IBD Meetup: Recommended Reading

To understand the CAN SLIM Investment System, you need to carefully read William O'Neil's book How to Make Money in Stocks, probably more than once. Take notes and use the book as a future reference. Additionally, for those who would like to delve deeper into the world of stocks and further sharpen their investing skills, below is William O'Neil’s recommended reading list:

William J. O'Neil's recommended reading list:

24 Essential Lessons For Investment Success - William J. O'Neil
How To Make Money In Stocks - William J. O'Neil
The Battle For Investment Survival - G.M. Loeb
Tape Reading And Market Tactics - H. Neill
How To Trade In Stocks - J. Livermore
Reminiscences Of A Stock Operator - E. Lefevre
How I Made Two Million Dollars In The Stock Market - N. Darvas
My Own Story - Bernard Baruch
One Up On Wall Street - Peter Lynch
How To Buy Stocks - Louis Engel
Tracking the Daily Market Averages
Your Most Important and Profitable Investing Skill

Tracking the market's direction is a powerful key to successful investing. If you trade in sync with the market, take advantage of new uptrends, and learn to reduce investments at the beginning of new downtrends, you can make, and keep, a lot of money. If you don't acquire these skills, you'll be fighting the market and find it much more difficult to buy big winners and retain most of your profits.

There are many market and economic indicators out there, but nothing is more valuable than what the market is actually doing. What difference does it make what the bull/bear ratio is if the market is telling you what is going on? These other indicators can be dangerous, because you may choose the metrics that support your view of the market. But, your opinion doesn't determine market direction. The market is telling you what it's doing, why not listen?

Daily Tracking of the Market
You need to track the market's activity every day. Whether the market is in a roaring bull or extended bear, you need to know what the market is doing day-to-day, to ensure you are making the correct decisions regarding your hard earned money. To help you with this, you should be looking at the general market charts on B2 (see chart on next page) of Investor’s Business Daily® and iBD™. These oversized charts for the Nasdaq, S&P 500 and NYSE, make it easier to spot price and volume clues, and the critical distribution days, rally attempts, and follow-through days.
Learning to read these charts with knowledge and skill will help you protect your cash before a big market downturn and start buying the big winners right away in a new confirmed uptrend. By using these charts, you'll begin to recognize where the market is, and what it is actually doing. We'll discuss the benefits of doing this in three parts:

- **Part 1 — Market Tops and Distribution Days**  
  (recognizing six distribution days over a five week period at the top of the market)

- **Part 2 — Rally Attempts**  
  (how to interpret each attempted rally)

- **Part 3 — Follow-Through Days**  
  (recognizing follow-through days - time to begin buying)

**Part 1: Market Tops and Distribution Days**

Most people don’t recognize market tops because they don’t know exactly what to look for. Some do know the clues of a market top, but ignore them since most distribution days occur while the market is still going up. Everyone is happy. Their stocks are going up. So, they do not pay attention and count the number of tell-tale distribution days. You must recognize these distributions days and how they will help you sell and raise some cash as the market tops, lock-in your gains, and reduce your risk exposure.

**Distribution Days**

Distribution in the market takes two forms:

- **Distribution Day** – This occurs when one of the major indexes (Nasdaq, S&P 500, NYSE), closes more than 0.2% lower on higher volume than the day before. It doesn’t matter how much higher the volume is, as long as it is higher. It’s that simple to spot and count the number of days. You can do it!

- **Stalling Day** – This occurs when one of the indexes listed above shows a volume increase from the day before, but the index itself shows a significantly smaller price increase compared to the larger price increase on either of the two days before, and/or barely finishes up for the day.
Market Topping Example

Now, let's look at the market top from Spring 2011 as an example of topping action. View chart to the right and the descriptions of distribution days on the next page.
Distribution Day #1 - The market is moving along, and all of a sudden, you get a distribution day. The first day doesn’t mean a whole lot. They occur naturally in a strong market.

Distribution Day #2 - A few days later, you may get a second. And, that doesn’t mean much either.

Distribution Day #3 - However, when a third distribution day occurs, that’s when you really must start paying attention. Now, you have to begin thinking, could this lead to 5 or 6 distribution days which almost always marks the top of a market?

