ASX *Investor Update* Newsletter
Robert Brain's contribution for the ATAA
What are the charts telling us? — Four stocks analysed
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The material below was the basis of an article published for the ASX monthly *Investor Update* email newsletter in June 2012. This material contains some additional text; but the published article very closely resembles that below. Larger charts and more information are available from Robert's ***Share Market Toolbox*** web site: www.robertbrain.com/asx.

You can view the published article online here:
www.asx.com.au/resources/investor-update-newsletter/201206-bargain-buys.htm
and you can view the full June 2012 edition of the ASX *Investor Update* email here:
www.asx.com.au/resources/investor-update-newsletter/InvestorUpdate-20120612.htm

Of course, the ASX is always keen for more people to subscribe to their free MyASX service, and to elect to receive the monthly *Investor Update* email when it is published on the first Tuesday each month. For more details, see the MyASX web page here:
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About the material below

The article and information below is a simple analysis of four "Mum and Dad" stocks using technical analysis: Telstra (TLS), Commonwealth bank (CBA), Qantas (QAN) and Woolworths (WOW). The introduction section on the next page helps put this into a stark perspective.

The theme and key points for this article are:

- *Support* and *resistance* on price charts
- The notion of *trends*
- *Stop Loss* approach to preserve capital
- Useful to study two different time frames (eg. big picture on monthly chart, and a daily).

For more information about technical analysis, see Robert's Toolbox here:
www.robertbrain.com/technicalanalysis

All price chart below are produced using the Australian BullCharts charting software package, for which Robert is the convenor of the national User Group. See more details here:
www.robertbrain.com/bullcharts/index.html

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ASX Investor Update Newsletter

Technical Analysis — What are the charts telling us?

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What the charts say for: Commonwealth bank (CBA), Woolworths (WOW), Telstra (TLS) and Qantas (QAN).

Introduction

The day-to-day and week-to-week performance of companies in the share market depends on the underlying mood and sentiment of all the investors and traders who participate in the market. And this sentiment may, of course, be influenced by fundamental data. When a company's share price rockets upward, or dives downward, it is because enough of the market participants have a strong enough view of the stock, or of the market generally, to cause the share price to move.

The underlying sentiment of market participants is reflected in the share price charts, and in the volume bars on the chart, and in the relative height of candlesticks on a candle chart, and the presence and length of tails on the individual candlesticks. And successive days or weeks of price movement can form patterns on the chart which also reflect the underlying market sentiment.

It is the emotions of fear, greed and hope which drive share prices (in addition to fundamental data), all of which are reflected in the price charts. The field of Technical Analysis is the study and interpretation of the price action of financial instruments and the "statistical prediction" of future behaviour. In Technical Analysis there is a substantial body of knowledge ranging from price charts (described here) to complex mathematical and computer studies. In the case studies below we look at the key concepts of *trends*, *support/resistance*, and the capital protection tool known as the *Stop Loss*.

Trends

A company's share price fluctuates up and down as people's views change from a perspective of over-sold (i.e. cheap) to over-bought (i.e. expensive). Over time, we would all like the share price to tend to rise, resulting in an increase in our investment capital.

The concept of a *trend* is a very important principle in this regard. 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 it is 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.

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

Commonwealth Bank (CBA)

Commonwealth Bank shares have been experiencing a nice uptrend from the lows of about $43 in September 2011. But let's not forget that it reached the $60 level twice in the last few years — in October-December 2007 before the GFC, and again in April 2010.

On the weekly chart here (until 18 May) 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 that "a trend is a trend until it is not a trend". On this chart we can see that the price has, in recent days, fallen below the rising (green) uptrend line to indicate that the trend is weakening. However, provided it turns up to form a trough which is higher than the last one (HT2), then the uptrend is still in place. If not, then the uptrend has finished.

[Note that the weekly price chart shows the close price each week, all joined together with short straight-line segments, and with no indication of the variation in price during each week.]

If we had have invested in CBA in recent months, we could have looked to preserving our capital by utilising 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). And we would raise our Stop Loss up to the next dip when it occurs.

Commonwealth Bank (CBA) — September 2011 to 2012

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Stop Loss

The principle of the *Stop Loss* is that we identify a price level on the chart below which we believe the stock should not trade, or below which our loss will be more than we want to bear. If the stock does trade below this level, then we should sell the stock to limit any losses, lock in any profit that we might have earned, and to preserve our investment capital.

One precaution that we should take is to set our Stop Loss a little bit below the obvious Stop Loss 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, and then return to a rising trend.

How do we determine where to place our Stop Loss level? Within Technical Analysis theory there are many approaches for this, with only one simple approach described in the text below.

Woolworths (WOW)

The Woolworths share price trended up from lows of around $5 in early 2000, and paused in a trading range of about $11-$13 for 3 years throughout 2002-2004, then rose to a peak of $34.85 in late 2007. The weekly price chart shows this price action.

