THE EDUCATED ANALYST

A Free Technical Analysis E – Magazine for Traders of Financial Markets

Volume 2, Issue 2
MAR / APR 2010

THE IMPORTANCE OF HAVING A CORRECT **MARKET EXIT STRATEGY**

Learning the lessons of exiting from the professionals and the unexpected.

- **Gann's timing calculation**
  When to expect a change in market direction
- **Real-Estate Cycles**
  How do they affect the Stock Market?
- **Buyers vs Sellers**
  The Balance of Power

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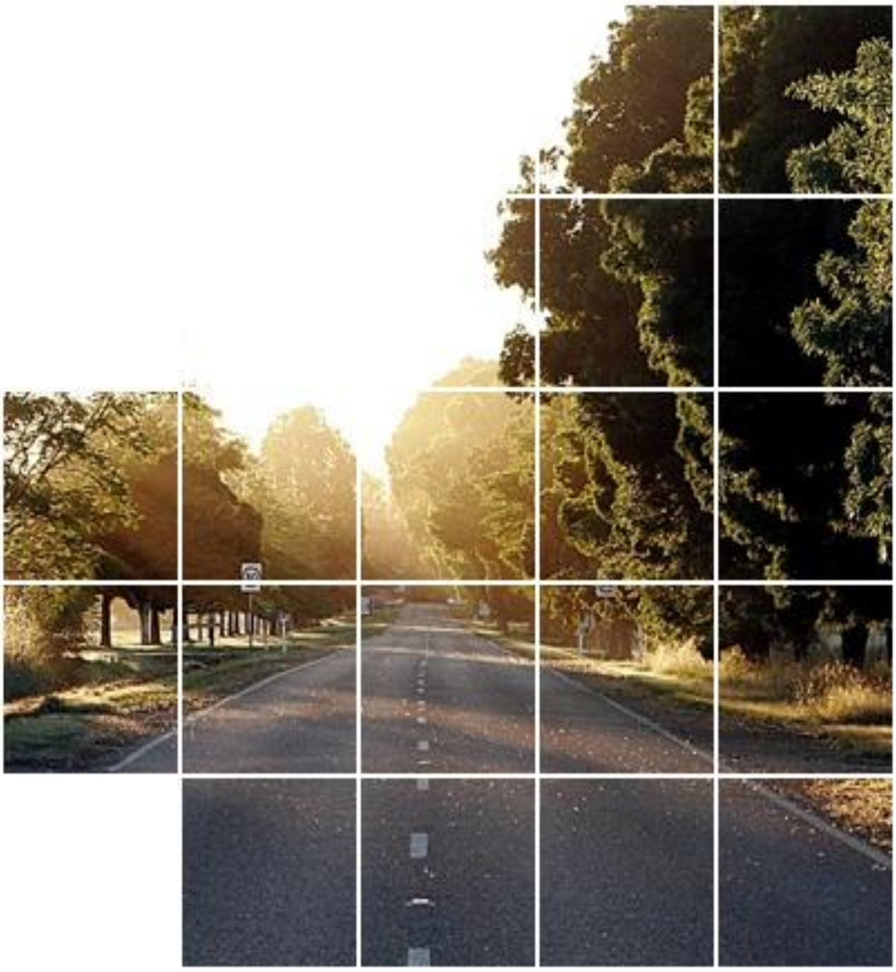


EDITORIAL

MAR/ APR 2010 - VOLUME 2 Issue 2

Hi and welcome to another edition of the Educated Analyst.

Once more we have a variety of articles available to help you with your analysis and trading. We are hearing so many mixed messages at the moment, from recovery being well established to sovereign debt which is about to unravel the markets. I think there is merit in both arguments. Many economies are doing well, Australia has just increased cash rates to 4% - the fourth rise in 5 months. However, the debt issues in Europe create a lot of uncertainty. The member states of the EU, while financially linked, are not fully politically linked and individual governments would face populous revolt if they bailed out their neighbours. Unlike the US and UK, these EU countries cannot print more money to make their debts "disappear", so this is going to be the most volatile issue that we will face in the first half of this year.

Another issue that is currently flying under the radar is that of Dubai. It's generous neighbour (Abu Dhabi) has only covered around 18% of Dubai's debts until the end of April to allow Dubai to restructure its loans. So far no details have been produced to show how this has been done, and the five year credit default swaps are at their highest level (651) in ten years. Higher than what they were at the height of the November crisis.

So where is the market going? With all the mixed news reports, it is difficult to say. What we do know is that there are a lot of "itchy fingers" out there and when the market moves (in either direction) there are a lot of people who jump on board increasing the volatility. The best thing to do is to come back to the basics, look for your signals, set your stops and work out before hand where you are going to exit.

This month there is a real bias towards money management and strategies that you can use to help you exit the market. I know from personal experience the anguish of holding a trade too long, or jumping out too early because I think the market has turned. There are two things that can help with this: The first is a good strategy for getting out of the market, that's what you'll find in this month’s Educated Analyst. Secondly, being satisfied that you made your target and you walk away with a win.

Again, I trust that the Educated Analyst is of benefit to you and ask that if you know someone that could benefit from reading the articles, send it on to them. Also remember that all the back issues are available free on our web site.

All the best,

Mathew Verdouw
Editor
The Educated Analyst

THE RELEVANCE OF **GANN'S TIME THEORY**

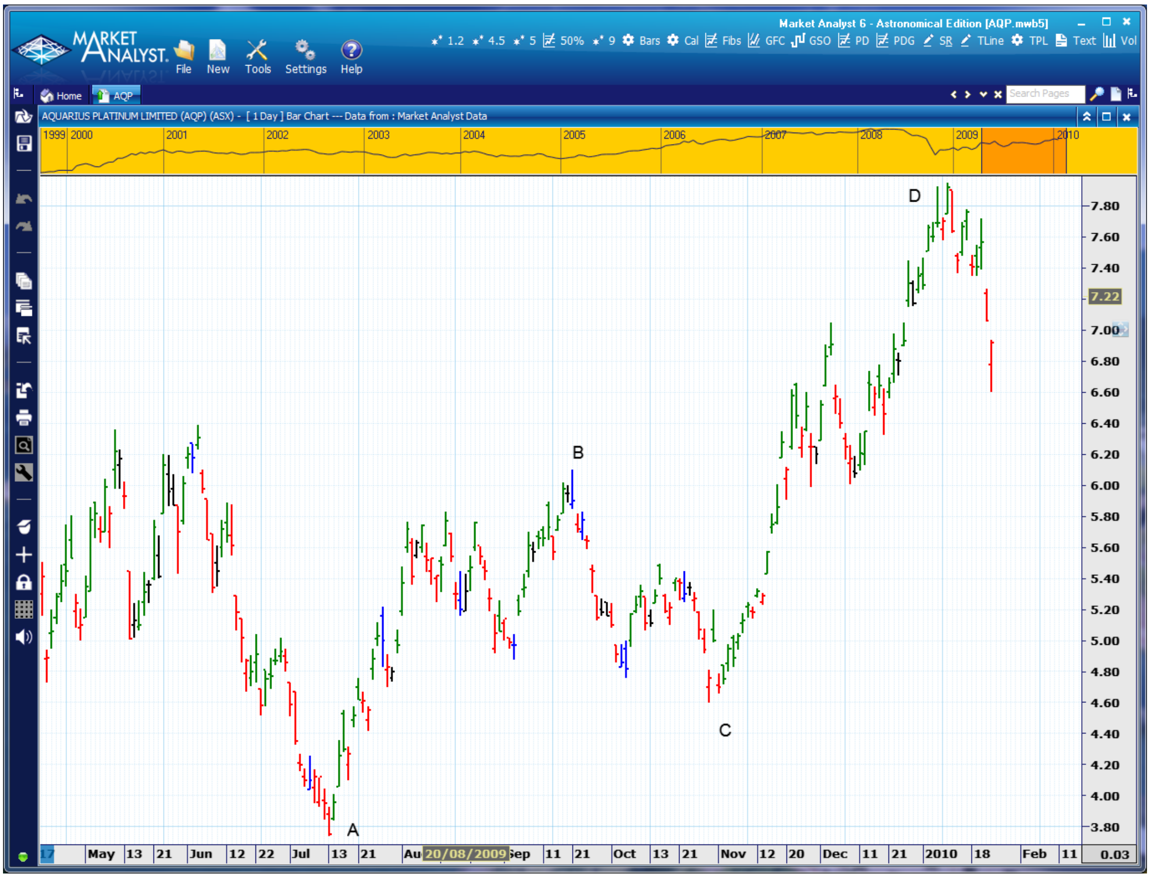
With Alan Oliver

It still amazes me whenever I talk to sceptics of the great works of W. D. Gann. I have used his timing theories and cycle analysis to make profitable trading decisions, yet others will dismiss the theories without a second thought. I suspect that these sceptics haven't put in the essential effort to really apply themselves to understand it, or it simply hasn't been explained well enough. There is a third reason, and I know that many people expect trading to be easy, lucrative and the playground of billionaires, because it is very easy to buy or sell either online or by picking up the phone to your broker.

Still, I know the Gann theory works, just as well today as it did 100 years ago, and we will look at an example of this on an Australian stock Aquarius Platinum Ltd. This stock came to my attention as an article I read pointed out that the ever increasing demand of platinum is likely to make prices skyrocket due to diminishing supplies. Supply and demand, after all, is a key to successful trading...

If we look at the chart, we can see a major low formed July 13, 2009 at a price $3.74. This point I marked as 'A' on the chart. The next major top occurred September 21 at $6.10 marked B, followed by another major low October 29 marked C, and finally the most recent top January 11, 2010 marked D.

Gann told us many things, but one that is of relevance here is that highs and lows are not spasmodic or random; they form as a direct result of mathematical relationships to previous highs and lows.



Source: Market Analyst 6 (www.Market-Analyst.com)

By now adding the Time Price label tool to the chart, we can see some important information that gives us vital clues to the next campaign or movement in the stock.

From the low at A, we see that it took 50 trading days to reach the high at B. Nothing spectacular or unusual about that, but it does give us a reference range in time and price to record for future use.

Gann told us Time was more important than price, so we must remember the time frame and look for any relationships to this count in the future.

Source: Market Analyst 6 (www.Market-Analyst.com)

Now, let's look at the next leg up from the low at C to the high at D. Again, we use the Time Price label tool in Market Analyst to see the details of this run.

The next chart (over the page) shows a remarkable market event that repeats consistently enough for educated traders to make great trades. The time count between point C to point D is 49 trading days, only 1 day different to the time it took from point A to point B.

Look closely at this chart and you will see another fabulous market tell tale, the pattern known as 'Three lower tops'. Perhaps it could be called two lower tops, but nonetheless we have the major high at D, then two consecutive lower tops marked 2 and 3 which reveal a distinct lack of buying strength unable to continue the momentum to higher prices.

So, perhaps platinum will continue on to make stellar prices as the groundswell of orders for the precious metal builds, but not today as this chart clearly shows a repeat of a previous time frame and a sell signal pattern of three lower tops: two definitive selling signals at point D.

This chart confirms the Gann theory is alive and well some 50 years after his death. It also proves that you will only achieve a result or profit which is directly attributable to the amount of effort you put into your education and trading.

May the trading gods be with you.

Source: Market Analyst 6 (www.Market-Analyst.com)

About Alan Oliver

Alan Oliver is a full time trader and private educator. Early in Alan's career he worked for two major Australian banks where his interest in the markets began. After developing and successfully honing the skills of a full time trader, Alan left the workforce to trade full time which is what he has been doing ever since. Most recently Alan has written a book on his favourite subject of Fibonacci and the Golden Harmonic ratio. Alan has travelled extensively, been invited as a key speaker to many countries including: Australia, Hong Kong, Malaysia, Singapore, Thailand and China.

Alan also runs a web site (named after his book) to assist traders www.tradingwithgods.com.

THE Coke BOTTLE TRADER

With Chuck Lebeau

Back in the late 1960s, I was a young commodity broker at E. F. Hutton and Co. Our office was a brand-new high-tech office (for its time) that was considered the "flagship office" for E.F. Hutton.

In this office about 30 brokers and as many clients shared one very large boardroom, and there were no private offices. The brokers had elegant and expensive desks, and the clients had a comfortable seating area in the front of the office where they could hang out and watch the tapes and monitor our state of the art commodity "clacker board."

Sitting at my desk near the front of the boardroom, I could read my Wall Street Journal and keep track of the commodity markets without looking at the board. By just listening to the rhythm and tempo of the mechanical clicks as the prices changed, I could easily tell when anything important was going on, because the tempo of the clicks would increase noticeably.

Just in front of my desk were half a dozen comfortable sofas facing a high mahogany-panelled wall with the tapes and the "clacker board." A gallery of traders, mostly retired "old-timers" who were trading real commodities like grains and pork bellies, lounged around on the sofas plotting their charts and talking about life and the markets. They typically arrived early to get a good seat in their usual spot and then spent the day trading, exchanging commentaries and offering unsolicited advice to one another on any subject.

For the most part, they were a very sociable group who would take coffee breaks together and greeted each other on a first-name basis. These traders enjoyed the elegant atmosphere and treated our well-appointed boardroom as their private men's club. (Were you aware that women were not allowed to trade commodities back in those days? My, how times have changed!)

One of these "old-timers" kept to himself and was not interested in becoming a member of the friendly and often boisterous social circle. He usually sat quietly by himself, intently watching the price changes on the commodity board and holding an old glass Coke bottle up near his ear.

The vintage-shaped Coke bottle had been emptied many years before and now contained only a 12-inch tube of bent and broken radio antennae, which extended awkwardly out of the top of the bottle.

Keep in mind that in the 1960s no one had yet heard of cell phones, so the purpose of this Coke bottle was a real mystery to everyone. When the trader would talk to the bottle from time to time, all the heads would turn, and the traders nearby would try to listen to the conversation. But the trader spoke very softly, and no one was able to eavesdrop on his conversations with the bottle.

The traders knew that the fellow with the Coke bottle was a client of mine, and eventually a representative of the group came to me and said they were extremely puzzled about this guy and his Coke bottle and asked me if I knew what was going on. I didn't know the purpose or meaning of the Coke bottle, but I was as curious as anyone was, and I promised I would find out. The next time the client came back to my desk, I promptly placed his order and then politely asked him about the Coke bottle.

