Where next for Australian bank stocks?

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What the share price charts say about CBA, ANZ and NAB, and how to use stop-loss techniques.

By Robert Brain, ATAA

With the share prices of the big banks having run hard in 2013, and many investors chasing dividend yield, might it soon be time to sell the banks? Should we have sold already, or should we continue to hold them, and how will we know when it is best to sell?

First, it is worth having a quick look at investor sentiment and psychology.

People participate in the sharemarkets of the world for a variety of reasons. But regardless of the reason, the opinions and emotions of all the active market participants are summarised in price charts. When a company's share price rockets upward, or dives downward, it is because enough of the market participants have a strong enough view of the stock or of the market generally, to cause the share price to move.

Prices of financial instruments (such as shares, commodities, currencies, etc.) move up and down based on personal opinions, or perceptions of value, perhaps using fundamental analysis, or based on an "expert" valuation (that is, someone else's opinion). Also, because of the underlying basic emotions of fear, greed and hope.

ANZ revisits past highs

On the right of the accompanying weekly price chart of ANZ, we can see the green sloping trend line TL sitting under the rising share price since a small double bottom pattern in late 2011. But look back six years to the start of the chart in 2007, where ANZ twice tried to move above about $31 as the market peaked in late 2007. (Remember that a weekly price chart shows the close price for the end of each calendar week. It cannot show the price range during the week.)

ANZ Bank weekly chart, 2007 to 2013

Source: © November 2013, Robert Brain

Larger chart and more details: Brainy's Share Market Toolbox

In fact, ANZ shares touched an intraday high of $31.50 on 18 April, 2007 (peak P1 on the chart), but closed lower at $31.27; there must have been enough sellers at that price level to overpower the buyers and pull the price down. The intraday high is not shown on this weekly line chart, but is readily apparent on a candlestick chart (not included here).

ANZ shares again touched $31.50 six months later (peak P2), and after several attempts to move higher over a three-week period (not apparent on this weekly chart) the sellers dominated and the price fell into the GFC - a fall of more than $19 (62 per cent) over 70 weeks, bottoming out in early 2009. Who said blue-chip stocks are "safe"?

Interestingly, when ANZ's share price again reached the pre-GFC peaks at peak P3 on 30 April, 2013 there must have been many shareholders who had bought in 2007 and who simply wanted to recover their capital. An excess of sellers caused the price to fall strongly during May 2013. The horizontal red line R1 indicates this resistance price level.

Was the ANZ sell-off of 2008 a once-off? Well, the share price has fallen by at least 20 per cent on at least six occasions since 1986, and five of those saw a fall of more than 35 per cent. Which prompts another question: is this normal behaviour?

Price support levels

Let's take the weekly price chart of ANZ above and zoom in on the daily chart version over the shorter period of October 2006 to February 2008 (the left side of the above chart). Notice there are many price levels where the buying and selling has stopped rising, or falling, and turned in the other direction.

A couple of these are indicated with the horizontal lines S1 and S2 (indicating price support) and line R2 (indicating price resistance). Remember that a daily price chart shows the close price for the end of each day. The line chart does not show any wild intraday swings.

ANZ Bank daily chart, October 2006 to January 2008

Source © November 2013, Robert Brain

Larger chart and more details: Brainy's Share Market Toolbox

The price behaviour at these price levels indicates a lot of opposing opinions about fair value, or intrinsic value.

A support level comes about on the price chart because when the price is falling and sellers offer their shares at lower prices, buyers step in and snap them up. As more and more buyers join the bidding war, they end up outweighing the sellers and the price moves higher again.

Subsequent attempts by sellers to sell shares at a similar level will continue to see buyers step in and buy the shares, until there are no more buyers at that price level. When that happens, the share price falls below the support line, and at the lower prices more sellers join in the selling and cause the share price to fall further and often faster.

This all happens because the market participants have different opinions about what the shares are really worth. Chartists, however, do not care about the opinions, as they just read the chart and go with the moves.

After the peak P2 on this chart, the ANZ share price continued to form a series of lower peaks and troughs as it sailed down past support level S1 and off the bottom of this chart, and plumbed the depths of the GFC for more than a year.

In hindsight, the price level S1 could have been a stop-loss level. That is, in late 2007, we could have adopted the view that if the price was to fall lower than S1; the sellers would probably continue to dominate. (Dow theory says that once a trend is confirmed, it is likely to continue.)

History is fine, but what about now?

We know that a number of Australian large-cap stocks have been paying high dividends lately. This might be because of company cash stockpiles as the economy improves, or perhaps in response to investors who are actively seeking higher yields. Whatever the reason, it probably will not last forever.

