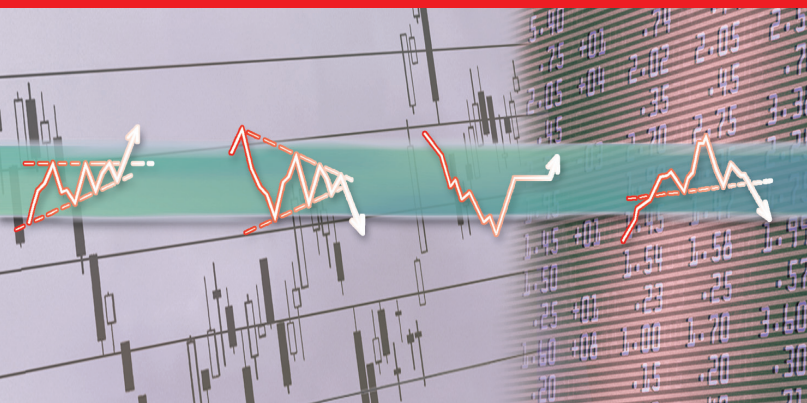


LOUISE BEDFORD

# Charting SECRETS

*STOP  
READING  
START  
PRACTISING*



- > PRACTICAL WORKBOOK FORMAT
- > CHARTING BASICS
- > MOVING AVERAGE SECRETS
- > DRAWING TRENDLINES
- > MACRO PATTERNS



# Charting SECRETS

*STOP  
READING  
START  
PRACTISING*

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L O U I S E   B E D F O R D



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# CHARTING SECRETS

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(T) indicates a top reversal pattern.

(B) indicates a bottom reversal pattern.

(C) indicates a continuation pattern.

A blank indicates a particular type of pattern that does not form a continuation or reversal by itself.

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(T) indicates a top reversal pattern.

(B) indicates a bottom reversal pattern.

(C) indicates a continuation pattern.

A blank indicates a particular type of candle that does not form a continuation or reversal by itself.

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# Acknowledgements

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- **Gary Stone** and the team at **ShareFinder Investment Services** ([www.sharefinder.com.au](http://www.sharefinder.com.au)) have provided me with valuable and appreciated ongoing encouragement for several years. I have a great deal of respect for Gary and his two successful methodologies for the Australian markets called Sustained Profit Advantage™ (SPA™) and Osprey STTM™. Gary's research has been used extensively to compile the chapter on *System Development Secrets* as well as Appendix B. ShareFinder can be contacted at PO Box 349, Black Rock, Vic., 3193; telephone 1300 STOCKS.
- The staff at *Shares* magazine have been very supportive of my writing endeavours. Several of the concepts reviewed throughout this book were originally explored in *Shares* magazine articles that I have written.
- The staff at *Your Trading Edge* magazine have been great to work with. Many of the more advanced trading concepts in this book initially appeared as articles that I have written for YTE.

## **MY STORY**

Trading means different things to different people. To me it means not having to work for anyone again, unless I choose to. That's why I take this whole game so seriously, and I would like to encourage you to do the same.

When I had a full-time job, I used to trade shares on the side, but I never realised that one day, the sharemarket would represent my primary source of income. Years ago I climbed up the corporate ladder to achieve the role of a national sales manager. I was having an absolute ball. Everything that I had aimed for was beginning to come true. However, even though I was being paid well, I was working far too many hours a week. I was fast beginning to lose touch with my family and friends outside the workplace. Maybe you can relate. I was cashflow rich, but time poor. Everything that I did in my career was scheduled, planned and focused on achieving the best possible results. To say that my life had become unbalanced was an understatement.

Then the unexpected happened.

Over a period of a few short months, I progressively lost the use of my arms through an unexplained tendon condition. I found that even simple tasks such as opening doors had become a day-to-day painful struggle. My performance at work began to suffer as I jumped on the health professional merry-go-round. From specialist to specialist I travelled. I was informed that it would take me several years to recover. Some of the less positive members of the medical industry did their best to obliterate any hope that I had of reaching a full recovery. I was told that 'you have to be realistic!'

The most basic physical functions were now daily challenges. I decided that I had to leave my beloved corporate role. Life was looking bleak indeed. I went from working over 60 hours a week to struggling to feed myself. My self-esteem hit an all-time low. I had no idea how I would manage to eke out a living for myself, other than the faint glimmer of hope that trading represented.

