

Colin Nicholson's Newsletter 47

4 March 2005

Some readers have reported problems with the newsletters.

One problem already identified is that email newsletters sent to email addresses on the Ozemail network are arriving without a Subject or a Sender. If you have an OzEmail, Business Pack, Family Pack, WOW, Access1, Camtech, SE Net, Harvey Norman, Packard Bell, PowerUp, Voyager, Gateway or winNET account, or if your domain is hosted by Ozemail, you will have this problem. The software developers are working on a solution to this problem already, so please do not report this problem.

However, if the email that you receive does not look right in any other respect, such as having HTML code in the message, would you please forward the email to me and tell me:

- Your operating system and what version number it is
- Your email client and what version number it is
- What your default settings are in your email client to receive emails – plain text or HTML. Note that is to RECEIVE emails, not READ emails, which can be changed after receipt.

This will hopefully help my ISP to find the reason for the problem and develop a solution. Thanks.

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This is a free email newsletter for people interested in investment and trading.

I do not allow anyone to use my list of email addresses.

If you have friends or clients who you think would like to receive the newsletter, please email it on to them and invite them to email me at colin@bwts.com.au to add their address to the list. My only proviso is that the newsletter be sent in full and unchanged.

Please read the Important Statement at the end of the newsletter.

Questions on My Book

My book, *The Aggressive Investor*, which has been published progressively on my subscription website www.bwts.com.au, is now completed and posted on the website, except for the case studies that are to go on the CD-ROM, which I will complete by the end of March. When I have a publication date in bookstores, I will advise it in a future newsletter.

I have had a great deal of feedback from subscribers, which has been very helpful and was a major reason for progressive publication on the website. These are some questions and answers from my response to some recent feedback from one of the subscribers, which may be of general interest:

Subscriber

Your case studies section is excellent, because you go into the detail behind the decisions you made at the time. It is good the way it brings aspects of your investment plan together. I highly recommend that in your CD-ROM to accompany the book you give the same detail to all your investments. Another way to present this information (rather than by each trade) would be in the form of a diary - this would allow the reader to understand the way you viewed market risk etc rather than just the tactics involved in each individual purchase.

Colin

I am yet to write the case studies for the CD-ROM. I will consider doing them chronologically, which would allow me to comment on the market risk elements. I was already tossing up doing it that way. Your thoughts are very helpful in confirming my instinct on it. However, in the chapter in the book, I want to focus on the individual investments.

I intend to do the CD-ROM case studies in the same detail.

Subscriber

Chapter 13 *Executive Summary of My Investment Plan* and Chapter 14 *Case Studies* could be structured as Appendices.

Colin

Chapter 13 *Executive Summary of My Investment Plan* - Yes, I considered that. I actually had it that way in a draft at one point. However, some other feedback and deeper consideration suggested that having explained the plan in detail, it made sense to logically have an easy summary for reference before starting on the case studies. That would make it easier for readers to check back on aspects of the plan. It also logically balances the Roadmap chapter analogous to a good lecture – first outline what you are going to teach, then teach it, finally reiterate the basic thrust of what you have taught.

Chapter 14 *Case Studies* is, in my opinion, and from feedback, the most important and valuable one in the book. It brings everything to life. I think it has to be an integral part of the book.

Subscriber

You seem to base your decisions solely based on pure price action. The only indicator you seem to use is the 260 day simple moving average. Has this always been the case? Have you ever used oscillators in your trading plan (e.g. for timing of entries into the market)? Given your other articles on your website and your obvious influence in the E114 *Technical Analysis* subject notes I would guess that at one stage you did or at least seriously considered it. In your experience is it common for "traders", "active investors" to base decisions primarily or almost solely on "basic chart data" rather than manipulating that data with indicators?

Colin

I started my life as a trader/investor with point and figure charts - pure price action. I learned over 20-odd years to read markets from the price action.

However, the learning process in almost any field involves consideration of a wide range of ideas and methods. I have looked at a great number of them over the years. I took each new method or idea and tested it against what I was already

doing. If it added value, it became part of what I do, but if not, I discarded it. Most of the things one tries “end up on the cutting room floor”, so to speak.

