

## Tracking Performance of the Wall Street Traffic Light Model

Some of the items at this website (such as this one) might be difficult to read—small print, fuzzy appearance and maybe even old eyes. The problem arises from the fact that I chose to present the material as a PDF file.

Well, the problem is easily solved. Just click on the **printer icon** in the upper left corner of the **gray area** above. When you put your cursor over the printer icon, a message appears saying: “Click to print this PDF file or pages from it.” Print whatever you desire; it will be easy to read. Why not start a **WSTL notebook**? I have one!

**To print the line chart for any year** at the website, use the File Print command. The wording in the box on each chart will be perfectly clear in printed form.

### Issue #4 for 2010 (February 28, 2010)

**Mark your calendar for my next update: April 2, 2010 (9:00am CST).** The U.S. stock market will be closed that day. **Note:** an interim update will be issued before then if the S&P 500 closes below 1000 or above 1200, which are within about 50 points of the lower and upper limits mentioned below.

Let's begin with some fun:

The woman applying for a job in a Florida lemon grove seemed to be far too qualified for the job. The foreman frowned and said, "I have to ask you this: "Have you had any actual experience picking lemons?" "Well, as a matter of fact, I have! [I've been divorced three times, owned two Chryslers, voted for Bush in 2004 and voted for Obama in 2008.](#)

Okay, on to the serious material:

The WSTL was **green** at the beginning of 2010. It turned **red**—the sell signal—on January 29<sup>th</sup> (1073.87). On that day, **2010 was classified as a 3C year**. The WSTL will turn **green**—the buy signal—later this year, depending on which of three limits the S&P 500 reaches first. As set forth on p. 48 of my book, the specifications for those limits in a 3C year are (full details are in last month's Issue #3 below):

- **Lower limit** The S&P 500 closes, for the first time after the sell signal, at or below **956.50**.
- **Upper limit** The S&P 500 closes, for the first time after the sell signal, at or above **1247.19**. This is a “stop loss,” meaning that the trade would be unprofitable.
- **Time limit** **End of November 2010**.

Isn't it amazing? Essentially all of the WSTL work is finished for 2010. The only thing to do now is to wait and see which of the three limits is reached first, and

then buy a low-cost S&P 500 index fund. Nonetheless, it's fascinating to look at the relevant history from C years.

3C years and 1C years: The only difference between these two types of years is the level of the preceding two years' average returns (see p. 15). As a result, I think it makes sense to analyze both types of years as one group. That said, I looked at the 3C and 1C years separately to see if there were any particular differences: None were found.

Mike Santoli at *Barron's* takes me to task for using small samples from which I draw conclusions. My response is always the same: "That's all the cases there are, and that's better than none." In this instance, there are 25 3C and 1C years (including 2010).

Examine Table 1 below. At the one-month mark after the sell signal on 01/29/10, WSTL investors are taking heat to the degree of **2.85%**. That ranks 7<sup>th</sup> out of the 25 cases. Although the S&P 500 has made a small run to the upside for the past month, history tells us that the S&P 500 could explode to the upside without warning. Obviously, WSTL investors do not want that to happen.

Table 1

1C and 3C Years, 1935-2010 (n = 25)

Year	Type of Year	Year's High Before Buy Signal	Degree of Heat One Month After Sell Signal		Buy Signal	Outcome of Trade
			Degree	Rank		
1974	3C	01/03/74	9.07%	1	07/10/74	10.5%
1970	3C	01/05/70	5.27%	2	05/14/70	13.7%
1981	1C	01/06/81	4.02%	3	09/25/81	18.0%
1956	1C	08/02/56	3.47%	4	End 11/56	-4.0%
1939	3C	01/04/39	3.25%	5	04/06/39	13.5%
1953	1C	01/05/53	3.25%	6	09/14/53	9.5%
<b>2010</b>	3C	01/19/10	2.85%	7	?	? ?
1962	1C	01/03/62	1.63%	8	05/23/62	11.0%
2005	1C	11/25/05	1.60%	9	End 11/05	-5.1%
1960	1C	01/05/60	0.92%	10	End 11/60	-0.4%
1990	1C	07/16/90	0.85%	11	End 11/90	5.2%
1940	1C	01/03/40	0.66%	12	05/14/40	12.9%
1984	1C	11/06/84	-1.04%	13	End 11/84	2.4%
1941	3C	01/10/41	-1.49%	14	End 11/41	3.6%
2003	3C	01/14/03	-1.70%	15	06/11/03	-18.4%
2000	1C	03/24/00	-2.01%	16	End 11/00	9.2%
2002	3C	01/04/02	-2.07%	17	06/20/02	9.5%
1977	1C	01/03/77	-2.17%	18	11/02/77	11.7%
1973	1C	01/11/73	-3.23%	19	07/03/73	11.7%
1957	1C	07/15/57	-3.26%	20	10/21/57	11.9%
1935	1C	01/07/35	-3.98%	21	03/14/35	17.7%
1948	3C	01/15/48	-4.70%	22	End 11/48	-4.7%
1969	1C	05/14/69	-4.74%	23	07/28/69	14.3%
1982	1C	01/04/82	-6.05%	24	06/21/82	18.4%
2009	3C	01/06/09	-10.99%	25	End 2/09	14.9%

