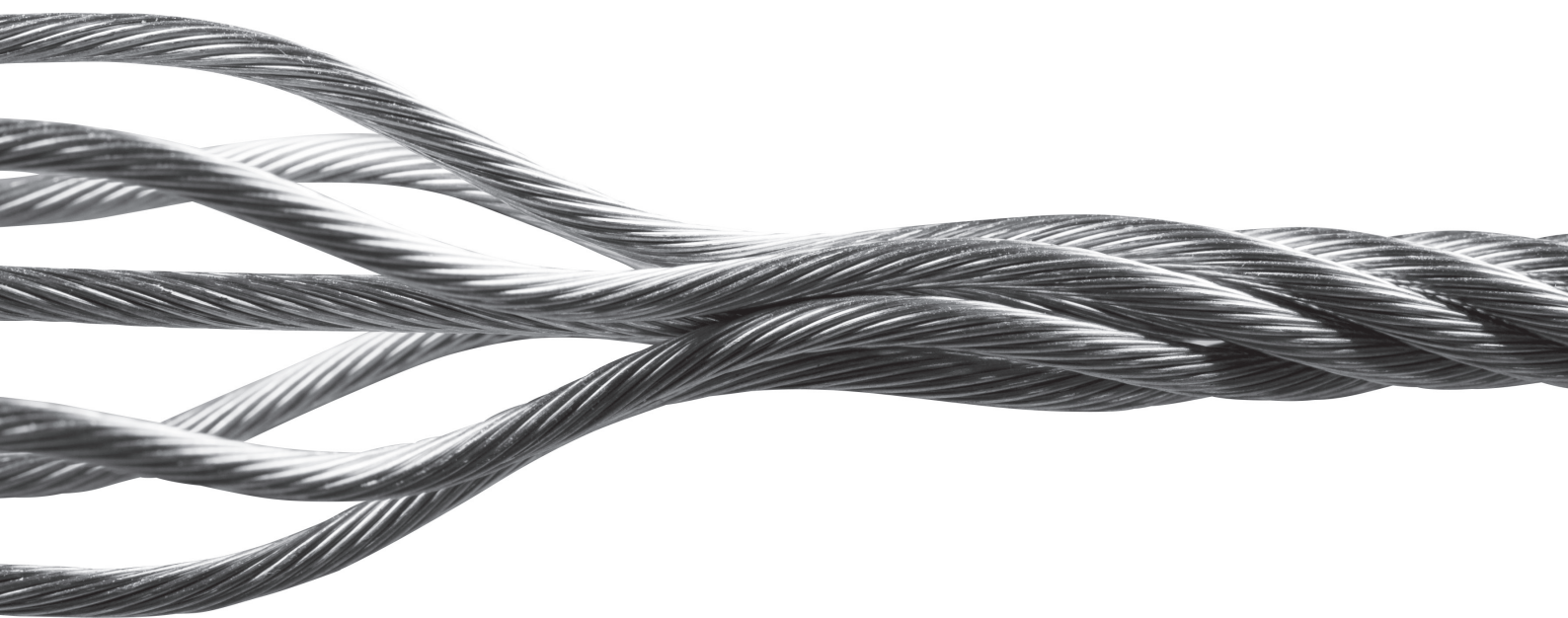


# **Harness the power** of technical analysis

nabtrade charting tools and research can give traders and long-term investors valuable insights on share price movements.



---

# 1 Understanding technical analysis

---

Consider how two people approach buying a car. The first carefully researches their favoured car and compares it to similar models. They read car reviews, talk to family and friends, take a test drive and decide if the car is a good investment.

The second stands outside the car dealership and looks for the best-selling cars. If demand for a model is rising, chances are its price will increase and the secondhand market will be strong. If demand is weak, the car dealer might have to lower the price.



### What is technical analysis?

The above analogy is a bit like fundamental and technical share analysis. Fundamental analysis involves researching a company's financial statements, industry, competitors and many other factors. The aim is to forecast the company's earnings and determine its intrinsic or true value.

Technical analysts use charts and other tools to identify patterns and understand price direction. Using market data, such as price and volume, they believe a security's past performance is a guide to its future performance and that price is the best signal. Similar to the car example, the technical analyst is not trying to value the security or make decisions based on published information. Instead, they rely on market action to determine which securities to buy and sell.