With a serious expression and no embarrassment, he explained to me that the Coke bottle was an inter-planetary communication device that had been given to him by aliens. He said the aliens were very interested in our commodity markets and they often gave him trading advice from their various observation points on other planets. He said he had just had a message from Mars and they were buying soybeans, so he had also purchased soybeans. After revealing his unique trading methodology, he returned to his seat and resumed his whispered conversations with the Coke bottle.

As soon as I revealed my discovery of the meaning of the Coke bottle to the other traders, all attention was immediately focused on the Coke bottle trader and the soybean market. The soybean market proceeded to go the wrong way, and the trade from Mars was eventually closed out at a loss. The other traders had no sympathy and were quick to begin ridiculing the trader and to poke fun at his beliefs.

The next trade, however, turned out to be a big winner, and the Coke bottle trader went from sofa to sofa telling his story and pointing to the clacker board while waiving his Coke bottle and bragging about the profitability of his most recent message from outer space. Because he was making money now, his previous critics had to endure his bragging about his success on the current winning trade.

After a few winning and losing trades later, a clear pattern of behaviour began to emerge. The Coke bottle trader was ridiculed unmercifully on his losing trades but was able to get his revenge and the last laugh during the winning trades. This trader might have been a little bit crazy, but he wasn't stupid. He soon learned that his only defense against ridicule was to hold on to winning trades as long as possible and to quickly get out of his losses.

As long as he was sitting on his sofa with a winning trade, no one could tell him he was crazy and make cruel jokes about his messages from Mars. In fact, while he was winning he was quick to wander around the room and ridicule the methods of the other traders who were not making as much money as he was. He displayed the profits in his trading account as hard evidence of the validity of his methods and offered copies of his statements as irrefutable proof that he was getting valuable advice from his alien contacts. Who could argue when his advice from other planets was obviously working?

For a young broker, this experience and the firsthand observation of the Coke bottle trader who suddenly became profitable gave me my first important lesson about the importance of exits. I knew the entry signals had nothing at all to do with his success. His batting average was not any better than that of any other trader. However, this crazy old trader seemed to be able to make money consistently, while other traders with more "sanity" and more valid entry methods were losing.

Before long I was able to recognize that this man had become a successful trader simply by his efforts to avoid ridicule. He knew he was vulnerable during his losing trades, so he closed them out very promptly. His winning trades became his shield against the ridicule of the other traders, and he kept his winners much longer than before his unorthodox methods were revealed.

In the many years since this experience, I have encountered many claims of success for entry methods that probably have even less validity than the Coke bottle messages. I have learned to look only briefly at the entries of winning traders and to examine their exit strategies very carefully. I am very fortunate that more than 30 years ago I learned from the Coke bottle trader that success in trading depends on our exits and not our entries.

About the Chuck Lebeau

Charles "Chuck" LeBeau began trading his first commodity system in 1963 and has been an active systematic trader in stocks and futures for more than forty years. He is the co-author of Computer Analysis of the Futures Market (McGraw-Hill, 1991) which is considered to be a classic work in technical analysis that is now published worldwide in seven languages. In addition to his bestselling book Chuck has also authored many magazine articles about trading and is considered a foremost authority on technical indicators, particularly the Average Directional Index (ADX), Average True Range (ATR) and various exit strategies.

On the Couch

With Chris Shea

Reflections on the Stop Loss

The subject of this article is the "Stop Loss". By this we mean the exit point for a trade if it goes wrong after it is initiated. Without a stop loss as part of your trading routine you are in danger of a huge capital, and worse, psychological loss. Even if you have a very high hit rate of successful entries it only takes one unprotected trade to wipe you out.

Exercising a stop loss should be like brushing your teeth: good trading hygiene. Exercising a stop however has deeper psychological implications. It means the initial entry was incorrect. If you are trading for ego rather than profit, this can be a blow. So much so that amateurs and beginners will be tempted to ignore the stop "in case the market comes back". It usually doesn't, so the one who lets the stop go is essentially in denial: he or she would prefer his or her view to prevail; even if the market reality presented to them is that the trade is not working and should be discontinued.

Now let's delve deeper into the stop loss.

A vast improvement in outcomes occurs when the trader consistently uses the stop loss, but unfortunately this will not lead to superior profits. Relying on a rigid stop loss alone probably means the trader will break even or slightly better. Why is this so?

A stop loss is like house insurance. You pay the premium but you never want to use it. If you saw a small fire on the kitchen bench, you wouldn't just say it doesn't matter if the whole house burns down because I have insurance and I can just cash it in. No, you would put the fire out immediately if you could. (The amateur without a stop loss trades without house insurance and hopes the fire in the kitchen will go out of its own accord).

What I am saying here is that relying on a fixed stop loss is a passive approach to the market. It's creating a worst case scenario defensive situation. The stop might be 2 ATR or 1% of capital away, but watching as your stop is about to become hit means you are not prepared to take responsibility or act by putting the small fire out while you can.

I'm not saying that when you enter a trade you do not need a stop loss. It's a must, just like insurance is for the home owner. But you shouldn't just rely on the worst case scenario as the trade plays out.

The market pays you for your agreeing with it. It doesn't have to agree with your view or position. It doesn't have to go up just because you buy.

When you enter a trade it must be for a reason. If the market confirms your entry, then you would hold the position with a view to working it as long as your trade was in accord with the market.

But what would happen if just after your entry the market contradicts rather than confirms the entry? Rather than let your insurance stop come into play, wouldn't you be better off to exit the position immediately? (Put out the fire when it is small!) This is what professional traders call a "Scratch" trade. Not only would you save some capital, but also you save yourself psychologically for a new entry as soon as it is indicated. This way you are aligned with the market with very small losses.

Let me give you an example using real data from my files.

A client came to me after a very bad experience in day trading the Australian SPI. He performed 312 consecutive trades in a 3 month period. His hit rate (Wins out of the total entries) was 37% and he lost 384 points. At $25 a point this is a sizeable sum of money to lose. He was aggressive but not prepared to take control of his outcomes.

Basically he didn't employ a stop loss consistently, although he was meant to have a 10 point stop. Let's see what would happen under these various scenarios applied to his data: same entries, but employing rigorous defence.

Action	**Outcome**
No Stop	-384 points
10 point stop	+133 points
8 point stop	+321 points
5 point stop	+699 points

Isn't this data striking?

It shows that a 10 point defensive stop avoids a calamity but a 5 point scratch stop enables very good profit. This data discounts the worry whether a scratched trade comes back after its execution. In the example above, on a few occasions the trade did come back after being scratched where it would have been advantageous not to scratch. But nevertheless it was not so often to make it worth ignoring the scratch rule for a couple of exceptions.

Lest you think that this idea applies only to day traders, here is another data set. These are the actual results, juxtaposed with a scratch and $200 stop of a position trader with $100,000 and an $800 stop (0.8 % of capital). This trader held the positions derived from chart patterns that could last for days.

2009	**Actual**	**Scratch**	**$200 Stop**
January	-8021	124	-2559
February	1231	4740	2992
March	11442	18662	15889
April	-2015	4440	3372
May	8299	16839	13870
June	528	10182	7843
July	-12171	173	-2716
August	6409	14300	10807
September	4848	9219	8210
October	9241	18886	14978
Total	**19771**	**97565**	**72596**

By itself the $800 stop gave a satisfactory return of 20% for the 10 months. It beats most superannuation funds for the period. But the results are quite unsatisfactory for what was possible if he traded out of the position when the market did not confirm it. His return applying the scratch rule was 97% for the period, some 5 times better than what he actually received. Even with some leeway on the scratch to the tune of -$200, he achieved a 72% return for the period. Not bad!

The evidence from these 2 case studies should make you very aware of some of the drawbacks of the traditional inflexible worst case scenario initial stop loss. It is psychologically comfortable to have your stop in place, and for investors it is probably a sound strategy. But for a trader it restricts profit.

A trader should know, before initiating entry of a trade, what information is required from the market to confirm the entry. If the market doesn't confirm the entry, then watching, waiting and hoping is not a strategy. There is only one thing a trader should do in this case, and that is to terminate the trade and go on to the next opportunity to get into agreement with the market.

Psychologically the scratch trade means that the trader is detached, objective and market aware, able to take decisive action if the market requires it. A trade is not scratched through fear or timidity. It is scratched because the trader has the courage to take responsibility for an action that is appropriate to the market conditions that prevail at the time.

Scratching is a dynamic, flexible and market focused stop loss strategy that really works as the data in this article shows. It is a new skill that every trader needs to learn. Through discipline and practice you can learn the skill and benefit from its application. When you ace it, you are on your way to becoming a trading professional.

About Chris Shea

Chris Shea is an investor, trader, educator and psychotherapist who specialises in coaching those who want to become and stay successful in financial markets.

Through his in depth Best Professional Practice Program Chris has an established a track record in coaching clients to develop the skills and drive to become independent, disciplined and very profitable full time traders.

Chris is author of "Licensed to Profit by Trading in Financial Markets".

Chris holds a Bachelor of Education, Master of Science as well as a Diploma of Professional Counselling. While based in Brisbane, Australia, Chris has private and institutional clients in Australia, New Zealand, Ireland, USA and Singapore.

www.themarketcoach.com

Do you have a question that you would like to ask Chris Shea? Email your question to thecouch@educatedanalyst.com

Natural Squares

Calculator Dates

With Ken Gerber

One of the advantages of studying the charts and papers of W.D.Gann has been the ability to study the many different ways that Mr. Gann used the Square of Nine and the movable date rings he attached to it.

When Nikki Jones and I created the Natural Squares Calculator, we tried to incorporate many of the different styles of date rings that Mr. Gann used. In combining the clockwise and counter-clockwise date rings, we uncovered another of the exciting mysteries that make Gann research so richly rewarding.

Since Mr. Gann used both date rings in his applications, we created both on the same ring. March 21 on the clockwise date ring aligns with September 23 on the counter-clockwise ring. This aligns the 2 equinox dates 180 degrees apart in the calendar year with each other.

The chart below is a continuous daily July Soybean chart put together, or concatenated, as Mr. Gann did on all of his commodity charts. It consists of the July 2008 contract of soybeans until its expiration, immediately followed by July 2009 soybeans until its expiration, then July 2010 soybeans.

The first high shown in the chart occurred on July 3, 2008. That is now the all-time high for July soybeans with a price of 1663.

If one locates the date of July 3 on either date ring of the Natural Squares Calculator, the corresponding date or inverse date on the other ring (progressing in the opposite direction), is June 11 (see Fig. 1 below). What we have discovered is that the probability of another change in trend on the inverse date is extremely high. In addition, the odds are very good that it will be the same trend change (significant high or low). Notice then on the chart that the high of the 2009 year comes on June 11 – exactly on the inverse date to July 3.

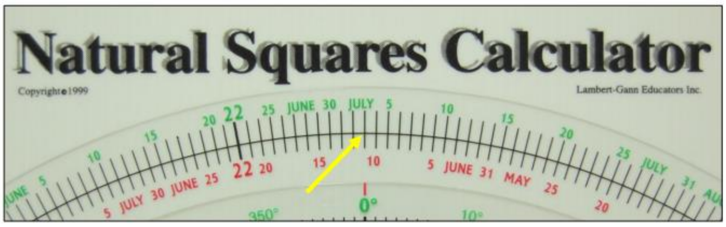


Figure 1

Source: Market Analyst 6 (www.Market-Analyst.com)

The next significant change in trend is the low on Dec 5, 2008. Using the same procedure as before, locate the Dec 5 on either date ring of the Natural Squares Calculator. The date next to it or inverse date (progressing in the opposite direction) is Jan 7 (see Fig. 2). Looking at the chart again shows that the next significant high is on Jan 12, just 3 trading days off. This example is the only one on the chart that switched from a low to a high.

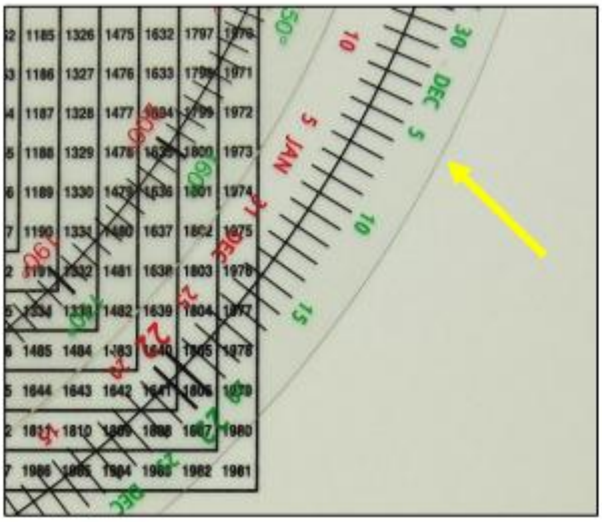


Figure 2

The first higher bottom after the Jan 12 high is on Mar 3. Locating Mar 3 on the Natural Squares Calculator date ring gives us a corresponding or inverse date of Oct 11 on the date ring which moves in the opposite direction (see Fig.3). Referring again to the July soybean chart finds the next significant low on Oct 6, just 5 days from the projected date.

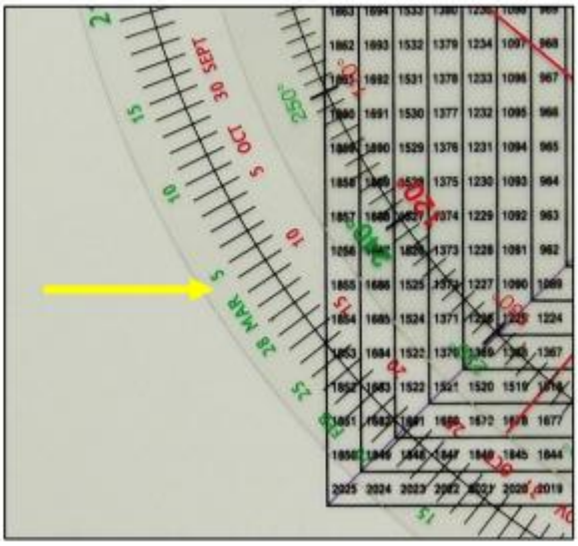


Figure 3

Using the Jan 12 high as a date to project another high from, we find that the date next to Jan 12 on the Natural Squares Calculator date ring is Nov 30 (see Fig. 4 below). Looking at the July soybean chart above, we can see that the last significant high on that chart occurred on Dec 1, just 1 day from our projected turning point.

