Roger Babson's Discoveries

in pattern correlation

Summary:

Like exploring for a previously lost ship under the ocean, thanks to advances in technology and huge databases, we can find lost treasures. Here the authors show that there are hidden treasures that Roger Babson, originally showed to the world at the first meetings of the Gravity Research Foundation. They were based upon how Newtonian physics relates to economics. Thanks to computer testing in an economic area where the most minute fluctuation is recorded, it can now be shown that Babson's effort to apply Newtonian Physics was a formula which is a universal supply and demand correlator..

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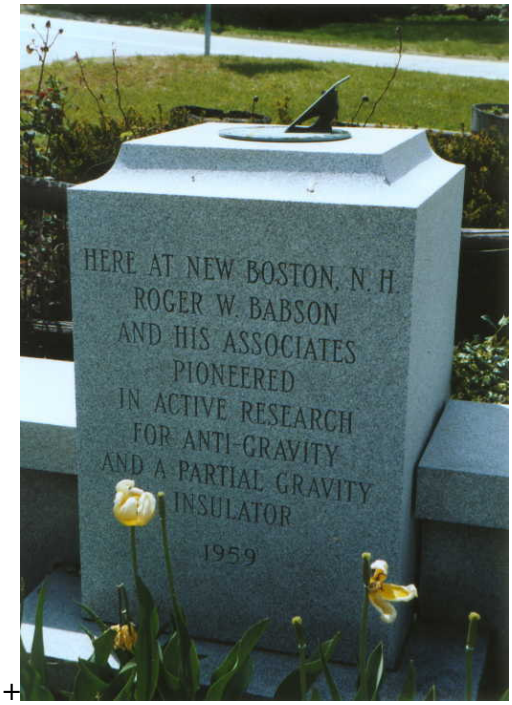

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Thanks to the work of Mandelbrot, Yorke publicized a theory that a butterfly flapping its wings in China can cause a tornado in Kansas. This was Yorke's metaphor for the unpredictable nature of complex systems, such as the weather. Using fractal geometry, and chaos theory, an attempt was made to explain the real world, which has significantly more factors involved than a classroom or laboratory. It was Roger Babson that brought to light that by applying Newtonian principals, one could forecast when and where a tornado is to occur, if the butterfly is actually what is causing it.

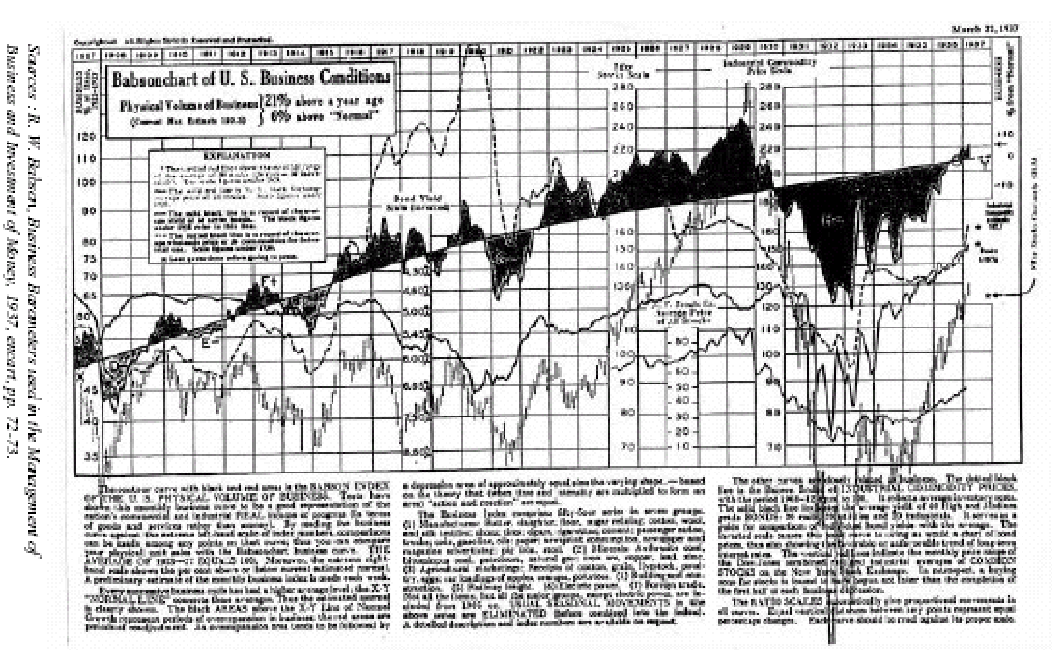
Roger Ward Babson did not confine the application of his theory to a classroom or laboratory, but put it to work in the real world. After having considerable success applying Newtonian Physics to the stock market, he purchased the personal belongings of Sir Isaac Newton and founded a museum in Massachusetts. Today with the availability of accurate data, computer technology and thorough ongoing research, it can be seen that his ideas were astoundingly accurate.

