

Stock Indexes and Sectors

For those picking up this book who have little to no experience in the markets, I'll start off by welcoming you to the world of trading and investing. One of the greatest achievements for the human mind and psyche is to identify a business opportunity and then profit by taking decisive action.

Let me start off by addressing the newcomer or novice investor. I am not going to scare you away with heavy technical stuff, at least not now because that will come later. For the advanced trader, there are quite a few golden nuggets of trading concepts packed in these pages.

I want to share with you a story about my next-door neighbors' experience. These are awesome people. The husband is retired; the wife works as a travel agent in a North Shore suburb of Chicago. As the world was facing the financial crisis back in early 2009, the wife came over to our yard while I was surveying the garden. She knew that I worked in the financial markets, but had no idea exactly what I did. In the past, she had seen me on CNBC commenting on gold or crude oil and wanted my opinion on what to do. She had a feeling that stocks were too cheap and that there might be something she should get in on. She was right; stocks were cheap in March and April 2009.

She explained that they hadn't invested in stocks since the tech wreck of 2000, but they had some money and wanted some advice. I had her come over the next week for a lesson. All we did was go over some companies and get her online to open a self-directed trading account. The online trading company at the time was Thinkorswim. Some of the stocks we started her off with were General Electric (GE), Starbucks (SBUX), and Bank

of America (BAC), and then later she asked me about other names like McDonald's (MCD). I talked and she listened, and more importantly, took decisive action. I found it amusing when making comments like "here is where your stop should go." It was like I had just said something in a foreign language. But she learned. I am not saying she experienced enough success to start her own hedge fund, but she did experience success.

I wanted to start the book off with this story to show the beginner that good things can and do happen, but it takes the human mind and psyche's ability to identify an opportunity and then take decisive action.

Technology in the new millennium has given all of us a more equal playing field as far as pricing in regards to the cost of doing business, direct access to the markets by means of the Internet, and transparency by means of order execution platforms.

Many individuals exclude themselves from the markets for one reason or another. As it has been said, I believe more people plan for a family holiday than they do for their investments or financial futures. Perhaps others have a profound fear of loss and shy from making effective reasoning rationale.

Yet this is a business where it takes money to make money. There is no question about that. One has to be able to afford to lose once in a while and not let that hinder one's ability to make better educated and therefore more reasonable actions in the markets. My goal in this book is to help you to learn how to structure a formulated perspective in order to overcome all disputes that often lead to poor judgments or inaction.

Remember, the reason you are looking to trade is simple: to make money. Never forget this. Friedrich Nietzsche, the German philosopher, stated long ago, "The most fundamental form of human stupidity is forgetting what we were trying to do in the first place." Never forget that this is the bottom line, to make money. Yet many do, mostly as fear, doubt, and greed interfere with rational thinking.

In order to give you the edge, I want to take a comprehensive look at how we can use the information in this book and apply it to real-time trading. There are obviously volumes of different material we can look at, like macroeconomic effects and the business cycle. Or microeconomic events like earnings and other situations that will impact a stock or a sector and the overall market's performance. Quite frankly, we will most likely cover many of those subjects in this book.

My goal was to put together a sophisticated yet simplistic book in such an organized manner that any trader would be able to walk through the steps contained in these pages, which combine the most relevant tools we have at our disposal, to make better, lower-risk, and more profitable trades as a direct result of better educated investment decisions. I have what I consider some simple tools in a technically oriented and complex time.

In order of importance, here is my ideal checklist of noncorrelated, yet corroborating tools to use:

- Sector analysis
- Seasonal trend analysis
- Contrarian indicators
- Price patterns
- Momentum indicators
- Volume studies
- Breadth indicators
- Moving average tools
- Support and resistance

You can use fundamental analysis (study of current events), or you can take a pure technician's approach to studying the markets. I believe a trader needs to do both. The issue with fundamental analysis is that you need to receive information from the media and third parties, which can be unreliable. You can also look at the company's balance sheet, like the price-to-earnings growth rate (PEG) and the earnings per share (EPS) over multiple quarters. Most of this information is listed on your brokerage firm's trading platforms; if not, Yahoo! Finance works wonders.

The really fundamental question for traders and investors is not to seek answers to the questions of fact or finance, but rather the really deep question to seek an answer to is: What is value? What gives a stock value? When Netflix was at 304.79 back on July 13, 2011, many perceived this stock to be a good value, especially if one was long from a lower level. Fundamental news was released that they were going to charge more for their services, and that is what created a higher opening. We called it a "gap" higher open. The fundamental facts were released, and investors measured the mathematics of future earnings, but the real question that begged to be answered was: Is this stock at this point in time a good value or overvalued? As it turns out, the stock was more than overvalued, as it cratered to a low of 62.37 by November 30, just shy of four and a half months.

Were there ways to uncover the truth of whether this market was at a good or overvalued price over 300 per share? And, if so, were there avenues one could employ to take advantage of it? To be certain, there is a reasonable approach to investing that is unbiased, factual, and incorporates mathematic formulas, but best of all, uses what we all have at our disposal. It is the information provided to us in the form of prices such as the market's or stock's high, low, close, and opening levels, as well as the amount of volume traded and the volume detected in both the up and down directions. The information is what we can find in what is called technical analysis.

