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By TONY CARIDEO

Between the Lines

ROCKET CAPITAL'S J. D. HURD STUDIES THE CHARTS TO LOOK FOR INDUSTRY TRENDS.

Every Monday night, J. D. Hurd looks at pictures. Squiggles, actually. They are stock charts—1,500 of them.

President of Rocket Capital Management in Wayzata, Hurd is a technical analyst. He and partner Mike Lippold use the past price movements of roughly 1,500 stocks as the first indicator of potential investments. The pair manages roughly \$17 million of other people's money—about \$3 million of which is in a hedge fund. They deal with such arcane concepts as “head and shoulders tops,” “cup and handle” patterns, and charts that are “breaking out,” “breaking down,” and “rolling over.” For instance, a stock that's “breaking out” has been trading in a narrow price range for some time, and is now “breaking out” of that pattern, with volume and interest building and the price climbing.

So let's see—1,500 charts every week for 19 years. That's 1,482,000 charts since 1985. Golly! What do you learn from all that?

You develop a feel for which patterns are more reliable, which produce better results over time. It enables me to identify which sectors of the marketplace are beginning to set up [firm up in price], because you see more and more

companies that are in the same industry with decent to good chart patterns.

If the market is a whole series of discounted cash flows, how can looking at squiggles on a chart tell you anything about the future?

I would describe the squiggles on the chart as a picture of the actions of all the people in the world who are smarter than you are in a given area—the guys and gals who have all the money. Typically, the institutional investors are the most well-informed people in the world. For instance, it would be foolish for me to assume I know more about a company in Silicon Valley than the 20 analysts that cover it for the 20 research firms that service the big institutional clients. So the charts don't really predict anything. Their great value is that they allow you to look on a daily basis at what the informed investors of the world are doing in terms of buying and selling, and it helps indicate what the next trend might be.

It sounds like you use charts to pick groups of stocks as much as individual stocks.

For the most part. For example, right now one of the most interesting groups is telecom wireless equipment. It was the last to get hit at the end of the bull market, and obviously has been the last to recover.

Companies like what are in that group?

Everything from Qualcomm [Nasdaq: QCOM] to Sierra Wireless [Nasdaq: SWIR]. But that's not where we stop. Technical analysis is purely our first cut. After that, we look for companies that are exhibiting strong revenue growth and growing profitability. With this group, for instance, we did work on all 42 companies in the group, and the few that fit had already moved too much.



J. D. Hurd:
pattern finder

So you go beyond technical analysis?

I don't believe that you can use technical analysis as a stand-alone tool. It's a great place to start and a great place to finish, but it has to be used in conjunction with other things. We look at a company's earnings and revenues per

share growth; the company needs to be a leader in its category and have a competitive edge over its peers, among other factors.

Can you give me an example?

If you go back and look at what we said a year ago, our favorite sector was the e-commerce sector. The whole world was saying at the time that the Internet was still dead. In reality, if you look at the charts on eBay [Nasdaq: EBAY] and Amazon [Nasdaq: AMZN] and Ticketmaster [a unit of InterActive-Corp—Nasdaq: IACI] and the University of Phoenix Online [a subsidiary of Apollo Group—Nasdaq: APOL]—the survivors in this case—they were all just turning profitable, and their chart patterns all looked fairly good at once. So my observation on that is that the market is telling me that the industry is doing well, and that I should own something in that group.

So which one did you choose?

The one we selected was a company called NetFlix [Nasdaq: NFLX], the online DVD fulfillment service. We purchased the stock [in January] at \$6.40 (adjusted for a split), and we still own it. It's at about \$31 a share [as of February 24], so it outperformed the group significantly. The group itself during the same time period was up 100 percent plus.

What about wireless companies?

We could have bought the wireless communications equipment sector when it looked good to us, but I just wasn't convinced. We couldn't find any companies in the group that met our other fundamental criteria.

So that's one you missed—where the market began running the stocks in spite of a lack of earnings and revenue growth.

We just couldn't find the right stock. And by the time we did, very early this year, those stocks were up 20-something percent pretty much across the board, and there was no calibration for quality. And I'm not one to chase stocks, because I liken sector analysis to surfing. There's always another wave, always another set, you just wait patiently on your board, and you don't chase the last one because you get worn out.

How do you tell when a chart is sending a strong sell signal?

A very strong sell signal on a stock is when the pattern that you bought is violated. There are a number of patterns that you can buy; the pattern that I buy is affectionately referred to as the cup with a handle—you know, the saucer bottom and it gets higher as you go. It's extremely reliable, and while there are other patterns that are reliable, I've found that the cup and the handle work the best for me. Typically, a stock will explode out of that pattern; and if it doesn't follow through relatively quickly, odds are fairly good that (a) your timing was bad, or (b) you bought the wrong stock.

What stocks do you own now?

We typically carry 15 to 20 stocks in a portfolio. If we really dislike the market, that might be a significantly smaller number, but probably never larger. There are actually 80 stocks in our universe at any given moment. The current portfolio is 35 percent information tech, 25 percent med-tech, 20 percent consumer discretionary and 20

percent other; the smallest company in there is ClickSoftware [Nasdaq: CK-SW]—it's got a market cap of \$107 million. The largest capitalization company in there is NetFlix—it's got a market cap of \$1.7 billion. Interestingly, if you go back and look at when we bought it, the market cap was \$268 million. The sweet spot for us is \$250 million to \$700 million.

Any locals?

We've owned SurModics [Nasdaq: SRDX] at various times. We didn't get it at \$7.50, after it went public, because it didn't have any earnings. We did buy it breaking out at \$13, and made a whole lot of money on it in a relatively modest period of time. And again, when the stock got in the low \$40s, we mechanically sold some. The stock got in the low \$50s, we mechanically sold some more. And then we sold the rest on the way back down through \$40.

There's another one whose blow-up [big price decline] was probably six months ago now, and that could be one that ends up back in our portfolios in the very near future, because the chart pattern has started to turn back up. They got the new management team in there, and the stock has acted better since the new team came in. We will let the chart dictate when the time is right.



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