Quick Start Guide:
The Basics 101: How to Read a Chart

Any one can pick a stock…

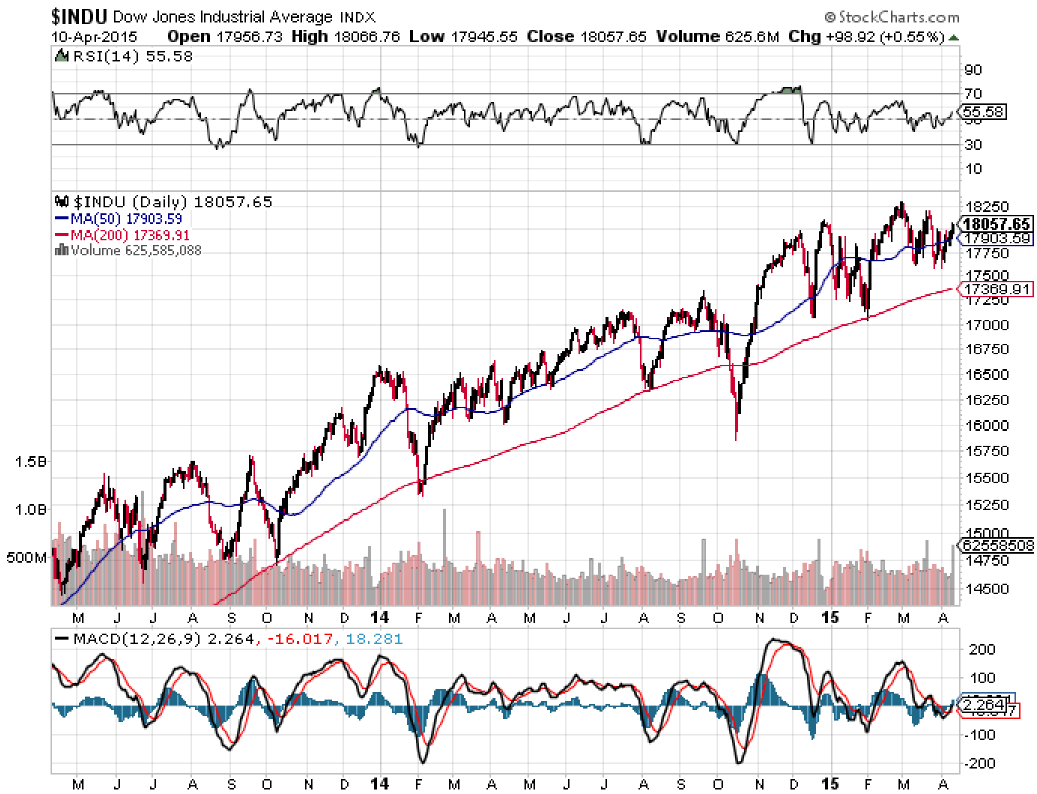
But it takes a disciplined, well-versed investor to pick a good stock.

If you're just starting out, charts, stocks, options, indexes… they can all be a bit overwhelming and confusing. Most throw in the towel on day one. But you'll never make money doing that.

At first glance, many beginners have no idea how significant this chart is. They have no idea what it says, or how to use it.

And they run from it.

But chart reading is simple. And it's a necessity.



As we all know a stock is a share in a publicly traded company.

Stocks represent partial ownership of assets and earnings. And as you buy more stock, your ownership of a company's assets and earnings increase, as well.

If you're strictly a fundamental investor – like billionaire greats like Warren Buffett – pattern recognition isn't of great importance to you.

The disdain of the chart technique is so wild that Buffett once remarked, "I realized technical analysis didn't work when I turned the charts upside down and didn't get a different answer."

Lynch observed, "Charts are great for predicting the past."

And Graham famously said, "In the short term the market is a voting machine, but in the long run it is a weighing machine."

I can personally tell you that charting works very well.

In fact, as we move on, I'll show you my methodology for successful charting and trading.

Why Study Charts…

Long before computers, not many of us had access to charts. Many of us couldn't study support and resistance points. We couldn't see trends, or wiggles on a chart.

Each chart had to be created by hand.

But with the advancement of computers and software, the use of charts… and the number of technical traders has increased significantly.

Just a single chart can tell the average person a great deal of information. They're an illustration of market psychology, the very struggle between buyers and sellers.

They help prove that prices move in trends, and that quite often, history repeats itself.

Charts tell us what a stock, index, ETF, etc. may do based on trends and history.

They're simply graphic representations of the price of a security over a set period of time, whether a year or 20 years.

Chart reading is not science. It's more of an art.

You and I may look at the same thing and see something completely different… and come to a completely different conclusion.

For example, many traders and investors may look at the tail end of this chart, and argue that further upside is very likely.

To me, though, I see danger, as the Dow re-tests overhead resistance at a triple top.

Chart reading isn't a science. It's an art. It's greatly open to interpretation.

So what's the best way to read a chart?

It's essential that you watch for trends, dictated by market supply and demand that can change depending on news flow, for example.

We must understand where a stock has been and what it's doing at present time. The Dow chart above for example is in a solid trend up. It's essential that we have a graphic ability to predict potential price points.

When a trader looks at a chart, they first thing they want to answer is what the trend is. Is it trending up, down, or sideways?

