

Colin Nicholson: free newsletter 116

27 November 2011

Reporting and dividend dates

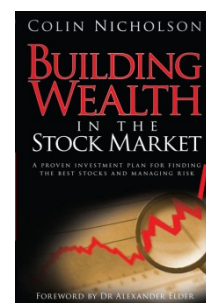
One of my readers has alerted me to the *Income Investor* website that provides lists of upcoming company reporting dates. It also has lists of upcoming ex-dividend and payment dates. To access this information it is necessary to register. Registration is free. For more details and to enter [click here](#)

A view of the Australian stock market

I have received a number of emails from readers asking about my analysis of the Australian stock market and my market exposure strategy settings. Normally, I would answer these through publication of a new case study on the members' website. On this occasion, I have decided to publish my analysis in the free newsletter.

Members of my website have known my views over the last few months by attending one of my presentations in Sydney, the slides for which I publish on the members' website within 24 hours, or as soon afterwards as I can if I am travelling.

Before I start on an update in this newsletter, please note that this newsletter does not purport to be advice of any kind to any reader. It is intended as a tool for teaching investment through practical examples and using as a basis my investment plan as set out in *Building Wealth in the Stock Market*. This document has been prepared without knowledge of, or regard to, the financial plans of any other person. Readers should consult licensed financial, legal and taxation advisers before acting on anything in this document. I am not a licensed adviser.



Where I use market index charts in this article, they will be the ASX All Ordinaries index (XAO). I prefer this index for market exposure work because it is the broadest index of the Australian stock market. I also have extensive historical data, which I will use at one point in this discussion. If the S&P/ASX 200 index (XJO) was used, the analysis would be basically identical, but my historical data is only from 2000 and therefore very limiting in looking at what has happened in the past.

My tools for market timing analysis are:

1. Phase analysis
2. Coppock indicator
3. Trend analysis

I will now take you through my analysis.

Phase analysis

Since I wrote *Building Wealth in the Stock Market*, I have further developed my method of assessing where we are in the phases of bull and bear markets. I have done this by listing all of the markers for

each phase and assessing where I judge that we are against each of them. No one marker is usually enough to draw any conclusions, although some are more important in some phases than the others. Instead, it must be an overall weighting based on the likelihood of each marker being in place. I have done this in a table and the way to judge where we might be is to go with the phase or phases that have the most Xs marked in the left hand columns.

I know that this method involves subjective judgements on many of the markers. Only some of them are susceptible of quantifying. Where I have a data series to use, I have shown it below. I am looking to collect more data on some measures of more of the markers, but this is an incomplete quest. I will show below where I am with this at present.

It is possible to begin in any of the phases and then proceed with assessing the markers for each phase in the order in which they will normally develop in the bull-bear market cycle. However, at the moment, I think it is generally agreed that the bear market finished in early 2009. A bull market is normally expected to follow. So, I will begin with the bull market phases.

Bull market phase one: Reviving confidence				
Phase marker	Has happened	Is happening	May be happening	Not happening
News on economy & market mainly negative	X	X		
The market is anticipating a recovery	X			
Private investors absent from market	X	X		
The market may ignore bad news			X	
Rise thought to be a bear market rally	X			
Initial disbelief becomes fear of missing out	X			
The market is fundamentally undervalued	X	X		
Enquiries into what went wrong	X	X		
Regulation is tightened	X	X		

News on economy and market mainly negative

This was certainly the situation in 2009 as we came out of the bear market. In my assessment, the news about the economy did improve for a while, but has turned more negative again now – especially in some sectors, retail and manufacturing in particular. I have therefore scored this marker as having happened.

Of course, this then poses another question. Were we in a bull market, but have now gone back into a bear market? Remembering that a downward trend in the short term is not, by definition, a bear market, this is a good question. In considering this question, I am cognisant that there has been no evidence of the terminal phase of a bull market: rampant speculation. Therefore, to take the view that a bull market has ended and that we are now in a bear market requires us to throw out the well-established tenet in Dow Theory that there are three phases in every bull market. We would need to assume that we had skipped at least the terminal phase, if not also the second phase. Each reader must make their own judgement on this, but my feeling is that we have not seen a completed three-phase bull market. However, let us continue with the discussion.

I have also placed a cross in the “Is happening” box for this marker because I am seeing this situation as still being in place now, especially coloured by the high exchange rate for the Australian dollar. Another important factor is the ongoing deleveraging in the household sector that has seen unusually high savings rates and a consequent reduction in spending that has impacted many sectors of the economy.

The market is anticipating a recovery

My assessment is that this was clearly the case from March 2009, well into 2010. The strength of the upward trend in 2009 could not be interpreted in any other way considering how far it ran. A mere bear market rally is unlikely to have carried that far. Moreover, there was a clear trend change signal on the index chart, as we will see later when I look at my third tool: trend analysis.

Private investors absent from market

This one is also an easy one. My observation is that most private investors are still heavily in cash, rather than owning or buying stocks. I have also placed a cross in the “Is happening” box for this marker because I am seeing this situation as still being in place now.

The market may ignore bad news

This one is a bit trickier to judge, mainly because of the degree of bad news around the world. My take on this marker is that it “may be happening”, because sometimes the market seems to absorb bad news. However, the market and public opinion is still very skittish and does react badly to news of an adverse nature, from overseas in particular.

Rise thought to be a bear market rally

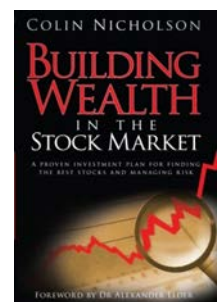
I judge that this marker happened in 2009 and is now well behind us unless we judge that we have gone into another bear market without completing the bull market phases on this occasion.

Initial disbelief becomes fear of missing out

This one has also clearly happened in 2009, as evidenced by the strength and range of the rise from the March 2009 low.

My observation is that most investors were totally disoriented by what happened in the bear market of 2008-09. The vast majority were frozen in fear and rode their stocks through the downward plunge.

At this point, I should acknowledge that feedback I have received from many of my readers was that they were glad they took notice of my public and published (in *Hot Stocks 2007*) warnings in 2007 and followed in some form the strategy for market exposure outlined in my book *Building Wealth in the Stock Market* and before it in the earlier book *The Aggressive Investor*. To remind readers, the nub of my strategy is to get out of the market gradually as we go through the last phase of a bull market and stay out until we see the bear market in its terminal phase. This has been very successful for me over many market cycles, but paid off handsomely in the last bear market that was unusually severe.



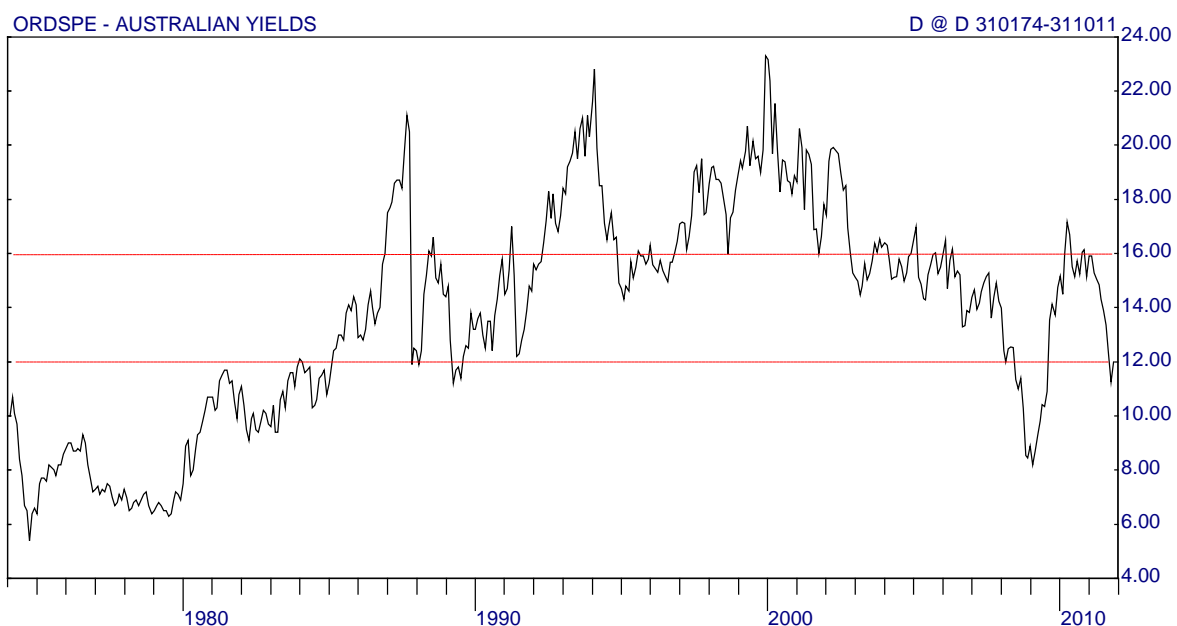
So the initial rise from March 2009 was seen by most private investors as most likely to be a bear market rally. There was a screaming bullish divergence on some momentum indicators, for those who use them. However, but from conversation with many, they did not have faith in the indicators and did not act. However as the rise continued, many savvy investors and most professional investors suffered from the fear of missing out and plunged back in, causing the rise to continue strongly out to October-November 2009. So I have scored this marker as having happened.

