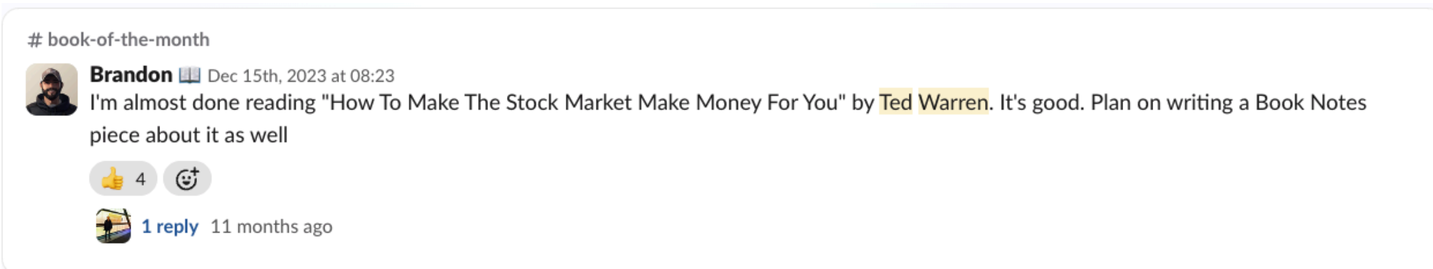
MACRO OPS
TRADE - LEARN - EVOLVE

November 27, 2024

Book Notes: *How To Make The Stock Market Make Money For You,* Ted Warren

I read Ted Warren's book almost a year ago. After reading it, I said I would write *Book Notes* outlining my favorite parts from each chapter. See receipts below.


book-of-the-month
Brandon Dec 15th, 2023 at 08:23
I'm almost done reading "How To Make The Stock Market Make Money For You" by Ted Warren. It's good. Plan on writing a Book Notes piece about it as well
4
1 reply 11 months ago

Today is that day. Shout-out to @Brent for nudging me every month or so to get this done.

Better late than never, right?

Ted Warren's book *How To Make The Stock Market Make Money For You* transformed my approach to investing, specifically in microcaps.

The book combined much of what I already knew (such as chart patterns, fundamental criteria, psychology, etc.) into a coherent framework.

Warren's simplified approach to "investolating" clicked. It blended perfectly with our Macro Ops *Trifecta Lens* framework.

And it's a powerful toolkit to add to your process.

This Book Notes aim to remove the fluff and share my favorite parts from each chapter.

I'll share tons of quotes and charts, too.

> *"By the use of long range stock charts, you will learn how the public reacts to various types of price actions. These actions, like history, repeat themselves over and over; they may be relied upon and used with confidence."*

Let's get after it!

Foundation: You Need To Be An 'Investolator'

Ted Warren's strategy is simple: **Buy like an investor, sell like a speculator.** The idea is to combine the best attributes of an investor and a speculator. Warren calls this an 'Investolator.'

> *"An investolator should have the patience of the **investor** but with his sights set for a large, long term capital gain."*

Seth Klarman calls value investors *"contrarians with a calculator."* Think of investolators as *"investors with a monthly chart."* Back to the book.

> *"To be an investolator, you must also **be chart conscious.** The charts you study in this book are 'long range' charts … if you **study these pictures with an open mind**, I will show why the 'sleepers' are the bargains, and that they are the ones with the largest potential profits."*

I write a lot about matching time frames with investment time horizons. As investors, we look 18-24 months out, envision realities others don't see, and (hopefully) profit from those realities.

Warren's process involves matching the **investor's time frame** with the **speculator's technical tool** – the monthly chart.

And it starts with buying at the lower end of long-term consolidations.

How To Buy In The Lower Price Ranges

There are four phases of a stock's price action:

1) The Base
2) The Rise
3) The Top
4) The Drop

Here's how Warren describes each phase (emphasis added):

> *"The quiet, low level period called the base can be termed the **accumulation period**. The rise is called the **markup**. The top range is called **distribution**. The inevitable drop is called **markdown.**"*

Stan Weinstein copied these phases *22 years later* in his famous book *Secrets for Profiting in Bull and Bear Markets*. He called them Stage 1, 2, 3, and 4.

