It's The

Journey

Not The Path . . .

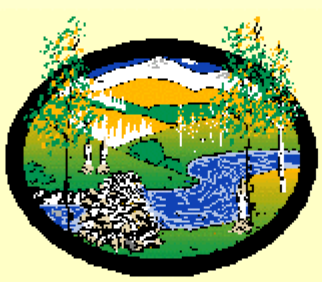
Many years ago (Really in Market terms this is like Dog Years in Reverse)...... i.e. days........ there were several good folk. Some were beautiful Women Folk, some were Handsome Men Folk, and others were like me...... kinda short, Fat and on the Homely side.

All went down the path of Investing. There was the "High Road", the "Low Road" and the "Middle Road".

All were clearly marked and easy to follow. Each traveler took his own road and made his own notes. They did their best to accurately relate their findings when they reached their destination. At the end of their paths they all had little Mail Boxes that were visited daily in order to relay this information back to their Homes. The Mail always ran, and was never late or lost. (snicker) Each traveler was honest and made no attempt to conceal, distort, or lie about his journey. They just thought the stories of their trials and tribulations would be of interest and may help out those who were certain to follow.

The First Traveler (couldn't tell by their mail if they were Male, Female, short, tall, or even good-looking or not) left this short story of "his" journey.

The Start



I awoke on the first day and decided to travel. Not sure why...... not sure where. Just knew I had to travel. I did know this......... I wanted to succeed! There was something out there that I wanted to accomplish. I wanted to see and do things I had not yet done. The desire and longing was almost a taste...... almost a smell. It certainly was "Front and Center" in my mind. I had to Travel. I came to a fork in the Road. I took the Low Road. Even though I was excited, I was also afraid of Heights. I knew my limitations.

The journey was full of wonderful new adventures. Friends were made, Homes visited, sites discovered & and most of all Sensations Indulged! The risks seemed minimal. The dangers never loomed so large as a Dragon waiting to pounce. In fact I never had a real worry so as to remember. Daylight almost always shined, and when the rain did come it only seemed to make the Flowers more beautiful the next day. All in all there were very few Bumps in the Road. Yes, you could even say the path was lightly stepped and easily trodden. Each day I would awaken and there was a Gold coin under my knapsack. Some days it would be a $5 piece, and other days a $20 piece. Regardless, it became a fixture of my day, and almost an afterthought. I placed it in my knapsack and journeyed further. I did not even notice the increased weight because the load only gradually changed and I became used to it daily. In the end I am not sure I would waste the time counting the pieces. There was more than enough to go around, and I was not sure that on the next journey they would let me have that much "Carry-on" luggage anyways. I dropped this note to let you know that the "Low Road" was the Right Choice. I just now saw a friend stepping out to greet me so I will close here. Be well and hope to see you on the Other Side.

The Second Traveler (I am not sure by the letter if they were short or tall, fat or thin, Black or White) left this letter of "his" journey.

My dear Beloved. I leave you this note to reassure you. The journey I told you I must take was accomplished and all is Well. I look forward to seeing you soon. I see a friend ahead so must drop this in the Box and hurry to meet them. Before I go I must say again........ Take the "Middle Road". Yes, it is the Way to Go!

The Start

I came to that place I told you I had heard about. It was at the junction of a Mountain and a Beautiful Valley. There were 3 Paths to choose, and as I am wont to do I picked the Middle. I figured I could see both the Beauty of the Valley and the Majesty of the Mountains and never worry about missing either. I know, I know........ I hear you right now. Your silly laugh singing "Stuck in the Middle with You"! You know that is why you love me. I am predictable. I will be pretty much where you expect me to be. While not completely constant, never far off base either, huh?

I started my journey and noted right away that I had picked the right shoes. I am glad I left the loafers at home. I definitely needed my Tennis Shoes. Anything less would not have been so comfortable. I am into comfort, don't you know. Still, they weren't Air Jordans......... *sigh*.

I proceeded along the Middle path and was quite enthralled. I met many a good friend along the way. In fact at times things got quite busy and we had to walk almost side by side. Still, not a day was lost on looking at things above and things below. At times I must admit I was jealous of those I saw hiking along the Mountain Path, the High road. They were up there almost among the clouds. The Beauty for them must have been breath-taking. Then I would think of the Chance for a stumble. A tragic Tumble....... even a fall off of one of those Lookout Cliffs, and I would feel safe and secure again right where I was. As much as I envied them at times, I saw the Dangers they faced and felt comforted in that no such danger lay along my path.

I oftentimes would gaze down into the Valley where I knew the folk who took the Low Roac must surely be. I could hear the Waterfalls and the sound of the Stream as it rushed along its path. It sounded so serene. Yes, Must have been great to sleep next to that on a clear Moonlit night. Still I wondered if they missed the view of the Mountains. Surely they couldn't have seen them as well as I. Maybe they didn't need to. Maybe what they saw was enough. Maybe their path had sites I also would have enjoyed. Yep, the High Road and the Low Road. Both must be something to behold.

Still, I was happy with the Road I was on. It was much as I had pictured it. Oh sure, sometimes we would have to descend through a briar patch and slash through a few thorns, but that was a minor inconvenience. All in all I was in Hog Heaven. The Best of both worlds. Saw everything I could have imagined. An odd thing though. I noticed that As I traveled on an upward path, a Gold Coin awaited me when I arose the Next Morning. Yep, right under my headrest. Be it Heather or Stone. I dutifully placed it in my Knapsack, but always was aware that my load had changed. Maybe it was just in my mind. I was never sure. If we slept on a site that was leading down into a gully, I had the feeling that something was missing in my Knapsack the next morning, but search as I did, I could not find anything missing. When I stopped on that rare occasion to check, it seems I always had more than before. In fact I was sure of it. Not that it mattered. I had planned well and was sure to have all that I needed when I reached my destination.

As I finished my journey and exited the path, I saw a couple of my friends. They are waving to me now so I will close. They both are smiling and seem quite glad to see me. In fact they seem to have a treat in store for me by the looks on their faces. I will tell you more when I see you. Love from this side to yours.

The Third Traveler (Also couldn't tell if they were born with a silver spoon in their mouths, came from the Holler, or were city Folk) left this scratched diary of "his" travels.

The Start

Whoa Baby! Have I got some news for you! First of all let me tell you something. You know that Screaming Demon we went on at Six Flags? It is a sissy ride compared to this little jaunt I have just finished. Got to drop this in the Box because I see one of my buds and one of my buddettes waving at me to join them at this Super Cool Fountain. Before I seal this with a Kiss, I just got to tell you. Take the High Road. Yep......... Nothing like it. Whew! It is worth the Price of admission and then some.

It got started just as I hoped. I left the Main road and headed out for the Mountain Top. Man am I glad I wore my Hiking boots and carried my extra pair of shoes as well. That little coil of rope you insisted I carried came in handy too. Let me get started.

I started out looking to scale that first Peak. Seemed easy enough and all went well. Made it to the top and was pattin' myself on the back for what fine shape I was in. Then lo and behold. There I stood in all my stupidity. I actually said out loud, "Well shut my mouth and call me a Dumb@$$"... would you believe me that there was an even Bigger Mountain peak behind that first? Only problem was that there was a bloomin' river with slippery rocks and Cold, cold water inbetween. Never saw it coming! And you know what? Never knew I was so clumsy either. Yep, you guessed it. Slipped right in and had a real nice trip down the coldest Freekin' Mountain stream I could imagine. At least I got out on the other side pretty much intact. At least I think so........... *sigh* Oh yeah, I almost forgot to mention. There was the most unbelievable Tree that lined the path the whole way. Each morning when I woke up there would be at least one and sometimes several Gold coins that were in the center of the most beautiful blooms I had ever seen. I always scanned them out and added them to my knapsack as I went along. I counted them every night and kept a log of how many I had. It was kind of silly I know, but I actually dreamed about how many I would have by the time I got through. I don't know why, because I knew I could never spend them all. Anyway, I will get to that later.

After several encounters with treks up the Peaks, and down the other side........ rivers and gorges in between, I must have fallen 50 times. Thank goodness for the Band-Aids you made me take. They came in handy. I must tell of this one place, just in case you run into the same spot. I was cruising along minding my own business with my head in the clouds when suddenly the rock I was standing on gave way! Yep, would have sworn it was solid rock, but sometimes looks can be deceiving I guess. Anyway I started sliding and felt like I was in the movies. I was going down what I thought was some sort of mudslide and was losing my stuff right and left when suddenly I remembered the rope you had me bring. I threw it over a tree I was sliding under and managed to just save myself before I went over this cliff that looked like something out of "Butch Cassidy and the Sundance Kid". Needless to say Most of my gear did go over the cliff including lots of those gold coins that I was storing in my knapsack. Didn't lose them all, but darn near did. I owe you, Babe....... really I do.

