

# Monthly Barometers, Investing in Dow Stocks

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# Overview

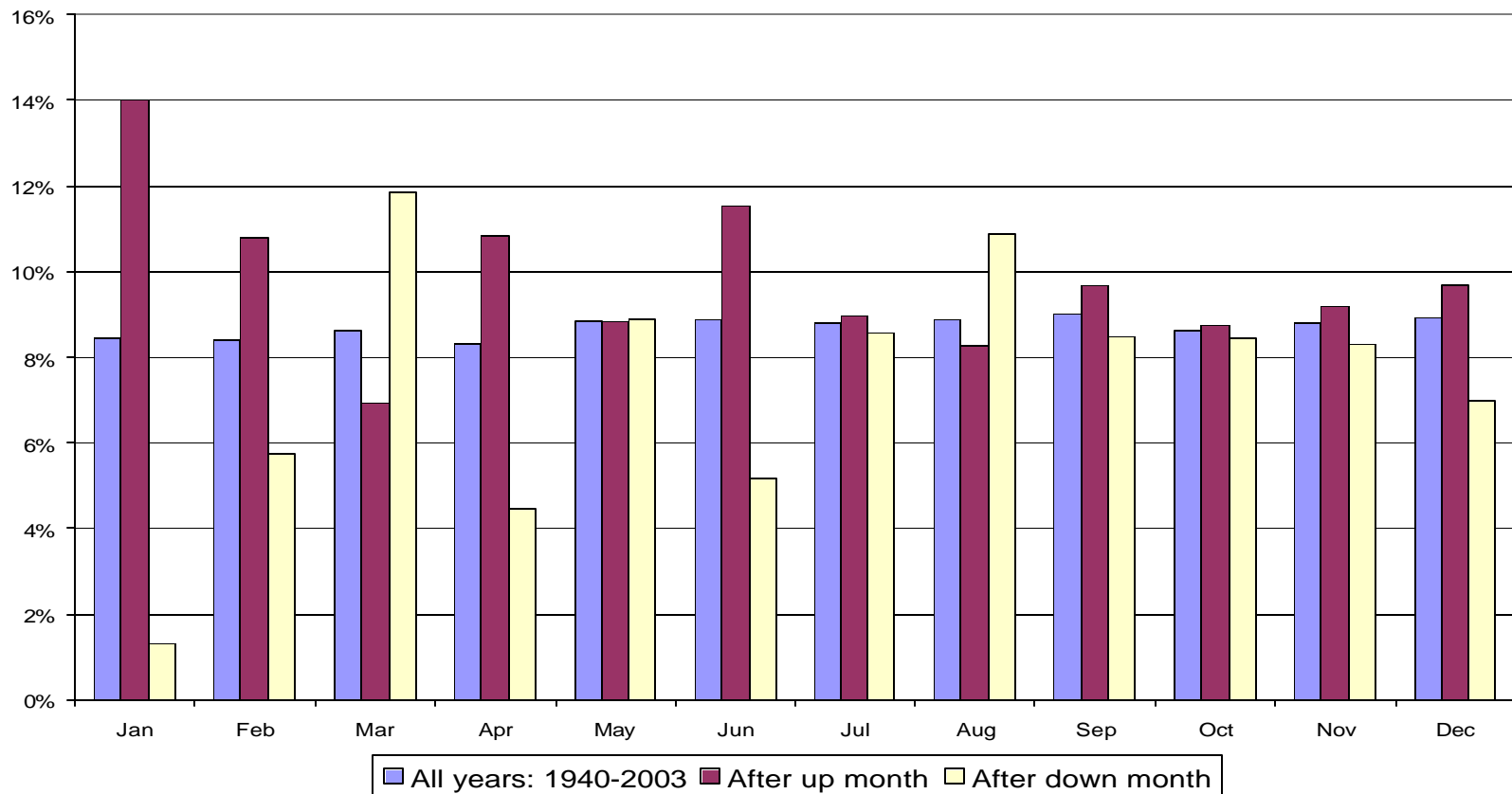
- Does “January Barometer” work for other months?
- Investing in Dow Stocks
  - Older “classic” books
  - More recent books/ideas
  - “Dow Turnarounds”

