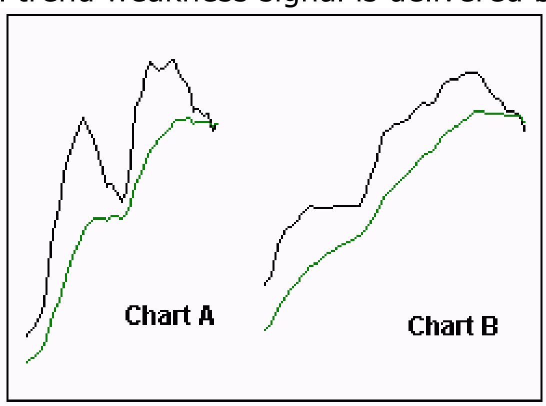
THE GMMA: EXITS

By Daryl Guppy

Many new readers have asked about the GMMA, how it is constructed and how it is used for trading. I developed the GMMA in 1994 and have used and refined its application over the past 20 years. It is a robust and reliable analysis indicator widely used in equity, currency and commodity markets. The GMMA can be applied in any time frame – daily charts, 1 minute charts, 1 hour charts etc. It tracks the psychological behavior of market participants. In FX markets, we use a Super Guppy to track the volatility clustering and identify trend change points. We include these notes for new readers. ED.

We buy stock for a single reason – we expect it to go up and make us money. We sell stock for many different reasons. Where possible we try to lock in the maximum profit possible from the trade. This does not mean getting out at the very top of the trend, but nor does it mean getting out long after the trend has well and truly turned down. As part of a good exit solution, we also want to avoid getting out of a trade on false trend breaks. This happens when prices dip, and then recover and continue the trend.

No single exit indicator, or group of indicators is going to provide the best solution to these wide variety of exit demands. The GMMA is useful in deciding when a trend is weakening, and this allows us to apply the most effective protect profit tool given our trading objective. In a fast moving bubble trade, the collapse of the bubble is managed using a volatility based stop loss such as 2xATR or the count back line. In a slower moving trend trade we may decide to apply the count back line after the initial trend weakness signal is delivered by the GMMA.



These two charts show a decision point based on a 10 and 30 day moving average crossover. They both look exactly the same. Had we purchased stock previously, then this signal would have us reaching for our sell orders. Unfortunately one of these stocks goes on to add 63% in the following months. The other loses 17%. Can you select the winning stocks based on the moving average display? It is a matter of luck.

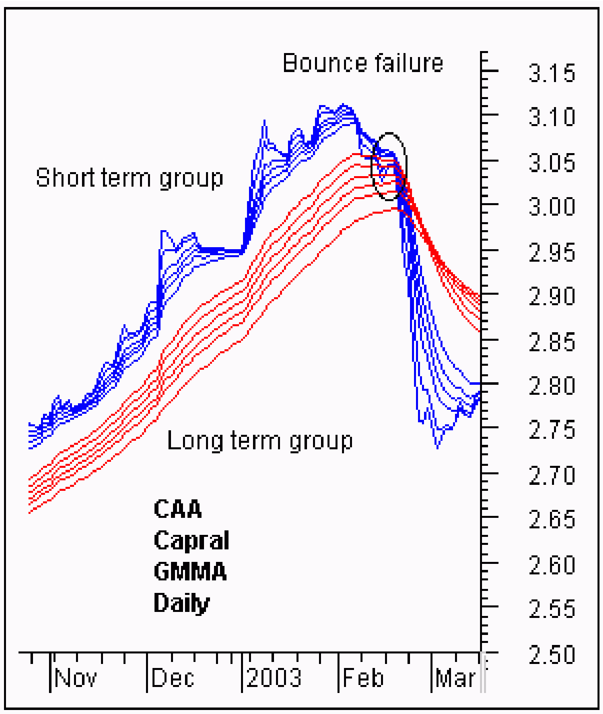
Although this pairing of moving averages is a useful trading tool, it is not very helpful in understanding the nature of the trend. It simply does not give the trader enough information to be able to decide where the balance of probabilities lies. The GMMA does provide a clear view and understanding. This is the information we use when applying it to the exit question. The eventual development for chart A and B are revealed in the footnote below.

There are four exit conditions where the GMMA is useful. They are:

- The failure to bounce and recover which indicates trend weakness.
- Multiple declining bounces. The steady slow collapse of the trend.
- A bubble trade exit.
- The sharp drop though the long term group of averages. This is a clear trend change signal.

Each of these exit conditions is managed using a specific selection of tools. The GMMA tells us which tools are most appropriate. The GMMA is designed to help the trader understand the nature and character of the trend. It is not used as a stand alone entry or exit tool. The key leading relationship is set by the traders. Trading activity leads the market. Investors follow. We have an advantage if we move with the traders.

Bounce failure



We examine two relationships when applying the GMMA to exit analysis. The first is the relationship in the long term group of averages. The second is the character of any bounce from the short term group of averages after a price drop. A trend continuation depends on continued trading activity. When prices drop we want to see new traders coming in and taking advantage of these lower prices. Their trading shows they are confident about the future. If this group does not bounce, then the key leaders in the trend have failed. Complete trend failure becomes a higher probability.

The CAA chart shows a wide spread in the group of long term averages. Investors are comfortable with this stock. Traders are in no panic, but they have sold the stock down steadily over previous weeks. Once their selling drifts into the long term group of averages we look for a rebound as new traders come in. They have to outbid investors who are holding stock, or adding to their positions.

This does not happen. The rebound fails to develop, and a sharp compression and fall in the short term averages develops. This is the exit signal – even though the long term group of averages is showing few signs of compression. If traders are jumping ship, then there is a strong probability the trend is faltering or about to end.

