LETTER FROM THE EDITOR

This month’s issue of Technically Speaking offers some of the theory underlying technical analysis and several examples of how this theory is applied.

The applications are specific and although diverse, charts are central to each. Although many of us have a number of quantitative tools at our disposal, price charts remain an indispensible part of technical analysis. For that reason, a number of charts are shown.

Jay Lefkowicz, CFA, CMT, uses long-term charts to make a bullish argument for U.S. stocks. Aksel Kibar, CMT, offers insights into some markets U.S.-based analysts may overlook. Nishant Bali ties together principles of market sentiment and intermarket analysis to build the bearish case for U.S. stocks. Each analysis is unique but well-structured and persuasive.

We would like the opportunity to include the work of other MTA members in future issues of Technically Speaking. If you publish research on a regular basis, please consider adding editor@mta.org to your distribution list.

Michael Carr
DO INDICATORS REALLY WORK AS ADVERTISED?
BY MIKE CARR, CMT

Market professionals understand that you can’t find success using standard technical indicators with the default settings. RSI, Welles Wilder’s Relative Strength Index, is a popular indicator but traders applying this tool exactly as Wilder described in his original work will be disappointed.

RSI is designed to highlight periods of time when the market action reaches an extreme. The value of RSI can range from 0 to 100 although readings below 15 or above 90 are rare. Wilder suggested using 30 as a level to define oversold markets and 70 to define overbought markets.

The indicator is calculated with a default setting of 14 days but uses exponential moving averages in Wilder’s formulation which means no data is ever completely excluded from the calculation. With simple testing, we can determine if 14 days is a useful value to use when calculating RSI.

Testing buy signals when RSI falls below 30 shows that this indicator would provide mediocre results. Buying when RSI falls below 30 and closing the positions after 20 days would deliver a profit about one third as large as a buy & hold strategy. This test was done using closing prices for SPDR S&P 500 ETF (NYSE: SPY) over the ten years ending in June 2013.

Waiting for RSI to rise back above 30 before buying, a signal that a new uptrend in prices should be underway, performs even worse and delivers only about 20% of the profits of a buy and hold strategy.

In both test cases, the percentage of winning trades is high. Buying when RSI rises above 30 and selling 20 days later would be a winning trade 69.2% of the time. However the profits would be small.

Over the years, Larry Connors has demonstrated that using a shorter timeframe to calculate RSI could be a more profitable strategy. Connors found that a 2-day RSI yields better results. Testing confirms this with a 2-day RSI beating buy and hold by more than 35% over the past ten years using the same rules described above. A high percentage of winning trades, 66.3%, is seen with RSI(2). Better results can be obtained with lower values of RSI, less than 10 for example, being used to offer signals.

A screener offered by TradingMarkets.com could help analysts find new ways to use RSI. Markets can be screened to find oversold, low-priced stocks with sufficient liquidity to meet your requirements. I found the list of stocks trading below $5 a share that are above their 200-day moving average with an RSI(2) below 10 to be great trading candidates.
These stocks are inexpensive and volatile which makes them ideal for short-term trading. Testing showed that trading the few stocks identified with the screen would be more profitable than holding them.

Screening software has been available for many years and is probably used by a majority of technical analysts. But technicians, like any other professional, can fall into a routine. Screens that are used are often the same screens that have been run for years. Using new tools can lead to new ideas. The TradingMarkets Live Screener is an example of a tool that could help any trader, whether they are just starting their career or more experienced than they care to admit.

This screener has all of the features a screening tool should have with various filters and the ability to save watch lists of stocks that are of interest based on their fundamental characteristics or their membership in a major index. Institutional managers may be restricted to a certain group of stocks, for example, and allocating a small percentage of their funds to stocks giving short-term buy signals could provide a way to add alpha.

Another contribution this screener makes to the idea generation process is the Connors RSI, an innovative way of calculating RSI that incorporates other variables to improve RSI. Connors RSI averages the traditional RSI calculation with a factor based on the length of the trend in the indicator and the strength of the indicator relative to its position in the recent past. The result is an adaptive indicator that can help identify market extremes quickly. The approach used for this calculation could be applicable to other indicators and might provide an edge to short-term traders. Code for ConnorsRSI in several different programming languages can be found at TradingMarkets.

Indicators generally do not work as advertised. That is true for MACD, stochastics or any other popular indicator in addition to RSI. However with minor modifications, many traditional indicators can become more useful. ConnorsRSI demonstrates that idea as does the 2-day RSI and both of these tools can be explored with the screener shown above. Historical volatility is another indicator included in the screener and volatility may be one of the least researched indicators in equity markets.
S&P 500 INDEX: TO INFINITY AND BEYOND?
NO, “JUST” 2584
BY JAY LEFKOWICZ, CFA, CMT

Editor’s note: This report was originally published by Concept Capital Markets, LLC, and is republished here with permission.

