- Ergo, he really leaned on A.G. to lower the rate. And A.G. does not want to start off on the wrong side of the man who's in charge of the country for at least the next four years.
- Bill

Readers Take Lead in New Stock-Picking Contest

Our new stock-picking competition officially began Dec. 1, and the readers are off and running. As of Friday, Dec. 15, the long portfolio was up 13% -- far ahead of the Nasdaq 100 (2%), S&P Midcap 400 (3%) and S&P 500 (unchanged). The short list gained 1%.

Although technology stocks this year have taken their worst drubbing since the '70s, techs dominated the long portfolio. Some readers cited value characteristics among the reasons for their tech picks.

One gold stock -- TVX Gold (TVX) -- and one tobacco stock -- U.S. Tobacco (UST) -- made the long list. One reader chose the Prudent Bear Fund (BEARX).

Two winners from our first contest entered again. Jim Daniels, whose job as scientist with a big telecom equipment company requires him to evaluate a wide range of products, put his chips on (RMBS) again as his long. Jim shorted IDEC Pharmaceuticals (IDPH), saying that the pharm bubble will pop sooner or later.

Jack Tierney, another winner, chose Infospace (INSP). "Naveen Jain, the CEO of Infospace, reminds me of the Ted Turner of old: brash, intemperate and wildly optimistic about his company ... and, generally, right on the money," Tierney wrote.

Tierney's short pick is Tribune Co. (TRB), of which he had this to say: "The latter merely accelerated its death spiral with the purchase of the LA Times and affiliated companies. Additionally, increasing technology problems, dwindling readership, a huge increase in debt, and a remarkable shrinkage in its investment portfolio (both in value and quality) bode ill for the future."

The short list is a motley group that includes a doughnut company, a newspaper company, a steel maker, a dressmaker and Coca-Cola (KO). To our surprise, only two tech stocks, Handspring (HAND) and Emulex.(EMLX) were submitted as shorts.

The contest ends May 31. We'll throw a party for the group that does best. The individual with the biggest gain from each group will be treated to a fish dinner and a cane for hobbling down to Wall Street in times of panic.

Given the sophistication and thoughtfulness of the explanations accompanying the contest entries, we suspect it will be a close race.

We were particularly heartened to receive an entry and note from a young-hearted 84-year-old speculator, Al "the Zipper." He writes:

"I read about your other distinguished members of academia, all learned, astute and erudite, who contribute to your columns, and wonder if this eight-something son of Italian immigrant parents – one of seven children – should dare to trod the turf where so many of your learned, faithful readers have shared their thoughts and wisdom.

P.S. If I should be lucky as to win a cane, I visualize that it would be extremely useful for probing the droppings around the NYSE, Amex and OTC Dumpsters, such as Xerox (XRX) at 7, Ampex (ACX) at 3/4 and China Continental (CHCL) at 11 cents. The last one, CHCL, is the Mother of all Specs. Its price is about half of its earnings and its P/E is about 0.5. Hope I haven't bored you."

No indeed, Al. You haven't bored us. In fact, we're sending you a cane just for writing.

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The Market Keeps Messaging

By Victor Niederhoffer and Laurel Kenner

Columnists

12/20/2000 10:31 AM

The market gave its worst performance on a Federal Open Market Committee meeting day ever, leading one of our readers, Mr. Peter Daniels, to urge us to "forgo all the minutiae and concentrate on the important stuff, so that you can finally get the direction of the market right for a change."

In such circumstances, it's best to read a book.

We therefore asked our friend Paul DeRosa, an economist who has been for some four decades both a highly successful participant in the market and a discerning observer of it, to review *The Message of the Market*, by CNBC reporter Ron Insana.

Paul did his [first review](#) for us earlier this month on the story of Long-Term Capital Management. We think you'll find his perspective on the stock market equally worthwhile, as well as timely.

– Laurel Kenner and Victor Niederhoffer

Opening a book by Ron Insana, a reader would justifiably expect to encounter an extension of the author's television persona -- genial, fluent and optimistic. In the case of *The Message of the Market*, that reader would not be disappointed. The book reads like a long session of swapping anecdotes and investment ideas with a knowledgeable friend, which, one suspects, is exactly the impression Mr. Insana intended to convey.

The author adds weight to his effort by stating his intention teach us to look behind market prices and to divine "the market's message, not just its movement." As a device for motivating his story this thesis works reasonably well, but it also puts Mr. Insana at some risk. It happens that the subject of the information conveyed by market prices and the way markets serve to economize on information is one of the deepest in the entire economic literature. It has occupied the exertions of economists from FA Hayek to James Tobin, which probably is not the company Mr. Insana meant to keep.

The Great Unknown

Without venturing out too far, one can get the flavor of this subject by considering the question of who knows how many computer-chip factories are needed in the US in the year 2000? The answer is no one knows. Like the number of Florida voters who intended to vote for Albert Gore, the number is essentially unknowable.

Thanks to the equity market, however, no one needs to know it. Investors collectively digest the dynamic of supply and demand for microchips and bid up or down the cost of capital to chip companies.

