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Reading stocks the 'price action' way

That's one of the investing principles trading coach Mirriam MacWilliams teaches. GENEVIEVE CUA finds out more about her investing methods

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AT a dinner party at the height of the dot-com rage, trader and trading coach Mirriam MacWilliams recalls meeting an accountant who revealed that she was retiring, thanks to a stock account that had ballooned to nearly US$2 million in value.

Mirriam MacWilliams: "I don't want people to focus on the news at all. Just focus on what you see happening on the stock. Believe that price action dictates everything.'

'I told her you might want to liquidate, make some investment in real estate ... She did not. All that money was tied up in Cisco Systems.' The long and the short of it was that the entire capital disappeared in the aftermath of the bear market that ensued.

The devastation of dot-com bust started Ms MacWilliams on a journey to discover why people were losing so much, and how they can be helped. She was then - and still is - the national education director of the US Stock Investors Club. She began to visit other clubs across the US.

'People were losing money because they were buying stock that they already own and wanted to average down. Or, they didn't own the stock but they remembered that at some point the stock was US$200, and now it's $100, so it must be a great buy - not expecting the stock to go down to US$10.

'People also did not place stop-losses on their positions. We decided we needed to do something to help members preserve their capital.'

She eschews the 'buy and hold' mantra. But of equal or greater disservice is the common practice of buying more shares on the way down to 'average down' your purchase price, she says.

Ms MacWilliams is one of several trading coaches on the seminar circuit here. You may have seen her ads touting her feat: She made US$2 million in two years. That occurred some eight years ago when she began a second career as a full-time trader, after quitting a regular job with a Coca-Cola bottler. She began to invest almost at the tail end of the US bull market in 1997, and claims she also made money as stocks plummeted through 2000 and 2002.

Preferred instrument

Her preferred instrument is options - and that's not surprising. The majority of investing seminars here centre on options. The latter's inherent leverage allows you to reap handsome returns on a fairly modest capital. But options themselves are not riskless, and some strategies can be very risky.

While Ms MacWilliams' ads may provoke scepticism, some of the principles she espouses are sensible, even if you don't believe that anyone can trade with any consistency. For instance, she tells people to practise through virtual trading before beginning with real money. And, never trade with your entire capital, but put only a fraction to work.

She spent a year studying how to invest before making the plunge. Her own US$2 million feat began with US$10,000 in capital. This grew to US$22,000 in less than a month with Home Depot stock as the underlying.

'I wanted to quit my job, but my husband was frightened. He said - can't you wait until you can do it again?' So, she took US$18,000 of the capital and invested in more options contracts, this time linked to Yahoo. 'At that time, I watched a little news - which I don't do today. I understood they were being added to the S&P 500 and that's a prestigious thing.' The US$18,000 grew to US$75,000. And so on.

At some point as her net worth grew, she became less comfortable investing large sums. She took the profits and invested in properties.

Ms MacWilliams teaches people how to read the 'price action' of a stock which reveals potential price targets. She also teaches a 'simple mathematical formula' to show the potential return at the point of entry, and a calculation for stop-losses. Beyond what the charts may show, an important indicator on the upside is the buy volume which must indicate institutional support for a stock. Volume, however, may not be indicative of potential selling pressure on the downside, as institutions tend to sell stocks quietly at first, before selling escalates.

Inherent in all this is the assumption that prices follow certain patterns. 'When you understand that the market is extremely predictable, and the movements are not random, there are price targets where the stock goes and meets a measure of resistance. Then you can capitalise on entering at a favourable time, capturing that move and getting out when the stock may potentially fall.' When volume is thin, she stays on the sidelines.

'I don't want people to focus on the news at all. Just focus on what you see happening on the stock. Believe that price action dictates everything. The closing price of the stock is going to dictate its direction next day.'

Numerous academic studies, by the way, indicate that technical trading does not work. In any case the 'X' factor may boil down to the all-important traits of discipline and patience. She says: 'You really have to focus on waiting for the opportunity to present itself. There are times when the market may be in a very bullish position with too many wanting to invest, or the opposite. Those two scenarios create opportunities for a strong market reversal. If the market is very, very bullish, smart money is ready to sell. You need to be aware of that. I've not traded to the upside for some time for a few weeks now. That can cause me to get impatient.'

Pitfall of early success

Early success can also go to your head. She recounts the experience of an investor who attended her course with little knowledge of stocks. He began investing and made money very quickly. 'He took $7,500 in capital and doubled that. Then he added $15,000 of his own money and doubled that. He was my poster child of success.' He then invested in options on a stock with very strong fundamentals and technicals. But instead of buying call options, he bought puts, effectively making a bet that the stock would fall. It continued to rise.

'He bought puts because he said the stock could not continue to go higher. As long as he followed the rules he made money. The signs were not there for a put. It frightened him to the point that he removed the stop loss. He ended up losing US$60,000.

'I almost wish people would lose money on the first trade so they could have some respect for the market. But they made money right away. They think if I take $10,000 and doubled it, I can take the $20,000 and double that and so on. That's not how you play.'

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