It all started when Roger Babson was in Professor Swain's Civil Engineering class at MIT. To make the class a bit more interesting, the professor used stock market charts to illustrate the application of Isaac Newton's theories. To illustrate his point, Professor Swain drew a straight line through the middle of a wiggly stock market chart. He called this line a normal line. He then discussed how Newton's Third Law of Motion could be applied to Economics and that the Actions and Reactions of the stock market and economy took place in relation to the Normal line.

The theory seemed rather straightforward. Events, which are considered actions that occur at one point in time, cause other events, which are reactions at a later point in time. The force of the reaction event is caused by the force of the action event and is equal and opposite. This concept is commonly know as "For every action, there is an equal and opposite reaction."

As a metaphor, when a company hires a new CEO with the track record of increasing profits by 30% a low pivot occurs and stock price starts to go up. Some time later the 30% profit objective occurs and a high pivot in the stock price occurs. Have you ever noticed that shortly after good news comes out stock prices often go down?

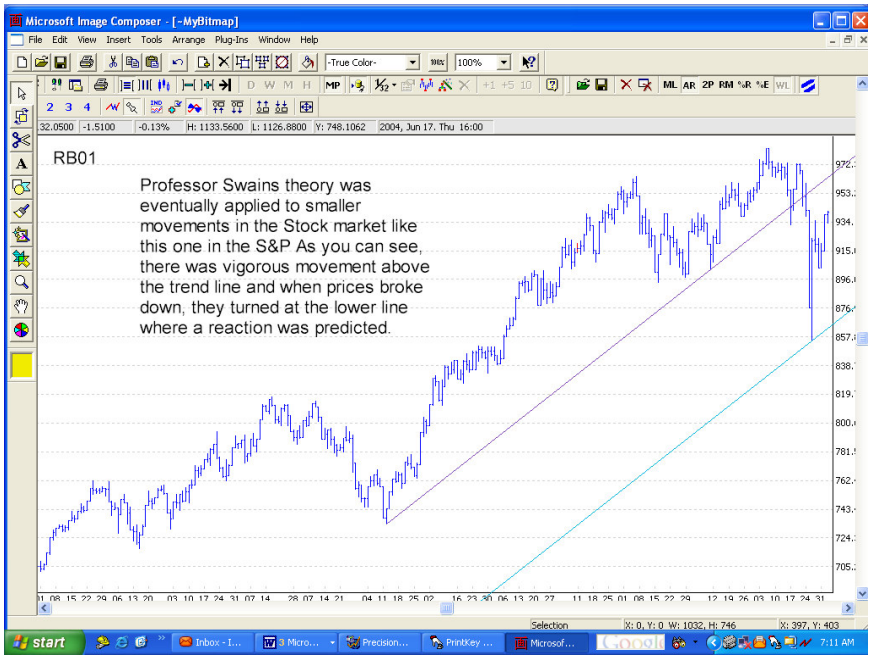
Professor Swian demonstrated that this is the case in the actions of the stock market indices, and was able to show to illustrate it with a chart:



