

Newsletter 02 - 31 Mar 02 – 14 Apr 02

This newsletter was started on holiday, as you will see, then edited later to add charts and whatnot - I hope you find some of it interesting or thought provoking. Onward then:-

Here I sit, laptop on my knees, about 20 clicks south of Alicante... okay, so I took my laptop on holiday after all.... And if only I had the other half of my source files I'd probably now have another section under way for Pfsan. I am continuing my usual process of development – think a bit, read other people's ideas, and see if anything good comes up... So far I've read Tom Dorsey's Trading Tips, a fair chunk of Murphy's TA of the Financial Markets, and a lump from Frost & Prechter on Elliot Wave analysis.

I've been looking in the main at Elliot Wave, Log scaling, Sector Bullish Percentages, and Exit timing.

So, in that order:

Elliot Wave – Apart from Frost & Prechter there's a fair amount on this in Murphy's TA epic. It looks quite good for market timing, largely inapplicable to trading most individual shares, and I remain unconvinced that it'll improve my trading. The problem is that there's a bit of an art to it – I've been looking at the FT100 and 350 for example, going back to 1994 or so, and have had a devil of a time trying to sort out the waves.... To cut a long story short, it seems to me that different analysts will identify different features as waves, or parts of waves/patterns, and whilst I'm happy to accept there's a 'true way' where all will be revealed, I am not happy that I can look at a chart and identify the same things as the next guy – making it a poor subject for automation. Don't get me wrong here, I am not saying it's no good – just that I can't see a significant improvement ahead compared to the way I assess market conditions already... the bullish percentage chart, which is far less open to debate in its interpretation.

I think, with a lot of work, I could code up something that would stumble through EW pattern finding, but I'd then find other analysts seeing things differently anyway... this does not look a very rewarding area for coding.

So, onto **Logarithmic scaling**. This involves 'translating' the share prices into log values of the share price, then plotting them rather than the prices... not that difficult, so likely to appear in due course. Advantages? Well, a log scaling ensures a move of x% on the chart always covers the same number of boxes, so a 5% rise in a £10 share will be 3 boxes say, as will a 5% rise in a 50p share. This is okay - I've looked at log scaled charts before, and (to be honest) don't see that much difference between a log and an arithmetic scaled chart most of the time. As it's an easy change, and adds another string to the bow, I'm inclined to add it as an option and will look to incorporate this sooner rather than later. What difference will it make to most users? I can't say – as and when it arrives you'll need to play with both types of chart and decide which 'feels' right, then use it.... 'conventional wisdom' suggests that log scaling comes into its own over longer timespans – this is fine, although pfsan has always been intended as a shorter term analysis tool...

This sort of ties in to the percentage selector in the filter setup display. This allows you to set the box size up to something other than the default. Increase the percentage (and save it, obviously, in a preferences file) and you will increase or decrease the number of signals you see on a chart. This also equates to changing the timescale of your charts... bigger percentages equal fewer signals which equal longer timescales, okay? A bigger percentage takes a larger swing to change the column from X to O and vice versa, so it'll happen less often. It will also make the boxes bigger, so price targets will be 'lower resolution' – price targets are multiples of the boxsize, so bigger boxes make for bigger 'steps' between target prices... so you should bear in mind that targets aren't exact forecasts, and the bigger the box size the less exact the target is likely to be. With any target, of any resolution, be aware of nearby resistance levels – if you have a target of 3.20 and resistance at 3.15, don't be surprised to see the rise stop at the lower figure.

Sector Bullish Percentage

Less applicable to the UK market, as some of our sectors haven't many shares in them. Load all the shares in a given sector in, produce a BP chart, and whilst some sectors are in terminal decline you can see a better sector to buy into.... Sector rotation, where different sectors become more or less popular, is well known and I figure it can't hurt to run sector BP charts where they have enough constituents to meaningful. Short term this means I'll try running sector BP charts for a few sectors, long term, if this pans out, I'll see about adding some sort of sector guide. Most likely implementation, for now, is a section of the website carrying sector info as a weekly update.

As you probably already know, I started this on return - charting a dozen sectors initially. This will continue on a weekly basis provided I have the time, though might just amount to a quick table update on the site rather than going for anything fancy.

