

# Guide to Fundamental and Technical Analysis



Elite Training

# Guide To Fundamental & Technical Analysis

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EDUCATION



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**INTRO**

# Introduction: Essentials of Success





“

You can break the rules  
and get away with it, but eventually,  
the rules break you for not  
respecting them.

- EDWARD TOPPEL

”

The markets are a unique and wonderful place. They see unfathomable amounts of money exchange hands on any given day. As a trader you will be amazed by the boundless opportunities that await you.

The training presented in this manual will help you propel yourself to succeed in the ever-changing and exciting world of today's markets. Each topic is critical on its own but it is vital to approach the information as a whole.

## Keys to Your Success

There are five principles pivotal to your success. By applying these principles, you separate yourself from the millions of investors who are simply taking a chance or gambling in the market. The stock market and gambling are two very different things to an investor who follows these keys.

**Notes****PRINCIPLE #1: Master Plan**

Any savvy investor will tell you that they have implemented a plan, which has led them to successful trades. They have a system, a routine, a structure and/or a road map. Your plan may be simply stated or very detailed but it is vital that you have one written out. The question is: Why are you trading?

**PRINCIPLE #2: Training**

Some people use newsletters, stock picking services, one of the talking heads on television or countless other “resources” as reasons to invest, but you will want to have the training and ability to do it on your own. Make sure that you understand each strategy that you are going to use. Be a professional and learn the ins and outs.

**PRINCIPLE #3: Tools**

In the current trading environment you will need to have advanced tools to give you an edge. One of the most important things for a beginner to learn is how to use the software tools that he/she has to implement the master plan. You may be very bright, capable and yet a lack of tools can hold you back from true success. Great traders still rely on helpful tools like the MachTrader to identify opportunities, stay organized and move forward day-by-day through the markets. Chapter 2 goes into depth on how to use the tools of the trade.

**PRINCIPLE #4: Discipline**

Fear and greed are a part of human psychology. They can be destructive forces in your trading account if you don't have a strict discipline to rules. Trading is quite simple at its core: You need to make good position choices and have the discipline to allow those winners to prosper as well as cut your losses to a minimum. Chapters 3 through 5 will help teach you how to make good position choices through fundamental, technical and indicator analysis. Chapter 7 will discuss how to create and follow rules that help control fear and greed.

**PRINCIPLE #5: Implementation**

It is common for beginners to have a little stage fright when it comes to trading. Many beginning investors want to “learn it all” before they get in there and start. Implementation is critical in the process of training. You have to practice to become good at anything. Starting

**Notes**

today you should begin this process. Paper and practice trade each and every strategy that you learn. Make a mental choice to take action. If you learn to follow principle #4 you can confidently apply and implement all of the strategies. Even the best of traders are wrong. You will need to understand that trading is not always about being right. It is about having the right strategies and implementing them over and over again so that you land on the right side of probability.

## Now It's Time to Begin

We just briefly introduced some of the products and concepts that you will need to understand to succeed in trading. This manual is designed to examine these concepts further as well as teach you how to identify opportunities to make money using these strategies.

There's an old story that has a student approaching a famous traditional scholar asking, "Can you teach me the entire Bible while I stand on one foot?" The scholar gets very angry and throws the student out of his office. Not giving up on his quest for enlightenment, the student then approaches a more open-minded scholar and poses the same question. The second scholar answers, "It is simple; love thy neighbor as you would thyself. The rest is simply explanation." This manual takes the same approach. You will be taught the most important of trading principles as simply and as straight-forwardly as possible.





---

# CHAPTER 1

# Getting Started





“ You can break the rules  
and get away with it, but eventually,  
the rules break you for not  
respecting them. ”

- EDWARD TOPPEL

As you read in the introduction, you will need to have an idea of what your master plan is. Most traders have some vague preconceptions of what it will be but haven't quite put the time in to define it. Alas, a trader puts pencil to hand and starts writing down his ideas of what he expects. The mapping process is detailed and specific and it reads: "Make Money! And lots of it!"

Of course we all want to make money. That's just part of the trading game though. This might seem like an obvious and sufficient goal. But to be successful, there has to be a road map from point A to Z.

**Notes**

By approaching the markets with dollar signs in your eyes, you can fall into some traps that many traders seem to find. The following are a list of common problems that traders encounter due to the flawed approach:

- Trading based on tips
- Trading stocks we “know”
- Getting emotionally attached
- Rationalizing bad trades
- Holding on to losing trades because of a refusal to take a loss
- Not having a trading plan
- Putting a large amount of risk into a single trade
- Taking profits too quickly

## Trading Based on Tips

Finding good stocks to trade can be difficult if you don't have the right tools. Many traders turn to so called “experts” like television personalities, newsletters and even their friends to pick stocks. Although any one of these people might be the best stock trader in the history of markets, their stock picks may not help you much.

Learn to do your own research. It can't be stated enough that the best trading comes from self-discipline and application. Nobody can do everything on his or her own, so it may be ok to take in a tip from an outside source. But, if you do, you will want to thoroughly research the stock and make sure it passes your system rules as well.

Consider a conversation that may occur between two friends about a stock:



*FRIEND:* “Hey, have you seen that stock XYZ lately? Man that is really cooking with gas. It was up two points today and has been rocketing higher! You may want to take a look and get onboard soon.”

*YOU:* “Really? How do you know?”

*FRIEND:* “I bought it last week and it's making me all kinds of money! This thing is going to the moon!”



**Notes**

So your friend made a great trade last week and now you're really interested because you want a piece of the action. Well, great for him but don't you think the stock's rewards and risks have changed since he bought it? Think about it this way: Even if the stock is going to continue upward, wouldn't it make sense to go out and do all of your own research first? Of course it would.

Rarely will great trades just fall in your lap. You will need to do your research and work for them. Much of trading is planning for the future. Think about it, you can't go back to last week and buy the stock when your friend did, can you? Of course not.

Other forms of tips include media and newsletter services. Many people love the television stock picking shows for their entertainment. Realize that's mostly what they are: entertainment. Can you glean some good information from turning the TV on?

It's possible but the same logic above would apply here. Don't buy a stock just because someone on television tells you to. Learn the right way to approach trading. It's done by responsibly putting in your own hard work.

## Trading Stocks We Know

It can be a good investment strategy to look for stocks that are tied to products that you're familiar with. It may also be smart to trade stocks of companies that you know well, either through their business ventures or management. This can be a smart way to go – in fact it can be a great way to approach building a group of candidates. It still doesn't tell you when to get in.

Good trading requires a multi-faceted approach. There can be many reasons why you're strategically bullish or bearish on a stock. You may think that the company has great products, low debt and a strong management team but that doesn't give you the entry point.

So the next time you look at your favorite shoes and think, "Man, I wear this brand, my kids wear this brand, and so do all the kids in the neighborhood"... wait. You may find the brand is a great investment. But you may also find that the company and the product lack a future. The point is to thoroughly think these things out and make sure they meet all of your trading rules.

**Notes**

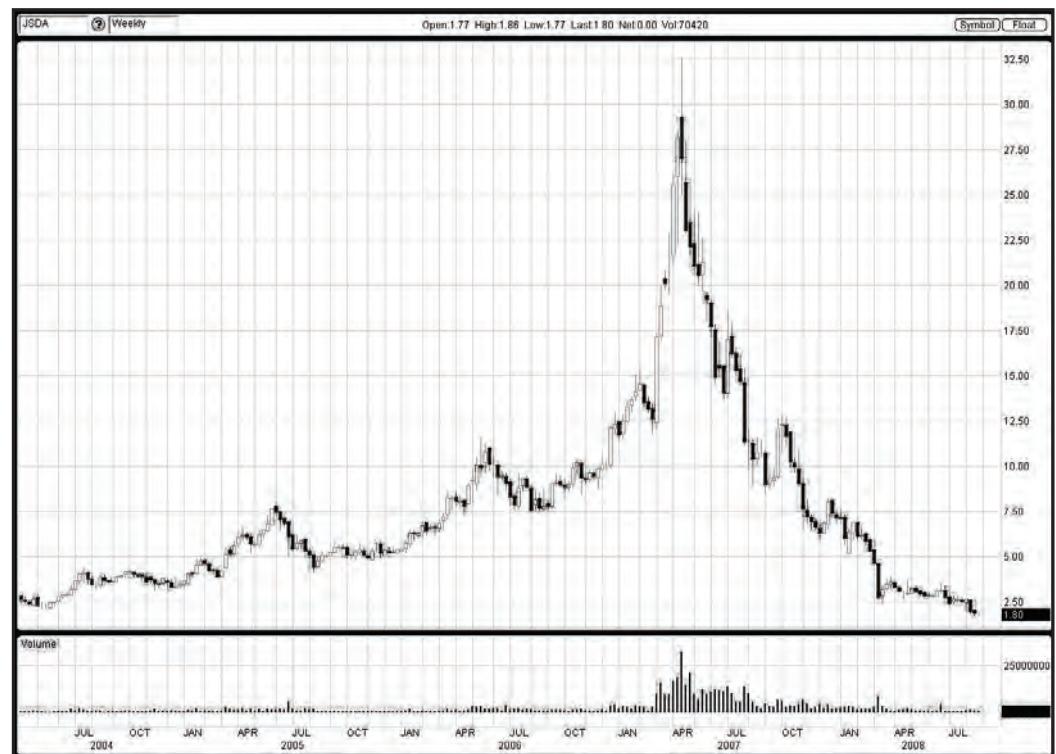
## Getting Emotionally Attached

Either of the two problems we've discussed can lead to another, more serious problem: getting emotionally attached to your investments. This happens naturally for many of us, and emotions are a normal part of investing. Since we are looking for companies we like, we often start with products we use. Brand loyalty is a pretty strong phenomenon. Apple or Microsoft? Many of us will have a preference. Getting emotionally attached to stocks means that we want to buy the stock and hold onto it forever. I love my iPod and use it every day, so it would make sense that I should buy Apple and hold onto it for as long as I can, right? Wrong! That is exactly the trap that so many of us fall into.

Getting "married" to a stock means that we hold onto the stock no matter which direction it is going. Our brokers and mutual fund companies indoctrinate us that we are investing for the long-term — if we like the company, we need to be willing to ride out the normal market fluctuations. DON'T BELIEVE IT!

Here's an example. In 2007, Jones Soda Company had been flying high based on a strong demand for business and new product placement in high-traffic areas. Basically, they had their unique brand of

FIGURE 1.1



**Notes**

sodas get shelf time in Walmart stores. At its peak the company's share price reached \$32.60.

Suppose you bought the stock on the run up because everyone was talking about it. Would you have had the discipline to get out when it started to turn down? I'm sure many of us think, "Of course I would! I would never hold a stock all the way to the bottom." But that's exactly what some buy and hold investors do. For many it works great, just until the time that it doesn't and it can burn you.

During that fall in the stock you may have had some thinking along these lines:

*INITIAL REACTION:* "It's just a little dip; I'm in it for the long haul.  
Market corrections happen. It's a great company."

*LATER:* "This company will come back! They can't keep dropping, can they? The fundamentals will start to work soon."

About the time you're shooting yourself in the foot: "Well I can't sell now! I've got to wait until it comes back to the price where I bought it!  
Let's put it in a shoebox somewhere and check it later."

One of the biggest problems with this scenario is not even that you lost the money. That hurts for sure. But can you imagine all of the emotional capital you spent watching the stock drop month after month? And think about this: If you would have stopped out like a good trader would have done, how many other trades could you have made with that money?  
When your money is tied up in a losing trade it can't be used for a winning one.

## Rationalizing

One of the most important rules you have as a trader is to cut losses quickly. It is wise to use a stop-loss order to do this. If you don't get out of trades before they go down it's easy to start to rationalize why you should stay in longer chasing the loss. Something emotional happens to a trader when he takes a loss. To many it seems like an admission of failure. To a veteran trader it was just a cost of doing business. One of the mindsets you'll want to embrace as you start to trade actively is that losses not only happen but they are part of the business. If you don't trade the losses well, it doesn't matter how good you are when you trade the winners.

**Notes**

Everyone feels like a genius when the trade is going in the direction we chose. A great measure of a trader is how does he manage the loss?

## Taking a Loss and Minimizing Risk

Getting out of a trade can be an important thing to do in your account. For a beginner it will be smart to set a protective order on every single trade that you make. Stop-loss orders are the most common form of a protective order. There are advanced techniques that involve protecting the risk through options and futures contracts and these can work great as well.

Adverse price movement is not the only risk to your trade. Too much volatility and time can be risks as well. Trading done correctly is most definitely a business. As a businessman you want to turn your product over a lot to be successful. If you stick with too many trades too long waiting for them to come back up, then you are sitting on a product that simply isn't moving off the shelves.

Here are some common complaints about the use of a stop-loss:

- I get stopped out too often
- The market seems to find my stop then it goes right back up
- I set the order up, but then it doesn't go through

Realize that by placing a stop out in the market you are protecting yourself from an adverse move in the other direction. This can help keep a losing trade manageable. Most mistakes with stop-loss placement happen because the entry point was off to begin with. The best way to ensure that your trade will work well is to make a strong entry into the stock. Bad entry can more easily lead to being stopped out prematurely.

Another error that is common with traders is to set the order up and then the trade doesn't behave the way that you thought it would. Order entry and software use are two of the most important things to master when you're new. You have to learn to communicate with your broker and you must learn the tools of the trade. Without them you will miss opportunities. Make it a goal to master these two areas now so that they become second nature.

**Notes**

## Always Have a Trading Plan

When you decide to go to the grocery store to buy something you'll naturally map out the route in your mind. Get in the car, turn on the car, pull out of the drive way, drive to the store, etc. As a trader you want the process of trading to become this natural. Until it does, it is important to map out the starting point, route and destination that your trade will travel. In other words, you need to make a trading plan when you trade.

There are three basic components to a trading plan. They are as follows:

- Entry point
- Stop loss
- Target

And some advanced components would include:

- Researching potential news events like earnings releases, economic reports and company reports that can affect my trade
- Deciding on adjustment techniques using equity options or futures contracts
- Assessing the risk the trade poses to my account as a whole
- Assessing the potential risk the trade poses if I end up taking a loss on the trade

It isn't required that you keep too many records but, at a minimum, you must write down the three basic components. It will be wise to also ledger some of the advanced components to the trade as well.

## Five Ts of Trading

The Five Ts of trading were developed to help provide an easy step-by-step method to identify and make trades. While the terminology may be a little new, the concepts are not. By walking through the Five Ts on each trade you will increase your probability of a successful trade. It also can help you develop and record your trading plans.

In time, the process of analyzing and executing your trades will become second nature to you. Until that point, don't be afraid of being systematic and following the checklists outlined here until they become habit.

**Notes**

## First T

### TRADE IDENTIFICATION

This occurs as we are reviewing our watch list and conducting our scans. While doing technical analysis on the stocks we will see trade setups occurring. Four setups that we will focus on here will be Bullish Retracement, Bearish Retracement, Bullish Breakout and the Breakdown.

Once a potential setup has been identified a trader should “score” the pattern according to their personal guidelines and rules associated with the pattern. These are broken down into four categories. More detail on these criteria is listed under the section dealing with each specific pattern.

The idea is to only put our money to work in the market when the number of factors suggesting a meaningful move in one direction is great enough to justify the acceptance of the risk of failure. We must understand the concept that trading is not about being able to predict the future; it is about the probability of what will happen. Trade Identification is one of the keys to increasing that probability.

## Second T

### TRIGGER

This is our entry point to the trade. For example, if our personal rules on a Bullish Retracement tell us to get in above the high of the previous day, then the moment the price goes above that point, we are “triggered” into action.

## Third T

### TARGET

This is our potential exit point to the trade. Targets should never be wishful thinking or areas we hope the stock gets to. Targets should be based on technical analysis and logical places the stock could get to.

**Notes**

## Fourth T

### TRADABLE INSTRUMENT

This is the vehicle we are using once our trade setup has been triggered. Stock is one tradable instrument. A Call option is another example. We will be discussing different tradable instruments involving options.

It is crucial that we use the correct tradable instrument with the trade identification setup we encounter. Understanding the basis behind the technical analysis and how the tradable instruments work important.

## Fifth T

### TRADE MANAGEMENT

While dealing with stop losses, trade management is far more comprehensive than placing a stop. What are our strategies if the stock goes up, stays stagnant or goes down? Is a simple stop loss the best course of action if our setup fails? Becoming familiar with the different management techniques and applying them may be an area of great interest.

It is important to note now that not all trade management strategies apply for all tradable instruments. Some results can be crippling if we do not understand how they work or when to apply them. Make sure there is no doubt in using a strategy before attempting to apply it to a live trade.

THE FIVE Ts can be a wonderful guide to walk you through a trade from start to finish. Simple in nature and easy to understand with a little study, they can help us think through any trade we make, keep us from missing critical areas of analysis, and increase the probability that the trade we make is a successful one. The following are two examples of trades recorded using the Five Ts of trading:

**Notes**

**FIGURE 1.2.**



**TRADE IDENTIFICATION:**

The stock has a long-term uptrend (weekly chart) with six months of consolidation bringing the price back into the primary trend line. Since the company missed its earnings target in April it has been in a consolidation between 55-65. It has a fundamental score of 97 carrying a PE ratio of 26 and the historical and projected numbers show growth quarter over quarter and year over year in earnings and revenue. The average analyst rating has improved over the last few weeks with an upgrade and an average target price of 73-77, its next earning out on 10/25/07 after the close.

**TRIGGER:**

I propose we enter a buy order to fill us on a breakout of 65.01

**TARGET:**

My target is 70. The ATR is running near 2.50 so this would be a 2 ATR target. Also a round number is usually a good place to see potential resistance. Also, if it broke 65 this would be an extension of a move started from 58.00 on 10/1/07 which would be a \$12 overall move which is about the max for a date and range swing trade for this stock.

**TRADABLE INSTRUMENT:**

2 January 65 Calls. These calls will be ITM on the breakout. The delta is currently at 51 but with few dollar move to the upside that delta will be around 60. They currently cost 5.6 where on the breakout we can roughly expect 7-8 for the contracts. That puts us at roughly 1500 invested and in-line with the money management we discussed.

**TRADING PLAN:**

Stop initially set at 62.5 to give it room to breathe on the breakout. If it continues up at 67.5 we'll adjust to stop @ 65.00 to protect gains. At 70 I propose selling 1 contract and holding the other with a stop at 67.5 and we'll adjust target appropriately. We also would need to put the order in now contingent to fill the options if the stock does breakout.

**Notes****FIGURE 1.3****TRADE IDENTIFICATION:**

Bearish breakdown trade. The stock has recently reversed trend and the price was breaking below a support zone.

**TRIGGER:**

Below 85.00

**TARGET:**

Around 70.00 which is the next support zone.

**TRADEABLE INSTRUMENT:**

Adjust the buy to cover down as the trade develops looking for a sell-off down to our target. At that point we'll re-assess whether we need to take profits or keep adjusting the stop.

As you see, each entry may simply be a page in a word processor program. You could even take notes in a journal manually if that is best for you. In Figure 1.2 the trader went to great lengths to detail the different components of his trade. In Figure 1.3 the trader simply stated each of the Five Ts very directly to keep a record of the trade. Which one will be best for you? The truth is that either will work fine as long as you keep records. You need to keep score in this game so that you know if you're doing well or poorly. The Five Ts are a great way to record our trades.

**Notes**

## Establishing Trading Rules

Trading rules are the essence of disciplined trading. Think about a jet airplane. Before takeoff, the pilot and crew go through an exhaustive checklist, from making sure the wing flaps work correctly to checking the air pressure in the landing gear tires. If any one of those items is not just right, the plane doesn't move. The same principle applies to trading stocks. Trading rules allow us to establish specific DO's and DON'Ts to guide our trading. We'll include some examples in this chapter.

This isn't an exhaustive list; it's intended to get you thinking about some of the kinds of rules you could use. The principle is simple - as soon as you start thinking seriously about buying a stock, be sure to compare that stock against your trading rules. If that trade would break any of your rules, then the decision is made for you; that trade won't get off the ground.

This is an idea that is new to most investors, even experienced ones. But this is how to minimize the effect of emotion in your trading. If you are looking at a company you are familiar with, you will quickly reach a point where emotionally you feel tied to that stock, and you will get excited about buying it. If that stock meets all of the trading rules you have outlined, then great! Buy it! But if it breaks any of your rules, you will have to rein back on those emotions and force yourself to stick with your established guidelines. The nice thing is that you will only have to force the rules on yourself a few times; after some experience and a few positive results (and seeing the negative results you saved yourself by not buying a bad stock), following the rules will become automatic to you.

So this strategy makes all kinds of sense, right? But as you start to outline the rules you need to incorporate into a trading strategy, you may get stuck and find yourself wondering, "What kinds of rules should I use?"

**Notes**

## How To Develop Trading Rules

If you are an experienced investor, you have a ready resource to draw on. Think about your previous trades. You probably have more than your fair share of horror stories. Think about those awful experiences. What could you have done differently? Was there something you should have looked at in the beginning that would have kept you out of the trade? Maybe there was something specific you could have done during the trade to preserve profit you lost or minimize the size of the loss you took. Write down your thoughts about those mistakes. Now you have your first set of trading rules to get you started.

If you are a new investor, don't fear! Your advantage is that you get to learn from - not repeat - the terrible experiences of other investors. You probably have friends, family, or associates who have shared some of their stock market horror stories with you. Review those stories to determine what your friends could have done differently. Write down your answers. And there you have it! Your first set of trading rules!

Keep in mind that your trading rules should be a dynamic, living document. This isn't an exercise you go through once, store them away and never refer to again. Your trading rules belong right in front of you whenever you do your investing and trading. As you gain experience use that experience to identify what you need to do differently the next time. Don't think that you are going to start by placing terrific trades right out of the gate. Most investors, even with terrific discipline, bump their toes a few times before they get the hang of it. Use experience as a learning tool for your subsequent trades.

Eventually, you will learn to utilize many different principles and tools to help you in your trading. Sometimes you will read something, or look at a chart to review an idea you have studied, and a light will go on inside your head. We call these "Aha!" moments. "Aha!" moments happen when an idea you haven't thought about before appears, or a concept that didn't previously make sense suddenly comes together. Whenever you have an "Aha!" moment about stock investing, you should write down the idea behind that moment. That insight will become a new trading rule. Even as you become a more disciplined, experienced investor you will find occasion to add, change, or otherwise modify your trading rules. Make sure you revisit these rules periodically. Each set of trading rules will be customized to fit your objectives, risk tolerance and personality. But there are some general rules that can apply to most traders.

**Notes****EXAMPLE RULES...Overall Account**

1. Trade in the direction of the trend.
2. Enter on a signal of confirmation.
3. Only enter trades that have been well thought out and have a trading plan.
4. If a trade is missed then wait for the next entry point rather than chasing this one.
5. Let profits develop and cut losses short.
6. Follow money management principles and never risk more than you're comfortable with.
7. Set a stop loss on each and every trade.
8. Don't add to losing trades. Adding to trades can only be done to winning trades.
9. Focus on strategies that you're having success with. Master each technique one at a time.
10. Trade strategies when the technicals and fundamentals agree.
11. If you go through a losing streak....you will take some time off to keep a clear head.
12. Run each trade through the Five Ts of trading.
13. Always establish the reward to risk ratio.
14. Check the historical and pending news on the company including the date of its next earnings release.

Next let's look at how a trader may also design rules for a specific technique. Example Rules...Bullish Retracement (Pullback):

1. Identify a bullish stock that has put in higher daily swing highs and higher daily swing lows.
2. Wait for at least three days of consecutive lower daily candlesticks.
3. Enter the bullish position when the stock goes above the high of the previous day's candlestick.
4. Set a stop loss below the low of the previous daily candlestick.
5. Make sure the stock has a 2:1 reward to risk ratio.
6. Manage the trade by trailing the stop daily below the current daily candlestick.
7. Set a target using technical analysis such as resistance points, Fibonacci extensions, etc.

The preceding lists include examples of rules that may be in your trading system as well as an example of how you would trade a specific type of technical setup. You will want to create your own and write them

**Notes**

yourself. You may not know all of your rules yet but you can get a good start now and add to them as you learn and gain experience. As you can see, the general trading rules in your system will be more abstract than the specific rules associated with how you make a specific type of trade.

We need rules. The odds are that you will eventually try to make a trade because “you think it is going up.” While you are entitled to your opinion, this is a dangerous path to travel. Good trading is disciplined, organized and structured. By setting up and following a good set of trading rules, we should be able to minimize the effect our emotions can have on our trading decisions.

Remember, each trade setup may have slightly different rules. You will want to create rules for each trading situation as well as your overall trading business. An example of the difference could be that in a bullish retracement trade, you may set your stop loss below the swing low. This is a specific rule to the specific strategy. In a breakout trade, you may set your stop loss a set percentage below the buy price. Again the rule in the account states that “we always use a stop loss,” but each specific strategy may dictate that we place that stop loss a different way.

When trading instruments like options and futures you will also have trading rules specific to that strategy. Whenever you bring a technical entry point or a specific strategy into your business you will want to write out the rules for that strategy.

## Goal Setting

Now that you have been introduced to some of the subject material it is time to set some goals for your trading business and personal education. Goal setting is an important component of success. By setting goals correctly our paths take a very different route than if we just try to float through it all. When setting goals you will want to be as specific as possible and associate a date with the goal. Vaguely written and open-ended goals rarely get met. Here are some examples of goals that you may want to set for yourself.

1. I will make five virtual trade entries per week while I am mastering my trading techniques.
2. I will keep records on each and every trade that I make.
3. I will master the bullish retracement technique by xx/xx/yyyy date.

**Notes**

As you probably noticed, we have not included an example of financial-based goals. You will want to do that for yourself. What is change to someone may be wealth to another. Ensure that the financial goals you set for yourself are high but yet attainable. Don't sell yourself short, you have all of the potential in the world right in front of you!

We're all starting down the path of investment training for slightly different reasons. It is important that you set goals and keep them. You have to be a professional from day one to expect to be one down the road. Hold yourself to high standards and you will achieve more.

## Practice Trading

By now you've heard mention of virtual trading in a few different contexts. It is critical that you start practicing your trading ideas immediately. The best way to implement the ideas you're being taught is to practice them. Some beginning investors will say, "But I don't know what I'm doing yet." That's exactly why you start practicing. Trial and error is a big part of learning. Even if you feel intimidated or don't know how to do it you still need to start somewhere.

If you have a brokerage account you will want to check and see if they offer virtual trading. If they do then you will want to enter your trades through their platform. This is helpful because then it will mirror the same order entry and trade executions you will be required to make when you live trade. If you do not have a brokerage account then simply get a notebook and do it the manual way and write down your entries and exits.

As you learn swing and position trading it would be a good yardstick to try to enter several new trades every week. Some weeks will have more trade setups than others but try to stay busy. Remember the more that you virtual/paper trade the faster your experience level grows.

If you are an experienced investor, you have probably used paper trading in the past. If you are new to the stock market, this may be a new concept. Paper trading is a way to act as if you are trading stocks - based on the analysis and signals you will learn to recognize - without risking any of your hard-earned money. For the beginning investor, paper trading is a great way to get started and begin to build experience. Smart, experienced investors will use paper trading from time to time to reinforce new concepts and systems they are integrating into their existing investment plan.

**Notes**

You can paper trade using several different methods. One method is simply to keep a paper log of each trade you make. As you find a stock that seems to fit your requirements, write down a buy order for the stock. Include the Ask price of the stock at the time, how many shares you purchased, and the total dollar amount. Write down the logic you followed to place the trade, and why it seemed like a good move. Your justification for the trade, how much money you allocate to the paper trade, and every step of your analysis should follow the methods described here. The more closely you follow the specifics of the method, the better paper trading will work for you.

After you have entered your initial buy order, put the stock in one of your watch lists and keep track of it on a daily basis. If the time seems appropriate to sell the stock and realize your profit, write down a sell order. If the stock moves in the opposite direction you had anticipated, write down a sell order. Include the Bid price for the stock at the time, how many shares you sold, the total dollar amount, and the reason you sold. Write down the difference between your buying and selling price.

This is where paper trading becomes especially valuable. If you have a profitable paper trade, then you have your first profitable trade under your belt. Look at the trade from beginning to end. Did you get lucky, or did you make the correct read? The fact that you are profitable doesn't necessarily mean that you hit the nail right on the head the first time. Don't feel bad if you got lucky; good traders will take luck when they get it. But good traders will also be sure to analyze the trade from beginning to end to see if there was something else they should have noticed or done differently. Write down your observations about what went well or what you could do differently, and how you intend to use that information in future trades.

When you have a profitable trade, make sure that you keep track of how profitable the trade actually was. Part of the purpose for paper trading is to log as many trades as possible. After you have several profitable trades, you can begin to compare each trade against the others and calculate your average profit level. This is an important number to keep track of as you develop your trading system. Make sure that you write down this number with the other information in your trading log.

**Notes**

If your paper trade was a loss, don't be discouraged. It is perfectly normal for every investor, regardless of knowledge and experience, to have losing trades. The beauty of paper trading is that you have risked nothing, and can use the information about the trade to figure out what went wrong. Examine the trade from beginning to end. Was there a signal you missed or should have been waiting on that would have kept you out of the trade in the beginning? Was there a signal earlier in the trade that would have gotten you out at a better time? It is entirely possible — in fact, likely — that you will have trade setups that look technically perfect, but simply don't work. Looking at the trade objectively will allow you to identify whether you misread the trade or whether it was just doomed to failure. Write down all of your observations about what happened in the trade and how you intend to use that information in future trades.

Just as it is important to evaluate how successful you are in winning trades, it is equally important to quantify just how much money you lose when you make a losing trade. You will have multiple losing trades; every investor does. Keep track of just how wide or narrow your loss was in each trade. After you have logged several trades, compare each losing trade against the winning trades and calculate your average loss. This number is commonly referred to as your "drawdown." Make sure that you write this number down with the other information in your trading log.

Once you have both average profit and average drawdown levels, you can begin to evaluate them against each other. This will help you determine how much money you should put into individual trades, and also help you apply other critical money management principles, which you will be learning about in more detail in the chapters to follow.

The greatest benefit of paper trading is that it allows you to build experience. This is useful anytime you are trying to learn a new trading system, which is why even experienced traders come back to paper trading from time to time. Using paper trades before you trade any real money will prove to be a valuable knowledge-building exercise.

## Being a Disciplined Trader

Everything we have discussed to this point is geared around helping you develop a trading system to follow consistently. Your ability to implement that system in the same way, trade after trade, is what will ultimately

**Notes**

dictate whether or not you are a successful trader. Most people start their trading thinking they have to be successful immediately and that every single trade they make has to be right on. This is a deadly assumption to make, because we all make mistakes. Your trading plan, rules, and goals will help you develop a very good system to follow in your trades, but that doesn't mean that every trade will be profitable. The most perfect system in the world (which, by the way, doesn't exist) will not prevent the occasional bad trade. If you think you have to be right every time, then when you do make a mistake you may become so discouraged and frustrated you won't be able to pull the trigger on the next trade you find.

Most people understand this idea, and think they are willing to accept the occasional bad trade - as long as MOST of their trades are winners. People who operate under this assumption are also mistaken, and for the most part they are not growing their portfolios the way they should be.

Successful trading is more about limiting loss and taking profit when it is there than it is about being right all the time. A common adage in the investment world is, "Cut your losses short and let your profits ride." The truth is that you can be wrong more often than you are right about which way a stock is going to move, and still make money - as long as you make sure that you get out of your bad trades quickly and take your profit when it is there.

This is what we mean by being disciplined. You won't acquire discipline in your trading just by setting up trading rules and a trading plan. Discipline refers to your ability to take the trading rules you have set up and apply them consistently, the same way, time and time again. Some people have no problem applying discipline to a concept they have just learned; others find it more difficult. Discipline is what will allow you to rein back the enthusiasm when you think you have a great trade on your hands, so that you can coolly compare the chart for that trade against your rules. It may take some practice (and usually does), but learning to apply this disciplined approach to your trades is well worth any initial delay in getting into the market. Think about it this way: Anyone who has become a successful investor and stock trader has done so by developing a disciplined trading system. The real challenge to developing this system and learning the discipline it requires is that it takes time. Becoming a disciplined trader may take years and thousands of dollars of losing trades. Most people have to learn it on their own, in a hit-or-

**Notes**

miss, haphazard fashion. This is probably the single biggest reason people fail in the stock market - they have neither the patience nor the financial resources to take that much time or lose that much money.

By applying the concepts discussed here, you can accelerate your learning curve, both in terms of the time spent developing the discipline you need and in the amount of experience you will be able to acquire before investing your own money. We understand what it takes to develop a proper trading plan, and have already developed the process. Not everybody will have the same trading rules or application of the method, but the methods taught in this manual can give you the tools you need to begin effective, disciplined trading as quickly as possible.

