KEITH LAW'S TRADING PLAN

Background

In 1994, I left a 31 year career with Telstra with a $94,000 redundancy payment and good accumulated superannuation. I knew nothing about finance and investment. What I quickly learned was that many financial advisers were really most interested in the commission they could earn. They wanted to put my funds into managed funds where they would receive upfront and trailing commission. After a short time of research I decided to roll-over my superannuation into a conservative no fee fund and to manage my own non superannuation funds.

I had to acquire knowledge on how financial markets work and how to manage my money. I enrolled with the then Securities Institute and after 4 years attained a Diploma in Financial Markets. In addition I joined the Australian Technical Analysts Association and attained its Diploma in Technical Analysis. In 2006 I completed a Graduate Certificate in Applied Finance and Investment. I am currently a Senior Associate of the Financial Services Institute of Australasia.

The hardest part of trading is to learn the necessary self discipline. It is hard to acquire and lack of discipline is often expensive. The four signs of a lack of self discipline are:

1) Guessing about market direction. You cannot predict markets but you can react to market trends. You might guess right sometimes but it is still only a guess.

2) Lack of a Trading plan or Trading method.

3) Following tips and broker recommendations instead of sticking with a trading plan.

4) Buying a stock because the price has fallen to a "cheap" level. This has cost me a lot of money as todays cheap is often tomorrows expensive. When prices fall they often go much further than you expect. Ensure you have read Denis Gartman’s Trading Rules on my website introduction page.

Gartman's trading rules are also listed at the end of this document.

It has taken me along time to acquire trading discipline and there are still times when I fall from grace and slip from the disciplined approach. This document outlines my trading philosophy and method.

The difference between a 'share trader' and a 'share holder'

The way in which income and expenditure are dealt with in relation to shares varies depending on whether you are a share trader or a share holder. A share trader is a person who carries out business activities for the purpose of earning income from buying and selling shares. This person's position may be briefly summarised as:

1) Receipts from the sale of shares constitute income.

2) Purchased shares are regarded as trading stock.

3) Costs incurred in buying or selling shares are an allowable deduction in the year in which they are incurred, and dividends and other similar receipts are included in assessable income.

A share holder is a person who holds shares for the purpose of earning income from dividends and similar receipts. This person's position may be briefly summarised as:

1) The cost of purchase of shares is not an allowable deduction, but is a capital cost.

2) Receipts from the sale of shares are not assessable income – however any net profit is subject to capital gains tax.

3) A net loss from sale of shares may not be offset against income from other sources, but may be carried forward to offset against future capital gains made from the sale of shares.

4) Costs incurred in buying or selling shares are not an allowable deduction in the year in which they are incurred, but

are taken into account in determining the amount of any capital gain.

5) Dividends and other similar receipts are included in assessable income, and Costs (such as interest on borrowed money) incurred in earning dividend income are an allowable deduction at the time they are incurred.

I am carrying on a business of trading in shares, options and warrants. I have an Australian Business Number ABN and I am registered for GST. My main source of income is from my trading activities. The decision to manage income from trading as business income rather than as investment income has significant taxation and accounting affects.

As a Share Trader, all shares are held as trading stock. Each year the stock on hand at the end of the year can be valued at cost price or market selling price. Stock on hand at the commencement of the year must equal the value of the stock on hand at the end of the previous year.

Where trading stock is valued at market selling price, the movement in prices in the year is treated as either a taxable gain or a taxable loss. All distributions need to be treated as income (dividends are include as a separate income source) .

Sales revenue (excluding dividends)

less Cost of goods sold

equals Gross profit/loss

where Cost of goods sold equals

Opening Stock @ market selling price

plus Cost of Purchases

less Closing Stock @ market selling price.

This has the advantage of treating each financial year as a separate, discrete business activity. Capital gain rules do not apply to trading stock. All “capital gains” are included in income, all “capital losses” decrease income. The advantage of this process is that when making trading decisions the fear of activating a capital gain event is removed. All gains and losses are brought to account within each year and this allows each stock's price to be considered on its merit not on taxation impacts.

Tools of Trade

I live and work in Orbost Vic. - a town of just over 2000 people and over 50 km from the next town of a reasonable size. I have access to ADSL2+ broadband with an effective 15 megabyte internet connection. I have a small Local Area Network consisting of 3 computers: a main trading machine, backup machine and a notebook for travelling.

I use the following tools because over time I have found they suit my skills.

