TRADING ROOM

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Chart tells story of sentiment shift

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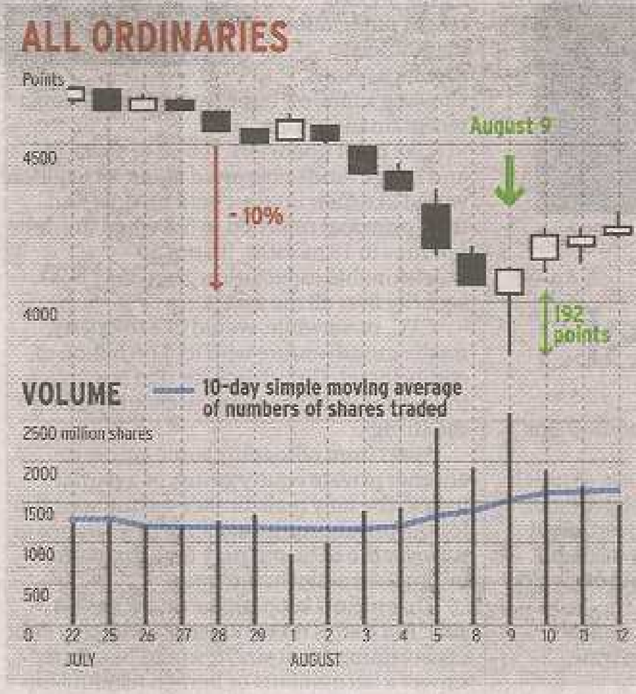
SHAREMARKETS, in the short term at least, tend to be driven more by emotion than reason, with fear and greed traditionally identified as the main psychological drivers.

Robert Brain, a director of the Australian Technical Analysts Association, says the power of psychology at work has been evident in recent times.

"After suffering heavy losses, many retail investors feel they can't take any more, and they sell their stock as the market and stock values plunge to severe lows," he says. "While they do this, more astute investors take the view that prices are cheap enough to buy, so they accumulate stocks at bargain prices."

For confirmation of this we can look at the attached chart — a daily price chart of the All Ordinaries Index. This shows that in five days from August 1 to 5 the market fell more than 10 per cent. The down days are marked by the black candlesticks on the graph.



The daily volume bars in the lower portion of the chart are also significant. They show that volumes were heavy, sometimes as much as 2 billion shares traded on those down days. The blue line on the chart, the simple moving average of share trades, was pulled upwards by some big-volume days.

The strong price move down on high volumes over those five days seems to indicate that investors were panicking and dumping stock. There was then an interesting change in investor psychology.

Look at the candle for Tuesday, August 9. This is known to technical analysts as a hammer candle pattern. Its long tail with a white cylinder (which indicates a rising price) on top demonstrates how the market made its dramatic turn. The long downward-pointing tail shows that sellers were aggressively selling stocks at lower and lower prices in the early part of the session. But buyers then decided that the doom and gloom was overdone and they entered the market.

The sellers had pushed the market down 192 points by the time the buyers started to flex their muscles. Remarkably, the buying sentiment was so aggressive that the market made up all those losses and more, closing up 75 points on the day. The vigour with which the buyers entered the market is demonstrated by the high volume bar for that day, with more than 2.5 billion shares changing hands.

So where to from here? Mr Brain observes that the chart pattern this month usually accompanies an upturn from a bear market because it indicates a profound change in sentiment. However, given the massive uncertainty in world markets, it could also indicate a market taking a breather before another down leg.

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