

Introduction to the dividend-channel method

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Disclosure

- I currently hold long positions in SO and UTMD.

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The DIA ETF displays well-behaved price action, but the dividend stream is erratic.



This stock exhibits a well-behaved dividend stream along with well-behaved price action.



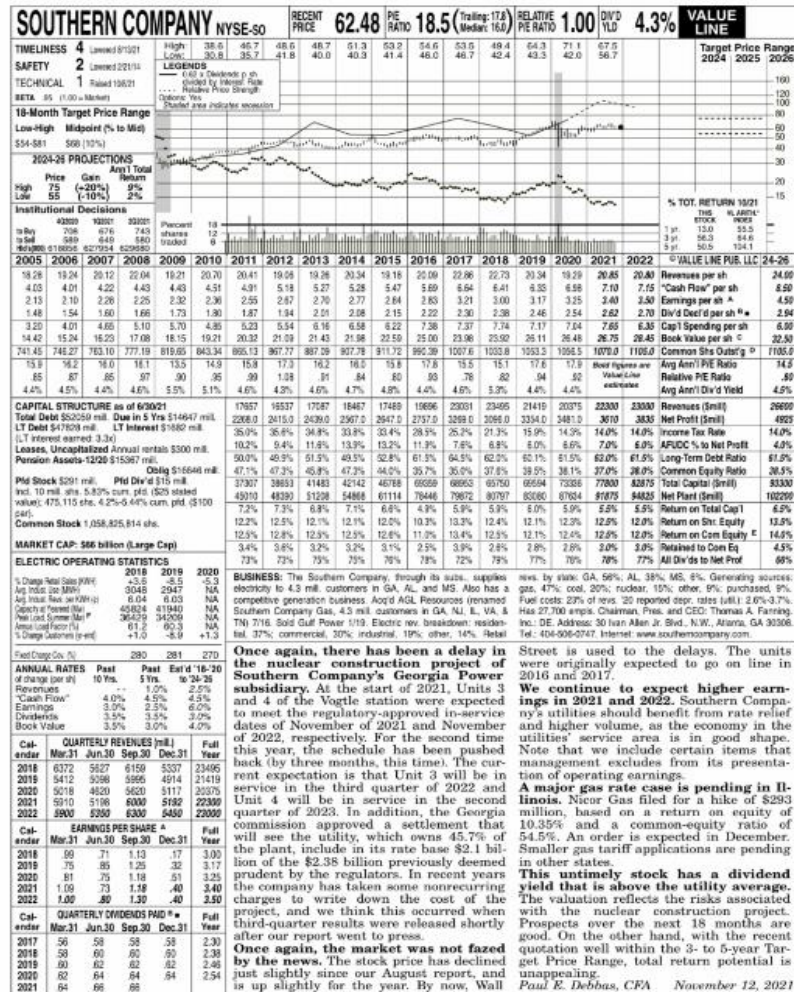
Once we have established that the dividend stream is well behaved, we look to make sure that the closing price is above the 50 month simple moving average.

