LETTER FROM THE EDITOR

In 1994, the MTA recognized Don Worden’s achievements with the MTA Annual Award. This award recognizes lifelong outstanding contribution to the development and widespread acceptance of technical analysis by institutional practitioners and individual investors. Don Worden truly did spend his lifetime making technical analysis accessible to institutions and individuals.

Sadly, Don passed away on May 31, 2014 at the age of 82. He was born before technical analysis was a formal field of study. His work from the 1950’s has led to a number of advances in technical analysis. He was a pioneer in the analysis of volume and his thoughts on how to interpret volume evolved as the markets changed. That might be Don’s greatest contribution to technical analysis – his ability to think about the markets as they are and to change his approach when the markets changed. Too many analysts impose rigid beliefs on the market and apply indicators with strict rules, ignoring changes in the market environment and risking losses as those changes render indicators less effective. In “Tape Reading in the Sleepy Fifties” we have Don’s own words to tell us how and why his thinking changed over a 40-year period. When an indicator stopped working, he explains, he sought to understand why and then built on his previous work.

In honor of Don’s contributions, we are also featuring the work of another pioneer in volume analysis, Buff Dormeier, CMT. Buff has quantified a unique approach to volume analysis and his work deserves a place next to Don Worden’s.

In future issues, we hope to continue demonstrating how thought leaders in technical analysis think about their work. If you would like more details on a particular technician’s work, please send your suggestions to editor@mta.org.

Sincerely,

Michael Carr

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Don Worden founded Worden & Worden, Inc., a stock market newsletter publishing company, in 1960 and continued providing tools for institutional and individual investors over the next six decades. He was a pioneer and leader in stock market research. In the first part of his career, he delivered his thoughts through newsletters. When computers became available, he immediately began to write programs that would produce charts for his newsletters. His experimentation with computers led to the development of a chart service that provided individual investors with access to market data accessible through dial-up modems.

Don spent much of his life on the leading edge of market analysis and technology. All of his work was dedicated to helping investors think for themselves, a philosophy his son Peter Worden described as based on the old saying “Give a man a fish, and you have fed him once. Teach him how to fish and you have fed him for a lifetime.” Peter and his brothers Christopher and Jon learned to “fish” from their father. Peter, for example, joined Worden & Worden where he helped update charts by hand.

In 1988, Don saw first-hand how his philosophy could influence the work of others. His sons Chris and Peter started Worden Brothers in that year, a business which continues teaching individual investors how to think for themselves.

This education-first approach took shape with his first newsletter. *Worden Tape Reading Studies* gained popularity at a time when other newsletters were devoted to providing tips on what to buy and sell. This approach continued in the 1970’s, shortly after exchange-traded options became available to the public, when Don began publishing *The Optioneer*, a newsletter built around a market commentary. *The Optioneer* also included statistical tables based on the Black-Scholes pricing model showing what prices of various options should be under different scenarios. In this way, *The Optioneer* helped identify the best options to trade while illustrating the process for finding the best trading opportunities. Don taught readers to never buy an option unless you expect it to double in price and always buy a lot of time. This trading rule accepted the reality that finding good trades is difficult and timing a big move can be even more difficult.

Don was able to adapt to changes in the industry because he understood how to develop indicators, explain the rationale of the indicators and clearly demonstrate how to apply the indicators to charts. The best way to gain insight into how Don thought, and lived, is to read his work. He was a great writer and it is impossible to improve on the way he explained how to trade. *Trader’s Manifesto*, published in 1993, is a complete guide to trading with everything traders need to know in order to succeed. The rules include:

1. You get paid for taking risks, a reminder that there will never be a trade that offers certainty and high rewards. This, Don notes, “should be obvious, it would be obvious, if an investor would once trouble to think it through. The market is not interested in showering you with money.”
2. Because you get paid for taking risks, you will need to buy before you are sure that prices will rise and, ideally, you will sell too soon.
3. Fundamentals and technicals are both important—“I am not impressed by either dogmatic fundamentalists or dogmatic technicians. These two approaches to the market are complementary. It seems obvious to me that they are both indispensable.”

4. Think for yourself.

5. Stay liquid.


7. Run scared—“Of paramount importance to the trader, though, is fear. I am convinced that it is absolutely necessary to “run scared.” Only an exaggerated emotion can generate the concentration necessary to survive as a trader.”

8. Work hard and be smart.

There is much more in Trader’s Manifesto and in the two volumes of Street-Smart Chart Reading. Volume 1: The Rudiments is an introduction to technical analysis. Volume 2: Digging Deeper explains the tactical side of trading and explains how the art and science of technical analysis are inseparable.

One of the most valuable pieces of advice Don offered individuals was unusual but demonstrated his strength of character. In Volume 2 of Street-Smart Chart Reading Don asks readers to answer the question “Do you have the right stuff?” He points out that trading isn’t for everyone, a statement that stands out in a business where many try to convince customers to stick with them even when they are failing miserably.

Don also emphasizes the importance of pairing action with thinking for yourself. We can all learn from Don Worden that:

You will never find a way to become completely objective. Accept the fact that all of your decisions—whether directly or indirectly—require judgment. Acting upon your judgment requires courage.

It took courage to see that indicators he had developed and used for years stopped working as detailed earlier in the article “Tape Reading In the Sleepy Fifties.” It took courage to switch from printed newsletters to a service relying on personal computers long before it was obvious computers would be any more than a toy used by a few. By acting with courage and taking risks, Don Worden helped thousands of individuals learn to trade. More importantly, he taught them the importance of thinking for themselves in trading and in life.

Editor’s note: This article is based on a conversation with Peter Worden and his cooperation was invaluable.
Editor’s note: The best explanation of Don Worden’s work comes from Don Worden himself. For many years, he provided newsletter readers and users of TC2000 with his thoughts on the market and insights into how he thought about the stock market. This article was originally posted by Don in 1994 and is available at http://go.mta.org/7353.

The really big changes in technical analysis came with the computer, though a change of attitude for some reason began to stir before its use became commonplace in market analysis. Joseph Granville’s book Fifty-Five Daily Indicators for Stock Market Timing was an immense success. Looking back, I see the wide acceptance of the new ideas in this book as a milestone in breaking away from the doctrinaire edicts of Edwards and Magee (The Technical Analysis of Stock Trends).

I personally served as a catalyst in the development of a totally new and ambitious tool. At the time it was called Tick Volume. It is now known as Money Flow.

In the late 1950’s I began tallying individual transactions on the New York and American Stock Exchanges. Nobody before had ever embarked on a systematic analysis of individual transactions or attempted to devise indicators based on the flow of individual transactions. Why, I don't know. The idea seemed rather obvious to me.

I had become fascinated with tape reading. Tape readers paid a lot of attention to the size of transactions and whether they were occurring on “upticks” or “downticks.”

I learned from a book by the late Humphrey Neill, Tape Reading and Market Tactics, that a company in New York, Francis Emory Fitch, published daily lists of all transactions on the New York and American Stock Exchanges. These were used by brokerage firms to verify disputed prices of transactions.

So I started marking these sheets each day. At first, since there are only 24 hours in a day, I marked only transactions of $100,000 or more. I used a red pencil and put a mark to the left of the volume on an uptick, to the right on a downtick. I then counted the upticks and the downticks, found the difference, calculated some moving averages, and plotted the results on charts.

Fitch had several years of back sheets and I bought them all. Soon I found that I had a really useful timing indicator for the overall market, which I called “The Worden $100,000 Indexes.” I plotted the results as oscillators. I found that, unlike any indicators I was aware of, the $100,000 Indexes showed great bursts of “big money” buying pressures early in intermediate or cyclical bull markets. This buying pressure diminished as the bull move progressed, rather than rising to an overbought climax.