The rest of the trip was relatively uneventful. I gathered more gold coins. Occasionally saw the folks in the Valley. But Most of all enjoyed the heck out of the Ride. Yep, the High Road was the one to take for excitement. Don't think the other Roads would have been as much fun. When it's your turn I think that is the way to go. I got plenty of Gold Coins, Memories galore, and only about 10 years taken off my life (Very big smile). Anyway, I see my friends up ahead and need to get this in the Mail before we all set off together. I really can't wait to see you and tell you more. Man is this a great World or What?

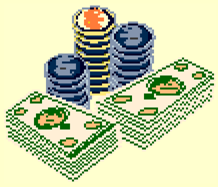
The End

As most have already guessed, the 3 travelers all ended at the same place. They all had their tales to tell and all had their Gold pieces. Thing was....... by the time they saw each other, all they wanted to do was sit down and share a good drink and a good story. They found out soon enough that they all had enough Gold and that they couldn't take it any further anyways. It could however be sent back by Mail to their friends and family. That was okay by them. Their loads were lighter, and they all agreed that there was way too much to do anyway. Still, they also said they wouldn't change a thing. They'd had the Best Trip ever. I don't know, but the Paths could have names. Maybe they are names we all already know.

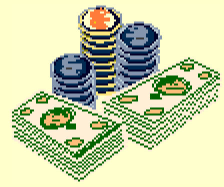
Doesn't matter, really. We know the Journey.......

* click me *

courtesy of WoolyBooger



What's A Chart?



A chart is a visual representation of transactions. The results of these transactions are depicted by either a line which will look like a map of the Pacific Coast Highway, or by a bar which represents the opening price (the little notch on the left side of the bar), the low for the day (the bottom of the bar), the high for the day (the top of the bar) and the closing price (the little notch on the right of the bar). At the bottom of the graph you'll usually also find volume bars which will tell you how many transactions were completed that day.

But beyond all this, a chart is a visual representation of buying and selling ***behavior*** on the part of investors, not just a tally, and this behavior creates patterns. Thus if you approach this from the viewpoint of psychology and sociology rather than cut-and-dried mathematical models, you'll have a leg up. These patterns do not exist in nature. They are created by the buying and selling dynamic.

Begin by thinking of the market as a giant bazaar. Lots of buyers and sellers, all excitedly negotiating prices until they cramp. If a lot of people are crowded around a particular merchant's stall, he can demand premiums for his goods. If another merchant is getting little or no traffic, he must lower his prices in order to unload his stock. If he's able to manufacture a demand, he can then raise them again. Either that or use whatever demand he creates to unload whatever crap he's selling and move on to something else.

Consider also that all stocks go through accumulation/distribution cycles. These cycles can last for anywhere from a few minutes to several years. Which cycles you focus on will depend on the kind of investor you are and what your time horizon is.

Here's how it works. Somebody's attention is caught by a particular company or its stock. They like it, think the price is reasonable, and begin accumulating it. But they do it gradually and in small lots so they don't attract attention to what they're doing. If they attracted attention, others would start buying the stock as well and the price would be driven up because of the increased demand.

When they've accumulated all that they want, they'll either hold on and wait or they'll "test" the market by offering some of their shares to see what the demand is. If the demand is there, they'll offer more as the price rises (and since there are now fewer shares on the market, there's less to stop the price from rising if the demand is sufficient). If the demand increases and the price rises further (because of buyers willing to pay ever-increasing premiums), they may hold back their shares and let other holders provide the supply for the time being, then sell more of their shares, or all of them, when the price represents their target profit level. Selling into this increased demand is "distribution". It, like accumulation, is quiet. The holder of the shares doesn't want to dump a huge amount of supply onto the market for fear that there may not be enough demand to absorb it, and the last thing he wants to do at this point is drive down the price. When the stock has topped out and the real selling takes place, he's already out of the stock. Thereafter, unless demand increases, the stock falls until it represents "value", to somebody, for some reason. Then the whole process starts all over again.

This is the basic process and cycle. However, it's complicated by the fact that there are many buyers and sellers, each with his own agenda. A seller may distribute all his stock, for example, but demand continues. It may not be enough to drive the price higher, but it may be enough to keep the price from falling. So, you enter a secondary (or whatever) base in which a new accumulation/distribution cycle begins.

The trick is to figure out whether this new "consolidation" period represents accumulation or distribution, and the only way I know of to be sure is to watch the relationship between price and volume. How does the stock react when a lot of stock is dumped onto the market? Does it tank or does it decline only a trivial amount? Is there follow-through to this action or are the following days business-as-usual? If it's a short, sharp decline with no follow-through, you're probably looking at a "shakeout" (forcing weak hands to sell their shares so the stronger hands can pick them up at a discount) or a spree of short-selling, but the latter is unlikely since it usually takes place over time.

Another help is to draw a line parallel to the bottom of your price-and-volume graph so that only the busiest days show above your line. Note what happens on the busier days. Is the price up or down? What about the slower days? Again, price up or down? If the price rises on heavier volume days (though not enough to break out of the base) and falls on lighter volume days, the stock is most likely being accumulated. Or vice-versa if it's being distributed.

It is important to remember that for a transaction to take place, there must be a buyer and a seller. Huge volume and an increase in price indicates a lot of buying, but it also represents an equal amount of selling. Volume, in other words, reflects only the number of shares traded. Whether the pressure is on the demand side or the supply side is reflected in whatever happens to the price. Unless you put this activity in a context of markets, market psychology, and demand and supply, you stand a good chance of misinterpreting what's happening.

Bases

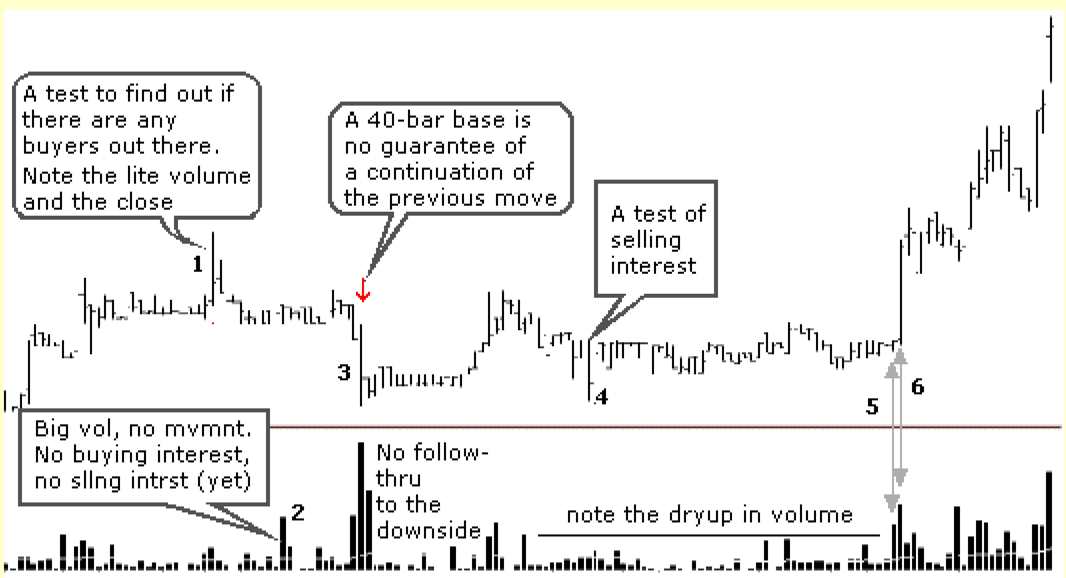
If a stock isn't trending upward or downward, it's in a base. This base may last for only a few days (or hours, if you're a daytrader), or it can last for several months.

What the base represents is an agreement -- however temporary -- between bulls and bears as to what the stock is worth at that time. There's no selling pressure and no buying pressure. Everybody is in harmony (as the mystic said to the hot dog vendor, "Make me one with everything").

If, however, what looks like a base is actually a roller-coaster in a narrow horizontal band with loads of volume to the upside and loads of volume to the downside, no agreement has as yet taken place, and to invest in this stock at this time would be extremely dangerous as there is no clue as to how this battle will be resolved.

