LETTER FROM THE EDITOR

*Technically Speaking* includes an interview with a practicing technical analyst almost every month. This month, we feature Amber Hestla-Barnhart’s exchange with Cynthia A. Kase, CMT, MFTA. Cynthia’s interview is striking for several reasons.

A standard question in each interview is “What advice would you have for someone starting in the business today?” The answers to this question are always interesting. This month, Cynthia provides a list of what every technician should consider as they strive for success. All readers, new and experienced analysts, should consider spending a few hours working through this list.

Cynthia lists 13 short pieces of advice in her answer. Each one of them is important. Technical analysts, and any other professional, will need to “be realistic about the “cost” of meeting your goals. Be prepared to “pay the price.” The other twelve items on the list are equally succinct but could require hours of thought to understand.

If you find these interviews and our other content to be valuable, or if you would like to be the subject of an interview, please email us at editor@mta.org to provide your thoughts.

Sincerely,

Michael Carr
For readers who are not familiar with the indicator, On Balance Volume (OBV) is designed to measure whether there is more buying or selling pressure in the market. It is a cumulative indicator, always adding the current day’s value to the previous value of the indicator. OBV is found by adding the total volume on days when the price closes higher and subtracting the total volume on down days. It can be calculated for major stock market indexes using the total volume for a stock exchange, for example charting the Dow Jones Industrial Average and calculating OBV with the total volume reported by the New York Stock Exchange. It can also be calculated for individual stocks using only the volume in that stock. Using a simplified example, we can consider a stock that closed up 1 point on volume of 10,000 shares. If OBV was 100,000 yesterday, we would add 10,000 to it and OBV would now be 110,000. If the stock closed down one point on that volume, OBV would fall to 90,000. Because the direction of OBV is used in the analysis, the price value of the indicator doesn’t matter. That means you can use any starting date and still have the same OBV line as any other trader. OBV is usually charted as a solid line under the price. When OBV is moving in the same direction as price, traders usually consider that to be confirmation of a healthy price trend. A declining OBV confirms a bear market and a rising OBV signals a healthy price advance is underway. Divergences between OBV and price can be used to predict reversals in price. If price is going up as OBV declines, traders expect prices to fall. In price declines while OBV is rising, traders look for a bottom in prices. Several examples of OBV are included in the Chart of the Month feature.

How On Balance Volume (OBV) came about is a story of multiple innovators, working independently, coming up with the same idea of relating volume to the direction of closing price by maintaining a cumulative total. The calculation was described in 1932 by Wall Street economist Paul Clay. In 1951, Frank Vignola and his wife Maude V. Woods, publishing in San Francisco, used OBV for stock trading. In 1948, Edward B. Gotthelf, a New York commodities trader, was using his “On-Balance Volume and Open Interest Method.” Until shown otherwise, we must believe these innovators did not know each other or of the others’ work. Joseph E. Granville claims that OBV came to him in 1961, but by then others had developed OBV.

On April 26, 1932, the American Statistical Association (ASA) held a dinner meeting in the Hotel Governor Clinton in Manhattan. The organization of statisticians, the ASA is the second oldest professional affiliation in the United States having been founded in 1839.

The topic for discussion was “Forecasting Methods Successfully Used Since 1928.” Four speakers were invited.

The second speaker was Paul Clay, whom the minutes recorded as being an investment counselor. The final presenter was James F. Hughes, who had worked alongside of Leonard P. Ayres (ASA’s President in 1926) to create the Advance-Decline Line.

Addressing the audience of 233 guests:
“Mr. Clay stated that he now felt that, in the past, he had underestimated the importance of the New York Stock Market itself in the industrial and financial affairs of the United States, and even of the world…. The movements of the stock market represent the net result of the industry of the United States and a considerable proportion of the rest of the civilized world. Because of this conclusion, Mr. Clay had been led to construct a new index similar, in general, to the Dow theory, but not based upon the Dow methods. This index number he calls a psycho-technical index. It contains five principal elements:

1. A volume index number made by giving the sign of the price movement to the daily volumes, and accumulating the plus and minus movements….

The psycho-technical index built out of these five elements looks much like a price chart with the false movements eliminated.

It has the very distinct merit of often moving contrary to the course of the market itself. This index is not used independently, but rather in conjunction with the economic indexes which formerly constituted the chief reliance of Mr. Clay.”

Clay used OBV as one element of an index rather than as an independent indicator. In spite of intense research, additional information about Clay’s index has not been found.

In 1951, M. V. Woods Market Analysis and Research published a report (authored and copyrighted by Frank Vignola) entitled *The Price-Curve Plan of Stock Market Trading with Countertrend Signal Analysis*. Vignola wrote that:

“Volume is the pressure gauge for measuring the balance between supply and demand, and for determining the quality of buying and selling in a stock or market Average…. VOLUME CAN BE ANALYZED TO BETTER ADVANTAGE when data is arranged in a time series or on a cumulative basis.” (emphasis in original)

Vignola used three series to analyze volume which he integrated with a 10-day moving aggregate of daily price changes in stocks or market indices called the “Price-Curve.” The first series was a 10-day moving total of aggregate volume called the “Aggregate Volume Curve.” Saturday’s volume was doubled to account for the short session. The second was a 30-day moving total of aggregate volume named the “Major Volume Curve.” These are time based series, but Vignola’s third series differentiated between buying and selling volume.

