Secrets for profiting in bull and bear markets

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1. Check market indicators for overall direction
2. Scan the industry groups to know which one to zero in
3. Cull out the stocks with the most potentially profitable formation within the favourable groups
4. Concentrate majority of buying in continuation-type buy patterns that are already in Stage 2, and reverse for bear markets

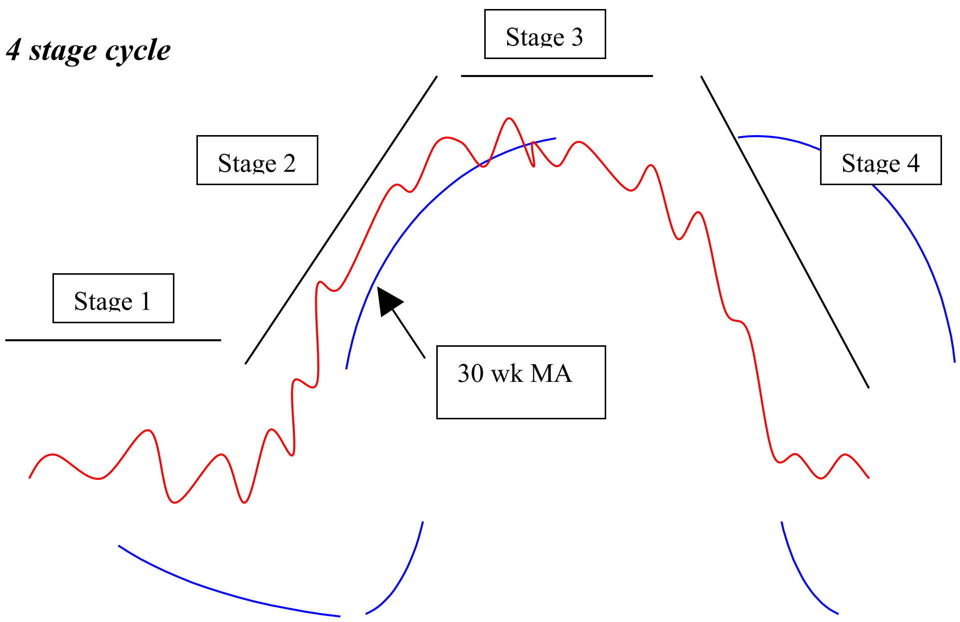
- Know where protective stop will be (ALWAYS use it) set before entering the order – if it's too far away, look for other stock or wait to purchase when safer level forms
- Never sell a stock in Stages 1 or (especially) 2, AND never buy a stock in Stages 3 or (especially) 4 – stage analysis can be applied to any investments that are governed by supply and demand
- Never guess a bottom (and go long)
- Don't feel that one has to be 100% invested all the times. Differentiate when charts and indicators point to fully invested and when to extreme caution
- Always be in harmony with the market – buy Stage 2 strength; sell Stage 4 weakness
- In case of conflict between price volume action and the earnings, *always* go with objective message being supplied by technical approach
- Always be consistent. Keep a diary and analyze actions

READING CHARTS

Daily for very short traders, weekly for intermediate (several months) traders. Below specifically on *weekly* charts:

1. Look at each high-low-close spike – forming pattern with insight into next major move
2. Look at volume plot – *very important that volume is large and expanding on breakout*
3. Look at 30 week MA – never long if P below declining 30-week MA; never short if P above rising 30 week MA
4. Be aware of its long-range background (yearly high-low, long-term support/resistance)
5. Look at its relative-strength line – long on uptrend, short on downtrend; watch those situations where it shifts direction

4 stage cycle



Stage 1: basing area. After several months decline, start sideways trend. Volume lessens (often starts expanding towards end stage 1). 30 week MA begins to flatten out.

