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Prolonged Liquidation

A Market Timer's New Buy Signal

By JAMES ALPHIER

FIVE years ago in Barron's *(Feb. 26, 1979, to be exact), James Alphier described his market timing theory of "urgent selling." It was, in his words, "a crude but original attempt to measure points in the stock market." He was looking to buy when "the news background is bleak, when few investors are bullish, and when stocks are selling with the hope squeezed out of them." Now, Jim Alphier has done some research and come up with another "simple method," which, he says, "can be used to positively identify those very profitable market junctures when the sellers have run out of ammunition, and investors are well into the final throes of depression." Applying the new theory, he figures the market bottomed on March 9, and he looks for an extended upswing. Details follow.*

A CONCEPT I call "Prolonged Liquidation," has, in the past 44 years, signaled every major buying point. All but two of the signals occurred at major bottoms, and the other two were profitable for several months. Prolonged Liquidation is basic to stock market behavior, and is unlikely to be affected by changes in laws, customs or the introduction of new investment products. While it has a better overall record than other heralded indicators for major stock market bottoms, it can be computed by anyone who can handle plus and minus numbers and count into the low double digits.

In fact, ease of calculation is one of the beauties of Prolonged Liquidation. Here's how it works. Each week, count how many days the Standard & Poor's 500 stock composite index closed up, and how many days it closed down. If there is any day the index is precisely unchanged, give that day the sign of the previous day. Ignore the magnitude of the rise or fall, and forget about holidays or other days the market was closed. At the end of each week, go back over the past 14 weeks of data. Count how many total days are up, and how many are down. You don't need to graph or otherwise manipulate any of these numbers.

If, in the past 14 weeks, there are *at least* 17 *more* down days than up days, you have an important buy signal. The amount by which the number of down days exceeds 17 (if any) is of only minor importance. When the signal occurs, the investor can rely on other studies (or personal judgment) if "fine tuning" the exact buying time is important. It probably is not, but that is not for this writer to decide for everyone.

Table I lists all of the periods when Prolonged Liquidation has occurred since 1938. The dates given are end-of-week. The actual number—or range—of excess down days is also shown.

Table II on Page 18 lists the 11 best long-term buying points since 1938. It would be hard to quibble with this list, which shows how Prolonged Liquidation stacks up against other popular indicators that analysts use to test investor despondency. The table allows two comparisons to be made. First, there's the comparison between the record of Prolonged Liquidation in calling each major buying point and the record of other methods. The results speak for themselves.

The second comparison is found in the final column, "Number of other losing signals, most charitable interpretation." Applying the *best* of the published interpretative rules for each indicator, we come up with the number of signals upon which an investor who bought would have clearly lost money. Many professional and lay stock market analysts will disagree with the number shown in this column. But most responsible analysts will agree that all of the popular indicators have given some false signals.

Prolonged Liquidation Periods

Table I

Date	Range or Number of Excess Down Days
3-26-38 through 4-2-38	17 to 18
4-23-38	17
12-13-41 through 1-10-42	18 to 24
11-23-46	18
8-28-53	17
10-27-56 through 11-30-56	17 to 22
12-14-56	17
11-1-57	17
5-11-62 through 7-6-62	18 to 28
10-14-66 through 10-21-66	17 to 19
4-24-70 through 7-17-70	18 to 25
8-30-74	18
9-13-74 through 10-11-74	17 to 26
10-25-74 through 11-22-74	17 to 21
2-17-78 through 3-3-78	17
7-30-82 through 8-27-82	20 to 30
3-9-84 through ?	17

This indicator is unlikely to be affected by revised customs, laws or new types of investments.

To date, Prolonged Liquidation has not given any false signals. The only signals that failed to occur at one of these choice buy times were very close together in 1956's fourth quarter. This wasn't a particularly bad signal; stock prices rallied irregularly before they finally peaked in July 1957, several months later.

Why does this simplistic concept work so well? Probably because this method is a good litmus test for the kind of extreme pessimism that must be seen at a major low. Stock prices, over the past several decades, have spent many more days going up than going down, even when not making net upside price progress over a period of years. Our statistical test, on the other hand, requires something close to twice as many down days as up days over more than three months.

