

## EQUITIES

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### COORDINATOR'S MESSAGE

**By Brian Matthews**

The first article by Colin Nicholson draws attention to the Coppock indicator that he states was designed to do only one thing, indicate the time to begin buying strong stocks for the long term. He notes it has nearly always been a good signal for when we are close to the bottom of the market.

In the July 2009 edition of the *Equities Bulletin*, Daniel Goulding provided a concise introduction to Elliott Wave Theory. This was followed by further articles in the August and November editions of *The Investors' Voice*. In his current article Daniel introduces us to 'The Expanding Triangle' as he provides us with 'The outlook for the ASX 200'. Reviewing his earlier articles, we note that Daniel remains 'on-message' as he continues to expect that the market will retest the March low in due course.

Our final article is a review by AIA member Tim Pope of the book by Kel Butcher *20 Most Common Trading Mistakes & How You Can Avoid Them*. As Tim points out, some tips can be adapted to longer term investment.

*Brian Matthews is a member of the AIA.*

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# HOW TO KNOW WHEN TO START BUYING

By Colin Nicholson

When a bull market begins, many investors have a fair amount of cash held waiting for the right time to start investing. When a bull market begins, most of us think it may be only another bear market rally. However, as the bull market goes higher, beginners hold back from committing their funds for fear the run will end. They look for a correction that will let them enter with safety. However, when prices begin falling, they fear a bear market and still hold off. They never do seem to get set, or only do so when it is far too late. In this way, it is said that bull markets climb a wall of worry.

So, how will we know when it is time to start buying? There is one indicator that has nearly always been a good signal for when we are close to the bottom of the market. This is the Coppock indicator.

This indicator was invented by Edwin Coppock, a US investment adviser. He designed the index to do only one thing; indicate the time to begin buying strong stocks for the long term. It is a little cumbersome to calculate, but it is doable by hand. It is built into some charting software.

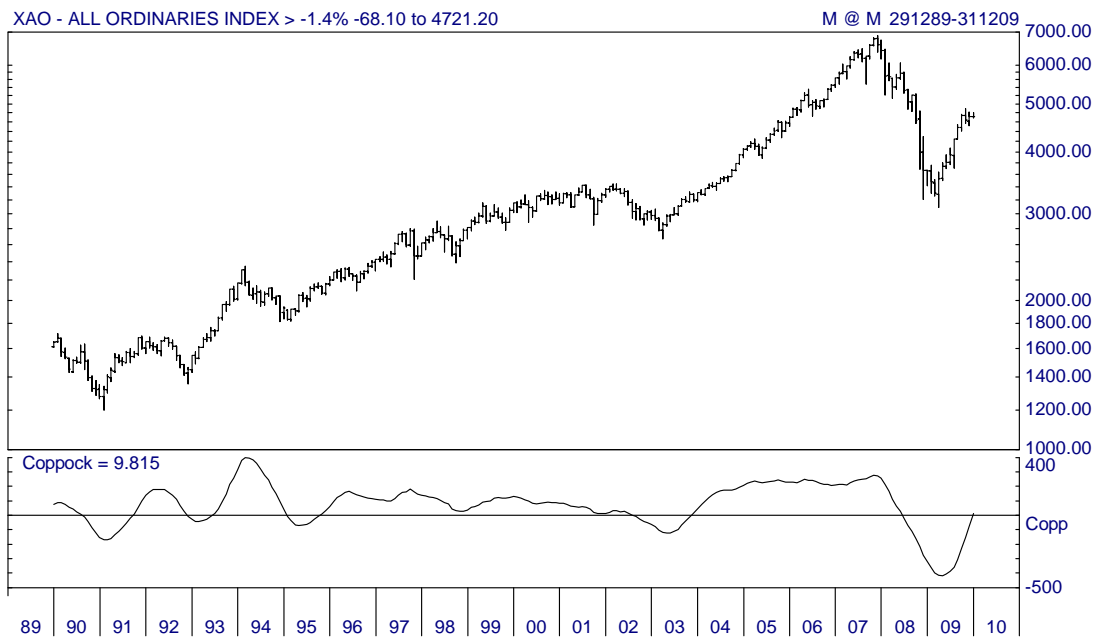
It can also be easily calculated on a spreadsheet. I have such a spreadsheet on the **Resources** page of my website [www.bwts.com.au](http://www.bwts.com.au). All that is necessary is to insert the closing price each month. Then copy and paste the last row down one row. I update it for users of my website soon after the end of each month. It is also possible to have someone print out the spreadsheet and it can be calculated by hand using the instructions at the top of each column.