As a WSTL investor myself (!), I hope the upper limit is not reached first in 2010. If that does happen, it would be only the 2<sup>nd</sup> case during 1935-2010 (76 years). As Table 1 indicates, the other case was 2003; that trade lost **18.4%**.

Always remember: (1) something that has seldom happened can happen again and (2) something that has never happened can happen (for example, there had never been more than two Tier 2 years in a row, until 2006, 2007 and 2008).

Examine Table 2 below and consider these **five points**.

1. For the column, "Year's High Before Buy Signal," if you count the number of years in which the high was in January, your total should be **18** ( $18 \div 25 = 72\%$ ). The current year is in that group. The 2010 high *so far* was on January 19<sup>th</sup>, which is the latest of the 18 cases.
2. During February 2010, WSTL investors took maximum heat to the degree of **3.29%** [ $(1109.17 \div 1073.87, \text{ at sell signal}) - 1 = 3.29\%$ ]. At this time, that ranks 17<sup>th</sup> out of the 25 cases.
3. For the **month and the day** of the maximum heat, 14 of the 24 cases (that is, all cases prior to 2010) happened by **April 8<sup>th</sup>**. That means there is a 58.3% probability the maximum heat in 2010 will occur by April 8<sup>th</sup>. Of course, it might have already happened on February 19<sup>th</sup>.
4. The five losing trades in the 3C and 1C years had their maximum heat on 06/11/03, 06/15/48, 08/02/56, 08/24/60 and 11/25/05. These cases account for 5 of the 10 not covered in point (3). The other five cases not covered in (3) are 05/02/84, 05/14/69, 07/15/57, 07/16/90 and 09/17/41.
5. Six of the 25 cases were years that end in a zero. That might seem like an odd observation to make, but I think that is important. That's because it is consistent with the cycles work of W.D. Gann in the first half of the 20<sup>th</sup> century. WSTL investors will be delighted to know that 4 of the 5 prior trades in years ending in zero averaged a profit of 10.3%. The other trade lost only **0.4%**.

Table 2

1C and 3C Years, 1935-2010 (n = 25)

Year	Type of Year	Year's High Before Buy Signal	Maximum Heat Before Buy Signal			Buy Signal	Outcome of Trade
			Date	Degree	Rank		
2003	3C	01/14/03	06/11/03	16.57%	1	06/11/03	-18.4%
1948	3C	01/15/48	06/15/48	16.13%	2	End 11/48	-4.7%
1956	1C	08/02/56	08/02/56	13.51%	3	End 11/56	-4.0%
1990	1C	07/16/90	07/16/90	12.12%	4	End 11/90	5.2%
1974	3C	01/03/74	03/13/74	10.02%	5	07/10/74	10.5%
1957	1C	07/15/57	07/15/57	9.86%	6	10/21/57	11.9%
2000	1C	03/24/00	03/24/00	9.54%	7	End 11/00	9.2%
1981	1C	01/06/81	03/25/81	8.04%	8	09/25/81	18.0%
2005	1C	11/25/05	11/25/05	7.36%	9	End 11/05	-5.1%
1939	3C	01/04/39	03/10/39	6.50%	10	04/06/39	13.5%
1970	3C	01/05/70	03/03/70	6.13%	11	05/14/70	13.7%
2009	3C	01/06/09	02/09/09	5.33%	12	End 2/09	14.9%
1940	1C	01/03/40	04/08/40	4.48%	13	05/14/40	12.9%
1960	1C	01/05/60	08/24/60	4.42%	14	End 11/60	-0.4%
1941	3C	01/10/41	09/17/41	3.97%	15	End 11/41	3.6%
2002	3C	01/04/02	03/19/02	3.55%	16	06/20/02	9.5%
<b>2010</b>	3C	01/19/10	02/19/10	3.29%	17	?	? ?
1953	1C	01/05/53	03/17/53	3.25%	18	09/14/53	9.5%
1962	1C	01/03/62	03/15/62	3.22%	19	05/23/62	11.0%
1969	1C	05/14/69	05/14/69	3.06%	20	07/28/69	14.3%
1935	1C	01/07/35	02/18/35	2.64%	21	03/14/35	17.7%
1973	1C	01/11/73	02/13/73	1.76%	22	07/03/73	11.7%
1984	1C	11/06/84	05/02/84	0.62%	23	End 11/84	2.4%
1977	1C	01/03/77	02/01/77	0.50%	24	11/02/77	11.7%
1982	1C	01/04/82	End 1/82	0.00%	25	06/21/82	18.4%

Potential Market-Slamming Events This Week (from *The Wall Street Journal*, February 27-28, 2010, p. B1):

“Concerns over policy in the euro zone continued to simmer, keeping market gains in check, with the European Union pushing Greece to adopt new austerity measures to reduce the budget deficit, according to a senior government official.

