LETTER FROM THE EDITOR

In this month’s newsletter, we are presenting a diverse group of articles to show the breadth of the work being done within the field of technical analysis. While each article offers a different viewpoint, all of the authors use a number of charts. This is an unchanging feature of technical analysis, even in a time when there is an increased ability to quantify data.

Complex analysis can be clarified with a chart. In this note, is an example of how Kirk Northington, CMT, and Carson Dahlberg, CMT, of Northington Dahlberg Research have developed a method to visualize risk and reward. They have converted the potential gains and losses on a trade to MACD-style histogram and found an effective way to visualize the data. Technical analysis is changing, but it also remaining true to its roots and using visual tools to explain complex analysis. If you would like to share your work in this area, please email us at editor@mta.org.

Michael Carr
PUTTING THE NETFLIX MOVE INTO PERSPECTIVE
BY JON BOORMAN, CMT

Editor’s note: This article was originally published at: http://go.mta.org/3791 and is reprinted here with the permission of the author.

“Netflix tumbles to levels not seen since... Thursday.”

That’s not a headline you’ll read anywhere but that’s one reality of what happened today. Let’s not sugar-coat it though, there’s no question that was one ugly session. I’m sure there have been fortunes made and lost today, and today’s session could become the stuff of legend and a test case for intraday traders everywhere.

But let’s just put it in perspective for a moment, because this is a classic example of how important time frames are, and how you view $NFLX today will likely be determined by your own particular time frame and methodology.

For people with longer time frames than mine, here’s the monthly chart of the last 5 years:

I commented last night that CEO Reed Hasting’s comments chastening momentum driven stock moves seemed like a way to distance himself from any potential repeat of the 2011 cascade. I tend to believe when a CEO is more cognizant of that, it probably coincides with the actual threat being diminished, but that’s a subjective opinion, and people did seem to latch on to those comments today.

Here’s the weekly for the last 2 years:
That’s one big scary reversal candle there, and it’s only Tuesday. But are you seeing what you want to see, is that candle influencing your interpretation? Here’s the exact same chart but with a line instead of candles:

Suddenly doesn’t seem quite so foreboding does it?

Here’s a daily showing this year:

And here’s today on a 5-minute (one of the few I will ever show in public):

In perspective, given the magnitude and potential significance of the move, that is quite an orderly decline.

Is the uptrend still intact? Strictly speaking, yes it is. But this is one of those rare occasions you will see a trend follower like myself exit a position which is still above its major MA’s, with a series of higher highs and higher lows largely intact. The reason? An ATR stop. At the end of the day we are in the business of analyzing price action, and when a significant change in behavior is evident an ATR stop will protect you. It’s a ‘game changer’ or ‘step aside’ signal to me, and it often involves taking a decent profit in something that moved extremely quickly but is way above the normal level you would need to see breached to confirm a trend invalidation. We saw a similar pattern in Taser International (NASDAQ: TASR) recently where we realized a 52% gain after a spectacular run and subsequent steep selloff.
Here’s the real takeaway from today’s move.

If you want to be the best trader you can be, I thoroughly recommend using hindsight. All my critics do. The trouble is, your P&L won’t reflect the wonderful insight hindsight provides you. Do I wish I could have taken profit at the highs? Actually no, because it would mean I would have broken my rules and created a precedent likely to be repeated at some point in the future. Probably at great cost too. Furthermore, the fact that this time would have been rewarded would have reinforced somewhere in the recesses of my brain that it was acceptable.

Calling tops and picking bottoms is not what I do. I find trends, I ride them, when they’re over or the risk changes, I get off. To do that effectively I need to wait for confirmation. It’s taken a while for me to get here but I’ve found what works for me. It might not work for you, that’s OK, I hope you find what does. Every now and then my method throws some real curveballs that leave others scratching their heads. This is one of them. If it makes you feel better, $NFLX made 24 new highs since our entry on July 9. Barring another huge gap at the open tomorrow, we’ll be exiting at a price that was the 21st of those 24 highs. So there you go, I’ll be selling it tomorrow right where you would have been telling me I was greedy if I didn’t, at the all time high of just 3 weeks ago.

Better?

Perspective is a wonderful thing.

Jon Boorman, CMT, is a market technician and trader with over 25 years’ experience in global equity, forex, and futures markets. He has held roles as a sales trader to hedge funds and institutions, proprietary trader, research analyst, and buy-side head of desk. Jon currently writes the Alpha Capture blog at jonboorman.com, where he employs trend following and momentum strategies to generate actionable trade ideas, and will shortly begin managing money for clients as President and CEO of Broadsword Capital, LLC.
STILL A BULL, BUT LOOKING OVER OUR SHOULDER
BY OLAF SZTABA AND RON MEISELS, CMT

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Our last Market Comment pointed to a market that “has plenty of fuel”, but may need a rest. We also said “in bull markets, surprises occur to the upside”. Indeed, despite the growing need for a correction, the bull has turned its back on a rest period and decided to plough its way higher.

The U.S. indices, accompanied by a newcomer, the S&P/TSX Composite Index, are rallying once again to new bull market highs. All trend-lines are intact and the 50- and 200-day Moving Averages are resolutely following the indices higher. If you are a bull, it may seem “all clear now”. But is this correct?

