Indicator of the Month

By MPFX

Our aim at S.T.I. is to make Technical Analysis as simple and uncomplicated as possible.

We will try to explain the concepts of each indicator in Plain English and include examples where possible.

No indicator is 100% accurate but by the use of several at the same time we may be able to eliminate many False signals.

We will start with the basics and work our way up to the more complex indicators.

1. Basic Trend Lines *by MPFX*

The basis for drawing trend lines onto charts is probably one of the most basic to do and master, yet it is one of the more powerful and reliable indicators used to determine a change in trend.

Trend lines can be applied to many different indicators but for the reference of this article we will use closing price data. This is the most common data used.

We will discuss the other uses at a latter stage.

Use the list below to navigate or simply scroll down.

Trend lines

When viewing most charts a pattern of the price formation is usually visible to the naked eye. This pattern is called a trend and these trends have three distinct patterns.

UP TREND : Prices increasing

DOWNTREND: Prices decreasing

HOLDING OR FLAT LINE : Prices stagnant or small trading range.

A trend line is basically a line drawn joining consecutive lows or highs in a trend pattern.

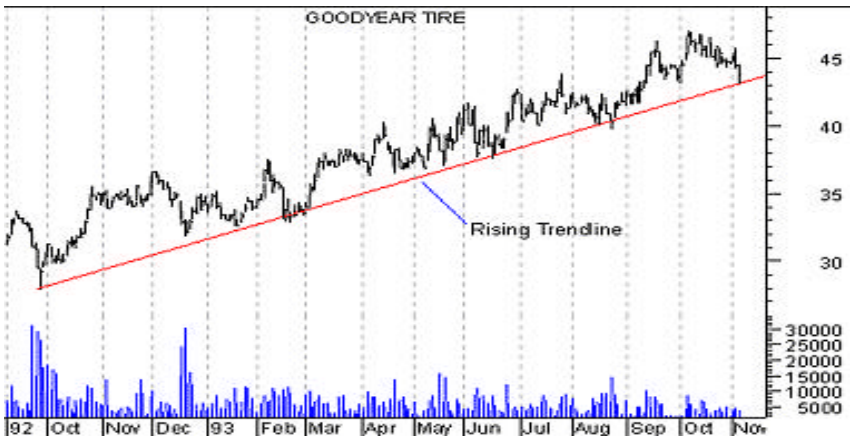
Draw a line connecting the lowest points on a chart in an up trend.

Draw a line connecting the highest points on a chart in a down trend.

Draw BOTH highs and lows for a holding pattern

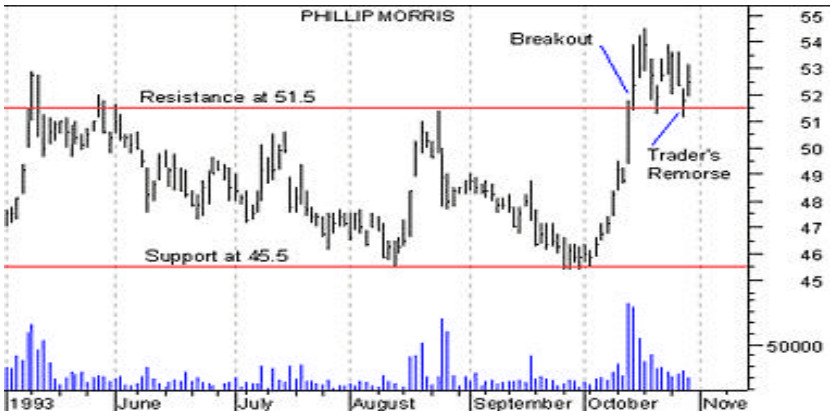
Note Rising volumes on lead up to Breakout

An Up trend with trend line drawn in



A down trend with trend line drawn in

Holding pattern with BOTH lines drawn in



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Support Line

When we draw a line joining all the lows of a price pattern together the line is called a Support Line.

These lines are a low point on the chart on which the price bounces
off consistently when reached.

Many traders elect to BUY when the price reaches this point.

It is our belief that the market likes to test Support lines more than once and we look for BUY signals after a second or third testing of this line.

If a support line is broken then the current trend is said to be broken or in a Down Trend and the market will look for a lower price to set up a new support level.

TOP

Support line

You will hear comments about support levels consistently on the chat rooms and in editorials.

These levels ARE very powerful and SHOULD be monitored diligently when reached.

Resistance lines

When we draw a line joining all the tops of a price pattern together the line is called a Resistance Line.

It is basically the exact opposite of the support, it is a series of highs on a chart where the market continually rejects the price thus not allowing it to go any higher.

Many traders elect to SELL when the price reaches this point.

It is our belief that the market likes to test Resistance lines more than once and we look for SELL signals after a second or third testing of this line.

The same applies for resistance in that it is a powerful level and one SHOULD think seriously about taking profit at this level.

Some traders like to sell small parcels to average out their price paid and leave the rest in hope of greater gains.

Resistance line is drawn in RED.

Support in Green

TOP

What to look for! Breakouts

We have now established what are trend lines and how to draw them. When one of theses lines is breached is called a Breakout.

If a breakout occurs on a Resistance line many Trader's will class this as BUY signal and act accordingly.

If a breakout occurs on a Support line many Traders will class it as a SELL signal an act accordingly.

Please note how the OLD Support line NOW becomes the NEW Resistance line

Resistance Broken

Note Rising Volumes on Breakout

Resistance Broken

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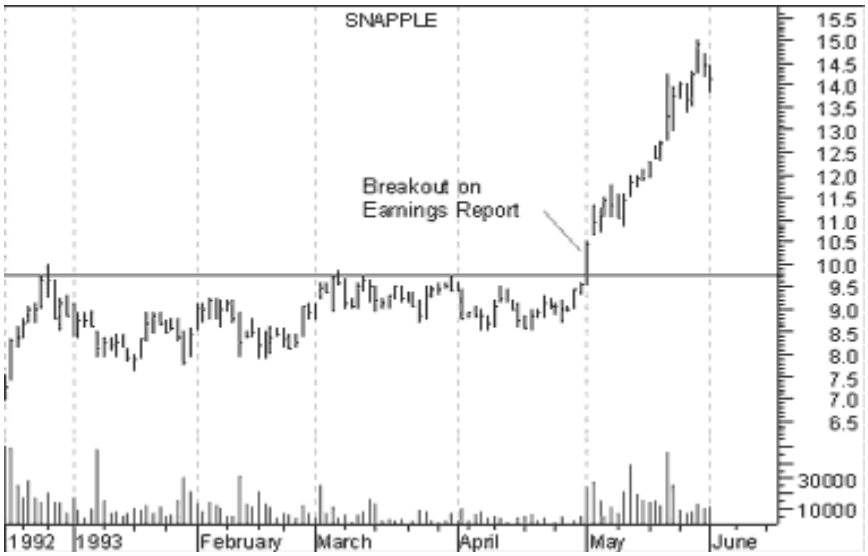


Support Broken

From time to time there will be FALSE signals given.

This is why it is important to WAIT FOR CONFIRMATION of a trend reversal or breakout.

It is at this point we need to add other indicators to help with our Analysis.

2. Price Patterns *by MPFX*

You should now have a basic understanding of Trend Lines and their workings from our first chapter. In this chapter we will discuss some of the patterns that form on the charts that help give a further indication of an impending Trend Reversal. Once again some of the patterns about to be discussed are very powerful and SHOULD be **respected!**

Use the list below to navigate or simply scroll down.

Head & Shoulder Pattern

The Head & Shoulder Pattern has claim to being one of the most reliable of all chart patterns. It is usually formed at the end of an upward trend or market rally and acts as a **SELL signal**.

There are four main components that make up a H&S pattern and they are :

The Left Shoulder

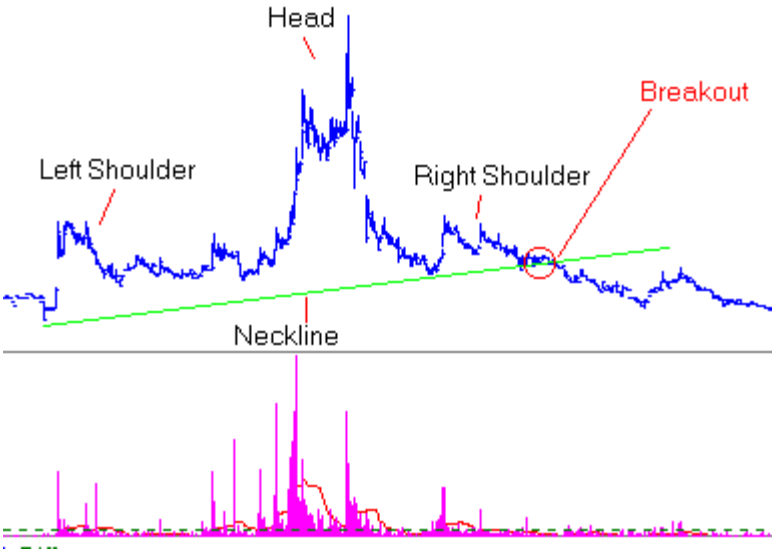
The Head

The Right Shoulder

The Neckline.

The Left Shoulder - The market looks to test higher price levels. Increasing Volumes. Followed by retracement to neckline.

The Head - Market again looks to test higher ground and succeeds with setting a higher price that was set by the Left Shoulder. Large Volumes Followed by retracement to neckline.



The Right Shoulder - Once again the market looks to test higher ground but this time fails to achieve the high price set by Head. Reducing Volumes. Again followed by retracement to neckline only this time there is a good chance of the Neckline being violated and the market MAY look to test Lower ground.

The Neckline - Is a line that is drawn connecting consecutive lows. It is a line where the price bounces off and refuses to go below. It is basically the same as a support line

Most traders who are familiar with this pattern would try to liquidate at the top of the Head or as it started to retrace towards the Neckline.

If you are still holding a stock during the Right Shoulder stage it may be your last chance to liquidate before the price tests lower ground.

I advise that you look to liquidate at the top of the Right Shoulder.

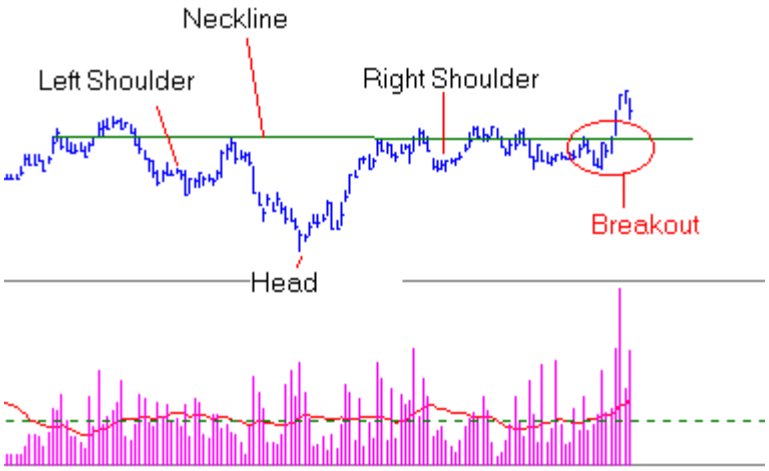
Inverse Head & Shoulder Pattern

This pattern is identical to the H&S discussed above except it occurs at the end of a downward trend or market sell off. It is made up of the same four components only this time they are acting in reverse and thus give a **Buy signal.**

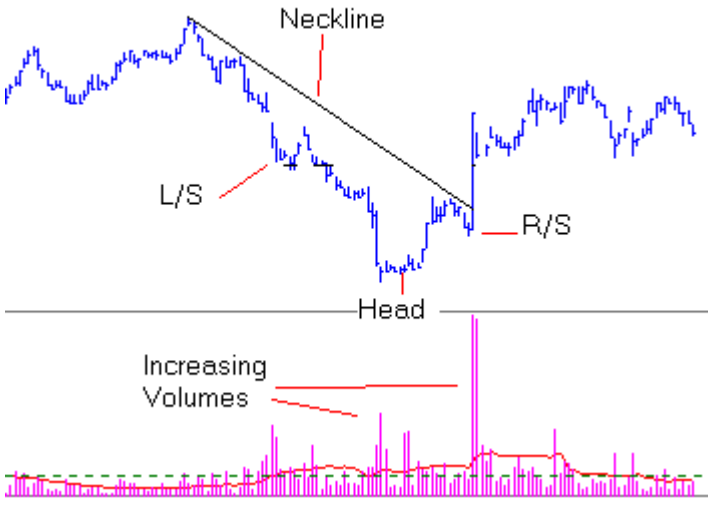
The Left Shoulder - The market looks to test lower price levels. Decreasing Volumes. Followed by test of Neckline.

