WHAT EVERY SHAREMARKET INVESTOR NEEDS TO KNOW ABOUT CHARTS

A Guide for Australian Investors



JOHN ROBERTS

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Published August 2017

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Why Invest in the Sharemarket?

Remarkably, Australia has one of the highest rates of share ownership in the world — something like 40% of Australians are shareholders.

What's the attraction?...

Well, apart from respectable historical returns, one of the benefits most investors love about the share market is ***liquidity***.

A *liquid* investment is one which can be easily bought and sold.

Compared to other investments with comparable historical returns — such as the property market — shares are incredibly *easy* to buy and sell, taking about as much effort as ordering a pizza!

One phone call to your broker does the trick. Or if that's too much trouble, place your order via the Internet.

If you need ready access to cash in an emergency, shares are just as easy to *sell* — no waiting months, or even years, to find a buyer and dispose of your investment.

And the down side?

Isn't the Sharemarket Risky???

We all know that property *only* goes up, right? — after all, "they're not making any more land!".

Whereas the share market... well it can crash at any time. The whole thing is just a kind of sophisticated casino. Right?

Well, that's often the popular perception. But let's look at the *reality*...



Here's a chart of the All Ordinaries Index (historically, the main Australian Stock Exchange index) from the *Yahoo! Finance* web site. It goes from 1984 (as far back as data is available on *Yahoo!*) to the time of writing. We can see that the index has increased from around 700 points to about 5300 points over the past 33 years — an average increase of 6.6% per annum.

And this period ***includes*** the “crash of '87”, the aftermath of “9/11”, and the Global Financial Crisis of '08 (when about half the value of the market was wiped out) — all periods of pronounced panic selling.

What's more, despite all the ups and downs, the increase is remarkably consistent — you can see from the chart the market was higher in 1996 than 1989, higher in 2003 than 1996, higher still in 2010, and higher still as I write.

Volatility — Blessing or Curse?

Nevertheless, we can see there *are* sustained down periods in the market. The perception of “riskiness” in the sharemarket comes from its ***volatility***. Although the market does seem to consistently move up over time, it *doesn't* do so smoothly and

predictably. That line is *jagged*. Short-term, the market seems to jump up and down all over the place. The "jaggedness" is what we refer to as *volatility*.

Put slightly more scientifically, volatility refers to the market's ability to move up and down significantly in a *short* space of time.

Ironically, the very volatility that puts people off from investing in the sharemarket, *can* be one of its greatest blessings to the investor.

After all, if the market has "the ability to make significant moves in a short space of time", then it has the ability to return significant ***profits*** in a short space of time — profits that would not be available if the market *did* move up sedately in a predictable fashion.

(But I'll save further discussion of the joys of volatility for another time.)

Is there an element of *risk* involved in investing in the share market? Of course there is! As there is in any investment that has the ability to provide *greater than average returns*.

But you'll soon learn that the risk can be *controlled* and managed by a variety of techniques including position sizing, stop losses and "hedging".

Share Trading is Simple — People Make It Seem Complicated!

Seriously.

When I watch the stock market roundup on the evening news, I often get the impression that there's a conspiracy in the financial services industry to make the whole business of investing in the stock market seem as arcane and complicated to ordinary folk as possible. Portentous meanings are ascribed to the most *trivial* of market movements.

Traders themselves often seem to rejoice in inventing complicated mathematical indicators to apply to share price charts. Some areas of the discipline of technical analysis of share prices (such as Gann angles, Elliot waves and Fibonacci retracements) seem to owe as much to mysticism as mathematics.

And the market is steeped in obscure jargon which makes it seem even more puzzling to most people.

Unfortunately, all this perceived complexity tends to make people rely on the advice of others when investing in the market — or avoid the market altogether. Personally, I don't think *either* option is a good move.

I'm a great believer in *taking responsibility for your own money* and making your *own* investment decisions, rather than relying on the advice of supposed experts — who often have a *vested interest* in the investments they steer you towards.

And there's no doubt the share market *is* a great investment vehicle. Apart from the potential of *high returns* and the *ease of buying and selling*, you can get started with a *small amount of investment capital*, and the *transaction costs* (i.e. brokerage) are *relatively low* compared to other popular investments such as property.

Time to De-mystify the Market!