• NO RECOMMENDATIONS HERE

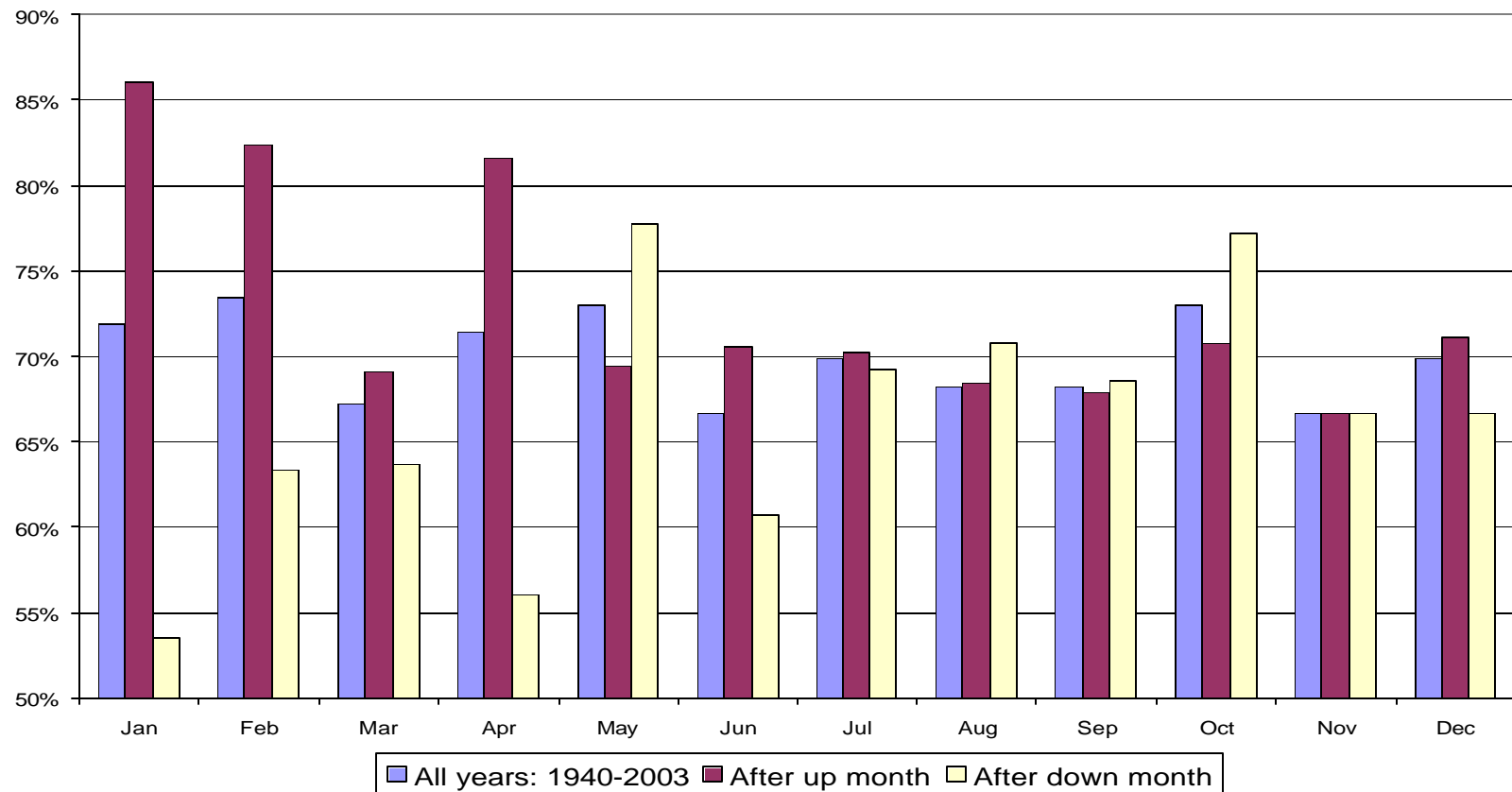
# January Barometer

- “As January goes, so goes the year”
  - After up January, gains are more likely and have higher average
  - Following 3, 6, 11, 12 months
- Test following 12 months for all months based on month’s direction
- Data: monthly S&P 500 1940-2003

