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IN TOM THEY TRUST: Traders swear by DeMark's market-timing techniques.

PERFORMANCE

Right on DeMark

Long a secret weapon for the hedge-fund elite, Tom DeMark's technical indicators are gaining a wider following. How reliable are these signals? You'd be surprised BY JAMES PATTERSON

IT'S A CHILLY AFTERNOON in early December, and Tom DeMark is set to deliver a speech at the New York Mercantile Exchange. A trusted market-timing consultant to some of the world's most revered money managers over the years – George Soros, Paul Tudor Jones and Stevie Cohen among them – DeMark has friends all over the financial landscape. Since he has a few hours to kill downtown, the Phoenix-based consultant warms up with a pop-in visit to iconic investor Leon Cooperman, a former client of his. After a quick bite and some catch-up time, the old friends huddle on the trading floor.

Pulling up DeMark's charting systems on a Bloomberg screen, Cooperman is oblivious to the overhead television tuned into CNBC. President Bush, flanked by Treasury Secretary Hank Paulson, is unveiling a White House plan to stem the American mortgage crisis.

The legendary PM doesn't look up even once; he wants DeMark's take on his biggest position while they still have a little bit of time together.

As a man who managed to bundle his arithmetically calculated entry/exit methodologies into some of the most advanced and respected systems in the trading world, DeMark should be much better known. With Bloomberg's recent rollout (to premium subscribers) of a slew of his market-timing tools – more than two dozen trademarked indicators – that's beginning to happen.

"I now have more than 35,000 users," he says with a happy-go-lucky grin.

DeMark might not be as wealthy or famous as the traders to whom he has consulted over the years (Cohen is his sole client now), but his day in the sun appears to have come.

A Bill Gates look-alike (had Gates been raised on a steady diet of Wisconsin cheese), DeMark is considered one of the foremost experts in the world on price exhaustion within trends. During his three decades of trading across all markets, the 59-year-old has established himself as a grand master of market timing.

"People sometimes scoff when I refer to DeMark's indicators – that is, until they see for themselves that they work," says UBS's Jason Perl, global head of the bank's fixed-income, rates and currencies technical strategy group.

As with any vaguely cultlike ideology, if enough people truly believe, outcomes can become something of a self-fulfilling prophecy. Just as 1490 seems to have served as both the support and resistance levels of choice for S&P futures traders during the bulk of 2007, certain outcomes are more likely to play out – if only because all eyes are expecting such a result. Bloomberg's DeMark offerings for getting in and out of a trade based on his Fibonacci-influenced directional price points

PHOTOGRAPH BY MARK PETERMAN

mean that the "cult" element of his mathematical prowess has gone commercial.

Most traders operate under the presumption that each instrument or product has a specific cadence with which it moves. So DeMark's assertion that his retracement analysis is based on a much larger theme ("believing there is a DNA code special to each market," he says, "is a mistake") is not easy to swallow.

Nor is it easy to believe that his tool, the "TD Sequential," can call bottoms via an elaborate bar-chart countdown pegged to the number 13. As it turns out, DeMark has nothing against fundamental analysis. But entries and exits are a whole other story.

"In '87, both TD Sequential and TD Combo indicated likely upside price exhaustion," DeMark says. "It was the convergence of the daily, weekly and monthly that alerted us to the likely upside price exhaustion. This is similar to what occurred in the currency markets in September 1992, when the British pound exhausted its upside momentum."

It's no secret that Paul Tudor Jones and his then-strategist, Peter Borish, were watching DeMark's patterns 20 years ago when they famously sold the market short prior to Black Monday. Coincidence? Maybe not. Either way, whether you view them as financial alchemy or genuine market science, DeMark's methods are not for the emotionally weak. The basic interpretation of price exhaustion is that you sell into relative strength and buy against outright weakness — counterintutive actions for traders.

Aside from being long the U.S. dollar, fading the market is probably the easiest way to lose a chunk of change these days. On the other hand, DeMark's presence on SAC Capital's payroll is the only signal you need to pay attention.

A star high-school basketball player who grew up near Milwaukee, DeMark first took notice of the securities markets' allure in the late 1960s, when he overheard one of his uncles discussing options strategies at a family dinner. "He described them as proxies for stocks and went on about how, with a limited investment, one could make many times more than just buying the stock," DeMark recalls. "I was hooked. I knew this was a business I wanted to be involved in but didn't know exactly how."

THE CONVERGENCE OF DEMARK'S MARKET-TIMING INDICATORS SEEMS TO HAVE PREDICTED THE '87 CRASH.

During graduate school at Marquette University, while working summers in the legal department of a brewery, DeMark befriended an attorney who subscribed to Abe Cohen's Chartcraft point-and-figure service. His first investment job, as an analyst, came in 1971 at NN Investment Services, a small pension-fund manager in Milwaukee. DeMark, whose appetite for technical-analysis information was close to insatiable, soon came across *Trendline* charts. He went wild, at times working late into the night, applying various analytical techniques to bar charts. His bosses saw his passion, and readily encouraged him to pursue his ideas. "It was as if I had died and gone to heaven," he recalls. "I could pretty much do what I wanted and get paid to do so." He developed for NNIS a proprietary quantitative system of market-timing techniques based on exhaustion points, something purely mechanical and not prone to even the slightest hint of subjectivity.

