BUY—DON'T HOLD

INVESTING WITH ETFs USING RELATIVE STRENGTH TO INCREASE RETURNS WITH LESS RISK

LESLIE N. MASONSON

Vice President, Publisher: Tim Moore
Associate Publisher and Director of Marketing: Amy Neidlinger
Executive Editor: Jim Boyd
Editorial Assistant: Pamela Boland
Development Editor: Russ Hall
Operations Manager: Gina Kanouse
Senior Marketing Manager: Julie Phifer
Publicity Manager: Laura Czaja
Assistant Marketing Manager: Megan Colvin
Cover Designer: Chuti Prasertsith
Managing Editor: Kristy Hart
Project Editor: Betsy Harris
Copy Editor: Cheri Clark
Proofreader: Williams Woods Publishing Services
Indexer: WordWise Publishing Services
Compositor: Nonie Ratcliff
Manufacturing Buyer: Dan Uhrig

Published by Pearson Education, Inc.
Publishing as FT Press
Upper Saddle River, New Jersey 07458

Printed in the United States of America

First Printing April 2010

ISBN-10: 0-13-704532-8
ISBN-13: 978-0-13-704532-7

Pearson Education LTD.
Pearson Education Australia PTY, Limited
Pearson Education Singapore, Pte. Ltd.
Pearson Education North Asia, Ltd.
Pearson Education Canada, Ltd.
Pearson Educatión de Mexico, S.A. de C.V.
Pearson Education—Japan
Pearson Education Malaysia, Pte. Ltd.

Library of Congress Cataloging-in-Publication Data
Masonson, Leslie N.
Buy—don't hold : investing with ETFs using relative strength to increase returns with less risk / Leslie N. Masonson.
p. cm.
ISBN 978-0-13-704532-7 (hardback : alk. paper) 1. Exchange traded funds. 2. Portfolio management. I. Title.
HG6043.M37 2010
332.63'27—dc22

2009048632

Foreword

In these tumultuous times in the global financial markets and the 24/7 flow of information and misinformation, the individual investor is not well served by following the buy-and-hold mantra promulgated by financial institutions, mutual funds, and brokerages over the past 50 years. As of November 30, 2009, the inflation-adjusted total return of the S&P 500 for the past 10 years is still negative and has been for over a year. That means that those who retired in 1999 and put their hard-earned retirement money in a market index such as the S&P 500 (because it always goes up, right?) have not earned a penny in the past ten years. If they pay an annual fee for account maintenance, do not reinvest the dividends, or have a systematic withdrawal to live on, they are truly hurting. During the past decade, younger investors have also not performed any better, and their children's 529 plans have also taken a hit, depending on when the funds were invested.

The "world of finance" and "Wall Street" have set the stage for investing for the long term in their onslaught of tactics to market themselves and sell investing ideas to an unsuspecting and financially uneducated public. A huge emphasis is put on diversification and how it will protect you for the long term. They have confused buy-and-hold with buy-and-hope. Commissions and fees are the fuel for most of their effort. I could go on and on about the misinformation that pours out of the financial institutions.

Corporate pension plans are being dumped, Social Security is in the tank, and our financial system is in the midst of a giant restructuring, because the stability of the past 25 years has caused prudence and what used to be called "common sense" to be set aside for greater leverage and higher risk. Retirees as well as younger investors are learning the hard way that "investing for the long term" has periods when the performance is poor and that those periods can last a decade or longer.

So, have I scared you yet? If I have, that was my intention. If you have not yet begun to invest for wealth creation, you need to start immediately, no matter what your age. If you are already investing, you need a better way to protect your money during the downturns. Now is the time to read and consider the guidance provided by Les Masonson in *Buy—DON'T Hold*. Masonson, a stock market researcher, investor, and author, has thoroughly covered all the essential bases of smart investing, and he has done so with the critical detail that is often lacking in hyped investing books written by so-called "gurus." The insights provided in this book are extremely helpful. The advice and methodology that Masonson offers throughout are useful for anyone (whether you are an investment newcomer or a longtime investor) who is interested in learning how to manage his or her investments.