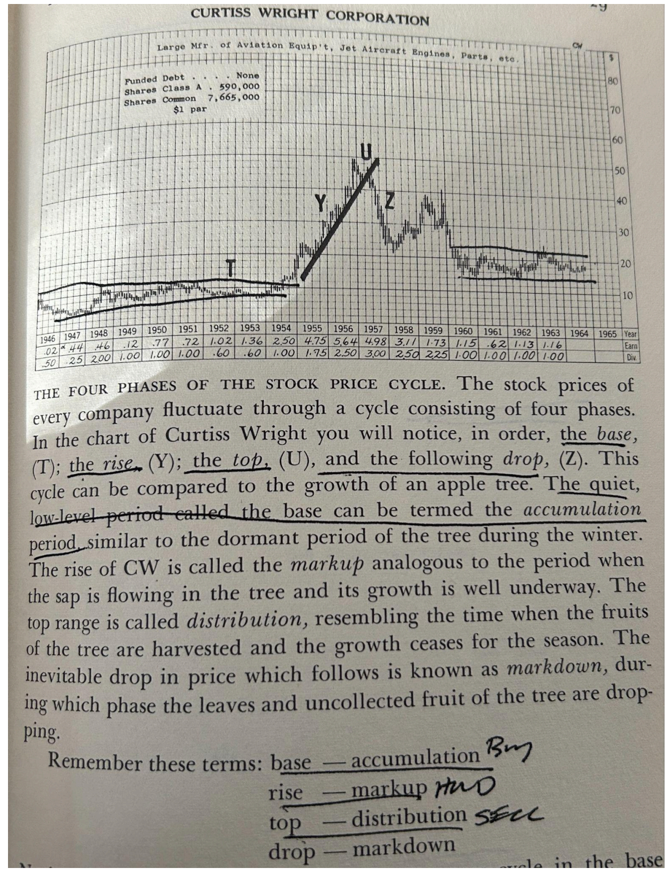
The point is that stocks, like markets, move in cycles. You can see these cycles in the long-term (monthly) charts.

> *"By the use of **monthly price ranges**, it is often possible to see by certain patterns of price actions over a period of years what phase of its cycle a stock is in, tiving you a clue to what ts next phase will be."*

Check out the chart on the right of Curtiss Wright Corp (CW). CW traded in an eight-year ascending triangle (base) before breaking out.

After the breakout, the stock raced from $10/share to $50/share in ~3 years.

