

TIMING SOLUTIONS FOR SWING TRADERS

A Novel Approach
to Successful Trading
Using Technical Analysis
and Financial Astrology

ROBERT T.H. LEE
PETER A. TRYDE

Copyrighted Material

Contents

Foreword

Preface

Disclaimer

Chapter 1: Be Prepared

Fundamental and Technical Analysis

Conclusion

Chapter 2: Let's Get Started

Patterns

Volume

Price Momentum

Price and Moving Averages

Combining the Four Dimensions

Beyond Technical Analysis

Financial Astrology

Keeping Count

Conclusion

Chapter 3: Essential Patterns

Open

High

Low

Close

Candlestick Patterns

Divergence Patterns

Diagonal Patterns

Patterns Continued

"M" and "W" Patterns

Head and Shoulders Patterns

Rectangle Patterns

Saucer Patterns

AB=CD Patterns

Gaps

Conclusion

Chapter 4: Elliott Waves

Wave 1

Wave 2

Wave 3

[Wave 4](#)
[Wave 5](#)
[Extended Waves](#)
[Three-Wave Structures](#)
[Corrective 3-3-5 Patterns](#)
[Corrective 5-3-5 Patterns](#)
[Rule of Alternation](#)
[Fibonacci Retracement and Projection](#)
[Application of Elliott Wave Analysis](#)
[Conclusion](#)
[Appendix: Ratios and Wave Relationship](#)

Chapter 5: Volume

[Basic Volume Plots](#)
[Reading Volume](#)
[Money-Flow Indicator](#)
[Deciphering Trend with Volume](#)
[Conclusion](#)

Chapter 6: Key Indicators

[Momentum Oscillator](#)
[Queuing Theory of Moving Average Crossovers \(QMAC\)](#)
[MACD](#)
[Average Direction Index](#)
[Protective Stops](#)
[Conclusion](#)

Chapter 7: Applied Systems

[Catching That Trend](#)
[Built-In Color Trend Indicator](#)
[Supporting Moving Averages](#)
[Trade on Daily Signals](#)
[Trading with Ichimoku](#)
[Conclusion](#)

Chapter 8: Formulating Your Trading Plan

[Determining Your Time Frame](#)
[Selecting Stocks](#)
[Risk Management](#)
[Determine Entry Points](#)
[Determine Exit Strategies](#)
[Reality Check](#)

Chapter 9: Financial Astrology

Using Lunar Cycles in Trading

How to Pick Winning Stocks

Choosing the Best Periods for Trading

Market Projection

Conclusion

Appendix 1: Ruling Planets of the Natural Horoscope

Appendix 2: Effects of Various Aspects

Appendix 3: Characteristics of the Twelve Zodiac Signs

Appendix 4: Formulas in MetaStock Format

Glossary

Bibliography

About the Authors

Index

Founded in 1807, John Wiley & Sons is the oldest independent publishing company in the United States. With offices in North America, Europe, Australia and Asia, Wiley is globally committed to developing and marketing print and electronic products and services for our customers' professional and personal knowledge and understanding.

The Wiley Trading series features books by traders who have survived the market's ever changing temperament and have prospered—some by reinventing systems, others by getting back to basics. Whether a novice trader, professional or somewhere in-between, these books will provide the advice and strategies needed to prosper today and well into the future.

For a list of available titles, please visit our Web site at

www.WileyFinance.com

.

Timing Solutions for Swing Traders

*Successful Trading Using
Technical Analysis
and Financial Astrology*

**ROBERT T.H. LEE
PETER A. TRYDE**



John Wiley & Sons Singapore Pte. Ltd.

Copyright © 2012 by John Wiley & Sons Singapore Pte. Ltd.

Published by John Wiley & Sons Singapore Pte. Ltd.

1 Fusionopolis Walk, #07-01, Solaris South Tower, Singapore 138628

All rights reserved.

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as expressly permitted by law, without either the prior written permission of the Publisher, or authorization through payment of the appropriate photocopy fee to the Copyright Clearance Center. Requests for permission should be addressed to the Publisher, John Wiley & Sons Singapore Pte. Ltd., 1 Fusionopolis Walk, #07-01, Solaris South Tower, Singapore 138628, tel: 65–6643–8000, fax: 65–6643–8008, e-mail:

enquiry@wiley.com

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor the author shall be liable for any damages arising herefrom.

Other Wiley Editorial Offices

John Wiley & Sons, 111 River Street, Hoboken, NJ 07030, USA

John Wiley & Sons, The Atrium, Southern Gate, Chichester, West Sussex, PO19 8SQ, United Kingdom

John Wiley & Sons (Canada) Ltd., 5353 Dundas Street West, Suite 400, Toronto, Ontario, M9B 6HB, Canada

John Wiley & Sons Australia Ltd., 42 McDougall Street, Milton, Queensland 4064, Australia

Wiley-VCH, Boschstrasse 12, D-69469 Weinheim, Germany

ISBN 978-1-118-33917-6 (Hardcover)

ISBN 978-1-118-33918-3 (ePDF)

ISBN 978-1-118-33919-0 (Mobi)

ISBN 978-1-118-33920-6 (ePub)

Foreword

Like many practitioners, my collection of books on technical analysis has grown over the years. In the initial years, during the 1980s, when such books were few and far between, I bought almost indiscriminately. Later, as my knowledge of the markets and analytical methods grew, my purchases became more selective. This well-written book, which focuses solely on the equity markets, will occupy an important place on my bookshelf along with Robert's first little gem of a book, *Power Tools for Traders* (1997).

Timing Solutions for Swing Traders has something for the novice as well as the seasoned trader. The first few chapters serve as both a learning aid for beginners and as a refresher course for the more experienced practitioner, while the latter chapters show how to combine and use the indicators and methods discussed to create a trading plan.

I found Robert's innovative approach to multiple moving averages, which he calls the Queuing Theory of Moving Average Crossovers (QMAC), to be very interesting. I particularly liked the way he dissects the interplay of long-term moving averages to anticipate major support and resistance levels and his use of colored candlesticks to differentiate between trending and non-trending phases based on simple but effective concepts.

It is the last chapter, on financial astrology, written by Peter, that I found to be most fascinating. Having never explored this area before—and not being very esoterically inclined—I found the material quite easy to follow. The astrology-based approach to selecting stocks, in combination with the more accepted methods of analysis along with the section on projecting future trends based on planetary influences, definitely merits further study. I hope the authors explore this fascinating new area in more detail, with examples from other equity markets and perhaps the currency markets, in a future publication.

I have known Peter since he was a rookie broker, and in recent years, I have come to know Robert as well. I have observed firsthand how their approach to analyzing the stock market can produce quite extraordinary results. Robert and Peter have many more innovative indicators and methods between them and I look forward to reading their next offering.

Ananda Bhaumik

Private Banker

Hong Kong

Preface

The title of this book, *Timing Solutions for Swing Traders: Successful Trading Using Technical Analysis and Financial Astrology*, defines its mission. It is all about detecting trend and exploring the best timing to trade. The first eight chapters are authored by Robert and cover comprehensive aspects of technical analysis, including a summary on the Theory of Elliott Wave Principle and the Queuing Theory of Moving Average Crossovers. The last chapter was contributed by Peter. It introduces the application of financial astrology to picking stocks and cycles, to finding the best period to trade, and to ascertaining the best period of your personal Part of Fortune.

The book covers four dimensions related to trend analysis: price patterns, volume, price momentum, and price moving averages. The objective is to decipher price trend and to develop the most effective and profitable method to trading. It will show how to use financial astrology in lunar cycle trading, select stocks with the best potential, and find the best time for profitable trading. And, it will introduce readers to the emerging trend of fusing technical analysis with cycle analysis and financial astrology.

This book is not about day trading of stocks and is not intended for day traders. Day traders are very short-term players and they make trades during market hours in one trading day. This is a book primarily for people who work from "9 to 5" and who do not have the spare time to monitor their stocks closely during the day. They are more likely to be position traders who make longer-term trades that may last from several days to several months, and can only find time after office hours in the evening. Many of them would like to have some sort of technical analysis method that can help them take better care of their trades, but they just do not know where to start. They would like to read charts. However, there are so many methods and systems to pursue that the whole process becomes somewhat overwhelming. This book is dedicated to these people who want to be more proactive traders. It will demonstrate a simple and practical approach to doing just that. It will not require the purchase of expensive and sophisticated software, as we are dealing only with end-of-day data and not real-time data. Other than the examples of charts in financial astrology, we are using MetaStock software and end-of-day data subscribed from data vendors to illustrate the charts. The formulas in the samples of this book are enclosed for the benefit of the readers. These formulas are not exhaustive or definitive; readers can of course amend them to suit their own style of trading. MetaStock also has many other popular indicators and systems available.

Our purpose is to show swing traders or non-day traders a concise method to trading and encourage them to take the subject to a higher level, particularly in configuring the indicators they will use for trading, management of risk, and use of financial astrology. In financial astrology, we try to show the application of astro-harmonics and how they are being used with common technical tools to give an extra edge in timing market turns. Every trader has his or her own habit of trading, such as preferred use of certain indicators and methods, and margin of acceptable risk. Most traders, however, depend entirely on the standard formula of a packaged program. Many of them have good ideas of what indicators they would like to use in their trading, but lack the time and patience to implement their concepts into a program. Others are still exploring different options to develop a trading program that suits all their criteria.

After countless hours of research, we have put together the essentials of a practical course on technical analysis in nine chapters, as described in Chapter 2, Let's Get Started. We feel the subjects covered will be more than adequate for trading stocks. There are many dos and don'ts regarding interpretation of analysis that we have encountered in our 35 years of trading

experience, and the book describes how to interpret developing patterns and trends. It also gives examples of how mechanical trading systems are designed, and how a standard indicator could be incorporated into a system. Taken together with the emerging trend of fusing technical analysis with cycle analysis and financial astrology, it is hoped the book may serve as a useful guide and inspire novice as well as veteran traders to further their techniques in the areas covered.

How to gauge different market scenarios is one of the trickiest issues facing traders every day. To help develop your trading techniques, the book contains many charts illustrating how to assess and analyze different kinds of conditions. The charts have been produced from various vendors' software programs. By the end, traders should have further advanced to an all-around understanding of using technical analysis in formulating a profitable trading plan

In the book, we have demonstrated a simple concept of a trading method. The stocks are selected at random and are not selected to fit the system. The system is not a mechanical or fully automated trading system, and parameters of the system and indicators are not optimized. The basic formulas used in the system are provided for reference. The formulas are simple and easy for traders to use. It should be easy also to adjust them for incorporation (with their personal system design) into their personal trading method. The program has a built-in color trend indicator to alert traders to the state of the stocks in the short time frame, and to validate the short-term trend by the medium-term indicators of the system. In essence, we want to trade when the short-term trend is moving in tandem with the medium-term trend, and trade signals are executed only in the direction of the longer trend frame. The application requires discretionary traders' decisions to anticipate market outlook for the intermediate trend. It uses candlestick patterns, Elliott Wave Principle, volume, and the interplay of three longer-term moving averages to decide whether relevant price rallies or corrections are expected to be short-lived or the start of a longer trend. It is also recommended to include a protective stop-loss system in every trading system. There are no standard parameters or definitive methods for applying stop-loss. Each trader has to define his own acceptable risk to set the appropriate stop-loss. For reference, the formula of a simple indicator for stop-loss has been included together with formulas of the various indicators mentioned in the book.

To a large extent, the success of trading depends on your frame of mind, money management ability, and trading methodology. Having a healthy frame of mind is a prerequisite for trading stocks. The mind greatly influences how you trade and how you manage your financial risk. Trading is all about making mental decisions. A frame of mind that is negative, tired, or anxious is not the right condition for trading anything. On the other hand, a healthy and cheerful attitude and learning to take a break from trading are indispensable factors in the unceasing quest to achieve the best trading results.

Robert T. H. Lee

Peter A. Tryde

Disclaimer

This book is sold with the understanding that neither the publisher nor the authors are engaged in offering legal, accounting, or other professional services or advice by publishing this book. Thus, if legal or financial advice or other expert assistance is required in a specific situation, the services of a competent professional should be sought to ensure that the situation has been evaluated carefully. The publisher, the authors, and any other person connected with the writing of this book disclaim any liability for any losses that may be sustained as a result of applying the methods suggested in this book.

This book should not be deemed to be a definitive investment guide and should not be taken to replace advice from a qualified financial planner or other competent professionals. There are always risks in investments of almost any kind and there is no guarantee that the investment methods described in this book will be profitable. System trading is a risky business and can result in heavy losses. Do not assume that the theories, systems, methods, or indicators mentioned in the book would be profitable or that they will not result in losses. The trading systems presented in this book are for guidelines only and serve to illustrate the relative theoretical results between different trading systems. They were produced from various technical analysis software programs developed by various vendors who are in no way responsible for the results. They do not warrant or make any representation regarding the use, or the results of the use of their software programs, or written materials in terms of correctness, accuracy, reliability, or otherwise. They are not responsible for any losses resulting from investment decisions based on information obtained through the use of the systems.

Certain information contained herein has been obtained from sources believed to be reliable, but which cannot be guaranteed as to accuracy or completeness, and is subject to change without notice. The risk of using any trading program or method rests with the user.

CHAPTER 1

Be Prepared

Trading stocks is 100 percent mental. Trading means the buying and selling of one or multiple stocks to take advantage of price fluctuations, rather than just holding on to the stocks indefinitely. Success as a trader is a difficult achievement; it has never been easy. Added to this, the 2008 financial crisis brought to the market a new age of volatility, as well as new thinking and new approaches in trading. If you do not know what you are doing, trading will now be even harder.

Markets consist of a multitude of investors from individuals to institutions, each with their own investment agenda. In aggregate, investors' emotions of greed, fear, hope, and despair dictate market fluctuations and directional movements. Similarly, the psychological state of a trader may affect his trading results because his emotions influence his decision making. To outperform the market and to succeed in trading, a trader needs to take charge of his emotions. To start off, he requires a patient and confident mind. If a trader is confused about what he is doing, the probable win ratio is zero and he might as well give up trading. The mind is mischievous and it often is the primary cause of failures. The market is always creating noises and if a trader fails to control his inner noises, how can he listen to what the market is trying to tell him?

In

Figure 1.1

, the Hang Seng Index showed that the market was in an optimistic mood for about 55 months from April 2005 to its exuberant high in October 2007. Fear began to take over in November 2007, and the market finally cracked in January 2008. The financial crisis struck across the globe, creating panic among investors. The collapse of confidence lasted about 13 months until the U.S. government began to announce concerted efforts to calm investors. Hope returned to the market with the announcements of the government's financial stimulus packages.

FIGURE 1.1

Greed, Fear, Hope, and Despair form the four psychological states of the market, swinging sentiment states from optimism to pessimism and repeating it all over again, time after time.



After approximately eight months, the buoyancy of the market slowed down and investors seemed to return to an anxious mood. Notice that the volatility of the market, shown by the wide monthly range, was greater toward the end of the greed and fear states of the market. The top window shows that the momentum oscillator stayed in the oversold zone for 12 months during the state of fear. During the optimism state, the momentum oscillator stayed continually above the oversold line and rose steadily to the overbought zone, supported by increasing volume.

The market is always dynamic. It is oblivious to your wins or losses. But too many traders blame the market for their failures. They do not consider for a moment that their failures are caused by a lack of preparation and irrational emotions. Whatever the cause, the best solution is just to move on to the next trade with a clear mind and in good spirits. A good trader should not dwell on the past. A trader's ego is his greatest hindrance to being successful. The best approach is to turn emotion into a positive tool. Whenever any negative emotions stir in him, a trader should take it as a wake-up call. He should not allow such emotion to blur his judgment and derail his trading plan. The most common fault in trading is overthinking—dwelling on the past and not keeping to the trading plan. Besides thinking too much, a trader may believe he is always correct and will refuse to accept the reality of the market. Thus, he should make extra effort to understand more of himself and his emotion, so that he will trade better and feel better.

FUNDAMENTAL AND TECHNICAL ANALYSIS

When a stock price is compared to its intrinsic value, it is termed as “fundamental analysis.” When the stock price is looked at from the angle of supply and demand, it is known as “technical analysis.” Each method of analysis is just as useful and important as the other, and both methods should be used in combination when reading the market and selecting stocks. However, it must be remembered that all analysis serves as a means to estimate the value of stocks.

Fundamentals refer to the financial information reported by the listed companies, which is always historical. A fundamental analyst calculates the stock’s future worth based on the company’s past reports, and projects its value and relative earnings. Fundamental analysts study the change in profitability of the corporation relative to its revenue trend, costs, and expenses, which will include an analysis of its business competition, its capitalization, and the strength of its business sectors. Fundamental analysts should be aware of the potential risk of change between the company’s latest report and its current situation. It takes generally at least three months from the cutoff date of the financial statements to have the audited results published. During that period, many things can happen and, as a result, the published results may not reflect the current state of the company’s financial position. Nonetheless, one would be foolish to ignore all fundamental analysis.

Fundamentals are more determinable and deliver fewer surprise punches. After studying companies with consistent earnings and growth, it should be possible to forecast these companies’ earnings per share (EPS) and the likely range of their revenue and earnings growth. It might also be possible to estimate the return on equity and the dividend payout ratio based on each company’s dividend policy. However, it would be difficult to do so for companies with volatile levels of revenue and earnings. Investors look for steady growth in both earnings and dividend payout over time. This does not mean the investment dividend has to increase each year. The dividend payout ratio is an important sign. If the dividend payout ratio starts to make a series of declines, business may be turning negative and it should trigger an alert to reassess the investment.

Fundamental analysis is more likely to be based on a uniform standard, which makes it easier for investors to understand the results. Fundamental and technical analyses are not alike, but there is a growing trend to combine both forms of valuation. In fundamental analysis, the P/E ratio is the indicator most often used. It indicates the multiples of earnings represented in the current price. However, the indicator has a major flaw; it tends to distort if and when the current information and the cycles of an industry have changed since the latest earnings report. In spite of this, the P/E ratio has remained a popular and decisive indicator used by many analysts for valuing stocks. Other ratios are important as well, including dividend yield and price to book value.

Investors have a tendency to overvalue stocks by pushing their prices to extreme levels, especially when such stocks are in hot demand for one reason or another. In such instances, P/E ratios can be used as a comparative guide of the stock’s value against other similar stocks in its industry, and when the P/E ratios are well above a specific level, the ratio can be used to eliminate such stocks. Also, P/E ratios make it practical and easy to search for stocks trading at a bargain price. Sometimes, stocks may have extraordinarily low P/E ratios because they may be priced too conservatively and the potential for profit is limited. Other times, very low P/E stocks should be avoided, as there may be certain undisclosed reasons why they are being shunned by knowledgeable investors. A more sensible way, perhaps, is to tread the middle

path, picking mid-range P/E stocks using the P/E of the Hang Seng Index or relative sector index as a benchmark. There is no single answer in the market. Additional analysis could include relative studies of the stock's dividend yield (see

Figure 1.2

) and business outlook and its market capitalization among the stocks in the same industry.

FIGURE 1.2

Hang Seng Index with the monthly yield for the past 16 years.



In

Figure 1.3

, the highs of the Index are marked H1, H2, H3, H4, H5, H6, and H7; and the lows are marked L1, L2, L3, and L4. For the past 16 years, the Index's P/E ratios have risen seven times to the approximate multiple of 20, four of which occasions (H1, H2, H3, and H6) caused major declines. H4 and H7 tops have produced smaller corrections compared with other tops. The Index managed to hold on to its levels though the P/E ratios in both cases are in the proximity of 20; these were the only incidents that did not result in a major decline. Note that for the same period, the P/E ratio lows, falling below a multiple of 10, offered excellent bargains at L2 and L4.

FIGURE 1.3

Monthly P/E ratios of the constituent stocks of the Hang Seng Index for the past 16 years.



Technical analysis, on the other hand, is the study of directional movement of prices using charts. A technical analyst looks at a stock's current price movements during the trading period, regardless of its fundamental value. Whether a stock is expensive or cheap relative to its fundamental value is immaterial. The only thing that matters is the price directional movement and where it might move in the future. The arguments are based on two criteria: that all known fundamental information is reflected in the price, and all changes in emotion and sentiment are shown in the relative action of price and volume. No matter what the stock is worth, it takes only buying and selling to move prices, without which no trade will ever be profitable. A technical analyst does not question why the stock price has moved, but how. His only concern is whether the present state of the stock price will be short-lived or will continue for his trading time frame. His challenge is to anticipate the next direction of the stock price and to time his decisions to either buy or sell based on the correlation of price and volume information, price patterns, and technical indicators.

Basically, a technical analyst looks at the market price action and its relative price patterns to determine whether there is a probable trend to trade. The most important point in attempting to read the market is to have an open-minded approach. It is disastrous to have a prejudicial frame of mind in reading the market. If a trader is biased, looking to fulfill his ego, he can easily get a distorted view of the market. He may be telling himself that he already knows what direction the market will go in, while the truth is he merely wishes it to go in that direction.

In summing up, it will be readily apparent that technical and fundamental analyses serve different purposes and the best strategy is to apply the technique that is most helpful in making the trade. Each approach can be used to complement the other. A long-term investor will more likely be focusing on fundamental information, while a short-term investor will concentrate on technical analysis. In a broader sense, fundamental and technical techniques are all about valuation of a company and its stock.

It may be of interest to note that there are software programs that combine fundamental and technical analysis into a hybrid trading methodology. Investors can use fundamental analysis to screen a universe of securities and identify stocks with good fundamentals and growth potential. They can then use technical analysis to determine the timing to purchase shares, such as near oversold levels, or after a retracement of prices of a certain percentage from the peak of a rally. In this book, we show another approach where financial astrology is used instead of using fundamental analysis to screen shares. The shares selected on this basis have greatly outperformed the shares selected on the more conventional basis, although it must be said that more comprehensive research is needed to establish that the superior

performance holds true under a greater variety of market conditions.

The book presents readers with a broad range of technical and financial astrology indicators that have been found to be effective in gauging market trends and approaching change in trends. The wide range may appear somewhat overwhelming at first. The intention is not for users to adopt all of these indicators, but, after a thorough review, to choose only those that suit their style of trading and which they themselves find most useful. In particular, we hope traders will also find that integrating some select technical indicators with financial astro indicators can boost their results. Whatever the approach, it is imperative not to overanalyze the market. As Mark Douglas pointed out in *Trading in the Zone* (2001), "I know it may sound strange to many readers, but there is an inverse relationship between analysis and trading results. More analysis or being able to make distinctions in the market's behavior will not produce better trading results." We have found this to be true as well, and readers would be well advised to take the time necessary to develop a simple yet powerful trading methodology of their own that does not involve overly extensive analysis.

Another common habit besides overanalyzing the market is the repeated use of the same type of information, whether intentionally or unintentionally, particularly in applying multiple oscillators, so that the result of each oscillator reveals the same type of information. Having one oscillator to confirm another oscillator will not serve the purpose if the calculation of the oscillators is derived from the same information. At all cost this must be avoided. As John Bollinger, author of *Bollinger on Bollinger Bands* (2002), puts it, "Multicollinearity is a trap in which several indicators seem to confirm each other, but really do not because they are each repeating the same message. A typical example of this is the use of several different momentum indicators."

Figure 1.4

is an example of multicollinearity in three oscillators that use the same series of closing price.

FIGURE 1.4

A chart showing an example of multicollinearity in the plots of three oscillators. The second window is a Stochastic Oscillator, the third window is the Relative Strength Index (RSI) Oscillator, and the fourth window is the Rate of Change (ROC) Oscillator. Note the similarity of the ups and downs of the three oscillators.



Indicators could be categorized into three main streams as follows:

1. Momentum Category includes Rate of Change, Stochastic (%K, %D), Relative Strength Index, Commodity Channel Index, Relative Momentum Index, Ultimate Oscillator, and Williams %R.

2. Trend Category includes Moving Averages, Parabolic SAR, Bollinger Band, Average True Range, Wilders Direction Movement Index (ADX), Trend Intensity index, Moving Average Convergence Divergence and Price Oscillator.

3. Volume Category includes Money Flow Index, Chaikin Money Flow, Volume Rate of Change, On Balance Volume and Price Volume Oscillator, Demand Index and Volume Zone Oscillator.

Figure 1.5

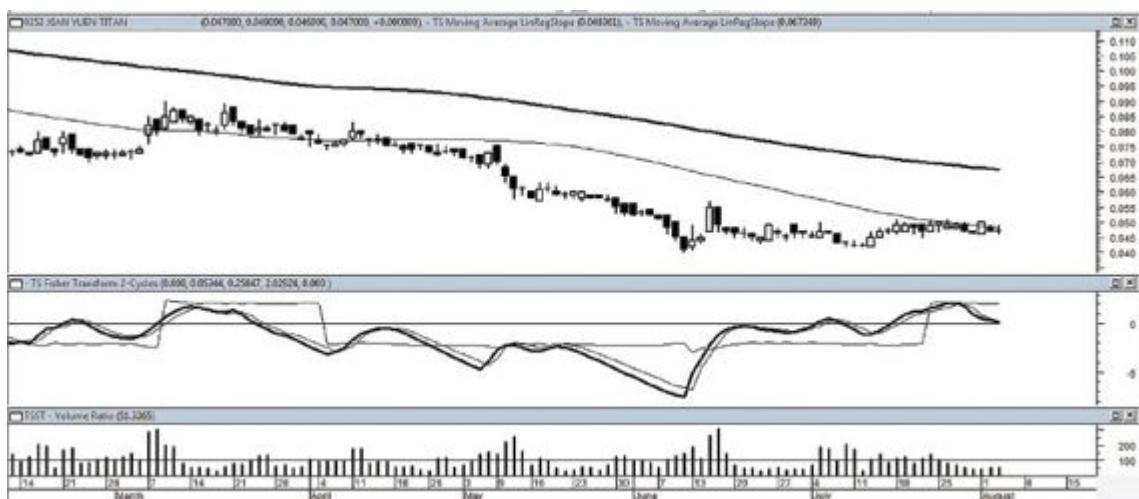
charts the same stock as

Figure 1.4

with three indicators, which highlight the directional movement of the stock in a more meaningful way.

FIGURE 1.5

The top window plots the 50-day and 200-day moving averages showing the price trend, the middle window shows the price momentum, and the bottom window shows the volume transactions of the stock.



An indicator that is collinear with another will basically rise and fall in about the same area and the same approximate time frame. Indicators that are collinear with each other will not help traders in gaining a proper view of the market and could result in a misleading perspective. Ideally, traders and investors should develop three noncorrelated market analysis approaches. The first analysis approach is to interpret price movements by studying the inter-reaction of the various indicators selected from each of the three categories—a momentum indicator, a trend indicator, and a volume indicator. The second analysis approach could be of Elliott Wave Theory and Fibonacci studies, and the third approach could include astro-harmonic analysis.

Besides maintaining the discipline of applying a systematic structure and technique in trading, a trader should take note of the following important advice from past masters.

Do not attempt to have a preset idea of price level or attempt to pick tops and bottoms of a price action. Accept that some points may be sacrificed at the beginning or end of a trend while waiting for a setup confirmation that the trend beginning or end are in place.

Understand that trend trading can lead to large gains but also to large losses.

Trading time frame is a key element in determining trend, because trend can take place on multiple time-frame levels.

Trends remain in force until they have exhausted themselves and their reversals are confirmed. Let the market decide when the trend has ended.

Volume confirms the trend.

Keep the number of stocks within a range you can manage well.

Always have an exit plan for every trade.

In trading, the objective is to win swiftly whenever possible. It is all about knowing how to handle the trade in accordance with the trading strategy and time frame. Sun Zi's military philosophy emphasizes the uncertainty, the deceptions, and the surprises of warfare. "As water shapes its flow according to the ground, an army wins by relating to the enemy it faces. And just as water retains no constant shape, in war there will be no constant condition." So it is with the market; there is no such thing as a constant market. The market changes all the time. It is always trying to throw us off balance. Traders have to hear what the market is trying to say and follow its flow; they need to be responsive and flexible in the development of the trading strategies. A trader must learn to take profits when the trend is over. Do not drag. The market has no rules. Remember, the ability to prevent defeat depends on us, or in the words of the legendary trader, W. D. Gann: "If we wish to avert failure in speculation, we must deal with causes."

CONCLUSION

This chapter highlights two very important issues for every trader who wishes to trade successfully in the market. Success in trading lies with the trader himself, not the trading system or the trading software. A successful trader should have a plan for each trade and should know how he will approach each investment. A successful trader needs to be patient, to do his homework, and to have trading discipline.

If a trader can take charge of his mind and quell the inner dialogue that creates all sorts of contradictions, and if he can keep his eyes on the time frame of his trading and focus on principles and techniques, he will stand a better chance of becoming a successful, happy, and confident trader.

CHAPTER 2

Let's Get Started

Technical analysis is a rule-based trading approach. There are many ways to analyze market information, and the potential variables are endless. A trend is the general direction in which prices are headed. In using technical analysis, the objective is to identify the probable trend as early as possible. Unfortunately, early detection of an impending change in trend is not that easy. There is no single method or system that does so accurately and consistently. Thus, it would be better to use a scorecard approach based on the collective methodology described in this book. In a bull market, most stocks go up and in a bear market most stocks go down. From trial and error in our trading experience and in our research, we have noted that when a trend is underway, four trend-related dimensions give us clues. These clues may not happen at the same time, but usually occur within a span of a few bars. The four dimensions are:

- 1.** Patterns
- 2.** Volume
- 3.** Price Momentum
- 4.** Price and Moving Averages

This chapter will briefly introduce each of the four dimensions that need to be studied. The purpose of the study is to learn the strengths and weaknesses of each dimension. The trader will then be able to see from the reactions in each dimension where a change in trend takes place and how to use that information effectively in his trading. And when the trader has learned to string together all aspects of the four dimensions and to apply their coherent signals in trading, he will be trading more confidently. Gradually, he will realize that he is trading more prudently and that the number of his trades has been reduced based on this trading method. He will discover one of the golden tenet of master traders—"More trades do not equate to more profits."

PATTERNS

Patterns are a very important aspect of technical analysis. They are the shapes or structures of formations that appear on a chart, including double tops, double bottoms, morning star, head and shoulders, triangles, rectangles, saucers, and so on. Patterns are the body language of price expressions and offer traders a means of forecasting probable price direction. There are two major types of patterns—reversal patterns and continuation patterns. Reversal is a formation pattern that indicates a likely reversal in trend is taking place, that is, from a bullish trend to a bearish trend, or vice versa. The continuation pattern indicates a temporary price retracement and on the breakout of the pattern, the prevailing trend will continue. Patterns are not infallible. There is no chart pattern that will tell you with 100 percent certainty where the price is heading. But learning the characteristics of each pattern formation and using them with other supporting indicators will give traders an edge in reading the market and timing trades. The various patterns are described in Chapter 3, Essential Patterns, which includes candlesticks and classical patterns, and Chapter 4, Elliott Waves, which includes various triangle patterns.

Candlestick charts place more emphasis on the relationship between opening and closing prices, known as the body of the candle. If the high of the candlestick is greater than the body, it is shown by a vertical line called the upper shadow. And if the low of the candlestick is lower than the body, it is shown also by a vertical line, the lower shadow. Long upper shadows indicate selling pressure and long lower shadows, buying support. The longer the upper shadows, the greater the selling pressure, and the longer the lower shadows, the greater the buying support. And if the closing price is higher than the opening price, the body is charted as a hollow candle. If the closing price is lower than the opening price, the body is filled. If the closing price is the same as the opening price, it will be shown as a short dash. The strongest candle will be a hollow candle (price closes at the high of the day) with no upper or lower shadows. The weakest candle will be a filled candle (price closes at the low of the day) with no upper or lower shadows. Various important candlestick patterns are described in Chapter 3. They are useful in gauging market sentiment and can provide valuable information when used in conjunction with volume. We would want to be in the trade with a pair of bullish candlesticks. The bullishness or bearishness of candlestick patterns should not be determined on the basis of a single candlestick.

Group patterns are formed by clusters of price bars over a given time period. There are two types of patterns. The linear patterns can be distinguished as bearish reversals (top reversal patterns) or bullish reversals (bottom reversal patterns), or continuation patterns. (See

Figure 2.1

.) They include head and shoulders (tops and bottoms), double bottoms and double tops, rectangle or line formations, diagonal patterns, and triangles. The rounding patterns are the bullish and bearish saucer patterns, or rounding tops and rounding bottoms. Patterns do not give outright buy/sell signals. They indicate market situations and serve as setup conditions for a probable change in trend. The patterns described in this book appear very frequently in stock trends and should be more than adequate to detect such probable changes of trend direction. A change in trend to the upside should have the support of a bullish reversal pattern, and a change in trend to the downside should have the pressure of a bearish reversal pattern. During a period where prices are under accumulation or distribution phases, movements of prices are contained within a short trading band like a rectangle pattern. Breakouts from these patterns, supported by volume and candlestick patterns, would signal the start of the relative trend. An important point to keep in mind is that traders should not try to be too critical when

determining the formation of patterns by trying to exactly connect the highs or lows of each pivot. Patterns do not need to be an exact fit.

FIGURE 2.1

Chart showing bullish and bearish patterns.



All markets will trend up when the better-informed buyers have completed their accumulation and will trend down when they have completed their distribution to the uninformed buyers, who are generally the public participants. One of the key factors that differentiates between informed investors and uninformed investors is the access to information. Better-informed investors have earlier access to information whereas uninformed investors do not have the means to gather such information. The trading activities between the informed and uninformed investors will cause a series of reactions that tend to have repetitive patterns and cycles. Elliott Wave Theory is based on the premise of such reactions or overreactions of the collective behavior and emotion of investors.

Elliott Wave Theory has been around for decades, but there seems to be no consensus among users as to how wave pattern analysis should be applied for maximum benefit. One reason is the old habit of zealous practitioners trying too hard to pinpoint evolving price patterns by crossing every t and dotting every i. The objective is not to label every turn all the time, which can make analysis of patterns overly complicated. The aim of Elliott Wave Theory is to identify the stage of the market and the specific setup of patterns to determine the trend and its probable future direction.

Briefly, the patterns of market prices are always in the process of formation, unfolding in a set structure of five waves in the direction of one larger trend and in a set structure of three waves when moving against that trend. The three-wave structure will correct the movement of the five-wave structure. A five-wave structure is normally labeled as 1-2-3-4-5 and a three-wave structure is labeled as A-B-C. In short, one full Elliott Wave cycle consists of five waves and three waves. It is easier to grasp the theory if we think in terms of a set of two root patterns—impulse waves and corrective waves. Impulse waves are those price movements that are rising in an uptrend or declining in a downtrend. Corrective waves are those that are declining counter to a rising trend, or rising counter to a falling trend. In an impulse pattern, there are two countertrend waves, Wave 2 and Wave 4. In a correction pattern, there is one countertrend wave, Wave B.

