The FRED Report
Financial Research, Education & Data

The FRED Report Training Manual

By Fred Meissner, CMT

www.theFREDreport.com

The FRED Report

4514 Chamblee-Dunwoody
Dunwoody, GA 30338
Web:
www.theFREDreport.com
Phone: 404-875-FRED
fred@thefredreport.com

About The Fred Report and Training

Welcome to The FRED Report Training Manual! This quick course arises from discussions we have had with advisor teams who use The FRED Report, but have little experience with Technical Analysis. While we realize that clients do not want to be technical analysts, many have indicated they want to understand a bit more about what we do. In the pages that follow we will:

(a) Give an overview of Technical Analysis and how it relates to the world around us,

(b) Explain our Three Market Principals and give some chart examples of each, and

(c) Give advisors an introduction to the Charting methodology we use in each publication of The FRED Report.

In the process, you will learn how The FRED Report can help you be a better advisor and portfolio manager.

The Overview

There are two main types of research on Wall Street. These are Fundamental Analysis, and Technical Analysis.

Fundamental analysis studies the behavior of companies and their managements.

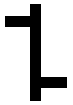
Technical analysis studies the behavior of investors and the trading pattern of stocks (or markets, or indexes, or ETFs or any traded instrument).

The key to remember is that charts are graphic depictions of human behavior – investor actions in a freely traded market. We believe that most stock investors are much more interested in the performance of the stock rather than the performance of the company and its' management – hence our use of Technical analysis.

The Importance of Bars

- Bars are the key to S.T. trading. Following are some explanations of bar action.

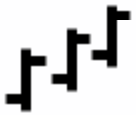
  Left hash = Open, right hash = Close

  (1)  = Demand wins (2)  = Supply wins

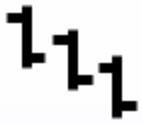
- The open is important as it is the only non-market price of the day.
  - A close above the open means accumulation
  - A close below the open means distribution

The Importance of Bars

Types of Formations

(1)  **Strong Rally**

(2)  **Weak Rally**

(3)  **Strong Decline**

(4)  **Weak Decline**

(5)  **Inside Day**

(6)  **Outside Day**

Most machines do not show open, but where the close is in the range shows the same thing

Changes of range size signify changes in trend much of the time

Fred's Three Market Principals

These are:

1. Sentiment
2. Internal Momentum
3. External Momentum.

We observe all of these through various technical indicators, some of which we show in various FRED reports. Our *Monthly Review* always updates subscribers on the status of these indicators.

One thing to remember about technical indicators is that there are two basic types:

1. Condition or strategic indictors
2. Tactical or trading indicators.

Of our Three Market Principals, external momentum is the only tactical principal.

Sentiment Indicators

Sentiment, or contrary opinion, **measures investor opinion on the markets**, **as well as investor actions with regard to those opinions**. We use two types of sentiment indicators:

1. **Sentiment polls**
2. **Put/call ratios**

Sentiment polls are more intermediate term in nature while put/call ratios can give short-term signals, but both are condition indicators.

Our favorite sentiment poll is Investor's Intelligence, and it tracks the amount of bulls, bears, and those looking for a correction. We only track the bears, as those folks are the ones most likely to take action. These are weekly numbers while Put/call numbers are reported daily, and therefore can be shorter term in nature.

