THE BOLLINGER BANDS LETTER

Bollinger Bands Letter Value Line Plan

The Value Line Plan was developed and added to The Capital Growth Letter in 2001. The system uses weekly Value Line Geometric Index data and is a purely mechanical system based on the Friday close of the Value Line Geometric Index. Each week in the weekly update we announce the state of the system--in or out of the market--and the buy or sell stop for the next Friday. If we are out of the market and the index closes above the stop we get in. if we are in the market and the index closes below the stop we get out. Having the reversal number in advance allows you to trade on Friday shortly before the close if it is clear that the reversal will be triggered, getting in or out a day early.

The system may be traded as either a long-only system that is in a money-market fund when it is out of the market, or a long/short system that is in the market all the time. In addition the VLP can be used in a defensive manner to govern hedging decisions--more on this below.

We base this system on the Value Line Geometric Index because it is an equal-weighted index that tracks 1,700 stocks and gives a good picture of the action of the real stock market. The VLE is a geometric index and mathematically must under-perform all other commonly accepted market measures. This is not a problem in this application as the index is being used to generate timing signals and not for investment.

While the purpose of the plan is to provide a guideline for your investment operations, it can be used as a timing system in-and-of-itself. Interestingly there is no good way to buy and sell the Value Line indices that we are aware of. So, if you want to use this plan for mutual-fund or ETF timing, ideally an equal weighted fund such as the NASDAQ 100 Equal Weight Index ETF (QQEW) or Rydex S&P Equal Weight ETF (RSP) is best. A broad-market cap-weighted fund such as a Russell 1000 or 3000 index fund can also be used.

How can the typical investor take advantage of the information generated by the plan? The real value of plan investing is that it is mechanical; the VLP is black and white, it is either in the market or out, no if, ands or buts. Thus the plan serves to eliminate emotion. One defensive approach is to remain long--that is to hold your existing positions--and hedge using futures, options or inverse funds when the plan exits the market.

As examples of how you could hedge a portfolio when the Value Line Plan turns negative, if you hold a small-cap portfolio, a hedge vehicle would be the Russell 2000 futures traded on the Chicago Mercantile Exchange www.cme.com. If you hold a large-cap portfolio you could use options on the S&P 100 to hedge it, as the S&P 100 is the very definition of a large-cap portfolio. The S&P 100 is known as the OEX and the options trade on the Chicago Board Options

Exchange www.cboe.com. Of course there are many considerations involved when hedging, so be sure to consult a futures or options expert for professional guidance before doing anything. Inverse mutual funds or ETFs also can be used as vehicles to hedge your portfolio.

When you operate the VLP in a defensive mode you are using it as a risk index and hedging when the plan indicates that downside risk is high. This tactic will not work all time, but it will work to protect you from sustained declines that destroy value.