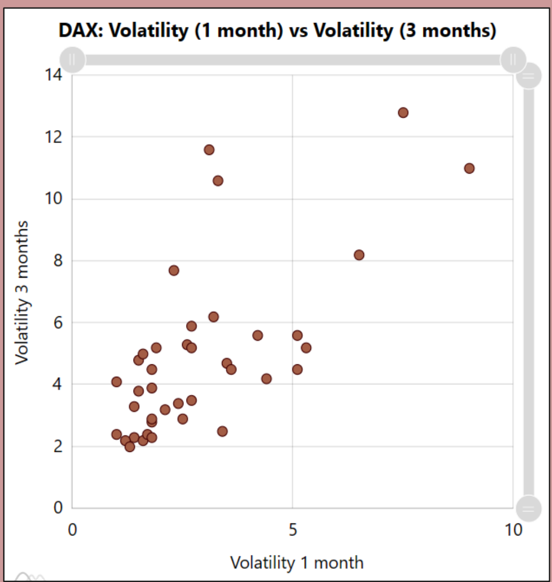
StoCoTo.com – Risk Assessment

Two Approaches to Understand Price Risk

The stock comparison tool provides two different ways to obtain an insight into price risk. They are presented in a graph with two different properties plotted against each other. The two visualizations that represent risk are based on (1) price volatility in recent month(s) and (2) the price position it currently occupies compared to the previous 12 months.

Risk cannot be derived directly as future price development is unknown, but past behavior can be visualized. Based on this recent behavior assumptions can be made if a certain stock carries a low, moderate or high risk of price change.

Short and Longer Term Volatility



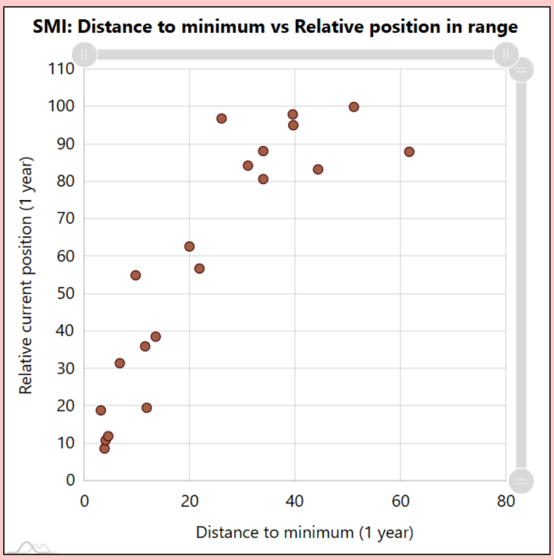
X-axis: Volatility over the previous 31 days
Y-axis: Volatility over the previous 92 days

Volatility shows the changeability of price over a certain time. It is not a direct indicator of risk, but is strongly associated. Furthermore, it does not indicate in which direction the price changes or that it fluctuates within a price range.

The general assumption is that stocks for which prices change more, there is a larger price risk. A price that fluctuates is more likely to change in an unexpected direction or a price that has grown for a prolonged time could stop growing.

With volatility it is possible to highlight stocks that recently have shown price changes or have remained stable. Combining the short term (1 month) with a medium term (3 month) volatility, it can be visualized if changes are recently or have been there for a longer time and an indication of price stability or fluctuation can be obtained.

Relative Price Position



X-axis: Distance to lowest price (1 year)
Y-axis: Relative current position compared to minimum and maximum (1 year)

The current price compared to the previous 12 months can be determined in two ways. (1) Having a relative distance to the minimum price and (2) a relative price point to the price-range of the last year.

The distance to the minimum price point indicates how much a price has changed over the last year. It could be argued that large price increases carry a risk of a large fall and for moderate price increases this risk is less.

The current relative price point in the range indicates where the current price is between its minimum and maximum price. This is the current performance compared to its performance over the last year and indicates if a share is on its peak or has fallen off. A value of 0 represents the minimum value and 100 the maximum value.

Developing a Trading Strategy that Incorporates Risk

To be successful in trading, a strategy needs to be developed. This is more than applying the risk insights from the two graphs, although they play a useful role. A first step is to understand the theory behind these graphs and how they are intended to be applied. Helpful are 'The Big Manual' and the articles on the technical indicator section of StoCoTo.com.

The two graphs are designed to indicate risk, although these are not exact as they are based on recent performance and changes in the market or for a specific company can change quickly. One useful feature of these graphs is the comparison to other companies to understand

This is also where the skills and experience of the traders come alive. This needs to be combined with an honest evaluation of past trades' risk experiences. Furthermore, an understanding of the company of interest by reading its quarterly or annual report and a sector review in which it operates provides more indications about its risk.

The stock market is unpredictable and all indicators shown in the webtool Stocoto.com are based on past behavior in price and volume.