



Brainy's Articles on Technical Analysis

Pulling it all together

Article No:
TA-1110
page 1 of 5
July 2014

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is free*

**Share market price charts summarise the
underlying opinions and emotions of the market participants.**

Every chart tells a story.

It pays to understand the stories in the price charts.

Introduction

In all reality, it is one thing to study the subject of technical analysis, but it is something else again to be able to put it into effective practise. It is not that easy because the subject itself is rather broad, and covers many different aspects. And to use it successfully, we don't have to master the entire subject. Provided we are aware of the broad subject, and are confident with just some of the detail, we can use technical analysis successfully.

So, the \$64,000 question is: *"In practise, how do we use technical analysis?"* Or, to put it another way: *"How to pull it all together?"*

This eBook (PDF) article in Brainy's series on Technical Analysis, **TA-1110, "Pulling it all together"**, provides some sound tips to explain how to get moving, and how to put it into practise. And this is even while you are learning more about it, and "practising on the job".

The other thing to point out is that technical analysis is all about analysing the markets. The process of investing or trading in the markets is actually something different, but closely related because one leads to the other. The material below talks about technical analysis and how to pull it together, and then briefly introduces the related topics that are more to do with investing and trading (the buying and selling). Readers are also encouraged to seek further information on this topic.

It should be noted that in the material here we talk about shares in the share market; but the principles and ideas here can apply equally as well to other financial markets and products.

The reality — practise, practise, and more practise

To become both confident and competent with using technical analysis, one needs to learn about the subject, but to also practise the knowledge and skill in real life. This means grabbing a price chart, and performing some analysis, and making notes about the analysis, and then revisiting the analysis at a later date to determine the accuracy of the analysis.

We could dig out some old charts, and hide the price action from a certain date, and then analyse the remaining visible chart features. In this case we have to make sure we don't cheat and analyse the chart knowing about the price action that we have hidden.

For example, the weekly candlestick price chart of BHP in Figure 1 at right, with price action from mid-February 2014 hidden, shows a horizontal Resistance level at about \$38, which appears to have been overcome with a Big White candle (the last candle visible on this chart), and on reasonable volume.

So many traders would have bought in the following week. With hindsight, would this have been a good decision? See the next chart below to see the subsequent price action.

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Figure 1: Hide the price action

* — Brainy's eBook (PDF) Articles are only available to **Share Market Toolbox** members. Visit www.robertbrain.com/articles/ for more information.

The first page of every article is free, and some of the articles are completely free (eg. shorter ones and Table of Contents).



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In the price chart in Figure 1 above, we used the BullCharts "Training Mode" tool to hide the price action from mid-February onwards. If we now reveal the subsequent price action as in Figure 2 at right, we can see that the price action above the \$38 resistance level discussed above was a false break (a bull trap). The share price fell and continued to trade in the trading range that has been evident on the chart since late 2011 (it pays to zoom the chart because the market is like an elephant).

These two price charts demonstrate the usefulness of being able to take a past chart, and hide the price action from a date before doing the analysis. The difficulty is that you need to ignore what you might have seen in the chart before hiding the recent price action.

The alternative to this approach of studying past price action is to pull up today's chart, and have a look at the history up until today, then perform and

record the analysis, and wait a few days or weeks to see what actually transpired. This approach will drag out the time it takes to perform the analysis, and then evaluate the accuracy of the analysis.

Whichever of these methods you choose, you will need a way to make notes, and to keep your analysis notes for future reference and evaluation. Included below are some tips for this.

Can we be 100% correct?

Can we be 100 percent right with our analysis? The short answer to this question is: **absolutely not!**

This is one thing that we all need to understand very clearly. No one can invest in the markets with a track record of 100 percent accuracy for picking winners. There will be some decisions that are just wrong. This is a part of the game.

Technical analysis is about looking for the probabilities, and investing with sound risk management principles to minimise the risks. So some of our analysis will prove to be wrong with hindsight. This is not too important.

What is important is that we can be correct enough of the time so that enough of our investment positions can be winners, and coupled with effective risk management if we can minimise the losses, then we can still be in front with our investing. The smaller the losses compared with the larger wins, the bigger the overall gains.

Emotion! — get on top of it!

