DecisionPoint Trend Model

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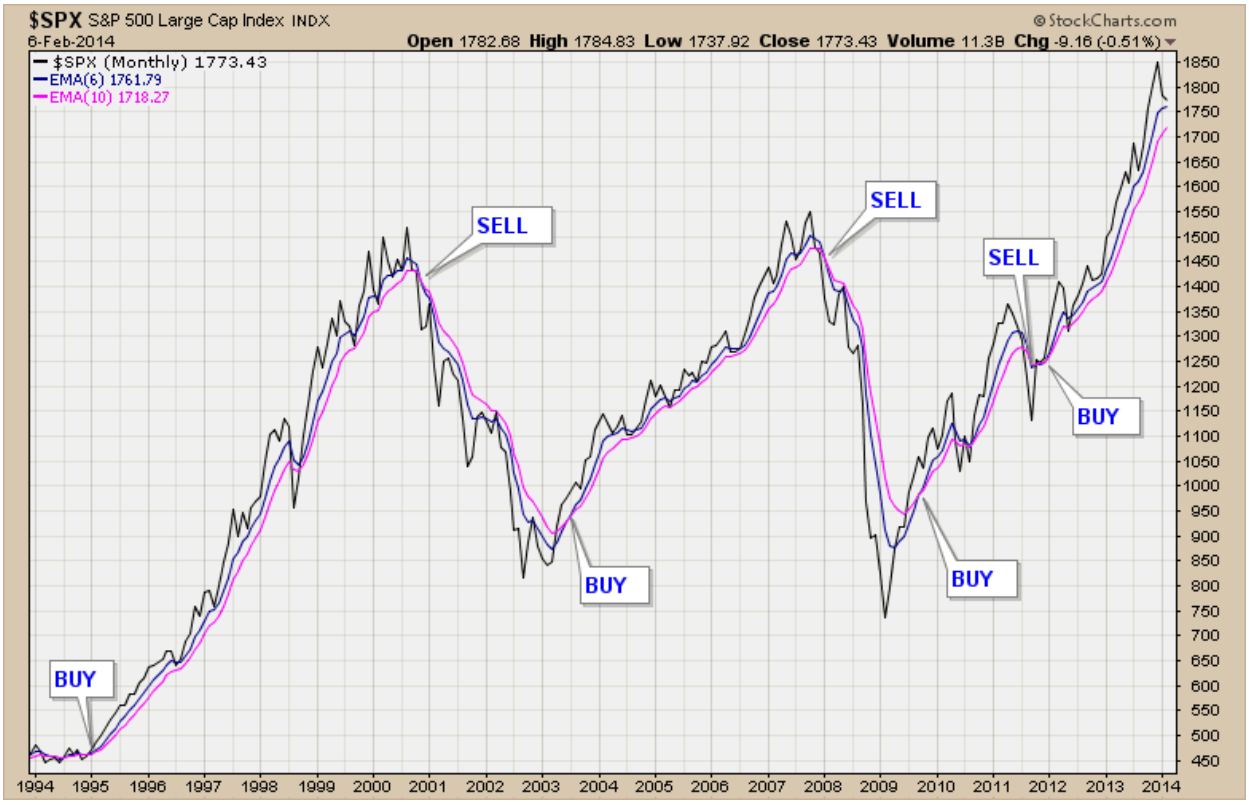
Introduction

The trend is the observable direction of the market – up, down, or sideways – and, by acting in concert with the market trend, we significantly increase our odds of success. The reason for this is that the trend of the market normally indicates the direction of most stocks and sectors. In fact, during a strong bull market over 90% of stocks can be trending upward together, which means our odds of picking a winning stock are nine out of ten.

DecisionPoint Trend Analysis focuses on three timeframes – **short-term** (days to weeks), **intermediate-term** (weeks to months), or **long-term** (months to years). These are broad definitions and can be shifted down into shorter timeframes (i.e. short-term could be hours to days), but it is important to always be aware of the trend in three consecutive timeframes because they are interrelated, and actions must consider all three. The longer-term trend is the dominant and most important trend, but the shorter-term trends can be where long-term trend changes can first be detected. In other words, the longer-term trend determines the strategic stance, but the shorter-term is where tactical moves are made.

Long-Term Trend

The long-term trend uses a Moving Average crossover signal on a weekly or monthly chart. A “fast” and “slow” MA is used. The fast MA is calculated on fewer periods and will respond to price changes faster than the slow MA. Look at the monthly chart (each data point represents one month) where a 6-EMA and 10-EMA (6-month and 10-month periods) are used. The trend is bullish when the 6-EMA is above the 10-EMA, and bearish when it is below. The 20-year period below is a perfect example of how well this methodology can work. It doesn't always work this perfectly, but overall it is very effective in correctly identifying the trend. Note how the 6-EMA crossed above the 10-EMA at the end of 1994, signaling the beginning of a new long-term bullish trend that lasted until late 2000. Then the trend changed to bearish as the 6-EMA crossed down through the 10-EMA where it remained for over two years during the worst bear market in decades, finally crossing up again in spring 2003. In early 2008 there was another downside crossover, which identified the beginning of another bear market even worse than the one before it. Then another upside crossover in late 2009. In 2011 there was enough volatility to cause a downside crossover, which was followed quickly by another upside crossover.



