As the number of investors in the market has increased over recent years, simple price and volume charts have become more readily available. (*Investor's Business Daily* subscribers have free access to 10,000 daily and weekly charts on the Web at investors.com.) Chart books and online chart services can help you follow hundreds and even thousands of stocks in a highly organized, time-saving way. Some are more advanced than others, offering both fundamental and technical data in addition to price and volume movement. Subscribe to one of the better chart services, and you'll have at your fingertips valuable information that is not easily available elsewhere.

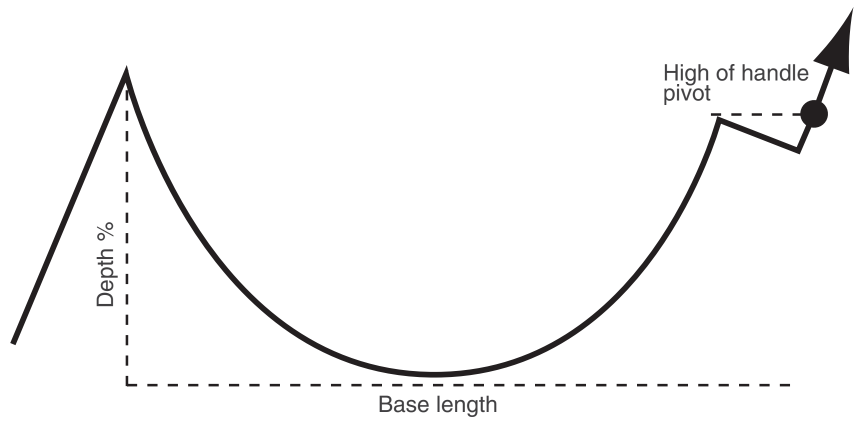
History Repeats Itself: Learn to Use Historical Precedents

As mentioned in the introduction, and as shown on the annotated charts of history's best winners in Chapter 1, our system for selecting winning stocks is based on how the market actually operates, not on my or anyone else's personal opinions or academic theories. We analyzed the greatest winning stocks of the past and discovered they all had seven common characteristics, which can be summarized in the two easy-to-remember words CAN SLIM. We also discovered there were a number of successful price patterns and consolidation structures that repeated themselves over and over again. In the stock market, history repeats itself. This is because human nature doesn't change. Neither does the law of supply and demand. Price patterns of the great stocks of the past can clearly serve as models for your future selections. There are several price patterns you'll want to look for when you're analyzing a stock for purchase. I'll also go over some signals to watch out for that indicate that a price pattern may be faulty and unsound.

The Most Common Chart Pattern: "Cup with Handle"

One of the most important price patterns looks like a cup with a handle when the outline of the cup is viewed from the side. Cup patterns can last from 7 weeks to as long as 65 weeks, but most of them last for three to six months. The usual correction from the absolute peak (the top of the cup) to the low point (the bottom of the cup) of this price pattern varies from around the 12% to 15% range to upwards of 33%. A strong price pattern of any type should always have a clear and definite price uptrend prior to the beginning of its base pattern. You should look for at least a 30% increase in price in the prior uptrend, together with improving relative strength and a very substantial increase in trading volume at some points in the prior uptrend.