One day, any high-yielding stock might wind back the high dividend and one result could be investors selling the stock to chase a high yield elsewhere. If this happens, the sell-off might be slight and short term, or it might be a stampede and long lasting. No one can say for sure until it happens.

Therefore, in case the sell-off might be significant, it seems sensible to decide in advance that if a company's price falls to a certain point, to sell and lock in profits and protect capital from possible further falls. Many successful investors and traders do this, utilising a stop-loss (*a pre-determined price point which you sell, to limit losses or lock in gains*) or a more serious exit strategy to sell on price weakness before the fall.

But if we want to do this, we need to make our strategy decision before we need to take action, not afterwards. Then we simply implement the strategy without emotion.

Stop-loss using price support

The method of using price troughs as support levels and possible stop-loss positions was discussed in the May 2013 *ASX Investor Update article, 'Bank stocks - buy or sell?*'.

Another good and current example is the accompanying daily price chart of National Australia Bank (NAB) from March to November 2013.

National Australia Bank, daily chart March to November 2013

Source © November 2013, Robert Brain
Larger chart and more details: Brainy's Share Market Toolbox

This chart shows a horizontal red line of price resistance at $34 in late April 2013, which stopped the rising price. After four more months, and a price fall of 17 per cent followed by a nice rising trend, the price retested that past resistance level in September, then rose above it and came back to sit on it in October, before rising to a higher peak (HP) in late October. At this point, we can see that the $34 support level would have been a good level to place a stop-loss; below $34 actually.

After the peak HP, the price trended down to the $34 level and below. At the time of writing, the downtrend is still in place. Remember, once a trend is under way, it is likely to continue. It is possible that the price could turn upwards and start a new rising trend, but there is no way to tell when this might happen. Until it does, the downtrend is confirmed.

Weinstein's weekly chart and the MA

Regular readers of *ASX Investor Update* articles will have read about Stan Weinstein and seen references to his book, '*Secrets for Profiting in Bull and Bear Markets'*.

In it, he advocates using weekly price charts and a 30-week moving average (MA). It is healthy to see the MA rising and the share price above the MA. Conversely, if the price is below the MA and the MA is falling, that is bad and a possible condition to sell. This is explained in the accompanying weekly price chart example of Commonwealth Bank (CBA).

Commonwealth Bank, weekly chart 2007 to 2013

Source © November 2013, Robert Brain
Larger chart and more details: Brainy's Share Market Toolbox

This chart covers the six years from October 2007 to November 2013. The price level R1 (a resistance level at about $61) was at the market top in late 2007, where CBA closed at $61.65. Over the following 15 months CBA fell and bottomed at $24.07 - a fall of $37.58 (61 per cent). During the fall in 2008, the shares range traded under resistance line R2, within a $9 band between about $37 and $46.

After the bottom in 2008, it took CBA four years until 2012 to make new sustained highs. Eventually it broke clear above the resistance R1 and continued to trend higher. Along the way it retraced to a trough at the price support level S2 at about $65.

This ought to be a strong support level going forward and could be a stop-loss level. If the price falls below this it is likely to continue lower. A higher stop-loss could now be set at the next trough at about $71.

But note the blue curved line on this chart, the 30-week simple moving average (SMA). Since it turned up in early 2012 the price has mostly stayed above it. In Weinstein's terms this is bullish. One possible exit signal to sell CBA would be if the share price falls below this SMA, and the SMA turns down.

Conclusion

The charts can tell us much about the underlying sentiment and opinions of market participants. If the general market is bearish on a particular stock it can show up in the charts. A sensible exit strategy, and use of a sound stop-loss approach, can capture profits and protect capital. Price charts can reveal a lot of very useful information.

About the author

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About the ATAA

The ATAA is a not-for-profit association of people interested in the application of technical analysis. Many operate their own SMSF, some are private traders/investors and some are professionals in the financial services industry. The ATAA has nine Chapters in Australia, based in capital cities and provincial centres. More details are on the ATTA website.

From ASX

Technical analysis, or charting as it is commonly called, has become more popular in recent years. In years past there was a big distinction between chartists who study share price patterns to buy and sell shares, and fundamental investors who use company information, such as balance sheets, to make decisions. These days more investors use technical and fundamental analysis to make decisions.

The ASX Charting Library covers more than 20 key charting topics and is a great place to start for investors who want to learn technical analysis basics. Learning about trendlines, support and resistance, Bollinger Bands®, relative-strength indicators, and candlestick charting, may not be everyone's idea of a relaxing summer read. But the information can help with investment decisions on what to buy and sell - and when.