In case we forget to mention it elsewhere, it needs to be stated that successful investors and traders tend to find that a good understanding of financial market psychology, and cognitive biases, is very beneficial. This is because it helps to be in control of both our own emotions and to have an understanding of the emotions of others that are reflected in the price charts.

Readers are strongly encouraged to seek more information on this topic as it is often overlooked; but it is so important and useful. At least take a look at eBook (PDF) Article **ST-2120, "Psychology and emotions"**.



Figure 2: Reveal the price action



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Doing the analysis

When studying share market price charts, we will often want to record our observations and analysis directly on the price chart. We might want to apply what we call *line studies* to the chart, or make an annotation on the chart (eg. circles, arrows, comments). We can accumulate a number of charts with annotations and comments on the computer, and review them from time to time, and we could print out a chart with annotations for easy future reference. After a period of time we might accumulate quite a pile of printed charts.

The chart annotations, line studies and comments that we apply to a chart during our analysis could be any of the following (see the simple example in Figure 3 below):

- Place an uptrend line under the price action, or a downtrend line above the price action.
- Place a horizontal line across a portion of the chart under price action to indicate a *support* level, or above price action to indicate a *resistance* level.
- Place a straight line on an angle across a portion of the chart to indicate the extremes of price movement up and down the chart. Two of these straight lines on either side of the price action (one above and one below) could help to identify a chart pattern (eg. a triangle, wedge, etc.).
- Place a circle around a swing high or low to indicate a turning point that might be significant for a Double Top or Double Bottom pattern, or for a Head and Shoulders pattern.
- Note the swings of a Moving Average (MA) indicator, and apply a note at key points such as when the price crosses the MA, or the MA turns from up to down or vice versa.
- Place a circle around one or more candlesticks on the chart to highlight something significant.
- Add a measuring tool to the chart to measure the price change, or amount of time, between two significant points.
- Add any number of chart tools to the chart to indicate a key feature, or search for a possible price level or time period.
- Add a zig-zag line to the chart to indicate the cyclical up and down price movements that might constitute the legs of an Elliott Wave pattern.
- Place a text comment on the chart adjacent to any of the above to record our thoughts about the current observation, or of the possible outcomes that might unfold.

In making annotations on the chart, we might be drawing conclusions about whether the stock is now, or soon might be, a candidate to buy. Or perhaps a short-sell opportunity.

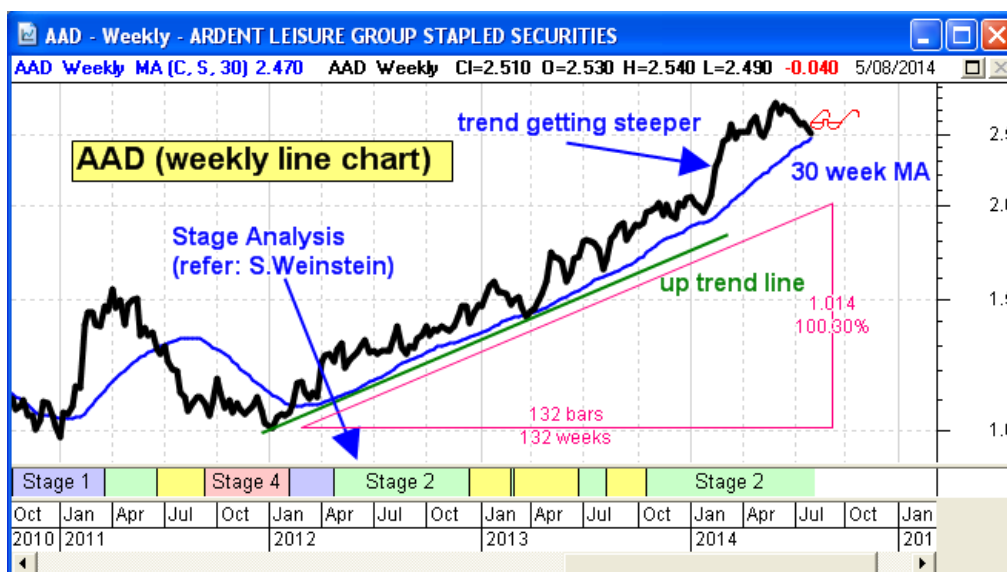


Figure 3: Simplistic example of chart annotations



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Recording the analysis

When we do the analysis, we mentioned above that there are two obvious ways to record the details:

- Print a price chart, and then draw our line studies and write our analysis on the printed page; and/or
- Use a software tool to display the price chart on the computer screen, and add our line studies and analysis details to the on-screen chart. We could subsequently print the chart complete with annotations, and put it aside for future reference.