Despite strong market performance, there is growing evidence that the market may come under some selling pressure. The latest sentiment data (courtesy of Investors Intelligence) paints a troubling picture. The number of bears declined to a mere 15.5% – the lowest number this year and since April 2011. At the same time, those with bullish views stand at 53.6%. This extreme discrepancy suggests investors have become confident that the market will continue higher. The recent excitement and accompanying vertical advances in some stocks such as Facebook or Twitter show a growing appetite for risk. However, such complacency is usually the harbinger of a large if not major pullback.

The record bullishness is not the only alarm bell. The recent market action has also produced a number of technical red flags. Among others, the growing gaps between market indices and their 200-day Moving Averages, the short-term MACD divergences and the contracting number of 52-week highs are just a few negatives that suggest a pullback could be around the corner. In addition, there is a cycle cluster about to occur (see Ron’s Briefs of Nov. 18th).

Stubbornly rising markets always bring the dilemma of sell-too-early vs. let-profits run. Our last Market Comment suggested a major overhaul of portfolios. A large number of stocks have had major up moves and taking profits in those stocks would be part of such a refit. If nothing else, one should consider the implementation of tight stops. In the case of a sudden change in the trend, carefully chosen reversal levels should protect investors from larger losses.

Concurrently, reinvesting those profits in sectors and stocks that are just joining this bull should be the other tactic for the next few weeks. One to consider is the Energy sector, especially in Canada. While many U.S. Energy stocks have had their fair share of advances, their Canadian counterparts remained stuck in their trading ranges. Recently, some major Energy names such as Canadian Natural Resources (CNQ-T), Husky Energy (HSE-T) and Suncor (SU-T) have come to life.
We have been fans of this bull market since its early days and we still are. However, the bullish bandwagon has recently become quite crowded and some participants have become too comfortable in their bullishness.

Such complacency has been the harbinger of a correction in the past. After all, bull markets don’t like company.

INTERVIEW WITH RON MEISELS, CMT
BY AMBER HESTLA-BARNHART

What led you to look at the particular markets you specialize in?

I began using technical analysis when my broker recommended a number of stocks based on their Fundamental Research and none worked out. He subsequently sent me a report with a chart and since I am visually oriented I was immediately attracted. This was 43 years ago and I am still making money.

Do you look at any fundamental or economic inputs to develop your opinions?

The stock market is a leading indicator to the economy and therefore this input has a low priority for me. As to fundamentals, I must know the sector and business of the stock we recommend since different sectors behave well at certain points in the cycle. For example, we are just entering into a period when the energy sector and its stocks should outperform. Aside of this, my opinion is strictly based on technical and behavioral analysis.

What advice would you have for someone starting in the business today?

Read, read and read. But remember that TA is not an art, nor a science, but a “métier”, a craft, a vocation, a profession. Aside from books, get a feeling for the market by daily experience. Take a chart, cover the last six months and forecast day by day what is likely to happen and then see what actually
occurred next day. And go on and on. This will give you the rhythm of the market/stocks. Most importantly study cycles. And, of course, get a CMT.

**What is the most interesting piece of work you’ve seen in technical analysis recently?**

I was very impressed to read and get to know George Lindsay’s work. A must read!

**What research area do you think offers the greatest potential in technical analysis at this time?**

Cycles. Very few analysts study and employ this discipline in their work. The knowledge does not come from staring at a screen, but being observant, looking at the rhythm of the markets. An over-bought market will tell you that a correction is imminent, but cycle-analysis will help to find the right moment. I would urge all technicians to read the work of Dewey and Hurst.

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Ron Meisels, Founder and President of Phases & Cycles Inc., has over 40 years of stock market experience. He specializes in the independent research of Canadian and U.S. securities. Institutions ranked him among the top three technical analysts for six consecutive years (Brendan Wood Survey). He is listed in the Canadian Who's Who. He has been publishing the technically oriented Phases & Cycles® reports since 1970. He was Director and Vice President of the brokerage firm Goulding, Rose & Turner from 1976 to 1982, and Vice President and Manager of Technical Research at Nesbitt Thomson Inc. (now BMO Nesbitt Burns) from 1982 to 1990. He founded Phases & Cycles Inc. in 1990. He has a truly distinguished track record in anticipating stock market moves, as illustrated by his famous “10,000 in 2000” prediction in January 1995 (based on his discovery of the 40-year cycle) when the DJIA was at 3800 (An audacious call in 1995 looks golden now, Report on Business, March 30, 1999). He first presented this research at the 1995 IFTA Seminar in San Francisco and subsequently in Chicago, Toronto, New York, London and most recently in Cairo (for the Egyptian Society of Technical Analysts).

Mr. Meisels is a co-writer of a weekly column in the Globe and Mail (“What the charts say”); he is a frequent guest on Business News Network (BNN) and is frequently quoted in major financial media such as the Globe & Mail, The National Post, Les Affaires, Bloomberg, Canadian Press, Reuters and MarketWatch. He is also a Founder and first President of the Canadian Society of Technical Analysts (CSTA), and founding Secretary and past Director of the International Federation of Technical Analysts (IFTA).
Investment Courses For Professionals

A sample of a growing list of fundamental and technical courses is shown below. The courses are associated with global destinations and dates, both for open and private client formats. They are produced by various knowledge vendors throughout the world. Details can be provided by contacting NYIF.COM, or John Palicka (palicka@pipeline.com).