Technical analysis shows us what the market is or has done. Certain tools, based on past performance, give us a clue what might happen but not what will absolutely happen.

However, there are several indicators and methods we can use to effectively help us in formulating a market opinion that can improve our chances for success. There are hundreds of methods for picking stocks to buy. The key is to know when to fold. I am talking about an exit strategy. Most individual traders have a hard time taking a loss, mainly because they believe the company's stock price will turn back in their favor. More importantly, most traders don't know when to take a profit either. Thus, the phrase "cut your losses and let your winners ride" might not be a complete truth. While it is important to cut losers, it is also just as important to establish profitable exit levels. This concept of setting an exit plan is imperative for overall success in trading. A pretty good analogy on this point can be summed up by a friend of mine, who once asked, "When flying a plane, what's more important—take-off or landing?" That's a profound question, as they are both important, but once you are in the air—just like once you are in a trade—landing is like your exit strategy. You need to have a profit objective in order to land the investment plane safely. That is why the subject on profit objectives will be covered in this book.

STOCK-PICKING QUANDARY

Picking stocks from a large universe can be overwhelming. So let's look at what I consider a systematic approach for picking stocks to trade. Rarely does one look at one method in what I call the top-down approach. Let's look at the Standard & Poor's (S&P) 500. It is compiled of 10 sectors. Jeffrey Hirsch, my co-editor in the *Commodity Trader's Almanac*, along with his father Yale, put together a seasonal guide from a study done long ago by Merrill Lynch. Yet I believe most traders are not aware of this, or at the least, it is most often ignored.

Many of the reasons we see seasonal strength or weakness in markets are very logical. We will cover many of these reasons when we delve into seasonal analysis in the next chapter.

Many individual retail investors and traders start off their careers by looking at stocks that are brought to their attention by either the company they work for or by some means of communication, either in an e-mail or the news media—print, online, cable TV, and so on—or, the best way of all, a hot tip from a family member or friend.

Others who are invested in the stock market indirectly, either in a 401(k) or through mutual funds, rely on the professionals who run those funds. The fund manager's sole responsibility is to beat the benchmark,

what is considered the S&P 500 Index. Here is the listing of these sectors:

1. Consumer Discretionary
2. Consumer Staples
3. Energy
4. Financials
5. Health Care
6. Industrials
7. Materials
8. Technology
9. Telecom Services
10. Utilities

The iShares U.S. sector and exchange-traded fund symbols are:

1. Technology (IYW)
2. Consumer Goods (IYK)
3. Consumer Services (IYC)
4. Energy (IYE)
5. Health Care (IYH)
6. Financial (IYF)
7. Industrial (IYJ)
8. Basic Materials (IYM)
9. Utilities (IDU)
10. Telecommunications (IYZ)

Next, there are the subsectors and then the stocks listed in those subsectors we can look at for investing and trading opportunities.

First, let's examine the Energy sector as a whole, not the actual commodities like Brent Crude Oil or West Texas Intermediate. I will cover these, including natural gas, in the next chapter.

We can break down this space into:

- a. Oil & Gas Exploration & Production
- b. Oil & Gas Storage & Transportation
- c. Oil & Gas Equipment & Services
- d. Oil & Gas Refining & Marketing
- e. Oil & Gas Drilling

EXCHANGE-TRADED FUNDS

In this section, we will cover the exchange-traded fund (ETF), including inverse ETFs, leveraged ETFs, and inverse leveraged ETFs. We will also cover the features, benefits, and risks of trading leveraged ETFs, good risk-to-reward opportunities, and a comparative market analysis that dissects a leveraged ETF and a sector ETF strategy.

ETFs are investment instruments that have their own symbol and are traded on stock exchanges. An ETF includes assets such as stocks, commodities, and futures. The easiest way to understand an ETF is to think of it as a mix between a mutual fund and a group of stocks in the same industry sector or futures contract. ETFs trade on an exchange just like an equity or futures contract, but contain bundles of the underlying asset like a mutual fund. Investors and traders are attracted to ETFs primarily because they have the ability to diversify risk like a mutual fund but have the flexibility of equities and contracts, which can be traded throughout the day and can be sold short. Since ETFs trade like stocks, a commission rate will apply just like a stock trade. Prices on an ETF change throughout the day as they are bought and sold, just like a stock. ETFs typically have lower marketing, distribution, and accounting expenses, and most ETFs do not have 12b-1 fees.

Investors look to ETFs to provide easy diversification, low expense ratios, and tax efficiency, while still maintaining all the features of ordinary stock, such as limit orders, short-selling, and options. ETFs are very versatile and can be included in an investment portfolio or trading plan as a long-term investment for asset allocation purposes, or to trade frequently to implement market timing investment strategies. The advantages of investing or trading in ETFs are:

- *Lower costs.* ETFs generally have lower costs than other investment products because most ETFs have lower management fees due to the fact that they are passively managed versus an index mutual fund or an active mutual fund that incurs higher fees due to increased trading and research expenses.
- *Buying and selling flexibility.* ETFs can be bought and sold at current market prices at any time during the trading day, unlike mutual funds and unit investment trusts, which can only be traded at the end of the trading day. As publicly traded securities, their shares can be purchased on margin and sold short (enabling the use of hedging strategies) and traded using stop orders and limit orders, which allow investors to specify the price points at which they are willing to trade.
- *Tax efficiency.* In most cases, ETFs generate relatively low capital gains because they typically have low turnover of portfolio securities.

