THE AUSTRALIAN TECHNICAL ANALYSTS ASSOCIATION NEWSLETTER

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The Australian Technical Analysts Association Newsletter is published by the Australian Technical Analysts Association Inc (ATAA). It is a vehicle for the interchange of ideas and information about technical analysis of markets. This forum is available at the discretion of the editor for the views of members, guest speakers and guest writers.

Contributing to the ATAA Newsletter is encouraged and will repay your effort by expanding and sharpening your analytical ability. The emphasis of the Newsletter is on original articles, although consideration may be given to material of interest previously published in other publications. Newsletters are published each January, March, May, July, September and November. The deadline for copy is the 20th of the previous month: ie December, February, April, June, August and October.

If you would like to discuss how you could contribute, telephone Roger Lawes on 02 375 6536. Contributions should be addressed to Roger and sent to him at GPO Box N255 Grosvenor Place Sydney NSW 2000. Our preference is that you submit articles in both hard copy and on IBM disk. Software packages preferred are WordPerfect 5.1 and Lotus 2.2. However, most packages will generate an ASCII file, which will be fine.

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Welcome to New Members

Nick Bury	VAUCLUSE	NSW	Leif Anderson	KILLARA	NSW
Michael Gavelis	DONVALE	VIC	Guy O'Donnell	BOWRAL	NSW
Martin Melse	SOUTH PERTH	WA	Kimberley Lathe	MOSMAN	NSW
Aldo Scalzi	PLYMPTON PARK	SA	Peter Somervell	ST IVES	NSW
Roger Berryman	SYDNEY	NSW	Simon Kitson	MELBOURNE	VIC
Richard Pinson	GEILSTON BAY	TAS	Mathew McCrum	MELBOURNE	VIC
Philip Hemstritch	RICHMOND	VIC	Bridget Stafford	THE ROCKS	NSW
Leith Whitehead	ASHMORE	QLD	David Loxley	ST LEONARDS	NSW

Our national membership has now grown to 256

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Member Profile

The Membership Directory was sent recently to those members who indicated their wish to be included. In all, seventy one members participated. Colin Nicholson has analysed the Directory to obtain a profile of the members who submitted details of their interests for publication. Since it represents about 30% of our membership, it is a reasonably representative sample. However, as it only includes those who wished to share their interests with other members, it may contain some bias.

The analysis is in percentage terms. That is, what percentage of the seventy one members in the Directory traded a market, or used certain software. In every case, there were multiple responses, so that a single member may trade several markets, or use more than one software package. The percentages therefore add to more than 100%.

WHAT MARKETS ARE TRADED?

Australian Shares was the most popular market traded, followed by Australian Options on Shares and SPI Futures or Options. Currencies was also a popular market.

Australian Shares	72%
Australian Options on Shares	52
SPI Futures or Options	48
Currencies	32
Aust. Financial Futures or Options	21
International Metals Futures	21
International Financial Futures	18
International Softs Futures	17
International Energy Futures	17
Intern'l Grains and Oilseeds Futures	15
Australian Share Futures	14
International Index Futures	13
Intern'l Fibre and Timber Futures	13
Overseas Shares	13
Intern'l Livestock and Meats Futures	11

The various futures markets were segmented in the Directory to give a more precise indication of interest. It is also interesting to look at one other measure: 52% of the members in the Directory traded at least one futures market.

TRADING HORIZON

The Directory allowed four categories. Again, many members trade more than one. The most popular time frame was Short Term, followed by Position Trading.

Short Term (days/weeks)	69%
Position Trading (Weeks/months)	55
Day Trading	23
Long Term (Investing)	23

There was thus only a slight bias towards the shorter term.

COMPUTER SOFTWARE

The most popular software packages, in order, are Metastock, SuperCharts, CompuTrac and Insight Trader. No other package had a double digit market share amongst our members in the Directory.

Metastock	33%
SuperCharts	25
CompuTrac	15
Insight Trader	10
Relevance	8
Wave Trader	8
Proview	6
Advanced GET	4
Knight Ridder	4
TeleTrac	4
Excell	3
Future Source	3
Indexia	3
Reuters TA	3
System writer	3
Dow Chart	1

Others with one user only were: Astro Analyst, Candle Power, Firm Hedge, K Time, Lotus 123, One Day at A Time, Parity Plus, Quattro Pro, Supercam, Time Analysis.

Only two of the software packages we listed in the questionaire did not attract any response: EzyChart and Pro Trader.

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DATA SOURCES

The Australian Financial Review was the most popular data source, followed by Almax, Research Technology, Other Daily Newspapers and Technical Tools.

Australian Financial Review	48%
Almax	31
Research Technology	24
Other Daily Newspaper	18
Technical Tools	14
Broker by Telephone/fax	13
EIS/Just Data	10
Resource Data	10
Stock Exchange Journal	8
Knight Ridder/Equinet	7
Teletext	7
Proview	6
ASX	4
CSI	4
Telerate	4
AAP Reuter	3
Elderlink	3
Hutchison	3

Others with only one user were: Adelaide BBS, Bourse Data, Bridge Data, Datastream, Infocast/Beacon, Information Express, Notley Info Service, Overseas Financial Newspaper, Overseas Newspaper, SFE.

We listed all the suppliers who responded to our Data Survey. Only one, In-Telegence, did not find a user in our Directory.

METHODOLOGY

(1) Chart Type

Bar Charts were by far the most popular, followed by Point and Figure (as a total) and Candlesticks.

Bar charts	83%
Candlestick charts	28
Point and Figure (3 box reversal)	18
Point and Figure (1 box reversal)	17
Swing Charts	15
Crocker price/volume charts	3
Equivolume charts	1

(2) Moving Average Systems

MACD led the way, followed by Bollinger Bands, and Moving Averages.

MACD/MACD Histogram	52%
Bollinger Bands	35
Double Moving Average	32
Triple Moving Average	25
Single Moving Average	23
Moving Average Envelope	10

(3) Price Momentum Indicators

Welles Wilder's RSI is by far the most popular, followed by Stochastic, Directional Movement Index, Rate of Change/Momentum, Parabolic(SAR) and Williams %R.

Relative Strength Index	66%
Stochastic	45
Directional Movement Index	39
Rate of Change/Momentum	30
Parabolic(SAR)	24
Williams %R	18
Relative Strength (Ratio)	14
Coppock Indicator	11
Commodity Channel Index	8
Demand Index	8
Elder Ray	6
Triple Screen Trading System	6
Williams Ultimate Oscillator	6
Force Index	3

(4) Sentiment Indicators

Advance Decline Studies	27%
Put Call Ratio	11
New High/New Low Index	3

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(5) Other Methods

The main ones are Gann Methods, Elliott Wave and, a long way behind, Vince's Optimal f.

Gann Methods	35%
Elliott Wave	28
Vince's Optimal f	6
Fibonacci Retracements/Projections	3

There was a wide range of other indicators, with only one user: Buying Power/Selling Pressure, Chaos Analysis, Commodity Selection Index, Cyclical Analysis, Easy Count Wave Count System, Elliott Oscillator, Fourier Analysis, Intermarket Analysis, Linear Regression, Market Profile, Money Flow, Neural Networks, Numerical Analysis, On Balance Volume, Pivot Points, Spiral Calendar, Symetrics, Tick Volume, Volatility and Cycles.

It will be interesting to do this analysis again for a later edition of the Directory to see whether there are changes in markets traded, software/data sources and methods used.

While our members have a great deal of common ground, there is a very wide range in all of these areas. Probably this is a good thing, or we might be accused of the self fulfilling prophesy syndrome. Difference in analysis and market view makes for a healthy market.

JIM BLANCHARD'S NEW ORLEANS INVESTMENT CONFERENCE
November 6-10th

This will be the 21st conference, an exciting event. Headliners include Louis Rukeyser, Dick Cheney, Floyd Brown of the Clintonwatch newsletter, a wide range of newsletter writers and fund managers.

If you have a trip to the U.S. planned and would consider attending call U.S. (504) 394 0050 or fax (504) 394 0054

FROM THE EDITOR

SPONSORSHIP

This is the first newsletter following the Association's acceptance of sponsorship from Knight Ridder Financial.

Under the arrangement Knight Ridder have kindly agreed to meet the costs of the printing and distribution costs of the newsletter, a not inconsiderable sum. In return the newsletter's front cover will include a statement confirming the sponsorship during the tenancy of the arrangement.

In a note to the Association, Greg Austin General Manager of Knight Ridder stated:

"As part of its program to support the Technical Analysis profession, Knight Ridder Financial is delighted to be able to actively support the ATAA in funding the production of this newsletter for the remainder of the financial year. This funding is seen by Knight Ridder Financial as a constructive way to provide resources to the ATAA so that both the use of Technical Analysis and the further development of the profession can be fostered.

Knight Ridder Financial's decision to support the local profession in this way is a means of our saying thank you for the tremendous success the Knight Ridder Financial technical analysis tool ProfitCenter has had in being widely adopted as the premium technical analysis tool in Australia."

We welcome the sponsorship and hope that the sponsorship will form the basis of a long term relationship to aid in the widening of the use of Technical Analysis and the raising of professional standards of local practitioners.

SUPERCHARTS

This package is now the second most used by members according to our research. Should members using Supercharts be interested in joining in a user group to further their knowledge and understanding of the many tools available then Tom Scollon has expressed an interest in forming such an association. Tom can be contacted at work on (02) 968 2454 or (02) 969 1303 after hours.

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An Interview with John Magee
By Peter Hof (nom de plume)

I was looking at the other day at a book that I have owned for some thirty years. It is called 'The Seven Fat Years: Chronicles of Wall Street' written by John Brooks. It contains a series of articles including an interview with John Magee titled 'John Magee and the Drooping Neckline'. Considering our avid interest in things technical I thought it would be interesting to quote some excerpts from this article.

John Brooks starts the article off by stating that, at the time, the financial pages of the newspapers were full of advertisements offering what he calls 'an infinite variety of mehods of forecasting, ranging from the hard-headed to the occult'. He then continues by saying that there is such a public thirst for pre-vision that some forecasters of a conservative bent have devised a special form of prose to keep their readers happy (at least for a time) without making any predictions at all. By using words like: 'A continued trend in the market is a distinct possibility but on the other hand, it should be noted that in view of the uncertainty of current business conditions in key industries a pattern of distribution may well develop over the next few weeks'.

Nothing much uncommon there, the writers knew that forecasting was a difficult business and they were just making sure that they had a foot in each side of the camp. He then continues to talk about the what he calls 'the fairly small but abnormally dedicated cult which engages in charting'.

He states that the practical results (of forecasting) often fall short of perfection but, just as in the case of a roulette gambler with a system, the chartist is seldom discouraged. If anything he is, if such a thing is possible, more enthusiastic that the solvent devotee.

Nothing new there either I guess. I can see that in myself. Hope springs eternal.

The balance of the chapter is devoted to his meetings with John Magee during the very early 1950's, the interesting snippets of which I will detail.

Magee, like many people today did not operate from anywhere near Wall Street but from Springfield, Massachusetts. The one difference with today of course is that then most chartists had to do their updating from the newspaper. One interesting story is mentioned about a pupil of Magee who, when asked how he was making out, said that he was keeping up a hundred charts and that by the time he finished there was no time to study the charts. He was quite desperate to recover money he had lost via tips and was literally pulling his hair out. 'I am only going nuts' he cried. Charts, charts, charts, all night long. If only he could find a way to speed up the process of updating the charts.

Magee is, of course, together with Robert D. Edwards, co-author of a widely used textbook on charting called 'Technical Analysis of Stock Trends', which I presume most of us have in our library. He also was the senior analyst of a chart orientated firm of investment advisors, author of a stock prediction section of its twice weekly advisory bulletin and a teacher (of charting) at an evening college in Springfield and, at the time, an inverate player of the market of some fifteen years standing.