The third series was the “Continuous Volume Curve” which “is made by adding the total daily market volume of trading to a base index figure, each day the market advances; and by subtracting the volume on days when the market declines.” Saturday’s volume was not doubled in this series. Vignola suggested a base number of at least 50 or 100 million. He did not use the term “cumulative volume.”

According to Vignola, this curve:

“Is an auxiliary timing device used in connection with other technical condition indices. It is extremely sensitive to price movement, and will indicate the relative balance between buying and selling at the peaks and valleys of market trends.
MINOR FLUCTUATIONS OF THE CONTINUOUS VOLUME CURVE follow the daily trend of the Industrial Average, and it is often difficult to distinguish the difference between them. This does not hold true with intermediate and major trends. The main price trend will often precede or lag volume action. The Continuous Volume Curve is a key to the supply and demand equation. Interpretation of this curve is based on a knowledge of divergence, and the breaking of established trend-lines and previously established points of trend reversal.” (emphasis in original)

Vignola determined an up or down day by the number of issues advancing or declining each day, which he believed to be preferable because they represent the action of the entire market, not the price trend of a few stocks. However, he recommended that if “the number of issues traded [is] not available, use the closing price of the Dow-Jones Industrial Average.” Vignola’s daily OBV was based on the direction of price or the DJIA, but he maintained a weekly Continuous Volume Curve based on weekly advances and declines.

**CHART 1 Continuous Volume Curve, April - August 1949**

Chart 1 shows the Dow Jones Industrials, a Continuous Volume Curve, and several trend lines. For simplicity, he omitted the last three digits of volume.

According to Vignola, the Continuous Volume Curve confirms an indication of strength (weakness) in a Price-Curve and an Aggregate Volume Curve. The Continuous Volume Curve gives a buy (sell) signal when it breaks above (below) one of its intermediate or major trend lines confirming the strength or weakness shown in the other two curves. All three curves have to trend in unison for a buy or sell signal to be given.
Edward B. Gotthelf (1908 - 1985) was an upstairs commodities trader from 1935 through 1945. In 1950, he became a member of the New York Mercantile Exchange and Chicago Mercantile Exchange. Later he acquired the basic COMMODEX® system, “one of the first futures trading systems when it was inaugurated in the 1950s.” Both father and son Philip refined COMMODEX®.

According to Philip, his father “developed a relatively simple method of measuring accumulation,” which Edward Gotthelf called “the On-Balance Volume and Open Interest Method.” Edward Gotthelf’s “notes reveal the development of this term as far back as 1948.”

Gotthelf assigned a “+” to the price for the day when price closed above the previous day’s level. If volume increased on the same day, the volume component received a “+.” A rise in open interest from the previous day was assigned a “+.” However, if price moved up, and volume moved down, the day’s volume was assigned a “-.” When price and volume moved down, volume was assigned a “+.”

Figure [3] recreates a worksheet.
Over time, the net plus and minus days would be counted. If on balance net pluses outnumbered net minuses, Gotthelf would be a buyer. If minuses exceeded pluses, he would sell. If net pluses and minuses were about even, he would stay neutral. Trading tactics were developed based on observations of the on balance plus and minus series.

Gotthelf believed his OBV method detected accumulation (open interest and volume rise) and distribution (the reverse) which led to overbought or oversold markets. Overextended markets, notably those following a long period of accumulation, could experience dramatic corrections which in turn gave buy and sell signals.

While Granville popularized OBV, Paul Clay and clearly, Frank Vignola and Maude Vignola Woods, had earlier originated OBV, while Edward B. Gotthelf used the term. Volume was uniquely important to the analytical work of Granville’s predecessors. They believed volume could presage the direction of price, and a cumulative count was a valid way to analyze buying and selling volume. All were intelligent observers of volume in stock and futures markets who merit recognition.

The full paper can be found at http://go.mta.org/8552.

About the Author

George A. Schade, Jr., CMT, is an accomplished market historian. He received his undergraduate degree from Stanford University (1968), and his law degree from The American University, Washington, D.C. (1971). George was previously sworn in as Special Master for the Arizona General Stream Adjudication in the Superior Court by Supreme Court Chief Justice Thomas Zlaket on April 3, 2001.
I was invited to write about the beginnings of the Charles H. Dow Award. This article looks back at the first five years of what is today a preeminent honor for market technicians. As the Associate Editor of the then Market Technicians Association Journal, I became involved in late 1993 in the dream that led to the Award.

The seminal idea was recognizing the best article on technical analysis that breaks new ground and/or best expounds the principles of technical analysis in the tradition of Charles H. Dow. The Award’s name was easy. Charles H. Dow (1851-1902) is considered to be the father of modern technical analysis.

The idea of an award was spawned in the Technical Analysis Group of Dow Jones Telerate, then a subsidiary of Dow Jones & Company. James Pilgrim of Dow Jones Telerate brought the idea to the MTA. Pilgrim saw an opportunity for personal and MTA recognition by a large audience of sophisticated market professionals and a medium to expound upon, illuminate, and clarify the significance or relevance of technical analysis to the markets and the financial community.