On May 10th, S&P 500 Index (SPX) confirmed the breakout above a 13-year ascending triangle pattern in the weekly chart that projects to about 2588.

On May 31st, SPX confirmed the breakout above in the monthly chart that projects to about 2536.

Since the monthly chart breakout validates the weekly chart breakout, our upside expectation becomes 2584 with an 8-year time horizon. That ties everything together with a nice, neat Fibonacci bow.

Based on a recent close of 1631.38, a move to 2584 would be a 58% advance. Over 8 years, that works out to a 5.9% compounded annual return.

As far as a real return, such an advance may not eclipse the real (inflation adjusted) SPX high from August 2000, depending on your inflation expectations. Going back to the start of SPX (December 30, 1927), it took 29 years (August 1929 to December 1958) and 24 years (November 1968 to December 1992) to reach new real highs. Expecting SPX to approach its prior real high in 2021 is not out of line with the two previous instances.
The most recent high in the real SPX was in August 2000. The prior peaks were in November 1968 and August 1929. It took 24 and 29 years respectively to eclipse the old peaks.

Fun with Fibonacci numbers

Below are the first 18 numbers in the sequence:

1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377, 610, 987, 1597, 2584

- The triangle took 13 years to develop
- The top of the triangle is 1588 this month (0.6% from 1597)
- The Weekly Chart projection is 2588 (0.2% from 2584)
- The Weekly breakout was confirmed on May 10 (2 days after Fibonacci day 5/8/13)
- The measured move from the Weekly Chart is 1000.7 (1.4% from 987)
- Expecting the move to take 8 years generates a familiar Fibonacci ratio (8/13 ≈ 61.8%)
- That makes our target date the next Fibonacci Day 8/13/21

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Jay Lefkowicz, CFA, CMT, Technical Strategist at Concept Capital Markets, LLC (CCM), began his finance career in 1988 with the fixed-income analytics department at Merrill Lynch & Co. After joining Instinet in 1992, he focused his attention on the area of stock market research known as technical analysis under the tutelage of Marc Chaikin. Prior to joining CCM, Jay was the Founder and Managing Member of Equitable Edge, LLC and Chief Market Strategist at Saratoga Capital. Jay holds a B.S. in Computer Science and Applied Mathematics from the State University of New York at Albany (1989). He was awarded the Chartered Financial Analyst designation in 2002 and the Chartered Market Technician designation in 2010.
Gold breaks below $1,330 levels

Following U.S. Federal Reserve Chairman Ben Bernanke’s press conference that mapped out a timetable for ending quantitative easing in 2014, markets experienced a sharp sell-off. Yields rebounded, equities sold-off and metals resumed their downtrend. In April, Gold price broke down below $1,525 level to reach $1,330 levels and the metal has since been consolidating between $1,500 and $1,330. The beneficiaries of quantitative easing have been precious metals and reversing this resulted in further weakness. Gold broke down the previous three-month consolidation and reached 1,270 levels. Price fell below April’s low levels, which will now become a resistance at $1,325; price should move above this level for the technical outlook to improve. Unless price recovers above $1,325, downward pressure will remain intact.

Emerging Market currencies depreciate in value against U.S. dollar

Anticipation of the withdrawal of quantitative easing resulted in reduced exposure to emerging market currencies and equities. Most emerging markets are commodity producers and the expected reduction of U.S. Federal Reserve asset purchases do not bode well for commodities either. Tech Talk recently analyzed emerging market currencies and drew attention to weakness against the U.S. dollar. A strong breakout on USD/INR at 55 levels resulted in significant weakness in the Indian rupee. Unless the cross rate reverses below 57.25, weakness will resume.
Over the past week, we have also seen rapid depreciation of the Turkish lira followed by a breakout above 1.83 levels. Now 1.83 becomes a support level and the cross rate is expected to edge higher, resulting in further weakness for the lira.

Bond yields complete major base formations; target higher levels in coming months

Rising yields will not fare well for home owners, especially for those seeking new mortgages. Yields rebounded sharply globally after U.S. Federal Reserve remarks on the asset purchase program. German 10 Year Bund yields are forming a clear double bottom chart pattern; usually seen as a bullish development. Yields already reached 1.74 levels from 1.15 levels over the past few months and should they break above 1.74, technical chart pattern price target will suggest 2.6 levels in the medium-term.
Similar price action can be seen on the 30-year U.S. government bonds, with yields rebounding from 2.5 levels to 3.5 levels over the past year. As long as it remains above the 3.2-3.5 range, long-term U.S. yields will target 4.5 levels. Higher yields will be negative for risk taking behavior.