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He operated from a second floor office which consisted of a reception office, the company owner's office which was very impressively done out (thick carpets, the works) and a large backroom office where the daily work was done. This workroom looked on the rather raggy side. In it were two secretaries busily typing away, two men busy oiling the stencil machine (which obviously was being used to print the newsletters which were sent to their clients in 46 out of the 48 states as well as in several overseas countries) and, at a desk in the middle, sat a black haired young man poring over a share chart. Then there was another man, in his mid fifties getting prices from a tickertape machine. This latter person was John Magee.

This business was apparently started many years before by Richard Schabacker.

John Magee was taught by Robert Edwards for whom he expressed a lot of admiration. Robert Edwards, since his retirement, spent his time teaching high school science and bird watching in his spare time. Apparently he had no interest whatsoever in making money and birds came before shares with him. Edwards was the person who got Magee first interested in charting. At one time or another, Magee had been an assistant sales manager, a cost estimator, an advertising manager, an advertising-copy writer and, yes, a Fuller Brush man. At the time he met Edwards, Magee was running a mail order company selling cast phenolic plastics (whatever that is).

Magee gave his interviewer a miniature rundown on the history of charting and told him that it was Charles Dow who basically started it all with certain trailbreaking ideas about share price forecasting in a series of editorials in 'The Journal' back in the eighteen nineties.

After Dow's death, Hamilton became editor of 'The Journal' and carried on his work, eventually organising Dow's ideas into what now is known as 'The Dow Theory'. Nowadays, that theory is much derided because it either gives its signals too late to do one any good, or else it gives a downright wrong kind of signals. Magee argued that whilst the theory certainly was not perfect it was basically sound and, above all, it served a useful purpose to introduce the technical approach. He said that his own methods certainly were not anti-Dow so much as post-Dow. Following these two gentlemen Richard Schabacker (financial editor of the Forbes Magazine) did some considerable work, which, when he died, was carried on by his brother-in-law, Robert D. Edwards.

Schabacker made reputedly about a quarter of a million dollars in the market (which, of course, at the time was worth a lot more than the same amount today).

Schabacker's greatest contribution was applying the chart principles to individual shares rather than working with averages. In fact Magee was quite forward in admitting that most of the signals he, Magee, used are mentioned in Schabacker's book and other publications.

Magee stated that the chart reflected everything that was important to the share and, in fact, it was not even important to know what business the particular share company was involved in, if you are a true chartist.

In fact there was a sign hanging in the office that said (sic): 'Don't confuse me with the facts'. However, he did also say that, as a practical matter, they did keep abreast of some fundamental factors just to keep the clients happy. So, even though recommendations were not made on fundamentals, they often did mention them anyway in their reports just to keep clients, who were not as yet fully sold on charting, happy.

Magee also mentioned that he was a great admirer of Jesse Livermore.

Magee did mention that there was a drastic mortality rate (figuratively speaking) amongst chartists, once they found out how much work was involved. Most of them fall by the wayside within six months.

One very important factor that Magee emphasized was the fact that it was important trying to see what the market was saying rather than clouding our judgement with pre-conceived ideas (such as: Is the market too high?)

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Postscript by Colin Nicholson:

Members wishing to read further in the areas covered by this article can consult the following books:

William Peter Hamilton "The Stock Market Barometer" published 1922. Recently reprinted by Fraser Publishing PO Box 494 Burlington Vermont 05402 USA $US18.00.

Robert Rhea "The Dow Theory" published 1932. Recently reprinted by Fraser (see above) $US14.00.

R W Schabacker "Stock Market Profits" published 1934. Recently reprinted by Fraser (see above) $US16.00.

John Magee "The General Semantics of Wall Street" Published by the author 1958. Now out of print. Try Fraser (see above), who found me a second hand copy.

Fraser may also be able to find you a second hand copy of the John Brooks book from which this article has been written.

PART 2 A Beginner's Guide to the Elliott Wave Analysis System

by Bernhard Liedtke

In this article I will examine one method of trading the All Ordinaries Index (AOI), the Elliott Wave System.

I have recently begun to use this technical analysis system to trade the AOI. I have been very impressed with its results. This system is a highly detailed method which is best suited to disciplined traders with analytical minds, who can devote a lot of time to learning, practising and applying the system.

It is based on the theory that many market types (stocks, bonds, gold etc.) fluctuate according to a well defined set of chart patterns. These chart patterns are a direct reflection of the mass psychology of all the investors involved in the market at that time. The theory states that human emotions (fear, greed, euphoria, etc.) are reflected in a set of around a dozen chart patterns. Because these combined market emotions unfold in the same way each time, a set of chart patterns repeats over and over again.

The amazing thing about this theory is that every movement of the market indicator is always supposed to fit into one of these chart patterns. The basis of the formation of the patterns and the working of the human mind is the Fibonacci sequence of numbers and their ratios.

The system works best with the major market indices such as the AOI. It is not recommended for all individual stocks, as they may not have a high enough trading volume to accurately reflect market psychology. Although some of the larger, frequently traded stocks often move according to the Elliott Wave Principle.

Trading the AOI short term is best done with SPI options or the SPI futures themselves. Long term investors can use the long term interpretations of the AOI, using Elliott Wave, to manage their share portfolios. Another important point is that graphing at least hourly data of the AOI is necessary for accurate short term analysis. Short term traders therefore need to watch the index throughout the day. Short term analysis of daily charts is possible, but is much more difficult as there are often periods where patterns become indecipherable, and in these cases a large number of possible interpretations exists.

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I believe that firstly, the theory itself and all the characteristics of the price patterns, such as what they look like, how they are labelled, when they can occur etc. must be fully understood and learned. The following book is a standard reference for this information 'Elliott Wave Principle. Key to Stock Market Profits', by Robert R Prechter and Alfred J Frost, 1990, New Classics Library Inc.

I would also strongly suggest reading this book 'Trading with the Elliott Wave Principle. A Practical Guide', by David H Weis, 1988, Tape Readers Press, which gives a practical guide to applying the Elliott Wave Principle using daily data. This book shows you how to use the technique in a real life trading situation and describes each day as it happened. It also helps you learn when to trade, placing stop loss orders etc.

After reading these books several times, and summarising their important points for reference, I spent the next 3 months charting the AOI using half hourly data and 'paper trading', this is where you write down trades without actually risking any money and keeping track of the number of points as profit or loss, with 2 points for commission. Only when I felt comfortable with the system did I trade for real.

Some people use only the basics of the system to trade with and complain that it doesn't work. I can't see how this can be successful because if you don't fully understand just one particular pattern and therefore label it incorrectly, then the system will break down. I believe that full dedication is required, or the trader will find applying it difficult and frustrating.

The hardest part in applying the system is that at any one time, there may be two or more possible patterns being formed. This is where the most important skill that an Elliott trader requires, comes into play. The skill is knowing what all the possible patterns could be at that time and then deciding whether to be long, short or out. One author stated that the Elliott Wave Principle is like playing a game of chess. You need to be constantly aware of all the possibilities at any one time, and constantly update these as the market changes. At certain times, the probabilities that the market will travel in a particular direction can become very high. This is the time to trade.

The system is best at predicting market direction, less accurate at predicting the extent of a movement, (however, you can often work out a number of price objectives which can be used as a guide) and predicting the time it will take to complete a move is less accurate again. The patterns repeat themselves constantly on hourly charts, and together they form the same patterns on yearly charts. So you need to have an idea where the index is in terms of a long term Elliott interpretation as well as the short term. Historical data going back many years would be helpful.

This is a fairly complex system that requires much time and dedication to learn and apply properly. But for those who are willing to give it that, it could prove to be a very worthwhile analysis system. The system is fairly objective, although you still need to decide at which level of probability you wish to place a trade and where to place stop loss orders.

I have included a half hourly plot of recent data of the AOI which is labelled according to Elliott rules. On the next page is the same time period, drawn according to the patterns as they appear in a text book. Note that this is only my interpretation which may not be free of errors where I have unintentionally broken Elliott rules. There may also be other valid interpretations of this period which still obey all the rules.

This is a fairly complex set of patterns which were hard to interpret while they were forming due to the fact that many of them occurred in June which is usually a quiet period on the stock market. So the index marks time and forms complex sideways patterns. However, for those of you who know the Elliott System and have only ever seen daily charts of the AOI, you may be surprised at how clear patterns appear on intra-daily charts. I have supplied an example of a half hourly chart with the corresponding period as a daily chart for comparison. Patterns are not always as clear as this, as I have chosen an obvious set of patterns, but I am sure you will agree how amazingly obvious they can be

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Interpretation of the Patterns

For those of you who know a bit about Elliott Wave analysis, my interpretation of the period shown is a triple bear zigzag (the first zigzag is not shown and is fairly small. It comes directly before the first pattern on the page), where the first 'X' joining wave is made up of a triple '3' (flat, triangle and zigzag). Within this triple 3, all three patterns are joined with two downward zigzag 'X' waves. The second zigzag (in the main triple bear zigzag set) began its 'a' wave fairly small, (the 'b' wave was a triangle) but the 'c' wave turned out to be huge in comparison (incomplete on this page).

The whole pattern shown on the page is probably the 'b' wave of a large flat, or expanded flat. Another possibility is that it is the 'b' wave of a triangle. An expanded flat is my preferred count at this stage, with a triangle as my alternate count. Either way, the predication which can be made from this data is that once the last zigzag is complete, a strong upward rally is to follow. If the whole pattern is a flat, then our expected minimum target is 2140 (the top of the 'a' wave of the flat) and the 'c' wave rally will be a 5 wave. If a triangle is forming, then the next rally will be a 3 wave with a higher or lower expected target, depending on the type of triangle forming. Using the Elliott Wave, it is hard to say when this will happen, and how long it will take to complete, but if the last zigzag is complete, then it should begin soon.

So you can see from my interpretation that a few outcomes are possible. But both suggest a rise is near, so I will pick a low risk time to go long when I think the final downward zigzag is near its end. If I am wrong, and the index falls further than I expect, then I will quickly close out, re-interpret the patterns, and try again later.

This interpretation may not be correct, but it gives you an idea how Elliott Wave analysis is carried out. It is based on constantly changing probabilities and exclusion. Experience in terms of the time spent reading charts is probably the best way to become good at this system. Then waiting until you can say "The market is now very likely to go up, as the two possible patterns which can be forming both have an upwave to come". This a good time to trade. If anyone else is following intra-daily Elliott Wave charts of the AOI and would like to make contact with me to compare ideas, interpretations etc. my details are on the contact list distributed by this Association.

Since writing the first part of this article, a strong rally did eventuate as expected. I initially believed it to be a 5 wave thinking that a large flat was forming. But it came to a point where a 5 wave wasn't making sense. The pattern makes much better sense as a 3 wave according to my half hourly chart. So a triangle is now my preferred count. It should be made up of 3 up waves and 2 down. When the last up wave is completed (a possible target of not even 2100), the larger bear market should continue.