Taught by John Palicka CFA CMT

FUSION ANALYSIS-
This is a professional approach that blends fundamental, technical, behavioral and quant strategies.

EQUITY PORTFOLIO MANAGER-
Serious managers will utilize this course to analyze leading Wall Street valuation models and investment strategies for equities using fundamental, behavioral/technical and quant approaches, and then study how these are modified by the best performing equity portfolio managers to produce risk-adjusted excess returns.

INVESTMENT FUND SELECTION-
This is a must attend course for all professionals involved in the selection and management of third-party investment managers.

TECHNICAL ANALYSIS CMT 1-
A must attend course for investment professionals wishing to gain the CMT Level I professional qualification in Technical Analysis from the Market Technicians Association (MTA).

GLOBAL EMERGING GROWTH CAPITAL

PORTABLE WEALTH INVESTING
Portable Wealth (PW) management offers investment opportunities for wealthy investors and their advisors. PW can generate attractive risk-adjusted excess returns to traditional and alternative investments.

Instructor John Palicka CFA CMT is a top-ranked portfolio manager of Global Emerging Growth Capital (WWW.GLGEGC.COM) with over 30 years experience of managing $ billions. He has doubled client money, on average, every 4 1/2 years since 1980*. His high course ratings from major investment firms reflect clear interpretations and practical applications of complex topics; knowledge applied to examples and cases found in the current worldwide and GCC marketplace; his experience with specific situations actually encountered in his career and consulting contracts that parallel the learning topics. John has an MBA from Columbia University and also teaches these courses for leading training institutions, including The New York Institute of Finance (WWW.NYIF.COM).

* Past performance is no guarantee of future results.
WHAT IS ABSOLUTE RETURN?
BY ROBERT PALMERTON, CMT AND PUNEET GUPTA

Editor’s note: This article was originally published at: http://go.mta.org/3793 and is reprinted here with the permission of the author.

Relative versus Absolute Return? Conventional investment strategies and managers seek to beat a pre-defined benchmark or basket of market indices across one or more asset classes and hence they measure themselves relative to this benchmark or index. This is true of most mutual funds and financial advisors and planners. Thus, if the benchmark, say the S&P 500 index is down 39% as it was in 2008, the manager or strategy is considered successful if it “beat” the market, even if they generated a 35% loss that year. A relative return manager, hence, has a built in excuse for not performing well with your investment, i.e. the markets were at fault.

Absolute Return Strategies: In contrast to relative return strategies, an Absolute Return strategy seeks to generate a positive return over a predefined period independent of whether an index or benchmark with similar risk characteristics is positive or negative over the same predefined period. Also called “alternative” strategies, Absolute Return strategies can use fundamental, technical, or macro-economic indicators or a combination of these to determine investment positions or portfolio allocations that are adjusted with changing market conditions as represented by these indicators or otherwise. Absolute Return strategies are almost as diverse as their developers and managers, and are not all created equal. They can be simple or sophisticated, include one or more underlying strategies and risk management approaches, use instruments other than stocks or bonds (like options, futures, etc.) to hedge existing positions or enhance leverage, can take both long and short positions in different markets (i.e. align the investment with direction of prices), have different trading frequencies, and most importantly can perform differently with different degrees of risk. In choosing Absolute Return strategies, the diligent investor will seek to gain an understanding of the underlying strategies, risks, and their performance before investing funds.

Why not “time-tested” Buy and hold Long-term Investing?

There are 5 reasons why we believe Buy and hold as an investment strategy for retirement is actually harmful for your portfolio, and that the right tactical Absolute Return strategies need to be a key part of your mainstream solution for retirement. Given the extraordinary misinformation distributed by the financial industry on the subject, we strongly recommend your reading through these points or calling us. The five reasons are:

1. Buy and hold has RARELY worked historically: We all know that investing in the stock market has not exactly been a winning proposition since 2000 where real dividend re-invested return (adjusted for inflation) for the S&P500 has been -3.4% annualized (thru the end of 2009) or a total real decrease in the purchasing power of a hypothetical portfolio invested in the S&P500 of 29%. But even if we assume a longer-term investment horizon, the story from the last 140 years is not pretty as shown in Figure 1 below which charts the 30 year annualized returns for the inflation-adjusted dividend-reinvested S&P
Composite index which does not account for any investment fees. Only in 27% of the last 120 years did the long-term real-returns from US equities go over 5%.

Traditional investment strategies and conventional wisdom promoted by Wall Street and embraced by most of the financial establishment (including possibly your very own financial adviser or planner) have ignored this reality and have foisted the idea upon us that 10% pre-inflation returns are obtainable from the stock market in the “long-term”, no matter what environment we begin investing in if we simply 1) Invest in a diversified portfolio of equities, bonds, commodities, real estate, etc. and 2) Hold-on through thick and thin for the long-haul with the quarterly or annual rebalancing. Let us test this idea using the above chart. The long-term rate of inflation which “everyone” knows is 4%, which means the claimed long-term real rate of return available from US equities is 6% if one re-invests dividends, right?

The red-dashed line in the chart above is drawn at the 6% level. The 30 year real annualized dividend reinvested returns for the S&P Composite index rise above 6% in only 14% of the 120 years from 1901 to 2010. We are coming off a brief 13 year period in which long-term investors have succeeded in garnering a >6% return but that is the exception rather than the norm historically. In fact, the average 30 Year US equity market real dividend reinvested returns for investors who retired between 1901 and 2010 was 3.6% on an annualized basis.