Nevertheless, this is not an absolute thing. One of the keys is to give each method a proper trial, or it is a waste of time. This meant that I learned a lot of analysis techniques well enough to teach them to others. Where the absolute comes in is that we will all find ourselves more comfortable with some tools than others. So, what I discard as not adding value, may add value to someone else’s existing or developing methods. Many tradesmen have a box full of tools that will do similar things, but they have their favourites, which they use a disproportionate amount of the time. Why they are favourites, or why they are comfortable to us will go to the very essence of who we are as an individual and the life journey we have made to the point of finding these methods.

For example, I grew up with the original IBM PC, the DOS operating system and Word Perfect. I learned how to do things very quickly using speed keys. Then Windows came along and we had a mouse and drop down menus and dialog boxes. The speed keys were still there, but the new generation who grew up only with Windows use the mouse and menus. So, to cut and paste something, they go from the keyboard to the mouse and drag it over the text to select it, click the Cut icon, or go to the Edit menu or right click the mouse etc etc. I can do all of that much faster without ever leaving the keyboard, except if I want to paste it to another document or a long way away in the same document, when the mouse might be quicker for that step.

So, it all depends on where you have come from. There is a big toolbox of ways to do the same thing in software and in technical analysis (also in fundamental analysis, when you get down to it). You choose what you are most comfortable with and what seems to be the most efficient for you. There are no rights or wrongs – just what fits the task and the person.

It is my subjective and unquantified observation that many experienced investors seem to rely mostly on the price information. However, there are many exceptions to that observation and I may not be making an accurate observation, because I may be attracted to people with similar approaches than to me.

Subscriber

Apart from your use of volume for an assessment of a stocks liquidity and therefore suitability for purchase, have you ever used volume data in managing your investments? You indicate that you may have used to at one point.

Colin

I have spent a great deal of time trying to use volume. The US text books seem to say how important it is. US stocks are generally deeper and more liquid markets than here – especially on the NYSE. I still find it difficult in the Australian market, even in quite liquid stocks. Maybe it is just me. I would not want to say what someone else might or might not find useful. It just does not seem to add much value for me.

There is one exception though – the Arms Index. I now think it is better than the naked advance-decline line because it reflects the volume of buyers and sellers.

Subscriber

You start with a monthly chart for your technical analysis screen. Does this mean that the stock must be in a monthly uptrend, or breaking out of a monthly consolidation phase, for you to purchase it? How about if the monthly trend was down but the weekly trend was up or in a weekly consolidation phase (which could still be picked up in a 52 week high scan)?

Colin

It must show an uptrend or a breakout on the monthly chart. i.e. reference back to the two models. If a stock is in a downtrend on the monthly charts, I would not buy it under any circumstances unless there was a breakout from an accumulation phase.

If you have read Dr Elder's work on short-term trading, *Trading for a living*, and *Come into My Trading Room*, you will know that he does much the same thing. The weekly trend tells him which direction he can trade on the daily chart.

This is a fundamental idea in technical analysis – trade in one time frame in the direction of the trend in the next higher time frame. The reason for this is simple. When a short-term or medium-term trend is in the direction of the trend in the next longer time frame, it tends to be much stronger and travel further than a shorter term trend that is counter to the longer time frame trend. This is well documented in the literature about cycle theory and has the jargon name of left hand and right hand translation.

Subscriber

In your "buying guidelines" do you have any "guideline" as to how close the price action should be to the 260 day moving average ?

Colin

No. I only use the 260-day moving average as a check on trend direction and speed. I am looking for consistency of trend above the moving average. That said, if a stock is stretched on the upside, I will wait for a better entry point. I can see this without indicators, but beginners might find a regression channel (on a very regular trend) or Dr Alexander Elder's percentage bands very useful here – see *Come into My Trading Room*.

Subscriber

Position Building Guidelines: You outline your 3-step process for buying from an accumulation zone. What strikes me as unusual is that your purchase price for the "second buy" could be below the purchase price for the "first buy". Is this not a form of averaging down which is widely regarded as bad practice by market commentators? I am guessing you are comfortable that it is not really averaging down as you are always within your 1% risk limit (i.e. your 3-step position building is really one overall trade/purchase).

I am trying to understand how you apply the 1% rule when you buy into a share in stages (i.e. add to your position). Assume you have capital of \$100,000. You initially buy share ABC at \$1.00 with a stop at \$0.60. You therefore could buy 2500 shares (risking 1%) but would have 2.5% invested. You therefore buy 2000 shares and have 2% invested and 0.8% at risk.