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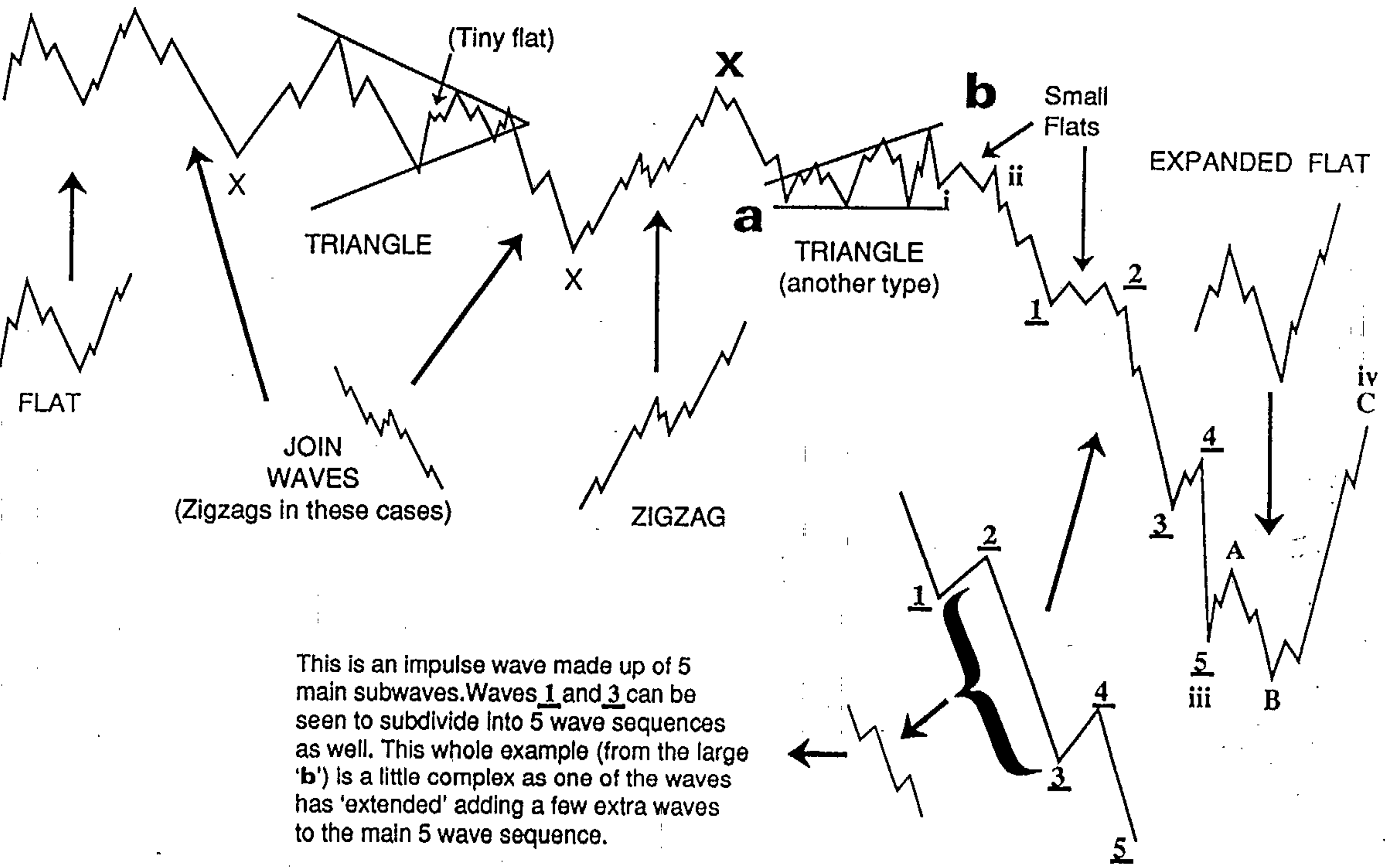
Explanation of Elliott Wave Patterns

(as shown on opposite page)



This is an impulse wave made up of 5 main subwaves. Waves 1 and 3 can be seen to subdivide into 5 wave sequences as well. This whole example (from the large '**b**') is a little complex as one of the waves has 'extended' adding a few extra waves to the main 5 wave sequence.

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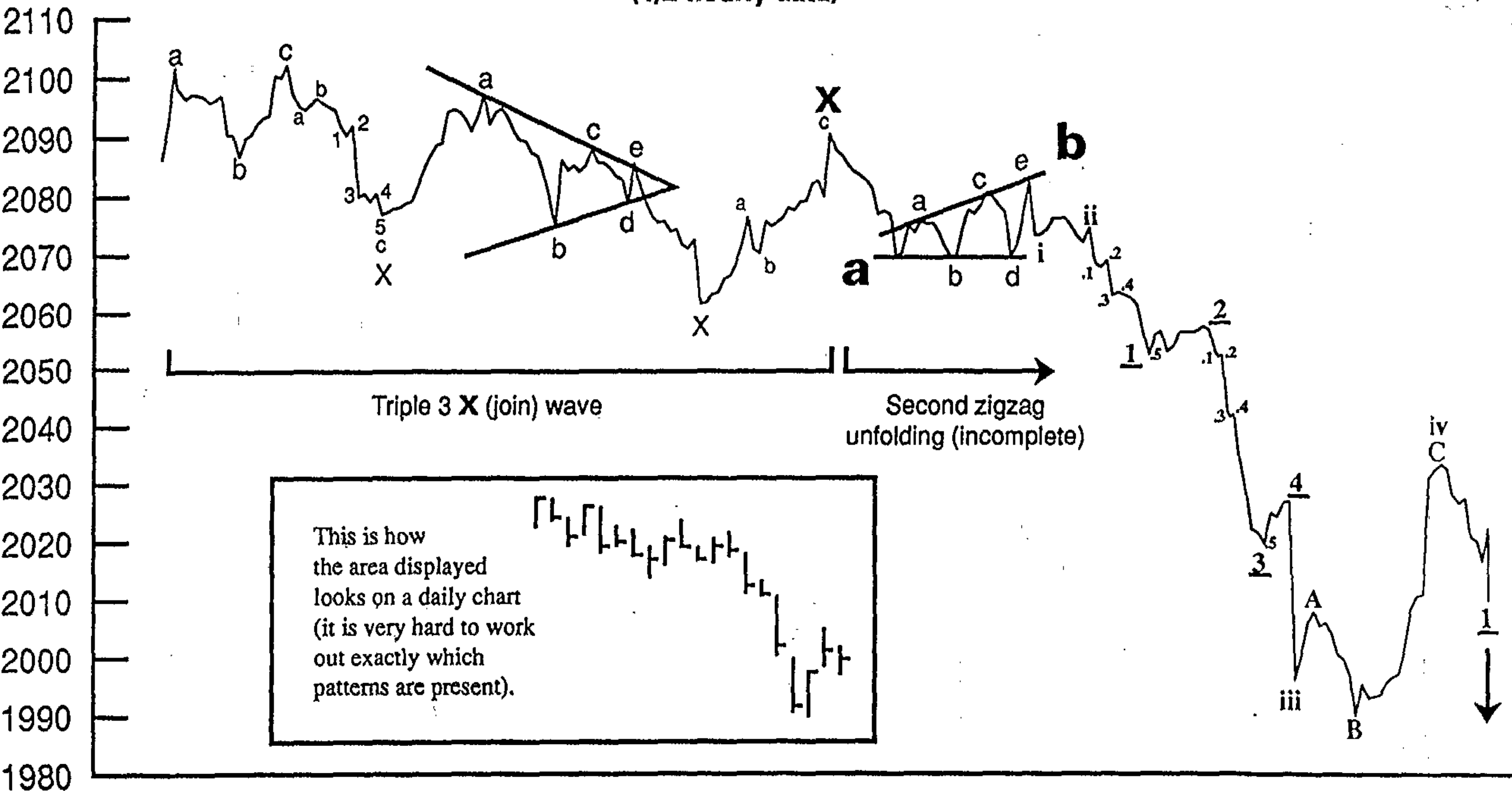

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CRB Index - *A Technical Alert*

What we already know.........

That the CRB Index (and by extension commodity price and inflationary expectations) have been in a secular uptrend for the last 18 months, see chart 1. Following this (and as a consequence) global bond markets, particularly in the US and Australia, suffered severe corrections in late 1993 and early 1994, see chart 2 and 3. It needs little elaboration that inflation and interest rate sensitive equity valuations also suffered internationally, see chart 4. It can be taken as fact that global financial market participants are focused on an unfolding bear phase/market in fixed interest securities. The $A, in this environment, has recovered from its previous over-sold bear trend of 1993 on a wave of positive sentiment towards commodities (and commodity currencies) rising to levels prevailing in mid 1992 price levels, see chart 5.

Chart 1: CRB Index past two years

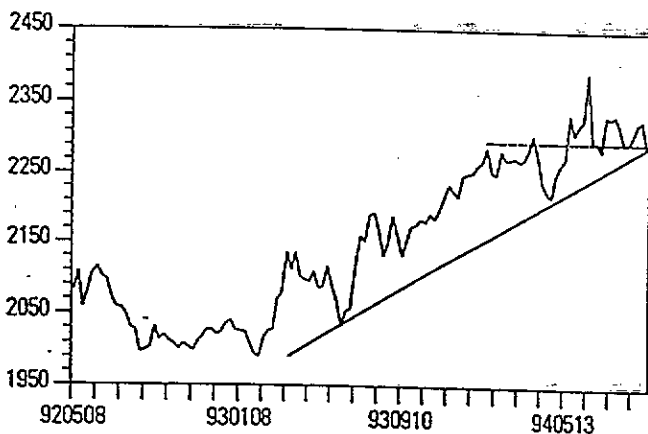


Chart 2: US bond prices, past year

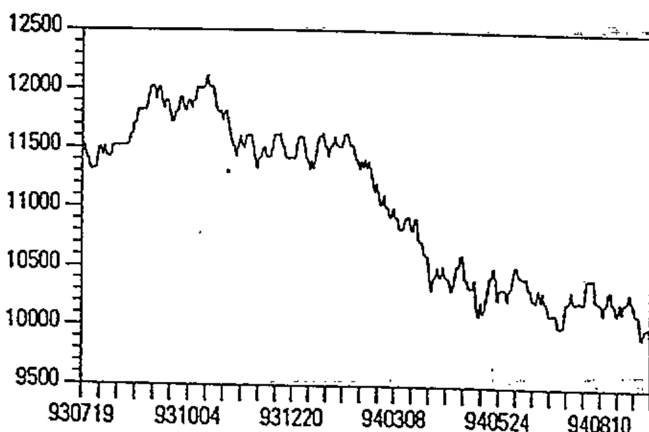


Chart 3: Australian 10 year bonds, past year

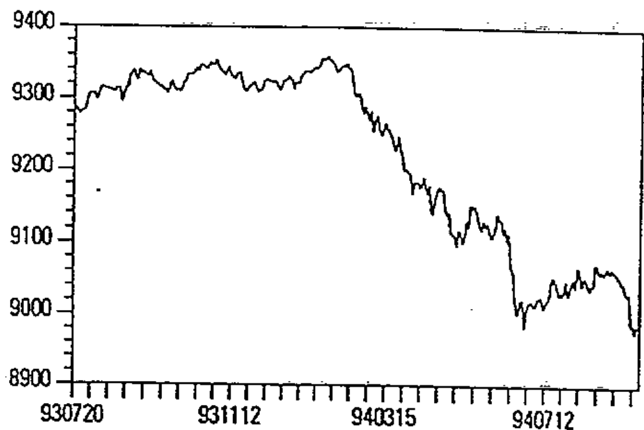


Chart 4: All ordinaries, past year

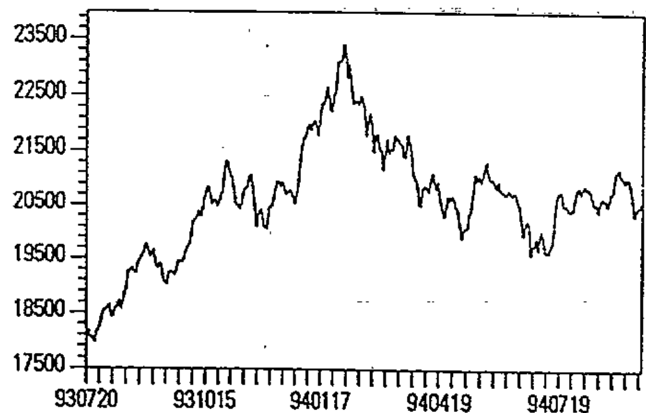
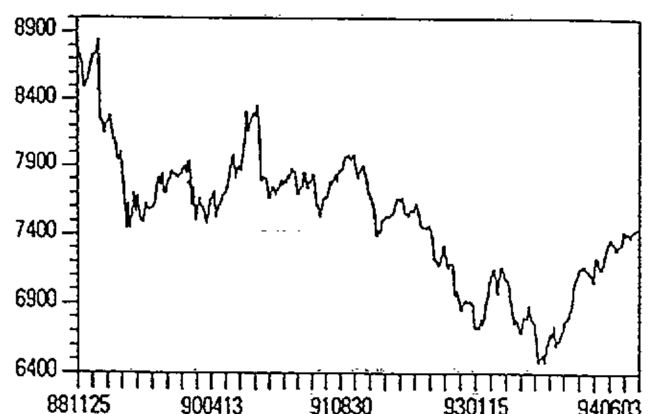


Chart 5: AUD/USD, past five years



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A closer look at trends of past 2 quarters

Contrary to (bearish) sentiment, price action in all the markets outlined above have gone into extended consolidation patterns. A close observation will reveal the sideways nature of the CRB, bond (both domestic and US), equity and $A markets for the past 6 months or so. This is most typified by the extended ranges in the futures valuations of the Euro dollar and T-bond December 1994 contracts, see chart 6 and 7.

