



# High Probability Investing

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AAll Research Triangle  
February 13, 2016

**DRACH MARKET RESEARCH**

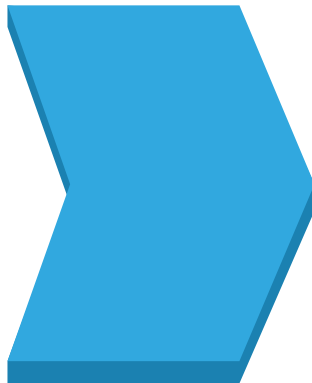
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# Monetary Infusion Cycles



## Combination of:

- Fiscal Stimulus (Legislated)
- Monetary Stimulus (Federal Reserve)



## Result in:

- Economic Growth
- Inflation
- Some of the strongest bull markets in history

CRISIS

NORMALIZATION

EXPANSION

## DJIA



## New Deal and 2<sup>nd</sup> New Deal

➤ +370%

➤ 4 Years 8 Months

# DJIA

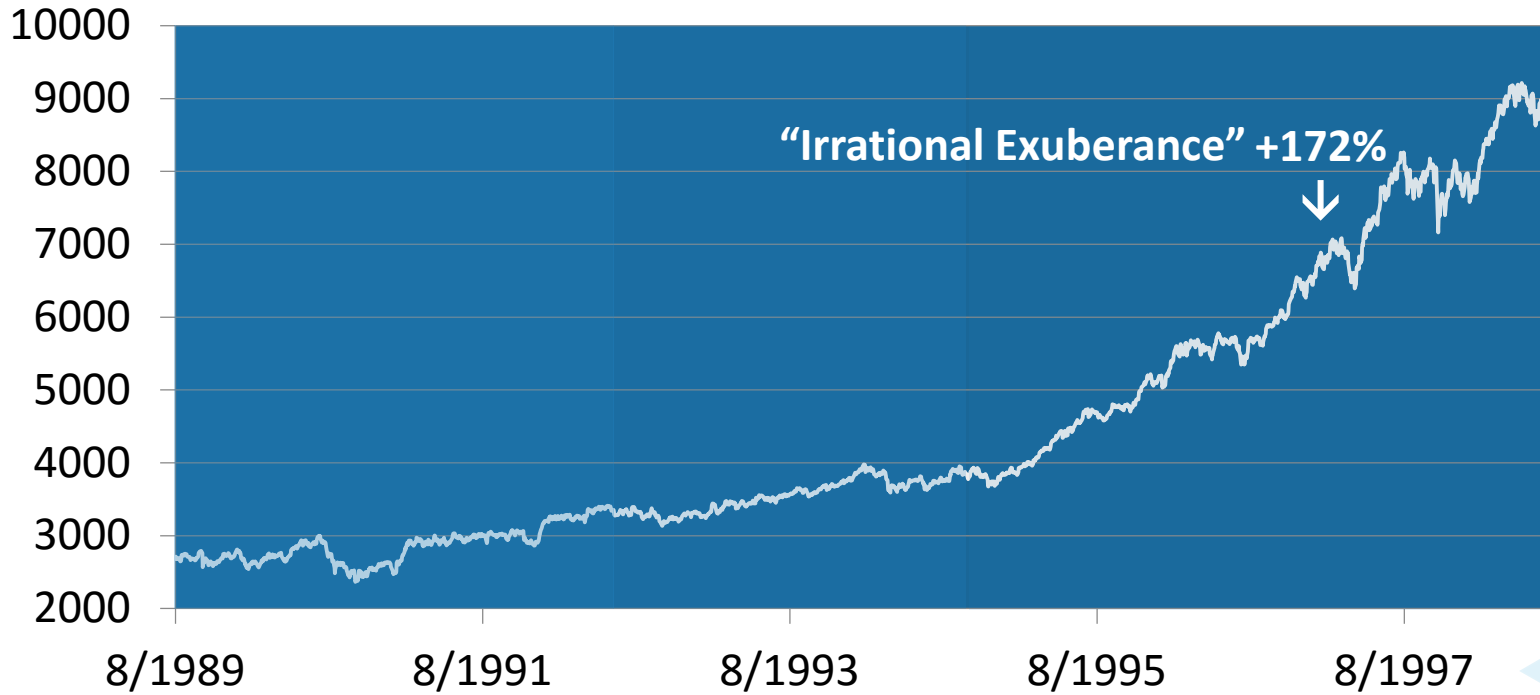


## World War II

➤ +129%

➤ 4 Years 1 Month