Chart: % Bears Sentiment Indicator

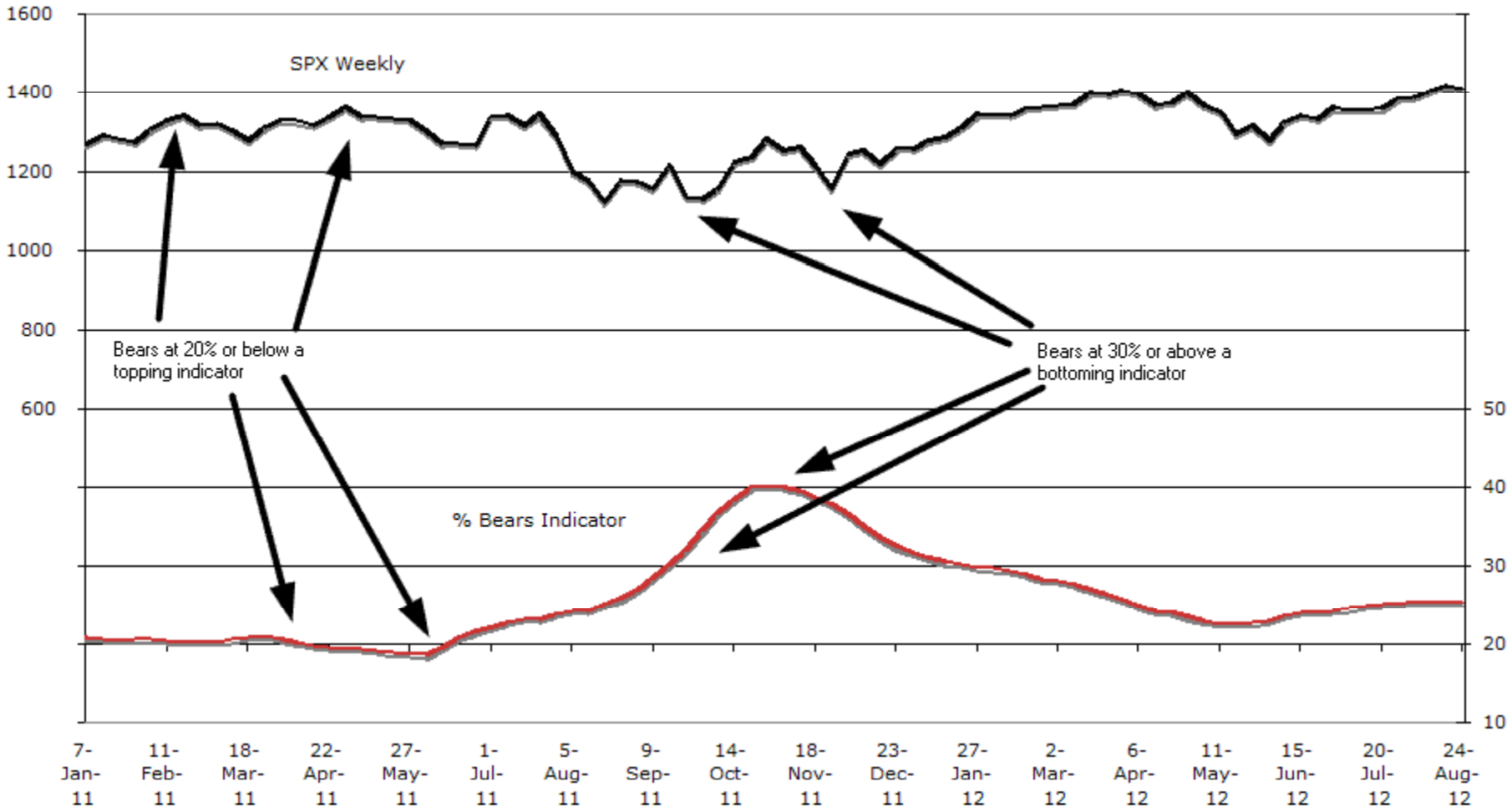
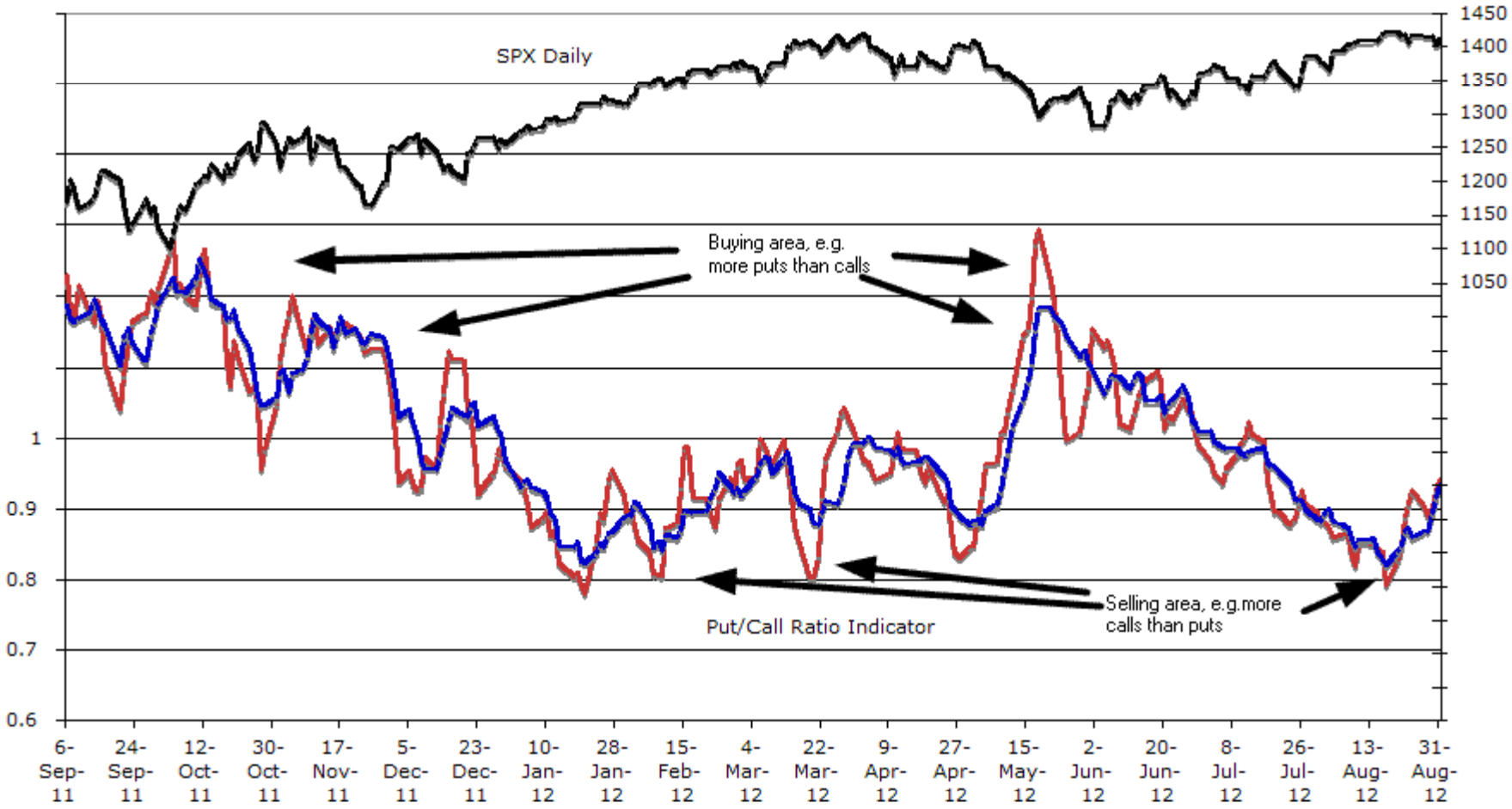


Chart: Put/Call Ratio Sentiment Indicator



Internal Momentum Indicators

Our favorite Internal Momentum indicators are breadth based. These indicators are mostly stock market indicators as other markets do not have such things as the Advance/Decline line, or New Highs and New lows. We look at many measures of breadth but only publish three:

1. **The McClellan Oscillator**, which is great for the short term
2. **New Highs and New Lows** on the NYSE, which is used to measure intermediate to long term strength
3. **Fred's Breadth Oscillator** (FBO), our own breadth tool which is designed to fill in the cracks left by the other two.

