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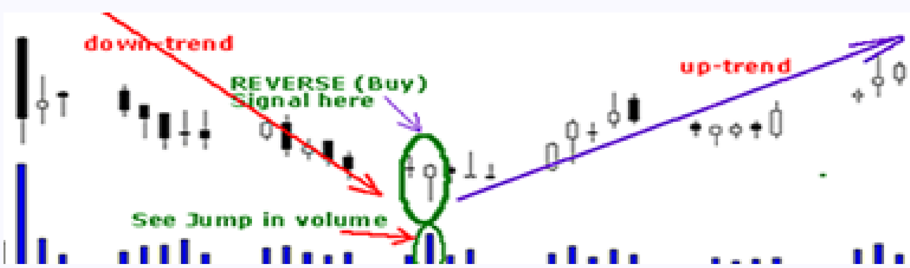

by Jayesh Patel, MBA, CFA

http://www.profitfromprices.com

Profit From Prices

A book on stock market trading
By Jayesh Patel, CFA

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THIS BOOK IS NOT AN INVITATION OR AN ATTEMPT TO INDUCE YOU OR ANYONE TO STOCK TRADING.

STOCK TRADING IS VERY RISKY AND IS NOT SUITABLE FOR MOST INDIVIDUALS. FOR SUCCESS IN TRADING, AN INDIVIDUAL NEEDS SURPLUS CAPITAL, EXPERIENCE, DISCIPLINE AND SELF-CONTROL. IT IS NOT RECOMMENDED FOR MOST PEOPLE TO TRADE STOCKS FOR SHORT-TERM.

PLEASE TAKE INTO CONSIDERATION YOUR INVESTMENT OBJECTIVES, FINANCIAL SITUATION, CIRCUMSTANCES, FINANCIAL OBLIGATIONS, LIQUIDITY REQUIREMENTS AND INVESTMENT EXPERIENCE BEFORE YOU ENTER TRADING.

INTRODUCTION

BY JAYESH PATEL, MBA, CFA

The simple premise of this book is that everybody knows something about something, but the market is the only one who knows everything about everything. The market is the sum total of all the players. For any stock, it knows at any point in time every piece of news- public or private, every expectation held by every individual as well as every trade executed in that stock. However, this enormous amount of information held by market is available in one simple number- the current stock price. Prices reflect every bit of information - public or private --, and the impact of every trading action of every market participant. So it is foolish to think that the price of a stock is some useless number; actually it is the most comprehensive indicator of the aggregate/consensus view held by all the market participants at a given point in time. Prices is the only thing that reflects complete picture of what all participants-- day traders, specialists, market makers, hedge funds, insiders, foreigners, individuals or institutions– are collectively thinking and how they are acting as of the moment!

As such, any market is a battleground where a war is constantly being fought between current, as well as prospective, buyers and sellers; and to decide who is winning, we just need to look at how the prices are moving as of that moment. By paying attention to price fluctuations, we can determine who, buyers or sellers, is gaining control and what is the magnitude of the control. Based on this insight, there are moments when we can predict with pretty much confidence in which direction the stock prices are likely to go. Once we *know* in which direction prices are heading, we can make profitable trades! Most of you might doubt: Is it really possible to trade stocks just by looking at prices? **Yes. It is and this is what this book is about**. By learning some simple techniques, you also can profit from prices.

In this book, I will teach you how to unlock tremendously valuable information for trading stocks just by looking at the four daily prices and how to use it in trading stocks. The secrets I am going to reveal in this book are simple and logical. Not only that, they are very powerful and time-efficient for trading stocks. My exhaustive study of prices, and charts to some extent, reveal consistent patterns that can be profitably used for trading stocks or Futures contracts. Besides prices, I have used various other trading methods, tools and indicators. However what I have found is that the four daily prices, OPEN, HIGH, LOW and CLOSE, give us much more than what we need to identify which stock to buy and when. They tell us of a change on the very same day it takes place. Profit From Prices (PFP) signals can be used as a stand-alone trading system; or if you have some strategy/system that works for you, these PFP signals will prove to be a great supplement.

What does a trader need for success in trading? I personally believe that there are three things which affect trading success:

1. Analytical skills, and a trading strategy, to find -- what to buy and when to buy. (This is the primary focus of this book. See Chapters 6 to 10.)

2. Trading Discipline and Money Management: Every trader in the marketplace has just one objective- to make money. However very few people are able to consistently make money in the market. When markets are rising, it seems easy to make money. However when they are trending down, they take away most of the profit or capital of many, if not most, individuals. Trading is a tough game with many traps. If a trader is not watching himself, his actions, his behavior or his emotions, he is likely to fall into some of these traps. To avoid such falls, it is imperative to be rational in trading decisions and to control emotions. This seems easy but as a matter of fact, emotions like greed, fear, hope,

overconfidence, regret, etc., are very difficult to manage. If there is a trading position with profit, should it be held a little longer or should it be closed to book profit? If a trade is going into loss, should one wait for the prices to recover or cut the losses? Such decisions are tough to make without getting emotional. To be rational, and free our mind from emotions, is a tough job.

So how should a trader trade stocks then? He should constantly strive for trading discipline; and, trading discipline can be achieved with strict money management rules. Every prospective trader should lay down a framework of policies and rules by creating a formal, well-defined trading plan. The plan should contain trading objectives and trading rules/guidelines based on one's financial situation, trading objectives and risk preferences. There should be rules or guidelines about how much fund to commit to trading, how to identify stocks for trading, how much fund to commit to each trade, when to close a position, how to control risk in trading and how to monitor trading progress. Such rules should be strictly adhered to. This can save a trader from taking large positions at high prices which seem to ruin most of the investors when market stages sudden reversals.

In Chapter 1, we will briefly discuss some trading pitfalls and then in Chapter 2: Trading With A Business-Like Approach, we will discuss trading plans in some detail.

3. Luck: Despite of having excellent analytical skills and trading plans, there are millions of factors outside an individual's influence or control. As an example, there is no way to know for sure what Alan Greenspan will do about interest rates in the next Fed meeting. One has no idea what the next Unemployment, GDP or Inflation report will be, or how good eBay or Amazon's earnings will be! I label such uncontrollable, unpredictable events as LUCK. Certain events can cause a sudden change in the mood of the market and the direction of the stock prices. Though one might have entered into a *correct* trade at the *correct* time, it may go sour in the next moment for any reason. So what should one do when something unexpected happens that causes the stock price to move contrary to one's expectations/position? One can, and should, use a Stop-loss. (See Chapter 4: Stop-loss: How to Use It In Stock Trading.)

A word of caution: It is quite possible for any one to lose money in trading. There is no trading system out there in the world that is 100% accurate. Every trader or trading system fails somewhere. Likewise, the Profit From Prices method of trading is no guarantee for success in trading. Having said that, in this book, I am going to offer you the best of my knowledge about how to identify profitable trading opportunities - what to buy and when to buy. I am going to teach you a simple but very powerful approach to trade stocks just by looking at four daily stock prices. There are times when certain price patterns take place and by exploiting them with a suitable Stop-loss, you can expect to earn good profit.

I can assure you that you will not be disappointed by Profit From Prices signals. I am also not going to waste half of my book like most authors do in arguments over why my method is superior to other methods or why other methods do not work well. You be the judge. Read this to-the-point book and see for yourself how easy it is to trade stocks just by paying attention to *prices*.

Welcome to the wonderful world of Stock Prices!

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ACKNOWLEDGMENTS

I began investing in stocks when I was a Computer Engineering student in India. Though my capital was limited, I was a successful, and happy, investor. Then after finishing my MBA from the University of California, Riverside, USA, I went back to India and officially entered into the investment profession. I founded an investment services company that later obtained membership (seat) in India's largest online stock exchange- National Stock Exchange of India Ltd (NSE). This was the period when I came in close contact with active traders and had a very close encounter with price fluctuations. And before I could realize it, I was infected with stock trading! I had turned myself into a trader from an investor and, like any novice trader, I was full of confidence about my success in trading. It seemed so easy to make my millions by tapping into this stream of fluctuating stock prices. In the beginning, I tried to play the game of trading with rules that I had learnt as an investor. Naturally it didn't work. Then I tried whatever I read, heard or came across. Nothing seemed to work for me. Nothing seemed to work for any trader I knew. I was frustrated with my losses; I was frustrated with the way stock prices kept moving against my positions.

In those days, when any new client asked me about what advice I had for him for success in trading, I would tell him to find an inverter machine which could convert his buy orders into sell and sell orders into buy! The only way I knew for guaranteed success in trading for anyone was to sell the stock when he was thinking of buying it, and to buy it when he was thinking of selling it! The market most of the time seemed to act against an individual trader. I was no exception. I had learnt and used a lot of technical indicators but none seemed to work consistently. I was desperately looking for something that could help me improve my trading odds. Then in 1998, I attended a seminar in which my stock-broker friend talked about how to read prices. That day proved to be a turning point for my stock trading. So my first thanks goes to Mr. Jitendrabhai Mistry, Chartered Accountant and CEO of a stock-brokerage firm in Ahmedabad, India, who showed me for the first time that Prices were enough for trading stocks. In the seminar, he talked about methods developed by the Late Kantilal Parekh, a multi-skilled individual who had worked closely with Mahatma Gandhi during India's fight for freedom. I was, and am still, impressed by the trading acumen of Mr. Parekh. I take this opportunity to convey a big thanks to Mr. Parekh whose trading methods transformed me into a successful trader. In 2003, I decided to write my experiments with prices in spare time and the result is what you are reading right now- the Profit from Prices book.

I am also thankful to Toni Franceschi who did a remarkable job in correcting mistakes in this book and making it more readable. She came to help me when my one-man mission to write this book was lacking something important. I am a numbers guy and English is not my native language either; writing is not my strength. So I needed someone to correct my grammar, help me organize my thoughts and give this book a formal shape so my thoughts and ideas could flow to the reader in a smooth manner.

When I started working on this book, I did not have any plans or ideas. All I wanted to do was to document my trading philosophy and timing strategies. I started creating a Word document on the computer at work. Being a computer literate proved advantageous as I could do most of the things myself- word-processing, image editing and creating a website (http://www.profitfromprices.com). Whenever I had some spare time, I would work on this project. Initially I cared about just one thing: content- getting my thoughts and ideas in a Word document. I never read back what I was writing. I

knew anyone trying to read this half-finished book at that stage would easily get frustrated. Still, I kept sending it out when someone showed even a bit of interest. Around this same time, Toni sent me an email probably after she had looked at some of my signals on the trading pages on my personal website (http://www.geocities.com/patel_jr) on the Internet. After sensing that she was interested in my trading strategy, I emailed her my book-in-the-making. I was looking for some voluntary feedback from someone. I did not know Toni at all, and I guess I don't know her much as of this moment either, but when she responded back with comments, I was really happy to receive my first official feedback! Not only that, she sensed where I was struggling. She offered to help me fix mistakes. Then with excellent editing and proof reading skills, she did a wonderful favor for me. Not only this, she fixed some of the fundamental mistakes I had made and this proved to me how intelligent and talented a person she is. I am really thankful to her for her valuable feedback and time in making this book readable and organized.

I will also take this opportunity to thank www.stockcharts.com and www.stockfetcher.com for letting me use their stock price charts for illustrations in this book. Last but not least, I am thankful to individuals like you who have shown great interest in reading prices and in this Profit From Price eBook. I am also thankful to the pioneers who invented the Internet and have made it possible for me to reach to like-minded individuals like you who may be thousands of miles away.

Chapter

1

TRADING: SOME THOUGHTS

BE SERIOUS

Most individuals usually research quite well for buying things like a camera, a TV or a mattress; however the same individual hardly does enough research when he is buying stocks. Before purchasing a camera or a mattress, an individual looks at competing brands/models, compares their features, reads reviews and finally looks for the best price. In short, he seeks 'good deal' in most of his purchases- a great item at the best possible price. However, stock purchases by most individuals are done without enough research. This is evident from the fact that most individuals purchase stocks at either the wrong price or at the wrong time. Quite often stock purchases are done emotionally without putting much effort to determine if they constitute a good deal. Sometimes thousand of dollars are committed to a stock position based just on a few minutes talk with a friend or based on a few lines in some article. Behind every stock purchase, one needs to determine: if it is a good deal- a good purchase at a good price; if the purchase is compatible with what he is looking for; if it meets his objectives; and if it is prudent with respect to his financial position, circumstances and liquidity needs.

TRADING IS A BUSINESS

Personally, I treat trading as if it is a business. Trading and any other business are both done for profit and they both require capital. Success in both of them depends on ability to sell at a price higher than what it is paid for. Business and trading both benefit from skills and experience and are affected by various external factors over which one has no or little control. One can fail in a business and similarly one can fail in trading too. Before starting any business, it helps to have a business plan outlining the initial and working capital required, strategies, contingencies and profit projections. In the same manner it is essential that a person have a trading plan *before* he enters trading. An ideal trading plan should include how much capital is spared for trading, what return/profit expectations are, what trade selection strategy would be used and how much trading volume would be required to attain trading goals. Once a person is in trading, like as for any other real business, he constantly needs to monitor his trading activities in the context of his trading plan and needs to make necessary changes in his trading behavior as well as in his trading plan. For a trader, it should be a constant endeavor to learn from his mistakes and from others' experiences. (See the next chapter for more details.)

THE GOAL IS TO MAKE MONEY

The ultimate goal of trading should be to make money. Period. Individuals who are rational most of the time in their lives often make many irrational decisions in trading. Losing money in trading is not the only issue. Fooling oneself, knowingly or unknowingly, is a bigger issue. Most individuals prefer to look at/study their profit in profitable positions than to confront the losses in the losing positions. They keep talking to their friends about their best picks and hardly ever even mention their wrong picks. Instead of focusing on the overall portfolio return, they keep looking at individual profitable positions. They pay more attention to winners than to losers in the portfolio, and this makes them feel that they are doing better than what the reality is! Sometimes some people don't seem to be in the game to make money, but to fulfill other needs- psychological needs and gambling needs. It is a sad truth that most people enjoy boasting about their winners so as to feel good and impress people! Sometimes some trades are done just for the excitement and for proving oneself to be smart! This is all nonsense. If a person is in trading, his goals must be just one- to make money along with keeping risk under control.

TRADE FOR BIG PROFIT AND SMALL LOSSES

If a trading position generates profit/fun, an individual usually tends to *avoid any risk to the unrealized profit*. So at the first sign of any risk, a profitable position gets closed. The result is: a successful trade is often closed too soon. The result is small profit and short-lived fun. On the other hand, if the position is generating loss/pain, he will tend to wait for some miracle that can bring the price/fun back so he can profit or break even! The result is: A wrong decision turns into a marriage. He ends up waiting too long mostly letting losses get bigger and consequently shattering his peace of mind. In short, most of the time, profits are short and losses are big. How on earth with an average of around a 50% success rate in trades can one make money in trading with small profits and large losses? Traders should be doing the contrary –Going short on pain and long on fun, having small losses and big profits: turning a correct relationship into a marriage but trying to sever any bad selection as soon as possible.

BE RATIONAL WHEN YOU TRADE

Individuals are rational but not at all times. There are times when they act irrationally. In a profitable position, an individual tends to avoid risk; while in loss, without knowing it, he is likely to embrace risk. Let us take an example.

Given two alternatives (1) a 50% chance of a 1000-dollar profit and a 50% chance of nothing, versus (2) a sure 500-dollars, most people would take the second alternative. Why? They don't want to face the uncertainty (take the risk). Most individuals would find 500 dollars in their pockets much sweeter than pursuing the uncertain 1000 dollars.

Now let us think about an opposite situation with two alternatives (1) a 50% chance of a 1000-dollar loss with a 50% chance of no loss versus (2) a sure loss of 500 dollars. What do you think most investors would do? They would take the first bet. They would take the risk to avoid the sure loss. Instead of losing 500 for sure, why not take a chance to lose nothing! Similarly in trading, when a person is in profit, he is most likely to avoid risk but when that same person is in loss he is most likely going to take a risk! The *Efficient Portfolio Hypothesis* assumes that investors are rational; but I have a different opinion - there are times people are not rational. There are times when individuals can't control their emotions and in stock trading, emotions are more likely to act against them than to help them. Instead of big gains, most individuals are more likely to end up with big losses and small gains.

THE MARKET IS FORWARD-LOOKING

Most common investors are often at a loss with the market. They often don't understand what is going on in the market. When the market is staging a smart recovery in the middle of most, if not all, bad news, most people don't believe in the possibility that the market has entered into an up-trend! This is normal because after seeing a decline for a considerable amount of time, most individuals tend to doubt any recovery in prices. So first they keep watching the rising prices from the sidelines believing that the rally will soon fade and that the prices will start going down again. However the prices keep going up. Then when the prices have gone up quite well, people will start hearing upbeat comments from analysts, reporters and/or their friends. So at this higher level of prices, they somehow get convinced that the market is really going up for good. My point is- most investors anticipate prices to keep going down when the market is at already nadir and when prices are very high, somehow most investors feel very comfortable with the market. I think this is the reason why most investors are not able to make money in stocks- they play stocks by hindsight rather than by foresight. They fail to understand that markets are forward-looking.

TRADING NEEDS TRAINING

Most investors don't see any need for training when it comes to trading stocks! They approach stock trading as if they were born with natural skills to trade stocks. A person spends years in college to learn engineering, medicine or law but somehow he thinks that he doesn't need any training or experience to trade stocks! Predicting stock prices is not an easy job but it can seem easy when one has only witnessed a bull market for many months or years. This causes a novice trader to think that he has all the skills that are needed to trade stocks. And guess what? Any fresh trader's first few trades are likely to make money for him (maybe because there was good research behind it or just some luck) and this is the beginning of a bigger trap. He starts taking big positions and due to over-confidence ignores the importance of a stop-loss. Then when the trend reverses, he fails to adjust himself to changing market conditions and his losses start getting larger. The end result is similar for most traders: losses, frustration and stress. Only with the experience of a few market cycles and with eyes wide-open for learning from one's own mistakes and from those of others, can a person be worthy of graduating in trading.

TAKE RESPONSIBILITY FOR YOUR OUTCOMES (DON'T BLAME OTHERS)

It is human nature to blame others for one's own mistakes. There is a saying: It is human to commit errors. Someone went a step further and added: It is human to err but it is even more human to blame others for one's own mistakes! This is quite true about stock market losses. When there is profit, most individuals feel they are smart and also genuinely believe that they are the ones who were intelligent to make profit in that/those trade(s)! However these same people would rarely ever blame themselves for a loss! For a loss, it is some close friend, or some magazine article that caused them to lose money. It is Enron and WorldCom who acted unethically and they are the ones responsible for pushing down stock prices! It is the Wall Street analysts who had put BUY and OUT-PERFOM ratings! This list never ends. The truth is, unless a trader assumes responsibility for his money, his trades and his losses, he is never going to change his trading approach, style or strategy. If someone believes there was no mistake on his part, how can he learn from it?

TRADING BASICS- RISK VERSUS REWARD

Every trade or bet a trader makes has to be done after figuring out potential risk versus a potential reward. There is no surefire way to make free money anywhere. In any job, one has to utilize his knowledge, skills and time for the employer in order to earn a paycheck every pay period. In trading however, one does not have to go to a workplace and do what his supervisor or his employer wants him to do. He is free as a bird. So what are the costs of trading? It is the risk taken in order to be able to make money. In a trade, one can lose money- this is my simple definition of Risk. When one enters into a trade, he does not know for sure what will happen. One has no control over outcomes. Though one may expect or hope that prices go up, they can go down! Thus in trading, a person can make money or he can lose it. So it is very important that a trader understands the amount of risk he is taking in his pursuit of profit.

Before entering into a trade, a trader needs to look at all possible outcomes in order to determine how much risk is involved versus the potential for gain. If the potential for profit justifies the risk in the position, then and only then is a trade worth entering into. Success in trading is very much dependent on a trader’s ability to find risk-efficient trading positions and to control his risks at all times.

Chapter

2

TRADE STOCKS WITH A BUSINESS-LIKE APPROACH

I believe trading is a business and hence I strongly recommend a prospective trader to treat his trading as if he were starting a new business. For any new business, a business plan is a must-to-have. Similarly, I strongly believe that a trader must have a trading plan. A business and trading both have considerable similarities. In a conventional business, we sell things at prices higher than what we have paid for them. The same objective is there in trading- buy low and sell high. Trading and business both require capital and are carried out with one objective- to earn profit. Success in both greatly depends on our ability to buy and sell smartly- buy as cheap as possible and sell as expensive as possible. Also, it is not difficult to see many businesses lose money or fail over time. Similarly, many traders also lose money in trading and are forced to quit.

Every business has considerable risk and hence a business plan is helpful in planning for the future. A business plan typically has some stated objectives and strategy about how to reach them. A business plan acts as a guide for its owner and keeps him focused on achieving his goals. The same can be said about a trading plan. It can help a trader formulate his goals and develop a strategy to reach them. Once formulated, it acts as a guide to keep efforts focused and as a control to keep one's behavior in check. As there is no one-plan-works-for-all business plans, there is no one-size-fits-all trading plans. What is good for one person may not work well for others! As no two people have exact similar skills, circumstances, constraints or preferences, there is no ready-to-use trading plan that will work for everyone. Every trader will need to create his trading plan by himself, and to provide some guideline, I will write about what I think should be included in a typical trading plan.

As most people usually don't bother to create a trading plan, let us think for a moment how they get into stock trading. As I know, most people start trading without putting any serious thoughts into it. Quite often, an individual hears a friend or a stranger talking about some impressive profit in some trades. This acts as a temptation for a novice to trade stocks for seemingly easy money. First, he starts by watching a few stocks, say around 6-8, but as time passes, his list gets narrower as stocks that are not doing well get dropped from his watch list. So after some time, he forgets about the stocks that were on his watch list but did not do well, and he keeps focusing only on those 2-3 stocks that are doing well. This fills him up with false *confidence* that he has exceptional stock-picking skills. At this point, he genuinely believes that he has skills necessary for success in trading and now he doesn't want to waste any time. He makes his first trade. It may be just a coincidence or there may be a lot of research behind it, but his first trade is more likely to be in profit than in a loss! Maybe that is a hidden law of Capitalism to bring more and more people into trading so as to keep the cycle of wealth rotation running smoothly! After the first trade, there is no looking back! Before one even realizes it, he is hooked up. He is addicted to stock trading! As there is no formal trading plan, in the end, most traders fall in known trading traps: small profit-big loss, taking positions against the trend and ignoring use of stop-loss. Hence I strongly advise that you must create a trading plan before you start trading.

As mentioned earlier, people enter trading without any plan or any idea about how they want to approach trading. To me, trading is like a business and like in any business one needs to do some thinking and planning before he gets into it. One has to decide how much money he wants/needs to start with, what his strategy is and what is his return objective. I strongly believe one should write down these things on paper before making any trade. This is like having a business plan/a game plan for succeeding in trading stocks.

Let me give you some ideas about what should be part of a good trading plan.

TRADING CAPITAL

There is no standard figure/amount that will work for everybody. It all depends on one's financial situation, circumstances, experience, investment objectives and risk tolerance. I think a novice trader should start with an amount from 5,000 to 20,000 dollars. <u>This starting amount has to be the amount that if one loses it all, it will not create financial hardship for him or for his dependents</u>. If it were all lost, it wouldn't cause much stress on one's bank account, retirement plans or on one's lifestyle. This is like a risk capital. Let me highlight the importance of this starting amount. There is a big difference between trading and any other business. In any other business, it is not difficult to determine when to call it quits. However in trading, I have seen people continue trading for a long time despite the fact that they know that they are not making any money! It may be that it is hard for one to accept the fact that trading is not for him or maybe it is the hope of winning in the end that is not letting him quit the game. Nevertheless it is very important for a person to accept his limits and understand that there are a lot of things for which one does not have the necessary skills, emotions and/or aptitudes. Every one of us can't be a successful auto mechanic, plumber or a heart surgeon! In the same way, stock trading may not be appropriate for every one of us! This is why it is important for a person to start with a pre-defined risk capital to test himself on trading, and then if successful, he can keep doing it. If he loses his risk capital, he will need to stay away from trading for a considerable time if not forever.

Write here: My risk capital is: ____________________$

TRADING OBJECTIVE

A businessman starts a business with some specific goals, objectives and expectations in mind. As I keep saying, trading is also a business but it is surprising to know that most traders do not have any specific trading goals or return objectives. (I am not talking about dreams of making millions. They are there in every trader.) Unless a person knows where he wants to go, how can he plan? Unless he plans, how can he get there? If a person has a goal, he can create a road map or a plan to arrive there. So it is essential for a trader to have a certain profit objective if he wants to be successful.

For a starting capital of 20,000 dollars, an objective could be to make 500/1,000/1,500/2,000 dollars every month. Or it could be like a 10, 25, 50 or 100% return per annum. So start with a figure that makes sense to you and then later in this Chapter you will see if this goal is achievable or not. If not, you will need to fine-tune it.

Write down here: My goal is a profit of ________per month or a ____% return per annum.

PLAN YOUR TRADES AND TRADE AS PER YOUR PLANS

How can a person plan his trading? How often should he trade? These are tough questions and there is no straight answer that fits all traders. However here are some guidelines and ideas. See if they make sense. If they don't, try to find your own road to reach to your trading objective.

To reach a specific Monthly Profit Target or Annual Return Objective, a trader needs to look at the following factors:

- Target Trading Odds or Trading Success Ratio (SR). If one has on average of around 6 trades profitable out of every 10 trades, his SR is 60%.
- Target or desired amount of profit in a successful trade- Profit per Trade (PpT).
- Target or desired amount of maximum Loss allowed in an unsuccessful trade- Loss per Trade (LpT).
- Target Trades per Month (TpM).

As an example, assume a trader who wants to make 1,000$ per month (Monthly Profit Target). If his stock selection is average, his trading odds will be 50%. Half of the trades result in profits and half result in losses. Now if he takes, say, 300$ of profit in a profitable trade and allows up to 300$ of loss in a losing trade, you can see that with a 50% success rate, he will not go anywhere. He will in fact lose money because of the commissions on both Buy as well as Sell orders. So in order to reach his trading objective, he will need to either boost his Trading Odds (Odds) and/or increase Profit per Trade (PpT) in comparison to Loss per Trade (LpT). Based on these three variables and your Monthly Profit Target, you will get an idea about how many trades you will need to make per month.

1. Increase the odds. What is the success rate or odds for a trade to be in profit? It can be any number between 0 to 100%. However for an average trader, it can be expected to be around 50%. That means If a trader makes ten trades, on the average, five may give profit and five may generate losses. So to come out as a winner in this game of trading, one will benefit by improving his trading odds. Now is it in a trader's hand to improve his odds for success? If yes, how far can one improve his odds? This is the topic most discussed in investment and trading books. There are several hundred books on this topic and this one- Profit From Prices – is one of them.

If I had to venture a guess, I think it is very difficult for any trader to improve odds beyond 80%. However if one takes trading seriously, he may be able to reach a success rate as high as 70% (7 out of 10 trades on average in profit). Based on my experience, I have found PROFIT FOM PRICES signals to have around 70% odds. However at this stage while when we are developing our trading plan, I would advise you to accept, for now, a 50% success rate (for every 5 trades in profit, there are around 5 trades in losses) in your planning calculations.

Write down: I want to achieve a success rate of __%.

2. Have more profit in a winning trade than a loss in a losing trade. With 50% odds in favor, this statement becomes very significant. As I have previously mentioned, **Big Profts, Small Losses** are very important for success in trading. I must insist that you abide by this principle.

(Most individuals have their emotions and psychologies trained in quite an opposite fashion, and most of the time this disposition acts against them. When a trade is in profit, a trader doesn't want to take any risk on that profit so at the first indication or sign of risk, a profitable position is likely to be closed. On the other hand, when a trade is losing money, the same trader is likely to neglect all negative developments and signals. Instead of acknowledging that he might have made a mistake, he holds on to the position hoping/praying for some positive news/development that would boost up the stock price in his favor. A losing position is often held too long in the hope that some day the stock price will reverse its course and there will be profit (or no loss)!!! So in short, normally an individual is practicing in the trading world what most religions have been teaching for thousands of years: Pass on the joy (profitable positions, I mean) and keep bad incidences/happenings/bad luck to oneself (losing positions). Pass on nice smelling flowers or perfume to others but keep holding on to rotten bad smelling corpses for yourself! Believe it or not, the truth for most investors is: Small Profits and Big Losses!)

So how much money should one risk per trade? How much profit should one go for in a trade? There are no straight answers but one can risk anywhere from 1% to 10% of his risk capital on one trade depending on his financial situation, circumstances and objectives. For most novice traders, I would say do not risk more than 5% of your risk capital on an individual trade. A profit target should be around two to three times the amount risked on that trade. ***I have made this a guideline for myself: Before I enter into any position, I like to see if the position offers me profit from two to three times the risk or exposure to loss I have.

My goal is to make a ____$ Profit per (successful) Trade (PpT) and I want to stop my loss at ______$, at most, in every unsuccessful trade (LpT).

3. How many trades will be required per month? Let us take some examples.

EXAMPLE 1: Let us assume that
a) our target SR (Success Ratio) is 50%.

b) Profit per Trade is 500$. This means our **Expected** Profit per Trade = SR * PpT= 50% x 500$ = 250$

c) Loss per Trade is 250$. This means our **Expected** Loss per Trade = (100% - SR) * LpT= (100%-50%) x 250$ = 125$

d) Let us now assume that we are looking for a 1000$ profit per month.

Let us now calculate **Expected Net Profit per Trade (ENPpT).**

Expected Net Profit per Trade = **Expected** Profit per Trade – **Expected** Loss per Trade.

So for our example above, Expected Net Profit per Trade = 250 – 125$ = 125$.

Now we can find out how many trades we need to make to reach our monthly profit target as follows:

Number of Required Trades per Month = Expected Monthly Profit /Expected Net Profit per Trade.

For our example above, # of required trades per month = 1000$ /125$ = 8 trades.

So we have this situation- 8 trades per month. With a 50% success rate, on the average 4 trades would be in profit and 4 would be in loss. This means our 4 profitable trades will give us 2000 dollars (we assumed that each profitable trade would give us 500$) and our 4 losing trades will cost us 1000$ (we assumed that each losing trade would cost us 250$). So with around 8 trades, we can generate 1000$ of profit per month.

Please remember that our figures are assumptions but that they do confirm that if we are able to have a 50% success rate (which is very well attainable), with a target of a 500$ profit and a Stoploss of 250$, we can reach our monthly profit target with 8 trades. One very important assumption we are making here is that we are able to find trading opportunities that have a 500$ profit potential at the cost of a 250$ loss potential. We have to integrate these two important numbers in our stock selection criteria- trade only when a 500$ of profit is possible at a risk of 250$.

EXAMPLE 2: Let us change our numbers a little bit. Let us assume that our Success Rate is 60%, PpT is 600$, LpT is 200$ and we have a Monthly Profit Target of 1000$.

b) Profit per (successful) Trade is 600$. This means our **Expected** Profit per Trade = SR * PpT= 60% x 600$ = 360$

c) Loss per (unsuccessful) Trade is 250$. This means our **Expected** Loss per Trade = (100% - SR) * LpT= (100%-60%) x 200$ = 40% x 200 = 80$.

Let us now calculate **Expected Net Profit per Trade (ENPpT).**

Expected Net Profit per Trade = **Expected** Profit per Trade - **Expected** Loss per Trade.

So for our example above, Expected Net Profit per Trade = 360 – 80 = 280 dollars.

Now we can find out how many trades we need to make to reach our monthly profit target as follows:

Number of Required Trades per Month = Expected Monthly Profit /Expected Net Profit per Trade.

For our example above, the # of required trades per month = 1000$ /280$ = 4 trades.

Thus in this situation, with a more meticulous stock selection, we can reach our goal with an average of 4 trades per month.

Now, put your numbers, SR, LpT, PpT and Monthly Profit Target, in the formulae above and find out how many trades you will need to make per month to reach your target profit per month. Make sure that your capital allows you to make that many trades per month and that you can reasonably find that many trading opportunities in a month. If your trading capital does not allow you to make this many trades, you must bring down your monthly profit target to a more reasonable level.

My Target Trades per Month are __________ trades.

TRADING STRATEGY- WHAT TO TRADE AND WHEN

This is the major component that will determine any one's success or failure and it forms the central part of any trading system. How to select which stock to buy or short? Does it have the required PpT potential at the risk of LpT? When to take this position? What is / shall be an exit strategy? It is not easy to answer these questions but let us try to address them.

Some trading strategies look at fundamentals of the stock or market to answer the above questions. Some others use the news, announcements or earnings. Some strategies even look at interest rate movements, money supply, inflation, consumer sentiment or other economic/psychological indicators. However the majority of trading systems base their trading decisions on technical indicators like MACD, ROC, Volatility, Bollinger Bands, or on contrary indicators. In short, a trader has thousands of choices. However, when you are choosing a strategy, you need to make sure it is capable of taking you where you want to go. Try to find answers to the following questions:

Has it the success rate you are looking for?
Has it the potential to give you your target Profit per Trade at the cost of target Loss per Trade?
Will it give you the sufficient number of trading opportunities that you need to reach your monthly profit target?
How many stocks would you need to buy or sell to get your target Profit per Trade?
Will your limited trading capital and other trading rules allow that size of a position?

Once you select a trading strategy (trade selection method), before you go ahead and make trades, test it out- first on paper and then in real life. Find what works for you and then stick to it.

This book is also primarily about trading strategies. In the subsequent chapters I am going to show you how to read daily stock prices and find trading signals to answer the two most basic questions: What to buy/short and when. I will also show you when to book profit or close a position, and how to protect yourself in case of a loss with the use of a Stop-loss.

DAY-TO-DAY MONITORING OF TRADING ACTIVITIES

Now thanks to Internet, it is relatively easy for any one to create a transaction portfolio on websites like Yahoo! Finance, or one can choose to use personal finance software like Quicken or Microsoft Money. Every trading day, he should look first at the aggregate portfolio value before looking at the prices/profit/loss of individual positions. The value of the trading portfolio should be viewed in context with his trading plan. One of the biggest traps for most investors is human psychology or emotions. An average individual hates to look at bad things or admit mistakes. Traders and investors alike keep looking at or talking about their winning positions more often than they look at or talk about their losers. This makes them feel happy and proud; but the neglected losers keep eating up their portfolio value more rapidly than what their winners are doing for them. As mentioned earlier, winners stay for a short time but losers end up maintaining a long relationship with most investors/traders. Being happy, feeling good is definitely a good thing but this has to be secondary in trading. The primary objective in trading needs to be to get rich and make more money. For just happiness and to feel good, Las Vegas is certainly a better alternative!

Also, before entering into a trade, a trader should write down at least the following things. (Our mind and way of thinking keep changing so often …that they work as our enemies in trading. Didn't you know that each of our friends and relatives sort of knew that we were in a big tech bubble from 1999-2000? I don't remember if anyone told me in those days that AMZN or Yahoo were about to crash from their 200 dollar levels; but if I ask most my friends today they sound like they were the people who knew exactly that there was a bubble going on!) For success in trading, one needs to be honest with oneself and one way to achieve this is to keep a diary and enter the following information for every position.

Stock
Trade date
Trade price
Number of stocks (100, 200, …1000…)
Justifications for this position
What the risks are
Trading with trend or against trend
Intended holding period in days/weeks
Profit Target in terms of stock price and in terms of overall amount of profit
Stop-loss in terms of stock price and in terms of overall likely amount of loss

Update information as required. After you close the position, write down when it was closed, why it was closed, at what price and with how much profit or loss it was closed. What are the lessons learnt if any. Then go through this diary and the closed positions at least once a month to see if trading is done as per trading rules established in the trading plan.

SOME TIPS ABOUT TRADING RULES

1. Keep a limit on the number of open positions. Decide in advance how many positions you can have open at any point in time. You can choose any number from one to ten. One natural trap in the market is over-confidence. When the market is around its Top, there is good news everywhere. Everyone is talking positively. So we are tempted to exploit the current opportunity in a big way. We start trading more aggressively, cross our limit and our portfolio gets overloaded. This is too much of a risk if the market stages a reversal. What we might have earned over a few months vanishes over a short period of time. So avoid this trap, never ever let your open positions exceed your pre-defined limit.

2. Take a break when all of the last three (or five) trades turn into losers. Take this as an indication that you are getting out of sync with current market trend.

3. Never average (buy more) in a losing position.

4. Never try to recoup from (buy again later on) the same stock just because you lost in it the last time. Similarly, resist the temptation to repeat a success story in the same stock in which you had good profit the last time. Trade objectively. Trade in the same stock only if you have a strong signal.

5. Control emotions- particularly greed and fear.

6. Follow all above rules.

A SAMPLE TRADING PLAN

Trading Plan

Date Created: October 10, 2004

Last Updated; October 01, 2005

Risk Capital: $20,000.

Trading Objective: $1,000 Profit per Month

Target Success Rate: To have overall 70% trades in profit

Desired Profit per Trade (PpT): $400 per Profitable Trade

Planned Maximum Loss per Trade (LpT): $200 per Losing Trade

Intended Holding Period for a Trade: Around 2 to 4 Weeks

Average Trades per Month (TpM): Around 6 to 8 Trades

Average Amount to be Invested in a Position: 20% or $4000 per Trade

Maximum Open Positions permitted at any point in time:

3 Open Positions

Stock Selection Criteria:

- Stocks with strong Trend Reversal signals (described in the following chapters).
- Trade in the direction of the main trend.
- Trade stocks that have average daily volume of 500,000 or more.
- Trade stocks with Market Capitalization of $300,000,000 or more.
- Resist temptation to call a Bottom or a Top in a stock unless it is confirmed by at least 2 Trend Reversal Signals.

Exit Criteria:

- Strictly adhere to predetermined stop-loss levels if the position gets into loss.
- Close at least 50% position when the profit target is reached.

(This is just a sample plan to give some idea to readers of this book.)

Chapter

3

STOCK PRICE TRENDS

MAIN (PRIMARY) TRENDS

Stock prices are volatile and they keep changing almost every moment. Sometimes they seem to go up and sometimes seem to go down. Sometimes they continue an upward movement for many days and sometimes their upward journey lasts just a few seconds! Also there are times when they just move around some price level or within a range as if someone had locked them there. So before learning about Profit From Prices signals, it will be useful for us to understand and define stock price movements.

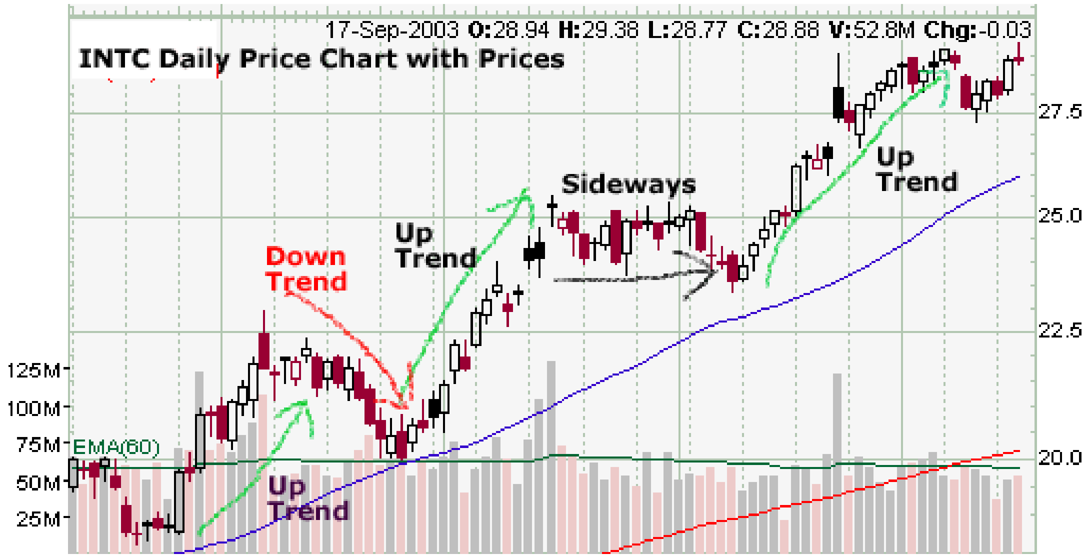
Normally people think of just two types of stock price movements or trends: an Up-trend or a Down-trend. An up-trend or upward price movement is the one in which the price of a stock keeps going up. A down-trend is a trend in which the price of a stock keeps going down. Besides these two trends, there is another price trend call the SIDE-WAYS trend. During Side-ways, a stock moves around some price level or within a specific range for considerable period of time.

Please look below at Intel's chart to see how its price is in an overall up-trend during this period. This overall trend that can last from a few months to a few years is called the Primary Trend. However, as we can see in the chart below, there are some periodic down-trends or side-ways movements during this primary up-trend. Such pauses, or minor/small trends against the primary major trend, are commonly referred to as reactionary periods or trends.

REACTIONARY TRENDS

Corrections and Reactions are short-term trends that take place within a major/primary trend.

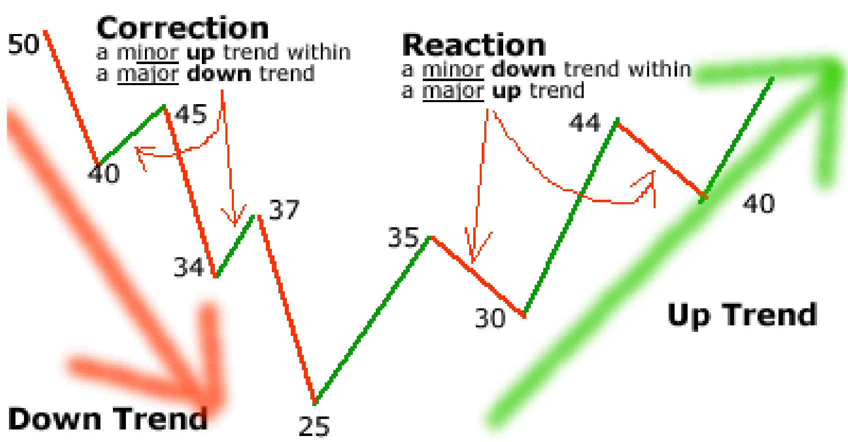
As mentioned above, for a stock in a primary up-trend, there are a few days during which it seems to be going down. This small down-trend (or side-ways trend) within a major/primary up-trend is called a Reaction. Similarly, a small up-trend in a stock that is currently in a major/primary down-trend is called a Correction.



"Chart courtesy of StockCharts.com"

These short-term trends can last from two days to a few weeks. These Reactionary trends (Reactions and Corrections) usually are rapid and have lower volumes.

Look at the figure below to see how Reactions/Corrections occur in a stock.



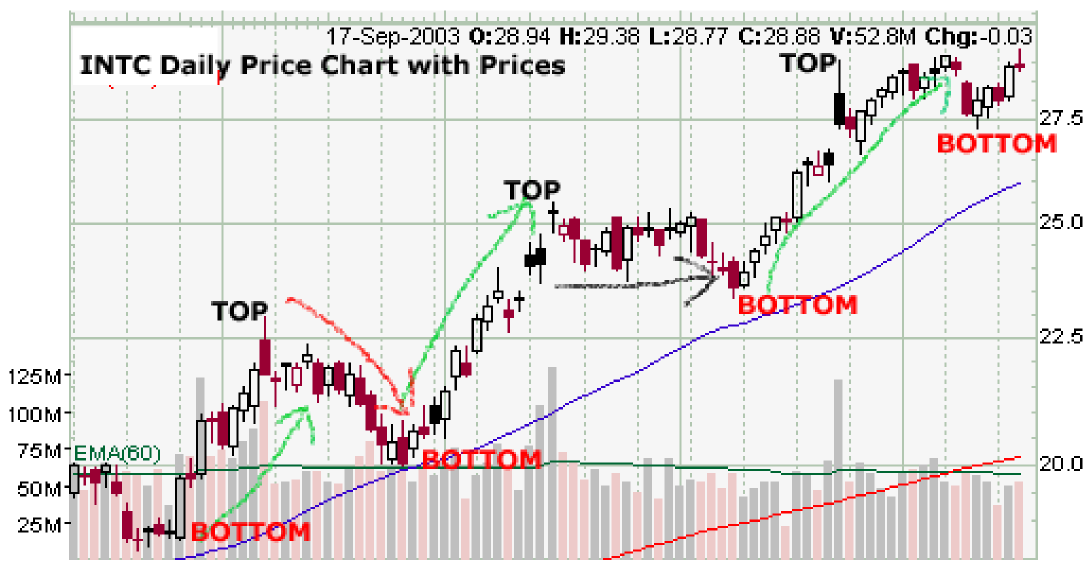
In conjunction with trends, there are two other widely used terms to describe stock price movements: Top and Bottom. These are the turning points at which the stock changes the direction of its trend. Very short term traders or day traders can see trends/reactions and Tops/Bottoms many times over a single day but as PFP signals are based on daily or weekly prices, we will confine our discussion generally to daily/weekly price trends.

TOPS AND BOTTOMS

TOP: A Top is formed when a stock that is in an up-trend changes its course and enters into a down-trend or goes Side-ways. The daily high price on the day this changeover occurs is called the Top (price). When you are looking at the historical prices or at a chart, it is straightforward to figure out various Tops most of the time. Sometimes, on the other hand, it is not clear particularly when a stock is in a Channel/Side-ways movement or fluctuating within some specific range of prices.

BOTTOM: A bottom is formed when a stock that is in a down-trend changes its course and enters into an Up-trend or goes Side-ways. The Low price on the day the bottom formed is called the Bottom (price).

A stock during its course keeps making successive Tops and Bottoms. If the successive Tops and also Bottoms are higher than Previous Top and Previous Bottom respectively, then the stock is considered to be in an Up-trend. If successive Tops and Bottoms are formed at prices lower than Previous Top and Previous Bottom prices, it is a down-trend.



"Chart courtesy of StockCharts.com"

After getting this thumb-nail sketch of Tops and Bottoms, Up-trends and Down-trends, let us take a closer look at them.

It is easy to spot an Up- or a Down-trend, or a Top or Bottom, on the chart above because we are looking at an historical chart. The Tops and Bottoms or the trends in the above chart are clear because we are looking at sort of a complete picture. A Top is not a Top unless prices are going down during the subsequent days' trading. Similarly it is not certain/clear/obvious if the trend in a particular stock reversed today or not. For this, one has to look at the next few day's price movement; and if the prices are going down during the subsequent days only then can we say: "Yes, that was the reversal" or "Yes, that was the Top". Unfortunately, in trading stocks, the sooner the trend reversals and Top/Bottom formations are found, the more profitable the trading is likely to be. Ideally, to take maximum benefit, one should attempt to find a Top or a Bottom, or a trend reversal as soon as possible. The other side of the coin is- often the assessment about a Top/Bottom, or a trend reversal can turn out to be wrong. This is the flip side of trading. One can't be correct all the times. Now the question is- how to find a Top/Bottom or trend reversals as early as possible?

Later in this book, I will explain how to identify a change in trend **on the very day it is taking place**. With confidence (and a proper stop-loss), a PFP signal will tell us that Today's High price is likely to form a Top for the current trend, or Today's Low price is likely to be the Bottom price for the next few days.

With PFP signals discussed in the following chapters, a person can answer various questions like:

Is the stock price trend in an Up-trend or a Down-trend as of the moment?
How likely is it that Today's High price is going to be a Top price for the next few days?
Is Today's Low price likely to be the latest Bottom for the current Down-trend?

As discussed previously, it is easy to label a day as a Top price day or a Bottom price day after looking at the prices of the subsequent few days. The more days we look forward, the more accurate we will be with our assessment. However in real trading, we don't have the luxury of waiting for a perfect confirmation. We have to make a decision, and then a trade, as early as possible to be able to capture profit as much as possible from the forthcoming price movement. This often means we have to trade with insufficient information. We are likely to be proven wrong many times and that is where the stop-loss comes in to our rescue. On the other hand, waiting a few more days for additional confirmation does not make our assessment any better! It is possible that on the day of confirmation for the previous Top or Bottom, the stock might be forming the next Bottom or Top. Like a fresh MBA, we can't wait for all information to be available particularly when we are trading stocks. Risk (uncertainty) is the second name of trading and the sooner we capture the current trend, the better and more profitable it is likely to be for us.

How to identify a Top or a Bottom:

There are several approaches that can be used to identify a Top or a Bottom. For simplicity, let us put them in two classes: Leading Indicators and Lagging Indicators.

Many traders use leading indicators like ROC, RSI to predict when the next Top or Bottom is likely to be formed based on overbought or oversold zones. This approach works sometimes but not always as stocks sometimes spend considerable time in over-bought or over-sold zones. These leading indicators are too mechanical to produce consistently reliable results. I don't find them much useful in short term trend trading.

On the other hand, there are some pretty good lagging indicators like MACD or moving averages. They do a good job I guess because they take the guessing part out of the game. With leading indicators, one has to sometimes make a guess about when the trend will reverse; however, with lagging indicators, we get confirmation of a Top or a Bottom two to ten days after it is formed. MACD, Moving Averages etc take into consideration the price movement of the subsequent few days and then only they signal whether the trend has changed or not, whether the high price on that day was a Top or not. So lagging indicators are good and bad. The good is- we know for sure what a Top or Bottom price was. The problem is- these lagging indicators may give a trading signal too late. If you are trading with MACD, you may be acting, say, four days after the Top was formed. It is quite possible for the downtrend to be only 4 days long! This means one might have shorted the stock when it was at the end of its downtrend. The point is MACD may be a useful indicator for medium to long-term investors but for active short term trading, it is not of much use!

So, how to identify Tops and Bottoms or trend reversals as soon as they are formed? The prices can be our friend here. In the following chapters of this book, I am going to show you how to read prices and how to figure out a Top or a Bottom sometimes as early as on the very day it is formed. My PFP signals will help you identify Tops and Bottoms, and trend reversals, with more assurance, accuracy and time efficiency than most other trading systems out there.

DAILY PRICE TRENDS

There are two other terms that I will be using quite frequently in following chapters. They are used to define stock price trend for one day at a time.

BULL DAY: A day in which the CLOSING price of a stock is HIGHER than the OPENING price is called a BULL DAY. The more the difference between Open and Close prices, the more useful it is. What is the significance of a Bull Day? It is a quick method to determine what happened *during* the day. The closing price higher than the opening price indicates that the Demand was more aggressive during the day than the Supply. The sentiment at the end of the day was more positive than it was at the beginning of the day. This fact taken alone may not give us enough solid information to get into a trade but when combined with some other tests, it is a very useful bit of information.

BEAR DAY: It is a day when the CLOSING price of the stock is LOWER than the OPENING price. It indicates that during a given trading day, the overall Supply was more powerful/aggressive than the Demand. A Bear Day means that the sentiment at the end of the day was less positive (or lower) than it was at the beginning of the day. Like a BULL DAY, this assumes greater importance when it is used with other indicators.

Now having broken down a stock's price fluctuations, we are ready to learn how to extract valuable information from prices. However, before we do that, it is time we learn about another very important trading term- Stop-loss. So in the next chapter, we will see what a stop-loss is and how we can use it to our advantage in trading.

OPENING PRICE TRENDS

This is one more component of most of the PFP signals.

STRONG OPEN: At the beginning of the session on any day, most stocks start (or open for) trading around the Close price of the previous trading session. However there are days when the Open price is significantly different than the Close price of the previous day. When the Open price today is higher than the Close price of the previous day, we will call it a STRONG OPEN. This is a measure used in PFP signals to capture changes in sentiment. A STRONG OPEN tells us that people are thinking more positively about the future price movement of the stock.

WEAK OPEN: Similarly, when the Open price on a day is remarkable lower than the Close of the previous day, we will call it a WEAK OPEN. It usually tells us that market participants are thinking more negatively about the stock than what they thought at the close of the previous day's trading session.

Chapter

4

STOP-LOSS: HOW TO USE IT IN STOCK TRADING

One important dimension of any trading system is the ability to keep losses small. This is achieved most of the time with the use of a STOP-LOSS. So let us spend some time to learn what a Stop-loss is and how one can use it in trading to his advantage.

Stop-loss is a widely used term in investment circles. As the name says, it is a price level at which one should stop or limit his losses in a position. Investing or trading is like gambling when one looks at it from the perspective of outcome. When a person gambles or speculates, he does not know what the outcome will be. He hopes the outcome will be in his favor but it could very well go against him. The same thing goes for investing or trading. When someone buys a stock, he might be thinking, and to a great extent hoping, that the stock price will go up, but it could very well go down. So what should a person do if the prices go contrary to one's expectations?

There are two alternatives: (i) He can continue to hold it believing, and hoping, that it will ultimately go up; or (ii) He can blame the unexpected mess on his wrong selection, bad judgment, bad timing or on circumstances/development beyond his control or imagination, and… get out of the position.

INTRODUCTION TO STOP-LOSS

It is a price level or a mechanism that forces a trader to take/book losses in a losing position instead of letting them grow any bigger. Ideally a Stop-loss level should be decided as soon as a trade is executed. If a stock say ABC is bought at 25$, Stop-loss for it can be kept at a price level somewhat lower than 25$. It can be 24, 23, 20 or even 15$. Let us assume the Stop-loss is kept at 20$. This means if the price of ABC, after buying it for 25$, goes below 20$, one should close the position by selling it. 5$ is the loss the buyer is limiting himself to. This might be a little confusing for novice traders because it involves closing a position willingly at a loss! Remember: In a long position, the Stop-loss price is usually lower than the entry price.

Likewise if a trader Shorts *(what is this term? It means sell first even if you don't own the stock with the hope to buy it back later at a lower price)* ABC stocks at 25$, he should keep a Stop-loss at any price higher than 25$. Say if it was kept at 30$, this means if the price moves up contrary to the initial expectations of its going down, and touches 30$, one should call it quits and square up the position. Thus, in a short sell, the Stop-loss price is higher than the price at which the stock was sold.

COST AND BENEFIT OF USING STOP-LOSS

The use of a Stop-loss has its merits, and problems too. Let us take two examples to illustrate the cost and benefit of it.

Let us assume someone bought a stock like, CMGI or ARBA, around the 150$-level during the Year 2000 boom period, thinking that it was a great company (Believe me there were many investors who believed so at that time). And if he continued to hold to that position during its downtrend (hoping that it would one day reach 200$!), he would have seen the stock price drop to as low as 1$ in 2002! In this kind of situations, one would wish he had kept a Stop-loss and limited his losses to 5 or 10$ per share. This makes a strong case for the use of a Stop-loss.

Now let us look at an opposite situation. Assume that the same person had bought Yahoo at split adjusted 10$ in October 1997 and kept a Stop-loss at 9$. Suppose the price went below 9$ and triggered his Stop-loss. He would be out of the long (buy) position in Yahoo at a 100$ loss. Then as time passed, Yahoo kept climbing up and ultimately reached as high as 500$ in January 2000. An initial 1,000 $ investment could have been worth 50,000$ if no Stop-loss were used! This is an extreme case against the use of a stop-loss.

Should a Trader Use Stop-loss?

So a million dollar question is: Should you use Stop-loss or not? The answer is that it depends. If you are an investor with purely long-term perspectives and with a diversified portfolio, you probably should not. On the other hand, if you are a trader trying to capture a 5 or 10$ movement, you need to book your losses as quickly as you would normally book your profit.

As the saying goes, there is no free lunch in financial markets. So the use of a Stop-loss has its benefits and problems. In a few paragraphs below, I will try to show you how to get the maximum out of this Stop-loss and how to use it in your favor. Let us go back to the above two scenarios one more time.

Let us assume that that 1000$ position in Yahoo at 10$ price had no Stop-loss. Do you think the buyer would have continued to hold onto it until it touched 500$? It is very likely he might be out before it even doubled or tripled! I think most of investors including myself would be pretty satisfied to have doubled or tripled our investment over a short period. Let us assume our buyer of Yahoo in this example is made of a different material. Suppose he had guts to hold on to a winning stock and he watched Yahoo go up to the 20, 50, 100, 150, 300$ level. I am curious to know what would have prompted him to sell Yahoo around that 400/500$ level. It is possible that his patience and guts may have glued him to that Yahoo position, even when the YHOO stock reversed its trend and price touched a 10$ level back somewhere in 2002. This is an extreme example and I have mentioned it to highlight two things: Most investors get satisfied with small profits, and use a new type of Stop-loss-**Progressive Stop-loss** that we will discuss later in this chapter.

What in the case of CMGI or ARBA? It is very likely that individuals who usually take small profits might have stayed in such losing positions all the way to zero! My point is: Most individuals play the stock market like a D or F-grade student! When it comes to booking profit, they easily get satisfied with a few points of profit but when it is a loss situation, they are likely to hold on and stick to the stock too long. Most investors are more risk-averse (they hate the risk of profit going down) in the profit zone and less risk-averse (they tend to take a lot of risk in the hope that prices will go up someday) when in a loss zone. This asymmetrical behavior is typical for most investors. What is the end result? Small profits but big losses!!!! This is the reason I advise most traders to use stop-loss when they are trading stocks or Futures.

