

TUTORIALS IN APPLIED TECHNICAL ANALYSIS

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The Australian Internet Trading Weekly with independent analysis


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Edited by Daryl Guppy with contributions from T D'Angelo, S Mangwani and P Rak

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GBP/USD, NDO, XJO.

Note. The more computer icons
 appearing after a section
heading, the more advanced the
material.

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SELECTING TRADING TECHNIQUES

By Daryl Guppy

TRADERS' GLOSSARY

WATCHLISTS

Watch lists are a fundamental tool for all traders. They are a list of stocks which the trader is interested in. They can be selected by many means, from hot tips, from eyeball scans, from complex technical explorations, from brokers' tips and newspapers. The list contains a group of stocks which the trader watches over the following days or weeks.

Some lists include stocks that are currently held. Others include just speculative holdings, or investment sections of the portfolio. The list might include stocks that have good trading potential and we want to watch them, ready to jump when money becomes available.

Watch lists allow the trader to efficiently organise his analysis of the market and quickly keep up to date with stocks of interest to him. Stocks in a watch list are automatically updated with each new day's data.

As has been evident in our market outlook notes for many weeks, we feel the market is approaching a significant pause, or turning point. The divergence signals using an RSI, or an advance/decline analysis have been strong. This simply means that the trading conditions that have prevailed for the past eight months or so are less likely to continue in the same way in the coming months. Any new uptrend is likely to have different characteristics and will call for slightly different trading strategies. Any prolonged sideways movement, or consolidation, will be best traded using quite different methods to those employed in the last year. A new downtrend, either for several months or longer, calls for a completely different trading approach with new tools, techniques and trading instruments.

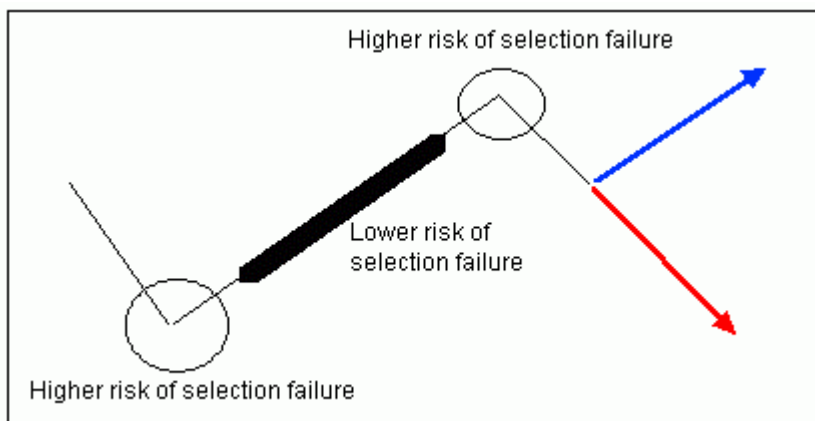
With many of the most recent nominal case study trades closed, the portfolio is cashed up and, like many traders, we wait for a clearer indication of the best strategy – cash, long, or short. Good traders are patient. We do not have to trade. This is the single most important advantage that we have as private traders. Opportunity appears in the market every day, so a delay does not mean we miss out. This frequency of opportunity means we can wait until the best and most suitable types of opportunity arise. What is best depends on your personal trading preferences.

Good traders are also always on the prowl for opportunity, whether they have the cash or not. We keep updated watch lists of all opportunities.

There are periods in market development where the risk of stock selection failure is lower than at other times. This occurs when a market is trending strongly, as the XJO has done in the past year or so. Stock selection techniques in this period are based on new highs, continued bullish strength and trend continuation. Any stock selected using these methods has a very good probability of delivering a profitable trade. The objective is to simply catch a ride with a boat that is rising on the general market tide.

In broad market terms, the most difficult periods are when the existing trend is in the process of changing into a new trend. Sometimes this trend change is dramatic and very clear. At other times, the trend change is slower, more difficult to detect, and paradoxically, capable of inflicting much more damage on our portfolio because we are too slow to act. In these periods, the risk of stock selection failure is higher. Traders use a different tool set, turning to breakout trading techniques, and perhaps shorter term trading approaches to get the best advantage in these conditions. In these periods, the investor is encouraged to buy quality blue chip stocks at bargain prices and to take a gamble on a future recovery. Traders prefer to use more exacting risk control measures in these periods, because the probability of failure is higher.

The diagram shows a simple trend structure where a downtrend turns to an uptrend and later the uptrend turns to a downtrend. Life is rarely as simple as this in the market, and these trend turning points are characterised by retreat and rebound behaviour. It is this potential behaviour that is of most



interest to traders in the current environment. The development of trend weakness characteristics in the XJO does not necessarily mean a new long term downtrend has commenced, as shown by the red arrow. Instead, traders could see a retreat followed by a rebound, as shown by the blue arrow. We use support areas to set the potential rebound points for this.

The difference is very important, because traders use a

different set of tools to trade each of these situations. If the downtrend continues, many traders will turn to derivative style trades to take advantage of the short side – selling high and buying low. This increases the appeal of short term CFD trading. Others will look for rebound rallies, concentrate on high probability chart patterns, or tighten stops of strongly performing stocks moving counter to the main market trend. These approaches call for a good level of trading skill and tight stop loss discipline.

If the market rebounds, then the advantage goes to those who buy early, because they can get the most out of the rebound, even if it turns out to be a short lived 2-3 month rally. Rebound trading takes advantage of short term rallies and high probability pattern trading. Derivative call trades are also an effective way to leverage profits from rallies and rebounds. We prefer calls because after a prolonged up trend, many traders remain bullish. They are more likely to buy calls rather than sell puts.

Aggressive traders, or investors who like to gamble, attempt to apply long term trend trading strategies in this environment. They regard the rebound as the start of a new uptrend and when they buy, they do not apply very tight stop loss conditions.

The diagram below shows one-way traders can make a decision about the most effective combination of strategies to use based on broad market analysis. Each group, bulls or bears, has a set of preferred tools. If we take a directional view of the market – the market is going to go up or down – then we gamble that our view is correct even though we recognise that at market turning points there is a higher probability of selection failure. If we believe the market is going to go up, then we buy a stock with this view in mind. If the market goes down, we could lose more than we expected to.

DEFINING SEARCHES

By Daryl Guppy

TRADING METHODS

CULLING TRADING OPPORTUNITIES

The trader cuts the mass of market data down to size using Metastock Explorer to look for specific relationships. The charts are also eyeballed, flicking quickly through them looking for chart patterns which are not detected by software scans. The chart patterns, or trading opportunities, include trading bands, breakouts and triangles. The trader usually only eyeballs for one type of pattern in each scan. This preliminary list is then narrowed down on financial and technical grounds. Traders develop their own techniques for cutting the data overload, so there is enough time for thorough analysis.

We select a search to find potential new opportunities by starting with an idea of what the result may look like. Our market analysis is covered in detail elsewhere in the newsletter, so we use just a summary here.

Anticipated market conditions

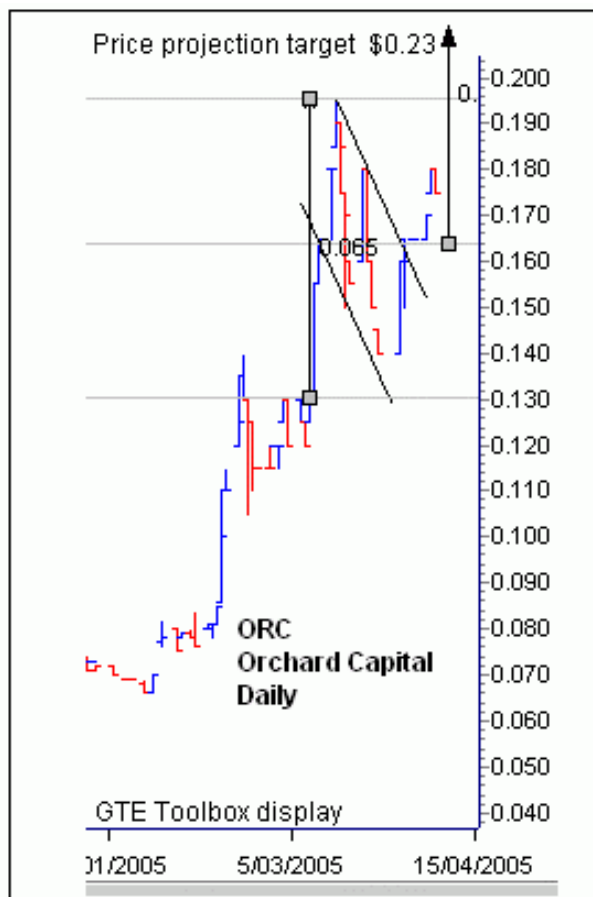
- Rebound from support followed by a decline from resistance.
- Trend weakness, but no downtrend yet confirmed.
- Time is a risk factor.