The top could last 5 to 7 weeks, 6 months or longer. But, the probability for a decline that will affect most stocks is very high.

Distribution Day #4 - When you get a fourth distribution day, you may now want to consider selling shares or begin to lighten up some positions. You don’t want to argue with what the market is beginning to tell you.

Distribution Day #5 - On the fifth distribution day, you should consider selling more of your holdings, since now we are nearing the sixth distribution day, which typically confirms this is topping action.

At this time, the market is still going up and people are happy as a lark, since things appear to be working and the news is probably pretty good. They have certain opinions, and they really like this stock or that stock. So, most people simply don’t want to think about selling. It’s all about human psychology.

Distribution Day #6 - Then, you get the sixth distribution day which tells you definitively that the market is now being overcome by supply about ready to correct. At this point you should be off margin, if you use it, and have safely raised more cash.

This is when you want to start building your watch lists with leading stocks that hold up relatively better during the correction and leading stocks that correct and begin forming new bases. Virtually all sound bases are created during market corrections. So, this is no time to go to sleep on the job. You’re now watching the market every day, looking for a rally attempt that, in time, leads to a follow-through day. That is your crucial signal to begin buying fundamentally strong stocks that start coming out of proper bases.
Part 2: Evaluating Each Rally Attempt

When the market is in a correction, it doesn't go straight down. There will be up days here and there, and there will also be several up days strung together. These signify an attempted rally. There are several signs to look for in a rally attempt to determine:

- a) if it’s for real and may lead to a strong follow-through day starting a new uptrend
- or
- b) if it is just the standard ups and downs of a market continuing to sink lower.

If you learn to differentiate between these and spot key clues, it can be very profitable. There are several factors you want to measure carefully when the market begins each new rally attempt.

Volume: Is it increasing or decreasing?

On the way up, is volume increasing each day as the market goes higher in price?

If so, you may have something. But, you still need to wait for confirmation of a new uptrend with a strong follow-through day.
or
Is volume declining each day on the way up?

This indicates no real demand for shares as the market rises. This is not a good indicator for a rally attempt, since the price rise increasingly lacks conviction, it can be short-lived before a new leg down.

**Volume: Is it above average or below average?**

Is volume on the way up above average or below average?

For example, as the market is drifting lower, are you seeing above average volume on several down days in a row, then when it turns up for a few days the volume is below average? That’s telling you there’s more supply than demand, which usually indicates the days up may be temporary and the general trend is still down.
Volume: Is it higher on the way up or on the way down?
Is volume on the way up higher than it was on the way down?

For example, you may have a few up days on above average volume, but if the previous four or five down days were on even higher volume, that indicates the rally may soon fail.

Does the Market Have a Personality?
When the market is drifting lower, it can start developing a personality. There may be a leg down on heavy volume, then a three day rally attempt in lower volume. Then, another leg down in heavy volume and another three day rally attempt on lower volume.

When you learn to recognize this, you can better stay in sync with the market.
Plus, if you’re shorting, this may be a great clue. If the market is rallying up on light and/or decreasing volume for a few days, then the first day it turns lower on heavy, increasing volume, that’s where you may (before new lows are made) want to short.

Eventually, the market will have the strength to start a real move higher, so the attempted rally will be successful and confirmed by a strong follow-through day on the fourth attempted rally day or even several days beyond the fourth day.

**Part 3: Follow-Through Days**

Successful investors understand the different stages of a normal stock market cycle and pay special attention to the importance of market corrections. Market downtrends can help you find new leaders since most chart patterns are created during market declines. It’s easy to give up and throw in the towel during a weak market, but investors must remember that the market will turn on some out-of-the-blue news, and a whole new uptrend may start with a strong, valid follow-through day. It’s important to note: new winners will emerge right on a follow-through day, so you need to be prepared, on the job and mentally ready to take advantage of a sudden developing new uptrend.

**Follow-Through Definition**

Follow-through days mark the start of all new market uptrends. After a period of market weakness, the market will mark a bottom, that’s the start of a rally attempt when a major index (Nasdaq, S&P 500, NYSE) will close higher in price.