I was already trading profitably before I left my career. However, things assumed a new urgency. I was terrified that I may never work again and amidst this sense of rising panic, my trading plan began to literally write itself with a clarity that I had never managed in the past. (Sometimes when we have our backs to the wall, we can achieve things that we never dreamed were possible.)

My computer was set up at home so that I could review the Top 200 shares one by one. After 12 seconds of looking at a chart, the software would flick forward and bring up a new share without me needing to touch the keyboard. My broker's phone number was programmed into the speed dial setting on my phone so I could push the button with a pen in my mouth. I was in business.

I didn't need to be able to use my arms, I just needed to see my charts and follow my trading plan. Trading became my career. It more than replaced my income and allowed me to scrape back some of my damaged self-image. It gave me something to focus on rather than my own somewhat dire situation.

Several years later I still have the occasional problem with my hands and arms, but my situation is much improved. The focus that I applied to trading, I have applied to physiotherapy, and I have regained my strength. Although I could now probably hold down a full-time job physically, I choose not to. The lifestyle that trading has provided has well and truly surpassed my expectations.

I realise that you may be facing an even more critical situation on your journey towards effective trading. If it is not a health issue, maybe you are looking for a way out of the usual grind of daily survival or perhaps you have a dream that your life could be better in some way. Harness the power of your desire and convert it into hard work. Then I will feel that my struggle has not only benefited my family, but also other families whom I don't know and may never meet. Trading profitably won't solve all of your problems, but it will take you on an incredible journey of self-discovery. Let me guide you towards becoming a more successful trader.

## PREFACE

Once upon a time there was an intelligent guy with movie-star good looks. With only one year of sharemarket experience, at the age of 42, he left his job to become a full-time trader. In between tennis matches and golf games, he traded and traded. During his first six months, he made twice his usual salary as a brain surgeon. He laughed heartily, his golden hair glistening in the sun. Next, he took an extended two-year holiday on his fabulous shiny yacht in the Mediterranean, with a harem of beautiful women half his age. By day they would bask in the sun and swim in the sea. By night they would drink cocktails and admire the perfect sunset before retiring to their cabins. Trading was so much easier than he had ever expected...

Quick reality check ... this is a fairytale. This will not happen to you.

For some reason, the myth that trading is more like an exciting trip to the fun park than anything resembling work has circulated in our society. I hate to burst your bubble, but trading is a precise and somewhat boring activity. The rewards are fabulous for the favoured few who manage to master the basics. These clever traders discipline themselves to apply, and endlessly reapply, their trading system, and watch their bank balances multiply.

People who make consistent profits in the sharemarket tend to do the same old things again and again (and again). They may be boring, but they work. These methods, if you perfect them, have the lovely by-product of delivering money to your door by the truckload.

*The rewards are fabulous for the favoured few who manage to master the basics.*

---

These days, there is so much information available in the field of trading. The number of books is overwhelming. Every bookshop has a whole section devoted to trading and investing. If you made it your life ambition to read every book before you put a cent into a stock, you would never put on your first trade. There are probably more books on this topic than there are shares listed. No wonder you're confused!

If you are a sharemarket book junkie, can I give you a quick piece of advice?

STOP READING! START PRACTISING!

The majority of traders finish a book as if it were a novel. They consider it to be an interesting read, but what did they really learn? The only way to cement a concept is to use it. Drop everything (apart from this workbook, of course). Put all those half-finished books back on your bookshelf.

Throughout this workbook, I will present you with the principles that you will need to complete the exercises I have set. When I want you to use your new skills, I will challenge you to:



You will get a chance to impress me with how much you have learned, and establish a firm foundation of trading prowess before you continue learning about new concepts. I have included enough information to get you started charting if you're new to the sharemarket, as well as some *Advanced strategies* for more experienced traders, which are highlighted in grey throughout *Charting Secrets*. In years to come when you require a quick reference about a particular charting topic, you will be able to read the relevant chapter without re-reading the entire book.

*It is perception  
that drives share  
price action.*

Educating yourself is the most effective way to gain knowledge. Reject that trendy newsletter that promises to make the decisions for you. Turn off the TV program that enticingly tells you the All-Ords is moving up or down. For goodness sake, stop staring at that ticker that shows all of the share prices moving across the bottom of the computer or TV screen. It will only hypnotise you, not help you become a more proficient trader.

Take my word for it; you will be one step closer to becoming a better trader if you start to 'do', instead of just 'read'. You will learn more than you ever realised by putting pencil to paper. Seeing how much you have internalised, and then checking your knowledge with someone who has walked the minefield before you, is the best way to learn.

