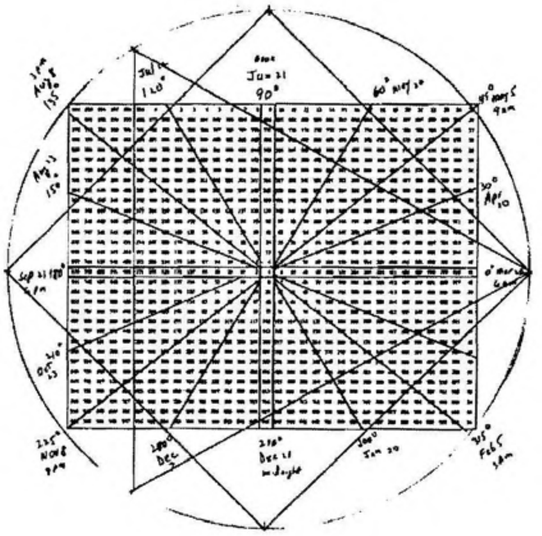
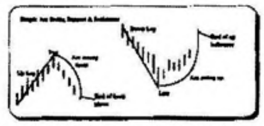
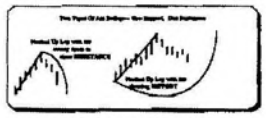
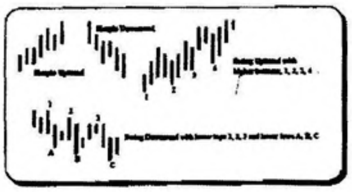






Michael S. Jenkins

Complete Stock Market Trading And Forecasting Course



Authentication No.__________ Signed Michael S. Jenkins

Acknowledgments

I wish to thank the following chart services for use of their charts in the various illustrations:

Daily Graphs
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Equis International, Inc.
3950 South 700 East
Salt Lake City, UT 84107

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Introduction

For the past several years many people who have read my two previous books, "Geometry of the Stock Market a Guide to Professional Trading for a Living" and "Chart Reading for Professional Traders", have written urging me to either write a course of instructions, or to put on more seminars to teach my methods of trading and stock market forecasting. This course of instruction is written to fulfill that need. By the time you finish reading this material, I expect you to have learned how to determine the true trend of any market, stock, or commodity on any world market, to forecast approximately how long a trend will persist and what the ultimate price targets are, and also to be able to successfully day trade the market. In short, this is a course of instruction on how to professionally take money out of the market and make a living doing so.

What this course is not designed to do is to teach you the basics of what a stock is, or how to open a brokerage account, or any other such rudimentary, basic endeavors. There are books available in any library on those subjects. This material is for the person who wishes to make a career of professionally trading the market, and has put in sufficient time and effort to begin serious study.

My perspective in this material is that of a technician and not a fundamentalist. Technical analysis is the study of the market with the underlying assumption that everything there is to know about the market or a stock is already reflected in the price and volume of the individual stock. No matter what the fundamentals are, or how they are changing, it takes buying and selling to move stock prices and without that, no investment will make any money. Even if a company has a hidden gold mine on its property, the stock won't go up until the insiders secretly start buying. The price action will inform the astute technician that a purchase is suitable, and the fundamentalist will often not get wind of the real news for months, or until the stock has had a tremendous rise.

This course, and my whole trading experience, has been developed around the principles of technical analysis, which forecast price trends and probabilities so that you can anticipate the big moves long before the fundamentals really develop. Of course, investing this way doesn't exclude using fundamental research in addition, but I only use that after the fact to better understand the true dynamics of the move. The price itself is the only real truth. If it goes up I want to buy, if it goes down I want to sell.

The art of speculation has often been likened to gambling, but there is a real difference between the two. In gambling, the house sets the rules and those rules favor the house. In speculation, like trading stocks, *you* set the rules. You decide *when* to buy or sell, *how much* to buy or sell, how much leverage to use and what your *stop out point* will be. You also have technical tools at your disposal, which will be covered in this course, and which can increase the odds of your being right in the trade by as much as 80 to 90%. This applies to both direction of the move and also the extent of the move. Speculation, then, is clearly different from gambling, and it can therefore be said that speculation can be a profitable profession, and you can professionally trade to make a living as in any business.

Fundamentalists are those who invest by looking at the economic facts and profit and loss statements of investment issues. Ninety percent of all the players in the market are fundamentalists, being either bank trust departments, mutual funds, pensions funds or wealthy individuals. Wall Street caters exclusively to this crowd because of the huge amounts of commissions involved and so technical analysis is often given a bad name and derided as not being worthwhile. "Market Timers" are always being criticized, but the facts are that the fundamentalists simply don't know how to forecast the market and would rather say it's impossible to do than give business away. There are many wealthy individual investors who have had books written about their successes in the market, and they frequently say that they bought a good stock and held on without market timing. That's certainly true, but those books are rare since they don't spend time writing about the millions and millions of investors who bought and held onto the wrong stock and broke even, lost money, or got wiped out. In short it sounds good to see that Coca Cola always went up, but I can show you many a chart book from 10 to 20 years ago where

10% of the big winners have disappeared and are simply not in the current books any more. In 1966 the big name stocks were General Motors and AT&T. If you held onto those names you only got back to the 1966 levels again by the mid 1980's. You would have been much better off selling and going to the bank or buying something else. For me, the long term buy and hold idea only works if your stock is perpetually going up. It doesn't make any sense to hold onto an asset that is in a long term downtrend, no matter how good the name is. This course will inform you, with 100% certainty, what the trend is and what you should do. Whether you are disciplined enough to do what the charts tell you is another matter. Some long term investors made out very well because they held on through thick and thin, while some traders jumped out but were afraid to jump back in even though the trend was up. In theory the trader who follows the rules or uses a mechanical system will always do better than the fundamental buy and hold investor if he follows the rules.

I'm constantly being asked the question as to whether someone can master day trading and make a business out of it. I always answer in two ways. First, I can teach you how. That's simple. The information for determining the trend and forecasting is readily available and not terribly difficult to learn. Second, I always say that trading is like dieting. Information on diets is plentiful and is a billion dollar a year business. But how many people go on a diet and keep the weight off? If you are disciplined enough to maintain a diet then you can easily become a successful stock trader.

In the final analysis there are four main driving factors in the human condition. These are Money, Sex, Power, and Religion, and perhaps a fifth, Art. These are what motivate people. All of these motivators are often found in the U.S. Congress to greater or lesser degrees, but in the area of money, the brightest minds in the world are either on Wall Street or Las Vegas. Note however, that all these bright minded individuals aren't all rich. Wall Street routinely pays millions of dollars a year in salaries to individuals, but most of that is for sales, not trading skills. You see, the market is fueled by the *emotions* of greed and fear. People who are attracted to the market, are attracted out of an emotional base of greed, and they use their rational mind to justify what they do. Since it's an emotional basis, however, they will always respond in an emotional way at precisely the wrong time and therefore lose money. This is why trading is like dieting. The principles in this course have been developed to strengthen your rational mind and mental skills to be able to control your emotions. You will be taught how to wait at emotional times to counter-trade the market against the emotional public and how to know when the trend is reversing, even though it looks emotionally scary. Technical analysis tools are objective measures that tell us without emotional involvement just what is to be expected. It has nothing to do with reading the newspaper or watching TV, thinking that news will make our stock go up or down. Perhaps for one day it might, but most of the time it's just random noise. In the cycle business we say " the news breaks with the cycle", which means it is the cycle that causes the news and not the other way around. This is simple enough to prove by just looking at the three or four big cycles that repeat all the time. These are 10 years, 20 years, 60 years and 100 years. The Kennedy-Lincoln 100 year cycle is well known, as is the decennial 10 year pattern. But the 60 year cycle has always been the key and since ages past, when the days of the week were named for the seven visible planets, it was known that those seven planets returned altogether to the same positions again each 60 years, and so that cycle has always been observed, from time immemorial. Currently, in the late 90's, we are replaying the late 1930's as to currencies, dictators, threats of world war and the rise of conservative governments and dictators (in a sense Churchill and Roosevelt *were* dictators relatively speaking). I'll discuss cycles more in detail in the following chapters, but for now bear in mind that if cyclic influences exist, and the evidence is overwhelming that they do, then fundamental cycles will return and prices will return to past habits. Technical analysis of those past patterns will be of great value to the professional trader.