Elliott Wave Theory is a multifractal system in which each cycle can be part of another cycle or form part of an expanded cycle. In its raw form, Elliott Wave Theory is about forecasting price trends based on chart pattern recognition, and serves as a complement to other technical

analysis tools. That is, it is best to buy when the market is in an impulse cycle, and to sell when it is in a correction cycle. Chart patterns delineate the imbalances of supply and demand; they are important because they inform traders of the status of the market at any given time and help to determine the likely direction of the trend.

VOLUME

Volume is an important component of analyzing directional price movements. Its importance is often overlooked by traders because it is such a simple indicator. Volume is often the precursor of price trend. But volume by itself is not a signal for entry or exit of trades, and a single volume bar will not be meaningful if it is not compared with its recent historical patterns. During an uptrend, volume will rise with rising prices and fall during a correction.

Volume can also serve as a tool for guiding wave counts and in projecting extensions of waves. For example, in a fifth wave, volume generally tends to be less than that of the third wave. If volume is greater than that of the third wave, an extension of the fifth wave is more likely. In any bull market, volume tends to expand and contract with the momentum of price change. Toward the end of a corrective phase, a decline in volume often indicates a decline in selling pressure and a low point in volume often coincides with a turning point in the market.

The discrepancy between volume and price spread is another indication to watch for price reversal. (See

Figure 2.2

.) Rising prices with low volume signifies trend weakness and increased volume on falling prices points to further decline in prices. Heavy volume with narrow price spread at new highs alerts traders to heavy resistance from sellers, whereas heavy volume at new lows is probably a sign of buying support. Whether in an uptrend or downtrend, any price movement with a comparative high volume will be deemed stronger than a similar move with low volume. Generally, we want to see good volume on a breakout as confirmation of the entry/exit signals and to distinguish a true breakout from a false breakout above resistance or below support. Price patterns and volume patterns should be interpreted conjunctively.

FIGURE 2.2

Chart showing application of volume to patterns in the lower window.



PRICE MOMENTUM

Price momentum measures the speed of the rise or fall of price relative to the selected period, the results of which are plotted as an oscillator. Most momentum oscillators are plotted with an average line. When the momentum oscillator crosses above or below its average line, it generates a crossover signal, which is similar to crossover in two different periods of moving average lines. The resulting momentum plot will fluctuate between its high and low points. Generally, when the momentum is above 40/50, it is considered to be in an overbought condition. And when the momentum is below negative (40/50), it is considered to be in an oversold condition. Overbought and oversold conditions signal that the market is overstretched. The center line is the zero line, and when momentum is above the zero line, it indicates strength. When it is below the zero line, it indicates weakness. In a bearish market, when the momentum moves from above to below the zero line and then reverses in an upward direction above the zero line, it does not mean the downtrend is over. It just means that the downtrend is slowing down. Crossover at an overbought level (overbought reversal) indicates bearishness and crossover at an oversold level (oversold reversal) indicates bullishness. A reversal indicates an increase or decrease of the price momentum and it may or may not coincide with a price reversal. When readings are at extreme highs, price momentum is considered to be overbought, and when readings are at extreme lows, it is oversold. When the oscillator reaches overbought or oversold conditions, it is an alert to probable change in price actions. And when there is a divergence between oscillator and price, it indicates an imminent change in the strength or weakness of the market. (See

Figure 2.3

.)

FIGURE 2.3

Chart showing addition of momentum indicator in the upper window.



There are certain weaknesses in momentum oscillators. Momentum shows the current state of the market relative to its past. Although the oscillator is a derivative of price actions, its directional movement does not represent price trends and does not necessarily move in the same direction as price actions. Momentum oscillators represent momentum trends. They are not stand-alone indicators and, therefore, do not offer any advantage when used in isolation. But when momentum of different time frames is used to gauge the market, it becomes an

invaluable tool. Time frame is one of the significant decisions we make in our trading. As stated earlier, the trading method in this book is not for day trading. Data used are end-of-day data and traders would only be looking at the market in the evening. Thus, the time frame for trading will be longer than daily, and one should, therefore, be looking at the next higher time frame, that is, weekly momentum. The MetaStock program can easily convert between daily and weekly data. It is much easier to see the broader state of the market using weekly data. On the daily chart, it might appear that the momentum is making an oversold reversal (bullish reversal), but if you look at the weekly chart, you might see that the weekly momentum is in an overbought condition or bearish. In such a condition, it would not be prudent to make any trade because the condition is not favorable and might pose a risk. A trade should only be considered when there is a bullish reversal in the daily time frame and when the weekly momentum is bullish and not in an overbought condition. In short, it means that the two time frames should agree with each other whether in an upward or a downward trend.

PRICE AND MOVING AVERAGES

The object of technical analysis is to get on the favorable side of the trend. An uptrend is when prices are making “higher highs and higher lows,” and a downtrend is when prices are making “lower lows and lower highs.” In an uptrend, the sum of the rallies will exceed the sum of the declines, and in a downtrend, the sum of the declines will exceed the sum of the rallies. To be able to spot trend reversal and to stay with the trend is the hardest part of trading because prices do not move in a straight line. Of the various methods applied in technical analysis to detect trend, moving average is one of the easiest methods to understand and provides good visual means of spotting a trend. Trading signals are generated when price crosses above or below the moving average. When price crosses below the moving average, it suggests sellers are taking control of the market, and when the price crosses above the moving average, buyers are gaining control. A trade may also be signaled when the shorter-term average crosses above or below the longer-term moving average. Two or more moving averages will allow a trader to see a longer-term trend compared to a short-term moving average.

In this book, we describe the use of three sets of moving averages to determine entry and exit signals and a prospective view of the longer trend. The first set consists of the short-term moving averages. The second set is made up of the mid-term moving averages, consisting of two moving averages: the 9-day and the 13-day. The third set is made up of the long-term moving averages, consisting of three moving averages: the 50-day, the 90-day, and the 200-day.

The first set of short-term averages plots the interactions of two 5-day moving averages and a 13-day moving average. The signals generated by the interactions of the three averages will color the price bars. The blue bars in

Figure 2.4

represent bullish signals, the red bars represent bearish signals, and black and red bars represent a probable change in trend (see

Figure 2.4

).

FIGURE 2.4

Chart showing the interaction of short-term moving averages represented by color bars.



The second set of mid-term averages, when used conjunctively with the first set of short-term averages, acts as the signals for entry and exit of trades. The second set of mid-term

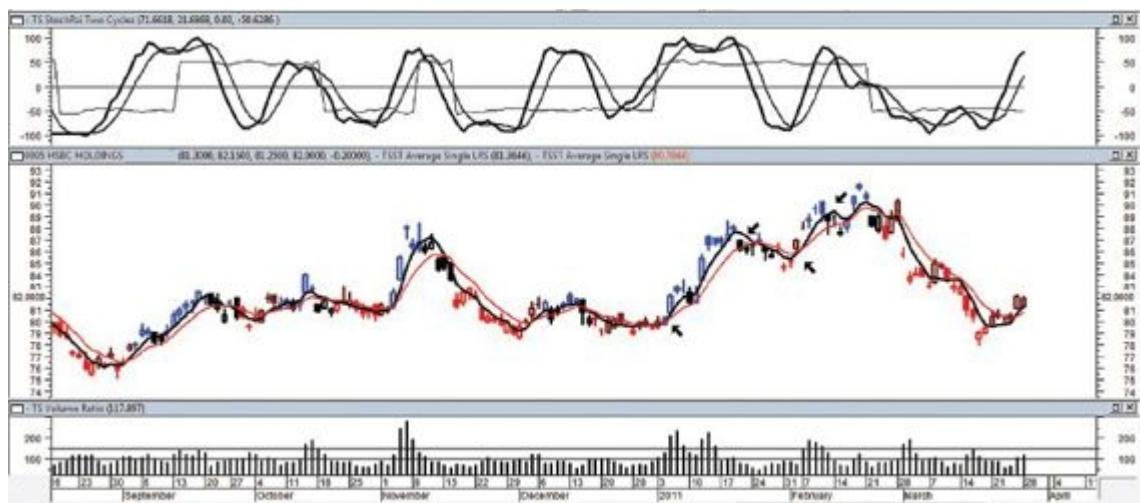
averages consists of the 9-day and 13-day moving averages. When the 9-day crosses above the 13-day average, and/or the close crosses above the two mid-term averages, it generates an entry signal. An exit signal is triggered when the 9-day average crosses below the 13-day average, and/or the close crosses below the two mid-term averages. A strong entry signal is triggered when the price crosses above the mid-term averages, shown in

Figure 2.5

by either a blue bar or a beige or brown bar. A strong exit signal occurs when the price crosses below the mid-term averages, shown by either beige, brown, or red bars.

FIGURE 2.5

Chart showing the addition of second set of moving averages and markings of probable trade signals.



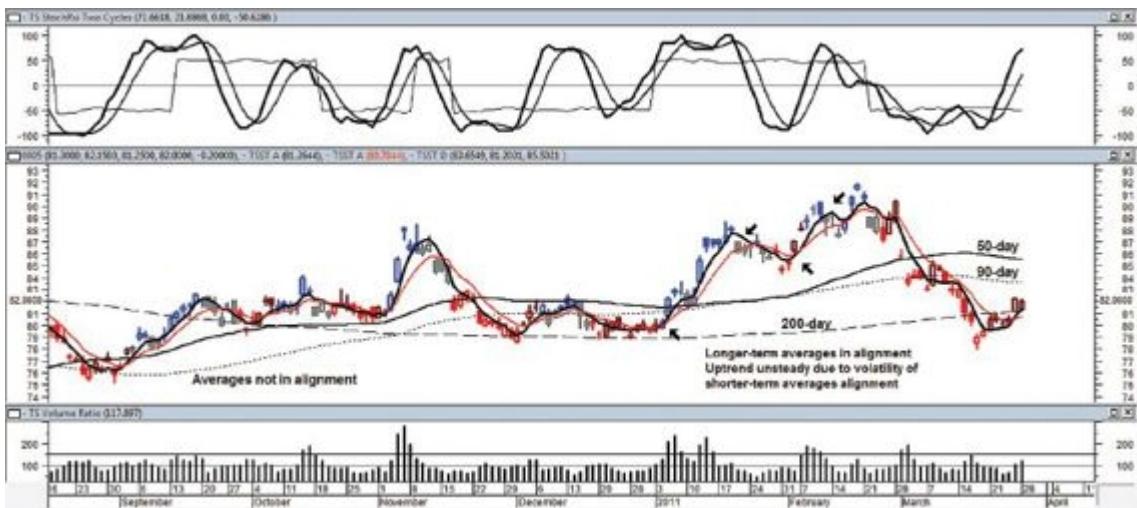
The third set consists of the 50-day, 90-day, and 200-day moving lines. The interactions of these three longer-term periods of moving averages play a very important role in deciphering the conditions of the market trend. They show the likely support and resistance levels of prices, and indicate whether entry/exit trades made in the shorter time period will sustain a longer time frame, and they will show the longer term outlook of the market. (See

Figure 2.6

.)

FIGURE 2.6

Chart showing the addition of the longer-term moving averages to identify longer-term outlook of the market. The three longer-term moving averages are converging, with the 50-day average moving downward to the 90-day average, and the 200-day average line moving flat. Though the short- and mid-term appear to be positive, the various averages are not in positive alignment, which likely points a non-trending pattern. If there is a rally, it will be short-lived.



In accordance with the Queuing Theory of Moving Average Crossovers, whether the outlook of the market is bullish or bearish, price and its various multiple averages should fall in an orderly alignment. In a bullish trend, price, being the leading indicator, is always above its moving averages, and it is followed in order by the moving averages of the shortest time period to the longest. As in the case of the third set of moving averages, when the outlook of the market is bullish, the alignment of price and the three averages should be in a positive alignment (from top down): firstly price, then the 50-day, 90-day, and 200-day averages. If it is bearish, the negative alignment (from top down) would be the 200-day, 90-day, and 50-day averages, and lastly, price. The market will cycle continuously from a negative alignment to a positive alignment and back again. There are no limits or fixed data for the time period and types of moving averages to be used. Expanding the Queuing Theory further, averages for periods of less than 50 days could also be included in the set for a total reading of market conditions.

Where there is a negative alignment of the longer-term moving averages during a market decline, and where the corrective pattern is not completed, any rally will likely be short-lived. The longer-term moving averages will generally indicate the resistance points. In a bullish trend, where there is a positive alignment of the longer-term moving averages during an uptrend, and where the impulse wave pattern is not completed, any correction will likely be supported at the levels of the longer-term moving averages, and price will continue its uptrend.

In summary, the rules of the first and second sets of moving averages dictate trade entries and exits relative to longer-term market conditions as indicated by the longer-term moving averages. The longer-term moving averages will be a guide to the probable support and resistance zones, which traders can use in calculating risk/reward ratios against entries.

COMBINING THE FOUR DIMENSIONS

We have described the usefulness of each of the four price-related dimensions: patterns, volume, price momentum, and price and moving averages. While an entry or an exit may be considered in terms of each dimension individually, a trader who is biased toward only one of these dimensions will probably experience a higher number of losses. But a trader who is patient enough to look for a proper balance among the four dimensions will definitely find better results.

We have included a simple scorecard in this chapter (see "Keeping Count") for use in combining the four dimensions as a total approach. The first step prior to making any decision is to see if there is a possible trade. We want to trade in the direction of the higher time-frame trend. The easiest way is to look at the weekly price chart. There is no need to go through every detail in the weekly chart. It will be sufficient to look at three factors: the weekly price momentum, weekly price and relative moving averages, and the position of the current weekly price relative to its recent historical prices. If we are considering a trade entry, we would want to see that the weekly price momentum is not overbought, and is not bearish, and that the weekly moving average is gaining strength at a level of support. Comparing the current weekly price relative to its historical prices will give traders a sense of the probable move, and where the significant support and resistance levels are in a longer time frame. Based on a healthy bullish setup, we would then look for the prospective timing on the daily chart to determine the price factor.

BEYOND TECHNICAL ANALYSIS

For those traders who are keen to advance their skills in technical analysis and wish to do a better job in calling the turns of the market, the next step is to go into astro-harmonics or financial astrology. Financial astrology is as useful as technical analysis in analyzing markets. Over the past millennium, astrologers have observed how the interactions of various planets in their orbits affect the markets. Just as the Moon is known to influence tides, emotions, and to cause swings in the mass psychology of investors, the other planetary bodies also have certain effects, though each in widely different ways. It can take years to learn and master this subject, but there is no doubt that while technical analysis works well under normal circumstances, added astro-economic indicators can improve technical analysis to an even more pinpoint accuracy and can forewarn traders of a change in trend. A brief section on financial astrology is included herein as a preliminary introduction to this methodology.

FINANCIAL ASTROLOGY

Chapter 9 covers some basic aspects of financial astrology, including cycles, selecting stocks, finding the best timing, and market forecast. Financial astrology is made much easier today with computing software. The development of financial astrology in combined use with technical analysis to assist in reading market timing and market directional movements, particularly in the plotting of planetary movements on price charts, is gaining popularity. It is likely that the fusion of these two independent systems will radically change the approach to technical charting in the future.

Financial astrology is an analysis of financial matters based on the observation of planetary movements. After trading the markets for some time, it will become apparent that major change in trend (CIT) points often coincide with certain astro-harmonic cycles. In fact, there is much evidence to show that astronomical cycles correlate with moves in the financial markets, as explained in Chapter 9. Planetary positions, which are available through astronomical almanacs or computer programs, may be plotted either as a horoscope chart or against a price chart. However, the interpretation of planetary movements and the events they imply is best explained by examples.

For traders who are new to the subject, it may be easier to start using a chart analysis program like TradeStation with an astro add-on module. The following charts are examples of plots of the lunar cycles, the eclipse cycles, the planets' positions, the planetary aspects, and planetary pairs, produced with add-on modules from

www.soulytion.de

Figure 2.7

shows the plots of the lunar cycles together with an indicator of solar and lunar eclipses in the lower window. The blue histogram bars represent lunar eclipses and the green histogram bars show the solar eclipses. As described further on, eclipses may increase the effect of either the new moon or the full moon.

FIGURE 2.7

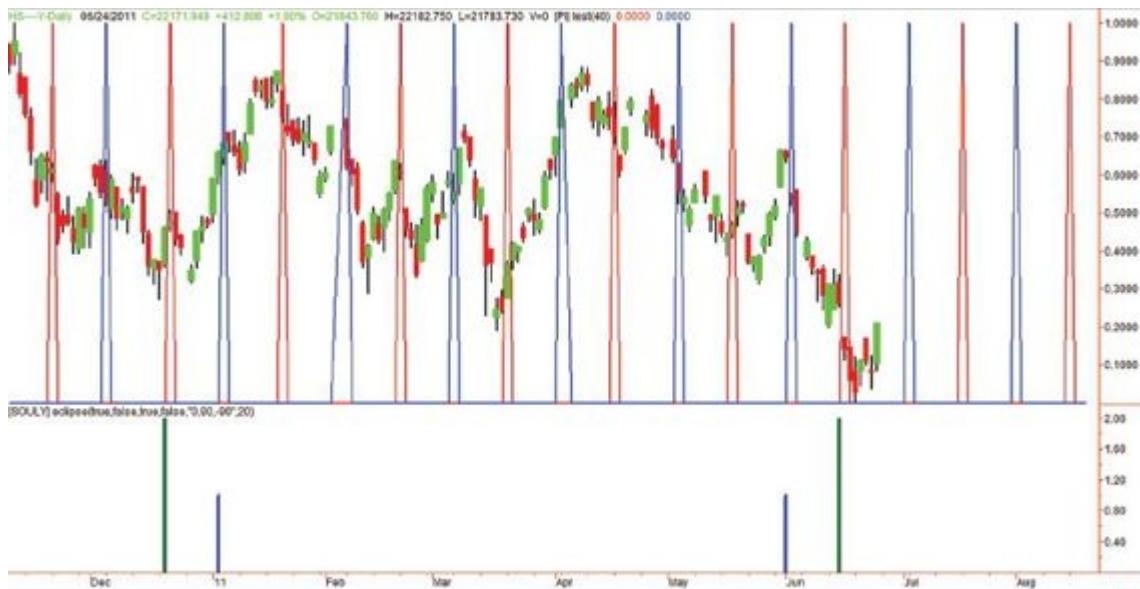
Chart showing how the full moon and new moon, called lunations, often coincide with highs and lows in the market. While the new moon (marked by blue lines) is a time to buy and the full moon (marked by red lines) is a time to sell, the phase may not always hold true in the short term.

Source: Omega Research—TradeStation Prosuite 2000i at

<http://fc-cd.com/omega.htm>

; Steffen Peter at

www.soulytion.de



Chapter 9, in the section called “Using Lunar Cycles in Trading,” details how a lunar-phased buy-sell strategy will produce returns which substantially exceed those of a buy-hold strategy only over several years. That said, for those who are actively trading the markets, it should be emphasized that the intention is not to trade on the basis of moon-phased buy-sell signals only, but if, for instance, the new moon correlates with a buy signal from a momentum system like stochastics and moving average crossovers, then it lends strength to that signal. Conversely, if the full moon correlates with a technical sell signal, it would add strength to that signal. Unless the signals are in harmony, it may be better to limit trading or stay on the sideline.

Another combination is to plot the solar and lunar eclipse points, as they quite often coincide with CITs. The eclipses have a much more intense focus than the regular lunar phases. When the Moon comes between the Earth and the Sun, the sunlight is blocked either partially or fully. It is called a solar eclipse and happens at the new moon. The full moon eclipse is called a lunar eclipse. This happens when the Earth gets between the Sun and the Moon, and the Earth’s shadow falls on the Moon. The effect of a solar eclipse is usually stronger than a lunar eclipse. However, the duration of the lunar eclipse on June 15, 2011, was 100 minutes, which is unusually long; only three other eclipses lasted longer in the last 100 years. The long duration is likely to strengthen the effect so instead of weeks it may last for months and when a transiting planet aspects the lunation point, it can trigger sudden wide price swings.

In

Figure 2.8

, the black lines reflect solar eclipses and the blue lines show lunar eclipses. They are plotted here on a weekly chart of the Hang Seng Index but may apply to any market. The correlation with CITs is quite high, so one would always want to remain on alert well ahead of time for the next eclipses, such as the ones that took place on November 25 and December 10, 2011.

FIGURE 2.8

Lunar eclipses and solar eclipses, plotted here on a weekly chart of the Hang Seng Index.



Furthermore, a little-known but valuable technique is to show projections 90 days before and 90 days after an eclipse, marked with dotted lines. These projections often coincide with important turning points in some markets. Certainly, in the case of the Hang Seng Index, they correlate very well with CITs. With these projections, as shown by the dotted lines in September 2011 (see

Figure 2.8

), one can always be prepared for a possible major change in trend.

The next chart shows how a market often moves in alignment or within the boundaries of planetary positions, whether geocentric (as seen from the Earth) or heliocentric (as seen from the Sun). The effect of the planets is dealt with in greater detail in Chapter 9 under “Choosing the Best Periods for Trading.” Usually, the various markets are affected by different planets. The planets involved may also depend on whether one is looking at shorter-term cycles or longer-term cycles. The former may be influenced by faster-moving planets and the latter by slower-moving ones.

Figure 2.10

shows how the aspects of planets may help indicate the possible direction of a market. The bars at the bottom reflect the most common aspects, such as 0 degrees (conjunction), 60 degrees (sextile), 90 degrees (square), 120 degrees (trine), and 180 degrees (opposition). The 0, 60, and 120 degree aspects are generally considered favorable, whereas the 90 and 180 degree aspects are considered unfavorable or stressful.

FIGURE 2.10

Planetary aspects have been applied to a chart of the Hang Seng Index. They are viewed on a heliocentric basis, which fits the Hang Seng Index and Hong Kong shares better than the usual geocentric basis. Overlaid on the aspects is the VZO (volume zone oscillator) indicator, described in Chapter 5, Volume. VZO is a simple money-flow indicator that can help reveal changing conditions of a market. In conjunction with the strength of the aspect bars, it may alert traders to possible changes in trend. Note: In this chart and other charts herein, the gaps appearing in the histogram bars represent non-trading days.



Traders may also wish to take note of the tendency of stock markets to react prior to the moment when two transiting planets are in an exact aspect or in conjunction with each other. So when the planets move within a certain angle or distance of each other, a company's stock horoscope (its price on the first day of listing) tends to react—upward or downward as the case may be—some time before the actual culmination of the transit takes place. Usually, it is a day before, but sometimes it is earlier. Therefore, on the day of the exact transit, the effect may already be over. This gives traders a great advantage as they can see the approaching aspects in advance and be ready for the possible effect.

Why the Hang Seng Index relates best to a geocentric view of planetary movements (

Figure 2.9

), whereas heliocentric planetary aspects correlate better with CITs in the same market (

Figure 2.10

) is one of the imponderables of astro-harmonics. The main thing, however, is that the application works and may provide useful clues for trading.

FIGURE 2.9

The chart shows geocentric ephemeris planet lines applied to the Hang Seng Index. (The ephemeris is a set of tables listing the rapidly changing positions of the planets as seen from either the Earth or the Sun.) As indicated by the arrows, the lower band of a planet's trajectory may act as a buffer to any further correction. Should the market fail to hold at the indicated level, it may fall to the next trajectory of the faster-moving planets or the cyan line of Jupiter.



Figures 2.11

and

2.12

offer two examples of planet pairing as they applied to markets such as the Dow Jones Industrial Average and the Hang Seng Index.

FIGURE 2.11

Chart showing the effect of the pairing of Mercury with Venus as applied to the Dow Jones Industrial Average. The two planets moved to 0 degree conjunction in early May and then moved to separate just before June. The technique is admittedly preliminary and rather simplistic. Further research may reveal pairings of planets that correlate even better than this example. Nevertheless, it shows another method by which one can identify possible future CITs. Naturally, the index is also influenced by other planets, but these two fast-moving planets correspond quite well to shorter-term moves. Note also the spike at the end of August, which may indicate the peak of an uptrend similar to the one in May.



FIGURE 2.12

Chart showing how Venus and Jupiter often correlate with moves in the Hang Seng Index on a

heliocentric basis. The spike in the bars at bottom indicate when transiting Venus and Jupiter were in conjunction (0 degrees), square (90 degrees), and opposition (180 degrees) to each other. These aspects are usually the strongest and prices did indeed top at those angles.

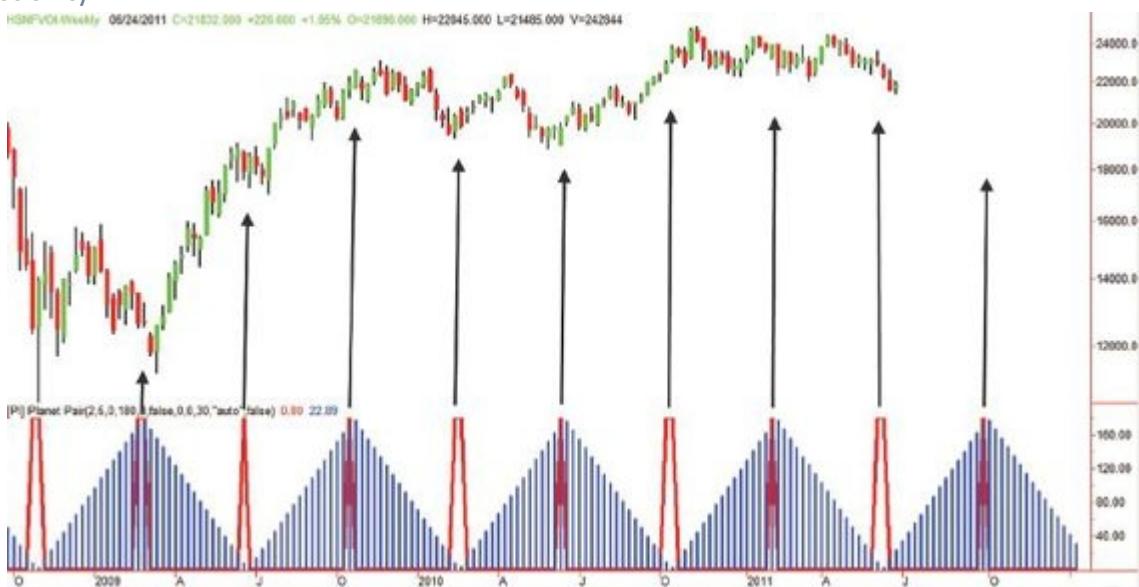


Figure 2.13

again shows the pairing of Venus and Jupiter but this time on a weekly basis and in 180 degree increments. That is, whenever the two planets are in 0 or, 180 degree aspect to each other, it is indicated by the blue and red spikes, respectively, at the bottom of the chart.

FIGURE 2.13

The 0 and 180 degree aspects of Venus and Jupiter on a heliocentric basis often coincide quite well with turning points in the Hang Seng Index, but not always. Note the spike appearing on October 1, 2011 and compare it with potential CITs from the other indicators shown earlier. All the dates may be listed in the Financial Astrology Checklist at the end of this chapter. When two or more indicators of a CIT converge, it gives that potential change in trend a higher probability.



A final example of applying technical indicators with astro aspects is shown in

Figure 2.14

for HSBC Holdings (0005.HK). Similar to

Figure 2.10

, the VZO money-flow indicator has been superimposed on the planetary aspects, but this time, the moving average convergence/divergence (MACD) indicator has been included at the bottom as well.

FIGURE 2.14

Planetary aspects and VZO–MACD indicators applied to HSBC Holdings (0005.HK). It should be noted that the planetary aspect bars do not indicate any convergence/divergence with the share price. They only indicate the strength of the various aspects of the planets that may alert traders to potential changes in trend.



The tall bars indicate when one of the aspects has reached culmination, where the effect is usually the strongest. These events often coincide with CITs or acceleration of the trend, as shown by the arrows. However, as mentioned earlier, the share or index may react one or two days in advance of the culmination of the aspect, and it is therefore advisable to watch the action in the VZO and MACD indicators very closely in conjunction with the planetary aspect bars.

Normally, one should pay attention only to the tallest bars; that is, those exceeding the gray line at 80. In some instances, however, those slightly below the line also coincide with a change in trend. After using this method for a while, traders will find that technical and astrological indicators integrate in an effective way, often acting in confirmation of each other and serving as a useful early warning system.

KEEPING COUNT

The Technical Analysis Scorecard and the Financial Astrology Checklist include various points covered in the chapter. The purpose of these lists is to give traders an easy reference to these points while interpreting the market. A probable bullish trend will have a more positive reading while a bearish trend will have a more negative reading.

Technical Analysis Score-Card

✓	Bearish	Description	Bullish	✓
Setup Position				
	Bearish/Oversold	Longer time frame momentum	Bullish/Oversold	
	Negative	Price and weekly moving average	Positive	
Patterns				
	Bearish candles formation	Daily candlesticks	Bullish candles formation	
	Bearish formation, e.g., double tops	Classical patterns	Bullish formation, e.g., double bottoms	
	Corrective waves	Elliott Wave Theory	Impulse waves	
Volume				
	Price > Volume	Price and volume Inter-reaction	Price > Volume	
	Price < Volume	Price and volume Inter-reaction	Price < Volume	
Momentum				
	Bearish reversal	Shorter time frame momentum	Bullish reversal	
	Bearish divergence	Shorter time frame momentum	Bullish divergence	
	Overbought alert	Shorter time frame momentum	Oversold alert	
Trade Timing				
	Price crosses below averages	Price and average crossovers	Price crosses above averages	
	Fast average crosses below slow average	Fast and slow average crossovers	Fast average crosses above slow average	
	Red	Built-in color system of average crossovers	Blue	
	Downward from a bearish pattern	Breakouts	Upward from a bullish pattern	
	Price and averages' non-alignment	QMAC	Price and averages' alignment	
Notes				

Financial Astrology Checklist

Stock Code	File No.	Date	
Name:			
Projected dates based on	Date	Date	Notes
Lunar cycles			
Eclipse			
Tall planet aspect bars			
Planets pair aspects			
Moon – Mercury – Geo			
Moon – Mercury – Hello			
Mercury – Venus – Geo			
Mercury – Venus – Hello			
Venus – Jupiter – Geo			
Venus – Jupiter – Hello			
Venus – Uranus – Geo			
Venus – Uranus – Hello			
Ephemeris planet line trajectory			
Meeting resistance			
Finding support			
Planetary outlook			

CONCLUSION

By now, traders should have a better understanding of the importance of using the collective signals of the four trend-related dimensions—pattern, volume, price momentum, and price and moving averages—as trading guidelines. Generally, trade entries occur when the coherent signals of these four dimensions are bullish, and trade exits happen when the signals are bearish. In addition, this chapter has shown how the addition of financial astrology can help further determine probable price direction and change in trend. But before we proceed to the chapters covering each of the four trend-related dimensions, here's a word of caution.

After trading for some time and making some profitable trades, traders may face one possible danger. Because technical analysis is a rule-based approach, the process becomes repetitive. Traders may start to get bored with the routine and begin to neglect their trading rules and methods. Boredom may cause traders to either adopt a complacent attitude or deviate from their trading methods. They may easily overlook the risks of trading. To overcome this syndrome, traders need to make every trade with attentive care as if it is their first trade.

CHAPTER 3

Essential Patterns

The price of a stock that has been concluded during a trading period between a buyer and a seller represents the agreed value of such stock for that time frame only. It is an equilibrium point at that moment in time. The value will, therefore, be greatly influenced by existing supply and demand for the stock during that trading period. The existing supply of stocks is the quantity that sellers intend to dispose of; the existing demand for stocks is the quantity that buyers intend to buy. It does not depend on the number of sellers or number of buyers. Thus, when the demand is greater than the supply, price will rise and when the demand is lesser than the supply, price will fall. Agreed value may fluctuate in a narrow range where substantial volume during the day is being transacted. This range will then become the accepted value area or the equilibrium zone. When price moves out of the zone, volatility in price will develop, and if the breakout from the equilibrium zone is accompanied by higher volume, the price volatility on breakout will normally be greater. A solid trend may evolve from such breakouts.

Stock prices fluctuate to make the highs and lows of the day. The daily range is the distance between the high and the low. The weekly range is the range between the weekly (trading days from Monday to Friday) high and low. Range is an important factor in reading price direction. If the price moves upward from a low with expanding ranges, this means the buyers are buying aggressively and overcoming the selling pressure. On an uptrend, if the price begins to increase with contracting range, this means that the buyers are no longer buying as aggressively as before, and it is probably a sign of an imminent top. It cautions one to raise a protective stop closer to the current price.

If the price moves down from its high with a large daily range, it means that the sellers are selling aggressively and are overpowering the buyers. Generally, the downward movement of prices with expansion of range is a sign that the downward movement will continue. In all phases of price movements, volume is a good indicator of the validity of the move. If the price moves down to a new low with the daily range contracting, this is seen as a sign that the sellers are not selling as aggressively as before, thereby signaling that a possible bottom may be in the making. Taking note of these subtle signs will help to understand the flow of the market. While a narrowing of the daily ranges in a downtrend in price is a warning that the prevailing trend is slowing down, it does not necessarily mean that the current move has come to an end; additional confirmation from subsequent market action is needed. When price ranges are contracting as the price moves up with unimpressive volume, the market is vulnerable to another downward move. Range expansion and contraction must always be looked at from the perspective of what ranges are doing now as compared with what they have been doing in the immediate past.

OPEN

The open refers to the price of the first trade at which a stock is traded for that day. It plays a key role in the analysis according to the candlestick system. If there is buying demand, the market will open up higher than its previous day's closing, and if there is a lack of demand, the market will open lower than its previous day's closing. If the price opens higher outside the previous day's range, the buying demand is very strong, and if it opens lower outside the previous day's range, there is great selling pressure. Traders have to be cautious on such days and expect greater volatility in the price's movements when it opens outside the previous day's range.

If the close of the day is higher than the opening price, then the buying power is stronger than the selling power of that day. To the contrary, if the close of the day is lower than the opening price, then the selling pressure is stronger than the buying power of that day. See

Figures 3.1

and

3.2

. A study of the relationship between the open and the close of the day will reveal the strength of the buying power or the pressure of the selling power for that day.

FIGURE 3.1

Black candlesticks are formed when opening prices are higher than closing prices. The illustration shows optimistic buyers buying at the top, but failing to push prices upward, and finally overcome by selling pressure toward the end of trading. The pessimists won the day.