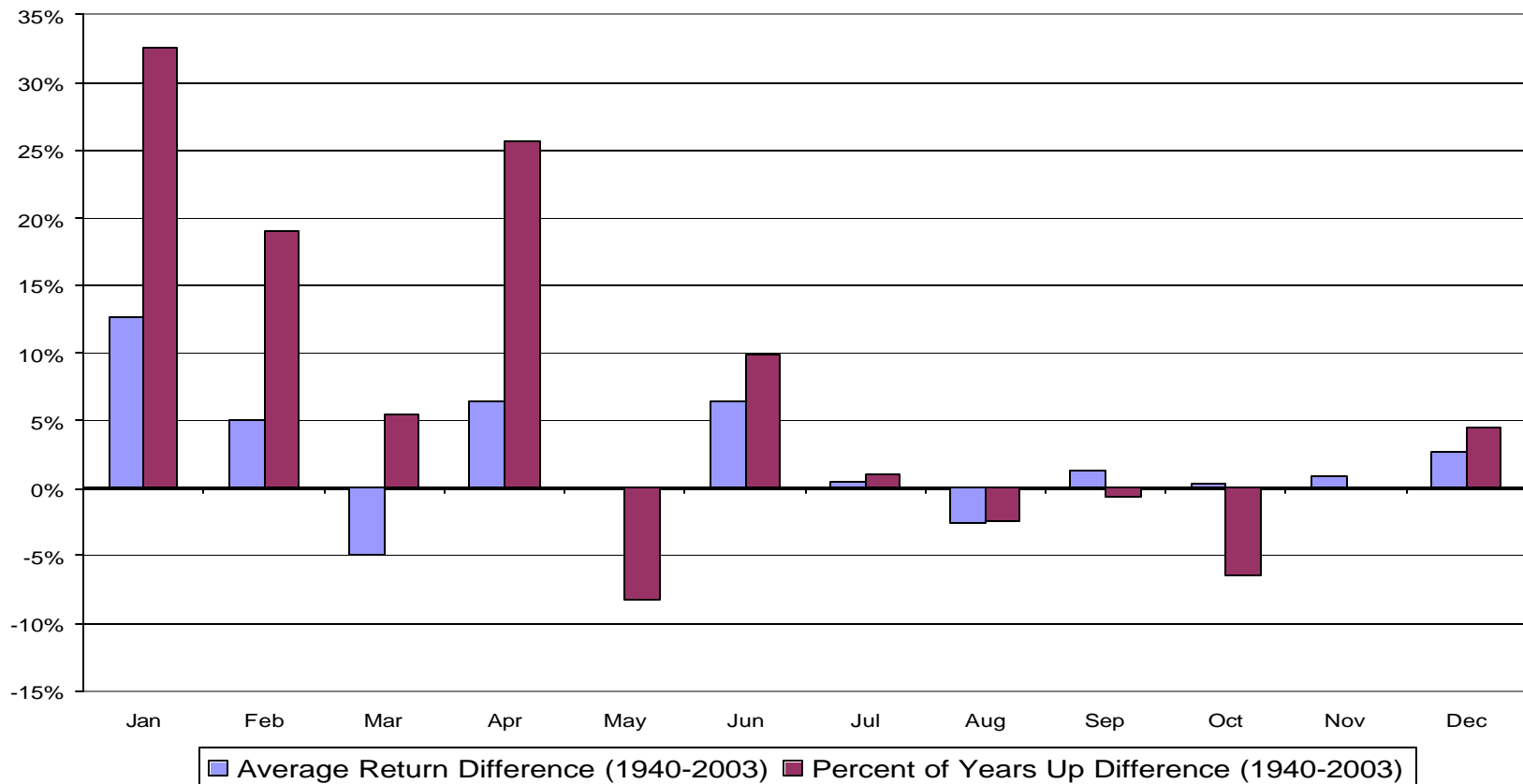
# Average Returns for Next 12 Months



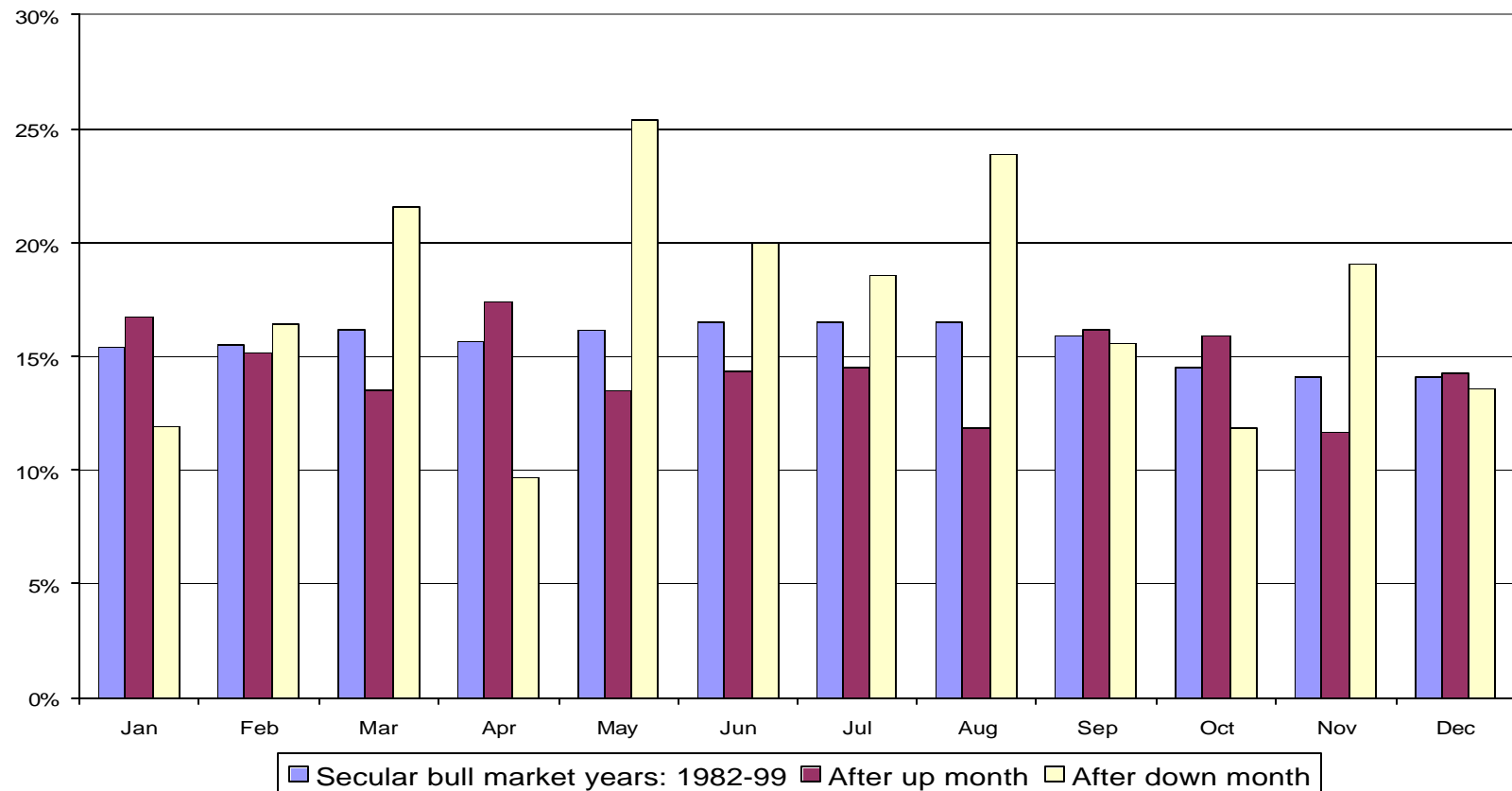
# Percent of Times Next 12 Months Up



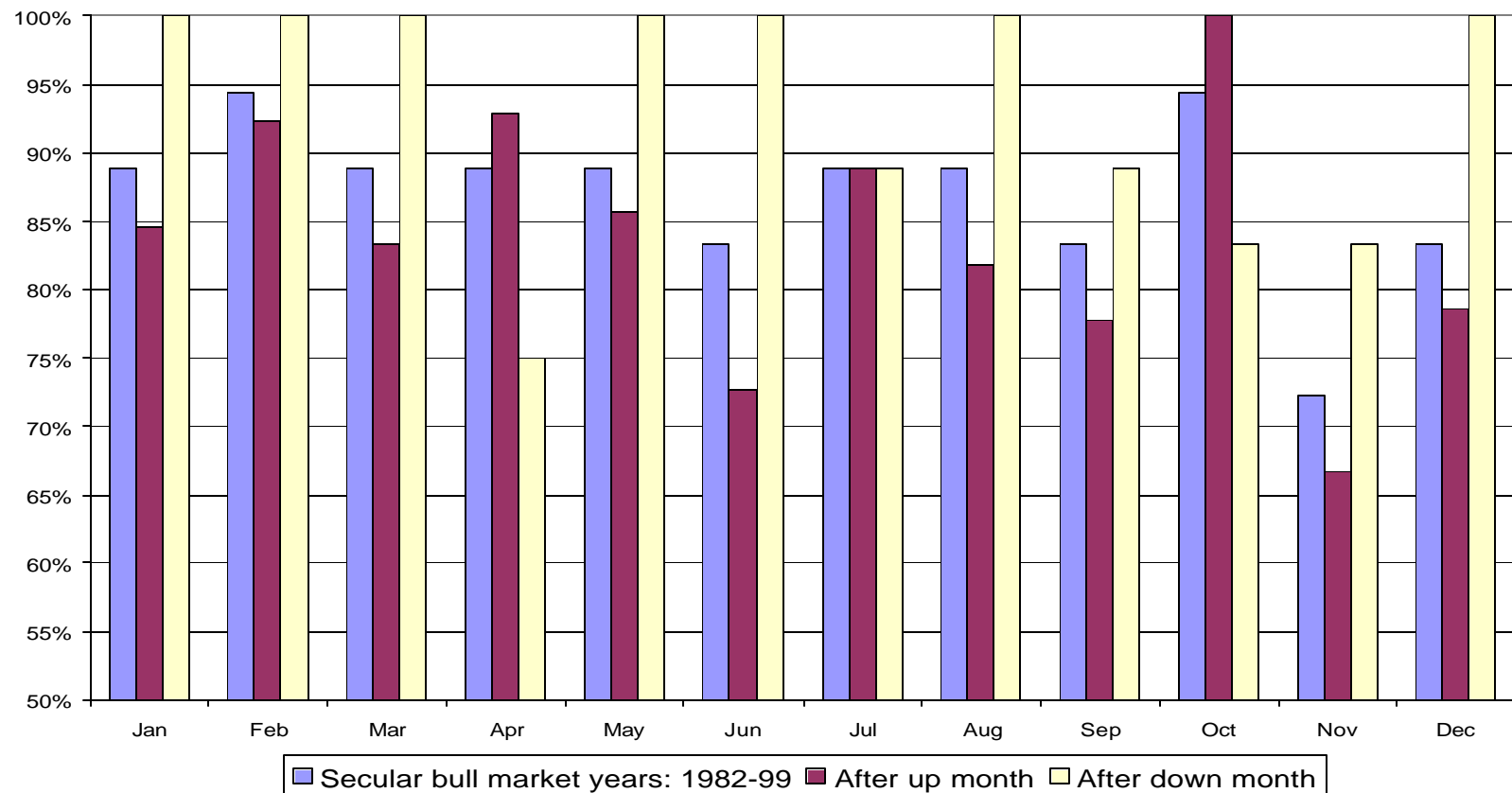
# Next 12 Months: after up - after down



# Avg. For Next 12: Secular Bull

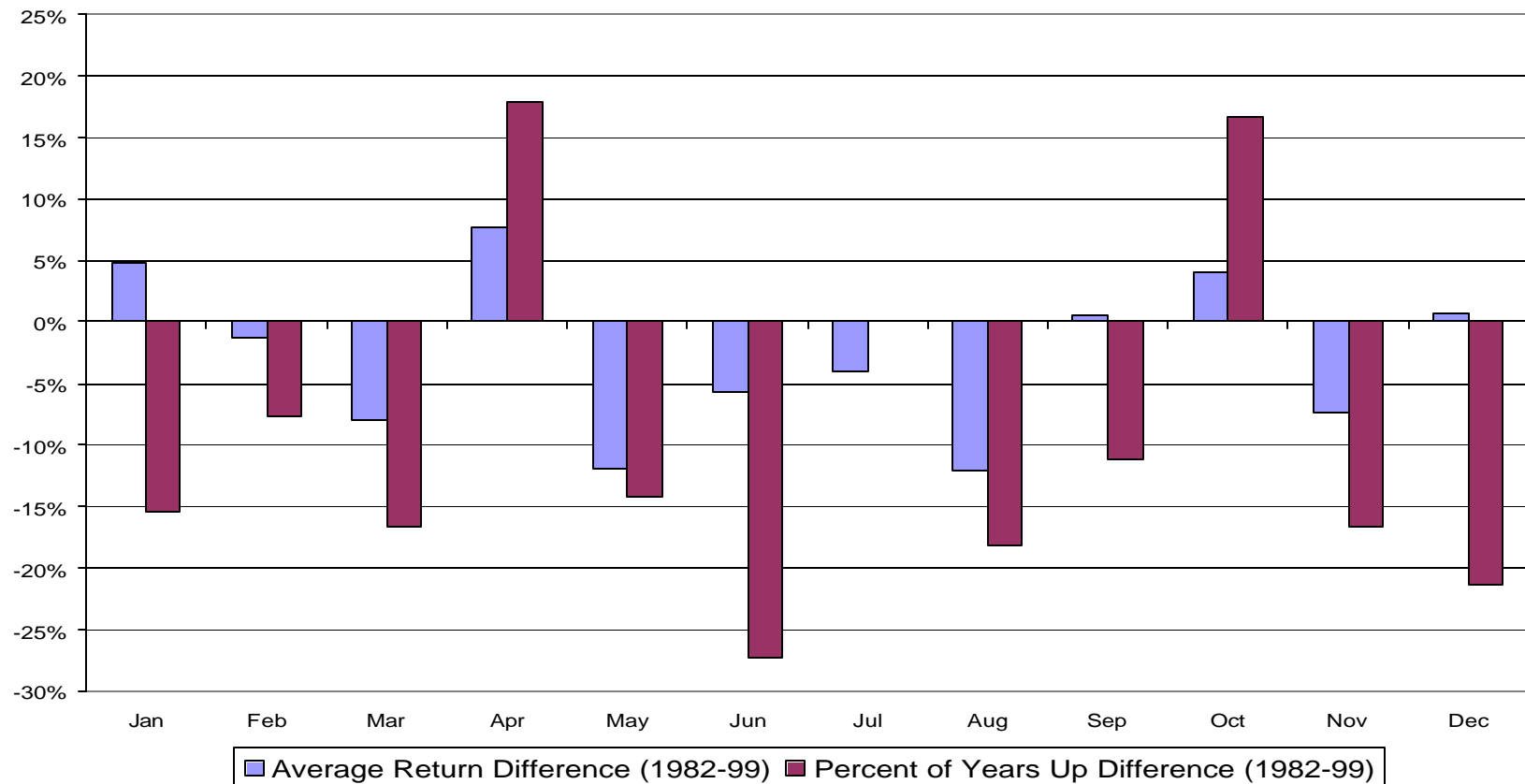


