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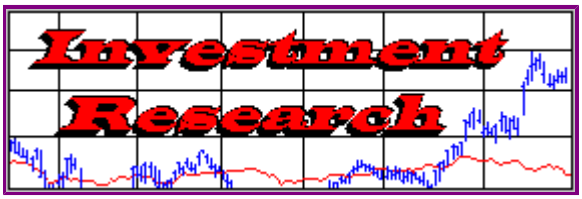
This is the second article in a series. **Click here to go to the first article.**

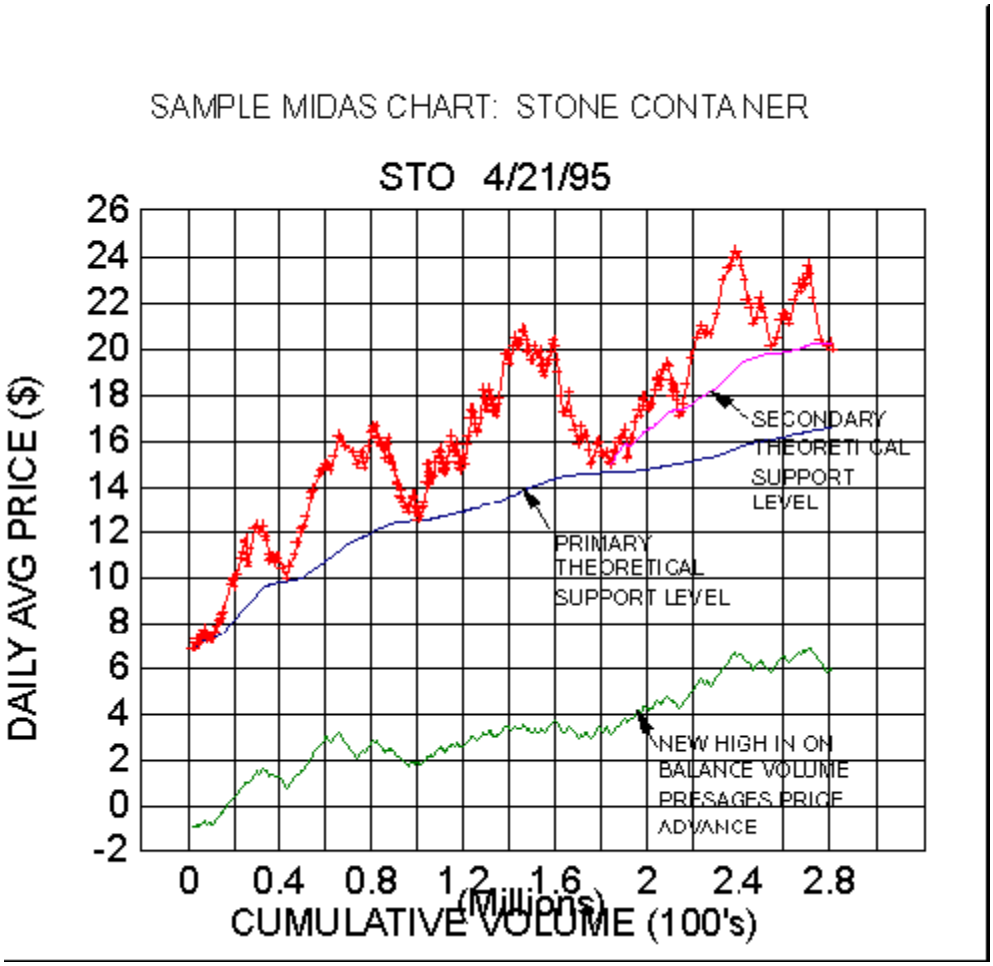


Introducing the MIDAS Method of Technical Analysis (2)
by Paul Levine

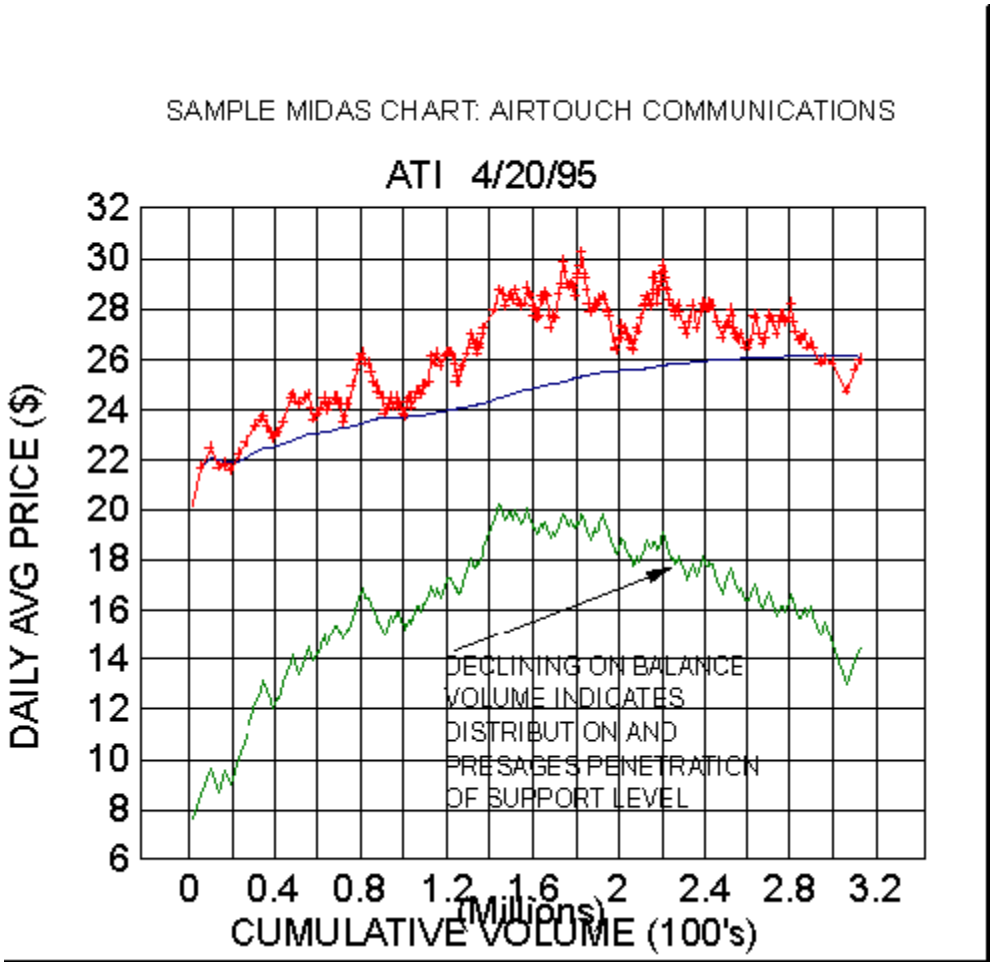
In the first article of this series we introduced the Midas chart as a new way of displaying historical price and volume data. Containing three essenial elements: daily (average) price, a theoretical support level, and on balance volume - all plotted vs. cumulative volume rather than time - the Midas chart provides a hitherto unavailable framework for categorizing and in many cases understanding the dynamics of price behavior.

Specifically, in this approach, it is the price relative to the theoretical support curve that determines the degree to which the stock or commodity is overbought or oversold. This is in contrast to the more familiar methods of technical analysis which focus instead on price relative to moving averages, linear trendlines and/or previous tops and bottoms. The on balance volume in turn provides a measure of the "strength" of the support curve, i.e. whether it will hold or be penetrated.

In this and future articles, we will develop these concepts by studying specific examples in detail. So let's turn first to the Midas chart for Stone Container below. Note first how well the theoretical "primary" support level curve predicted the actual trend reversal points. (Traditional technical analysis would have anticipated that the pullback from the peak at around 21 would be stopped at about 17 - the previous peak).



Next note how the movement of the on balance volume to new high ground correlates with the subsequent move to new highs in the price. This is in contrast to the second example below, Airtouch Communications, where the marked declining trend of obv correlates with the subsequent penetration of the theoretical support level. In the absence of the obv data, one might have expected the support level to "hold" and give rise to a new upward price leg since up to that point it had indeed provided support just as in Stone Container.



