



How to Buy During a Market Pullback

Editor: Alexander Nikolov

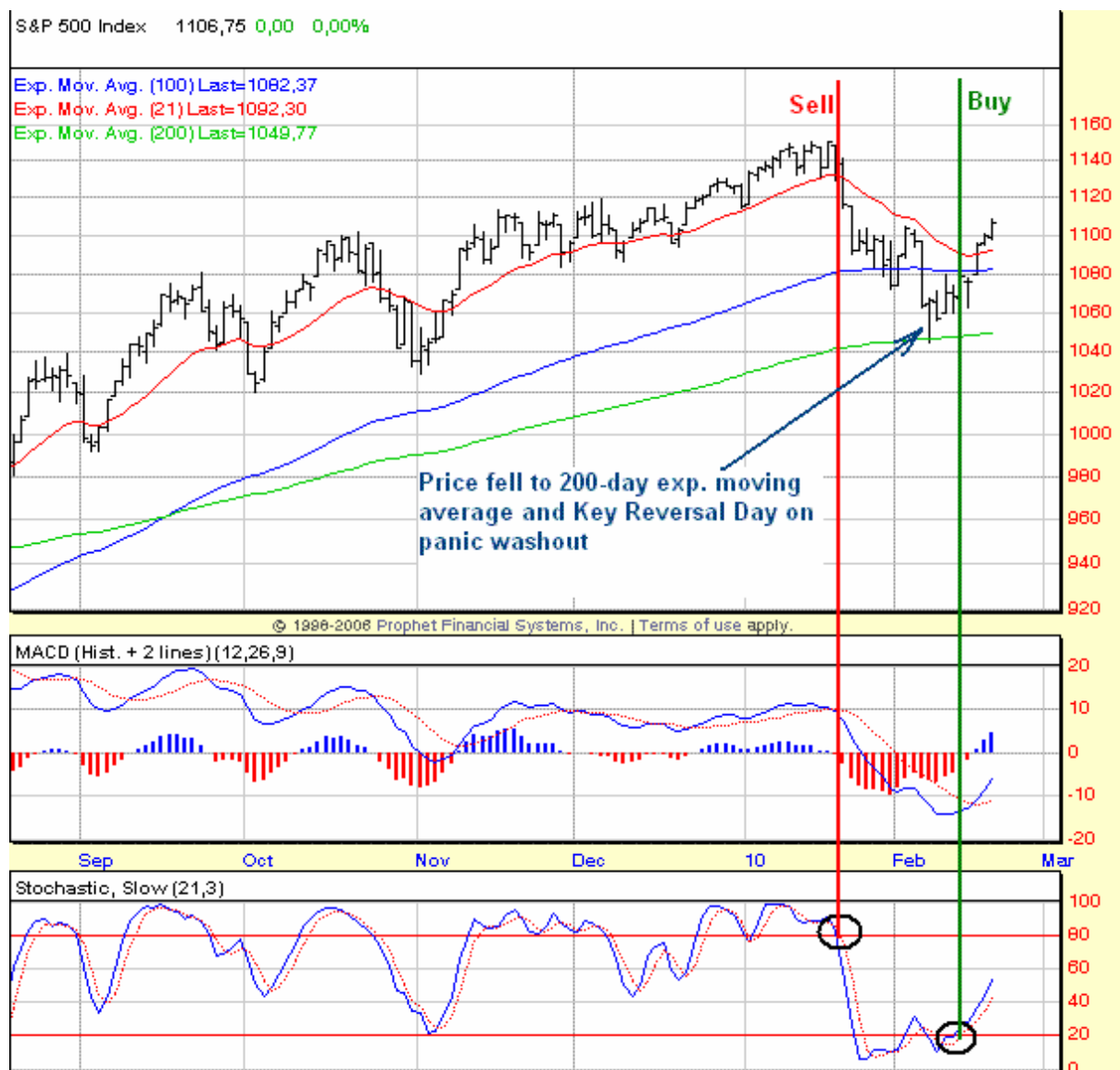
Feb, 22nd, 2010

The article discusses the question when to buy during a market pullback if one believes the larger degree trend remains higher. The problem arises from the fact that you need to find a good entry point - you can't just buy when the market is pulling back from a recent top even if you believe the larger degree uptrend will resume, simply because this larger degree uptrend may not resume. Thus, most of the people actually buy during the early stages of a bear market (believing the pullback is just a temporary correction) and then hold on their long positions as the bear market unfolds. In this article I look at a most recent example (the pullback in the U.S. stock market from mid-January 2010 to early February 2010) to show how one should approach the market and find a good entry point. And then I discuss the question what should one actually buy – a broader market index, a sector index ETF or individual stocks.



