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# Technical Disciplines

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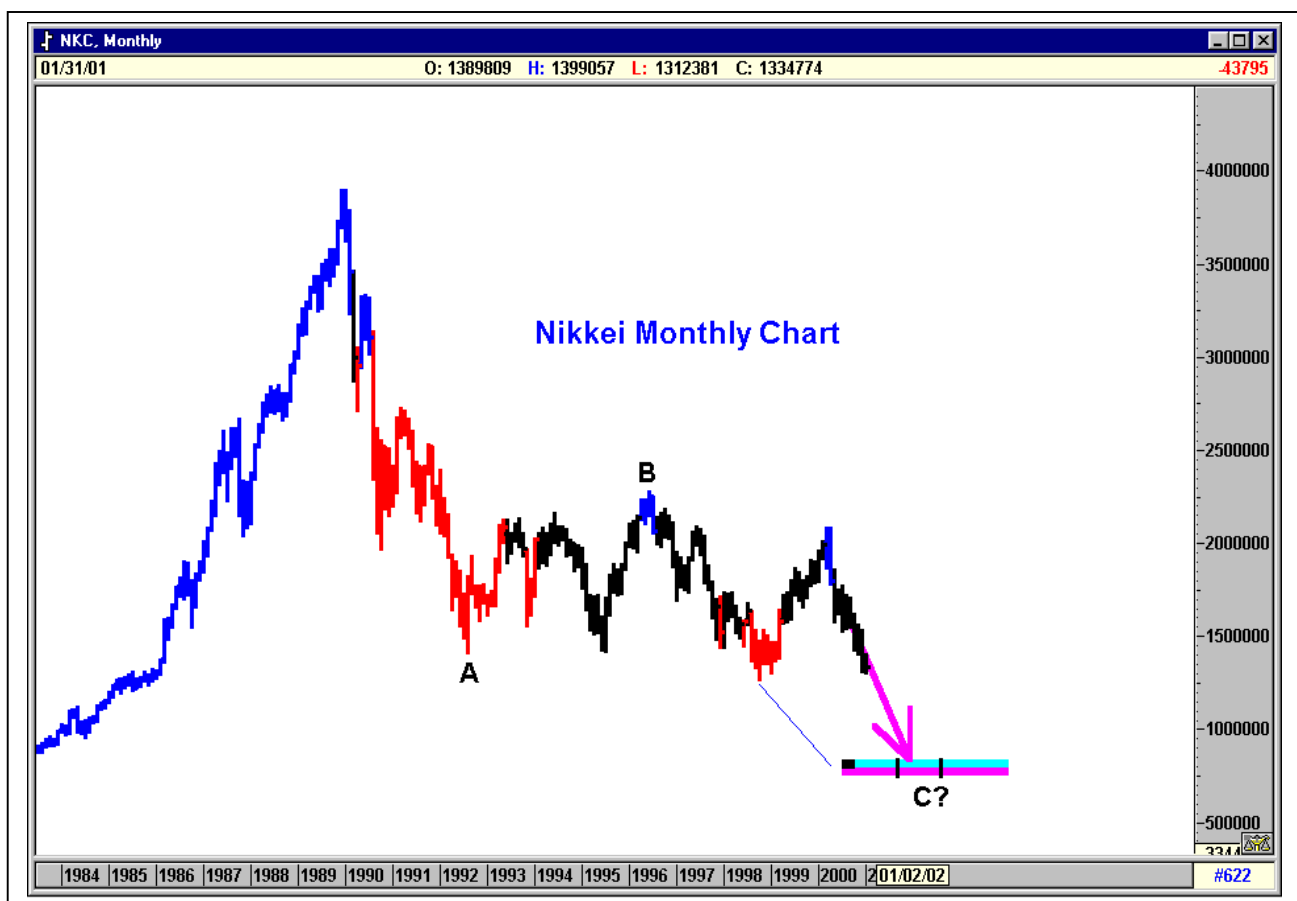
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## *Contrarian Ideas for the Technical Trader*

**Rex S. Takasugi, Editor**

**January 14, 2001**

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In past editions I have suggested that the 1998 low in the Nikkei would be broken. Prices are now at that low. Why am I still looking for new lows? See inside for further details...

# Macro Overview

## Stock Market:

Short Term **Cautious**  
 Int Term **Bullish**  
 Long Term **Neutral**

## Bond Market:

Short Term Neutral  
 Long Term Bearish

## Inflation:

Up slightly

## Gold:

Long-term Neutral

## Oil:

Cautious

## Dollar:

Short-term Neutral  
 Long-term Bearish

## Economy:

Soft Landing (US)

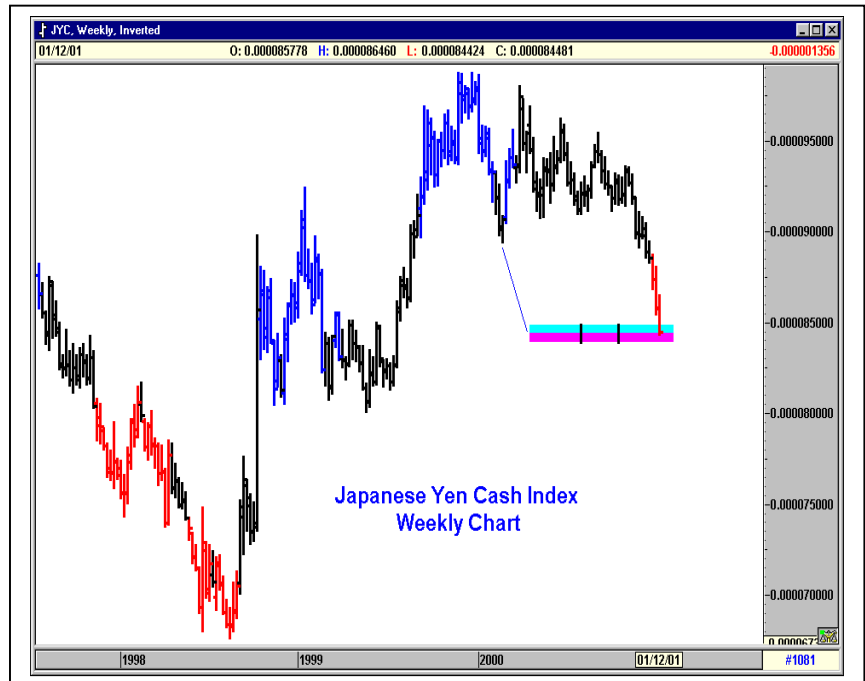
One major reason is the weakness in the Japanese Yen.