Then, the first two or three days of the rally are disregarded, as it has not yet proven it will succeed and follow-through with power and conviction to confirm this rally is a real new uptrend in the market.

Therefore, the follow-through day needs to come on or after the fourth day of a rally attempt. A follow-through day occurs when one of the major indexes listed above closes up usually around 1.5% to 2% or more for the day on increased volume vs. the day before. This indicates that the market, in the majority of cases, has changed direction and is probably beginning a new uptrend.
Follow-Through Days Occur When You Least Expect Them (Again, it’s all about human psychology.)

When the follow-through does occur, it comes when you’re probably not feeling great about the market, the market has been declining for weeks or months, maybe you lost a little money at the end of the last rally, and the news is almost all negative. The “experts” will be saying the economy is poor and the market is terrible. Most people listen to the news and not the market. It defies human nature to buck the trend or resist popular opinion, but you must watch and carefully track the day-to-day market averages and when the follow-through occurs, you need to take some action.

The Big Winners Can Come Out Fast

The big stock leaders that go up 100% to 200% or more can break out ON the follow-through day or immediately after. This is why you never want to give up on the stock market or cancel your subscription to save a few dollars and end up missing out on $10,000, $50,000, $100,000, or more. You always want to be there ready to act. If you buy at the right time, you can enjoy the entire run, plus, you’ll be in a position to better execute proper add-on purchases to increase your potential profits even more. If you wait, you could be chasing a stock and get shaken-out during a normal pullback.

You may say: “what if the follow-through fails?” Well, then the CAN SLIM® Investing System’s many sell rules will help you get out quickly. Then, you get ready for the next follow-through. Remember, a new bull market has never started without a follow-through day. And, every time there is a successful follow-through, the big new leaders break out quickly, typically on the first day or during the first 10 to 15 days. This fact has been proven through 27 different stock market cycles over decades.

This is something you want to learn how to always spot and never miss in the future. Why? Because, there will be many strong follow-through days and hundreds of dramatic new leaders in every future uptrend. America’s innovators and inventors lead each new market cycle due to our unlimited freedom and opportunity for virtually everyone. That’s why so many people the world over continually come here. So, learn how to recognize and capitalize on our never-ending parade of new innovators.

Examples from the September 1, 2010 Follow-Through

Many leading stocks broke out on, or right after the 9/1/2010 follow-through day. Here are examples of just three of them:
Chart A:
This daily chart shows the 9/1/10 follow-through day and three winning stocks that took off right away (CMG, SINA, and LULU), with their percent price increases achieved in the months after the breakout.
Chart B:
This weekly chart for Chipotle Mexican Grill shows you the follow-through, CMG’s breakout and the ensuing run.
Chart C:
This weekly chart for Sina shows you the follow-through, SINA’s breakout and the ensuing run.
**Chart D:**
This weekly chart for Lululemon shows you the follow-through, LULU’s breakout and the ensuing run.

**Final Note:**
It’s important to note, that, as of this writing, LULU and CMG are still making new highs.
The Basics: Daily Charts

- Blue Bar = Up Day
- Pink Bar = Down Day
- Horizontal line = closing price
- Day's price range
- 50-Day Moving Average Line
- 200-Day Moving Average Line
- Relative Strength Line: Compares stock's performance vs. S&P 500
- Horizontal line shows avg. volume over last 50 days
- Price
- Volume (# of shares traded)
The Basics: Weekly Charts

- **Blue Bar = Up Week**
- **Pink Bar = Down Week**
- **Week’s price range**
- **Horizontal line = closing price for week**
- **10-Week Moving Average Line**
- **40-Week Moving Average Line**
- **Relative Strength (RS) Line:** Compares stock’s price performance to that of S&P 500 over last 52 weeks
- **Horizontal line shows weekly avg. volume over last 10 weeks**
- **Price**
- **Volume (# of shares traded)**
What to Look for in a Chart

Unusual Volume
Institutional investors (banks, mutual funds, etc.) are main drivers of stock prices.

Charts show you what big investors are doing by tracking price & volume on daily or weekly basis.

Would you see these key signs without a chart?

Unusually heavy volume on UP days = buying among big investors.

Unusually heavy volume on DOWN days = selling among big investors. Watch out!