# DJIA



## The 1990s

➤ +295%

➤ 7 Years 9 Months

# DJIA

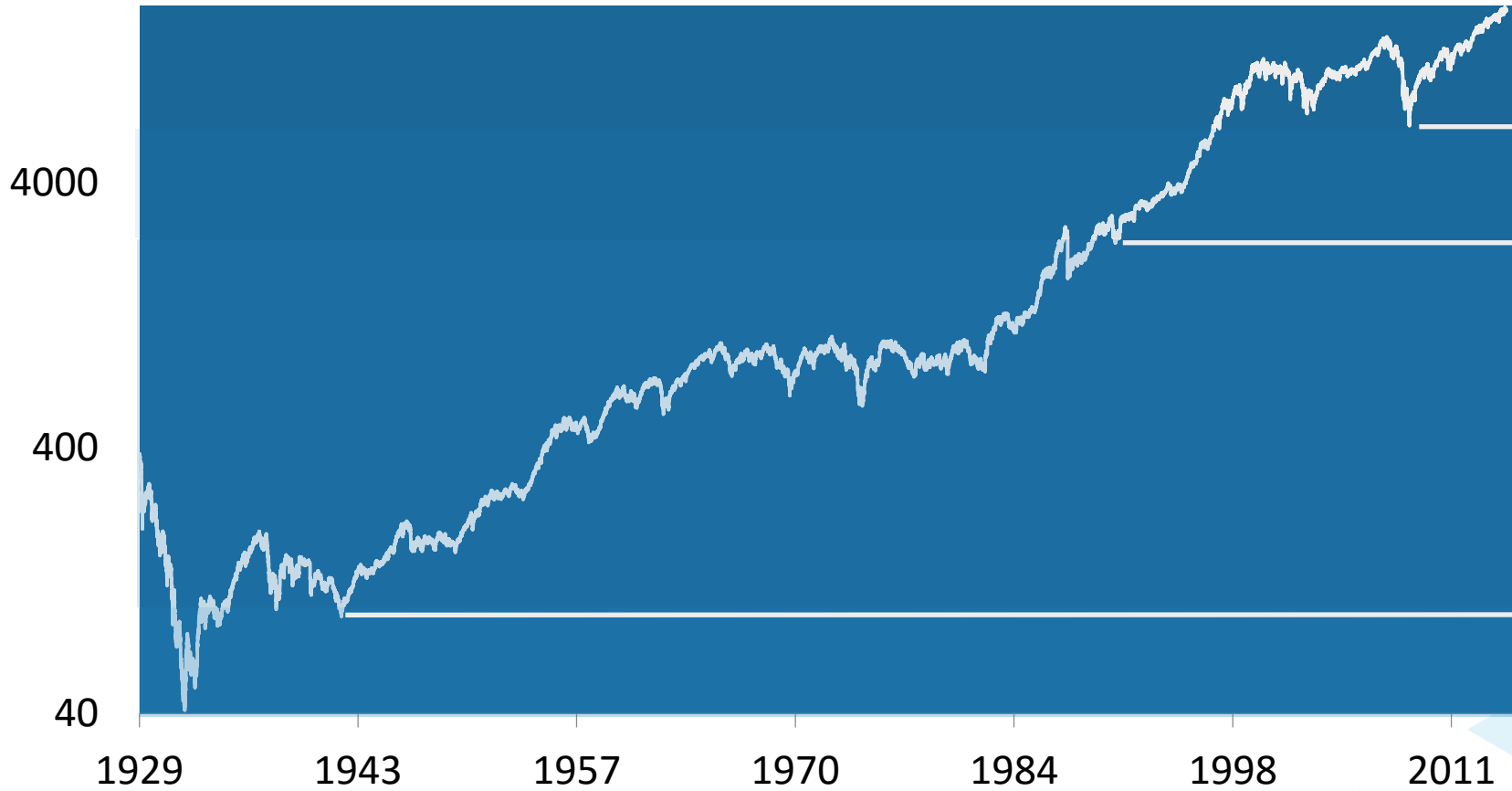


## Financial Crisis

➤ +149%

➤ 6+ Years

# DJIA



**Never Look Back**



# **FUNDAMENTALS**

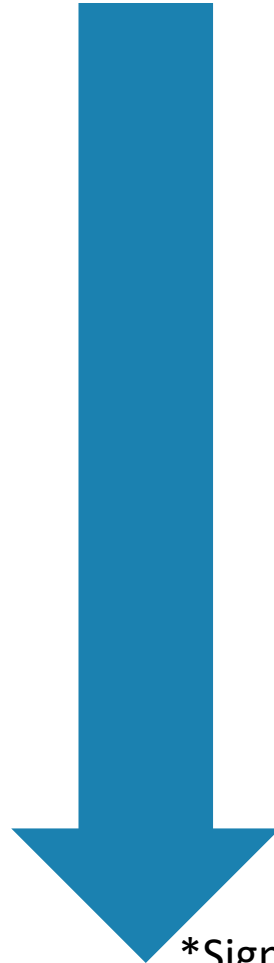
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Stocks are expensive.

# Historical Analogs

Each analog has been followed by a major market crash and depressed long term returns

1929	
Decline from peak	-89%
Decline from signal*	-89%
Time to break even	24 years 10 months
Lagged T-Note	20 years 1 month



1964	
Decline from peak	-48%
Decline from signal*	-22%
Time to break even	10 years 9 months
Lagged T-Note	10 years 6 months