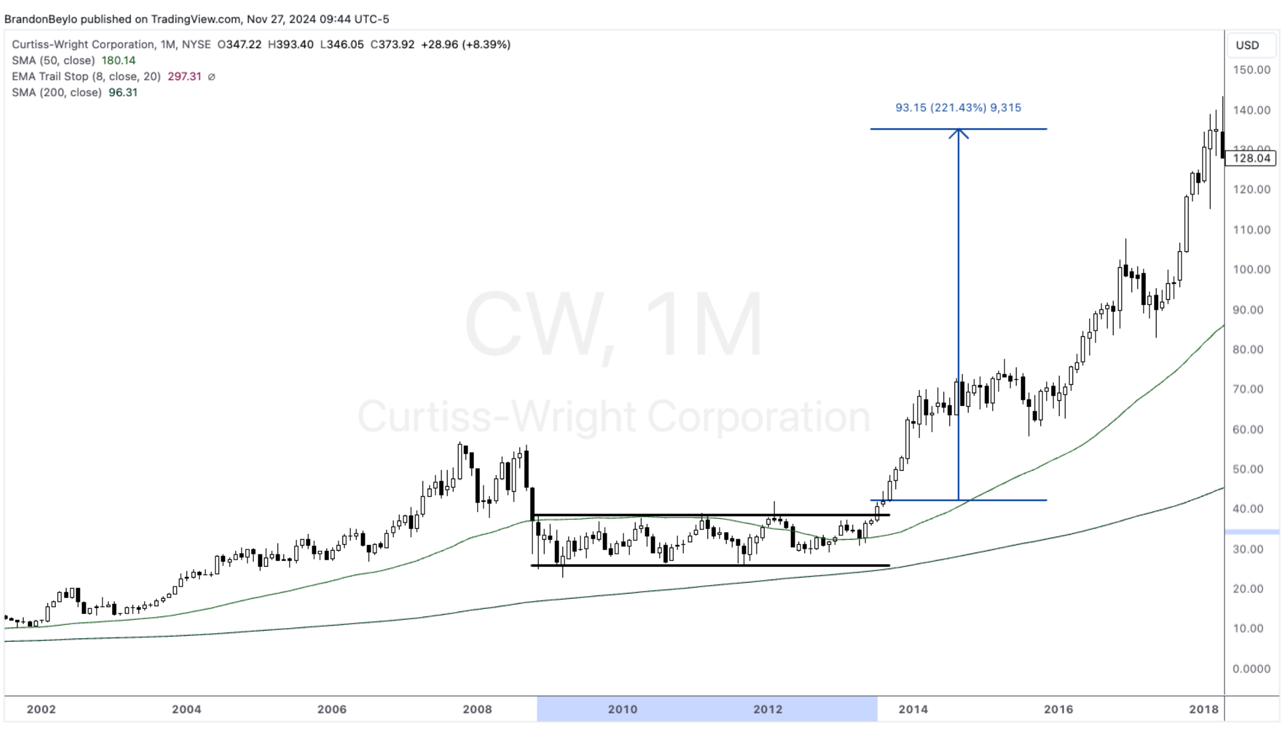
These cycles or phases don't just happen. They're embedded in the psychology of millions of traders every day.



THE FOUR PHASES OF THE STOCK PRICE CYCLE. The stock prices of every company fluctuate through a cycle consisting of four phases. In the chart of Curtiss Wright you will notice, in order, the *base*, (T); the *rise*, (Y); the *top*, (U), and the following *drop*, (Z). This cycle can be compared to the growth of an apple tree. The quiet, low-level period called the base can be termed the *accumulation* period, similar to the dormant period of the tree during the winter. The rise of CW is called the *markup* analogous to the period when the sap is flowing in the tree and its growth is well underway. The top range is called *distribution,* resembling the time when the fruits of the tree are harvested and the growth ceases for the season. The inevitable drop in price which follows is known as *markdown,* during which phase the leaves and uncollected fruit of the tree are dropping.

Remember these terms: base — accumulation Buy
rise — markup HOLD
top — distribution SELL
drop — markdown

It's why we see these patterns *over and over* throughout history. Don't believe me? Here's a similar base breakout from *the same company* from 2008 - 2013 (see below).



In 2013, CW broke out of a five-year rectangle base. It took another 5 years to reach a high of $140/share for a 221% gain (44% annualized).

That's the *same company with a* similar base, 62 years apart.

It's All About That Base

If there's one thing to remember from this book, it's that bases are the most important part of a chart. They're the foundation of any successful trade.

You can't have a long-term winning trade without a long-term base. Here's Warren's description of bases (emphasis added).

> *"A base is formed **during a period of accumulation.** This is when insiders and others 'in the know' are buying the stock at bargain prices."*

How can you spot a base?

> *"Sound bases are easily seen when the prices of stocks **have been extremely quiet in a low range** for a period of at **least three years** … the price action of a stock is what influences the public to be bullish or bearish."*