Anticipated type of trading opportunity

- Rebound rallies.
- Increased reliability of pattern trading as less experienced traders see the dip as a buying opportunity.
- Increased crowd emotions which produce more defined trading patterns.
- Short term trades.

Search or exploration methods

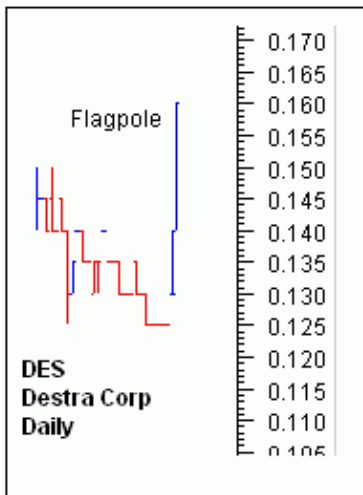
- Flag search looking for recent flagpoles. These show the pole, and any subsequent development over the last week.



This example uses the GTE Toolbox display. Using the parallel trend line tool, the upper edge of the flag is plotted. The parallel trend line retains its slope and can be positioned accurately at the base of the flag. Selecting the grab handle on the right of either line and dragging will change the slope of both lines. This speeds up this pattern plotting. We use the price projection tool to measure the height of the flagpole and project the target from the point at which price breaks out above the upper edge of the flag.

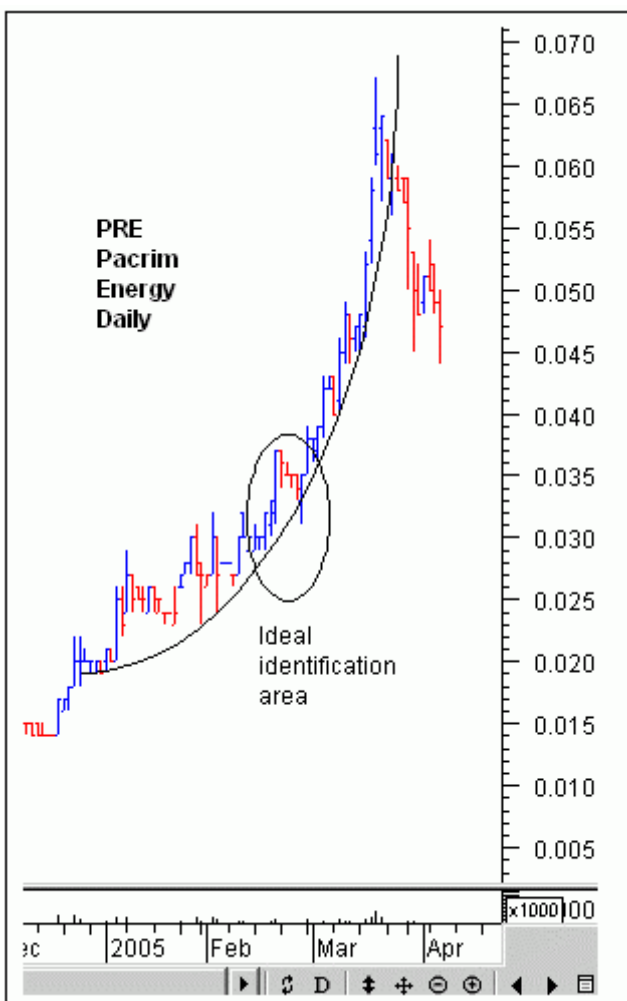
This is a valid flag pattern, but the breakout is weak, so it is not a good trading opportunity.

- Flag search looking for current flag poles. Put these on a watch list to see how the flag develops.



This is the type of activity we are interested in, but it may take another 5 to 10 days for any flag pattern to emerge.

- Peak to trough exploration. This is useful in finding some parabolic trend opportunities.



This is an effective search formula, but sometimes it locates parabolic trends too late in their development. The PRE chart appears on the search list, but the opportunity is fully developed. The circled area shows the idea identification point. We have not developed a specific search for parabolic trends. The peak to trough search is one of the more successful technical searches that tends to throw up a number of developing, and completed, parabolic trend opportunities.

- Use CPFinder to locate specific patterns.

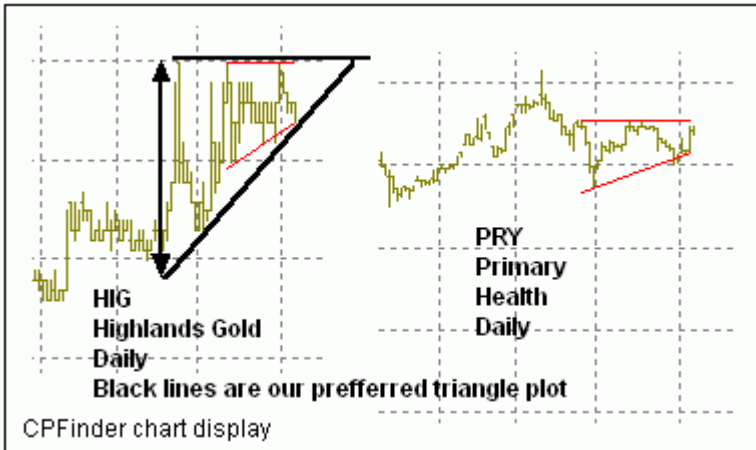
The objective is to trade during an emotional period. Many traders are confused, or worried and this increases the probability that they will overreact. This increases the level of market inefficiency and provides short term trading opportunities. This short term 3 to 5 day focus is also consistent with the change in the risk profile of the market. The longer we have a new open position, the greater the risk of a significant market lurch. This is no longer a staid, solid, trending market, so we must anticipate surprises.

The two Metastock technical searches are completed and the search results saved as lists in the favourites file. The stocks are then eyeballed looking for these features:

- Parabolic trends.
- Flag patterns.
- Up sloping triangles near completion or just starting breakouts.
- Strong trends easily defined using a straight edge trend line and a count back line. In particular, we look for those where a rebound has developed from the trend line.
- Other patterns which can be exploited. We add an example of this in the management notes.

- Final selection is based on price leverage. Lower priced stocks have the capacity to generate higher percentage returns in a short period and this matches our trading strategy.

Our technical searches were not particularly productive when we ran them on Thursday using Wednesday's close. In these market conditions, we will continue to run the searches every 2 or 3 days, assessing the search results for opportunity.