### **Fundamental vs technical analysis**

In the investment field, there is often a tug of war between those with a fundamental viewpoint versus others with a technical perspective. *Fundamental analysis* seeks to detect which shares have a probability of increasing or decreasing in value based on announcements, company balance sheets and profit/loss details. However, even a surprisingly good track record does not necessarily ensure sharemarket success. It is perception that drives share price action. The emotions of the players in the

market will ultimately create an uptrend or a downtrend. Positive announcements that are released to the press are often already factored into the share price, so even a strong profit result will not necessarily lead to a bullish reaction. Even if you use fundamental analysis in your investing, charting may help time your entry into a position.

Developing skill with *charting* requires you to review actual price and volume action of a share to reach conclusions about the likely future direction. *Technical analysis* involves using formula and indicators, based on share price action, to estimate the likely future share price direction. The benefit of technical analysis and charting is that it crystallises the sentiment in the market by displaying price action in a visual format. Specific trading rules can be developed. This book focuses on charting and technical analysis, as well as the individual techniques I use when I trade to create an income.

## Can you do this?

I firmly believe that anyone who really wants to become a good trader will be able to — given enough opportunities to practise his or her skills. Effective trading comes from mastering the basics. Any Olympic athlete will tell you that even naturally gifted competitors have to train relentlessly to perform at such high levels. There are also some initially non-gifted kids who end up at the Olympics because of their grit and determination. Trading favours anyone who is willing to put in the work required to succeed. Persistence, discipline and practice are the keys. Procrastination is your enemy.

There is hope — it's disguised as hard work though. By completing the exercises in this book, practising to recognise patterns as they occur, and being exposed to a vast number of charts, you will develop skill and confidence in share analysis.

This workbook is specifically designed so that you can test your knowledge in as close to real-life situations as you can get — the hard right edge of the chart. This is the area where history meets current reality. When the market opens at 10.00 a.m., everything you have learned will tend to blur into confusion. Your heart will race and your blood pressure will soar to new heights. Overcoming these reactions requires confidence. My goal is to help you build that confidence by working through real-life examples.

*Persistence, discipline and practice are the keys. Procrastination is your enemy.*

---

To create a business-like profit, you must treat trading as a business, not a hobby. If the goal of trading well is right down the bottom of your priority list, I can tell you with absolute certainty that you will never derive a substantial income from the markets. The best investment that you can ever make is in yourself. If you look at successful people from all walks of life, you'll see that this philosophy acts as the common denominator. Trading follows this principle to the letter.

### Workbook

I am prepared to take you under my wing to guide your activity. However, the secrets within this book will only be revealed if you commit to completing the exercises. I can lead you to the essential principles behind the examples, but it will be up to you to discover their inherent wisdom for yourself.

*If the goal of trading well is right down the bottom of your priority list, I can tell you with absolute certainty that you will never derive a substantial income from the markets.*

---

Did you ever feel tempted to peek at the 'teachers' guide' when you were at school so that you could know all of the answers? What a great short cut. The only problem with that approach is the moment you are given the answers, a little button in your brain activates to stop you from thinking. Most of the skirmish taking place in the sharemarket is within your own mind. Don't let

yourself get lulled into reading this book the way you would any other — use your self-discipline to complete every exercise. Do this before you read my explanation.

If you are already familiar with a particular method, you are welcome to skim read that section, or skip it altogether. Just focus on the sections that you need the most development in. If you are already skilled in a particular area, you could even skip forward to the:



symbol, and reinforce your skills before progressing. If you are uncertain about the meanings of any of the terms that I use, flick forward to the Glossary (on page 300).

You should also consider that my explanations are just one possible way of interpreting the chart. Just because I feel that a particular trendline, for example, should be positioned just so, doesn't mean you are unable to disagree. There is no one right answer. Use my explanation to help you along, but if you vehemently disagree and can justify your decision, who is to say that your interpretation isn't equally as valid?

If you would like me to be your coach and your guide, then I ask that you make a commitment to me. Pick up a pencil and a ruler and be prepared to turn this publication into a smouldering heap of notes! By the time you've finished with it, I want to see comments, lines, descriptions and insights written down in the margins. If I meet you once you've completed this book, and your copy is not wrinkled, squashed or at least a little worse for wear, I will be secretly disappointed. If, by the final page, your book is not somewhat tattered, you will have missed the lessons that I am trying to convey.

Test yourself to develop your skills. Go on ... I dare you!