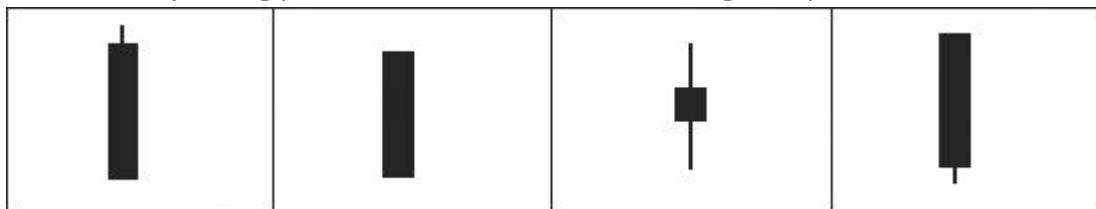
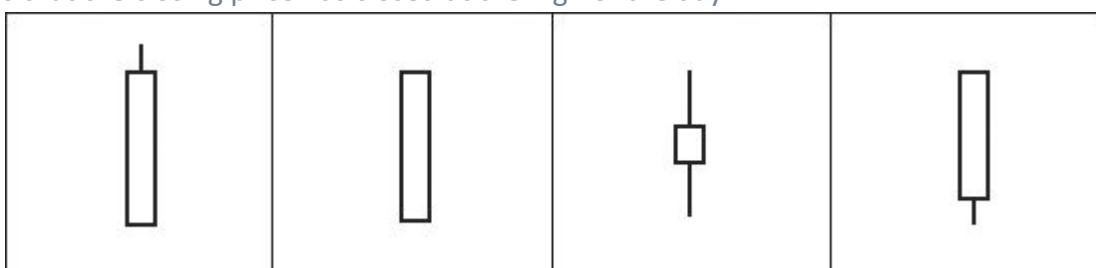


FIGURE 3.2

White candlesticks are formed when closing prices are higher than opening prices. Bald or shaven heads, which are commonly used in candlesticks, indicate there are no shadows extending from either end of the body. In this set of candlesticks, the shaven head candlestick means that the closing price has closed at the high of the day.



HIGH

The high is the highest price at which a stock is traded in a day or in a specific period. This is the highest point of the trading period at which buyers are willing to buy. It is also the highest point of the trading period at which the supply has overpowered the demand; that is, the sellers have gained control of the market. If the high of the day is at or near the opening of the day, then the sellers have been the dominant force, overwhelming the buyers. If the high of the day is at or near the close and the open was at or near the low of the day, then the buyers have been in control for that day. Previous highs often become a stumbling block to advances. When prices reach these previous highs, analysts should be on the lookout to see if the supply is trying to overpower the demand at these levels again.

One particular area where the market is most susceptible to a sudden reversal is immediately after the price has traded up to a new high or down to a new low. At these levels, we would expect new buying or selling to enter the market and it should generally cause the market to continue moving in the same direction. If, however, the market behaves otherwise and does not conform to expectation, then something is amiss, because the price action is not behaving as would normally be expected.

Price cannot continue to go up if there is no new buying and the price cannot continue to go down if there is no new selling. Aggressive traders may want to act immediately on seeing a new high or a new low that penetrates a previous pivot point. This may be a high-risk approach. Conservative traders may wish to wait for the subsequent price action to confirm the action. Traders must decide for themselves the risk they are prepared to take.

LOW

The low refers to the lowest price at which the stock was traded in a day or in a specific period. This is the lowest price of the day at which sellers are willing to part with their stocks. They are not willing to push the price any lower. It also means that at this low point of the day, the buyers have entered the market again and taken control of the market.

If the low is at or near the opening of the day, the buyers have been the dominant force in the market. They have forced the price up from the low. If the low is near the close of the day, and the open was near the high of the day, then the sellers have been in control of the market, driving the market down. As with the highs, previous lows will also act as support to stop further declines. When prices reach these previous lows, analysts should be on the alert to see if the demand will attempt to overwhelm supply again at a later stage near these same levels.

CLOSE

The close is the price transacted at the end of a trading day or of a trading period. This is the most watched and most frequently quoted market-generated price information. Most of the trading strategies, indicators, and oscillators are based on using the day's close as the key component. The close is often seen as the result of the struggle between the bulls and the bears. If the close is at or near the high of the day and the opening was near the low, evidently buying power was more powerful. If selling pressure was greater than buying power, then it would have caused the market to close down from the high. If the close is at or near the low of the day and the opening was near the high, then the selling pressure was dominant for the day. If the close is halfway between the high and the low, irrespective of the opening, then it may be assumed that the market is evenly divided between buying power and selling power. It is common, as the market enters a rally stage, that the close tends to be near the high of the period, with the open near the low.

A doji is a sign of a probable change in market direction and it should be read in combination with additional candlesticks. See

Figure 3.3

. It is not a stand-alone signal. A gravestone doji is formed when both the open and the close meet at the low of the day's range; it gives a bearish signal when it is found at the top of an uptrend. Its counterpart is the dragonfly, which is the reverse pattern of a gravestone doji. In a dragonfly, both the open and the close are at the high of the range. The dragonfly has bullish properties.

FIGURE 3.3

Four doji patterns. A doji is formed when the closing price closes at the same price as the opening price, or the price closes extremely near to the opening price. The patterns tell of a conflict between the bulls and bears, the outcome of which is yet undecided.



CANDLESTICK PATTERNS

In 1996, Gunduz Caginalp and Henry Laurent, from the Mathematics Department of the University of Pittsburgh, published a brief paper, “The Predictive Power of Price Patterns,” based on samplings of candlestick patterns. They concluded, among other things, that “a trader who has the same information as others plus the knowledge of this method will have a competitive advantage.” It is said that the practice of candlestick charting was started in eighteenth-century Japan by a man named Munehisa Honma, who controlled a large family rice business. He used this technique to monitor the daily movements of the price of rice. Candlesticks charting has become increasingly popular since its introduction to the West in the 1970s by Steve Nison, who has published many great articles and books on the subject, including his earliest book, *Japanese Candlestick Charting Techniques*.

Over the years and with advanced software programs, candlestick analysis has developed into a more visual and descriptive study, and candlestick patterns can now be incorporated into any customized trading system. For instance, in a customized system, if all candles are plotted in red color in a downtrend, the software could further decipher and separate the patterns of the red candlesticks into bullish and bearish candles. A bullish candle will have a hollow red candle while a bearish candle will be a filled red candle. Very often in a downtrend, the appearance of a hollow red candle signifies a support area and probable reversal area. On the other hand, if the candles in a customized trading system are plotted as blue in an uptrend, filled blue candles will often indicate resistance and a probable reversal area.

Candlesticks plot price movements over a set period. Regardless of the time frame, a minimum of two candlesticks is required to identify the probable market direction and its relative strength and weakness. Identifying patterns that always work is difficult. Readings of candlestick patterns should not be based on a single candlestick but should be made in combination with other candlesticks. Candlestick patterns are more predictive when the markets are at extreme overbought or oversold levels. A momentum oscillator would be a handy tool to check such extremes.

Figures 3.4

to

3.8

show useful patterns that are frequently found in candlestick charts.

FIGURE 3.4

Engulfing patterns are similar to outside day patterns in classic bar charts. Engulfing candlesticks are more significant if they have larger engulfing candlesticks. A bearish engulfing pattern at or near the top would mark the peak, and when it appears in a downtrend would seem to indicate further declines of the market. Bullish engulfing patterns tend to indicate support areas, especially when occurring at the low of a downtrend. A breakout from an engulfing pattern generally is short term, lasting no longer than 10 trading days.

Bearish Engulfing	Bullish Engulfing
	

FIGURE 3.5

Dark cloud cover is a bearish pattern and is generally found at the end of a congested trading area or at the end of an uptrend. Piercing line is a bullish pattern and is more dependable when it is found at the bottom of a declining market. These two patterns are easy to miss.

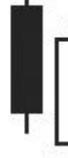
Dark Cloud Cover	Piercing Line
	

FIGURE 3.6

Evening star and morning star are both three-candlestick reversal patterns. Evening star is found at the end of the uptrend, while morning star is a bottom reversal looking upward for the sunrise or rising prices.

Evening Star	Morning Star
	

FIGURE 3.7

Three black crows is a top reversal signal consisting of three long black candlesticks closing consecutively lower near their lows. Three white soldiers is a bottom reversal signal that has three white candlesticks closing consecutively higher near their highs.

Three Black Crows	Three White Soldiers
	

FIGURE 3.8

A harami pattern implies the preceding trend is coming to an end. It is a reversal pattern.

White Harami Cross	Bearish Harami	Black Harami Cross	Bullish Harami
			

Harami patterns, as shown in

Figure 3.8

, are the opposite of engulfing patterns. They are referred to as inside days in bar charts. When a large white candlestick is followed by a small white candlestick at or near the top of an uptrend, it is common for this bearish pattern to break downward. The failure of the second candlestick to push price higher outside the range of the first candlestick indicates that buyers are losing stamina. Conversely, when a large black candlestick is followed by a small black candlestick, it is a bullish pattern and is expected to break upward. The reason is that the second candlestick manages to hold off the downward drive of the first candlestick. Market practice says to follow the break from harami patterns when the previous day's high or low is exceeded, because a trend will normally continue in the direction of the break. This pattern is often tricky and confirmation of the next day's candlestick is important. We should also use our momentum oscillator as a filter to check whether the stock is oversold or overbought.

Figure 3.9

shows two candlestick patterns, hangman and hammer. Hangman appears after a long uptrend where the market is overbought. Hammer is found at the low of a long downward trend where the market is oversold. Comparing the two patterns, hangman indicates a potential confirmation of an uptrend reversal, but it is not as dependable as a hammer pattern, which occurs at the low of a downtrend. When it comes to hangman, it is common to see confirmation in the form of a gap down the next day. Hammer with a long shadow shows that the bears have failed to push price lower and is more reliable, especially when its shadow is much longer than its body. With the hammer, a gap up opening the next day with strong support of buying may be all that is necessary to enter a trade.

FIGURE 3.9

A bearish hangman and a bullish hammer share the same pattern, having a top-heavy body and long lower shadow. The color of the actual body is unimportant. The key difference is where they appear in a chart.

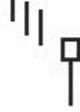
Bearish Hangman	Bullish Hammer
	

Figure 3.10

shows the application of candlestick patterns as described in the preceding.

FIGURE 3.10

Candlestick patterns occurring at critical points at a turn of trend. Note also the increase of volume and price projection from the break of the neckline, which becomes the resistance line when price attempts to reenter previous levels. In the momentum oscillator window, a bearish divergence pattern confirms the continuation of the bearish trend; and a bullish divergence alerts to the bottoming of price.



DIVERGENCE PATTERNS

Divergence occurs when the movement of a momentum oscillator does not agree with the price movement. Divergence gives signs of the hidden strengths and weaknesses of a price trend. Prices may rise and fall, but if the momentum oscillator fails to confirm the corresponding price trend, the resulting discrepancy is an advance warning of a probable change in the price trend in the very near term.

There are four patterns of divergences. They are the two classic divergences, comprising bullish divergence and bearish divergence; and the two hidden divergences, comprising hidden bullish divergence and hidden bearish divergence.

Bullish divergence occurs when the price is declining while the momentum oscillator is rising. This pattern can be seen generally at a market low. Bullish divergence occurs when the market is reaching a support level and is preparing for an eventual rally. In the beginning of a bullish buildup, the price fails to show any signs of rallying as weak investors are selling to strong investors. As more investors enter the market and when the accumulation process is over, the price will rally.

The other classic divergence is bearish divergence. Bearish divergence is the opposite of bullish divergence. It occurs when the price is rising while the momentum is declining. The pattern looks for higher high prices and lower low oscillator values. Bearish divergence happens when the market is preparing for a corrective decline. In the beginning of the bearish buildup, price fails to show any sign of corrective action as weak investors are buying from strong investors. When more strong investors exit the market and the distribution is finally over, the price will fall. (See

Figure 3.11

.)

FIGURE 3.11

Classic divergence patterns.



Another pair of divergence patterns, known as hidden divergences, should not be ignored. (See

Figure 3.12

.) Like classic divergences, hidden divergences do not appear on every price move, but when they do, they function equally well. They help to keep the trader on the right track of the trend

or to anticipate a trend change. Most hidden divergences indicate continuity of the prevailing price trend.

FIGURE 3.12

The lower panel shows two hidden divergence patterns between the movement of price and the momentum oscillator. The first pattern of a hidden bearish divergence occurs when price fails to continue its upward movement despite the momentum crossing above the center line. Although price is trading in a downtrend, the momentum is trending upward. The second pattern is a hidden bullish divergence where price is trading at a higher level but the momentum oscillator is at a lower low.



The first type of hidden divergence is hidden bullish divergence. Hidden bullish divergence sees higher price lows and lower oscillator lows. In a rising market, a hidden bullish divergence is formed when momentum oscillator makes a lower low value, but the price makes a higher low. It occurs mostly during correction in an upward trend. Hidden bullish divergence signifies underlying strength in the price movement and often is an opportunity for the trader to reenter the market.

The opposite pattern of a hidden bullish divergence is a hidden bearish divergence. Hidden bearish divergence seeks lower price high and higher oscillator high values. In a declining market, a hidden bearish divergence is formed when the momentum oscillator makes a higher high, but the price makes a lower high. Hidden bearish divergence occurs mostly during corrective rallies in a downward trend. It signifies underlying weakness in the price movement and often provides an opportunity for the trader to exit from the market.

Whether divergences are classic or hidden types, they warn of potential trend changes. They provide opportunities for the trader to reassess his position and to either exit from the market or to commit to a new position in anticipation of the trend change. Sometimes, in a strong trending market, several divergences may occur. The more divergences that are occurring, the more significant they become. For instance, at a market top, the greater the number of bearish divergences appearing, the greater the weakness of the underlying price trend; and, at a market bottom, the greater the number of bullish divergences appearing, the greater the strength of the underlying price trend.

In studying divergence patterns between the price and the momentum, an important point to bear in mind is that the momentum oscillator is displaying the velocity of the price and not the price trend. The momentum oscillator does not represent the price trend or the price direction.

The trend is reflected in the directional movement of the price. In order to trade better, it is

worthwhile to pay attention to divergence patterns. The key is to recognize classic and hidden divergences when they appear and to take the appropriate actions.

DIAGONAL PATTERNS

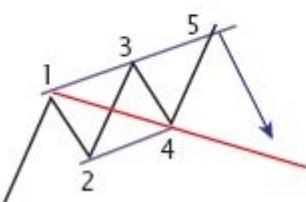
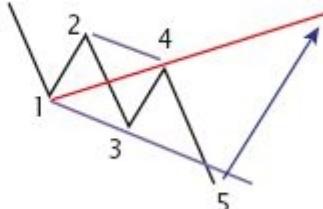
In her book, *Street Smarts*, Linda Raschke writes, "All you need is one pattern to make a living!" She then introduces a pattern called Three Little Indians, developed by her good friend, Bill Wolfe. Others call the pattern Wolfe waves, three drives, three tops, and so forth. There are certain applicable ratios among the five waves in the diagonal, but for all practicable purposes, it has been found that the pattern is reliable most of the time without measuring or counting such ratios. (See

Figure 3.13

- .) It does not matter by what name it is called. As long as the pattern gives a good reading, it will be worthwhile to pay close attention to it when it appears.

FIGURE 3.13

Bearish and bullish diagonal patterns.

Bearish Diagonal	Bullish Diagonal
	

The setup of the waves in the pattern is symmetrical, and wave 5 sometimes makes a false breakout move outside the protracted line of waves 1 to 3. In other respects, the pattern is similar to diagonal triangles, though perfect Wolfe waves are rarely found in charts of all time frames and if there is one, it would take an inordinate amount of time to find it unless the trader is prepared to buy a special pattern-recognition program to trace it. See

Figures 3.14

to

3.17

- . The pattern consists of five waves, labeled 1 to 5, and can occur at the end of any movement that has five waves, usually in wave C or in a fifth wave of an Elliott wave pattern structure.

FIGURE 3.14

Bearish diagonal patterns. The waves of the first bearish diagonal pattern are marked 1 to 5; and in the second bearish diagonal pattern they are numbered 1 to 5 and the numbers are circled. Notice in both patterns the projection of price target by connecting wave 1 and wave 4 is mind-boggling. Furthermore, in the second diagonal pattern, there is another wavelet diagonal pattern, creating a pattern within a pattern.

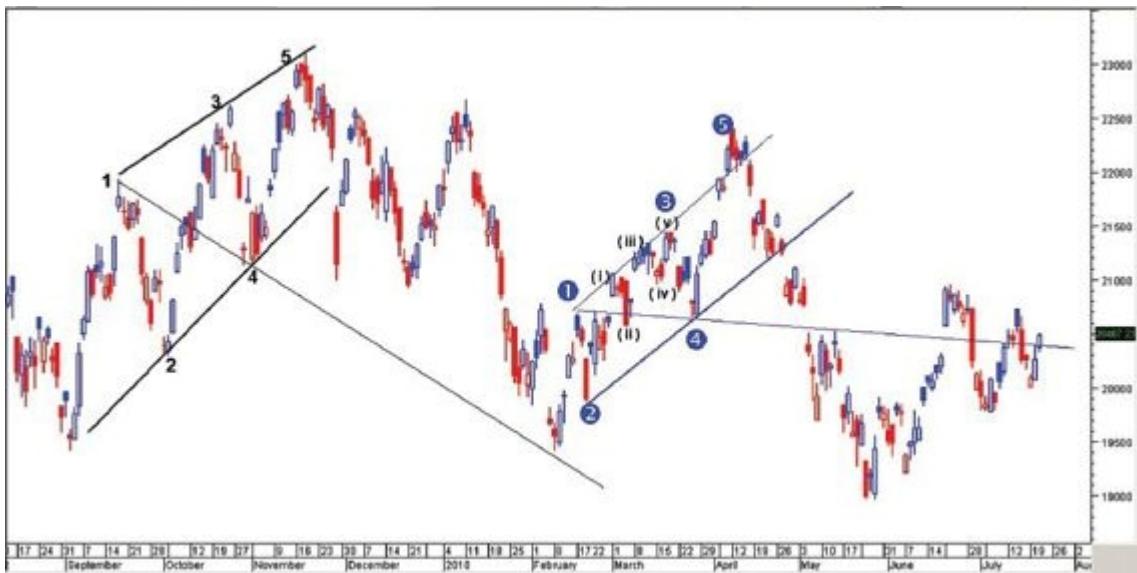


FIGURE 3.15

Bullish diagonal patterns. In this chart, there are two bullish diagonal patterns. The important point to note is the dependable projection of price target by the connection of wave 1 and wave 4.

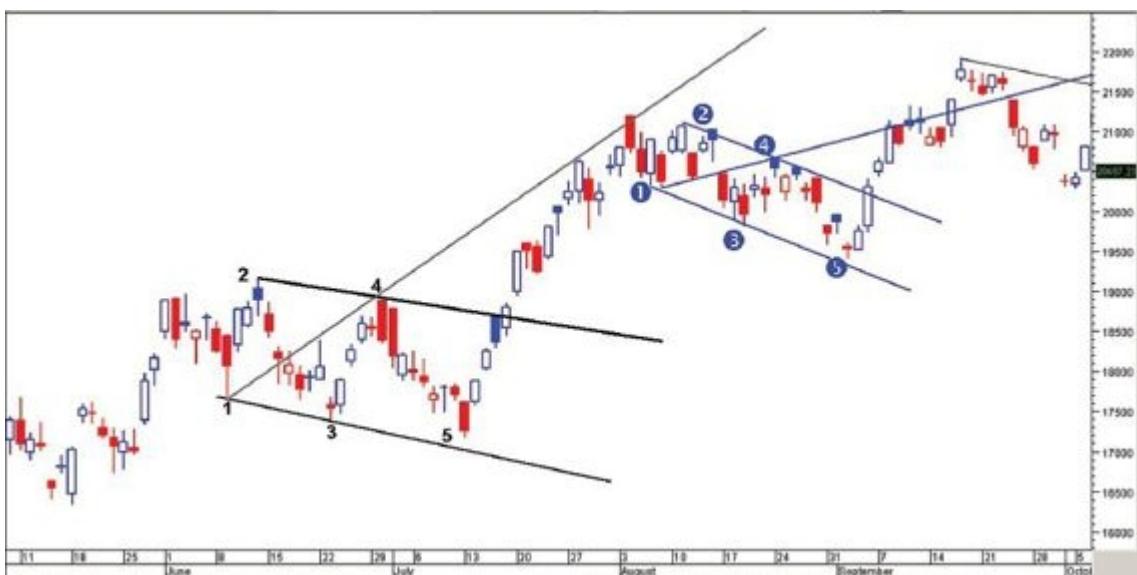


FIGURE 3.16

A bullish reversal after price breaks out from the bullish diagonal pattern.

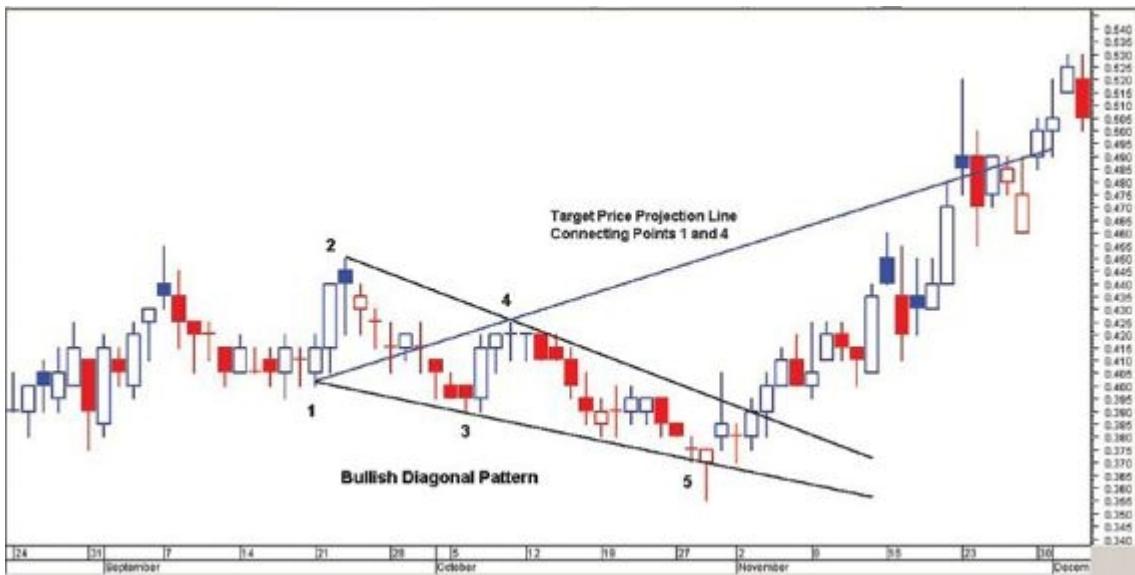


FIGURE 3.17

Monthly Hang Seng Index. This chart shows the projection line that becomes the major obstacle of the bullish market in 2007. The line is drawn by connecting point 1 and point 4 of a Wolfe wave pattern.



Figure 3.17

shows another Wolfe wave pattern, which took approximately eight years to form.

PATTERNS CONTINUED

Patterns indicate the psychology of a market. Martin Pring, in his book, *Martin Pring on Price Patterns*, writes, “The more I work with markets, the more it becomes apparent that prices are determined by one thing and one thing only, and that is people’s changing attitudes toward the emerging fundamentals.” Another great technician, Garfield Drew, says, “Stocks don’t sell for what they are worth, but for what people think they are worth. If it were not for the fact that these changing attitudes move in trends and that trends tend to perpetuate, market prices would be nothing more than a random event, which would mean that technicians would be out of business.”

There are two general categories of patterns, reversal and continuation. Reading of patterns is based on the three basic assumptions in technical analysis: prices discount everything, trend will continue in the direction of the previous direction, and history tends to repeat.

When prices continue to trend up, they become more vulnerable to profit taking and the market becomes congested as sellers and buyers pit their strength against one another. On the other hand, when prices continue to trend down, buying support will reenter as prices seem more appealing to the buyers. If prices fail to continue in the direction of the previous trend, they change direction and reversal patterns are formed. The ability to detect reversal patterns often offers the best reward.

Continuation patterns allow the market to pause for a time before the previous trend resumes, allowing traders to get out of the market or even to add new commitments to a previously established position.

Patterns tell the behavior of a market and they can be predictive. Recognizing chart patterns is a method by which we can gauge market trends and turns. Recognizing even the most predictable patterns is not easy. However, if we are paying attention, we should be able to see that there are certain patterns that occur far more frequently than others, and there are certain stocks which keep repeating the same patterns.

Prices do not move in straight lines. They fluctuate to make peaks and troughs. A simple method to determine the primary trend and trend reversals is to observe the sequential patterns of peaks and troughs. When prices are in an uptrend, each successive peak and trough will be at a higher level than the preceding level; prices will be making higher highs and higher lows. In a downtrend, each peak and trough will be making lower highs and lower lows, and they will be lower than previous levels. Generally, reversal patterns evolve when such succession of peaks and troughs is broken, signaling that a change of trend is taking place.

When prices get bogged down in congested price areas, patterns begin to form. Popular groups of patterns include the “M” and “W” patterns, the head and shoulders patterns, and the rectangle patterns.

“M” AND “W” PATTERNS

“M” and “W” patterns (see

Figure 3.18

) are also known as double tops and double bottoms, respectively. A double top is a pattern for two successive peaks, which may or may not be of the same price levels. The pattern looks like an M. A double top pattern occurs when the stock fails to continue the uptrend in its second attempt as it meets resistance pressure from sellers at its highs. In a market rally, sellers suddenly take control and push the price downward. Price begins to retreat to a level that is considered attractive for buyers. The buyers enter the market and push the price up to make a second top where it finds new selling pressure, which pushes the price down past its last trough. When the price declines below the low point established between the two tops, a double top pattern has been activated.

FIGURE 3.18

The chart shows a typical double top pattern. At T1, selling pressure pushes prices down to a trough, where prices regain buying support and rally to a new top. At T2, prices encounter further selling pressure and retrace below the horizontal trend line to confirm a double top reversal pattern.



A double bottom is the inverse pattern of a double top and has two successive troughs, which may or may not be at the same price levels. It looks like a W. In a double bottom, prices must close above the high point between the two bottoms before a trading decision can be made. Once this occurs, the implication is that prices will rally as far above the high point as the distance between the high point and the two lows.

HEAD AND SHOULDERS PATTERNS

Head and shoulders is another popular pattern and it is quite a reliable reversal pattern. It often has a symmetrical pattern in respect of the price magnitude and the time spent during the formation of the pattern.

Basically, a head and shoulders top pattern is a bearish signal. It consists of a peak followed by a higher peak and then another lower peak that fails to hold the continuing uptrend with a break below the neckline. The neckline is the trend line drawn across the lows of the two intervening troughs.

The highest peak is the head of the pattern and the peaks to the left and right of the head are the shoulders. The shoulders are priced lower than the head and are about the same distance from the head. After a strong rise, the left shoulder is formed when prices face resistance from selling pressure and make a correction to a level, which attracts further buying support. When prices begin to rise above the last peak, or the left shoulder, sellers suddenly take control of the market and push prices downward below the low of the left shoulder, creating the formation of the head. When prices correct to about the level of the last trough of the left shoulder, buyers begin to reenter the market to drive prices upward. This time, prices fail to exceed the highs of the head. Normally, prices will face resistance at about the high of the left shoulder and make a retreat downward, forming the right shoulder. A head and shoulders pattern is completed when prices break below the neckline.

Generally, volume will be high on the left shoulder and low on the right shoulder, and will increase sharply on the break below the neckline (see

Figures 3.19

and

3.20

). The extent of the breakout move can be estimated by measuring the distance from the head down to the neckline, and then projected downward from the point of the breakout.

FIGURE 3.19

A typical top reversal pattern of a head and shoulder formation.



FIGURE 3.20

A bearish reversal pattern of a head and shoulder top with two left shoulders and two right

shoulders. Note that the neckline becomes the resistance line to the subsequent rally after completion of the pattern.



A head and shoulders bottom is a bullish reversal pattern in a downward trend. A typical head and shoulders bottom has three troughs and two peaks. The first trough is the left shoulder. The left shoulder is followed by a lower trough, the head, and then another trough forms the right shoulder, which is higher than the head. A head and shoulders bottom is the inverse pattern of the head and shoulders top and is considered a positive pattern. It indicates a probable change in trend direction from a downward trend to an upward trend when prices break above the neckline. The neckline is the line that is drawn across the two peaks of the pattern. Volume will generally be highest on the left shoulder and lowest on the right shoulder. It is important that the volume at the point of breakout of the neckline is higher than the average volume during the formation of the pattern. The increased volume at the breakout of the line will register the enthusiasm of buyers (see

Figure 3.21

) and marks the end of the downward trend.

FIGURE 3.21

Two bullish reversal patterns: a head and shoulders bottom and a double bottom. Notice the increased volume at price breakout of the neckline in both cases. Note also the neckline in the double bottom pattern becomes the supporting line of the retracement of the price after completion of the pattern.



In peaks and troughs, there are two categories of patterns: (1) bullish reversal patterns, such as double bottoms and head and shoulders bottoms; and (2) bearish reversal patterns, such as double tops and head and shoulders tops. In these patterns, the relative neckline is a very important key. In a bullish reversal pattern, the neckline is the price's resistance line during the formation. After a price breakout, the neckline serves as the support line in a retracement. On the contrary, in a bearish reversal pattern, the neckline becomes the support line during the period of formation, and after the completion of the pattern, it is the resistance line.

RECTANGLE PATTERNS

Theory is one thing, but getting down to doing it right is quite another. A rectangle is one pattern that is difficult to trade, particularly when the trading range is narrow.

A rectangle pattern is a consolidation phase in which the bulls and the bears are in a tug of war, with neither side in decisive control. (See

Figure 3.22

.) It is normally expected for prices to continue in the same direction the market was trading in before the consolidation began. An important point to take note of is that the pattern is not complete until a breakout has successfully occurred.

FIGURE 3.22

Two examples of rectangles. The first rectangle shows the force of the bears pushing prices below the support level. The second rectangle shows the bulls, after a long consolidation, taking control and pushing prices to a new high.



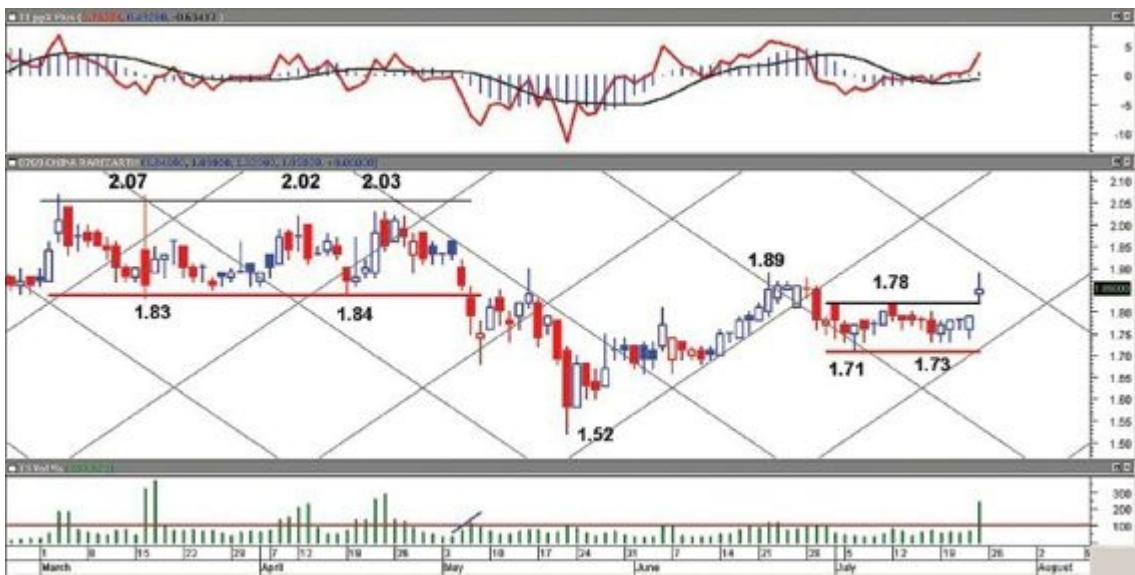
Rectangle patterns are sometimes called box patterns. You do not often hear market commentators mention them in the news. They usually refer to the pattern as a trading range or a consolidation. (See

Figure 3.23

.) Rectangle patterns represent a period of range trading during which prices move between two parallel trend lines: the upper resistance line, which connects the highs; and the lower support line, which connects the lows. Prices will test the levels of support and resistance several times before a breakout from the upper and lower boundaries. Once prices break out of the range in either direction, they are deemed to be trending in the direction of the breakout. An upside breakout from the box is a technical buy signal, while a downside breakout is a technical sell signal.

FIGURE 3.23

Prices fail to break above the resistance line in the first rectangle pattern, and finally break below the support line with increased volume. The second rectangle shows the stubbornness of the bulls, who hold prices at the support level to eventually overcome the bears' resistance.



In Elliott Wave Theory, rectangle patterns are corrective waves and normally appear as Wave 2, Wave 4, and/or Wave B.

In general, a rectangle does not show any particular volume pattern. Volume will mostly be light as the pattern develops, but when extraordinarily heavy volume takes place during the consolidation, it provides an indication of the direction of the future breakout. Typically, volume will also rise in the direction of the ultimate breakout. (See

Figure 3.24

.)

FIGURE 3.24

One long rectangle over a period of about 12 months. A long wait, but worthwhile as prices catapult to new highs.



Rectangle patterns can extend for a few weeks or many months. We just have to wait until prices break out of the support or resistance lines and go with the direction of the breakout. The maxim that we have learned in trading the box pattern is “Think outside the box.”

SAUCER PATTERNS

Saucer bottom formations belong to the group of patterns that seemingly have curve-line or rounding turns. Prices during the period of formation, especially at the rounding turns, have low volatility and move narrowly, forming a gradual bowl shape. Saucer bottoms are found at the end of a downward trend and are considered to be bullish reversal patterns. The initial downward slope indicates an excess of supply. The excess supply forces prices downward until buyers enter the market at the low price at the bottom, which increases the demand for the stock. Once the rounding is complete, the prices break out and continue in an upward trend.

Saucer patterns can also be referred to as cup-and-handle patterns when, upon a breakout of the pattern, prices retrace to form a right handle that drifts slightly downward. This pattern's time frame varies from several weeks to several months. The longer it lasts, the more significant it becomes. (See

Figures 3.25

and

3.26

.)

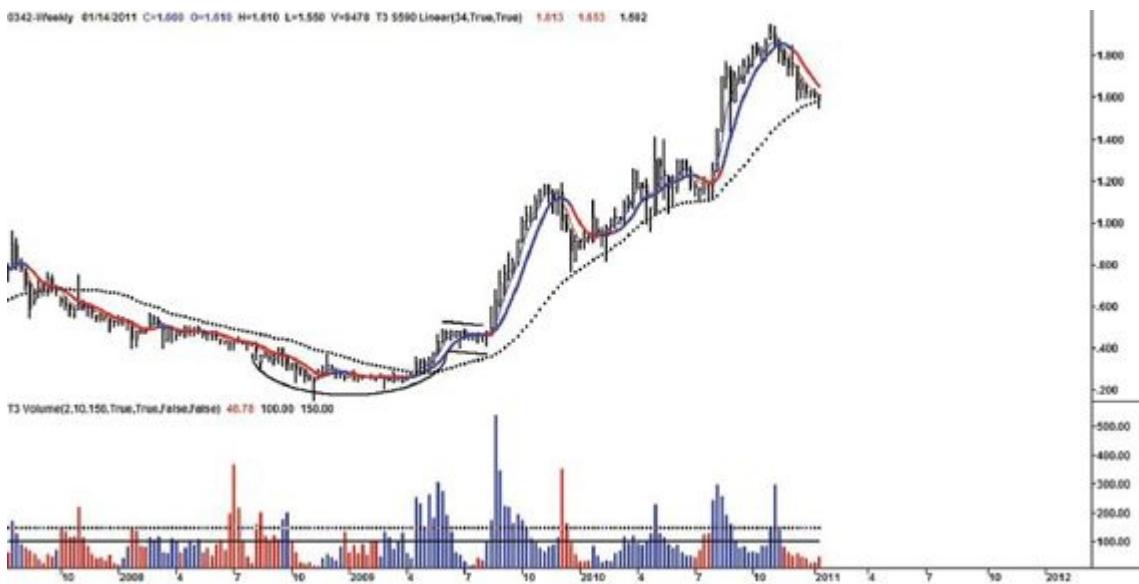
FIGURE 3.25

In this chart, the completion of the saucer pattern coincides with the crossover of the 50-day moving average (50-DMA) over the 200-day moving average (200-DMA).



