TUTORIALS IN APPLIED TECHNICAL ANALYSIS

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The Australian Internet Trading Weekly with independent analysis

INCLUDES SEMINAR DETAILS!

Weekly for Saturday June 4, 2005 Based on Thursday's Close 22 pages
Edited by Daryl Guppy with contributions from T D'Angelo, L Wilson, and P Rak.
Guppy Trading Essentials Chart pak, Metastock , Ezy Charts & SuperCharts. Data from JustData, Paritech, MarketCast & theNextView.

Stocks mentioned in this issue

MCC, NCM, NCMWOT*, XJO, ADB, CUE.

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

CONTENTS

ACTIVE TRADE MANAGEMENT

By Daryl Guppy

Due to technical problems with the Turkish internet, the update management notes did not appear last week. A summary did appear in the notes published on the Sanford site. We have included them below in red along with the updates for this week. (I was working in Turkey delivering an analysis of soybean and palm oil markets for the Turkish national oilseed annual conference).

Two weeks ago we started a new exercise designed to test the effectiveness of some new insights into crowd behaviour provided by the book **The Wisdom of Crowds**. For new readers, we include a reprint summary of the background to this exercise and the progress, at the end of these notes. We also include trade management notes.

So far we have used this process to select a stock, to set price targets, and this week, we take the test one step further with a new exercise for readers.

The core concept is that a diverse crowd making independent decisions about a single event is able to make a better judgement than a small group of experts. This is not a pooling of ignorance, but a way to combine the diverse talents of many people to reach a better decision. The collective wisdom of the crowd is not the result of discussion, argument, endless meetings, coordinated analysis, or agreement. It is an aggregate of individual guesses and calculations.

This idea suggests that the collective wisdom of all participants is a consistently better indicator of the 'best' choice than the choices of any single individual.

In the first week we asked readers to select a stock from a list of stocks.

In the second week we asked readers to vote on the preferred stop loss and profit target points.

SUBJECT SUMMARY

WORKING WITH PROBABILITY

Chart analysis is often confused with predicting the market. Chart analysis uses the action of price and volume to clearly show how the market has behaved. For traders, the past pattern of behaviour helps to identify market situations that have a high probability of a specific action. The trading approach requires the trader to develop a plan to cope with the probability, or when that probability does not eventuate.

Many trading techniques use higher probability situations to project future price action and act in anticipation of this. Here we stand at the traffic lights, stepping out confidently when the walk sign flashes. Sometimes we get wiped out as a car crashes through the walk signal, but most times the signal is reliable. When we see the signal we can forecast the action for a selected period of time. Here traders act when the event occurs.

Prediction is a different beast altogether. It carries a high level of certainty about the occurrence of events at a specific time. Some Gann and Elliott wave analysts make quite specific predictions. This is like saying that I know there is a set of traffic lights at the end of the block, and that at 10.38 am the signal will be flashing walk. This leaves little room for probability, although there are times when such predictions match the co-incident events. This means the predictions come true. Separating the co-incidence for accurate predictive ability is difficult.

The focus of this newsletter is in making the most effective use of probability analysis.

Again our objective is to gather diversified opinions so voting is not restricted to those who voted previously. Anybody can participate in this test. Ask you friends, relatives and others to become involved.

We gave two questions to voters.

- Based on an entry price of MCC, how high do you believe this stock can go? We will use the average of these votes to set the profit exit target. The average target price was $7.99. In the case study trade we will use this as the profit exit management technique.
- **This gives a trade return of 14.4%**
- Based on the entry price at $7.00, how low do you think this stock can go and remain consistent with the current anticipated rising trend? In other words, how far can a price retreat fall before we are forced to close the trade? Readers applied a wide range of techniques in reaching this decision. We are interested in the collective wisdom, not in the validity of one technique compared with another. Again we use the average of readers' choices to set this figure and it will become the stop loss management technique applied to this sample trade.

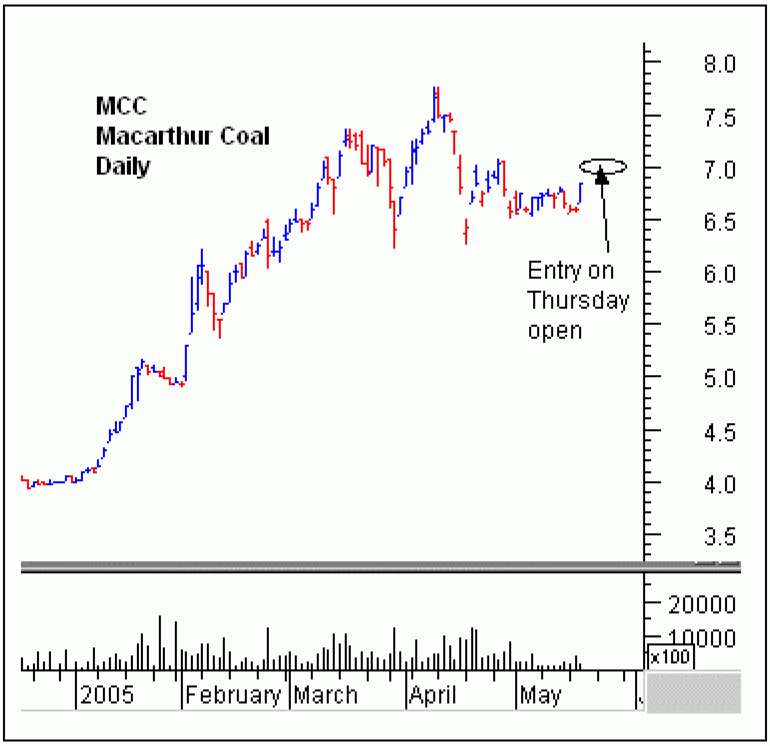
The average stop loss price selected was $6.47.

Now we have the stop loss figure, we adjust position size in the newsletter case study trade so that it is compatible with the 2% rule. **We stay with the standard position size of $20,000. Price can fall to $6.30 before a loss of 2% of trading capital is experienced. With the stop loss set at $6.47, the**

loss is set at $1,521, or 1.5% of total trading capital.

The stop loss is lifted to the current value of the sloping trend line. This is currently $6.85. Until the value of the trend line lifts above the entry price at $7.00, this trade remains technically unprofitable. A fall to the stop loss point would mean an exit from the trade at a loss.

This week we have decided to extend this concept one step further. Our original intention was to take the stock selected by readers, use the stop loss and profit target points, and manage the trade using the most appropriate technique. In other words, take the average conclusions from readers and then execute the trade using more 'expert' techniques. This would be inconsistent with the very approach we are discussing. The whole point of the exercise is to use the wisdom of a diverse crowd rather than the opinion of a smaller skilled group.



In the spirit of the underlying objective of this exercise, we again ask readers to vote. This time we ask you to vote on the best way to manage this trade. We have provided several options and combinations. They are:

- Use count back line
- Use straight edge trend line
- Use 10 and 30 day moving averages
- Use Guppy Multiple Moving Average
- Use CBL, GMMA and trend line
- Use GMMA and trend line
- Use 10 and 30 MA and CBL
- Use momentum indicator MACD – Exit on turn down above upper trigger level
- Use momentum indicator RSI – Exit on turn down above upper trigger level
- Use stochastic – standard default settings and trading method.
- Set sell at average target level and hold until target is reached.

We ask you to vote on-line for each management method on a scale of 1 to 10 where 10 = most appropriate trading method and 1 = least appropriate trading method. Please cast a vote for each of the 11 management methods. The chart is also shown on www.guppytraders.com/gup249.htm.

Last week we accidentally provided a second incorrect page reference which took readers back to an earlier voting page. We are going to extend the management voting again this week. If you have not voted, and wish to do so, please use the page reference above. The spreadsheet provides a summary of voting for each management method to date.

MANAGEMENT METHODS										
1	2	3	4	5	6	7	8	9	10	11
6.23	5.71	6.19	6.09	7.03	6.18	6.50	3.79	3.13	3.03	3.16

We reprint the same chart as used in the original notes because this was the information available at the time of the initial test, so we feel it is more appropriate to also base the trade management assessment on this information. Of course, we expect some voters will look at current charts. That is OK. It is the diversity of opinion that is important.