Above all, I notice that the profiles of my indicator lines often diverged markedly from the direction of price itself.
About that time (1960), I began publishing my results in a market letter, *The Worden Tape Reading Studies*. I must say that it was clearly the right product at the right time. I doubt if any market letter ever made a more promising debut. For many years it was one of America’s leading stock market newsletters.

Soon after I developed the $100,000 Indexes I began working with individual stocks. This was a lot more work. I wasn’t yet at the point where I could afford to hire a room full of people to “mark the Fitch sheets.” To start with we tallied only transaction of 1000 shares or more. I arrived at a number of ways of calculating individual stock indexes. The results were promising to say the least.

The work I was doing had great appeal to market technicians of the time. It seemed like a gigantic step forward. There had been nothing like this before. The essence of the approach was that my various indexes seemed to be separating “big money” activity from “small money” activity. Implied here was “insider activity”. It was available instantly, not a couple of months later in bureaucratic reports.

It was amazing how word of these new “magic indicators” spread like wild fire. At one point the New York Stock Exchange called me for information on certain individual transactions. I referred them to Francis Emory Fitch. On a number of occasions the SEC called me for advice on how to detect manipulation.

At that time, institutional activity accounted for only about a third of the volume. Most of the trading volume came from the "little guy"—the public.

Soon I started a small staff tallying every single transaction every day. And we went back and did it all retrospectively. This is what we needed for Tick Volume. This indicator was calculated by adding the volume on upticks and subtracting on downticks, much like OBV (On Balance Volume). (Incidentally, OBV and Tick Volume were developed completely independently of one another. Joe Granville’s book on OBV came out just a few months after we introduced Tick Volume. His book had obviously gone to press well before we came out with our new indicator.)

About this time Scantlin Electronics came out with the Quotron desk quotation device. This meant a new source of stock market data, this time on magnetic tape. We hired computer service bureaus to do the tallying for us.

This was astoundingly expensive when I look back. In fact, even ten years later in the 1970’s, when I had my own computer, I remember paying $1.00 per day per stock merely for price and volume quotes.

Exorbitant as it was, we became computerized just in the nick of time. Volume on the NYSE was expanding so rapidly that we could never have handled the job by hand.

When I began tallying the Fitch Sheets, volume on the NYSE ran about 2.5 million shares a day. When we switched to the computer in 1966, volume was averaging over 6 million shares and climbing fast. Volume had so overtaxed the equipment of the time that they closed the New York Stock Exchange at two o’clock every day for about a year to hold volume down and to provide more time for the back offices to keep up.
One Great Leap to the Seventies

By the early 1970’s things had changed a lot and they were still changing fast. Adam Smith’s book *The Money Game* proved the definitive word of the times. Smith, among others, was able to foresee that institutions were taking over the market in entirety. There was talk that the public would not even be allowed to trade directly in stocks.

I had been able to see for a long time that Tick Volume was losing its effectiveness. From the very beginning I had noticed a slight negative bias in my indicators. This was because a greater number of large transactions occurred on downticks than on upticks. The larger the transaction the more likely it would be on a downtick. (You can observe this yourself. As a direct result of my work, *Barron’s* has been publishing tallies of large blocks in the Market Laboratory section.)

And there were other uncontrollable aberrations as well. With over 90% of trading coming from institutions, the entire rationale of Tick Volume was lost. The original idea was that it could ferret out "big money" trading, the implication being that "big money" was apt to be "smarter money" than "little money."

Now what we were having was "big money" trading with "big money." One indicator that we kept, called the “Power Index,” a gigantic Tick Volume tally for the entire NYSE, had totally lost the power to turn positive. It had been fluctuating below the zero line for years.

Well before that, I had started experimenting with other price/volume indicators --- some of which worked very well. However, I had to admit that none of them ever seemed to work quite as well as the "original" Tick Volume in its early days.

In what way were they inferior? They did not have that incredible power to contradict price direction. At its best Tick Volume could "show you" buying pressures in the form of positive numbers, while the price was falling. The effect was sensational. Other indicators, to various degrees, have the power to diverge, which is a form of contradiction, of course. But Tick Volume could literally stand up and shout at the price, "Hey, you're going the wrong way!"

Tick Volume’s strongest point was also perhaps its weakest. It was often too early. This was true at both tops and bottoms. This is precisely what contradiction is.

Further, there are many reasons to either buy or sell a stock. Not all of these involve the expectation of a specific move in price. Even if the expectation is there, the buyers or sellers could be wrong. Not everybody who trades in big quantities is smart.

And on it goes. A price advance is not the inevitable outcome of systematic "big money" buying. And vice versa.

But when it comes to probabilities? All other things being equal, I'd rather be in the stock that the "big money" is buying every time. A stock revealing signs of "sponsorship," signs of systematic "accumulation," that’s for me. Perfection? In its best days, Tick Volume was never perfect. Democracy isn’t perfect either. But what is it they say? It's just that it works better than any other form of government.
Tick Volume is Now a Zombie Named Money Flow

Ironically, as I discarded Tick Volume, a number of brokerage firms had become very interested in it. In fact, I had an arrangement with one New York firm that allowed them to use it for their institutional clients. Others had started doing the same thing.

Some people have asked me why I never sued any of these firms. Two reasons. First, mathematical formulas weren't patentable at that time (today certain software decisions suggest this is no longer completely true). Second, by the time they started horning in, Tick Volume wasn't working right anyway and they weren't damaging me. I was losing interest in it.

I can't deny that some of those guys irritated me, though. Particularly the one who named it Money Flow and pretended it was something new he had invented. That brings to mind a funny incident. Years later I happened to be talking to a salesman for an institutional data distributor. He had no idea who I was other than what he assumed to be a prospect. He was pitching Money Flow. He told me that Money Flow was thought to be responsible for the success of Salomon Brothers. I told him I would think it over.

Didn't any of these firms run into the same horrendous aberrations that I had? Sure. They just don't care. In one case, they noticed that the largest transactions were causing an unmanageable negative bias. So they deleted all transactions of 10,000 or more shares. Just threw them out, compounding the chances for aberrations. I suggested to them that it
would make more sense statistically to truncate these large transactions to a less dominating size. They suggested that what they had done seemed to work well enough. That operation was later sold to a well-known bank.

To this day, that bank still sells Money Flow to institutions with and without 10,000 share transactions. Like hot dogs, with or without mustard.

I doubt that anybody actually makes investment decisions using Money Flow. Every now and then I check it out for one stock or another. It just doesn’t work anymore. I suspect it is used as sort of a "sales prop" by some money managers: good for show but not for dough.

I do hope this does nothing to erode your confidence in the institutional money manager looking after your money.

One More Attempt at Not One -- But Two -- Holy Grails

A few years ago I entered into a joint venture with a regional brokerage firm to develop a price/volume indicator designed for institutional use. Brokerage firms like to sell special products for what they call "soft dollars" – that is, for commissions instead of hard money. It’s very profitable, since institutions don’t mind paying big with what they probably think of as something like "funny money."

I developed an indicator based on the flow of individual transactions. But since I knew Tick Volume didn’t work, I based it on another concept I had been toying with for a number of years. Instead of using upticks and downticks, I tallied price and volume changes at specific times of the day.

For reasons not worth going into, in writing computer programs, I found it useful to improvise a formula that could temporarily mimic the indexes I was building based on individual transactions. The mimic-index was based on day-end data. As I progressed, I found that the "temporary" mimic-index worked better than the other. This was because I was never able to completely eliminate the aberrations inherent in the flow of individual transactions in an institutionally dominated market.

Although Worden Brothers doesn’t want me to reveal how this indicator is calculated, I will tell you something about it. About thirty years ago a young man walked into my office and showed me an indicator he had developed that had “a power to contradict” – much like Tick Volume. I had popularized this concept of contradiction through my work and writing at the time. His method was not based upon individual transactions.