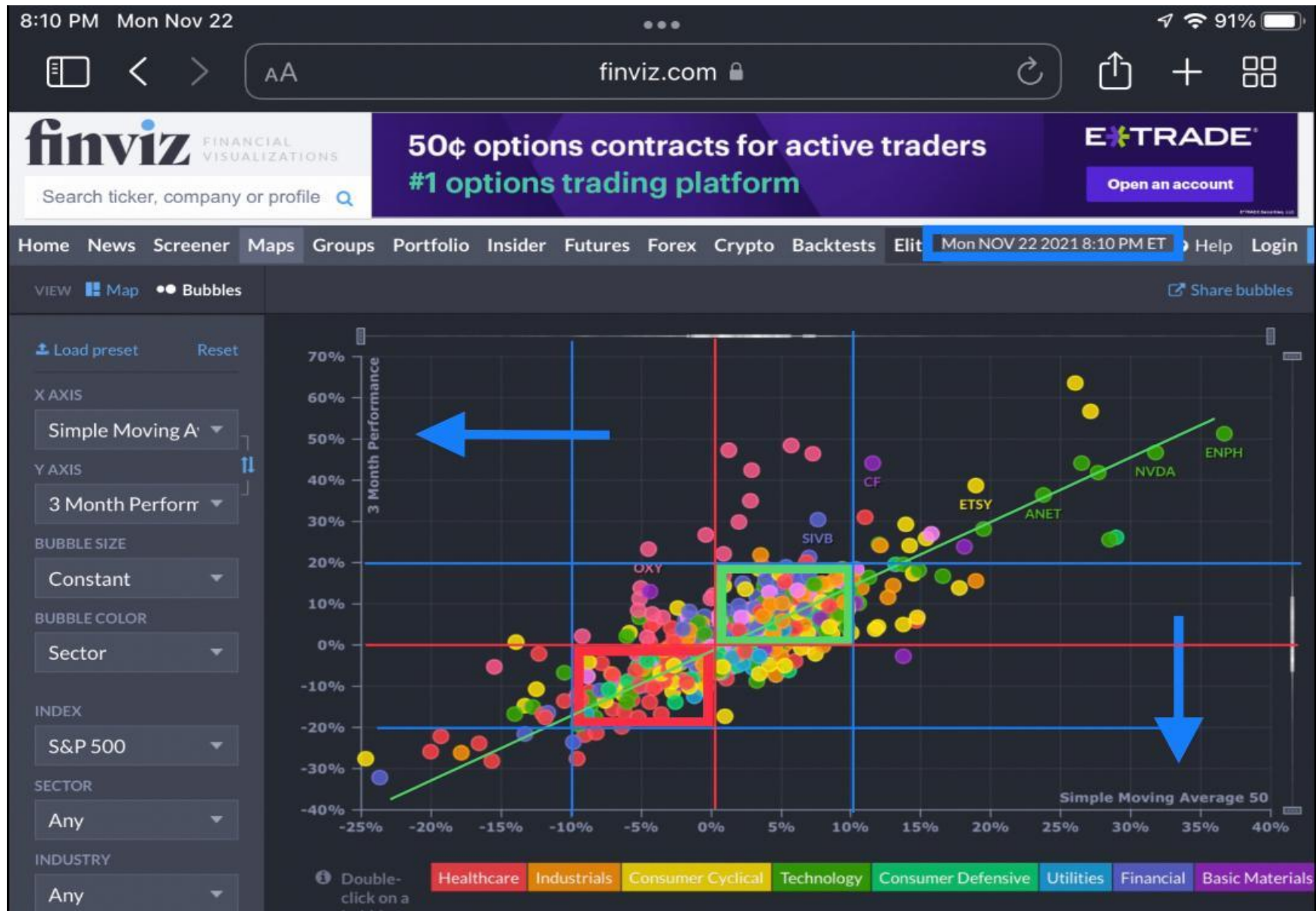


Next, we confirm that the 50 month simple moving average is above the 200 month simple moving average.