Who Was W.D. Gann?

Much of my perspective in this material comes from the great master W.D. Gann, who died in the mid '50's, but was a major influence in forecasting and trading since the turn of the century. Perhaps no one before or after has ever been able to forecast as accurately or trade as well. While there are many Gann courses around, most are incomplete, as Gann wrote only a few that were not deliberately encrypted. Gann was a Mason and studied numerology, the planets, the Bible and other esoterica, and believed that the student must put in the time and effort and prove himself worthy before he could obtain the key. His thinking was similar to the Pythagorean school, which made new initiates prove themselves by taking a vow of absolute silence, without uttering a single word for a period of three years. In the Gann material there are deliberate "smoke screens" set up to distract the casual reader, but after years of study the more advanced student will find all kinds of esoteric and astrological truths hidden in his papers. I will try to reveal some of these methods in this course, but truthfully, many of these are simply too advanced for a course for the general public and I'll leave that for another time and place. Gann basically used angles, numbers and astrology to forecast and he developed dozens of number squares that were used for trading individual stocks and commodities. The Square of Nine is the most famous, and is used by as much as 20% of the pit in Chicago every day, so Gann still does exert a great influence. Most computer programs now routinely include Gann angles and cardinal cross numbers for the square of nine. I will mention these in the following chapters. You should at some point study Gann independently from my works, but be advised that most of the available courses and books in print tell only half of the story. I have been privileged to have spent nearly thirty years working in the market now, and over twenty years studying Gann, and over the years I have come to know well perhaps a dozen of the world's finest practitioner's of Gann's methods. I mention this only to warn you about the charlatans in the Gann business these days (and it is a real business!). The truth is more subtle and is not yet in print to my knowledge, although several recent books point in the right direction. My advice is to first master the basic principles of angles, cycles, numerology, charting, and then spend a good ten years on basic astrology and then you can attempt some of the Gann Bible interpretations as they relate to stock trading. Conversion of planetary longitudes into stock prices, and Biblical stories and age longevities converted into longitudes on the globe for commodity conditions are part of the key. There is much more, but none of that is needed to trade effectively and to make a living doing so. It's more of a spiritual discipline for later life. Suffice it to say Gann was a one of a kind genius who went to the grave with his secrets, but his writings offer clues as to how precise forecasting can actually be. Much of my perspective in this work is the same as Gann's and I will try to explain much of it as we go along. One final interesting note is perhaps in order. Gann became famous in the 1920's and 1930's when he accurately forecasted the 1929 top almost to the day and the ensuing great depression. Looking back with what we know about his methods utilizing astrology, numbers and cycles, it's easy to replicate that forecast, but Gann said he did it by another means. He said he read about it in the Bible. He often remarked that the Bible was the greatest book ever written and he read it over and over again and urged others to do the same. Perhaps this was his religion speaking, but a recent N.Y. Times best seller "The Bible Code" perhaps provides an answer that shows Gann's true genius. The Bible Code is based on a fantastic and ingenious idea that God encrypted all knowledge and future events in the Bible. The original Hebrew version of the Old Testament that has been hand copied down through the ages, with not one letter altered, has been tested in a high-speed, super computer, with regards to trying to identify letter sequences that might spell out words or sentences. Every letter in the Bible was strung out in a long sequence of hundreds of thousands of letters and then the computer compared every 2nd, every 3rd, every 4th every 5th, etc. letter combinations until it found "crossword puzzle like" sequences of phrases and names. Now, any big book will sooner or later comes up with random sequences of famous names like J.F. Kennedy or the like, but significant, non-random sequences would prove that the Bible was some sort of encrypted code that could contain an infinite amount of data, if these sequences were laid out in multi-directions and different dimensions. Indeed the size of the Bible, when comparing every nth letter, would be enough to include every name of every person on the earth today and facts about what would happen to them. In the Bible code book, huge military computers were used because of the enormity of the task, and it was indeed found that when 100 names and birth places of famous religious figures who came after the Bible was written were entered into the computer, all 100 came out in sequences that made complete reading sense as to their names and places of birth. Other names like Einstein being "brainy" or the Kennedy assassination and the names of Ruby and Oswald were also discovered. The purpose of this paragraph, however, concerns the computer discovery of a phrase similar to "1929 stock market crash and Great Depression." That's a paraphrase since I read the book briefly, long ago, but it stuck in my mind because of some study I was doing on Gann at the time. The essence of the Bible Code book is that it is only now, in the current generation, with high-speed, super computers that we can "crack" this Bible code and find the key to the coming purported, final millennium conflagration before it's too late. This was not available in prior ages since the technology wasn't developed. Only by having preserved the original Bible for four thousand years has this project been possible. Anyway, getting back to Gann, he didn't have access to a high-speed computer but he was a master numerologist and Mason. He also said he liked Isaiah the most of all the Bible chapters and religious scholars have told me that Isaiah is a miniature Bible in and of itself, mirroring each chapter in the Bible in its structure. My guess is that Gann found a master key in Isaiah that allowed him to interpret portions of text and come up with many of his prophetic forecasts. Perhaps a little Bible study could help us all.

Basics

Trading, as opposed to investing, consists of buying and selling the same stock many times in an effort to capture more price fluctuations than just holding on for the long term. Many stocks appreciate 20 to 50% or more each year, but these same stocks can often swing through these ranges several times over the year. Just catching one or two complete swings will usually double the return of the trader over the simple buy and hold investor. Technical analysis tools like charts and trendlines combined with timing methods are what allow us to exploit these daily and weekly fluctuations to our betterment. But before we start using charts to examine price action, let's review the typical investment cycle and discover who the players are that make the market move.

The big money in the market comes from institutional investors like pension funds and mutual funds, or bank trust departments. Some wealthy individuals affect some stock prices, but it usually takes the 10 million share institutional buyers to make stocks move. Without institutional support most stocks languish in long term flats with little significant price movement. In the past, economic cycle swings in the economy greatly affected companies' earnings and the price of these issues were quite volatile. Over the past ten to fifteen years however, the massive amounts of money going into institutional coffers has created an environment where there are consistent buyers almost every day, regardless of fundamentals. Price earnings ratios have climbed from 12 to 14 times to over 30 times. Some "go-go" stocks have P.E. ratios of 70 or more. This is more a sign of popularity and anticipated growth than actual economic prowess. Just before the Japanese bubble imploded in 1990, typical stocks had P.E. ratios of 70 or as much as 125! Even today with that market still down 50% for the past eight years, the P.E.'s remain near 30 times. In these times of somewhat irrational fundamental valuations, technical analysis of price movement is even more important than ever before. There will come a day when these P.E.'s will start to shrink for years and years and people will buy into such declines believing that they are bargains. Only an objective analysis of the price action at that time will save investors and traders. Because the money flows into the large institutions have been so big, the mutual funds industry has grown from some 700 funds in 1980 to over 8,000 at present. Keeping in mind that the entire NYSE has only 3000 listed issues, you can see the effect on stock prices of the growth of these investing behemoths. For them the strategy has simply been buy and keep buying the fastest growing companies and never sell. Because they have had perpetual cash inflows, they always bought dips each year as the market had corrections, and as a result always showed performance figures twice that of the general market appreciation during the year. If the Dow Jones went up 10% during the year, but had three dips of 5% along the way, and they added on every dip, their average cost would be such that if the market closed at the high of the year (and it always did) their return would usually be 20-30% or more. This was not due to any great investment philosophy or method, but simply the fact that if a market goes straight up and closes at the high each year and you add money, you will out-perform that average. The shock will be great the first year that the market closes at the low and the funds have added all year long.