It is feasible that (small) profits in ten positions can easily be wiped out by two/three big losses! So even if a trader has a 70 to 80% success rate in stock selection, he would hardly break even if he does not stop his losses! I think this is one of the main reasons why our trading results in losses most, if not all, of the time! I think this makes a solid case for every trader to understand and learn to use a Stop-loss on every trading position.

HOW TO EFFECTIVELY USE STOP-LOSS

Almost every person loves to take profit but if things go contrary to his expectations, he must also use a Stop-loss to limit his losses. Question is how much loss is enough? There is no clear answer to this question that will suit every trader's needs and circumstances. If one does not want to lose a great deal, he should keep the Stop-loss close to his trade price. The benefit is a small loss. However this would increase the probability of the Stop-loss being triggered. So the result is small but frequent losses. On the other hand, if a trader does not want his Stop-loss levels to be frequently triggered, he should keep more distance between his entry price and the Stop-loss. This will result in less frequent but higher losses. So how much loss is ideal? It is really an individual's decision based on his risk-tolerance, asset base, trading system, return objective in the position, market conditions and the nature of the stock itself.

So how much is enough?

One should look at the stock's price, volatility, current market conditions and return expectations to determine **an efficient loss/risk amount** for him. For an average individual, it could be from 5% to 25%. For a 5$ stock, with high volatility and expectations for 100% return over the intended holding period, it could be 25% of the amount invested. This means if someone buys at 5$, Stop-loss could be kept at 3.75$. In the opposite extreme, for a 120$ stock with average volatility and a target return of 30%, the Stop-loss can be placed even as low as 3%. As this kind of Stop-loss will protect one from big unexpected losses, they are frequently called a **Protective Stop-loss**.

What should be a base/price level to calculate stop-loss price?

Let us assume that 5% is the ideal Stop-loss or safe distance percentage for a given position. Now another question is what level should one use to calculate his Stop-loss price. If he buys this stock at 50$, the most obvious choice is to use the 50$ level and go for a safe distance of 5%. This will be 47.50$. This is the most widely used approach to determine Stop-loss levels- to use the purchase price as the base price.

However John Magee in his classic book on Technical Analysis of Stock Trends (good reading for people who use Technical Analysis) suggests using **Minor Tops and Minor Bottoms** as base points. It makes a lot of sense. An individual's purchase price has no meaning in the universe of constantly fluctuating stock prices but Minor Bottom/Minor Top is a somewhat significant price level. Minor bottom is the price point where at least for some time buyers were more aggressive than sellers and were able to push prices higher. Minor Bottom means buyers gained more strength to outbid selling pressure. Similarly a Minor Top - the recent high price - is the price at which the stock attracted more selling.

How to decide on a Minor Bottom?

It is tricky and subjective. Different people can have different methods or parameters to find Minor Tops and Bottoms. Here also, I like John Magee's definition. Let me try to explain a Minor Bottom:

(1) Suppose prices are going down for a stock for some time (how much is *some time*? It could be 2, 3 or more days. One can pick his own number and fine tune it as he gains trading experience.)

(2) The stock price makes a low of 45$ on day X. The high on that day was 48$.

(3) Let us call this *high price (48$ in this case) on the low price day* (X) a Key Price. As soon as there are <u>three consecutive days on which stock does not trade below this Key Price</u> (48$ in this example), the low price of day X will become a Minor Bottom (45$ in this case).

The same thing can be applied in reverse for calculating a Minor Top. Read this again and again until you comfortably understand it. Thus for best results, one should use the Minor Top or Bottom as his basis to calculate the Stop-loss level for his position. This is likely to provide better protection than a stop-loss calculated based on the entry/trade price.

PROGRESSIVE STOP-LOSS

Stop-loss is mostly referred to in a loss situation. **This should not be the case**. Stop-loss can also be used to a trader's advantage in a profitable trade when prices are moving in the direction he wanted them to move. A Protective Stop-loss level can be changed in the direction of the stock price. If one has taken a long position and the prices are going up, he can increase his stop-loss level. This makes it a **Progressive Stop-loss.** (The word "Stop-loss" becomes deceptive in this context. Instead of relating to a loss, it is used to protect a profit).

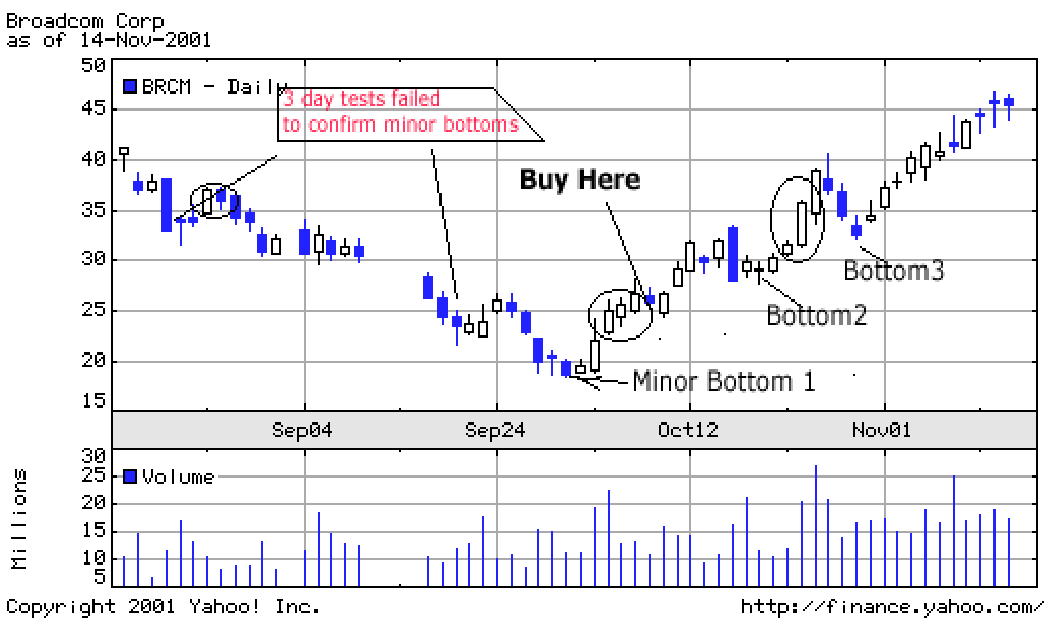
Let me explain a Progressive Stop-loss in more detail. Let us continue our example above. Assume that the trader bought the stock at 50$ after a Minor Bottom was confirmed at 45$, and kept a stop-loss with a 5% distance which is 42.75$. This is the initial **Protective Stop-loss**.

Assume that the stock price goes up and touches 55$ and then enters into a reaction and slides back to 50$. The day it touches 50$, the high was 52$. Now again the price seems to be going up and there were three consecutive days on which stock traded above 52$. This will confirm a higher Minor Bottom at 50$! Now he can raise the Stop-loss to 47.5$ (50$ minus 5%) from the initial level or 42.75$.

Assume that the stock resumes it up-trend and makes a higher Top at 65$. Then it slides back to as low as 58$ and passes the 3-day test of a Minor Bottom. So now one can raise his Stop-loss to 55$ (58$ minus 5%). This trading position is in profit now and profit is also sort of guaranteed! Say the upward trend in prices of this stock continues. It touches a price as high as 85$. Subsequently let us say a Minor Bottom is confirmed as per our *three consecutive days* test at 78$. So the new Stop-loss level is now at 74$ (78 minus 5%).

Now let us assume that after the last Top and Bottom being confirmed at 85$ and 78$ respectively, the stock fails to go higher than 85$. This is an indication of some weakness. Now when it starts going below 78$ (the last Minor Bottom), one should get worried. Still there is no need to sell the position because the stop-loss is 5% below the last Minor Bottom. This helps us if the stock is forming a mid-trend pattern like a flag or a pennant. If after going as low as 75$, the stock resumes its upward trend and goes above 85$, one is still in the game! However if it does not go higher and instead goes below 74$ (current Stop-loss level), one should close the position. As you can see, even if the stop-loss was triggered, the position had a profit of 24$ (Sell price 74$ versus purchase price of 50$) per share!

I hope the above description about Progressive Stop-loss makes sense to you. Here is one real example:



This is the Chart of BRCM (Broadcom Corp)- a one-way superstar, during 2002. Around that time, I was watching it closely. It was drifting from 40$ down to less than 20$ but did not confirm any Minor Bottom on the way according to the 3-consecutive-days test. Ultimately it touched 18.40$ and then later on, on the3rd, 4th and 5th days it passed the 3-day consecutive rule! It formed a Minor Bottom as marked on the Chart. It was a buy signal for the first time and one could have bought it for around 25$. The initial Protective Stop-loss would be at 16.50$ (18.40$ minus 10%) allowing a loss potential of 8.50$/share!

The next Bottom -- Bottom2 -- was confirmed at 27.50$ which would bring the Stop-loss to 25.00$ (27.50$ - 10$). Then it made another higher Minor Bottom -- Bottom3 -- around 33.00$ bringing the Stop-loss to 30.00$. At the time, the Chart was drawn, BRCM stood at 45$. At that time, one could have booked a profit of 20.00$ or like an astute trader, he could have held on to it with a 30.00$ Stop-loss and see it rise progressively higher if the stock continued to confirm new higher Bottoms.

Chapter

5

INTRODUCTION TO SIGNALS

MARKET ECONOMY- HEART OF THE CAPITALIST SYSTEM

Any market is made of buyers and sellers/suppliers and there is always a conflict going on between these two groups. Buyers want to pay the minimum possible price while sellers on the other hand want to get maximum possible price. If the price is too low, buyers would demand a large quantity but sellers would not want to sell much at this low price. If price is too high, sellers would love to sell a large quantity but buyers would not want to buy much. This is a kind of war between two groups - one trying to push prices lower and the other one trying to push prices higher. In market economy, price keeps changing until it reaches a point where the quantity demanded by buyers equals quantity supplied by sellers.

Stock market is the mother of all markets. One will see these Demand and Supply curves change more rapidly for a stock than for any other item. That is why we see stock prices changing almost every moment. For a stock, individuals and institutions that hold the stock or intend to short the stock are the potential sellers and they collectively define the supply curve. There are thousands, if not millions, of reasons that may motivate or prompt a market participant to sell a particular stock he or she is holding or intending to short sell. Similarly, individuals and institutions that are thinking/planning to buy the stock form the Demand curve. There would also be several reasons why they want to buy this stock. As we all know, a stock's price is likely to go up if the Demand is increasing or the Supply is decreasing. Similarly it is no rocket science to figure out that a stock's price would drop if the Demand is shrinking and/or the Supply is expanding. So when a trader is buying a stock, he wants its prices to go up after he has bought it. He wants the Demand for the stock to go up or the supply to dry up.

STOCK PRICES- HEART OF THE STOCK MARKET

The demand and supply curves for any stock are constantly changing. Variety of economy, industry related or company related events, news, discussions, analyst reports and political and global developments constantly change the demand and supply curves for any stock. Add to this, the fact that given a certain piece of information, a person can't be sure how people will react to it. Aren't you surprised to see that even after some unexpected strong positive news about a stock, the stock keeps being traded! Ideally, if the news is too good, everybody should be a buyer and there should be no seller! If there were no seller, there would be no trade! But the fact that most of the stocks keep trading every moment when the Market is open indicates just one thing: There are people with totally different views about the prospects of a stock at any given moment. Everyone who is driven to buy or sell a stock has his own criteria to value the stock, his own set of expectations, and his own unique financial situations and circumstances. This makes it almost impossible to draw complete demand and supply curve for any stock at any point in time. And if we do not have any idea about how aggregate demand and/or supply are changing, how can we predict future stock prices with confidence?

Exactly this is where stock prices come handy. The net impact of everything happening in a stock or a company gets immediately reflected in the price of the stock. Price is the point where millions of different counter acting forces balance out. So with enough attention to changes in the price of a stock over a day or two, there will be times when we can visualize changes that are taking place in aggregate demand/supply of that stock, and based on that, we will be able to determine in which direction the price of the stock is likely to move over the next few days. There is no need to get into complex world of demand and supply curves; all we need is to keep an eye on where the balance between them is heading. Once we know this, we can take calculated risk in order to earn some reward.

STOCK PRICES- DAILY AND WEEKLY

What I mean by prices are four different prices: **Open Price, High Price, Low Price and the Close price.** The movement of a stock over a day or a week can be summarized in these four different prices.

Open price: This is the price at which a stock starts trading for a day. For weekly prices, **Monday's Open price,** or Tuesday's O pen price, if the market was closed on Monday, is the Weekly Open price.

High Price: This is the highest price the stock traded during the day. Similarly for weekly prices, this is the highest price the stock was traded during the entire week. In other words, the highest High of all days of the week is that Week's High price.

Low Price: This is the day's lowest price at which the stock was traded. Similarly Weekly Low is the lowest price the stock had traded during the week. In other words, this is the lowest Low of all days in the week.

Close price: The daily Close price is the last trade price for the day. The last closing price of the last trading day of the week, Friday or Thursday, if Friday was a Market holiday, is the Weekly Close.

Volume: This is total number of stocks traded for the day or for the week.

These four prices are usually displayed in following sequence: Open, High, Low, Close, Volume. In this book, this is how the prices are going to be listed.

Table 1. INTC (Intel Corp.) Daily Prices and how Weekly Prices are derived from it.

Daily Prices for INTC (Intel Corp). Bold Prices become weekly prices						
	DATE	**OPEN**	**HIGH**	**LOW**	**CLOSE**	**VOLUME**
Monday	25-Aug-03	27.56	27.76	27.07	27.24	52,037,500
Tuesday	26-Aug-03	26.96	27.74	**26.68**	27.71	65,213,400
Wednesday	27-Aug-03	27.61	28.08	27.42	28.02	58,217,200

Thursday	28-Aug-03	28.1	28.35	27.85	28.3	48,631,600
Friday	29-Aug-03	28.18	28.65	28.04	28.59	41,986,600
Tuesday	2-Sep-03	28.77	28.84	28.17	28.74	58,841,200
Wednesday	3-Sep-03	28.94	28.97	**28.04**	28.22	60,714,800
Thursday	4-Sep-03	28.32	28.74	28.04	28.6	63,744,700
Friday	5-Sep-03	28.83	29.1	28.37	28.71	68,429,900
Monday	8-Sep-03	28.88	29.2	28.8	29.18	52,154,000
Tuesday	9-Sep-03	29	29.13	28.66	28.79	49,792,900
Wednesday	10-Sep-03	28.44	28.49	27.63	27.66	57,999,300
Thursday	11-Sep-03	27.62	28.35	**27.29**	28.03	56,654,900
Friday	12-Sep-03	27.81	28.39	27.55	28.34	51,931,600
	DATE	OPEN	HIGH	LOW	CLOSE	VOLUME
Weekly Prices for the INTC (Intel) for above period						
WEEKLY	25-Aug-03 (Previous to Previous Week)	27.56 QWO	28.65 QWH	26.68 QWL	28.59 QWC	266,086,300
WEEKLY	2-Sep-03 Previous Week	28.77 PWO	29.1 PWH	28.04 PWL	28.71 PWC	251,730,600
WEEKLY	8-Sep-03 This Week	28.88 TWO	29.2 TWH	27.29 TWL	28.34 TWC	268,532,700
	WEEKLY	OPEN	HIGH	LOW	CLOSE	

FOUNDATION OF PROFIT FROM PRICES SIGNALS

As such, the Open, High, Low and Close prices for a day are just plain figures/numbers. Most people are unable to extract any useful information from them so it is not surprising to see them paying attention only to the Closing prices. For most people, the Open price is a totally useless number and so are High and Low prices often times. As I will show you in next few chapters, the four daily/weekly prices and trading volume numbers contain tremendous amount of information and it is not a complex science or math to extract it and use it for trading stocks. Four daily prices tell us one very important thing: **How the demand/supply curves for any stock are changing and how we can predict future stock prices in certain situations.**

In this book, I am going to show you how simple it is to read between the lines when you are looking at the four daily prices and trading volume for a stock. Though modern investment world has started ignoring Open price, it is a very important number when one compares it to previous day/week's Closing price or with the current day/week's Closing price. In this book, I will often refer to two primary tests that form the heart of the Profit From Prices theory. The first test is to capture changes in sentiment. By sentiment, I mean psychology and expectations. With this first test, I attempt to capture net changes in perceptions, outlook and feeling about a stock by market participants. The second test is to summarize the actual trading activities during a session and to capture net changes in aggregate Demand and aggregate Supply. In the first test, I try to measure changes in sentiment and in the second test, I want to see how people are actually acting or behaving. Emotions/opinion/sentiment has no value unless a person actually acts on it. My two basic tests do just that: they try to capture changes in how market-participants are thinking, and how they are acting. Then I have some additional tests to quantify strengths of such changes and to determine what implications they hold for future price movement.

1. What happened while the market was closed, or when the stock was not trading? To answer this question, I compare Today's Open price (TDO) to the Previous Day's Close (PDC) price. If Today's Open price is higher than Previous Day's Close price, it tells me that there is a change in investor sentiment, and the change is for the better. Whatever happened overnight, while the market was closed, it has resulted in positive implications for the stock today: It has caused Demand to increase and/or Supply to dwindle. Why would buyers pay higher prices today for the same thing that was available previous day for less? No one in the market system likes to pay a penny more for the same thing. This is even more true for stock market. This happens only when someone is convinced of a bigger profit down the road than the additional amount he is paying in terms higher price. For this reason, I take Strong Open as an indication of improvement in investors' sentiment towards it. (The reverse is true when Today's Open price is lower than Previous Day's Close price. Such Weak Open means deterioration of investor sentiments).

   There is one caveat: Only a strong Open is not sufficient reason to buy any stock. It does indicate improved sentiment but it is only half of the story. Improved sentiment has to result in higher demand and hence higher prices. This can be confirmed only after watching the full day's trading. So for this, this is my second test.

2. The second test is: What happened today during the entire market session? As an answer to this question, I compare a day's Open price to the Closing price of the same day. If Today's Close (TDC) is higher than Today's Open (TDO), I conclude that, during the entire session today, buying in the stock has been more powerful than selling. The sentiment at the close was at a level higher than where it was when the market opened or the stock started trading today. A comparison between the Open and the Close price for any day gives us the net summary of the war in the marketplace between buyers and sellers. If the stock closed at a price lower than where it opened at the start of the market session, it means that the sentiment in the stock deteriorated during the session.

   As I said earlier, these two tests though they provide useful information are not sufficient for entering into any trading position. So I have few more tests to augment the strength of my signals. When I explain various signals in the following chapters, I will show you these supplementary tests/conditions that take us few steps further and give us some quantitative information: how significant is the change in sentiment, how long it is likely to last, and what we should do to take advantage of it.

PROFIT FROM PRICES TRADING SIGNALS- AN INTRODUCTION

A PFP signal is an indication to buy or sell a stock. Every signal is a collection of some conditions. When all, or majority, of conditions are fulfilled for a signal, we will say we have a buy or sell signal in that stock. I have given unique names to signals and we will learn about them in detail in the following chapters.

Let us now look at various components of a signal. Every signal in this book will have typically following components:

1. Type- Buy Versus Sell: A stock can be traded in two different ways- you can *buy* a stock or you *sell* it. Hence every signal in this book will be discussed in these two opposite market conditions- one that generates a BUY signal, and its counterpart that generates a SELL signal. The BUY version of a signal is used to capture profitable opportunities by taking long position (buying the stock). This will be labeled with suffix **(BUY)** because it gives a signal to buy the stock. Then we will discuss the same signal in the reverse market conditions to identify 'Sell' signals. They will be suffixed with **(SELL).** (BUY) signals can be used to close/cover existing *short* positions and/or to initiate fresh *long* positions. Similarly, (SELL) signals should be used for closing existing long positions and/or to initiate fresh short positions. As an example, U TURN is one of our signals. It will have two versions: U TURN **(BUY)** to give us buy signals and U TURN **(SELL)** to give us sell signals.

2. A set of tests/conditions: A signal can have from two to up to eight tests (conditions). When all or most of the important tests of a given signal are fulfilled (are true) for a given stock, we can trade as per that signal by buying or selling that stock. An example of a condition or a test is- Today's Open price is *lower* than Previous Day's High Price. Another example is- Today's Low price is the lowest price over last three to five days.

3. Action: Every signal has one of the two specific implied actions- BUY or SELL. However, when there is an existing short position in a stock, then a BUY signal can be used to cover that short position. Similarly, when there is a SELL signal, it can be used to close an existing long position.

4. Stop-loss: This is another very important component of every Profit From Prices signal- the stop-loss. This is like an expiry date printed on most of the perishable items we buy in grocery stores. As time decays most of the food items, it also decays a signal. However unlike expiration on a specific date for a food item, a signal expires at a specific price level. This is called stop-loss about which we have already seen in the previous chapter. Our signal few days back might be a powerful one, but subsequent developments may have adversely affected the stock price. If there is some news or some people are suddenly dumping the stock, we have to incorporate it into our trading. Because our signal told us to buy a few days or hours ago, we should not blindly stick to our position. So when the stock price crosses the stop-loss level, we take it as a failure of our signal. Every signal we will discuss will have a stop-loss component.

HOW GOOD IS OUR SIGNAL?

The Profit From Prices signals that we are going to study in the next few chapters vary in strength. Some of them are very powerful for short as well as for long term trading and some are good mostly for taking advantage of only the next few days' price movement. So before we get into individual signals, let us look at the factors that have significant influence on the strength of any PFP signal. I strongly advise you to take them into consideration before acting on any signal.

- Current Market Trend: It is always easier to swim with the trend than against it. Same thing applies in stock trading. Most stocks normally move with the market. So if the market is going up, it is easy for an average/ordinary stock to go up than to go down. Hence it is important that we pay attention to the overall trend in the market before we act on any PFP signal. The success of a trade in response to any PFP signal significantly depends on the current trend of the **overall market**. For a reversal signal to have more odds for being in profit, it should meet two conditions - first, it should take place after a strong trend in the stock itself and secondly, the new implied trend should be in the direction of the current trend in the general market. As an example, when we get a BUY Trend Reversal signal in a stock that has been consistently going down for the last few trading days while the overall market is going up, we should treat our signal as a strong signal. However if we get a BUY Trend Reversal signal after a small downtrend in the stock price and/or when the overall market is in a down-trend, we should take our signal with caution.

- Volume: PFP (Profit From Prices) signals attempt to fathom trends and trend reversals by looking at various prices. Based on various tests applied to prices, we can determine if demand and/or supply, and sentiment are changing. However to assess the magnitude or the strength of such changes, trading volume is a very useful indicator. It is the trading volume (number of stocks traded) that tells us how strong or significant the action of buyers/sellers is. For real trend reversals to occur, it is important that the counter-acting forces demonstrate significant power. This means that for a stock that is going down, an emergence of **decisively strong buying interest** is essential if the stock price is to really reverse its course and go up. Hence we would expect a significant increase in volume on the day a trend reversal signal takes place. Personally, as a rule, I expect at least a 30% jump in volume over the average volume of the last three to five days. The higher the jump in volume, the better it is. On the other hand, if a trend reversal signal occurs with no jump in volume, one should take that signal cautiously or even ignore it.

- The Stock: When we have a buy or a sell signal, it helps to take into consideration the nature of the stock itself before we make any trade in it. This helps us better understand and control risk versus rewards. Some of the things I look at are following.

  - High Volume Big Company stocks are better for trading: Price-based trading signals work best with high volume large market-capitalization stocks. Such stocks are widely followed by individuals as well as by institutions and hence they have an orderly, and efficient, market. As we know, insiders or people close to company management often trade with material non-public information and their actions have a larger impact on the prices of thinly-traded stocks than on heavily traded stocks. Also in small volume or small company stocks, sometimes some buyer's buying of a few thousand or a few tens of thousand of stocks may alter the price of the stock disproportionately. Also, in thinly traded stocks, some trading errors, or manipulations, can sometimes distort the High or

Low price for a given day giving us *wrong* signals. For us, right prices are key inputs for our PFP signals and hence if inputs are wrong, our signal is more likely to fail. So it helps to prefer high volume large cap stocks for trading than small volume stocks.

- Avoid small or low-volume stocks in short-selling: It is true that a stock has limited room to go down (it can go down at most to zero) but has unlimited room to go up. This is one reason to avoid small cap stocks or low priced stocks in short-selling. Another reason is that many times some hidden news is not properly discounted in the prices of thinly traded or small company stocks. When such news is out or when some unexpected positive event takes place in a thinly-traded stock, it is not rare to find up-to a 500% jump in prices over a short period of time. Price movement of this magnitude rarely takes place in heavily traded stocks. So I personally avoid short-selling any stock that is quoted below 20$ or has average daily volume less than 1,000,000 stocks. So remember, when you are trading, trade only in efficient stocks- the stocks in which all information is reasonably reflected and it is really difficult for anyone to move the stock price in any direction by his wish or his personal trading actions.

- It helps to avoid stocks with pending company news or announcements: If there is an earnings release date scheduled over next few days for a stock, one should *generally* avoid trading in it. It is true that prices capture actions of all participants and many times they are able to tell us what the price is going to be. However earnings release by a company can surprise or shock the market causing a large unexpected movement in prices. Such events when they happen in our favor, they give us large profit but if they move the price against our position, we may not get time to exercise our stop-loss. My point is- if we know some event is scheduled that could affect the stock price in a significant manner in the near future, it is better to stay away from such uncertainty. It is true that we have to deal with uncertainty in trading all the time but it is prudent to stay away when we know the timing of the uncertainty. We want to make profit not by mere speculation but by controlling risk as much as possible.

- Take big price fluctuations with caution: Particularly for small cap low volume stocks, it is quite possible for it to open at a wrong price. Similarly during session sometimes the stock trades at a too high or a too low price. So blindly applying our conditions, we get a signal but the prices we used as input to our signal could be wrong/inaccurate. To give an example, for a stock that is normally fluctuating a dollar on a typical day, if there is a fluctuation or two dollars or more, one will need to check the prices to eliminate any trading accident or data processing mistakes. This sort of price movement validation can be done in the US markets by looking at intra-day or a five-day candlestick chart on http://finance.yahoo.com or on most brokerage websites. Any aberration in trading will stand out there on intra-day charts.

- It is more profitable to trade with the trend: I have already mentioned this earlier. If the overall market trend is up, it helps to act on *buy signals* than on *sell signals*. In other words, during bullish (good) general market conditions, a slightly weak buy signal might be more profitable than a strong sell signal.

- Make sure you feel comfortable with the stock you are trading: If there is a signal in a high risk Bulletin Board (BB) stock but if you do not feel comfortable with such stocks, you should avoid that trading signal. If you don't feel comfortable shorting technology stocks, avoid sell signals in them. The primary purpose of our trading is to earn money and the primary use of money is to us happy. So it is fine to maintain peace of mind by skipping few trading opportunities.

- Stop-loss: PFP signals are very timely. They tell us the day a material change in sentiment or demand-supply is taking place. However as you know, stock prices are constantly fluctuating. There is always something happening- economical, political or company-related news or developments. So even if there was an indication (signal) of powerful buying yesterday, it is likely that something might have turned the battle in favor of sellers again. There might be some negative comments or a downgrade by some stock analyst, some news report or it could be a company press release. Sometimes, the buying we felt may be just a spike- a one-day event. Such things can cause the signal to fail. As you know, markets are too dynamic for any person or system to make any perfect prediction.

  So what do we do in such situations? Any Buy signal we get is good as long as the stock price stays above the low price of the last one to five days (we call it *stop-loss* level). Similarly a Sell signal is good as long as the stock price stays below the high price of the last one to five days (I will narrow down this range to a specific number when we discuss each signal individually). So after buying a stock when it goes below this low price (stop-loss), we should close the position. Every signal is good as long the prices are in our favor. However when the stock price crosses the stop-loss, it means just one thing: **our signal has failed.** It is time to close the position and watch for another trading opportunity. We listen to the prices; we do not argue with them. After a Buy signal, when the stock trades below stop-loss, prices are telling us that sellers are still ruling and are in command. It is time we withdraw ourselves. It is okay to be on the losing side in a real battle for some grand cause; but stock market battle is always for money and we have freedom to switch parties. If we see buyers losing battle, why should we stay with them?

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HOW TO ACT ON A SIGNAL

After there is a trading opportunity in a stock based on PFP theory or any trading strategy as such, when should one buy (or sell) that stock? At next day's open price? Or should one wait for a pull back or should one wait for prices to go above signal day's High price? There is variety of possible alternatives. Frankly speaking, there is no science or an exact answer that will fit every trader and every trading situation. What works good for one might not work as well for others. What works well in one situation might not work as well in some other circumstances. There is no one-size-fits-all answer that works all the times. You will have to use a blend of art, common sense, experience and insight to find an ideal entry point for given trading opportunity. So let me offer you some thoughts about this based on my experience. I usually consider various factors, including but not limited to current trend, nature of the stock, price fluctuations and change in volume on the signal day etc. in my decision.

I guess every trading opportunity offers us four choices as such.

1. Trade Now: This alternative tells us to make a trade as soon as we have a valid signal in the stock. So unless a situation or a signal falls in one of the next three groups, Trade Now

is a normal thing to do. *When we have a Trend Reversal Signal accompanied with heavy jump in volume or due to some sudden powerful news, or when we are trading in response to a Trend Continuation signal (like Restart or Gap), it is advisable to trade a stock NOW*.

2. Trade in a Pull-back: Sometimes the price may have gone up or down significantly on the day of a valid trading signal. So we have a choice here with regard to when to act: Instead of taking an immediate action at the Open price of the next day, we can wait for the stock to come back a little over the next day or two (I call this Pull-back in prices). If you decide to wait, you should be aware of the risk in this choice. It is likely that the stock may not get as much pull-back as we might have expected. So for seeking a trade at a more favorable/safe rate, we risk to miss the profit opportunity signaled by our trading system. As always, there is no free ride or lunch in financial markets.

   When should we wait for a pull-back? In certain situations, it does make sense to wait for a pull back. Let us look at certain situations: (1) If we have a strong buy signal in a stock when most similar stocks or the market as a whole is going down, it may turn out to be a wise decision to wait for a pull-back in order to buy it little cheap. Similarly for a Sell signal, if most other stocks or the market are in strong up-trend, it makes sense to wait before we jump immediately in response to the sell signal and short it. (2) Sometimes there is a significant price movement on the day of the signal. Say a 10$ stock jumped 2$ today (and made a High at, say 13$) and gave us a very strong buy signal. Most likely scenario is that the prices for the next few days will not be able to cross the signal day's High price of 13$. Or if there is some significant change in fundamentals, it is also likely that the next day the stock could open up in a gap at $14 or even $15. So instead of buying this stock at such a high price, we can wait the stock to come back to around 11-11.50$ range for a safe entry.

   How much pull-back should we wait for? So if you decide to wait for a pull back, let me tell you my rule- for a buy signal, I go with a limit order with the limit at the average of (low price of the last two days, high price of the signal day). So if the low was at 10$ and the high on the buy signal day was 12$, I would keep a limit order to buy at 11.01$ (I like to buy at 1 cent above the round number and sell at 1 cent below any round number). Similarly if I had a strong sell signal for the stock which made a recent high at 22 dollars but made a low of 20$ on the signal day, I would keep a limit to sell it around 20.99$.

3. Wait and Trade only after a confirmation: This is another valid alternative that is quite opposite to the second alternative we just discussed. Here instead of waiting for the pull back, we want the stock to pass one more test of the strength. Instead of buying at a lower price in a pull-back, we want the reversal to prove its strength and cross some higher price level. If it passes, then we will buy at that higher rate. As an example, let us say a stock ABCD gave us a strong buy signal today with close at 11$ and the High price at 11.50$. Now instead of buying this at next day's open or at during pull-back at 10.51$, I will want the price to go above 11.51$ or even above12$ to prove to us that the reversal we are looking at has real strength in it! (Like any trading choice, this one also backfires in certain situations.)

   When should we wait for a confirmation? Many times, reversal signals we get are due to one-day aberration in prices or a reactionary trend in the main trend. Such signals often fail. So as to save us from entering in and out at a loss, we can wait for the stock to demonstrate favorable price movement over the subsequent two to three days before we actually buy it. When does this waiting for another confirmation is a good decision?

In certain situations, it does make sense to pay a higher price for what we are buying (or get a lower price for what we are selling). Let us look at certain situations: (1) *If we have a strong buy signal in a stock when most similar stocks or the market as a whole are going down, it may turn out to be a wise decision not to immediately jump on.* We can doubt the reversal given by our signal unless we see higher prices over next two to three days. Similarly, for a Sell signal, if most other stocks or the market are in strong up-trend, it makes sense to wait before we jump immediately in response to the sell signal and short it. It helps to wait some time to make sure the prices are really going down. (2) When *a stock is in a rapid or a sustained fall over the last few days*, it is generally due to some very bad piece of news or development about the company. So a trader should resist every temptation to act in response to the first buy signal in it. Instead, he should wait for a confirmation or an occurrence of second buy signal. (3) Another situation is when a signal has some conditions fulfilled in a weak form. This may be due to an insignificant increase in volume or due to a weak/marginal Bull or a Bear day. When trading in such situations, it is prudent to wait for a confirmation of strength. This will improve the odds for profit in such positions. This is like buying an insurance policy. It reduces the risk for loss in the trade; but on the other hand, you have to pay premium on this insurance policy in the form of a higher entry price

<u>How long should we wait for?</u> So if we decide to look for another confirmation for the reversal, how should we go for it? It is very difficult to answer this question. Let me give some guidelines. For a BUY signal, we can go with a STOP LIMIT order at 1 to 2% *above* the <u>High price on the signal date</u>. So if the High price on the buy signal day was 12$, I would keep a limit order to buy at 12.21$ (I like to buy at 1 cent above the round number and sell at 1 cent below any round number). Similarly if I had a SELL signal for the stock which made the low of 20$ on the signal day, I would keep a STOP LIMIT order to short sell it around 19.79$.

What is a STOP LIMIT order? A buy Stop Limit order for a stock currently quoting at 11 dollar is to buy the stock at say 11.45$ or lower ONLY AFTER it has traded above the Stop price of say 11.45$. Please make note that the Stop price as well as limit price both are usually higher than the current price. A sell Stop Limit order for a stock quoting at 20$ might look like to sell the stock at 19.70 or above only after it has traded below our Stop price of 19.79.

Another version of STOP LIMIT order is a STOP MARKET order. Here, there is no limit but just a Stop price. As soon as the stock trades above (below) the Stop price, our Buy (Sell) order becomes a market order.

4. <u>Don't Trade</u>: Ignoring a trading signal and taking on action on it is also a recommended path in certain situations. (1) If one has his last three (or number as per his trading rules) in losses, he should not act however strong the trading signal he may be. He needs to do a favor to himself by giving some cool-down period in trading. (2) If one has more than 5 (or as allowed by his trading system) positions open, he should ignore any subsequent trading signals or he could close one of the existing open positions to get into a new one. One should always limit oneself within the maximum number of open positions allowed or within the maximum number of open positions in losses. (3) When a company is in bad troubles or when its stock is going thro precipitating fall, it is advisable to resist every temptation to do bottom-fishing at the very first signal you get. Wait for at least another or two more signals before you place a buy order in it. (4) Or if you are busy with work or family responsibilities,

or if you are going on a vacation in near future, it might be worthwhile not to add to the tension by opening new positions. Money should not be the end goal in life but it should just be a means to take us to happiness or to the goals in our life. .

For effective management of trading and emotions, I strongly recommend that you keep a trading diary. Before entering a trade, write down the stock, the quantity you are trading along with the signal or the reason behind it. Next to it, you should identify and note down the entry point, a target price and a stop-loss. This is basic information I want you to maintain but you may want to keep additional information (stock's primary and current trend, market trend, last Top, last Bottom, expected resistance/support, etc.) as you get more experienced in trading. This kind of trading log not only will save you from psychological traps that have ruined many traders but will also prove instrumental in improving your trading skills by learning from your own mistakes.

HOW TO TRACK PRICES/GENERATE PFP SIGNALS

As you know by now, PFP signals for trading are generated from four daily prices and volume. In this section, I am going to give you some ideas about how to track prices for various stocks. Surprisingly enough, at my end, it has been an interesting evolution. Initially I started using a notebook in which I had one page devoted to every stock. I followed around 10 to 15 stocks. On each page, I would write down daily prices for a particular stock at the end of market session everyday. Then I used technology to make this tracking of prices easy by writing a software application. Currently this tracking of prices and using them for various PFP signals is pretty easy for me. I can say that this part is currently on autopilot!

(For any new thing we learn, first we have to try to master it/memorize it. But as we practice it more, it gets hard coded into our brain. In the end, we can do that same thing unconsciously, without putting any real effort into it. When we first learn how to drive a car, we have to be conscious about so many things! After few years of driving, the unconscious mind takes over the job and we drive car sometimes without even noticing! Same thing goes here too. After looking at prices for last few years, I can see most of the PFP signals directly on the stock price charts.)

As such, for a beginner, there are three alternatives for keeping track of daily prices.

Manual Tracking: You can get a notebook and create seven columns as shown below on a page. You can reserve that page for the stock you are following. This is exactly how I used to write/track daily prices and volume in 1998.

In the first column, enter date for which you are recording prices. At the end of every week, add one line titled weekly for weekly prices. Next four column would have Open, High, Low and Close prices followed by Volume. The last column is used for notes, remarks and signals. This method works great for beginners. At the end of the day, update prices for every stock you are following.

See an example below with Google stock prices during early 2005.

Date	Open	High	Low	Close	Volume	Notes
01/24/05	188.69	189.33	180.32	180.72	14,022,700	

01/25/05	181.94	182.24	176.29	177.12	10,659,200	Strong Open but closes low
01/26/05	179.27	189.41	179.15	189.24	12,307,900	Prices above previous day close of 177.12. **Full Stop (BUY) Signal**
01/27/05	188.76	188.86	185.20	188.08	6,627,400	Volume pretty low!
01/28/05	190.02	194.70	186.34	190.34	12,208,200	
Weekly	**188.69**	**194.70**	**176.29**	**190.34**		**Weekly Reversal (BUY)**
01/31/05	193.69	196.36	191.72	195.62	9,596,700	
02/01/05	194.38	196.66	190.63	191.90	18,839,000	
02/02/05	215.55	216.80	203.66	205.96	**32,799,300**	Earnings/**Significant Day**- a BEAR DAY. Sell below 203 with SL at 217. Also a **Failed GAP. SELL**.
02/03/05	205.99	213.37	205.81	210.86	12,988,100	Just a Pull back? Resumption of uptrend?
02/04/05	206.47	207.75	202.60	204.36	14,819,300	Weak Open plus A bear day
Weekly	**193.69**	**216.80**	**190.63**	**204.36**		
02/07/05	205.26	206.40	195.51	196.03	12,960,400	Breaking down…
02/08/05	196.96	200.02	194.53	198.64	11,480,000	
02/09/05	200.76	201.60	189.46	191.58	17,171,500	
02/10/05	191.97	192.21	185.25	187.98	18,982,700	
02/11/05	186.66	192.32	186.07	187.40	13,116,000	
Weekly	**205.26**	**206.40**	**185.25**	**187.40**		
02/14/05	182.85	193.08	181.00	192.99	**38,562,200**	High Volume. Weak Open but Strong Close. **U TURN (BUY)**
02/15/05	193.60	199.84	193.08	195.23	25,782,800	
02/16/05	194.70	199.33	194.30	198.41	16,532,300	
02/17/05	197.83	199.75	196.81	197.90	10,414,400	
02/18/05	198.51	198.84	196.66	197.95	8,485,900	Can' cross 200! Volume also going down
Weekly	**182.85**	**199.84**	**181.00**	**197.95**		A Nice week **Weekly Reversal (Buy) but price already too high from Low**

Using Technology: Technology generally makes life easier and we can benefit form it here too. Yahoo!Finance offers great tools for investors and its portfolio tool may prove quite useful for tracking prices too. Underneath every portfolio you create there, you will see a link at the bottom of it to download that day's prices for the securities in that portfolio. Then if you are familiar with Excel, you can program the conditions of certain PFP signals and generate Buy/Sell signals.

After manually tracking prices for a month, I decided to use technology in 1998. Having software background, it wasn't much difficult for me. However as I had done no programming for many years, I knew my limitations. So I asked a friend to teach me Power-builder development tool (thanks to Tushar Anjaria) and then I was on my way! The program I had written would import prices for data files, store them in database and then at click of a button, it would run most of my signals on the stocks in my portfolio! I was able to follow around 50 stocks everyday. It was working but it started getting tedious and restrictive.

Screening Website- www.stockfetcher.com: Around a year back (Feb 2004), I came across this website- http://www.stockfetcher.com- which offered simple English sentences to screen stocks. First I thought it might be just for traders using standard technical indicators like RSI, ROC, MACD, etc. but I found that its framework included comparison of simple prices! I tried with one of my signals and I was able to screen stocks that had that signal on that day! It was exciting as I could now screen through all 5000 plus US stocks everyday. This was what I was precisely looking for. Since then, I have subscribed to their website and for a 25$ quarterly payment, I enjoy running my signals on every NYSE/NASDAQ/AMEX listed stocks at the end trading every business day.

Stockfetcher.com also offers certain FREE access to non-members. For a free user, there are two restrictions. A free user can create and run his screens (another name for signals) on prices 3 days old. So if today is Thursday, his signals would be running on Monday's prices. The other restriction is that a free user can't save his screens. I would recommend every reader to visit and take a look at the http://www.stockfetcher.com/ website.

While discussing signals in subsequent chapters, I am going to include my stockfetcher.com syntax for that particular signal. I believe this will prove to be helpful to augment understanding of various PFP signals. After you have studied a signal, go to the Stockfetcher.com and use the signal syntax to find stocks in which that signal took place (Remember, as a free user you would be looking at 3 day old data). Please remember one thing- when you run a signal in stockfetcher, you will need to keep in mind what we have discussed earlier in this chapter. The stockfetcher syntax is not able to take into consideration current market-trend, nature of the stock, pending earning releases, etc. For such things, you will have to use your judgment. Also if a screen lists 20 stocks, you will need to use your judgment to pick 1 or 2 best candidates from them. As I have mentioned earlier, a weak BUY signal in a good market (up-trend) is better than a strong BUY signal when the overall market is going down. So if the market is down, the SELL versions of PFP signals will have more probability of being right than BUY signals. The reverse will be true when the market is strong. BUY signals will be more accurate than SELL signals.

One more thing I want to highlight here. The syntax I have mentioned here is too tight. I keep changing various numbers in them to get more, or sometimes less, stocks on my radar. So please feel free to make changes to them. It is quite possible that some of you might come out with better syntax than what I am currently using or have mentioned in this book.

(**Disclaimer**: I am not trying to sell stockfetcher services to you nor am I going to get any kind of financial compensation from Stockfetcher. I am just trying to show you a tool/framework which you can use to manage your stock selection during trading.)

Quick Instructions on how to use StockFetcher.com:

1. When you are online, visit http://www.stockfetcher.com/ web site.
2. Once you are there, click on Create link in the Custom Filter box.

3. You will see a Textbox on the page that opens up. In that box, type in or ‘copy and paste’ the stockfetcher.com syntax given in the following chapters. As an example, for U-TURN (BUY Signal), type in the following statement without making any error.

   Show stocks where Close gained more than .15% percent over the last 1 day and open is more than .25% below the low 1 day ago and close is above the open 1 day ago and LOW reached a new 4 week low and volume gained more than 20% over volume 1 day ago and volume is above 200000

4. Click on the **Fetch Stocks** button underneath the text box.

5. Stockfetcher.com’s engine will run above conditions on every stock and will generate a list of stocks who pass every test mentioned above! There will be a list of stocks on the page in which **U TURN (BUY)** was generated (3 days back if you are a FREE USER of Stockfetcher.com). Hint: If there is no stock in the list, there may be either no stock passing our U TURN (SELL) signal on that day or there could be some typing mistake.

6. Now click on the 3m (3 Month Price Chart) link next to each stock in the list and see how the stock has been moving over the last 3 months. You can also look at a 6m (6 months) or 1y (1 year) charts.

PFP SIGNAL TERMINOLOGY

PRICES: As we know, four daily prices form a critical input to our signals. For various prices, we will use a three-character symbol, as shown below.

1. The first character is optional and assumes T for Today, P for Previous, and Q for the day or week before previous.

2. The second character assumes one of the following values: D for Day, W for Week and M for Month.

3. The last character takes a value based on what price it is: O for Open, H for High, L for Low and C for Close.

Here is a list of acronyms that would be used throughout the book. They are easy to remember.

TDO = Today’s Open price
TDH = Today’s High price
TDL= Today’s Low price
TDC= Today’s Close price

PDO= Previous Day’s Open price
PDH= Previous Day’s High price

PDL= Previous Day's Low price
PDC= Previous Day's Close price

TWO= This Week's Open price
TWH= This Week's High price
TWL= This Week's Low price
TWC= This Week's Close price

PWO= Previous Week's Open price
PWH= Previous Week's High price
PWL= Previous Week's Low price
PWC= Previous Week's Close price

Similarly replacing P above with Q would give us respective prices for the day or week before previous. So QWO means the Week before Previous Week's Open price.

QWO= Previous to Previous Week's Open price
QWH= Previous to Previous Week's High price
QWL= Previous to Previous Week's Low price
QWC= Previous to Previous Week's Close price

Please see in the weekly price table above, what these symbols mean. These symbols are put next to weekly prices.

Few more terms used in this book are as following.

BULL DAY: A day in which a stock has the Closing price higher than the Opening price is called a BULL DAY. What is the importance of this? It is a quick method to know what happened *during* the day. A Closing price higher than the Opening price does indicate that the Demand was more aggressive during the day than the Supply. This fact taken by itself does not give solid information but when combined with other tests, it is powerful supporting evidence.

BEAR DAY: A day in which a stock has Closed lower than its Opening price. It indicates that during the trading day, the Supply was more powerful/aggressive than the Demand. It is a negative indicator for a long position. Like a BULL DAY, this assumes greater importance when it is used with other indicators. Nonetheless it is important to know what a BULL DAY and a BEAR DAY mean.

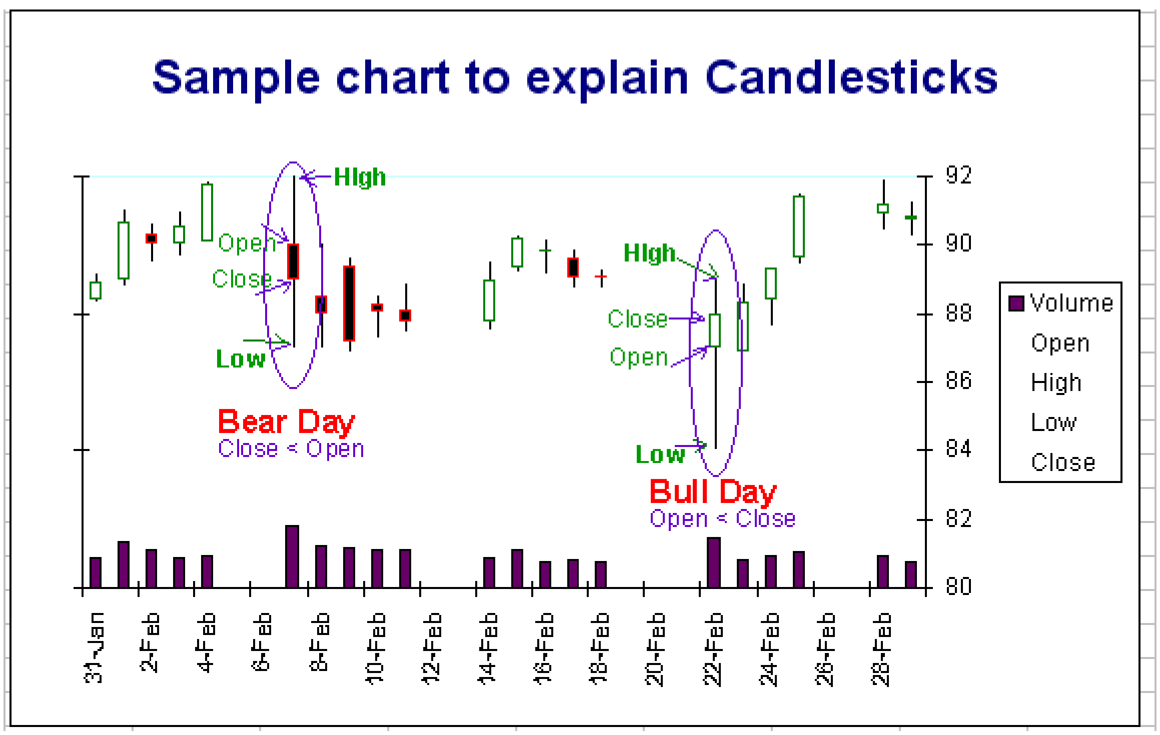
STRONG OPEN: At the beginning of the session on any day, most stocks start (or open for) trading around the Close price of the previous trading session. However there are days when the Open price is significantly different than the Close price of the previous day. When the Open price today is higher than the Close price of the previous day, we will call it a STRONG OPEN. This is a measure used in PFP signals to capture changes in sentiment. A STRONG OPEN tells us that market participant are more positive about the future price movement of the stock.

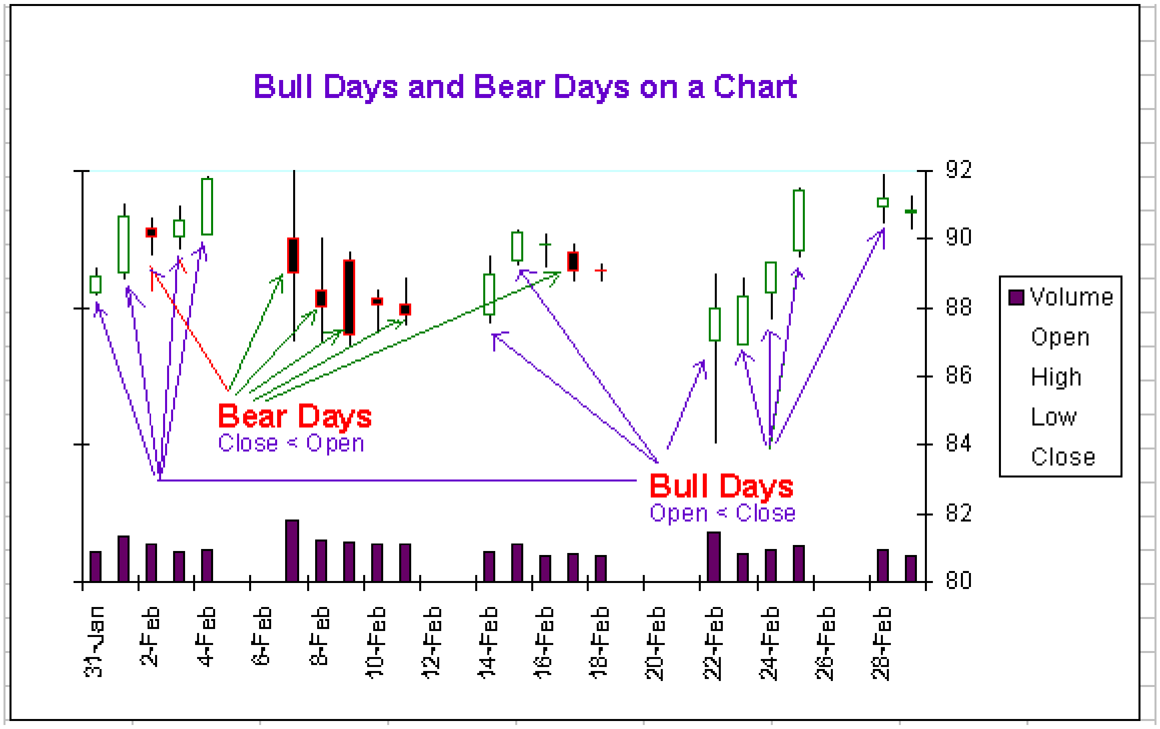
WEAK OPEN: Similarly, when the Open price on a day is remarkable lower than the Close of the previous day, we will call it a WEAK OPEN. It usually tells us that market participants are thinking more negative about the stock than what they thought at the close of the previous day's trading session.

Candlestick charts: While explaining various signals, I am going to use Candlestick charts. So let me take few moments to show you how to read various daily prices on a Candle Stick chart. Unlike traditional stock charts that are either a line chart of the Closing stock prices or a bar chart, a Candlestick chart has all four prices, Open, High, Low and Close, reflected.

A candle has two parts: It has a body and two lines attached to it. The high point of the UPPER LINE is the High price for the day or week or the month depending on the chart you are looking at. Similarly the low point of the LOWER LINE is the Low price. The upper and lower points of the BODY reflect Open and Close prices depending on the type/color of the candle. The body is either filled (dark) or empty (white). Please see the chart below. When the body is filled (dark), the upper edge of the BODY (and not the line) is the Open price and the lower edge is the Close price. In other words, when the Closing price is lower than the Opening price, the body is dark to indicate that it was a BEAR day. Similarly when the body is empty (white), the upper edge reflects the Closing price and the lower edge reflects the Opening price. So such empty (white) bodied candles mean a BULL day, reflecting the fact that the Closing price was higher than the Opening price.

See a Candle Stick chart below for better understanding:




Bull Days and Bear Days on a Chart
Bear Days
Close < Open
Bull Days
Open < Close
92
90
88
86
84
82
80
Volume
Open
High
Low
Close
31-Jan
2-Feb
4-Feb
6-Feb
8-Feb
10-Feb
12-Feb
14-Feb
16-Feb
18-Feb
20-Feb
22-Feb
24-Feb
26-Feb
28-Feb

Chapter

6

TREND REVERSAL SIGNALS

Now we are beginning our study of various trading signals. In this chapter, I am going to explain some of my most favorite signals- Trend Reversal (TR) signals. In subsequent chapters, I will show you some Trend Continuation (TC) and Side-ways trading signals. In the end, we will look at some chart based powerful signals that can be easily identified on price charts.

TREND REVERSALS

Profit From Prices Trend Reversal signals are very powerful trading signals and offer attractive trading opportunities. They usually offer large profit potential with a close stop-loss. This means when a PFP trend reversal signal turns out to be right, it is likely to generate substantial profit. However, when it fails, the trading position can be closed with a small loss. Also PFP signals catch most of the trend reversals and the changes in market moods. However before we explore PFP trend reversal signals, I want to highlight the importance of previous chapter in this book. As mentioned in the previous chapter *Chapter-5 Introduction to Signals*, PFP signals come in different degree of strengths and they produce best results when used prudently. Hence I strongly recommend you to read Chapter 5 very carefully to understand how and when to apply and use a PFP signal. With those guidelines, you will be able to avoid certain positions that are more likely to result into losses.

When a reversal signal takes place after a long trend, it usually points to a major primary trend reversal. If the new trend indicated by the PFP reversal signal is also in the direction of the overall market trend, our signal is in Strong Form. However if it takes place after a trend of few days, say 4 to 20 days, or has some conditions fulfilled in a weak fashion, it should be usually taken as pointing to the beginning or an end of Reactions/Corrections. I will refer to it as Weak Form of the signal.

HOW TO FIND TREND REVERSALS

Most ordinary investors/traders use ‘gut feelings’ when looking for a trend to reverse. If the price of a stock has come down significantly over last few days or weeks, people start seeing a ‘value’ in it. They *expect* the decline to stop soon. Similarly, if a stock has gone up too high too rapidly, people take it as an overpriced stock and they *expect* its price to drop. My feeling is that such situations offer traders a high degree of confidence and comfort. This is because one is buying something cheap for which many investors might have paid a high price just a few days ago! As such, there is nothing wrong with this strategy. It is widely used by value-oriented investment managers. However for a trader, there is quite a mismatch between his objectives and Value strategy. Sometimes a stock that has just dropped in value might be just getting out of favor, and it may take several weeks if not months for it to regain its lost glory! Hence I strongly recommend you to control your emotions or desire to call a stock’s price too high or too low. You should stay away from predicting trend reversals just based on a large drop or sudden rise in price. When a stock is going up, it is going up because other investors/traders are willing to pay higher price for it. They might have information that most other traders may not be aware of! This shows strength- a strong demand. In such a situation, instead of guessing when sellers will gain power and cause the price to drop, it makes sense to ride the train than to stand in front of the locomotive! If you find the price too high or too low, you may want to abstain from taking a position. However for taking short or long positions contrary to the current trend, you should use some formal indicators or signals and just in few minutes I will show which signals are these.

