Introduction

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When starting out in the business of share trading or investing, many people are confused by the huge range of possible analysis methods and strategies.

Even with experience, some traders who use discretionary analysis methods manage to overlook some basic principles. So, let’s go “back-to-basics”...

How can this help you?

• Are you looking for trading ideas for your trading/investing strategy?
• How to go about it?
• Perhaps you are an advanced trader/investor and overlooking something? So looking for clues to tweak your strategies?
Session purpose

By group discussion (to share):

1) To look at some **key considerations** for a trading/investing strategy

2) To discuss the **pros and cons** of some of the elements of a strategy.

*Your input will be requested!!*
(of relevance to both novice and advanced)

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**Strategy elements**

Some topics that ought to be covered need a lot of time, so cover briefly, or skip over today

- Trading Plan / Strategy elements
- How much capital?
- Trading objectives
- Position sizing
- Risk management
- Markets to trade
- Results targets (eg. win/loss ratio)
- Trading time frame
  - Market cap
  - Stock universe
  - Sector
  - Liquidity

See next slides
Market cap — Does it matter?

- Large cap (> ~$1.2b)
- Mid cap  (> ~$500m)
- Small cap (> ~$50m)
- Micro cap (< ~$50m)

Stock universe?

Market cap

- Smaller cap stocks can be *illiquid*
- Large cap stocks are well researched with many broker recommendations, and traded by many “investors”
- Some traders draw the line at a particular market cap (eg. $50 million, etc.).
Sector focus — Is it useful?

- There are 11 sectors to choose from

Could choose to ignore specific sector(s)

Or to focus on specific sector(s)

Look for “best performing” sectors?
  - But, how to define “best”?
  - Miss out on performing stocks in poor performing sectors.
Liquidity — Does it matter?

- Is liquidity important?
- Define liquidity...

What might happen if you hold a $20,000 position and want to sell it quickly? If this stock:

- ...tends to trade only 10 times each day?
- ...turns over $100,000 each day (ie. your position is 20%)
Liquidity “rules”

Some possible “rules of thumb”:

- Take a position with $ value: < 5% of daily $ turnover
- Take a position with volume < 5% of daily volume.
- Take a position that trades > 50 times per day (on average)

Some sample strategies

- Trend following
- Mean reversion
- Dividend stripping/harvesting
- Breakout
- Swing trading
- “Discretionary” !!

There are lots of possibilities!
Simple case study samples

How to find stocks with:

- “Share price > 10 day MA”
- “Share price momentum rising”
- “RSI < over-sold and rising”

How to find these conditions? 
But is that sufficient?

Chart Analysis

When looking for “ideas” for a trading strategy, it can be very helpful to actually view a price chart and observe your desired “criteria” on the chart.

BUT! How to start?
Let’s look at a past example...

Telstra — Case study

• In June 2010, spotted Uptrend after 3 months of sideways consolidation
• Then a Breakout candle on 18th June
• So, was it a buy?
• Let’s take a look...
Telstra — Case study

- Perhaps we should check further back in time?
- Let’s zoom out (remember the market is like an elephant)
- And maybe switch to weekly chart.
Telstra (TLS)
Weekly
17 months
Feb 2009 - June 2010

We have zoomed out (elephant!)
Lower Peaks and Troughs,
so perhaps our May 2010 Uptrend
has ended the August+ 2009 Downtrend?
Maybe view a candle chart for detail!!

August+ 2009 Downtrend
Lower Peaks

Support at $3.20
Resistance at $3.20

May 2010 Uptrend

Is it safe to buy?
Has the big downtrend of
August to May finished?
Would candles tell us more?

Telstra (TLS)
Weekly
17 months
Feb 2009 - June 2010

We have zoomed out (elephant!)
Lower Peaks and Troughs,
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Maybe view a candle chart for detail!!

August+ 2009 Downtrend
Lower Peaks

Lower Peaks and Troughs
Support at $3.20
 Resistance at $3.20

Do the candles tell us more?
Should we move the trend lines?
Is it safe to buy?
Perhaps zoom out further...
Monthly line chart (11 years)
Is it safe to buy?
Any point in viewing candles?

