
Timing the Trade – How to Buy Right before a Huge Price Advance

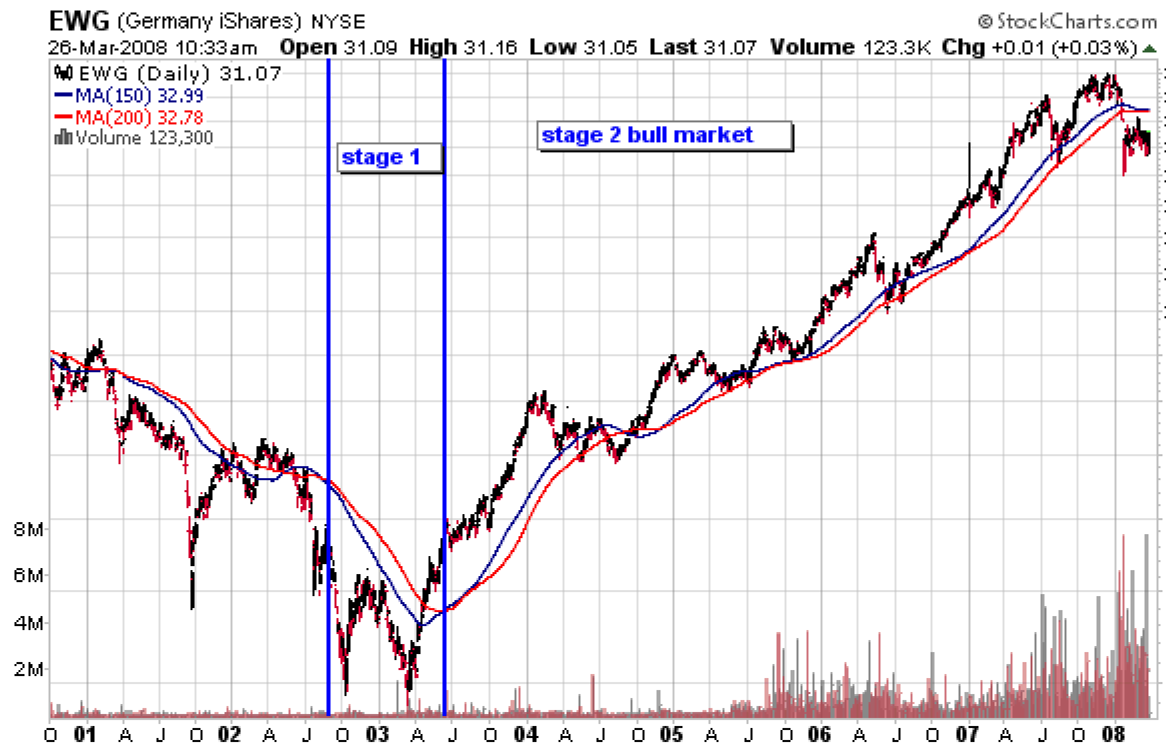
By now you should have read my first two ebooks and learned about the life cycle of a market, stock, or ETF, and discovered the best indicators to use to analyze a chart. These are the building blocks of knowledge you will need to start your mastery of the stock market.

Proper timing of your entry point is the first component of making a successful investment. The other components are risk management and having a plan to sell. We'll discuss those in later lessons. But for now we need to focus on your next block of success – knowing when to buy.

There are two times to buy a stock, market or ETF. The first is just as the market you are following makes the transition from a long-term stage one period of consolidation to a stage two bull market. The second is during a stage two bull market. Both require different approaches.

You should realize that you never want to buy a stock in a stage four bear decline. You can identify this easily by looking at the chart. You know to stay away if you see the price below the 150-day moving average and that moving average is sloping down.

Of course the most profitable time to buy is when a market or stock is making the transition from stage one to a stage two bull market. The profits that can be made by holding throughout the duration of a bull market are enormous. Ironically few people are paying attention when it is the best time to buy. The masses buy at the top when all of the news is good and talking heads say everything is going to go forever and then ride their positions down during stage four bear declines.



