TUTORIALS IN APPLIED TECHNICAL ANALYSIS

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The Australian Internet Trading Weekly with independent analysis

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Note. The more computer icons appearing after a section heading, the more advanced the material

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CAUTIOUS MANAGEMENT

By Daryl Guppy

SUBJECT SUMMARY
TREND VOLATILITY LINE
The trend volatility line (TVL) is an advanced application of the Guppy Multiple Moving Average indicator. It is applied to end-of-day, to intra-day and to scalping. It is used to overcome the limitations of stop loss trade management methods based on price volatility. The developing trend is best managed with a measure of trend volatility. TVL is applied in intra-day trades, and for the transition from intra-day to multi-day trades. The methods also deliver better management of position trades in stocks, derivatives, futures and FX.

We have added no new positions to the case study portfolio because the market is indicating a turn and possible substantial retreat. Under these conditions it is more effective to trade in the same direction as the market rather than try to identify stocks that are moving in a counter direction. Some traders will move to the short side until a strong rebound develops. Our preference is to trade from the long side so the objective is to scan the market for pullback and rebound opportunities.

This is the last newsletter for the 2008-2009 financial year. It has been a difficult year with a bear market in the first 9 months followed by a rapid momentum driven rally. Trading has been challenging, with many whipsaws. Our total realised portfolio return is 97.08%. This means we started the financial year with a nominal $100,000 in the case study portfolio. For much of the year we remained underinvested, using just a portion of the nominal $100,000. Profits banked during this period were $97,080 which gives a 97.08% return. This does not include current profits on open positions of $630.00. Next week we will bring you a complete review of trades over the past 6 months, and an annual review of portfolio performance.

MRM

When the value of the 23 EMA is above $1.68 the 17 EMA is used as the stop loss calculation. When the value of the 23 EMA is above $1.68 traders also calculate the position of the Optimised Trend Volatility Line (OTVL). The OVTL is a method of managing the trader's exposure to the trade trend. The OVTL does not define the trend. The OTVL is a development of the TVL line used for intraday trading and discussed more fully in the GMMA Trend Volatility Management DVD.

The OVTL is not applied until the value of the long term moving average is equal to the entry price for the trade. The OVTL calculation starts from the entry price line at $1.68. A horizontal line is drawn at this level. The horizontal line tells the trader the duration of the stop loss. When the horizontal line crosses the value of the 23 EMA it is time to change the value of the stop loss. A vertical line is placed between the 23 EMA and the 14 EMA. This defines the amplitude of the trend. When the vertical line crosses the 14 EMA a new horizontal line is drawn. This is the value of the new stop loss. This value remains unchanged until the horizontal line crosses the 23 EMA. Then the OTVL calculation is repeated again.

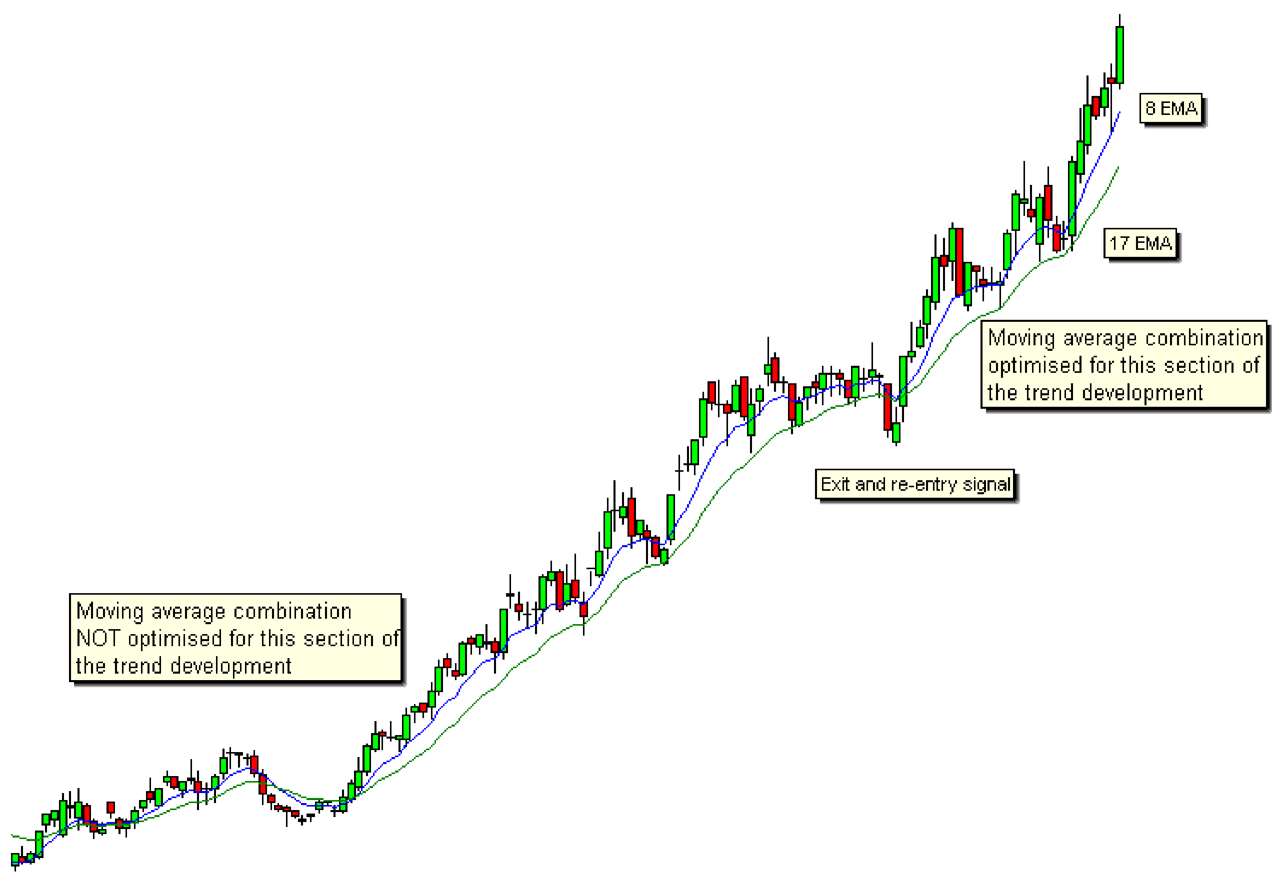
A new OVTL stop loss is created at $1.72.

The optimised moving averages values are 14 EMA and 23 EMA. Initial trade management uses the 14 EMA as a stop loss. This captures the momentum of the trade. The price open below the 14 day EMA is an alert exit signal warning. However the exit signal is a close below the 14 EMA. We will continue to follow this case study trade development and the application of this new method. The OTVL should be applicable next week.

Trade entry is at $1.68 for a position size of 12000 for a cost of $20,160. The stop loss uses the value of the 14 day EMA which was at $1.64 when the entry was made. This put $480.00 at risk, or less than 0.05% of total trading capital.

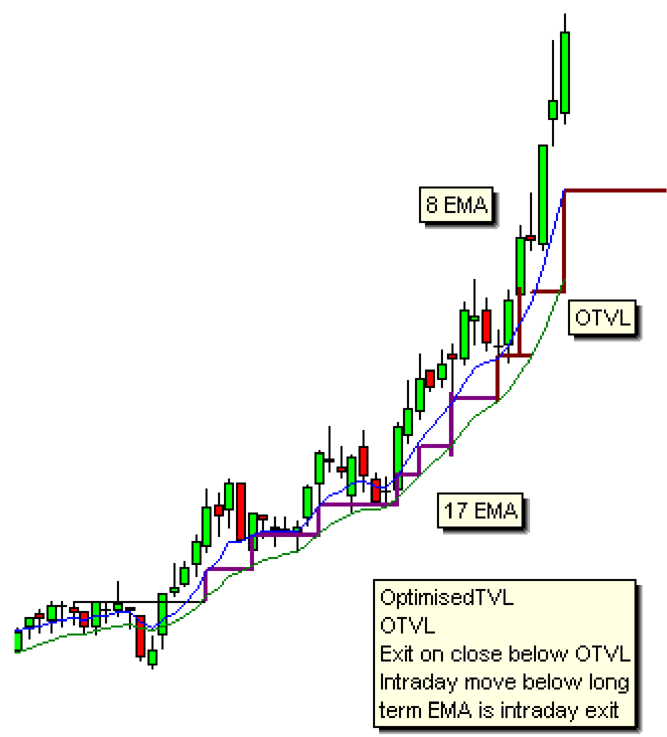
OPTIMISED TREND VOLATILITY LINE

In our China work for sister publications we have been working with a new trade entry and trend management method. We called it the Optimised Trend Volatility Line (OTVL). This trading method involves two processes. It starts with an optimisation of the existing trend. We use a short term, and long term moving average. The objective with the short term EMA is to find the best bit or optimised fit that captures the bulk of price activity in the trend. This is used as the initial stop loss in the trade.



