

>: Finding Entry Points in an Uptrend. Buying on a pullback...

Thursday, October 4, 2007 | Chris Rowe

Members of [The Trend Rider](#)

made big profits by taking bearish positions before and in the very early stages of the recent correction. At the bottom of the correction, we went bullish on certain positions, some of which moved 40% - 50% higher in about a month.

There are SO MANY reasons to be bullish right now, it's scary. But at the same time, you want to stay calm and not be emotional. You want to buy at the right price, not chase stocks (or call options) higher, right?

It's hard to be patient when the market is gunning higher, isn't it?

What you want to do is to buy the strongest stocks within the strongest sectors *-but you want to buy them on a pullback*

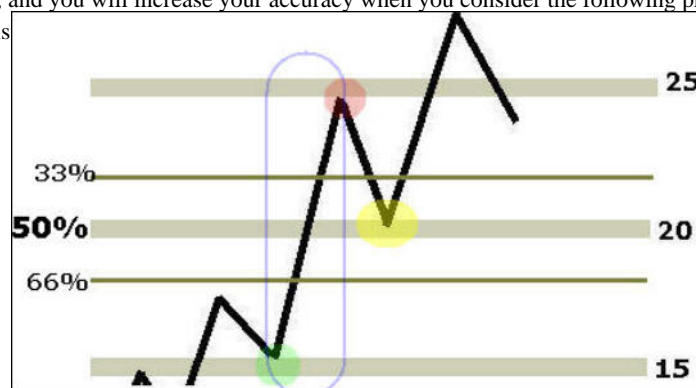
. But how do we know how much a stock is going to retreat before its next advance?

There are a number of ways, most having to do with past support levels, many in the form of popular [moving averages](#) and [trend lines](#)

. I have a number of simple indicators that I use to decide what to trade and when.

But today I'm going to go over one of the most basic "Technical Analysis 101" principles that will lay down a foundation for understanding how far a stock is likely to retreat before the next bull run.

Don't forget, these are just the basics, and you will increase your accuracy when you consider the following principle in conjunction with identification of past support and resis



You always want to trade in the direction of the trend. And a trend is obviously a series of zig-zags. These zig-zags obviously move in the direction of the trend and then retrace before continuing in that same direction. (Like I said, technical analysis 101.)

While secondary parameters are set at 33% and 66%, the most common percentage retracement before resumption is the 50% retracement.

I know, this might sound absolutely crazy if this is your first time hearing it, but if you look at a bunch of stock or index charts after reading this article and apply these percentage retracement principles, you'll be absolutely amazed!

The way that traders use this application, for example, would be to look for approximately a 5-point retracement after a stock advances by 10 points from a low to a new high (because 5 points is 50% of the 10-point gain).

So when a stock trades 10 points higher from \$15.00 to \$25.00 and then reverses lower, traders would look for support around \$20.00.

Again, this is certainly not a strict rule, and the secondary parameters wouldn't have been set near 33% and 66% if it were. In fact, other theories set retracement parameters around 62% and 38% while maintaining the 50% point as the average retracement.

Secondary Parameters

When it comes to retracements, 66% is a *critical area*.

For instance, in the case of an uptrend, if a stock retraces 66% of the recent move and starts to bounce higher again, it's considered to be a

relatively low-risk buying opportunity. But if the 66% retracement area is violated, a reversal of the prior uptrend is very likely.

This is also true in the case of a downtrend. If a downtrending stock retraces about 66% of the recent decline and resumes its downtrend, that area is a good place to sell-short the stock or buy put options. If the downtrending stock retraces more than 66% of the recent decline, then the downtrend is likely to reverse to an uptrend.

But, keep in mind that in a stronger trending stock (or stock market), the retracements are much more likely to be between 33% - 50% of the recent gain. And this is, of course, a strong trending market.

The market corrected by over 10% to oversold levels not seen since the 2002-2003 bear market bottom. A correction like that is incredibly healthy. And the next market advance would likely have stood on weak legs had this recent decline not been so brutal.

The correction shook out lots of weak institutional investors that otherwise would have been quick to take trading profits on every stock market advance, thus adding supply pressure to the market.

So don't be afraid to get bullish, and don't get so crazy that you're chasing stock.

Test this out by staring at five charts, and I bet you'll be shocked (if this concept is new to you). Let me show you what to look for with one example...

Stock Example



- Stock moves from about \$2.20 to about \$3.50 (not counting intraday movement). This is a \$1.30 advance, half of which is 65 cents. The stock retraced by about 60 cents. (This retracement also coincided with the gap higher, which tends to act as the new support level.)

- Stock then moves from about \$2.90 to \$3.25 (a 35-cent move). Fifty percent of that is 17.5 cents. The stock retraced by nearly that amount before moving higher.

- Then focus on the blue box. You can see that after a 50% pullback, the stock gapped even lower, and the trend reversed from an uptrend to a downtrend.

- Between August and September, the stock traded from about \$2.60 to \$3.20 (a 60-cent move), followed by a retracement of about 30 cents.

- Then, if you check out the blue line, the intermediate move was from \$2.90 to about \$4.20 (a \$1.30 move), followed by a retracement of nearly 65 cents.

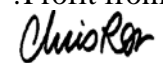
- If you look at many of the short-term retracements and resumptions *within* the intermediate move (blue line), you'll see similar action.

This chart happens to have lots of 50% retracements. But remember the secondary parameters, and try to match them with past established support or resistance levels to estimate retracements.

And remember, this is a very basic principle. I thought I would give you something today that was far from complex. The good news is that other,

more "sophisticated" parameters that traders look for are *just as easy to understand!*

?Profit from the Trend?

A handwritten signature in black ink that reads "Chris Rowe". The signature is written in a cursive, slightly slanted style.

Chris Rowe

Chief Investment Officer

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