My decades of experience have taught me that there are times when one should not be in the markets and are better off preserving your capital in cash equivalents because bear markets can set you back for very long periods. That is why buy-and-hold is a misguided, and often costly, investment approach. While writing and researching my book *The Complete Guide to Market Breadth Indicators*, I found that specific technical indicators are helpful in determining the changing market environment.

Additionally, the firm that I work for, Stadion Money Management, uses a proprietary technical rules-based, data-driven model to oversee the management of over $3 billion in assets in two mutual funds, separate accounts, and 401(k) plans. There are periods when these accounts are moved more into cash to protect principal. For example, in 2008 when the S&P 500 declined 37%, our Stadion Managed Fund (ETFFX with the sales load included) declined 11.22% because of our defensive approach. This fund can be invested 100% in cash if conditions dictate. Interestingly, Masonson provides an investing plan for all types of investors, with specific rules for buying and selling exchange-traded funds using a momentum-investing model based on relative strength. He first provides guidance on determining the market's overall condition using eight technical indicators so that investors are on the right side of the market. Although we use different indicators, methodologies, and ETFs, his investing approach and ours are similar in that we both strive to reduce risk and minimize losses while investing when conditions are deemed appropriate. Also, we both will exit the market and go fully into cash when the "weight of the evidence" indicates that a sell decision is warranted.

Keep in mind that the closer you get to needing your money for retirement, your children's education, or other joys of life, the worse the effect a severe bear market can have on your assets. It is critical to understand the concept of avoiding the bad markets and participating in the good markets. Masonson has offered a relatively simple approach to acquiring wealth with adequate attention to risk, and he provides the much-needed discipline to reach it. By taking the prudent advice provided in this book, you won't need luck to become a consistently profitable investor. It's never too early, or too late, to invest intelligently for your future. You have already taken the first step by reading this information-packed book. I sincerely hope that you prosper from your newly gained knowledge.

Gregory L. Morris

Gregory L. Morris is Chief Technical Analyst of Stadion Money Management, and author of *The Complete Guide to Market Breadth Indicators* and *Candlestick Charting Explained*. Previously, he served as a Trustee and advisor to the MurphyMorris ETF Fund. Greg was featured in a *BusinessWeek* article in July 2008 and was interviewed in *Technical Analysis of Stocks & Commodities* in September 2009 in an article titled "The Danger Zone with Greg Morris."

Introduction

"We've got a long, long way to go before this secular bear market is over."[1]

Barry Ziskin, portfolio manager Z-Seven Fund

"For those properly prepared in advance, a bear market in stocks is not a calamity but an opportunity."

John Templeton, investor, philanthropist, mutual fund pioneer, and billionaire

My Early Beginnings in the Stock Market

In 1957, when I was 13, my interest in stock market investing was permanently set in motion. My grandmother, Dora Tuchman, gave me one share of PanAm Airways as a birthday gift. I had no idea at that time that I would be fascinated by the stock market for the rest of my life, have a 40-year banking and financial career, and have the opportunity to author three books on investing, and three books on corporate cash management.

During the 1960s and 1970s, I attended shareholder meetings in Manhattan and Brooklyn. I encountered the Gilbert brothers and Elaine Davis, shareholder activists, who challenged management in a spirited discussion of salary and perks and other relevant issues of the day.

I graduated from The City College (The City University of New York) with a BBA, majoring in Finance and Investments, and received my MBA from The Bernard M. Baruch College (The City University of New York), majoring in Operations Research. My master's thesis title was "Statistical Evaluation of the Relative Strength Concept of Common Stock Selection." I've lectured on investing on cruise ships, and I've provided guidance on mutual fund investing to friends who needed some input. From 2005 to 2009, I was a Financial Advisor advising clients on their investments.

My Investment Experience Spans Over 50 Years

Having studied the stock market for over 50 years, I've invested in mutual funds, stocks, options, futures, and commodities. Also, I've day traded NASDAQ stocks and E-mini-NASDAQ futures from 1998–2000 during the Internet and technology boom times. Additionally, I have read more than 500 books on investing and trading over the years, and I've become proficient in technical analysis. I've posted more than 60 financial book reviews on Amazon. Moreover, I've written investing software reviews for *Technical Analysis of Stocks & Commodities* magazine, and articles for *SFO* and *Active Trader* magazines. In addition, I've used many investing and trading software programs over the years, including Telescan, OmniTrader, DTN, TradeStation, ULTRA, VectorVest, and High Growth Stock Investor. Also, I continue to use many free charting, investing, and trading sites on the Internet.