Every trader should keep two things in mind: **A TREND IS A FRIEND**, and **TRENDS ARE LIKE CRAZY RIVERS**. It is easier to swim with a trend than against it. So unless a trend reversal signal discussed in this chapter or some other method objectively indicates a trend reversal, you should resist every temptation to call the current price of a stock the Bottom or the Top just based on some 'gut feelings'. The price of any stock is never too expensive or too cheap. Market dynamics and millions of people in the market make sure every stock is traded at what they think is the fair price of it. To know if a stock is expensive or cheap, you would have to know its *value*. For finding value, you would need more than just the prices - the company, its products, management, industry outlook, competitors, -the list is endless. Once you find what its true value is (in your eyes), then only you can say if the current price is expensive or if it is cheap. This is more than just listening to the prices! As I have mentioned earlier in this book, for profit in stock trading all that is needed is just the current stock prices. Watching a stock move; and, if various conditions are fulfilled, acting on the trading signal by taking, or closing, a position is all one needs to be doing. Valuations are good for long-term investors. They are good for an institutional manager who has to convince his boss that he is doing right things. For a trader who is riding a stock for a few days, valuations do not matter much in most cases. What matters most is the changes in demand and supply for the stock.

Besides PFP signals, there are many trend reversal indicators in use, like ROC, MACD, Moving Averages, %Williams, etc. They fall into two classes - leading or lagging indicators. The problem with leading indicators is that they fail quite often. A ROC or RSI indicator may stay in the oversold position for weeks and months before the stock price starts climbing up. On the other hand, lagging indicators are sometimes too outdated for trading! They take few days to confirm a reversal which for a trader could be too much to sacrifice. The Profit from Prices signals over-come these problems. PFP method gives signals on the day the stock is changing its course and they do this by looking at changes in the underlying demand and supply. The advantage is - one can exploit the significant part of the impending new trend and that too with a small, calculated risk. Most PFP signals offer potential for Big Gain at a Small Risk, which is helpful in order to be able to maximize overall trading profit.

Every trend reversal signal in this chapter will be discussed for two opposite trends. First, I will show how to apply it in a bear market (down-trend) to capture trend reversal from a bearish (down-) trend to a bullish (up-) trend. This will be labeled with suffix **(BUY)** because it gives a Buy signal. Then I will discuss the same signal in the reverse market conditions- in an up-trend, around Top prices, to identify reversals to a down-trend - from bullish sentiment to bearish sentiment. This will have suffix of **(SELL).** (BUY) signals can be used to close/cover existing *short* positions and/or to initiate fresh *long* positions. Similarly, (SELL) signals should be used for closing existing long positions and/or to initiate fresh short positions.

TYPES OF TREND REVERSALS

As per PFP theory, trend reversals take place either (i) during market hours when trading is taking place, due to sudden emergence of powerful buying or selling, or (ii) outside market hours (when trading is not taking place or the Market is closed) when some powerful news or event takes place. We can call these reversals intra-day and inter-day trend reversals respectively.

Intra-day reversals take place due to two reasons. First due to the release of some significant economical, political or general market related news or event(s) during market hours when trading is going on. This causes many traders to change their outlook on this stock. However some Intra-day reversals take place when influential traders, investors and/or institutions start buying/selling the stock to take advantage of its currently too high or too low stock price.

Intra-day trend reversals are the most powerful reversals and they catch most of the ordinary investors and traders by surprise. This total change in sentiment is reflected in prices but only a few market players are able to comprehend what is happening and are able to take advantage of such reversals **on the very same day**. To name a few signals that fall in this category and about whom we are going to learn are U-TURN, TURN AROUND, REVERSE and WEEKLY REVERSALS.

Inter-day reversals take place when markets are closed. They are mostly due to the same types of news/reasons/events that cause intra-day reversals but here the news/reasons/events are happening over night or when the market is closed. Unlike intra-day reversals, these reversals often take place due to some company specific news or announcement of earnings. In the USA and also in the most other countries, companies are prohibited from releasing material information during market hours. So most of such information is disseminated before or after the market hours. Then when the market opens and the stock starts trading on the next morning, there is usually a sudden jump or a fall in its price. However a higher or lower Open price is not a sufficient condition to term a day as a trend reversal day. One needs to watch the entire day’s trading to see if the real buying and selling confirmed the change in sentiment indicated by the Open price. Some of the Inter-day signals, like JUMP START and FREE FALL, are also powerful indicators of trend reversals.

There is one important thing to keep in mind about any type of trend reversal signal. There must be noticeable increase in volume since the stock reached the high or low price from where it turned its direction. This makes Volume figures as important as the four daily prices for trend reversal signals.

Let us now look at our first PFP signal- U- TURN.

SIGNAL R1: U-TURN

U-TURN (BUY)

U-TURN (BUY) is one of my most favorite signals. As mentioned earlier, the (BUY) version of U-TURN takes place when a stock is in a down-trend and is likely to enter into an up-trend. It signals possibilities about the start of an up-trend.

Assume a stock is going down for quite some time. The following are quotes for the latest two days:

Today 22, 27, 21, 26
Yesterday (Previous Day) *25*, 26, **23**, *24*

Yesterday, the stock opened at 25$, touched a high of 26$ and a new recent low of 23$, and at the end of the day it closed at 24$. Now today, when market opens, this stock opened at 22$ (a price lower than the Previous Day's Low price of 23$) and started going down. Now when it is trading as low as 21$, there are signs of fresh buying which pushes the price higher. Not a big thing so far because this kind of buying could be seen several times during any trading session. However, when the stock manages to trade higher than today's Open price or 22$, we need to be vigilant for a likely trend reversal. Now if the stock keeps going up and closes for today at say 26$, which is higher than both Previous Day's Open price of 25$ and the Previous Day's Close price of 24$, we have a trend reversal signal! The stock that has been going down for the last few days and also during the first few hours today, somehow closed with a happy ending and a strong Close price. This reflects a 180-degree change in the sentiment. Hence we will call this signal a U-TURN (Buy) signal.

What makes U TURN a powerful Trend Reversal signal? As we know, when a stock is in a downtrend, sellers out-number or out-power buyers. In such circumstances, it is normal for the stock to keep making lower *Low* prices as time passes. This reflects bearish, negative sentiment or outlook for this stock. Now when trading starts for today, this stock opens at a price lower than Previous Day's *Low* price. This is common for any stock that is going down and it just indicates the continuation of the negative sentiment. Now if at some point in time during the session, the stock stages a reversal and starts trading higher. This is likely due to an emergence of fresh demand at current low price of the stock. Now how can we determine that the stock is really staging a reversal? To answer this question, the following tests can help us differentiate a strong reversal from a temporary emergence of buying. First, there has to be a noticeable increase in volume since this turning point. Second, it has to keep going up and cross Previous Day's *Open* and also the *Close* price. If both these conditions are fulfilled, we can be sure that the buying in the stock has been real and powerful. To take advantage of the currently low stock price, some players seem to have started buying it decisively despite the strong negative sentiment held by most other players. This buying must be significant because it not only absorbed what most players had to sell/offer, but buyers kept asking for more stocks even at higher prices. Today's demand not only absorbed the selling pressure, but it even pushed the price higher than the prices of the Previous Day! Isn't this a convincing reversal in stock prices?

This is a complete U-TURN in the stock price trend and now with a Stop-loss at Today's Low price, one can start taking long positions.

Key Points to remember: Current Trend- Down. Weak Open. Strong Bull Day. Increase in Volume.

Conditions:

1. The stock has to be in a continued downtrend.

2. Today's Low price (TDL) has to be the LOWEST price for the stock over the last few days. (If it is the lowest for the last few weeks, we are likely to have a strong *major trend* reversal signal- a strong form of U-TURN. However if Previous Day's Low price is the lowest for only the last three to ten days, we have a signal that is more likely to mark the beginning of a Correction or the end of a Reaction – a weak form of U-TURN).

3. **WEAK OPEN**: Today's Open price (TDO) has to be LOWER than Previous Day's Low price (PDL).
   TDO < PDL (The more the difference between TDO and PDL, the more powerful the signal is going to be)

4. Today's Close price (TDC) has to be HIGHER than Previous Day's Close price (PDC). **TDC > PDC**

5. Today's Close price (TDC) has to be HIGHER than Previous Day's Open price (PDO). **TDC > PDO**

6. Today's Volume has to be decisively HIGHER than the normal volume over the last few days or Previous Day's volume. If you don't see a jump in the volume today, the signal loses some of its strength.

Stockfetcher.com syntax: "Show stocks where Close gained more than .15% percent over the last 1 day and open is more than .25% below the low 1 day ago and close is above the open 1 day ago and LOW reached a new 4 week low and volume gained more than 20% over volume 1 day ago"

Here is an example: See the prices below for PCS (Sprint PCS Co.) during May 2003.

When you look at the Chart, you will notice that the stock is in a downtrend (Condition 1). On the 16th, the stock opened at 3.50, which was lower than Previous Day's Low of 3.55 (Condition 3). During today's trading stock touched a low of 3.50 that was sort of the lowest price for the last five to ten days (Condition 2). At the end of the day, however the stock closed at 3.80, which was higher than Previous Day's Open (3.67) and higher than Previous Day's Close price (3.55) (Conditions 4 and 5). As you see, the volume on May 16th was also higher than the previous few days' volumes (Condition 6). Thus all the conditions were fulfilled here for a perfect U-TURN (BUY) signal.

Daily Prices with Volume for PCS

16-May-03	3.5	3.81	3.5	3.8	23705400
15-May-03	3.67	3.71	3.55	3.55	12393200
14-May-03	3.78	3.82	3.64	3.67	10333600
13-May-03	3.8	3.84	3.75	3.78	5211000
12-May-03	3.75	3.86	3.75	3.85	9816100
9-May-03	3.82	3.84	3.78	3.84	6566900
8-May-03	3.79	3.84	3.75	3.82	3851600

ACTION:
There are two primary variations of this signal as regards to Condition 2. The signal can take place at the end of a major trend as described above for PCS or it can take place at the end of a Correction or a Reaction.

In the first scenario, U-TURN (BUY) - in a Bear Market - is usually a very powerful signal and has the strength to change the current major trend from down to up-trend. Here you can expect the stock price or index to go up to the tune of 20%! So as soon as you have a U-TURN (BUY) in a major trend, you should be convinced of a trend reversal; and close short positions and you can also initiate fresh long positions to take advantage of this new emerging up-trend. So here in the case of PCS, Today's Low price was the recent lowest price so the U-TURN (BUY) today was likely to end the current down trend and initiate an up trend in PCS stock prices.

In the second variation, U-TURN takes place somewhere in the middle but not after a sustained trend. So Today's Low price may be the lowest price for only the last three to ten days, but not for the last few weeks! So the signal here may just mean the beginning or end of a Reaction/Correction. So what do you do here? You should not expect as much gain as you would in the first variation, but you can make new trades to take advantage of the price movement over the next three to ten days. If you understand major trends and Reactions/Corrections in prices, you will be able to distinguish these two variations and trade accordingly.

STOP-LOSS

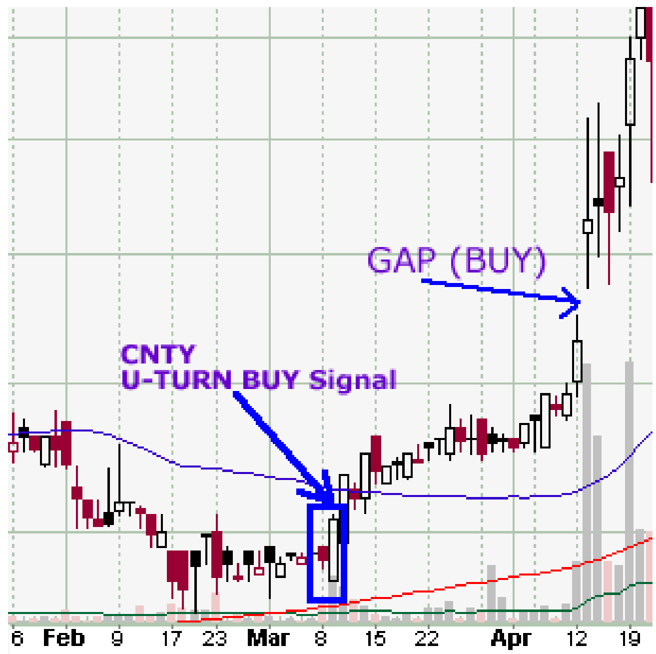
As with any trading system, you must be alert to getting out of a position if the stock moves contrary to your expectations. The U-TURN signal works best most of the time but not always. If I were pressed for a figure, I would say it is correct around 75% of the time. So you should be watchful to protect yourself by selling your long position if the prices start going down. When to quit the position and book losses? It really depends on your risk-tolerance but I would advise you to keep a Stop-loss at Today's Low prices (minus 1%). Here in the case of PCS, we would keep a Stop-loss at 3.47.

See on the full Chart of PCS below what happened after the signal took place:

After giving a strong reversal U-TURN (BUY) signal on the 16th, the stock was a little idle for the next two days. This was an opportunity for people like us to take a long position.

Then on the next day the stock jumped up again and took us to our target of 4.20. On the next day, the stock continued its up movement and closed around 4.50 and then rested for some time. Then after a few days it restarted its journey and ultimately went as high as 6.50 within a month!

The beauty of this signal is that it tells you to take a position on the very day the stock is changing its course. You don't need a computer or any software to identify this or most other PFP signals. You can identify them just by looking at the daily prices of the stock on some websites. You can go Online and watch (and also download from the link at the bottom of the page) current as well as historical prices or charts on many website. One such website it Yahoo! Finance (http://finance.yahoo.com/q/hp?s=AMZN)

EXAMPLE 2: Look at the chart of CNTY below for one more example of U-TURN (BUY) signal. Take note of the increase in volume on the day of the U-TURN (BUY) signal. An explosive up-trend in the prices was seen immediately after the signal, which gave an 80% return over just a few weeks! Who would not like to ride this kind of trend from **the very first day** it begins? (You have not learnt about GAP signal yet but come back to this page after you have studied it.)	 "Chart courtesy of StockCharts.com"

U-TURN (SELL)

Now it is time to look at how this powerful signal works in a reversed situation. Like the U-TURN (BUY) signal in a Bear market, U-TURN (SELL) signal is equally powerful to indicate a change in trend when a stock is going strong and is making new higher prices (in a Bull market). All of a sudden in a Bull trend the stock puts up a disappointing down day and surprises most people. Many people think this as just a Reaction and expect the stock to resume its continued ascending movement soon; but it does not happen most of the time when the reversal conditions of the U-TURN (SELL) signal are met.

Here are the conditions for the U-TURN (SELL) signal with Bearish implications in a Bull market. Please note that the signal discussed here takes place when the stock is in a up-trend (Bull market) but the signal actually indicates that the stock is about to enter into a Bear market or a down trend.

Key Points to remember: Current Trend- Up. Strong Open. Strong Bear Day. Increase in Volume.

Conditions:

1. The stock has to be in a continued Up-trend.

2. Today's HIGH price (TDH) has to be highest price (TOP) for the stock in the last few days. **(If it is the highest for the last three or more weeks, we have a strong form of a U-TURN (SELL) signal. If it is the highest for the last three to ten trading days only, we have a weak form of U-TURN (SELL) signal. The strong form indicates a likely trend reversal for the current major trend; and a weak form is related to just the start of a Reaction or the end of a Correction.**).

3. Today's Open price (TDO) has to be HIGHER than Previous Day's High price (PDH). **TDO > PDH** (The more the difference between TDO and PDH, the more powerful the signal is going to be)

4. Today's Close price (TDC) has to be LOWER than Previous Day's Close price (PDC). **TDC < PDC**

5. Today's Close price (TDC) has to be LOWER than Previous Day's Open price (PDO). **TDC < PDO**

6. Today's Volume has to be decisively HIGHER than the normal volume of the last few days or Previous Day's volume. If the above conditions are fulfilled, you will mostly see a decisive jump in stock volume today. If you don't see a jump in the volume today, the signal loses some of its strength.

Stockfetcher.com syntax: **"**Show stocks where Close dropped more than .15% percent over the last 1 day and open is more than .15% above the high 1 day ago and close is below the open 1 day ago and high reached a new 3 week high and close is above 2 and volume is more than 20% above volume 1 day ago and volume is above 500000**"**

ACTION:

There are two primary variations of this signal with regard to Condition 2. The signal can take place at the end of a major up-trend or it can take place at the end of a Correction.

In the first scenario, U-TURN (SELL) is a very powerful signal and has the strength to change the current major trend from up-trend to downtrend. Here you can expect the stock price or index to go down to the tune of 20%! So as soon as you have a U-TURN (SELL) in a major up trend, you should be convinced of a trend reversal; and you should close Long positions and you can also initiate fresh Short positions to take advantage of this new emerging down-trend.
In the second variation, U-TURN (SELL) takes place somewhere in the middle of but not after a sustained trend. So Today's High price may be the highest price for the last three to ten days, but not for the last few weeks! So the signal here may just mean the beginning or end of a Reaction/Correction. So what do you do here? You should not expect as much drop in prices as you would in the first variation, but you can make new trades to take advantage of the price movement over the next three to ten days. If you understand major trends and Reactions/Corrections in prices, you will be able to distinguish these two variations and trade accordingly.

STOP-LOSS

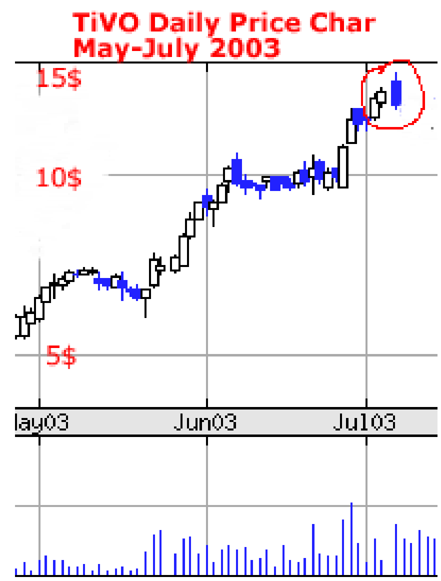
When to book losses in U-TURN (SELL) signals? It really depends on your risk-tolerance but I would advise you to keep a Stop-loss at Today's High prices (plus 1%).

Let us now take an example of a valid U-TURN (SELL) signal :

Daily Prices with volume for TIVO

7-Jul-03	14.05	14.51	12.75	*12.88*	3768100
3-Jul-03	*13.05*	13.75	12.78	*13.5*	1194300
2-Jul-03	12.34	13.39	12.23	13.22	2675400
1-Jul-03	12.35	12.35	11.75	12.22	1048200
30-Jun-03	12.75	12.75	11.75	12.09	2388100

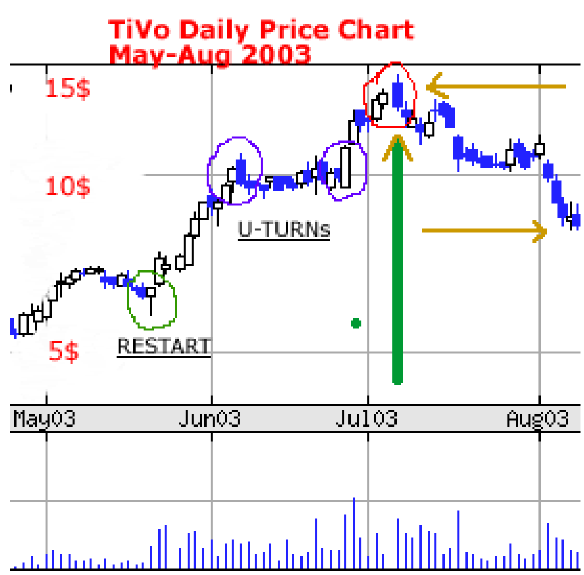
As you see on the Chart to the right, the stock was making new high prices day after day (Condition 1). However on July 7th, TiVo opened at 14.05, which was higher than the 13.75 of Previous Day's High (Condition 3). Also Today's High of 14.51 was the highest price for TiVo over the last few weeks (Condition 2). After touching a high of 14.51, it started going down during the day and closed at a price that was lower than Previous Day's Open as well as lower than the closing price (Conditions 4 and 5). Volume was also very high on that day (Condition 6).



Thus we had a perfect U-TURN (SELL) signal on TiVo. If you were following this signal, you could have easily sensed the profit taking that happened in TiVo on that day and also would have sensed the intensity of supply/selling in the stock. It was obvious that despite the recent up-trend, sellers did not mind selling positions or shorting the stock even at lower prices during the day!

Let us look at the Chart on the right to see what happened after the U-TURN (SELL) signal occurred in the stock.

After making a TOP on the U-TURN (SELL) day at 14.50, the stock entered into a downtrend and went down to touch 8.00 in a week.



I would also like to mention one more U-TURN (SELL) signal on the Chart above. If you look at the beginning of June, there was a U-TURN (SELL) signal at a previous TOP price (slightly above 10$). This U-TURN signal did end the up-trend but the stock did not enter into a clear downtrend here. It just got into a Side-ways-trend. Thus you can see how U-TURN temporarily stops a major trend and starts a Reaction. Now if you look a little further on to the right (toward the end of the Side-ways movement), you will see a big white candle. This was probably another U-TURN (BUY) signal with Bullish implications (from bear to bull trend). However the day's low price wasn't the lowest price for the last few weeks! So it was a weak U-TURN (BUY) signal (Variation 2 discussed above) and was just pointing to the end of a Reaction and a resumption of the stock price movement in the direction of the major trend- an up trend.

We have not yet discussed RESTART and TURN-AROUND signals but I would like to show them on this chart. There was a RESTART signal at the end of the first Reaction in the Chart above- around the 6$ level. See how it marked the end of the Reaction and restarted the price movement in the direction of the major trend! Also there is the failure of a TURN-AROUND signal on June 30th (three days prior to the major U-TURN (SELL) signal we have discussed in the beginning of the section).

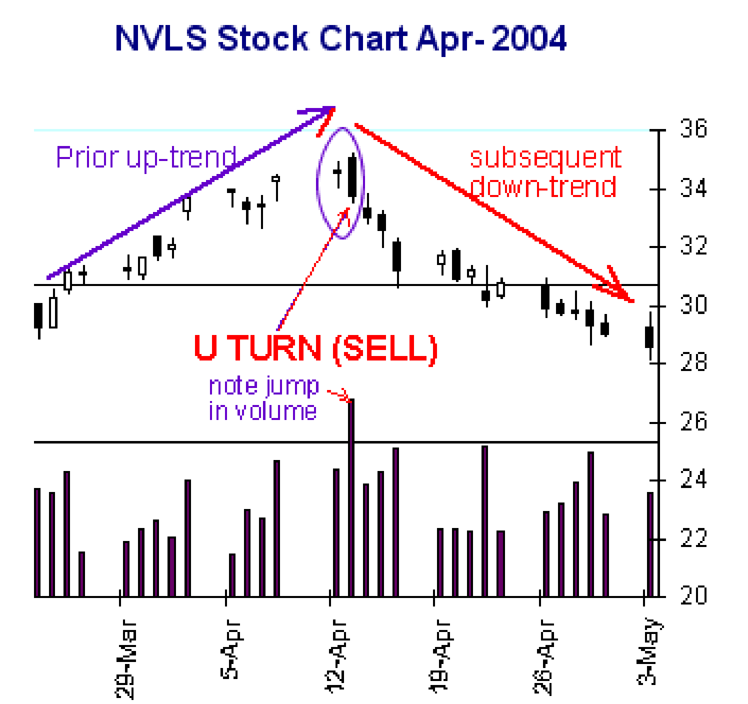
Let us now look at one more example of U-TURN (SELL) Signal. Look below at the chart of Nike, inc. (NKE) for the U-TURN (SELL) signal. As soon as we had our signal, NKE showed the end of its up-trend and entered into a nice downtrend. There wasn't any bad news about the company which prompted the down-trend but it was probably the action of some influential investors who might have seen this high price of 77$ as an opportunity to book profit or maybe they were smart hedge funds or short sellers who had started selling NKE!!! It does not matter to us who was behind this sell-off but our U-TURN (SELL) signal did tell us about this beginning of the fall in prices on the day when the stock hit its High price!

We have not yet learned about TURN AROUND (SELL) signal but you will find an instance of that signal a few days prior to U-TURN (SELL) signal on the chart. As you can notice, the TURN AROUND (SELL) signal was also effective and its stop-loss was never triggered. Thus, after TURN AROUND (SELL) signal, we had U-TURN (SELL) too after a few days at the same Top prices, and therefore was money for us in short selling NKE during April 2004!

"Chart courtesy of StockCharts.com"

Here is one more example of a U-TURN (SELL) signal.

As shown on the Chart on the right, NVLS stock was in a strong up trend. When it was around the High of 35$, the company came out with stellar earnings. The stock was traded higher in after-markets. It also opened strong on the next day but closed significantly lower with a significant increase in volume. This was our U-TURN (SELL) signal. See on the chart, how the stock changed its course and touched a Low price of 28$ within 2/3 weeks!



SIGNAL R2: JUMP-START

JUMP-START (BUY)

JUMP-START (BUY) is also a very powerful trend reversal signal. Unlike U-TURN, JUMP-START is an inter-day reversal signal.

To understand this signal, let us assume that a stock XYZ is in a down-trend and has the following prices for the last two sessions:

Today	**20.05**	23.84	19.85	23.24	32,016,200
Previous Day	18.21	**19.31**	16.85	17.02	4,088,100

XYZ opened yesterday at 18.21, made a High of 19.31 and a Low price of 16.85 and closed weak at 17.02$. As XYZ is in a down-trend, it would normally be expected to open at around previous day's close or lower. However today, it opened above 20$ which is significantly higher than where it closed yesterday. In fact, the Open price is even higher than Previous Day High price of 19.31$. Unless there was some powerful reason, no one would want to pay such a high price for a stock in a down-trend! With respect to price of 17$ yesterday, why would people suddenly show willingness to pay too high a price for it? Something must be going on in the stock…

The strong open is no doubt positive for XYZ but it is not enough to assess reversal of trend yet. The buying interest at the open of the market has to be sustainable. Buyers have to keep demanding this stock throughout the session. Now as we see from the prices, during the entire session today, XYZ stayed above 19.85 which is significantly higher than Previous Day High of 19.31$. Not only that, there was a significant jump/increase in trading volume today. All these things together do indicate a possibility for a reversal in sentiment today accompanied by a strong demand for the stock. It is sort of safe to assume the stock is showing a reversal of trend from recent down-trend to an up-trend.

Here is what makes this JUMP-START (BUY) is a powerful signal. The stock is in a downtrend means it is making lower Low prices over most recent days. This indicates that the sentiment or general outlook on this stock is bearish. However when this stock opens for trading today, it starts trading at a price that is higher than the High price of the previous day. What does this mean? It means that something must have happened overnight or in the morning that has caused a sudden and significant change in Demand and/or Supply for this stock! Many players in this stock seem to have changed their view/outlook on the stock. A very strong Open price indicates the possibility of a change in sentiment but this is just the first half of the story. It is not sufficient or conclusive evidence enough to assume a trend reversal! For confirmation, we would like to see the stock stay above Previous Day's High price throughout the day and we will also like to see it close higher than Today's Open price. If all conditions mentioned above are fulfilled, we can be sure that the positive sentiment at the time market opened was for real. The demand that caused the stock to open higher today was unabated during the entire market session. Informed and/or influential market participants' are now buyers in this stock in a decisive manner despite the general negative sentiment (selling) up till the previous day. They not only absorbed what sellers had to sell but they kept demanding the stock even at higher prices throughout the day. This is like a JUMP-START event that has charged up a declining stock. Based on this signal, we can expect the stock to end its current downtrend and enter into an Up-trend.

Conditions: Here are the conditions required for the JUMP-START (BUY) signal:

1. The stock has to be in a continued downtrend.

2. Previous Day's Low price (PDL) has to be the LOWEST price for the stock over the last few days. (If it is the lowest for the last few weeks, we are likely to have a strong *major trend* reversal signal- a strong form of JUMP START. However if Previous Day's Low price is the lowest for only the last three to ten days, we have a signal that is more likely to mark the beginning of a Correction or the end of a Reaction - a weak form of JUMP START (BUY)).

3. Today's Open price (TDO) has to be HIGHER than Previous Day's High price (PDH). **TDO > PDH** (The more the difference between TDO and PDH, the more powerful the signal is going to be)

4. Today's Close price (TDC) has to be HIGHER than Today's Open price (TDO) making it a BULL DAY. **TDC > TDO**

5. Today's Low price (TDL) has to be HIGHER than Previous Day's High price (PDH). **TDL > PDH** (A GAP condition)

6. Today's Volume has to be decisively HIGHER than the normal volume for the last few days or Previous Day's volume. If the above conditions are fulfilled, you will mostly see a decisive jump in the volume today. If you don't see a jump in the volume today, the signal loses some of its strength.

Key Points to remember: Current Trend- Down. Strong Open. Bull Day. Increase in Volume.

Stockfetcher.com syntax: " Show stocks where open is more than .10% above the high 1 day ago and close is above open and low 1 day ago reached a new 2 week low and low is above high 1 day ago and high is more than 3% below a 10 week high and volume is above volume 1 day ago and volume is above 500000 "

Let us take an example now. See the prices below for EXTR (Extreme Network) during July 2003.

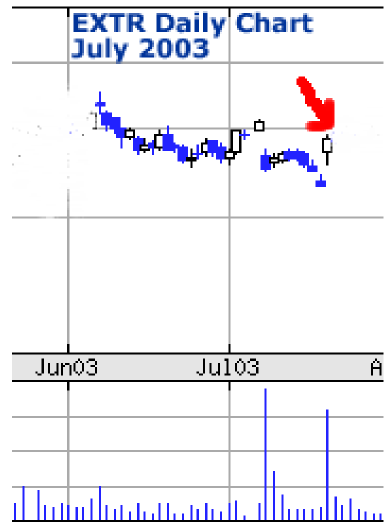
Daily Prices with volume for EXTR

18-Jul-03	5.44	5.84	*5.1*	5.75	32016200
17-Jul-03	4.75	*4.88*	4.66	4.67	4088100
16-Jul-03	5.06	5.21	4.96	5	3285800
15-Jul-03	5.36	5.4	5.09	5.12	3183100
14-Jul-03	5.43	5.45	5.24	5.27	3613200
11-Jul-03	5.44	5.45	5.22	5.29	3063900
10-Jul-03	5.2	5.44	5.15	5.36	7413300

As seen from the prices in the Chart on the right, EXTR was in a downtrend prior to July 18th(Condition 1). On the 18th, the stock opened at 5.44, which was higher than Previous Day's High of 4.88 (Condition 3). During the entire session today, EXTR stayed higher than 4.88, the high price of July 17th

Here is the chart of EXTR

(Condition 5). At the end of the day, EXTR closed at 5.75 which was higher than the opening price of 5.44 making it a Bull Day (Condition 4). Also, the low price 4.66, of the previous day (Jul 17th) was the lowest price for the stock for the last few days (Condition 2). As you see, the volume on July 18th was also higher than the previous few days' volume (Condition 6).



Thus we had all six conditions nicely fulfilled on July 18th for a perfect JUMP-START (BUY) signal.

<u>ACTION:</u> This JUMP-START (BUY) comes with two forms, weak or strong, primarily with respect to Condition #2. If Previous Day's Low price is the lowest price for the last *few* weeks and/or there was a significant jump in volume on the signal day, it makes it a STRONG form JUMP-START (BUY) signal. However if Previous Day's Low price is the lowest price only for the last three to ten days, it is a WEAK form of the JUMP START signal.

A STRONG form of JUMP-START (BUY) signal indicates the reversal of the primary trend from a down-trend to an up-trend. Hence all existing short positions should be closed as soon as possible and fresh long positions can also be initiated with confidence. As a rule of thumb, one can expect the stock to appreciate by around 20% or more over the next few days/weeks in response to a STRONG form JUMP START (BUY) signal.

A WEAK form JUMP-START (BUY) signal usually marks the start or the end of a Reaction/Correction. In other words, if Previous Day's Low price is the lowest for only the last three to ten days, the JUMP-START (BUY) signal is not as powerful as it is when the Previous Day's low is the lowest price for last many weeks or months. So in response to the weak form of the signal, one should trade only for short time or for smaller positions. Closing of any Short positions is definitely recommended though.

In the example of EXTR above, all conditions were fulfilled very nicely making it a strong form JUMP-START signal. So if there were any short position in it at that time, they would need to be immediately closed and fresh long positions should also be taken.

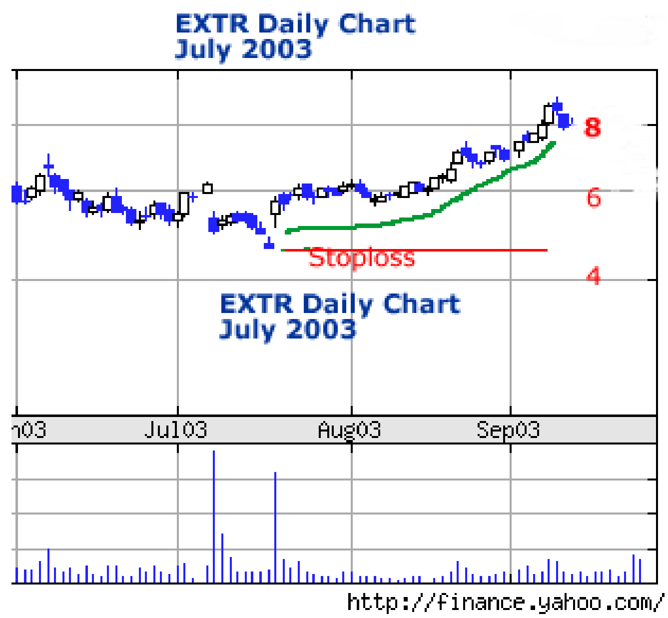
STOP-LOSS

As with any trading system, a trader must be careful to get out of the position if the stock starts moving opposite to his expectations. The JUMP-START (BUY) signal works best most of the time but not always. (If the stock is up because of some acquisition or merger news, the stock may be just trying to reach the offer price and hence the signal should not be used). Hence you should be watchful to protect yourself by closing your long position if the stock price starts going the other direction. When to quit the position and book losses? It really depends on a trader's risk-tolerance but I would advise to keep a Stop-loss at Previous Day's Low price (minus 1%) in most cases. So here in the case of EXTR, Stop-loss should be kept at 4.62$.

See on the full chart of EXTR below what happened after the signal took place:

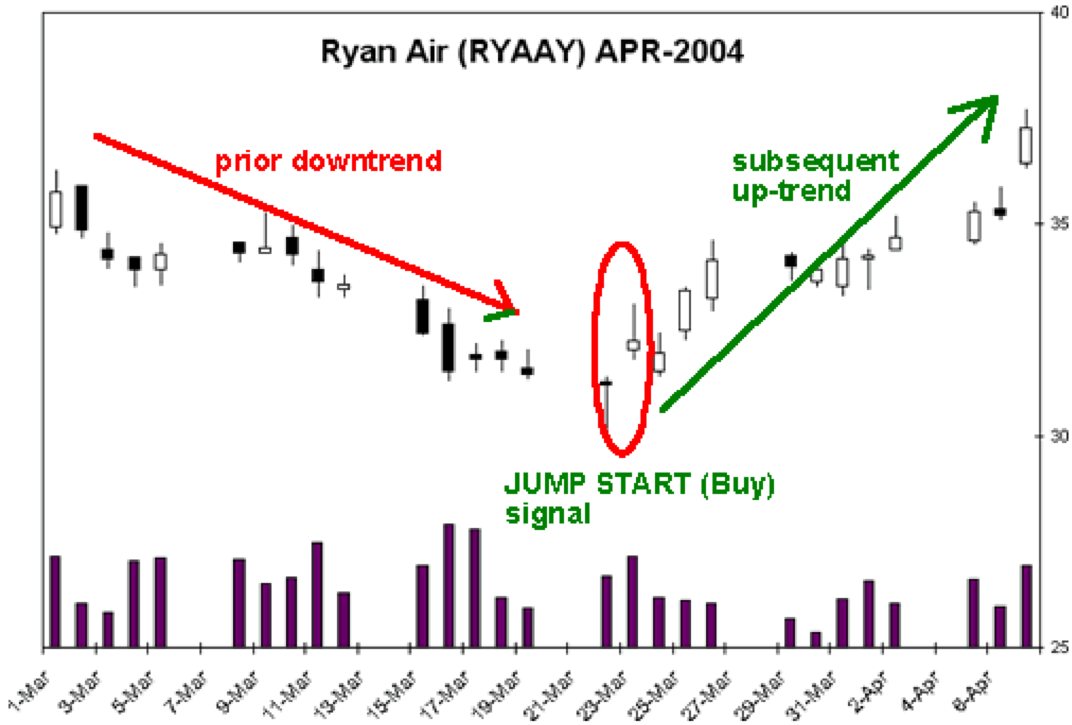
After giving a strong reversal JUMP-START (BUY) signal on the 18th, the stock was a little idle for the next two days. This was an opportunity for traders like us to take a long position.

As you can see, the stock slowly and steadily kept going up and made a Top around 8.50$. For a risk of around 1.00$, there was a gain of around 2.50 to 3.00$!



(**Note:** We have not yet learnt about JUMP START (SELL) signal (also known as FREE FALL). However there is one weak form of it on the Chart above. During the first week of July, when EXTR touched 6.00$, there was a GAP in prices with very high volume on the subsequent day. This GAP fulfilled almost all conditions for a JUMP START (SELL); however the Previous Day's High price was the highest price for only the prior few days and not for the prior few weeks. Hence this signal was a weak signal and it just indicated the end of the Correction EXTR was going through.)

Here is one more example of JUMP START (BUY) signal. Please look at the RYAAY stock chart of Mar-Apr 2004. As shown on the chart, when Ryan Air was in a solid downtrend, there was a sudden trend reversal reflected by a JUMP START (BUY) signal. You can see how the trend was jump-started to up-trend from a down-trend, and the RYAAY stock made a high of 39.00$ from the signal day's low of around 32.00$ just over the next few days.



JUMP-START (SELL) also known as FREE FALL

Let us now see how our powerful JUMP START signal can be applied in a reverse situation- for a stock in an up-trend. However for this specific signal, instead of calling it JUMP-START (SELL), I would like to call it a FREE FALL signal. JUMP-START has positive implications and FREE FALL on the other hand has negative price implications.

Conditions for FREE FALL are pretty much the same conditions that we apply for JUMP START (BUY) but as both these signals occur in completely opposite situations, we have to reverse our conditions.

Let us say a stock is going up. This means it is making higher high prices over most recent days. This indicates that the sentiment or general outlook on this stock is strong/bullish. Now when stock opens for trading today, it starts trading at a price significantly lower than the low price of the previous day. What does this mean? Something must have happened over night or in the morning that has caused informed/influential players to change their view/outlook on the stock. A significantly lower Open price for a stock that has been in an up-trend indicates the possibility of a sudden change in sentiment. Now if during the entire market session today, the stock stays lower than Previous Day's Low price; and then if it closes LOWER than Today's Open price (making it a Bear Day), we can draw an important conclusion: The news, company specific development or whatever reason that indicated the change in sentiment at the time of Today's Open was for real and also powerful. It is likely that today may be the beginning of the downtrend in prices and the stock is likely to keep going down for the next few days/weeks! Informed or powerful sources have decided to take advantage of current high stock prices and have started taking profit in their long positions or are initiating fresh Short positions. This is like a FREE FALL event and signals a sudden falling of prices.

The conditions required for this signal are:

1. The stock has to be in a continued up trend.

2. Previous Day's High price (PDH) has to be the HIGHEST price for the stock over the last few days. (If it is the highest for the last three or more weeks, we have a strong form of a FREE FALL signal. If it is the highest for the last three to ten trading days, we have a weak form of FREE FALL signal. The strong form indicates a likely trend reversal for the current major trend, and a weak form is related to just the start of a Reaction or the end of a Correction.)

3. Today's Open price (TDO) has to be LOWER than Previous Day's Low price (PDL). **TDO < PDL** (The more the difference between TDO and PDL, the more powerful the signal is going to be)

4. Today's Close price (TDC) has to be LOWER than Today's Open price (TDO) making it a BEAR DAY. **TDC < TDO**

5. Today's High price (TDH) has to be LOWER than Previous Day's Low price (PDL). A GAP condition. **TDH < PDL**

6. Today's Volume has to be decisively higher than the normal volume of the last few days or Previous Day's volume. If the above conditions are fulfilled, you will most probably see a decisive jump in the volume today. If you don't see a jump in the volume today, the signal loses some of its strength.

<u>Key Points to remember:</u> Current Trend- Up. Weak Open. Bear Day. Increase in Volume.

<u>Stockfetcher.com syntax:</u> " Show stocks where open is more than .10% below the low 1 day ago and close is below open and high 1 day ago reached a new 2 week high and high is below low 1 day ago and average volume (10) is above 100000 and close is above 5 and volume is above volume 1 day ago "

Let us take an example of a FREE FALL signal. See prices and the Chart below for DCLK (DoubleClick) during June 2003.

Daily Prices with volume for DCLK

3-Jun-03	10.39	*10.39*	9.84	10.17	2404800
2-Jun-03	10.65	11	*10.65*	10.78	3627900
30-May-03	10.17	10.55	10.16	10.5	1980300
29-May-03	10.08	10.4	9.9	10.06	1345900
28-May-03	10	10.12	9.81	10.08	1482500
27-May-03	9.29	9.93	9.17	9.86	1159400
23-May-03	9.23	9.31	8.89	9.27	788900

As we can see, DCLK was in a clear up-trend during May and the beginning of June 2003 (Condition 1). On June 3rd, it opened at 10.39$, significantly lower than Previous Day's High of 10.65$ (Condition 3). Also after opening at 10.39$, it closed at the end of the day at 10.17$ making the 3rd of June a BEAR DAY (Condition 4). Also during the day, DCLK stayed lower than the low price of 10.65$ on June 2nd. In other words, the high price of June 3rd was lower than Previous Day's Low price of 10.65$ creating a GAP in prices over those two days (Condition 5).

Also Previous Day's High price of 11.00$ was the highest price for the stock over the previous few days (Condition 2). Volume on June 3rd wasn't much higher when compared to Previous Day's volume as required by our last condition. The very high volume on June 2nd may have been due to some piece of good news. However when we look beyond June 2nd, all previous days had lower volumes than we had on the 3rd of June. So in this specific case, I would consider Today's Volume as having satisfied our Condition 6. Thus we had almost all conditions fulfilled for a FREE FALL signal in DCLK on June 3rd.

ACTION: For a stock that is going up, you can see FREE FALL signal forming on a day when you see it opening with a down GAP. At the very moment the stock opens lower than Previous Day's Low, you can close your long positions and also can think of selling it short. Having said this, you do have to check all the above conditions to see if the FREE FALL signal is validated on Today's High, Low and Close prices. Once we have a valid signal, we can assume that the stock is now going to be in a downtrend; and hence we should close long positions and get into short positions.

Sometimes most of the conditions for the signal are fulfilled, but one or two conditions are not fulfilled. This makes the signal weak. Say, all conditions are met but today turns out to be a BULL DAY or, it may be that today we don't see high volume. **Such things make this, and also other signals discussed in this book, weak, and at that time you should use your judgment and experience to decide what to do.**

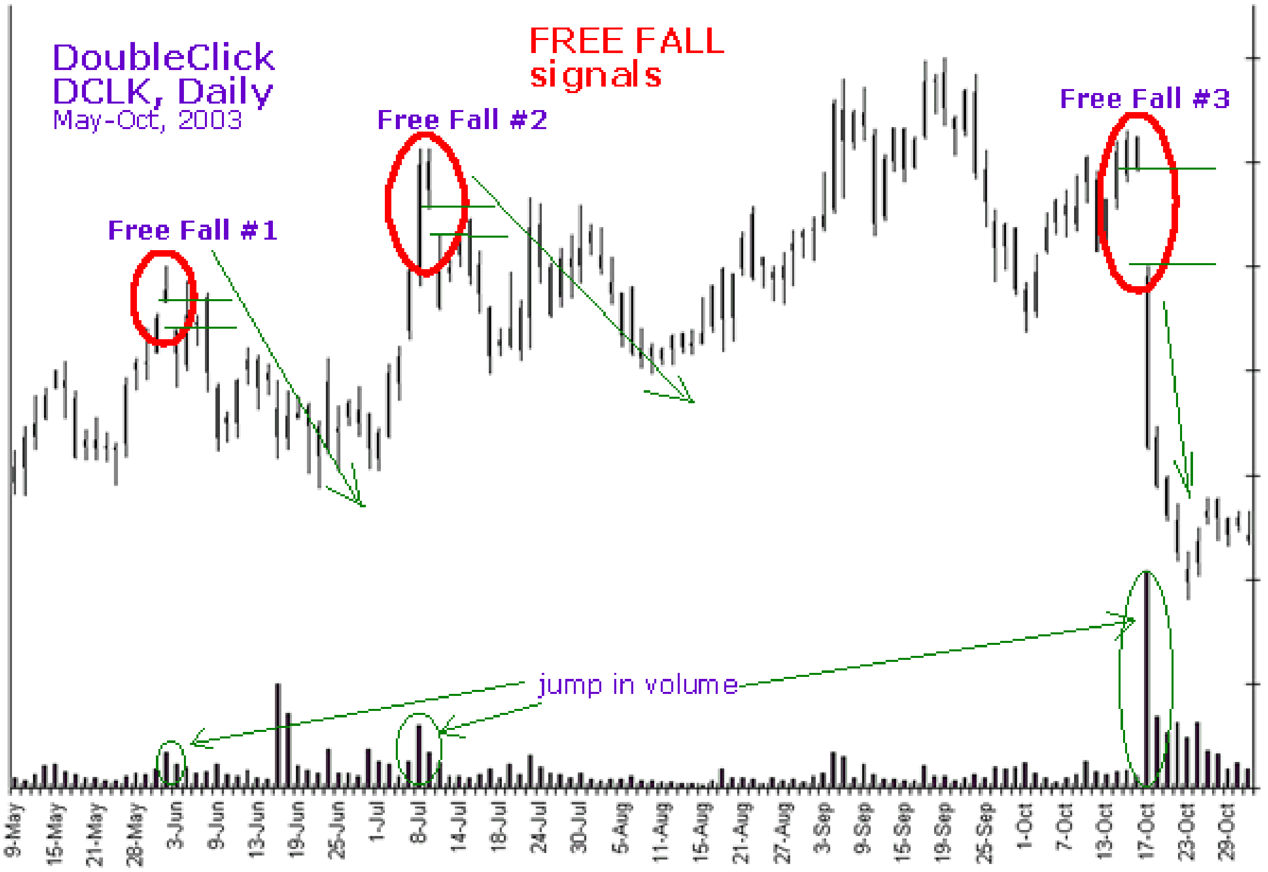
STOP-LOSS If I were to be pressed for an educated guess, I would say this signal is correct around 70% of the time. However it also fails sometimes. So you should be watchful to protect yourself by covering your short position if the stock starts going in the other direction. When to quit the position and book losses? It really depends on your risk-tolerance but I would advise you to keep a Stop-loss at Previous Day's High price (plus around 1%).

See on the full Chart of DCLK below what happened after the signal took place:

After giving a FREE FALL (or JUMP_START (SELL)) signal on June 3rd, DCLK did trade higher for the next two/three days giving us ample opportunities to sell it at around 10.25-10.75$ with a Stop-loss at 11.10$. Then the downtrend in prices gathered momentum and the stock touched a low price of 9.00$ over the next few days.

Let us now look at a few more FREE FALL signals to understand it better. See below the Chart of DCLK for a longer period of time. You can see three different FREE FALL signals, with few variations, taking place in the stock over a six-month period.

The first FREE FALL (1) signal has already been discussed above. The second FREE FALL (2) signal took place around early July. Here we had all conditions met but one. *The day of the second signal was a Bull Day instead of a Bear Day and the Volume wasn't very much higher either. This made the signal a little weak; but on the other hand, it happened when the stock had a very solid up-trend over the last few days. This indicated a very bullish sentiment; and, therefore, a FREE FALL signal, in the middle of such a run up has to be taken very seriously. Over the next two days, after the signal took place, the stock moved around the same price level; and on the third day it opened higher and closed lower than previous day's prices, giving us a weak U-TURN (SELL) signal (the day's High price wasn't a recent high!). This U-TURN signal was pointing in the same direction, in that way strengthening our FREE FALL (2) signal. During the subsequent two days, the stock dropped significantly and touched 10.00$ from a high of 11.50$!



Then again during mid-October, DCLK came out with weak figures and hence it opened lower; and we had one more FREE FALL signal (3). As soon as it opened at 11.00$ which was much lower than Previous Day's Low price, we should have been able to sense the possibility of a FREE FALL, and we could have shorted the stock as soon as it trades 2 to 3% lower than Today's Open price. Here the previous few days' trend was up, but the Previous Day's High price wasn't the highest recent price (of the last ten days or so). But still it was a big GAP and it did have very high volume. Both these strong points compensated for some of the weaknesses (Previous Day's High wasn't the highest price when it opened lower). The day of the signal turned out to be a big BEAR DAY. The next three days brought the stock further down, in line with our signal, and DCLK touched a low of 7.80$.

SIGNAL R3: FULL STOP

FULL STOP (BUY):

FULL STOP (BUY) is an inter-day trend reversal signal. It is not as powerful as the previous two signals we studied earlier and hence this signal should be generally used for small positions and for short-term trading. This signal tends to fail often so one should use it judiciously with strict adherence to its Stop-loss. Also, this signal is very similar to the JUMP START signal the only difference being the

Open price. For a JUMP START (BUY) signal, the Open price has to be very strong- above the Previous Day High Price. For FULL STOP (BUY), it just needs to be above the Previous Day Close. For a JUMP START (BUY), the Low price has to stay above the Previous Day High and for a FULL STOP (BUY), it just needs to stay above the Previous Day Close. In other words, we can say that every JUMP START (BUY) is also a FULL STOP (BUY) but every FULL STOP Is not a JUMP START signal. This means FULL STOP is found more frequently than JUMP START. About FULL STOP, I can say that for an experienced prices-reader, this signal can also generate considerable profitable trading opportunities mostly signaling beginnings of short-term price trends (Corrections/Reactions).

Let us now attempt to study this signal. Assume a stock has been going down for quite some time with the last two days' quotes as below:
Today 25, 27, 24.5, 26
Yesterday *25*, 26, **23**, *24*

As we can see, this stock opened at 25 on the previous day, touched a high of 26 and a low of 23, and closed at 24. Now today, when market opens, this stock opens at 25 (a price higher than Previous Day's Close price of 24). Now during the entire day, if it never trades below Previous Day's Close price and manages to close higher than Today's Open price of 25, this is our FULL-STOP (BUY) signal. This signal when all conditions are fulfilled points to the end (**full stop**) of the current trend and hence we will call it a FULL STOP signal.

Why is this signal an important trading signal? Let me explain the logic behind this signal. When a stock is in a down-trend, it keeps making lower LOW prices as time passes. This reflects a negative tone of sentiment regarding this stock. Now when market opens today, the stock opens at a price higher than Previous Day's Close price. For a stock in a down-trend, it is common to see it Open lower. However here we see a sort of strong Open. This is an indication of some fresh buying demand and positive change in sentiment today. Now throughout the entire day, if the stock never trades lower than Previous Day's Close price, we can reason/assume that the positive sentiment we saw in the morning is real and causing people to buy this stock even at higher prices. For us, this is enough to conclude that buyers are more aggressive today and/or sellers are not willing to sell at current low prices. This can be the beginning of the new trend in the reverse direction. To strengthen our assessment, we would also like to see a confirmation in the form of a BULL DAY- the stock has to close higher than the price at which it opened on the signal day. Another important confirmation I look into this signals is either a significant jump in volume on the signal day or the Close price has to be above the High price of the previous day. The buying should be aggressive and powerful. So when all these conditions are fulfilled, we can say that yesterday was the last day (full stop) of the down-trend so now we can take long positions to take advantage of this change in trend.

Conditions:

1. The stock has to be in a down-trend over the last few days/weeks.

2. Previous Day's Low price (PDL) has to be the LOWEST price for the stock in the last few days or Previous Day's Close (PDC) has to be the LOWEST Close for the stock over the last few days. (If it is the lowest for the last few weeks, we are likely to have a strong form of FULL STOP (BUY) signal. However if Previous Day's Low (or Close) price is the lowest (or lowest Close) for only the last three to ten days, we have a signal that is more likely to mark the beginning of a Correction or the end of a Reaction – a weak form of FULL STOP (BUY)).

3. Today's Open price (TDO) has to be HIGHER than Previous Day's Close price (PDC). **TDO > PDC** (The more the difference between TDO and PDC, the more powerful the signal is going to be)

4. Today has to be a BULL DAY. So Today's Close price (TDC) has to be HIGHER than Today's Open price (TDO).
 TDC > TDO

5. Today's Low price (TDL) has to be HIGHER than Previous Day's Close price (PDC). **TDL > PDC**

6. Today's Volume has to be decisively HIGHER than the average daily volume of the last few days or TDC has to be above PDH. If this is not true, the signal loses considerable strength.

Key Points to remember: Current Trend- Down. Open positive but not strong. Bull Day. Increase in Volume or a strong Close price. Current Market Trend has also to be Positive.

Stockfetcher.com syntax: "Show stocks where low is more than .10% above the close 1 day ago and high 1 day ago is above low and close is above open and close is above high 1 day ago and low 1 day ago reached a new 6 week low and and volume is above volume 1 day ago and volume is above 500000 "

Here is an example of this signal in eSpeed (ESPD) during May 2003.

Daily Prices and Volume data for ESPD.

8-Aug-03	18.14	19.15	18	18.88	819700
7-Aug-03	17.9	18.19	16.54	16.81	592000
6-Aug-03	18.3	18.38	17.47	17.98	402700
5-Aug-03	18.6	18.65	18.03	18.36	285300
4-Aug-03	18.8	19.03	17.86	18.58	160000
1-Aug-03	18.66	18.96	18.4	18.8	265400

It is obvious that ESPD was in a down-trend during early Aug 2003 (Condition 1). On Aug 8th (Today), it opened at a price (18.14$) higher than Previous Day's Close of 16.81$ (Condition 3). Also, it closed at 18.88$ which was higher than the day's Open price at 18.14$ making Aug 8th a BULL DAY (Condition 4).

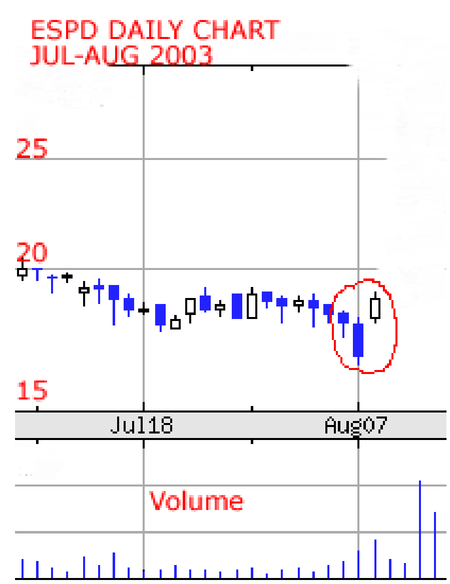


Chart courtesy of Stockfetcher.com.

Also, Today's Low price of 18.00$ was higher than the previous day's closing of 16.81$. This means that throughout the entire market session, the stock did not trade at or below the Previous Day's closing price (Condition 5). Previous Day's Low price of 16.54$ was also the lowest price over the last few weeks (Condition 2- the strong form). Also, Previous Day's Close of 16.81$ was the lowest Close price for the last few days/weeks. On the volume front too, there was a significant increase in volume on Aug 8th- the day of our signal.

Thus all conditions were fulfilled for a perfect FULL-STOP (BUY) signal.

ACTION: In response to a strong of FULL-STOP (BUY), any existing Short position should be closed and fresh Long (buy) position can also be initiated.

In response to a weak form of FULL STOP (BUY) signal, only a Reaction in prices can be expected initially. In other words, we should expect only a minor up-trend over the next few days. Hence depending on other factors, we may want to close any existing Short position for the time-being with a view to be able to Short it again at a higher price level over the subsequent few days. Also, depending on fulfillment of conditions and other circumstances, it is also recommended for one to open fresh Long position with strict adherence to Stop-loss.

STOP-LOSS: No trading system or strategy knows for sure how stock prices will move in the future. So every system fails somewhere. However as a protection against failure of any stock price movement prediction, we must use Stop-loss.

For a long position based on the FULL-STOP (BUY) signal, Previous Day's Close (PDC) or Previous Day's Low price (PDL) are good choices as Stop-loss. So for the ESPD position above, the Stop-loss should be kept at either 16.75$ or at 16.49$.

Now let us look at the full chart of ESPD below to see what happened subsequent to our FULL_STOP (BUY) signal.