Simply cast your vote in the box and click to send the results.
Here is the methodology we are going to use to test this idea.

- We calculate the average vote value for each management method.
- We calculate the average value of all votes for all the management methods.
- We select the management method where the average value is closest to the average value of votes for all management methods.

We have absolutely no idea how this exercise will work out, but we believe it has some very interesting potential. As this test progresses, we will share with you the conclusion and analysis, along with any specific trading techniques that we develop based on these concepts. We encourage you to vote by going to page www.guppytraders.com/gup249.htm. This is a diverse approach, so encourage your friends, relatives and others to also vote.

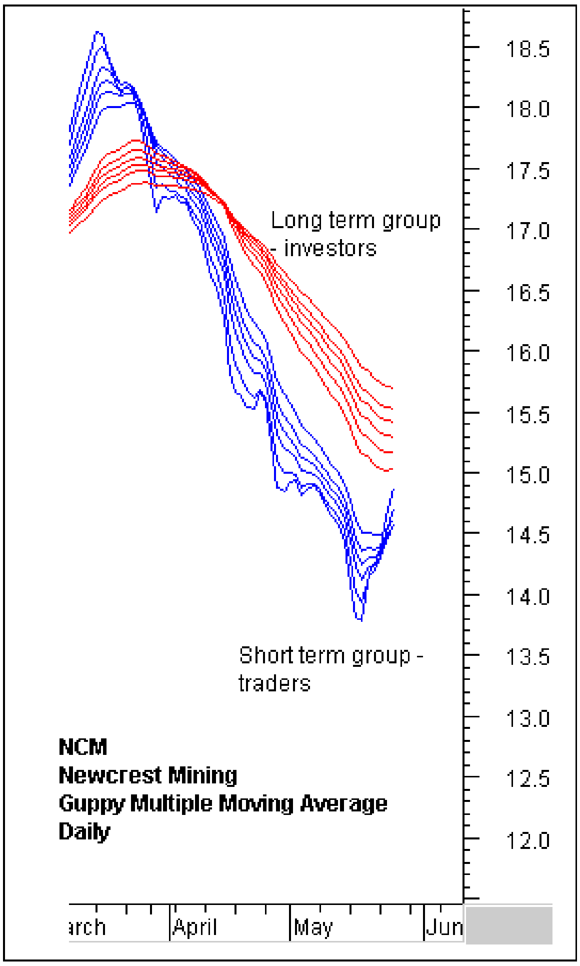
TYPE OF TRADE – ANTICIPATED PUT WARRANT TRADE – NCMWOT*

(Management notes are short this week as I am working in Turkey delivering a presentation at a Commodity Conference in Turkey. Different time zones and airline flights make market monitoring more challenging).

The objective is to rejoin an established downtrend using a put warrant. The entry condition is when prices of the parent stock again move up and approach or touch the downtrend line.

The first key step is to locate a parent stock with an established downtrend. Of those stocks that are in downtrends, traders look for a warrant series with a high level of volume. High volume makes it easy to buy the warrant in sufficient size. When it comes time to sell, the high volume makes selling more effective. The warrant can always be sold carefully by selling to the market maker. Where necessary, we will illustrate this strategy.

The objective in this trade is not to capture the start and end of the trend. The objective is to capture part of the downtrend and take relatively quick profits.



TRADING PLAN

Last week we established a proposed trading plan in anticipation of a short lived rally in the market. **The chart shows the beginning of the rally. Note how the long term GMMA shows the price rise is most likely to be a rally.** As noted elsewhere, this rally has continued. The trading plan was not implemented, but it remains on **standby as a means of taking advantage of any rally collapse. This calls for quick trading.**

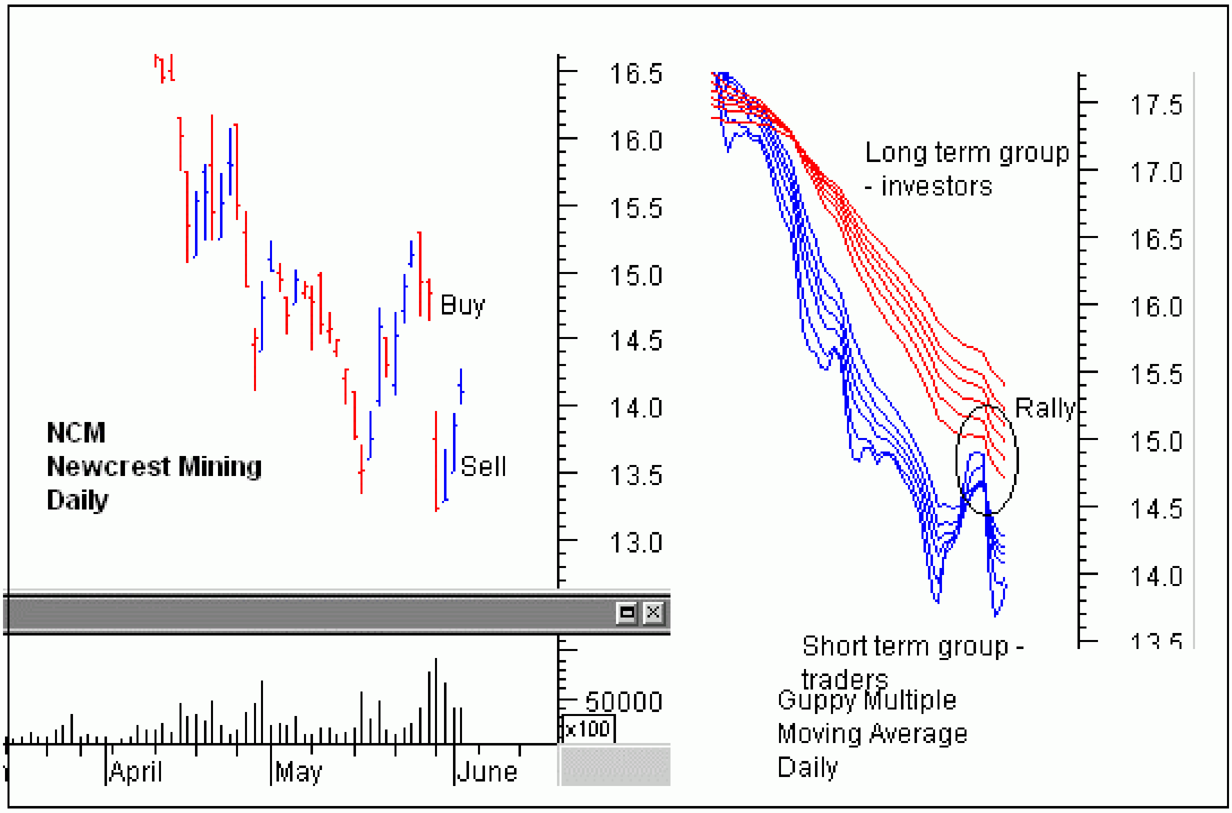
Alternative strategies call for traders to wait for the retracements and then buy on the rebound. We will detail this strategy in the next issue.

For tutorial purposes we take a position on the second day of the rally collapse. For tutorial purposes we exit this trade on the second day of the rally collapse rebound. This is consistent with the trading plan notes highlighted on green from the previous week.

This trade opportunity developed as prices dropped after the rally failed.

The plan for the fast short trading opportunity on a retreat from the rally is to ride the downtrend using:

Locate stock with an established strong downtrend. This is applied to the parent stock. We use NCM as an example.