The market is fundamentally undervalued

There are many ways to try to measure this marker. My preference is to use the historical or trailing average price earnings ratio for the market. I use the average price earnings ratio for the All Ordinaries index. Because there are more stocks in this index than the S&P/ASX 200 index, its average price earnings ratio has tended recently to be a bit lower, but not significantly so. This could vary more greatly in other market phases, but I have not studied this difference.

For beginners, the price earnings index for a stock is a very simple idea. We take the latest price of the stock and divide it by the earnings per share (EPS) for the stock. The EPS is published in financial statements, so we do not have to calculate it ourselves, just look up the last annual report. So, if a stock last sold at \$6.00 and had earnings per share of 60¢ in the last year, then its price earnings or PE ratio is $6.00 \div 0.60 = 10$. This is read as the price for the stock to be ten times its earnings. If we then calculate the PE ratio for another stock and find it is 15 times, then we can gauge that the first stock is cheaper because it would only take 10 years of earnings to repay shareholders' investment, whereas the other company is more highly priced because it would take 15 years to repay shareholders' investment.

I have kept an average market price earnings ratio series back to 1970. I publish a chart of this data series updated every month on the members' website. This is the chart to the end of October 2011:



The chart has two red lines across it. These mark my assessment of the range of the ratio that represents fair value. Above the upper red line (16 times), the market is deemed to be overvalued. Below the lower red line (12 times), the market is deemed to be undervalued.

At the end of October the market average PE ratio was 12 times, right on the lower boundary of the fair value range, after dipping below it in September. So far in November it has not moved very far. This suggests that the market is fundamentally undervalued, but nowhere near what it was in early 2009. We now seem to be back in the region the ratio was in the late 1980s and early 1990s before the long bull market to the early 2000s peak. This will resonate when I get to discuss my third tool: trend analysis. In short, the market is cheap. We should be looking to buy when it is cheap, not hoarding our cash. Accordingly, I have scored this marker as having happened (in 2009) and also to be happening now.

Enquiries into what went wrong

This is an easy one. There have been numerous enquiries in various areas as to what went wrong both in Australia and overseas. Some enquiries are still ongoing, so I have scored this marker as having happened and still to be happening now.

Regulation is tightened

This one is also simple in that it follows on from the previous point. Increased or tightened regulation has and still is happening in Australia and overseas in many sectors of the financial markets and in particular in banking and financial advice areas. Accordingly, I have scored this marker as having happened (in 2009) and to be happening now.

Conclusion: Bull market phase one: reviving confidence

If readers cast their eyes back to the table of markers for this phase, it will be seen that most of the Xs are towards the left side. This is strongly suggesting that we are still in this phase. However, it could be that we are in transition to the second phase of a bull market: increasing earnings. So, we should look at that next.

Bull market phase two: Increasing earnings				
Phase marker	Has happened	Is happening	May be happening	Not happening
Earnings increases emerging		X	X	
Good news is announced		X	X	
Employment picks up	X	X		
New companies are being floated			X	
Significant corrections end higher	X			X
Fundamental values return to normal	X			
Sector rotation			X	

Earnings increases emerging

The last two reporting seasons have showed quite a few earnings increases. However, it has been patchy, with many reporting flat or falling earnings. On top of that, many companies are reluctant to give positive guidance looking forward to the second half of the financial year and even beyond that. I have therefore scored this factor as a bit of both may be happening and is happening. This is clearly one of the more important factors for this phase and it is far from conclusive to my mind.

Good news is announced

This factor is very much in line with the first factor. There is some good news emerging, but it is a long way from across the board and there is even more bad news or at least dismal views of the economy generally. I have therefore scored this factor as both may be happening and is happening.

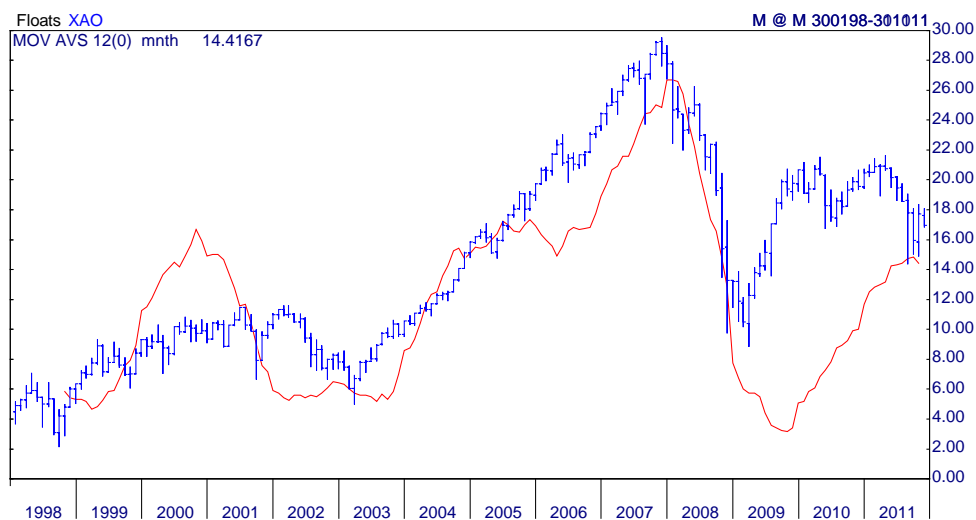
Employment picks up

This is a difficult one to score because of what is rather inane called the two-speed economy. In some areas, primarily resources companies and the sector that supplies them, there is a real shortage of skilled labour. Also, there is quite a low level of unemployment in Australia, although the rate of decline has slowed more recently. There are some sectors that have been reducing staffing levels and these workers are not always amenable to move across the country to the areas of shortage for reasons of lack of appropriate skills and reluctance to sell up and move, especially in such a weak housing market. That said, the key is that employment is very full in Australia and I think I must score this factor as both is happening and has happened.

New companies are being floated

This is also a difficult one to score. In the resources explorer and Exchange Traded Funds sectors there have been many new companies/entities floated. However, outside of these sectors, many potential floats have been pulled prior to launch and there is a clear reluctance to bring new companies to the market in the present situation.

One piece of fundamental data that I have collected over the last two and a bit cycles is the number of new listings on the ASX. I publish the data files soon after the end of each month on the free website and on the members' website I publish a chart of the data against the market index. These data are strongly seasonal (peaks leading to the half year and full year balance dates), so to eliminate the seasonality, I plot a 12-month simple moving average of the number of new listings. Because the number of companies listed grows over time, it is the direction of the moving average line, rather than its absolute value, that is important. At the end of October, this was how it looked:

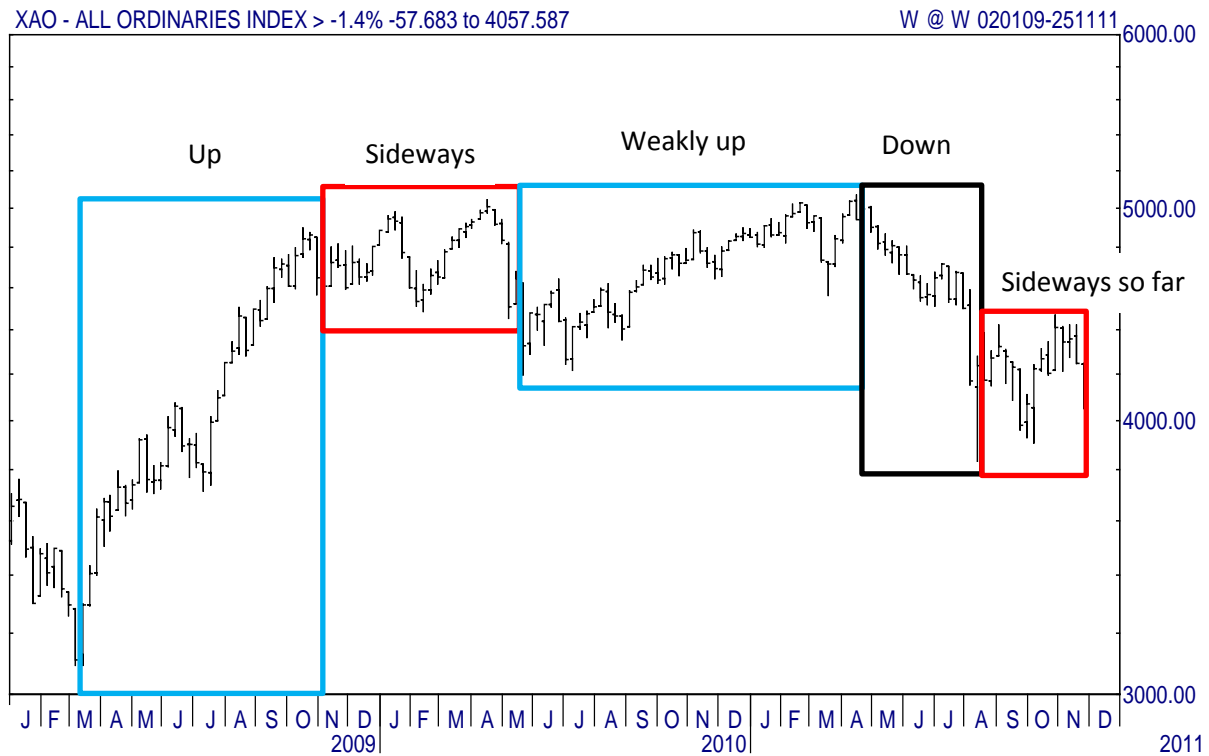


Clearly, if we ignore the sector bias explained above, there has been quite a pick-up since the bear market lows. However, the line has tailed off somewhat of late as the market fell in the second half

of 2011. I have therefore scored this factor as may be happening.

Significant corrections end higher

This factor is, likewise, a difficult one to score. On the chart below I have inserted a weekly chart of the market index and marked in the important swings that I am seeing since the bear market low in early 2009.



What emerges are five separate periods, which I have labelled. After the bear market low, the trend was clearly up. This morphed into a sideways period. After that there was a weak, but persistent upswing, followed by a nasty down trend. That has morphed so far into another sideways period.

This suggests that, at this point, I should score this factor as having happened, but I have also scored it as not happening because the upward trending phase has clearly gone into a large generally sideways pattern since the bear market low. This is an unusual scoring, but I think it is all that I can do to represent what I am seeing.

Fundamental values return to normal

At last, an easy one. I showed the graph of the price earnings ratio above when discussing the first phase. From a deeply undervalued reading, the price earnings ratio steamed up into the normal or fair value, range and is still just near the lower boundary of the normal range. Thus, I have scored this one as having happened.

Sector rotation

This is a quite subjective factor. I see some evidence that it did happen for a while since the bear market low, but it is equally arguable that it may not be happening much since, especially in more

recent times. I have therefore not regarded this as a very strong factor and scored it as may be happening.

Conclusion

If we now look back at the two completed tables for the first two phases of a bull market, it seems to me that there are more Xs toward the left of the table for the first phase (reviving confidence) than there are for the second phase (increasing earnings), where the Xs are spread across the table.

I am making the judgement that we are still in the first phase (reviving confidence), but I am prepared to accept that we may be in a prolonged transition to the second phase (increasing earnings).

Having reached this conclusion at this point, I nevertheless have gone on to score the third phase (rampant speculation) of a bull market and the three phases of a bear market. I will not comment on them in detail at this time, because I feel that the patterns of Xs in them indicate that we are not currently in any of those phases.

Bull market phase three: Rampant speculation				
Phase marker	Has happened	Is happening	May be happening	Not happening
Significant fundamental overvaluation				X
Interest rates relatively high				X
Increased price volatility		X		
Many new floats and capital raisings			X	X
Private investors heavily in the market				X
Day traders heavily in the market				X
Increase in use of debt and leverage			X	X
Much new commercial building activity				X
Increased media coverage				X
New paradigm theories advanced			X	
Market driven by few stocks			X	

Bear market phase one: Abandonment of hopes				
Phase marker	Has happened	Is happening	May be happening	Not happening
Fundamental valuation still high				X
Interest rates peak				X
The economy is still very strong			X	
Public see a buying opportunity				X
Volume falls; buying is done				X
Market may ignore good news				X
Shock news causes shakeout				X
Public panic, maybe causing a crash				X
Floats fail then abandoned				X

Bear market phase two: Decreasing earnings				
Phase marker	Has	Is	May be	Not

	happened	happening	happening	happening
Earnings decreases announced generally				X
Market ignores good news			X	
Former market leaders may fail				X
A recession begins				X
Sharp rallies leading to further falls				X
Few new floats				X
Public lose interest		X		

Bear market phase three: Distress selling				
Phase marker	Has happened	Is happening	May be happening	Not happening
Significant undervaluation				X
Unemployment peaks				X
Many bankruptcies and failures		X		
Bad news is discounted			X	
Market rarely in the news			X	
Low public participation		X		
Stock price charts show accumulation			X	

My overall view of these other four phases is that we are not in them now. However, some elements of bear market phase three (distress selling) may still be hanging around, strengthening my view that we are still in bull market phase one (reviving confidence). There are many around us that are still in a bear market mindset and I think it quite arguable that what we are going through is a very difficult phase where the move from bear to bull is prolonged. I will comment more on this when I look at trend analysis.

I have spent quite a long time discussing phase analysis because, in many ways, it is my most important tool for market timing. In particular, it is what gets me out of bull markets before the bear begins to prowl and is therefore the most potent method I have to time the market. This is because it nails the rampant speculation phase well before there is much evidence on the price charts that the trend is about to change.

Coppock indicator

The key thing to understand about the Coppock indicator is that it is long term momentum oscillator that was created for only one thing: to warn that the bottom of the market may be close and that it is time to begin accumulating uptrending stocks for long term appreciation.

For those readers who do not have charting software to plot the Coppock indicator, I publish an updated workbook of spreadsheets for the major markets that I track: ASX, DJIA, S&P500, Nasdaq, FTSE100, Nikkei225 and Shanghai. I have now marked the signals on those spreadsheets back as far as my data goes, which for some is just over 100 years. I update the spreadsheets as soon as I can after the end of each month (the Coppock indicator is calculated on month-end index values). I have constructed the spreadsheets in such a way that it is easy to make what-if calculations to determine what end of month index value might trigger a signal. The spreadsheet for the ASX looks like this at the end of October 2011:

Coppock Indicator - ASX All Ordinaries Index

This spreadsheet is set up so that it may be updated either on a PC or by hand

Note that Coppock rounded column 17 to the nearest ten points. THIS SPREADSHEET NOW HAS COLUMN 17 ROUNDED TO THE NEAREST 10