Exit timing: Much more fun!

I am convinced this is where the real money is to be made....one of my all time hates is that stupid 'nobody went broke taking a profit' saying, here's a better one: 'cut your losers, run your winners'. So, learn when to cut a loss, and when to take profits. This is NOT about to make you a fortune, sadly I'm still trying to get this stuff right, so instead of pearls of wisdom that will instantly double your returns, here's some of what I'm thinking – feel free to add bits yourself.

So, figure on selling when you penetrate a stop... the stop is based on your choice of:-

On your chart, mark all the support and resistance lines you can, down to about last close minus 15% or so. That includes....

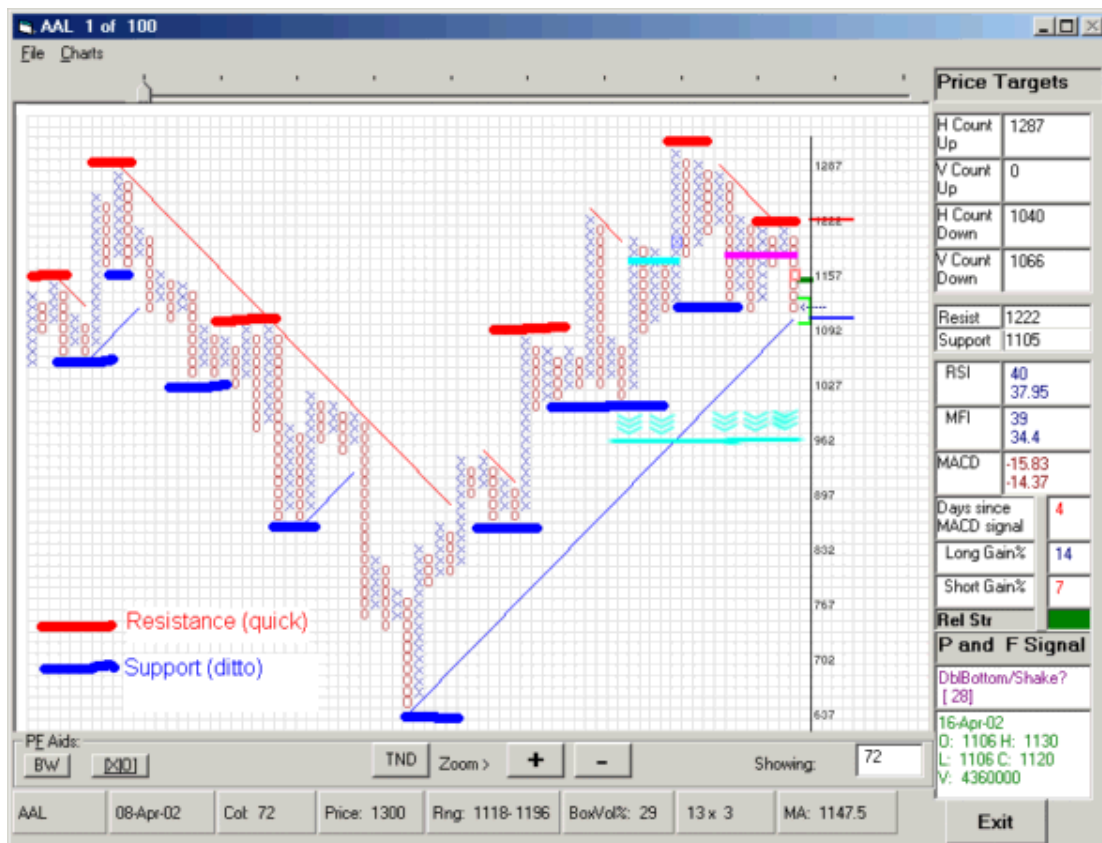
The ends of bullish support/bearish resistance trendlines