While this is an advantage they share with other index funds, their tax efficiency is further enhanced because they do not have to sell securities to meet investor redemptions.

- *Market exposure and diversification.* ETFs provide an economical way to rebalance portfolio allocations. ETFs are designed to track the underlying assets, which may contain hundreds or even thousands of securities. This offers the trader or investor the diversification of an index mutual fund with the trading flexibility of a stock. ETFs offer exposure to a diverse variety of markets, including broad-based indices, international and country-specific indices, industry sector-specific indices, bond indices, and commodities.
- *Transparency.* Most investment vehicles provide quarterly disclosure of their holdings. ETFs, whether index funds or actively managed, publish their exact holdings on a daily basis (transparent portfolios) and are priced at frequent intervals throughout the trading day. Investors are able to see exactly what is included in the ETF, from fees to the basket of assets.

There are many types of ETFs, ranging from stock indices like the S&P 500 (SPY) to commodities that relate to precious metals like gold (GLD), energies such as crude oil (USO), and agricultural markets like grains (DBA) and livestock (COW). In addition, there are ETFs that correlate to the financial markets such as bonds (TLT), and those that reflect changes in the yield (TBT). In December 2005, Rydex launched currency ETFs, with the first being FXE, which tracks the euro currency.

Inverse ETFs

Inverse ETFs are structured to perform in the opposite direction of the underlying or benchmark asset. These funds short-sell derivatives and other leveraged investments as the basis for the inverse relationship. Over a short time frame, the inverse ETF should provide performance, which is opposite the benchmark vehicle. For example, if the established benchmark is the S&P 500, the inverse ETF should move in the opposite direction by a similar amount. If the S&P 500 declines by 1 percent, the inverse ETF should rise by 1 percent (not including fees and costs). Because short-selling stocks is extremely risky, inverse ETFs can provide trade opportunities for stock traders in bearish market conditions, since bear ETFs should rise during a declining market.

Leveraged ETFs

Leveraged ETFs are designed to take advantage of short-term market swings by using debt to amplify the returns of the underlying asset.

The goal of the ETF fund manager is to maintain the debt ratio at 2:1 or 3:1 depending on the fund. In the case of a 2:1 debt ratio, the ETF is matched with twice the amount of debt to investor capital, while a 3:1 debt ratio is matched with three times the amount of debt to investor capital. With this leverage, the ETF is expected to gain a return of 200 percent or two times (2×), or 300 percent or three times (3×) the average return of an underlying index or other benchmark over a specific period of time. For example, if the S&P 500 goes up 2 percent, a 2× S&P 500 ETF is expected to return 4 percent.

Leverage is two-sided. While leverage applied to a winning trade compounds the size of the return, leverage applied to a losing trade compounds the size of the loss. If a trader wishes to profit from uptrends in an index, sector, commodity, or currency move with less cash outlay than traditional ETFs, they will take advantage of the increased compounding effect that is found with leveraged ETFs. The opposite is also true. If the market moves against the direction of the fund, the losses will be compounded as well.

Another important consideration in trading leveraged ETFs is to understand that fund managers work to maintain the leverage balance and produce returns over one trading day. If the fund is out of balance, the manager will incur trading losses because they need to keep the debt ratio intact. This means that in a bear fund, they must buy when the index goes up and sell when the index goes down in order to maintain a fixed leverage ratio. For example, if an ETF is a -2× bear fund, a 2.5 percent daily change in the index will reduce the value by about 0.18 percent per day, which means that about a third of the fund may be wasted in trading losses within a year ($0.9982^{252} = 0.63$).

Inverse Leveraged ETFs

When a trader wishes to trade the inverse, or opposite, of the daily performance of the benchmark asset in a single day and wishes to use leverage, he or she would look to trade an inverse leveraged ETF. Using a combination of leverage and the inverse relationship to the benchmark, the inverse leveraged ETF will seek a return of -2× (-200 percent), positioning itself in the opposite direction of the benchmark.

Detailed information regarding leveraged ETFs can be found at the following web sites:

ProShares: www.ProShares.com
Direxion Funds: www.direxionfunds.com
Rydex-SGI: www.rydex-sgi.com
Deutsche Bank: www.dbfunds.db.com

Following are some of the most well-known ETFs, as well as specific examples of several ETFs and their application:

- *SPY ETF*. One of the first ETFs developed was SPY. Known as the SPDR, the benchmark is the S&P 500.
- *QQQ ETF*. Known as the “Q’s,” this ETF uses the Nasdaq 100 as the benchmark. In 2011, the name was changed from QQQQ.
- *DIA*. Dow “Diamonds” uses the Dow Jones Industrial Index as the benchmark.
- *XLF*. The financial select sector SPDR is produced to match the returns of the financial select sector.
- *SSO*. The SSO is a leveraged ETF that uses the S&P 500 as the benchmark and seeks investment results of 200 percent utilizing leverage of 2:1.

The SPY ETF is a product that could provide a good trading vehicle for a trader that is looking at an investment option that provides good liquidity and volume and does not wish to utilize more leveraged products such as futures.