# Percent of Next 12 Up: Secular Bull

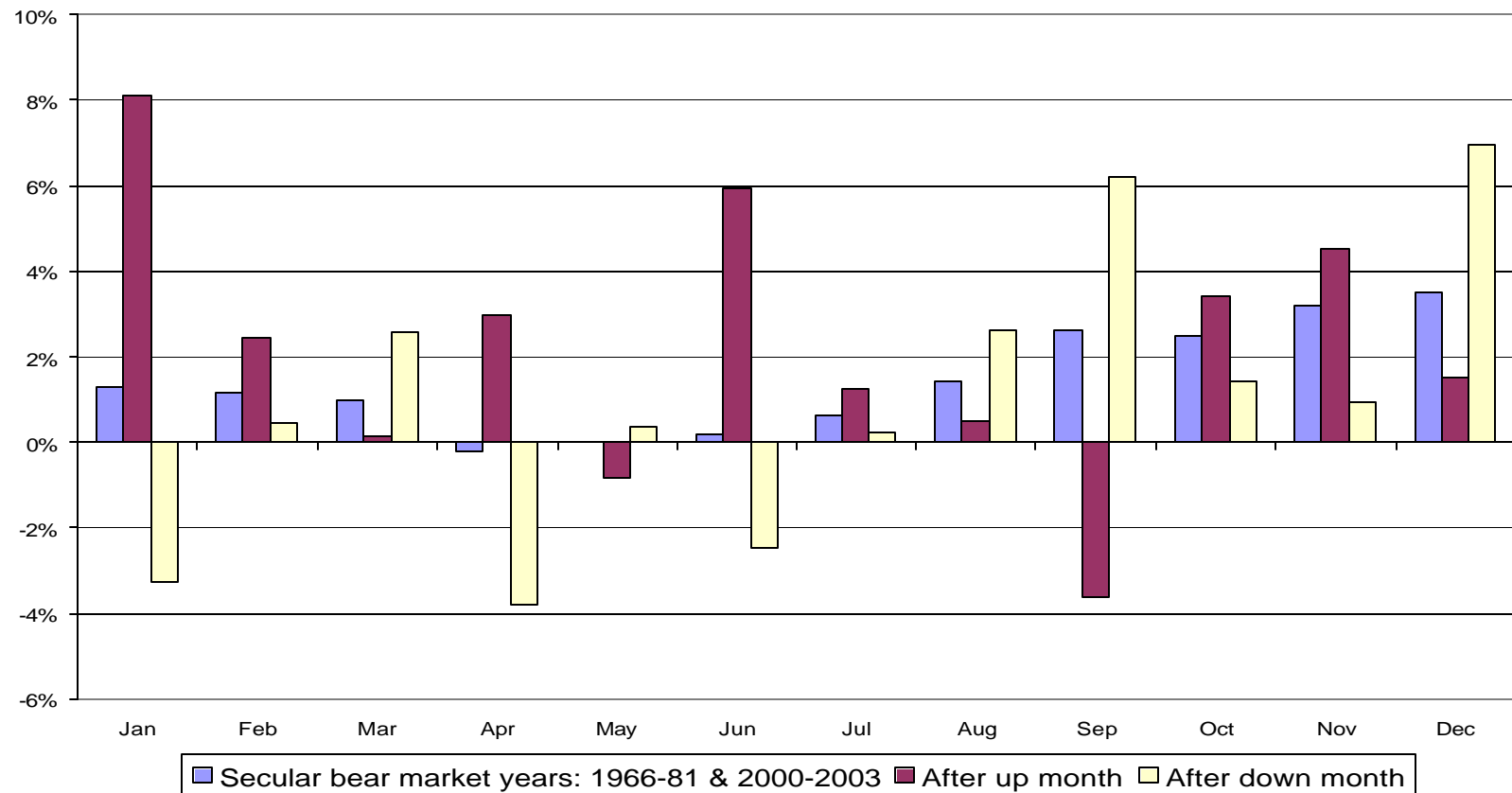




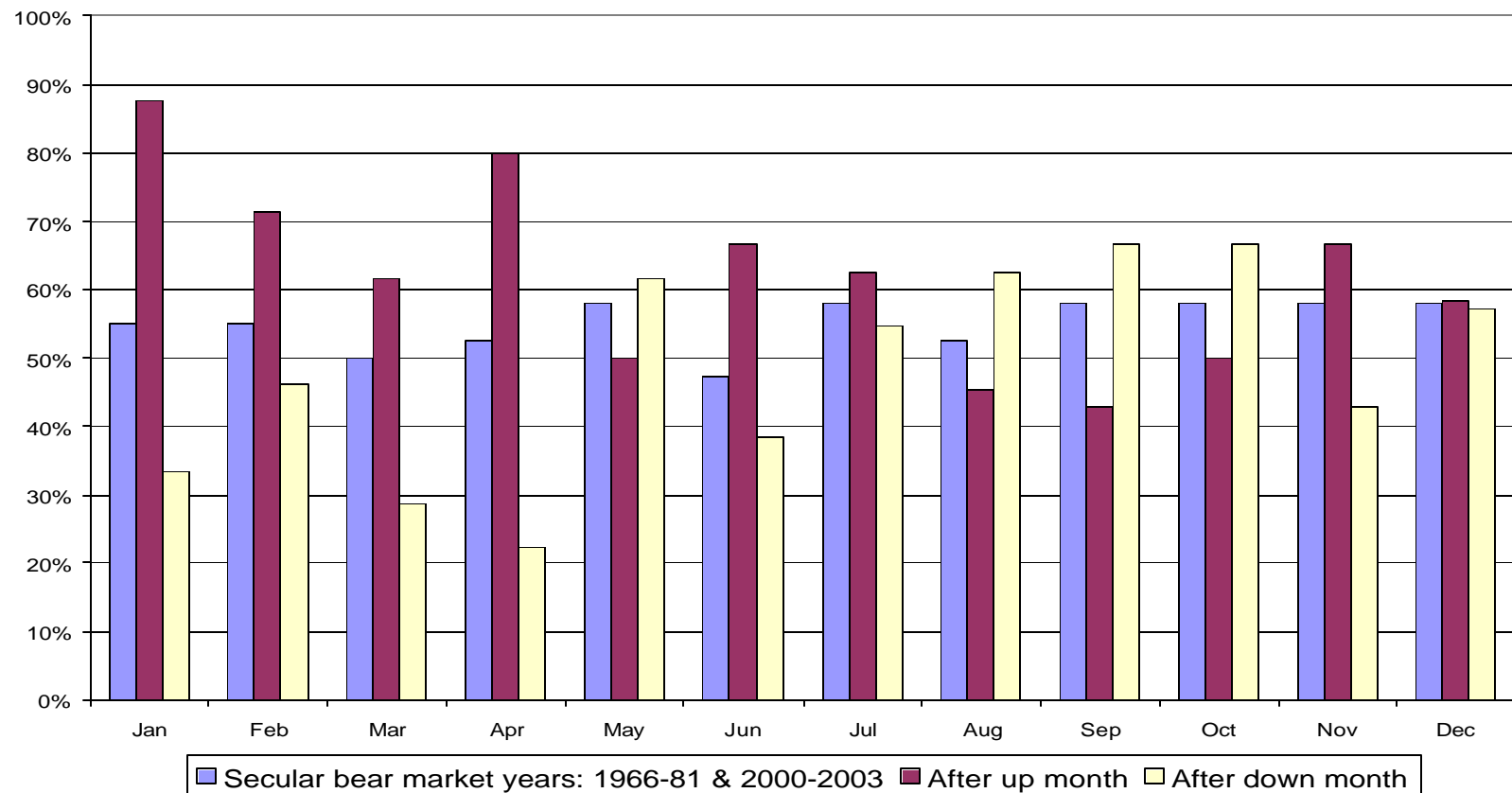
# Next 12: Up - Down in Secular Bull



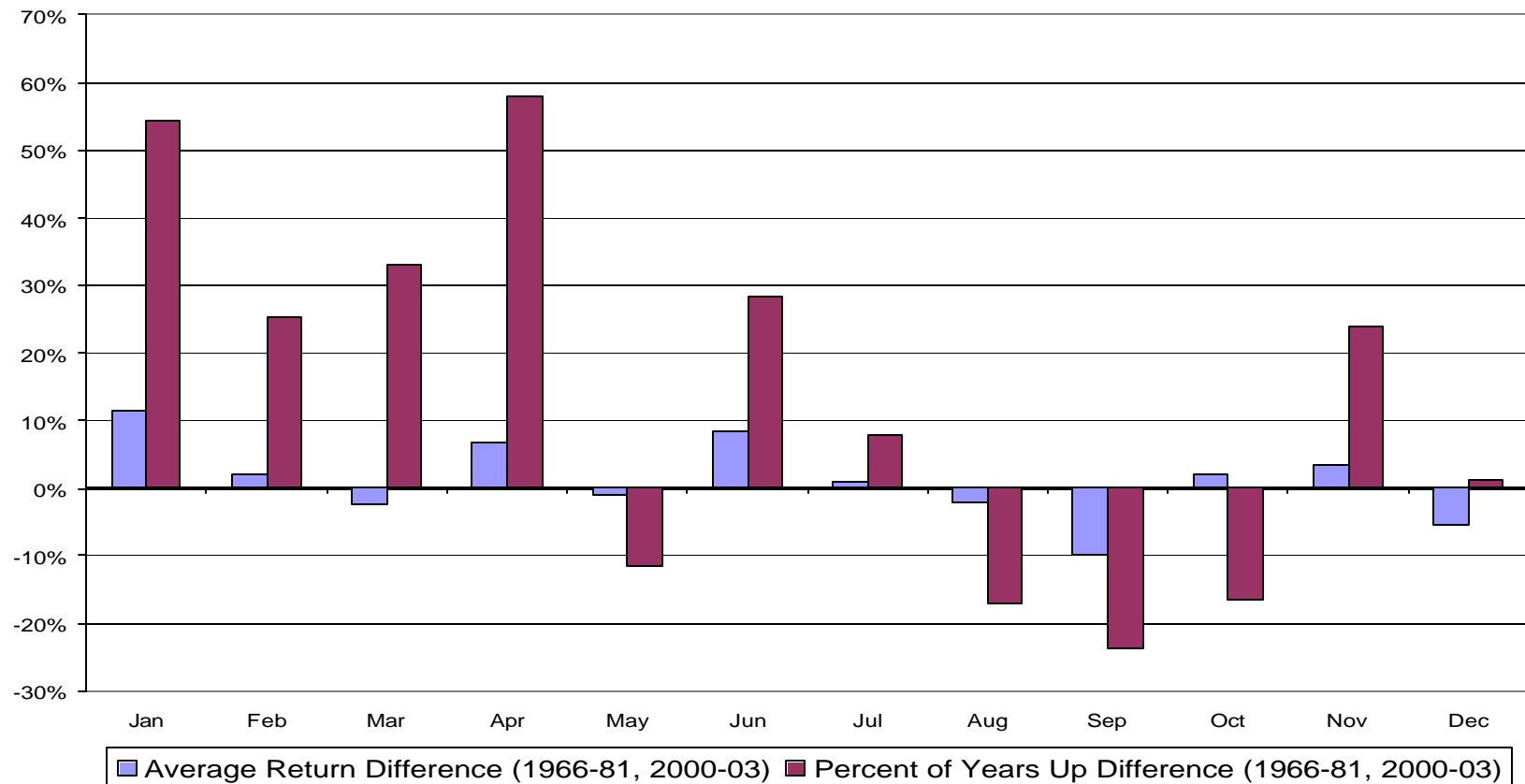
# Avg. For Next 12: Secular Bear



# Percent of Next 12 Up: Secular Bear



# Next 12: Up - Down in Secular Bear



## “Barometers”: Following 12 Months

- January, April are best
  - “Work” overall, in both bull and bear
  - February, June also good, but do not work in secular bull market
  - May be few cases in secular periods
- May, Aug., (Sept.): “inverse”  
barometers: do the opposite after
- During secular bull, better to ignore
- None are “statistically significant”

## How Can We Use This?

- Might decide whether or not to invest stocks after each January (IRA contributions) or April (tax refunds)
- During a secular bull market, better to just invest when funds available
- Use with other indicators, models
- How about deciding for the next month based on the prior month?