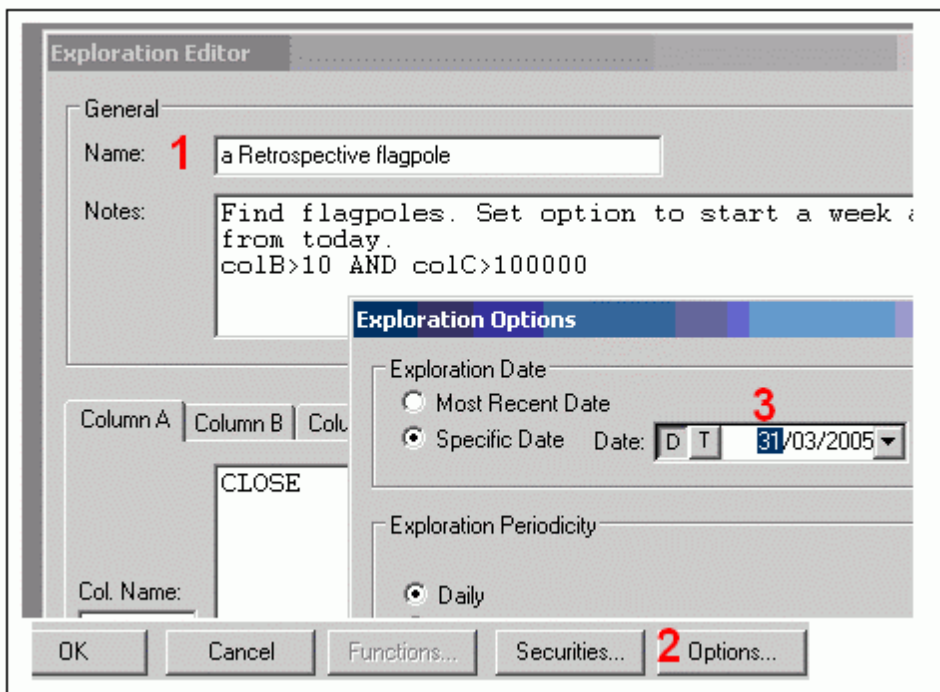


The CPattern Finder flag pattern search was also unproductive in terms of flags, but it did include some other potential trading opportunities.

METASTOCK - RETROSPECTIVE FLAGPOLES

Col A: Close CLOSE
 Col B: 5 Day ROC(LOW,20,percent)
 Col C: VOLUME*CLOSE
 Filter colB>20 AND colC>10000

METASTOCK – PEAK TO TROUGH
 Original source <http://www.meta-formula.com>
 Col A: ((Peak(1,H,1)-Trough(1,L,1))/Trough(1,L,1)*100)
 Col B: CLOSE>Ref(HHV(C,25),-1)
 Filter colB=1 AND V>200000 AND C>Mov(C,40,E) AND colA<=15



GOT A QUESTION YOU WOULD LIKE TO ASK?

This is the only chat room where you will find Daryl Guppy and other recognised traders and authors. Post a question and get quality answers. Just visit and browse the discussion boards for educational information on trading techniques, using Metastock, and the questions that we all need to ask. This chat room has an international audience.



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MANAGING CHANGE

By Daryl Guppy

RELATED TOPICS

TIME IN THE MARKET

Trading objectives should be matched with time in the market. The greater the time exposure - weeks or months - the greater the risk of the market moving in an unpleasant direction. Open positions held for a long time must offer better returns for the risk associated with the time in the market.

Trades offering smaller returns should be closed when they have spent weeks failing to reach your profits. Matching time in the market against risk and with potential reward is a judgment call, but unlike a safe, but low paying CMA account, the market carries risk.

High risk markets are best traded for a short time span with maximum, usually leveraged, returns. Risk management also means time management

This week we show you the management methods we applied to the remaining open case study trades. Elsewhere in the newsletter we examine the options available for better trading in a more uncertain market environment. Until the market establishes a clear direction, traders look for shorter term defensive strategies that are designed to lock in profits and limit the impact of time. We will show the advantages, and disadvantages of this in the coming issues using three case study trading examples.

Next week we will produce our first ever 'theme' issue. We have asked some of our regular contributors and noted traders to tell us how they handled the substantial market wobble in the last two weeks. This will give readers an opportunity to compare techniques and reactions from a variety of skilled sources. This information will be invaluable in assisting you in constructing your own trading plan.

Surviving a significant market collapse calls for absolute trading discipline. We simply cannot tell how far this retreat is likely to go, so traders give trades no latitude. When the sell signal is triggered, we take an exit. This change in volatility turns our attention to shorter term trading tactics because time has now become a significant risk factor. In this issue, we show how to search for rally and rebound trades and locate short term, high probability patterns. These tactics deliver ongoing profits until the market re-establishes a more consistent trend behaviour.

We expect a certain percentage of trades to fail. The long up trend has distorted this relationship. Over the past year traders have grown lazy as the market has simply carried many trades upwards. A series of failed trades in coming weeks, as market conditions, change will return the long term performance back to the average. Traders will do their best to avoid losing trades, but unless they adapt quickly to market conditions, the number of losing trades will increase.

We close the last of the old case study trades this week. Despite closing a trade at a loss last week, our tight risk management rules mean that the portfolio realised return starting July 1, 2004 is 59.6%. This is still an acceptable return.

TYPE OF TRADE – STAIRWAY TRADE

These are a chart pattern that form above a strong up trend. The pattern starts with a sharp rise over several days above the trend line. Over the next few days, or weeks, price move between the trend line and the initial high. This often creates an up sloping triangle that uses the main trend line as its sloping base. The next breakout in the pattern usually starts as the triangle pattern is almost completed. It is a sharp rise over a day, or several days. It usually confirms the price projection targets of the first triangle. Again prices drop back from the high, testing the trend line, and the high point of this second move. A new, small up sloping triangle develops. This is the second step in the stair case.

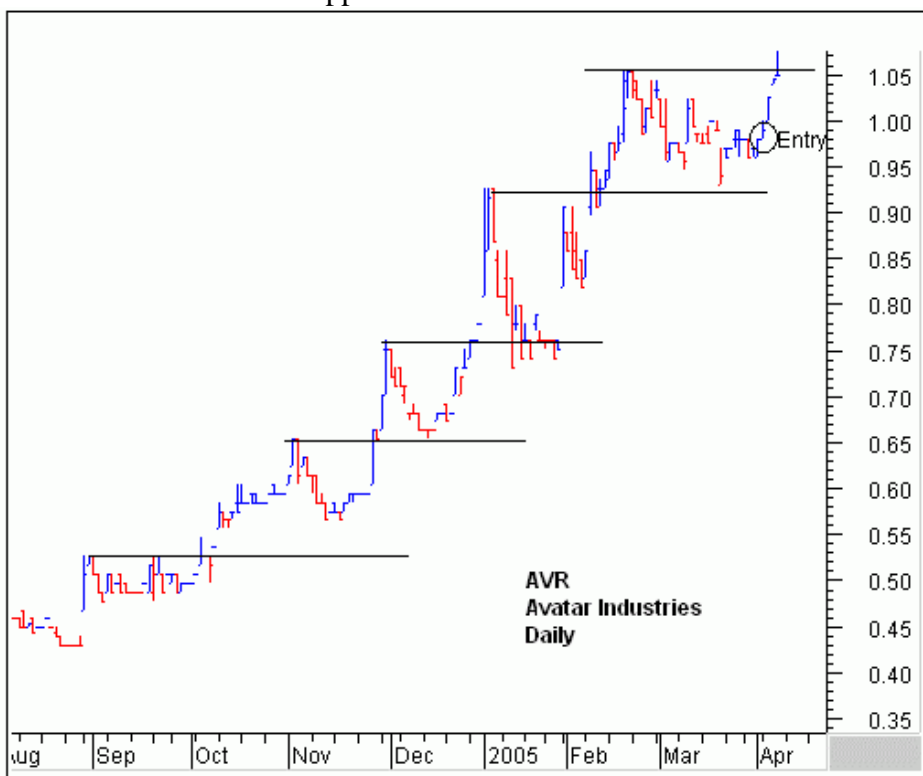
An alternative for this pattern is where the peak on each rise sets the resistance, and later the support level, for each new move. This is similar to an extended Darvas style trade, but the bands, or boxes, are defined by the peaks and lows.

The pattern finishes when the step pattern is disrupted by a gap pattern. This is like a missing step in the sequence and signals the top of the pattern. This is an exit signal. Another exit signal is when the step failed to move upwards in a continuation of pattern. This signals traders to take the best exit possible, and this is usually confirmed by closes below the major trend line.

TRADING PLAN

The plan is to ride the trend using:

- The most recent resistance level as a support level once the breakout occurs
- Setting new resistance levels based on the peak of each move.
- The trend is constructed from a series of trading bands. Trend lines are not used in this trade management
- A 10 and 30 day moving average is used as a broad confirmation of the trend, and as an initial signal that the trend may be in trouble. This tells the trader to be ready to act on a move below the most recent support line.



Position size, stop loss and protect profit conditions

For tutorial purposes we buy 20,200 for a total cost of \$19,988. The stop loss is based on the most recent support line at \$0.92. This trade puts at risk \$1,414 when initially entered. Early identification of this trade would have provided a better entry point and reduced the risk. We keep position size at around the same level for each case study trade so each trade is easily compared. Another way to reduce the risk in this trade is to reduce the position size.