One of the most important disclaimers or warnings on a leveraged ETF is to advise you to do your due diligence, as these instruments employ constant leveraging and compounding, which can skew the average returns. Make certain you clearly understand how this investment vehicle works before entering a trade.

If we use a chart on the ETF index XLE that represents the energy complex, based on past historic price data we can draw a seasonal chart, which I have included in the lower quadrant of the graph as shown in Figure 1.1. You will see that the seasonal trend history shows the typical annual high is established in the May through June time frame. The market then typically bottoms in October, with a strong move upward starting in early February. With this chart one can conclude that by buying in late October and holding through late May, one may capture the best upside trend of the year for this sector.

Now let’s look at the subsector Refining & Marketing as shown in Figure 1.2 from 2011. Notice that the seasonal peak was around late April and bottomed in early October. This is a very similar pattern to the overall sector as shown in Figure 1.1 with the XLE.

Now let’s look a bit further and dissect this energy sector to examine one of the companies listed under that subsector. I started with Sunoco (SUN), as shown in Figure 1.3. The seasonal chart on this stock itself resembles the seasonal chart on the subsector it is listed under and as was just explained the seasonal price movement of that sector formed a peak in May and bottomed in October. Now we can conclude not only is it highly

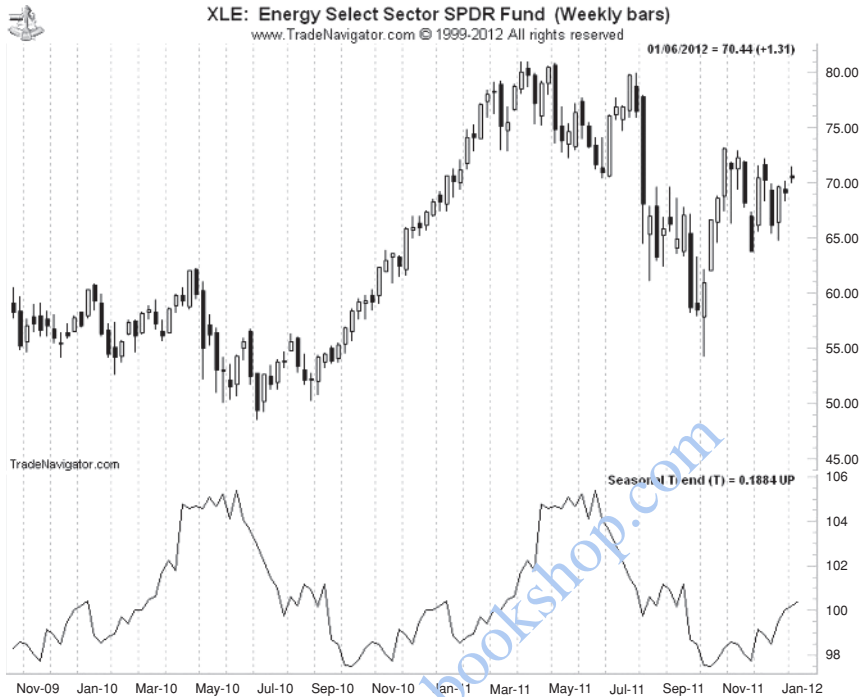


FIGURE 1.1 XLE: Energy Select Sector SPDR Fund (Weekly Bars)
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correlated to the subsector and the subsector, but Sunoco is highly correlated to the Energy complex itself as represented by the XLE. Armed with that information, one can now start looking for buying opportunities in October and start looking for a profit target by the late April through early May time frame.

Let's examine another sector, Telecommunication or Telecoms. In the chart in Figure 1.4, the seasonal study shows where we typically have a strong buying opportunity from late August through early October that can last into the first part of January. Once we scan and look for the top stocks in that space, we can then apply a seasonal study to if the individual stock has a similar seasonal price pattern compared to the sector itself.

Now let's look at one component in this sector, Verizon (VZ), as shown in Figure 1.5. Notice that a seasonal low is established in the July time period and then makes an annual low in early October. We then see a peak or deceleration in price gains by mid-January. Not every year is created equally, meaning we cannot expect the same performance year after year.



FIGURE 1.2 \$-OIG3: Oil & Gas Refining & Marketing (Weekly Bars)
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Some years, as we experienced in 2010, will see magnified moves and others, like 2011, will have a muted or less price appreciation than in prior or past years. The point is, we have a method for setting up selected stocks during certain times of the year.

Now let's examine one more sector, the Pharmaceuticals, as shown in Figure 1.6 represented by DRG. Notice that it, too, sees a seasonal low in July that lasts through until January. Then it makes a seasonal decline and starts the bullish cycle again from early March through May. Since 2009, as the chart shows, there have been five cycle periods of seasonal and annual lows, so this trade has worked four times for an 80 percent win for this small sample back-testing period. As the chart reveals, we have made a progression of higher peaks and higher lows almost like a rising staircase. This leads to another interesting concept: nothing moves up in a straight line. Now, armed with this idea that if this sector, which is comprised of specific drug companies, moves up and down with considerable consistency, then I can surmise one of two things. Pay attention to buy a stock that is contained in this sector when it is near the seasonal low and look to take