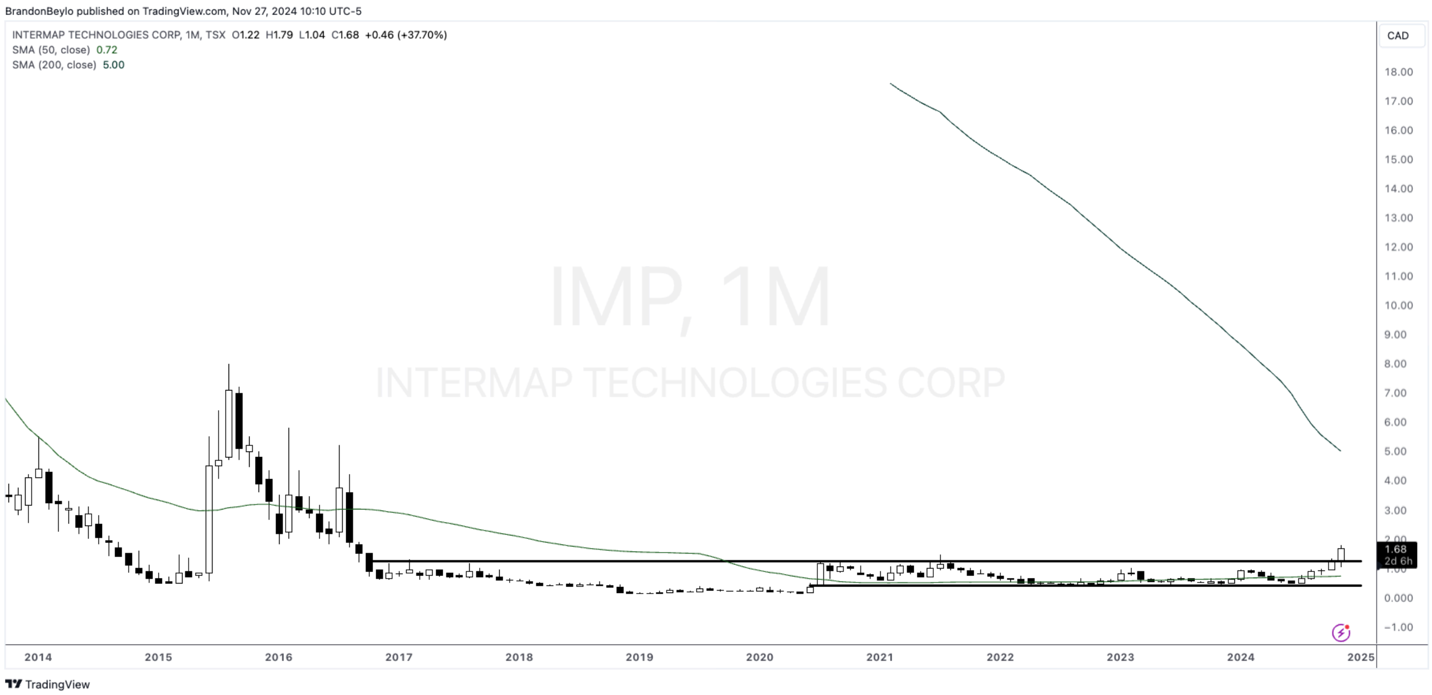
A proper base meets the following criteria:

1) Trading in a tight range on low-volume
2) The base is at least three years long (36 monthly candles)
3) Bombed-out bearish sentiment

Long-term bases aim to shake out as many weak hands as possible while strong hands accumulate at low prices. This is why Sentiment is one of the three factors in our Trifecta Lens approach.

> *"These foundations are built from inducing the public to sell out. The higher the percentage that are sold out, the sounder the base … **There can never be a sound base unless a large percentage of the public has for one reason or another sold out.** This is accomplished by price actions that are discouraging to them."*

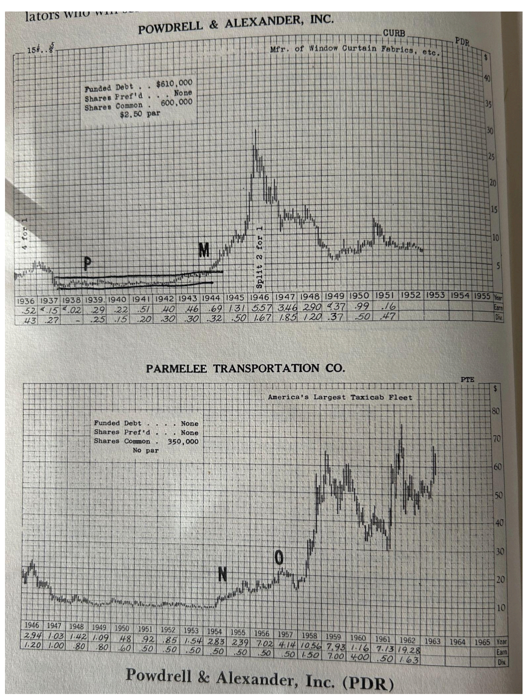
Our latest investment in Intermap Technologies (IMP) is an excellent example of a long-term bases (see below).



