Advisors Sentiment User Guide

November 2009

www.investorsintelligence.com

Summary

The Advisors Sentiment report surveys the market views of over 120 independent investment newsletters (those not affiliated with brokerage houses or mutual funds) and reports the findings as the percentage of advisors that are bullish, those bearish and those that expect a correction.

The report has been widely adopted by the investment community as valuable anecdotal evidence as to extremes in investor confidence: conditions which are often seen at major market turning points. The Survey is published every Wednesday morning.

History

Abe Cohen, the founder of Investors Intelligence, devised the Advisors report in 1963. Cohen had in mind that the results would alert him to conditions when a majority of advisors had become bullish thus providing a relatively good signal to increase exposure to the market. This turned out not to be the case as, after several years of comparing his data to the subsequent market action, Cohen became aware that the best signals from his data were in fact contrarian in nature. He found that a majority of advisors and commentators were almost always wrong at market turning points. Quite simply, professional advisors are just as susceptible to market emotions as individual investors – they become far too greedy at the top of trends and far too fearful near the bottom.

Cohen passed the survey onto Mike Burke and John Gray in 1981. Mike and John have been editing the survey ever since, providing continuity.

Methodology

Producing the weekly sentiment poll is a daunting task. The survey covers over 120 independent financial market newsletter writers (advisors). We exclude brokerage house letters.

The newsletters are all subscription products via Email, Websites or US Mail. The opinions of the newsletter writers are received in the same format and time frame as is offered to their subscribers. Most letters are composed weekly, with some intra-week updates and a few are bi-weekly or monthly.

While a number of newsletters have been produced for a long time, others come and go, so we monitor Barron's, IBD and other places looking for additional new letters to include. Several years of continuous publication is normally required before a newsletter is included.

The poll editors, Mike and John, capture the advice the newsletter is communicating to its subscribers. Basically they determine “Are they telling their readers to buy or sell?”

If the Advisor has a list of stocks to buy now, they are bullish; if they say sell everything and raise cash they are bearish; if they show a list of stocks to buy, but at lower prices, they are judged as “correction” status. Judgment is exercised when comments are ambiguous with both bearish and bullish arguments and in these cases, the current stance is compared to what the Advisor had said previously, looking for changes.

In summary - for every newsletter, our editors categorize the advisors opinion to one of three groups: bullish, bearish or correction.

Publication

The survey is published weekly and reflects the opinions of the advisors up until the Tuesday of the publishing week. The Sentiment Report is emailed to subscribers every Wednesday morning and the report uses that date.

However, on the data file we show the prior Friday's date. This is because the vast majority of those newsletters are composed after the markets close that Friday, and hence we also include the final DJIA and S&P500 for that Friday.

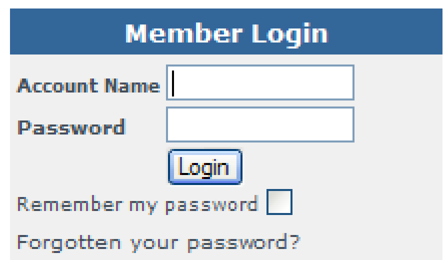
Note - The survey was monthly for 1963, then bi-weekly through June 1969. After which it was shifted to the weekly schedule and that continues through the present.

How to access sentiment readings

At the same time the report is emailed out to subscribers on Wednesday morning, the report is also published on the Investors Intelligence website.