Stage 2: advancing phase. Ideal time to go long when stock swinging out of its base into this more dynamic stage. Breakout above resistance zone *and* 30-week MA should occur on impressive volume. Usually after initial rally at least one pullback (the less the pullback the stronger the stock).
30 week MA usually starts moving up shortly after breakout. Expect price to move two steps forward and one sharp step back – ok as long as above 30 week MA.
When angle of ascent of MA slows down considerably and prices closer and closer to MA, stock becomes a hold.

Stage 3: top area. Upward advance loses momentum and stock starts trending sideways. Volume usually heavy and moves sharp and choppy. Prices tiptoes below and above MA on declines and rallies. Keep emotions in check.

Stage 4: declining phase. Stock breaks below bottom of support zone.

WHEN TO BUY

1. Stock initially moves out of Stage 1 base and enters Stage 2. Risk extremely low (support just beneath purchase price) and excellent upside potential (entire Stage 2 advance lies ahead), *but* need patience (it can take time for solid Stage 2 momentum to build).

2. After Stage 2 is well underway, when stock drops back close to its MA and consolidates. MA should still be clearly trending higher. Then it breaks out anew on top of resistance zone – this is *continuation* buy.

Early in bull market plenty of stocks breaking out for the first time, later very few but still plenty of continuation variety buys.

Rule of thumb: 80% continuation buys, 20% early stage 2 variety.

Use buy stops, within set limits, good-till-cancelled (GTC):

A. Don't have to watch market closely – frees attention
B. Better, less emotional decision (not involved in market energy)

The more mechanical the system and the less subject to judgements and emotions, the more profitable.

Buying/Selling patterns
4 Year presidential cycle: first year bear, second year bear until midway then bullish, third year most bullish, fourth tear choppy – usually first half weak, then strong
Months - bullish: Nov-Jan, April. Bearish: Feb, May, June, September
Day of week: Monday worse, Friday strongest.
Day preceding holidays usually bullish.

Selecting the sector
Use same criteria as stocks, most important criteria that group be healthy (not in Stage 3 or 4), breaking into Stage 2 with a minimum of resistance overhead. One difference: if group well in

Stage 2 far above support and one stock just breaking out of Stage 1 basis it's ok to buy; same if group just moved in Stage 2 but one stock as continuation pattern, ok to buy.
For trader, ideal is a continuation breakout within a dynamic group exhibiting the very same sort of pattern.
If several sectors are well, best will be one with best individual top chart patterns.

REFINING BUYING PROCESS

Resistance
Always check where and how much overhead resistance there is on any stock, first on 2-4 years, then on 10 years chart.

Volume
Never trust a breakout that isn't accompanied by a significant increase in volume. Either:
a. a one-week volume spike that is *at least* twice the average volume of the past few weeks, or
b. a volume build-up over the past 3-4 weeks that is at least twice the average volume of the past several weeks, *coupled with* at least some increase in the breakout week

Relative strength
Measure of how strong a stock is in relation to the overall market. *Never* buy a stock if its relative strength is in poor shape.

Buying checklist
a. Check overall direction of market
b. Scan the industry groups that look best technically
c. List stocks in favourable groups that have bullish patterns but are in trading range. Write down price they need to break out.
d. Narrow down the list discarding ones with overhead resistance nearby.
e. Narrow list further by checking relative strength
f. Set what stop loss level should be – discard unacceptable ones
g. Put in buy-stop orders for half of position on stocks that meet buying criteria
h. If volume is favourable on breakout and contracts on decline, but other half position on a pullback near the initial breakout
i. If volume pattern is not high enough on breakout, sell stock on first rally. If it fails to rally and falls back below the breakout point, *immediately* dump it.

Further tips on buying
Some chart patterns one needs to be familiar. Do *not* anticipate their completion.
1. **head-and-shoulder** (easier on daily than weekly charts) – most powerful and reliable of all bottom formations. Important indicators: 30 week MA not declining and crossed by prices at breakout; there must be a significant increase in volume on the breakout. Head-and-shoulder can also be indicator for a group or overall market, if several similar patterns in same time span.
2. **double bottom** – very profitable formation when it occurs in conjunction with impressive volume, favourable relative strength and minimal overhead resistance (frequent, so look for confirmation signals).