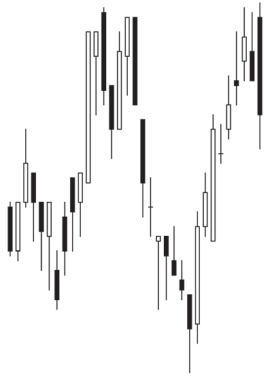
Louise Bedford  
[www.tradingsecrets.com.au](http://www.tradingsecrets.com.au)  
Melbourne, March 2004

### ALSO BY LOUISE BEDFORD

*Charting Secrets* is the ideal book for you, whether it is the first book on trading that you've picked up, or if you've read a few other books and you're looking to test your knowledge. You may have even read one of my other titles: *Trading Secrets*, *The Secret of Candlestick Charting* or *The Secret of Writing Options*, but you're looking for a bit more guidance in relation to charting techniques.

It would probably be logical to start with either this book or my earlier title *Trading Secrets*. These two books work well together when read as a pair, providing enough information to safely get you started trading or investing. Once you've read these titles, move onto *The Secret of Candlestick Charting*, which will give you more detailed information on this fascinating charting technique. When you've worked out how to trade shares, you may feel ready to apply leverage and read *The Secret of Writing Options*.

In addition to these books, you can visit my website [www.tradingsecrets.com.au](http://www.tradingsecrets.com.au) and complete my *Candlestick Charting Home Study Course* or watch *The Secret of Candlestick Charting Video Program*. There is an options video program available too and you may find the reference posters valuable. The posters currently available are *The Secret of Candlestick Charting Poster* and *The Secret of Pattern Detection Poster*. You will find that [www.tradingsecrets.com.au](http://www.tradingsecrets.com.au) is designed to fulfil all of your trading home-study requirements.



# 1 Charting basics

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If this is the first book about technical analysis that you have ever picked up, you are going to need to grasp some of the basics before moving on. This chapter will provide you with a foundation for the exercises I have set out further down the line.

In the coming chapters, you will have the opportunity to see how I analyse a chart and to practise these skills for yourself. There is no one perfect answer, but to find out whether you are on the right track, you can turn to the ‘Answers’ section following each set of exercises or at the end of each chapter.

Will you promise me that you will not turn to the answers section immediately? Resist the temptation to immediately flick forward. I want to give you a chance to fill out the review sections for yourself first. This approach is consistent throughout the book. I can guarantee that the people who do not immediately turn to the answers will benefit most in the long run.

We will start laying the groundwork for your charting career by looking at a few main concepts, the first of which is *weight of evidence*.

### WEIGHT OF EVIDENCE

Imagine you are a private detective and you are working towards solving a crime. You wouldn't look at just one piece of evidence, would you? You'd look at several key pieces of evidence and then make up your mind. That would be the most logical way to progress.

Use the same method when looking at a chart. When several chart patterns and indicators point in the same direction, their signals are reinforced. If the weight of evidence of several indicators suggests that the share is uptrending, then the bulls have probably taken control of the market.

*When several chart patterns and indicators point in the same direction, their signals are reinforced.*

By using more than just one or two pieces of evidence that the share is trending in a particular direction, you are stacking the odds in your favour. The best chartists try to maintain complete objectivity and remove any emotion or gut-feel from their analysis.

There are hundreds of indicators to choose from. They don't all help your trading results. If you use 50 indicators, you'll probably just end up a quivering mess of nerves huddling in the corner. It's far better to choose a few judiciously. A method that I have found to help me do this is to separate the indicators into five categories.

### The families

Indicators tend to fall into several distinct 'families'. I use at least one of the indicators from each family in order to form an opinion about the share price's likely direction. This is an ideal application of the weight of evidence theory. The families are:

- the line family
- the moving average family
- the momentum family
- the volume family
- the pattern family.

Throughout the coming chapters, we will explore each of these in turn. You will find some of these families simpler or easier to relate to than others. This is perfectly

natural. You can start trading without fully grasping every aspect of charting (I certainly did!). Too much knowledge can paralyse you.

If you are familiar with the way charts are constructed and want to get into the meat of the book, turn to the next chapter which commences on page 9 and we will begin our analysis using support and resistance lines, and trendlines. Keep reading if this is your introduction to charting or if you'd like a quick refresher on the way price action appears on a chart.

## **CHART CONSTRUCTION**

Your computer charting package can produce several different types of charts. We will look at each in turn below.