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WHY TECHNICAL ANALYSIS WORKS
BY MIKE CARR, CMT

There are three simple precepts defined by John Murphy in Technical Analysis of the Financial Markets:

- Market action discounts everything.
- Prices move in trends.
- History repeats itself.

The trending behavior of prices is one of the reasons that technical analysis can help analysts beat the markets in the long run. While technicians know this is true based on their experience, it can be difficult to demonstrate this without using advanced and confusing mathematical principles. While there is no substitute for the math, it can be helpful to look at the distributions of returns to see how trends develop over time.

The charts below show the returns over rolling one-year periods, rolling one-month periods and one day. Data from January 2001 through June 2013 is used. Over that time span, there are 2,885 rolling one-year time periods; 3,116 one-month periods; and 3,136 days.

SPDR S&P 500 (NYSE: SPY) has provided buy and hold investors with a compound annual growth rate (CAGR) of 3.49% over the test period. SPY closed higher on 54% of the days and delivered an average one-day gain of 0.02%.

On a monthly basis, SPY was up 62% of the time and gained an average of 0.42% in one month.

On an annual basis, SPY was up 72% of the time and gained an average of 5.63%. This annual return differs from the CAGR of 3.49% because it measures rolling one-year returns rather than the single start and end point in the traditional CAGR calculation. Rolling returns might offer advisors a
better way to manage client expectations since few clients start investing on
the first of the year and close their account on the last day of the year.

The charts of SPY illustrate that one-day returns might be essentially
random but over longer periods of time, the distribution of returns
demonstrates that trends exist. The existence of trends makes it possible to
develop trading strategies that rely on technical analysis.

This pattern can also be seen in the distribution of returns of individual
stocks. Monster Beverage (NASDAQ: MNST) has delivered a CAGR of 54.82%
since January 2001. This company was formerly known as Hansen’s Natural
and traded under the symbol HANS. Despite the extraordinary gains over a
12.5 year period, MNST actually closed higher on less than half (49%) of all
trading days.

The one-month distribution of returns shows more skew and MNST
delivered one-month gains 65% of the time. The average gain over that time
was 4.68%, more than ten times higher than the average monthly return
from SPY.
Over one-year periods, MNST was up 82% of the time and the chart below shows little resemblance to a standard normal distribution associated with a bell curve and the random walk of prices.

A similar pattern can be seen with long-term losers. Citigroup (NYSE: C) has provided a CAGR of -15.03%. Those losses are masked in the daily distribution of returns which shows a bell-shaped pattern and gains on 49% of all trading days.

On a monthly basis, C was up 52% of the time but a large number of losing months drove down the average return and C actually lost 0.22% in an average month.

C actually demonstrates the problem of tail risk on a long-term basis. The one-year distribution of returns shows a large number of large losses that
mask the fact that C closed higher in a majority (51%) of the rolling one-year windows.

It is probably an unrelated but interesting fact but WhaleWisdom.com shows that 1,014 investment managers had position in C at the end of the first quarter of 2013. Only 344 managers reported a position in MNST.

From the distribution of returns, we can see strong patterns emerge over the longer term. Each symbol reviewed in this article showed that on any given day, there is about a 50% chance of a gain or loss. Longer-term, trends develop and these trends are why technical analysis works.
THE END IS NOT FAR OFF
BY NISHANT BALI

After analyzing major sentiment tools, intermarket principles and Elliott Wave, we reach the conclusion that the end of the bull market is not too far in the future. In this article, we show that a variety of indicators are showing an extreme level of optimism but the most important indicators are associated with “timing the market” and these are bearish as well.

Our advice for the medium to long term is summed up as “sell the dollar; sell equities; sell the Nikkei; long Japanese yen; long Australian dollars; and long commodities.” Now, we’ll look at the charts that led us to those conclusions.

1. Margin Debt

Margin debt levels, and their rate of change, are sometimes used as an indicator of investor sentiment because margin debt rises when investors feel good about the prospects of the stock markets. In the past, margin debt levels have peaked at the same time market indexes reached relative peaks. Although it should not be used as a market timing tool, the implication of this indicator is contrarian bearish.