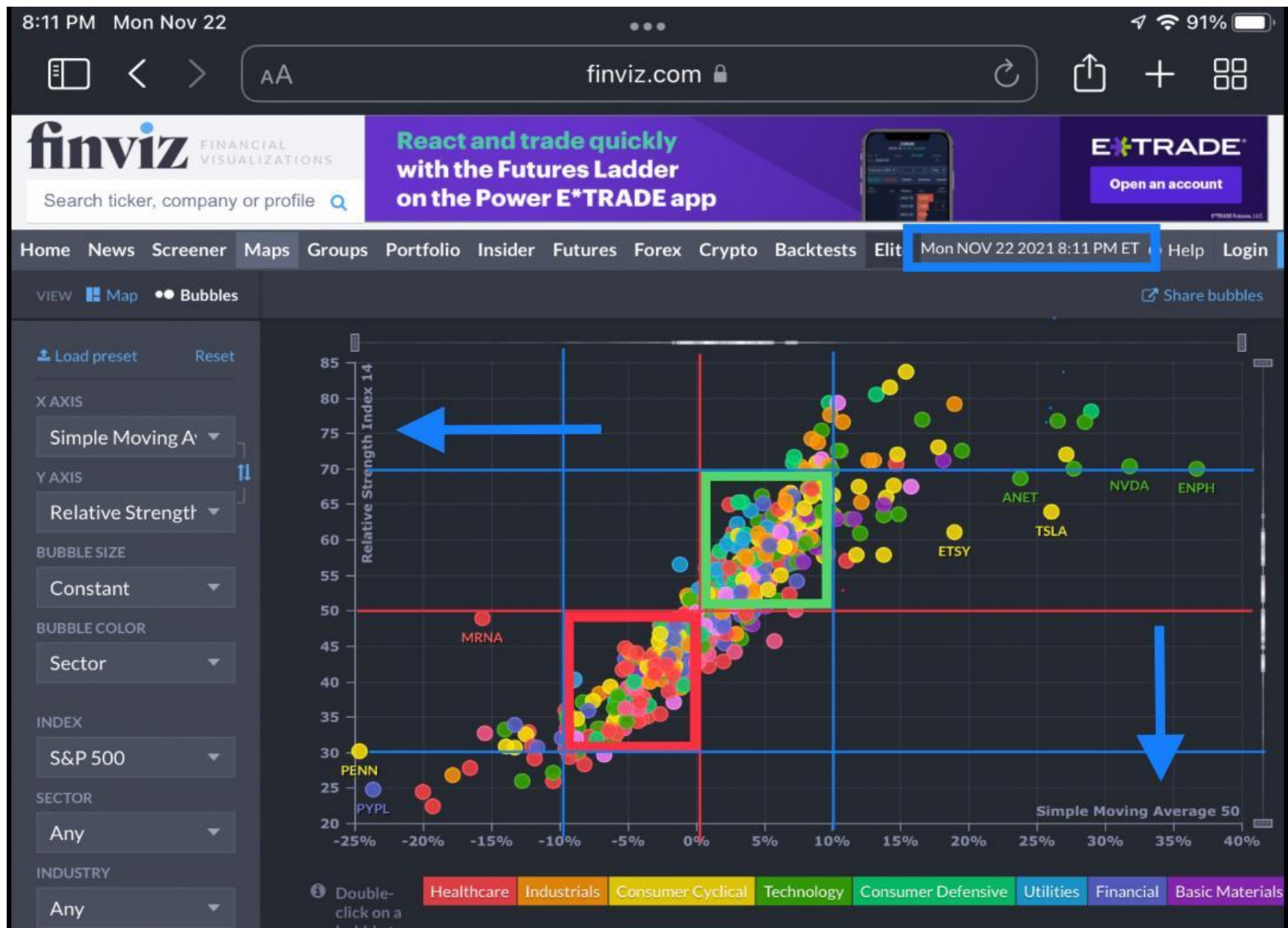


If we are looking to buy the stock, we now look to make sure that the MACD histogram is also positive.

