Bargain buys?

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What the share price charts say for CBA, Woolworths, Telstra and Qantas.

By Robert Brain, ATAA

The concept of a trend is a very important charting principle. An uptrend is defined on the price chart as a series of higher peaks and higher troughs, and once a rising trend is in place it is considered to remain until confirmed to have finished. Hence the saying, "the trend is your friend". Once a trend is established, the statistical probability of it continuing is well proven.

A downtrend is a series of lower peaks and lower troughs on the price chart, also considered to be in place until confirmed to have finished. We should not be buying a share while the price is in a downtrend; often this would be buying on hope rather than evidence. Those with some wisdom might tell us to buy while it is cheap, but we need to understand that it might get even cheaper. There were many examples of this in 2008.

The four charts below of Commonwealth Bank, Woolworths, Telstra and Qantas Airways - some of market's most widely held shares - illustrate the concept of uptrends and downtrends. *(Editor's note: do not read the analysis below as recommendations. Do further research of your own or speak to a financial adviser).*

1. Commonwealth Bank (CBA)

Commonwealth Bank weekly line chart - September 2011 to 2012

*Source: © May 2012, Robert Brain, **Brainy's Share Market Toolbox***

Commonwealth Bank shares have been experiencing a nice uptrend from the lows of about $43 in September 2011. But don't forget they reached the $60 level twice in the past few years, in October-December 2007 before the GFC and again in April 2010.

On the weekly chart here (until May 18) CBA has been making a series of higher peaks (HP1, HP2) and higher troughs (HT1, HT2) and is therefore in an uptrend. One of the six tenets of Dow Theory basically says "a trend is a trend until it is not a trend". The chart shows the price has, in recent days, fallen below the rising (green) uptrend line, indicating the trend is weakening. However, provided it turns up to form a trough which is higher than the last one (HT2), the uptrend is still in place. If not, the uptrend has finished.

(Note that the weekly chart shows the closing price each week, all joined together with short straight-line segments, with no indication of the variation in price during each week.)

If we had invested in CBA in recent months, we could have looked to preserving our capital by using the stop-loss approach, by having a sell point just below each of the troughs; about $45.20 (at HT1 from November) and $48 (at HT2 in March 2012). We would raise our stop-loss up to the next dip when it occurs.

Using a stop-loss

The principle of the stop-loss is that we set a price level on the chart below which we believe the shares should not trade, or below which our loss will be more than we want to bear. If they trade below this level we should sell to limit any losses, lock in any profit, and preserve our investment capital.

One precaution we should take is to set the stop-loss a little below the obvious level. Many investors might choose the same price level for their stop, in which case we should have our own stop a few cents further down. Sometimes the price can spike low during the day or week to take out the obvious stop-loss positions, then return to a rising trend.

How do we determine a stop-loss level? There are many approaches within technical analysis theory, with one simple approach described in the text below

2. Woolworths (WOW)

Woolworths weekly line chart - 2000 to 2012

Source: © May 2012, Robert Brain, ***Brainy's Share Market Toolbox***

The Woolworths share price trended up from lows of around $5 in early 2000 and paused in a trading range around $11 to $13 for three years throughout 2002-2004, then rose to a peak of $34.85 in late 2007. The weekly chart shows this price action.

During the GFC in 2008, Woolworths shares fell from the $34.85 peak to $23.10, a loss of 33 per cent, which was not too bad considering many blue chips fared much worse over the same period. Since then Woolworths has traded sideways, mostly within the $25 to $30 band for the past four years.

In terms of capital, there has been no positive returns on the shares for four years, only the dividends.

Astute investors may have sold Woolworths on price weakness in 2008, and looked for shares with a greater chance of capital returns. We might have been able to invest our capital in another company with both dividends and a rising share price.

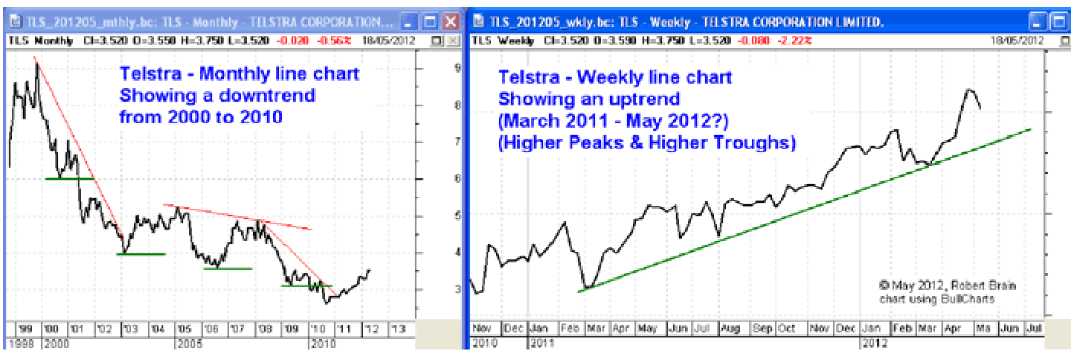
Should we consider investing in Woolworths now? Well, it has been showing an uptrend since late 2011, and if we zoom in and switch to a daily chart this would be easier to see. And remember, "the trend is your friend".

Note on the chart that when the price eventually rises to R3 at about $28, there will be a number of investors and traders who will want to sell out. Some people will have bought at this level in the past three or four years and will want to recover their capital before the shares fall again. The same is true at level R2 at $30, and the price peak R1 at about $35. That is, these three price levels will potentially be areas of resistance on the chart, with an excess of sellers causing a rising price to pause and possibly fall again.