By raising the market value of another chip factory well above the cost of constructing one, the markets induce managers to expand until there is sufficient capacity to produce the chips the economy needs. The number of plants isn't always perfect, but the adjustment moves in the right direction, and it incorporates the best available consensus.

This statement may sound obvious, but bear in mind that centrally planned economies fail in good measure because they deprive themselves of the information imbedded in market prices. They invariably have an individual or group who pretends to know the required number of shoes, bulldozers or computer chips. The consequences of this pretext are shortages of some items and gross oversupplies of others — a result that is comical for everyone except the manager of the computer manufacturer, who has to buy a bulldozer in the hope of bartering it for microchips.

The Info Is the Thing

Mr. Insana is concerned with neither high theory nor the price of microchips. He wants to talk about asset markets and the useful information they convey.

"What," he asks rhetorically, "if you did pay attention to what the market says, not just what it does? Would you be better off? Would your investments be better protected? Would you make better-timed big-ticket purchases or even save some money on gasoline or heating oil or food?" The immediate continuation of Mr. Insana's literary career, of course, demands these questions be answered in the affirmative.

He later points out that, "At each stage of the economy's development, the stock market sends important messages about prospective winners and losers in the struggle for economic viability." That is to say, a high stock price today means economic supremacy tomorrow. Maybe.

Thus begins a broad summary of the great equity market events of the twentieth century, with an explication of their messages. The Great Crash of 1929 foretold the Great Depression; the rise in the stock of Radio Corporation of America after 1920 portended the dawn of the communications age; the wasting away of value in stocks like Bethlehem Steel signaled the end of Big Steel. And so on.

None of these stories is particularly new, but they are engagingly told, and there's a pleasant nostalgia in reliving the great moments of financial history.

A Trader Behind the Writer

Mr. Insana is not completely content with the role of historian, however. There's also a stock player lurking behind that pensive façade. As a result, though he parses the market events for their messages, he can't resist a search for signs that might have foreshadowed the events themselves.

The Crash foretold the Depression, but what little-seen clues signaled the Crash? We end up with a bit of a swirl, with the market presaging the future and pregnant signs hinting at the market. At some point, one begins to suspect 20/20 hindsight has come to play.

While the tone of *The Message of the Market* is consistently upbeat, its author is no Dr. Pangloss. He readily admits the message in the market is at times Delphic and not easily discerned. Bubbles send out misinformation, so while it is generally advisable to take work with a company whose stock price is rising, it isn't always the case. Ask Heidi Miller, who bolted from Priceline.com (PCLN) last month.

When it comes to current conditions, Mr. Insana similarly demurs the role of cheerleader. He is as prepared as anyone to embrace a technological future, but he will not pay dear prices for tech stocks. The Japanese stock market in the 1980s, he says, was the bubble of the time, and the market value of Nasdaq alone last March exceeded that of the entire Tokyo Stock Exchange at its peak. The reader is left to finish the syllogism.

An economist reading *The Message of the Market* cannot help feeling Mr. Insana resembles the

fisherman who threw out his line expecting to pull up flounder but hooked into a giant tuna instead and is holding on for dear life. Most readers, thank the gods, are not economists and are free to enjoy the book for what it is — an amiable run through some of last century's more important events. Whether or not they learn anything of lasting value will depend upon them. The study of history is always edifying, and for the reader who is not a student of financial history, the book cannot help but impart valuable perspective.

There is, however, one howler that cannot be ignored, if only because it appears on the first page of the first chapter and is doubtless a result of hasty editing. The emeritus professor at MIT and holder of the Nobel Prize in economics is *Paul* Samuelson not *Robert*. Robert Samuelson is an excellent financial journalist but is on no one's short list for the Nobel.

(Paul DeRosa began his career in the securities industry as the money market economist in Citibank's bond trading division. He later became the bank's chief proprietary bond trader and subsequently was named head of Citibank's financial derivative and capital markets businesses in North America. In 1986, Mr. DeRosa joined E.F. Hutton Co. as co-head of bond trading with particular responsibility for mortgage trading and finance. In 1989, Mr. DeRosa helped to establish Eastbridge Holdings Inc., a bond and currency trading company in New York, where he eventually served as CEO. Mr. DeRosa holds a Ph.D. in economics from Columbia and has served as a staff economist for the Federal Reserve Bank of New York.)

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Questions Multiply, Answers Dwindle

By Victor Niederhoffer and Laurel Kenner

Columnists

12/21/2000 09:38 AM

Like a river swollen by a 25-year storm, the market on Wednesday continued its downstream rush, devouring trees, small animals and profits. The Nasdaq closed below 2,500 for the first time since Aug. 10, 1999. The Dow clung to a perch a perilous 318 points away from 10,000. S&P 500 futures dropped 38 points, the worst loss since the dreadful day of April 14.

Our e-mail boxes, usually buzzing all day long, were ominously silent until toward the market close, and then the notes began to pour in. "When will this carnage end?" "Is there any sense to this insanity?" "Why don't you calculate how low all three indexes could go?"

In addition to those questions -- unanswerable, at least by us -- we received some practical queries and observations.