This hardly ever happens. When it does, it says investors are shell-shocked enough to be

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The 11 Best Long-Term Buying Points Since 1938

Table II

Date	April 1938	1st Qtr. 1942	Lows During 1946-9	Late 1953	4th Qtr. 1957	June-Oct. 1962	Oct. 1966	May-July 1970	4th Qtr. 1974	1st Qtr. 1978	Mid-1982	Charitable Interp. Number of Other Losing Signals
INDICATOR	**Did it call the buying point?**											
Prolonged Liquidation	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	None
Short Sales[1]	Didn't Exist	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Five
Odd Lot Shorts	Didn't Exist	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Probably Not	No	No	Four
Short Interest Ratio	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Three
25-Day Plurality Index	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	No	Eight
Arms Index[2]	Didn't Exist	Didn't Exist	Didn't Exist	Didn't Exist	Didn't Exist	Yes	Yes	Yes	Yes	No	Yes	Four
Investors Intell. Poll	Didn't Exist	Didn't Exist	Didn't Exist	Didn't Exist	Didn't Exist	Didn't Exist	Yes	Yes	Yes	Yes	Yes	One

[1]Includes specialist, member and public short sales. The BEST-performing of these as predictors—alone or in various combinations—is used for the comparisons in each period.
[2]Ten-day and alternate interpretation.

net sellers on most trading days. By the time such selling has been going on for 14 weeks, the very worst fears and expectations have been built into stock prices. Contrary opinion devotees contend that, in that kind of psychological climate, disaster is expected and good news is a surprise. This is just the stuff of which bottoms are made.

One might study Table I and theorize that the greater the number of excess down days, the better the buying point. And, in fact, the four largest numbers of excess down days did come before fast, sizable price jumps—in 1962, 1970, 1974 and 1982. However, the bare minimum was met in late 1953, at what turned out to be the dawn of a 2½-year bull market that was one of the most fabulous on record. The minimum was also just met in 1957 and 1978, prior to no small waves of speculative buying. This method probably so coarsely measures investor pessimism that we can regard any number as only a rough approximation of the amount of current fear. If so, trying to hone things down to a final precision will be a vain effort.

As Table I shows, the condition of Prolonged Liquidation was again met recently, in the week ended March 9, 1984. If this rule of thumb—one hesitates to call it a method—is correct again, stock prices should be in a general bottoming area right now. How long would an upturn last? In the past, there has been no signal for long-term investors to sell until at least six months after the buy signal. The 1938 and 1978 lows were succeeded, about a half-year later, by market tops that probably would have called for defensive measures.

A mastery of technology and higher math isn't needed to make wise decisions on the market.

If past is prologue, market historians will regard the current time and price as an approximate low area, following which there was a worthwhile general market advance for at least six months. In practical terms, this suggests stock price strength at least into September of this year, and perhaps considerably past that.

Besides being an effective stock market timing tool, Prolonged Liquidation highlights a heartening truth: The sensational advances of computing technology and a knowledge of higher mathematics are not necessities for people who want to make successful stock market decisions. A bit of thought and research and some simple calculation still can win the day. Human nature being an unchanging thing, this may always be so. ■

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"Urgent Selling"

It's An Effective Way to Gauge Investor Sentiment

By JAMES E. ALPHIER

INVESTORS with even a modicum of experience know that the best time to buy stocks is when things are darkest: when the news background is bleak, when few investors are bullish and when stocks are selling with all the hope squeezed out of them. That being so, it's no surprise that a number of savvy market analysts have been striving to measure the Street's bearishness as a way to fix key buying points. These efforts have run the gamut: from overbought/oversold indicators based on the action of stock prices themselves; through studies of upside and downside volume on the exchanges; to analysis of buying, selling and short-selling activities of selected investment groups. And some of these indicators have long since become conventional market wisdom.

Yet one of the simplest and most logical methods has been largely overlooked. Anyone who can count can spot stretches of what is termed "urgent selling." This is a crude, simplistic, one-dimensional test for emotionally based liquidation in the stock market. It is designed to identify periods when investors feel pressure to unload stocks almost continually in near desperation. This test is based on the number of trading days on which a representative price average moves up or down, with the following provisos:

- You must use a price average representative of the total stock market—the Standard & Poor's Composite, for example.
- Only closing prices must be considered.
- Any period of at least 15 trading days during which the average closes lower four or more times as often as it closes higher qualifies as a period of urgent selling. The size of any day's price change is not important. For example, if in the past 15 trading days, the average has closed lower 12 times and higher three times, all minimum conditions are met.
- A day in which the average is unchanged is counted as a down day only if the preceding day closed lower.