Quicken Home & Business

This is an essential tool for managing income and expenditure with excellent portfolio management tools. I have maintained detailed financial records since 1994 with all income and all expenditure recorded. This makes decision making and tax management simple.

Commonwealth Securities

I have been a client of Commsec for over 10 years. The website provides a comprehensive service for share trading. I use both Commsec's WebIRRESS Platform and the normal website facilities. I trade using a margin loan account to increase my leverage. The Commsec site has been continually improving and now allows conditional trades (stop/loss orders) on my margin loan trading account. I have on-line access to Shares, Warrants and Exchange Traded Options.

Technical Analysis

Technical Analysis is the study of historical price and volume movements in an attempt to predict on the balance of probability likely future prices. Any prediction method that uses the study of market data (price, volume, open interest, and market capitalization) can be included under "The Art of Technical Analysis." Technical Analysis is also known as the study of market psychology.

The powerful forces of greed and fear have been prevalent in markets ever since the first public trading exchanges were opened. As markets rise, greed takes over until everyone wants to own the item. Then, when there are no more buyers at the current price, the market collapses and may even plummet as fear takes over.

Before looking at the “system” I use it is important to note a number of things. Firstly, technical analysis does not work as a standalone way of looking at the market. Much of “technical analysis” is not backed up with plausible evidence – in particular I see the theories that claim to predict market direction such as GANN and ELLIOT to be based on wishful thinking and astrology and cannot be relied upon with any confidence.

Chart Analysis

There are many charting options available both online and in software. Most provide reliable images and have built in Technical indicators. I have used many of these in the past but as my trading is less technical analysis orientated than when I commenced I find that Incredible Charts and Commsec on line charts provide all the options I need.

My prospecting system is still based on trend following and trend change indicators with immediate price action through candle formations also as a main consideration. However, there are so many listed companies that it is impossible to understand them all. I have a sub population of companies that I attempt to understand and monitor on a fundamental basis. This “watch list” is then examined by Technical analysis for trading decisions.

My Watch List

In all, I closely monitor a population of about 30 to 40 stocks. Diversification is a critical component of my plan. I have in the past developed an over attachment to particular stocks and held too large a position in an individual stock. If this stock is not highly liquid a sudden fall in last trade value perhaps on light volume can cause margin loan collateral fluctuations. I like to have between 6 to 12 positions active depending on general market circumstances.

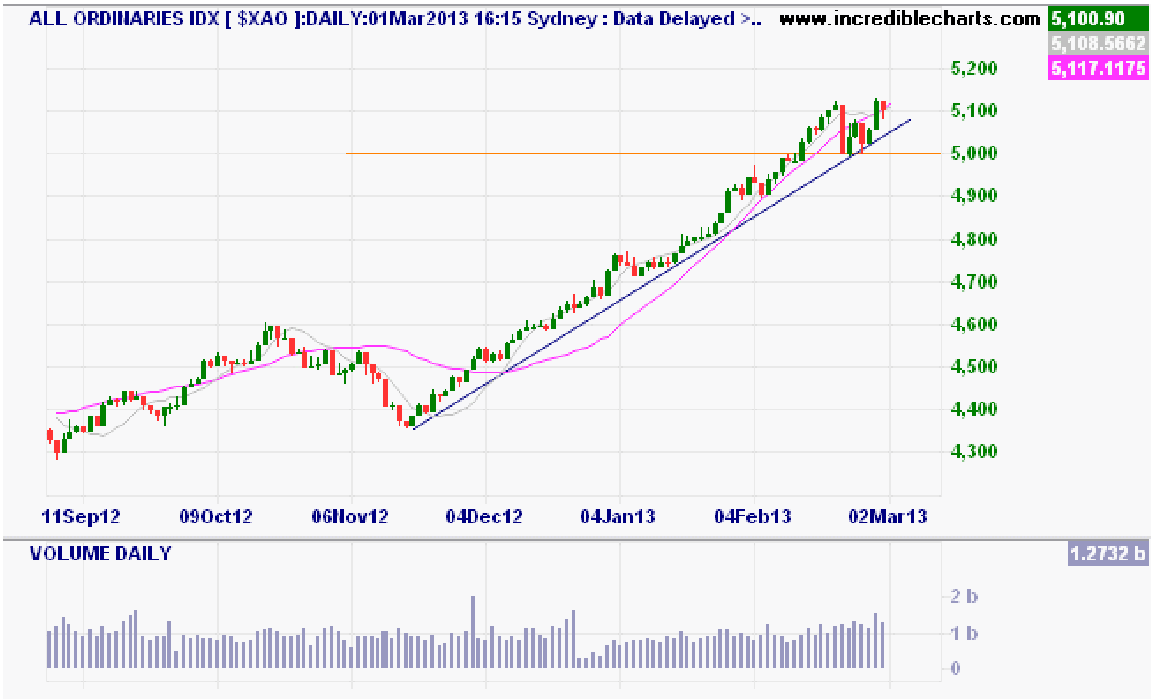
Following the Trend.