Hundreds of people had brought me ideas (usually the valuable secret they whispered to me was an idea to calculate OBV by multiplying price times volume instead of adding). Nobody had ever brought me a really good idea, not even a decent one.

But he had a very good idea. Since Tick Volume was working very well and I had a small research and publishing organization of about only twenty people in total, I didn’t see that I could do justice to his abilities. I suggested he take his ideas to New York, which he did. He became very successful and well known. His name is David Bostion. His idea was to take the difference between close and high, and subtract it from the difference between close and low. A very ingenious idea!
I tinkered with it from time to time, but I was always troubled by what seemed to me excessive spikes at extremes of buying or selling. Later Larry Williams, whom I've never met, came up with something similar for commodities. Mark Chaikin later came up with a similar idea that combines price and volume.

The MoneyStream has certain similarities to Chaikin's indicator. However, I discovered what I consider a logical error common to all three of those approaches. Which is all I have to say about how the MoneyStream is calculated.

The MoneyStream embodies both price and volume, although if volume is not available, an automatic adjustment takes place in the formula and the indicator is calculated and displayed. The pure price version has less power to contradict than that embodying both price and volume. But it is quite useful nonetheless.

I find that the Cumulative MoneyStream (CMS) moves much like OBV, but it has a bit more power to contradict. The way to interpret it is simple and direct. Normally, the MoneyStream will form a pattern exactly like the pattern of the price. This tells you nothing, except that "nothing is broke." Which let me add, is well worth knowing.

If the MoneyStream is stronger than the price pattern, this is a forecast of strength to come. This is bullish. If the MoneyStream is weaker than the price pattern, it is bearish.

To help investors see these relationships easily and consistently; I developed a technique using linear regression lines. Here is how it works:

The price profile and The MoneyStream are set up in windows and on scales that make them directly comparable.

A short-term and long-term regression line are put in each window simultaneously and automatically. (The shorter-term line is 30 bars, the longer-term line 100 bars.)

The analyst can then eyeball the "slopes" of these regression lines for an easy-to-assess comparison of price performance versus the performance of the MoneyStream. Remember when the slopes differ, it is the MoneyStream that is considered to be the more valid interpreter of the strength of the trend.

Some really impressive divergences develop in The MoneyStream profile when compared to the profile of the price. As you will learn, I have developed another indicator with a greater power to contradict, but The MoneyStream has unique virtues of its own. It embodies an ability to detect changes in momentum and is often serves as an invaluable timing aid.

I use the MoneyStream in tandem with another indicator, an indicator with a unique power to contradict and to bring out underlying patterns of systematic accumulation or distribution that would otherwise lie hidden beneath the surface. I call this indicator "BOP" (for Balance of Power).

**BOPping Around TC2000**

I developed BOP about five years ago. I have been using it privately together with CMS to make investment decisions for more than four years. I rely on these indicators heavily. Neither of these indicators has ever been published or described in print or in any public forum before.
BOP AND CMS ARE OFFERED EXCLUSIVELY AS FEATURES OF TC2000. Their formulation is the intellectual property of Worden Brothers, Inc. who has purchased all rights. (Since the three Worden brothers are my sons, I made them a good deal.)

**Finally, a Holy Grail (but with fewer holes than most holy grails)**

Necessity is usually the mother of invention. In the case of BOP it was not. I wasn't trying to develop anything. I thought CMS was the best I could do in a price-volume indicator, and I was content to hope it would keep working.

The truth is, I am willing to admit, I developed BOP playing with my computer. By playing, I mean that I like to write programs. I don't enjoy learning software written by other people.

Just for the fun of it, I've written application programs in such diverse fields as handicapping football and teaching foreign languages.

I generally use a chart program I wrote myself because I can tinker with it and make endless changes. I know darn well my son Chris, who is a far better programmer than I am, would never let me tinker with the source code of his TC2000. (Good as he is, I taught him his first algorithm, and I have a pretty good idea of how Arnold Palmer's father felt.)

BOP was based on a concept I hit upon many years before. For some reason I could never get an indicator based on that concept to act the way I thought it should. Each time I tried, I wound up abandoning the project.

As I said, I was just tinkering. I don't know what set me off on that old concept again. I do remember that, once I started on it, I knew that I could make it work. I think this was just a matter of long experience, with the computer as well as with market indicators. (I started writing computer programs about 1970.)

Anyway, this time it fell together without a hitch and worked exactly the way I expected it to.

Let me give a word of advice here to anybody who would like to develop some of his own indicators. I never shotgun an indicator. That is, I don't say to myself: "Hey, that OBV of Granville's is great. But he adds the volume each day according to the sign of the net change. I wonder what would happen if I multiplied the net change times the volume instead of simply adding."

I would never use such an approach. I always know exactly what I am looking for and how I expect it to work. If I hadn't used this approach, I would never have dreamed up a workable indicator. You see, there are thousands of combinations of parameters and mathematical operations I could try using the shotgun approach. How many would have any value? One in a thousand? One in ten thousand?

Before I put together an indicator, I know what it will solve for me, how and why?

An indicator is merely a manifestation of a concept I already understand. The indicator is a way of communicating that concept.
Take OBV, for example. I didn’t invent it, but I can assure you I know exactly how Granville’s thought process worked. It went something like this. "I am tired of laboring over these charts, meticulously comparing day by day price movement with expansions and contractions of volume. It’s hard to see and hard to keep track of the positive and negative events in my head. What am I looking for? Why, I guess I’m just looking for sort of a running tally of the total volume on advancing days versus the total volume on declining days. Let’s see, there must be a more systematic way of doing that and saving myself some time. In fact, if I tally these comparisons systematically, I will probably see some things in the pattern I would otherwise have missed. I think I’ll give it a try."

You see, the indicator is a statistical interpretation of the facts in a raw form. But unless you know how to interpret the facts in a raw form, you can’t think of an indicator. You can try until you’re blue in the face. The indicator is a statistical depiction of the way you have already learned to interpret raw data.

Generally, a useful indicator solves a specific problem you have been having in interpretation and, especially, in consistency.

What Mr. BOP Has to Say

BOP is a marvelous indicator. But it doesn’t tell you whether a stock will go up or down. By itself, it can hardly be described as a pinpoint timing indicator. What it tells you is whether the underlying action is characterized by systematic buying (accumulation) or systematic selling (distribution). This is exactly what I designed it to be. BOP is a statistical
interpretation of a concept that ferrets out subtle evidence of systematic buying or selling. The process of development, like any of my indicators, developed in a similar fashion to the fantasy of how Joe Granville thought up OBV (described above).

BOP fits into a category of devices that I call "trend quality" indicators. It tells you about the quality of the underlying action. From this you can infer the various tactical judgments you must make to arrive at an effective decision. BOP, for example, can help you formulated a judgment as to the vital risk-reward ratio of a prospective trade. It can help you determine whether the supply-demand balance will be in your favor. It will help you spot changes in the character of a stock’s action.

Just the other day a friend called me and asked for some input on a stock he was thinking of buying. His interest was based on the prospects for a hot new product coming on the market. I checked the chart. BOP displayed a mildly negative, partly ambiguous pattern. The important thing was there had been absolutely no change in the general character of BOP following the announcement of the new product. If the product could genuinely impact the company’s profit picture, there would be plenty of people in the industry that would recognize it. It would very likely show in some kind of a change in BOP. In this case there was nothing on the chart suggested the stock was about to change its languorous descent.

So you see, before I actually begin to show you examples of BOP in action, I want to caution you that there are no magic bullets, no way of sparing you the necessity of thinking.