Figure 4

Finally, we would use the next significant change in trend to project into the future the next turning points. The low of Oct 6 would project a significant low to occur on or about Mar 8. I have just briefly touched on this subject in this article and would invite anyone interested in pursuing this analysis as well as forecasting future direction and trend to contact W.D.Gann Inc. of Pomeroy, WA (see advertisement in this publication). They hold periodic seminars where I fully explain how to use this methodology in many markets as well as detailed forecasting lessons.

About Ken Gerber

Ken Gerber is an active professional commodity trader and teacher of technical trading.
After reading about W. D. Gann in 1981, Ken began to study Mr. Gann's writings to learn more about 'cause and effect' relationships. In 1985, Ken started a brokerage office with the purpose of spending more time on study of the Gann material. That study has led to a career as a private trader and teacher. Ken has conducted professional trading seminars on all levels in major cities in Australia as well as in the United States. He has addressed meetings of the Market Technician's Association (MTA) in the United States and the Australian Technical Analysts' Association (ATAA). Ken brings to The W. D. Gann Experience a wealth of experience as both a broker and a trader.

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18 YEAR **PROPERTY CYCLE**

With Phil Anderson

"The further backward you look the further forward you see".

- Sir Winston Churchill.

A study of American history reveals a very clear (average) 18-year cycle in US real estate prices, measured from trough to trough or peak to peak. Stock market investors and traders should be aware of this because towards the end of every real estate cycle, the US stock market has broken into all time new highs and formed a major top, then, shortly thereafter, collapsed and lost a minimum 50% of its value, but usually more. Every 18 or so years, since 1800. This seems to catch everybody by surprise, despite the fact that the event is as regular as clockwork. The stock market recovery from the eventual bottom is always slow and drawn out (though faster now than it was prior to the Second World War and the then belief in government inactivity) and takes years (at least ten years) before they climb back up to approach previous all time highs.
This can be helpful to know, since:

-There is actually very little information around to show traders how to recognize a major market top, but even more important, how to exit before the dramatic fall which inevitably follows. Identifying a major stock market top can, therefore, help traders / investors to avoid large capital losses, or, indeed, short almost any stock on the way down, especially banks.

-It may help investors "time" the market better, both at the top and at the ultimate final (higher)low before the new bull market, and

-present a way for traders to have the strength to actually do the opposite to the herd, always so thunderous at momentous market peaks like the one recently seen in 2007 / 8.

One of last century's great traders, W.D. Gann, suggested an exact 18.6 year cycle (18 years and 8 months) is present in the US stock market, which he published as a chart, in 1909.

Gann's financial time table

1784	1803	1821	1840	1858	1877	1895	1914	1932	1951	1969	1988
1785 A	1804 A	1822 A	1841 A	1859 A	1878 A	1896 A	1915 A	1933 A	1952 A	1970 A	1989 A
1786	1805	1823	1842	1860	1879	1897	1916	1934	1953	1971	1990
1787	1806	1824	1843	1861	1880	1898	1917	1935	1954	1972	1991
1788	1807	1825	1844	1862	1881	1899	1918	1936	1955	1973	1992
1789 B	1808 B	1826 B	1845 B	1863 B	1882 B	1900 B	1919 B	1937 B	1956 B	1974 B	1993 B
1790	1809	1827	1846	1864	1883	1901	1920	1938	1957	1975	1994
1791 C	1810 C	1828 C	1847 C	1865 C	1884 C	1902 C	1921 C	1939 C	1958 C	1976 C	1995 C
1792 D	1811 D	1829 D	1848 D	1866 D	1885 D	1903 D	1922 D	1940 D	1959 D	1977 D	1996 D
1793	1812	1830	1849	1867	1886	1904	1923	1941	1960	1978	1997
1794	1813 E	1831	1850 E	1868	1887 E	1905	1924 E	1942	1961 E	1979	1998 E
1795 E	1814 F	1832 E	1851 F	1869 E	1888 F	1906 E	1925 F	1943 E	1962 F	1980 E	1999 F
1796 F	1815	1833 F	1852	1870 F	1889	1907 F	1926	1944 F	1963	1981 F	2000
1797 G	1816 G	1834 G	1853 G	1871 G	1890 G	1908 G	1927 G	1945 G	1964 G	1982 G	2001 G
1798	1817 H	1835	1854 H	1872	1891 H	1909	1928 H	1946	1965 H	1983	2002 H
1799 H	1818	1836 H	1855	1873 H	1892	1910 H	1929	1947 H	1966	1984 H	2003
1800 J	1819 J	1837 J	1856 J	1874 J	1893 J	1911 J	1930 J	1948 J	1967 J	1985 J	2004 J
1801	1820	1838	1857	1875	1894	1912	1931	1949	1968	1986	2005
1802	1821	1839	1858	1876	1895	1913	1932	1950	1969	1987	2006
1803	1822K	1840	1859 K	1877	1896 K	1914	1933 K	1951	1970 K	1988	2007 K
1804 K	1823	1841 K	1860	1878 K	1897	1915 K	1934	1952 K	1971	1989 K	2008
		1842									

LEGEND	
A.	Extreme low stock prices, strikes, repression, despair and beginning of new business generation for 18-3/5 years. 4 years of rising stock prices and improving business, markets bare of goods, young men becoming prominent.
B.	High stock prices
C.	Panic
D.	Low stock prices
E.	High stock prices
F.	Panic
G.	Low stock prices
H.	Very high stock prices, most prosperous year waste over extravagance, most money in circulation, much speculation
J.	Major panic, CRASH. 4 years of falling prices, business stagnated, breadlines, soup kitchens, despair, unemployment
K.	Same as A, plus strikes, unemployment, many prominent deaths

Gann suggested it was his "most important ever discovery", though he went on to say that about several other things as well. Nevertheless, the discovery involved "time", the first time Gann ever mentioned the fact, and since cycles are time based, perhaps it is worth a look. Study in particular the years as marked with a 'k'. It was my study of US real estate collapses that first drew me to this Gann Financial table many years ago. 1914, 1933, 1952 and 1970: all subsequent major stock market lows. Remember, Gann published that in 1909!

W.D. Gann also observed what he came to call "the decade cycle". In his many commodity and stock market courses, he described the decade cycle this way:

"By studying the yearly high and low chart and going back over a long period of time, you will see the years in which bull markets culminate and the years in which bear markets begin and end. Each decade, or 10-year cycle, which is one-tenth of 100 years, marks an important campaign... In referring to these numbers and these years, we mean the calendar years. To understand this, study 1891 to 1900, 1901 to 1910, 1911 to 1920, 1921 to 1930 and 1931 to 1939. The ten year cycle continues to repeat over and over, but the greatest advances and declines occur at the end of the 20-year and 30-year cycles, and again at the end of the 50-year and 60-year cycles, which are stronger than the others...

Year:

1. A year in which a bear market ends and a bull market begins. 1901, 1911, 1921.

2. The second year is a year of a minor bull market, or a rally in a bear market will start at some time. 1902, 1912, 1922, 1932.

3. Starts a bear year, but the rally from the second year may run to March or April before culmination, or a decline from the 2nd year may run down and make bottom in February or March, like 1933. 1903, 1913, 1923.

4. The fourth year is a bear year, but ends the bear cycle and lays the foundation for a bull market. Compare 1904, 1914.

5. The fifth year is the year of Ascension, and a very strong year for a bull market. See 1905, 1915, 1925, 1935.

6. The sixth year is a bull year, in which a bull campaign which started in the fourth year ends in the Fall of the year and a fast decline starts. See 1896, 1906, 1916, 1926.

7. Seven is a bear number and the seventh year is a bear year because 84 months or 840 degrees is 7/8ths of 90. See 1897, 1907, 1917, but note 1927 was the end of a 60 year cycle, so not much of a decline.

8. The eighth year is a bull year. Prices start advancing in the 7th year and reach the 90th month in the 8th year. This is very strong and a big advance usually takes place. Review 1898, 1908, 1918, 1928. (2008 did not follow this pattern, which is where a little real estate cycle knowledge was helpful in this instance.)

9. Nine is the highest digit and the ninth year is the strongest of all for the bull markets. Final bull campaigns culminate in this year after extreme advances and prices start to

decline. Bear markets usually start in September to November at the end of the 9th year and a sharp decline takes place. See 1869, 1879, 1889, 1899, 1909, 1919 and 1929, the year of the greatest advances, culminating in the fall of that year, followed by a sharp decline.

10. Ten is a bear year. A rally often runs until March and April; then a severe decline runs to November and December, when a new cycle begins and another rally starts. See 1910, 1920, 1930.

Putting all that together, we can expect US stock markets to have a year with a downward bias, for 2010, with probable lows later in the year, around October / November, then a decent rally into 2011, into the Northern Hemisphere summer, with then further (higher) lows in 2012. By then, the recent GFC will be but a distant memory and the US will be well into its next – inevitable – real estate cycle: inevitable because the underlying structure of the economy has not been altered. Indeed, the current President has done all he can to preserve it, laying the basis for the non-interruption of these cycles and patterns.

Gann's Financial Timetable is a fraction out now, as originally published by Gann, but, for reasons I will not go into here, if you replace '1989', with 1991, and count forward, this will give you something VERY interesting to follow over coming years.

About Phil Anderson

Phil Anderson is Managing Director of Economic Indicator Service Ltd, an economic forecasting service based in London. Phil uses Market Analyst to help with forecasting and trading decisions. His book 'The Secret Life of Real Estate' was published in the UK in 2008. The web site can be found at http://www.businesscycles.biz

TRADING **PATTERNS** Part 4

With Peter Varcoe

Continuing on from our last article, I know that many out there would have looked at the exercises which I left you with last time and thought to themselves that – "this does not apply to me", or "I already know how to identify consolidations", or "I am not going to participate in childish exercises" or some of many other thoughts which constantly appear when faced with this type of exercise.

I have, over many years of being involved in education in this industry come across all of these thoughts, in fact I thought some of them myself when I was first learning, including "Let's get over this ?#@%, show me the real stuff".

When I first embarked upon the education route in this industry, my mentor Rob Lennox told me that I needed to ignore these comments and attitudes as they appear, because it probably means that you (meaning I as the ecducator) had failed to effectively communicate the importance of these exercises to all of the people in front of me, and that when hearing these things, I should re examine how I have presented these thoughts and do what I can to improve the communication.

So for all of you who did not understand the importance of identifying some of the nuances which help identify the differences between consolidations and retracements, I do apologise for my inadequate communication, if that was the issue.

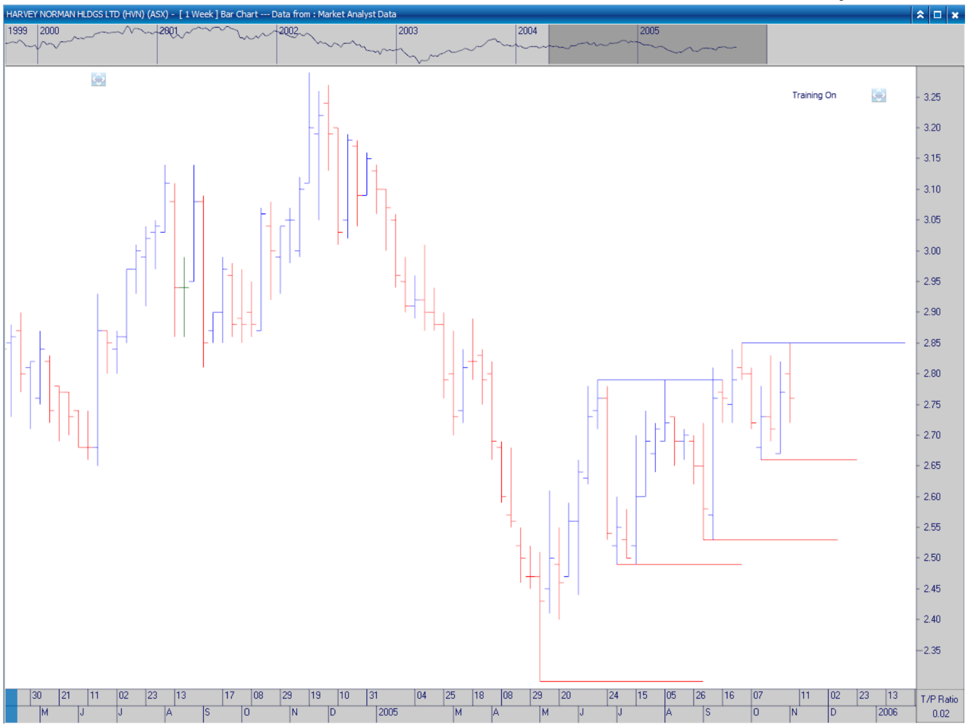
What everyone reading this series of articles needs to keep in mind is that these are based on my own personal experiences, study, input from others I respect in the industry, not the least of which are from Rob Lennox and Leon Wilson. They are all of this, followed by thousands of hours of my own refinement of the techniques, identification criteria which have had to be adapted as the market changes character, and identifying some very specific criteria which can help to make these trading techniques very highly reliable.

A favourite quote of mine is a quote from a book called *Good to Great*, by Jim Collins. When he was at university, his favourite professor told the group of students – "The best students are those who never quite believe their professors, but they should not reject the data merely because they do not like what the data implies".

So with that in mind, I would urge you all to take whatever you can from these articles, not just mine – but all in the publication and try to prove them wrong, but while keeping in mind the need to accept what the data is telling you.

Why would I say that? Because if you approach any exercise like this with the mindset of trying to prove it wrong, you are not just blindly following, as many do. You are approaching the subject with an open mind, willing to look at data from different angles and in this state, you are more likely to develop your own consistent trading style and refine techniques to suit your own methodologies.