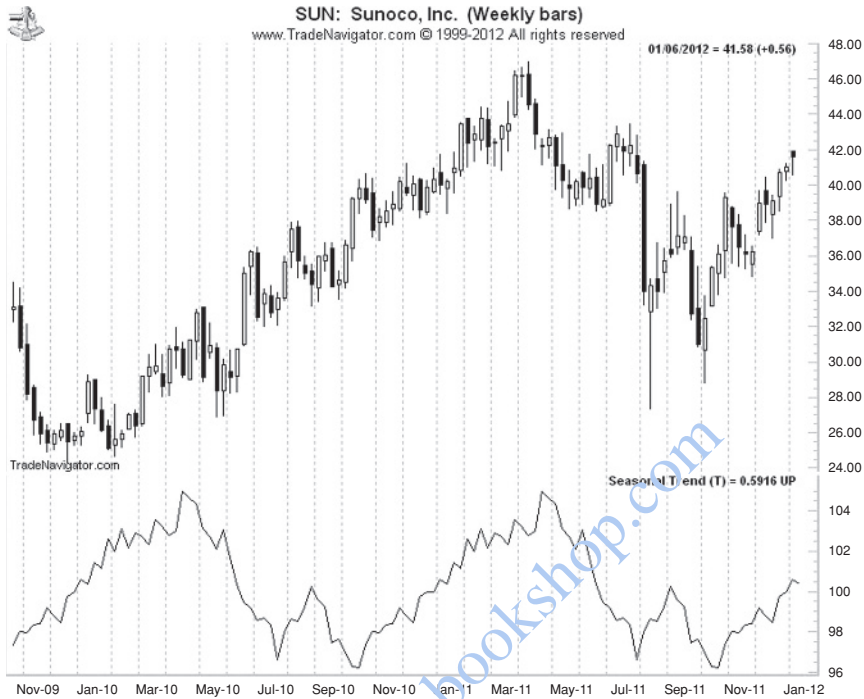


FIGURE 1.3 SUN: Sunoco, Inc. (Weekly Bars)

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a profit no matter how big or small when the seasonal highs are due. This way you can rotate your working capital in and out of the market when the timing is right. Famed trader Jesse Livermore was quoted as saying, “It isn’t as important to buy as cheap as possible as it is to buy at the right time.” So, timing must be important.

What determined this timing was simply the historical study of past price action applied to a mathematical ratio calculation. Once again, the overall price action is dictated by value from supply-and-demand functions every single year. Oh, the wisdom gained from learning history! Another famous piece of wisdom to live by in this industry is to learn from history or be doomed to repeat it.

Now let’s take this simple top-down approach again and look at one drug company, Bristol-Meyers Squibb (BMY; see Figure 1.7). It’s a very popular and heavily-traded company. On an individual traded basis, this stock looks like it has had a much healthier price gain than the overall sector it is in. But comparing an apple to an apple here buying at or near the seasonal low, which occurs in July and lasts through until January, see how you have

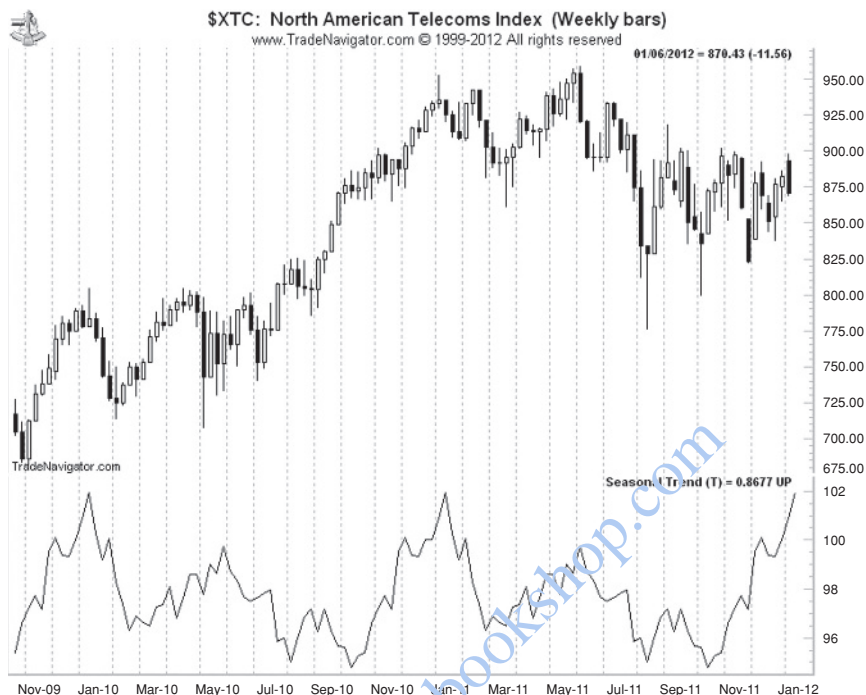


FIGURE 1.4 \$XTC North American Telecoms Index (Weekly bars)
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been able to pick the right stock and time the market direction for a profitable move consistently?

By just looking at specific stocks in specific sectors year after year, one can capture an edge and literally keep the number one fundamental idea of trading engrained in your thinking, which is making money for yourself.