The late Mike Epstein was the MTA’s President. His and Pilgrim’s dynamic collaborative leadership made the Award a reality. All the Presidents immediately thereafter, Philip Erlanger, CMT, Philip J. Roth, CMT, and Paul F. Desmond strongly supported the Award.

Jim Pilgrim worked with MTA member James Stewart, Jr., CMT, who was on the Board of Directors representing the newly formed MTA Educational Foundation. In 1993, Pilgrim and Stewart drafted guidelines for the first Award.

The objectives were to foster and recognize originality, assure practical application of the published work, and facilitate its wide use. The original core guidelines were the following:

1. The work may be either original or a significant extension of a previously known work.
2. Practical application of the work is desired, as is the strength and clarity of the writing.
3. It is desirable that the subject matter should be of general interest, not limited to one market, a specialized indicator, or an arcane subject.
4. Articles that have previously been commercially published are not eligible.

These guidelines have remained in effect. From 1994 to 1999, I chaired the annual drafting of guidelines. A requirement that has remained all these years has been a limit of around 4,000 words. Guidelines were adopted to assure that recipients would appropriately publicize the Award for their professional benefit, and decisions of the panel of judges are final without recourse to Barron’s, Dow Jones Telerate, or the MTA. As word processing and graphics software advanced, the guidelines accommodated the changes. A cash prize came many years later.

The judging for the first Award was done by the editorial staff of Barron’s and the Editor of the MTA Journal. Thereafter, Dow Jones Telerate participated in the judging. Hank Pruden, Editor of the MTA Journal, chaired the first two Charles H. Dow Award Committees. I chaired the 1996 - 1999 committees. The committee has never participated in judging.
Figure 1 shows the initial announcement sent to the membership. Charles D. Kirkpatrick II, CMT won the first Charles H. Dow Award for his paper Charles Dow Looks at the Long Wave. The paper suggested how Dow would have analyzed the “long wave” that occurs every 40 to 60 years using the business cycle interest rates. Kirkpatrick is the only author who has received the Award twice, in 1993 and 2001.

The honor accorded by the early Awards was the professional recognition and gratitude of the community of market technicians. It began for the recipients with their prime time presentations at the annual conference. Dow Jones Telerate printed copies of the paper for distribution at the conference.

However, the first two Awards were unique in that the winning papers were published in a supplement of Barron’s which had offered to publish the winning paper. Barron’s published Kirkpatrick’s paper in its June 27, 1994 issue.

The late William X. Scheinman won the Award in 1995 for his paper Information, Time, and Risk based on the core theories of Charles H. Dow and prolific technician Edson B. Gould, Jr. Barron’s wanted financial support to publish a supplement. After much discussion, Barron’s published a condensed version of the paper.

Having met Scheinman when we dealt with Barron’s over publication, I contacted his son after Scheinman passed away in May 1999. Arrangements were made for the donation of many of Scheinman’s papers. The collection was the first substantial donation of personal and historical materials to the MTA. It survived 9/11.
Timothy W. Hayes, CMT won the 1996 Award for his paper *The Quantification Predicament*. Hayes expanded upon his paper in writing his first book, *The Research Driven Investor* (2002). *Barron’s* did not publish the paper but announced Tim’s Award. See Figure 2.

The Award was not given in 1997 because the judges did not believe the submissions presented the desired quality and substance. This was the first, but not the only, year the Award has been vacant.

In 1998, Christopher L. Carolan’s *Autumn Panics: A Calendar Phenomenon* was honored. It was the first winning paper that dealt with an enticing subject - lunar calendars and financial markets. The paper exemplified the objective of recognizing originality. *Barron’s* announced the Award. See Figure 3.
Eric Bjorgen and Steven C. Leuthold received the 1999 Award for their paper *Corporate Insiders’ Big Block Transactions*. The paper analyzed market data used to gauge “smart money’s” sentiment, a subject of great interest.

The Charles H. Dow Award has honored a diverse group of authors and rich themes. It has increased our body of knowledge and expanded the boundaries of technical analysis.

The following made it possible: Jim Pilgrim and Stephen Cox of Dow Jones Telerate; Robert R. Paradise, Richard Rescigno, Gene Epstein, and Jacqueline Doherty of *Barron’s*; Gibbons Burke; Mike Epstein, James Stewart, Jr., Hank Pruden, Phil Erlanger, Phil Roth, Paul Desmond, and Jim Bianco of the MTA.
How would you describe your job?

Well I wouldn’t really ask the question that way. I would ask, “What do you do professionally?”

I don’t really think of myself as having a job, per se, as I have owned and operated my own business, Kase and Company, Inc., since 1992. The company has two foci. One is providing hedging and trading advisory services and software solutions to the corporate and institutional energy sector. In that context we publish two weekly newsletters, one on WTI and Brent, and another on natural gas, NG. In addition we have energy sector hedging services that include quarterly risk management studies and software products delivered via web. One is called the Kase HedgeModel and the other Kase ezHedge. So, I direct, review and edit the forecasts involved with these services, and I still do the hedging recommendation write ups myself. Dean Rogers who’s an MTA member manages the day-to-day functions. Dean also writes the newsletters. We also do custom consulting and expert legal witness work in the energy trading and hedging sector, in which I am usually not only directly but principally engaged.