Against the uneasy backdrop, the country is expected to try to sell a new 10-year bond next week, providing another potential trigger for volatility if it does poorly.

The stock market will get further clues next week on the pace of the economic recovery, with has been cast in somewhat of a dim light by recent data. The week culminates with the release of the critical nonfarm-payrolls report.”

Frequently Asked Questions: An expanded list of 15 FAQs were posted to the website today. Here is a sample.

**Q1:** My dad gave me a copy of your book last week. He knows I want to learn the basics of investing. (I have a decent-sized 401(k) and a small Roth IRA.) After taking a quick look at the book, it seems to be mostly numbers, and I’m not fond of numbers. What should I do?

**A1:** I suggest you just do the bare minimum due diligence: (i) Turn to p. 29 and see the gray-shaded numbers for the WSTL return and the S&P 500 return—14.16% vs. 11.22%, a *very large* WSTL advantage of 2.94% for 1970-2006, (ii) Read the two-sentence summary on p. 35 and (iii) Read the bullet points on the front cover. Now despite your number phobia, you know something about investing, perhaps enough to decide if you are going to be a WSTL investor. If so, all you need to do is watch when the WSTL changes color on the homepage of the website: from **red** to **green** (move money from a money market fund into a low-cost S&P 500 index fund—see p. 51), from **green** to **red** (sell the S&P 500 index fund and put the proceeds into a money market fund for safety) and so on.

**Q13:** I can tell the WSTL model has a very good, but not perfect, track record: There were two unprofitable trades during 1970-2009. Can you provide any stats on this notion of very good but not perfect?

**A13:** Your question is perceptive. Combining the test period (1970-2006) and the live-test period (2007-2009)—a total of 40 years, the answer is incredible:

WSTL return > S&P 500 return	$12 \div 40 = 30.0\%$
WSTL return = S&P 500 return	$26 \div 40 = 65.0\%$
WSTL return < S&P 500 return by 0.45% to 5.08%	$1 \div 40 = 2.5\%$
WSTL return < S&P 500 return by 18.36%	$1 \div 40 = 2.5\%$

Is all of this WSTL history any guide for the future? In this case, history should be an excellent guide for the future, because it is not feasible that either of the propositions underlying the WSTL model (set forth in A11) will weaken.

Acting on the Sell Signal One Day Late: Sell signals (and/or buy signals) can be acted on one or more days after they occur. This can happen because: (i) When the stock market is about to close, it is not clear whether the S&P 500’s closing price will reach the lower limit or upper limit or (ii) Some WSTL investors are not available to make the trade—they are in a meeting, they forgot about it and so on. What was the effect of acting on the 1/29/10 sell signal one day late? See p. 53. By acting this year’s sell one day late (on February 1<sup>st</sup>), the gain was 1.30% [ $(1089.19 \div 1073.87 = 1.30\%)$ ], which ranks 4<sup>th</sup> of out the 33 cases (including

2009 and 2010). By acting one day late on all 33 sell signals, 19 of them would have had a gain.

The Profitable Trade in 2009: The WSTL investor who started 2009 with \$10,000 would have ended 2009 with an accumulation of \$14,400. The investor who bought-and-held the S&P 500 would have ended 2009 with an accumulation of \$12,646.

Bull Market Top on 01/19/10?: This question will be answered in the fullness of time. If 01/19/10 was a bull market top, it would have plenty of historical company. Consider the months of January and February. Four times a bull market top occurred then: 02/09/66, 01/11/73, 01/04/02 and 01/06/09. And three other cases nearly qualified as bull market tops: 01/11/38, 01/05/53 and 02/13/80.

After the S&P 500 reaches the top of a bull market, its moves are somewhat analogous to a drowning swimmer. For the sake of illustration, assume that the S&P 500 had its bull market high on 01/19/10 at 1150.23. Since then it reached a high of 1103.32 on Feb 2<sup>nd</sup> and 1109.17 on Feb 19<sup>th</sup>. As time passes, we'll see if this swimmer actually drowns.

Announcement: [The Tutorial for my book](#) will be available at "About the Book" in the last two weeks of March 2010.