2. **Buy and hold is a matter of luck:** Markets are cyclical and have historically alternated between secular (long-term) bull and bear markets as is shown in Figure 2 below. Actually secular bear markets have lasted for at least 15 years (to 19 years) whereas the two secular bull markets in the early 20th century were 9 years long and the two since 1948 have been 18 years long each.

Since 1880, Secular Bull markets have roughly been in force 41% of the time while Secular Bear markets have been in force for 59% of the time. Stocks have grown (in real terms) at a 12.8% annual rate during the secular bull markets since 1900 but have lost investors -3% annually (in real terms) in the secular bear markets in the same period. Average real loss during any of these secular bear markets over the 15 to 19 year period was 42%.
Figure 3 below dramatically illustrates the cyclical nature of the long-term returns available from buying and holding the market. We will somewhat arbitrarily call a long-term real return above 4% as being “good” and below 4% as being “poor”. The green shaded regions are the “good” years to retire in and the red shaded regions are the “poor” years to retire in. These green and red shaded areas correspond to secular bull and bear markets respectively shown in Figure 2 (except being shifted forward by a few years as one would expect since we are looking back 10 yr to 30 yr to calculate returns). So whether a long-term investor’s net return, after adjusting for inflation, was positive or negative, was mostly a matter of when he started and when he stopped investing, i.e. whether he was born at the right time and/or retired at the right time or even made his investable money at the right times. Most people today are rapidly falling into the “unlucky” category. If these cycles continue to hold, we should see a further deterioration in long-term returns in the 2nd decade of the 21st century as the cyclical pattern indicates. Looks like a bad decade or more to retire in for committed buy and holders, which a significant part of the population will be.

3. **Buy and hold is not worth the risk or the heartache:** buy and hold as a strategy has no risk management built into it. You buy, and then you hope for the best. If the markets start dropping, you keep holding, hoping that the market will eventually recover, hopefully sooner rather than later. In fact you are encouraged by your financial advisor, if you have one, to keep holding no matter what the draw-down (a technical term for the peak-to-trough drop in the value of your portfolio). Using the same real dividend reinvested S&P Composite data we have been using, Figure 4 shows the drawdown reached subsequent to each preceding portfolio peak. This is the “heartache” or “lurching stomach” factor which your financial advisors may not have prepared you adequately for when they try to sell you their services. Are you prepared to grit your way through a 50% drawdown? What if you plan to retire in 10 years ... or 5?
Another way to look at this is to compare a Buy and hold strategy with other investments or strategies in terms of the risk-to-reward. Figure 1 above in the light red shaded area shows the risk-spread for investing in equities, i.e. the amount of excess 30-Year real return available from investing in the US stock market compared to the 30 Year real return from holding the 1-year T-Bills. The average 30 Year Real return for our Long-term stock market investor for the last 110 years has been 3.6%, only 1.62% higher than the 30 Year Real return for our Long-term 1-year T-Bill investor. Our stock market investor had to risk about $2 for each dollar of gain, to get a 1.62% higher yield than the almost no-risk T-Bills. And our hypothetical retirees obtained a risk-spread greater than 4% for investing in equities relative to the 1-year T-Bill in only 14% of the years since 1901. Is the possible gain worth the pain?

4. THIS TIME it IS very DIFFERENT: Many Wall Street firms and investment professionals are continuing to recommend holding stocks, sometimes albeit defensive ones, through this economy and are refusing to learn from the full historical record. The underlying assumption they are making about this downturn is that it is fundamentally not different from other post-40's recessions. In September of 2010, there is still a very large camp of investment advice givers who continue to argue that double-dip recessions are extremely rare and that we will not see one after the 2008/2009 experience. In other words, business is as usual and the “make us whole” long-term bull market is right around the corner.

Reinhart and Rogoff, leading economists, in a comprehensive investigation of global financial crises going back 800 years compiled in their 2009 book titled “This Time is Different”, have this to say in the preface – “If there is one common theme to the vast range of crises ..., it is that excessive debt accumulation, whether it is by the government, banks, corporations, or consumers, often poses greater systemic risks than it seems during a boom. Infusions of cash can make a government look like it is providing greater growth to its economy than it really is.

Private sector borrowing binges can inflate housing and stock prices far beyond their long-run sustainable levels, and make banks seem more stable and profitable than they really are. Such large-scale debt build-ups pose risks because they make an economy vulnerable to crises of confidence, particularly when debt is short-term and needs to be constantly re-financed. Debt fueled booms all too often provide false affirmation of a government’s policies, a financial institution’s ability to make outsized profits, or a country’s standard of living. Most of these booms end badly.” In other words, this crisis is not made of the same cloth as other post-World War II recessions.
The Great Depression of the 1930’s was a crisis similar to this one in that it was also caused by excessive debt accumulation, rather than inventory corrections or inflation which have been the cause for other post-40’s recessions. For an investor who invested in the stock market in the late 1920’s, it would have taken 25 years before their account values were back to break-even. Hope does not preserve capital. Can you afford to wait?

