

How to use the EV-AB combination for different types of stocks

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.

There are many different types of stocks that could be in different stages in their development. I will compare here only two types: the rising star "leader" and the fallen angel "junk" stock.

Since I had a question on FUQI, I will take that example for the "leader" and CEPH will be our "junk". We suppose that we are only interested in playing long and that we do not care about the general economy and the general market movements.

It is therefore an "out of context" technical analysis. Let's first look at the long term patterns of these two stocks.

FUQI (Chinese jewellery chain) was noticed in March and jumped in three stages to today's situation. We are now in a falling wedge after having experienced two weeks of strong selling during September.

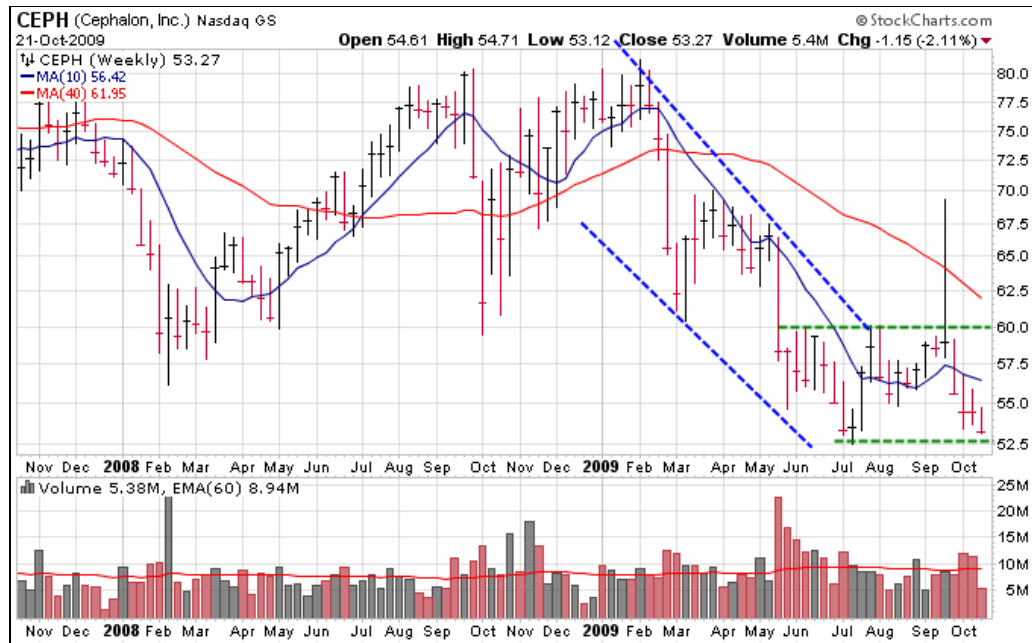
The question is: are we going to move down or are we consolidating the uptrend before launching to a new upwards move?



CEPH (Biopharmaceutical) managed rather well the 2008 crash and started falling sick when the market decided to reverse up.

The stock is now in a -green- trading range after a long fall -blue trend- that pushed it below its 200day MA (40Week MA).

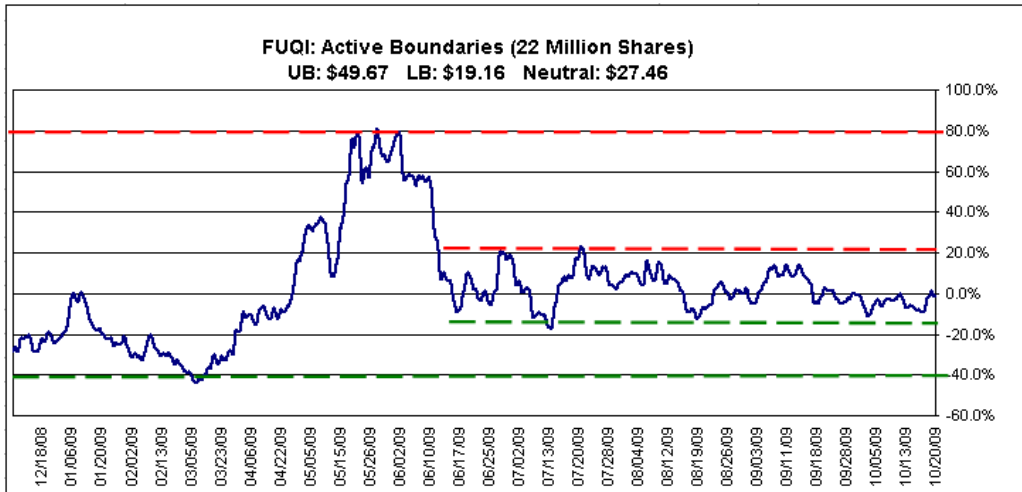
The question is: are we going to break the green trading range to the downside and resume the blue downtrend, or are we going to move back to the \$60 level?