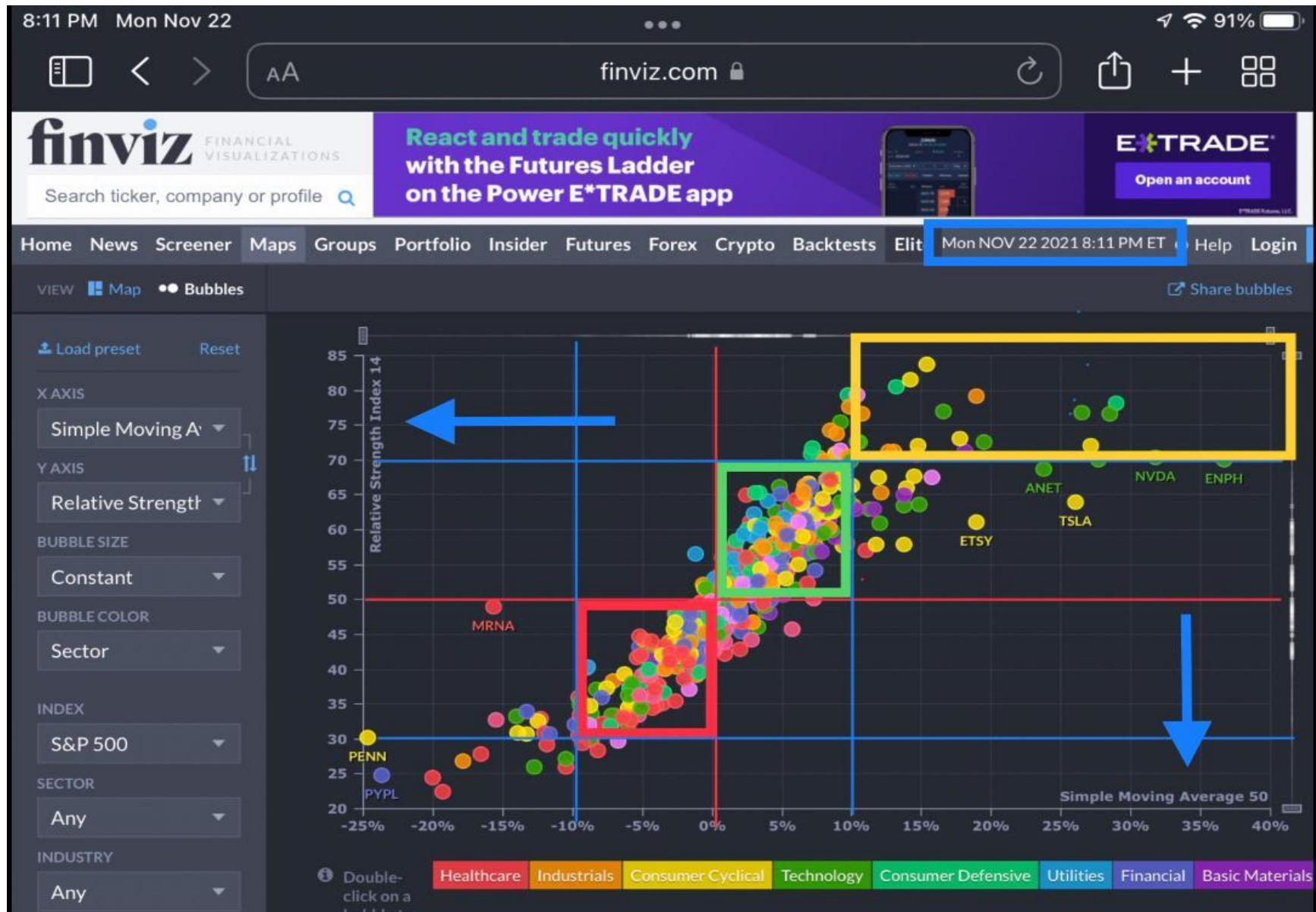




I got the idea for the channel method back in 2015 by looking at S&P 500 scatterplots. On daily charts, the bulk of S&P 500 firms trade $\pm 10\%$ around their 50 day SMA. The green box is the upper channel; the red box the lower. Each dot is a stock and its current price is plotted relative to its own SMA50.



With the same group of stocks you see that the RSI for the group is constrained between 30 and 70 on the RSI for those $\pm 10\%$ daily trading bands. Since the RSI is relatively scale independent, this allows us to compute appropriately sized trading bands for monthly charts ($\pm 40\%$ around the 50 month SMA).



