

Outside The Beltstreet

September 2004

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Following the Herd vs. Following the Few

“To buy when others are despondently selling and to sell when others are greedily buying requires the greatest fortitude and pays the greatest potential reward. Never follow the crowd.”

-John Templeton

After 16 years in the financial planning industry and watching the carnage of 2000 to 2002, I embarked on a journey to seek tools that investors could use to profit in a bear market. Not lose less and wait it out, but actually making money in down markets. This article contains one of many lessons I have learned in my endeavors.

Looking back at the late 90s, we see many examples of “herd” behaviors. Two of the most easily observable are insider and retail investor trading patterns. In February 2000 insider selling hit its highest level ever at that point. Insider shares bought were valued at \$168 million, while selling amounted to a whopping \$10.8 billion.¹ *The few were getting out.*

The only numbers more staggering than insider sells, were cash inflows into equity funds. January and February of 2000 saw inflows of \$53.6 billion and \$53.7 billion, respectively.² *The herd was piling in.*

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Special points of interest:

- 2000 vs. 2004
- Conflicts of Interest
- C. Confidence
- 97.2 vs. 2.8
- After the 8.2
- Great Sunrises



Hey Pete. Do you believe it is hard to break away from the herd?

Follow the Herd vs. Follow the Few

So how does this compare to 2004? This past April, Alan Newman, wrote poignantly in his newsletter, Crosscurrents, that insider trading in the top ten NASDAQ companies over the previous six months had been at “a pace we have **never** witnessed before.” Only eight thousand shares had been bought while over more than 70.6 million had been sold! ² *The few were getting out.*

So how about the retail investor? In January 2004, the mutual fund industry saw inflows of \$43,758 billion. ³ This number was only exceeded in two other months in history (noted two paragraphs prior). If you need help with which two months these were, back up two paragraphs. *Again, the herd was piling in.*

Incredibly, once again, we see the masses loading up in a market while insiders run for the exits. It is imperative that as you read this, you ask yourself, “Am I following the herd or the few?” As 2000 to 2002 showed us, this is certainly much more than an academic exercise.

References and Sources:

1. www.stockfirst.com/strategies/insiders.htm2000
2. The Federal Reserve Bank of New York, Monthly Mutual Fund Report, April & May 2000.
3. www.crosscurrents.net April 2004 edition
4. Investment Company Institute, January Mutual Funds Report, www.ici.org

In order to know when to sell read the reports by stock market analysts. Right?

In the **July issue**, I pointed out how the number of weeks that investment advisors were **more bullish than bearish had been 96% of the 228 weeks since the January 2000 top in the Dow**. Read this again. *Not during the 1995-1999 period, but 2000-2004*. But surely the stock analyst who were watching things go up and up in price, and who sat on the front lines recommending various companies, must have been saying that stocks were getting too expensive? Right? Well let's see.

Conflicts of Interest.

1. A sell rating might alienate a corporate client of the firm and risk future investment banking business.
2. Analysts readily admit that companies would communicate with them much more freely when they had issued a good recommendation on that companies stock.
3. Being an analyst for a large Wall Street firm is very difficult, prestigious and lucrative. Luring institutional investors, All-American analyst routinely take home \$1 million a year in compensation.

If you want to learn more about this bias, let me suggest reading “*Stock Analyst: Experts on Whose Behalf?*”, *The Journal of Psychology and Financial Markets*, 2002 Volume 3, No.4, pages 198-201. Type in the article or Journal name at www.google.com to find this article. See page 3 for the sells versus buys from 1996-2001. Also review the **June issue** chart on page 3. Additionally, see the chart on the next page!

Technicals

Beginning of Bear (Wave I Down)		
	Date	Level
Dow Jones Industrial	1/14/2000	11,722
NASDAQ Composite	3/10/2000	5,048

Last Major Low (Wave II Up)		
	Date	Level
Dow Jones Industrial	10/9/2002	7,286
NASDAQ Composite	10/9/2002	1,114

2004 Highs (Start of Wave III Down)		
	Date	Level
Dow Jones Industrial	2/19/2004	10,753
NASDAQ Composite	1/26/2004	2,153

Current Levels (In Wave III Down)		
	Date	Level
Dow Jones Industrial	9/23/2004	10,038
NASDAQ Composite	9/23/2004	1,885

Public Confidence and Market Levels		
	10/2002	1/2004
Yale Consumer C. Index	85.5	95.5
Mich. Consumer C. Index	80.6 (10 yr. Low)	103.8 (15 yr high)

I have shown these numbers since the May issue. These two measurements of consumers' confidence are also excellent contrarian indicators for those who want to go opposite the herd. Notice how the lows and highs in the NASDAQ over the last 3 years matched with these indicators to the exact month! Which are you following? *The herd or the few.*

Year	Buy and hold	Sell	Total Calls
1996	96%	4%	29,734
1997	97%	3%	30,350
1998	98%	2%	35,445
1999	97%	3%	37,318
2000	98%	2%	32,633
Average & Total	97.2%	2.8%	165,480



Florida Sunrise.

Photos by: Doug Wakefield

Insider trading in the top ten NASDAQ companies was at "a pace that we have never witnessed before."



Atlantic Sunrise

Feel free to send any question you may have to: doug@genadv.com

True Strength or Short Term Steroid Pop?

Crash diets, steroid injections, and government manipulations of GDP. All three produce immediate effects but rarely lead to lasting results.

Sub par GDP growth for much of the current economic recovery that began in November of 2001 had many questioning the recoveries validity. Finally their fears were laid to rest with the release of the GDP growth numbers for the third quarter of 2003. A huge 7.4% increase, that on November 25, 2003 was revised up to 8.2%. The Dow closed that day at **9763** and the NASDAQ at **1943**. "Second fastest quarter in 20 years." wrote one columnist. "Growth is now super-super strong compared to super strong" commented an economist.

At the same time there were those who were just "sour apples". Rudolph-Riad Younes, who had just been named Morningstar's Manager of the Year, shared some sobering thoughts, "We had the mother of all stimuli in the U.S. economy over the past year: a weaker dollar, tax cuts, yields collapsing, corporate spreads collapsing, war spending, [and] real-estate prices going higher. Stocks are up. But these measures are not sustainable. The economy is barely growing, and we are loosing jobs."

Three quarters later the GDP is down at 2.8%, not bad, but the markets closed at **10,038** and the NASDAQ at **1886** on Sept.23. Are the steroids wearing off?

Three Questions you should ask your advisor(s) today. WE HAVE already addressed these.

1- *If my account declines, how long do you think it will take for the markets to bring it back up?*

2- *What strategies could I use to make money (NO, NOT REDUCE LOSSES) during a down market?*

3- *On 1/5/82 Fannie Mae was .6875 (split adjusted). On 8/23/04 it closed at 73.27. Should I consider a rise of over 10,000% in value on a Government Sponsored Entity (GSE) speculative?*

(Update - By the close of on September 23, Fannie Mae had lost 11.25% over the last 2 days.

For REAL WORLD solutions in highly uncertain times, please drop me an email or call Ben and arrange a time we can talk. If you are doing the same thing you were doing when the DVD came out in February 2004, then I encourage you to address each of these tools, and HOW they work in declining markets. (See chart, pg.3)

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