Colin Nicholson's Newsletter 53

8 November 2005

Upcoming Speaking Engagements

In the next few weeks I am going to be speaking in NSW and Queensland:

ATAA Newcastle
Date: Saturday 12 November
Time I am speaking: 11.20am (meeting starts 9.45am)
Place: Hamilton RSL 119 Tudor Street, Corner of Chaucer Street, Hamilton
Topic: Common Mind Traps for Traders and Investors
I will be discussing some of the most frequently encountered psychological biases in decision making for traders and investors.
Further information: www.ataa.com.au and bbeacham@networksmm.com.au

Brisbane Sunday Traders
Date: Sunday 13 November
Time I am speaking: 10am
Place: Easts leagues Club Main Avenue Cooparoo
Topic: The Simple Big Idea and How I Implement It
My investment plan is based on a simple idea that I believe gives me an edge in the market. I will explain this idea and then show how my investment plan actually uses it.
Further information: Shean Gannon shean@gannon.com.au

ATAA Sunshine Coast
Date: Monday 14 November
Time I am speaking: 6.15pm (meeting starts 5.30pm)
Place: Kawana Surf Club 99 Pacific Boulevarde Buddina
Topic: Common Mind Traps for Traders and Investors
I will be discussing some of the most frequently encountered psychological biases in decision making for traders and investors.
Further information: www.ataa.com.au and Paul Lightbody paul@kaostraders.com.au

Insight Trader Sunshine Coast User Group
Date: Tuesday 15 November
Time I am Speaking: 1.30pm
Place: Buderim
Topic: Implementation of my Investment Plan in Insight Trader
This session is only relevant to Insight Trader users. Attendance is open to Sunshine Coast and Toowoomba User Group members. I will be showing how my methods are carried out using the Insight Trader charting software.
Further information: Colin Weston colsyb@pacific.net.au

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ATAA Brisbane
Date: Thursday 17 November
Time I am speaking: 5.30pm
Place: Mansfield Tavern Corner Wecker Road and Luprena Streets Mansfield
Topic: Common Mind Traps for Traders and Investors
I will be discussing some of the most frequently encountered psychological biases in decision making for traders and investors.
Further information: www.ataa.com.au and Jason Sidney jasons@marketinsight.com.au

ATAA Sydney
Date: Tuesday 22 November
Time I am Speaking: 5.15pm
Place: Auditorium Level 1 Bowlers Club 95 York Street Sydney
Topic: Basics of Candlestick Charting for Beginners
This is a lead-in presentation before the main speaker, Dan Gramza at 6.15pm
Further information: www.ataa.com.au and Colin Nicholson colin@bwts.com.au

Sunday Traders Club NSW
Date: Sunday 27 November
Time I am Speaking: 10am
Place: Harbord Diggers Club Evans Street Harbord
Topic: The Simple Big Idea and How I Implement It
My investment plan is based on a simple idea that I believe gives me an edge in the market. I will explain this idea and then show how my investment plan actually uses it.
Further information: www.bullsandbearsnetwork.com.au and admin@bullsandbearsnetwork.com.au

Divergences

Question
I'm looking at the weekly chart of the ASX All Ordinaries index on 4 August 2005. I use three momentum indicators on this chart with the standard settings - MACD, RSI, and Stochastic.

One of the things I try to look for is divergence, but I'm still learning the signals at this stage. What is concerning me is that the new high in the price chart is not being matched on the MACD or RSI. Both have a downward slope from the highs of March to the new high of last week.

The trend is still intact with my trend line from March 2003 touching in May 2004, August 2004 and twice in May 2005.

My concern is this momentum divergence seems to confirm your BRW article of this week regrading the Arms index and the 20-day moving average of

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Advances. I also noted that Dr Alexander Elder's last newsletter was mentioning the MACD divergence on the SP500.

How do you feel about the MACD and RSI? Is this a clear divergence? Or just me gazing at the charts for too long?