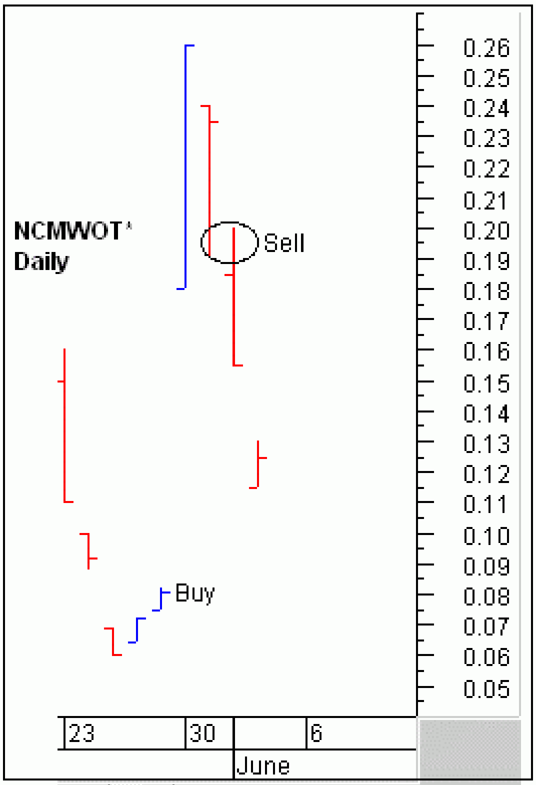
- Easily defined trend with straight edge trend line. This is applied to the parent stock.
- **Breakout above trend line, but still in a general downtrend. The GMMA confirms the rise as a rally rather than a trend change.**
- Strong downtrend as defined by the GMMA.
- **This is still in place.**
- Locate a warrant with high volume.
- **Volume remains steady, but entry and exit tactics based on using the market makers' obligations were applied. These tactics were detailed in previous newsletters.**
- Buy at market price as the parent price moves towards the trend line. Although warrant volume may be high, typically the order line includes only 1 or 2 orders on the buy and sell side. It is more effective to take the price offered rather than place an order in line. If we want to buy at a lower price, then in a thin order display market, there are advantages in waiting for price to reach our target buy level before placing the order on the screen.
- Sell before the end of the downtrend. Warrants are particularly reactive to anticipation of the end of the downtrend and the reaction can slice a lot of profit from the trade. This gap volatility is a characteristic of warrant trading.
- **Sale was delayed until after the initial rally collapse ended.**

Position size, stop loss and protect profit conditions

Trade was entered at $0.08. Entry could be made at lower price levels, but we use the high and close of the day for tutorial purposes. Stop loss is based on the action of parent stock and initiated if intraday prices moved to $15.20. Objective is a fast trade based on price collapse and continuation of the downtrend. Exit is taken after the price rebounds. Exit at $0.195 is possible over two days. For tutorial purposes we use the worst exit price for the day. An exit at the close of

$0.235 would have boosted profits to 196% or by $31,464. For newsletter purposes, we take an exit at $0.195 which delivers a profit of 146% and adds $23,464 to the case study portfolio.

Trade status



This 4 day trade is opened on Friday and closed on Wednesday.

Is this a reasonable case study trade? We think so. It uses exactly the same techniques that we personally used in this trade over the same period. This includes working with the market makers' obligation to post a bid and ask when no other trader is active. These techniques we discussed in detail two weeks ago.

This is the second personal trade in NCMWOT where we have applied the tactics discussed in the newsletter. These are short, sharp trades, not necessarily completed at the best possible price ie the very low and the very high. However, the leverage and volatility means that even by entering slightly later and exiting at less than optimum prices, these types of short term trades can return excellent profits. These are the handful of trades that contribute significantly to portfolio performance during the year. Just as shown in the newsletter, in real life most trades are average, with returns of 10% to 15%. They are training and preparation for the handful of excellent trades that turn in 100% returns or better. In the coming seminars, we will examine these techniques.

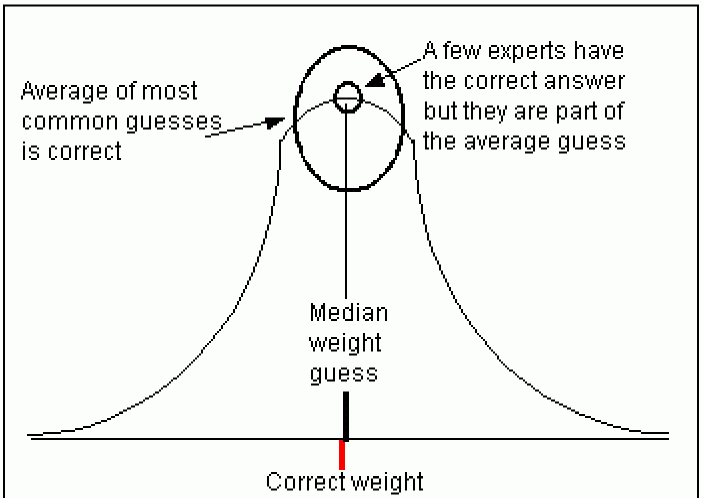
REPRINT OF THE PHILOSOPHY UNDERPINNING THIS EXERCISE IN USING AVERAGE OPINION

Our understanding of crowd behaviour comes from the classic work by Charles Mckay – **Extraordinary Popular Delusions** – and Gustave LeBon – **The Crowd**. It can be summed up with the comment that "A crowd is about as intelligent as the most stupid person in the crowd."

But what if the collective wisdom of the crowd, as reflected in price and other behaviour, was much more intelligent? British scientist, Francis Galton, introduced us to the familiar bell curve. The curve is a graphic representation of clustering and is so commonly accepted that we call it "normal distribution." When students take an exam, we expect some students to do very poorly, and some to do very well. The bulk of students will perform about average. If we graph these results, we get a bell curve.

Towards the end of his life, Galton found an interesting anomaly. He attended an agricultural show where there was a weight guessing competition. The challenge was to guess the weight of the bullock after it had been slaughtered – the dressed weight. People from all walks of life estimated the final figure. Some were skilled butchers, others were experienced farmers, some were housewives while others were simply passing and attracted by the opportunity to bet. (It's all a bit like setting price in the market where we assume that price is the product of the knowledge of all participants, good, bad and indifferent).

When the competition was finished, Galton was given the betting slips. He plotted the estimates, expecting to find a bell curve distribution where the average guess bore little relationship to the experts' guess. He expected to see just a handful of people – presumably experts and the lucky – get the weight correct. He also averaged the price of all the estimates. The shape of the curve remained as he expected, but the average of guesses was astoundingly accurate. The slaughtered and dressed beast weighed in at 1,198 pounds and the crowd had estimated, on average, that it would weigh 1,197 pounds. Collectively, the crowd was particularly intelligent.



Crowd skill and the bell curve

This observation has been repeated in many experimental situations since and we aim to add to this body of knowledge in a way that has not been done before.

There are several key elements in these observations. They include:

- Decisions were made independently by many participants.
- Participants came from a wide variety of backgrounds, skilled, unskilled, expert, novice.
- The average of results is not a consensus opinion. A consensus opinion is one where most people agree. The average of results, the exact figure of 1,197 pounds, is a figure about which most people disagree. The people on either side of this average point did not agree with the average figure of 1,197. It is entirely possible that no single individual actually nominated this figure.
- The collective wisdom of the crowd is not the result of discussion, argument, endless meetings, coordinated analysis, or agreement. It is an aggregate of individual guesses and calculations.

Our first task in the voting in the past week is to establish if the wisdom of the crowd applies to stock selection. Readers could apply whatever analysis techniques they thought are appropriate. They can use the knowledge of the stocks behaviour in the days that follow the last newsletter. Despite this opportunity, we found that the vast majority of votes arrived over the weekend before the market opened. We also invited trial readers to participate, and our office staff and their friends. The decisions, and the methods by which they are reached, are independent of every other voter and include a very diverse range of views and skills.

Each of the 10 stocks offered a voting choice on a scale of 1 to 10 where 10 = excellent trading opportunity and 1 = not a good trading opportunity. Here is the methodology we use to test this idea.

- **We calculate the average vote value for each stock.**
- **We calculate the average value of all votes for all stocks.**
- **We select the stock where the average value is closest to the average value of votes for all stocks.**

  MCC passed this test.

This exercise is very different from classic methods of assessing market opinion. Superficially it resembles the idea that we look at brokers' recommendations or recommendations in Shares magazine and use this as a basis for stock selection. It is different from these in two important ways.

- Brokers' recommendations come from "experts." The author of **The Wisdom Of Crowds** convincingly illustrates how decision by a small group of experts are less reliable that decisions made by a diverse group of people from many different areas using many different perspectives. Readers might like to examine the chapter on the Shuttle disaster for a more detailed insight into the problems inherent in using a small group of experts.
- Using this method, the usual approach is to select the stock that is supported by most brokers. This believes the majority verdict is most likely to be correct. The idea that we

are testing is that the average of opinion is most likely to be the best guess rather than the majority of opinion.