Trade management

This trade is managed using the support line as a stop loss. Once there are a series of closes above the upper resistance level, this will become the new trailing stop loss point. Initial trend weakness warning comes from the 10 and 30 day moving average relationship. This can be further

verified against the Guppy Multiple Moving Average, however the primary management method is to use the pattern of support and resistance levels.

Trade status

Trade is open

TYPE OF TRADE – PARABOLIC

The parabolic curve is plotted to get the best fit on the known low points of the trend. A characteristic of this type of trade is the rapid collapse of prices once the trend is broken when price moves to the left of the trend line. This is a short term trade with a defined end point.

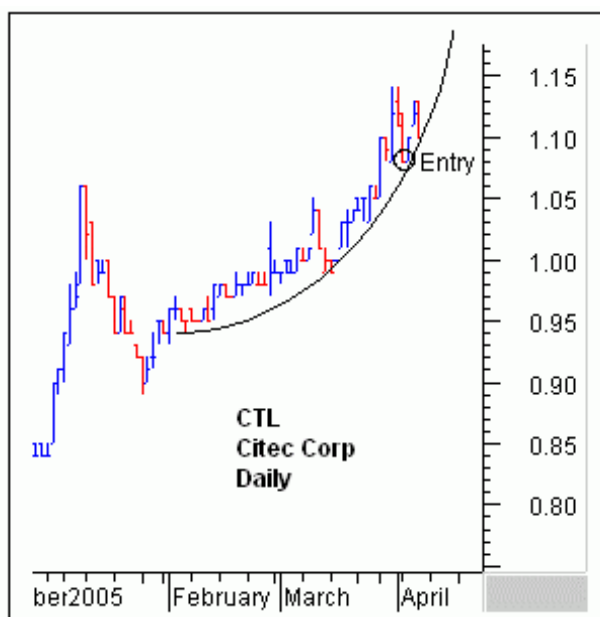
TRADING PLAN

The plan is to ride the trend using:

- A parabolic line as a stop loss and trend management tool
- A close below the parabolic line signals an exit.
- As the line approaches vertical, an exit is taken on the day before prices will inevitably move to the right of the line.

Position size, stop loss and protect profit conditions

For tutorial purposes we buy 18,500 for a total cost of \$19,980. The stop loss is based on the parabolic line as shown at \$1.07. This is a tight stop loss, but it is consistent with the nature of parabolic trades. This trade puts at risk \$185 when initially entered.



Trade management

This trade is managed using the parabolic line as a trailing loss. There is no price objective. There is a time based objective as prices inevitably move to the right of the parabolic trend line as it approaches vertical. An exit is signaled when prices move to the right of the parabolic trend line. As the curve approaches vertical an exit is signaled when prices will clearly close below the parabolic trend line. This calls for intraday management. This is appropriate in nervous market conditions because the price collapse may be very dramatic.

Trade status

Trade is open

TYPE OF TRADE – COUNT BACK LINE

The count back line is a volatility based stop loss. It can be applied early in a trend before the trend can be fully defined using other methods. We do not recommend its use in this context, however it can be applied in this way when trading a continuation of the trend. This is the way we use it in this trading example.

The chart display is from the new Guppy Traders Essential Toolbox, which reads Metastock data. This small program is designed to work alongside Metastock and will be available for download within the next 2 to 3 weeks.



TRADING PLAN

The plan is to ride the trend using:

- A count back line as a stop loss and trend management tool
- Define the developing trend with a straight edge trend line as appropriate.

Position size, stop loss and protect profit conditions

For tutorial purposes we buy 103,000 for a total cost of \$20,085. The stop loss is based on the interim count back line as shown at \$0.175. This trade puts at risk \$1,545 when initially entered.

Trade management

This trade is managed using the count back line as a trailing stop loss. The objective is to trade the continuation of this trend.

On the day of the entry the correct count back line calculation is made from the high at \$0.205. It is placed at \$0.16 as shown.

Our objective is to capture the rebound that is part of the new trend. We use an interim count back line calculation based on the most recent high on the trend on the day prior to the entry. This sets the stop loss at \$0.18. This is a correct application of the count back line calculation, but the starting point is not correct. However, the calculation captures the immediate volatility on this stock and this is important for this particular trading strategy.

This strategy sees time as the most significant risk. We enter with a tight stop loss, ready to sell at the first indication of weakness. By tightening the stop using the most recent volatility we achieve this objective.

When a new high above \$0.16 is made, we use this as the new stop loss point. This is currently at \$0.19. We continue to use the correct application of the count back line as the new trend emerges.

Trade status

Trade is open

TYPE OF TRADE - Exchange Traded Fund Strategy

The key management of this trade is a 10 and 30 day moving average crossover. Based on the Thursday close, this indicator is on the cusp of crossing. Until the crossover is confirmed, this trade remains open. We will bring you management notes for this next week.

This trade is closed on the day following the moving average crossover. Note that the moving average crossover is not confirmed until the end of trading on Friday. We do not get to act on this exit signal until Monday. For tutorial purposes, we take an exit at \$42.00. This returns \$3,085 or 17.74% from this case study trade. In the same period, the market added 15.28%, so the ETF has beaten the market performance. This is due to the impact of dividends. This superior return comes from using absolutely simple management tools – a 10 and 30 day moving average. Unlike managed funds, there are no management fees.

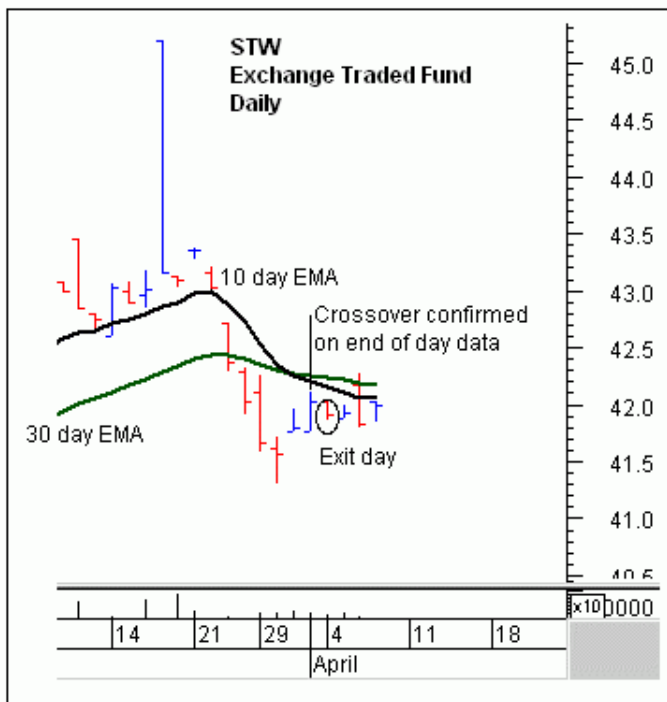
We will continue with the ETF strategy in future issues if appropriate. Our contention is that over an extended period, the strategy shown in this case study will outperform the buy and hold strategy, and most managed funds.

For the past months this has been a profoundly boring trade. It simply kept going up. The main challenge with this type of trade is to develop the discipline to sit back and do nothing. Many traders have observed that trading, when implemented successfully, is quite boring. This is a good example of that observation.

The market offers a lower rate of return than that available from trading individual stocks, so why use an ETF strategy? This strategy offers two main advantages.

- Ease of management for exposure to the broad market.
- Access to dividends from the top 200 companies.

We note several points of market inefficiency in this fund. These spikes do not match the XJO



performance. This market inefficiency can be helpful in making better than expected exits and entries. The danger is that as the XJO continues to stall, there may be sudden STW dips. This is also market inefficiency at work.

This technique uses a simple trend analysis tool to confirm when a trend change has taken place. As the conditions develop we use defensive techniques to fine tune our decision making so that when the time comes we can take the appropriate defensive action. The purpose of the newsletter is to educate. Part of that education process means giving readers the opportunity to examine a range of strategies as they develop and unfold in real time. Equipped with this information, readers are more informed and can make a better choice about how appropriate a selected strategy is for their particular circumstances.

