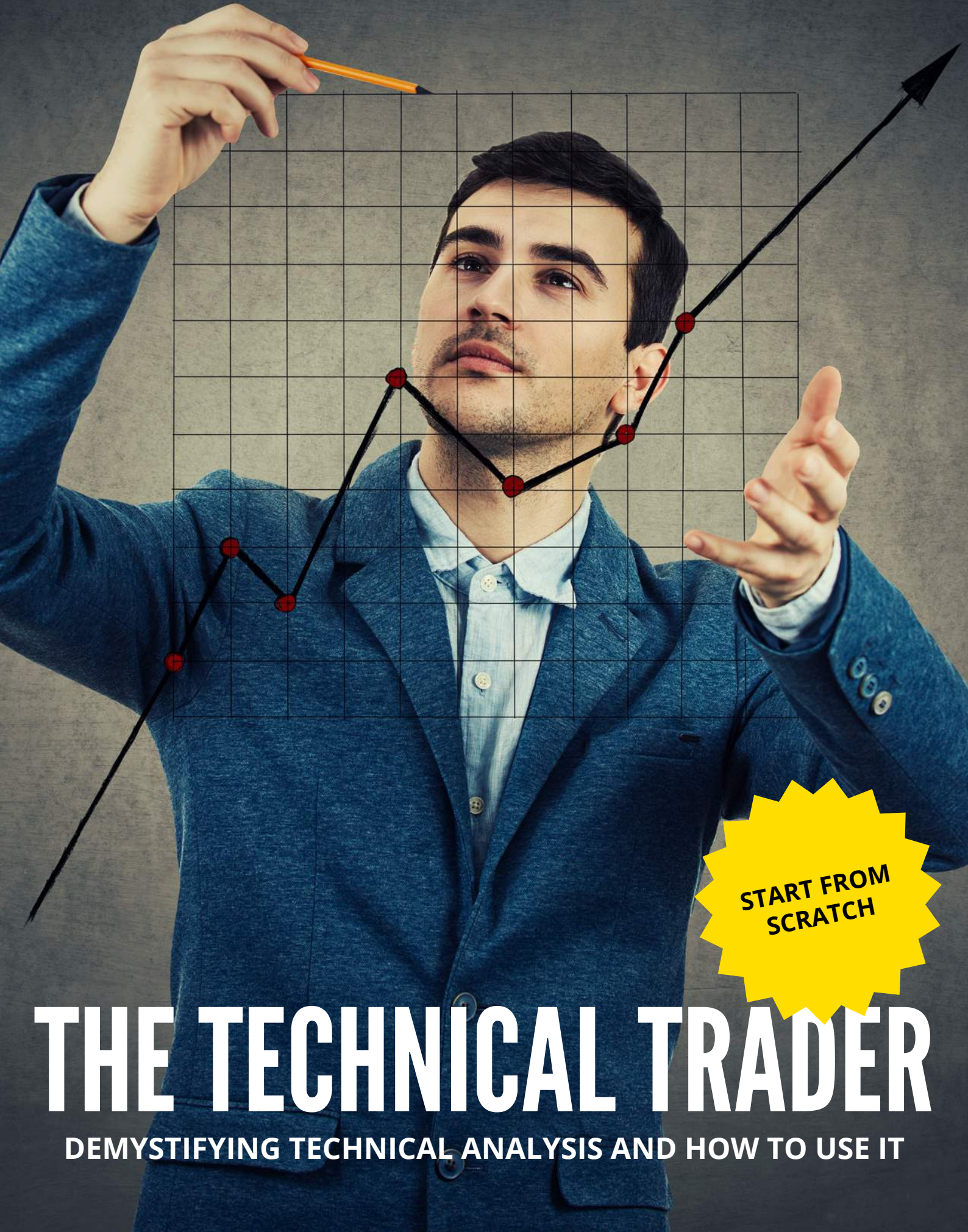


ZEBRA LEARN



**START FROM
SCRATCH**

THE TECHNICAL TRADER

DEMYSTIFYING TECHNICAL ANALYSIS AND HOW TO USE IT

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WELCOME ABOARD

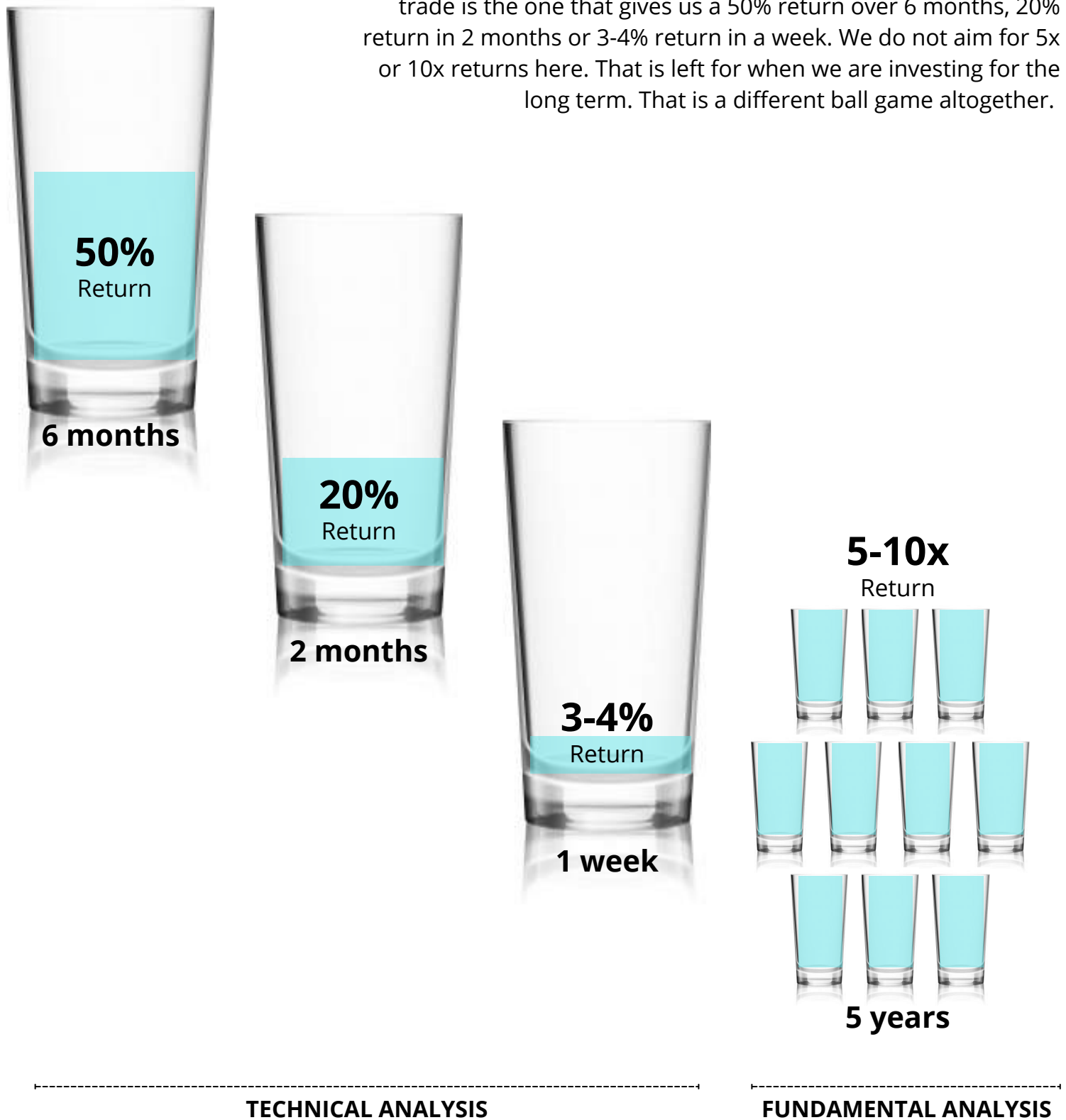
Welcome to this beautiful journey that you have enrolled for with us. A journey centred around trading in different listed assets – stocks, currencies and commodities. Not only will we decipher the world of trading but also learn to ace the same. We will create a trading system for ourselves and follow it religiously to have winner trades. By the end of this journey, we will be capable of putting together a self-sustaining system that manages profits and losses well.

Currently, we could be someone who is either entering the field of technical analysis for the first time or someone who has tried trading and burnt their fingers due to lack of proper training. This is our chance at redemption. We might as well be someone who has incurred major loss in trading and is looking to get back up and learn more and develop the trading system. NO matter the circumstances, this is the correct place. We will start from scratch to end about how to create a trading strategy that works.