With different software charting tools there are different ways to record annotations and comments on a price chart. The BullCharts charting and technical analysis software package is one tool that can be used for this purpose. Refer to Brainy's eBook PDF Article on BullCharts, **BC-07-910**, "**Saving chart details and annotations**", for further details.

If we start accumulating printed price charts with annotations, then we will need to be able to file them somehow — perhaps in a loose-leaf binder, and sorted by stock code (eg. BHP charts, then CBA, then NAB, then Westpac, Woodside, etc.). So give some thought to this aspect as well.

Making decisions with a strategy

In order to make good buy/sell decisions, we need to have a sound strategy for identifying candidate stocks, and for use as a **buy trigger**, as well as an **exit strategy**. A written **Trading Plan** and/or **Trading Strategy** is a must for those who don't have thousands of hours of experience. The very experienced investors/traders might be able to get away with **discretionary trading**, and with no written plan; but everyone else can benefit from a written plan.

And a sound strategy ought to be tested before being used — either **back-tested** or **paper-traded**. If the strategy proves successful, then we could have a high degree of confidence that the strategy ought to be profitable. Without confidence in the strategy, it will only take 3 or 4 consecutive losses to induce great fear and doubt in the strategy, and smash your confidence.

Your strategy might also make use of a **Position Size Calculator** to help determine an optimum position size.

Recording the buy and sell transactions

How should we record the details of each buy/sell transaction? Whether it is back-testing, or paper trading, or real live trading, we need to be able to keep relevant records both for tax purposes, and also so that we can step back later and evaluate how well, or how poorly, we have done. We might need to make some revisions to our overall approach or strategy, or to our understanding and interpretation of the analyses.

Many investors/traders keep at least the following records:

- **Trading Diary** — A record of "things" that happen on the day. This can include an observation and opinion about the market(s), snippets of relevant news, or an observation about one's own emotional state (because emotion is important in this game).
- **Trading Journal** — A record of the buy/sell transactions.

Readers can review eBook Article **ST-5210**, "**Trading Journal and Trading Diary**" for details and samples.



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Managing the risk

An essential element of the total equation is to use an effective **money management** and **risk management** strategy.

It is very useful to have a clear idea of how large a portion of our capital to invest in any one position, and how much of our capital is to be put "at risk". Also, some pre-thought for managing the black swan events — eg. what will we do if another bear market phase starts? or if world war three breaks out. But what if something simple happens and we want to close a position but we don't have our computer handy (perhaps it broke, or was stolen, or we are away on holidays)?

For further information on this topic, readers should refer to the collection of eBook Articles that are numbered ST-4xxx, and include titles such as: **ST-4000, "Risk and Management"**, **ST-4024, "How to reduce risk"**, **ST-4100, "The 2 Percent Rule"**, **ST-4300, "Risk and Reward"**, and others.

Summary

One very important ingredient in this mix is to perform some technical analysis on real charts, and keep notes for future review to help fine tune your ongoing learning. This author has been using BullCharts software for this since 2005¹.

In this article in Brainy's series on Technical Analysis (TA-1110) we have provided some tips and food for thought on how to implement the things that we are learning about technical analysis. And we have made mention of a number of tools and documents that people find useful.

Readers should also refer to other eBook (PDF) articles, including those mentioned in the article above, and also in particular the following:-

- **TA-1100, "Beginners start here";**
- **TA-2000, "Technical analysis introduction";**
- **BC-07-910, "Saving chart details and annotations";**
- **ST-2120, "Psychology and emotions";**
- **ST-24xx**, for articles on trading styles, plans and strategies;
- **ST-3100, "Trading Practise (back test, paper trade);**
- **ST-3200, "Capital protection";**
- **ST-4000, "Risk and money management";**
- **ST-4xxx**, for articles on the topic of risk and money management.



For more information on Share Trading, or
Technical Analysis, or BullCharts,
look for more of Brainy's articles, or the other resources, in
* **Brainy's Share Market Toolbox:** www.robertbrain.com

Your own notes and comments:

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1 Declaration — Robert Brain is an authorised reseller of BullCharts software, and the convenor moderator of the Australian BullCharts User Group.