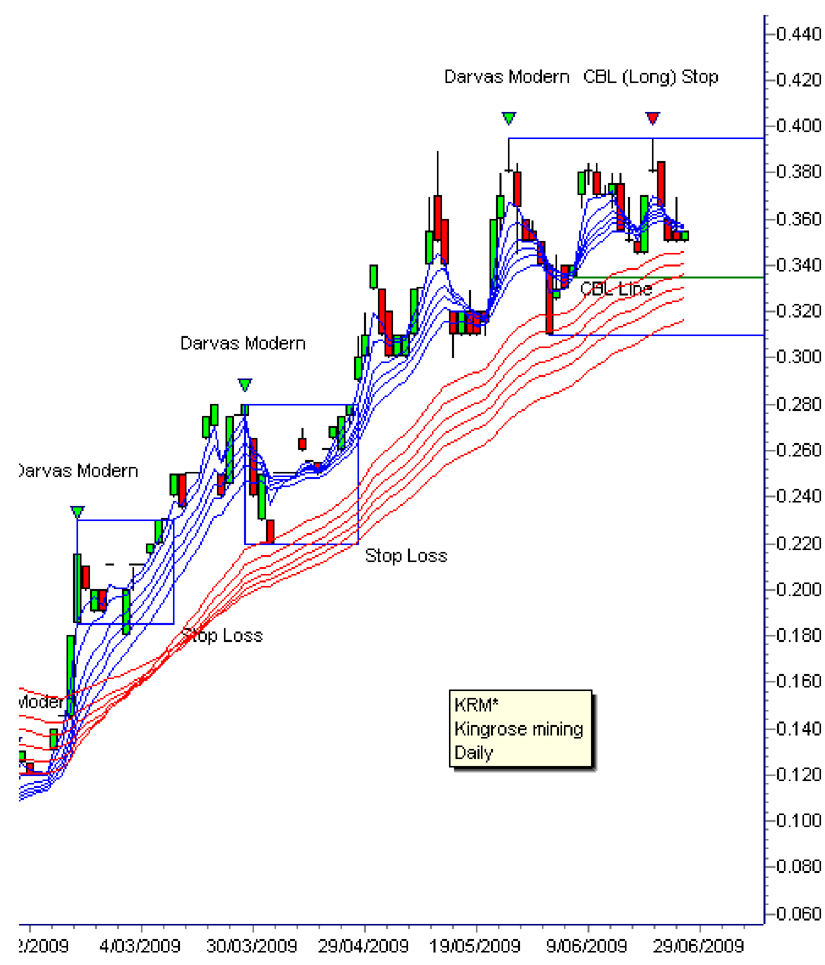
The objective with the second longer term EMA is to define the extremes of the price volatility for the selected period. It's important to apply this only to the developed trend we intend to trade. The optimisation is only relevant to the current trend. It may not be relevant to previous trends. The chart extract shows the way this optimisation is applied. The selection of moving average periods is a judgement call rather than a mathematical solution. This is easy with GTE charting. Simply apply the moving average, and then open the properties box. As you change the value of the moving average the display automatically adjusts. The moving average line slides up or down and it's easy to judge the best fit solution.

The initial trade entry used the optimised short term EMA as a stop loss level. When the value of the longer term EMA is equal to the value of the entry price the management of the trade changes. We apply an OTVL approach. The GMMA TVL as discussed in the newsletter and in the GMMA TVL DVD uses the value of the upper and lower sections of the GMMA to define the trend volatility.



The OTVL uses the value of the optimised short and long term EMA as shown in the diagram. We have found this is an effective method to manage entry and to manage developing trades in increasingly strong momentum driven markets. As with the GMMA TVL, the OTVL does not define the trend. It defines the management of the trend based on the selected entry point.

KRM*



The position of the CBL is adjusted based on the equal high. The CBL stop loss is now at $0.335. There is no other change in the management of this trade. It's simply a waiting game.

The new six month high was created on May 25. The low for the new Darvas box was created on June 1 and confirmed on June 4. The entry is made on June 5 on the day after the Darvas box confirmation is delivered.

We aim to be profitable. In particular traders will look for rebound entry opportunities.

- Trade stocks with price leverage. The KRM example is in this category.
- Trade blue chip stocks which have been sold down.
- Trade the blue chips using a derivative to maximise the return from the rally. The objective is to increase the return from the underlying price movement.
- Trade index behaviour using a CFD. This eliminates stock specific risk and lets the trader concentrate on market risk only.
- Finding strong rebound rally opportunities. The KRM example is in this category.
- Trade defined chart patterns.

Market strength continues and in many cases stocks are making new 6 month highs. This is the time period when Darvas box trading can be applied. When it is applied to stocks making new 3 month highs the Darvas method does not give any particular advantage. Stocks making 6 month and 12 month new highs are more compatible with Darvas method trading and the approach delivers an edge.

Darvas trading can be applied in 3 ways.

- Locate stocks that have just made a new high for the 6 month period. Check to see if this new high is a breakout above an existing Darvas box. We use a modern Darvas box calculation, and we use GTE charting to plot these automatically. If the price is a breakout above an existing Darvas box, then traders may use this as an entry signal. The stop loss is set at the lower edge of the existing Darvas box.
- Locate stocks that are making new highs for the 6 month period and wait until a new Darvas box is confirmed. Enter when price moves above the upper edge of the new Darvas box.
- Locate stocks that are making new highs for the 6 month period and wait until a new Darvas box is confirmed. Enter when a rebound develops from the lower edge of the new Darvas box. This is the method we use in this case study with KRM*.

TRADING BETWEEN THE FLAGS

By Daryl Guppy

SUBJECT SUMMARY

INDEPENDENT ANALYSIS

Trading and investment analysis should be objective. One of the strengths of charting and technical analysis is that it uses an objective set of figures – price activity – which are readily available to everybody interested in the market. How individual traders choose to apply and interpret those techniques is a matter of subjectivity.

The fundamental analysis relies on figures created by the company in annual reports and press releases. He works with figures generated by outsiders, such as auditors and accountants. He also works with figures derived by others for particular purposes. For instance, if the analyst works for a brokerage involved in an IPO launch then the figures are often a little brighter than market reality would suggest. The application of fundamental analysis is a subjective process from the very start because very few of the figures used can be independently verified. Even the balance sheet is a carefully massaged document.

A significant problem for traders and investors who rely on the research and analysis of others is the objectivity of the research, and recommendations. When a research company is being paid for a company to do the work then it is not uncommon for the report to put the best possible gloss on the situation. When a brokerage is preparing a report on a company, and it is also handling trading work for the same company, then the same constraints apply.

One of the advantages of this newsletter is that we are not tied to any company

The latest proposal from the regulator to identify 'between the flags' investment fails the most basics of tests. It simply begs the question by suggesting that between the flag investments include blue chips. Can we assume that blue chips do not include General Motors, General Electric, Bear Stearns, or closer to home, that blue chips exclude Centro, Great Southern on the grounds that their failure shows they really not blue chips after all? Or does blue chip include stocks like the banks with an average peak to low loss from 2007 to 2009 of around 60%?

Investing, so we are

told, is a long term business with a 20 year time span. This means we should be selecting blue chip stocks in 1988 with an eye to seeing strong performance all the way through to 2009. This, of course, is largely garbage. In 1988 I owned a top of the range PC with less computing power than my current mobile phone. The 4.5 inch floppy disk was a dream, let alone a CD. In 1988 we were told that our biggest future challenge would be what we would do with all our spare leisure time because the working week would be 25 hours or less! In 1988 China was still a closed state and economy. Even if you had accurately forecast these developments there were simply not the investment vehicles available to allow you to capitalise on your predictions.

BETWEEN THE FLAGS FAILURE	
1988	1998
20 years	**10 years**
BHP	News Corp
ANZ	AMP
Boral	ANZ
Brambles	BHP
BTR Nylex	Brambles
Colesmyer	Cable & Wireless
Comalco	CBA
CRA	Coca Cola Amatil
CSR	Coles Myer
Elders IXL	Colonial
Goodman Fielder	Fosters
ICI Australia	Lend Lease
MIM	NAB
NAB	National Mutal
News Corp	Rio Tinto
North Broken Hill Peko	Telstra
Pacific Dunlop	Westpac
TNT	WMC
Western Mining	Woodside
Westpac	Woolworths

The table shows the top 20 listed ASX companies in 1988. They are 'between the flags". Those not highlighted still appear in the top 20 companies in 2009. The survival rate is exceptionally low. 15% of 1988 stocks either no longer exist, or have been taken over by companies that are not in the top 20. Any investment holdings in these companies have been diluted in takeovers and restructurings. On a 20 year time frame you have a 85% chance of making a wrong choice.

