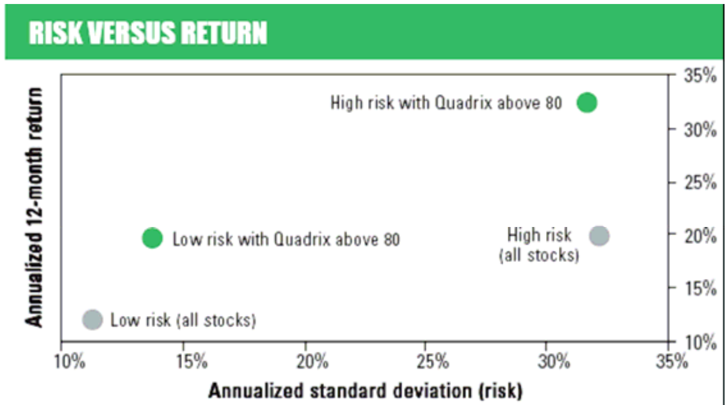
DOW THEORY FORECASTS
Stock Market Trends & Securities Reports Since 1946

Low-risk picks click with investors

On Wall Street as elsewhere, those who cannot remember the past are condemned to repeat it.

For investors blindly speculating in the riskiest U.S. stocks, the last month of trading has delivered a painful reminder on the importance of knowing what you own. Stocks with volatile share-price histories, which led the market over much of the past 18 months, have been hammered in the correction that began in early May.



In a back-test to year-end 1996, stocks in the Dow Jones Total Market Index (TMI) were divided into portfolios based on our Relative Risk scores. Assuming monthly rebalancing, the portfolio of all high-risk TMI stocks delivered an annualized return of 19.9%, versus 12.1% for all low-risk TMI stocks. However, for low-risk stocks with scores above 80 in our Quadrix stock-rating system, the return is 19.7%. Standard deviation measures the volatility of monthly portfolio returns.

As a result, investors are gaining renewed appreciation for low-volatility stocks. *Dow Theory Forecasts* assigns Relative Risk scores to more than 5,100 U.S-traded stocks, ranking stocks on five measures of share price volatility over the past 60 months:

- Bull-market performance reflects a stock's returns in months when the S&P 500 Index gained at least 3%.
- Bear-market performance reflects returns in months when the S&P 500 declined at least 3%.
- Worst three-month performance measures a stock's worst return in any three-month period.
- Beta measures a stock's sensitivity to stock-market movements.
- Standard deviation reflects the volatility of a stock's monthly returns. Based on percentile ranks for these five metrics, stocks are divided into five risk categories: high, above average, average, below average, and low.

As illustrated in the chart, stocks with high risk tend to deliver market-beating returns, while those with low risk tend to deliver inferior returns. However, by selecting high-potential stocks from the lower-risk groups, you can enjoy the best of both worlds. For example, in a back-test to yearend 1996, low-risk stocks with Quadrix® Overall scores above 80 delivered an average annualized return of 19.7% — nearly equal to the 19.9% return of all high-risk stocks.

While high-risk stocks with Quadrix scores above 80 performed even better, the lesson for conservative investors is clear: You don't need to take on outsized risks to earn attractive returns in the stock market.