## Summary

Setting investment goals and trading rules is critical to successful stock trading. Going through the process of thinking about what we want to accomplish with our investments and how we intend to get there allows us to more effectively determine the level of risk we are willing to take. It also teaches us effective, disciplined trading skills so that we will cut losses when we have to and take profit when it is there. More than any other trading tips, these strategies will help you build your investment portfolios and reach your financial goals.

Paper trading is an important way to reinforce the concepts, techniques and strategies you are learning about. The amount of time you spend paper trading should be limited to the length of time you need to begin developing confidence in your skills. When you are beginning to see good results in those paper trades, it is time to move on to real trading. This process can take some time, or it could happen very quickly for you. Don't assume that you will need to have everything you are going to be learning about mastered within the next few weeks. Take the time you need to develop confidence in your new trading skills.

**Notes**

## Session 1 Review

1. It may be smart to trade stocks of companies that you

\_\_\_\_\_.

2. Getting emotionally attached to a position or stock can?

- a) Usually help your trading
- b) Usually hurt your trading
- c) Usually doesn't make much of a difference to your trading

3. It is important to have a trading plan for what type of trade?

- a) Position trades
- b) Swing trades
- c) Day trades
- d) Any trade you do

4. List the Five T's of Trading.

a) \_\_\_\_\_

b) \_\_\_\_\_

c) \_\_\_\_\_

d) \_\_\_\_\_

e) \_\_\_\_\_

5. The Five T's can be a wonderful guide to walk you through a trade

from \_\_\_\_\_ to \_\_\_\_\_.

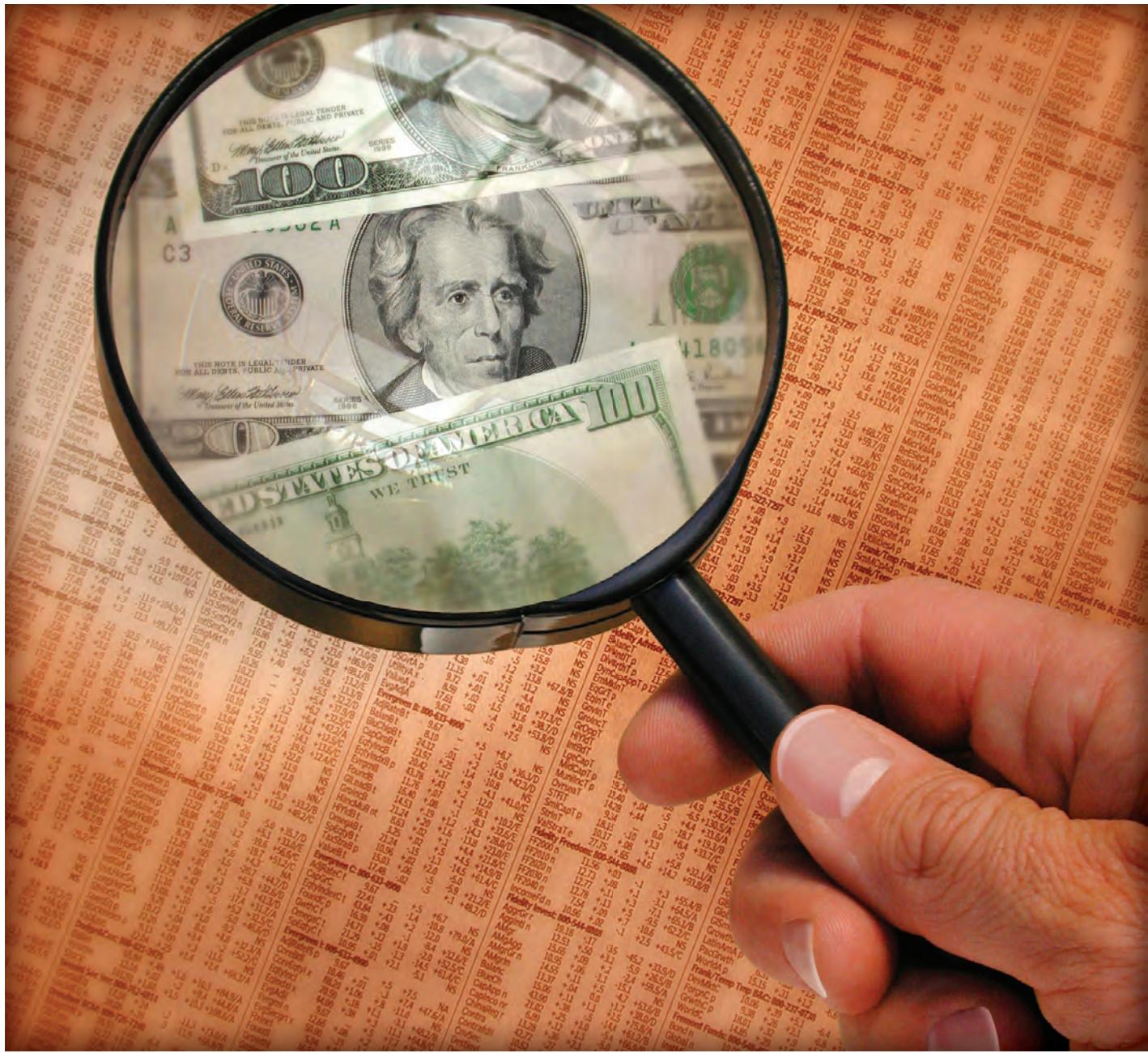
6. Trading rules will minimize the effect of \_\_\_\_\_ in  
your trading.

**Notes**

7. By setting goals correctly our paths take a very \_\_\_\_\_ route than if we just try to float through it all.
  - a) Easy
  - b) Short
  - c) Difficult
  - d) Different
8. (T / F) It is HIGHLY recommended that you paper trade before you begin live trading.
9. Successful trading is more about limiting loss and taking profit when it is there than it is about being \_\_\_\_\_.
  - a) Right all the time
  - b) In a trade everyday
  - c) Able to pick the very top or bottom

## Session 1 Homework Assignments

1. Write down your short-term and long-term goals.
2. Develop some basic trading rules. Use the example rules in the section to help guide you. These rules will just be a start; we will modify them and add to them in the future.
3. Set up a brokerage account where you can start paper trading, you don't need to fund the account yet.
4. Call the Tigrant Learning Hotline #866-467-7065.
5. *Read and prepare for Session 2.*



# CHAPTER 2

# Fundamental And Broad Market Analysis





“ You must fully understand, strongly believe in, and be totally committed to your trading philosophy. ”

- RICHARD DRIEHAUS

Now the fun begins! After you have compiled a list of promising stocks, you can dig into analyzing those stocks for their potential as good investments. You want to discover what each company is about. What makes the company tick? Does the management team effectively steer the company in the right direction? When you can answer these questions to your satisfaction, you are on your way to a great investment.

In this chapter we will examine fundamental analysis in depth and discuss not only the various components of fundamental analysis, but also specifically how to use that information to identify strength in a company's overall business. The MachTrader software offers several capabilities to allow you to get to the information you need to look at, which we

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## How to Approach Fundamental Analysis

When trading stocks, there are two questions you should ask yourself:

1. Is this a stock I would want to buy?
2. Is this a good time to buy the stock?

The many different methods for addressing these questions generally fall into two schools of thought. The first method centers on fundamental analysis. This is generally the logic that most long-term, buy-and-hold investors apply. The logic behind this method is this: If a company has good fundamental strength, then long-term prospects for the stock are also likely good, therefore, this stock is a good opportunity. It is sound reasoning. Fundamentally strong stocks have a built-in reason to go up - those companies are making money, increasing their profits, and growing their business.

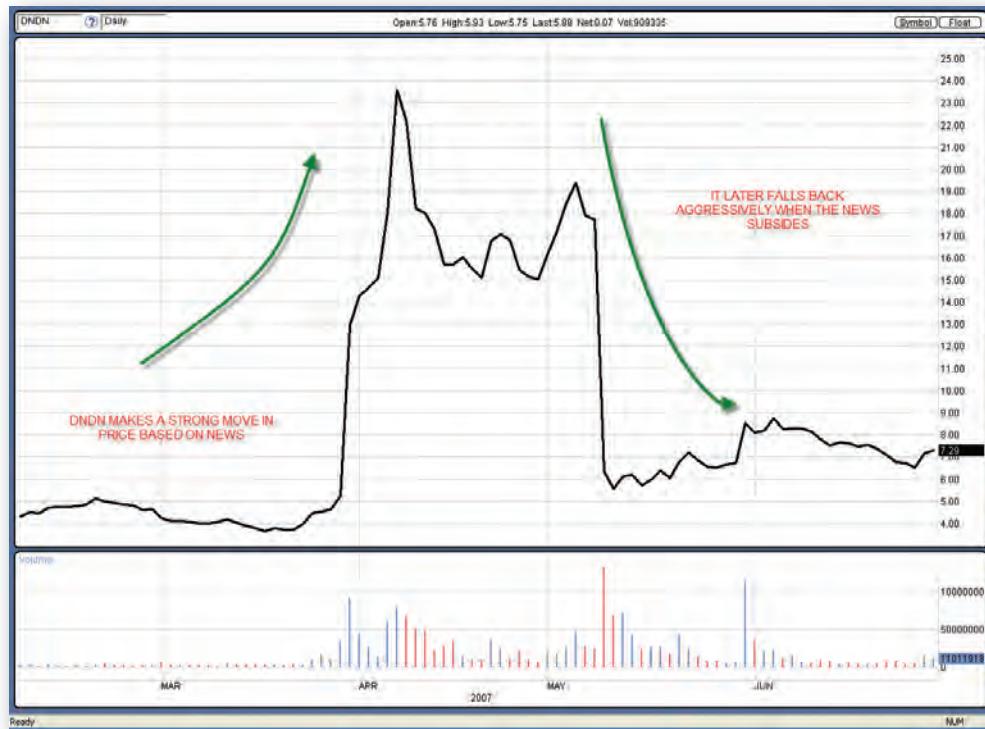
The problem with this logic is that fundamental analysis does not address the current state of the stock. A good company and a good stock are not necessarily the same thing. A company can be making lots of money and doing a wonderful job of increasing revenues and profits, and yet their stock could still be going down. You have likely seen or heard of plenty of examples of this kind of event in the last few years.

**Notes**

The second major school of logic regarding stock trading deals primarily with technical analysis. Traders who rely only on technical analysis for their investments don't worry about fundamental strength at all; in fact, some technical traders couldn't even tell you what business the stock is in if you asked them. They rely only on reading their charts and stock graphs for specific stock patterns and buying and selling signals. This perspective can be just as limiting as relying solely on fundamental analysis. Relying exclusively on technical strength to identify investment opportunities does little to consider the amount of risk involved with that company.

The reason fundamentally strong stocks may go down is the same reason any other stock goes down: selling. The events that lead investors to sell stocks, regardless of fundamental strength, can be as general as negative sentiment in the broad economy or interest rate fear, or they can be more specific. Nervousness in a company's sector, or concern about an anticipated earnings report, can all contribute to a stock's downward slide. When the broad market is in a downward decline, such as we have seen in recent years, it doesn't matter how fundamentally sound a stock is - it will probably go the way of the rest of the market.

FIGURE 3.1



**Notes**

So remember this: Although fundamental analysis is a critical component of your overall evaluation, fundamental analysis alone isn't a reason to buy a stock. Fundamental analysis only answers the first question we posed earlier, "Is this a stock I would want to buy?" Fundamental analysis allows you to look into the specifics of how a company makes money and how well they execute their business plan.

## How Do Fundamental Analysis and Technical Analysis Work Together?

The stocks that ultimately belong on your watch list are those with good fundamental strength. Again, remember that fundamentally strong stocks have a built-in reason to go up, but that doesn't mean that they will start to rise as soon as you start watching them. Put them in your watch list so that you can watch those stocks on a daily basis; then your technical analysis can identify the proper time to buy.

For example, consider investing in a pharmaceutical company. Pharmaceutical stocks are typically among the most volatile stocks in the market because of the extreme swings they sustain over short periods of time. Prices can fluctuate wildly based on news alone. Suppose you are following a company that announces they have developed a formula to cure cancer. ZOOM! The stock has gone up BIG to start a nice upward short-term run. Then, a while later, it is disclosed that the FDA has shut down research of the new drug. BAM! The stock now drops BIG in the early morning hours. In Figure 3.1 you saw an example of this type of action in the company Dendreon. This kind of back and forth action can be very difficult to trade. Looking for sound fundamental companies can help you avoid the wild action.

Different stocks represent different levels of risk. The best way to get an accurate sense of what those differences are is by performing fundamental analysis. Fundamental analysis won't tell you to buy the stock right away, but fundamentally strong companies have characteristics that lend themselves to good short-term trading. First, they tend to be less volatile than highly speculative stocks such as the pharmaceutical example mentioned above. That doesn't automatically mean that the growth potential in those stocks isn't significant; it just may not be as dramatic. The advantage in these stocks is that the

**Notes**

lower volatility of the stock makes it easier to identify key elements of technical analysis, such as entry and exit threshold prices and support and resistance zones. This makes managing the downside of your trade easier and more predictable.

## Fundamental Terms and Definitions

Let's start by defining some of the common terms used in fundamental analysis. Fundamental analysis usually starts by looking at the historical earnings reports a company is required by the Securities and Exchange Commission (SEC) to make on a quarterly or annual basis. Here are some of the common terms you'll find in these statements.

### ASSETS

Assets are specifically what a company owns. Generally, a company will categorize its assets based on its business. For example, a bank might list among its assets Cash, Property, and Loans and Notes, while a heavy equipment manufacturer could list Cash, Property, Machinery, and Equipment.

### LIABILITIES

This is generally categorized by a single word: debt. It is useful; however, to remember that there are different types of debt. Companies will usually differentiate between long-term debt, which usually includes corporate bonds or other long-term loans, and short-term debt, which usually involves lines of credit from a lending institution, short-term corporate bonds, and accounts payable. Other types of liabilities that you could see in a statement could include royalty payments amortized over time, or settlement payments from a lawsuit. Generally, short-term debt is more dangerous to a company's financial stability than long-term debt.

### SHAREHOLDER EQUITY

Shareholder Equity is also called Net Worth or Book Value, and reflects what would be left if the company were liquidated and all of its liabilities paid off. An accountant would tell you that a company's assets should be equal to liabilities plus shareholder equity. The reason for this is that the balance (or lack thereof) can give you a sense of how much of the company's business is financed through debt or capital raised by selling shares of stock.

**Notes****EARNINGS PER SHARE**

If you have studied fundamental analysis in the past, you are probably familiar with the maxim: "Earnings, Earnings, Earnings." Subtracting a company's expenses from revenues, then dividing that number by the shares outstanding gives us Earnings per Share (EPS). In other words, EPS is a reflection of net profit. Comparing the current Earnings per Shares to historical values through the Trade Center is a good way to determine whether or not a company has been successful in growing profit over time. In each of the areas mentioned above, it is possible to have positive or negative numbers. Rather than using a negative (-) symbol, financial statements usually enclose negative numbers in brackets. For example, if a company reported a net loss for the first quarter of \$.25 per share, it would show in the financial statement as \$(0.25).

**PRICE/EARNINGS RATIO (P/E)**

This number is calculated by dividing the price of the stock into the earnings per share over the last four quarters. The result shows how much higher the stock price is than earnings. This number can give you a sense of whether the stock is undervalued, overvalued, or fairly valued. There are acceptable ranges for how high you want the P/E ratio to be, but these ranges are somewhat fluid; a high P/E ratio doesn't necessarily mean that the company isn't fairly valued.

**PRICE/EARNINGS TO GROWTH (PEG RATIO)**

This ratio is a derivation of the P/E ratio and expected growth rates. It is calculated by dividing the current P/E ratio by the expected Earnings Per Share (EPS). The PEG Ratio is another way to measure whether a stock is undervalued, overvalued, or fairly valued. It takes the P/E Ratio one step further since it not only compares the price to earnings but also factors potential growth into the evaluation. PEG Ratio uses 1 as its baseline. A PEG Ratio of 1 implies a balance between the stock price, earnings, and future earnings growth. A PEG Ratio of less than 1 is generally indicative of an undervalued stock, while higher than 1 is an indication of an overvalued stock. Essentials of trading favors companies with lower PEG Ratios, since this is widely considered to be a better valuation measure than the P/E Ratio alone. Finding stocks with low PEG Ratios will often give you lower-priced stocks with high growth prospects. However, remember

**Notes**

that even a high PEG Ratio is not categorically bad, while a low PEG Ratio is not categorically good. If a stock with great earnings has sustained a continuous uptrend in the recent past, it is likely to have a high PEG Ratio already, but since it is making new highs we wouldn't shy away from it. Conversely, a stock with good earnings and a low PEG Ratio may have some other extenuating circumstances weighing the stock price down despite their fundamental strength - pending litigation, a breakup in management, and so on. Do not rely on the PEG Ratio as a sole indicator of buying or selling. Make sure you continue to analyze the stock fully.

**MARKET CAPITALIZATION**

How big is the company? Market capitalization is calculated by multiplying the current stock price by the shares outstanding. This is used to define whether a company is categorized as a Large, Mid, Small, or Micro Cap stock.

Larger capitalization stocks generally trade more shares on a daily basis and are thus thought of as being more liquid. It can be smart for a new trader to focus on liquid stocks. There isn't a set number that "has" to be there, but if a stock trades more than 500 thousand shares of stock per day on average, that is a good amount of liquidity.

**SHARES OUTSTANDING**

How many shares were authorized for sale when the company went public? All data expressed in per share format is based off the number of shares outstanding.

Occasionally a company will issue a stock split. Stock splits are events where the company takes all of the shares outstanding and then issues more shares to the owners to put more available shares outstanding onto the market. For example if a stock has one million shares outstanding and then announces a 2:1 stock split, then the stock will have two million shares outstanding after the event.

**FLOAT**

The float is calculated by subtracting the shares outstanding by the number of shares held by insiders. The float indicates how many shares are available for sale in the stock market. This can be an important measurement to determine how much of the

**Notes**

company is privately held, as well as to measure the liquidity of a stock.

The more shares held by institutional traders can be an indication that the stock has started to reach a peak in growth. It doesn't mean they will stop growing; it just may indicate that many traders in the market who want to own the company already have purchased it. It can be a great strategy to go for companies that have low institutional ownership. The lower the institutional ownership and the stronger the fundamentals can be a strong indication that the company may soon start to be acquired by those institutions.

**REVENUE**

Revenue is also called Income, Current Income, or simply Sales. Comparing historical revenues to current data helps identify whether or not the company has been successfully increasing sales.

Revenues (or sales) are an important part of the overall fundamental strength of a company. Keep in mind that it is possible for a company to show increasing earnings even in the face of declining revenues, so seeing increasing earnings is important, but it is also valuable to make sure that revenues are increasing as well. The logic behind this is simple: A company experiencing declining sales on a consistent basis is going to have a difficult time staying in business. If you do see a company with improving earnings on declining revenues, you can assume the company is cutting drastically to make the financial picture look better than it really is. This is a temporary situation; if revenues don't begin to rise, all of the cuts in the world aren't going to keep the company in business indefinitely.

**DEBT/EQUITY RATIO**

This is an important measurement that will help you identify how the company is capitalized. A high debt/equity ratio usually means the company has borrowed heavily to finance its operations.

The Debt/Equity Ratio is a standard measurement that shows how much debt a company carries compared to their shares outstanding. A ratio of 1 implies an exact 1:1 balance between the debt carried and the equity amount. A ratio higher than 1

**Notes**

generally implies the company is financing a disproportionate amount of their business operations through debt, so we prefer to see this number as low as possible. It is also important to compare the company's debt to the industry average.

Debt/Equity Ratio gives us a way to see how a company deals with its debt. Businesses generally gain greater tax advantages by using longer-term debt instruments such as corporate bonds than they do for short-term instruments. Also, when a company uses long-term debt in a low-interest rate environment such as we have been in for the past few years, it provides cost savings down the road when interest rates rise. If a company is using short-term debt instruments, they are repaying those loans more quickly, but they are leaving themselves more exposed to higher-interest rates down the road.

**RETURN ON EQUITY (ROE)**

ROE is a reflection of management effectiveness. Return on equity is calculated by dividing earnings for a one-year period by the shareholder equity. This measurement gives investors a sense for management's ability to effectively build cash from existing assets. In simple terms: For every dollar the company has to work with, how much do they get back?

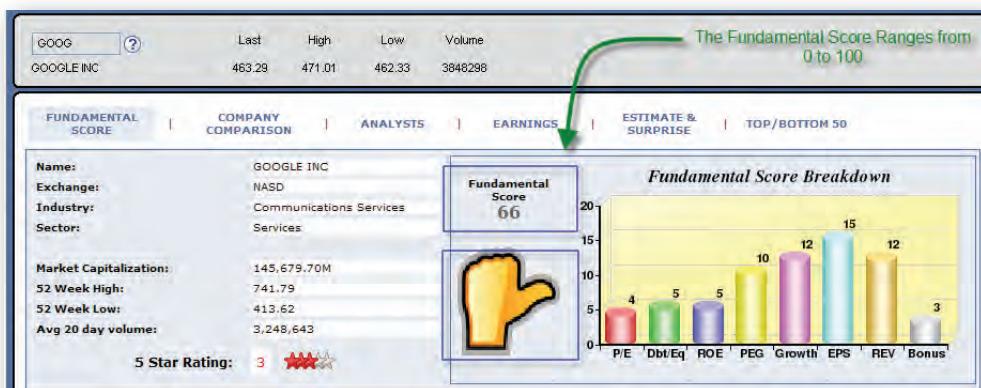
We use Return on Equity to evaluate the ability of management to effectively use the money that comes in from business operations. As you track specific stocks over time, you will occasionally see situations where the ROE of a company that may have started out impressively begins to decline. At first blush, this may seem like an undesirable situation since the lower number means that the company isn't generating as much profit relative to shareholder investment; in other words, investors aren't getting as much back as they used to. This is a time when it becomes very valuable to balance the decline against the rest of the business fundamentals.

If your analysis of the fundamentals of the company's business shows declines in other areas, then there is something wrong with the stock and you may want to stay away from it. Poor management, adverse market conditions, and ineffective cost management are just a few examples of the kinds of problems the

**Notes**

company could be facing. On the other hand, when a small, up-and-coming company has been growing aggressively in recent years as reflected by a high ROE and its other fundamental measurements, it isn't unusual for their growth to begin to taper off. This is more a function of size than it is of management issues or any dire warnings: Small, growing companies become large; it is harder for a large company to see aggressive growth than a small one. If the rest of their fundamentals are still solid and their ROE is higher than the industry average, you wouldn't want to count declining ROE against the company, since it is a simple reflection of their increasing maturity.

FIGURE 3.2



## Fundamental Scoring System

For a beginning trader, trying to process all of this information can seem like a daunting task. What if a company has strong earnings but a high PEG ratio? How strong is it if the D/E ratio is .70 but the company has a ROE of merely 12 percent? Thankfully, to save you time and to help put the numbers in context, the MachTrader software has developed a Fundamental Scoring System that will answer these questions for you. Now it is important that you keep expanding your knowledge on the specific fundamental data points, but it can be wise to just use the scores as a general gauge of fundamental strength.

In MachTrader you will find a score that ranks each stock's fundamentals. The score ranges from 0 to 100 with a lower score being poor fundamentals and a higher score being very strong fundamentals. Each stock is subjected to a tough analysis of some of its fundamental strengths and weaknesses. You won't find many

**Notes**

scores near the top of the range. This was done to make sure that when a stock has a high score that it really is a standout.

The fundamental score analyzes historical and projected earnings and EPS trends, revenue, valuation (including P/E and PEG ratios), management effectiveness (including ROE, ROI, and ROA). The basic idea is to look for companies that have good historical earnings growth while maintaining projected earnings growth. It also looks for companies whose management teams have outperformed their peers, as well as companies with fair valuations. The strongest weight is placed on EPS and revenue trends while management effectiveness is not far behind.

The fundamental data and score are updated anytime the company releases information on one of the areas mentioned above (as well as a few others). If you are a bullish trader and you focus on scores on the high end of the range, you will have an edge to have fundamental data behind your trade.

## What Does It Mean If a Score Is In the Middle of the Range?

You will find most companies have a Fundamental Score in the middle of the range between 0 and 100. This doesn't mean they're poor companies nor does it mean they shouldn't be traded. All it simply means is that they don't have the strength behind them in fundamental data that others might. As a trader there will be many times you go ahead and trade a company with a middle-range score. In Figure 3.2 you see Google has a score of 66. This puts Google in the upper 1/3rd of companies in terms of scoring. You will have to determine based on Google's prospects, charts and business model whether or not you want to continue to pursue it.

As a general rule, a stock with a total score of 75 or above is a good choice, because most of the items scored will have met the quality criteria used by the MachTrader Software. A high score points not only to fundamental strength, but also to classic growth characteristics. As you will see, scoring is weighted to emphasize those characteristics that point both to historical growth and to the likelihood of continuing growth. Often, this future growth is relatively long-term, so another way to approach fundamental analysis is to see it as a way to identify stocks that represent better long-term opportunities than just looking for well-known, "blue-chip" stocks that have likely already enjoyed their most dramatic price increases.

**Notes**

FIGURE 3.3



## Five Star Ranking System

The software's scoring system goes one step further than the fundamental score. It brings in technical data to help rank the stock as well. In Figure 3.3 you see the company Sears Holdings Corporation has a four of five Star Rating. This indicates it has considerable strength when analyzing fundamentals and technical analysis together. The following is a description of how the five star scoring system is computed. The maximum score is five.

**Notes****FUNDAMENTAL SCORE:**

Any stock above 70 on our scoring system would receive a 1.

The fundamental scoring system is a system in which stocks are rated based on seven criteria. The score is out of 100.

- P/E RATIO
- Debt/Equity
- PEG
- Growth Rates
- Return on Equity
- Earnings Comparison
- Revenue Comparison
- Bonus Column

**TREND:**

The Trend of the stock must be going up. This means that the 20 SMA and the 50 SMA must both be going up and the 20 SMA stacked on top of the 50 SMA. We could do a pivot based Elliot Wave; however, this seems too much given that we are creating a basic screening system that ranks the stocks. If the above criteria are met the stock receives a one.

**INDUSTRY/SECTOR:**

Much of our education is based on the Top Down approach. This approach focuses on analyzing the broad markets, sector, and stock. Furthermore, the sector is responsible for up to 50 percent of the stock movement and that is another reason we should include the sector. If the above criteria are met the stock would receive a one.

**MACD:**

Keep it simple. The MACD and Stochastic indicators are easy to understand and helpful to beginning investors. The system would analyze two areas. If either of the following two criteria were met, the stock would receive a one.

**Notes**

- **HOOK:**  
The term look for the hook refers to the reversal of the MACD cross. It shows momentum and reversals. Combined with other indicators, it makes a powerful tool.
- **UPWARD MOVEMENT AND SEPARATION:**  
We would look for stocks with increasing momentum in the upward movement.
- **STOCHASTIC:**  
If Stochastic is hooking above the 20 band and moving up, the stock would receive a one.

## Application of Fundamental Analysis

Think of fundamental analysis as a pop quiz for your potential investments. Once you have identified a stock that seems to be a good potential candidate, you are going to administer a test to the stock to see if it passes your fundamental analysis requirements.

Remember that the objective of fundamental analysis is to determine two things: What are the future prospects for the stock to increase in value? And how much risk may be involved? A fundamentally strong stock has a great built-in reason to go up, whereas a stock with poor fundamentals has to rely on market speculation, rumor, and hopefully favorable general market conditions to push it higher. It is one thing to look at our 1-100 percent grade scale and see a good score. It is quite another thing to examine why the company scores the way it does. Looking at the fundamental information helps you understand what business the company is in, and helps you get a sense of how effective that company is in executing its business. Many people don't worry about fundamentals at all, but focus instead on the technical aspects of the stock, such as support and resistance and the current trend. Remember: A stock with great technical signals may give you a strong move on the upside, but if the fundamentals are poor, the downside is likely to be just as strong or even more dramatic. You have certainly heard of the market referred to as a roller coaster - this is why. The comparison is apt because a stock drops faster than it rises. It can be wise to not rely solely on technical signals. Choosing a stock to place on your watch list should be dictated by the information you learn from fundamental analysis. Fundamental analysis will help you minimize and manage risk. Of course, this is not to say you should look only at fundamentally strong stocks as potential investments. But using fundamental analysis will provide you with a more exact view of a company's fundamental strength, and alert you to how much risk

**Notes**

you may be exposing yourself to by investing in companies with lower fundamental scores.

## The Role of News

Checking the news regularly for the stocks you are following is a critical part of fundamental analysis and vigilance that you must be careful not to overlook. There is a market maxim: “Buy the rumor, sell the news.” This popular saying underscores the impact that the news has on stock movements (particularly on the downside).

“Buy the rumor.  
Sell the news.”

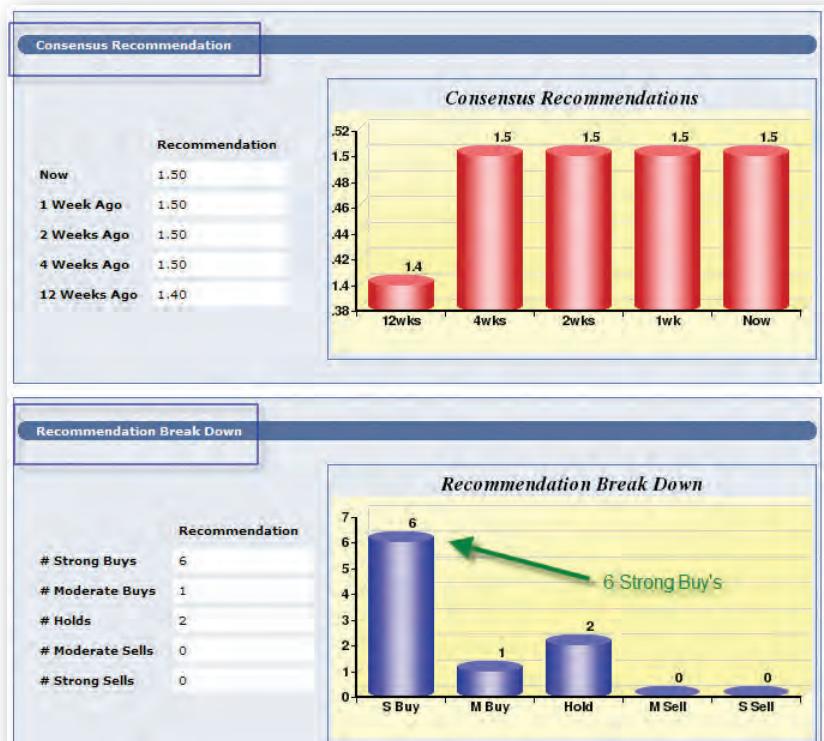
News generally has an immediate effect on a stock, especially news that is related to earnings, analyst estimates, revenues, and management issues, which is the basic reason you should make sure to check the news every day. For example, if you have bought into a stock and the CEO of the company suddenly resigns amid a swirl of controversy and criminal allegations, you aren’t likely going to want to stay in the stock. When this news hits the market, the stock will likely take a significant drop very quickly; if you aren’t checking the news every day, you won’t be able to react quickly and will be sitting in a bad position. As you read the headlines for different stocks, think about the news in terms of their particular businesses. If you are looking at an oil refiner and a hurricane is about to hit the Gulf Coast, would that news impact the stock? Certainly. Try to analyze whether the news you are looking at appears to be good or bad. In order for a stock to qualify for your buy watch list, it should have good news or at least “business as usual” news. If there is categorically bad news you probably shouldn’t even bother with the stock until some time has passed and the company has had a chance to recover. When you own a stock, pay attention to the news. It is critically important to identify any signs of trouble or any hallmarks of continued strength. “Business as usual” news, or no news, can be thought of the same way; neither is bad. A common saying states, “No news is good news.” Since what you are really watching out for more than anything else is bad news, don’t be discouraged if a company has business as usual or no news.

**Notes**

## Key Characteristics of a Good Company

Remember fundamental analysis is not just a report card of past results. It is a look forward. So how do we know what will happen with a company in the future? Well as far as projections go, that's where analysts come in. Analysts are professionals who simply analyze securities. They generally work for big banks and/or institutions. They have two important functions. They grade the stocks and give guidance for what they expect to happen in the future. Analysts are expected to have the gift of hindsight. We all wish we did. However, even though analyst recommendations lag market forces, their sheer recommendation will always have an impact on the stock price short-term. Analyst recommendations should be buy or strong buy. This will ensure that enough of the investment community sees your trade as a good stock as well.

