PROTECTING YOUR FUNDS

"Safety First" Market Timing for Conservative Mutual Fund Investors

3 June, 1996 Volume 4, Issue 6

DOW FINALLY CONFIRMS BROAD MARKET ADVANCE

Last week the Dow Jones Industrial finally confirmed the breakout of the broad market averages; however, by the weeks end the breakout had failed. Wow, that a lot of jargon for an opening line. But, please read on and I promise to explain.

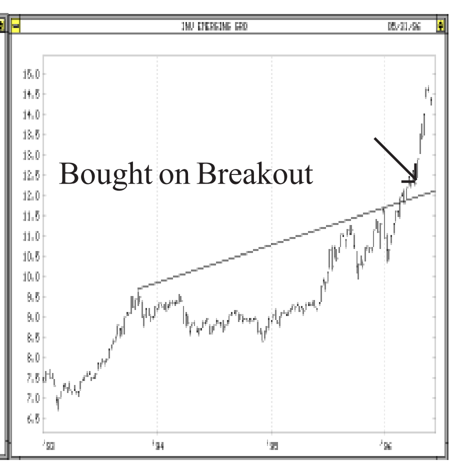
Part one: The Dow Jones Industrial Average. The Dow is a price weighted average made up of 30 actively traded, blue chip stocks (the big guys). One hundred years ago it used to be composed of all industrial, manufacturing type stocks with the idea that how the industrials go, so goes the economy. However, over time our economy has become more diverse with the service sector actually exceeding the industrial sector in the number of workers employed. With that in mind the Dow has substituted the modern giants such as McDonalds, American Express and AT&T. But does the Dow really indicate where the economy is heading? I don't think so. It is still only 30 stocks and still only the biggies. Our economy is so diverse and predominately made up by small to medium businesses that I think the Dow lags behind the real economy both in being the last to start up moves and the last to break down.

So if the Dow does not represent the economy, why even mention it? Just forget it and I can end this article right here. Unfortunately, it is not that easy. The Dow is important because it is so widely followed and thus becomes a measure of market psychology. Newspapers, television and every other information distribution channel to the masses use the Dow as representation of the "Market". Therefore, the Dow deserves our attention because it indicates what Joe Six Pack thinks the market is doing.

Part two: "...confirmed a breakout of the broad market averages...." What? Stay with me; it's not as bad as it sounds. Let me explain the end of this section first. "The broad market averages" (again like the Dow Industrial Average) are composed of the average price of a group of stocks. However, these averages are much broader in scope. The Value Line Composite Index, for example, is made up 1700

Continued on page 2

FUNDS IN THE SPOTLIGHT



FUNDS IN THE SPOTLIGHT

This month we look at the two funds held in our conservative growth account. We are currently split 50/50 between Invesco's Gold and Emerging Growth funds. We originally purchased gold on the breakout above the declining tops line (see chart below) on 1/1/96. We exited temporarily but were given a new buy single as of 5/10/96. Invesco's Gold fund specializes in junior gold mining companies like Diamond Fields and Gold Star Resources verses the biggies like Homestake Mining; so, this fund often move up even when gold or the XAU Gold Index may be moving down.

Emerging growth was purchased as a switch from Europe on 3/18/96 and has shown tremendous acceleration. This purchase coincides with the testing and subsequent breakout of the NASDAQ or OTC composite. While a short lull is expected, great inertia is still present and should allow the move up to continue.

MANAGED ACCOUNT PERFORMANCE

Account Type	Year to date Returns	1995
Bonds	4.08	11.54
Tax-Free	-1.84	8.22
Growth & Income	14.55	27.17
Conservative Growth	25.17	34.45

*Returns achieved through 5/31/96 with approximately one half the risk of a buy-and-hold strategy.

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Status of Timing Models

Portfolio	Status	Current Signal	Holding	Signal Date
Income Bonds	Yellow light.	Buy	High Yield	(05/21/96)
Tax-free	Yellow light.	Buy	Muni Sec.	(05/21/96)
Conservative Growth	Green light	Buy	Emgth & Gold	(04/23/96), (05/10/96)
Growth & Income	Green. to Yellow	Buy	High Yield, Gold & Emgth	(05/21/96), (05/10/96) (04/23/96)

Current Outlook:

Stocks

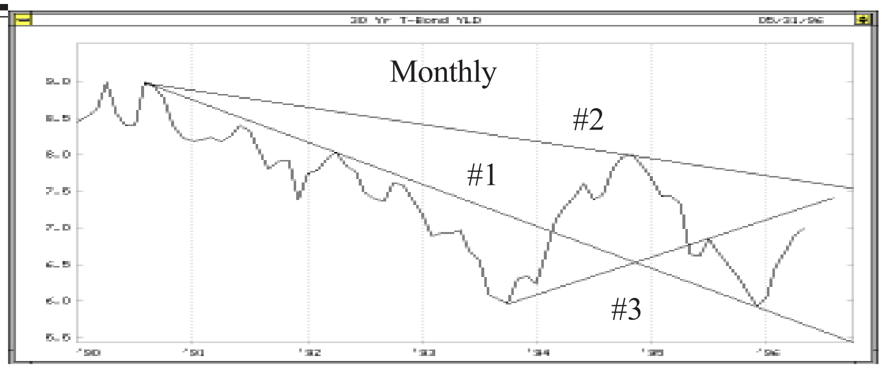
I am still bullish (positive) on the stock funds. As the cover story, indicates, I expect to see a small amount of softness over the next week, but expect a resumption of the rally after that. This outlook would change if the broader market averages also moved below their breakout levels. A bright note is that the 100 lower priced stocks of the S&P 500 which have been in a declining market over the last two years, have also recently had a breakout to the upside, indicating the internal strength of the most recent move.