Converting a Traditional IRA to a Roth IRA in 2010 [from an article by J.R. Brandstader, "You Can't Take It With You, but You Can Convert," *Barron's* (January 18, 2010), p. 23]: New York-based John Carl, president and founder of the retirement learning center in Brainerd, Minnesota answered the question, **Should you convert your IRA to a Roth IRA?: "For anyone up to the age of 58, this [conversion] is a no-brainer. In fact, the younger your age the greater the advantage because of the time value of money allows your investment to compound tax-free, rather than tax deferred."**

To make the conversion in 2010, there are no limitations in regard to your income, and the income tax can be paid in 2011 and 2012. The open window in 2010 is expected to be shut tightly in subsequent years. While I didn't do the research, I think there are significant advantages for your children who inherit your Roth IRA instead of your traditional IRA, and that advantage might go to the next generation as well. Before making a conversion, be sure to check with your tax professional.

New No-Fee Trading for ETFs Suitable for WSTL Investors: [from Charles Jaffe's syndicated column (Feb. 10, 2010) and *The Wall Street Journal* ((Feb. 3, 2010, p. C15)]:

Fidelity investments announced that it will offer 25 iShares exchange-traded funds (ETFs) [with more than \$212 billion in assets [which means excellent liquidity] commission-free, effectively allowing no-load purchases of the most

popular asset classes. The commission-free period for those ETFs is expected to last at least three years starting Feb. 3, 2010. The move is a response to Charles Schwab creating a commission-free ETF platform in Nov. 2009, and it signals a new era not only for ETFs but for fund investors.

ETFs are, essentially, mutual funds that trade throughout the day like stocks. Traditional no-load mutual funds trade only at their closing prices at the end of the day but can be bought (and sometimes sold) without paying a commission or sales charge.

Fidelity's lineup of commission-free ETFs is impressive because it includes the kinds of funds to build core portfolios. In particular, three of those ETFs are ideal for the 401(k)s and IRAs of investors [and WSTL investors!]: S&P 500 (symbol **IVV**); Russell 3000, which accounts for approximately 98% of the total value of the U.S. stock market (**IWV**); and Russell 2000, which is small-cap stocks (**IWM**).

May the Wall Street Traffic Light help illuminate your financial path,

John K. Harris  
February 28, 2010

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### Issue #3 for 2010 (February 1, 2010)

#### **Mark your calendar for my next update: February 28, 2010 (3:00pm CST).**

Note that an interim update will be issued before that date if the S&P 500 moves to the neighborhood of either 956.50 or 1247.19 (the two levels explained below).

In *Barron's* (February 1, 2010, p. 13), Mike Santoli describes me as one of "the analysts in the white coats." So, here's the report from my laboratory.

### 2010

As a result of the sell signal on January 29, 2010, 401(k) and IRA investors using the WSTL should sell their low-cost S&P 500 index fund and put the proceeds into a money market fund. Now (like a year ago), money market funds are earning almost nothing. For example, the Fidelity Cash Reserves fund's YTD performance as of 01/29/10 is a mere 0.01%! Nonetheless, the goal is to preserve capital while the WSTL is **red**.

For the 32 sell signals in the 1935-2009 history of the WSTL, there has been little effect of acting on those signals one day late (that is, February 1<sup>st</sup> in the 2010 case). See my book, pp. 52-54.

As I reported in Issue #1 for 2010, based on the reversion-to-the-mean component of the WSTL model, 2010 is in Tier 3, which occurs when the S&P

500's average annual return for the preceding two years is below 6.2% (see p. 15). The S&P 500 had a return of -37.0% for 2008 and 26.5% for 2009, so the two-year average is -5.3%.

The S&P 500's December 2009 low (1091.94 on the 8<sup>th</sup>) was first broken on January 22<sup>nd</sup> (1091.76), and January's change was -3.70% (from 1115.10 to 1073.87). Therefore, **2010 is a 3C year** (see pp. 17-18). The S&P 500's closing prices for the December-through-January period are depicted in the [line chart for 2010](#), which appears in "The Research" section of the website. This chart will be updated weekly or more often as we go through February, March and April.

The WSTL was **green** at the beginning of 2010. It turned **red**—the sell signal—on January 29<sup>th</sup> (1073.87). The WSTL will turn **green**—the buy signal—depending on whichever of three limits the S&P 500 reaches first: the *lower limit*, the *upper limit* or the *time limit*. As set forth on p. 48, the specifications for those limits in a 3C year are as follows:

- **Lower limit** The S&P 500 closes, for the first time after the sell signal, at least 10.93% below its closing price on the day of the sell signal. That is:  $1073.87 \times (1 - 0.1093) = \mathbf{956.50}$ .
- **Upper limit** The S&P 500 closes, for the first time after the sell signal, at least 16.14% above its closing price on the day of the sell signal. That is:  $1073.87 \times (1 + 0.1614) = \mathbf{1247.19}$ . The upper limit is a "stop loss," which means the trade would be unprofitable. In the 75-year history of the WSTL model (1935-2009), the only year in which the upper limit was reached first was 2003, a 3C year; the trade that year **lost 18.36%**.
- **Time limit** The **end of November 2010**. In the 75-year history of the WSTL, four of the eight 1C and 3C years that triggered the time limit had **losses**: 1948 (3C) **4.56%**, 1956 (1C) **3.99%**, 1960 (1C) **0.45%** and 2005 (1C) **5.08%**.