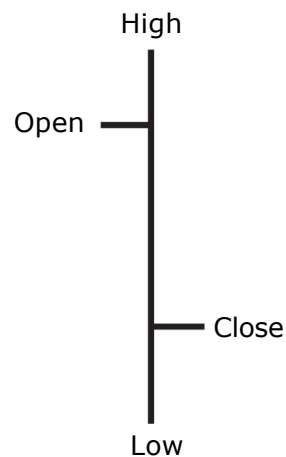
### **Bar charts**

The individual building block of a bar chart is a single bar. Drawing a single bar requires an opening price, a high, a low and a closing price (see Fig. 1.1 below). The vertical line shows the high and low of that period. The two horizontal lines depict the open and the close. The open is the horizontal line on the left of the vertical line and the close is the horizontal line on the right of the vertical line.

Depending on what you ask your charting software package to produce, you may view an intra-day, a daily, a weekly or a monthly chart. On a daily chart, one bar will show the share price action for one day. If you look at a weekly chart, the open price will be the opening price at the start of the week and the closing price will be the final price recorded at the end of the week. The high and low will be the overall high for the week and the overall low for the week. In other words, whichever time period you utilise, the bar will show the activity for that session.

When many of these single period bars are plotted on a chart with the horizontal axis representing time and the vertical axis showing the share price, a traditional

**FIG. 1.1 – A single western bar**



bar chart is created (see Fig. 1.2 below). The inter-relationships of the bars show whether the share is generally going up in value (that is, bullish), or going down in value (that is, bearish). Periods of sideways progression are also evident.

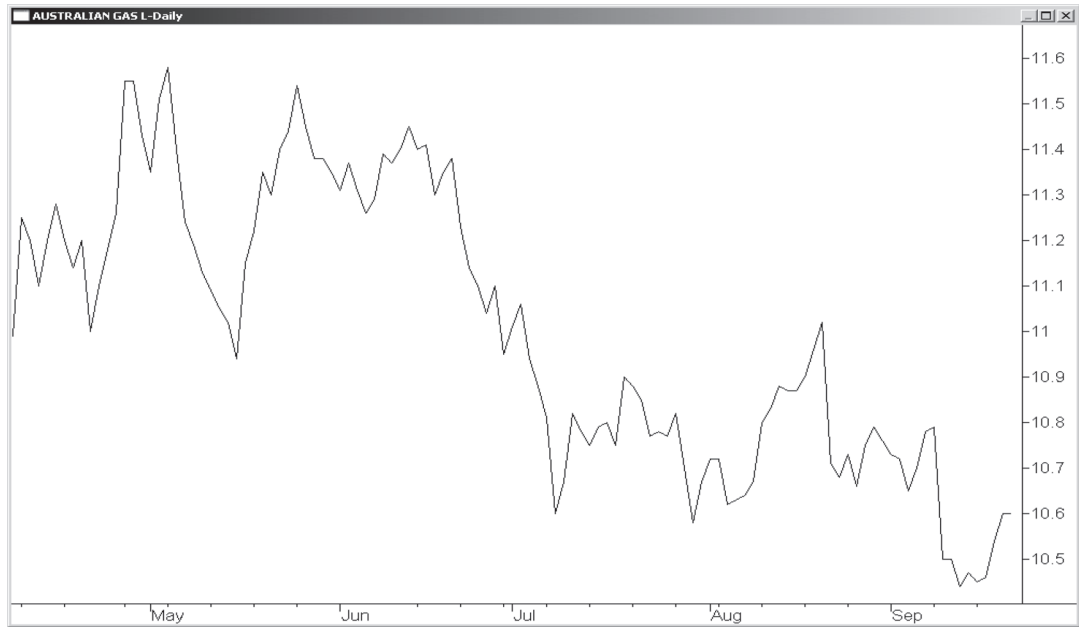
Indicators may help you understand whether or not the predominant direction is likely to continue. You cannot predict the market direction. As legendary trader Jim Rogers, author of the bestseller *Adventure Capitalist*, says, 'Markets will rise higher than you think is possible and fall lower than you can possibly imagine.' The best that you can do is analyse the type of trend that existed in the past and take an educated guess that history will repeat itself. This is the main focus of technical analysts.

**FIG. 1.2 – AGL daily – bar chart**



### Line charts

A line chart (see Fig. 1.3 opposite) connects the closing prices for each period, providing less information, but it is, perhaps, a simpler chart to interpret in comparison to the bar chart.

**FIG. 1.3 – AGL daily – line chart**

## Candlestick charts

A single candlestick represents the same data that you will find in a single bar, however they look completely different. The origin of the name is obvious when looking at the chart (see Fig. 1.4 overleaf) — a candlestick chart looks like a series of candles with wicks at either end of the candle. In the next section we will explore the specific implications of each part of the candle.