FIGURE 3.26

A typical cup-and-handle formation showing extreme volume upon breakout of the right handle of the pattern.



As prices move down toward the bottom, volume decreases, and prices enter a period of consolidation at the bottom as trading bounces within a certain range. A rounded bottom is formed as market sentiment shifts gradually from bearishness to bullishness. As market sentiment becomes more bullish, prices make a gradual upturn, and volume increases as investors become more decisive about the bullishness. In a saucer pattern, volume tends to follow the shape of the pattern, and accelerates upon the breakout of the pattern. (See

Figure 3.27

.)

FIGURE 3.27

Prices rally on a breakaway gap (marked with a red circle) with good volume and enter into a consolidation of a saucer pattern before taking off to new highs.



In

Figure 3.28

, prices break above the neckline of a bullish reversal—an inverted head and shoulders pattern—and consolidate in a saucer bottom. The upward trend ends when the supporting line of the bearish diagonal pattern fails to hold off the selling pressure. Note also when prices break off from each of the respective trend lines of the patterns, volume increases.

FIGURE 3.28

This chart shows a saucer bottom as a continuation pattern.



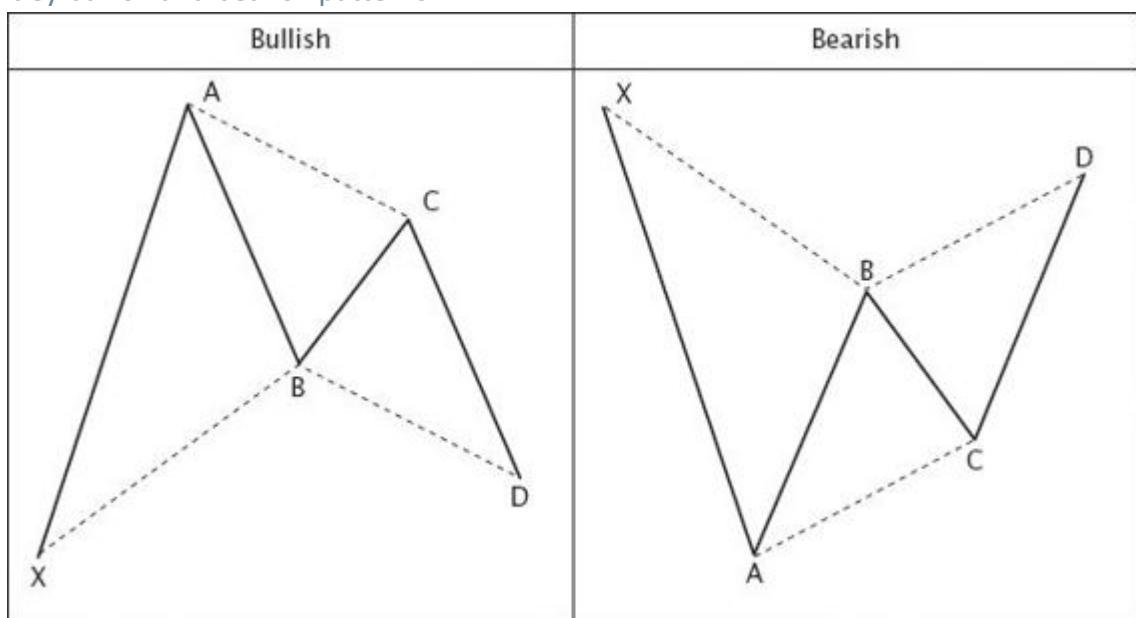
AB=CD PATTERNS

The AB=CD pattern is a classic pattern found in all time frames. The pattern was highlighted as the Gartley Pattern in H. M. Gartley's 1935 book, *Profits in the Stock Market*. The key to the pattern is the distinct parallelogram of ABCD, where AB=CD and AC is parallel to BD. (See [Figure 3.29](#))

.) Gartley did not specify any application of Fibonacci ratios, but in later years, technicians added the applicable ratios to it. The important ratios were that B should be at 0.618 of XA and D should be at 0.786 of XA.

FIGURE 3.29

Gartley bullish and bearish patterns.



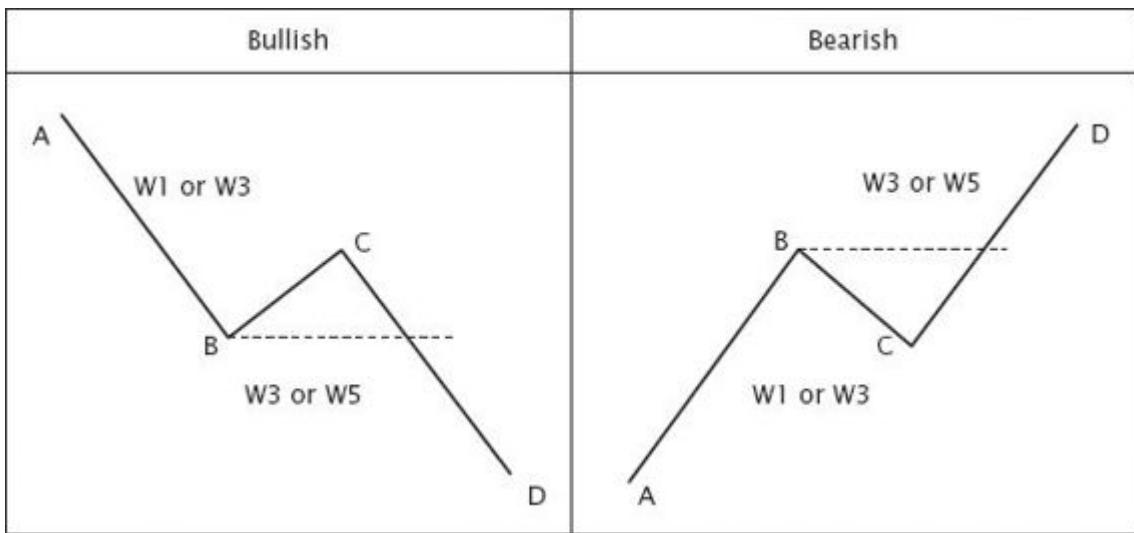
The concept of AB=CD is also mentioned in Elliott Wave Theory. In the formation of five impulse waves (see Chapter 4, Elliott Waves), when Wave 1 is extended, Wave 3 may be equal to Wave 5. And when Wave 5 is extended, Wave 1 and Wave 3 may be equal. Each point, X, A, B, C, and D, is a significant high or low. The points A, B, C, and D represent three consecutive price swings. AB may represent Wave 1 or Wave 3 in an impulse waves pattern, or Wave A in a corrective wave pattern; BC represents Wave 2, Wave 4, or Wave B; and CD represents Wave 3, Wave 5, or Wave C. (See [Figure 3.30](#))

[Figure 3.30](#)

.)

FIGURE 3.30

Formations of AB=CD patterns. In a valid AB=CD pattern, D is the area for considering trade entries in a bullish AB=CD, and for making trade exits in a bearish AB=CD.



AB=CD is a very common pattern found in the measurement of movements between price swings of Hong Kong stocks.

Figure 3.31

shows two variations of AB=CD patterns: line (1–2) = line (3–4), and line (2–3) = line (4–5). Minor “ab=cd” patterns often develop within a larger “AB=CD” swing.

FIGURE 3.31

Two major AB=CD patterns used to project support and resistance levels.



In using AB=CD (

Figures 3.31

and

3.32

), it is not necessary to be very particular to get the exact point; the purpose of using the pattern is to estimate the probable support or resistance level.

FIGURE 3.32

An example of a bearish AB=CD pattern. After reaching the point at D, price makes a corrective move.



GAPS

A gap is an opening outside the previous day's range, creating an area where there are no trades. In an uptrend, a gap occurs when the price opens above the previous day's high and the space (the area between today's low and yesterday's high) is not filled during the day. In a downtrend, the day high gaps down below the previous day's low.

Generally, most gaps are eventually filled, some on the next trading bar, while others may take a much longer time and some may never get filled. It depends on the types of gaps—breakaway, common, runaway, or exhaustion. Breakaway gaps are not filled quickly and occur when the market is in the early stage as prices break out of a trading range or consolidation area. Breakaway gaps move prices into new territory and do not often retreat to fill the gap in subsequent trading.

Breakaway gaps are found mostly in impulse waves (Wave 1) or corrective waves (Wave A or Wave C). Breakaway gaps can be reliable trading signals, particularly when they occur during high volume.

Common gaps (see

Figure 3.33

) develop within a trend and reaffirm the conviction and strength of the trend's direction. They are probably caused by going ex-dividend and the gaps get filled quickly. They appear most often in Wave 2 and Wave 4, or Wave B.

FIGURE 3.33

Chart showing various types of gaps in a short rally and a corrective A-B-C wave.



Runaway gaps are series of gaps over several days with price moving in the same direction of the trend. They commonly appear in impulse Wave 3 or Wave C.

Exhaustion gaps sometimes signal the end of a trend. In an uptrend, they develop in the last phase of the buying trend, when practically everyone is convinced of the bullishness of the market and buyers cause the market to gap higher. Finally, when there is no one left to buy, the uptrend is effectively over. In a downtrend, practically everyone becomes bearish on the market, selling increases, and the market gaps down. Exhaustion gaps are likely to appear at impulse Wave 5 and Wave C.

Gaps do not hold every time. They become reference points as long as they hold. The longer the gaps hold, the greater the probability of the trend's continuation. The farther away from the previous day's range a market opens, the greater the likelihood that the market has temporarily overextended itself. When this occurs, responsive sellers will often try to narrow the gap by selling to push prices toward the previous day's close.

The gap is important because it implies significant changes in trading range and in the sentiment of professional players. Gaps happen when there is an unexpected announcement of information about a company made while the market is closed. This information may include earnings reports, earnings pre-announcements, or analysts' ratings. If the information is positive, it will drive a stock price higher on the open relative to previous day's close, and if the information is negative, it will cause the price to gap down on the open.

Gaps are perhaps indirect killers of a trend trading system. Prior to point Y2 in

Figure 3.34

, everything looks positive, until the disclosure of a negative announcement at the close of market. Prices gap down by 9.6 percent when the market opens on the morning of the next trading day. Gaps may be caused by aggressive market players or professional traders who may have better information. As an example, a listed company is required under good corporate governance practice to disclose immediately any price-sensitive information that is not of public knowledge and which may affect its stock prices. However, such information is sometimes not released in a timely manner. This may cause a difference between the time the company becomes aware of the information and the time the information is disclosed to the public. Therefore, timely release of the information may be delayed. During this delay period, some tactical trading could have been implemented by smart professional traders. When the information is finally released, it may come as a shock to the general traders, and in turn cause a gap.

FIGURE 3.34

A chart showing the habitual occurrence of gaps, which appear to be cyclical. The gap at point Y2 would have caught most bullish buyers of the stock by surprise.



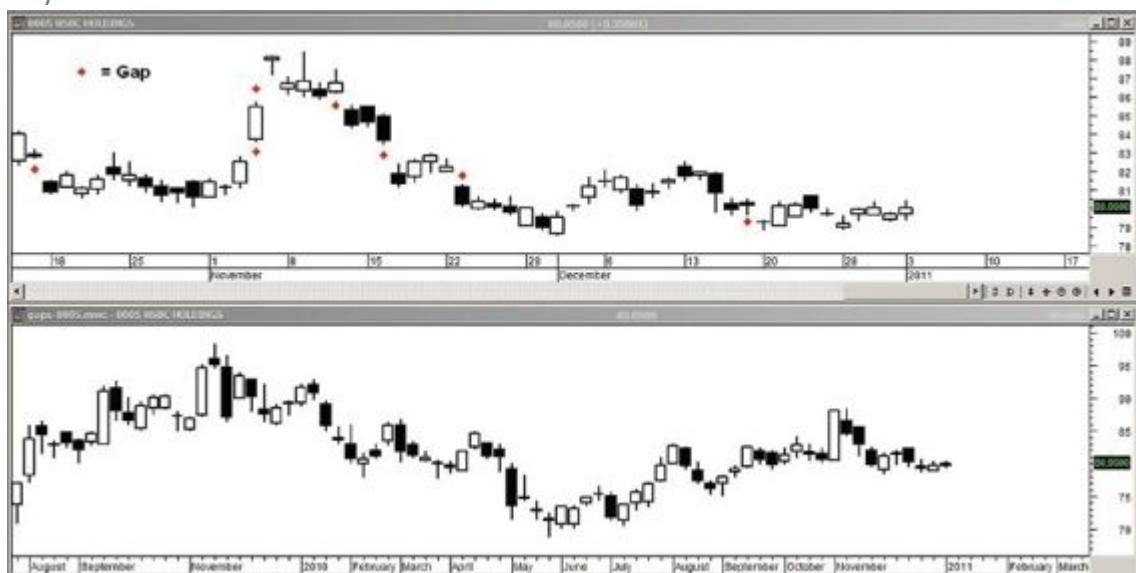
Gaps occur on all time frames, but the longer time frames will have fewer gaps. In addition, it is observed that stocks paying quarterly dividends and having listings on various exchanges tend to be more prone to gaps, as shown in

Figure 3.35

.

FIGURE 3.35

The upper window is the daily chart and the lower window is the weekly chart of a stock that is listed on three exchanges and pays quarterly dividends. The gaps are marked in the daily chart by red diamonds.



CONCLUSION

In this chapter, two groups of patterns have been described—the short-term patterns and the long-term patterns. Short-term patterns are often reversal patterns that show combinations of price bars ranging from two to five trading days, and are much easier to identify when displayed in candlesticks. Such candlestick patterns include the morning star, evening star, dark cloud cover, piercing line, and so on. They give traders the underlying signs of investors' confidence and alerts to the probable change in trend in the near term. Though a single candlestick may indicate the bullishness or bearishness of a specific period, it is strongly recommended, as described in the chapter, that trading decisions should not be based on one candlestick. Long-term patterns take a longer period in their formations, which may sometimes be prolonged to several weeks. They are the classical patterns having names that are derived from their shapes, such as double tops ("M" patterns), double bottoms ("W" patterns), head and shoulders, saucers, rectangles, and so forth. Compared with short-term patterns, long-term patterns indicate a longer-term projection of the underlying trend. Though short-term patterns may appear more frequently than long-term patterns, traders should not make decisions solely on the basis of short-term patterns without taking into consideration other supporting indicators. A short-term pattern may be formed within the overall picture of the long-term pattern, and when prices show a breakout from both patterns, the validity of such signals is stronger.

Included in the chapter are two specific patterns that belong to the group of long-term patterns. Traders should take note of these patterns as they are very useful in the measurements of price projections. Also highlighted are divergence patterns and gaps. The divergence pattern is not a price pattern per se; it is included in the chapter to stress its importance as an early warning signal of an imminent change in trend. As to the gap patterns, these are the fearful patterns that appear more frequently in penny stocks. There may not be any early warning from price patterns or indicators, as gaps generally occur unexpectedly as a result of a sudden development or announcement of information. This is the risk in trading. Traders should, therefore, always have a trade plan to minimize their risks.

CHAPTER 4

Elliott Waves

Elliott Waves serve as a road map to understanding the state of the market. The most difficult aspects of learning Elliott Waves are the labeling of the first count, where to expect the likely levels, and where to begin the next count. In counting Elliott Waves, the most common difficulties are found in complex correction and identifying the beginning of Wave C, and in completion of an A-B-C pattern. Under certain market conditions, wave analysis can become extremely ambiguous and very hard to decipher. But when the count is right, it can be most thrilling.

The Elliott Wave Principle was first presented to the investment world in 1938 by Ralph N. Elliott. His theory is based on the premise that market prices are a reflection of crowd behavior. Each wave of price movement represents a series of emotional reactions by investors, which have certain repetitive patterns and cycles.

Elliott considered Fibonacci ratios to be the most important factors in determining the extent of price movements, including the time movements in any market. Fibonacci numbers are 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377, and so forth. Each number in the sequence is the sum of the previous two numbers. A Fibonacci ratio is the ratio between any successive numbers of the sequence. Elliott saw that markets moved in waves that corresponded to Fibonacci numbers—in series of five up waves and three down waves. The five up waves and the three down waves, totaling eight waves, are all Fibonacci numbers.

After the first four numbers in the sequence, the ratio tends to approximately equal 1.618, the inverse ratio of which is 0.618. The ratio of 1.61803 39887 49894 84820 was named by the Greeks as the Golden Ratio. In the world of mathematics, the numeric value is called *phi*, named for the Greek sculptor Phidias, who frequently applied the ratio in his sculptures.

Fibonacci ratios are used to target levels of support and resistance. Target levels are more reliable when they are arrived at using Fibonacci ratios than by other projection approaches. A high concentration of projections appearing in the same area, or in the proximity of the area, will be more dependable than that of a single projection target level. The most commonly used Fibonacci ratios are 0.236, 0.382, 0.5, 0.618, 0.786, 1.618, and 2.618.

Price patterns are always in the progress of formation, unfolding over and over again in a structure of five waves in the direction of one larger trend, and a structure of three waves when moving against that trend.

In a five-wave structure of an uptrend, the waves are counted as 1, 2, 3, 4, and 5. Waves 1, 3, and 5 are called impulse waves. Waves 2 and 4 are called corrective waves. Wave 2 will correct the movement of Wave 1, and Wave 4 will correct the movement of Wave 3. In a three-wave structure of a downtrend (see

Figure 4.1

), the waves are called A, B, and C.

FIGURE 4.1

The chart shows the structure of a five-wave pattern being corrected by the A-B-C waves.



The three-wave structure, A-B-C, corrects the movement of the five-wave structure. Wave A can be divided into three waves or five waves; Wave B is divided into three waves; and Wave C is always divided into five waves. Each of the impulse waves and corrective waves can also be further subdivided and repeated in a similar pattern.

In counting a five-wave structure (shown in

Figure 4.2

), there are three rules to observe:

FIGURE 4.2

This is a chart showing a five-wave pattern of Elliott Waves. Wave C, as shown here, is incomplete. Notice the breakup of prices with heavy volume in early March from a line formation pattern.



1. Wave 2 cannot go below the beginning of impulse Wave 1.
2. Wave 3 is never the shortest wave of the three waves.
3. Wave 4 does not overlap impulse Wave 1.

WAVE 1

Wave 1 is the first impulse wave of the five-wave structure. Wave 1 is the beginning of the trend movement. It is generally accompanied by a strong reading in the momentum oscillator, especially when prices have undergone a prolonged correction. Wave 1 is used to project the target level of Wave 3. Extension of the wave means there is a subdivision of the wave into another five-wave structure. When Wave 1 is not extended, the target level of Wave 3 is normally either (1) 1.618 of Wave 1 measured from the low of Wave 2, or (2) equal to Wave 1. When Wave 1 is extended, the target of Wave 3 is normally about 0.618 of Wave 1 measured from the low of Wave 2. (See

Figure 4.3

.)

FIGURE 4.3

Projection of Wave (3) is 1.618 of Wave (1) measured from the low of Wave (2).



WAVE 2

Wave 2 is the first corrective wave of a five-wave structure. Wave 2 will correct the movement of Wave 1 but the correction must never retrace the entire Wave 1. Normally, it will retrace about 38.2 to 61.8 percent.

The corrective patterns often found in Wave 2 patterns are flats or zigzags. If Wave 1 is extended, the retracement of Wave 2 is about 38.2 to 50 percent of Wave 1. Sometimes Wave 2 may retrace as much as 78.6 percent of Wave 1, but it should not retrace more than 100 percent of Wave 1. In short, Wave 2 cannot make a new low. According to the Rule of Alternation, if the pattern of Wave 2 is a complex formation, then it can be anticipated that the pattern of Wave 4 will be a simple formation. If the formation of Wave 2 is a simple pattern, then it can be expected that Wave 4 will be a complex pattern.

WAVE 3

Wave 3 is the most forceful wave of the three impulse waves. Wave 3 is never the shortest wave of the impulse waves. Its slope is almost always steeper than Wave 1 and is accompanied by heavy volume and strong momentum readings. Very often, a price gap will occur in the middle of the wave movement, which helps to identify such waves. (See [Figure 4.4](#).)

FIGURE 4.4

Wave [3] shows the subdivision of another five-wave structure. Notice the oscillator readings of Wave (4) and Wave [4], both of which show the momentum oscillator falling below the zero line.



When Wave 3 is not extended or is not the longest wave, then either Wave 1 or Wave 5 will be shorter than Wave 3. If Wave 1 is longer than Wave 3, then Wave 5 will be the shortest wave. If Wave 5 is the extended wave, Wave 1 would then be shorter than Wave 3. Wave 3 is the most likely wave to extend. When Wave 3 extends, the probable target could be as high as 1.618 or 2.618 of Wave 1 measured from the low of Wave 2, making it the most profitable wave to be in.

WAVE 4

Wave 4 will often become the first support level of the corrective A-B-C retracement following the completion of a five-wave structure. Wave 4 should not retrace the entire Wave 3. Wave 4 does not retrace past the end of Wave 1 or enter the territory of Wave 2. Frequently, the end of Wave 4 is accompanied by extreme readings in the momentum oscillator. The momentum oscillator will normally drop by more than 90 percent from its highest bar to below its zero line. Wave 4 normally retraces about 38.2 to 61.8 percent of Wave 3. Triangle patterns are often found in Wave 4. According to the Rule of Alternation, the pattern formation of Wave 4 will alternate with that of Wave 2 in time and price.

WAVE 5

Wave 5 is the last impulse wave of the five-wave structure. At Wave 5, it is most common to find divergence between directional movement of price and the momentum oscillator. The target of Wave 5 is normally about 0.618 of the distance covered by Wave 1 and Wave 3, plotted from the low of Wave 4.

If Wave 5 extends, then the probable target is about 1.618 of the distance covered by Wave 1 and Wave 3. When Wave 5 does not extend, it could be retraced entirely by Wave A of the corrective A-B-C pattern.

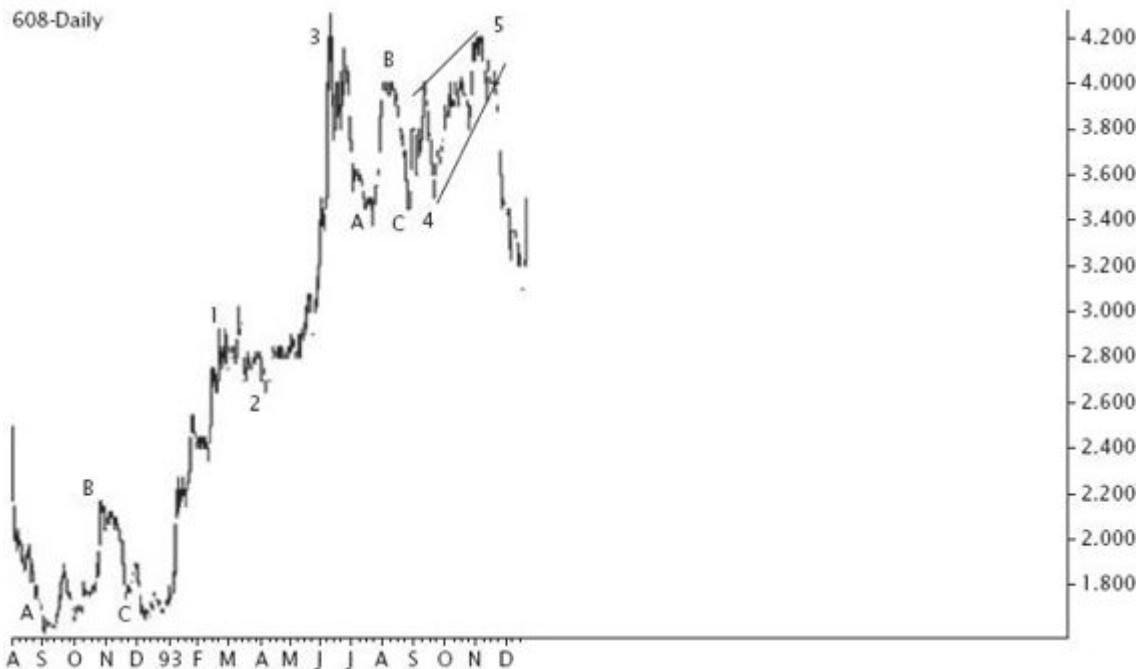
A fifth wave's failure means that Wave 5 fails to move above the end of Wave 3. A failure in Wave 5 could occur when Wave 3 is the extended wave. In such an instance, Wave 5 will relate to Wave 1 in price by 38.2 percent to 61.8 percent. Wave 5's failure usually happens when it is the fifth wave of a larger impulse Wave 5 pattern. Wave 5 could also develop into a diagonal triangle. A diagonal pattern development at Wave 5 usually signals the termination of the trend. (See

Figure 4.5

.)

FIGURE 4.5

A fifth-wave failure, ending in a diagonal triangle pattern, signals the termination of the uptrend.



EXTENDED WAVES

An extended wave applies to the longest wave in any of the three impulse waves. Extension can be expected to occur in only one of the three impulse waves, either in Wave 1, 3, or 5. A further extension may also occur in the extending wave itself.

In any extension, the Rule of Equality applies to the two non-extended waves; that is, they tend to be either equal in price or related by a Fibonacci ratio, or both.

Figures 4.6

to

4.8

show examples of extended waves.

FIGURE 4.6

Wave (1) is extended where the Rule of Equality applies to Wave (3) and Wave (5).



FIGURE 4.7

Wave [3] is extended and the Rule of Equality applies to Wave [1] and Wave [5].



FIGURE 4.8

The Rule of Equality applies to Wave 1 and Wave 3 in the extended Wave 5 of [5].

1 CHEUNG KONG-Weekly



THREE-WAVE STRUCTURES

In a three-wave structure, the waves are called A, B, and C. Corrections are always counted as A-B-C. The three-wave structure, A-B-C, corrects the movement of the five-wave structure. Wave B retraces the movement of Wave A.

Price movements in a three-wave structure can be further subdivided into smaller waves. Wave A can be subdivided into five-wave movements or three-wave movements. Wave B can only be subdivided into three waves and Wave C can only be subdivided into five wave movements or a diagonal triangle pattern. The formation of an A-B-C correction will therefore consist of two main patterns: A3-B3-C5 or A5-B3-C5 (see

Figure 4.9

and

Figure 4.10

).

FIGURE 4.9

Formation of an A-B-C correction (A3-B3-C5) after a five-wave pattern.

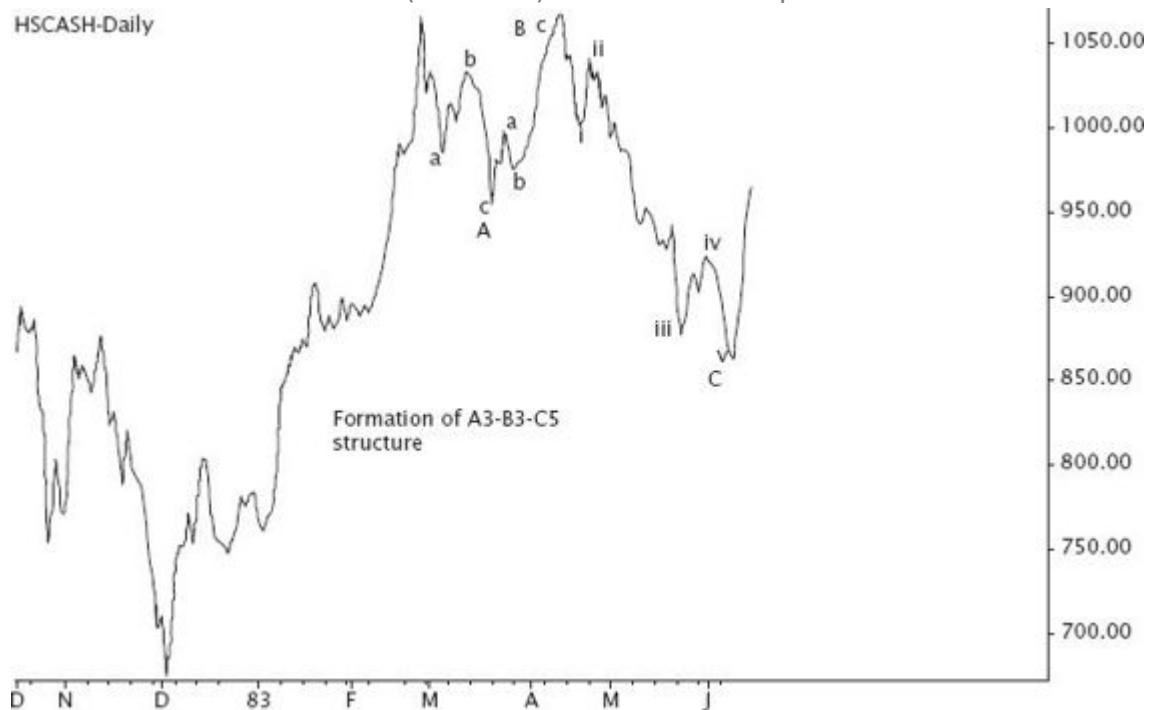
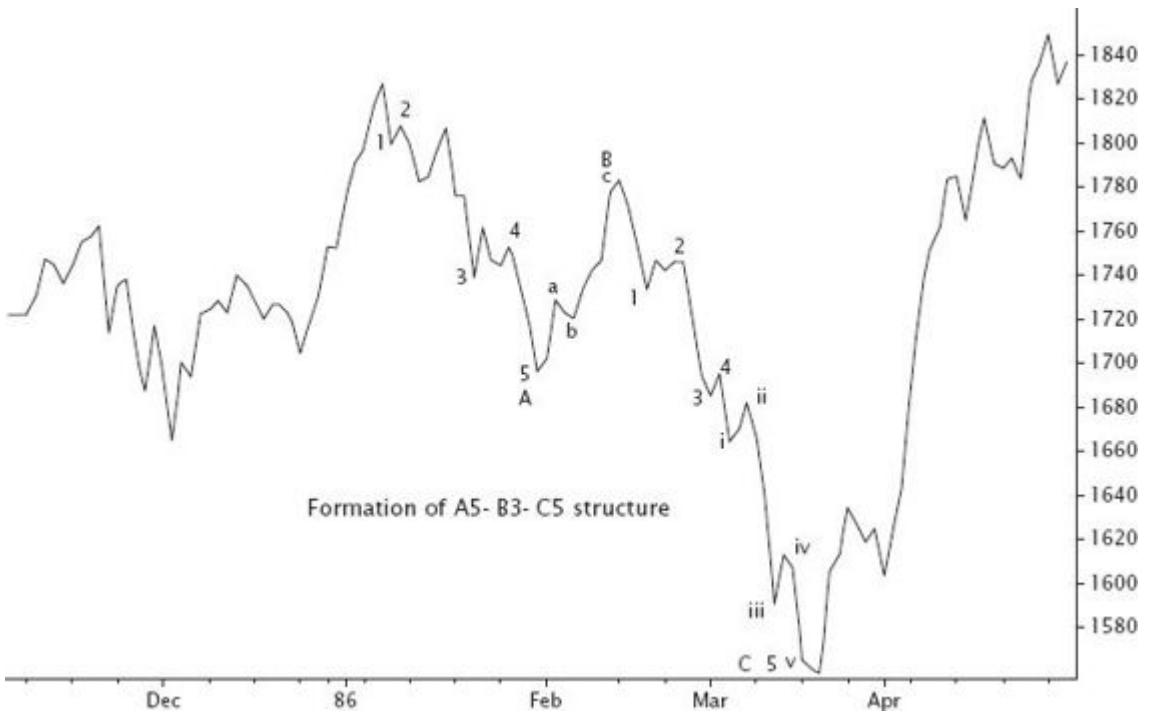


FIGURE 4.10

Formation of an A-B-C correction (A5-B3-C5) with extended Wave 5 in Wave C.



Wave A is the first corrective movement of an A-B-C correction. If Wave A is subdivided into a three-wave structure, then it signals the beginning of an A3-B3-C5 corrective formation. Generally, in an A3-B3-C5 formation, Wave B should do one of the following:

Retrace approximately the entire Wave A in the case of a normal flat.

Retrace approximately 61.8 percent of Wave A if Wave B is a failure.

Retrace beyond the beginning of Wave A by approximately 38.2 percent in the case of an irregular flat.

If Wave A is subdivided into a five-wave structure, then it signals the beginning of a zigzag (A5-B3-C5) corrective formation. In a zigzag formation, Wave B should normally retrace Wave A by approximately 38.2 to 61.8 percent of Wave A.

Wave C is the last wave of an A-B-C correction and is always subdivided into a five-wave structure. The principle of the Three Rules also applies to a downward five-wave structure of Wave A or Wave C. Frequently, Wave C is the strongest in an A-B-C correction.

In an A3-B3-C5 (flat) corrective formation, Wave C will do one of the following:

It will be approximately equal to Wave A.

It will correct the entire Wave B and will be greater than Wave A by approximately 1.618.

It will not correct the entire Wave B and will end approximately 38.2 to 61.8 percent of Wave A in an irregular flat.

In an A5-B3-C5 (zigzag) corrective formation, Wave C will do one of the following:

It will equal Wave A.

It will be greater than Wave A by 1.618 in an elongated zigzag.

CORRECTIVE 3-3-5 PATTERNS

The A3-B3-C5 patterns consist of normal flats and irregular flats.

Flats

The characteristics of a normal flat are as follows:

Wave B terminates close to the level of the starting point of Wave A.

Wave C closes near the level of the terminating point of Wave A.

A flat will generally produce strong subsequent movement. A flat formation (see

Figure 4.11

and

Figure 4.12

) may be composed of repeated flats, totaling counts of 7 or 11 waves. In a five-wave structure, when Wave 2 is a flat, the subsequent Wave 3 can be expected to be as strong as, or stronger than, Wave 1. When Wave 4 is a flat, then Wave 5 will be stronger than Wave 1 and Wave 3. In accordance with the wave principle, flats will often alternate with zigzags.