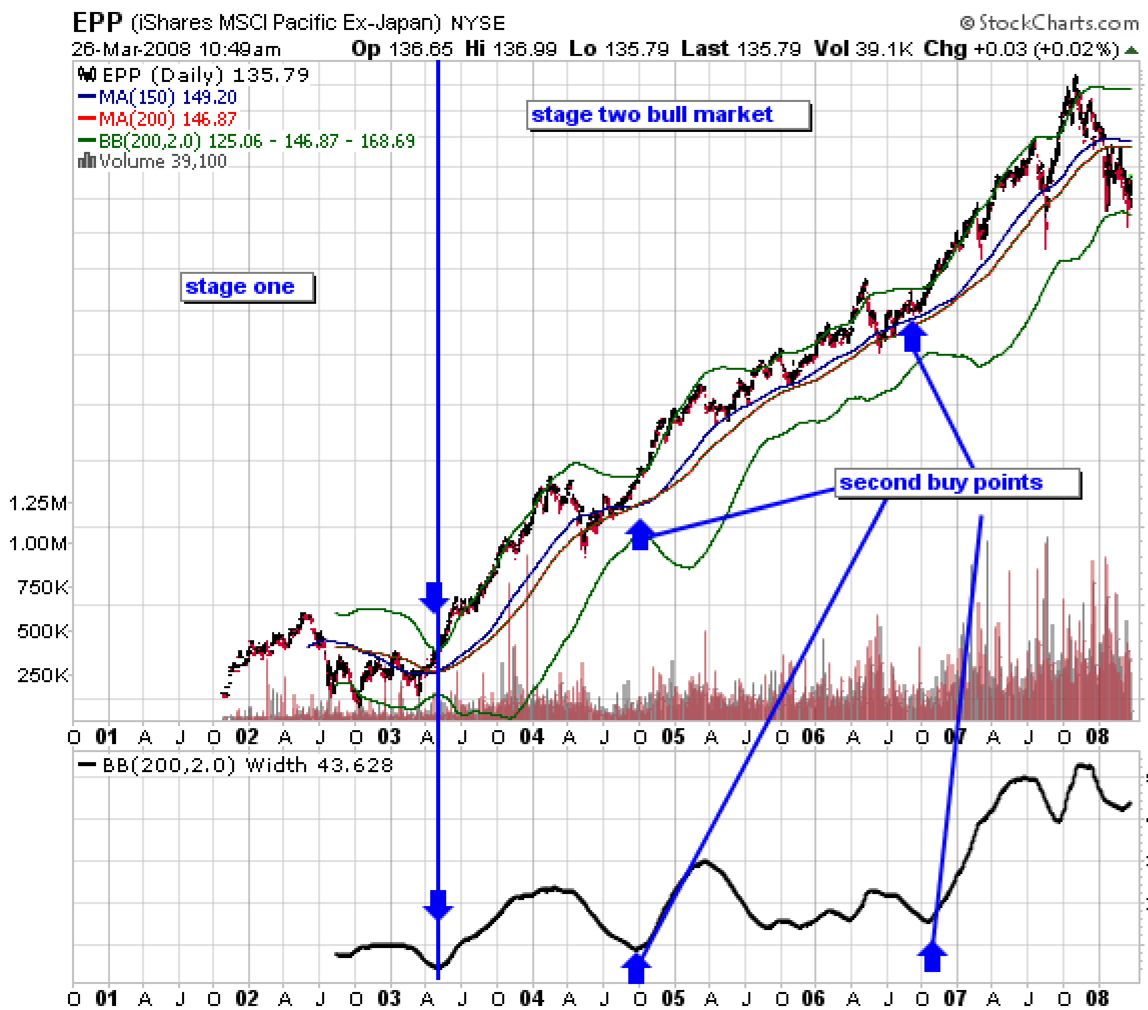

You can tell when a stock or market goes from stage one into a stage two bull market by watching its long-term 150 and 200 day moving averages.

As a stock goes through a stage four decline these moving averages fall along with price. During stage one these averages form a bottom. They then either go sideways for a long time or begin to turn up. Which happens depends on how long the stage one period lasts.

