



## Stock Market Barometer



### Quote of the month:

“In any investment you expect to have fun and make money” - Michael Jordan

# STRATEGIC STOCK TRADING

Master Personal Finance Using Wallstreetwindow Stock Investing Strategies With Stock Market Technical Analysis

97.34 84.63 81.88 785.32 34.36 63.33 84.54 98.65  
84.64 93.48 98.65 31.85 95.48 96.54 05.02 13.95 96.54 54.36 82.84 15.95 136.10 65.32 65.32 75.15 156.10 98.65 151.85 84.54 84.54 36.54 151.85 84.54 36.54 151.85

**MICHAEL SWANSON**

## A Critical September Is In Front Of Us , How Many Positions Should You Own? (09/002/13)

August was a very interesting month for the global stock markets. European markets and metals and mining stocks did well while the S&P 500 and the US stock market dropped. While the US stock market is in a correction these other markets are going up. We seem to be in a period of transition in which leadership is now shifting out of the US stock market, which has been in a mature full year long-bull market, and into markets that are early in a bull market, such as the European markets, or going through a post-bear market transition period, such as gold, and into a new bull market.

The way the charts are lining up it appears that this trend of transition which we witnessed in August will be complete in September. I want to show you some of the key charts I am looking at now and then talk a little bit about investing and the number of individual stocks you should own.

First of all the US stock market is in a bit of a correction. That correction appears to reaching its final phase. Corrections often end in some sort of selling climax and come when people get worried about the market. Sentiment polls such as the Investors Intelligence survey show that the number of people bullish on the market has been dropping over the past few weeks, while the put/call ratio and the VIX are telling us that more and more people are hedging their positions.

This is important, because a lot of people instead of selling when they worry simply buy puts to hedge against further losses. At major bottoms a climax of worry and fear often occurs that shows up in

the options market. The volatility premium that people pay tends to spike up and then reverse at the end of corrections. Typically the VIX will jump above its upper-200 day Bollinger Band and then have a key reversal day in which it goes up 5% or even more during the day and then finishes in the red. I've seen it happen over and over again throughout my whole investment career. On Friday the VIX closed at 17 and its upper 200-day Bollinger Band is at 18.50 it appears to be on the verge of happening again.



US stock market corrections also tend to come to an end on a day in which 90% of the volume on the Nasdaq and the NYSE is initiated by sell orders and in which 90% of the stocks are down. They also usually always end somewhere around the 150-day moving average, which acts as long-term support in a bull market. It's at 1600 on the S&P 500 right now. I would not expect the S&P 500 to fall much further than that, if it even falls that much. The bottom line is that the correction that the US stock market has been going through in August should come to an end in September.

It could end this week or next. Perhaps it ends when Obama launches the missile strike on Syria he has been itching to do of late. Or perhaps the September 15 FOMC meeting will mark a turning point. There has been a lot of speculation the past six weeks on whether Bernanke will "taper" his QE money printing operation. I believe whether he does or not in the big scheme of things it won't matter, because I do not think such a thing would represent a new tightening policy on the part of the Fed, but would be a symbolic gesture on the part of Bernanke as goes into retirement.

But if he is going to taper QE he needs to basically do it in September, because he won't want to do it right before he leaves the Federal Reserve as someone new takes his place. That means that after the September 15 FOMC meeting whether or not the Fed reduces QE or not the "taper" question will be off the table. He is running out of time. I take the September FOMC as a potential positive catalyst for gold, commodities, and

really all financial markets. Even bonds may finally bounce after that meeting's announcement. I cannot predict though exactly when this current S&P 500 correction will end. It could end right around the FOMC meeting or even before it. All that matters is that the VIX and sentiment indicators are showing us that it can end soon. A spike in the VIX above 18 1/2 and reversal when it happens should signal the end.

Even though buying after a correction is the best time to buy into a bull market, I'm not really interested in using this move to buy US stocks. Instead I'm more interested right now in metals and mining stock-stocks, because they aren't four years into a bull market, but appear to be just starting one. So they have much more upside.

The HUI gold miners index put in a bottom in June and then rallied over 36% where it stopped at 280, the points of its May and June highs and near its 150-day moving average at 290. It now has resistance in the 280-290 area.

It should spend another week or two below it, but if it breaks through that level in September it will break out of a stage one post-bear market base and begin a new bull market.

It would then go up for the rest of the year and beyond. So that makes September a potential key pivot point for metals and mining stocks. Most likely they will consolidate this week and breakout sometime around the time period of the September 15 FOMC meeting. My plan is to buy a few more positions this month. Now it isn't just metals and mining stocks that are in a position to have a key breakout in September. So is the entire commodity complex as a whole.

Take a look at the GCC ETF, which has been in a bear market downtrend since the first half of 2011. If it breaks above its upward resistance downtrend line and begins a sustainable rally it will also go into a bull market. It's a bullish sign for all commodity related stocks. The simplest way to invest in all of this if you just want to buy a few positions



is through the gold stock GDXJ ETF, silver ETF SLV, gold ETF GLD, and the GCC ETF, which would give you the lowest amount of volatility out of these, and conversely the least amount of upside potential.

Of course individual stocks give you the most bang for the buck. Now here is a question for you - how many positions do you need to own to be properly diversified? If you have all of your money in one stock you are at risk of losing everything if it were to crash due to some bad earnings news, accounting fraud, or even the company going bankrupt. There is no need to take big risks like that. It's obvious that you need to have your money in multiple positions.

