



COLIN NICHOLSON

Building wealth through shares

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Email Newsletter No 11

This email newsletter is published free from time to time to people who have previously contacted me about technical analysis and trading. If you would prefer not to receive it again, please let me know.

I do not allow anyone else to use my list.

If you have friends who you think would like to receive the newsletter, please feel free to email it on to them and invite them to contact me to add their address to the list.

Time has simply flown by since the last Newsletter. I have been incredibly busy building up the web site, writing and travelling.

I have also been busy with the two technical analysis subjects offered by the Securities Institute of Australia and the Australian Technical Analysts Association. It is time to start thinking about them for second semester 2001, which starts in July. The new brochures should be on www.ataa.com.au in the next two weeks.

Web Site

Please visit my web site, which was launched between Christmas and New Year. It has grown enormously since then. The web site is designed to be a service to traders and investors. There is a great deal of useful information available. The address is www.bwts.com.au. Back copies of the newsletters are available on the web site.

You Must Know What You are Doing

There is an old saying in the finance industry "never invest in anything you don't understand". This should be extended to include not investing or trading through any medium if you do not understand its rules. This was brought home to me a couple of months ago, when a good friend sent me this message:

I wanted to mention an experience I have had with Etrade in case you have not heard of it and which may become important in volatile markets. It seems that an "at market" order cannot be executed if it involves a transaction further than 3 cents (in securities between 50cents and \$100) from the last trade. Furthermore even a limit trade will not be executed if it is further than 10 cents from the last trade. The implication in fast moving markets, especially with higher priced stocks is obvious.

Now, I trade mainly on the telephone, but because I am travelling a lot this year I have set up an Internet trading account with my broker Andrew West & Co. It seemed to me that this was something I should follow up further. Conversation with several friends revealed that this matter was unknown to them, so I thought it would be interesting to many of my readers.

First, I fired off an email to Etrade, since I would not wish to publish anything about them without ascertaining their side of the story. I also examined my own broker's site on the same matter. I did not find an answer, so I fired off a query to them also. Since my broker replied immediately and Etrade took some days longer (why I use my broker – the service), I will deal with my broker's situation first.

Colin to Andrew West & Co:

I have my own web site now part of it is a service where I field questions. Also I publish a free email newsletter. There has been lively discussion about Internet broking. One recent contribution from a very good trader is:

(I inserted the above message)

I am going to alert people to the need to understand the terms on which their broker accepts orders and to make sure those terms suit their trading needs, as ETrade's obviously do not for this fellow. It seems unbelievable to me, but I will verify it with them before I publish.

Then I thought I should take my own advice. So I went to your web site to check your terms. There did not seem to be any limits of this kind. Would you please confirm this is so? My particular interest is that I will be overseas for two and a half months and will trade on the net. I want to be sure it works as I think it does.

Andrew West &Co to Colin:

I hope you don't mind if I provide you with some background. The principles of how brokers should deal with orders is set out in Corporations Law and ASX Business Rules. As you would know brokers have an obligation to provide an orderly market and detect and stop market-rigging practices. This includes orders that increase, decrease or stabilise the price of securities.

You may think that every order will in effect do this, however the ASX requires we look at the "intention" behind each order. For instance, if a client places three separate orders in the same stock at the same price, you might wonder why. Other examples could be: placing a number of orders on the buy (or sell) side, just outside the market price at various levels which have the effect of making the stock look strong (or weak); placing orders on both sides to stabilise the price; making a trade 5 minutes before the close of the market, at the end of a quarter, in an illiquid stock that is substantially above the last sale (guaranteed ASX investigation!).

Another requirement, which is more specific to your enquiry, is that the sale should reflect the recent history of trades in that stock. Of course in a volatile market this is extremely difficult to police and this is where the differences between the Straight Through Processing engines emerge.

Certainly it is tempting to just look at the last sale of a stock when assessing whether an order is suitable to go onto the market. The problem arises, of course, when there is no sale for quite some time and the last sale no longer reflects the market. Our engine is better informed in that it looks at the highest bid and offer price, and the last sale. With some smarts in the system it eliminates one of these prices to come up with a "market", what we call the Highest Bid Price (HBP) or Lowest Offer Price (LOP), to base its calculations on.

A ratio is then applied to determine if the order is in the suitable range. What in effect you get is a risk engine, which tracks the market rather than just the last sale. However, during market hours there is one overriding rule: ***we currently do not allow buy orders that over-bid the highest offer by 2 price bids, or sell orders that under-offer the highest bid by 2 price bids.*** (not cents!).