The Head - Market again looks to test lower ground and succeeds with setting a higher price that was set by the Left Shoulder. Steady to slightly increasing Volumes. Followed by test of Neckline.

The Right Shoulder - Once again the market looks to test lower ground but this time fails to achieve the low price set by Head. Increasing Volumes. Again followed by test of the neckline only this time there is a good chance of the Neckline being violated and the market MAY look to test Higher ground.



Please note volumes rising.



The Neckline - Is a line that is drawn connecting consecutive Highs. It is a line where the price bounces off and refuses any Higher. It is basically the same as a Resistance Line

Again most traders who are familiar with this pattern would try to Buy at the bottom of the head but it is a safer way to trade if you wait till confirmation that the Right Shoulder has formed and is looking to test the Neckline once again.

Where you decide to take your position is a matter of personal preference and risk adversity.

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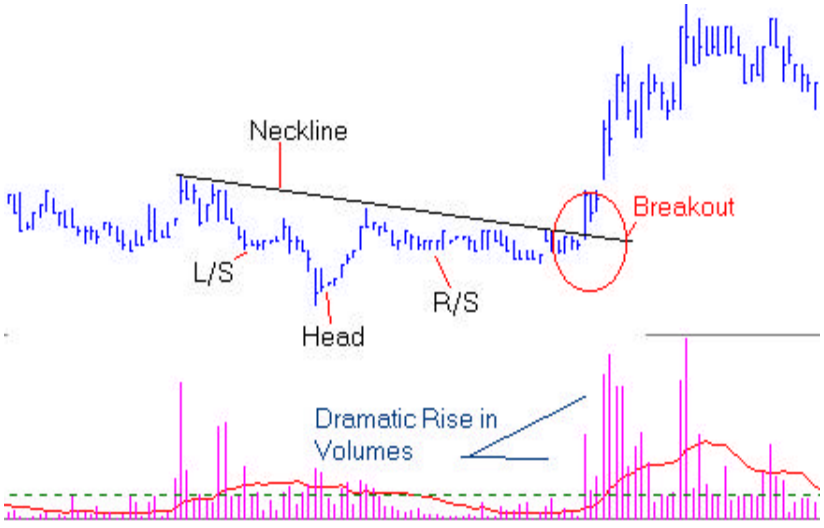
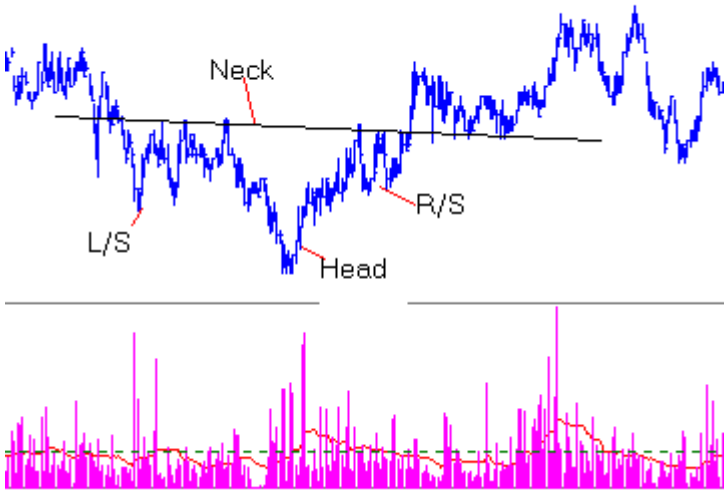




Double Tops

This is another powerful pattern that MAY indicate that the market is looking to test Lower levels.

It occurs at the end of a upward trend or market rally.

Double tops basically tell us that the market has tested a price level on two occasions and on both times refused to go higher.

They can also come in the form of triple and quadruple tops.

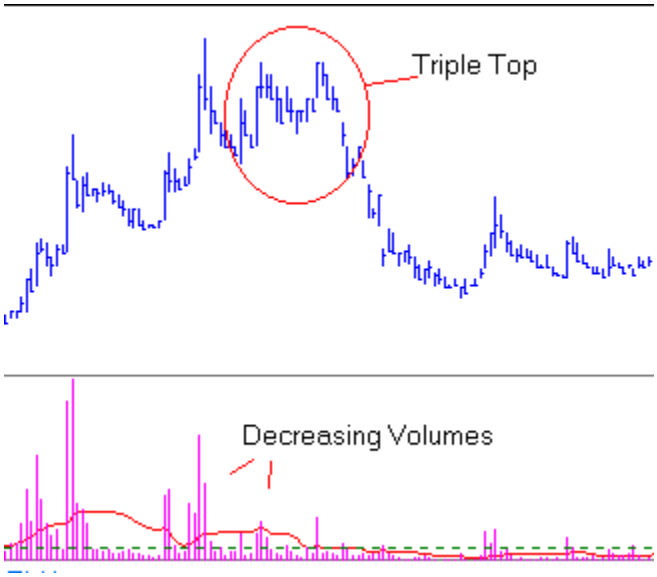
Volumes on the second top should be lower than the first top.

If you hold a stock that exhibits a double top be ready to liquidate as there is a good chance the market will go lower.

TIP

Bar and Candle Charts will give you a better example of double tops than line charts.

Examples of Double and Triple Tops:



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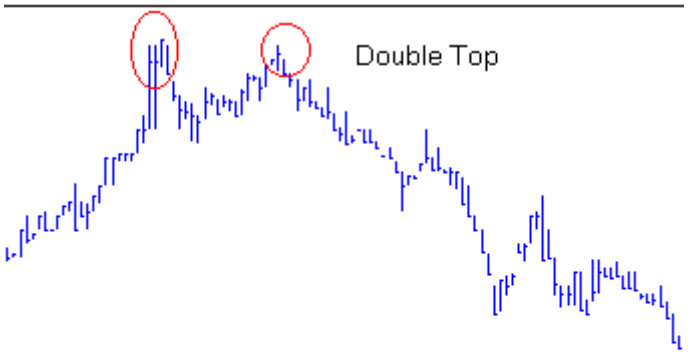
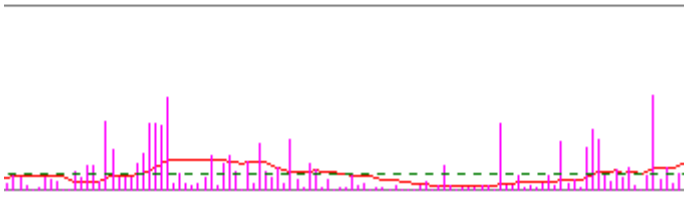
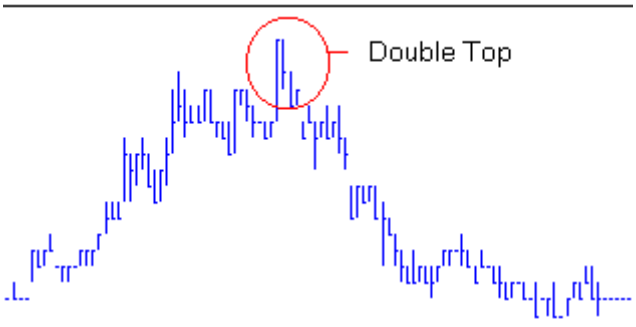
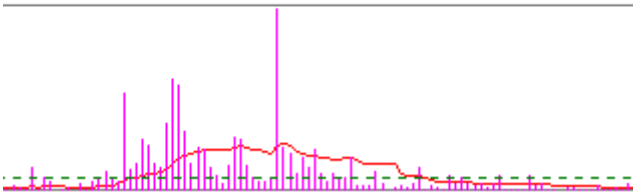








Double Bottoms

Double bottoms are identical to double tops except they work in the opposite way and thus create a Buy signal.

Double bottoms basically tell us that the market has tested a price level on two occasions and on both times refused to go Lower.

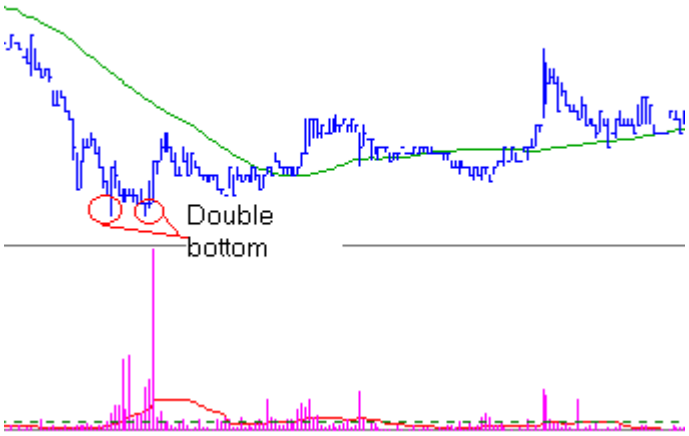
They can also come in the form of triple and quadruple bottoms.

Volumes on the second bottom should be Greater than the first bottom.

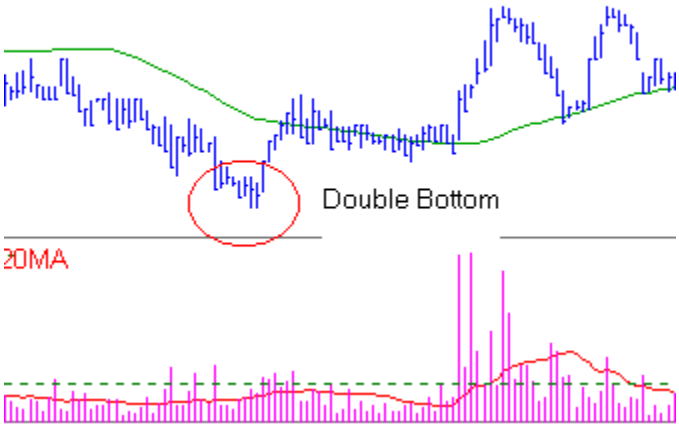
Double bottoms can give an excellent Buy signal and most Technical Traders would act on such a sign.

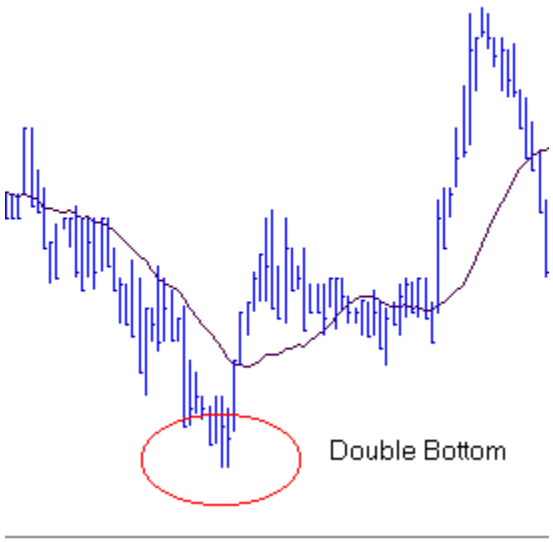
TOP

Examples of Double Bottoms :



Note Dramatic rise in volumes on second bottom





Rounded Top / Saucers

The formation of a rounded top on a chart is a good indication that the market will look to test Lower ground soon and thus giving us a Sell signal.

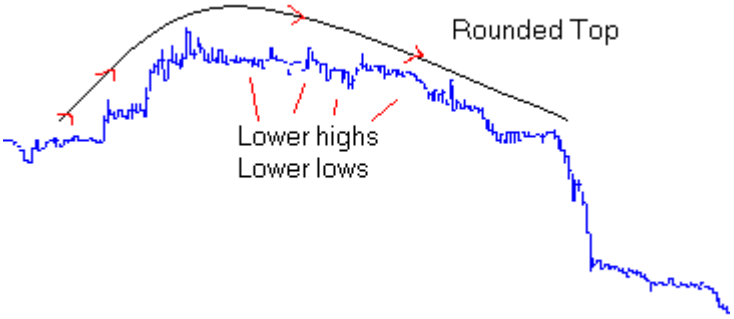
It can also be called a saucer or distribution curve and is seen at the end of an upward trend. It shows the market is running out of steam and cannot achieve new highs.

Volumes will start to reduce as the price reaches it's peak and increase as the price starts to fall.

Most experienced Traders would note this and exit their position.

TOP

Some example of Rounded Tops:



Rounded Bottoms

This formation has the same characteristics as a rounded top only this time it works in the opposite way and creates a BUY signal. Rounded bottoms are sometimes called Saucers or the Accumulation Period.