# Predicting the next month

- Similar to, weaker than next 12
  - January, June are best
  - Sept. is best “inverse” indicator, likely due to a few October “crashes”
  - Not statistically meaningful
- Trading by last month’s up/down
  - Improves a bit with Sept. inverse
  - Better than buy & hold, especially during secular bear periods
  - Not as good as Triple-40 model

# Triple 40 Timing Model

- Weekly (Friday data) calculations:
  - 40 week moving average of S&P 500
  - 40 week MA of 90-day T-Bill rate
  - 40 week MA of 10-year T-Bond rate
- Model signals (comparisons to MAs):
  - Buy if S&P is above its MA and at least one T-rate is below its MA
  - Sell if S&P is below its MA or both T-rates are above their MAs



## Why to Invest in “Dow” Stocks

- Industry leaders, broad spectrum of household names
- Virtually certain to be around in five years unless bought out or merged
- Comparable non-Dow stocks, but *Wall Street Journal* publishers have done much of the spadework

# Elements of *the Dow*

*Below, the 30 current members of the Dow Jones Industrial Average, and the three stocks that will replace three others before the start of April 8 trading.*

CONSUMER CYCLICALS							INDUSTRIALS	
\$258.33 <b>WMT</b> Wal-Mart								\$307.60 <b>GE</b> General Electric
	TELECOM			TECHNOLOGY	FINANCIAL	HEALTH CARE	ENERGY	
\$85.00 <b>HD</b> Home Depot	\$81.24 <b>SBC</b> SBC Communications	Market capitalization, in billions		\$269.54 <b>MSFT</b> Microsoft	\$267.07 <b>C</b> Citigroup	\$150.54 <b>JNJ</b> Johnson & Johnson	\$273.16 <b>XOM</b> Exxon Mobil	\$64.16 <b>MMM</b> 3M
\$51.17 <b>DIS</b> Walt Disney	\$15.50 <b>T</b> AT&T	Stock symbol		\$176.36 <b>INTC</b> Intel	\$86.34 <b>JPM</b> J.P. Morgan Chase	\$98.32 <b>MRK</b> Merck		\$44.50 <b>UTX</b> United Technologies
		Company	BASIC MATERIALS					
			CONSUMER NON CYCLICALS					
\$36.26 <b>MCD</b> McDonald's	<b>VZ</b>		\$42.08 <b>DD</b> DuPont	\$158.00 <b>IBM</b> IBM	\$66.58 <b>AXP</b> American Express	<b>PFE</b>		\$32.86 <b>BA</b> Boeing
\$26.41 <b>GM</b> General Motors			\$30.13 <b>AA</b> Alcoa	\$69.68 <b>HPQ</b> Hewlett-Packard	<b>AIG</b>			\$29.18 <b>HON</b> Honeywell
\$7.50 <b>EK</b> Eastman Kodak			\$20.30 <b>IP</b> International Paper					\$27.00 <b>CAT</b> Caterpillar
			\$135.55 <b>PG</b> Procter & Gamble					
			\$123.00 <b>KO</b> Coca-Cola					
			\$110.60 <b>MO</b> Altria Group					

# Dividend Yield Approaches

- “Classic” books
  - *Beating the Dow*, O’Higgins & Downes (1991)
  - *The Dividend Investor*, Knowles & Petty (1992)
  - *The Motley Fool Investment Guide*, David & Tom Gardner (1996)
  - Web site: [www.dogsofthedow.com](http://www.dogsofthedow.com)
- Problem with yield-based approach: too few now make the top ten
  - Nature of last two changes to Dow
  - Changed corporate attitudes, but new tax law, weak markets may reverse

## “Outperform the Dow”

- Book in 2000 by Meissner & Folsom
- Own **best** 5 Dow performers over last year for the next year
  - Does not test well over 1971-2003, does worse than Dow, S&P
  - Very poor 2000-03, after book written!
  - Books tests July-June “years” for 1973-98, which does better
  - I don’t have monthly data that far back

## “Outperform the Dow” (2)

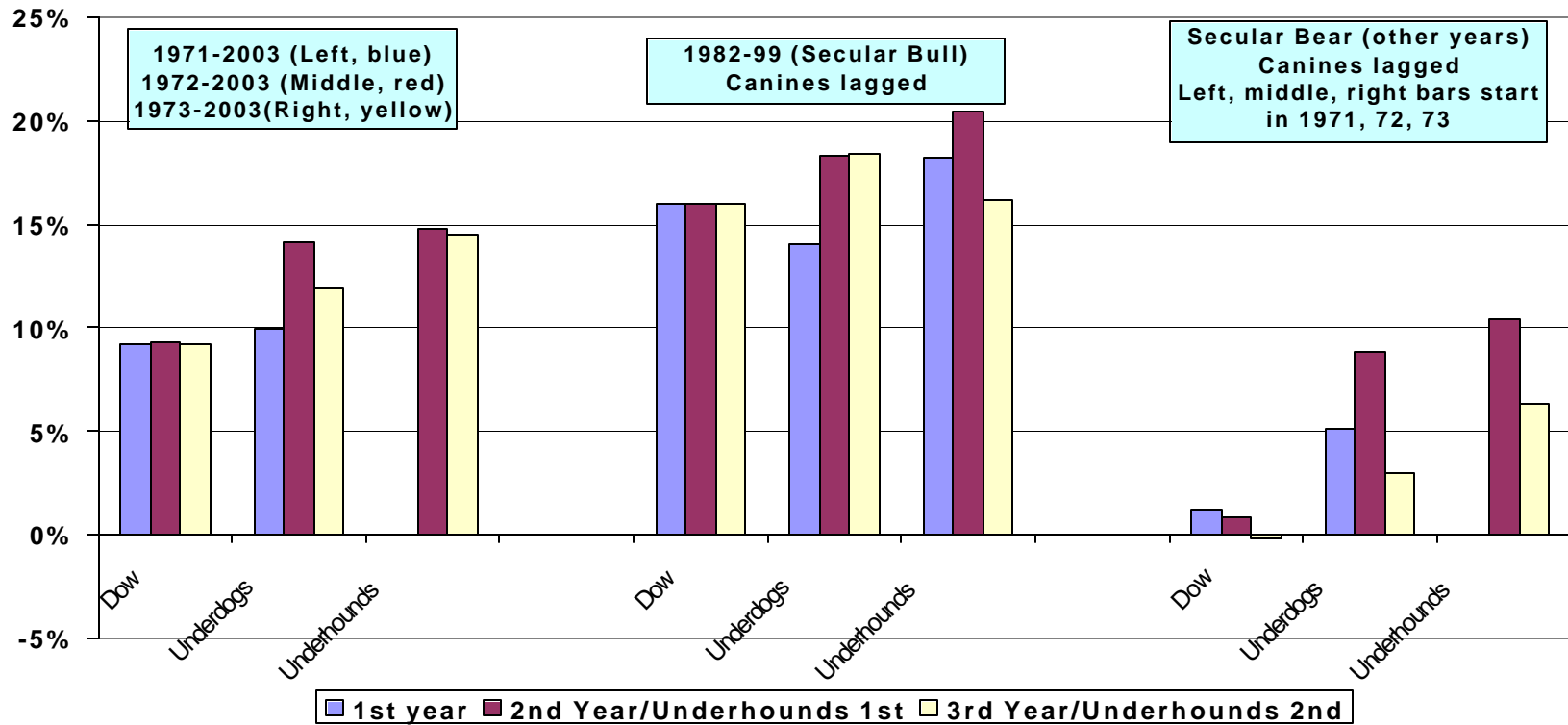
- “Smooth Risers” strategy
  - 10 best of Dow over last 12 months
  - Buy 5 least volatile, hold for next year
  - Volatility = Std. Dev. of last 12 months
  - Does not test as well in book as buying best five performers
- Many other approaches, including using futures, options
- Interesting, not highly recommended

