

Checklist for Bases with Net Distribution

by Erik Grywalski

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One of the first things that I learned about technical analysis was that a healthy base should have **more accumulation than distribution**.

If not, it's likely a **faulty base** and an unlikely candidate to lead the market.

But before you write-off a stock with net distribution in its base, let me give you some background on my choice for the topic of this article.

I recently started my own base archive that contains over **300 annotated bases**.

After going through it with a fine-toothed comb, I found that **negative accumulation and distribution counts should be checked with other items before you come to a conclusion on the base**.

Some of the bases in my archive had **more distribution than accumulation**, but they all ended up having varying degrees of success.

Please don't get me wrong.

It's a plus if a base has more accumulation than distribution, but a **stock that shows net distribution within its base shouldn't automatically be passed over without some further investigation**.

My own experience also confirms my research on negative accumulation and distribution counts.

I missed several opportunities because I put too much emphasis on accumulation/distribution.

This was my fault, but it motivated me to come up with a **new way of evaluating bases**.

With that said, I have created a checklist for myself that I would like to share with you.

My checklist is a collection of questions that you can run through when you see a stock with net distribution within its base.

Along with your own due diligence, my checklist may help you in your base analysis.

You may even have some of your own questions that can add to or improve my list.

Here's my checklist for bases with net distribution:

Question #1: How old is the market uptrend?

Stock market uptrends will typically have several (2 or more) 10-20% corrections before becoming entrenched in a new bear market.

This is important because the majority of stocks tend to follow the market's main trend.

If you're in a market uptrend that's relatively young (less than 18 months old) and a stock's base shows net distribution, it might be insignificant in the big picture.

This may be especially true if the stock and general market are correcting for the **first time** since the start of their respective uptrends.

Historical Stock Chart Examples 1A & 1B: America Movil (AMX) 2004

America Movil (AMX) advanced 190% off the March 2003 bottom before falling into its first base during the Spring of 2004.

AMX declined 23% and by October 2004 was perched atop a 28-week base.

In its base, AMX had more distribution than accumulation by an 8 to 3 count.

That wasn't a problem as AMX broke out in late October 2004 and shot up over 400% by 2007.

In 2004, both AMX and the market were correcting for the first time since the bear market bottomed in 2002 This correction occurred within 12 months of the March 2003 low.



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Question #2: Have any of its peers recently broke out?

Group leadership is an important component of robust bull markets.

Group leadership occurs when multiple stocks within the same group break out of bases and start to trend higher.

These breakouts provide the leadership that's important to a durable market uptrend.

A good generalization to make is that if one stock in a group breaks out, others in the group are likely to follow.

While there's no guarantee that other group members will follow, it's common for stocks in the same group to move in unison given the backdrop of a strong market.

This "follow the leader" characteristic of group moves may override technical flaws such as net distribution within a base.

Historical Stock Chart Examples 2A & 2B: PMC-Sierra (PMCS) 1999

PMC-Sierra (PMCS) was one of the beneficiaries of the late '90s Internet build out.

PMC-Sierra along with its semiconductor peers experienced huge price gains between 1998 and the March 2000 top.

In the Fall of 1999, PMCS took a breather and set up in an 11-week base.

However, upon further inspection, its base showed 3 weeks of distribution and 2 weeks of accumulation.

Was this a cause for concern?

No and here's one possible reason why.

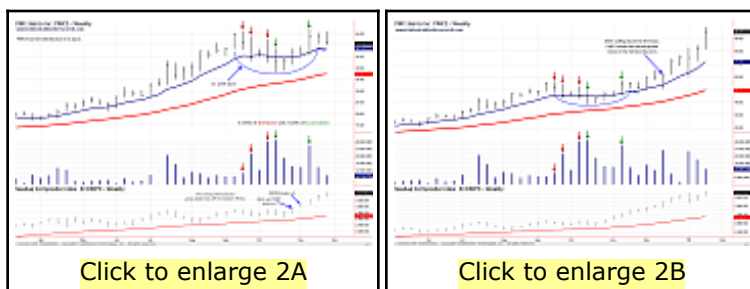
A month before PMCS left its base behind and started an advance, many of its peers started breaking out of bases during the initial surge off the October 1999 Bottom.

Marquee institutional names like Broadcom (BRCM), Q-Logic (QLGC), Triquint Semiconductor (TQNT) and Applied Micro Circuits (AMCC) were pressing into new high ground as the technology stock feeding frenzy entered its final phase.

By the time PMCS broke out (12/3/99), its fellow group members had already gone up anywhere from 15-55%.

From its base that featured net distribution, PMCS advanced 350% to the March 2000 top.

The semiconductors were involved in a strong group move during late 1999 and early 2000.



Question #3: Did the stock outperform the market before it began basing?