OK, 20 years is a long time. Perhaps a 10 year blue chip time frame is better. Now there are 45% of companies that survive 10 years in this list. You only have a 55% chance of making the wrong choice.

The suggestion of picking companies just because they are 'between the flags' shows an appalling ignorance of market reality and structure. The market index always rises, but the composition of the index changes. The index rises because it only includes winners - 15% from the 1988 list survive until 2009 - 45% from the 1998 list survive until 2009.

This announcement closely followed an article that boldly discussed how investors could know when good companies go bad. This was several pages of mumbo-jumbo constructed with the benefit of 20/20 hindsight that failed to mention a single chart. Investors know when good companies go bad through watching their price activity which includes the behaviour of investors who really do know when a company is going bad.

The GTP chart shows how this works. The chart from Centro, GM, GE, Beare Stearns and Satyam Computers all have the same characteristics. There are multiple warning signs in the price activity. This is a fire alarm. You run first, and later forensically reconstruct the reasons why the company went bad.

The one essential thing the regulator appears not to be considering is a better distinction between investment advice and investment education. Whilst people are educated by organisations with a vested interest in the students future trading activity then the education will always be questionable and married by self interest.

How to avoid the conflict of interest in market commentary? How do you gather the skills necessary to undertake this task? We suggest there are two ways.

- Charting and technical analysis is not just a way of trading the market. It is also a way to understand what is happening. It is a tool that can be used to verify other types of information produced by analysts using different methods. The purpose of this newsletter is to teach readers how to use these tools more effectively. We do this by examining case studies and highlighting approaches that work, and approaches that do not work.
- Establishing the level of analysts independence. Who pays the analysts wages? What income stream, current or future, do their employers get from the companies being analysed or the product being promoted? Does the employer benefit when readers trade the shares in the companies mentioned? What is the balance of buy and sell recommendations? Do they ever admit a mistake, or do they just quietly forget to ever mention again the stocks that 'bombed'?

There are some very good analysts, and there is some very good research done by those who work for brokerages and other research institutions. These five questions are designed to help you decide if there is a potential conflict of interest and if there is, the extent to which it may 'skew' the analysts report. The answers to these questions are a mandatory disclosure in the US but Australia has never followed this lead.

Here is our disclosure statement for these questions

Who pays their wages?

Our wages are paid by subscribers to the newsletter.

What income stream, current or future, do their employers get from the companies being analysed, including advertising?

None. We do not receive advertising from stocks mentioned in the newsletter. We do not get commissions, pick up back door contracts, or get taken out to lunch.

Does the employer benefit when readers trade the shares in the companies mentioned?

No. There is no commission or brokerage stream, no finder fee, no kickbacks or payment that comes from any trading or investment decisions made by our subscribers.

What is the balance of buy and sell recommendations?

We do not give recommendations. We discuss the tools and techniques that allow readers to make better decisions. We do highlight the technical conditions that generate a buy or sell signal, and we always include risk management analysis to set stop loss sell points.

Do they ever admit a mistake, or do they just quietly forget to ever mention again the stocks that 'bombed'?

Yes. We follow-up up on all the case study examples, including those that 'fail' in the sense that they are closed at a loss. Each 6 months we publish full results of ***all*** the case studies.

Independence is preferable, but not always possible. If you are aware of the potential conflict of interest you can make a better judgement about the quality and intent of the educational material provided. We are one of the very few independent newsletters dedicated to teaching readers the skills necessary to improve their chances of market survival. We value our independence and we believe that readers value this as well.

We believe investor protection comes from independent education backed up by regulation. We believe investor survival comes from trading the changes in trend rather than from blind buy and hold – flags or no flags.

GROUP PSYCHOLOGY AND TRADING part 2

By Gavin Hewitt

SUBJECT SUMMARY

PSYCHOLOGY AND TRADING

The longer you trade the more you come to understand that psychology has a vital part to play in your trading success. Our first understanding of this impact is when we confront fear and greed in an unrestrained fashion. Making more money than we ever dreamed possible for what looks like little work is a heady experience. It has many interesting, and unexpected consequences on our behaviour. Some of them are not very pretty to observe.

Fear becomes an intimate companion when our hard earned cash is gobbled up in a falling market. This is no thrill ride with a guaranteed safe ending like a theme park roller coaster. We react in quite unexpected ways and they are not always pleasant. Greed and fear are the base emotions that trigger psychological reactions. When we move beyond these raw emotions we find that there are many other factors that come into play.

Experienced traders find that success rests as much upon understanding more about themselves and their motivation than it does on understanding the market. For some traders there may be a need to seriously address underlying psychological issues that stop them achieving trading success. These issues are also likely to play a role in their non-trading life. For most traders the issues are less crippling, but still significant.

Recognizing repeated self-defeating behaviours like failing to act on a stop loss, is the first step towards overcoming, changing, or neutralizing these responses. Ignoring them will not make them go away. Everybody has different psychological reactions in detail, but it is useful to examine the broad psychological factors that can inhibit trading success.

Last week we left readers with a diagram and a question. We introduced the idea of group psychology, let's start by asking you to look at a common paradox. Have you ever wondered why people attribute such authority to institutional stock picking services, when these groups rarely beat market indices with their own funds? And yet there are fifty recommendations a day published on internet chat rooms that, by and large, remain ignored. An understanding of group psychology as depicted in Figure 2 helps put these different information sources in perspective. My intention here is only to look at causal factors, not to recommend any particular service.

Which of the three models do you think best represents that of a professional stock picking service?

Clearly diagram 3, the wheel, where the trader public and the stock analysts don't talk freely to each other, but are coordinated through a central information dissemination mechanism. This conveys a massive amount of leadership authority to the centre of the wheel, so it's unsurprising that traders allow themselves to be influenced by it. This structure does not encourage a broad discussion regarding the knowledge held by the centre authority; it is proprietary, and generally just a condensed final recommendation is distributed. This model self-selects its clients, as people who want financial markets simplified are attracted to wheel structures, as we will see later.

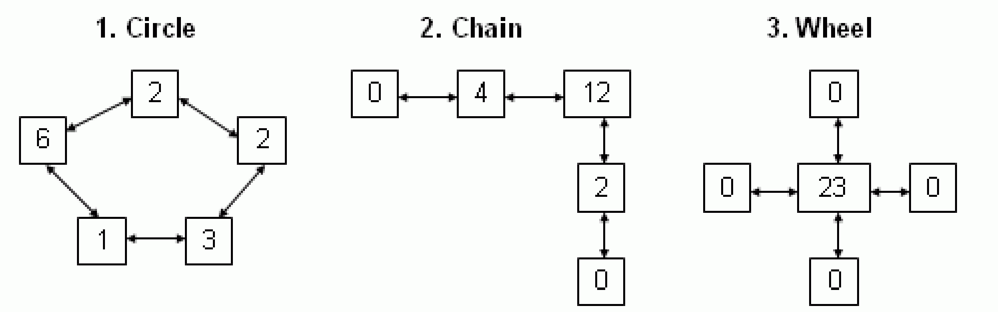


Figure 2: *How communication networks confer leadership authority. In this test participants were given information to be shared between themselves. Squares connected by lines communicate directly with each other. The number in the square represents the number of times participants identified that person as the leader of the group.*

A precise model for an internet chat room is not given, but would be approximated by diagram 1. In this case anyone is free to interact with anyone else, and they apply their own standards to assess leadership and authority. Perhaps people are influenced by the complexity of the indicators used, the writer's claims to success, the length of the internet post, or heck, by the word "megabucks" in their email address. I am not saying one is better than another, but it is interesting how informational structure changes our perception of the information content.