As stage one nears its end the price of a stock or market will go above these moving averages. They then usually form a base before breaking out into a full stage two bull market advance.

For instance in the EWG exchange traded fund, which tracks the German stock market, stage one lasted from October of 2002 and June of 2003. During this time the price formed a double bottom and then launched a rally above the 150 and 200-day moving averages as the German stock market began a new bull market.

Markets that transition from stage one to stage two with fast rallies like EWG had can be tricky, because the transitions happen so quickly. It can be difficult to spot such markets right before they make their transition. However, by using a combination of the moving average analysis like in the example of EWG and the 200-day Bollinger bands you can easily detect markets that are making the transition from stage one to stage almost to the exact moment.

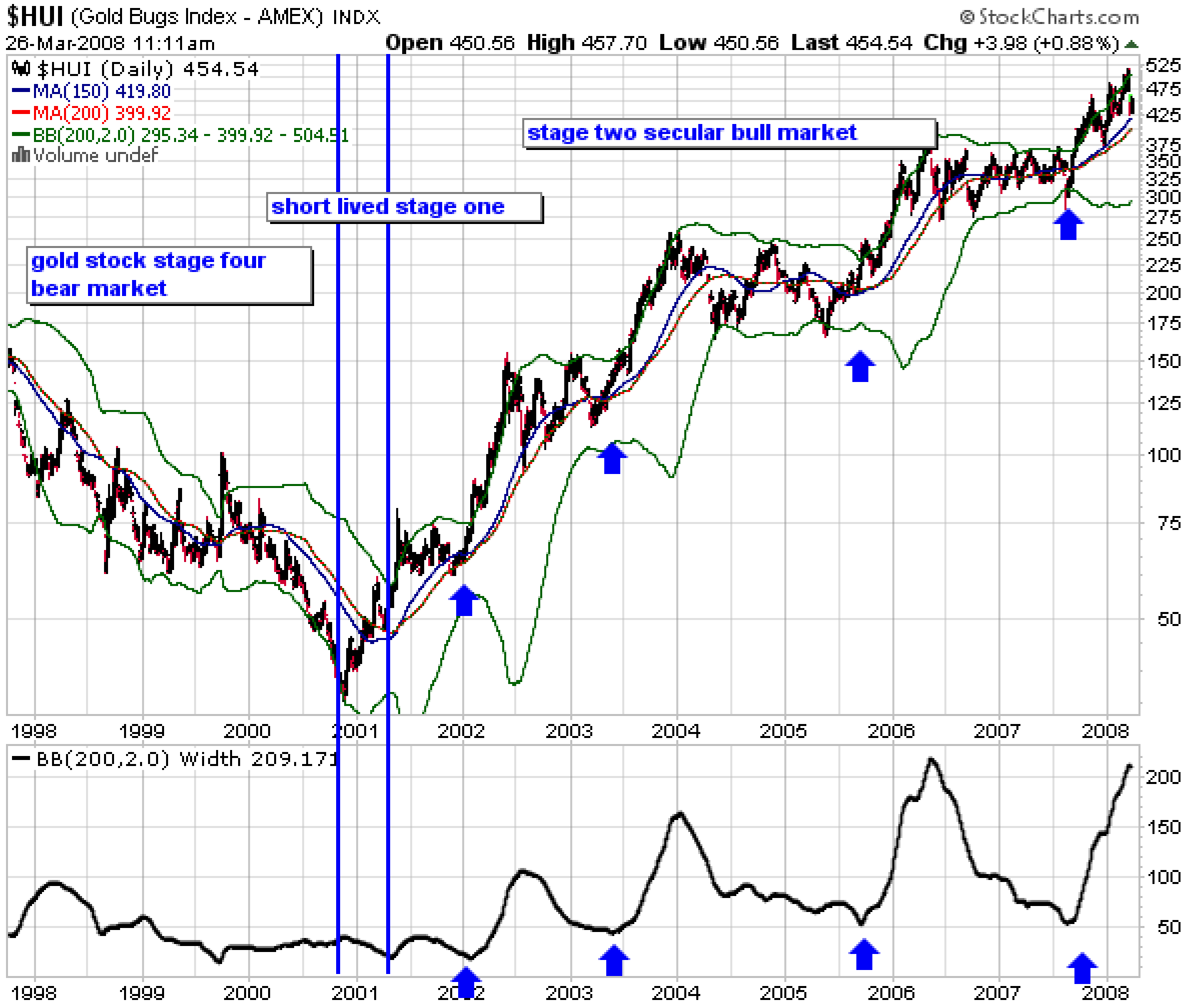



Remember Bollinger bands measure the volatility in a stock. For a recap of Bollinger bands go back to the Magic Indicator ebook. Most of the time I use short-term 10 or 20-day Bollinger bands on a daily chart, but when I want to look at the long-term trends, which is what I focus on to find markets or stocks going from stage one two stage two, I use an analysis of the moving averages and the 200-day Bollinger bands.