So, you look for a base with quiet volume, preferably horizontal, though it can slope downward slightly. The longer, the better, partly to give the accumulation that needs to take place the time to do so. Once enough stock has been accumulated by those who want it, then you start looking for signs of demand. Perhaps there will be a succession of days where the stock closes at its high but doesn't move much. Perhaps there will be a gradual increase in volume. But sooner or later, attention will be attracted, the stock will draw interest, and unless a huge supply of it is dumped onto the market and demand is drowned, the price will rise.

There are, of course, many "sub"-bases, and technicians have given some of them very colorful names, like "sawtooth". What's essential to hang on to, though, is the concept of what bases are for and what they're supposed to do. If the base you're looking at isn't accomplishing what it's supposed to accomplish, it's not a productive base, no matter how well it fits the criteria. If the base you're studying looks like a giant tug of war is going on (do the bars tend to be long?), then it most likely is, and you'd best wait until that contest settles down a bit before you put your money on the table.



Base

This is almost a cat-and-mouse sort of base. Though the mice may not have been amused, whoever was playing the cat must have had a ball (pun intended). The base overall lasted for over 120 bars. And the volume during the first act was fairly low. But note the hiccup in the first quarter ("1"), enticing you to buy (not really enough volume, though). Then there's that much bigger spike at "2". But the price never went anywhere. Then there's what looks like a big shakeout at "3", a quick, sharp spike to the downside, intended to scare weak holders out of the stock, and to clear the stops of those who have 10% limits to the downside. And there's no follow-through to the selling, which is another characteristic of shakeouts, though if this had been a genuine shakeout, one would expect the stock to begin advancing long before the ultimate breakout. Someone, it seems, may just have been having fun -- sometimes you never know.

Then volume dries up again, even more so than in the first part of the base. There's what looks like a breakout to the downside at "4", but it turns out to be false. And there was no volume behind it. There is a volume spike ("5") toward the end, but it's really no different than the one at "2" and, again, there's no effect on price. But the next day ("6"), ***Whammo!*** The volume comes in, the price breaks out of the upper range, and it's time to buy.

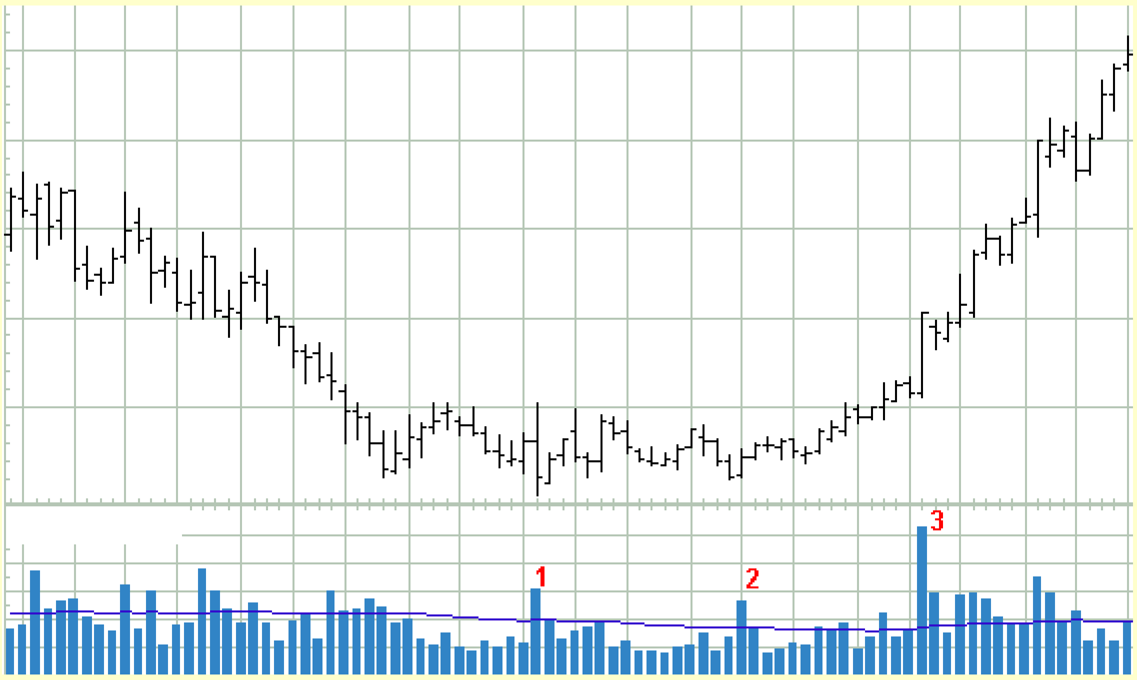
Buying early in this base would have driven most people crazy as it lasted so long. And most who bought on that spike at "2" would have been stopped out at "3". But those who waited and watched and were patient and bought at the right time with the right volume and the right price behavior would have been rewarded with more than a double in less than four months.

Not all bases are pencil-thin, of course. Some rectangular bases are actually wide enough to trade (see the Rectangles file). However, the narrower rectangle can and does perform the duties of a base just as well as its slimmer cousin. This particular base doesn't have the up down up down sawtooth pattern that's so easily tradeable, but this base accomplishes what a good base is supposed to accomplish, i.e., it allows the accumulation process time to develop and ripen.

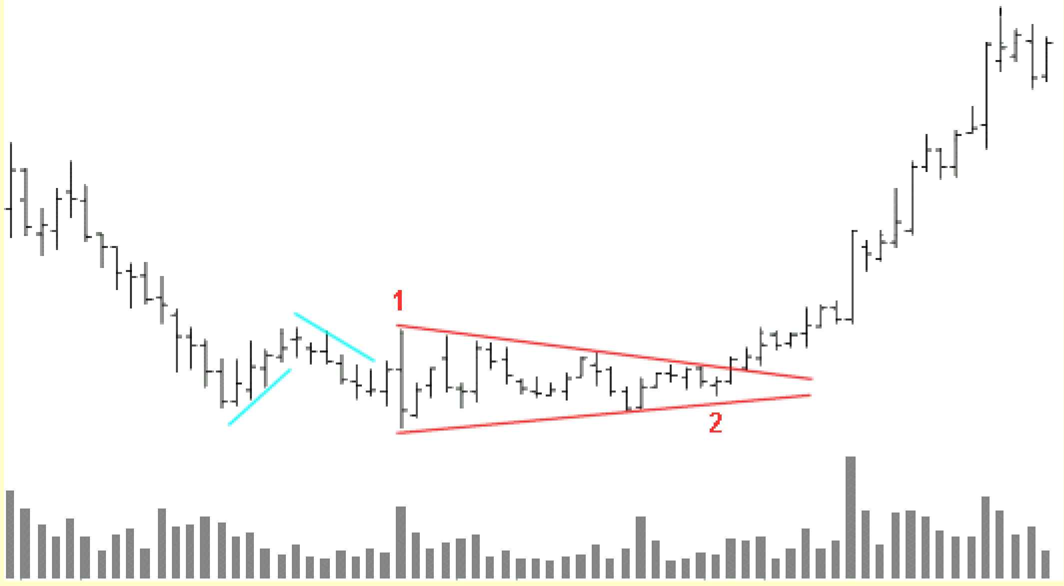
Note that the base, though it isn't arrow-straight, does have a lateral trendlessness that has definite upper and lower boundaries. This particular stock had been bouncing up and down a bit before thinking about settling into a base, but had to make one last test of selling interest at **1**. Selling interest was apparently spent, however (note that the close is well above the low), and buying interest was not yet sufficient to move the price anywhere (note the volume four bars later at **2**), so the stock could settle in for a well-deserved rest (note how volume drops to almost nothing).

There are further tests here and there, now and then (3, 4, 5, and others), but there's little buying or selling interest, and the accumulation process continues on its lateral path. When it's complete, so many shares have been accumulated that there's little supply left to squelch demand, and price can take off with very little to block its way.

This next base occurs at the end of a lengthy decline. Price doesn't bounce into the base like the previous example. Rather it glides in for a soft landing, doing nothing to excite the passengers. This lack of excitement may be due partly to "pre"-accumulation, that is accumulation that begins before the base begins to form (this is actually pretty common, and is one of the reasons the base forms in the first place). Note in this case that nearly all the high volume bars are coincident with price bars which close higher than the open or which at least close higher than the low. There are a couple of bars which close near the low, but there are no big downbars, no follow-through to the downside. Rather there is a steady, controlled decline. There is one selling test in the base at **1**, and a half-assed noodge at **2**, but volume is characteristically quiet. The base accomplishes what it's supposed to accomplish, though, allowing the accumulation of shares so that there's little supply to impede the breakout when it occurs at **3**.