The truth is, successful, profitable share market investment is *not really that difficult*. It's *simply not necessary* to understand *all* the ins and outs of the market in order to make good profits. In fact, most successful share traders use simple, basic, easy-to-understand strategies.

There are strategies that can make you profits in *rising*, *falling*, or even *sideways* trending markets.

I set up Strategic Share Trading to show ordinary Australians how they can earn *substantial profits* from the sharemarket — *without* taking unnecessary risks — all explained in *simple, easily understood language*. The first step is to learn how to read the market.

So let's get to it!...



The Two Basic Methods of Share Analysis

A vital part of learning about the stock market is to discover how to use stock analysis to work out if a share is good value.

I suppose the *first* thing we need to consider if we're going to invest in the stock market is:

Which share, or shares, should I invest in? And how do I know if I'm getting that share at a good price?

One way to decide is to rely on the advice of others… But I do ***not*** recommend it!

Do yourself a favour and develop the ability to analyse the market *yourself*, and make your *own* decisions — rather than rely on "tips". The tip may well have come from a source with a *hidden agenda*. Sometime false rumours and misinformation are deliberately spread to create demand for shares that someone else wants to *sell*.

If you do your *own* research and make your *own* decisions, you can be sure you're dealing with *facts* — not hearsay.

So how do we do our own analysis?

There are two main methods: *Fundamental Analysis* and *Technical Analysis*...

What is Fundamental Analysis?

Realise that when you're buying shares, you are investing in a *business*. Now if you're going to invest your hard-earned into a business, aren't you going to want to know something about its prospects of success? Like:

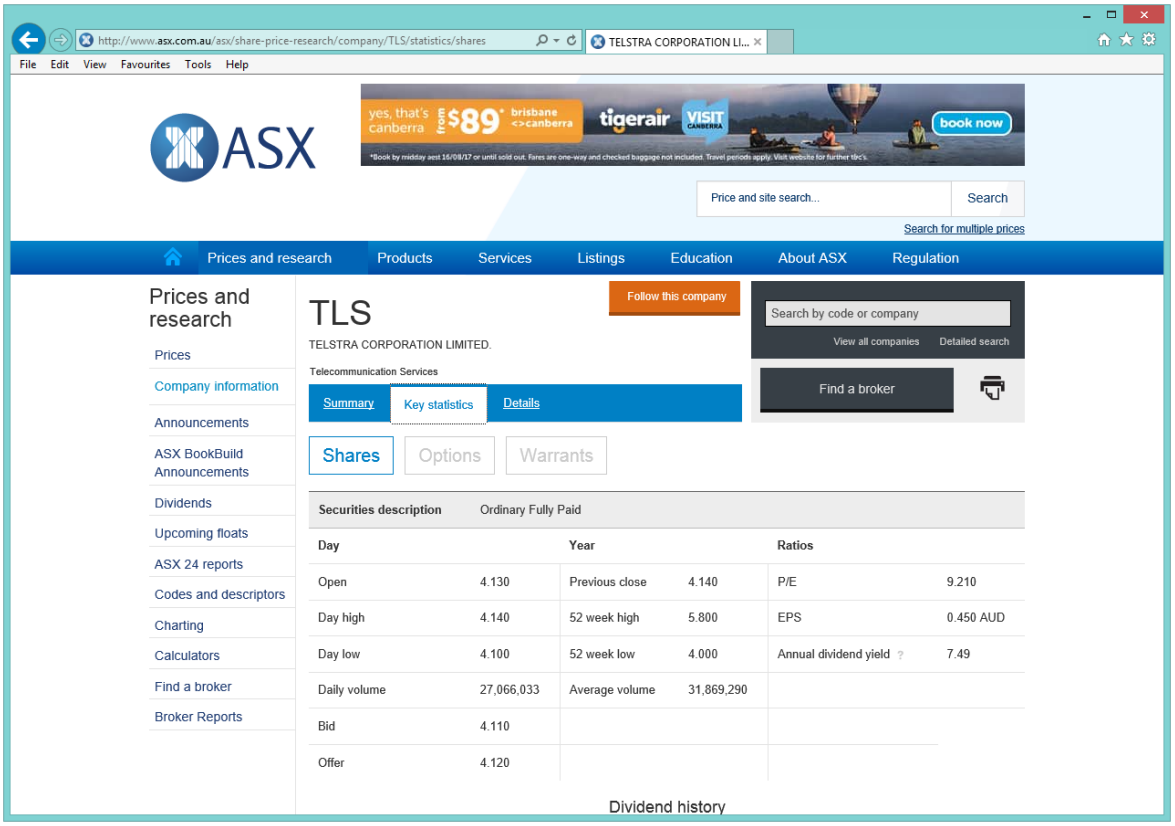
- What's the company's financial position?
- Does the management have a good track record?