Telstra (TLS)
Monthly
11+ years
1998 - June 2010

We have zoomed out further!
Imagine the opinions of the investors who bought during the long downtrend...

Support at $2.90
(on Daily!!)
Will it hold?

This box is what we saw on the weekly chart.

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Monthly candle chart.
Do we think the bigger downtrend might have finished?

Telstra (TLS)
Monthly
11+ years
1998 - June 2010

We have zoomed out further!
Imagine the opinions of the investors who bought during the long downtrend...

Support at $2.90
(on Daily!!)
Will it hold?

This box is what we saw on the weekly chart.

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Let's re-visit the daily chart and look at more price action...
So, is it safe to buy Telstra at this point?

Daily candle chart showing more price action. Lucky we didn’t buy!!!!
Telstra — Case study

Lessons / conclusions:

• Bigger picture charts are useful
• Useful to use different periods (daily, weekly, monthly)
• Trends — can occur within trends
• Support and resistance can be sustained over time.

Back to our search...

So, how to go forward?
Possible Steps

Following is one possible sequence of steps:

- View a “big picture” price chart
eg. monthly line chart over 2+ years
  (remember the market is like an elephant)
- Look for key “observations” (see next slide)
- Then view smaller time frame
eg. weekly line or candle chart over 12-24 mths
- Then view smaller time frame
eg. daily price chart over several months or less.

Chart Analysis — Step 1

- **Big picture*** — eg. *monthly* line chart
- Time frame? — at least a couple of years
  (and maybe much longer)
- Look for levels of **Support** and **Resistance** (they can apply for years)
- Look for **trends** — up, down or none
- **Chart patterns**

* The market is like an elephant
Searching for a Strategy

Why?

Why look for:
• support?
• resistance?
• trends?
• chart patterns?

What do these price chart features tell us?

Why look for these?

Why look for: Support, Resistance, Trends and Chart Patterns?

Because price charts summarise the opinions of the market participants regarding the share price, and these chart features help us to understand those opinions.
Chart Analysis — Step 2

Repeat step 1, except for shorter term:

- Shorter term — eg. **weekly** chart
- Time frame? — perhaps 12-24 months
- **Candle** chart (or **bars**) can be useful
- **Support** and **Resistance**
- Look for **trends** — up, down or none
- **Chart patterns**
Chart Analysis — Step 3

Repeat previous, except for shorter term:

- Shorter term — eg. daily line chart (or even candles / bars)
- Time frame? — a few months
- **Support** and **Resistance**
- Look for **trends** — up, down or none
- **Chart patterns**

Chart Analysis — Step 4

**Utilise chart indicators** to help understand what has been happening:

- Trend, and trend strength (eg. MA, ADX, ROAR, etc.)
- Price momentum (Momentum, etc.)
- Price volatility? (eg. ??)
- Price over-sold / over-bought (eg. RSI, Stochastic, etc.)
- Volume indicators?
Chart Analysis — more

Maybe also:

- Candlestick patterns:
  - Observing the presence or absence of candle tails (wicks)
  - Observing the length of tails and bodies.
  - Observing the position of one candle relative to the previous candle(s)

- Observations of volume.

What else?

What have we missed?

What else is there?
SUMMARY

One possible sequence of steps:

- View a “big picture” price chart
eg. monthly line chart over 2+ years
  (remember the market is like an elephant)

- Look for key “observations”
  (eg. support, resistance, trends, patterns, etc.)

- Then view smaller time frame
eg. weekly line or candle chart over 12-24 mths

- Then view smaller time frame
eg. daily price chart over several months or less.

Brainy’s **Share Market Toolbox**

- More information on this topic and others;
- Technical Analysis information;
- Subscribing Toolbox Members have access to lots more information;
- A special version of this slide set including “Speaker Notes” will soon be available to Toolbox Members.

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