



What about Technical Analysis?

I wrote the following for a traders forum at the beginning of 2011.

It surprises me that whole tribes of traders still have the illusion that by using technical analysis they are able to predict the direction of the market.

Let's say for the sake of the subject that today some brilliant mind came up with an indicator that indeed is able to predict the market. Let's call this indicator "moneymaker"! Now don't go running to the fridge to get that bottle of Dom Perignon just yet.

You open your chart and the following situations occur:

A) At a certain point in time (let's call this "T") the moneymaker signals that the market is about to go up!

You buy and with that you enter a long position. Smart move because the moneymaker signals a rising price and indeed the price goes up!

B) At T+11 (or 19, 37 or 76) the moneymaker signals that the market is about to go down again.

You sell and with that you close your long position and collect your profits. Well done, since the moneymaker just signalled a falling price and indeed the price drops. Profits in the pocket open that Dom Perignon the sabrage way (with a sword)! Or...

All seems very logic right?
Now I have two questions for you:

1. Who is dumb enough to sell in situation A?

Would you sell? Who the f*ck is going short while the moneymaker, the brilliant technical indicator indicates that prices are going to rise!? So you can buy all you want, but there is no seller!

2. Who is dumb enough to buy in situation B?

Would you buy? Who the h*ll is going long while the moneymaker indicates that prices are falling!? So you can sell all you want, but there is no buyer!

If, yes **IF** technical analysis is able to predict the market, that same magical ability would kill the ability to predict the direction of the market by itself.

Technical Analysis is lagging data, present perfect tense, it's history and therefore exceptionally useless for trading!



Some readers argued that not everybody sees the same and that traders interpret the indicators their own way. Very true! I wrote them the following.

That's true, so each trader sees something different! Matthew uses a 12 tick breakout chart, Denise uses a point & figure chart, Victor uses a 10 minute candlestick chart, Pedro uses a 20 tick breakout chart, Donald uses a daily bar chart, Sophie uses a 60 minute candlestick chart, etc. etc. I don't think I need to go on.

Furthermore they all have different settings in the timeframe of their technical indicators. One has RSI over 7 periods, the other over 15 periods, MACD 24, 12 or 48, 32, Stochastics over 12, 16 or 52 periods, etc. etc.

Besides that there is virtually an unlimited number of indicators! But about 50 technical indicators are most common. The professionals (salespeople with their courses) tell you a combination of three is most solid. That's $50 \times 50 \times 50 = 125000$ combinations! And that's without all the options of different chart types, chart settings and different settings on your technical indicators. Include those variables and that would add up to billions of combinations!

So every individual with his own settings for TA sees something different. Unfortunately one individual trader is not able to give the market a certain direction. And if everybody sees something different, there is no arguing about a possible self-fulfilling prophecy either! So what is the predictive value of TA...? Zero!

But why is TA often looked at as being an important decision making tool?

It helps a lot if you can say e.g.: "ah my MACD shows me I need to enter a long position at this moment". Rather than : "f*ck I have totally nothing that shows me what to do" at that very same moment. Though the outcome of both trades will be exactly the same - it's not that entering on the basis of TA at the same price and at the same moment gives you a better result than that same entry on the basis of nothing - the moment of entry is more easy, because you have something to hold on to! And people mentally need something to hold on to.

So TA has a lot to do with the mental issues involved in trading and nothing with predicting future price development and with that your success in day trading. Unfortunately it is widely used for the second reason and that's why around 99% of all vendors are teaching you to trade on the basis of TA. Newbie's and even experienced traders think : "Ah when I learn how to read TA, I'm gonna make profits in the markets". Wrong thought but it's why 90% of all day traders fail. The few that succeed learned to let go of TA to some sort of extent before they ran out of cash. The 90% that failed would have been much better off with a 6 to 12 months mental face to face training. That doesn't mean that they will automatically all succeed, but I believe the success rate will be much higher.



Just Google "day trading strategy" and you'll find tens to hundreds of vendors who will teach you how to trade based on TA. Now I wonder is it that all those that want to learn how to trade can't find one of these vendors on the internet? Or is it that what these vendors are actually selling is complete crap? If these vendors were actually able to teach you how to trade based on TA the success rate would be much higher than that 10%. Besides that, why teach if you can trade? Brokers often team up with a teacher (vendor). Now why would someone work at a broker handling your and other traders calls and emails? At the same time he/she could be trading at home using the "profitable" strategies the vendor teaches. They know the strategies based on TA don't work.

Quit following the advice on the use of TA that all the scammers on the internet try to give you in return for hundreds or thousands of dollars. They are the ones that failed in becoming profitable by trading. And now they are trying to make money by teaching you about technical indicators. Apart from the fact that it is useless, the info on TA is also to be found for free on the internet.

Markets move at random and there is NO way to predict the market's next move. But that doesn't mean that there is no opportunity to make money trading!

Shaka,

Frits

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