For many years, fundamental and technical analysis were seen as polar opposites. Fundamental analysis, used by the majority of investors, said past price performance was no guide to future performance. Technical analysts believed the most reliable information was market price and their style was seen as the fringe of mainstream investing.

That is no longer the case. Today, more investors and traders are combining fundamental and technical analysis to make better investment decisions. They use fundamental analysis to decide what to buy and sell, and technical analysis to decide when to buy and sell.

**The Tool tips throughout will help you use the nabtrade website.**

**Quick tips provide helpful information about online investing.**

### Tool tip

nabtrade's powerful Global Scanner tool lets you filter securities based on criteria you're looking for including both fundamental and technical options.

Access Global Scanner by logging into nabtrade  
-> hover over Insight Centre -> under Tools & Scanners, select Global Scanner

## What is charting?

The chart below, of Telstra Corporation over five years, is an example of charting. The blue line shows Telstra's price and the black line is a trendline. The price chart was created through nabtrade and one of its charting tools was used to draw the trendline.

Of course, many investors prefer fundamental analysis over technical analysis, or vice versa. Or they believe technical analysis is too complicated; that it requires expensive software and data subscriptions, and is only something for day-traders or sharemarket speculators.

Through nabtrade's research- and tool-rich online broking platform, investors can use technical analysis tools that were once mostly the preserve of professional investors. These powerful tools are simple to use and a valuable resource for chartists or fundamental investors who want to combine some basic charting techniques with their company research. Charting can be as complex as you want it to be: nabtrade's charting tools range from basic indicators, such as drawing trendlines on charts, to more complex charting techniques such as Bollinger Bands, a Relative Strength Index, or Candlestick charts.

Charting is not only a trading technique. Long-term

## Tool tip

If you have not used technical analysis before, consider using nabtrade's charting tools to gain a different perspective through the analysis of a security's price and volume. Interactive Charts are easy to access and can be done by logging in -> selecting a company -> clicking on the Charts.

portfolio investors, such as self-managed superannuation fund (SMSF) trustees, can use it to identify key turning points in stocks or other securities, or as a tool to protect their capital before or during a market correction.

The point is, charting comes in all shapes and sizes and suits many types of investors and traders. If you have not used technical analysis before, consider using nabtrade's charting tools to gain a different perspective through the analysis of a security's price and volume.

### Chart 1: Telstra Corporation

5 year price performance (AUD)



Source: nabtrade. For illustrative purposes only.

## 2 Basics of technical analysis

Although it looks easy, charting, like most investment techniques, requires education and experience. Making investments based on a quick glance of a share price chart is dangerous, just as relying on “hot stock tips” is a poor form of fundamental analysis.

Rather than attempting to identify complex share price patterns, start with three basic charting-related techniques:

- **Momentum trading**
- **Stop-loss orders**
- **Price support and resistance points on charts.**

### 1. Momentum trading

Momentum trading involves buying or selling stocks that are moving strongly in one direction, usually on high volume. The investment adage, “the trend is your friend”, neatly captures the essence of momentum trading: look for stocks making higher price highs and higher lows.

In some ways, momentum trading goes against the instincts of an investor who uses fundamental analysis. A momentum trader will buy rising stocks and sell falling ones. A fundamental analyst might sell stocks after they have risen (because they look expensive) and buy stocks after they have fallen (because they look cheap). The momentum trader prefers to let the trend dictate their strategy.

Consider the chart below of Flight Centre over five years.

**Chart 2: Flight Centre**

5 year price performance (AUD)



Source: nabtrade. For illustrative purposes only.

The first black trendline on the chart, from mid-2012, shows Flight Centre in a strong price uptrend. A momentum trader might have used the chart to identify a price breakout, when Flight Centre stopped moving sideways and started to head higher, and held it all the way through its uptrend to above \$50.

In early 2014 the uptrend lost steam and Flight Centre formed what chartists refer to as a “double top reversal pattern” (a bearish sign made up of two consecutive price peaks). A momentum trader might have identified that as a turning point for Flight Centre and sold all or some of their shares.

By late 2014 Flight Centre was trending higher again. Momentum traders will watch whether Flight Centre can break price resistance around the mid-\$40 mark and make new highs, or if the uptrend fails and the price downtrend returns.

Momentum trading techniques also help long-term portfolio investors. Although they are not “trading the trend”, they can use these techniques to buy stocks when they are rising and protect their capital by selling stocks when they break long-term uptrends and head lower.

The chart below of Woolworths over five years shows how long-term uptrends can become downtrends and destroy capital for those who have to sell.