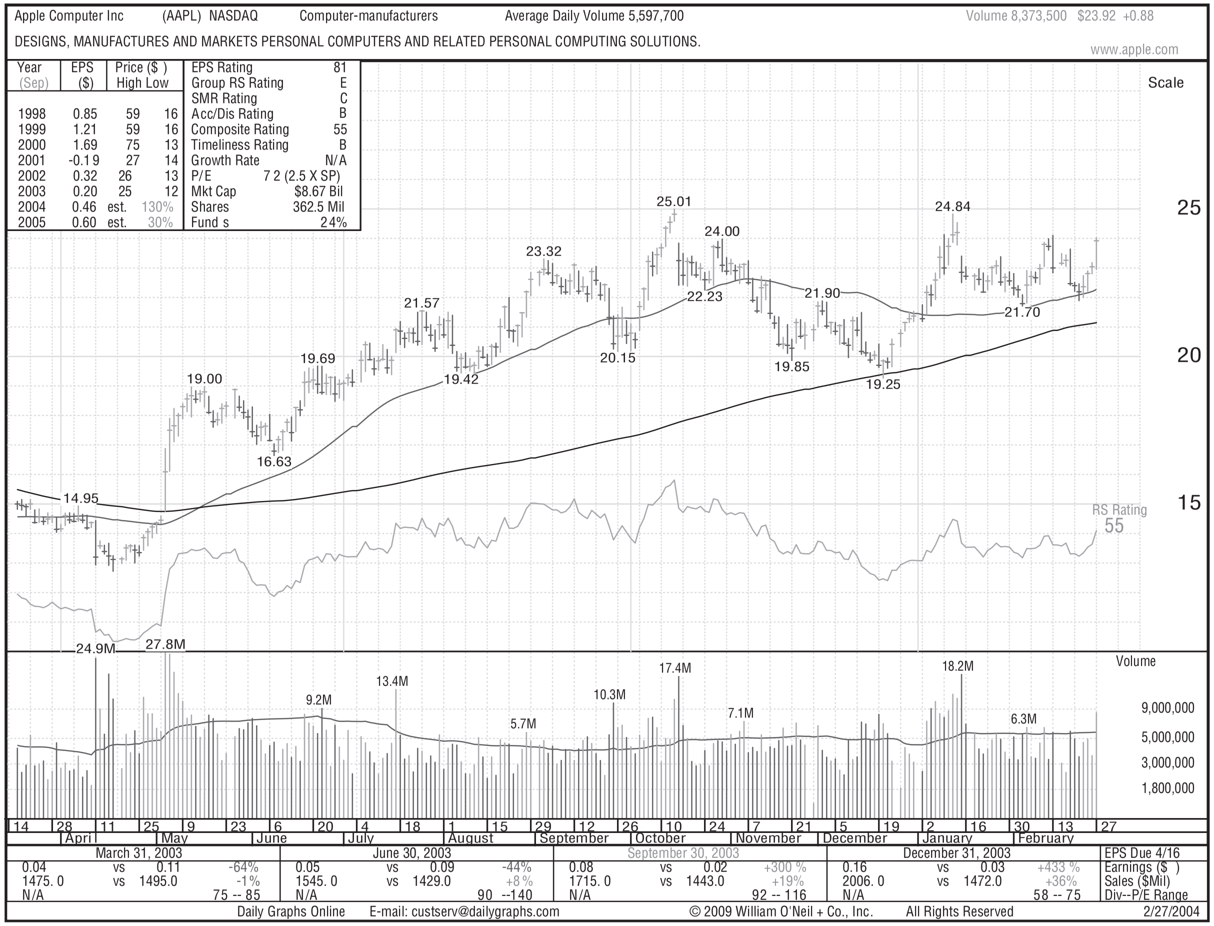
In most, but not all, cases, the bottom part of the cup should be rounded and give the appearance of a "U" rather than a very narrow "V." This char-



acteristic allows the stock time to proceed through a needed natural correction, with two or three final little weak spells around the lows of the cup. The "U" area is important because it scares out or wears out the remaining weak holders and takes other speculators' attention away from the stock. A more solid foundation of strong owners who are much less apt to sell during the next advance is thereby established. The accompanying chart from Daily Graphs Online® shows the daily price and volume movements for Apple Computer in February 2004.