The distance between the 200-day upper and lower Bollinger bands narrows during times of long consolidation in a market or stock. When this happens after the 200 and 150-day moving averages have been trading flat in a stage one base it almost always signals the approach of a new stage two bull market. It is at this moment that I look to buy the ETF that tracks the market or individual stocks that make up the market or sector about to make the transition into a phase two bull market.

For example this occurred with EPP, an ETF which tracks the Pacific Rim markets, in the spring of 2003. This stage two bull market continued until the summer of 2007 when EPP appeared to begin a stage three top. As of the time of this writing the moving averages for EPP have flattened out. If they start to turn down they will display all of the characteristics of a stage four bear decline.

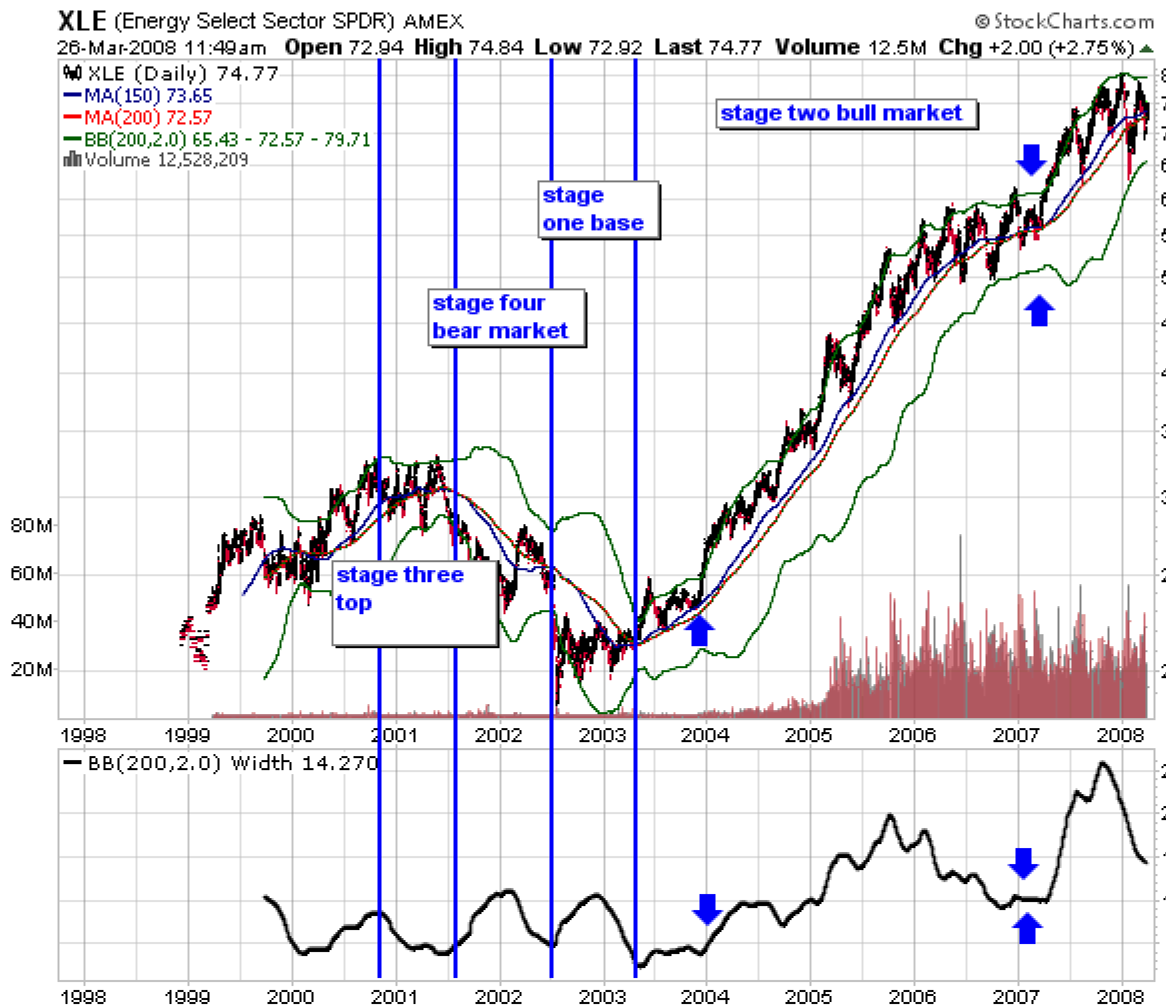
If you'll notice the 200-day Bollinger bands for EPP also narrowed in August of 2004 and August of 2006. During long bull markets you often see short-term periods of consolidation during the long-term bull trend. These consolidation periods can be used in conjunction with the 200-day Bollinger bands to provide additional entry points if you did not buy during the start of the bull stage or wish to add on to your position or find an entry point for a short term trade. I'll discuss buying during stage two later in this report. For now let's look at a few more examples.