Answer
I am writing this answer in the last week of October. I am sorry it took so long to respond to your questions. There are two reasons for this. Firstly, I have been very busy. Secondly, as you will be aware, I must be careful not to comment on current markets without a licence to advise people. The comments I am making below are therefore not to be construed as advice, but seen only as a discussion of the methods referred to for educational purposes. Although I know in part the outcome of the situation you have asked about. I will do my best to respond in such a way that I am not using hindsight to drive the analysis.

First, I have two rather general points I would like to make:

Divergences
I find there is a problem with bearish divergences in an uptrending market. It is true that there tends to be a divergence before the trend ends. However, prior to that, there is often one or more divergence that did not presage the end of the trend, but only a correction in the trend. That is not to say they are not valuable and that we should not take notice of them. However, it can result in very premature exits if we act on the first divergence in an uptrend. Ideally, we should be using a trend following indicator to trade an uptrend. So, if we see a divergence, I would not act on it as a trend ending unless I also had a trend following signal or a clear price signal like a trend ending or completion of a reversal pattern.

Trend lines
A trend line is very unfortunately named (as is Relative Strength Index) because it suggests that the indicator is doing something it is not. A trend line is not a trend following indicator. It is a momentum indicator. A trend is defined by peaks and troughs. A trend line, measures the speed or momentum with which the trend is unfolding. So, if price hugs the trend line, the trend is very consistently moving at the slope of the line. If the price is moving up away from an upward sloping trend line, then the speed of the trend is increasing. Note this assumes you have the trend line drawn on a semi-log chart, otherwise it may be just a scale effect. If the price is falling towards or through, such a trend line, then it tells us the trend is slowing down or losing momentum. There will often be a divergence when this occurs – for the same reason. This can be forewarning of the end of a trend, because trends often slow down before they turn, but it is not the definitive end of the trend, by definition, when the price falls through the trend line. As with the other momentum indicators, I would take notice of a break in the trend line, but I would not act on it as a trend ending unless I also had a trend

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following signal or a clear price signal like a trend ending or completion of a reversal pattern.

Having said these things, it must be stressed that there are many ways to trade markets. If you are a swing trader, your trading plan may be to sell on divergences and trend line breaks and this could be a rewarding way to capture most of any one swing an a trend. However, if you are trying to stay in the whole trend, these rules would tend to throw you out prematurely. As in all these things, a question or answer is only relevant in terms of what you are trying to do. You have not told me, but it sounds as though you are implying you are looking to hold in corrections and through to the end of the bull market.

Looking at your trend line first, you are clearly drawing it on a linear chart. As I said before, I always draw trend lines on semi-log charts. In that case, trend line analysis has been very difficult. Successive trend lines have been broken forming the fan pattern described in the textbooks. That can be an important signal too – like divergences, fan lines often occur before a trend ending, but each fan line, or any particular one in the sequence, is not invariably followed by a trend ending. The rule for me is that I would only use a trend line on a linear chart if it had a very small dynamic price range. The range in question is 2600 to 4800 on my software. This is not clearly a small range, but nor is it clearly a big range. So it is arguable which scaling is appropriate. If in doubt, I err towards semi-log.

Because of these problems, I prefer an alternative approach. As you will know from my weekly columns in BRW, I do not use conventional trend lines. Instead I prefer to use regression lines with channel lines through the maximum excursions from the regression line. I use a semi-log chart unless the price range is very small on a short term chart. This is just a personal preference, but I prefer this method. It is an expression of the well known tendency to revert to the mean, except when the trend changes. It seems to keep me in major trends, with shorter term regression lines used to track each upswing. At the time of your email the index was quite close to the regression line. This was not a place where we might normally expect a correction or trend ending. There were some signs of a possible correction which I noted in BRW. This might have meant a correction back to the lower channel line. In the event we got more uptrend through to October – the first expectation.

