

DECEMBER, 1990

FELLOW TRADERS, ANALYSTS AND MARKET PARTICIPANTS.

The year is rapidly drawing to an end. And what an eventful year it has been - even if the stockmarket did not have its much talked about October crash. Actually, since 1925, the Dow Jones Industrial Average has only closed lower in October 33% of the time. (It does not seem to be a rewarding way of trading the market!)

It should not be forgotten the Dow Jones Industrials did manage to make a new historical high, as did the Nikkei Dow. Since then, both markets have declined "substantially" - the US Stockmarket from 3024 to 2344 (22%) and the Japanese Stockmarket from 38950 to 19780 (49%).

How low is low? On an historical perspective, the Dow Jones fell 86% from 1929 to 1932. This is not a forecast of coming events!

On the international front, the Oil market has gone through the roof (after the technicals lined up perfectly, as illustrated in our previous newsletter), Gold has not been overly exciting, Silver has collapsed to lows not seen since before the late 1970's surge, the US Dollar is probing new lows against many of the other currencies, the grains have been reasonably subdued, Sugar had a nice move from 16 cents down to 9 cents (43%)..... But otherwise things have been fairly quiet.

Unless, of course, one charts Real Estate prices. They have been rather interesting around the world. If someone is charting this market, and I know some who are, please drop me a line.

On the local front, there is talk of doom and gloom, the

Australian Dollar first rose against the US Dollar - totally against market sentiment - and then promptly collapsed, interest rates have been declining all year and finally the Australian Stockmarket has been wanting to test the 1987/88 crash lows. Some of the individual stocks have already achieved this honour.

In the midst of all this turmoil (or should it be organised chaos), the Australian Technical Analysts Association came into existence.

I am pleased to report that we, that is you - members of the ATAA - have been recognised by the International Federation of Technical Analysts, Inc.. This will give you an opportunity to expand your network by getting in touch with fellow traders and analysts around the world directly (courtesy of the International Directory) or through this newsletter.

It is hoped that our newsletter is developing along the lines that you are looking for. I want to personally thank the following members for their contribution to the ATAA newsletter:

Mark Frost, Peter Pontikis, Richard Lee, Colin Nicholson, Christopher Carr, Dawn Bolton-Smith and Steven Mutch.

Finally, on behalf of the committee of the Australian Technical Analysts Association, I would like to take this opportunity to thank all of you for your support and to wish you all:

**MERRY CHRISTMAS AND A JOYOUS, SUCCESSFUL, CHART-FILLED
1991!**



**IVAN KRASTINS
EDITOR**

STOP PRESS: At the time of writing, the membership of the ATAA has reached the Fibonacci level of 34. The next Fibonacci number of fifty-five must be just around the corner! This evidences the appeal of Technical Analysis in Australia.

THE OIL MARKETS REVISITED

Well, haven't these markets been rather interesting since the last ATAA newsletter. The Special Report Update that appeared there at the end of August addressed the *Technical picture* of the Oil complex based on both weekly and monthly charts.

"All the indicators are in overbought zones...the current position warrants stop-losses being raised to lock in profits...a light short position could be a real consideration..."

The very next day, the Oil complex started to drop dramatically, and continued to decline for two more days. Because the indicators had, all but one, confirmed the new highs in price of the previous week, a major top had not been signalled. In fact, the move down halted after a Fibonacci number of days. This enabled the market to "wear off" its previously overbought state.

Another interesting observation is that the 3 day decline retraced almost exactly 50% of the sharp rally from "B" to "C" (refer to Figure 4). The end of that move down is a good example of the fact that turning points are (usually) marked by a *confluence of both price and time factors*.

The Fibonacci (233) weekly potential change in trend (CIT) period for the week beginning September 17 (listed in the previous newsletter), came and went. One way of dealing with such projected CIT dates is, either to pull stops closer to the current market action if one is riding a profitable move, or to wait for a confirming signal to enter the market. As it turned out, the market did not react to the downside at all.

FIGURE ONE

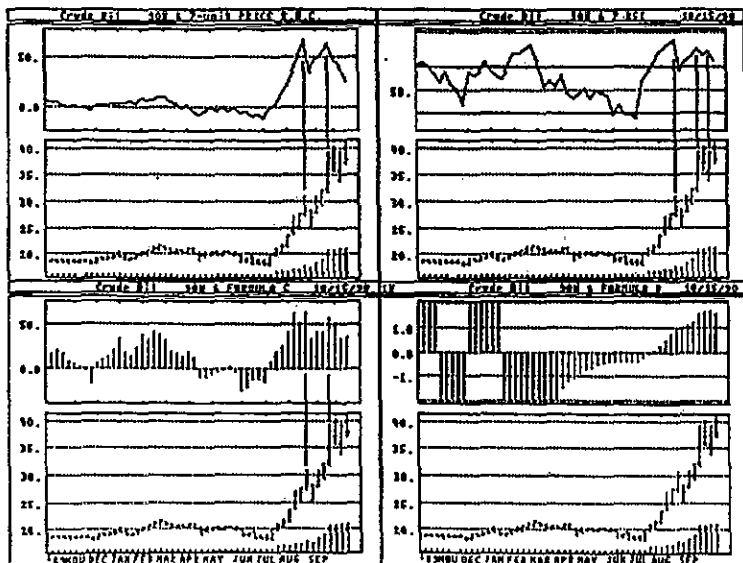
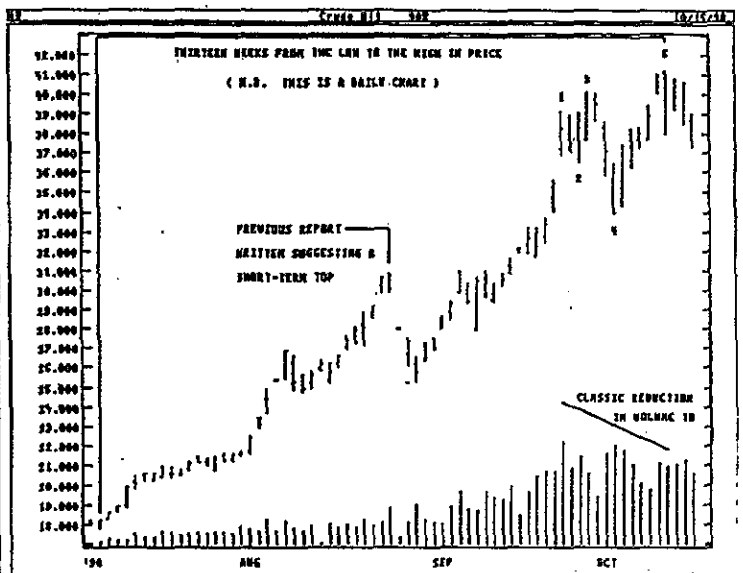


Figure 1. illustrates the position of the *same indicators* (on a weekly chart) that worked so well at the low back in June/July of this year. You can clearly see that *three out of the four* are giving **BEARISH DIVERGENCE** signals at the highs. Another important clue of a top is provided by the fact that the entire move up had taken *thirteen weeks*. Fibonacci strikes again!

The daily bar chart in Figure 2. includes a histogram of Volume at the bottom. Classic chart analysis techniques warn of an impending top - the Volume has been *declining as the price has continued to rise*. (Compare the Volume between Points 1 and 5.) A closer look at the Volume shows that Volume actually *increases as the price declines* into the low at Point 4.

