Analysing Bar Charts

This article was written some years ago, but is very relevant to today. The charts used to illustrate the text are now somewhat dated, but still relevant for the present purpose of teaching a technique.

If the price of a share is moving strongly upward, it can be said that buyers are in control of the market in that company's shares. This is because the price will be rising for the simple reason that buyers are keener to get their orders done than are sellers. When buyers are keen and there are insufficient sellers offering enough shares at current prices, buyers will make a higher bid, or accept a higher offer from a seller sitting above the last price. So, when buyers are keener than sellers, the price will tend to rise as the buyers seek the shares they are anxious to obtain.

Likewise, if a share price is falling strongly, it is a sign that the sellers are in control of the market for the company's shares. The price will be falling because those investors who are looking to sell are more committed to getting out than are buyers. When sellers are so keen and there are not enough buyers bidding for enough shares at the current price, sellers will offer their shares at lower prices to get their orders filled. This will impart a downward pressure on prices.

It is therefore clear that rising prices mean buyers are in control of the market and falling prices mean that sellers are in control of the market. This is always valuable information when making decisions to buy or sell shares. However, what can be far more useful is to detect when control of the market may be changing. This aspect is a little more difficult to detect and requires bringing together many of the aspects of analysis of opening and closing prices which have been discussed in previous charting articles.

There are three components of the analysis of whether control may be changing. Each is clear on its own, but the problem can be that on occasion they seem to be in conflict with each other. This is not because one or other of the observations is incorrect. Rather, it is because each of the three observations is identifying a somewhat different aspect of the overall situation. When they are all giving a similar clear indication, this confirmation is a very clear signal that the situation is either unchanged, or has changed dramatically. When the three aspects seem to be in conflict, it is often a signal that the situation is changing. Either commitment, control, or both, are in the process of shifting.

To make an assessment of the present commitment and control situation, all three observations need to be synthesised into a composite picture of what is happening. This is a higher order skill than just looking at one thing at a time. It will require some time and effort to develop the discipline needed, but can be quite rewarding.

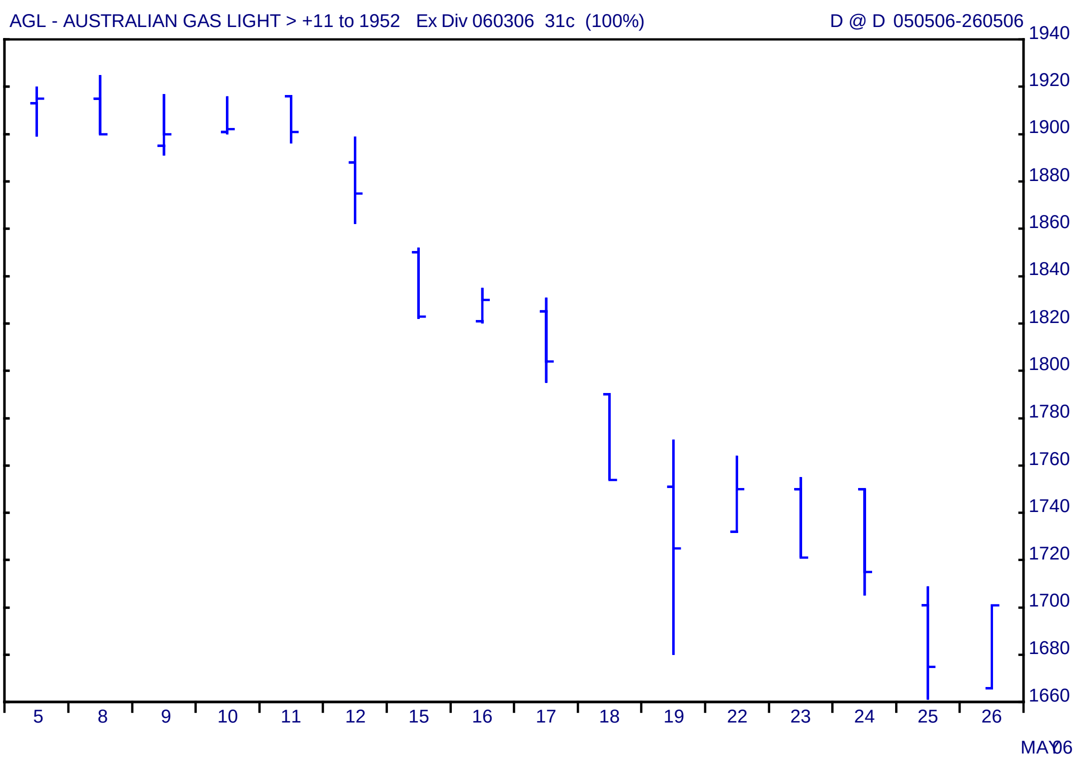
Observation One: The closing price today relative to yesterday
This observation focuses on ***how much progress has been made*** by the side which is controlling the market. If the closing price today in an uptrend is well above yesterday's closing price, buyers are still strongly committed and in control that day. However, if the closing price today is not much higher than yesterday, or even lower than yesterday, then buyers can be judged to be losing commitment and control may even have passed to sellers. In a downtrend, a closing price well below yesterday's close means the sellers are committed and in control. However, if the closing price is not far below, or even above, yesterday's closing price then sellers may be losing commitment and control, or it may have already passed over to the buyers.

Observation Two: The closing price relative to today's range
The range is the price difference between the highest and lowest prices traded on a day. When prices are rising, with buyers committed and in control, the position of the closing price in the range is signalling who was ***in control at the end of the day***. Closing prices that are near the daily high in an uptrend and near the daily low in a downtrend indicate that the side in control has maintained its commitment. However, when the closing price is well away from the daily high in an uptrend and the daily low in a downtrend, this can be an indication that commitment and control is weakening or has changed.