Now, to consider your divergence on the weekly MACD. I am sorry, but I cannot see this divergence on the MACD on either the MACD line or the signal line. I have reconstructed the chart as at 4 August and the MACD line is still rising above the rising signal line. There is a potential divergence (and see the next item in this newsletter), but no turn down to form a second peak after March, as you describe. However, close observation using the MACD Histogram shows that the weekly bar for the week to 5 August had ticked down. The reason this was not immediately apparent on the MACD chart was that it was caused by a rise in

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the Signal line faster than the MACD line rather than the more common situation where the MACD line turns down first.

2004 saw several premature consecutive divergences on the MACD. Likewise the MACD Histogram. This rather backs up my observation of lots of charts, in that all it meant was that the trend had slowed down for a while. What happened was that instead of leading to trend failure, it led to a period of much faster growth in the trend.

I do see the potential divergence forming on the RSI August versus March (you said standard setting, but I am not sure what that is. I assume you mean Welles Wilder's original suggestion of 14 weeks?). However looking at the period since May, there is only a low grade divergence (equal peaks on RSI) June versus August.

Going back to the big picture on the RSI, the long term divergence in April 2004 versus September 2003 did not lead to a trend ending. Why would we worry about this one except that the bull market is older?

It is my experience that momentum oscillators are best used to enter uptrends on corrections, rather than to exit them on divergence – always assuming that we are trying to stay in the long trend. If we are only trading each swing, weekly divergences are probably much more important to tell you which divergence on the daily oscillator to act on.

Identifying a Divergence

Question
When is a divergence completed?

Answer
This is an excellent question. It has not been made clear in my articles. Nor have I been able to find an answer elsewhere after searching some textbooks. Most commentators in textbooks show you examples in the middle of the chart when the divergence has already been clearly completed. However, an analyst or trader is required to act on the right hand side of the chart. As you rightly ask, when is an apparent divergence actually complete?

Since we are dealing with trends, it is tempting to simply fall back on the definition of trends. In an uptrend, a peak can not be definitely called until the price either falls below the previous trough (the end of a trend) or has made a subsequent trough. That trough in turn is only definitely in place once the price has risen above the peak we are concerned with. This can be reversed for a downtrend. The problem with this is that it is all too late to be of practical use except by a pedant teaching students.

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The practical answer is that some judgement is needed. If we are looking for a divergence in an uptrend, we may be inclined to act on a potential divergence. So, if we have a series of higher peaks in an uptrend and in an oscillator and then we notice that the oscillator is nowhere near its last peak as the price turns down from a peak, we may conclude that a divergence is likely to be formed. Of course, we may be wrong sometimes in hindsight, but at least we will have protected our capital if we turn out in hindsight to be correct in our assumption.

You asked specifically about Stochastic divergences. In my experience, unless there is a Lane's Classic Divergence, which involves three peaks or troughs, most divergences could have been correctly diagnosed as soon as the indicator turns at the second peak or trough. If we acted on such a signal and then Lane's Classic Divergence formed, we would have only been premature on acting when an even more powerful signal unfolded. Some may argue that we had acted too soon, in hindsight. However, this is heard from people who are still trying to pick the exact bottom or top of the market. I would ague that, especially at tops, it is better to be early on the odd Lane's Classic Divergence, than late on the others, all of which would cost us money. Lane's Classic Divergence is explained in the Stochastic article in the Technical Analysis Articles section of my members web site as well as in some textbooks.

More Feedback on *The Aggressive Investor*

I've just finished reading your book. It is exceptional. The large of number of case studies both in the book and in the CD set it apart from everything else. The writing is clear and highly readable. Thanks for making it available.

ooooOoooo

I've just finished reading "The Aggressive Investor" for the second time. As a "mature" fundamental investor (20+ years experience) who has been experimenting with technical analysis for a couple of years, may I say how superbly you have managed to combine these two disciplines. I'm sending my subscription so I can enjoy the full benefits of your web site. My thanks and congratulations on a book, which presents a clear and superbly constructed trading and investing approach.

ooooOoooo

I have really enjoyed reading your book. It has a remarkable symmetry and the economy and simplicity of language is striking. I found the Case studies in the book and CD especially illuminating. They really bring the trading plan to life and your thoughts at the time for the various decisions taken, combined with the fact that a lot of the charts are relatively recent, give one a real appreciation for the controlled risk taking involved.

ooooOoooo

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I read your book, and it is very good. It is always interesting and informative to compare the nuts and bolts of someone else's trading methods with your own

For more information and to order the book, go to www.bwts.com.au and click on The Aggressive Investor. If you are viewing this in HTML, click this direct link: http://www.bwts.com.au/text.cfm?42

Pyramiding

Question

I have been told that your investment plan involves pyramiding. Could you please explain this aspect of your plan?