FIGURE 3.4



In Figure 3.4 you see the page where the analyst recommendations appear. To locate the page simply click on the word "analyst" at the

**Notes**

top of any fundamental analysis window. In the example, the company has six strong buy recommendations out of nine analysts who track the stock. This is very strong. You also see in the top section that the recommendations have held steady for four weeks in a row and are up from 12 weeks ago. The top section on "Consensus Recommendation" can give you an idea of the trend in analyst opinions. If the red bars are increasing from left to right, then the company is getting better recommendations over time. If it is falling, then the recommendations are falling as well. Using analyst recommendations can be another piece of information to help your trading results.

Analyst recommendations can give us a lot of insight into the health and future of various companies. It is not critical for timing the stock. It is very helpful in watch list building and our own peace of mind.

## When Reviewing the Fundamentals of the Overall Market

Economic news drives the market. Every week there are economic reports that are released that affect the direction and sentiment in the market. Imagine there was a painter who never put down his brush. He just kept painting and painting. Each brush stroke changed the nature of the picture. Some are subtle and others are obvious. As he paints, the entire look, feel and meaning of the painting changes. That's kind

FIGURE 3.5

| Economic Calendar  |           |                                     |       |        |                   |                | Week  |
|--|-----------|-------------------------------------|-------|--------|-------------------|----------------|-------|
|  |           |                                     |       |        |                   |                | Week  |
|  |           |                                     |       |        |                   |                | Week  |
| Calendars: <a href="#">U.S. Earnings</a>   <a href="#">Conf. Calls</a>   <a href="#">Surprises</a>   <a href="#">Mergers</a>   <a href="#">Splits</a>   <a href="#">IPO</a>   <a href="#">Economic</a> |           |                                     |       |        |                   |                |       |
| Last Week  |           |                                     |       |        |                   |                |       |
| Date   | Time (ET) | Statistic                           | For   | Actual | Briefing Forecast | Market Expects | Prior |
| Aug 25   | 10:00 AM  | <a href="#">Existing Home Sales</a> | Jul   | 5.00M  | 4.95M             | 4.90M          | 4.85M |
| Aug 26   | 10:00 AM  | <a href="#">Consumer Confidence</a> | Aug   | 56.9   | 53.0              | 53.0           | 51.9  |
| Aug 26   | 10:00 AM  | <a href="#">New Home Sales</a>      | Jul   | 515K   | 535K              | 525K           | 503K  |
| Aug 26   | 2:00 PM   | FOMC Minutes                        | Aug 5 | -      | -                 | -              | -     |
| Aug 27   | 8:30 AM   | <a href="#">Durable Orders</a>      | Jul   | 1.3%   | 0.2%              | 0.0%           | 1.3%  |
| Aug 27   | 10:35 AM  | Crude Inventories                   | 08/23 | -177K  | NA                | NA             | 9390K |
| Aug 28   | 8:30 AM   | Chain Deflator-Prel.                | Q2    | 1.2%   | 1.1%              | 1.1%           | 1.1%  |
| Aug 28   | 8:30 AM   | GDP-Prel.                           | Q2    | 3.3%   | 2.8%              | 2.7%           | 1.9%  |
| Aug 28   | 8:30 AM   | <a href="#">Initial Claims</a>      | 08/23 | 425K   | 425K              | 425K           | 435K  |
| Aug 29   | 8:30 AM   | Personal Income                     | Jul   | -0.7%  | -0.5%             | -0.2%          | 0.1%  |
| Aug 29   | 8:30 AM   | Personal Spending                   | Jul   | 0.2%   | 0.3%              | 0.2%           | 0.6%  |
| Aug 29   | 9:45 AM   | <a href="#">Chicago PMI</a>         | Aug   | 57.9   | 50.5              | 50.0           | 50.8  |
| Aug 29   | 10:00 AM  | Mich Sentiment-Rev.                 | Aug   | 63.0   | 63.0              | 62.0           | 61.7  |

**Notes**

of like the market with economic reports. We start with a basic idea of what's out there. We know what consumer prices are, what the unemployment rate is and how fast industrial production is expanding or contracting. But, with each brush stroke the economic painting is changed.

As an investor it is important to know what the current economic conditions are. You will also want to know when the major brush strokes are coming. Being aware of key economic events before they come out will help you avoid problems in the market and adjust your exposure to risk during times of uncertainty.

In Figure 3.5 you see an economic calendar that can be found in the MachTrader software. To locate it simply click on the tools button in the main software, highlight calendars and then select the word "economic." As you see there can be many reports that come out in any given week. How do we know which reports are critical and which are merely afterthought?

The most important of all economic releases comes from the Federal Open Market Committee (FOMC). The FOMC meets periodically to discuss the state of the economy and decide on what level they will set the federal funds rate. Traders set real interest rates in the bond markets. The Federal Reserve gets to control the rate at which banks can borrow money from the Federal Reserve overnight. This either opens the valve of liquidity or closes it slightly. Anytime the Federal Reserve says anything about the economy or market, it is sure to move.

The consumer is generally thought of as the oil that greases the engine. Without consumption an economy doesn't fire on all cylinders. Consumer sentiment reports, consumer price reports, and unemployment reports are direct examples of events that give us insight into how strong consumption will be and how much buying power consumers really have.

Most of the reports have a blue link that you can click on. This will give you a grade to determine the importance of any given report.

FIGURE 3.6

**Economic Calendar Terms**

### Personal Income and Consumption

- **Importance (A-F):** This release merits a C+.
- **Source:** The Bureau of Economic Analysis of the Department of Commerce.
- **Release Time:** 8:30 ET around the first business day of the month (data for two months prior).
- **Raw Data Available At:** <http://www.bea.gov/bea/rels.htm> -- see personal income release.

**Notes**

In Figure 3.6 we've selected the report "Personal Income and Consumption." The importance of this release is a C+. Does this mean that it won't be a market mover? Not necessarily. What it does mean is that historically it hasn't been the most important of economic releases nor has it been the least important. This can be a good guide for a beginner to gauge the nature of an economic report.

## Bringing Individual Company Analysis and Broad Market Analysis Together

Up to this point we've mostly discussed how to interpret the fundamental analysis of an individual company. In the following sections we will explain how using broad market and inter-market analysis can give you a big edge in your results.

## Inter-Market Analysis

One of the least understood concepts in financial analysis is the interrelationship of different independent financial markets. The financial news reports the stock market's reaction to rising interest rates. Why is the stock market concerned about interest rates? The financial paper features an article on rising oil prices. How will this affect your investment portfolio?

The financial markets are composed of two types of traders: institutions and individuals. Institutional trades are referred to as "Big Money" because of the sheer volume of cash that they control. When Big Money buys or sells, it moves the market. Big Money is also smart money; institutional traders are professionals who are aware of economic opportunities. The key to success for individual investors is to be there when Big Money moves in and to get out when Big Money moves out.

**Notes**

## Independent Financial Markets

What does the term independent financial market mean? Essentially, a financial market is a place where financial instruments trade. A market is independent because it is self-regulating and trades autonomously. While there are many independent financial instruments and many independent financial markets, the following markets may have a significant impact on your stock portfolio:

- Stock market
- Bond market
- Currencies market
- Commodities market

It is important to note that although these markets are considered independent, all markets are connected somehow. Stock and bond prices are influenced by interest rates. Inflationary pressures of the economy peg interest rates. Inflation is gauged by tracking the price of basic materials or commodities. In our global economy, commodity prices are largely influenced by the strength of the dollar through import and export business. The performance of these independent financial markets can have a ripple effect through the entire network of financial markets. Intermarket analysis is the study of how one market influences the performance of other markets. You can use basic trend, support/resistance, and other technical tools to analyze the direction of any single independent financial market. This kind of analysis can provide you with valuable insights into what influences the markets, and a better understanding of how different markets influence each other. By analyzing different markets, institutional traders can anticipate the direction and strength of the stock market. In his book “The Intermarket Technician” (1989), trading expert John J. Murphy makes several key observations about interrelated markets. Murphy notes that many stock analysts keep a close eye on non-stock financial developments. For example, some institutional traders are known to watch currency trends to see where global money was flowing; other analysts closely monitor commodity prices to gauge inflation. The bonds market and interest rates have long been considered as leading indicators of the stock market.

We will begin by looking at the commodities market as our foundation for understanding other independent financial markets. The commodities market is the backbone for understanding intermarket analysis.

**Notes**

## Commodities

Commodities are the building blocks of the financial industry. Commodities are basic resources (such as food, grains, metals, oil, etc.) that are used to produce the goods and services we consume. Given its fundamental nature in the economy, the commodities market is one of the most important independent financial markets; its performance is highly scrutinized by the business and the political world.

## Commodities and Policy Makers

Economic policy makers keep close tabs on the cost of basic goods and services in order to measure inflation. The Consumer Price Index (CPI) is an index developed to measure the price of basic goods today and compare them to the price of basic goods and services last month, year, etc. Policy makers understand that if the costs of goods and services climb too fast, the economy (and ultimately their constituencies) begins to suffer. They also know that if the cost of goods and services grows too slowly, the economy could potentially suffer.

This upward climb in price is called inflation, and can lead to a reduction in the buying power of consumers. Policy makers closely monitor inflation because of its effect on the welfare of consumers. (People do not like having to pay \$0.25 more for milk this month than last month!) Investors also closely monitor inflation because of its impact on corporate earnings.

A downward fall in price is called deflation, and leads to economic stagnation and recession. Somewhere between inflation and deflation is a happy medium that policy makers like to maintain.

The commodities market was formed to hedge against wild fluctuation in the price of basic materials. An extensive discussion of the commodities market is beyond the scope of this manual, but suffice it to say that the commodities market is reflective of the true cost of basic goods and services. For example, if commodity prices are going up, the cost of manufacturing goods and services will go up. If commodity prices are going down, the cost of manufacturing goods and services will go down. Persistent changes in commodity prices over a period of time are passed on to consumers; the increased cost to consumers will be measured as inflation. Inflation is bad for

**Notes**

consumers, which means it is bad for policy makers. The relationship among commodities, inflation, and government policy makers reflects an important link between the financial markets and interest rates.

## Interest Rates and Commodities

Interest rates are important to the economic condition of the country, especially as they can effectively calm or stimulate business activity. During periods of economic expansion, the demand for basic materials increases. When the demand for basic materials goes up and supply remains constant, companies must pay more to produce their goods or services. Even though there are increased costs, there is an opportunity to increase corporate revenues created by the expanding economy. Lured by the prospect of better earnings, companies begin to look for ways to fund the expansion. They turn to lenders and investors to provide capital to grow their business. Lenders and investors know that companies are hungry for money and are willing to pay a premium to fund the growth. When interest rates drop, companies will rush out and borrow money because the cost of funding expansion is cheap. This effectively stimulates a sluggish economy. On the other hand, when interest rates climb too high, companies will not borrow money because the cost of funding expansion is too expensive. This effectively cools a heated economy.

Policy makers use interest rates to control inflation. As commodity prices increase, it puts inflationary pressure on the economy. The government can step in and raise interest rates, effectively cooling the economy. As commodity prices drop, it puts recessionary fears on the economy. The government can step in and lower interest rates, effectively stimulating the economy.

Whereas policy makers use the CPI to measure inflation, investors often track commodity prices using the Bridge's Commodities Research Bureau (CRB) index. The CRB index tracks the price of 21 of the most economically influential commodities, including oil, gas, steel, wheat, etc. When measuring the CRB, you should keep in mind the following:

- When CRB index goes up, interest rates generally go up
- When CRB index goes down, interest rates generally go down

**Notes**

## Interest Rates

To understand how interest rates work, remember that when the government raises interest rates, it is to fend off inflation and to stop the economy from growing too quickly or “overheating.” When policy makers lower interest rates, it is a signal that the economy is losing steam, or stagnating, and consumers need an incentive to spend. There are three published interest rates that have significant impact on the financial markets:

1. FEDERAL FUNDS RATE
2. FEDERAL FUNDS DISCOUNT RATE
3. PRIME RATE

### Federal Funds Rate

Banks are required by law to maintain a specific reserve of money at all times; reserve requirements are set by the Federal Reserve Board. Maintaining this reserve can be difficult to manage, so there is a mechanism in place where banks can borrow money from other banks if they don't have enough money to meet their reserve. Banks with surplus funds at the end of a business day can loan money to banks that don't have enough money to meet the Federal Reserve's requirements. The Federal Funds Rate is the interest rate that banks charge each other for overnight loans.

Investors watch the Federal Funds rate as a leading indicator of the direction interest rates are trending. The Federal Funds rate changes daily, and is the most sensitive rate of the three interest rates. The Federal Funds rate is considered important to traders because no one feels the effects of changes in interest rates more than banks. Changes in the Federal Funds rate are generally small, and the market responds slowly.

### Federal Funds Discount Rate

The Federal Funds Discount Rate is the rate at which banks may borrow money directly from the government to meet overnight reserve requirements. The discount rate is set manually and controlled by the Federal Reserve Board.

**Notes**

The Federal Reserve Board holds eight or more meetings during the year to discuss monetary policies that influence the economy, which is reflected in such factors as inflation, economic output, and employment. The Federal Reserve can't control inflation or influence output and employment directly; instead, it affects them indirectly, by raising or lowering the Federal Funds Discount rate. The Discount rate is considered a floor for interest rates, since most banks will not offer an interest rate lower than what they can borrow from the Federal Reserve Bank. This is the rate you will see prominently featured as you read financial reports or watch financial news because it has immediate impact on the stock market. There are two significant facts you should always be aware of concerning the Federal Funds Discount Rate:

1. Always know when Federal Reserve Open Board meetings are being held. These are public meetings where monetary policy is reviewed.
2. Always know the market consensus on interest rates. There is almost constant interest rate dialogue on financial news stations and in financial periodicals. Stay up to date with news and trends to be aware of how interest rate changes might affect your portfolio.

## Prime Rate

Prime Rate is the interest rate that banks charge their most creditworthy borrowers, such as large corporations. The prime rate is considered a lagging indicator, because it changes in sympathy to a change in the Federal Funds rate or the Discount rate. Its importance lies in how it directly influences the borrowing decisions of corporations.

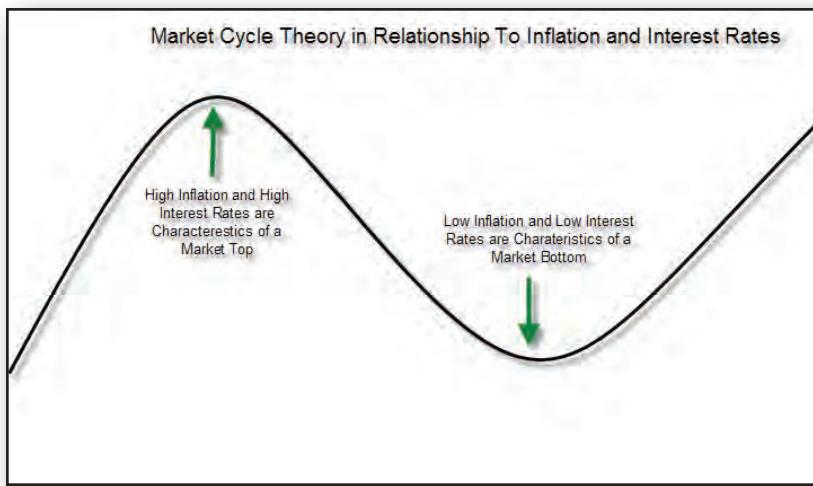
## Interest Rates and the Stock Market

How do interest rates affect the stock market? Rising interest rates are historically bearish for the stock market. In order for a company to grow its earnings it needs to do one of three things: increase sales, produce new products, or reduce the cost of producing current products. This type of progress does not come without costs, so the company turns to the financial markets for funding - either to sell more corporate stock, or borrow money from lenders. If interest rates are high, the company will pay a premium to

**Notes**

fund its progress. This will slow the growth of earnings and the price of the stock should go down. If interest rates are low, it is cheaper for the company to borrow money. This will increase the growth of earnings, and the price of the stock should go up.

FIGURE 3.7



In Figure 3.7 you see a hypothetical relationship of interest rates and cycles in the broad market. Remember these two facts about interest rates and the stock market:

- When interest rates go up,  
the stock market goes down.
- When interest rates go down,  
the stock market goes up.

## Bonds

The bond market is called the debt market. A bond is essentially a promissory note that a company issues when it borrows money from the public. There are three basic elements to a bond: the face value, the coupon rate, and maturity date.

The face value of a bond is the amount the company promises to repay when the bond matures. Most bonds are issued in face values of \$1,000 (called par). When the bond is issued, the company agrees

**Notes**

to pay back the amount on a specific date called the maturity date. The company also agrees to pay interest on the loan at a specific rate called the coupon rate. The interest that a bond pays is called a dividend. After the company issues the bond, it is often traded in a secondary market, called the bond market.

## Interest Rates and Bonds

To understand how interest rates affect bond prices, let's assume you spend \$1,000 and buy a bond from a corporation that promises to pay you 10 percent interest per year. Two years later you decide to sell the bond. What will the bond be worth when you decide to sell?

To answer this question you need to know the current rate of similar bonds. If the current rate is five percent, you will sell your bond for more than you paid for it. Your bond will sell at a premium because it pays a better dividend than is currently available on the market. There would be many investors willing to pay you a little extra to get a 10 percent annual dividend.

If the current interest rate is 15 percent, you would have to sell the bond for less than what you paid for it. Your bond will trade at a discount. No one will buy your bond from you when they can buy a new bond that pays 15%. You will need to entice buyers by lowering the price of your bond.

This is a simplified example, because there are many additional factors affecting bond prices. However, you can rely on these two basic guidelines:

- When interest rates go up,  
bond prices go down.
- When interest rates go down,  
bond prices go up.

## Bonds and Stocks

It is also important for you to understand the relationship between stocks and bonds. Bond and stock prices generally trend in the same direction. Many investors own both stocks and bonds, sometimes

**Notes**

moving their money from stocks to bonds and other times moving from bonds to stocks. Exactly when they make the switch depends on inflation. The higher the inflation rate, the more interest borrowers will have to pay lenders. Remember that when interest rates increase, bond prices decrease. The higher the interest rates, the more attractive bonds are to investors looking for a safe place to put their money. With a high interest rate, investors will begin to sell their stock portfolios and buy bond portfolios. This movement of money from stocks to bonds is known as flight to quality because investors seek safer, higher quality investments for their money.

## Bond Market as a Leading Indicator

Stock traders pay close attention to the bond market as a leading indicator of the direction of the stock market. Bonds are generally more sensitive to small changes in interest rates than the stock market. While it is impossible to track all bond issues individually, traders generally use the yield on government bonds for their analysis. A yield is different from the coupon rate because it is the actual rate of return you would get if you bought the bond at the market price. The coupon rate and the yield can be completely different.

Government bonds are debt securities issued by the U.S. Treasury Department. U.S. government bonds, also called treasuries, are among the safest investments in the world. There are three types of government-issued debts securities:

1. Treasury Bills: U.S. government debt securities with maturity dates under one year.
2. Treasury Notes: U.S. government debt securities with maturity dates of 1-10 years.
3. Treasury Bonds: U.S. government debt securities with maturity dates over 10 years.

Treasuries are highly correlated to interest rates and inflation, and small changes in the treasury yield can have a dramatic effect on the stock market. The sensitive nature of treasury yields makes them an appealing technical indicator. Treasury yields are reported daily and are an excellent way to monitor the bond market.

**Notes**

As a general guideline, remember the following when analyzing treasury yields:

- Increasing treasury yields negatively affect the stock market.
- Decreasing treasury yields positively affect the stock market.

## Currencies

There is no question about the global nature of the financial markets. Much of the business in America is influenced by import and export. You hear it in the news - the U.S. calls on the Organization of the Petroleum Exporting Countries, more commonly known as OPEC, to increase oil production. You hear it on television - Congress increases tariffs on Chinese steel imports. You read it in the paper - concerns over the U.S. trade deficit.

All global business and government transactions involve an exchange of currency. Currency is the medium that facilitates international trade and business, so naturally it has a significant impact on the U.S. economy. Consider this example of the importance of the currency exchange: Daimler Chrysler makes as much profit in the foreign exchange market as it does actually selling cars.

Currencies trade in the Foreign Exchange market called the Forex. The Forex market is the largest and most liquid market in the world, with \$1.5 trillion average daily volume versus \$25 billion dollars on the NYSE. Entire countries have been known to thrive or go bankrupt because of the underlying value of their currency.

## How the Forex Market Works

Currency values are always changing. The Forex market facilitates the exchange rate between different currencies. For example, if a U.S. manufacturer buys basic steel from a Japanese business, they cannot just write a check to pay for the steel. The U.S. manufacturer must first change their dollars into Japanese yen and then wire money through the banking system. If the U.S. dollar is weaker than the yen, the American company can't afford to buy as much steel as they could if the dollar is stronger than the yen. This is root of the relationship between currencies and the commodity prices.

**Notes**

## The Dollar and Commodity Prices

As a general rule, a rising dollar leads to falling commodity prices. The logic is relatively simple. The U.S. imports vast amounts of raw materials, particularly oil. If the dollar strengthens, it becomes more valuable than foreign currencies, meaning it has more buying power. If demand remains unchanged, supply of basic commodities will increase and prices will go down. The opposite is true as well: A falling dollar leads to an increase in commodity prices.

As a general rule, remember the following relationship between the U.S. dollar and commodity prices:

- A rising dollar leads to falling commodity prices.
- A falling dollar leads to increasing commodity prices.

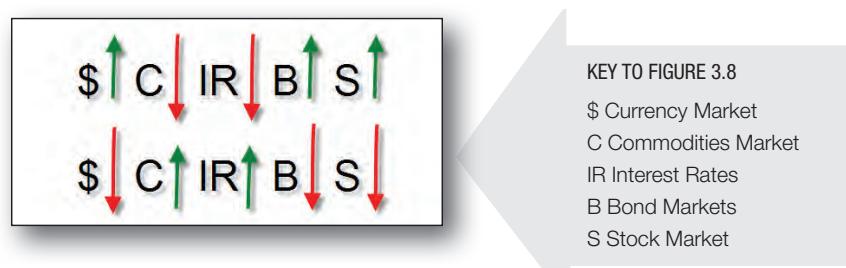
## Pulling It All Together

The currencies market influences the commodities market, which influences interest rates, which influences the bond market, which influences the stock market. If you see a strong rising dollar, you can expect to see commodity prices start to drop, which would push interest rates lower, which would increase bond prices, which would in turn be positive for the stock market.

If the U.S. dollar begins falling significantly, this would eventually increase commodity prices, which would tend to increase interest rates, sending bond prices lower, and have a negative impact on the stock market, which indirectly impacts your stock.

From this discussion you should have a basic understanding of intermarket analysis and how changes in one market can affect your stock portfolio. The illustrations below show a graphical representation of intermarket analysis.

FIGURE 3.8



**Notes**

## How Does It Fit In With the Other Points of Analysis?

One of the basic tenets of technical analysis is that the markets discount everything. This means that every influential piece of data is calculated into the price of the market, including every economic, political, fundamental, and operational influence. An accurate reading is best accomplished when you look at the markets from different angles. Intermarket analysis is one of those angles.

Remember the game, “Name That Tune”? The object of the game was to guess the name of the song in as few notes as possible. If no one was able to guess the tune after the first note was played, you would proceed to play the second note, then the third, and so forth until someone recognized the tune. When evaluating stock, you don’t want to try and guess what the market is doing with just one note. By all means, listen to as many notes as possible!

## Conclusion

Broad market and fundamental analysis is not just a look back at the report cards of each company and the current state of the economy. It is also a look forward at expectations and guidance for the future. In a very real sense, fundamental analysis comes down to looking for companies in sectors and areas that should grow based on their position in the business cycle. It may also be that the product that they offer happens to be one that you believe will be a major player in the future.

Ideas drive fundamentals. In fact, many fundamental-based trades are driven by core ideas on how you see the market and the world. Do you see solar stocks as taking a larger role in delivering alternative energy? Are consumers upgrading handheld technology devices? Are housing prices inflated and starting to trend lower? Is global development forcing countries to build infrastructure like roads, buildings and bridges? However you answer these questions, there will surely be an area of the market that will either benefit from or be hurt by it. This can be the starting point to good fundamental analysis.

**Notes**

To be great at fundamental analysis you don't only need to be someone who can crunch numbers; but you need to be a critical thinker as well. Develop your thinking process to always be looking for good ideas. Effective thinking is mostly a product of good habits. When you are presented with new ideas challenge them. If you hear a story through the media ask how it will affect the market. What companies may benefit? Which sectors? Here's an example. Let's say that you hear that the Federal Reserve has lowered interest rates. Who benefits? Who doesn't? There are many domino effects when it comes to broad macro trends. Most likely, in our example, commodities and companies who sell commodities would benefit. Global companies who conduct business overseas may benefit. The U.S. dollar will most likely suffer. When these macro trends establish, you can work a core fundamental idea for a long time. It requires that you keep your eyes and mind open and always ask the basic question: Who are the winners and losers?





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CHAPTER

# 3

# Technical Analysis





“Experience is that marvelous thing that enables you to recognize a mistake when you make it again.”

- FRANKLYN P. JONES

## How to Approach Fundamental Analysis

What, you may ask, is technical analysis? Technical analysis is the discipline of forecasting future price based on the study of current market action.

One basic tenet of technical analysis is the efficient market theory: “Everything known about a company is reflected in the current market price.”

Technical analysis considers all current economic, fundamental, psychological, political, and any other prevailing market influences.

Technical analysis also holds to the theory that price moves in trends. People derive signals from the action of someone

**Notes**

else. Think about it this way: If Warren Buffet called 100 people on the phone and told them that he was buying XYZ Company stock, a good percentage of those people would take that as a signal they should buy XYZ as well. At this point, you would see all of these traders enter the market. This is the start of a buying trend.

The technical analyst, or technician, carefully studies charts because certain patterns and trends will develop time and time again. Market history does repeat itself. If you can recognize historically documented patterns early, you can profit from the expected movement.

## Charting

Charts are the business of trading. Up to this point we've discussed many important areas of research, software, market analysis, and fundamental analysis and yet the most important content is still in front of you. Charts are a history of price, action and volume. They show you where the stock has been, where the points of supply and demand are and also where the trend is heading.

There are many advanced charting concepts that can help you identify entry points into a trade. Indicators can explain changes in momentum and price, but before you explore those advanced techniques you need to have a foundation built on basics. This chapter is devoted to that task. You should master these concepts, make sure you're applying them correctly and then build on them as you develop your trading skills.

## Types of Charts

The stock chart is the basic foundation of technical analysis. The chart and all of its supporting indicators can serve as the instruments and help the trader navigate the route of trading. Stock charts became popular in the late 19th century, thanks to Charles H. Dow and his writings in the Wall Street Journal. These writings became known as the Dow Theory and purported that markets moved in measurable trends and that these trends could be interpreted and forecasted in the price movement recorded on charts. Coupling fundamental and technical analysis (charting) together can provide investors with a better basis on which to experience success in the market.

**Notes**

Technical analysis is founded on the idea that studying the past behaviors and patterns of a security allows traders to develop a reasonable forecast of what the stock is likely to do in the future. In other words, history tends to repeat itself. Essentially, technical analysis is based on the belief that all fundamental data is already conveyed in the market price and that this information can be expressed in some type of graphical format. This graphical format is known as a stock chart. Until the 1990s, there was little in the way of financial software that performed charting, and what had been developed was so expensive and complex that its use was limited mostly to institutional traders. This left most individual traders that used technical analysis to draw their own charts, based often on the opening, close, high, and low prices of the previous day as published in the newspaper.

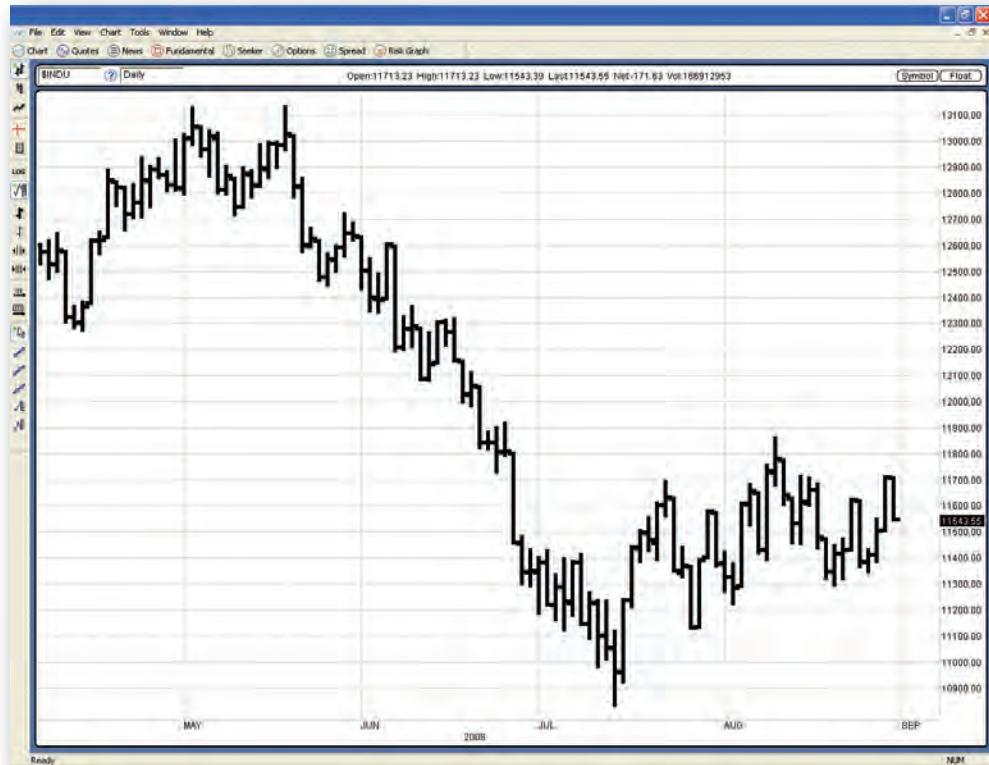
Today, of course, you can get a software-generated chart for any stock in the market in any number of ways, which has removed the need to develop your own charts. As charting technology evolved, several types of stock charts have been developed and are used in the market. The four most common are bar charts, point and figure charts, line charts, and candlestick charts. The focus of this manual is primarily on candlestick charts since we believe this chart type provides the fastest, most complete synopsis of a stock's price activity over any given time period; however, in order to give you as complete a view of charting as possible, let's briefly look at the others. Keep in mind that there isn't one type of chart that everybody uses. There are many ways to conduct technical analysis, and the chart type a trader will use depends ultimately on the traders' preference.

## Bar Charts

The bar chart, also known as a Western Bar Chart or an OHLC (open, high, low, and close) chart, gives us a clear representation of what a security has done during a certain period of time.

**Notes**

FIGURE 4.1



In Figure 4.1 you see a bar chart for \$INDU, the Dow Jones Industrial Average. Each bar represents one period. When using a daily chart each bar represents one day. How to read the bar is explained below.

FIGURE 4.2



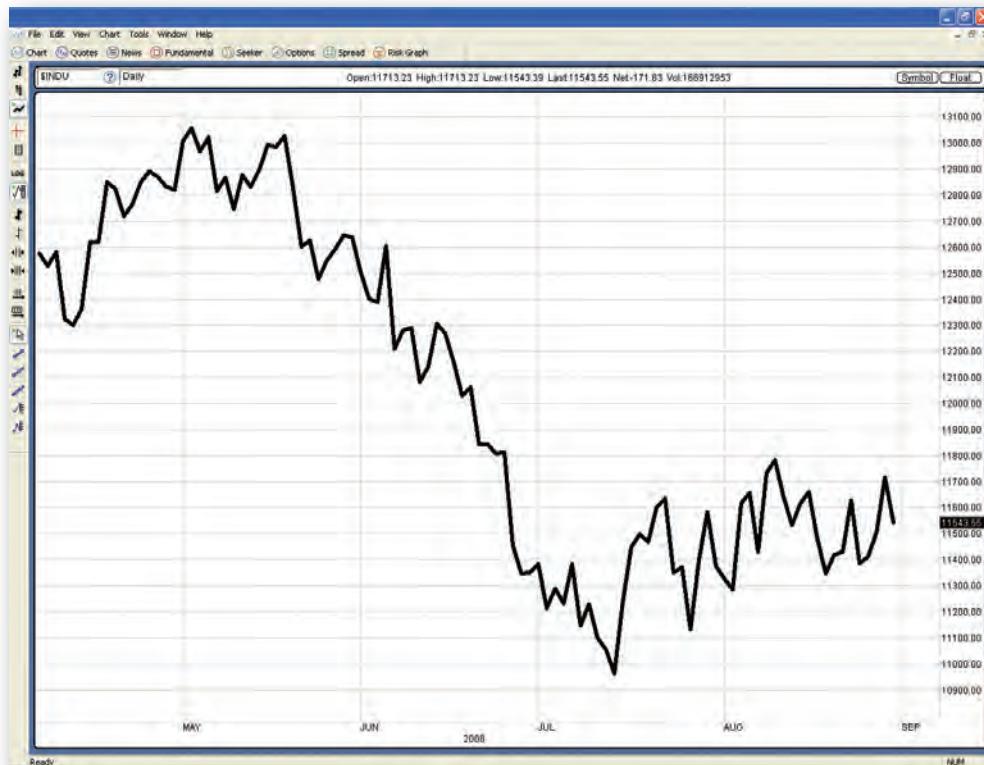
**Notes**

In Figure 4.2 you see the explanation of a single bar. The top of the vertical line represents the highest price at which the security traded for during the period, and the bottom of the vertical line represents the lowest price during the same period. The horizontal line on the left side of the bar indicates the opening price, and the horizontal line on the right side indicates the closing price of the period.