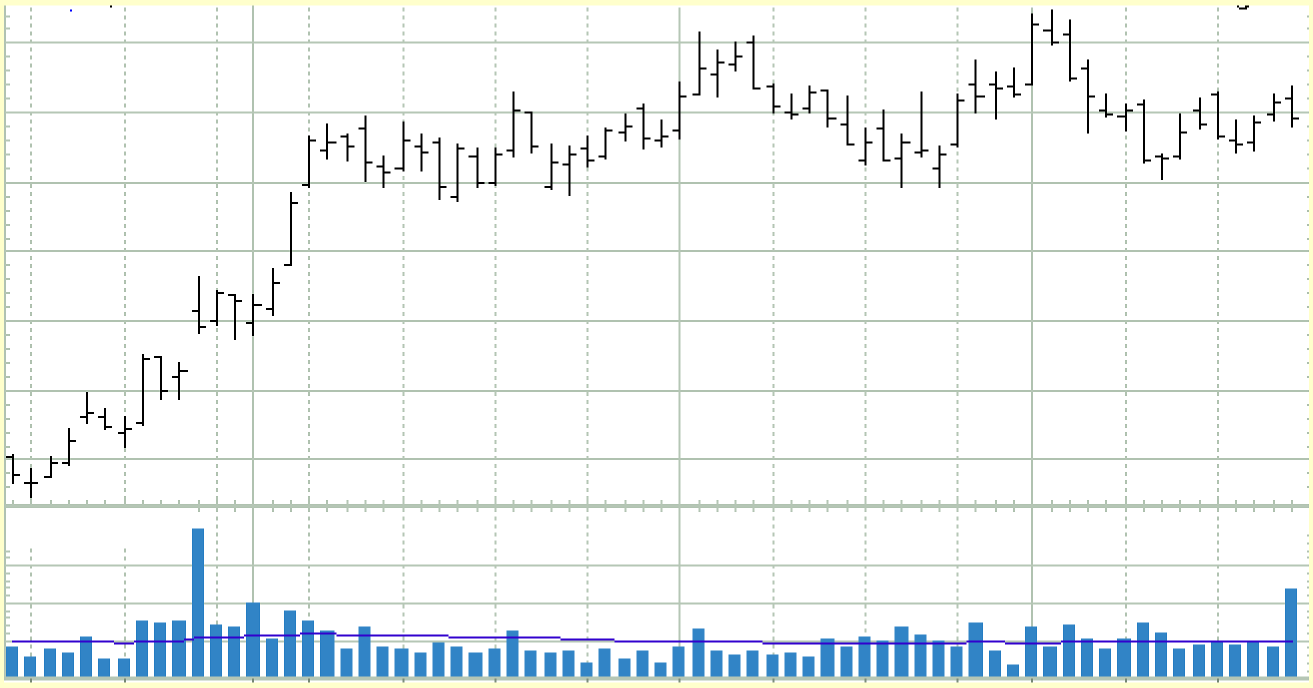


There is one other interesting feature about this particular base which can be found in many other, similar bases and should be looked for. If we zoom in a bit, we can see that there is a small bounce when the stock strikes bottom, then a long bar which encompasses the range of the bounce **(1)**. After that, the range narrows, the bars tend to become shorter, the volume remains relatively quiet, all of which signifies that the stock is reaching "equilibrium", i.e., that price which bulls and bears agree represents fair value. Once that point is reached **(2)**, all that is needed is some spark to ignite the advance or a further decline from this "springboard".



Granted that looking for these "patterns" has something of a "Where's Waldo?" aspect, detecting them in real time requires that the chartist focus on the bar lengths, the relationships among the open/high/low/close, the volume and the bar/volume relationships -- in short, the trader behavior that is occurring and only ***potentially*** causing the pattern to form. Looking for the "pattern" instead will nearly always mean getting it wrong since the chartist's focus will be misdirected.

Finally, an example of a base created after a bottom but before the **real** advance. Here, the stock has bottomed, broken out of that bottom, but is now in a staging area or consolidation. There are all sorts of reasons why such a base might form so soon after bottoming. Perhaps the bottoming process wasn't thorough enough. Perhaps the breakout was orchestrated prematurely. In any event, there's enough supply to prevent an advance, but enough demand to prevent a resumption of the decline. That there is continued disagreement over value can be seen in the "sawtooth" dynamic that forms halfway through the base (which is also tradeable), disagreement which would not be there if the accumulation process had continued to its natural conclusion.



But before we say aloha to bases, an example of a mess. There is nothing here that suggests acummulation, equilibrium, calm, focused intent. Rather there is a wild thrashing around, looking for a trade. High-risk, low-probability. Just the sort of thing novices love.

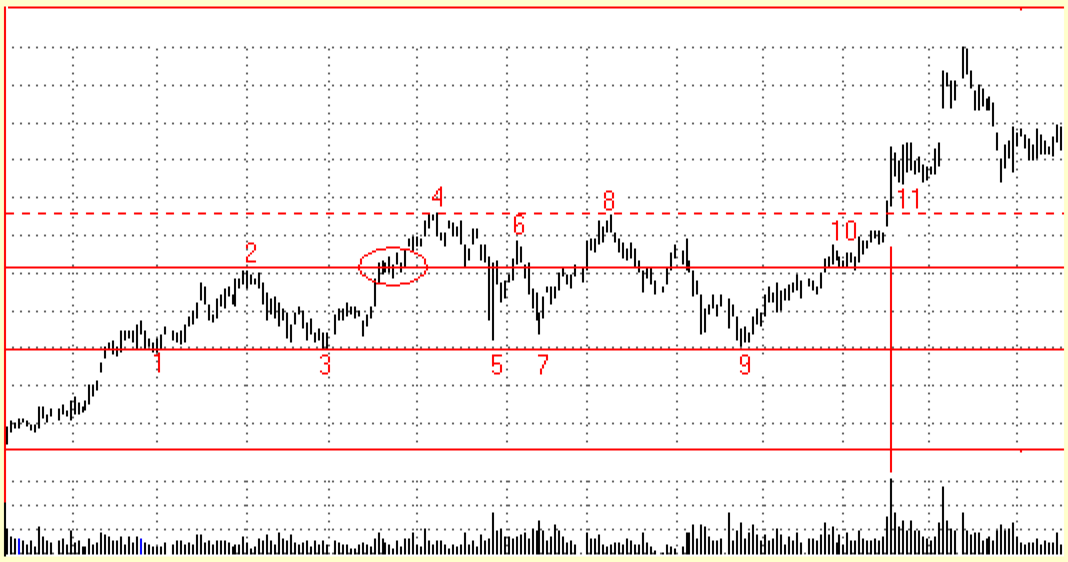
Rectangles

Rectangles are a particular kind of base. They move sideways like a flat base, but they sure ain't flat and they sure ain't quiet. And they illustrate the phenomena of support and resistance in a very simple and easy-to-interpret way, better than almost any other kind of base.

What causes a rectangle is that the stock reaches some sort of limit -- for whatever reason -- and heads in the opposite direction. It then makes another U-turn and reverses course yet again. But instead of just thrashing around in an undisciplined, random way, it proceeds to where it stopped the first time, pauses and reverses in the same place, then repeats this performance over and over again. What you end up with is a pattern that looks like a zig-zag or a sawtooth, always bound by a consistent (more or less) and parallel pair of lines top and bottom (you'll also hear a rectangle called a trading range or consolidation pattern).

There is nothing quiet about the volume pattern in these bases. To the contrary, they are a graphic illustration of the battle between bulls and bears: the bulls buy at support and sell at resistance; the bears short at resistance and cover at support. There is a lot of energy in these patterns (the longer and/or wider the pattern, the more energy it represents), and when the stocks eventually break out of them either to the upside or downside, the moves can be explosive. And, as mentioned earlier, these bases are anything but flat. Not only can the ranges from top to bottom be quite wide, but the time it takes to make the round-trip can be quite lengthy, making these patterns attractive to intermediate-term traders with a short-term bias.

Before getting all excited about the possibilities here, though, we have to figure out where to draw our lines. Sometimes it's easy. More often it requires judgment.



This sort of pattern is common. Support in this particular case is obvious, but resistance is problematic (or vice-versa in other instances). The short-term retest of support at **(1)** gives us a tentative support line (it'll be a while before it actually gets tested for real). When the stock stalls at **(2)**, we have a tentative resistance line. When the stock retests support at **(3)**, we have more confidence in our not-so-tentative support level.

When this stock retests resistance, however, it waffles around in what's called a "congestion area" for six bars, then seems to break out to the upside. One might be forgiven for buying this breakout, even though it's not confirmed by volume. After all, he'd get 10% out of it. But, as it turns out, this breakout wasn't to be **(4)**, and the stock falls back into the trading range.

