



Brainy's Articles on Technical Analysis

Indicators and Tools for Stops

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Introduction

One of the dilemmas for traders is to determine where the *Initial Stop* should be placed when a position is opened. Another dilemma is how to place the *Trailing Stop* to protect profits as the trade moves favourably. And yet another dilemma is how to implement the stop — by placing a conditional sell order in the market for immediate execution when the stop level is reached, or by manually placing a sell order in the market on the following day.

One important thing for the new trader to understand is that there is not one single right answer to this dilemma. There are a number of right answers, some of which could apply to one trader and not to another. And they can depend on a whole lot of different things, such as the trader's risk tolerance, investment horizon, aggressiveness, and so on. A lot of text books have been written exploring this topic.

The theory behind how to calculate a *stop loss* level is really a topic for a Share Trading article, and not in Brainy's series on Technical Analysis. However, there are some ways to determine a stop level based on technical analysis which can be explored here.

This article in Brainy's series on Technical Analysis (number TA-5100) provides an introduction to the topic of using either *chart indicators*, or *chart tools*, to determine *stop loss* levels. Some of these are explored in other Articles in Brainy's series on Technical Analysis.

It should also be mentioned here that Brainy's charting software package of choice is the Australian BullCharts software, so there is some reference below to relevant features in the BullCharts package.

Chart tools for stops

There are a number of technical analysis *chart tools* that could be used to assist with determining where to place a *stop loss* level — either for an *initial stop*, or for a *trailing stop*. These might be manually determined and placed on a price chart, or a charting software package might have them built-in.

The BullCharts charting software package includes the following tools which can be used for this purpose:

- Count Back Line
- Line segments to indicate levels of support and resistance.

Count Back Line

The Count Back Line (CBL) technique is one method that can be used to determine either an entry point, or an exit point, for either a long position, or short. (This volatility-based indicator was developed by Daryl Guppy.)

In the notes here we will only consider the *long position CBL for exit* to keep it simple and relevant to the topic of stops.

With reference to Figure 1 at right, note the following:

- The CBL is based on the most recent significant High (that white candle on 3 April).
- To determine the position of the "Long CBL Stop" line, you look back in time across the chart and down to the last Low price — in this case it is the



Figure 1: Count Back Line on BHP
for Long position stop.