So where is the speculative space? The green box is the upper channel (here on daily charts), the red box is the lower channel and the yellow box is speculative space where the RSI exceeds 70 and the price action is occurring above the top of the upper channel!

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Translating to monthly charts, we have re-sized our trading bands to +/- 40% around the 50 month SMA. This methodology was discussed in another presentation. Analysis of the dividend stream was another innovation that was added later on to improve results.



Now let's look at the price action. Attractive stocks with rising prices tend to travel in the upper channel (around the 50 month simple moving average). Stocks with falling prices stay in the lower channel.



The first sign of trouble is that the dividend flat-lines. It is still being paid but it is no longer incremented up as a step function. Also recall that rising stocks flow in the upper channel; falling stocks flow in the lower one.



Previously, the dividend stream was well behaved with an increasing step function with four equally-spaced payments per step. In the last step when the fifth payment is made at the same level, the stream flat-lines.



An even earlier signal that something is wrong occurs when the 50 month simple moving average is penetrated and the stock price enters the lower channel.

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Another sign of further troubles occur when the 50 month simple moving average drops below the 200 month simple moving average; a condition known as the “death cross”

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Here's another example of a stock headed for trouble after a long period of successful speculation suddenly ends. If the RSI is greater than 70 (the stock price is above the top of the upper channel) and the MACD histogram turns negative, we sell. Later the price falls through the 50 month SMA.



Here's another example of a stock running into difficulty after a long period of speculation. The sell signal occurs well before the company decides to no longer support dividend increases.