Seeded by NNIS, DeMark formed a consulting firm in 1978, advising many of the country's largest pension funds, including those of IBM and the state of Oregon, before founding his own firm in 1982. His client roster grew larger and more prestigious, and in 1988 he joined forces with Tudor Jones. He has never stopped trying to perfect his systems, molded by his proximity to an array of historical events and industry titans. "It's extremely difficult to buy when everyone else is selling, as it is to sell when everyone is buying,"

THE TIP SHEET

SUPERFLY: Popular market-intelligence provider **The Fly on the Wall (theflyonthewall.com; subscriptions $25 per month and up)** is an unending stream of analyst calls, IPO announcements, buy-side maneuvers, rumors and rumblings. In an exciting overhaul set to occur in mid-2008, the operation is retooling its Web site, putting greater emphasis on analytics and quantitative tools so traders can better harness this plenitude of data. A concerted attempt to make tradable sense of the mayhem? That is *so* fly.

SINGLES SCENE: Largely ignored by traders and shunned by brokerages, single-stock futures nevertheless warrant a closer look in an environment of rising borrowing costs. "This is a financing tool whose time has come," says David Downey, a former Interactive Brokers operations executive who now heads **OneChicago (onechicago.com)**.

The Windy City–based firm, partially owned by IB, lists futures on 500 individual stocks. Downey predicts leverage-seeking traders will increasingly embrace SSFs as an alternative to paying interest on margin loans. If you go long via these instruments, the Fed funds rate is priced into the contract, but there's no additional interest. On the short side, if a customer sells an SSF instead of the underlying stock, he can collect 100 percent of the income stream from the interest, rather than the fractional rebate he would otherwise get from his brokerage house.

Downey admits it's sometimes cheaper to buy the stock than the future (OneChicago charges 14 cents per contract executed), especially if a customer's margin rates are low and the loan term is brief. However, he adds, traders who combine SSF positions with underlyings can optimize cash and generate reliable rates of return: "You can use SSFs to refinance positions much the same way people refinance their homes." That might not be the most inspired analogy these days, but we get the picture: Think outside the bulge.

HUNTER-GATHERER: Compilations of chats with famous traders almost always contain a few nuggets of wisdom, and the recently published ***Hedge Hunters*** (Bloomberg Press), by Bloomberg News reporter Katherine Burton, is no exception. She scored insightful interviews with such heavyweights as Michael Steinhardt, Marc Lasry, Boone Pickens, Richard Perry, Julian Robertson, Daniel Loeb and Dwight Anderson. But what makes her collection so fertile is its focus on rising stars: Following the chapter on Anderson come profiles of Roberto Mignone and Bruce Ritter, both of whom Anderson hand-selected for Burton in a sort of biographical chain letter. As for Mignone and Ritter's picks for future greats . . . well, perhaps we'll have to wait for Burton's next book.

Rich Blake, Eric Capper and Scott Eden he says. "Trend-exhaustion identification is critical to being successful in the market."

Seeing, of course, is believing. Over a handful of weeks this past November, DeMark put on a dynamic clinic on pivots and entry points across GOOG, crude and the euro, as well as Nasdaq and S&P futures. Each time, the entry point in question was literally the high/low of the session or even the entire move. The samples weren't exactly random, and they did tend to correspond to commoditized chart patterns and Elliott Wave analysis. Still, the TD Combo, with its 13 waves of fury, worked to a T across a vast array of products and asset classes.

The difference between DeMark's indicators and those of other chart theorists is simple: "My indicators are in real time and dynamically show reversals," he maintains. "Those of Elliott Wave and others are backward-looking."

That Bloomberg now offers DeMark's indicators to a wide audience should concern upper-echelon industry practitioners no more than if a chef at their favorite restaurant were to publish a cookbook. (DeMark, for his part, has written several books that have revealed his methods.)

DeMark's evolution and reinterpretation of the static tools of yesteryear far outstrip anything he faces now. He was one of the first to realize that existing oscillators were often obsolete and that while one man's oversold MACD indicator could be viewed as a buying opportunity, momentum traders may see it as a signal to sell. In this business, there's no distinction between being early and being wrong. So it was only a matter of time before DeMark and others focused on timing, not merely the point where the red line cuts across the blue.

DeMark experimented often with existing oscillating indicators with limited success, given that one variable — Father Time — continued to scramble the outcome. There was, at the time, no application he had discovered to be successfully consistent — so DeMark decided that if he was going to be able to employ oscillators, he would have to develop his own in order to leverage the timing component.

"IT'S GOTTEN TO THE POINT WHERE I DON'T EVEN LOOK AT A CHART WITHOUT DEMARK'S INDICATORS."

This early work led to his most important market tool, the 13 Wave TD Combo — which, when combined with the popular TD Sequential, is a powerful aid in understanding market rhythm and calculating price-inflection points for entry, pivots and exhaustions.

With Bloomberg now rolling out his work, DeMark is acting as the industry's global orator across foreign exchange, energy, equity and fixed-income. "It's gotten to the point where I don't even look at a chart without overlaying DeMark's indicators," says Passport Capital founder John Burbank.

Price exhaustion is the simple fact that will ultimately have to be pared back to a reasonable point of equilibrium. But given that emotion and greed are two significant variables that cannot be isolated, it bears wondering how a quantitative approach to gauging entry can rely simply on price patterns while casting away emotion. Or is it that price does indeed plot the emotional story, and if a trader were macro enough in his pricing analysis, he'd be accounting for emotion? DeMark says he would be.

Even if his decades of work don't ultimately result in a widely used tool for traders as they engage in a global battle across overlapping markets, DeMark will always have the satisfaction of having been so close to so many of trading's trailblazers. He has not only stood on the shoulders of giants, after all — he's rubbed elbows with a few, too. ■