## Nikkei Commentary

There has been little focus on the recent decline in the Nikkei, despite the severity of the decline and the potential ramifications if it does not stop.



The red arrow in the weekly Nikkei chart above is where I had a public debate/discussion with another columnist where I took the bearish side and reiterated my bearish stance towards the Nikkei. Prices are now at key support levels. Why might these support levels not hold?



# Macro Overview (continued)

The Japanese Yen has been plummeting the last several weeks. Confidence in the supposed economic recovery has been smashed. Consumer spending continues to decline, and industrial production is down. 3Q GDP is being revised from being slightly positive to being negative, although it is difficult to have any confidence in the official figures. Japanese government officials seem to be content letting the Yen slide, as this will help their exporting companies. A weak Yen means foreigners will be less likely to want to own Yen denominated paper, whether stocks or bonds. The Yen has been weak not only against the US Dollar, but also against the Euro, as shown below:

Yen/Euro



The Nikkei is certainly oversold short-term, and the MOB shown on the page 2 chart of the Yen could provide some support. However, I believe that the **unwinding of cross-held shares** is the major reason behind the recent declines in the Nikkei and will continue to be so if major long-term support is broken. Bank balance sheets are weak as they go into the March 31 fiscal year-end. Some banks are selling off their cross-holdings to shore up balance sheets, but the declining share prices further weaken the balance sheets. Vicious spirals like this are what Wave 3s are made of. I have been warning readers to watch for Asian Contagion Part II. A banking crisis in Japan will be a sign that Part II has begun. As Part II reaches a climax, I expect to turn bullish on the Nikkei. What else would you expect of a contrarian?

## Asian Contagion Part II

# Macro Overview (continued)

Value Line New High!

Fed Cuts

Investor Sentiment

## Stock Market Commentary

Over this past year, I have been consistently expecting new highs in most of the major stock market indices. Thus far, I have been consistently wrong, but that may be changing. With little or no fanfare, the Value Line Arithmetic Index just moved to a new high this past week on Friday.



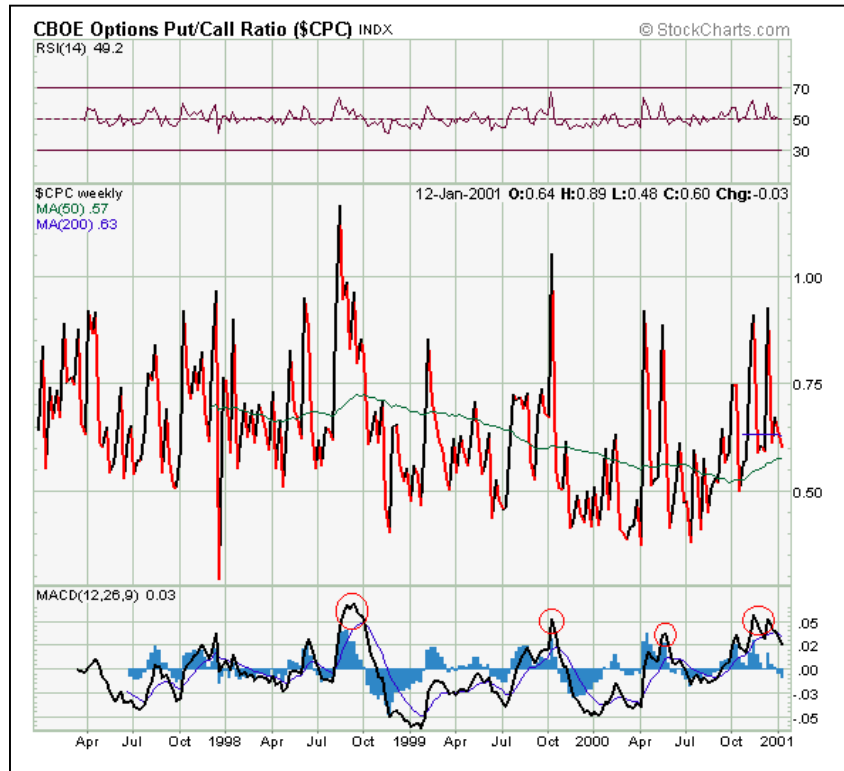
I continue to expect the DJI, S&P, NYSE Composite and similar indices to move to new highs over the next several months. Although the NASDAQ is far from new highs, I expect quite a rebound in the NASDAQ. A significant rally in the NASDAQ should also fire up the mid-cap and small-cap stocks, causing the Russell 2000 to make quite a nice rally as well. Why am I so positive for the intermediate term?

As mentioned in my **Flash Update** of 3 January 2001, the **Fed's rate cut** has positive implications for the monetary picture. The Fed usually makes at least three cuts, and the total cuts amount to at least 75 basis points. My expectation is for a 25 basis point cut at the next FOMC meeting. Some are calling for a 50 basis point cut, but that is too optimistic.

This improvement in the monetary picture is accompanied by **investor sentiment** that rivals most any major market bottom.