Another "strategy" the funds have used is the diversified portfolio idea of buying at least 200 individual issues that were growing at great rates and to just keep buying. That way no one issue would account for more than 1/2 of a percent of the portfolio and even if that stock went to zero, the hit to the fund would only be 1/2 %. The result of this strategy is that when earning expectations disappoint, there is the wholesale dumping of entire investment positions of millions of shares and individual issues can and do drop 50% or more in a single day! This is insanity from an investment point of view, since no earnings fluctuation should have that kind of effect, but nevertheless that is the current strategy and one must adapt a trading plan around such outcomes, like avoiding stocks about to release earnings, or "piling on" once the break starts.

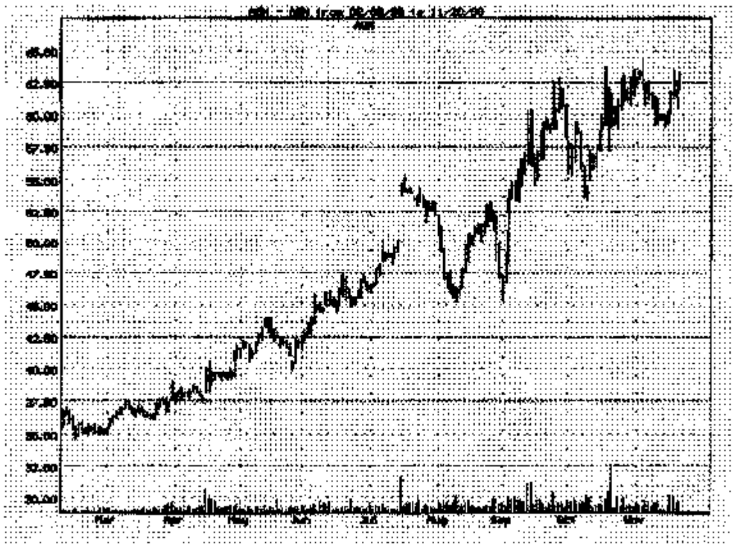
Institutional investors sell in an eyeblink on bad news, but they often buy quietly at limit prices over very great periods of time. To accumulate a 10 million share position or more in a stock that trades 300,000 shares a day might take six months. The rule of thumb has been that for every institutional order on the floor, that order will generate 3 times that volume by others "front running" the order and trying to jump in first. This is illegal, but it is a fact of life and most day traders make most of their incomes by jumping in front of big orders and making the institution pay up. The beauty of charts, however, is that these big orders show up in chart patterns as higher bottom patterns, where a level is held for several days and the volume increases, and then the stock moves up to another level slightly higher. The fund will often wait there for a few weeks and then if not satisfied will move up yet again. This is a sign of accumulation and is a sure sign of higher prices. As long as the price is creeping higher week after week, and each correction only goes back to a prior support level without breaking, that indicates the big money is not finished buying and is still there to catch the stock. A good strategy for day traders, is to identify such long term up trending patterns and buy into dips back to those known support levels. This can only be done through the use of a chart or log of stock prices over time, to record the various levels of price and volume transactions.

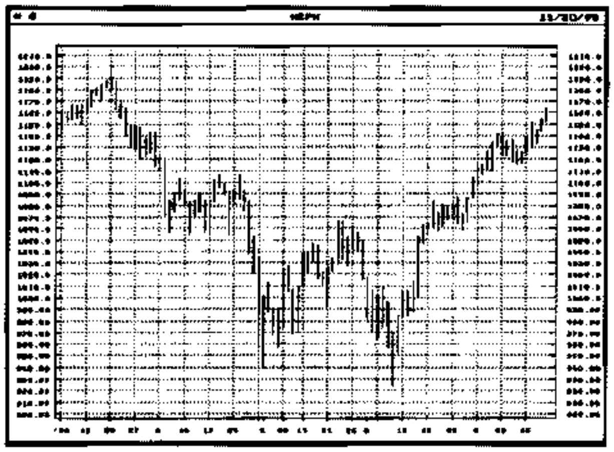
A declining phase will show a similar pattern only in reverse. The funds will start selling a few thousand shares every day using a limit order, and after a few hours to days of not being able to sell, they lower the price to another slightly lower limit for a few days. These walk down stair steps show downtrends and are used to sell short and only cover if the stock regains a prior high. Individual institutional positions can usually affect a stock's price for months at a time. At the end of an economic cycle, as the economy turns down into a recession, numerous institutions need money as investors pull out, and the massive liquidations create a bear market that can last for two to five years at a time. Individual stocks often go down for five years and can frequently stay out of favor for ten years before coming back. Only charts will help you decide at what point in the cycle a given stock finds itself and whether it should be bought or sold. So we begin our course in trading stocks with the study of price patterns, as seen on charts, in order to quickly identify trends to decide whether the stock in question should be bought or sold.

Charts

There are many types of charts that traders have used over the years, such as *line charts* which connect the dots of hourly or daily closes, *bar charts* which show a vertical line to represent the open, high, low, and close for each time period, and *point and figure* charts, which only record reversals in trends, such as every $3 movement in a direction. These point and figure charts are very good at showing long term swings and trend but they do not have a time element, so they can often show potential, but it may lie dormant for months or years. *Japanese candlesticks* are more visual and attempt to show reversals and volume by visually changing the size and shape of the daily bar. Thicker bars can show more volume, reversal bars have "tails" pointing in up or down directions, and colored bars (black or white) show the current trend compared with the prior bar. These visual bars are probably the best ones to use, but require much study and most chart services in this country don't always support them. *Logarithmic* bar charts show percentage moves on the vertical price scale, while the standard bar chart shows unadjusted time and price scales. Each of the various chart styles have something to say and can be used, but to start in a simple manner and demonstrate the beauty of price and volume patterns, we will start with the standard bar chart in this course. Later you may want to switch to other charts, but the principles will always remain the same no matter what chart we use. Basically, we just need a price history that easily shows us whether or not the price is going up, and enables us to overlay some trendlines and time cycle counts.