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.

Stocks marked with an * are open trades held by Daryl Guppy.

BUILDING A PRIVATE INDEX

By Daryl Guppy

INDICATOR BUILDER
THE PRIVATE INDEX

The idea of a private index was introduced in **Share Trading**. The private index is derived from a user specified group of stocks. This might include just the stocks he is trading, or just those in an investment portfolio. It may also include a collection of stocks that the trader consistently tracks in the market looking for opportunity.

The private index is calculated by taking the closing price of each stock in the group and determining the average of this. The manual process for this is covered in Share Trading. This value is plotted on a chart. The final display is shown as a line chart with the index value for each day shown.

The private index is usually displayed against a benchmark market index, such as the All Ordinaries, or ASX 200. This allows the trader to see how his selected area is performing. The objective is to outperform the market most of the time. This tool provides an important way to monitor trading and stock selection performance.

In last week's newsletter, we discussed in detail how to use a private index. This week we will discuss how to build a private index using BodhiGold from JustData, which gives you the vital tools to manipulate data directly and, hence, effectively create your own private index.

When I wrote **Share Trading,** I used a Private Index as a means of tracking my trading selections against the performance of the general market. At the time, this was relatively easy because data was so expensive - $2,000+ a year. Many traders just downloaded data for the stocks they were following. As the data supply market changed, it became more effective for data suppliers to provide the entire market to subscribers, and at a very much cheaper cost. This made constructing a private index more difficult. Some charting programs, such as Ezy Charts, eventually included a private index tool. Metastock has a similar tool. Both these tools are difficult to use because they rely on the charting program, or downloader, to manipulate data. The result is not always satisfactory.

The most effective way to construct a Private Index is by manipulating the data directly. Some data suppliers give you the tools to do this, and we look at how BodhiGold from JustData tackles this.

BodhiGold makes it easy for users to create their own private index. We show how this is done using a gold index as an example. This index builder allows you to specify the securities you wish to track and then save them as an index. You can also choose to weight your securities by entering numbers into the **Weight** column. If you are making an index from the securities already in your portfolio, you could weight them according to the *volume* or *total price* they hold in your portfolio.

BodhiGold creates the index by averaging the prices (open, high, low, close, volume and open interest) of your group of securities and displaying the result as a bar chart. This index is treated like any other security that comes directly from the Stock Exchange.

Private indices can be used as a valuable indication of your personal trading portfolio, or to duplicate sub-indexes that have been consolidated into the GICS sector structure. Once created, you can use simple moving average techniques to see if your portfolio is in an up or down trend. You can compare your index against other ASX indices created from Market Capitalisation as opposed to price volatility. You can create indices based on a watch list of securities or break down the ASX Industry sectors to smaller denominations.

To create a Personal Index, you need to tick the securities you want to be part of your index, then save the ticked list ensuring that you have selected **Create Index**. Once saved, you can clear the ticked selection, as you are not required to keep these securities ticked. In fact, there is no requirement to update any of these securities.

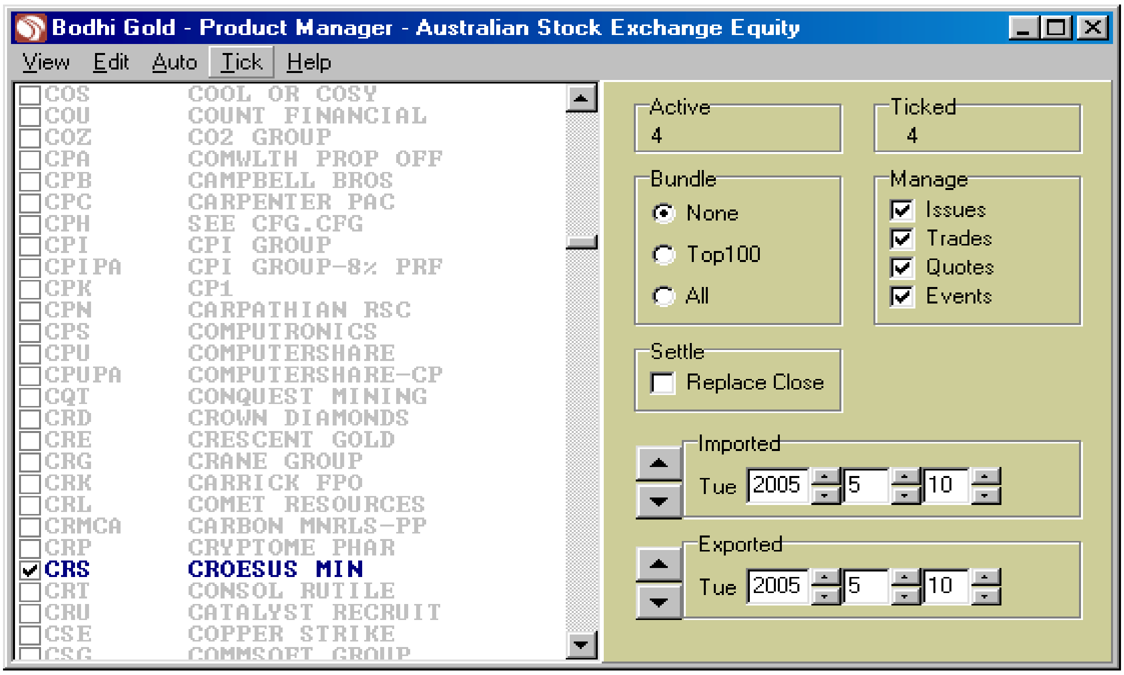
If you want to change your history, you will need to re-import/export the updated index. Personal Indices are created when BodhiGold is exporting information. You can change what securities are used in any of your personal indices by simply changing the securities in the saved ticked list.

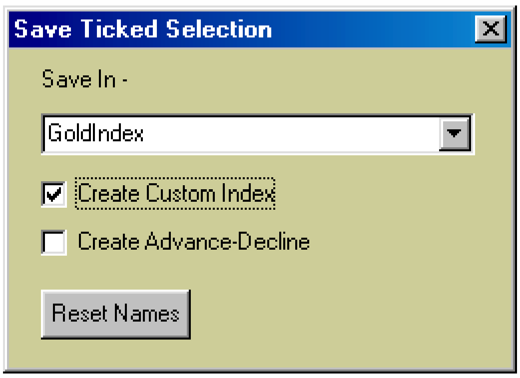
Creating a Private Index

In this example, our objective is to build a Private Index using four gold securities from the Australian Stock Exchange and weighting them in percentages. We use four, but a full index would include all Gold stocks. A private index will include many different stocks using the same selection steps shown below.

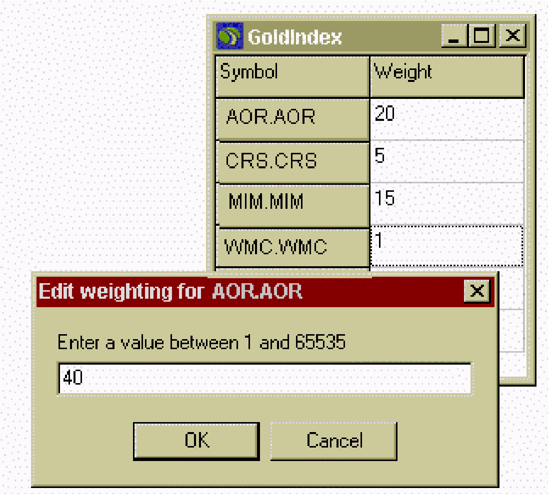
To create a Gold index from your personal portfolio of shares, do the following:

1. Open BodhiGold.
2. Click **Configure**.
3. Double-click **Australia**.
4. Double-click **Australian Stock Exchange**.
5. Click **Equity**.
6. Tick the following securities: **AOR, CRS, MIM, WMC**.