Management notes layout.

These management notes provide an ongoing record of how a trade was identified, how it was entered, the management decisions made during the life of the trade, and finally the exit and evaluation of the trading strategy. We use colour highlights to make it easier for readers to select either the updated notes, or examine the decisions during the life of the trade example. **Each week the new notes are added and highlighted in bold blue.** The notes from the previous week are summarised and added to the existing notes in plain text. In some weeks we want to highlight an advance trading trigger mentioned in the previous week and acted upon in the current week. In this case we highlight the **relevant sections in bold green.**

To avoid crowded confusion on charts, we may delete the earlier chart comments from the latest version of the chart. Sometimes the text management notes may refer to a feature, ie circle A, that is not seen on the current chart. Readers will need to look at past issues to find the relevant management notes and chart with that feature.

We believe this layout method develops a useful reference of ongoing management of each case study trade. Readers can quickly see the new management notes while still having access to the previous management decisions.

TRADING WITH ANDREWS PITCHFORK

By Suniel Mangwani

INDICATOR REVISION ANDREWS PITCHFORK

This looks like a pitchfork with three lines. The starting point in a downtrend is a clear retracement. Point A is the low of the retracement started. Point B is the highest point of the retracement. This line is then bisected by the long term trend line started from a previous high. This is a median trend line that bisects the retracement line. The trend line from the high is plotted exactly in the middle of the AB line. The developing trend is contained within the upper and lower line. Breaks above or below these lines indicate a change in the development of crowd emotion. Patterns by themselves do not.

The Andrews Pitchfork or the Median Line method is basically a method to estimate the trend, and visually calculate a target. It is a study of trendlines consisting of three parallel lines, which give the appearance of a Pitchfork. The method for drawing the Andrews Pitchfork is fairly simple. In a downtrend you need to wait for a decent retracement. Point A will be the lowest low before the retracement started and Point B will be the highest point of that retracement. Once you have these two points, you then look for a major high to use as Point C. You then draw a trendline from Point C exactly in the middle of the AB line. In other words, it bisects the AB line.



Pitchfork, which we label as point C. We draw a trendline originating from point C, which goes exactly through the centre of AB. This is the important line, also known as the median line. We then draw 2 parallel lines to this, from points A and B. This completes the Pitchfork. According to Andrews, the purpose of the median line is to determine the trend. The most important part of this concept is that prices typically make it to the median line 80% of the time. Prices typically head in the direction of the median line and in a strong market touch the far parallel line. That by itself is a powerful factor, that you can visually see where prices would most likely go.

But any effective concept is not complete without defining the points of entry and exit, and following money management principles. We will add two more trendlines to the basic concept of the Andrews Pitchfork, which will help us define our entry and exit for a trade.

First we draw a line connecting points C and B extended forward. This we will label as the Upper Trigger line or our Line of Resistance. The concept is that, so long as price stays beneath this line,



the downtrend is in place. In fact, usually price comes back to test this line of resistance and fails to penetrate it. This makes it even more effective as a resistance level. So we place our stops above this line. Now we need a proper entry point. Even though the trend is in place, prices do tend to whipsaw back and forth as mentioned earlier, if only to test the resistance level. So we draw a line connecting the lows of all the bars between points A and B. This is our Entry Trigger line, shown as line AD in the chart. When price breaks this line, we get

As we can see in the chart, GBP/USD has been in a downtrend and in the process makes a retracement, which we label as point A to point B. We connect the points A and B with a trendline. We then look for a major high before the retracement, to complete our third point of the

the downtrend is in place. In fact, usually price comes back to test this line of resistance and fails to penetrate it. This makes it even more effective as a resistance level. So we place our stops above this line.

Now we need a proper entry point.

the confirmation of our entry. This is because the line forms a minor support level, and price generally breaks it with sufficient momentum, making it the safest point to enter.

So now that we have the entry and stop defined precisely, we need to manage the trade. Trading 10 lots in this example, I closed 5 lots when price touched the central median line, and moved the stop to breakeven to the entry point. I then closed 3 lots when price touched the lower median line, which defined the range of the trade, and moved the stop to the central median line. I now had 2 lots riding in profit, which were also closed for a profit when price started retracing, and hit the upper median line. It can be seen that prices started rallying up, and a change in trend was signified, when price broke our original line of resistance – the upper trigger line.

So by using these simple additions to the original concept, we can manage our trades visually from the charts.

READERS' QUESTIONS: DRAWDOWN

By Tom D'Angelo

SUBJECT SUMMARY

THE BUSINESS OF TRADING

Trading is a business. The trader deals in buy and sell contracts and has an inventory of shares that are the same as the 'stock' in a retail shop. His customers do not walk in the door. They are found throughout the country and are connected by a broker and an exchange which facilitates the sale of 'shares'. Every business has its profitable, and less profitable sections. Trading is no different and our profits come from particular techniques and processes. Successful traders create a professional trading environment to manage their trading activities similar to a successful business.

Good software assists in this process. These articles explain how ManusRisco money management software is used to improve the business control and management of trading.

Failure to adopt a professional, disciplined businesslike approach towards speculation and investment will significantly decrease your chances of achieving long term profitability in today's volatile trading arena. These articles are designed to teach you how to create a professional trading environment so you can manage your trading activities similar to a successful business and make confident, disciplined trading decisions.

Over the next few weeks we will cover these topics:

- Introduction - How successful businesses are organised
- The Profit Centre business model applied to trading
- A professional, disciplined money management methodology
- Positive and negative expectation games
- **Drawdown**
- Return on Investment
- PTR / UTR
- Breakeven Analysis
- The edge: Who has it and how to get it.

In previous articles, we learned the basics of creating a disciplined money management methodology, organising your trading results, using proven business models and the importance of playing only positive expectation games.

Our Profit Centre structure organises our trading results into manageable businesses and we are now able to create the Analysis Reports which are necessary to make confident and educated trading decisions.

In this article, we will discuss drawdown, which is one of the most important reports produced by our business organisation. Drawdown is defined as a decrease from a previous equity high. For example, if you start off with \$10,000 and make three winning trades for a total of \$1,000, equity has reached a new equity high of \$11,000. If your next trade loses \$500, you are in a \$500 drawdown and you will continue in drawdown until the previous equity high of \$11,000 is surpassed.

Most traders, even very profitable ones, will be surprised to learn that they are in a drawdown at least 70 % of the time. Drawdown is both financially and psychologically destructive, and to compound the problem, many traders do not have the business structure designed to provide the information required to reduce the fear and anxiety produced by drawdown.

If trading results are not organised in a structured, businesslike environment, the trader is left in the dark as to when, where, why and how much drawdown is occurring. The lack of information

creates the fear of the unknown, which causes many of the psychological problems traders must confront on a daily basis.

As discussed in our article “**The Profit Centre Business Model Applied To Trading**”, a properly designed business structure can organise trading results to provide the information necessary to produce informative and practical Analysis Reports, such as the Drawdown Report.

A properly designed Drawdown Report should contain the following information:

% of Time at New Equity High
% of Time in Drawdown

Current % Drawdown
Worst % Drawdown
Average % Drawdown

Current \$ Drawdown
Worst \$ Drawdown
Average \$ Drawdown

Current \$ Profit / Current \$ Drawdown
Current \$ Profit / Worst \$ Drawdown
Current \$ Profit / Average \$ Drawdown

\$ Difference Between Worst \$ Drawdown and Current \$ Drawdown

The first image displays a Drawdown report on a trade by trade basis. The second image displays the Summary Page of the Drawdown Report, which summarises all the important statistics described above.