FIGURE TWO



Those of you who have attended one of my intensive Technical Analysis courses will recognise the pattern marked by the points 1 through 5. You will know how potentially powerful this particular pattern is! (*It has to be stressed that the actual numbering has absolutely nothing to do with Elliott Wave Analysis.*)

FIGURE THREE

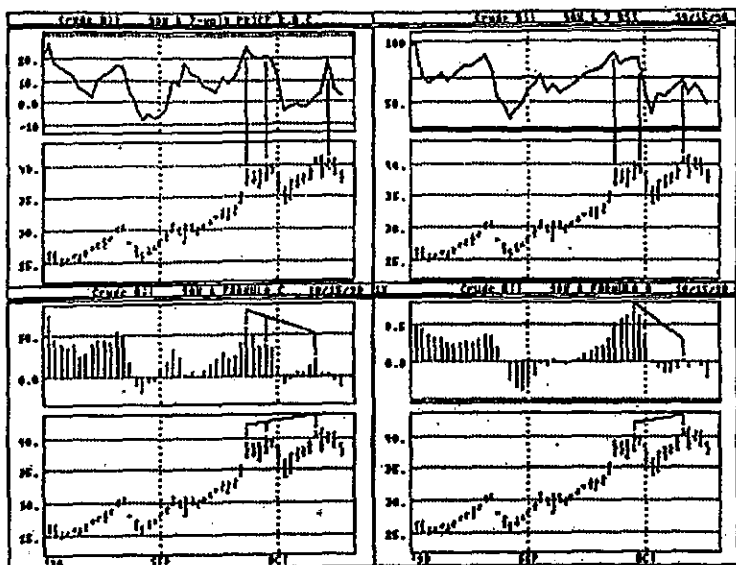


Figure 3. applies the same indicators (as in the weekly chart) to a daily bar chart of Crude Oil. The **DOUBLE BEARISH DIVERGENCE** on *three of the four* indicators could only be ignored at ones own peril. In fact, on the daily chart (Figure 3.) you can see that the day of the actual high is a *Key Reversal*. This is one of the *four classic chart patterns* that can herald in a change of control (or the beginnings of a change in trend) in a market.

Figure 4., a daily bar chart, brings us up to date. The Crude Oil market has again confirmed the bearish assessment that was made from the previous charts. You will notice that the initial decline in prices has retraced *fifty percent of the entire advance*. This decline in prices has halted on another weekly CIT date mentioned in the previous ATAA newsletter - 377 weeks from the August 1983 high.

The strategy mentioned in the earlier part of this report (dealing with how to use these projected CIT dates) would have ensured that the stop loss on a very justifiable short position would have been moved down to lock in profits from the \$9.00 + move down. Because the market failed to close below the critical 50% retracement level, the market was indicating that the stop should have been very close indeed.

The potential dangers associated with using a target can also be seen on Figure 4. Once the prices had broken down below the low marked on the chart, a further move down to the \$26.30 level was indicated. The market bottomed \$1.00 above this target. At the time, a market participant with a fixed target in mind may have waited too long to exit the profitable short

position.

Currently, the Crude Oil market has reached a very fascinating juncture. The move down from "E" to "F" has been retraced by 66% to "G", whilst that move ("F" up to "G") has been corrected by 50% at "H". Because of this *conflicting evidence*, one *should* look for some other clues as to what may be in store.

The market seems to be *winding itself into a coil*, from which it should spring extremely decisively. A trader is faced with a dilemma - wait for a clear break either way, or take a position now! From a practical point of view, this is a great opportunity to use an Option strategy. I am referring to the purchase of a *Straddle*. But more on that at another time.

On the last day shown on the chart, the market has *closed higher than it opened*. This evidences that the buyers, at least on that day, have overpowered the sellers. Another message, for the aware analyst, is that the *ranges have not expanded* as the prices have declined. Combining these *subtle clues* with the fact that the market could not close below the important 50% retracement level, the *probabilities do favour the upside*.

One of the wonderful advantages of being a *speculator*, as opposed to being a forecaster, is that one has the freedom of *choice to stand aside* from a particular market when the picture is unclear. There are many times when, even with the use of Technical Analysis, the balance of probabilities favour neither a Bullish nor a Bearish view.

Some important future Change-In-Trend periods to keep in mind are :

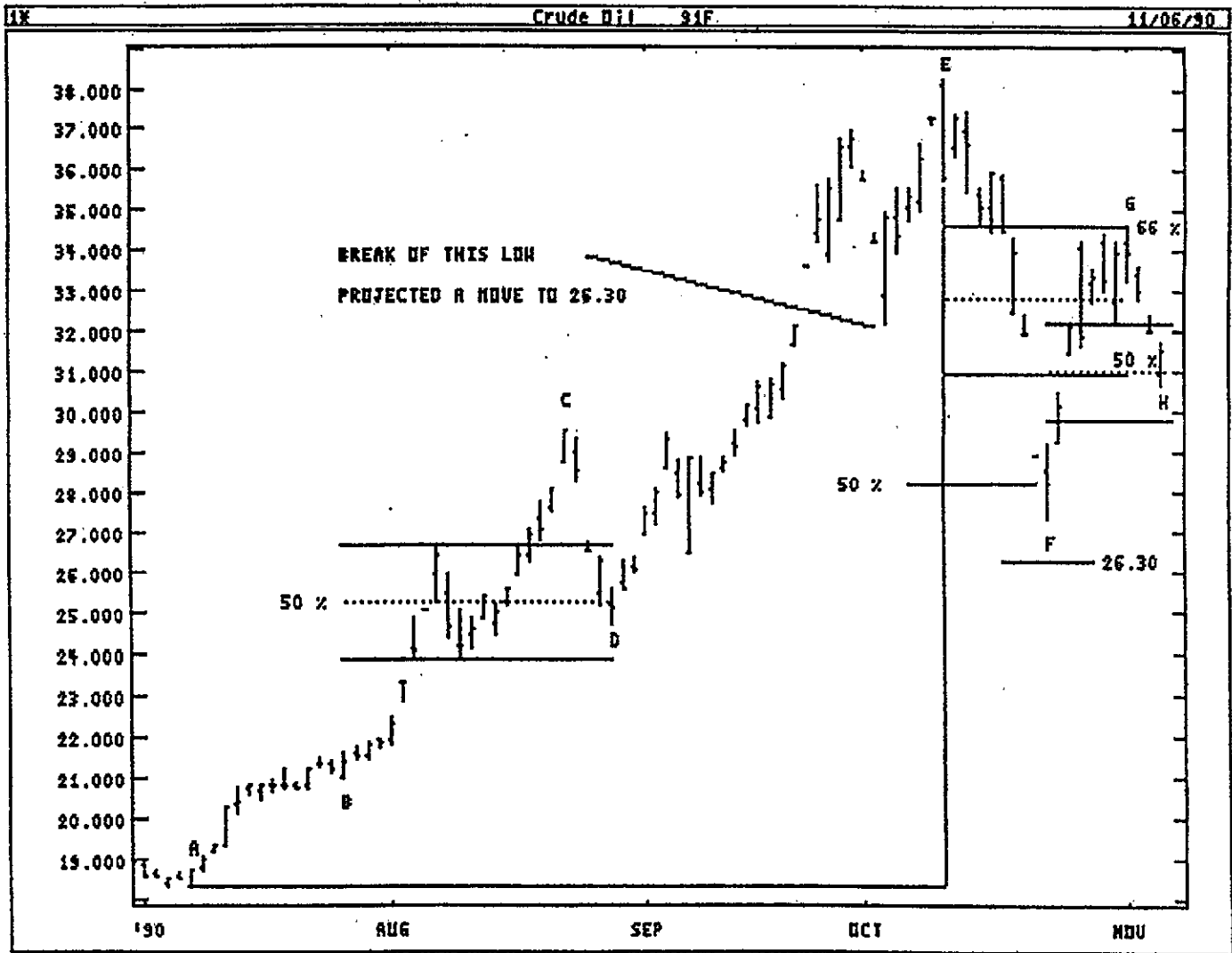
MONTHLY: November - 55 months from the low in April, 1986;

December - 5 months since this rally commenced.

WEEKLY: The week of December 3 - 21 weeks from the low in July;- 8 weeks from the October high.