For its 75-year history, the WSTL has had 27 profitable and the five unprofitable trades—a success rate of 84.4%. **Compared to buying-and-holding the S&P 500, the WSTL has not had much risk of loss and has had much reward.** The following data will give you a handle on the effect of the reward in terms of the total accumulation for 401(k) and IRA investors, assuming they started with \$10,000 (see p. 28-29, which I updated here through 2009; and see pp. 135-136).

Period	S&P 500	WSTL	Advantage of WSTL	
			Accumulation	Gain
1970-2009	\$430,453	\$1,261,608	\$831,155	193.1%
1935-1969	\$502,679	\$1,776,418	\$1,273,739	253.4%

WOW! These long periods are excellent illustrations of what John Bogle calls “the magic of compounding.”

Taking the Heat: While the WSTL is **red**, WSTL investors **take the heat** whenever the S&P 500 has a net gain (that is, buying-and-holding the S&P 500 outperformed the WSTL). Taking the heat increases in direct proportion to the size of the S&P 500’s net gain. Emotionally, it can be quite challenging to take the heat. WSTL investors can help prepare themselves for the high likelihood of taking the heat in 2010 by looking at the table on p. 59. In future updates in 2010, I’ll keep you informed regarding the maximum heat being taken while the WSTL is **red**.

Bull Market Top on 01/19/10?: This question will be answered in the fullness of time. If 01/19/10 was a bull market top, it would have plenty of historical company. Consider the months of January and February. Four times a bull market top occurred then: 02/09/66, 01/11/73, 01/04/02 and 01/06/09. And three other cases nearly qualified as bull market tops: 01/11/38, 01/05/53 and 02/13/80.

The Tutorial for My Book: I’m writing the Tutorial to help you learn and understand and the important aspects of my book. By March 15<sup>th</sup>, I will put the Tutorial at the About the Book button.

For Experienced Investors: The following table presents key aspects of the 15 1C and 3C years during 1935-2009 in which January declined by 3.50% or more:

**1C and 3C Years in Which January Declined by 3.50% or More, 1935-2010**

Year	January's Change Ranked	Outcome of Trade	Buy Signal vs. Year's Low (trading days)	YTD Decline at Year's Low
1940	-3.52%	12.90%	22 days before	22.94%
1956	-3.65%	-3.99%	217 days after	5.21%
<b>2010</b>	-3.70%	? ?	?	?
1962	-3.79%	11.01%	23 days before	26.88%
1948	-3.99%	-4.65%	196 days after	9.54%
1957	-4.18%	11.94%	1 day before	16.48%
1935	-4.21%	17.70%	0	15.16%
1981	-4.57%	17.98%	0	16.93%
1941	-4.82%	3.56%	24 days before	20.89%
1977	-5.05%	11.67%	0	15.59%
2000	-5.09%	9.22%	14 days before	13.92%

1990	-6.88%	5.23%	35 days after	16.40%
1939	-6.89%	13.51%	1 day before	22.94%
1960	-7.15%	-0.45%	24 days after	12.67%
1970	-7.65%	13.71%	8 days before	24.73%
2009	-8.57%	14.88%	6 days before	25.10%
<b>Mean</b>		<b>8.95%</b>		<b>18.44%</b>

Both the average (mean) profit per trade (8.95%) and the mean YTD decline at the year's low (18.44%) are large figures. It's noteworthy that in regard to the year's low for the **15 years** in the table, **eight of the buy signals occurred an average of 12 trading days before the low, three were exactly at the low**, and four occurred an average of 118 trading days after it. Although not shown in the table, **seven of the year's lows were bear market lows, three were not far (in percentage terms) from being bear market lows**, and five were neither.

Finally: Remember to mark your calendar for my next update: **February 28, 2010 (3:00pm CST)** as well as **the possibility of an interim update** as noted above.

I welcome your feedback at: harrisjohnk@hotmail.com.

May the Wall Street Traffic Light help illuminate your financial path.