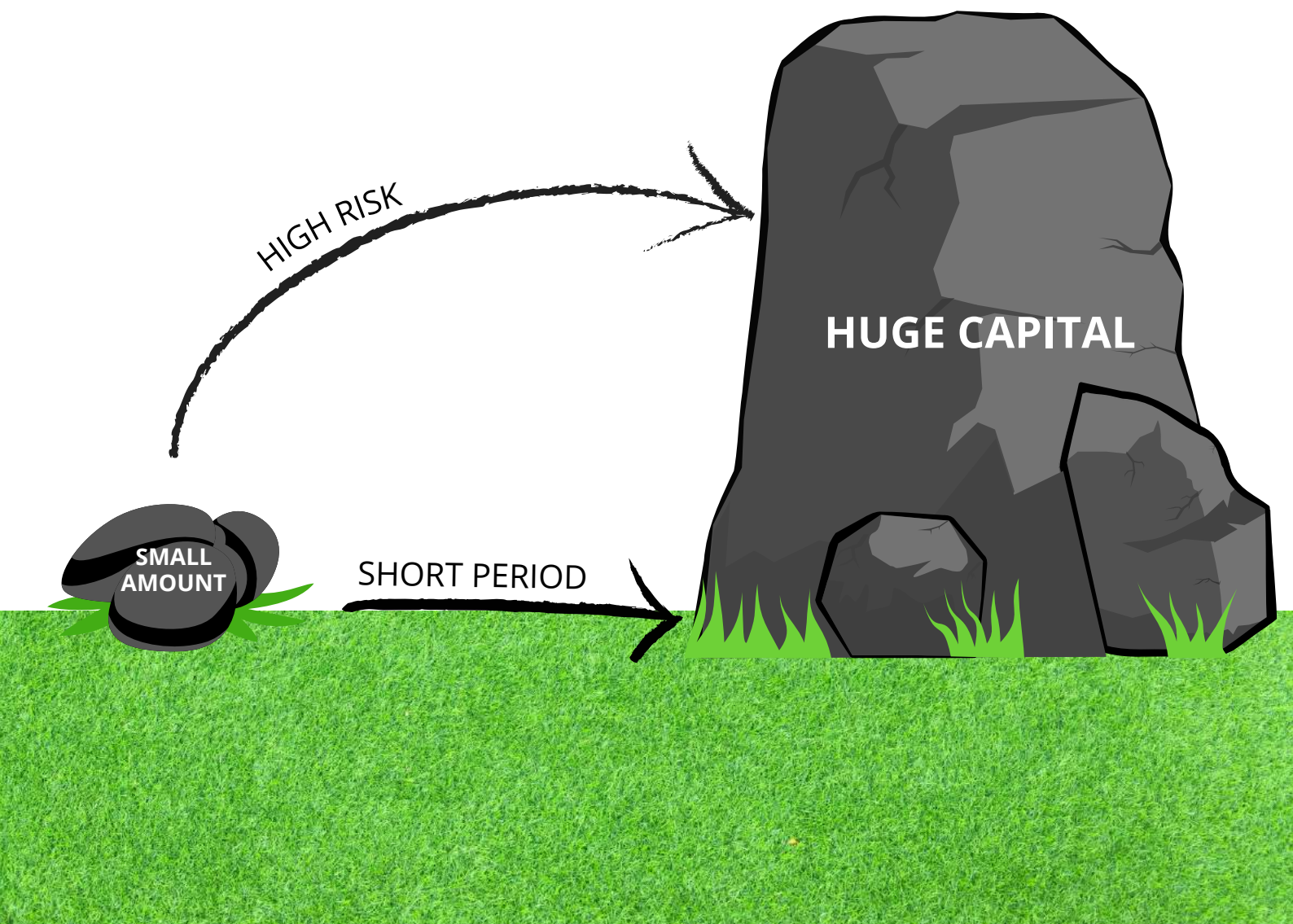
We will focus on trading i.e. buying and selling assets for relatively shorter periods of time. The span can range from a few hours to a few months. We will generally stay away from long trading periods which may extend up to years.

We will learn to develop a system to buy assets at cheap prices and sell them at higher prices in a relatively short period of time. A good trade is the one that gives us a 50% return over 6 months, 20% return in 2 months or 3-4% return in a week. We do not aim for 5x or 10x returns here. That is left for when we are investing for the long term. That is a different ball game altogether.



We need to understand that investing and trading are two completely different subjects. Investing is more about decisions based on fundamental factors such as industry, competition, margins and so on. It requires thorough research. Trading, however, is purely based on price behaviour. We will be carefully observing price movements so that we can identify patterns. These patterns will help us predict the rise and fall in the share price.

If done well, trading can create a lot of capital for the trader by investing a very small amount in a relatively shorter span of time. In trading, we take additional risks to grow our capital at a relatively faster pace. It would be a grave mistake to trade with every penny that we own, and deploy only a part of it.



In this book, we will talk about tried and tested methods and tools that have been in use for a very long period of time. We will learn to use these tools and put them together to create a profitable trading system. A trader's success in the market is determined by the effort put into the creation and execution of the trading system and the degree of discipline.

EFFORTS



DISCIPLINE



WHAT WE WILL LEARN

In this set, we will first learn about technical analysis and its variation from fundamental analysis. We will then get introduced to different analytical frameworks to conduct technical analysis. We will understand candlestick patterns, chart patterns, indicators and oscillators and so on, to determine the price movements. Using this, we will create trading strategies. Then, we will back-test and evaluate whether a strategy is working or not. Finally, we will put together different strategies to create a winning trading system.