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
All	14	11	Total	10 x	9 x	8 x	7 x	6 x	5 x	4 x	3 x	2 x	1 x	Total	Plot	
Ords	Month	Month	Cols	Col 5	Col 5	Col 5	Col 5	Col 5	Col 5	Col 5	Col 5	Col 5	Col 5	Cols	Col 16	
Date	Index	% Chg	% Chg	3 & 4	1 ago	2 ago	3 ago	4 ago	5 ago	6 ago	7 ago	8 ago	9 ago	6-15	/10	
30/04/09	3744.70	-34.0	-35.1	-69.2	-691.5	-680.0	-701.7	-601.7	-490.7	-435.0	-303.4	-170.5	-76.2	-39.5	-4190.2	-420
31/05/09	3813.30	-29.5	-28.5	-58.0	-580.0	-622.4	-604.4	-614.0	-515.8	-408.9	-348.0	-227.6	-113.7	-38.1	-4072.9	-410
30/06/09	3947.80	-30.2	-21.9	-52.1	-520.8	-522.0	-553.2	-528.9	-526.3	-429.8	-327.2	-261.0	-151.7	-56.8	-3877.7	-390
31/07/09	4249.50	-26.4	-18.5	-44.9	-449.2	-468.7	-464.0	-484.1	-453.3	-438.6	-343.8	-245.4	-174.0	-75.9	-3597.0	-360
31/08/09	4484.10	-15.9	-3.2	-19.1	-190.9	-404.3	-416.6	-406.0	-414.9	-377.8	-350.8	-257.9	-163.6	-87.0	-3069.9	-310
30/09/09	4739.30	-6.2	19.0	12.8	128.0	-171.9	-359.4	-364.6	-348.0	-345.8	-302.2	-263.1	-171.9	-81.8	-2280.7	-230
31/10/09	4646.90	-10.9	26.5	15.6	156.2	115.2	-152.8	-314.5	-312.5	-290.0	-276.6	-226.7	-175.4	-86.0	-1563.0	-160
30/11/09	4715.50	1.8	28.9	30.7	306.8	140.6	102.4	-133.7	-269.5	-260.4	-232.0	-207.5	-151.1	-87.7	-792.1	-80
31/12/09	4882.70	22.6	40.4	63.0	629.8	276.1	125.0	89.6	-114.6	-224.6	-208.3	-174.0	-138.3	-75.6	185.1	20
31/01/10	4596.90	25.2	39.4	64.6	646.0	566.8	245.5	109.4	76.8	-95.5	-179.7	-156.2	-116.0	-69.2	1027.8	100
28/02/10	4651.10	27.1	31.7	58.8	587.8	581.4	503.9	214.8	93.7	64.0	-76.4	-134.8	-104.2	-58.0	1672.2	170
31/03/10	4893.10	40.7	30.7	71.4	713.5	529.0	516.8	440.9	184.1	78.1	51.2	-57.3	-89.8	-52.1	2314.3	230
30/04/10	4833.90	46.6	26.8	73.4	733.8	642.2	470.2	452.2	377.9	153.4	62.5	38.4	-38.2	-44.9	2847.4	280
31/05/10	4436.70	25.6	12.4	38.0	379.9	660.5	570.8	411.4	387.6	314.9	122.7	46.9	25.6	-19.1	2901.1	290
30/06/10	4324.80	15.5	1.8	17.3	172.6	341.9	587.1	499.5	352.7	323.0	251.9	92.0	31.2	12.8	2664.7	270
31/07/10	4507.40	18.2	0.5	18.7	187.2	155.4	303.9	513.7	428.1	293.9	258.4	188.9	61.4	15.6	2406.5	240
31/08/10	4438.80	12.4	-6.3	6.1	61.0	168.5	138.1	265.9	440.3	356.8	235.1	193.8	126.0	30.7	2016.1	200
30/09/10	4636.86	9.1	-0.2	8.9	89.0	54.9	149.8	120.8	227.9	366.9	285.4	176.3	129.2	63.0	1663.2	170
31/10/10	4733.41	5.6	0.4	5.9	59.4	80.1	48.8	131.1	103.6	189.9	293.5	214.1	117.6	64.6	1302.6	130
30/11/10	4676.37	-1.3	-4.2	-5.6	-55.5	53.5	71.2	42.7	112.3	86.3	152.0	220.2	142.7	58.8	884.0	90
31/12/10	4846.88	4.3	5.4	9.7	97.4	-50.0	47.5	62.3	36.6	93.6	69.1	114.0	146.8	71.4	688.6	70
31/01/11	4849.95	2.9	4.3	7.1	71.3	87.7	-44.4	41.6	53.4	30.5	74.9	51.8	76.0	73.4	516.0	50
28/02/11	4922.60	0.8	0.6	1.4	14.2	64.1	77.9	-38.9	35.6	44.5	24.4	56.2	34.5	38.0	350.6	40
31/03/11	4928.61	7.2	2.0	9.2	91.8	12.8	57.0	68.2	-33.3	29.7	35.6	18.3	37.4	17.3	334.7	30
30/04/11	4899.05	5.3	10.4	15.8	157.5	82.6	11.4	49.9	58.5	-27.8	23.8	26.7	12.2	18.7	413.4	40
31/05/11	4788.92	-2.1	10.7	8.6	86.0	141.8	73.4	9.9	42.8	48.7	-22.2	17.8	17.8	6.1	422.1	40
30/06/11	4659.79	-3.6	3.4	-0.2	-2.2	77.4	126.0	64.2	8.5	35.6	39.0	-16.7	11.9	8.9	352.7	40
31/07/11	4500.53	1.4	1.4	2.8	28.3	-2.0	68.8	110.3	55.1	7.1	28.5	29.2	-11.1	5.9	320.1	30
31/08/11	4369.85	1.0	-5.8	-4.7	-47.2	25.5	-1.8	60.2	94.5	45.9	5.7	21.4	19.5	-5.6	218.1	20
30/09/11	4070.09	-9.7	-14.0	-23.7	-237.2	-42.5	22.6	-1.5	51.6	78.8	36.7	4.3	14.3	9.7	-63.2	-10
31/10/11	4360.46	-1.8	-6.8	-8.5	-85.2	-213.4	-37.7	19.8	-1.3	43.0	63.0	27.5	2.8	7.1	-174.4	-20

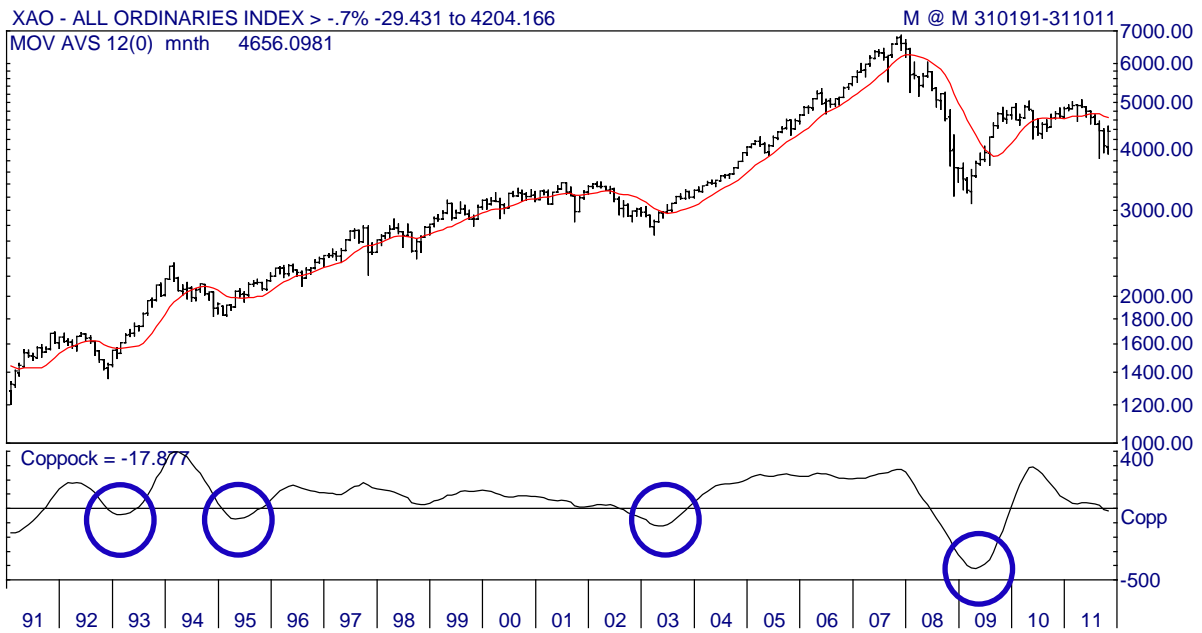
The last signal is highlighted with a small red rectangle. Earlier signals are marked the same way and may be located by scrolling upwards through the spreadsheet.

Note also that the Coppock indicator is easy to calculate by hand. It only requires one row of calculations each month. The arithmetic involved is described above each column and is highlighted above with the large red rectangle.

The Coppock indicator only gives one signal: when to begin buying uptrending stocks for long term appreciation. This buying should ideally be completed by the time the indicator value crosses up through the zero line (turns positive). This latter requirement is a very useful discipline in getting us into bull markets in their early stages, rather than much later as most beginners tend to do.

I use *Insight Trader* charting software, which calculates the Coppock indicator correctly with one exception: it does not round the final value to the nearest 10. As of the end of October 2011, the chart of the Coppock indicator in a sub-chart of the ASX All Ordinaries index was shown on the next page.

The Coppock signal is very simple: it is given when the Coppock indicator line turns up from below zero. In the chart, I have marked with blue circles the four signals since 1991. It should be noted that if a bull market runs for a long period, there will also tend to be a long time between signals, as happened between 1995 and 2003.