## Line Charts

Line charts are the most basic of charts used by market technicians. With a line chart, one simply plots the point of the open, high, low, or close on a chart and draws a line connecting these points. The most commonly used point is the closing price. These charts can show the overall trend of a stock and are very simple to calculate.

FIGURE 4.3



**Notes**

In Figure 4.3 you see the exact same chart of \$INDU but now it's displayed as a line chart. Line charts offer a clear and easy to read viewpoint of where the stock has been and what pattern it is in. Many beginners use line charts to help identify support and resistance. If you've never tried a line chart, it's simple using MachTrader to flip back and forth from one chart type to another. Simply click the chart style you want to display on the top left of the tools column.

## Candlestick Charts

Centuries ago the candlestick method of tracking price was used by a Japanese man named Munehisa Homma. Mr. Homma was born into a wealthy family in 1724 and was given control of the family business in 1750. At that time he began trading rice in the port city of Sakata. Mr. Homma became so successful in trading rice futures that he amassed a huge fortune and in his later life became a financial consultant to the government and was given the title of samurai. Mr. Homma died in 1803. The candlestick charts known today are a direct result of Mr. Homma's trading principles and philosophies in the rice markets.

Candlestick charts consist of the same pricing information as bar charts (open, close, high, low), but utilize a more visually enhanced and identifiable method that resembles a candlestick. The thick part of the candlestick (both shaded and non-shaded) is called the "real body." This real body represents the difference between the opening and closing of the stock (or security) during that time frame. If the real body of the candlestick is non-shaded (also referred to as hollow or clear), then that indicates that the stock closed above its opening price. If the real body of the candlestick is shaded (or filled in), this indicates that the stock closed below its opening price. The lines above and below the real bodies are called shadows (also referred to as wicks or tails).

In Figure 4.4 you will now see the \$INDU displayed as a candlestick chart. Notably, when comparing candlestick charts to the other charts we've discussed, these charts render much more information on what has happened and what is currently happening, as well as better clues about what is likely to happen next.

**Notes****FIGURE 4.4**

A few of the many reasons candlestick charts are so widely used include the following:

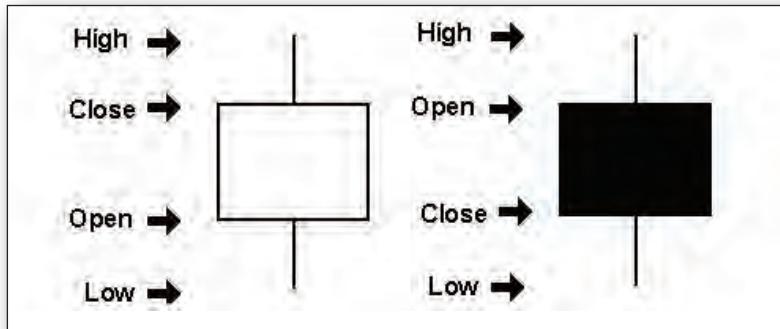
- **ENHANCED DISPLAY:** Candlestick charts build upon the information given from line charts and bar charts. Utilizing the wide variety of patterns that candlesticks can form, we can gain more insight into what is happening in the market than what is provided in any of the previously described chart types.
- **EARLIER INDICATIONS:** Not only will candlesticks tell you what has happened, they will often give an indication of what is likely to happen in the near future. Candlestick formations have proven to be quite reliable over time, and when we see certain patterns forming, we can make better decisions quicker.

**Notes**

- EASY TO UNDERSTAND: The same data that is used in drawing some of these other charts are used in candlestick charts. Anyone from a novice to a professional can learn to interpret candlestick patterns and their meanings.

As we refer to individual candlesticks during this section, for the sake of simplicity, we will make mention that candlesticks either refer to a session or a day. Candlesticks, like most charts, can be utilized for various durations of time. Using the MachTrader software, these durations can start with a one-minute candlestick and go all the way up to a weekly candlestick.

FIGURE 4.5



In Figure 4.5 you see a description of how information about price movement is displayed using candlesticks. You can customize your candlesticks to display any color you want for an up day or a down day. To do so simply right click in a chart and select format.

## The Body

The box that makes up the difference between the open and the close is called the body (or real body) of the candlestick. This difference is the range between the opening price and the closing price of the period, which the candlestick represents. When the body is shaded (or filled in), the price was lower at the close than at the open. A non-shaded (hollow or clear) body means that the price was higher at the close than at the open.

Regarding the coloring of the candles on down days, this shading will usually be in either red or black. The majority of shaded candles that are bearish will be filled in with red, although you can see shaded candlesticks in a number of colors. For a bullish candlestick, it may be open or white or a variety of colors.

**Notes**

## The Shadows

Candlesticks often have thin lines above and/or below the body. These lines are known as shadows (also referred to as wicks or tails) and represent the high and low prices achieved by the stock during the trading period. The upper shadow represents the high, and the lower shadow represents the low. These shadows are what give these charts the appearance of a candlestick and its wick.

Although the real body is frequently considered the most important component of the candlestick, the length and position of the shadows also give us important information and cannot be ignored. If a candlestick has a shadow, it can be above or below the real body, or even above and below at the same time.

Many candlestick patterns have been studied for hundreds of years and these patterns represent to the trader, a very exciting way to predict the movement of the stock or option.

## Using Charts to Identify Trends

For a moment, let's remove ourselves from the world of trading and explore the general concept of trends. A dictionary definition of the word trend is "the general direction in which something tends to move; a general tendency or inclination."

Trends are common in many environments. Meteorologists measure trends in weather. Economists measure trends in the economy. City planners measure trends in population growth. Fashion designers measure trends in fashion. Let's examine the stages of a trend by taking the fashion industry as an example. Suppose a cutting-edge designer grapples for attention and respect by introducing bell-bottomed jeans. Soon other designers catch the vision, and begin incorporating bell-bottom jeans into their fashion lines. Consumers take notice and begin buying bell-bottoms. The movement starts small, with one visionary designer, and gradually grows from person to person until the popular trend is solidly established. Soon it seems like the whole fashion-conscious world is wearing bell-bottoms. (Meanwhile, cutting-edge designers have moved on and are working to introduce the next fashion trend — parachute pants.) You've probably heard the saying,

**Notes**

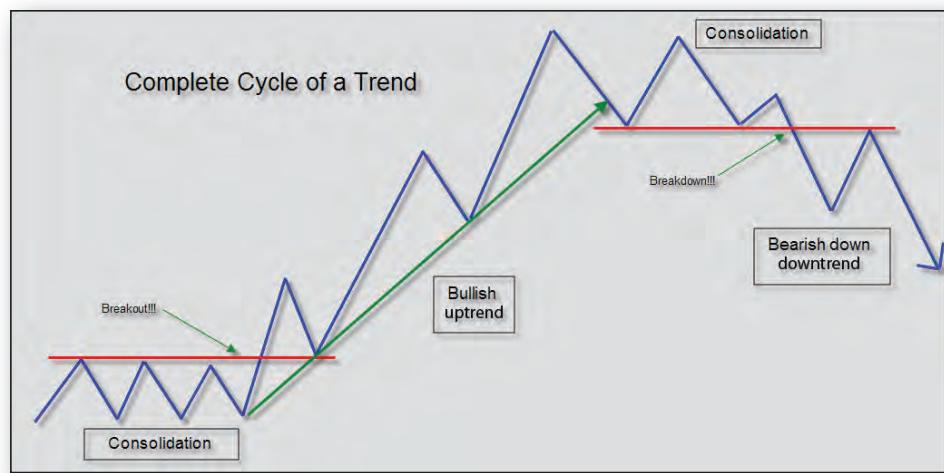
In the market, the trend is more than just your friend; it is your “best friend.” Learning to recognize trends is a very important part of the traders overall toolkit.

“  
**The trend is  
your friend.**  
”

## Cycle of a Trend

In Figure 4.6 you see a drawing of how a typical trend develops, runs and then eventually reverses. If you can understand the theory behind how trends evolve, you will be much better at the pattern recognition and entry point strategies that we'll discuss in the next chapter.

FIGURE 4.6



To explain Figure 4.6, let's use a simple example from the world of physics. Imagine that you're holding a baseball in your hand. A friend of yours has climbed up into the highest branches of a tree. He calls to you and asks for you to throw him the ball. You reach down and thrust

**Notes**

the ball 30 feet into the air. As it approaches him a gust of wind comes through and he decides to not reach out and grab the ball. It falls back to the ground and you pick it up to make your second attempt.

What does this have to do with charting? Everything. Momentum is the force behind a trend. At the beginning of the story you simply held a ball in your hand. It was motionless. When you decided to throw it into the air the ball broke free and started into an uptrend.

In Figure 4.6 the consolidation at the beginning of the chart can be thought of as you holding the ball in your hand. It's not going anywhere yet. The breakout from that consolidation is like you throwing that ball. A breakout can be one of the most bullish technical signals to buy. We will discuss the technique next chapter. But for now let's examine the rest of the travel of that baseball.

As you let the ball go it has the most amount of force exerted upon it. Right at the moment of release it is the strongest. That's the same with the trend of a stock. When it first breaks free the stock is open to make a big move. Once you recognize that a trend has established you will want to start to trade in the direction of that trend. During the bullish uptrend stages of a trend traders look for retracements back into the trend line as signals to go long (buy the underlying stock).

At some point trends will fail. When the baseball reaches its apex it has lost all upward momentum. If your friend would have reached out and grabbed the ball it would have felt motionless. Once a trend loses its momentum many traders will start to become cautious or even look for a new trend to evolve. The consolidation at the top of the chart is a sign that the trend has stalled. Many of the most bearish chart patterns like triple tops, head and shoulders and M patterns happen after a trend has failed and moves into a consolidation.

The breakdown is the point when the ball then starts its descent back to the ground. Active traders look to take positions in both directions. You will want to learn how to make money as stock trends move down. Downtrends are typically more ferocious and faster than uptrends. Fearful investors that see downtrends develop start to dump their stocks as losses start to accumulate. Most participants in the market have never traded a bearish strategy, but it can be one of your strongest weapons to learn to do so.

**Notes**

Back to our illustration, eventually the ball will hit the ground. When you pick it up and throw it again, that is just another trend starting. Likewise, stocks will cycle back and forth. And when they do, the more you can recognize the trends behind their movement, the better you'll be at using them to your advantage. In this manual, we'll discuss just four of the trend patterns and strategies you can use as entry techniques. They include the bullish breakout, bullish retracement, bearish breakdown, and bearish retracement. You will become better at applying each of these techniques as you gain a firmer understanding of trends, so let's delve further into the topic.

FIGURE 4.7



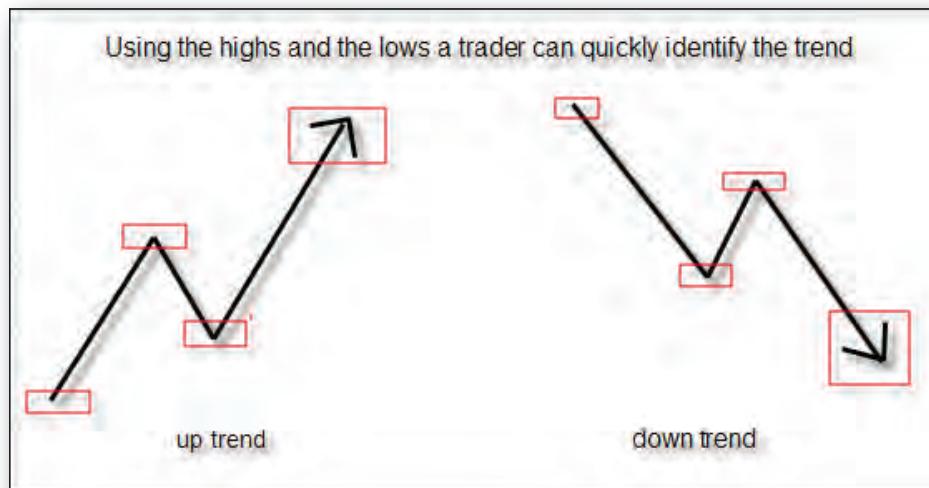
In Figure 4.7 you see the trend cycle applied to the stock Apple (symbol: AAPL.) In this example AAPL starts with a consolidation in February and March of 2008. After establishing a resistance zone near 130.00 AAPL broke out in late March. The bullish uptrend lasted a little over two months and then the stock moved again into consolidation. As Apple's stock then began to breakdown below its support the stock developed a bearish downtrend.

**Notes**

## Highs and Lows

The direction of the stock can be mapped out by drawing trend lines. If you see a stock that has higher highs (peaks) and higher lows (valleys) then it is said to be in an uptrend. If the trend is lower highs and lower lows then it conforms to the definition of a downtrend. A consolidating, or trendless, market has highs and lows that are not moving higher or lower. In Figure 4.8 you see a quick look at how the highs and lows can establish a trend.

FIGURE 4.8



### TREND LINES

One of the first tools in technical analysis that can be used to determine trend direction is the trend line. A trend line is simply a graphical representation of the trend.

An uptrend line has a positive slope and is drawn below the market. To draw an uptrend line, the trader will connect two valleys (or lows), where the second valley is higher than the first. The uptrend line can act as a support level. If the price remains above the trend line, the uptrend is considered solid. If the price breaks below the trend line, a change in trend could be imminent.

**Notes**

FIGURE 4.10



In Figure 4.10 you see a downtrend drawn for the stock XLF. Downtrend lines should be drawn above the stock connecting the highs as the stock falls.

## Trends and Time Frames

Is it possible for a stock to be in an uptrend and a downtrend at the same time? Yes; it happens every day. In fact probably every stock on the market will have a conflicting trend. How can this be? Well depending on what time frame you look at the stock, it can frame the trend into a different context.

There are three general time frames to consider when you're charting and they are as follows:

1. LONG-TERM – the primary trend can be anywhere from a few months to several years in time. The exact amount of time isn't critical. The primary trend is the bigger picture trend that establishes the long-term bullishness or bearishness in a security. Many traders use weekly or monthly chart time frames to identify the long-term trend.

**Notes**

2. INTERMEDIATE TERM – Intermediate term is generally thought of as the last two quarters. This would be about three to six months in time. Most traders use daily time frames to identify the intermediate trend.
3. SHORT-TERM – Short-term is what's happening now. It generally is somewhere between one and three weeks in time. Traders use intraday charts anywhere from five minutes to one hour in time frame to identify the short-term trend.

Many stocks will have the long-term trend saying one thing, the intermediate another and the short-term pointing in different directions as well.

**FIGURE 4.11**



In Figure 4.11 you see an example of a bullish long-term trend for USO. USO is the United States oil fund that tracks the performance of oil produced in the U.S. We're going to examine this stock using different time frames to illustrate how trends can be competing.

## Notes

FIGURE 4.12



In Figure 4.12 you see an example of the daily chart for USO. In our weekly chart we saw a long-term healthy uptrend. We don't see the same picture here. The stock has fallen sharply between July and August retracing nearly 25 percent from its high. What does that mean about the stock? Well on its face value it means that long-term demand has been healthy but short-term demand has been weak. In other words, shorter-term traders have been selling it aggressively in the recent months.

You should also notice a few concepts that we discussed before can apply here as well. The breakout in April from a consolidation got the trend started and the failure in July was the momentum shift that sent it spiraling downward.

What do you suppose will happen from here? What signal would USO be giving us if it breaks upward above resistance? The different time frames of trend allow us to get perspective that we would not have otherwise. Now let's look at it on a shorter-term time frame.

**Notes**

FIGURE 4.13



In Figure 4.13 we now have reduced USO down to an intraday chart. By starting with the long-term, moving to the intermediate and then down to the intraday you can see how it allows you to get many perspectives of the pricing of this stock. As you recall we saw the long-term weekly chart in a bullish uptrend. The daily had been down ferociously and seemed to currently be consolidating. What does the intraday then tell us? Well from the trend line and action of the stock it would seem to confirm that consolidation.

One great use of the short-term time frame is to identify the exact entry price you would enter. We'll go into this in length next chapter but think about it like this: Which time frame allowed us to get the most detailed about where the resistance support and trend lines were? It was the intraday.

It's always important to have perspective. Beginners will often rush into a stock because it looks great and not realize that it may be giving conflicting information on another time frame. That is not to say that you

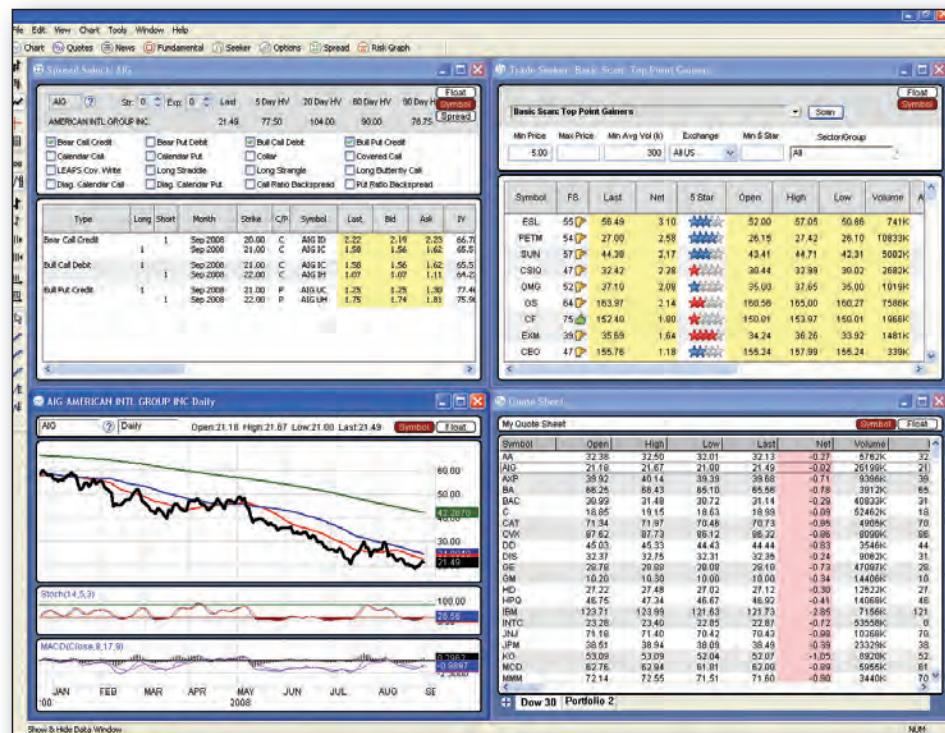
## Notes

must have all trends line up. On the contrary, the conflict between time frames is what can force a stock to make a volatile move in one direction or the other. If the short-term day traders are selling a stock aggressively and then BIG money comes in to buy that same stock based on a long-term signal, usually the shorter-term players will quickly get out and that can force the stock up even further.

## Support

Support is at the end of a decline and is commonly defined as the price level or zone where demand for a stock overwhelms supply. A support is also called a floor. Support zones can be catalysts for an upward move in price. Many traders look for a stock to find support before they take a bullish position in the stock. There can be significant differences in the way you identify support in a consolidation versus how you will identify it in an uptrend.

FIGURE 4.14



In Figure 4.14 you see two examples of support. The left side shows an example of support during a consolidation. This kind of support zone will have many points of confirmation. It is easily identified. During the course of a trend though, it may be difficult to identify support. Remember

**Notes**

support is an upward movement in price where buyers have stepped in and shown demand for the security.

Old resistance is a level that many traders look to as a potential level of support. If a stock breaks out of a resistance zone many times it will retrace to that same level to test it out as support. Traders who didn't buy the breakout then step in and buy up the stock at that point. Old resistance will be an important area to identify in an uptrending stock as it might not be as easy to identify support.

FIGURE 4.15



In Figure 4.15 you see an example from the stock Potash Corporation. POT has a strong uptrend on the daily chart and there were many times that as the stock broke out to new highs it would come back and test the old resistance zone. Old resistance zones can be areas of new support in an uptrend.

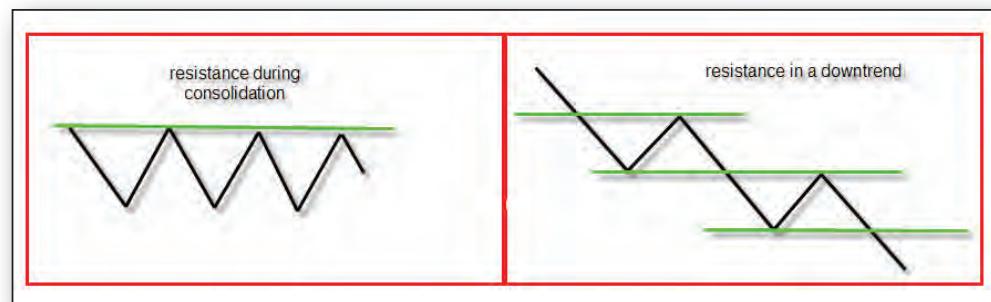
## Resistance

Resistance occurs at the end of a rally and is commonly defined as the price level or zone where the supply for a stock overwhelms the demand. A resistance level is also called a ceiling. Support and

**Notes**

resistance are like floors and ceilings in a building. As you go from a bottom floor to an upper floor and then back down again, the floors and ceilings take different roles. If you were to go from the first floor to the second floor, then the first level ceiling becomes the second level floor. Remember, the old resistance becomes new support, and in the opposite fashion, old support becomes new resistance as the price breaks down.

FIGURE 4.16



In Figure 4.16 you see two examples of resistance. Resistance during a consolidation period is easily identified. Resistance acts as a barrier to change. When price approaches the resistance traders hesitate - maybe even sell - and the price starts to fall. This psychological mindset is one reason why a break of resistance can be such a bullish signal to go long. As the price breaks through a barrier, much like water breaking through a dam, it is free to run and trend begins.

Using the old support zone often identifies resistance in a downtrend. As prices break down the old floors will become ceilings in the future.

In Figure 4.17 you see the stock Bank of America (symbol: BAC). When stocks are downtrending old support zones have a high probability of becoming new resistance zones. As you see at the beginning of the chart in July of 2007 support at 47.00 became resistance at 47.00 in November and December. In January and March of 2008 support near 35.00 became a strong resistance in August of that same year.

**Notes**

FIGURE 4.17



## Trend Reversals

We've said before in this chapter that you want to trade in the direction of the trend. But what if the trends are changing? Trend reversals are an important part of trading.

Much of the chapter has focused on trends that continue in their direction. As you read in the section on trend cycles, trends will all eventually fail and reverse. In this section we're going to explore the failure of trend and explain what signs will point to a reversal.

Here are some technical signals to watch for to identify a shifting trend:

1. Trend Violation
2. Consolidation
3. Volume Spikes
4. Decreased Momentum

**Notes**

## Trend Line Violation

The first sign that a current trend is failing is when the price of the stock penetrates the trend line. Trend line violation occurs when price fails at the trend line. In Figure 4.18 you see an example of a bullish trend failure.

FIGURE 4.18



In Figure 4.18 you see the stock Ensco (symbol: ESV). ESV has recently shifted from a longer-term uptrend into a downtrend. What signals were there that the stock was going to fail? Using advanced indicators we could have picked up on a shift in momentum, but simple trend failure showed us the first signs. In July two of ESV's trends failed.

When a stock retraces into a trend line buyers step up and enter to try to make money on the stock. In fact one of the entry points we discuss in the next chapter will show you how to make this very trade. If the stock doesn't bounce up traders who are long the stock get stopped

**Notes**

out or start to sell because of the losing stock position. This trend failure is also a shift in sentiment at the same time. A stock that looked poised for a big upside move instantly looks like it should be treated with caution.

FIGURE 4.19



In Figure 4.19 you see the stock Precision Cast Parts (symbol: PCP). In July the stock undergoes trend failure. What was a ferocious downtrend now moves into a consolidation range. These are the signals you should look for as a trader if you want to be a part of the next move up. This pattern is very common for a trend reversal. In fact the sideways consolidation can be thought of as intermission in between the two trends. Many times after a big move has stalled it will consolidate before turning back around.

## Sentiment During a Consolidation

Consolidation is an important part of understanding momentum and trend reversal. Let's try to consider what the sentiment would be around

**Notes**

a stock that was going aggressively down and then started to move sideways. Let's consider it from many different perspectives.

Long-term holders of the stock will feel relieved that their holding isn't going down anymore. A reduction of fear and panic turn into complacency and a more bullish outlook. Well at least they're not so worried. Bearish traders (market participants that were betting the stock would continue to fall) are now seeing their profits stall. They may even start to lose. They decide to get out and thus exit their short trade. That's another bullish sentiment shift.

What about the traders sitting on the sidelines? Well they see a stock turning around and all of that money that can be made. What was a beaten up company now has a new shine to it. It's looking great. Now all we need is a reason to buy!

## Volume and Reversals

Volume is the raw number of shares that are traded during a period. When volume is spiking it is indicating an increase in participation. Who do you suppose holds enough money to make the volume go through the roof? Not the average retail trader that's for sure. Institutions like hedge funds, investment funds and mutual funds are the participants holding the money. When volume is spiking it is a direct indication that institutions are doing something.

In Figure 4.20 you see the stock Schein Henry INC (symbol: HSIC). The stock has shown some of the same signs we're looking for in trend reversals but is also confirming with an increase in volume. To designate a volume increase, a "spike" generally looks for the bars to be about twice the size of a normal volume bar. In January and February as the stock was turning down volume spiked to mark two swing highs. That was a bearish confirmation of institutional intent to sell the stock. In August you see a volume spike after trend line violation. Volume can be the catalyst that moves a stock from a consolidation back up into an uptrend.

**Notes**

FIGURE 4.20



## Decreased Momentum

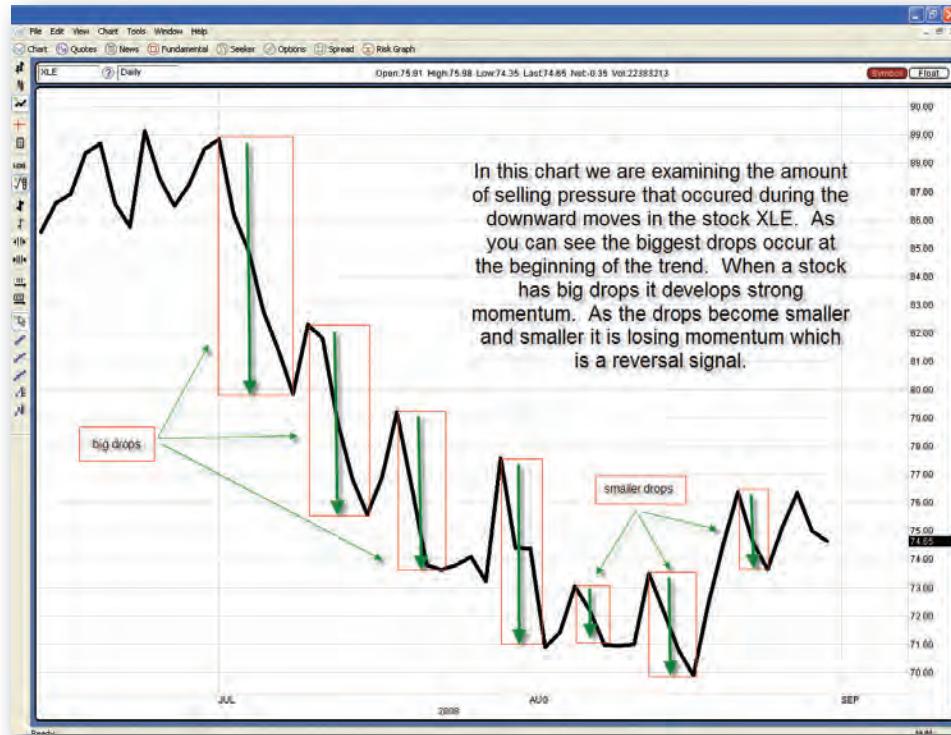
Up to this point we've covered specific pricing signals as trend line violation, consolidation and volume are concerned. What about subtle signals about the trend that might be there even before we get confirmation? Momentum is a driving force in trend analysis. From our example earlier about the baseball, you should remember how slowing momentum might indicate that a trend is slowing down.

In Figure 4.21 you see the stock XLE. The amount of distance the stock drops on a downward move can be a measure of momentum. As the trend started the stock experienced big moves to the downside. As the momentum slows the drops become less severe. This is a sign of a potential reversal.

When identifying trend shifts it will be wise to look for as many of these characteristics as you can find. The more there are present the more confirmation you have that a reversal is imminent.

## Notes

FIGURE 4.21



In Figure 4.22 you see the stock Cameron International. The stock had a strong uptrend going but was losing momentum. After trend line violation the stock couldn't recover as it broke down into a downtrend.

FIGURE 4.22



**Notes**

Learning to spot this kind of a signal can put you in a position to protect yourself from adverse moves in the stocks you own. It also can set you up to profit from these moves as you make entries on trends that are changing.

## Summary

Volume is the raw number of shares that are traded during a period. When volume is spiking it is indicating an increase in participation. Who do you suppose holds enough money to make the volume? Remember that technical analysis is a function of using historical price action to forecast future price trends. This is not an exact science. We are working in the world of probabilities. It is because of probability that we are able to become profitable in the stock market. It is because of uncertainty that the discipline of technical analysis works. We cannot emphasize enough the importance of trends, support, and resistance. These three concepts tip the scale of stock market probability in your favor. Be sure to identify your rules and be disciplined in following them. In the next chapter we will take the concepts we've discussed here and explain how you can make entry and exit decisions using the breakout, breakdown, bullish retracement and bearish retracement techniques.

**Notes**

## Session 4 Review

1. What type of chart will you most likely be using for the majority of your trading?
  - a) Bar Charts
  - b) Line Charts
  - c) Candlestick Charts
  
2. In the market, the trend is more than just your friend; it is your \_\_\_\_\_ friend.
  - a) Best
  - b) Worst
  - c) Long lost
  - d) Distant
  
3. (T / F) Refer to the story with throwing the baseball, momentum is the force behind a trend.
  
4. If you see a stock that has higher highs (peaks) and higher lows (valleys) then it is said to be in a \_\_\_\_\_
  
5. List the time frames for the following trends:
  - a) Long-Term Trend- \_\_\_\_\_
  - b) Intermediate Trend- \_\_\_\_\_
  - c) Short-Term Trend- \_\_\_\_\_
  
6. Old resistance is a potential level for new \_\_\_\_\_
  - a) Trends
  - b) Support
  - c) Stock offerings
  
7. Resistance can also be referred to as a \_\_\_\_\_
  - a) Basement
  - b) Wall
  - c) Ceiling
  
8. (T / F) When volume is spiking it's indicating an increase in participation.
  
9. Technical analysis is a function of using historical price action to forecast future price \_\_\_\_\_

**Notes**





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CHAPTER

# 4

# Portfolio Management





“There are old traders;  
and there are bold traders;  
but there are no old bold traders.”

- ANONYMOUS

We have introduced both fundamental and technical analysis strategies in order to “fast track” the development of your trading system. You will want to develop a defined trading regimen that includes a set of rules for systematic interpretation of the general markets, an individual company, and determining when to execute your trade. This style of trading will allow you to develop and fine-tune your strategies. It will also let you track and monitor the success rates of your system, and help you guard against emotional investing.