Answer

My approach is to enter a position ideally in three stages. When I buy into a breakout, it means one third on the breakout, one third on the subsequent correction and one third on a new high for the now evident trend. When I buy into an existing trend, it means one third on a new high for the trend, one third on the subsequent correction and one third on a new high for the now confirmed trend. This is a three-stage entry to a trend, it is not pyramiding. Let me explain the difference.

Pyramiding is defined as *using unrealised profits … as security to borrow funds to buy … additional positions.* (Edna Carew *The Language of Money*)

Pyramiding is most common in the property and futures markets. Using a margin, a position is purchased. If the contract rises in price substantially, the balance in the margin account grows to the extent of the paper gains. If the margin account grows sufficiently, there will be enough there to enable the speculator to buy another contract. This continues so long as the price of the contract continues to rise, with more contracts being purchased using the paper gains as margin for the new positions.

To the extent that my position size calculations reflect any growth in the size of the portfolio when I buy the second and third parcels, there is a very small element of reinvestment of paper profits. However, it is nothing like the enormous leverage being used in true pyramiding.

Pyramiding is the explicit use of leverage and I do not use any leverage in my investment plan by choice. I do not choose to do so because there is quite aggressive assumption of risk in other areas of the plan as explained in my book.

Breadth Data on the Internet

One of my readers has kindly advised that Yahoo Finance is now offering Australian breadth data. To find it, go to www.yahoo.com.au, then Finance, then ASX Indices, then Market Digest.

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I checked the figures they show for 11 October against my calculations using Insight Trader. The advances were one different, the Declines were the same, but both the New Highs and the New Lows were greater. I suspect that the Yahoo data for New Highs and New Lows includes stocks that have not yet traded for 52 weeks. This is not my preference, but so long as it is used as a consistent source, the Yahoo data may be OK for readers who do not use Insight Trader.

US Fundamentals on the Internet

Question
Where can I see New York Stock Exchange fundamental data on the Internet?

Answer
I don't know where you can see NYSE fundamental data. However, there is S&P500 PE ratio and Dividend Yield chart which is constantly updated at http://www.ny.frb.org/research/directors_charts/i-page20.pdf

There is also long term data at http://www.econ.yale.edu/~shiller/data/ie_data.htm, but it is only updated infrequently.

All Ordinaries Accumulation Index

Question
Where can I get the ASX All Ordinaries Accumulation Index?

Answer
It is supplied by three data vendors that I know of, and probably more. Dial & Chart provide it with the code XAOAC01. Just Data provide it, but I do not know the code they use. Almax provide it with the code XAO-AC.

The data is also published in the Australian Financial Review, but is one day delayed.

Adjusting for Dividends?

Question
My current data supplier adjusts ASX data for stock splits, but not for ordinary dividends. However, it is my view that a dividend payment creates a non-technical price gap in the price history of a security and that this dividend gap, for the purpose of accurate system back-testing, should be removed by back-adjustment of the historical price data for that security. This would be akin to a continuous back-adjusted futures contract where the roll-over gaps are removed by back-adjustment of individual futures contract months.

Are you be aware of an Australian data provider of ASX data who provides such a service?

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Answer
I am not aware of a vendor who is providing such a service.

You could do it manually using Insight Trader or MetaStock for those stocks you are interested in, but I guess you want to do it for them all, which would be a big job manually.