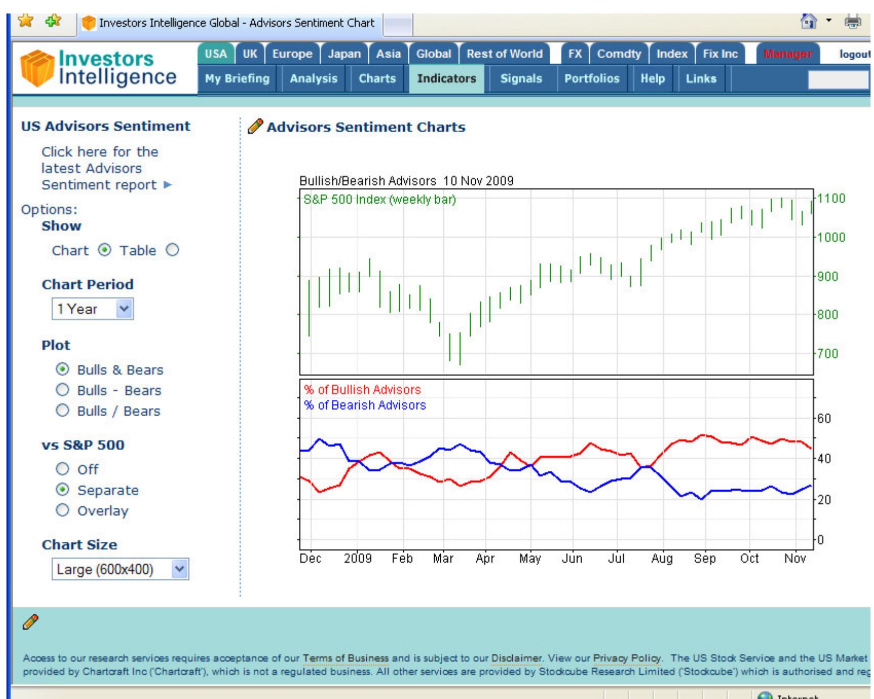
Accessing the online report:

- Visit the **www.investorsintelligence.com** website
- Enter your login account name and password in the top left of the screen
- Click on the "My Briefing" tab to access your subscriptions
- Click on the "Advisors Sentiment" report



Displaying the Advisors Sentiment Chart:

- Once logged into the website, click on the "Indicators" tab, just to the right of the "My Briefing" tab.
- Scroll down with the mouse to the "Advisors Sentiment Charts"
- A chart will appear along with analytical tools, as per the screen shot below. Chart parameters can be adjusted from here.
- By selecting "Table", historical data for the last seven months can be displayed.
- *Note – a full data set going back to 1963 can be purchased for $900. Contact our subscription department for details.*



How to interpret the survey readings

Advisors Sentiment is a **contrarian indicator**. This style of investing is expanded upon at the end of the user manual.

Subscribers use the sentiment data to establish whether the risk is to the downside or the upside. That information can then be used as part of one's investment strategy. It contributes best to medium and long-term strategies and would have no value to day trading. Additionally, it is not intended to be used on its own to make investment decisions.

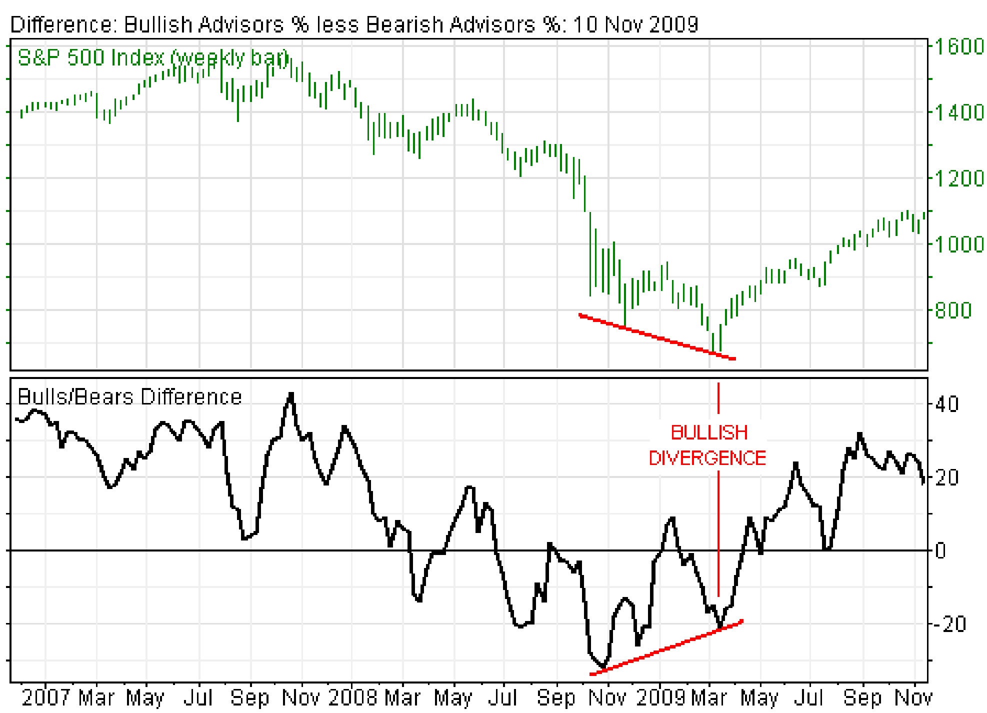
Interpreting the data is of course dependant upon ones own investment goals. However, over time, observing divergences and extremes, which can either be bullish or bearish, have proved to be the most effective and straight forward technique for reading the data. Below we reference historical examples to illustrate these two techniques.

