

In this lecture we are going to examine what happens in the market after a high volatility move. If we think about volatility for a second, we will realize that it is the opposite of price fluctuation. In every financial market on the planet, price tends to rise slowly and drop quickly, and that's not an accident. That happens because there is an asymmetry between certainty and uncertainty. What I mean by this is that certainty is very fragile and can dissipate in a matter of seconds. Uncertainty on the other hand is much more stable and it doesn't dissipate so easily.

Let me give you a practical example of this. If everything is ok in the market, and prices are naturally rising because the economy is going well and companies are growing for example, price doesn't skyrocket all at once. It slowly rises. However, if an unprecedented event suddenly happens like we are seeing right now with the coronavirus and the oil crisis, markets drop quickly. This is why I said that volatility is the inverse of price fluctuation. Price fluctuation rises slowly and drops quickly. Volatility rises quickly and drops slowly.

Another way of visualizing this situation is that the natural world has entropy, which is the tendency of things to go out of order. That means that a constant effort must be made just to maintain things working normally. That's why it's difficult to make a company grow and it's very easy to go bankrupt for example. Yet another way of thinking about this is that it is much easier to demolish a house than it is to build it. To build a house, you need a lot of money, you need intellectual capital, you need a tremendous amount of work, and everything must go to according to plan in the end. To demolish the house, you just need a bulldozer.

This is precisely the reason why after a high volatility and irrational move in the market, we can expect a low volatility and rational move that is relatively easy to trade compared to the wildness of a downward market. Just as a parenthesis, markets can skyrocket in the very short term in very low timeframes due to the nature of speculation, but not in higher timeframes. In this chart we can see a good example of what happens after a high volatility move. You can observe that in the 1-2 vector, the market goes straight down with a tremendous amount of volatility.

One detail here is that price tends to get stretched out in the end of a move like that as we can see in low number 2. Notice how the last bar really accelerates to the downside as if it was making a final thrust to finish the move. Notice that the last bar of the 1-2 vector is larger than the previous 5 bars. That's obvious once we point it out, but many people fail to notice that in a move like this, especially because people start to panic once they see something like this in the chart.

After low number 2, price starts to create a minor flow in the opposite direction with a significantly decreased level of volatility. One particular nuance about this scenario is that since the previous down move wiped out everything in its way, the upward minor flow has a good amount of headroom to travel so to speak. From number 2 to number 5, we can see the formation of a solid low in number 4. Another way you can view this is that after the large bar that creates low number 2, it is as if the market was restarted in a way. That allows us to trust the minor movements that we can identify in the minor flow after the high volatility move.

If we plot a pitchfork using high number 3, low number 4, and high number 5, we will see that low number 6 falls right back to the centerline of the pitchfork, which is a textbook retracement move of a running flow. The moment where this happens also coincides with the minor supply zone that comes out of low number 4. It is from this moment on that we can start looking for an entry for a long trade, but before we do that, let's review the

context for this long trade. The first thing that should grab your attention here is that the notion of market trend can change very quickly.

We were clearly going down until number 2, and it only took a few bars after that for us to identify an upward movement with solid lows. This is why this notion of market trend can be tricky sometimes. However, considering the whole context of how the market went down, we can be open minded about the speed of how the apparent trend changes. Once we have the fractal bar in number 6, we can plot another pitchfork to attempt catching the edge of where the market will start going high next. By plotting the pitchfork in low number 4, high number 5, and low number 6, we can see that we have a pitchfork that is too steep.

The solution for that is to modify the pitchfork. By doing so, we can see that the lower line of the pitchfork catches the lower tails before price starts to go up in the direction of number 9. If you were unable to catch that in real time, the market would give you yet another opportunity before the rise to number 9. If we look carefully, we can find yet another retracement caught by a pitchfork in number 8, but let's just say that you also missed that. The last resort here would be finding the immediate edge right after number 8. We can do this by plotting a small pitchfork using the lowest edge after low number 6, high number 7, and low number 8.

We can see that this small pitchfork catches the edge after 8 with a small frequency shift that if corrected, would catch the edge near number 9. Number 9 is also an interesting situation for a peculiar reason. If we look at the 1-2 vector once again, we will see that right in the middle there is a small bump. Normally we wouldn't care about this bump, but the fact that it is in the middle of a powerful move like that makes it important precisely because it's small. In other words, the fact that a small move like that was able to emerge in the middle of the storm of the 1-2 vector says a lot.

The inward frequency line that comes out of this small move in the middle of the 1-2 vector represents a possibility for a short trade in number 9, especially after observing that number 9 is a market edge as we saw with the small pitchfork. If we compare the power of sellers coming out of the small bump with the buyers leading into number 9, it's not difficult to see which one of them is more powerful just by looking at the volatility of the bars. Price indeed starts to go down after number 9.

If we were trying to catch the edge right after number 9, we could plot a pitchfork using the small bump in the middle of the 1-2 vector, low number 2, and high number 9, and then modify the pitchfork. Notice that in this case, the pitchfork would fail to catch the market edge. However, this pitchfork correctly points to an exhaustion in its centerline in number 10 with a small undershoot. Notice that low number 10 falls exactly in the level where the market finally decided to create the vector 8-9. Buyers and sellers were fighting from number 2 to number 8 with a small advantage to the buyers since we observed an upward flow, but low number 8 is where the sellers finally gave up and let the buyers go up to 9.

Just like price remembered number 8 in number 10, it remembered number 9 in number 11. If we adjust the frequency shift of the pitchfork in the centerline, we can see that the upper line of the pitchfork catches number 11 perfectly where there is a fractal bar and a very clear dynamic frequency breakout. It would be fine to go short in number 11 with a stop above number 9, and a target in the centerline of the pitchfork, but there is a newer pitchfork that can be drawn here using high number 9, low number 10, and high number 11 as the axes. This pitchfork could also give a further perspective on the trade's target.

Hopefully you were able to apprehend how the context given by the volatility of price moves can shape the way we use linework to find good trade opportunities.