- How much market share do the company's products have?

... and so on.

Finding the answers to these kinds of questions is what's called *Fundamental Analysis*... where we look at the *fundamentals* of the company's situation rather than what's happening to its share price on a day-to-day basis.

Fundamental analysis is all about what the company does, and whether it is profitable. It takes into account the state of the economy, the company's balance sheet and its prospects for the future.



The company information page on the website of the Australian Stock Exchange (ASX)

Fundamental analysis can be a lot of work — be prepared to trawl through company annual reports, follow the financial press and keep up with ASX announcements.

Usually a “full service” stockbroker can help with fundamental information.

Personally, I think it's important for beginners in the share market to *keep things simple*. Stick with *"blue chip"* companies when learning to invest — the larger, well-established companies. Don't make things complicated for the sake of it.

Fortunately, there is *another* form of analysis that I find much easier to come to grips with...

What is Technical Analysis?

Technical analysis takes an almost *opposite* approach to that of fundamental analysis. It *disregards* fundamental factors entirely and focusses on *just one thing*…

What has the company's share price been doing historically?

In *technical analysis* we *chart* the changes in the company's share price over time. This *visual picture* makes it easy to identify *patterns* in the behaviour of the price. These patterns then suggest the *likely future direction* of the price — which at the end of the day, is all we really care about.

Now focussing only on changes in the share price may seem to be dangerously oversimplifying the process of analysing a share. *But is it really?…*

Sure share prices are affected by fundamental factors, international markets, economic events, company news, interest rates, rumours, market sentiment... *all* these things have an effect. But when all is said and done, the question of whether the share price will rise of fall depends upon just one thing: *Are buyers more enthusiastic than sellers, or vice versa?*

If *buyers* are more enthusiastic, the price will *rise*. If *sellers* are more enthusiastic, the price will *fall*.

Technical analysis assumes that all these many factors, including company fundamentals, just influence the *relative enthusiasm* of buyers and sellers and are *automatically reflected in the price chart*.

It boils down to this: a company's share price really has *nothing to do* with fundamental factors, but with the buyers and sellers *perceptions*.

The market is driven by *fear* and *greed*. Fear of loss, and hope of gain. When *fear* dominates, prices *fall*. When *greed* dominates, prices *rise*. Simple, huh?

The Trend is Your Friend

It's because of the battle between fear and greed that prices move in *trends*.



Take this chart of BHP. Although the price jumps up and down in the short term, we can discern definite *underlying trends* that go on for months. When the overall market perception of this stock is *negative*, the trend is *down* — and that down trend will persist *until* this market perception changes. Likewise for an *uptrend* — it will remain in effect as long as market perception remains *positive*, despite short term ups and downs.

So our goal then — if we want the price of our stocks to rise over time — is to ***only buy shares that are in an uptrend***.

You can already see how charting the share price gives us valuable information.