\*Signal is when we first saw record earnings and ~19x P/E ratios in each cycle

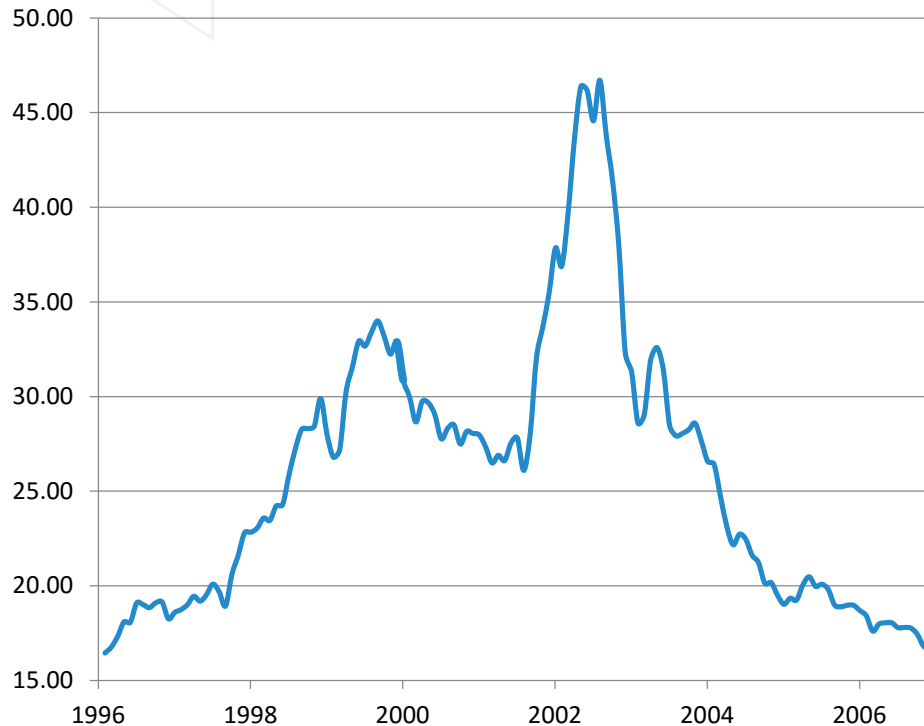
# Recent History

	1996	1999	2004
Decline from peak	-19%	-49%	-57%
Decline from signal*	N/A	-43%	-40%
Time to break even	N/A	6 years 4 months	7 years 4 months

\*Signal is when we first saw record earnings and ~19x P/E ratios in each cycle

# Recent History

## S&P 500 P/E Ratio



\*Signal is when we first saw record earnings and ~19x P/E ratios in each cycle

## One Cycle 1996-2009

Decline from peak	-57%
Decline from signal	-4%
Time to break even	12 years 7 months
Lagged T-Note	16 years 3 months

# Hope for 1990s

Paying 20x P/E within 12% of earnings highs.