The reason nobody is offering such a service is that the mainstream thought is that charts are not adjusted for dividends. The usual reasoning is that once a dividend is paid, it passes out of the price, but the next dividend is then progressively incorporated into the price. The way you adjusted all the data between dividends to reflect the portion of the dividend that is already reflected in the price would be highly theoretical. There would also be practical difficulties of maintaining the data in fractions of a cent to many decimal places to accurately reflect all the changes. However, none of this would be impossible, now we have computers with big fast hard drives, unlike the old days of hand-drawn charts. The question is whether it is worth doing and it seems the general consensus is no.

The quick-and-dirty method you propose is used for special dividends, which are in effect capital returns. It is sound theoretically for capital returns because they can generally not be anticipated and are therefore not already reflected in the price, except for the short period between announcement and the ex-dividend date.

My feeling is that you pose an interesting argument to correct a discontinuity in the chart. The quick-and-dirty method you propose is practical, but questionable theoretically.

If anyone knows of a data vendor who is adjusting for dividends, please let me know and I will pass it on to the questioner.

List of Dividends

Question
Where can I find a full list of all upcoming dividends?

Answer
One would have thought that it would be on the ASX web site. But not so. You have to put in the code for each company for which you want the dividend information.

Fortunately, Aspect Huntley Equity Review has a more user friendly website. On the Aspect Huntley website you can find a full list of the key upcoming dividend information for every company. Naturally, the information is not there until the dividend is announced, but then it goes up very quickly. The downside is that

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there is an annual subscription. I think this is one of the best-value subscriptions on the Internet. There is currently a 14-day free trial offer. Go to http://www.aspecthuntley.com.au/af/aerhome?xtm-licensee=aer to enjoy the trial.

Once you have signed in, the listing is found by clicking on Upcoming Events, and then Upcoming Dividends. The page may be searched using the standard Windows search initiated with Ctrl+F. You may also sort the ASX code field into alphabetical order by clicking on the heading.

My broker (Andrew west &Co) also has this information on his online trading website without having to pay the subscription. However, you must be a client to log in. Other broker website also provide access to this list.

Dan Gramza Seminar

Dan Gramza is without doubt the best teacher of Japanese candlestick analysis in the world. He is a Chicago USA based trader and adviser to a hedge fund. As such, he is more than an analyst, but is a complete trader and investor who brings his practical experience to bear on his seminars. Dan will be in Australia again in November to teach traders at a large institution, something he is in demand for all over the world. While he is here, he will teach a one-day seminar for private traders and investors on **Saturday 26 November**. I cannot recommend Dan's seminars too highly. For full details and how to book, go to www.bwts.com.au and click on Gramza Seminar, or go directly to http://www.bwts.com.au/text.cfm?46.

Ten Rules for Losing

It is instructive to consider the best ways to lose on your investments. It is often easier to avoid doing the wrong thing than it is to do the right thing. The following ten rules for losing were described by James Fraser in a little book called *Ten Rules for Investing*:

1. It you don't know – guess
2. Trade with the crowd
3. Trust all ideas from other people – do not think for yourself
4. Have pride in your own opinion – be inflexible and dogmatic
5. Never question popular views
6. Be greedy – never leave anything on the table
7. Be late to pick up the latest investment fad
8. Listen to all advisers – especially those saying what we want to hear
9. Blame "they" for all losses
10. Never look beyond the price (only use technical analysis)

New Facility on my Web Site

I am continuing to improve the facilities on my new web site. If you change your email address, you may now effect the change on the website instead of having

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to write me an email. Just go to the Newsletters page on www.bwts.com.au and click on the relevant link.

Hope for Mac Users

In the last newsletter I observed that finance is a PC world and there was not much charting software out there for Mac users. Fortunately, I reader has come to my assistance:

Finance is a PC world as you asserted in your reply to a reader query BUT for those of us who can't give up the beauty and purity of the Mac interface ProTA Gold is the software of choice. It is very complete, very reasonably priced and with a (relatively) straightforward programming language. All the indicators one could ever want and transparent code. www.beesoft.net is the place to look. Your correspondent may be interested.

Thanks for this. I welcome additional information from readers on any topic discussed in newsletters.