Table I shows all instances of urgent selling from 1885 to date. The averages used are: 1885 to 1896, a combination of the Dow Jones Rail and Industrials representing between 12 and 20 stocks; 1897 to 1915, the Dow Jones Rails; 1916 to 1927, the Industrials; 1928 to present, Standard & Poor's 500 stock composite. (The Rails are used for 1897-1915 because they had a far greater market value than the early Industrial Average.)

Typical of the Bear

In those 93 years, there have been 62 instances of urgent selling, counting the latest, from Oct. 10-31, 1978. As Table I reveals, selling is by no means uniformly distributed over the years but appears in "clumps," with isolated instances relatively few. This urgent selling is primarily a bear market phenomenon. In all, not more than a half-dozen cases have occurred during bull markets.

Regardless of any other consideration, the record shows that following a termination of any wave of urgent selling, there's a two-out-of-three chance that the next 20% move will be up, as extremes of investor pessimism give way to at least a slightly brighter view.

Gloomier Still

Urgent selling, on average, has occurred about once every 1½ years in the period studied. Several bouts of it, packed closely together, indicate investors are particularly hard-pressed to unload, a phenomenon typical of the gloomy, fear-ridden atmosphere found at bear market bottoms or other key buying junctures. Table II shows what happens when a fairly difficult requirement has been met: five waves of urgent selling within 36 months. This ought to show when investors feel things are darkest. And when this condition has been met, it has indeed been a good time to buy stocks. The second to the last entry on the table is particularly interesting. In early 1978, many commentators were waiting for "traditional" indicators to show that the decline was overdone and that pessimism was becoming climactic. Meantime, five waves of urgent selling, between July 1975 and January 1978, did just that, pointing to an excess of investor fear, and the market tacked on 22% in the next eight months.

The urgent selling that ended on Oct. 31, 1978, also marked an ultra-gloomy juncture. It was, moreover, only the fourth time that the "five waves in 36 calendar months" requirement was met twice in less than a year. The three other occasions, August 1921, September 1974 and August 1975, all preceded large advances. On the basis of this study alone, it appears that plenty of scope exists in the current market for further gains. (The 36-month rule is arbitrary and doesn't preclude the use of other time frames.)

A great deal of urgent selling often precedes times of brisk speculative activity, as the emotional pendulum swings from one extreme to the other. For instance, the 1917-1921 span saw eight waves of urgent selling, the most concentrated in the 93 years studied. It was, of course, followed by the massive speculation of the 'Twenties. Many other urgent selling concentrations led to what was, in retrospect, excessive speculation. By contrast, the bear market troughs of 1942, 1949, and 1953, which were not preceded by unusual concentrations of urgent selling, opened the way to market advances in which speculation was relatively subdued for a considerable time.

The past few years have seen another major concentration of urgent selling. It may appear unlikely now, but this study suggests that the next few years could see more speculation than many now believe possible.

It's also possible to cite scarcity of urgent selling as indirect evidence of market tops. As can be seen in Table III, all major bull market tops have been preceded by at most one wave of urgent selling in the previous 18 months. This makes sense, as key market tops are marked by an absence of pessimism and of selling pressure. The table could have provided an historical argument that the tops in April 1971 and July 1975 were unlikely to prove more than temporary. Yet, at both these pauses, many investors wrongly concluded that the bull market had ended. Both April 1971 and July 1975 had seen more than one wave of urgent selling in the previous 18 months.