Coppock described the calculation of the indicator and its use at some length in his paper ***Realistic Stock Market Speculation***, which seems to have been last revised about 1967 and has been long out of print. The indicator was designed for the Dow Jones Industrial Average and is calculated monthly. It has been found to work on almost any stock market index.

Although some books suggest the indicator is calculated from average monthly values of an index, it is clear from Coppock's paper that the closing value is used. The steps in its calculation are as follows:

- ❖ Calculate the percentage change between the index value in the current month and its value 14 months earlier.
- ❖ Calculate the percentage change between the index value in the current month and its value 11 months earlier.
- ❖ Total the two percentages.
- ❖ Calculate a 10 month weighted moving average of the total of the two percentages.
- ❖ This is the indicator, which is plotted on a chart.

The Coppock indicator will swing between positive and negative values. It is usually charted as a line in a sub-chart below the index chart. It will look like this for the ASX All Ordinaries Index:



Source: *Insight Trader (the same can be done in Stock Doctor)*

The signal for long-term investors to begin buying is when the indicator turns up from below the zero line. In other words, when the Coppock index line rises for the first time (its value is less negative than it has been). The Coppock indicator does not give very many signals, but when it does give a signal, it is invariably reliable. The Australian chart above shows the last five signals from the Coppock, which have been excellent.

Long-term investors should complete their buying before the indicator reaches the zero line. That is, before it turns positive, as it has now done at the end of November 2009.

Coppock claimed his indicator was only for entering the market. He used other means to exit. These were not disclosed in his paper and are beyond the scope of this article.

The Coppock indicator is simply a long term momentum oscillator. It has given premature signals in the past, but few of them have been in Australia and not for many decades. Even long-term passive investors can use the Coppock indicator to know when to invest cash that has accumulated during a bear market, in that they would know they are most likely to be buying near the bottom of the market.

Colin Nicholson is a renowned author and educator. More information can be found at his website *Building wealth through shares* <http://www.bwts.com.au/>. This article is copyrighted to Colin Nicholson. No re-publication or copying in any way, including electronic means, may be made without the prior written consent of Colin Nicholson.

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# THE OUTLOOK FOR THE ASX 200

By Daniel Goulding

My favoured short-term count for the benchmark Aussie equities index, the S&P/ASX 200 (XJO) is presented below in Figure 1.

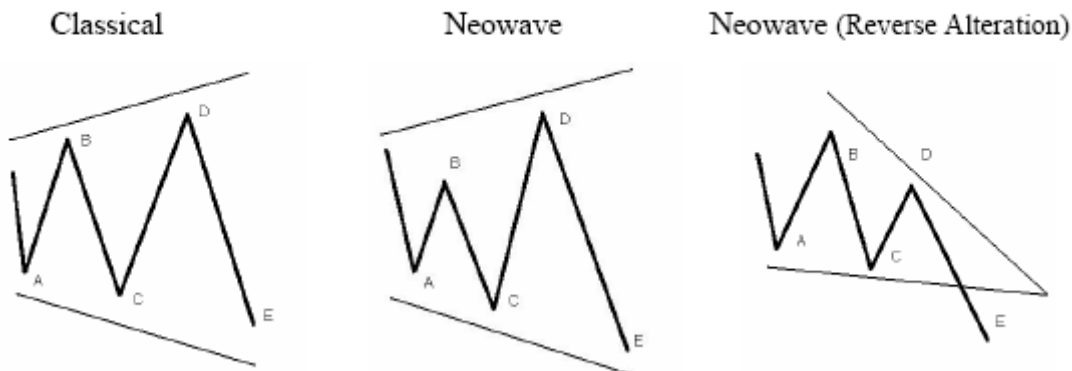
**Figure 1: Weekly Chart of the XJO (Log scale)**

Source: IRESS



The weekly chart depicts an expanding triangle, kicking off in November 2008. An expanding triangle is a corrective pattern that consists of five legs, denoted A-B-C-D-E. Figure 2 presents the various interpretations of this pattern according to the different schools of thought with respect to Elliott Wave.

**Figure 2: The Expanding Triangle**



The expanding triangle as I have counted it above, displays what is called Neowave Reverse Alteration (the Neowave school was founded by *Glenn Neely* in light of his significant theoretical extensions to the original theory of *Ralph Elliott*), where wave D is smaller than Wave B in price, reversing the common relationship between these two legs. As a result, wave D will also be smaller than Wave C, so that the trendlines containing the triangle converge rather than expand as per a 'vanilla' expanding triangle. Such a configuration is not permissible according to the Classical school (a term I use to denote the body of knowledge that remains predominantly consistent with the original teachings of *Ralph Elliott*) where wave D must always exceed wave C in price.