The HUI gold stock index was in a bear market until it bottomed in 2000. It then went through a very short lived stage one base for less than a year. As you can see during this time the 150 and 200-day moving averages bottomed out. Once they turned up at the end of 2001 the gold stocks began a secular bull market.

I actually bought my first gold stocks in 2002. Remember the longer stage one lasts the easier it is to spot the transition from stage one to stage two. We have since seen the 200-day Bollinger bands narrow and give three buy signals during this bull market, the last one at time of this writing being in the second half of 2007. These other buy points can also make good entry points.


The 200-day Bollinger bands for the EWG German market ETF have also given multiple buy signals. Since its stage two bull market began in 2003 the 200-day Bollinger bands have given three long-term buy signals.




The 200-day Bollinger bands do not always give so many buy signals in a long-term secular bull market. For example take a look at XLE, the Energy sector oil stock spyder ETF. In 2003, around the time of the start of the Iraq war, it completed a transition from a stage one base to a stage two secular bull market. That bull market has been going on for over five years and the 200-day Bollinger bands have only given two buy signals since it started.

It is rare for a bull market to go on for that long and give so few long-term buy signals. Unfortunately when it does happen it happens in the most powerful and strong markets.

Luckily there are other tactics that I use to make entry points for a shorter time frame. Using the 200-day Bollinger bands for entry points is conducive for a strategy of buying and holding in which you place up to 20% of your account into a sector and ride out the bull market until signs point to a stage three top or the beginning of a stage four bear market. It is almost impossible to get out at the exact top of a bull market, but by waiting until the 150 and 200-day moving averages make a top and began to curl down you can get out near the top and before a stage four bear market begins. If you bought at the transition from stage one to stage two and sell when stage four begins you'll make massive profits and even have them taxed at a lower long-term capital gains rate.