I have subscribed to *The Wall Street Journal* and *Barron's*, and for pleasure I read many financial magazines, including *Money, SmartMoney, Forbes, Fortune*, and *Kiplinger's Personal Finance*. And, when I have the time, I go to my local library to read *Investor's Business Daily*, *Morningstar Mutual Funds*, *Value Line Investment*

Survey, *S&P Outlook*, and *The New York Times* business section. Over the years, I've attended many online trader expos, Money Shows, and specialized trading and investing courses. And, of course, I access useful information about investing on the Internet.

As an investor and trader, I've had successes and failures. But after many years of mixed results, I've found that mechanical non-emotional trading and investing has the highest probability of making money. In the future, I expect to not only reap more consistent returns, but also avoid bear markets. Perhaps you will follow in my footsteps and decide to use the active investing approach provided in this book or one that you develop for yourself.

I urge you to sit down and review your past investment results and determine your rate of return through today. If you are disappointed with your results for any reason, you will hopefully benefit from the approach I recommend in this book. It is critical to your investment success to find a consistent way to make money while minimizing your risk. I've concluded that buy-and-hold investing is very risky and can lead to huge losses; therefore, I've developed a more realistic, easy-to-use approach that will help you become a more consistent and more profitable investor. My goal is to provide you with the key to investment success, which is to know what to buy, when to buy, and when to sell. Profits need to be taken; otherwise, you may give them back over and over again in bear markets. That is not a smart way to manage your money. I am using the approach outlined in this book to invest my money, and I expect to have many profitable years, mainly by avoiding the bear markets and certainly by making better-than-average market returns during the bull markets.

The Purpose of This Book

My goal is to provide you with a nonemotional, systematic approach to investing that will make money in bull markets and protect your portfolio, and even make money in bear markets. This will be accomplished with a simple-to-implement strategy that has less risk than buy-and-hold because you will be out of the market during those market declines. Based on the fact that bear markets follow bull markets, if you use a buy-and-hold approach you will always lose money in bear markets. That is why you need to abandon that approach and use a proactive approach that avoids these deadly market debacles, such as the one that cost investors $11 trillion in losses during the last bear market. As an investor, you need to realize that since 1900 there have been 121 market declines of at least 10%, and 32 of these declines were 20% or more.[2]

This book provides insight about the never-ending cycle of bull and bear markets, and how to take advantage of the market's volatility. It will explain the true risks and rewards of investing, and above all provide an investing plan to sidestep the brunt of future bear markets. As a self-directed investor, you will be provided with a complete step-by-step investing approach to capture the market's upside and minimize losses, if any, when the market starts to change its trend and begin to sink. Moreover, this book provides a realistic investing approach using a time-tested strategy to first determine the market's direction based on a handful of indicators. Then after providing an appropriate universe of exchange-traded funds (ETFs) for investors of different risk levels (conservative, moderate, and aggressive) to consider, the focus shifts to using relative strength analysis to act as the filtering mechanism to select the best-performing ETFs for your investment dollars. Because ETFs have the edge in many respects, as is delineated in Chapter 4, "Exchange-Traded Funds—The Most Suitable Investment Vehicles," stocks and mutual funds are not recommended as the investment vehicles for this strategy.

Just as an airline pilot needs instrumentation to safely take off and land at the planned destination, especially during weather turbulence, investors need a reliable dashboard of instruments to maneuver through the volatile and uncertain stock market. Before the flight, the pilot reviews his or her checklist before the plane leaves the ground. Likewise, a surgeon has a protocol to follow before, during, and after operating on a patient. Similarly, as an investor you need a complete plan of action before putting your money at risk in the stock market so you know exactly when to buy and sell. Otherwise, the results could be catastrophic, similar to what could happen to a pilot or surgeon who fails to properly follow protocols and monitor the situation during the flight or surgery.