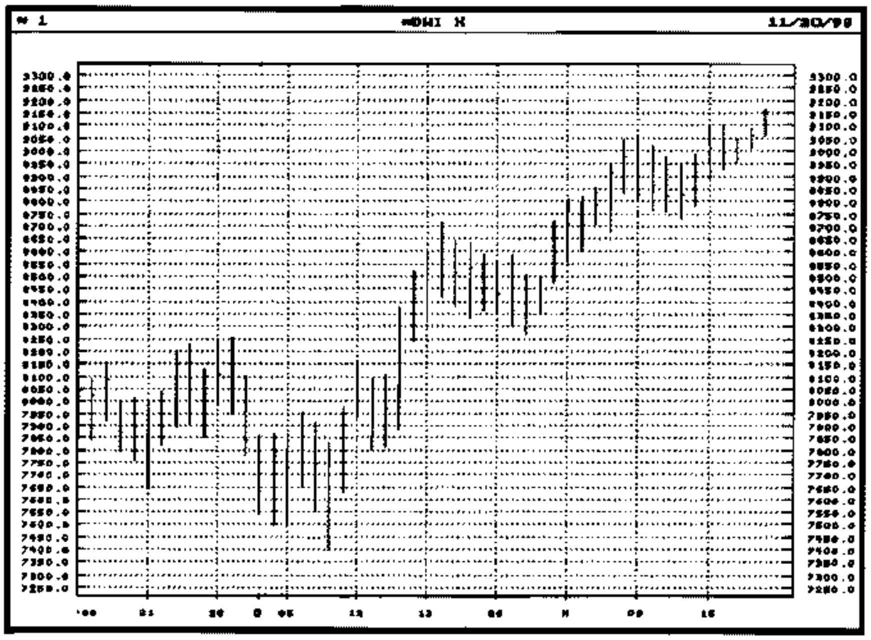
This first chart on the next page is a typical bar chart on a daily basis (one bar for each day) for an individual stock. The price is shown on the vertical scale and along the bottom are bars representing volume for each day and the time axis in days. We clearly see that this is an up trend, with few breaks to the downside that lasted more than a couple of days. Volume has been relatively consistent and low so that nothing appears to be happening here to change the present forces in play. If we were bullish on the outlook for the market we would make up a list of such issues and buy them on pull backs to past support levels.





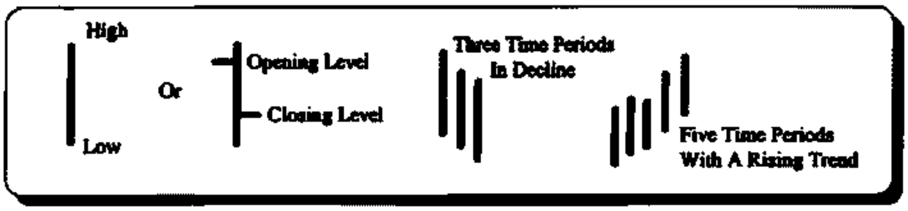
At right is a daily chart of the S&P 500 Index showing a downtrend into the October '98 low and an uptrend coming out. If one were to draw parallel channels around the highs and lows you could clearly see the directions of the trends. The width of the daily bars is usually fairly constant, or when it's not, it usually is a multiple of the average move, so if the normal day's movement is 10 to 15 points, a big day would be twice that, or three times that amount. Later we'll learn about "measured moves", which are standard fluctuations that most patterns exhibit and are very useful for forecasting price targets.

This next chart of the Dow Jones shows individual bars of about the same magnitude, but also note that the highs and lows of each



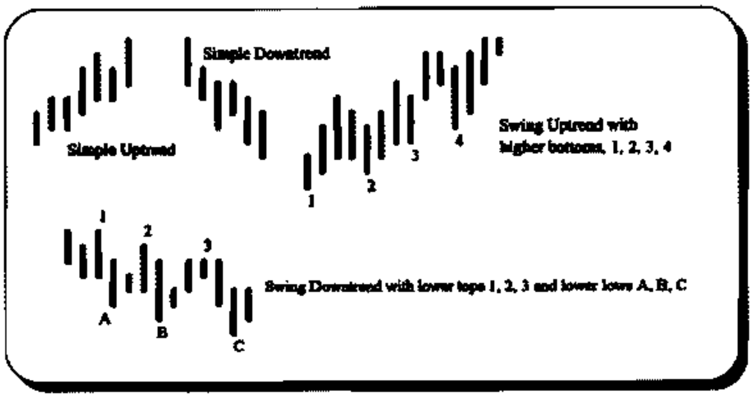
day don't greatly exceed the highs and lows of surrounding days except during times of "runaway" momentum moves. Most bars overlap the prior day's high or low by slight amounts and then fall back into the trading range. The most common error in all of trading comes from the tendency to buy or sell the "breakouts" thinking a big move is underway only to see it fail and later fall back into the middle of the range. Many day trading mechanical systems use this idea to scalp trades going against the move in the first 30 minutes of each day if there's a small overlap without much momentum. The ideal buying strategy is to wait to buy at a pullback point near the prior day's low, plus or minus a small percent and buy with a stop. Ninety percent of the time if you are disciplined enough to do this you will have a very good trade going for the next day. The emotional difficulty here is that usually the market opens up overlapping the prior day's high slightly and gradually trades down to the low of the day, which is the perfect buy point, but traders are so emotionally afraid that the trend is reversing, that they won't make the trade at the end of the day and carry it overnight. When that happens the buyer of last resort is of course the specialist, and he buys cheap stock and marks it up the next morning. Sometimes the best trades are ones we put in to buy with stop orders, or limit orders at a set price determined the night before, in the calmness of looking over the charts at the end of the trading day. If the charts truly don't lie, then those objective decisions made with careful calculations and protective stops, are the best ones and our emotions shouldn't override those decisions. Here again it's like dieting. If you're afraid to trade because you might lose money, you're trading with the emotion of fear and similarly you probably only buy out of greed to make money. This is not the way to beat an emotionally driven creature like the stock market. We must buy when we feel we must sell, and vice versa. We just can't be stupid and buy into a panic free fall or avalanche of sell orders on a bad earnings report. Interpreting the bar chart can help us determine the trend and the support and resistance levels we should trade near.

Let's start with the simple trend. The trend is up if the low of the daily bar on our chart makes a higher bottom than the previous low on the preceding bar. This trend can extend for long periods of time depending on how it is defined on a longer term chart. For instance, an hourly bar that's higher than a prior hour is up for that hour, but says nothing about the day or week's trend. Whereas a weekly bar on a chart composed of 5 days activity compressed into a single bar, will show trends lasting a week to three weeks at a minimum. When a market reverses it is similar to a series of Chinese nested boxes that fit one within the other. In other words, a turn on a 15 minute chart as it extends, usually turns the hourly chart, and after a few hours the hourly chart turns the daily chart and finally, after a few days the daily chart can turn the weekly chart. Big moves come when all these time frames cluster tightly together and all turn simultaneously. Oftentimes that's just after a very narrow flat with little price movement.



Traders love to jump aboard a flat breakout, since a big move comes very fast.

Basic Trends



Trends usually persist or else they wouldn't be of help in trading. The persistence of trend is usually at least *three bars at a minimum.* This is the rule of three, or three day rule, or three week trend, or three month trend. If the trend lasts more than three consecutive bars it will usually go a Fibonacci number of bars such as 3, 5, 8, 13, 21, 34, 55 etc. (The Fibonacci ratio 1.618 is achieved by an additive series of adding each number to its neighbor to get the next and is found in all aspects of nature. Here we have 1 and 1 to get 2, 2 plus 1 to get 3, 3 plus 2 to get 5, 5 plus 3 to get 8. etc.). On hourly charts a five hour advance is usually a sign of an uptrend, and we then look at 8 hours, 13 hours and 21 hours for reversal points.

