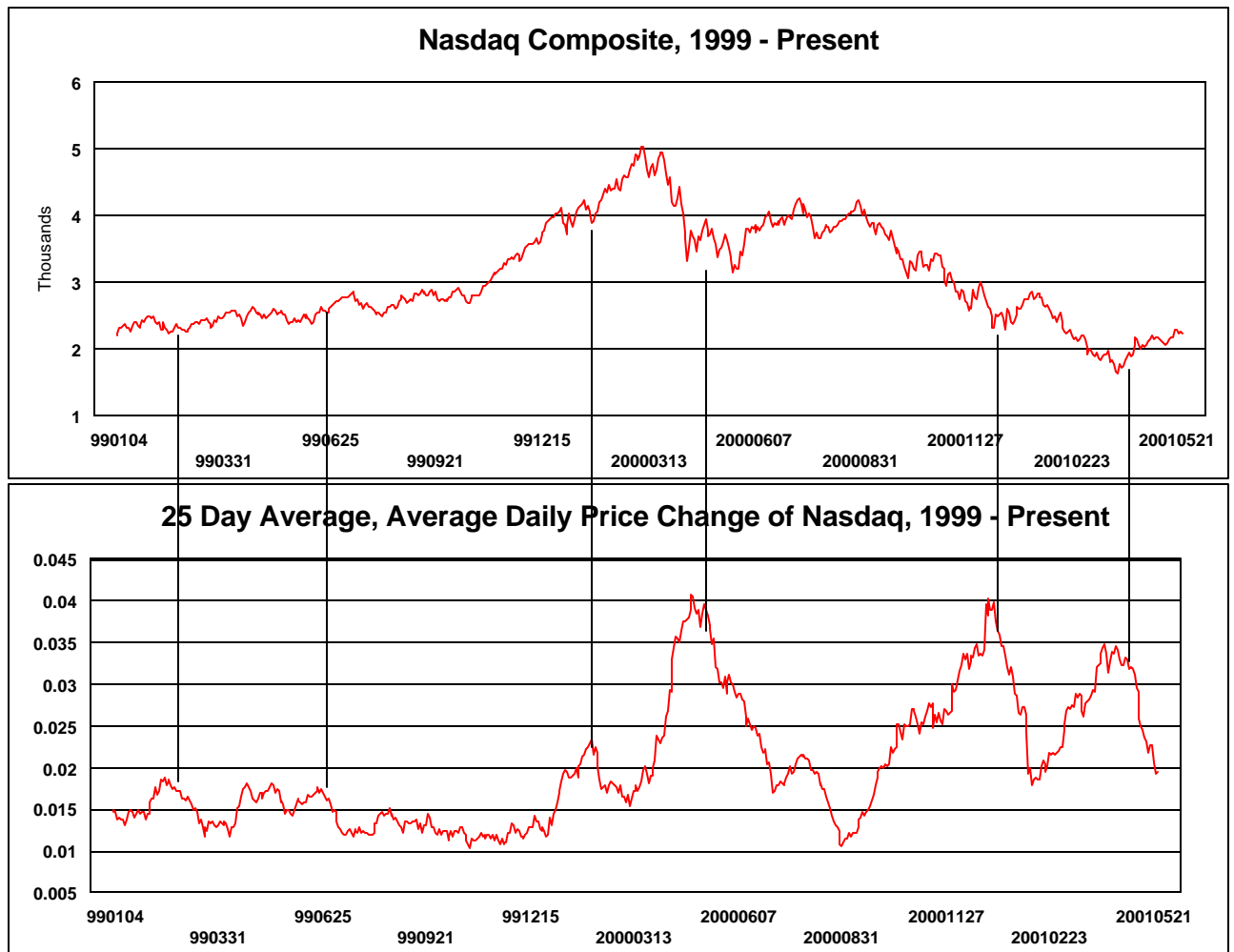


## THE SIGNIFICANCE OF MARKET VOLATILITY -- RISING AND HIGH IS BAD, A TURNDOWN IS GOOD....



### VOLATILITY RANGES AND PATTERNS.....

We have, of late, been mentioning volatility on the hotline quite frequently -- we really know of no other advisor who makes such a point of this. Perhaps the chart above illustrates our concern with volatility patterns and how they may be employed. This chart shows the 25-day average of daily price changes in Nasdaq, regardless of the direction of price movement. For example, a level of .04 indicates that the average daily price change over the previous 25 days was 4%.

The chart which begins early in 1999 starts with volatility patterns that have been fairly typical since 1970, when our own data starts, though volatility did take a brief, if sharp, jump at the time of the 1987 crash, and before then during the final stages of the 1973 - 1974 bear market. Neither resulted in volatility readings seen over the past two years.

Should volatility build up during market declines, the odds appear fairly clear that the decline is not likely to come to an end until volatility peaks and turns down. I have drawn in vertical lines to mark areas in which it has appeared more certain that maximum volatility levels for that swing have already been reached.

With levels of volatility reaching unprecedented (at least since about 1931, as best we can tell) levels, it is hard to come to well researched conclusions regarding its implications. It does seem clear that short term timing models such as DNS are adversely affected by high levels of volatility for reasons too lengthy to discuss at this time. Unfortunately, DNS was introduced just as volatility was soaring to levels not seen in our lifetime, so we were not fully aware of the implications involved.

It remains somewhat unclear as to whether levels of daily volatility above 2% are likely to be bearish, or whether turndowns of perhaps 1/2% from a peak reading (e.g. from 4% to 3.5%) establish a favorable enough volatility climate. In either event, entry into the stock market when volatility is high and still rising is very likely to be premature. For now, still falling, last seen, but we are carefully watching for an upturn.