The other focus of the business is technical analysis indicator/algorithm development and related products. Our Kase StatWare is carried by many charting platforms, including Bloomberg, eSignal, CQG, etc. I spent the better part of 2013 developing a new product that was launched as KaseX on Bloomberg. So the actual algorithm design and tweaking, I do myself, and Dean oversees the programming.

I also write educational articles, design classes and the like. I write a Tech Brief for Bloomberg every other week or so. I’m currently working on a 13-part video series and workbook for a major educational publisher.

Much of what I do is run the business. My first priority is making sure we stay in business – that means ensuring we have a steady stream of new business. A key challenge is that now that Kase has been in business so long, many of my long time contacts are retiring.

Running the business also involves coordinating with Dean and his staff, developing marketing strategy, deal making – directly with clients as well as with third-party and other cooperative ventures, and overseeing the mundane aspects of business, accounts payable and receivable, writing contracts, setting priorities, dealing with insurance, taxes, and that sort of thing.

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

As an algorithm developer, I deal with all markets. As a trading and hedging advisor, I specialize in energy. I have a BS and ME in Chemical Engineering, and worked for 10 years as an engineer, starting in 1973. I joined Standard Oil Company of California (now Chevron after the merger with Gulf) in 1980, working in the corporate engineering department, and three years later, as part of their management development program, was transferred into Chevron
International's oil trading group. That was the same year that crude oil futures began to trade, and in which we saw PCs leave “test” rooms and arrive in offices. My department had one PC with two floppy drives. I think it was an 8086. I was transferred to NYC in late 1985 where I traded international physical cargoes, first of crude for a while, then clean products. My territory was (more or less) the western half of the western hemisphere and Trans-Atlantic, plus Chile.

At the end of the decade I went to work for Chemical Bank as their first commodity derivatives trader, and then consulted with the Saudis after that. When I started Kase and Company, Inc., being independent was a key goal, and, with my background in energy, that specialty was a natural fit.

So that’s why I have always specialized in energy, and more broadly in futures, as opposed to equities.

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

No.

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

1. Set goals. Describe what sort of life and work you want now and in the future.
2. Be realistic about the “cost” of meeting your goals. Be prepared to “pay the price”.
3. Convince those around you, especially family and friends to be supportive of your goals.
4. Stay healthy.
5. Being smart is not enough. Time and effort are the differentiators.
7. Study. Carry a book, magazine or tablet with you at all times.
8. Choose a path that emphasizes your strengths, and suits your personality.
9. Seek a mentor.
10. Strive for excellence, not perfection.
11. Hone your communication skills.
12. Be ethical and honest.
13. Persevere.

How did being oriented towards commodities influence your trading style, your work as an analyst/forecaster and your algorithm development?

As an oil and refined products trader, and energy futures trader (and I this is true for those who trade sugar, or wheat, for example, as well) I have never focused on stock picking or building and managing a portfolio. I’ve never done sector analysis, or looked at relative strength. My emphasis was on trading one or two instruments at a time, well. A gasoline trader, for example, doesn’t have the luxury of choosing to trade soybeans or lumber if the gasoline market isn’t trending or is otherwise difficult.

So my focus has always been on market timing and trade risk management. This is why I developed my trading algorithms, Kase StatWare and now KaseX and Kase Private Label. The key is that when one is trading a portfolio, diversification helps reduce risk. If you have 100 trades in place on a given day, and you cut losses and let profits run,
your odds of having a winning day are better than if you trade one instrument using the same system that day. So a one thing at a time trader needs to be more precise, and monitor risks much more closely.

Another difference is that I have always been a trader or trading advisor, not an investment advisor. My time horizons have always been short term. Most of the market participants in the energy industry tend to rely on fundamental advice for long term decisions. Technicals are good for surviving the short term in order to be around for the long term. So when I say "short term", I don’t mean day trading per se, but holding trades from three to five days, to perhaps a few weeks. The challenge is for single instrument traders that normal market fluctuations on a daily chart are often too large to tolerate, and at the level of a daily chart, if the market isn’t trending, it’s too tough to trade without dropping down to intraday.

Because my focus has always been using intraday – meaning bar lengths of less than a day – I have been interested more than portfolio managers would be in different bar types. That’s why I developed my Universal Bars back in the I at ‘80s, now known as Kase Bars. Also, for a long time now, energy and many other futures markets have become, more or less, 24 hour markets. This has made bar types that adjusts for slow overnight periods followed by a burst of activity when the day session opens increasingly important.

Having to deal with a particular market under all conditions, trending, choppy, erratic, volatile, increases the importance of developing detailed expectations of future market behavior. So, forecasting becomes an important element of trading strategy. That’s why my firm has published weekly forecasts on crude and natural gas since early 1993. Also, I’ve never known a professional energy trader to use an automated, black box system. Traders are expected to be flexible relative to their firms’ fluctuating needs and goals, and to use their judgment in developing their strategy. This often comes as a surprise to retail traders – but – if a firm used automated systems, they wouldn’t need traders, after all. Another reason is that diversification, often necessary for the success of a black box system, isn’t available to single market traders.

Technically, volume doesn’t play much of a part. That’s because, as a futures contract becomes more prompt, it becomes more active. There might be lower and higher volume days, sure, but overall, the time to expiration overwhelms any volume considerations.