The price then rises and retreats so that it has slipped back slightly into your congestion zone. You think it has formed a trough and you want to purchase more at

\$0.95 (stop still at \$0.60). Assume your total capital remains unchanged. Under your method you would calculate that overall your maximum position could be 2857 shares ($\$1,000 / 0.35$). The maximum value of shares under the 4% rule that you could own would be \$4,000 (so you are not in breach of this). Initially you bought 2,000 shares so you could purchase an additional 857.

Under this scenario you have risked \$800 (2000 shares at \$0.40) on the first trade and on the second one \$300 (857 shares at \$0.35). Therefore in total you have risked \$1,100 which is more than your 1% rule! The question is why do you do it this way? I am guessing it is to keep things simple as it is only a factor if the purchase price for the second position is less than the purchase price for the initial purchase. You will probably comment that any such difference will be relatively immaterial under your trading plan (especially if the overall capital value of your portfolio is rising).

Using the example above, an alternative would be:

- a) Initial position as above
- b) For position 2 recognise that you have 0.8% at risk and therefore can only risk 0.2% (or \$200) on position 2. This would allow you to buy 571 shares for position 2 leaving your overall risk at 1%.

Colin

Please go back to the book and re-read the first section of Chapter 2 *Forget What you Paid*. The reality is that you are not risking more than 1%, because the shares are no longer worth what you paid for the first lot. That money no longer exists. I am building a position. As such, I am not averaging down because I do not think the first parcel is still worth what I paid for it. It is worth what I can sell it for.

This is one of the most important of the ways in which I believe that winners think differently to beginners, so I put it first in Chapter 2. Chapter 2 is also at the start of the book because everything else hangs on the way I think about the markets.

I know that many people will read my book and skip over Chapter 2 thinking it is touchy feely rubbish. This will be a big mistake. I cannot emphasise too much how important the way we think is in determining investing success. It is one of the most important things I learned from Dr Alexander Elder's work – that there are three aspects to trading – method, money and mind. Mind is psychology or the way we think. I am glad you have asked this question because it allows me to emphasise this point.

I must also make a confession. I had not realised this error in my investment plan myself until the last year when I have spent enormous time and effort writing the book. In my videotape/DVD seminar I did the calculations the way you are suggesting. This goes to show what I talk about in the introduction to the book – that learning to invest is a long process of gradual improvement and the job is never finished. There are always some lessons we have not totally internalised and this has been one of them for me and is still for you.

Subscriber

This section ("How many shares to buy rules") could be expanded and put as an appendix.

Colin

Chapter 14 and the additional case studies on the CD-ROM will take the reader through many examples, so expanding Chapter 12 is probably not necessary. However, I will keep your comments in mind and maybe discuss this issue in an appropriate case study.

Subscriber

When you add to your position ("position 3"), and previous positions ("positions 1 and 2") taken in the same share are "in profit" based on the stop loss level for the current purchase ("position 3") why can't you risk a full 1% (i.e. ignore the previous purchases). This assumes you remain within the 6% guideline. Note that this would be identical risk to purchasing all your position in 1 lump and risking 1%. I am guessing you do it this way because the calculation of your capital (and therefore the 1% applying to the purchase of position 3 will include unrealised gains on these shares (positions 1 and 2)? If I am right, is this what you refer to as "there is an element of pyramiding in the way I build a profitable position"?

Colin

I take the new purchase price. I establish the sell stop level. That gives me the risk per share. I calculate the number of shares I may buy. I subtract the number of shares I have already bought. That tells me how many shares I may buy now. My new risk at that point is the full 1%.

In other words, I am re-valuing the existing holdings at their market price and recalculating the risk. I totally ignore the original purchase price. This is consistent with the earlier answer on averaging down. What I do not do is to ignore the risk in the existing holding. That risk is now market price less sell stop.

Subscriber

You describe your selling rules. Then you later refer in the section on re-entry guidelines...."I then have a decision to make whether to switch out of an existing holding..." Does this mean you have additional guidelines for selling if you find something better? That is, the current holding has not met any of the selling rules, but you find a share which you consider a better prospect.