Once we have done all this, we will combine it with a proper risk management strategy. Risk management ensures that we do not risk our survival and have our capital get wiped off completely.



We have used the vending machine as a metaphor to explain the components of an efficient trading system

TOOLS

Each can represents a technical analysis tool. The holders protect the cans

STRATEGY 1

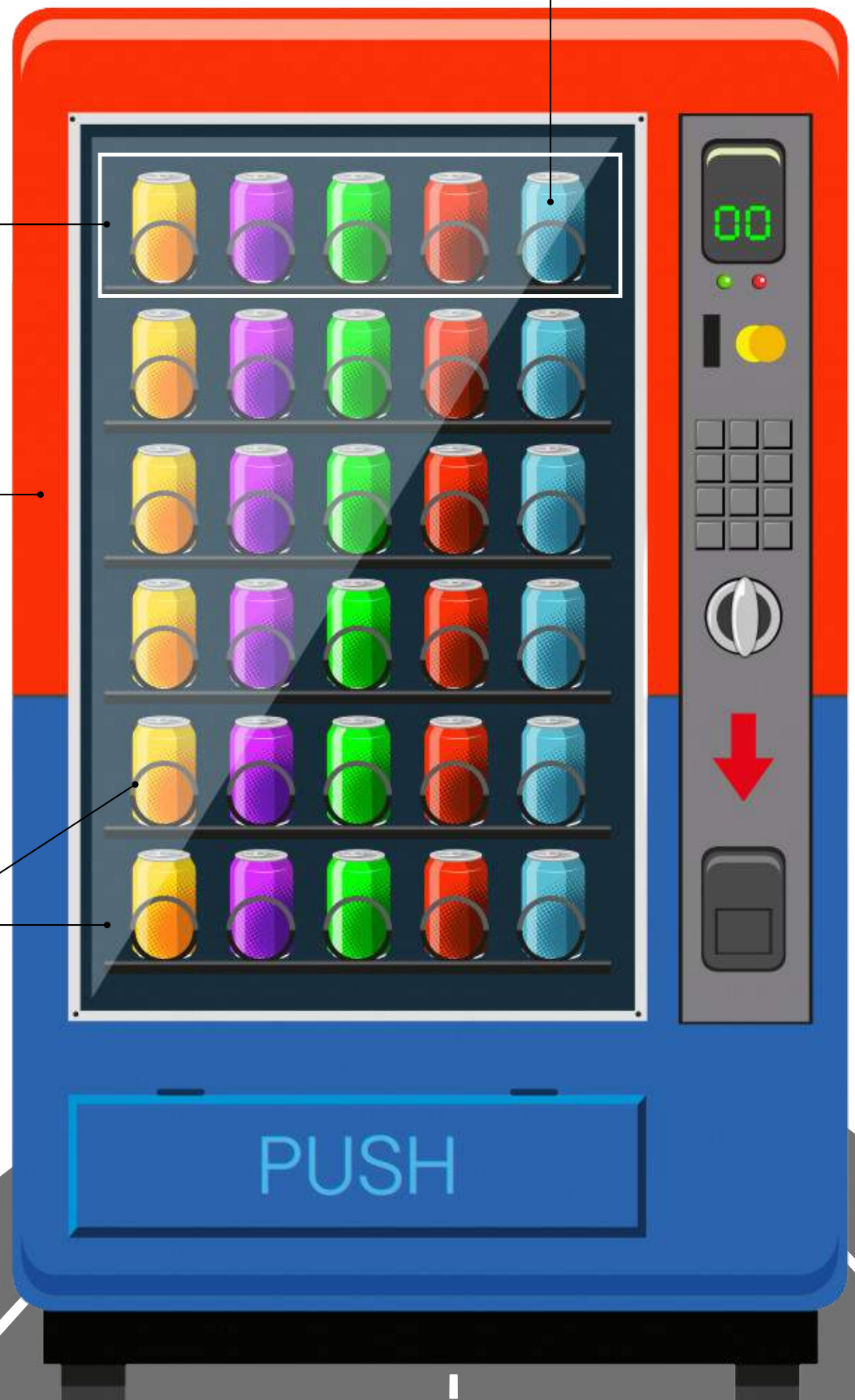
Each row represents a strategy created using a combination of tools

SYSTEM

All the strategies combined together form a system. Protected by the outer glass

RISK MANAGEMENT SYSTEM

The can holders and the outer glass represent the risk management system. Protects individual tools and the overall system from breaking apart.



So far, we have seen a very rosy picture of technical analysis and trading. However, the truth is that trading is not a 'Get Rich Quick' system. If that had been the case, everyone would be rich by trading in assets. It requires a lot of effort, patience and discipline. It takes time to build a discipline and practice it religiously despite the ups and downs. A very large number of people who start in the field, quit after a while as they incur losses. Nevertheless, those who patiently stick to it are most likely to achieve great results.