Let's have a look at the Active Boundaries/EVpatterns for both stocks:

For FUQI, we can clearly see a first strong push that brought AB to the 80% limit, followed by a slower up-trend whose Upper Boundary is 20%.

This AB figures tells us that we have a potential to reach 80% gain again (\$49.67), but the stronger probability is that we will reverse down when reaching the 20% limit. A 20% Upper Boundary would give us a target of \$32.5 from yesterday's close.

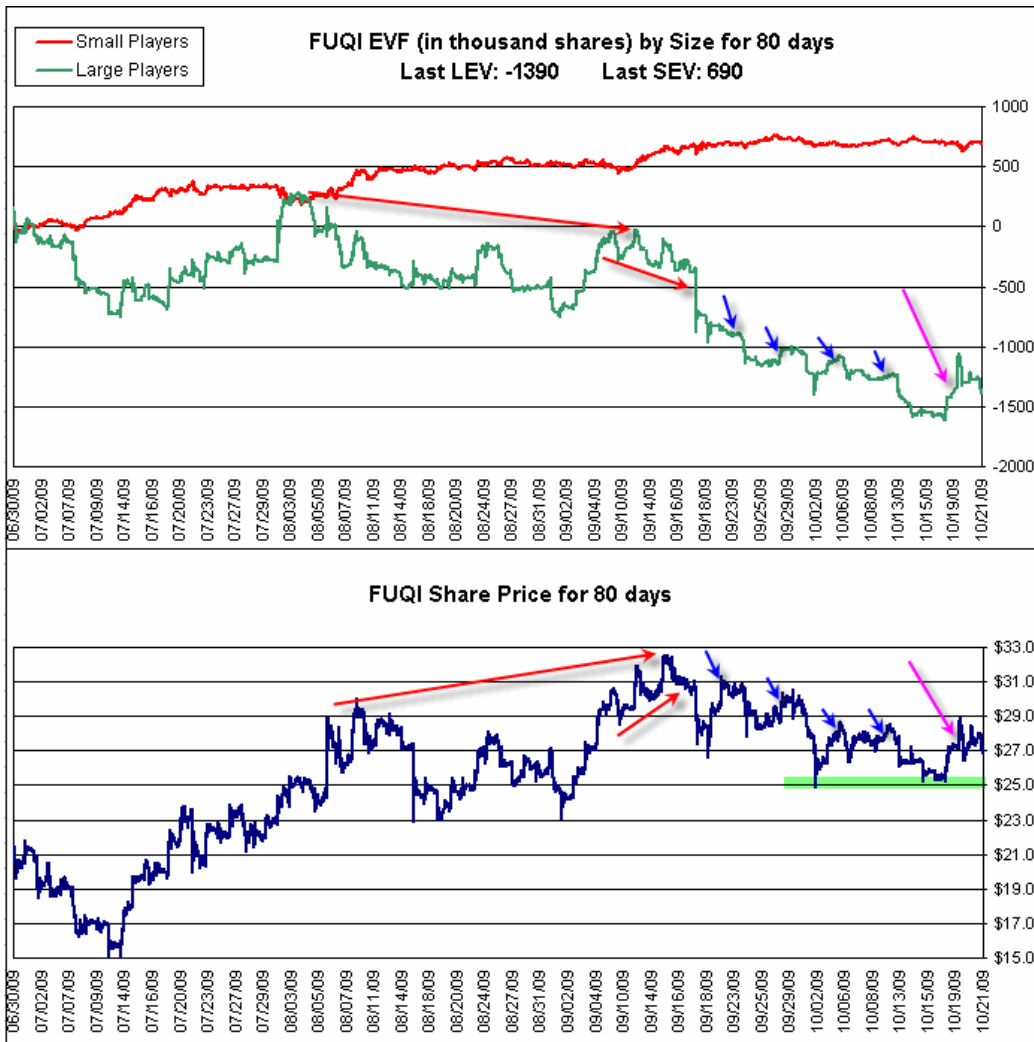


We can see below the LEV pattern for FUQI. FUQI is a volatile stock with two characteristics: A high short interest level (30% of the float) and a quick shares turnover (35 days). This means that the stock could move very fast from one situation to the next and reverse as fast. For this type of stock, I am not looking at the LER (Large Effective Ratio) level -which compares the actual accumulation level to past accumulations-, because shareholders are changing too fast for a meaningful comparison. What I am looking is first to see if the price is back to a value zone. If this is the case, then I will look at possible changes in the LEV pattern that would indicate a coming trigger - which would be amplified by shorts covering activity.

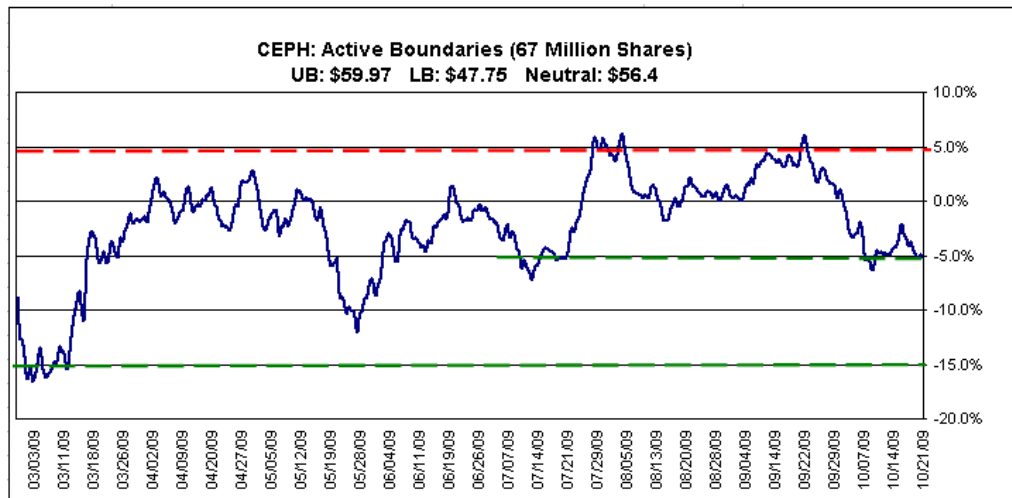
In the figure below, we have three sets of arrows:

- The red arrows are warnings that higher prices stopped attracting more buyers. It does not mean that the stop will drop and that we should short it. It means that there might be a problem developing there.
- The blue arrows allow to judge if buyers are coming in. Each price reversal occurred with fewer buyers. This is not the sign of a reversing situation.
- On October 19 however, we have a "stronger" set of large players coming in. The stock had successfully retested the \$25 price and was showing to be ready to reverse.

In summary: you buy a leader when it pulls back to value and when a good trigger appears.



CEPH also shows different sets of boundaries: the long term Lower Boundary indicates that we might drop another 10% from here, while the short term Lower Boundary shows that we should reverse back up from here. In both cases, the potential gain is limited to about \$60 from the current price of \$52.5



We can see that CEPH is close to a support zone, while LEV is strongly trending up. How strong is it? The LER figure indicates that LER is above its historical peaks average. In other words, today, CEPH is in the best possible conditions for someone who wants to take a long position in a "junk" stock. It will however rise slowly due to the large resistance overhead and it has a mere 12% potential gain.

In summary: you buy a "junk" or a standard not leading stock when it reverses from its Lower Boundary and if large players have been accumulating positions for some days (especially in terms of LER).

(LER: Large Effective Ratio: it is the ratio between LEV and the total volume exchanged during the analysis period of 3 to 5 days. LER is used to "quantify" LEV compared to historical values)