What else does group psychology tell us about trader's conformance to institutional stock recommendations? Conformance is influenced by the following factors:

- Available information. Conformity is increased based on both our belief about how well-informed others are, and how little confidence we have in our own judgement. Professional stock picking services spend a lot of money to ensure they look successful, investing in good business addresses, well-dressed agents, and flash websites. They also provide triumphant claims about the accuracy of previous recommendations. Compared, for example, to Big Boe in the chat room, they inspire confidence. What about our own judgement? Many beginners or lazy traders are confused by the array of choices available in the trading world. They want someone to simplify their choices for them, and so, tragically, the people least adept at determining the value of a tipping service are most attracted to them.
- Fear of deviance. Most people fear being seen as deviant, do not like to stand out, want to be accepted, and feel comfortable as part of a group. Tipping services appeal to people who want to make decisions that they believe will align them to, and allow them to be accepted by, a group they see as important.
- Group unanimity. People faced with unanimous decisions are under great pressure to conform. One study showed that 97% of people agreed with a unanimous decision made by a group when offering an opinion about something subjective. However, only 40% of people agreed with the group if there was even as little as one group dissenter. Stock tippers are unanimous -- they don't give simultaneous buy and sell decisions -- whereas web site discussions often hold numerous dissenting opinions.
- Group size. If two people stood in a cold room and one of them said it was warm, the other would be unlikely to agree with him. However, once the group size extends beyond three or four the perceived honesty and reliability of opinions increase. When a large firm makes a stock tip it is our implicit assumption that the entire firm is backing this recommendation. Hence we are more swayed by a group than by an individual tipster.

Please note that I am not a psychologist but I have ready widely on Social Psychology. So while not providing the definitive answer, I hope that my observations will stimulate some rewarding analysis and investigations of your own. In the next article I will begin to look at how group psychology affects market price movement, and answer some of the questions raised at the beginning of the article.

Gavin Hewitt is a private trader and investment writer. During the period of his returning to Australia from South Africa (where he is sick of getting up at 2:00 a.m. to trade the ASX) he may be contacted at gavhewitt@hotmail.com

RIGHT PLACE, WRONG TIME

By Alexander O'Malley, Staff Writer

TRADING METHODS

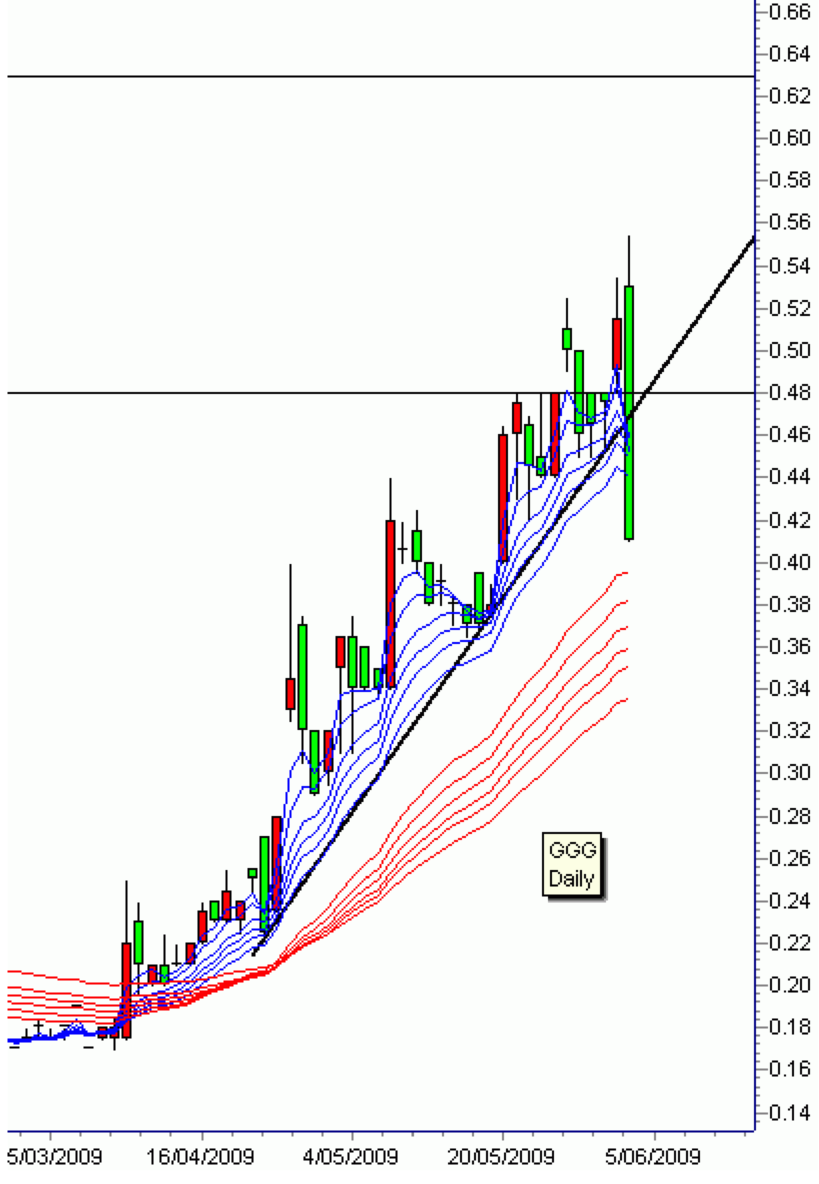
STOP LOSS

A stop loss is a pre-determined exit point. When a trade is first planned the stop loss is designed to protect the trader's capital. The exact price of the stop loss is the result of a relationship between the maximum level of risk as determined by the 2% rule, the logical support levels on the chart, and the amount of capital the trader wants to allocate to the trade. By varying these three figures the trader is able to reach an ideal trading solution that controls risk effectively.

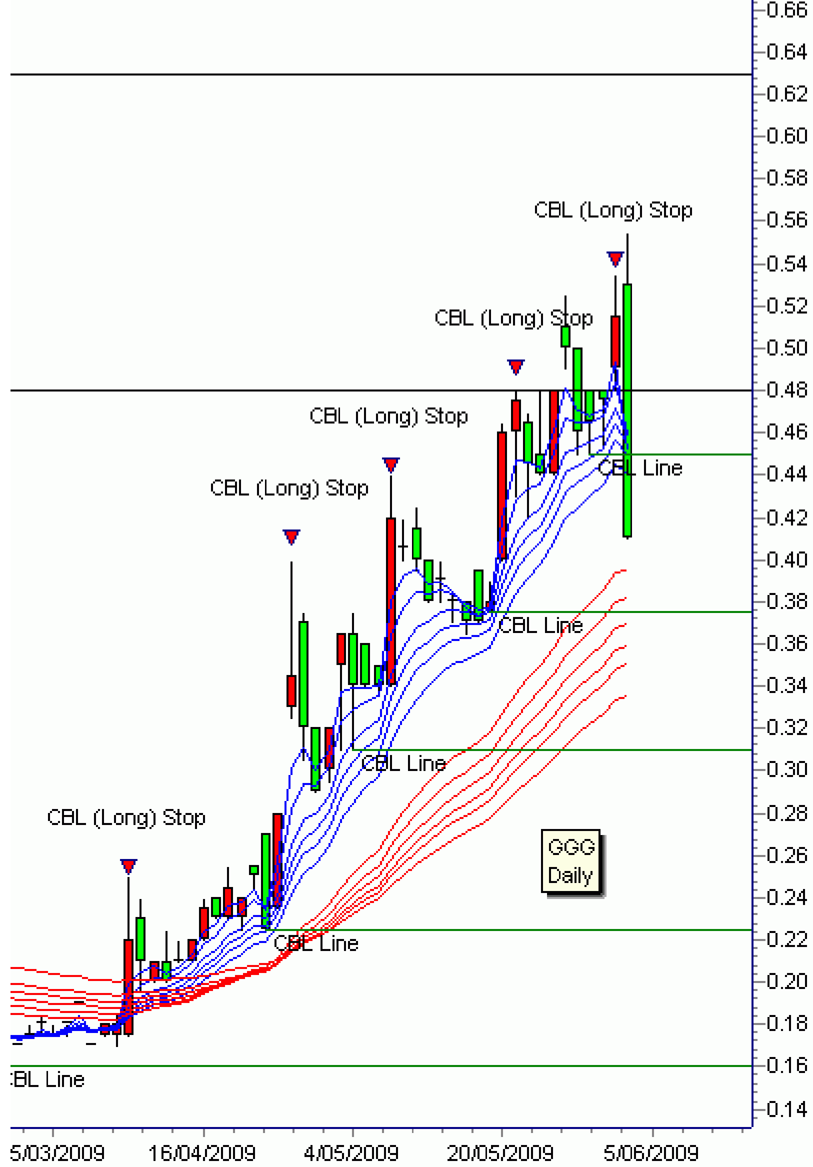
A stop loss order should always be constructed at the same time that any trade is planned or entered. Disciplined stop loss sell orders are the key to long term trading success.

There are many traders who are so confident about their trading methods that they feel it is a waste or a sign of weakness to have a stop loss. Many brokers will charge you to have a stop loss in place and this is an extra cost that eats into profits like brokerage does. It is a cost some people feel is not worth incurring because they have absolute confidence is their trading plan. A stop loss is a trader's way of being prepared for the unexpected.