Throughout our practice, we will make sure to not risk our survival in the market even for a second, no matter how attractive profits they offer. So, now that we have an idea of what we are getting into, we will stay disciplined, not skip steps and stick to the process. With this, let us get started with technical analysis.



INTRODUCTION

Without any further adieu, we will jump on to – What is Technical Analysis?

The entire field of decision-making in capital markets – equity, debt, currency etc. can be categorized under two broad methods, based on which all decisions of buying and selling are made. The two methods are-

FUNDAMENTAL ANALYSIS

The fundamental analysis mainly refers to the investment decision-making process where analysts first understand the industry and business fundamentals of an investment. Then, they proceed on to take an investment decision based on these factors. Here the analyst is expected to understand topics such as competition, valuation, industry characteristics, financial ratios and so on. They must also conclude if they intend to buy or sell the asset.

TECHNICAL ANALYSIS

Technical analysis is starkly different from fundamental analysis. Here, the analyst focuses on price and volume and the movement of the asset prices in the past. Then, conducts statistical operations on them. Taking them into account, they predict the direction of the price based on which they decide to buy or sell the asset. The analyst does not focus on the quality of the underlying asset and wants to profit from prices movement/fluctuations.

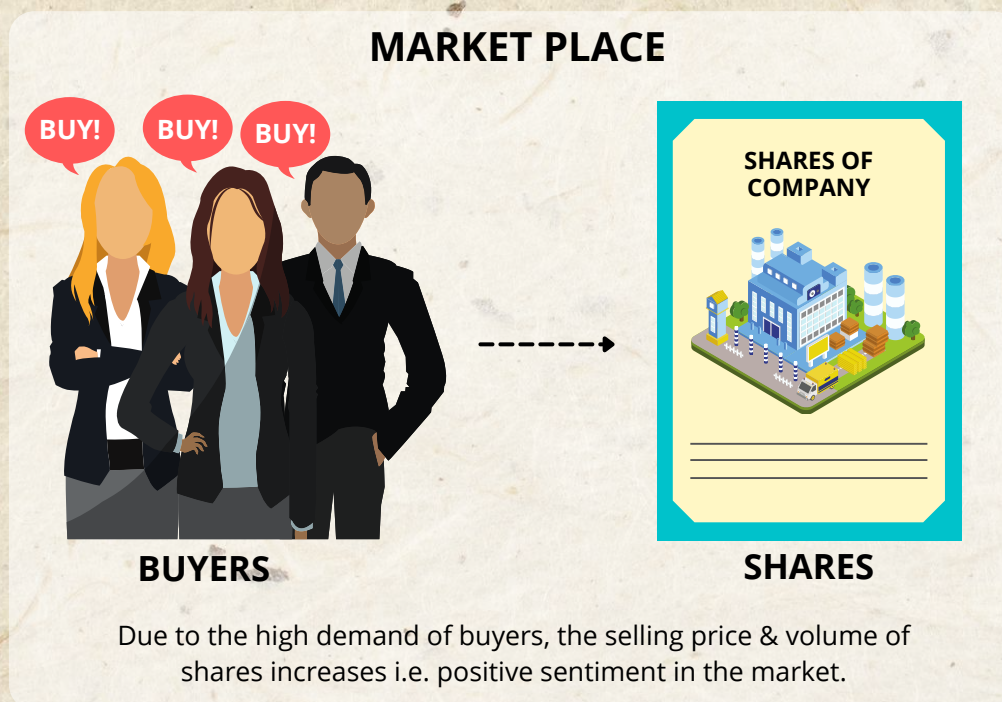
Difference	Fundamental Analysis	Technical Analysis
Meaning	Mainly deals with understanding the underlying quality of assets and then making a decision based on the quality.	Mainly deals with understanding the supply and demand of an asset in the market, and the resulting price behaviour, then making a decision.
Investment Philosophy	The focus is on finding high-quality assets that are relatively underpriced concerning its potential.	Focus is on finding assets that are popular at the moment and have strong positive or negative sentiments associated with them.
Focus of Analysis	Here, the analysis is conducted on competition, disruption threat, financial performance, quality of management, market demand and supply of the product and so on.	Here, the focus of analysis is on the trends in prices of the asset, volumes with which they are being bought and sold, statistical operations and so on.
Tools of Research	The analyst goes through the annual report, con call, financial analysis, management meetings, industry reports, on-ground research etc. before they conclude.	The analyst mainly spends time on charts and works to identify patterns on these charts, based on which, purchase and sale decisions are taken.
Duration	Fundamental analysis decisions are taken for long-term investments.	Technical analysis decisions are mostly short-term decisions, even though it is occasionally used for long term decisions.
Guiding Document	An investment philosophy is a guiding principle to take investment decisions.	A trading system is the underlying guiding principle behind such decisions.
Return Expectations	The analyst expects a multi-fold return over multiple years.	The analyst expects a small appreciation in a much smaller period.