Buy Signals

Extremes - Bearish Advisors from 45% to 50%, or above, is a BUY signal. The signal is strengthened by a count of 25% bulls or lower.

- Two bearish readings above 55% occurred in 1994 prior to the commencement of the uptrend that took the Dow Industrials from 4,000 to 12,000 over a six year period.
- At the October, November 2008 and March 2009 bottoms the bears reached an average of 52%, 45.8% and 43.2% respectively for each month. These readings came ahead of a 50% rally by the Dow. Note that the bears retreated over these months, even though the Dow was falling, and that brings us on to the phenomenon of divergence.

Divergence - The "bulls-bears" tool for the sentiment chart, plots the bull bear difference. This feature simplifies the data so that divergences can be observed. A bullish divergence would occur when the stock index makes a new low but the bull bear difference does not.

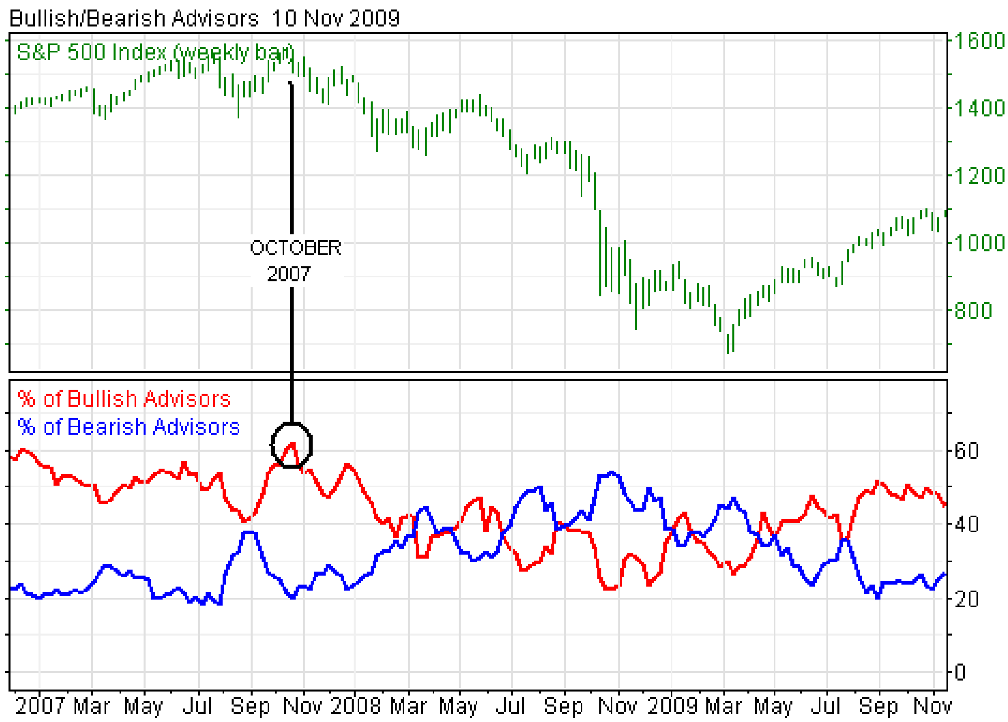


- The 2009 bottom (see chart) is an example of this and the divergence was confirmed in early March when the bull bear difference turned up. Note that it is important for the divergence to be confirmed by the bull bear difference turning up before proclaiming a buy signal.

Sell Signals

Extremes - Bullish Advisors from 55% to 60%, or above, is a SELL signal. The signal is strengthened when the bearish advisors are 20% or lower.

- The bulls exceeded 60% in 2001, as the technology bubble was bursting.
- More recently, the bulls hit a 60% extreme in October 2007 ahead of the 2008/9 collapse. The Dow then shed just over 50% of its value.



Divergence – This is the inverse of a bullish divergence detailed above. A bearish divergence would occur when the index makes a new high but the bull bear difference does not. The divergence has to be observed over a period from 2 to 6 months. Again, confirmation of the divergence is imperative before drawing conclusions, in this case that would be the bull bear difference turning down.

What is Contrary Investing?

Contrary investing aims to profit from particular conditions where investors act on their emotions rather than reason. Essentially, it is going against the crowd.

The advisors sentiment survey captures extremes of fear and greed. Those extremes are often seen at major market turning points, providing the astute contrarian with opportunities to both enter and exit the market with aplomb.