Dear Vic and Laurel,

Let me simply state that any investor, trader, speculator, gambler, or betting man who has entered financial markets, assuming this person is not a four-flusher and a liar, has at one time lost money. Simply put, the position went against him. Many readers have probably lost some money in this latest Nasdaq drama. If they have not, then they are A) probably not moving around very much money, or B) they will inevitably lose money sooner or later or C) are a cheater and a baby. Fact: Investing cannot be done without some, hopefully small, losses. Would you discuss in your column strategies for cutting losses?

Is there any way an investor can protect himself? Peter Lynch once aptly said: "Show me an account with 10% stops and I'll show you an account that will lose exactly that much." True enough, but an account with no exit strategy could be equally debilitating. How much profit should one give back? Can one protect oneself with a low P/E strategy?

When should you sell?

This, my friends, is the question of the hour.

Signed,

Bottom Fisher

J.P. Morgan used to say that one should "sell to the sleeping point." If you stay awake worrying, take action.

In practical terms, sell when you're 20% or 25% down from a high.

As to when the carnage might end, we received this discerning observation from our friend Dick Sears:

So often lately one hears statements like: "This can't be the bottom. Too many people think it is."

At some point, don't contra-indications become contra-indicated? If the conventional wisdom is always wrong, and everyone knows it, doesn't the situation reverse itself as we all rush to make use of the (mis) information?

And in Similar Years

http://www.worldlyinvestor.com/print.cfm?article_id=13703

12/22/00

Duncan Coker got tired of watching the stampede, and laudably decided to do some counting. Mr. Coker looked at what happened in January after a year in which the low came in November or December:

"I found four cases -- 1957, 1971, 1973 and 1987. In three out of four, the market was up the following January. The one down January year was 1974."

Vic's former partner Steve Wisdom reports another diversion for the market-weary: a new parlor game, "Class-Action Bingo":

"List major Lerach-type law firms on the X-axis, stocks down >75% on the Y-axis, draw in the grid. Players scan daily press releases for actions filed."

The law firm to which Mr. Wisdom refers, Milberg Weiss Bershad Hynes & Lerach LLP, has conveniently set up a Web site, milberg.com, should you wish to participate in the game or learn the latest company being sued by shareholders.

The Fed Problem

Diversions aside, we all sooner or later must pay attention to the problem at hand. It is, of course, the Fed. If Doc Greenspan had heeded our advice to give up central banking and take Patrick Ewing's place on the Knicks, the team and the market might both be doing better.

We still have the basketball shoes that the Doc's PR department sent back to us, and would be happy to resend them if he does decide to take the plunge into a new career before further damage to his reputation as the Great Helmsman.

As the barbecue-loving Virginia Tech finance professor Mark McNabb wrote:

"The Fed was late in '90 and '94 to turn from tight to ease, and too loose in '99 for fear of Y2K. They trade the economy with all the precision of picking closing prices in this market.

"Seems idling auto plants, lowered revenue at appliance companies, and layoffs and consolidation in finance and consumer products companies, increased debt allowances throughout the economy and the slow Christmas season, plus higher energy prices serving as a form of rate hike would argue for increased concern by the Fed.

"But the 'ideology' of going from inflation bias to deflation watch is unfathomable to the Fed, and thus no cut. They could wait until early January and then look at data they've already observed and grant a cut with the statement they are being responsible to the threat of recession. Thus, independence is preserved and the fight vs. nonexistent inflation ends.

"In naming stocks, you could mention many retailers that have been halved, which are real businesses with people working long hours to earn a wage, rather than dot-commers getting massage therapy and surf vacations in Western Samoa.

"So whether Greenspan is stiffing the techs or not, he has done damage to Main Street. Many of the best-performing groups (health, finance, energy) are at prices from 1998, not exactly a glowing review of the government's growth policy. Remove GE (GE) and a few others from the market-weighted indexes others point to as validation of Old World economics, and you have a picture that damage was more widespread than just tech.

"My disappointment with big G is that he recited the productivity mantra, then went against it."

Bearing Small Gifts

The Federal Open Market Committee's three-paragraph statement on Tuesday was the most bearish on the economy within memory, while offering no reason for the decision not to cut rates. And that set off an orgy of Fed interpretation that one can only find pathetic and unseemly for a free people.

Bipin C. Pathak, enclosing one such contorted between-the-lines explanation that sought to predict when the Fed might make its move, wrote:

"This analysis reminds me of Sovietologists trying to gain insight into power struggles in USSR by examining the position on the podium during the May day parade."

We will refrain from speculating on what the Fed was trying to tell us. Instead, we note the insight of wrestling coach/hedge fund manager David Ciocca:

"Alan Greenspan and his fellow travelers have been pounding the table against consumer debt, equity growth, etc., for a long time. The 'irrational exuberance' speech was four full years ago. Now that the economy has begun to contract, seemingly rapidly, why are they not pounding the table in anti-recession rhetoric?"