Why I Wrote This Book Now

I've met too many individuals in all age groups, who as buy-and-holders lost a large portion of their wealth by being fully invested over the past decade or just since the last market top of October 9, 2007. Unfortunately, most of them stayed fully invested based on advice from their investment advisors or based on freezing and not knowing what to do. These investors would have been better off using a strategy such as a simple moving average price crossover (for example, see the ten-month moving average chart in Figure I.1) that would have gotten them safely out of the market in November 2007, thus avoiding the entire debacle, and back in the market in June 2009 for the ride up. Hopefully, most investors decided not to sell at the March 2009 market bottom because the market then rebounded over 60% into December 2009.

Over the years I've spoken with many investors, and I've discovered that for the most part, they have a limited knowledge of investment basics, while only a small percentage really understand the key factors. That is why the majority of investors use stock brokers, financial advisors, investment professionals, and mutual fund managers. A much smaller percentage of investors manage their own money. Unfortunately, the two bear markets have interrupted many investors' plans for growing their wealth. Luckily, young people have time to recover their losses, although older individuals don't have that luxury. Most self-directed investors also took a shellacking because they were fully invested, even though they may have been well diversified. And

Figure I.1 S&P 500 Index with a 10-month simple moving average

Source: www.dshort.com

of course, a small percentage of self-directed investors probably did very well because they had a game plan that they followed religiously.

Just as in football, soccer, basketball, and other competitive sports, both offense and defense are needed to win games; you need the same two elements to win the investing game. With no defensive strategy you will be continually faced with the bull and bear market cycles, and you may experience no profits after decades of investing. That is not the way to build wealth.

Millions of investors have lost close to $14 trillion combined in the last two devastating bear markets this past decade. This has had devastating consequences on their lives, their families, and their futures. Investors cannot simply buy-and-hold a diversified portfolio and not look at it for 5, 10, 15, or 20 years. They may be shocked they didn't make any money at all, and after taking into account inflation and the opportunity cost of funds, they may actually come out behind. It is true that there have been no 20-year rolling periods where investors would have lost money if fully invested, but a number of those periods had very low returns—a few percent at best. Moreover, *all that matters going forward is how the markets perform over the next 20 years or more.* No one knows how that will work out from the investing perspective. That is why investors need a viable plan so that they do not repeat their mistakes of the past and possibly end up unable to retire or enjoy life to the fullest because of poor stock returns.

And that's what this book will do for you. It will show you how to read the market's overall condition, how to determine your risk level, what investing rules you need to develop, which ETFs to use, and how to put it all together to make better investment decisions, allowing you to sleep better at night.

This is a practical, easy-to-read book with an easy-to-understand investing strategy. All the data, charts, and information necessary for you to make intelligent investing decisions are readily available free on the Internet. All the key Internet sites are provided so you can get what you need. Additionally, for those of you who want more sophisticated tools, I've included a description of two user-friendly and reasonably priced software products that can provide tremendous insight into the stock market's condition with the tools and weekly commentary to take advantage of the changing market conditions.

I want to point out ahead of time that you might find that the chapters on exchange-traded funds, stock market dashboard, and relative strength somewhat intense, long, and complicated—that is not the case. It was necessary to provide you with the critical background and details so that you can easily put the recommended strategy in place. After you have worked through these chapters in particular and the remainder of the book, I'm sure you will see how easy the strategy is to set up and use on a weekly basis.

This is *not* a book about day trading or trading stocks for a living. Instead, it offers investors a road map for handling their investments in a systematic, logical, and nonemotional manner. Day trading is for those individuals who possess a certain skill set and emotional temperament to handle the stress of minute-by-minute trading. Keep in mind that day trading is extremely difficult. For those with success in other fields or a high IQ, day trading is no place to try a new profession without proper training. Otherwise, the results can be disastrous, not only financially but also emotionally. For those readers interested in determining whether day trading is for them, I refer them to my book published in 2000 as a first step, titled *Day Trading on the Edge: A Look-Before-You-Leap Guide to Extreme Investing*. It is out of print, so check your local library or used books on the Internet. Of course, there are many other more current books on the subject that provide methodologies, trading tips, and psychological pointers that you can find on Amazon or at your local book store.

