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TRADING

'Out of the box' theory that made a millionaire

TECHNICAL ANALYSIS

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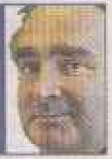
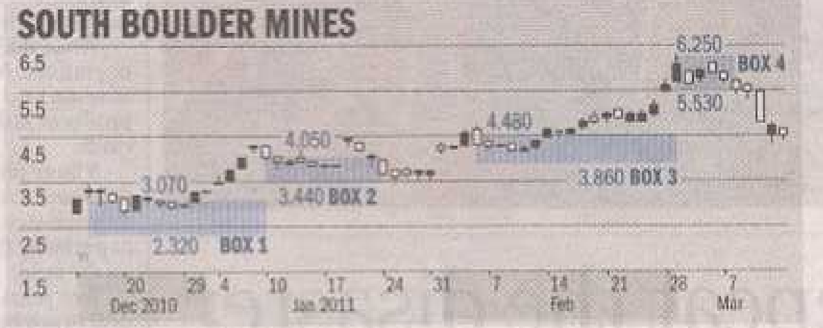


THIS week Robert Brain, national director of the Australian Technical Analysts Association, introduces us to the work of Nicolas Darvas, an economist and professional dancer who made more than $2 million in the sharemarket over an 18-month period in the late 1950s while he toured the world dancing.

Darvas had practised his theories in the market for the previous five years, with varying degrees of success, before he went on to fully develop and reap the benefits of his theory. Darvas describes his experiences and strategies in a world best-selling book *How I Made $2,000,000 in the Stock Market*, which has been reprinted several times and is still available.

His eventual winning strategy was based on several factors, including his Darvas Box theory, which the column showcases today. The accompanying daily price chart shows South Boulder Mines over three months from December last year.



Each Darvas Box has an upper and lower limit that marks the top and bottom of a trading range based on several key criteria, including a sharp rise in volume (not shown on this chart). The trading range includes the daily high and low values, hence the need to view either a bar chart or candlestick chart to create a box.

Darvas's observations of stock price movements led him to conclude that once a box was formed on the chart, it often indicated the presence of keen buyers of the stock, and an increased likelihood of a move to the upside. For example, "Box 1" on the chart is delineated with a low at $2.32 and a high of $3.07.

As soon as the stock broke through the top of the box, Darvas would enter with a tight "initial stop loss" just below the top of the box. As the top of the box price was breached, the theory formed more boxes at higher levels.

Darvas observed that his detailed strategy produced winning trades about 50 per cent of the time. But by quitting losing stocks early, and letting profits run, he managed to amass his fortune.

He also pyramided his positions by buying more shares as the price rose. Darvas helped manage his risk using an initial stop loss to protect his capital, and a rising trailing stop (a stop loss that rises with a rising stock) to protect his profits.