The last two are definitely condition indicators, while the McClellan can function as both. The McClellan Oscillator is an indicator used to measure breadth momentum. We use it because of all of the breadth tools we have looked at, this gives the best "early warning" signs. When used in conjunction with our proprietary Fred's Breadth Oscillator it gives an excellent indication of whether breadth is overbought or oversold within a short to intermediate-term market cycle. Generally the market will stage some sort of reversal when the McClellan is at plus or minus 200, and when those areas are reached we start to look for confirming signs from other indicators.

Chart: McClellan Oscillator Internal Momentum Indicator

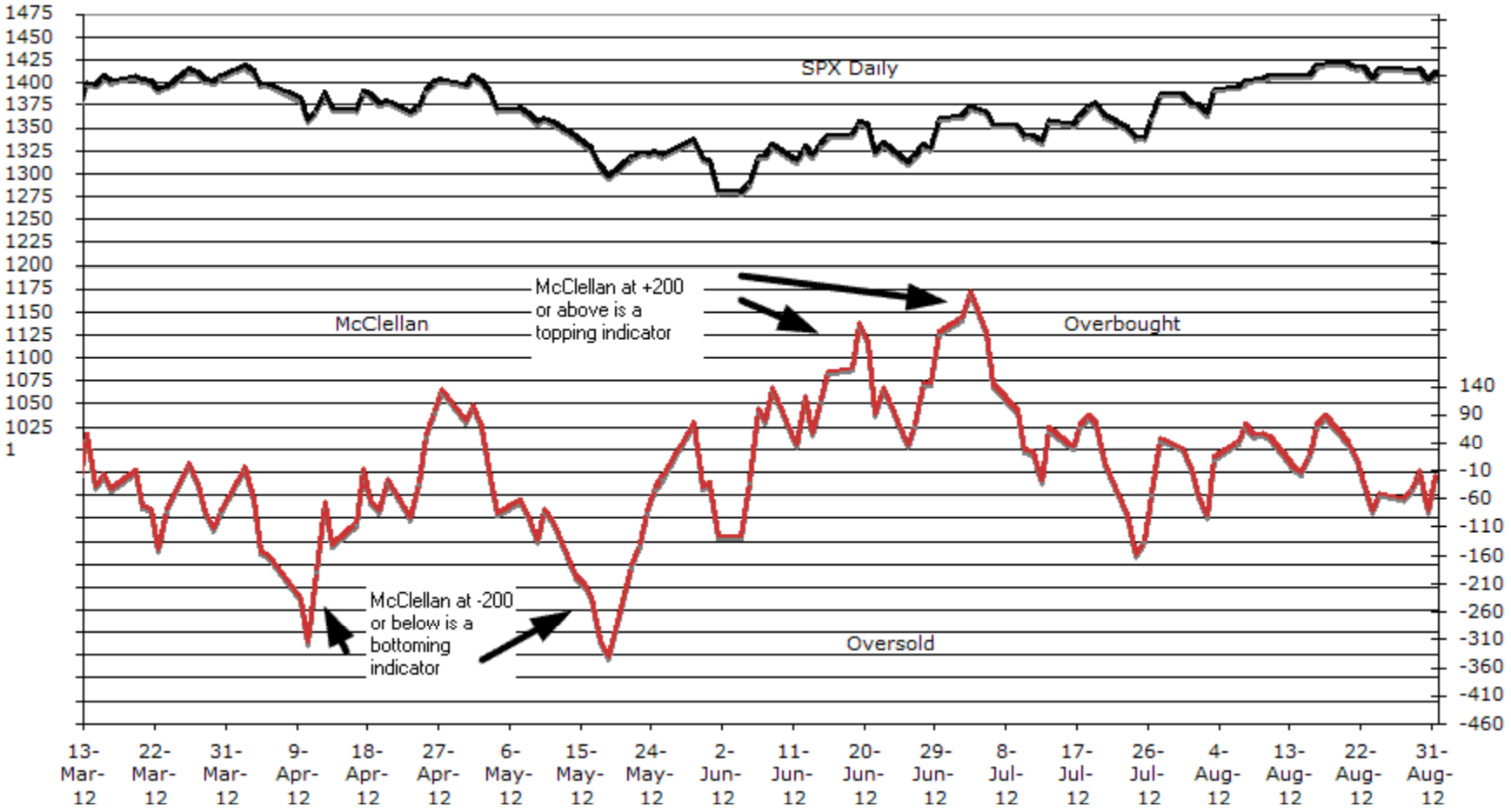


Chart: New Highs New Lows Internal Momentum Indicator

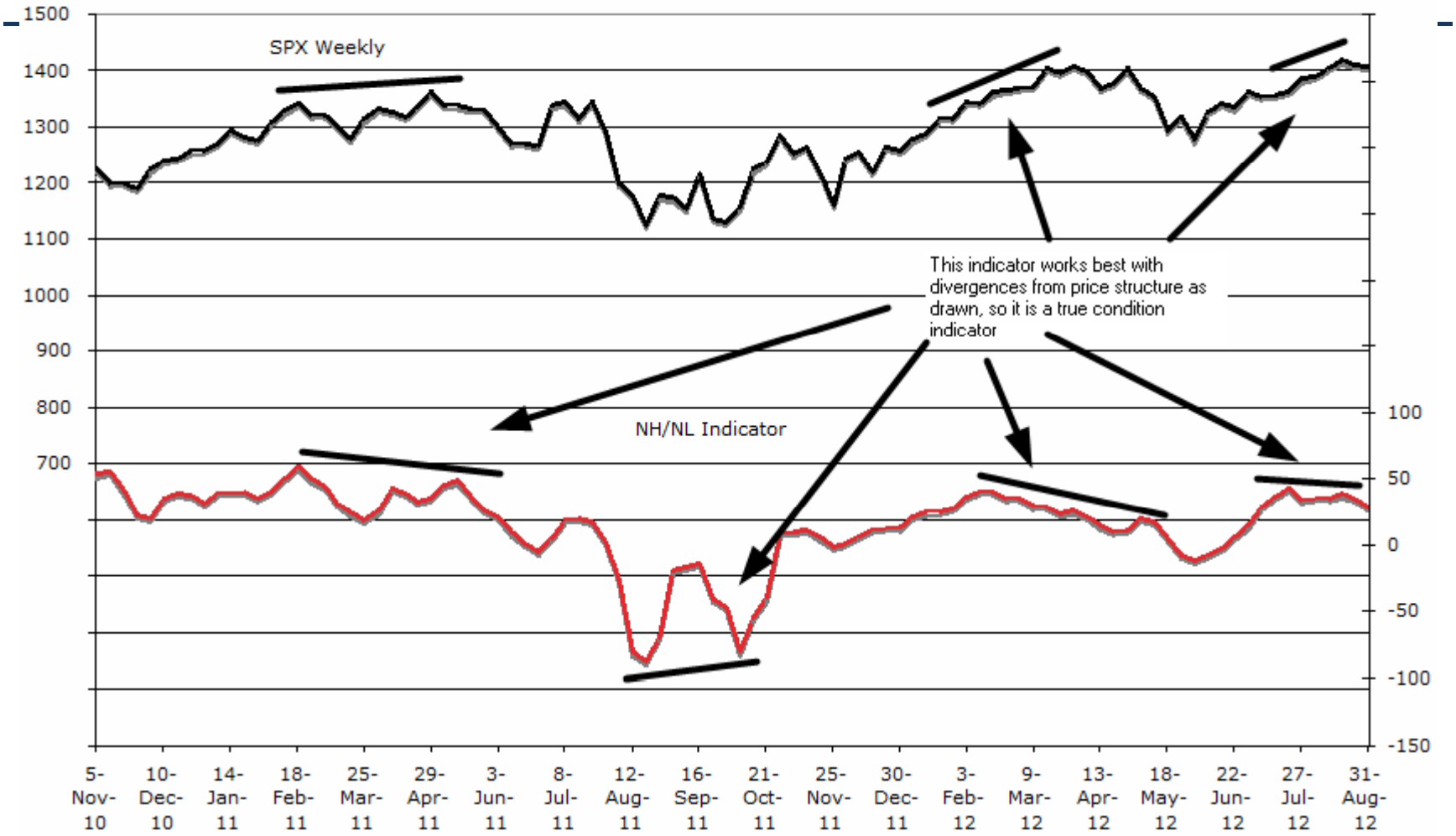


Chart: FBO Daily Internal Momentum Indicator

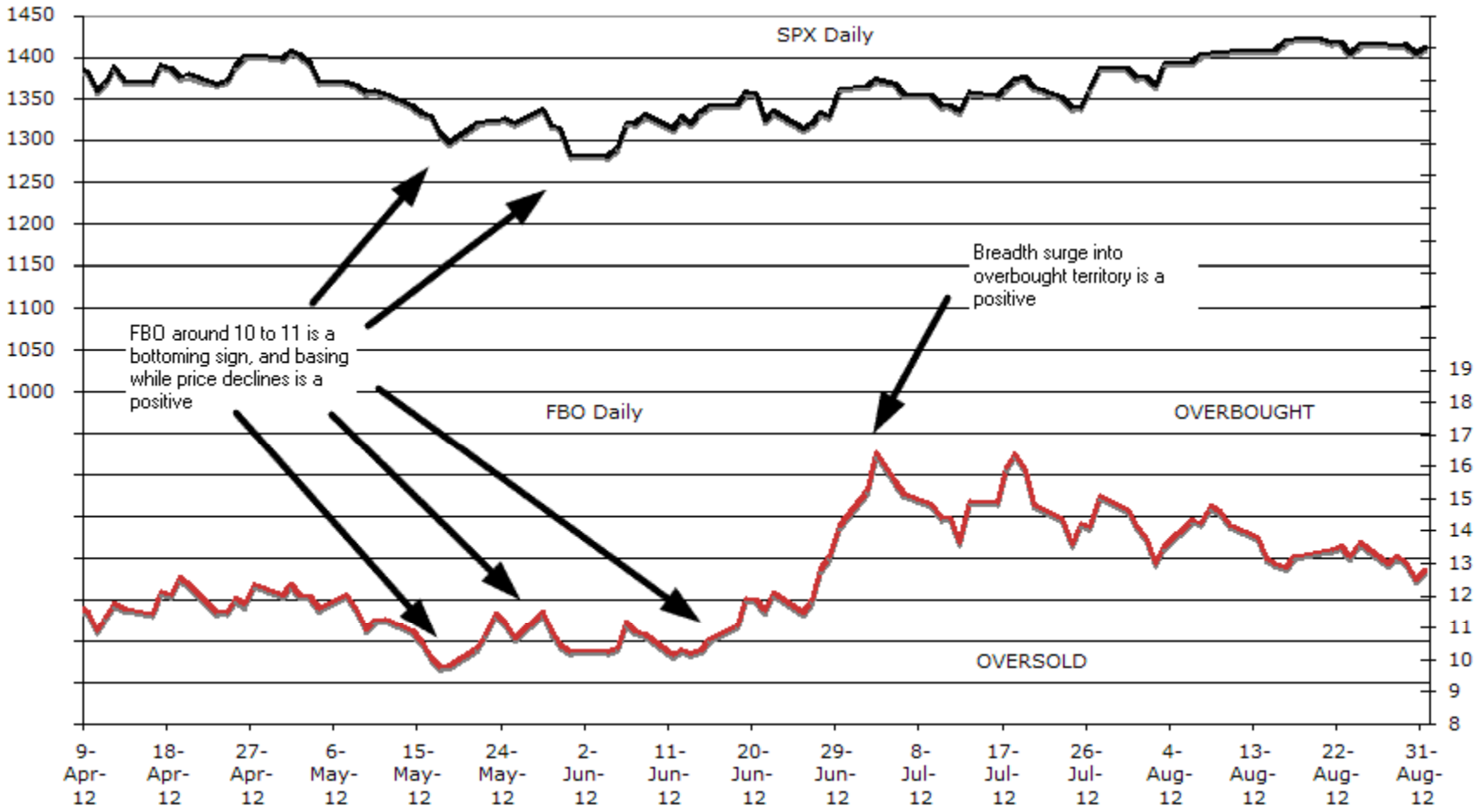
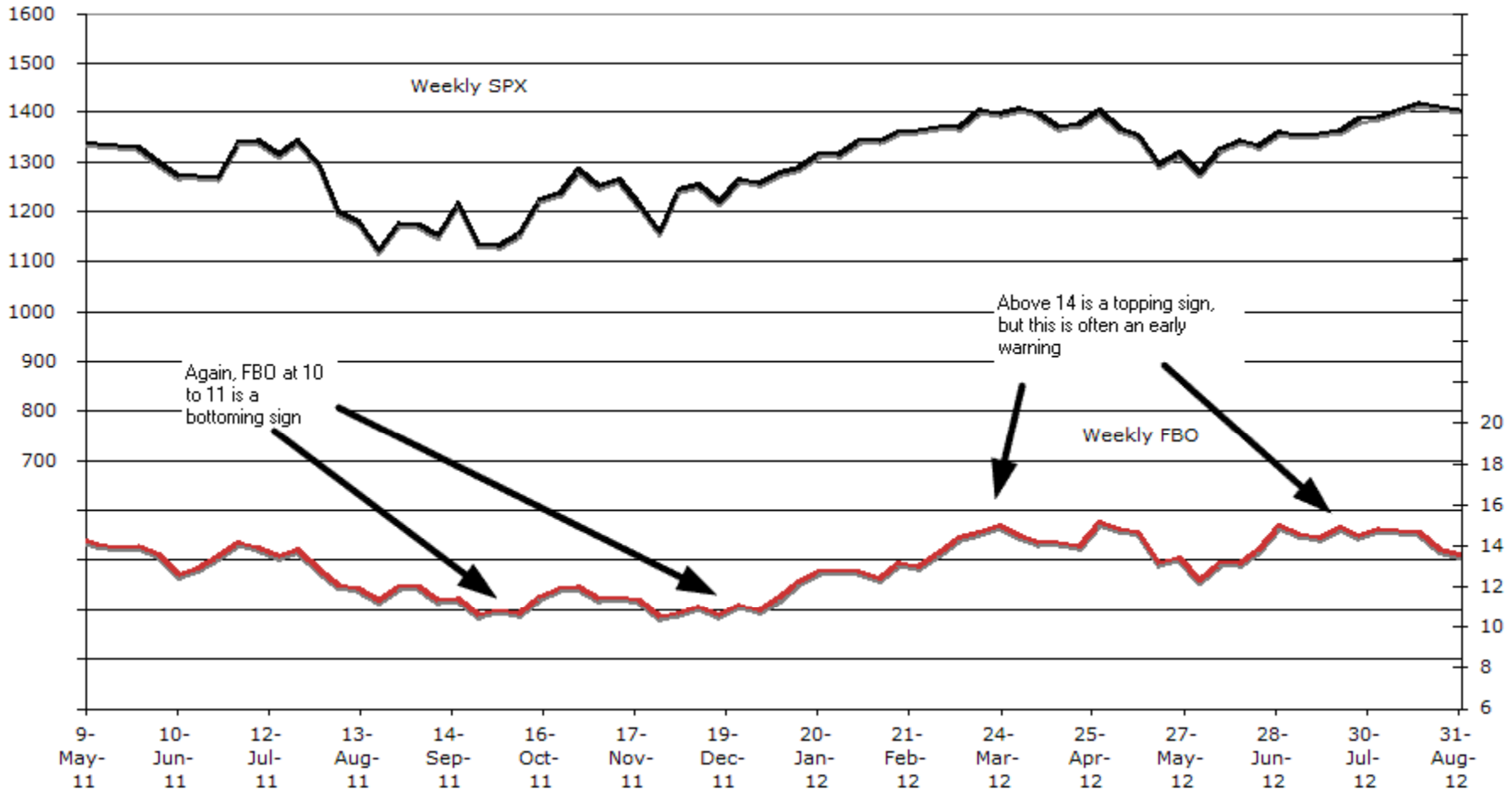


Chart: FBO Weekly Internal Momentum Indicator



External Momentum Indicators

External momentum is the most easily observed for advisors, as the technical indicators on the workstations at most of our client firms measure this. Of the many indicators available, we show charts depicting

1. Moving Averages
2. Stochastics,
3. A number of our own indicators (Fred's Price Oscillator or FPO is the most common).

We will show all of these charts, but take a "time-out" to show our Basic Chart. This consists of price combined with moving averages in the top pane, and the stochastic oscillator in the bottom pane. Initially, we came up with this chart as a way to train advisors and give them a "quick and dirty" method to evaluate the technical condition of a market. A glance will tell whether the trend is up or down, and if the unit is overbought or oversold within that trend. From this can come a quick evaluation of risk and reward. This evaluation is part of our advanced training class, given in person in branches.