## “Winning with the Dow’s Losers”

- Book in 2004 by Charles Carlson
- Own some of worst Dow performers over last year for the next year
  - Book shows 1, 3, 5, 10 since 1931
  - I tested 5 for 1971-2003
  - First year performance not impressive
  - Much better in second, third years
  - Worst 5 over past two years also perform well over next year, two years

# Average Annual Price Changes

Underdogs = 5 worst in year, Underhounds = 5 worst over 2 years



## “Winning with the Dow’s Losers” (2)

- Strategies to consider
  - Own “underdogs” from 2 years ago (HD, INTC, MCD, GE, IBM for 2004)
  - Own “underhounds” (T, SBC, HD, IBM, GE for 2004)
  - Better during secular bear markets
  - Will be more volatile than Dow or S&P



## “Winning with the Dow’s Losers” (3)

- Book has a lot in it
  - Other strategies
  - Extensive historical data back to 1931
  - History of the Dow
  - Anticipated Dow deletions (EK sure to go) and possible additions
- Recommended for Dow stock traders
- Web site: [www.dowunderdogs.com](http://www.dowunderdogs.com)

# “Trouncing the Dow”

- Book in 1998 by Kenneth Lee
- Target high, low prices based on
  - Current and 10-year average ROE
  - Current, 10-year average book value
  - 10-year average yearly highs, lows
- Buy “undervalued” stocks
- Sell rules not really specified
- Works best with large, fairly stable firms & can apply beyond Dow

## “Trouncing the Dow” (2)

- Book has data for all Dow stocks 1991-96, some back to 1973
- Claims impressive real-time, backtested results
- Web site: [www.trouncingthedow.com](http://www.trouncingthedow.com)
  - Shows recent historical selections (Dow, non-Dow), results
  - Requires subscription for all full access, current selection

# Dow Turnarounds

- Buy & sell stocks in the Dow
  - First buy on “fresh” 52-week low
  - Buy more lots on 8-12% drops
  - Sell when 45% above average purchase price
  - Sell if gets 25% above average and then falls by 20%
  - Sell may factor in taxes, market conditions, available buy candidates
- Option strategies can be used

# New Buys in 2003

Company	Purchase information			Sale/recent price information			Dow since 1st buy
	Date(s)	Avg. Price	# of Buys	Date	Price	Avg. %	
<i>Boeing</i>	2/20/03 - 3/6/03	27.32	2	11/13/2003	40.00	46.4%	24.3%
DuPont	3/5/2003	35.01	1	4/2/2004	43.71	24.9%	34.7%
<i>General Motors</i>	3/7/2003	30.79	1	12/3/2003	46.00	49.4%	35.3%
<i>SBC Communications</i>	3/10/2003	19.56	1	9/24/2003	21.88	11.9%	24.5%
<i>AT&amp;T</i>	3/10/03 - 4/10/03	15.37	3	7/28/2003	22.00	43.1%	22.4%
<i>Altria (Phillip Morris)</i>	3/12/03 - 3/31/03	32.38	3	7/8/2003	47.00	45.1%	22.1%
<i>Eastman Kodak</i>	7/21/03 - 9/26/03	23.41	3	3/22/2004	25.20	7.7%	10.6%
Johnson & Johnson	8/22/2003	49.09	1	4/2/2004	51.18	4.3%	12.0%
Merck	10/20/03-10/24/03	46.51	2	4/2/2004	45.06	-3.1%	9.1%
<b>Average:</b>						<b>25.5%</b>	<b>21.7%</b>

# Additional “Dow Quality” Stocks

- S&P Dividend Aristocrats
  - Have at least 25 years of dividend increases
  - List of 57 including 10 Dow stocks
  - Download Excel file from [www.standardandpoors.com](http://www.standardandpoors.com), search on “dividend aristocrats”
  - 3/29/04 Barron’s lists 26 with highest S&P ratings (7 are Dow stocks)
- Candidates for Dow Turnarounds, Trouncing the Dow methods

# Mark Pankin

- RIA since October 1994
- Managed account expertise/services
  - Market timing: tactical asset allocation
  - Dow Jones Industrial stocks
  - Sector fund trading (Fidelity, Rydex)
  - Portfolio design, rebalancing
- Much more at [www.pankin.com](http://www.pankin.com)
  - Click on Investments, then Managed Accounts, follow links
  - Info about Mark and his interests