IMP recently broke out of a seven-year base. That's seven years of disappointing shareholders. Seven years of reaching CAD 1.20/share, only to see it fall. Seven years to shake the weak hands from the strong holders.

> *"When a stock appears **unable to rise above an apparent resistance level, this is almost positive proof that it eventually will**, because this action induces public selling. The perfect buy signal was when the resistance level finally broke."*

Here are two more examples from the book.



The obvious question now is, “*When do we buy?*”

When To Buy: Base Breakouts

Warren bought when the stock broke above prior resistance from its long-term base. Think [“Darvas Box”] but on much longer time frames.

> *“When I refer to a buy signal, I mean that when the price moves above certain types of past action for a long base, it invariably signals an upward breakaway from that action. Usually, it is the very beginning of a 200% or more rise that wil require several years to take place.”*

Koninklijke (HEIJM) is a recent example from my trading log (see below).

The stock broke above its thirteen-year rectangle base and triggered a buy signal (green circle above).

Acorn Energy (ACFN) is another great example of a clear buy signal this month (see below).

It's all pattern recognition. The more charts you see, the better you get at identifying long-term bases and proper buy signals.

Remember: Don't Buy Downtrends

Besides identifying highly asymmetric bets, Warren's strategy keeps us from catching falling knives.

At the end of the chapter, Warren stresses the importance of *not buying downtrends* (emphasis mine):

> *"To avoid buying when a stock only appears low, never buy during a downtrend. It is as simple as that. Your guess could be right. But far too often you would be wrong."*

I can't tell you how often I've bought a falling knife because "I'm a value investor, damnit" or "it's a great price, and I hope it gets cheaper."

That's my ego talking. A better approach is to wait for a long-term base, for the weak hands to shake out, and sit until a proper buy signal triggers.

Take offshore services vehicles (OSVs) like Tidewater (TDW). If you liked it at $80, you'd love it at $65 and marry it at $50 … right?

WAIT FOR THE BASE.

As Warren says to end the chapter … *"Backed by the logical use of long-range charts you will develop the strength of mind to buy when you should and to sell only with large profits. If nothing else you should be able to keep yourself out of serious trouble."*

Pay Attention To Relative Strength

Another core pillar of our Macro Ops trading philosophy is buying relative strength leaders.

These stocks outperform their peer group, an underlying commodity, the general market, or a combination of the three.

Relative strength leaders buck overall market trends. They tell investors, *"we march to the beat of our own drum."* And strength begets strength.

Here are Warren's thoughts on relative strength (emphasis added):

> *"Rather than buying stocks at what appear to be low prices after a general break,* ***check the charts for those that resisted the general market break.*** *They attract very little attention by their action, but they show one of the most positive*

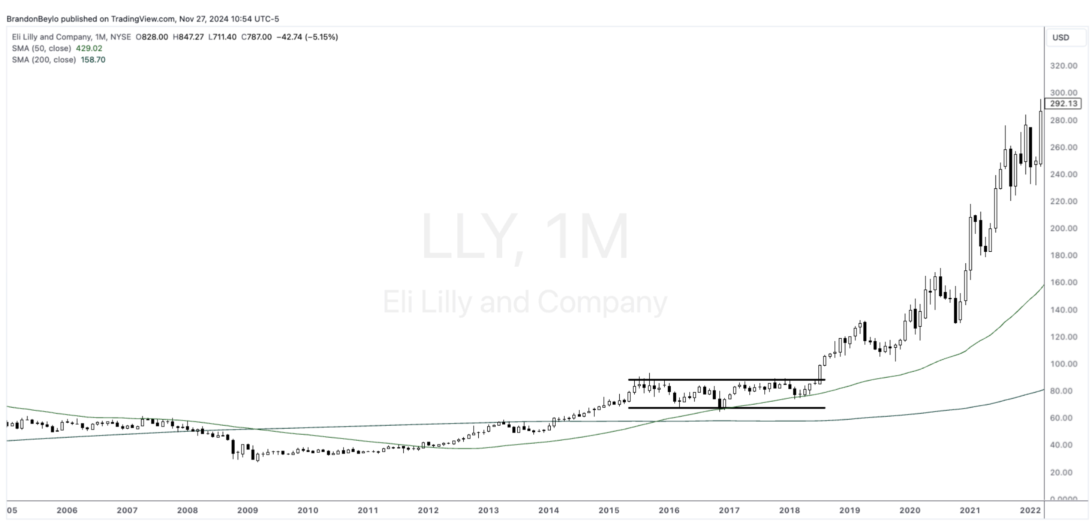
indications of internal technical strength. ***Heavy selling fails to develop in these names because the majority of Nervous Nellies have long ago sold out.*** *The selling that does appear is well taken by the smart money."*