**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)?**

A relatively new field has to do with how data is presented. I mentioned Kase Bars earlier, equal True Range bars. I would like to work on developing 3D charts. Let’s say you were to cut a tube in half, and plot, say, 60 minute bars on the inside of the tube, you could make all the bars appearance the same height by increasing or decreasing the radius of the tube. I actually wrote a paper back in the ‘80s on this idea, and maybe now technology is catching up enough to do this. You could get a read-out of the radius or even display a virtual plot of the tube. Another thing I think would be great is to integrate sophisticated forecasting techniques into everyday trading tools.

I also would like to do some statistical work on wave formations and retracements, such as how often one sees a complex versus a simple correction. How often corrections are, say 62 percent versus 89 percent, and the percent of the time waves extend to various Fibonacci projections. We’ve done a lot of work on this in the past, but pure research always comes behind programming for business.
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In the July 24 issue of *Bloomberg Brief Technical Strategies*, Bloomberg’s analysts detailed developing chart patterns could have in two important markets.

In *Nasdaq Composite Index Showing Larger-Than-Normal Bearish Divergence*, Paul Ciana, CMT wrote:

“Fewer components within the Nasdaq Composite are participating as the index advances to new highs, a possible signal of a larger-than-normal correction. The index is also showing a lack of participation when compared to the prior two-year trend.

[Below] is a two-year daily chart with three simple moving average periods of 50-, 100- and 200-days. Below that is the Cumulative Advance Decline Line (ADL) for the index's constituents. Arrows pinpoint recent times when new price highs were not confirmed by the ADL. Two small divergences occurred in March and July 2013. They produced small corrections in line with the small signal.”

Ciana concludes, “A short-term range may be forming. A break above 4,486 would violate the potential range and suggest the trend continues. A break below 4,350 would suggest a short-term price target of 4,210. Given the short-term price
action as it pertains to the longer-term trend, the ADL needs to stay above the May low to retain any bullish credibility. If it breaks lower, the warning of a correction will only get stronger as the rally becomes more dependent on large caps."

In *Natural Gas Shows Classic Triple Top Pattern, Suggesting Lower Prices*, Cynthia Kase, CMT, MFTA, provides important advice for analysts of all skill levels:

“One of my trading maxims is “start with the chart.” Before the advent of personal computers or even calculators, technical analysts were often called “chartists.” Technical studies can enhance one’s understanding of market behavior, but it’s always a good idea to start with bare charts. Many traders, having learned technical analysis in this computer age, always look at charts “dressed up” with studies.”

Kase then demonstrates how to follow her advice:

“The chart [below] is a recent September 2014 natural gas daily bar chart, showing a classic or “textbook example” triple top. Not only is approximately the same price reached on three consecutive highs (prices are within $0.03 of one another), but the support line is also within the same tolerance.

Triple tops are reversal patterns and can be used to project lower targets. Take the difference from resistance ($4.856) to support ($4.275), or $0.581, and project down from support, and the result is $4.275 - $0.581, or $3.694. In addition, the $3.913 low formed support, and was followed by a breakaway gap. The top of the down gap of July 21, 2014 was $3.91. The gap and close below this level confirmed a bearish tone. If we assume it’s a midpoint gap, this gives another method with which to estimate a downside target. Take the difference between the most recent swing high from July 14 of $4.159 and the top of the gap, $3.938, and that’s $0.221. Deducting $0.221 from the bottom of the gap yields $3.689, just $0.005 from the triple top target.”

Kase details an additional technique, wave projections, to develop a price target of $3.687, “just $0.002 below the midpoint gap target.” She concludes by explaining the importance of multiple targets on a chart:
“A price determined by three different calculations is called “confluent” and forms a “confluence point.” In this case, 3 that price is about $3.69, and if September fails to meet it, the phenomenon would be just that – a failure. So the expectation is for $3.69, and if it’s not met, the bounce and/or recovery will likely be more significant than if it had taken place after meeting the target.”

For more on Kase’s work, including weekly forecasts on crude oil and natural gas, Bloomberg users can see KASE<GO>. This issue of Technically Speaking also includes more on her work.
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Fundamental data can be charted and analyzed. The chart below illustrates this point. The price-to-earnings (P/E) ratios of the stocks in the Venn Circle Sacred Stock Index are shown. P/E ratios are calculated using forward earnings for fiscal year (FY) 2015 for each company. The multiples for each of the 13 stocks co-exist in the US Stock Market Venn Circles.

The average forward price-to-earnings (P/E) ratio, as of July 30 2014, is approximately 16.

Federal Reserve Chair Janet Yellen considers the valuations of biotech stocks to be stretched (see her July 15, 2014 testimony to Congress). Perhaps so, but for four biotech stocks in the Venn Circles, the average forward P/E ratio is just over 15, in line with the broad market. The three Dow Jones stocks inside the VENN circle have an average FY2015 forward multiple of 13.5. If any stocks inside the Venn Circles are overvalued relative to the broad market it is the stocks in the Social Media and Internet ETFs.

Apple is trading at 14 times FY2015 estimated earnings. It is the only stock on this list that does not find itself inside a Venn Circle. Apple is included because of its overall importance to the Nasdaq by virtue of its 11% weighting in that index.