John K. Harris  
January 31, 2010

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### Issue #2 for 2010 (January 29, 2010)

Some decisive movements in the S&P 500 have occurred this month. The S&P 500's December 2009 low (1091.94) was barely broken on January 22<sup>nd</sup> (1091.76). But a fraction of a point counts in the WSTL model. And barring a monster rally (closing above 1115.10) today, the S&P 500 is going to be negative for January. That change was -2.74% as of yesterday's close. The December-January period to date is depicted in the [line chart for 2010](#), which appears in "The Research" section of my website; note the steep and rapid decline in the S&P 500 during the last seven trading days. Therefore, **2010 is a 3C year and the WSTL will turn red at the close of trading today**. See the flowchart on p. 18 of my book.

Because the WSTL model's 33<sup>rd</sup> trade since 1935 will occur in 2010, it's important to keep the track record in mind. Overall, 27 of the previous 32 trades were profitable vs. buying-and-holding the S&P 500, for an 84.4% success rate.

Of the five unprofitable trades, only one had a loss greater than 5.08%; that loss was 18.36% in 2003.

**Remember, the onus is on you to mark your calendar for my next update. It will be posted by 3:00pm CST on January 31, 2010.**

If you are so moved, email me your comments and questions:  
**[harrisjohnk@hotmail.com](mailto:harrisjohnk@hotmail.com).**

### **A Dozen Odds and Ends**

1. The objective of the WSTL is to use infrequent market timing to outperform buying-and-holding the S&P 500—that is, achieve a higher average annual return and take less risk.
2. The applicability of the WSTLI is limited to **401(k)s, 403(b)s, 457s, IRAs and other tax-advantaged accounts**. Despite the excellent performance of the WSTL over the past 75 years, it would **not** have beaten buying-and-holding the S&P 500 in **taxable accounts**.
3. My role in these Market Commentaries is to explain what's going on with the WSTL in the current year and **report quarterly** on the returns for the WSTL vs. buying-and-holding the S&P 500.
4. By March 15<sup>th</sup>, I will put the **Tutorial** for my book at the About the Book button. The purpose of the Tutorial is to explain **how to “invest” (say) six to ten hours** in reading and studying my book so that you can really understand the WSTL, even if you let the Market Commentaries actually do the work for you. **Armed with the Tutorial and the help of the website, even novice investors can feel confident in making some of their most important investment decisions.**
5. The watchword of the WSTL model is: “Sell and buy lower.” This differs from the age-old advice for investors: “Buy low and sell high.” Practically speaking, while the age-old advice would be of obvious benefit, nobody has enabled individual investors to implement it consistently. On the other hand, it is simple to consistently implement the WSTL model. Keep in mind that its **success rate is 84.4%** (27 profitable trades out of 32 total trades), not 100%.
6. Compared to buying-and-holding the S&P 500, the WSTL achieved a higher average annual return and took less risk for **every rolling decade** in the 1935-2009 period (1935-1944, 1936-1945...2000-2009). That is **“sleep well” performance** indeed.

7. **To know how the WSTL performed after my book was written, read the 2000-2009 section of Issue #1 for 2010 below.**
8. If you decide to be a WSTL investor, I charge you nothing. (The only thing I'm selling is my book.) Moreover, with the help of the website, using the WSTL requires no more than three or four hours of your time per year. That's an ideal combination for investors who are busy and want to be frugal in managing their portfolio.
9. Investment costs are obviously an important factor for investors to keep in mind. Unfortunately, however, many investors virtually ignore the investment costs they incur each year—partly because some of the costs are rather hidden. *The Wall Street Journal* said recently that the individual investor's **investment costs average roughly one to two percentage points a year**, before including the fees paid to a financial planner. In contrast, I recommend that investors use a low-cost S&P 500 index fund costing less than 0.10% a year (see pp. 51-52 of my book).
10. The WSTL is best suited to trading into and out of the S&P 500 (that is, US large-cap stocks). The WSTL is reasonably well suited to the Nasdaq Composite (US tech stocks) and the Russell 2000 (US small-cap stocks). That's because the movements of all three indexes tend to be rather highly correlated over time. The WSTL is **not** well suited to non-US stocks, because the movements of those stocks often are not highly correlated with the movements of the S&P 500.
11. At any given time, the WSTL is either **green** or **red**; it is never yellow.
12. Amazon has in stock the 1<sup>st</sup> printing of my book. I did a 2<sup>nd</sup> printing to eliminate minor errors. I'll sign and mail you a copy of the 2<sup>nd</sup> printing for \$26 (\$20.95 + \$5.05 for postage). All orders must be prepaid by check. My mailing address: 6667 S. Jamestown Place, Tulsa OK 74136.

May the Wall Street Traffic Light help illuminate your financial path.