2. Speculative Positions vs Dow Jones Industrial Average (DJIA)

This chart depicts the net speculative positions at the market top. At market tops, nearly all speculative stocks will be climbing faster than the broad market averages. This can be seen when both the DJIA and net speculative positions are marking higher highs.

Volatility measures the intensity of the market. Traders “buy when volatility is high and sell when volatility is low”. The S&P 500 is trading above its 200-day simple moving average (SMA) and VIX, a measure of volatility, is trading more than 5% below its 50-day SMA. This reflects a degree of complacency among investors. It would be too early to predict that this is the turning point but it clearly reflects that investor sentiment is reaching an extreme.

5. DJIA vs Inflation-Adjusted DJIA

The inflation-adjusted chart shows the true nature of the U.S. stock market. On the chart, the long-term trend line in green shows an average return of
1.9% per year. If we factor in the long-term capital gains tax, the return is lower. Since the capital gains tax is not adjusted for inflation, the average tax must be based on the 5.4% trend of the non-inflation adjusted chart, and investors could lose 15% of 5.4% (0.8%) to taxes. This reduces a 1.9% return to 1.1% after taxes.

The Dow has historically moved within well-defined channels. The boundaries of the channel have been touched only 4 times since 1910. The top of the channel was last touched in 2000. There is clearly a divergence developing between the DJIA and the inflation-adjusted DJIA.

6. Quantitative Easing vs CRB index

Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

This chart shows that except for QE 1, QEs have not boosted commodities.

7. CPI vs U.S. 10-year Bond Yield

This chart shows the relationship between the U.S. Consumer Price Index and U.S. interest rates. Since November 2011, both CPI and yields are falling in a contradiction of general economic rules. The early contractionary phase of the stock market starts with these kinds of warnings, i.e. falling rates are not pushing CPI higher. A similar scenario was seen before the stock market decline in 2000.
8. Yield Curve

In this chart, the spread between 10-year bond yields and 30-year yields is shown. The yield curve is forming a symmetrical triangle, and trading near its apex. Sooner or later, prices could pierce the downward sloping trend line. We assume this will happen sooner rather than later and we believe it will be caused by 10-year yields starting to rise, which again is an early sign of a contraction.

9. DJIA vs Dividend Yield

The stock market is a leading indicator and generally falls before investors realize just how bad the economy is. The stock market also recovers before economic activity picks up.

Long among the most popular of valuation measures, the dividend yield is calculated by dividing the indicated dividend rate for the next twelve months by the current price of a stock. This figure can also be calculated for any market average, or most meaningfully, for all stocks in aggregate. When investor enthusiasm is high, they accept a much lower dividend yield than average. When yields are very low, stock prices are, by definition, high, and frequently overvalued as well. A low market yield has usually been followed by declining prices.

Currently, the ratio is about 1.91%, a low ratio warning of a possible contraction.
10. DJIA Elliott Wave

At this time, the DJIA is in the 5th motive (primary) wave and forming an extension wave within that structure. This wave might travel to the 16350-16550 level, which is 1.618 times the length of wave 3. After that, we assume the Dow will form a corrective A-B-C pattern.

11. 2013 is a mirror image of 2006.

From studying the intermarket relationship between the 10-year U.S. bond yield, the CRB index and the DJIA, we expect to see an inverse relationship between bond prices and commodity prices and a positive relationship between bond prices and the equity market. During early-2006, the relationship decoupled as both bond yields and equity prices rose. We believe this is due to the fact that the U.S. dollar index at that time was falling and that was a negative for bonds after September 2006.

2006 vs 2013

Both the CRB index and the DJIA are now experiencing moves similar to those seen in 2006. We assume the CRB index might witness a mirror image of 2006 in the coming months.
12. Sector Rotation

In this chart, we look at the relative strength of the energy sector, basic materials and utility index compared to the DJIA. During the late expansionary phase of the stock market, we expect the energy sector to peak and during the early stages of a contraction, utilities and basic materials should start to perform well. That summarizes the current situation.

13. Timing the market

The bond market usually leads both equities and the commodity markets. Bond prices made an important high in July 2012, leading us to expect that the economy might top within 17 months, or before December 2013. We expect to see an equity market top near September 2013, 14 months after the bond peak. We also expect to see a commodity market top near December 2013 or by late January 2014.
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Nishant’s market analysis focuses on market sentiment, Elliott Wave, volatility studies, intermarket analysis and commodity arbitrage. He received an MBA in finance from the ICFAI business school and Certified Technical Analyst from Association of Technical Analysts.
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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).