In pre-open we ignore this rule and the ratio operates both ways to allow an overlapping market.

If we look at a market of say, Example Ltd: Market status is OPEN

Buyers	Qty	Price	Price	Qty	Sellers	Last Sale	5.00	Hi	5.00
1	1000	5.00	5.01	1000	1				
1	3000	4.99	5.02	1000	2				
2	5000	4.98	5.03	2000	2				
1	4000	4.97	5.04	3000	2				

A client wants to buy 5,000 shares. He looks at the market and thinks to get 5,000 he needs to pay up to 5.04. The system will stop him and refer the order to a DTR at 5.03, which is two price bids above the offer price. This doesn't look so bad and the DTR will probably allow it.

But can you imagine if we didn't have the rule and the order was to buy 20,000 up to 5.20! The client will have paid up to 5.20 and sure as anything the next sale would be 5.00. Good morning ASX Market Control, goodbye client!

(This is disclosed in the help panel when buying and selling). This is our interpretation of the rule that says the sale should reflect recent trading history and is an additional check against market rigging. This rule is not enforced during pre-open although our other rules are (it would not be a reflection of an orderly market if in pre-open someone put in a bid at \$100 on a stock which looks to be opening at 5 cents).

Our system has four ways of dealing with orders.

- The first way is to accept the order and place it on the market;
- The second is to place it on the market and alert the Designated Trading Representative (DTR). This means that the system, through its checks, has found the order questionable and suggests further investigation;
- Thirdly, divert the order to a DTR. This is how exceptions to the above rules are currently handled. The DTR can over-ride the system if need be.
- Lastly the order can be rejected outright - this can happen in extreme circumstances.

The system is constantly being fine-tuned and may get only one or two problem orders a day. I think the industry as a whole can do more education-wise and we will be doing this shortly. The topic is obviously a very large one with just the market-checking module making perhaps a dozen checks. I would be happy to go further into it if you need to.

Colin to Andrew West & Co:

Thanks for your very comprehensive response. I always advise people that they should never trade something they do not understand, and this has shown that I need to take my own advice, because I did not realise these rules existed.

This explains a long-running problem my readers keep asking about - the "phantom" bids and offers that are placed before 10am, but vanish just before the market opens. It seems to many people like an attempt to create a false market and I guess it is, but is within your rules. I assume other brokers have similar rules?

Andrew West & Co to Colin:

I think you're right about the phantom bids and offers. Someone may well be trying to manipulate the market. We know when a client has more than one order in a stock and a DTR is alerted to make sure everything is OK.

But consider this – an unscrupulous broker has a sell order in a stock. So, to make the stock look strong, the broker places a number of large buy orders. Internet traders follow this large order up. A matter of seconds before open the broker cancels and puts in a sell order. There is absolutely no way the Internet traders can cancel their buy orders in time.

The only further clarification needed here is that for a stock trading around 500 in the example, the minimum bid, or tick, is one cent. Hence the system stopping the order at 503, three bids below the market.

I would like to thank David Spessot at Andrew West & Co for his help in this matter. Colin

Colin to Etrade:

Let me introduce myself. I am principal lecturer in technical analysis at the Securities Institute, past president of the Australian Technical Analysts Association and I write for **Shares** magazine and **Shares Weekly**. I also teach trading and technical analysis and have my own web site and email newsletter.

One of my readers has amazed me with this message:

(I inserted the original message)

Now, what I thought I would do is warn my readers that they should be aware of the terms of trading for their Internet broker and make sure they suit their trading style, using these terms of yours as an example.

However, before I do so, I would ask if you could confirm the statement by my reader is true, as I do not want to misrepresent your terms.

I would also be interested in the reasoning behind such terms, which seem to be a disaster just waiting to happen for your clients in a fast market or a thin market. I have often had to make bids or offers more than 10 cents from the last price in thin stocks or high priced stocks. I am glad my broker lets me trade with more flexibility.

Many thanks for your attention to my request.

Etrade to Colin (I also received a phone call from their Marketing Manager):

As you may be aware, our service is offered entirely online and orders are sent 'straight through' to the market without any human intervention. For this reason we have placed restrictions on 'at market' and 'at limit' orders to ensure that customers are not caught out by large and fast market movements, to ensure that the value of an 'at market' order does not exceed the customer's available to trade balance and to guard against market manipulation (applies to our rules regarding 'at limit' orders).