All of these patterns indicate that the downward trend is running out of steam and the market is looking to test higher ground once again.

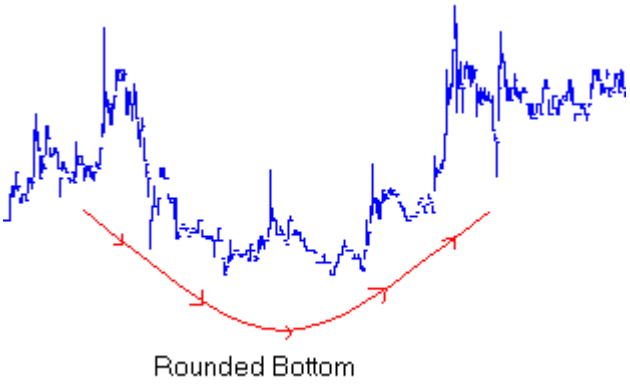
Most experienced traders would be looking to position themselves in this accumulation period, it is called the accumulation stage as that is exactly what is happening, traders are accumulating shares.

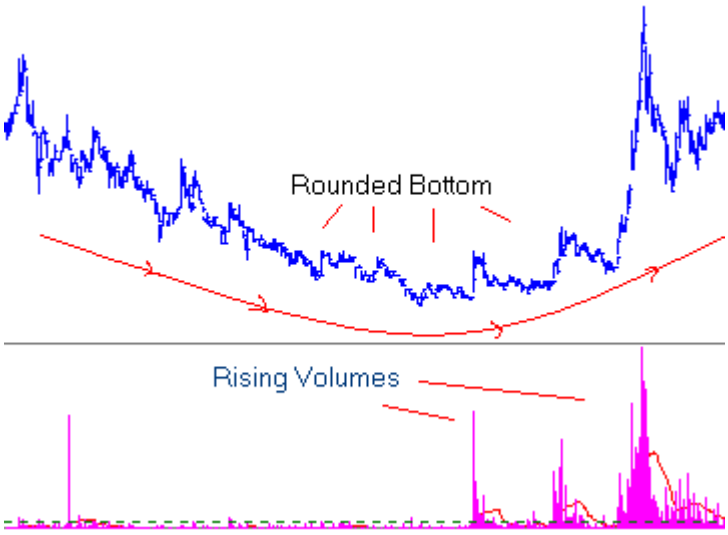
A further extension of the rounded bottom is a formation called a Cup. It is basically a completed rounded bottom with a smaller rounded bottom formed on the right hand side thus giving the appearance of a handle for the cup.

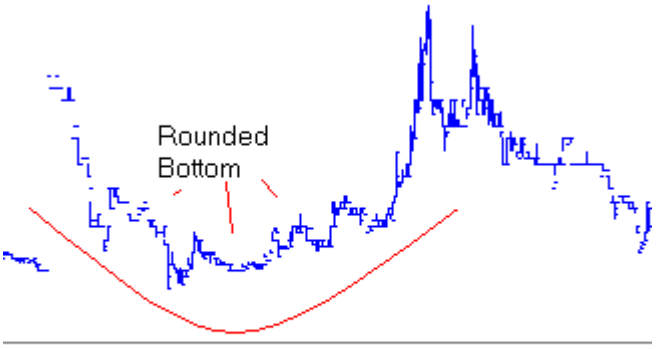
Volume should be on the increase as the bottom starts to climb upward.

There should be even larger volumes again during the Handle stage.

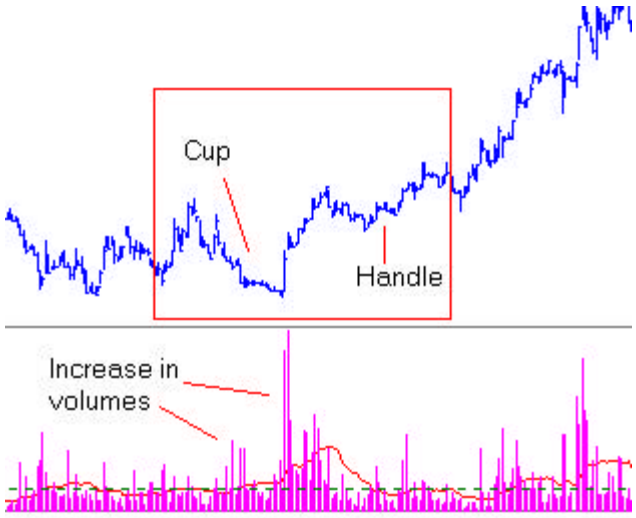
Below are examples of rounded bottoms and cups:

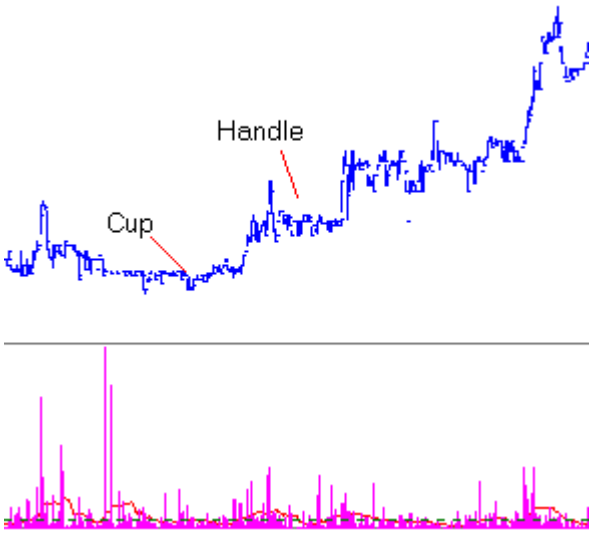






The Handle is maybe our last chance to take a position before the market tests higher ground.





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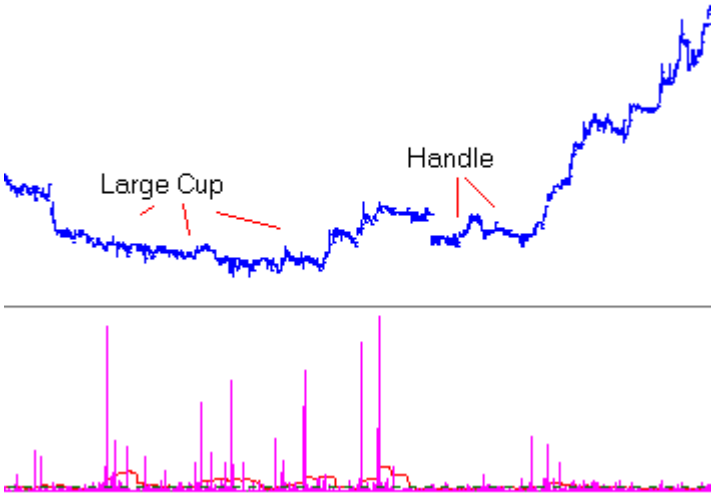


Triangles

Triangles and wedges are probably the most frequently occurring pattern to form on the charts and can give a possible early indication of a trend reversal.

As they occur so frequently they are not as reliable as some patterns previously discussed but are still a very useful indicator for the Technical Trader.

Drawing Triangles onto charts is basically just drawing BOTH support and resistance lines at the same time.

They can be found nearly anywhere on a chart. Sometimes an entire up trend or downtrend may be made up of lots of little triangles.

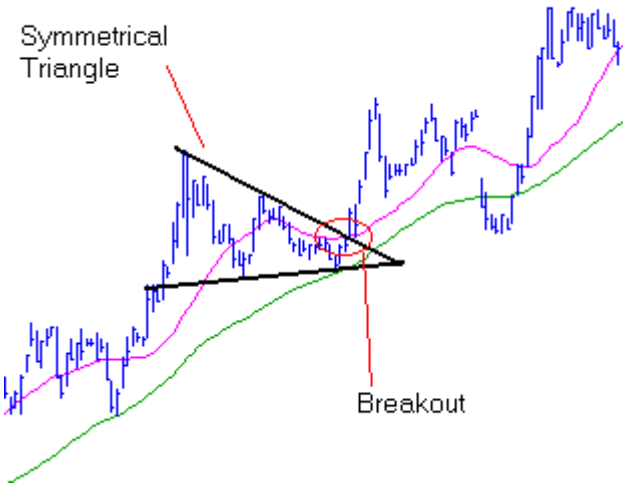
The two main types of triangles that can be found are:

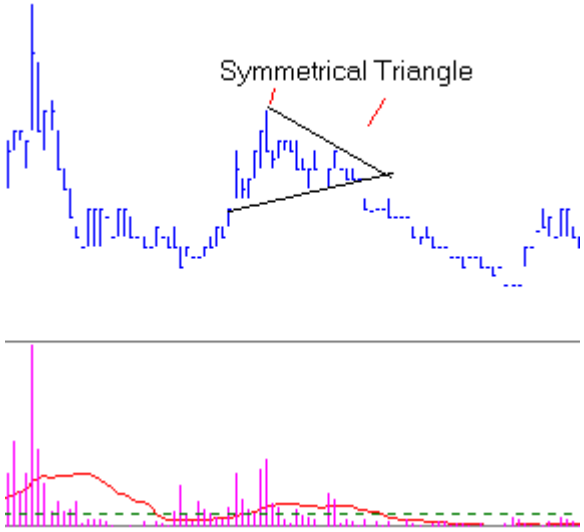
Symmetrical Triangles and **Right Angled Triangles:**

Symmetrical Triangles - These occur when the price is locked into a reducing trading range. Both support and resistance lines meet in a point.

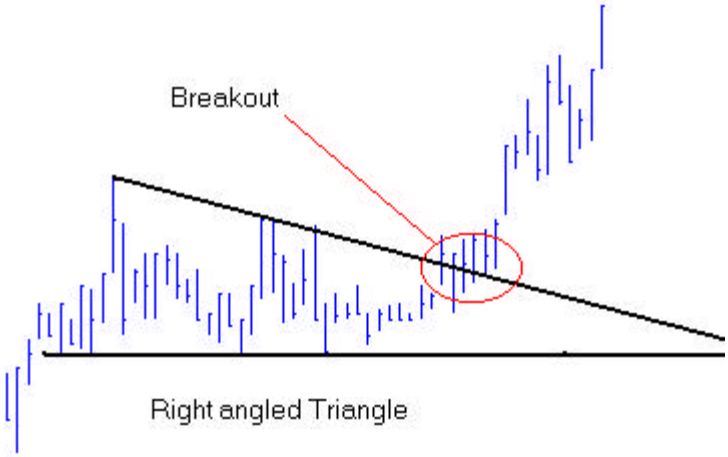
The lines are said to be in Convergence. Volumes slowly reduce as the price nears the point of the triangle and then on breakout surge considerably.

Below are examples of triangles :





As Traders we are looking for this breakout and would either buy or sell according to the direction of the breakout.

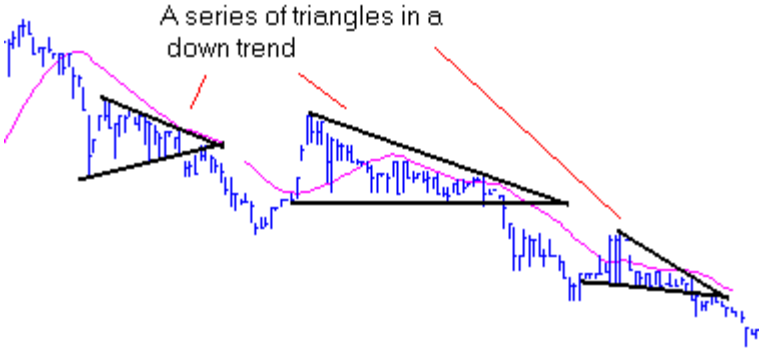


Please remember that false are common with this type of pattern.

Right Angled Triangles - Are similar to symmetrical triangle but instead one of the lines drawn will either have a flat top or flat bottom and is drawn near perfectly horizontal.

These triangles are probably more accurate than all others and may also indicate which way the price could break.

Again extreme caution is needed when using triangles as they DO generate false signals.



Flags Pennants Wedges

Flags, pennants and wedges occur on both up and down trends and indicate the market is reassessing the share price or more simply taking a breather.

They are more often than not formed at the halfway stage of a trend.

They are drawn onto charts by drawing both support and resistance lines simultaneously.