"Pure politics. If they cut immediately, it gives the impression to the masses that they over-tightened last year, which is a big political negative. I remember him saying, 'We must act proactively against inflation.' Apparently proactivity only works one way -- when tightening through the roof in periods of low inflation under the guise of the Phillips curve and its zero correlation to inflation. But I digress. Let's not confuse testing theory with the Delphic Fed's decisions."

"Don't rule out deep-seated motives for this asymmetry in policy. When 'Doc' and his gang see tons of instant hi-tech millionaires who have made their riches without the pedigrees of honorary doctorates and zillion-page memos to one another on untested theories from the 1950s, there's bound to be some enjoyment in watching these serfs come crashing back to earth. My grandfather, a quintessential old-heart, just used to say 'I told you so.'"

"But the hero must be honored in the end. If we get some big deflationary economic numbers in the next couple weeks, they'll do the politically correct thing and cut before the next meeting quicker than you can say bar-be-cue."

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	1.04	Down 2	-10	-3.2
S&P 500	0.87	Down 2	-14	-6.4
Nasdaq	0.92	Down 7	-43	-17
Europe STOXX-50	1.06	Down 1	-4.4	-4.0
Dollar/euro	0.84	Up 1	-12	1.8
Nikkei	0.77	Down 5	-27	-6.5
Dollar/yen	0.95	Down 2	-15	-2.4
Gold	0.72	Up 2	-5.3	-0.7
Oil	1.26	Down 2	45	-12

Bond Futures	1.21	Up 1	16	1.5
2-Yr Note Futures	1.11	Up 1	2.2	0.3
Bund Futures	1.14	Up 1	5.7	0.4

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*.*

Laurel Kenner is a financial writer in New York City. Formerly head of US stock market coverage at Bloomberg News, she previously reported on police, politics and aerospace during her 17-year news career.

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Modeling Market History to Harness Future Moves

By Victor Niederhoffer and Laurel Kenner

Columnists

12/22/2000 08:28 AM

(Editor's Note: Brett N. Steenbarger, Ph.D. is a licensed clinical psychologist and periodic guest contributor to the Daily Speculations column. This is the second article in a two-part series examining cognitive aspects of trading.)

It is Wednesday, Dec. 20, 2000. The Nasdaq (\$COMPQ) is hitting yet another annual low, down over 7% on the day. Quality stocks are breaking down as well, including Cisco Systems (CSCO) and General Electric (GE). Already I have received several e-mails from column readers and colleagues, asking when the carnage will stop. Usually that has been a sign that we're near a bottom. But it's 3:30 pm EST and I need to decide if I'm going to wade into the market before the close. How will I make my decision?

As we saw in the [first column](#) in this series, market modeling is a discipline that allows decisions to be grounded in historical data rather than subjective bias. The essence of modeling is straightforward: identify past occasions similar to the present one and observe how the market behaved under those circumstances. If you have a significant statistical edge in those past circumstances, you may have some confidence for entering the present market.

Let's consider a very simple model. We'll say that I have two candidate predictors: the past five-day movement in the Standard and Poor's Index of 500 stocks (\$SPX) and the past five-day reading of the Arms short-term trading index (\$TRIN). My model says: I think future prices will be sensitive to the past five days' price action and the degree to which volume is flowing into advancing versus declining stocks over that time.

When I look at current five-day readings, I find that the S&P is down approximately 7% on a five-day TRIN of about 1.40. So I query my database, which includes all market action since 1965, to name all occasions where the market was down over a five-day period by at least 7% with a TRIN of at least 1.40. Interestingly, after eliminating any overlapping time periods (by selecting only the first day in any series of consecutive days), I find only 15 occasions where this has occurred. So I know that this is a rare circumstance.

On those 15 occasions, the next day's S&P was up 7 times and down 8 times, with an average change of minus 1.32%. The next week's S&P was up 10 times and down 5, with an average gain of over 2%. And 40 days later, the market was ahead 13 times and only down twice, with an average rise exceeding 5%. In other words, I don't seem to have an edge for the next day, but over a longer time frame there is a growing bias to the upside. If this were my only model, I might consider holding off and entering strength the next day.

Too Simple

In actuality, our models are apt to be more sophisticated than this two-variable example. John Wolberg, author of *Expert Trading Systems* (Wiley, 2000) explains, "We have done a lot of work with technical indicators and in fact are currently in the midst of such an effort. What has always been clear to us is that if technical indicators have any value, it is always in a multidimensional space. Any single indicator that has value is very rapidly discovered and then ceases to be useful."

Dr. Wolberg notes that, in his book, he examined model-based trading using indicators provided by Barra (BARZ). "The results far exceed a buy-and-hold strategy for the S&P for this 13 year period," he observes. "Even taking trading costs into consideration, the results are still much better than buy-and-hold."

As we add predictors and increase model dimensionality, however, there is a mushrooming risk of creating models that are overfitted to the historical data. I asked Neal Falkenberry, founder and chief investment strategist for Autumn Wind Asset Management, Inc. and general partner of Autumn Wind Capital Partners, how he guards against this problem in his work with neural network-based modeling.

