

GRAIL SECURITIES (SWITZERLAND)



CHÄSIGASS 7, CH-6331 HÜNENBERG, SWITZERLAND



Telephone & Fax: 0041(0)41 781 36 01
Cell Phone: 079 693 26 45

Email: info@grailsecurities.com
Website: www.grailsecurities.com

Time your entry using the 50 day moving average

It is evident that trends in stock prices can be very volatile, almost haphazard at times. One technique for dealing with this phenomenon is the moving average (MA). An MA attempts to tone down the fluctuations of price series into a smoothed trend, so that distortions are reduced to a minimum. There are many variations of MAs used in technical analysis, but the most commonly used by the market is the 50-day simple moving average (50 DSMA).

Characteristics of a Moving Average

A smoothed version of a trend and the average itself is an area of support and resistance. In a rising market, price reactions are often reversed as they find support in the area of the MA. Similarly, a rally in a declining market often meets resistance at an MA and turns down. The more times an MA has been tested, that is, when it acts as a support or resistance area, the greater the significance when it is violated.

A carefully chosen MA should reflect the underlying trend; its violation therefore warns that a change in trend may already have taken place. If the MA is flat or already changed direction, its violation is fairly conclusive proof that the previous trend has reversed.

If the violation occurs while the MA is still proceeding sharply in the direction of the prevailing trend, this should be treated as a preliminary warning that a trend reversal has taken place. Confirmation should await a flattening in the angle of ascent or descent, a change in direction in the MA itself, or alternative technical sources.

Generally speaking, the longer the time span covered by an MA, the greater the significance of the crossover signal. For instance, the violation of an 18-month MA is more important than the crossover of a 30-day MA.

Reversals in the direction of an MA are usually reliable. A very powerful and reliable signal is given in instances in which a change in direction occurs close to a market turning point. However, in most instances, a moving average reverses well after a new trend has begun and is useful as a confirmation.

In short, think of an average as a type of moving trend line that obtains its significance from its length (time span), the number of times it has been tested, and its angle of ascent or descent.

Timing your Entry

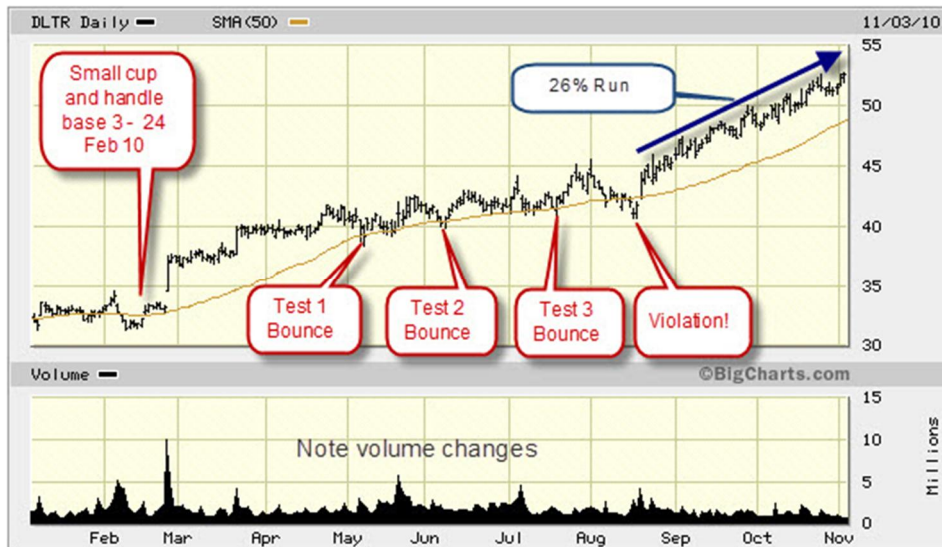
Many of the stock market's greatest winners will offer you several chances to buy. But not all entries will be from consolidation and reversal points, called bases. Watch out for a first or second pullback to a rising stock's 50 day moving average. Enter at your peril after the second test of the average line following a breakout from the base. Once the third test occurs, you may be pushing your luck.

The importance of the 50 DSMA line is because it tends to draw support from large market players looking to

add to their positions on a setback. These institutions may not only want to buy some shares on the cheap. By shoring up the retreating stock's price at the 50 DSMA line, they're also protecting their full position. Also bear in mind that not all retrenchments to this moving average are alike. Remember, a stock that has fallen badly is likely to have tested its 50 DSMA line and seriously breached it.

How can you tell if a stock's retreat to its 50 day moving average line should be bought? Look for declining volume as the stock falls and rising volume as the stock bounces from the line.

There is a proper price range in which to scoop up shares, so it is advisable not to buy too high, such as when the stock is trading more than 6-8% above the left side of the base before the stock pulled back to its 50 DSMA, since it may become quickly over-extended.



An Example . Dollar Tree (DLTR)

A look at Grail stock Dollar Tree, an operator of discount variety stores, shows that a small base was formed in the period from 3 to 24 February 2010. From that breakout point the stock climbed continuously on a relatively shallow gradient which involved four tests of the 50 DSMA! On the last test it finally violated the average after a gain of 24%. In view of the upward trend of the price action covering the test areas 1 to 3 may have been risky. That is why confirming the fundamental condition of the stock is key to such a decision. In DLTRs case it was always excellent. We know that during the test period from 3 May to 31 August the SP 500 fell 13%, but DLTR moved in the other direction, and gained 11%. On 18 August, after a short slide of 7%, the stock upwardly penetrated the 50 DSMA on good volume to close up from that point until the close of November 5, 2010 a further 26%.

November 6, 2010

John Henry Smith, MBA, FCMI