I like to call this the outperformance factor.

When looking for the outperformance factor, you're searching for signs of strength while the market is weak and floundering around.

For example, a sign of strength (outperformance) may be when a stock is trading above all of its main moving

averages while the market is trading below them as is often the case in a bear market.

If you can find a sign of strength, you may want to give the stock the benefit of the doubt despite the distribution in its base.

After all, there might be something good about the stock if it outperformed the market in the first place.

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Historical Stock Chart Examples 3A & 3B: J2 Global Communications (JCOM) 2003

J2 Global Communications (JCOM) went on a nearly 500% advance from February 2002 to November 2002 before falling into a well-deserved basing period.

During that time, the market, locked in a bearish move lower, fell 20%.

J2 clearly stood out at a time of extreme market weakness, but its basing period yielded a 19-week base that contained more distribution than accumulation.

J2 Global Communications shrugged it off and broke out in late March 2003, which also happened to be the start of the 2003-2007 Uptrend.

JCOM proceeded to go up another 275% before topping out in October 2003.

JCOM outperformed in a weak market and was rewarded when the market turned in 2003.



Question #4: Did price hold the 40 Week MA during the basing period?

I've noticed that if a stock can hold its 40 Week Moving Average (MA) during a market correction, it has the potential to break out if the market turns back higher.

This behavior stands out even more when a stock holds its 40 Week MA, but the market can't.

As a general rule, a stock that holds its 40 Week MA while the market went below it is a positive divergence worth noting despite the distribution within its base.

Historical Stock Chart Examples 4A & 4B: Fossil (FOSL) 2010

Fossil went on a 280% run after bottoming in early 2009.

It then set up in its first base, a choppy, 15-week consolidation, which featured net distribution.

However, during the market's 2010 Correction, Fossil was able to hold above its 40 Week MA while the market couldn't, a bullish divergence.

Fossil then broke out ahead of the market (a sign of leadership) and rallied 215% before topping out in July 2011.

FOSL based above its 40 Week MA when the market couldn't and it turned out to be a market leader.



Question #5: Did the stock show evidence of price thrusting within its prior uptrend?

Sometimes looking at a base with a wide-angle lens can give you a different perspective on the health of a stock. What exactly do I mean?

Please let me explain.

Many stock investors only use the price action within a base to determine whether or not a stock is healthy. However, this can be misleading because it ignores demand (volume) for the stock that led up to its basing phase.

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How so?

Demand for a stock before it bases is located in the prior uptrend.

As I mentioned, the prior uptrend is not used in base analysis.

However, demand from the prior uptrend may be very helpful in keeping things in the proper perspective.

Specifically, it may help you compare whether or not distribution within a base is significant or just part of a normal correction.

I like to call this process **Qualifying Distribution within a Base**.

Qualifying distribution within a base is a simple process.

Here are the steps that you need to follow in order to qualify distribution within a base:

Step 1: Use a weekly chart.

Step 2: Find a stock with net distribution in its base during a market uptrend.

Note: I would focus on institutional/liquid stocks and stay away from low-priced stocks that have little liquidity.

Step 3: Look for a price thrust (accumulation week) in the stock's prior uptrend. The price thrust range should be at the bottom of the base.

Note: If there is no price thrust in the prior uptrend, then you can't qualify distribution within the base.

Step 4: If the price thrust volume is heavier than the volume in the distribution weeks within the base, then the distribution in the base **may not be significant**.

That's all there is to the process.

You are essentially using the volume from the prior uptrend as a **benchmark** against the distribution volume within the base.

Please keep in mind that this is a technical process only and doesn't include fundamental analysis.

Fundamental analysis may also help you understand a stock so you should include that in your review process.

Let me show you how this works on a chart.

Do you remember my first chart example?

If not, it was America Movil (AMX) from 2004.

If you recall, America Movil's base had 8 weeks of distribution and only 3 weeks of accumulation.

Now - let's qualify the distribution within its base to get a clearer picture of whether or not the distribution is important.

Please take a look at the chart below.

Historical Stock Chart Example 5A: America Movil (AMX) 2004



Did you see how including the price thrust from the prior uptrend makes a difference in giving weight to the distribution weeks within the base?

America Movil (AMX) had significant price thrusting in its prior uptrend, which exceeded most of the distribution volume within its base.

I have some [more examples of this process in Step 2 \(Base Categories\)](#) if you'd like to see a few historical charts.

In conclusion, net distribution within a stock's base isn't necessarily the end of the world for a stock.

I've given you five (5) questions to ask if a stock has net distribution within its base.

This may help you in future markets.

Items like fundamental analysis are also an important part of the review process and should be included with any technical work.

Many things in the market are not black or white and that's where **historicalstockresearch.com** can help you better understand the stock market.