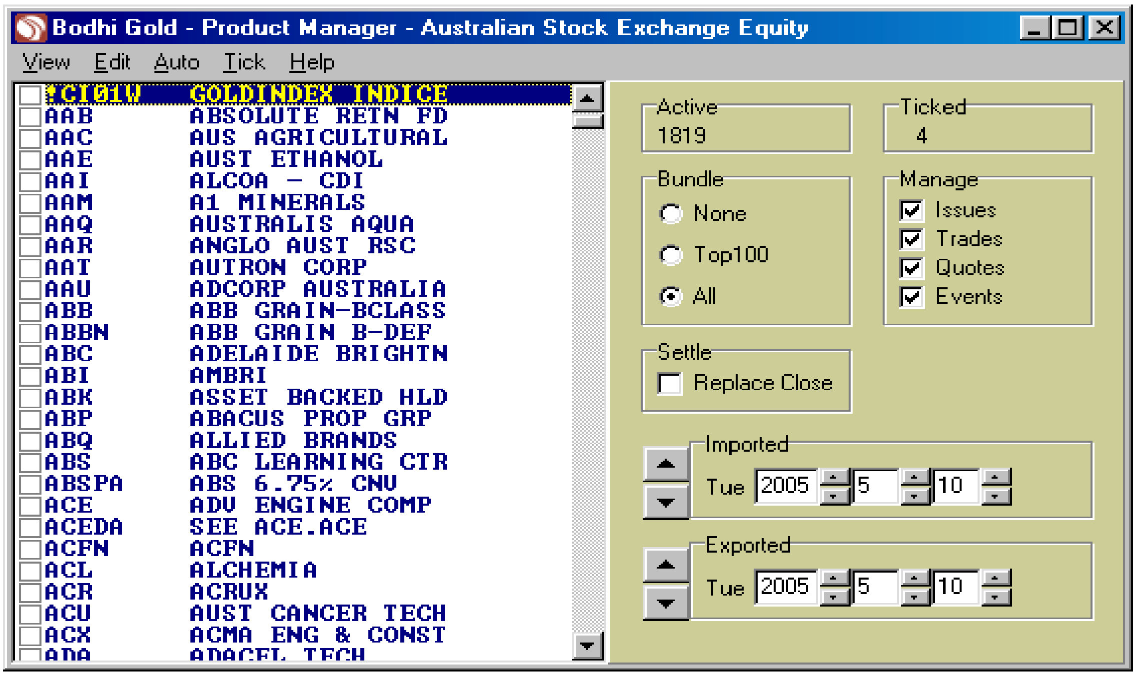


7. Go to **Tick** and then select **Save**.
8. In the **Save In** box, type **GoldIndex**
9. Tick the **Create Custom Index** box.
10. Exit the **Save Ticked Selection** by clicking the **X**. The Gold Index weighting dialog box will appear.



The weighting for each security is automatically set to 1. If you leave it like this, BodhiGold will weight your securities evenly. For the sake of this example, we will weight our Gold stocks according to the percentage they hold in value in our portfolio.

11. To change these values, double-click the corresponding cell and enter the following: AOR = 20 ; CRS = 5 ; MIM = 15 ; WMC = 40



12. When you have entered all the values, exit the Gold Index box by clicking the **X**.
    Note: You can change the weighting at any time by loading the list then re-saving it.
13. If you do not have any Equities selected, tick one (your new index will not appear until after **Catchup**).

Put your **Exported** date back to the date you want to start exporting data for this index. Historical data will eventually be stored for 6 months.

14. Exit the Equity parcel list by clicking the **X**.
15. Exit the **BodhiGold – Module Manager** box by clicking the **X**.
16. Click **Catchup**. When finished, go back into your **Equities** list. Your new index will be at the top of the list with a symbol starting with an exclamation mark (**!**).

Changing Securities in my Index

If you want to change your history, you will need to re-export the updated index. If you want to add or subtract some securities from a personal index, do the following:

1. Open BodhiGold.
2. Click **Configure**
3. Go to the product list of the product where you saved your ticked list (i.e. Equity).
4. Go to **Ticked** and then select **Load**.
5. Highlight and select the desired list from the **Symbol lists** box.
6. Exit the Symbol lists box by clicking the **X**.
7. Your tick list will now load. Tick or untick the securities as desired.
8. Go to **Ticked** and then **Save**.
9. Select the name of the list from the drop-down box.
10. Exit the box by clicking the **X**. (You are not required to tick the **Create Index** box).
11. These changes are now saved.

Creating History on a new Index

If you have just created a new index or you have changed the securities in a previous index and would like to create some history, follow these directions:

1. Open BodhiGold.
2. Click **Configure**
3. Double-click **Australia**.
4. Double-click **Australian Stock Exchange**.
5. Click the product group where the Index is listed. (i.e. Australian Equity).
6. Change the **Exported** date to the first date you require history.
7. Exit the Product list by clicking the **X**.
8. Exit the **BodhiGold – Module Manager** box by clicking the **X**.
9. Click **Catchup**.
10. BodhiGold will re-export all your Australia Equity data, creating history on your new index.

The private index is an essential tool for tracking the performance of your preferred selection processes. The BodhiGold data manipulation makes it very easy to maintain several private indexes which can be used to track all the analytical approaches you use in your trading.

THE EDGE: WHO HAS IT AND HOW TO GET IT – PART 2

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 facilities 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 how to create a Profit Centre structure designed to organise our trading results similar to a successful business. We also took a look at the Drawdown, Return on Investment, PTR / UTR and Breakeven reports, which can be created from the trading results we entered into our Profit Centres.

We will now take a look at what every trader is seeking - the edge.

"The race is not always to the swift, nor the battle to the strong, but that's the way to bet it!"

Damon Runyon

The edge, also called the advantage, comes in three forms:

- The perceived edge
- The actual edge
- The variable edge

Last week we discussed both the perceived edge and the actual edge. This week we will discuss the most important edge of all - the variable edge.

The Variable Edge

The trading game is a completely unique situation. A trader can become a better, more educated and disciplined trader and can actually change a losing (negative expectation) situation into a profitable (positive expectation) game.

You cannot become a "better" roulette player or a "better" keno or dice player since you cannot change the negative expectation which is hard wired into the game itself. You will always suffer the negative financial effects of trying to overcome a negative statistical disadvantage.

However, a negative expectation is not "hard wired" into trading. Traders who evolve and develop psychologically and emotionally through education and experience are able to turn an unprofitable situation into a profitable, positive expectation enterprise.

The book **"Market Wizards"** by Jack Schwager is littered with tales of numerous traders who lost significant amounts of capital when they started trading but overcame their difficulties and eventually became very successful and profitable speculators and traders**.** In other words, a negative expectation was turned into a positive expectation.

Thus, we now encounter the variable edge, the most important factor which determines every trader's success or failure, from the million dollar high volume professional trader, to the small account, part time novice.

The variable edge is so named because it varies (surprise!). It may be positive and becoming more positive, it may be positive and becoming less positive, it may be negative and becoming less negative or it may be negative and becoming more negative. In other words, the type of game you are playing is constantly changing.

The only certainty about the variable edge is that it is uncertain, and that is what makes the adrenalin pump and the heart beat faster when a trader initiates a new position.

The trader knows, either consciously or subconsciously, that his equity curve will rise and his equity curve will fall. One day you're up and happy and the next day you're down and depressed**.** Traders enjoy profits and traders suffer losses.

One month you have the edge and the next month you don't, and worst of all, it is impossible to predict with absolute certainty if your next trade or next week or next month will be a winner, loser or a breakeven.

The variable edge is like smoke from a cigarette - you reach out to grab it and you think you've got a hold of it, only to open up your hand and discover that it has disappeared.

Traders start out unprofitable, rise up the learning curve and become profitable, only to become complacent, arrogant, greedy, over confident and become unprofitable once again - another victim of the variable edge.

All traders are imprisoned in a twilight zone of uncertainty caused by the variable edge, and this is the main factor causing the high failure rate of individuals who choose to participate in the trading game.

In case you are a little confused about the variable edge, or don't believe it exists, then answer the following questions**.** It doesn't make a difference if you are a 20 year professional trader who has made millions or if you have never traded before - the answers will be the same.

The questions are:

- Will you show a profit or loss after your next 100 trades? (Requires a definite, guaranteed answer - "It depends", "could be", "maybes" etc are not allowed).
- What will be your <u>exact</u> dollar profit or loss after the next 100 trades?
- For your next 100 trades, exactly how many trades will be profitable and how many trades will be unprofitable? (No estimates allowed, we need exact numbers).
- What will be your worst drawdown in your next 100 trades?