My purpose in using technical analysis is to define market trends. The market fluctuates between up phases (Bull Markets) and down phases (Bear Markets) while individual stocks also fluctuate either in line with the general market direction or counter market when a specific fundamental issue can cause buying or selling. The purpose then is to establish the current trend direction and to look for signs of impending trend reversals.

There is a plethora of trend following indicators available in Technical Analysis theory. I have used a number of these in the past and I particularly liked the Multiple Moving Average concept espoused by Daryl Guppy. Basically this looks at trends in differing time frames (short and long) and looks for reversals when trends consolidate and crossover. As today's computers allow for almost instantaneous performance of complex computations, I use a Moving Average Crossover system based upon linear regression analysis. Sounds complicated but it is just a more precise method of calculating moving averages.

A Linear Regression Line uses the least squares method to plot a straight line through prices so as to minimize the distances between the prices and the resulting trend line. A Linear Regression Line shows where equilibrium exists. The Linear Regression Curve calculates a Linear Regression line for every set of ***n*** bars and determines the price where the trend line intercepts the last bar in each data set. Thus, one data point is determined for each bar in the chart, and these data points are then connected to create a Linear Regression curve, quite like a moving average

This graph shows six month of the All Ordinaries Index as at 01 March 2013 with two trend lines highlighted. The light grey line is a trend line calculated using a 21 day linear regression. The pink line is a longer term trend using a 60 day linear regression. This Incredible Charts' Linear Regression Indicator is used for trend identification and trend following in a similar fashion to moving averages. The indicator should not be confused with Linear Regression Lines — which are straight lines fitted to a series of data points. The Linear Regression Indicator plots the end points of a whole series of linear regression lines drawn on consecutive days. The advantage of the Linear Regression Indicator over a normal moving average is that it has less lag than the moving average, responding quicker to changes in direction. The downside is that it is more prone to whipsaws. Red candles are down days where closing price is lower than opening price. Green candles are up days where closing price is higher than opening price.