In this chapter we will discuss how to manage risk in your portfolio. Risk is an essential part of trading. Making a trade can be thought of as a decision to take risk. Most successful trading systems have a disciplined approach to risk. You will need to determine how much risk you are willing to take in each position as well as your overall account. We will avoid teaching absolutes like always risking a set amount or always cutting losses here or there. Much of your risk determination will depend on the time

**Notes**

frame you trade as well as the volatility of the underlying instrument you are trading. If you are a day trader your risk analysis should be done differently than if you are buying a stock to hold it for an investment. You will want to develop risk aversion techniques like setting stop losses and portfolio management as well.

## Risk Management

Once you can track and quantify your trading system, you can begin to manage your risk. There are essentially three elements involved in a stock trade:

1. What to buy
2. When to buy
3. How to execute the trade

Risk management has everything to do with "how to execute the trade." Your risk management rules will tell you how much to invest; these rules will analyze diversification, reward-to-risk ratio, success rates, and drawdowns. This is the element of trading that nearly everyone neglects, but is vital to the success of your trading system development.

It is very difficult to make consistent money in the stock market without a proper system of risk management. It can be done, but more often than not trading systems fail without proper money management. For example, suppose your trading system develops successful trades 80 percent of the time. When you are right you win an average \$100,000; when you are wrong you lose \$5,000. If you start with an account size of \$10,000 and lose your first trade, you are now down to \$5,000. Frustrated but still hopeful, you try again...and lose a second time in a row. That's it, end game, you're out of money. You hit your 20 percent losing streak on your first two trades, completely wiping you out. Even though your chances of winning far outweigh your chances of losing, you have already lost your ability to trade due to poor risk and money management decisions.

Here are some general guidelines to help you get started developing money management rules. Please note that these are more guidelines than rules. Always use discretion when trading.

**Notes****BEING FULLY INVESTED IN THE MARKET  
EXPOSES YOU TO RISK**

Many traders will keep some of their money in cash to manage risk. To trade you need to put money in the market but having cash on hand does two very important things: One, it makes sure that if market risk happens due to an economic event like a key news release, then you don't take the full brunt of the adverse move. Second, if you are fully invested, how can you make any more trades? By keeping money in cash you keep arrows in your quiver. When an opportunity presents itself you can take action.

**ON ANY GIVEN TRADE  
RISK NO MORE THAT YOU'RE WILLING TO LOSE**

This means that your losses should never exceed your risk tolerance of your account size, unit size. This seems self evident but many new traders fail to examine potential risk in their trade. When you make a new trade ask yourself "if I'm wrong how much will I lose?" Try to project possible scenarios that the stock can go through. How much will you lose if stopped out? How much will you lose if the stock gaps against you? Responsible traders are aware of the downside. If you can properly manage your risk then the rewards will be there.

**IN THE BEGINNING,  
STAY AWAY FROM OVER LEVERAGING**

If you knew your account would be successful 80 percent of the time you would be trading as often as you could, right? Even in this scenario, would you put most of your account out at risk on one single trade? Because losing happens you need to avoid over leveraging. The money in your account can be thought of as your employees in your trading business. Keep them working but don't put their jobs at risk.

So how much do you put in? The appropriate amount of size in a position will change from trader to trader. Think about it like this: if you're trading a blue-chip, liquid stock that doesn't move very fast and an IPO start-up that moves very fast the risk potential is very different in each situation. You will want to recognize the risk in the position you're taking and always make sure that your losses don't become too excessive.

**Notes**

## Diversification

Any discussion on risk should be accompanied with a discussion on diversification. Diversification is a strategy of investing in different markets, products and time frames. Account diversification reduces your exposure to risk. Since no two people share exactly the same level of risk tolerance, diversification is highly personalized and difficult to quantify. If you are too diversified, large winnings in one market may be averaged down by small winnings and losses in other trades. On the other hand, you definitely don't want to put all your proverbial eggs in one market basket.

There are many ways to diversify. Buying 20 stocks will clearly be more diversified than buying two. But it doesn't have to end there. You can mix long-term positions with short-term positions, as well as have bearish positions mixed in with your bullish positions.

Market risk is the risk that every trader deals with. If a hurricane hits the gulf coast the market may react negatively. If you are entirely in bullish positions then your account will take a deep drawdown. But, if you have a mix of bullish and bearish positions you can reduce the impact of market risk.

Diversifying in different products can accomplish the same thing. Many traders use stock, bonds, futures and options concurrently. If you have a good mix of products and positional direction you can reduce the risk in your account. Depending on your personal tolerance for risk and your investment objectives, the amount of diversification can change from trader to trader. Remember, it's easy to be completely focused on the prize, but you have to ask yourself: how much am I willing to pay to get it?

## Reward to Risk Ratio

Each trade will present a potential reward versus potential risk. The word potential is key. We really don't know how much money we can make on a trade. It can be much greater (or less) than we anticipated. Using reward to risk ratios can be a method to help identify potential. Let's examine three hypothetical trading systems to show how the actual reward to risk may differ from trader to trader.

**Notes**

In the first trading system, let's assume a day trader has an expectancy to be correct 70 percent of the time in his trades. Based on this success rate he decides to set a stop loss and target at equal levels from his entries. This would be a reward-to-risk assumption of 1:1. When he profits, he profits as equally as the loss he takes when he loses. For this trader's system, 1:1 reward to risk would work fine.

In the second trading system, let's say a swing trader has an expectancy to be correct 50 percent of the time. Based on his success rate he decides to set a target twice as high as his stop loss. When he profits he makes twice as much as the loss he takes when he loses. Based on the success rate he needs to have a higher reward-to-risk potential in his trades. This trader would need to find trades that offered more upside potential than the day trader.

In the third trading system, let's assume a speculator who trades aggressively has a success rate of 30 percent. He only wins one in three trades roughly. When he wins he wins big, though, at five times the amount of loss that he takes. His reward-to-risk potential is 5:1. The trader looks for situations that offer big upside potential when he's right but realizes that he won't be right that often.

Which system is best? In all three of our examples the traders would be profitable based on the success rates and accompanying reward-to-risk assumptions. The answer though, is that none of them are best. They are all just dynamically different. The important point is that you need to understand your success rate, and then you can set stop and targets based on your assumed rate.

Some people would say, why not trade the 70 percent success rate system and look for potential trades that offer 5:1 reward to risk? Why not get the best of both worlds? Well if you can find a system that works that way then absolutely go for it! In the trading world most often the higher amount of reward you expect or demand the lower probability you have of actually getting there.

Again, the only way to know what potential you have in your techniques will be to trade them a lot so that you can get enough results to know what to expect. Paper trading can serve this function. Most traders will practice any new strategy vigorously until they can make valid assumptions about its potential. For many of you, these strategies

**Notes**

you've learned will be your first exposure to a trading system. You will need to practice them over and over again to get an idea of how they work.

## Success Rates

So how often does a trader need to be right to have success? Let's examine the idea of success rates through an analogy. Let's assume there is a basket of ping pong balls. Forty of the balls are red and they represent losing trades. Sixty of the balls are white and they represent winning trades. Every time you reach in and grab a white ball you have a profit and when you pull a red ball you have a loss.

If this were the market you'd be reaching your hand in as fast as you can and pulling out ping pong balls right? Maybe. Success rates are only a part of the equation. As we examined before, you must also determine how much potential reward you have versus the potential risks you are taking. In our example, what if you lost \$2 for every red ball but only gained \$1 for the white ones? Well then you wouldn't be so eager to reach in.

Would you be surprised to hear that many trading systems have more losing trades than winning trades? Would it surprise you more to hear that many of those traders are actually profitable in the end? You do not have to have a positive success rate to make money in the market. The key to success in these types of systems is that the money you make on your winning trades must be greater than the money you lose on your losing trades.

What kind of system are you trading? Well the techniques described in this book can convert into a success rate and reward-to-risk potential that can vary greatly from trader to trader. If you use the techniques and apply them to long-term trading you'll have certain results, and if you apply them to day trading you'll have other results. The bottom line is this: we've given you a blueprint but your results will be different from someone else's.

Keep track of your results so that you have an expectation of what you can assume based on the types of trades you take and how well you execute them.

**Notes**

## Drawdowns

The term drawdown refers to the total amount of money your trading system will lose during a losing trade or losing streak. Many new traders approach the market with the assumption that if they can just learn the perfect strategy they can be right all of the time. When they see losses start to accumulate the assumption is that either the strategy doesn't work or that they're not doing it right.

It's hard to build confidence when you're losing. Hopefully if you have a good idea of how drawdowns are a natural part of a trading system it won't shake you too much if and when you run into a losing streak. Let's go back to our analogy of the ping pong balls. This time let's say that when you pull a white ball it gives you a \$2 gain and a red ball gives you a \$1 loss. This system has a positive success rate (60 percent) and a positive reward to risk ratio (2:1). This is a good trading system.

How would it feel if you pulled out 10 red balls in a row? You might start to question your system. Your confidence might slip. What if you were highly leveraged and those 10 balls in a row caused us to draw our account down 50 percent of its value? In trading you never know when you're going to run into a losing streak. Even the best traders in the market experience them. In fact, in many ways how you handle the losses in trading can define how well your system runs.

Every system will experience drawdowns. The goal in account management is to keep the drawdowns to a minimum so that you don't have such a long climb back up. There are many things you can do to reduce the size of potential drawdown in your account. Diversification, position size and stop loss techniques can help reduce drawdowns.

You will need to determine what you're comfortable with. As has been said before remember to always ask yourself: how much am I at risk if this doesn't work? That amount needs to be a comfortable amount. When you trade comfortably you can simply pull out as many ping pong balls as you can because you know you have a winning system that won't be too deeply affected by drawdowns.

**Notes**

## Trading Losses and Emotions

We are programmed to win. We want to win, we like to win, and even if we lose, we find some way to justify why we should have won. Be careful! This “win at all costs” attitude is terrible for trading, because we become emotional when we hit a losing streak. Every trader, from the beginner to the veteran, at some point, gets into a rut where things just don’t work out.

From childhood we’ve been taught to stand up to a bully and never quit in the face of adversity. You will want to embrace these mindsets in regards to entrepreneurship, taking risk, building your trading business and furthering your training. You do not want to bring these mindsets to any one individual trade. There is nothing wrong with selling a trade for a loss. You will have to take each situation on a case-by-case basis but realize that you will lose on some trades. It’s natural. Sometimes, the only way to get onto the next profitable trade is to get rid of that current losing one.

You may have the best trading system in the world, and still hit a losing streak. How are you going to deal with it? On the other hand, how are you going to handle a winning streak?

## How Will You Handle Being on Top?

One day a young dog goes out to play in the backyard of his house. He’s approaching adulthood so he’s strong and quick but still playful like a puppy. He sees a tree house in the back of the yard and, knowing how much fun the kids have when they play in it, he’s determined to climb up. He makes attempt after attempt until finally he figures a way to climb the wooden steps and reach the top. Finally he has reached his goal through hard work and ingenuity. He then looks around and sees that it isn’t as much fun as he thought it would be. As he approaches the door and looks down his entire perspective then changes. What seemed easy to do going up now seems impossible to deal with. Of course, panic then sets in.

**Notes**

What does this have to do with trading? From time to time, new traders get into the market, and through hard work, training and ingenuity soon reach their goals and their dreams seem achievable. Some traders start to get a little too arrogant, and the dreaded over-leveraging occurs. In the example with the dog, you need to know what you're going to do when you reach the top. If your account grows exponentially, how will you react?

The point is this: know what you're going to do in the face failure AND success. In previous sections we've discussed how to handle losses. It is also important to know how you're going to handle the winning. It may seem self-evident; but you will be surprised. Expect to succeed, and be ready for it when it gets there.

## Position Sizing

Position sizing is the process of deciding how many shares to buy. While there are several approaches to position sizing, we will explore three:

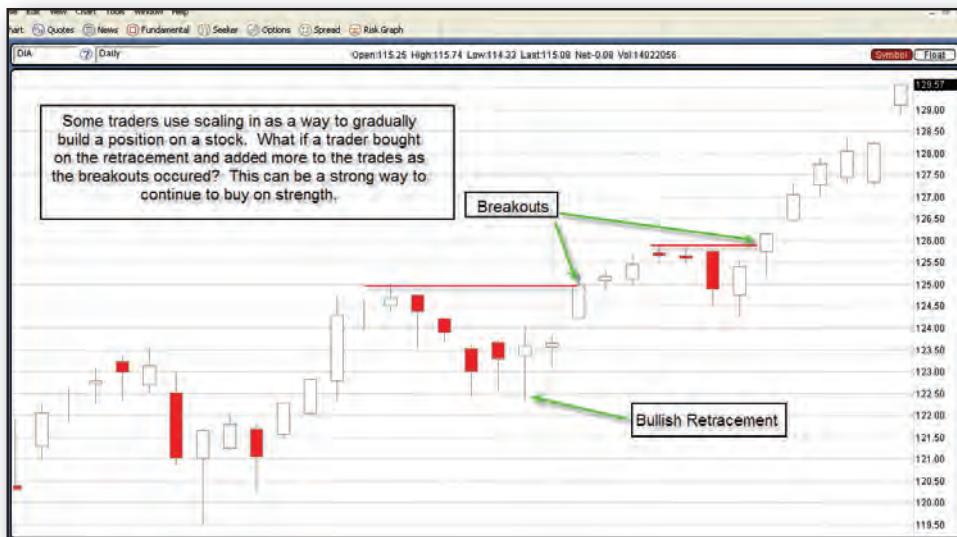
1. Scaling in
2. Fixed percentage
3. Scaling out

### Scaling in

To understand the concept of scaling into a trade, let's consider the dynamics of a trend. As a trend begins to develop, the risk level is at its highest. Traders who get in on the beginning of the trend take the highest risk and are also paid the highest return. As the trend matures, the level of risk decreases, but so does your expected return. One way of dealing with the risk at the beginning of a potential trend is to start with a smaller investment; as the trend matures, you can add to the investment. This way, a small portion of your money is in the investment for the big wins. If the big win doesn't pan out you are not exposed to the high risk.

**Notes**

FIGURE 5.1



In Figure 5.1 you see an example of the stock Diamonds (symbol:DIA). As you can see, scaling in could be a good way to build a position. Using the entry techniques you learned in previous chapters, buying some of your trade on a bullish retracement signal and then adding to it as the stock breaks-out would be a classic example of scaling in.

## Fixed Percentage

Another approach to position size is the fixed percentage approach; it assigns a fixed percentage of your account size to each trade. For example, assume that you are willing to trade 1 percent of your account on each trade. If you have an account size of \$100,000 you will risk \$1,000 per trade. Given the odds we used in an earlier example where you win 80 percent of the time and lose 20 percent of the time, your chances of getting wiped out after the first two trades is impossible since you are risking only two percent of your total account. Although this is an easy way to determine the size of your trade there may be some subtleties to fixed percentage trading that you may not have considered.

## Why Risk is More Important Than Size

Using fixed position sizing is widely accepted as a way to control risk. The thinking goes like this: if I always buy the same amount of size per

**Notes**

trade then I am never at more risk on any given position. Is this correct? Let's examine two examples.

Let's assume that we take a position on the ETF QQQQ. In Figure 7.2 you see a chart on the QQQQ. How fast does it move? On an average week what kind of up and down can you expect?

FIGURE 5.2



Now in Figure 5.2 you will see the ATR indicator has been added so that we can get an idea of how volatile the stock is. This stock has moved roughly 2.00 per week. If we buy 100 shares as a fixed position size, or conversely invest a set dollar amount as a fixed position size we can use ATR as a gauge for potential risk.

Now let's take our second position and compare the two.

In Figure 5.3 you see the stock AK Steel Holdings (symbol: AKS). The ATR for AKS is over 8.0 on a weekly basis! If you bought 100 shares of the QQQQ and 100 shares of AKS you would be assuming nearly four times the risk in the second position.

## Notes

FIGURE 5.3



When determining the number of shares to buy or the amount of money to spend you need to always consider the underlying risks that you are taking in the position. If you were trading derivative products like options contracts or futures contracts, they have different risks than a stock position. There really won't be a hardened rule. You will need to determine this for yourself. That decision will depend on your account size, risk tolerance and the assumed success rates and reward-to-risk ratios of the trades you are entering.

## Scaling Out

Position sizing doesn't just apply to buying a stock; it is also a consideration when you are looking for a way to get out of a trade. You have learned about entry and exit points for your trades, as well as identifying support and resistance zones in an upward trend where a stock is likely to continue its upward rally. These resistance zones can act as opportunities to take profit off the table. You can sell out of a stock entirely at these points if you are happy with your profit. You can also use these as opportunities to stay in a trade, and take a portion of your money back.

In Figure 5.4 you see an example where scaling out could have been applied. If a trader buys the breakouts on IBM he could use scaling out as a way to take some profit off the table as it hits resistance near 120.00. Traders who simply get out of the trade will not be there for the bigger move. Traders who never take profits will be exposed to giving back gains. Think of the scaling out strategy as a happy medium between the two extremes.

FIGURE 5.4

**Notes**

## Stop Losses

One of the most effective methods of controlling risk is to use an order called a 'stop loss'. Stop losses can be used for any type of trade including bullish and bearish positions. If you remember our discussion on order entry from a previous chapter, the word 'stop' really means 'trigger'. A stop loss order is a triggering order to get you out of a position. It's the time that a trader tells his broker to exit the trade. If you remember from our examples on trading systems, you can have the best success rate in the world but if you don't accompany it with an appropriate reward-to-risk ratio then it may not matter.

While stop losses may not work the way that the trader wants them to work all of the time, they are an important part of the risk management process. Several different methods of stop losses are used in the market. It is important for the trader to start with a basic stop loss and then as he/she works the market, the methods can be molded or shaped for different situations. We will discuss several different entry techniques. One of the most important questions you should ask yourself when setting a stop is: where do I no longer want to be in?

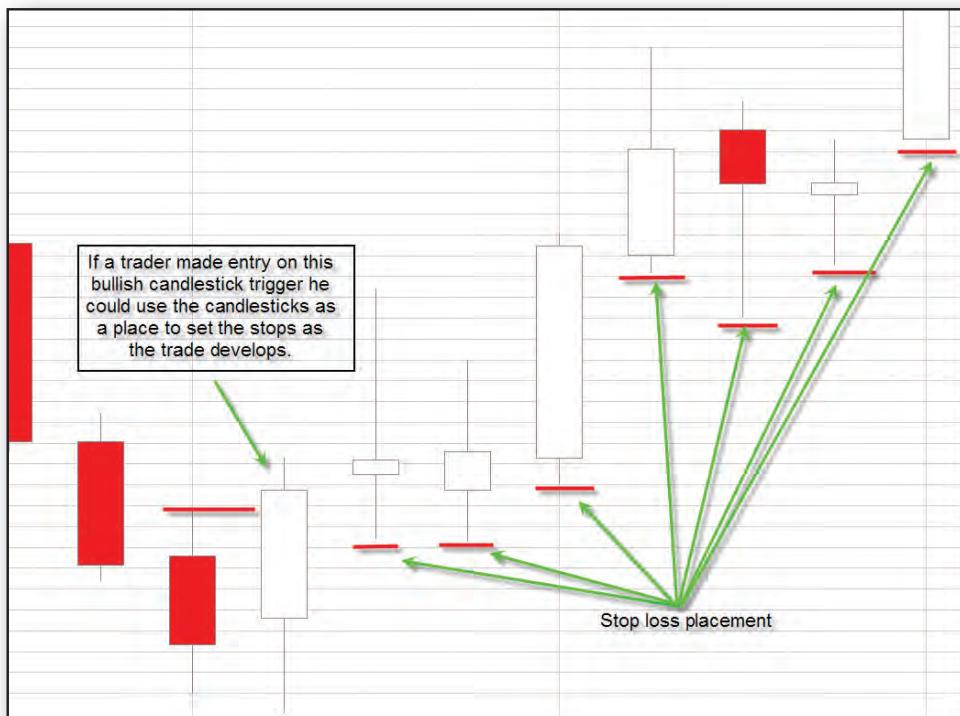
**Notes**

## Percentage Method

The percentage method of setting stops would be used by a trader looking for consistency and ease. Using the percentage method would mean that you place your stop loss a set percentage below either the current price, the entry price, the low of a candlestick or some other set technical criteria. Which of those points you choose is your preference.

Remember, this is just a starting point. You may have to adjust this depending on market conditions. The advantage of the percentage method is that it is easy and consistent. The major disadvantage is that it's not based on any technical strategy. What if you use 4 percent below the price you paid, and that level happened to land right on top of a support zone? Would you really want to set a stop loss right above the support that's supposed to hold the stock up? Probably not. If you decide to use the percentage method you will also want to consider common sense as your entering the numbers. Again ask yourself: is this where I no longer want to be in?

FIGURE 5.5



**Notes**

## Daily Candlestick High and Low

A good method for stop loss placement is to use the current candlestick as a place to enter the order. Candlestick patterns are very important in trading. As candlesticks break above or below the previous bar they start to show signals of strength or weakness in the stock.

In Figure 5.5 you see an example of a bullish trade. As the candlesticks develop, the trader would adjust his stop loss to just below the previous day's candlestick. As you can see this serves the function of locking in profits as the trade moves upward.

One drawback to the candlestick method is that it may get you stopped out prematurely. In Figure 5.5, on the 5th day into the trade, the stock put in a red candlestick that would have stopped the position out. As you can see the next two days the stock moved higher. How do you prevent this? Well using the candlestick method in conjunction with the other methods can help you avoid being whipped out.

## Intraday Chart Method

As was discussed in a previous chapter, many traders will use different time frames of charts while trading. One of the best uses of an intraday chart is in trade management. As stocks develop, the intraday chart will give you the most detail of what's going on with your trade.

## Notes

FIGURE 5.6



In Figure 5.6 you see the stock General Electric (symbol: GE). This chart is set to 60 minutes, which is an intraday time frame. By using an intraday chart a trader can get a more accurate portrayal of where the pricing points are such as support and resistance. When setting a stop you may want to go a little bit beyond the point you initially identify. In this example if you see support at 28.00 you may want to set your stop loss below that at 27.89. Most traders will drop their stop loss slightly below the technical level. The amount below will change from chart to chart. Eleven cents below support might work for GE but probably would be too tight for a trade on Google, which is priced hundreds of dollars higher.

## ATR as a Guide

The ATR indicator can be helpful in setting stops as well. Because ATR gives us an idea of the average day of volatility for a stock we can use the ATR number to let us know where to place a stop loss.

FIGURE 5.7

**Notes**

In Figure 5.7 you see the stock Johnson and Johnson (Symbol JNJ). As you can see using the ATR can be a method to set a stop loss. Some traders take the ATR, subtract it from the current price and place the stop. Other traders take the ATR from the low of the current candlestick and set the stop. Whatever stop loss method you decide on you will want to have it written down, consistently apply it, and only change it after you've practiced a new, more effective method.

Traders constantly debate where to set a stop. It is mostly a preference based on risk tolerance and trade objectives. If you believe in the long-term potential of a move you may want to loosen up your stop. If you are looking to make a quick striking trade that you get in and get out with profits you most likely will want to keep a tight stop loss.

## Using Several Methods Concurrently

Some of the best trading systems will take into account all of the previous methods and set a stop based on the sum of the evidence. By having a set percentage that you're accustomed to and then also analyzing the low of the candlestick, intraday pattern and assessing the

**Notes**

ATR a trader can make a comprehensive judgment on where the stop loss should be placed.

## Summary

Money management is one of the most overlooked factors in the investing process. It is also one of the most important. Most people rely on intuition for their money management, but as we have learned, intuition can have a disastrous effect on your portfolio.

Be certain that you know your entrance points and your exit points, and try to calculate your reward-to-risk ratio before entering the trade. You will be able to better manage your assets. Develop a set approach to your trading system and be consistent in following it.

Money management requires just as much commitment and discipline as choosing your stock. If you are consistent in your approach you will soon be trading like a pro.

## Session 7 Review

1. (T / F) More often than not trading systems thrive without proper money management.
2. One of the most effective methods of controlling risk is to use \_\_\_\_\_.
  - a) MachTrader
  - b) A credible broker
  - c) Stop Losses
3. \_\_\_\_\_ is a strategy of investing in different markets, products and time frames.
  - a) Diversification
  - b) Scaling in
  - c) Stop Losses
4. (T / F) Having a risk reward ratio that meets your trading rules is not that important when considering a trade.

5. The \_\_\_\_\_ method assigns a fixed percentage of your account size to each trade.
- a) Scaling in
  - b) Scaling out
  - c) Fixed percentage
  - d) Percentage
6. (T / F) A good method for stop loss placement is to use the current candlestick as a place to enter the order.
7. (T / F) The ATR indicator can be helpful in setting stops.

**Notes**





# CHAPTER

# 5

# Taking Action





“ Good judgment comes from experience, and experience comes from bad judgment.

- BARRY LE PLATNER

Now that you have completed the bulk of the material it is time to review your progress. Learning the business of trading can be a difficult and time consuming task. You have studied concepts ranging from software use, fundamental analysis, technical analysis, entry points, indicators and portfolio management. Now you're ready to trade like a pro right? Yes. But it will require a commitment level that is rigorous and consistent.

Good trading systems are businesslike and disciplined. Trading is a business that if applied correctly can give you a great reward. If you haphazardly apply your trading system and inconsistently work at it, you probably won't achieve the same results. In this section we are going to discuss some of the proper mindsets you need to bring into this business. We will also teach you how to commit your time to be most efficient.

**Notes**

If you are an experienced investor, this material should help to reinforce some of the things you are probably already doing well, and perhaps introduced some new concepts and techniques you can use to fine-tune your trading methods. If you are new to the stock market, the key for you now — if you haven't started already — is to begin trading! More than anything else, successful trading is about applying a consistent, disciplined system. In the very first chapter, you learned how to establish your investment objectives. Everything else you do — searching, analyzing, and watching for entry and exit signals — should flow from what you ultimately want to accomplish. In the last chapter, you also learned about analyzing risk and the importance of that process.

This final section is designed to further discuss some of the mindsets that you will need to develop to be successful. You should develop your system while keeping in mind the principles you've learned in this program, but remember that nobody can tell you exactly what your system has to be. Your trading system will be specific and unique to you, your preferences, attitudes, and lifestyle.

## Commissions

Trading in the market has costs associated with it. There is money spent in education to learn how to do it, there is money spent to have software that will allow you to find opportunities, and there is money spent with your broker to execute the trade. Commissions are the cost of trading with your broker. Simply put the higher the commission the more costly your trading becomes. Many traders with small accounts burn through their money quickly unaware that most of it is going to the broker itself. You will need to be aware of the commissions you pay. When calculating your rewards versus your risks in a trade it will be important to include commission costs in the calculations.

How much should you be willing to pay? There are many brokers with many commission structures. We don't recommend any one specific broker but make sure that you are aware of the commission structure. You will want to look into several brokerage houses and compare rates. Be a responsible consumer and research it well.

## Software

We spent an entire chapter discussing the importance of software. You will need to master the software you use. Software should be your home base. Using the MachTrader software can help you organize your trading

**Notes**

business by assessing risks in the trades you're in as well as helping you find new trading candidates. If you don't feel confident with your ability to use the software you need to get to work. Software should lift your trading up and not hold it back. One important thing to remember is that if you don't feel like you've mastered something with the software, reach out and ask for help. Some people have an unwillingness to ask for directions. The people who work on the technical support, customer support and trading hotlines use the software regularly. They can help you if you need it.

## Orders

Order entry has been discussed in different sections in this manual. The order is the direct communication you have with your broker. Mastering order entry is critical to be a successful trader. Orders can be confusing for a beginner. The language, execution, button pushing and general fear of entering an order can limit a trader from making trades effectively. Remember that you need to master this area so that you can make proper entry and exit.

Entering a trade requires that you can project forward. Making an entry is a decision to take risk. Entering an order is the willingness to take risk only if certain conditions are met. Many beginners open a search using the Seeker software, run through a bunch of scans and keep hoping that the perfect trade will just appear in front of them. When you enter an order you aren't necessarily making a trade. Order entry is most often made so you can get into a trade when the conditions you require are met. Think about our case studies from previous chapters. Even before breakouts occurred we entered orders so that we could be a part of the trade as it was happening.

How often should you enter orders? Active traders enter orders every single day, maybe every other day. If your goals as a trader are to stay active, learn the business and perfect your trading system, you should enter orders often. Many traders try to enter a new order every time they look at the market. If you see a consolidation pattern, why wouldn't you enter an order to get you in on the breakout if it occurs?

If you recall from the portfolio management section, risk is an essential part of trading. Taking it and managing it are the main jobs of a portfolio manager. The only way you can take risk is if you get into trades. The only way you can get into trades is if you enter orders frequently. Learn to enter orders. It can be said that the two most important things

**Notes**

that a beginner needs to master are order entry and software use. It is important that you feel confident in these two areas.

**MARKET ORDER -**

A market order is an order to buy or sell a stock at the next available price—whatever that price is. A market order gets you in at the first available opportunity the market maker can find for you.

**LIMIT ORDER -**

A limit order allows you to specify the price you want. This can be very useful on either the buy side or the sell side, if it is handled correctly. If you are trying to buy a stock, a Buy Limit order specifies the exact price you are willing to pay, while a Sell Limit order specifies the exact price at which you want to sell. With limit orders, you are saying that you don't want to take the price the market has set for that specified stock.

**STOP ORDER -**

With a Stop order, you specify the price at which you want in or out of the stock; the price acts as a trigger for the buy or sell order. When activated, a Stop order becomes a market order, meaning that you will be bought in or sold out of the stock at the next available price. Think of the Stop order as the trigger order. When the price is met, that's when the order triggers and the broker executes your trade.

**STOP LIMIT ORDERS -**

A Stop-Limit order combines the features of stop order with those of a limit order. A stop-limit order will be executed at a specific price (or better) after a given stop price has been reached. Once the stop price is reached, the stop-limit order becomes a limit order to buy (or sell) at the limit price or better. It can be thought of as having two parts: (1) the stop price, and (2) the limit price. Most brokers consider these elements to be the same thing, but we find it useful to think about it in two parts because there are actually two events that have to take place to have the Stop Limit execute. Buy Stop Limit orders are excellent orders for entry into a trade.

Entering orders will be part of your daily routine. There are orders that need to be entered to get you into trades and there are orders that

**Notes**

will be entered to protect you once you are into a trade. Learn to do it regularly so that it's a point of confidence for your trading system.

## Self-Discipline

While trading the markets there will be times that you're tired. There will be times that you just don't feel like managing your account. There will also be times that you've convinced yourself that this next trade is the biggest and best trade you've ever come across. Discipline is required when you trade. You have to be consistent in your approach and you have to show restraint when it comes to risk management. As human beings, we all get tired and we all want to take some time off occasionally. That's natural, but when those periods occur you may want to just take a break from trading. The wonderful thing about the markets is that they will always be there. You can take a vacation and come back – guess what - the market is still trading.

One of the most important things that you can do on a daily basis is adjusting the stop loss orders you have in your account. Even if you can't go through all of the work of searching, researching and executing new trades you MUST manage the trades you are already in. Stop loss execution is a big part of your trading system. Learn to do it daily. Make sure that the money you have invested in trades is being managed effectively.

Discipline also requires that you show restraint. There will be trades that come along that look like the best thing since apple pie. If you want to put everything you own in the trade – well – it is your money after all. But good trading systems never overtly risk their entire account on any one idea. You never know when that next red ball is going to come out of that ping pong basket. You absolutely must execute your trading rules if you expect consistency in your results.

## Accountability

It's easy to get into the blame game. When the stock moves against you, maybe you can blame the news. When the market moves against you, it's possible to blame broad economic forces. If you run into a losing streak you may want to blame luck. Don't participate in the blame game. YOU are in control of your trading success. If you embrace the techniques taught in your courses, if you apply them consistency and with discipline and if you commit to the training it's required to learn this business, you will succeed.

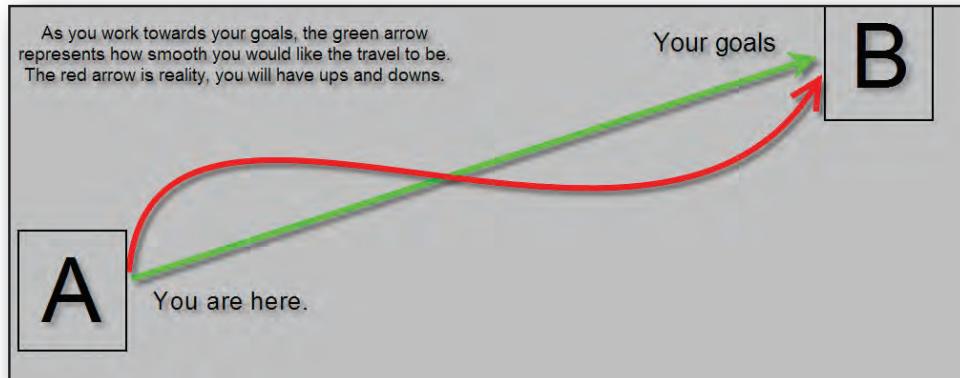
**Notes**

Life is full of people who are willing to blame anything but themselves when they're wrong. If you lose on a trade – take accountability! Treat your trading system like a business. If you have to take a loss then so be it. The worst thing you can do is start to justify why it happened or why you should hold onto it. Losing is a part of winning. Maybe the greatest president of the United States was Abraham Lincoln. It is common knowledge that he failed many times before he eventually reached his goals. You will fall on the way towards the top. Just be ready to get back up and keep moving forward.