"It would take a book's worth of material to properly answer your question," he responded, "but I believe the short answer is to commit to a valid in-sample/out-of-sample testing approach that validates data by building a true out-of-sample, walk-forward track record. Too many neural network users train a model on two years of data, apply it for the next six months and make judgements on the outcome."

In his work, Falkenberry observed, "We typically train data over X periods, apply the next X/5 periods, then shift the entire data set forward and restart the process. We will eventually link many years of the walk-forward sessions together to get an output set that will be used for system development."

Wolberg agrees with the need to test model results from one historical period to other periods for validation. "When the number of predictors is high and the data set is not especially large," he notes, "the best approach is to look for subspaces with predictive power."

In fact, this is a good approach even if there is a large amount of available data. It is pure insanity to try and find a model that includes all the candidate predictors if this is a large number. The best you can do is limit the number of predictors to a value that can be supported by the data (for example, up to three dimensions) and then consider all the available three-dimensional spaces."

The Seeds of the Process

Through a process known as kernel regression (and described in his book), Wolberg is able to navigate these dimensional spaces (regions where the predictors intersect) and test each region for predictive power. Statistical significance tests, as well as out-of-sample testing, help to ensure that the output is not a mere artifact of overfitting.

Ultimately, modeling can be no more accurate than the data utilized by the investigator. This was a major motivation for Falkenberry's purchase of Tick Data, Inc. (tickdata.com). Using proprietary algorithms, Tick Data "scrubs" all data to remove "bad ticks," or inaccurate data values.

"Regarding the relationship of model output to data quality," Falkenberry asserts, "you cannot overstate the importance of using clean data. . . To be realistic, a trading system must be tested on intraday data to avoid the problem that end-of-day data has with regard to stops. Did the low or the high occur first? We test our systems down to the tick level to ensure we simulate a trading environment that uses stop and limit orders as is our practice."

David Aronson, professional options trader and expert in financial modeling, raises the sobering possibility that human traders may go the way of human chess players, replaced by "Deep Blue" computers capable of mining tons of data for nuggets of predictability. He also observes, however, that now as never before the software and hardware tools needed for modeling are available to individual traders. An excursion through the www.kdnuggets.com site will reward readers with a variety of tools that can aid in the development and testing of models.

Speculator's Scorecard				
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Dow	1.05	Up 1	-8.8	-1.2
S&P 500	0.88	Up 1	-13	-5.1
Nasdaq	0.92	Up 1	-42	-15
Europe STOXX-50	1.05	Down 2	-5.6	-5.2
Dollar/euro	0.85	Up 2	-12	2.8
Nikkei	0.76	Down 6	-29	-8.8
Dollar/yen	0.96	Up 1	-14	-1.7
Gold	0.73	Up 3	-4.7	0.2
Oil	1.27	Up 1	46	-9.7
Bond Futures	1.21	Up 2	16	1.7
2-Yr Note Futures	1.11	Up 2	2.3	0.5
Bund Futures	1.13	Down 1	5.5	0.4

Brett N. Steenbarger, Ph.D. is a licensed clinical psychologist and Assistant Professor of Psychiatry and Behavioral Sciences at the SUNY Upstate Medical University in Syracuse, NY. His primary research interest is multivariate behavioral modeling of the stock market. He welcomes comments and questions at steenbab@aol.com. He does not hold a position in any of the stocks discussed in this column. Positions may change at any time.

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Fishing in the Internet Waters

By Victor Niederhoffer and Laurel Kenner

Columnists

12/26/2000 09:29 AM

A Letter to Laurel from Fisherman Vic

Dear Laurel:

It was a pleasure to dine with you at Lundi's Friday at the 496th consecutive meeting of Stock Talk. How good and appropriate it was to be back at Lundi's, even in this much scaled-down version. Highly appropriate for the times. It seats 500 today versus the 2,500 when I sold it swordfish and oysters directly from my boat at Sheepshead Bay 25 years ago.

I was not surprised at all by the fantastic rally at the end of the week, leaving the S&P 500 futures up for the week, after they hit a low of down 4% on Thursday.

The Stanford boys who were shunning the jobs at old-line firms to take \$500,000 a year jobs at the venture-capital companies have finally come back to the sea. They are lining up all over Maine to get fishing jobs on the boats. But there's nothing for them there at all now. And that's why I'm here.

Risk of Retracement for Dow

It is rumored that Vic was seen tasting barbecue at the Salt Lick in Austin this week. Laurel, I hope you trade him in. Have him stay in Texas with Michael Dell and his stock down 70% from its high. They both apparently spent more time faking out their professors in school than learning, and in rough seas like this, the fish come back to spawn.

This is a time to get rid of those quantitative Speculations computers of the old Trader Vic. There is just too high a risk that the Dow will retrace the last two years' rise as the Nasdaq just did and end up around 9,000 to 9,500. I hope that I am wrong, but as my friend Dr. Andy Coulter from Long Beach who has been on my boat says, "Bear market trends tend to last for extended time periods, and affect virtually all sectors and indexes."

Under the circumstances, I would humbly suggest that the only quantitative analysis now appropriate is to figure out the optimal hedging methodology to protect a long portfolio.