FIGURE 4.11

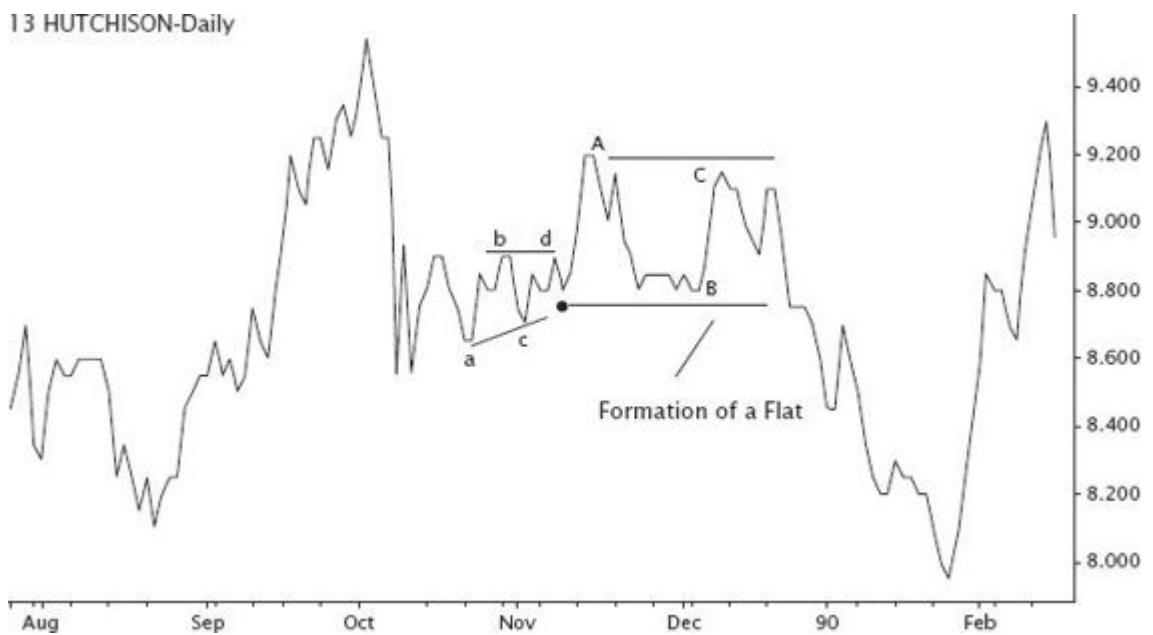
Example of a flat formation pattern.



FIGURE 4.12

Formation of a flat pattern in an A-B-C correction.

13 HUTCHISON-Daily



Irregular Flats

In irregular flats (see

Figure 4.13

and

Figure 4.14

), Wave C tends to be the strongest and approximately equals 2.618 of Wave A.

FIGURE 4.13

Formation of an irregular flat with an elongated Wave C.

HSCASH-Daily

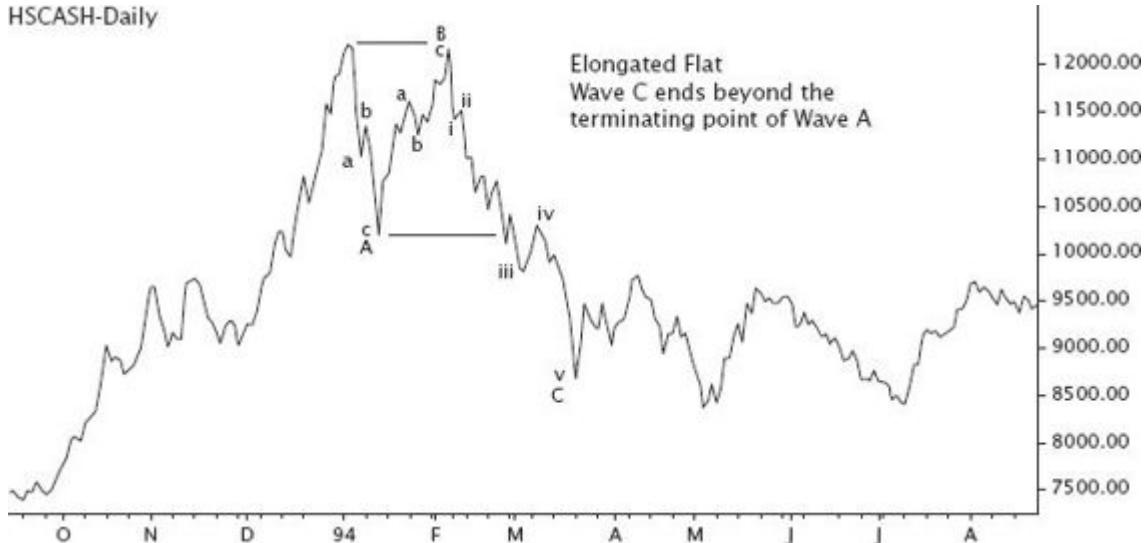
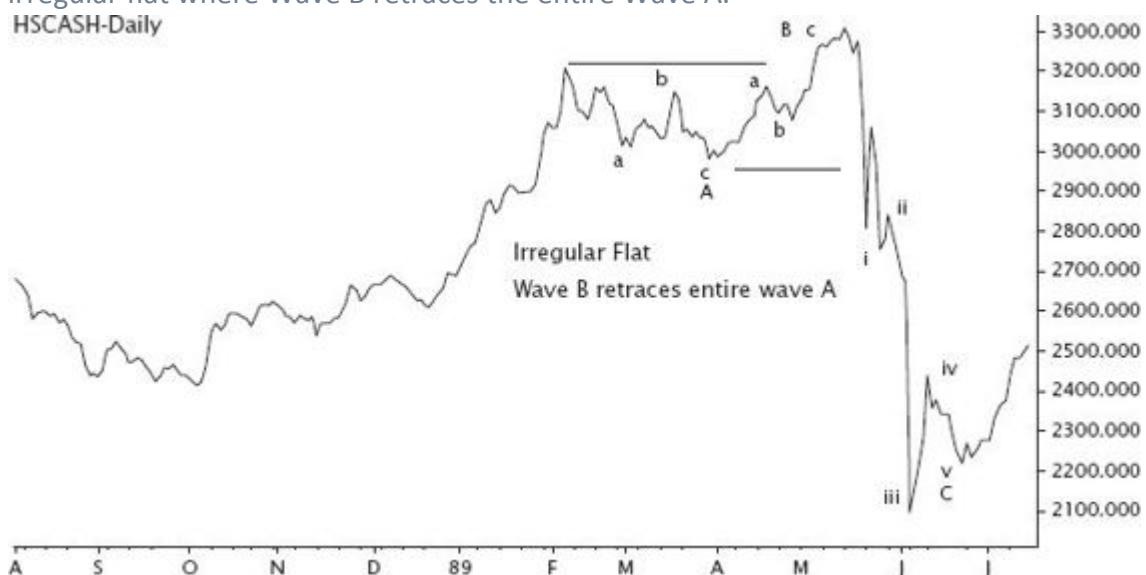


FIGURE 4.14

An irregular flat where Wave B retraces the entire Wave A.

HSCASH-Daily



CORRECTIVE 5-3-5 PATTERNS

The A5-B3-C5 patterns consist of zigzags.

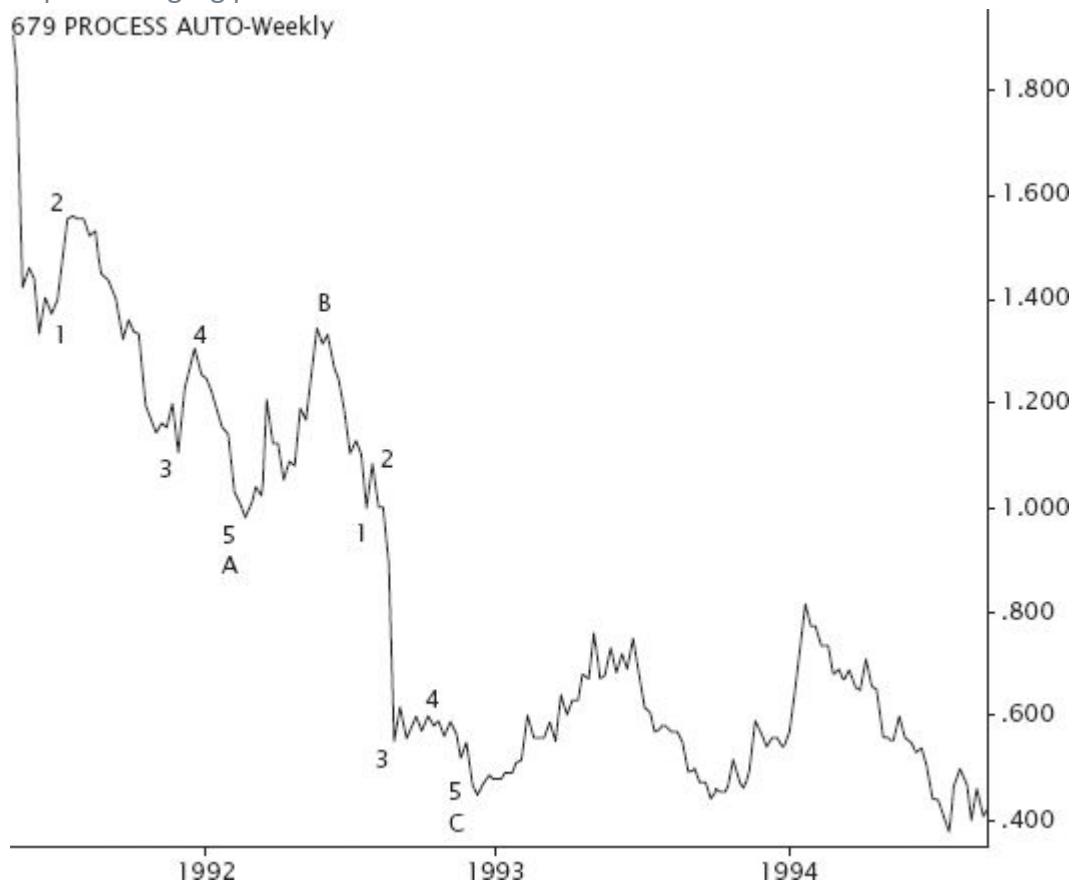
Zigzags

A zigzag pattern (shown in [Figure 4.15](#))

) consists of three prime movements: a steep decline of Wave A comprising five waves, a Wave B rally, and a continuation of the declining trend by Wave C. Wave C is always made up of five waves. Frequently, Wave C will either be equal to Wave A or 1.618 of Wave A. Zigzags are corrective waves and have the same characteristics as those of five-wave structures. Zigzags can also be extended.

FIGURE 4.15

An example of a zigzag pattern.



Complex Corrections

Complex corrections are formations composed of random combinations of corrective patterns such as flats, zigzags, triple flats, and triangles. They are the most difficult patterns to interpret in the wave principle.

Sometimes an A-B-C correction is called an X-wave. X-waves are used to discern sets of corrective patterns and are marked between corrective patterns in a complex formation. They can be composed of any corrective structure formation. The Rule of Alternation also applies to X-waves. When the first X-wave is a zigzag, the following X-wave will not be a zigzag; it will either be a triangle or a flat.

Figures 4.16

to

4.20

are examples of complex corrections.

FIGURE 4.16

An example of a complex correction.



FIGURE 4.17

Complex correction showing subdivision of waves.



FIGURE 4.18

Complex pattern of A-B-C corrective waves separated by an X-Wave.



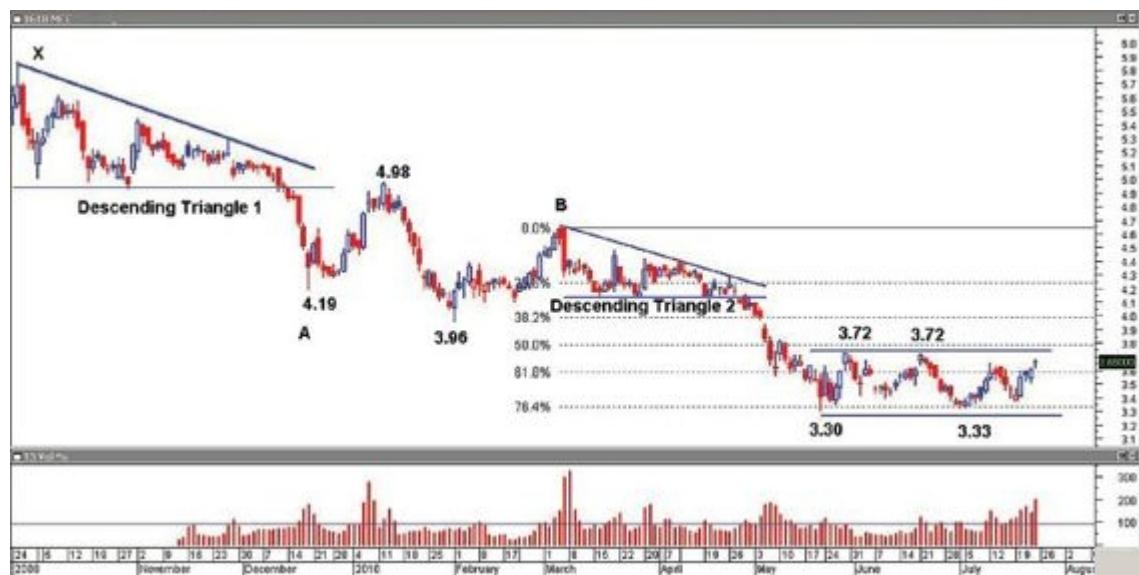
FIGURE 4.19

This is an interesting chart displaying two triangles in a trading zone. The first triangle (triangle points marked in black) is a converging triangle, and the second triangle (triangle points marked in red) is the reverse of the converging triangle, a broadening triangle.



FIGURE 4.20

Two descending triangles moving in a downtrend before finding support in a trading zone at approximately 78.6 percent of XA measured from the high of B.



Triangles

Triangles generally are corrective waves. Triangles are patterns occurring between or dividing two waves moving in the same direction: (1) between Wave 3 and Wave 5, or (2) between Wave A and Wave C. Triangle patterns are characterized by a contraction in price range and converging trend lines. Triangles are generally labeled alphabetically as "a," "b," "c," "d," and "e." The structure of a triangle is divided into five waves in which each wave is subdivided into three smaller waves, forming an a3-b3-c3-d3-e3 formation.

A triangle can occur in Wave 4, Wave B, and in X-waves. Triangle patterns consist of contracting, expanding, ascending, descending, and diagonal triangle patterns. While the shapes of the triangles matter, the directional price movement is of more importance when it breaks out of the triangle. Triangles can form as reversal patterns, but normally triangles are seen as continuation patterns of the previous trend.

Figures 4.19

to

4.25

are examples of triangle patterns.

FIGURE 4.21

Not all descending triangles point to a downtrend, as shown by this example. Be alert for unexpected movement.

432 COMPANION BU-Daily

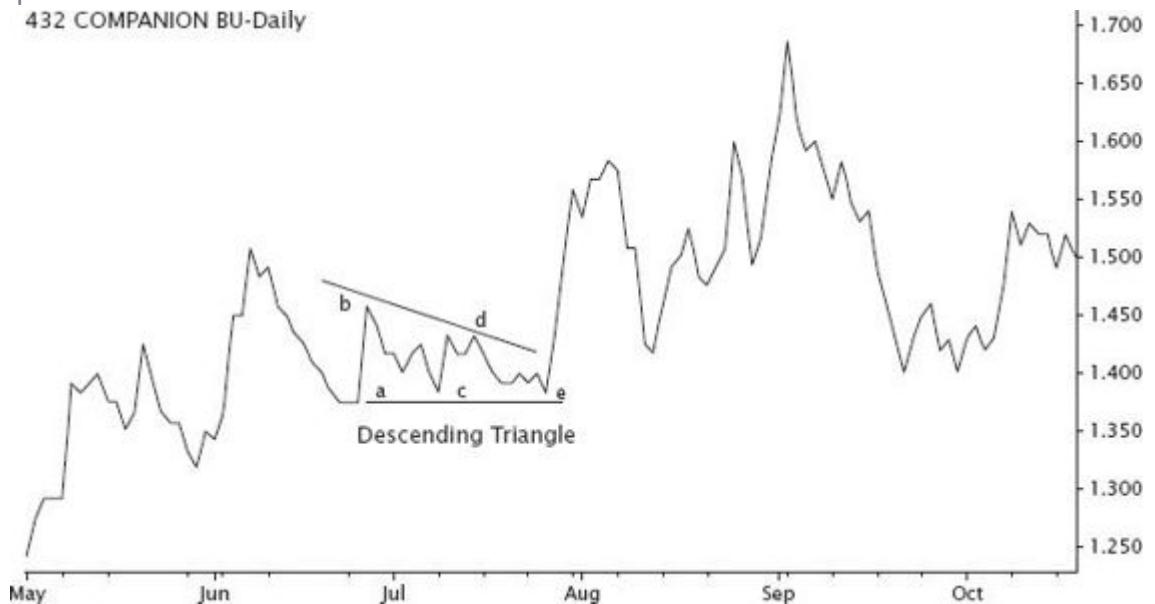


FIGURE 4.22

An expanding triangle occurs when there is heavy volatility in price movements.

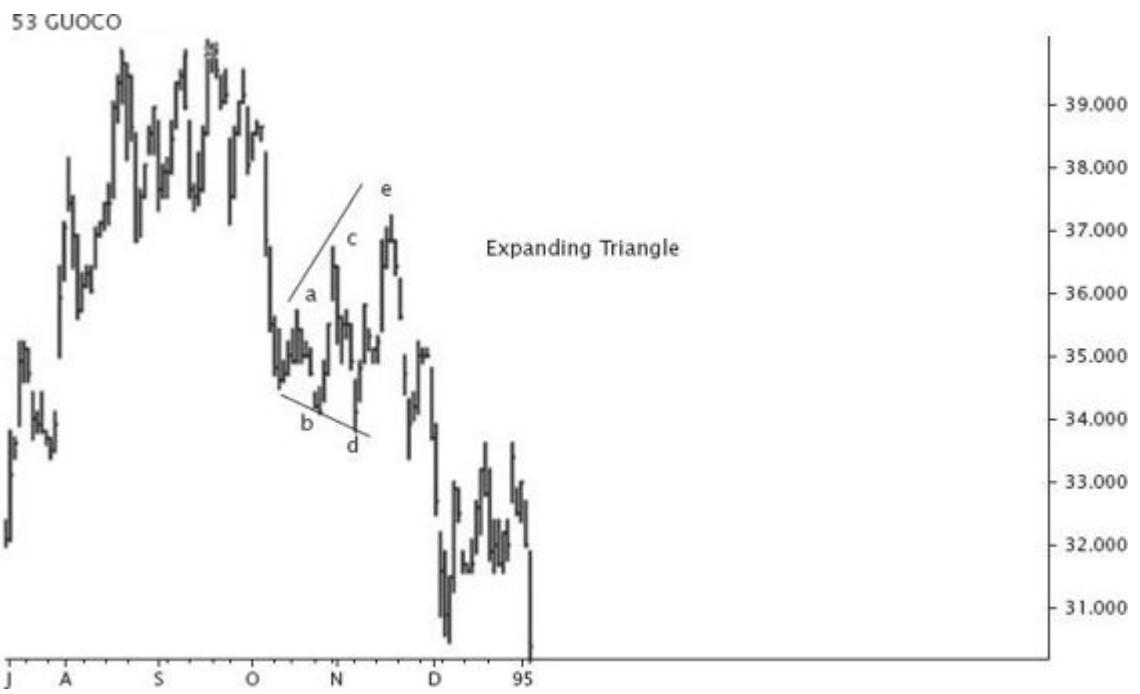


FIGURE 4.23

An expanding triangle in an uptrend.

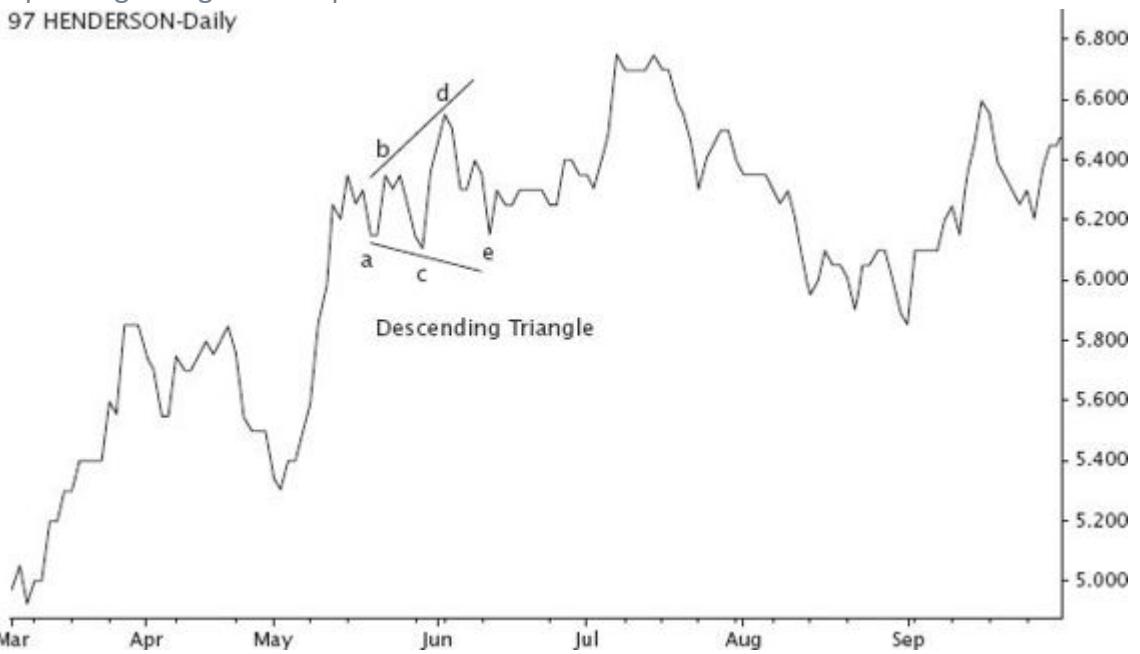


FIGURE 4.24

An ascending triangle that fails to stop the downtrend.



FIGURE 4.25

Patterns in stocks seem to repeat. This stock has three triangles. The first triangle is the start of the decline, the second triangle fails to hold off the bears as prices continue to decline, and the third triangle is a continuation triangle.



RULE OF ALTERNATION

The practicality of applying the Rule of Alternation is more useful when it relates to alternate waves rather than adjacent waves. In a five-wave structure, Wave 2 can be expected to alternate with Wave 4 in at least one of the following ways:

- Pattern of construction
- Time of formation
- Strength and depth of formation

When Wave 2's formation is a complex correction, Wave 4's formation can be anticipated to be simple. (See

Figure 4.26

.)

FIGURE 4.26

The Rule of Alternation says, if Wave 2 is a complex pattern, then Wave 4 should be a simple pattern. Here, Wave 4 is a simple corrective pattern.



When the formation of Wave 2 is a simple correction, Wave 4's formation can be anticipated to be a complex pattern. (See

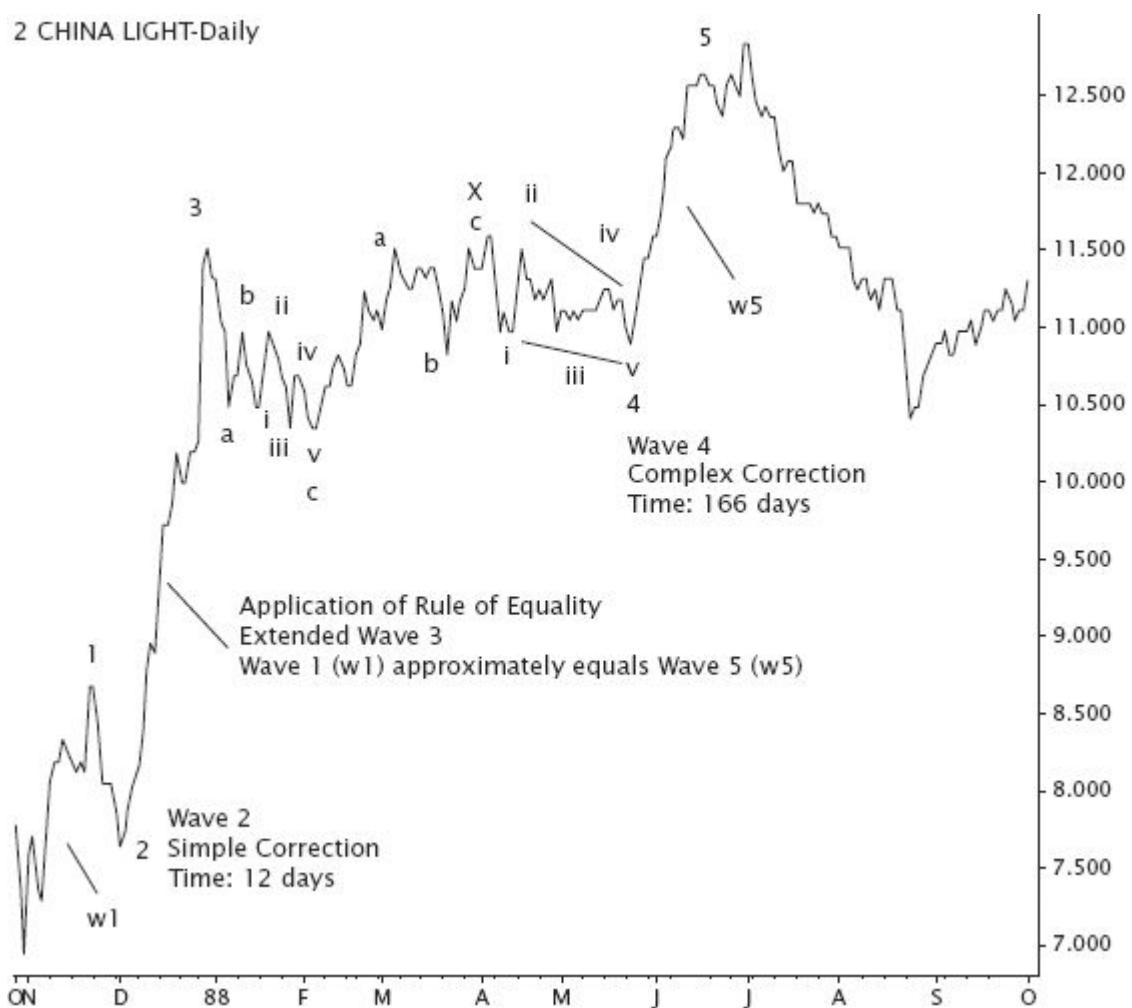
Figure 4.27

.)

FIGURE 4.27

This chart shows the Rule of Alternation. Wave 2 completes a simple correction in 12 days, but Wave 4 completes a complex correction in 166 days (138 percent of 12 days in Wave 2). Note that 138 percent is 100 percent plus 38 percent; and 38.2 is a Fibonacci number.

2 CHINA LIGHT-Daily



FIBONACCI RETRACEMENT AND PROJECTION

Support and resistance lines and projection lines are areas where prices are expected to meet probable buying support or selling pressure. At these crucial points, a continuing trend may come to either a temporary consolidation or a trend reversal.

In the MetaStock program, there are two utilities, Fibonacci Retracement and Fibonacci Projection, which can be very useful in identifying the levels of various movements of waves. Fibonacci Retracement will display a series of horizontal lines relative to the selected trough and peak of a trend line. You can add or remove levels as you wish. The horizontal lines will be useful to mark the likely retracement or rebound points. After a significant move, prices will often rebound or retrace to ratios of the original move at or near the Fibonacci Retracement levels, such as 23.6 percent, 38.2 percent, 50.0 percent, 61.8 percent, 78.6 percent, and so forth. Fibonacci Price Projection is very popular among traders, particularly those who practice Elliott Wave Theory. Generally, the 50 percent level tends to generate a field of gravity around it. After a long trend, price seems to easily retrace or rebound to the 50 percent level. It is a number that is worth remembering in trading.

Fibonacci Retracement is used to calculate the probable support or resistance areas of the current wave swing relative to its preceding swing. An example of calculating Wave B is to determine the Fibonacci Retracement Ratios from the length of the preceding Wave A. The probable target level of a corrective wave composing A-B-C is measured against its preceding impulse wave, 1-2-3-4-5.

Fibonacci Projection projects Wave C from the immediate waves of Wave A and Wave B. Wave C is often calculated at 61.8, 100, or 161.8 percent of Wave A, and 127 percent of Wave B. The areas where the various projected lines are clustered will be where stronger support and resistance levels are expected. We often wonder whether there is magic in these numbers as they harmonize with market moves, or they are made real because many traders are making decisions based on the same numbers. It does not matter what the reality is, as long as we know how to use the numbers fruitfully.

Figure 4.28

shows the Fibonacci Projection of Wave C by projecting the price swing of XA from the peak at B. The ratios used are 100, 161.8, 200, and 238.2 percent. The chart also shows the Fibonacci Retracement ratios of the rally to P from the low of C relative to the price swing of XC. For the Fibonacci Retracement ratios in the chart, only three ratios are used: 38.2, 50, and 61.8 percent.

FIGURE 4.28

Application of Fibonacci Retracement and Fibonacci Projection. Prices moved downward from X in three swings. Using Fibonacci Projection to plot the probable targets relative to the length of XA, four major ratios were used—100, 161.8, 200, and 238 percent. Prices finally held at 238 percent and made a strong rebound. Fibonacci Retracement was used to determine the probable resistance levels of the rally relative to the swing of XC—23.6, 38.2, 50, and 61.8 percent. Prices hit the resistance level at 61.8 percent.



Figure 4.29

shows the application of Fibonacci Retracement and Fibonacci Projection.

FIGURE 4.29

Prices moved from a low of \$3.35 to a high of \$7.87 (X) and started to retreat to the low of \$4.50 on May 23, 2011.



In

Figure 4.29

, plots of the ratios of retracement for the major swing (OX) from \$3.35 to \$7.87 are displayed by the Fibonacci Retracement to mark the probable support levels in the downswing. The ratios are 23.6, 38.2, 50, 61.8 percent, and 78.6 percent. Interestingly, at every first test of prices at these support levels, prices make a rebound. This chart provides excellent examples of symmetry of wave movements and application of Fibonacci ratios. The first example of the Fibonacci Projection is the projection from point Z on February 9, 2011, of the relative swing, X to Y. The resulting target levels are projected at 61.8, 100, and 161.8 percent, as shown on the chart. Of the three target levels, 61.8 and 161.8 percent closely match the OX retracement ratios; 61.8 percent projection ratio to 38.2 percent retracement ratio, and 161.8 percent projection ratio to 78.6 percent retracement ratio. The 100 percent projection ratio is in proximity to the 100 percent retracement ratio. Prices seem to hold when they hit these levels. The second example is the B Retracement of Y1 to Z1, which is an AB=CD pattern (YZ=Y1Z1) in

the chart). The ratios used are 61.8, 100, and 161.8 percent. When plotting these three ratios they often cluster closely to the 38.2, 50, and 61.8 percent of the major OX retracement levels.

Figure 4.30

is another example of the application of Fibonacci Projection and Fibonacci Retracement relating to wave analysis.

FIGURE 4.30

Application of Fibonacci Projection on an impulse wave pattern, 1-2-3-4-5, and subsequent application of Fibonacci Retracement of a correction, A-B-C.



In

Figure 4.30

, the stock demonstrates a five-wave impulse structure that is followed by an A-B-C correction. Prices break out from a line formation from a low of 40 cents to \$1.07 on July 25, 2007 at Wave 1 with steady volume. The stock retreats to 60 cents at Wave 2. Volume increases slightly at the end of Wave 2 and on September 17, volume suddenly spikes up, which is more than triple the 10-day moving average volume. Prices also spike up sharply beyond Wave 1, reaching a high of \$1.52 at Wave 3. At Wave 3, which is about 138.2 percent of Wave 1 measured from Wave 2, a strong force of resistance blocks the powerful thrust. The stock went into a consolidation period for about 30 days and reached a low of \$1.18 on November 2 to form Wave 4. And on January 12 the price spikes up with increased volume for another sharp rally to \$1.86 on November 19, 2007 at Wave 5. The target of Wave 5 is \$1.87, calculated at 61.8 percent of the distance from the start of Wave 1 to the end of Wave 3 (\$1.52–\$0.40) measured from \$1.18 of Wave 4.

After completion of the five impulse waves, prices start to weaken into the formation of an A-B-C correction. The projection of the decline is calculated as follows:

Projection using Wave A and Wave B

1.618 of Wave A measured from Wave B

2.382 of Wave A measured from Wave B

Projection using Wave B

1.62 of Wave B measured from Wave B

2.62 of Wave B measured from Wave B

APPLICATION OF ELLIOTT WAVE ANALYSIS

The Elliott Wave Principle enables traders to formulate a suitable trading strategy as the market progresses. It provides a tool to effectively monitor the position of the market relative to the trend and the probable target of the market's movements.

The wave principle works better if it is applied to market averages and blue-chip stocks that are supported by active turnover. Generally, it is not practical to apply wave analysis to thinly traded stocks or penny stocks if such stocks have no transactions or supporting volume. When turnover starts to dwindle to practically zero and prices stay dormant for weeks, there is no possible way to do any counting because no transactions are being done and there will only be a horizontal line. It is not practical to get bogged down in detailing every small wave or in pinpointing each of the corrective counts. It is a common mistake to try to count every move, which not only overcomplicates the matter, but may lead to deep confusion.

When reviewing the count of waves, count the broadest swings first. If the counts total 5, 9, or 13, the pattern is an impulse wave pattern. Then dissect the waves to see if a fit can be made. If the broad swings total 3, 7, or 11, the pattern is a corrective wave pattern.

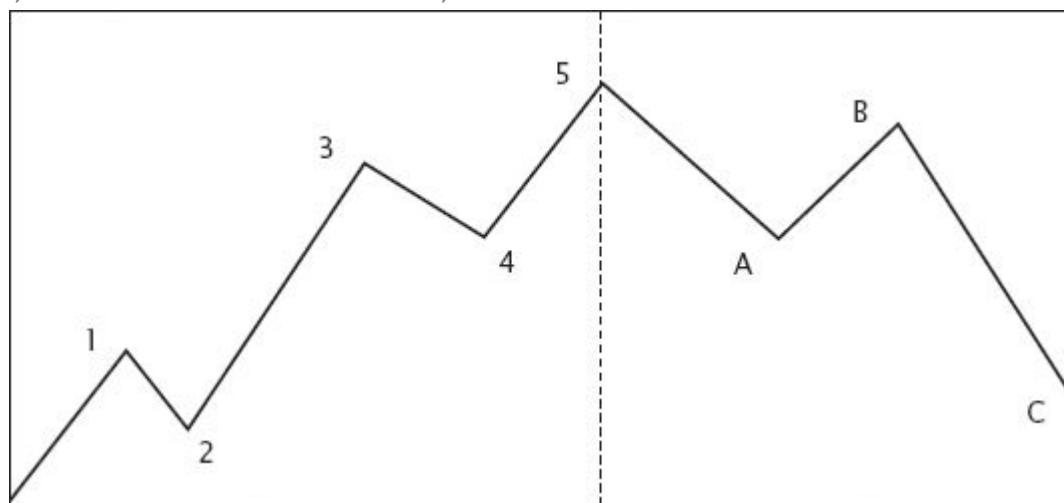
An Elliott Wave pattern is easier to understand if seen as a set comprising an impulse swing of five waves and a corrective swing of three waves. Each pattern can be a part of another cycle or can form part of an expanded cycle.