200MA

Recent tops/bottoms – particularly when several are at the same price level

Major tops/bottoms in the past

10% below the last close



This sort of thing - I just grabbed the first FT100 share along, and very quickly splodged (in MS Paint) a quick line to mark the tops and bottoms that stood out. You don't need all of them to set a stop, of course, just those that are up to 15% below the close - which was 1120 here, so all support down to $1120 - 15\% = 1120 - 168 = 952p$ which is just below the light blue pattern I drew above. In the AAL case above, the 200MA is above the last close, which is sitting on the end of the blue trendline, whilst there's a blue splodge line across just above the £10 mark a couple of boxes above the 'light blue pattern' I drew. So, 10% is at $1120 - 112 = 1008$, the 'blue splodge' is actually at 1001. Well, 10% at 1008, support at 1001 and 1105 (from the trendline - this is the level pfsan has reported support at as well), so a box below 1001 might be a good place to decide this is a loser - a stop might be set at 988 then, a little over 10% down, to allow the second support level to kick in - or you could play it quite tight, as the share is sitting at support already, and say 'no, 10% is plenty' and stick to the 1008. Not exact then, but your stop will be around the 10% mark, choosing 988 or 1008 is not as bad as staring mesmerised at a Marconi chart, is it <g>

Okay, pick the support level you want up to and including the 10% loss line – if you haven't got support between the last close and 10% below it, then maybe you might like to reconsider buying in the first place as blind faith makes a poor support level. As an initial stop I have no problems with a mechanical 10%, it is nice to know, however, that any drop following the purchase of the share is likely to bounce off support inside that 10%.

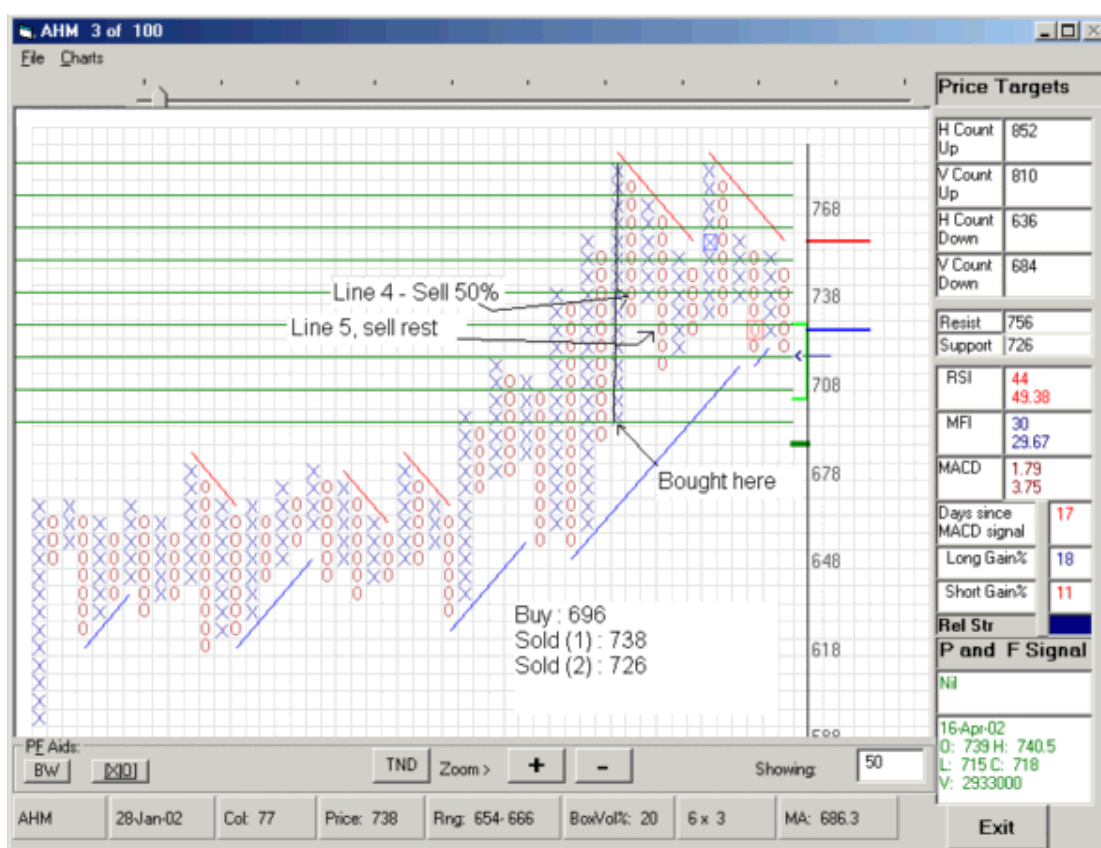
The hard bit – your share goes up, maybe up and down, and you've a small gain you don't want to lose. Not a major problem really – your initial stop PROBABLY still applies, but eventually you'll have a larger profit (hopefully) to consider. At this