A Top That's Not

On past evidence, the September 1978 top is unlikely to go down in the history books as a major bull market high. If it

TABLE I
PERIODS OF URGENT SELLING 1885 TO PRESENT

Start	Month-Day End	Year	Down Days	Up Days	Next 20% Move Was
4-30	5-19	1891	13	3	Down
7-11	7-30	1891	13	3	Down
12- 1	12-22	1893	14	3	Up
10-15	11- 9	1895	17	4	Down
12- 2	12-21	1895	15	2	Up
6- 1	6-20	1900	13	3	Up
2- 9	3- 3	1903	13	3	Down
5-26	6-10	1903	12	3	Up
1-23	2-10	1904	12	3	Up
7-14	8- 1	1910	13	2	Down
7-21	8-16	1911	18	4	Down
1-30	2-25	1913	16	4	Down
5-22	6-11	1913	13	2	Down
4- 7	4-25	1914	13	2	Up
9-25	10-15	1917	13	2	Up
10-20	11- 8	1917	12	3	Up
5-14	6- 1	1918	12	3	Up
11- 9	11-29	1918	12	3	Up
10-25	11-20	1920	17	4	Up
12- 4	12-21	1920	13	1	Up
5- 5	5-31	1921	16	4	Up
8- 2	8-24	1921	16	3	Up
10-10	10-29	1929	12	3	Up
9- 1	10- 5	1931	22	5	Up
11- 9	12-17	1931	26	6	Down
3- 8	4-20	1932	29	7	Down
4-27	5-14	1932	12	3	Up
9-27	10-16	1941	13	2	Down
12- 4	12-23	1941	12	3	Up
8-13	9- 4	1946	12	3	Up
3-27	4-15	1947	12	3	Up
5-16	6-13	1949	16	4	Up
5- 8	5-25	1951	12	3	Up
8- 3	8-31	1953	17	3	Up
5- 4	5-28	1956	14	2	Up
8- 8	8-30	1956	13	3	Up
9- 6	10- 1	1956	14	3	Up
7-24	8-14	1957	12	3	Up
8- 3	8-24	1959	12	3	Up
3-15	4-12	1962	16	4	Down
4-19	5-28	1962	21	5	Up
5-19	6-10	1965	12	3	Up
2- 9	3- 7	1966	14	3	Up
4-21	5-17	1966	16	2	Up
8- 5	9- 8	1966	18	4	Up
1-12	2- 5	1968	13	3	Down
5-22	6-23	1969	18	3	Down
7- 3	7-29	1969	13	3	Down
11-10	12-17	1969	21	5	Down
4- 1	5-21	1970	29	7	Up
10- 7	11- 1	1971	14	3	Up
9- 1	9-25	1972	12	3	Down
1- 5	2- 5	1973	16	4	Down
7-26	8-16	1973	12	3	Down
10-26	12- 5	1973	22	5	Down
7-24	9-13	1974	21	5	Up
7-15	8- 8	1975	15	3	Up
9-21	10-14	1976	14	3	?
3-16	4- 6	1977	13	2	?
10- 3	10-25	1977	13	3	?
12-30	1-23	1977-8	12	3	Up
10-10	10-31	1978	12	3	?

TABLE II
Five Waves of Urgent Selling Within 36 Months

Condition Met		3 Months Later	6 Months Later	Subsequent Price Change 9 Months Later	12 Months Later
May	1921	− 9%	+ 5%	+16%	+30%
August	1921*	+19%	+33%	+50%	+56%
May	1932*	+26%	+40%	+15%	+60%
February	1968	+ 7%	+ 6%	+12%	+12%
May	1970*	+10%	+16%	+34%	+40%
November	1971	+12%	+15%	+17%	+21%
December	1973	+ 6%	− 3%	−23%	−28%
September	1974*	+ 3%	+28%	+39%	+28%
August	1975	+ 4%	+16%	+18%	+21%
January	1978(*?)	+ 7%	+10%	+10%	+13%
October	1978	+ 7%	?	?	?
	Average	+ 8%	+16%	+19%	+25%

*Led to historic market low.

TABLE III
Number of Instances of Urgent Selling Within 18 Months Prior to a Major Top

Bull Market Peak	Urgent Selling Occurences
1887	0
1890	0
1893	0
1901	1
1906	0
1909	0
1916	0
1919	1
1929	0
(1930)*	(1)
1937	0
1946	0
1956	0
1959	1
1962	0
1966	1
1968	1
1973	1
1976	1

*Included as bull market, although market historians may disagree.

does, it will be the first such high in 93 years that was led by two waves of urgent selling within 18 months.

A final point on tops: in each case in which one wave of urgent selling occurred 18 months or less prior to a bull market peak, it led a final, straight-line push upward.

While the methodology of urgent selling studies is elementary—and much of the time the indicator will have nothing to say about the market—it does boast 30-40 years more history than just about any other psychological indicator. And, measured by a number of gauges, several waves of urgent selling have stood out as a highly reliable signal of important buying points.