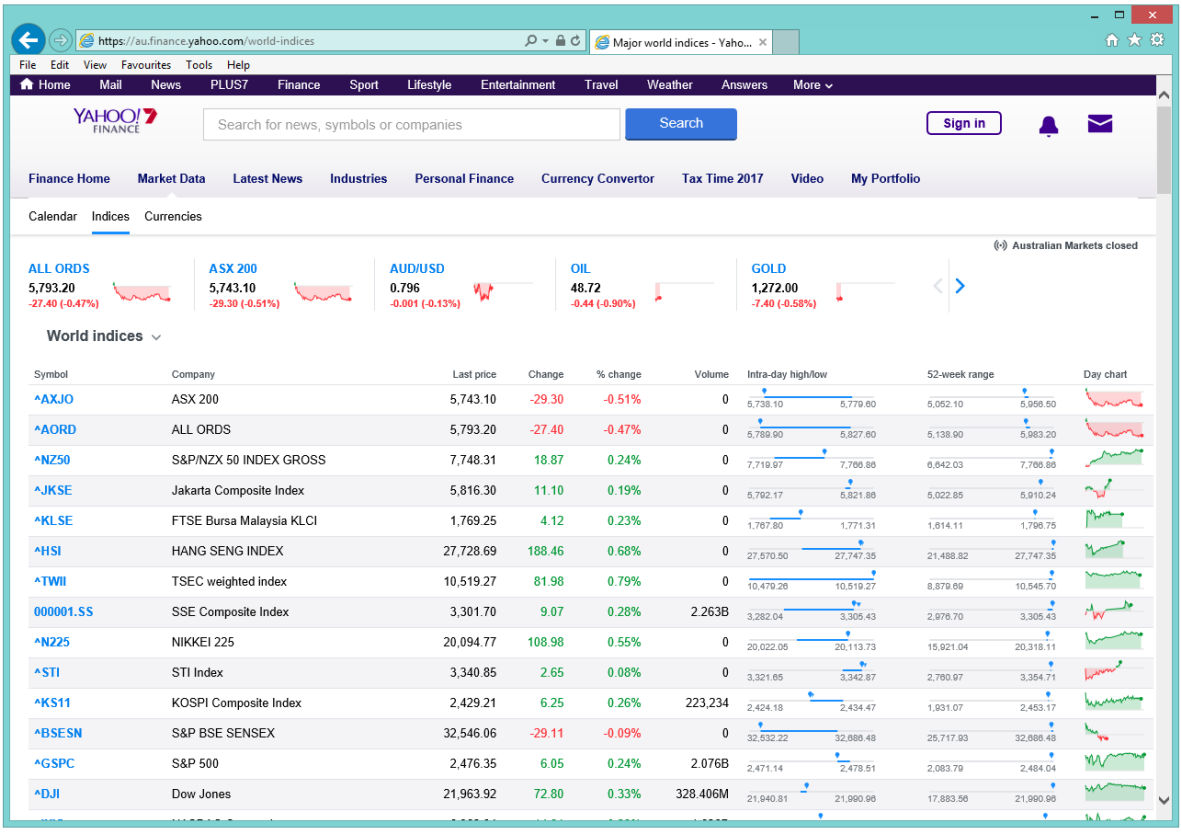
Only buy shares in uptrends

So the first step in the technical analysis of a share is to work out:

Is it in an uptrend, or a downtrend (or the third possibility, NO trend — just going sideways)?

To work this out we need an up-to-date chart of the price.

We can get basic charts for free off the Internet, for example from *Yahoo!*…



Market data from Yahoo! Finance Australia

How to get free share charts from Yahoo!

Here's a chart of Commonwealth Bank that I made with my commercial share charting software...



And here's the *same chart* from the *Yahoo!* Web site...



I've posted a ten minute video on YouTube that shows you *exactly* how to create up to date charts like this of Australian shares using *Yahoo! Finance*. Here's the link.