As you can see, it doesn't matter if you are a profitable trader, an unprofitable trader, experienced or novice. The answers are uncertain and the edge will vary.

The profitable trader may be more profitable in the next 100 trades, less profitable, breakeven, or he may be unprofitable. Likewise, the unprofitable trader may become more unprofitable, less unprofitable, breakeven, or become profitable.

Every trader, regardless of experience or account size, has the front seat on the volatile ride of the variable edge roller coaster. The variable edge can only be managed by having properly organised results of trading performance. The fruit of this information is to:

a) inform the trader where he is located on the variable edge and

b) the current direction and trend of the edge.

A trader possessing this information is able to answer questions such as: What type of game am I playing, positive or negative? Am I getting better or worse at the game? If I am playing a negative expectation game, should I stop playing it or should I continue to play and hope I can turn it around? Am I better playing some games versus other games? Why am I better playing some games and worse playing others? Should I become more aggressive in games where I have the advantage and the edge is increasing? Why am I playing a negative expectation game which is becoming more negative?

The Profit Centres are the games and the Analysis Reports provide the information necessary to answer these questions**.** The end result of this process is a slowly evolving, disciplined, confident, professional and hopefully, profitable trader**.**

There may be an easier way to approach the trading game, but the question is, how long can you remain profitable before you get blindsided by the variable edge and fall victim to the uncertainty and confusion resulting from an amateurish and inadequate money management methodology?

We have all learned that the trend is our friend when analysing a price chart, but the same principle applies to money management**.**

It is imperative that you monitor the trend of your expectation by graphing the Profit Factor as discussed in our previous article **Positive And Negative Expectation Games**. A graph of the trend of the Profit Factor as described in **Positive And Negative Expectation Games** reveals not only if you are profitable or unprofitable, but also, if you are becoming more or less profitable or becoming more or less unprofitable. The trend of the Profit Factor reveals your growth and maturity as a trader.

Mastery of the money management, psychological development and trading methodology disciplines is required for long term success**.** Competence in one or two of the disciplines is not sufficient for long term profitability. All three need to be mastered and incorporated into your trading personality to afford you the best possible chance of achieving long term profitability.

Money management, psychological development and trading methodology are three paths all traders must walk to safely arrive at the destination of long term profitable speculation.

Hopefully these ten short articles have provided concepts which will enhance your money management skills and enable you to adopt a more professional and disciplined approach towards speculation and investment, and may the variable edge always be going your way!

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.

READERS' QUESTIONS: INITIAL HIGHS – PART 2

By Leon Wilson

SUBJECT SUMMARY
SYSTEM TESTING

System testing is a software approach to rule based trading systems. Advanced system testing software performs analysis with any of the following combination:

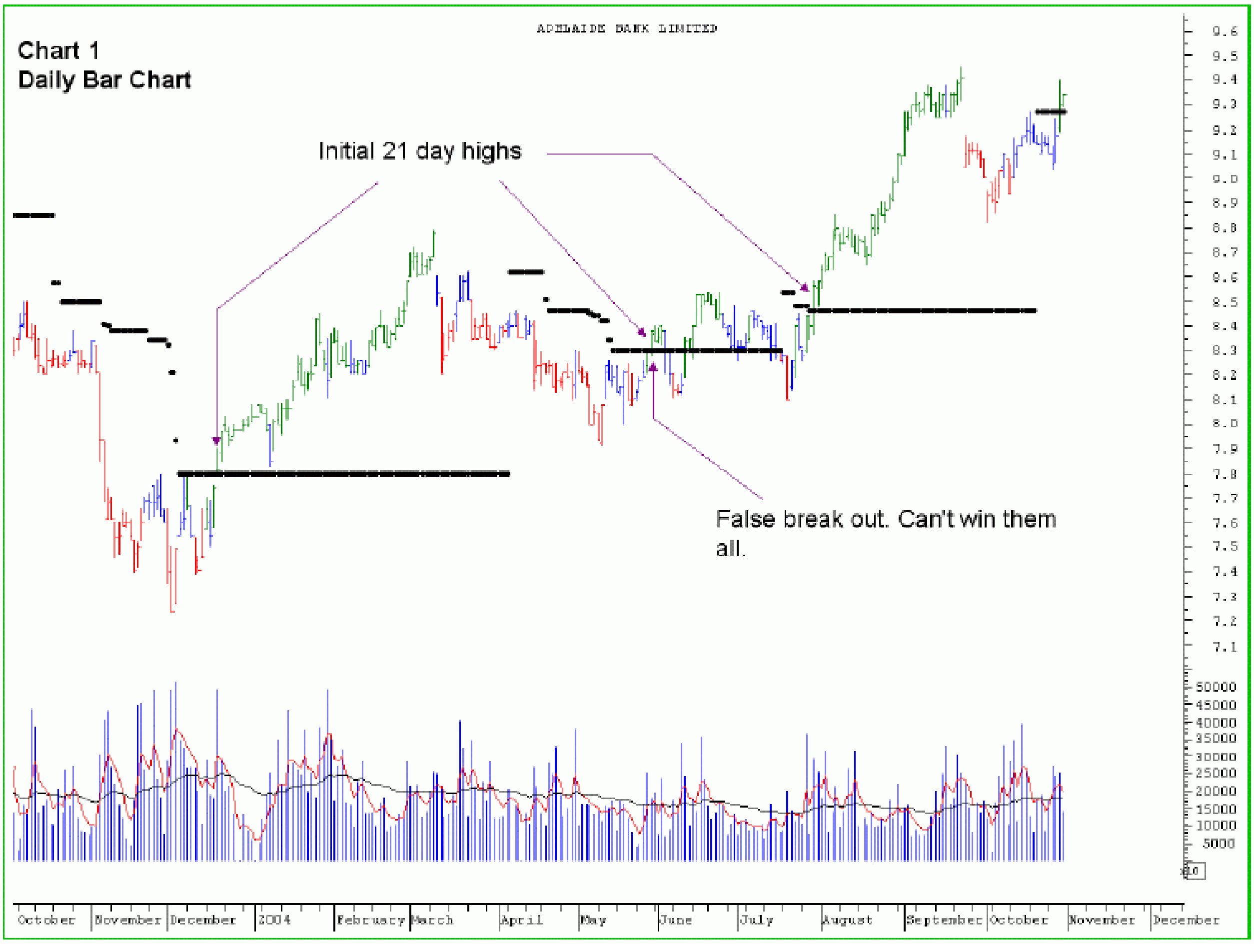
- A single system applied to a single security
- A single system applied to multiple securities
- Multiple systems applied to a single security
- Multiple systems applied to multiple securities

Good system testing software displays these results in a graphic as well as table format. Advanced system testing offers additional features such as true 3-D plotting seen in advanced mathematics and statistical packages, along with better equity curve analysis. They also offer access to fuzzy logic approaches that allow the system to incorporate a number of self adapting rules.

These advanced system testing modules often call for strong computer skills.

Last week I discussed the basic application of an initial 21 day high. Some readers have requested assistance with developing an initial 21 day high search and matching indicator. We are looking for an initial 21 day high so our first step involves parameters requiring that today's closing price is greater than the high of 21 days ago. I take this one step further by stipulating that the closing price must also be above our high price of 21 days ago.

