Making sense of the squiggly lines

Technical analysis can help give you a clearer picture of commodity markets

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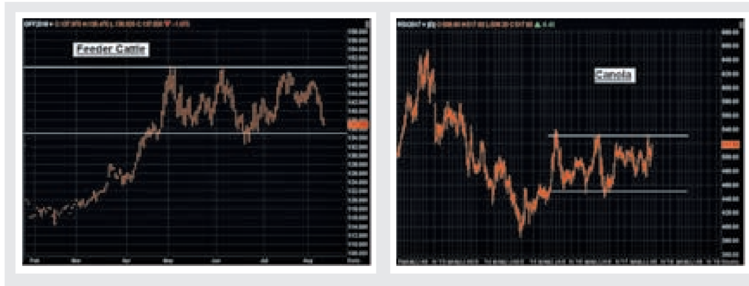
CHART 1 & 2

CHART 3 & 4

FEEDER CATTLE & CANOLA MARKETS



A picture is indeed worth a thousand words so when it comes to markets, there is no better picture than a price chart.

Charts are a visual interpretation of market behaviour that encompass all news, research and analysis of economic business activity by all investors, traders and hedgers. It is an illustration of the cumulative fear and greed of the marketplace.

Unfortunately, many market psychology and behavioural economic studies have shown that humans often see things in pictures that don't exist. This can lead to less-than-optimal decision-making. There are many "price patterns" that catch the eye as well as the imagination which don't have a strong or consistent enough history to have any predictive value. There are, however, many valid price patterns and trends in financial markets that persist over time that are worthwhile taking a closer look at.

The mind can play tricks on you and people can fool themselves into believing their point of view. So, hedgers and traders should crunch some numbers and perform data analysis to develop some objective technical chart analysis.

Thomas Bulkowski's book *Encyclopedia of Chart Patterns* does a great job of helping in this area. His research offers a thorough and serious analysis using a database of 500 stocks over a five-year period that generated over 15,000 chart formations to uncover around 50 chart patterns. As he writes in the introduction to his book, "It suggests which chart patterns work best and which ones to avoid."

It covers many technical chart patterns you have heard of like head and shoulders, dead-cat bounce and double-tops, showing which patterns tend to be reversal or consolidation patterns, which typically have the biggest moves and those with the highest success rate.

Many of the top chart performers are trending patterns; meaning there is momentum moving prices either up, down or sideways steadily over time like in Chart 1 and 2.

Once this momentum changes, that up, down or sideways trend may change as well.

Another important pattern to look for is a consolidation pattern with a lot of sideways choppy price action. These are some of the most consistent patterns. Whether it's signalling a beginning, continuation or end of a trend, markets often move sideways ahead of another important price move. Many of the chart patterns you may find useful are ones that look like Chart 3 and 4 — almost like the calm before the storm.

What I like about Bulkowski's research is that it provides a high-probability approach to technical chart analysis that is supported by some hard numbers. This allows you to apply both the art and science of technical analysis along with other market research tools to real-time hedging and trading decisions. This doesn't mean you are going to be right every time, but at least you can strive to be more right over time.

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Now, here are a couple of current real-time commodities to look at.

First, after a 30 per cent move higher from about 115 to 145 during the winter and spring, feeder cattle has since been moving sideways for the past three months. Whether this breaks out higher to continue the uptrend or breaks down through price support to signal a reversal in trend remains to be seen. However, given this trading range is already a few months old, any sustained break below 135 on the charts and the odds are that this recent cattle uptrend may be turning lower. Regardless of whether cattle ultimately moves higher or lower, prices are good. If you haven't protected your cattle revenues, now is a good time to use live or feeder cattle option strategies for downside floor price protection but that still give you some upside potential as well.

Next, canola has also been showing a wide trading range but over a much longer period of time. The weekly canola chart shows a channel between C$450/tonne and $530/tonne over the past few years going back to 2015. With such a defined range, we have a good sense of where near-term tops and bottoms are and can plan hedging strategies accordingly. Canola may still go sideways yet and there is some upside potential. All the more reason to use canola option strategies to protect your downside without locking in, without limiting your upside and without committing to delivery.

Bottom line, charts don't always reveal the future but a numbers-based analysis, along with options and futures hedging strategies, can help you benefit from pricing opportunities for your farm commodities.

Keep your chart and technical analysis simple. Markets can only go up, down or sideways so look for trends, a breakout from an existing sideways range or a change in price direction. Don't overcomplicate things and don't worry about every daily 25-cent move. You'll drive yourself crazy and likely spend a lot of time for very little reward.

Instead, focus on bigger-picture medium- to longer-term trends. Incorporate proper hedging strategies that are right for the current market conditions to help you meet your operational as well as financial budgets and targets.

This approach should help make all those squiggly lines a more meaningful part of your overall marketing plan.

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