(Editor's Note: The moving average combinations chosen are not “magic bullets.” They are effective for DecisionPoint Trend Analysis, but other combinations could also be used similarly.)

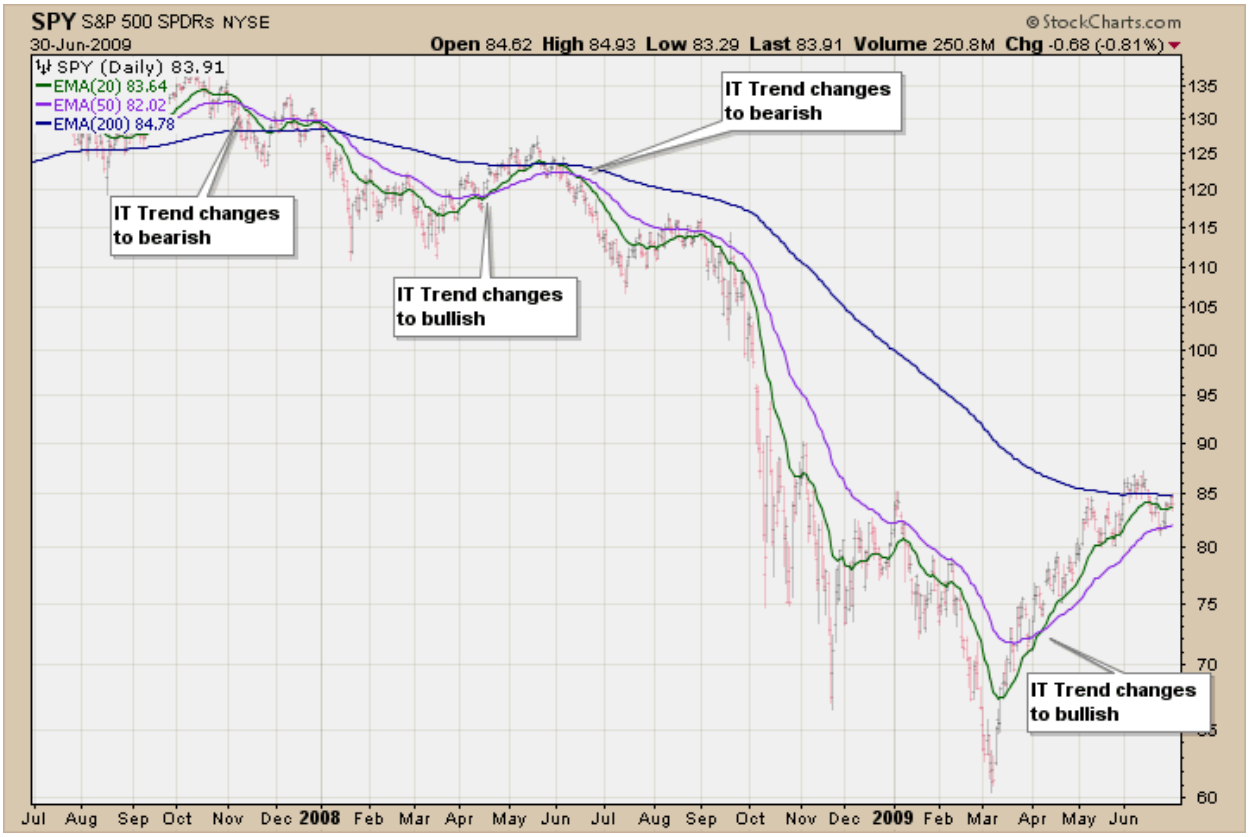
While the EMA crossovers offer an unambiguous way to determine the trend, there are other nuances that are useful in refining trend assessment. Note that there are times when the price index crosses through the EMAs, as well as times when one or both the EMAs move counter to the trend. Any time one or more of these actions occur, you should consider the trend to be neutral, leaning toward bullish or bearish depending upon how many of these countertrend conditions exist.

The monthly chart is effective, but we have to wait until the end of the month close before the numbers are “official,” so a similar mechanism for a weekly chart was developed so an official reading on the long-term trend can be reached at the end of each week. On the weekly chart, the 17-EMA and 43-EMA are used, and the same rules for the monthly chart apply. Note that the EMA crossovers occur at about the same places, and, except for the added detail from weekly closing prices, there is very little difference between the two charts.

Finally, the long-term trend can also be derived from a daily chart using the 50/200-EMAs. The same methodology applies. If the 50-EMA is below the 200-EMA it implies a bear market and if the 50-EMA is above the 200-EMA it implies a bull market.

Intermediate-Term Trend

To determine the intermediate-term trend, the 20-EMA and 50-EMA are used on a daily chart. Again, the same rules apply regarding EMA crossovers, EMA countertrend movement, and the relationship of price to the EMAs. If the 20-EMA is above the 50-EMA, the trend is bullish. If the 20-EMA is below the 50-EMA the trend is bearish.