Subsequent to a FULL STOP (BUY) signal on Aug 8th, the stock price of ESPD started its upward journey.

As seen on the chart, the stock price moved up from 18.00$ to ultimately reach a high price of 26.00$ over the next few weeks.

I want to emphasize timing attribute of the Profit From Prices signals. In response to most signals, we are usually able to capture the new trend from the very first day. If the signal fails, our Stop-loss is also very close. So with minimum exposure to risk, we can expect substantial profit with PFP signals.

Chart courtesy of Stockfetcher.com.

FULL STOP (SELL):

Let us now look at the reverse of the FULL-STOP (BUY) signal- FULL STOP (SELL) signal. This one is used for a stock that is about to end its up-trend.

Conditions

1. The stock has to be in an up-trend.

2. Previous Day's High price (PDH) has to be sort of the HIGHEST price for the stock in the last few days; or the Previous Day's Close has to be the highest Close price. (If it is the highest for the last three or more weeks, we have a strong form FULL STOP (SELL) signal. If it is the highest for only the last three to ten trading days, we have a weak form of the FULL STOP (SELL) signal. The strong form indicates a likely trend reversal for the current major trend, and a weak form is related to just the start of a Reaction or the end of a Correction).

3. Today's Open price has to be LOWER than Previous Day's Close price.
   TDO < PDC (The more the difference between TDO and PDC, the more powerful the signal is going to be)

4. Today has to be a BEAR DAY. So Today's Close price has to be LOWER than Today's Open price.
   TDC < TDO

5. Today's High price has to be LOWER than Previous Day's Close price. This means that during today's trading session, the stock should not trade higher than Previous Day's Close price at any point in time.
   TDH < PDC

6. Today's Volume has to be decisively HIGHER than the normal volume over the last few days or the previous day's volume. If this is not so, the signal loses most of its strength.

<u>Key Points to remember:</u> Current Trend- Up. Open negative but not too Weak. Bear Day. Increase in Volume helpful.

<u>Stockfetcher.com syntax</u>: "Show stocks where high is more than .10% below the close 1 day ago and low 1 day ago is below high and close is below open and high 1 day ago reached a new 6 week high and and volume is above volume 1 day ago and volume is above 500000

Let us see this with an example for Amgen (AMGN).

Daily Prices with Volume for AMGN

19-Sep-03	*69.3*	69.74	67.93	*68.89*	14975900
18-Sep-03	69.62	70.14	69.07	70	7424600
17-Sep-03	69.56	69.82	69.04	69.63	7933500
16-Sep-03	68.75	69.84	68.54	69.81	6910200
15-Sep-03	68.54	69	68.27	68.5	5492600
12-Sep-03	68.11	68.72	67.36	68.52	6227400

As seen from the prices above, AMGN was in an up-trend (Condition 1). On the 18th, it made a high price of 70$ which was the highest price for the stock over the last few weeks (Condition 2 - the strong form of the signal).

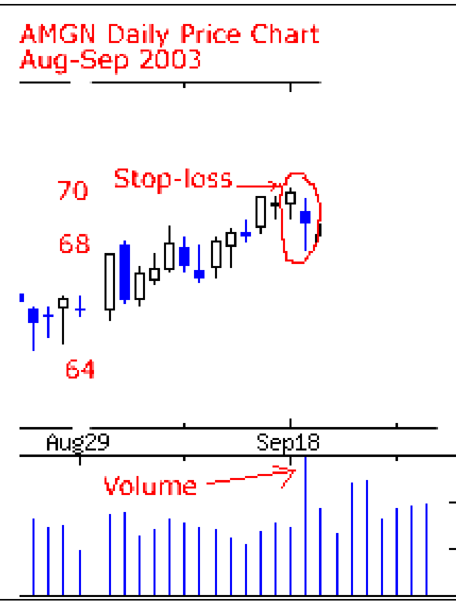


	Chart courtesy of Stockfetcher.com.

While the 18th was a BULL DAY, on the next day AMGN opened at 69.30$ but closed lower at 68.89$ making it a BEAR DAY (Condition 4). Also, 19th's Close at 68.89$ was significantly lower than Previous Day's closing price of 70.00$ (Condition 3). Also 19th's High price of 69.74$ was lower than Previous Day's Close of 70.00$ (Condition 5). This means that during the entire session of the 19th, AMGN traded lower than the previous Close price! The Volume on the 19th was also higher than the past few days' average Volume (Condition 6). Thus all conditions were fulfilled for a strong form FULL-STOP (SELL) signal. Hence we could expect that 19th's drop in stock price was not just a Reaction in prices but it was likely to mark the end of the current up-trend in stock prices.

The Chart on the right shows us what happened subsequent to our FULL STOP (SELL) signal in AMGN on the 19th. AMGN stock which was in an up-trend entered into a down-trend and traded as low as the 64.00$ level.

We have not yet discussed REVERSE/ RESTART signals but if you look at the right extreme of the Chart, we had a RESTART signal on the day AMGN hit the lowest price. This signal pointed to the end of the down-trend that the stock was passing through, and suggested to us that we close our short position.

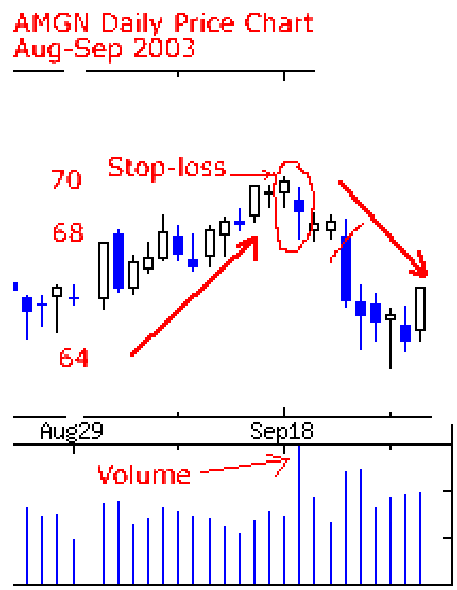


Chart courtesy of Stockfetcher.com.

ACTION: In the case of the strong form of the FULL STOP (SELL), we should close our long position and consider initiating fresh short position in the stock. If there is a weak form of the signal, it marks the end of a Correction or the start of a Reaction. So if you decide to cover Short or go Long, you should trade small-amount positions for a short-time period from three days up to few weeks at most.

STOP-LOSS: For a FULL STOP (SELL), Stop-loss should be kept at Previous Day's High price or Previous Day's Close price (plus around 1% for safety margin). For AMGN here, our Stop-loss would be either at 70.14$ or 70.50$ (plus up to 1%).

Let us look at one more example of the FULL STOP (SELL) signal in the chart of MCEL during October- December 2004.

The trend prior to the signal was up. Then on the signal day, there was noticeable jump in the volume and the prices failed to go above the High of the Previous Day. After the signal, you can see that a down-trend started which took the stock price to go as low as 8$.

SIGNAL R4: TURN AROUND

TURN-AROUND (BUY):

TURN AROUND (BUY) is also an intra-day trend reversal signal. It is very similar to the U-TURN (BUY) signal. Both take place in similar situations and have almost similar conditions. The major difference between them is the extent of the reversal. A U-TURN signal indicates a complete reversal on its own while in the case of TURN AROUND signal, the Close on the day of the signal is not as strong as we find it in U TURN signal. Hence TURN AROUND is not as strong as U TURN. Nonetheless it is a useful trend reversal signal and can help identify important trend reversals.

How to recognize TURN AROUND (BUY) signal? Assume that a stock is in a down-trend. This means the sentiment or general outlook for this stock is bearish. Now when the market opens today, the stock opens at a level lower than Previous Day's Low price. This reflects continued negative sentiment and a further build-up of selling pressure in the stock. However at some time today, the stock reverses its direction and starts trading higher. Now when it crosses the Previous Day's Close or Previous Day's Open price, it tells me that there is a powerful emergence of fresh buying in the stock today. Some influential/informed market participants are likely to have started accumulating the stock in a decisive manner in spite of the obvious negative view held by most other players. This sudden emergence of demand is powerful because it not only absorbed what other players had to sell/offer but it also pushed prices higher. This is a TURN AROUND in the trend of the stock price and now with a Stop-loss at Today's Low price, one can start taking long positions.

Let us look at a scenario to understand this signal. Assume that a stock is currently in a down-trend for some time with prices for the latest two days as below:

Today (Day 2)   22, 25, 21, 24
Yesterday (Day 1) *25*, 25, **22.5**, 23

Previous Day's (Day 1) Open, High, Low and Close prices are 25, 25, 22.5, and 23 respectively. Now today (Day 2), when market opens, this stock opens at 22 which is lower than the Previous Day's Low price of 22.5. Now sometime during today's trading, the stock reverses its downward movement and starts trading higher. At the close of the market, the stock manages to close higher than Previous Day's closing price of 23. This so far is similar to a U TURN signal. However unlike in a U TURN signal, Today's Close price can still be lower than Previous Day Open.

In a U-TURN (BUY) situation, the stock is required to close higher (on Day 2) than both- Previous Day's Open as well Previous Day's Close. However for a TURN AROUND signal, it has to close above any of those two prices. This makes TURN AROUND (BUY) signal a little less powerful than a U-TURN signal. To compensate for this weakness, I like to watch the next day's (Day 3) price movement. On Day 3 if the stock closes higher than Day 1's Open as well as Close prices, I consider it as a strong form of TURN AROUND (BUY) signal. This is nothing but a 2-DAY U-TURN (BUY) signal, completed in two days instead of one day.

Conditions:

1. The stock is in a down-trend.

2. Today's Open price has to be LOWER than Previous Day's Low price.
   TDO < PDL (The more the difference between TDO and PDL, the more powerful the signal is going to be)

3. Today's Close price has to be HIGHER than Previous Day's Close price.
   TDC > PDC

4. Today's Low price has to be the LOWEST price for the stock in the last few days. (If it is the lowest for a few weeks, we are likely to have a strong *major trend* reversal signal- a strong form TURN AROUND (BUY). However if Previous Day's Low price is the lowest for only the last three to ten days, we are looking at a weak form of the signal which is likely to mark the beginning of a Correction or the end of a Reaction instead of a complete trend reversal).

5. Today's Volume has to be HIGHER than the normal volume over the last few days or the Previous Day's Volume. If the majority of above conditions are fulfilled, there will be a decisive jump in stock volume today. However if there is no jump in the volume today, the signal loses much of its strength.

6. A condition nice to have, but not required – that the previous day be a Bear Day. Previous Day's Close price is LOWER than Previous Day's Open price.
   PDC<PDO

Key Points to remember: Current Trend- Down. Open- Weak Open. Close- positive but not too strong. Day- Bull Day. Volume- must increase.

Let us look at a real life example. See the prices below for HOV (Hovnanian Enterprises) during Jul-Aug 2003.

Prices of HOV:

4-Aug-03	*47.2*	49.08	47.15	48.74	837700
1-Aug-03	49.4	50.11	*47.51*	47.92	929800
31-Jul-03	51.19	51.45	49.31	49.35	637200
30-Jul-03	51	51.5	50.5	51.13	499200
29-Jul-03	50.77	52.25	50.1	51	461500
28-Jul-03	51.58	51.83	50.45	50.76	590700
25-Jul-03	51.8	52.7	50.64	51.83	567800
24-Jul-03	51.75	53.17	51.67	51.81	661700

From the prices above or from the Chart, it is easy to see that HOV was in a clear down-trend as of Aug 1st, 2003 (Condition 1). Now on August 4th, it opened at 47.20$ which was lower than Previous Day's Low price of 47.51$ (Condition 2).

Chart of HOV

"Chart courtesy of StockCharts.com"

Now after making a recent new low price of 47.15$ (Condition 4), HOV started trading higher. When it traded higher than the Previous Day's Close of 47.92, there was a TURN AROUND (BUY) signal in the making. If the prices had kept going up and had closed for the day higher than both the Previous Day's Open as well as the Previous Day's Close, there would be a U TURN (BUY) signal. When HOV closed for the day (Aug 4th) at 48.74$, we had our third condition fulfilled for the TURN AROUND (BUY) signal (Condition 3). Today's Volume, though lower than Previous Day's Volume, was relatively higher than the average volume of the preceding four to ten days (Condition 5). Thus with all of our conditions fulfilled for a TURN AROUND (BUY) signal, we had a trading signal for initiating Long positions.

ACTION:

In response to a valid TURN AROUND (BUY) signal, any existing Short position in the stock should be closed. *Now if you are a risk-taker*, you can also initiate a long position in the stock right on the day this signal occurs. *However if you are somewhat risk-averse*, then you should close existing Short position but to initiate any fresh Long position, you should wait for prices to fulfill a 2-DAY U TURN (BUY) signal.

As TURN AROUND is not as strong as a U-TURN signal, one should watch the next day's trading too to see if there is a 2-DAY U-TURN signal. As we know, a 2-DAY U-TURN is stronger than a TURN AROUND signal but is weaker than a regular U-TURN signal. In a 2-DAY U-TURN (BUY) signal, we need to have the next day's Close price higher than Previous Day's Open as well as higher than Previous Day's Close price. In our example above, we need to see if the Close price of Aug 5th is HIGHER than both- the Open as well as Close prices of August 1st. If there is a valid 2-DAY U-TURN signal, there is a much higher probability of success with our TURN AROUND signal.

If a 2-DAY U-TURN (BUY) is signal is not completed subsequent to a TURN AROUND (BUY), we can wait until the stock does close above our "Previous Day's" Open as well as our "Previous Day's" Close price. The more days it takes for the U TURN to be completed, the less powerful the reversal becomes. Also, waiting for an additional confirmation for TURN AROUND (BUY) usually results in the sacrifice of some of our potential gain but this can also save us from some losing trades.

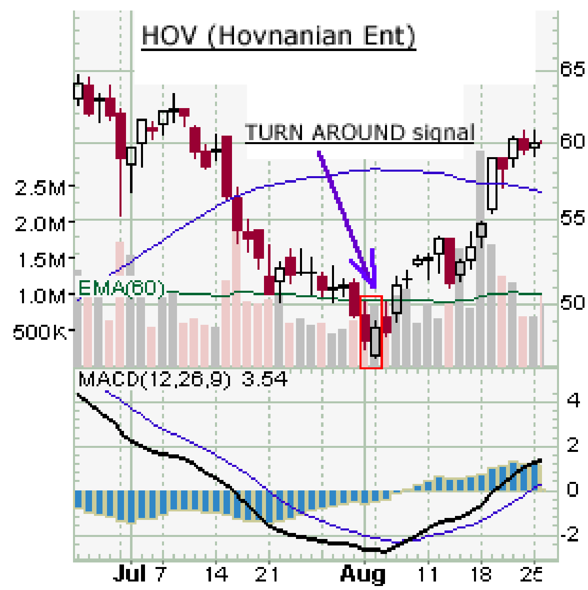
<u>STOP-LOSS:</u> The TURN AROUND (BUY) signal works well most of the time but not always. So if the prices start going the other way, one should be quick to close his existing positions. When to quit the position and book losses? It really depends on one's risk tolerance but from the Profit From Prices perspective, the recommendation is to keep a Stop-loss at Today's Low price (minus up to 1%). So here in the case of HOV, our Stop-loss would be at around 46.90$.

The full chart of HOV below shows what happened subsequent to our TURN AROUND signal:

Subsequent to the TURN AROUND (BUY) signal of Aug 4th, HOV was dormant the next day. As you can notice we did not have our nice-to-have confirmation of a 2-DAY U-TURN (BUY) as HOV closed at just 48.40 on Aug 5th. However on Aug 6th, HOV closed at more than 51.00 (higher than the Open of 49.50 and Close of 47.92 on Aug 1st). Thus we had our TURN AROUND signal validated!

If you look at the Chart on the right, Aug 4th did mark the end of the downtrend and the beginning of an up-trend for HOV. Over the subsequent few days, the HOV stock kept going up and touched a high price of 61.00.

I hope this example helps strengthen your understanding of TURN AROUND (BUY) signal.



"Chart courtesy of StockCharts.com"

In the preceding section, we talked about TURN AROUND (BUY) signal that takes place in a down-trend and points to the beginning of an up-trend. Now it is time to look at the reverse of this signal to find trend reversals from up-trend to down-trend - TURN AROUND (SELL).

<u>TURN AROUND (SELL):</u>

Here are the <u>conditions</u> for the TURN AROUND (SELL) signal.

1. The stock has to be in a continued up-trend.

2. Today's High price has to be the highest price (Top) for the stock in the last few days. (If it is the highest over the last three or more weeks, we have a strong form of a TURN AROUND (SELL) signal. If it is the highest for only the last three to ten trading days, it is a weak form of TURN AROUND (SELL) signal. The strong form indicates a reversal of the current major trend and a weak form indicates just the start of a Reaction or the end of a Correction.

3. Today's Open price has to be HIGHER than Previous Day's High price.
   TDO > PDH (The more the difference between TDO and PDH, the more powerful the signal is going to be)

4. Today's Close price (TDC) has to be LOWER than Previous Day's Close price (PDC). TDC < PDC

5. Previous Day has to be a Bull Day -- a nice-to-have condition but not absolutely required. (User discretion can be used depending on the degree of fulfillment of the other conditions).
   PDC > PDO

6. Today's Volume has to be decisively HIGHER than the normal volume of the last few days or Previous Day's volume. If you don't see a jump in the volume today, the signal loses some of its strength.

<u>Key Points to remember:</u> Current Trend- Up. Open- Strong Open. Close- negatice but not too weak. Day- Bear Day. Volume- must increase.

Let us now take an example of a TURN AROUND (SELL) signal:

Stock prices of AVNX during early Sep 2003.

9-Sep-03	*6.71*	7	6.2	*6.23*	2878300
8-Sep-03	6.2	*6.5*	6.07	6.5	2784200
5-Sep-03	5.38	6.15	5.29	5.94	3077100
4-Sep-03	5.36	5.49	5.27	5.37	1724400
3-Sep-03	4.82	5.5	4.79	5.25	2952000
2-Sep-03	4.75	4.91	4.72	4.81	781200
29-Aug-03	4.85	4.92	4.71	4.75	532800
28-Aug-03	4.71	4.94	4.7	4.8	772700
27-Aug-03	4.68	4.8	4.59	4.71	501300
26-Aug-03	4.48	4.76	4.45	4.67	548400
25-Aug-03	4.81	4.91	4.43	4.63	998900

Chart of AVNX (Avanax Corp.)

Chart courtesy of Stockfetcher.com.

As seen on the Chart and also in the Table above, the stock was in a strong up-trend prior to September 8, 2003 (Condition 1). On Sep 8th, AVNX touched a new High price of 6.50. On the next day, it opened at 6.71, higher than the Previous Day's High price of 6.50 (Condition 3). Then it traded as high as 7.00, which was the highest price for the stock over the last several weeks (Condition 2 -- strong form). Then all of a sudden, the selling intensified pushing the stock down to 6.20. It closed at 6.23 for the day, which was lower than Previous Day's Close price of 6.50 (Condition 4) but wasn't lower than Previous Day's Open price of 6.20. So we missed the U-TURN (SELL) signal; but we did have the TURN-AROUND (SELL) signal on that day. Notice that the volume on the 9th wasn't much higher than the volume on the 7th or the 8th, but it was significantly higher than what the stock used to a have few days ago. Also the High price as high as 7.00 on the 9th and a big GAP on the Open price- both circumstances added a good deal of strength to the TURN AROUND (SELL) signal here. So any Long position in it must be closed as soon as possible. Not only that, we can also take a Short position in the stock with a Stop-loss at 7.05.

Please look at the Chart on the right to see what happened in AVNX subsequent to our strong form of TURN AROUND (SELL) signal on the 9th.

During the subsequent five/six days, the stock price moved within the 6.00 to 6.50 range. This gave us ample time to sell/short AVNX. Our Stop-loss at 7.00 was never triggered. After a week or so, the distribution/selling in the stock showed its impact and the stock started a down journey. It went below 5.00 over the subsequent few days.

Chart courtesy of Stockfetcher.com.

As a practitioner of PFP signals, you should create a habit to look out for stocks that have too strong or too weak Open prices when market opens. As I mentioned in the beginning of this book, this is half of the story behind the power of prices. For the second part, we should watch how the trading unfolds over the rest of the day for such stocks. Such situations are most likely to be trend reversals in the making and this is the beauty of PFP signals- being able to find a trend reversal on the very first or second day the trend is changing its direction! Once you are comfortable with these signals, you will be able to apply them just by following stock prices. You won't need a computer or any fancy software to find trading opportunities.

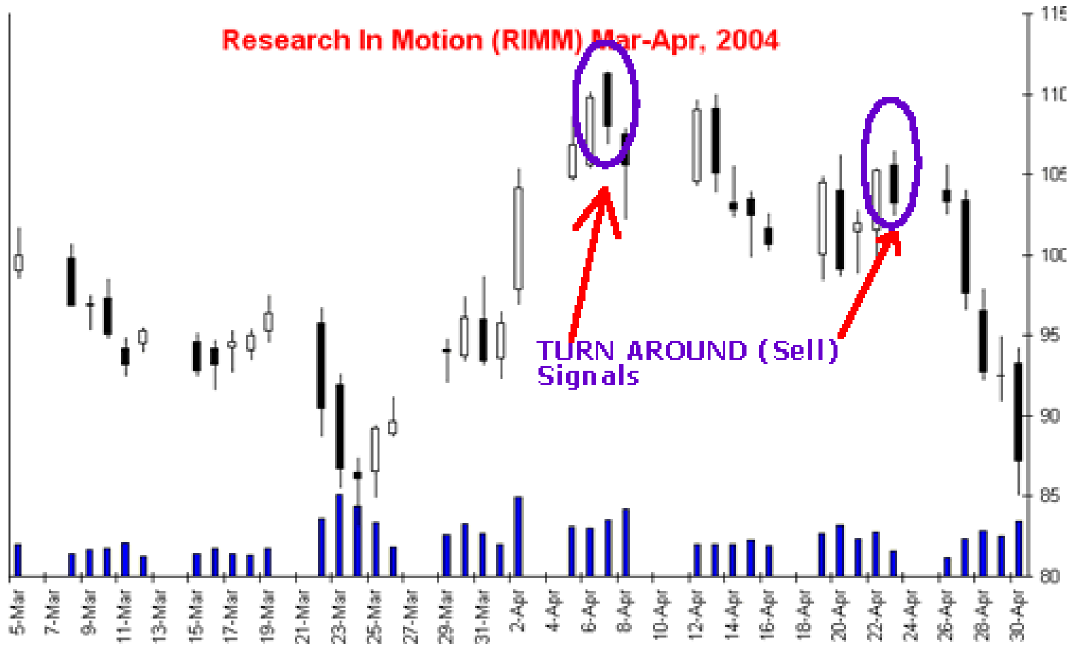
ACTION: If we have a strong form of the TURN AROUND (SELL) signal, we should close all long positions and we can consider opening fresh new short positions. We can expect bearish movement in the stock prices over the next few days/weeks.

When we have a weak form of TURN AROUND (SELL) signal, we should consider today's signal as the beginning of a Reaction or the end of a Correction. Hence whatever position we take, we should attempt to close it over the next few days instead of carrying it for a longer period of time. If we were Long on the stock we could sell it in order to buy it back at a lower price later on; or we could also Short the stock with a view to cover it back over the next few days.

As mentioned earlier while discussing TURN AROUND (BUY) signal, it is advisable for risk-averse traders to look for a subsequent confirmatory signal for any TURN AROUND (SELL) signal. As we know a TURN AROUND is not as strong as a U-TURN signal. Hence it is advisable to watch the next day's trading to see if there is a 2-DAY U-TURN (SELL) signal. A 2-DAY U-TURN (SELL) is a weaker version of a U-TURN (SELL) signal and takes two days to complete it instead of one day. However it acts as a powerful supplement for any TURN AROUND (SELL) signal. If there is a valid 2-DAY U-TURN (SELL) signal, we can be more confident about the success of our TURN AROUND (SELL) signal. If the U-TURN (SELL) signal is not completed within 2 days, it is okay to look for it to complete over another day or so.

STOP-LOSS: A Stop-loss at Today's High price is recommended in most cases.

Let us take one more example of Turn Around (Sell) signal.



On the Research in Motion (RIMM) chart above, we can see that it was in an up-trend. On the day it made a new 52-week High of 110, there was a Turn Around (SELL) signal. This actually proved to be the end of the major up-trend. A subsequent down-trend can be seen on the chart. Also, there is one more occurrence of Turn Around (SELL) signal marked on the chart. This signal also proved successful and marked the beginning of another series of down days for RIMM as we can see on the chart.

SIGNAL R5: REVERSE

REVERSE (BUY):

This is another powerful trend reversal signal. This signal is very similar to the RESTART signal that we will see in the next chapter. The only difference between them is - REVERSE signal takes place after a sustained trend and with significant increase in volume while RESTART takes place after a Reaction or a Correction. REVERSE signal usually results in reversal of a major trend while RESTART has trading implication only for next few days or weeks. In other words, a REVERSE signal is useful for traders as well as investors while the other signal is useful only for traders.

REVERSE signal is a very useful signal as far as Trend Reversals are concerned and it is also very profitable. Like other previously described signals, this signal also gives us an indication of the new trend on the very first day. However if it fails, the stop-loss is very close and hence there would be minimum losses. In short, this signal has impressive odds for success; and whenever this signal takes place, profit should be booked in existing open positions and new long short-term positions can also be initiated.

Let us look at how REVERSE (BUY) signal is applied to a stock that is in a down-trend. As it is in a down-trend, there is negative sentiment or bearish outlook for this stock. Let us assume that it is the same story for today too: It opens weak and starts going down. At some point of time during the day, the stock is trading significantly lower than the low price of the previous day. The more the difference between Previous Day Low and Today's Low price, the better it is for this signal. This adds lot of power to out signal. Now during the trading today, all of a sudden, the trading volume in the stock increases and the stock starts trading higher. Now if this rally continues and the stock manages to close at a level higher than Previous Day's Close price as well as higher than Today's Open price, we have a solid evidence of emergence of fresh buying in the stock. This new buying has the power to reverse the price trend of the last few weeks and push prices higher. Hence we call this signal REVERSE (BUY) signal.

Conditions:

1. The stock price has to be in a down-trend.

2. Today's Low price (TDL) has to be the lowest price for the stock over the last few weeks. (If it is the lowest for the last few weeks and we have Condition 3 fulfilled strongly, we are probably looking at REVERSE (BUY) signal. If this is not true and Today's Low price is the lowest only for the last three to ten days or so, we are looking at probably a RESTART (BUY) signal.)

3. Today's Low price (TDL) has to be significantly LOWER than Previous Day's Low price (PDL).
   TDL < PDL

   Note: The difference between TDL and PDL has to be significant. As a rough guide, it has to be around 1% or more. The more the difference, the more powerful the signal is going to be and the greater the probability that the signal is pointing to a major trend reversal.

4. Today's Close price (TDC) has to be HIGHER than Previous Day's Close price (PDC).
   TDC > PDC

5. Today has to be a BULL DAY. Today's Close has to be HIGHER than Today's Open.
   TDC > TDO

6. Today's Volume has to be HIGHER than the normal volume over the last few days or Previous Day's Volume.

   NOTE: If you do see a significant jump in the volume since the time the stock changed its course from Today's Low price (hard to see in daily prices but can be seen on an intra day chart), it adds a lot of strength to the signal and points towards a major trend reversal.

Let us take as an example SUNW (Sun Microsystems).

- SUNW was in a clear downtrend from its high price of 5.50 a few weeks back. (Condition 1)

- On August 12th, SUNW made a low price of 3.39 that was kind of the lowest price over the last few days, fulfilling our Condition 2 for the REVERSE signal.

- The low price, 3.39, of August 12th was *significantly* lower than Previous Day's Low of 3.52 (Condition 3). Today's Low was almost 3% lower than Previous Day's Low price. This was a boost to the strength of our signal and created a possibility that today's REVERSE signal might be pointing to a major trend reversal rather than to a minor Correction in prices over the next few days.

- Also today (on the 12th), SUNW closed at 3.59 which was higher than Previous Day's Close of 3.58. Ideally here we would like to see a little more difference, but as the volume and Condition 3 were fulfilled in a significant way, 3.59 would be acceptable under these circumstances. Thus Condition 4 was also fulfilled.

- Today was a Bull Day as SUNW closed at 3.59, which was higher than the Open price of 3.53 (Condition 5).

- Also, today's volume of 84 million stocks was significantly higher than the last few days' average volume.

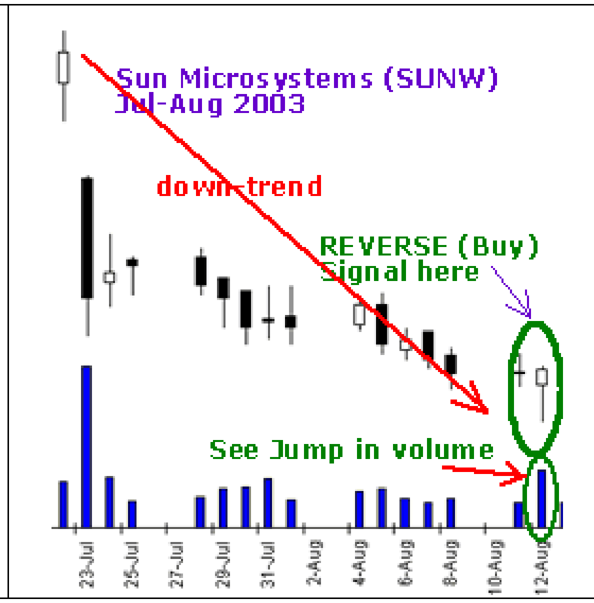
<u>Key Points to remember:</u> Current Trend- Down. Open- doesn't matter. Close- strong. Day- Bull Day. Volume- must increase.

<u>Stockfether.com syntax:</u> "Show stocks where Close gained more than .2 percent over the last 1 day and low reached a new 1 week low and low is more than .75 percent below low 1 day ago and close is more than .2 percent above open and volume is more than 20% above average volume (5) and volume is above 500000 and close is above .60 "

Thus not only all conditions were fulfilled for REVERSE (BUY), but we had all desirable attributes too. So this REVERSE (BUY) was a powerful Trend Reversal signal.

SUNW Daily Prices:

12-Aug-03	3.53	3.6	3.39	3.59	84775200
11-Aug-03	3.57	3.65	3.52	3.58	36586200
8-Aug-03	3.64	3.67	3.51	3.57	43841800
7-Aug-03	3.73	3.73	3.59	3.62	36696400
6-Aug-03	3.66	3.74	3.62	3.7	44529000
5-Aug-03	3.83	3.87	3.64	3.68	57687500
24-Jul-03	3.91	4.09	3.82	3.95	75312500
23-Jul-03	4.3	4.31	3.71	3.85	2.39E+08
22-Jul-03	4.65	4.85	4.51	4.77	68855000



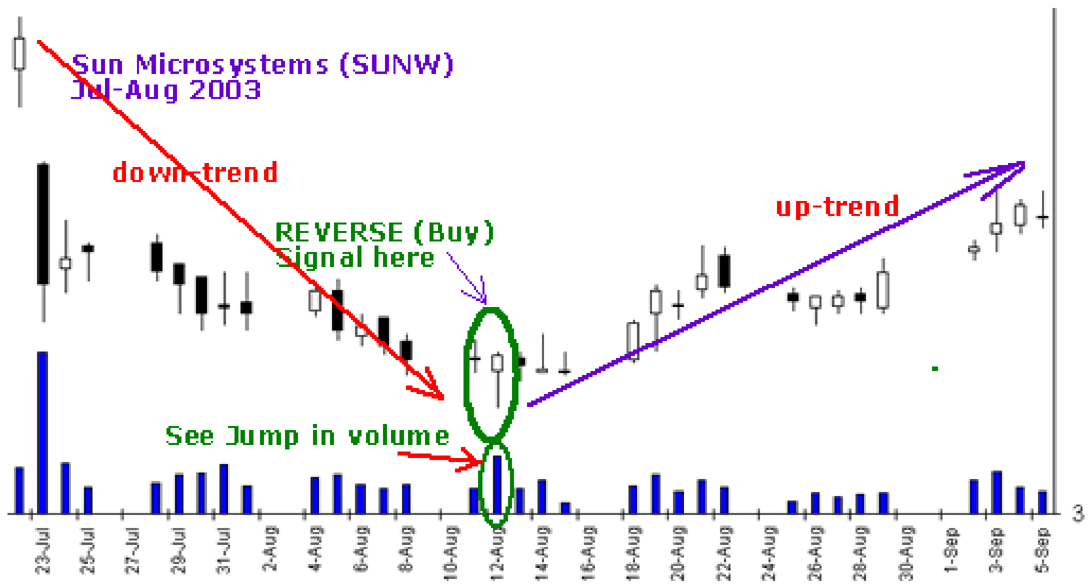
PROFIT OBJECTIVE: Normally a REVERSE (BUY) signal should be initially taken as an indication for the start of a Correction. This means we should expect the stock to have a few good days, ranging from one to ten. So depending on our risk tolerance and trading system, we can close our short positions and may also initiate new long short-term positions. However when this signal has all desirable features too (Conditions 2, 3 and 6 fulfilled in a strong manner), it becomes a powerful Trend Reversal signal and hence we should not only close all open short positions but we can also confidently open new long positions. In response to a strong REVERSE (BUY) signal, we can expect the stock to appreciate significantly over the next few weeks/months and hence not only traders but investors should also take fresh positions.

If you are an aggressive trader, I would recommend you act early on this signal when it is forming. If you are looking at a powerful intra-day reversal with significantly higher volume, you can take a long position as soon as the stock starts moving higher or when it moves higher than Previous Day's Close and Today's Open prices. If you wait for the final closing price of the day, you may lose some gain that you might have captured by trading the stock earlier during the day. However, if you apply this signal during the day instead of waiting till it closes, you must later apply all the conditions to the actual closing price at the end of the day to see if the signal is still valid.

ACTION: If the signal indicates a few good days: Close short positions, if you are a short-term trader. You may also buy this stock to benefit from next few days' (anticipated) up-trend. If we have a powerful version of this signal: Not only short-term traders, but every trader should close Short positions and open fresh new Long positions.

STOP-LOSS: Ideally, Stop-loss should be kept at Today's Low price (minus up to 1% for added safety). So here in the case of SUNW, our Stop-loss would be at 3.36$.

See below on the full chart of SUNW what happened after the signal took place:



As shown on the chart, subsequent to our strong REVERSE (BUY) signal on the 12th, SUNW moved around the 3.50 level during the next three days without going below our Stop-loss level of 3.36$. Then it started its journey exactly as our signal told us it would- it entered into an up-trend and traded at a high price of 4.25$. So against a risk of 14 cents per share, there was an opportunity to make almost 50 to 75 cents!

On this chart, we can also see another signal. Subsequent to the REVERSE signal mentioned above, SUNW touched the 4.00$ level on the 8th trading day. On the 9th day, it again touched a high of 4.00$ and then, as you can see from the Chart on the right, it entered into a small Reaction and touched a low of 3.75$. On the subsequent day we had RESTART (BUY) signal- a signal very similar to a REVERSE signal. This RESTART (BUY) indicated a resumption of the up-trend and in the next four to five days, SUNW went up from 3.75 to 4.25$. (We will learn RESTART in more details in the next chapter.)

REVERSE (SELL):

Now we will look at REVERSE (SELL) that will help us identify trend reversals from up-trend to down-trend.

Conditions:

1. The stock has to be in an up-trend.
2. Today's High price (TDH) has to be the highest price for the stock in the last few days. (If it is the highest for the last few weeks and Condition 3 is also fulfilled strongly, our REVERSE (SELL) signal becomes very strong. However if Today's High price is the highest only for the last three to ten days, our signal is a weak signal.)
3. Today's High price (TDH) has to be HIGHER than Previous Day's High price (PDH) by at around 1% or more.
   TDH > PDH
   (NOTE: The more the difference between TDH and PDH, the more powerful the signal is.)

4. Today's Close price (TDC) has to be LOWER than Previous Day's Close price (PDC). TDC < PDC
5. Today has to be a BEAR DAY. Today's Close has to be LOWER than Today's Open. TDC < TDO
6. Today's Volume has to be significantly HIGHER than the normal volume of the last few days or Previous Day's Volume.

NOTE: For more accurate assessment of Condition 6, you should look at the intra-day chart for the stock. You can easily find a 1- or a 5-day chart on Yahoo! Finance and many other websites. If you see a significant jump in the volume since the time the stock started trading lower than Today's High price, this is strong evidence of emergence of fresh selling pressure and hence you can be more confident about the success of today's Sell signal.

Let us take an example of REVERSE (SELL) signal on 24th Sep, 2003 in SINA Corporation.

- SINA was in an up-trend from its low price of 30.00 a few weeks ago. (Condition 1)
- On Sep 24th, SINA made a High price of 45.51 which was the last few weeks' highest price. (Condition 2)
- The High price 45.51 of Sep 24th, was higher than Previous Day's High of 43.85 (Condition 3). It was also significantly higher (>4%) than Previous Day's High. This provided a significant boost to our signal.
- Also, SINA closed at 41.65 for the day which was lower than Previous Day's Close of 43.30. This fulfilled Condition 4.
- SINA had opened at 43.85 but closed lower at 41.65 for the day so Sep 24 was a BEAR DAY too. (Condition 5)
- Volume of 12 million stocks for the day was also significantly higher than the average volume over the last few days. (Condition 6)

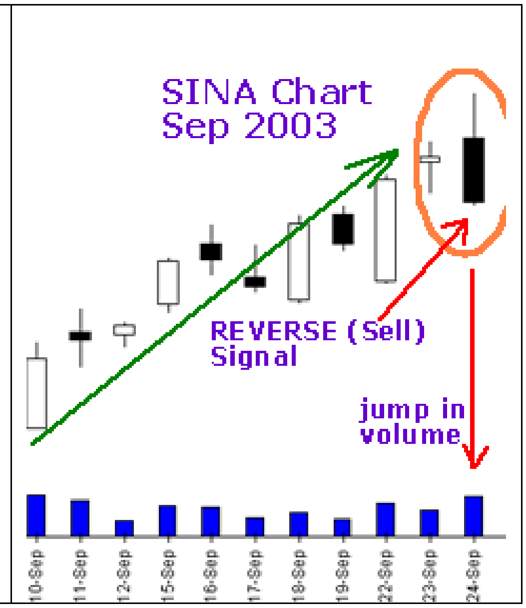
Key Points to remember: Current Trend- Up. Open- Doesn't matter. Close- very weak. Day- Bear Day. Volume- must increase.

Stockfether.com syntax: "Show stocks where Close dropped more than .25 percent over the last 1 day and high reached a new 2 week high and open is more than 1% percent above close and volume is more than 20% above volume 1 day ago and High gained more than 1% over the high 1 day ago and average volume (10) is above 500000 and close is above 5 "

Thus all conditions were clearly fulfilled for the REVERSE (SELL) signal.

SINA Daily Prices:

24-Sep-03	43.85	45.51	41.58	41.65	12443000
23-Sep-03	43.09	43.85	42.02	43.3	8160600
22-Sep-03	38.89	42.67	38.84	42.53	10375600
19-Sep-03	41.3	41.6	40	40.23	5273600
18-Sep-03	38.27	41.24	38.16	40.95	7537800
17-Sep-03	39.1	40.2	38.55	38.73	5966000
16-Sep-03	40.26	40.9	39.13	39.66	9189300
15-Sep-03	38.1	39.74	37.85	39.67	9723200



ACTION:

When REVERSE (SELL) signal takes place in its strong form with fulfillment of Condition 3 and Condition 6 in a decisive manner, it has significant trend reversal implications. In such situations, a trend reversal of the major trend can be expected from up-trend to down-trend and hence all open Long positions should be immediately closed and fresh Short positions should be initiated.

If the signal is somewhat weak on one or more conditions, you should act gradually. First, close all existing Long positions. Then, only when the stock has traded lower than the signal day's Low price, should you create fresh Short positions.

Also, if you are actively watching the market, you can act on a REVERSE (SELL) signal as early as you get the feel of the reversal. This is usually after a sudden downward movement in stock price with high volume subsequent to the stock making a significantly higher High price for the day. You can act on an anticipated REVERSE (SELL) signal as soon the price drops below Today's Open or Previous Day Close. (However for most traders it is always recommended to wait till the market closes so one can confirm a signal.) Sometimes waiting till market-close means sacrifying some gain. So if you are trying to capture bigger gain by taking additional risk, it is okay to act during the day on an anticipated signal. Sometimes when the reversal is very powerful, the stock could close very low by the time market closes. However, if you act on this signal during the day instead of waiting till stock closes, you must apply all the conditions to the actual Close price to verify if the signal is still valid. So in the example of SINA above, an active trader could sell it Short as soon as it dropped below 43.25 (after trading higher at 45.51) instead of waiting for the close at 41.65$.

STOP-LOSS: As mentioned earlier, the REVERSE (SELL) signal can have different variations and degrees of strength. However in all cases the ideal Stop-loss would be at Today's High price (plus around 1% for added safety). So in this example of SINA, our Stop-loss would be at around 46.01.

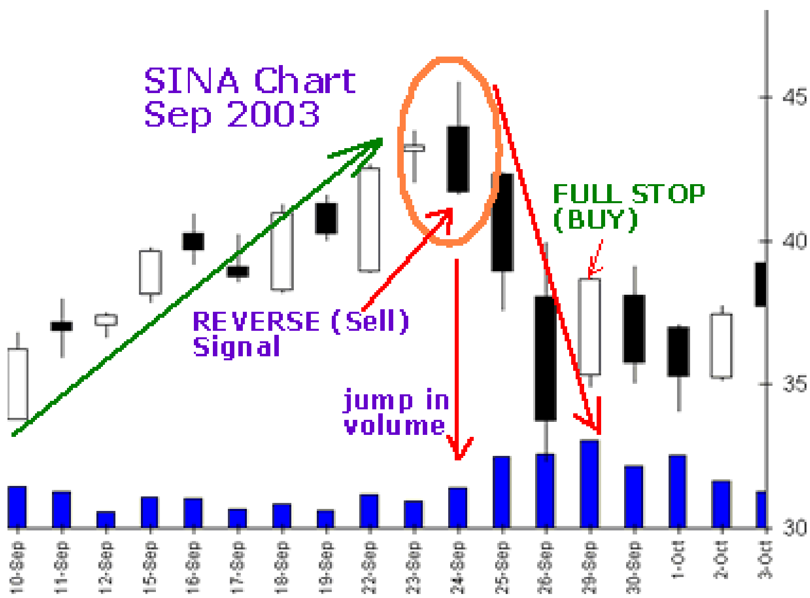
The full chart of SINA below shows what happened subsequent to REVERSE (SELL) signal in it.

26-Sep-03	38.05	39.96	32.3	33.68	22733400

Subsequent to REVERSE (SELL) signal on the 24th, there was a big Sell-off in the stock over the next two days which brought SINA as low as 32.30$.

Thus we could have made almost 10.00$ in three days or so if we had

25-Sep-03	42.35	42.39	37.55	38.92	22195700
24-Sep-03	**43.85**	**45.51**	**41.58**	**41.65**	**12443000**
23-Sep-03	43.09	43.85	42.02	43.3	8160600
22-Sep-03	38.89	42.67	38.84	42.53	10375600
19-Sep-03	41.3	41.6	40	40.23	5273600
18-Sep-03	38.27	41.24	38.16	40.95	7537800
17-Sep-03	39.1	40.2	38.55	38.73	5966000
16-Sep-03	40.26	40.9	39.13	39.66	9189300
15-Sep-03	38.1	39.74	37.85	39.67	9723200



Let us look at some more signals on this chart. On the next day after it made a Bottom of 32.30, SINA had a Full-Stop (BUY) signal with very heavy volume signaling the end of the down trend. Then the stock started moving up and ultimately touched around 43.00.

You may argue here that the down-trend in SINA in response to our REVERSE (SELL) signal lasted only two days and hence it should be called a RESTART (SELL) signal. I want to point out here that there are no hard rules on how to distinguish a Reaction from a normal trend movement or how long a trend or a Reaction should last. Markets are very mystic and volatile and hence no hard rules work all the time. However as you gain more and more exposure and experience, you will be able to feel things intuitively. A trading system can also come in handy in such situations. If you took a Short position in SINA at 42$ expecting a 6$ drop, for you, the signal is correct as long as it takes you down to your target level. It is really tough to predict the drop as well as the timing. Having said this, after we had our strong REVERSE (SELL) signal, we should assume that the trend in SINA is down now and hence at every rise we should watch for potential Sell signals. Also every Buy signal we get can be used only for short-term small Long positions.

TREND REVERSAL SIGNALS BASED ON WEEKLY PRICES

Most of the PFP signals use daily prices or daily price charts. However there are a few useful signals that use weekly prices. We will discuss these weekly signals now. These are also very powerful trend reversal signals, and are useful in predicting price movement over the next three or more weeks. (If you are not familiar with the distinction between daily and weekly prices, please read the previous chapter.)

There is one very important thing to remember about weekly signals. Unlike daily signals, you don't have to wait for the final closing price of the current week to apply any weekly signal. Waiting till the close on Friday can sometimes prove very expensive because some trend reversals are V-shaped and very rapid. If a weekly signal seems to be in the making based on the price movement of Monday or on any day prior to Friday, one can take action as early as Monday instead of wasting time. This is because if the trend reversal is powerful, waiting a few more days just to get a confirmed This Week Close (TWC) price can result in missing out on an opportunity or a big part of it. Hence, in conditions of a weekly signal, one can use the current price as the TWC price. As soon as all or most of the important conditions for a given weekly signal are fulfilled with the current price as the TWC, one can act on the signal and take positions. Then, after the week actually ends, it is important to verify if the actual TWC (This Week's Close) price also fulfills all conditions. If it does, hopefully the early action during the week based on the anticipation of the signal is already in the money. If the actual TWC does not validate the signal, it important to liquidate those positions as soon as possible.

There is nothing like a free lunch in financial markets. Hence if a trader acted during the week and was correct in sensing the weekly reversal, he would have profits larger than had he waited till the close of the market to get a confirmed signal. However if the weekly signal could not be confirmed based on actual TWC, he would have to close the position at a loss. Hence if he had waited for the actual TWC, he would have avoided a loss. So it's a choice and one will need to consider major market trend, the nature of the stock, etc. in deciding when to act.

SIGNAL R6: WEEKLY-REVERSAL

WEEKLY-REVERSAL (BUY):

DESCRIPTION: WEEKLY REVERSAL (BUY) signal is very much like the REVERSE (BUY) signal we just discussed. The only distinction is REVERSE uses daily prices while WEEKLY REVERSAL signal uses weekly prices. Both of these signals are also very easy to identify on price charts.

Conditions:

1. The stock has to be in a continued downtrend. This means that at least for the previous three or more weeks, the Weekly Low price has to be getting lower.

2. Previous week has to be a Bear Week. This means Previous Week's Close price has to be LOWER than Previous Week's Open price.
   PWC < PWO

3. This week (current week) has to be up till now a BULL WEEK. This means, the current price or This Week's Close (TWC) price has to be HIGHER than This Week's Open price.
   TWC > TWO

4. This Week's Low price (TWL) has to be significantly LOWER than Previous Week's Low price (PWL).
   TWL < PWL. (The more the difference between PWL and TWL, the more powerful the signal will be).

5. This Week's Low price (TWL) has to be the lowest price for the stock for the last few weeks.

6. Subsequent to fulfilling Condition 4 and 5, if the current price (also known as This Week's Close price (TWC) as the week progresses) is HIGHER than Previous Week's Close price, one can anticipate a WEEKLY REVERSAL (BUY) signal. If this week is over and we have a final TWC price, we must have TWC higher than Previous Week's Close.
   TWC > PWC

7. Volume is not as important for weekly signals as it is for daily signals mostly because weekly signals span across multiple days and hence the effect of volume associated with the reversal event does not get properly reflected in weekly volume. However if there is a noticeable pick up in volume since the stock made This Week's Low price, this acts as a powerful boost for the signal.

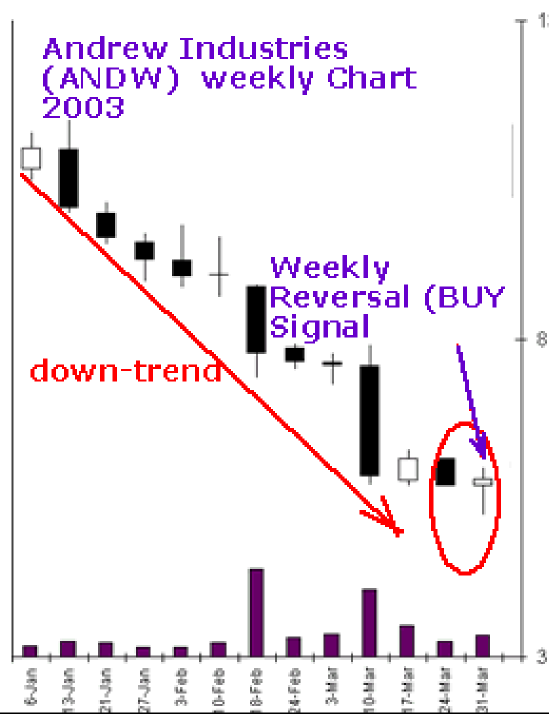
<u>Key Points to remember:</u> Current Trend- Down.Close- must be very strong. Week- Bull week. Volume- increase in volume is helpful. Low of this week should be the lowest.

Let us look at the weekly prices for ANDW (Andrew Industries) during March 2003.

31-Mar-03	5.69	5.97	5.23	5.79	1379780
24-Mar-03	6.11	6.11	5.68	5.69	951480
17-Mar-03	5.76	6.25	5.69	6.11	2001040
10-Mar-03	7.57	7.9	5.71	5.84	4259380
3-Mar-03	7.64	7.77	7.28	7.58	1421520

During this period, ANDW seems to be in a clear down-trend making lower low prices (Condition 1). Then during the early part of the March 31st, it continued to go down and made a low price of 5.23. This was not only lower than Previous Week's Low price of 5.68 (Condition 4) but it was also the lowest low price for quite a few weeks (Condition 5). Also the week of March 24th (Previous Week) was a Bear week because the stock had closed lower at 5.69 than the Week's Open price of 6.11 (Condition 2).

Here is the weekly Chart of ANDW.



StockFetcher.com Syntax: "Show stocks where Close gained more than .5 percent over the weekly close 1 week ago and close gained more than .5 percent over open and close gained more than 1% over close 1 day ago and weekly close gained more than .5 percent over weekly open and weekly Low 1 week ago is below weekly low 2 week ago and weekly close 1 week ago is below weekly open 1 week ago and weekly close 2 week ago is below weekly open 2 week ago and weekly low reached a new 7 week low and weekly low dropped more than 2 percent below low 1 week ago and volume is above 500000 and close above 2 and chart-display is weekly and close is 15% below 10 week high "

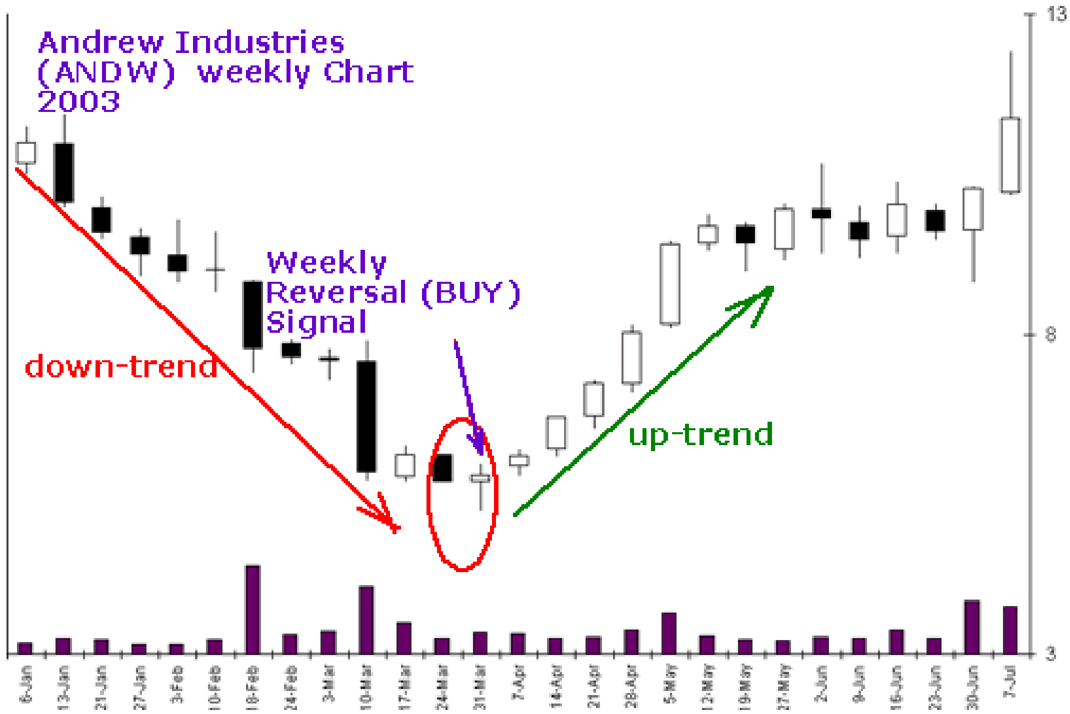
However during the week under review, after making a low price of 5.23, ANDW changed direction and started trading higher. When it traded higher than 5.69 (Previous Week's Close price), it fulfilled Condition 6. Also this price was higher than the current week's open (TWO) at 5.69. So there was a possibility that the current week could be a Bull week (Condition 3). So when the stock started trading higher than 5.69, there was a pretty good possibility for a WEEKLY REVERSAL (BUY) in ANDW. When the week ended, it actually closed at 5.79, which was higher than Previous Week's Close price. So almost all the conditions were nicely fulfilled for our signal WEEKLY REVERSAL (BUY) signal.

ACTION: A valid WEEKLY REVERSAL (BUY) signal indicates the end of the current down-trend and the beginning of up-trend. Hence if there are any open Short positions, they should be closed. Fresh Long positions should also be initiated. Sometimes when this WEEKLY REVERSAL (BUY) occurs only after a two/three weeks' downtrend making This Week's Low price the lowest only for the last three weeks or less, it is a weak signal and hence only open Short positions should be closed but for new Long positions, one should wait for other confirmations of trend reversal.

As mentioned earlier, there is no need to wait for current week's official Close (TWC) to act on this signal. If a stock makes a new Low price lower than the previous few weeks' low prices on Tuesday and then it starts going up and if on the following day Wednesday it trades higher than the Previous Week's Close price as well as This Week's Open price, one can assume it is a WEEKLY REVERSAL (BUY) signal and close current Short positions and/or open fresh Long positions as on that very Wednesday. When the reversal is sudden, then waiting till Friday may forfeit a big part of the opportunity. However if Friday's Close turns out to be lower than Previous Week's Close price, the signal has not materialized and hence one would need to abandon positions opened during the week. So sometimes an early bird catches the worm and sometimes it is the early bird who gets killed first! Unfortunately, there is hardly ever any risk-free trading opportunity for anyone.

STOP-LOSS: For positions in response to WEEKLY REVERSAL (SELL) signal, This Week's Low price (minus 1% or so) should be used as a Stop-loss. As in other signals discussed in this book, a Stop-loss is a **must** for this signal too.

Now let us look at what happened in the ANDW stock after our WEEKLY REVERSAL (BUY) signal. From the chart below, it is easy to see that the Weekly Low price (our Stop-loss) for the WEEKLY REVERSAL (BUY) signal was not broken at all. The stock actually started its upward journey then from that low price to touch a high price of 14.00 over the subsequent few weeks. (If you look carefully at the following chart, you will see quite a few successful weekly reversal signals with various degrees of strength.)



