WHERE WE HIT...
1. We had advised investors to move to a 58% cash position by the time the DJIA peaked in August; and up to 88% cash on September 30th - just 4 days before the DJIA's largest 1-day loss in history.
2. On our September 29th Hotline Report, we stated: "unless our key indicators QUICKLY turn around, we feel the market is heading into a steep decline in the coming weeks. This is the strongest warning that we've given in over 2 years - we don't feel it should be taken lightly!"
3. For the first time since May, subscribers to our special STAR Trading Service were telephoned with a new trade - a short position on 9/29.

WHERE WE MISSED...
1. In perfect 20/20 hindsight, it was obvious that a number of our stocks were exited prematurely - some up to 4 months before the market peaked.

WHAT LIES AHEAD...
The steep decline of the past few weeks has carried the market to one of the most oversold levels of the year, so a near-term rally toward DJIA 2500 should be expected. But while many analysts seem quick to pronounce that "the correction has almost run its course," our key indicators have failed to improve from the levels that warned us of this impending trouble. So evidence indicates that any rally from current levels could merely be the 'eye of the storm' lulling investors into complacency as it passes through.

NOTE: See page 4 for the tentative schedule of James Stack's upcoming media appearances.
MONETARY ANALYSIS

Has the Federal Reserve begun a long-term tightening? Probably not. But monetary conditions have deteriorated to the worst level since the 1984 correction. Our MEP Monetary Model has dropped to -62 (Figure 1), while the Monetary Composite tracked by Ned Davis Research (Figure 2) has fallen sharply into the negative region as expected from our 9/25 issue.

Meanwhile, key short-term interest rates have yet to halt their upward trend. And with the Federal Funds Rate now 1/2% above the Discount Rate (Figure 4), the Federal Reserve may have no choice but to hike the Discount Rate another 1/2% in coming weeks.

Obviously, one influence on the Federal Reserve's interest rate decisions has been the continuing Improvement in the Commerce Department's two economic forecasting tools shown in Figure 3. However, with the stock market being one of the major components of the Index of Leading Economic Indicators, we can count on this Index falling sharply with this month's calculations.

What is the Federal Reserve's next move? Most likely, more of the same. Interest rates should edge higher in an attempt to stabilize the U.S. Dollar and squelch any inflationary fears. Notice in Figure 4 that since the first of the year, the Federal Reserve has already slowed money supply growth at an alarming rate. The pressure to ease will increase in coming months; and if the Federal Reserve DOESN'T reverse its stance and push interest rates downward by yearend, a recession may become unavoidable.

TECHNICAL

A comprehensive look at the technical side of this market is presented in the technical boxes on the next two pages. Figure 5 should also be of interest to investors as it reveals that corporate insiders have ended their mid-summer buying spree... not a very good omen.

One argument you may hear in coming weeks, is that Mutual Funds have a high cash position which should cushion any downward slide (Figure 6). As we've discussed in detail in previous issues, such an argument is extremely misleading. Once nervous mutual fund investors begin exiting their no-load funds, these cash levels will fall sharply. So our advise is to turn to other technical indicators for guidance.
There is one ray of hope that interest rates MAY (and we emphasize 'may') already be near a peak. And that message comes from the interest rate sensitive DJ Utility Average (Figure 2), where the falling secondaries and plummeting Blue Chips have failed to drag the Utility Index under the May-September lows.

![Graph - DJ Utility Average](chart-courtesy-of-wall-street-journal)

**WHAT TO DO NOW:**

All-in-all, both the technical and monetary pictures remain quite grim at this time. That means the stock market will most likely run headlong into more trouble in coming weeks. And under these conditions, investors are faced with one of two questions:

1. Those investors who are safely in a high-cash position (such as our model portfolio), are asking "WHEN AND WHERE DO WE LOOK FOR THE NEXT INVESTMENT OPPORTUNITY?"

One chief controlling factor lies with the Federal Reserve, whose hands are partially tied by the falling U.S. Dollar. However if they can find room to ease, we are confident they will. And such a move should turn both our MEP Monetary Model as well as our key technical indicators dramatically upward.

The Leadership Index for the NYSE has now dropped to the most bearish level since August of 1984; and indicates a significant loss of upside momentum in this Bull Market. As you may remember, it was the inability of this index to climb above +90 in August that caused us to advise a more cautious position.

Although not as disturbing as NYSE Leadership, this same Index for the OTC market has also fallen into the negative region. So until both of these important indices can climb back above 0, the outlook for the stock market will remain unfavorable.