Practice		Individual Trades Drawdown Analysis							
ALL Trade Dates									
Trade Date	Symbol	Pos	# Traded	\$ P/L	Cum \$ P/L	Equity	\$ DD	% DD	Cum \$P/L / \$ DD
Beginning Trading Capital						\$ 13,000			
09/08/2004	ES	Buy	2	(\$ 318)	(\$ 318)	\$ 12,682	(\$ 318)	(2.5 %)	
09/08/2004	ES	Buy	2	\$ 182	(\$ 136)	\$ 12,864	(\$ 136)	(1.1 %)	
09/08/2004	ES	Buy	2	\$ 82	(\$ 54)	\$ 12,946	(\$ 54)	(0.4 %)	
09/08/2004	ES	Sell	1	(\$ 209)	(\$ 263)	\$ 12,737	(\$ 263)	(2.1 %)	
09/08/2004	ES	Buy	1	\$ 41	(\$ 222)	\$ 12,778	(\$ 222)	(1.7 %)	
09/08/2004	ES	Buy	2	(\$ 318)	(\$ 540)	\$ 12,460	(\$ 540)	(4.3 %)	
09/08/2004	ES	Buy	1	\$ 141	(\$ 399)	\$ 12,601	(\$ 399)	(3.2 %)	
09/08/2004	ES	Buy	1	\$ 191	(\$ 208)	\$ 12,792	(\$ 208)	(1.6 %)	
09/08/2004	ES	Buy	1	(\$ 209)	(\$ 417)	\$ 12,583	(\$ 417)	(3.3 %)	
09/08/2004	ES	Buy	1	\$ 91	(\$ 326)	\$ 12,674	(\$ 326)	(2.6 %)	
09/08/2004	ES	Sell	1	(\$ 209)	(\$ 535)	\$ 12,465	(\$ 535)	(4.3 %)	
09/08/2004	ES	Buy	3	(\$ 252)	(\$ 787)	\$ 12,213	(\$ 787)	(6.4 %)	
09/08/2004	ES	Buy	1	\$ 91	(\$ 696)	\$ 12,304	(\$ 696)	(5.7 %)	
09/08/2004	ES	Buy	1	\$ 91	(\$ 605)	\$ 12,395	(\$ 605)	(4.9 %)	
09/08/2004	ES	Sell	2	\$ 182	(\$ 423)	\$ 12,577	(\$ 423)	(3.4 %)	
09/08/2004	ES	Buy	1	(\$ 109)	(\$ 532)	\$ 12,468	(\$ 532)	(4.3 %)	
09/09/2004	ES	Buy	1	\$ 141	(\$ 391)	\$ 12,609	(\$ 391)	(3.1 %)	
09/09/2004	ES	Buy	2	\$ 382	(\$ 9)	\$ 12,991	(\$ 9)	(0.1 %)	
09/09/2004	ES	Sell	1	\$ 141	\$ 132	\$ 13,132	\$ 0		
09/09/2004	ES	Buy	1	\$ 91	\$ 223	\$ 13,223	\$ 0		
09/09/2004	ES	Buy	1	(\$ 259)	(\$ 36)	\$ 12,964	(\$ 259)	(2.0 %)	
09/10/2004	ES	Buy	1	\$ 91	\$ 55	\$ 13,055	(\$ 168)	(1.3 %)	0.3
09/10/2004	ES	Buy	1	\$ 191	\$ 246	\$ 13,246	\$ 0		
09/10/2004	ES	Buy	1	\$ 66	\$ 312	\$ 13,312	\$ 0		
09/10/2004	ES	Buy	1	\$ 141	\$ 453	\$ 13,453	\$ 0		
09/10/2004	ES	Buy	1	(\$ 109)	\$ 344	\$ 13,344	(\$ 109)	(0.8 %)	3.2
09/10/2004	ES	Sell	2	(\$ 293)	\$ 51	\$ 13,051	(\$ 402)	(3.1 %)	0.1
09/10/2004	ES	Sell	1	\$ 41	\$ 92	\$ 13,092	(\$ 361)	(2.8 %)	0.3
09/10/2004	ES	Sell	1	\$ 104	\$ 196	\$ 13,196	(\$ 257)	(1.9 %)	0.8
09/10/2004	ES	Buy	1	(\$ 59)	\$ 137	\$ 13,137	(\$ 316)	(2.4 %)	0.4
09/10/2004	ES	Buy	1	\$ 128	\$ 265	\$ 13,265	(\$ 188)	(1.4 %)	1.4
09/10/2004	ES	Sell	1	(\$ 96)	\$ 169	\$ 13,169	(\$ 284)	(2.2 %)	0.6

Practice	Individual Trades Drawdown Analysis	
	ALL Trade Dates	
	Summary	
Equity High:	\$17,690	1/3/2005
Equity Low:	\$12,207	9/10/2004
\$ Difference Equity High & Equity Low:	\$5,483	
% Difference Equity High & Equity Low:	31.0 %	
Total Trades:	426	
Time at Equity High	33	
% of time at new Equity High	7.7 %	
Time in Drawdown:	393	
% of time in Drawdown:	92.3 %	
Worst \$ Drawdown:	(\$3,571)	12/13/2004
Worst % Drawdown:	(26.9 %)	12/13/2004
Average \$ Drawdown:	(\$1,468)	
Average % Drawdown:	(10.2 %)	
Current \$ Drawdown:	(\$159)	
Current % Drawdown:	(0.9 %)	
Final Cum \$ P/L / Worst \$ Drawdown (Recovery Factor)	1.27	
Final Cum \$ P/L / Average \$ Drawdown	3.09	
Final Cum \$ P/L / Current \$ Drawdown	28.50	

The trader who has taken the time to organise his trading business using the techniques described in previous articles, will be able to create a Drawdown Report for any combination of Profit Centre, Symbol and Number Traded. For example, a Drawdown Report for the Breakout Profit Centre, ES Symbol and Number Traded, where the trade was for more than 2 contracts.

The trader now has the information which significantly reduces the fear and anxiety produced by trying to trade in the dark. He knows if he is currently in a drawdown and by how much, how much worse the drawdown can get compared to his historical performance and how much profit he has to "cover" his average, current and worst drawdowns.

The trader who attempts to beat the trading game without the information provided by an informative business structure, will not know where he was, where he is or how to get to where he would like to go. Information produces knowledge, which creates confidence, which leads to a professional approach towards the trading game.

Another benefit of trading in a business environment is the ability to determine your percentage return on profitable and unprofitable trades, one of the most important factors which will determine your eventual success or failure in the trading arena, and that will be the subject of our next article.

Tom D'Angelo is the CEO of ManusRisco Inc. The money management methodology described in these articles is used by ManusRisco money management software which can be found at www.manusrisco.com. This software adds an important business dimension to the business of share trading.

CHART TECHNIQUE BRIEFS: NIDO PETROLEUM (NDO)

By Petra Rak

TRADING METHODS CHANNEL TRADING

Channel trading is created when there are clearly defined support and resistance levels. Price movements rebound between these levels. Traders buy at the support level and sell at the resistance level. Many channel trades are part of a prolonged sideways price movement. Trend channels are created when the stocks trend upwards and two parallel trend lines can be plotted. These also act as support and resistance levels. Traders buy up support and sell on resistance. These trades are more profitable, as the resistance level moves upwards over time.

NDO was previously covered in these analysis notes on 26th February 2005. We now refresh this analysis.

To recap, the NDO chart shows an uptrend which commenced with a decisive breakout from a long consolidation between \$0.013 and \$0.018 in September. To date, the trend has developed as a series of intra-trend rallies separated by sharp retreats and consolidation. Connecting the lows allows us to draw an upward straight edge trend line. We also note that the intra trend rallies tend to be of a similar magnitude, which suggests a trend channel under a sloping resistance parallel to the trend line.

Since the last analysis, the trend line and the upper channel boundary have been re-confirmed, and both remain valid and unchanged. NDO is currently testing the trend line as part of a retreat from the recent intra-trend rally.



UP CONDITIONS

Monitoring trend strength requires an analysis of trend continuation or failure signals. Our key tools are the trend line, GMMAs and the CBL trailing stop loss, supported by pattern development such as triangles and signals, such as RSI divergence (not pictured).

We now consider these signals, one by one:

The NDO trend line has been re-confirmed and remains valid, though it may be tested again in the next few days. Repeated confirmations throughout the trend have reinforced the certainty of the trend line (and the upper channel boundary) as a monitoring tool.

The GMMAs reflect the recent retreat towards the trend line, but this has not resulted in a significant narrowing or downturn of the long term group, which is behaving in a similar fashion as

during past intra-trend retreats. Trend continuation will be confirmed when the short term group turns and moves back above the long term group.