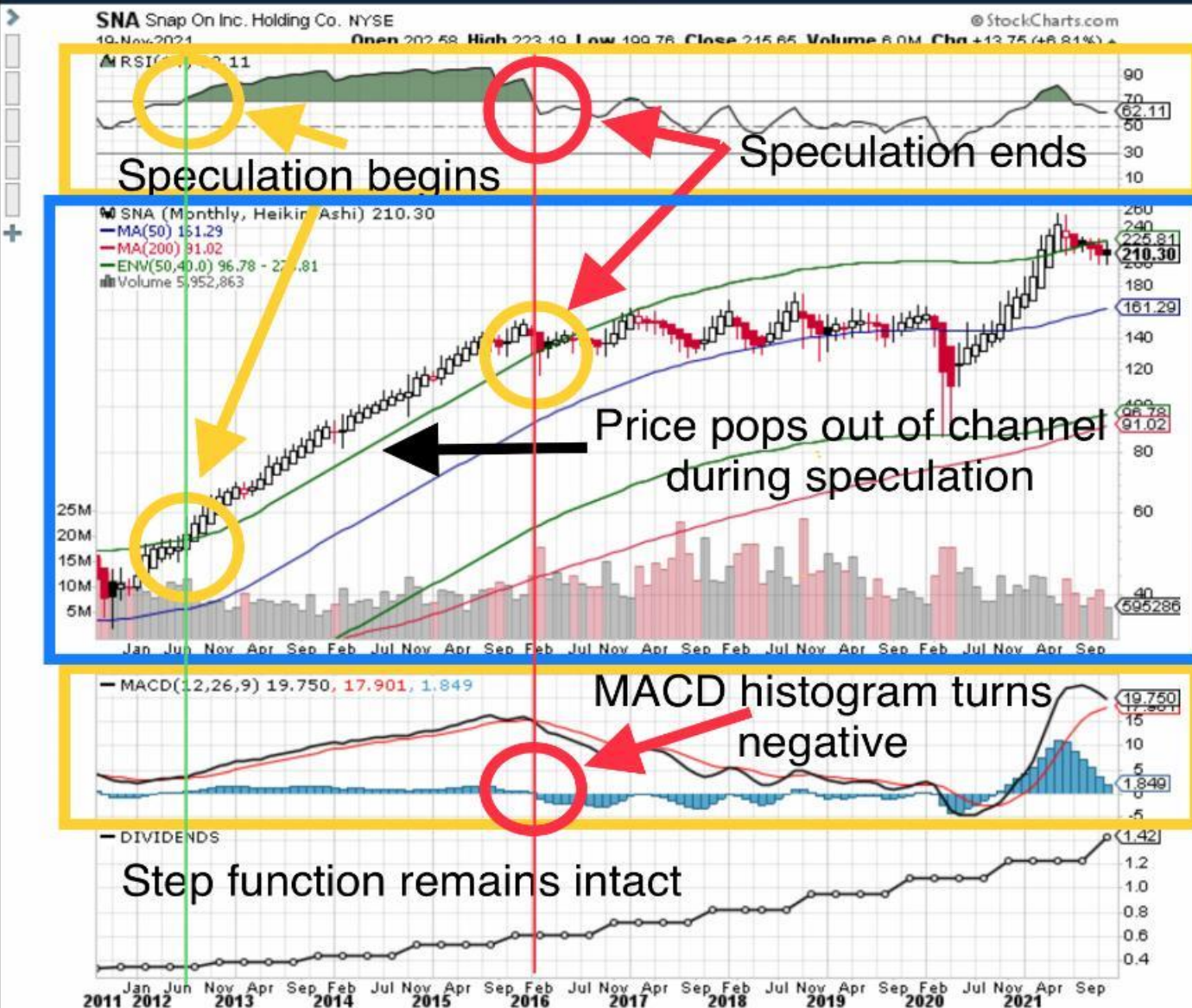


Shorter speculative periods (when the price action is above the top of the upper channel and the RSI is above 70) are very common and serve to give regular boosts to the stock price. We may still sell here out of caution as we don't know how far the price will drop at the red line.

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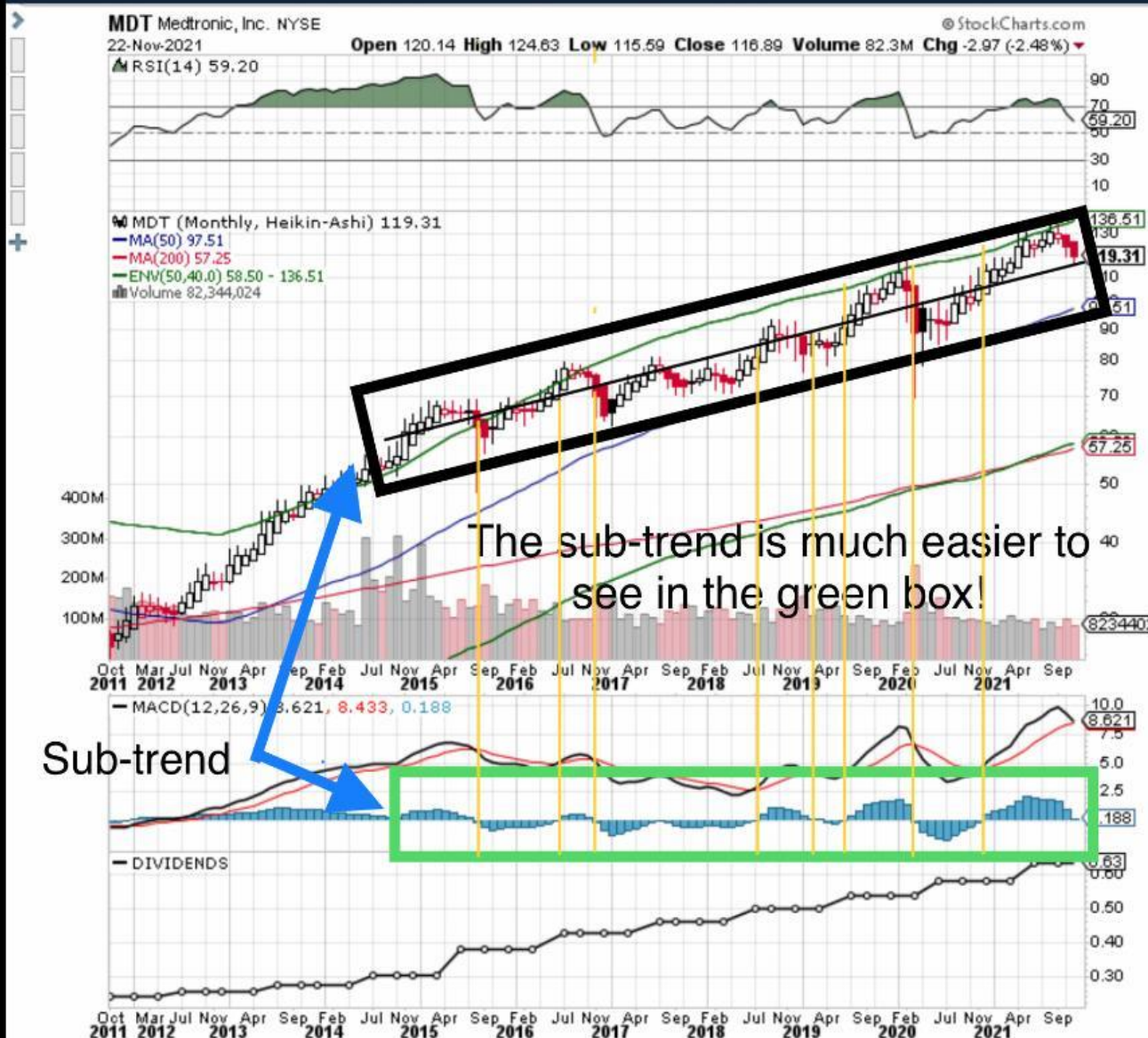
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Even if the price doesn't fall after a long period of speculation, it may go sideways for a very long time as the next base is being built.



