

How to find short candidates

This document was written in October, 2009 by Pascal Willain as part of a training program on the use of the Effective Volume tools.

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The author is French speaking.
This report has not been proof-read for the proper use of English language.

Because of the violence of bear reversals, shorting is often more difficult than taking long positions.

There are some basic rules to follow to short trade:

1. Shorting a new high is forbidden. There is a new high for a reason. Strength attracts strength.
2. It is easier to short stocks that are below their 200MA or even better, when they reverse back up to their 200MA.
3. When locating shorts, it is easier to find them in sectors that have a weak relative strength.

When the 20DMF tells to short, my back-test has shown that the best sectors to short are the weakest in terms of 20 day price strength.

At the close of September 1, the weakest sectors were the following:

September 30, 2009	20-D Price Strength
Agriculture	-3.8%
Car Parts	-3.1%
Cars	-2.9%
Home Builders	-1.0%
Info services	0.3%
Grocery Stores	0.3%
Waste Management	0.6%
Communication Equipt.	0.6%
Utilities	0.6%
Health Care	0.7%
Drugs	0.8%
Restaurant	0.8%
Fertilizers	1.0%
Sftw Enterpr	1.1%
Heavy Constructions	1.2%
Discount Chains	1.6%
Rail	1.9%
Biotech	2.2%
Drugstores	2.4%

The strongest sectors were:

September 30, 2009	20-D Price Strength
Airline	30.3%
Silver	21.8%
Ind Metals	14.3%
Construction Machinery	12.2%
Military	12.1%
REIT Retail	11.8%
Gold	11.2%
Clothing	10.4%
Medical equipments	10.2%
Data Storage	10.2%
Leisure Serv.	10.1%
Medical SW	10.0%
Coal	9.9%
Banks Foreign	9.6%
Gold Canada	9.5%
Solar	9.4%
Oil Sands	9.4%
Oil Services	9.3%
Copper	9.2%

The next step is to list all the stocks in the worst sectors (for example I took the seven worst sectors) and rank them by "Thrust"

The "thrust" is defined as the level of TEV for the last trading day compared to the average of the absolute value of the TEV of the past 10 days.

For example, TOL shows a thrust of -2.13. This means that TEV was negative yesterday and the force is 2.13 times higher than the average force of the past 10 days.

Even if this concept of "thrust" works well for short trades, it works still better to buy oversold stocks when the market reverses from an oversold condition.

SECTORS	Stock	Strength Aver Tot EV	Thrust
Home Builders	TOL	87%	-2.13
Cars	TM	81%	-2.11
Communication Equipt.	NOK	0%	-2.03
Cars	F	3%	-1.90
Car Parts	ORLY	97%	-1.70
Communication Equipt.	RIMM	40%	-1.59
Home Builders	PHM	93%	-1.55
Agriculture	ADM	82%	-1.35
Communication Equipt.	HRS	100%	-1.29
Car Parts	PBY	3%	-1.13
Grocery Stores	KR	100%	-1.08
Home Builders	LEN	87%	-0.98
Home Builders	KBH	66%	-0.92
Waste Management	WM	99%	-0.88
Grocery Stores	WFMI	100%	-0.65
Agriculture	SYT	0%	-0.56
Car Parts	AAP	0%	-0.40
Communication Equipt.	CSCO	100%	-0.39
Communication Equipt.	CIEN	100%	-0.37
Waste Management	CLH	10%	-0.28
Communication Equipt.	TLAB	30%	-0.25
Communication Equipt.	IDCC	26%	-0.20
Home Builders	DHI	76%	-0.19

Below is also a list of the 20 worst negative "thrusts". You will find here stocks that might be in trouble.

Of course, you will need to look at these one by one and see why they might be shorted.

My preferred way for shorting is either by buying an inverse ETF, or if it is an individual stock, by waiting for the stock to reverse back up into resistance after a first selling wave.

SECTORS	Stock	Strength Aver Tot EV	Thrust
Rail	GSH	0%	-4.66
Heavy Constructions	PWR	0%	-4.36
Steel	STLD	40%	-3.45
Telecom Foreign	TNE	100%	-3.33
Internet	SVVS	66%	-2.97
Rail	BNI	40%	-2.93
Sftw Enterpr	NOVL	95%	-2.92
Pipe Lines	SE	94%	-2.92
Biotech	BIIB	98%	-2.79
Food	BMS	47%	-2.77
Drillers	OII	100%	-2.75
Semiconductors	OVTI	100%	-2.70
Telecom Wireless	TKC	96%	-2.65
Steel	X	95%	-2.63
Utilities	NU	89%	-2.55
Aerospace & Defense	ERJ	89%	-2.50
Paper products	MWV	95%	-2.47
Utilities	SWX	51%	-2.46
Paper products	ARA	90%	-2.46
Telecom Foreign	BT	99%	-2.42
General Machinery	IR	81%	-2.40
Semiconductors	MU	99%	-2.34
Sftw Desktop	RHT	79%	-2.31
Finance-Services-Misc	MA	34%	-2.31
Biotech	MDVN	8%	-2.30
Drugs	BMJ	100%	-2.22
Restaurant	DRI	100%	-2.22
Steel	MT	15%	-2.18
Pipe Lines	WMB	0%	-2.16
Home Builders	TOL	87%	-2.13