For heaven's sake, put Vic back in the ocean or the frying pan where he belongs and use your great aesthetic powers and sensitivity to the nuances of the waves to guide your readers with me in a qualitative fashion.

Move from Quantitative to Qualitative

This isn't a market correction we have here, Laurel. This could be the perfect storm, or what Donald Coxe of Harris Bank calls a triple waterfall.

"The principle effect," he says is "to alter permanently the pattern of trading by destroying confidence in the market." The first was in 1929, the second was the collapse of 1973 to 1975 and the other one was the "triple waterfall that rolled the Japanese Nikkei from 1989 through 1995." Now it's the Nasdaq's turn, in Coxe's view.

And if it isn't clear to you now, Laurel, you're fishing where the schools of fish were biting in the previous years, not where Coxe and many others believe you should be fishing today. Laurel, like a rotten fish, Vic's beginning to smell. I am available to fish with you in these troubled waters.

Sincerely,
Fisherman Vic

A Letter to Laurel from Trader Vic on Insider Internet Fish

Yes, Laurel, I did go to Austin to study at the feet of David Buss, professor of evolutionary psychology at the University of Texas, Austin. Yes, I did have some great barbecue at the Salt Lick. Let me tell you why.

I didn't want to play the role of coming up with one bullish reason after another, while the market was going down. Too many of our readers have written in to describe the anguish they were caused by staying out of the market as the old-hearted Grigbufson group talked them out of buying stocks as the Nasdaq rise from 350 in 1990 to 5,000 a few beautiful months ago.

I felt even as I left that the markets were more bullish than I've ever seen them before. My reasoning at the most elementary level is that the ratio of expected growth of Nasdaq over the next five years compared to the long-term bond rate adjusted for the price/earnings ratio of stocks is at an all time favorable level. In simpler terms, the bond-to-Nasdaq ratio is at a three-year high.

But this sounds all too close to what the old-hearted were saying for the past 10 years about the ratio of stocks to gross national product, the absurd Tobin Q ratio that belongs in the dustbin of discarded 1920-style garbage popularized by retired colonels from the First World War days, of the kind that Alan Greenspan relied on in his consulting company.

So I went to Austin to learn about the universal tendencies of humans to suppress those below them in the social structure so that they can maintain their ability to procreate. Crickets, Laurel, have great recollection of their victories over other crickets in fights. And yes, Laurel, male crickets who have won become much more active in seeking the favors of female crickets.

Dawkins suggests that this be known as the Duke of Marlborough effect based on his double efforts at the Blenheim Palace with the Duchess after returning from the wars. I propose it be known as something else, which you can guess from the eponyms used above.

I won't burden you now with the current research on how the emotion of jealousy and envy tend to lead to the survival of the human. Suffice it to say that if one of our ancestors weren't sufficiently well-versed in this tendency to ward off competitors then neither you nor I would exist.

All I will say is that this seems to me the root cause of the irrational-exuberance movement that has so detrimentally affected stocks during the last year along with the hatred of successful business philosophy that also had the market in its grip.

But humans can conquer these tendencies. And economic rationality, the desire to buy a company that in five years will be selling at eight or 10 times its likely earnings, then will prevail. It's too attractive compared to a bond yield of 5%.

I have some very specific recommendations on individual stocks. I recently read the excellent book "The

100 Best Internet Stocks to Own" by Greg Kyle. It was apparently finished in April 2000, and since that time the average stock recommended has fallen by about 40%.

But I recommend the book and applaud the knowledge and analytical framework contained therein. I am impressed with Mr. Kyle's approach, which he describes as "start at the top, look at the big picture first, ask a number of key questions." The questions involve market share, quality of the income statement, burn rates, volatility of the stock and the risk of owning it. This is a very sensible and detailed approach quite comparable to the best that one sees in the typical high-powered white-shoe research report emanating from the Tiffany brokerage firms.

The only problem is that many of his recommendations in the Internet sector have been killed since then.

But therein lies the opportunity.

Many of the stocks have insider buying and I still go with my "Lobogola" theory of returns -- a trampling herd of elephants will return along the same path that it first passed; you have the choice of setting a trap for them on their return or getting trampled again. A good speculation is that these stocks will go right back to their old highs, just like the market did after October 1987 and so many times since.

Kyle recommends 100 Internet stocks as the best of the lot based on metrics of income statement and risk-related metrics. Here are the 10 with recent insider buying in the last month, down an average of 90% for the year:

Company name.....Symbol..... 2000 % decline

Etrade.....(EGRP).....-69%
 PSINet.....(PSIX).....-96%
 Double Click.....(DCLK).....-92%
 ITXC.....(ITXC).....-80%
 Rhythms Network.....(RTHM).....-97%
 Ameritrade.....(AMTD).....-62%
 Razorfish.....(RAZF).....-95%
 24/7 Media.....(TFSM).....-98%
 Expedia(EXPE).....-73%
 Cobalt Group.....(CBLT).....-83%
 Cylink.....(CYLK).....-82%

I don't own any of these now but I plan to buy all of them. Remember that fishing in troubled water is often dangerous and that many of these may not end with their bellies down.