INTRODUCTION TO STEALTH TRADING USING FUSION, ALGORITHMS, AND DERIVATIVES FOR PROFESSIONALS-

Today, portfolio managers increasingly must use stealth trading in order to disguise their intentions and thus benefit from best execution.

ADVANCED CAPITAL MARKETS ANALYSIS
Spot, forwards, futures, swaps, options, and statistical issues are discussed in dynamic capital market strategies.

STRATEGIC GOLD INVESTING
Gold has been one of the very few assets to have created wealth in the past several years. Gold offers investment opportunities for investors, traders, and financial engineers.

GLOBAL SMALL CAP INVESTING
Global small cap stocks offer investors the ability to participate in the world’s future big winners.

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.
INTERVIEW WITH J.C. PARETS, CMT
BY AMBER HESTLA-BARNHART

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

When I was a junior at Fairfield University I interned at Merrill Lynch, in the wealth management department. At a very young age I was able to see that the old timers “managing” the portfolios for their high net worth clients were doing very little, if any, managing at all. They would go on golf trips to Europe and take long lunches, all while never talking about the markets. They would just do whatever their analysts told them to do.

They were okay with that, but I wasn’t. I learned very early on that these guys did not know much of anything, other than how to gather assets. It wasn’t about the market; it was about bringing in the next eight-figure account. Wealth management was really wealth gathering. I know this now, but to a 20-year old it can be quite a revelation.

After college I knew I did not want to work for a big institution. I wanted to work with a smaller boutique firm where I could be more hands on and help clients. Once again, I quickly learned the older guys around me didn’t know much of anything when it came to the stock market. What scared me was that they thought they knew something. That’s when I knew that if I didn’t want to end up like them, it was time for me to start learning.

I hit that fork in the road: do I study for my CMT or CFA? Do I want to learn how to analyze companies? Or do I want to learn how to analyze the market? To me this was a very easy decision, and I’ve been a technician ever since. Best choice I ever made.

Over the years, my goal was to eventually launch my own fund. As you can imagine, this is much easier said than done. I came into 2012 focused on that goal and fortunately we were able to get Eagle Bay Capital, LLC, off the ground last summer. These are certainly some exciting times. Although this is a dream come true, I know I have my work cut out for me. Of course, no one said it would be easy.

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

I don’t necessarily look at the fundamental or economic data itself, but more so the market’s reaction to that data. I’m not the guy that’s ripping though balance sheets and income statements.

I would say that I look at the markets’ reaction to “good” or “bad” news. For example, a stock is getting crushed for months, and then comes out with lower guidance or worse than expected earnings, and the stock rallies on that news. The market is telling us there is a good chance that the news was priced in and the selling is overdone. We see the same thing to the upside when a market can’t rally on good news after a large price move higher. The lack of a reaction in the direction of fundamental data is a sign the market is exhausted and is likely to reverse course.

What advice would you have for someone starting in the business today?
Check your ego at the door. The market is the most humbling place on earth. Athletes understand this better than most. I don’t care who you are, or what sport you’ve played. At some point or another you’ve struck out to lose a big game, or dropped an important pass, or missed that jump shot at the buzzer. Athletes know how to lose - they have to pick themselves up and move on.

When it comes to the market, it’s important to recognize when you’re wrong. Try to do it early. Don’t be that, “it’ll come back” guy. Know where you’re wrong before you even enter the trade. Know when you’re going to take some off. Use those numbers to then calculate what the risk/reward is and whether it’s even worth it to put it on.

So my advice to someone starting out? Manage risk. The profits will come. Think about it - you can’t control how high a stock you just bought is going to go and you can’t control how low a stock you just shorted will go. There isn’t enough homework you can do or time you can spend staring at the screen to control the direction of a stock (trust me I’ve tried). The only thing that you can control is the risk you take. Since that’s the only power we have, my advice is to focus on that. Always ask – what’s the risk?

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

To me, the most interesting development in the field of technical analysis is the amount of sharing and online communicating taking place among technicians. Through the use of blogs, YouTube, and online communities such as Stocktwits and Twitter, there is a ton of information and idea sharing from some of the top technicians on earth. There’s no doubt about it. When I was first starting out in the business, some guys out there like Brian Shannon at alphatrends.net were publishing daily videos on technical analysis of the markets. But today there is so much more. Young kids first getting into the business have a huge advantage and now have access to some of the best minds in the field of technical analysis. And the best part is that it’s only getting bigger. Every week another brilliant technician comes out with a new blog or signs up for a site like stocktwits. I am very excited to see what’s to come.

What research area do you think offers the greatest potential in technical analysis at this time (something like an indicator, charting technique or trading tool)?