Figure 4.31

shows the basic pattern.

FIGURE 4.31

A rudimentary cycle pattern of Elliott Waves, comprising an impulse pattern of five waves, 1-2-3-4-5, and an A-B-C correction running counter to the impulse waves. In the impulse pattern, there are two corrections, or countertrend waves, Wave 2 and Wave 4, and in the correction pattern, there is one countertrend wave, Wave B.



Wave analysis often becomes complicated when it comes to analyzing the corrective patterns of Wave 2, Wave 4, or Wave B, especially if such patterns are of a complex nature, consisting of more than three waves. The difficulty arises in determining whether the market is in a trend or in a corrective mode, and whether the corrections are completed.

There is a guideline generally used to determine when a market is making a correction. If the market is making an A-B-C correction, prices will often make attempts to overlap the prior

section as illustrated in

Figure 4.32

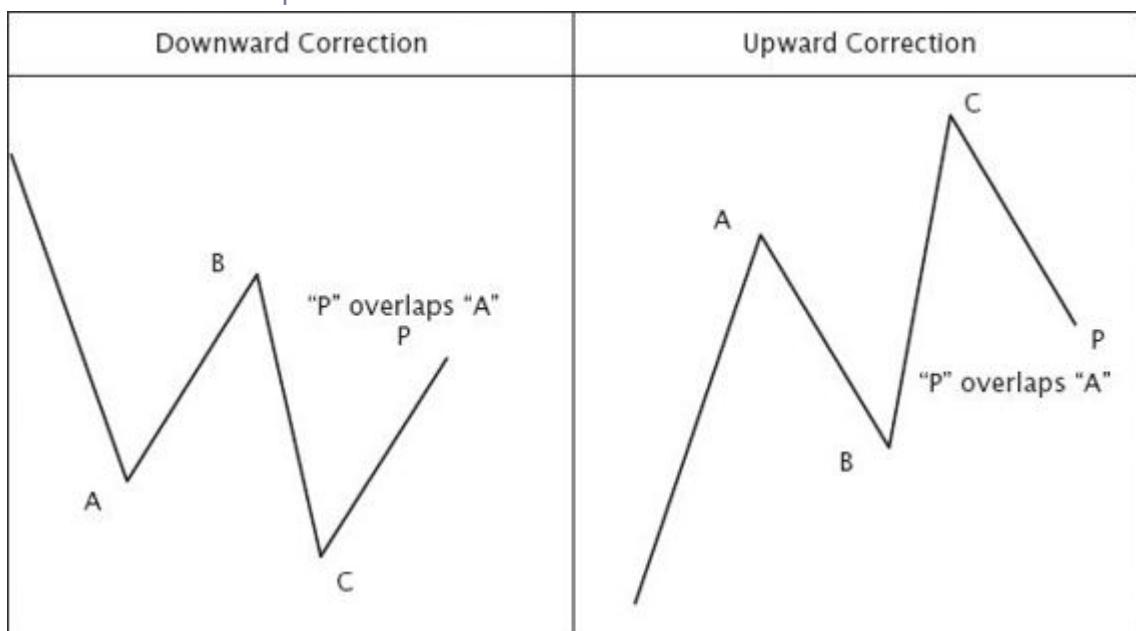
. Prices move to new levels beyond A and retrace their movements to overlap into the prior range of Wave A. If prices move beyond the extreme of Wave B, that will be a confirmation that the correction should be complete and prices should continue their prior trend. As corrections are countertrends, the prior trend in a downward correction will be an upward trend, and in an upward correction, the prior trend will continue in a downward trend. (See

Figure 4.32

.)

FIGURE 4.32

Two typical A-B-C corrective patterns. In a downward correction, prices make a new low below Wave A and then reverse their movement upward to overlap into the range of Wave A. In an upward correction, prices make a new high above Wave A and then make a downturn to overlap into the range of Wave A. If prices move beyond the extreme of Wave B, it indicates the correction should be complete.



The overlap guideline is a valuable clue to identifying price direction. It enables a trader to identify when the market is in a corrective phase, and combined with other trading tools, it may help plan a trading strategy so that when the correction is complete and the trend resumes, the trader is ready to enter the market. We would want to be in a trade when there is a trend. Coupled with the application of Fibonacci Retracement and Fibonacci Projection, the guideline should give a good indication of the levels at which prices will find support and resistance, and where trade entries and exits could be considered.

CONCLUSION

The basic tenet of Elliott Wave Theory is that market movements are based on crowd behavior. Market movements occur as a series of impulse and corrective waves, and these movements can occur in predictable cycles. A bullish swing will be corrected by a bearish swing. The bullish swing will consist of five waves, three waves up and two waves down, and the bearish swing will consist of three waves, two waves down and one wave up. The sum of the waves in the entire cycle will be eight waves. Impulse waves refer to the waves in the bullish swing, and are numbered as 1, 2, 3, 4, and 5. And corrective waves refer to the waves in the bearish swing, and are numbered as A, B, and C. Impulse waves are waves that move in the direction of the main trend, and corrective waves are waves that move in the opposite direction of the main trend. Impulse waves can be further broken down into another set of minor impulse waves, and likewise, corrective waves can be further broken down into another set of minor corrective waves. The cycle can be repeated as it expands or contracts in accordance with different time frames. All such impulse and corrective waves adhere to the rules of the theory.

Elliott Wave Theory can be used effectively when applied, as described in this chapter, to a suitable trading strategy in which risk can be minimized. One difficulty is in identifying the count, and recognizing whether waves are impulse waves or corrective waves. Another problem is in determining which phase of the market the prices are moving in according to the theory, in order to predict the next probable direction and target. Counting every wave can be subjective, but if the trader can identify the direction of the primary wave, he can still make a profitable trade. Here are several guidelines that may help traders to count the waves.

The first guideline is for getting the counts right. Getting the right count may be made more difficult by a complex structure comprised of impulse waves and corrective waves of major waves, minute waves, and subwaves, and so on. Traders, therefore, should try to identify the counts on a best-effort basis. Traders should avoid getting bogged down in trying to identify every exact count and being too concerned about getting the wrong count. Wave counting has a high degree of subjectivity. The best approach to wave counting is to determine the primary count so as to get the bigger picture. Doing a wave count of the longer time frame, that is, weekly, is a good way to find out the state of the market. This will protect the trader's position even if he gets the count wrong in the daily time frame.

The second guideline is for locating trades that have less risk in accordance with the primary trend, and avoiding trades that have greater risk. For example, picking trades at the end of the fifth impulse wave or the beginning of a corrective Wave C can lead to huge losses.

The third guideline is for learning to differentiate impulse waves from corrective waves. Corrective waves frequently tend to overlap. In an A-B-C correction, Wave C will exceed the low of Wave A, and when Wave C moves back into the range of Wave A, it has made an overlap movement. When Wave C rallies beyond the peak of Wave B, the correction is deemed completed. In an impulse wave pattern, Wave 1, Wave 3, and Wave 5 should not overlap each other and should comply with these three rules:

1. Wave 2 cannot go below the beginning of impulse Wave 1.
2. Wave 3 cannot be the shortest wave of the three waves.
3. Wave 4 should not overlap impulse Wave 1.

If Wave 2 goes below Wave 1, then the uptrend is invalidated. And if the retracement of Wave 4 overlaps Wave 1, it also violates the rules of the impulse waves. Wave 3 can be equal to

Wave 1, or Wave 3 can be equal to Wave 5, but Wave 3 cannot be the shortest of the three waves. This rule is probably derived from the observation that, in a strong market move, the second upward wave (Impulse Wave 3) appears frequently to be the strongest of the three waves. But when Wave 1 is extended in a strong trend, Wave 3 will equate with Wave 5. And also when Wave 5 is extended in a strong trend, Wave 3 will equate with Wave 1. The understanding of these rules will help to distinguish trending waves from corrective waves.

The fourth guideline is for checking the slopes of the three impulse waves (Wave 1, 3, and 5). They will generally be steeper than the slopes of the corrective waves (Wave 2 and 4). In a bearish reversal of a major market correction, A-B-C, the slopes of Wave A and Wave C will be steeper than that of Wave B. In their steep declines, Wave A and Wave C will also show strong impulse waves and Wave C will be the strongest of the three waves in the corrective waves. To distinguish the impulse waves from the corrective waves, it is helpful to look at the slope of the relative waves.

The fifth guideline is for looking at the overbought or oversold values of the Elliott Wave Oscillator (EWO), which is popularly used to check Wave 4. EWO is a 34-period price moving average subtracted from the 5-day price moving average. The difference is plotted as a histogram. The concept of EWO is that the highest/lowest point of the oscillator is related to the bullish/bearish Wave 3 of the swing. When price is in an upswing, Wave 3 should be reflected by the highest point of the oscillator, and when price is in a downswing, Wave 3 should be reflected by the lowest point of the oscillator. The correction of Wave 4 should be over when Wave 4 crosses above the zero line in an upswing, and the correction of Wave 4 should be over when Wave 4 crosses below the zero line in a downswing.

Lastly, in an impulse wave pattern, the patterns in Wave 2 and Wave 4 will alternate. That is, if Wave 2 has a simple pattern, then Wave 4 will probably have a complex pattern. This knowledge will help traders to locate Wave 2 and Wave 4. In Wave 1, Wave 2 should be greater in time and price than any correction within Wave 1. In Wave 3, Wave 4 will also be greater in time and price than any correction within Wave 3.

Since the publication of the Elliott Wave Theory in 1938, research and development of the theory has continued. The theory has also been expanded by the development of computerized programs that count the waves based on interrelated Fibonacci ratios. For example, it has been learned that both Wave 5 and Wave C can end in a diagonal triangle pattern or in an expanding triangle pattern. Whether or not a computerized count can do the job, the aim of the trader in using Elliott Wave Theory is find those waves that work best for him in his trading strategy.

APPENDIX: RATIOS AND WAVE RELATIONSHIP

The following are popular Fibonacci ratios applied to a five-wave structure, listed here for easy reference:

Fibonacci Ratios	Wave Relationship
0.382	(1) Correction of Wave 2 to Wave 1
	(2) Correction of Wave 4 to Wave 3
0.618	(1) Correction of Wave 2 to Wave 1
	(2) Correction of Wave 4 to Wave 3
	(3) Projection of Wave 3 if Wave 1 is extended
	(4) Projection of Wave 5 on the distance from the beginning of Wave 1 to Wave 3
0.786	(1) Correction of Wave 2 to Wave 1
	(2) A-B-C correction of five-wave structure
1.000	(1) Projection of Wave 3 to Wave 1
	(2) Projection of Wave 5 (non-extended), which is equal to the non-extended wave of either Wave 1 or Wave 3
1.618	(1) Projection of Wave 3 to Wave 1 if Wave 1 is non-extended
	(2) Projection of extended Wave 5 on the distance from the beginning of Wave 1 to Wave 3
2.618	(1) Projection of extended Wave 3 if Wave 1 is not extended

The following are popular Fibonacci Ratios applied to a three-wave structure:

Fibonacci Ratios	Wave Relationship
0.382	(1) Retracement of Wave B to Wave A in a zigzag
	(2) Retracement of Wave C to Wave A in a zigzag
0.500	(1) Retracement of Wave B to Wave A in a zigzag
0.618	(1) Retracement of Wave B to Wave A in a zigzag
	(2) Retracement of Wave C to Wave A in a zigzag
	(3) Projection of Wave C to Wave A in a flat or irregular flat

1.000	(1) Projection of Wave C to Wave A in a zigzag
	(2) Projection of Wave C to Wave A in a flat or irregular flat
	(3) Retracement of Wave B to Wave A in a flat
1.618	(1) Projection of Wave C to Wave A in a zigzag
	(2) Projection of Wave C to Wave A in a flat
2.618	(1) Projection of Wave C to Wave A in either a zigzag or an elongated flat

CHAPTER 5

Volume

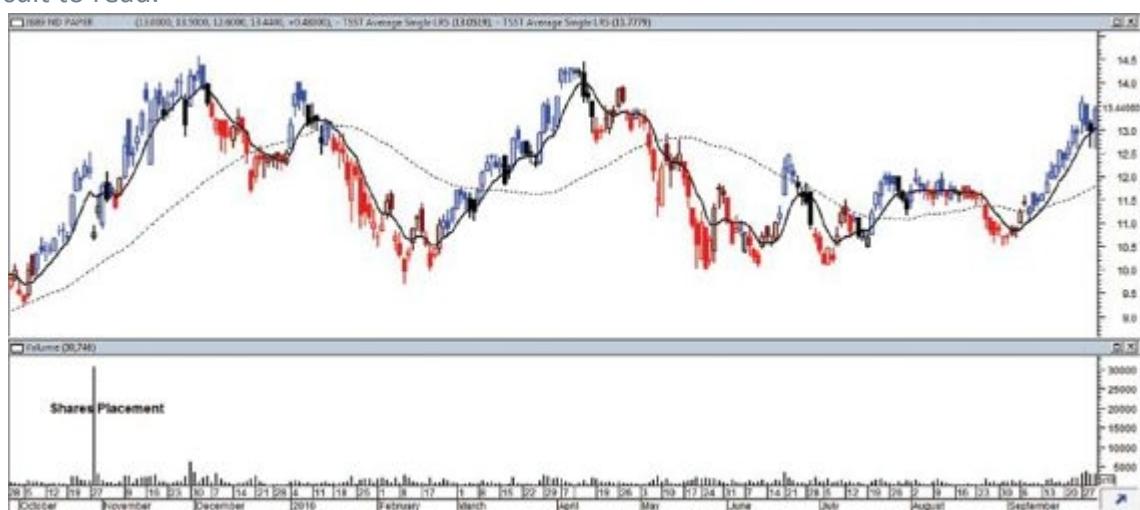
Volume represents the number of stocks transacted between buyers and sellers during a specified period, as shown in

Figure 5.1

. The period may be one day, one week, or one hour. The specified length of the period depends on the analyst. If we wish to arrive at a short-term view of the market, the price and volume should be analyzed daily or even hourly. On the other hand, a longer-term analysis would require a longer time frame. To determine the trend of volume, a running record should be maintained to compare the daily volume with previous figures. However, there is no standard rule as to the requisite number of days that should be used. Volume is generally plotted as a histogram below the corresponding price action.

FIGURE 5.1

The daily volume of the stock is shown in the bottom window. Note the huge placement of shares in October 2009, which suppresses the scale of the rest of the daily plots, making them difficult to read.

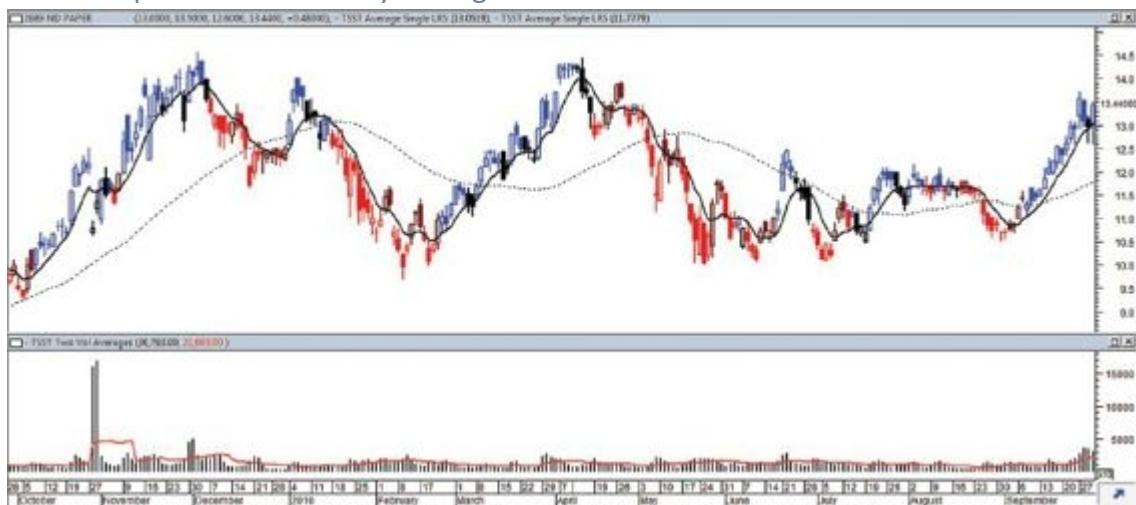


BASIC VOLUME PLOTS

One approach to determining the volume trend is to plot two average lines of volume, a fast and a slow-moving average. This has the advantage of showing a potential change in trend when the fast average line crosses above the slow average line. (See [Figure 5.2](#).)

FIGURE 5.2

The histogram bars of the volume in the lower window are plots of the 2-day average, while the red line represents the 10-day average.

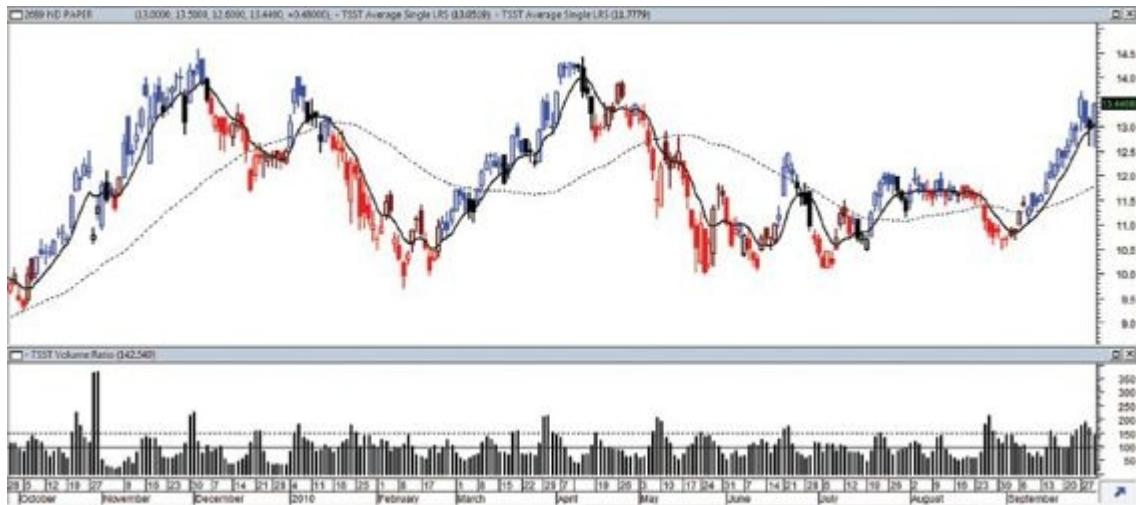


Another method is to plot a comparison of the longer-term average to a shorter-term average by percentage, as shown in

[Figure 5.3](#)

FIGURE 5.3

The volume is plotted as a percentage ratio between its 2-day average and 10-day average.



READING VOLUME

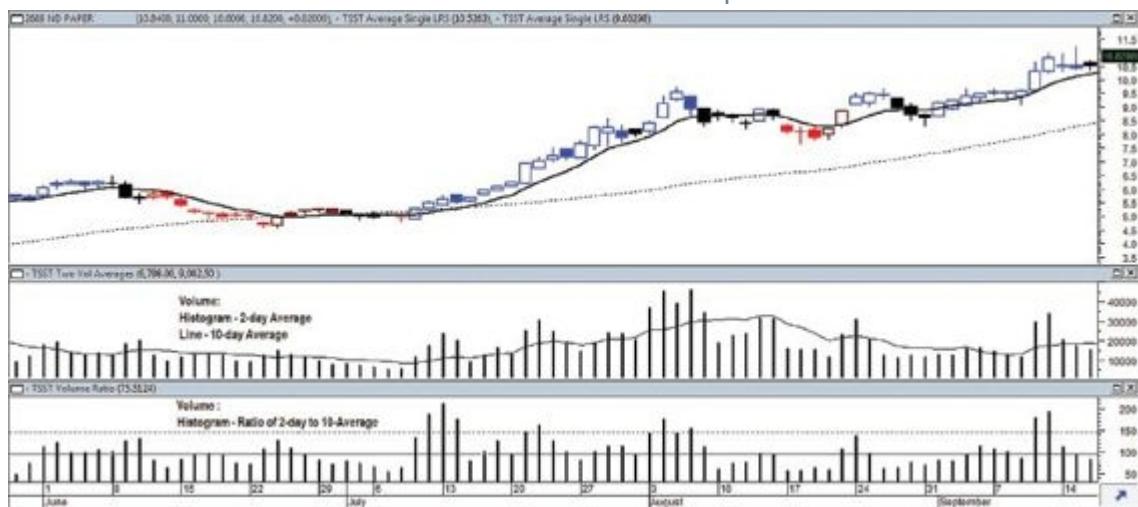
Volume is not always easily deciphered. Is the market trying to tell us something when an exceptionally low volume occurs in a single day, or when an exceptionally high volume was transacted recently? A single volume bar by itself will not be meaningful. Volume is always analyzed in conjunction with the price movement of a stock as it develops with the market's changing activity. Volume is the key to evaluating price directional movement and shows the market's ability to facilitate trade. It serves as a gauge of the strength of market development and shows when such money-flow is either increasing or slowing down.

Under normal market conditions, volume tends to expand and contract with the price trend; the movement of price and volume should be similar progression. During the upward price movement, volume should expand; and during the downward price movement, volume should contract. We use volume to assess the strength and health of the prevailing trend. The specific number of a single volume bar is not important and the interpretation of volume should not be based only on a single daily bar. Volume should be studied in perspective with its recent action. Volume as an indicator will often be more meaningful when average volume is used (see

Figure 5.4
).

FIGURE 5.4

The middle window shows the plots of the 2-day and 10-day averages. The bottom window shows the plots of the percentage ratio of the 2-day and 10-day averages. Notice that the expansion and contraction of volume move in line with the price trend.



The use of volume as an indicator is more reliable when it refers to heavy turnover stocks. Volume of secondary securities with little or no trading volume will not provide reliable clues. Volume is the indicator of the market's ability to facilitate trade. Even in a bullish market, if volume is decreasing, then the likelihood of a continuing uptrend is in question. A market that is not facilitating trade will not survive for long.

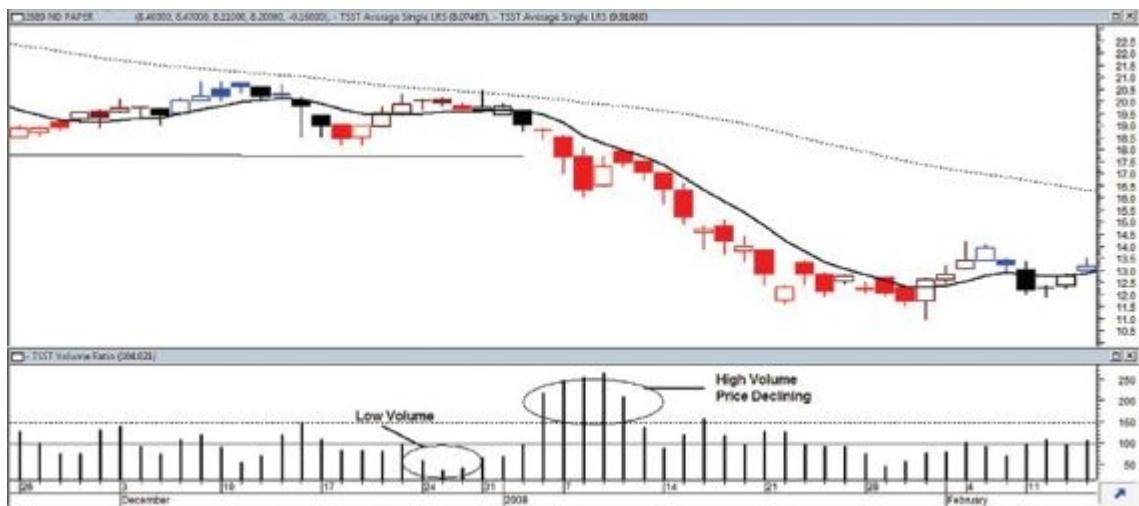
Volume is a combination of activity by buyers and sellers. Thus, all markets tend to seek to trade at an accepted price level that maximizes volume. If a market is not allowing trade at such price level, it will seek a new level that will provide better trading. Thus, if the price movement is relatively static and volume continues to decline, the chances are that the market will break out of that region in search of new activity. (See

Figure 5.5

.)

FIGURE 5.5

Prices try to make a second thrust toward the 50-day average line but the attempt is not supported by sufficient volume. Instead, prices break the support line accompanied by heavy volume.



Market change offers both risk and opportunity. The important point is to identify market change as it is developing. By using volume as an added tool, a trader can anticipate market behavior in the early stages of change. When movements of volume and price are not progressing in similar order, it warns of a probable change of trend. The firmness of the stock trend is expected to weaken when advancing price is accompanied by diminishing volume, as decreasing volume indicates a rejection of higher prices. And when declining price is accompanied by a trend in increased volume, it indicates an overhang of selling pressure. The trend is expected to be strong when advancing price is accompanied by a trend in increasing volume. Often, a low point in volume indicates a quiet market or an imminent turning point in the market. If the volume trend does not expand while the price trend is rising, it is an indication that the price movement is approaching a resistance level. As long as the volume trend continues to expand with the upward price trend, it can be assumed that further advances in prices are likely.

Normally, volume will diminish in a declining market and expand in an advancing market. In Elliott's wave principle, volume pattern at Wave 2 will be less than that of Wave 1, and volume at Wave 4 will be less than that of Wave 3. Volume of Wave 3 will be higher than volume at Wave 1. Volume at Wave 5 can be lower than that of Wave 3, indicating the termination of the overall wave movement. If the volume at Wave 5 is greater than that of Wave 3, it indicates that Wave 5 will likely be extended.

Figure 5.6

and

Figure 5.7

show examples of the relationship between the volume patterns and price movements.

FIGURE 5.7

Price breaks upward from a line formation with increasing volume.

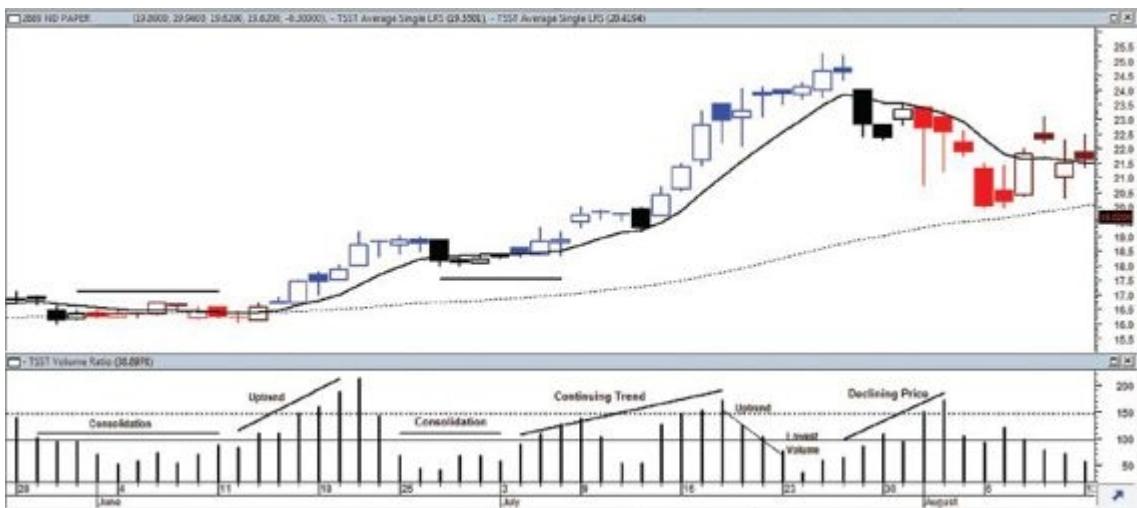


FIGURE 5.6

This chart shows the support of volume at every rally of the price until the final phase when it gives an early warning of trend weakness with declining volume. Prices begin to trade narrowly in a sideway market with low volume. A reversal of the uptrend finally occurs when prices dip downward with increasing volume.



Volume increases as the price rallies and decreases as the price pulls back into a consolidation pattern. When the price breaks upward away from its consolidation, buyers start buying heavily, as indicated by the increase in volume. When volume starts to decline as price continues its upward move, it gives a warning that a topping of the price is near. When price breaks downward with increasing volume, it signals the end of the upward price trend.

Volume is useful to confirm whether a current move is likely to continue or is merely a false start. In general, most market participants are bullish and are aggressive buyers. The stock market is an active battleground where a constant battle is going on between the buyers and sellers. Volume analysis may often provide clues as to who is gaining the upper hand.

MONEY-FLOW INDICATOR

Besides plotting the volume data to monitor the correlation of price and volume, nowadays, with the ease of computers, various oscillators have been developed to quantify the relationship between price and volume. These indicators are generally called money-flow indicators. There are many of them. The main purpose of price volume indicators is to segregate the total volume into positive volume and negative volume, which may reveal a new condition of the market when derived from certain calculations with the price. A money-flow indicator can be used as a stand-alone indicator, but it is better to combine it with another price-derivative trading system.

Figure 5.8

shows a simple money-flow indicator called volume zone oscillator (VZO). VZO is easy to understand.

FIGURE 5.8

Volume zone oscillator shows a drastic drop on the day of the announcement of a substantial placing of stocks, which causes the price to open with a downward gap. However, prices subsequently recover and rally back to the previous high.



VZO was developed by Walid Khalil and David Steckler. Details of the indicator and how to use it are stated in the May 2011 issue of *Technical Analysis of Stocks & Commodities* magazine and in the *IFTA Journal*, 2008 edition. The original formula, together with its proposed trading method, is also described in the articles.

Certain modifications have been made to VZO as it is shown in the example, including the addition of the scale factor to allow the plotting of daily percentage change of moving average volume. This allows readers to understand the relationship of volume and the concept of positive volume as represented by VZO. VZO is positive when the closing price is greater than the previous closing price. A moving average line is also added to let readers see the bigger picture of the money-flow trend. Readers may remove the plot of the daily percentage change of moving average volume when they are familiar with the overall concept.

Reading VZO is just like reading any momentum oscillator. Its main functions include signals for trade entries and exits. The indicator is basically divided into four zones. The market is positive when VZO stays above the 50 percent level and negative when it is below 50 percent. When the market is trending positively, the indicator will fluctuate between 50 and 70 percent,

the bullish zone. And when the market is trending negatively, it will fluctuate between 50 and 30 percent, the bearish zone. In a trading market, VZO will generally move between its 30 and 70 percent lines. The market is deemed to be overbought when it is above 70 percent, and in an extreme overbought condition when it is above 80 percent. On the contrary, the market is deemed to be oversold when it is below 30 percent, and in an extreme oversold condition when it is below 20 percent. Signs of weakness or strength in the market are sometimes reflected in the divergence between the indicators and price movements.

The horizontal percentage lines serve as the signal lines. When VZO crosses from below the 30 percent line to above, a trade entry is indicated, and when VZO crosses from above the 70 percent line to below, an exit entry is indicated. When the VZO moving from below crosses the 50 percent line, it also indicates an entry signal. But when VZO declines from above the 50 percent line and reenters to cross above the 50 percent line again, a buffer line of 57.5 percent may be used as a safeguard to protect from a whipsaw signal.

Traders must always look at price patterns and their related volume patterns together. In this case, VZO is plotting the flow of positive volume. The plot should stay positive in a strong market that is above 50 and negative in a weak market that is below 50.

DECIPHERING TREND WITH VOLUME

A trend directional system, shown in the middle window of Figure 5.9

, may also be incorporated into the volume indicator. The lower window shows just the percentage plot of the volume indicator without the trend indicator. When the trend is weak, the color histogram of the volume plot is red, and it is blue when the trend is strong. A tall red histogram generally at the halfway point of the decline would indicate bearishness in the market, and a tall blue histogram would indicate bullishness.

FIGURE 5.9

The difference in the plots of a volume indicator. The lower window shows the normal plot of a percentage volume indicator and the middle window shows addition of a trend system to the volume indicator.



The formula for computing an indicator combining volume and trend in TradeStation format is as follows:

{Parameters Input}

Input: VolLength1(2), VolLength2(10), Percent(200), ShowTrendMarker(True);

{Input of variables}

Vars:BarColor(0), SMA(0), WMA(0);

{Input volume indicator criteria here}

If CurrentBar>1 then begin

Value10=XAverage(Volume,VolLength1);

Value20=Average(Volume,VolLength2);

If Value20<>0 then Value30=100*(Value10/Value20)

```

else Value30=0;
end;

{Input your system conditions here}

If CurrentBar>1 then begin

SMA=T3(Close, 5);

WMA=T3(TypicalPrice,9);

If SMA > WMA then

BarColor=Blue else

If SMA <= WMA then

BarColor=Red else

BarColor=DarkGreen;

End;

{Input plots here: true/false}

If ShowTrendMarker then begin

Plot1(Value30,"Volume",BarColor);

Plot2(100,"100 Percent");

Plot3(Percent,"Volume Limit");

End;

```

Note: T3 moving average was developed by Tim Tillson. It is a smoothing technique that is intended to produce better signals. The function in an EasyLanguage version of the formula is described in the January 1998 issue of *Technical Analysis of Stocks & Commodities* magazine.

CONCLUSION

The aim of this chapter is to show traders the importance of understanding volume in technical analysis and how volume can be used to identify the change in trend. When volume is used in conjunction with other supporting indicators, the probability of picking a winning trade is increased. Price represents the consensus value in a transaction between the buyer and seller, and volume represents the financial commitment. In short, volume is the liquidity of the market, without which the market is stagnant. And so, volume is deemed to be the driving force of price movements. Generally, a rising price trend has to be supported by a positive volume trend. When volume fails to support the continuing rising price, it signals a weakening of the rising price trend. On the other hand, when the price is declining with increasing volume, it confirms the continuity of the bearish outlook. A market is healthy when the trends of both volume and prices are moving in tandem. But when the movement of price starts to diverge with the volume trend, the continuation of the prevailing market trend is in doubt. For example, when a price, trading in a narrow range, fails to continue its rising trend despite heavy volume, traders should take note as the price may have reached a strong resistance level. And in reverse, traders should also exercise caution when heavy volume cannot push the price any lower and price continues to hold its trading in narrow ranges; it may indicate the price has reached a strong support level. When price spikes up with unconvincing volume, the price spike is usually short-lived. But when the price spikes up on heavy volume, traders should pay attention to a probable change in trend, and look for confirmation from other indicators. In summary, the importance of volume should not be overlooked as it often presages price direction.

CHAPTER 6

Key Indicators

Price is the only key that leads the direction of trend. There is nothing on a chart that matters more than price.