GGG was a case of right place at the wrong time. GGG has been in a strong uptrend since the beginning of April 2009. A strong momentum day breakout above the long term GMMA followed by a short consolidation. This is classic breakout behaviour and a sign that the breakout is sustainable. As time goes on the trend develops with the short term GMMA group separating showing good short term strength and as the long term GMMA group compresses and turns up GGG is in a genuine uptrend.



GGG recently overcome the first hurdle in this uptrend as it neared historical resistance at $0.48. Price touched this level and finally broke above it. This breakout is what caught my eye when looking for a new trade opportunity. GGG was already in a well established uptrend with good GMMA relationships and a well defined trendline. GGG also had good CBL history giving a reliable way to manage this trade. The move above the $0.48 gave me a good stop loss point as a fall below the $0.48 support level was a clear sign the resistance level though weakened was still in place.

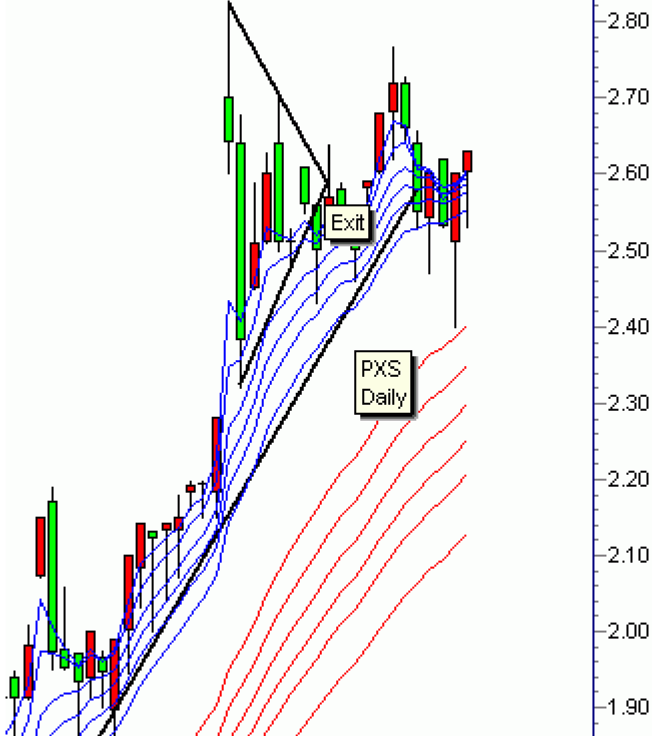


GGG opened at $0.53 and fell back towards the 0.48 support level. When price began to recover I entered this trade at $0.51. When trade entry was confirmed I immediately entered my sell order at the target of $0.62, just below the next historical resistance level. I also entered by contingent stop loss order at $0.48. When I checked on the trade later that morning price had already gone up to $0.55. A tidy 10% profit. In the afternoon however I received an email saying that my stoploss had been activated and my position sold. During the day there had been a news announcement and the stock price had collapsed unexpectedly. GGG closed for the day at $0.41.

If I had not had a stop loss in place I would be sitting on a 25% or more loss in a single day instead of a small 5%. It is because of these types of events where everything pointed in the direction of a good solid trade but something happens and the market reacts, that traders pay that little bit extra for a stop loss. A stop loss is what protects your capital against the unexpected.

But that is not to say that a stop loss is infallible. While holding a trade in PXS price developed into an equilateral triangle. This is a pattern of indecision so I changed my stop loss to capture any price movement below the equilateral triangle. My stop loss was set at $2.52, the value of the lower edge of the triangle and as price moved down my stop loss was not activated. The reason for this was that price gapped below my stop loss. Because price did not trade at my

stop loss level it was not executed and remained in place. Luckily price recovered during the day and my stop loss was hit as price moved higher for the day.



Having a stop loss is not a 100% fool proof way of getting out of a failing trade. Not having a stop loss in place means you do not even have a chance. Even if your stop loss is not triggered it is the safety net that gives traders ease of mind as they go off to work for the day, or allows the trader to enjoy the free time his trading has given him. No one wants to be stuck in front of the computer all day watching a trade and the stop loss gives traders that freedom.

CHINA SECURITY TECHNICAL ANALYSIS AND TRADING PLANS

English edition - Weekly

ALERT! **China has just announced it will allow foreign investors take stakes in its publicly listed firms by buying their tradable A shares according to Xinhua China newsagency. Direct trading will be possible. Avoid paying for expensive mistakes learning how to trade this market. Get the inside edge based on years of experience in trading this market.**

With an established record of China market tracing, RED-K-LINE gives you all you need to know about trading the China market. Extracted from the weekly Chinese 红-K-线 trading newsletter, this is the information Chinese traders rely on for their trading decisions. RED-K-LINE is written by leading trading expert, Daryl Guppy. Every week RED-K-LINE is translated into 红-K-线. With 20 stocks a week and a 75% success rate, it is the leading mainland Chinese language weekly trading publication of its type. Includes Shanghai or Shenzhen market analysis every week.

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All you need to know about trading China markets and how they really work.

TRADING WITH ANDREWS PITCHFORK

By Suniiel Mangwani

> **INDICATOR REVISION**
> **ANDREWS PITCHFORK**
> This looks like a pitchfork with three lines. The starting point in a downtrend is a clear retracement. Point A is the low of the retracement started. Point B is the highest point of the retracement. This line is then bisected by the long term trend line started from a previous high. This is a median trend line that bisects the retracement line. The trend line from the high is plotted exactly in the middle of the AB line. The developing trend is contained within the upper and lower line. Breaks above or below these lines indicate a change in the development of crowd emotion. Patterns by themselves do not.

The Andrews Pitchfork or the Median Line method is basically a method to estimate the trend, and visually calculate a target. It is a study of trendlines consisting of three parallel lines, which give the appearance of a Pitchfork. The method for drawing the Andrews Pitchfork is fairly simple. In a downtrend you need to wait for a decent retracement. Point A will be the lowest low before the retracement started and Point B will be the highest point of that retracement. Once you have these two points, you then look for a major high to use as Point C. You then draw a trendline from Point C exactly in the middle of the AB line. In other words, it bisects the AB line.

As we can see in the chart, GBP/USD has been in a downtrend and in the process makes a retracement, which we label as point A to point B. We connect the points A and B with a trendline. We then look for a major high before the retracement, to complete our third point of the Pitchfork, which we label as point C. We draw a trendline originating from point C, which goes exactly through the centre of AB. This is the important line, also known as the median line. We then draw 2 parallel lines to this, from points A and B. This completes the Pitchfork. According to Andrews, the purpose of the median line is to determine the trend. The most important part of this concept is that prices typically make it to the median line 80% of the time. Prices typically head in the direction of the median line and in a strong market touch the far parallel line. That by itself is a powerful factor, that you can visually see where prices would most likely go.

But any effective concept is not complete without defining the points of entry and exit, and following money management principles. We will add two more trendlines to the basic concept of the Andrews Pitchfork, which will help us define our entry and exit for a trade.

First we draw a line connecting points C and B extended forward. This we will label as the Upper Trigger line or our Line of Resistance. The concept is that, so long as price stays beneath this line, the downtrend is in place. In fact, usually price comes back to test this line of resistance and fails to penetrate it. This makes it even more effective as a resistance level. So we place our stops above this line.

Now we need a proper entry point. Even though the trend is in place, prices do tend to whipsaw back and forth as mentioned earlier, if only to test the resistance level. So we draw a line connecting the lows of all the bars between points A and B. This is our Entry Trigger line, shown as line AD in the chart. When price breaks this line, we get the confirmation of our entry. This is because the line forms a minor support level, and price generally breaks it with sufficient momentum, making it the safest point to enter.

So now that we have the entry and stop defined precisely, we need to manage the trade. Trading 10 lots in this example, I closed 5 lots when price touched the central median line, and moved the stop to breakeven to the entry point. I then closed 3 lots when price touched the lower median line, which defined the range of the trade, and moved the stop to the central median line. I now had 2 lots riding in profit, which were also closed for a profit when price started retracing, and hit the upper median line. It can be seen that prices started rallying up, and a change in trend was signified, when price broke our original line of resistance – the upper trigger line.

So by using these simple additions to the original concept, we can manage our trades visually from the charts.

CHART BRIEFS: ROC OIL COMPANY – (ROC)

By Petra Rak

INDICATOR REVISION

SAUCER BOTTOMS

The saucer or rounding bottom is a long term chart pattern. It is a very strong reversal signal. The shape of the bottom is best described with an arc rather than with a single trend line. The pattern develops over weeks or months. It is not a short term pattern. There are two price projection methods. The first is the height of the saucer. This is projected upwards to set the targets. Less reliable, but still useful, is the width of the saucer. When this is projected upwards it gives indicative price targets. Confirm this with a point and figure count based on the same pattern. These are much more accurate.