Encart 2 : Le Babsonchart des affaires : Etats-Unis, 1907-1937

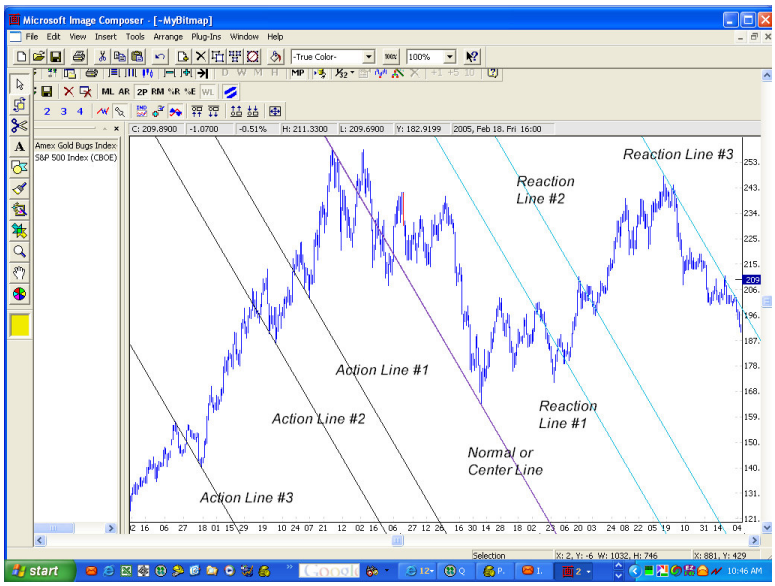
Sources : R. W. Babson, *Business Barometers used in the Management of Business and Investment of Money*, 1937, ouvrage, pp. 72-73.

The above chart is commonly known as a Babsonchart from Roger Babson. It shows the concept that was explained by Swain. The concept is that the line between the high black areas and the low black areas was designated as a normal line and when the blackened area below the normal line was about equal to the area above the normal line the economy as depicted by the stock market indices was ready to move up again.



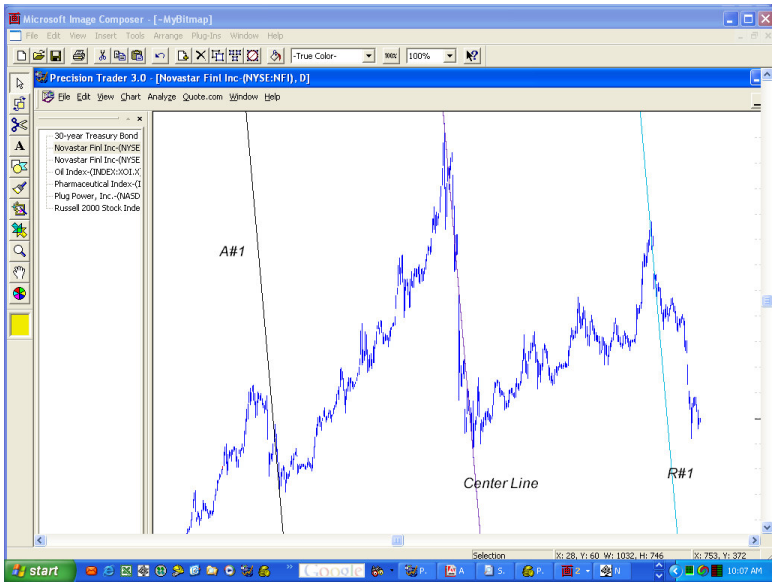
Roger Babson researched this theory and used it to forecast important turns in the market. Speaking at the Annual National Business Conference on September 5, 1929 Roger Babson observed, "Sooner or later a crash is coming, and it may be terrific". JK Gailbraith records: "Babson was not a man who inspired confidence as a prophet in the manner of Irving Fisher or the Harvard Economic Society. As an educator, philosopher, theologian, statistician, forecaster and friend of the law of gravity he has sometimes been thought to have spread himself too thin. The methods by which he reached his conclusions were a problem. They involved a hocus pocus of lines and areas on a chart. Intuition and even mysticism played a part. Those who employed rational, objective and scientific methods failed to foretell the crash. In these matters, as so often in our culture, it is far, far better to be wrong in a respectable way than to be right for the wrong reasons. Wall St was not at a loss as what to do about Babson. It promptly and soundly denounced him."

Babson held that stock market behavior could be accurately forecasted with Newton's Laws of Motion. Babson made so much money applying Newton's Laws that he went to England, where he purchased Newton's belongings and set up a museum in New England.



