



An Anatomy of a Collapse: E*trade Financial (ETFC)

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We have harped for years upon the importance of technical analysis as a tool alongside fundamental analysis within an investment game plan. Fundamental analysis is going to answer the question of "What to Buy?" and technical analysis will answer the question of "When to Buy?" We all want to own fundamentally sound companies, but we also want to make sure it is a good time to be owning their stock. While it is rarely difficult to make the case to someone uninitiated to technical analysis, it can be difficult to show the benefits quickly. One of the most effective presentation tools that we have developed to convey this message in short order is through the "Anatomy of a Collapse". The concept is quite straightforward and the examples are plentiful, and it typically leaves a client or prospect with a very clear understanding of how important technical analysis can be to an investor. Some recent examples over the years in the "Anatomy of a Collapse" series of articles have been:

All of the above articles are merely examples of the importance of incorporating technical analysis in your portfolio management process, and each of which you should consider keeping in your casebook as most prospects likely owned, or heard about, at least one of these aforementioned stocks. Each of these Companies experienced very public un-doings, with the "cause" of said decline being revealed only after the stock was already un-done. The reality of these collapses runs counter to the way most investors like to envision the stock market, which is as an efficient machine with information being equally shared and quickly incorporated into the price of a stock. As a matter of fact, we know that markets are not really all that efficient. Here is what famed investor Mr. Warren Buffet had to say about how efficient the markets are.

"I'd be a bum on the street with a tin cup if the markets were efficient. Investing in a market where people believe in efficiency is like playing bridge with someone who has been told it doesn't do any good to look at the cards."

What we find, however, is that the technicals very often foreshadow the coming demise of the fundamental picture in such extreme cases as those mentioned earlier. From time to time we like to provide new examples for you to use in prospecting campaigns. The most recently feature prior to this one dealt with the subprime lenders, namely Countrywide Financial. Today, we continue to see the subprime crisis adversely affecting the equities market, especially in the financial-related stocks. Today we want to focus on a stock that has been making the front page headlines over the past month due to its subprime exposure: E*trade Financial [\[ETFC\]](#). ETFC is a member of the Wall Street sector, which for years was one of the leading areas of the market. Looking at a long term chart of ETFC shows that this stock rallied from the single digits in 2003 all the way to \$27 dollars by the beginning of this year. However, by July of this year this stock began to show signs of deterioration that became apparent by looking at the Point & Figure chart when it would have otherwise seemed as if everything was okay.

Let's take a look at the Point & Figure chart of ETFC in order to see how this story has unfolded, or maybe folded is a better way to put it, over the course of the year. In March of this year the trend chart of the ETFC traded above the \$27 for only the second time in history. Since reaching this mark, ETFC experienced a steady decline over the next few month prior to the flushing the stocks took of late. Despite being ever so gradual, it was at this point that ETFC began to show a negative divergence against the overall market. It is like the beginning of a wild roller coaster ride. After the steady ascent to the top of the mountain, the train makes it to the apex in the tracks and ever so slightly edges its nose downward in preparation of the plunge that is just moments away. While you are perched atop the roller coaster awaiting the plunge, there is that thought that crosses your mind that just maybe it won't be a steep this time around. This is how the beginning of the end started for ETFC. The stock peaked in March of 2006 and while the overall market was hitting new highs in July of 2007 the trend chart of ETFC was reversing down and making a lower top. This may not have been the "scream" that you were looking, but at this point, ETFC was showing a negative divergence against the overall market. Then, later in July the trend chart of ETFC gave its first sell signal of the year at \$20, a triple bottom sell signal to violate any major near term support on the chart. It was shortly after this breakdown that prompted us to write the following comment on the stock:

*(7/27/2007) E*trade Group, Inc. (\$18.77) - Wall Street - This stock broke a triple bottom at 20 yesterday. The decline then fell to 19 on its chart, its lowest level since June of 2006. Still above its uptrend line but its RS charts are in O's. The low to mid 20's would now be resistance and would consider hedging positions here or on any rallies.*