At this point, one could move the upper limit to where I've drawn the red dotted line. Or one could leave it where it is and make the higher limit tentative until the behavior of the stock becomes more clear. If nothing else, the solid upper-limit line can serve as an early warning of a breakout in the event one doesn't actually want to buy there but would prefer to wait for confirmation if and when the stock breaks through the dotted line.

In the meantime, our support level is tested once again **(5)** and found to be solid. This is followed by another false breakout **(6)**, another retest of support **(7)**, and yet another false breakout all the way up to resistance at the dotted line **(8)**, indicating once more that the dotted line is the most likely area of resistance that must be penetrated when the stock finally gets off its duff and makes a real effort.

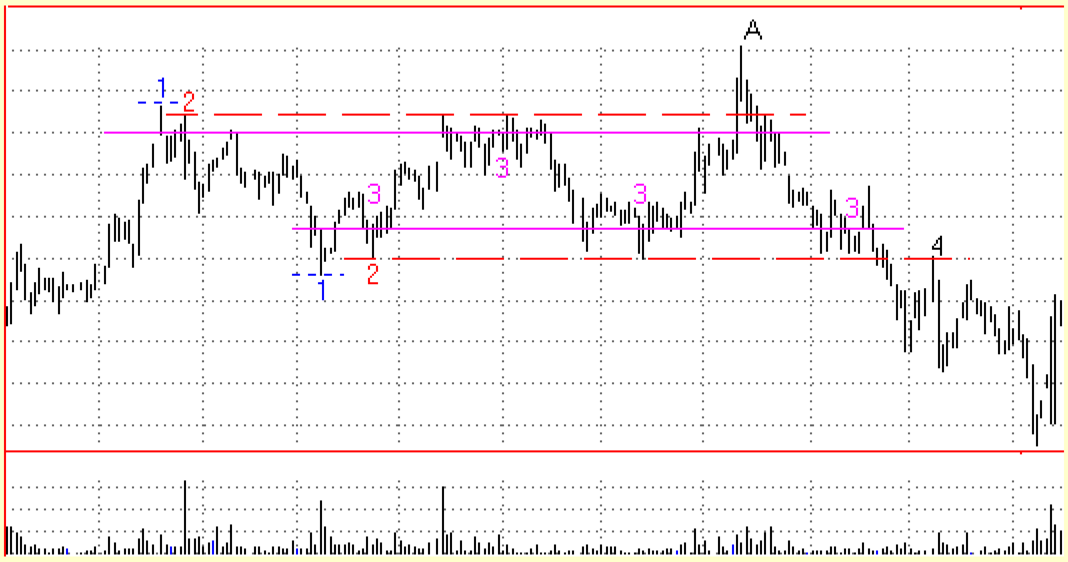
After yet another retest of support at **(9)**, the stock gives it another shot, getting caught up in another congestion zone **(10)** similar to the one between **(3)** and **(4)**. Is this a prelude to another false breakout or not? Still no volume, and nothing to indicate anything out of the ordinary, even when it resumes its tentative advance. Then the volume kicks in, propelling the stock through resistance represented by the dotted line. Traders had one full bar's notice here, as the big-time volume doesn't come in until the following bar, forcing the can't-be-missed upmove **(11)**.

One of the most appealing aspects of rectangles is the multiple opportunities it gives you to buy. Even before the rectangle has legitimately formed, one has at least two opportunities to buy: when the stock bounces off support, and when the stock penetrates resistance to the upside. If the volume isn't there at the "breakout" and you decide to wait, you have yet another opportunity when it tests support the second time. And maybe the third. And even the fourth. And all the while you're gathering up other interested buyers along the way, all of whom are going to add additional power when that eventual breakout comes (you're not the only one kicking yourself that you didn't buy it the first chance you had to do so).

(If you reverse the above paragraph from "buy" to "short", "support" to "resistance", and "buyers" to "short-sellers", you'll see the possibilities for increased profits.)

As stated earlier, the best times to buy (short) this pattern are when the stock bounces off support (if long, or resistance if short) or when it breaks through resistance (if long, or support if short). One of the nicest features of this pattern is that you needn't wait by your computer day-by-day, hour-by-hour, never knowing when that breakout is going to come and not wanting to miss it when it does, a common occurrence with cups and flat bases (and Ws, if the stock decides to form a ledge at the breakout point). With rectangles, you can see the breakout coming a mile away. Your biggest challenge is being patient.

There is one snag here, and that's the false breakout, either to the upside or downside. Since what may seem like a false breakout may actually be the result of having drawn your upper and lower limits in the wrong place, let's look at another thorny example.



There are at least three places here where one could draw his upper and lower lines. The first (**1**) is at the upper and lower limits of the pattern. This would be legal and correct, according to many, and doing so wouldn't steer you too far wrong. The problem with doing this with this particular pattern is that the breakouts, when they come, may be within the boundaries of the lines you've drawn, not "at" them. Thus the breakouts may be well in progress before you even notice them.

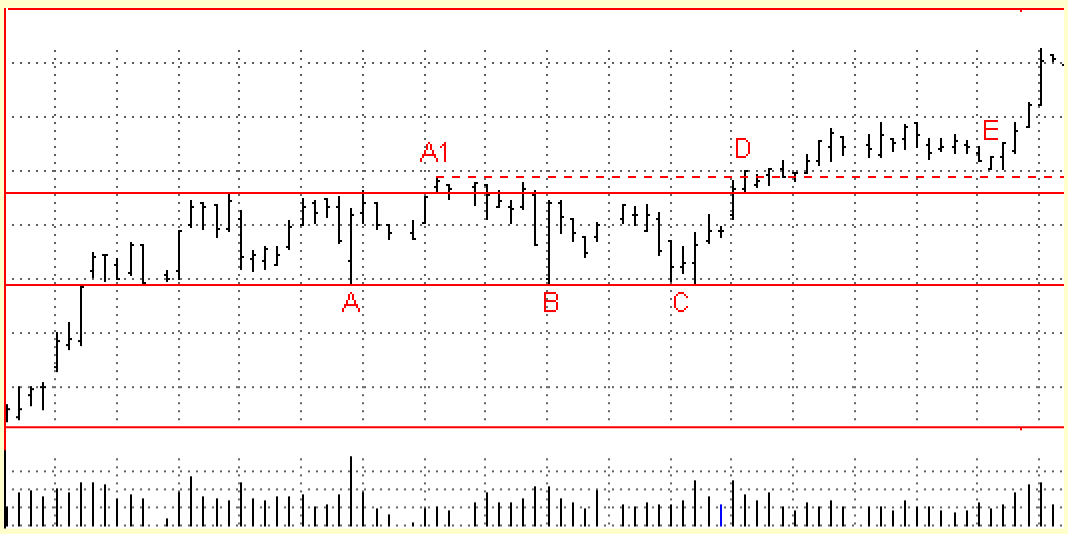
Making lines drawn at **(1)** tentative and keeping your eyes open for natural areas of support and resistance would, in this case, result in lines being drawn at **(2)**. Notice how many times the lines drawn at these levels are tested and retested. Clearly they are more natural lines than those drawn at **(1)**.

A third school would have you draw your lines through the congestion areas **(3)**. This has its advantages in that it puts you right on stage when the breakout comes. The disadvantage is that you have to monitor the stock much more closely when the price re-enters one of these zones. They can drag on for days or weeks, and in the meantime, you've got other things to do. Personally, I prefer the natural lines drawn at **(2)**. They give me notice, but they don't require me to stay glued to my seat (note also that the retest of support-become-resistance at **(4)** indicates that these lines are in fact the lines to beat).

Theory aside, the lines drawn at **(1)** and **(2)**, at least in this example, give you the fewest number of false breakout signals: in each case one, at **"A"**. How would you have avoided being suckered into this one? The volume was good but not great. But it was good enough. And the price certainly behaved as if it were being shot out of a cannon. Avoiding this move, therefore, would probably have been a mistake. An even bigger mistake, though, would have been to buy this breakout and not watch your back. A pro would have set his stop just below the upper limit and triggered it without hesitation. If a stock re-enters the trading range after what one thinks is a breakout, the stop must be exercised, no questions asked. The fact that there was no follow-through whatsoever to this particular move up would have strengthened the backbone of anyone tempted to let this one slide and pushed him to trigger that stop. And note that when the real breakout came to the downside, a stop placed just above the lower limit at **(4)** would not have thrown you out of the stock.