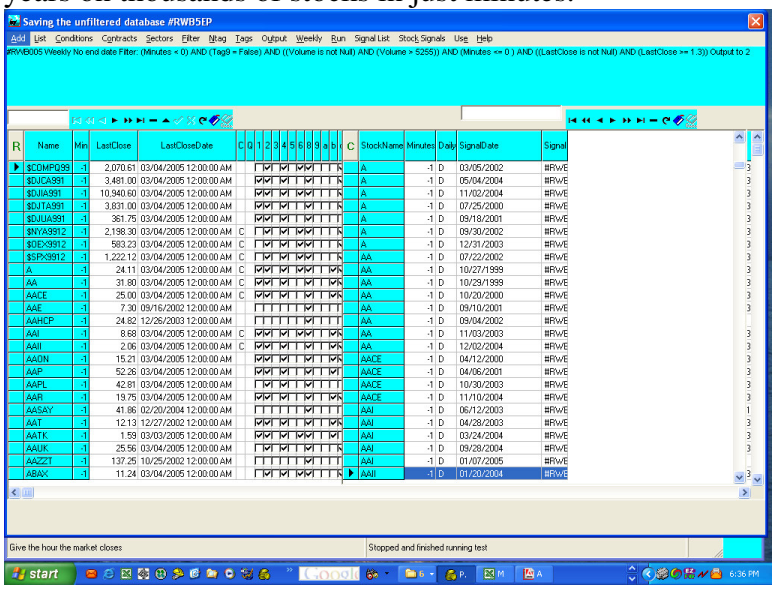
Babson's research into the application of Newtonian Physics led him to find ways that far surpassed the teachings of Professor Swain. Testable criteria were developed for categories of normal lines. One was the peak to low normal line seen in the Gold Index chart above. After drawing the normal or centerline, previous low pivots are noted and a parallel line is drawn at each one of them. Thereafter, the reaction lines mirror the distance from the action points to the Center Line. When a valid centerline is used and valid Action pivots are used the Reaction lines are used to find the location of future pivots as seen above. From a stock analyst point of view Babson found a technique Universal Supply Demand Correlator.

Above is a recent Semiconductor Index chart again showing the accuracy of the Action Reaction Method (without the line labels) as in the gold index chart. The pivots after the validated centerline occurred near the reaction lines. It is the location of the reaction lines that enable the forecasting of where and when.



This even applies to individual stocks, as can be seen above chart of the stock with the symbol NFI. Locations of future reaction points may be verified by triangulation, using various types of center lines some of which may be different time units in the data series. Roger Babson recognized that this was no holy grail of stock trading and noted that there were some cases when the use of standard Action Reaction lines were inappropriate. He wisely developed tools for dealing with those situations.