If the price ever falls back below $23 (the horizontal green line), a downtrend might be confirmed, in which case we could put a last-resort stop-loss under this level to protect our investment capital from further falls.

3. Telstra Corporation (TLS)

Telstra weekly and monthly line charts
2000 to 2012



Source: © May 2012, Robert Brain, ***Brainy's Share Market Toolbox***

Monthly line charts are very useful to see the big picture and where the shares have come from. It shows the closing price at the end of each calendar month, all joined together with short straight-line segments and no indication of price variation during the month.

Telstra's monthly line chart shows a persistent downtrend from late 1999 until 2010, indicated with straight lines drawn above the price action (the downtrend line seems to act as a ceiling for the price). The slope of the line indicates the relative speed of the downtrend.

If we had considered buying Telstra during this downtrend in anticipation of a rising share price, we could have identified a stop-loss level below which the price should not trade. If it did, we could have sold to preserve our capital. The potential stop-loss levels are shown on the left-hand chart with short horizontal (green) lines).

For example, as Telstra's price fell and formed a lower trough in early 2003, we might have bought as the price rose to start a new rising trend in 2003-2004, with a stop-loss set just under $4 (the last trough in early 2003).

This monthly chart is perhaps too much of the big picture to accurately determine the stop-loss levels in practise, but it illustrates the point. While Telstra's share price fell from the highs of 2000, it would have been difficult to maintain the value of our capital invested. Some people might have stuck it out to take the dividends. But if we do the sums we are likely to find that the amount of dividend income received in this period was less than the amount of capital lost.

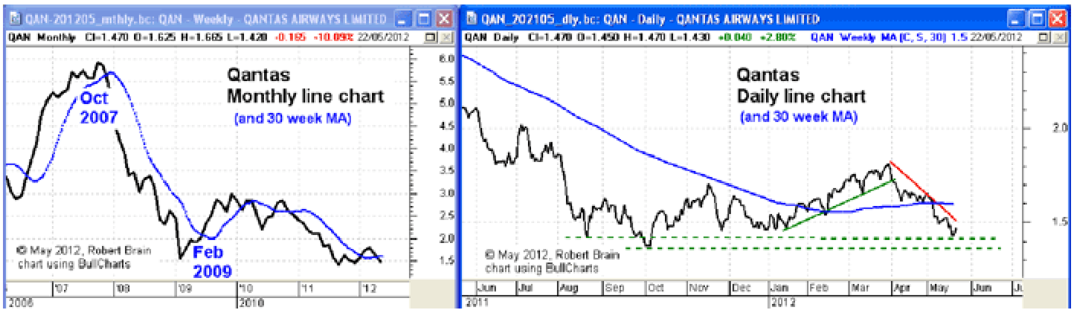
The right-hand chart below is a weekly chart showing the share price in an uptrend since the last low in March 2011 (which doesn't show up on the simpler monthly chart). The rising green line is the uptrend line showing the price falling back to touch it on three occasions.

Was it time to buy in 2011? The rising trend suggests so. Is it too late to buy? The weekly chart shows a good rising trend, but at the time of writing the price is a long way above the trend line. It would be prudent to wait for an anticipated retracement back towards the trend line before joining the trend.

If we were to buy Telstra we should identify a recent trough on the chart and use that as a basis to determine a stop-loss level, perhaps below the March trough of $3.20 (on the daily chart). As mentioned, there are many ways to determine where to place a stop-loss and the one described here is just one of them.

4. Qantas (QAN)

Qantas weekly and monthly line charts
2006 to 2012



*Source: © May 2012, Robert Brain, **Brainy's Share Market Toolbox***

The Qantas share price was around $6 in late 2007, then fell to a low of $1.40 in February-March 2009. It rose to around $3 in late 2009, then suffered a long-term sell-off to a low of $1.39 in September 2011. All this price action can be seen in the (left-hand) monthly price chart.

In the (right-hand) daily price chart we can see that Qantas traded mostly sideways for a few months in late 2011, then trended up from January 2012 to late March (the rising green uptrend line indicates the uptrend), before being sold off again through April and into May (with the falling red line indicating the downtrend). *(Editor's note: Qantas announced a significant profit downgrade in early June and its shares fell sharply on the news. The above share price charts, which are intended to show Qantas shares over several years, do not reflect price action in June. Readers are advised to consider the latest Qantas share price movements in the context of this long-term analysis.)*

On both charts the gently curving blue line is a 30-week Simple Moving Average (SMA), as per Stan Weinstein's strategy (refer to his classic text, Secrets for Profiting in Bull and Bear Markets, 1988). His view is that if the price is below the SMA and the SMA is heading down, we should avoid the shares. Conversely, if the price is above the SMA and the SMA is rising, we could consider investing in them.

Can we see any price levels at which the sentiment of buyers overpowered the sentiment of sellers? On the daily chart, the horizontal dotted lines indicate areas of possible price support where the buyers stepped in and took control on two occasions, to stop the price falling further. Going forward, this may or may not happen again.

Until the Qantas share price is showing a confirmed rising trend, it has an unappealing chart from a technical analyst's perspective. Remember that a downtrend is a downtrend until it is confirmed to have finished.

About the author

Robert Brain is a share trader and sharemarket analyst, and runs Brainy's Share Market Toolbox, a web-based business supporting investors and traders. He is a national director of the Australian Technical Analysts Association (ATAA) and vice-president of the Melbourne ATAA Chapter. He uses the Australian BullCharts software platform.
The Australian Technical Analysts Association is a not-for-profit group of people interested in the application of technical analysis. Many members operate their own SMSF, others are private traders/investors and others are professionals in the financial services industry. The **ATAA** has nine Chapters in capital cities and provincial centres.

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