John K. Harris  
January 29, 2010

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### **Issue #1 for 2010 (January 7, 2010)**

I published my book, *The Wall Street Traffic Light*, in January 2008. The last year of data included in the book is 2006. At the time of publication, I planned

to post monthly market commentaries on this Website. As the months have gone by since then, I realize my monthly commentaries were not a good idea. That's because the buy signals and sell signals generated by the Wall Street Traffic Light (WSTL)—being infrequent—meant filling my commentaries with a lot of stock market history *unrelated to the model*. By so doing, I strayed from the simplicity that is an important feature of the WSTL. As a result, (effective at the beginning of 2010), I am replacing my monthly commentaries with this feature: **“Tracking Performance of the Wall Street Traffic Light”** This is Issue #1 for 2010. In it, I will report on 2007, 2008 and 2009—the three recent years not included in my book. Then I will report on 2010 and subsequent years on a real-time basis as relevant movements in the S&P 500 occur. As a minimum, there will be one update per calendar quarter. **My next update will be the morning of January 29<sup>th</sup>**, the last trading day of the month.

I promise you that my discussion on applying the WSTL to each year will be **brief but complete, and timely as 2010 and subsequent years unfold**. Your understanding of the discussions will be greatly enhanced if you are familiar with my book, especially pp. 13-19 and 47-49.

## 2007

Based on the reversion-to-the-mean component of the WSTL model, **2007 is a Tier 2 year**. A Tier 2 year occurs when the S&P 500's average annual return for the preceding two years is in the range of 6.2% to 13.6% (see my book, p. 15). The S&P 500 had a return of 4.9% for 2005 and 15.8% for 2006, so the two-year average is 10.4%. In a Tier 2 year, there is no trade out of the S&P 500 during the year. In other words, the WSTL was **green** throughout 2007.

2007 Performance: The return for both the S&P 500 and WSTL was 5.49%.

## 2008

Based on the reversion-to-the-mean component of the WSTL model, **2008 is a Tier 2 year**. A Tier 2 year occurs when the S&P 500's average annual return for the preceding two years is in the range of 6.2% to 13.6% (see my book, p. 15). The S&P 500 had a return of 15.8% for 2006 and 5.5% for 2007, so the two-year average is 10.7%. In a Tier 2 year, there is no trade out of the S&P 500 during the year. In other words, the WSTL was **green** throughout 2008.

Interestingly, 2008 was the third Tier 2 year in a row. In the 74-year history of the WSTL model (1935-2008), it was the first case when more than two Tier 2 years occurred in a row.

2008 Performance: The return for both the S&P 500 and WSTL was -37.00%. **This is the S&P 500's and the WSTL's worst annual return for 1935-2008, and the only Tier 2 year that had a return of less than 5.2%.** In other words,

2008 was an atypical year for the WSTL based on 74 years of history. During 1935-2008, the S&P 500 return was worse than -25% only two other times: -35.0% for 1937 and -26.5% for 1974. Meanwhile during that period, the WSTL return was worse than -16% only one other time: -32.0% for 1937.

Viewed through the lens of the WSTL, 2008 also was very unusual in regard to risk. Prior to 2008, the model had a profitable trade in *every* year when the S&P 500's return was negative (see p. 42). Also prior to 2008 for years when there was no trade, the S&P 500 declined 14.2% or more within the year *only three times* (see p. 43). Such declines occurred *four times during 2008 alone*.

## 2009

Based on the reversion-to-the-mean component of the WSTL model, 2009 is in Tier 3, which occurs when the S&P 500's average annual return for the preceding two years is below 6.2% (see my book, p. 15). The S&P 500 had a return of 5.5% for 2007 and -37.0% for 2008, so the two-year average is -15.8%.

The S&P 500's December 2008 low (816.21 on 12/01/08) was first broken on 01/20/09 (805.22), and January 2009 had a decline (from 903.25 to 825.88, or -8.6%). Therefore, **2009 is a 3C year** (see pp. 17-18). These data points are depicted in the [line chart for 2009](#), which appears in "The Research" section of the website.

Being a 3C year, there was a trade out of and back into the S&P 500 during 2009. The WSTL was **green** at the beginning of the year (as is the case every year), turned **red**—the sell signal—at the end of January (825.88), and turned **green**—the buy signal—on 02/27/09 (735.09). This buy signal occurred because the S&P 500 had declined the required 10.93% from its level on the date of the sell signal (see pp. 47-49). **The buy signal was only six trading days before the bear market low on 03/09/09.** Buying at or near the year's low occurred in eleven other cases (see p. 22 and p. 81).

Over the years, many of the WSTL's sell signals were at the end of January, but 2009's buy signal is the only one that was in February. Three buy signals were in March: 03/12/01, 03/14/35 and 03/35/38.

2009 Performance: The outcome of the trade was profitable; the size of the profit was 14.94%. For the year, the S&P 500's return was 26.46% versus the WSTL's return of 41.40% (26.46% + 14.94%). [If desired, I will send you the calculations for the 41.40%. Email requests to: [thewallstreettrafficlight@cox.net](mailto:thewallstreettrafficlight@cox.net)].