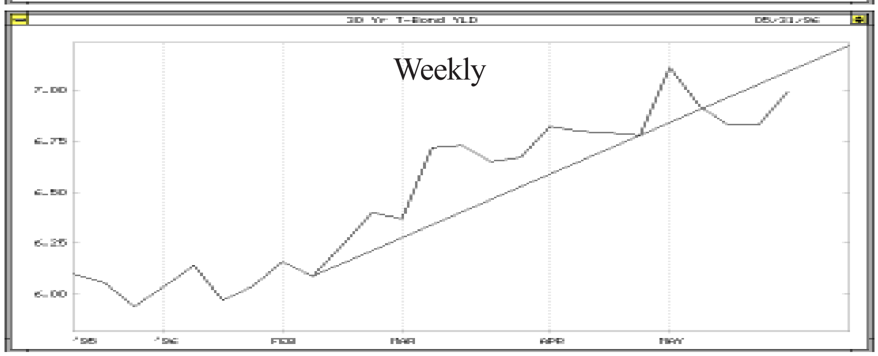
Bonds

As usual the Federal Reserve is causing havoc in the bond market. On Friday, 5/31/96 an Ex-Federal Reserve Governor made a statement that he believe that the Fed. would raise rates by 50 basis points or one half of a percent in July. This statement sent the 30 year bond market reeling to drop over one full point for most of the day and back above the 7 percent yield.

The graph on the upper right is the monthly close of the 30-year bond yields. There are three trendlines to consider. First is the resistance line that contained yields from late '90, '92 and finally broken in early '94, coincidentally provided support in December of '95. These trend lines work!

The second and the third are active today with the third offering a possible resistance point at or slightly above the current level. The chart below is a weekly chart. The yield broke and has turned back towards the trendline rising under the current move up. As expected, the yields are moving up to test the trend line, which is now resistance, and should be stopping point for the rise. If the trend line is penetrated to the upside, the resistance should be met by the declining second trendline off of the November '94 highs. (above chart) This could allow yields to get as high as 7.75%. On a historic basis, May 31 has represented the low in bond prices and the high in yields for 17 of the last 18 years. Why? I don't know, but there seems to be some fundamental shift in the bond market psychology as the summer starts.