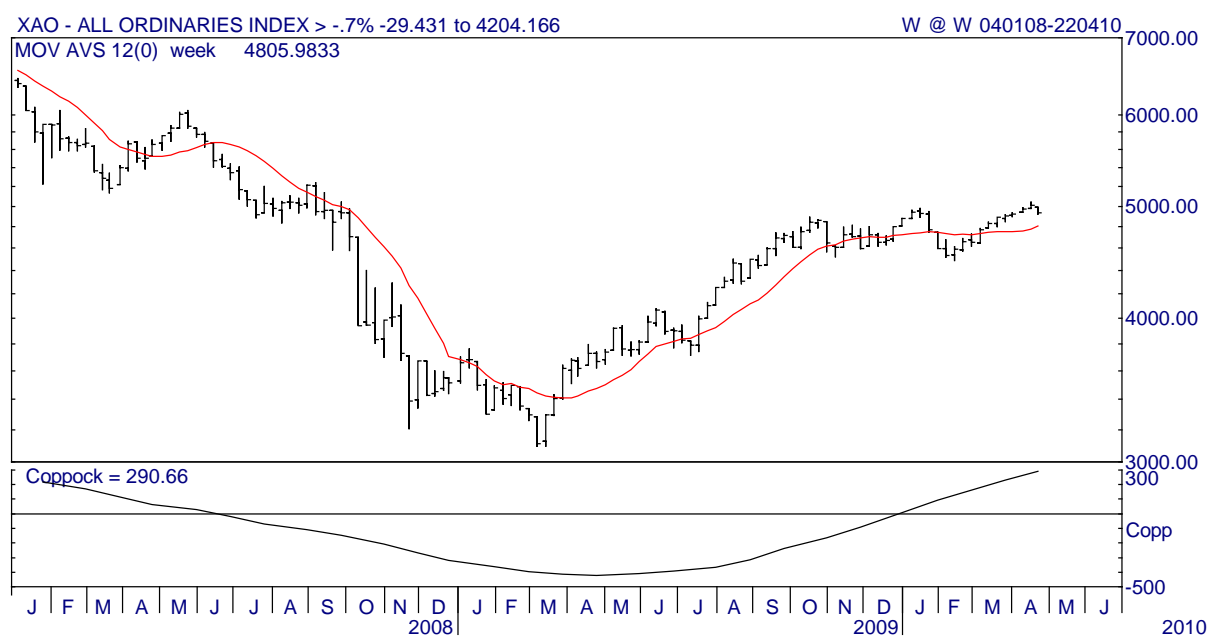
Alert readers will see what I was meaning about rounding the value of the Coppock line by comparing the value in the chart above (17.877) and on my spreadsheet on the previous page (20). I believe that the reason Coppock did this was to cut out some of the very minor fluctuations in the Coppock indicator value. For this reason, I prefer to check what is on the chart against my spreadsheet when the upturn looks marginal on the chart. If the chart is difficult to read in this file, use the Adobe Reader zooming tool to enlarge the area of detail that you wish to study.

What is obvious from the chart and the spreadsheet is that the last signal was at the end of May 2009. At that point, the market index chart looked like this:



I have enlarged the sub-chart to better see that the Coppock indicator has turned up at the right hand edge of the screen. At the time the signal was given at the end of May 2009, the index was at 3,813 points. It then rose substantially to a peak of 5,007 points at the end of April 2010, a rise of

31% in eleven months as shown on the chart below.



The Coppock indicator had the potential to have helped us reap some of this gain.

As of the end of October 2011, the Coppock indicator has again swung into negative territory and stood at minus 20. It looks as though we will get another signal down the track and makes it worthwhile watching it. Members of my website will be watching the chart that I publish on the members' website at the end of each month. Non-members can track it from the spreadsheet that is uploaded to the free website at the same time.

Trend analysis

I am aware that many of my readers have had trouble with interpreting the market index chart since 2008. In fact it was a question from one of my members that prompted me to publish this analysis in the free newsletter. It is normally only published from time to time, as I think necessary and have time, on the members' website. In between, where I have covered this ground in a presentation, the slides I used are uploaded to the *Presentations* page on the members' website as soon as I can after giving the presentation.

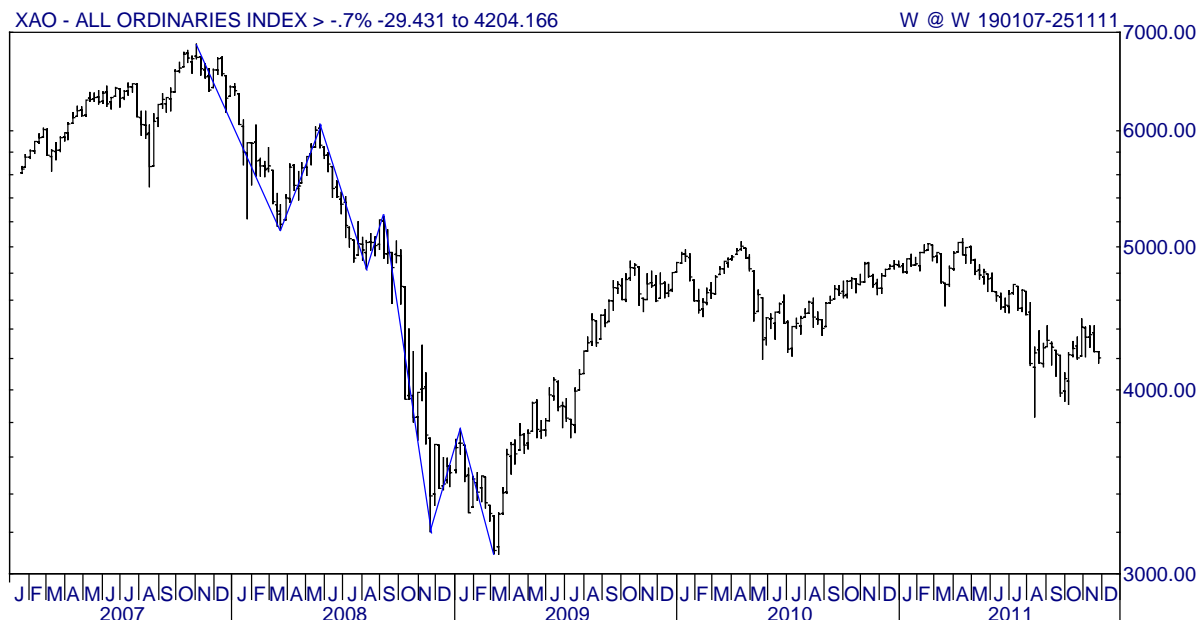
The reasons why readers have had this trouble is multi-faceted. The more important reasons are:

1. Focusing on the chart only and neglecting the other two tools that I use and have discussed above: phase analysis and Coppock Indicator.
2. Focusing on the short term, without regard for the lesson on the long term chart that I will discuss shortly.
3. Sideways markets are the most difficult to analyse and invest in. It is when those with long experience have a big advantage over beginners.

To start with trend analysis, I will remind you of the definition of trend that I use: An uptrend is a series of rising peaks and troughs, although in assessing change in trend, it is the requirement to have rising troughs that is critical. A downtrend is a series of falling peaks and troughs, and it is the peaks that are critical for trend change. Notice that I used "peak" and "trough" above. This was

deliberate. I use “high” and “low” for bars or candles. In explaining things, this distinction helps avoid ambiguities. However, if you prefer “high” and “low”, translate my explanation to the terms you find easier to understand.

I will start with a chart of the swings in the last bear market:



On the chart I have marked in the main peaks and troughs in the bear market. Some of the swings could have been divided into more peaks and troughs, but it would not change anything. The course of the bear market was fairly easy to follow, but the real point is: when does the trend change?