Because rectangles usually telegraph their behavior so strongly (i.e., give you plenty of notice as to what they have in mind), it's not difficult to become complacent, particularly if the stock has rewritten its timetable and decided to take a little longer to reach support/resistance than you'd expected. While you're not looking, the stock hits support, bounces upward, and is well on its way to your upper line. Missed it. Or maybe it didn't quite reach support before making a U-turn and running for daylight. Missed it anyway.

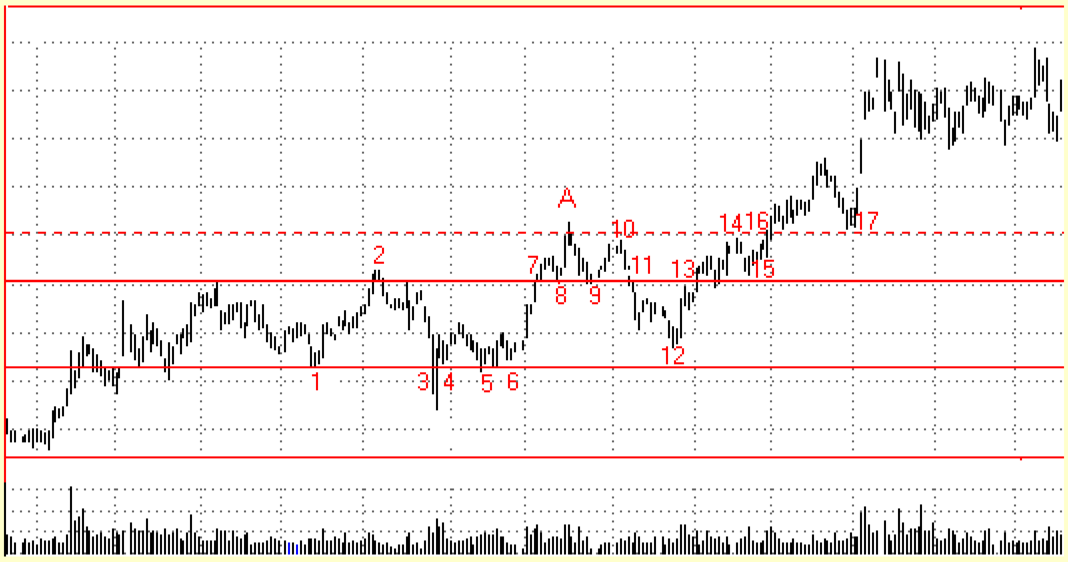
So you decide to wait and see if the stock breaks out this time when it hits resistance. Lo and behold, it does, but volume seems a bit weak and you think it's another false breakout. So you let it go. This time, however, the stock holds four of a kind and the breakout's for real. Do you chase it? Or is there a third opportunity to pick it up?



Here is a good example of a third opportunity. The support line here is almost eerie. You could eat dinner off this line. **A** would have seemed like a good opportunity to buy, but it didn't work out (unless you were buying support and selling/shorting resistance within the range). **B** may have been another (again, if you were trading the range), but the volume wasn't all that great. The best opportunity came at **C**, but you'd already been faked out twice and didn't feel like being yanked around again (which, of course, would be the time to buy). So you missed it.

Your second opportunity, however, is just around the corner. The stock breaks through the upper line at **D** and never falls back into the trading range. Do you buy it? Are you still concerned that it may turn on you and bite you? Maybe you're eyeballing that half-hearted attempt at a breakout at **A1**, and you think the stock is trying to pull another fast one (even though the volume back then was pitiful). So you decide to wait again, looking for a sign. You even draw a new, tentative, upper line (dotted), daring the stock to cross it.

Well, it does. Did you miss it again? Maybe not. You do have a third opportunity to buy, when the stock retests what was resistance and should now be support at **E**. Volume pumps in and gives you a third and final opportunity to buy without chasing the stock.



Three opportunities? For the aggressive trader who plays both sides against the middle, there can be multiple opportunities to buy and short. The truly aggressive could find even more than I've numbered here. If you are even close to being tempted to try this high-wire act, though, remember that you must have a definite exit strategy in case the stock decides to play with you. Notice that toy head-and-shoulders formation at **A**? How would you handle that? Where would your stops be? I suggested earlier that the stop for a long buy could be just below what had been resistance and the stop for a short sale could be just above what had been support. But whether you use stops such as these or place them elsewhere, you can't waffle around. These ranges can be quite wide, and the profit potential from bottom to top (or vice-versa) can be very attractive. The narrower the range, however, the less wiggle room you have. Therefore, it's best to get in the habit of a rigid stop-strategy regardless of the distance between the upper and lower limits of your rectangle.

Again, playing the ups and downs of the stock within the rectangle is only for the very aggressive. Conservative traders will allow the energy to build and buy only when a bounce off support is accompanied by strong volume or when strong volume accompanies a breakout through resistance (or perhaps when and if they miss the first two opportunities and the stock retests support after breaking out). Once in, they will then apply their favorite trade-management strategy so that all this waiting around yields more than just a few points.

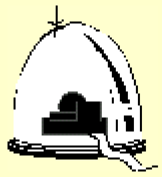
Price and Volume: Practicum
(Excerpt)

. . . the experience of the past few years has emphasized the value of disregarding all considerations except those which relate to price movement, volume and time. If one is endeavoring to realize profits from the principal swings in prices of stocks, it is my opinion that he should disregard fundamental as well as corporate statistics relating to the stocks in which he is trading, stick closely to a study of the action of the market and become deaf and blind to everything else.

-- Richard D. Wyckoff

This effort is centered around the **Law of Supply and Demand** and how it's manifested in price and volume. It's not about tactics per se. Understanding the law comes first (though one can, of course, trade without having the slightest idea what supply and demand are). Once that law is understood, there are many, many sets of tactics that can be employed to profit from what one has learned, not only with regard to entry and exit, but also with regard to trade management.

The charts used for illustration employ a 5m bar interval. However, the principles of supply and demand, support and resistance, and trend apply regardless of the bar interval, whether 5m, 60m, daily, weekly, etc. I should add, however, that, even though these charts use 5m intervals, it's important to consult at least one chart with a larger bar interval, at least 60m in this case, if not daily or weekly, in order to get some idea of the general or "macro" trend. It's also important to consult at least one chart with a shorter bar interval, e.g., 1m or 2m or even a tick chart, in order to see what's going on within each candle or bar, particularly the long ones (if using a daily chart, one would want to bracket it with, for example, a weekly chart on the one hand and maybe a 15m or 30m chart on the other).



Before opening our booklets, however, it becomes necessary to address some basic principles (laws, such as the Law of Supply and Demand are absolute; *principles* are not). Otherwise, it is unlikely that the trader will know what he's looking at. The most important of these principles has to do with **support** and **resistance.**

Support (S) and resistance (R) provide those zones at which or in which one expects to see some action. To trade without regard to support and resistance can mean a lot of little stopouts and a lot of breakevens, called amongst the more lurid traders a "slow bleed".

Essentially, support and resistance levels can be found at those levels or zones in which a relatively large number of trades took place. These trades need not have occurred on only one occasion. In a base, for example, when "big money" is accumulating shares, these trades take place over an extended period of time over a narrow range of prices. Therefore, all told, many trades have taken place even though volume has been low.

Many trades can also occur in a broader range over a period of time which may be shorter or longer than an accumulative base. For example, if a given level is hit repeatedly and price is "supported" there by professional demand, that level becomes strong support, even though the number of shares traded during any one occurrence are not impressive.

Ditto all of this for resistance. There will be a level at which shares or contracts or whatever are repeatedly sold, though the reasons for the sales may be difficult if not impossible to determine. These sales can take place in a "zone of distribution". Or they can take place over time when a particular level is repeatedly tested.

Support and resistance, then, can be found in a swing point or the top or bottom of a reaction, but it is highly unlikely that the support or resistance found there will be important as it doesn't represent enough previous trades. In other words, there just aren't enough traders who care about it to make it important.

For the same reason, whatever support and resistance seem to be found with indicators or trendlines are most likely coincidental since these other lines don't represent previous trading activity. In fact, they're constantly moving.

The term "law of reciprocity" or **"principle of reciprocity"** is sometimes applied to the tendency of support to become resistance when it's penetrated, or vice-versa. However, "law" and "principle" are a bit high-toned to apply to this concept. There is nothing absolute about S/R. In fact, S/R can be quite soft. For example, if a given level is tested repeatedly as support, those holders who bought there may eventually begin to become concerned over these tests and over the fact that whatever they bought isn't going anywhere. Some of them may decide to sell some of all of whatever they bought if and when another test occurs. In this way, support fails.