The current CBL stop loss at \$0.074 was broken last week, which would generally indicate trend weakness. However, we need to look at signals within the context of the price history: In NDO, the CBL is useful for intra-trend rally management, but is not as useful for monitoring overall trend strength, as the intra-trend retreats have tended to break through the CBL in the past.

Hence, the valid and re-confirmed trend line and reasonable GMMA strength indicate a good probability of trend continuation. Trading just above the trend line sets up conditions for a potential new intra-trend rally opportunity.

Any such trades can be managed by applying a short term upward trend line and trailing stop loss to the intra-trend rally, and observing volume and order depth indicators. An indicative trade target can be set just below the upper trend channel boundary.

DOWN CONDITIONS

Failure of an upward trend line will signal trend weakness and exit from any trades, and would likely be accompanied by further narrowing and flattening of the long term GMMA's and deeper penetration of the short term group into the long term group as investor support erodes.

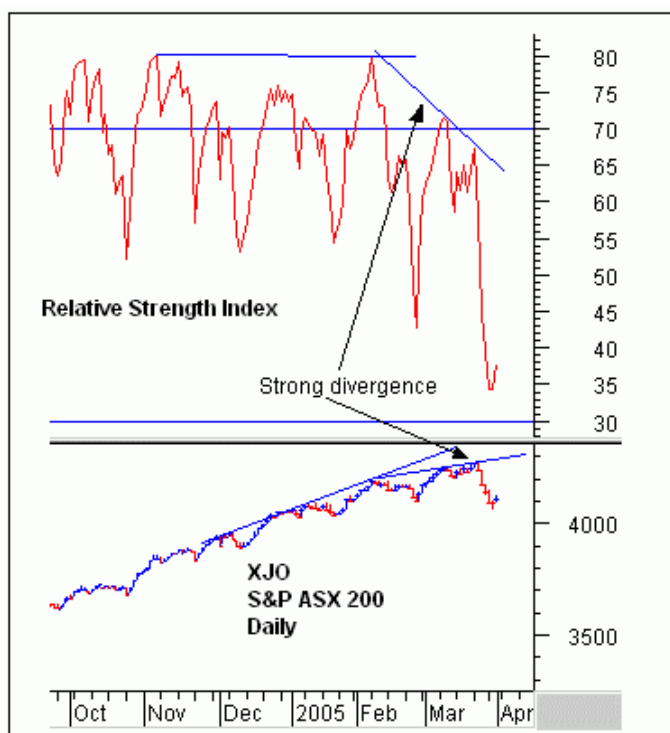
In the event of a trend line break, traders will look for support around historical support levels at \$0.064 and \$0.05.

NEWSLETTER OUTLOOK – CONFIRMING SUPPORT

By Daryl Guppy

The key message from market activity this week was the confirmation of support at 4100. The resistance level at 4200 is a key indicator. Failure to move above this sets up a short term head and shoulders pattern. The downside target matches the long term trend support level between 3900 and 3950. This remains an uncertain market, so traders focus on short rallies and rebounds.

One of the most reliable signals in technical analysis is the RSI divergence signal. Unfortunately, it is also one of the least useful in terms of timing. The inability to provide even a broad time frame for price action is the major disadvantage of RSI analysis. This is why we have focused so



strongly in recent weeks on the behaviour of the index as it approaches the support levels. The ability of these to hold, or not hold, is the critical leading indication of trend collapse in an environment where RSI analysis has revealed divergent weakness.

The primary technical problems with these market conditions are blue sky charting. The support levels we identify are based on very little information. They provide a potential support level, but they must be tested and retested successfully several times before we can have confidence that they are genuine and effective. We have shown these two upper levels as weak and until there are successful retests we will continue to treat these as potential support areas.

A continued market fall will use the 4090-4100 level as the next support base. This is a little stronger, but it has not been

seriously tested on a pullback. **We have to move back to 4030 to find a support area that has been tested more often. This sets our lowest figure for an index retracement based on support.**

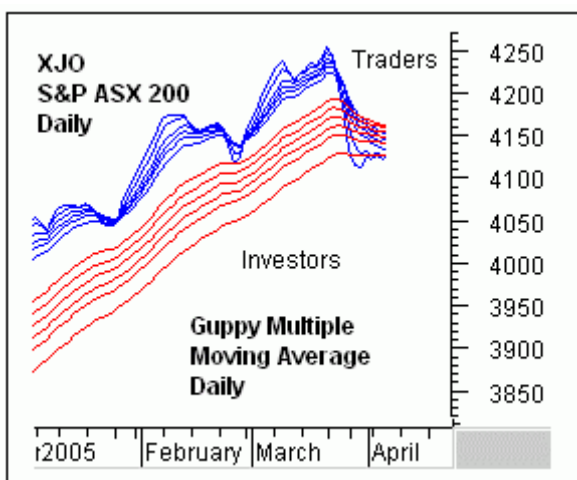
The market can retrace as far as 3950, based on the current long term trend line values, and still remain consistent with a long term uptrend. A retreat to these levels will cause serious pain for any investors, however it is not inconsistent with the trend.

Traders will look for buying opportunities if the market probes towards support at 4030.



To put this shorter term analysis into perspective, we turn to the Guppy Multiple Moving Average display. We use the Guppy Multiple Moving Average as one of our primary trend analysis tools. A substantial retracement could take place and still remain consistent with the trend.

The sections highlighted in green are the trigger conditions which confirm developing trend weakness. They also provide the conditions necessary to gauge the strength of any rebound or recovery rally. The long term group continues to maintain a consistent parallel separation. **The long term group has turned down quickly and begun to compress. This indicates significant trend weakness.** Traders are alert for significant compression in this group. **The degree of penetration by the short term group is a leading indication of trend strength.**



Penetration has been more significant and is the first occurrence since August 2004 and shows little indication of a rebound. The rebound behaviour provides important clues about the potential for the trend to continue. As the short term group moved towards the long term group, we expected to see a rebound develop as occurred in February. This failure was the first important clue that this was a significant trend change. It was confirmed with the support resistance analysis, as noted above. The pattern of rebound and retreat is crucial. Lower retreats signal significant trend weakness. This is the key feature traders now look for.

If the short term group rebounds and holds above the long term group, then we look for a slowing of the trend and a recovery. Failure to move above the long term group confirms a developing downtrend with downside targets based on support in the region of 4030.

The indicator suggests that this substantial index retreat is no longer consistent with the long term underlying trend. The GMMA is not a stand alone indicator. Our preference is to use it in conjunction with other indicator tools. These include the support and resistance levels, and the trendlines discussed above.

Each week we make a choice about the material we include and the subjects we cover. The selection is based on our outlook for the current and coming market. Our objective is to illustrate effective trading strategies that readers can apply to current market conditions. We do not identify recommended individual stocks. We identify opportunities and appropriate trading methods for them. Our outlook is not a forecast. It is a probability framework. Use it as just one part of the other information you are reading about the market. Our summary outlook will be included each week.

NEWSLETTER NOTES

VOTE FOR YOUR PREFERRED SEMINAR TOPICS

We are preparing to offer a new trading education workshop series in Australia. For the first time in any Australian financial seminar, we are inviting you to nominate the areas that you like Daryl Guppy to cover. We have started with a list of seven potential workshop subject areas and we invite you to vote for your preferred topics.

Or you can nominate another subject you would like to see covered. Unlike many trading seminars, which are really designed to hard-sell a product, a training system, or an expensive trading program, our objective is to help you to learn how to understand market behaviour and make better trading and investment decisions using charting and technical analysis tools. The seminar options are similar to the certified professional education modules delivered by Daryl Guppy for Stock Exchanges to floor traders, institutional traders and brokers.

We are interested in your opinions and participation in this survey does not obligate you in any way. In fact, we do not even want to know your name or email address.

REASONS FOR NOT SUBSCRIBING TO THE NEWSLETTER #5

I want hot tips

“Why don’t you give trading tips like other newsletters?” one trial reader asked recently at the end of his four week free newsletter trial. The answer is simple. Our focus is education. Our objective is to provide readers with information so they can further develop their trading skills. There are many different paths to success in the market and it can be very expensive exploring them on your own.