Colin

This is a good point and one that I will discuss in the book. My strong inclination is not to make a switch. However, if I do, it will rest on two ideas:

1. I will tend to do it in stages. i.e. Reduce a holding in steps, making the new investment prove its case that it is performing better than the original holding.
2. In comparing the existing and proposed investments, I will disregard what the existing investment has done to date. In other words, I try to compare them on the assumption that I currently do not hold either of them and consider whether I would buy it in preference to the proposed new investment as I see it today.

Subscriber

In the FUN case study you seem to use a different method of adding to your position on 22 July 2004. There is no mention of what the sell stop was (except for just under the trading range) or the 1% rule.

Colin

The key to what I did here was explained in the book thus:

I recognised that I was outside my investment plan, so had to think out what to do in this situation, but still be consistent with my investment plan. What I decided to do was to bring Funtastic up to 3% of the size of my portfolio at the time. That is, half what it would be if I had built a new position from scratch to 6% of my portfolio at today's value originally and had taken half of the position off when the price doubled.

So, yes, I did do something different here.

I honestly don't know now if I made the 1% calculation at the time. I did not write it down, so I have no way of being sure. I suspect that mental arithmetic suggested that I was nowhere near 1%, so I did not actually make the formal calculation. I will put the calculation in the book like this:

I did not write down the calculation of how many shares to buy in my diary, so I can't be sure whether I did it or relied on mental arithmetic to see I was nowhere near risking 1%. If I had done the calculation and written it down, it would have looked like this:

Funtastic (FUN) 22 July 2004
Buy Price 2.23
Less Stop 1.88
Risk 0.35
No of Shares $9,500 \div 0.35 = 27,100$

Since I was only going to 3% of the portfolio, the risk was about half of 1%.

Subscriber

You mention under diversification guidelines that you avoid having more than two companies in the same industry sector. How are these industry sectors defined?

Colin

Good point. I said sector loosely. I will amend the text of the book to delete the words "sector of the market". I was using "sector" in the very general meaning, but it is so entrenched in industry jargon to imply a sector index, that it was ambiguous. Thanks for highlighting this.

Subscriber

You discuss when a trough is significant. In the case studies you draw the trends you "see" on your charts. In the *E114 Technical Analysis* subject at the Securities Institute of Australia, considerable time is spent discussing trends in various timeframes (eg. 1st, 2nd, 3rd). How does this concept relate to the way you view trends? I am guessing you don't use a simple rule (eg. always view trends in the 2nd timeframe) but rely on the "gut feel" you have obtained through experience.

Colin

Yes, exactly. Except that I describe your "gut feel" as my judgement based on experience. I think E114 is a good way to teach something to beginners and makes

them aware of timeframes. However, in hindsight, it is rather too prescriptive and inflexible in practical situations.

Subscriber

In your postscript to AMP you state that it is still outside your investment plan. Why is this?

Colin

The PE ratio was not far enough below the industry average and the dividend yield not that far above it either. All things considered, and I put a lot of discussion into this example, it was not close enough to what I am looking for.

Of course, that does not mean it would not turn out to be a good investment. Lots of stocks that I will not touch do even better than many that I do buy. It is a question of risk. Because my approach is aggressive in the aspects flagged in the book – see Conclusion – I like to have a margin of safety in other parts of the plan.

Shares Magazine Predictions

Question

Shares magazine gave your predictions a bit of a drubbing in the February 2005 edition. How do the large losses in some predictions fit with your investment plan?

Answer

It is unfortunate that several of the stocks that I predicted to perform in 2004 did poorly over the 12-month period. However, predicting the stocks that should do well in the next year is not something I claim to be able to do. I am actually reluctant to write for these cover stories and I only do so because the editor asks me to do so. My first preference would be to decline and only write educational pieces as usual, but since prediction is an endlessly fascinating sport for the punters, I submit my best guesses.

My investment plan is based on a clear assumption that it is impossible to predict the stock market. I do not buy a share with the intention of holding it for a specific period of 12 months, as is assumed in the *Shares* article. Instead, my investment approach is based on finding uptrending stocks which seem to have a reasonable margin of safety and I buy them. If the trend persists, I hold and build a full position. If and when the trend fails, I get out. I actually try consciously not to predict the market, because it sets me up psychologically to defend my prediction through unconscious selective reading of information and interpretation of the evidence on the chart. I would prefer to be without that pressure and to simply buy and sell as the market prompts me to do so.