One of the first things to understand about chart reading is that most charts are ambiguous most of the time. You can’t expect to pick up a chart at random and demand: "What is BOP saying here? What is CMS saying? What is OBV saying? Most of the time a randomly picked chart has only one thing to say: "No comment!"

But you see, the amateurs are constantly trying to force opinions out of their charts. They are sure there is a message in every chart if someone will just, please, show them how to read it. Consequently, think of the time they waste chasing those windmills. Think of the bad decisions they make.

Look at a thousand charts. If only one gives you a clear message, isn’t that enough? It is, yes, providing that you recognize that the other 999 did not have anything to say.

But remember you know more about a chart than just what you see. You know such things as whether there have been earnings surprises, litigation, fierce competition, changes in management, what other stocks in the industry look like, how the market in general is doing.

Interpreting a stock chart is like reading the expression on somebody’s face. You will see far more in the expression of somebody you know. The mere absence of expression when he should be glowing with joy would tell you much.

The examples I choose to show you will all be selected because they demonstrate BOP and/or CMS performing at their best. Keep in mind that in real life there are always more ambiguous charts than anything else. Learn to hold out for the best ones.
One more thing to remember about any chart. No matter how perfect it is, no matter how classic, there are few situations that cannot be torn asunder by the action of the overall market itself. The most bullish patterns, the strongest support – it will all snap like straws in a hurricane if the overall market goes on the rampage.

**Using The MoneyStream and BOP Together**

Not only are BOP and The MoneyStream excellent indicators in their own right, but they complement one another nicely as well as acting as checks on one another. They are based on entirely different concepts.

You will find, not uncommonly, that BOP and The MoneyStream disagree. Most of the time, you will probably restrict yourself to trades in which both indicators are in gear.

Both indicators represent significant steps forward in the way they are presented for ease of interpretation. The MoneyStream is very convenient with its automatic display of linear regression lines for ready comparison of the respective strength of trends in CMS and the price.

The BOP scale runs from +100 to –100. The indicator itself can rise above or below these extremes, but it is relatively rare. When it happens, we just truncate the profile at the top or bottom of the chart. We believe it is more important to keep all the charts on the exact same scale than it is to include the "outliers" on the chart.

Some will ask whether the direction of the BOP profile is more important than whether BOP is above or below the zero line. The answer is that above or below the zero line is most important, especially when it represents a change in relation to the price.

But whether BOP is getting stronger or weaker is also important. How do you know where to place the greatest emphasis in an individual situation? That is the art of it my friend. If it were so cut and dried that it was mechanical, it wouldn’t work for anybody.

BOP, which has incredible power to contradict price movement, is shown in color: Green for buying pressure, red for selling pressure, yellow for a more neutral area of lighter buying or selling.

These colors are repeated in the price bars as well as the bars in the indicator itself. This is a very effective way to spot changes in buying or selling as it reflects in the price pattern. For example, you will often find that the price bars have turned red well before a top is reached.

Actually, it would be possible to interpret BOP based only on the colors in the price bars, without even seeing the indicator itself. I know this to be true, because for a while that’s the way I did it. In my own program I can’t display indicators simultaneously the way Chris has it set up in TC2000. Therefore, I used to get the price bar set up with BOP colors, and then put CMS in the indicator window.

The TC2000 setup is much more convenient without being cluttered. A panel with three windows pops up and overlays the basic bar chart. You can still see the right portion of the underlying chart.
This is very powerful, not only because you can see CMS and BOP on the same panel, but also because you can, if you wish, view them in a different time frame than that on your underlying chart.

The way is opened for very convenient and powerful comparisons, limited mainly by your own ingenuity and imagination.

**A Tip about Large Company Stocks**

The predictive value of BOP and CMS tends to diminish with the size of the company. This is because the market action in large, blue-chip type stocks is more efficient. Such stocks are held heavily by institutions. They are analyzed carefully by dozens of analysts. Virtually everything there is to know about them is known. Further, the management and boards of such companies tend to be more concerned about personal liabilities under the insider laws. Great care is taken to prevent leaks.

Patterns of informed accumulation or distribution are less likely to occur in the big blue chips. When interesting patterns do appear, they may be less trustworthy.

Also, many large companies are included in the S&P 500. These companies are included in large index funds (not to mention in "baskets" of stocks used in "programmed trading" and arbitrage schemes). Index funds buy and sell them under the automatic guidance "programmed trading" and arbitrage schemes. Index funds buy and sell them under the automatic guidance of computers in order to mimic the S&P 500 average. These forces can result in unpredictable and sometime unexplainable behavior patterns.

Particularly susceptible to these various aberrations is BOP, which is an indicator almost purely of buying and selling. BOP cannot tell you the why or the who of the buying and selling evidence it detects. The MoneyStream, while also an indicator of buying and selling, embodies significant momentum elements.

I should point out that this kind of phenomena is true of technical analysis in general (which shouldn’t be surprising since all technical analysis is more or less trying to accomplish the same thing).

Having warned you about big stocks, let me carry it full circle and say that technical indicators often do work with big stocks. A "change of character" in trading usually means something no matter what kind of a stock it is. Just be aware of the potential difficulties.

Not only must the stocks of larger companies be analyzed with caution and perhaps greater imagination, the same can be said of market averages.

**Example - Home Depot Inc. (HD)**

IMPORTANT NOTE – Since the original printing of this document, Home Depot, Inc. posted a 3 for 2 split on July 7, 1997, a 2 for 1 split on July 2, 1998, and a 3 for 2 split on December 31, 1999. This accounts for the discrepancy in the prices listed in the text and those on the charts.
Home Depot: This is an excellent example for a number of reasons. First, we have a company that is widely appreciated and admired. Second, not only did BOP show the ability to ignore the exalted image the company eventually developed but also the ability to show systematic selling while the price was rising to repeated new highs. Third, it shows how well CMS and BOP work together.

To start with, let’s pick the stock up at the end of the year, 1991. You may well have been one of many enjoying huge profits.

At the outset of 1986, waves of buying pressure began to be evident in the BOP pattern. The price was well below 2. The price climbed steadily throughout that year, carrying almost to 5, with unrelenting buying underlying the rise.

Came the 1987 crash and Home Depot was cut in half along with just about everything else. But there was very little selling pressure. The brave or the wise or whatever had the opportunity to pick it up under 2.

Buying was restrained as it returned to its old high in 1988. As it moved above that high and above 5, really heavy buying pressures set in again. That continued without significant interruption for the next three years –as the stock rose and rose and rose.

I think it is fair to say that anyone watching it would have had ample opportunity to buy it somewhere between 1 and 10. Even had you paid 10, you would have made a killing.

As we pick it up on CHART 2, the first signs of selling worth worrying about have begun to appear. We detect signs of a “change of character.” As the stock continues to rise into the 30’s, BOP has dropped perceptively, spending much of the time below the zero line (in direct contradiction of the price trend).
We know that we don’t need selling pressure as intense as the buying pressure previously enjoyed in order to break the uptrend. As buying dries up, a stock tends to drop of its own weight.

As the stock moved above 30, we had a decision to make. We might well have decided to sell at about 35. As the old saying goes, “You can’t go broke taking a profit.” And there was a lot of profit to protect. To sell would not have been a mistake.

On the other hand, you would have come out better had you stayed with it. What might have kept you in? In this case, it would have been The MoneyStream. The regression lines stayed in lock step with the price lines. This was enough to justify holding out until CMS itself began to show some cracks.

With this possibility in mind, refer to CHART 3. Here, as we near the end of 1992, BOP continues to show comparatively light but steady selling. The shorter-term regression line for The MoneyStream is slowing down distinctly. The longer-trend line is okay.
The price is into the 40’s now and continues to rise. This is happening during the year that Home Depot’s image of invincibility rose to its zenith. It was compared to a young Wal-Mart (all of which, incidentally, may still be perfectly true).