WHAT IS TECHNICAL ANALYSIS

Technical analysis is the study of demand and supply of an asset through an understanding of the changes in price and volume of trade of the asset. In other words, we will combine the trading volume with price movements for the analysis purpose. We will conduct a statistical analysis of the same which will provide us with the foundation for making the buy or sell decisions about the asset.

Here, we are least interested in the quality of the asset or what we are buying. If many others are buying the asset i.e. the prices are increasing and there are high volumes for the same, it shows that the market sentiment about the asset is positive, and therefore we buy the asset. We just expect the trend to continue and make a profit out of it. We are least interested if that is a major blue-chip company or a small and struggling company. Our entire focus is on identifying the trend rather than understanding the underlying reason for price movements. We will ride the increase or decrease till the time trend continues and exit when it comes to a stop.

To identify share price trends, we need to understand the price and volume history of assets. Also, we need to conduct a statistical analysis. We will be conducting most of the analysis using charts. Let's move on to the elements of technical analysis.



YOU



I want to buy this share to make profits from the increasing market prices

THINGS TO KNOW

FOCUS ON PRICE AND VOLUME

Technical analysis is the study of demand and supply of an asset. We want to own assets that are high in demand and low in supply and want to sell assets that have lower demand and higher supply. Price and volume are the best representatives to understand demand and supply of an asset and therefore, technical analysis in a way becomes a study of price and volume of an asset.



MORE BUYERS
High Demand

High Demand leads to
increase in price & volume



LESS SELLERS
Low Supply

WANT TO OWN THE ASSET



LESS BUYERS
Low Demand

Low demand leads to
decrease in price & volume



MORE SELLERS
High Supply

WANT TO SELL THE ASSET

When prices are increasing and with heavy volumes (more people are buying), it indicates that the asset has a relatively higher demand at the moment. When this characteristic sustains for a while, we can say that the asset has a sustaining demand and we can expect it to continue. Hence, we purchase the same. If the prices are increasing but with low volumes (fewer people are buying), we anticipate that the stock does not have a high quantity of buyers at the moment and the trend is therefore not strong. The reverse of these circumstances is also true.

VOLUME	HIGH VOLUME	STRONG INDICATOR of increase in demand	STRONG INDICATOR of decrease in demand
	LOW VOLUME	WEAK INDICATOR of increase in demand	WEAK INDICATOR of decrease in demand
		INCREASE IN PRICE	DECREASE IN PRICE

We combine these with statistical analysis to increase our conviction of the prediction. Some people depend more on price and volume behaviour whereas others depend more on the statistical analysis. Irrespective of what strategies one uses, all of the technical analysis is built around price and volume data.

IT IS BUILT AROUND STATISTICAL OPERATIONS

CANDLESTICK PATTERNS

INDICATORS

OSCILLATORS

CHART PATTERNS

TRENDLINES & CHANNELS

We saw that technical analysis is mainly concerned with price and volume data of assets. However, various operations and calculations are conducted with these parameters to come to conclusions and take actions. Given beside are the different kinds of statistical analysis that are conducted.