There are many styles and numerous ways to invest or trade and pick stocks; in fact, we have more stock indexes such as the Dow Jones Industrial Average, which is compiled of 30 large-capitalized stocks, all of which are in the S&P 500. Next we have the Technology weighted sector, the Nasdaq, and the Nasdaq 100. Then the Russell 2000, which represents the small-capitalized stocks in that sector. And don't forget about the Transportation and Utility sectors. Next, we can look at the world of ETFs, of which we now have a whole universe to explore, including inverse as well as leveraged ETFs. Then, we can look at specific commodity-based stocks and commodity futures. As you can see, picking stocks from this wide variety of market indexes can be exhausting and can create an extensive workload if you are not a specialist or veteran analyst. So how do we look

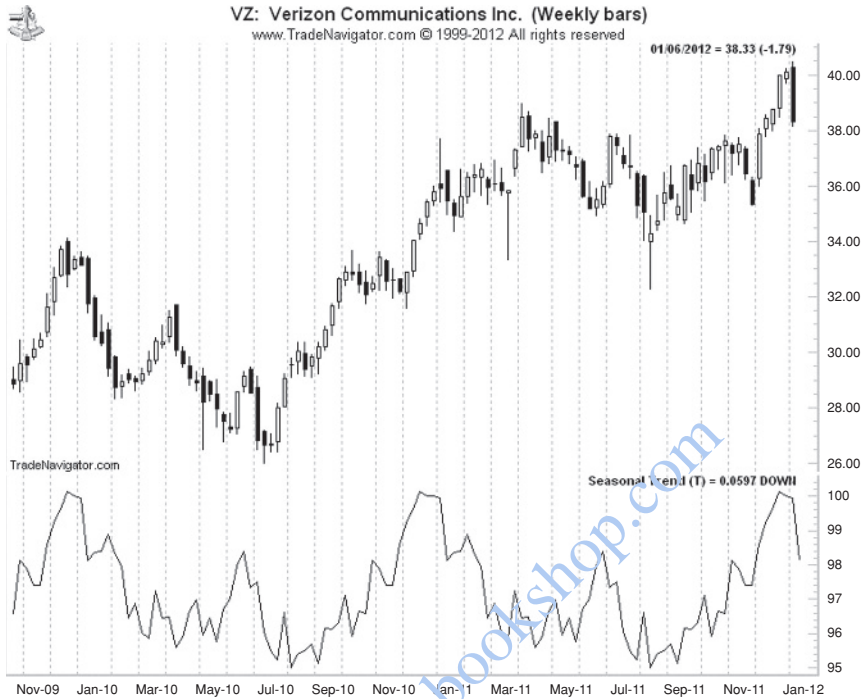


FIGURE 1.5 VZ: Verizon Communications Inc. (Weekly Bars)
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for opportunities as to where and when we should look at specific sectors and stocks in those sectors? That's what we are here to do—learn what form of market and the best possible combinations of confirming technical analysis tools can give us a higher degree of probable success. After all, if we can determine a market or stock's direction, the next phase is to determine an entry level, a risk or loss amount we are willing to lay out, and then an exit strategy or profit objective. So, figuring out and determining market direction or value is paramount to making money, and that is our fundamental idea.

THE OPTIONS MARKET

For those readers who are veteran traders, it would not be fair for me not to mention the “O” word: options. The options market is another derivative product where one can optimize strategies to protect a stock position as

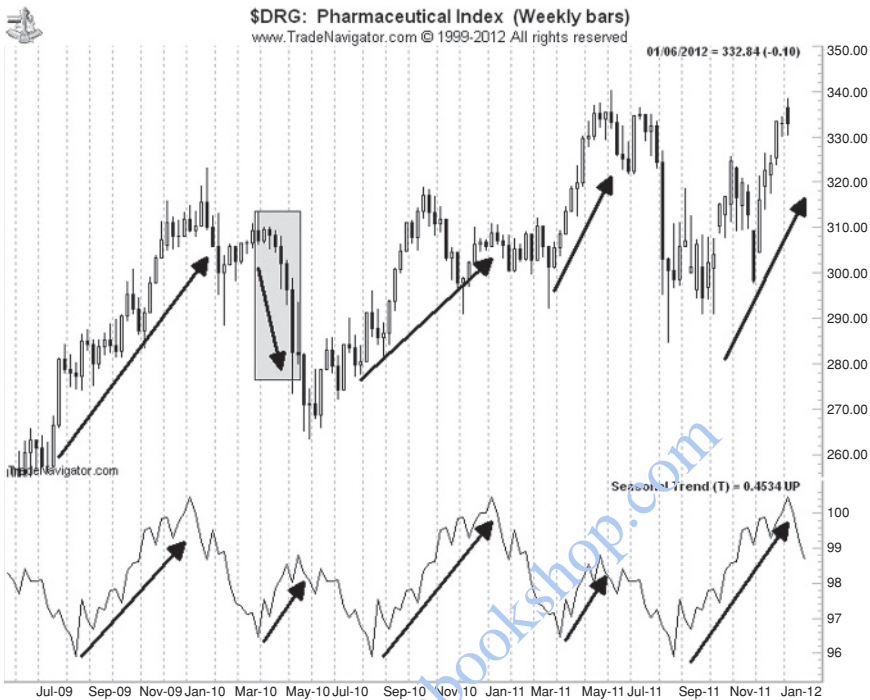


FIGURE 1.6 \$DRG: Pharmaceutical Index (Weekly Bars)
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well as simply implement a stock replacement strategy. To start with, you may see a risk disclosure stating, “Using options is risky”; no doubt it is a true statement. However, buying Google (GOOG) before earnings, or Netflix back in July, 2012, or tens of thousands of other long stock purchase examples was even more risky.