The three charts shown in Fig. 1.2, Fig. 1.3 and Fig. 1.4 all represent the same information, and the same time scale, however, their graphic format ensures that each chart looks very different.

In my view, using a candlestick chart is clearly superior to using a bar chart or a line chart. I think that bar and line charts are ugly little characters. Bar charts are positively anorexic compared to the full-bodied candles, and line charts only show 25 per cent of the information shown in candlestick charts. (So, basically, candlestick charts are 75 per cent more intelligent than line charts.) I suggest that you avoid these inferior types of charts altogether. There are many patterns that a candlestick chart displays that cannot be shown on a bar chart or a line chart. It may take a bit

of effort to learn how to interpret these types of charts, but it will give you an edge over other traders in the market.

**FIG. 1.4 – AGL daily – candlestick chart**



I usually start with a weekly chart and then review charts of increasingly shorter time increments for the share that I am interested in trading. Any of the patterns

*...start with a weekly chart and then review charts of increasingly shorter time increments...*

we are discussing will be apparent on monthly, weekly, daily or intra-day charts. The word 'session' or 'period' means the time increment of that chart (for example, one period means one day on a daily chart).

The markets are made up of people's emotions towards shares. If market participants predominantly feel fear that they will lose their capital or profits, the share price will ultimately decrease. If they mainly feel greed or hope, the share price will go up. A chart will show this interplay of emotion visually. It is one of the purest ways to analyse share price action.

## CANDLESTICK CHARTING

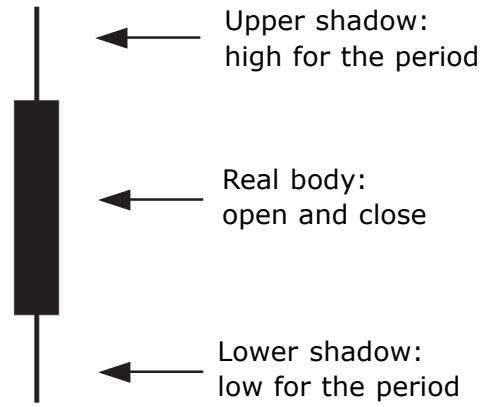
The thick part of the candle is called the real body. This shows the range between the opening and the closing price (see Fig. 1.5). When the real body is white (or empty), it means that the close was higher than the opening price. When the real body is black (or filled in), the close was lower than the opening price. The colour of the candle depicts whether the candle is bearish or bullish. On a colour screen bullish candles are often shown in green and bearish candles in red.

The thin lines at either end of the real body are called the wicks, tails or shadows of the candle (regardless of whether they are above or below). The upper tail (the high for that period) is located above the candlestick's real body, and the lower tail (the low for that session) is located below the real body. The tails are usually considered to be of less importance than the real body, as they represent extraneous price fluctuations. The open and the close are considered to be the most emotionally charged points of the day and therefore they contain the highest level of significance in candlestick analysis.

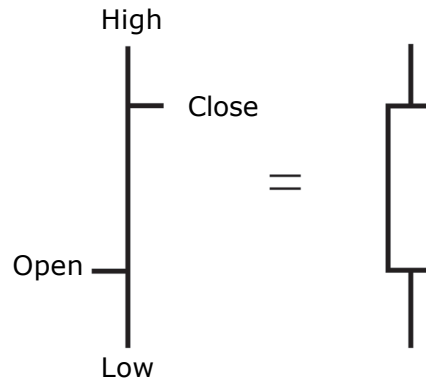
### The white candle

When the day closes higher than it opened, this is a positive bullish sign. There is demand for the share and buyers are willing to pay higher and higher prices. The price is driven up as demand outstrips supply (see Fig. 1.6 above).

### FIG. 1.5 – Definition of a candlestick



### FIG. 1.6 – The white candle

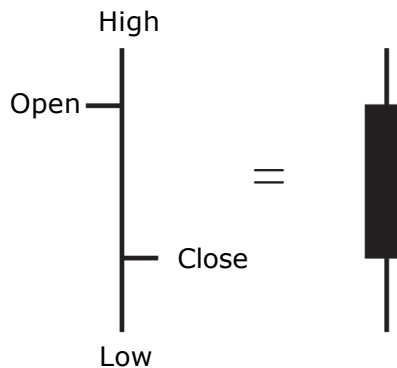


### The black candle

When the day closes lower than its opening price, it is a sign that sellers have fear in their hearts. This has the effect of driving the share price down. The market sentiment is pessimistic, creating a far greater supply of shares for sale. Therefore the close is lower than the opening price, and the colour of the candle is black. A black candle clearly shows that the bears were in control for that period (see Fig. 1.7).