Even "failure", however, may not be as important as first thought. S/R isn't, and need not be, rigid. In fact, it is quite flexible. A level or line can be penetrated to what seems to be an intolerable degree, but if price rebounds to that level or line and finds S/R there yet again, then that level or line can become even "stronger" (more important) than it was before, which is why it's better to think in terms of S/R "zones" than of specific prices.

S/R may, in fact, be too soft for some traders to fool with. However, if one understands that correctly-drawn S/R lines represent levels or zones in which a large number of trades took place, and that one can expect important action to take place at important S/R ("important" defined earlier), he can then avoid wasting his time on relatively trivial trades and prepare himself to take advantage of more potentially profitable opportunities. As always, it's best to put a *face* on principles so that one has a deeper understanding of what's going on (i.e., what traders are thinking) rather than just busy himself with only lines and calculations.

We're used to the idea of strong volume being "good" if it's on the upside and "bad" if it's on the downside (assuming we're long). But volume in and of itself has no good or bad connotations. All volume signifies is number of shares (or contracts or whatever) traded. Only by relating the volume to the bar does the volume carry any implications.

Here, for example, there's a nice, strong volume bar at 10:05, and if we were using "color-coded" volume, it would be green. But all is not well in VolumeVille. Notice that the price bar closes well below the high, apparently finding **R**esistance from the **P**revious **D**ay, signifying a shift in balance between buying pressure and selling pressure, and the news ain't good for the buyers. Hence, the volume bar is not "good"; it just signifies a lot of activity. You have to look at the price bar to figure out the nature of that activity (note also the lack of **F**ollow **T**hrough two bars later).

Similarly, that long, strong volume bar at 11:00 would seem to give heart to sellers. But that much activity often points to a "selling climax" (**SC**), which results in either consolidation or reversal (the same is true for the "buying climax", **BC**). Note that after the SC, trading activity -- as recorded by the volume bar -- trails off rapidly and dramatically, and so does the downward progress of price. It waffles around for a half hour, but then buying pressure gains the upper hand, breaking the **T**rend **L**ine, and trading activity increases. For a while. Shortly the activity trails off, but the selling is pretty much done, so price can drift higher without a lot of "volume" (though it does find R from the **O**pening **H**igh along the way before staging a **B**reak **O**ut and reaching a **N**ew **H**igh).

You're going to have to look at a lot of charts before this becomes clear to you, much less second nature. But if you remember the first time you looked at a chart and had no idea what all those lines meant, you'll have some idea of what it means to learn a particular way of seeing, or of perceiving reality, much less of creating and developing a concept of it.

The **PDH** is, of course, the **P**revious **D**ay's **H**igh, which you can see for yourself by scrolling up to the previous chart. Price finds R there, fails to make a **N**ew **H**igh, volume trails off indicating a lack of interest in the whole thing, each attempt at a high is lower than the last; it doesn't look good for the buyers.

Finally, *Wham!* and we have a potential SC already, forming a hammer at Support from the Previous Day (the Opening High, tested at 14:00). And the downward momentum is retarded, though not ended. Price takes an hour to decline just a few points. Sellers aren't desperate to unload, but buyers aren't exactly on fire, either. So though we end the day six points lower, it's all mostly a sideways drift.

So how was one to profit from all this? Focus on the balance between buying and selling pressures. Note first the successively lower highs mentioned earlier. Note also that the bars get shorter and shorter as the buy/sell balance reaches equilibrium during the first 2+ hours. Then, at 11:55, it all lets go, to the downside, as if price had eaten a bad taco.

Where to sell? Up to you. Price continues to make lower swing highs until late afternoon.

The preceding is an excerpt

THE BASICS

Winning the Mental Game on Wall Street
by John Magee, W. H. C. Bassetti (Editor)

This is the book I would recommend to anyone interested in trying his hand at the stock market.

It is not, however, exciting, by any stretch of the imagination. Nor is it a book to read over the weekend. Magee takes his time, and the reader would do well to take his time also.

This is a book to think long thoughts about. It is not at all difficult. It is, in fact, very easy. But the concepts which it addresses are fundamental, in the deepest sense of the word, to an understanding of what markets are, how they work, and what one can expect to earn from them.

The Nature of Risk/How to Buy/When to Sell
by Justin Mamis

Once you understand the basic concepts explored in Magee's book, these three will tell you most everything else you need to know to be a successful trader/investor. These are classics, which to some people means "old" or "out of date". How to Buy and When to Sell were, in fact, out of print for a while, but reader demand brought them back, which is always a nice endorsement.

Following are the reviews I wrote for The Nature of Risk:

It's been four years since I first reviewed this book [next review]*, and I still consider it to be absolutely essential for anyone considering any sort of involvement in the financial markets. In fact, it's probably essential for anyone who is considering anything at all that entails more than minimum risk.*

The amateurs miss the point. This is not about the best stochastic settings or how to massage the bid and the ask. This is about facing up to the very real risks inherent in the financial markets, including the very real risk of financial ruin. Amateurs don't see the risk; therefore, they don't bother to grapple with it. Instead, they would rather blow up and disappear. If one wants to last, he must come to terms with the nature of risk, his own tolerance for risk, an understanding of how to manage risk. Without that, he's doomed.

The Nature of Risk is a seminal work for anyone who understands that self-knowledge is key for success in the financial markets, particularly at market extremes. Rather than babble about risk in general, Mamis takes this engine apart and examines its parts, among which are information risk and price risk. He explains that as one's tolerance for information risk increases (the need to know why the stock is doing whatever it's doing), one's price risk diminishes (one is better able to jump in and take advantage of whatever opportunities for picking up cheaper shares present themselves). On the other hand, if one has no tolerance for information risk and must know everything about a stock's movement, his price risk will be that much greater because the price will likely, by then, have risen to an over-extended level. Therefore, having identified these components of risk (time risk is another), one must then balance them out in order to approach the markets rationally and unemotionally.

An extremely important work, particularly for the investor who is plagued by doubt, confusion, and anxiety.

The Nature of Risk and When to Sell were "updated" in 1999 and How to Buy in "2001", largely because they hadn't been updated in years. And while most novices want whatever is hot off the presses, the concepts presented in these books are timeless and require no "updating" whatsoever.

What did and does require updating were the "indicators" which Mamis used for helping him get a feel for what was going on underneath the market, and by "indicators" I don't mean mathematically-derived appliances like RSI and MACD and CCI, I mean indicators of breadth and sentiment and so on, such as those which Zweig has used for so many years, e.g., specialist short-selling, odd lot sales, new highs/new lows, etc.

Unfortunately, what with the dominance of funds, hedging, arbitrage, and online short-term trading, most of these indicators are no longer of much use, leaving advancing and declining volume pretty much alone as a guide to underlying sentiment.

Studying these three will enable you to obtain much of what is covered in Wyckoff's books and to skip Weinstein entirely.

TAPE READING

Since most novices -- and not-so-novices -- are interested primarily in buying when the blue line crosses the red line and are therefore searching for which blue line is the "best" and what settings are the "best", there isn't much out there on the basics of supply/demand, support/resistance, price/volume. Those who would like to understand what's going on rather than just be told which button to push will benefit from:

Techniques of Tape Reading
by Vadym Graifer, Christopher Schumacher

My review: *There's been little of value written on tape reading since Neill's book in the 40s, and before that, Wyckoff's work in the 20s and 30s. Possibly the popularity of "indicators" stole some of tape reading's thunder, since indicators are purportedly "simpler" to use.*

I had hoped that the book would be a bit more thorough, but after finishing it and giving it a second read, I understood that what Vad and Chris are trying to do is reduce TR to a set of basic principles, easy to explain, easy to understand. The buts and unlesses and on the other hands are left to many specific examples which illustrate just what it is they're trying to get across. In this way, one can come up with his own examples to illustrate the concepts rather than rely on some sort of "blueprint", in the event that he is trading a different market, a different bar interval, a different timeframe, or even using indicators to supplement his judgement.

Unfortunately, the book begins with what has become the obligatory "once I was a loser and then I became a winner" section. Not that it's boring or that there's anything wrong with this sort of autobiographical touch. After all, one would most likely be put off by someone who puts out a trading book beginning with only his successes and giving no hint of the often rocky road one must travel in order to achieve those successes. But those who have read more than a few trading books are likely to find that they could have skipped this and gone right to the meat of the book, i.e., the principles of tape reading, and there's plenty of meat here. No, the book is not encyclopedic, but, contrary to what you may have heard, tape-reading does not require the encyclopedic approach. Keep It Simple.