There's little to add about market breadth (or participation), which we haven't already said. Our CDI has been in a 9 month downtrend, confirming that this past Bull Market leg has had fewer and fewer stocks taking part. Such a deterioration in breadth is usually the first, and one of the most reliable indications of probable trouble ahead.

The CDI for the OTC market has held up better than for the Blue Chips. But in recent months, it too has dropped to new yearly lows. If these measurements of market breadth could stabilize for two or three months, we would be presented with a low-risk buying opportunity by yearend.

The NASDAQ OTC Index is now at the same level as last March... 7 months ago. So it's little wonder that investors who haven't profited from the precious metals are becoming frustrated. A drop under 425 would break an important support level and confirm the onset of sharper declines ahead.
The risk is, that we may see the signal AFTER the market has already bottomed. But that is a relatively small price to pay for the comfort of safely sitting out this high-risk period.

We believe a solid bottom could be in place as early as December. And if the Federal Reserve IS the trigger for another Bull Market leg, look for the precious metal stocks to turn in stellar gains followed by the secondary OTC issues.

2. Those investors who have instead remained heavily invested through this decline, are struggling with the following questions: "HAVE WE ENTERED A FULL-SCALE BEAR MARKET" and "IS IT TOO LATE TO STEP OUT NOW?"

A very simple approach is: 'If you own a stock or mutual fund that you would NOT currently buy, then consider selling it'. And following this premise, we would STILL encourage investors or new subscribers to build up cash at this time. Sure the market seems ready to rally, and we know that raises the hope that this Bull Market can get back on its feet. In addition, the strength in the Utility stocks is also an encouraging sign that interest rates may start leveling off.

However, until we see solid evidence that the market's technical strength (leadership & breadth) is improving or that the Federal Reserve is about to push interest rates lower, it would be foolish to underestimate the downside risk in this market.

As for "WHETHER WE'VE DROPPED INTO A BEAR MARKET?", we believe the answer is no. But only because there is an extraordinary amount of political pressure (both here and abroad) for the Federal Reserve and the Finance Ministers of our trading partners to keep the economy moving forward. So if the DJIA were to free-fall toward the 2000 level, we would almost bet our last dime that the Federal Reserve will panic and push interest rates dramatically lower. This is no guarantee, mind you; but past actions are pretty reliable when watching the Fed.

Our major short-term indicator, the Pressure Factor, has once again dropped toward the oversold region raising the probability that the market may find temporary support at DJIA 2400. We expect any rallies to be sharp bounces and limited on the upside by investors anxious to sell at DJIA 2500.

The late September rally fooled most analysts into believing that DJIA 2500 would serve as an important bottom for this correction. But now, the next important support level is in the low 2400's... where we now are after today's 95 point plunge.

MR. STACK WILL BE APPEARING on the following financial news programs this month:
October 29 - 'MoneyTalk' on Financial News Network (FNN) 4:30pm EST
October 29 - 'Investors Club of the Air' radio program - KIEV Radio 3:00-4:00pm PST Woodland Hills, CA

THE INVESTECH FINANCIAL HOTLINE NUMBER will change on October 19th. The new number has been sent to all current subscribers. The INVESTRIEVE password for computerized retrieval will change on 11/02 to 'SICK'.

WE APOLOGIZE to current subscribers who receive promotional literature soliciting a subscription to InvesTech. In the course of marketing, we purchase lists and have no way of deleting the names of our subscribers. We hope that if you have received one of these mailings, you will pass it on to a friend.
Our model portfolio has now gained 31% for 1987, more than ANY of the popular averages. But more importantly, we've accomplished this with relatively low risk... and have now locked in virtually all profits. Of the stocks 'Under Consideration', Pegasus Gold announced record quarterly production of 83,750 oz of gold as compared with 33,000 oz for the same period in 1986. Mark IV released quarterly earnings of $.56/34c, up 65% (earnings include $.31/share of non-recurring profit from the sale of stock). Mark IV is now trading on the NYSE; symbol IV. Quick & Reilly's earnings were up 23% at $.49/40. Many of our monitored stocks will be releasing new earnings within the next couple weeks.

Stock groups considered favorable (with the highest relative strength) are the Coal, Farm Equipment, Precious Metals, Railroad Equipment, Steel and Tobacco. Unfavorable groups to avoid include: Banks, Bond Funds, Food, REIT's, Retail, Textiles and Toys. Both the Oils and Utilities are now on uncertain ground.