I believe options have been given a bad rap due to the lack of ability for the masses to time entries. It is a terrible feeling to be correct on your investment idea but lose money because you were wrong on the timing.

Many investors will never use options to implement their investment ideas simply for this reason. Investors have an outlook on “value,” as we have discussed, meaning they buy a company because they believe that the company’s share price can move higher in time. What can happen is that they are right, but find out only after their option has expired, meaning the stock price moved up after their option expired worthless or slightly in the money, which would leave them without a profit. Then, at that point in time, they are at the same decision point as in the first place, which was whether to buy another option or get long the stock.

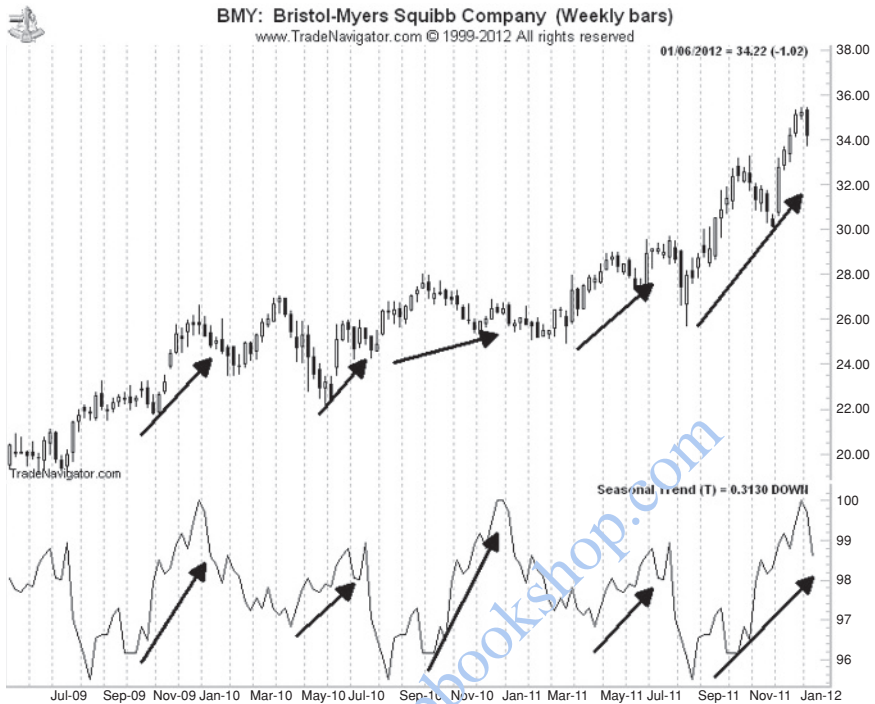


FIGURE 1.7 BMY: Bristol-Myers Squibb Company (Weekly bars)
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So what about options around earnings season? This is a more useful concept because the timing is known, meaning the earnings report date is a known event that will generally prompt a market reaction. Using options for a short-term trade makes sense in this aspect. One reason is that many times, one can put down little money and see a 3, 4, 5, or even a 10 percent move in the underlying stock overnight. In this instance, investors can utilize weekly options and not pay as much premium due to a longer maturity dated option such as the monthly or quarterly expiration.

So whether you want to trade a stock into earnings or protect your capital on a long stock that will be exposed to an earnings event, options strategies are a smart choice for traders and investors in the new millennium.

Take a look at Figure 1.8, the daily chart on Google before earnings that came out after the closing bell on January 19, 2012. The market fell 8.25 percent on the opening the next day. If an investor who was long this company had the knowledge to use options, then he or she would have been



FIGURE 1.8 GOOG: Google Inc. (Daily Bars)
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able to buy a put option for protection. To take it one step further, one would not need to buy much in a far-out time value as the earnings event was known. The trader would simply be looking for protection with limited outlay of capital. So, in this case, buying a weekly option would have done the trick.

Now let's explore this a bit further. No doubt this is what we would consider (if long) a very ugly opening, correct? It would almost serve you better to get a root canal—you might have more fun, and it would most likely be cheaper. But what about a trader who was bearish and had some good, solid technical analysis that may have indicated a market decline? What about the trader who didn't have \$64,357 to sell this company short—that's right, sell short first and buy back later. It's a trader's right to do so. In this situation, put options or a bearish option strategy would have been a great day indeed.

Here are the tools that we will cover in this book that actually helped give an indication that Google was, in fact, in a bearish market condition. These are just a few techniques and technical analysis indicators that I

will spell out for you in detail in order for you to help determine a stock, a commodity, or ETF's value. With that information, you will be able to aptly make better informed trading decisions. Remember what Nietzsche said: "The most fundamental form of human stupidity is forgetting what we were trying to do in the first place." As traders, we are here to make money.