Chart 6: December 1994 Eurodollars

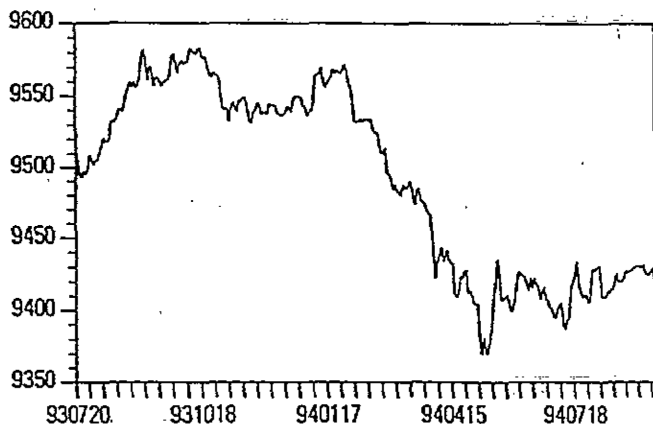


Chart 7: December 1994 T-Bonds

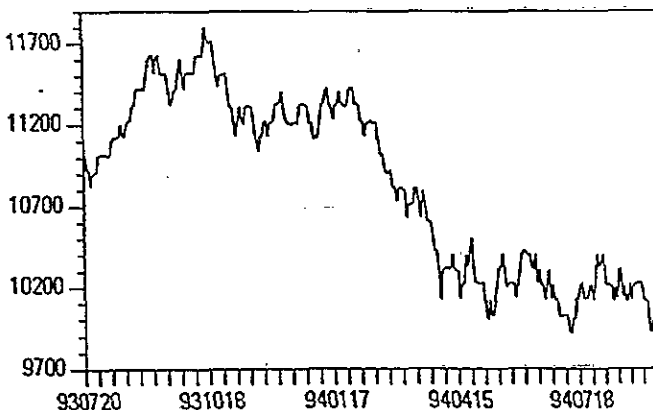
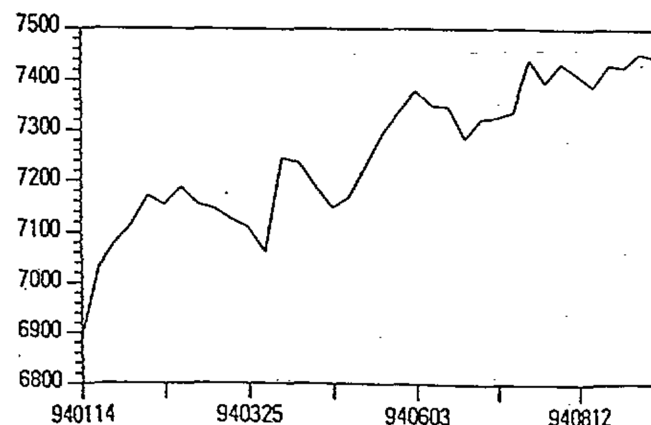


Chart 8: Australian Dollar



So what does this have to do with the CRB?

The CRB has (so far) sustained an 18 month uptrend; but a view of the index's price action in 1994 reveals a less than upbeat story. Comparing its January 1994 levels with those current - the index in essence is unchanged. The mid-year volatility (which coincided with the US and AUD bond price lows) of itself constitutes, with technical indicators, as an **intermediate topping pattern** in the index. It means, in general terms, commodity prices have stagnated in this calendar year. The index price resting on an important trend support region of 228-229. So far holding, see chart 1 trend line. The important thing to notice is that (short lived panics aside) this year, inflationary expectations, as manifest in the CRB index and allied commodity markets, have not worsened since the beginning of 1994. Add to this 'stalling' of commodity price bullishness, the distinct technical possibility of CRB falls through major support of 229 and we are faced with the prospect of an intermediate correction down of the CRB. This is not an ending of the multi-year commodity bull market beginning in early 1994 - it is more likely a significant pullback on its previous 18 months price action. This expected intermediate correction in the CRB will impact bonds, stocks and the $A in a variety of ways.

An easing CRB index : Next 2 quarter strategy

US Bond market implications

Given the stalled ranges in this market - one consolidating its losses of the past 12 months; a significant CRB easing will take bearish pressure off bond valuations leading of course to the likely rally of bond prices above levels existing in the previous two quarters. This price rally potential in the 10 year bond is within an expected time frame of between 3-6 months. This should be viewed as a reasonable guide only to the unfolding rally. The impact on Australian bonds will be analogous. This is, AUD bonds should recover by about 1.00 - 1.50 points in the 10 year instrument.

Equity Market Implications

In keeping with the 3-6 month expected revival of the bond markets, (call it a bear market rally), the equity valuations should in the US and to a lesser extent the Australian markets attempt their recent February 1994 highs. Unlike the bond markets, beyond a six month time frame, these 1994 highs are expected to be bettered and sustained.

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$A Implications
Cross border bond and equity plays aside; international asset allocation will tend to "Pressure the A$ down somewhat (in conjunction with other stylised 'commodity' currencies) versus the USD and on its cross relationships".

This pressure should be comparatively mild and moves below 7000/7100 support is deemed extremely unlikely. An easing of the AUD should be viewed here, like the CRB, as a pullback within the context of a multi-year bull market, and in essence will provide an opportunity to investors to buy $A at slightly cheaper levels.

Summary
The CRB index as a surrogate for inflation and inflationary expectations needs little elaboration of its impact on bond and stock markets in the United States and the world generally. It's rises of the past eighteen months as such put an end to the five year US bond bullmarket rally just past.

This much is clear and already very much factored into global financial markets on a price and sentiment basis.

What is less apparent is in fact the short-term top already achieved in commodity prices (as typified by the CRB index).

Given the eighteen month up cycle in the CRB (and allied) markets is over. By implication it follows that the bond and stock market sell-offs of the first half of 1994 are also over for now. Further, the recent 9 month up-move in the $A is also complete. Strategies for the remainder of the calendar year should focus on a partial down retracement of general commodity price levels. On the basis of historical financial market patterns this should:

- relieve pressure off bond price (which should stage intermediate recoveries)
- see a recovery in stock valuations
- have a negative effect on the Australian dollar

Warning
This summary of strategies to the end of the year/1st quarter 1995 can only be read as an intermediate one. Sight should not be lost of the larger inflationary cycles in play - which have only paused for now.

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TRADING IS A TWO-EDGED SWORD

Excerpted from Traders Notebook - by Joe Ross

Trading for many of us is a two-edged sword. We love the thrill of trading. We love it when we win. We love to engage in the battle of the markets, and we love it when we pierce the enemy with our sword and take home the spoils.

On the other hand, we hate the agony of trading when we lose. We hate to engage in the battle of the markets when we are unsure of ourselves, and we hate it when we stab ourselves with our own sword and go home horribly defeated and dejected, while the market takes home the spoils.

Trading is a love-hate relationship unlike any other I've ever encountered. I discussed this in part in my book TRADING THE ROSS HOOK. Some of my students have been calling and writing, and it is evident that they are learning some valuable lessons. You can be sure that I, too, had to learn every one of them, many the hard way. Some of these lessons are difficult, but must be learned before you will know real success trading the markets.

There are several areas I want to address in this article, areas which we all need to work on. Interestingly, they all involve greed and avarice in their many forms. In my mind, there is a difference between greed and avarice. Greed is wanting more and more of what you already have or what is free for the taking. Avarice is wanting what the other person has.

Both will destroy us in the markets. Both are deeply ingrained character flaws of human nature. Both will cause us to become unbalanced in our attitude and in our approach to trading.

Let's look at these two enemies of our trading.

Greed

My definition of greed is the excessive desire for getting, having, or keeping, more and more of anything you already have, or which, not belonging to someone else, is there for the taking. We often use this word to describe an inordinate desire for wanting and taking all that one can get, certainly more that one needs. It is totally self-centered, and leads to our eventual destruction.

Since some of us tend to think of the markets as impersonal. We feel the money is there for the taking, and we want to take, and take, and take from the markets. Our trading is like a feeding frenzy. We simply can't get enough. Greed causes us to bash ourselves against the markets, much as a moth throws itself at a source of light. The result is that we are soon exhausted, defeated, and burnt out.

Avarice

My definition of avarice is the compelling and excessive desire for getting, having, or keeping, that which is not yours and for which you have no need, but which rather belongs to another person. Some of us tend to think of the markets as personal; we are looking for ways to take what is his from another person. The result is an endless stream of scheming and conniving with the sole purpose of getting the other person's money. Avarice can cause us to become thieves. It, too, can destroy us.

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Who Me?

Take a good look at brokers, boiler room operators who want to manage your money, the Hunt brothers, etc., if you want to see greed and avarice at work in the market. Unfortunately, some traders also want to take, and take, and take from the markets or from another person. Next, take a good look at yourself.

Which one are you? Which view of the markets is yours?

Oh, I know very well how you rationalize these things. I've been there, remember? You say, "All I want to do is to take a decent living out of the markets. If I can make a few good trades a week and can take home a few hundred a day, I'd be happy. Yes, I'd be happy with that."

Some have told me, "All I want to do is make a few bucks to supplement my retirement. That's all I need, that's all I want." The tragic part of these thoughts is that you believe them!

You actually convince yourself that all you want is a small, reasonable number of winning trades. The truth is that you really want to win all the time, and you want to take great amounts of money from the markets. The truth is that it is virtually impossible for you to ever get enough, to ever be satisfied.

To my way of thinking, there is a difference between greed and avarice. However, for purposes of this issue, I will treat them the same. I will address them both as greed.

Have you ever wondered how brokers can attain to the mind-set that many of them have? I have known and talked with dozens of brokers who, early in their careers, were full of the notion of service and helping others. Their intentions were wholesome and honorable. Then came the reality of the markets. They saw the traders come and go.

They saw that the average trader lasts about six months. They found that no matter how honestly and truthfully they served their clients, the clients were gone in a short time. They saw the unbridled greed and avarice in the markets, and they started to become hardened and greed driven.

They soon realized that the only way they could prosper was to get your money while the getting was good. This led them to the next step, managed money. Why should they depend on a few trades from you for their commissions, when, if they could get control of your money, they could trade it in such a way as to maximize their commission. This desire for your money, and the desire to increase their own wealth, led them to rationalize that they could trade your money just as well (or as badly) as you could.