I actually owned each of the shares I covered in the 2004 article at the time that it was printed. However, several hit my sell stop afterwards and I sold them and reinvested the funds in other shares. The sales were shown on my website on the day that I made them. The losses were only a small part of my total portfolio as is anticipated in my investment plan. These losses are a normal consequence of my investment plan. My portfolio exceeded my target return (12.5%) in 2004 by a wide margin as is set out below.

The shares that I selected for the 2004 predictions and the way they performed over the year were:

Company	ASX Code	Price 16.1.04	Price 31.12.04	%Change
Ausdrill	ASL	0.85	0.51	-40.0
HGL	HGL	1.90	2.02	+6.3
HomeLeisure	HLD	0.63	0.355	-43.7
Integrated Gp	IWF	1.69	2.55	+50.9
Oroton Group	ORL	2.87	2.40	-16.4

Here is a brief summary of how these shares fared in my portfolio, which is a true reflection of my investment plan:

Company	ASX Code	Average Buy Price	Average Sell Price	Gain/Loss % of total Portfolio
Ausdrill	ASL	0.84	0.61	-1.0
HGL	HGL	1.94	1.84	-0.1
HomeLeisure	HLD	0.63	0.52	-0.7
Integrated Gp	IWF	1.08	1.51	+0.9
Integrated Gp	IWF	1.83	1.69	-0.2
Oroton Group	ORL	2.97	2.60	-0.2

Note I bought Integrated Group on two separate occasions. I made a good profit on one lot, but a small loss on the other.

Notice that, in line with my investment plan, the maximum loss in this group was 1% of my total portfolio.

My investment plan envisages that I will make losses like this. However, I should also make profits on other investments. The aim is for the net total to be strongly positive. To put these specific shares in perspective, with respect to my investment plan, it is therefore necessary to look at the performance of the overall portfolio. I measure my performance for the Australian July-June financial year, rather than the calendar year and it is a big job to go back and recalculate it for a calendar year. Calendar 2004 overlaps two financial years, one of which is incomplete as I write. The performance of my total portfolio was:

2003/04	+17.48
2004/5 to 2.3.05	+26.8

So the investment plan is working pretty well. The problem was that I chose some poor predictions to make for *Shares* magazine. This highlights my strong conviction that it is impossible to predict the stock markets and that it is counter productive to do so. Consistent with this, if I ever try to take credit for making good predictions in *Shares* magazine, please remind me that predictions that came out well were not due to skill, but to sheer luck.

The investment plan that underlies the performance shown above is set out in my book, which is being published progressively on my subscription website www.bwts.com.au.

New on the Subscription Website

Starting from the end of January, I am putting some Australian stock market breadth indicator charts on the subscription website. The breadth indicators being provided are the Advance-Decline line, the New Highs-New Lows line and the Arms index.

There are several charts for each indicator. Subscribers are invited to inspect the new feature by clicking *Breadth Indicators* on the blue navigation bar at the left of the subscription home page. I am not allowed by law to provide an analysis of these charts, so please do not email me questions. I comment on them from time to time in my weekly column in *BRW* magazine.

Which Indicators?

Question

Should I use the same indicators in both bull and bear markets?

Answer

In general terms yes, you should. You should try to become very familiar with the indicators that you have chosen to use. It is easier to make good calls on the market using tools you know and understand, rather than trying to use unfamiliar tools.

The tools you use should also be driven by your investment plan. The rules and guidelines that you have for buying and selling should be driven by the tools that your investment plan uses. It is not a good idea to be introducing new tools unless you change your investment plan to include them and the way you include them is consistent with the plan in its entirety.

However, there is some scope to use different parameters in bull and bear markets. In very general terms, many up trends are slower than down trends.

PDF Problem

I understand that a security problem has been found in Acrobat Reader Version 6. This has been corrected in Version 7, which can be downloaded free from www.adobe.com. I have upgraded to Acrobat Version 7 for the creation of PDF files for the website. This should not pose any problems for users of earlier versions, but if you do experience a problem, particularly with a recently posted file, the first thing to do is to upgrade to the free Acrobat Reader Version7 and try again.

Books and Articles on Indicators

Question

Where can I find detailed instruction on indicators?

Answer

There are many articles on indicators on my subscription website www.bwts.com.au in the *Stockwatch* articles, the *Technical Analysis* articles and in the *Shares* magazine Charting articles.