Chart: “Basic” External Momentum Indicator

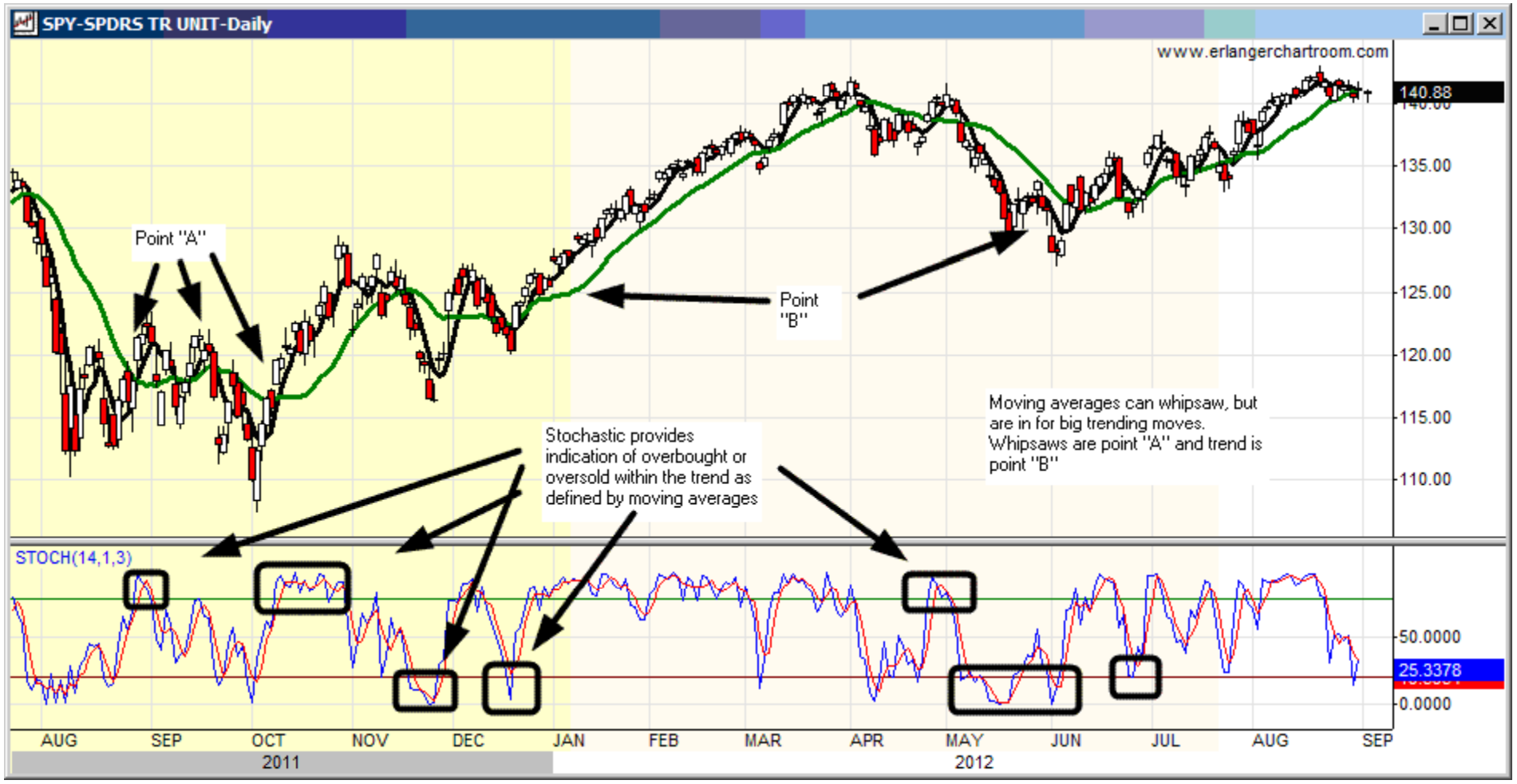


Chart: “Basic” External Momentum Indicator

Chart: "Basic" External Momentum Indicator

External Momentum Indicators

Many ask if evaluation of the Basic Chart is our “process”. It is not. Rather, it is the method we teach advisors to monitor trend, and it is one method, but not the only method, that we use to monitor trend here at the FRED Report. It has the virtue of being quick and easy to use. PLEASE NOTE: It has strong measuring, but WEAK predictive, value. Our predictive indicators remain behind the curtain but the results of these indicators are represented in our daily, weekly and monthly commentaries.