Crowd psychology is central to those extremes. It has been observed for many years and unfortunately, as investors, we provide rather ideal “laboratory rats” for its study. In 1841, Charles Mackay published a book entitled “Extraordinary Popular Delusions and the Madness of Crowds” in which he sited phenomena such as the Dutch Tulip Mania and the South Sea Bubble as examples of this form of mass investment hysteria.

It is hard to dispute that investors instinctively like to adopt a popular theme on which to base their strategy and in his book Mackay noted that “men think in herds…go mad in herds (and) recover their senses slowly, and one by one”. In other words, once we begin to think with the crowd, our reasoning becomes irrational and based on the emotional impulses of that crowd rather than on our own capital-preserving instincts.

Another legendary contrarian was Humphrey B. Neill whose book “The Art of Contrary Thinking”, published in 1954, helped popularize this strategy for investment. He too observed that “when everyone thinks alike, everyone is likely to be wrong”, and promoted the practice of “throwing your mind into directions which are opposite to the obvious”.

Neill provided much practical advice on how, and importantly when, to apply contrary thinking. He was happy to admit that the public is right more of the time than not and concluded that “the crowd is right during the trends but wrong at both ends”. In other words, as a market trend develops, there is still a dichotomy of views amongst investors and it is not until these views become extremely uniform that investors resemble a crowd. This was aptly described by Sir John Templeton “bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria”, the extremes in this case being pessimism and euphoria.

If Mackay and Neill were correct in their observations as to crowd behavior then, could Cohen have stumbled upon a means of identifying conditions when such behavior was at an extreme? The answer to this question is dependent on whether or not the Advisors surveyed in the report act as “the crowd” or rather as “experts” who are emotionally divorced from the irrational exuberances often shown by the investing public. The historic sentiment readings show that Advisors views do indeed follow the crowd. They do after all (subconsciously or not) have to satisfy a market-orientated readership, being generally reflective of market optimism during uptrends and pessimistic during market declines.

Thank you for your interest in the Advisors Sentiment Report. If you have any questions, or require more information, please contact Grace Ann in our US office on 914 632 0422, or Sarah in our UK office on +44 (0)20 7352 5435.