During the GFC in 2008, the Woolworths share price fell from the $34.85 peak to $23.10, a loss of only 33% which is not too bad considering many blue chip stocks fared much worse over the same period. Since then it has traded sideways, mostly within the band of $25 to $30 for the last 4 years. So, in terms of capital, there has been no positive returns on the stock in 4 years, only the dividends. Astute investors may have sold Woolworths on price weakness in 2008, and looked for a stock with a greater chance of capital returns. We might have been able to invest our capital in another stock with both dividends and an increasing share price, rather than a stock with just the dividends.

Should we consider investing in WOW now? Well, it is showing an uptrend since late 2011. If we zoom in and switch to a daily chart this would be easier to see. And remember that “the trend is your friend”.

On the chart, note 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 last 3 or 4 years, and will want to recover their capital before it falls 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 a potential 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), then 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.

Woolworths (WOW) — weekly chart, 2000 to 2012

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Telstra (TLS)

Monthly line charts of a stock are very useful to see the big picture and where the stock has come from. A monthly chart 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.

The monthly line chart of Telstra shows a persistent downtrend from late 1999 until 2010, indicated on the chart 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 have 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. And 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).

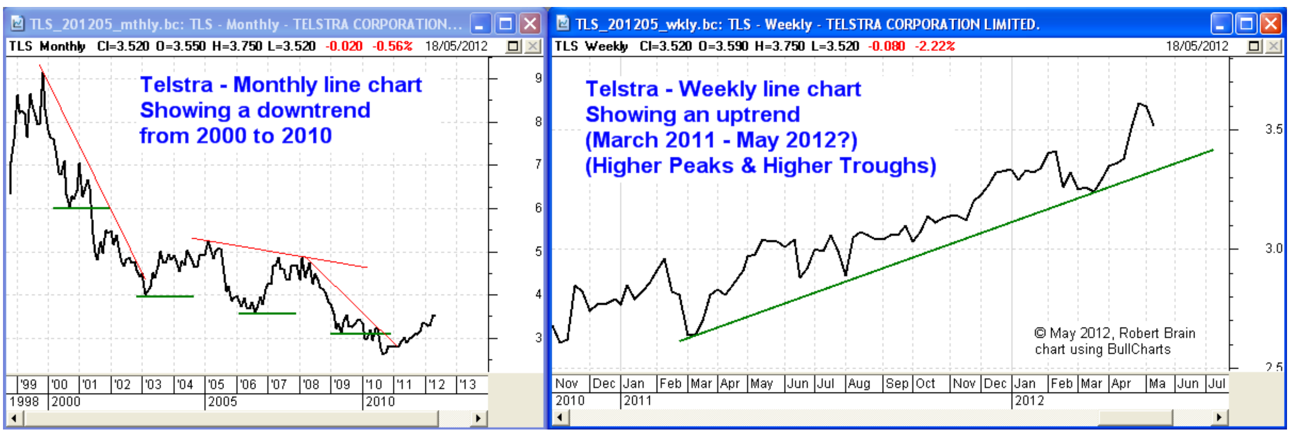
For example, as the Telstra price fell and formed a lower trough in early 2003, we might have bought as the price rose to start a new rising trend in 2003-2004, with a Stop Loss set just under the $4 level (the last trough in early 2003).

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 in the stock. Some people might have stuck it out in order 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 is less than the amount of capital that was lost.

The right-hand chart 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 we said above, there are many ways to determine where to place a Stop Loss, and the one described here is just one of them.

Telstra (TLS) — a monthly and a weekly chart



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Qantas (QAN)

The Qantas share price was around $6 in late 2007, then fell to a low of $1.40 in February-March 2009. It then rose to around $3 in late 2009, and 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).

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, then we should avoid the stock. Conversely, if the price is above the SMA and the SMA is rising, then we could consider being invested in the stock.

Can we see any price levels at which the sentiment of buyers over-powered 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 is dangerous to invest — risking a loss of investment capital. Remember that a downtrend is a downtrend until it is confirmed to have finished.

Based on all the historical price action shown here, Qantas cannot be a long-term buy opportunity. At best, we could hope to profit from periods of short-term investment, once an uptrend is confirmed. If you are considering buying Qantas now because the price is "cheap", then why not wait a little longer because it might get even cheaper? And who knows, several well known blue chip stocks disappeared in 2008 due to overly depressed share prices that brought on other difficulties during the financial crisis.

Qantas (QAN) — a monthly and a daily chart

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About the author

Robert Brain is a share trader and share market analyst, and runs Brainy's Share Market Toolbox web-based business supporting investors and traders. He is a National Director of the Australian Technical Analysts Association (ATAA), and also the Vice-President of the Melbourne ATAA Chapter. Robert uses the Australian BullCharts charting software platform.

About the Australian Technical Analysts Association (ATAA)

The Australian Technical Analysts Association is a not-for-profit association of people who are interested in the application of technical analysis. Many of the members operate their own SMSF, others are private Traders/Investors and others again, are professionals in the Financial Services Industry. The ATAA has nine Chapters in Australian Capital Cities and some provincial centres. Visit the ATAA website for details: www.ATAA.com.au.