Chart: PowerShares DB Oil (DBO) Weekly

Chart: PowerShares DB Oil (DBO) Daily

Chart: PowerShares Emerging Markets Debt (PCY) Weekly

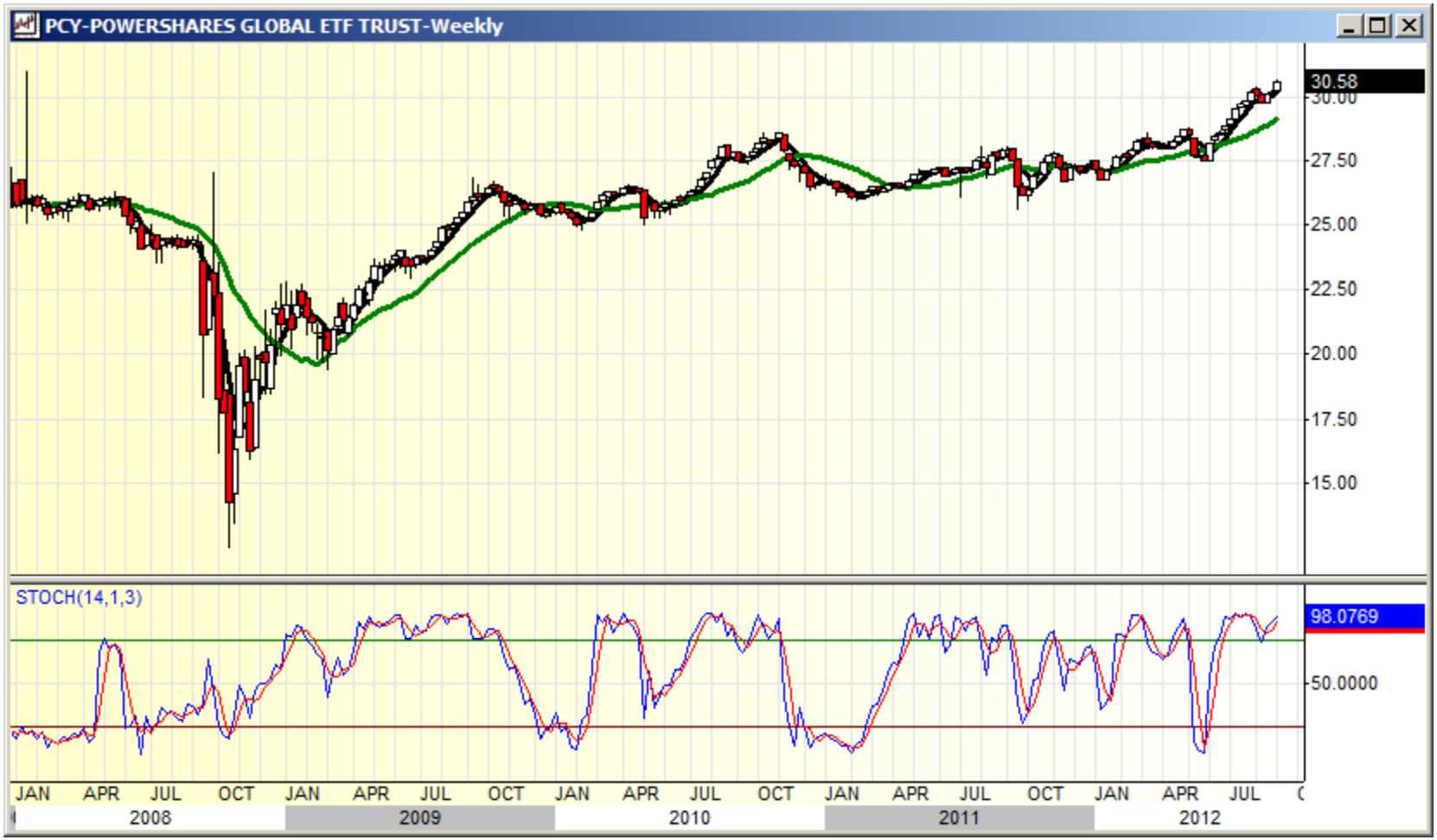


Chart: PowerShares Emerging Markets Debt (PCY) Daily

Conclusion: Non-Discretionary vs. Discretionary

We have covered most of the charts we show in The FRED Report. We close with some general discussion on our approach to the markets, and discuss some other technical approaches as well.

Technical traders often use either non-discretionary (mechanical) or discretionary (allows for judgment and interpretation) methodologies. An example of a mechanical method, or system, is to buy or sell every time a moving average crossover occurs. The idea is that if every signal is taken, eventually one will be a big move.

At The FRED Report we use discretionary methods, although we do monitor some mechanical systems as part of our trend following approach. There are several reasons for this, the most important of which is advisors tend to act for reasons outside of a purely mechanical approach.

The other thing to note is that we have a trend following, not a relative strength based, methodology. This causes quicker signals, but also more signals. These can be whipsaws if not filtered with some of our more discretionary tools.

Putting It All Together: October 4, 2011 FRED Alert!

E-mail sent on October 4, 2011 6:13am est: This alert is meant as an addendum to the Monthly Review, as while that was in production the SPX (and SPY) have made the new price, and closing lows, forecast in early August, to complete the pattern and potentially forecast a rally of some magnitude.

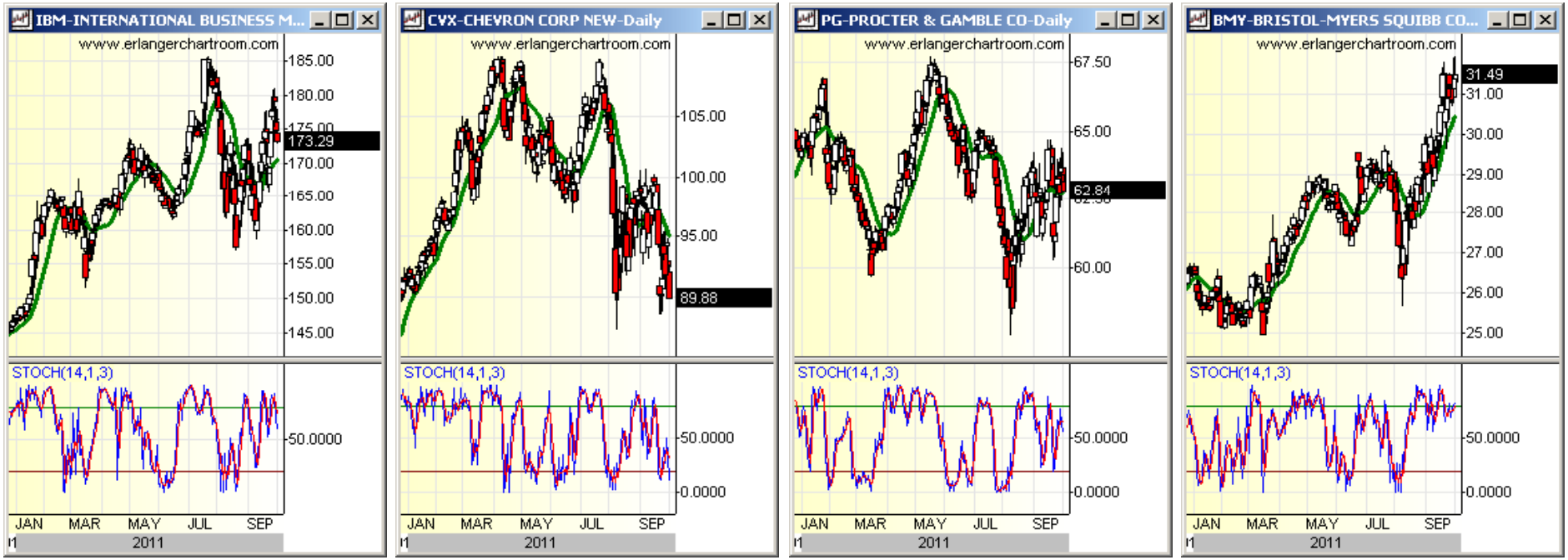
We have had a number of questions about this that we will attempt to answer, below.