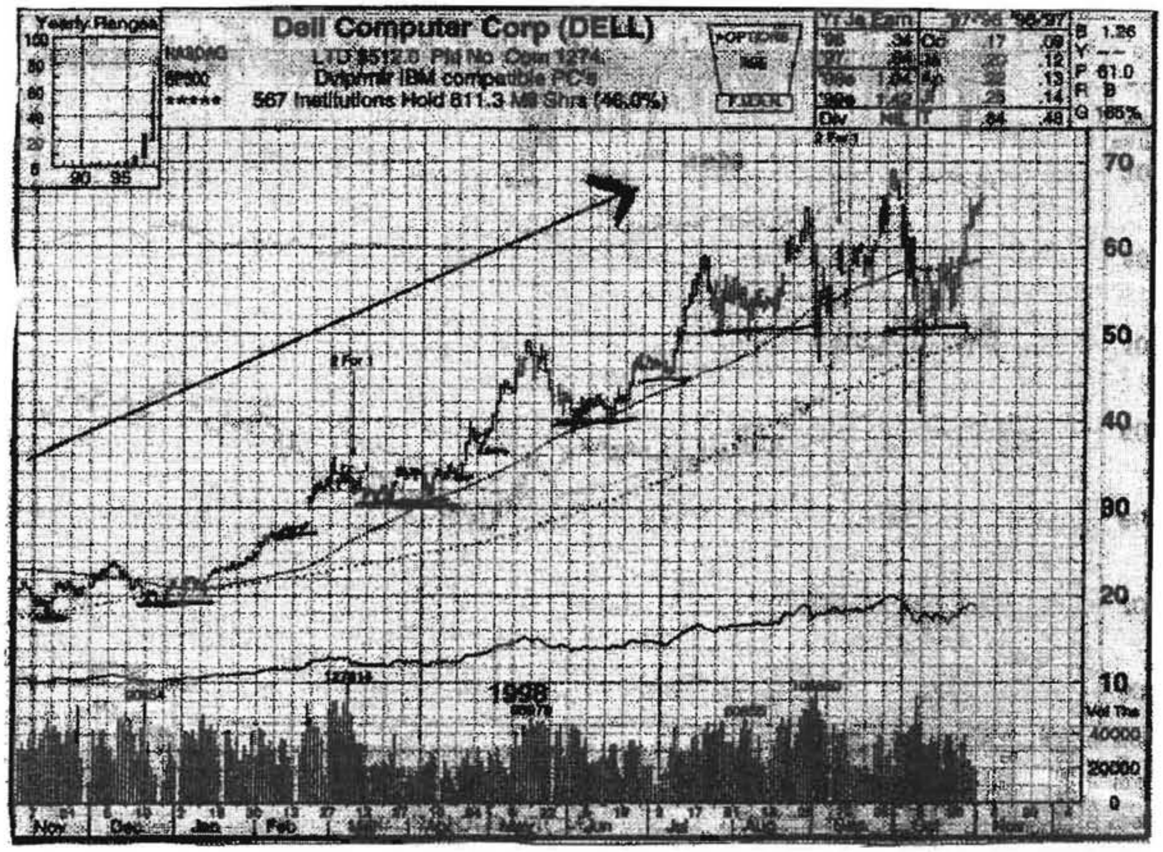
The bar chart examples shown above show simple trends and we need to know more about the volume traded each day and some long term perspective, but before we can do that, we need to examine reversals in trend and define just what that is. Since trends manifest to greater or lesser degrees, such as hourly, daily, weekly, and monthly, we will often get reversals of a *minor* nature, that will not change the main trend. In the final analysis, this confusion of which trend is the dominant one is the key that separates good traders from everyone else. For instance, over the past decade each time the Dow

Jones averages dropped a few hundred points, it looked like the long term trend had turned down. Certainly the hourly, daily and even weekly bar charts showed lower bottoms and lower tops, but the yearly chart never broke a low from the prior bar (year) and neither did the quarterly chart (3 months to a bar). In most cases the monthly bar chart only broke the low of one bar and not three months, to show a persistent trend that would define a long term decline. For traders, the trade turned bearish with the hourly chart breakdown and the daily chart breakdown, but when the bottom was made the hourly chart and daily turned up before the monthly turned down again. Long term investors, like mutual funds never sold, since the breaks were so short lived, but it was scary to hold positions through 200 to 500 point Dow Jones drops if you didn't really know what the trend was. At the end of this lesson you will know.

The *uptrend* is defined as a bar chart that makes *higher bottoms,* or the lows on each bar are higher than the prior bar's low price. Note that this definition says nothing about the *highs* on the bars. Uptrends are caused by accumulation by big institutions, who buy at the bid side of the market on limit orders and don't chase prices. As long as the bid side holds and goes up it shows unsatisfied buyers in competition with each other, so they keep raising prices to higher levels creating the higher bottoms pattern. Day traders and the inexperienced public often chase stocks up on good news, creating the high tick on the daily bar chart and are forced out at a loss as soon as the price drifts down. Usually the low that they sell out at is slightly higher than the last low and the perfect place to buy, not sell. This points out the emotionalism of the market. When people buy out of greed, they chase stocks and buy high to later sell low. We want to buy low to sell high. That's impossible if you buy when everyone else is doing so and the stock *looks* good. We want to make note of the prior day's low, or better yet the prior week's low, and be prepared to buy at that point with a trailing sell stop if we're wrong. To summarize again, the rising trend shows a series of higher bottoms on bars on each of the various time periods traded.

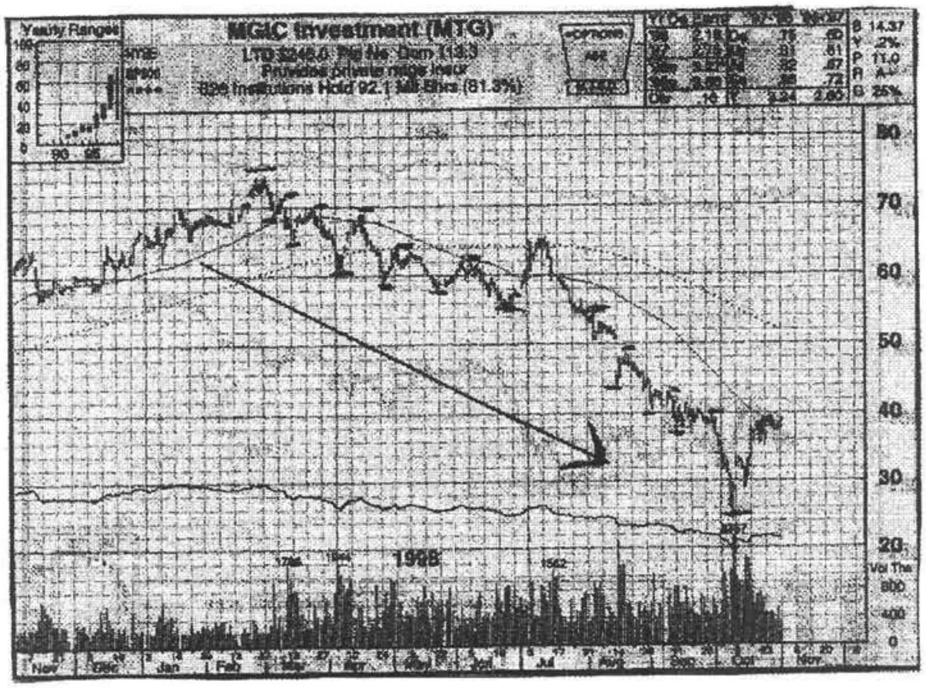
The downtrend needs *two* criteria to validate the trend. It needs *a series of lower lows* or bottoms, *and a series of lower tops* or highs. Each low should be lower than the prior low and each high should also be lower than the preceding high. Note that this is a *pattern.* The most important idea in all of the discussion about trend is that *trends are defined by patterns.* In uptrends it's simply higher bottoms. In downtrends it's both lower highs and lower lows.

Keep in mind the process of selling or liquidation. Investors are in competition with each other to sell out because of bad news, or need for funds, and if the volume doesn't support the selling they must lower their prices to get out. The only buyers are usually bargain hunters, who only show up at new lows for a scalp, or the buyers are shorts who are covering at a profit. This creates the pattern of lower lows and lower tops, as people continuously lower their expectations. Basic Uptrend:



Trend is up. Bottoms are all higher or at the same level.
Small breakdown in October during crash, but lows are quickly regained which is a classic sign of another buy signal.