I have framed these 13 stocks as being "sacred stocks /cows" because of their relative importance to the Nasdaq and the Venn circles in which they reside. These are all high quality, widely recognized names. Generally, all have strong earnings and revenue growth rates (except for the Dow stocks) and positive forward-looking outlooks. When the broad stock market corrects in 2014, investors should consider adding these companies to their portfolios for 2015-2016.
Once we have identified the 13 sacred stocks in the Venn Circles with the Nasdaq as the nexus, we can then construct an index from this basket of stocks that we can chart and analyze with standard technical tools.

Based on swing theory, a bull trend is defined as a market or index that is making higher highs and higher lows. The January 31, 2014 low was broken in April-May of this year. By definition, that broke the bull trend. Thus, the subsequent rally may be a secondary or lower high that exhausted on July 23, 2014 after Apple reported earnings. To confirm the suspicion, the Venn Circle Sacred Stock index must close below the July 17 swing low near 3025 and below the quarterly moving average and the mean of the linear regression channel from June 1, 2012 that are now both sloping into 2993.

Bear markets are defined as corrections of 20% or more. Overlaying an ABC Elliott wave count, the May 8 low is Wave A, the July 23 high is Wave B. If the Wave B high is confirmed and a Wave C unfolds that is fairly symmetrical to Wave A, the Venn Circle of Sacred Stocks will experience roughly a 20% decline. That would take Venn Circle Sacred Stock Index back to the November 7, 2013 low at 2608. Between now and early November, the 2nd standard of deviation of the linear regression channel will be supportive of the November 7, 2013 low.

If the Wave B high is confirmed and a Wave C unfolds, the November 7, 2013 low should be the terminal point to a Wave C Correction off the March 4, 2014 high this fall. By charting the Venn Circle Sacred Stock Index in this way, we should have a fairly good approximation of how deep the broad stock market correction for the Nasdaq and other indexes may be before significant support may be found. This correction could be about 20%. 

AUGUST 2014
Stock market declines of 20% are common when exogenous shocks occur, e.g., Long Term Capital Management in July - October 1998; the oil embargo from October to December 1973; and Nixon’s potential impeachment from July to October 1974. As the conflicts in Gaza, Ukraine and the rest of the world escalate in July 2014, the U.S. stock markets could be on the precipice of an exogenous shock that precipitates a 20% market decline.

About the Author

Piper Jaffray Technical Research
Defining the Trend in Technical Analysis

Piper Jaffray Technical Research studies the market through the use of its proprietary MicroGroup charts and intermarket analysis for the purpose of forecasting future price trends in the broader market and individual equities. Through a disciplined study of price action via charts, the Piper Jaffray Technical Research team identifies emerging trends and themes as well as key support and resistance levels in the market.

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What information does a trader really need? There are a number of ways to answer this question but most readers will find many of the answers to be inadequate. For some, the answer will be that a trader just needs a chart and a current quote. For others, the answer will involve various indicators or wave counts. The truth is that in the modern markets, it often takes more than a chart and a current price quote to succeed. In the past few decades, a number of new stock and derivative markets have been developed around the world and a number of older markets have become increasingly important. At the same time, all of these markets have become increasingly connected to each other. The pace of trading activity in these markets has also become increasingly fast. For example, a GDP report from India can now affect U.S. stocks but just a few years ago, most traders beyond India would not have even had access to the report. In today’s markets, a significant news event, and at times insignificant events that are interpreted quickly, can move prices a couple of percent within a couple of seconds. The question is, “do traders need this information?”

In Global Macro Trading, Greg Gliner tackles this question and explains what a trader needs to know in order to succeed in rapidly evolving markets. If we think of Edwards and Magee’s Technical Analysis of Stock Trends as the introductory course for trading, Gliner has written a book that would be used in a master’s level course.

Global macro trading strategies have traditionally been the realm of hedge funds. George Soros famously made $1 billion in one day with a global macro trade against the British pound. Gilder recounts that episode and walks traders through a process they can use to complete a similar analysis today.

Part of what makes this book unique is the step-by-step instructions on what information global macro traders need to trade. Catching big trends requires much more than a chart and a quote – traders need to understand global economic trends, or to use the most current buzzwords, traders need to understand central bank macroprudential policies.

Recently, Mohamed El-Erian the former investment manager of Harvard’s endowment fund and then the second-highest ranking executive at the $1.97 trillion asset management firm Pimco, wrote in the Financial Times that, “In a perfect world, investors would turn to economists for predictions on two key issues supporting equity prices at current valuations: productivity trends and the effectiveness of macroprudential policies.” It is far from a perfect world and investors need to develop their own understanding of both productivity trends and the effectiveness of central bank policies because the economy does drive stock market prices.

El-Erian’s statement shows that markets and economic thinking are always changing. The term “macroprudential policies” doesn’t seem to have existed prior to 2013 according to Google Trends.
The broader term macro-prudential seems to have grown out of the financial crisis.

The word may not have existed until recently but the concept has been important to global macro traders for decades. Soros' British pound trade was a bet against the effectiveness of the Bank of England's macro-prudential policies.