Harvey Norman



Source: Market Analyst 6 (www.Market-Analyst.com)

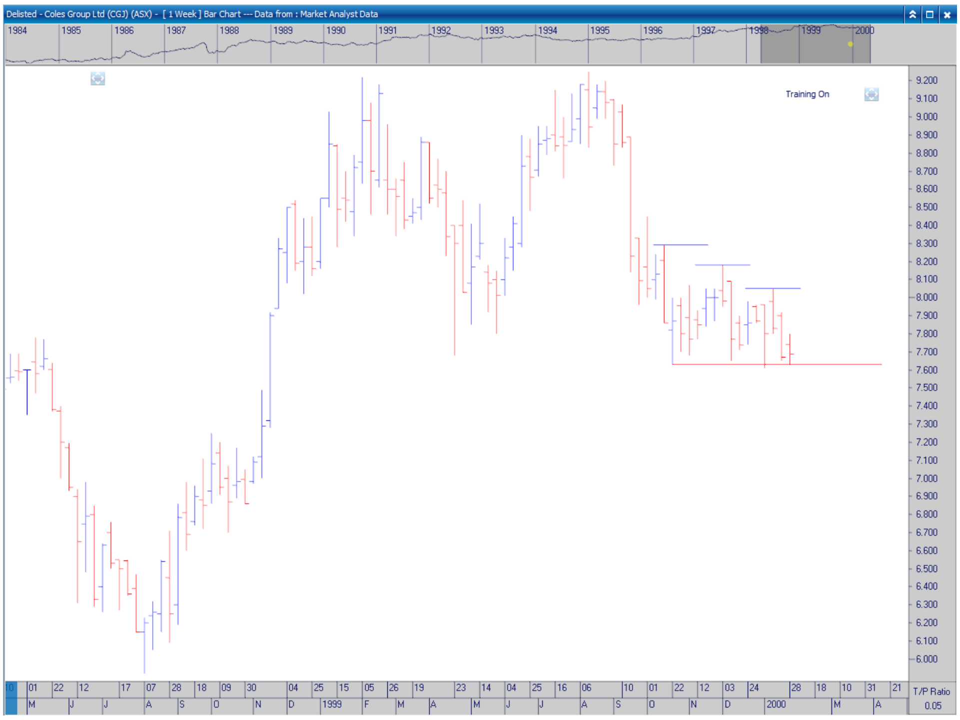
With Harvey Norman we can clearly see that a directional change occurred in May 2005 and an uptrend, which was confirmed in September 2005 by breaking through the resistance level to give us a higher high, in addition to the higher low already in place, has been in place since.

While this was technically an uptrend, it is clearly not a strong one and the price action really seems to be wallowing along sideways. The resistance levels are not very far apart, however an interesting thing occurring here is the significant rises in the low turning points, during this period.

This sort of price action demonstrates a compression effect within the action and prepares the way for a possible consolidation.

Another observation we can make from here is that within last the compression, the average range of movement (distance between the high and low of each bar) is getting smaller or is also compressing. This is also another indicator we can use to assist in identifying consolidations, and therefore potential trading patterns.

Coles Myer Limited



Source: Market Analyst 6 (www.Market-Analyst.com)

With Coles Myer Limited, we also have a directional change occurring in August 1999, followed by a significant fall in price action, with a significant support level occurring at around $7.63. It wasn't until January 2000 however, that the down trend was confirmed by the lower low during the week ending 7th January.

The lower highs which occurred merely confirmed that price action was compressing, indicating a possible consolidation. But it wasn't until January that we were able to confirm that the average range of movement had definitely decreased and that this was more likely to develop into a probable consolidation, for the purpose of trading.

I probably need to pause here for a moment and make what I believe to be an important point. There are many patterns and formations which have been identified by a large number of people over the last 50 or so years, many by theoretical Technical Analysts who do not actually trade, but study Technical Analysis.

As a result, many of these formations have not been tested in the rigourous environment of trading, by traders who have their hard earned money on the line, where mistakes can, and frequently do, cost the trader money, sometimes serious amounts of money.

I am not putting down these patterns or their credence as a theoretical subject, but when looking to learn from anyone, the major question you need to ask yourself is – "Do I want to learn from someone who has only studied the theory, or from someone who has taken the theory, applied it in real time to the markets and through continuous testing and refinement, proven them to work?".

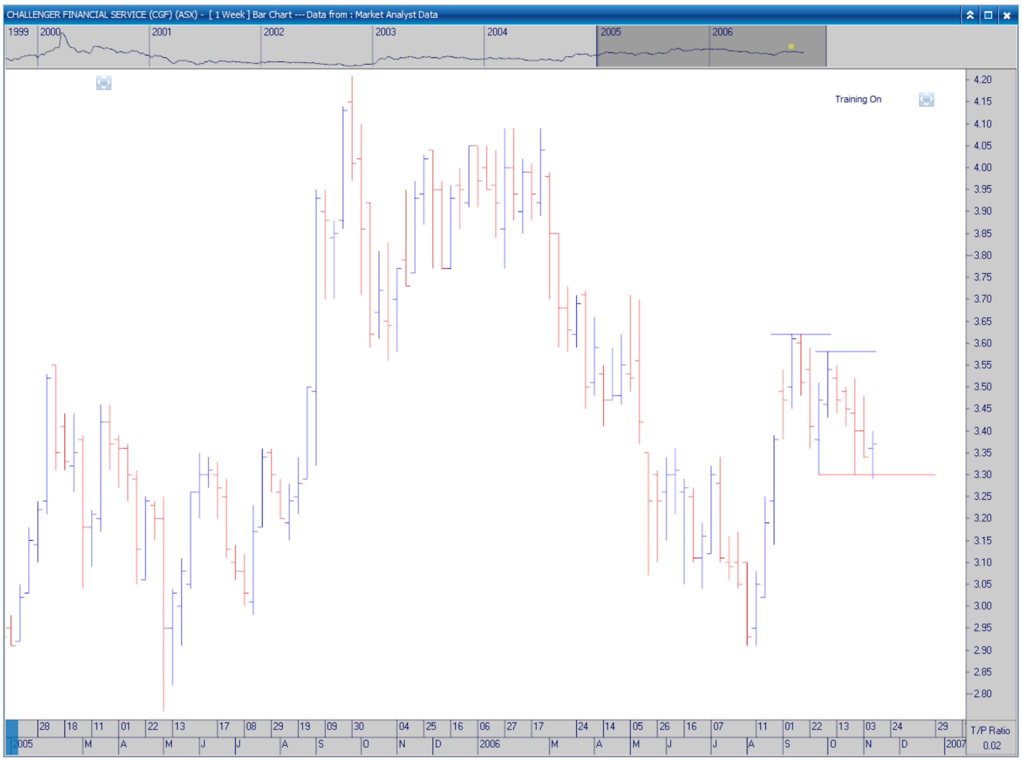
There are also many patterns which have been developed by traders and the developers of these patterns apply a great deal of credence to them, such as V-Top, V-Bottom, Cup & Saucer, and many others.

Many of these, I have not been able to make work to the same degree of probability that I have with the patterns I am covering in this series of articles. This is not to say that the patterns do not work, it may be as simple as myself not being able to correctly identify them, may not have devoted enough time to testing, or not being able to develop a set of acceptable risk parameters to apply which could give them the same level of reliability as the ones I use.

Hence my use of the term for the purpose of trading, as opposed to the term, for the purpose of study.

Again I urge you to do your own testing and development. Don't take what I, or indeed any other author, have to say and blindly follow it. Please have a healthy measure of scepticism and be prepared to try to prove it wrong.

Challenger Financial Group



With Challenger, we can clearly see that directional change occurred in August 2006 and a strong drive up resulted in this change. We then clearly see that price seemed to change direction in September of 2006, we have a Low Turning Point late in September, followed by a rise in price, then a fall again beginning mid October.

The question we need to ask here is: "Is this formation a consolidation, or a retracement? Therefore will it possibly form a pattern which I can **reliably identify and trade?**".

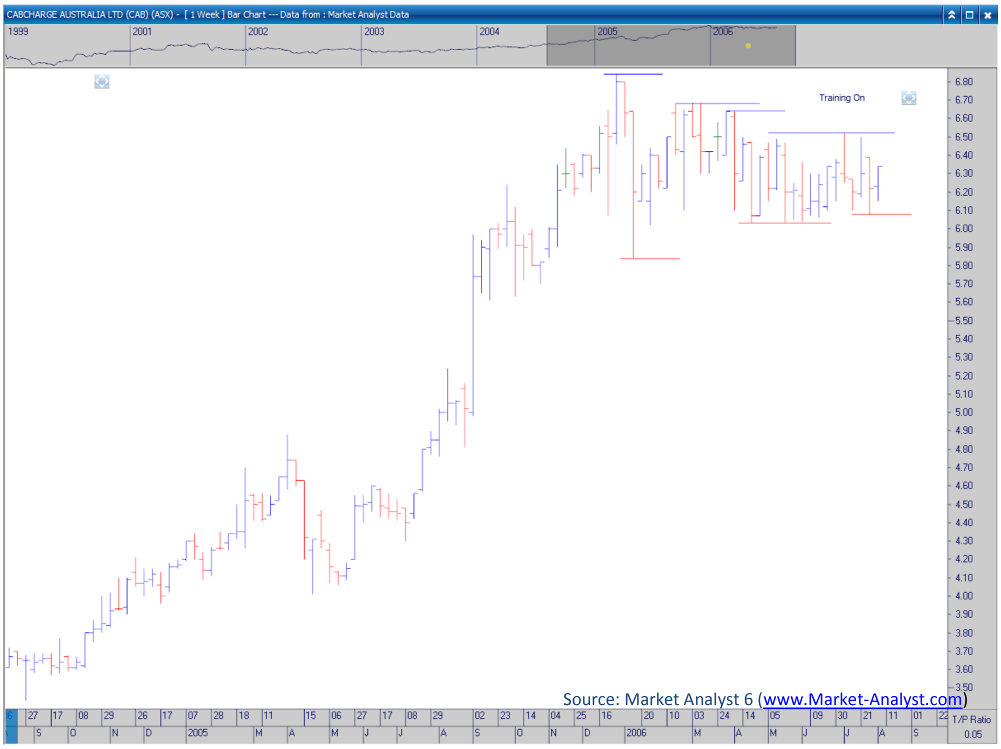
There is no doubt that there is strong support at around \$3.30, there have been 1 Low Turning Point and 2 lows at that level, during which time, price formed a new high turning point. So we can assume that price action is compressing, is it forming a consolidation?

It could be argued that the ROM (Range Of Movement) has reduced, but if we look at volume during this period, it has sustained or possibly increased.

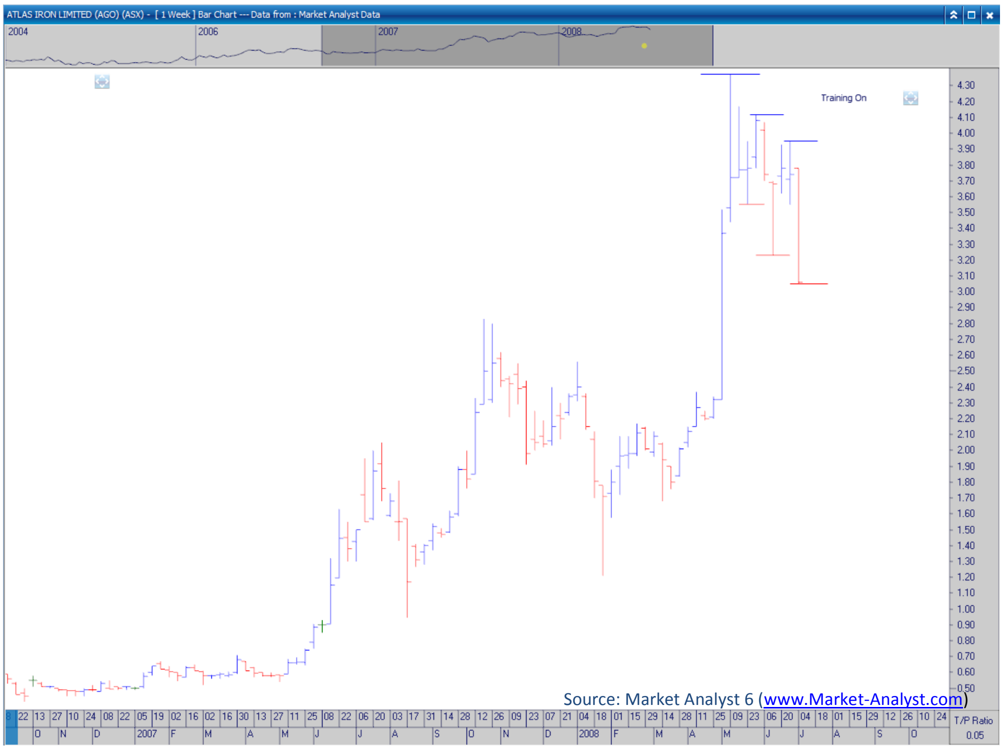
Remembering that most retracements seem to be volume driven with sustained or increased volume during the formation, is this more likely to be a retracement or a consolidation, when looked at in conjunction with the fact that ROM has not reduced a great deal?

A price compression does not necessarily equal a consolidation, therefore, every compression we identify needs to be looked at in the context that is can be a precursor, but is not always an identifiable consolidation or pattern.

Cabcharge



Atlas Iron



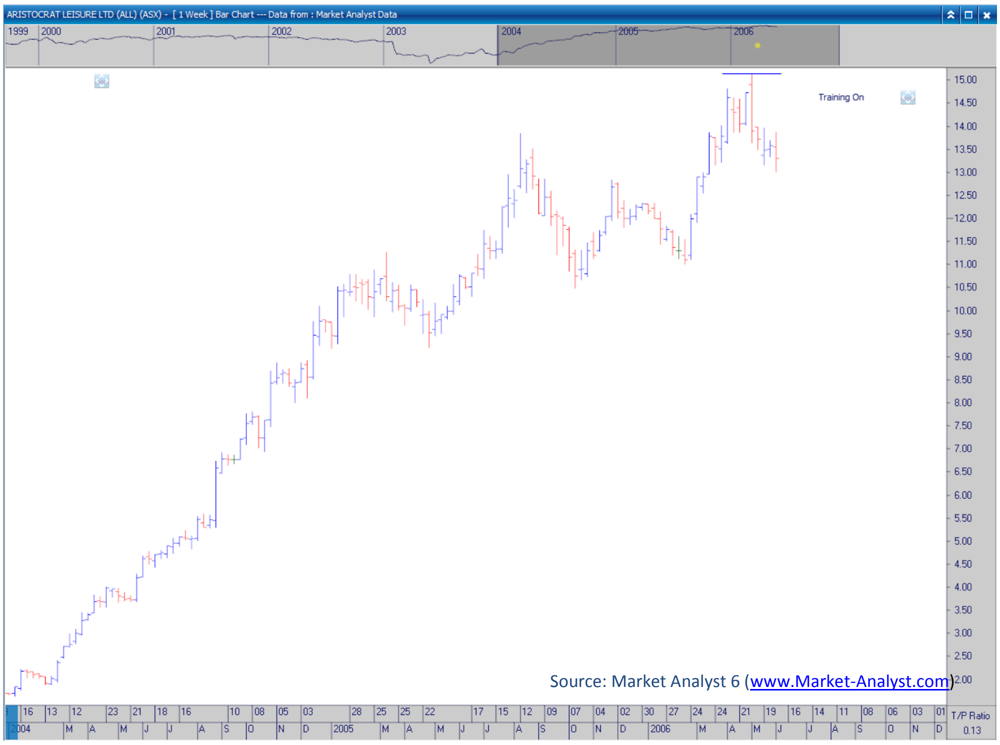
With cab charge we can clearly see that there was an existing uptrend in place until the end of December 2005, and then the price action proceeded to drift sideways incorporating a series of lower highs and higher lows as has been illustrated. This price action is definitely forming into a compression, but will it form a tradeable pattern, is it a consolidation?