One of the best detailed books on indicators is *Martin Pring on Market Momentum*.

J Welles Wilder Jr. describes the indicators that he invented brilliantly in his original book *New Concepts in Technical Trading Systems*.

Dr Alexander Elder's books *Trading for a Living* and *Come into my Trading Room* also include some very clear descriptions of certain indicators.

Newsletter Publication

Question

When do you publish your free email newsletters?

Answer

There is no set timetable. I build them up over time and when I seem to have enough, I send them out. I try to do this roughly monthly, but it depends on what ideas I come across, questions I get sent and how busy I am with other deadlines, especially the ones I get paid to meet.

Why Trending Stocks are Missed

One of my readers offered some thoughts that may be of more general interest to readers:

Reader

I thought about the reasons for failing to invest in trending stocks:

- 1. Not recognised (unusual)*
- 2. Trend thought to be too early*
- 3. Thought to be too late*
- 4. Prejudice against the company*
- 5. Market climate thought to be unfavourable*
- 6. Waiting for consolidation (i.e. close to Sop-Loss)*
- 7. Reluctance to invest in multiple stocks at the same time for fear of major loss should markets turn before any of them rise above first consolidation allowing for orderly exit.*

Not all of these scruples are irrational. Even best long signals fail in falling markets. See 5 and 7. Problem 1. can be remedied by inspecting weekly charts where 'inflexion' points are easier seen because the chart does not fill the whole screen. Waiting for consolidation (See 6) is reasonable when chart rises in stepwise manner. Otherwise arbitrary entry and exits are preferable.

Colin

The ones that I would like to add something to are:

3. Thought to be too late

I hear a great many beginners saying this. My reader is not a beginner, but even experienced investors can find this a challenge. The theory is that trends tend to persist. The best trending stocks always look as though they have already gone to far. There is much to be gained from disciplining ourselves to build positions on any weakness in the best trends rather than buying ideal entries in sedate trends. The only exception is when a trend has been going on for several years and seems to be in an acceleration phase.

4. Prejudice against the company

I don't think this is a bad thing, providing the prejudice is rationally based on your investment plan. There are some companies I will never invest in because I have severe reservations about the industry, the business, the management or its general risk profile. The hard thing to live with is that some of these companies do very well in hindsight. However, we tend to overlook the other like them that really were dogs. Psychologically it is called regret.

5. Market thought to be unfavourable

I am very comfortable with this. It is an integral part of my market exposure strategy.

7. Multiple Stock Risk

I am less worried about this because my risk on any one stock is never more than 1% of my total portfolio value and I tend not to have more than 20 stocks. However, I would also be very reluctant to have 20 stocks all with 1% at risk. I would even be uneasy with 20 stocks if in total as much as 10% of the portfolio was at risk. I would also tend to build the portfolio and expand it gradually as I can move the sell stop level on earlier purchases into profit.

White List Please

Every month I get emails asking me what has happened to the newsletter because it has not been received for months. There are many reasons for this – the main one being that the person changed their email address and forgot to tell me. However, a close second are those who have installed anti-spam software, or enabled anti-spam software run by their ISP, or are using the Junk mail filter in Microsoft Outlook 2003. All of these have the potential to mistake the newsletter for Spam. The solution is easy – put colin@bwts.com.au on the white list for the software you are using.

Briefings to Analysts

Question

Under continuous disclosure should a company be allowed to give private briefings to analysts without informing the market?

Answer

The issue is often a matter of opinion as to whether the information obtained is really price sensitive. Companies are pretty careful about this after a few high-profile actions by ASIC - one was against AMP that I recall, but there were others.

It could be that the company told them nothing new, in which case the company did not have to make disclosure. Sometimes it is just a matter of taking the analysts through the published figures so that they have a "better understanding" of them. This is a very fine line, I agree.

Some companies follow the excellent approach of publishing any briefing to analysts to the market and even mailing it to shareholders. You did not mention the company, so I could not check. However, all you have to do to find all announcements is to go to www.asx.com.au.

Finally, it is possible that the analyst concerned learned nothing new at all, but is trying to give an impression that he or she knows something to get you to act. That may not be illegal, but it could be given a name.