WEEKLY REVERSAL (SELL):

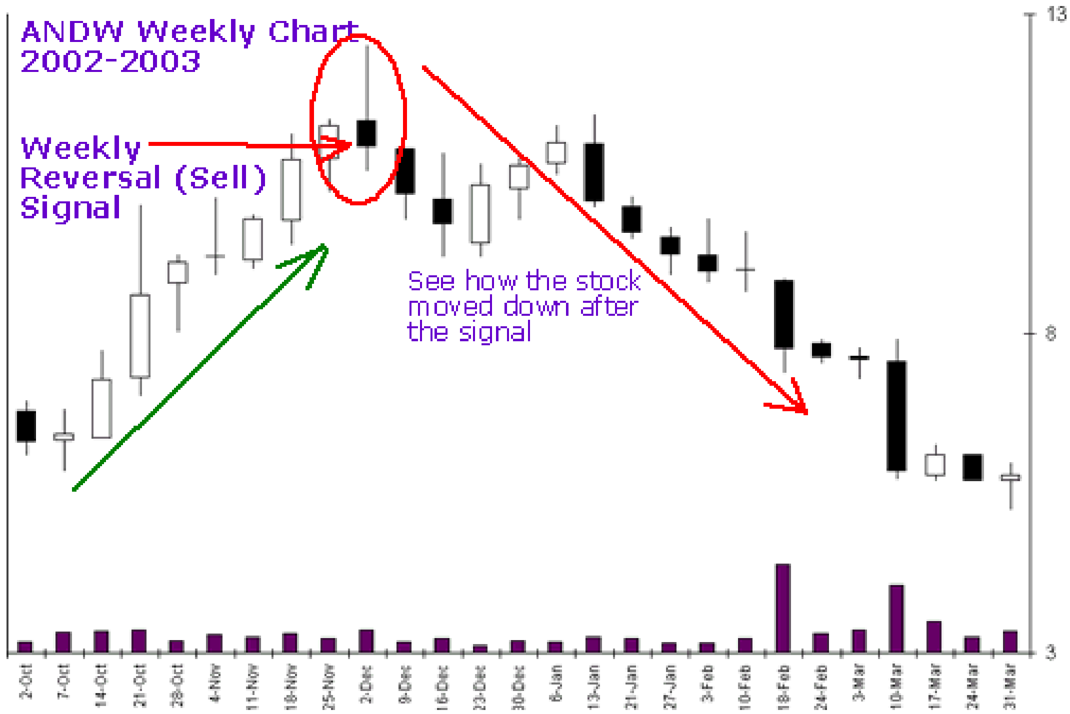
In the preceding section, we saw how a WEEKLY REVERSAL (BUY) signal took place when a stock is in a downtrend. Now let us look at how this signal takes place during an up-trend and indicates a reversal from a bullish trend to a bearish trend. We will call this signal WEEKLY REVERSAL (SELL). We will also use the same stock ANDW as our example to explain this signal.

See below the weekly prices as well as weekly chart of ANDW around November 2002. For this period, the stock seems to be making new high prices week after week.

2-Dec-02	*11.33*	12.51	10.54	*10.91*	1458400
25-Nov-02	10.72	11.35	10.21	**11.25**	878325
18-Nov-02	9.76	11.13	9.38	10.73	1220400
11-Nov-02	9.14	9.86	9	9.8	1008400
4-Nov-02	9.21	10.12	8.91	9.2	1122760

The stock had a weekly High and also a recent few weeks High price at 11.35$ during the week of 25-Nov-02. Then during the next week, the stock continued its upward journey and reached a High of 12.51$. Then it started trading lower. When it went below the current week's Open of 11.33$, it created a Bear Week up till then. Then when it traded below Previous Week's Close price of 11.25$, there was a potential WEEKLY REVERSAL (SELL) signal in the making.

This was the time a trader would contemplate closing Long positions and taking Short positions on ANDW. Also when the week actually ended, the stock closed at 10.91$ which was lower than Previous Week's Close of 11.25$. So our WEEKLY REVERSAL (SELL) signal was confirmed.



On the Chart above, you will be able to see what happened in ANDW stock since we had our WEEKLY REVERSAL (SELL) signal in it during the first week of Dec 2002. The stock changed its course from the prior up-trend to a downtrend and ultimately dropped to around 6.00$. As we have already seen in our discussion of WEEKLY REVERSAL (BUY) signal, around this 6$ price level, we had a buy signal, WEEKLY REVERSAL (BUY), prompting us to close Short positions and start fresh Long positions.

Let us now summarize the conditions for WEEKLY REVERSAL (SELL) signal during an up-market.

1. The stock has to be in a continued up-trend. This means that for at least the previous three or more weeks, the weekly high price has to be getting higher. As seen above for ANDW, prior weekly highs were getting higher: 9.86, 11.13, 11.35.

2. Previous Week has to be a Bull Week. This means that Previous Week's Close price has to be HIGHER than Previous Week's Open price.
PWC > PWO (11.25 > 10.72 for ANDW)

3. This week up until now has to be a BEAR WEEK. This means that the current price or the TWC price has to be LOWER than This Week's Open price. **TWC < TWO**

This signal started taking shape when ANDW traded below 11.33. At the actual end of the week, it proved to be a Bear Week: (10.91 < 11.33)

4. This Week's High price (TWH, 12.51 for ANDW) has to be HIGHER than Previous Week's High price (PWH, 11.35 for ANDW). **TWH > PWH**

The more the difference between TWH and PWH, the more powerful the signal is going to be. For ANDW, this was a significantly large difference of 1.16$!

5. This Week's High price (TWH) up till now has to be the highest price for the stock in the last few weeks. (The price of 12.51 was in fact the highest price for ANDW over many preceding weeks.)

6. If the current price (which we take here as TWC, This Week's Close, for the moment) is LOWER than Previous Week's Close price, we can see this as a WEEKLY REVERSAL (SELL) signal in the making. If this week had actually ended, we would have confirmed the test for this condition. **TWC < PWC**

Volume is not as important in weekly signals as it is in the previously discussed daily signals. However if volume is also heavy during the WEEKLY REVERSAL (SELL) signal week, it does give a boost to the signal. For the case of ANDW above, we do see a significant increase in volume during the reversal week.

<u>Key Points to remember:</u> Current Trend- Strong Up-trend. Open- Doesn't matter. Close- must be strongly negative. Week- Bear week. Volume- increase in volume is helpful. High of this week should be the highest.

<u>StockFetcher.com Syntax:</u> "Show stocks where Close dropped more than 1 percent over the weekly close 1 week ago and weekly close dropped more than 1 percent over weekly open and weekly close 1 week ago is above weekly open 1 week ago and weekly close 2 week ago is above weekly open 2 week ago and weekly high 1 week ago is above weekly high 2 week ago and weekly high reached a new 5 week high and weekly high gained more than 1 percent above high 1 week ago and volume is above 500000 and close above 2 and chart-display is weekly "

<u>ACTION:</u> When this signal takes place it indicates the end of the current up-trend. So if you have any Long positions, you should consider closing them. You can also sell the stock and initiate fresh Short positions. Sometimes when this WEEKLY REVERSAL (SELL) occurs only after a prior two/three weeks' up-trend making This Week's High price the highest only for the last three weeks or so, it is not a strong signal. In this scenario, if you have Long positions, you should close them but for fresh Short positions, it might be more advantageous to wait for some additional confirmation.

<u>STOP-LOSS:</u> This Week's High price plus a margin of safety (0.5% to 1%)

SIGNAL R7: 3-WEEK REVERSAL

<u>3-WEEK REVERSAL (BUY):</u>

This is another weekly signal that uses weekly prices instead of daily prices and it is little more difficult to apply than the signals discussed so far. Like a WEEKLY REVERSAL signal, this 3-WEEK REVERSAL is also a powerful trend reversal signal. This signal can be used as a stand-alone trading signal but it acts as a powerful confirmation for other trend reversal signals. If we have a 3-WEEK REVERSAL signal on the same day or on the subsequent day of a U-TURN, TURN AROUND, REVERSE or a JUMP START signal, we can be very sure of a major trend reversal.

As was explained for a WEEKLY REVERSAL signal earlier, we don't have to wait for the final weekly Close price (Friday's Close) to apply a 3-WEEK REVERSAL signal. A trader can take the current price as This Week's Close (TWC) price and apply it to the other conditions of this signal; and as soon as all or most of the important conditions are fulfilled, he can trade the stock. However when the week actually ends, he will need to see if the final Close price also fulfills the conditions for the 3-WEEK REVERSAL signal. If the signal is not valid on the actual Close price, he should close the positions taken during the week on anticipation of the signal. There is a trade-off here - if he waits till Friday's Close, he can save himself from some erroneous trades and losses. However if the reversal in prices is very powerful, the Friday's Close is going to be too high. So waiting till Friday's Close can turn into a lost opportunity. Hence considering one's objective, circumstances, nature of the stock and the tone of the market, a trader can trade during the week as soon as a reversal shows some signs or can wait till the close of markets on Friday to be sure of a valid signal. One middle ground approach is to close existing positions that are against the likely new trend as soon as the current price signals a 3-WEEK REVERSAL signal and then take new positions only after Friday's Close (This Week Close) fulfills all conditions and gives us a valid 3-WEEK REVERSAL signal.

Conditions for a 3-WEEK REVERSAL (BUY) signal:

1. The stock has to be in a downtrend for the previous five or more weeks.

2. The Previous Week has to be a Bear Week. This means that Previous Week's Close price has to be LOWER than Previous Week's Open price.
   PWC < PWO

3. The Previous-to-Previous week has to be a Bear Week. This means, that Previous to Previous Week's Close price has to be LOWER than its opening price. (This condition is nice-to-have but not always required.)
   QWC < QWO

4. This week has to be a Bull Week. This means that the current price during the week or the TWC price has to be HIGHER than This Week's Open price.
   TWC > TWO

5. The current price during the week or This Week's Close has to be HIGHER than Previous Week's High price and should also be HIGHER than Previous-to-Previous Week's Close price.
   TWC > PWH and TWC > QWC.

6. Volume is not as useful in weekly signal as it is in signals based on daily prices. However if volume is also heavy during the 3-WEEK REVERSAL (BUY) signal week, it does boost our signal.

Key Points to remember: Current Trend- strong down-trend. Open- Doesn't matter. Close- must be strongly positive. Week- Bull week. Volume- increase in volume is helpful.

StockFetcher.com Syntax: "Show stocks where Close is above the weekly high 1
week ago and close is above the weekly close 2 week ago and
weekly close gained more than 1 percent over weekly open and
weekly Low 1 week ago is below weekly low 2 week ago and
weekly close 1 week ago is below weekly open 1 week ago and

weekly close 2 week ago is below weekly open 2 week ago and volume is above 500000 and close above 2 and chart-display is weekly and close is 15% below 10 week high”

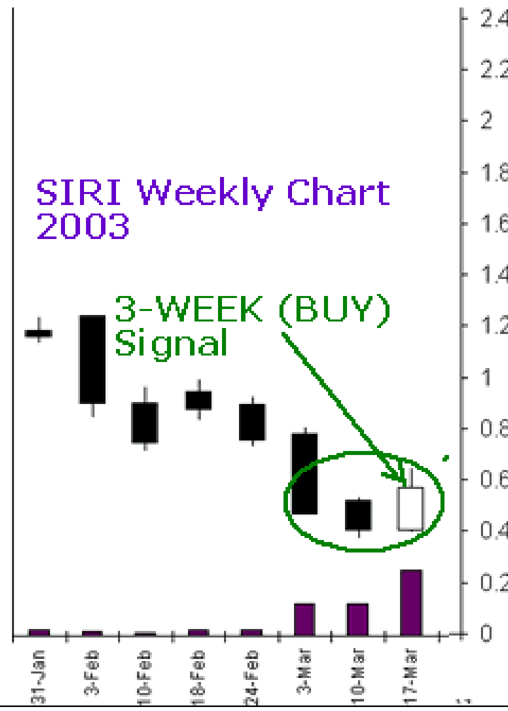
Let us look at the weekly prices for SIRI (Sirius Satellite Radio) around March 2003.

17-Mar-03	0.41	0.65	0.4	0.58	67366840
10-Mar-03	0.53	0.54	0.38	0.41	33822040
3-Mar-03	0.79	0.81	0.47	0.47	32603140
24-Feb-03	0.9	0.93	0.74	0.76	5931080
18-Feb-03	0.95	1	0.84	0.88	6507000
10-Feb-03	0.91	0.97	0.72	0.75	3179060
3-Feb-03	1.25	1.25	0.85	0.9	4336760
27-Jan-03	1.23	1.25	0.94	1.16	6273000

As we are going to apply this signal during the 17-Mar week, it is our This Week. The week of 10-Mar is the Previous Week and the week of 03-Mar is our Previous-to-Previous Week.

From the chart on the right or the prices above, a downward trend in SIRI’s prices is quite obvious (Condition 1).

Weekly price chart of SIRI Mar 2003



Now during the week of 17-Mar-03, it reversed the trend. When it traded above 0.54$ (higher than Previous Week’s High price, as well as higher than Previous-to-Previous Week’s Close price), it passed one of the most important TEST conditions for a 3-WEEK REVERSAL (BUY) signal (Condition 5). When the week ended, the stock actually closed at 0.58$. Also the previous week was a Bear Week (Condition 2) and so was the week prior to it (Condition 3). However the current week was a Bull Week as the stock closed (at 0.58$) higher than the Open price of 0.41$ (Condition 4). This was the first Bull Week after quite a few Bear Weeks. Thus we had almost all the conditions for 3-WEEK REVERSAL fulfilled.

ACTION:

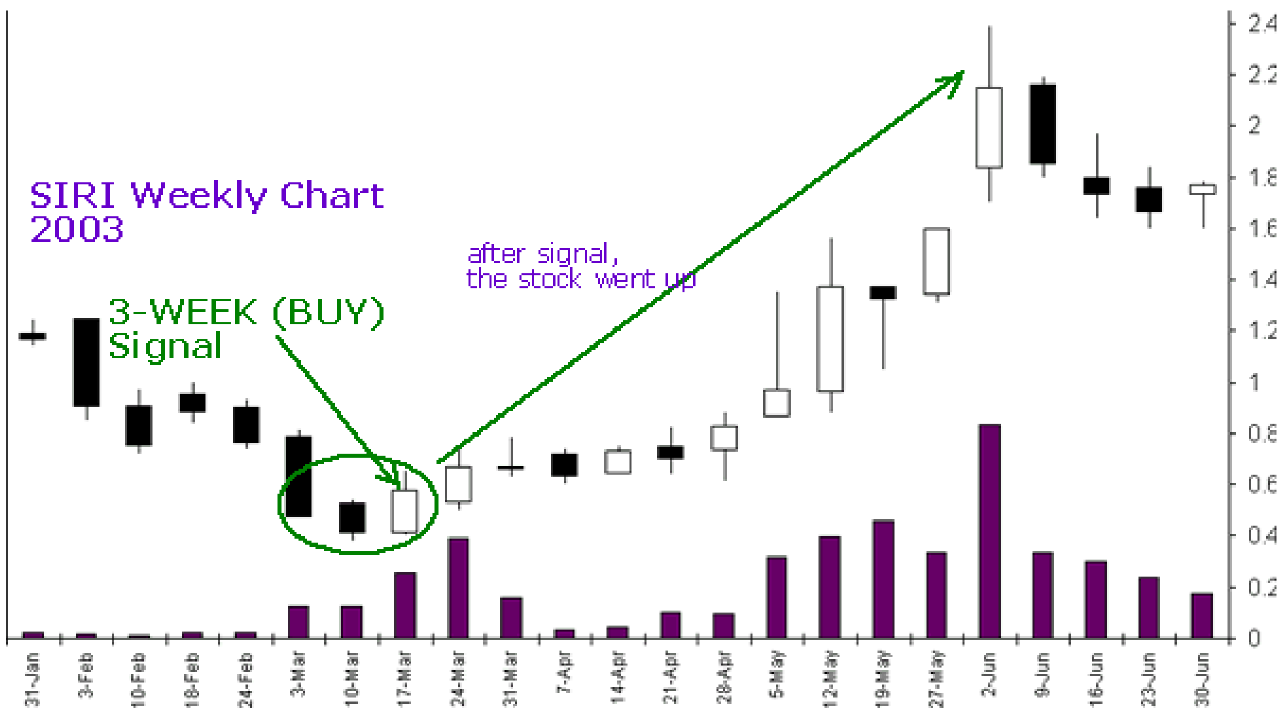
When a 3-WEEK REVERSAL (BUY) takes place, it indicates the end of the current down-trend. Hence any existing Short positions should be immediately closed and fresh Long positions can also be initiated. Subsequent to a valid 3-WEEK REVERSAL (BUY), a trader should consider the new trend to be an up-trend until the Stop-loss is triggered.

Sometimes when this 3-WEEK REVERSAL (BUY) occurs on the same day or within two/three days of the U-TURN (BUY) or TURN AROUND (BUY) signal, **this duo makes one of the most powerful amazing trend reversals.** In such situations, one can take large positions subject to a proper Stop-loss.

STOP-LOSS:

For trades in response to a 3-WEEK REVERSAL signal, Stop-loss should be kept at the lowest price of the three weeks we are analyzing (minus 1% or so). In our example of SIRI, our Stop-loss is at 37 cents.

Now let us look at what happened to the price of SIRI's stock subsequent to our 3-WEEK REVERSAL (BUY) signal. From the chart below, it can be seen that the Stop-loss of 37 cent was not broken. SIRI entered into an up-trend and ultimately touched 2.50$. So for a trend reversal that was indicated at 56 cents with a Stop-loss at 37 cents, the stock ultimately touched a high of 2$ and 40 cents. What an impressive trend-reversal!



3-WEEK REVERSAL (SELL)

In the preceding section, we saw how a 3-WEEK REVERSAL (BUY) signal takes place when a stock is in a down-trend. Now let us look at how the reverse of this signal, which we will call 3-WEEK REVERSAL (SELL), takes place during an up-tend and indicates a reversal from a bullish trend to a bearish trend

Conditions: Let us first list conditions for the for a 3-WEEK REVERSAL (SELL) signal during an up-trend in prices.

1. The stock has to be in a continued up-trend for the previous five or more weeks.

2. Previous Week has to be a Bull Week. This means Previous Week's Close price has to be HIGHER than Previous Week's Open price.
   PWC > PWO

3. Previous-to-Previous Week has to be a Bull Week too. This means, that Previous to Previous Week's Close price has to be HIGHER than its opening price. (In certain cases, this condition can be ignored.)
   QWC > QWO

4. This week has to a Bear Week. This means, the current price during the week or the TWC price has to be LOWER than This Week's Open price.
   TWC < TWO

5. This Week's Close or the current price as of the moment has to be LOWER than Previous Week's Low price; also it (This Week's Close) has to be LOWER than Previous-to-Previous Week's Close price.
   TWC < PWL and TWC < QWC

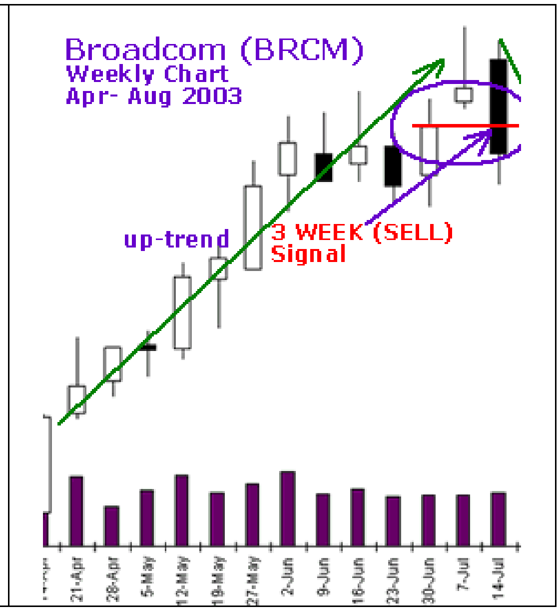
6. As said earlier, Volume is not as important in weekly signals as it is in daily signals. However if volume is also heavy during the 3-WEEK REVERSAL (SELL) signal week, our trend reversal assumption gets a big boost.

Key Points to remember: Current Trend- strong up-trend. Open- Doesn't matter. Close- must be very negative. Week- Bear week. Volume- increase in volume is helpful.

Let us now take an example to strengthen our understanding of 3-WEEK REVERSAL (SELL) signal. Please look at the weekly prices and also the Weekly chart of BRCM around November 2002 when it was in a solid up-trend.

BRCM Weekly Prices

14-Jul-03	**28.85**	**29.5**	**24.54**	**25.56**	**13268980**
7-Jul-03	27.37	29.96	27.13	27.86	12687480
30-Jun-03	24.84	27.5	23.8	26.56	12668300
23-Jun-03	25.86	26.36	23.88	24.45	12446520
16-Jun-03	25.25	27.75	24.65	25.86	14358820
9-Jun-03	25.63	27.03	24.63	24.65	12982880
2-Jun-03	24.87	26.89	23.61	26.01	18661460
27-May-03	21.63	25.35	21.6	24.51	15618075
19-May-03	21.28	22.58	19.6	22.03	13361780
12-May-03	18.88	21.88	18.54	21.4	17813360

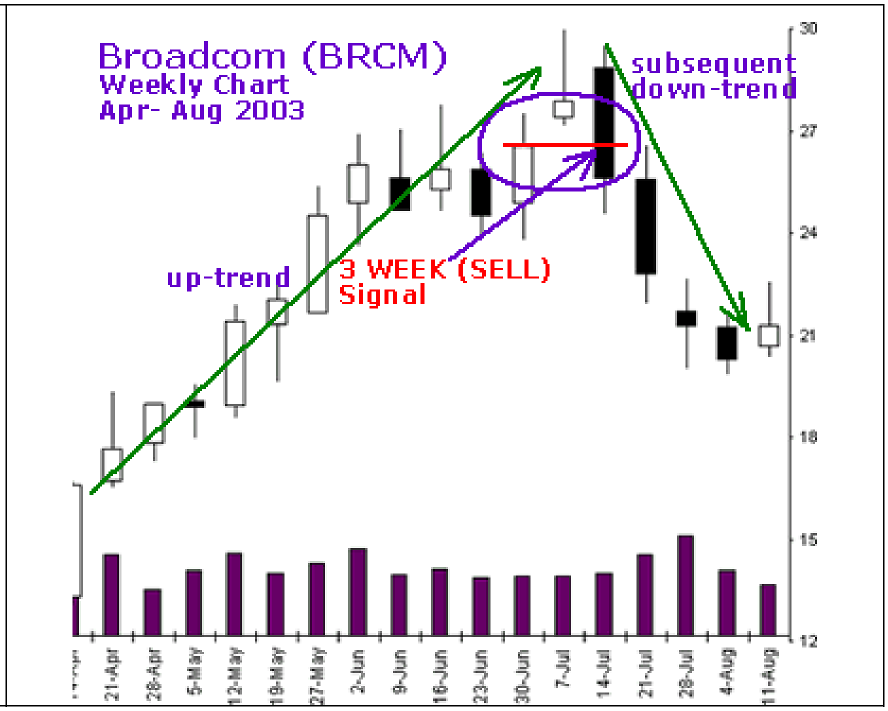


Prior to the week of July 7, BRCM was in a definite up-trend (Condition 1). Also, the weeks of July 7 and June 30 were both Bull weeks (Condition 2 and Condition 3).

During the week of July 14, BRCM opened at 28.80$ and closed lower at 25.56$ making it a Bear Week (Condition 4). Also as you notice, 25.56$ was lower than Previous Week's Low of 27.13$ and lower than Previous-to-Previous Week's Close of 26.56$, fulfilling the important Condition 5. Volume was also kind of higher, favoring us. Thus we had a pretty good 3-WEEK REVERSAL (SELL) signal, passing all the required conditions.

An active trader paying close attention to prices during the session would have caught this signal as soon as BRCM started going below 26.50$ which was lower than the Low of Previous Week as well as the Close of Previous-to-Previous Week. He could have traded right around that level. As mentioned earlier, he would not have to wait till the close on Friday to apply this signal.

Look at the Chart to the Right to see what happened to the BRCM stock price subsequent to our 3-WEEK REVERSAL (SELL) signal. The stock changed its course from the prior up-trend to a downtrend and reached a low of 20.00$ over the next two to three weeks. This proves the strength of this signal in spotting trend reversals that might have been missed by previous signals.



ACTION: When 3-WEEK REVERSAL (SELL) signal takes place, it indicates the end of the current up-trend. Hence any Long positions should be immediately closed and fresh Short positions can also be initiated.

When this 3-WEEK REVERSAL (SELL) occurs on the same day or within two/three days of the U-TURN (SELL) or TURN AROUND (SELL) signal, **this duo makes one of the most powerful amazing trend reversals and such opportunities should never be missed.**

STOP-LOSS: For new positions based on this signal, Stop-loss should be kept at the highest price of the three weeks used in the signal (plus 1% or so). So for our example above, the Stop-loss for any Long position in BRCM would be at 30.00$.

Chapter

7

TREND CONTINUATION SIGNALS

In the previous chapter, we learned about Trend Reversal signals. Now in this chapter, we will look at some Trend Continuation signals. Trend Reversal signals are designed to help us identify trading opportunities when the trend in stock prices is reversing or changing direction. On the other hand, Trend Continuation signals take place while the stock is trading in a trend. They suggest, and confirm, that the current trend in stock prices is likely to continue over the next few trading sessions. Trend Reversal signals can sometimes provide us highly profitable trading opportunities and such positions can be held for a longer period of time- sometimes up to few months. On the other hand, Trend Continuation signals usually should be used for holding trading positions over a relatively short period of time and for relatively smaller amount of profit. Normally, Trend Continuation signals do not have as powerful trading implications as Trend Reversal signals do. Sometimes we get a Trend Continuation signal when the stock has already appreciated well. So if the trend were to reverse subsequent to our trade, there are possibilities for substantial losses. So it is very important to enforce strict stop-loss in trades initiated due to Trend Continuation signals. I am not trying to say that these signals, which we are going to see in this chapter, are more risky or less effective but I want to highlight the relatively shorter time frame for such trades and the importance of Stop-loss as a protection mechanism if the signal fails.

There is one good thing about Trend Continuation signals. When we take an action based on such signals, the trend is in our favor. So even if the signal is not very strong, our position has a higher probability to result into profit! A trend is a friend. So whenever a trade is made in the direction of the current trend, it is more likely to result into profit than in loss. This means when the trend is up, even weak BUY signals can give us profit, and when the trend is down, it is usually profitable to trade on even weak SELL signals. The caveat here: protect yourself with a stop-loss. Another thing to remember with regard to trend-trading is- protect yourself from your emotions. Most of us, at some point, suffer from the smartest person's syndrome, and that gets us into trouble. We somehow get convinced, maybe because a friend, an analyst, CNBC or some article has a strong positive/negative opinion on the outlook of a stock, that the current stock price is too high or too low. So we start expecting a trend reversal! Despite the fact that the stock is in an up-trend, we feel very comfortable taking short positions in it. So despite our initial 'intelligence' and then subsequent wishful thinking, the stock may keep going up hurting us financially. The usual end result of this approach is even more dangerous. Because we were convinced of an imminent reversal, we might have decided to ignore the Stop-loss this time. We stick to this trade too long despite the fact that it is going against us. As time passes, it becomes harder and harder for us to justify why it is going up. At this point in time when the stock has appreciated significantly since we shorted it, to close this position and to book a loss seems like a direct attack on our intellect/keenness/self-esteem! Buying back this stock at even a higher price looks more stupid to our smart eyes and hence we decide to wait a few more days. And usually we end up with significant financial losses in such trades. The loss in such trades is not the complete story- the really big loss is the loss of trading opportunities while the stock continued its journey in its trend. So Trend Continuation signals can often prove valuable in protecting us from our emotions and save us from getting into wrong trading positions. They can keep us stay focused on listening to what prices are telling us, instead of falling into common trading traps.

Now let us explore our trend-trading signals. To find trend continuing signals we will first look at the signals during an up-trend and then we will also look at how the same signal takes place in a downtrend. Similar to what we have been doing in previous chapters, we will suffix these signals with (BUY) for bullish implications or (SELL) for bearish implications.

SIGNAL C1: GAP

GAP (BUY):

This is a common signal. Most of you may already know of it or have at least heard about it. Most of the time, a stock trades in a continuous price range but sometimes it jumps to a higher or a lower level abruptly. This usually happens when because of some piece of news or some development, a stock opens for trading the next day too high or too low with a gap in prices. This is commonly referred to as a GAP. It is easier to spot a GAP on a chart but if you are following the four daily prices, it is not that difficult to find this incident in these prices too. If Today's Low is higher than Previous Day's High price, we have an upward gap. If Today's High is lower than Previous Day's Low price, we have a downward gap.

The GAP signal mostly occurs on a daily chart but sometimes it can be seen in weekly prices or a weekly chart too. Let us take an example of a GAP signal. Suppose a stock has the following daily prices for two consecutive days.

19-Aug-03	23.26	24.38	23.16	24.29	6866600
18-Aug-03	21.78	22.52	21.76	22.46	1913500

On 18th Aug, it traded between a high of 22.52 and a low of 21.76. Then on the next day, the stock trades between a high of 24.36 and a low of 23.16. As you notice, over these two days, the stock traded as high as 24.38 and as low as 21.76, but there was not one single trade that took place between 22.52 (Previous Day's High) and 23.16 (Today's Low price). This is called a GAP.

Conditions:

Here is the list of conditions required for an ascending GAP (BUY) signal to take place.

1. The stock has to be in an Up-trend. So for the last few days, the stock has to be moving higher.

2. Today's Low price has to be HIGHER than Previous Day's High price (a GAP condition). **TDL > PDH** The more the difference between, TDL and PDH, the more powerful the signal will be.

3. Today has to be a Bull day. Today's Close has to be HIGHER than Today's Open. **TDC > TDO**

4. It is desirable to have higher volume today in comparison with the volume of the last few days. This is not required but if it is true, it further strengthens the signal.

Key Points to remember: Current Trend- up-trend. Open- strong Open. Day- must be a Bull day. Volume- increase in volume is helpful.

Stockfetcher.com Syntax: Show stocks where low is more than 1% above the high 1 day ago and close is above the open and volume reached a new 3 day high and average volume (10) is above 200000 and close is above .40

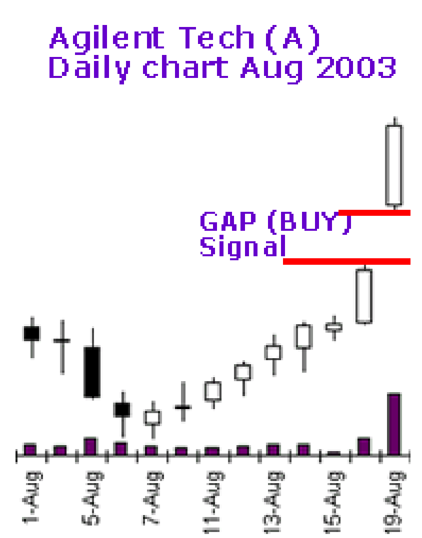
BRIEF EXPLANATION: The stock is in an Up-trend. This means its price is moving higher for the last few days indicating that buyers in the stock are demanding it even at a higher price and they are more aggressive than sellers. Now because of some good news or development overnight or maybe just for some psychological/emotional buildup, the stock opens strong for trading today at a price higher than yesterday's high price. As Demand and Supply in Economics would indicate, higher price should usually reduce Demand and/or increase Supply. So one would expect the price to go down. However if the stock trades higher than Previous Day's High price for the entire trading session today, we can confer that there was some powerful shift in the demand curve or the supply curve. This wasn't just some emotional or psychological build-up overnight. If the stock closes higher than today's opening price too making it a Bull day, we can be sure of an accumulation that happened throughout the trading today. What does this mean to us? This means the up-trend in the stock price is gaining further momentum so we can expect it to continue going up from the current level.

Let us take an example of A (Agilent Technologies) to understand this signal.

Daily prices for A:

19-Aug-03	23.26	24.38	23.16	24.29	6866600
18-Aug-03	21.78	22.52	21.76	22.46	1913500
15-Aug-03	21.66	21.87	21.54	21.78	481200
14-Aug-03	21.45	21.79	21.15	21.76	1246400
13-Aug-03	21.3	21.63	21.1	21.49	1232200
12-Aug-03	21.05	21.29	20.85	21.25	1085600
11-Aug-03	20.79	21.08	20.69	21.02	989900
8-Aug-03	20.73	21.02	20.52	20.69	1015700
7-Aug-03	20.48	20.78	20.31	20.67	1149200

During early August, the stock was in an up-trend (Condition 1). Then on the 19th, Agilent had a Low of 23.16 that was higher than the high price of the previous day at 22.52 (Condition 2). Also on the 19th, Agilent closed at 24.29, which was higher than that day's opening price of 23.26 making it a Bull Day. This fulfilled our second important condition (Condition 3). Volume on the 19th turned out to be higher than the previous few days' volumes, which gave a further boost to our signal. So all of our conditions were fulfilled for a GAP (BUY) signal.



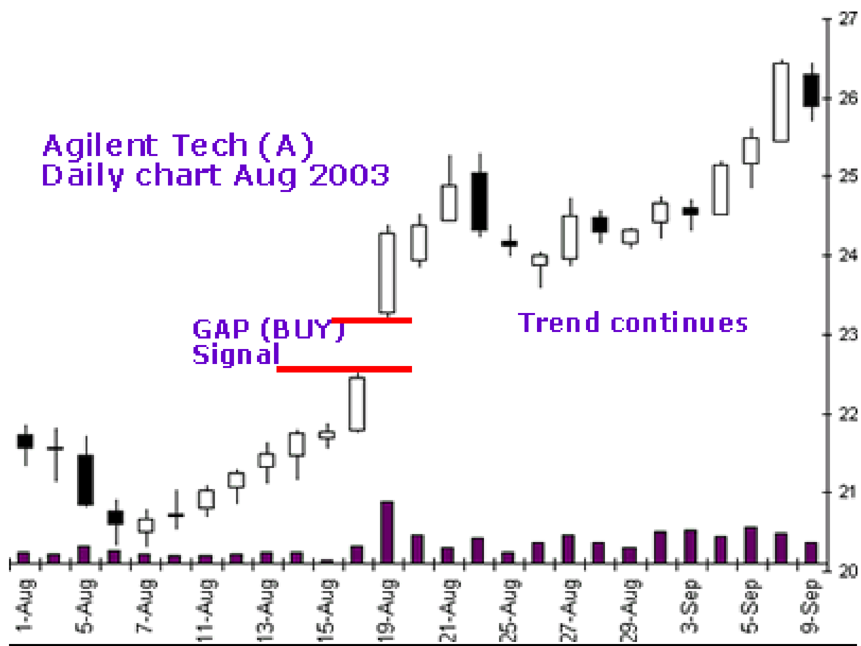
ACTION: When this signal takes place in an up-trend, you should close any short positions you may have in the stock. You can also initiate fresh long positions.

STOP-LOSS: It is not easy to suggest one price level for a Stop-loss for this signal. Possible Stop-loss levels are Today's Low price, Previous Day's High price or Previous Day's Low price. A reader should choose his Stop-loss based on his risk tolerance, the stock's volatility, market conditions and other factors.

Sometimes a gap is so large, a Stop-loss at Previous Day's Low price looks ridiculous. So I would leave it mostly to the reader. Having said this, I would ask my reader to keep some Stop-loss and not to ignore or overlook a Stop-loss for this signal.

I would also like to add one more thing here. After you buy any stock based on the GAP (BUY) signal, you should look for a Close price higher than the high price on the signal day over the subsequent three days. If this is not happening, you may close the position at the end of three days instead of waiting for your Stop-loss to be triggered.

PRICE OBJECTIVE: Now let us look at a complete chart of Agilent after the GAP (BUY) took place. As can be seen from the Chart below, the stock continued its upward journey. It did not trigger our Stop-loss and it did touch a new high price of 26.00.



GAP (SELL)

Let us see how to identify this signal in a downtrend. As this is a trend continuation signal, when it takes place during a stock in a downtrend, it indicates further continuation of the downtrend and you can expect new lower prices in the stock. Let us first list the conditions that form this signal and then we will take one example to strengthen our understanding.

Conditions:

1. The stock has to be in a downtrend. So for the last few days, the stock has to be making lower daily low prices.

2. Today's High price has to be LOWER than Previous Day's Low price (a GAP condition). **TDH < PDL**. The more the difference between Previous Day's Low (PDL) and Today's High (TDH), the more powerful the signal will be.

3. Today has to be a Bear Day. Today's Close has to be LOWER than Today's Open. **TDC < TDO**

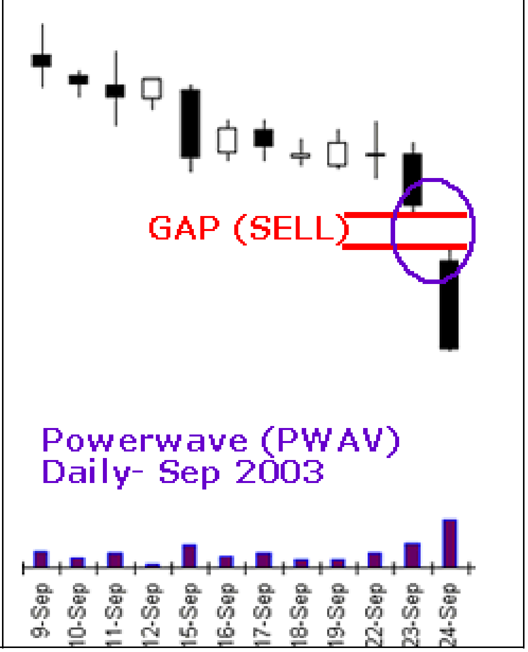
4. It is desirable to have higher volume today in comparison with the volume of the last few days. This is not required but if it is true, it further strengthens the signal.

<u>Key Points to remember:</u> Current Trend- down-trend. Open- weak Open. Day- must be a Bear day. Volume- increase in volume is helpful

<u>Stockfetcher.com Syntax</u>: " Show stocks where high is more than .25% below the low 1 day ago and close is below the open and volume reached a new 3 day high and average volume (10) is above 100000 and close is above 1 "

Daily prices of PWAV (PowerWave technologies):

24-Sep-03	8.37	8.5	7.37	7.38	10580500
23-Sep-03	9.55	9.66	8.89	8.97	5189200
22-Sep-03	9.51	9.89	9.27	9.54	3156400
19-Sep-03	9.4	9.8	9.37	9.66	1788200
18-Sep-03	9.5	9.7	9.4	9.54	1599100
17-Sep-03	9.81	9.91	9.45	9.61	3243000
16-Sep-03	9.55	9.91	9.45	9.82	2618200
15-Sep-03	10.24	10.3	9.33	9.49	4980700



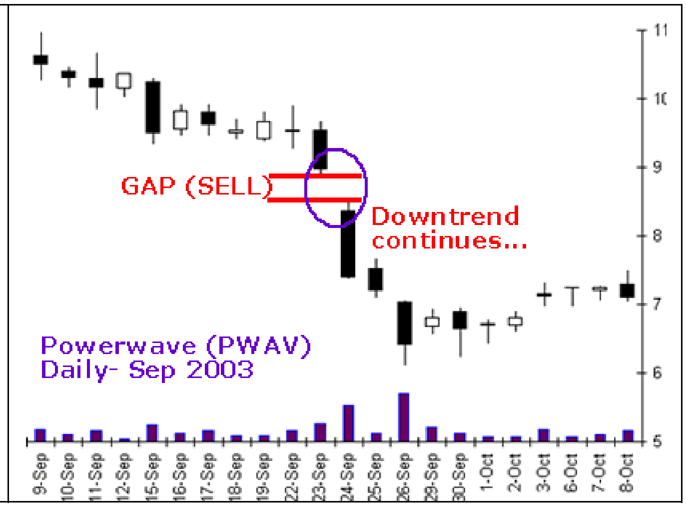
As seen on the Chart above, in late September, PWAV was in a downtrend (Condition 1). It was making lower low prices over these days. On September 24th, PWAV had a daily High price of 8.50, which was lower than the Previous Day's (September 23's) Low price of 8.89 (Condition 2). So during these two days, PWAV stock did not trade between 8.89 and 8.50, creating a GAP in prices.

Also on the 24th, PWAV closed at 7.38, which was much lower than that day's opening price of 8.37. This made it a Bear Day and fulfilled our important test (Condition 3). Volume on the 19th was also higher than the daily volume over the previous few days. This boosted the significance of the GAP (SELL) signal and enhanced our confidence that today's sell-off in the stock was not likely to be the end of the sell-off the stock is portraying/we are witnessing. Our signal GAP (SELL) advised us to go short in the stock at current prices.

See below what happened to the PWAV stock over the next few days. The next day the stock gave various opportunities to take fresh short positions around 7.50. The stock closed for the day at 7.19 - a lower close than Previous Day's Close of 7.38. This provided a confirmation for our signal. Then on the subsequent day, PWAV made a low of 6.10 and closed at 6.40 with very heavy volume. This was the final sell off in the stock. If you go to the prices of Sep 29th, you will see that there was a FULL STOP (BUY) signal on that day. After the previous day's sell-off, the stock had stayed higher than Previous Day's Close of 6.40 throughout the session. This would have prompted us to close our short positions and initiate long positions with a Stop-loss at 6.10.

Here is what happened to PWAV after the GAP (SELL).

30-Sep-03	6.89	6.95	6.23	6.64	2370200
29-Sep-03	6.66	6.93	6.57	6.8	4369700
26-Sep-03	7.03	7.05	6.1	6.4	13942900
25-Sep-03	7.52	7.67	7.09	7.19	2464900
24-Sep-03	**8.37**	**8.5**	**7.37**	**7.38**	**10580500**
23-Sep-03	**9.55**	**9.66**	**8.89**	**8.97**	**5189200**



ACTION: When GAP (SELL) signal takes place, you should close existing Long positions, if any, that you may have in this stock. You can also initiate fresh short position with a proper Stop-loss.

STOP-LOSS: As mentioned previously for GAP (BUY), it is difficult to suggest one good Stop-loss level for trades based on this signal. Possible Stop-loss levels are Today's High price, Previous Day's Low price or Previous Day's High price. A reader should choose his Stop-loss based on his risk tolerance, the stock's volatility, market conditions and other factors.

Sometimes a gap is so large, a Stop-loss at Previous Day's High price looks ridiculous. So I would leave it mostly to the reader. Having said this, I would ask my reader to keep two things in mind: (i) Do keep some Stop-loss, and (ii) see if the trade meets a 3:1 or 2:1 ratio of potential for profit to the potential for a loss.

I would also like to add one more thing here. After you Short a stock based on the GAP (SELL) signal, you should look for a Close price lower than the Low price on the signal day over the subsequent three days. If this is not happening, you may close the position at the end of three days instead of waiting for your stop-loss to be triggered.

SIGNAL C2: RESTART

RESTART (BUY)

This signal indicates continuation of the major up- or down- trend **after a Reaction or a Correction**. For a stock in a Bull trend, its price has an overall upward movement but as we know this movement is not continuous. The stock does not keep going up every day. The stock may go up a few days and then profit-taking or selling increases at a higher level and the stock goes down for a few days. This is a like a pause before it continues its upward movement. These types of movements that are contra to the main trend are called Reactions in a Bull trend. In other words, a Reaction is a temporary pause of the bullish trend. Similarly in a downtrend, when a stock goes up for a few days, we call this temporary up-trend in a major downtrend a Correction.

The signal we are going to discuss is primarily used to spot when the stock is likely to end its Reaction/Correction and resume its main trend. So let us call it the RESTART signal because all it does is to tell us that the main trend is about to restart. Like the previous signal (GAP), this RESTART signal is also easier to spot on a chart; but if you are following daily prices, it is not that difficult to see it occur. This signal mostly occurs on a daily chart but sometimes it can be seen in weekly prices or on a weekly chart too.

Let us first discuss the conditions that form the basis for this RESTART (BUY) signal, and then we will take an example.

Conditions:

1. The main trend for the stock has to be an up-trend but for most recent days, three to ten or so, the stock should be in a kind of Side-ways or downtrend movement.

2. Today's Low price has to be LOWER than Previous Day's Low price. **TDL < PDL**. The more the difference between, TDL and PDL, the more powerful the signal would be. A small difference that is less than 0.5% to 1% of the stock price would make this signal weak.

3. Today has to be a Bull Day. Today's Close has to be HIGHER than Today's Open. **TDC > TDO**

4. Today's Close has to be HIGHER than Previous Day's Close. This is also a very important required condition for this signal. **TDC > PDC**

5. Today's Low price has to be sort of the lowest price of the current Reactionary trend.

6. It is desirable to have higher volume today in comparison with the volume of the last few days that form the Reaction. The more the increase in volume on the day of the RESTART (BUY), the stronger the signal.

Key Points to remember: Current Trend- minor down-trend. Open- doesn't matter. Close- must be strong(positive). Day- must be a Bull day. Volume- increase in volume.

BRIEF EXPLANATION: The stock is in an up-trend for the last few weeks/months. However for the last few days (roughly three to ten days), the stock seems to be going down or seems to have stopped its up-trend. This makes many people doubt the continuation of the up-trend. What is happening in this situation is simple: the Demand and the Supply phenomena of Economics are at work. As the stock has kept going up for the last few weeks/months and has made a new high price, the Demand is going down and there is likely to be some profit-taking or even short selling at such a high level. So it is as if the stock were in a pause or were resting so when it is ready, it can resume its up-trend with much more vigor.

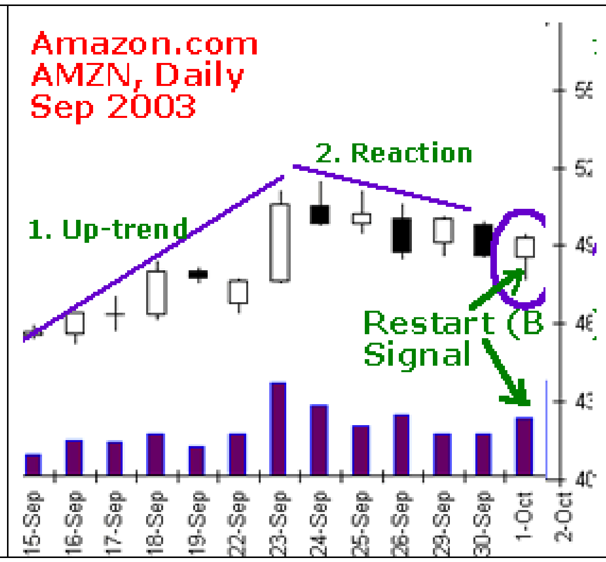
What does this signal mean? As said the stock is in a powerful up-trend but it is trading lower for the last few days. Today it makes a significantly lower Bottom than yesterday's Low price and Today's Low is also the lowest price since the Reaction set in. Now after making a lower Low, the stock turns back and starts going up usually with relatively heavy volume. Now when it trades higher than Today's Open, it makes today a Bull Day. So it seems the RESTART (BUY) signal is in the making and when it goes higher than Previous Day's Close too, our signal has passed all necessary tests. You can close your short positions if any and can initiate long positions at the current price. However, if you act based on current price during the day, you have to look at the day's closing price and see if all conditions are still fulfilled. If today is a Bull Day and Today's Close is also higher than Previous Day's Close, we can confer that there was some powerful shift in Demand today. This wasn't just some emotional or psychological buildup overnight but today's lower price attracted fresh buying in the stock and/or kept sellers away at these lower prices. So what does this mean for us? We can expect happy days to be back!

Let us take an example from AMZN (Amazon.com).

Daily prices of AMZN:

1-Oct-03	48.37	49.28	47.51	49.12	12563800
30-Sep-03	49.65	49.76	48.35	48.43	9264600
29-Sep-03	48.88	49.97	48.4	49.86	9039300
26-Sep-03	49.9	50.46	48.3	48.56	13438500
25-Sep-03	49.66	50.95	49.28	50.05	11033300
24-Sep-03	50.35	51.3	49.6	49.61	15330200

During 2003, AMZN was in a strong upward trend that had over the past few months brought the stock price from a Low price of around 10 to the current level of 45. Daily prices/the chart shown here are for the Reaction period (Condition 1) that had started a few days back at around 51.



As you can see, prices during the Reaction were going down. Then on Oct 1st, AMZN opened at 48.37, kept going down and touched a low of 47.51. This Today's Low of 47.51 was significantly lower than Previous Day's Low of 48.35 (Condition 2). Today's Low price was also the lowest price for the current Reaction (Condition 5).

After trading as low as 47.51, the stock changed its course and when it traded higher than Today's Open price (48.37) it created a possibility of today's being a Bull Day (Condition 3). Then when it traded higher than Previous Day's Close of 48.43, it was a RESTART (BUY) (a kind of reversal) in the making (Condition 4). The volume was also strong for the day. Now when the trading ended for Oct 1, AMZN actually closed at 49.12 in line with our expectations. So based on the closing prices, we had a confirmed RESTART (BUY) signal.

ACTION: When this signal takes place during a Reaction, it indicates that stock is back to its major up-trend and you can expect it to not only cross the Previous Top but also make a higher Top. In response to a confirmed RESTART (BUY) signal, you should close your Short positions and initiate fresh Long positions.

STOP-LOSS: Possible Stop-loss levels are Today's Low price, or Previous Day's Close price. The recommended Stop-loss would be at Today's Low price minus around 1%.

PRICE OBJECTIVE: Once this signal takes place, you can *expect* the stock to cross the last Top and make a new higher Top.

Now let us look at a complete chart of AMZN after the RESTART (BUY) took place. As seen from the chart below, the stock continued its upward journey. Our Stop-loss wasn't triggered and the stock crossed the previous high of 51 and ultimately made a new high of 59 over just two weeks.

Daily prices of AMZN:

9-Oct-03	57.41	59.1	57.4	57.86	21606900
8-Oct-03	55.44	56.28	55.12	55.7	13558000
7-Oct-03	54	56.25	53.95	54.91	20299900
6-Oct-03	52.89	54.24	52.59	54.15	7773100
3-Oct-03	51.13	53.22	51.03	52.89	14175600
2-Oct-03	48.94	50.2	48.68	50.09	8219900
1-Oct-03	48.37	49.28	47.51	49.12	**12563800**
30-Sep-03	49.65	49.76	48.35	48.43	9264600
29-Sep-03	48.88	49.97	48.4	49.86	9039300
26-Sep-03	49.9	50.46	48.3	48.56	13438500
25-Sep-03	49.66	50.95	49.28	50.05	11033300
24-Sep-03	50.35	51.3	49.6	49.61	15330200

As you can see from the prices and also from the Chart here, Oct 1 proved to be the actual end of the Reaction AMZN was going through. Since then, AMZN resumed its upward movement and made a high price of 59 just within the next ten trading days.

RESTART (SELL)

Let us now see how a RESTART signal works in a primary downtrend. As we know during a downtrend, a stock often has a few up days during which the stock seems to be going up. This point in time may be actually confusing. It is hard to differentiate if an actual trend reversal is going on or if it may just be that a Correction is taking place. So in the middle of such a crucial time, if you see this signal taking shape, it tells you that the stock is still not done with its down-trend! You can expect it to not only cross the Previous Bottom but to form a new lower Bottom.

Let us first list down the conditions/tests required for RESTART (SELL) and then we will look at an example to clear our understanding.

Conditions:

1. The main trend for the stock has to be a downtrend but for a few recent days, three to ten or so, the stock should be in kind of a Side-ways or up movement. (A Correction in stock prices.)

2. Today's High price has to be HIGHER than Previous Day's High price. **TDH > PDH** The more the difference between TDH and PDH, the more powerful the signal will be. A small difference that is less than 0.5% to 1% of the stock price would make this signal weak.

3. Today has to be a Bear Day. Today's Close has to be LOWER than Today's Open. **TDC < TDO**

4. Today's Close has to be LOWER than Previous Day's Close. This is also a very important required condition for this signal. **TDC < PDC**

5. Today's High price has to be sort of the highest price of the current Reactionary trend.

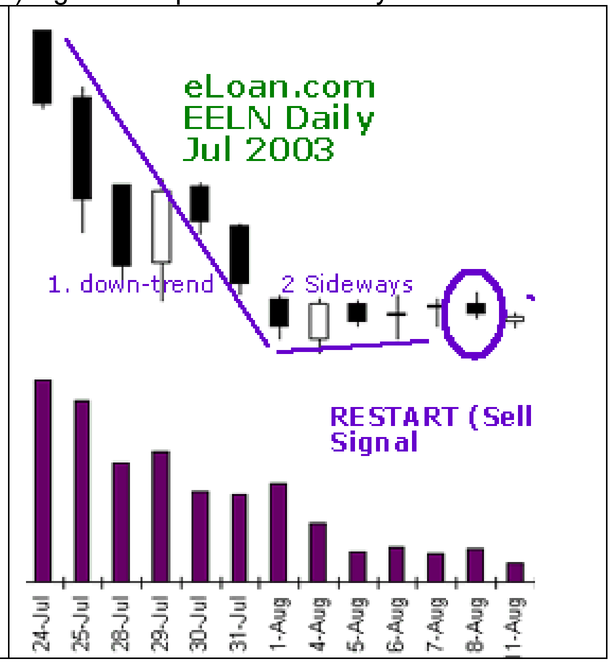
6. It is desirable to have a higher volume today in comparison with the volume of the last few days that form the Correction. The more the increase in volume on the day of the signal, the stronger the signal.

Key Points to remember: Current Trend- minor up-trend. Open- doesn't matter. Day- must be a Bear day. Close- must be strongly negative. Volume- increase in volume.

Let us take an example to understand this signal in a downtrend. When you look at the Chart below of EELN (eLoan.com), you will see EELN in a definite downtrend. However during early August, it seemed to be in Side-ways with daily prices becoming more stable in comparison to the strong downtrend of the last few weeks. Now on August 8th, the stock gave us a RESTART (SELL) signal telling us that with a Stop-loss of around 4.14, we could short sell EELN and could expect it to make a new low Bottom. Let us see how this RESTART (SELL) signal took place on that day.

Daily prices of EELN (eLoan.com):

8-Aug-03	4.02	4.1	3.9	3.94	1800300
7-Aug-03	4	4.05	3.85	4	1551800
6-Aug-03	3.95	4.07	3.75	3.93	1923700
5-Aug-03	4.02	4.04	3.84	3.88	1633700
4-Aug-03	3.75	4.05	3.65	4.02	3214500
1-Aug-03	4.05	4.08	3.75	3.85	5320800
31-Jul-03	4.58	4.59	4.08	4.15	4761200



As evident from the Chart, EELN was in a downtrend but over the recent few days it demonstrated that it was in a Side-ways movement. So the downtrend seemed to end for the last five to six days (Condition 1). Now on August 8th, EELN opened at 4.02 and made a high of 4.10 that was higher than the Previous Day's High, on Aug 7 of 4.05, fulfilling our Condition 2. Today's High of 4.10 was the recent highest price (for the last six days), fulfilling our Condition 5. As trading continued on Aug 8th, EELN started going down and when it traded at below 4.02, it created a possibility for today to be a Bear day (Condition 3). Then when it traded below 4.00, it was also trading lower than Previous Day's Close (Condition 4). Volume was also a little higher than the average volume of the last three days.

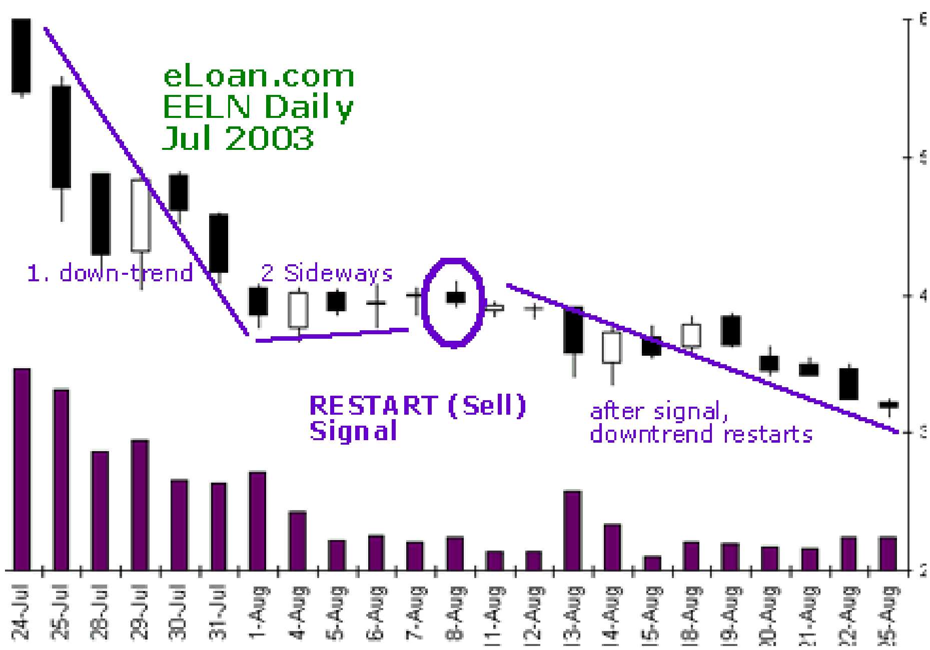
Thus we had almost all conditions fulfilled to make August 8th a RESTART (SELL) signal day indicating that the last few weeks' downtrend may resume again pushing EELN prices down to form a new lower Bottom. You can note that the volume wasn't significantly higher and also that the difference between the high price of Aug 8th and the high price of Aug 7th was only 5 cents. Both these facts made our signal a little weak but still it was a complete RESTART (SELL) signal passing our important tests.