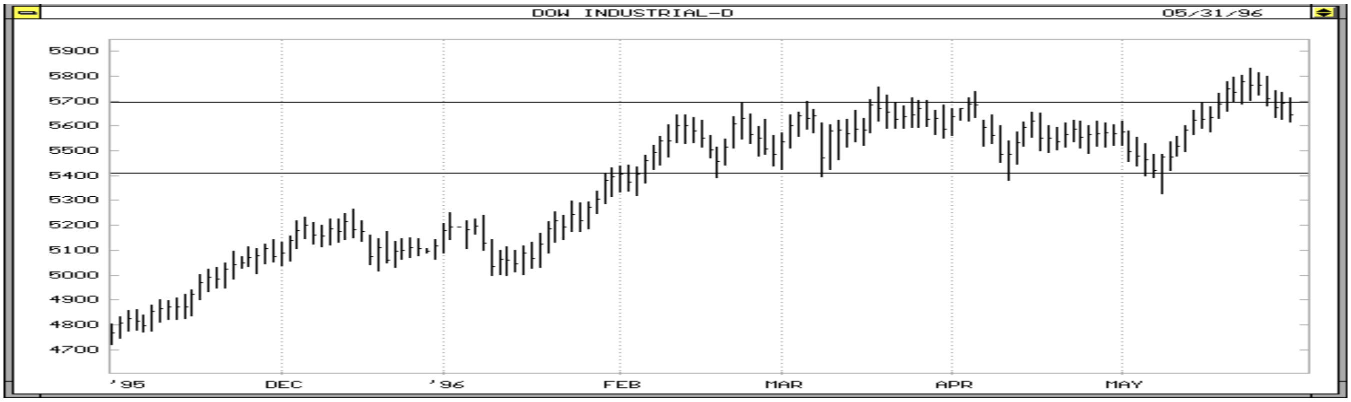


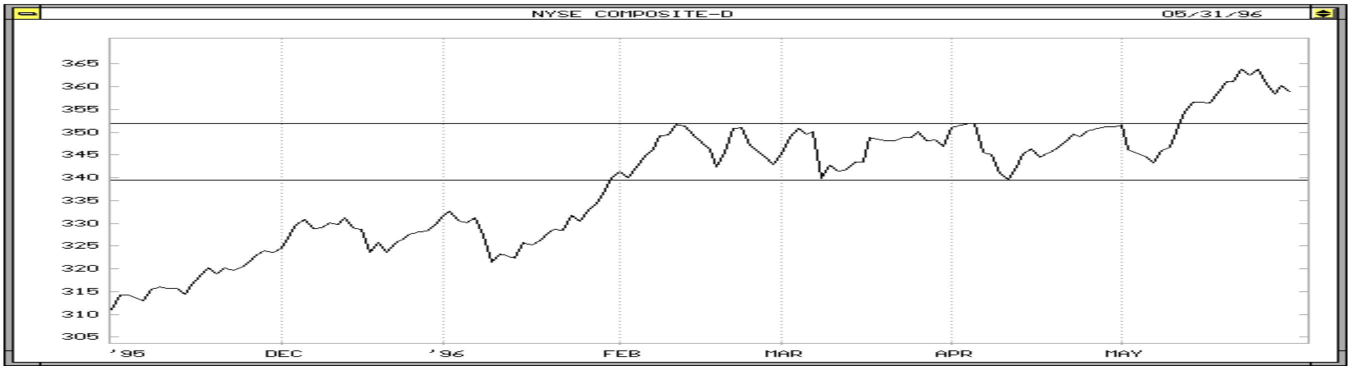


Continued from page 1

stocks, some of the stocks traded on the New York Exchange, the American Exchange, and others from the Over-the-Counter Market. Now we are talking a representative average and my personal favorite. The Value Line is a much bigger average, spanning large, medium, and small companies. It represents well established industry, maturing services and up and coming technologies and therefore more accurately depicts the direction of the nation's economy. This is not the only average. There are many more, but the idea is that a broad market average encompasses a larger group of stocks and is therefore more representative of the market as a whole.

Now that you know what broad market averages are, let me explain what they did. For this, I am going to use some graphs. It will be easier to see and this is only a three page newsletter. On page 3 there are two graphs. The top graph is the NYSE Composite Index (all the stocks traded on the New York Exchange) and the bottom the Dow Jones Industrial Average. On each graph, I have drawn two horizontal lines, with the lower line showing support under the market (a price level at which the demand from buyers exceeds supply, thereby stopping a decline) and the upper line indicating a resistance line (a price ceiling at which sellers, supply, increases resulting in a halt of price advance). The case of the NYSE Composite the price was turned away from the upper resistance line six times before it successfully broke through in early May. This penetration is referred to as a "Breakout" from old resistance by jargon using guys like me. A





breakout above a resistance line is a positive sign for the market and usually indicated a period of accelerated growth. The longer in time the resistance held, and the more times the price approached it and was turned back, the greater the significance and expected growth of the breakout. The breakout of the NYSE Composite thereby gives me considerable confidence that the market will continue higher for some time. The fact that the Dow Jones also experienced a breakout above its upper resistance line adds to the continued growth confidence in the indication that Joe Six Pack will be fed the information that the market should continue to grow from the media and he will start to invest, albeit a week or two later.

Finally, the end of the sentence. "...however, by the weeks end the breakout had failed." Please go back to the graph of graph of the Dow to see that the price closed below the upper resistance line by Friday of last week. Some extra information will be needed here. Once the price of an item experiences a "breakout" then the line that was resistance above the price changes and becomes support below the price. I could show proof of this on countless graphs, but space is limited so please just take my word for it . When the price moves above a resistance line it is normal and expected behavior for the price to come back down to the line. This is called "testing support" and one of my favorite buying places. However, on the rare occasion that the line does not hold then it is know as a "breakout failure" or a "bull trap" at which time the price will normally accelerate to the down side, often dropping all the way down to the old support level.

Now all the jargon is removed and the opening sentence reads as follows, "Last week the psychological measure of the market for both the media and Joe Six Pack finally caught up to the more encompassing average measure of the market that more accurately indicates what the market and therefore the economy is doing by having demand for stocks absorb a previous supply surplus at a price level that could not be sufficiently over come on six previous occasions; however, by the weeks end the price closed once again below the supply surplus price level possibly indicating that at this higher price level a larger number of investors prefer to liquidate their positions overwhelming the number of investors seeking to purchase, meaning that supply exceeded demand thereby driving the price lower."

Wow! That's one big sentence and its exhausting. Hopefully now you see why I use so much jargon. Each word represents a whole area of thought or implication of what is going on in the market.

Now that you understand the opening sentence, please let me continue. It is significant that the Dow closed below the old resistance/new support. If it were not for the fact that the other broad market averages like the Value Line, S&P 500 and OTC Composite were marketablely above their support lines, I would be greatly alarmed. Additionally, it is also normal for the broader market to consolidate or come back down to retest support after the Dow finally confirms the breakout. I suspect that the broader market averages will test and hold support within the first week of June and from there move substantially higher with the Dow reversing to the upside as well.

See, now you can read this stuff like a pro. The scary thing is that it is starting to make sense too.