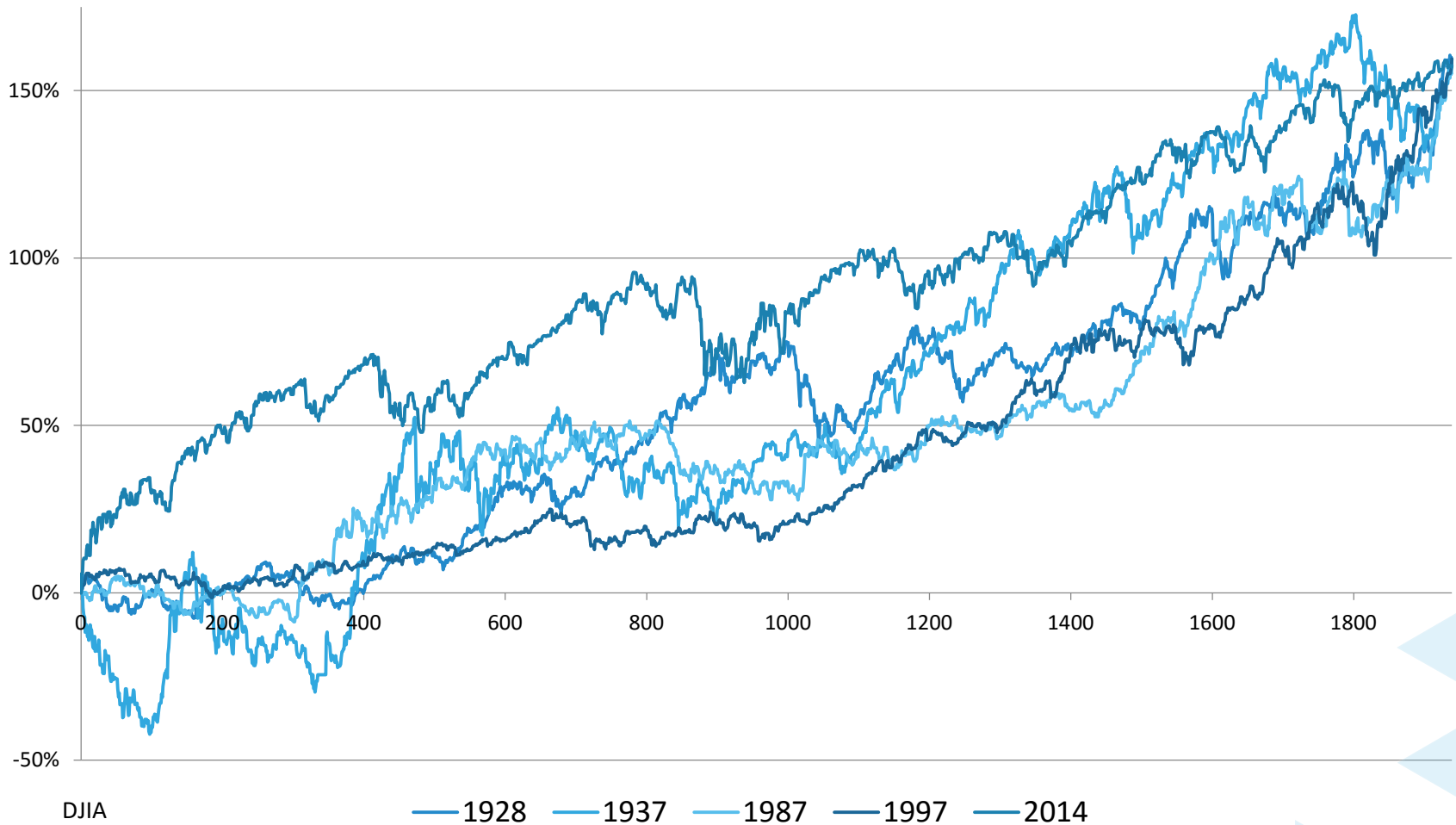
	1929	1962	1987	1994	1997	2003
Drawdown	-85%	-21%	-22%	-5%	-5%	-30%

## High P/Es and Heading Higher

	<b>1991-1993</b>	<b>2009</b>
P/E	22.83 – 25.15	42.12 - 123.73
Earnings	22-37% below 1989 Peak	70-92% below 2007 peak
Price/Max Earnings	15.30 - 17.65	8.92 – 12.57

# TECHNICALS

Too far too fast.