When the first and second observations seem to be in conflict, it can reinforce the suggestion that commitment and control is weakening or has changed.

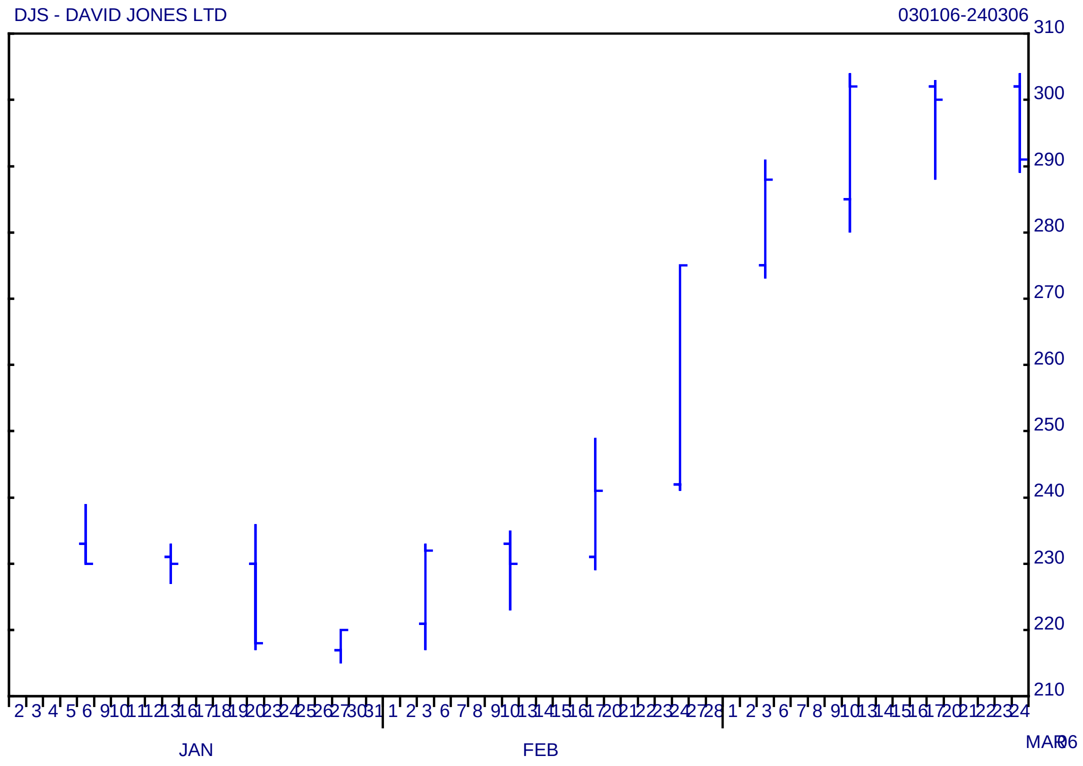
Observation Three: The relative positions of today's opening and closing prices
This observation measures the ***strength of commitment***. In an uptrend, if the opening price is near the daily low and the closing price is near the daily high, then the buyers are seen to be still strongly committed. When the opening and closing prices are near the centre of the range, the commitment of buyers has weakened. If the opening price is closer to the daily high and the closing price is closer to the daily low, then commitment would seem to have changed and control may have been lost. In a downtrend, commitment is maintained when the opening price is near the daily high and the closing price is near the daily low. When they are near the centre or the daily range, then the strength of commitment by sellers is weaker. If the opening price is near the daily low and the closing price is near the daily high, then sellers seem to have lost their commitment and may have also lost control.

The synthesis of these three observations into a composite picture of commitment and control of buyers or sellers is a very powerful and useful analytical tool, as shown by the discussion of the two example charts. The insights provided have the potential to benefit both traders and investors in the better timing of both entry and exit decisions.



Australian Gas Light (AGL) Daily Chart May 5 to 26 2006

In the Australian Gas Light (AGL) daily chart (below), we see a strong downtrend through the second half of May 2006. A buyer looking to get back into AGL might have been very interested after seeing the last bar on the chart. Right from the start, the sellers had not been able to take prices lower than the day before. Not only was their commitment less, but the closing price at the high suggests that control had changed and buyers were committed at the close. There is not a guarantee that the down trend had ended, but buyers could look for follow through on the upside for a buying opportunity. Placing a buy stop above the last closing price may have been appropriate. Likewise, short sellers should have been concerned and be looking to close out their positions, or at least tighten up their protect profit stops.



David Jones (DJS) weekly Chart January – March 2006

The weekly chart of David Jones (DJS) shows how this analysis method may also be employed by investors. As February 2006 unfolded, a strong uptrend developed and continued into March. The third weekly bar in March should have rung alarm bells. The buyers were unwilling to take the price higher than the previous week. Moreover, after Monday's open, sellers had been able to offer prices significantly lower without buyer commitment to hold the line. This showed evidence that buyers had easily lost commitment in the face of keen sellers, though the week finished with control still in the hands of buyers, as evidenced by the closing price near the weekly high. This bar should have warned buyers to guard against at least a pause in the ongoing uptrend and possibly that a correction was in the wind. Those concerned to protect profits might have closed up their protect profit stop. Those with uncompleted buy orders may have been disinclined to bid higher. A potential short seller may have set an entry stop below the low of the week.

The last weekly bar on the chart shows that buyers lost commitment as sellers poured in and took control. The week opened just above the previous closing price. Buyers took it a fraction higher before committed sellers took profits or established short positions. The week closed near the low of the weekly range, with sellers in control, while erstwhile buyers still held on anxiously.