If the expanding triangle is a valid interpretation of reality, a break of the green line on the weekly chart will provide confirmation that the expanding triangle has completed. Upon completion I would expect to see a downturn push the market towards 4100ish initially. The nature of this decent and the inevitable bounce/rally from this level will provide more clues as to the expected evolution of the market going forward. Unfortunately, because expanding triangles usually unfold within protracted complex corrections, a number of alternatives exist with respect to the future. Regardless of how the future unfolds, volatility will remain a key theme going forward. And I continue to expect that the market will retest the March low in due course.

I have seen some Elliott scenarios where the March 2009 low, rather than the November 2008 low, is counted as the bottom of Wave A in this bear market. In my opinion, these counts are unsatisfactory. According to my technical work, both sentiment and the market internals bottomed in the vicinity of the November 2008 low. Last but not least, the January 2009 to March 2009 decline was more laborious than the November 2008 to January 2009 rally. As a rule of thumb, momentum usually sides with the prevailing trend making it unlikely that March was an important low in terms of market psychology.

In the event an expanding triangle is incorrect, the price structure is nevertheless not amiable to a new bull market kicking off in March in its current form. Impulse waves sport little or no overlapping and they tend to show at least some hint of acceleration through the middle of wave 3. Deceleration rather than acceleration is evident in the move off the March low. And there is a plethora of overlapping. Both conditions rule out categorically that a bull market kicked off in March 2009.

We must remain cognisant of the fact however that Elliott Wave is the quantification of the collective mood. Bear markets do not necessarily terminate at the price low. According to Glenn Neely, psychological and price extremes only equate in approximately half of all cases. In those other instances, the uptrend or downtrend will terminate at a lower high or higher low respectively. So even though a new bull market is unlikely to commence for a number of years yet, it is not a strict prerequisite that new lows should be witnessed even though I favour this outcome. In the event the March 2009 low holds as the price low of this bear campaign, it is a harbinger of a significant bull market starting sometime next decade.

*This report was prepared by Daniel Goulding through independent research facilities. It is not intended for use by any third party, without the approval of Daniel Goulding. While this report is based on information from sources which are considered reliable, its accuracy and completeness cannot be guaranteed. Any opinions expressed reflect my judgment at this date and are subject to change.*

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## BOOK REVIEW

Title: **20 Most Common Trading Mistakes & How You Can Avoid Them**  
Author: Kel Butcher  
Publisher: John Wiley & Sons, Brisbane, 2009  
RRP: \$32.95  
ISBN: 9781 7421 69293  
Reviewer: Tim Pope

This book is written by Kel Butcher, an Australian based trader, with excerpts included throughout the chapters from well known traders and educators such as Van Tharp, Jake Bernstein, Larry Williams, and Louise Bedford.

The book is primarily aimed at traders, where most of these issues tend to be amplified, but the lessons can be equally well applied to investing. I found the style of the book easy to read. However, it is general in nature, so don't expect to find any specific solutions or trading secrets within.

The book consists of 20 chapters, with each chapter addressing a particular mistake that traders commonly make. The mistakes are general and mostly just provide a structure with which the author has attempted to cover the various aspects of trading. The 20 mistakes covered are:

1. Defining a trading mistake
2. Jumping into the market before having learned the required skills
3. Not having a clearly defined and documented trading plan
4. Not trusting your own ability
5. Not aligning your trading strengths
6. Overcomplicating the entry process
7. Making trading too complicated
8. Not understanding money management
9. Paying good money for a dodgy trading 'system'
10. Failing to understand the numbers
11. Misusing margin and leverage
12. Confusing time frames and trading strategies
13. Not having a clearly defined exit strategy
14. Listening to the advice of media and others
15. Averaging down
16. Lacking discipline
17. Emotive and subjective trading
18. Overtrading
19. Operational errors
20. Avoiding the paperwork

While the more seasoned traders will be familiar with the covered topics, this is probably particularly pertinent for aspiring traders, or anyone just wanting to take stock and refresh. The book gives the reader a pretty good insight into what trading is about and what you need to consider to at least give yourself a chance at surviving at it. You'll still need to do a lot more research after reading the book, but it will provide you with a pretty good map to the areas you need to consider in more detail.

I enjoyed reading this book. The style was easy to follow and, while the depth wasn't particularly deep, the breadth of topics is pretty comprehensive. I would especially recommend it to anyone relatively new to trading.

*Tim Pope is a member of the AIA.*

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