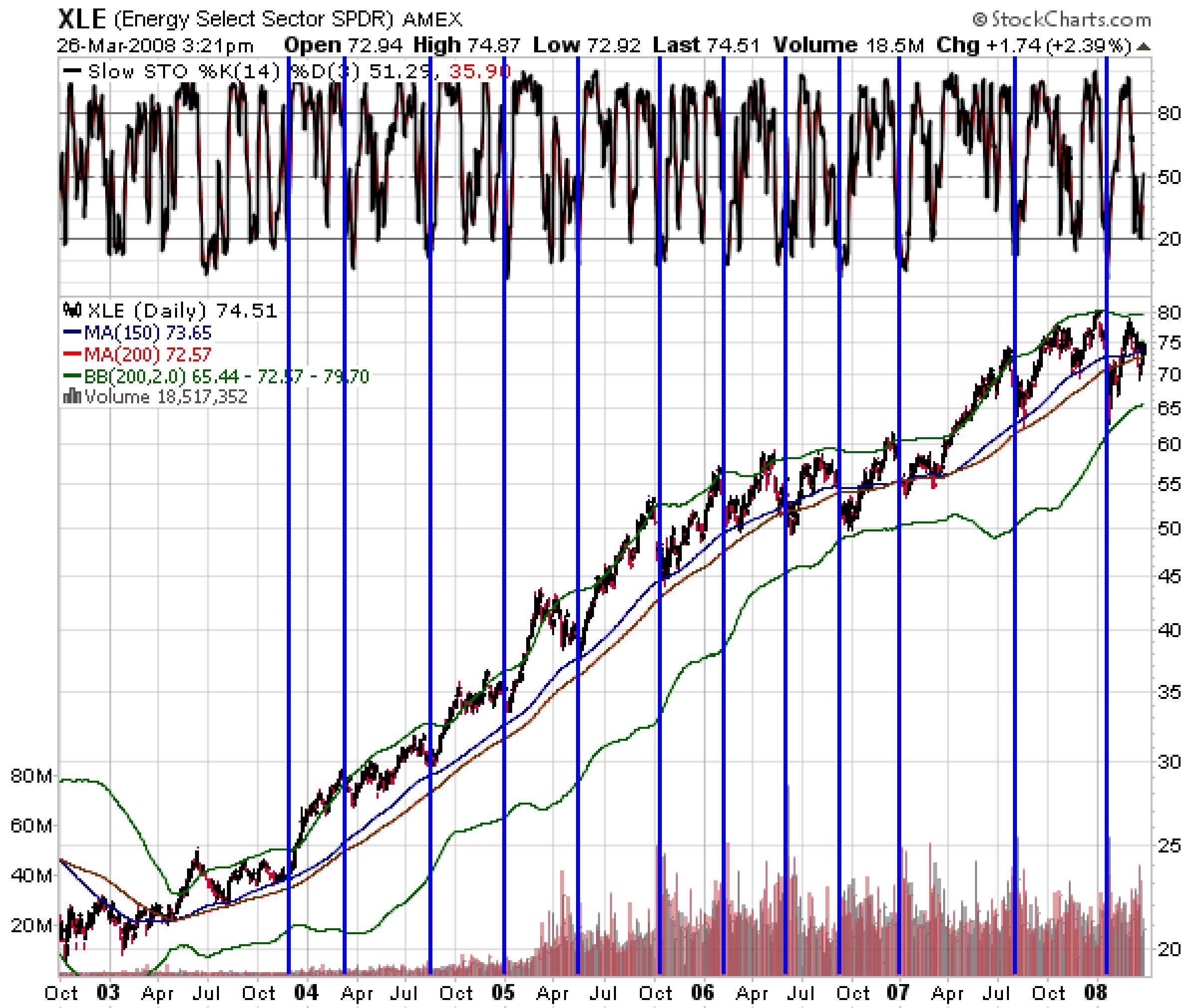
I advocate investing only 20% in a long-term position, because anymore than that and it becomes very difficult psychologically to hold through the fluctuations. You can use the rest of your money by diversifying into other sectors or by using a portion of it for short-term trading instead of just long-term buying and holding. This is what I do. If taking a low risk approach is more appropriate to you then you may simply want to place the bulk of your assets in interest bearing securities and use remaining for long-term buy and sell points in the more volatile stock market.

There are tactics I use for shorter term trading(typically a holding period of 3-8 months) that I will outline to you now. These tactics can also be used to buy into a bull market if you didn't buy right at the transition from stage one to stage two. These tactics are designed to take advantage of short-term pullbacks in a long-term phase two secular bull market.