## Losers

Some traders have tried everything. They enter a new system as soon as the old one starts a drawdown. There are even some traders that treat this as gambling, searching for the golden egg of trading systems. There is no perfect trading system. You will lose from time to time but that doesn't make you a loser. Embrace your techniques. Master them. The consistency of how you apply your trading system will be your greatest asset. Losing traders are constantly jumping from ship to ship willing to abandon their system at a moment's whim. Winners make small adjustments when needed but stay the course.

FIGURE 6.1



In Figure 6.1 you see two arrows drawn from point A to point B. As we work towards our goals it would be great to just travel directly towards success. The reality is that you will have to make adjustments along the way.

An old wise trader once said, "The market is a beast, you need to treat it with respect." Bring a winner's attitude to your trading business. Yes, you will run into some resistance at times but you must embrace your goals, trading system and work ethic. It is required if you expect to become great.

**Notes**

## Business Risk

One thing that may help you deal with the emotions of winning and losing is to think of trading as a business. When you take a trade you aren't much different from a merchant selling items out of his store. If a trade is a product on your shelf then you simply want to put it on the shelf and sell it for a profit at some point. Risk is a critical component of reward. Without the trade you can never make any money.

If you take a loss simply think of it as an expense. It didn't mean that you weren't a good businessman or that you don't have a good product. It just didn't work. You took an expense. A gain can conversely be thought of as a profit. Expenses and profits – that is the business of trading. When you have probability on your side and you build your confidence you won't worry that much about a losing trade here or there. They are just expenses that come naturally as you run your business.

## Record Keeping

In order to make adjustments from time to time, correct small imperfections in your execution and simply keep score, you must keep a record of your performance. Most traders keep their records using a software program. If your broker has tools that are good for record keeping than by all means use them. But it will be critical that you have a record of what you've done.

The Five T's of trading are a record keeping tool. It's a way to organize each trade that you enter. You can use this as a template for each and every trade that you make. If you don't feel comfortable with your abilities to use a computer to enter them, then you can do it in a notebook. The medium isn't critical, but the execution is.

You should also become accustomed to keeping records of how your overall account performance has done. Most trading systems look for an orderly upward curve in account equity. If your returns are very volatile this can be a sign that your account could become victim to risk.

## Organization

There are thousands of companies that are available for stock trading. It can feel a little overwhelming at times. As a trader it will be important to stay organized so you can take advantage of opportunities as they

**Notes**

present themselves. Earlier in the manual you were taught about the importance of watch lists. How many companies should you keep track of? That will all depend on how organized you are.

There are some techniques that can help you stay organized. Many traders will set up daily and weekly routines to ensure that the needed research is being done regularly.

## Daily Routine

A question many people ask is, “Is there a specific time of the day that I should spend looking at the market and my stocks?” If you have the ability to watch the market during the day, you retain the ability to be nimble and react quickly to significant news events. The truth is, though, being able to watch the market constantly isn’t critical to being a successful investor. It is more important to make sure that you are paying attention to it on a daily basis, when you can make time available to track what is happening. Your investment experience has to work within the scope of your daily life, so while you will likely find yourself making time to accommodate your stock analysis and trades, make sure that the time you do dedicate to it doesn’t detract from the other parts of your life that have to have priority — work, family, and so on. There isn’t a right or wrong way to do this. Determining when is best for you is a question of practice, experience, and preference.

Some people prefer to be up bright and early in the morning before the market opens, searching for stocks, analyzing their current positions, and making decisions about how they are going to approach that day. For others, late in the evening may be better, after the kids have been put to bed, dishes have been done, and the other daily obligations have passed by.

You may find a combination of the two works well. For example, you could use the evening to find potential trade setups, and the morning to identify specific entry points for the orders you will place during the day. Perhaps you do have the ability to watch the market during the day and can manage your trades within the constraints of your normal day. Experiment with the time you have and you will settle into a pattern that works best for you.

In regards to the daily routine, it is much better to be consistent in the time you spend than it is to haphazardly approach it. A trading system and business is best served when you can monitor it everyday. You don’t

**Notes**

necessarily need to do it all day long but you need to be in control of the risk in your trades.

## What Information to Monitor

There is so much information available through the MachTrader software and on the market in general. What information is the most important? And what information could you afford to disregard?

There are three basic things you should do everyday:

1. Research and study in the market to understand what's going on out there. This is generally thought of as top-down analysis.
2. Manage the positions you are in. Adjusting stop losses and trade management.
3. Enter new orders based on trade setups you've identified.

This routine is generalized. You may decide that you need to check additional information beyond what is listed before you put in an order for a given stock. Start with the routine as it is outlined here, and as you become more familiar with the process you will get a feel for what you may need to modify.

## Trading for a Living

Many jump into the markets with the goals of trading for a living. It's said that if you can trade for a living you can do it anywhere in the world. It is appealing for its freedom and challenging environment that it provides. You have no boss, no customers, and no traffic to deal with.

The truth is, freedom begins in your mind and not your bank account. There are plenty of professional traders who are still stuck to the computer screen. It is important that you approach this business with a healthy mindset.

Trading for a living might be the best decision you've ever made. You will need to work towards those goals with dedication. It will not fall in your lap. Make sure that you have a history of success before you ever try to trade for a living.

**Notes**

## Applying a Trading System

Defining a trading system is an individual process. It takes time, practice, and patience to develop a system that works well for you. But in the long run, applying that system consistently, trade after trade, will help you minimize the effect of emotion on your trades, and improve the probability of your success in stock market trading.

From here you will want to take each concept and decide exactly how it will fit into your decision making. Some of the questions you need to answer to define your trading system will include:

### 1. WHAT MARKETS WILL YOU TRADE?

Are you going to trade stock, options, futures or a mix of all of them? It is important to know what tradable instruments you are going to use. If you want to trade options but just don't know how yet, make it a goal to bring that into your trading system over time. Starting with stocks is the most conservative approach.

### 2. WHAT SEARCHING METHODS WILL YOU USE?

You've read about the importance of watch lists. Many traders will decide to make their trades from designated watch lists. Others will want to use Seeker to find their trades. You can use both but you should have a good idea how you approach searching.

### 3. HOW MUCH WEIGHT WILL YOU PUT ON FUNDAMENTAL ANALYSIS?

Some technical traders simply look past fundamentals. Other traders check fundamentals every time they make a trade. Determine how you will use Fundamental Analysis.

### 4. WILL YOU TRADE IN THE DIRECTION OF THE TREND ONLY?

In chapter 4 you read the section on trend analysis. The old adage says that the trend is your friend. You must learn to identify trend and momentum signals that it is either continuing or slowing. What kinds of trends will you be willing to trade?

### 5. ARE YOU GOING TO TRADE IN BOTH BULLISH AND BEARISH SECURITIES?

Some traders have an aversion to selling a stock short or taking a bearish position. Most trading systems are built on the idea of trading up and trading down.

**Notes****6. HAVE YOU DEVELOPED YOUR RULES FOR EACH OF THE TECHNICAL ENTRY SETUPS?**

Entry point can be a very straight forward part of your system. You will need to define the parameters of what you're looking for, how you will trigger into the trade and how you will place the entry order.

**7. HAVE YOU DEVELOPED RULES FOR YOUR OVERALL ACCOUNT MANAGEMENT?**

How much risk will you take per trade? The chapter on portfolio management covered some of the areas to consider when analyzing risk. Make sure you know how your account will be run.

As you develop your trading system you will want to write down the rules for each section. You will want to use this manual as a blue print. Build your system according to your goals and risk tolerance.

## Summary

Congratulations! You have completed the manual. As you read in this section there are many decisions you have to make as you build your trading system. A trading business can be a fun and exciting enterprise.

As you remember from the introduction to the manual, it is important to have a master plan. Now that you have been taught some of the cornerstones of the trading business you will need to move forward with the right mindset to apply them correctly. Build your system. You will want to write it out, just as you would a business plan.

The markets can present immense opportunities. If you apply the techniques taught in your courses and this manual you will be in a position to succeed. Move forward with a businesslike mindset and be ready for success.





# Glossary

**Notes****20-DAY HISTORICAL VOLATILITY**

This is a measure of how volatile the underlying contracts has been for the 20 trading days prior to each observation date in the data series. It is an annualized standard deviation of price changes expressed as a percentage.

**5-DAY HISTORICAL VOLATILITY**

This is a measure of how volatile the underlying contracts has been for the five trading days prior to each observation date in the data series. It is an annualized standard deviation of price changes expressed as a percentage.

**52-WEEK HIGH**

This is the stock's highest closing price during the past 52 weeks.

**52-WEEK LOW**

This is the stock's lowest closing price during the past 52 weeks.

**60-DAY HISTORICAL VOLATILITY**

This is a measure of how volatile the underlying contracts has been for the 60 trading days prior to each observation date in the data series. It is an annualized standard deviation of price changes expressed as a percentage.

**90-DAY HISTORICAL VOLATILITY**

This is a measure of how volatile the underlying contracts has been for the 90 trading days prior to each observation date in the data series. It is an annualized standard deviation of price changes expressed as a percentage.

**ADVANCE DECLINE LINE**

The line that measures the net daily difference between the number of advancing issues and the number of declining issues thus reflecting market breadth. It provides an indication as to the overall strength of the market.

**Notes****AMERICAN DEPOSITORY RECEIPTS (ADR)**

Certificates issued by a U.S. Depository Bank, representing foreign shares held by the bank, usually by a branch or correspondent in the country of issue. One ADR may represent a portion of a foreign share, one share or a bundle of shares of a foreign corporation. If the ADR's are "sponsored," the corporation provides financial information and other assistance to the bank and may subsidize the administration of the ADR's. "Un-sponsored" ADR's do not receive such assistance. ADR's carry the same currency, political and economic risks as the underlying foreign share; the prices of the two, adjusted for the ADR/ordinary ratio, are kept essentially identical by arbitrage. American Depository Shares (ADS) are a similar form of certification.

**ANALYST**

Employee of a brokerage or fund management house who studies companies and makes buy and sell recommendations on their stocks. Most specialize in a specific industry.

**ANNUAL REPORT**

Yearly record of a publicly held company's financial condition. It includes a description of the firm's operations, its balance sheet and income statement. SEC rules require that it be distributed to all shareholders. A more detailed version is called a 10-K.

**ARBITRAGE**

Profiting from differences in the price of a single security that is traded on more than one market.

**ARMS INDEX**

Also known as Trading Index (TRIN):= #advancing issues/#declining issues Total up volume/total down volume and advance/decline market indicator. Less than 1.0 indicates bullish demand, while above 1.0 is bearish. The index often is smoothed with a simple moving average.

**ASK**

The lowest price anyone is willing to sell a specific stock or commodity at a given moment in time. Also called the offer.

**ASK SIZE**

This is the number of shares a seller is selling at a specified ask price. Basically, a seller is willing to sell a certain amount of shares, the price does not matter, only the number of shares the seller is offering.

**Notes****ASSETS, CURRENT**

The individual Current Asset line item. This item is NM for companies that do not distinguish between current and long-term assets.

**ASSETS, CURRENT TOTAL**

The Total Current Assets is the sum of the Cash and Equivalents plus Investments - ST Other plus Investments plus Accounts Receivable plus Inventory plus Prepayments and Advances plus Current Assets-Other. Some companies such as Insurance companies, Banks, and Industrial companies with captive finance subsidiaries do not distinguish current and long-term assets. They report only Total Assets. For these companies the title and the COA code will be blank, the financial statement values will be zero, and the calculated values will be NM.

**ASSETS, LONG-TERM**

The individual Long-Term Asset line items. For companies that do not distinguish between current and long-term assets this will simply be an asset line item.

**ASSETS, TOTAL**

Total Assets is the sum of all short-and-long term asset categories.

**ASSET TURNOVER**

The Asset Turnover is calculated as the Total Revenues divided by the Average Total Assets.

Where:

Average Total Assets = Total Assets for the most recent fiscal period + Total Assets for the preceding fiscal period

**NOTES:**

1. The quarterly calculated value has been annualized to make it more readily comparable to the annual and trailing twelve month values.
2. This ratio is only calculated for companies classified as Industrial and Utility in the Market Guide database.

**AT-THE-MONEY**

An option is At-The-Money if the strike price of the option equals the market price of the underlying security. For example, if a

**Notes**

stock is trading at 75, then the 75 option is at-the-money. You can essentially think of this as the break-even point (when you don't take into commissions and any other account transaction costs).

**AUDITOR CODE**

The code used by Market Guide to identify the Auditor of the company's most recent year-end financial information.

**AUDITOR NAME**

The name of the Auditor of the company's most recent year end financials.

**AUDITOR OPINION CODE**

The Auditor Opinion Code: Qualified, Unqualified, Adverse or Disclaimer Opinion. (This item is not currently in use.)

**AVERAGE DIRECTIONAL MOVEMENT INDEX (ADX)**

The ADX is an indicator which was developed by Welles Wilder. It is a calculation based upon positive directional movement (+dma) and minus directional movement index (-dma). The ADX is used to measure how strong a trend is; regardless of if this trend is up or down. A high ADX measure reflects a strongly trending market and a low ADX reflects a non-trending market. In general, if you find a stock which meets the Core Swing trade Buy or the Core Swing trade Sell set up criteria and has an ADX above 35, you have a set up with great potential for large 3 to 5 day gains.

**AVERAGE TRUE RANGE (ATR)**

This study was developed by Welles Wilder and introduced in his book, New Concepts in Technical Trading Systems (1978). The Average True Range measures the volatility of a security.

**BACK OFFICE**

Brokerage house clerical operations that support, but do not include, the trading of stocks and other securities. Includes all written confirmation and settlement of trades, record keeping and regulatory compliance.

**Notes**

# B

**BALANCE SHEET PRESENTATION CODE**

The Balance Sheet Presentation Code specifies whether the company breaks down assets and liabilities into current and long term sections (= 1), or whether it just reports all line items under total assets and total liabilities (= 0). Insurance, Banks, and Industrial companies with captive finance subsidiaries do not segregate their balance sheets between current and long-term items and would be classified as 0.

**BAR CHART**

A style of chart used for technical analysis. It consists of a vertical line at the top, which indicates the high for the period a security traded at during the given time period, and the bottom represents the low. The close/last is displayed on the right side of the bar, and the open is shown on the left side of the bar.

**BEAR**

An investor who believes a stock or the overall market will decline. A bear market is a prolonged period of falling stock prices, usually by 20 percent or more. Or, anyone who takes a pessimistic view of the forthcoming long-term trend in a market. One who thinks that a market is or will soon be in a long-term downtrend.

**BEAR MARKET**

A long-term downtrend (a downtrend lasting months to years) in any market, especially in the stock market, characterized by lower intermediate lows (those established in a time frame of weeks to months) interrupted by lower immediate highs.

**BETA**

Beta is a measure of a company's common stock price volatility relative to the market. The Market Guide Beta is the slope of the 60-month regression line of the percentage price change of the stock relative to the percentage price change of the S&P 500. Beta values are not calculated if less than 24 months of pricing is available.

**Notes****BETA, UP**

Up Beta is the volatility of the company's common stock price relative to the S&P 500 for the periods in which the S&P 500 goes up. Beta values are not calculated if less than 24 months of pricing is available.

**BETA, DOWN**

Down Beta is the volatility of the company's common stock price relative to the S&P 500 for the periods in which the S&P 500 goes down. Beta values are not calculated if less than 24 months of pricing is available.

**BID**

An indication by an investor, a trader or a dealer of a willingness to buy a security or commodity; the price at which an investor can sell to a broker-dealer.

**BID SIZE**

This is the number of shares a buyer seller is selling at a specified Bid price. Basically, a buyer is willing to buy a certain amount of shares, the price does not matter, only the number of shares the buyer is willing to purchase.

**BLOCK TRADE**

A trade so large that the normal auction market cannot absorb it in a reasonable time at a reasonable price. In general, 10,000 shares of stock or \$200,000 worth of bonds would be considered a block trade.

**BLUE CHIP STOCK**

The equity issues of financially stable, well-established companies that have demonstrated their ability to pay dividends in both good and bad times.

**BOLLINGER BANDS**

Bollinger Bands were invented by John Bollinger and they consist of a set of three curves drawn in relation to securities prices. The middle band is a measure of the intermediate-term trend, usually a simple moving average, which serves as the base for the upper and lower bands. The purpose of Bollinger Bands is to provide a relative definition of a dynamic, ever changing high and low range within that moving average. By definition prices are high at the upper band and low at the lower band.

**Notes****BOOK VALUE IN U.S. DOLLARS**

Book Value in U.S. Dollars, also referred to as Common Equity, is the Total Equity as of the fiscal period end minus Preferred Stock and Redeemable Preferred Stock.

**BOOK VALUE PER SHARE**

The Book Value Per Share is defined as the Book Value in U.S. Dollars divided by the Shares Outstanding as of the end of that period.

**BOOK VALUE PER SHARE, FIVE YEAR GROWTH RATE**

The Book Value Per Share Growth Rate is the annual compounded growth rate of Book Value Per Share over the last five years. Note: If the value for either the most recent year or the oldest year is zero or negative, that year is ignored. If a five-year growth rate cannot be calculated, a four-year growth rate is used instead. If a four-year growth rate cannot be calculated, a 'NA' (Not Available) code will be used.

**BOOK VALUE PER SHARE GROWTH RATE,  
NUMBER OF YEARS**

This is the number of years over which the Book Value Per Share Growth Rate is calculated.

**BOOK VALUE (TANGIBLE) IN U.S. DOLLARS**

The Tangible Book Value in U.S. Dollars is the Book Value in U.S. Dollars minus Goodwill and Intangible Assets.

**BOOK VALUE (TANGIBLE) PER SHARE**

The Tangible Book Value Per Share is the Tangible Book Value in U.S. Dollars divided by the Shares Outstanding at the end of that fiscal period.

**BREADTH**

This is one of those technical terms you might hear mentioned in a trading room. It simply demonstrates how broadly a market is moving. When three-quarters of the stocks on the New York Stock Exchange, for example, rise during a given day, an observer might say the stock market had good breadth. Often, observers will measure the number of stocks advancing against the number declining as one way of monitoring breadth.

**Notes****BREAK EVEN DOWN**

The symbol can break-even below the price.

**BREAK EVEN UP**

The symbol can break-even above the price.

**BREAK EVEN POINT**

1) The point at which gains equal losses. (2) The market price that a stock must reach for an option buyer to avoid a loss if he - exercises. For a call, it is the strike price plus the premium paid. For a put, it is the strike price minus the premium paid.

**BREAKOUT**

A rise in a security's price above a resistance level (commonly its previous high price) or drop below a level of support (commonly the former lowest price.) A breakout is taken to signify a continuing move in the same direction. Can be used by technical analysts as a buy or sell indication.

**BRIEF**

The Brief is a condensed text description contained in up to eight lines of 60 characters each. It describes the company's activities, its year-to-date performance compared to the same period a year ago, and the reasons why the performance is up or down.

**BULL**

An investor who thinks the market will rise.

**BULL MARKET**

A market which is on a consistent upward trend.

**BUYOUT**

Purchase of a controlling interest (or percent of shares) of a company's stock. A leveraged buyout is done with borrowed money.

**Notes**

# C

**CALL OPTION**

An option contract that gives the holder of the option the right (but not the obligation) to purchase, and obligates the writer to sell, a specified number of shares of the underlying stock at the given strike price, on or before the expiration date of the contract. Opposite of a PUT.

**CANDLESTICK CHARTING**

Method of drawing stock (or commodity) charts which originated in Japan. Requires the presence of Open, High, Low and Close price data to be drawn. There are two basic types of candles, the white body and the black body. As with regular bar charts, a vertical line is used to indicate the periods (normally daily) high to low. When prices close higher than they opened a white rectangle is drawn on top of the high-low line. This rectangle originates at the opening price level and extends up towards the closing price. A down day is drawn in black. The combination of several candles results in patterns (with names like “two crows” or “bullish engulfing pattern”) which give insight into future price activity. For other Japanese charting approaches also see Renko and Kagi charts.

**CAPITAL GAIN**

When a stock is sold for a profit, it's the difference between the net sales price of securities and their net cost, or original basis. If a stock is sold below cost, the difference is a capital loss.

**CAPITAL LOSS**

The difference between the net cost of a security and the net sale price, if that security is sold at a loss.

**CAPITAL SPENDING, FIVE-YEAR GROWTH RATE**

The Capital Spending Five-Year Growth Rate is the annual compounded growth rate of Capital Spending over the last five years. Capital Spending is the sum of the Capital Expenditures items from the Statement of Cash Flows. Note: If the value for either the most recent year or the oldest year is zero or negative, that year is ignored. If a five-year growth rate cannot be calculated, a four year growth rate is used instead. If a four-year growth rate cannot be calculated, a ‘NA’ (Not Available) code will be used.

**Notes****CASH ACCOUNT**

An account in which the customer is required by the SEC's Regulation T to pay in full for securities purchased not later than two days after the standard payment period set by the NASD's Uniform Practice Code.

**CASH DIVIDEND**

A dividend paid in cash to a company's shareholders. The amount is normally based on profitability and is taxable as income. A cash distribution may include capital gains and return of capital in addition to the dividend.

**CASH FLOW PER SHARE, TTM (\$ per share)**

This value is the trailing twelve month Cash Flow divided by the trailing 12-month Average Shares Outstanding. Cash Flow is defined as the sum of Income After Taxes minus Preferred Dividends and General Partner Distributions plus Depreciation, Depletion and Amortization.

**CASH FLOW, 5-YEAR GROWTH RATE**

The Cash Flow Five-Year Growth Rate is the annual compounded growth rate of Cash Flow over the last five years. Cash Flow is the sum of Income After Taxes minus Preferred Dividends and General Partner Distributions plus Depreciation, Depletion and Amortization. Note: If the value for either the most recent year or the oldest year is zero or negative, that year is ignored. If a five-year growth rate cannot be calculated, a four-year growth rate is used instead. If a four-year growth rate cannot be calculated, a 'NA' (Not Available) code will be used.

**CASH FROM FINANCING**

The individual financing activities cash flow line items.

**CASH FROM FINANCING, TOTAL**

Total Cash from Financing Activities is the sum of the individual financing activity cash flow line items.

**CASH FROM INVESTING**

The individual investing activities cash flow line items.

**CASH FROM INVESTING, TOTAL**

Total Cash from Investing Activities is the sum of the individual investing activity cash flow line items.

**Notes****CASH FROM OPERATING**

The individual operating activities cash flow line items.

**CASH FROM OPERATING, TOTAL**

Total Cash from Operating Activities is the sum of the individual operating activity cash flow line items.

**CASH, NET CHANGE** Net Change in Cash is the difference between the beginning and ending cash as reported on the balance sheet. Note: It can also be calculated by adding cash from operating, investing, and financing activities and foreign exchange effects from the Statement of Cash Flows.

**CASH PER SHARE**

Cash Per Share is the Total Cash plus Short-Term Investments divided by the Shares Outstanding at the end of the fiscal period.

**CASH, TOTAL (Preliminary)**

The Preliminary Total Cash is the Total Cash figure provided by the company in their earnings announcement. Note: This value is not always provided by the Company in their preliminary earnings announcements.

**CHANGE**

This is the difference between the current price and the close from the previous day. If a stock closed at \$25.00 yesterday and today is trading at \$26.22 then the change would be +\$1.22.

**CHART**

This is where price action of the underlying symbol can be displayed and Technical Analysis added. Symbols can be viewed in Bar, Candle Stick, or Line form inside Tigrant MachTrader.

**CHART OF ACCOUNTS TYPE CODE**

Market Guide's "As Reported line item descriptions" are mapped to one of four "industry specific" chart of accounts. The Industry Type Code indicates the chart of accounts to which this company's line items are mapped.

**CHOPPINESS**

This study measures the direction of the market. If the choppiness is low then the market is in a trend. If the choppiness is high then the market is not trending, more likely in a sideways market.

**Notes****CITY**

This is the city where the company's headquarters are located. The city is verified quarterly from the most recent 10-K or 10-Q.

**CLOSE/LAST**

(1) The price of the last transaction for a particular security on a particular day. (2) The mid-price of a closing trading range.

**COMMISSION**

The fee paid to a broker to execute a trade, based on number of shares, bonds, options and/or their dollar value. In 1975, deregulation led to the creation of discount brokers, who charge lower commissions than full service brokers. Full service brokers offer advice and usually have a full staff of analysts who follow specific industries. Discount brokers simply execute a client's order; they usually do not offer an opinion on a stock.

**COMMON STOCK**

Value of outstanding common shares at par, plus accumulated retained earnings. Also called shareholders' equity.

**COMPANY AVERAGE RATING** (MG's Average Senior Debt Rating)

This is an average senior debt rating from the current ratings of Fitch Investor Service, L.P., Moody's Investors Service, and Standard & Poor's Rating Group.

**COMPANY NAME**

The company name. Generally, this is the name of the company as specified in the company's charter. However, some companies are better recognized and accessed in the Market Guide database by using their popular names or acronyms, such as AT&T.

**COMPANY, NEW**

A flag indicating that the company has been added to the database in the latest week. A value of one (1) indicates that this is a new company addition to the database. A value of zero (0) means that this company has previously been included in the database.

**COMPANY STATUS**

The Company Status indicates whether the company's common stock is still traded. Companies that have been acquired, taken private or are no longer in business, are kept in the database for reference purposes, and are flagged as inactive.

**Notes****CONFIRMATION**

The written statement that follows any “trade” in the securities markets. Confirmation is issued immediately after a trade is executed. It spells out settlement date, terms, commission, etc.

**CONSOLIDATION**

An area of price congestion in which a stock will trade sideways within a narrow price range for some period of time. Often occurs before a continuation of the prior trend. Also known as a shelf or line.

**CONTACT NAME AND TITLE**

The first name (CONTACTFNM), last name (CONTACTLNM) and title (CONTACTTITL) of the person designated by the company as its investor relations or investor contact person. (Some companies, especially the larger ones specify a title only, e.g. Director of Investor Relations. For these companies, the first and last name will be blank.)

**CONTINUOUS IMPLIED VOLATILITY CALL/PUTS**

Volatility measures the fluctuation in the market price of the underlying security. Mathematically, volatility is the annualized standard deviation of returns. Implied volatility measures whether option premiums are relatively expensive or inexpensive. Implied volatility is calculated based on the currently traded option premiums. A mathematical formula, using stock price, strike price, time to maturity, interest rate and historical volatility, is used to arrive at the implied volatility number.

**CONVERGENCE**

The movement of the price of a futures contract toward the price of the underlying cash commodity. At the start, the contract price is higher because of the time value. But as the contract nears expiration, the futures price and the cash price converge.

**COST**

This column shows the how much it would cost for the selected option symbol in the Spread Select window.

**COVERED CALL**

A short call option position in which the writer owns the number of shares of the underlying stock represented by the option contracts. Covered calls generally limit the risk the writer takes because the stock does not have to be bought at the market price, if the holder of that option decides to exercise it.

**Notes****COVERED PUT**

A put option position in which the option writer also is short the corresponding stock or has deposited, in a cash account, cash or cash equivalents equal to the exercise of the option. This limits the option writer's risk because money or stock is already set aside. In the event that the holder of the put option decides to exercise the option, the writer's risk is more limited than it would be on an uncovered or naked put option.

**CROSS HAIR**

This will display the cross hairs for the selected chart. The cross hairs will display the Date and Price on the X and Y axis for the chart.

**CROSSOVER**

When the faster indicator crosses above (bullish crossover) or below (bearish crossover) the slower indicator.

**COST OF GOODS SOLD**

The Costs of Goods Sold, also called the Cost of Revenue, is the cost of all raw materials plus the work in process and the cost of producing the finished goods. Note: This item is not meaningful (NM) for Banks and Insurance companies.

**COUNTRY**

The name of the country where the company has its corporate headquarters.

**COUNTRY CODE**

The code used to identify the country in which the company's corporate headquarters is located.

**CURRENCY**

The currency that the financial statements are reported in.

**CURRENCY CODE**

The code used to identify the currency that the financial statements are reported in.

**CURRENCY EXCHANGE RATE, CURRENT**

The most recent Currency Exchange Rate reported as the number of foreign currency units per U.S. Dollar. The currency rate is as of Thursday of the prior week as reported in The Wall Street Journal on Friday.

**Notes****CURRENCY EXCHANGE RATE, FISCAL YEAR AVERAGE**

The Average Exchange Rate for the most recent fiscal year, in foreign currency units per U.S. Dollar.

**CURRENCY EXCHANGE RATE, FISCAL YEAR END**

Currency Exchange Rate as of the last day of the most recent fiscal year, in foreign currency units per U.S. Dollar.

**CURRENT RATIO**

The Current Ratio is Total Current Assets divided by Total Current Liabilities. This item is not available for Banks, Insurance companies and other companies that do not differentiate between current and long term assets and liabilities.

**CUSIP**

The CUSIP number for the company and issue being tracked by Market Guide. When a company has multiple classes of common stock, the CUSIP indicates which issue is being priced and being tracked for dividend information. All pricing and dividend information is for this issue only.

# D

**DATA, ANNUAL OR QUARTERLY**

This is a one character field which identifies whether the data on the file is from the annual (A) or quarterly (Q) financial statements.

**DATA WINDOW**

The data window displays the Date based off of the location of the Pointer, Open (O), High (H), Low (L), Close (C) for where the pointer is positioned or the current data. As well the Data Window will display any Study values that are added to that Chart.

**DATE, FILING**

The Filing Date is the date that the source documents were filed with the Security Exchange Commission.

**Notes****DATE, FISCAL PERIOD END**

The Fiscal Period Ending Date is the date of the last day of the period. It is the date found on the financial statements as reported by the subject company.

**DATE, FISCAL PERIOD END, MOST RECENT**

The Most Recent Fiscal Period Ending Date is the date of the last day of the most recent period. It is the date found on the financial statements as reported by the Subject Company.

**DATE, "FLASH" OR "CURRENT PERIOD" END**

The Ending Date of the "Current" or Most Recent fiscal period available on this company. This is the latter of the ending date of the most recent quarterly data, or the date of the quarter for which an earnings announcement (press release) has been made.

**DATE, PRICING**

The Pricing Date is the date at which the issue was last priced. NYSE, AMEX & NASDAQ companies are priced every day as of the close or last bid. For those Pink sheet companies whose pricing information can not be obtained on a daily basis, Market Guide updates the price at least once per quarter when the financials are updated. The date is expressed as YYYYMMDD or 19940926.

**DATE, RESTATEMENT - BALANCE SHEET**

If a financial statement is restated, the restated information replaces the information originally reported for that period. The Balance Sheet Restatement Date is the ending date of the fiscal period in which this restated information was released. Because there are various SEC mandated historical reporting requirements for each type of financial statement, we have a separate restatement date for each financial statement.

**DATE, RESTATEMENT - INCOME STATEMENT**

If a financial statement is restated, the restated information replaces the information originally reported for that period. The Income Statement Restatement Date is the ending date of the fiscal period in which this restated information was released. Because there are various SEC mandated historical reporting requirements for each type of financial statement, we have a separate restatement date for each financial statement.

**Notes****DATE, RESTATEMENT - STATEMENT OF CASH FLOWS**

If a financial statement is restated, the restated information replaces the information originally reported for that period. The Statement of Cash Flows Restatement Date is the ending date of the fiscal period in which this restated information was released. Because there are various SEC mandated historical reporting requirements for each type of financial statement, we have a separate restatement date for each financial statement.

**DATE, UPDATE**

The update date is the date the information for the subject company was last updated by a Market Guide analyst. Other information such as prices, volume, dividend rates, insider and institutional holdings, exchange rates, etc. are updated more frequently. The frequency of these updates is not reflected in the Update Date. The format for the update is YYYYMMDD or 19940902.

**DAY ORDER**

An order to buy or sell stock that automatically expires if it can't be executed on the day it is entered.

**DEBT/EQUITY**

This is a measure of a company's financial leverage. It compares assets provided by creditors to assets provided by shareholders. It is calculated by dividing its total liabilities (long-term debt) by stockholders' equity. It indicates what proportion of debt and equity the company is using to finance its assets.