Have you given your money to a broker to trade as a result of your greed? They know virtually nothing about trading, but they won't tell you that. Instead, they tell you about the marvelous track record of someone whose trades they are going to follow.

You, in your greed to get rich quickly without having to take the personal responsibility for learning how to trade, throw your wealth at the market via the broker. The broker then gets all his commissions in three months rather than six. Not only that, but he makes sure to trade your account enough to lose a lot more of your money than you would have been willing to lose had you traded on your own.

I am amazed at the great number of traders who are initially introduced to the markets in this manner. Someone has lost their nest-egg for them while "managing" their money. Then, instead of gracefully accepting the losses incurred due to their own foolishness, they go on a crusade. They set out to prove that they are even greater fools than they proved themselves to be when they first turned over their money to be managed.

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They reason, "If I'm going to lose my money in the futures markets, I can do it myself." And then they set out to do that very thing. In a desperate effort to get back what they have lost, they throw good money after bad by trading their account themselves, with probably less knowledge of how to trade than that of the broker who previously managed their money.

The resulting additional losses from trading on their own cause them to realize how very little they actually know about trading. They are now a perfect target for the greedy parasites who are waiting to feed on them.

In an urgent search for knowledge of how to succeed in trading the markets, they become the victims of the "gurus" who are going to teach them how to trade. As you well know, most of these "gurus" are not traders. They cannot teach you to trade successfully, because they have never done it themselves. Invariably, these "gurus" place the largest, most prominent ads everywhere and everyplace they think you will see those ads.

At my seminars, when students sit there with their mouths hanging open as a result of some of the things I have revealed to them about trading and markets, I usually ask this question with reference to what the other so-called teachers have taught them: "If these "gurus" have ever really traded successfully, why have they not taught you these things? Is it that they have never been there themselves? How can they claim to teach you what you need to know, but not teach you the things I have been showing you here?"

I am constantly shocked by the lack of knowledge that is extant among most people who trade. Worst of all is that most have no idea of how much they don't know and how much they have yet to learn. In the markets, what you don't know can really hurt you.

The lack of knowledge, supplemented by greed in the form of "hurry to make the money," causes most traders to seek short-cuts. Greed is the source of their impatience.

They accurately come to the conclusion that they need more knowledge. They reason that surely someone else has that knowledge. They further conclude that someone with a good reputation can help them. Thus they become the victims of trading advisors.

They subscribe to advisory services and follow the trades of some guru. There are a number of problems with this. One is that most "gurus" couldn't trade their way out of a paper bag. Another is that, even if people could follow a real, bonafide trader, trade for trade just the way he calls the trades, they can still lose, and lose a lot. The reasons for this are many, too many, in fact, to go into in this article. Suffice it to say that I have sat with other traders and traded with them trade for trade by telephone, and I made money while they lost money.

You might think, "how can that be?" Here are a few reasons. There were differences in execution, slippage, commissions, and fees. There were differences in comfort level, size of account, and lot size. There were differences in style of execution, in order giving, and speed of fills. I could go on and on spelling out the differences, but please take my word for it that you can exactly follow an advisor and still not have the same results. I have personally known some excellent trading advisors who have given up their advisory services because most of the people who followed the trades lost, while the advisor himself was making money from those exact same trades.

Greed causes an impatience in learning to trade properly. You are in such a hurry to win in the markets that you are not willing to put in the time to learn to do it properly.

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Recently I was reading a book by Mark A. Ritchie, entitled GOD IN THE PITS. I would recommend it to anyone. Mr. Ritchie is a professional floor trader. It's light, easy reading and packs a double message. Whether or not you are a religious person, Mark's message about what this industry is really like is important to your knowledge. The book also carries a religious message. That message will have great meaning for those who are the more religious among you, and perhaps those of you who are missing that dimension of life, but could really use a good dose of it. I'm going to quote from Mr. Ritchie's book.

"I thought everyone knew what greed was until the news broke about the inside traders on Wall Street. Then I heard a psychiatrist on national TV try to explain why a wealthy man would engage in illegal activity to add more hundreds of millions to his already sizeable wealth. The psychiatrist's first response was that his action had nothing to do with greed. 'This man has more money than he can ever possibly spend,' he commented with an air of certainty. 'That demonstrates that his need for more couldn't possibly be greed.' Now I was really puzzled. I had always thought that greed was the desire on the part of a person to have a great deal more than one could ever need. Now this psychiatrist, who certainly should know, says that a person who strives for more is not greedy if he can show that he has no need for it at all."

"One of the inside traders demonstrated the confusion. He was well received at a prestigious business school when he said, 'I think greed is healthy. You can be greedy and still feel good about yourself.'"

"The first maxim of speculating is that no one should ever risk money that he needs. But if he doesn't need the money he is risking, he certainly doesn't need the profit which that speculation could bring. Does that mean that his aim for further profit is based on greed? Who's to say? Looking back on my first investment in commodities, I doubt if I understand what part greed had to play in my actions. It may be the most difficult of all vices for a person to recognize in himself."

Greed causes us to overtrade, to trade too much and too often.

I have stated in other of my writings that the only thing we can change is ourselves. Mr. Ritchie also mentions this in his book. We cannot change the markets. We cannot become a part of the solution to the problem the market presents. Yet many of us do try to change the market. We try to do it in an absurd way.

Let's pretend that the market we want to trade today could talk. It might say to us, "I don't want to be traded today, I'm not ready for you to trade me. I'm tired, and I don't want to break out of here. I just want to rest." Will you rape the market? Will you try to force it to do your will?

Is there any virtue in making a job out of trading? Do you think because you have invested time and money in trading that you somehow have to do it every day? Can you accept the fact that trading is not something that needs to be done every day? Can you accept the fact that on some days the market is tired and doesn't want to go anywhere? If you can't, it is only because you will not change yourself. You have a notion in your head that you must go to work every day, that you must have a job.

Can you see the terrible conflict between this and your reasons for wanting to be a trader in the first place? Ask yourself why you want to trade. Isn't it, in part, to have the good life? Isn't it so you won't have to work all the time?

You have a dream that you want to be rich. Yet you have the attitude that you must go to work every day. The two may be in conflict.

It is greed that drives you to the workplace every day. You are afraid you'll miss the "big" move. In fact, you haven't yet shed the "get rich quick" mentality that will destroy you in the markets.

Haven't you yet realized that getting rich is a process?

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With the exception of a very few who win the lottery or the Irish Sweepstakes, most wealth is acquired slowly, steadily, over a period of time. Sure, you could have been lucky enough to be long Soybeans in 1973 or 1988. But that's what it would have been, luck. Chances are that the best traders missed a lot of those moves. Why? Because they would have taken profits early. It is the steady taking of profits out of the market that creates winners. Taking profits while they are there is a winning habit. That is the kind of behavior that makes one wealthy.

Successful trading is not hitting it big on a trade that may come along once every ten years. Rather, it is learning to make money in normal, everyday markets. Successful trading is taking steady profits from the markets as they trend and congest most of the time.

You must learn to be patient. Any fool can make money in a trending market. If the market is going up, buy. If the market is going down, sell. Even in these not-so-trending markets we are seeing today, where the trends do not last nearly as long as they used to, you can still spot a trend and jump on it.

You can still sell at the top of large trading ranges and buy at the bottom of those same congested areas.

Nothing other than greed forces you to trade the middle of congestion. Nothing other than pure lust for "more" causes you to trade every day.

Learn to wait until the market says to you, "I feel so good, I'm just itching to break out of here. I want some action. Trade me today, and I'll give you a ride to the moon!"

Resolve in your mind that you will not trade every day, all day. Trading is not like other jobs where you have to go to work every day and stay at it for eight or more hours.

Learn to trade only when you are at your very best. Trade only when you don't have a lot of other things on your mind. Many have heard me say this at my seminars, but few who attend ever let it sink in. Trading cannot be like work. Trade when you feel good. Trade when you are well rested. Trade only when the world is going right for you.

Learning to trade only when you are at your best is a lot like learning to overcome greed. In fact, it is one and the same thing. Just as the desire for material riches (greed) will cause you to lose, so too, will the desire to trade all the time. Spending money (having fun) is pleasurable, so we want more and more. Making money (trading and winning) is pleasurable, so we want to trade more and more.

Can you see the relationship? It is greed in another form. It's like anything pleasurable, you think you can never get enough of it. Trading and winning can bring much pleasure, and you have the idea that you can never get enough of it. But like overeating, or anything else you overdo, there are penalties for overindulgence. Overindulgence in anything is unbalanced, and has a negative final result.

The Bible, containing the wisdom of old, talks about the concept of never being satisfied, of never having enough.

"All things are wearisome, more than one can say. The eye never has enough of seeing, or the ear its fill of hearing."

Ecclesiastes, Chapter 1, Verse 8.

"There are three things that are never satisfied, four that never say, 'Enough!' The grave, the barren womb, the land, which is never satisfied with water, and fire, which never says, 'Enough!'

To those I would have to add the overtrader who can never seem to get enough.

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Greed can never get enough. It is greed that drives the overtrader. Whether it is lust for more money, lust for 'action', lust for self-esteem, lust for some form of personal aggrandizement, or lust for any other form of gratification, it is still greed.

A Balanced Approach

You must learn to have a balanced approach to the markets. You must learn to stick with what works. There are no perfect trading systems or methods. The greedy quest for a perfect system has destroyed many a trader. About the best you can do is have 65% wins from any sound technique. This percentage can be enhanced and earnings increased by knowing yourself and working on your behavior (personal management), improving your money and risk management, and learning to employ proper trade management.

The best thing you can do is to pick a single system, method, or technique, one with which you are comfortable, and stick with it for a long, long time. I suggest at least three years. That way you can work out any bugs in that particular method of trading, while at the same time you work out the bugs in your personality as it relates to trading, you work out a sensible scheme of money management, and you work out the best way for you to employ trade management.

Manifestations of Greed

How does greed manifest itself in your trading? Here are a few examples of how greed may show itself:

1. You may tend to chase market moves you've missed, thereby entering at a disadvantage.

2. You may be impatient, hurry your trades, and fail to thoroughly plan and think them through.

3. You may stay in trades too long, the result being that you will fail to take profits while they are available. You will give back a lot of the money you could have kept.

4. You may trade too often, thereby entering trades for which you may not be adequately prepared psychologically, emotionally, or financially.

5. You may enter trades in markets in which you have no sound business reason to be trading. You may take trades in those markets based upon your lust for riches, when in fact those markets are too thin, too illiquid, and not suitable for trading by anyone other than those having a professional and fundamental reason for trading them.

6. You may trade more contracts (size) than you should reasonably attempt in relation to your account size, or in relation to your emotional capability.

These manifestations are not always entirely clear and may make totally unexpected appearances. They may combine in ways more complicated and subtle than those I've shown.

Recently I came across a manifestation of greed that was an excellent example of how subtle greed can be. It was so elusive that it was virtually impossible for the trader to see that his problem was greed. It took me a few hours of review and thought before I myself could see the problem.

Over the years he had, at times, made a great deal of money trading in various futures markets. Yet he invariably gave that money back along with additional funds. After many years, he was a net loser of a substantial amount of money.

In fact, what seemed to be a virtue of this man's trading was the very thing that was destroying him in the markets. This seeming virtue, strangely enough, was linked within him to a profound level of greed.

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His virtue was this: He had inured himself to financial pain to the point that he was able to accept a considerable draw-down in his account while he patiently waited to be "right" in the trade.

This was an amazing manifestation of greed. His greed was so great that he could subject himself to, and withstand, the tremendous mental, emotional, and financial pain and discomfort that his style of trading brought to him.