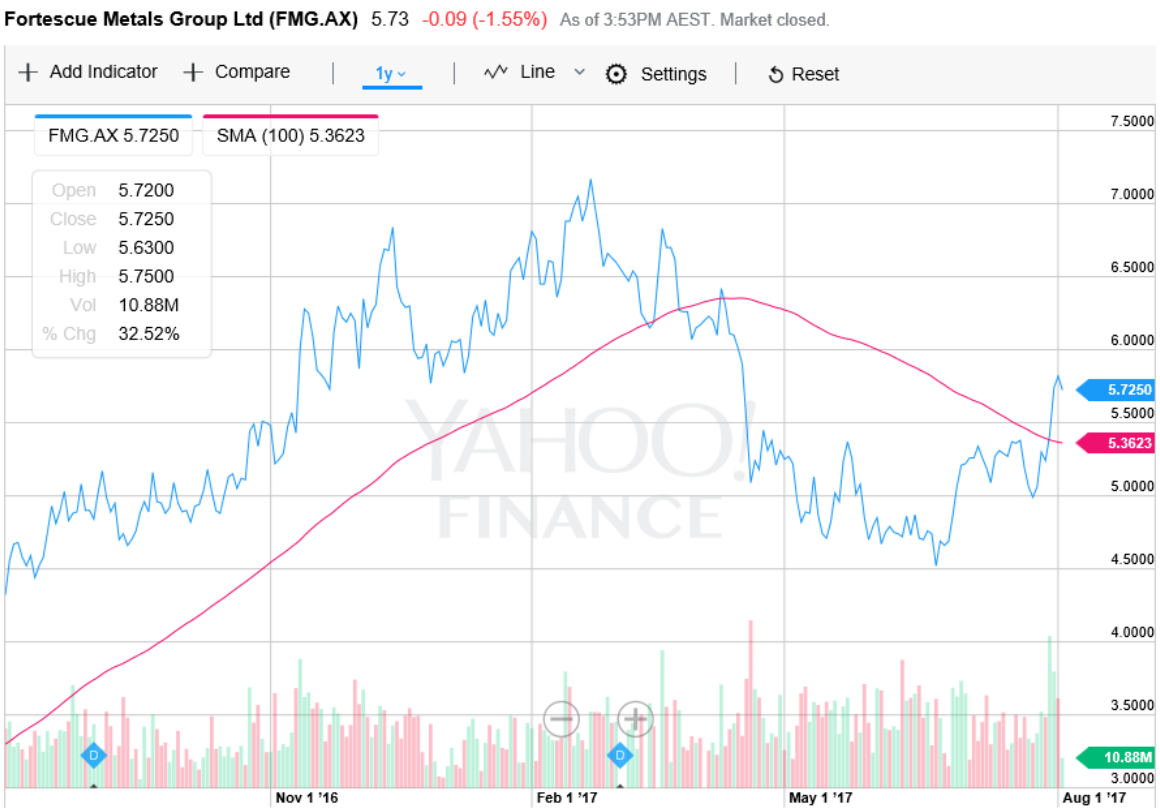
Introducing... Indicators!

The next step in learning to technically analyse a share chart is to learn something about *indicators*.

Indicators are mathematical manipulations of the share price data that are drawn on the chart. They may reveal patterns in the price activity that aren't immediately obvious from looking at the raw price data.

An example should make this clearer...

One of the most common technical indicators is called a *moving average*. It's a line on the chart created by averaging the price of the share over a certain period of time. The effect of the averaging is to smooth out small fluctuations in the price, making the main trends easier to see.