point, in the past, I've tried trailing stops – the problem is that 10% is actually a big lump to give back....

So, my ace theory.... Set a stop at 10% until you are at the original price+10%, then swap to a retracement based version, which is:

Using the eighths tool , every day trace the eighths line out from your purchase price up to the top of the last X column, and watch for the O's to retrace to the fourth line (first stop therefore is at 50% retracement) or 5th line (second stop 62.5%) – sell half your holding at the first stop, and the rest at the second. If the price dips through the fourth line then rebounds you still have half the shares going for max profits, having banked a part of your gain. On a bad day, when your share tanks, you'll get out ahead of the game with half sold at roughly 37% of the gain and the rest at 50% whilst on a good day you could run at least half the position until you've made rather more.

Waiting for the first 10% means you don't need to get clever etc with shares that advance a few percent then flop, you just spend extra time managing the better buys. Anything that doesn't climb 10% at least is pruned out by the simple 10% initial stop.



Here's an example - not based on a real trade, just a random chart to show you how the lines are set. Imagine I'd bought AHM at 696 (arrowed) I then see it climb, then drop back. I trace the up column for the eighths tool line, line 4 is crossed in the downmove so I sell - 50% of the holding is sold at 738. Just before line 5 it reverses, so I keep the rest and see the new X column climb again.... The eighths tool still runs to the top of the previous X column, I am using the eighths to trace out from my buy up to the highest box so far at all times. Sadly the new X column stops short, the share retraces again, and this time the 5th line is crossed so I sell at 726. Out of interest the share is yet again at this line, don't be surprised if it bounces again.

So, not a share I've bought or anything, just a dummy really to help explain what I tried to explain above. In an ideal world I'd have kept more of the upside - I could use lines 3 and 4 perhaps, but that'd whipsaw more. The buy point, of course, wasn't a real buy signal or anything, just a convenient starting point...line 6 goes through a buy signal earlier on, using that as the buy would squeeze the lines together more, and both buy and sell prices would be higher - feel free to trace that out for practise. You don't HAVE to use the eighths for this, just put a 10% stop on until the price has got more than 10% ahead, then keep a note of the highest price so far, deduct your buy price from it, divide by two and that's how big a drop you want to sell at (50% of profit given back) ... perhaps the eighths tool is quicker <g>

The main drawback here is that a big winner, unless it just keeps climbing for ages, will probably retrace at some point and stop you out - you probably won't reach the top of many of your better buys with the original stake intact, only half of it. So, if you are very good at calling the top, forget this idea ... it's designed for those of us who still can't see the top a fortnight after the event.

Other news:

For the three people left on the planet who haven't heard, pfscan is going to be reviewed in a magazine, Technical Analysis of Stocks & Commodities, probably the July 2002 issue. (June originally, the date has slipped due to my being out of the country at a critical time). This is a magazine I subscribe to and read, finding it very interesting - there's a bit of a shortage of good TA reading here in the UK. Whatever they say about pfscan, it's a magazine you should take a look at if you haven't seen it yet. (www.traders.com for details).

PfscanVB is shareware, there is a copy of the demo on the downloads page of the site, and there are a collection of DOC and PDF files on the registered users page for download (no access restrictions - the only 'protected' part of the page is the download link for the registered version updates). The DOC/PDF files contain the manual, how to use charts and indicators, all sorts of stuff.

You can also have a demo on CD, this comes with all the docs/pdfs included.

Anybody registering the program who has not already got a demo CD can ask for a registered version on CD, (if you have a demo already I don't send a new CD out as the 'unlock' is a small piece of code that turns your demo version 'live').