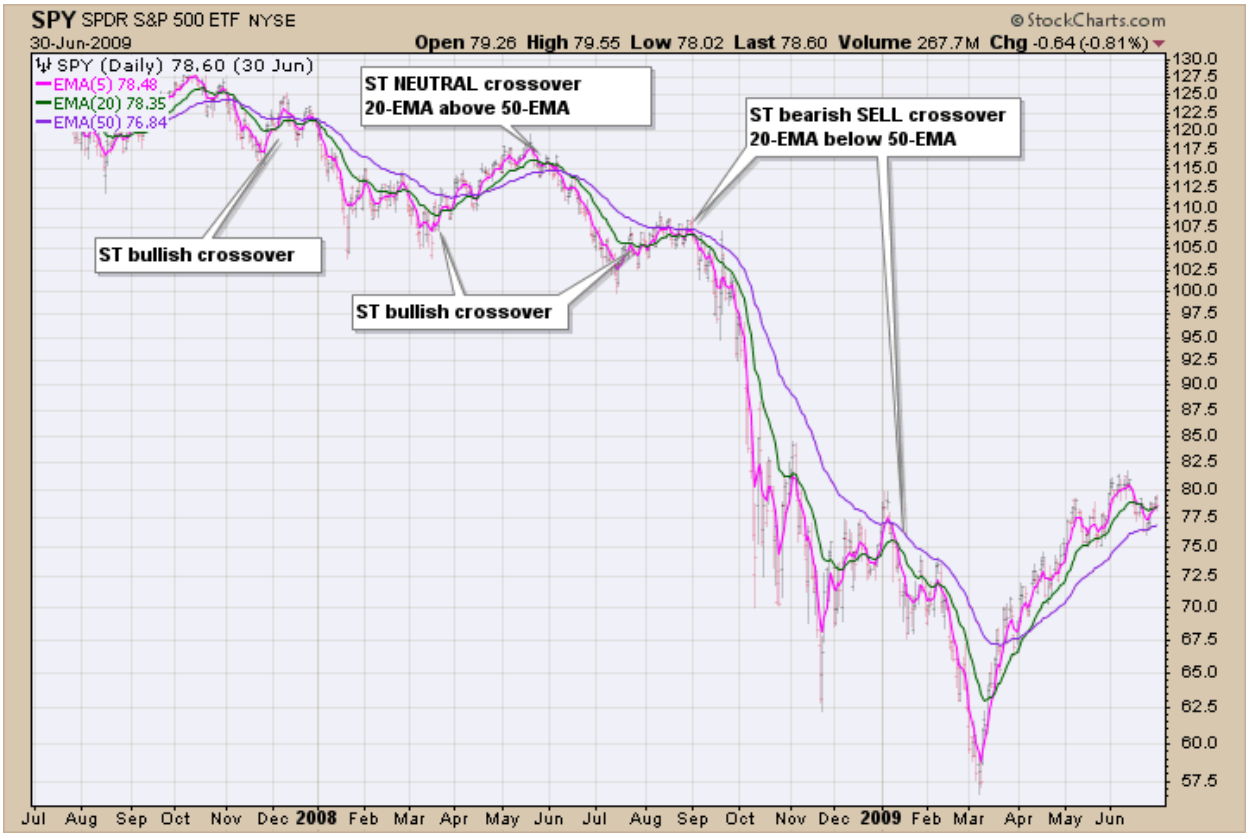


For negative 20/50-EMA crossovers in the intermediate-term, the 20/50/200-EMAs can be used together to determine if a bearish crossover is a sell (sell/short) or neutral (hedge or cash) trend change. If the 20-EMA crosses below the 50-EMA while the 50-EMA is BELOW the 200-EMA, the signal is especially bearish or a sell/short trend change. If the 20-EMA crosses below the 50-EMA while the 50-EMA is ABOVE the 200-EMA, the trend change is neutral because technically, if the 50-EMA is above the 200-EMA it implies the longer-term trend is bullish or in a bull market so “neutral” is more appropriate than a “sell”.

Short-Term Trend - Bull/Bear Market

The short-term trend is determined using the direction of the daily 20-EMA. If it is moving up, the short-term trend is bullish, and vice versa.

This can be taken one step further by adding in the 5-EMA and following 5/20-EMA crossovers as with 20/50-EMA crossover in the intermediate term. For example, if the 5-EMA crosses above the 20-EMA it is a bullish short-term trend change. If the 5-EMA crosses below the 20-EMA while the 20-EMA is above the 50-EMA, it is a neutral trend change. If the 5-EMA crosses below the 20-EMA while the 20-EMA is below the 50-EMA it is a bearish “sell” trend change. Note that the 5/20-EMA crossovers occur frequently, so following the direction of the 20-EMA is the preferred method of determining the short-term trend.



Conclusion

DecisionPoint Trend Analysis is an uncomplicated moving-average crossover system that is designed to catch short-, medium- and long-term trend changes relatively early in the move. It uses a 5-, 20-, 50-, and 200-EMAs (exponential moving averages) for this analysis; however, another combination of moving averages could be used that is more suited to your own preferences.