Your reader is correct in saying that 'at market' orders will execute only if the opposing bid or offer is within 3 price steps of the last trade. This ensures that our customers cannot suddenly find themselves in an overdrawn situation. Most customers who have some experience in trading will place orders 'at limit' to ensure execution.

Your reader was not entirely accurate with their 'at limit' interpretation. An 'at limit' order can be placed 10 price steps above the bid if you are buying and 10 price steps below the offer if you are selling.

For example if market depth (sic) is \$1.02 bid and \$1.03 offer, the highest bid an E*TRADE Australia customer could place online would be \$1.12, the lowest offer an E*TRADE Australia customer could place online would be \$0.93.

We have also found it necessary to place rules for the opposite direction. 'At limit' orders can be placed up to 50% worse than the bid if you are buying or offer if you are selling.

In the above market depth (sic) example the lowest bid an E*TRADE Australia customer could place online would be \$0.51 and the highest offer would be \$1.54. These rules have been put in place to guard against customers intentionally or unintentionally moving the market and to ensure customers are not placing orders far from the market. Our phone service is always available and our Trading Specialists are able to override any system rules in place, if appropriate.

Rules such as the ones I have described are necessary and take the place of the human judgement that is present with full service and other online brokers who do not offer 'straight through processing'. There are occurrences where our Trading Specialists will override our

system's rules. However these are not all that frequent. In these situations the additional phone brokerage rate is not charged.

I flagged that the term "depth" above is, I think, wrong. I would have called this the "spread". The depth is the distance from the highest to the lowest bid or offer.

I would like to thank Mei Lin Ford at Etrade for her help in this matter. Colin

Conclusion

This should reinforce the need for all traders and investors to know the rules of the game.

In the case of telephone trading, the broker is there on the line to stop you doing something that is silly, wrong or illegal. This is the protection you pay for in dealing by telephone (there are other benefits too, especially the broker's dealing ability).

In the case of Internet trading, it is incumbent on you to know the rules and how they operate. We all sign pieces of paper (or click "I agree" buttons on the rules and regulations page when we start an Internet account. Most of us do not take the time to actually read them. We should make the time.

Trading Camps Come to Australia

Trading camps are a very popular way to learn trading. Dr Alexander Elder has run them in the US and the Caribbean for several years. I have worked with him at the Pacific camps in Fiji in 2000 and Vanuatu in 2001. Next year the Pacific camp will be in New Zealand.

Many readers have asked why they cannot be run in Australia. There were many obstacles, but I have worked through them and can announce that the first Australian Traders and Investors Camp will be held at Terrigal, just north of Sydney 19 to 24 October 2001.

I have arranged for Tony Plummer (author of **Psychology of Technical Analysis** – US title, **Forecasting Financial Markets** – UK title), Neil Costa and Garnett Znidaric to join me in the teaching.

Tony Plummer is a recently retired professional trader and fund manager, with a lifetime experience in the UK. He is now working as a consultant to very senior UK fund managers. He will speak briefly at the ATAA Conference, but the camp is a unique opportunity to learn from him in depth.

Neil Costa and I will both teach our trading approaches in detail. Garnett Znidaric will add very useful insights to trading.

The value represented by the camp is extraordinary, compared to taking seminars or courses from us separately. And you will have time to discuss things with us.

Full details are on www.bwts.com.au. Click on Camps, then Australian Investors and Traders Camp.

Managed Funds Data

On the notice board for the last Newsletter was the request that if anyone knows a vendor of end of day prices for managed funds that is downloadable into Metastock, to let me know.

I received the following reply by a round about route:

We have heard from Mr Ray Bricknell (AIA) that you are interested in the managed funds data and require data in Metastock format. We have data available in Metastock format, please visit our web site for price details: <http://www.dialchart.com.au/>

If you have any enquiry, please do not hesitate to contact us on (03)9563 4388 or email to us.

Regards
Steven Lam
Dial & Chart Pty Ltd
Steven's email address is: dialchart@dialchart.com.au

Sterling Willmott and Richard Watkins also advised the same information. Thanks to all who helped track this down.

Building Wealth Trough Shares Seminars

I am running my weekend seminars again this year in

Auckland 30 June – 1 July.
Brisbane 21-22 July
Sydney 18-19 August
Melbourne 22-23 September

I have priced the Auckland seminar very cheaply for several reasons. It is the full seminar - nothing is being left out. It affords an opportunity for Australians to fly to Auckland and do the seminar for around the Australian price after airfare.

Full details of seminars are on www.bwts.com.au. Click on Seminars.