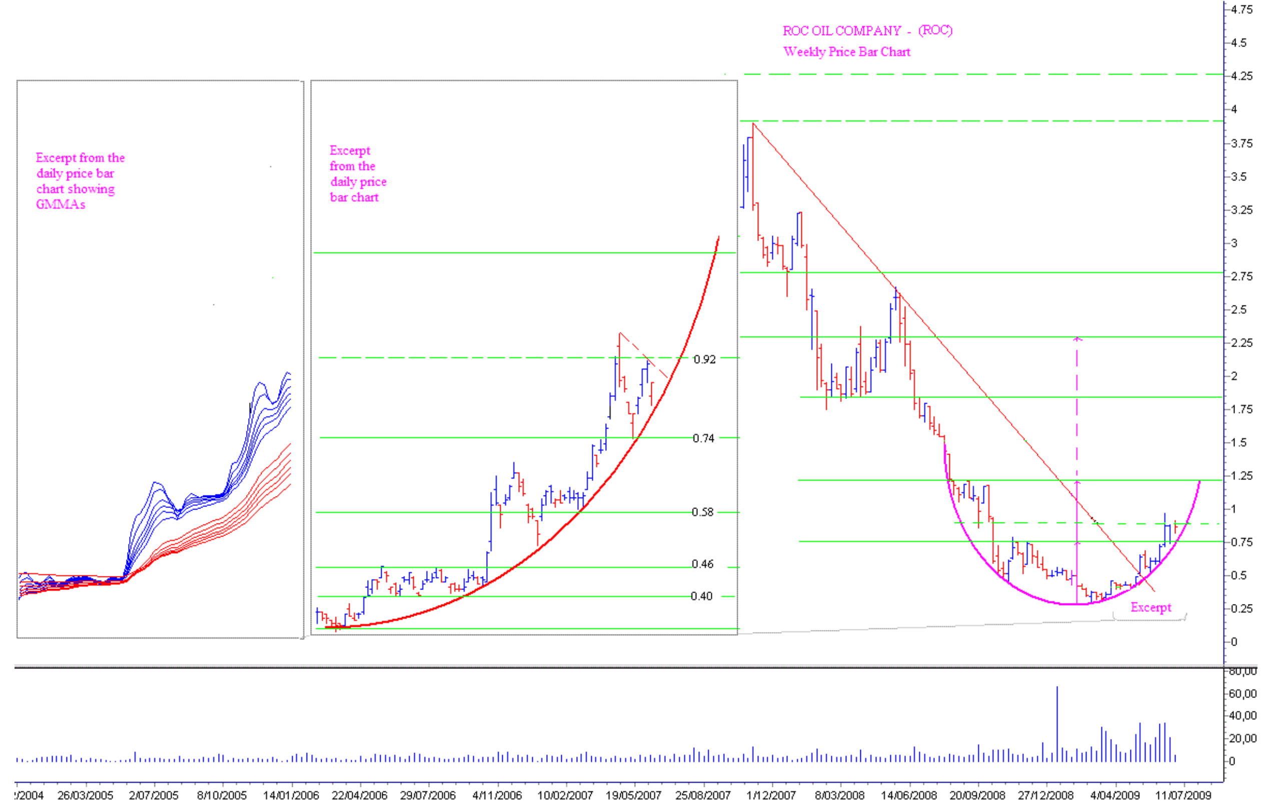
A common feature of the saucer pattern is the development of a handle on the right hand side. This is similar to the cup and handle short term pattern. This handle - a sideways consolidation movement - is a very bullish signal and provides very good entry opportunities.

The weekly chart of ROC shows a bullish trend reversal from a long-term downtrend, which is developing in the shape of a rounded bottom pattern.

In detail, the long-term downtrend started to decelerate around September last year, and bottomed out in late February at

$0.29. Prices then very gradually commenced a recovery, initially in the form of an extended consolidation between $0.40 and $0.46. This consolidation continued until May, when a rally through the channel roof ended the consolidation and also delivered a breakout above the long-term downward trendline on the weekly chart. The subsequent gradual acceleration of the reversal through rallies separated by consolidations has defined the upward curve of the rounded bottom pattern.

Early this month prices broke through the estimated mid-point pattern resistance around $0.74, and have since risen to a high around $0.92 before softening into an equilateral triangle and closing just above the rounded bottom trendline on the last day shown on the daily chart, around $0.86.



UP CONDITIONS

The uptrend remains valid, defined by the gradually accelerating (parabolic) rounded bottom trendline. The GMMAs confirm this, and indicate that the reversal has now matured into a typical uptrend pattern with a well spread long-term group moving below the short-term group and signalling good support from investors.

In the short-term, potential opportunities to enter into the accelerating uptrend require reconfirmation of the parabolic trendline through a rebound, which would also deliver an upside breakout from the short-term equilateral triangle on the daily chart. (Entry in anticipation of such a reconfirmation carries a high risk, given the uncertainty signalled by the equilateral triangle). Hence, the coming days will be critical as prices are very close to the parabolic trendline and so will shortly confirm either a fall through the trendline (and exit from any existing trades), or a rebound and potential opportunity. The short-term equilateral triangle can be applied as a very useful indicator of direction, as an upside or downside triangle breakout is a much more precise signal compared to attempting to precisely define the placement of a rounded curve which is subject to far greater interpretation.

Confirmation of the rounded bottom pattern through a rebound will set up a potential opportunity, with indicative targets initially at the $1.20 pattern lip (where a cup shaped consolidation may develop), and above this the historical resistance around $1.85. In the long-term, the full rounded bottom pattern depth suggests an indicative target around $2.30. Of course these targets are indicative and high level only, and any trades need to be managed daily based on shorter-term indicators, including support and resistance levels on the daily chart.

DOWN CONDITIONS

As noted above, a downside breakout from the short-term equilateral triangle will likely confirm the failure of the parabolic trendline and by extension the rounded bottom pattern (noting again that defining a rounded bottom with precision is subject to interpretation, so precise confirmation of pattern failure is often difficult).

Ongoing weakness back below the old long-term downward trendline, and especially below the downtrend lows around $0.29, will signal a return to downtrend conditions. Conversely, a rebound from underlying support levels will set up a potential reversal continuation and associated opportunities.

CNBC – GREEN SHOOTS OR BAMBOO SHOOTS?

By Daryl Guppy

SUBJECT SUMMARY

CHART NOTES

Each week we provide CNBC-OnLine with analysis of a selected chart, index or commodity. We reprint the original unexpurgated version of analysis for newsletter readers.

The warrior King Macbeth asks the three witches to “"look into the seeds of time, and say which grain will grow, and which will not"” Four centuries later he could be asking the same question about the recovery from the global financial crisis. Are the green shoots of growth about to be nipped in the bud, or will they be smothered by fast growing bamboo shoots? Chart analysis provides one method to assess the viability of the green shoots and the bamboo shoots.

The key point of analysis is the character and the nature of the trend. The character of the trend relates to the volatility of index behaviour. Is the trend stable, or is it dominated by waves of increasing volatility? The nature of the trend examines the structure of the trend reversal and its foundations.