Trend is down. Series of lower tops and lower bottoms. Only one small exception of lower tops in entire move and that is quickly erased. Also note that this is an identical time period to chart before, demonstrating two very different investments.



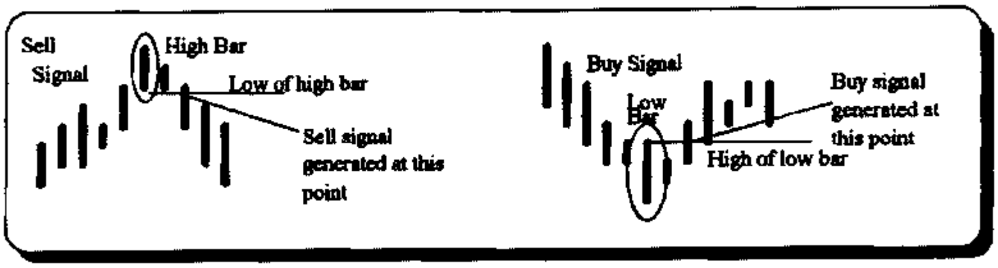
These two examples of trend clearly demonstrate the importance of trading each stock individually and not as part of a general market theme. Usually stocks will follow the main trend of the market averages, but there are many exceptions, and if you just held onto this declining example you could have lost a lot of money waiting for it to turn around. Trends persist, and I have seen past leaders turn sickly and go continuously down for three to five years before attempting a comeback. You must therefore be objective and trade the patterns and not use guesses.

Reversal of Trend

We know that an uptrend is a series of higher bottoms and a downtrend is a series of both lower tops and lower bottoms, but what indicates a reversal? In its simplest form a reversal on a bar chart occurs when the extreme bar is identified as being the prior bar and the opposite extreme of that bar is exceeded on the next bar. In other words, in an uptrend you find the high day bar where the high was the highest price for the move and you note the ***low*** of that bar, not the high. Most technicians will tell you to watch the high, but that's not what happens in real time. At the high, the reversal is made when exhaustion sets in, and since the big buyers are always on the bid side of the market, the penetration of the low is the sign that the buyers are gone. Sometimes the penetration of that high bar low won't occur for several days and the price will be in a narrow range, neither taking out the high nor the low, but once the low is taken out, the sell signal is given.

The reversal of a downtrend occurs the same way. You identify the low bar of the move and note the ***high*** of that bar. When that high is subsequently exceeded, the trend turns up and you can go long with a stop at the low of the move, which would negate the buy signal if it went back down to that low. Again, keep in mind that the sellers use

Reversal Bar Signal Pattern

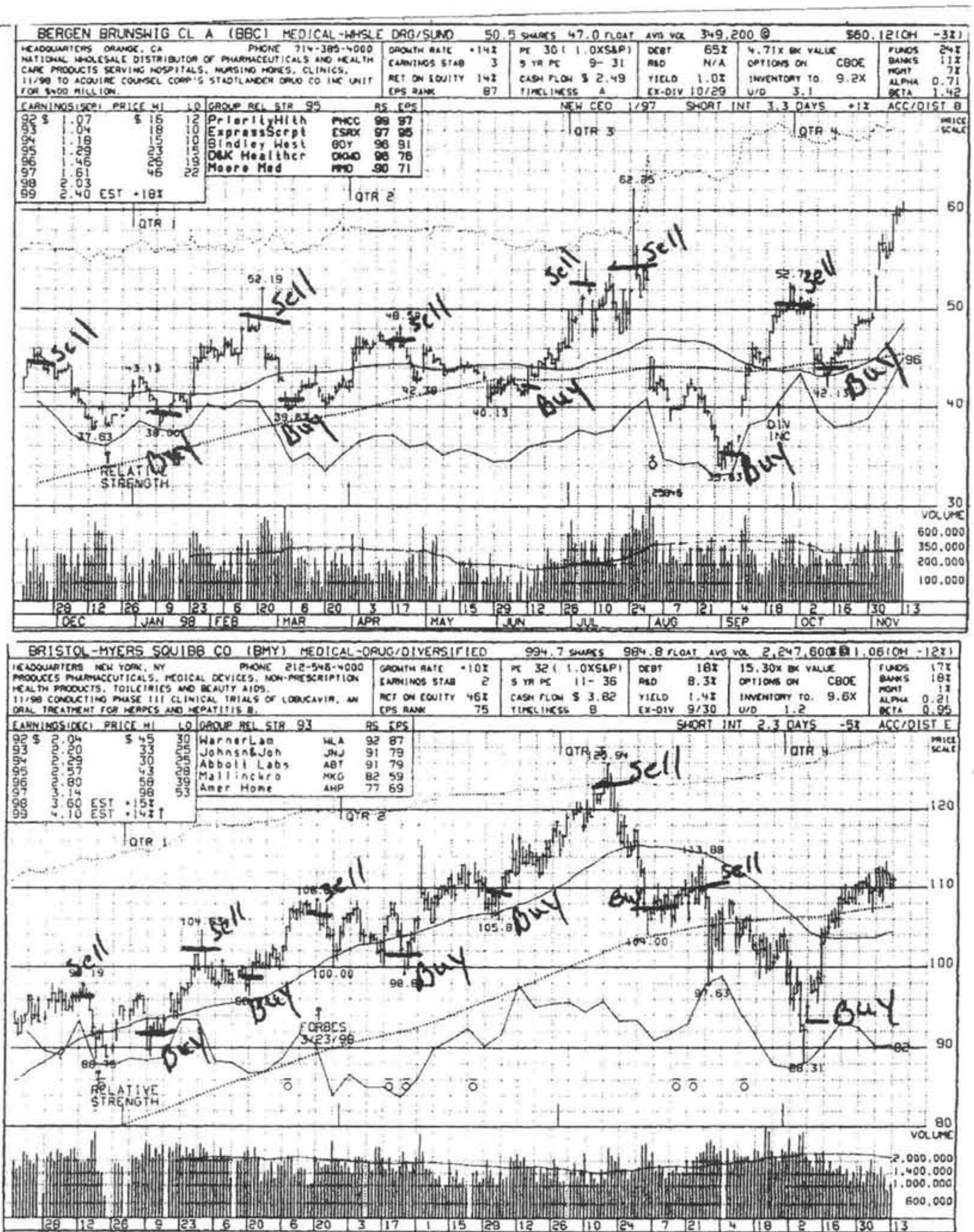


limits and are working the offer side of the bar, so that when that is exceeded the sellers are gone, at least for the time being. The illustration above shows examples of both signals.