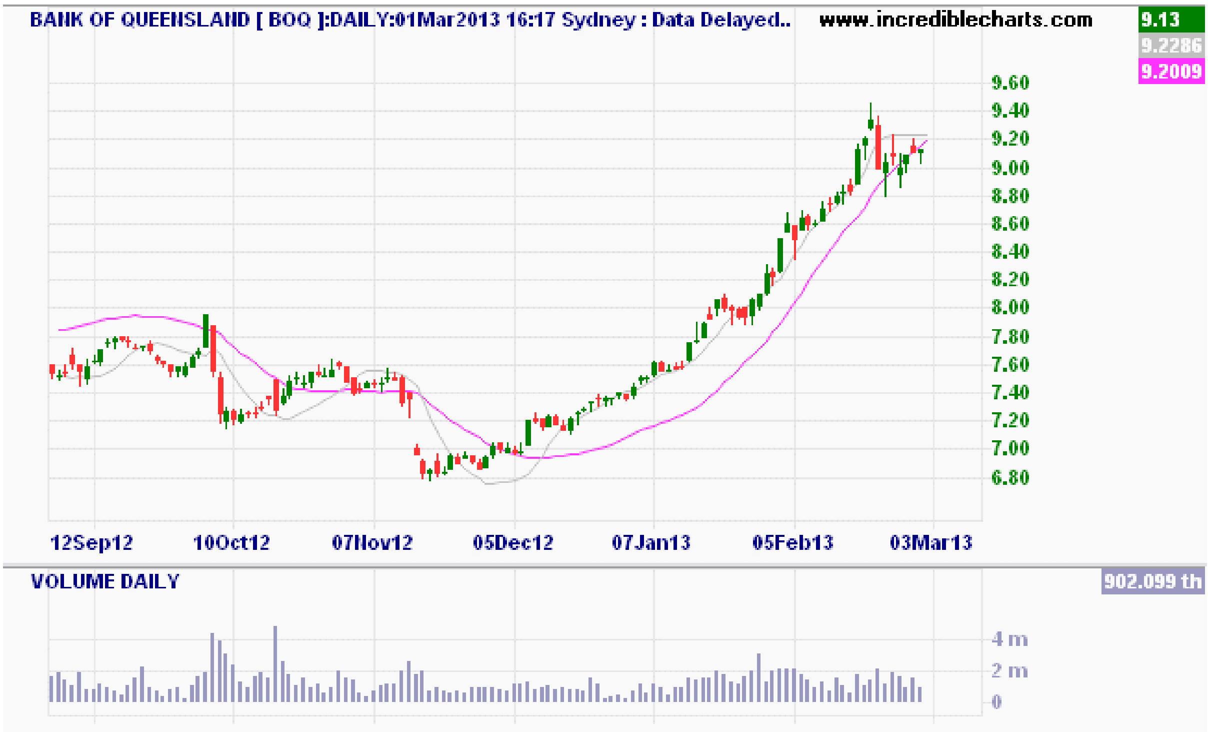


It is very unlikely that you can buy at the low point and sell at the high point of a trend. The use of crossovers between short and long term trends means that you will do well to capture

70% of the trend move. A trend is not established until the short term line passes through the long term trend. The value you use for these trends determines the sensitivity of the crossovers. Too sensitive and you have too many short term trades while too relaxed means you can miss out on much of the trend movement.

Buy Signals

I do not rely on the buy and sell signals generated by the software. They are at best simply a guide. I rely upon my visual inspection of the graph combined with knowledge of the current fundamental position to seek buy and sell signals.



This BOQ chart shows a trade that I entered at $7.12 in December 2012 where there was a reversal with the short term trend passing to the upside of the longer term trend which had also shown a reversal to the upside. In addition the dividend yield was extremely attractive and company fundamentals are sound although there had been some provisioning for expenses that had caused the market’s negative response. I exited 50%

of the trade at $8.63 and I am holding the balance of the trade while price remains above $8.70 profit stop. My target for selling is $9.50.

Exit Strategy

Exiting trades is always difficult. Indeed selling is a more emotional experience than buying. This is where the greed and fear really do take a toll. Therefore a strong exit strategy is the key to trading profits. When to exit from a trade whether as a stop loss or by realising a gain is the area of trading I find most difficult. My good intention of strictly following my exit rules has regularly failed. I have watched trades fall through my stop loss and continue down to painful loss levels; I have watched trades soar to a good profit only to reverse and give up most of the profit; I have watched stocks continue to soar to new heights after I have exited a trade with a modest profit. My implementation of my Exit Strategy has been a weakness in my trading.

Protective Stops

Protective Stops are used to limit losses in the event of a trade turning against you. You must always set your protective stop before entering a trade. Depending on the chart formation, I use either Fixed Loss Pivot Stop: Signals an exit when price moves to the loss side of the last loss side pivot point, formed before entry; or Fixed Loss Stop: Signals an exit when price moves to the loss side and reaches a pre-determined level from the entry.

It doesn't matter which system you use for protective stops what is important is that you always use a protective stop and you always exit the trade when they are triggered. Always is the hard part.

Profit Stops

Once price has moved to the gain side of a trade, Profit Stops are used to maximize gains without over-reacting to retracements. The aim is to simply have a profit exit that keeps you in trending markets but exits you from the market when there is real weakness or reversal. I can never get it absolutely right so I try not to worry about the price action after I exit a trade.

"The argument for the use of stop-loss rules seems inherently sound, yet there appears to be no real evidence that stops are providing the safety benefits that many traders expect." *Dr. Bruce Vanstone*

Read the research items on stop loss orders here: http://www.incrediblecharts.com/sitemap.php?mgroup=162

Using Options & Warrants.

While it is possible to short sell on the Australian Market, the most realistic way for small traders to take short positions is by the use of put options and warrants. These are not available on all stocks and of course there is a premium to pay whenever you buy a warrant or option. For this reason I tend to avoid short positions unless there is a particularly strong signal. I find that short signals are best used as exit signals from existing positions.

I tend to use warrants rather than options as they can be bought through SEATS and the brokerage is less. Before using warrants it is important to determine the precise conditions of the particular warrant. This information is available through the Comsec website or from the ASX's website. Put warrants can be used when an existing position is in a long term uptrend but the recent price action shows weakness with a downside average crossover. Instead of exiting the position, I sometimes protect my profits by buying a put warrant. This gives a breathing space to see if the recent price action is a pause in the uptrend or a significant downside break. The cost of this insurance action is the premium paid to buy the warrant.