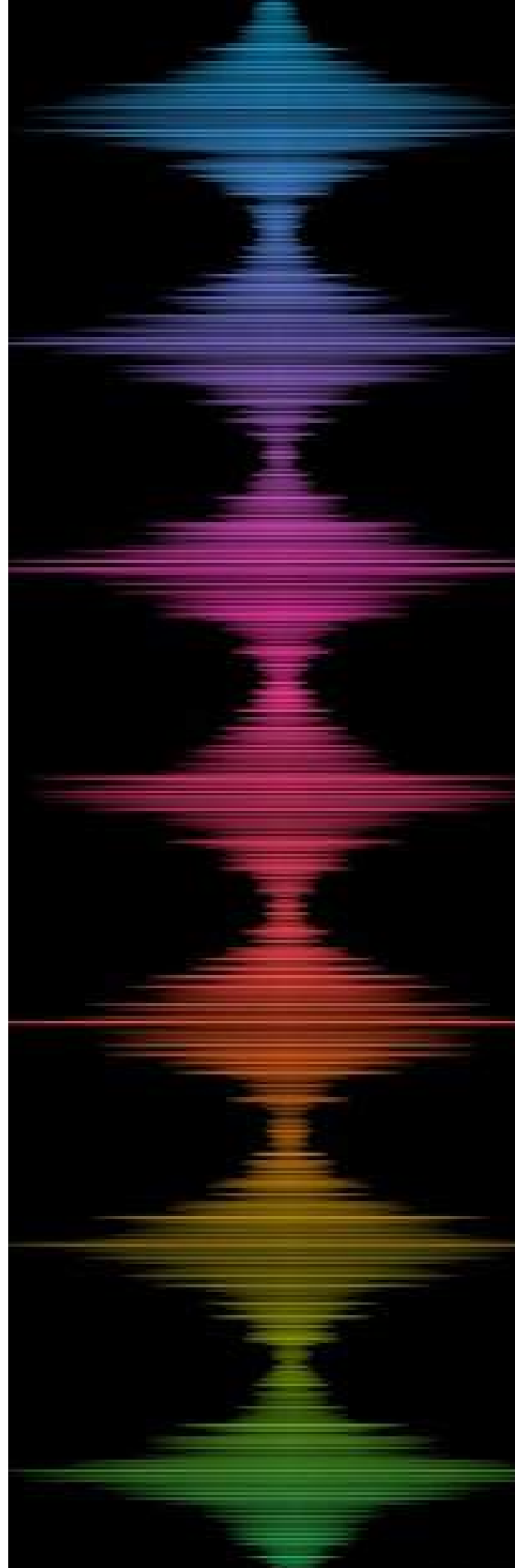
Reaching conclusions require extensive analysis deploying various operations. A lot of people are confused into thinking they need to be extremely good with statistics to conduct technical analysis. However, this is very far from the truth. When we deal with technical analysis using charts and auto-built indicators and oscillators, we do not need to know the sophisticated statistics behind each indicator. For this, we assume that the person has zero statistical background and they should be in a position to get started with technical analysis.

Each tool that we will discuss going further, has a statistical meaning attached to it. It is not required for one to understand the statistical calculation of each tool. However, it is recommended for those who are willing to create a career in technical analysis to understand the statistical calculations.

TECHNICAL ANALYSIS IS DEPENDENT ON REPEATING PATTERNS

Technical analysis assumes that patterns that have played out in the past, will repeat themselves. So the focus is on finding situations where similar circumstances have occurred. All the calculations and price-volume data assume that the patterns will repeat themselves going further.

A system is created around this, and at times when the system holds and the pattern repeats itself, the analyst or the trader ends up with a profit. At other times when the pattern does not repeat itself, the trader ends up with a loss. The math of the system should make sure that it is sustainable in itself. We will see all this in the later stages, going ahead.





TECHNICAL ANALYSIS IS ABOUT CUTTING DOWN NOISES

Technical analysis in a pure sense is about cutting down noise and focusing on pure price and volume data. Analysts often try to combine 'What' with 'Why'. This means if they see a certain trend in price and volume data for an asset, instead of purely focusing on 'What' the trend is, the mind starts to ponder on 'Why' it is the trend. There may or may not be an answer to this every time.

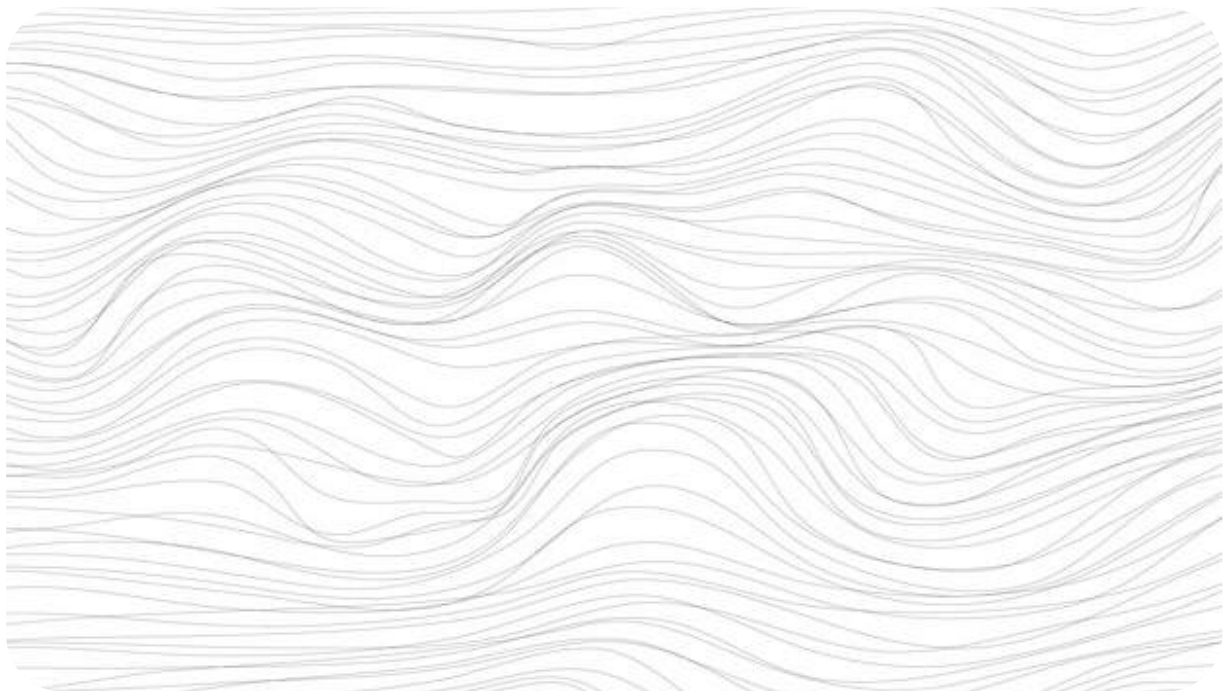
All the pondering and overthinking is certainly a recipe for disaster in this field. Technical analysis is about cutting down noises and purely focusing on price and volume data and factors influencing it directly. It is the ability to call oranges, 'oranges' without letting the brain over-think. Technical analysis is mentally very consuming and can easily lead to overthinking and mistakes.