**DEBT, LONG-TERM**

Long-Term Debt is debt due after one year such as Long-Term Notes Payable, Debentures, and Long-Term Debt. Each of these items may represent various types of Long-Term Debt or Capitalized Lease Obligations.

**DEBT (LONG TERM) PER SHARE**

The Long-Term Debt Per Share is the Total Long-Term Debt divided by the Shares Outstanding at the end of the fiscal period.

**DEBT, LONG-TERM (Total)**

The Total Long-Term Debt is the sum of all Long-Term Debt and Capitalized Lease Obligations.

**Notes****DEBT (Long-Term) TO ASSETS RATIO**

The Long-Term Debt to Assets Ratio is the Total Long-Term Debt divided by the Total Assets.

**DEBT (Long-Term) TO TOTAL CAPITAL RATIO**

The Long-Term Debt to Total Capital Ratio is the Total Long-Term Debt divided by Total Capital.

**DEBT (Long-Term) TO TOTAL EQUITY RATIO**

The Long-Term Debt to Total Equity Ratio is the Total Long-Term Debt divided by Total Equity as of the latest fiscal period.

**DEBT, TOTAL**

Total Debt equals Short-Term Debt + the current portion of Long-Term Debt and Capitalized Lease Obligations + Long-Term Debt + Capitalized Lease Obligations.

**DEBT, TOTAL (Preliminary)**

The Preliminary Total Debt is the debt figure provided by the company in their earnings announcement. Note: This value is not always provided by the Company in their preliminary earnings announcements.

**DEBT (Total) TO TOTAL ASSETS RATIO**

The Total Debt to Total Assets Ratio is Total Debt (Long-and Short-Term) including Capitalized Lease Obligations divided by Total Assets.

**DEBT (Total) TO TOTAL CAPITAL RATIO**

The Total Debt to Total Capital Ratio is Total Debt divided by Total Capital.

**DEBT (Total) TO TOTAL EQUITY RATIO**

The Total Debt to Total Equity Ratio is Total Debt divided by Total Equity. Note: This ratio is not meaningful for banks.

**DECREASE SPACING**

Decrease Spacing will decrease the spacing between the displayed bars on the chart. This will also decrease the spacing of the time scale shown at the bottom of the chart.

**Notes****DELTA**

The ratio comparing the change in the price of the underlying asset to the corresponding change in the price of a derivative. Sometimes referred to as the “hedge ratio”. For example, with respect to call options, a delta of 0.7 means that for every \$1 the underlying stock increases, the call option will increase by \$0.70. Put option deltas, on the other hand, will be negative, because as the underlying security increases, the value of the option will decrease. So a put option with a delta of -0.7 will decrease by \$0.70 for every \$1 the underlying increases in price. As an in-the-money call option nears expiration, it will approach a delta of 1.00, and as an in-the-money put option nears expiration, it will approach a delta of -1.00.

**DEPOSITORY TRUST CORPORATION (DTC)**

The Depository Trust Company (DTC) is the world's largest securities depository with more than \$10 trillion worth of securities in custody. In 1995, DTC processed \$41 trillion of securities through its book-entry settlement system. DTC is a national clearing house for the settlement of trade in corporate and municipal securities and performs securities custody-related services for its participating banks and broker-dealers. DTC is owned by members of the financial industry and by their representatives who are its users. DTC is 35.1 percent owned by the New York Stock Exchange on behalf of the Exchange's members. It is operated by a separate management and has an independent board of directors. It is a limited purpose trust company and is a member of the Federal Reserve.

**DEPRECIATION EXPENSE, STATEMENT OF CASH FLOWS**

Depreciation Expense, Statement of Cash Flows is the sum of Depreciation plus Amortization expenses. Since these values are not always specified on the Income Statements, these values are taken from the Statement of Cash Flows.

**DILUTION ADJUSTMENT**

The Dilution Adjustment is the after-tax adjustment to earnings used in calculating diluted earnings per share. It generally reflects the after-tax effect of income earned/expense avoided should all dilutive securities be converted to common stock.

**DIVIDEND**

Distribution of a portion of a company's earnings, cash flow or capital to shareholders, in cash or additional stock.

**Notes****DIVIDEND, ANNUAL**

Distribution of a portion of a company's earnings, cash flow or capital to shareholders, in cash or additional stock on an annual basis.

**DIVIDEND, CASH (from the SCF)**

Cash Dividends Paid is reported in the Statement of Cash Flows. This is the total dividends paid on common and preferred stock.

**DIVIDEND DECLARED, LAST QUARTERLY**

The Last Quarterly Dividend Declared is the amount of the last quarterly dividend, if one has been declared by the company.

**DIVIDEND EX-DATE, LAST QUARTERLY**

The Ex-Dividend Date is the first date on which a person purchasing the stock is no longer eligible to receive the last announced dividend. If a prospective dividend payment has been announced, this may be a future date.

**DIVIDEND GROWTH RATE**

The Dividend Growth Rate is the compound annual growth rate in dividends per share. DIVGR percent is calculated for three years whenever four years of dividends are available. If the value for either the most recent year or the oldest year is zero or negative, that year is ignored. If the required four years are not available for any given company, the result is a NM (Not Meaningful) or a NA (Not Available) depending on the condition. If the Five-Year Dividend Growth Rate (DIVTRENDGR) can not be calculated, a four-year growth rate is used instead.

**DIVIDEND GROWTH RATE, NUMBER OF YEARS**

This is the number of years over which the Dividend Growth Rate (DIVGR percent) is calculated.

**DIVIDEND PAYMENT-DATE, LAST QUARTERLY**

The Last Quarterly Dividend Payment-date is the date on which the dividend payment for the last dividend declared will be made to the shareholders.

**DIVIDENDS PER SHARE**

The Dividends Per Share are the common cash dividends per share for each fiscal period.

**Notes****DIVIDENDS PER SHARE, TTM (\$ per share)**

This is the sum of the Cash Dividends per share paid to common stockholders during the last four fiscal quarters.

**DIVIDEND PERCENT CHANGE, YEAR TO YEAR**

The Year To Year Dividend Percent Change is the percent change in the most recent fiscal year Dividends Per Share as compared to the same period one year ago.

**DIVIDEND RATE, INDICATED ANNUAL**

The Indicated Annual Dividend Rate is the total of the expected dividend payments over the next twelve months. It is generally the most recent cash dividend paid or declared multiplied by the dividend payment frequency, plus any recurring extra dividends.

**DOJI**

A Doji is a candlestick bar as used in Japanese Candlestick Charting in which the open and close prices are the same. It is a reversal pattern that, used along with other indicators, can point towards a change in the direction of the current trend.

**DIVIDEND YIELD**

The dividend yield is a percentage calculated by dividing the indicated annual dividend by the current price. This can be used to screen for stocks with a dividend yield above or below a certain number. It can also be used to screen for companies that do not pay a dividend by searching for stocks with no dividend yield.

**DOUBLE BOTTOM**

Price action that resembles the letter W in which price declines stop twice at, or near, the same lows.

**DOUBLE TOP**

Price action that resembles the letter M in which price rallies stop twice at, or near, the same highs. The most widely quoted and oldest measures of change in stock prices. Each of the four averages is based on the prices of a limited number of stocks in a particular category.

**DOWNGRADE**

A classic negative change in ratings for a stock, and or other rated security.

**Notes****DRAG AND DROP**

The Quote Sheet offers the ability to drag and drop symbols from one line to the next and from the Quote Sheet to a Chart. To drag a symbol from the Quote Sheet to another line within the Quote Sheet, another Quote Sheet or any chart just click with the left mouse button and hold it down while moving your cursor to the desired location for the symbol to be moved. When you are at the desired location release the left mouse button and the drag and drop will be complete.

**DUE DILIGENCE**

The careful investigation by the underwriters that is necessary to ensure that all material information pertinent to an issue has been disclosed to prospective investors.

# E

**EARNINGS**

Net income for the company during the period.

**EARNING COMPARISON**

Earnings Comparison is a technique or approach used by corporations and government entities to better determine if earnings are trending, increasing or decreasing from one period to another in a consistent pattern. This information can be used in many different ways. Earnings comparison information can be used internally, within an industry, or by government entities for policy formation or administrative application.

**EARNINGS PER SHARE (EPS)**

Also referred to as Primary Earnings Per Share. Net income for the past 12 months divided by the number of common shares outstanding, as reported by a company. The company often uses a weighted average of shares outstanding over reporting term.

**EPS CURRENT QUARTER**

The actual Earnings Per Share (EPS) reported from continuing operations for the current fiscal quarter.

**Notes****EPS ESTIMATE NEXT QUARTER**

The consensus Earnings Per Share (EPS) estimate for the next fiscal quarter.

**EPS ESTIMATE NEXT YEAR**

The consensus Earnings Per Share (EPS) estimate for the next fiscal year.

**EPS FISCAL YEAR**

The consensus Earnings Per Share (EPS) estimate for the most recently completed fiscal year.

**EQUITY**

The value of the common stockholders' equity in a company as listed on the balance sheet. (2) In a margin or short account, equity equals what is owned minus what is owed.

**ESTIMATE NET SPREAD VOLATILITY**

This Volatility number estimates the current spread volatility for the specific spread/symbol. It updates with the market and will update the Risk Graph when it is clicked on.

**EXCHANGE**

The marketplace in which shares, options and futures on stocks, bonds, commodities and indices are traded. Principal US stock exchanges are: New York Stock Exchange (NYSE), American Stock Exchange (AMEX) and the National Association of Securities Dealers (NASDAQ).

**EXECUTION**

The process of completing an order to buy or sell securities. Once a trade is executed, it is reported by a Confirmation Report; settlement (payment and transfer of ownership) occurs in the U.S. between one (mutual funds) and five (stocks) days after an order is executed. Settlement times for exchange listed stocks are in the process of being reduced to three days in the U.S.

**EXPONENTIAL MOVING AVERAGE**

Applies a percentage of today's closing price to yesterday's moving average calculation thus giving more importance to the most recent days unlike the simple moving average which considers each day equally.

**Notes****EXPIRATION DATE**

The last day (in the case of American-style) or the only day (in the case of European-style) on which an option may be exercised. For stock options, this date is the Saturday immediately following the 3d Friday of the expiration month; however, brokerage firms may set an earlier deadline for notification of an option holder's intention to exercise. If Friday is a holiday, the last trading day will be the preceding Thursday.

**EXTENDED LINE**

An Extended Line is a straight line that connects two or more price points and then extends indefinitely into the future or past to act as a line of support or resistance.

# F

**FIBONACCI EXTENSION**

Fibonacci Extension is a technical analysis tool designed to identify or predict price movements and market momentum. It can be used as a basis for determining price projections along with support and resistance levels. Fibonacci Extension numbers can be used as targets for taking profits, or for identifying potential price levels where the next big major moves may be able to transition.

**FIBONACCI RATIOS**

They can be applied both to price and time, although it is more common to use them on prices. The most common levels used in retracement analysis are 61.8 percent, 38 percent and 50 percent. When a move starts to reverse the three price levels are calculated (and drawn using horizontal lines) using a movement low to high. These retracement levels are then interpreted as likely levels where counter moves will stop. It is interesting to note that the Fibonacci ratios were also known to Greek and Egyptian mathematicians. The ratio was known as the Golden Mean and was applied in music and architecture. A Fibonacci spiral is a logarithmic spiral that tracks natural growth patterns.

**Notes****FIBONACCI RETRACEMENT**

Fibonacci Retracements is a tool designed to identify support or resistance, buy or sell levels once a pullback occurs within a trend or swing move. Retracements are temporary price reversals that take place within a larger trend. The key here is that these price reversals are temporary, and do not indicate a change in the larger trend. Support and resistance levels provide key stop-loss levels for money management purposes.

**FLOAT**

The number of shares of a security that are outstanding and available to the trading public.

**FLOAT WINDOW**

Using the float option on the Chart, Option Chain, Quote Sheet, Risk Graph, Spread Select, and/or Trade Seeker enables the ability to take a window out of the main program window. It then can be moved and resized anywhere on the screen. When the Page is saved the window(s) that are outside of the main program will be saved in those locations as well.

**FORMAT**

By right clicking on the Chart and selecting format there will be multiple options available to manipulate the chart formatting.

**FUNDAMENTAL ANALYSIS**

A method of evaluating securities by attempting to measure the intrinsic value of a particular stock. Fundamental analysts study the overall economy, industry conditions and the financial condition and management of particular companies.

# G

## **GAMMA**

The rate of change for delta with respect to the underlying asset's price. Mathematically, gamma is the first derivative of delta and is used when trying to gauge the price of an option relative to the amount it is in or out of the money. When the option being measured is deep in or out of the money, gamma is small. When the option is near the money, gamma is largest.

## **GOOD 'TIL CANCELED**

Sometimes simply called "GTC", it means an order to buy or sell stock that is good until you cancel it. Brokerages usually set a limit of 30-60 days, at which the GTC expires if not restated.

## **GROUP**

Groups are an orderly collection of similar businesses.

## **GROWTH RATES**

The Growth rate is expressed as a percentage of the Year over Year change in revenue growth.

## **Notes**

# H

## **HEAD & SHOULDERS**

In technical analysis, a chart formation in which a stock price reaches a peak and declines, rises above its former peak and again declines and rises again but not to the second peak and then again declines. The first and third peaks are shoulders, while the second peak is the formation's head. Technical analysts generally consider a head and shoulders formation to be a very bearish indication.

**Notes****HEDGING**

A strategy designed to reduce investment risk using “call” options, “put” options, “short” selling, or futures contracts. A hedge can help lock in existing profits. Its purpose is to reduce the potential volatility of a portfolio, by reducing the risk of loss.

**HIGH PRICE**

The highest (intraday) price of a stock over the past 52 weeks, adjusted for any stock splits.

**HOME**

Chart Home will snap the chart to the right side of the screen in order to see the last bar. Any formatting that has been applied to the chart will not be lost. The chart will just be moved to the default offset.

# I

**IMPORT SYMBOLS**

To import a text list of symbols to the Quote Sheet right click on the quote sheet and select Import Symbols... then locate your list of symbols to import and open the file.

**IMPLIED VOLATILITY**

Implied volatility measures whether option premiums are relatively expensive or inexpensive. Implied volatility is calculated based on the currently traded option premiums. A mathematical formula, using stock price, strike price, time to maturity, interest rate and historical volatility, is used to arrive at the implied volatility number.

**INCREASE SPACING**

Increase Spacing will increase the spacing between the displayed bars on the chart. This will also increase the spacing of the time scale at the bottom of the chart.

**Notes****INDIVIDUAL RETIREMENT ACCOUNT (IRA)**

A retirement investing tool for employed individuals that allows an annual contribution of 100 percent of earned income up to a maximum of \$5,000 to \$6,000 depending on your age. The maximum amount can constantly change from year to year. Some or all of the contribution may be deductible from current taxes, depending on the individual's adjusted gross income and coverage by employer-sponsored qualified retirement plans.

**INDUSTRY**

An industry is the category describing a company's primary business activity. The largest portion of revenue usually determines this category. To screen for companies in a particular industry, select the industry from the drop down menu.

**INITIAL PUBLIC OFFERING (IPO)**

A company's first sale of stock to the public. Securities offered in an IPO are often, but not always, those of young, small companies seeking outside equity capital and a public market for their stock. Investors purchasing stock in IPO's generally must be prepared to accept very large risks for the possibility of large gains. IPO's by investment companies (closed end funds) usually contain underwriting fees which represent a load to buyers.

**INSIDER INFORMATION**

Relevant information about a company that has not yet been made public. It is illegal for holders of this information to make trades based on it, however received.

**IN-THE-MONEY**

A "call" option is in-the-money if the strike price is less than the market price of the underlying security. A "put" option is in-the-money if the strike price is greater than the market price of the underlying security. For example, a xyz "call" option with a 52 strike price is in-the-money when xyz trades at 52 1/8 or higher. A xyz "put" option with a 52 strike price is in-the-money when xyz is trading at 51 7/8 or lower.

**Notes****INTRINSIC VALUE**

The actual value of a company or an asset based on an underlying perception of its true value including all aspects of the business. This value may or may not be the same as the current market value. Value investors use a variety of analytical techniques in order to estimate the intrinsic value of securities in hopes of finding investments where the true value of the investment exceeds its current market value.

FOR CALL OPTIONS, it is the difference between the underlying stock's price and the strike price.

FOR PUT OPTIONS, it is the difference between the strike price and the underlying stock's price.

IN THE CASE OF BOTH PUTS AND CALLS, if the respective difference value is negative, the intrinsic value is zero. Intrinsic value in options is the in-the-money portion of the option's premium. For example, If a call options strike price is \$40 and the underlying stock's market price is at \$50, then the intrinsic value of the call option is \$10. An option is usually never worth less than what an option holder can receive if the option is exercised.

THE TOTAL VALUE OF AN OPTION is the sum of its intrinsic value and its time value.

# L

**LAGGING INDICATOR**

A measurable economic factor that changes after the economy has started to follow a particular pattern or trend. Lagging indicators are believed to confirm long-term trends. Examples include average duration of unemployment, corporate profits and labor cost per unit of output.

**LAST**

(1) The price of the last transaction for a particular security on a particular day. (2) The mid-price of a closing trading range.

**Notes****LEADING INDICATOR**

A measurable economic factor that changes before the economy starts to follow a particular pattern or trend. Leading indicators are believed to predict changes in the economy. Examples include new orders for durable goods, slowdowns in deliveries by vendors and numbers of building permits issued.

**LIMIT ORDER**

An order to buy a stock at or below a specified price or to sell a stock at or above a specified price. For instance, you could tell a broker “Buy me 100 shares of xyz Corp at \$8 or less” or to “sell 100 shares of xyz at \$10 or better.”

**LINE CHART**

A style of chart that is created by connecting a series of closing prices, from given time frames, together with a line. This is the most basic type of chart used and it is generally created by connecting a series of past prices together with a line.

**LISTED STOCK**

The stock of a company that is traded on a securities exchange. The various stock exchanges have different standards for listing. Some of the guides used by the New York Stock Exchange for an original listing are national interest in the company and a minimum of 1.1 million shares publicly held among not less than 2,000 round-lot stockholders. The publicly held common shares should have a minimum aggregate market value of \$18 million. The company should have net income in the latest year of over \$2.5 million before federal income tax and \$2 million in each of the preceding two years.

**LOG SCALE (LG)**

An alternate type of scale used on a chart that is plotted in such a way that two equivalent percent changes are represented by the same vertical distance on the scale, regardless of what the price of the asset is when the change occurs. The distance between the numbers on the scale decreases as the price of the underlying asset increases. This is the case because a \$1 increase in price becomes less influential as the price heads higher since it now corresponds to less of a percentage change than it did when the price of the asset was at a lower level. Also referred to as a “log scale or LG”.

**Notes****LONG POSITION**

The purchase of a borrowed security, commodity or currency with the expectation that the asset will rise in value. This occurs when an individual purchases and then owns securities. An owner of 1000 shares of stock is said to be "Long the Stock."

**LOW PRICE**

The lowest (intraday) price of a stock over a certain period of time.

# M

**MACD** (Moving Average Convergence/Divergence)

The MACD is used to determine overbought or oversold conditions in the market. Written for stocks and stock indices, MACD can be used for commodities as well. The MACD line is the difference between the long and short exponential moving averages of the chosen item. The signal line is an exponential moving average of the MACD line. Signals are generated by the relationship of the two lines. As with RSI and Stochastics, divergences between the MACD and prices may indicate an upcoming trend reversal.

**MAKE A MARKET**

To stand ready to buy or sell a particular security as a dealer for its own account. A market maker accepts the risk of holding the position in the security.

**MARK-TO-MARKET**

The daily adjustment of margin accounts to reflect profits and losses.

**MARGIN ACCOUNT**

A leverage able account in which stocks can be purchased for a combination of cash and a loan. The loan in the margin account is collateralized by the stock and, if the value of the stock drops sufficiently, the owner will be asked to either put in more cash, or sell a portion of the stock. Margin rules are federally regulated, but margin requirements and interest may vary among broker/dealers.

**Notes****MARKET ORDER**

An order to buy or sell a stock at the going price.

**MARGIN CALL**

The Federal Reserve Board's demand that a customer deposit a specified amount of money or securities when a purchase is made in a margin account; the amount is expressed as a percentage of the market value of the securities at the time of purchase. The deposit must be made within one payment period.

**MAX PROFITS**

This column in the Option Chain shows the maximum profits available for the selected option symbol.

**MAX RISK**

This column in the Option Chain shows the maximum risk associated with the selected option symbol.

**MOMENTUM**

Momentum provides an analysis of changes in prices (as opposed to changes in price levels). Changes in the rate of ascent or descent are plotted. The Momentum line is graphed positive or negative to a straight line representing time. The position of the time-line is determined by price at the beginning of the Momentum period. Traders use this analysis to determine overbought and oversold conditions. When a maximum positive point is reached, the market is said to be overbought and a downward reaction is imminent. When a maximum negative point is reached, the market is said to be oversold and an upward reaction is indicated.

**MONEY FLOW**

This indicator is a measure of the strength or a summation of average money flow into and out of an equity. Is heavier trading occurring on days when price is trending up, down or sideways. Money flow is considered positive on days where there is an increase in average price and negative on days when average price declines. The daily average price is calculated by averaging the high, low and closing prices. Money flow (MF) is computed by multiplying the volume for the day by this average price. On days that average price is higher, the positive rolling summation is increased by the money flow amount (MF) and on days where the average price has declined, the MF is added to the negative

**Notes**

rolling summation. A money flow ratio is calculated over a period of time between the up and down summations and normalized within a range between 0 and 100 where 100 indicates extreme positive money flow and 0 indicates extreme negative money flow. Market tops are many times accompanied by higher volume and can be seen on the charts when money flow goes above 80. Bottoms occur when the indicator drops below 20 on the chart.

**MONEY MARKET FUND**

A mutual fund that invests only in short term securities, such as bankers' acceptances, commercial paper, repurchase agreements and government bills. The net asset value per share is maintained at \$1.00. Such funds are not federally insured, although the portfolio may consist of guaranteed securities and/or the fund may have private insurance protection.

**MONTH**

The day on which an options or futures contract is no longer valid and, therefore, ceases to exist. The expiration date for all listed stock options in the U.S. is the third Friday of the expiration month (except when it falls on a holiday, in which case it is on Thursday).

**MOVING AVERAGES**

The moving average is probably the best known, and most versatile, indicator in the analyst's tool chest. It can be used with the price of your choice (highs, closes or whatever) and can also be applied to other indicators, helping to smooth out volatility. As the name implies, the Moving Average is the average of a given amount of data. For example, a 14-day average of closing prices is calculated by adding the last 14 closes and dividing by 14. The result is noted on a chart. The next day the same calculations are performed with the new result being connected (using a solid or dotted line) to yesterdays. And so forth. Variations of the basic Moving Average are the Weighted and Exponential moving averages.

# N

## **NAKED OPTION**

Sometimes called an uncovered option, a naked option is one whose seller does not maintain an equivalent position in the underlying security. For example, the owner of a call has the option to buy the underlying stock from the writer of the call. However, if the writer does not own that stock the option is naked. When the holder decides to exercise his option, the writer will be forced to buy the stock on the open market, and then resell it at the lower strike price. This will result in a loss for the writer. For obvious reasons, writing naked options is risky and must be done in a margin account.

## **NAME, COMPANY**

The company name. Generally, this is the name of the company as specified in the company's charter. However, some companies are better recognized and accessed in the Market Guide database by using their popular names or acronyms, such as AT&T.

## **NASDAQ**

The National Association of Securities Dealers Automated Quotation is a global intranet providing brokers and dealers with price quotations on traded over-the-counter. Unlike the NYSE auction market where orders meet on a trading floor, NASDAQ orders are paired and executed on a computer network. Level I service provides the best bid and offer (BBO) in a given security without identifying the market maker. Level II service provides the BBO and identifies the market maker. Level III service allows registered market makers to compete and trade by entering their own bids and offers.

## **NASD**

The National Association of Securities Dealers is an industry association of broker/dealers in the over-the-counter securities business. The NASD is self-regulatory body and administers the NASDAQ stock market.

## **Notes**

**Notes****NATIONAL MARKET SYSTEM**

A national market system was mandated by the Securities Act Amendments of 1975, the most important federal securities legislation since the 1930s. At the heart of the national market is the ITS, which began operation in 1978. Nine markets -- the American, Boston, Cincinnati, Chicago, New York, Pacific, and Philadelphia and NASD over-the-counter market -- are linked electronically by ITS computers. This allows traders at any exchange to seek the best available price on all other exchanges that a particular security is eligible to trade on. The national market system also includes a consolidated electronic tape, which combines last-sale prices from all markets into a single stream of information.

**NEAR-THE-MONEY**

An option that is Near-The-Money means that the strike price of the option is close to the market price of the underlying security. For example, if a stock is trading at 75, then the 74 or 76 underlying security is Near-The-Money.

**NOISE**

Price and volume fluctuations that can confuse interpretation of market direction.

**NEW YORK STOCK EXCHANGE (NYSE)**

The NYSE marketplace blends public pricing with assigned dealer responsibilities. Aided by advanced technology, public orders meet and interact on the trading floor with a minimum of dealer interference. The result is competitive price discovery at the point of sale. Liquidity in the NYSE auction market system is provided by individual and institutional investors, member firms trading for their own accounts, and assigned specialists. The NYSE is linked with other markets trading listed securities through the Inter-market Trading System (ITS).

NYSE-assigned dealers, known as specialists, are responsible for maintaining a fair and orderly market in the securities assigned to them. Most trading, however, is conducted by brokers acting on behalf of customers, rather than by dealers trading for their own account. For this reason, the NYSE is often described as an agency auction market. The interaction of natural buyers and sellers determines the price of an NYSE-listed stock.

# O

## **ODD LOT**

An amount of a security that is less than the normal unit of trading for that security. Generally, an odd lot is fewer than 100 shares of stock or five bonds.

## **ODD LOT THEORY**

A technical analysis theory based on the assumption that the small investor is always wrong. Therefore, if odd lot sales are up - that is small investors are selling stock - it is probably a good time to buy.

## **OFFER**

Indicates a willingness to sell a futures contract at a given price.

## **OFFSET**

This will offset the chart by a specific number of bars in the chart Format menu.

## **ON BALANCE VOLUME (OBV)**

Developed by Joe Granville. This study detects momentum. Its calculation relates volume to the change in price. This can help determine when a security is being bought or sold in a large number of buyers or sellers.

## **OPEN**

The Open displays each issue's open price for the day or current time frame selected.

## **OPTION**

Gives the buyer the right, but not the obligation, to buy or sell stock at a set price on or before a given date. Investors, not companies, issue options. Investors who purchase call options bet the stock will be worth more than the price set by the option (the strike price), plus the price they paid for the option itself. Buyers of put options bet the stock's price will go down below the price set by the option.

## **Notes**

**Notes****OPTION CHAIN**

The Option Chain shows the available options for the selected symbol that is loaded. To the right of the symbol you can modify the Expiration Month.

**OSCILLATOR**

A momentum line that fluctuates off a center, usually a zero value line. They are used to measure overbought/oversold levels, show negative and positive divergence, and can be used to measure a price move's velocity.

**OTC MARKET**

The security exchange system in which broker-dealers negotiate directly with one another rather than through an auction on an exchange floor. The trading takes place over computer and telephone networks that link brokers and dealers around the world. Both listed and OTC securities, as well as municipal and U.S. government securities, are traded in the OTC market.

**OUT-OF-THE MONEY**

A call option is out-of-the-money if the strike price is greater than the market price of the underlying security. A put option is out-of-the-money if the strike price is less than the market price of the underlying security.

**OVERBOUGHT / OVERSOLD**

An indicator that attempts to define when prices have moved too far and too fast in either direction and thus are vulnerable to reaction.

# P

**PAGES**

Pages of Charts and other applications that are loaded inside of Tigrant MachTrader can be saved or opened.

**Notes****PARABOLIC SAR**

The Parabolic SAR displays the “Stop And Reverse” spots in a specific market. If the market crosses or touches one of the points it is designed to indicate that the position should be reversed, hence the stop and reverse.

**PE RATIO OR PRICE/EARNING RATIO**

The PE ratio is figured by dividing the price of a stock by the company earnings per share. An example would be a stock selling at \$40, with earnings at \$4 per share for the previous year, has a PE ratio of 10 ( $40/4 = 10$ ).

**PEG RATIO**

The PEG ratio is a common valuation ratio calculated by dividing the F1 P/E ratio by the long-term growth consensus estimate. A low PEG ratio may indicate that a stock is undervalued.

**POSITION**

An interest in the market, either long or short, in the form of open contracts.

**PREFERRED STOCK**

A security that shows ownership in a corporation and gives the holder a claim, prior to the claim of common stockholders, on earnings and also generally on assets in the event of liquidation. Most preferred stock pay a fixed dividend, stated in a dollar amount or as a percentage of par value. This stock does not usually carry voting rights.

**PREMIUM**

The price of an option contract, determined on the exchange, which the buyer of the option pays to the option writer for the rights to the option contract.

**PRICE (STRIKE)**

The stated price per share for which underlying stock may be purchased (in the case of a call) or sold (in the case of a put) by the option holder upon exercise of the option contract.

**Notes****PRICE EARNINGS RATIO**

Shows the “multiple” of earnings at which a stock sells. Determined by dividing current price by current earnings per share (adjusted for stock splits). Earnings per share for the P/E ratio is determined by dividing earnings for past 12 months by the number of common shares outstanding. Higher “multiple” means investors have higher expectations for future growth, and have bid up the stock’s price.

**PRICE TO BOOK VALUE RATIO**

Shows the relationship of stock price to the company’s net worth. A ratio of four means that the stock price is four times (or 400 percent of) the book value. Usually, the higher this ratio, the greater the risk.

**PROGRAM TRADING**

Trades based on signals from computer programs, usually entered directly from the trader’s computer to the market’s computer system and executed automatically.

**PROTECTIVE STOP**

A predetermined exit point used to limit losses in cases where the market goes against your position.

**PUT OPTION**

An option contract that gives the holder the right to sell (or “put”), and places upon the writer the obligation to purchase, a specified number of shares of the underlying stock at the given strike price on or before the expiration date of the contract. Opposite of a CALL.

**QUICK LOAD**

The Quote Sheet/Window is where one can list any and all symbols that they wish to follow inside Tigrent MachTrader.

**Notes****QUICK RATIO**

Cash and equivalents plus receivables divided by current liabilities (i.e., debt) for a given corporation.

**QUOTE SHEET**

The Quote Sheet/Window is where one can list any and all symbols that they wish to follow inside Tigrent MachTrader.

# R

**RSI - RELATIVE STRENGTH INDEX**

This indicator was developed by Welles Wilder Jr. Relative Strength is often used to identify price tops and bottoms by keying on specific levels (usually "30" and "70") on the RSI chart which is scaled from 0-100. The study is also useful to detect the following:

1. MOVEMENT which might not be as readily apparent on the bar chart
2. FAILURE swings above 70 or below 30 which can warn of coming reversals
3. SUPPORT & resistance levels
4. DIVERGENCE between the RSI and price which is often a useful reversal indicator

The Relative Strength Index requires a certain amount of lead-up time in order to operate successfully. The formula for calculating the RSI is:

```
# rsi=100-(100/1-rs)
# rs= average of x day's up closes divided by average of
x day's down closes
```

**RANGE**

A security's low price and high price for a particular trading period, such as the close of a day's trading, the opening of a day's trading, or a day, month or year.

**Notes****RAY LINE**

A trend line is a straight line that connects two or more price points and then extends into the future or past to act as a line of support or resistance.

**RESET**

Reset will reset the chart back to original scaling as well as original thickness of bars and to the original offset. Thus any and all formatting will be removed from the chart.

**RESISTANCE**

An area where sellers are expected to hold the price in. Often we will see a rest or reversal at areas of resistance.

**RETURN ON EQUITY (ROE)**

The Return on Equity is a measure of a company's profitability that shows how much profit a company has generated with the money that shareholders have invested.

**REVENUE COMPARISON**

Revenue Comparison is a technique or approach used by corporations and government entities to better determine if revenue is trending, increasing or decreasing from one period to another in a consistent pattern. This information can be used in many different ways. Revenue comparison information can be used internally, within an industry, or by government entities for policy formation or administrative application.

**RISK GRAPH**

The Risk Graph is a detail oriented screen that shows a graphical view of the profit or loss of an option at different prices.