MetaStock has the capability of plotting the initial 21 day high which helps with our visual assessment of price action and the high being referenced. I have selected Adelaide bank as it is less than an ideal example of the initial 21 day high. The following chart will help users of other programmes understand the concept visually. Showing a perfect example may give the impression of an infallible technique which is definitely not the case as previous testing results have shown. The coding for an initial high indicator is as follows:-



The exploration process is written in a slightly different manner. We retain the same basic coding used for identifying the initial 21 day high, however, the exploration feature will not accept variables. When using the indicator, we have the ability to specify which high will be referenced be it 21, 30 or 250 initial day high for example. The indicator then plots accordingly. The indicator builder allows for the input of variable data, however, the exploration is not as accommodating as it requires specifics in order to function correctly. Here is an easy coding tip for you. We change the top line of the coding by removing the input function, however, we leave the initial high reference. We replace the input function with the number of required periods. If you decide that you would like to change from 21 to a 30 initial day high indicator, then by simply changing the 21 to 30 on the top line of our search criteria, the exploration matches our indicator settings for future analysis purposes. This allows for the easy adjustment of search parameters as market conditions change while minimising the likelihood of errors with more complex explorations. Place the following formula in the filter section.

```
Indicator name: - Initial High
InitialHigh:=Input("Initial Day High",1,260,21);
HH:=InitialHigh-1;
If(Ref(HIGH,-HH)>=HHV(HIGH,HH),HHV(HIGH,HH),
If(Ref(HIGH,-HH)<HHV(HIGH,HH),PREV,0));
```

```
Exploration Name:- Initial High
InitialHigh:=21; {change the initial high value to match the indicator settings used}
HH:=InitialHigh-1;

InitHigh:=If(Ref(HIGH,-HH)>=HHV(HIGH,HH),HHV(HIGH,HH),If(Ref(HIGH,-
HH)<HHV(HIGH,HH),PREV,0));
CLOSE>InitHigh AND Ref(HHV(HIGH,20),-1)<=InitHigh
```

I have not included any additional parameters beyond the identification of the initial high, such as volume or long term trend support. I have stipulated a 21 day requirement for the identification of the initial high, however, these values are not cast in stone. While these parameters are suitable for trending stocks, reducing the initial high periods will allow for a more effective entry in range bound markets. The problem with reducing the time periods in order to produce a more responsive entry is increased exposure to potentially false signals. If our intention is to reduce the initial high parameters, then we can apply count back and the GMMA as a means of confirmation and existing trend analysis.

CHART TECHNIQUE BRIEFS: CUE FPO (CUE)

By Petra Rak

> **INDICATOR REVISION**
> **CUP AND HANDLE**
> This is a bullish chart pattern. Prices trend upwards slowly, then pause to consolidate over several days. The next up trend is projected by taking the distance from the bottom of the cup to the brim, or alternatively, from one edge of the cup to the other. Often these give targets within a few cents of each other and this is quite an accurate method. The cup and handle pattern provides confirmation of a safe entry as trends pause. This pattern should not be confused with sharp declines and rallies. The cup and handle pattern develops over weeks rather than days. There are some day trading applications of this pattern, but they are not as reliable.

The daily chart of CUE shows the development of a saucer pattern, a type of longer term parabolic reversal. Parabolic reversals (rounded bottoms, saucers and cups) are strong reversal and continuation patterns, which can be used to set long term upside targets.

A parabolic reversal pattern describes the gradual reversal of a downtrend, where price movement during the reversal is best described using an arc rather than straight support/resistance levels or trend-lines. Hence, the pattern comprises of three stages: a shallowing downward trend, sideways bottom movement and an accelerating upward trend.

In CUE, the initial downtrend commenced in December last year when prices fell through the upward trend line and into a relatively short downtrend, which soon bounced upward into a recovery along an offset, parallel upward trend line. This new short term uptrend was however capped at 0.35, and CUE fell into a new downtrend which we can now identify as the downward curve of the saucer pattern. CUE is now in the second half of this pattern, an area characterized by a series of small rallies that retrace, but to successively higher levels.

UP CONDITIONS

Parabolic reversal patterns indicate a good probability of continued upside movement, and can be used to set three successively higher indicative targets:

The initial reversal target is the mid-point resistance of the pattern, the level below which rally highs tend to cluster during the sideways portion of the pattern. In CUE, this can be placed around the $0.27 resistance. At present, CUE is just retreating from a rally to the mid-point resistance. A rebound from the parabolic curve in the coming days will confirm the pattern, and signal a potential breakout above the $0.27 level. Such a breakout appears reasonably likely, as indicated by the GMMAs, which have crossed over, and are starting to turn upwards.

A sustained breakout above the mid-point resistance signals a likely transition from broadly sideways movement with rally behaviour to an accelerating upward trend, and indicates a potential opportunity. On breakout, we can calculate the second indicative target, at the saucer lip, by projecting the distance between the reversal bottom and the mid-point resistance (0.27 – 0.18 = 0.09) upward from the $0.27 resistance, indicating a $0.36 target. However, in CUE, the $0.35 level is a more likely target, as this level may develop into a strong resistance after capping the recovery rally early in the year.

Finally, a breakout through the saucer lip signals the completion of the saucer pattern, and a good probability of an ongoing uptrend that can commonly be defined using a straight edge trend line. A third indicative target can be set at $0.52 by projecting the total pattern depth ($0.17) upward from the second target at $0.35.

The above is a summary of the ideal saucer pattern development. As with all patterns, saucers and their indicative targets are only guides. On a day to day basis, any developing trend can be managed using the usual trend trading tools, such as the GMMAs and the CBL stop loss, as well as the saucer pattern which sets an overall bullish context.

DOWN CONDITIONS

Failure of the pattern will be signalled by significant price movement beyond the curved saucer trend line. This could lead to the development of extended sideways movement below the $0.27 resistance level with a potential support around $0.19. Falls below the $0.19 support will indicate a likely new downtrend.

SIMPLY BETTER TRADING
Making and Keeping Profits in Nasty Markets

GET THE BEST OUT OF THE MARKET BY USING EASY TO MANAGE TRADING TECHNIQUES AND BETTER RISK MANAGEMENT TO BEAT A 27% MARKET RETURN!

In the 12 months to the end of February 2005 the market added 27%. This is the type of investment and trading return that should have been achieved in this period, either in your own trading, or by your fund manager. (Even a simple Exchange Traded Fund strategy outperformed the market with access to full dividends from the top 200 companies).

This is the starting point for measuring return, but simply better trading tactics can improve these returns further with better analysis and better application of stop loss and protect profit strategies. This seminar will teach you how the Guppy trading tools and indicators are combined with effective risk management to improve your trading results in the changing market conditions. We use material also used when we teach international professional traders and dealers. You can learn how they use risk management in their trades. It is risk management that underpins continued trading success.

THE TOOLS. Do you really know how to use these most effectively together? The Count Back Line and the Guppy Multiple Moving Average form the core of a propriety trading technique developed by Daryl Guppy and covered in his books. The first session details how these two indicators are used to identify and manage trades. Our focus is on applications in current market conditions. We will apply them to trades nominated by you.

MANAGING RISK. Learn what works and why. Traders need to understand the relative effectiveness of various technical based stop loss techniques and the way these need to be applied appropriately to different types of trades. Few traders take the time to calculate risk reward ratios, yet these form a significant way of selecting trades and identifying the best opportunities. We compare, evaluate and apply several techniques used to set financial stops, protect capital stop loss and a protect profit stop. We show you what works and why.

SEMINAR VENUE DETAILS Includes a light meal

SYDNEY	Tuesday June 14	BRISBANE	Wednesday June 15
MELBOURNE	Wednesday June 22	PERTH	Thursday June 23

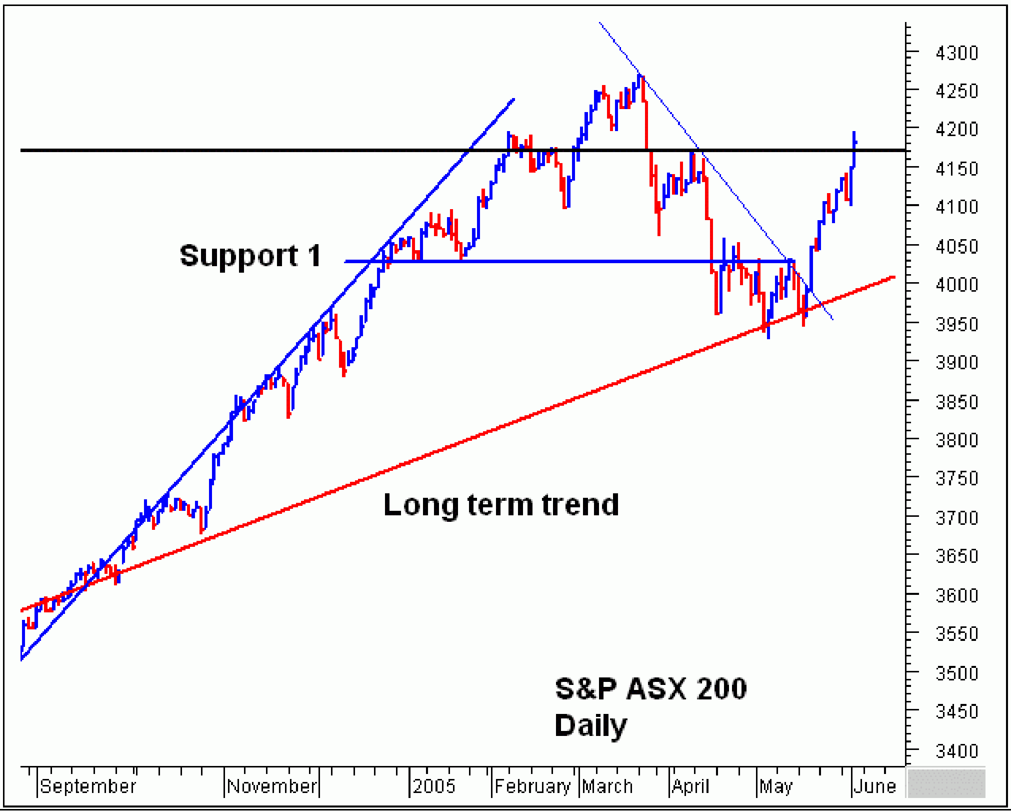
DETAILS ON: http://www.guppytraders.com/gup173.htm