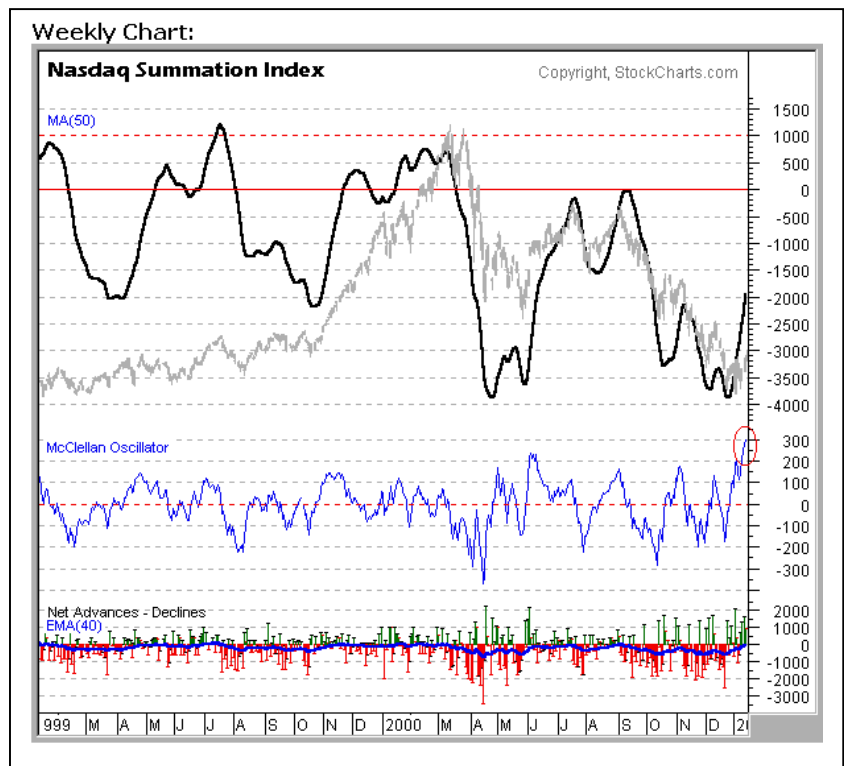
# Macro Overview (continued)

For measuring investor sentiment, I prefer indicators like the **Put/Call ratio** to other indicators like Investor's Intelligence or polls of the members of the AAll, because I would like to know what investors are actually doing rather than what they might be saying; there is a big difference (credit goes to John Mendelson for pounding that concept into my brain).



I try to smooth out the volatility in the Put/Call ratio with a simple MACD indicator, as shown at the bottom of the chart above. Notice that I have circled in red the peaks in MACD, which nicely correspond with major bottoms in the stock market.

As predicted in the last couple of editions, the **weekly NASDAQ Summation Index** has turned up (heavy black line). I definitely want to be positive when the Summation Index is moving up. Now, both the NYSE and NASDAQ Summation Indices are moving up together. However, I am worried about the very over-bought **McClellan Oscillator**, as circled to the right. This suggests some short-term pullback or consolidation.

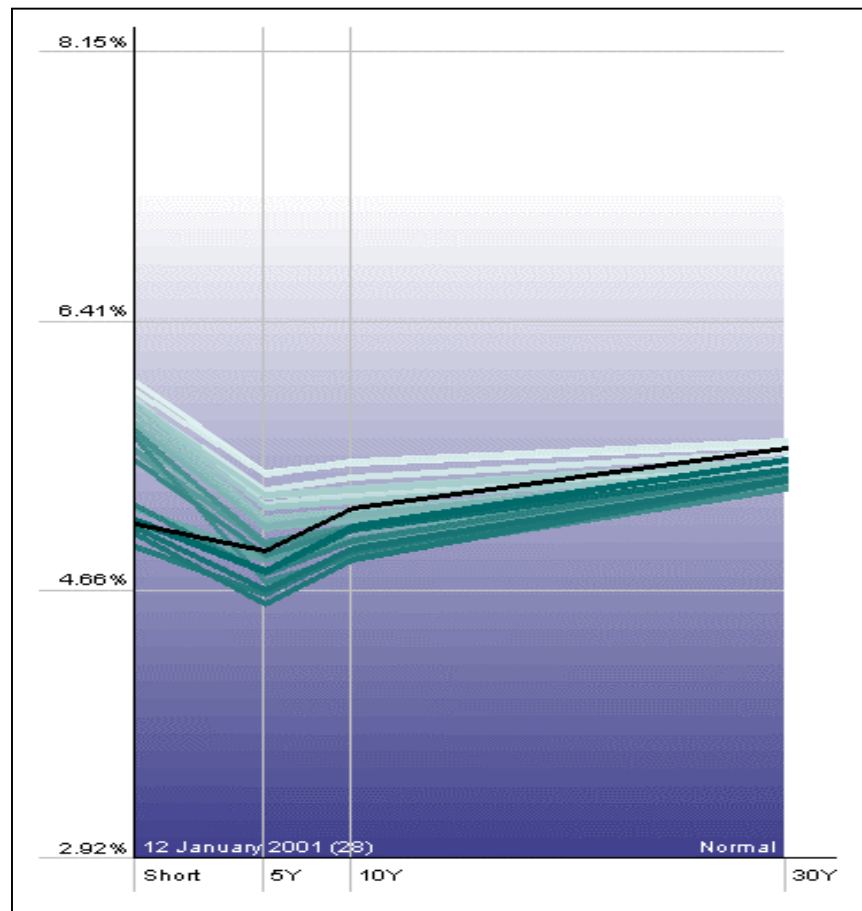
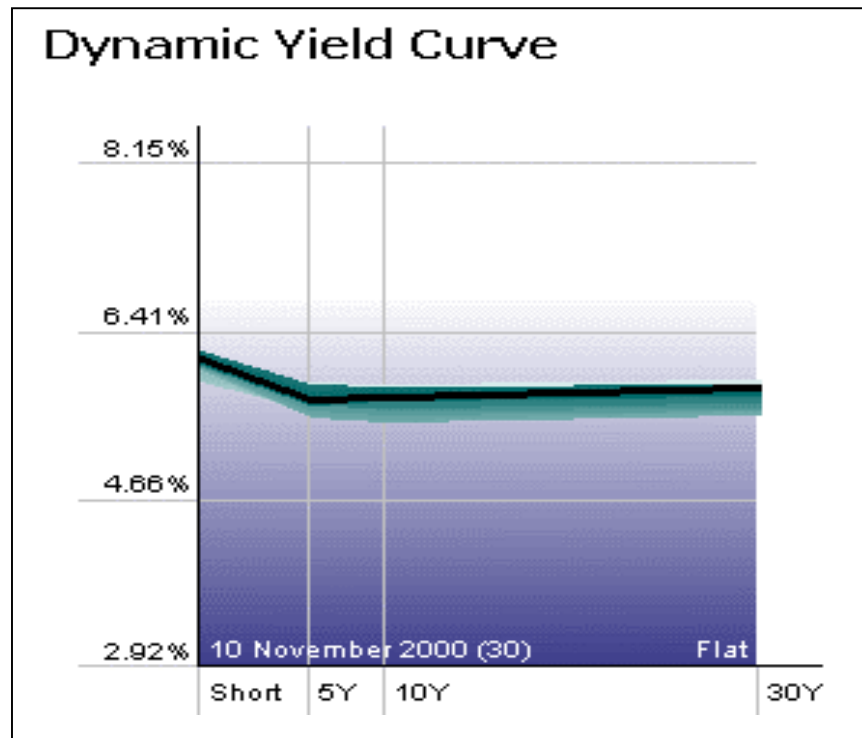