This newsletter explores many new paths at no cost to the reader. You hear of a new trading technique, a new twist on an old approach and chances are that we are already exploring it in the newsletter columns. We save you time by developing, testing and adapting the formulas and indicators. We save you money by including real time examples of the techniques in the sample portfolio. This is rigorous paper trading so you get to see what works, what fails, and why.

Hot tips, or a list of stocks to buy, are easy to generate and easy to sell to the gullible. The truth is, any cheap analytical program will give you a list based on conditions as simple or as complex as you like to make them. The real problem is deciding which hot tip represents a real opportunity that suits your preferred trading style. To make that decision you need the knowledge that comes from education and experience. We provide education based on sharing our experience.

Tips are for waiters, not traders. There is only one hot tip in this newsletter and it is this: “Market success is built on education.”

GUPPYTRADERS TOOL BOX – RELEASE ON SCHEDULE (ALMOST)

The new GuppyTraders Essentials Toolbox and charting program is in final testing stages. Toolbox pricing will be under \$100. We will also release a GTE Charting package. We will offer an attractive changeover path to those who wish to *changeover* from the original Market Analyst version of the GTE charting package or toolbox. We own the licensing and copyright to these products and they are no longer associated with Market Analyst. The new version of the GTE Toolbox produced by Guppytraders will be available by the end of April 2005. (OK, we got a little enthusiastic with progress).



Features include:

- Full count back line capability. This is CBL for long side trading, and for short side trading
- GMMA display
- Parabolic trend line plots – including long side and short side plots. Also includes convex plots as shown in Leon Wilson books.
- Symmetrical and a-symmetrical saucer plotting
- Pattern price projection tools
- Darvas boxes including:
 - Modern
 - Classic
 - Ghost boxes – just click and add.
- An effective ATR plot that operates as a stop loss display as well as a standard indicator display option.
- ATR stop loss configured for both long side and short side trading.

- **One click display of 1, 2 and 3 moving average combinations.**

The GTE Toolbox is designed to work with a variety of data formats. It is a small utility application that gives traders access to a selection of Guppy tools and indicators that might not be included in the charting program they are currently using. We are currently upgrading the GTE Toolbox and adding some new indicators and other enhancements.

If you want first access and leading development then this is available through our weekly newsletter and the Guppytraders version of Guppy TradersEssentials toolbox and charting program. Please note that Market Analyst stopped working with GuppyTraders.com in mid-2004 as they made a decision to stop producing the GTE toolbox and the GTE Charting package. We no longer provide MarketAnalyst with access to updated tools and techniques. Market Analyst, like every other software developer, such as Bull Charts, Ezy Charts, Metastock etc, have access to our tools and techniques only AFTER they are in the public domain and published in books or articles.

12 MONTH SUBSCRIPTION RENEWAL OFFER OPEN TO RESUBSCRIPTION AT ANY TIME

With every 12 month subscription renewal we are including a free copy of either Martin Pring's, **Breaking the Black Box** (rrp \$45.95) or Robert Prechter's, **Conquer the Crash** (rrp \$39.95). We do have limited numbers of these books and once they are used, this 12 month subscription renewal offer will end. This offer is made each week to all those readers whose subscription periods are currently coming to an end. However, this offer is available to any subscriber who resubscribes for a 12 month period. If your subscription is due to end in May, then if you resubscribe now for 12 months we will send you your choice of free book. Just note your preferred book in the Comments section on the order page.

TRADING STRATEGIES WITH METASTOCK BY JIM BERG



This is a comprehensive guide that takes you step by step through a 2 day trading strategies workshop using Metastock software. This is excellent value and quality work.

The workbook is well set out with clear screen shots of the processes under discussion. The trading strategies include the Berg Volatility Indicator which has been featured in Technical Analysis of Stocks and Commodities magazine. The full coding steps for all indicators are included, along with detailed explanation of how the strategies are implemented. This guide is now available through our Guppytraders store at <http://www.guppytraders.com/gup240.htm>

ASK YOUR QUESTIONS IN THE CHAT ROOM

Thank you to newsletter readers who have participated in the new chat room. www.Stockmeetingplace.com is operated by a group in Singapore and their objective is to provide an independent forum, for the discussion of financial market trading issues. I have agreed to work with them exclusively. If you wish to ask me a question, discuss issues raised in the newsletter, or follow up on issues in my books, then post your question on www.stockmeetingplace.com

I am confident that www.stockmeetingplace.com will develop into a premier educational chat room which will attract a quality group of people who genuinely want to learn about the market and assist others. That is why I have agreed to exclusively participate in this chat room. This chat room has an educational bias where traders from around the world come to exchange ideas, swap exploration formulas and discuss trading techniques. I am active in several sections. If you want to ask me a specific question, this is the best place to go. You will receive a reply from me, and also additional information from StockMeetingPlace regulars. There are many solutions to any question and StockMeetingPlace taps into a wide range of trading experience.

NEWSLETTER DELIVERY

If you have a question about delivery of the newsletter, the progress of an order or your subscription details please email support@guppytraders.com We will respond within 24 hours (a little longer over weekends).

WHICH GUPPY BOOK?

Many people have asked this question. Here is a summary guide.

Want to know more about trading?	Share Trading	Beginner to experienced
Want to know more about charts?	Chart Trading	Beginner to experienced
Want to know more about tactics?	Trading Tactics	Beginner to experienced
Want to improve your trading results?	Better Trading	Experienced to professional
Want to master simple but powerful techniques?	Trend Trading	Beginner to experienced
Want to understand short term trading?	Snapshot Trading	Experienced to professional
Want to survive difficult markets?	Bear Trading	Beginner to experienced

PORTFOLIO CASE STUDIES- MONEY MANAGEMENT

PORTFOLIO CASE STUDIES - MONEY MANAGEMENT

Starting cash position \$100,000 - no brokerage or slippage 2% of risk = \$2,000

NOTE Entered date is the *newsletter date* which contains the case study discussion.

Stock	Price	Qty	Pur Value	Close	Cur Val
STW	\$36.390	550	\$ 20,015	\$ 42.00	\$ 23,100
		Newsletter date	11-Sep	Open Profit	3,085.50
			dividend Jan 6		464.48
				profit	3,549.98
MA trend manage				Percentage	17.74

Security/Counter/Stock	Price	Qty	Pur Value	Close	Cur Val
AVR	\$0.990	20,200	19,998.00	1.055	21,311.00
		Newsletter date	8-Apr	Open Profit	1,313.00
Step and stairway				Percentage	6.57

Security/Counter/Stock	Price	Qty	Pur Value	Close	Cur Val
CTL	\$1.080	18,500	19,980.00	1.100	20,350.00
		Newsletter date	8-Apr	Open Profit	370.00
parabolic				Percentage	1.85

Security/Counter/Stock	Price	Qty	Pur Value	Close	Cur Val
GME	\$0.195	103,000	20,085.00	0.180	18,540.00
		Newsletter date	8-Apr	Open Profit	-1,545.00
CBL				Percentage	-7.69

Sell STW for a profit of \$3,549 or 17.74%

SUMMARY MONEY MANAGEMENT

Overall profit to date since July 1, 2004 = \$59,580 or 59.6% return on trade equity.

Profit 2003/04 = 48.7% return on trade equity. Profit 2002/03 = 75.9% return on trade equity.

Profit 2001/02 = 71.3% return on trade equity. Profit 2000/01 = 59.2% return on trade equity.

Profit 99/00 = 111.2% return on trade equity. Profit 98/99 = 102% return on trade equity.

Profit 97/98 = 94% return on trade equity. Profit 96/97 = 66.5% return on trade equity.

Direct investing in the stock market can result in financial loss. Historical results are no guarantee of future returns. Results reflect absolute trading stop loss discipline. Case study trades are monitored and managed in real time, and management reports are delivered every week in the newsletter. Except where noted, all case study trades are notional examples using reasonably attainable entry and exit points.

Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have over or under compensated for impact, if any, of

certain market factors, such as lack of liquidity. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. Full trade summaries, with charts, are provided every six months.

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