

"Buy The Dip"

Thursday, May 19, 2011

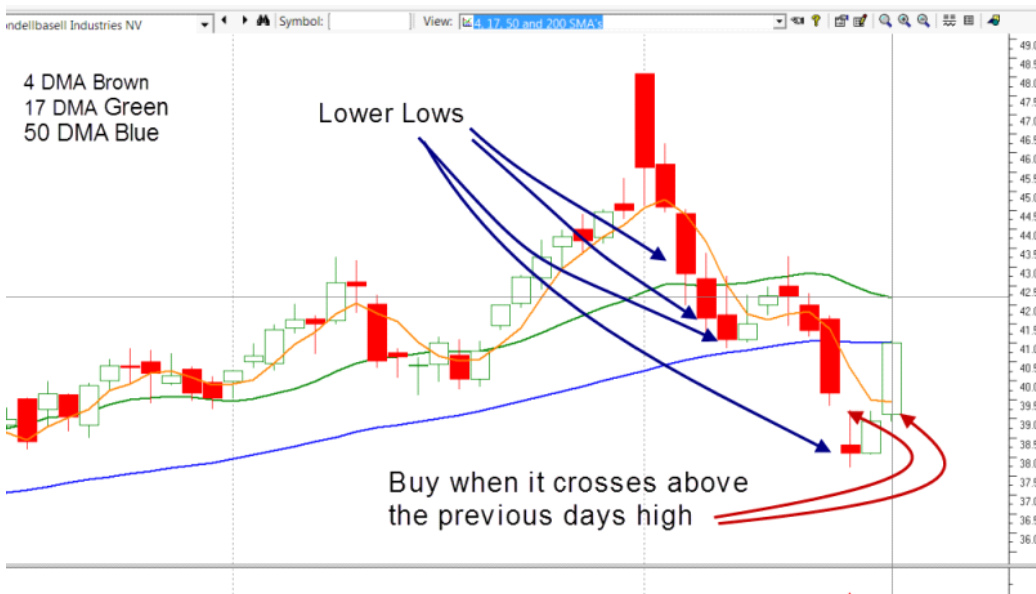
One of the favorite phrases in investing is "Buy The Dip". A great idea but how do you safely buy the dip? Looking at a stock chart it's easy to point out past buy the dip opportunities, but there is no way to look at a current dip in a stock price and know if the pull back is going to turn around and it is safe to buy.

As we all know the moving averages usually provide decent support and when the stock touches a moving average a buy is possible. The chart usually provides a good history lesson and we can use that lesson to evaluate a buy.

Here is LYB's chart from May 18, 2011. It shows numerous buy the dip opportunities. All were easy "hit the average" buy's except the dip it started on May 3. When LYB dropped below support of the 50 DMA on May 13 it was un safe to buy.



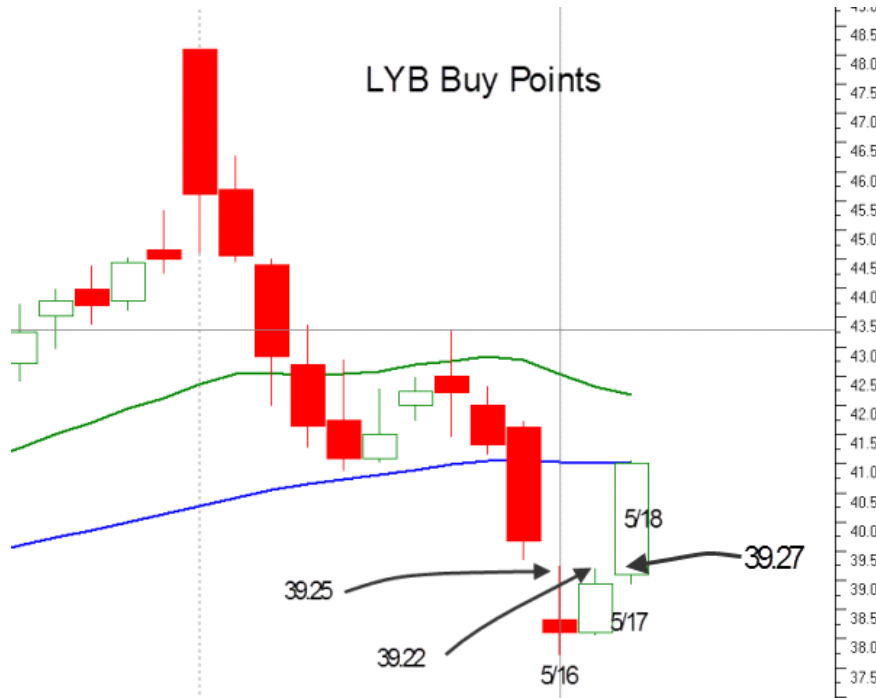
Starting May 3 LYB exhibited a series of lower lows. When you have a series of lower lows a buy can not be considered until that pattern is broken. One can't assume it's safe to buy, you need proof the pattern is broken. Ideally you want a series of higher highs before a trade can be made.



On 5/16 LYB gapped down on higher than normal volume so we assume at the moment it was a sell off. The high of the day was 39.25.

The next day 5/17 we place a "Stop Market" buy order for a few cents (39.27) above the previous high. What this does it requires a buy only if the stock goes up past yesterdays resistance. On 5/17 the high of LYB was 39.22 so your buy wasn't executed. If we had gotten the trade, you would place a stop at the previous days low/close of 38.11.

Since we didn't get the buy, the next day 5/18 we place a new "Stop Market" order a few cents (39.27) above the previous days or the day before high, which was 39.25. At the open LYB opened at 39.11 and climbed all day, when it crossed 39.27 your buy was executed. A stop would be placed low of 38.11, the previous days close/low.



This method of placing your buy above the previous days high can be used for most "leading" stocks in an up trend which pull back. If your buy doesn't get executed and the stock continues to go down you aren't in a bad trade. If your buy isn't executed and the stock drops again, the next day place a new order above the previous days high and try the trade again.

Keep in mind, you also need the wind at your back with a good market and the stock's group is also going in the correct direction for a "safe" buy.