# Macro Overview (continued)

In my November 12, 2000 edition I said, "I would expect the Yield Curve to steepen into a normal shape, with short-term rates lower than long-term rates. Most of the Yield Curve should shift upwards." The chart of the yield curve as shown in November is to the right.

Here is the current yield curve. The curve did steepen as predicted, but not exactly as I had anticipated. Expected Fed cuts in the future will bring down the short end of the curve to solve the partial inversion, which should help to relieve recessionary fears. Notice how the curve from 0 to 5 years has moved from a very steep inversion to being only mildly inverted now. This is telling me that the markets have already priced in a 25 basis point cut at the upcoming FOMC meeting. A 50 basis point cut seems overly optimistic.

## Yield Curve Analysis



# Industry Sectors

## Sectors of Interest

- Cash
- REITs
- Tires
- Fuel Cells
- Mobile Homes
- Batteries
- Grocery Stores
- Food
- Department Stores
- Chemicals
- Drug Stores
- SE Asian Funds\*
- Communication Equip
- Toy Stores
- Fertilizer
- Waste Mgmt
- Long Distance
- Computers\*
- Auto & Truck Parts\*
- Paper/Forest Products
- Greeting Cards
- Personal Care
- Private Label
- Disk Drives
- Golfing
- Shoes
- Housewares
- Regional Banks
- European Funds
- Steel
- Semiconductors
- Booksellers
- Computer Retailing
- Catalog Retailers
- Textile-Apparel
- Farm Equipment
- Industrial Metals
- Gold & Silver Mining

## Sectors to Avoid

- Autos
- Utilities\*
- Building Products

Deleted:

- Computers
- Mutual Fund Mgrs

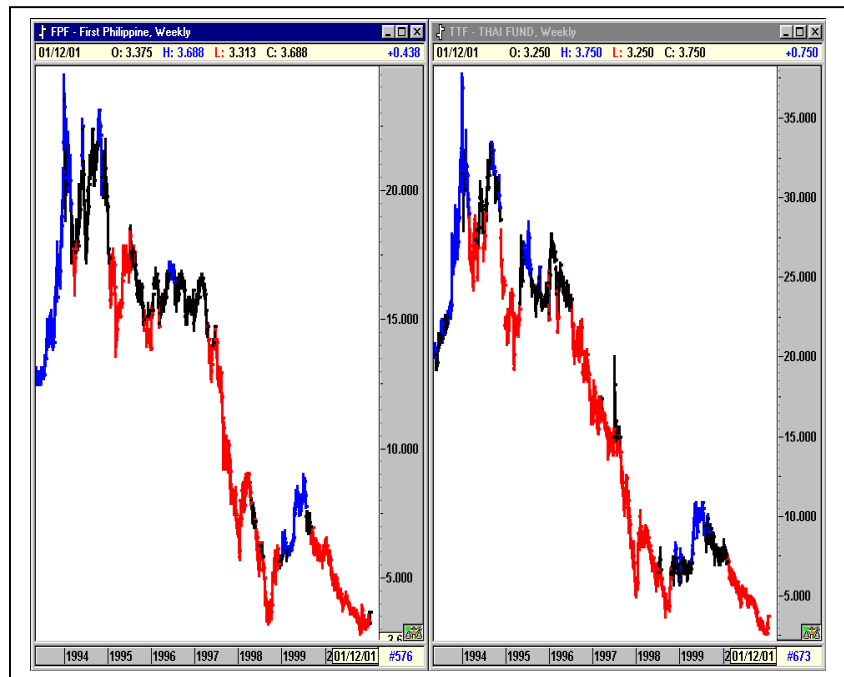
(Sectors listed above in order of emphasis)

\* = new additions to the list

## Discussion of Industry Sectors

A reminder: industry sectors listed in my **Sectors of Interest** list are sectors that I am investigating, but may not necessarily be buying at the current time. Likewise, **Sectors to Avoid** includes sectors I would avoid, but may not necessarily be shorting at the current time.

I am adding the **SE Asian Funds** sector to my **Sectors of Interest** list. The closed-end funds I have in mind are ones like FPF (First Philippine), IF (Indonesia), MF (Malaysia), ROC (Taiwan) & TTF (Thailand). Here are charts of FPF and TTF, showing the dramatic declines and a Type 2 bottoming formation.



I have had the **Computer** sector on my **Sectors to Avoid** list for some time, fortunately for any readers who heeded the advice. However, I think the damage has been done, and pessimism within that sector is overwhelming. Thus, in line with my contrarian method of thinking, I am removing the Computer sector from my **Sectors to Avoid** list and I am now adding it to my **Sectors of Interest** list. The stocks I have in mind are ones like AAPL, DELL, GTW, HWP, MUEI and SUNW.