Hemisphere Energy (HME) is a textbook example of Warren's base and relative strength philosophies (see chart below).

The stock traded in a six-year base before breaking out. During the breakout phase, oil increased by ~60%. Yet HME's stock rose over 400%.

That's relative outperformance!

Or Eli Lilly (LLY) in 2016 - 2022.



The stock broke out of a three-year base in 2017-2018 and ran 245% by 2022. The leading pharmaceutical ETF XBI increased by only 40% during that same time.

Relative strength matters.

Warren's process layers his emphasis on long-term bases with relative strength leaders to create a robust trading system. It removes all other noise and cuts to what matters: **price action.**

He explains …

> *"Learn to buy when a stock shows quiet strength, not during the violent displays of strength in the high ranges … By the use of long-range charts, you should be able to pick a bargain. Forget the question of the economic health of the corporation.* ***Your only interest should be, has the stock action been acting in a way that has been worrying the shareholders into selling?*** *Does the stock now appear to be in strong hands?"*

When To Sell: The Toughest Part of The Process

Warren has two selling rules:

1) Sell after the stock has risen to where you think it should (given the base length).
2) Sell when the stock breaks a 45-degree upward trendline.

On the first rule …

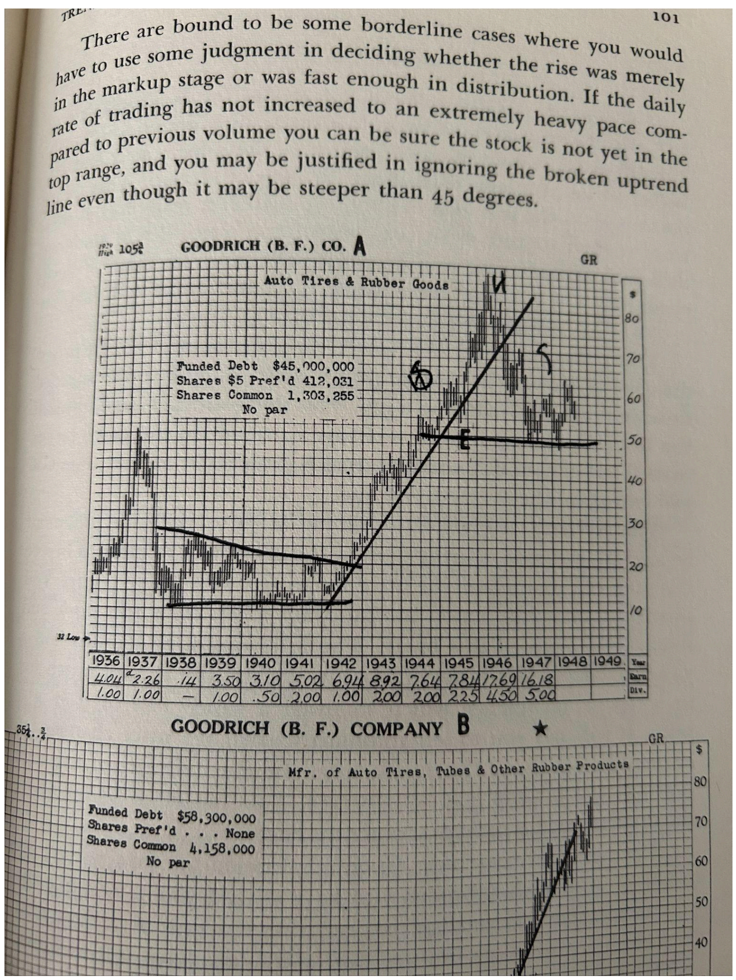
> *"Another prerequisite is: has the stock risen to the heights you were justified in believing it should go, according to the length of time and type of action during its previous base?* ***The sounder the foundation, the higher the expected rise*** *… From a base of four years,* ***you should expect a minimum rise of over 200%*** *from its average base price."*