5. **Theories underlying buy and hold are full of holes:** Buy and hold and the idea of building a diversified and static portfolio using domestic and global stocks and bonds according to one’s risk tolerance or investment goals, is built on the foundation of the Efficient Market Hypothesis (EMH), Modern Portfolio Theory (MPT), and the idea that markets follow a “Random Walk” rather than exhibiting any systematic structure. EMH is the idea that security prices are rationally determined, reflect all available information, and seek equilibrium. MPT, which resulted in a shared Nobel Prize in 1990 for its founder Harry Markowitz, puts forward the concept of diversification and the thesis that a portfolio can be constructed on the “Efficient Frontier” that optimally balances risk and reward from an “uncorrelated” selection of investments. The random walk hypothesis is a financial theory stating that stock market prices evolve according to a random walk per the bell curve or Gaussian distribution and thus the prices of the stock market cannot be predicted.

Some significant facts that fly against these hypotheses are:

a. Warren Buffett and successful market timers who have gotten lucky for a very long time (if these hypotheses are true)

b. Structure that exists in the markets in terms of clear trends and repeatable patterns which manifests itself as fat tails in price statistics where EMH expects a normal Gaussian distribution.

c. Large discrepancies between price and fundamental valuation of assets seen frequently over large time periods or during bear markets like 2008, and

d. A correlation in global markets and asset classes seen most strongly since 2008 where most asset classes (stocks, bonds, commodities, real estate, etc.), have generally dropped and then risen together, some more than others.

Until recently, theorists lacked exposure to a persistent, years long downtrend, so the belief in the Efficient Market Hypothesis (EMH) and the impossibility of a fully diversified crash persisted. According to this hypothesis, investors cannot consistently beat the markets because markets move in a random fashion and adjust instantly and rationally to the news. The only path to higher returns is to bear greater risk, however the theory goes on to propose that the risk can be reduced by remaining fully diversified at all times. Modern Portfolio Theory (MPT) builds off these tenets to propose an “efficient frontier” where risk is supposedly minimized and return maximized.

Counterarguments began surfacing in the media after the 2008/2009 market beating. A Feb 14th, 2009 headline from *Barron’s* proclaimed “Modern Portfolio Theory Ages Badly: The Death of Buy and Hold”. People are questioning the standard fifty year definition of “long-term” and calling for
100-300 years of data which provides a better perspective to understand the decline in 2009 and the subsequent market rally. Research that contradicts these modern financial theories from the budding field of behavioral finance and from top universities has also been emerging. Prechter and Wagner compile this research in a June 2007 paper published in the *Journal of Behavioral Finance* titled “The Financial/Economic Dichotomy in Social Behavioral Dynamics – The Socionomic Perspective”, in which they also propose an entirely new model based on the new concept of socionomics to better explain the workings of financial markets.

The most commonly held out explanation for these times by EMH practitioners is that 2008 was a “black swan” event, i.e. something that happens very rarely, and that things will happily get back on the “random walk” track and efficient markets will return for the long haul ... so please go on buying and holding through this discontinuity, and in fact buy some more if you will, thank you. The scientific method would state that the exceptions render the entire theory untrustworthy, especially since there is no way to objectively determine when the theory would work and when it would not. Benoit Mandelbrot, the late Professor Emeritus of Mathematics at Yale and the author of *The Fractal Geometry of Nature* and *The (Mis)behavior of Markets* wrote in a 2006 *Financial Times* article that “The problem is that measures of uncertainty using the bell curve simply disregard the possibility of sharp jumps or discontinuities and, therefore, have no meaning or consequence. Using them is like focusing on the grass and missing out on the (gigantic) trees. In fact, while the occasional and unpredictable large deviations are rare, they cannot be dismissed as “outliers” because, cumulatively, their impact in the long term is so dramatic ... One can safely disregard the odds of running into someone several miles tall, or someone who weighs several million kilograms, but similar excessive observations can never be ruled out in other areas of life ... Despite the shortcomings of the bell curve, reliance on it is accelerating, and widening the gap between reality and standard tools of measurement. The consensus seems to be that any number is better than no number – even if it is wrong. Finance academia is too entrenched in the paradigm to stop calling it ‘an acceptable approximation’.” Clearly, there is a massive disconnect between market behavior and economic reality and the rational behavior of investors. The pillars of modern financial theory may actually have been made of sand rather than stone. Do you want to build your financial house on these?

Though traditional investment approaches and their underlying theoretical bases cannot be “proved” wrong, the markets and those who understand them, and the buying power of a general investor’s portfolio values tell a different story. Progress was unleashed on the world after Kepler and Copernicus rang the death knell of the “Flat Earth” hypothesis in the 1500’s. Our goal is to manage portfolios based on theories that better align with market price and economic history, and which use tactical investment strategies and sophisticated risk management that seeks to preserve your capital, expose your portfolios to less risk for higher potential returns, and provide absolute returns independent of market direction.
The Absolute Return Opportunity

It becomes apparent after a quick study of a long-term price chart, like the chart shown above above, that markets tend to trend – either upwards, or sideways-to-downwards and are not random. If an investor had purchased stocks at the bottom of each of the secular bull markets since 1900 and sold them at the top of the bull market, then the investor would have earned an annualized real dividend re-invested return of 5.1% versus 3.2% if they had simply bought and held stocks for the entire century. If the investor had shorted stocks during the secular bear markets, the investor’s real return would have increased to 6.9%. But it is impossible to time the markets this way, you may be thinking. To be this accurate, maybe not, however there are trend-following and trend forecasting techniques that have been shown to capture 25% to 50% or more of a trend and/or keep one’s portfolio out of trouble.