My intensive version of the seminar, given in New York, is also available on videotape. Details are on www.bwts.com.au. Click on Videotapes.

Lessons From The End Of The Bull Market

For the May 2001 issue of **Shares** magazine, I wrote an important charting article analysing the end of the bull market. This is how it began:

We have now seen the end of the bull market in the major market indices that are of interest to readers – the Dow Jones Industrial Average (DJIA), the S&P500 and the Nasdaq in the USA, The FTSE100 in the UK and the ASX All Ordinaries Index in Australia.

There is an old saying on Wall Street is that “nobody rings a bell at the top”, which applies both to the market index and to individual stocks. On the one hand, this reflects the truth that it is usually impossible to pick the exact high price of a bull market. On the other hand it conceals another truth that technical analysis can tell us when we can be reasonably certain that the top has been passed.

For many months, I have been warning readers that the great 1990s bull market was in its terminal stages and suggesting that strategies be adopted that deal with this market condition. These warnings have been based on the charts of the indices, all of which have at some point given a clear signal that the bull market has been completed.

Analysing the index charts in this way was not difficult intellectually, but many people found it challenging psychologically. This was essentially because they did not want to see what the charts were telling them. In psychological terms, they were in denial, trying somehow not to recognise the obvious. They found many ways to avoid the truth, mainly based on the idea of rationalisation, also known as “clutching at straws”. Some even resorted to the old solution of “shooting the messenger” by suggesting that it would be better not to publish articles pointing out that the bull market was over.

Knowing that the bull market is finished does not mean that all opportunities to profit from the markets are over. Of course, the nature of those opportunities will change, but smart investors and traders will recognise that they must be in tune with the reality of market conditions, rather than trying to turn back the tide by ignoring it. They know the importance to both traders and investors of preserving capital and managing risk. So, they appreciate that

avoiding losses to capital is as important as making profits. Also, they know that the secret to bear markets is to have the flexibility to take advantage of the eventual opportunities.

Actually, sensible readers who are trying to build their financial wealth in the share market will welcome the end of the bull market, because one of the most treacherous market conditions, the terminal stages of a bull market, is over and the process of returning to sane investment values has begun. They should be well cashed up and waiting patiently for the time to buy as soon as the bottom of the market is detected.

I then went on to discuss, using charts, each of the major world markets, showing how the bull market ending was detected. Obviously, I cannot reproduce it all here, but you may read it by obtaining the magazine or from the Fairfax web site for a small fee.

Notice Board

If there is something you want to know, or you want to contact people with particular knowledge or interests, you may use the notice board section of the Newsletter to post a request or notice. Just email me at colin@bwts.com.au

New Insight Trader User Groups

Two new Insight Trader User Groups are in the process of formation. If you live in the Newcastle area of NSW or inner Brisbane and wish to join with other Insight Trader users to share your experiences to get the most out of your software you should contact either of the following people below.

Hunter Insight Trader User Group

A number of Hunter ATAA members are interested in forming a new Insight Trader User Group. You don't need to be a member of the ATAA., those interested please email Grahame Dickson at mail@cardyclamp.com.au .

Inner Brisbane Insight Trader User Group

I am intending to set up a users group for Brisbane metropolitan area, hopefully we can meet once a month to help each other with the programme. If anyone is interested they can contact me, Alan Richardson on 0412 722 721 or (07) 3366 2301 or awr@powerup.com.au

Questions to the Web Site

One of the largest sections of the web site is Ask Colin, in which I answer questions about technical analysis, software, education, trading and investing. Please understand that I choose not to give advice. I am not a licensed adviser. Please do not ask questions about specific current markets. I am happy to answer questions about almost anything else, though. Please also check the site to see whether I have not already answered your question, before sending them to me.

Back Issues of the Newsletter

One of the more important functions of my web site is making back issues of the email newsletters available for downloading. This is much faster than email attachments and very flexible by allowing readers to only download what they want.

Newsletters will generally be posted to the web site when the following issue is sent out, so my email list is still the fastest way to get to see it.

Administration

If you receive two copies of this newsletter, it may be that I have two different addresses for you in my list. If you do not want both copies, please email me which address to delete.

Whenever I send out the Newsletter, I get a great number that are returned undeliverable. Many are cancelled addresses, but a fair number are because the mailbox is full. I do not re-send these Newsletters. Also, after sending two Newsletters unsuccessfully, I delete the address from my list. If you hear anyone complain they did not receive the Newsletter from me, please ask them to get in touch with me to reinstate their address on the list. Thanks

Regards Colin