There’s definitely trouble ahead. Sell now? Probably.

There are those who would have stayed longer. They would have been one of two types. First, is the guy who just can’t believe that “everybody else” could be wrong. He reads that Home Depot can’t be stopped, and he believes it no matter what his charts say.

Then there is another type, far more rare, that wants to hold out for the top. He knows the stock has been under distribution for a year. He sees that The MoneyStream is losing some momentum as well, but he notices that it is nevertheless attaining new highs. He decides to stay until CMS fails to attain a new high along with the price of the stock, or until some kind of a trailing stop is violated – whichever comes first.

As the top was reached (above 50), CMS had turned down a couple of weeks before. Somewhere around 50, the great trader might have sold. But this would be perfection.
The final Home Depot chart shows the resolution. This chart shows a broad sweep of five years, during which Home Depot rose from below 5 to above 50 – a tenfold increase. Following this was a protracted correction of about a year, amounting to over a 30% retracement. During the rise, the company’s earnings rose spectacularly, the story of its extraordinary management and success at blowing the competition away became widely known. Going by price alone, there was no significant change of character discernible throughout the entire rise to its high above 50.

Notice, though, that it was during the last year of the spectacular rise that BOP changed from positive to negative. The selling remained steady all the way to the top and, of course, beyond.

This shows what I mean by the power to contradict. Relentlessly heavy buying characterized the rise from below 5 to about 30. Then a clear pattern of "distribution" set in.

You could have sold for a large profit well ahead of and below the high above 50. Better, of course, to hold for the higher price (if possible). Various techniques might have achieved this.

As I have said or implied before, CMS also has the power to predict, but not to the degree that BOP has. And as you can see, after BOP began to reveal underlying selling pressures, CMS continued to rise. There was a negligible slowing down, a slight change of character, but enough strength remained to suggest it was not yet quite the time to sell.

As this is written (at the end of March 1994), BOP has begun to show signs of renewed buying interest. CMS is not confirming (far from it) and this is happening against a dangerous market background. Chances are, as I see it now, that sometime in the next year, Home Depot will again be an attractive buy. But many things could happen along the way that would change my mind. On the other hand, it may be a buy sooner than I think..
Buff Dormeier, CMT, has written extensively about how to incorporate volume into a comprehensive analysis. His work on *Price & Volume, Digging Deeper* was recognized with the Dow Award in 2007. The complete paper can be downloaded by clicking here.

In that paper, Buff wrote, “When securities change hands on a securities auction market, the volume of shares bought always matches the volume sold on executed orders. When the price rises, the upward movement reflects demand exceeds supply or that buyers are in control. Likewise, when the price falls it implies supply exceeds demand or that sellers are in control. Over time, these trends of supply and demand form accumulation and distribution patterns. What if there was a way to look deep inside price and volume trends to determine if current prices were supported by volume. This is the objective of the Volume Price Confirmation Indicator (VPCI), a methodology that measures the intrinsic relationship between price and volume.”

VPCI is available in many charting software packages, making it easy for technicians to implement and test the concepts. The indicator was featured in the July 2007 issue of *Technical Analysis of Stocks and Commodities* magazine and was the subject of their Traders’ Tips feature. Several major software platform providers published the code to implement VPCI on their platforms and that code can be downloaded by clicking here.

Buff believes volume should be used in an analysis because it increases what he calls the “Four R’s”

- Responsiveness: are signals more timely?
- Reliability: are signals more accurate?
- Risk: is drawdown, a trader’s measure of risk, reduced?
- Return: are dollar gains bigger with the new indicator compared to the baseline?

Generally, systems traders find that increasing responsiveness tends to decrease reliability. In other words, quicker signals tend to result in more losing trades. Buff has demonstrated in his testing that volume helps to overcome this problem.

Price is defined as “an agreement to disagree” in Buff’s mind. As a buyer, he feels price is too low, but needs to find someone who is bearish in order to execute a trade. Volume is synonymous with the force of the convictions that investors hold and volume tends to lead price. Technicians have long noted that volume typically leads and confirms price action, and divergences between price and volume often presage changes in the trend of the price. VPCI is built on these basic technical concepts.
In the 1990’s, Buff developed volume-weighted moving averages, first presenting the concept in his CMT paper. The VWMA is calculated by weighting each time frame’s closing price with the time frame’s volume compared to the total volume during the range. The formula for this indicator is shown in his paper:

\[
\text{Volume-Weighted Average} = \text{sum} \{\text{closing price (I)} \times \left[\text{volume (I)} / (\text{total range})\right]\}
\]

where \(I\) = the day being studied

The VWMA tends to be more responsive to price trends. This is logical based upon the idea that volume measures the conviction of trader’s beliefs.

Calculating the VPCI is slightly more complex. From his paper:

“The VPCI involves three calculations:

1) volume-price confirmation/contradiction (VPC+/-),

2) volume-price ratio (VPR), and

3) volume multiplier (VM).

The VPC+/− is calculated by subtracting a long-term SMA from the same time frame’s VWMA. In essence, this calculation is the otherwise unseen nexus between price and price proportionally weighted to volume. This difference, when positive, is the VPC+ (volume-price confirmation) and, when negative, the VPC- (volume price contradiction).

The next step is to calculate the volume price ratio (VPR). VPR accentuates the VPC+/− relative to the short-term price-volume relationship. The VPR is calculated by dividing the short-term VWMA by the short-term SMA.

The third and final step is to calculate the volume multiplier (VM). The VM’s objective is to overweight the VPCI when volume is increasing and underweight the VPCI when volume is decreasing. This is done by dividing the short-term average volume by the long-term average volume.

Finally, the VPC+/− is multiplied by the VPR which is multiplied by the VM. The interpretation of VCPI requires considering the recent price trend and the recent levels of the indicator itself. In general terms, if price and VPCI are both rising, it would be bullish.

Related to interpretation of the indicator, Buff has updated his work and noted, “…that I had a change in my opinion regarding some of the VPCI indications since then. At the time, I believed a falling trend and falling VPCI was bearish, it is in fact a bullish indication. I also may have stated a falling trend and a rising VPCI was bullish, however it is a bearish indication. Everything else should be OK.”

Additional signals can come from VCPI crossing its own moving average and the indicator crossing above and below zero can offer useful signals to traders. The indicator can be used over any timeframe with varying inputs.
In the Dow Award winning paper, Buff fully discloses how to calculate VPCI and demonstrates how it can be used. The test results are impressive and do demonstrate that the VPCI can increase trade reliability. The table below is taken from that paper and shows VPCI compared to a buy and hold strategy, a MACD strategy and a strategy based in on balance volume (OBV).

### Table 2: Comparing strategies’ returns

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Annual Return</th>
<th>Time invested</th>
<th>Std Dev</th>
<th>5yr Sharpe</th>
<th>% Profitable</th>
<th>Profit Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy Hold</td>
<td>9.64%</td>
<td>100.00%</td>
<td>17.75%</td>
<td>0.10</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>MACD</td>
<td>-3.88%</td>
<td>24.79%</td>
<td>13.03%</td>
<td>0.27</td>
<td>41.79%</td>
<td>0.97</td>
</tr>
<tr>
<td>VPCI</td>
<td>8.11%</td>
<td>35.63%</td>
<td>7.42%</td>
<td>0.74</td>
<td>65.15%</td>
<td>2.47</td>
</tr>
<tr>
<td>OBV</td>
<td>-1.57%</td>
<td>27.02%</td>
<td>17.40%</td>
<td>0.05</td>
<td>42.88%</td>
<td>1.00</td>
</tr>
</tbody>
</table>

*Dividends not included*

After publishing his paper, Buff subsequently wrote a book, *Investing With Volume Analysis*, that expands on the ideas he presented in *Price & Volume, Digging Deeper*.