Managing Your Financial Affairs Is Critical

You might be very upset and financially less well off than you were in early 2000, based on the stock market's performance over the past ten years, or even over just the past two years. This is quite understandable. With one financial mess after another, culminating in one of the worst global financial and banking crises since the 1929 depression that resulted in a bust of the housing, credit, and stock markets, the past decade has been horrific. The question is what steps you are going to take *now* to minimize your risk of potential substantial losses when the next financial meltdown or stock market crash occurs. It eventually will come—although we don't know when. We do know, based on history, that bear markets will come like clockwork to clean out your accounts, again and again. And stock market crashes arrive every 20 or 30 years, so being forewarned is being forearmed.

There is one approach that you can use that is very simple to implement: do nothing different and hope for the best. That is what most buy-and-holders do. A smarter approach is to make plans to better manage your finances and investments going forward. This book focuses on your investments. But you need to make sure that you review all aspects of your current financial situation and take the appropriate steps to put your house in order, if you have not done so already. That means budgeting; cutting expenses; saving more money; and having a will, healthcare proxy, power of attorney, and proper amount of life, health, disability, and long-term care insurance, if you can afford to pay all the premiums. And, if you have children or grandkids, make sure that you help them understand the importance of properly managing their financial matters—whether they are 8 years old, 18 years old, or older. Unfortunately, as the most recent surveys have shown, the financial literacy of our citizens is poor. And this problem needs to be urgently addressed at the public school level and beyond.

Because no one can predict where the stock market is going, why waste your money and time paying someone or some firm to baby-sit your money? More than a few top mutual fund managers have been embarrassed and humbled by the whipping their funds took in this latest bear market (for example, fund manager Bill Miller of Legg Mason Value Trust and fund manager Ronald H. Muhlenkamp of Muhlenkamp Fund, among others). And the big Ivy League endowment funds with their cadre of highly paid staff had negative performance as well.

Benefits of Managing Your Own Investments

As this book suggests, you need to immediately take control of your own investments. To help you do that, it provides a step-by-step investing approach. Here are five benefits of going this route:

- No need to subscribe to investment newsletters, magazines, or Web sites or to listen to stock tips.
- No need to listen to financial TV and radio shows to get guru recommendations.

- No need to buy load mutual funds from brokers or advisors or even no-load funds with their annual internal costs eating into performance.
- No need to buy risky individual stocks (probably after spending countless hours selecting and monitoring them or just following a guru's tip).
- No need to pay advisors 1% to 1.5% a year to manage your money. That fee eats into your performance and can amount to tens of thousands of dollars over 10 or 20 years.

Moreover, you can do the following:

- Use ETFs as your investment vehicle of choice.
- Use a low-cost discount broker to execute your trades for less than $10 each and obtain free use of their portfolio management, charting, and technical indicator software platform.
- Alter your portfolio when the market trend changes from bullish to bearish, and vice versa.
- Use the tools provided in this book to manage your investments.
- Feel confident of your ability to protect your principal even in bear markets, and sleep better at night.

After reading this book, please e-mail me your thoughts, comments, criticisms, and questions, and I'll respond. I can be reached at lesmasonson@yahoo.com. Please use the subject line "Comment on Book" in your e-mail so that I know it is not spam. I have also set up a Web site at www.buydonthold.com for additional information on the strategy presented here. If you enjoyed this book, please recommend it to friends, family members, and co-workers. The more individuals who are exposed to the approach delineated in this book, the higher the probability that they can preserve and grow their money. Be careful, be a smart investor, and be your own investment advisor. That's one way you can win the investing game.

Leslie N. Masonson
Monroe, New York
December 2009

Endnotes

1 Ziskin quoted in "Secular Bear Market Could Last into 2010, Maybe Through 2020." *Ethiopian Review*, posted July 26, 2009, by Desta Bishu.

2 Ned Davis Research as of June 30, 2009, as reported in 2009 Oppenheimer Funds *Pulse of the Market*, p. 2.

INDEX

L

M

Q–R