**FIG. 1.7 – The black candle**

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The bulls' and the bears' (buyers and sellers) struggle for dominance forms the basis of each candlestick formation. A single candlestick, or a group of candles, often has particular bullish or bearish significance.

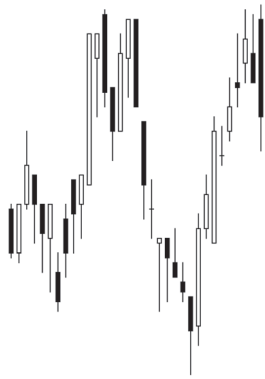
Once you get used to the way candlesticks can assist in your analysis, it is unlikely that you will ever return to looking at bar charts or line charts. Their unique graphic display of patterns can assist in identifying the reversal or continuation of trends. My trading has been so influenced by these little gems that I wrote a book on the topic — *The Secret of Candlestick Charting*.

If you haven't read my candlestick book or you'd like a basic understanding of some of the patterns that can help you become a more effective trader, turn to Appendix A on page 271. The rest of this book assumes that you are familiar with these patterns, so you will derive much more benefit if you focus on these types of formations before reading on. I have included a few exercises for you in this Appendix also. These will test your knowledge if your candlestick analysis is a little rusty.

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***Now that you've grasped some of the basics, let's begin our discussion of charting techniques. The next chapter focuses on the line family and will help develop your skills using these important tools.***

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## 2 Line secrets

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It's amazing how much information one or two little lines can reveal about the direction of the share price. In this chapter we will have a look at the line family. This includes support and resistance lines, as well as trendlines. I will explain the principles behind these lines, provide an example, and give you a chance to practise your skills. By the end of this section of the workbook, you should confidently be able to draw in these lines to help you diagnose the share price direction. Let's start by looking at support and resistance lines.

### **SUPPORT AND RESISTANCE**

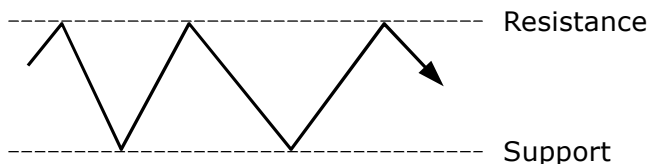
Support and resistance lines help you ascertain when a share is trading in a lateral band. Some analysts have suggested that this sideways movement can occur up to 70 per cent of the time. The support line can be seen along the base of a range of consolidation, and the resistance line can be seen along the top. They are horizontal lines that reflect the perimeter of sideways-moving share prices.

The share is basically bopping up and down, hitting its head on the resistance line and kicking against the floor to create a support line. It may be getting ready to break out of its confines. If the bulls win, the effect will be similar to a jack-in-the-box, and the break out will be upwards. If the bears are victorious, support will give way and the share will begin an avalanche.

For an example of how these lines appear, have a look at Fig. 2.1.

**FIG. 2.1 — Support and resistance**

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Drawing in support and resistance lines is an essential component of effective trading, and this will become clear as you progress through this workbook. To draw a valid support or resistance line, ‘they’ say that it is important to connect at least two points of share price action for a tentative line, and three or more for a

*...a clear trend is  
necessary to benefit  
from and make  
substantial profits.*

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confirmed line. However, in real life ‘they’ won’t be sitting beside you as you trade — so feel free to defy ‘them’ occasionally. A bit of rebellion never hurt anyone, so long as the weight of evidence is suggesting that the share is trending in a particular direction.

### **Why draw support and resistance lines?**

There are several reasons for drawing these lines. You may want to see whether a share is actually trending, or just moving in a sideways band. Trying to trade a share that is going nowhere is always a frustrating endeavour. The unfortunate implication with a sideways-moving share is that your capital is tied up, preventing participation in other more lucrative opportunities. This opportunity cost is a frustrating consequence of being involved in non-trending shares. When using shares as a vehicle, a clear trend is necessary to benefit from and make substantial profits.

If a share is not trending, then just walk away. You will find many more opportunities. All you have to do is keep looking. When interviewed by Jack Schwager in *Market Wizards*, James Rogers stated, ‘Be very selective. Never trade for trading’s sake. Have the patience to sit on your money until the high probability trade sets up exactly right.’ This attitude will ensure your longevity in the markets and give you a chance to develop profitable strategies.