NEWSLETTER OUTLOOK – TREND BREAK CONFIRMED

By Daryl Guppy

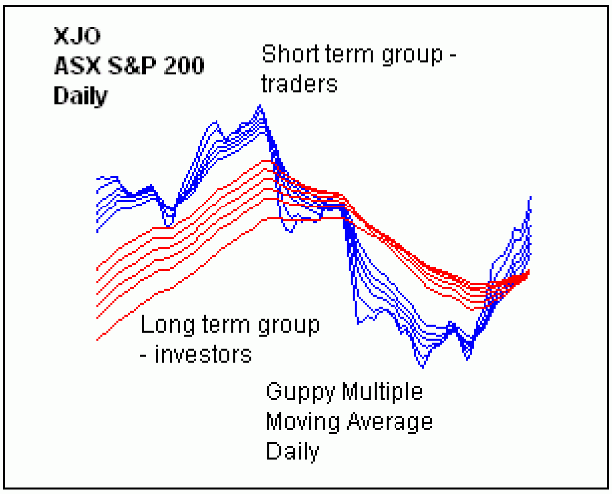
Rally or a trend break? This question was answered clearly this week with a move above the level of the shoulder line. This is the key question and the answer is in part determined by the top of the right hand shoulder. On many criteria, this is a potential trend break.

- The 10 day moving average has moved above the 30 day moving average. This has been a reliable way to define the XJO trend.
- **This continues to confirm the trend break.**
- **The downtrend line from the peak in March has been broken.**
- Short group in the GMMA has moved above the long term group.
- **This remains a strong move, but there is room for a pullback.**
- Long term GMMA group has turned up.
- **This has compressed. Traders will now watch for separation to develop to provide extra support for the emerging trend.**



All of these are strong bullish features. However, the level of the shoulders in the head and shoulder pattern at around 4170 has not been broken. This suggests that this rally will retreat and rebound. It is this rebound that both defines the nature of the emerging trend and provides an entry opportunity. Until this second rebound point is created we cannot effectively define the emerging trend.

The shoulder level has been broken, but the possibility of a retreat remains. The bottom of the retreat will define the emerging trend.



The dominance of the very long term trend line remains an interesting feature. Traders look to this opine to provide support in any market retreat.

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

GUPPYTRADERS TOOL BOX – PRE-RELEASE VERSION AVAILABLE FOR DOWNLOAD FROM WWW.GUPPYTRADERS-ESSENTIALS.COM.

Thank you for the feedback you have provided. We have identified some problems we had not discovered, and we have enjoyed the constructive comments. The new GuppyTraders Essentials Toolbox and charting program is in final testing stages and we have released a fully functional pre-release version. This will only be available as a free 30 day trial period version as we are particularly interested in user feedback and comments. Once feedback comments have been incorporated, we will offer a full release version. We will also 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 June 2005. (OK, we got a little enthusiastic with progress).

Features include:

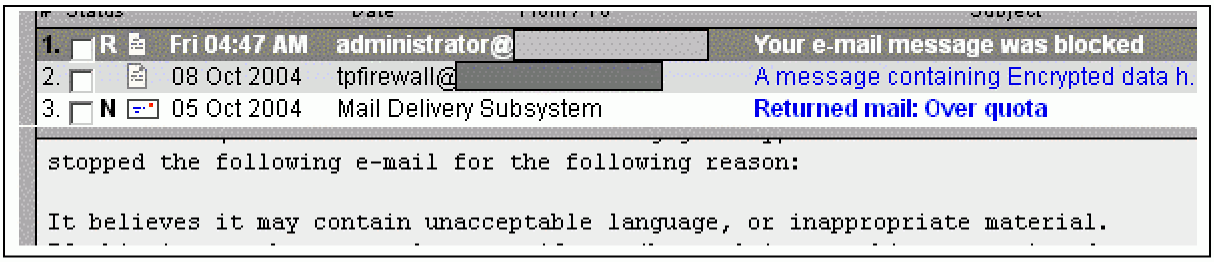
- **Full count back line capability. This is CBL for long side trading, and for short side trading**
- **GMMA display**
- **Parabolic trend line plots – including long side and short side plots. Also includes convex plots as shown in Leon Wilson books.**
- **Symmetrical and a-symmetrical saucer plotting**
- **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 Traders Essentials 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 Market Analyst 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.

IS THIS WHY YOUR NEWSLETTER DOES NOT ARRIVE?

This screen shot from our 'bounce back' mail box shows the top reasons for non-delivery of the newsletter. The most common is the 'over quota' message. The weekly newsletter is a large document, so it may be necessary to make sure your mail box has enough space to receive it. Some readers set up a special mailbox just for the newsletter. They use one of the free hotmail or yahoo addresses for this.



Increasing spam attacks and the use of spam filters has seen an increase in the other two categories of reject notices. The first of these usually occurs with company firewalls. These reject ZIP and PDF documents on the grounds they may contain 'encrypted data.' (This of course begs the question of how companies can work effectively with e-commerce when ZIP and PDF files are the most effective way of transferring large data files). Again, the solution is to not use your company email account. Open a special free email account instead. Alternatively, we can send you just a text message so you can log on and collect the newsletter each week using the password combination.

Although it is mildly amusing to be told that the email header “Guppy trading newsletter now available” is rejected because “it may contain unacceptable language or inappropriate material” this is really an assault on your right to receive the information for which you have paid. This is granny spam filtering at its worst. We have considered this type of blocking and we have decided that it is the user’s responsibility to ‘teach’ their granny filter to accept the newsletter material that you have ordered. We cannot control or modify the behaviour of these inappropriate spam filters, but the user can.

Every week we send out emails to our readers. Only a very small proportion bounce back. If your service is affected by one of these conditions, then there are things you can do to ensure you receive the newsletter every week.

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 and Alfred Frost’s, **Elliott Wave Principle** (rrp $49.95). 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

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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
NCMWOT*	$0.080	200,000	$ 16,000	$ 0.195	$ 39,000
		Newsletter date	4-Jun	Open Profit	23,000.00
			dividend Jan 6		464.48
				profit	23,464.48
				Percentage	146.65

Stock	Price	Qty	Pur Value	Close	Cur Val
MCC	$7.000	2,890	$ 20,230	$ 7.99	$ 23,091
Average choice		Newsletter date	21-May	Open Profit	2,861.10
Stop loss $6.47				profit	2,861.10
				Percentage	14.14

Sell NCMWOT for profit of $23,464 or 146%.

SUMMARY MONEY MANAGEMENT

Overall profit to date since July 1, 2004 = $105,936 or 105.9% 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.

OFFICES; Head Office, 22 Hibernia Crescent, Brinkin, **Darwin, Australia**, Level 36, Menara Citibank, 165 Jalan Ampang, **Kuala Lumpur, Malaysia**, Penthouse Level, Suntec Tower Three, 8 Temasek Boulevard, **Singapore,** RmB 30G Majestic Garden, No 6 Middle of Beisihuan Road, **Beijing, China.**