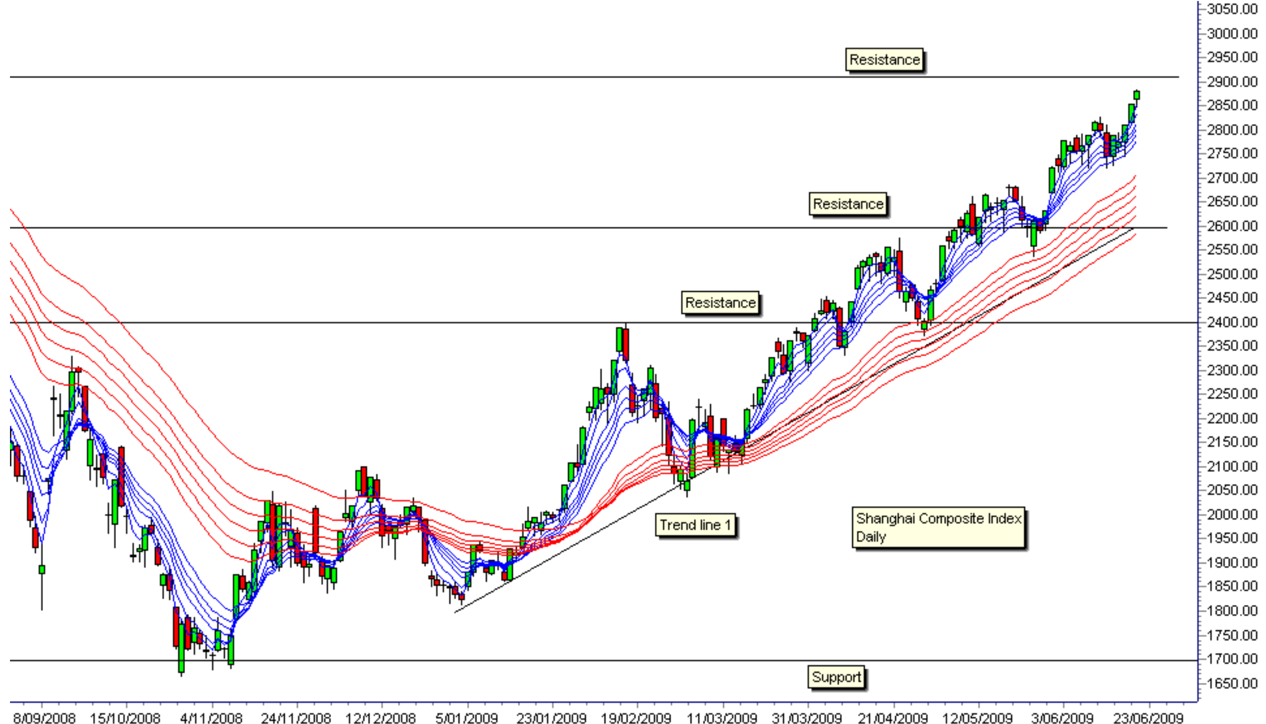
Green shoots are planted in American soil and we use the broader S&P 500 index to assess the growth. We start with the nature of the trend change and observe some weakness in the foundation. The trend reversal did not start from a solid support area near 800. The rebound starts from near 660. This was a minor resistance area in 1996, so it seems unusual for it to act as a significant rebound support area in 2009.

The long term downtrend line has been broken but the index is now moving back to this level and using it as a support point. It’s a slippery downwards slope that may provide an unsure footing for a strong rebound.

The most significant resistance area is near 1060 and until this area is overcome the trend is treated with caution.

The character of the trend is defined with the GMMA. The most important feature is the behaviour of the red long term GMMA. The degree of separation indicates the strength of investor support for the developing trend. The expansion has been slow to develop. In the short term traders look for a convincing rebound from the long term GMMA and a move above 960. This emerging trend cannot be convincingly defined with a up trend line. This means it is difficult to decide which pullback signals an uptrend failure, and which is consistent with a continuation of the uptrend.

These green shoots need intensive care and sustained nurturing before they develop good strength.



Bamboo shoots are planted in Chinese soil and the Shanghai index 70% march towards 3000 is very different from the behaviour of the S&P. This trend has a more vigorous and robust character. The downtrend was tested and retested several times in late 2008 before a successful breakout developed. The breakout has then successfully tested and retested the new uptrend three times in 2009. In each case the long term GMMA has absorbed the sell-off and provided a foundation for a strong rebound. The long term GMMA did not compress and it showed increasing investor support for the developing trend. The long term GMMA quickly moved to a broad and consistent separation.

The nature of the trend development is also more secure. This is a step and stair pattern with a smooth progression between support and resistance levels. The trend reversal developed from a well established historical support and resistance level. Although not shown on this chart, the breakout developed from a series of fan trend lines. This is a pattern associated with long term and sustainable trend change. The foundation nature of this trend change is different to the nature of the trend change with the S&P 500.

These bamboo shoots are a better example of sustainable trend recovery. They include features which need to develop in the S&P 500 before we can say with confidence that the green shoots will survive.

Macbeth asked a difficult question and the answer from the witches was elliptical. The answers from the chart are more clear cut, but as Macbeth discovered, the future is what we make of it.

METAL BRIEFS – NICKEL, LME

By Daryl Guppy

SUBJECT SUMMARY
METAL NOTES
Each week we provide Reuters newswires with analysis of metal trading on the London Metals Exchange. We reprint this analysis for newsletter readers.

The retreat found support near 14,500 as expected. The long term support near 13,500 was not tested. This is a strong and sustainable uptrend and the rebound will test previous highs near 16,000. Traders continue to watch for consolidation and a retreat from resistance near 17,000.

NEWSLETTER OUTLOOK – WATCH JULY 16

By Daryl Guppy

SUBJECT SUMMARY
XJO INDEX
We use the S&P ASX 200, or XJO, in these notes because this is the benchmark index followed by fund managers and institutions. The All Ordinaries is a popular headline figure, but it is the XJO that underpins professional assessment of the market.

July 16 is the most critical date for the XJO. This is the date when the downtrend line intersects with the horizontal support line. This is essentially a very long down sloping triangle. There are three possible reactions to this chart point.

The first is a successful breakout above the trend line. This is the most bullish outcome because its shows that support has been successful near 3800. (Notice how irrelevant the media driven 4000 level is when it comes to chart analysis) This breakout is only confirmed if it is able to move above 4100.

The second is a continuation of the downward triangle pressure with a failure of support near 3800. Failure here sets a retest of the March lows near 3100. It is a significantly bearish outcome.

The third is just a simple drifting sideways into the future with the market locked in a drift between 3800 and 4000. This is the least probable outcome.

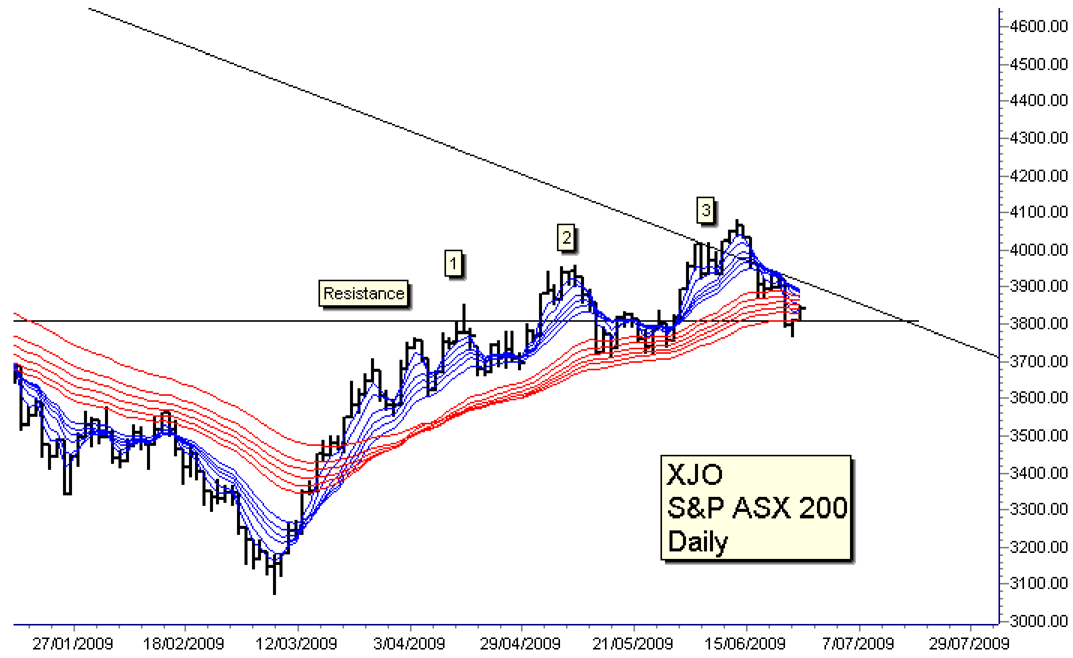
This XJO now has several support or resistance levels. The first is the value of the long term trend line. The second is support near 3800. This is the most important technical support level. The third support feature is the long term GMMA. The lower edge of this is now slightly above 3800 support.

The breakout also provides the first weekly close above the value of the head and shoulder neckline projection seen on the weekly chart.

This does not mean we will not have pullbacks and retreats. However it puts these retreats into the context of a more sustainable uptrend. The broader analysis is reprinted below.