Trading Plan

Some of my readers may think I made this one up, but it is a real question to my web site:

Question

I have read many articles that refer to trading plans, but have yet to see an example of one. I don't have a trading plan, but I am not sure where to start. Can you help?

Answer

This is exactly why I wrote my book *The Aggressive Investor*. These three paragraphs from the introduction explain:

For many years, I have taught the important idea that investors need to develop their own investment plans. They need to do this because everyone comes to investing with different attitudes, beliefs and tolerance for risk. Unless the investment plan we adopt is consistent with our personality, the inevitable conflict will lead us to unconsciously sabotage the plan and we will fail. This is not to be underestimated. Indeed, the longer I work in this area, the more I respect this idea. So, for a long time, I was reluctant to teach my specific investment plan, because it is what is appropriate for me, but not necessarily for others.

Then people started to come to me and say that they accepted the idea of needing an investment plan. They also said that they accepted that they had to do this for themselves. However, they had a problem. When they took a blank sheet of paper to write their plan onto, they had no idea how to start. Nor did they know what needed to be in it, before they could consider it to be complete.

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I could have chosen to teach a purely theoretical approach to the development of an investment plan. However, it seemed a better idea to use my own investment plan as a model. My investment plan is built around what risks need to be managed. It shows how I have gone about managing them. It follows that my investment plan should not be simply copied, but must be adapted as is necessary by each reader. You will have to manage the same risks, but you should feel free to vary the methods for doing so.

To order the book, go to http://www.bwts.com.au/text.cfm?42

Don't Ignore It This Time

Just a reminder to Insight Trader users who subscribe to the Database Manager: You will be seeing a message about CEUCA when you open Winit after running Update From Web each week. Don't ignore it this time because you don't understand it. See Newsletter No 48 – item *Did You Do It?*

Create my Chart Arrangement

Question

How do you create the four-chart Chart Arrangement in Insight Trader, which you showed in *The Aggressive Investor*?

Answer

My four-chart Chart Arrangement consists:

Upper Left Window
A monthly semi-log bar chart with all available data displayed

Lower Left Window
A weekly semi-log bar chart with a running time window displaying the last 1500 days of data

Upper Right Window
A daily linear bar chart with a running time window displaying the last 365 days of data

Lower Right Window
A daily linear candlestick chart with a running time window displaying the last 100 days of data

All four charts have a 260-day simple moving average on them.

I create, and save as a Saved Chart, a template using St George Bank (SGB) [it could be any stock listed for about five years or more]. To create a chart arrangement for any stock I simply retrieve the template Chart Arrangement from Saved Charts and press Ctrl+N followed by the stock code. When I then press

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enter, all four windows are replaced with the new stock. I can then save this new Chart arrangement if I need to.

The key to having the running time window in the three windows other than the first one is to set the X Axis to From – n, [minus n], where n is the number of days to be in the running time window. What this setting does is tell the software to start the X axis from n days before the date on the computer clock (ie today). The running time window therefore automatically ensures that the software will always display the last n days only and requires no adjustment by the user.

The keystrokes to create my chart arrangement are:

Note: I will use hot keys, but you can do the same things with the relevant icons or menus in many cases.

Launch Winit
Alt+C
V
If your standard configuration is semi-log, press F
N
SGB
Enter
A
Tab
260
Enter
X
S
-100
Enter
C
+/= (the plus/equals key)
SGB
If not already checked, tick Close Dialog on Acceptance
Enter
X
S
-365
Enter
B
+/=
Enter
F
X
S
-1500

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Enter
+/=
Enter
Ctrl+F3
Horizontal tile

By the way, you could have learned these elements of the operation of Insight Trader and much more from Bernard Chapman's Interactive Seminar on CD. I could not recommend it too highly to anyone who is learning Insight Trader (who does not have more to learn?). See the next item.