A number of new tools are introduced in the book, including volume-weighted moving averages, volume-weighted MACD, and the Trend Thrust Indicator. Practical applications of these ideas are developed, with the underlying logic and strategy explained. Traditional volume indicators are also included, making this book a comprehensive review of volume analysis and *Investing With Volume Analysis* is the only source you’ll need to gain expertise on the topic. Not surprisingly, the book expands on the VPCI.

As an example of the ideas in the book, the chart below shows the volume-weighted MACD compared to a traditional MACD. VWMACD is shown in the center of the chart with MACD at the bottom. VWMACD consistently signals earlier than the traditional MACD. The VWMACD is particularly useful near market bottoms when earlier signals allow investors to enjoy more of the rapid gains usually seen at the beginning of a new bull market.

Some quick testing shows the value of earlier signals. Using weekly bars, I found the VWMACD significantly decreased risk compared to MACD when trading SPDR S&P 500 ETF (SPY). Applying more of the techniques described by Buff Dormeier in his book and paper could lead to greater profits with lower risk for many traders.

**Buff will present “Volume Analysis--Pump Up the Volume” on July 30th, 2014 in the Educational Web Series.**

_In this presentation, Buff reveals how volume validates, interprets, and leads price. Using volume analysis, you'll learn to uncover surprising shifts in investor enthusiasm, identify disparities in market opinion, and sniff out coming trend_
reversals. Mr. Dormeier teaches you his own groundbreaking approaches and how to apply them. You’ll further learn how to assess the strength and/or weakness in both bear and bull markets by integrating volume analysis with other common portfolio techniques.

Register online at [http://go.mta.org/shop](http://go.mta.org/shop)

About the Author

Buff Dormeier is first vice president of investments and personal investment management (PIM), portfolio manager with Wells Fargo Advisors. Armed with proprietary indicators and investment programs, Dormeier Wealth Management, a group of Wells Fargo Advisors, dynamically advises affluent and institutional clientele on strategies to meet or exceed their specific investment objectives in what are often uncertain market conditions. He is a celebrated source of investment knowledge. Mr. Dormeier received the 2007 Charles Dow Award, which recognizes research papers breaking new ground or which make innovative use of established techniques in the field of technical analysis. The Charles H. Dow Award is considered one of the most important recognitions in the field of technical analysis. His work with market indicators and trading system design has been published and referenced in *Barron's*, *Stock's & Commodities*, and *Active Trader* magazines, and the IFTA and MTA Journals. Mr. Dormeier is also a featured speaker at national and international conferences.
Editor’s note: This was originally published in December 2008.

The Market Technicians Association established the Charles H. Dow Award to encourage technically based research and strengthen the credibility of technical research. The Charles H. Dow Award has become the most significant and prestigious recognition in the field of technical analysis.

The Award is named after Charles H. Dow, the modern era pioneer of technical analysis, and the creator of the Dow Jones Industrial Average. In accordance with the MTA’s mission of educating the investment community, participant’s works are judged under stringent criteria by a judging panel consisting of some of the industry’s most respected practitioners.

Prior recipients of the Award include an outstanding group of researchers and authors who have creatively broken new ground while demonstrating the richness and depth of technical research.

The Award provides an incentive to share that which may be determined to be this year’s most noteworthy contribution to the field of technical analysis. A $5,000 cash prize will be given to the winner, but if this is your motivation for entering you’re missing the major point. What you contribute to technical analysis may not be nearly as important as whom you become from your contributions. Building credibility in technical analysis is the goal of the Award and the winner of the Charles H. Dow Award has an opportunity to receive lots of it. This is an opportunity to be elevated to an elite status of analysts and researchers.

Who should consider entering? Good ideas are hard to come by and even more so the people who can develop and execute them. The Charles H. Dow Award is a worldwide competition. The opportunity to win is freely open to all who follow the competition’s guidelines. The ideas and concepts introduced by the competition’s champions shall build upon the rich reputation of technical analysis.

Consider entering this year’s Charles H. Dow Award competition.

I remember being nearly forced to write my dissertation paper for the CMT program. I like the exploration of new research, I even enjoy writing but I hated the idea of writing a research paper. I would have certainly opted out had it been an option at the time. But it was not.

However, writing a research paper did something which few of us willfully desire - it challenged me. But this challenge is what I needed to grow professionally. Thanks to the hard work and writings of others in the field, I understood and could apply technical analysis effectively. However, the research forced me to think outside the proverbial box and come up with my own theories. In order to prove the merits of my ideas, these theories needed to be critically evaluated using the scientific method and proved through the empirical evidence. Through this experience, I not only grew in knowledge and
understanding, but in the confidence in my own thoroughly tested research. From this exercise, I grew as a technician stretching the concepts and applications of my ideas. I was honored to receive the 2007 Charles H. Dow Award.

As believers in technical analysis, we understand that most practical, reasonable, and profitable ideas cannot work if not explored and later employed. If you don't start exploring you most certainly won't arrive. You have nothing to gain by your absence, a world to grasp by your participation.
In the June 26 issue of *Bloomberg Brief Technical Strategies*, Bloomberg’s analysts offered insights into how traders could use Fibonacci ratios to develop trading strategies.

In *Technicals Show Shanghai Composite Index Nearing Inflection Point*, Paul Ciana, CMT wrote:

“The Shanghai Stock Exchange Composite index has seen gains of more than 500 percent during the last 10 years and declines of as much as 72 percent. While these rallies and declines seem to happen fast with little time for investors to act, technicals can offer clues about the direction of the next move.”

The chart highlights the technical →

Ciana concludes:

“To the upside, there are two near-term resistance levels. There is a downward sloping trend line whose current value is 2,115. Its slope is about 5 points so either this line or the 61.8 percent level (shown in the chart) will be broken soon. There also is a narrowing Ichimoku cloud. A narrowing cloud suggests a decline in the presence of resistance, which today is 2,145.

Set alerts on all three levels and await a breakout to indicate if this index is going higher or lower.”

Tom Schnedier looked at the FX market in *Fibonacci Retracements Provide Near-Term Targets for Mexican Peso*. Tom noted, “The Mexican peso (MXN Currency) recently tested the 38 percent Fibonacci retracement level from its early June low of 12.8193 before finding support at the 23 percent retracement level at 13.0050. While the signals are mixed for the direction of the peso, the Fibonacci retracement levels provide good targets for the near-term.”
The chart provides the basis for an actionable insight:

“A break of the 13.0000 level would indicate a target of 12.8190 and 12.6000 (previous support). A break of the trend channel to the upside should produce a re-test of 13.1199 and, if that fails, a trading range between 13.2128 and 13.3057 is possible.”

This type of analysis can be useful for the professional trader looking to develop a trading strategy. Fibonacci ratios could define support and resistance because they are popular and widely followed. Breaks of the lines are news and that can lead to profits. Bloomberg Brief demonstrates that analysis doesn’t need to be lengthy if the goal is simply to make money in the markets.

Bloomberg Brief financial newsletters provide unique news, data and analysis across 17 titles, from Hedge Funds, Economics to Private Equity and many other areas. Our award winning subscription only newsletters give you the edge in today’s market with access to Bloomberg's proprietary data, charts and tables. Get your free six month subscription to Bloomberg's Technical Strategies Brief at http://fs16.formsite.com/brief/MTA/index.html
BLOOMBERG EDGE 2014

DATE: Thursday, July 17, 2014
TIME: 8:00am – 7:30pm EDT
LOCATION: Bloomberg Global Headquarters
731 Lexington Avenue
(between 58th and 59th Streets)
New York, NY 10022

In its fourth year, Bloomberg EDGE continues to be the premier charting and technical analysis event. Throughout the day we will cover a variety of topics and tools that will provide actionable insight and the opportunity to interact with Bloomberg’s top specialists. Please join us for this enlightening event as well as the networking and cocktail reception that follows.