### Current Advice

#### Aggressive Stocks

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<tr>
<th>Company</th>
<th>Symbol</th>
<th>Exchange</th>
<th>52 Week</th>
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<th>P/E</th>
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#### Conservative Stocks

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1. 6% Position
2. 9% Position
3. 12% Position

#### Short Sales

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#### Futures

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FEATURED STOCKS

The following stock is currently held in our model portfolio:

LORAL CORPORATION / LOR (nyse - 43.00) Loral manufactures electronic counter-measures, warfare equipment, and microwave components for military use. Loral's profits for 1987-88 should rise sharply as production accelerates on two new defense systems for tactical jet fighters. 12mo sales are up 27%, 5yr sales/earnings growth rate = +25%/+19% respectively. Jun 2nd qtr earnings, at $8.64/share, are up 16% with Sep earnings due October 30. Although the acquisition of Goodyear Tire & Rubber's aerospace unit resulted in an expanded company debt load, increased production is expected to offset acquisition costs for at least the next few years.

The following stocks are among our stocks listed as "Under Consideration":

HEICO CORP. / HEI (amex - 32.13) (Formerly Heinicke Instruments) Heico constructs and repairs jet aircraft engine parts for foreign and domestic commercial and military markets; also manufactures medical and biological laboratory products. Its jet engine division accounts for nearly 70% of total revenues and all of the company's income. 12mo sales are up 16% with 5yr sales/earnings growth of +19%/+59%. Jul 3rd qtr earnings were relatively flat at $.92/share.

LUMEX, INCORPORATED / LUM (amex - 14.88) Lumex is engaged in the manufacture of geriatric, rehabilitative, and exercise equipment. Markets include hospitals, nursing homes, athletic training centers, and the home care consumer. 12mo sales are up 14%. 5yr sales/earnings growth rate = +18%/+13% respectively. September 3rd qtr earnings are due the end of this month.

BOWNE & COMPANY / BNE (amex - 20.25) One of the largest commercial printers in the country providing legal, commercial, financial, and corporate printing services. 12 plants in cities throughout the U.S. and Canada are linked by advanced telecommunication devises which allow instant document transmission to and from any of these coast-to-coast facilities. 12mo sales are up 25%. 5yr sales/earnings growth rate = +15%/+13%. Jul 3rd qtr earnings, at $.41/share, are up 24% and the company should easily meet or exceed its 1987 earnings projection of $1.35/share.

SUMMARY

BLASPHEMY

With the DJIA having lost 227pts in just the past seven trading sessions, investors are just waking up to the fact that the market could be falling into a sizable correction. But most have yet to wonder whether they should seriously consider reducing their positions in stocks and mutual funds. For the most part, they feel safe riding through any short-term corrections as it's blasphemy to even THINK about the possibility that this Bull Market won't continue on its journey to 3000... 3600... or even 4000 (as some project).

But the technical evidence that has unfolded in recent months is disturbing:

1. Inflation statistics flaring up in the U.S., Germany, and even Japan.
2. Short-term interest rates rising to the highest level in 18 months.
3. Our MEP Monetary Model plunging to the lowest level in 3 years.
4. The Federal Reserve's hands being tied by a weak U.S. Dollar.
5. Our Leadership Index (which correctly warned of the pending trouble) now dropping to the most bearish reading in over 2 years.
6. Market Breadth (our CDI) deteriorating for 8 long months prior to the August peak.

And until key indicators in these areas show signs of improvement, we will continue to advise a defensive, high-cash position. After all, when you live right next to majestic Glacier National Park, the first lesson you learn is that if it waddles like a bear, smells like a bear, and growls like a bear... it's better not to stick around and shake hands.

James B. Stack

THE INVESTECH FINANCIAL HOTLINE REPORT IS MADE AT NOON ON SATURDAY AND AFTER 2:00pm SATURDAY & 9:30pm TUESDAY,EDT
TECHNICAL OUTLOOK:

- MEP MONETARY MODEL: Bearish
- NYSE: CDI - (Market Breadth)
- LEADERSHIP INDEX
- OTC: CDI - (Market Breadth)
- LEADERSHIP INDEX

GROUP OUTLOOK:

- SPECULATIVE FUNDS: Favorable
- GROWTH FUNDS
- GROWTH & INCOME FUNDS
- INCOME FUNDS
- GOLD FUNDS
- INTERNATIONAL FUNDS

CURRENT STRATEGY: "How Sweet It Is"

Even with a portfolio gain of 35% for 1986 plus a 37% gain in 1987, we still had reservations about dropping to only a 25% invested position in September. At the time, it seemed like such a drastic turnaround from the 95% invested position with which we entered 1987. Yet the ensuing weeks have calmed our anxieties as the DJIA dropped over 300pts and many secondary stocks are now off 20% or more.