Learn to Use Insight Trader

It takes a long time to learn all the features of any charting software. No matter how experienced we are, there are always new tricks to learn that enable us to work more productively. The best way to learn to use Insight Trader charting software is to attend one of Bernard Chapman's weekend interactive seminars. Even so there is a challenge to assimilate the enormous amount of material presented in two full days. For those who cannot attend the seminars, or for those who wish to take it more slowly and go over the material until it is embedded in their normal routines, Bernard recorded the last seminar – audio and video of the screens – on a CD.

This seminar has particular relevance for those who follow my methods, because there is a significant segment of the seminar devoted to implementation of my investment plan using Insight Trader.

I recommend this to both beginners and more experienced Insight Trader users. For more information and to order the CD, go to www.insighttrader.com.au and click on Training on CD, or go directly to http://www.insighttrader.com.au/cart_product_detail.php?id=47.

When to Start Investing

Question

If this is the top of a long bull run (end September 2005), then might I have to wait a couple of years for the right moment to be entering the market?

Answer

I have no idea whether the end of September 2005 is the top of the bull market. To know that involves being able to predict the future and I avoid doing that for two reasons. Firstly, it is an exercise in futility, because nobody has ever found a way to do it with any consistency and mostly forecasters get it totally wrong. Secondly, once we make a forecast, especially if we do it in public, our ego gets involved and we lose our objectivity. We start to protect our forecast and selectively see only information that supports it.

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My approach is totally different. I start with the view that anything can happen. I then assess the level of risk in the market and adopt a strategy to deal with it as best I can. This is all explained in detail in my book *The Aggressive Investor*.

Now that is out of the way, your real question should be, not whether it is the top of the market, but what you should do. I am not allowed by law to advise you in any way, because I choose not to hold a license to give advice. Instead I am focussed on education. All I can do is what I think is more valuable than specific advice and that is to make you aware of some things to think about and on which you should seek professional advice as to whether they may be appropriate for you.

Try not to look at the market too short term unless you are intending to be a short term trader. Your question suggests that you are not, but that you are an investor looking to ride the big trends. This year we have seen two corrections in a bull market. In April-May the market fell sharply, but has since gone on to much higher levels. The key thing is that the correction only undid a fraction of the gains since the bull market began in March 2003. We are now going through another correction. It may turn out to be the start of a bear market, though there is no conclusive technical evidence of that. It may therefore be appropriate to await clear signs that the falls are finished. If you never get such signs, then you are kept out of a bear market. However, if you do get such signs, then you can look for opportunities.

The opportunities are not found on the chart of the index. The chart of the index should drive only your global risk appraisal, never the actual buying and selling decisions, which must be made on the basis of individual stock charts. There are many ways to invest. Mine is to buy stocks that present a margin of safety in fundamental terms and which are breaking upwards out of an accumulation (value model) or consolidation (growth model) zone on the chart and therefore likely to trend upwards or which are already in an established uptrend. This is all described in detail in my book *The Aggressive Investor*.

Another way to deal with the big cycles in the market is called dollar cost averaging. This is not my method, but the following is an outline. I think it is an extremely sound way for someone to enter the market for the first time when they have no great experience. The method is based on the idea that it is difficult to time the market. It is therefore dangerous to put all your money into the market at one time. You just might pick the top for several or even many years. Instead, you put some of your money into the market each year for, say, five years. The aim is to spread it over the cycle. Some will be bought on the way down and some on the way up. You take 20% of your money and invest it in each of the five years. You always invest the same dollar amount. If the market is high, you will buy smaller numbers of shares. If the market is low you will be buying larger numbers of shares. The idea is that the average cost may be closer to the average for the cycle, rather than the top and also the bottom, both of which are

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equally difficult to identify except in hindsight. You can select some stocks and buy more of them each year, which is the ideal. However, if you do not have a lot of money to invest, you might be buying very small parcels, which will mean high transaction costs (brokerage). Therefore, you could also buy different stocks each year, so long as you understand that some will turn out to be better buys than others, but the overall portfolio cost will be average for the cycle. Avoid buying popular stocks that are highly priced at any time. Study the value investing approach and use that. Don't forget that dividends are a third of the total average return from stocks.

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