Returning to Stone Container, note finally that we have introduced a new feature of the Midas method: the concept of a hierarchy of support levels. We thus speak in terms of a "primary" support and a "secondary" support. (While we have yet to present the equations for these theoretical curves, for now we can say that both the primary and secondary support curves are generated by the same algorithm.) Indeed, in articles to follow we will show examples of strongly trending stocks for which one can clearly distinguish primary, secondary, tertiary and even fourth order support levels.

To introduce some Midasspeak, a Midas theorist would describe Stone Container thusly: "STO is in a primary bull move, with a thrice validated primary support level. It has currently pulled back to and is pausing at a doubly validated secondary support. No deterioration in the upward trend of obv is yet evident, so the expectation is that the secondary will hold and the price will resume its upward motion. If the secondary fails to hold, the price would be expected to decline at least to the primary support level at about 17."

Even though we have only looked at three Midas charts in this and the previous article, there should already be a change in the way we look at a conventional price vs time bar chart. One should focus on the trend reversal points and see whether one can visualize a series of support curves to which they might correspond. To facilitate this visualization, in the article to follow we will transform Midas charts from the cumulative volume to the time domain. In addition, since these three examples are all in contemporary real time, we will revisit them later to see how useful the Midas framework has been in characterizing their subsequent behavior.

Return to Investment Research

Paul Levine first became interested in technical analysis when he was a "runner" on Wall Street as a high school student. After graduating from MIT and gaining a PhD in theoretical physics from CalTech, he took a fresh look at the problem some thirty years ago and stumbled upon what has now evolved into the Midas method. Following retirement as Chief Scientist

and a co-founder of Megatek Corporation in 1981, he developed further elaborations of the method and is now in his fourth year as a professional trader. He can be reached at: **winmidas@winmidas.com or visit the WinMidas website.**