Taking into consideration the long-term 150 and 200-day moving averages is still key when looking for shorter term buy points. If you look at all of the examples so far you'll notice that both moving averages tend to act as support during stage two bull advances.

This is normally true of all bull markets and doesn't matter if you are analyzing markets, ETF's, sectors or individual stocks. During markets prices rarely go below their 150 and 200-day moving averages for longer than a month. If they do then it is usually a sign that the market has entered the stage three topping process or is even in a stage four bear decline.

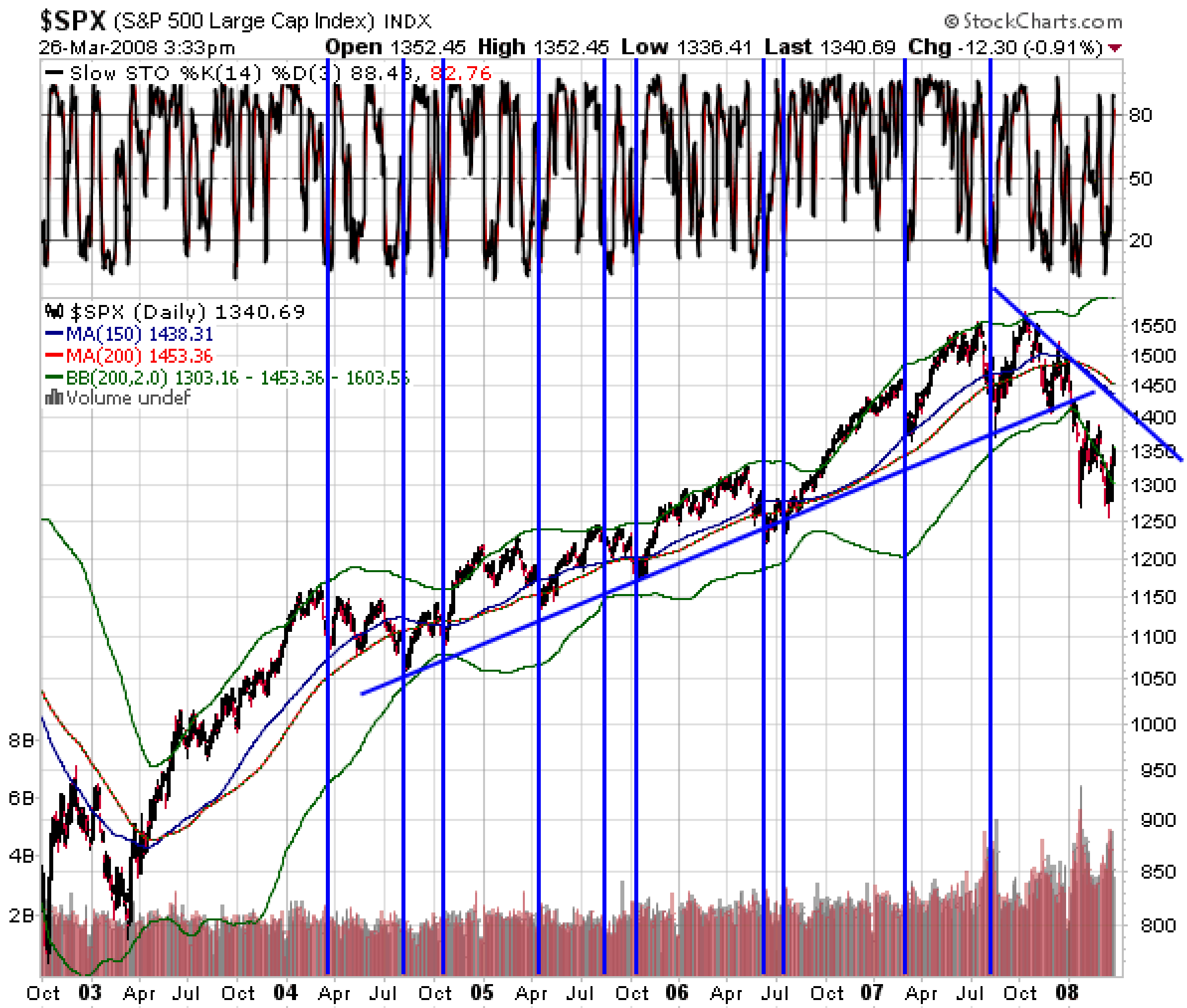
This makes the 150 and 200-day moving averages good places to consider taking a position on a pullback. For buy points in stage two advances I look for buy signals from the stochastics indicator after the market has pulled back around these moving averages for entry points.




