Market Dynamics

Volume 10, Issue I33

August 27, 2011

Performance Management System

The Use Of Time Cycles In The Stock Market

Portfolios heavy with under-performing stocks almost never outperform the market.

Ignat's Law

"You don't see the garbage on the beach until the tide goes out."

Unknown

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In the late 1960's I began to follow the forecasts of a well-known stock market analyst named Edson Gould. He made some uncanny market calls in those years, especially his cycle forecast for the low of the 1973-1974 bear market.

A book was published in 1970 by J.M. Hurst titled ***The Profit Magic Of Stock Transaction Timing.*** His whole approach to the stock market was based on time cycles. He had used a well known mathematical technique called The Fast Fourier Transform (FFT) to analyze the prior 40 years of stock market history to determine the lengths and magnitudes of time cycles in the stock market. He concluded his book with a chart that showed the results of his work using the FFT.

He reported on the importance of the four-year cycle and other cycles of shorter length His summary table showed that longer term cycles have bigger amplitudes (power) than shorter term cycles and the strength of the cycles steadily diminished as the time period got shorter.

This book made a very strong impression on me and I have focused on the four year cycle ever since, with good success. Experience over subsequent years showed that while the cycle averaged about four and a half years, it could be as short as three years or as long as five years. The cycle length was based on the time period from low to low in the stock market.

Over the past ten years, I have used the canned FFT program that is built into the Microsoft Excel application. I was interested in determining if there were shorter term cycles that could be used successfully for anticipating stock market fluctuations. I determined that the shortest cycle I could find had a period in the forty to fifty day range. (It should be noted that these are trading days not just calendar days.) Cycles of shorter duration than forty days were too unstable to be used as a forecasting tool.

This work has been a significant part of my marker research and reports in more recent years. We know how to measure oversold conditions using breadth of market statistics for various sectors such as the S&P 500, the S&P 400 and the S&P 600. When an oversold condition develops at about the same time the cycle work predicted a low, then we have a fairly strong conviction that a meaningful stock market low has developed.

It should be remembered that the cycles are not precise and they can vary in length and magnitude from one time period to the next. Experience shows that no matter how good a forecasting technique might be, it can always change in unexpected ways, Even given these caveats, there are very few stock market prediction methods that have any reliability at all, so time cycles should be included in the investor's set of tools.

It is amazing that given the significant changes that have occurred in the stock market over my career, that time cycles have remained fairly constant. To the casual observer, the stock market is completely random and unpredictable and yet the data show that there are some fairly regular time cycles that can help investors manage their investments. It is in the nature of the stock market to move up and down in waves and these fluctuations can be fairly constant in length.

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