I'm late on adding the **Utility** sector to my **Sectors to Avoid** list, but better late than never. Even though the damage is primarily to the California utilities so far, I would think that investors would be more worried about other utilities as time goes on.

# Featured Stock Idea

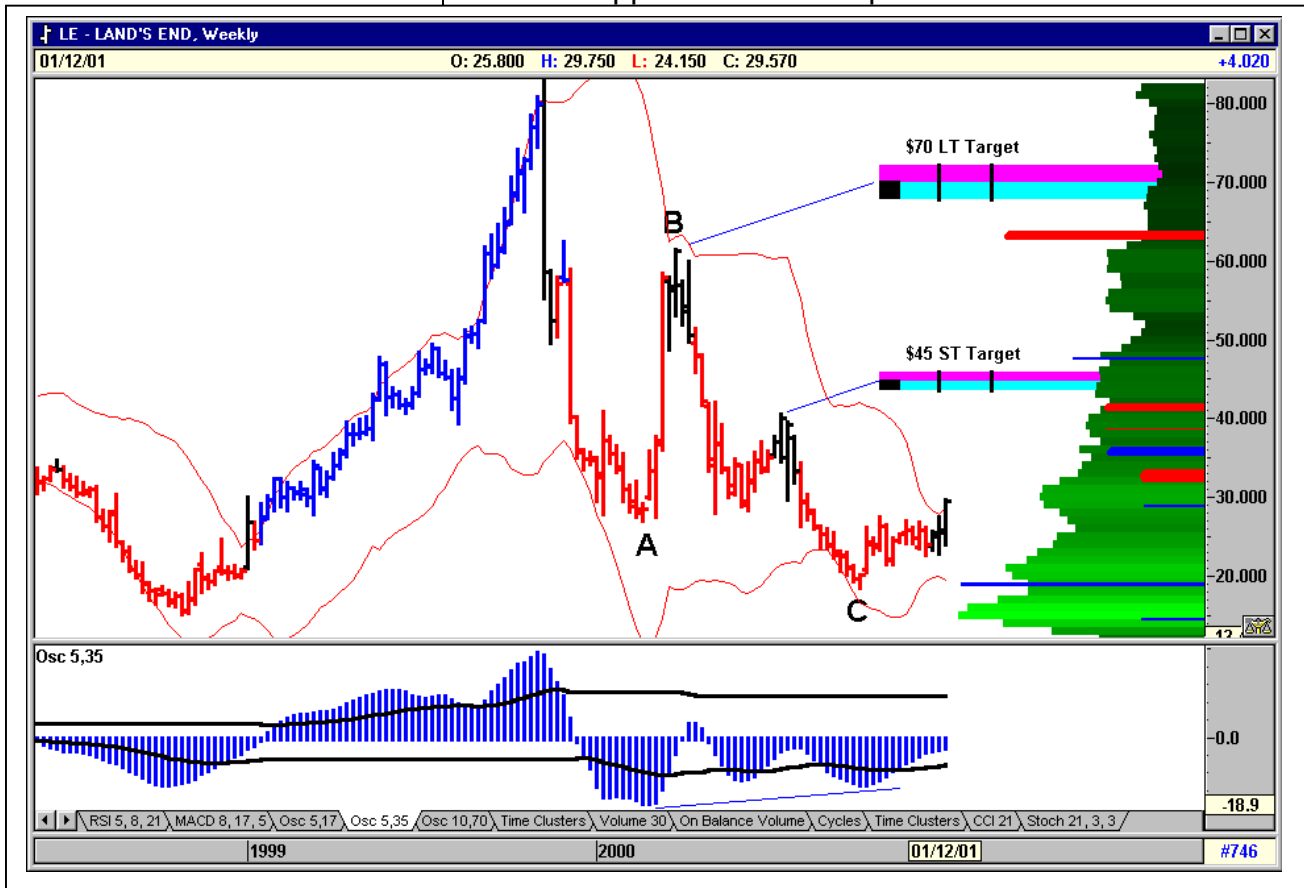
Land's End (LE)

Mid-cap  
Contrarian Value

## Land's End (LE)

Various retailing sectors have been on my **Sectors of Interest** list, and this month I wanted to focus on the catalog retailer, **Land's End**. Most of you probably receive the catalogs that are sent out by the millions, featuring quality casual clothing for men, women and children. **LE** is one of the best-known, customer-friendly, catalog retailers in existence, with brand awareness worth millions.

Although **LE** is not totally without fault, it is clear that **LE** was not alone in this price decline, as most retailers have been hit very hard over this same time period. LE's insiders still own a majority of the shares, and they are backing a share repurchase program, which should lend some support to the stock price.



Technically, LE had an upside price breakout on Friday. Notice the narrowness of the Bollinger Bands (red bands) much like the narrowness seen in December '98; expect an explosive move from these levels. The MOB at \$45 is my short-term target. Short interest amounts to over 12 days of average daily volume, which should act to give the stock price some upward force once the shorts start to cover.

# Featured Stock Idea

Dana Corp (DCN)

Large-cap Contrarian Value

## Dana Corporation (DCN)

This idea is one of those “deep” contrarian ideas, meaning that you know you are a true contrarian if you like this idea. Earnings estimates have been slashed, and virtually all the analysts who follow this company have “hold” ratings (which really means “sell” in this business).

**DCN** is in the auto and truck parts business. This has been a difficult business to be in lately, not just for **DCN**, but for most of their competitors as well. But, that makes the valuation ratios quite attractive, and the 7% dividend yield is also hard to ignore. **DCN** has made 252 consecutive dividend payments – extending back to 1936 – without a missed or reduced payment, so there is enormous pressure on the board to maintain the dividend.