Data of daily transactions of prices are generally reported with information of the price range consisting of open-high-low-close, volume, and turnover of shares. The information is then used as the basis for calculating indicators.

All indicators in technical analysis are mathematical attempts to predict the future trend of stock prices based on historical data. Indicators are used as added value to the analysis of price movements to form buying and selling decisions. Indicators are not indubitable and should only be used as handy tools. In calculating indicators, it is important to ensure that price data are adjusted accordingly if there are changes to the company's equities as a result of schemes of arrangements, rights issues, or bonus issues. It is also necessary to make adjustments to the data when trading in the shares is suspended. Such suspension may last from one day to several months. If the price data are not adjusted, especially when trading in the shares is suspended for a long period, it is not advisable to do any wave count or any reading of the indicators or patterns following the resumption of trading.

Figures 6.1

and

6.2

show two charts of a stock whose shares have been suspended for trading. Note the differences in the patterns of price and indicators before and after adjustments of the price data due to the suspension of trading.

FIGURE 6.1

Trading in the shares was suspended for 28 days, represented by a flat dotted line. The red line represents the 50-day moving average. The lower windows are the 14-day RSI and volume. The drawing of a trend line is meaningless, as it has been distorted by the suspension period. Compare this chart to

Figure 6.2

.



FIGURE 6.2

Data and indicators adjusted for the suspension on trading in the shares. Patterns of price, indicators, and volume are showing the true trend, and the drawing of the trend line is reliable now.



A good chart layout should facilitate meaningful reading of price movements. The layout should not be crowded with too many indicators. It should have informative indicators that tell the different aspects of the market, such as a trend indicator to show the probable direction of the trend, a momentum indicator to measure the speed at which price is changing, and a volume indicator to measure the stock activities. On no account should the layout have similar types of indicators, whose functions are of the same nature and parameters.

Oscillators are indicators that are constructed so that the results are plotted between positive and negative levels, in which case the centerline is 0. If a plot fluctuates within a range of 0 to 100, the centerline is 50.

Oscillators are useful in identifying overbought and oversold conditions of the market, and in divulging divergence of directional movements between oscillators and prices. When the oscillator is above the centerline, the interpretation is positive, and when it is below the centerline, it is negative. When the oscillator is positive and shows readings in the upper positive range, it suggests that the market is overbought and is due for a correction. On the

other hand, when the oscillator is negative and shows readings at the bottom of the negative range, it suggests an oversold market that is due for a rebound.

An alert to sell is triggered when the market is overbought, and when the market is oversold, traders should be prepared to buy. This does not mean that one should rush to buy when the market shows the first sign of being in an oversold condition, or to sell when the market is overbought. The reason is simple. When a market enters initially into either overbought or oversold conditions, it may continue to remain in such conditions for some time. The market can even become more overbought or more oversold before making a definitive reversal. Therefore, it is necessary to keep an eye on the weakening of price when in overbought condition, and the strengthening of price when in oversold condition. When the oscillator breaks out from its overbought or oversold levels, it is important to ensure that the breakout of the oscillator corresponds with the directional movement of the price. This will help traders avoid getting caught in a false breakout of the oscillator. Sometimes, the oscillator attempts to break out early from its overbought or oversold levels, only to reverse immediately to its former levels.

When using more than one oscillator, it is important to make sure that the parameters of each oscillator are different. A common error is to unknowingly plot various oscillators on the same chart with the same parameters, particularly the use of closing price for all oscillators. This is tantamount to multiple counting of the same information. As a result, the readings generated by each of the oscillators tend to be similar. A better way is to choose different types of oscillators to complement the trading systems, and use different approaches to analyze the directional movement of the market. It will not serve any useful purpose if the oscillators are repeating the same criteria.

MOMENTUM OSCILLATOR

Momentum is perhaps one of the easier oscillators to understand. It measures the speed of price changes. The *Longman Dictionary of Contemporary English* defines momentum as “the force gained by the movement or development of events.” In technical analysis, momentum is a technique of comparing prices at different times.

A price rise, or a price decline, from one day to the next day, is described as a one-day momentum. That is, today's momentum is today's close minus yesterday's close.

A 10-day momentum means the comparison of today's price to the price 10 days ago: *Price [today] less Price [previous 10-day]*. If today's price is greater than the price 10 days ago, it will be a positive momentum, and if today's price is less than the price 10 days ago, it will be a negative momentum. Momentum is also known as the rate of change of price.

Momentum oscillators include popular classics like Appel's MACD Histogram, Stochastic, Wilder's Relative Strength Index, and Williams %R. Momentum is useful in identifying early trend direction. Momentum has one powerful trait; it tracks how fast the price trend is moving, and gains or losses of speed. Unfortunately, momentum is sometimes not easy to identify because price and momentum do not always move in tandem.

If the price increases on a rally, the momentum becomes positive and rises with the price. However, when the price gets closer to its imminent peak or goes into a bracket market, the continuing rally in price will slow down its speed, which will then cause a change in the direction of the momentum. Momentum direction will decline instead. From this, we can make two simple and powerful observations: (1) momentum's trend will not always be in the direction of the price trend; and (2) momentum's oscillators do not represent price trends. From these two observations, it can be surmised that reversal of momentum will not necessarily coincide with a price reversal.

Momentum oscillator is useful in depicting divergence of trend slope between the price and the oscillator. A bearish divergence occurs when the oscillator is making new lows while prices are making new highs, and a bullish divergence occurs when the oscillator is making new highs while prices are making new lows.

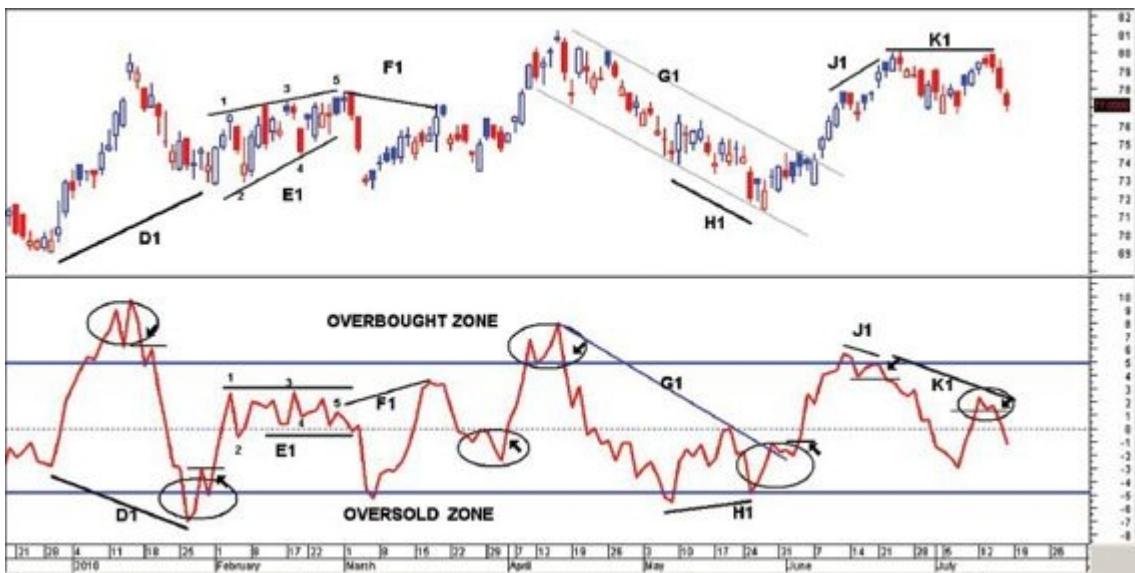
Figure 6.3

shows the behavior between the movements of momentum and price. E1 and G1 show that momentum trend does not reflect price trend. Momentum trend will not always be in the direction of the price trend. E1 shows a diagonal triangle in price while momentum is in a horizontal range. G1 shows price declining in a downward channel while momentum was declining in a parabolic arc. G1 also illustrates that we can draw a trend line to price as well as in momentum. D1 and H1 show bullish divergences between momentum and price, and F1, J1, and K1 show bearish divergences. F1 is also known as a hidden bearish divergence, and such divergences are not often noticeable. Momentum also develops pattern formations; examples of double tops and double bottoms are indicated by the circles in

Figure 6.3

FIGURE 6.3

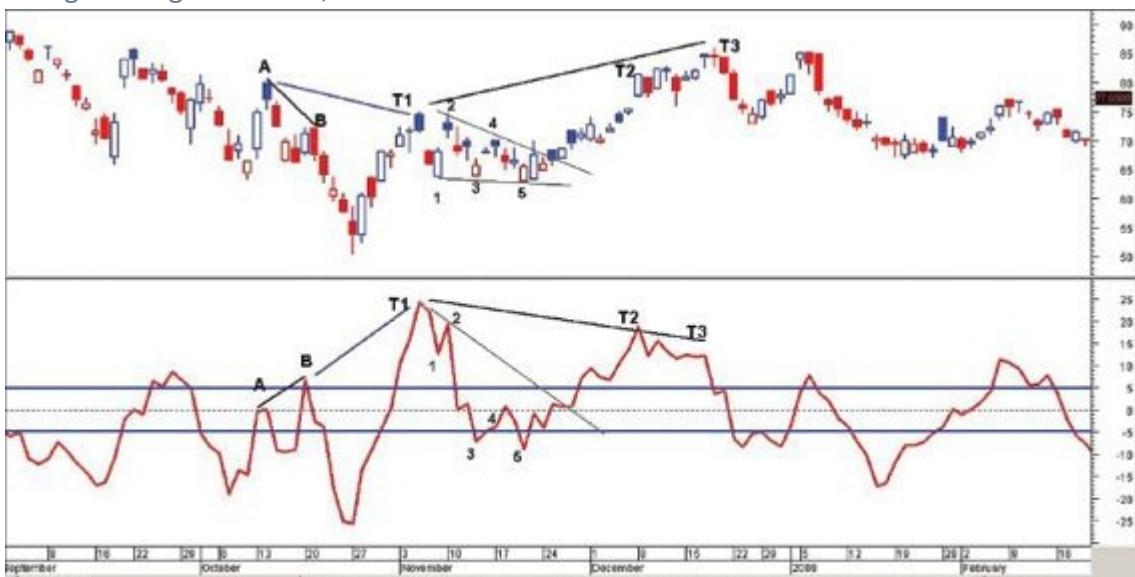
The bottom window shows the directional movements of momentum of price.



Another important point to note is, when prices have declined for a while and start to change to bullishness, the momentum oscillator will respond by crossing above its centerline into a high value area (compared with its historical threshold). Generally, prices will tend to go still higher, and momentum will form another high, but it will be lower than its previous thrust. (See [Figure 6.4](#).)

FIGURE 6.4

Directional movement of momentum responds to change in price trend. After falling for the prior three months, price reaches its low in October 2008 and starts to reverse. Momentum responds with great strength to a new high at T1. Thereafter, price goes into a consolidation before rising again to new highs at T2 and T3, but momentum fails to rise to new highs. Notice the divergence signals at A-B, and A-T1.



Conversely, if momentum reaches a very low value area, L1 (compared with its historical threshold), and turns up, forming a higher low, L2, prices may not follow momentum direction and fall further.

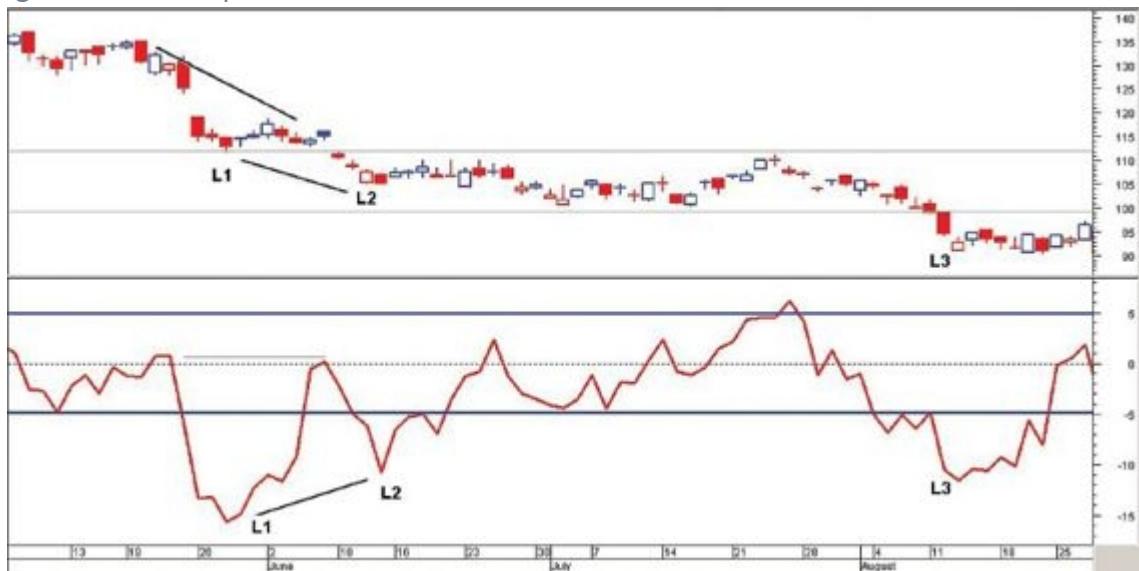
Figure 6.5

shows an example of such characteristics. Notice how price continues to fall to L3 but

momentum holds at about its last low. Again, note that the trend of momentum does not always reflect price trend. Momentum direction will not always be in the direction of the price trend.

FIGURE 6.5

Momentum reaches a new low before price, as in L1 and L3. The slope of L1 and L2 marks a divergence between price and momentum movements.



Momentum oscillators are often plotted with two lines: the raw data line (or, the fast line), and its moving average. There are three methods of calling entry and exit signals using the momentum oscillator: (1) zone crossing, or crossing of the oversold or overbought lines; (2) centerline break, or breaking above or below the centerline; and (3) crossing of the average line by the fast line.

For those who would like to go further into the subject, they may want to read *Momentum, Direction, and Divergence* by William Blau, *The New Technical Trader* by Tushar S. Chande and Stanley Kroll, and *Martin Pring on Market Momentum* by Martin Pring.

QUEUING THEORY OF MOVING AVERAGE Crossovers (QMAC)

The moving average has remained the most powerful method for analyzing and trading the market. Moving averages can be applied to a wide range of uses, from identifying market trend in any time frame, to detecting overbought or oversold conditions. They are easy to use and form the basis of many trend trading systems. There are numerous ways of calculating moving average mathematically: simple, exponential, weighted, time series, volume adjusted, and so forth. Over the years, many new innovative ideas have been added. The basic idea is to smoothen short-term price fluctuations to have a better picture of the main trend.

The periods commonly used for plotting moving average lines range from 2 days to 250 days. In this book, moving averages are categorized under three groups. The first group is the short-term period from 2 days to 9 days, the second group is the mid-term period 9 days to 34 days, and the third group is the 50-day to 250-day group. When a market is in a strong trend, prices will cross above all the averages of these three groups, and moving averages lines from each of the three groups will also follow suit. That is, the shorter period will also cross above the longer period. And the order of alignment is reversed when the market is very weak. When the market moves to an extreme level, whether bullish or bearish, prices will lead the directional change, and will be followed by the various moving averages. This is the first observation of the Queuing Theory of Moving Average Crossovers (QMAC). That is, when prices make a bullish or bearish directional change, its relative moving averages should also follow suit and be in a sequential order. The shorter period moving averages will also cross above or below the slower period averages. If the price and its moving averages are not aligned in a sequential order, the respective rally or retracement most probably will be short-lived and prices can be expected to continue to move in their previous direction or to make further consolidation. For practical purposes and ease of usage, three moving averages, the 50-day, 90-day, and 200-day, are illustrated below as examples of the application of QMAC. It also shows the relationships of price and moving average crossovers, crossovers between two moving averages, and the relationship of price and two moving averages.

The most popular method of interpreting a moving average is to compare the relationship and crossovers between a price and its moving average to determine current trend direction and to anticipate its most likely future direction. Moving averages, though used as a smoothing technique, also filter out the fluctuations of short-term volatility in price movement. There is, however, one deficiency in that most moving averages are lagging technical indicators, which means they tend to trail behind the current price in fast-moving markets. (See

Figure 6.6

.) All moving averages have this weakness—the lag effect. Thus, in a highly volatile or non-trending market, trading signals using moving averages tend to generate faulty signals. This will cause repeated whipsaws, which can pile up trading losses.

FIGURE 6.6

Crossovers of two moving average lines. Notice the lagging effect of the intermediate-term average as is typical in a volatile market. Circles mark the crossovers of the two average lines. If entry and exit were based entirely on the crossovers of the average lines, the lag of the intermediate-term average would take out a substantial part of the profit.



A sell signal is generated when the share price falls below the moving average, and a buy signal is generated when the share price rises above its moving average. The critical element in a moving average is the time period used in calculating the average. The objective of a moving average system is to pick a trade with a probable price trend by buying shortly after the share price bottoms and selling after it tops.

Another method is the use of multiple moving averages. For example, in a system with two moving average lines, a buy is signaled when the shorter moving average crosses above the longer moving average, and a sell is signaled when the shorter line crosses below the longer line. The shorter the length of a moving average, the more sensitive it will be to short-term fluctuations, and the longer the length, the less sensitive to abrupt fluctuations. Shorter-length averages lag the market less than longer-length averages.

A study in moving average will not be complete without the study of the eight principles regarding the interpretation of price to moving average. The rules are mentioned in *Technical Analysis of Stock Trends* by Robert D. Edwards and John Magee. The Eight Rules of Moving Average Crossovers (Eight Rules) refer to movements between price and its 200-day moving average. The 200-day moving average is generally accepted as the key psychology line used by many long-term investors.

The Eight Rules can be applied to almost any period of moving average.

- 1.** If the 200-day average line flattens out or advances following a decline, and the price of the stock penetrates that average line on the upside, this constitutes a major buying signal.
- 2.** If the price of the stock falls below the 200-day average line while the average line is still rising, this also is a buy signal.
- 3.** If the stock price is above the 200-day line and declines toward it, but fails to go through and instead turns up again, this is a buying signal.
- 4.** If a stock price falls too fast and far below the declining 200-day average line, a short-term rebound toward the line may be expected.
- 5.** If the 200-day average line flattens out or declines following a rise, and the stock price penetrates that line on the downside, this constitutes a major selling signal.
- 6.** If the price of the stock rises above the 200-day average line while the average line is still falling, this also is a sell signal.

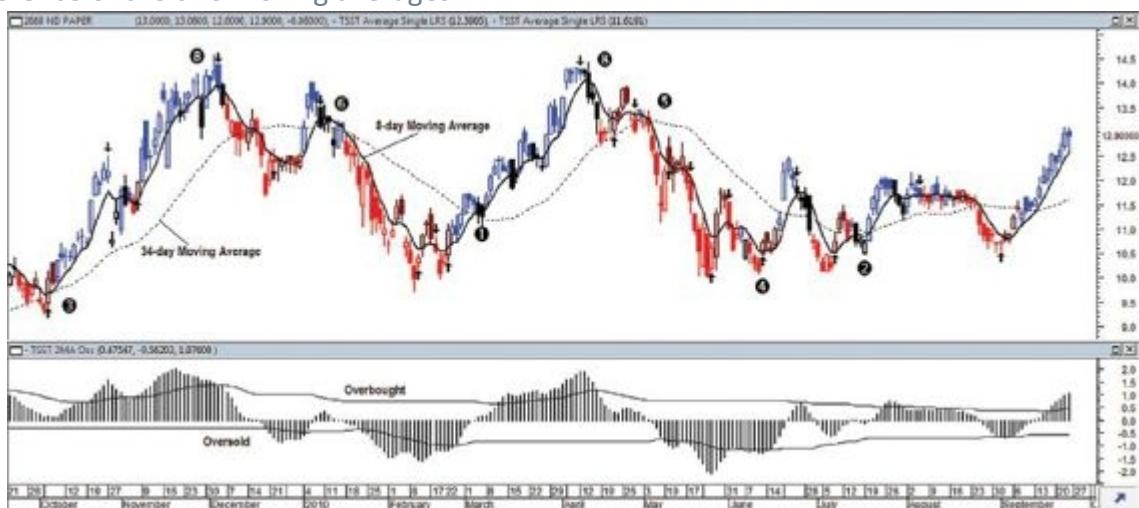
7. If the stock price is below the 200-day average line and rises toward it, but it fails to go through and instead turns down again, this is a sell signal.
8. If the stock price rises too fast above the rising 200-day average line, a short-term reaction may be expected.

Figure 6.7

shows the application of the Eight Rules on the crossovers between an 8-day moving average and a 34-day moving average as well as the plot of a momentum oscillator between the two moving averages. When the 8-day moving average crosses above the 34-day average, the oscillator will be above the zero line.

FIGURE 6.7

The top window displays examples from the Eight Rules principle between the interplay of an 8-day moving average and a 34-day moving average. The bottom window shows the overbought zone and oversold zone of the momentum oscillator, which is derived from the difference of the two moving averages.



Referring to the Eight Rules, if another moving average is plotted between price and 200-day average, say a 50-day average, there will be two moving average crossovers, a 50-day average and a 200-day average.

The interplay of these two moving averages, 50-day and 200-day, is popularly used in considering prospective bull and bear markets. When the 50-day is above the 200-day, the market is considered to be in a long-term bull phase, and when the 50-day is below the 200-day, the market is considered to be in a long-term bear phase. When the 50-day crosses from below to above the 200-day, it is referred as the Golden Cross, signaling a market change to a bullish outlook, and when the 50-day crosses from above to below the 200-day, it is referred as the Dead Cross, signaling a market change to a bearish outlook.

Generally, the combination of two moving averages is effective as well as easy to interpret. The faster line tracks the shorter-term trend, while the slower line tracks the longer-term trend. When there is a crossing between the faster line and the slower line, it indicates a probable change in trend. This method of crossover is commonly used in developing automated setup conditions, and in a rule-based trading system, which will be discussed in later chapters of the book. However, this system alone is subject to whipsaws in a bracket market condition and should be supported by a subsequent entry condition or by another supporting oscillator.

In a crossover system of two moving averages, we have three factors: the price, a short-term moving average, and a long-term moving average. Let's take the price as the closing price, the

short-term moving average as 50-day, and the long-term moving average as 200-day. In a bullish trend, the alignment of these three factors (from top to bottom) will be: price, 50-day, and 200-day; the price will be above its 50-day line and the bottom line will be the 200-day. In a bearish trend, the order is reversed, with the 200-day at the top and the price at the bottom. When the price is between the 50-day and the 200-day, the interpretation becomes less obvious. Under such conditions and subject to other supporting technical analysis, we may want to stay on the sideline until the situation improves, unless an automated trading system is being used.

What is being described so far refers to the application of 50-day and 200-day moving averages in a daily chart. If it is a weekly chart, the time frames for the averages will have to be changed to 10-week moving average (equivalent to 50-day moving average) and 40-week moving average (equivalent to 200-day moving average), as shown in

Figure 6.8

. In a weekly chart, the Golden Cross refers to the crossing of 10-week average above the 40-week average and the Dead Cross refers to the crossing of 10-week average below the 40-week average.

FIGURE 6.8

Weekly chart of the Hang Seng Index showing the Dead Cross on March 7, 2008 and the Golden Cross on May 22, 2009.



Figure 6.8

is a weekly chart. It shows the application of the Eight Rules of moving average crossovers between the 10-week moving average (that is 50-day moving average in a daily chart) and the 40-week moving average (that is 200-day moving average in a daily chart). The right-hand side of the chart shows the market entering a bracket condition as indicated by both of the averages going horizontally. In such market conditions, we see whipsaws between the 10-week and 40-week line.

Figure 6.9

shows a possible pattern of movements among the three factors, from a bullish condition to a bearish condition and back again to a bullish condition.

FIGURE 6.9

Movement patterns of price and two moving average lines.

P	50	50	200	200	P	P
50	P	200	50	P	200	50
200	200	P	P	50	50	200
Bullish	P<50	P<200	50<200 Bearish	P>50	P>200	50>200 Bullish

With three averages, there will be four factors. Using the preceding example, we add another medium-term average of 90 days. The moving average system will now consist of price, 50-day, 90-day, and 200-day averages.

Figure 6.10

shows the Queuing Theory of directional movements of price and moving averages.

FIGURE 6.10

Movement patterns of price and three moving average lines.

P	50	50	90	90	90	200	200	200	200	P	P
50	P	90	50	50	200	90	90	P	P	200	50
90	90	P	P	200	50	50	P	90	50	50	200
200	200	200	200	P	P	P	50	50	90	90	90
Bullish			Setup		Dead Cross	Bearish			Setup		Golden Cross

There are various scenarios for the interplay of price and its three moving average lines.

Figure 6.10

is one of the scenarios showing the alignment order of the relationship of averages and price. Subject to the volatility of prices, the various respective movements do not necessarily move at an orderly pace as shown in the table. Prices could traverse the average lines at the same time. (See

Figure 6.11

and

Figure 6.12

.)

FIGURE 6.11

Daily chart showing the interplay of three moving averages and price from a downward trend to an upward trend, and then to a bracket market.



FIGURE 6.12

Daily chart showing the relationship of price and its three moving averages, the 50-day, 90-day, and 200-day lines, are a guide to the longer-term outlook of the market. The crossings between the 90-day and 200-day averages confirm the validity of the Dead Cross and Golden Cross. The crossings between the 50-day and 90-day averages act as setup positions and will alert a technician to a possible change of trend.



Based on the scenario shown in

Figure 6.11

and

Figure 6.12

, the setup for a bearish trend is when the price is below both the short-term (50-day) and medium-term (90-day) averages, and the 50-day crosses below the 90-day. The setup for a bullish trend is when the price is above the short-term (50-day) and the medium-term (90-day), and the 50-day crosses above the 90-day. In a crossover of two averages, take note of the slope direction of the longer line. In a bullish crossover, the longer average line should either be rising or moving in a flat, while in a bearish crossover, the longer average line should be moving downward or in a flat direction. The setup position is vulnerable to false breaks when prices go into a consolidation phase. When the 50-day is below the 90-day, and the 90-day is above the 200-day, it confirms continuing downward trend of price; and, vice versa, when the 50-day is above 90-day and 90-day is below 200-day, it confirms the continuing upward trend of price. The advantage of using a three moving average system is that it provides a wider perspective of market directional movements. For example, when the longer-term moving averages are not in a queue of bullish alignment, any rally signals by the crossovers of shorter-term moving averages will be short-lived.

The preceding are examples of how to read the probable trend of the market in the relationship of movements in different moving averages. It is possible to add more averages to the combination, which gives even more possibilities of movements, and these can be split up into sets of long-term and short-term moving averages. The set of long-term averages will serve as the indicator of the overall trend, and the set of short-term averages will serve as the entry and exit signals of the overall direction of the main trend, as shown in

Figure 6.13

FIGURE 6.13

Two sets of moving averages at work. The pair of short-term averages acts as entry and exit signals for the overall market, as indicated by the set of long-term averages.



There are many ways of using moving averages to trade. Using crossovers of averages to trade may be the easiest mechanical system, but the method can baffle traders because the effect from a set of moving averages crossovers does not apply consistently to price behavioral patterns. This appears to be more discernible in the application of longer time frame averages—for example, the crossovers of 50-day and 200-day moving averages.

Let's examine a chart of the Shanghai A Share Index (

Figure 6.14

). The lower window of the chart is the index, with a set of three long-term moving averages: the 50-day, 90-day, and 200-day averages. The upper window shows two oscillators: the line plot of price to its 200-day moving average, and the histogram of the 50-day moving average to the 200-day moving average. When price crosses above its 200-day moving average, the line plot will be above the centerline. And when the 50-day average crosses above the 200-day average, the histogram bar will be above the centerline. They are both momentum plots. The oscillator plots could be construed as the comparative momentum between the shorter-term line plot and the histogram, or the longer-term period.

FIGURE 6.14

Comparative crossing of a set of long-term moving averages.



There are three points, 1, 2, and 3 as marked in the chart, which are worth looking into. Point

2 is a common pattern of moving average crossovers inside a contracting triangle. The index broke slightly below the 200-day on January 28, 2010, at about point "d" toward the end of a contracting triangle (marked as a, b, c, d, and e), and managed to cling fast and vacillate around its 200-day average. On March 23, 2010, the bearish sign appeared: the 50-day average dipped below the 200-day average. But instead of declining, the index made further advances until April 19, when support finally yielded to selling pressure. The advance by the index following the bearish crossing of the 50-day and 200-day averages was a false move. The three longer-term averages, 50-day, 90-day, and 200-day, were not aligned in a sequential order. Incidentally, the sharp drop on April 19 also saw the beginning of the destruction of the consolidation pattern, a pattern formed by the contracting triangle when the index finally went below the mirror trend line of TL1 toward the mirror line of TL2-1.

Point 1 and Point 3 are good examples of how price reactions can be contradictory when the 50-day average crosses above the 200-day average. In the first example, at Point 1, the index went above the 200-day average on March 23, 2009, for the first time after a long decline of approximately 14 months. And at X1 on April 9, 2009, the 50-day average pushed above the 200-day average, paving the way for the index to make a small bullish run to early August. In the second example, at Point 3, the index crossed above the 200-day average on October 12, 2010 after a six-month decline. And at X2 on November 10, the 50-day average made a crossing similar to the first example moving above the 200-day line. If a trade had been executed on the assumption that a bullish run would follow as in the first example, the result would have been disastrous because the index made a U-turn downward the next day and fell sharply. There was no follow-up bullish run.

What exactly happened? At Point 1 on March 23, 2009, and at Point 3 on October 12, 2010, the index crossed above the 200-day average, which was followed by the 50-day average crossing above the 200-day average on April 9, 2009 (X1) and November 10, 2010 (X2), respectively. In the first example, the 50-day crossover generated a small bullish trend, but in the second example the 50-day crossover did not generate any bullish follow-up trend. The difference in the effect of the two crossings is in the strength of the index's trend at the time of crossing. When the 50-day average crossed the 200-day at X1, the index broke out of a bullish reversal pattern, but at X2, the index was entering into a bearish diagonal pattern. Thus, at X1, the strength of the trend is stronger than at X2. At X2, the index is subject to heavy resistance as it has reached the center of a saturated area of resistance, the contracting triangle (a-b-c-d-e). It has retraced over 61.8 percent of the decline from P to Q and 100 percent of the recent decline from "e" to Q, and at X2 its strength has weakened. This is noticeable by the negative divergence between the 200-day price oscillator and the index. Such divergence is often overlooked by novice traders.

Rule 1 and Rule 5 of the Eight Rules on the Interpretation of Price to Moving Averages can be applied to moving average crossovers between a shorter-term and a longer-term average. For easy reference, we have repeated the two rules below and substitute the word "price" with "50-day average" in the rules.

Rule 1: If the 200-day average line flattens out or advances following a decline, and the 50-day average penetrates that 200-day average line on the upside, this constitutes a major buying signal.

Rule 5: If the 200-day average line flattens out or declines following a rise, and the 50-day average penetrates that 200-day average line on the downside, this constitutes a major selling signal.

Another significant and finer reason for the difference in the resulting effects on the

crossover between the 50-day and 200-day averages at Point 1 and at Point 3 is stated in the two rules. The rules refer to the slope and directional movement of the longer-term moving average, the 200-day average. In other words, when the 50-day average crosses with the 200-day average, it is important to note the direction and slope of the 200-day average also. In the first example at Point 1, the 200-day average is rounder and flatter and subsequently moved in the same direction of the 50-day average. In the second example at Point 3, the 200-day average has a steeper and straighter decline, which reduces the strength of the crossing. Thus, instead of trading at just any crossovers, trades can be implemented when the longer-term average levels out and when the shorter-term average diverges and moves farther away from the longer-term average. In this respect, perhaps a buffer could be added to avoid whipsaws.

A trend line is a straight line connecting a minimum of two points. In

Figure 6.14

, two trend lines, TL1 and TL2, are shown. The more points a trend line connects, the more reliable it is. TL1 is the trend line connecting the low in late October/early November 2009 and the low in early July 2010, which forms the major support line. The trend line above TL1, the mirror line, is parallel to TL1. The two lines, TL1 and its parallel line, form the upward trend channel. TL2 is the downward trend line connecting the various high points, and with its mirror line, forms the downward trend channel. The market is deemed bullish if prices are above the trend line and bearish if prices are below the trend line.

MACD

Moving average convergence/divergence, or MACD, was developed by Gerald Appel. It is a popular momentum indicator that shows the relationship between moving averages of prices. It has two plotted lines. The standard configuration for MACD, the first plotted line, is the difference between 12-day and 26-day exponential moving average lines. The second line, also known as the signal line, is a 9-day exponential moving average of the first line.

Figure 6.15

shows the plot of MACD.

FIGURE 6.15

The upper window shows the plot of MACD and its signal line. The plot of the difference of the two lines is shown in histogram bars. Note the early signals shown by the divergence of histogram bars, warning of a slowdown of price momentum as it approaches its top. The lower window shows the plot of the 50-day, 90-day, and 200-day moving average lines. Note that price trend turns positive upon the crossing of the 50-day and 90-day, holding off selling pressure at the 90-day average line.



The buy and sell signals used in MACD are similar to those used in crossovers of moving average lines. When the MACD line crosses above the signal line, a buy signal is triggered. Conversely, when the MACD line crosses below the signal line, a sell signal is generated. When MACD and its signal lines are above the zero line, it indicates bullishness in the market, and when they are below the zero line, it indicates a bearish market. An indication that an end to the current trend may be near occurs when the MACD diverges from the security. A bearish divergence occurs when the MACD is making new lows while prices fail to reach new lows. A bullish divergence occurs when the MACD is making new highs while prices fail to reach new highs. This MACD divergence is different from an MACD Histogram divergence.

MACD Histogram is the difference between MACD and its signal line, and it is worthwhile to spend more time in getting to know the indicator. Dr. Alexander Elder, in his book, *Trading for a Living*, published in 1993, had this to say about MACD Histogram. "MACD Histogram offers a deeper insight into the balance of power between bulls and bears than the original MACD. It shows not only whether bulls or bears are in control, but also whether they are growing stronger or weaker. It is one of the best tools available to a market technician." Divergences between MACD Histogram and prices give some of the most reliable messages in identifying

major turning points.

Positive MACD Histogram is plotted above the zero line and is formed when the MACD line is above its signal line; negative MACD Histogram is plotted below the zero line and is formed when the MACD line is below its signal line. MACD Histogram is plotted as vertical bars above or below the zero line. When the two lines, MACD and the signal line, are moving away from each other, the histogram bars will increase in length, above or below the zero line. MACD Histogram is basically a fast momentum indicator displaying the difference between two moving averages and can be used in conjunction with a slow momentum indicator to form a hybrid oscillator. (See

Figure 6.16

.)