**ROUND LOT**

The normal unit of trading of a security, which are generally 100 shares of stock or five bonds

# S

## **SEC**

The Securities and Exchange Commission, the primary federal regulatory agency of the securities industry

## **SECURITIES INVESTOR PROTECTION CORPORATION (SIPC)**

A nonprofit membership corporation created by an act of Congress to protect clients of brokerage firms that are forced into bankruptcy. Membership is composed of all brokers and dealers registered under the Securities Exchange Act of 1934, all members of national securities exchanges and most NASD members. SIPC provides customers of these firms up to \$500,000 coverage for cash and securities held by the firms (although coverage of cash is limited to \$100,000).

## **SCALP**

To trade for small gains. Scalping normally involves establishing and liquidating a position quickly, usually within the same day, hour or even just a few minutes.

## **SECTOR**

A market sector is an accumulation of industrial groups with similar macro business characteristics.

## **SELLING SHORT**

If an investor thinks the price of a stock is going down, the investor could borrow the stock from a broker and sell it. Eventually, s/he must buy the stock back on the open market. For instance, you borrow 1000 shares of XYZ on July 1 and sell it for \$8 per share. Then, on August 1, you purchase 1000 shares of XYZ at \$7 per share. You've made \$1000 (less commissions and other fees) by selling short.

## **SETTLEMENT DATE**

The date on which payment is made to settle a trade. For stocks traded on US exchanges, settlement is currently five business days after the trade, but this will be reduced to three days in 1995. For mutual funds, settlement usually occurs in the U.S. the day following the trade. In some regional markets, foreign shares may require months to settle.

## **Notes**

**Notes****SHORT**

1. The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value.
2. In the context of options, it is the sale (also known as “writing”) of an options contract.

**SHORT INTEREST**

This is the total number of shares of a security that investors have sold short -- borrowed, then sold in the hope that the security will fall in value. An investor then buys back the shares and pockets the difference as profit.

**SIDEWAYS TREND**

This trend occurs when prices move up and down within an established range.

**SLIPPAGE**

The difference between estimated transaction costs and actual transaction costs. The difference is usually composed of revisions to price difference or spread and commission costs.

**SIMPLE MOVING AVERAGE**

A simple moving average calculates the average value of price over a period of time. It is determined by totaling closing prices of a stock over a defined period of time and dividing that by the total number of days in the period.

**SIZE/QUANTITY**

The amount of shares or size of trade.

**SMALL ORDER EXECUTION SYSTEM (SOES)**

Allows individual traders to participate in real-time day-trading on the NASDAQ exchange. Eliminates the normal 15-minute delays in price quotes and provides instant display of the Bid and Ask prices of a stock.

**Notes****SORTING COLUMNS**

Columns can be sorted in the Option Chain by clicking on the desired column.

**SPECIALIST**

A stock exchange member who stands ready to quote and trade certain securities either for his own account or for customer accounts. The specialist's role is to maintain a fair and orderly market in the stocks for which he is responsible.

**SPREAD**

- (1) In a quotation, the difference between the Bid and the Ask prices of a security.
- (2) An options position established by purchasing one option and selling another option of the same class but of a different series.

**SPREAD LINKING**

Clicking the Spread option will drop down the color link window for Spreads and link the Risk Graph and Spread Select.

**SPREAD SELECT**

The Spread Select gives you the ability to type a symbol in and then click the Load button or press the Enter key on your keyboard to load the different available spread options.

**STOCHASTIC**

The Stochastic Indicator is based on the observation that as prices increase, closing prices tend to accumulate ever closer to the highs for the period. Conversely, as prices decrease, closing prices tend to accumulate ever closer to the lows for the period. Trading decisions are made with respect to divergence between percent of "D" (one of the two lines generated by the study) and the item's price. For example, when a commodity or stock makes a high, reacts, and subsequently moves to a higher high while corresponding peaks on the percent of "D" line make a high and then a lower high, a bearish divergence is indicated. When a commodity or stock has established a new low, reacts, and moves to a lower low while the corresponding low

**Notes**

points on the percent of "D" line make a low and then a higher low, a bullish divergence is indicated. Traders act upon this divergence when the other line generated by the study (K) crosses on the right-hand side of the peak of the percent of "D" line in the case of a top, or on the right-hand side of the low point of the percent of "D" line in the case of a bottom. Two variations of the Stochastic Indicator are in use: Regular and Slow. When the Regular plot of the Stochastic too choppy, the "Slow" version can often clarify the results by reducing the sensitivity of the calculations. The formula is: Note: five Days is the most commonly used value for percent K percent  $K=100 \{(C-L5)/(H5-L5)\}$  The percent D line is a three day smoothed version of the percent K line percent  $D=100(H3/L3)$  where H3 is the three day sum of (C-L5) and L3 is the three day sum of (H5-L5).

**STOCK SPLIT**

An increase in the number of a corporation's outstanding shares that decreases the par value of its stock. The market value of the total number of shares remains the same. The proportional reductions in orders held on the books for a split stock are calculated by dividing the market price of the stock by the fraction that represents the split.

**STOP ORDER**

An order to sell a stock when the price falls to a specified level.

**STRIKE PRICE**

The stated price per share for which underlying stock may be purchased (in the case of a call) or sold (in the case of a put) by the option holder upon exercise of the option contract.

**SUPPORT**

An area where buyers are expected to hold the price up. Often we will expect a rest or reversal at areas of support.

**SYMBOL**

An arrangement of characters (usually letters) representing a particular security listed on an exchange or otherwise traded publicly. When a company issues securities to the public marketplace, it selects an available ticker symbol for its securities which investors use to place trade orders. Every listed security has a unique ticker symbol, facilitating the vast array of trade orders that flow through the financial markets every day.

**Notes**

A unique series of letters assigned to a security for trading purposes. NYSE and AMEX listed stocks have three characters or less. NASDAQ-listed securities have four or five characters. If a fifth letter appears, it identifies the security as other than a single issue of common stock. They are also known as "ticker symbols". Stock symbols are the most recognized type of ticker symbol. Stocks listed and traded on U.S. exchanges such as the NYSE have symbols with up to three letters. NASDAQ-listed stocks have four-letter symbols.

Ticker symbols for options are structured to represent the underlying stock ticker they are based on and also their expiration date and contract type (either a put or a call option). Mutual fund ticker symbols are usually alphanumeric and end with the letter X to differentiate them from stock symbols.

**SYMBOL LINKING**

Clicking the symbol icon in any window will drop down the color link window and link the current window with any other window that is using the same colored link.

# T

**TECHNICAL ANALYSIS**

A method of evaluating securities by analyzing statistics generated by market activity, such as past prices and volume. Technical analysts do not attempt to measure a security's intrinsic value.

**THICKEN BARS**

By selecting Thick Bars it will thicken the bars of the chart or make them bolder and larger.

**THIN BARS**

By selecting Thin Bars it will thin the bars of the chart or make them thinner and skinnier.

**Notes****TICK**

This refers to a change in the price of a security. An up tick occurs when the last trade in a security takes place at a higher price than the prior trade. A down tick occurs when the last trade in a security takes place at a lower price than the prior trade. An indicator may be fashioned from the difference between the number of NYSE issues showing up ticks on the last trade and the number of NYSE issues showing down ticks on the last trade. This indicator is known as the TICK, and is found on many quote screens. A TICK of +236 means 236 more NYSE issues last traded on up ticks than those trading on down ticks.

**TRADE**

A trade is a transaction involving one party either buying or selling a security. This is usually handled through a brokerage company.

**TRADE SEEKER**

The Trade Seeker gives the ability to quickly scan the market based off of any of the pre-built scans.

**TRADING HALT**

A pause in the trading of a particular security on one or more exchanges, usually in anticipation of a news announcement or to correct an order imbalance. During a trading halt, open orders may be canceled and options may be exercised.

**TRADING RANGE**

The difference between the high and low prices traded during a period of time; with commodities, the high/low price limit established by the exchange for a specific commodity for any one day's trading.

**TREND**

The general direction of the market.

**TRIPLE-WITCHING**

This occurs on the third Friday of March, June, September and December when futures and stock options, based on the S&P 500 index, all expire on the same day.

**Notes****TRIN** (Traders' Index)

Also known as Arms Index:= #advancing issues/#declining issues. Total up volume/total down volume and advance/decline market indicator. Less than 1.0 indicates bullish demand, while above 1.0 is bearish. The index often is smoothed with a simple moving average. NYSE #adv/#dec/advVol/decVol

**TYPE**

This column in the Spread Select shows the different types of spread strategies that are available for the selected symbol.

# U

**UNCOVERED CALL**

A short call option position in which the writer does not own shares of underlying stock represented by his option contracts. Also called a “naked” call, it is much riskier for the writer than a covered call, where the writer owns the underlying stock. If the buyer of a call exercises the option to call, the writer would be forced to buy the stock at market price.

**UNCOVERED PUT**

A short put option position in which the writer does not have a corresponding short stock position or has not deposited, in a cash account, cash or cash equivalents equal to the exercise value of the put. Also called “naked” puts, the writer has pledged to buy the stock at a certain price if the buyer of the options chooses to exercise it. The nature of uncovered options means the writer’s risk is unlimited.

**UNDERLYING SECURITY**

Options: the security object to being purchased or sold upon exercise of an option contract. For example, IBM stock is the underlying security to IBM options.

**Notes****UPTREND**

A series of higher highs and higher lows in the market, indicating the trend.

# V

**VOLATILITY**

This analysis is based on the idea that stocks bottom from “panic” selling, after which a rebound is imminent. One way of measuring this phenomenon is to observe a widening range between high and low prices each day. In general a progressively wider range, observed over a relatively short period of time, can indicate that a bottom is near. Price tops are generally reached at a more leisurely pace and can be characterized by a narrowing of the price range. This measure of the trading range takes place over a specified period in order to determine whether or not an issue is being “dumped” and is approaching a bottom. A pre-requisite to a valid bottom is an increase in the volatility line above the reference line. In a similar manner, an indication of an imminent top would be a decrease in the volatility line below the reference line. As long as volatility is rising, in all probability a stock will not approach a top. It should be noted that this study should be used in conjunction with trend following analyses and momentum oscillators for confirmation and accuracy.

**VOLUME**

The number of shares or contracts traded in a security or an entire market during a given period of time. It is simply the amount of shares that trade hands from buyers to sellers as a measure of activity. If a buyer of a stock purchases 1,000 shares from a seller, then the volume for that period increases by 1,000 shares based on that transaction.

Volume is an important indicator in technical analysis as it is used to measure the worth of a market move. If the markets have made a strong price move either up or down the perceived strength of that move depends on the volume for that period. The higher the volume during that price move, the more significant the move.

# W

## **WARRANT**

A security entitling the holder to buy a proportionate amount of stock at some specified future date at a specified price, usually one higher than current market. This “warrant” is then traded as a security, the price of which reflects the value of the underlying stock. Warrants are usually issued as a “sweetener” bundled with another class of security to enhance the marketability of the latter.

## **WRITER**

The seller of an option contract.

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## Option Spreads

### **BULL CALL DEBIT**

A Bull Call spread is an options strategy where a trader buys a lower strike call and simultaneously sells an equal number of call options with the same expiration month but at a different higher strike.

This can be a good strategy to use if you expect the stock has the ability to rise more than it falls. It is the most popular of the bullish spread strategies.

A Bull Call spread can be called a “vertical” or “debit” spread because it uses the same expiration month but different strike prices and it is also an options spread where the premium of the bought option is greater than the premium of the sold one. In a bull call spread the investor pays a net premium so they have a debit balance.

Why create a Bull Call spread? If the market is moderately bullish and has some volatility, if you use a Bull Call spread you can minimize your cash invested in a position and minimize your risk. You end up still reaping a little higher profit potential because you are essentially hedging your investment. Your potential loss is limited to the premium you paid for the calls, minus the commissions and the premium you collected for the calls you sold. This spread is a strategy commonly used and usually offers good liquidity.

### **BULL CALL SPREAD DISADVANTAGES**

- ☒ Your commission expense is a little higher.
- ☒ It can be a little more complicated than just buying a put or call so you have to know what you are doing.
- ☒ If the stock goes up, your return is not as high as buying just a straight call option.

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- ☒ If the stock continues to soar, your gains are limited.

**BULL CALL SPREAD ADVANTAGES**

- ☒ There is less capital outlay so your risk can be lower if you are wrong.
- ☒ If the stock goes down and you are confident in your prediction, you can close the higher strike sell call position and then sell it again when the stock goes back up.

**VISA BULL CALL SPREAD EXAMPLES**

Visa, Inc. (V) was an initial public offering (IPO) in March, 2008. After a month of trading the stock began a bullish trend. The stock began its first pullbacks in early May. If expectations are for this stock to remain moderately bullish in the near-term, a June Bull Call spread is worth checking out. We explore Buying an at-the-money or out-of-the money June call and Selling a call further away from the money than the June call purchased. We have around 30 days before expiration, and we believe it is reasonable to expect a push back into the \$85 range or higher in that time frame. Using the Spread Select feature within Tigrent MachTrader we identify two attractive Bull Call spreads. The first Bull Call spread we Buy the June 75 strike and Sell the June 80 strike. Under this Bull Call spread strategy the maximum we risk is \$210 and the maximum profit we would be able to receive is \$290.

The second Bull Call spread we buy the June 80 and sell the June 85 strike. We could lose about \$160 yet make more if Visa pushes above \$85 in the next 30 days, as it has larger maximum profit potential around \$340.

**BULL PUT CREDIT**

A Bull Put spread is an options strategy where a trader buys a lower strike price put and simultaneously sells another put with a higher strike for the same expiration month. Both the buy and the sell sides of this spread are opening transactions, and are always the same number of contracts.

**Notes****BULL PUT SPREAD**

A Bull Put spread is used when a market can be volatile, where the investor anticipates the market still has bullishness to it, or where the expectations are a market should rise more than fall. The spread is like writing a put with protection in place against a collapse in that market.

The Bull Put spread is a strategy similar to the Bull Call spread but the Bull Put spread there is a premium or credit that goes into your account when you establish the position. The bull call spread can be considered a doubly hedged strategy. The price paid for the call with the lower strike price is partially offset by the premium received from writing the call with a higher strike price. The investor's investment in the long call, and the risk of losing the entire premium paid for it, is reduced or hedged. The goal is to keep the premium. The basic idea is you want the asset to remain bullish and the sell puts to expire worthless. Because the Bull Put Spread is a "credit spread" you make money if the underlying asset stays stagnant through the decay part and the expiration of the more expensive short put options. A Bull Put spread is similar to a Naked Put with the exception that you minimize your margin requirement and you limit your downside risk by purchasing a lower put strike price. Many traders like the idea of starting a trade with a profit. In a Naked Put or a Bull Put spread this happens when you get a credit to your account. With a Naked Put the trade can start to move against you and you cannot limit your downside risk. With a Bull Put spread you can essentially limit that portion of risk.

When compared to most options spreads the Bull Put spread is a lower risk but also lower reward potential strategy. While it ends up limiting a loss it also limits gains. The Bull Put spread strategy is a cheaper way of gaining exposure to a rise in the stock price than an outright buy of a call option and is safer than a naked written put.

**THE RISK POTENTIAL FOR THE BULL PUT SPREAD IS CALCULATED AS FOLLOWS:**

MAXIMUM RISK = Difference between long and short put strike prices – initial credit.

THE LOSS POTENTIAL = short put strike price – long put strike price – initial credit.

**THE REWARD POTENTIAL FOR THE BULL PUT SPREAD IS**

**Notes****CALCULATED AS      FOLLOWS:**

MAXIMUM PROFIT = initial credit.

PROFIT = short put premium – long put premium

NET CREDIT = money received from selling in-the-money puts -  
money paid for buying out-of-the-money puts

There are different strategies to use when looking for Bull Put spreads. One would look to initiate the spread on dips or pullbacks in a strong bull market or to look for the lower end of the trading ranges before initiating the spread. A second idea is to initiate this spread by looking for a good strike to sell is the “at-the-money” put or the just “outside-the-money” put to give you the greatest time value. If the stock makes a strong move up, it is reasonable to roll the spread up (to buy back the short put at a lower price and to sell another one at a higher price). If the underlying stock drops, you can also undertake a protective action where you buy back the short put at a loss and sell another one at a lower strike. It is better to sell the at-the-money put which contains more time value. Remember that the price of the protective put you bought goes up. Rolling your spread down you can reduce your losses even more.

**ADVANTAGES OF BULL PUT SPREAD:**

- 1) The loss is limited if the stock falls instead of rising.
- 2) If the stock fails to rise beyond the strike price of the out-of-the-money short put option, the profit yield will be greater than just buying call options.
- 3) You will be able to profit even if the stock remains stagnant.

**DISADVANTAGES OF BULL PUT SPREAD:**

- 1) Often there will be more commission involved.
- 2) Your profits are limited.
- 3) Credit spreads usually require margin requirements to put on

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the position.

- 4) If the short put remains in-the-money, there is a possibility of it being assigned.

You may then have to purchase the stock to meet the short put obligation.

## Bear Call Credit

### **BEAR PUT SPREAD INTRODUCTION**

If you simultaneously buy and sell options with different strike prices you are establishing a spread position. If a market is relatively volatile and you feel it maintains a general negative tone, sometimes a Bear Call Spread can become an attractive options spread strategy. This bearish strategy is similar to selling naked calls, in that it puts premium into your account when you establish the position. It becomes profitable when the stock price moves below the break-even point, which is the lower strike price plus the net credit balance.

This strategy works best when the range traded is somewhat limited. The purpose of the spread is to provide limited downside risk but we also limit our profit potential in doing so. You use this strategy when you are moderately confident of a drop in the underlying asset and you want some kind of protection and profit should the underlying asset remain stagnant in its trading movements. Hopefully your stock is a bit more likely to fall than rise during the option time range. The Bear Call Spread strategy is a good position to be in if you find yourself wanting to be in a stock but are unsure of bearish expectations.

This strategy is considered moderately bearish because the investor is using the sale of a call to reduce his or her risk while still positioning for a decent profit should the stock price move below the lower strike price.

One reason why a trader uses calls instead of puts is to take advantage of options that are viewed as overpriced. Since the trader is selling the spread, the receipt of higher premiums is a benefit. There can also be greater liquidity in calls than puts which gives greater flexibility when entering and exiting the spread.

The maximum loss potential is realized if the stock moves above the

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out-of-the-money or higher call option strike price.

**DEFINITION: CREDIT SPREAD POSITION**

A Credit Spread is an options strategy where a high premium option is sold and a low premium option is bought on the same underlying security. A Bear Call spread is a credit spread created by purchasing a higher strike call and selling a lower strike call with the same expiration dates. Some call these “vertical credit spreads” because they use the same expiration cycle. Vertical credit spreads can be either Bear Call spreads or Bull Put spreads.

A Bear Call Spread is the purchase of an out-of-the-money (higher) call option while simultaneously selling the in-the-money (lower) call option on the same underlying stock. You can make money if the underlying asset stays stagnant through the decay and expiration of the more expensive short call options.

Because the sale of the in-the-money (lower) strike price brings in cash flow greater than the cost of the out-of-the-money (higher) buy call option position, it is considered a “Credit Spread.” To emphasize this point, if a spread position takes in more through the sale of one call option position than it costs to purchase the other call option position, it is a credit spread. If the opposite were true (the call purchase position costs more than the sale of the other call position), it is a “Debit Spread.” A Debit Spread occurs with Bull Call Spreads and Bear Put Spreads. A Bear Call Spread position is always considered a Credit Spread because the sale of the in-the-money (lower) call options takes in more than it costs to purchase the out-of-the-money (higher) call options.

**INVESTOR SENTIMENT:**

The Bear Call strategy is considered a moderately bearish strategy because you profit if the underlying stock price decreases. The more bearish a trader, the more inclined to look for lower strikes to select. This gives one more credit and requires more substantial stock price downward movement to realize the profit potential.

**PROFIT POTENTIAL:**

There are two ways a Bear Call Spread can become profitable. If the stock goes down, the short call option goes down in price and will eventually expire out-of-the-money when the underlying asset drops beyond the strike price of the short call option. While the underlying asset stays stagnant, the premium on the more expensive short call

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option will continue to decay until it has no value thereby allowing one to pocket the price of the short option.

Because it is a credit spread the maximum profit potential of a Bear Call Spread is the net credit gained when the position is put on. This occurs when the short call option expires out-of-the-money.

**RISKS:**

If the stock price increases above the out-of-the-money call option strike price at the expiration date, then the investor will experience maximum loss. (the difference between the two strike prices minus the net credit received when the spread was established)

**ADVANTAGES:**

- ❑ Loss is limited if the underlying financial instrument rises instead of falls.
- ❑ The profit potential will be greater than just buying put options if the underlying instrument fails to drop beyond the strike price of the out-of-the-money short call option.
- ❑ Able to profit even when the underlying asset remains completely stagnant.
- ❑ Lower risk than simply writing naked call options as maximum downside is limited by the long ATM/OTM call option.

**DISADVANTAGES:**

- ❑ No additional profits will be possible if the underlying asset drops beyond the strike price of the short call option.
- ❑ As long as the short call options remain in-the-money, there is a possibility of it being assigned. You may then have to purchase the underlying stock to meet the short call obligation.
- ❑ Margin requirements required to put on the position because it is a credit spread.
- ❑ Possibly more commission expenses.

**PROFIT / LOSS SUMMARY:**

NET CREDIT = money received from selling in-the-money call options  
- money paid for buying out-of-the-money call options

MAXIMUM PROFIT POTENTIAL = net credit received (limited)

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MAXIMUM LOSS POTENTIAL = difference between strike prices - net credit received (limited)

## Bear Put Debit

### **BEAR PUT SPREAD INTRODUCTION**

The Bear Put Spread strategy requires the investor to buy In-The-Money (higher) strike price put options while simultaneously selling Out-of-The-Money (lower) strike price put options on the same underlying stock. A Bear Put Spread strategy is profitable when the stock price moves below the break-even point: upper strike price minus net debit. A characteristic of the vertical Bear Put Spread is the put options are sold and bought on the same underlying stock with the same expiration date (the reason why it is referred to as a vertical spread). The benefit of the Bear Put Spread strategy is that risk never exceeds the net investment of buying and selling put options simultaneously. This strategy is considered moderately bearish because the investor is using the sale of a put to reduce his or her risk while still positioning for a decent profit should the stock price move below the lower put option strike price. The maximum loss potential is reached if the stock moves above the in-the-money (higher) put option strike price.

### **BEAR PUT SPREAD INTRODUCTION**

The Bear Put Spread is one of the most popular bearish strategy. The strategy profits when the underlying stock falls. It is a technique used to buy puts at a discount. It is a good position to be in if you want to be in the stock but are unsure of the general bearish expectations.

**STRATEGY SUMMARY:** Buy put option with a higher strike and sell another put option with a lower strike, producing a net debit. It is more effective when the market outlook is moderately bearish, or when the volatility outlook is steady to increasing.

**MORE DETAILED EXPLANATION:** The Bear Put Spread strategy requires the investor to buy In-The-Money (higher) strike price put options while simultaneously selling Out-of-The-Money (lower) strike price put options on the same underlying stock. A Bear Put Spread strategy is profitable when the stock price moves below the break-even point: upper strike price minus net debit. A characteristic of the vertical Bear Put Spread is the put options are sold and bought on the same underlying stock with the same expiration date (the reason

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why it is referred to as a vertical spread). The benefit of the Bear Put Spread strategy is that risk never exceeds the net investment of buying and selling put options simultaneously. This strategy is considered moderately bearish because the investor is using the sale of a put to reduce his or her risk while still positioning for a decent profit should the stock price move below the lower put option strike price. The maximum loss potential is reached if the stock moves above the in-the-money (higher) put option strike price.

**DEFINITION - DEBIT SPREAD POSITION**

As previously mentioned, a Bear Put Spread is the purchase of an in-the-money (higher) put option while simultaneously selling an out-of-the-money (lower) put option on the same underlying stock. That is, there is one strike price above the stock price and one below. Because the sale of the out-of-the-money (lower) strike price brings in less cash flow than the cost of purchasing an in-the-money (higher) strike price put option, it is considered a "Debit Spread." To emphasize this point, if a spread position takes in more through the sale of one put option position than it costs to purchase the other put option position, it is a "Credit Spread." If the opposite were true (the put buy position costs more than the sale of the other put position), it is a "Debit Spread." A Debit Spread position occurs with Bull Call Spreads and Bear Put Spreads. A Bear Put Spread position is always considered a debit spread because the purchase of the in-the-money (higher) put strike price costs more than is received for selling the out-of-the-money (lower) put option.

**INVESTOR SENTIMENT:**

**MODERATE BEARISH STRATEGY (SMALL DEBIT SPREAD):**  
Is considered a bearish strategy because you profit if the underlying stock price decreases. Bear Put spreads are typically used when a trader anticipates at least a moderate drop in the underlying asset.

**PROFIT POTENTIAL:**

This strategy requires the investor to buy an in-the-money put option and sell an out-of-the-money put option on the same stock with the same expiration date. This is also known as a vertical bear put spread. If the stock price closes below the out-of-the-money (lower) put option strike price on the expiration date, the investor reaches maximum profits.

**RISKS:**

If the stock price increases above the in-the-money (higher) put

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option strike price at the expiration date, the investor has a maximum loss potential of the net debit.

**ADVANTAGES:**

- ☒ Easy to implement.
- ☒ There can be little margin deposit or margin calls required.
- ☒ Requires less capital than out-right purchases of a put option.
- ☒ You know the most you can gain or lose from the spread.

**DRAWBACKS:**

- ☒ The spread strategy only provides limited gain.
- ☒ Bear Put Spread offers only limited downside price protection. It protects only prices down to the strike price of the put option sold.
- ☒ Check broker, you probably will be charged two commissions.
- ☒ The put option sold can be exercised by the buyer of the option at anytime.

Bear Put Spread strategy can provide a lower risk than strictly buying a put option, but it also limits the profit potential. Bear Put Spreads can be used as a hedge against a falling market. However, if the market falls below the strike price of the sold put option, the cash price plus the gain from the spread will decrease. The maximum profit potential only happens if the stock decreases below the out-of-the-money (lower) put option strike price. Similar to a Bull Call Spread, this strategy is a debit spread position. That is, the amount of the sale of the put option position brings in less than is needed to purchase the put option position.

**OTHER CONSIDERATIONS:**

If the stock falls sharply unexpectedly, some will exit the strategy once the lower strike price is reached. They do this because the time decay benefits the spread near the lower strike price; however, a trader becomes concerned with avoiding exercise on the short leg of the spread. Traders may unwind the spread if the stock price rises suddenly to avoid the taken put losing too much of the time value. One more thing: Traders do not leg into this strategy but rather trade

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both options at the same time.

**PROFIT / LOSS SUMMARY:**

NET DEBIT = Money received from selling out-of-the-money (OTM) put options - Money paid for buying in-the-money (ITM) put options

MAXIMUM PROFIT POTENTIAL = Difference Between Strike Prices - Net Debit

MAXIMUM LOSS POTENTIAL = Net Debit

**CALENDAR CALL**

Calendar Calls are a bullish strategy. This strategy is the reverse of the Calendar Put Spread. A conservative investor will look to trade Calendar LEAP spreads by purchasing an in-the-money (ITM) one-year or two-year LEAP and then selling At-The-Money (ATM) or Out-of-The-Money (OTM) near term calls against the LEAP (diagonal spread). Basically, this strategy is a leveraged covered call position because the investor will pay less for the LEAP than they would to own the stock. A profit is realized if the stock is trading above the break-even point at expiration. Since the ITM LEAP will always cost more than the premium on the short call, the position is entered at a debit. An investor can also trade horizontal spreads where the strikes of the two options are the same but have different expiration dates.

**CALENDAR PUT**

The Calendar Put Spread (including LEAPS) is a bearish strategy. This strategy is the reverse of the Calendar Call Spread. In this strategy an investor will use to buy a (long) an in-the-money put that is typically six months to two years before expiration and sell a (short) near-term put at a lower strike price. Because the long-term purchased put is in-the-money and has more time value, this strategy is always a debit transaction. A profit will be realized if the underlying stock moves below the break-even point. Some investors will trade the same strike Calendar Put Spreads (horizontal) which is a less conservative strategy than diagonal spreads.

**LONG BUTTERFLY CALL**

A Long Butterfly is a short straddle with a conservative twist. By purchasing two out-of-the-money options (one Put and one Call) the investor's maximum risk exposure becomes definable.

As was the case with the short straddle, the investor should select this position only if XYZ is expected to trade within plus-or-minus five

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percent of \$60 over the next 90 days. By buying the two options, the straddle's risk has been capped, but the range of profitability has been reduced. Unlike the short straddle, this strategy has limited risk. It can be viewed as being short one 60-65 Call Vertical and short one 55-60 Put Vertical. Its maximum potential profit point is at the strike price (\$60) at expiration, and it is equal to the spread's initial credit. Most of profit develops in the last month because of rapid time decay. Maximum loss in either direction is equal to strike price differential of one vertical spread (5) minus initial credit.

**BREAK-EVEN POINT:** Upside: Strike price of straddle + net premium received.

**DOWNSIDE:** Strike price of straddle - net premium received.

**TIME DECAY:** Positive. If XYZ is near the strike price (60), profits from decay accelerate most rapidly in last few weeks before expiration.

**Volatility:** Because an increase in volatility has a larger impact on the two options making up the straddle than the two OTM options, an increase in volatility is a negative for the spread. The impact will depend to a large part on both the amount of time left until expiration and the price of XYZ relative to the strike price. Because an increase in volatility can have a negative impact, it is important that the implied volatilities of XYZ's option be near historic highs before an investor consider this spread.

**ASSIGNMENT RISK:** This spread contains two written options. The investor must watch XYZ for possible assignment if XYZ is either significantly above or below the strike price as expiration approaches. By monitoring the time premium of the in-the-money option, the investor can determine the likelihood of assignment.

### **CREDIT CALL**

A Credit Call is an options strategy where a high premium option is sold and a low premium option is bought on the same underlying security.

**Long Straddle-**

A strategy of trading options whereby the trader will purchase a long call and a long put with the same underlying asset, expiration date and strike price. The strike price will usually be at-the-money or near the current market price of the underlying security. The strategy is a bet on increased volatility in the future as profits from this strategy are maximized if the underlying security moves up or down from present levels. Should the underlying security's price move a small amount, (or not at all), the options will be worthless at expiration.

**Notes****Long Strangle-**

The Long Strangle position is similar to the Long Straddle strategy, except you purchase the call option(s) and the put option(s) at different strike prices. When entering a Long Strangle an investor will purchase a certain number of out-of-the-money (OTM) call contract(s) and then purchase the same number of out-of-the-money (OTM) put contract(s) for the same target month. Like the Long Straddle position, the Long Strangle has unlimited profit potential if the stock price moves enough in either direction.

**TIME DIAGONAL**

1. **A DIAGONAL TIME SPREAD USING CALL OPTIONS:** A trader sells an at the money or out-of-the money call that expires in no less than 21 days and purchases a call with a different strike price in a deferred month. If the purchased call has a lower strike, it's closer to the money (or in-the-money) and the spread has a bullish bias. If the purchased call has a higher strike price, it's further out-of-the-money and the spread has a bearish bias.
2. **A DIAGONAL TIME SPREAD USING PUT OPTIONS:** A trader sells an at-the-money or out-of-the-money put that expires in no less than 21 days and purchases a put with a different strike price in a deferred month. If the purchased put has a higher strike, it's closer to the money (or in-the-money) and the spread has a bearish bias. If the purchased put has a lower strike price, it's further out-of-the-money and the spread has a bullish bias.
3. **TRADER THEN WAITS.** The Diagonal Time Spread can earn a profit over a wide range of prices provided the underlying futures contract doesn't move contrary to the delta bias and provided implied volatility doesn't collapse. The potential profit comes from positive time decay.
4. **POTENTIAL LOSSES** are limited because the long option partially hedges the short option. Potential profits are also limited and come at expiration date of the short option if the underlying futures are near the strike price of the short option.
5. **THE DIAGONAL TIME SPREAD** can be adjusted to accommodate a swiftly trending market. The trader can "roll" the short option or

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the long option (or both) in the direction the underlying futures contract moves.

**COLLAR**

The Collar Spread is similar to the Covered Call trade, except an investor will purchase an Out-of-The-Money (OTM) put to protect against a sudden decline on the stock. Like the Covered Call, the Collar Spread is a neutral to bullish strategy. In a Collar Spread, an investor will buy shares of stock and then sell an At-The-Money (ATM) or OTM call against those shares. The investor will purchase an OTM put. The primary risk in a Covered Call strategy is that the underlying stock may decline faster than premium collection. By purchasing an OTM put option, we can protect the position from a large drastic decline in the stock price. The Covered Call sale helps finance the purchase of the put option.





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