To me, I think it’s the power of simplicity. All of the new tools available to a trader make it the easier it is to become confused. I can’t tell you how many times I walk behind someone’s desk to see five different momentum indicators on a chart, all giving different signals. If you’re waiting for RSI, stochastics, MACD and ROC to tell you the same thing, will you ever generate a buy or sell signal? Same thing with moving averages, what do you do if the stock is above the 200-day, 150-day, 100-day and 50-day, but below the 5-day, 10-day, 20-day and 34-day? Are these simple or exponential? See my point?
Keep it simple. Edwards and Magee didn’t have moving averages. They didn’t have twelve oscillators under their charts. These guys had price and volume.

I do look at RSI and I use a couple of moving averages. But a lot of times I find myself going back to my daily and weekly single-colored bars before making the bigger decisions. You’d be amazed at how much cleaner your charts look. Less is more sometimes.

J.C. Parets, CMT, is the Founder & President of Eagle Bay Capital, LLC. He is the Senior Editor of the technical analysis blog Allstarcharts.com, which is read daily in over 150 countries. He has been featured on CNBC, Bloomberg, Yahoo Finance, CNN Money, Business News Network, and the Wall Street Journal, among other major media outlets. J.C. is an experienced technical analyst with a diverse analytical skill set. He employs a top-down approach using intermarket analysis with particular emphases on trend recognition and Fibonacci projections. He has also constructed a variety of proprietary oscillators that he adjusts over time. Currently, J.C. manages money for high net worth Investors, charitable foundations and other hedge funds. He focuses on all areas of asset allocation including stocks, bonds, currency and commodity markets. His approach emphasizes market timing, sector rotation strategies, stock selection and most importantly, risk management.

These questions and answers are compiled by Amber Hestla-Barnhart, a writer specializing in options for profitabletrading.com. If you’d like to participate in a future interview, please contact Amber at amzhondacbr@yahoo.com.
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MEMBER PROFILE: DEREK HERNQUIST, CMT
BY AMBER HESTLA-BARNHART

Derek Hernquist is a Portfolio Manager at D. Scott Neal, Inc., where he focuses exclusively on implementing an ETF-based Tactical Asset Allocation program for the firm’s investment clients. He studies price action across multiple time frames in search of sectors and asset classes transitioning from one phase of sentiment to another. Derek believes that big moves start with early clues, and equity markets give us the ability to spot when the underlying components begin to leave those clues for us.

His philosophy was shaped by years spent observing clients, first as a stockbroker and then running a retail trading desk in the late 1990s. These experiences led him to combine behavioral finance with his math background to more objectively measure the collective psychology of the market. The following chart is an oversimplification of his general philosophy but clearly explains the dynamics of supply and demand in the markets.

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<tr>
<td>Average Demand</td>
<td>Up</td>
<td>Noise</td>
</tr>
<tr>
<td>Low Demand</td>
<td>Way Up</td>
<td>Up</td>
</tr>
</tbody>
</table>

He explained to me how this information can be used:

To make money by anticipating high demand, we’re saying something needs to deviate from normal. Buyers need to become less patient, or larger, or sellers need to step away. That said, it’s entirely possible that sellers may be just as impatient and just as large and thus, an offsetting force. By contrast, a low supply approach allows us to profit from normal, everyday demand, and catch lightning in a bottle if for some reason that demand expands.

So how can we measure this minimalist form of analysis? Let’s hop into the mind of a fund manager, and consider the following reasons we may sell:

1) Overvaluation - price discovery leads to higher prices which prompts us to take our profit.

2) Relief - having started with losses, we (and everyone else who bought recently) are so relieved to get back to even that we sell and move on.

3) Performance - planned (as in the case of stop losses) or not, we can no longer tolerate the drawdown and accept our outcome.

4) Conditions - whether forced by redemptions or by internal controls, across the board sales must be made even in our favorites.

5) New information - planned (such as earnings announcements) or not, the facts have changed and we act on the updated story.
Indicators can be used to minimize the risks associated with each of these factors except new information. Some details on Derek’s preferred indicators can be found in a posting called “Some Simple Trading Math” on his blog. His blog, at http://derekhernquist.com/, is used to archive his thoughts but Derek also hopes readers might speed their learning curve with his approach to common behavioral tendencies.

When asked what advice he has for anyone entering the business now, Derek stressed the importance of finding a mentor. This advice comes from personal experience. Derek spent time trying to learn about the markets on his own and now realizes that years of lessons could have been learned much more quickly had he not been forced to learn them all on his own.