In addition to spawning new central bank policies and new ways to describe those policies, the financial crisis of 2008 also allowed some global macro traders to make multibillion dollar profits as markets crashed. Could individual traders duplicate their success? Probably not in 2008 but there are more specialized ETFs available now and it is possible for
individuals to participate in an increasing number of global markets. There are inverse funds and leveraged ETFs that allow for returns that beat the market when they pay off. These developments - the increasing interconnectedness of markets, the importance of economic policy to markets, and the introduction of new trading vehicles - make Global Macro Trading a timely book.

This book is also timeless because it explains the ideas behind global macro trading. To start with there is a definition of the term. Global macro trading is a strategy that is flexible and opportunistic, intended to trade the best market at the best time. Equities, currencies, fixed income products and commodities can be traded with a systemic or discretionary approach.

Each of the different trading products and an overview of the possible strategies are explained in different sections of the book. Techniques that contribute to trading success are also explained.

Position sizing is one of the most important aspects of trading especially when leveraged and diverse assets are being traded. Interestingly and significantly, Global Macro Trading addresses position sizing before covering how to trade. The section on position sizing is followed by a discussion of risk management. The decision to place those topics before the sections on how to determine what to buy and sell seems to be deliberate. Leverage increases risk and the expected volatility of a position needs to be understood before an order is placed. Diverse assets like stocks and currencies can in fact be highly correlated, especially in bear markets, and leveraged positions in highly correlated assets increases risk.

An overview of trading system development, the basics of back testing and the foundations of technical analysis are also provided. Many books include a short section on technical analysis. Global Macro Trading goes beyond the typical listing of chart patterns and indicators and includes open interest and Commitment of Traders (COT) data for futures. These indicators offer unique insights into markets and are rarely covered in detail.

After understanding the basics of trading, global macro traders then need to turn their attention to data. There are thousands of data series a trader could consider. At the most basic level, all data is related to either the economic conditions of a country or supply and demand factors affecting a market. Each type of data is explained and sources to find the most important data are provided.

This section of the book is almost like looking over the author’s shoulder as he pulls data from his Bloomberg terminal. That is a unique opportunity – Greg Gliner worked at AQR Capital Management, Tudor Investment Corporation, BNP Paribas, Citigroup’s Financial Institution Group and Thracian Capital, a hedge fund seeded by Man Capital PLC/GLG. Those are some of the largest and most successful organizations involved in global macro trading. In this book, Greg virtually takes you to his trading desk and walks through the data he follows. This can help the new trader cut through the noise of extraneous data and focus on what’s important. Experienced traders will benefit from insights into what other traders think is important and in the markets, news that a large fund follows could be market moving.

Finally, Global Macro Trading is a reference book. Among the diverse reference material provided, the history of quantitative easing by major central banks is provided along with data on metal production by country. Global grain planting seasons are shown on a calendar to help explain when these markets can move. There is much more data in the
book and again it is like looking over the shoulder of a hedge fund trader. This is the information that large firms access when making trading decisions and it is now compiled into a single source.

In *Global Macro Trading*, traders will find the information they need to make buy and sell decisions.

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**About the Author**

Greg Gliner most recently worked at AQR Capital Management on the Global Asset Allocation team and as an analyst at Tudor Investment Corporation, a global macro hedge fund focusing on discretionary macro in equities, commodities, foreign exchange, and fixed income. Prior to this, he was with Thracian Capital (a hedge fund seeded by Man Group PLC/GLG), where he was a Portfolio Manager. Greg also worked at BNP Paribas in their equity derivatives business and was also with Citigroup's Financial Institution Group in investment banking where he was involved in various M&A, equity, and debt transactions. He holds MBAs from Columbia Business School and London Business School, and has a BS and BA from Miami University (OH) in finance and history. Greg pledges all personal profits from the sale of this book to charity.
The title of this book, *Trading Options Using Technical Analysis to Design Winning Trading Trades*, summarizes the book. This is a comprehensive look at what options are and how these trading instruments can be traded. This is a unique work because it provides basic knowledge about the subject along with detailed strategies that can be applied in the markets.

*Trading Options* includes a general overview of technical analysis, options and options strategies. These sections are all comprehensive and useful. The book also includes sections on how to design a trade and how to develop and implement a trading plan based on that design.

Options trading is a topic that is widely written about but it is usually addressed in general terms. Greg goes beyond that model of writing and provides specific examples of how to implement different options strategies. The examples use actual stocks rather than notional symbols and contracts. *Trading Options* is a complete course in trading.

When designing a trade, Greg emphasizes the concepts of a Driver, Funding, and Risk limiter. The Driver is the specific call or put option that you want to be long or short. After identifying the Driver, the next step is to identify the option or combination of options that will be used to reduce the cost of the trade and provide sufficient leverage. The Funding options will pay for the trade. The Risk Limiter is an option that can be used to cut down on the risk of the trade.

An example, taken from a recent recommendation Greg posted at DragonFlyCap.com on July 14th, 2014 can illustrate the concepts. Every week, Greg posts his top trade ideas, in a format similar to trading plan he explains in Trading Options. This trade idea was selected for reprinting here because it included a specific options strategy. This allowed for an assessment of how the trade worked and the follow up is included below.

Visa, $V$, is pressing up against resistance since the beginning of April at 217. It is finding support at the 100 day SMA since the last jump up making for a higher low. The RSI is bullish and strong and the MACD is rising, both supporting the
upside. A push through the resistance region carries a target to 236 to 237. There is very large Open Interest this week at the 220 Strike on the Call side. The company reports earnings July 24th.

