

BEWARE POOR TECHNICAL ANALYSIS

By Daryl Guppy

It's good to see more technical analysis appearing in broker's advisory notes. It's very disappointing to see how poorly understood this analysis is. Some of it is downright dangerous to your wealth. It becomes even more important to have a good understanding of technical and chart analysis so you are not misled by poor quality analysis. Here's an example with our notes in italics.

"A Descending Triangle is a bearish pattern with traders generally looking for a downwards breakout. The descending triangle forms as a consolidation period within the downtrend and indicates downwards continuation will follow. *(Consolidation features patterns of sideways price behaviour as price consolidates around a support level. A down sloping triangle is a dynamic momentum pattern – the exact opposite of a loss –of-momentum consolidation pattern)*

"This pattern is easily recognisable, as it resembles a triangle. A horizontal trend line connecting multiple lows can be drawn indicating support beneath current prices." *(It's called a support or resistance line, not a trend line. Trend lines have changing values over time. Support and resistance lines have constant values.)*

"A second descending trend line is drawn above the stock prices connecting multiple lower highs, completing the descending triangle pattern. A breakout typically occurs when the support is penetrated. A breakout should occur at about two thirds of the way into the triangle. **A stock, which does not break down prior to reaching the apex of the triangle is generally sluggish and often a less reliable trading candidate.** To determine the expected price fall, which could follow, the widest portion of the triangle may be measured and added to the breakout point -support level." *(There is no base in this " triangle " pattern, so there is no triangle pattern. A breakout above a trend line is breakout above resistance, not support.)*

"There are instances when descending triangles form as reversal patterns. When bearish patterns fail, they can produce extremely quick and powerful bullish moves." *(This contradicts the section in red. It's also an inaccurate statement as upside breakouts from down sloping triangles are usually very weak due to the extreme selling pressure that creates the down sloping triangle.)*

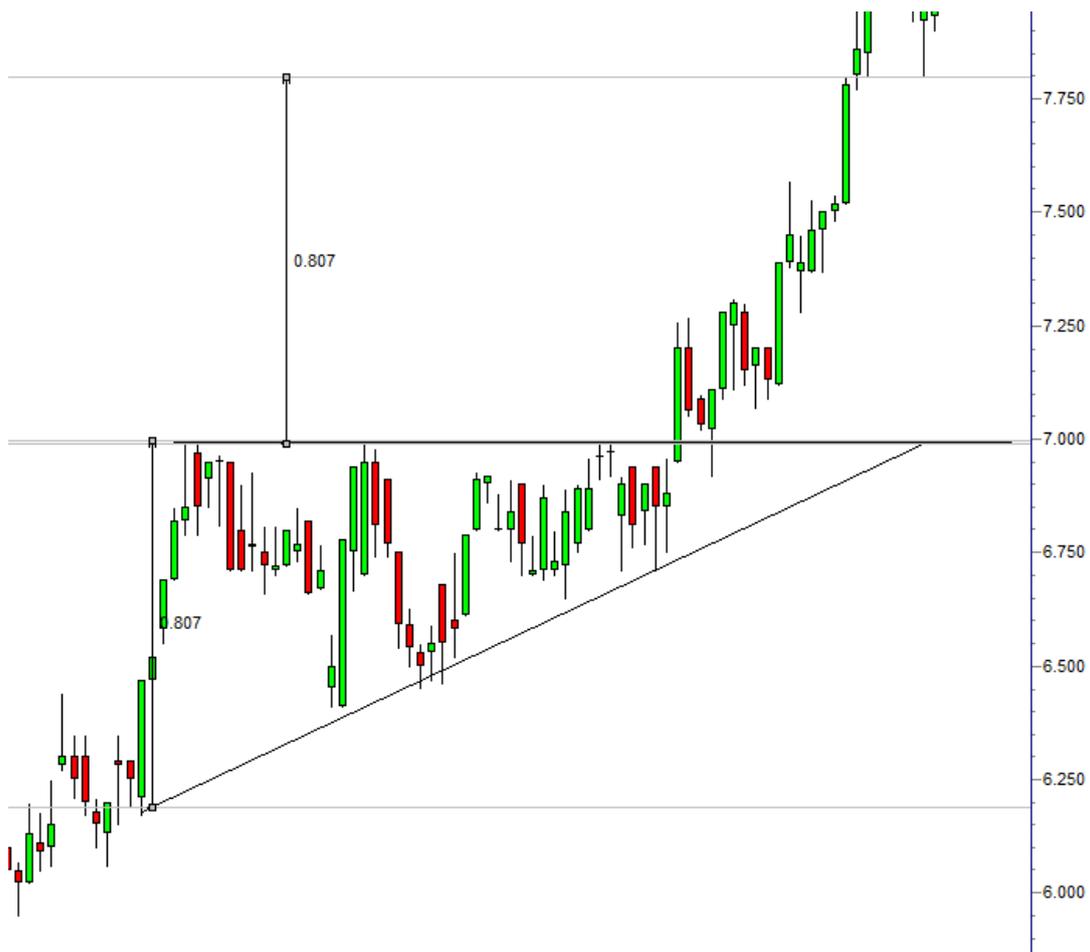


"The chart illustrates a descending triangle as indicated by the trend-lines in blue." *(Incorrect trend line position. Trend line should start from the high at \$5.91 just above the upper blue line)*

"We can see that the stock bounced off support at \$5.50 *(there is no support at \$5.50. It's not validated in either short term or longer term historical charts.)* and tested resistance of the counter trend line."

"This price action of down trending lower highs and bounces off support repeats until the price breaks through resistance in the case." *(The notes recommend a long side trade but give no upside target although perhaps it's at the level of the second blue line.)*

This is what a correctly formed triangle pattern looks like. It has a well defined base, and accurately plotted trend line, and a verifiable support or resistance level.



From our perspective the first chart is too muddled to provide clear technical analysis signals. There are no clear trend lines which define the price activity. Support and resistance levels cannot be validated. Long term historical support is well defined at \$5.35 but not at \$5.50. Resistance is relatively well defined at \$6.00, but not at \$5.80. This is not to say there is not a trading opportunity but we see it as a gamble because there is no valid stop loss method to apply and the breakout is part of erratic price behaviour.