Technically, this is looking like a Type 2 trade, trying to buy the bottom of a five wave pattern, in this case, the five waves are part of a C wave. Notice the divergence in the weekly 5/35 Oscillator.

I may be early on this one, so wait for a break of the trendline before entering this trade.

# Follow-up on a Featured Stock Idea

## Beverly Enterprises (BEV)

Small-cap  
Contrarian Value

### Beverly Enterprises (BEV)

I was admittedly early in recommending **BEV** in my January 9, 2000 edition a year ago (see green arrow in the chart below). **BEV** proceeded to torment me in the first half of the year, but I had confidence that **BEV** was not going to go out of business, and that government legislation would change to allow **BEV** to survive. In my recommendation, I advised not using a stop loss on this trade, primarily due to my uncertainty as to when government legislation would come to the rescue. Fortunately, things finally worked out as expected and the stock has taken off.

Although not as cheap as a year ago, **BEV** is still not fundamentally in the overvalued area. The election of a Republican president is certainly more positive than the election of a Democratic president, as far as **BEV** is concerned.



Establish stop at \$5 5/8.

Technically, I believe a Wave 3 is in progress. The recent pullback cannot be a Wave 4, as it overlaps Wave 1. This suggests higher levels for Wave 3. The volatility of the stock price makes it difficult for wave interpretation, but in looking at other long-term health care and hospital stocks, I feel more confident that a Wave 3 is still in progress.

# Follow-up on a Featured Stock Idea

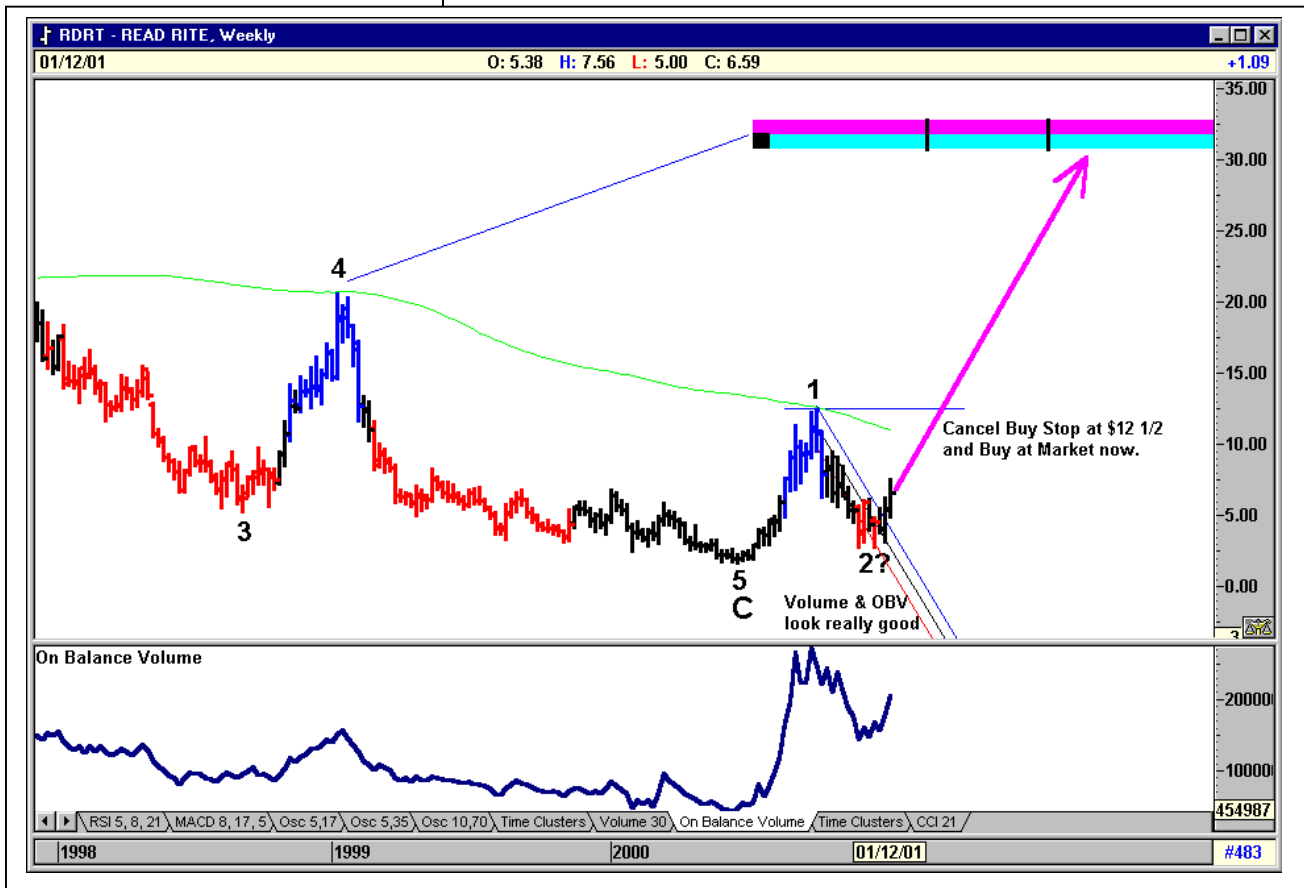
## Read-Rite (RDRT)

Small-cap  
Contrarian Value

## Read-Rite (RDRT)

**RDRT** was recommended in my November 12, 2000 edition, but because I wasn't certain that Wave 2 was complete, I recommended waiting for a break of the top of Wave 1 prior to initiating the trade. I am now more confident that Wave 2 is complete, and thus recommend that the buy stop at \$12 ½ be cancelled and that the stock now be bought at the market.

**RDRT** is seeing their core business turn around, as evidenced by their most recent quarterly earnings release, and the announcement that their upcoming 1Q earnings will exceed analysts' estimates. But, investors are also jazzed by the **RDRT's** creation of a new company called Scion Photonics, which is developing components used in fiber-optic networks.