Line indicates avg. volume
What to Look for in a Chart

**Support from Big Investors**

Big investors make or break stocks. Charts show you if they’re buying – or selling – a stock at key times, such as:
- Pullback to 50-day (or 10-week) moving average line
- Breakout from chart pattern

Support: Stock quickly goes back above 50-day line. Means big investors are buying shares.

Sell-off: Big investors sell on heavy volume, pushing stock below 50-day line.

Charts are easiest way to see support or sell-off.
What to Look for in a Chart

Uptrend, Downtrend, or Sideways Trading?

Buy when a stock is moving up, not down.

One glance at chart shows you stock’s direction.

Ignore opinions & predictions. Check the chart!

Uptrend
Stock headed in right direction. Still need to wait for proper buy point.

Downtrend
Avoid. Wait for stock to form proper base & rebound before buying.

Sideways (or Flat) Trading
Direction unclear. Is it forming a sound base?
What to Look for in a Chart

Chart Patterns
Before making big runs, the best stocks tend to form patterns. Learn to recognize them! Patterns help you:
→ Reduce your risk
→ Pinpoint the right time to buy

Keep It Simple!
Get Started with 3 Patterns…

See the Best Time to Buy

What’s a “Buy Point”?
- Point from which a stock is most likely to go UP in price
- Every chart pattern has a specific buy point
- Based on detailed study of all big winners since 1880s

Weekly Chart
Buy Point
Cup-with-Handle
Cup-with-Handle

Most Common and Profitable Pattern

Stocks that go up 50%, 100% or more often form cup-with-handle at start of big run.

Reaping big gains starts with recognizing this pattern.

• Resembles teacup viewed from side
• Many occur in every new bull market
Cup-with-Handle: Checklist

- **Prior uptrend:** ≥ 30%
- **Base depth:** 20% – 30% (more severe in bear markets)
- **Handle:** Depth 12% – 15% (up to 33% range in bear markets). Volume should get lighter, not heavier.
- **Base length:** ≥ 7 weeks (Could be much longer)
- **Buy point:** Handle peak + 10 cents. Volume at buy point should be 50% higher than average daily volume.

**Buy Market Correction Buy Point?**

- Buy points are at a dip after a decline. Make the stock prove its strength by rising markets at 10 cents at a market weakness before market pulls individual stocks down.
Cup-with-Handle: What’s Happening?

Prior Uptrend: Near peak, story too obvious. Not enough new buyers left to push stock higher.

Sell-Off: Big investors take profits. Overall market may be weak. Late buyers now frustrated by losses.

Handle: Late buyers with losses sell now that they’re near break-even. Big investors sit tight.

Buy Point: Big investors push stock through prior point of resistance in big volume. Shows enthusiasm for higher stock price. May be new market uptrend.

Right-side of Cup: Big investors slowly accumulate shares. Late buyers with losses dream of getting back to break-even. Overall market may be strengthening.

Bottom: Big investors done selling; start buying shares.
Apple (AAPL) 2004 Cup-with-Handle

**Story Behind the Stock**
- Hot new product: iPod
- Triple-Digit Earnings: +433% & +300% in 2 quarters BEFORE breakout
- Accelerating Sales: +8%, +19%, +36% in 3 quarters BEFORE breakout

**Prior Uptrend**
- Buy Point: peak of handle + 10 cents

**Big volume at breakout**
- Take closer look with DAILY chart →
Apple (AAPL) 2004 Cup-with-Handle

- **Peak of handle**
- **Buy Point:** peak of handle + 10 cents
- **Breakout:** On volume over 50% above avg.
- **Base depth = 23%**
  → Safely within 20% – 30% range
- **Handle:** Forms in upper half of base. Volume lighter.
Apple (AAPL) Run After March 2004 Cup-with-Handle ➔ 1,534% gain in 99 weeks

Buy Point
2004 Cup-with-Handle
(as shown in prior slide)

Notice how weekly chart gives longer term perspective than daily chart.
IBD Stock Research Tool

The IBD Stock Research Tool is located on the home page of the new Investors.com, and gives you quick access to everything for your investing needs. This tool was designed to give you an effective step-by-step process for using the CAN SLIM® Investing System.

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