But how many? I'm talking about individual stocks here. When it comes to exchange traded funds and mutual funds almost all of them already own multiple positions - many positions in fact. Sometimes hundreds. So if you are just thinking about exchange traded funds and other investment vehicles it isn't so much the number of funds you own that you have to think about, but what asset classes and markets you want to invest in. Do you want to diversify in several or just own one?

That is a whole other subject and really depends on the big picture of market cycles. I just want to talk about individual stocks right now and ask the simple question how many should you own to manage the risk of investing in a stock? I wrote in my book Strategic Stock Trading that most people should have at least ten positions if they are going to buy individual stocks.

Ten is the point at which you start to get the benefits of managing risk by owning multiple positions. Owning three isn't really enough. Owning ten is where you get most of the impact of diversification. It's also a level at which most individual investors feel confident that they can keep track of what is going on. If you are engaging in a lot of short-term trading it may be difficult for you to own more than ten positions and keep an eye on them, especially if you are trying to study all of the news surrounding them and daily stock market action.

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97.54	98.65	65.32	97.54	84.54	98.65
54.63	54.64	84.54	54.63	98.65	54.64
51.85	95.48	98.65	51.85	54.64	95.48
785.32	96.54	54.64	51.85	95.48	96.54
54.36	05.02	95.48	785.32	96.54	05.02
65.32	15.95	96.54	54.36	82.84	15.95
84.54	156.10	65.32	65.32	75.15	156.10
98.65	151.82	84.54	84.54	36.54	151.82
54.64	36.54	98.65	98.65	96.21	36.54

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People have studied this. Here is data from an academic study in the Journal of Financial and Quantitative Analysis from 1987 which crunched the numbers, looking at the impact of position size on portfolio performance and risk:

**TABLE 1**  
**Expected Standard Deviations of Annual Portfolio Returns**

Number of Stocks in Portfolio	Expected Standard Deviation of Annual Portfolio Returns	Ratio of Portfolio Standard Deviation to Standard Deviation of a Single Stock
1	49.236	1.00
2	37.358	0.76
4	29.687	0.60
6	26.643	0.54
8	24.983	0.51
10	23.932	0.49
12	23.204	0.47
14	22.670	0.46
16	22.261	0.45
18	21.939	0.45
20	21.677	0.44
25	21.196	0.43
30	20.870	0.42
35	20.634	0.42
40	20.456	0.42
45	20.316	0.41
50	20.203	0.41
75	19.860	0.40
100	19.686	0.40
200	19.423	0.39
300	19.336	0.39
400	19.292	0.39
450	19.277	0.39
500	19.265	0.39
600	19.247	0.39
700	19.233	0.39
800	19.224	0.39
900	19.217	0.39
1000	19.211	0.39
Infinity	19.158	0.39

Source: Elton and Gruber [8], p. 35. Portfolios are equally weighted. Elton and Gruber reported variances of weekly returns. We have converted these to standard deviations of annual returns.

There is also a transaction cost in doing lots of trades and the less money you are using and thereby putting in an individual position the more transaction costs matter. For example if it costs you \$20 a trade than if you place \$4,000 into a position you are already losing one percent after you buy and then sell it, because \$40 of \$4,000 is one percent. However, if you are putting \$5,000 into a position and can pay cheaper transaction costs than \$20 a trade the fees really are small enough that they don't really matter anymore.

Ten is probably the right number for most people, but it isn't the optimal number to reduce position size risk. To really get the greatest of benefit from owning multiple positions you really should own over thirty positions, and probably forty. After forty the additional benefit of owning more positions diminishes with each additional one thereafter to become negligible. After forty you need to have a hundred to receive much more of a meaningful benefit, and it isn't a huge difference, and after that it no longer really makes any more difference if you add more positions.

So thirty or forty is best if you are simply looking at position size

risk, but is it right for you? There is a cost to multiple positions. If you have less than \$100,000 in your account than the transaction costs involved in owning multiple positions would suggest no. If more than ten position is too much for you to keep track of then the answer is probably also no.

However, you should ask yourself how much are you really keeping track of positions as it is? How much do you even need to? That depends on the type of trading and investing you are doing. The more short-term your holding period the more you have to watch things and the longer your holding period the less you do, but most people think they are managing their positions much more than they are - or they are doing it too much! I like to do it so I don't have to manage them much at all.

If you invest with a long-time horizon than you really don't need to watch your individual positions that much if you own over thirty of them or use small position sizes. The reason why is that if you are investing than you should be buying stocks, because they have cheap valuations and are in a position to go up for a long time regardless of the "news." They should be just about to or just starting a new bull market. If you are doing that then you don't need to watch the daily gyrations of your stocks or really pay attention to the news stories surrounding them. All you need to do is just check on things every few weeks really. Investing then becomes easy, because you don't really have to care anymore what the stock does in any one day and most news stories have little impact over a few years.

I already own enough positions, but I do want to put more money to work. I still have about 10% of my account in cash and hope to put some more deposits in the coming weeks in my account, because of the opportunities in the market right now. I plan on buying more positions, but will keep using the same position size I have been, because I don't want new positions to overshadow the size of the ones I already have. As far as owning enough positions for diversification I have more than enough, but I just want my individual stock positions to stay pretty balanced with one another if I put more money to work.

I really think we are in a transition that began in August and should be complete this month in which market leadership is shifting out of the US stock market and into European markets and commodity related investments, such as metals and mining stocks. Europe made a bear market bottom last year and now is beginning a full out bull market while commodities appear to have put on a bear market bottom in June and have been basing since then. If mining stocks break out of the base they have been forming they will begin a full blown bull market. That makes the next few weeks a critical time to get in a position to take advantage of them. You can do it by putting ETF's in your account or individual stocks. I'll let you know if I buy more.

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