In our analysis, it is important to differentiate between the main trend and the sub-trend within the price action. Recall that rising stocks live in the upper channel. The main trend is marked by the green arrow,



Here the main trend is represented by the black line. Note that the price oscillates around the main trend but that the pattern is much easier to read in the green box than in the black one. That's why we love to use the MACD histogram to keep an eye on the sub-trend!

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You can also easily see levels of price support and price resistance from the charts. Here we see strong price support at the 50 month SMA.

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An example of price resistance at the 50 month SMA. We would not ordinarily look at this stock because the dividend stream is so lousy. Note that the price action lives in the lower channel and the monthly SMA50 is below the SMA200.

Observations on selling

- Sell when ***any*** of the following conditions are true:

The main trend is a downtrend.

The current price is below its 50 month
simple moving average (SMA).

The stock is overbought and the sub-trend
is a downtrend.

```
// SELL SCAN USING MONTHLY CHARTS
```

```
[
```

```
  [FAVORITES LIST IS 45]
```

```
  AND
```

```
  [
```

```
    [MONTHLY SMA(50) < MONTHLY SMA(100)]
```

```
    OR
```

```
    [CLOSE < MONTHLY SMA(50)]
```

```
    OR
```

```
    [[MONTHLY MACD LINE(12,26,9) < MONTHLY MACD SIGNAL(12,26,9)]
```

```
    AND
```

```
    [MONTHLY RSI(14) > 70]]
```

```
  ]
```

```
]
```

Observations on buying

- Buy when ***all*** of the following conditions are true.

The main trend is an uptrend.

The sub-trend is an uptrend.

The current price is above its 50 month
simple moving average (SMA).

// BUY SCAN USING MONTHLY CHARTS

[

[FAVORITES LIST IS 45]

AND

[MONTHLY SMA(50) > MONTHLY SMA(100)]

AND

[MONTHLY MACD LINE(12,26,9) > MONTHLY MACD SIGNAL(12,26,9)]

AND

[CLOSE > MONTHLY SMA(50)]

]

Questions?