Laurel, I will conclude with a report from Dr. Buss. Jealousy is an evolutionary strategy to cope with mate defection. The psychology of jealousy is designed to deter a romantic partner from "leaving or committing an infidelity." Of course, for the old-hearted human, the strategy of keeping the younger competitors down enables the ideas and position of the older-hearted to be propagated.

I am not going to demean myself by saying anything against the advice that fisherman Vic has given you to base your decisions on the qualitative abundance of Stanford or University of Texas graduates, what have you, looking for work.

All I can say is that you and our readers will have to decide whether you wish to throw my quantitative

spec computers out for the qualitative advice of Fisherman Vic.

Respectfully yours,
Trader Vic

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*.*

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Keep Your Qualitative and Quantitative Tools Handy

By Victor Niederhoffer and Laurel Kenner

Columnists

12/28/2000 09:16 AM

To the tune of *Can't Help Loving Dat Man* by Jerome Kern and Oscar Hammerstein II:

*Fish got to swim and birds got to fly
A Spec's got to test and quantify.
Can't stop counting those price moves now.*

A Letter to Fisherman Vic from Laurel

Dear Fisherman Vic:

First, I want to thank you for picking up the bill for our dinner at Lundi's for 267 speculators at last week's Stock Talk! session. It was very kind of you, and it cheered us to hear that you're doing so well in the swordfish trade. The newspapers make it seem like everybody's being fired or forced out of their stocks to meet margin calls.

Fisherman Vic, you seem like a direct kind of guy, and as you probably have noticed, I'm not the type of gal who has to be told to fish or cut bait. So I'll get to the point straight away.

In your note on Tuesday, you suggested that I throw out Trader Vic and his quantitative approach because his Daily Spec computers aren't calibrated for detecting really big storms. And you kindly volunteered to watch out for me in the troubled waters.

I did give some thought to your proposal. Any woman would do the same if a suntanned sea captain showed up on her doorstep with bubble-wrapped boxes of South Sea pearls and lots of good stories.

But to get to the bottom line, Trader Vic is here to stay. He's not the type of guy to just throw back in the sea, and he doesn't deserve to walk the gangplank. In fact, ever since he heard that you were on the scene making counteroffers to me, he has been studying up on fishing. He's out on a trawler down in Florida waters at this moment, and the Daily Spec listening posts say he has been hauling in some good catches.

I'll confess that I have had doubts about quantitative analysis. It seems like it often tries to fit moves as subtle as the phrasing in a Beethoven sonata or one of the heroic symphonies into an eight-bar time framework that only works with oompah band music and simple little songs. However, you can only analyze subtleties in retrospect. Not even Wynton Marsalis with his trumpet could improvise to a Beethoven sonata he had never heard.

Nor is nature itself perfectly symmetrical; it likes the interesting twist. For example, why is the heart on the left side of the body and not the center?

For purposes of speculation, though, and for giving subtle speculators a rudder to reach their own conclusions, the best hypothesis is that there will be an upbeat and a downbeat in the usual places.

And while Trader Vic hasn't been 100% right, he has put plenty of shrimp on the table this year.

He and those computers of his predicted the rallies after Memorial Day and July 5. Lately, he's taken to giving sell recommendations, which is new for him. Readers who heeded his advice to take profits on Calpine (CPN) and Idec Pharmaceuticals (IDPH) on Nov. 7, for example, would have saved 17% and 19%, respectively, in the following 10 days.

With great respect and sincere hopes for a continuing friendship,

Laurel

A Letter to Trader Vic from Laurel

Dear Vic,

Thought you'd enjoy this message from a reader:

Dear Vic & Laurel,

Please don't throw the baby out with the bath water. Keep those spec computers humming, they are the path that guides the way through the darkness. The qualitative path is often murky and it too is easy to lose sight of the trail. An enchanted reader,

Mark Benjamin

By the way, I heard from our mysterious and politically connected Mr. X yesterday evening. He says that by next week, everyone will have stopped talking about the slowing economy and will be focused on Bill Clinton's push for DC statehood. Think "Mayor Clinton."

Mr. X is very bullish through Jan. 20, Inauguration Day. Says Internet stocks will double. I asked him which ones, and he just said, take your pick.

Actually, the Bloomberg U.S. Internet Stocks index offers a remarkable spectacle of rampaging market elephants that Mr. LoBagola, that African Jewish writer you like, would have enjoyed. In 1999, one-fifth of them were up more than 90%; most of them weren't around yet. Almost one-third of the 275 stocks are down 90% or more this year.

The latest game in Seattle and Connecticut is to look up the wildly bullish analyst recommendations from a year ago on individual Internet stocks and see which of the stocks that once traded above \$50, \$100, \$200 or \$300 now trade for less than \$1 a share.

Speaking of Internet stocks trading below a buck, one of those 10 Internet stocks with insider buying you recommended on Tuesday – PSINet (PSIX) – is up 4%. (PSINet went for 60 a share in March.) Doubleclick (DCLK) also rose 4%. The portfolio as a whole is down 4%.