DISCUSSION TOPICS WILL INCLUDE:
› Technical Strategy Design and Testing
› Understanding Market Picture
› Heikin Ashi Candles Revealed
› Scattercharts, Statistics and Data Visualizations
› Screening Markets for Technical Signals

SPEAKERS:
› Tom Schneider
  Charts & Technical Analysis Specialist, Bloomberg L.P.
› Anthony Bosco, CMT
  Charts & Technical Analysis Specialist, Bloomberg L.P.
› Paul Ciana, CMT
  Charts & Technical Analysis Specialist, Bloomberg L.P.
› Eugene Sorenson
  Charts & Data Visualization Global Product Manager, Bloomberg L.P.

View the full agenda.
Most charting services attempt to deliver everything a trader could possibly dream of. TraderMade has taken a different approach and provides forex traders with what they actually need.

TraderMade is a portal providing advanced charting capabilities, news feeds and professional quality research. The site is designed for forex traders and it takes just one click to move between currency pairs or to obtain different perspectives. The service covers all major currency pairs. An example of a typical screen is shown below.

David Upton, the company’s founder, describes TraderMade as ideal for the “prosumer” or an information consumer with the need for a professional level of knowledge. Ninety percent of the firm’s subscribers are institutional clients, the large trading desks that act as market makers in forex. Recent upgrades to the software make forex trading suitable for risk managers at banks, corporate treasurers, smaller hedge funds and individuals seeking a professional platform.
Without a central exchange, trading in forex takes place almost continuously in banking centers around the world. Trading desks operating in Asia will set prices while other global markets are closed. European traders will then provide a transition to North American traders during the day. Trading continues virtually around the clock, with quotes available continuously from Sunday evening to late Friday afternoon based on New York time. TraderMade recognizes these market hours and incorporates features that make it possible for even part-time forex traders to keep up with the markets that almost never sleep.

Commentary written by professional technical analysts is continuously updated throughout the day. Detailed analysis is hand written, not updated with automated templates that many other services have adopted. Analysts are at their desks in London from 7:00 AM to 6:00 PM GMT. They are monitoring a basket of currencies, generating charts and research notes throughout the day, on all major currency pairs.

Customized analysis highlights important developments on short-term, medium-term (considered to be up to week) and longer-term charts. An example of the medium-term analysis is shown below. Analysts highlight key levels and include comments on a trading strategy that could be followed.

Economic news, a key driver of price moves in the currency markets, is available for every country.
Much of the news is generated by in-house analysts. TraderMade is actually a source for the news feed seen on other platforms include the platform operated by BNP Paribas. Outside services, such as the Market News International feed from Deutsche Bourse, are also included at TraderMade.

Now that TraderMade has developed a complete platform for forex, they are adding other markets that impact forex prices. Gold and silver are currently covered in the service. Important equity and fixed income markets are being added.

TraderMade could be a resource for traders considering diversifying their portfolios. If PIMCO’s Bill Gross is correct, stocks and bonds might deliver below average returns in the future. Gross argues we are transitioning from a New Normal with slow economic growth and low investment returns to a New Neutral which also includes slow economic growth and low investment returns. Forex could be a way to increase returns in this environment.

Some readers may not be familiar with the potential benefits of trading forex. While stock markets will always capture the attention of most investors, foreign exchange markets are actually the largest market in the world. Every day, trillions of dollars worth of trades are executed in the forex markets, dwarfing the size of global stock and fixed income markets. Total trading in U.S. stocks, even in extremely volatile times, is typically less than $250 billion a day.

Forex markets were originally established to facilitate international trade. Consider a company like Coca-Cola that sells its products in Germany where it is paid in euros. If the company wants to spend that money in the United States, it will need to convert euros to U.S. dollars. The company might also choose to convert euros to Canadian dollars in order to invest in a Canadian factory or into reals to finance an expansion in Brazil. Large banks have been helping large companies and countries convert currencies like this for hundreds of years.

Now, only a small percentage of market activity represents this type of transaction. Individuals and hedge funds have are trading alongside multinational corporations in the forex market and speculation has replaced international commerce trade as the driving force behind most trading.

While anyone can buy and sell forex just like a stock, unlike trading on the stock market, forex prices are not set on a central exchange. Most currency trading occurs in the interbank market where large banks bid on transactions and set prices in a way that allows them to generate a profit.
No matter what time you trade, when you trade forex, you aren’t actually buying a physical product. Buying a currency is almost like buying a share of stock in a particular country. When you buy the Swiss franc you are betting that the economy of Switzerland will be strong in the future. The trading price of any currency simply reflects what market participants think about the future direction of that country’s economy.

While the forex market shares some similarities with stocks, forex has a unique pricing mechanism. All forex quotes involve a pair of currencies. The two symbols are listed and separated by a slash, for example, USD/CAD or GBP/JPY. In these quotes, the first symbol is the currency you will be buying and the second one is the currency you will be selling to fund the purchase. In the first example, you would be getting the price to buy U.S. dollars with Canadian dollars and in the second you would be selling Japanese yen to buy British pounds.

In this example, you would pay 1.0852 U.S. dollars to buy 1 Canadian dollar.

The fourth decimal place in the quote above is known as a pip which is the unit of trading in forex. One pip is the smallest possible price change and in this case is measured in ten thousandths.

To convert a pip to a dollar amounts, we have to divide one pip by the quoted price. In this case, it would be 0.0001 / 1.0852, or 0.000092. If we had bought 100,000 Canadian dollars, a one pip move would be worth $9.20.

Despite the arcane language of the market, there are a number of benefits to trading forex. Even during stock market declines, there is always an opportunity to find profitable trades in the currency market. During the bear market of 2008 and early 2009, the euro enjoyed gains against the U.S. dollar, for example, and forex investors were able to generate sizable profits.

A widely advertised advantage of forex trading is that it is done with leverage. This means that with only a small margin deposit, traders can control a relatively large amount of currency. Many forex brokers offer 100 to 1 leverage, allowing a trader to control $50,000 worth of currency with a $500 margin deposit. Leverage cuts both ways and high leverage can lead to large losses. If you are using 100 to 1 leverage, a 1% move against your position could wipe out 100% of your account equity.

Information about the markets and an expert analysis of that information are the best risk management tools available to many traders. TraderMade can be a primary source of the information needed to successfully navigate the forex markets.

To learn more about TraderMade, visit their web site at http://www.tradermade.co.uk/.
INTERVIEW WITH JAMES DANIEL, CMT

BY AMBER HESTLA-BARNHART

How would you describe your job?

I run a small RIA and serve retail clientele as a financial planner and investment manager. I pursued the CMT designation as a way to differentiate myself from other financial advisors. It’s my belief that after 2 market meltdowns in the last 14 years, the retail public is tired of the buy and hold mantra.

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

I take a broad look across all asset classes. In building client portfolios you have a fiduciary duty to adhere to the constraints that each client agrees to, however as a technician I tell clients that we will adapt to the market depending on conditions.

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

I do pay attention to GDP, P/E ratios and analyst projections of S&P targets for year end.

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

There is a lot of opportunity within the investment industry and you just have to find the best fit. I took the route of working with individual clientele, some prefer the institutional side, prop trading or working with funds. The biggest piece of advice is to never stop learning. Be curious and keep exploring the profession. Eventually you will find your right place.

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

I’m a relatively new CMT, having just finished the program last year. From my perspective the value of the CMT program was simply the exposure to many areas of technical analysis that I had never previously heard of. Just like finding your place in the industry, with technical analysis you look at all of it through the course work and then settle into a few areas that really interest you. I have found that Murphy’s Intermarket Analysis and Brown’s use of RSI is very helpful in my business along with a real fascination of Elliott Wave.