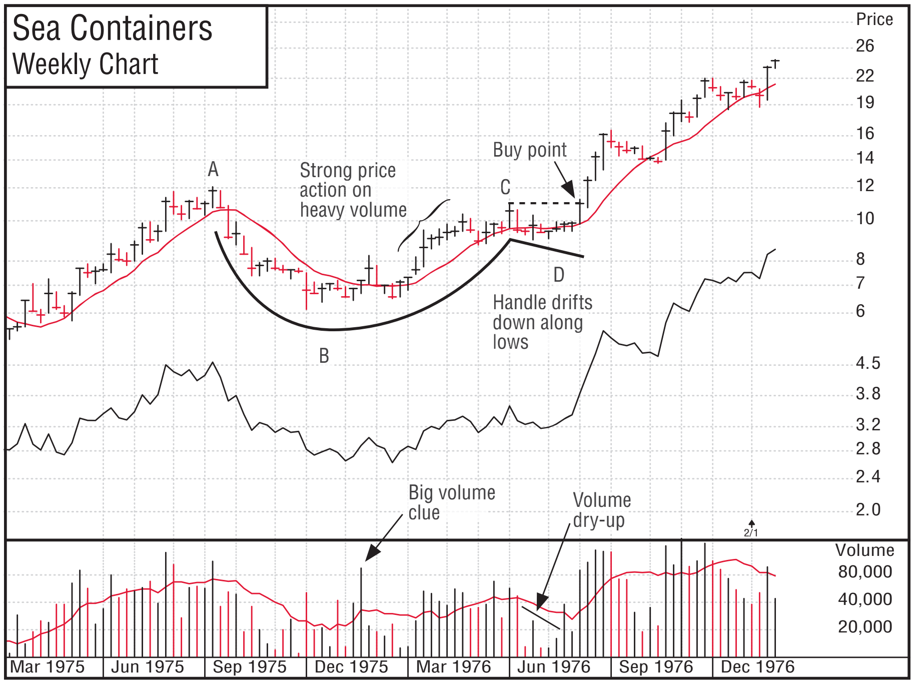
It's normal for growth stocks to create cup patterns during intermediate declines in the general market and to correct 1½ to 2½ times the market averages. Your best choices are generally stocks with base patterns that deteriorate the least during an intermediate market decline. Whether you're in a bull market or a bear market, stock downturns that exceed 2½ times the market averages are usually too wide and loose and must be regarded with suspicion. Dozens of former high-tech leaders, such as JDS Uniphase, formed wide, loose, and deep cup patterns in the second and third quarters of 2000. These were almost all faulty, failure-prone patterns signaling that the stocks should have been avoided when they attempted to break out to new highs.

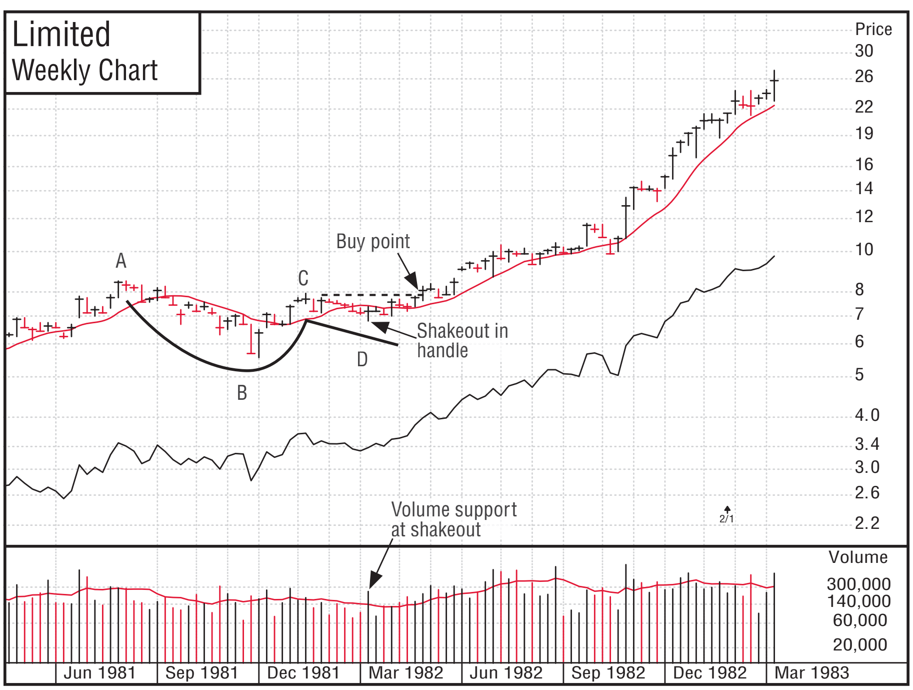
A very small number of volatile leaders can plunge by as much as 40% or 50% in a bull market. Chart patterns that correct by more than this amount during bull markets have a higher rate of failure if they try to make new price highs and resume their advance. The reason? A downswing of over 50% from a peak to a low means that the stock must increase more than 100% from its low to get back to its old high. Historical research has shown that stocks that make new price highs after such huge moves tend to fail 5% to 15% beyond their breakout prices. Stocks that come straight off the bottom into new highs off cups can be more risky because they had no pullbacks.