25-Aug-03	3.22	3.25	3.11	3.18	1804200
22-Aug-03	3.46	3.5	3.23	3.23	1809900
21-Aug-03	3.5	3.54	3.41	3.41	1210200
20-Aug-03	3.56	3.63	3.41	3.44	1297600
19-Aug-03	3.84	3.87	3.61	3.64	1485000
18-Aug-03	3.61	3.84	3.57	3.79	1575900
15-Aug-03	3.7	3.77	3.53	3.56	789500
14-Aug-03	3.5	3.78	**3.34**	3.73	2490500
13-Aug-03	3.91	3.91	3.4	3.57	4326900
12-Aug-03	3.9	3.94	3.82	3.89	1029100
11-Aug-03	3.88	3.95	3.83	3.92	1003000
8-Aug-03	4.02	4.1	3.9	3.94	1800300
7-Aug-03	4	4.05	3.85	4	1551800

Now look below at EELN's prices and also the Chart to see what happened after we had this signal.

After this Correction (or a Side-ways movement) during the first few trading days of August 2003, the RESTART (SELL) signal indicated that the downtrend was again likely to gain momentum and this was exactly what happened thereafter. EELN kept sinking and made a low of 3.34 on the fourth trading day (August 14th).

Then if you look at the prices, there was another minor up-trend (or you can call it Side-ways) phase for the next three days, Aug 14th to Aug 18th. After making a higher high of 3.87 on August 19th, EELN closed at 3.64 which was lower than Previous Day's Close price of 3.79 as well as lower than Today's Open of 3.84 (a Bear Day). Thus on the 19th, we had a RESTART (SELL) signal once again. However this was a weak signal as on the 19th, the high of 3.87 was only slightly higher than Previous Day's High or 3.84. Volume wasn't much higher either. Anyway, this RESTART (SELL) signal pointed out that EELN was likely to go below the last Bottom of 3.34. If you look down the four following days, you will see that EELN broke below 3.34 and made a new low price of 3.10!



ACTION: When RESTART (SELL) takes place during a Correction, it indicates that stock is likely to continue in its major trend- downtrend, and you can expect it to not only cross the Previous Bottom but to also make a lower Bottom. In response to a confirmed RESTART (SELL) signal, you should close your Long positions and initiate fresh Short positions.

STOP-LOSS: Possible Stop-loss levels are Today's High price, or Previous Day's Close price. The recommended Stop-loss would be at Today's High price plus around 1%.

PRICE OBJECTIVE: Once this signal takes place, you can *expect* the stock to go below the last Bottom and make a new lower Bottom.

Chapter

8

MISCELLANEOUS TRADING SIGNALS

SIGNAL M1: MONDAY MORNING Signal

Here is one important signal that gives you almost one trading signal every week! This is a simple signal and all it takes to identify it are just two prices --Friday’s Close (FC) and Monday’s Open (MO) prices! Also because this signal is very simple, it tends to fail more often than the signals discussed earlier. However, the Stop-loss is very narrow for this signal and hence a losing position gets closed generally within a few hours with minimal damage to our portfolio. Thus the success rate may be lower for this signal, but this signal does have impressive payoffs. This signal provides many opportunities to earn profit two to three times more than the risk undertaken.

What is the logic behind this signal? There are certain justifications for this signal that make it a powerful indicator of the subsequent few days’ price trend.

- Stock markets almost all over the world are usually closed on Saturdays and Sundays but, as we know, things do happen on these days. What I am referring to here are some natural, geographical, economical or some political events that take place between Friday night and Monday morning. So all that happens between Friday's Close and Monday's market opening gets reflected in Monday's Open price. So Monday's Open price vs Friday's Close price is a good summary of all that happened in between and how that impacted on stock prices.

- Also, thanks to holidays, a lot of regular traders as well as investors find time to analyze the market of the previous week. This is the time many people come up with their game plan for the next week and create a wish list of what they want to buy, sell or trade during the upcoming week. This, on the aggregate level, influences the market on Monday.

- From Friday night to Sunday night, there is time for parties and socializing. This is the time most interactions take place among friends, relatives, strangers etc and often people discuss stocks. Though this may be on a smaller scale it does influence the market of the subsequent week. This is one of the reasons behind strong market openings on Mondays in a bull market.

- Last but not least, influential weekly publications as well as private paid investment newsletters are published on Friday evenings and they try to reach individual's homes, and minds, during the weekends. I am referring to Barron's and thousands of other newsletters people subscribe to. They, and also the weekly Business section of almost every newspaper, talk about the market and individual stocks in detail, and influence/shape quite a few people's investment actions for the coming week.

This all gets reflected in Monday's market opening as well as in the trading throughout the day. So I think Monday's open price is a powerful indicator of the stock prices for the subsequent few days. Let us now explore how to apply this signal and how to trade stocks based on it.

As said earlier, this signal is not suitable for every one. It makes sense for traders who typically hold a position for a few days only, *from one to three/five days at most*! This signal is suitable for people who are in constant touch with the market and who can open/close positions without any hesitation within a few hours.

With this signal you get an indication to buy or sell a stock exactly <u>on Monday morning</u>. As soon as the market opens on Monday morning, you can execute a trade within the next few hours. Let us now see how to enter into a position using this signal.

1. First, you need to know what trend the stock is currently in. A stock can be in an up-trend, a downtrend, in a Reaction/Correction or in a Side-ways movement.

2. Then you need to know Friday's Close price.

FOR A RISING STOCK (IN A BULL/UP TREND)

CASE 1: <u>If the trend is up and Monday Morning's Open price (MO) is HIGHER than Friday's Close (FC)</u>, you can take a <u>long position</u> as soon the stock/index trades HIGHER than the opening price. Keep a Stop-loss at Monday's Open price *minus* ½ % (preferred Stop-loss) or Friday's Close price *minus* ½ % (for people who hate to open and close positions too hastily).

<u>Conditions</u>:
1. Trend is Up (One quick way to find out is to look at the price chart and see the current price trend).

2. MO > FC, the stock price seems to be going up from today's opening level.

<u>ACTION</u>: You BUY this stock preferably after it starts trading higher than today's opening price level. As trading during the first 10-15 minutes of a day is usually unstable, it is also advisable to wait a few minutes (10 to 30) before you take any action. This gives the stock/market a little time so that trading can become normal and we are able to feel the trend for the day more confidently.

CASE 2: <u>If the trend is Up and Monday Morning's Open price (MO) is LOWER than Friday's Close (FC)</u>, you can take a <u>short position</u> as soon as the stock/index trades LOWER than the opening price/level. Keep a Stop-loss at Today's Open *plus* ½ % (preferred Stop-loss) or Friday's Close price *plus* ½ % (for people who hate to open and close positions too fast).

<u>Conditions:</u>
1. Trend is Up (One quick way to find out is to look at the price chart and feel the current trend).

2. MO < FC, and it starts going down from the opening level.

<u>ACTION</u>: You can BOOK PROFIT in a long position (or Short Sell it if you are a courageous trader) in this stock preferably after it trades somewhat lower. It is also advisable to wait 10 to 30 minutes after the market opens so the stock has time to cool down from the morning's choppy trading. Though we might lose some gain, this makes us more confident about our assessment of the trend emerging.

FOR A FALLING STOCK (In a Bear/Down-trend)

CASE 3: Now if the trend is **Down** and **M**onday Morning's **O**pen price (MO) is LOWER than **F**riday's **C**lose (FC), you can take a short position as soon the stock/index trades *LOWER* than the opening price. Keep a Stop-loss at Today's Open *plus* ½ % (preferred Stop-loss) or Friday's Close price *plus* ½ % (for people who hate to open and close positions too quickly).

Conditions:
1. Trend is Down (One quick way to find out is to look at the price chart and feel the current trend).

2. **MO < FC**, and it seems to be going down from the opening level.

ACTION: Not only should you close your existing Long positions but you can also SELL/SHORT this stock when it starts trading lower than the day's opening price. It is also advisable to wait a few minutes (10 to 30) so the trading in the stock becomes normal and we feel more confident about the trend emerging for the day.

CASE 4: If the trend is **down** and **M**onday Morning's **O**pen price (MO) is *HIGHER* than **F**riday's **C**lose (FC), you can close current Short positions and/or take long positions as soon as the stock/index trades HIGHER than the opening price/level. Keep a Stop-loss at Today's Open *minus* ½ % (preferred Stop-loss) or at Friday's Close price *minus* ½ % (for people who hate to open and close positions too rapidly).

Conditions:
1. Trend is Down. (One quick way to find out is to look at the price chart and feel it).

2. **MO > FC**, and it starts going up from the opening level.

ACTION: You can COVER (or *BUY* for more active traders) this stock not at the opening price but after it trades somewhat higher. It is also advisable to wait a few minutes (10 to 30) before trading to give the stock time to cool down from the morning's choppy trading.

Now let us see how we can apply this signal in real life. The following is a Chart from the famous NASDAQ market index ^IXIC. On the chart, vertical dotted lines represent Monday candles/prices. Also to make it easy, I have marked numbers from 1 to 17 to represent various signals we get on various Mondays.

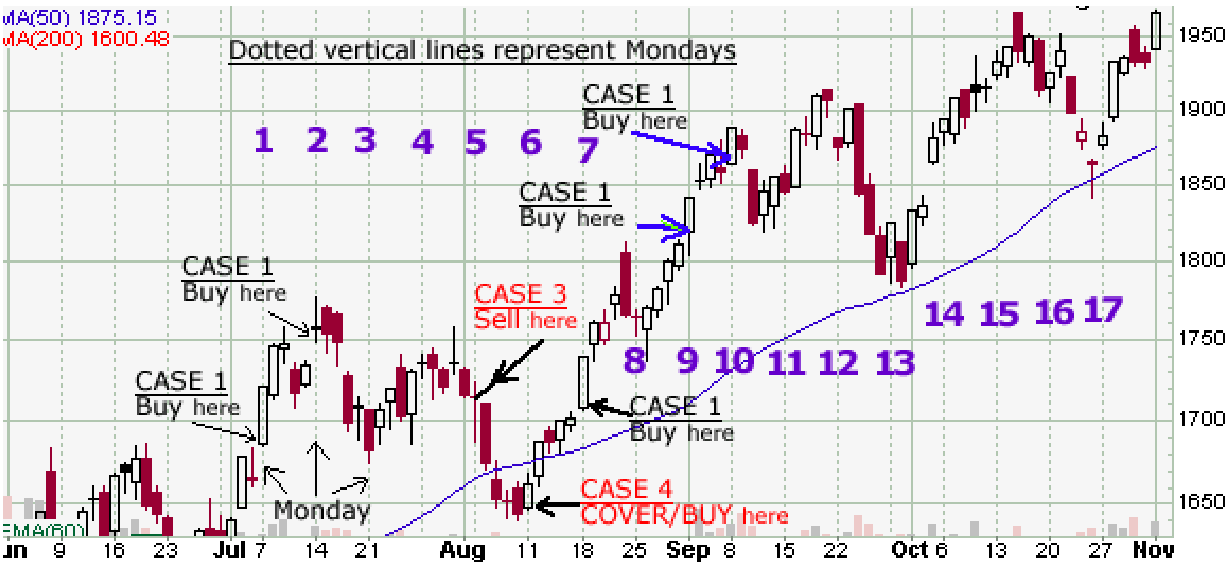


Chart courtesy of StockCharts.com.

On Monday, July 7th (marked as week/Monday 1 in the chart), IXIC opened significantly higher than previous Friday's Close level. So we would apply CASE 1 discussed above and would take long positions on that Monday morning. Now as you see IXIC kept going up over the next three days. So trades based on this signal would give good profit here.

Look at Monday, July 14th now (marked as Week/Monday 2 in the chart). Again Monday's Open was significantly higher than Friday's Close. So as per CASE 1, we would go long. Here, the index did not go higher but stayed around the same level for the next two days. So here we may or may not have good profit!

If you look at Number 3 on July 21st, it told us to go short in the morning as per CASE 3. Then the price did go lower and closed lower for the day. However if we did not book profit on the same day, we could have closed our short position on the very next day as we had a FULL STOP (BUY) signal pointing to the end of the Reaction the stock was going through! So we would have been able to close our short position without much profit/loss here.

The next signal would not offer us much profit or inflict much loss either. Now look at Number 5 on Aug 4th. The stock opened at almost the same rate as Friday's Close. However after going up a few points, it started going down and when it went below Friday's Close, we would go short as per CASE 3. The next four days would have brought us good profit here. Similarly Number 6 and 7 would have told us to take long positions on those Monday mornings; and if you looked at the subsequent days, you would find good profit there too.

For Number 8, we would have been in and out of the trade quickly without any significant profit or loss. However Number 9 would have yielded us a handsome profit! Similarly Number 14, 15 and 17 were very profitable MONDAY MORNING signals.

I hope you are able to clearly understand this signal. I would like to emphasize a few things here.

- Apply this signal to stocks that usually have powerful trends. Don't use them on stocks that are cyclical and are range bound (Side-ways) most of the time.
- A MONDAY MORNING signal fails frequently. However when it fails, you are able to close your positions quickly and with small loss.

- When these signals succeed, they usually generate attractive profit.
- When there is a significant GAP (difference) between Friday's Close and Monday's Open, the resultant signals tend to be more accurate and powerful.
- These signals are useful for traders who usually settle their trades quickly, at most, within three to five days.

SIGNAL M2: SIGNIFICANT DAY Signal

Let us add one more signal- a very simple signal. There is no complicated mathematical condition to remember. This signal has just two parts.

First, watch for a day of significant importance for the stock you are following. This can be a day that is psychologically important. Let me try to make a list of events that are likely to make a day a Significant Day.

- Initial Listing Day: This is the first day when an IPO starts trading. Applicable only to new listings.
- Split Day: When a stock starts trading at post-split rates.
- Earnings Release Day.
- Merger or Acquisition Announcement Day.
- First day of trading post-Merger or Acquisition.
- Federal Reserve meeting to decide on changing Discount/Fed Funds rate (applicable mostly to indices or ETFs, or interest rate sensitive stocks.)
- A surprise global or political event- a big earthquake, a sudden war, a terrorist attack or some significant announcement by the Government.
- A surprise market event- A day of significant development in other markets like a sudden rise/fall in some currencies, gold or a default by a major nation.

This list is by no means complete. In short, a day is a Significant Day when something that is material to a stock is scheduled to happen or there is some material announcement by the company itself.

Once a day is labeled as a Significant Day, its Open and Close prices are very important for us. If the day is Bullish (Close price higher than Open price), one can expect the stock to trade higher over next few days. Similarly if it is a Bear day (Close lower than Open price), a slide in stock price is expected.

Conditions: We have just three conditions for this signal:

1. A day has to be a Significant Day for the stock we are considering.

2. Because it is a Significant Day, there should be a significant increase in Volume on that day. This is also one way of confirming that the day really holds significance for a stock or the market. The more the increase in volume, the more powerful our signal is.

3. If this day turns out to be a Bull Day (TDC >TDO), you can buy this stock to benefit from the subsequent upward price movement over the next few days. If this day turns out to be a Bear Day (TDC<TDO), expect this stock to go down and you can sell it.

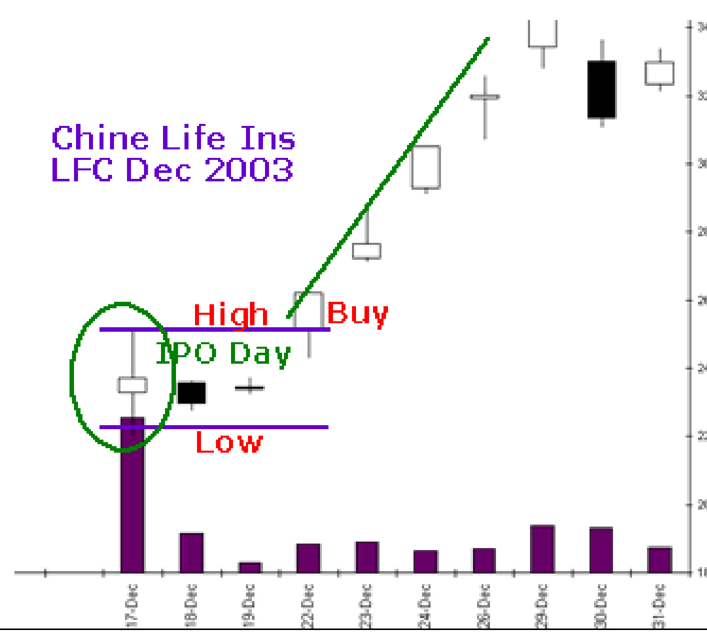
<u>ACTION</u>: If the significant day is a BULL DAY, you should look forward to buying this stock. If it is a BEAR DAY, you should look forward to shorting/selling this stock.

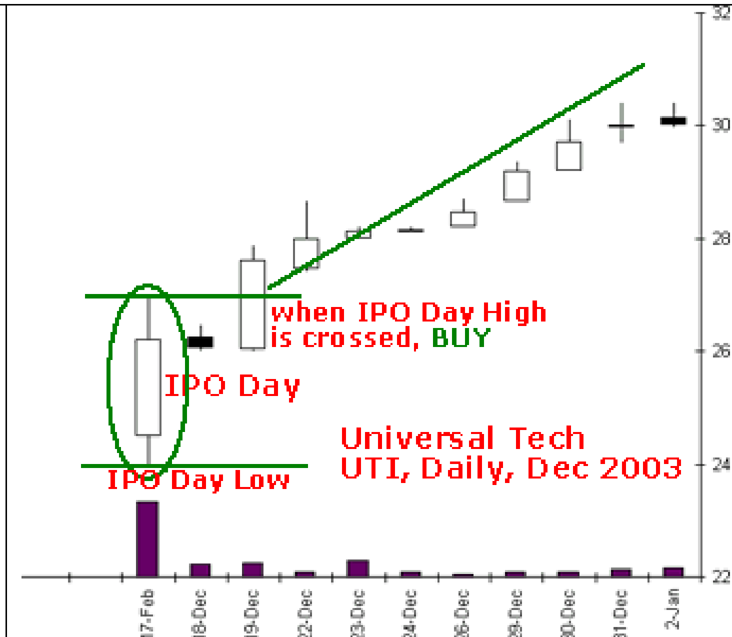
When to Buy or Sell? There are two choices with quite different pay-offs. If you want to capture more gain, you have to take more risk. This is a simple rule of investments. If you like to take more risk in order to have higher profit, you can buy or sell the stock at the time of closing on the Significant Day, or when market opens for trading on the subsequent day. This will result into higher profit but there is also a higher possibility for a loss.

The other alternative is to watch its price over up-to five subsequent days and buy (or sell) only when the price crosses the High (or Low) price made on the Significant BULL DAY (BEAR DAY). This is a safer choice to trade on this signal.

<u>STOP-LOSS</u>: Stop-loss for a Significant Day (BUY) signal should be kept at that day's Low price minus around 1 to 3%. Similarly, Stop-loss for a Significant Day (SELL) signal should be kept at Significant Day's High price plus 1 to 3%.

Let us take some examples here to better understand this signal.

<u>IPO Day</u>: China Life Insurance Company (LFC) had an Initial Public Offering in USA on December 17, 2003. On the very first day of trading, it opened at $23.25 and closed at $23.72 making it a Bull Day. Also the High price for the day was $25.20 and the Low price was $22.00 As it was a Bull Day, we should Buy this stock when it starts trading higher than $25.30 (1/2 % safety margin) and keep a Stop-loss at $21.80 (the Low price on the Significant Day). Now look at the Chart on the Right to see what happened during the subsequent few days. There were a few nice Up-days that brought the stock to as high as $35.50.	
Another example of an IPO day. Stock Universal Technical Institute, Inc. (UTI) had an IPO on December 17, 2003, and the subsequent trend for the stock. As you can notice on the chart, UTI	

had a BULL DAY on the IPO day with a High price of 27 and Low price of 24. So as per our Significant Day trading signal, we would go Long on this stock when it starts trading above the 27$ level and keep a Stop-loss at the 24$ level (minus a safety margin of 10 to 20 cents). Now when you look at the chart on the right, you will see what happened to the stock on the subsequent few days! It reached a high of $32.50!	
Earnings Announcement Day.	
Post Split First Day:	

SIGNAL M3: DERIVATIVES EXPIRATION Signal

A derivative security is a security or an investment vehicle that derives its price/value from some other security. Some examples are like Options, Futures, Options on Futures, SWAPs, etc. Price of any of these securities depends on its underlying instrument. If a stock goes up, Call Options on it are also likely to go up. When Gold is going up, Gold Futures are also likely to trend higher.

Why do we care about derivatives trading when we are trading stocks? Trading volume in stocks have exploded over the last several decades, but when the trading volumes of their derivative securities are also considered, there is much more activity going on than what appears in its daily volume on the stock exchange. Many players, mostly speculators and hedgers, have shifted from stocks to Options and Futures contracts for their trading needs. On the other hand, the invention of derivative securities has also created a group of people who just try to take benefit of the misalignment in prices between the underlying security and its derivatives. This is known as arbitrage. These two groups' trading actions have resulted in significant implications for the technical analysis of stocks and have altered demand and supply (in the form of the Substitution effect) of stock.

As this book is about Profit from Prices, we are not going to get into explanations of what is an Option or a Futures contract, or what do Put to Call Option ratio, Volatility, etc mean. Instead I am going to show you one quick indicator that is helpful in figuring out the impact of speculators and hedgers in a stock price or an index level. As we know, Options and Futures have a limited time horizon. As a matter of fact, they expire on every third Friday of the month in USA. Every three months, three of the biggest stock derivatives- Options, Futures and Options on Futures, expire on the same day. These days are known as Triple Witching days among investment professionals. So on the Options/Futures expiration day, many contracts of immediate maturity (usually with high volumes) expire and hence a significant proportion of outstanding positions get closed. On the next day, many new contracts with new maturities are opened/introduced for trading. So based on these two days' price levels, we apply our Derivatives Expiration signal.

How does this signal work?

1. Find out the High and Low prices for this two-day period- expiration day and the next day. As an example, the following are the prices of QQQ (NASDAQ 100 tracking stock) for these two days. Dec 19th was the Triple Witching Day and Dec 22nd was the next day when new contracts were introduced.

22-Dec-03	35.35	35.68	35.29	35.57	63580000
19-Dec-03	35.61	35.65	35.20	35.46	89762304

Here we need to see these two days as one continuous period. This will give us 35.68 and 35.20 as High and Low price. These are our benchmark numbers.

2. After we have figured out the Low and the High prices as above, we should take a Long position (BUY) when the stock or the index crosses (or closes above, for risk averse traders) the High price; or we can Short (SELL) it when it starts trading lower (or closes lower) than the Low price above.

STOP-LOSS: If you take a Long position (BUY), you should keep a Stop-loss at the Low price of this 2-day period (minus up to ½ % for a safety margin). If you take a Short position, you should keep a Stop-loss at the High price of this 2-day period (plus up to 3 % as a margin of safety).

Now look at the prices below of QQQ for the subsequent period.

12-Jan-04	37.85	38.35	37.68	38.33	77668400
9-Jan-04	37.71	38.35	37.59	37.73	94296496
8-Jan-04	37.85	38	37.6	37.98	76800896
7-Jan-04	37.28	37.68	37.07	37.68	71830000
6-Jan-04	37.08	37.42	36.95	37.34	60033000
5-Jan-04	36.58	37.16	36.56	37.09	69717904
2-Jan-04	36.66	36.79	36.22	36.36	55234100
31-Dec-03	36.62	36.64	36.25	36.46	60494600
30-Dec-03	36.53	36.58	36.3	36.56	48249400
29-Dec-03	36.03	36.53	36.02	36.44	63296200
26-Dec-03	35.96	36.09	35.82	35.85	25497600
24-Dec-03	35.84	36.02	35.8	35.9	44840300
23-Dec-03	35.6	36.02	35.53	35.84	66999800

22-Dec-03	35.35	35.68	35.29	35.57	63580000
19-Dec-03	35.61	35.65	35.2	35.46	89762304

As we know, our High and Low prices were $35.68 and $35.20 for this DERIVATIVE EXPIRATION period of Dec 19th and Dec 22nd. Now on December 23, QQQ started going up and when it started trading higher than $35.68, we had a BUY signal. So we would go Long on QQQ on that day with a Stop-loss around $35.20. Now if you look further up in the table, you will find that the stock kept going up during the next few days and made a high of 38.00$.

Here is another example of how this signal works in a stock. The following are the prices of Amazon (AMZN) for the last three months. To avoid confusion, please read this table from bottom to top, starting from September 2003 prices.

Date	Open	High	Low	Close	Volume	Signal
16-Jan-04	56.27	56.37	55.27	55.72	9114200	Stop-loss of the last EXPIRATION DAY signal not triggered. Price is going up.
15-Jan-04	54.73	56.78	54.62	56.18	12217300	
14-Jan-04	54.62	55.99	54.15	55.8	11134100	
13-Jan-04	52.67	54.99	52.41	54.91	14522300	
12-Jan-04	51.61	53.03	50.8	52.95	9450900	
9-Jan-04	49.77	52.15	49.1	51.59	12779200	Price getting lower but it is still higher than Stop-loss
8-Jan-04	52.09	52.1	50.03	50.24	10320300	
7-Jan-04	52.18	52.66	50.94	51.9	9242700	
6-Jan-04	53.11	53.5	52.74	53.03	5985500	
5-Jan-04	52	53.6	51.37	53.27	11284100	
2-Jan-04	52.76	53.13	51.43	51.9	6639900	
31-Dec-03	52.82	53.48	52.4	52.62	5307200	
30-Dec-03	53.18	53.5	52.6	52.83	5152400	
29-Dec-03	53.79	53.84	52.13	53.47	8056900	
26-Dec-03	54.14	54.94	53.14	53.47	7078400	Touched a high price of 54.94$
24-Dec-03	52.3	53.88	52.15	53.32	5659800	
23-Dec-03	50.02	52.62	49.77	52.48	11004000	BUY when it crossed 50.10$.
22-Dec-03	48.98	50.1	48.7	49.89	7799700	High 50.10$, Low 48.26$
19-Dec-03	48.8	49.41	48.26	49.24	8045900	Options Expiration day
18-Dec-03	47.61	48.89	47.45	48.75	10750700	
17-Dec-03	49.47	49.61	47	47.58	13856800	
16-Dec-03	49.6	49.8	48.63	49.5	10549800	
15-Dec-03	52.05	52.25	50.05	50.41	9676800	
12-Dec-03	50.99	51.31	49.92	50.99	6190600	
11-Dec-03	49.26	51.15	49.19	50.8	9405500	
10-Dec-03	49.45	50.17	48.31	49.2	9254600	
9-Dec-03	51.17	51.65	49.3	49.34	10460500	
8-Dec-03	51.55	52.2	50.12	51.08	8376400	
5-Dec-03	51.2	52.7	51.2	51.56	7501500	
4-Dec-03	51.45	52.43	50.75	51.8	10216200	

3-Dec-03	54.1	54.25	51.36	51.51	11570800	
2-Dec-03	54.5	54.75	53.85	53.93	6237900	Price is going up as suggested by this signal
1-Dec-03	54.4	54.75	53.05	54.65	11522800	
28-Nov-03	52.84	54.06	52.83	53.97	3983000	
26-Nov-03	52.83	53.54	51.87	52.96	8907700	
25-Nov-03	51.35	53.3	51.25	52.47	13771300	BUY when it crossed 51.45$.
24-Nov-03	49.28	51.45	48.65	51.33	10631500	High 51.45$, Low 47.76$
21-Nov-03	49	49.2	47.76	48.58	9193400	Options Expiration day
20-Nov-03	49.1	50.46	48.34	48.85	12337600	
19-Nov-03	48.71	49.85	47.67	49.53	14079000	
18-Nov-03	50.73	50.98	48.45	48.5	12600200	
17-Nov-03	51.92	52.19	49.58	50.36	12996900	
14-Nov-03	54.43	54.78	52.21	52.45	8365300	
13-Nov-03	54.04	55.13	53.57	54.8	7073000	
12-Nov-03	52.57	54.29	52.11	54.13	9259300	
11-Nov-03	51.84	52.75	50.76	52.23	10920100	
10-Nov-03	53.95	54	51.74	51.98	9120500	
7-Nov-03	55.61	55.7	54	54.31	8500400	
6-Nov-03	56.81	56.87	54.75	54.99	8791800	
5-Nov-03	56.13	56.99	56.08	56.74	5307400	
4-Nov-03	56.7	57.49	56.06	56.86	7009500	
3-Nov-03	54.8	56.8	54.31	56.74	9131100	
31-Oct-03	55.9	56.13	54.38	54.43	7726700	
30-Oct-03	57.4	57.52	55.57	55.83	9825400	
29-Oct-03	56.65	57.15	56	56.69	8776500	
28-Oct-03	55.19	56.9	54.55	56.73	9230900	
27-Oct-03	54.9	55.25	54.5	54.82	6391900	
24-Oct-03	54.55	54.94	53	54.51	10438200	
23-Oct-03	52.98	54.52	52.91	54.32	14611700	
22-Oct-03	56.05	56.15	53.73	54.03	32701900	Another trend-reversal signal: FREE FALL SIGNAL. Today a GAP and yesterday was a recent Highest price day.
21-Oct-03	59.73	61.15	59.01	59.35	17114900	BUY when it crossed 60.24$ as per DERIVATIVE EXPIRATION signal; but the stock also closed lower with heavy volume after making a new high of 61.15$ giving us a strong REVERSE signal. So this EXPIRATION signal failed here.
20-Oct-03	59.56	60.24	58.92	59.59	11086100	High 60.24$, Low 58.65$
17-Oct-03	59.3	59.9	58.65	59.69	11932900	Options Expiration day
16-Oct-03	58.16	59.91	58.09	59.91	10211100	
15-Oct-03	60.39	60.41	58.43	58.54	10297100	Reached a high of 60.oo$ but Stop-loss never triggered.
14-Oct-03	58.1	59.98	57.8	59.91	9986600	
13-Oct-03	57.94	58.69	57.44	58.3	8329000	
10-Oct-03	57.7	58.33	57.44	58.06	11435400	
9-Oct-03	57.41	59.1	57.4	57.86	21606900	
8-Oct-03	55.44	56.28	55.12	55.7	13558000	

7-Oct-03	54	56.25	53.95	54.91	20299900	
6-Oct-03	52.89	54.24	52.59	54.15	7773100	
3-Oct-03	51.13	53.22	51.03	52.89	14175600	
2-Oct-03	48.94	50.2	48.68	50.09	8219900	
1-Oct-03	48.37	49.28	47.51	49.12	12563800	
30-Sep-03	49.65	49.76	48.35	48.43	9264600	
29-Sep-03	48.88	49.97	48.4	49.86	9039300	
26-Sep-03	49.9	50.46	48.3	48.56	13438500	
25-Sep-03	49.66	50.95	49.28	50.05	11033300	
24-Sep-03	50.35	51.3	49.6	49.61	15330200	
23-Sep-03	47.41	50.92	47.35	50.44	20295900	BUY when it crossed 47.97$.
22-Sep-03	46.56	47.53	46.2	47.47	9240000	High 47.97$, Low 46.20$
19-Sep-03	47.87	47.97	47.35	47.58	6249500	Options Expiration day

SIGNAL M4: VOLUME SPIKE

This is a short to medium-term trading signal and is applied when we see a <u>sudden and significant</u> jump in the trading volume of a stock. There are two other things that are usually seen on such days. (1) There is usually a larger than normal price fluctuation on such days. (2) This spike in trading activity is usually in response to some news or event that has material impact on the company.

Let me now try to quantify what I mean by sudden significant jump in Volume. By sudden I mean the jump in volume takes place almost unexpectedly. For days prior to the Volume Spike day, the stock had normal trading Volumes. By significant, I mean a jump in volume to the tune of more than three to ten times the normal daily volume. In quantifying a day as a Volume Spike day, we should also consider the nature of the stock as well. For a stock with an average volume of 1 million per day, a 3 million or more volume on any day is a sudden significant volume day. For an active stock like INTC or MSFT, a jump in volume by 100% also qualifies as a Volume Spike day. On the other hand, for a stock that has a daily volume of say 20,000 stocks, even a ten times jump in volume may not be enough to apply this signal. So you will need to determine if a day passes as a Volume Spike day. One suggestion is to look at the price chart of the stock. A real Volume Spike day normally stands out in a chart.

What causes sudden spikes in volume? There are two primary reasons: (1) Trends often climax with heavy trading activity and larger than normal volume. So when there is a sudden jump in volume after a sustained trend in one direction and there is no specific news to attribute this Volume Spike to, this is usually an indication of a reversal of trend. If we have one of our Trend Reversal signals, we have a nice trading opportunity in front of us. The Volume Spike day is likely to mark the beginning of a new trend. The jump in volume for a stock that is going up is usually an indication of large-scale profit taking or fresh short-selling at the prevalent high prices. Similarly, for a stock in a down-trend for a considerable time period, a sudden significant jump in volume without any news is usually due to bargain-hunting activity or short-covering to take advantage of the currently attractive stock price level. (2) Sometimes a jump in volume is attributable to some unexpected news, event or developments. Such events or news can alter demand and supply for the company's stock in a significant way. However at the end of the Volume Spike day, it is not obvious in which direction the stock's price will move from the current level. Is the bad news fully digested or does it still have some poison left to cause a further drop in stock price? Is the good news completely reflected in Volume Spike day's closing price? This is all difficult to predict. However if we watch a few sub-sequent days' trading activity, we can get some clues in most cases.

Let us now look at how to identify and act in response to a Volume Spike signal.

Conditions:

1. The jump in volume is sudden and significant.
2. The price movement on the day is larger than normal. (Note: This condition is more to filter out a jump in volume in small stocks that is due to some odd individual trades. As an example, for a 50,000-volume stock, sometimes two parties put through a trade of say 300,000 stocks for record keeping or to mislead other players. In applying this signal (or any price-based signal), we should be vigilant so we don't get trapped in a position for a wrong reason. A good alternative is to look at the intra-day chart of the stock so we can see that jump in volume is spread across the trading session of that day.)

Stockfetcher.com Syntax: Show stocks where volume 1 day ago gained more than 300 percent over the last 1 day and volume 1 day ago gained more than 300 percent over the last 2 day and volume 1 day ago gained more than 300 percent over the last 3 day and volume dropped more than 25 percent over the last 1 day and Average Volume(90) is above 200000 and close is between 5 and 250.

How to trade in response to a valid Volume Spike day?

Remember one thing with regard to Volume Spike signal. If the spike in volume is occurring along with trend reversal signals we discussed in previous chapters, we have a signal with considerable profit potential over the next few weeks. However if it is in response to some news or events, it is more likely indicative of short- to medium-term trading (three days to a few weeks).

Now once we have identified a day as a valid Volume Spike day, we need to note down the High and Low prices of the day. Let us call them VS Low (Volume Spike Low) and VS High (Volume Spike High) respectively. Now if the Volume Spike day is a Bull day (VS Open is lower than VS Close), we should close any short positions that we have in that stock. On the other hand, if it is a Bear day, we should close any existing long position in the stock. Remember, I am telling you just to close existing positions unless we have one of our Trend Reversal signals.

Now within the subsequent five days if the stock trades above VS High (plus around 1% for a safety margin), we should take a long position with a stop-loss at VS Low price (or, for aggressive traders, stop-loss at Volume Spike day's High price minus 1 to 3% as a safety margin). However if stock price drops below VS Low (minus around 1%) price, we can create fresh short positions with proper stop-loss at either (VS Low price + 1 to 3% margin, or VS High price + 1 to 3% margin).

Let us now take some examples:

Example 1: The following are daily prices and volume figures for KKD (Krispy Crème Donuts) during July, 2004. Prior to July 29th, KKD had normal volume of around 1.5 million shares on a typical day. However on the 29th, more than 7 million shares were traded. This obviously qualifies it as a Volume Spike day and hence 17.25$ and 15.60$, High and Low prices for that day, are our key VS High and VS Low prices. Now if over the next five days, KKD traded above 17.40$, we would go long and if KKD traded below 15.45$, we would short it. As we can see, on the next day KKD traded below our key VS Low price, so we would short it with a stop-loss slightly above 17.40$.

30-Jul-04	15.49	15.85	15.08	15.74	3,583,900
29-Jul-04	**16.9**	**17.25**	**15.6**	**15.71**	**7,079,500**
28-Jul-04	19.05	19.14	18.37	18.66	926,900
27-Jul-04	18.7	19.24	18.7	18.88	1,328,300
26-Jul-04	18.7	18.71	18.3	18.6	1,334,600
23-Jul-04	18.1	18.74	17.95	18.21	1,940,000
22-Jul-04	17.27	18.16	17.27	18.07	1,592,500

Let us now look at KKD's chart for this period. As we can see from the chart below, KKD touched as low as 13$ over the next few days. Think back to the RESTART/REVERSE signal because we can find that signal on the day KKD stock price touched the 13$ level. After a subsequent up-trend/pull back, we had another Volume Spike day, with VS High and VS Low prices respectively around 14$ and 13$. The stock did come close to the 14$ level, as we can see in the chart, but it failed to trade decisively above 14$. Then on the fifth day after Volume Spike -2 signal, KKD traded below 13$ telling us to short it. As we can see, the stock entered into another down-trend and touched a low of 11.5$ over the next few days.

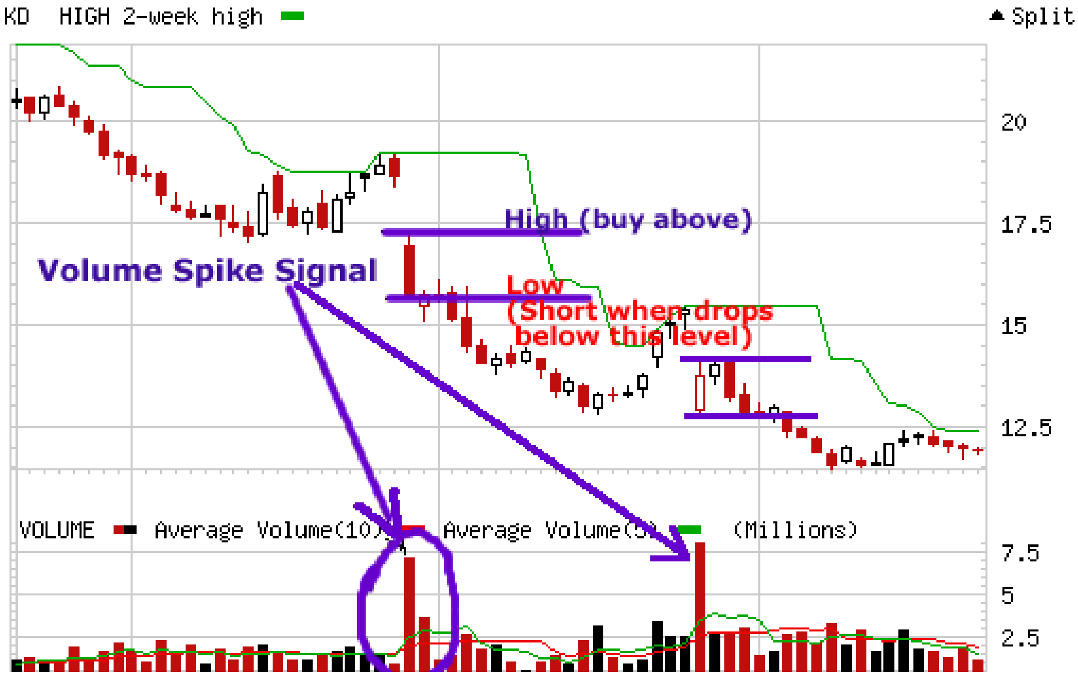


Chart courtesy of Stockfetcher.com.

Example 2- IMCL (Imclone)- Daily prices

22-Jul-04	62.36	67.45	60.52	66.68	11,216,800
21-Jul-04	**73.15**	**74.22**	**64.13**	**65.44**	**24,676,500**
20-Jul-04	78.14	81.43	77.55	80.73	4,384,500
19-Jul-04	76.81	78.25	73.6	76.76	3,564,000
16-Jul-04	79.70	79.88	76.34	77.01	2,707,900
15-Jul-04	80.43	80.43	79.12	79.89	1,258,300

From IMCL's daily prices here, we find that prior to Jul 21st, it had an average trading volume of around 3 million shares. However on July 21st around 24 million IMCL stocks were traded making it a Volume Spike day. As this was a Bear day (Close lower at 65.44 than Open of 73.15), we were told to close any existing long (Buy) positions. The High and Low of 74.22 and 64.13 on that day were our critical VS High and VS Low prices and hence during the subsequent 5 days, if IMCL traded above VS High, we would buy it and if it traded below VS Low, we would sell it. On the very next day, IMCL traded lower than VS Low and hence we had a Volume Spike (SELL) signal. Now when you look at the chart below, you will see that IMCL traded as low as 50$ over the subsequent few days.

Chart courtesy of Stockfetcher.com.

<u>Example 3: C (Citicorp) Daily prices</u>

20-Sep-04	46.06	46.25	45.26	45.4	25,440,700
17-Sep-04	**47.28**	**47.29**	**46.76**	**46.95**	**17,339,900**
16-Sep-04	46.98	47.47	46.9	47.18	8,254,400
15-Sep-04	47.07	47.26	46.91	46.98	7,135,300
14-Sep-04	47	47.41	46.9	47.19	8,343,600
13-Sep-04	47.21	47.33	46.83	47	9,167,400
10-Sep-04	46.85	47.37	46.76	47.24	7,278,300

From Citicorp's daily stock prices and volume figures above, we can see that its average volume prior to Sep 16th was around 8 million shares. On the Sep 17th, almost 17 million shares were traded! As this is a large company stock with active trading, this 100% jump in the volume was enough to qualify it as a Volume Spike day. 47.29$ and 46.76$ were our VS High and VS Low prices.

Now on the very next day, the stock opened lower than 46.76 generating Volume Spike (SELL) signal. (On Sep 20th, 25 million shares traded but we don't consider this day as a Volume spike day mostly because we saw a significant spike on the very day before.)

The chart on the right shows how Citigroup stock fared over the subsequent few days' trading.

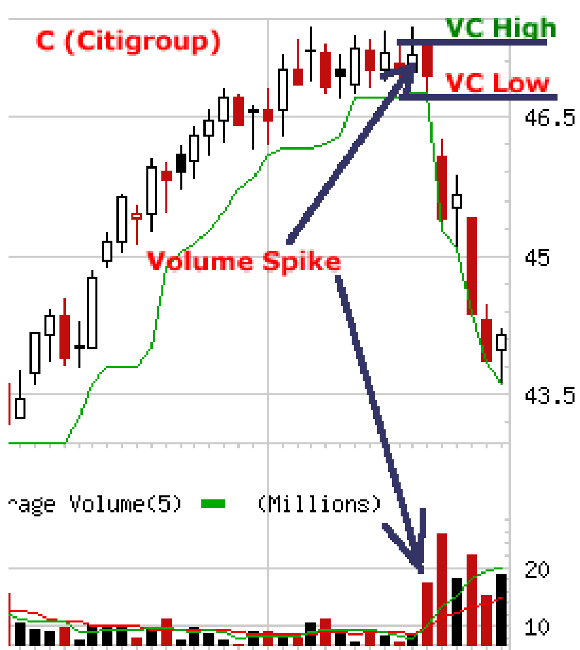


Chart courtesy of Stockfetcher.com.

Example 4: Look at the AMD daily price chart below that shows two Volume Spike signals- the first one SELL and the other one was to BUY. (Note: On the day after the first Volume Spike signal, there was very high volume but this one does not qualify as a Volume Spike signal because for a valid Volume Spike signal, the volume on the prior few days should be low and normal.)

Chart courtesy of Stockfetcher.com.

Chapter

9

HOW TO TRADE IN SIDE-WAYS?

In this chapter, we will look at signals that are useful for stocks in Side-ways movement. As we know, a stock spends time in one of three phases:

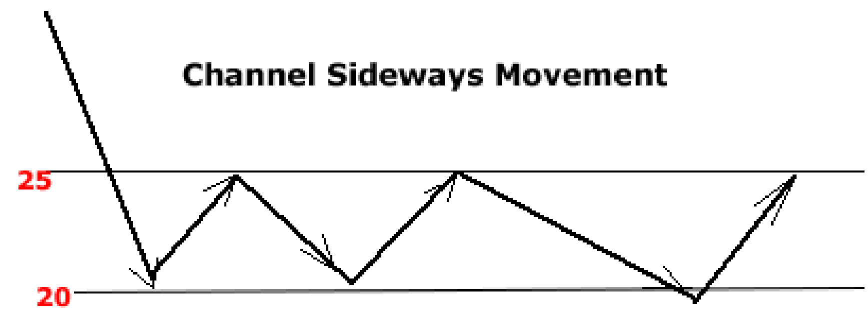
- UP-TREND: The stock price is going up making new high prices as time passes.
- DOWN-TREND: The stock is going down and is making new low prices as time passes.
- SIDE-WAYS Movement: The stock seems to be locked in a certain price range and it seems difficult for the stock to trade above or below this range. It seems to be fluctuating within this range, say 20 and 25 dollars. After going as high as 25 dollars, it starts drifting lower. However when it comes back to around 20 dollars level, some how Demand picks up and/or Supply dries up. Hence the stock starts trading higher. However it seems difficult for the stock to trade outside these two price levels- below 20$ and above 25$ in our case. We call this a Side-ways movement.

So far, we have seen signals that help us trade with Trend Reversals as well as Trend Continuations. Now we are going to see some signals for trading in a stock's Side-ways movements. Before we go further on with this topic, let us see how many types of Side-ways there are.

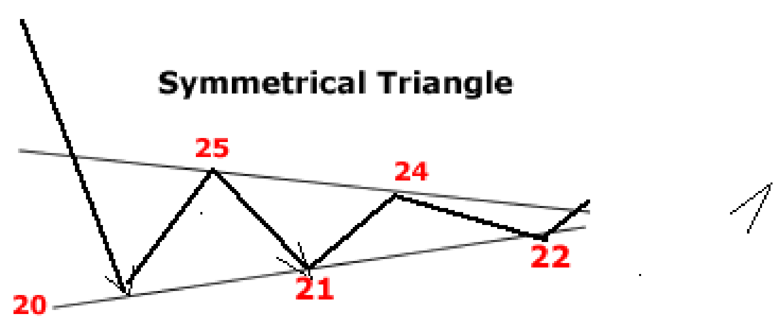
TYPES OF SIDE-WAYS MOVEMENTS

There are primarily three types of Side-ways movements:

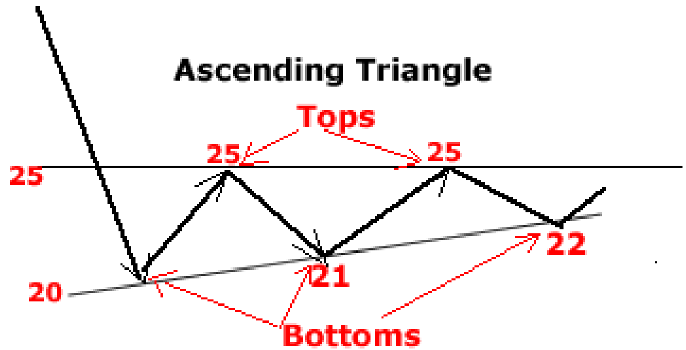
1. Channel: A Channel is a movement of prices within two price levels. As discussed in an example above, a stock in this Channel Side-ways movement keeps moving between 20 and 25 dollars. Every time it touches 20 dollars, it jumps back to 25 dollars. Then after touching 25 dollars, it falls back to 20 dollars. This is comparable to a channel on its price-chart and hence we call it a Channel. Look at the schematic diagram of a Channel below.



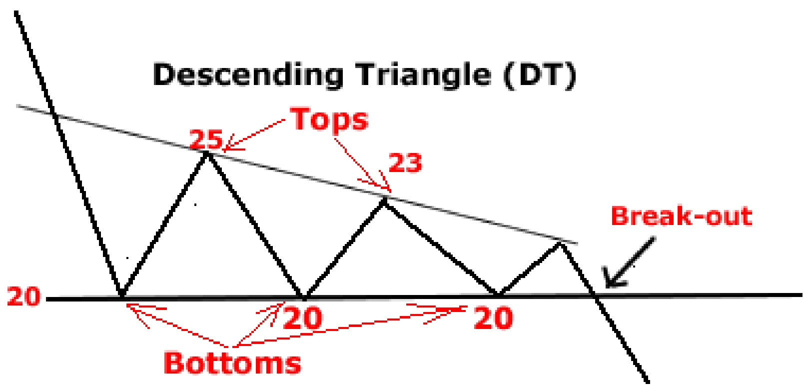
2. Symmetrical Triangle (ST): This movement is similar to Channel but in this formation, the subsequent Tops become lower while subsequent Bottoms seem to be getting higher as shown below. Let us assume that the initial Bottom is at 20 dollars and the Top is at 25 dollars. Now the stock falls back but does not go as low as the Previous Bottom of 20 dollars, but this time it makes a higher Bottom at 21 dollars and starts moving up. Then instead of going as high as the previous Top of 25 dollars, the stock ends its upward journey at 24 dollars and starts going down. This time it again makes a higher Bottom at say 22 dollars. We will call such Side-ways movement in which the stock forms higher Bottoms but lower Tops a Symmetrical Triangle movement.



3. Asymmetrical Triangle (AT): This is the hybrid version of the two types we discussed above. Like a Channel, it has either a constant Top or a constant Bottom. As an example let us say it has a constant Top. Now like a Symmetrical Triangle, the successive Bottoms are forming at higher price levels. We will call such formations Asymmetrical Triangles. As the subsequent Bottoms are forming at higher levels, we will call it an Ascending Asymmetrical Triangle (AAT) Side-ways movement or an Ascending Triangle (AT) in short.



Similarly, a triangle can have Bottoms at one price-level but each subsequent Top at a lower level as shown in the diagram below. We will call such a formation a Descending Asymmetrical Triangle or a Descending Triangle in short (DT).



(Note: When I say Bottoms at 20$ for a Channel or a Descending Triangle, I mean Bottoms around that level. I don't mean that each Bottom should form precisely at the 20$ level. The fiirst Bottom could form at 19.90$, the second one could be at 20.05$ and the third one might be at 20.01$.)

How to identify Tops and Bottoms in prices? If you are looking at a price chart, it is not that difficult. Tops and Bottoms usually stand out on a price chart. However a Top or a Bottom is not that obvious when just looking at prices. How many days' worth of data should we look at to determine a Top or a Bottom? Two days? Four days? Or, ten days? There is no standard rule. You have to see what works better with your trading system. Let me show you a little method that I use in my program to identify Tops and Bottoms. While looking at prices, try to observe short-term trends by looking at subsequent daily Low and High prices. The lowest Low price and the highest High price during X number of days' price movement can be usually considered as a Top and a Bottom respectively. The highest price during any X number of consecutive days is a Top and similarly the lowest price during any X number of consecutive days is a Bottom. In other words, Top is a price point from where the short-term trend changes from up-trend to down-trend. Similarly, the lowest price during a short-term trend change from down-trend to up-trend is a Bottom.

Let me try to explain this by an example. Assume that we are looking for a Top and the last few days' High prices are 21.00, 21.50, 20.80, 21.45, 22.00, 21.45, 21.80, 21.90, 20.50 and 19.95 respectively and my rule is a 3-day rule. This means that the first day's high price of 21.00 was broken by next day's higher high price of 21.50. So 21.00 is not a Top here. The new high price of 21.50 was also broken by the subsequent third day's high price of 22.00. So 21.50 is not a Top price either. Now none of the high prices of the following three days are higher than 22.00. So 22.00 is my Top. Similarly, if the Low prices were 18.00, 19.00, 18.00, 17.50, 17.30, 17.90, 18.00, 18.45, 17.45, as per my 3-day rule, 17.30 was the price which was not broken by subsequent three days' Low prices. So that is my Bottom. Depending on your trading system, you can pick any number between 3 to 10 for your rule to determine Tops and Bottoms. As I said earlier, another approach is to look at the daily price chart. It is easier to spot Tops/Bottoms on a daily chart than to figure it out by reading daily prices.

There are two types of trading opportunities with Side-ways movement.

- Within Side-ways movement: These opportunities are frequent but only for short term trading during the period when the stock is passing through a Side-ways movement. Such opportunities generally have a tight Stop-loss and limited profit potentials.

- Break-outs: The second set of trading opportunities arises when the stock moves out of the Side-ways movement. These are called Break-outs. An important thing about them is that the longer a stock moves in a Side-ways (Channel or Triangle) movement, the more powerful the trend is going to be after the break-out from the Side-ways movement.

Let us now look at some Side-ways trading signals.

SIGNAL S1: TURN BACK

TURN BACK (BUY)

TURN BACK signal is primarily used for trading during short-term trends that usually last from two to ten days. This signal is based on Top and Bottom prices. As we know, a Top is the highest price a stock reaches between a short up- and a short down- trend. It is like a peak when you are looking at the stock prices of a few days. Similarly Bottom is the lowest price that the stock made over the last few days.

A TURN BACK during a down-trend signals a potential up-trend over the subsequent few days. Hence we call it a TURN BACK (BUY) signal. Similarly a TURN BACK that takes place during an up-trend creates the possibility of a subsequent short-term downtrend, and hence we will call it TURN BACK (SELL).

Conditions: To keep it simple, let us first look at the conditions that need to be fulfilled for a valid TURN BACK (BUY) signal:

1. The stock is currently in a short-term downtrend.

2. Today's Low price is LOWER than Previous Bottom (PB); Today's High price has to be HIGHER than that Bottom. (In short, today the stock has to have fallen through the last Bottom). **TDL < PB and TDH > PB**

3. Today is a Bull Day (Today's Close has to be HIGHER than Today's Open). **TDC > TDO**

4. Today's Close has to be HIGHER than Previous Bottom. This is also a very important required condition for this signal. **TDC > PB**

5. Today has to be the first or the second day on which the stock trades below the Previous (confirmed) Bottom.

TURN BACK (SELL)

Let us now look at the conditions for a TURN BACK (SELL) signal- the reverse of the TURN BACK (BUY).

1. The stock is currently in a short-term up-trend.

2. Today's Low price is LOWER than the Previous Top, and Today's High price is HIGHER than that Previous Top (PT). (In short, today the stock has to have traded above the Previous Top). **TDL < PT and TDH > PT**

3. Today has to be a Bear Day (Today's Close is LOWER than Today's Open). **TDC < TDO**

4. Today's Close has to be LOWER than Previous Top price. This is also a very important required condition for this signal. **TDC < PT**

5. Today has to be the first or the second day on which the stock price trades above the Previous Top (after a Bottom was confirmed subsequent to this Previous Top).

BRIEF EXPLANATION: Please keep in mind that this signal is used generally for short-term trends. What is the importance of the Previous Bottom day? It is the most recent day on which the stock had completed a down-trend and resumed an up-trend. It is the day when demand had increased over supply and pushed the prices higher. So Previous Bottom was the price level at which sellers paused and/or more buyers jumped on. This is the price that marks victory of buyers over sellers. Now on the TURN BACK (BUY) signal day, if all of our conditions are fulfilled, we can infer/deduce that the Previous Bottom's psychological value is still intact. Around this Previous Bottom price level, market participants on the whole still prefer to buy this stock than to sell it. Similarly a TURN BACK (SELL) signal suggests that the Previous Top's psychological value is still more or less intact. Around this price level, market participants seem to be unwilling to buy or are willing to book profit in their long positions and/or sellers may be turning more active. In other words, market participants are unwilling to carry long positions but willing to enter into short positions at this price level.

What does this signal mean? Every stock has some price level(s) with significant psychological/sentimental values attached to them. When it reaches that level, it may be getting too overvalued or undervalued in the eyes of many investors and traders, or when a particular level is broken, momentum traders may be jumping on to benefit from the ensuing trend. Hence such price levels are instrumental in the emergence of fresh buying or selling. For me, Previous Top and Bottom prices also qualify as important price levels. These are the price points which in the recent past have marked the victory of buyers over sellers or vice versa. So a valid TURN BACK signal offers the possibility of history repeating iself – that what happened the last time in the vicinity of this price level is likely to be repeated one more time. So in response to a TURN BACK “UP” (BUY) signal, we can expect a short up-trend pushing prices higher towards the Previous Top level. Similarly in the case of TURN BACK “DOWN” (SELL), we can look forward to a short-term downtrend causing prices to drop to as low as the Previous Bottom.

ACTION: If the TURN BACK (SELL) takes place, you should close your long position in the stock and start short-term short positions with the price target of the Previous Bottom. Similarly in response to a valid TURN BACK (BUY) signal, you should close any existing short position and you can initiate a fresh long position with the price target of the Previous Top price.

STOP-LOSS: For TURN BACK (SELL) signal, Stop-loss should be kept at Today’s High price plus 1%, and for long positions in response to the TURN BACK (BUY) signal, Today’s Low price minus 1% should be used as a Stop-loss.