To illustrate this, a simple trend-following system constructed from a 45-day moving average is shown along with its profitability from January 2008 to August 2010 in the next figure. A buy signal is given when the S&P 500 crosses above the moving average line and a sell signal is given when the S&P 500 crosses below the moving average line. There is some filtering that has been included to reduce false signals. This simple trend-following system has provided an annualized return from January 2008 through August 2010 of 21.8% compared to an annualized 14.3% loss for the S&P 500 buy and hold investor. In addition, the maximum drawdown of this strategy was 13% versus 56% for the buy and hold strategy using the S&P 500. The green bars on the top graph show the growth of the initial $100,000 to $165,000.

There are other trending degrees, for example primary trends which last for 1 to 5 years, and secondary or intermediate term trends which last a few months to 2 years, and shorter trends all the way down to intra-day trends. We have determined that timing short-to-intermediate-term trends provides
the best returns at the lowest risk for our trend forecasting and trend following methodologies. We believe contrary to popular opinion that returns are not a matter of “time in the markets” but of “timing the markets”, i.e. of using robust methodologies that are designed to harness the inherent structure in the markets and to align the direction of your portfolio and capture significant portions of these inevitable trends while controlling risk through active money management.

Robert F. Palmerton, Jr., CMT, has over 25 years’ experience in corporate finance. He has held positions as CFO, Director of Finance, and Financial Management and Analysis roles for Fortune 500 and multi-national firms (ADP, Honeywell, BOC Group) as well as for early-stage and emerging growth ventures (Online Tech and PeopleForce Solutions). As founder and a key executive in startups and emerging-growth technology companies, Bob has raised equity and debt financing, and has focused on driving his ventures to scalable, profitable results. He has served as the Managing Director of Venturegrowers, LLC, a venture capital firm based in Ann Arbor, MI.

Bob is actively involved in the MTA’s membership committee and building its knowledgebase of technical analysis and theory. His market analysis focuses on sector timing research, market sentiment and volatility studies, trend-following and breakout trading opportunities. Bob has been using a blend of technical and fundamental analysis for the past 15 years. Bob received an MBA in Finance from the University of Michigan, and a BA in Economics and Statistics, summa cum laude, from Fordham University in New York. Bob can be reached at rpalmerton@theabsolutereturn.com.

Puneet Gupta is Chief Investment Officer of the Absolute Return, LLC. He was most recently an Investment Advisor Representative with H. Beck, Inc. Prior to his financial services career, Puneet has 16 years of experience in the technology industry at Intel Corporation, where he held increasingly responsible roles in supply chain management, technology development, and program management. Puneet received his B. Tech. in Electrical Engineering from the Indian Institute of Technology (Madras, India) and a Master of Science in Electrical Engineering from the University of Texas at Austin. Puneet is a Chartered Market Technician (CMT) Level 3 candidate. His market analysis focuses on Elliott Wave technical studies, price inflection forecasting, cycle-superposition theory, intermarket relationships, and in developing and maintaining a coherent, holistic picture of the global economy and asset classes. Puneet can be reached at puneet@theabsolutereturn.com.
Plot Fibonacci Retracements from Extreme Prices to Set Synthetic 100% Target – Equity Index

Fibonacci ratios are essential for analyzing the health of trends by gauging both corrections and projections in all asset classes. They apply well to all asset classes, whether equities, commodities, FX, or fixed income.

When used in a disciplined manner, Fibonacci ratios can enhance your trading and analytical skills. In this article I am analyzing the use of the Fibonacci Retracements tool to generate future targets.

Typically, traders use Fibonacci retracements from the lowest low to the highest high of a specific range of a time series to gauge the magnitude of retracements. Let’s turn this around and set some targets for ongoing trends instead.

The conditions for this method are:

1. the formation of a sideways market, and
2. a subsequent move from this consolidation in the direction of the original trend.

Consider the uptrend of the S&P500 (.SPX). The weekly chart in Figure 1 shows that the lowest low was reached during the week of October 7, 2011, at 1,074.77. The S&P then made a choppy move upwards and put in highs for the uptrend in September and October 2012 in the 1,460-1,475 area. It then pulled back down into mid-November 2012 before turning up again and retesting the aforementioned trend highs in January 2013. This consolidation area between September and January is bordered by a white rectangle.

Once the index broke out of the sideways market, I was able to apply the Fibonacci Retracements tool to set the major target of this uptrend.
To apply this method, I started the retracement from the lowest low at 1,074.77. Then, I fitted the September and November sideways market between the 38.2% and 61.8% Fibonacci retracements. Once I set these levels, the target of the uptrend, measured in late January as the 100% of the uptrend, was 1,736.78. As of now, the .SPX reached a high of 1,729.86 during the week of September 20th, 2013. As measured from the breakout area, the .SPX surged approximately 16.4%; not too bad for a long-term target! While not essential in this case because the .SPX came very close to the objective, I am confident that the index will actually reach and even surpass the original target.

Let’s recap this method. Essentially, the first leg of the uptrend covers the range up to the 61.8% level of the entire range of the uptrend. So, if 0% to 61.8% is 1,483.89 – 1,074.77 = 409.22, then 0% to 100% should be 1,736.78. See Figure 2.

