

Dealing With Stocks In Long-Term Trading Ranges

**Portfolios heavy
with
under-
performing
stocks almost
never
outperform the
market.**

Ignat's Law

**“Buy at the bottom
of the trading range
and sell at the top of
the trading range.
Remember, it can
only breakout once!”**

Mr. P. Marble

**An accomplished
speculator I met
years ago in Denver,
Colorado**

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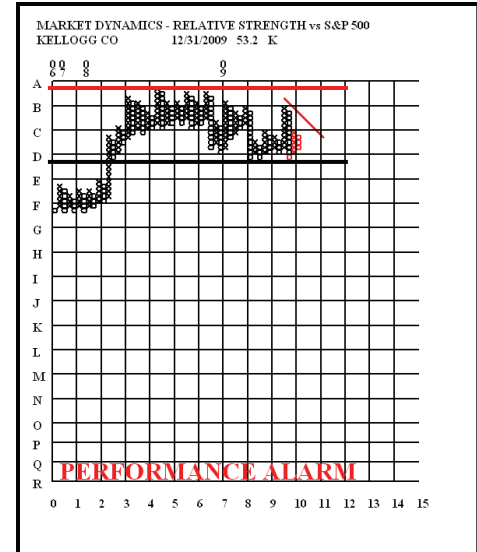
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Experience shows that there are three kinds of trend behaviors among stocks. There are about 30% in strong up trends and about 30% in strong downtrends and the remaining 40% are in sideways trading ranges. It is critical for an investor to know how his stock is trending or perhaps, not trending.

Trend following methods should be used on stocks in strong trends, either up or down. But for stocks in trading ranges the investor should focus on historic support and resistance levels. A resistance level develops when the buying diminishes and the selling increases causing the stock's short term trend to turn down. Conversely, a support level develops when the selling diminishes and the buying increases and the short-term trend turns up.

It is amazing how frequently these reversal levels match up. A stock in a trading range will show the upper and lower boundaries of the trading range on a long-term chart. The recognition of these historic support and resistance levels is essential when dealing with trading range stocks.

It is best to use charts that show at least four years of history to be able to observe support and resistance levels from a few years ago. It is amazing how many times a support or resistance level from three or four years ago will influence the current behavior of the stock. Experience also indicates that historic support and resistance levels show up very well on the long-term charts of relative strength. It suggests that the



long-term point and figure charts of relative strength are actually measuring relative values in a general sense.

The horizontal movement of the stock whose chart is shown above clearly shows a trading range that has persisted for almost two full years.

The stocks that show long-term trading ranges most frequently are the stocks of large, mature businesses that do not show dynamic changes in their financial performance from year to year. These stocks tend to dominate the capitalization weighted S&P 500 index. Their relative strength charts do not often show big trend movement versus the S&P 500.

The best approach to dealing with trading range stocks is to observe when the stock reaches the upper boundary of the trading range and to sell at that point. Conversely to buy at the low end of the trading range.

Investors must recognize that a stock can breakout from a trading range and the position should be reversed at that point. The probabilities suggest that the trading range will continue to dominate the behavior of the stock but breakouts can and do occur, so be prepared.

W. Clay Allen CFA