Another key reason for drawing in support and resistance lines is so that you will have an alternative entry trigger into a share that is already trending. Areas of lateral movement can represent a temporary pause prior to the share continuing upward or downward. Once the share breaks out of these areas of congestion, this can be a buy signal, or a sell signal. These lines can also form part of larger macro patterns (which are discussed in Chapters 6 and 7) such as double tops or head and shoulders. If there is close overhead resistance, you may choose not to enter a position in that stock, as the profit potential may be limited.

*Marathon runners find the hardest part of the race is the uphill and downhill sections — the flat areas allow the runner to conserve energy...*

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Periods of temporary sideways consolidation are very healthy in a trending share. Marathon runners find the hardest part of the race is the uphill and downhill sections — the flat areas allow the runner to conserve energy and to prepare for sections of the course that are more difficult to manage. Shares behave in the same way.

To assess the strength of support and resistance, two factors should be considered. Firstly, the length of the consolidation is very important. The longer the period of consolidation, and the more times a support or resistance line is touched by share price action, the more these prices will be retained in the trader's memories. The other main concept is turnover. The higher the volume during the consolidation, the more investors have entered or exited at the support or resistance prices.

If you are not sure where you should draw in your lines, a quick rule of thumb is to draw a resistance line above a previous high price. All-time highs provide a level of resistance because traders tend not to enjoy buying at an all-time high. Also, if you draw a line just below a low price, this can be a proxy for a fully confirmed line of support. I realise that this does not comply with the previously mentioned 'three touches of the share price to confirm a valid line' concept — but it can work surprisingly well.

I want to teach you the theory regarding these concepts, but also show you what I do in my own trading. Live trading doesn't always comply with the exact definitions I am presenting to you. For this reason, it is important to stay flexible in your approach.

## **Change of polarity**

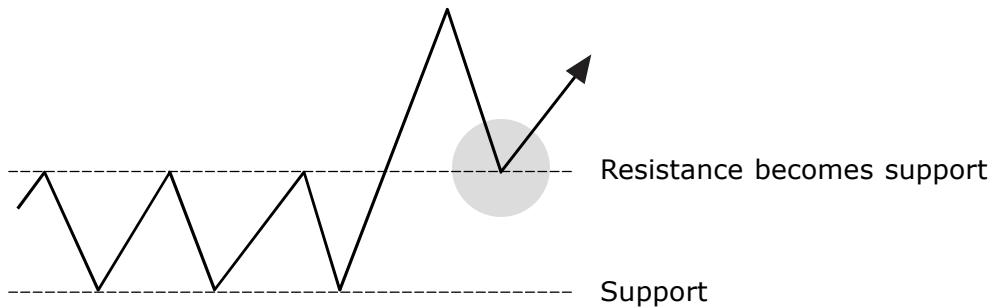
The change of polarity principle suggests that once prices break a significant resistance line, then this line should act as support for future trading activity. This

will only occur if the uptrend is strong. When resistance becomes support, this is a very bullish sign. Fig. 2.2 (below) is an example of how change of polarity may appear on a chart.

The less a share pulls back, the stronger the trend.

**FIG. 2.2 – Change of polarity**

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When the opposite happens and support becomes resistance, the bears have drawn a line in the sand that the bulls will have trouble crossing in the future. This is a sign of a downtrend that is likely to continue.



For each of the charts shown (Figs. 2.3 to 2.5), draw in where you would locate support and resistance. Once you have done this, circle any areas of the chart that show a change of polarity. Pick up your pencil and have a go.

**FIG. 2.3 – CSL weekly**



**FIG. 2.4 – EQI weekly**



**FIG. 2.5 – NRT weekly**



Please do not turn to the answers yet. We have a bit further to go until you can see how clever you are by drawing the lines in the right place. Give yourself a quick pat on the back for resisting temptation. We still need to discuss uptrends and downtrends before you can check your charts against mine.

## UPTRENDS

A trendline is one of the most basic tools that can help you ascertain whether or not a share is trending. These lines provide valuable clues regarding who is winning the war — the bulls or the bears.

An uptrend is apparent when prices on the chart consistently make higher lows. Each dip in share price action is followed by a subsequent trough that occurs at a higher price level. A trendline can be drawn on the chart to connect these low points. When there is sustained movement below this line, the uptrend is likely to be broken. When drawing a trendline, try to connect at least two low points for a tentative trendline, and three or more to confirm a trendline.