IVAN KRASINS

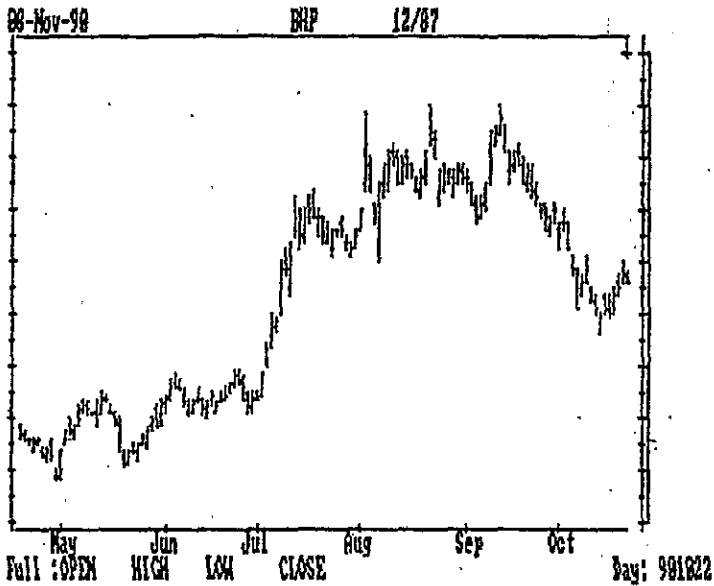
FIGURE FOUR



FOCUS ON STOCKS - BHP

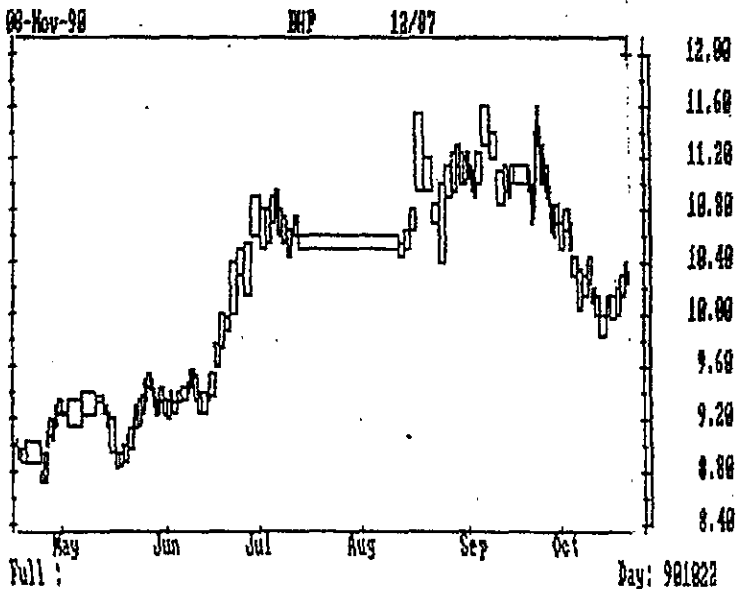
We have seen recently some interesting indicator convergence in BHP. Look at the bar chart of BHP (Fig. A). The week ending September 14 saw the completion of a TRIPLE top. Of course there may be room for argument about such tops, especially when they occur over such a short period.

FIGURE A



(Editor's Note: After discussing this point with Christopher, the fact that, seeing the first high in BHP was at \$11.55, the second and third highs were at \$11.60, we came to the conclusion that the vast majority of analysts would regard it as a triple top. At this stage it is only academic, but we both agreed that a "purist" would regard the scenario as representing merely a DOUBLE top. Take your choice.)

FIGURE B.



An examination of Figure B., an Equivolume chart above, evidences a decline in Volume during the completion of this topping pattern. (This is classic "Edwards and Magee" at its best!!! Ed.)

FIGURE C

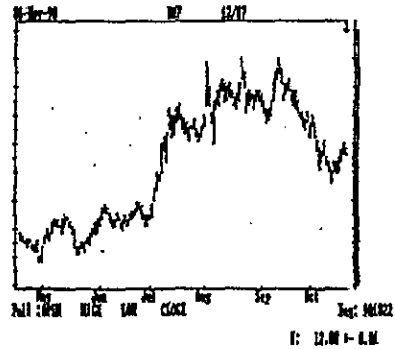
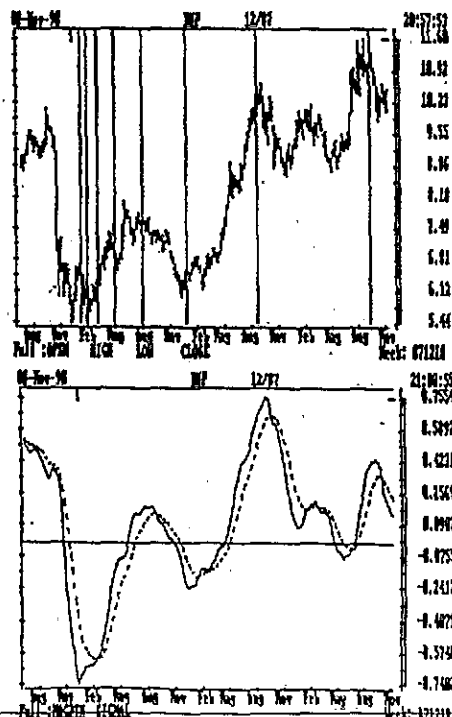


Figure C. illustrates the daily Moving Average Convergence Divergence (MACD) indicator over the same period. Note the NEGATIVE divergence, an important precursor of the subsequent price decline. Note the reinforcement of the daily indicator by the weekly MACD in Figure D. The weekly "lags" the daily, but for a conservative trader, provides confirmation.

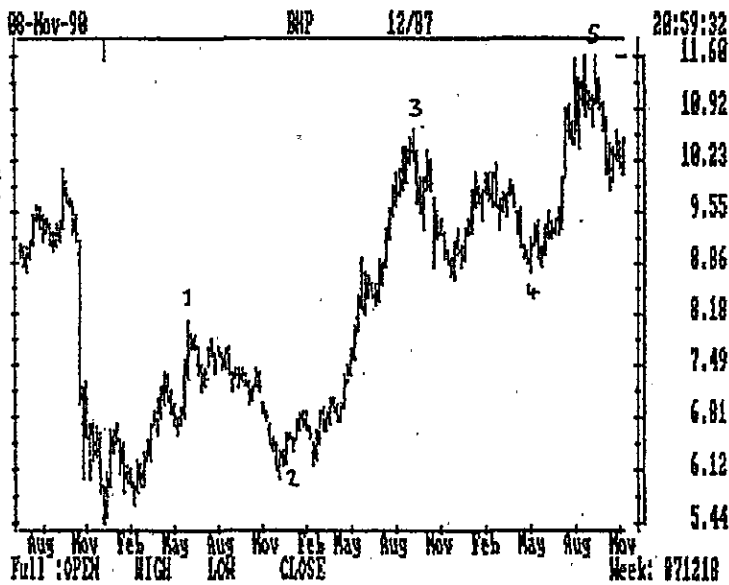
FIGURE D



If you actually count the weekly bars on Figure D., you will find that the recent drop in price started immediately after the week that was 144 weeks from the post-crash low - the week ending December 11, 1987. The adjusted price for BHP was \$5.44. 144 is a Fibonacci number. Thus, we have started a price decline in what appears to be a new major cycle.

(Please refer to the previous A.T.A.A. newsletter. The article on the Oil market illustrates the use of Fibonacci time zones for the timing of market turns - on a monthly, as well as a weekly basis. Ed.)

FIGURE E



Further reinforcement of this view can be provided by using Elliott Wave analysis. Refer to Figure E. Of course, the main problem with Elliott Wave is that it looks so clear in hindsight. Some friends of mine (with a touch of masochism) try to use Elliott Wave as a daily trading tool - they talk about preferred counts, alternative counts etc. If it does have a clearly defined structure, it can be a useful confirmation of other signals. Generally, Elliott Wave works best with market indices or commodities. But stocks with ready tradeable shares are sometimes susceptible to Wave analysis. BHP appears to have a defineable 5 wave pattern up from the bottom in December, 1987.

How far and how long will BHP sustain a major downtrend?? Personally, I avoid such predictions. I do not, however, criticize those who do make specific price and time projections. The danger is that one can be locked into a straitjacket and fail to respond to the other market signals. I suppose that we could see a steep price decline or a shallow downward drift over a long period of time, to name but two of many possible scenarios. We should simply watch our

indicators and be ready to change when divergences start to appear.

FIGURE F

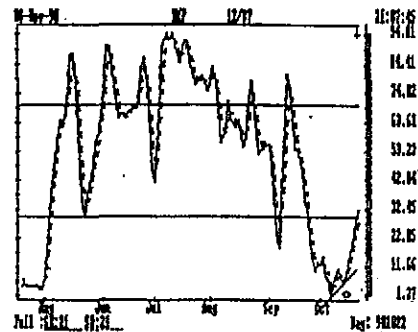
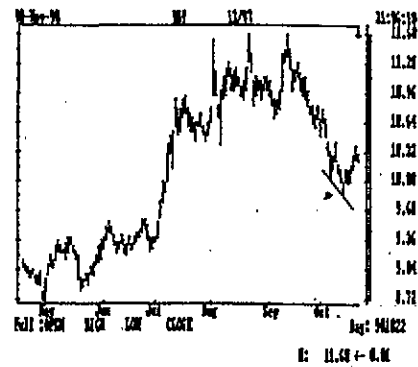


Figure F. above is a chart showing a daily slowed Stochastic. I am using 21 day periods, rather than the standard 5 day period, so as to eliminate excessive whipsaws. The Stochastic indicator should only be considered as a very short-term trading tool. It works quite well within a continuing major trend, but like other indicators with a fixed mathematical range, it becomes inoperative during a major market directional change.