He continues to study new techniques and is a newer adherent to Market Profile, so he enjoys discovering ways of interpreting volume data and time structure. Also fascinated by the work he’s seen tracking social media trends and real-time sentiment.

In the future, he thinks more fluid and comprehensive measures of market breadth could help investors more effectively avoid dangerous conditions.

Amber Hestla-Barnhart is an investment strategist specializing in options at profitabletrading.com. Her work has been featured in financial publications in the U.S. and Great Britain, including Technical Analysis of Stocks & Commodities, SFO, Shares magazine and Technically Speaking.
WRESTLING, MICHAEL JORDAN, AND LOSING TRADES
BY GLEN LARSON

Editor’s note: This article was originally published at Trade Ticker by Trade Navigator and is reprinted here with permission.

I recently attended a high school wrestling match to support a friend’s son. It brought back memories of when I used to wrestle in high school. I had all but forgotten a secret I had learned in wrestling that helped get me to state championships in both tennis and wrestling.

How could wrestling or tennis relate to trading? How do these relate to investing in losing, my trading, and my life? That is what I discuss this month.

Investing in Losing

I was invited to join the high school wrestling team my junior year. I had participated in football but not wrestling. Walking out in the one piece unitards was not my idea of fun. My coach kept telling me how much fun it would be and to, “give it a try.”

At first, all I could see and feel was a hard workout with guys, doing all kind of weird and impressive moves, to gain the upper hand on their opponents. I was reserved and not willing to lose. That was until my coach said, “Pretend like no one is watching you. Make a fool of yourself and try all the moves that come to mind. Be okay with losing. BE OKAY with losing ...”

That got me to thinking, “What the heck, I’ll wrestle and know it’s okay for me to lose.”

What a mind-freeing realization that was. I was now willing to wrestle the current state champ on our team, who consistently pinned me. That was okay, because I was seeing just how he did it and learning what I could do to improve. Everyone else on the team avoided being his wrestling partner because they knew they would get pinned. Since I was okay with getting beat by the state champ, I could volunteer to be his partner. Then, I would wrestle our heavy weight, who could easily toss me around like a doll. Again, it didn’t matter because I was doing my best and getting better even though I was losing.

When I entered my first wrestling meet, the opponent I wrestled was state ranked, very experienced, and I was admittedly, intimidated. At the whistle, we locked-up and began jockeying for position against one another. All of a sudden, he tried a move that our state champion had used on me in practice. After having that tried on me so many times, and getting pinned, I was able to counter the move and pulled off an upset. My coach looked and me and asked where I had learned that move. I mentioned it came from wrestling someone better than me. Getting pinned all those times had just paid off. I had been willing to invest in losing to get better. This approach took me to state championships my junior and senior years.
What I found interesting was that I carried that same attitude when I began playing tennis after the wrestling session. Once again, I would seek out a player who was better than I, to play against as often as I could. Sure enough, I would consistently get beat by the better player. However, when a great shot was made, or I was setup, I would go over the method used by the other player. The more I got beat, the better I became.

My reflexes in responding to the various conditions began to just feel right.

It wasn’t until I was watching my friend’s son wrestle that I was reminded of my approach … of being willing to invest in losing to get better.

I was thinking about the concept of investing in loss to get better and my mind quickly turned to trading and, in general, our lives. It seems we tend to avoid those conditions or circumstances where we would not look good in front of others. We worry too much about our image and, “what if I screw up,” more than considering what we could learn from the experience, regardless of the outcome.

We all want to avoid losing …

We all tend to want to avoid losing. Often, we will do everything we can to avoid losing that we miss the opportunity for growth. For example, my kids were complaining about quizzes their teachers gave during their classes. I asked them, “If they didn’t ever give you a test and never gave you a quiz, how well would you really learn the material?” And if they didn’t know that without studying they could fail tests and quizzes, would they learn the material as well? They conceded that they probably would not learn as well as they do with the quizzes and the knowledge that they will be tested.

So it is, with our trading, and in our lives. If we weren’t pushed or tested, if we didn’t experience failure or challenges, we wouldn’t progress. It is in experiencing the losses that we are helped and experience growth the fastest … if we allow it.

For example, in our trading we avoid certain types of trades because we are afraid of them. Perhaps we only take long trades and not short trades. Or maybe, only trade shorts and never trade long because when you do, you always take losses. We then begin to stay away from trading in all conditions. Why practice any trading, in any conditions? Sooner or later, you will get caught in a long or short position, so you need to know how to react and how you will trade these different conditions. To get that exposure, you have to be willing to invest in losing.