Once drawn they should take on the appearance as their names imply. I.e. A Flag looks like a Flag

A basic rule to follow is ' If a Flag, Pennant or Wedge forms in an up or down trend, the trend USUALLY continues on the same path'. I.e. An up trend continues Up

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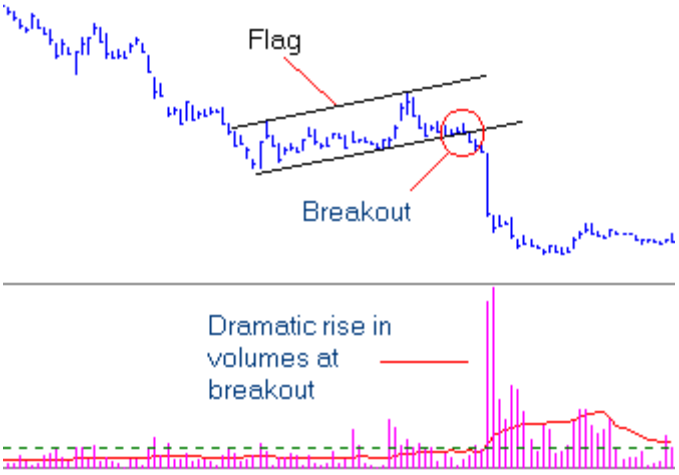
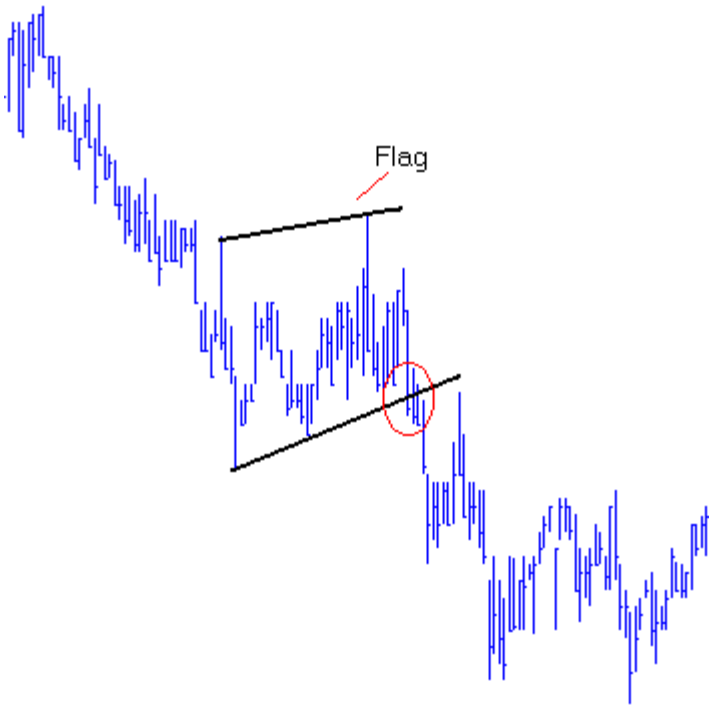
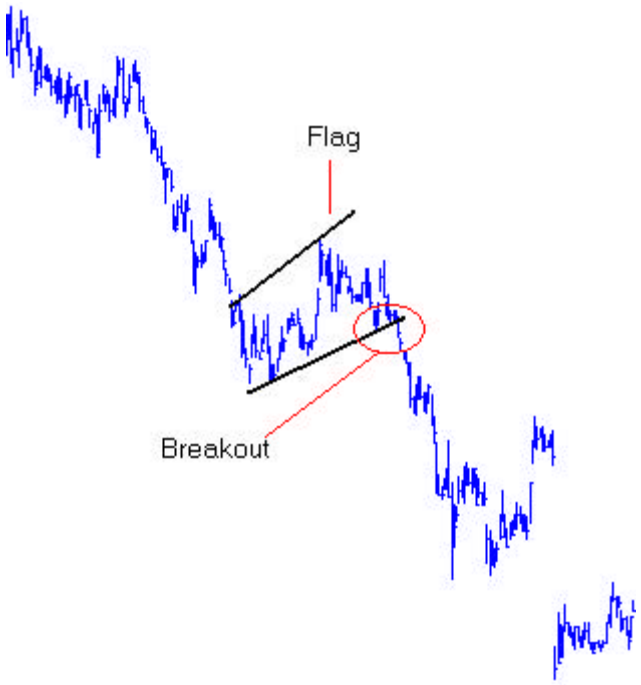
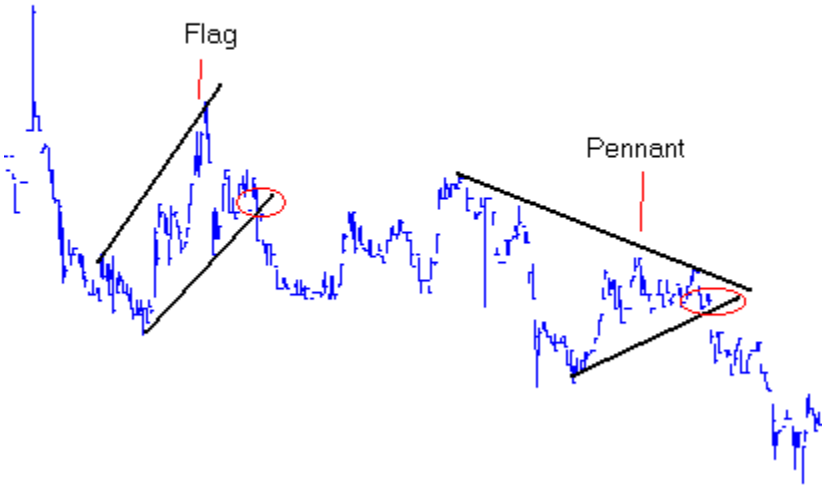
Below are some examples :





If holding a stock and one of these patterns forms on the chart it is a signal for caution and a breach of either the support or resistance should be acted upon





As you can see Wedges and Pennants are very similar in appearance but in essence as Traders we are only interested in which way they will break as opposed to what to call them.

FOOTNOTE:

Be Warned.. ALL of the above mentioned in this chapter

CAN and WILL give False buy and sell signals.

It is at the Traders discretion whether to act on any of these signals.

It is my recommendation that diligent monitoring should be applied if you

are holding a stock that exhibits ANY of these patterns mentioned.

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Chart Types *BY MPFX*

When looking at a chart we have the option to view the price formations in four main styles, these are: Line, Bar, Candle and Point and Figure. All of these have their strengths and weaknesses and which style you choose will be a matter of personal preference.

I personally elect to use three of the four types with point and figure the one I never use. This works for me but there are many Technical Traders out there who trade with great success using only P&F so as already stated this really is a personal choice that you will have to make.

Line Charts Bar Charts Candle Charts

The line chart is the one most of us would have seen many times before and is usually plotted using closing price data.

This chart is good for visualizing the overall trend of a stock and on some charting programs it will allow you to see more data over a longer time span.

It's use is limited as it is basically what I call a one dimensional chart as it uses only one form of data.

Good for glancing, but not for analyzing.

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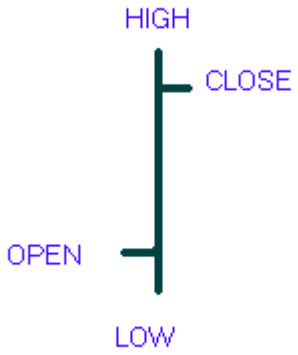
Line Charts

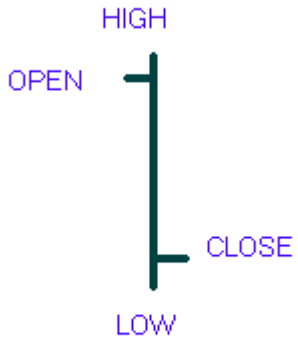
Bar charts are probably the most widely used by traders and not only give us the closing price but also the high, low and opening prices.

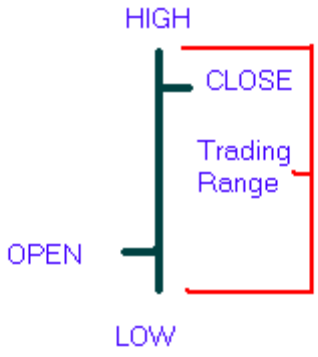
As traders we need to know as much as possible about a stock and its movements and these bars are the perfect tool for the job.

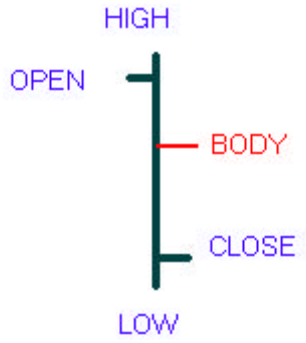
With a single glance at one of these bars we can get a feel for how investors traded this stock for the day and their general sentiment towards it.

Bar Charts



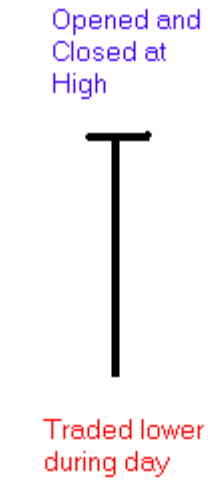


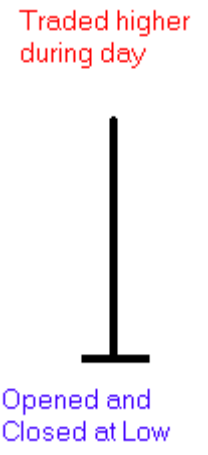




Small bars (or bodies as they are Technically called) are a sign the market maybe consolidating its position or thinking about its nest move.

Long bodies could indicate the market is again on the move and looking to test new levels.



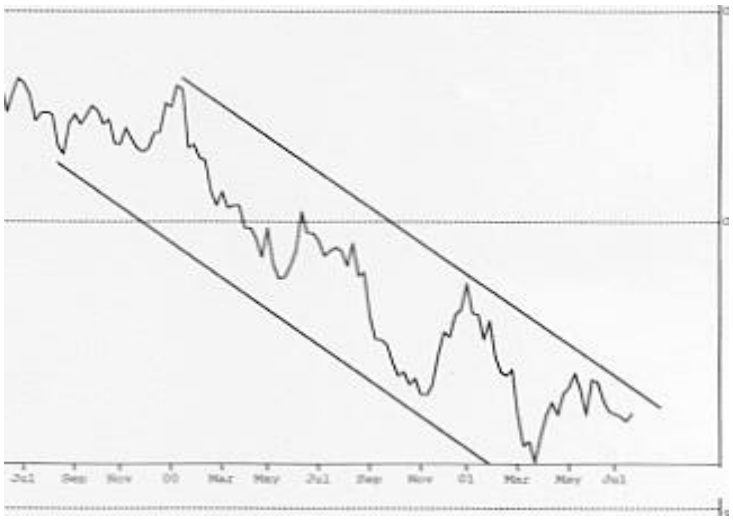


Some charting packages will only show the close on the bar, many traders elect to use this style with great success. Some say the opening price does not give a true indication of market sentiment and choose to ignore it.

Showing Close Only

There is a marked difference when drawing trend lines on a line chart compared to a bar chart. With a bar chart you get the entire trading range and a trend line can be drawn using these ranges as opposed to only using closing price data on a line chart. To make this more clear please refer to diagrams opposite.

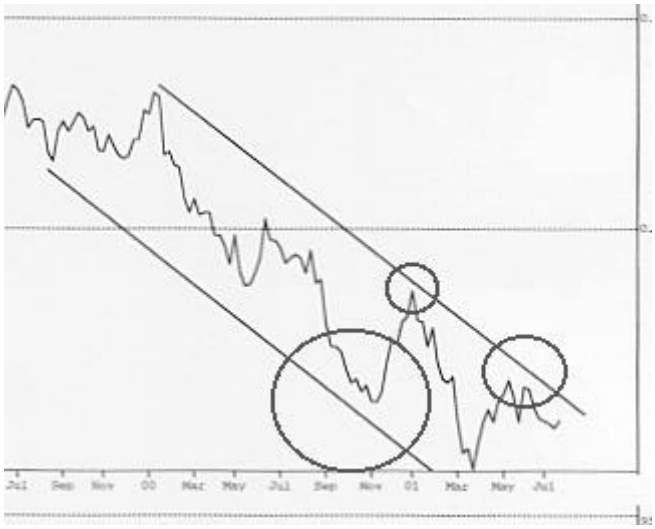
These two charts are identical except one is a line chart and one is a bar. The trend lines drawn in are the same for both charts based on the bar chart only.



In the circled areas you can see the clear difference between the two.

With a bar chart we are drawing trend line based on trading ranges rather than end of day closing prices.

By doing this we are allowing ourselves a better chance of gaining a lower entry price and a higher exit level. We also increase the range in which the stock may trade thus allowing greater profit margins.