Watch out for rogue waves, and come back soon.

Laurel

Speculator's Scorecard			
Days Up/Days Down Ratio	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)

	(YTD)			
Dow	1.05	Up 4	-6.0	0.1
S&P 500	0.94	Up 4	-9.6	-2.3
Nasdaq	0.95	Up 1	-38	-10
Europe STOXX-50	1.07	Up 1	-4.4	-5.7
Dollar/euro	0.86	Up 5	-10.0	6.2
Nikkei	0.81	Down 1	-26	-7.8
Dollar/yen	0.93	Down 3	-16	-1.9
Gold	0.74	Up 2	-4.4	2.3
Oil	1.29	Down 1	49	-5.9
Bond Futures	1.21	Down 2	16	0.7
2-Yr Note Futures	1.12	Down 2	2.2	0.4
Bund Futures	1.14	Down 1	5.0	0.3

*Victor Niederhoffer is a private speculator specializing in futures and options trading. His positions often change during the day based on shifting market expectations and volatilities. He is the author of the best-selling *The Education of a Speculator*, which is available [here](#).*

Laurel Kenner is a financial writer in New York City. Formerly head of US stock market coverage at Bloomberg News, she previously reported on police, politics and aerospace during her 17-year news career.

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**Speculators End Year With High Hopes**

By Victor Niederhoffer and Laurel Kenner

Columnists

12/29/2000 09:15 AM

The market in the past five trading days once again outmaneuvered the old-hearted men who have declared victory for Old Economy stocks. Since reaching a low for the year on Dec. 20, the Nasdaq 100 is up 12% – more than double the 5% gains in the S&P 500 and Dow Jones Industrial average.

After the terrible carnage in tech stocks this year, seeing such an end-of-year rally recalls the panicked retreat of the French at Waterloo. But with speculators' corpses still strewn over the battlefield, we feel it inappropriate to crow in full cry just yet.

We received a missive from Capt. David Ciocca, however, that gives us some encouragement as to the outcome.

I looked at the number of times that the Fed has made an easing move after the previous move was a tightening move. It's only happened four times since 1987.

I then looked at what happened in the 12 months following this initial ease in the cycle in the S&P cash index.

<i>Ease Date</i>	<i>Following 12-month S&P Move</i>
9/29/98	21%
7/6/95	19%
6/6/89	13%
11/4/87	11%

Four observations don't make a conclusion, but we found his message suggestive.

Our optimism for the New Year is barely diminished by the forecast from our Daily Spec computers for today, the last trading day of the year. If the pattern of the last decade holds, the expectation is for a decline on the order of 0.3% today, with 90% certainty. (No patterns show up for the first trading day of the year.)

The extraordinary triple set of records for the Dow, S&P 500 and Nasdaq set last year on Dec. 31 makes us particularly wary, given the market's love for doing exactly the opposite of what is most vivid in the public's memory.

Not least, the weather forecasters are calling for a big snowstorm in New York.

When we began writing together early this year, we little suspected how much insight, humor and inspiration we would receive from readers of our columns. We therefore feel it appropriate to close the year by celebrating them by reprinting the best "Guaranteed to Happens" sent in response to our Dec. 15 piece.

Here are things that happen in the market that are....

GUARANTEED TO HAPPEN:

When your overnight bid at the lowest price you think has a chance gets filled in the first two minutes after the open, you are about to lose on this trade. – *Jim Holub*

When the markets have been in a free fall and have wiped out all the gains of the last year, Louis Rukeyser will remind you in his show's opening monologue that, after all, the market is still up 10% from two years ago. – *Jim Holub*

The market analysts who make a famously accurate market prediction will be wrong on their next three predictions. – *Bill Haynes*

The market will offer you a second chance if it realizes it forgot to get your money the first time. – *Henry Carstens*

After a market fall, when the news is bleak and looking bleaker, later on it will be clear that would have been the time to buy stocks. – *Terek*

We are sending canes for hobbling down to Wall Street in times of panic to Jim, Bill, Henry and Terek.

Our heartfelt thanks to all the many readers who shared their thoughts and expertise with us in 2000. You've made our columns surpass our highest expectations. Please keep writing. And to all, a very happy, prosperous and productive New Year.

Speculator's Scorecard				
	Days Up/Days Down Ratio (YTD)	# Days in Latest Streak (YTD)	% Change YTD	% Change (last 10 days)
Dow	1.06	Up 5	-5.5	1.8
S&P 500	0.95	Up 5	-9.2	-0.5
Nasdaq	0.96	Up 2	-37	-6.3
Europe STOXX-50	1.08	Up 2	-3.6	-2.8
Dollar/euro	0.86	Down 1	-10	4.4
Nikkei	0.80	Down 2	-26	-6.6
Dollar/yen	0.92	Down 4	-16	-2.0
Gold	0.74	Down 1	-5.5	1.0
Oil	1.28	Down 2	45	-4.9
Bond Futures	1.20	Down 3	16	0.2
2-Yr Note Futures	1.11	Down 3	2.2	0.3
Bund Futures	1.13	Down 2	4.9	0.02

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