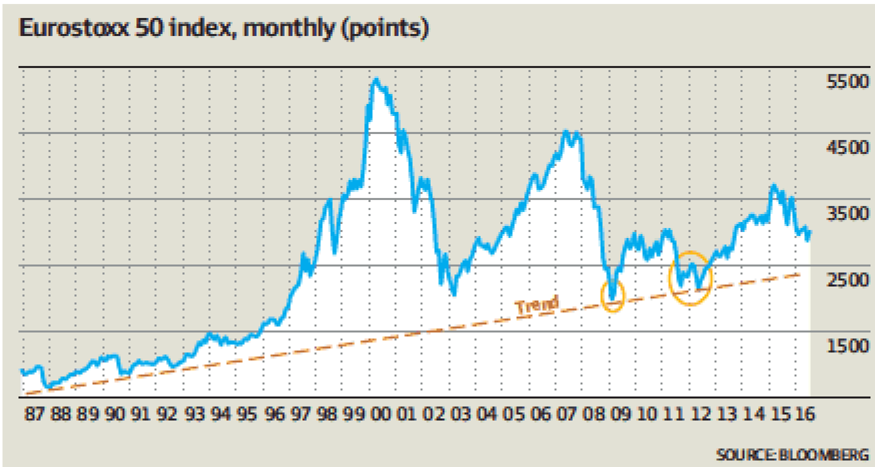
HOW NOT TO DRAW A TREND LINE

By Daryl Guppy

There is a limited attempt by fundamental analysts to use the basic tools of technical analysis but they use them so incorrectly that is dangerous. They use the tools so badly that they self-reinforce their conclusion that technical analysis is not useful.

This chart from Bloomberg is a case in point. Its used by a fund manager to explain why European markets are showing upside.



The placement of the trend line is technically correct, having three anchor points in 1987, 1990 and 1992. Only the second of the circled areas actually touches the trend line and can be counted as a confirming trend line rebound. So what's the problem?

The problem is that this type of chart is essentially useless for investment or trading decisions. Its not more than a pretty picture. The suggestion in the analysis article is that now is the time to buy European equities because the index is near the trend line and poised for a rise. Current value is 3350 and trend line value is 2400. Enter now and ride the fall to the trend line and it will deliver investors a 28% loss on your investment!!!

Using the same logic, investors who missed the trend line rebound in 1992 had to wait until 2008 for another opportunity to buy a trend line rebound.

Its also worth noting that the analysis made no suggestions about how to tell when it was time to sell.

This type of wishful thinking provides no indication of how an investors could have ridden the rise from 1300 to near 5500 (323%) , captured profits, and then captured profits again with the rise from 2350 to 4500(91%) . The rise from the trend line from 2300 to above 3500 (52%) is also ignored, even though these are all multi- year trends of between 3 and 5 years.

No rapid trading footwork required to lock in returns. However a better application of even basic technical analysis and trend line analysis is a prerequisite for locking in profits. Investors using a simple ETF strategy and correctly placed trend lines could have locked in those returns.

These types of long term charts are simply pretty pictures and meaningless for any investment strategy. The fact that these are used to illustrate fund managers investment strategies going forward is a significant sign warning of caution.