**What too far too fast looks like.  
Dow up 158% in just over 5 years.**



# The Aftermath

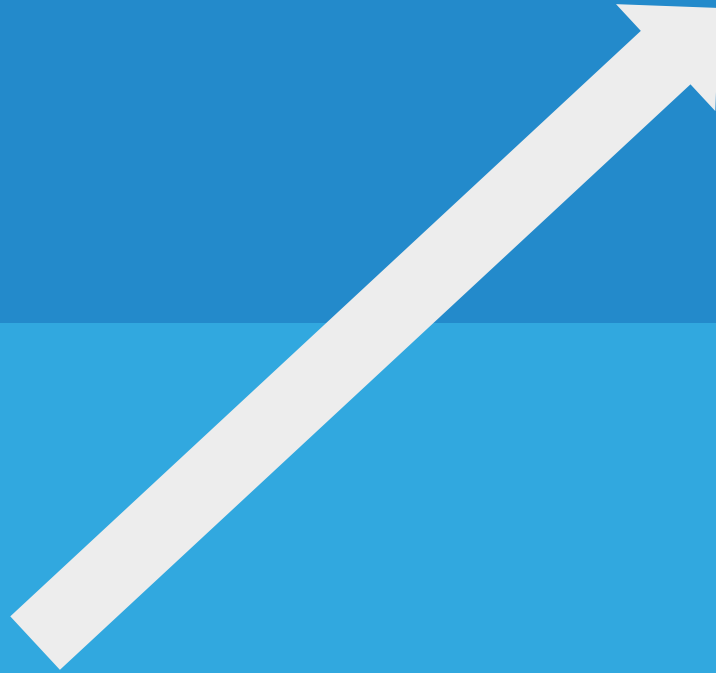
	1928	1937	1987	1997
Decline from peak	-89%	-51%	-36%	-54%
Decline from signal*	-84%	-50%	-21%	-21%
Time to break even	> 22 years	> 12 years	< 2 years	< 12 years

Signal is a 158% gain over ~5 years

**Is it different this time?**

Probably not.

**SELL HIGH**



**BUY LOW**

**Wholesale**

**Retail**

# RULE #1

## Know your customer

### NOT

- Corporate Insiders
- Market Makers

### ARE

- Those seduced by misinformation/hype/Wishful thinking/media
  - Scared

# **RULE #2**

**Know your inventory**

**Construct an investment universe  
of 60 or more quality names**

# Basic Application

- Buy stocks in your universe when they are down 10% or more over the last 4 weeks.
- Sell those same stocks when they have returned over 10%.
- Sell losing stocks only if they have been eliminated from your universe for quality reasons – not price performance → ALWAYS sell into strength.
- Target full investment, but if not enough opportunities, hold cash.

# DrachResearch.com “NBR” model portfolio

	Initiated 5/5/1995
Closed Positions	559
% Profitable	91%
vs S&P 500 (annualized)	+56% (+0.74%)
	Excludes trading costs and Dividends



# Increase Probabilities: Add Timing

- Buy when 75% or more of your universe is trading down over the last four weeks. (Technical)
- When public/media sentiment are low (Psychological/Media)
- Specialists & Insiders are long. (Professional Positioning)
- Buy gradually over 4-5 weeks.
- Probabilities can be improved by adding ancillary data sets.

# Newsletter: Ancillary data

Look for a majority of the following to confirm a BUY indication:

- Technical
- Psychological/Sentiment
- Professional Positioning
- Media
- Fundamental
- Federal Reserve
- Non-Professional Cash Reserves
- Structural
- Macroeconomic

# What to Buy – (Newsletter)

Concluded Trades	<u>EARNINGS</u>	<u>YIELD</u>	<u>PRICE</u>
Total Positions	759	759	729
% Profitable	93.54%	92.62%	91.50%
Average Gain	8.27%	5.44%	9.32%
# of Weeks Held	28.69	27.23	29.83
Annualized Return	14.99%	10.39%	16.25%

# Sell Discipline

- Sell only if you have a sell indication
  - 75% of your stocks have advanced over the last 4 weeks.
  - When public/media sentiment are positive
  - When specialists & Insiders are short.
- Can confirm with ancillary data sets.
- Sell gradually – over 4-5 weeks
- Lock in biggest winners. Only take losses on stocks that have been removed from your universe for fundamental reasons.

# Time Overlay Portfolios

	15 Years
Closed Positions	199*
% Profitable	92%*
vs S&P 500 (annualized)	+56%** (+2.43%)
*Sampled from one account as of 9/30/2015 ** Median return of accounts with a 15 year history that have not deviated from strategy. Time-weighted. Includes trading and management fees as of 9/30/15	

Not an offer to sell securities. Past returns are not indicative of future returns. Data is provided by past advisors and third parties, and accuracy is not guaranteed.