Yet his steadfastness had all the appearances of being a virtue. Why? Because his ability to stay with and bear the pressure and heat of huge draw-downs often finally resulted in winning trades. He was able to stay with a bad trade until it turned into a good trade. Since this behavior had brought forth some huge winners, it became an acceptable way to trade - at least from his point of view.

However, all too often, this pattern of trading behavior resulted in enormous losses. There was only one thing that can explain his drive to continue to punish himself in the markets. That one thing was greed. His lust for money was greater than his fear of losing it. So for fifteen years, this gentleman has had his ups and downs. He has now lost enough money that he is willing to throw good money after bad, in the hope of somehow regaining his losses.

What if he were to regain the money he has lost? Would he then stop trading? I leave it to you to decide. I'd be willing to bet on which human failing would drive him to continue on - you guessed it, greed.

Unless he is able to overcome this foible in his character, he will be doomed to repeat his failure again and again.

Resolve to trade carefully. Resolve to put greed out of your trading and out of your life. Strive for balance. Realize you won't win all the time. Learn to be satisfied with steady wins in the markets. It is the regular, steady, unspectacular profits that identify the mature, wise trader.

On occasion, you will be in the market and catch the "big one." It will not be by any skill of yours. It will be pure luck. I have had three such fortunate occurrences in 37 years. Can you imagine how much money I would have lost if I had sat around waiting for those to happen? Perhaps they would never have happened. I'm still waiting to hit a 500 point move in the S&P. Maybe it will never come. I'm content with a steady 40 to 50 points per trade for each contract set on days when the S&P shows me it is ready and willing for action.

I know traders who have earned a great deal of money over the years yet have never had a really great, get-rich-all-at-once trade in their entire trading careers. But they drive fine cars and live in beautiful homes. They are happy craftsmen who have learned the art of trading. They take steady, meaningful profits out of the markets on a regular basis.

Yours for more profitable trading,
Joe Ross.

Joe Ross has been a successful professional futures trader for over 30 years. He has written the books TRADING IS A BUSINESS, TRADING THE ROSS HOOK, TRADING BY THE BOOK (selected by Trader's Almanac as BOOK OF THE YEAR) amongst others. Many very good traders swear by his methods particularly trading strategies, trading tactics and money management. Mr Ross will be in Australia in February & March 1995 to do a series of seminars. He can be contacted on phone 0011 1 (512) 259 0727 or fax 0011 1 (512) 2599 0747.

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TRADING OPTIONS
(FROM THE AUTHOR OF OPTURES & FUTIONS)

I get a lot of phone calls asking me about options. Although I'm an options trader primarily in the futures markets, I also trade some in the Stock Market - when I have time.

Even if you don't trade options, you can learn a lot from what is discussed here. If you are inclined to trade options, I think you will find a great deal of truth in this issue.

Even when trading options, you should try to stick with the trend. Attempting to pick tops and bottoms, or trying to "catch a piano" as the Fibonacci retracement traders do, will kill you in options just as in futures. Do not confuse Fibonacci ratios with proven support and resistance levels, which often have nothing to do with Fib ratios.

One of the best ways I've found to trade options in a trend is to use a long-term moving average. A 39 X 5 offset moving average of the close (MAC) is good, as are 59 bar MACs and 200 bar MACs. A contract should be at least above a 39 X 5 MAC before you consider purchasing calls, and it should be below the 39 X 5 MAC before put purchases are considered.

In a trending market, calls should be purchased at support levels and puts purchased at resistance levels. This is consistent with the "good trader mentality." Good traders buy retracements and short rallies, because most often the trend will continue. When a trending market corrects, consider buying puts and calls, in an effort to keep the probabilities on your side.

When I consider options purchases, I prefer to purchase options in true commodity markets. Essentially, these are things that are consumable. Naturally, sufficient liquidity is of the utmost importance.

When trading options, I like to look at related commodities for trade confirmation. I will look at the entire Soybean complex. I look at the energy futures as a complex. At times, I view the grains as an entire complex, although the grains do not always track each other, due to variations in planting and harvest times, as well as the varying demand from overseas markets. The 1991-1992 Wheat market was a good example of this. Wheat trended marvelously for six months, while the rest of the grain complex went either nowhere or down.

The best option trading opportunities seem to occur when an entire complex is trending. Then, I select the contract that has the greatest open interest. For instance, if the energy complex is up, I most often select the Crude Oil. You can be murdered on options in Heating Oil or Unleaded Gas. These markets are much too thin. You can see enormous profits disappear while waiting and waiting for a fill.

Another good rule is to choose steady, non-volatile trends in the underlying commodities. A nice steady trend, or a long-term tight congestion is what you want for the purchase of options. Avoid highly volatile, choppy markets unless you are a seller. That necessitates waiting until you see a market commit itself. With option trading, low volatility equates with low premiums. High volatility equates to high premiums. Remember that. If you pay high premiums, it is difficult to profit, even though you are going in the right direction.

Although I don't normally look at fundamentals, there are a couple of times when they do count. One is rumor in the market, and the other is surprise or unexpected news.

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This year, I made a terrific trade in the futures because I read of a rumor in the news on my live data feed. Intraday option traders could have made a good profit as well. If you are quick enough, buy short term puts or calls based on rumor or surprise news stories. An example of a surprise news story might be the Fed lowering the Discount Rate by a full point when the most anyone expects is a half point.

Other surprise news stories center around freak weather, sudden freezes, droughts, or unexpected political events. Reactions to some of these are very short term and can be traded only intraday.

Trading from the fundamentals must be quick and sure. Otherwise, you may be facing high premiums which have been bid up in anticipation of the actual news or event.

A futures trading strategy may be equally valid in the options markets: Take profits based on price; limit your losses based on time.

I do this when trading futures. If anything, it is more important with options. With futures, if the market doesn't soon do what I expected it to do, I exit. I exit options the same way.

Profits on options need to be taken at a price. As soon as I can cover costs, I cash part of my position. I then set an objective based upon a percentage of gain in price. When I have that percentage gain, I take my profits and run.

I never use stops based on options prices when purchasing options. To my way of thinking, they are unnecessary when trading options. If anything, I use a stop in the underlying futures to protect profits. Here's why:

First, options are relatively inexpensive vehicles to which you are committing a small amount of capital. Your risk is automatically limited to that amount, so why use a stop and take a chance of being stopped out of what may turn out to be a sizable move? I prefer to limit losses with options by limiting the time I will hold the option. For instance, buy a three month option, and close it out after one month while it still has some time value.

You are using a time stop to keep your losses from becoming too great. This way, you also prevent the option from expiring with a loss of all your premium.

Second, the floor loves to run stops. With the wild swings sometimes found in the options markets, you run a high degree of probability of getting stopped out. It is better to take advantage of high volatility by placing resting profit objectives in the market. When a wild swing takes place, you may find yourself filled at a profit, long before you would normally have expected it. When the floor traders run the stops, they will fill you, too. This may happen with a very small move in the underlying futures contract.

Never trade with more than a fraction of your trading capital. You don't need to, because the leverage you obtain from options allows you to have the tail wagging the dog. You don't need a lot of money to make a large profit with options. Of course, the same is true with futures, but the leverage in options is even greater.

You must take advantage of the fact that options are usually relatively inexpensive. This allows you to diversify. The beauty of trading something inexpensive is that it allows you to participate with only a small part of your total trading capital.

When trading options, I try to diversify. I hedge my positions by purchasing both puts and calls. I use spreads, straddles, and, strangles. I do all of these, and still consider myself to have a straightforward, simple approach when it comes to trading options. I do these things at the simplest of levels, usually without benefit of an options model.

Earlier I stated that I prefer to trade options on real commodities. One reason for that is that I feel that the index options are totally overdone. They are very popular, especially the OEX.

One of the problems with index options is that you are either right or wrong. You are undiversified when you trade them. You need to be quite good at market timing. Few are adept at that.

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Index options are so popular that the premiums tend to run very high. The options are often simply too expensive, by comparison to the premiums on consumable commodities.

Here's another thing I've pointed out in previous articles: You don't have to trade all the time. That is true for options as well as futures. Trade options only when the situation is right. Since there are many options from which to choose, you can afford to wait for those opportunities which are perfectly configured.

It's as important to filter option trades as it is to filter futures trades. However, the filters are a bit different and not quite as technical in nature.

The first filter is open interest. If you want to buy a call, and there is heavy out-of-the money open interest in calls, pass up the trade. Heavy out-of-the money open interest in puts should keep you out of them, too. Contrary opinion has to rule here. If everyone is bullish, stay out. If everyone is bearish, stay out. When the open interest is heavy in one direction or the other, the premiums will be too high.

Option purchasers are usually wrong. That's why option writers get rich. You want to avoid being part of the crowd when you're trading options.

The option trading on the floor is going to be mostly on the opposite side of the heavy open interest. The floor has an incentive to try to limit the trending of the underlying futures. This is especially true of the options trading floor. The options floor traders will trade in the futures market in an effort to stifle trending behavior.

The option floor traders do not want options purchasers to be successful. Remember this. They will run a market up or down in response to where they see a heavy open interest in either puts or calls.

You can find out where the heavy open interest is by looking at the newspaper, viewing it from your live data feed, or asking your broker. What is considered to be "heavy" open interest? If the open interest on the most actively traded out-of-the-money strike price in the direction you wish to trade is twice the total volume of all strike prices, that is too heavy. Stay out of that market as a purchaser of options at the strike prices that have the heavy open interest.

The second purchase filter is whether there is chart support at your put strike price, or chart resistance at your call strike price. If so, don't take the trade. If you do, you will be betting on a breakout. While this is okay for futures, it doesn't pay to do it with options. The odds are too low, and your option may expire worthless while you are waiting for a lasting breakout to take place. Remember, there may be a number of false breakouts from congestion, especially in the stock indices.

A third purchase filter is whether a report is due out at the time you want to enter your option trade. You don't want to get caught going the wrong way on a crop, meat, or API report. The same is true for some of the more important government reports, such as PPI, CPI, and Employment.

Different reports have differing results, depending upon any number of factors that affect the markets. Better to be safe than sorry. At times the markets will completely ignore the GNP, or the unemployment report, while at other times any of these reports will cause major trauma in the markets.

The final purchase filter I will mention is volatility. If the implied volatility on the option you are looking to buy is far in excess of what the historical volatility has been, don't purchase.

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This is a judgment call. If recent volatility has been fairly great because of some underlying fundamental factor, it may be okay to take the trade, even though the premium will be higher due to that volatility. One way to make this judgment is to see if there has been a recent trend toward more volatility in the underlying futures, as opposed to a sudden increase in volatility. It would be okay to trade if there were an increasing trend. But if the volatility increase is sudden, stay out.

When the volatility increase is sudden, it is usually associated with a temporary condition such as freak weather, a political event, or some unexpected news. The volatility can go up suddenly, based upon some market expectation.

Then, even if you're right, you'll be wrong. The market will move your way, but you will have paid such a high premium that you will end up losing even though you were right. It's hard enough to lose money when you're wrong. You don't want to lose it when you're right.

The rule here is to avoid trading when the option implied volatility is one and a half times the historical futures volatility. If you don't have options trading software, then you will have to attempt to find this information elsewhere, or, compute it yourself if you have programmable software. To obtain the historical volatility compute the average daily range of prices for the last ninety periods of the underlying futures. Compare this with the volatility of the last five periods. This should give you a pretty good idea of the relationship. To compute average volatility, take the sum of the differences between high and low for the last "x" periods and divide the total by "x".

There are some additional Trade Selection factors to consider:

Avoid buying too much or too little time. Once you have selected an underlying futures, you will find there are a number of option expiration dates from which to choose. Avoid the extremes.

Don't buy options with more than six months of life remaining. The premiums are generally too high. This cuts down substantially on your potential profits, as does the lack of liquidity, which can cause you to have to purchase at a high price and sell at a low price. If your time frame is that long, you would be better off entering the underlying futures.