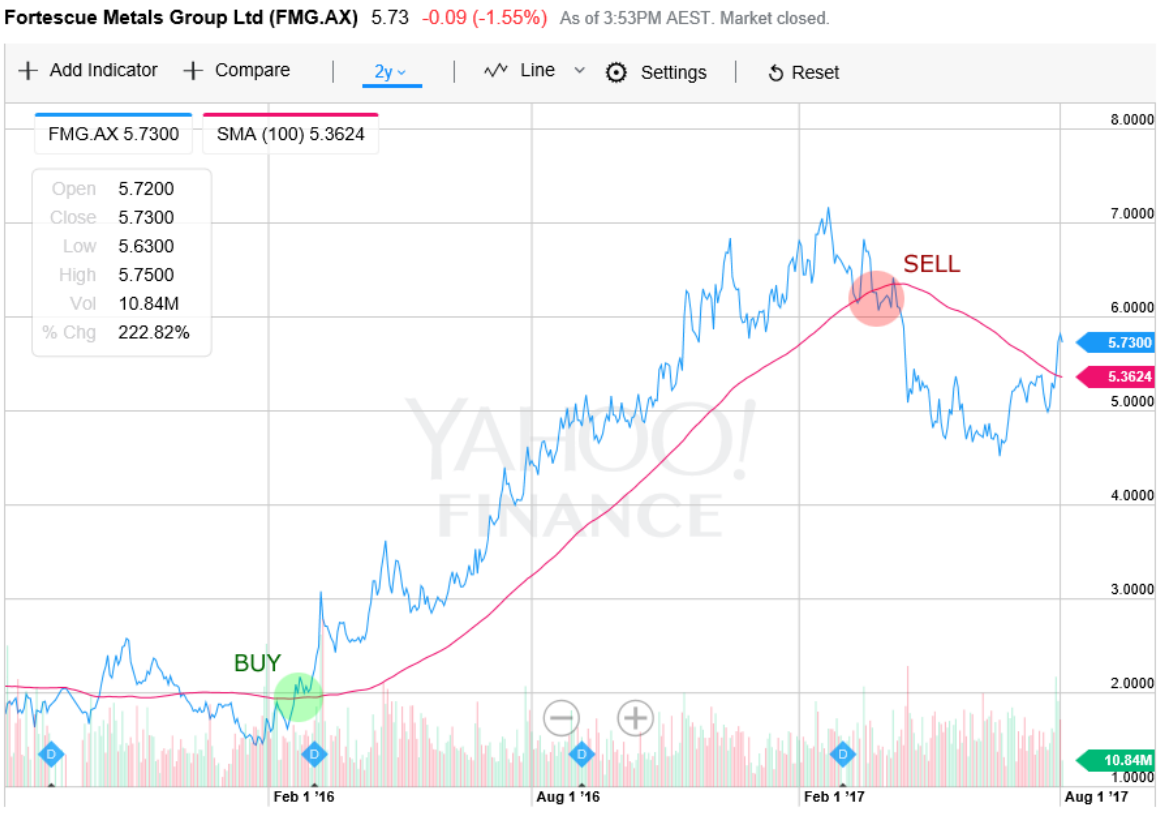


Here's a chart of Fortescue Metals Group (FMG) with a moving average applied. The *blue* line is the raw *price data* — the day-to-day price of WPL shares. The *red* line is an *average* of these day-to-day prices over the past 100 days. In other words, every point on the red line marks the average price of WPL shares over the previous 100 days. We would call this a "100 day moving average".

What's the point?

Well, apart from smoothing out small fluctuations, the *position* of the average with respect to the price helps to make the main trends easier to spot. Notice that when the share price is in an *uptrend*, the blue line is *above* the red. When the share price is in a *downtrend*, the blue line crosses *below* the red.

If we were to buy and hold this share *only* when the blue line was above the red, and *sell* when the blue line crosses below the red, we would effectively *filter out* the down trends. That way we would only be holding the share when it's *going up* in value.



If we expand the FMG chart out to the past two years, you can see we would have bought the share at around two dollars in February '16, and sold it for over six dollars in March '17— a profit of over 200% in just over a year!

Before investing in a share, you may want to check whether or not it's trading above the 100 day moving average.

Advice on Starting Out...

It's a good idea to try *paper trading* for a while before plunging into the market with your newly acquired share analysis skills.

Paper trading means monitoring a *dummy* portfolio for a period of, say, six months to test how successful your investing strategy is going to be.

In the meantime you can be saving more money to invest, while gaining confidence and learning more about *technical analysis* and other stock market analysis techniques.



Swing Trading —Learn to Trade Short-Term to Boost Your Profits

Swing Trading is an approach to stock market trading that uses *short-term price movements* as the basis for your stock trading system.

Technical Analysis is based on the idea that *patterns recur* in the price activity of shares.

By *charting* the share price, we can identify these patterns as they begin to appear and get a good indication of the *likely* future direction of the price.

One of the technical analyst's most basic tools is the *trend line*...

Drawing Trend Lines

Trend lines are straight lines drawn on the share price chart to give a *clear visual picture* of the *dominant trend* of the price.



Downtrend lines join two or more *peaks* in the share price. As long as the downtrend line is unbroken, we can conclude that the downtrend is still in effect.

Uptrend lines are, of course, just the opposite. They join *troughs* in the share price. Again, the trend can be assumed to still be in effect until the uptrend line is broken.

What about Share Prices Going Sideways?

Well, there is a kind of a *horizontal* trend line — the *support / resistance* line…

Support and resistance lines are horizontal lines marking prices where the trend of the stock price has often *reversed*.



Support lines join *troughs* — they support the price like a floor, preventing it from falling any lower.