But given that BHP is now in a major downtrend, we may observe from the chart that:

- (1) BHP is oversold on a short term basis
- (2) There is a positive divergence which points to a short term rally.

CHRISTOPHER J. H. CARR.

Editor's Note - Since receiving the original copy of this article on October 19 from Christopher, BHP has indeed performed according to the closing observations. The price of the stock has risen from \$10.30 to \$10.60. This rally has served to reduce the "oversold" state in the stock. BHP is currently trading near the high for the rally - \$10.50.

Well done Christopher, and I guess we should also congratulate George Lane - the originator of the Stochastic indicator back in the early 1980's.

THE THIRD ANNUAL CONFERENCE OF THE INTERNATIONAL FEDERATION OF TECHNICAL ANALYSTS.

I recently had the pleasure, along with Merrill Armstrong, of attending this conference - TECHNICAL ANALYSIS IN THE 90'S hosted by the Canadian Society of Technical Analysts at Le Chateau Montebello, Quebec. Indeed a stimulating experience to be amongst the 140 delegates from 20 countries. I received an especially warm welcome as Vice President of The Australian Technical Analysts Association.

Only organisations can be members of I.F.T.A. whose aim is to unite the Technical Analysts of the world. It is obvious how meaningful and important I.F.T.A. will be in the coming year to all of us as professionals. There is strength in numbers. But more importantly, we as technicians have the only true universal language; our charts and theories transcend all national boundaries and linguistic hurdles.

It is certain that this decade will bring to others the real benefits of Technical Analysis. Despite the precarious state of the world investment industry, membership to the various T.A. groups around the world is continuing to rise.

The venue of the 1991 Conference is likely to be Mexico with prospects for Australia being host Nation in 1997. There is considerable interest "down under" and the intervening years will give us a chance to grow in numbers and receive the benefits of being able to heighten our analytical skills through the exchange of information and ideas.

The four day conference was packed full of interesting speakers and workshops and went all too quickly. The venue itself was interesting in that not only is it the biggest log cabin in the world, it was also the venue for the 1981 World Summit conference.

Some of the more interesting points made by the various speakers were:

The general consensus for world markets was one of recession and bear markets characterised by lack of volume and breadth of market.

The Bond Market usually leads the Stock Market. It was suggested for use as a Technical Indicator for Stock Markets.

On a global basis, Japan is the key market.

Precious metals tend to lead the CRB Index.

Generally, indicators work well when GOING WITH THE MAIN TREND.

Simplest indicators have the best reliability.

The Relative Strength Index - can't rely on "oversold" or "overbought" - use RSI divergence in TRENDING MARKETS. Divergences can go on for a long period of time. The same applies to Stochastics.

Gold has gone back into its "no-one cares" basket.

Real Estate in most countries are also in Bear markets.

Banks are in trouble not only in Japan.

Smart Money is on the sidelines and waiting for the REAL FALL!

Prospects for a rally in most Stockmarkets - DON'T LET THE RALLY FOOL YOU!!!

CRB Index broke trend - major break in inflation - deflation next? Sell all oil stocks (from recent Cambridge Conference)

U.K. GILTS suggested as one of a FEW safe investment areas.

Moodies Commodity Index - depression instead of recession?

Technical Analysis so transferrable. Tremendous edge over economists.

THE TRUTH IS IN THE CHARTS. Important to look at the global scene.

Presentations and tutorials were given on a wide range of technical subjects including the Candle Chart patterns used by the Japanese. New indicators included a Pressure Indicator from Elli Gifford, Investment Research, Cambridge. Discussion groups were held on a wide variety of Indicators/Barometers with a free interchange of ideas.

One of the main speakers John Murphy, author of the best seller "Technical Analysis of the Futures Markets" (NYIF Corp., 70 Pine St., New York, New York 10270) and with 20 years experience in T.A. placed emphasis on futures for the 90's with futures contracts on everything.

Bronwen Wood, a leading U.K. analyst, gave an address on THE WORLD IS YOUR OYSTER with emphasis on TECHNICAL ANALYSIS - the best discipline!

We are now in a world where global money is gaining control. The Financial Times last year came out with a chilling caption "SLEEP WITH A DEALING MACHINE BY YOUR BED". It is becoming increasingly apparent that Fund Managers need to translate currencies into their actions. The decisions made by equity investors are affecting currencies. She emphasised for many good reasons that TECHNICAL ANALYSIS is absolutely the TOOL that Fund Managers are going to acknowledge as being the greatest help they can possibly come by.

Bronwen also held the view that if investing Overseas, it was important to have a clear view of the currency as well. This was well illustrated by chart examples and some others were shown supporting her theory that the Pound was a "tired" currency.

Far Eastern Markets at this stage from a technical viewpoint have the best chance of Bull markets in the 90's. Although the TAIPEI WP INDEX of Taiwan had a tremendous run in 1990 to over 12,000 (now 2,800), 75% from the peak. It is a reminder of what can happen in a Bear market.

The last speaker, Rof Berschi, VP of Credit Suisse, proved to be one of the best. He discussed Mood, Sentiment and Crowd Psychology with a novel presentation. 100 years ago we had the same problems as today.

The price reflects the price that humans make. Value - the measure of optimism/pessimism that is projected into the future. Charts show the mood of the cycle. In the next 10 years science will help us to learn more about Stockmarkets. The

laws of nature that govern complexity are surprisingly simple. Personal emotions restrict everyone from making money. Only way to overcome this is with TECHNICAL ANALYSIS.

The final evening of the Conference was indeed a special occasion with an address by the Canadian Finance Minister, Mr. Michael Wilson. The press reports on the following day confirmed Canada's recession.

The Conference was certainly one of life's more rewarding experiences with the realisation that one is forever learning about markets. Certainly with the background of the A.T.A.A. and I.F.T.A. to inspire, educate and encourage, it can only lead to better analysts.

DAWN BOLTON-SMITH (Vice President of A.T.A.A.)

END OF DAY 100 AUSTRALIAN STOCKS FOR \$299 PER YEAR.

"LIVE" SYDNEY FUTURES EXCHANGE DATA FOR \$43 PER WEEK.

END OF DAY - S.F.E. MARKETS FOR \$59 PER YEAR.

END OF DAY - U.S.A. MARKETS (150 CONTRACTS) FOR \$US 40 PER MONTH.

"LIVE" U.S.A. FUTURES FOR \$US 400 PER MONTH.

HISTORICAL TICK DATA ON U.S.A. FUTURES MARKETS

HOURLY AUSTRALIAN DOLLAR EXCHANGE RATES FREE

As part of the aim of the Australian Technical Analysts Association in keeping our members informed of developments in the general world of finance, we would like to report on some changes that have been quietly taking place.

These changes are of particular significance to perhaps the smaller individual trader in both the stockmarket and the futures markets, but should be of benefit to the corporate users of the various markets, as well as the brokerage industry. In these times of talk of recession and/or depression, costs and overheads in general are of concern to all. With this in mind, it is pleasing to see that the financial markets in Australia are maturing and developing along the lines of some of the overseas markets.

I am specifically referring to the largely unobserved, and certainly uncommented on, fact that traders are being presented with an ever increasing choice in their source of data. This applies equally to "live" intra day data, end of day O-H-L-C data, tick data and historical data.

Part of this change has come about as a result of the acceptance of the markets by a growing number of users, deregulation of the financial system, competition in the field

of communications, not to mention the foresight of several "enlightened" people.

The purpose of this article is not to name names, but merely to make you aware that there are many choices available to Australian trading and investing participants.

This information is strictly "for members only". A special report on this specific topic has been prepared for you, our members, by The Investment Educator and will be forwarded to you upon request. All of the services have been used extensively, or in some cases merely trailed, before inclusion in the extensive listing. Some of the services may already be known to a number of you, whilst others - even for the local stock and futures markets - may not be familiar at all.

