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'We never ever fight the market'

By Larry MacDonald
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Ron Meisels outlines how technical analysis works

Your first impression of Ron Meisels might be that he is an erudite and kindly professor. He's actually one of Canada's top technical analysts.

Mr. Meisels has served as chief technical analyst at a number of brokerage firms, including a stint from 1982 to 1990 at Nesbitt Thomson (now BMO Nesbitt Burns). Currently he runs the advisory Phases and Cycles Inc., and writes a column for this newspaper.

What Mr. Meisels likes about technical analysis is that it deals with actual behaviour in the market. You are not creating an analytical model and making predictions of what prices should be; you are using the market's own, and likely superior, anticipation of the future - as embodied in prices set by the supply and demand for stocks.

"We take advantage of the 'discounting mechanism' of the market by focusing entirely on the market's interpretation of economic facts, and we restrict to the minimum our own judgment. We never ever fight the market," he says.

This approach is better, in his estimation, because markets are not driven by people rationally weighing all possible data and optimizing their probability functions. Markets are driven by sentiment - the emotions of fear and greed.

This gives rise, for example, to support and resistance levels in stock prices.

"Imagine a brokerage firm underwriting a stock at $30," Mr. Meisels says. "Let's say it then goes down to $20 and comes back to $30. Quite likely there will be a ton of supply at that price because the people who bought at $30 before are thinking they can break even."

One of his tools for identifying trends is the 40-week moving average.

"A 40-week average is the sum of the past 40 weeks' closing prices divided by 40. When this exercise is repeated week after week, this average will 'move' and becomes a 'moving average.' "

When the 40-week moving average is turning up, money is moving in. The discounting mechanism in the market is saying the future looks good - so it's sending a buy signal. Vice versa, when the 40-week moving average is falling, get out of the stock.

The moving average helps avoid false signals. But it won't avoid them all: Sometimes the moving average will flash a buy or sell signal only to have the price turn around and trend in the opposite direction.

So it's important to realize that technical analysts are not perfect.

"We understand that we are in a business of making mistakes. We cannot be right all the time," Mr. Meisels says.

"That's why the key to survival is money management: cut losses short and let profits run. ...

"This is essential. We cannot emphasize it enough. If you are wrong, admit it and get out."

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Cheat sheet on technical analysis:

- Data about price and volume provide signals that help identify and assess trends.
- Trends are often signaled by stock prices breaking out of trading range on high volumes.
- They are also signaled by an upturn in a moving average of the prices. The trend is still in place if the moving average continues to rise.
- Support and resistance levels reveal exit and entry points.