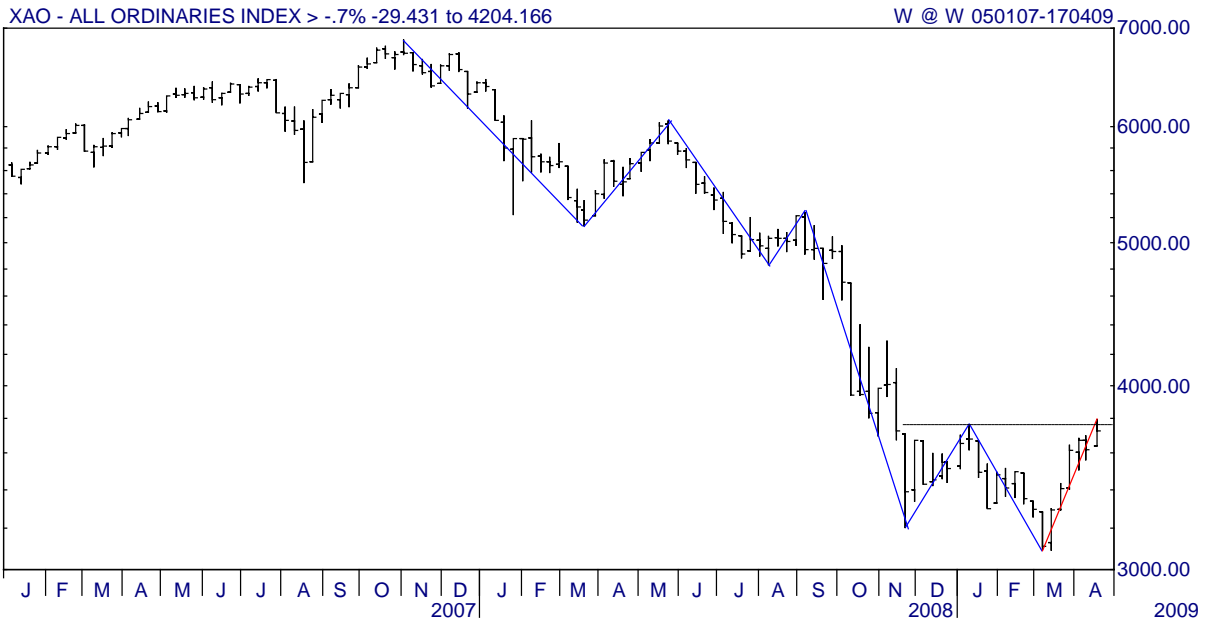
In looking at a trend change, we have in fact got two questions to answer:

1. When does the bear market end?
2. When does a bull market start?

Sometimes they can be at the same point, but in this case they were not. So, let me start with where a downtrend (bear market) ends.

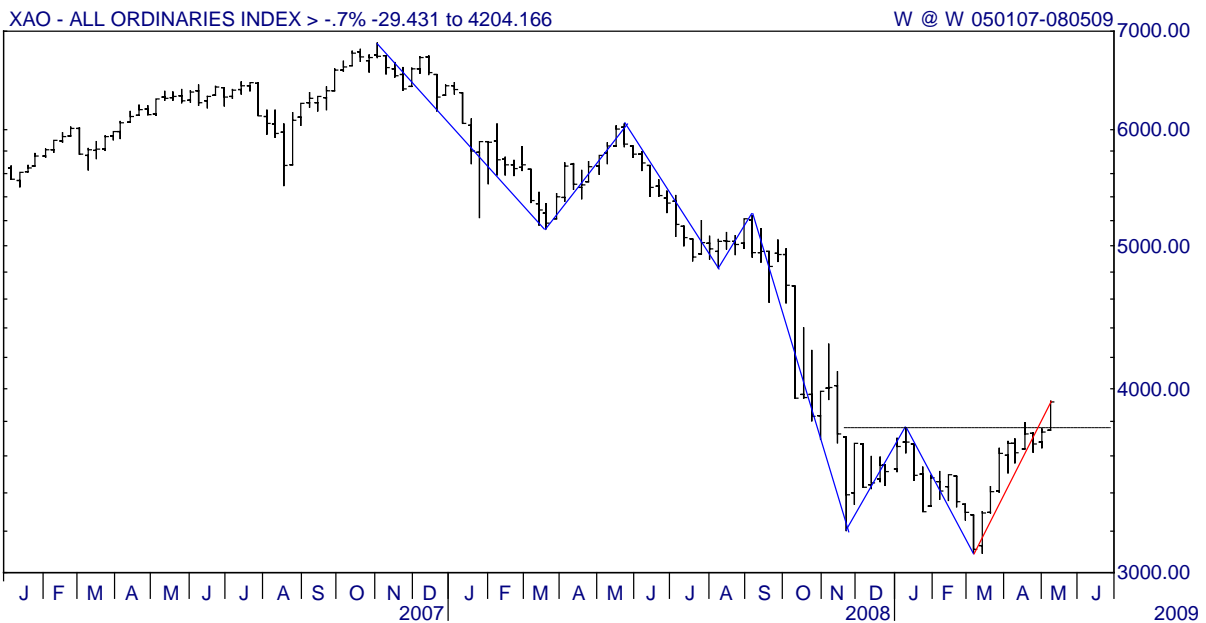
I will start with a reminder of the definition of a downward trend: the critical test is that each peak has to be lower than the one before. If we get a rise above a significant peak in the downtrend, then this condition no longer holds and we have to conclude that the downtrend has finished. However, it does not mean necessarily that an upward trend has started. We will come to that shortly.

On the next chart, which is on the next page, I have shown the initial swing that established a higher peak. It is shown with a red line. The key level is the black horizontal line through the lowest peak in the bear market. As it turned out, this was open to interpretation. The week ending 17 April 2009 witnessed a small breakout above the highest price in the lowest peak in the bear market. I think that we would have been justified on acting on this, although personally I was a little cautious, in part because the breakout had not been large and also because the market had not closed above the previous peak. It can be argued that I have now introduced two modifications to my trend definition. Not so, all I am doing is judging the quality of the observation and in doing so we are allowed to use



some judgement and take subtle observations into our assessment. That said, I think that we would have been quite entitled to ignore these subtleties and rely on the naked definition that a higher high on that bar compared to the high of the bar that defined the peak indicated that the bear market had finished.

However, even though I was cautious, it was not long before we had a quite decisive bar that dispelled the doubt:

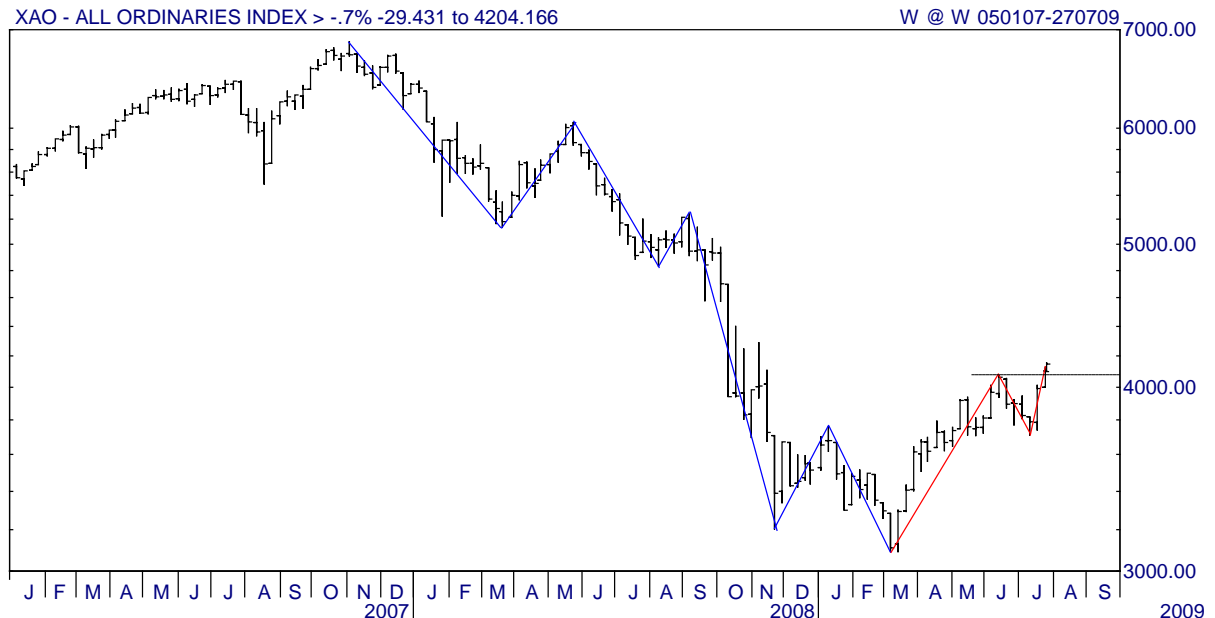


The chart above shows that three weeks later we had a bar that punched decisively above the lowest peak in the bear market in the week ending 8 May 2009. The strength of this bar was partly its range and partly the close that was very close to the high.

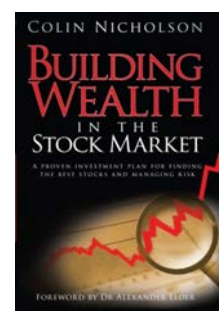
This was, for me a strong sign that the bear market was finished and came just three weeks before the Coppock signal at the end of the month. It was possible at this time to have done a "what if?"

calculation on the Coppock indicator spreadsheet so, as the month unfolded, we could assess the likelihood of a confirming Coppock signal.