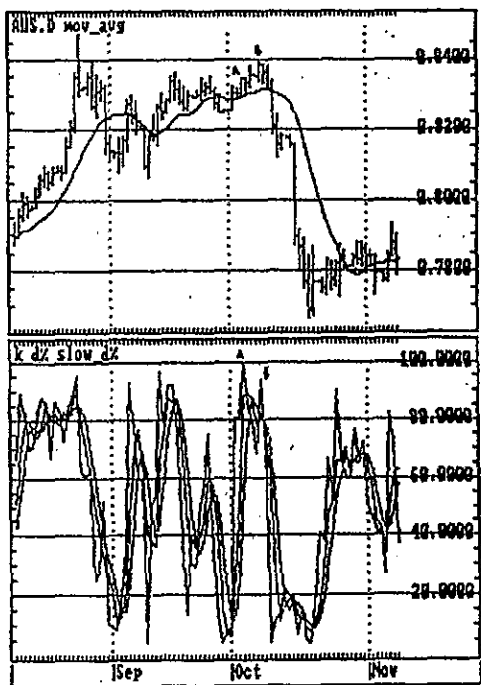
The situation has arrived where individual, private traders can have access to virtually whatever information they may require, on any market, anywhere in the world (almost). Previously, this was the domain of only brokers and banks.

Costs for this data, even live intra day data, have become extremely competitive. In some cases, the data is free. One no longer has to rely on the generosity of the broker to supply data and can maintain a greater independence in the mark

TECHNICALS W RN AUSTRALIAN DOLLAR

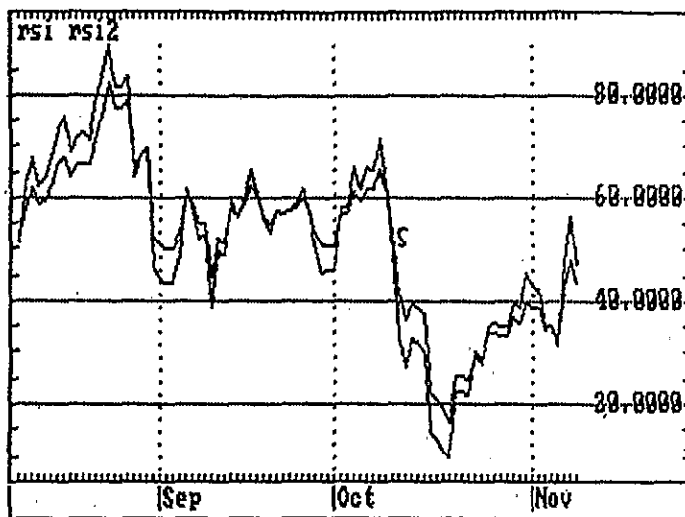
The technical indicators turned bearish on the Australian Dollar (AUD/USD) one week prior to the final easing of monetary policy and Reserve Bank selling. This occurred on Monday morning, October 15, instigating a week of bearish sentiment and a fall of approximately 5 cents. Let's look at the lead-up to that Monday morning. From the daily bar chart displayed below, Graph 1, with moving average superimposed over price movements, we see a period of consolidation where the price movements hugged the moving average prior to the final sell signal S on October 9, prior to the intervention.

Graph 1/Graph 2, (Bar/moving average & Stochastics)



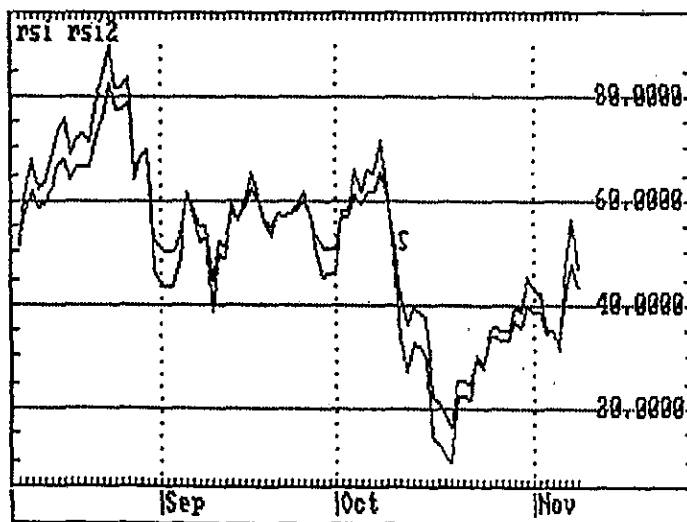
The Stochastics, see Graph 2, give us an excellent sell signal picking the top B beautifully. The double peak, A-B coincides with price values A & B on October 3 and 8 respectively from Graph 1. Divergence had occurred with higher price tops and lower stochastic peaks. This picked the absolute top however one bearish indicator is not enough for one to induce a trade. A closer examination of the RSI's, Graph 3, shows a crossing or passing over of the faster RSI 1 to the slower RSI 2 (at point S), downwards.

Graph 3 (RSI)



This is a relatively fair sell signal but because of its magnitude being in the 50 % proximity, not an overly strong one. Further, that that would have given one good reason to sell is the downturn in both spread and momentum at S. Refer Graph 4 below. These indicators, when coincide, instigate some of the most powerful bull and/or bear runs.

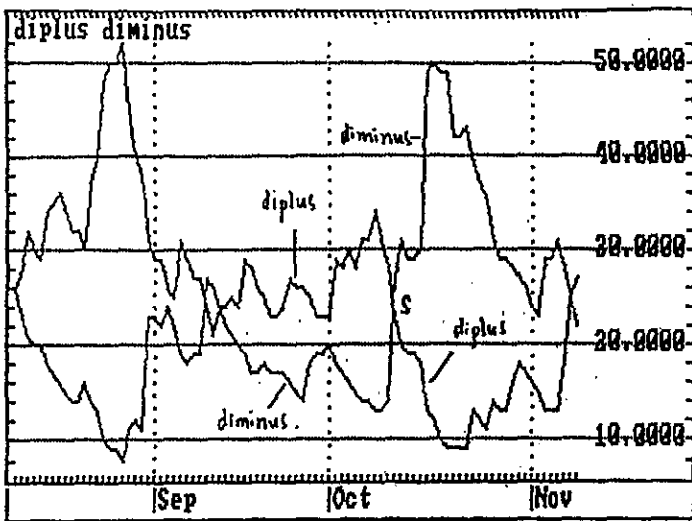
Graph 4 (Spread/momentum)



Finally, a confirmation comes from the directional movement indices Diplus and Diminus. These signal a bullish directional movement when Diplus crosses above the Diminus and a bearish directional movement when the Diminus climbs above the Diplus index.

