

The Analysis behind buying the Dow, September 2009



Let us now discuss some of the most fundamental principles of technical analysis. Trendlines. Trendlines could well be called signal lines, and sometimes we do. The breaking of trendlines is always significant. The longer the trendline, the more important the signal. Buying on the break of trendline A here is obviously extremely aggressive -- and the most profitable, but as we know there is a high degree of risk that the trend will not continue.

Buying the B trendline break is still aggressive, especially as we remember the conditions of last March. We were holding our breath that the financial

weapons of mass destruction might result in a Doomsday Machine (a la How I learned to Stop Worrying and Love....).

Note that we are stepping up from two or three week trendlines to 2 1/2 month and then at C around six months. At C we are still in aggressive territory, especially for investors who want to remain invested for long periods. D is less aggressive still but a trade here is inhibited by the obvious formation of a petite head and shoulders formation.

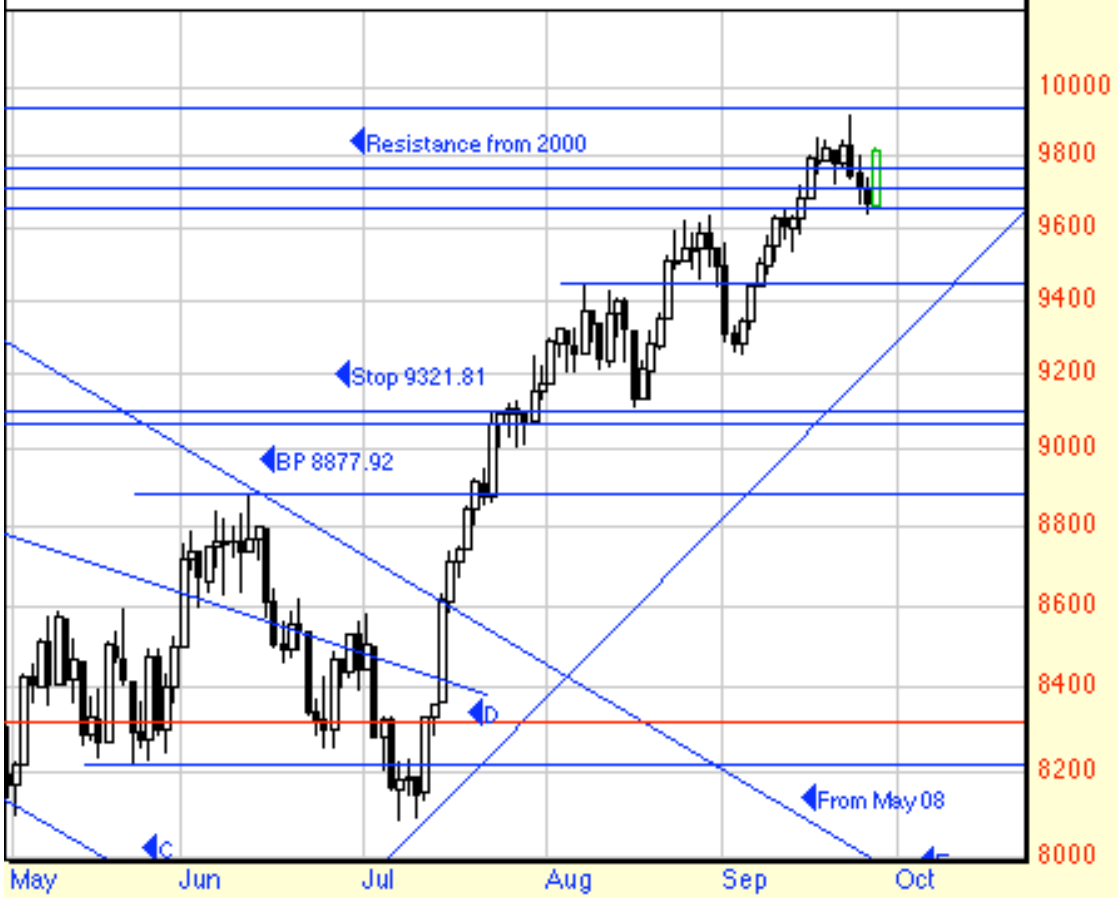
But the top of this formation, when it is negated represents a Basing Point which creates a stop at 9321. The penetration of this stop and the breaking of the E trendline and the penetration of the horizontal trendline represents the most conservative investor's trade. An enormous piece of the trend is foregone in this process and this drives investors and critics crazy: (as they say) Dow Theory (and long term trend following) gives up the first third of the trend, the last third of the trend and sometimes there isn't a middle third.

Now consider this fact to put things in perspective: Imagine that we had executed this process in November 08 and had drawn similar trendlines. And had gone long on the break of an imaginary trendline A or B. We would have felt very sad about our portfolios in March 09, had we not stopped them up prudently.

It is all very well to take these A and B trendline breaks if you are extremely agile, bold, and willing to lose your bet. As long as you know what you are doing and realize the possible consequences. As they say, there are bold pilots and old pilots, but there are no old bold pilots. Readers will notice that we often identify signals as for the aggressive or the conservative.

Here is a close up:

Dow Jones Industrial Average Index 9813.02 147.83 1.53%



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