- Trade Idea 1: Buy the stock on a move over 217 with a stop at 212.
- Trade Idea 2: Buy the July 25 Expiry 217.5 Calls (offered at $3.60 late Friday) on the same trigger.
- Trade Idea 3: Buy the July 25 Expiry 217.5/July 220 Call Diagonal ($2.86) on the same trigger.
- Trade Idea 4: Buy the July 217.5/220 Call Spread (94 cents) on the same trigger.
- Trade Idea 5: Buy the July 217.5/220 1×2 Call Spread (20 cents) on the same trigger.

Follow up (prepared by the editor):

The buy signal was triggered on July 14, the day of the post when V opened at $218.75.

The July 25 $217.50 call was trading at about $4.60 at that time. As the chart shows, V continued moving higher and closed at $220.22 at the end of the week. The call ended the week at about $5.03, a 9.3% in five trading days for Trade Idea 2. The other trade ideas also provided profits.

About the Author

Greg Harmon, CMT, CFA, founded Dragonfly Capital Management, LLC to provide daily technical analysis of securities markets and consulting services to the marketplace. He is also a Founding Partner and CIO of Presidium Capital Management, an asset management firm investing for clients in separate accounts. Prior to that, he spent time trading in the Securities markets beginning in 1986. He has held senior positions including Head of Global Trading, Head of Product Development, Head of Strategy, and Director of Equity and Portfolio Swaps Trading at Chase Manhattan, State Street Corporation, and BNP Paribas. Greg earned an MBA in Finance from NYU Stern School of Business, and a BS in Mechanical Engineering from Cornell University.
Let me begin by saying if there are any readers out there who are considering starting a chapter in their area; do it! The MTA is greatly supportive of its members who are willing to put in the time and effort to start their own chapter.

To start, I’d like to give a bit of background on our chapter in Charleston, South Carolina. Back in the summer of 2013 myself, along with Marc Johnson, and Bryant Clayton, began designs on bringing the practice of technical analysis to the Charleston area. In our collective experience, we felt that we had not encountered very many technical practitioners in our area, and felt that we had an opportunity to change that. Together, with the support of the MTA, we formed the Charleston chapter and began hosting meetings in November 2013. Our meetings usually begin with a brief presentation about various technical analysis topics (Ichimoku Cloud, Elliot wave, market breadth etc.) and aim to educate attendees on unique topics of technical analysis. These presentations are conducted by any one of the founding members.

One of the main goals with which we founded this chapter was the idea that our meetings would be open to the general public and professionals alike. We felt that in order to develop the practice of technical analysis in the area, we had to reach out to those with an interest in technical analysis, not just those who had investing credentials.

Another one of our intended objectives that we carry into each of our meetings is the notion that we should be providing *ways to achieve actionable information*, through a thorough understanding of any overlays, oscillators or indicators that we may be discussing that evening. I had visited several out-of-state chapter meetings prior to the formation of the Charleston chapter, and found this to be an overriding theme to all of them. It is not our aim as chapter officials to be dispensing what securities our attendees should be buying or selling; instead our intention is to give our participants knowledge of that meeting’s subject so that they can make their own informed decisions.

After the presentation of that evening’s topic, we informally ask what is on everyone’s mind in reference to the markets. At the most recent meeting the topic of a near universal occurrence of downside gaps in the oil refiners was brought up. Various charts were displayed with a projector and annotated in various ways to facilitate discussion as to the cause of the drop and possible strategies moving forward. Typically some effort was put into relating a particular chart back to the presentation of the evening in an effort to create a sense that what was discussed earlier can be used in an effective manner.

At our most recent meeting, I highlighted the work of Hamilton Bolton. Those of you with a sharp memory of Martin Pring’s *Technical Analysis Explained* book will recall him as an analyst who took it upon himself to adjust the way he measured an advance/decline line. I won’t go into specifics for the sake of brevity, but the point that I derived from mentioning his name was the fact that he adjusted an established way of measuring market breadth and the result was an advancement in the field of technical analysis. I find this to be a fascinating aspect to our craft. While adhering to the third Standard of the MTA’s *Code of Ethics*, any technician can contribute to this international organization.

Since the start of our chapter meetings, we have achieved an increased attendance rate at every interval. I believe this reflects the hard work that our chapter officials have put into effectively marketing our chapter and generating interest in
both the retail and professional sectors. Where there was previously no organized group of technical analysts and interested parties in the area, we have funneled our passion for technical analysis into something that is trending upward and will continue to do so in the future.

About the Author
Trent Derrick is an Accounts Manager with Legacy Wealth Management in Charleston, South Carolina. Legacy Wealth Management is a Financial Consulting Firm, offering the experience and advice of Investment Professionals to help individuals understand the opportunities and potential rewards available from a proactive approach to their personal financial situation.
On Balance Volume (OBV) is charted for ETFs tracking several major market indexes from around the world. These charts were created at Stockcharts.com.

**SPDR S&P 500 ETF (NYSE: SPY)**

**iShares Russell 2000 (NYSE: IWM)**

**iShares United Kingdom (NYSE: EWU)**