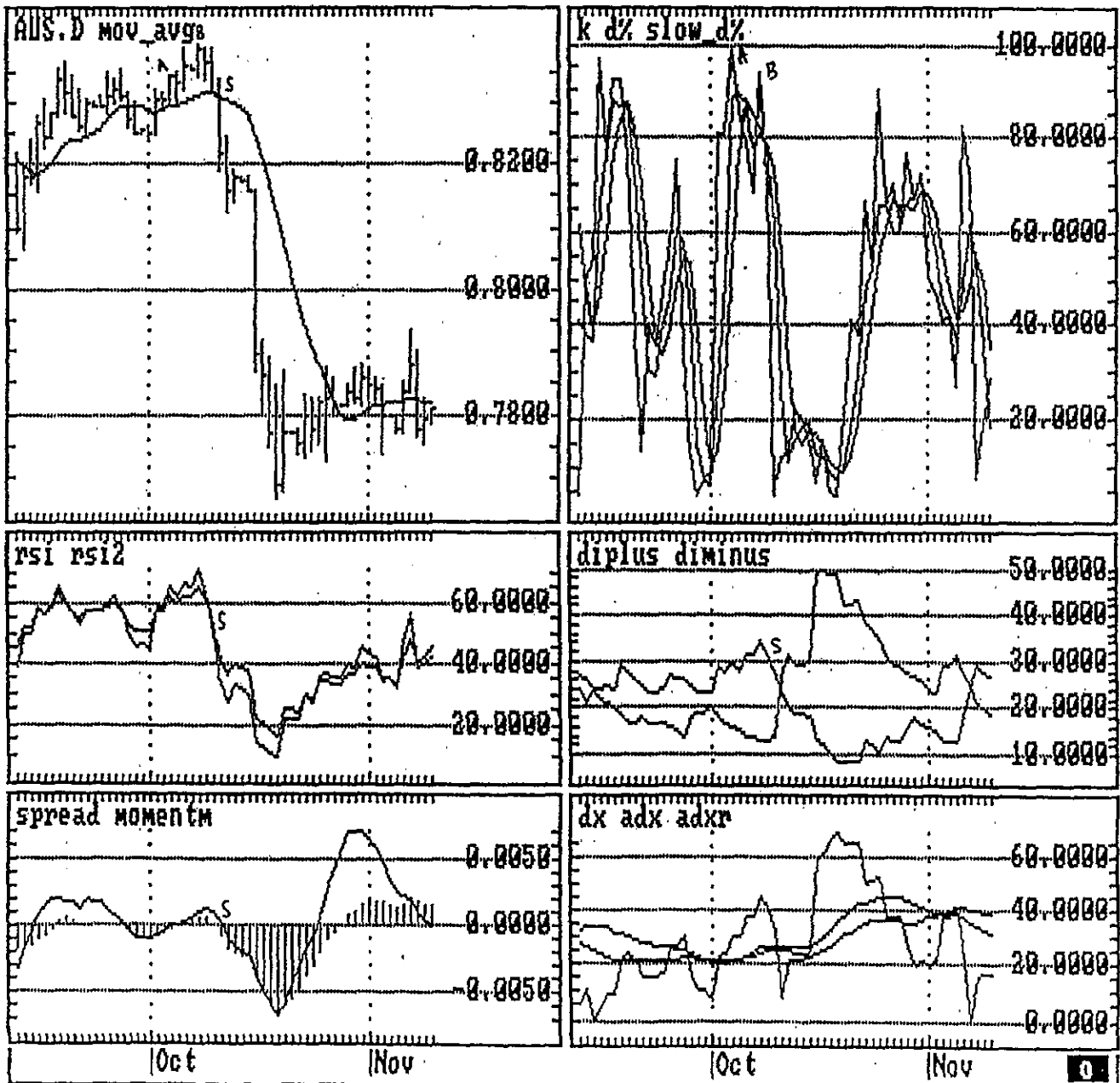
See Graph 5 over .

Graph 5 (Diplus/Diminus)



Based on the above examination of the daily price movements of the Australian Dollar, it favours a short AUD/USD position prior to the final easing of interest rates and central bank Australian Dollar selling. Moreover the opportunity cost from the initial sell signal prior to the intervention was 2 cents.

Charles ALEXIOU National Australia Bank Sydney



SHEER LUNACY.

I was first exposed to the concept, or should it be the really absurd concept, of a correlation of the phases of the moon and the financial markets back in 1981 when I read Larry Williams' book "How I Made One Million Dollars ...Last Year ...Trading Commodities" (Windsor Books, P.O. Box 280, Brightwaters, N.Y. 11718, U.S.A.).

Now I know what you are thinking! What is this person talking, or writing, about? The moon and the honourable financial markets? Next we will be told to look up our daily horoscope to divine whether we should be buying or selling the Australian Dollar, or our stock portfolio! What rot!!! What would my Treasurer say? And to add insult to injury, we have just paid One Hundred Dollars to join!

One major asset of a Technical Analyst is to have an "open mind". In this fashion, one can investigate whether there is any possible foundation for using a form of analysis that can only be described as belonging in the "esoteric" section of available technical analysis tools.

Over sixty years ago, a small tome appeared in the U.S.A. titled "The Great Wheat Secret" and sold for the then hefty price of Thirty Dollars. The work provided a methodology for trading the grain markets based to the Full Moon and the New Moon. At the time, not dissimilar to now, the concept was largely derided.

The point here is not that there is necessarily a causal relationship between the phases of the moon and the various markets, but rather that there may be a synchronicity between the two.

After all, the moon cycle is an extremely powerful natural cycle of 27 days, 7 hours, 43.25 minutes, but say 28 days. It may well be that the markets also exhibit a "regular" twenty-eight day cycle.

A line that I have used in many of my courses is that "half of the world have known about such a cycle since the beginning of time".

As a speculator (Latin for observer), I have over the years plotted the full moon and new moon phases on literally scores of charts and have seen how, almost uncannily, those days have coincided with many turning points in the markets. The phases of the moon may not have always marked the exact day of a high or a low, but are extremely often within one or two days of the final high or low.

This seems to be far more than mere random chance, especially when one can plot these potential turning points days months in advance.

But how on earth (excuse the pun) can this be of benefit in actually trading a market, or even calling a market turn I hear

you ask?

Well, the answer is quiet simple. By studying the various markets you can determine whether a Full Moon is bullish or bearish for a particular market - be it the stockmarket, the gold market, the grain market, the interest rate market or even the currency market.

Armed with this information, you may choose to assign a higher money management weighting to a trading signal generated by your system or other tools from the arsenal of Technical Analysis when they coincide with the appropriate phase of the moon, or even design a stand-alone trading system based on the phases of the moon, or simply dismiss this concept entirely.

The Full Moon has been found to be Bullish for the Stockmarket and Bearish for the Gold market! Have a look at your own charts to see whether the statement has any validity, or is based on superstition.

On the Australian Dollar versus US Dollar futures chart (IMM) overleaf, I have plotted the Full (Arrow down - sell) and the New (Arrow up - buy) Moon phases.

At first glance some seem to mark the exact turning day, others are within one or two days from a turn and others are nowhere near it.

Based on selling on the close on the day of the Full Moon and then reversing to long on the close of the day of the New Moon, a true stop and reverse system, the results are tabulated below:

WINNING TRADES - 8; LOSING TRADES - 8;
POINTS WON - 13.39;
POINTS LOST - 8.34;
NET PROFIT - 5.05 (US \$ 5,050);
AVERAGE GAIN - 1.67;
AVERAGE LOSS - 1.04.
GAIN/LOSS RATIO - 1.61

Obviously this is an hypothetical example of applying this concept as a stand-alone system. As such, slippage, margin calls and brokerage have not been factored into the result. No rules, other than to buy/ sell on the close of the appropriate moon phase day, have been used.

By way of a simplistic comparison, the most profitable moving average that I could find, using the price penetration approach, produced the following results:

WINNING TRADES - 13; LOSING TRADES - 24;
NET LOSS - 0.42 POINTS

THIS WAS A 7 DAY EXPONENTIAL MOVING AVERAGE

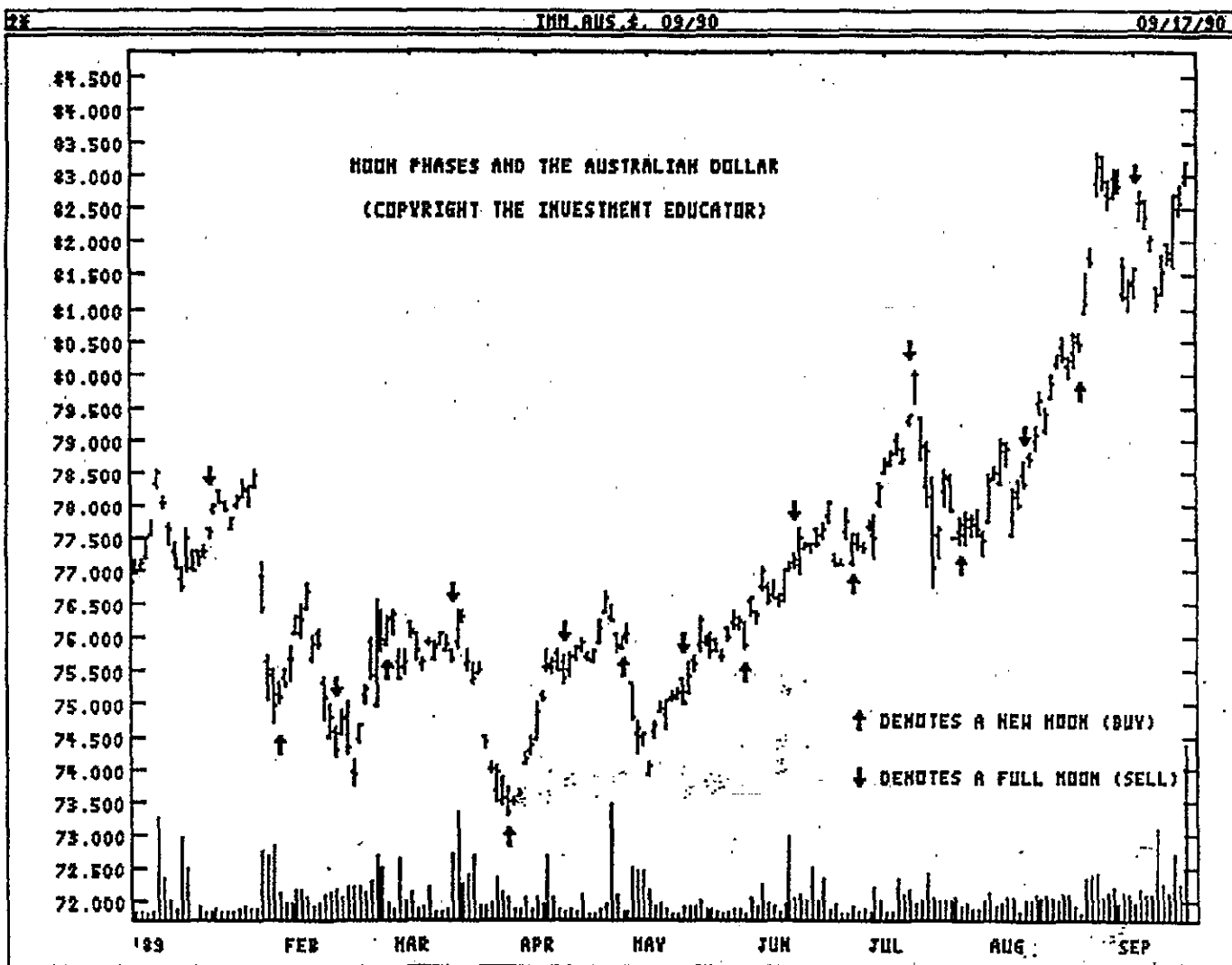
This is but the tip of the iceberg! The esoteric concept is being used today by traders around the world - even here in Sydney. Some of my previous students have developed their own trading rules around the phases of the moon and are doing very nicely.

Lunar eclipses and solar eclipses also play a role in heralding in a change of price direction in various markets. How many of you recall the secondary top made in the D.J.I.A. on October 6, 1987? It was on no less than a lunar eclipse.

The extreme low of the bear market in the US T-Bond market in 1984 was marked by, and commented on by many eminent financial journalists, a solar eclipse.

The purpose of this article has been not to put Technical Analysis into disrepute, but rather to illustrate that there may be other areas of research that you, as analysts and traders, can explore.

OR MAYBE, IT IS SHEER LUNACY!.....OR
MAYBE NOT?



N.B If you have actually read to the end of this article, I have a question for you. What were the phases of the moon on October 4 and October 18 of this year? October 4 was a *Full Moon* - a *Bearish omen* - just two days before the *Top* whilst the exact day of the *Low*, October 18, was accompanied by a *Bullish New Moon*!! (Notch up another 5.82 cents profit.)

ADJUSTING SHARE PRICE FILES FOR RIGHTS ISSUES OR...Are you losing your support and resistance?

It is generally agreed that when a company makes a pro rata issue of shares, technical analysts need to adjust the file of previous prices and volumes so that the past data is compatible with the present data. Although this seems straight forward enough, it is not as simple as it seems if the analyst is to maintain the integrity and quality of his charting.

There is a considerable body of literature indicating that it is sufficient to merely adjust the scale on the chart. This was perhaps appropriate in the days before computers, where there was simply not enough time to make accurate adjustments. However, any competent analyst saw this as a compromise between convenience and integrity of data. The best analysts made the time to adjust the chart data properly.

Once the computer was with us, the issue ceased to be one of convenience, as it was now quick and easy to massage large amounts of price and volume data. However analysts need to be constantly aware of the "garbage in, garbage out" syndrome.

Even today there are some analysts who do not adjust their computer files for issues that are small or are made close to the market price. This is sloppy practice, because although the pre and post issue data on the chart appear to join almost seamlessly, it overlooks the effect of the issue on price action at other points in the history file. The critical importance of this lies in identifying congestion areas that constitute either support or resistance zones.

For some time, I have been concerned about the way the Australian Stock Exchange, and hence data suppliers, adjust history prices for pro rata cash issues. Although we should be careful to make proper adjustments as they occur, when buying historical data we need to understand whether the data file being purchased has been correctly adjusted for previous issues.

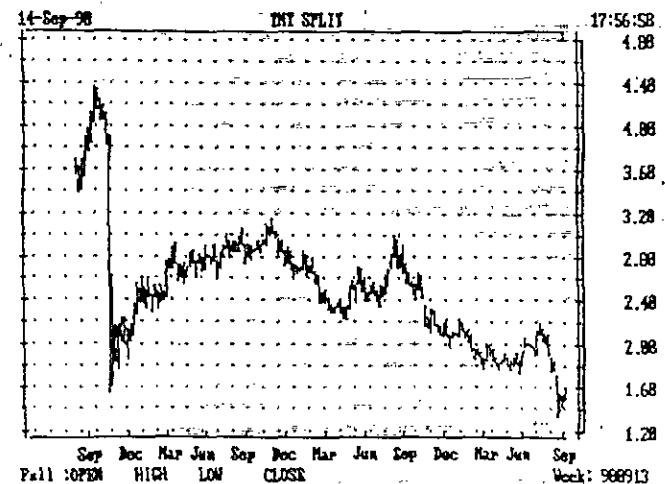
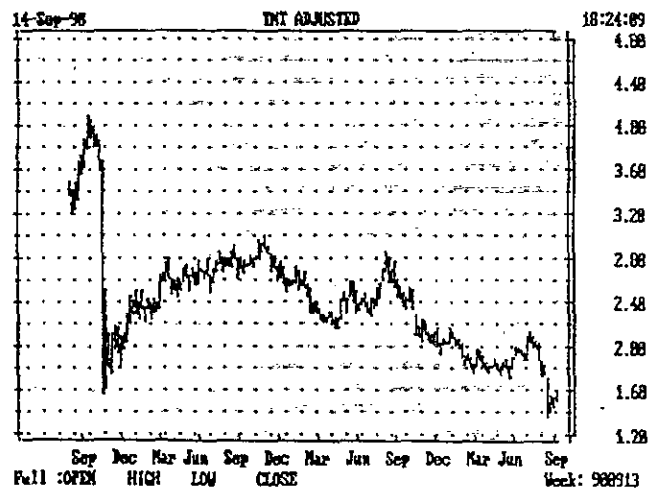
The Australian Stock Exchange seems to adjust historical data using a dilution factor which is applied across the entire file and a new factor is established each time an issue is made. There is no problem with the logic of this procedure if the pro rata issue is a bonus issue or stock split. However, it is very dangerous if used for pro rata cash issues.

Most of my analysis is done using CompuTrac software. CompuTrac indicates that all issues can be adjusted using the procedure for stock splits. Most of my purchased data is from Research Technology and, as far as I can determine, they follow the stock split procedure used by the ASX and CompuTrac.