This method can be applied only if the sideways market breaks in the original direction of the trend.

Plot Fibonacci Retracements from Extreme Prices to Set Synthetic 100% Target – Commodities

In Figure 3 there is a less than perfect application of Fibonacci retracements as target seekers in Soy futures. The sideways market was volatile and didn’t fit ideally between the “what-if” 38.2% (1,344 ¼) and 61.8% (1,498 ¾) Fibonacci retracements of the uptrend formed between December 2011 and September 2012, when soy made a new high for the uptrend. The target was 1,748 ¾, while the highest high soy reached before crashing was 1,794 ¾. However, extra profit never hurts!

Plot Fibonacci Retracements from Extreme Prices to Set Synthetic 100% Target – Interest Rates

The yield of the US 30-year bond started its latest leg of the uptrend on May 1, 2013. It displayed a bullish-biased consolidation between June 6 and June 19. Once the yields broke higher on June 20, I fitted approximately the lows.
and highs of the daily bars for these dates as 38.2% and 61.8%. The Fibonacci retracements generated an upside target for this uptrend in the 3.8240 area. The current top of the yield is 3.9400 (100%), which was reached on August 22. The Fibonacci retracements put us on the correct trajectory and their target was reached and surpassed.

Plot Fibonacci Retracements from Extreme Prices to Set Synthetic 100% Target – Currencies

For part of 2013 the foreign exchange space was consumed by concerns over the fund outflows from the emerging markets. Here is an example of how the Fibonacci retracements were able to provide a target for one of the BRIC components: the Indian rupee against the dollar (INR=). The INR=surged between May 1 and July 8, 2013. It then consolidated through August 15. Starting on August 16, the INR= resumed its uptrend. I fitted the 38.2% and 61.8% Fibonacci retracements at 58.4822 and 61.4798, respectively. Based on this setup, on August 16 I was able to establish the target for the INR= at 66.332 (100%). The volatile INR= peaked at 68.800 on August 28. Once again, this method put us on the right trajectory, and the target was reached and surpassed.
Cornelius Luca is the Product Manager for Charts, at Thomson Reuters since joining the Eikon Charting team in February, 2012. He has spent his entire professional life in international finance both on the sell and the buy sides. He authored "Trading in the Global Currencies Markets," published by Prentice Hall (3rd edition — 2007), a comprehensive analysis of the foreign exchange markets, instruments, players and methods of forecasting, and "Technical Analysis Applications in the Global Currencies Markets," also published by Prentice Hall, an exhaustive and unique coverage of currency chart analysis.

He also authored "Technical Analysis Applications," which is published by McGraw-Hill, and "Introduction to Technical Analysis," which is published Euromoney. He has taught courses at the New York University, Pace University - Lubin School of Business Graduate Division in New York City, and at the New York Institute of Finance since 1990. Outside the U.S., he presented courses and participated in conferences in London, Paris, Frankfurt, Milan, Geneva, Moscow, Singapore, Shanghai, Beijing, Taipei, Johannesburg, Sydney, Toronto, Sao Paulo, Rio de Janeiro, Dubai, Cairo, Kuwait and Riyadh. Cornelius has an MBA with a double major in Finance and International Business from the New York University Leonard Stern Graduate School of Business.
Apps for Technicians
By Mike Carr, CMT

Apps are a rather recent development but they have become an essential part of life for many. There are apps for everything but few professional-quality apps that help technical analysts do their jobs. Three useful apps for technicians are listed below.

Some apps focus on the current market. One of those is Bollinger Bands®, a free app that provides current market quotes and charts plotted in candlestick, Bollinger Bar, traditional bar, or line chart format. Several dozen indicators, including the Bollinger Band suite of indicators with Percent b (%b) and BandWidth, moving averages, and volume weighted MACD, can be added to the charts.

Voice command can be used to modify the chart display, date range, or add and remove indicators. Audio expert technical analysis of chart patterns can be used to listen to an overview of the chart setup. This feature-rich app also includes the ability to screen stocks.
Other apps provide a historical perspective. One of those apps is **Stock History Mini**. This app provides some amazing charts including one with 800 years of price index history in the United Kingdom, 220 years of U.S. stock market monthly charts, and 115 years of Dow Jones Industrial Average daily charts which can be viewed in charts covering ten years at a time. Also included are charts of the Tokyo Stock Exchange by decade since World War II, along with historic data from Germany, Korea, Hong Kong, China and Taiwan. Current market quotes and news are also available. The charts are annotated with important historic events.

A unique app from **MTR Investors Group** provides short quotes from some of the greatest investment books ever written.

This app could be thought of as an inspirational calendar for traders and offers wisdom from Jesse Livermore, Mark Douglas, Nicholas Darvas and Ben Graham who Ralph Acampora has pointed out is a market technician who advised investors to focus solely on price. Quotes from turtle trader Curtis Faith and *The Zurich Axioms* are also included. *The Zurich Axioms* may not be widely known but that is one of the books that trading legend Larry Williams has placed on his short list of must-read books.
How would you describe your job and what led you to look at the particular markets you specialize in?

I am the Chief Technical Analyst of Raiffeisen International. My bank is the investment-banking spearhead of a locally well settled consumer bank, with a focus on Central & Eastern Europe and some offices in Asia, the U.S. and U.K. My team deals with most asset classes, cross-rates, bonds, stock- and commodity-markets worldwide.