Avoid buying options that expire in just a few weeks or days. As a rule, these options are for trading by professionals. They are in position to take advantage of the extreme decay in time value in the final weeks and days of an option's life. Buy options that have about three month's life, and close out your trade while there are still at least four weeks to go to expiration. The worst decay takes place in the final month of the option's life.

Avoid buying too little or too much intrinsic value. Intrinsic value is that portion of the option price that is due to it being "in the money." Deep in the money options are usually too expensive, and have limited profit potential. Out-of-the-money options require the underlying futures to move considerably more in the direction of the trend then they are apt to move. The best value is to be found "at-the-money."

Try to pick options with a strike price that is within a point or so of the underlying futures price. This may be slightly out-of-the-money.

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The most conservative method would be to buy slightly in-the-money options. You would sacrifice some profit potential, but also lower your risk with in-the-money options. I'm convinced that purchasing out-of-the-money options should be avoided, no matter how tempting the lower premium looks.

Avoid purchasing solely call options. Put options are as good or better, and, as a rule, downtrends make money for you a lot faster than uptrends.

Very often, puts are relatively less expensive than calls when the underlying futures is a consumable commodity. Unfortunately, this is not true of options in the stock indices, where puts are often priced at extremely high premiums, especially since the Crash of 1987.

Try to diversify by purchasing both puts and calls within a commodity complex. Learn about spreads, straddles, strangles, and butterflies, so that you can hedge properly.

Just as with futures, don't pyramid your profits. Don't risk all of your capital on a single trade. Because there will always be losing trades, by pyramiding your capital after a few profitable trades, you are leaving yourself wide open to some very serious losses, once a losing trade comes along.

You need staying power with options, just as with futures. Some options will show early paper losses, but eventually turn out to be winners. This happens often. Follow the rule of trading only a portion (8%- 10%) of your trading capital committed to any one trade.

Get the correct perspective. Option buying is not for perfectionists. You trade in order to achieve profits and happiness. If you can't stand the slop involved with trading options, don't trade them. Keep in mind that the advantage to purchasing options is that you are able to truncate risk. You can never lose more than your original investment, but your profits are theoretically unlimited.

Realize that successful option buyers typically have more losing trades than winning trades. This is because you are playing against a stacked deck. If you haven't realized it, then now is the time to know that option writers usually win. Ninety percent of all options expire worthless, yet you can make money buying options.

If you are patient and are willing to win only two or three out of ten trades, then you have the correct mind-set for purchasing options.

Winning trades in options yield far more dollars per trade than are lost by losing option trades. You have to know that and count on it. As a rule, the profit on one winner will exceed the loss on four losers to the extent that you will see a fifty percent profit on all five trades.

Never trade without a profit objective and a closeout date. I cannot emphasize this enough. Option markets can be very fast. As I write this, the indices rose early on a speech by the President. A few hours later, they plummeted on a speech by the Federal Reserve Chairman. Winning positions can be turned into losers within a matter of minutes or hours. Therefore, it is necessary to select a profit objective at the time you establish your option position. A full service broker can monitor your positions for you and sell when prices achieve your target, or better yet you can issue sell orders at your objective prices in advance.

Just as some greedy futures traders will sit and watch their profits evaporate, and their winning trades turn into losers, the same thing happens to option traders who refuse to take profits when they are there. Wealth accumulation is a process that covers many trades.

You are not going to make it all on one trade unless you get very lucky. If that's your mind set, then try the Irish Sweepstakes.

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Have a resting sell order at a profit objective, and have a date at which you will close out your position if your objective is not achieved. The close-out date should be no later than four weeks prior to the option expiration date.

If you decide to become an option writer, don't sell naked options without a good plan of defense. Naked options have unlimited risk. If you are going to do that, you might as well trade the futures. How would you like to have written naked stock index puts in October of 1987, or 1989? There was no way to unwind them until the market hit dead bottom.

Don't place orders to take place at the open or the close. Most especially, never give a market order to take place at or near the open or the close. Options are not very liquid in early trading. Options on the indices should never be entered after 3 p.m. CST.

One of the best suggestions I've seen is this: Determine the strike price that you'd like to buy and then move one strike "closer to the money." Why? Because most options traders incorporate their most optimistic expectations for the underlying futures into their strike price decision. They fail to take into consideration such things as unfavorable market movements and small rather than big movement in the underlying futures.

If the price of the closer option is too expensive, then you probably shouldn't be trading the riskier, less expensive option.

Utilizing the same reasoning, go to the next expiration month beyond that which you are looking to buy. Most option players don't give themselves enough time until expiration for their scenario to work out, and many get caught up in the extremely difficult game of buying options with just a few weeks or even days until expiration. While you normally shouldn't go much further than three months out, if you must buy a far out-of-the-money option, make sure you have 4, 5, or even 6 months until expiration.

Finally, just as with futures, shop around for discount commissions. If you are trading with a full service broker, push him for a discount. Keep in mind that full service means he keeps track of your orders, confirms executions and provides you with information when you want or need it.

Good luck and good trading.
Joe Ross.

Mr Ross can be contacted on 0011 1 512 259 0727 or fax 0011 1 512 259 0747 for further information. He has been a professional trader for over 30 years and brings a wealth of experience to the subject of trading. He will address the February 1994 Sydney and Melbourne meetings of the Australian Technical Analysts Association

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Videotape Library

New Videotapes

David Hunt has donated a copy of Elder "Psychology of Trading" to the library, so there are now two copies of this video circulating. If any other member has copies of video tapes they would like to donate to the library, they will be greatly appreciated.

Further additions to the library have been made this month in the form of three tapes by Martin Pring on Momentum and three tapes by Thomas Bierovic on SYNERGETIC TECHNICAL ANALYSIS.

Members who have previously ordered all tapes should note that they need to place a specific order for these new tapes and the other recent additions. Phone Colin if you are in doubt as to what you currently have on order.

The ATAA has established a collection of videotapes that members may borrow. The videotapes are in VHS format and are available for loan to ATAA members free of charge. You are only asked to pay the postage to return them promptly when you have finished watching them.

In order that the maximum number of members may take advantage of the library, you are asked to view each tape and return it within one week. Members consistently taking too long to return video tapes may be dropped from the waiting list for further borrowings.

We lend these videos on a type of first-come-first-served basis and maintain a waiting list. While we will place you on the waiting list for more than one video tape, you will only ever be sent one at a time. Members who have not received a videotape before are placed at the top of the list and will receive the next video that is returned to the library and was ordered by them. That member's name then drops to the bottom of the list and he/she will not be sent another video until his/her name works its way to the top of the list again. This system ensures that all members experience a similar waiting period (currently 6 to 8 weeks) between videos, depending upon the demand. However, it also means that the order in which members receive their selections will be random, depending upon which video next comes back when their name is at the top of the list. However, members ordering Elder: "Technical Analysis in 52 Minutes" or Pring: "Principles of Technical Analysis" will be sent those tapes first, if they so request. This may delay receipt of the first tape, however.

The tapes currently available for loan are:

Schwager: What it Takes to be a Great Trader
Elder: Technical Analysis in 52 Minutes
Elder: MACD and MACD-Histogram
Elder: Relative Strength Index (RSI)
Appel: Day Trading with Gerald Appel
Elder: Directional System
Elder: Triple Screen Trading System
Elder: Elder Ray
Elder: Stochastic
Elder: Williams %R
Fuller: Market Opportunities '94
Elder: Psychology of Trading
Plummer: Forecasting Financial Markets
Pring: Basic Principles of Technical Analysis
Pring: Price Patterns
Pring: Support, Resistance, Trendlines & Moving Averages
Pring: Momentum, Relative Strength & Volume
Pring: Mechanical Trading Systems & Correct Investment Attitudes
Pring: Momentum 1 - Basic Principles of Momentum Interpretation
Pring: Momentum 2 - Selected Indicators 1
Pring: Momentum 3 - Selected Indicators 2
Bierovic: How to Increase your Trading Profits with Synergy
Bierovic: How to Synergise Oscillators with Trend Indicators
Bierovic: How to Manage your Account, Your Trades and Yourself

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If you would like to borrow any of the videotapes, contact Colin Nicholson to be placed on the waiting list. There are three ways to do this:

1. Telephone Colin on (02) 436 1610

2. Write to:
   Colin Nicholson
   3 Eastview Street
   Greenwich NSW 2065

3. Fax to:
   Colin Nicholson
   C\- Christopher Carr
   (02) 901 4468

Bibliography: Technical Analysis and Trading

The following further book sources are suggested for the UK and USA and might be added to those provided in the July Newsletter.

Further Overseas Sources: UK and USA

Parks Bookshop. 244 High Holborn, London, WC1V 7DZ, UK. Tel. 071 831 9501, Fax. 071 405 9412. Stocklist No. 2: Finance, Investment & Banking - contains numerous TA and trading titles of current publication. Fax orders and credit cards accepted.

Allan C. Davies Financial Education. 1617 Linner Rd., Wayzata, Mn 55391, USA., Tel. 612 473 7574, no fax. facility. Specialises in rental [US customers only, but sales to foreign customers] of a superb classic collection of original courses by Gann, Pugh, Jiler, Tubb, Wyckoff, etc. Large collection of out of print books. Catalogue US$5, refundable. Foreign payment by International Money Order.

Knight-Ridder Financial Publishing. PO Box 94513, Chicago, IL 60690, USA, Tel. 800-621 5271, Fax not known. Specialises in currently published titles. Catalogue available. Credit cards acceptable.

Ron Bever Books. Route 3, Box 243-B, Edmond, OK 73034, USA. Tel. 405 478 0125. No fax facility. Specialises in out of print books on commodity and stocks trading/investment, no courses. Will conduct book search for specific titles not in stock. Foreign payment by International Money Order.

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Cycle Analysis

A brief synopsis of a report "Technical (Cycle) Analysis" by Bruce Davenport
Article prepared by Roger Lawes

Bruce Davenport is a technical analyst employed by Potter Warburg and employs a specific methodology and approach to the analysis of market and stock "cycles".

The original author of the theory of mathematical cycle analysis was J.M.Hurst in 1962. His views contend that 75% of all stock price motion is driven by fundamental events, that 23% of price motion is due to non-fundamental factors, and 2% is considered random in nature. Cycle analysis is therefore dedicated to assisting in profitable trading, predicated on "reading" part of the 23% segment.

Cycle Measurement

Cycles in the market, or more correctly "rhythms," can be measured in a variety of ways that involve a range of complexity, with resulting accuracy differences. The fact that cycles exist does not imply that they exist all the time. Cycles come and go. Experience shows that cycles useful for trading only relate to 23% of the price action. Cycles are generally measured from significant bottoms , because they tend to be more defined, giving a clearer picture.

The approach calls for an examination of and filtering of cycles as determined by fourier analysis, maximum entropy spectral analysis and inter-dimensional cycles as well as the use of tools such as dividers, rulers or computer aided cycle finders. An envelope is produced whereby the price is contained within the various envelopes as is demonstrated on the following examples.

From an analysis various cycles of differing length may be determined and then from the last major cycle termination future cycle highs or lows can be projected.

Envelope analysis tells us approximately when and where to expect price turns and the magnitude expected for the trade. Trend lines are really straightened out segments of curvilinear channels. The "trend lines" become increasingly steep as the channel shortens. The stock needs to demonstrate what is expected, before a financial commitment is made. A valid trend-line accomplishes this objective. Therefore when the stock is within the time boundaries of the time zone and price break through the trend-line on the upside a buy signal is given. A stop loss is placed below the swing low, and if broken demonstrates that there is a larger cycle in play.

When the unexpected occurs there are three main causes.