If all you have, then, are Wyckoff and Neill, this should pull everything together for you in a way that will enable you to gain some traction on this tape-reading stuff. The advice on how to create a setup and how to evaluate what you've created should be of particular benefit to beginners who continue to struggle with this and with the misleading notion that the riches lie in finding that one perfect golden setup.

Tape Reading and Market Tactics
by Humphrey Neill

Never got around to writing a review of this one, but you're talking about three tape-reading books in a hundred years. This may not be an absolutely essential book, but it's easy and interesting and he may just put something in a way that makes sense to you that didn't make sense before.

Studies in Tape Reading
by Richard Wyckoff (sometimes Rollo Tape)

My review: *Virtually everything written after Livermore and Wyckoff are variations on themes developed by these two men. Wyckoff was among the first to explain the accumulation-distribution cycle (which makes stock and market timing possible) and to develop the use of "surrogates", self-made indexes which consist of a handful of leading stocks in a group (such as semiconductors), which warn the investor of impending moves, and which enable the investor to filter out all the noise of broadcasters, publishers, newsletters, message boards, and chat rooms.*

Understand Wyckoff and you'll understand the engine that drives stocks and markets rather than be distracted by the genuine imitation wood trim and the smell of the leather seats.

[Note: anything written by Wyckoff is worth study, but there's only so much to say, so if you're trying to read everything he ever wrote, don't be surprised by a sense of repetition; at that point, move on to Neill or Graifer or review Mamis and Magee.]

THE MENTAL GAME

The Disciplined Trader and **Trading in the Zone**
by Mark Douglas (and, yes, you need to read both, The Disciplined Trader first)

The number one reason that I like The Disciplined Trader is that Mark Douglas has no formal training in psychology. Rather, Douglas was trained in the only classroom that matters: the battlefield of actual trading. Even though this book was published in 1990 and there have been a plethora of trading-psychology books published since then, Douglas' material stands out as an innovative classic. He uses his own gift for seeing the mental shortcomings of the losing trader and spells out his own fresh insights on what we, as traders, need to do to experience real success in trading.

Douglas starts the book out from a perspective that many traders can identify with: crushing defeat. Humbling himself to the higher power that is the market and analyzing the formula for defeat, Douglas shows how he was able to reverse-engineer it to find the formula for success that many of the book's readers over the years have found useful in exorcising their own psychological demons.

Central to Douglas' thesis is that the elements of character that produce success in most of life's endeavors are completely different from those that will make you successful as a trader. To thrive in business or some professional career, you have to work hard to develop the skills that will allow you to be in control of your environment. To build a business empire, you have to be a great leader of people. To become a heart surgeon, you have to learn how to control your scalpel. To be a good mother, you have to know how to discipline your children.

But successful trading, says Douglas, is the process of yielding to the market and being in control only of yourself and the way you respond to changing market conditions. When the idea of being in control of yourself sinks in, you realize that you as a trader get exactly what you deserve from the markets. If you consistently get poor results, you deserve this. If you consistently get great results, you deserve that. The market doesn't care, one way or the other.

As with any book filled with original and profound ideas, The Disciplined Trader isn't always an easy read, particularly as it slogs through the painful process of pummeling away at our self-destructive mechanisms. Fortunately, as with life, the journey provides a reward and Douglas spends the final chapters of the book explaining practical techniques that will help you to "get it together" as a trader.

-- Tradingmarkets.com

The process of becoming a successful trader is not just about learning about markets and developing a trading system that works; there is so much more to it than that. Most people get wrapped up in the practical nuts-and-bolts of trading or investing but miss the most important step: developing the proper mental and psychological skills.

To become consistent, it is essential that one spend some time getting to know what the market really is as opposed to what the trader would like it to be. The market is not your enemy, does not owe you anything, and does not care whether you win or lose. It just is. The sooner one accepts that, the faster he/she progresses. This means performing a careful self-assessment, identifying beliefs that will short-circuit consistency, and getting them out of the way. As Douglas describes it, 95% of the trading errors all traders make are due to his or her attitudes (fears) about four things: 1) being wrong, 2) losing money, 3) missing out, and 4) leaving money on the table. Getting over them may seem daunting in the beginning, but that is where [Trading in the Zone] *comes in.*

Douglas also describes the process that all successful traders must go through and that is developing a probabilistic mindset. All great traders have learned to think in probabilities. This means that every market decision is made only once a risk/reward ratio has been determined, stop losses and profit goals established, and pre-determined conditions for taking the trade known. By removing the extraneous "noise" that causes undue emotional and psychological stress, decisions become easier to make. As is true of most things in life, sounds easier to do than it is, but the good news is that, with a little practice and with help of an exercise outlined in the book, it is very doable.

Zone is a book that you will want to read multiple times. As Douglas says, it is a book that took him five years of his life to write. It was obviously a labor of love. This comes through loud and clear when reading it. The book is also one that should be in the library of anyone in the markets today, no matter whether his approach is straight technical analysis, strictly fundamental, or somewhere in between. My book is covered in post-it notes, underlines and yellow highlighter. It is also one of the three best books on trading to date that I have reviewed.

-- Matt Blackman (regular contributor to TASC magazine)

Zen and the Art of Poker
by Larry Phillips

From the perspective of a trader, I loved this book. I find it ironic but strangely fitting that one of the best books on trading psychology I have ever come across turns out to be a flimsy little throwaway paperback that was not written about trading at all.

Poker and trading are strikingly similar disciplines. They are both one-man endeavors; they are both zero sum games played for financial gain at the expense of opponents; they are both oriented towards luck in the short run but skill in the long run; they both require proficiency in the realm of probability and statistics; they both require a taste for risk and an aversion to risk in equal amounts; they both require an ability to read the emotions of others while controlling the emotions within yourself; and they both see profits consistently flow from the losing many to the winning few over time. Because of these similarities, the skill sets of the poker player and the trader are in many ways interchangeable.

Of the 100 "rules" for poker presented in this book, I would say at least 80 of them have a direct and valuable application to trading (just mentally substitute "losing" [or being "stopped out"] for folding, "markets" for cards, and so forth). Many of the rules overlap, or repeat a principle that was highlighted only a few pages back, but unless you are a nitpicker, this does not take away from the book. Some of the unique observations truly shine, for example, I was immediately struck by the concept of viewing inaction as a weapon, and intrigued by the nonstraining nature of patience (hint: if you are struggling, you are not doing it right).

I can't claim that this book taught me a lot of new things. Instead it clarified my vision of old things, which is truly far more valuable. I cannot stress enough how valuable it is to deepen your understanding of the principles that you think you already know, but in reality do not. Focusing on depth rather than breadth of knowledge is so central that it has been a constant underlying theme in my growth as a trader and a student of life in general.

Certain sections of this book, not to mention the full book itself, could literally make it worth 100 times the price to the beginning trader. If the lessons sink into your psyche, they could easily help shave a few thousand dollars off the cost of your "tuition" (the losses incurred from the time you begin to the time you achieve profitability, if ever). A few powerful sections that spring to mind immediately are the ones on folding and inaction, the nature of patience, the interplay of skill and chance, the long-run aspects of the game, and potential hidden motives for playing.

-- "trader 75"

Additional files available

The following, along with the "Introduction" (**What's A Chart?**), **It's the Journey**, and **Bases** and **Rectangles**, are, in a sense, chapters in an e-book. However, they are in separate pdfs rather than a single pdf because to order them in some way implies that there is a "best" way to read them, much less study them, and whatever best way there may be is up to the reader.

The **Demand/Supply** "chapter" is at the core of all of this and, to a very large extent, it can stand alone. However, there is no logical "next step". Perhaps one might want to go right into the topping and bottoming processes addressed in **Demand/Supply**. Or maybe the /\/\s and \/\/s that form there are of special interest. Perhaps one wants to move right into **Trendlines**, or has need of **The MindGame**. It really doesn't matter what routes the reader follows, making the book in a sense inductive, enabling the reader to put the pieces together in whatever way is most beneficial to him.

Demand/Supply: the auction market, and how the law of supply and demand creates cycles of accumulation, markup, distribution, and markdown

The Big W: recognizing and trading the "W" (or double-top/double-bottom) pattern

Tops 'n' Bottoms: market timing

Bottom Fishing: the art and science of buying low

Trendlines: what they are, how to apply them, how to benefit from them

Stalking the Wild Equity: what to buy and when to buy it

The MindGame: finding and maintaining a psychological edge

Price and Volume: Practicum: the relationship between price and volume, the dynamics of buying and selling pressures, determining support and resistance, choosing strategies, developing and implementing tactics

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