More importantly, the warning signals which caused our move to a defensive stance have taken a sharp turn for the worse. The reliable MEP Monetary Model turned negative several months before the market peaked and is now at the most bearish level in 3 years. Our weak Leadership Index played a vital role in our decision to lock-in profits and step aside. And now, it has dropped to the most bearish reading in over 2 years.

We now have to warn you that such readings are NOT typical of just a temporary Bull Market correction. So even though we look forward to an excellent buying opportunity as early as December, those mutual fund investors who have remained heavily invested in the growth funds, just might wish they hadn't by the time this so-called "correction" has run its course.
Mutual Fund investors are nervous... they're a little disappointed that they didn't get out last month... and they've more or less chosen to now ride through this 'temporary correction'.

If our subjective gauge of investor psychology is correct, THAT is the general consensus at this point in time. And that's ALSO how the average investor becomes trapped in a falling market. It's not really a conscious decision to stay invested, but rather an INDECISION to do anything.

We would like nothing more than to inform you that this Bull Market is merely resting, and will be back to full strength within a couple months. Unfortunately, that scenario is uncertain.

What we can tell you with a high degree of confidence, is this: Monetary conditions have now deteriorated to the most bearish level since the major correction in 1984, as the Federal Reserve struggles to support the U.S. Dollar at current levels. And until the Dollar firms enough to let the Federal Reserve ease, this Bull Market is in trouble. The internal breakdown in both breadth and leadership is merely confirming the high risk present at this time.

We also believe that the most prudent approach under these conditions, is to step a major portion of one's investment portfolio OUT of stock mutual funds and into the safety of a Money Market Fund. This may not seem exciting, but it has permitted our model portfolio to gain additional profits during the past month as the vast majority of mutual funds tumbled downward.

SPECULATIVE FUNDS:
As expected, some of the highest losses from this decline have been turned in by the speculative funds. Whenever monetary conditions turn sour, the higher risk investments are typically in the brokerage stocks or the mutual funds which use leverage in their positions. We therefore still advise liquidating any speculative funds remaining in your portfolio.

GROWTH FUNDS:
In today's stock market, the long-term track record of the growth funds has created a false sense of security. But the table at left shows that when the market slides, these funds are often in the forefront of the decline. This is the reason we exited the Growth Funds in September, before the trouble began.

GROWTH & INCOME FUNDS:
The stumbling bond market has carried these funds down almost as much as the less conservative funds discussed above. But with history as a guide, the Growth & Income Funds should receive better treatment in coming weeks if the bond market rallies. They'll STILL fall if the market heads lower, but the losses should be smaller.

INCOME FUNDS:
In the last issue, we warned of lower bond prices ahead. But the ongoing havoc within the bond market (Figure 1), is greater than even we expected. As yet, there is no support zone for bonds. Nonetheless, we'll be surprised if the bond market doesn't stage a short-term rally from these oversold levels. Any such rallies should be limited by the strong resistance in the 85-87 range.

GOLD FUNDS: (25% invested)
We've continued to hold these funds (between 25-50% invested) through most of 1987. It's not that we're "married" to them, but we think their potential clearly outshines the alternative funds. If interest rates edge higher, then gold should come under some selling pressure (Figure 2). But if... and when the Federal Reserve finds room to ease late this year, this group should be leading the charge upward.

INTERNATIONAL FUNDS:
Once again, we're only neutral on this group of funds. The upside potential has been (and will continue to be) limited by the Federal Reserve's desperate efforts to prevent the U.S. Dollar from further declines. However, there is a new element of risk within the International Funds as interest rates in both Germany and Japan have begun rising during the past month.
## CURRENT ADVICE

**PERCENT**

- 25% BULL & BEAR COLONDA
- 75% MONEY MARKET FUND
- 100%

**FUND**

- BULC: BULL & BEAR COLONDA
- F60X: FIDELITY SELECT BROKERAGE
- FIDYX: FIDELITY DYNAMICS
- HRTX: HARTLEWY LEVERAGE
- SRFX: STEIN ROE CAPITAL OPPORTUNITY
- VALLX: VALUE LINE MORTGAGE GROWTH