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)?

I prefer the keep it simple method. My personal preference is to focus on price while just using a couple of indicators: RSI, MACD and volume. For price projections I tend to use traditional charting methods and have become a student of EWT for added forecasting. There are a number of CMT’s that I follow that are much smarter in the use of indicators, so I am always trying to learn from them and incorporate the best techniques into my practice.
About the Interviewee

James A. Daniel, CFP, CMT, EA is the owner of The Advisory Firm, LLC in Alpharetta, Georgia, an independent RIA and Financial Planning practice. His undergrad degree was in Electrical Engineering and he was employed in that profession through the late 1990’s until the daytrading bug got him. He traded his own account out of Protrader Securities in Atlanta until 2002 when he moved into the retail financial advisor field with American Express. In 2006 he started The Advisory Firm as a fee-only practice. His professional qualifications include the Enrolled Agent (EA) designation allows James to represent clients before the Internal Revenue Service. He can be reached through his web site, http://www.theadvisoryfirm.net/.
GDP and Stock Prices

This article was originally published on April 30th, 2014.

Top Down security analysis starts with GDP which is the overall growth in the economy (gross domestic product is all goods and service produced within the US geographic boundaries) and then flows down to sectors and finally stocks to see how they would benefit from economic growth. In the long run, stock price growth should correspond to GDP. In the short run you will always have supernormal growth periods in new industries, technology advances or companies that are leading their sectors. Over time basic economics says that if that company is making money hand over fist, competitors will enter the market to absorb some of that profit and growth will slow as the industry matures.

Many high flying stocks from the past couple of years in areas such as 3D printing, Big Data, Internet and Biotech are getting sold fairly hard this year. The stocks that are performing well are consumer staples, utilities and energy. This isn’t exactly the leadership you would want to see if the economy is expected to hit a growth phase.

Then after all the Fed Stimulus, today’s GDP report came out. This little bump in the road may have a few economists scratching their heads about how we are going to see 4% growth this year:

IRA high yielding investment tax trap

This article was originally published on April 25th, 2014.

This Marketwatch article on high yielding stocks (click here) got me thinking that that it might be a good idea to reiterate a warning to investors regarding some tax issues with the strategy. In all fairness, the author tells investors with IRA’s and 401k’s to examine tax rules, but I think many spot the outsized yields and really don’t think about the tax drawbacks, let alone the potential financial warning signs that oversized yields bring.

LP’s and MLP’s:

If you see a stock or investment with LP in the name, think twice about putting that in your IRA. Why? LP’s or MLP’s are partnerships and have different tax structures than corporations. They are structured as pass through type entities. If you buy the stock, then you become a limited partner. This is great if you hold the investment in a taxable account, because as a limited partner come tax time you get a K1 (instead of a 1099) and get to claim your share of depreciation and non-
taxable return of capital (along with the nice dividends). However, this is a nightmare if you hold in an IRA. An IRA is officially its own entity, so if K1 income is issued to an IRA then your IRA gets to deal with a separate tax issue called “unrelated business taxable income” or UBTI for short.

**Here is the IRS’ definition of UBTI:**

The term “unrelated business taxable income” generally means the gross income derived from any unrelated trade or business regularly conducted by the exempt organization, less the deductions directly connected with carrying on the trade or business. If an organization regularly carries on two or more unrelated business activities, its unrelated business taxable income is the total of gross income from all such activities less the total allowable deductions attributable to all the activities.

You will note that the definition refers to exempt organization, typically you associate UBTI with a tax exempt org that has unrelated income. However, this also pertains to your IRA……..

**So what happens when you hold an LP or MLP in your IRA?**

If your total UBTI (K1) income from these investments if over $1000, then your IRA / Custodian must file a form 990-T and your IRA has to pay the tax. This means a distribution will have to come out of your IRA and go direct to the IRS to cover tax due on these investments, since your IRA is the limited partner (not you). Furthermore, if you are under 59 1/2 you will incur an early withdrawal penalty and ordinary income tax on the money that comes out of your IRA to pay tax on the UBTI. It isn’t pretty.

**What’s an alternative?**

The alternative is MLP type mutual funds that hold some of these high yielding investments but all income is 1099. You are a shareholder of the fund, not a partner of the LP. I’ve used several of these for clients and we continue to collect a nice dividend on a diversified set of energy companies, and don’t have to worry about K1’s.

**ETF’s structured as LP’s:**

There are a lot of ETF’s on the market and several are structured as Limited Partnerships (LP) so be careful if investing in them inside your IRA. Most are the commodity tracking ETF’s that track things like oil, natural gas, agriculture, etc. These are fine to use as long as you pay attention to the distributions. Most are simply non-distributing funds that track the futures market, but be careful if you buy one that has a yield. Holding it to long could toss you over the $1000 threshold for filing a 990.
Editor’s note: Recently, Dent Research posted a position in the MTA’s Career Development Center. If you are actively seeking a new position, the Career Development Center could be among your most valuable MTA membership benefits. This brief note simply highlights some information about Dent Research.

The core of the work at Dent Research is based on the Dent Method, which was developed in the late 1980’s by the firm’s founder, economic expert Harry S. Dent Jr.

According to Dent Research, “The Dent Method has the only documented record of success at forecasting long-term economic trends based on the study of and changes in demographic trends and their impact on our economy and the markets. It works by showing how predictable consumer spending patterns, when combined with demographic trends, allow us to forecast the economy years or even decades in advance.”

The method is based on five key precepts:

- **Predictable spending patterns at different ages and stages of life:** As we move through life, we change our spending in very predictable ways. These predictable spending patterns impact our economy, business, and product trends. Everything from the demand for potato chips and real estate to inflation rates, cycles of innovation, economic growth, immigration rates, and domestic migration — locally, nationally and globally — are impacted. By analyzing this information, Dent Research can forecast how spending will change in the years and decades to come.

- **Who spends what in the economy and its demographic impact:** Personal consumption, or what people do as consumers, represents about 70% of the Gross Domestic Product. That means that how people as consumers spend money is the largest influence on our economic health. As larger groups of consumers age and spend more, the economy grows. When large groups in the population pass their peak stage in spending, this leads to less spenders and slows down the economy.

- **Our birth rate and the immigration adjusted birth index:** New generations come along about every 40 years. As they age, they move through predictable earning, spending and productivity cycles. The peaks and troughs of these cycles can be forecasted by moving forward the birth index (which Dent Research adjusts for the births of all past and future projected immigrants) by the appropriate number of years.

- **Our Spending Wave:** Looking at U.S. history, Dent Research identified extended booms for 26 to 28 years followed by busts for 12 to 14 years. This happens because new generations come along about every 40 years. As mentioned above, as they age, they move through predictable earning, spending and productivity cycles. Peaks and troughs of these cycles can be projected by moving the birth index forward by the appropriate number of years to estimate peak spending.

- **The Inflation Indicator:** Economists think that inflation is largely a monetary phenomenon. It’s not. In reality, inflation is the economy’s means of financing not only the new, young generations that will become highly productive in the future, but also the new technologies these new generations bring. Based on the combination of...
a slowing economy from declining Baby Boom spending after 2010 and a slowing of workforce expansion, Dent Research expects a deflationary slowdown in the U.S until 2023.

Based on those precepts, the firm is able to generate important insights into the economy and the potential returns available in the stock market. Based on predictable spending patterns within each stage of life, Dent Research produced the following chart →

While this cycle highlights the broad demographic trend in the United States, Dent Research has found a similar pattern is unfolding around the world:
Volatility, as measured by the VIX, is low and is now at levels last seen in 2007 and previously in the mid-1990's. Although low volatility is often associated with market tops, there is no consistent pattern as to when the top will occur. Low volatility can and has persisted for months and years at a time.