The volume and OBV indicator show that there is some serious interest in **RDRT** due to recent developments. Notice how the OBV did not pull back as much as the stock price in what I am calling a Wave 2. An XTL breakout trade is developing on the daily chart (not shown).

# Trading Tips

## Closed-end Funds

Herzfeld publishes a newsletter that specializes in closed-end funds.

Why buy closed-end funds in the first place?

## Analyzing Closed-end Funds

Closed-end mutual funds are mutual funds that are initially sold to the public with a fixed number of shares in an initial public offering (IPO). Subsequently, in the secondary market the market price may trade above or below (premium or discount) the net asset value (NAV) of the fund, depending on investor demand. Most closed-end funds are traded on the NYSE or the ASE. Traditionally, the NAV was reported weekly, but in the last couple of years, many of the closed-end funds have started to report their NAV daily. This data is available from some data providers. If the closed-end fund symbol is RFI, for example, then the NAV symbol for that fund is likely XRFIX. More symbols can be found at this site:

[www.herzfeld.com/linksto.htm](http://www.herzfeld.com/linksto.htm)

Closed-end funds can be purchased at the initial public offering, but this is not generally recommended, because a commission or fee of five to seven percent is built into the price you pay. Generally, you can purchase the fund several months after the IPO at a discount, only paying a normal stock trade commission, assuming you really want that fund. Closed-end funds can be bought and sold any time during the trading day, whereas most open-end funds are only purchased or sold at the end of the day.

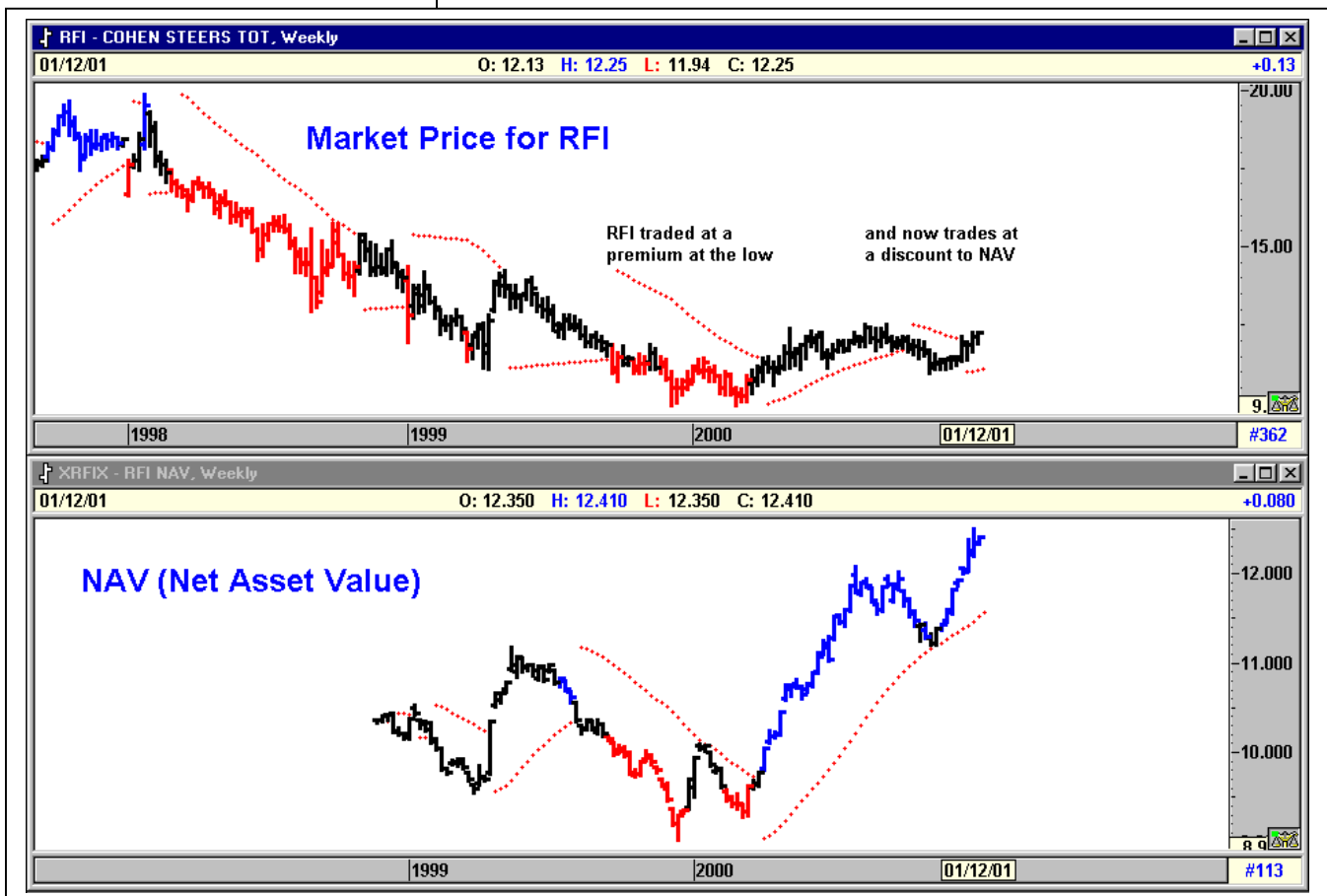
It is this **discount to NAV** that often makes investors interested in purchasing a closed-end fund instead of an open-end fund. What value investor wouldn't be interested in picking up a dollar of assets for 85 cents? Not only can a value investor buy assets cheaply, but if the assets go up in value, then it may be possible to sell the shares at a premium to NAV, nicely leveraging the gain over the open-ended fund investor.

The closed-end fund manager also does not have to worry about shareholders redeeming their shares, as the only way to redeem one's shares is to sell them in the open market. Thus, the closed-end fund manager is able to remain more fully invested than the open-end fund manager. Because the asset base is fixed, the fund manager also does not have to worry about trying to invest extra incoming funds when his sector is popular, which is usually the wrong time to be investing, at least from a contrarian standpoint.