On the second rule …

> *"You must sell when an uptrend line of over 45 degrees has been positively broken, providing that the percentage of rise has been at or above the minimum expected according to its base."*

I hate to pick on TDW, but this is an excellent example of selling at a trendline break. We were lucky to sell around that time and lock in gains (see below).

Warren also shares an example of BF Goodrich (see below).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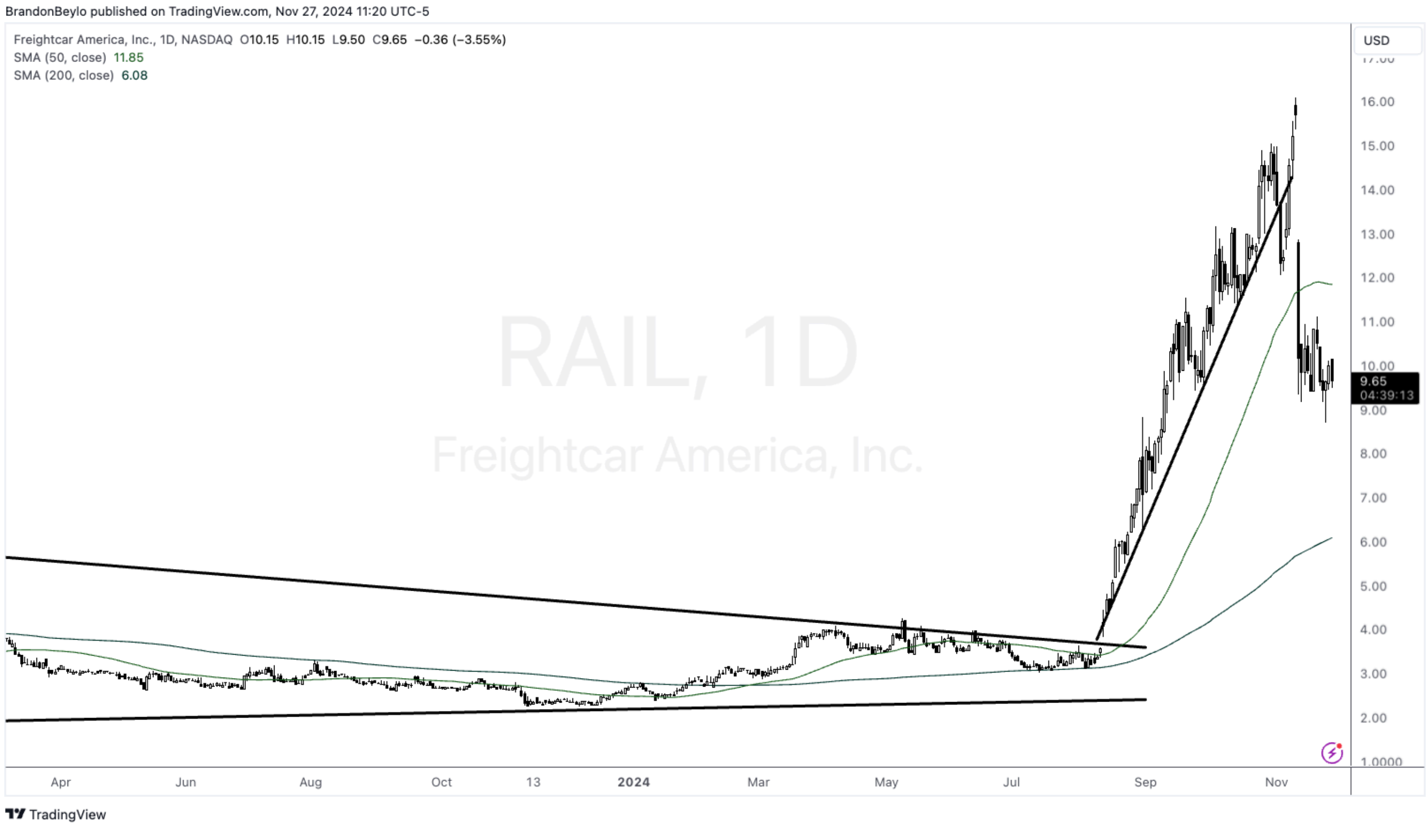
There are bound to be some borderline cases where you would have to use some judgment in deciding whether the rise was merely in the markup stage or was fast enough in distribution. If the daily rate of trading has not increased to an extremely heavy pace compared to previous volume you can be sure the stock is not yet in the top range, and you may be justified in ignoring the broken uptrend line even though it may be steeper than 45 degrees.