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END

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June 29, 1984

Gigi Mahon
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New York, New York 10007

Dear Gigi,

Here's a long overdue letter to thank you very much for publishing my last article in BARRONS. Its as much of a thrill as when I was a teenager and was invited to speak to an investment club for the first time. I started saving the Market Laboratory page in 1961, and in all the BARRONS' read since then, its still hard to believe my name has been there.

Incidentally, just for the fun of it, I wanted to send you some tables that I sent to the other portfolio managers within the firm, and in letters to a couple of close friends in the business on the outside.

1) The "Prolonged Liquidation" criteria were met again on 4-13-84, for just that single week.

2) My original "Urgent Selling" article showed what happened when one had 5 waves in 36 calendar months. Here's an up-dated table of the "Urgent Selling" waves since the article was published in 1979, and an up-dated table on the "5 wave rule" as well.

3) Another table is enclosed on what happened when both of these simplistic methods flashed within four months or less. The second occurrence usually was quite an important buying time.

Well, who knows what will happen this time around. Just thought I'd give you an up-date. The "bloodless verdict of the marketplace" will be given in a few months (maybe even less).

Sincere best wishes,

Jim Alphier

WAVES OF "URGENT SELLING" SINCE BARRONS ARTICLE APPEARED

Start Date	End Date	Days Up	Days Down
3-4-80	3-27-80	3	12
2-5-82	3-8-82	4	16
5-7-82	6-21-82	6	24
7-16-82	8-12-82	3	16
1-6-84	1-30-84	3	13
5-2-84	5-24-84	3	13

4 OCCURENCES OF "URGENT SELLING" IN 15 MONTHS

END OF 4TH PERIOD	NEXT LARGE MOVE BEFORE SIGNIFICANT REACTION
November 1918	+ 50% in approx. 1 year
August 1921	+ 60% in approx. 1½ years
May 1932	+ 90% in 2 months
August 1957	- 14% in 2 months, then + 50% in approx 2 years
September 1966	+ 36% in approx 1 year
May 1970	+ 46% in approx 1 year
September 1974	+ 50% in 10 months

FIVE WAVES OF URGENT SELLING WITHIN 36 MONTHS

Condition Met		Subsequent Price Change ⊗ 3 Months Later	6 Months Later	9 Months Later	12 Months Later
May	1921	- 9%	+ 5%	+16%	+30%
August	1921*	+19%	+33%	+50%	+56%
May	1932*	+26%	+40%	+15%	+60%
February	1968	+ 7%	+ 6%	+12%	+12%
May	1970*	+10%	+16%	+34%	+40%
November	1971	+12%	+15%	+17%	+21%
December	1973	+ 6%	- 3%	-23%	-28%
September	1974*	+ 3%	+28%	+39%	+28%
August	1975	+ 4%	+16%	+18%	+21%
January	1978*	+ 7%	+10%	+10%	+13%
October	1978	+ 7%	+ 9%	+11%	+ 9%
March	1980*	+14%	+25%	+36%	+36%
May	1984	?	?	?	?
AVERAGE		+ 9%	+16%	+19%	+25%

* Led to historic market low.

⊗ Counting from the exact low of Urgent Selling wave which no investor could tin

TIMES WHEN THE "PROLONGED LIQUIDATION" CRITERIA WERE MET AND THE "URGENT SELLING 5 WAVES IN 36 MONTHS" OR "4 IN 15 MONTHS RULE WAS MET, ALL WITHIN A FOUR MONTH PERIOD

First Indication	Second Indication	Result after Second
Urg. Sel. - August 1957	Pro. Liq.- Nov. 1957	2 year bull market
Urg. Sel. - Sept. 1966	Pro. Liq.- Oct. 1966	2 year bull market
Pro. Liq. - April 1970	Urg. Sel.- May 1970	2½ year bull market
Pro. Liq. - Aug. 1974	Urg. Sel.- Sept. 1974	down 1 month, then 2 year bull market
Urg. Sel. - Jan. 1978	Pro. Liq. - Feb. 1978	down 1 month, then bull move to Sept. 1978 or Feb. 1980, depending on your preference
Pro. Liq. - Mar. 1984	Urg. Sel. May 1984	??????????????????