PRICE OBJECTIVE: As refers to the TURN BACK (SELL) signal, it is very likely that Today’s High can be the next Top (which can only be confirmed after following the subsequent two/three days’ price movement) and you can expect the stock to touch the Previous Bottom price level.
Similarly a TURN BACK (BUY) signal indicates that Today’s Low price is likely to form the next Bottom price and you can expect the stock price to rise over the subsequent few days attempting to touch Previous Top’s price level.

Let us take as an example VZ (Verizon, Inc.).

Daily prices of VZ:

Date	Open	High	Low	Close	Volume
5-Aug-03	35.85	35.85	34.96	35.05	7740800
6-Aug-03	35.46	36.44	35.32	36.05	8215700
7-Aug-03	35.97	36.06	35.26	35.35	6168500
8-Aug-03	34.76	35.76	34.51	35	6045100
11-Aug-03	35.24	35.5	34.92	35.2	4910200
12-Aug-03	35.57	36.1	35.23	36.08	7718300
13-Aug-03	36.4	36.4	35.4	35.62	5061100
14-Aug-03	36.1	36.1	35.5	35.75	6283400
15-Aug-03	35.75	35.85	35.26	35.82	3117000
18-Aug-03	36.61	36.61	35.75	35.85	4196600
19-Aug-03	36.23	36.23	35.41	35.78	5766000
20-Aug-03	35.65	35.8	35	35.8	4670000
21-Aug-03	36.05	36.55	35.81	36.05	6177700
22-Aug-03	36.1	36.25	35.05	35.22	7230000
25-Aug-03	35.02	35.26	34.59	34.8	5056700
26-Aug-03	34.78	35.2	34.26	35.01	6410300

Chart of Verizon (Aug-Sep 2003)

27-Aug-03	34.75	35.4	34.75	35.07	4671800
28-Aug-03	35.2	35.66	34.92	35.6	6076700
29-Aug-03	35.4	35.41	34.98	35.32	4265000
2-Sep-03	35.06	35.7	34.96	35.55	7194300
3-Sep-03	35.8	36.26	35.65	36.25	7870800
4-Sep-03	36.25	36.94	36.2	36.65	7699000
5-Sep-03	36.8	37	36.2	36.3	7698600
8-Sep-03	36.4	36.44	35.63	35.79	7673400
9-Sep-03	35.43	35.56	35.1	35.15	6660400

Chart courtesy of BigCharts.com.

Look at Verizon's daily prices during Aug 2003. On Aug 6th, it formed a Top at 36.44 and entered into a short down-trend. Then on the 8th, it formed a Bottom at 34.51 and started an up-trend. On Aug 18th, VZ crossed the Previous Top of 36.44 and traded as high as 36.61. As the stock crosses the Previous Top (36.44), we can apply the conditions to see if TURN BACK (SELL) signal takes place today.

As of the 18th, VZ was in an up-trend (Condition 1). The price crossed the Previous Top (36.44) as VZ traded as high as 36.61 and as low as 35.75 (Condition 2). Now Today's Close of 35.85 was lower than Today's Open of 36.40 making today a Bear Day (Condition 3). Also after crossing the Previous Top (36.44), VZ closed below it (Condition 4). Today was also the first day since the formation of the Previous Top (36.44) and the subsequent Bottom at 34.51 (Condition 5). Thus all of our conditions for TURN BACK (SELL) are fulfilled nicely telling us to close any long position and to initiate a fresh short position with Stop-loss at 36.51 and target price of 34.51 (Previous Bottom).

On August 26th, Verizon's stock price reached a low of 34.51(Previous Bottom) and fulfilled the requirement of Aug 18th TURN BACK (SELL) signal. Now interestingly enough, as of August 26th, VZ was in a down-trend as required for Condition 1 of TURN BACK (BUY) signal. The Previous Bottom (34.51) was broken as VZ traded as low as 34.26 and then as high as 35.20 (Condition 2). Today's Close of 35.01 was also higher than Today's Open of 34.78 making it a Bull Day (Condition 3). After having broken Previous Bottom of 34.51 and having made a low of 34.26, when VZ started trading above 34.51 (Previous Bottom), we could see a TURN BACK (BUY) signal forming (Condition 4). Aug 26th was also the first day since the last Bottom of 34.51 and the subsequent Top of 36.61. This fulfilled our last condition too. Thus with all conditions fulfilled for a TURN BACK (BUY) signal, we can now close any existing Short position and initiate a new Long position with price target of 36.61 (Previous Top) and Stop-loss of 33.99$ (Today's Low minus around 1%).

As you can see from the prices of the subsequent few days, VZ confirmed a new Bottom at 34.26 and made new higher High prices. On Sept 4th, it crossed Previous Top (36.61) making our TURN BACK (BUY) signal on Aug 26th a successful one. Now on Sep 4th, the stock closed higher than Previous Top (36.61) but on the next day (variation of Condition 5), it closed below 36.61. It was also a Bear Day. Thus once again we had a TURN BACK (SELL) signal pointing to a short-term down-trend with Stop-loss at 37.00 and target price of 34.21. The daily prices of VZ for subsequent days are not shown above, but it did not trigger our Stop-loss of 37.00. However it did break the last bottom of 34.26 and touched a low of 32.80 on September 23rd.

SIGNAL S2: NEXT TOP/BOTTOM

This signal is similar to TURN BACK discussed above. The main difference between them is, that unlike as in TURN BACK (SELL), the Close is above the Previous Top price. Similarly when compared to TURN BACK (BUY) signal, the Close in this signal has to be below the Previous Bottom. In TURN BACK (BUY), the stock after trading below the Previous Bottom price has to close above it on the same day or on the next day. However in NEXT BOTTOM signal, the stock needs to close below the Previous Bottom. Similarly in NEXT TOP signal, unlike as in TURN BACK (SELL), the stock has to close above the Previous Top price.

<u>NEXT TOP Signal</u>

<u>Conditions</u> for this signal are almost similar to the TURN BACK (SELL) signal with few changes. The changes are highlighted in red.

1. The stock is currently in an up-trend.
2. Today's Low or Previous Day's High price has to be LOWER than the Previous Top, and Today's High price has to be HIGHER than that Previous Top (PT). (In short, today the stock has to have broken through the last Top).
   (TDL < PT or PDH < PT) and **TDH > PT**
3. Today has to be a **Bull Day**. Today's Close has to be HIGHER than Today's Open.
   TDC > TDO
4. Today's Close has to be **HIGHER** than the Previous Top. This is an important required condition for this signal.
   TDC > PT

<u>ACTION</u>: For NEXT TOP signal, the stock has to not only trade above the Previous Top but has to <u>close</u> above it. This serves as evidence of powerful buying- the stock not only traded above Previous Top price but also stayed and closed above it during the session.

Please note that these NEXT TOP and NEXT BOTTOM signals are not as strong as or as accurate as other signals discussed in this book. They should be used for only short-term trading positions. When a NEXT TOP signal occurs, we can close any existing short-term Short position. If other factors also make sense, we can also initiate fresh short-term BUY position. We should never trade a <u>large-amount</u> position nor stay in a position for too long in response to this signal.

It is important to keep one more thing in mind when we are looking at a stock which crosses above Previous Top. During the day, it is difficult to know with confidence if it close above or below the Previous Top or if it will be a Bear or a Bull Day. These unknowns are part of two important conditions for this signal. Hence I advise you not to trade during the day on expectations but wait for the market to close so we can apply the real Close price in our conditions. So the earliest you can trade on these two signals is just around the market close or during the subsequent day's trading. One exception is when a stock opens strong at a price higher than the Previous Top price. In such a situation, you don't need to wait till market closes. You can trade any time during the session providing the stock is trading higher than the Previous Top price. When a stock opens above the Previous Top or below the Previous Bottom, there is a possibility for a GAP signal too. When we have both these signals on a single day, we have a strong reason to buy/sell the stock.

PRICE OBJECTIVE: In response to this signal, one usually expects the stock to repeat the upward movement it showed from the Previous Bottom price to the current (or the Previous Top) price level. If a stock made Previous Top at 20$ and then a Bottom at 17$, the difference is 3$. So now when the stock closes above 20$ with a valid NEXT TOP signal, one expects that the stock price will repeat the upward movement of 3$ one more time and touch 23$ (PT + the difference). Thus the 23$ level becomes our target NEXT TOP and hence we call this signal- NEXT TOP. Now if and when the price reaches this NEXT TOP target, we should book profit in our long position in response to this signal.

STOP-LOSS: This signal is not as strong as many signals discussed in this book so it fails quite often. For a long position based on NEXT TOP signal, a Stop-loss should be kept at the Previous Top minus around 1% or at the Low price of the signal day.

NEXT BOTTOM Signal

Conditions: This is the reverse version of NEXT TOP signal. Let us look at the required conditions for a valid NEXT BOTTOM signal.

1. Stock has to be in a short-term down-trend.

2. Today's Low price has to be LOWER than Previous Bottom (PB); Today's High price or Previous Day's Low has to be HIGHER than that Bottom. (In short, today the stock has to have fallen through the last Bottom).
   TDL < PB and **(TDH > PB or PDL > PB)**

3. Today has to be a **Bear** Day. Today's Close has to be LOWER than Today's Open.
   TDC < TDO

4. Today's Close has to be LOWER than Previous Bottom. This is also a very important required condition for this signal.
   TDC < PB

ACTION: For a valid NEXT BOTTOM signal, the stock has not only to trade below the Previous Bottom but also has to close below it. This serves as important evidence for this signal- the absence of fresh buying today at this price level unlike what was seen around this same price level the last time when Previous Bottom was formed.

As mentioned earlier, NEXT BOTTOM is not a strong signal and hence one should trade cautiously in response to this signal. In response to a NEXT BOTTOM signal, we should close any existing short-term Long position. A fresh short-term Short position can also be added with a proper Stop-loss.

As mentioned earlier for a NEXT TOP signal, we should not anticipate trade on a NEXT BOTTOM signal either. A Close below Previous Bottom and a Bear Day- are both important conditions for this signal. So we should apply this signal only when we have the real close price. If you can see the TURN BACK (BUY) and NEXT BOTTOM signals are opposite in nature and only the Close price decides which signal we have. The former tells us to go long while the latter tells to take a Short position! Hence one should not base trading decisions on intuition during the day but must wait for the market to close. The earliest you can trade in response to these signals is toward the close of the market or on the next day when market opens for trading.

PRICE OBJECTIVE: In response to a valid NEXT BOTTOM signal, one can expect the stock to repeat a downward movement of the same magnitude that it showed from the Previous Top price to the current (or the Previous Bottom) price level. As an example, if Previous Bottom was at 20$ and then a Top was at say 24$, the difference between these two prices is 4$. This means when the stock closes below 20$ subsequent to the last Top at 24$ with a fulfilled NEXT BOTTOM signal, one can expect that the stock will repeat the downward movement of 4$ one more time from this current price of 20$ (Previous Bottom minus the difference) and reach the next target of 16$ (our NEXT BOTTOM). Now if and when the stock price reaches this NEXT BOTTOM target (of 16$ in this case), we must book profit in our short position.

STOP-LOSS: This signal is not as strong as many signals discussed in this book so it fails quite often. So if you decide to trade in response to this NEXT BOTTOM signal, Stop-loss should be kept at the (Previous Bottom or Today's High) plus around 1%.

SIDE-WAYS BREAK-OUT SIGNALS

When a stock is passing through a Side-ways movement, the trading volumes in the stock usually tend to go down. Now when you find the price of the stock breaking above or below this price range or the trend-lines with a significant jump in volume, you are probably looking at a Break-out.

Most Break-outs are very powerful and offer attractive trading opportunities. They are much easier to find on price charts so we will look at them in the next chapter when we discuss Chart-based trading signals. So please look at the trend-line based signals in the next chapter and you will be able to adapt them to situations where a stock is breaking out of the Side-ways movement.

Chapter

10

CHART-BASED SIGNALS

So far we have looked at signals that can be identified by applying certain formulas to various prices. For each signal we had a set of conditions and by testing those conditions with appropriate prices, we saw if some signal could be applied to the stock or not. Initially these conditions and signals may be hard to memorize but once you understand the underlying logic behind them, you will be able to identify most of those signals just by looking at a candle-stick or an OHLC (Open High Low Close) price chart.

The new signals we are going to discuss now can be seen only on charts. There are no *easy* mathematical conditions here. Instead, we will USE a few qualitative conditions to identify these new signals. If you are familiar with charts and technical analysis of market/stocks, probably you are already familiar with the signals that I am going to discuss here. These are patterns and Trend-line-based signals. If you are already familiar with them, you may want to skip this chapter. Unlike most other technical analysis books, I am **not** going to discuss every technical signal/method out there; and certainly **I am** going to describe my favorite signals that I find very useful.

Chart-based signals can be grouped into two classes and we will see them one by one.

CHART-BASED TREND REVERSAL SIGNALS

CH-TR1: ISLAND REVERSALS:

If you are familiar with technical analysis of stocks, you probably know about Island Reversal. It is formed after a sustained up- or down-trend and has powerful trend reversal implications. An Island Reversal is relatively easy to spot on a chart like our Gap signal. However it is made up of two opposite gaps in prices over a short period of time which makes it sort of a rare signal. You do not find island reversals frequently but whenever you find one, you should not miss this trading opportunity.

How to spot an Island Reversal? For recognize Island Reversals, you should be familiar with Gaps (for more information about Gaps, please look at the Trend Continuation Signals Chapter in this book). There are two types of Gap signals- Gap (Buy) and Gap (Sell). When you see both of these Gaps take place in a stock within three to four days, you are most likely looking at an Island reversal. Let us look at some charts to understand it.

ISLAND REVERSALS (BUY)

Conditions:

1. The stock is in a down-trend.

2. There was a GAP (SELL) signal in the stock yesterday. In other words, Previous Day's High was lower than Previous to Previous Day's Low price. (PDH < QDL).

3. Now today, you see a GAP (BUY). This means, Today's Low Price is higher than Previous Day's Low price. (TDL>PDL)

Important Note: Sometimes the second Gap signal takes place not on the next day but within 2/3 days. This weakens the signal a little but still it is powerful enough for one to initiate fresh Long positions.

Stockfetcher.com syntax: Show stocks where low is more than .25% above the high 1 day ago and high 1 day ago is more than .25% below the low 2 days ago and close is above the open and average volume (10) is above 100000 and close is above 1.00 and low 1 day ago reached a new 5 week low

ACTION: You should close existing Short positions and initiate Long positions in the stock.

STOP-LOSS: Keep Stop-loss at the Low price of day(s) between these two Gaps.

ISLAND REVERSALS (SELL)

Conditions:

1. The stock is in an up-trend.

2. There was a GAP (BUY) signal in the stock yesterday. In other words, Previous Day's Low was higher than Previous-to-Previous Day's High price. (PDL > QDH).

3. Now today, you see a GAP (SELL). This means, Today's High Price is lower than Previous Day's Low price. (TDH < PDL)

Important Note: Sometimes the second Gap signal takes place not on the next day but within 2/3 days. This is normal and acceptable. Though it weakens the signal a little it is still powerful enough for one to initiate short positions.

Stockfetcher.com syntax: " Show stocks where high is more than .25% below the low 1 day ago and low 1 day ago is more than .25% above the high 2 days ago and close is below the open and average volume (10) is above 500000 and close is above 1.00 and high 1 day ago reached a new 3 week high "

ACTION: You should close your long positions and initiate fresh Short positions in the stock.

STOP-LOSS: Keep stop-loss at the high price of the day(s) between these two Gaps.

Let us take a look at the eBay chart and prices around July 2003. This is the period when eBay was making new high prices and had made a 52 week High price on 24th July, 2003.

Date	Open	High	Low	Close	Volume
25-Jul-03	55.02	**56.16**	54.55	56.12	13069600
24-Jul-03	57.75	58.93	**57.58**	57.87	9696000
23-Jul-03	56.36	**57.48**	56.05	57.07	5815600
22-Jul-03	55.7	55.95	54.85	55.58	4868400
21-Jul-03	55.02	55.55	54.6	55.53	4126600

These prices are taken from a period when eBay was in a strong up-trend so it was normal to see Gap (Buy) signals. As you can see on the chart or from the prices above, there is an Up-Gap on July 24th, 2003. That day's Low price of 57.58 was higher than Previous Day's High price of 57.48.

Now if you look at the next day's prices, you will see a Down Gap. On the 25th, the stock had a High of 56.16 which was lower than Previous Day's Low price of 57.78. As you remember, this is a Gap (Sell) signal. Thus over three trading days, the stock had two opposite Gap signals. You can also see this on the Chart.

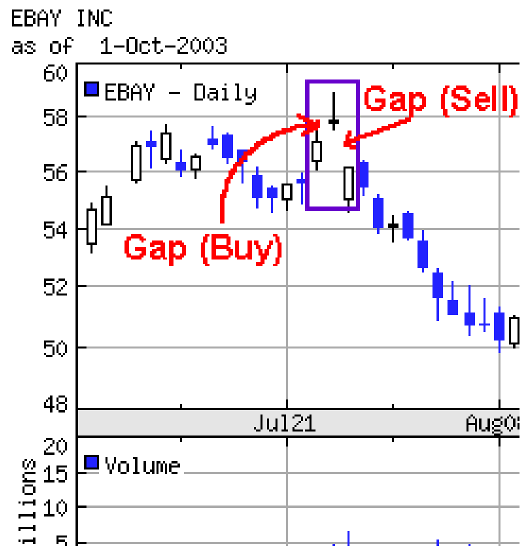


Chart courtesy of Stockfetcher.com.

Thus, after making a new 52 Week High at 58.93 on July 24, 2004 and having an Island Reversal (Sell), eBay reversed its trend and entered into a Down-trend. Though it is not shown on the chart it took quite a few months for eBay stock prices to cross July 24's Top of 58.93.

One more example of Island Reversal (SELL) signal:

On the left side of the following Chart, you will see EGHT was in a strong up-trend (Condition 1). Then it had a Gap (Buy) signal as shown in the chart (Condition 2). The stock made a new 52 Week High on that day. Now on the subsequent day, the stock surprised everyone and opened lower than Previous Day's Low price. As you see on the Chart, there is a Gap (Sell) signal (Condition 3). Thus we had two opposite Gap signals over two days! This was a classic example of an Island Reversal signal.

Now when you look at the prices after the reversal signal, you will see that it indeed was a reversal. The EGHT entered into a down trend and never crossed the signal day's High price. So if one had Shorted the stock based on the Island Reversal signal, he would have made good money.

(There is one more signal in the EGHT Chart. Before the Island Reversal signal, the stock was in a steep up-trend and it had a nice FLAG signal. You will learn about it later in this chapter.)

Chart courtesy of StockCharts.com.

In the last two examples of eBay and EGHT, we had two gaps on two consecutive days. As I mentioned earlier, this is nice to have but not an absolute requirement. Depending on stock and situation, it is also acceptable if these Gaps take place two or even three days apart. Let us take an example to highlight this.

Look at the prices and Chart of TXN during April 2004.

Date	Open	High	Low	Close	Volume
6-Apr-04	29.76	29.80	28.86	29.16	28,419,400
5-Apr-04	30.41	31.01	30.12	30.94	9,378,000
2-Apr-04	30.5	30.6	30.14	30.41	13,790,200
1-Apr-04	29.36	29.98	29.35	29.9	10,293,400

As you can see from the Chart on the right, TXN was in an up-trend prior to April 2004 (Condition 1). Then on April 2, 2004, TXN had a GAP (BUY) signal because that day's Low of 30.14 was higher than Previous Day's High price of 29.98. (Condition 2). The next day the stock kept its upward march and there was no sign of looking back. Now on April 6, 2004, TXN opened lower and displayed a GAP (SELL) signal because April 6th's High price of 29.80 was lower than April 5th's Low of 30.12 (Condition 3).

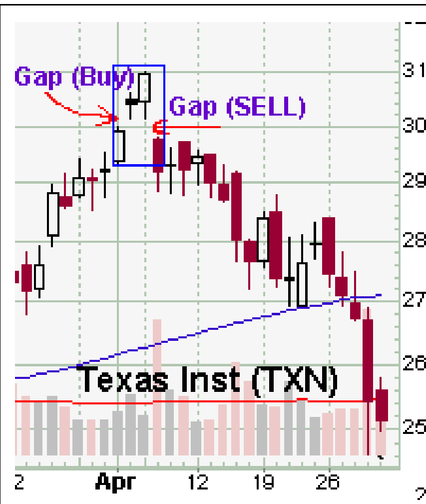


Chart courtesy of StockCharts.com.

Thus we had all three conditions fulfilled for Island Reversals but with one important variation. The two opposite Gaps were two days apart instead of one day! This makes the signal a little weaker but still it is one of the most powerful trend reversal signals out there. Now as we can see on the Chart, this signal showed its power. TXN subsequently entered into a down-trend and made a low price of 24 by the end of the month.

A few things to remember with regards to Island Reversals:

- When looking for an Island Reversal it does not matter if the days are Bull or Bear days. That means, when I mention Gap (Buy), you do not need to test for the day to be a Bull day nor for a Gap (Sell), the day does not need to be a Bear Day. Two Gaps in opposite directions are more important and critical for Island Reversals.

- You will mostly see a jump in volume around Island Reversal days and that adds to the strength of the signal.

- When looking for an Island Reversal signal, make sure you are not looking at foreign stocks (including ADRs, GDRs or International country funds). Such stocks are more actively traded in their home countries and hence being based on price movements there, they often open with Gaps in US markets but those Gaps do not mean much from our analysis perspective.

- Look for Island Reversals after a sustained trend. If you get an Island Reversal (SELL) in a stock that is already in a down-trend, you should ignore that signal. There is no trend reversal implied!!!

CH-TR2: TREND-LINES

If you are familiar with stock price charts, you probably know what a Trend-line is. It is a straight line that is drawn on a chart by joining more than one of the Tops or Bottoms of the stock. It is possible that a stock may be in an up- or downtrend but we may not be able to draw any useful Trend-line. Also, drawing a Trend-line on any chart is more of an art than a science. Hence it is possible for any two people to draw totally different Trend-line(s) on the very same chart! One more important thing to know about Trend-lines is that there is no precise method to know if a particular Trend-line is right or wrong! Having said this, I am going to give you some guidelines about how to draw an effective Trend-line on a given chart and how to interpret it to identify trading opportunities.

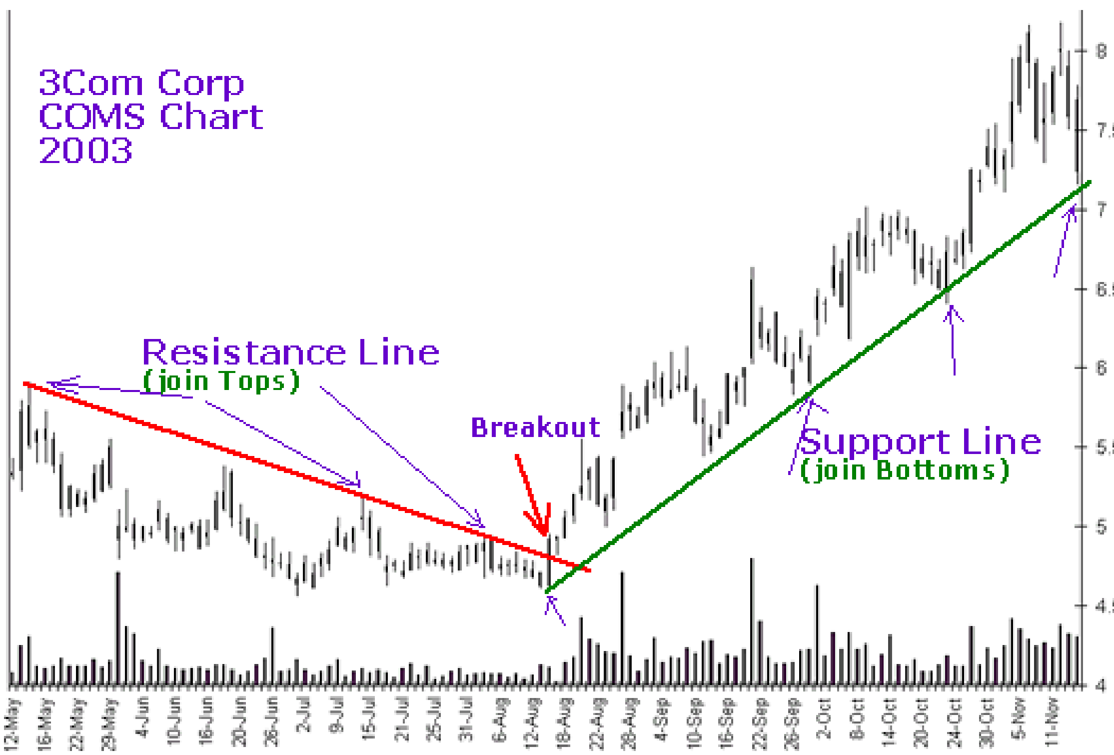
There may not be a trend-line(s) on every chart, but when we find one that touches the last two (three is more desirable) or more Tops (or Bottoms), we are looking at some profitable trading opportunity down the road. Trading signals based on a Trend-line are powerful; but like any other signal, they also fail. However if we have a Trend-line that touches the last four or more Tops or Bottoms, the trading signals based on it are more powerful and are more likely to generate significant profit.

There are two types of Trend-lines. For simplicity, we can divide them into two groups.

1. **Support Trend-line (ST)**: Support Trend-lines, mostly but not always, are drawn in a stock that is in an up-trend. As we know, most of the stocks will have Reactions during their upward journey. Each Reaction would define a new Bottom, usually higher than the Previous Bottom. Now if when you look at a chart you can visualize a line that is touching or passing thro the last three or more Bottoms, you have found a Support Line! Ideally a line should be drawn by

joining the Low prices on the Bottom days; but the important thing is to draw a good line and hence it is okay if you draw a line that joins non-Low prices (any point between the day's Low and Close prices) of a few of these Bottom days. This may sound confusing or difficult initially, but when you study the charts below, you will discover how to draw good Support Trend-lines.

2. **Resistance Trend-lines (RT)**: Resistance Trend-lines are usually drawn in a stock that is in a downtrend. As we know, stocks that are in a downtrend, will give Corrections now and then during their downward journey. Each Correction would define a new Top usually lower than the Previous Top. Now when you are looking at a particular price chart, if you can visualize/draw a line that touches or passes thro the last three of more Tops (or between High and Close prices of), that is our Resistance Trend-line.



Here is a recent Chart of COMS (3 Com Corporation) from Jun 2003 to Nov 2003. As drawn on the chart, it has one Resistance Line during its downtrend. Then during mid-Aug, there was a break out and for the first time in the last three or more months, COMS stock traded (closed) above the Resistance Line implying the likely end of the down-trend. Then as you will see on the chart, there was an up-trend in the COMS stock prices. Now as you join Bottoms days along the way, you will see a Support Line being formed. Whenever the stock entered into a Reaction, it found a support (buying) on or around the line.

There are a few things to keep in mind with respect to Trend-lines:

- Not all Tops (or Bottoms) will find resistance (or support) on the line. Some Tops (Bottoms) may be formed at some distance below (above) the line. The purpose is to draw a line that touches as many Top (Bottom) days as possible. In the Chart above, A and B do not precisely touch the support line; but I guess this is okay. It is NOT always possible to find charts on which we can draw a textbook style Trend-line(s). So, do not pursue perfection. Remember: Our goal in trading is to make money, and making money is hardly ever an obvious or easy thing!!!

- Drawing and analyzing a Trend-line is more of an art than a science! My Trend-line may be different than yours. Given the same chart, it is likely that different individuals will draw different Trend-lines on it.

- Some times it is okay if one or two Top (or Bottom) Days' High (or Low) prices are above (below) the Trend-line that is joining a significant number of Tops (or Bottoms). Here, rules can be bended to join Close prices for few Tops (Bottoms) instead of a day's High or Low prices. Look at day C marked in the chart above.

- Usually a break out from a Trend-line occurs with a significant increase in volume, and such increase in volume speaks well about the strength of the signal. However when we don't have this confirmation, we should look for an alternative confirmation -- the next two days' prices should stay above the Resistance Line (or below the Support Line).

- Frequently a stock after breaking a Resistance (or a Support) Line, comes back to touch the Line it broke but from the opposite side. This is normal behavior, and if it comes back, we can expect that Resistance (or the Support) Line to act as a Support (or a Resistance) line now. In such cases, when the stock price is about to touch the line but this time from the other side, it is a relatively safe trading opportunity with a close Stop-loss; but here you have to exercise a considerable amount of caution as sometimes this stock may keep trading under/above the broken Trend-line for a considerable period of time. I will illustrate this in an example later in this chapter.

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ACTION: Trend-lines give us two types of trading opportunities: Trend Continuation and Trend Reversals.

Trend Continuation Signals: Now we know that for a stock in a downtrend, what we draw is a Resistance Line by joining a majority of recent Tops. So when this stock enters into a Correction, it seems as if it is going to touch or cross the Trend- (Resistance) line. So when it touches, or is about to touch, the Resistance Line, you will expect a kind of resistance (selling pressure) to its current minor up-trend (Reaction). So you can sell (short) the stock at this time. As you can see from the Chart above, most of the time the stock forms the next top around the line, and continues in its down-trend. Similarly for a stock in the up-trend, we have a Support Line. So when the stock enters into a Reaction and is about to touch, or touches, the Support Line, we will take a Long position (BUY) reasoning that the Reaction is done/about to be done and the stock is likely to find buying support at this level. The logic behind these signals is simple: until we get a significant Trend Reversal signal, it is beneficial to trade with the major trend: *A trend is a friend.*

A Few Important Notes:

- For such Trend-line-Based Trend Continuation signals, you would not see a significant increase in volume around the days you make such trades.

- Also these trades have a narrow Stop-loss and hence loss will be minimal most of the time but not always: Sometimes a powerful break-out (trend reversal) can take place over the next two or more days, and the stock price may open with a big GAP in the other direction. When this happens, you may end up with a bigger loss than you initially anticipated.

- If a Trend-line is clearly established, it is easier to know at what price to make a trade and what Stop-loss will be behind it. Also if you see more than four Tops or Bottoms touching the line and the stock movement recently becoming very narrow, you should abstain from the (primary or major) trend continuation trades. Narrow price range and/or lower daily volume are good signals of an imminent break-out, or, in other words, a primary trend reversal; and this may happen many times with a significant gap in prices giving us no opportunity to close our position(s) at our pre-determined Stop-loss! This may result in an unexpectedly larger loss. So please exercise caution in such circumstances.

<u>Trend Reversal Signals:</u> Now when a stock breaks out from the Trend-line with significant increase in volume, this is likely to signal a major trend reversal. This can be confirmed when a stock that is currently in a down-trend with a clear Resistance Line, closes above the Line with an increase in volume, or if it also has two consecutive closes above the line. So as soon as it crosses the Line beyond our safety margin (comfort level), we must close our short positions and we can also take fresh long positions. Similarly for a stock in the up-trend, as soon as its price crosses or closes below its support line, if there is one, we can close long position(s) and/or we can initiate fresh short positions.

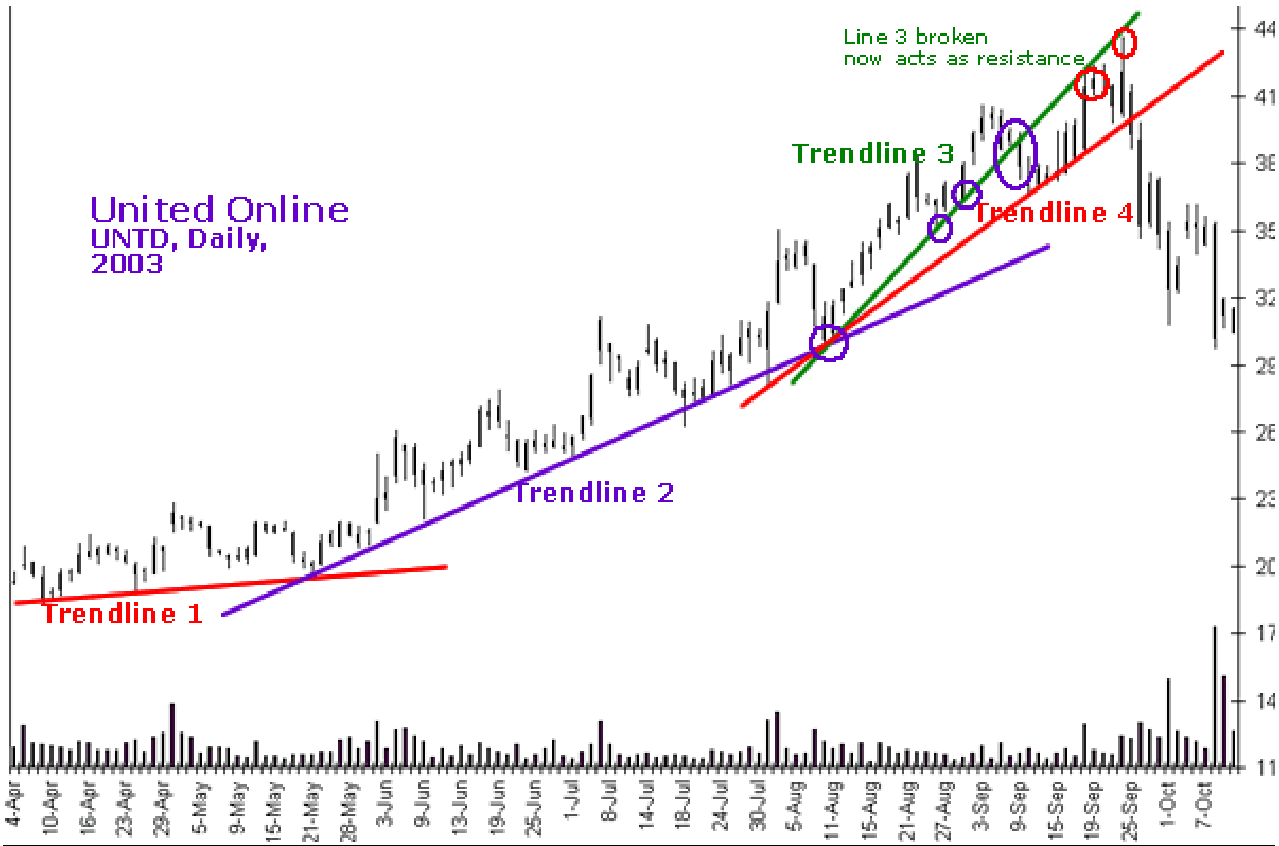
In short, for Trend Reversal signals (based on Trend-lines), the Close has to be on the other side of the Line. Accompanying increase in volume makes these signals stronger. If the Trend-line is crossed with a GAP, this is a very powerful Trend Reversal signal. Also you should apply the conditions of other trend reversal signals that we discussed in previous chapters (U TURN, FULL STOP, FREE FALL, JUMP START, WEEKLY REVERSAL, etc.) around these days to see if any of them are also applicable.

<u>STOP LOSS:</u> When you trade based on a Trend-line signal, you should keep a Stop-loss at the price that is from up to 1 to 2% on the other side of the Trend-line for today (or the day you are looking at).

As an example, say the stock X just broke the Support Line by trading below the current support level of 24$ for today. So if you short the stock, keep a Stop-loss at around 24.25$. Similarly, when a stock breaks up its Resistance Line with today's resistance level (on the line for today) at say 20$, your long positions should have a Stop-loss at 19.79$.

Please note one important thing: For Trend-line break out signals, the Stop-loss keeps changing as we move down or up the line as days pass by! You will need to use your judgment and act prudently in such cases.

See below a few more charts for better understanding of the Trend-lines and the signals they give. Sometimes, the stock is in a powerful trend and during its upward or downward journey, it keeps changing its speed. In such circumstances, we need to keep redrawing/redefining our Trend-lines. Here is an excellent example of a company, UNTD (United Online, Inc.), that bucked NASDAQ's down-trend of 2001 and 2002, and had a run up from a low price of around 1.50$ to more than 28$ when most stocks were sliding down. If you had been watching this stock during the mid 2003, you would have gotten a Trend-line 1 as shown in the chart. But as the stock gathered momentum, it lifted itself high above Trend-line 1. In such circumstances, it was meaningless to keep waiting for the stock to break Line 1!



So around mid-July, we were able to draw a more appropriate Trend-line 2 as shown on the Chart. This Line 2 became a significantly powerful Trend-line by early August because it had four to five Bottoms touching it! But when you see down the chart beyond August, you will see that the up-trend in the stock was accelerating and was gaining further momentum. It had started forming Bottoms that were way above Trend-lines 1 and 2. So towards the end of August, a third Trend-line was emerging as shown in the Chart. This Trend-line 3 reflected the stock dynamics more accurately for that period of time. Now during the first half of September, our Trend-line 3 was broken and the stock started trading below it! This was the first signal to sell UNTD stock around the 39$ level. Subsequently, UNTD failed to cross Trend-line 3 but was still trading higher than Line 2 for the next few days. Now around mid September, UNTD made a new High price of 42$ but still it was below Line 3. Line 3 was now acting as a Resistance Line for the stock! As said earlier, a stock often comes back to touch the line it has broken. UNTD serves as a nice example of it! Now at the end of September, we were able to draw a new Trend-line, Line 4, as shown in the chart. This support line had a powerful support of almost five recent Bottoms. So now this Line 4 was a critical support line for the stock. As you will see in the Chart, this line was also broken and over the next two days, the stock also broke Support Line 2. All supports were being broken for the stock, one by one, and this meant just one thing: the end of the up-trend that UNTD was going through over the previous two to three years! What happened to UNTD subsequently? It is not shown on the chart above but over the next three months the stock kept going down and touched a low price of 25$ (split-adjusted 16$) on December 17, 2003!

CHART-BASED TREND CONTINUATION SIGNALS

CH-TC1: FLAGS AND PENNANTS

These are powerful trend continuation signals and are relatively easy to identify. They are more likely to occur in small to medium capitalization/volume stocks than in large capitalization stocks. They usually occur half way in a *rapid* trend. A Flag and a Pennant both are very similar in strength and in trading implications with only one difference- their shapes are a little different.

Let us first look at how these patterns take place in an up-trend. For simplicity, flags and pennants can be divided into three parts/phases:

1. Phase One is a sudden very rapid up-trend with extremely heavy volume. This trend lasts from one day to over ten to twenty days. This up-trend is outstanding on the chart.

2. Phase Two forms a consolidation. It seems as if the up-trend in Phase One is losing its steam. **Volume also gets lower day by day** and every day the stock **seems to be making lower low prices**. This price movement looks like a rectangle (flag) or a triangle (pennant) on the chart. This phase can last from around the same number of days as in Phase One to up to two or three times the number of days. **One important note: Even though the stock is making lower prices here, these prices are still much higher than prices we had before Phase One started in this stock.**

3. If you see a stock fulfilling these two conditions above, or the formation of this pattern on the chart, it is time to pay close attention to it. When its price crosses, with increasing volume, the Top price for the last few days, you can look forward to as much gain in the stock as there was during Phase One.

<u>ACTION:</u> You can exploit Flag/Pennant patterns in two different ways based on your risk tolerance and trading preferences.

1. If you like to take more risk for larger potential gains, you can BUY towards the end of Phase Two near the lower support line of the flag. You can buy as much stocks as you want quietly when nobody else seems to be interested in it! The risk of this approach is: the stock may never enter into Phase Three and you will have to close your position with a loss. The good side- if you are correct in your anticipation of Phase Three, you will have significant profit in a short period of time.

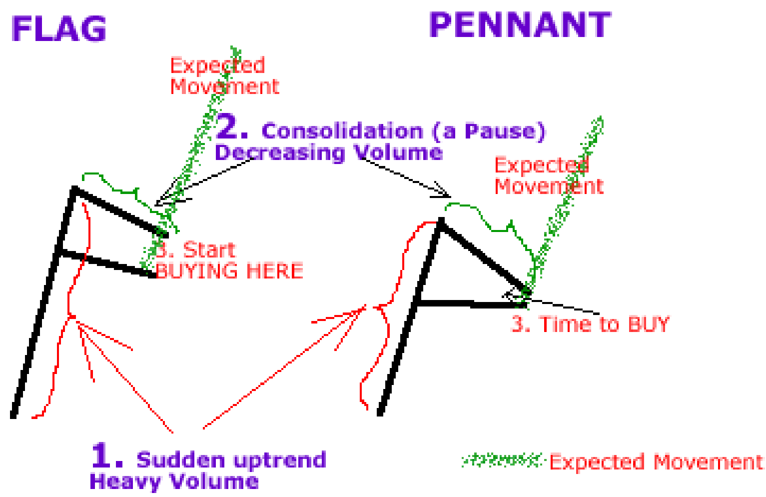
2. If you are risk averse, I advise you to keep an eye on the volume and price movement of this stock. As soon as the stock price picks up with significant increase in volume, you should jump on. The risk here is- you may miss getting on board in time as sometimes the stock may go up with a GAP or you may not be watching the stock at that very moment. The good side of this alternative is- you are more likely to be in profit, though smaller, than in the alternative 1 above.

I usually like to take a hybrid approach trading with Flags and Pennants. I buy half of my intended position as per alternative one. Then when Phase Three seems to start, I will add the remaining half.

STOP-LOSS: The recent Low price during Phase Two, minus 1%. Please keep in mind one specific risk here. As Flags and Pennants are more likely to be seen in stocks of small to medium sized companies, your position is subject to high volatility and a GAP in prices. Hence sometimes when the stock starts going in the reverse direction, you may not be able to close your position at the right time or at the right price level.

TARGET: When in Phase Three there is as much gain as there was in Phase One, book profit in your long position.

Look at the sketch below to understand the above reasoning:



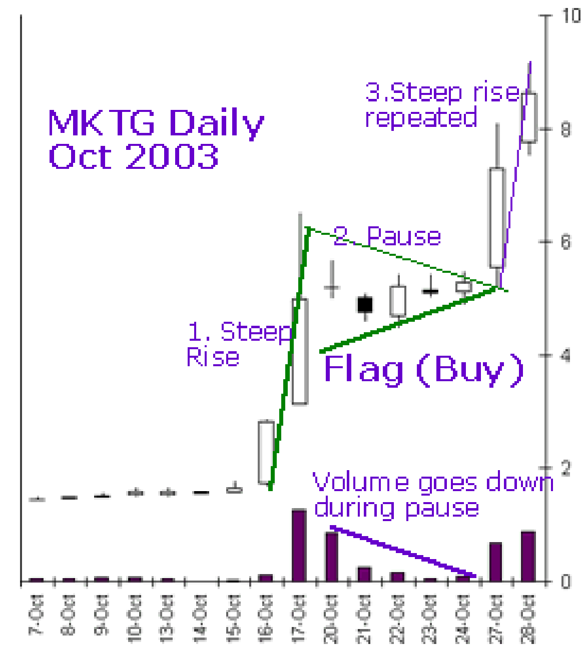
Pennants

This is a pattern that is formed usually exactly mid-way in a rapid up- or down- trend. Look at the prices and the chart of MKTG Services, Inc below.

Prior to October 2003, the stock wasn't moving! It was fluctuating between the 1 and 2$ level for a long time. Volume was also very low- around 10k to 20k per day. For traders, there was no fun/point in looking at or following this stock!

MKTG Services Inc.

28-Oct-03	7.74	9.14	7.51	8.62	355700
27-Oct-03	5.53	8.08	5.18	7.3	273600
24-Oct-03	5.1	5.46	4.87	5.29	32200
23-Oct-03	5.14	5.42	5.02	5.09	22500
22-Oct-03	4.68	5.42	4.48	5.21	65700
21-Oct-03	5.01	5.08	4.58	4.75	97600
20-Oct-03	5.16	5.67	4.99	5.2	343900
17-Oct-03	3.11	6.5	3.11	5	508900
16-Oct-03	1.72	2.85	1.66	2.83	45100
15-Oct-03	1.55	1.75	1.55	1.65	13100
14-Oct-03	1.55	1.55	1.54	1.55	500
13-Oct-03	1.51	1.65	1.48	1.57	19600



However something happened in this stock on the 16th of October! The stock broke away from its dull trading range, touched a high of 2.85 and closed at 2.83. When you compare this close to Previous Day's Close of 1.65, there was more than a 70% return in just one day! Then on the next day, it kept its upward journey and made a high of 6.50 and closed at 5.00. In terms of the high price of 6.50, this was a gain of almost **4.75** (Remember this figure) and in terms of return- it was a phenomenal return of 300% over just two trading days! The volume also jumped from a normal daily volume of 20k to 45k on the 16th and to 500k on the 17th! This kind of gain over just two trading days would make anyone dance with joy! If you had been watching this stock at that time, it is very likely that you would have expected the stock to go down from this level. If you were lucky enough to have made a purchase before this sudden jump, probably you would have closed your long position. Our common sense may even tell us to short this stock! But as you will see in a few moments, this wasn't the end of the story!

Over the next five trading days, MKTG sort of paused. The prices drifted a little lower and volume was also going down. It looked as though the story of this stock was over! Over Oct 22nd, 23rd and 24th, the stock kind of faced a resistance at 5.45. If you look at the Chart above, you will see the pattern of a pennant -- a straight line up and then a body of *narrowing price fluctuations and lowering volume.* Now on the 27th, MKTG was ready to finish its half-told story. It restarted its up-ward journey; and made a high of 8.08 and on the next day it touched a high of 9.18. If you look at the low price in the pennant of 4.48, we had another quick gain of almost 4.75 over the subsequent two days.

FLAG

See the Chart of AVSR (Avistar Communications) below for a few flag signals that took place during its phenomenal move from 50 cents to more than 3.50$ over a short period of time during October 2003.

Chart courtesy of StockCharts.com.

Here is another chart that has first a Pennant and then a Flag. EGHT (8x8) showed a rapid up-trend during third quarter of 2004 and had two of these patterns as shown on the chart below:

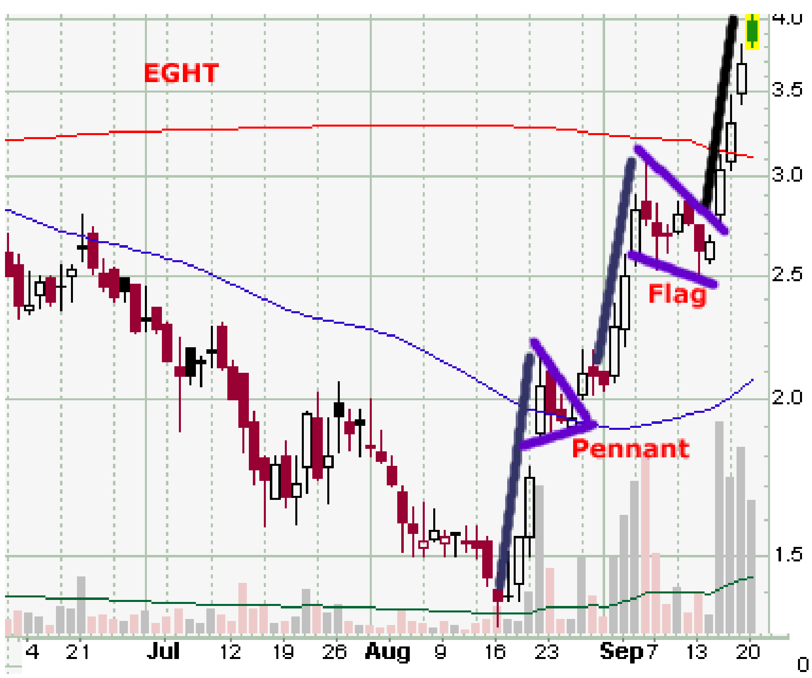
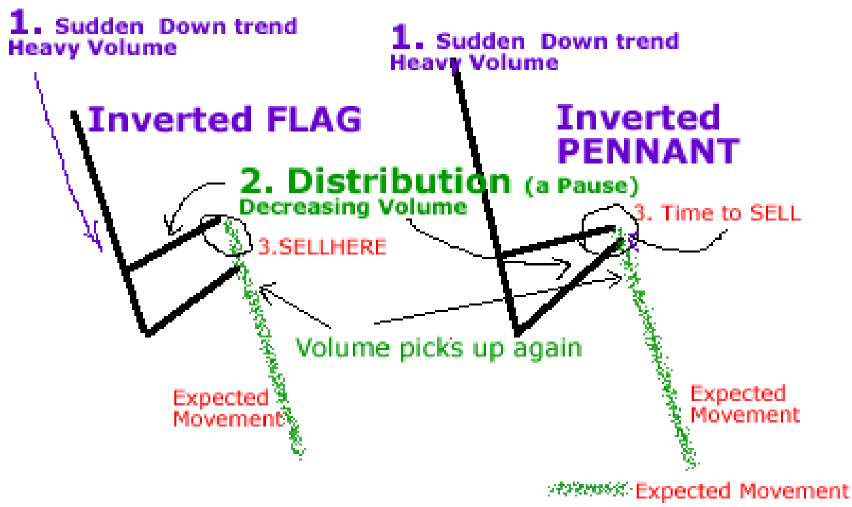


Chart courtesy of StockCharts.com.

INVERTED FLAG (IF) AND INVERTED PENNANT (IP) IN A SUDDEN DOWNTREND

In the previous section, we looked at Flag and Pennant patterns in a sudden up-trend. These two patterns also occur in a downtrend and act like a mid-point of a fall in stock prices. In a downtrend (Bear market), they are referred to as an Inverted Flag/Inverted Pennant because they look inverted as shown in the figure below.



Now let us look at salient features of these two inverted signals:

1. Phase One: A sudden very rapid downtrend with extremely heavy volume. This trend lasts from one day to over ten to twenty days. This downtrend is sudden and clearly visible on the Chart.

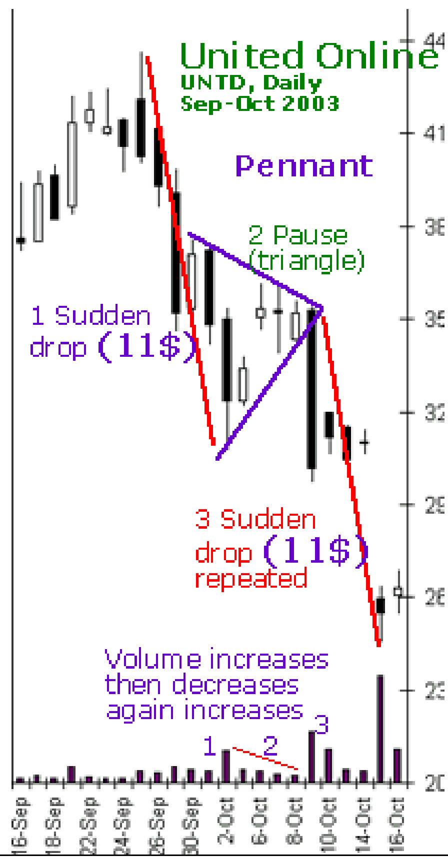
2. PhaseTtwo forms a Distribution. It seems as if the downtrend in Phase One is losing its steam! **Volume also gets lower day after day** and every day the stock seems to be **making higher high prices**. This price movement could resemble a rectangle (flag) or a triangle (pennant). This phase can last from around the same number of days as in Phase One or up to two to three times longer.
One Important Point: Even though the stock is making higher prices over the last few days, these prices are still clearly lower than the prices we had before the start of Phase One.

3. If you discover a stock fulfilling these two conditions above and the formation of this pattern on a chart, it is time to keep an eye on it. As soon as it drops, with increasing volume, below the Bottom price of Phase one (or the low price of the last three to five days), it is time to exploit this opportunity.

ACTION: SELL. As mentioned earlier for the normal Flag/Pennant, you have the same two choices with regard to Inverted Flag/Pennant signals. You can anticipate the end of Phase Two and SELL this stock when the volume is going down significantly, or you can wait for a Break-out from Phase Two and SELL when it enters Phase Three.

STOP-LOSS: Recent High price during Phase Two, plus 1%.

TARGET: When in Phase Three there is as much drop in price as there was in Phase One, cover your Short position.



Let us look at one example of an inverted flag/pennant pattern on the chart of United Online, Inc. (UNTD). UNTD stock was in a powerful up-trend for the last two years, touching from a low of less then 2$ to a high of 44$. On Sep 24, 2003, the company announced a split in the ratio of three stocks for every two stocks held, but for some reason, the market did not like this announcement. The stock sold off rapidly from that day's high of 44$ to a low of 32$ over the next six trading days with a relatively high volume on each day. This was Phase One -- a phase of a sudden and rapid decline. Then the stock paused for the next five days and formed a pennant as shown in the chart, with declining volume. Then, there was a Break-out with a high volume that pushed the price from 36$ to 25$ over the next five days! This was Phase Three. As you will see on the chart, Phase One and Phase Two both took around five to six days, and each of them had almost equal drops of 11$!

Chapter 11

SUMMARY

TREND REVERSAL SIGNALS

SIGNAL 1R: U-TURN

U-TURN (BUY)	U-TURN (SELL)
-Down-Trend -TDL< past three or more consecutive Lows* -TDO<PDL ** -TDC>PDC -TDC>PDO -TDV>NV/PDV*** <u>Action</u>: Strong form (a sustained trend), close SHORT positions and initiate BUY positions. Weak form (occurring mid-trend): You may want to close existing Short positions, and you may Buy this stock to take advantage of next few days' up-trend. <u>Stop-Loss</u>: At Today's Low, minus 1% <u>Target Price</u>: A gain of 20% for strong form. For a weak form: an up-trend in prices for next three to ten days.	-Up-Trend -TDH> past three or more consecutive Highs* -TDO>PDH** -TDC<PDC -TDC<PDO -TDV>NV/PDV*** <u>Action</u>: Strong form (a sustained trend), close existing LONG positions, if any, and initiate SELL positions. Weak form (occurring mid-trend): You may want to close existing Long positions, and you may Short this stock to take advantage of next few days' down-trend. <u>Stop-Loss</u>: At Today's High, plus 1% <u>Target Price</u>: A drop of around 20% for strong form. For a weak-from: a down-trend in prices for next three to ten days.

SIGNAL 2R: JUMP-START /FREE-FALL

JUMP-START (BUY)	FREE-FALL (SELL)
-Down-Trend -PDL< past three or more consecutive Lows* -TDO>PDH ** -TDC>TDO Bull Day -TDL>PDH -TDV>NV/PDV*** **Action**: Strong form (a sustained trend), close SHORT positions, if any, and initiate BUY positions. Weak form (occurring mid-trend): You may want to close existing Short positions, and you may Buy this stock to take advantage of next few days' up-trend. **Stop-Loss**: At Previous Day's Low, minus 1% **Target Price**: A gain of 20% for strong form. For a weak-from: up-trend in prices for next three to ten days.	-Up-Trend -PDH>past three or more consecutive Highs* -TDO<PDL** -TDC<TDO Bear Day -TDH<PDL A Gap -TDV>NV/PDV*** **Action**: Strong form (a sustained trend), close existing Long positions, if any, and initiate Short positions. Weak form (occurring mid-trend): You should close existing Long positions, and you may Short this stock to take advantage of next few days' downtrend. **Stop-Loss**: At Previous Day's High, plus 1% **Target Price***: A drop of around 20% for strong form. For a weak-from: down-trend in prices for next three to ten days*

SIGNAL R3: FULL-STOP

FULL-STOP (BUY)	FULL-STOP (SELL)
-Down-Trend -PDL< past three or more consecutive Lows* -PDC<Closes of last few days/weeks -PDC<PDO Nice to have but not required -TDO>PDC ** -TDC>TDO Bull Day -TDL>PDC -TDV>NV/PDV*** Action: Strong form (a sustained trend), close SHORT positions, if any, and initiate BUY positions. Weak form (occurring mid-trend): You may want to close existing Short positions, and you may Buy this stock to take advantage of next few days' up-trend. Stop-Loss: At Previous Day's Close, minus 1% Target Price: Up-trend in prices for next three to ten days.	-Up-Trend -PDH>past three or more consecutive Highs* -PDC>Closes of last few days/weeks -TDO<PDC** -TDC<TDO Bear Day -TDH<PDC -TDV>NV/PDV*** Action: Strong form (a sustained trend), close existing Long positions, if any, and initiate Short positions. Weak form (occurring mid-trend): You should close existing Long positions, and you may Short this stock to take advantage of next few days' down-trend. Stop-Loss: At Previous Day's Close, plus 1% Target Price: Down-trend in prices for next three to ten days

*If lowest/highest for over a week/weeks, the signal is much stronger
**The greater the difference, the stronger the signal
***If volume is not greater, the signal loses some of its strength

SIGNAL R4: TURN-AROUND

TURN-AROUND (BUY)	TURN-AROUND (SELL)
-Down-Trend -TDL< past three or more consecutive Lows* -TDO<PDL ** -TDC>PDC -PDO>PDC (Bear Day) -TDV>NV/PDV*** <u>Action</u>: Cover SHORT positions, if any, and initiate BUY positions, if the signal is strong, or BUY the stock after 2-Day U-TURN (BUY) is completed. <u>Stop-Loss</u>: At Today's Low, minus 1% <u>Target Price</u>: Up-trend in prices for next few days or weeks.	-Up-Trend -TDH>past three or more consecutive Highs* -TDO>PDH** -TDC<PDC -PDO<PDC Bull Day -TDV>NV/PDV*** <u>Action</u>: Close existing Long positions, if any, and initiate Short positions now or after a 2-DAY U-TURN (SELL) is confirmed. <u>Stop-Loss</u>: At Today's High, plus 1% <u>Target Price</u>: Down-trend in prices for next few days or weeks.