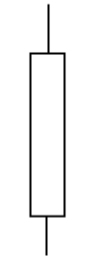
TOP

Candle stick charting was developed by the Japanese several centuries ago and has undergone a resurgence in popularity in recent times. This form of chart is by far my personal favorite and I usually use it exclusively. Although more complex to understand, once mastered, candle charts can give you the best overall view of market sentiment. In this section I will give you a brief summary of candles but the purchase of a book dedicated to candle charting should be a must for anyone serious about developing their charting skills.

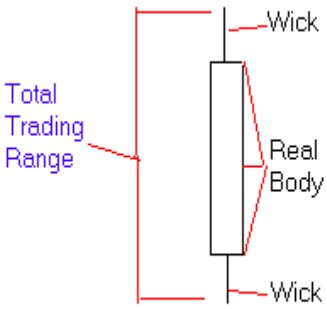
Candles are similar to bar charts in that they show all four data components (open , close, high and low) but that is where the similarities end.

Candle charts use rectangular boxes that join the open and closing prices together, and use vertical thinner lines to define the trading range. The boxes are called the ' Real Body ' and the thin trading range line are called the ' wicks or shadow

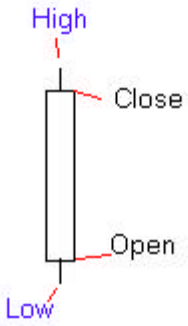
Candle Charts

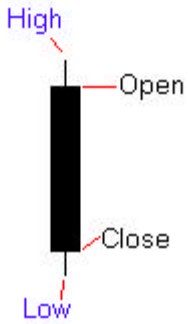


Candle



If the closing price is **higher** than the opening price the body will be **white**, if the closing price is **lower** than the opening price the body will be **black.**





Opposite is a basic list of common candle stick formations.

A = Open/close the same. large trading range.

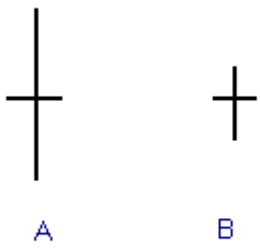
B = Open/close the same. small trading range.

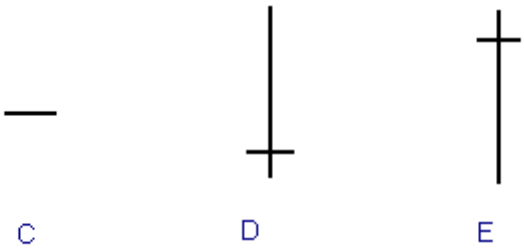
C = Open/close the same. no trading range

D = Open close the same. Market tested higher levels but failed to close any higher than open.

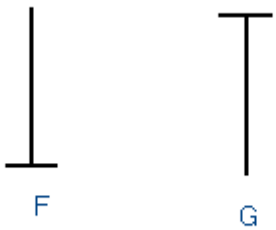
E = Open close the same. Market tested lower levels but failed to close lower than open.

F = Doji with market testing higher levels but refusing to close above open. Also known as a ' Hammer ". The appearance of a hammer at the top of a trend could suggest lower prices may follow. Bearish sign.





The correct term for a line that represents a price that opened and closed at identical levels is ' Doji '



G = Doji with market testing lower levels but refusing to close below open. Also known as Hammer. The appearance of a hammer at the bottom of a trend could suggest higher prices may follow. Bullish sign.

H = Hammer with close higher than open. Bullish at bottom

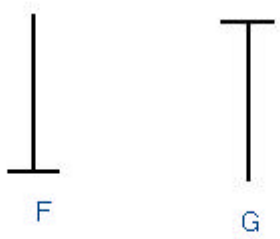
I = Hammer with close lower than open. Bullish at bottom.

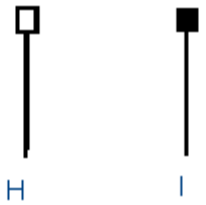
J = Hammer with close higher than open. Bearish at top.

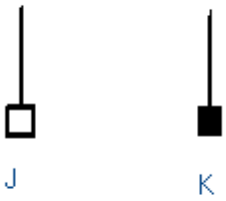
K = Hammer with close lower than open. Bearish at top.

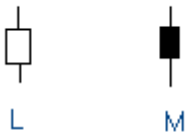
Please note that Hammers are also referred to as ' umbrella lines ".

L & M = Both of these are known as spinning tops. They represent small trading ranges and are important in some candle chart patterns. Again where they occur is of the up most importance.

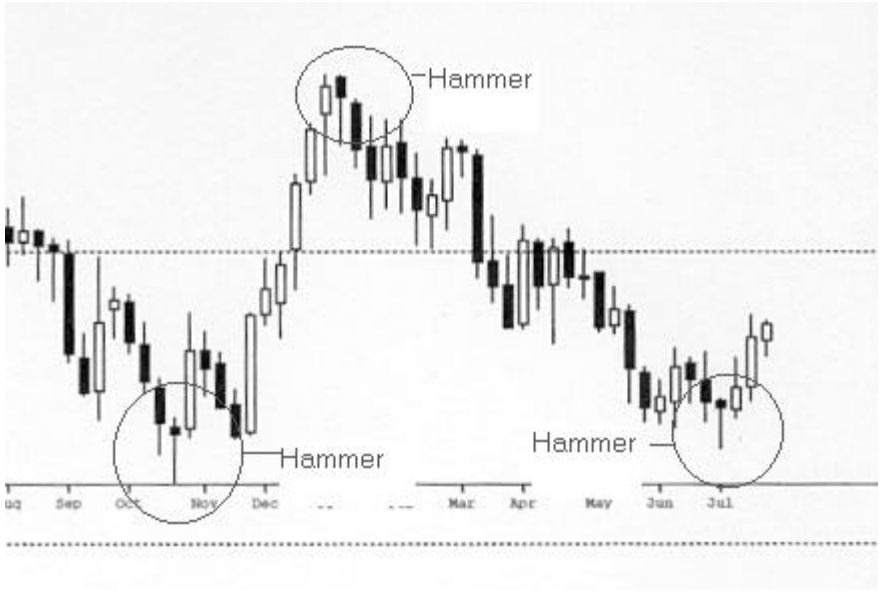




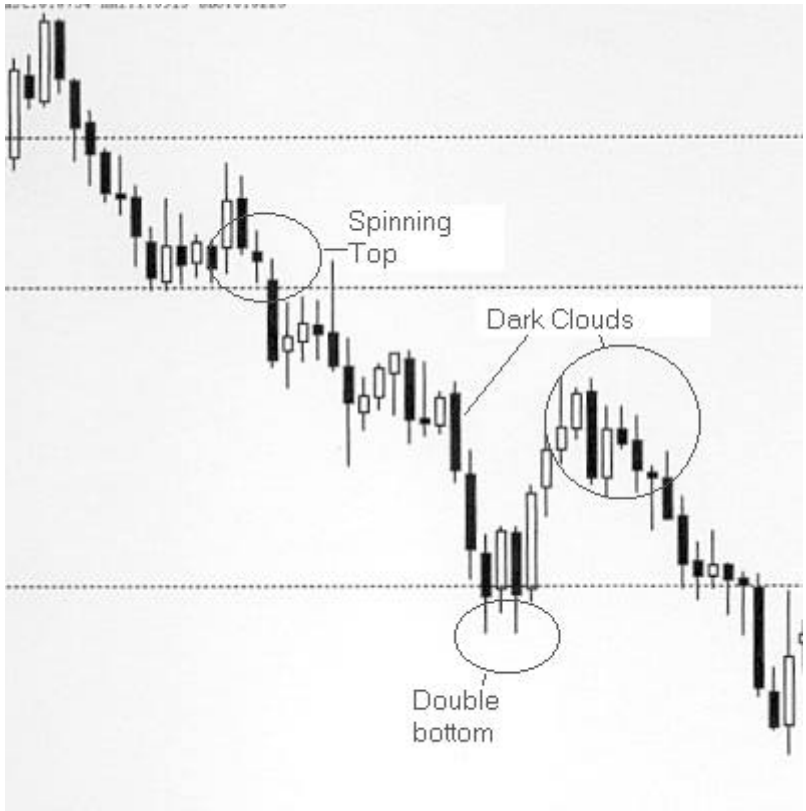




Opposite are 3 examples of Hammers. The bottom two are bullish while the top one is Bearish.



The appearance of Dark clouds is not a good sign. It is formed with a white real body followed by a Larger black real body that closed lower than the previous days close.



As mentioned at the start of this chapter Candle stick charting is so involved that the purchase of a book solely dedicated to this subject should be must for any serious trader.

I have only scratched the surface of this invaluable method of charting in this chapter.

Moving Averages have been around for many centuries and helps the trader to try and eliminate some of the volatility that is associated with stock prices. There are three main types of moving averages: Simple, Exponential and Weighted.

I personally use only Simple M/As for my trading. This suits my trading style and all examples shown here are based on this.

I suggest that you experiment with all 3 on the same stock to see how all three behave just that little bit differently.

Moving averages are basically the share price smoothed out over a set time frame. They are calculated by adding all the closing prices together for a set number of days and then dividing this total by that set number of days. So for a 20 day m/a we use the last 20 days of data. As new data becomes available the earliest entry is replaced with the latest entry thus keeping our 20 day total intact.

Moving Averages By MPFX

The four charts below are all of the same stock with only the time frames changed on the m/a.

The longer the time frame the less false signals.

As most charting packages automatically construct all three types of moving averages I believe that time is better spent here explaining how to trade using them as opposed to their how they are mathematical made up.

The first and most basic method for the use of m/a's is to wait till the price of the stock crosses over the m/a.

This works as both a buy and sell signal and is one of the most widely used methods.

The key to this method is the time frame. The basic rule is the longer the time frame the less false signals. This is fine but with this you also get the longer the time frame the later the buy or sell signal.

Day traders and short term speculative traders may elect for shorter time spans than a long term, more cautious trader. Ranges from 9 days to 24 months can be used. The most common used by traders would be 9, 20, 25, 30, 50, 75, and 100 days.

I advise that you run tests on a stock you are familiar with, changing the m/a time frame to see the differences in entry and exit levels.

As we have already discussed trend lines we can now apply them together with a m/a on the same chart.

We now how have two indicators giving us signals.

Sell Signal = 50 m/a crossed to the downside and support line has been broken.

Buy Signal = 50 m/a crossed to upside and resistance line has been broken.

Interesting to note that the 50ma gave a sell signal before the support was broken but gave a buy signal after the resistance was broken.

Above and below are the same stock with only five days added to both m/a's in the one below. It is interesting to note that such a small change can effect the timing of the signals.

The second method for the use of m/a's is to apply Multiple Moving Averages.

This is the preferred method by many traders and the method I personally elect to use.

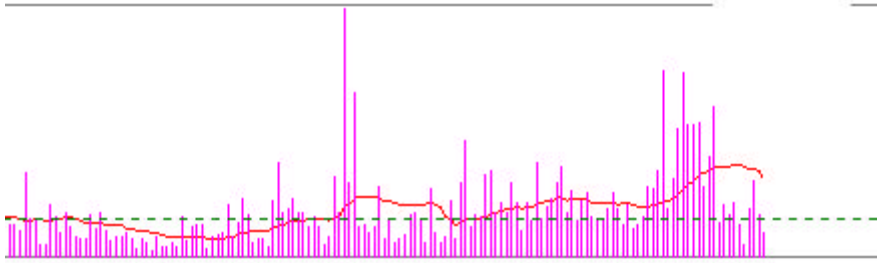
It involves the use two or more moving averages at the same time which are set at different times spans.

When the moving averages cross each other, either a buy or sell signal is generated.

When the faster moving average (25ma) crosses above a slower moving average (50ma) it is classed as a Buy signal.

When the faster moving average crosses below the slower moving average it is classed as a Sell signal.

Once again the time frames used have a great impact on where the signals are generated on the charts.