Apple Computer Inc (AAPL) NASDAQ Computer-manufacturers Average Daily Volume 5,597,700
Volume 8,373,500 $23.92 +0.88
DESIGNS, MANUFACTURES AND MARKETS PERSONAL COMPUTERS AND RELATED PERSONAL COMPUTING SOLUTIONS.
www.apple.com
Year (Sep) | EPS ($) | Price ($) High Low
1998 0.85 59 16
1999 1.21 59 16
2000 1.69 75 13
2001 -0.19 27 14
2002 0.32 26 13
2003 0.20 25 12
2004 0.46 est. 130%
2005 0.60 est. 30%
EPS Rating 81
Group RS Rating E
SMR Rating C
Acc/Dis Rating B
Composite Rating 55
Timeliness Rating B
Growth Rate N/A
P/E 7 2 (2.5 X SP)
Mkt Cap $8.67 Bil
Shares 362.5 Mil
Fund s 24%
Scale
25
20
15
14.95
19.00
16.63
19.69
21.57
19.42
23.32
20.15
25.01
24.00
22.23
21.90
19.85
19.25
24.84
21.70
RS Rating
55
Volume
24.9M
27.8M
9.2M
13.4M
5.7M
10.3M
17.4M
7.1M
18.2M
6.3M
9,000,000
5,000,000
3,000,000
1,800,000
14 28 11 25 9 23 6 20 4 18 1 15 29 12 26 10 24 7 21 5 19 2 16 30 13 27
April May June July August September October November December January February
March 31, 2003 | June 30, 2003 | September 30, 2003 | December 31, 2003 | EPS Due 4/16
0.04 vs 0.11 -64% | 0.05 vs 0.09 -44% | 0.08 vs 0.02 +300 % | 0.16 vs 0.03 +433 % | Earnings ($)
1475. 0 vs 1495.0 -1% | 1545. 0 vs 1429.0 +8% | 1715. 0 vs 1443.0 +19% | 2006. 0 vs 1472.0 +36% | Sales ($Mil)
N/A 75 -- 85 | N/A 90 --140 | N/A 92 -- 116 | N/A 58 -- 75 | Div--P/E Range
Daily Graphs Online E-mail: custserv@dailygraphs.com © 2009 William O'Neil + Co., Inc. All Rights Reserved 2/27/2004

Sea Containers was a glowing exception. It descended about 50% during an intermediate decline in the 1975 bull market. It then formed a perfectly shaped cup-with-handle price structure and proceeded to increase 554% in





the next 101 weeks. This stock, with its 54% earnings growth rate and its latest quarterly results up 192%, was one of several classic cup-with-handle stocks that I presented to Fidelity Research & Management in Boston during a monthly meeting in early June 1975. Upon seeing such big numbers, one of the portfolio managers was instantly interested.

As you can see by this example, some patterns that have corrected 50% to 60% or more coming out of an intermediate bull market decline or a major bear market can succeed. (See the charts for Sea Containers and The Limited.) In these cases, the percent of decline is a function of the severity of the general market decline and the tremendous extent of the stock's prior price run-up.

Basic Characteristics of a Cup's Handle Area

The formation of the handle area generally takes more than one or two weeks and has a downward price drift or "shakeout" (where the price drops below a prior low point in the handle made a few weeks earlier), usually near the end of its down-drifting price movement. Volume may dry up noticeably near the lows in the handle's price pullback phase. During a bull market, volume in the majority of cases should not pick up during a correction in the handle, although there have been some exceptions.

Although cups without handles have a somewhat higher failure rate, many stocks can advance successfully without forming a handle. Also, some of the more volatile technology names in 1999 formed handles of only one or two weeks before they began their major price advances.

When handles do occur, they almost always form in the upper half of the overall base structure, as measured from the absolute peak of the entire base to the absolute low of the cup. The handle should also be above the stock's 10-week moving average price line. Handles that form in the lower half of an overall base or completely below the stock's 10-week line are weak and failure-prone. Demand up to that point has not been strong enough to enable the stock to recover more than half its prior decline.

Additionally, handles that consistently wedge up (drift upward along their price lows or just go straight sideways along their lows rather than drifting down) have a much higher probability of failing when they break out to new highs. This upward-wedging behavior along low points in the handle doesn't let the stock undergo the needed shakeout or sharp price pullback after having advanced from the low of the base into the upper half of the pattern. This high-risk trait tends to occur in third- or fourth-stage bases, in laggard stock bases, or in very active market leaders that become too widely followed and therefore too obvious. You should beware of wedging handles.

A price drop in a proper handle should be contained within 8% to 12% of its peak during bull markets unless the stock forms a very large cup, as in