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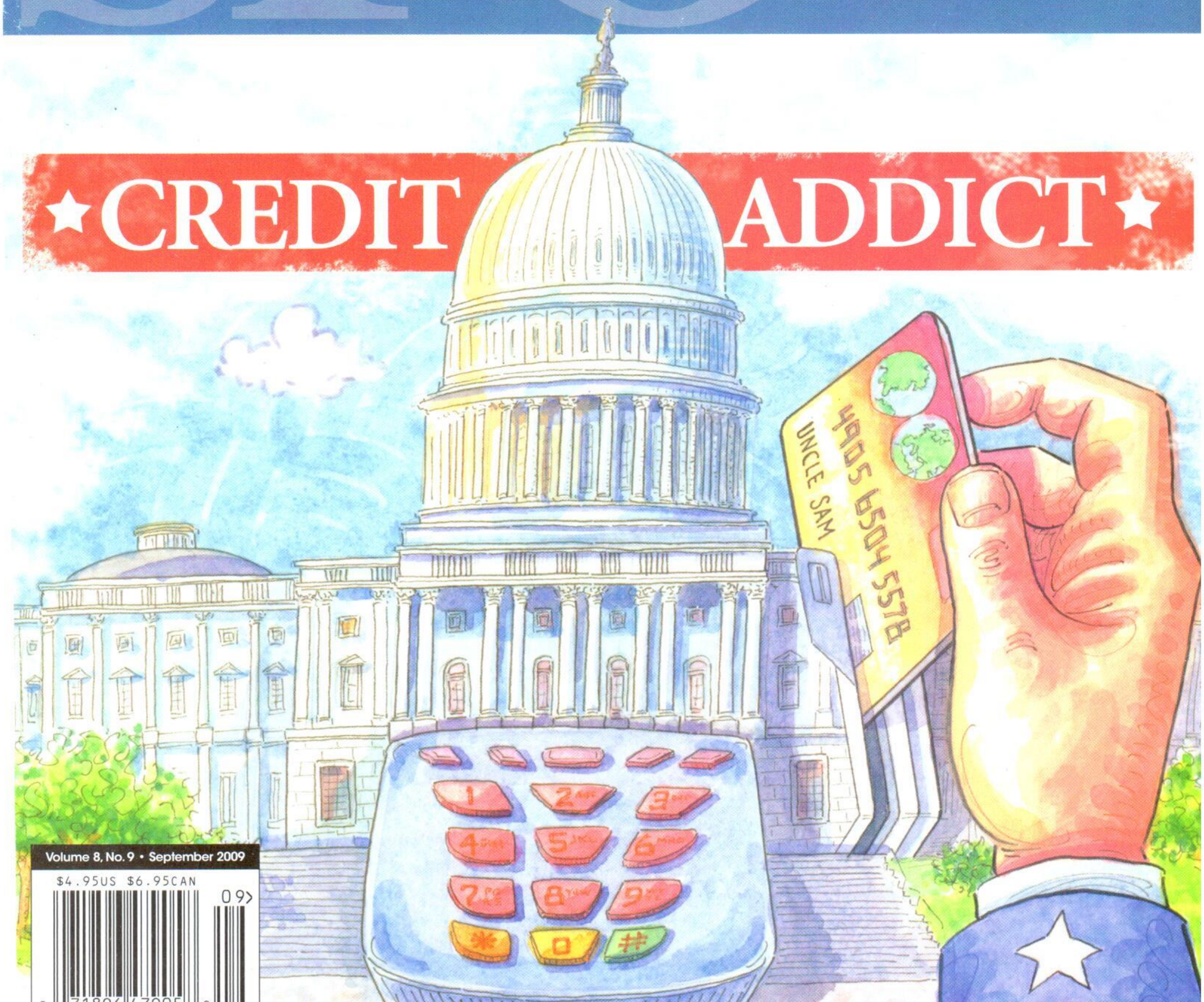

Volume 8, No. 9 • September 2009
$4.95US $6.95CAN

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USING THE 50 DMA

By Brian Shannon

One of the most common technical indicators is the 50-day moving average (50 DMA). Because of its popularity, traders can dig into the psychology of the indicator to learn how the majority of participants respond to price movement around this technical measure.

50-DAY IN ACTION

Figure 1 is of the Nasdaq 100 Powershares ETF (QQQQ), and three distinct market phases are evident and emphasized by the location and slope of the 50 DMA. In late 2008, the market experienced a clear pattern of lower highs and lower lows. This weakness led to a declining slope of the 50 DMA as the average price was dropping.

As a general rule, when a market is below a declining 50 DMA, no rally attempt should be trusted—it should be treated as "guilty until proven innocent."

Rally attempts to a declining 50 DMA often fail as buyers become less aggressive with their purchases, thereby reducing demand. At the same time, a market near a declining 50 DMA is often an area where long holders lighten their losing positions and short sellers look to establish positions or add to their bearish bets; these actions result in more supply.

The dynamic of less demand and more supply near a declining 50 DMA often creates a self-fulfilling failure of prices at this widely watched level.

In early 2009, QQQQ began a recovery attempt from the previous decline as prices began to stabilize near 28. During this neutral phase, prices oscillated above and below the 50 DMA with no clear direction as buyers battled for control. Indecisive stages are times to either be out of the market, switch to a shorter timeframe or find another market to trade.

FIGURE 1: Daily Nasdaq 100 Powershares ETF

Source: RealTick

In early April, the market recovered and broke past the resistance at just under 32. Notice how the higher high for the year dragged the 50 DMA with it, which validated the unfolding rally.

When a market is above an ascending 50 DMA, traders should monitor pullbacks for buying opportunities and should consider the market "innocent until proven guilty." Many buyers focus on new purchases as prices revert to an advancing 50 DMA as the stock often finds support in that area. The support is the result of fresh long purchases, bigger participants adding to existing longs and losing short sellers repurchasing near the widely watched average.

WHO'S IN CONTROL?

It is the combination of supply and demand dynamics that often make the 50 DMA a key fulcrum from which large moves can materialize. The true value of chart study is that it enables traders to observe money flows and uncover who is in control of a market (buyers or sellers). Because of its popularity, the 50-day moving average is an important level in understanding market dynamics, and therefore, traders can study shorter-term timeframes to identify low-risk trade entries.

Brian Shannon is author the book *Technical Analysis Using Multiple Timeframes* and provides daily market analysis at AlphaTrends.net. Follow him through Twitter via @alphatrends.