First, several advisors have asked whether this needs to be a WEEKLY closing low to complete the pattern? Our answer is that while that would be ideal, it is not necessary – and **more important is that for this to work the market should stabilize in this 1100 to 1075 – 1080 area and not just fall apart**. It is certainly possible that the market churns around here, make a new closing low, and rally over the next few weeks. Use risk management: it is certainly possible that the decline continues – we have been wrong before, and as mentioned – the fundamentals suggest more decline is possible, trend following systems (which often lag at turns) remain negative.

Putting It All Together: October 4, 2011 FRED Alert!

Second, we are not surprised that we have arrived in this price area. **What IS surprising is that some of the indicators in the Monthly look as positive as they do**. We have to be bullish here, but with risk management in place, as if this area fails to hold this is likely the *halfway point of the decline*. Could we test the 920 area on SPX if this market fails to hold? Absolutely - SO: Risk Management and flexibility is key.

Third, we note that stocks in strong sectors are doing quite well – several advisors are trying to buy some of the strong stocks in our Sector Review cheaply (such as IBM, CVX, PG, BMY) and they are not getting fills. This could change if the market can continue the decline, but it is certainly a positive surprise.



Putting It All Together: October 4, 2011 FRED Alert!

Fourth, we have had a lot of questions on financial stocks. We remain underweight these issues, and will not change this until our BAC accumulation model improves – the model continues to make new lows ahead of the stock price, and is at an all time low once again. Financials may stage the biggest quick rebound on a trading basis, however.

Fifth, several advisors have asked about the efficacy of averaging in slowly here, and others have asked about selling puts on stocks they want to own. We assume most of our subscribers have sizeable cash positions waiting to be put to work, so those are decent ideas. **We would like to see a down open Tuesday followed by a relatively quiet day.** How we close today is more important to us than how we trade during the day. We will have more comments out in the midweek report tomorrow.

Technicals Defined

Moving Averages:

Moving averages are one of the building blocks of Technical Analysis, and there are almost as many ways to use this indicator as there are technicians.

At the FRED report we teach and use a dual moving average crossover system to determine trend. Our favorites are the 5 period and 20 period moving averages. We consider the trend to be up if the 5 is above the 20, and down if below it.

Stochastics:

The Stochastic Oscillator is one of the commonly used momentum oscillators and is standard on charting programs. There are two lines on the chart below, %K and %D.

%K is the faster of the two lines, and represents a mathematical formula that *measures where the current close is in relation to the trading range of the last "X" periods of time*. We use a 14 period look-back, so in plain English %K says where the current close is in the trading range of the last 14 days, expressed as a %.

At the FRED report we use it somewhat differently than is commonly taught. The standard way to use the indicator is to register a buy signal when it moves below, and then above, 20 (the lowest 20% of closing prices in the last 14 days). A sell signal is when the indicator moves above, and then below 80 (the highest 80% of closes over the last 14 days).

The other line, %D, is a 3 period moving average of %K. We have found that the Stochastic is sensitive, so we advocate taking signals only in the direction of the trend. When looking at the standard FRED report chart, this would mean taking buy signals when the 5 is above the 20, and sell signals when the 5 is below the 20, but using a different technique to exit positions. The reason for this is the Stochastic is quite sensitive, and can give early indications, especially in new trends. It also can get "stuck" in the direction of trends, which connotes strength and not weakness. Another, preferred interpretation, is to use the indicator to measure risk. An example: buy in an uptrend, not when the stochastic is at 90% but rather wait until it falls below 50%, This way, even if a stock, commodity, or ETF does not give one of the "classic" signals, you can still use the indicator to assess risk, and leg into positions.

The FRED Report – Got FRED?

The FRED Report is a unique independent research service designed primarily for Financial Advisor Teams and small institutions. There are four levels of service built in layers, described below.

The Newsletter Service, our basic service, consists of the basic reports. These are:

–The Weekly Report, six pages discussing Stocks, Bonds, Commodities, International, and a Chart of Interest, published Monday morning.

–A Midweek Update, which is generally two pages, updating the weekly report, published Wednesday.

–The Monthly Review, which is a comprehensive review of all of the markets we cover, plus a research piece. It is generally forty pages.

–FRED Alerts, or quick updates, in fast market conditions.

COST: $30/Month or $360/year, payable by credit card, or check for annual only.

The Conference Call Service consists of the Newsletter service PLUS:

–A Thursday morning conference call where advisors and managers from all over the world participate. This is a live call where stocks are discussed, and all questions are answered in real time. A replay is available.

–A comprehensive Sector Review where the 10 GICS Sectors are discussed and stocks in each sector discussed.

–There is some idea generation with equities and ETFs.

–There is limited consultation via phone and email also attached to this service.

COST: $80/month or $768/year, payable via credit card, or check for annual only. Depending on workload, we reserve the right to limit subscriptions to a certain manageable number.

The Institutional Level: Consists of Newsletter and Conference call services PLUS:

–A chart analysis of the portfolio once per month,

–A conference call for your institution,

–Consultation via phone and email.

We will limit subscriptions to a certain manageable number: COST: $300/month.

The Premium Level: Consists of the Institutional level PLUS:

–Unlimited access and consultation – we even work weekends! We will limit this to 10 clients. We take this level of client only if the work interests us.

COST: $1,000/month. Quarterly billing and soft dollar payment can be arranged for Institutional and Premium Levels of Service.

The FRED Report
Financial Research, Education & Data

This presentation was made possible by The FRED Report. For more information, visit us online at

www.thefredreport.com

The FRED Report (www.theFREDreport.com) was started to provide Financial Advisors and investors access to unbiased market research. The President of The Fred Report**, Fred Meissner, CMT** has been practicing Technical Market Analysis since 1983 and has worked in the research departments of Merrill Lynch and Robinson – Humphrey /Smith Barney. In addition he has served the public as a portfolio manager and financial advisor. We know the problems investors face and have devoted our career to helping find the best possible investments in all environments. Interested readers can also see his work every week at www.thestreet.com.