## Trading Tips (continued)

Closed-end funds also offer a way to invest in some countries for which there is not an open-end fund or index fund. For example, if you wanted to invest in Indonesia, there really are not many ways to invest in that country other than through a closed-end fund called the Indonesia Fund (IF).

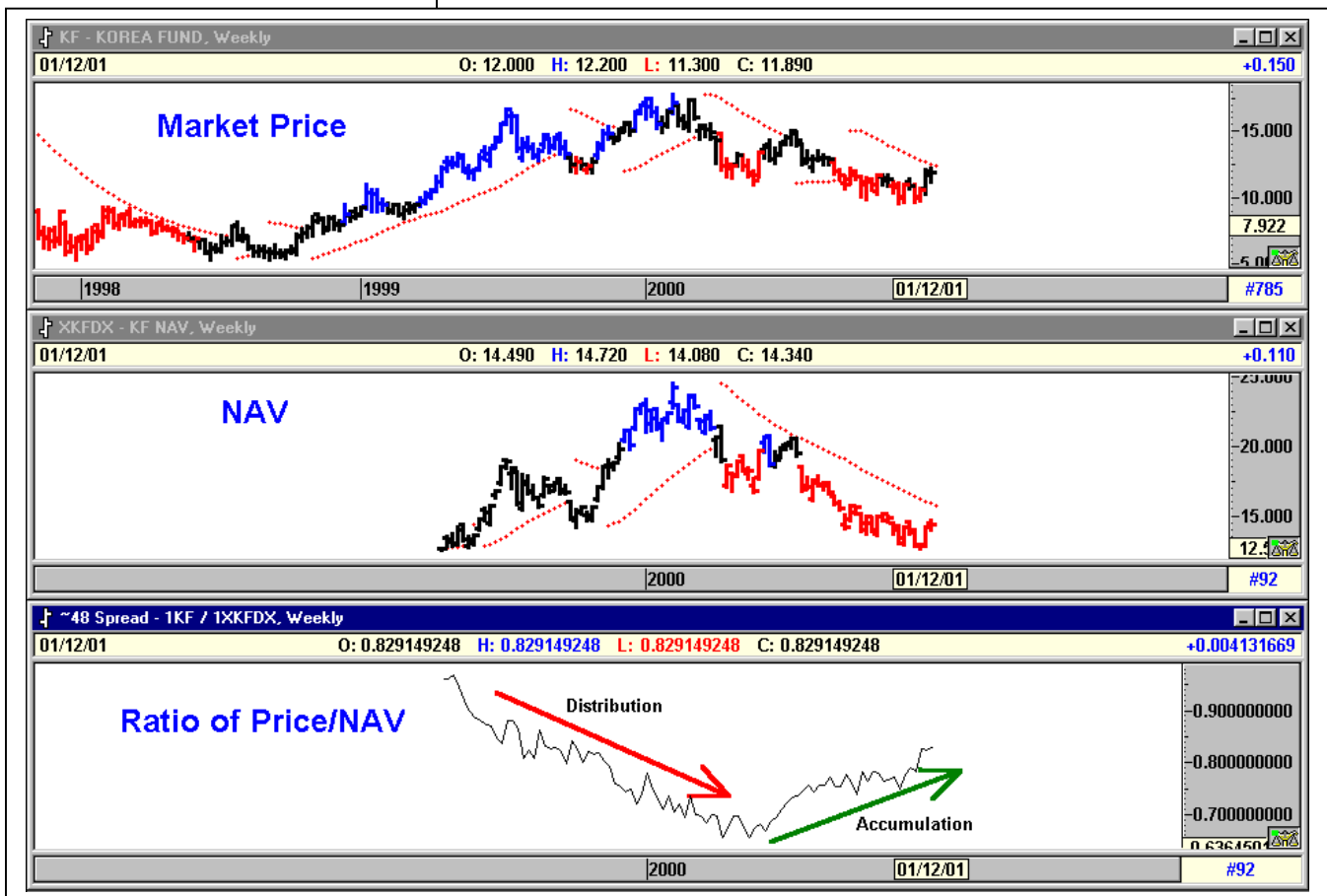
In order to analyze closed-end funds, you really need the NAV data for the funds. This data is published weekly in *Barron's* or you could subscribe to Herzfeld's newsletter, *The Investor's Guide to Closed-End Funds*, to get an idea of which closed-end funds were trading at discounts. Now that the data is available to be downloaded, and enough data has accumulated to be somewhat meaningful, it is possible to use your technical analysis software to analyze closed-end funds.



In this chart above, I have plotted the market price in the top chart and the NAV in the lower chart. You may also want to overlay the NAV onto the market price chart, if you have that capability with your software. A simple chart like this can tell us a lot, subject to one's interpretation, of course.

## Trading Tips (continued)

When I recommended RFI about a year ago, REITs were clearly out of favor, yet RFI was trading at a premium to NAV. Why? My interpretation is that the “smart money” was moving into REITs, believing that REIT prices were near a major bottom. Now, the NAV has risen significantly, and RFI trades at a slight discount to NAV. Why? My interpretation is that the investing crowd has still not discovered REITs, but when they do, I would expect that price might catch up to the NAV, but possibly not if the “smart money” investors are taking chips off the table. It could be that the “smart money” investors are taking chips off the table now and that I should be doing the same.



In this chart of the Korea Fund (KF), I have added a third chart, which is a ratio of Price/NAV. This chart shows the degree of premium or discount to NAV. Notice that the discount was becoming greater as the KF approached a high, indicating distribution, and has recently been decreasing (rising) as prices are down, indicating accumulation by the “smart money” investors. The lesson of RFI and KF is that one should not blindly buy discounts and avoid premiums in trading closed-end funds. Sometimes it is better to follow the “smart money.”

# Money Management

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"Love is grand;  
divorce is a hundred grand."  
Unknown

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**"He who finds a wife finds what is good  
and receives favor from the Lord."  
Proverbs 18:22 (NIV)**

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