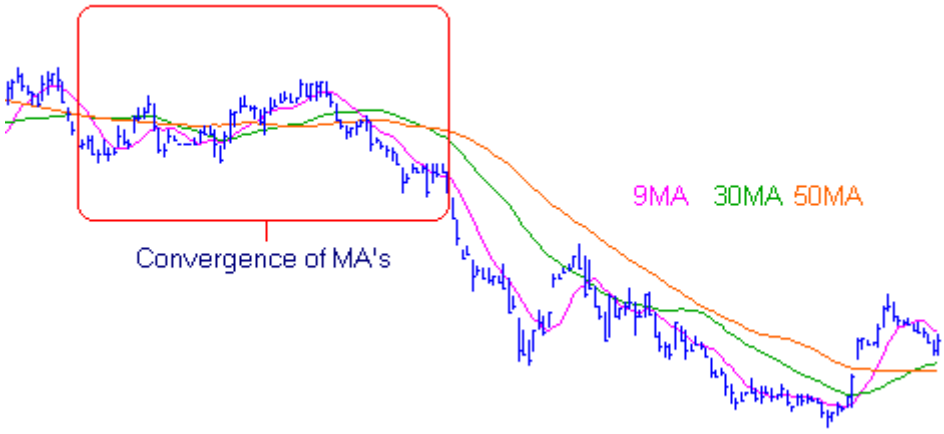


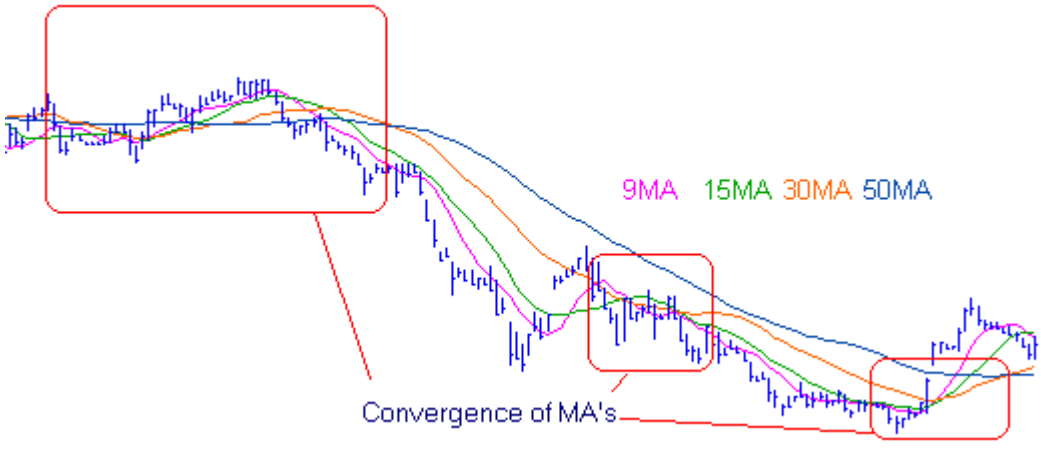
Below are all the same stock with a moving average added each time. It is of PBL daily.

I advise running numerous tests adjusting the time frames on both m/a's. Make sure you use the same stock for the tests. This method is by far the best way to truly understand moving averages and will allow you develop your own set of trading criteria.

Some traders like to use up to 6 moving averages at a time believing that when all the averages converge to the same spot on the chart a change of trend is very near.

As you can see from charts opposite, by the time we use four m/a's the chart begins to look very busy. This method definitely its merits as the lines converging is sometimes the first indictor to get the attention of the Technical Trader and is a sign that this stock should be placed in the ' watch closely basket '.





In summary I would like to advise that the best way to gain a real understanding of moving averages is to run tests. Please keep in mind that once you have tested the ma's on the one stock and you are comfortable with the settings you have chosen, try testing those settings on at least 50 others stocks to see if they still show the same results. The more time spent testing, the more comfortable you will be when making your trading decisions.

In closing I have included a chart opposite with the settings I use when trading. It is of PBL and is a current chart. I have included all signals that are relevant that have been discussed so far. PLEASE do not just copy my settings and take them as gospel. This works for me and may not be suitable for you, PLUS it will not aid in your own development as a trader, please take the time to run the tests, you will be more than rewarded in the end.

MACD

MACD indicators are yet a further extension of the moving average theory. They are part of the Momentum indicator family.

MACD simply stands for Moving Average Convergence Divergence.

The most common form used by traders is the MACD Histogram. It is constructed by measuring the convergence and the divergence of two moving averages.

The most widely used time frame is a 12,26,9 macd.

The 12 and 26 ma's are divided and plotted as the Red line, the 9 ma is plotted as the blue line.

A horizontal line is drawn and is used as the point when these two moving averages are at the exact same level. (The 12,26 macd crosses the 9 ma) This is called the Equilibrium Line .

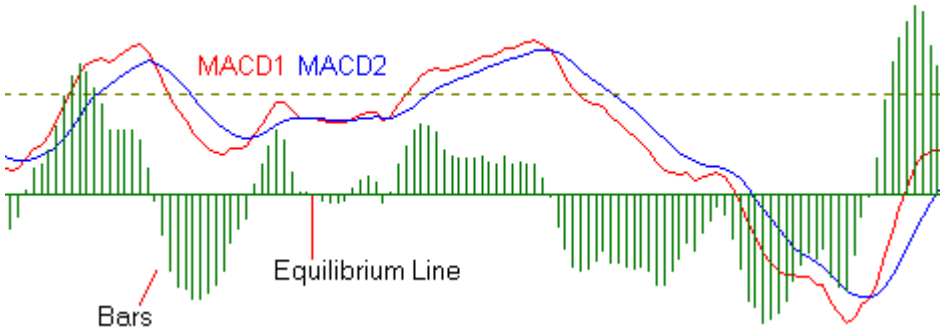
A dotted line is usually added which represents the zero line.

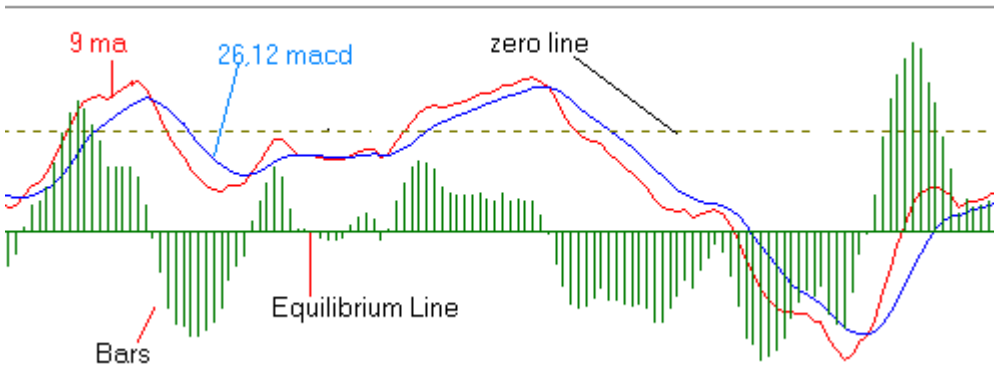
Bars are used as a visual aid in determining the position of the faster moving average in relevance to the slower moving average.

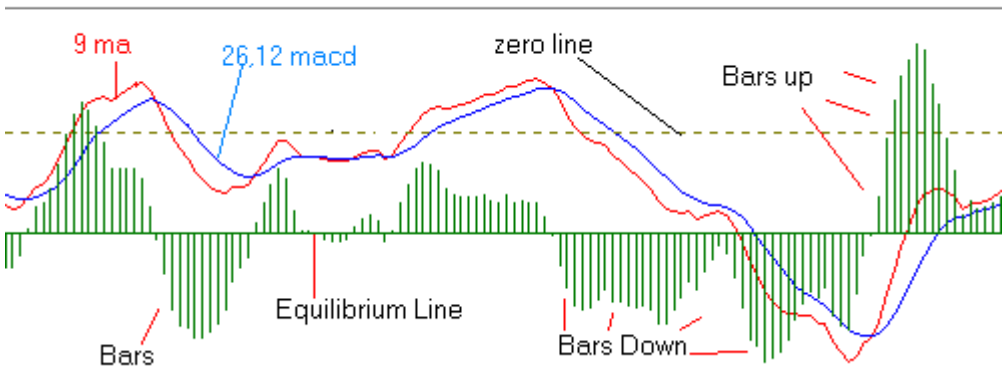
Bars pointing above the Equilibrium Line indicate that the Macd average is above the 9 day moving average.

Bars pointing below the Equilibrium Line indicate that the Macd average is below the 9 day moving average.

MACD *by MPFX*







There are 3 mains ways to trade when using Macd's.

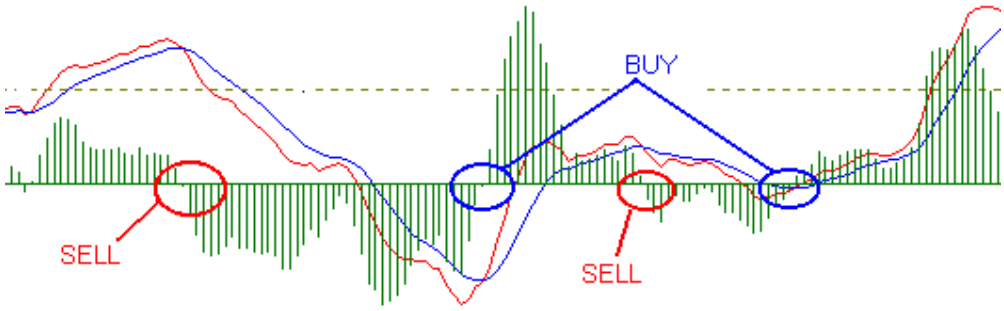
The first is use the crossing of the m/a's as a signal.

A buy signal is given when the bars first point above the equilibrium line.

A sell signal is given when the bars first point down below the equilibrium line.

The chart opposite shows two buy and two sell signals. It is interesting to note where the signals given correspond to the price action on the main chart. The first two signals are pretty much spot on, but after the second sell signal was given, the price moved higher before moving down again. On the second buy signal the price drifted lower before moving up again. The second sell signal was too low and the second buy signal was too high. This is important because traders who set tight stop losses on their trades run the risk of getting out of their trade only to watch the stock rebound.

This is why it is so important not to rely on only one technical indicator, it is the culmination of many indicators that are positive or negative at the same time.

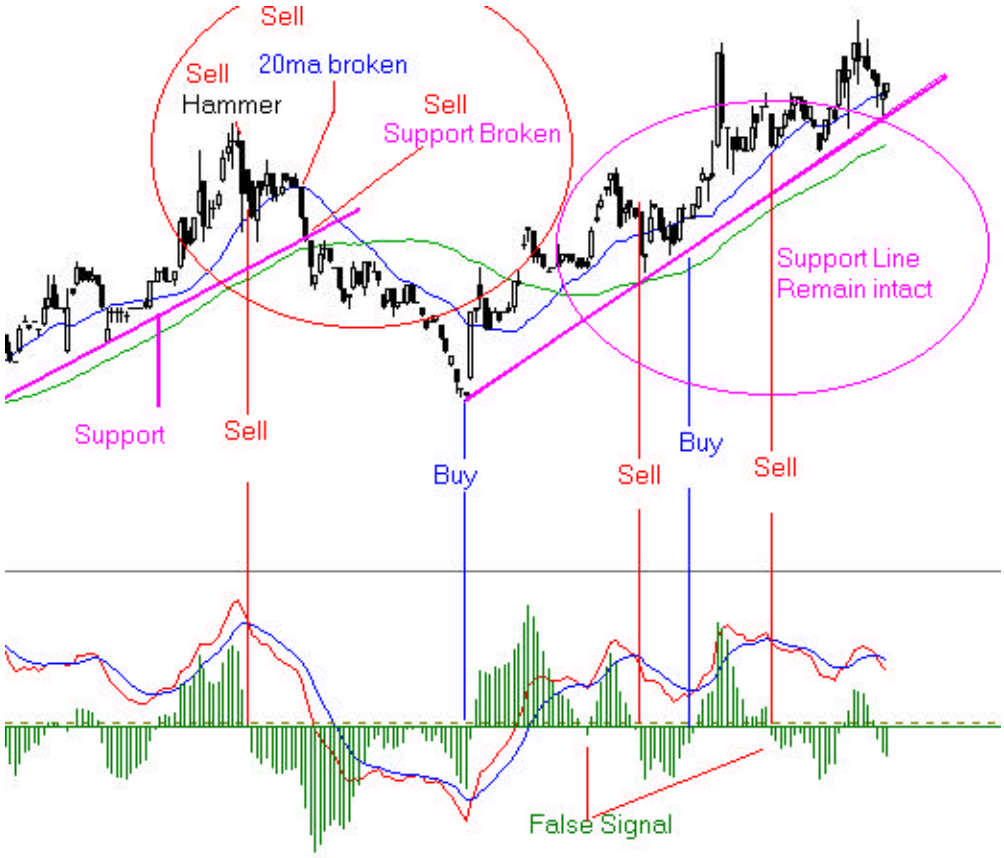


On this next chart we have five signals being generated by the Macd.