This breakdown was the early warning signs of trouble to come from this stock; however, it was not long after that the technical attributes for ETFC fell below the acceptable 3 threshold, which occurred on August 1st of this year. This was the first time that ETFC had a technical attribute reading below the 3 level since May of 2003. From May 2003 to August of this year ETFC more than doubled the return of the overall market, 190% versus 88% for the S&P 500 Equal Weighted Index. This outperformance occurred while the ETFC had a strong technical attribute rating. Since August 1st, when ETFC fell below the 3 positive technical attribute threshold, ETFC is down more than 68% compared to just a 2% loss for the overall market. In other words, even if you thought the triple bottom sell signal in July was a false signal for ETFC, you were afforded another opportunity to sell the stock in August when the technical attribute rating dropped to a 2 for 5'er, and has not been back above 3 since. Keep in mind that this was at about \$17. The Point & Figure chart gave you another chance to get rid of this laggard later in August when ETFC violated its long term bullish support line that dated back to 2003. This trendline violation occurred with the move to \$14.50 causing the overall trend of the stock to shift to negative and caused the technical attribute reading for the stock to drop to a lowly 1 for 5'er. If you missed this sell signal, then as they say...three strikes and you are out! In this case, out of luck and out of capital in ETFC. The subprime exposure losses and write-down announcements did not come to a head until October and November causing the stock to fall from the teens down into the signal digits in short order.

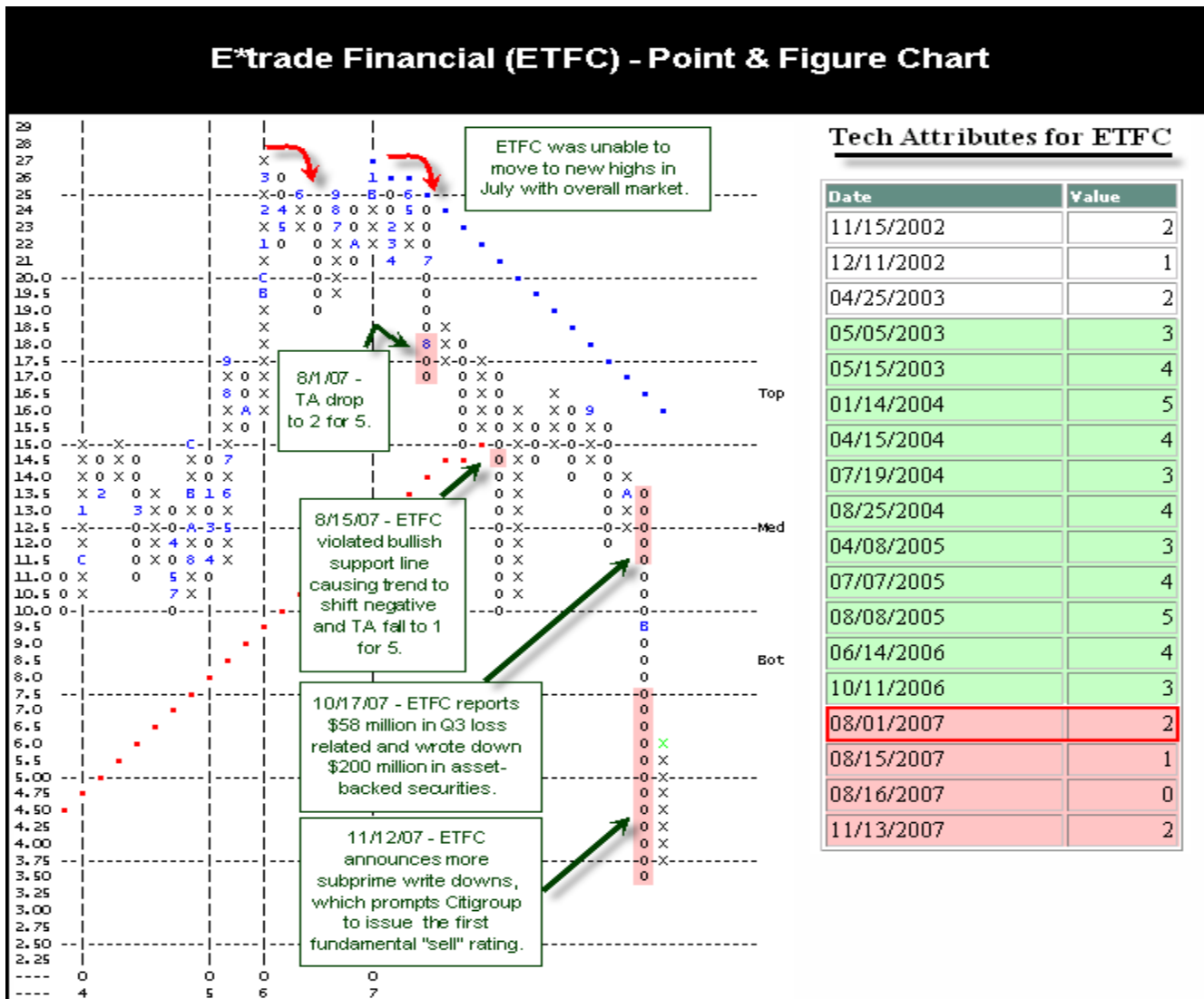
More Comments from DWA on ETFC's Descent:

9/11/2007

*E*trade Group, Inc. (\$14.350) - Wall Street - Like many in the group, ETFC continues to struggle. It once again failed below the bearish resistance line and reversed down to make a lower top. The next breakdown comes at 13.5, a double bottom. Continue to avoid here. Next support is the 11.5 to 11 area, the bottom of the ten week trading band and the bearish price objective.*

10/19/2007

*E*trade Group, Inc. (\$11.570) - Wall Street - ETFC broke a double bottom at \$11.50, a third straight sell signal with trend already negative. This move comes after an earnings announcement, but even prior to the most recent drop the stock was already a 0 for 5'er. The sector also moved to defense from above 70% this week, suggesting high risk. Continue to avoid this one.*



The interesting thing about cases like this is that it took until the November 12th of this year for the first “sell” rating to be placed on ETFC from the fundamental recommendations. By this time ETFC was already in the single digits; however, if you would have overlaid the technical picture on the fundamental picture then you would have been able to steer your clients out of the bulk of the decline of ETFC. You will notice on the fundamental recommendation table below that coming into 2007, there were two “overweight” recommendations, one upgraded to “buy” and one “neutral”. Therefore coming into 2007 the fundamentals and technicals were lined up. However, by the middle of the year the technical picture was deteriorating having given a number of sell signals warning you of trouble very early on. However, in 2007 there were two initiated fundamental recommendation of “buy” in 2007, and prior to October only one downgraded recommendation to “hold”. It took the last big flushing from about \$7.50 to \$3.50 in order to generate the first “sell” recommendation from the fundamental side of the equation.

E*trade Financial (ETFC) Fundamental Recommendations

Date	Research Firm	Action	From	To
12-Nov-07	Citigroup	Downgrade	Hold	Sell
12-Nov-07	Sandler O'Neill	Downgrade	Buy	Hold
12-Nov-07	Friedman Billings	Downgrade	Outperform	Mkt Perform
18-Oct-07	Deutsche Securities	Downgrade	Buy	Hold
22-Aug-07	UBS	Downgrade	Buy	Neutral
12-Apr-07	Deutsche Securities	Initiated	-	Buy
22-Feb-07	UBS	Initiated	-	Buy
4-Dec-06	Credit Suisse	Initiated	-	Neutral
30-Nov-06	Morgan Stanley	Initiated	-	Overweight
7-Nov-06	Prudential	Initiated	-	Overweight
23-Oct-06	Goldman Sachs	Upgrade	Neutral	Buy

Source: www.marketwatch.com and Yahoo! Finance

Whether you blame it on the subprime crisis or the credit crunch, the bottom line for ETFC is that the price of stock fell because there were simply more people selling the stock than there were people buying the stock. It is this simple economic concept, the same thing that drives the price of produce in a supermarket that drives the price of stocks on Wall Street: Supply and Demand. The Point & Figure chart does not care if the stock underlies a good company or not. There is no preconceived bias and there is absolutely no emotion in the Point & Figure chart. It is only concerned with the price action of the stock in order to record the imbalances of supply and demand. The technical picture of ETFC suggested to us very early on that supply had regained control of ETFC long before the stock plummeted more the 50% in a single day, and certainly before any of us heard about their \$200 million write-down in asset backed securities.

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