For instance if you take a look at the XLE energy ETF, although the 200-day Bollinger bands have given only two buy signals since 2003 and 2008, the daily stochstics have given 12 buy signals by falling below 20 and then crossing back above 20 while the price of the XLE either got near its 150 and 200-day moving averages or briefly fell below them. Such buy points usually occur 2-3 times a year in long-term stage two bull price advances. If you don't know what stochastics are or need to brush up on them go to the Magic Indicators ebook for a discussion of them.

Some sectors, such as gold stocks, also have other indicators and market relationships that are useful in making entry points.

For gold stocks for instance the performance of gold stocks versus the metal is useful to gauge when making buy or sell signals, but this method of using the stochastics and the long-term 150 and 200-day moving averages is basic to all markets and stocks.




Stochastics will give you several buy signals a year for most markets when they are in long-term stage two bull uptrends. For instance from the S&P 500’s bottom in 2003 to its top in October of 2007 the stochastics gave oversold buy signals by falling down below 20 and crossing above it while price of the S&P 500 was near its 150 and 200-day moving averages ten times.

By late October the 150 and 200-day moving averages began to curl down, which was a clear warning that a bear market was beginning and indeed I made note of this in WSW Power Investor time after time between late October and early January 2008.

Remember stochstatics are used to identify oversold points during bullish uptrends. They will not give you reliable buy signals during stage four downtrends. They are not an indicator that you can use by itself. All indidactors must be combined with stage analysis of the market or stock you are applying them to in order to be useful. Many people get carried away in trying to find a group of indicators that can make all of their decisions for them. The market doesn't work that way. Stage analysis is always key and has to be done by you by looking at the trend of the market you are following and the activity of the long-term 150 and 200-day moving averages. So called "black box" programs and software that promises to pick winning stocks for you does not work, because none of them incorporate stage analysis.

Once a position is initiated during a short-term correction in the market two decisions must be made. First an initial stop must be placed on the position to protect yourself in case the market actually falls further and the correction turns into a stage four decline.

Barring that a second decision must be made on when to sell and take profits. For me that depends on how long we are in the stage two advance. If it is the beginning I am more apt to give my positions more time and room. If it is late in the game I am much quicker to take profits.

To do that I use a combination of indicators and methods, including support trendlines connecting the lows of the ETF or stock that I own, stochastics, and resistance points. I have 3-8 month holding periods for most of these positions. If the daily stochastics, and in some cases weekly stochastics - if the positions are not volatile or if I am early in the stage one advance, enters overbought territory I often take profits. I'll then wait for a correction that brings what I sold back into oversold conditions again or take my money into another stock, market, or ETF that is ready to advance. The buying and holding for me is done in the 20% core investment positions. The goal of short-term trading is not to sell out at an exact top, but to take a position, get a nice gain, and then repeat the process again by buying back what you sold on a correction or to make a gain in something else providing a good entry point.

Since I focus on both the short-term and long-term trends in WSW Power Investor it is suitable for both investors and traders no matter what their time frame. In fact the WSW Power Investor service has bulletins on a daily basis to aid people who do 2-5 day swing trades. In my report The Secret to Daytrading I explain how these same indicators can be used to put together a method for 2-5 day swing trading. Even if you do not plan on trading with that small of a time horizon the principles used are helpful to apply to long-term investing and especially the type of shorter-term(3-8 month) position I've discussed in this report. In fact they will help you make pin point buy points no matter what time horizon you have.