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Handling Market Reactions

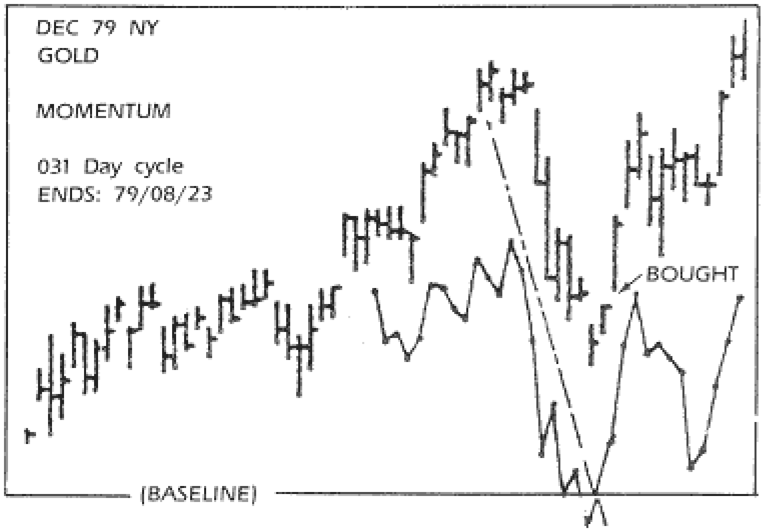
by JOHN E. ROSENSTOCK

All markets exhibiting prolonged price trends invariably have reactions against the trend. These reactions can be of short or long duration and can retrace small or large portions of the preceding swing. They can be very sharp reversals or have periods of congestion prior to the retracement. The question is: How are these reactions anticipated, measured, and taken advantage of? One very excellent method used in my computer analysis of market reactions is the momentum concept. This theory is based on market velocity and can be aptly described as "the steam in the boiler" method. The most difficult part of working with reactions is determining when they are over. Momentum is ideal for this purpose. The market to be measured must first be tuned to is dominant cycle. Measuring from tops to tops or bottoms to bottoms and halving this figure will produce a workable factor. For example, say our cycle is 20 days. The price today is compared with the price 20 days ago. If it is higher than 20 days ago, it is plotted above a base line. If lower, it is plotted below the base line. Using silver as an example, if today's close is 10 cents higher than 20 days ago, a point is put 10 points over the base line. The next day may be only 5 cents higher than 20 days ago, so a point is put 5 cents over the base line. This continues for each consecutive day, plotting points either above or below the base line. This chart can yield two very important bits of information: 1) When the reaction is over; and 2) When the main trend will resume.

The momentum chart will form a wavy line moving back and forth from extremely positive to extremely negative. When the line reverses its trend near extremes of the graph, it indicates that prices have probably run as far as they can. If this occurs while a market has been reacting against its main trend, additional contracts can be added to the original position in line with the trend. Open stop loss orders can be entered in a logical place to protect the recently added position. When the momentum line crosses over the base line again on its way to the other extreme, the continuation of the main trend is confirmed. If an orderly market ensures, the momentum line may move around the base line for a time until pressure builds in the market.

If pressure builds slowly, the momentum will gradually work its way to an extreme. In volatile markets, the line may shoot to an extreme of the chart rapidly and the old extreme may be exceeded, confirming expectations for the main trend. If the main trend changes shortly after momentum reverses from an extreme, odds are the move is over and it is time to work the other side of the market. Best results are obtained using a shorter cycle for momentum than the cycle used for trend.

Chart explanation: Momentum moved into negative ground for only one day and promptly moved back into the positive zone, breaking the momentum downtrend. This indicated that 1) the reaction was over and 2) the uptrend was resuming. A buy on the opening next morning was clearly indicated.



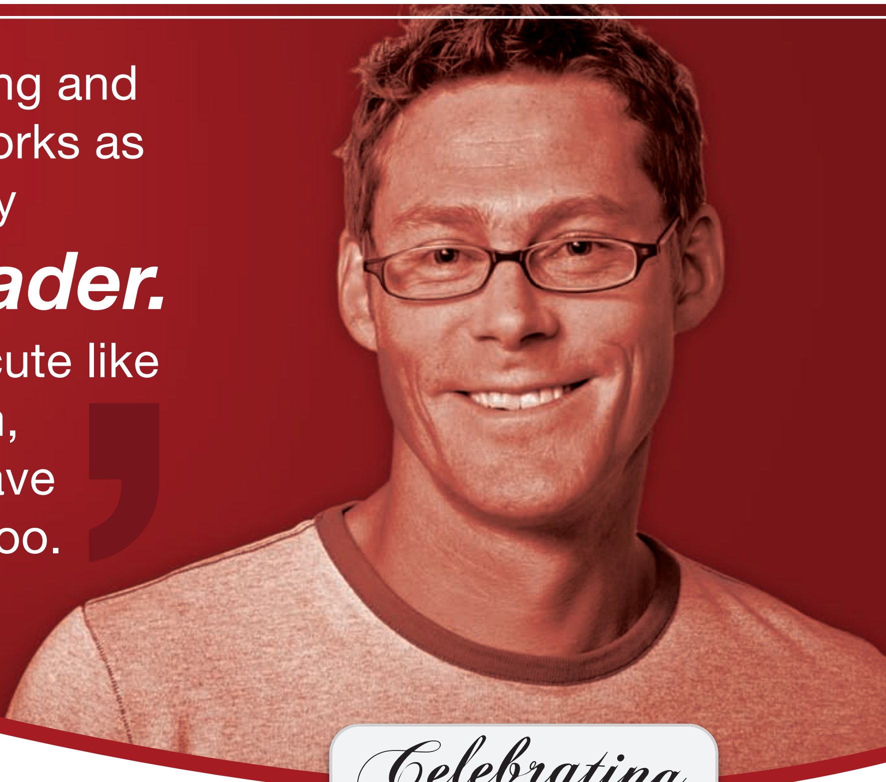
AUTHOR'S BACKGROUND

—"Integrated Systems Approach to Technical Commodity Analysis" by John Rosenstock, a COMPU TRAC member and Technical Trading Manager with Rudolf Wolff Commodity Brokers Inc., New York.

—"What Else Does It Do?" (i.e. the Apple) by Steve Ross an econometric forecast programmer with Weyerhaeuser Company.

—"Forecasting Commodity Prices Using ARIMA" Time Series Analysis Using ARIMA Based on Box-Jenkins Methods by Eric Weiss, Ph.D. (Economics), President of The Winchendon Group. This series of articles describes application of the Autoregressive-lntegrated Moving Average (ARIMA) forecasting method based on past price movements. For information on EASI/ ARIMA Software contact the Winchendon Group, 3907 Lakota Road, P.O. Box 10114, Alexandria, VA 22310 (703) 960-2587.

—"To Trade Or Not To Trade (Or How I Done It)" by Jack K. Hutson a COMPU TRAC member and publisher of 'Technical Analysis of Stocks and Commodities'. He has traded Stocks for the last 12 years and Commodities for 3 years. His education includes both an Engineering and Business background. He has been a Mechanical Engineer with The Boeing Company for the past 9 years where he has made extensive use of a mainframe computer for time series analysis.



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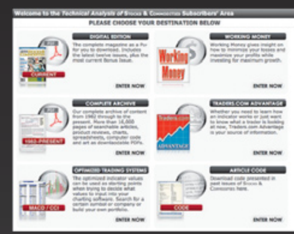

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