Typically, traders look to buy on upward trending stocks rather than downward trending stocks… unless of course, you're looking to buy a put option or sell share short. Either way, looking at overall historical direction gives us a better indication of what may lie ahead.

We also need to identify support and resistance points to tell us how bulls and bears historically react at certain price points.

What are key levels of support and resistance?

Simply put, support and resistance are the key levels of stocks where bulls and bears meet. It's at those levels where supply and demand take over.

Support is a price level at which prices are so low that they draw in buyers. The logic here, of course, is simple. At certain price levels the selling becomes exhausted, and buyers become more inclined to buy. □□In short, it's the level where price slides typically end and buying resumes—otherwise known as a bottom. □□

Resistance is the level where prices are so high that few buyers are willing to bid. Moreover, since it is also a level where traders are looking to sell, it creates an oversupply that eventually drives down the share price--otherwise known as a top.

There are many chart patterns to understand. We'd be here for another 10 hours talking about them, including head and shoulders, bump and runs, rectangles, cup and handle. But let's keep it simple. Let's talk about the ones we find and use most often with the technical indicators we discussed above.

As any technician will tell you, figuring out the future is partly a function of studying the past. □□As a result, support and resistance levels can be found by studying charts and identifying general price points where the market tended to bounce or top.

Here's a chart of the Dow for example.

Look at what happens when it challenges prior tops. Most of the times it fails after a push too high, too fast.

As for support, look at Boeing for example.

It's tested $120 since early January 2014 finding buyers each time. It then finds resistance around $135 where sellers come out.

It's a game of tug o' war.

You can literally see the fight inside what's known as the trend line.

When Coke nears double top resistance, it's not smart to chase it. Once it hits those high marks, I know to stay away. When – and if – it finds prior support as it did at double bottom, I can buy and wait for a swing higher.

You must watch support and resistance to know how bulls and bears react to one another at certain price points.

Barnes and Noble is a great example. This stock has been just torn apart over and over again. It's important to you can identify tops and bottoms on a chart, or you risk losing money.

On BKS, for example, it's never safe to chase it above $24 because it fails and falls lower. Over the last two years, though, most buyers reemerged around $13. We have historical markers here.

In a nutshell, those are the key things to identify when looking at a chart.

But there's a trick to really uncover the psychology of the bulls and bears. All we have to do is watch key momentum indicators on a chart, which I'll explain.

The Ian Cooper School of Technical Trading

If you pull a rubber band too far, too tight, what happens?

It snaps back.

Well… the same thing happens with stocks driven by two of the most powerful forces on Wall Street – fear and greed.

If traders get too greedy, they send stocks too high, too fast. And it becomes an unsustainable move. Eventually, a stock will pull back, allowing us to profit.

If traders get too fearful, they send stocks down too much, too fast. And again, it becomes an unsustainable move. Eventually, the stock bottoms out, allowing us to profit.

Sounds simple, right?

So how can the average trader – you – spot these excessive moves?

That's the easy part. You can find them just about anywhere, especially after news has been released.

Opportunities like these happen all the time.

One of the best ways to catch them is by watching for massive volume spikes, anticipatory momentum, news dissemination and the death of news, to name a few.

For example, when the Ebola story hit, panic sent related stocks – like Tekmira (TKMR) – up 333% in no time at all.

No one knew how high it was headed…

But we did.

After that sizable run, look at what momentum indicator, Relative Strength (RSI) was telling us. It was screaming, "Sell me."

Once RSI topped out above that 70-line, we knew the stock would reverse, as it did.

Historically, an RSI read above the 70-line tells us it's overbought. A read at or below the 30-line tells us it's oversold.

But we can't just rely on a sole indicator for directional change. That's not safe.

So we move to confirm what RSI is telling us by looking at another popular momentum indicator known as moving average convergence divergence (MACD).

All we're looking for here are obscene moves from the mean.

Massive spikes in either direction give us an indication that a reversal is likely on a mean reversion in MACD, as you can see here. Look at the spikes in MACD above 2.0. Each time that happened here – with confirmation from RSI – the stock reversed.

We can strengthen our argument a bit more by looking at the momentum of money flowing in and out of the name with the Money Flow Index (MFI).

Notice what happens when MFI moves above its 80-line or below its 20-line. It reverses.

While these three indicators work well in determining the death and rebirth of momentum, we can confirm a bit more by seeing just how far we can pull the rubber band.

To do so, we identify the Bollinger Bands, which let us know how far we can “pull” the stock. As we can see in this example, about 80% of the time, the lower and upper Bollinger Bands told us exactly how far we could pull the stock.

Coupled with the above-mentioned indicators, our chances for success increase substantially.

We can confirm even more, though, with the ultimate momentum indictor, Williams % Range (W%R). Here, look at what happens when Williams % Range reaches zero, considered overbought.

It reverses.

Now look at what happens when Williams % Range reaches -100, considered oversold.

It reverses.

Granted, there are hundreds of indicators and patterns to watch when identifying reversal patterns. But when used together, these indicators alone are some of the most powerful because they look at the momentum generated by the crowd.

They allowed us to exploit crowd mentality, driven by two of the most psychologically powerful tools of the market – fear and greed,

All stocks, indexes, ETFs – are all driven by fear and greed.

If we can identify where and when those reach an extreme, we increase our chances of success.