We can also see that while there has been a reduction in the range of movement, it did not occur until late in the compression and when we look at volume, it also has remained high until late in the compression.

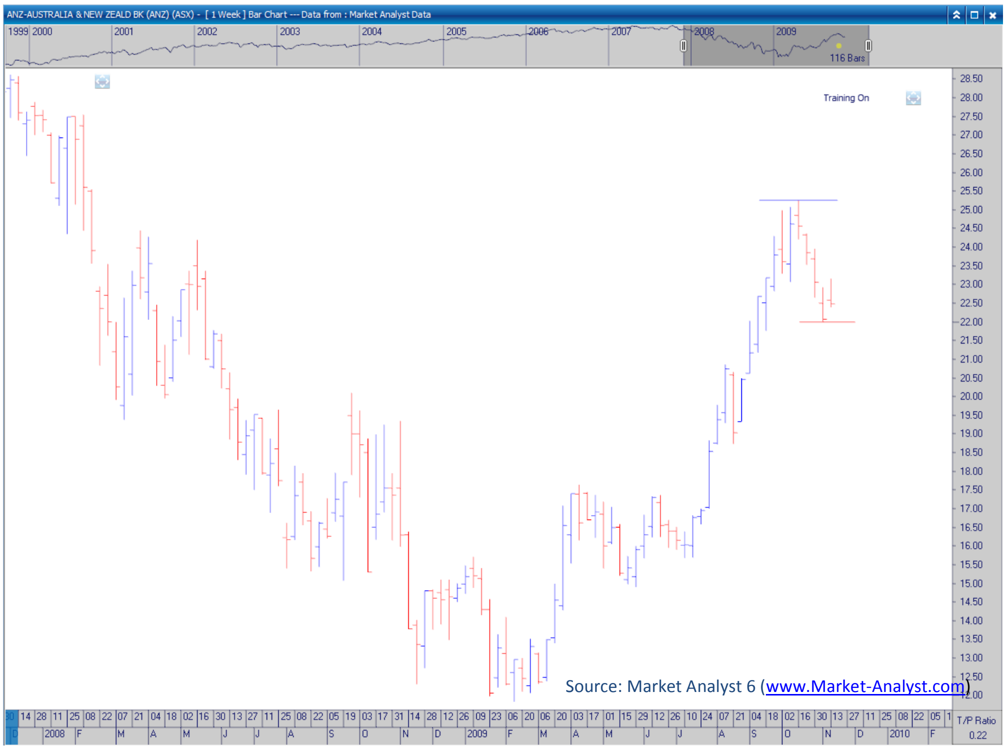
This late reduction in ROM and volume is a common trait for triangular patterns, which we will go into in more detail when we start into individual pattern identification. But bearing in mind this is a common trait, we can keep this formation on our watchlist a little longer.

With Atlas Iron, we can clearly see an uptrend in place from the Low Turning Point in January 2008 until the peak of price in early May 2008. Apart from the 2 weeks leading into the peak of week ending 9th May, the ROM of the weekly

Aristocrat Leisure



Australia and New Zealand Banking Group



bars was quite small compared to all that came after the week ending 25th April 2008.

What is also apparent from the price action is that the price has changed direction and has formed a downtrend, as is evidenced by the successive low highs and lower lows.

This price action is neither a consolidation nor a retracement, it is a directional or trend change which is heavily supported by volume. There is no way that this is a pattern of the type we are discussing here, for the purposes of trading and making a profit.

With Aristocrat Leisure, we can see an extended run up in price to the peak in May 2006. But what happened after this is a retracement or pull back in price, the price has just driven down, and this is supported by sustained volume during this period.

There is no pause in price action, there is no compression of price action, there is just a change of direction, and therefore cannot be considered as a continuation pattern or Mid move consolidation.

ANZ is a relatively easy retracement to identify, a very clear change of direction, a significant drive down in price and when we look at volume this was also sustained.

While the range of movement has actually decreased during the fall in price, this is a straight drive down in price and is not a consolidation nor even a compression. A classic retracement.

National Australia Bank

Source: Market Analyst 6 (www.Market-Analyst.com)

With NAB, we have an obvious strong uptrend from late 2004 until April 2006, when price changed direction again.

When we look at the price action, the peak was at the end of April, the range of movement increased as the price fell, and the volume sustained its previous rate, again a classic retracement.

Conclusion:

Price compressions can be a prelude to a consolidation forming, but a compression does not mean that there will be a consolidation, it is an alert indicator and no more.

Consolidations generally show a reduction in ROM as well as volume, whereas retracements don't normally show a decrease, they normally sustain or increase either or both.

However, as we saw with the ANZ example, retracements can show a decrease in 1 of the ROM or vol and still be a retracement.

Pattern identification, I believe, is a bit like driving a car. When you first start out you misjudge distances, speed, closing rates and it all seems overwhelming. However when you have enough experience, you develop a feel for these things and your driving is much more relaxed and precise. So I have found with learning pattern identification, you do develop a feel for it and they do start to jump off the screen at you and sing "here I am, take me".

If you are having difficulty in this at the beginning, please persist, as the markets do change character, and it is advisable to learn several strategies which will enable you to adapt to changing markets and continuously make profits from whatever the market throws at you.

I do trust this exercise has proven advantageous for many of the readers of this publication, and that it has added some ideas for further testing and development of techniques.

I also trust that we have assisted in clearing up some of the misconceptions involved in pattern trading. There are many out there who would keep it "mystical", and I hope that we have progressed the learning of some of the subscribers in this highly profitable trading area.

I look forward to working with you further in subsequent publications, and look forward to any feedback from subscribers.

Have a great start to the year, and may the markets go with you.

Peter

About Peter Varcoe

Peter started learning about trading with Wallstreet Group from Melbourne in 1999. He then joined the company to head up the Queensland Branch in March 2000. He left Wallstreet Group during 2002 and Joined Stock Market Investors Group to help with their program of educating Primary Producers, and for the next 2 ½ years was educating Primary Producers in Victoria, Queensland and Western Australia.

Peter joined Australian College of Financial Education as Senior Lecturer in 2005 and contracted to them for education, a position which he still holds today.

Peter's experience is mainly in shares and CFD's but Forex is filtering its way into his trading for future incorporation. He has done many thousands of hours work with patterns, in particular, flags, pennants, triangles and has developed some very specific, reliable techniques around these continuation entries.

Peter heads up Aztec Trading & Training which is a subsidiary of WIN Financial Group incorporating WIN Financial Network and WIN Investors Club.

Peter Varcoe can be contacted through his e-mail PeterV@WinFinancial.com.au.

THE BALANCE OF **POWER**

With Michael Parsons

Every buyer needs a seller and every seller needs a buyer. If you have more buyers than sellers, then the price will rise. More sellers than buyers, then the price will fall. This is simply known as supply and demand and it is a basic tenet of market value. Whichever way the buyer/seller balance happens to bias, then you can bet that the market will follow. Traders spend fortunes betting on which way they think the bias is leaning. Many will simply use reports and gut feelings to make that decision, but the balance of power is already revealed in a subtle way by price action. Learn to see the subtleties that reveal it, and you have the edge that everyone is looking for.

Price will typically develop a channel where a trend line parallels itself between the upper extreme of price and lower extreme of price, maintaining a similar distance and angle during most of the trend. This is referred to as a balanced trend. But when it comes to the battle between buyers and sellers, the balance is never permanent. Frequently price will distort a channel and it is these distortions that reveal subtle changes in the bias within the balance of power. Anytime you see the upper price extreme not in agreement with the lower price extreme then an imbalance exists.

If you have studied basic technical analysis then you may already be familiar with a host of patterns that have non-parallel upper and lower trend-lines or channel lines. One such example would be that of the triangle pattern which has both lines angled toward one another. Depending on how the triangle forms, standard technical analysis tells you what bias to expect from the market based on the pattern's shape or angle of lines. An ascending triangle has an upward bias, while a descending triangle has a downward bias. A symmetrical triangle has no indicated bias until price makes a commitment one way or the other. The view of each of these patterns and their bias is based on past experience alone, but the reality is that their very shape and angle of lines already establish both their bias and what to expect. When you understand how to read the bias of channel lines, then the patterns themselves start to make a great deal more sense. Further, you are then able to apply these same principles to a much greater portion of price activity, far beyond that of just mere patterns.

When the balance of power is extreme as you find during a strong trend, then it is easy to determine what that bias is. But when it is subtle as it is during consolidation patterns, then it is much more difficult of a task to determine. Yet, it's during the subtle times that knowing the bias often is of the most benefit. So what is the secret to determining the bias in the balance of power?

Two Factors That Determine Balance of Power

There are two factors to consider when reading market bias; the overall direction of the channel and any distortion between the angles that form the two lines.

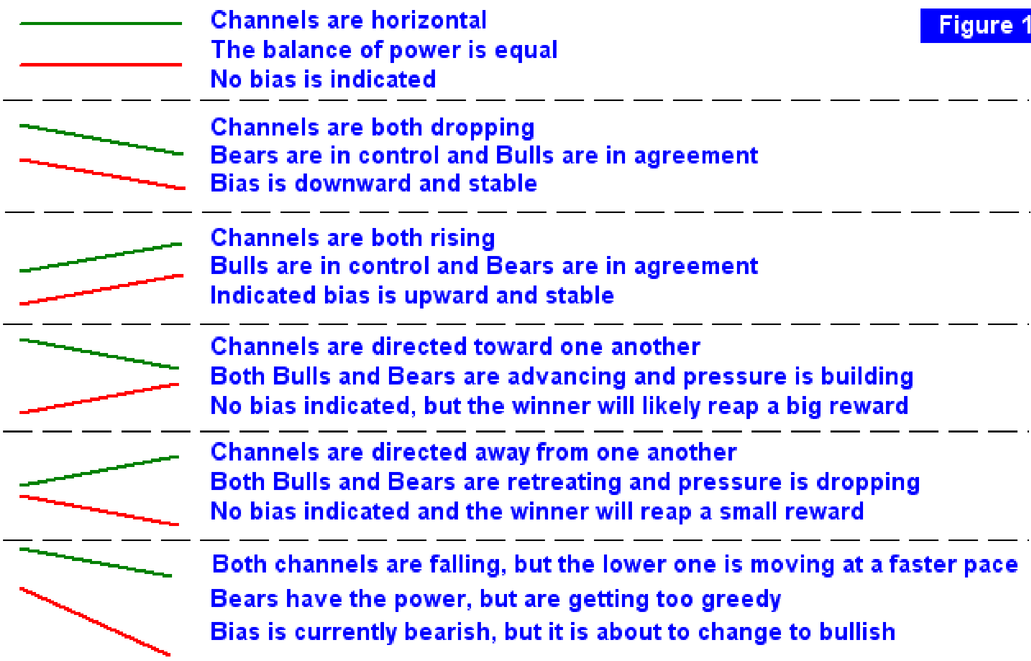
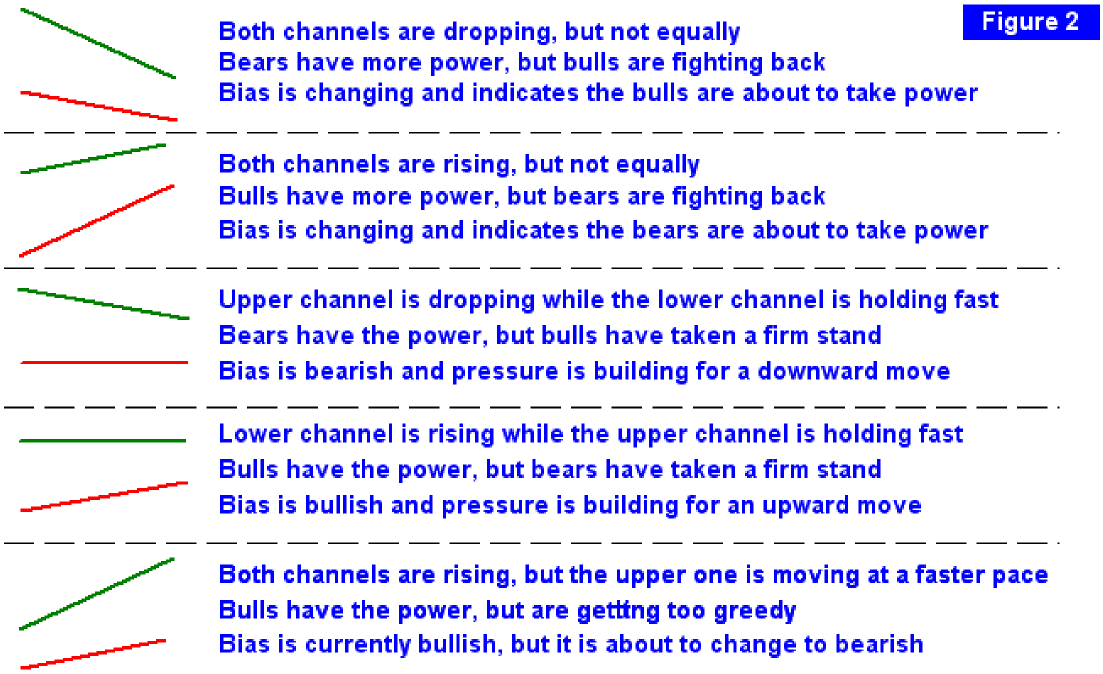


Figure 1

The first factor is easy to understand; the overall direction of the channel indicates market bias. This means that if both channel lines are moving higher, then the market bias is upward, following the direction of the channel. It is as simple as up is up and down is down. When you have a trading range with two horizontal channel lines, then the bias is neutral. So whatever direction the channel is facing indicates the bias of the market. Despite moving higher or lower, parallel movement between the two lines indicates that both buyers and sellers are in unison about the bias of a market. Any battle between the two is minimal.