1. Unpredictable fundamental factors.
2. The unpredictability of magnitude-duration fluctuations of the trading cycles.
3. Over looking the status of the longer term components.

Conclusion

One of the primary objectives is to improve transaction timing of entry and exit points; to be able to have a well organised plan to maximise and then protect profits through stop-loss points.

Copies of reports prepared by Bruce for the week ending 7 October for the Share Price Index and the 10 Year Bonds follow.

A full copy of Bruce's study is available on request from Roger Lawes on (02) 375 6536

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Bruce Davenport [02]-375 6852
8 October 1994

10 yr Bond Future SFE - (nearest future)

Last Sale 89.645 (10.355%)

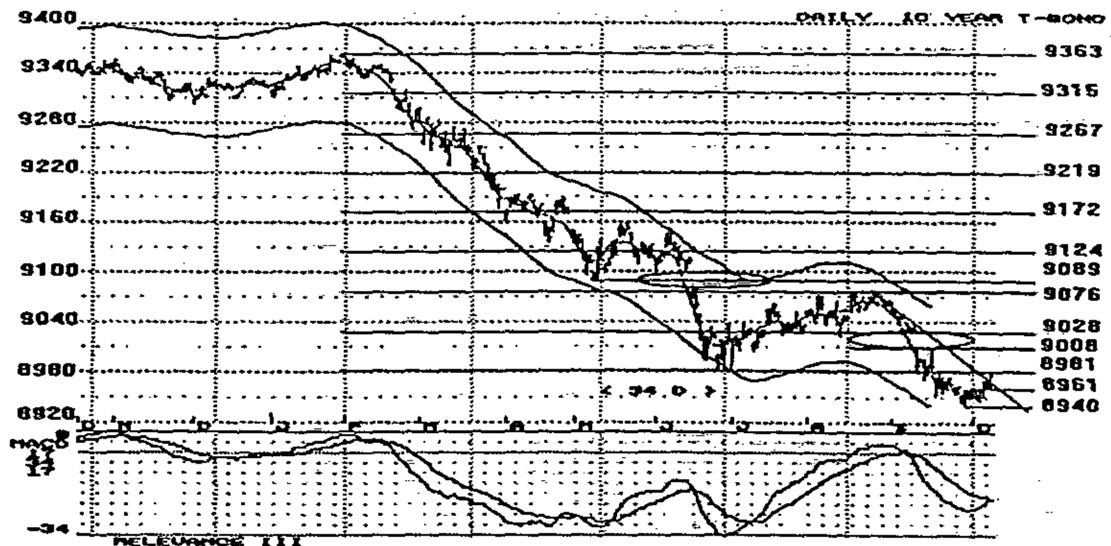
Weekly Window

Conclusion: The main trend is down, and any rallies to be considered as corrective.
Weekly view: The weekly cycle indicates a down-trend with a target of 88.86. The cycle low is due late January 1995.
Daily view: Corrective rally targeting 90.04 to 90.08, with cycle high mid-October 1994.

Comment:
Weekly: The dominant 32 weekly cycle indicates a low late January 1995, with a price target of 88.86. There is good historical support at 89.34, though 88.86 is the preferred level. Reassess on prices reaching targets. Currently there is a corrective rally in progress. Refer to daily analysis below. Prices closing below 89.61 will signal down-trend has resumed.

Daily: The 34 trading daily cycle low occurred early October 1994. The corrective rally is targeting 90.04 to 90.08, with the daily cycle high mid-October 1994. The suggested stop-loss for a long position is 89.61 initially. Progressively move stop-loss up as rally advances. Reassess once target is reached and refer to resistance levels below.

Cycle analysis considers 2% price action to be random in nature, 75% relates to fundamental, and the remaining 23% is cyclical.



Daily - 10yr Bonds Futures SFE - (nearest future) Graph.

Cycle Structure

Average Cycle Period	Date of Last Turning Point	Time Since Last Turning Point	End of Cycle	Est Price Trend within Cycle.
34 (± 2) Days	Low - 3rd Oct 1994	4 Days 12% along	18th Nov 1994	Up
32 (± 2) Weeks	Low - 17th June 1994	16 Weeks 50% along	27th Jan 1995	Topping
49 (± 2) Months	Top - January 1994	9 Months 18% along	February 1998	Down

Summation: The main trend is down, and any rallies to be considered as corrective.

Resistance Levels: 89.75 89.81 90.04 90.10 90.22 90.28 90.37 90.73 90.89
Support Levels: 89.61 89.57 89.53 89.40 89.34 89.10 88.86 88.38 87.90 87.43
(The support/resistance levels above are historical swing highs and lows)
Stop-loss: Short positions stop is currently - Weekly 89.75 - Daily - Activated

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Bruce Davenport [02] 375 6852
8 October 1994

Share Price Index SFE (nearest future)

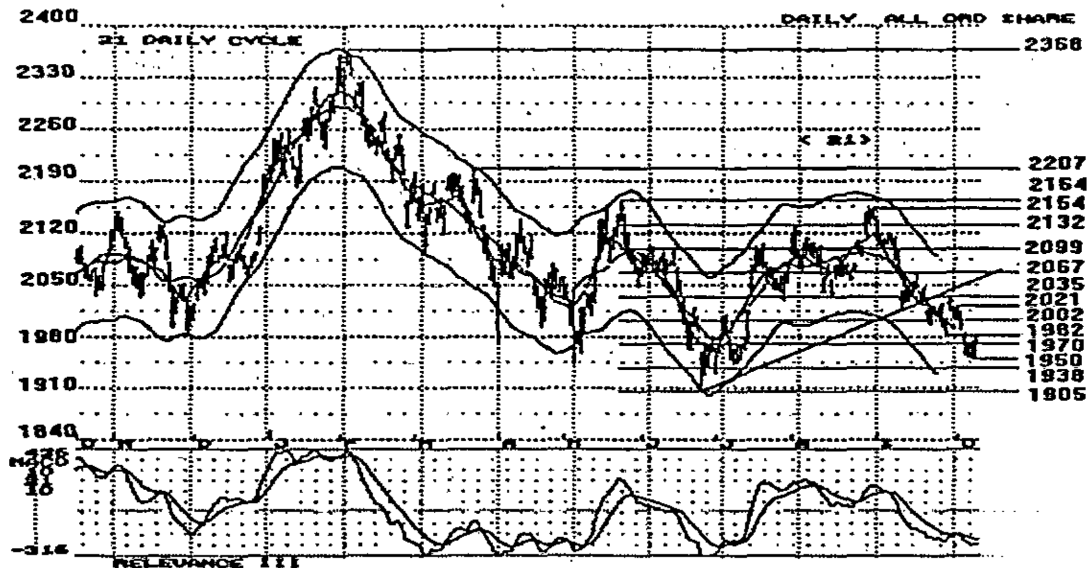
Last Sale 1957.0

Weekly Window

Conclusion: Main trend is down.
Weekly view: 32 weekly cycle is targeting 1905.0 in early January 1995.
Daily view: The price action indicates that the cycle low could be in place, and a corrective rally is in progress targeting 2002.0 in the current week.

Comment:
Weekly: The last cycle high occurred mid-September 1994, according to the dominant 32 weekly cycle. The 32 weekly cycle has been on schedule for the last seven occasions, and the next cycle low is due early January 1995. Prices are targeting 1905.0. Reassess position once price target is reached.
Daily: The 21 trading daily cycle low is due mid-October 1994. However, price action indicates that the cycle low could already be in place, with a corrective rally targeting 2002.0. (The suggested stop-loss for long positions is 1950.0.) Prices breaking below 1950.0, on a close basis, will confirm that the down-trend is continuing. Refer to support levels listed below. Once price penetrates a support/resistance level on a close basis, generally it will test the next level.

Cycle analysis considers 2% price action to be random in nature, 75% relates to fundamentals, and the remaining 23% is cyclical. Cycles are generally measured from significant lows.



Weekly Share Price Index SFE (nearest future) Graph.

Cycle Structure

Average Cycle Period	Date of Last Turning Point	Time Since Last Turning Point	End of Cycle	Estimate Price Trend within Cycle.
21 (± 1) Days	Top - W.E. 30th Sep 1994	5 Days 24% along	31st Oct 1994	Down
32 (± 2) Weeks	Top - W.E. 16th Sep 1994	2 Weeks 9% along	28th Apr 1995	Down

Summation: Main trend is down. Intermediate rally is topping.

Resistance Levels: 1970 1982 1997 2002 2016 2021 2032 2029 2035 2056 2062
Support Levels: 1950 1943 1937 1930 1905 1873 1854 1841 1809
Stop-loss: Short positions stop is currently - Weekly - 2032.0 - Daily - 1991.0

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Australian Technical Analysts Association Inc
Application For Membership

First Name: .... Family Name:..

Company (If membership paid by a company): ....

....

Address:..

....State: .... Postcode: ....

Telephone:
(Business hours): .... (Evening): ....

Facsimile: ....

Do you use Technical Analysis for your trading/investing decisions?: YES / NO

If Yes, please describe your use of Technical Analysis: ....

....

....

For our records, how did you first hear of the ATAA? ....

....

Membership is by payment of annual subscription of $100.00.

For membership purposes, our year runs from July 1 to June 30.

We do not pro rata the annual subscription for memberships beginning part way through the year. Instead, we offer two concessions:

(1) Members joining between July 1 and December 31 receive a copy of all Newsletters published in that period.

(2) Members joining between January 1 and June 30 are credited with the remainder of the current year free, such that their initial annual subscription covers membership up to June 30 of the year following the year in which they join.

For information call the Honorary Secretary, Colin Nicholson (02) 436-1610; or Victorian Chairman Paul Simmons (03) 497 3551.

Please mail the Application Form with a cheque for $100 to:

The Honorary Secretary
Australian Technical Analysts Association Inc
GPO Box 2774
Sydney NSW 2001

Make Cheques payable to Australian Technical Analysts Association Inc

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AUSTRALIAN TECHNICAL ANALYSTS ASSOCIATION INC

The aims of the Australian Technical Analysts Association Inc (ATAA) are:

* To establish personal contacts between analysts both inside and outside of Australia with a view to promoting the theory and practice of technical analysis,

* To help raise the level of community awareness and respect for technical analysis,

* To provide meetings and encourage the interchange of materials, ideas and information in order to add to the knowledge of its members and

* To encourage the highest standards of professional ethics and competence among technical analysts.

The ATAA is affiliated with the International Federation of Technical Analysts helping us to keep abreast of international markets and techniques.

Founded by a small group of technical analysts that met on a regular basis, the association was officially launched on 26 April 1990.

Membership is varied in employment, geography, market interest and approaches to the markets. Current members include corporate treasurers, fund managers, bank analysts and traders, stockbrokers, financial planners, private and local traders and investors. The members will be professional Technical Analysts, or people using Technical Analysis for private investing or trading.

Benefits include monthly meetings and a bi monthly newsletter, both of which provide an opportunity to learn technical analysis techniques, as well as being a forum for discussion and new ideas. In addition, members have access to a video tape library and discounts on various technical, psychology and trading courses and books.

Meetings are held each month except December and January. In Sydney, meetings are usually held on the third Monday of each month at 6.00pm. In Melbourne, meetings are usually held on the third Wednesday of each month at 6.30pm. All meetings are advised in advance by mail. Alternatively, contact the Honorary Secretary in Sydney, or Paul Simmons in Melbourne. Informal meetings are held in other states at various times.

Subscription can be obtained by filling in the membership application form on the reverse side and mailing it to;

The Honorary Secretary
Australian Technical Analysts Association Inc
GPO Box 2774
Sydney NSW 2001

For further information call the Honorary Secretary, Colin Nicholson on (02) 436 1610, or the Victorian Chairman, Paul Simmons on (03) 497 3551.

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