SIGNAL R5: REVERSE

REVERSE (BUY)	REVERSE (SELL)
-Down-Trend -TDL< Lows of past few weeks: Strong form* <Lows of past 3 -10 days: Weak form -TDL<PDL ** -TDC>PDC -TDC>TDO A Bull Day -TDV>NV/PDV**** <u>Action</u>: Cover SHORT positions, if any, and initiate BUY positions, if the signal is strong. <u>Stop-Loss</u>: At Today's Low, minus 1% <u>Target Price</u>: Up-trend in prices for next few days or weeks.	-Up-Trend -TDH>Highs past few weeks: Strong Form >High of past 3 -10 days: Weak form -TDH>PDH** -TDC<PDC -TDC<TDO A Bear Day -TDV>NV/PDV**** <u>Action</u>: Close existing Long positions, if any, and initiate Short <u>Stop-Loss</u>: At Today's High, plus 1% <u>Target Price</u>: Down-trend in prices for next few days or weeks.

SIGNAL R6: WEEKLY-REVERSE

WEEKLY-REVERSE (BUY)	WEEKLY-REVERSE (SELL)
-Down-Trend -TWL<Lowest for last few weeks * -PWC<PWO A Bear Week	-Up-Trend -TWH> Highest for last few weeks * -PWC>PWO A Bull Week

-TWC>TWO A Bull Week -TWL<PWL * -TWC/Current Intra-Day price>PWC -Greater Volume**** Not so relevant, but welcome Action: Cover SHORT positions, if any, and initiate BUY positions, if the signal is strong. Stop-Loss: A must. This Week's Low, minus 1% Target Price: Up-trend in prices for next few days or weeks.	-TWC<TWO A Bear Week -TWH>PWH* -TWC/Current Intra-Day price<PWC -Greater Volume**** Not so relevant, but welcome Action: Close existing Long positions, if any, and initiate Short positions depending on strength of the signal Stop-Loss: At Today's High, plus 1% Target Price: Down-trend in prices for next few days or weeks.

SIGNAL R7: 3-WEEK REVERSAL

3-WEEK REVERSAL (BUY)	3-WEEK REVERSAL (SELL)
-Down-trend -PWC<PWO A Bear Week -QWC<QWO A Bear Week -TWC/Current Intra-week Price>TWO A Bull Week -TWL<PWL* -TWC/Current Intra-week Price>PWH, also TWC/Current Intra-week Price>QWC -Greater Volume**** Not so relevant, but welcome Action: Cover SHORT positions, if any, and initiate BUY positions Stop-Loss: A must. At lowest price over the last three weeks, minus 1% Target Price: Up-trend in prices for next few weeks.	-Up-trend -PWC>PWO A Bull Week -QWC>QWO A Bull Week -TWC/Current Intra-Week Price<TWO A Bear Week -TWH>PWH* -TWC/Current Intra-week Price<PWL, also TWC/Current Intra-week Price<QWC -Greater Volume**** Not so relevant, but welcome Action: Close existing Long positions, if any, and initiate Short positions Stop-Loss: At highest price of the last three weeks, plus 1% Target Price: Down-trend in prices for next few weeks.

*If lowest/highest for over a week/weeks, the signal is much stronger
**The greater the difference, the stronger the signal
***If volume is not greater, the signal loses some of its strength
****If there is a significant jump in volume, it adds a lot of strength maybe indicating a major trend reversal

TREND CONTINUATION SIGNALS

SIGNAL C1: GAP

GAP (BUY)	GAP (SELL)
-Up-trend -TDL>PDH * -TDC>TDO A Bull Day -Greater Volume**** further strengthens signal <u>Action</u>: BUY <u>Stop-Loss</u>: At Today’s Low price, minus 1% <u>Target Price</u>: Up-trend in prices for next few days.	-Down-trend -TDH<PDL * -TDC<TDO A Bear Day -Greater Volume**** further strengthens signal <u>Action</u>: SELL (Short) <u>Stop-Loss</u>: At Today’s High Price, plus 1% <u>Target Price</u>: Down-trend in prices for next few days.

SIGNAL C2: RESTART

RESTART (BUY)	RESTART (SELL)
-Up-trend, but the last three to ten days form a down- or a Side-ways phase (Reaction) -TDL<PDL* -TDC>TDO A Bull Day -TDC>PDC -TDL< the Low prices during the reactionary trend -Greater volume today in comparison with the average volume during the days of the Reaction formation <u>Action</u>: BUY <u>Stop-Loss</u>: At Today’s Low price, minus 1% <u>Target Price</u>: Up-trend in prices for next few days.	-Down-trend, but the last three to ten days form an up- or a Side-ways phase (Correction) -TDH>PDH* -TDC<TDO A Bear Day -TDC<PDC -TDH> the High prices during the reactionary trend -Greater volume today in comparison with the average volume during the days of the Correction formation <u>Action</u>: SELL (Short) <u>Stop-Loss</u>: At Today’s High Price, plus 1% <u>Target Price</u>: Down-trend in prices for next few days.

*If lowest/highest for over a week/weeks, the signal is much stronger
**The more the difference, the stronger the signal
***If volume is not greater, the signal loses some of its strength

MISCELLANEOUS TRADING SIGNALS

MISC ONE: MONDAY MORNING

CASE ONE (for a rising stock) -Up-trend -MO>FC <u>Action</u>: Take a long position after stock starts trading higher than opening price and after a 10-30 minute wait. <u>Stop-loss</u>: Monday's Open minus ½% (preferred) or Friday's Close minus ½% (for less dynamic traders)	**CASE TWO** (for a rising stock) -Up-trend -MO<FC <u>Action</u>: Book profit in long position. Take a short position after stock trades lower than opening price and after a 10-30 minute wait. Courageous trades can Short Sell. <u>Stop-loss</u>: Monday's Open (TDO) plus ½% (preferred) or Friday's Close (for less dynamic traders)
CASE FOUR (for a stock in down-trend) - Down-trend - MO>FC <u>Action</u>: Close Short positions, and/or take long positions when stock trades higher than opening level and after a 10 – 30 minute wait. <u>Stop-loss</u>: Monday's Open (TDO) minus ½% (preferred) or Friday's Close minus ½% (for less dynamic traders)	**CASE THREE** (for a stock in down-trend) - Down-trend - MO<FC <u>Action</u>: Close long positions and take a short position when stock trades lower than opening level and after a 10-30 minute wait. <u>Stop-loss</u>: Monday's Open (TDO) plus ½% (preferred) or Friday's Close plus ½%(for less dynamic traders)

MISC SIGNAL TWO -- SIGNIFICANT DAY

-Today is a special day for a stock/ a market/ an instrument -TDO<TDC A Bull Day -There should be an increase in Volume. The more the increase the more powerful the signal. <u>Action</u>: Buy because the projected outcome is an increase in prices over the next few days.: A) Buying at Significant Day's Close/Subsequent Day's Open = higher profit, higher probability of loss; B) Waiting to buy when price crosses the High made on the Significant Day = lesser profit, lesser probability of loss. (Safer recommended method) <u>Stop-loss</u>: Significant Day's Low minus + -1%.	-Today is a special day for a stock/ a market/ an instrument -TDO>TDO A Bear Day -There should be an increase in Volume. The more the increase the more powerful the signal <u>Action</u>: Sell because the projected outcome is a decrease in prices over the next few days; A) Selling at Significant Day's Close/Subsequent Day's Open = higher profit, higher probability of loss; C) Waiting to sell when price crosses the Low made on the Significant Day = lesser profit, lesser probability of loss. (Safer recommended method). <u>Stop-loss</u>: Significant Day's High plus + - 1%.

MISC SIGNAL THREE-- DERIVATIVES EXPIRATION

-Every third Friday of every month, or -The third Friday of the month that ends each quarter (Triple Witching Day) -Find the Low of one of the Fridays above on which derivatives expire -Find the High of the Subsequent Day (usually a Monday) Action: Take a long position (buy) when the stock/index CROSSES above (or CLOSES above for risk-averse traders) the High of the Subsequent Day. Stop-loss: At the Low price of the Friday being studied minus up to ½%.	-Every third Friday of every month, or -The third Friday of the month that ends each quarter (Triple Witching Day) -Find the Low of one of the Fridays above on which derivatives expire -Find the High of the Subsequent Day (usually a Monday) Action: Short (sell) when the stock/index CROSSES below (or CLOSES below for risk-averse traders) the Low price of the Friday being studied. Stop-loss: At the High price of the Subsequent Day plus up to 1%.

MISC SIGNAL FOUR–VOLUME SPIKE

-Apply when there is a sudden, unexpected and significant jump in volume. -Decide if there is a larger than normal price fluctuation on that day. -Decide if this spike is due to some news/event that has impact on the company. -Study the nature of the stock to see if high volume is surprising. It will stand out on a chart. -Find the Low of Volume Spike Day -Find the High of Volume Spike Day Action: IN CASE NO TREND REVERSAL SIGNA CAN BE APPLIEDL, iIf a Bull Day, close short positions; and If a Bear Day, close long positions. IF SPIKE WAS DUE TO NEWS and stock stays higher than VS HIGH plus +-1% of Spike Day, take a long position.). Stop-loss: Select Volume Spike Low OR if aggressive, Volume Spike High minus 1 to 3% Thoughts: This is a short- to medium-term trading signal . The spike should be from 3 to 10 times the normal volume. Check intra-day chart to assure that volume is spread across session.	-Apply when there is a sudden, unexpected and significant jump in volume. -Decide if there is a larger than normal price fluctuation on that day. -Decide if this spike is due to some news/event that has material impact on the company. -Study the nature of the stock to see if high volume is surprising. It will stand out on a chart. -Find the Low of Volume Spike Day -Find the High of Volume Spike Day Action: IN CASE NO TREND REVERSAL SIGNAL CAN BE APPLIED, if a Bull Day, close short positions; and If a Bear Day, close long positions. IF SPIKE WAS DUE TO NEWS and stock drops lower than VS LOW minus +-1% over subsequent five days, create fresh short positions Stop-loss: Select Volume Spike Low plus 1 to 3% as safety margin OR if aggressive, Volume Spike High plus 1 to 3%as safety margin. Thoughts: This is a short- to medium-term trading signal . The spike should be from 3 to 10 times

Which of two reasons for spike: a) It is an explosion at end of trend to announce reversal of trend in absence of specific news. If coupled with a Trend Reversal Signal, take advantage b) It is an explosion due to news. In which case study subsequent days.	the normal volume. Check intra-day chart to assure that volume is spread across session. Which of two reasons for spike: a) It is an explosion at end of trend to announce reversal of trend in absence of specific news. If coupled with a Trend Reversal Signal, take advantage b) It is an explosion due to news. In which case study subsequent days

TRADING IN SIDE-WAYS

SIGNAL ONE: TURN-BACK

TURN-BACK (BUY)	TURN-BACK (SELL)
- Last three to ten days form a down-trend (Reaction) -Today should be first/second day that the stock trades below Previous Bottom -TDC>TDO A Bull Day -TDL<PB and TDC > PB -Volume not relevant for this signal <u>Action</u>: Close short, initiate new long positions <u>Stop-Loss</u>: Today's Low price, minus 1% <u>Price Objective</u>: Previous Top price	-Last three to ten days form an up-trend (Correction) -Today should be first/second day that the stock price crosses Previous Top -TDC<TDO A Bear Day -TDL<PT and TDC < PT -Volume not relevant for this signal <u>Action</u>: Close long; start short-term short positions <u>Stop-Loss</u>: Today's High price, plus 1% <u>Target Price</u>: Previous Bottom price

SIGNAL TWO: NEXT TOP/NEXT BOTTOM

NEXT-TOP (BUY)	NEXT-BOTTOM (SELL)
-Stock in short-term up-trend -TDL<PT -TDH>PT -TDC>TDO A Bull Day (Important) -TDC > PT (Very important) <u>Action</u>: Book profit in Long positions if stock reaches Next Top; close short-term Short positions; start fresh short-term BUY positions or add to existing short-term Long positions. <u>Stop-Loss</u>: Previous Top minus +-1% <u>Price Objective</u>: Next Top price **which is** Previous Top plus the difference between Previous Top and Previous Bottom. <u>Thoughts</u>: This is a signal weaker than others so confirm suspected direction with level of TDC	-Stock in short-term down-trend -TDL<PB -TDH>PB -TDC<TDO A Bear Day (Important) -TDC < PB (Very important) <u>Action</u>: Book profit in Short position if stock drops to Next Bottom; close short-term Long position; start fresh short-term Short positions or add to existing short-term Short positions <u>Stop-Loss:</u> Previous Bottom plus +- 1% <u>Price Objective:</u> Next Bottom price **which is** the Previous Bottom price minus the difference between Previous Bottom and Previous Top. <u>Thoughts</u>: This is a signal weaker than others so confirm suspected direction with level of TDC and see if TDC<TDO. The only exception is if

and see if TDC>TDO. The only exception is if there is a strong up-Gap between PT y TDO. Never put a lot of money in these positions.	there is a strong down-Gap between PB and TDO. Never put a lot of money in these positions.

CHART-BASED TREND REVERSALS

SIGNAL CHART1: ISLAND REVERSALS

ISLAND REVERSAL (BUY)	ISLAND REVERSAL (SELL)
-Down-Trend -PDH<QDL (A Sell Gap) -TDL>PDL (A Buy Gap) <u>Action.</u> Close Short positions; initiate Long positions. The 2nd Gap condition may appear within 2/3 days making this signal weaker but still powerful. <u>Stop-Loss</u>: At Low price of day(s) between these two gaps. <u>Target Price</u>: Up-trend in prices for next few days. <u>Thought</u>: A Bull/Bear Day is not important for this signal. The two opposite Gaps are extremely important.	-Up-Trend -PDL>QDH (A Buy Gap) -TDH<PDL (A Sell Gap) <u>Action</u>: Close Long positions; initiate Short positions. The 2nd Gap condition may appear within 2/3 days making this signal weaker but still powerful. <u>Stop-Loss</u>: At High price of the day(s) between these two gaps. <u>Target Price</u>: Down-trend in prices for next few days. <u>Thought</u>: A Bull/Bear Day is not important for this signal. The two opposite Gaps are extremely important.

SIGNAL CHART2 (A): TREND-LINES: TREND CONTINUATION SIGNALS

SUPPORT TREND-LINE (BUY)	RESISTANCE TREND-LINE (SELL)
-Usually found in an Up-trend -Display of a Support Trend-Line which is a line passing through the last 3 or more Bottoms. -Volume would not have a significant increase around trading on such days. <u>Action</u>: Buy (Take a Long position) <u>Stop-loss</u>: Narrow to keep loss to a minimum, but no way to prevent big loss in a Break-out. <u>Thought</u>: Until we get a significant Trend Reversal Signal it is beneficial to trade with the major trend. If there are more than four Bottoms and the recent movement is very narrow, abstain from this Trend Continuation Signal. Narrow price	-Usually found in a Down-trend -Display of a Resistance Trend-Line which is a line passing through the last 3 or more Tops. -Volume would not have a significant increase around trading on such days <u>Action</u>: Sell (Short). <u>Stop-loss</u>: Narrow to keep loss to a minimum, but no way to prevent big loss in a Break-out. <u>Thought:</u> Until we get a significant Trend Reversal Signal, it is beneficial to trade with the major trend. If there are more than four Tops and the recent movement is very narrow, abstain from this Trend Continuation Signal. Narrow price

range and/or lower daily volume point(s) to an imminent Break-out (a primary trend reversal). Caution.	range and/or lower daily volume point(s) to an imminent Break-out. Caution.

SIGNAL CHART2 (B): TREND-LINES: TREND REVERSAL SIGNALS

SUPPORT TREND-LINE (SELL)	RESISTANCE TREND-LINE (BUY)
Usually found in an Up-trend -Display of a Support Trend-Line which is a line passing through the last 3 or more Bottoms. -Stock crosses or closes below Support Trend-Line (Is on the OTHER SIDE of the Line) -Volume should increase significantly; if not, confirm that next two days' prices stay below the Support Trend-line. <u>Action</u>: Close Long position(s) and/or initiate fresh Short positions. <u>Stop-loss</u>: Today's (or day under consideration) support level plus from 1 to 2%. Has to be continually brought up-to-date. <u>Thoughts:</u> A trend-line touching the last two Bottoms is powerful; but a line touching the last three is more powerful than the last two and so on unless the pattern narrows. Ideally the line connects the Low prices of Bottom days, but a few non-Low prices are admitted. A stock crossing with a GAP produces a very powerful Trend Reversal Signal. Apply other Trend Reversal signals.	-Usually found in a Down-trend -Display of a Resistance Trend-Line which is a line passing through the last 3 or more Tops. -Stock crosses or closes above the Resistance Trend-Line (Is on the OTHER SIDE of the Line) -Volume should increase significantly; if not confirm that next two days' Close prices stay above the Resistance Trend-line. <u>Action</u>: Close Short positions; take fresh Long positions. <u>Stop-loss</u>: Today's (or day under consideration) resistance level minus from 1 to 2%. Has to continually brought up-to-date. <u>Thoughts</u>: A trend-line touching the last two Tops is powerful; but a line touching the last three is more powerful than the last two and so on unless the pattern narrows. Ideally the line connects the High prices, but a few non-High prices are admitted. A stock crossing with a GAP produces a very powerful Trend Reversal Signal. Apply other Trend Reversal signals.

SIGNAL CHART3: TREND CONTINUATION SIGNALS
FLAGS AND PENNANTS and INVERTED FLAGS AND PENNANTS

FLAGS/PENNANTS (BUY)	INVERTED FLAGS/PENNANTS (SELL)
Phase One. -Sudden, rapid Up-trend -Extremely high volume for 1 to 10 days (usually 2-5) **Phase Two.** -Consolidation lasting 3-10 days (usually 4-7) -Volume lowers -Stock price slowly lowers creating a flag pattern -- rectangular or triangular (pennant). Price is still higher than price level prior to Phase One.	**Phase One.** -Sudden, rapid Down-trend -Extremely high volume for 1 to 10 days (usually 2-5) **Phase Two:** -Consolidation lasting 3-10 days (usually 4-7) -Volume lowers -Stock price slowly rises creating an inverted flag pattern -- rectangular or triangular (pennant). Price is still lower than price level prior to Phase One. **Phase Three.** -Clear display of inverted flag/pennant – sell or wait to

Phase Three. -Clear display of flag/pennant pattern – buy or wait to confirm. Action. Buy quietly toward end of Phase Two (+risk….may never enter Phase Three….with + gain if it does); or follow and buy when price crosses Top price of last few days with increased volume (hoping to buy before an unforeseeable up-Gap). There is a hybrid approach consisting in buying half of the pretended position at end of Phase Two and buy the remainder when Phase Three seems to start. Stop-loss. Recent Low during Phase Two, minus 1%. Target Price.: When in Phase Three there is as much gain as in Phase One, book profit in Long position.	confirm. Action. Sell; or follow and sell when price crosses Bottom price of last few days with increased volume. Stop-loss. Recent High during Phase Two, plus 1% Target Price. When in Phase Three there is as much drop as there was in Phase One, cover Short position.

BACKTEST SUMMARY

BACKTEST SUMMARY: U TURN (BUY)

Just out of curiosity I tested U TURN signal for a period from 12/31/2003 to 6/29/2004.

- During this period, **Annualized Return on Investment (ROI) for U TURN (BUY) was 23.88% against the ROI of S & P 500 index of 4.81%.**

- You would find that the loss amount when the signal failed was much lower than the profit amount in trades when the signal was correct.

Please note that this was an approximate test (courtesy of http://www.stockfetcher.com/). I was not able to create exact entry and exit points in the test the way I do in real life. Also, past results are not true predictors of future performance. Use this test results for enhancing your understanding of PFP signals.

Backtest Summary: U TURN (BUY)	
Entry Filter	Show stocks where Close gained more than .15% percent over the last 1 day and open is more than .25% below the low 1 day ago and close is above the open 1 day ago and close is less than 10% percent above low and LOW reached a new 4 week low and volume gained more than 20% over volume 1 day ago and volume is above 500000 and close above 5
Basic Setup	
Approach Type:	Long
Start Date:	12/31/2003
End Date:	6/29/2004
Benchmark Symbol:	^SPX
Exit Setup	
Stop Loss:	5%
Profit Stop:	10%
Trailing Stop Loss:	*N/A*
Minimum Holding Days:	*N/A*
Maximum holding days:	30
Exit Trigger #1:	LOW reached a new 4 week low

[Advanced Options]()	
Selection Method:	select by volume descending
Entry Price:	Open
Conditional Entry:	No
Exit Price:	Open
Maximum Trades Per Day:	25

Approach Information

Approach Name: U TURN (BUY)

Test started on 12/31/2003 ended on 06/29/2004, covering 123 days

Trade Statistics

- There were 65 total stocks entered. Of those, 55 or 84.62% were complete and 10 or 15.38% were open.
- Of the 55 completed trades, 22 trades or 40.00%resulted in a net gain.
- Your average net change for completed trades was: 0.94%.
- The average draw down of your approach was: -4.02%.
- The average max profit of your approach was: 5.24%
- The Risk/Reward ratio for this approach is: 1.41

Annualized Return on Investment (ROI): 23.88%, the ROI of ^SPX was: 4.81%.

Exit Statistics

- Stop Loss was triggered 20 times or 36.36% of the time.
- Stop Profit was triggered 14 times or 25.45% of the time.
- Trailing Stop Loss was triggered 0 times or 0.00% of the time.
- You held for the maximum period of time (30 days) 7 times or 12.73% of the time.
- An exit trigger was executed 14 times or 25.45% of the time.

Statistics By Holding Period

	Completed	2 day chg	5 day chg	10 day chg	25 day chg	40 day chg
Winners:	22	29	36	33	37	33
Losers:	33	35	29	32	28	32
Win/Loss Ratio:	0.67:1	0.83:1	1.24:1	1.03:1	1.32:1	1.03:1
Net Change:	0.94%	-0.13%	0.04%	-0.16%	1.82%	-0.66%

Statistics By Variable: Match Price

	<10	<20	<30	<40	<50	<60	<70	<80	<90	<100
Completed	5:05	4:10	8:08	4:04	0:04	0:01	1:01	-	-	-
2 day chg	6:06	6:11	11:07	2:06	1:03	1:01	1:01	-	1:00	-
5 day chg	7:05	7:10	11:08	4:04	4:00	1:01	1:01	-	1:00	-
10 day chg	6:06	9:08	13:06	4:04	0:04	0:02	1:01	-	0:01	-
25 day chg	6:06	10:07	13:06	4:04	3:01	0:02	1:01	-	0:01	-
40 day chg	5:07	8:09	12:07	5:03	2:02	0:02	1:01	-	0:01	-

Statistics By Variable: Average Volume

	<1.5M	<3.0M	<4.5M	<6.0M	<7.5M	<9.0M	<13.5 M	<15.0M
Completed	18:24	2:04	1:01	1:01	0:01	0:01	-	0:01
2 day chg	25:24:00	2:04	2:02	0:02	0:01	0:01	-	0:01
5 day chg	27:23:00	4:02	3:01	2:00	0:01	0:01	-	0:01
10 day chg	27:23:00	3:03	2:02	1:01	0:01	0:01	-	0:01
25 day chg	27:23:00	5:01	2:02	2:00	0:01	1:00	-	0:01
40 day chg	25:25:00	3:03	2:02	2:00	0:01	1:00	-	0:01

Individual Trade Details:

Symbol	Trigger Date	Entry Price	Exit Date	Exit Price	Draw Down	Max Profit	Gain/Loss	Exit Type
HRP	1/8/2004	9.98	2/11/2004	10.98	-1.80%	10.62%	10.00%	PROFIT STOP
CPB	1/21/2004	26.39	3/5/2004	28.11	-0.87%	8.75%	6.52%	BUY-HOLD
UNP	1/21/2004	66.91	1/26/2004	65.53	-2.26%	0.73%	-2.06%	TRIGGER
GBBK	2/4/2004	27.1	3/19/2004	28.3	-1.99%	9.59%	4.43%	BUY-HOLD
NDN	2/4/2004	25.57	3/9/2004	28.13	-2.03%	11.03%	10.00%	PROFIT STOP
FDC	2/6/2004	38.4	3/4/2004	42.24	-1.90%	11.12%	10.00%	PROFIT STOP
SCSS	2/6/2004	22.42	2/11/2004	24.66	-1.20%	11.24%	10.00%	PROFIT STOP
UBB	2/6/2004	23.55	2/19/2004	22.37	-6.58%	5.18%	-5.00%	STOP LOSS
XXIA	2/11/2004	12.12	2/13/2004	13.45	-2.31%	13.20%	10.97%	PROFIT STOP
HIW	2/25/2004	25.5	4/6/2004	25.29	-2.20%	5.10%	-0.82%	TRIGGER
ABI	2/26/2004	22.45	3/4/2004	22.35	-1.92%	2.45%	-0.45%	TRIGGER
ADP	2/27/2004	42.46	3/16/2004	41.5	-4.92%	4.92%	-2.26%	TRIGGER
BBT	2/27/2004	37.16	3/16/2004	36.39	-3.58%	1.67%	-2.07%	TRIGGER
D	2/27/2004	62.83	4/13/2004	62.87	-1.07%	4.81%	0.06%	BUY-HOLD

Symbol	Trigger Date	Entry Price	Exit Date	Exit Price	Draw Down	Max Profit	Gain/Loss	Exit Type
KEM	2/27/2004	14.69	3/9/2004	13.96	-7.15%	5.45%	-5.00%	STOP LOSS
KO	2/27/2004	49.73	3/5/2004	48.75	-2.37%	0.20%	-1.97%	TRIGGER
KOF	3/1/2004	24.76	3/8/2004	23.52	-7.63%	0.36%	-5.00%	STOP LOSS
NOVL	3/1/2004	11.02	3/9/2004	10.47	-9.17%	5.81%	-5.00%	STOP LOSS
AGU	3/11/2004	13.96	3/16/2004	13.75	-2.22%	1.58%	-1.50%	TRIGGER
BNI	3/11/2004	30.6	4/26/2004	32.91	-1.63%	8.37%	7.55%	BUY-HOLD
CPN	3/11/2004	5.49	3/15/2004	5.22	-6.38%	2.91%	-5.00%	STOP LOSS
ELBO	3/12/2004	26.88	4/1/2004	29.73	-2.05%	10.64%	10.60%	PROFIT STOP
LENSE	3/12/2004	5.96	4/15/2004	6.1	-4.19%	8.39%	2.35%	TRIGGER
NCR	3/12/2004	21.27	3/23/2004	20.56	-4.54%	0.00%	-3.36%	TRIGGER
PRU	3/12/2004	45.55	3/16/2004	44.79	-4.30%	0.09%	-1.67%	TRIGGER
SIMGE	3/12/2004	9.93	3/15/2004	9.43	-8.96%	0.50%	-5.00%	STOP LOSS
ANPI	3/17/2004	24.53	3/19/2004	23.3	-6.16%	0.65%	-5.00%	STOP LOSS
AIV	3/22/2004	31.4	3/31/2004	30.86	-3.89%	0.67%	-1.72%	TRIGGER
SBUX	3/22/2004	37.23	5/5/2004	39.7	-1.50%	7.31%	6.63%	BUY-HOLD
IDEV	3/26/2004	6.06	4/7/2004	6.75	-1.82%	11.72%	11.39%	PROFIT STOP
EK	3/30/2004	25.93	4/5/2004	24.63	-5.01%	1.81%	-5.00%	STOP LOSS
DF	4/15/2004	33.1	5/28/2004	34.67	-2.60%	7.98%	4.74%	BUY-HOLD
FCN	4/21/2004	16.86	4/27/2004	16.02	-6.88%	3.20%	-5.00%	STOP LOSS
CDX	4/22/2004	22.35	6/3/2004	24.59	-4.92%	10.47%	10.00%	PROFIT STOP
DNB	4/22/2004	54.2	5/10/2004	51.49	-5.96%	0.00%	-5.00%	STOP LOSS
ET	4/22/2004	12.33	4/29/2004	11.71	-7.14%	0.16%	-5.00%	STOP LOSS
FORM	4/23/2004	20.4	4/27/2004	19.38	-6.67%	2.55%	-5.00%	STOP LOSS
TEO	4/23/2004	9.76	4/28/2004	9.27	-6.45%	0.41%	-5.00%	STOP LOSS
RBK	4/27/2004	38.26	4/30/2004	36.94	-4.03%	0.00%	-3.45%	TRIGGER
CTL	4/28/2004	27.15	5/4/2004	29.86	-0.15%	10.13%	10.00%	PROFIT STOP
AZN	4/29/2004	47.95	6/15/2004	46.85	-4.15%	3.25%	-2.29%	BUY-HOLD
LAUR	5/3/2004	36.58	5/10/2004	34.75	-5.41%	2.43%	-5.00%	STOP LOSS
AU	5/10/2004	32	5/27/2004	35.45	-3.87%	11.50%	10.78%	PROFIT STOP
CMVT	5/10/2004	16.69	6/3/2004	18.4	-1.02%	14.62%	10.25%	PROFIT STOP
FCX	5/10/2004	29.58	5/17/2004	28.1	-6.12%	1.66%	-5.00%	STOP LOSS
FLSH	5/10/2004	17.6	5/12/2004	16.72	-6.59%	2.27%	-5.00%	STOP LOSS
MDG	5/10/2004	9.67	5/12/2004	10.64	-1.65%	22.03%	10.00%	PROFIT STOP
ISIL	5/11/2004	19.3	5/12/2004	18.33	-5.03%	0.31%	-5.00%	STOP LOSS
CZR	5/12/2004	12.72	6/4/2004	14	-4.40%	11.64%	10.06%	PROFIT STOP
DDS	5/12/2004	19.2	5/13/2004	18.24	-9.38%	0.00%	-5.00%	STOP LOSS
KTC	5/13/2004	16.95	5/17/2004	16.6	-1.06%	0.00%	-2.06%	TRIGGER
VITX	5/19/2004	10.31	5/21/2004	10.4	-2.04%	2.81%	0.87%	TRIGGER

Symbol	Trigger Date	Entry Price	Exit Date	Exit Price	Draw Down	Max Profit	Gain/Loss	Exit Type
FRNT	5/21/2004	8.94	6/8/2004	9.87	-1.57%	13.65%	10.40%	PROFIT STOP
CTL	6/17/2004	29.6	-	-	-0.51%	1.93%	-%	OPEN
FNFG	6/18/2004	11.94	-	-	-2.01%	2.18%	-%	OPEN
MCCC	6/18/2004	8.19	6/21/2004	7.78	-5.13%	0.12%	-5.00%	STOP LOSS
BLDP	6/22/2004	9.05	-	-	0.00%	3.87%	-%	OPEN
GS	6/22/2004	91	-	-	-0.52%	4.56%	-%	OPEN
MWD	6/22/2004	52.16	-	-	-1.44%	2.63%	-%	OPEN
PHG	6/22/2004	25.84	-	-	-0.43%	5.46%	-%	OPEN
KB	6/23/2004	29.62	-	-	-0.14%	6.28%	-%	OPEN
KOSN	6/23/2004	8.1	-	-	-2.47%	3.77%	-%	OPEN
CCBI	6/25/2004	17.27	-	-	-2.90%	2.26%	-%	OPEN
TMR	6/25/2004	6.99	6/28/2004	6.64	-5.15%	0.14%	-5.00%	STOP LOSS
VRTY	6/25/2004	13.11	-	-	-2.82%	0.84%	-%	OPEN

BACKTEST SUMMARY: U TURN (SELL)

Let us now look at the opposite version of the same signal during the same time period- from12/31/2003 to 6/29/2004. During this period, U TURN (SELL) signal would have given us Annualized Return on Investment (ROI): 35.72% for U TURN (SELL) versus the ROI of S & P 500 index of 4.81%.

Please note that this was an approximate test. I was not able to create entry and exit points the way I normally do in real life. Also, past results are not true predictors of future performance. Use this test results for enhancing your understanding of PFP signals.

Backtest Summary: U TURN (SELL)	
Entry Filter	Show stocks where Close dropped more than .15% percent over the last 1 day and open is more than .25% above the high 1 day ago and close is below the open 1 day ago and close is less than 10% percent below high and high reached a new 4 week high and close is above 5 and volume is more than 25% above volume 1 day ago and volume is above 1000000
Basic Setup	
Approach Type:	**SHORT**
Start Date:	12/31/2003
End Date:	6/29/2004
Benchmark Symbol:	^SPX (S & P 500 index)

Exit Setup	
Stop Loss:	5%
Profit Stop:	10%
Trailing Stop Loss:	*N/A*
Minimum Holding Days:	*N/A*
Maximum holding days:	30
Exit Trigger #1:	HIGH reached a new 4 week HIGH
Advanced Options	
Selection Method:	select by volume descending
Entry Price:	Open
Conditional Entry:	No
Exit Price:	Open
Maximum Trades Per Day:	25

Approach Information

Approach Name: U TURN (SELL)

Test started on 12/31/2003 ended on 06/29/2004, covering 123 days

Trade Statistics

- There were **95** total stocks entered. Of those, **83** or **87.37%** were complete and **12** or **12.63%** were open.
- Of the **83** completed trades, **35** trades or **42.17%**resulted in a net gain.
- Your average net change for completed trades was: **1.38%**
- The average draw down of your approach was: **-3.72%**.
- The average max profit of your approach was: **6.72%**
- The Risk/Reward ratio for this approach is: **1.53**

Annualized Return on Investment (ROI): 35.72%, the ROI of ^SPX was: 4.81%.

Exit Statistics

- Stop Loss was triggered **8** times or **9.64%** of the time.
- Stop Profit was triggered **25** times or **30.12%** of the time.
- Trailing Stop Loss was triggered **0** times or **0.00%** of the time.
- You held for the maximum period of time (30 days) **7** times or **8.43%** of the time.
- An exit trigger was executed **43** times or **51.81%** of the time.

Statistics By Holding Period

	Completed	2 day chg	5 day chg	10 day chg	15 day chg	20 day chg
Winners:	25	46	45	37	37	39
Losers:	47	48	49	57	58	55
Win/Loss Ratio:	0.74:1	0.96:1	0.92:1	.65:1	.64:1	.71:1
Net Change:	1.38%	0.05%	0.34%	-2.04%	-3.50%	-3.85%

Individual Trade Details:

Symbol	Trigger	Entry	Exit Date	Exit	Draw	Max Profit	Gain/	Exit Type
DIA	1/2/2004	104.84	1/6/2004	105.25	-0.75%	0.04%	-0.39%	TRIGGER
EK	1/2/2004	25.3	1/7/2004	26.35	-4.31%	0.99%	-4.15%	TRIGGER
HD	1/2/2004	35.07	1/8/2004	35.89	-2.91%	0.74%	-2.34%	TRIGGER
NXTL	1/2/2004	28.1	1/6/2004	28.99	-3.17%	0.60%	-3.17%	TRIGGER
SLE	1/2/2004	21.71	2/12/2004	21.55	-1.01%	7.09%	0.74%	TRIGGER
HCA	1/5/2004	42.88	1/9/2004	42.75	-3.61%	1.82%	0.30%	TRIGGER
ADRX	1/8/2004	23.99	1/23/2004	25.23	-6.50%	1.83%	-5.17%	STOP LOSS
CHKP	1/8/2004	17.9	1/13/2004	19.07	-5.59%	0.67%	-6.54%	TRIGGER
KLIC	1/8/2004	14.85	1/21/2004	16.4	-12.59%	3.03%	-10.44%	TRIGGER
RNWK	1/9/2004	6.27	1/13/2004	6.79	-7.66%	2.55%	-8.29%	TRIGGER
IO	1/12/2004	5.4	1/23/2004	4.82	-1.48%	12.04%	10.74%	PROFIT STOP
SPG	1/12/2004	48.8	1/14/2004	48.8	-0.20%	1.54%	0.00%	TRIGGER
SSRI	1/12/2004	12.35	1/15/2004	10.85	-0.81%	16.44%	12.15%	PROFIT STOP
AMAT	1/13/2004	23.96	2/3/2004	21.28	-2.67%	13.23%	11.19%	PROFIT STOP
CHKP	1/13/2004	18.44	1/16/2004	19.16	-4.34%	0.00%	-3.90%	TRIGGER
GFR	1/13/2004	16.44	2/12/2004	16.9	-3.41%	2.80%	-2.80%	TRIGGER
IGV	1/13/2004	39.4	1/16/2004	40.5	-3.02%	0.25%	-2.79%	TRIGGER
PGI	1/13/2004	10	1/21/2004	10.71	-7.00%	1.10%	-7.10%	TRIGGER
SWIR	1/13/2004	21.46	1/20/2004	25	-9.46%	6.15%	-16.50%	TRIGGER
BR	1/15/2004	28.17	1/21/2004	29.23	-4.06%	0.83%	-3.73%	TRIGGER
JPM	1/15/2004	39	1/22/2004	40.04	-2.82%	0.31%	-2.67%	TRIGGER
SLM	1/15/2004	38.51	2/3/2004	39.7	-3.22%	3.17%	-3.09%	TRIGGER
AMR	1/20/2004	13.97	1/22/2004	15.6	-5.08%	2.65%	-11.67%	TRIGGER
ANF	1/20/2004	25.46	1/22/2004	25.64	-3.18%	0.24%	-0.71%	TRIGGER
BA	1/20/2004	43.23	2/9/2004	44.2	-4.14%	4.00%	-2.24%	TRIGGER
DCX	1/20/2004	48.08	1/22/2004	49.3	-1.91%	0.64%	-2.54%	TRIGGER

Symbol	Trigger	Entry	Exit Date	Exit	Draw	Max Profit	Gain/	Exit Type
MMM	1/20/2004	80.95	3/4/2004	79.01	-2.67%	4.18%	2.40%	BUY-HOLD
RNWK	1/20/2004	6.76	1/30/2004	5.82	-0.59%	20.12%	13.91%	PROFIT STOP
SSTI	1/22/2004	12.61	3/8/2004	12.92	-5.87%	10.79%	-2.46%	BUY-HOLD
AYE	1/26/2004	12.75	2/10/2004	13.5	-7.53%	4.08%	-5.88%	STOP LOSS
CAT	1/27/2004	81.3	3/11/2004	73.35	-1.05%	9.75%	9.78%	BUY-HOLD
EWT	1/27/2004	12.39	1/29/2004	12.06	-0.48%	2.18%	2.66%	TRIGGER
ADM	1/30/2004	15.98	2/4/2004	16.32	-2.44%	1.44%	-2.13%	TRIGGER
GSF	2/4/2004	27.41	2/12/2004	28.92	-5.11%	3.47%	-5.51%	TRIGGER
MYL	2/11/2004	24.65	3/19/2004	22.16	-1.22%	10.95%	10.10%	PROFIT STOP
MHS	2/12/2004	35.75	2/20/2004	31.5	-0.48%	13.57%	11.89%	PROFIT STOP
FLEX	2/13/2004	18.86	2/20/2004	18.58	-4.03%	0.85%	1.48%	TRIGGER
MAY	2/13/2004	35.14	2/19/2004	35.85	-1.85%	0.48%	-2.02%	TRIGGER
NOK	2/18/2004	22.77	3/8/2004	23.42	-2.99%	4.66%	-2.85%	TRIGGER
NT	2/18/2004	8.23	3/9/2004	7.29	-0.12%	15.80%	11.42%	PROFIT STOP
HLIT	2/19/2004	12.19	2/24/2004	10.95	-2.05%	13.86%	10.17%	PROFIT STOP
LLTC	2/19/2004	41.72	3/9/2004	37.49	-0.60%	11.51%	10.14%	PROFIT STOP
SNWL	2/19/2004	9.42	3/2/2004	9.95	-6.16%	7.86%	-5.63%	STOP LOSS
TGT	2/19/2004	42.32	3/1/2004	44.16	-5.58%	0.64%	-4.35%	TRIGGER
CHINA	2/27/2004	11.6	3/9/2004	10.37	-0.78%	12.93%	10.60%	PROFIT STOP
UPL	3/4/2004	14.45	4/2/2004	15.55	-8.86%	6.23%	-7.61%	STOP LOSS
SRP	3/8/2004	8.08	3/17/2004	8.33	-3.34%	4.83%	-3.09%	TRIGGER
RBK	3/9/2004	40.32	3/30/2004	40.31	-2.63%	3.99%	0.02%	TRIGGER
CNCT	3/24/2004	22.22	4/21/2004	19.52	-2.34%	12.33%	12.15%	PROFIT STOP
HL	4/1/2004	8.17	4/14/2004	6.9	-4.16%	15.54%	15.54%	PROFIT STOP
C	4/2/2004	51.94	5/10/2004	45.75	-0.92%	13.42%	11.92%	PROFIT STOP
CREE	4/2/2004	22.16	4/29/2004	19.76	-1.76%	17.19%	10.83%	PROFIT STOP
KRB	4/2/2004	27.75	4/29/2004	24.56	-1.87%	12.61%	11.50%	PROFIT STOP
INFA	4/6/2004	9.32	4/22/2004	7.95	-2.90%	16.95%	14.70%	PROFIT STOP
COST	4/8/2004	38.04	5/24/2004	36.58	-1.87%	7.86%	3.84%	BUY-HOLD
JWN	4/8/2004	39.24	5/24/2004	39.9	-2.09%	11.19%	-1.68%	BUY-HOLD
KMB	4/12/2004	63.57	4/21/2004	64.72	-2.39%	0.42%	-1.81%	TRIGGER
BRCM	4/13/2004	41.05	4/26/2004	42.19	-6.67%	6.99%	-2.78%	TRIGGER
BSC	4/13/2004	84	5/26/2004	81.4	-0.58%	10.19%	3.10%	BUY-HOLD
CCI	4/13/2004	13.58	4/16/2004	14.37	-9.35%	1.03%	-5.82%	TRIGGER
NOVL	4/13/2004	11.83	4/30/2004	10.1	-2.11%	20.37%	14.62%	PROFIT STOP
NVLS	4/13/2004	33.3	4/28/2004	29.65	-1.50%	11.56%	10.96%	PROFIT STOP
WDC	4/13/2004	11.1	4/23/2004	9.28	-2.70%	21.98%	16.40%	PROFIT STOP
UIS	4/15/2004	13.9	5/17/2004	12.26	-3.88%	13.31%	11.80%	PROFIT STOP

Symbol	Trigger	Entry	Exit Date	Exit	Draw	Max Profit	Gain/	Exit Type
ERES	4/20/2004	19.8	4/22/2004	21.09	-10.87%	4.67%	-6.53%	STOP LOSS
IBB	4/20/2004	79.55	4/26/2004	83.8	-3.22%	0.82%	-5.34%	TRIGGER
MEE	4/20/2004	23.91	4/23/2004	26.5	-11.46%	2.43%	-10.83%	STOP LOSS
MVK	4/20/2004	25.76	5/3/2004	22.63	-3.11%	12.81%	12.15%	PROFIT STOP
SAFC	4/20/2004	44.14	6/3/2004	42.26	-2.20%	6.28%	4.26%	BUY-HOLD
BIIB	4/26/2004	60.14	5/25/2004	62.6	-4.17%	8.30%	-4.09%	TRIGGER
MICC	4/26/2004	26	5/7/2004	23.11	-5.08%	13.46%	11.12%	PROFIT STOP
ETN	4/28/2004	60	5/5/2004	61.07	-3.32%	2.95%	-1.78%	TRIGGER
TALK	4/28/2004	9.23	5/10/2004	8.25	-2.93%	14.41%	10.62%	PROFIT STOP
WLP	4/28/2004	92.15	6/8/2004	92.18	-0.33%	9.04%	-0.03%	TRIGGER
FDRY	5/27/2004	12.41	6/2/2004	13.7	-9.11%	1.53%	-10.39%	TRIGGER
FDX	5/27/2004	73.35	6/7/2004	74.46	-1.84%	1.46%	-1.51%	TRIGGER
KGC	6/1/2004	5.9	6/15/2004	5.26	-1.36%	11.69%	10.85%	PROFIT STOP
ACI	6/2/2004	32.61	6/21/2004	33.9	-3.13%	4.35%	-3.96%	TRIGGER
AMKR	6/2/2004	10.27	6/14/2004	8.77	0.00%	17.23%	14.61%	PROFIT STOP
BP	6/8/2004	53.31	6/21/2004	53.95	-3.11%	2.59%	-1.20%	TRIGGER
AMD	6/9/2004	15.66	-	-	-0.89%	10.22%	-%	OPEN
SFD	6/9/2004	29.05	-	-	-3.89%	2.44%	-%	OPEN
XLI	6/9/2004	27.72	6/17/2004	27.99	-1.01%	0.83%	-0.97%	TRIGGER
MHR	6/18/2004	9.65	6/23/2004	10.46	-12.23%	0.00%	-8.39%	STOP LOSS
SWIR	6/22/2004	31.68	6/24/2004	33.89	-12.25%	1.17%	-6.98%	STOP LOSS
CACSE	6/25/2004	12.37	-	-	-1.13%	4.77%	-%	OPEN
KMG	6/25/2004	54.08	-	-	0.00%	1.26%	-%	OPEN
RBK	6/25/2004	37.12	-	-	-0.46%	0.38%	-%	OPEN
AAPL	6/28/2004	16.03	-	-	-2.87%	2.06%	-%	OPEN
AG	6/28/2004	19.9	-	-	-0.70%	0.45%	-%	OPEN
ELAB	6/28/2004	41.46	-	-	-3.06%	0.53%	-%	OPEN
IR	6/28/2004	67.34	-	-	-0.70%	0.48%	-%	OPEN
NEM	6/28/2004	38.7	-	-	0.00%	1.96%	-%	OPEN
SYK	6/28/2004	54.6	-	-	-0.44%	0.18%	-%	OPEN
X	6/28/2004	33.45	-	-	-5.05%	1.26%	-%	OPEN

GLOSSARY

Accumulation. A time period during which market participants with a strong positive opinion/outlook for a given stock are buying /accumulating it. In other words, informed circles are taking long positions with a view to hold the stock for relatively larger gains.

Arbitrage. Simultaneous positions in two strongly related assets to capture mis-pricing between them. An arbitrage is usually a pair of trades that has guaranteed profit at no risk.

Ascending Asymmetrical Triangle (AAT). A triangle like pattern on the stock price chart that has successive Bottoms at higher price levels

Asymmetrical Triangle. This is a hybrid of a Channel and a Symmetrical Triangle. Like a Channel, it has either a constant Top or a constant Bottom. As an example let us say the triangle has a constant Top. Now like a Symmetrical Triangle, the successive Bottoms are getting higher. This is called an Ascending Asymmetrical Triangle (AAT).

Bear Day. A Bear Day is a day when the closing price is LOWER than the opening price for the day.

Bottom. A Bottom is the lowest price that stock makes over a period of few days. In other words, the turning point between a downtrend and the subsequent up-trend is a Bottom.

Breakout. Breaking out from the current trend or a current price pattern. As a rule, there is one important thing to remember and that is that the longer a stock spends in Side-ways (Channel or Triangles) or in a trend, the more powerful is going to be the successive trend after the stock breaks out.

Bull Day. A day in which a stock has its closing price higher than its opening price; TDC > TDO;

Candle. A candle is a day's (or a period's) prices shown in a Japanese Candlestick charting. A candle has two parts: It has a body and two lines -upper and lower – attached to it. The high point of the UPPER LINE is the High price for the day (or week or month). Similarly the low point of the LOWER LINE is the Low price. The upper and lower points of the BODY reflect the OPEN and CLOSE prices depending on the type/color of the candle. The body is either filled (dark) or empty (white). When the body is filled (dark), the upper edge of the BODY (and not the line) is the OPEN price and the lower edge is the CLOSE price. Similarly when the body is empty (white), the upper edge reflects the Closing price and the lower edge reflects the Opening price. Empty-bodied (white) candles mean a BULL day and a dark/black candle represents a BEAR day.

Channel. A Channel is a movement of prices within two price levels. For example a stock is moving between 20 and 25 dollars. Every time it touches 20 dollars, it jumps back to 25 dollars. Then after touching 25 dollars, it falls back to 20 dollars. This is comparable to a channel.

Close Price. The daily Close price is the last trade price for the day. The last closing price of the last trading day of the week, Friday or Thursday, if Friday was a Market holiday, is the Weekly Close. Similarly, the closing price on the last trading day of the month is called a monthly closing price.

Correction. A Correction is a short (temporary) up-trend that takes place within a major downtrend. This is a sort of a pause in falling prices.

Descending Asymmetrical Triangle (DAT). Like a Channel it is has a constant Bottom, and like a Symmetrical Triangle, the successive Tops go lower.

Distribution. A phase in stock price movement during which informed/powerful players are selling/shorting the stock. Strong/informed players are passing on stocks to weaker/less informed players.

Downtrend. Stock is going down and is making new low prices as time passes.

Flag. This forms in a sudden up-trend. After a sudden upward price break out, the stock trades in a narrow range and creates a flag like pattern on the stock chart.

Full-stop (BUY) A powerful trend reversal signal that takes place in a down trend when today's prices stay higher than Previous Day's prices, and the day is a Bull Day.

Gap. Most of the time, a stock trades in a continuous manner but sometimes it jumps to a higher or a lower level abruptly. When Today's High price is LOWER than Previous Day's Low price, the GAP (SELL) is in a downtrend. TDH<PDL. When Today's Low price is higher than Previous Days High the GAP (BUY) is in an up-trend. TDL>PDL In both cases there is a range or vacuum prices during which stock does not trade at all.

Inverted Flag (IF) See **Flag.** This forms in a sudden downtrend, acting like a mid-point of a fall in stock prices.

Inverted Pennant (IP) See **Pennant**. This forms in a sudden downtrend, acting like a mid-point of a fall in stock prices.

High Price: This is the highest price the stock traded during the day. Looking at weekly prices, this is the highest price the stock was traded during the entire week. In other words, the highest HIGH of all days in the week is that Week's High price.

Key Price. A high/low price used as a reference.

Low Price. This is the day's lowest price at which the stock traded. Similarly the Weekly Low is the lowest price the stock was traded during the week. In other words, this is the lowest LOW of all days in the week.

Minor Bottom. This is the lowest price over a period of three or more days during which the stock trend changed from the downtrend to up-trend. In other words, this is the price point where buyers out-powered sellers, and were able to push prices higher. (Here is my precise definition: (1) Prices are going down for some time. It could be two, three or more days; (2) Stock, let's say, makes a low of 45 dollars on day X. The high on that day was 48 dollars; (3) Let us call this high price, 48 dollars, on the low price day (X) a Key Price. As soon as we have three consecutive days on which stock does not trade below this Key Price, 48 dollars, the low price of day X will become a Minor Bottom, 45 dollars in this case. Minor Bottom means buyers' strength outnumbers selling pressure and vice versa for a Minor Top.)

Minor Top. This is the opposite of Minor Bottom. This is the highest price over a period of three or more days during which the stock trend changed from up-trend to a downtrend. In other words, this is the price point where sellers were able to push prices down.

Open Price. This is the price at which a stock starts trading for a day. If you are looking at weekly prices, Monday's Open price, or Tuesday's Open price, if Market was closed on Monday, is the Weekly Open price.

Pennant. This is a pattern that is formed usually exactly in the middle of/at exactly mid-way in a rapid up- or downtrend. The pattern of a pennant -- a straight line up and then a body of *narrowing price fluctuations and lowering volume.* This price movement is like a tri-angle.

Progressive Stop-loss. A method in which the stop-loss level is changed as the price of the stock moves in a trader's favour.

Protective Stop-loss. As an example, for a 120.00$ stock with average volatility and a target return of 30%, the Stop-loss can be placed at 3%, less margin than in a normal Stop-loss. Such a Stop-loss will protect us from big unexpected losses so it is often referred to as a **Protective Stop-loss.**

Pull-back. A small price movement during which a stock moves opposite to its major trend.

Reaction. A Reaction is a temporary pause of the bullish trend. It is a *temporary* short term (minor) down (or a Side-ways) trend that takes place within a major up trend. This is a like a pause before it continues its upward movement. This type of movement that is contra to the main trend is called a Reaction in the Bull trend.

Reactionary Trend. A temporary trend usually with lower volume that lasts from two days to a few weeks within a major up or a down trend and is against the price movement suggested by the major trend.

Restart (signal): This signal takes place when the stock in a reactionary down-trend (up-trend) makes a new low (high) price during the session and then abruptly changes its direction on a relatively heavy volume, and manages to close higher (lower) than Today's Open as well as the Previous Day's Close prices. It indicates a continuation of the up-trend.

Reverse (signal). A signal very similar to a RESTART signal with only difference being, REVERSE takes place in the major (primary) trend and indicates the change of trend from up- to down-down (SELL), or from down- to up-trend (BUY). On the contrary, RESTART signal takes place at the end of a Reactionary trend.

Risk-Taker/Risk-Tolerant. An investor or trader who is willing to take risk of losing money in return for an opportunity to earn profit.

Sell-off. A sudden appearance of significant selling pressure causing prices to fall abruptly.

Short. Sell first even if you don't own the stock with the hope of buying it back later at a lower price.

Side-ways Trend. The stock seems to be locked in a certain range. It fluctuates between two prices. It moves up from its low price to its high price and then it starts drifting down again. However when it comes back to its initial Bottom (low) price, somehow Demand picks up and/or Supply dries up, so the stock again goes up to its initial Top (high), and so on. As a rule, there is one important thing to remember and that is that the longer a stock spends in Side-ways (Channel or Triangles), the more powerful the trend is going to be after the stock breaks out.

Spike. A one-day event

Stop-Limit. A buy Stop Limit order for a stock currently quoting at 11$ is to buy the stock at say 11.45$ or lower ONLY AFTER it has traded above the Stop price of say 11.31$. A sell Stop Limit order for a stock quoting at 20$ might be like to sell the stock at 19.70$ or above only after it has traded below our Stop price of 19.79$, for example.

Another version of STOP LIMIT order is a **STOP MARKET order**. Here, there is no limit but just a Stop price. As soon as the stock trades above (below) the Stop price, our Buy (Sell) order becomes a market order.

Stop-Loss. A price level at which you should stop or limit your loss in a position. If you bought stock ABC at 25$, your Stop-loss would be somewhat lower than 25$. It can be 24, 23, 20 or even 15$. If price of ABC, after you bought it at 25$, goes below your Stop-loss level, you will sell it and book the loss.

Likewise one who shorts stock ABC at 25$, Stop-loss would be any price that is higher than 25$. When ABC moves up contrary to the initial expectation of its going down, and hits the Stop-loss level, one should call it quits and square up his position. Thus, in a short sell, the Stop-loss price is higher than the sale price.

Strong Bear day. A Day on which a stock's Close price is significantly *below* that day's Open.

Strong Bull day. A Day on which a stock's Close price is significantly *above* that day's Open price.

Strong Open day. A Day on which a stock's Open price is significantly *above* Previous Day's Close price.

Symmetrical Triangle. This movement is similar to a Channel but in this formation, the Tops get lower and Bottoms get higher as the stock moves on.

Target Price. The estimated price at which you should book profit in a position taken in response to occurrence of a specific signal

Top. A Top is the highest price that a stock makes over the last few weeks. It is like a peak, the turning point between the change from an up- to a downtrend.

Trade-off: A situation where you can pursue more profit by taking additional risk or can attempt to reduce risk by scarifying some gains.

Trend line. An arbitrary line that is drawn on a stock price chart and touches most of the tops or bottoms in stock prices.

Trend Reversal. Trend reversals usually take place either (i) during market hours when trading is taking place (Intra-Day), or (ii) outside market hours when trading is not taking place or the Market is closed (Inter-Day).

Up-trend. The stock is going up and is making new high prices over a period of time.

U-Turn Signal. Stock that seems to be going down at the start of the day has a happy ending with its price going up towards the end of the day.

Volume: This is the total number of stocks traded for the day or for the week.

Volume Spike: A sudden and significant jump in volume. A significant day for a stock from trading perspective.

Weak Open day. A Day on which a stock's Open price is significantly *below* Previous Day's Close price.