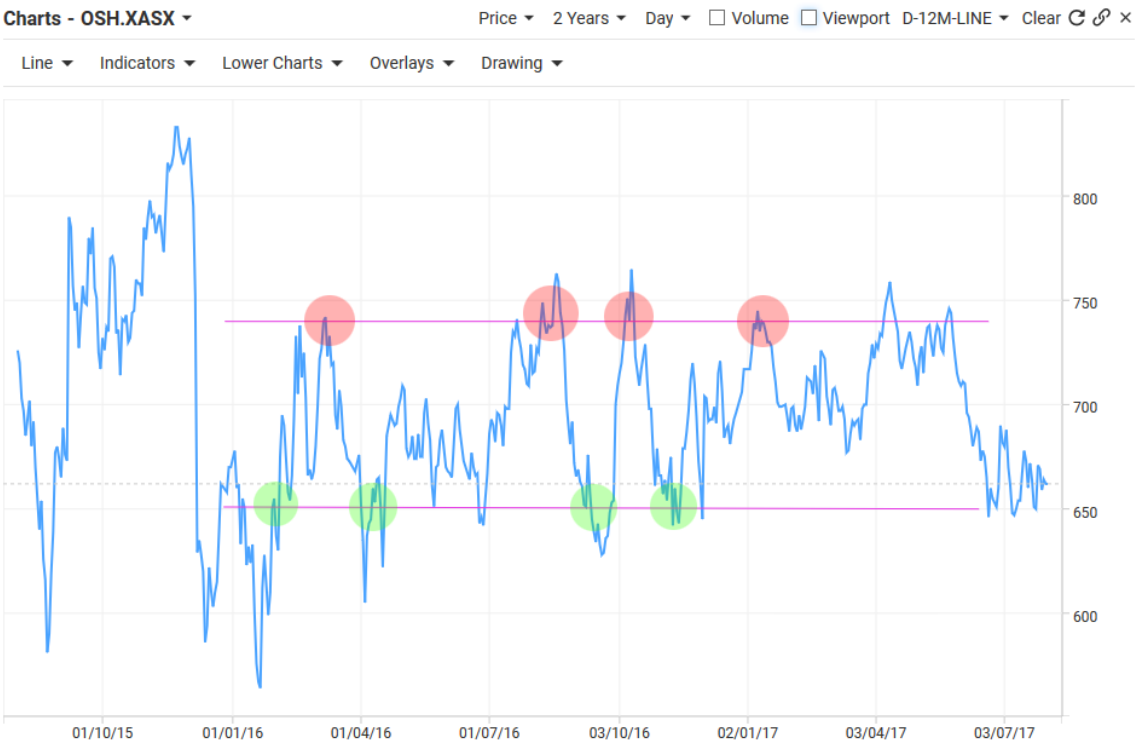
Resistance lines join *peaks* — they mark a price where there is market resistance to the price climbing any higher.

Eventually, of course, *all* trend lines are broken.

When the price is confined *between* lines of support and resistance, it's called a *trading range*. Trading ranges can offer *great opportunities* for share traders! Once we've identified the trading range, we can *buy* near the *bottom* of the range (once we've *confirmed* that the price has indeed bounced back off the support line, and not broken through it). And then *sell* at the *top* of the range. It's possible to do this *several times* in the same trading range, making respectable profits out of a share that's essentially going *sideways*!

The Joy of Trading Ranges

To illustrate, consider this chart of Oil Search Limited...



OSH actually went from a price of $6.50 per share to $7.40 per share... no less than ***four*** *times* in the space of a year. That's a rise of 90c per share (or over 13%). Doing that four times in a year equates to a rise of 4 x 90c = $3.60... or *55%* .

That's a potential profit of 55% for the year on a share that seems to be going sideways.

Now, this is just a simplified illustration — we couldn't possibly have foreseen every one of these opportunities — but it demonstrates the *potential* profits that are available to *short term* traders... and *unavailable* to *long term* investors who "buy, hold and forget" about their shares, *hoping* that they will appreciate in value over the long term.

The Biggest Mistake People Make Investing in the Stock Market

Profiting from trading ranges — and other market patterns — is only possible by charting the share price and keeping track of what's going on.

Most investors unfortunately let others do their thinking for them, and fall prey to market sentiment… in other words, fear and greed.

When the market is buoyant and prices are at all times highs, the media publicises the great gains to be made in the stock market… and people jump in and buy (greed).

When prices plummet and the news surrounding the market is all doom and gloom… people panic and sell (fear).

This leads to buying high and selling low. Hmmm… not a great strategy.

Of course, the best time to buy is when prices are low… exactly the time when most people hesitate to put money into the market.

To be successful at trading shares, we need to learn to be dispassionate in our approach to the market — to resist the emotions of fear (at lows) and greed (at highs).

Create your own charts and learn to apply your own swing trading analysis to them. Charts and trend lines don't lie and they don't get emotional — they just present facts.