I know from past experience that many readers will pick up a book, read the first chapter, and skim through the rest to find what appeals to them, especially books on trading. At the Traders Expo New York back in 2007, after I completed a workshop, a man approached me in front of a small audience wanting to ask questions, and stated that the material I went over was not in my book that he read twice over, cover to cover. The subject, incidentally, was the basis of Person's Pivot Indicator and the moving average formula used to filter the support and resistance targets. I said, "Really?" I mean, I wrote the book and I knew it was in there at least three times, so I pulled out a copy of the book, *Candlestick and Pivot Point Trading Triggers*, and said, "It's in Chapter 5, on page 135; again in Chapter 6, on pages 161, 170, and 175; and in Chapter 11, on page 284." His response was priceless. In front of 40 or so people, he said, "Oh, perhaps I should read your book again." The crowd laughed and he went on his way. So, believe me, I know some will not make it through the entire book. But I beg you to try. The methods have and, I believe, will continue to stand the test of time. But for those who will flip through these pages like a leaf in a windstorm, here is a small sampling of what will be covered in coming chapters. Examine Figure 1.9. This is a weekly chart; the very peak was formed by a bearish candle formation called a shooting star. In addition, overlaid on top of the price chart are the monthly "Person's Pivots" price targets projecting the January high right near where the actual high was created. Next, and just as important, we have an old indicator least used by the masses, the on-balance volume indicator, created by financial writer and speaker Joe Granville. Notice on the chart at point A where prices made the high, at point B the on-balance volume indicator made a lower high from the first major price peak from July. This condition is called bearish divergence. Simply stated, this means that the price of the stock rallied on weaker volume.

WHY USE SEASONAL ANALYSIS?

Here is one more bit of information that was missing from the last two charts that really sealed the deal that this market may move lower. We talked about seasonal analysis at the beginning of the chapter. Aren't you the least bit curious what typically happens to Google at this time of the

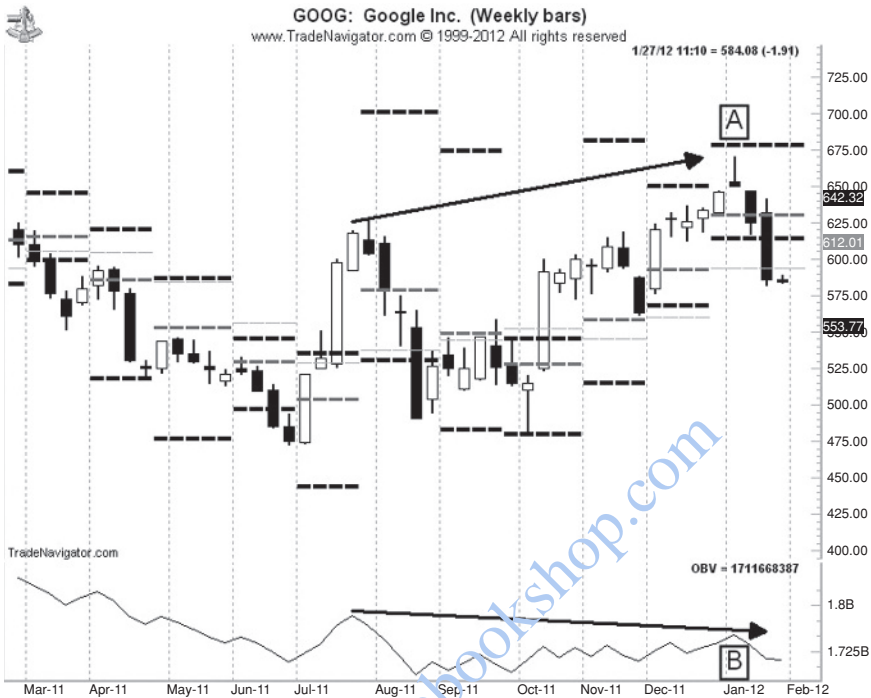


FIGURE 1.9 GOOG: Google Inc. (Weekly Bars)
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year? Figure 1.10 is the same daily chart, but this time with the seasonal trend study in the lower quadrant. Typically, Google peaks on or around January 4 and continues its decline into the first week of March. So, once again in order of importance, check the seasonal trend of the market on a sector or an individual stock, look what candle price patterns are showing, then look to see if the market is overvalued or trading near a resistance level, and look at the volume analysis to help confirm the market condition, either bullish or bearish. Once that is done, formulate a game plan, and then take action. As with any trade, if the risk does not look like it's worth the reward, take a pass on the trade. However, during earnings season on individual stocks, this is a great methodology for short-term traders looking to capitalize on a directional option strategy.

Okay, if I can teach you to look for a particular candlestick pattern at a Pivot Point resistance level using other indicators like seasonal analysis to help give confirmation of a weakened uptrend, then you will have a great start on making better trading decisions. Fair warning: The steps, indicators, tactics, and real trade examples that will be covered in this book all



FIGURE 1.10 GOOG: Google Inc. (Daily Bars)
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have one thing in common: each outcome is different. That's right, we will never know what the exact outcome will be in the future. Just like with Google, who knew the market would trade 8 percent lower? Most were willing to take 5 percent; that's my point—it is up to us to make logical and systematical decisions based on a series of defined rules and a great set of criteria and then act on them. If the trade has merit, then we will be rewarded.