PRINCIPLES OF TECHNICAL ANALYSIS

There are certain principles when it comes to technical analysis that we need to keep in mind. These were first discussed by Charles Dow which then became the base for what later came to be known as the Dow Theory. The three basic principles of technical analysis are -

HISTORY NEVER REPEATS ITSELF, BUT IT ALWAYS RHYMES

Technical Analysis is built on the principle that what has happened in the past will not exactly repeat itself, but will rhyme i.e. will have similar patterns if not exact patterns. Technical Analysis says that when similar circumstances arise in terms of how price and volume are behaving and how different indicators are behaving, the asset prices going ahead will move in a pattern that is similar to what has been the case in the past.



TRENDS ARE BASED ON SENTIMENTS

As per, technical analysis, the market has a sentiment for each asset. The strength of the sentiments may vary and based on these sentiments, asset prices move in trends. The trend changes when the sentiment about the asset changes.

With technical analysis, the aim is to understand the sentiment behind an asset by studying its price and volume behaviour. Hence, prices of assets move in trends – upwards or downwards, and these trends are based on the sentiments – positive or negative



MARKETS ARE SUPREME

Under technical analysis, the markets are supreme. The market refers to a total of all the buyers and sellers participating in any kind of transaction. All buyers and sellers may have opinions and feelings about each asset and together they determine the collective market 'sentiment' behind the asset. At any given moment, the asset price will reflect everything i.e. emotions, competition, earnings, potential growth, inventory levels etc.

We will never try to fight the market prices and trends by going against the same. This means, when market data shows an asset is in momentum or it is following a particular trend, we do not want to fight it by going against the market because they are reflecting all the above-mentioned factors.

Market discounts everything and all news and actions are reflected in the asset price. No individual or system is above the market and at the end of the day, the market determines whether our strategy and systems are working or not. The market will reward us when our systems are correct and punish us when they are wrong. The market is supreme and is the ultimate decision-making authority.



HOW IT WORKS?

1

MARKET REFLECTS ALL FACTORS

Technical analysis begins with one of the principles discussed earlier. It begins with the assumption that all the information, news, responses, actions, fundamental factors, market sentiments etc. are reflected in the prices at any given point in time.



2

UNDERSTAND THE MARKET WITH PRICE-VOLUME DATA

We then analyze price and volume data. We conduct statistical operations, read the charts and use various combinations of oscillators, indicators, candlestick patterns and so on. We will conduct these operations to understand the market sentiments reflected in the price and see if we can take any action based on what we infer from this data.



3

TAKE POSITIONS BASED ON PAST PATTERNS & INDICATORS

Based on our analysis and the patterns observed in the price and volume data, we take positions (i.e. buy or sell assets) in the market. We expect that history will at least rhyme if not repeat itself and in the future, the asset prices will move in the direction that we would predict them to. We will not be accurate every time and the asset prices in a different direction.





4

REQUIRES A SYSTEM

Based on the above method, we take individual calls in the market. However, to reduce the effect of our psychology and randomness and to make a profit sustainably, we need to have a systematic approach rather than taking individual calls as discussed above. So, based on the patterns and trends, we create a system which defines the rules when we enter a trade and when we exit one. The strategy and system are then checked by backtesting – we will see how often we are right, how often we are wrong, how much we win when we are right, how much we lose when we are wrong, what the maximum drawdown is (the fall in the portfolio value) and so on.

So, this is how broadly technical analysis and the system of trading around it works. There are applications of the same in multiple asset classes, some of them being very complicated. However, the underlying approach remains the same. The focus of analysts is on how well they can analyze the asset prices and volume, how they define entry and exit rules and largely, how well they can create a system. Let us begin with understanding the charts and the tools used to conduct the analysis.