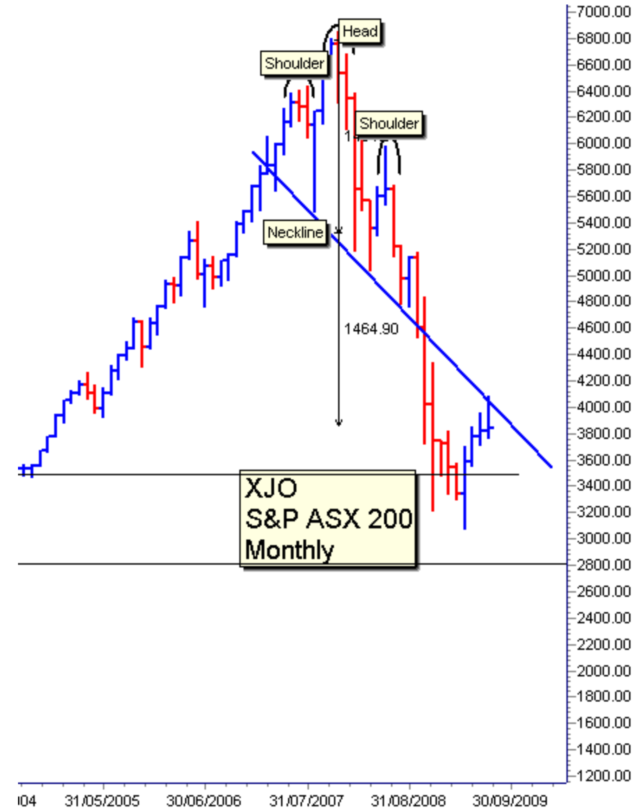
The retreat from 4000 confirms a series of higher rally highs and this is bullish. The successful test of support provided by the long term GMMA is also a bullish outcome. To a

significant degree, the long term GMMA did not compress during this test and this shows increasing investor support for the new trend development.



There are three developments which will confirm continuing trend strength. They are:

- A successful test and rebound from the long term GMMA. This is an indication of trend strength rather than rally strength. This has not yet developed .
- A retest of and breakout above resistance near 3750 to 3800. This retesting shows increasing rally strength. It is bullish and suggests the potential for the rally to develop into a sustainable trend. This may develop.
- The reaction of the long term GMMA to the retest of support near 3800. Expansion shows that investors are coming into the market as buyers. Compression is a leading indicator of trend weakness. Some compression is developing.



On a longer term perspective on the weekly chart we see the index has failed to sustain the move above the long term downtrend. The weekly close above this level would confirm the start of a new bullish trend.

Each week we make a choice about the material we include and the subjects we cover. The selection is based on our outlook for the current and coming market. Our objective is to illustrate effective trading strategies that readers can apply to current market conditions. We do not identify recommended individual stocks. We identify opportunities and appropriate trading methods for them. Our outlook is not a forecast. It is a probability framework. Use it as just one part of the other information you are reading about the market. Our summary outlook will be included each week.

NEWSLETTER NOTES

IS THE NEWSLETTER TAX DEDUCTIBLE?

It is that time of the year again, and the ATO has warned people against the flush of tax driven schemes that appear in the financial newspapers. This newsletter is not a tax scheme. We understand it is a legitimate expense for readers who are trading the market or managing their investments. We are not taxation consultants, but in a broad sense we understand that costs associated with earning an income are normally tax deductible.

For traders and investors this includes the cost of market newsletters, books about trading and investing, and other research and analytical reports that are relevant to the market or stocks that you trade. Some educational workshops and seminars are also tax deductible under certain circumstances.

When it comes time to prepare your tax return you should include our invoice/receipt for the newsletter. It is GST compliant. Your accountant will give you qualified advice on which parts of your expenditure on the market, market training, and market education are tax deductible.

We do encourage readers to think of the newsletter as an asset that helps you to improve your trading knowledge and skills. If it is also a tax deduction then treat this as an additional bonus, but please, not as a primary reason for subscribing.

CASE STUDY TRADE CONTINUITY

A new reader asked how he could follow the gist of what was being discussed in some articles, especially if the article was a continuation from a previous week. Many of our case study trades last for several weeks. We always give readers the date of the original issue where the trade was first featured. If you are particularly interested we can send you the original newsletter. Each week we also provide a summary of the original trade conditions so that new readers have some background. The new updated notes are shown in blue each week.

We regularly feature new case study trades, so readers soon get to follow case study trades from beginning to end. Case study trades are a mixture. Some are intra-day trades. Others last for 2 to 3 weeks. Some examples remain open for several months. Each is designed to illustrate a particular set of trading tactics or techniques.

We receive many articles which are too long for the newsletter. Printed in their entirety they would take half or more of the newsletter space. We run these as 2 to 6 part articles spread over several weeks. This ensures the newsletter covers a variety of topics each week. If you are particularly interested in the preceding articles in a series then just email us requesting the first part of the article. Full back issues in six month or yearly bundles are also available.

The newsletter is not a set of lessons with a beginning and an end. It is an ongoing examination of the market. Many themes, such as stop loss and trading discipline, are regular features so new readers will get a full coverage of how these trading techniques are used in current markets. We do not give stock tips. Tips are for waiters, but if you want to own the restaurant you need to know how to manage a business. This newsletter is for those who want to manage the business. A successful business constantly examines new techniques to keep abreast of the market. This is the function of the newsletter.

CHINA TRADING

CMC markets includes many Hong Kong Listed Red Chip CFDs. These are stocks that are jointly listed in China and Hong Kong. This provides one way for foreigners to trade the growth of China markets. It could cost traders thousands of dollars to learn how to trade the Chinese market. We provide a short-cut on the learning curve with an English language version of our trade advisory weekly.

Each issue covers around 20 to 30 stocks each week, but does not include some of the fundamental commentary included in the Chinese language edition. Red-K-Line includes Shanghai or Shenzhen Index analysis every week which is not included in the Chinese language edition.

- Red-K-Line is essential reading for traders interested in understanding how China trading is different from trading in Western financial markets.
- Red-K-Line teaches you which strategies work in Chinese markets.
- Red-K-Line is essential for expats who are interested in trading the China market.
- Red-K-Line is essential reading for those who want to be ready to participate in China market trading when the market opens

Red-K-Line is the most successful China market trading weekly publication available in English.

Full newsletter details are available on www.guppytraders.com/RKLChina Email chinaorders@guppytraders.com for a free sample copy of Red-K-Line, English version.

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Want to co-ordinate your trading?	The 36 Strategies of the Chinese for Financial Traders	Beginner to experienced
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Want to know more about charts?	Chart Trading	Beginner to experienced
Want to know more about tactics?	Trading Tactics	Beginner to experienced
Want to improve your trading results?	Better Trading	Experienced to professional
Want to master simple but powerful techniques?	Trend Trading	Beginner to experienced
Want to understand short term trading?	Snapshot Trading	Experienced to professional
Want to survive difficult markets?	Bear Trading	Beginner to experienced

PORTFOLIO CASE STUDIES – MONEY MANAGEMENT

Starting cash position $100,000 - no brokerage or slippage 2% of risk = $2,000

NOTE Entered date is the ***newsletter date*** which contains the case study discussion.

Stock	Price	Qty	Pur Value	Close	Cur Val
	$0.590	34,000	$ 20,060	$ 1.000	$ 34,000
		Newsletter date	22-Aug	Open Profit	13,940.00
				Dividend	0.00
				profit	13,940.00
				Percentage	69.49

Stock	Price	Qty	Pur Value	Close	Cur Val
KRM*	$0.370	54,000	$ 19,980	$ 0.355	$ 19,170
Darvas		Newsletter date	8-May	Open Profit	-810.00
				Percentage	-4.05

Stock	Price	Qty	Pur Value	Close	Cur Val
MRM	$1.680	12,000	$ 20,160	$ 1.800	$ 21,600
OTVL trend		Newsletter date	12-Jun	Open Profit	1,440.00
				Percentage	7.14

Overall profit to date since July 1, 2008 = $97,080 or 97.08% return on trade equity.

Profit 2007/08 = 116.7% return on trade equity. Profit 2006/07 = 106.7% return on trade equity.

Profit 2005/06 = 94.2% return on trade equity. Profit 2004/05 = 104.3% return on trade equity.

Profit 2003/04 = 48.7% return on trade equity. Profit 2002/03 = 75.9% return on trade equity.

Profit 2001/02 = 71.3% return on trade equity. Profit 2000/01 = 59.2% return on trade equity.

Profit 99/00 = 111.2% return on trade equity. Profit 98/99 = 102% return on trade equity.

Profit 97/98 = 94% return on trade equity. Profit 96/97 = 66.5% return on trade equity.

Direct investing in the stock market can result in financial loss. Historical results are no guarantee of future returns. Results reflect absolute trading stop loss discipline. Case study trades are monitored and managed in real time and management reports are delivered every week in the newsletter. Except where noted, all case study trades and notional examples using reasonably attainable entry and exit points.

Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have over or under compensated for impact, if any, of certain market factors, such as lack of liquidity. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. Full trade summaries, with charts, are provided every six months.

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