It is instructive to consider investor psychology from the perspective of investors using the WSTL to manage some portion of their 401(k)s and/or IRAs in 2009. The greatest bear market since the Great Depression lasted 17 months, from

10/09/07 to 03/09/09. For the period, the S&P 500 declined 56.8%. Moreover, the WSTL was **green** throughout the entire period from the buy signal at the end of 11/05 (1249.48) to the sell signal at the end of January 2009 (825.88), and during that time the S&P 500 declined 33.9%. Psychologically, the sell signal came at what seemed like the wrong time. *Without question, it would have been an extremely difficult decision to sell then;* for the other ten cases of selling the S&P 500 at a loss, see p. 60. Assuming the sell signal and the buy signal (four weeks later) were acted on, investors received an increase in their 2009 return from market timing of 14.94%. The year 2009 is a classic case of successful market timing from using the WSTL: **“Sell the S&P 500 and then buy it lower.”** (see p. 4).

1935-2009 Scoreboard: The WSTL had 27 profitable trades and 5 unprofitable trades. All of them except 2009’s profitable trade are listed on p. 80 and p. 89. As a way to think about the historically low risk of using the WSTL for market timing, only one trade lost more than 5.1%—the loss of 18.4% in 2003.

## 2000-2009

This is a decade investors would like to forget. The S&P 500 (including reinvested dividends) lost 9.12%. In sharp contrast, the WSTL gained 9.02%, for a difference of 18.14%. Moreover, the WSTL led the race throughout the decade! The year-by-year comparisons are in the following table:

### Buying-and-Holding S&P 500 vs. Using the WSTL Model, 2000-2009

This comparison assumes each method invested \$100,000 at the end of 1999.

End of Year	S&P 500 Return	S&P 500 Accumulation	WSTL Return	WSTL Accumulation	Advantage of WSTL
1999		\$100,000		\$100,000	
2000	-9.10%	\$90,900	0.12%	\$100,120	\$9,220
2001	-11.89%	\$80,092	-6.25%	\$93,863	\$13,771
2002	-22.10%	\$62,392	-12.59%	\$82,045	\$19,654
2003	28.68%	\$80,286	10.32%	\$90,512	\$10,227
2004	10.88%	\$89,021	10.88%	\$100,360	\$11,339
2005	4.91%	\$93,392	-0.17%	\$100,189	\$6,798
2006*	15.79%	\$108,138	15.79%	\$116,009	\$7,871
2007†	5.49%	\$114,075	5.49%	\$122,378	\$8,303
2008	-37.00%	\$71,867	-37.00%	\$77,098	\$5,231
2009	26.46%	\$90,883	41.40%	\$109,017	\$18,134

\*This is the last year of data included in the book, *The Wall Street Traffic Light*.

†The book was published January 2008.

In troubled economic times or in good economic times, the WSTL provides 401(k) and IRA investors with easy-to-understand answers to two basic questions: (1) *When* to invest in the S&P 500? (2) *When not* to invest in the S&P 500? **The performance for 1935-2009 was fantastic: For every rolling decade in period (1935-1944, 1936-1945...2000-2009), the WSTL achieved higher returns and took lower risk than buying-and-holding the S&P 500.** That is “sleep well” performance indeed. Using the WSTL involves no fees and—with the help of this website—requires no more than three or four hours per year.

Compound Annual Growth Rate: Although many investors are not familiar with the CAGR, it is the best measure of any investment strategy’s average annual return (see p. 29). The WSTL had an impressive market-timing advantage for the past decade and for the three years since my book was written:

	S&P 500	WSTL	Average Annual Advantage of WSTL
CAGR for 2000-2009	-0.95%	0.87%	1.82%
CAGR for 2007-2009	-5.63%	-2.05%	3.58%

The WSTL uses S&P 500 index funds that cost about 0.10% per year (see p. 51), and there are no management fees. As a result, the average annual advantage of the WSTL in the table above overstates **alpha** (see definition p. 10) by approximately 0.10%.

## 2010

Based on the reversion-to-the-mean component of the WSTL model, 2010 is in Tier 3, which occurs when the S&P 500’s average annual return for the preceding two years is below 6.2% (see my book, p. 15). The S&P 500 had a return of -37.0% for 2008 and 26.5% for 2009, so the two-year average is -5.3%.

The next order of business in using the WSTL is to determine whether 2010 is a 3A, 3B or 3C year. Step 1 is to know the S&P 500’s December 2009 low: **1091.94** on 12/08/09. Step 2 is to wait and see if the December low is broken during the January-through-April period of 2010. And if so, when? **See the flowchart, p. 18.**

Mark your calendar for my next update:

The morning of January 29<sup>th</sup>, the last trading day of the month.

May the Wall Street Traffic Light help illuminate your financial path.

John K. Harris  
January 7, 2010