This pattern says nothing about the speed of the collapse. With CAA the collapse gains momentum very quickly. The GMMA relationship tells us that these lows are not temporary dips. They are created by traders desperate to get out, and very quickly, by investors who are trying to lock in profits.

We do not wait for the GMMA crossover. We use the information about the changing nature of the trend to take an early exit.

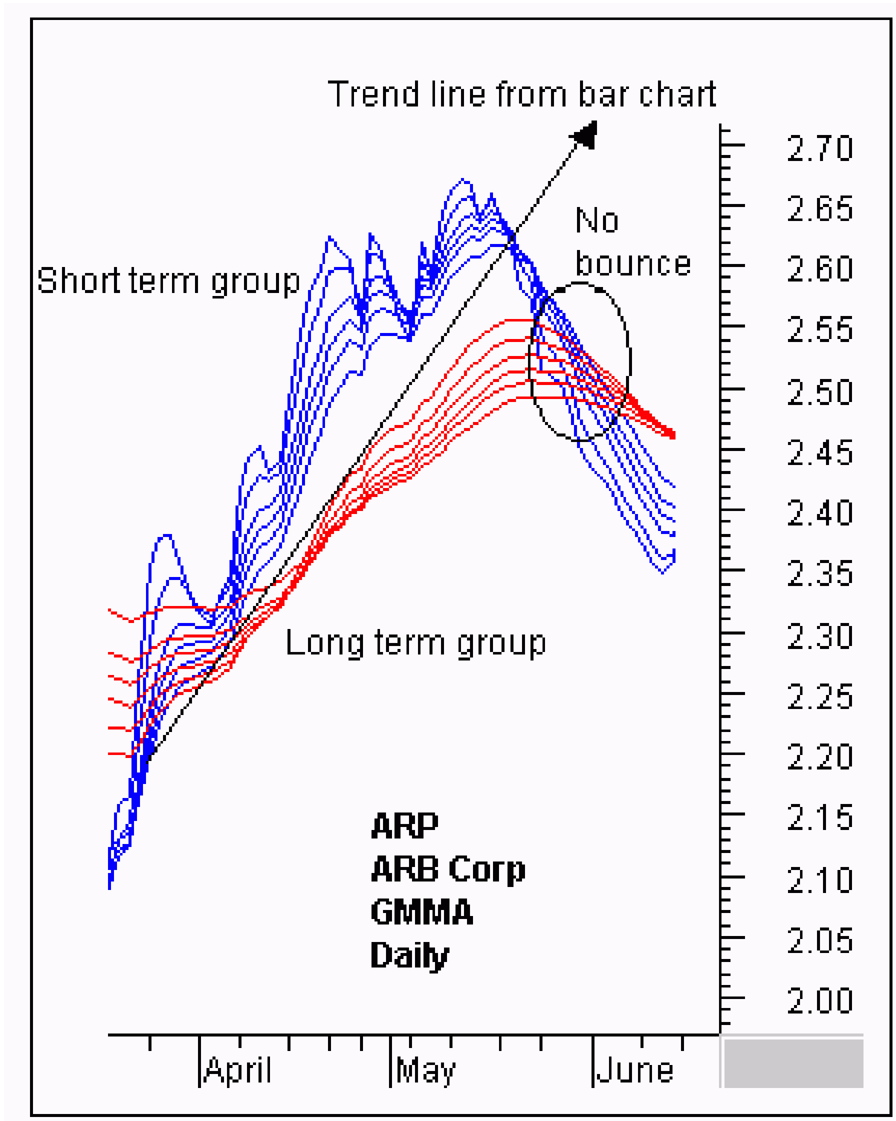
Sharp drops

The most disheartening trend change of all is the sudden drop. The GMMA is no more useful in the early detection of these sudden drops after unexpected bad news than any other indicator. However, the GMMA does help the trader to understand what is happening in a fast moving decline spread over several days. These declines are always led by traders. Their activity has the effect of constantly probing the market for signs of weakness and strength. They react to bad news aggressively, sending prices downwards. The compression, crossover and reversal in this group is shown with ARP.

Watch for how the short term group behaves as it penetrates the long term group. There is no sign of a rebound here. Everything just keeps on moving down. Additionally, the short term group is widely separated. This suggests that traders are desperate to get out. Instead of waiting for a price rise, showed by compression, they simply take whatever price they can get in the market. This pattern takes 5 days to compete and this gives the trader time to get out. It may not be at his preferred price, but under these conditions an early exit in the face of substantial trend change is an advantage.

In this same 5 day period the long term group of averages very quickly compresses and turns down. This confirms a significant trend change is developing and that the price dip is unlikely to be temporary. This confirms the trend change.

As the straight edge trend line plot shows, the early warning of a trend change came initially when the short term group of averages compressed and turned downwards so why wait for this final GMMA confirmation signal? Experienced traders would not wait. The close below the trend line, and the GMMA compression is enough to initiate the exit. But not all traders are experienced, or disciplined. Many wait for further evidence the trend has changed. They hope the price fall is temporary. This is an even stronger emotion if they entered the trade just a few days before the close below the trend line.



The GMMA evidence that develops in the next week should be enough to convince even the most hopeful investor that this stock is heading for a significant change in trend. While we might dismiss the activity of traders, we cannot afford to ignore the activity of investors. As prices fall, the long term group compresses, and changes direction. This confirms that the up trend is seriously weakened.

The GMMA is not a predictive tool. It is used to understand the nature of the trend, and assists the trader in making a decision about the probability of trend continuation. When this balance of probabilities changes, the trader and investor may decide to modify their trade management tools, to take a protective exit or to capture an unexpected profit.

The GMMA does not always protect the trader against a false exit, but it does clearly indicate when the trader needs to prepare for the worst.