The Red circle indicates 4 sell signals occurring within 2 weeks of each other. This is a what I mean by more than one indicator turning negative at same time, it does not have to happen on the same day.

The Pink circle indicates that although the price did drop on both sell signals, the support line remained intact. The price only crossed the 20ma on the first sell signal but remained above on the second.

The 20 ma remained above the 50ma on both sell signals.



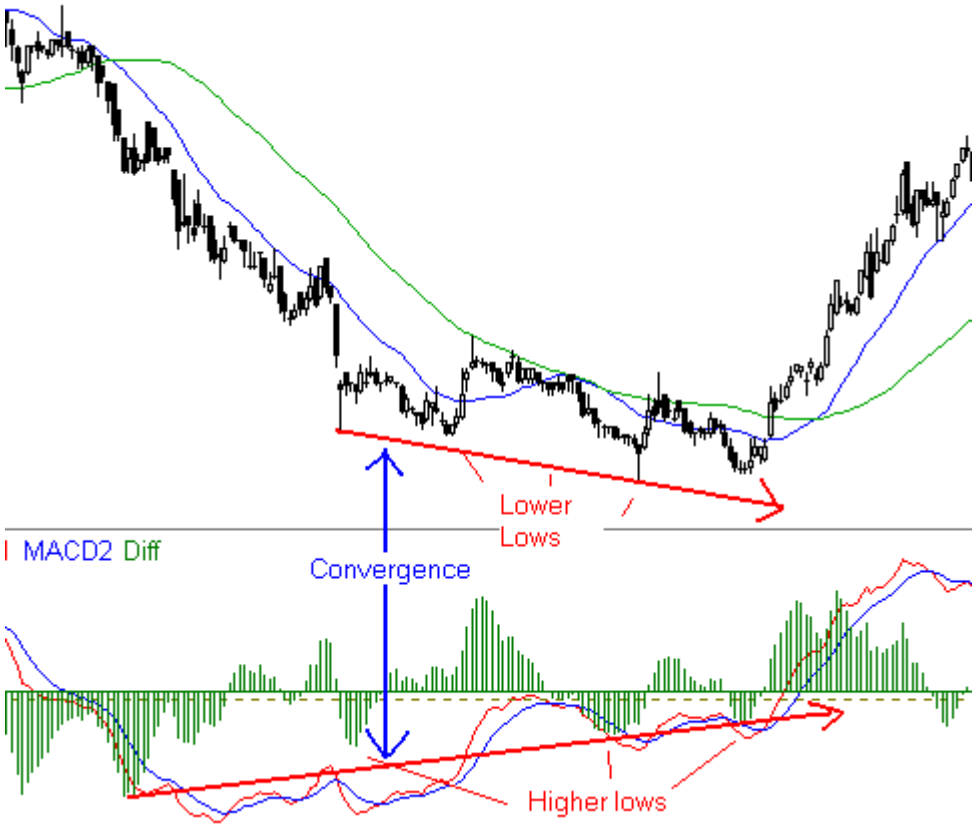
The second method used with Macd's is the Convergence / Divergence method.

Convergence means two separate objects heading towards the same meeting point.

Divergence means two separate objects moving away from a meeting point.

For the use in trading we are interested in the convergence or divergence of the price chart and the indicator that we have selected, in this case Macd.

What we are looking for is lower lows on the price chart and higher lows on the Macd. This creates a buy signal or at least should alert the trader to a possible trend reversal.



Using this method is a good visual aid for seeing that a trend is slowly running out of steam. Nearly all momentum indicators exhibit these converge / diverge properties. Most technical traders use what is called a lead indicator. This is the indicator that is the first to show signs of an impending trend change. Momentum indicators are usually high on this list.

The same applies when we are searching for sell signals. Instead of the lines converging, this time we are looking for divergence of the price and the Macd.

We are looking for the price to be making higher highs but the Macd to be setting lower highs.

We are looking for the price to be making higher highs but the Macd to be setting lower highs.

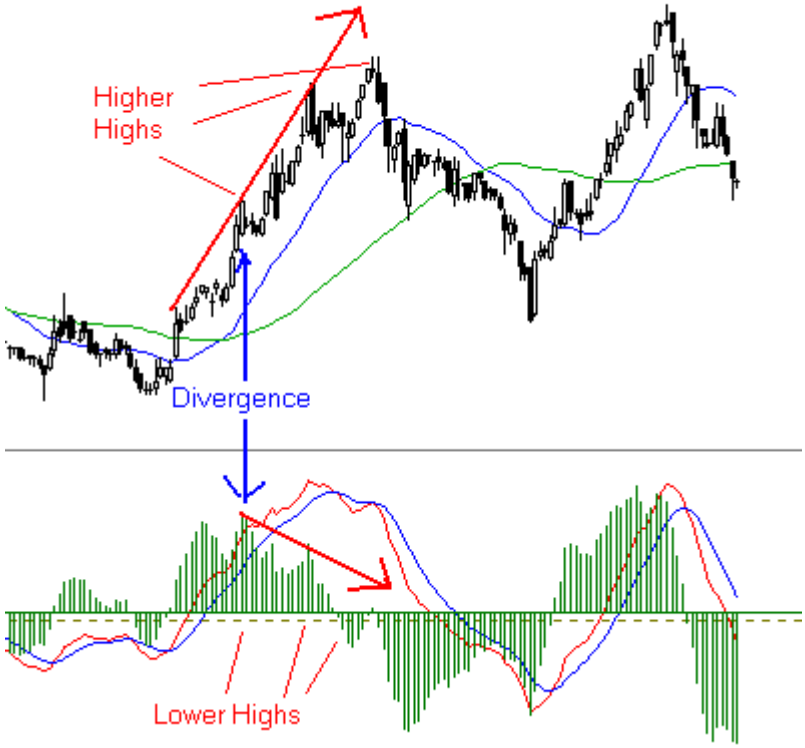
Again these signals are only part of the equation when look to buy and sell. If a trader only looks to use one indicator he will get caught out more times than not, but on the other hand, I believe the use of too many indicators is just as a fatal mistake as using only one. It is a fine balance of the indicators that you feel most comfortable with.

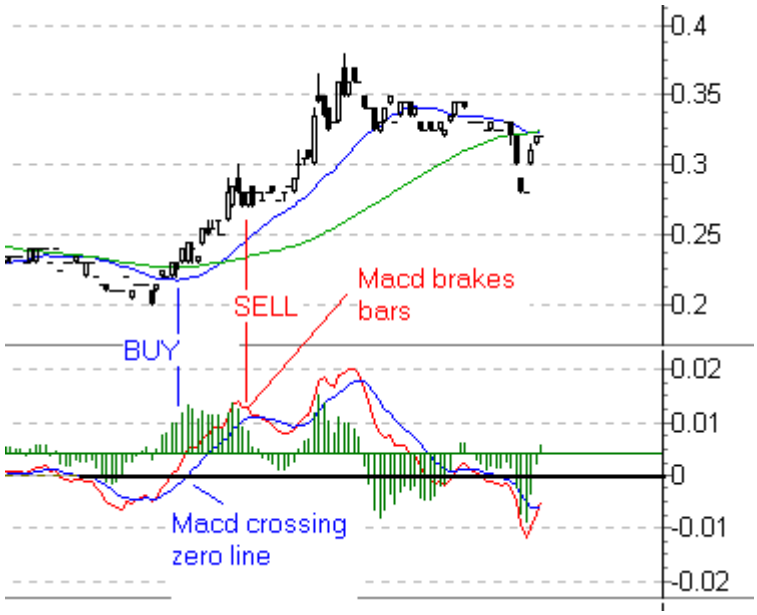
The third method used is to use the macd line crossing the zero line as a buy signal and the macd line making a clear break of the histogram bars as a sell signal.

This method creates the least amount of buy and sell signals but also the least amount of false signals.

This method is also the slowest to generate a signal and is good for the longer term trend changes.

Of course it still generates false signals like ALL indicators so advice mentioned already above about multiply signals should be heeded.





Time Fames.

Choosing which time frames to use varies greatly and experimentation is by far the best way to educate yourself. Again use the same stock and adjust the settings of the macd to see the difference in where buy and sell signals are being generated.

Some standard time frames are :

12, 26, 9

8, 17, 9

12 ,25, 9

Please take the time to do your OWN experimentation.

As you can see above a faster Macd gives an earlier buy signal but many more false signals.

STOCHASTIC

Stochastic indicators are part of the momentum indicator family and are extremely useful for determining whether a stock has moved into an overbought or oversold area.

There are usually 2 lines plotted on the standard stochastic, these are the %K and the %D lines.

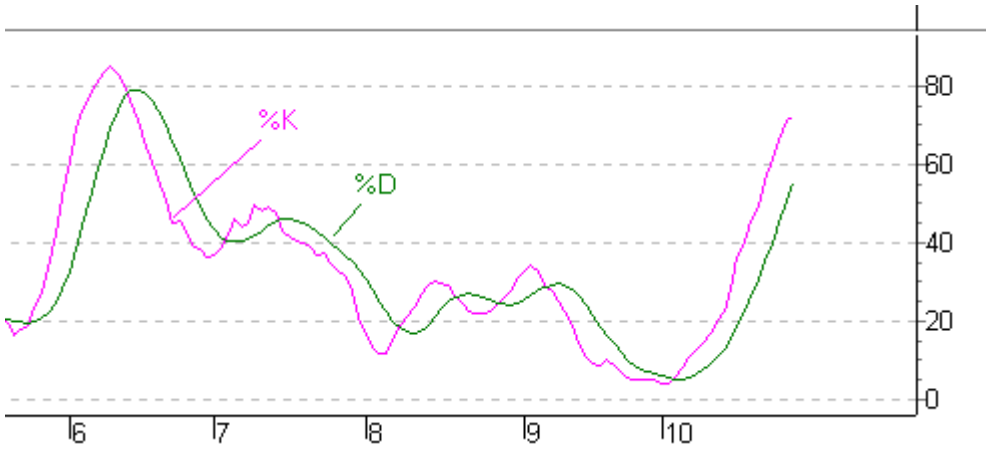
%K is a moving average of a stocks past trading range relative to its current price.

%D is a moving average of the %K line.

These lines are plotted on a chart with a range of 0 - 100.

As most charting packages do all these calculations for us I believe that time is better spent learning to read them as opposed to their mathematical make up.

Stochastic *by MPFX*



a several ways to trade using the stochastic indicator.

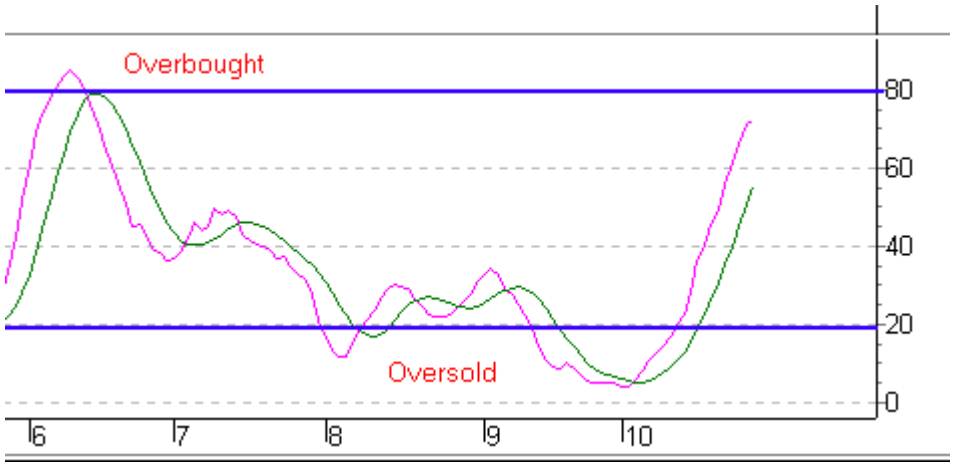
The first is by the use of bands at the 20 and 80 mark.

A stock is considered overbought (Sell Signal) when the stochastic is at or above the 80 level.

A stock is considered oversold (Buy Signal) when the stochastic is at or below the 20 level.

Of course this does not mean sell when it hits 80 and buy when it reaches 20, as false signals are common place as the chart opposite illustrates.