If I have taken a position in a stock which goes into a trend, I may supplement the position by buying call warrants or options. This increases the leverage into the position. If the trend ends than the only cost of the additional leverage is the premium on the warrant or option. When buying warrants or options it is important to realize that the warrants and options can expire worthless (most do) and a sound exit strategy is important. I tend to buy warrants and options with at least 3 months to expiry and always exit these warrants and options well before the full premium erodes.

I mainly use RBS Mini shorts and Mini longs. You can research these products on this link:
http://www.rbs.com.au/warrants/main.asp?y=y

Actual Trading Results

My actual trading results can be seen on my website :
http://privatetrader.biz

I have had good years and bad years. On average however I have been able to generate sufficient income to maintain my life style. While the quantum of trading capital has varied with performance it is pleasing to note that my trading capital today is slightly above the level it was when I started trading in 1996.

You may consider these results to be mediocre? A return on capital of 25% is very difficult to achieve on a regular basis. My aim is to achieve a working income commensurate with my capital, time and effort. I will never make really large returns as I have a cautious investment nature and seek to achieve good but not spectacular returns at minimal risk. I am no Investment Guru but I am a hard working share trader.

DENNIS GARTMAN'S SIMPLE RULES OF TRADING

1. Never, Ever, Ever, Under Any Circumstance, Add To A Losing Position... Ever!

Adding to losing positions will lead to ruin. You can count on it. Ask the Nobel Laureates in Economics at Long Term Capital!

2. Trade Like A Mercenary Soldier: As Jesse Livermore said, it is not ours to be bullish or bearish, but to be right.

3. Mental Capital Trumps Real Capital: Capital comes in two types; mental and real. Holding losing positions costs measurable real capital, but immeasurable mental capital.

4. We Are Not A Business Of Buying Low And Selling High; We are, however, a business of buying high and selling higher. Strength begets strength, and weakness further weakness almost always.

5. In Bull Markets One Can Only Be Long or Neutral, and in bear markets, one can only be short or neutral. This may seem self-evident, but very few understand it, and fewer still embrace it.

6. "Markets Can Remain Illogical Far Longer Than You Or I Can Remain Solvent." J.M. Keynes. Illogic does often reign, and it is our duty to learn to handle it as best we might.

7. Buy Markets That Show The Greatest Strength; Sell Markets That Show The Greatest Weakness: Metaphorically, when bearish we need to throw rocks into the wettest paper sacks, for they break most easily. When bullish we need to sail the strongest winds, for they carry the farthest.

8. Think Like A Fundamentalist; Trade Like A Chartist: The fundamentals may drive a market and need to be understood, but if the chart is not bullish, why be bullish? Trade when the technicals and fundamentals, as you understand them, run in concert, one with the other.

9. Trading Runs in Cycles; Some Good; Most Bad: In "good times," even errors turn to profits; in "bad times," the most well

researched trade will go awry. This is the nature of trading; accept it and move on.

10. Keep Your Technical Systems Simple: Complicated systems breed confusion; simplicity breeds elegance. The great traders we've known have the simplest methods of trading. There is a correlation here!

11: In Trading/Investing, An Understanding Of Mass Psychology is Often More Important Than An Understanding of Economics: Simply put, "When they are cryin', you should be buyin'! and when they are yellin', you should be sellin'!" This is psychology at work and it's most elegant.

12. It Takes Buying And Lots Of It To Put A Market Up; It Takes Only A Lack Of Buying To Put Any Market Down: Gravity is an amazing force of nature; it is even more amazing in the world of investing.

13. There Is Never Just One Cockroach: The lesson of most markets is that bad news follows bad... usually hard upon and always with detrimental effect upon price, until such time as panic prevails and the weakest hands finally exit their positions.

14. Be Patient With Winning Trades; Be Enormously Impatient with Losing Trades: The older we get, the more small losses we take each year... and our profits grow accordingly.

15. Fear Turns To Greed At Break Even... And Vice Versa: Know this; understand this; accept this and deal with it.

16. Do More Of That Which Is Working and Less Of That Which Is Not: This works in life as well as trading. Do the things that have been proven of merit. Add to winning trades; Cut or eliminate losing ones. If there is a "secret" to trading (and of life), this is it.

17. All Rules Are Meant To Be Broken.... but only very, very infrequently. Genius comes in knowing how truly infrequently one can do so and still prosper, but when one must, one must!