## Tool tip

With nabtrade, you can access Trading Central's latest technical analysis reports on a particular company by typing in the stock code and selecting Trading Central in the Research tab.

Woolworths has been a great company for a long time. The first trendline, starting in early 2011 shows strong price gains to 2014. But then Woolworths moved sideways, broke price support (shown by the horizontal black line) and started a downtrend.

A SMSF trustee who bought Woolworths based on fundamental analysis could have used this charting technique to take some profits around \$35 a share, reinvest in another stock in an uptrend or keep that money in cash, to buy Woolworths again at lower prices, when its price turns higher.

### Chart 3: Woolworths

5 year price performance (AUD)



Source: nabtrade. For illustrative purposes only.

## 2. Using stop-loss orders

The Woolworths chart on the previous page shows the importance of setting stop-loss orders. A stop-loss order is a predetermined price point at which a chartist sells a stock to limit their loss and protect capital.

There are many stop-loss techniques. A chartist who buys a stock at \$1 might set the stop-loss order at 90 cents. If it drops 10%, the chartist sells out and cuts their losses. If the stock moves higher, the chartist lifts their trailing stop-loss order. When the stock rises to \$2, the stop-loss order is \$1.80. In this way, the chartist locks in most of their capital gains.

An ability to protect capital is arguably the key trait of high-performing investors and traders. Effectively used, a stop-loss order can help SMSF trustees better protect their retirement savings and minimise the damage of a big capital loss from a key stock in their fund.

The chart below, of Telstra over the past 12 months shows the benefits of setting stop-loss orders.

Lets consider a chartist who bought Telstra in July 2014. If they had set a trailing stop-loss level of 2% - ie they were prepared to take a loss of 2% in the share price, they would have been sold out of the share when it dropped from \$6.46 to \$6.31 on 26 February 2015. They would have still reaped the benefits of Telstra's rise up from around \$5.20 in June 2014, but not suffered the subsequent fall.

There is no hard or fast rule for what level to set a stop-loss at, and it depends on the share price volatility of the particular stock. A 2% stop-loss wouldn't work for a company that fluctuated by more than 10% in a week, and a 10% stop-loss order wouldn't work for a blue chip company like Telstra.

Stop-loss orders require discipline and a willingness to take a small loss. All too often, investors watch small losses become large ones or they try to buy more shares on the way down, believing a stock is cheap and forgetting that price downtrends sometimes take years to unfold. They fall for that great bear trap of "trying to catch a falling knife".

### Tool tip

Stop-losses on nabtrade can be performed through IRESS Trader or IRESS mobile. Visit [nabtrade.com.au](http://nabtrade.com.au) for more information.

**Chart 4: Telstra**

1 year price performance (AUD)



Source: nabtrade. For illustrative purposes only.

### 3. Price support and resistance

The third benefit of technical analysis discussed here, identifying price support and resistance levels, is related to the earlier concepts around momentum trading and stop-loss orders.

One way to think about price support and resistance points on charts is as an intersection of where demand and supply for a stock meet.

Support is the point on the chart where buyer demand is thought to be strong enough to stop the price falling further. Resistance is the point where selling is strong enough to prevent the price rising further.

Ever noticed how a stock will bounce higher every time it hits a certain price support, or fall when it hits a price resistance, as it seemingly bounces between a price floor and ceiling? That is support and resistance in action, and a useful guide of market psychology or how buyers and sellers view a stock.

The chart below, of Macquarie Group over one year, shows the concept of price support and resistance.

The first horizontal black trendline shows price support for Macquarie around \$55 a share. Each time it hits that level, buyers move in, presumably because they think Macquarie is undervalued at that level.

The second horizontal trend line shows price resistance



around \$81. When Macquarie hits that level, sellers move in, presumably because they believe it is overvalued, and Macquarie struggles to break price resistance. Technical analysts would watch this chart closely to see if Macquarie's uptrend is failing, or simply consolidating before the next move higher.

**Chart 5: Macquarie Group**  
1 year price performance (AUD)



Source: nabtrade. For illustrative purposes only.



Price support and resistance levels can also be used on long-term charts. The chart below of Wesfarmers over 10 years illustrates this concept.

Note the price support for Wesfarmers just below \$30 between 2010 and 2012 and price resistance around \$35.

When Wesfarmers finally breaks that price resistance, it moves above \$40 in early 2013 and the next channel of price support and resistance emerges.