We take a global view before going asset specific. Our work is based on my basic principles of charting together with both macro and micro economic analysis, an understanding of derivatives including ETFs and CFDs, and portfolio-management. I have published a 1,200-page overview with the title “Das Große Buch der Börse” (The Big Book of Exchange). Our understanding of technical analysis and knowing how to work with charts improves the quality and transparency of our research.

Which technical indicators do you rely on and how do you combine them?

Indicators are easily relied on too much, too early. If you go beyond analysis and into investing, systems make more sense as a wide array of time series which have to be kept under surveillance. A typical analyst in charge of a couple of markets could concentrate on charting, ideally in accordance with the rules mentioned earlier. But because indicators are a world of variables and soft guidelines, the parameters have to be defined and a signal procedure has to be applied. Only then can one consistently produce high quality and reliable signals. This can also suit the risk preference of the client and her/his costs. In the end we combine our understanding of technical analysis, market structure and risk management systems.

Why do you think systems are important in the current environment?

A systematic approach to financial research of whatever kind is imperative. This is nothing new, but sure, modern times have their influence when it comes to the growing demand of reliable performance numbers and statistical control of what’s done with the clients’ capital. Since 2008 investors increasingly look for clear-cut and reliable performance figures. We have increased our quantitative work providing explanatory models of various stages of intricacies to our clients, affiliate banks and internal investing units.

Can you describe any popular system or share some specifics about your system?

The most popular system in the world seems still to be the “simple trend-following-tool-with-an-edge.” It can be crafted easily out of a MACD plus an oscillator to cut losses faster. Systems like these were sold widely throughout Europe in the 1990s and not much has changed since then.

The most sophisticated tool we currently are working on is based on a simple idea. It scans the markets for major trends globally and sector-wise, while in addition following a bottoms-up approach. The stock markets covered are
scanned for possible reversals and useable price movements or swing trades. This might add up to exposure or it might work as a hedge the overlay. The positions held are in the direction of the recognized trends and are kept under control by equity curves that are set to trigger alerts shutting down single positions or even the whole scheme. In the latter case the basic idea is the same and the defined parameters are continuously subjected to re-evaluation. We need systems that can distill ideas that could create alpha.

**What do you think about intermarket analysis? Do you it can be used as a standalone system?**

The financial world is increasingly complex with many sectors, (structured) products, services offered and derivatives all competing for attention. Links between two asset classes, markets or time-frames might not be obvious but deeper analysis can be used to find them. Once this is obtained on a constant basis, it’s a faster way to locating inter-asset convergence and divergences, confirmations, understanding market structure and sector- rotation, indexing and other useful information. Honma used this approach back in the 18th century, when he had flag posts signal prices from Edo to Osaka and vice versa.

**Do you look at any fundamental or economic inputs to develop your opinions?**

With my background as both a market maker and primary analyst, my special skill is to combine disparate information. It makes sense to understand what a company is going through at the current time and its future plans. Information can be obtained from reading a balance-sheet’s figures and media reports about a company, but I would never bet any money on a company with a chart that doesn’t suit the intended investment.

To rephrase the question, if I would I have to opt for only one method, charts would always win.

**Which school of thought do you belong to, inflation or deflation heading into 2015-2017?**

Academics are good for learning basic principles, life and markets teach us the rest, so what if they existed both in the same time and place? As a simple guy, I can't help but notice that some goods are getting cheaper since 2008, like fashion items, and are in a deflationary routine sold to the public.

Other things, like housing and construction or public services, are getting increasingly expensive and wages are not rising alongside the price gains. So we might soon get to see what the reaction will be to a bullish reversal of both basic prices and carbon allowances. There are hints of some additional inflation pressure about to arise and most probably, an interest rate hike will not be an option.

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Robert Schittler leads the Raiffeisen Bank’s Technical Financial Markets Analysis group. Robert meets the multiple and different needs of a global clientele.
In previous positions, he has been a Relationship Manager, head of sell-side analysis, an editor with the Austrian Press Agency (APA), a tutor for trading with derivatives, a market maker and co-founder of companies with a focus on education and forex. As an editor with be24.at, he was ranked #2 from among more than 1,000 financial bloggers and his contributions to cashkurs.com are appreciated by a large number of readers.

Robert is also Co-Chair of the MTA Vienna Chapter and plans to host a regular meetings in Vienna with the goal of bringing together entrepreneurs, master traders, media, investors and top-of-the-line analysts to gain fresh insights into the market.

AUTHOR GUIDELINES

The Market Technicians Association serves a global community and the organization’s publications strive for articles that can be easily understood by readers around the world. To meet that objective, all submissions to Technically Speaking should be in English and minimize the use of vernacular phrases and references. This is necessary to improve the readability for international members who may not understand phrases commonly used in one region but unknown in most of the world.

In Technically Speaking, we want to publish articles that use simple language whenever possible. Specific terms associated with financial analysis in general and technical analysis specifically should be defined unless they are found in the MTA’s Body of Knowledge. The editors may have to make changes to any work that is published for clarity and consistency.

Submissions should not use text boxes or advanced text formatting, as they make it more difficult for our staff to implement into our newsletter layout.

Please send any material you would to have considered for publication before the 20th of the month. We will work to include anything received by that date in the next issue.