The U.S. stock market topped out in mid January this year and pulled back strongly till early February. One of the questions one could have asked during this decline was, when it was time to buy again and the other question was probably what to buy when the pullback was over. Most of the investors don't ask these questions as they are eager to buy and hold their positions even if a bear market is starting. But to be successful on the markets, you need to follow a more disciplined approach where you look for a low risk entry points and then use a proper money management technique. This article describes one approach that can be used to find a good entry point during a market pullback.

The decline in S&P500 in January 2010 after the strong bull market of 2009



Source: www.prophet.net

Let's start with the technical picture of the broad stock market, using the S&P500 index. As the trend on the daily chart was definitely on the upside prior to the January peak, one should assume that the decline that started in mid January was just a Short-Term correction but not a start of a bear market. And even, if a bear market has started, it is plausible to suggest that at least initially the market is likely to find some support as it approaches a key level on the daily chart or a



longer-term moving average (like for example, the 200-day moving average). Going back to the S&P500 case, after the daily Stochastics gave a sell signal in mid January, the market was in a declining mode until Feb 5th 2010. On that day the market declined to its 200-day exponential moving average (the green line on the chart) and then rallied to close higher for the day, thus making a Key Reversal day. Doing so, the market also held above the important 1020 support level (the lows from October and November 2009). This Key Reversal pattern came after a panic sell-off and a spike of VIX (VIX – Volatility Index – not shown on the chart above).

Since the market found support right at the 200-day moving average and above the previous important level at 1020 and spotted a key reversal pattern, one could have started to look for buy signals from daily oscillators. Such a buy signal came few days later from the daily Stochastics. And then, on Feb 16th, the market gapped up above the small chart resistance at 1080 that had been created for the previous several days. So, the market was once again in a bullish mode confirming that a Short-Term low had already been in place.

The next question is, what can we buy if we have a confirmation that the broad market has already made a Short-Term (or at least a temporary) bottom. One way, of course is to buy the S&P500 index itself. This approach has the advantage that you trade exactly the instrument you have been followed. The disadvantage is that if you are wrong, you can lose. Of course, you can always be wrong and lose, but is there a way, in which you can increase the odds of being right in your favor? I think one way to do that, is to find a stock or a sector {using exchange traded funds (ETFs)} that also has a reliable chart pattern but that has been stronger than the market recently. Such a stock or an ETF can rise more if the market indeed goes higher and may not decline a lot if you are wrong and the market turns lower again.

If one had examined the chart patterns in various ETFs in mid February, he/she could have found ETFs that held stronger than the S&P500. One such example is shown on the chart below. The chart shows the pattern in the media stocks ETF (symbol: PBS). You can see on the chart that this ETF pulled back toward a strong chart support at 11.10 (previous strong resistance in October and November last year) but also held above the 100-day exponential moving average. Remember, the S&P500 declined to its 200-day moving average, while PBS (media stocks ETF) only declined to its 100-day moving average on Feb 5th (actually the prices did not even touch this moving average). This fact was a sign that this ETF had been stronger than the market. Once it cleared the small resistance at 11.60 a few days after the bottom, it could have been bought. And as seen, this ETF has been much stronger than the broad market since then and has already made a new high for the year.



The media stocks proved stronger than the broad market indices

PWRSHRS DYNAM MEDIA PORTFOLIO 12,20 0,00 0,00%



Source: www.prophet.net

This is just one example how one can approach such situations when the market has declined to oversold levels on the daily chart and has held above an important support level and then has turned higher. You can find reliable patterns in many sectors or individual stocks but you can increase the odds of being right in your favor if you find sectors or individual stocks that have held better than the market during the pullback. Those sectors or stock are likely to go higher more than the rest of the market once the previous uptrend resumes....



DISCLAIMER

This report is intended for informational and educational purposes only. While a course of conduct regarding investments can be formulated from the presented analysis, at no time will Trend Recognition make specific recommendations for any specific person, and at no time may a reader, caller or viewer be justified in inferring that any such advice is intended. This analysis is not a recommendation to buy or sell securities or an offer to buy or sell securities. The publishers of Trend Recognition website are not brokers or registered investment advisors and are not acting in any way to influence the purchase or sale of any security and/or its derivatives. The data for information provided is obtained from sources deemed reliable but is not guaranteed as to accuracy, or completeness. The use of Trend Recognition services is done so at your own risk.

It is possible at this or subsequent date, the publishers of Trend Recognition may own, buy or sell the securities discussed therein or their derivatives. Trend Recognition or its publishers, are not liable for any losses or damages, monetary or otherwise that result from trading the securities and/or derivatives discussed within the Trend Recognition website. The publishers of the Trend Recognition recommend that anyone trading securities and/or derivatives should do so with caution and consult with an experienced broker and/or investment advisor before doing so.

ANY REDISTRIBUTION of the Trend Recognition website or information published therein, without the written consent of the Trend Recognition, is STRICTLY PROHIBITED.

You can send your opinion or ask questions regarding this report, at info@trendrecognition.com