Patience

Question

A share has been in an uptrend for a time and then prices start to go sideways between the support and resistance lines. The support line then becomes your stop loss. How long are you prepared to wait for a breakout above the resistance line, before you sell the share and invest in another, particularly if you are in a profit situation? In other words, how long will you wait for something to happen?

Answer

I have not generally found this to be a problem. Most of these sideways patterns seem to get resolved within 12 months. However, I would hold longer if I have to. I do not have a rule or guideline for how long I will hold. Remember the section earlier in the book on patience. It is a very important part of investing.

However, this should not stop you from having such a guideline in your plan. Remember mine is only a model for you to adapt.

I would emphasise one thing though – I would not take my eye off the chart. I keep watching daily any chart I sell out of for any reason until I am sure that the trend has changed. Adtrans is a good example. The consolidation zones have been wide, but breakouts have been very rewarding. As it happens it has hit my sell stop level each time and I have not sat through the whole consolidation. But I would if the sell stop was not hit.

Trend Lines

Question

How do you deal with the situation where a stock has broken below the trend line but resumes its uptrend?

Answer

I do not use trend lines in my investment plan except for one situation. If a share's price is rising almost vertically and I want to sell part of my holding into the first sign of weakness, a short term trend line drawn through the lows of the bars may be useful. I would sell either on the day the first bar broke the trend line, if I saw it on the day, or on the next day. Remember that trend lines only seem to work well if the trend unfolds at a fairly even rate. When it doesn't., trend lines may not be very useful. Other tools may be better. A short term reversal signal can be useful. The Parabolic indicator is also useful.

However, to answer your question for what I might do if trend lines were part of my investment plan. It would then depend on what the rules were for the plan. A trend line that is broken tells us that the rate of ascent of the trend has slowed down. This might be used in an investment plan as a signal to take some profits. It may then be that the plan calls for the sale to be reversed if the trend makes a new high.

Personally, I do not use trend lines at all. I trade the trend. So, if the trend is intact, even if it cuts a trend line, I would not take any action. I would continue to hold my position. However, as I say, that is my investment plan. You may have another plan and it may call for you to take action on the trend line break and again on confirmation of the trend. It is up to you to test if that is workable and to build it into your decision rules. There are many different ways to write a plan. The key is that the plan suits your personality and risk tolerance.

Equity Curve

Question

What is an Equity Curve?

Answer

Equity is a common accounting concept. Equity is defined as Assets minus liabilities. i.e. What you own minus what you owe.

If you are not using any borrowed money to invest, you simply revalue all of your investments each day, week or month and add any cash reserve. That total is your equity. You would normally chart your equity as a line chart or as a histogram.

If you are investing with borrowed money, you would subtract what you have borrowed from the total value of your investments and cash reserve.

Past Issues of the Newsletter

Past issues of the email newsletter are available for downloading from my free access web site www.bwts.com.au. Newsletters will generally be posted to the web site when the following issue is sent out, about a month later, so my email list is still the fastest way to get to see it.

Duplicated Addresses

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

Not Receiving Newsletters?

Whenever I send out the Newsletter, I get a number that are returned undeliverable. Common reasons for failure to receive a Newsletter are:

- *Readers change their email address and don't tell me.*
- *The reader's mailbox is full (over quota) - especially Hotmail.*
- *The reader has failed to keep their Hotmail or similar account active.*
- *The reader has not allowed my messages through their anti-spam blockers.*
- *The reader's ISP is using anti-spam blockers that stop legitimate messages as well as spam.*

Regrettably, I do not have time to follow up these situations. If the newsletter bounces, I delete the address from my list. If you stop getting newsletters, or hear anyone complain they did not receive the Newsletter from me, please get in touch with me to reinstate the address on the list. Thanks.

Important Information

The newsletter is intended to be a forum for discussion of interesting ideas about technical analysis, trading and investment. It is primarily educational in nature. I have taken reasonable care in its preparation. Nevertheless, everything in it should be read as my opinion, unless otherwise stated, and requires the reader to check the accuracy of facts and test the validity of my opinions before acting upon them. My opinions are not intended to be recommendations to trade or invest in any stock or financial security. Nor are they intended to be recommendations to use any particular trading or investment method. Readers who do not have the ability to assess the relevance to them of any matter discussed in the newsletter should consult a competent and licensed adviser before acting upon them. I am not a licensed adviser.

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