The bigger the base, the bigger the move.

Diversify stocks and groups.

WHEN TO SELL

Don't average down in a negative situation
Don't refuse to sell because the overall market trend is bullish
Don't wait for the next rally to sell

Always have protective stop-loss. When set initial stop, pay less attention to 30 week MA and more to prior correction low. Place it *below* round number.
After buy on breakout, place stop-loss below lower end of base.
When trending, give it plenty of room and raise it after each substantial correction have stopped.
At stage 3, become more aggressive with stoploss. Do not wait for 30 week MA to be violated before selling.

Using trendlines
Way of locking in even more of the profits. Sell at least part position when trendline (connecting at least 3 points) violated.
Either whole position stoploss just under trendline, or half there and half under last correction low.

Swing rule
Does not appear often, but very accurate. When there is an important decline, subtract new low price from previous peak, then double it: this gives potential near term price area for upswing.

Losing
Taking a loss on some positions is just a cost of doing business.

SELLING SHORT

Stocks fall much faster than they rise, because fear causes a panic reaction while greed takes a while to simmer.
Don't short a stock that is too thin – or covering position will raise the price.
Don't short a stock in Stage 2 (above 30 week MA)
Don't short a stock that is part of a strong group.
Always set a buystop.

Sequence

1. *Market*. Check that market is bearish
2. *Group*. Isolate market sectors that are potentially vulnerable. In group chart: below its 30 week MA, relative-strength is trending lower, possible negative chart pattern, several chart from that sector are technically weak
3. *Individual chart pattern*. Stock should have had significant runup before top was formed. Far from significant support areas.
4. *Relative strength*. Indicator must be trending lower.
5. *Volume*. Not a major priority on the short side.

Ideal to short at breakout, but ok to short well into Stage 4. However, make sure a consolidation pattern forms beneath the declining MA and then a new breakdown occurs.

MARKET LONG TERM INDICATORS

Stage analysis
30-week MA

Advance-Decline line
As long as AD line and index are moving in gear it's ok. When AD line starts losing upside momentum and the index charges higher, that's a *negative divergence* signalling market trouble ahead – also negative divergence if the index is rallying to new high and the AD line refuses to confirm. If the divergence takes place over a short period of time (several weeks) the decline is likely to turn out to be a correction within an ongoing bull market. If the divergence continues to take shape over a long period of time (several months), then the market advance is becoming dangerously selective, with money out of the broad market and into blue chips. Sign of a problem.
When a major bottom is forming, the index will reach the ultimate low and then refuse to drop further, while the AD line continues to move lower and lower, this is a *positive divergence*.
Whether top or bottom, the longer a divergence lasts, the more significant the eventual reversal will be.
Graph the NYSE AD line on the same page as the DJ Industrial. Can also use point and figure on a daily basis.

Momentum index 200 day moving average of AD line. Its most important signal is the cross of the zero line (the longer it was above or below, the more significant the cross).
It's more helpful at spotting tops than bottoms. At the bottom, it acts more as a confirming signal. In a bull market, it peaks before the DJ.

New hi – new lo On a weekly basis. It offers very early warning.
When consistently positive or negative, it's a long term indication. When an important divergence takes shape, a reversal in the trend is starting to form.

REDUCING RISK

To increase probability of success when trading options

1. Buy a call option only on a stock that is in Stage 2 or is moving into Stage 2. Buy a put option only on a stock that is in Stage 4 or is first entering that phase
2. Buy only an option that has big potential – you are going to be wrong more often with options than with stocks. Selectivity is absolutely crucial!
3. Give a reasonable amount of time before expiration – 40/50 days to 3 months
4. Buy an option that is close to the striking price and, if possible, in the money. Or if it's out of the money, make sure it's very close to the striking price.
5. Use a very tight protective stop (mental) on option positions – any sign of weakness is a reason to say goodbye to a position