The second factor requires a little more effort to understand. Any distortion from a parallel angle between the two channel lines indicates bias in the balance of power. This means that if the two lines are drawing closer to one another then there is a bias indicated. If they are drifting further away from each other then there is a bias indicated. In addition, how the altered lines are in relation to one another further dictates how this bias would be interpreted. What this means is that both the angle and direction are important in determining market bias. Image 1 and image 2 show several series of configurations that depict what can appear and their meaning.

Some of the configurations and their indicated bias may seem at first contradictory. For example, if the upper line rises slower than the lower line it indicates a bearish bias rather than a bullish bias. Now compare this to the pattern where a horizontal line stops price from advancing any higher while the lower line continues to ascend, which indicates a bullish bias. Both of these examples fit descriptions to patterns known as a wedge and an ascending triangle of which you may already be familiar with. But the real question here is why do they indicate the bias that they do? Understanding the why and how will give you the opportunity to apply these same principles to many more situations beyond either of these patterns.

The answer to why and how is inseparably connected to crowd psychology. There is a battle going on between buyers and sellers. The upper line represents the battle line of the buyers, while the lower line represents the battle line of the sellers. Remember, a buyer is looking to purchase at the very best possible price and may have previously sold short. So it is not in his best interest to have prices rise higher, that is at least not until he has actually bought. On the other hand, a seller is looking to sell at the very best price that he can obtain whether he has already bought and looking to liquidate his position or simply looking to sell short. Either way, he does not want price to drop further, not at least until he has actually sold. It is those who accept the bids and offers that change the value of a market. So it is the traders that are actually looking to buy or sell that matter here, not those that already hold positions, unless they are looking to exit their trades. When actual trading activity occurs there is a bid price and an ask price where buyers and sellers make offers to the other side. The bid price is what the buyers are offering and is naturally lower than the ask price, which just happens to be what sellers are offering. Each is offering what they think they can get from the other side.

The battle between buyers and sellers through the bid/ask spread is nothing more than the balance of power at work, and the principles of this struggle extend to a greater level far beyond this momentary spread.

The bid/ask action may give us our first glimpse as to who has the upper hand, but unless you happen to be a floor trader with the ability to exploit this momentary spread, then it really is of little value in determining which way a market is leaning. The spread is just too narrow and short lived for most trading. So our view of this battle has to move to higher ground; the battle lines of channel lines.

In any advancement, whether up or down, it is the line that is pushing the market that controls the trend's design and survival. In an uptrend this would be the lower channel line, and during a down trend this would be the upper channel line. In either case this line is referred to as an inside channel line because it faces future trading activity. If this line is broken, then typically it is the wise course to exit from any trade that may be profiting from a trend.

When there is a distortion in the parallel of the two lines, the culprit is usually the other channel line, referred to as an outside channel line since it faces past trading activity. This particular channel line is typically the variable in the equation or the troublemaker, although the inside channel line can provide its own fair share of deviant behavior as well. If the outside channel line advances too fast for the inside channel line to keep up, then the market will exhaust itself because it needs the help of the inside channel line to sustain any move. Such an advance in an uptrend would demonstrate that the sellers are over-inflating the value by demanding more with fewer buyers willing to give in to those demands. Some are still willing, but many are refusing to do so demonstrated by the fact that the inside channel line refuses to accelerate as fast as the outside channel line. Buyers who give in so willingly are usually just desperate and eventually these desperate buyers will dry up, ending the over-inflated run. When price begins to snap back from the outside channel line, the gap between the two lines alone will be enough to create a sellers panic and cause prices to tumble down in haste.

As it is true with the bid/ask spread, the alignment of these two lines define who has the upper hand in a market; the buyers or the sellers. In fact, it is actually an extension of the bid/ask spread itself because it contains the extremes of what each believes they can get from the other. The advantage of channel lines is that they show with greater depth the battle between both sides, and are not limited to just a few minutes sampling of trading. So a history of the battle develops and the battle plan becomes obvious. The key element of this battle is that of the inside channel line because it is the foundation of which everything else depends upon. When the outside line begins to accelerate the important factor will be in how the inside line chooses to respond. If it fails to accelerate as fast as the outside line then the move has a serious problem and an imbalance between the buyers and sellers exists. The common theme throughout all the configurations illustrated is that if both are not in unison then a battle is raging between buyers and sellers over market bias.

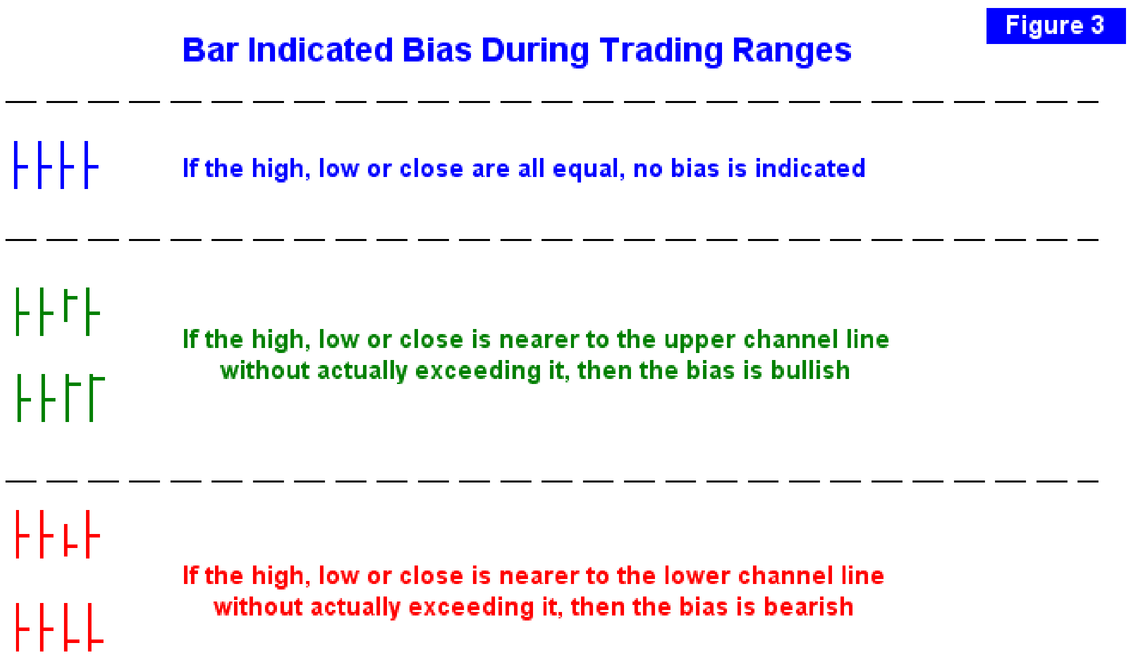
To get a better idea of how this battle is revealed by the action of channel lines, consider a few chart patterns that you are probably already familiar with; triangles. There are three basic types of triangles; symmetrical, ascending and descending. The lines that are drawn to outline a triangle are in fact nothing more than channel lines, although they are non-parallel. As the lines draw closer to one another, pressure builds up to a point where it is finally forced to break, usually resulting in a substantial move. But even before this happens the bias or balance of power is already indicated by the way the lines have formed.

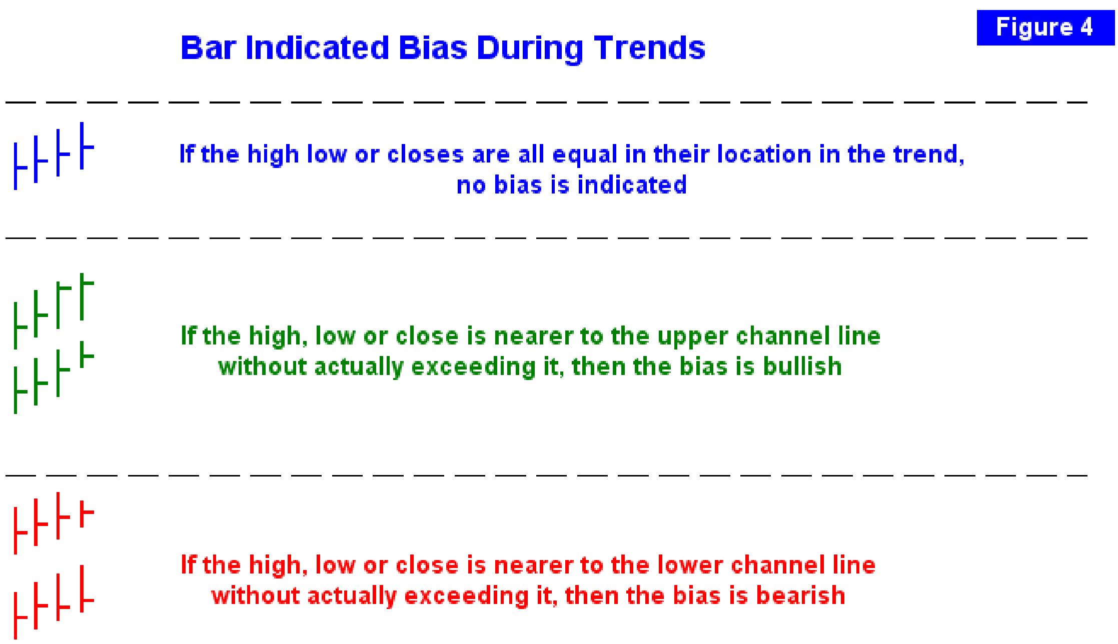
In an ascending triangle the outside channel line comes to a complete stop and appears as a horizontal line, all the while the inside channel line continues to advance toward it. The very fact that an inside channel line is rising tells you that the bias is toward higher prices and that the power belongs to the sellers. What makes this pattern different from that of a wedge pattern is that the buyers have entrenched themselves and are refusing to budge at all, yet they are still losing ground. So few buyers are liquidating their position and many are waiting for lower prices before buying, which means that if prices do move higher then they will be caught off-guard and will face a point of desperation as they either panic to get out of their trades or try to profit from the rapidly moving trend. The buyers may be attempting to hold a battle line, but they just can't stop the progression entirely and eventually that battle line collapses as it gives way to higher prices.

Because triangles are so well documented in technical analysis you may already have a good handle on how to trade them. But there are times when they will not follow their expected bias or are subject to false breakouts. Using channel lines to make an analysis of a pattern can offer a critical insight as to which way the balance of power is leaning and the direction that the pattern is likely to break. Sometimes the balance of power will be indicated by the entire pattern, but other times you may have to look at individual pieces of the pattern as it develops. Either way, the bias is usually somewhere to be found in the pattern itself.

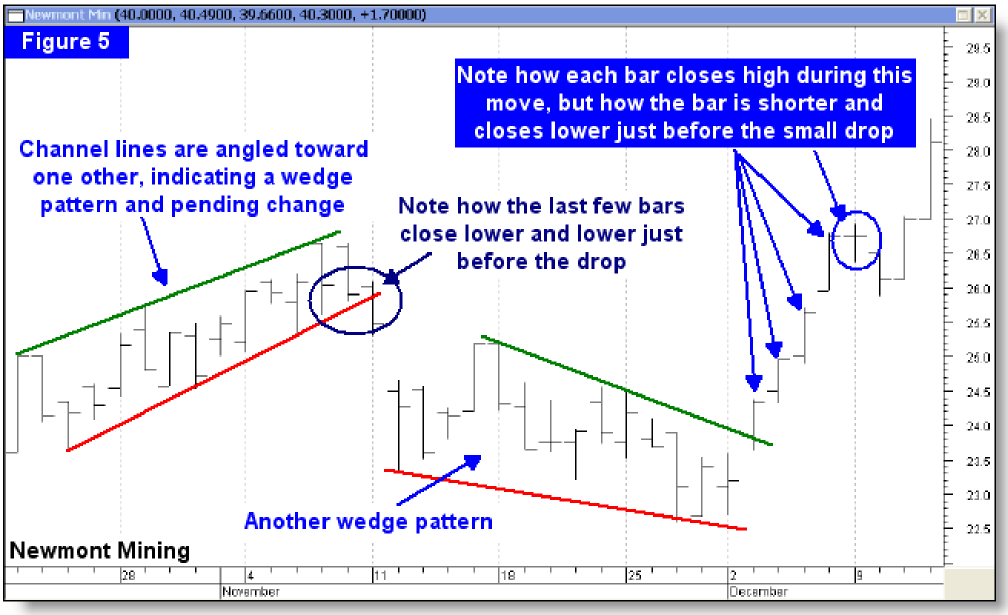
Obviously, a large cross-section of a pattern will provide you with the strongest bias, but even strong bias can change its leaning rather quickly. Small cross-sections offer you the advantage of providing the earliest indication of bias or changes in its leaning. The earliest warning can at times be the most critical when entering and exiting, so there is great value in being able to interpret this with just the most subtle of variations within channel lines. The more subtle the configurations you can read and interpret, the quicker you can respond. This in turn allows you to enter or exit at better prices, generating greater profit.

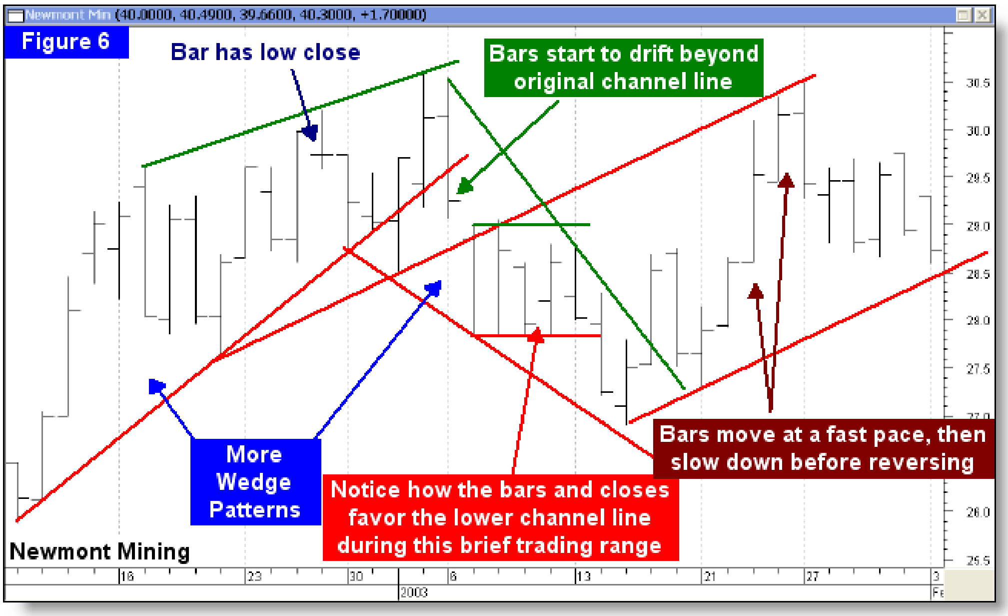
Often, the initial indication of bias rests in a single bar that doesn't quite reach as far as prior highs or lows within a pattern. The signal may be subtle, but it is the first warning to where the balance of power is leaning and of course where price is likely to be headed in the near future. Since price frequently moves rapidly after leaving any consolidation pattern, understanding these subtle signals can make the difference between making a quick profit and taking a quick loss. Image 3 and image 4 show a series of bar configurations and their subtle indications.