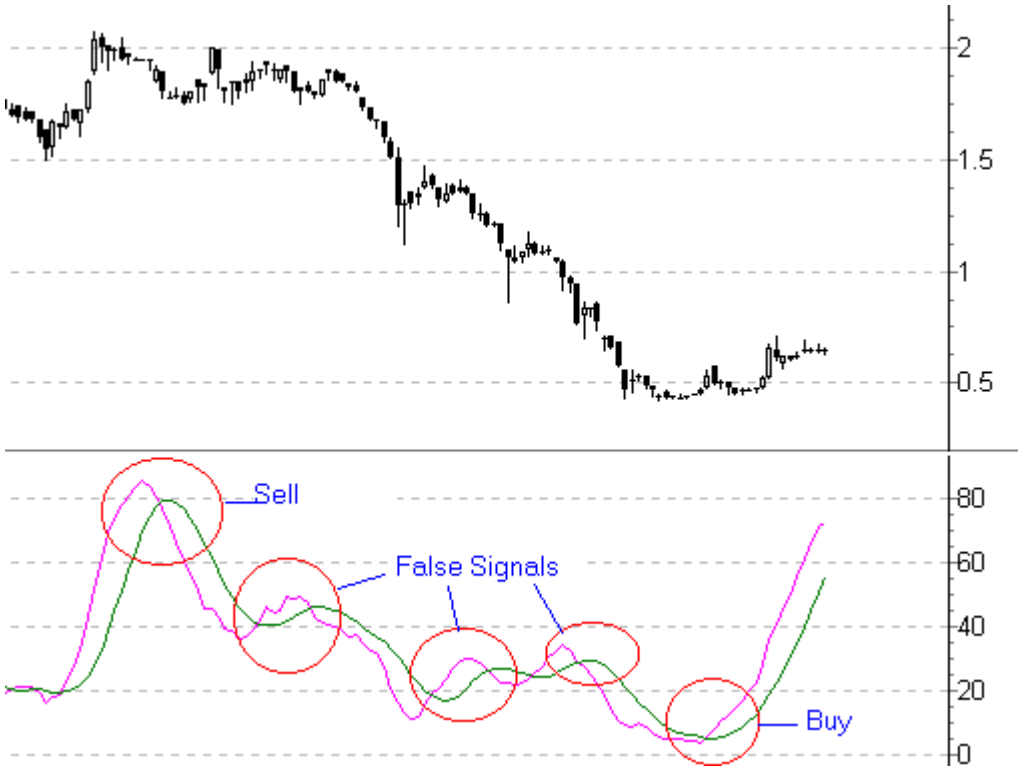
It does however indicate that the trend, in either direction, is running out of steam.



This is a current chart of BDL

method is to buy and sell at the crossing of the %K and %D lines. This is the same method applied to 2 multiple m/a's on a price chart.

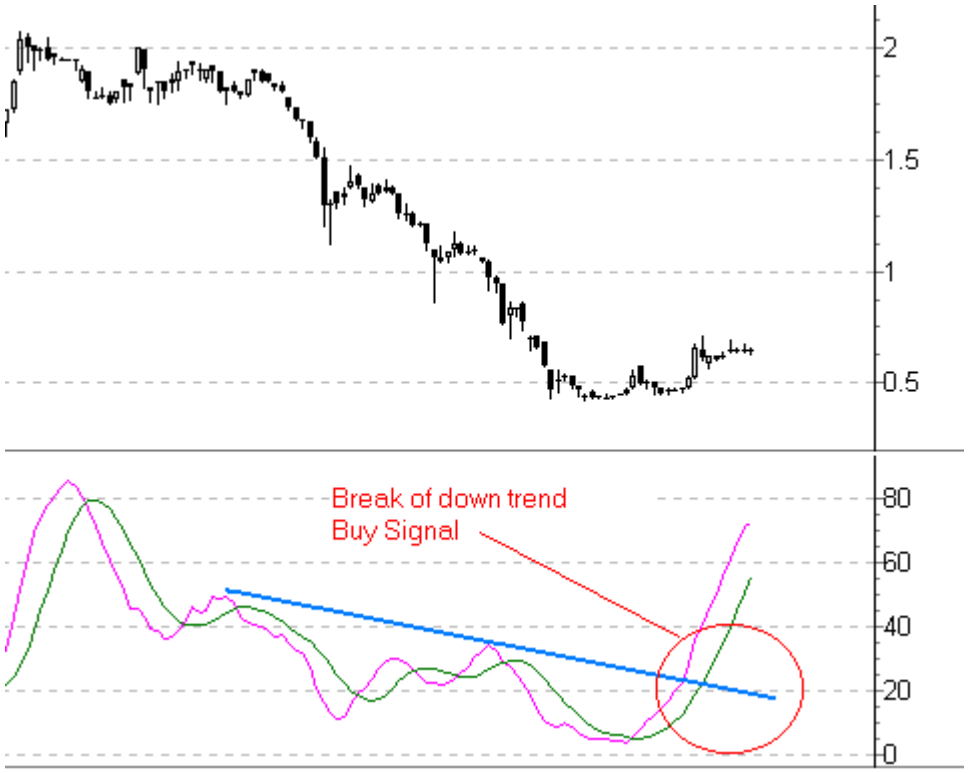
Once again there are many false signals given using this method. On the chart opposite you can see 5 signals being given. Only 2 of these are valid and would have resulted in profit or saved losses.



The third method that can be used is by the addition of trend lines to the stochastic chart in the exact same manner as you would on a price chart.

As the chart opposite illustrates the down trend (Blue Line) has clearly been broken by both lines.

This works for both up trends and down trends.



What levels to set

will have to be a personal preference to suit the type of trader you are.

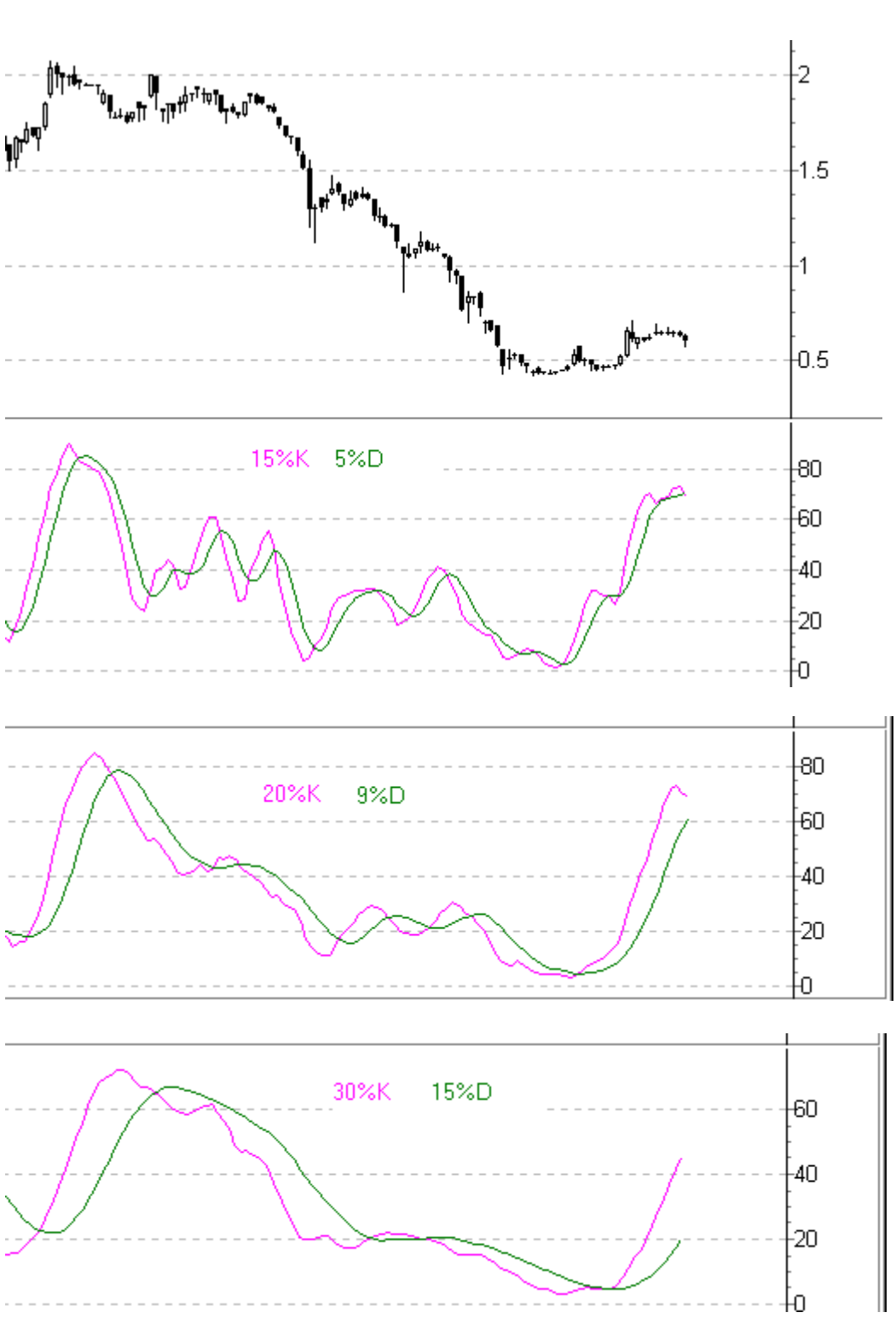
The default on most charting programs is set to 20 & 9. Once again I strongly recommend experimenting with the levels to find a combination which best suits your trading style.

On the chart opposite I have included examples of three different settings. You can clearly see that the slower stochastic, the less false signals.

My personal preference for stochastic on a daily chart are 17 and 9.

If using intra-day charts these numbers could possibly go as low as 5 and 3.

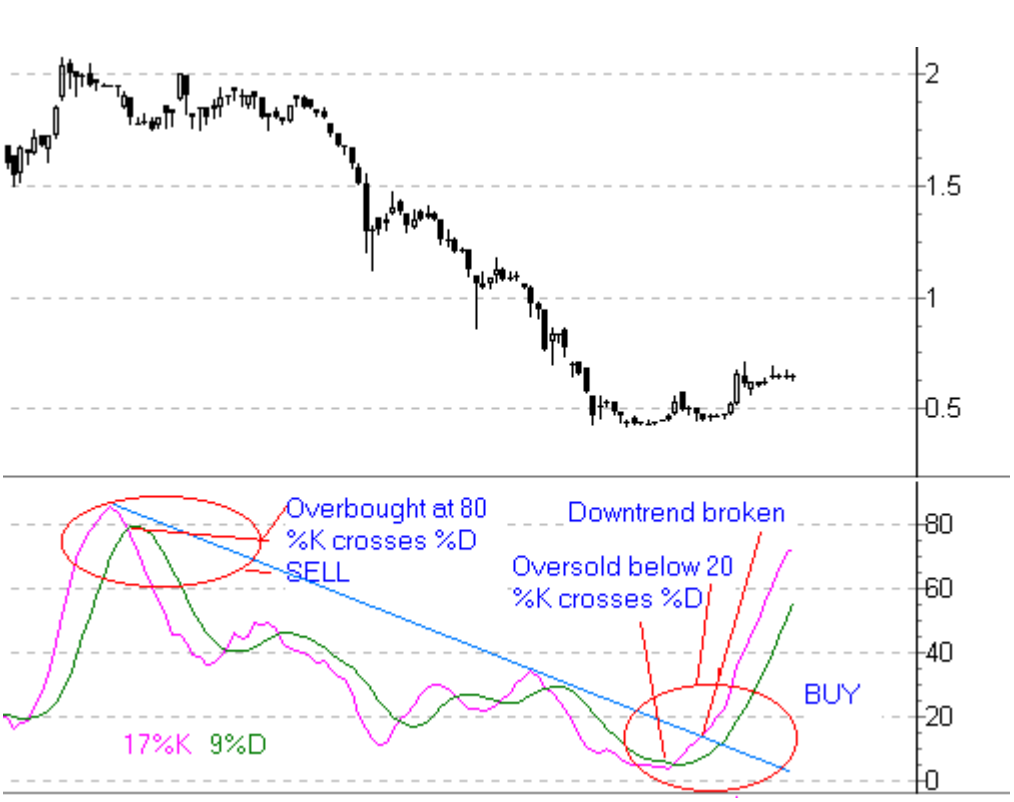
Please take the time to experiment.



After much back testing I have found that the best way to use stochastic indicators is to combine the entire above mentioned rules.

On the chart opposite you can see these confirmations occurring.

The top sell signal shows 2 out of our 3 rules confirmed, while the bottom buy signals shows all 3.



time to put all that has been mentioned so far onto the one chart.

The chart opposite shows a combined total of 10 positive signals from 4 different indicators.

Throughout this editorial I have stressed the point that T/A is a combination of many signals given at the one time and this is an excellent example of this.

The chart opposite is of BDL dated 30-10-2001.