Freightcar America (RAIL) is another example of selling after a trendline break (see below).



I find selling more complicated than buying. The rules are more straightforward around buying. You see the base, wait for the breakout point, and then buy. It's solid.

Selling feels more like jello. It's squishy, and what works with one stock might not work with another. And you always feel like you left *something* on the table.

Next, we'll cover volume.

Volume: How To Use It & What To Look For

Volume, like selling, is another squishy metric. Alex and I often disagree on its importance. I like volume and use it in my trading, whereas Alex relies less on volume and more on price action.

Price action GOAT, Al Brooks, doesn't use volume analysis in his process, either.

Here's what Warren thinks about volume.

"Volume of daily trading can be an important subject, but I do not intend for the investolator to go into this too deeply. ***There are times when it can be very misleading."***

Let's keep volume simple.

You want **light** volume during **accumulation, heavy** volume during **distribution**, and **light** volume during **tops**.

"You will seldom see heavy volume on a sound base. Heavy volume may appear on a shake-out during a rise, sometimes because of adverse news. But only a rally of varying degrees and times will follow heavy volume on a selling climax uring a bear market. The final lows are yet to be made."

Fundamentalists vs. Chartists: Mindset Matters

As we mentioned earlier, the investolator combines the best parts of a fundamental investor and a technical speculator to create something new.

A fundamental investor may know what a stock might be worth in the future, but they have no idea what the path to that realized value will look like over the next 6-12 months.

Here's Warren's take.

"A fundamentalist may properly evaluate a stock at 35, but he has no way of knowing whether its next move will be to 17 or 70."

This is why I love our Macro Ops Trifecta Lens approach. It marries the best of fundamental analysis with simple, textbook technical analysis, so we're not holding dead money trades or buying falling knives.

"An investolator shouldn't care less [about fundamentals]. The price action of the stock indicates that the smart money is interested in buying it."

The market is mostly efficient most of the time. So why not wait until we get confirmation from millions of intelligent, efficient fundamental investors that *now* is the time to buy?

Conclusion: The Big Themes From Ted Warren

I hope you enjoyed this *Book Notes* on *How To Make The Stock Market Make Money For You*.

Here are my top big themes/takeaways from the book.

1) **Use monthly stock charts.**
2) **Focus on bases of at least three years in length.**
3) **The longer the base, the greater the breakout.**
4) **Focus on relative strength leaders (industry, general market, underlying commodity).**
5) **Buy only when the price breaks above the prior base resistance.**
6) **If the base is at least three years, expect a 200%+ move higher before selling.**
7) **Sell only after the stock reaches its profit target (200%+) or breaks an upward 45-degree trendline.**
8) **You want light volume during accumulation, heavy volume during distribution, and light volume during a top.**
9) **Avoid all other market noise.**
10) **There are no good or bad stocks, only good or bad charts.**

I'm sorry this review took so long, but I'm glad I did it. This 1966 book contains so much wisdom.