It is important to stress here that this was a clear signal that the bear market was finished. However, that is not the same as what is required to say that a bull market had started. For that we need a trough that is higher than the bear market's lowest trough and a peak that is above the peak that preceded formation of the trough. That came in the week ending 24 July 2009:



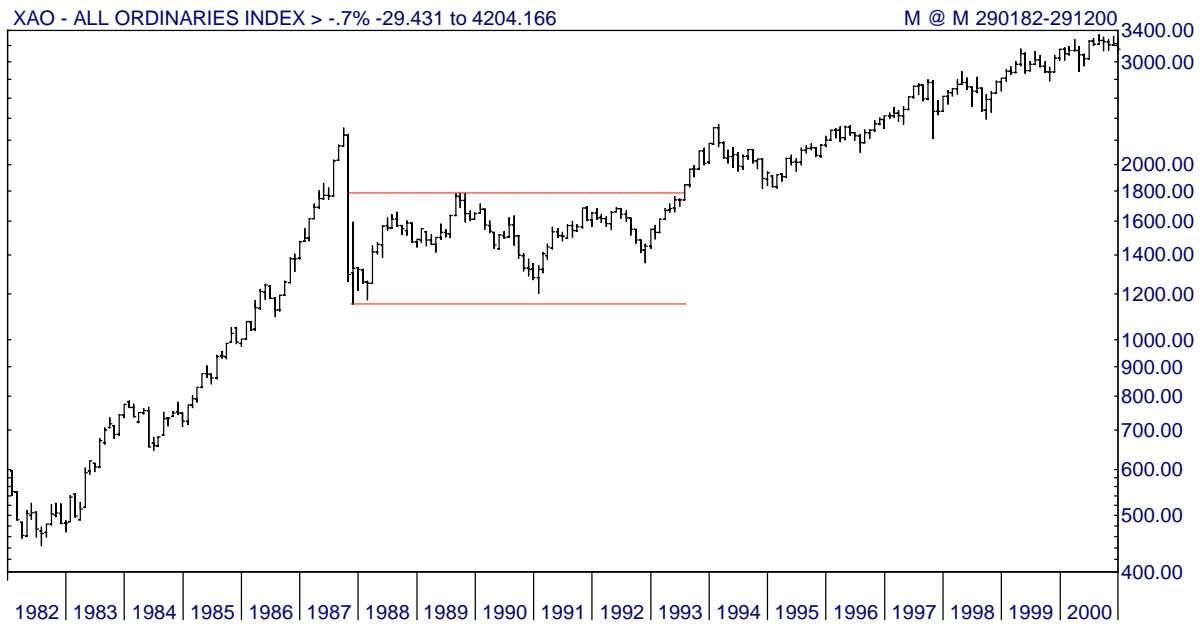
This chart shows a significant correction that established a higher trough that in turn was validated by a move above the previous peak in what is now a bull market. By this point I was urgently trying to build my exposure to the market in upward trending stocks, or stocks that were breaking out of sideways accumulation patterns on value model charts or consolidation patterns on growth model charts. For definitions of these models, see my book *Building Wealth in the Stock Market*.



By this point, we had everything in place for a bull market, phase analysis, Coppock indicator and trend analysis. The only problem was how quickly I could move to being fully invested. It took me a while, but I got there within a few months of this decisive signal. The reason that I was late getting in was that so many value model charts did not have clear accumulation pattern to break out of. Instead there were a great number that had formed V-type bottom patterns. I kick myself now that I did not anticipate this from my experience in 1974-75 when the same kind of plunging bear market quickly reversed. So, I had to some extent been left behind for failure to remember my own experience. I will not forget this again, if I get another chance like this in my lifetime.

I will not now do a detailed analysis of what followed, but skip to the immediate problem of understanding what I think may be happening since. Just as I should have remembered 1974-75, I have possibly partly redeemed myself by remembering what happened at another time in the past. Since I became involved in the markets in the mid-1960s there has been one really similar occasion in my experience. This was in the 1980s, when we had a debt-fuelled boom that led to the only

major “crash” that we have had on our market. I think that what happened as the leverage was unwound at that time is happening again as we unwind the leverage built up leading to the 2007 peak. Here is the monthly bar chart of last time:



The market retraced more than half the “crash” fall and then formed a huge sideways pattern over the next four years. After that it was off to the races in the next bull market. I think the similarities that time, following the latest debt-fuelled boom, are remarkable:



It seems to me that a similar pattern is playing out. The market regained over half of the bear market plunge and is now unfolding in a sideways pattern. My prognosis is that we will see a multi-year sideways pattern. It may retest the bear market low and it may not. It may take four years, or it may take longer. Nobody can forecast that. However, what I know from the phase analysis is that price earnings ratios are low. They may go lower, or they may not, it does not really worry me. Now is a time to be looking for undervalued companies that will be prospects to buy as soon as they start

turning upwards. As Warren Buffett has reminded us many times, we should be buying when prices are low, not waiting until they are high as most inexperienced investors always do. When prices are low the risks are low. When prices are high, the risks are high. My whole approach to investing is predicated on the idea getting onto bull markets early when the risk is low and getting out late in the bull market when the risk is high.

Caveat

My thesis above is based on a comparison to one previous example. The cause of the previous pattern is directly analogous to this time around, which makes it persuasive in my mind. However, that does not make it sound, relative to many other possible scenarios. All I can do is to define its boundaries on my chart and watch it unfold, tailoring my investment strategy accordingly.

My strategy

Before I lay out what I am doing, let me remind readers that each of us is different and therefore should have an appropriately different investment plan. What I do is right for me, but not for readers. My purpose in stating my strategy is simply to help readers learn by example. Readers will be able to see how I am thinking. Then you, dear readers, have to think for yourself. I cannot get inside your mind. I can tell you what has worked for me over a long period, but it may not be what works for any individual reader. The most vulnerable readers in this are the ones who just assume that what is good for me is good for them and, without thought, try to copy my strategy. Let me warn readers who are tempted to do it that they will lack the faith in my plan that is necessary to carry it out under pressure in the market. So, here is my strategy, consider it and then start thinking for yourself.

1. Because the bear market is clearly finished in 2009, I would like to be invested fully now. I was for a while, but stock after stock hit their stops and I had to sell them. I am finding it difficult to find many investment grade stocks that are turning up or already trending up at present, which is why I am currently only 21% invested. I am endeavouring to publish a case study on the members' website of every holding that I have. This is done as a teaching method, not as a recommendation. I repeat: what is right for me is not automatically right for anyone else. I called my first book *The Aggressive Investor* because my style is not passive –it is very aggressive in terms of the risk in investing in smaller industrial stocks. I do not recommend that any inexperienced investor try to copy my strategy in this respect until they have been through at least one bull and bear cycle.
2. I have a watch list of stocks that I have researched and check their chart every day. I will buy more of them as I think they are turning up. In this regard, readers may check what stocks I hold from the *Portfolio Disclosure* link to be found at the foot of every page on my website (don't forget to scroll down to find it). I update it the moment an order is completed in the market. In addition, every time I make a change to my portfolio I update the *Portfolio Details* page on the members' website. This has complete details of everything in my portfolio. I generally update it within a day of any change being made.
3. Every stock I hold has a soft stop and a hard stop. The explanation of this detail is on the members' website in Members' Newsletter 004. If a hard stop is hit, I sell without hesitation. I may sell before that if a soft stop is convincingly violated. The idea here is to protect my portfolio from disastrous losses. Yes, sometimes I am shaken out prematurely and have to

buy back again later, but this is only an inconvenience compared to trying to recover from a large loss. Do not copy me unless you have the experience that breeds the necessary discipline. This is one of the most difficult of disciplines to develop in investing.

4. My market exposure strategy at this time is to aim at being 100% invested as soon as the opportunities emerge that justify buying more stocks or building existing positions further.

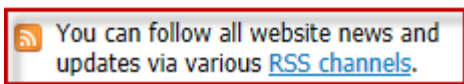
I hope readers enjoy this longer than normal newsletter.

Keeping up with additions to the website

WHAT'S NEW

The December 2011 Loan Market Group newsletter article titled *Investment thoughts for 2012* has been uploaded to the Members' website on the [Fundamental Analysis Articles](#) page. # 20 Nov

The scans as at 18 November 2011 have been uploaded to the [Interesting Charts and Scans](#) page on the Members' website. # 19 Nov



The *What's New* panel on the home page of www.bwts.com.au shows at any time the last two additions I have made. At the left is how it looks as I draft this part of the newsletter.