### Chart 6: **Wesfarmers**

10 year price performance (AUD)



Source: nabtrade. For illustrative purposes only.



## Tool tip

### Take advantage of nabtrade charting tools

The above charts use only one feature of nabtrade's charting tools: trendlines. More advanced chartists could use a range of other price indicators or different type of charts, such as Candlestick charts, which use rectangles to show the price high and for a period, and different colours to show up or down days in price.

These charting tools are easy to access in nabtrade: type in the company's security code and click Charts.

From there, set the time period for the chart, choose your preferred charting style, and price and volume indicators that best suit your analysis. It's that easy.

Or go a step further: use nabtrade to source fundamental information, such as companies with a price-earnings (PE) multiple below 12 & a dividend yield above 5%. Read nabtrade research reports, consider the recommendation and apply the charting tools.

You might find a stock that looks like a good investment based on fundamental analysis, and has a favourable chart pattern: for example, its price is making higher highs and lower lows, and is in a clear uptrend on reasonable volume.



Source: nabtrade. For illustrative purposes only.

# 3

## Next steps for technical analysis

Charting patterns can be hard to identify, look different depending on the timeframe, and change quickly. There is no guarantee that a price pattern will continue: the key is being able to respond to market action in a stock, not trying to predict it.

nabtrade has partnered with leading technical analysis provider Trading Central, which provides short and medium term recommendations on thousands of ASX-listed and international securities, and also indices, currencies, commodities and bonds.

### Trading Central combines:

- a chartist approach to assess directional moves and price targets
- mathematical indicators to confirm initial thoughts and fine tune timings
- Japanese candlesticks to confirm trend reversal or acceleration
- To access Trading Central's research reports, log-in to nabtrade, select a stock, go to the Research tab and select Trading Central.

The Australian Technical Analysts Association (ATTA) is also a great place to learn more about charting. This not-for-profit organisation provides useful charting articles and links, and hosts events to help promote the correct use of technical analysis.

The Australian Securities Exchange's online charting library can help new chartists navigate through a sea of technical analysis jargon. This comprehensive library has free information on the main patterns, chart formations and technical indicators.

There are many good books on charting from well-known Australian authors and traders, such as Colin Nicholson, Daryl Guppy and Alan Hull. Nicholson's book, *Building Wealth Through Shares*, shows how to combine technical and fundamental analysis, and is popular with those new to charting.

Those seeking more formal education can consider enrolling in **Kaplan Professional's technical analysis subjects** and obtaining a Diploma of Technical Analysis, for ATAA members. The International Federation of Technical Analysts (IFTA) recognises holders of that qualification as a Certified Financial Technician (CFTe).

Once you understand charting basics, consider registering for the **ASX public sharemarket game**. As one of the world's great simulated sharemarket trading games, the ASX Sharemarket Game lets you test your charting strategies in real-time sharemarket conditions, without risking your capital. Treat the 15-week game as a key part of your introduction to charting.

Finally, use nabtrade charts to assess each stock in your portfolio. There is no better way to learn about charting – or the sharemarket generally – than through stocks you own. Use nabtrade's watchlist tool to build a list of potential stocks to buy, and apply your favourite charting.

### Link library

<http://www.ataa.com.au/>  
<http://www.asx.com.au/prices/charting-library.htm>  
<http://www.kaplanprofessional.edu.au/fin231-technical-analysis/>  
<http://www.asx.com.au/education/sharemarket-games.htm>

### Important information

The information in this document has been prepared without taking into account your objectives, financial circumstances, or needs. You should consider the appropriateness of the information with regard to your objectives, financial circumstances or needs before acting on it. Where the information relates to a financial product, you should consider the relevant Product Disclosure Statement or disclosure documents available at [nabtrade.com.au](http://nabtrade.com.au).

This analysis is for educational purposes only. It does not imply stock recommendations. All charts are sourced through nabtrade. All trendlines were drawn using nabtrade charting software. All prices are to June 4, 2015. nabtrade recommends investors do further research of their own or seek professional advice before acting on themes or ideas in this article.

The nabtrade service (nabtrade) is the information, trading and settlement service provided by WealthHub Securities Limited ABN 83 089 718 249 AFSL No. 230704 (WealthHub Securities), a Market Participant under the ASIC Market Integrity Rules and a wholly owned subsidiary of National Australia Bank Limited ABN 12 004 044 937 AFSL 230686 (NAB).