### THE TOP RATED FUNDS

<table>
<thead>
<tr>
<th>SYMBOL</th>
<th>RISK</th>
<th>1985</th>
<th>1984</th>
<th>S</th>
<th>R</th>
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<tr>
<td>FSLB</td>
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<td>-2.7%</td>
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<td>0%</td>
<td>0%</td>
<td>+11%</td>
</tr>
<tr>
<td>FSLX</td>
<td>Medium</td>
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<td>+3%</td>
<td>+1%</td>
<td>+25%</td>
</tr>
<tr>
<td>FSA</td>
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<td>-4.3%</td>
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<td>+1%</td>
<td>+10%</td>
</tr>
<tr>
<td>FLDX</td>
<td>Very High</td>
<td>+2%</td>
<td>+1%</td>
<td>+1%</td>
<td>+1%</td>
<td>+21%</td>
</tr>
<tr>
<td>FLDX</td>
<td>Medium</td>
<td>+11%</td>
<td>+2%</td>
<td>+3%</td>
<td>+2%</td>
<td>+37%</td>
</tr>
<tr>
<td>FMRX</td>
<td>Medium</td>
<td>+11%</td>
<td>+2%</td>
<td>+3%</td>
<td>+2%</td>
<td>+28%</td>
</tr>
<tr>
<td>CNXK</td>
<td>Medium</td>
<td>+11%</td>
<td>+2%</td>
<td>+3%</td>
<td>+2%</td>
<td>+28%</td>
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<tr>
<td>FDRX</td>
<td>High</td>
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<td>+1%</td>
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<tr>
<td>FDRX</td>
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<tr>
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<td>+1%</td>
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<tr>
<td>FEDX</td>
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<td>+2%</td>
<td>+3%</td>
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</tbody>
</table>

### GROWTH FUNDS

- FIDELITY CONSTRUCTION FUND
- FIDELITY MCGILLIAN
- FIDELITY INDUSTRIAL
- FIDELITY MUTUAL
- NEUBERGER-BERMAN MANHATTAN
- WPG TUDOR FUND

### INCOME FUNDS

- FIDELITY HIGH INCOME
- VANGUARD HIGH INCOME
- VANGUARD INVESTMENT GRADE BOND

### GOLD FUNDS

- B & B COLONDA INVESTORS
- FIDELITY SELECT PR METALS

### INTERNATIONAL FUNDS

- FIDELITY OVERSEAS
- ROWE PRICE INTERNATIONAL
- Vanguard MLD INT'L GROWTH

### NOTES

- 1% Return with dividends & capital gains reinvested
- 2% Sales: R - Redemption
- 3% Net assets in millions of dollars
- 4% Price - Net asset value/share (NAV)
- 5% Available for trading through Schwab
- 6% Available for trading through Fidelity
- 7% Not available in all 50 states
- 8% Uses leverage, options or margin

Data Source: Lipper Analytical Services, Inc.
"As everyone knows, the Dow Jones Industrial Average took the largest beating in history yesterday, dropping nearly 92 points. Our analysis is that this is a delayed reaction on the part of the stock market to the recent rise in interest rates.

"The stock market remains in a bull market. Even with yesterday's historic drop, the Dow Jones Industrial Average has not broken its daily moving average, although it is close to doing so."

Editor: Dr. James McKeever
Publisher: McKeever Strategy Letter
Cost: $195/yr
Box 4130
Medford, OR 97501

"Risk of a stock market collapse in October has risen substantially. Here's a 'scoreboard' of indicators that we follow and their current standing: fundamental stock valuations are ominous; monetary indicators are moderately bearish and getting worse daily, technical 'tape' indicators are moderately bullish, but breadth readings are poor and market sentiment ranges from very negative to very bullish, when looking at super high levels of cash in stock-oriented mutual funds.

"We suspect that a rapid shift towards the bearish camp would occur if the Dow Industrial Average declined below 2468.99 and was confirmed by a Dow Transportation Average break of the 988.90 level. These are the levels to watch for an indication that the month of October could produce a stock market massacre."

Editor: Craig Corcoran
Publisher: Davis/Zweig Futures
Cost: $400/yr
Box 5345
New York, NY 10150

"Strategy depends upon the temperament of the investor. One who doesn't mind a 50/50 risk of a 10% decline from here in order to hold for the long term target of 3600+ may wish to stay fully invested. A bullish trader may wish to step aside only if the Dow falls below 2544, a .618 retracement of the last two weeks' rally, which no sizable second wave has done in this bull market to date."

Editor: Robert Prechter
Publisher: New Classics Library
Cost: $233/yr
Box 1618
Gainesville, GA 30503

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