The irony is, it seems, that we do all we can to avoid losing. Since each loss comes at the expense of losing money, we obviously do all we can to not lose. After all, controlling losses is how you make money. But notice I didn’t say anything about not having any losses, I said, “controlling losses.”
Here is the part that fascinates me and other traders. We know we should take losses, we know we will have losses, but often we will make mistake upon mistake to avoid these losses.

For example, in NFL football, the great quarterbacks can throw an interception, go off the field, and they learn from that mistake. The great quarterbacks do not let that first interception throw them. They are able to come back on the field and continue, leaving the mistake behind them. The common quarterback is unable to let go of his first mistake and continues to make additional mistakes trying to compensate for his first interception. He allows his mistakes to compound.

That is how we need to approach trading. We need to be willing to get in and get after the trades. When a trade doesn’t work out, we need to review if a mistake was made or if the trade just didn’t work out. We shouldn’t add to an initial mistake or error by holding on just a little longer. Or worse, we shouldn’t compound the mistake by buying more positions so you average down or by moving your stops. Compounding our mistakes are the types of errors that will cost you.

The Path to Excellence Is Paved With Loss

I must reiterate, do not lose the value of any losses you may have had. The great chess player Josh Waitzkin, of whom the movie Searching for Bobby Fischer was based, always kept a journal of his matches. When he lost, he would go back, recreate the conditions at the critical moves, and determine what he was thinking; what he was feeling and why he made that choice. By going through this review process, he was able to gain from his losses. His investment in losses was paid back in being able to overcome similar challenges when they arose … just as I had, when overcoming a similar move in my first wrestling match.

Another example of investing in loss is Tiger Woods. Due to his poor performance in recent years, he has invested in deconstructing his complete swing in order to improve it. Has he had losses since he has been rebuilding? Most certainly, but he also is beginning to have a few more wins.

My challenge this month is that you be willing to invest in losses and make the most of them. Don’t just look at how much you lost and fail to review the conditions in your mind, emotions, and the market.
conditions. If you only trade in one direction, paper-trade both sides, also. Learn the long and short conditions and signals. Tear down your trading methods, like Tiger did his swing, if you need to improve your trading. Be willing to take those trades when your system signals to. Be willing to rebuild and invest in losses. If you find yourself unable to take your system trades, try trading the smallest units possible or simulate trading with paper trading. But whatever you do, DO something! Gain the most from your losses by learning from them, by-and-by reviewing these losses. Don’t let them slip by otherwise your losses are just losses with no value.

When you have made a mistake in life or in trading, stop and determine if your next actions are compounding your original mistake. If so, stop it!

"I've missed more than 9000 shots in my career. I've lost almost 300 games. 26 times, I've been trusted to take the game winning shot and missed. I've failed over and over and over again in my life. And that's why I succeed."

~ Michael Jordan ~

Remember, Michael Jordan was known as the best at taking last-second, winning shots. What he is not known for is having taken the most last-second losing shots, too. But he was willing to take the shot and invest in losing so he could improve his performance. What made him great was not his perfection, but his willingness to put himself out there. So it should be with our lives and our trading.

I urge you to take time to review your trades and review your actions in your everyday lives. If you are afraid of trying a new skill or worried about how you might look, or what people might think, go ahead and psychologically give yourself room to invest in loss. You might just be on the road to becoming a legend, yourself.

Glen Larson is President, Genesis Financial Technologies, the provider of advanced analysis and trading platform Trade Navigator. To read more from Glen, please visit his blog. Trade Navigator offers data from U.S., Canadian, Australian, Indian, Japanese, and European markets. They are offering MTA members the opportunity to try Trade Navigator with libraries that allow for finding Bradley siderographs, testing markets based on lunar cycles and adding other planetary indicators to charts.
CHART OF THE MONTH

CHART PROVIDED BY TRADE NAVIGATOR
MTAEF ANNOUNCES FALL 2013 FUNDRAISER ON NOV. 14TH – SAVE THE DATE

The MTA Educational Foundation is pleased to announce that a date has set for our Annual Fall Fundraiser! Join the MTAEF on Thursday, November 14th, 2013 at the Newman Library at Baruch College in New York City for an evening of cocktails and an exciting panel discussion, including a current market outlook. This year, we’re proud to feature the following speakers:

- ROBERT AX
  SEE FULL BIO
- ANDREW MCKNIGHT
  SEE FULL BIO
- JERRY PARKER
  SEE FULL BIO
- RUSSELL RHOADES
  SEE FULL BIO
- MIKE SANTOLI
  SEE FULL BIO

Registration will open soon! Visit MTAEF.org for more details.

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.