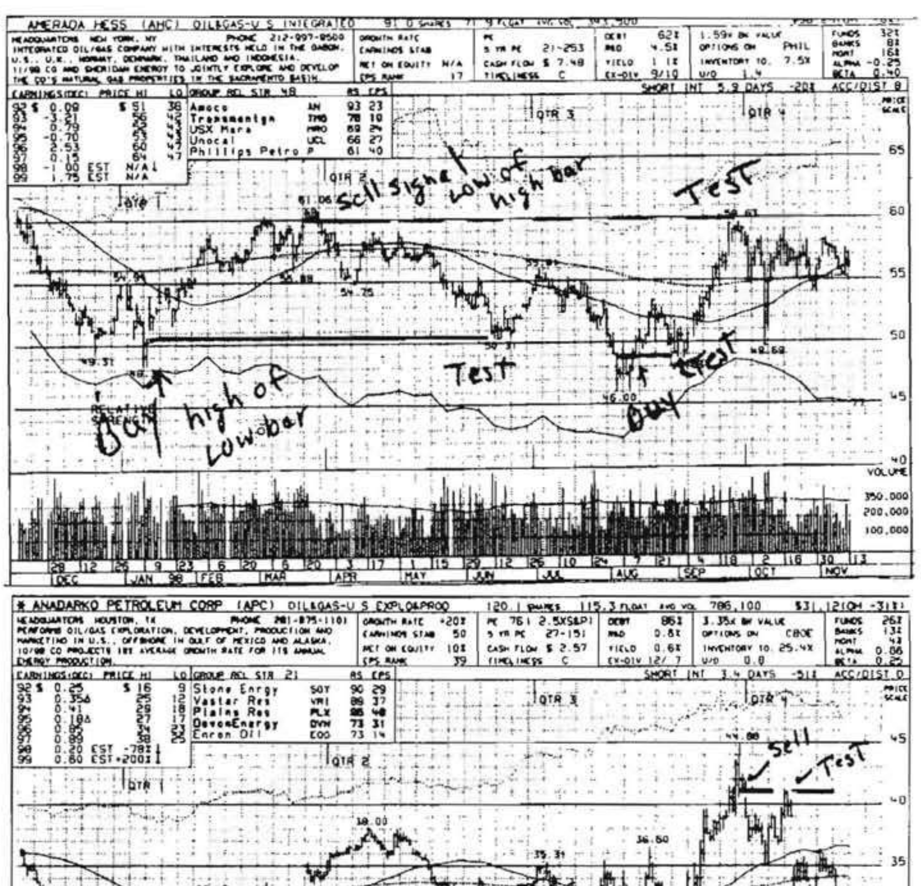
These are simple buy and sell reversals and if taken indiscriminately will lead to swift and sure bankruptcy. What is needed is some judgment as to how long a trend has been in effect and whether a normal measured move in some direction has occurred, which usually ends the move. Trendlines breaking, combined with time cycle counts coming to an end, are usually helpful. High volume is usually indicative of reversals and price reversal momentum is also often a key. In big moves like the endings of bull markets, the first few weeks can often reverse the entire gains of the past year or two. But no matter what happens, the first sign will be a reversal of an individual bar and that should be noted for reversals on all next larger size time scales, like hourly turning to daily, weekly, etc. The next page shows two examples of several simple buy / sell signals. Not all of them are shown, but as you can see, the ones that came at the end of extended moves were good for several points at a minimum and often went weeks before reversing out.

I've used the term "measured move" before and we'll see examples of it later on, but the concept is basically that over a given time period like six months to three years, the players in the market are the same. Over long time periods their composition may vary, but for the intermediate term they exhibit the same buy and sell habits and their reactions to extremes don't change very much. If we examine a chart over a few months to a couple of years and note the extremes, we will notice that each stock or commodity has an extreme bullish and an extreme bearish phase and these can be "measured" with a ruler, compass, or even our fingers on the chart. The idea is simply that once a trading move has reached this usual extreme, a reversal in trend is expected. Looking for reversal bars can be beneficial if they fall at one of these normal extremes or "measured moves" (see page 28).

Simple buy and sell signals



Tests of prior buy or sell reversal bars usually come at the point the original signal was generated.

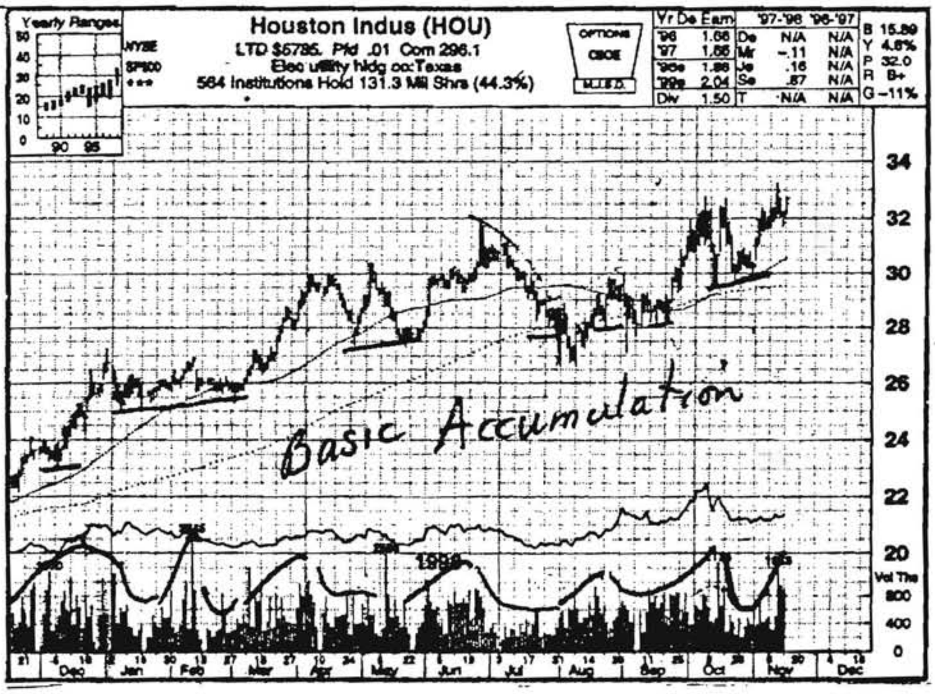


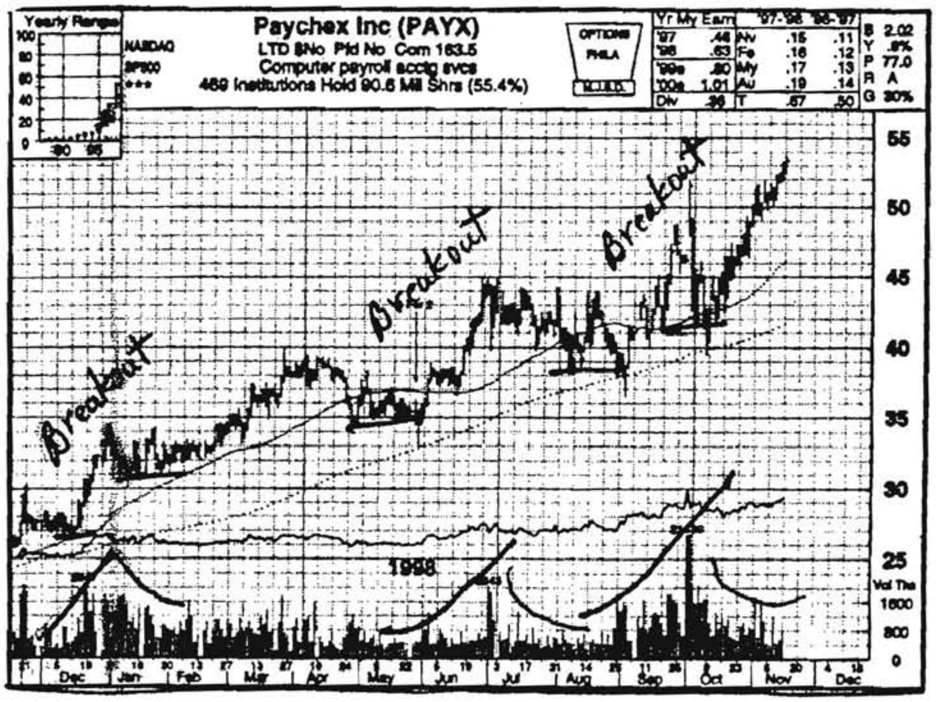
An adjunct to the simple buy / sell reversal bar idea is that once the signal has been generated and you later get a counter trend movement back to where the signal was given, that movement will usually fail exactly at the point of the original signal. Ninety-nine percent of all other books on technical analysis erroneously tell you to expect a test of the high or low and that's what all traders watch for. It hardly ever happens, however, as these charts indicate (page 22). The move will stop before the extreme, at the place where the buy or sell signal was given. In a long term trend that is one way to validate that the long term trend is still operative. For example, if you get a buy signal and six weeks later on a correction you go back down to the "test" area and then generate another buy signal, the second signal confirms the first as being long term valid. It's quite possible to see a string of such signals stretched over a year just pulling back to prior signals and confirming their initial ruling.