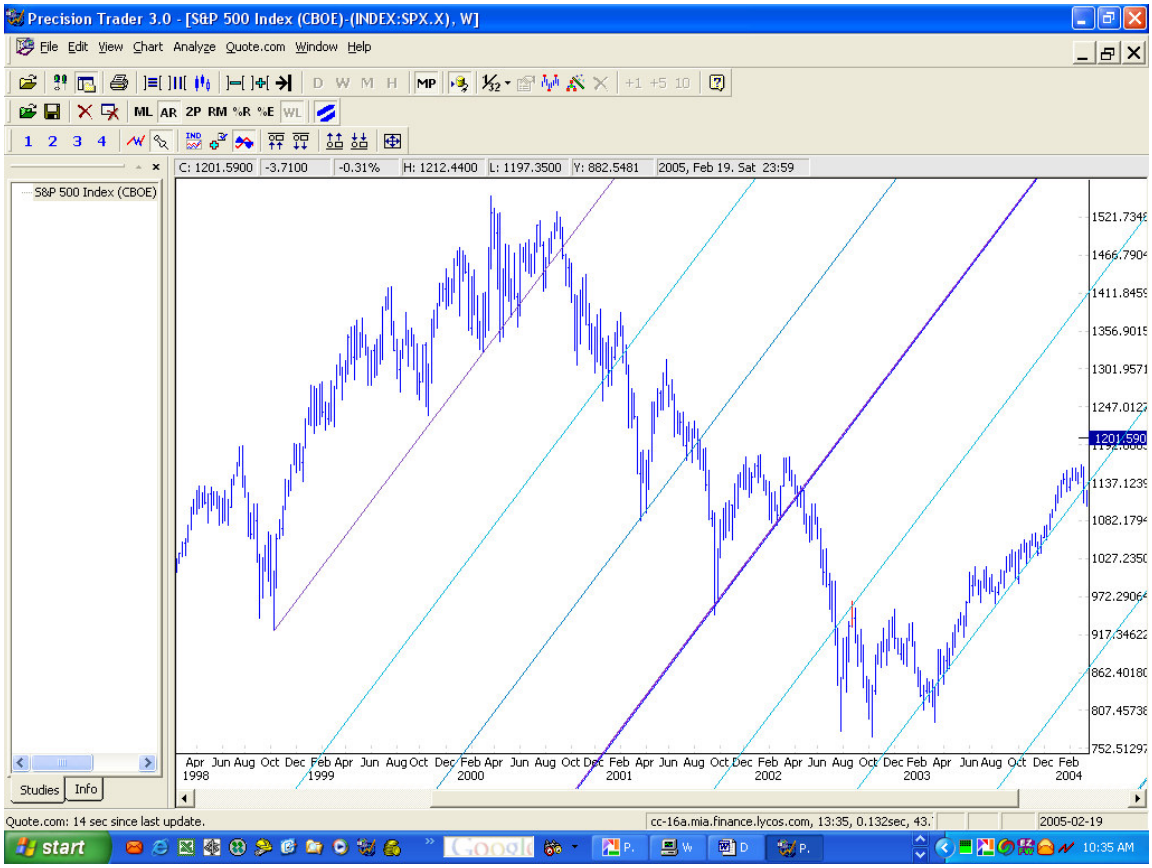
In his research, Roger Babson found that not all moves in the stock market were subject to Newton's Principals. He discovered that some were due to other factors and the high probability turning points could be determined by other means. These were found to be ideal for computer testing. His reasoning was put into computer code and tested over years on thousands of stocks in just minutes.



Above is a computer screen of a multi year test from Roger Ward Babson patterns developed by stockturnfinder.com. On the right you can see a listing of the dates the computer gave an alert of a pattern being complete in a few days in specific stocks. A completed pattern indicates that a reversal lasting several weeks (bars on the chart below) is probable soon.

Above is the weekly bar chart for the stock that is represented in the tests letter A. The arrows (>) on the chart note the dates noted for probable turns using RWB pattern.

Long-term trends provided a special challenge to Babson's Research. His methods were flexible enough to find ends of intermediate term trends that were actually the end of action points by looking at them as reactions of the entire prior move. He accomplished this by developing a set of rules that specify when to use multiples of the same action point for determining multiple future reaction lines. In theory each ladder rung would be the "bounce point" of either high or low pivots.



In the weekly above S&P 500 index graph the top line is the Centerline and each line below it is an equal distant reaction line. The thick line is one that prices bounced off of when the market reopened after September 11, 2001. Above each line represents point where a turning point for several weeks. This is very different from the description of his method that he put forth in his autobiography "Actions and Reactions"

Roger Babson's methods had an extensive rule set that he developed with ways to validate the various lines. In addition to using the methods for determining buy and sell points for his portfolio of stocks and bonds he also taught the rules to small select group.

The Action Reaction pattern correlation methods have their roots at the meetings of the Gravity Research Foundation. It was there, that Roger Babson found an atmosphere that was open to hearing his theories about his methods for finding points in the future where reactions should occur using stock charts as a metaphor. At the first meeting where this material was presented Alan Hall Andrews was present. Alan Andrews was the son in Andrews and Son, an investment advisory firm to the rich and famous of the day.

Prior to his passing, Alan Andrews sent his Gravity Research Foundation notes on the work of Roger Babson along with many other documents to his friend, Dr. Balk. It was Dr. Balk that donated all of his Andrews related memorabilia to what is now the Andrews Memorial Library, near Lake Hodges in California. The library also contains videotapes of live seminars given by Alan Andrews covering the methods. This is the basis for the growing research, in Babson's pattern correlation theory and the development of the universal supply and demand correlator

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