

The stocks we seek to cover in our newsletters are those with a growth rate expected to be in the 10% - 20% range or more. Expected growth rates are estimated by research analysts or the company itself and are dependent on assumptions being correct.

Many factors can affect growth estimates resulting in lower or higher than expected earnings. The confidence the market has in the anticipated growth rates is reflected in the share price. If doubts about continued growth emerge, a sustained correction may occur, or if confidence is boosted by analysts or company reports a strong advance may ensue.

A strongly performing growth stock has a share price chart that is characterised by minor corrections. These corrections are usually retracements of 12% - 33% of the move from the last significant low.

Elliott Wave analysis allows us to identify the important high and low points and where to expect significant corrections. The Elliott Wave system allows us to view the potential of a stock from a technical angle. For example the completion of a major wave (2) may result in a large decline and as sentiment begins to turn negative at this time, an assessment can be made as to the probable extent of the fall.

If a retracement of over 38% occurs in a growth stock, this can indicate a change in circumstances and we would no longer consider this an AA or AB stock.

Analysing share prices from an Elliott Wave perspective is similar to being a detective - every move tells us something about the sentiment surrounding the stock and we can often draw accurate conclusions about the performance of the company.

Growth stocks usually have low price earnings ratios (P.E.'s) and are priced on future expected earnings which is fine when the company continues to perform however if the growth prospects diminish or reverse a severe fall in the share price can occur. This is the risk with such companies and the technical position of the stock gives a guide as to when to be wary of such a change.

For example, a major wave (3) top may indicate a time when market sentiment has run to an extreme with future earnings needing to be exceptional to support the current price.

Markets run on sentiment as much as fundamentals and Elliott wave analysis, pointing to a major top, combined with an excessive P.E. ratio may indicate the end of the run.

### **GROWTH STOCKS IN BEAR MARKETS:**

Is it a stock market or a market of stocks? Major sharemarket corrections result in most stocks following the trend however growth stocks may continue to perform well even in a falling market. At the very least they may hold steady and form a long sideways consolidation pattern before eventually advancing. Some investors select stocks regardless of the position of the general market.

Provided they can see value in the stocks they select, they buy and adopt a long term view, believing that no matter what the market does, value will eventually be reflected in the company's share price. This approach has been used successfully by many well known investors such as Warren Buffet and Peter Lynch.

**RETRACEMENTS:** Strongly performing stocks have minimal retracements - usually in the range of 12% -33% of a move from the starting point of the wave pattern. Because such reactions are short and sharp they do not exhibit a 2 wave corrective pattern as is normal for most retracements. Therefore it is not possible to be very precise about forecasting

the extent of the falls from targets except to say that they should fall into the range of 12% -33%.

A fall of 50% is abnormal for a growth stock and if this occurs it may negate further upside potential, at least until a larger correction is completed. Such a fall may indicate that the stock has stalled and the growth prospects may have been affected by a change in the marketplace for the company's products, competition has entered the market or some other reason. When growth stocks stall, i.e. the growth no longer appears to be there, the subsequent sharemarket re-rating can lead to severe falls.

From a fundamental point of view, a growth stock may be identified by the way it is expanding its business. A retailer for example may be expanding outlets and increasing profits by increasing market share. A previously poorly run company may, under new management become a turnaround situation and grow profits by becoming more efficient at what it does. An example of the latter was U.S. carmaker Chrysler which almost went broke and then became a very successful company under new management. The shares as a consequence soared.

Often the long term growth prospects of a company are overlooked by the market which usually concentrates on the possible short term negatives. This is when long term charts can give us confidence in certain price levels being likely to hold.

With mining companies what we look for is stocks with the potential to prove increased reserves. A series of good drilling results over a good strike length gives us confidence that the prospect may be a potential mine. If the company is committed to a significant drilling program, this will continue to fire market interest in the stock. Often a popular exploration stock completes a major wave (3) move and then goes into a large decline - even if a prospect becomes a potential mine.

The market is inspired by drilling results but once the growth factor generated by exploration is taken out of the equation, the stock will invariably fall even as the mine is developed. Once the mine starts producing, the stock is then usually re-rated as a producer. As long as exploration continues to prove reserves which are being diminished by mining, the stock may continue to perform however if this is not happening the stock may decline unless there is a surge in the price of the commodity being mined.

**Short term versus longterm investing:** Generally, from my observations, it seems that long term investors seem to do better than short term traders. It is very difficult to time the market on a short term basis however it is much easier on a long term basis.

The 4¼ cycle has gained a following and research on this cycle does seem to prove its validity to a degree. Followers of this cycle may sell their holdings near the top of this cycle and buy back near the low of this cycle, so reducing the long term cost of their investments, resulting in exceptional returns.

I am yet to be convinced whether this a true cycle however as the 55 week Fibonacci number multiplied by 4 equals 4¼ years and important turns in the market can often be seen at 55 week intervals. There is also a 2 yr. cycle that is close to ½ this cycle as well as a 3.4 yr. cycle that can expand to about 4.3 yrs. Despite this confusion the 4¼ yr. cycle, possibly tuned into the U.S. Presidential election period of every 4 yrs. has worked remarkably well since the 1987 crash. Prior to this event, going back to 1929, the 2 yr. cycle seems a better fit, so I believe this is the true cycle.

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