Some actual chart examples of the subtle changes in bias can be seen in image 5 and image 6. Can you identify who is winning the battle over the balance of power?





So it is to your advantage to look beyond patterns and see what is actually happening within the price action itself. It is fine to understand triangles, flags, wedges and so on, but the real signals are contained within the channels that actually form them. Besides, it is much easier to memorize the few channel patterns than all the hundreds of patterns that can develop on a chart. Channels can reveal much more about the balance of power and is much easier to learn, interpret, and implement.

Especially when you see non-parallel channel lines will there be subtle indications of a bias in the balance of power. While momentary bias doesn't guarantee that a market is headed in any specific direction, it does provide you with an early warning and will usually be the precursor to the market's direction when it finally commits to one. Any early indication in the balance of power can provide you with an edge that allows you to have more success with your trading. Understand how to read the balance of power and you will tip the scale in your favor.

About Michael J Parsons

Michael J Parsons is a professional futures trader and published author of several trading books and courses. He is a pioneer of several new and unique methods of trading that are revolutionising how markets are analysed and traded. His astounding market insight and ability enabled him to publicly predict in advance the exact week that the 2008 decline of the S&P market would begin, and to even forecast just how low it would drop.

For more information about his work visit http://www.greatesttradingtools.com/

TRADING WITH THE

SINGLE IN/SCALE OUT METHOD

With Ross Beck

"What type of trader are you? Are you a position trader, swing trader or day trader?" After trying a few different trading styles, we may answer, "I'm a swing trader." Our decision as to what style of trading is often based on personal preference and our individual risk tolerance. Each style has its own benefits and drawbacks. For example, the benefit of trading like a day trader is that you are always flat (no positions) at the end of the session. Also, a day trader will get results every day, quick profits scalping the market. The downside to the day trader style is that they will never enjoy the possibility of a ten bagger (to steal Peter Lynch's description of increasing your initial investment X10) like a position trader.

On the other end of the trading style spectrum is the position trader. This style of trading involves keeping a trade on for weeks to months with the hope of capturing a major trend move. The benefits to this style of trading are obvious; it *is* possible as a position trader to have one of those windfall trades where you turn a $1,000 investment into $10,000. The downside to being a position trader is that often the risk on the stops is significant compared to a day trader who may have tight stops;and/or the position trader will have to lose several times in a row before they get the "windfall" trade.

Then there are the moderate swing traders who fit neatly between the day traders and the position traders. These ones like to hold on to a trade for a few days to perhaps a few weeks. These ones select the "middle way" (are Buddhists swing traders?!)… moderate risk, moderate return.

Most traders eventually find that the middle way of the swing trader suits them the best. However, as swing traders sometimes hold trades overnight, they may awake to see that the significant profit of the previous session has evaporated; "Oh, if only I was a day trader!" they may lament. Or sometimes a swing trader may liquidate a position after a few days only to notice that if he left the same position on for six months, he could have retired!; "Oh, if only I was a position trader!" If you have had these feelings, you are not the only one. The answer to this dilemma is to trade with the single in/scale out strategy. The single in/scale out strategy allows you to increase your return and reduce your risk at the same time!

The single in/scale out strategy allows you the flexibility to have different exit rules for each one of the contracts that you have bought or sold. The exit rules for one of the contracts will be "day trader" rules. With the day trader contract, you will quickly be in and out of the market, usually intraday, for a quick profit. Another contract will have "swing trader exit rules"; you will hopefully keep this position on for a day or two or longer to secure additional profits not obtained by the day trader contract. You will also have a contract that will have a "position trader" style of exit. Though this contract doesn't pay out often, when it does, it is significant! I will sometimes refer to this contract as the lottery ticket contract.

The single in/scale out strategy works best when entering a position where you know what your initial risk is. If you use market orders with your trading strategy, you won't know what your initial risk is until you get filled, even if your stop level is clearly defined. Ideally, we want to use limit orders and clearly defined stops when using the single in/scale out strategy.

Here are the simple rules for the single in/scale out strategy:

1. Buy or sell three contracts (or more in multiples of three) at your limit price. Use a single protective stop on all three contracts. The difference between your entry and your stop is your "initial risk".

2. Calculate your first target. Your first target is 50% of your initial risk. Liquidate one position at this level. If you hit your first target, move your protective stop on the

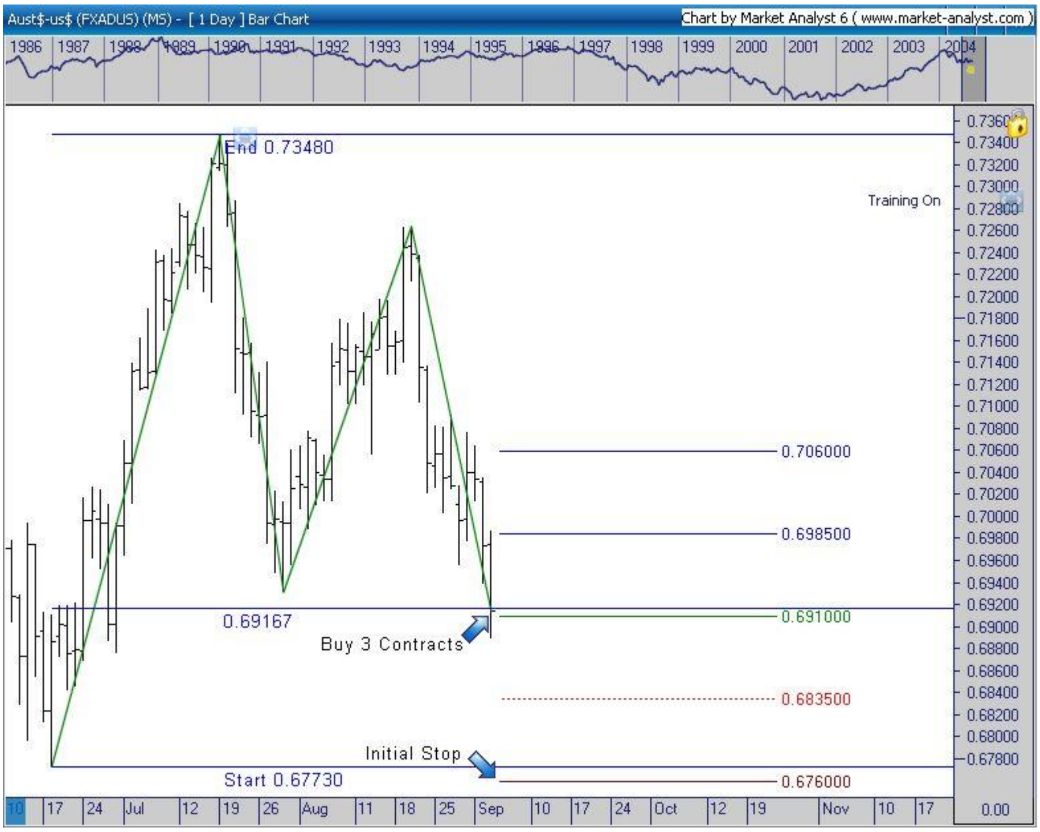
remaining two contracts in the direction of the trade by 50% of your initial risk.

3. Calculate your second target. Your second target is 100% of your initial risk. Liquidate one position at this level. If you hit your second target, move your protective stop on the remaining contract to your entry point.

4. Manage your last position with a trailing stop. Use a three bar trailing stop (more on this in the next issue) or some other volatility based trailing stop on your last contract as long as the trailing stop is not above (for short trades) or below (for long trades) your entry price. In other words, the worst case scenario with the last contract is getting stopped out at your entry price without a loss. Once you have one contract left, increase the time frame on the chart for your trailing stop. If you initiated your position on an intraday chart, change to a daily, if you initialted your trade on a daily chart, change to a weekly..

Let's look at an example below in figure 1 of the single in/scale out strategy. In this example we have a bullish Gartley pattern on a daily chart of the AUD/USD spot Forex. We will be entering the position at the 78.6% retracement at .6910 and the initial protective stop is set to just below the beginning of the Gartley Pattern at .6760. The risk on this trade is theoretically set at 150 points per contract. As discussed, we will be buying three contracts so that means our initial risk for all three contracts is 450 points. Remember to keep within your risk parameters! Now that we have our risk defined, now we need to set our profit targets. To calculate your first profit target, simply subtract your stop price from your entry price. This price differential will define the initial risk per contract. The first target price is 50% of your initial risk. In the example below, the initial risk is 150 points per contract. The first target would be 50% of 150 or 75 points. If you add 75 to .6910, you get .6985 as seen on the chart. The second target is equivalent to 100% of your initial risk. Since our initial risk per contract is 150, we can calculate our second target by adding 150 points to our entry price of .6910 to give us .7060. If this sounds complicated, there is an easier way. In the Beck Toolkit for Market Analyst, there is a Single In/Scale out drawing tool that determines the levels described in this article with three clicks on the chart. These levels can be seen plotted below in figure 1.

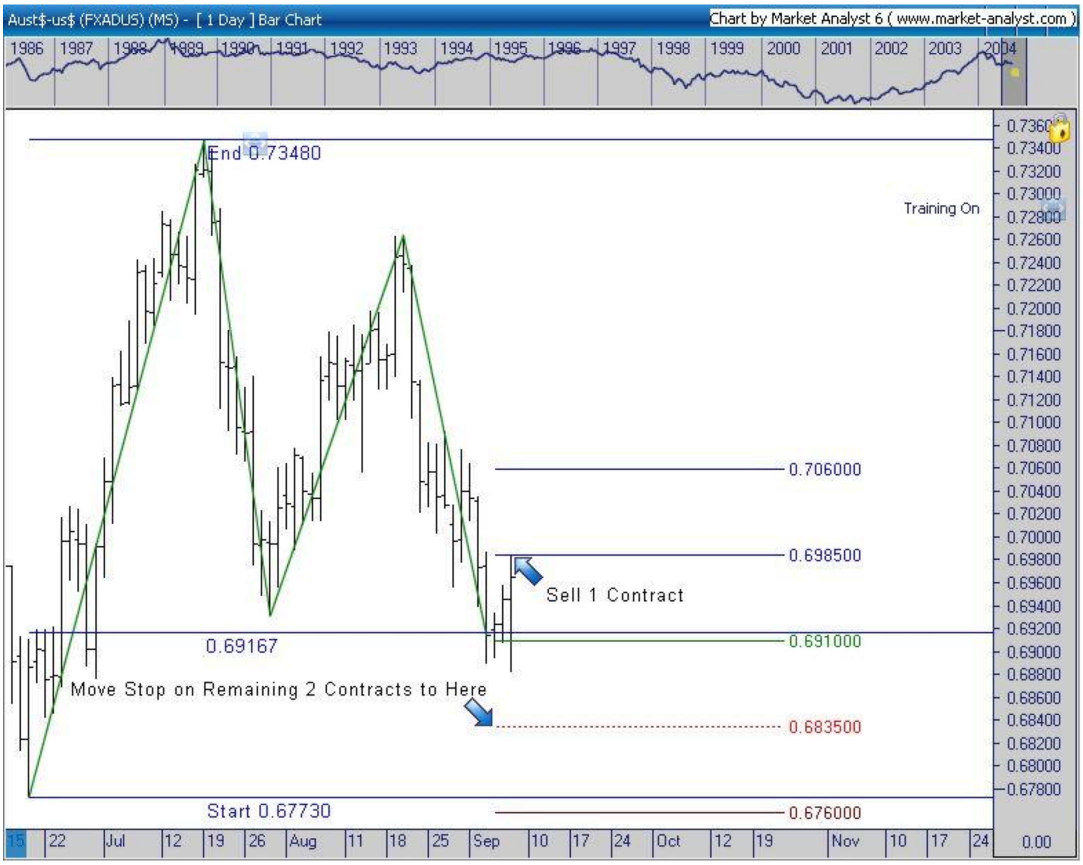
Figure 1 ***Single In/ Scale Out Targets***



Source: Market Analyst 6 (www.Market-Analyst.com)

Let's assume that we have been filled at .6910 on the chart in figure 1. The worst case scenario after our fill would be that the market drops like a stone and we get stopped out at .6760 and lose 450 points. However, the likelihood of that event is low. Why? Because the most probable event in this situation is that the AUD/USD will hit your profit target first. The reason for that outcome is not due to the magic of the Gartley Pattern, but rather due to cold hard statistics. Once the position is filled at .6910, there is a higher probability that the market will trade at .6985 rather than .6760 due to the fact that the first profit target is half the distance from our entry price compared to where our stop is located. What this means is more often than not, we will hit our first target out of sheer randomness. Another reason why we should hit the first target before getting stopped out it due to an increase of volatility that usually accompanies a retest of a recent high or low. Usually, a market won't rip through significant support or resistance levels without first testing it. It is at this moment of uncomfortable indecisiveness that volatility will typically increase before a break or bounce takes place. Therefore, it is very common to hit the first profit target when this type of volatility is displayed at the completion of a Gartley Pattern at a 78.6% retracement level close to a previous high or low.