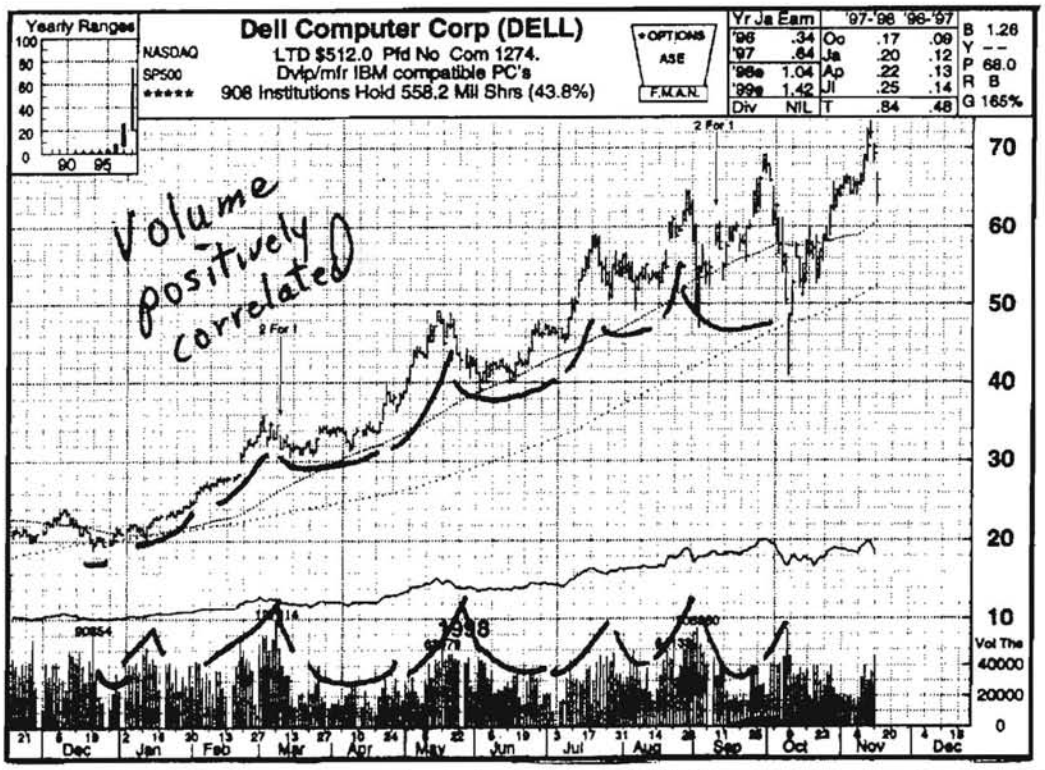
Volume

No basic discussion of chart patterns is complete without examining volume patterns. Unfortunately, little is written about volume, although it is one of the most important considerations to the trader. No significant move can ever take place without some heavy volume being done, but in the middle of most moves, volume dries up. It is imperative therefore, that in examining charts that you notice where the very heavy early accumulation took place. Big volume starts as the move is just beginning, because the big institutions take large positions and it may last several months to a year or more before it subsides. After that the stock may rise another year or two before seeing big volume again, this time on the sell side, as they start to get out. In general, it is said that volume is positively correlated, or that the heavy volume goes with the direction of the primary move and especially in the bull move, the volume goes up as the stock goes up. This is the only time that volume is really bullish - when the move is just getting started. Most of the time volume is negative, in that when it shows up, buying and selling are matched and a top is made. A decline then usually results until the volume dries up to the lowest reading of the move and then when it increases, the buyers are back and the advance starts again. Some technicians use a simple general market sell signal tied to three day or five day moving averages of the volume. After a high volume reading, as soon as the moving average turns down, the market tops out.

You must pay attention to the pattern of volume over a several week period. During that period you will note the normal spikes of volume that are usually found within a day or two of all the swing highs and lows. If an advance has been underway for three weeks, and then the biggest volume of the month is recorded, it is a certain sign of a coming correction. Likewise, when you are day trading and buying into a three day dip, you are likely to see increasing volume with little price movement. That usually means the seller is getting "cleaned up" and the stock is about to reverse. I once learned this from an old professional, who pointed out to me a stock that was doing about 6 million shares that day when the average volume was 1.2 million. I was bearish and the stock was down 50 cents on the day on that heavy volume, but he correctly inquired of me why it wasn't down a lot more if the volume was really selling and not scale buying. Of course he was right and the stock reversed up on the close and quickly ran about $10 over the next three days. I now make it a point to match my predicted lows and highs with exceptional volume. Cycles also bring in the volume and in the general market you



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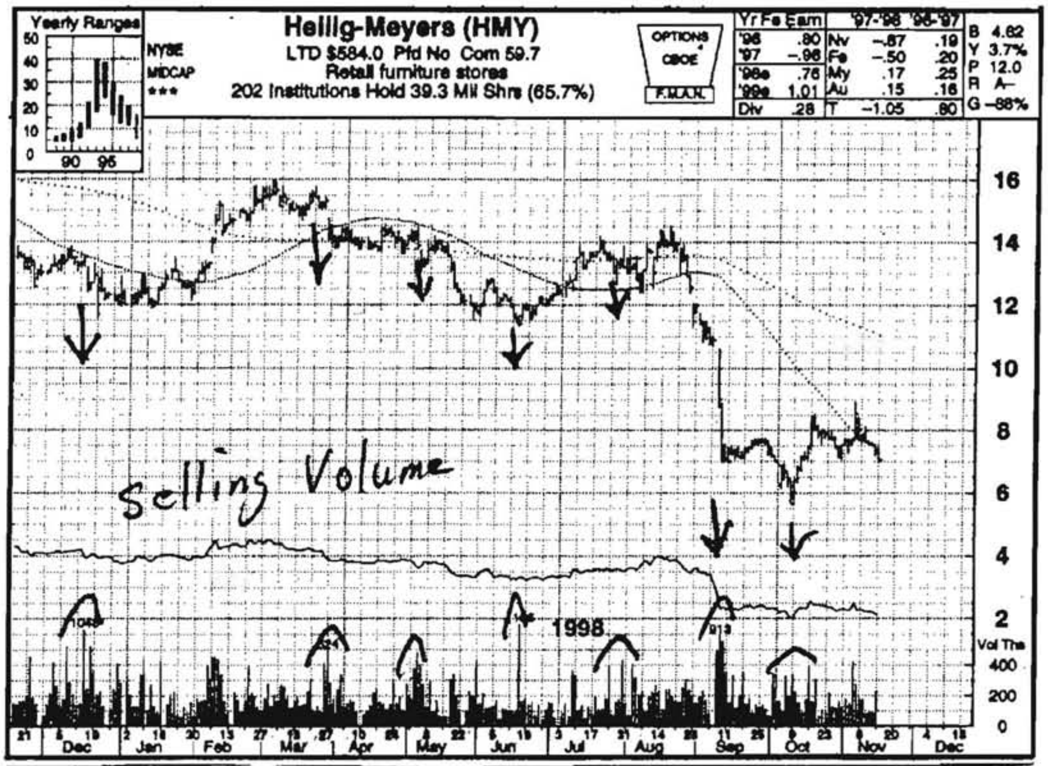
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NYSE
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Yearly Ranges
Selling Volume
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