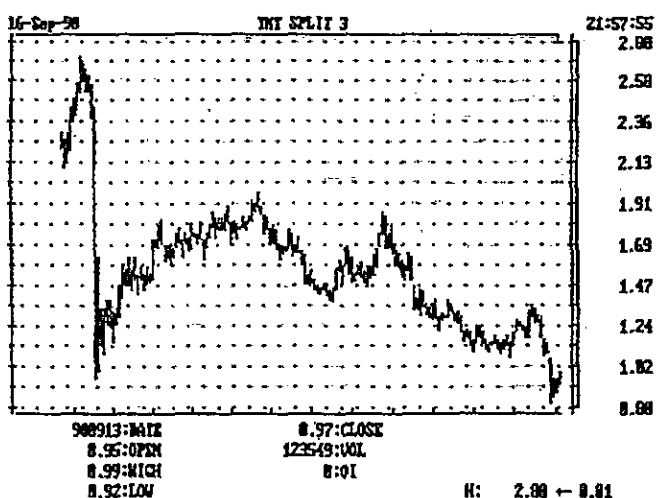
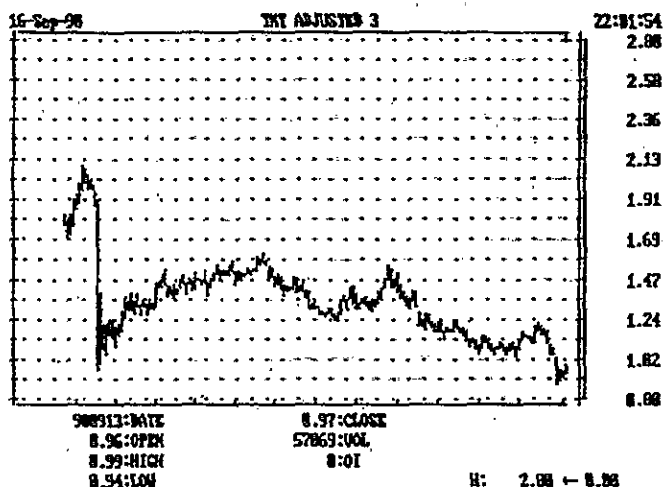
After using the CompuTrac method for some time, I became concerned that what should have been support and

resistance levels seemed less effective than previously when I had maintained charts manually. While it was possible there had been a change in the internal structure of the market, I was reluctant to assume this when it had been valid for decades through all sorts of markets here and overseas. I soon noticed that shares making frequent issues were the least reliable. After reflecting that issues confuse investors as to true average cost, I started to look into how an investor would properly determine his average cost and from there it was blindingly obvious that the problem lay in incorrect adjustment of the data used to draw the charts. Since then, I have been quietly doing the calculations correctly and have had considerable success in obtaining charts with accurately positioned support and resistance levels.

To demonstrate what a difference the two methods make, I have constructed two charts using TNT as an example. Both charts have been adjusted for a theoretical issue of 1 for 2 at 50c. Chart TNT SPLIT has been adjusted using the CompuTrac stock split function. Chart TNT ADJUSTED has been adjusted using the actual cost method (see below). Note the different positioning of the price action in the various congestion areas and at the three distinct highs on the charts.



Naturally, the closer the price is to the level at which the adjustment is made, the less the difference. The amount of difference is also affected by the terms of the issue. Moreover, the differences are further compounded over time as various issues are made by a company. It is common in Australia for companies to make frequent rights issues. To demonstrate the compounding effect of several issues, I have adjusted the TNT charts for two further 1 for 2 at 50c issues. The chart TNT SPLIT 3 shows the resulting chart using the stock split method. TNT ADJUSTED 3 shows the effect of using the actual cost method. Again, note the difference in positioning of the congestion areas and of the three highs.



The following is a detailed explanation of the concept:

1. Data

Take a stock currently selling at 10.00

The highest price on file is 20.00

The lowest price on file is 5.00

A pro rata cash issue is made: 1 for 5 at \$7.00

2. Stock Split Method (ASX/Computrac)

Take the pre-issue price of 10.00

Calculate the "ex" price 5 shares at \$10 50.00
+ 1 share at \$7 7.00

Cost of 6 shares \$ 57.00

Average cost each (The "ex" price in theory) \$9.50

Calculate the implied stock split factor

Old price 10.00

New price 9.50

Ratio (Old/New) 1.052632

That is, to achieve the New price a stock split of 1.05 for 1 is implied.

All the prices on file are then adjusted by dividing them by the split factor. If we take the ranges assumed in our Data above:

Highest price on file 20.00
Divided by Split factor 19.00
Lowest price on file 5.00
Divided by Split factor 4.75

3. Actual Cost Method

Here we do the calculation an actual investor who purchased at each price level would make:

Current price: For each 5 shares his cost is 5 x 10 50.00

He must take up 1 more share at \$7 7.00

His total cost for 6 shares 57.00

His average cost is 9.50

Note: For the Current price, the adjusted price is the same on both methods.

Highest price: For each 5 shares his cost is 5 x 20 100.00

He must take up 1 more share at \$7 7.00

His total cost for 6 shares 107.00

His average cost is 17.83

Lowest price: For each 5 shares his cost is 5 x 5 25.00

He must take up 1 more share at \$7 7.00

His total cost for 6 shares 32.00

His average cost is 5.33

4. Comparison

Stock Cost	Actual Method	Split Method
Current price (\$10.00)	9.50	9.50
Highest price (\$20.00)	19.00	17.83
Lowest Price (\$5.00)	4.75	5.33

5. Discussion

The Stock Split method has the advantage of being simple. However the actual calculation of average cost made by each investor is as shown in the Actual Cost Method.

Is this important to the analyst?

Yes. To understand why, we need to look at investor psychology. It is generally agreed that the psychological explanation of support and resistance levels rests on the urge to get out square from a loss situation or to buy at a missed opportunity price if it occurs again.

Thus to take the Data above, consider an investor who bought at the highest price of \$20. He now sees the price at \$10. Suppose he takes up the issue. His average cost is now \$17.83. Should the price return to \$17.83, he will be tempted to sell out and get his money back. Hence if there are many like him, \$17.83 will be a resistance level. If the Actual Cost method has been used to adjust the data file for the share issue, a chart drawn from it will show the resistance level in the correct place. However, if the data file has been adjusted using the stock split method, the analyst would have been looking for the resistance level at \$19.00.

The same reasoning applied to an investor who failed to buy at the opportunity level of \$5.00 would show that the support level will be at \$5.33. However, using the stock split method, an analyst would be looking for the support at \$4.75.

6. What can be done?

What I do is to export the data files to a spreadsheet, where I adjust them using the Actual Cost Method. I then import the file back into Computrac for analysis.

I am not aware of any other Technical Analysis software that allows the adjustment to be done correctly. Does any member know of one?

Also, does any member know of a data supplier who produces correctly adjusted history files?

Perhaps one thing the ATAA could work towards is encouraging software and data suppliers to provide properly adjusted price data.

COLIN NICHOLSON Sydney September 1990

A PARTING NOTE:

As the year is drawing to a close, the time has come to start planning for the new year. Some of the proposed regular features for this newsletter next year will be:

1. A section devoted to quotes and articles attributed to members of the ATAA that appear in the media - be it in a newspaper, a magazine or interviews on radio or television;

As you can imagine, this is a rather ambitious task that will need the support and backing of our members. However, it will serve *the aim of raising the profile of Technical Analysis in Australia.*

2. Faced with a financial industry that is going through a

time of contraction, a new section that will deal with employment opportunities for Technical Analysts may not go astray. This is not meant to be a formal placement service, but rather a service to both our members as well as the financial industry.

Again, this can only be achieved with the *cooperation and the assistance* of all concerned - you and the potential employers.

I look forward to your response - support, enthusiasm, criticism - on the concepts outlined above. There are many tasks at hand can only proceed with the assistance of you - members of the ATAA.

ON THE INTERNATIONAL FRONT:

The main story in this section surely has to be the fact that the *International Federation of Technical Analysts, Inc.* is looking to Australia as the venue for the *1997 Annual Conference!!* This is both a great compliment for such a young organisation as the ATAA, as well as an immense challenge. As this situation develops you will be kept informed through this newsletter and through direct contact.

Secondly, the *Market Technicians Association, Inc.*, of New York, have started a programme of videotaping their monthly meetings. This is then broadcast via satellite on FNN Pro, a subscription business television channel. I am currently in the process of endeavouring to get a copy of the first two tapes for viewing in Australia.

The first tape features *Mr. Steven Nison*, Secretary of the MTA, as well as VP Technical Analyst/Option Strategist for Merrill Lynch in New York. *Mr. Jack Schwager*, Director of Futures Research and Trading Strategy at Prudential Bache Securities Inc. in New York and acclaimed author of "*Market*

Wizards" and "*A Complete Guide to the Futures Markets*", is on the second tape.

Once these tapes have been received and converted for viewing on Australian television sets, we shall make them available to you.

Finally, it is rather pleasing to see, especially for myself as a professional Educator, that the trend is continuing in the U.S.A. of *presenting Technical Analysis at the University level*. The latest University to do this is the *University of Virginia*. It may take a while, but I am confident that this will be (*eventually*) the situation in Australia as well!

Finally, I trust that you like the new format and presentation of this newsletter. This is totally due to the *immense efforts*, not to mention *the know-how*, of *Steven Mutch*.

Congratulations & thank you Steven!