Figure 2 ***First Target Hit***



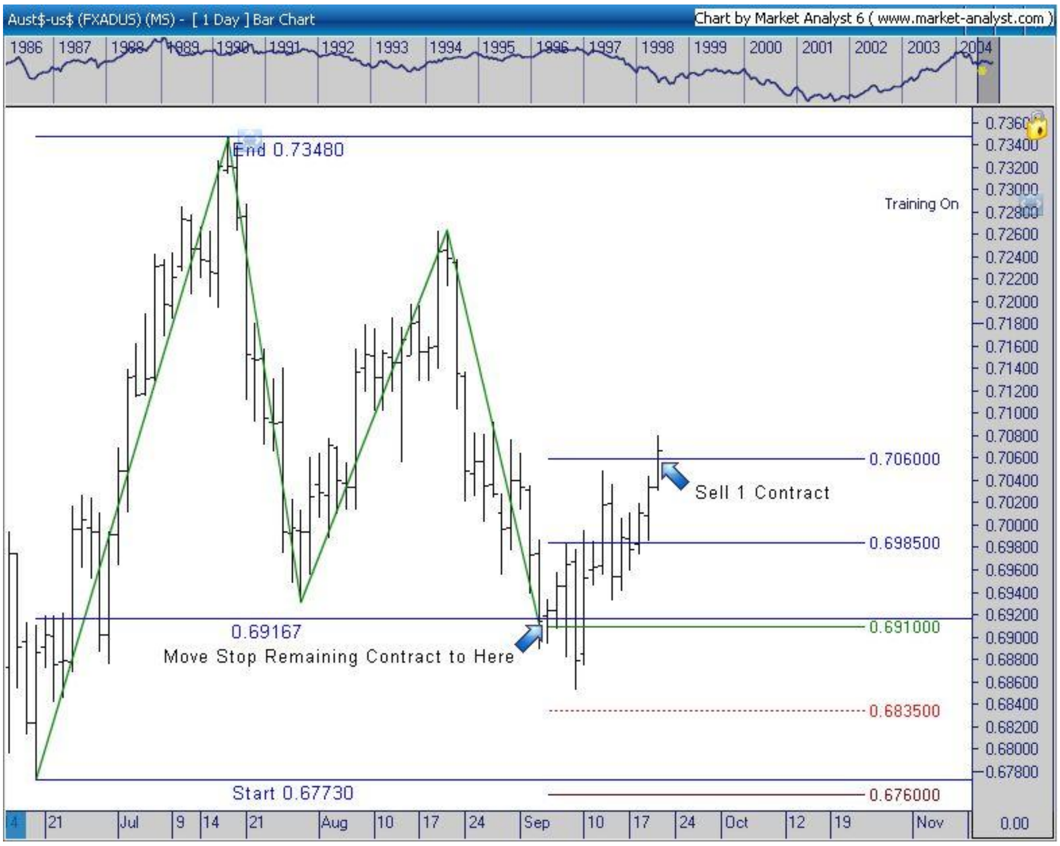
Source: Market Analyst 6 (www.Market-Analyst.com)

As expected, we have hit our first target at .6985 in the chart above in figure 2. At this level we need to liquidate one of our positions with a 75 point profit. Our net position now is long two. Rather than leaving our stop down at .6760, we need to move it up 50% of our initial risk (150 X .5 = 75) or 75 points to .6835. We have now reduced our risk by 83%! Our risk on all three contracts initially was 450 points (150 X 3) and now it is only 75 points of risk. This 83% risk reduction after the first target is hit can be confusing the first time so let me explain.

We've determined that the initial risk on all three contracts was 450 (3 x 150.) Then we took a profit of 75 points when we hit the first target. Now what is the risk on the remaining two contracts? By moving the stop up 75 points on the two remaining contracts, our risk on each of the contracts is 75 points, or a total of 150 point for the two of them. But the risk is not 150 points because we now have to subtract the 75 point profit that we have already made when we liquidated the contract when we hit the first target. When we subtract the 75 point profit from the 150 point risk that we have with the remaining two contracts, this gives us a risk on our overall position of 75 points if we get stopped out at .6835. A 75 point loss is a lot better than a 450 loss! - and as discussed earlier, hitting our first profit target is a high probability event!

Now that we have hit our “day trader” target at .6985, our focus is on our second profit target at .7060. The second profit target is always 100% of our initial risk (150 X 1), or in this case 150 points above our entry price of .6910.

Figure 3 ***Second Target Hit***



Source: Market Analyst 6 (www.Market-Analyst.com)

As seen in figure 3, we now have hit the second profit target at .7060 and it’s time to liquidate our second “swing trader” contract at this level for a 150 point profit. Just as we moved the stop up 75 points when we hit the first profit target, we need to do the same now that we have hit the second target. Rather than leaving the stop down at .6835, we move it up by 50% of our initial risk (150 X .5) or 75 points to .6910 which happens to be the price that we bought all three contracts at. We are now in a very comfortable position. We have locked in a 225 point profit and our protective stop on the remaining contract is at the same price that we entered. Now we have one contract left, we are left with our long term “position trader” contract. As such, we need to use a big, loose position trader style of stop on this contract. I refer to this contract as the lottery ticket contract because it doesn't "pay out" as often as the other two contracts do. However, when it does work, you will remind yourself that the few times in a year that you win the “lottery,” it was well worth the time managing your multiple contract positions. In the next issue of *The Educated Analyst*, I will show you how to manage your “lottery ticket.”

About Ross Beck

Ross Beck, FCSI is VP of Business Development for Market Analyst International and author of the forthcoming book published by Wiley Trading entitled, “The Gartley Trading Method.” For more information, go to gartleytrader.com.

PLANETARY CYCLES

METHODOLOGY

With Mariano La Rosa

"I have proved to myself, and I proved to other people that the law of vibration explains every possible phase and condition of the market." W.D.Gann

All the big cycles and the trend of the financial markets activities are related to the planetary cycles trends.

Gann realized that there are always the same laws acting in the universe, and the difference was only into the different fields treated and not in the cyclical events. It was just this basis defining the "Universal law of Vibration" that leads to the "Theory of the Planetary Cycles" allowing to Gann to become the greatest trader up to date.

Through this theory, Gann combines the movement of a security or an index coming on future regular bases. He drew them up on a calendar containing the most important days (or periods) of the year, in regard of the Solar System Planets Motion.

Recalling the Biblical quotation "There Is Nothing New Under The Sun", Gann said that the future was just a repetition of the past, and it was possible to glean all possible future events through the cyclical planetary movement that in the past was in perfect harmony with a hypothetical financial market.

On an intuitive level we could imagine the Universe as a big orchestra which generates infinite cosmic melodies coming out from the planet motion movement around the Sun. This movement producing a vibration, that is a sound itself, and according to the Law of Resonance, its frequency is inaudible to humans and such vibration could vibrate other bodies on the Earth, like persons and things.

Sympathetic Resonance is the scientific term used for a natural phenomenon so that a body, subject to an external source of vibration and having a frequency equal to the natural frequency of the body itself, begins to vibrate.

When two strings of a violin are at the unison and one of the two is played, the other one will oscillate at the frequency of the played chord. This will happen even though the second chord won't be touched by the violin bow.

Nature tends to synchronize all the elements initially appearing to be discordant. Sometimes, achieving this sync state requires the maximum entropy until a common denominator is obtained… after that stability comes out.

We have thousand of these examples in nature.

Sync happens even with physical appearance, because, year after year, persons living together tend to resemble each other. Older couples not only achieve similar habits, but seem to be more similar than they were when they met.

In the case of financial markets, survey work consists of searching for the item in nature with which a particular market is synchronized, and then applying to it mathematical-geometric solutions for its prediction.

The duration of different planetary cycles, intended as the period of time to make a full revolution about the Sun, in many cases, appear to be in harmony, respecting the musical diatonic system. We can see an example hereby:

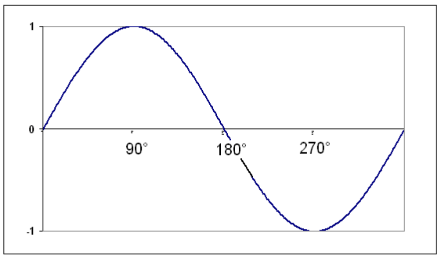
Uranus cycle

Fundamental tone=	84 years
Octave (180°)=	42 years - similar to sinodic Saturn-Uranus cycle
Double Octave (90°)=	21 years - similar to sinodic Jupiter-Saturn cycle
Fundamental /12=	7 years - similalar to: sinodic ½ Jupiter-Uranus 1/3 Jupiter-Saturn ¼ Saturn cycle

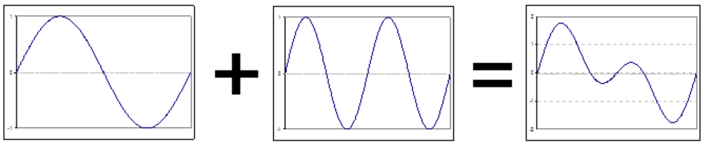
Sinodic Saturn-Uranus cycle:

Fundamental tone=	45 years - similar to Octave of Uranus
Octave (180°)=	22 ½ years - similar to Double Octave of Uranus
Fundamental /12	3.75 years - similar to Two Mars Cycles

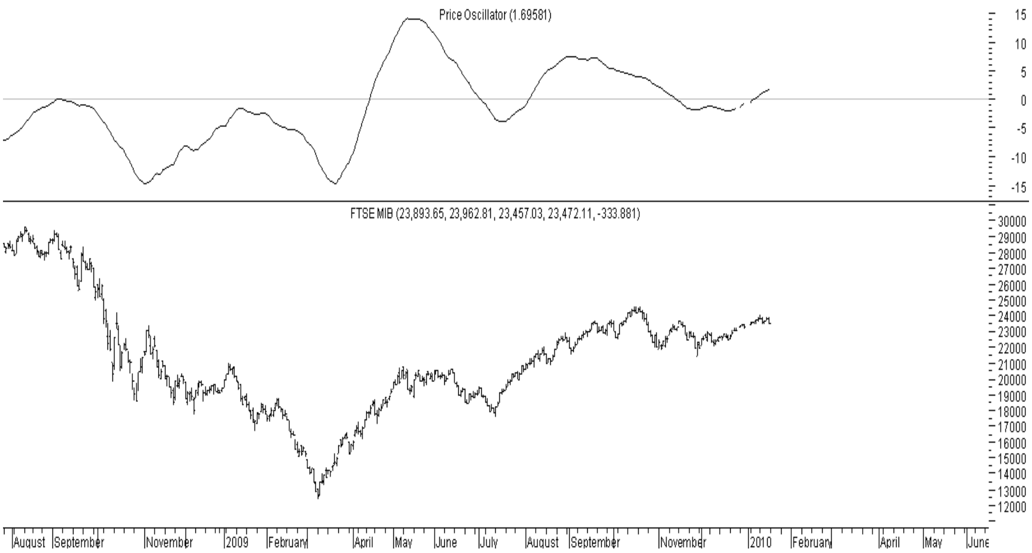
Since each cycle, either Synodic or Sidereal, moves over an angle going from 0° (degrees) up to 360° (degrees), using the SIN trigonometric functions we can easily turn circular movement into a sinusoidal movement.



Through appropriate weights weighting, the combination of multiple cycles with different harmonics allows one to obtain a composite cycle that, once synchronized with the past motion of a market, extrapolate future developments with a measured approximation.



It is important to keep in mind that the composite cycle resulting does not provide indications about price, but only about time. That's the reason why carrying out surveys about the past will be necessary to deduct the trend from that movement through common price oscillators, as in the following example.

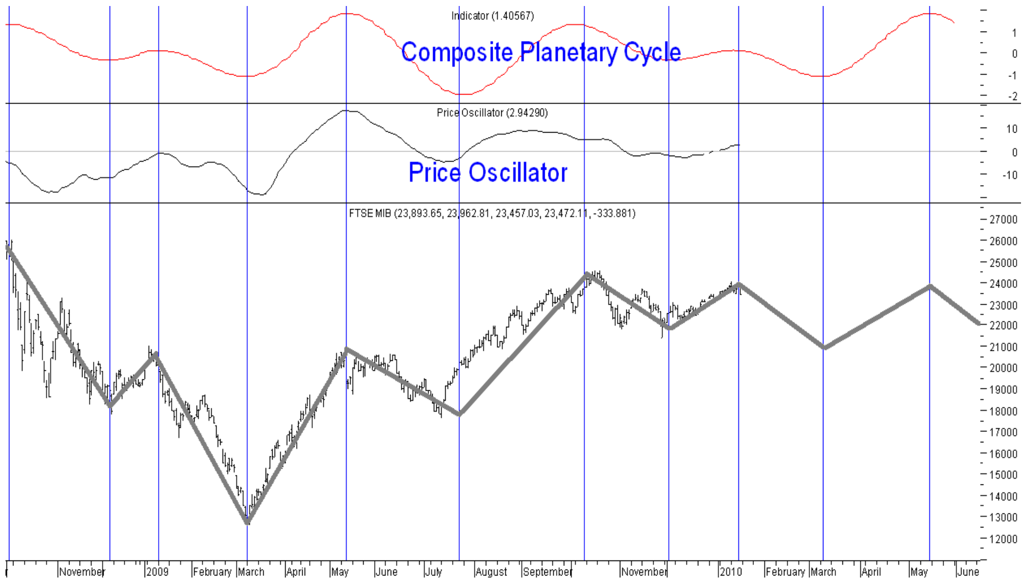


As we can see in the chart, the oscillator allows us to find underlying cycles regardless of the price, because the indicator oscillates around zero.

This is the only way to conduct the survey on those planetary cycles which can interpolate better the oscillator, so that they can extrapolate the future trend. With regard to the long term trends, it appears that we will have to use very slow cycles; in fact very interesting tips come from Jupiter, Saturn and Uranus cycles. However, with regard to the short term trends, it will be important to use shorter cycles, before all the Solar cycles.

With regard to a short term analysis about the Italian market, we used the octave of the fundamental tone of the Solar cycle (to recall the diatonic system we mean 180°, as discussed above) combined together with a smaller harmonic of the same cycle. Once added and put in phase with the two waves, we got a composite cycle. It is very useful to extrapolate the mid-term trends within the calendar year, as shown in the following chart.

The only input of the above application is the coordinates of longitude of Earth revolving around the Sun, expressed in degrees. This gave us a satisfactory result with some approximation within two weeks. Obviously this cycle will be inserted into the longer planetary cycles, in order to extrapolate future trends for periods exceeding one year.



About Mariano La Rosa

Mariano La Rosa graduated in Economics and has twenty years experience trading in advanced technical analysis and cyclical analysis of the financial markets. He is a student and has a keen interest in the well known W. D. Gann Theory. Mariano forecasted, with great accuracy, the exact week and day of the end of the markets downtrend, which took place between the 6th and the 9th of March 2009. All this happened during a live show on ClassCNBC Television, on February 2009. Mariano is one of the best traders in the world in managed portfolio demonstrable returns and has a wide experience in futures and options, and is widely recognized by the specialized press and ClassCNBC financial television.