I try to add to this panel as soon as I can after each change I make to the website.

If you have not checked it for a while, and want to see what you may have missed, click the *What's New* heading, which is also a link to the *What's New* page.

This will open up a page on which there is a list of all prior additions to the website back to when the page was

started in May 2011. The top of this page currently looks like this:

Colin Nicholson [Building Wealth Through Shares](#)

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[Home](#) [About Colin](#) [Buy Books](#) [Resources](#) [Building Wealth Resources](#) [Copyright Material](#)

What's New

I am continually adding new material to the website. These additions are to both the free website and the members' website (paid).

Some additions are merely updates made at the end of each month to data files and files of charts See the [Resources page](#) on the free website and the [Interesting Charts](#) page on the members' website. These regular updates will not be listed below.

Newsletters are advised by email when they are ready for downloading. The previous newsletter is then added to the [Newsletters page](#). New newsletters will not be listed below.

New material will be generally be advised through the News column on the right of the Home page. However, it is not practical for the list to grow ever longer. Therefore the News column on the Home page will only list the most recent additions. This What's New page will include what is in the News column on the Home page and those items will continue to be listed on the What's New page even after they have been removed from the Home page News column.

New additions to the website are listed below by their date of publication on the website with the most recent at the top.

Links to pages on the members' website below are effective only if you have first logged in as a member.

I hope website users find this useful.

- 20 November 2011 The December 2011 Loan Market Group newsletter article titled *Investment thoughts for 2012* has been uploaded to the Members' website on the [Fundamental Analysis Articles](#) page.
- 18 November 2011 The scans as at 18 November 2011 have been uploaded to the [Interesting Charts and Scans](#) page on the Members' website.
- 12 November 2011 The scans as at 11 November 2011 have been uploaded to the [Interesting Charts and Scans](#) page on the Members' website.
- 9 November 2011 The [Portfolio Details](#) page on the Members' website has been updated to 9 November 2011 reflecting the purchase of **Ramsay Health Care (RHC)** and **Credit Corporation Group (CCP)**.
- 9 November 2011 A new case study of **Credit Corporation Group (CCP)** has been uploaded to the ongoing section of the [Stock Case Studies](#) page on the Members' website, following purchase 9 November 2011.
- 9 November 2011 A new case study of **Ramsay Health Care (RHC)** has been uploaded to the ongoing section of the [Stock Case Studies](#) page on the Members' website, following purchase 9 November 2011.
- 8 November 2011 An improved version of the New Position Size Calculator has been uploaded the the [Data and Other Files](#) page on the free website. It now rounds the Position allowed to the nearest 100 shares.
- 5 November 2011 The scans as at 4 November 2011 have been uploaded to the [Interesting Charts and Scans](#) page on the Members' website.
- 2 November 2011 The [Portfolio Details](#) page on the Members' website has been updated to 2 November 2011 reflecting the purchase of Fleetwood Corporation (FWD).
- 2 November 2011 A revised version of the end October 2011 Coppock indicator spreadsheets file has been uploaded to the [Resources](#) page on the Free website. The changes made are: (1) Addition of Shanghai All Ordinaries (2) Column 17 has now been rounded as Coppock did it, which eliminates some marginal signals and (3) All signals have been marked going back to 1900 or the start of the data that I have.

I hope that not too many readers see there things that they have missed, but I suspect there are many.

WHAT'S NEW

The December 2011 Loan Market Group newsletter article titled *Investment thoughts for 2012* has been uploaded to the Members' website on the [Fundamental Analysis Articles](#) page. # 20 Nov

The scans as at 18 November 2011 have been uploaded to the [Interesting Charts and Scans](#) page on the Members' website. # 19 Nov



You can follow all website news and updates via various [RSS channels](#).

However, it is not necessary to go to the website frequently looking for changes to *What's New*. The easy way to keep up is to use the RSS channels. At the bottom of the *What's New* box on the front page is a link to RSS channels in a red rectangle in the screen shot at the left.

RSS channels send you an alert, or "feed" every time there is a change to something you are interested in.

When you click on the RSS Channels link shown at the left in the red rectangle, you will see the page shown below:

Colin Nicholson [Building Wealth Through Shares](#)

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RSS Channels

While RSS is available for public view, all links are protected. Members have to be logged in to read files in the **members only** section of the website. If a member is not logged in he/she will be redirected to the home page with an error message asking them to login or join.

I have RSS feeds for following sections:

- [Ask Colin](#) (**free** section of the website)
- [News and Events](#) (**free** section of the website)
- [Articles](#) (**members'** section of the website)
- [Presentations](#) (**members'** section of the website)
- [Market Case Studies](#) (**members'** section of the website)
- [Market Scan Examples](#) (**members'** section of the website)
- [Stock Case Studies](#) (**members'** section of the website)

About RSS

RSS or *Really Simple Syndication* is a useful tool for keeping updated on your favorite web sites. RSS makes use of an XML code that constantly scans the content of a web site for updates and then broadcasts those updates to all subscribers through a feed.

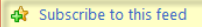
If you want to be advised of every addition, just activate the *News and Events* feed, which will alert you to anything I post in *What's New*. If you want only to be advised of some types of addition, you may select one or more of the other feeds.

Some readers have asked for even more instruction about setting up RSS feeds than is on that page. One problem with that is that there are many ways it can be done depending on the browser and software you have on your computer. However, here are the steps to set up an RSS feed for News and Events for readers using the **LATEST VERSION (V8)** of *Internet Explorer* (with some software you may first need to install some add-ins):

First, click the *News and Events* link shown above on the RSS Channels page. That will take you to the website page shown at the top of the next page:

Colin Nicholson: Building Wealth Through Shares - News and Events

You are viewing a feed that contains frequently updated content. When you subscribe to a feed, it is added to the Common Feed List. Updated information from the feed is automatically downloaded to your computer and can be viewed in Internet Explorer and other programs. [Learn more about feeds.](#)

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The December 2011 Loan Market Group...

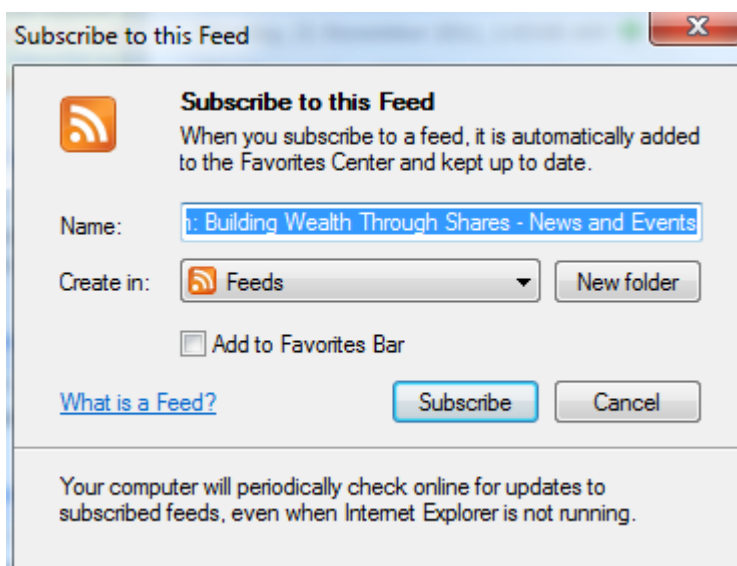
Monday, 21 November 2011, 1:43:00 AM →
 The December 2011 Loan Market Group newsletter article titled *Investment thoughts for 2012* has been uploaded to the Members' website on the [Fundamental Analysis Articles](#) page.

The scans as at 18 November 2011 have been...

Saturday, 19 November 2011, 7:12:00 PM →
 The scans as at 18 November 2011 have been uploaded to the [Interesting Charts and Scans](#) page on the Members' website.

The scans as at 11 November 2011 have been...

Sunday, 13 November 2011, 6:02:00 AM →
 The scans as at 11 November 2011 have been uploaded to the [Interesting Charts and Scans](#) page on the Members' website.



In the red rectangle is a link called *Subscribe to this feed*. Click it and this dialog box will open:

Click *Add to Favourites Bar* if you wish.

Click *Subscribe* and you are done.

For more help and assistance, click the *What is a feed?* link in the dialog box. This will open up an information box. At the bottom of it is another useful link to more information called *Viewing Feeds*.

I hope this is useful to readers and that those who take a few minutes to set it up will gain much greater enjoyment from my website.

Note: Please do not ask for help with other browsers. I do not have knowledge of them. However, there is much on the internet to assist you – just to use Google or another search engine.

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