FIGURE 6.16

In the lower panel, the first oscillator is a fast momentum oscillator, the MACD Histogram, and the second oscillator is a slow momentum oscillator. The two oscillators form a hybrid indicator. MACD Histogram will generally signal an imminent reversal in advance of the slow momentum by showing its divergence. The crossover of the two lines in the slow momentum oscillator confirms the turn of the short-term trend. Notice the interplay of the various moving average lines, shown in the upper panel, as discussed in this chapter.



AVERAGE DIRECTION INDEX

Average Direction Index (ADX) is a valuable indicator that is widely used by analysts to identify whether a trend exists, and to quantify trend strength. ADX was developed by J. Welles Wilder Jr., and published in his 1978 book, *New Concepts in Technical Trading Systems*. We shall not get down to the nitty-gritty calculations of ADX; it is available in all technical analysis software programs.

ADX was developed as part of a direction movement indicator, which is generally plotted together as two related directional movement lines, the positive directional movement line and the negative directional movement line.

ADX is an oscillator that fluctuates between 0 and 100. ADX's value, with a standard 14-day setting, seldom exceeds 60 or falls below 10. ADX is plotted as a single line and is not a directional indicator. As a rule of thumb, when ADX crosses above 20 from below, it suggests that the price trend is getting stronger. On the other hand, when ADX crosses from above to below 20, price trend strength is getting weaker and is entering into a non-trending market. Thus, a high ADX value can indicate a strong downtrend as well as a strong uptrend.

Higher ADX value represents a stronger price trend, while lower ADX value represents a weaker price trend. Thus, a rising value of ADX reflects a strong trend is in progress, a declining ADX value reflects a weakening trend, and a flat ADX reflects an absence of trend. As a result of its behavioral patterns in revealing trending and non-trending conditions of the market, a trader can use ADX to form a trading strategy. However, ADX has its limitations. It lags price movements and should not be used as a buy or sell signal. It takes approximately 30 bars to establish the value of the ADX with a 14-day period.

Having said that, the value of ADX is that it confirms the trend strength and not its directional movement. We would like to add that the directional movement of ADX is also important and should be carefully observed. When the ADX moves up, it reaches its high and makes a subsequent downward turn. This pattern is very important. The turning of direction in the ADX implies that there is going to be a change of trend strength. When there is a change in the trend strength, it implies that there will probably also be a change in the price trend and direction soon.

Thus, when prices have been trending downward and the ADX, moving in the opposite direction to price, rises to reach its extreme high level and then makes a turn downward, we should be on the lookout for a change in price trend shortly. On the other hand, when price is falling rapidly, and the ADX rises to reach its high to make a downward turn, it indicates the price trend will be improving soon. A steep slope of ADX movement shows strength while a slope that is almost flat indicates weakness.

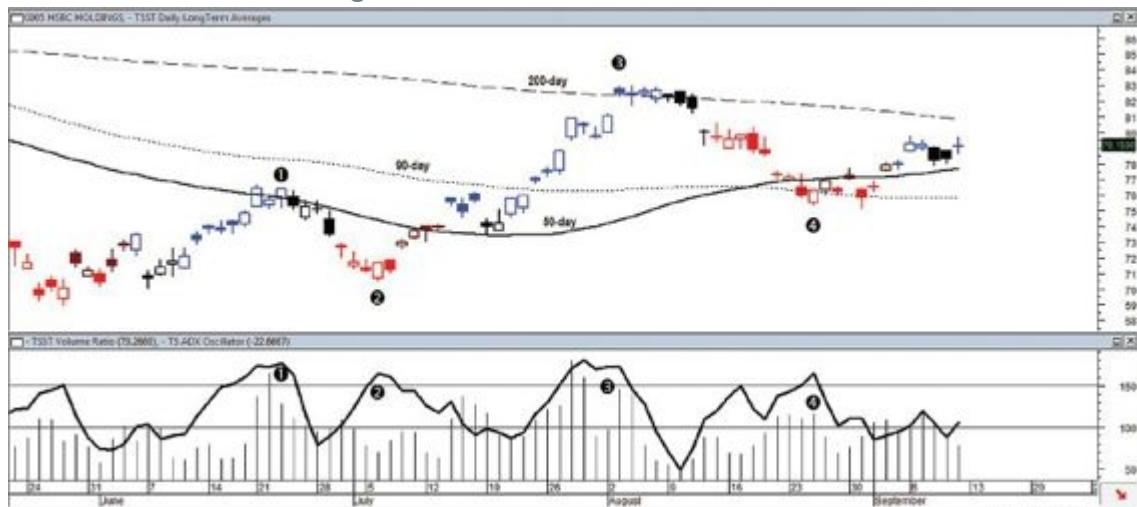
Directional movements often hide the true message of ADX and run contrary to price movements, as shown in

Figure 6.17

. Take note of the uniqueness of the movements of ADX; ADX reaches a high value regardless of whether the price is high or low. When ADX crosses above the alert line, it warns of a probable change of price trend. At Point 3, price is meeting resistance at the 200-day average line, and ADX is turning down and crosses below the alert line, which confirms weakening of price. At Point 4, the 50-day average crosses above the 90-day line from below. This is a bullish sign that is supported by the fact that price is holding well at the 90-day level and by the subsequent change in ADX's direction from its high as it crosses below the alert line.

FIGURE 6.17

The upper window of the chart shows the interplay of three moving averages, the 50-day, 90-day, and 200-day. The bold line in the lower window shows movements of the three-day period ADX, and the volume in a histogram.



The formula for the ADX used in

Figure 6.17

is as follows:

```
prd:=Input("Adx Period",1,89,3);
a1:=Input("LookBack 1",1,89,13);
a2:=Input("LookBack 2",1,89,8);
a3:=Input("LookBack 3",1,89,5);
adxm:=(ADX(prd)+Ref(ADX(prd),-a1)+ADX(prd)-Ref(ADX(prd),-a2)
+ADX(prd)-Ref(ADX(prd),-a3)+ADX(prd))/3;
adxm;
```

PROTECTIVE STOPS

Figure 6.18

shows a strong trending stock plotted with protective stops. Volume is plotted in the lower window.

FIGURE 6.18

Plot of protective stops indicated by black dotted line.



Average true range is commonly used in the calculation of protective stops (or stop losses). Average true range is a volatility indicator that measures the strength of price reactions. That is, the price movements from low volatility to high volatility and from high volatility to low volatility. The formula for average true range is included in all technical analysis program packages. Protective stops may also be used as a guide for trade entries and exits. In a long position, a trade exit is triggered when prices close below protective stops. And when prices close above or remain above protective stops, a trade entry may be considered if other indicators are also showing support of the probable positive trend.

There are many stop-loss or trailing stops systems available, but getting the right parameters and settings of such stops can be difficult. When the market is choppy, trailing stops will always be triggered too soon if the stops are set too close to the price bars. And on the other hand, if the stops are set too far apart, traders will probably not be able to lock in their profits as their stops will never be reached.

The following is a simple formula of the protective stops indicator for reference only. It is not recommended to be used in trading.

{Protective Stops Long}

```
AtrX:=Input("ATR Multiple",1,89,1.3);  
Period:=Input("ATR Period",2,89,13);  
LookBack:=Input("Lookback",2,89,13);  
Lng:=Close-AtrX*ATR(Period);  
LngHi:=HHV(Lng,LookBack);
```

```
LngSignal:=If(Lng<LngHi,PREV,Lng);
```

```
LngSignal;
```

CONCLUSION

This chapter discusses five key indicators: momentum, moving averages, MACD, ADX, and protective stops, which will help traders to understand the purpose and use of indicators in a trading strategy. In planning a chart layout, traders should ensure that the layout covers different aspects of the market. A good layout should not be cluttered with indicators but should be neat and simple. Yet it should be meaningful and complete. Basically, the chart will have a trend indicator to show the probable direction of the trend, a momentum indicator to measure the speed at which price is changing, and a volume indicator to measure stock activities. Traders should avoid using multiple indicators that show the same type of information in the chart.

Momentum measures the speed of price change and is used in identifying price strength by the variance of the change in speed of price. It is the basic concept applied in most indicators. MACD is also a momentum indicator. It consists of three plots. The first MACD line is derived from the difference of two different periods of exponential moving averages. Standard parameters are a 12-day period and a 26-day period. The second line, the signal line, is a 9-day exponential moving average of the first line. The third line is plotted as a histogram. The histogram is the difference between the MACD line and the signal line. The slopes of the histogram will often diverge with the price directional movement to alert traders to probable turning points in trend. A trader must take note that, when using momentum oscillators, the trend of the momentum does not always represent the price trend. Momentum oscillators are useful in identifying overbought and oversold conditions of the market. Overbought conditions reflect the underlying strength of the market, and oversold conditions reflect the weakening of the market. As a timing tool for buying and selling, momentum provides more reliable signals when traders use two different time frame momentums, daily momentum and weekly momentum. The objective is to trade when the daily time frame is in the direction of the weekly time frame, unless the momentum is overbought or oversold.

In the chapter, two methods of using moving averages have been described. The first is the popular method of using the crossing of price and its moving average as trading signals for trade entries and exits, which can also be applied to reading crossings of two different moving averages. The second method is a new concept, the Queuing Theory of Moving Average Crossovers. The theory is based on the assumption that when there is a trend, the price and its relative moving averages should move in a sequential order of alignment. In a bullish trend, price will lead and be above the shorter moving average, which will be followed by the longer moving average. In a bearish market, price will also lead the declining trend, but it will be below the shorter moving average, which will be below the longer moving average. Any change in sequential order of alignment of the price and its moving averages will indicate a weakening of the prevailing trend. A price rally or a price retracement that occurs when there is a disorderly alignment can be expected to be short-lived. The application of the theory will help traders to assess the probable risk and reward before making trade decisions, to determine trading time frames, and to form a better perspective of the market.

Two optional indicators have also been included in the chapter, ADX and protective stops. ADX is used to identify whether a trend exists and to quantify the strength of the trend. The common practice is to determine a benchmark that serves to identify the trend; the higher the value of ADX, the stronger the trend, irrespective of whether the trend is up or down. Traders often get confused when applying this indicator. An easier application is to use a shorter period for the ADX and just focus on the turning points of its peaks. This method will greatly help to

catch the change in trend of the market.

Protective stops are used by traders as a last resort to get out of the market. There are many methods of formulating protective stops; many of them use average true range as a key component in the calculation. Protective stops are discussed in this chapter for traders who normally opt for taking greater risks. The application and the method of using protective stops are subject to the personality of each trader and his or her trading strategy. There are no hard and fast rules. If a trader has designed his trading system to take care of trade entries and exits, there is no need to use another indicator as a reminder.

CHAPTER 7

Applied Systems

There is not going to be any disagreement when it is said that the market is complex and chaotic. Sometimes the market rises dramatically and sometimes it falls drastically. A rising market is followed by a declining market that is again followed by a rising market, and the cycle repeats again and again. But these cycles do not happen or repeat in uniformity. There is no reliable way to predict precisely when the next direction of the cycle will take place or how long it will last. Prediction of a longer-term cycle is made even more difficult by movements of smaller cycles. Elliott Wave practitioners believe these cycles are the result of psychological reactions of market players. Economists maintain that all these movements and cyclical patterns are caused by economic factors. Financial astrologists believe these cycles are influenced by various planetary movements. Yet, in its chaotic behavior, the market seems to conceal elements of order, displayed at times in symmetrical and harmonic patterns.

These patterns become the catalyst for technical analysis, which is based on the premise that prices tend to move in trends. Simply put, this means that once a trend of the share price is established, the next move of the share price is more likely to continue in the same direction. In other words, if a share price is firmly established in a bull trend, the share price is more likely to continue increasing rather than decreasing in the next trading period. Most technical trading strategies are based on this assumption. Every trader needs a trending market to make money. If there is no trend after a trade has been executed, there will not be any profit.

With today's developed technologies and high-speed computers, more and more equity funds are turning to programmed system trading using superfast computers to catch the trend by employing complex algorithmic information to churn revenue and profits.

Having a trading system helps to alleviate fear and tension, reducing the burden of discretionary decisions and the anticipation of price reversals or breakouts. A good trend system is one that generates reliable trend signals most of the time. It will help us to respond quickly to price actions.

The trading method introduced in this chapter is not a fully automated trading system. It is a discretionary trend system. The method's core system is based on crossovers of price and various moving averages and the synchronization of moving average crossovers to reflect trends in progress and probable change in trend. The trading method includes two additional indicators: a volume indicator for additional confirmation of trend breakouts, and a momentum indicator to depict the velocity of trend.

CATCHING THAT TREND

Catching the trend, whether it is an uptrend or a downtrend, is the key to profits because, if we can catch it, half of our work is completed. However, understanding the forces at work in trending and non-trending markets, and the transition from one phase to the other phase, is the most difficult task. An uptrend means a series of higher highs and higher lows. Each high is followed by a higher high and each low is followed by a higher low. A downtrend means a series of lower highs and lower lows. Each high is followed by a lower high and each low is followed by a lower low. Defining whether a trend exists will be subject to the trading time frame of the trader. For instance, let's assume a scenario in which a stock closes at its high of \$10 with an opening of \$10, and that its low for the day is \$9. The trading time is four hours. With the stock opening and closing at \$10, it would appear that there is no trend for the day. However, if we look at the minute chart, there will be a downward trend and an upward trend in a period of four hours' trading time. At the opening bell, sellers push the price downward to \$9, the low of the day, where it finds support from buyers, who push the price upward to close at the high to form a dragonfly doji bar. This example is an illustration of intraday trends and it exemplifies that trend is valid only for the relative time frame in which it occurs.

Market prices tend to behave irregularly at different periods. A market tends to move from a well-defined trend to a period of congestion, and then from a period of congestion back to a well-defined trend. Each phase of movement between a well-defined trend and the congestion period provides clues to the traders for the next phase. At times, the clues are obvious, and at times they are hidden from our naked eyes, making it harder to see the next directional movement from the evolving patterns, which are generally formed at periods of congestion.

When the market is not trending, continually making new highs or new lows, and when the spreads between highs and lows are narrow, there is no margin of profit to be made if slippage and commission are taken into account. In such non-trending or sideways markets, moving averages are often relatively flat and price movements may fluctuate between two points in a relatively horizontal movement that can last for a long period of weeks to months. A sideways market usually occurs at a price support level where accumulation takes place, or at a price resistance level where distribution takes place. Such price patterns take place when buyers and sellers are more or less in balance, with neither side in control. Trading becomes difficult and the best thing to do is sit back and wait for the development of the next trending phase.

Irrespective of the different types of price formations, the most important rule in market trading is to never commit any trade against the trend. If the trend of the stock price is headed downward, then it is not safe to buy that stock until the trend has changed direction. However, many ambitious traders still habitually trade against the trend in an attempt to get in at the exact bottom of the market or get out at the exact top of the market. This is too high a risk to take and the extra dollar is not worth the loss that will eventually squeeze the trader out of subsequent price movements. Whatever may be said, the habit is still common among traders, and there is a price to pay for being ambitious. Using a trade system is helpful. A trade should only be made when there is a signal from the trading system that the trend has changed direction. In other words, act in accordance with what has happened and do not act in anticipation of what will happen. Perhaps there will be losses for a few points but, on the other hand, catching 80 percent of every trend movement will greatly improve trading results in the long run. And as for the balance 20 percent, it is better left for lucky traders and ambitious daydreamers. In the systems and various indicators introduced in this book, intraday data are ignored. We will not be dealing with minute charts or hourly charts. We will be using end-of-

day data only and will focus on the daily and weekly charts.

BUILT-IN COLOR TREND INDICATOR

Acting on the trend means we should be a buyer when the trend is up and a seller when the trend is down. Most of us, when we are trading, hope to identify the trend early and benefit to the full extent of the trend by employing various mathematical tools. There have been many trend systems developed but one of the easiest market tools to identify trend is moving averages. In a strong trending market, moving averages work very well. It is during the non-trending market that moving average systems falter.

Figure 7.1

shows two weekly charts of the same stock. The left panel shows the common candlestick chart, and the right panel shows the candlesticks with a built-in color (BIC) trend indicator.

FIGURE 7.1

The left panel is the normal weekly candlestick chart, in which the candlestick is blue when the day close is higher than the opening price. The right panel also shows the weekly candlestick chart of the same stock, except it incorporates a built-in color trend indicator.



In

Figure 7.1

, price movement that is deemed to be bullish is shown by a blue candle, bearish movement by a red candle, and neutral candles are colored in black and dark red. When the candlestick is neutral, the indicator is undecided as to the continuity of the bull or bear trend as there is a probability of a change in trend.

When the stock, as in

Figure 7.1

, uses the BIC trend indicator, the blue candlesticks will be hollow if the price closes higher than the opening price, and filled if the price closes lower than the opening price. When price is assumed to be heading in a downward trend, the red candlesticks will be hollow if the price closes higher than the opening, and filled if the price closes lower than the opening price. When the price is probably going through a change of trend from bullish to bearish or bearish to bullish, the candlesticks will be either in black or dark red. Hollow black or dark red candles reflect closing prices that are higher than opening prices, and filled black or dark red candles reflect closing prices that are lower than opening prices.

Let's look at

Figure 7.1

again. The stock went through a period of consolidation before breaking its previous high of \$1.42 with a strong hollow blue candle. During the period of consolidation, the system color reflected an inherent bullish trend. The candlesticks were mostly colored in blue, with occasional dark red candles. At point A, although the price showed a dip, the general trend was still deemed bullish. At point B, although the price showed a strong rally, the candlesticks color system did not support the rally, and the two candles were both red. The rally was short-lived.

The concept of the BIC trend indicator is based on the intersecting crossovers of three moving averages. These three moving averages form a set of short-term moving averages consisting of two 5-day moving averages and a 13-day moving average. The purpose of the BIC trend indicator is to signal when there is a probable correction of price movements by displaying neutral-colored (black or dark red) candlesticks. When such color signals occur, the indicator is telling that the continuing trend is facing resistance. However, such signals are not to be used as an entry or exit signal system. We have to double-check with the corresponding price patterns and the signals from other supporting indicators, such as momentum and volume indicators, for confirmation.

Weekly charts are used to recognize the market structure and to identify the trend that is in progress. They are used as preparatory trade positioning prior to using the daily charts for the execution of trade entries and exits. In short, a trader should first refer to the weekly charts to identify probable market structure and trend, and second, use the daily charts for timing of execution of trades. The rule is to trade in the trending direction of the next higher time frame of the daily price, that is, weekly. The objective is to trade when the daily and weekly are trending in tandem. Weekly charts will simplify the reading of trend; they clear away a lot of noise inherent in short-term fluctuations while providing meaningful clues with respect to potential longer-term trend perspective.

SUPPORTING MOVING AVERAGES

Continuing with the example of the weekly chart, we shall enhance it with further supporting indicators, including two additional sets of moving averages and a volume indicator, as shown in

Figure 7.2

.

FIGURE 7.2

Reading of the weekly chart is improved with the additional supporting indicators of a set of mid-term moving averages, a set of longer-term moving averages, and a volume indicator. Through trial and error, it was found that a 63-week moving average line correlates closely with the support and resistance levels of this stock.



Before going into reading

Figure 7.2

, traders need to know how the weekly chart is constructed in the system. Each bar of the weekly chart represents the price range of the trading days of that week. If the week has three trading days, the bar represents the range of the three days. The opening price of the weekly bar is the opening price of the first trading day in the week, the closing price is the closing price of the last trading day of the week, the high represents the highest price of the week, and the low represents the lowest price of the week.

Thus, each weekly bar is a summary of the trading days of the week, from Monday to Friday, and trying to find which day in the coming week will be the best day to buy or sell would be difficult. Weekly bars may often be very volatile, and for those who do their trading based on signals generated by weekly charts, it is important to have the ability to stay with the longer-term trend and patiently sit through the volatile period. Price dictates all movements of trend, and there is no one system that is able to predict precisely and constantly where the price will be heading in the next period. Thus, the system recommends traders use weekly charts as treasure maps, and as a means of getting on the right path.

Now, let's look at the upper panel of

Figure 7.2

, which shows the weekly price movements with BIC trend indicator and four moving average lines. The first pair of average lines shows the medium-term moving averages, consisting of a fast average in red (RMA) and a slow average in black (BMA). The second pair of average lines shows the longer-term averages, consisting of the 21-week moving average and the 63-week moving average. The lower panel is the percentage ratio indicator of 2-week volume moving average to 10-week volume moving average. There are also two horizontal lines, a 100 percent line and a 150 percent line. If we assume the 2-week average volume is 110 percent, which is above the 100 percent line, it means the 2-week average volume is greater than the 10-week average volume by 10 percent. When the 2-week average volume is above 150 percent, it means the 2-week average volume is greater than the 10-week volume by at least 50 percent. This is an extreme level, which functions similarly to the overbought/oversold concept. When the 2-week volume average goes beyond 150 percent, it is justifiable to take a second look at the chart, because something interesting may be brewing.

Please note that all weekly charts and daily charts included in the book as examples have been adjusted for the relative period of suspension in trading of shares. References to dates in weekly charts will mean the week-ending dates.

Figure 7.2

displays price bars from July 4, 2008, to October 15, 2010, a period of approximately 126 weeks. Prices declined from the level of approximately \$1.45 in early July 2008 to a low of \$0.48 in late October 2008, where they finally found firm support to make a bullish trend reversal. The stock then rallied to a new high level of \$3.30 in late January 2010. Under heavy selling pressure, prices could not sustain the new highs and headed down in a zigzag A-B-C correction to new low levels of approximately \$2.19, where support from renewed buying appeared.

The bullish five-wave run from the low in October 2008 to the high in October 2010 lasted approximately 65 weeks. The system will not be making any suggestion for trading entry or exit points from the weekly chart, but will highlight such points as positive and negative areas. All executions of trades have to be made from the patterns of the daily chart, whose trend should be in tandem with the weekly chart; that is, the daily and weekly should both have positive trending patterns. Look at the weekly, trade on the daily.

In the upper panel of

Figure 7.2

, there are nine black-circle markers (referred to as B1, B2, and so forth) and six black-circle markers (referred to as V1, V2, and so forth) in the lower panel.

B1 indicated a probable change of trend or a pause of continuing downtrend when the candlesticks turn to black (neutral position). Volume was below the 10-week average but moved in small increments as prices started to become more resilient. Price initially hugged closely to the RMA line until the fourth black bar, when it made a thrust above the RMA and BMA lines. Please note that the fast RMA average did not cross above the slow BMA average until B2, with increasing volume going above the 100 percent line. The 100 percent line is the 10-week volume average line. The colors of the candlesticks then changed to blue and remained blue throughout the consolidation period. Although the volume had not shown much zest, this was the first indication of a positive area since the decline.

At B3, the strength for the price support improved, and trade continued in a narrow range, staying above the BMA and 21-week line. The two signal lines, the RMA and BMA lines, crossed the 21-week line. Volume indicated strong demand moving toward the 150 percent line. See the black-circle marker (V1) at the volume indicator. A price pattern of a small bullish cup-and-handle formation formed. The BMA and RMA lines were trending upward and the gap between the two averages and the 21-week line widened and were more visible. This was the second

positive area.

Price continued to trade upward. Weekly bars were showing longer-range bars and more noticeable hollow bars representing strong weekly closing prices. At V2, volume in correlation with the upward trend went above 150 percent for the first time since the decline, and at B4, both BMA and RMA crossed above the 63-week average, indicating a bull trend was in progress. Though at B4 there was one bearish bar, it did not penetrate below the 63-week line. The 21-week line and BMA average showed the strong support of buyers at this price level. B5 witnessed the crossing of the 21-week line from below to above the 63-week line, while the 63-week line was moving in a flat direction. This was the third positive area. Note also another macro bullish cup-and-handle pattern was being formed.

Prices went into a 14-week consolidation and broke the high of \$1.42 and the resistance line on October 23, 2009, supported the following week by a powerful thrust with significant volume going above the 150 percent line. Interestingly, in hindsight, it proves the greatest amount of volume generally occurs at the halfway mark of the trend (see V3). Cross-checking with MetaStock Fibonacci Retracement plots will also show the retracement is at about the 50 percent level, where the high volume is concentrated.

Prices continued to rally but volume was not supportive. Volume was moving in the opposite direction. It was decreasing. Price reached the peak of \$3.37 for the week, which showed a bearish spinning top pattern candlestick, representing an indecisive tussle between the bulls and bears, and engulfing the previous week's bar. The following bars turned to dark red, indicating a likely change in trend as in B6. However, the RMA did not cross below the BMA. Prices renewed the rally but failed to hold on to the gain and declined again at B7. Note that the bar color changed to dark red, RMA and BMA merged, and prices crossed below both averages. This was the first negative area after the bullish rally. Prices tried to regain their thrust, as in B8, but failed again as bars turned red and RMA crossed below BMA. This was the second negative area. At B9, prices fell below both the RMA and BMA and the 21-week line. The bears had taken control. This was the third negative area. Note that volume was increasing quietly as at V4 in the negative areas, and at the two similar bearish patterns of dark cloud cover candlesticks, as marked at (1) and (2).

At V5, an alert was sounded when volume went above 150 percent and the two average lines, RMA and BMA, converged, indicating a probable trend reversal. At point (3), a bullish piercing candlestick was formed. The bullishness was confirmed by the following week's dark red candlestick as price crossed above RMA, BMA, the 21-week line, and the 63-week line. Bullish sentiment continued with upsurge of volume as at V6, and prices held firmly above all averages, indicated by blue candlesticks. This was the first positive area after the zigzag correction.

In the preceding paragraphs, we have detailed the trend system using moving averages covering a bullish impulse trend, bullish and bearish reversals, and an A-B-C correction. Although the chart showed a positive indication of a probable new trend in the making, as at the last bar of the weekly chart, it should not be presumed that such trend will rally to a new high.

TRADE ON DAILY SIGNALS

There is no question that spotting the beginning and end of a profitable trend, and the staying with the trend during its course, is the most difficult task. A trend can be disrupted by many other trends of different time periods because each time frame attracts different groups of interacting players. This results in convergence and divergence of the trend through different time periods.

Trends of very short time periods will be difficult to trade. In order to improve their performance, successful traders adjust their trading time frame to match their preferred holding period. The purpose is to separate the trend for the specific trading time frame from disrupting noises as much as possible. Risk is defined as the amount of money that a trader is willing to risk, and reward is the anticipated return multiple of the risk. It means if a trader is prepared to take a loss of \$1 on his trade, it would be worth the risk to expect a return of \$3. If a risk of \$1 is assumed to be a loss of 10 percent, the projected reward should assume to fetch a return of 30 percent. The 3:1 reward to risk ratio is a good ratio to use particularly for Hong Kong stocks, which tend to go into consolidation after a rise of 30 percent. However, the risk to reward ratio is subject to the personal decision of each trader. Trading time frame analysis of setup position will identify opportunity and risk in most cases. For example, when a promising setup appears on the weekly chart, a trader should check it to identify the major support and resistance levels that may have an impact on the 3:1 reward to risk ratio, and then use the daily chart to time the trade execution. This is an efficient and safe approach to trading.

For easy reference, let's recapitulate the preceding weekly chart in

Figure 7.3

(from June 12, 2009, to October 15, 2010) so as to work with the daily chart in

Figure 7.4

(from October 5, 2009, to October 15, 2010) for timing of trade execution. A momentum oscillator is added to both the weekly and daily charts as a supporting indicator to the system.

FIGURE 7.3

The weekly chart captures the bullish crossover of the medium-term average lines, as at EOW October 23, 2009.

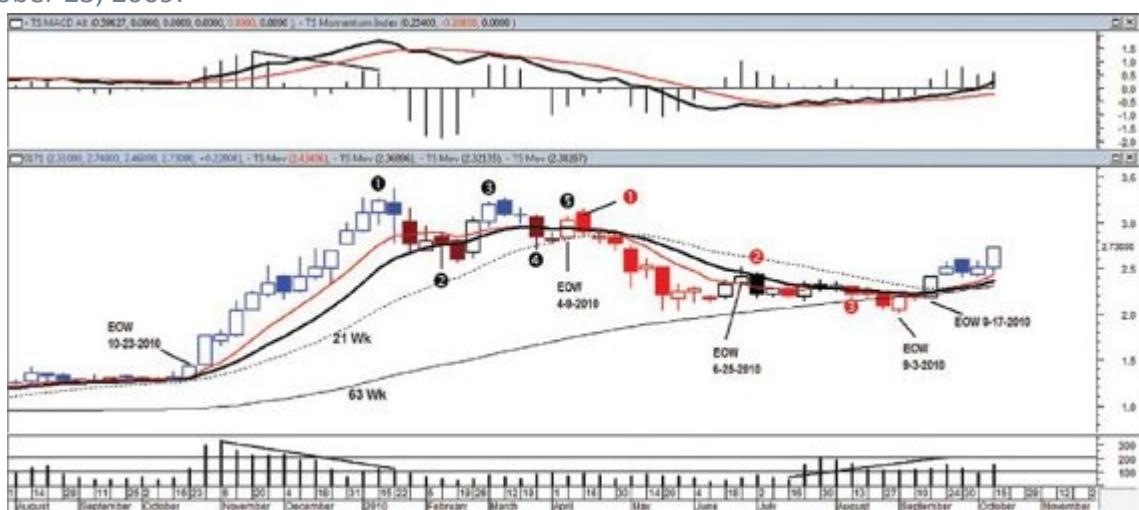
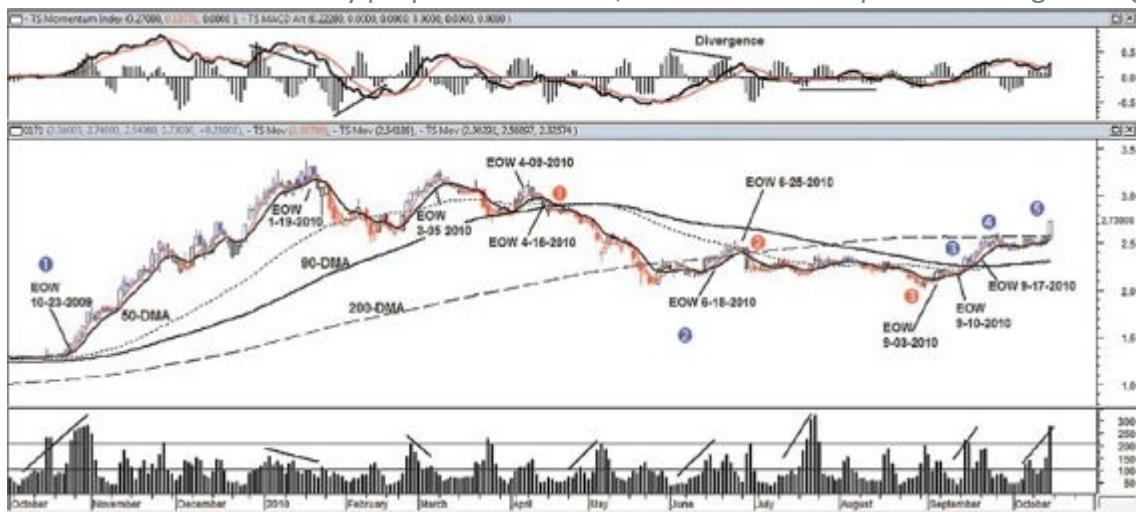


FIGURE 7.4

Daily chart of the same stock shown in

Figure 7.3

. The upper panel is the hybrid oscillator of a long and short momentum. The short momentum is the MACD histogram. The middle panel is the chart of the stock price with a BIC trend indicator, a pair of medium-time frame moving averages, and three longer-term moving averages. The bottom panel is the volume percentage plot between a 2-day moving average and a 10-day moving average of volume. For purpose of explanation of the system, end-of-week references are marked by perpendicular lines, which will not be plotted during trading.



Let's look at the weekly chart in

Figure 7.3

. The stock had been rising quietly since December 2009 (see

Figure 7.2

), and entered into a rectangle consolidation. The consolidation ended at the breakout of the pattern at end-of-week (EOW) October 23, 2009, which started the uptrend, pushing the price to a new high of \$3.30. Thereafter, the stock went into a triangle consolidation (see the blue circles marked 1, 2, 3, 4, and 5), which failed to uphold prices. Price broke away from the triangle pattern at end-of-week April 9, 2010, and started its downtrend move until end-of-week September 3, 2010.

The upper panel in

Figure 7.3

is the weekly momentum oscillator. The plot in histogram is the shorter time frame momentum of MACD. The line plot is the longer time frame momentum. The shorter time frame momentum has greater volatility and catches the minor fluctuation. It has an advantage by giving early divergence signals. The longer time frame momentum is less volatile and complements the shorter time frame and moving average system in confirmation of a probable trend reversal.

The weekly chart in

Figure 7.3

turned bullish at end-of-week October 23, 2009. For that week, daily prices moved above both the BMA and RMA, and the BMA also crossed above the RMA. The longer-term moving averages (50-day, 90-day, and 200-day) were also moving in order of alignment, indicating a probable bullish rally (see Chapter 6, Key Indicators). Both short- and long-term momentum showed bullish reversals confirmed by increased volume. This indicates a good opportunity to

buy in response to a probable change in trend. A buy should be taken on the next immediate trading day, Tuesday morning, October 27, 2009 (Monday being a holiday). The price at the open of the day was \$1.45. A tactical trading technique is to purchase two lots of the stock. The purpose of this technique will unfold as the process of trading is described further.

Prices trended up strongly for five weeks and began to slow down to form a diagonal pattern (see markings 1, 2, 3, 4, and 5 in chart in

Figure 7.3

). Although the pattern was bearish, prices failed to fall below the trough at Point 4 of the pattern, and the BIC trend indicator did not show any weaknesses. Weekly price movements indicate a continuing upward trend; weekly moving averages, RMA, and BMA were diverging, and long-term momentum was still trending upward.

In

Figure 7.4

, on Wednesday, January 20, 2010, although the BIC trend indicator remained positive, price did not make a new high. Instead, it closed the day with a bearish candlestick pattern, dark cloud cover. Long- and short-term momentum trends also remained listless, and together with the bearish price pattern, signaled a likely pause of the uptrend. This was confirmed on January 21 with the daily price falling below both the RMA and BMA, and the change of the color of the BIC trend indicator to neutral. A hangman candlestick was formed on January 22, as price continued downward. The week closed with a wide range bearish spinning top, and daily price fell below both the RMA and BMA with increased volume. Long and short momentum continued to be weak. It warned of a corrective phase in progress, which was confirmed by both weekly and daily BIC trend indicators to neutral color. One lot of the position was sold on Monday morning of January 25, 2010, at \$3.01, keeping one lot on hand just in case the market should turn bullish again.

On January 26, 2010, the daily price fell below the previous bar closing price, RMA also crossed below BMA, and the BIC trend indicator showed its first red bearish signal after a 14-week bull run. It might be deemed a coincidence, but a red bar after a long period is often a portent of further weakness. It is like seeing the first fall of snow as a sign of the coming winter. Prices trended downward to break below the 50-day average line, and started to settle at this level, vacillating around the average line. Weekly prices did not show any sign of extreme weakness, its RMA still trading above its BMA. The BIC trend indicator maintained its neutrality.

On February 23, prices made a bullish reversal. Prices crossed above both the RMA and BMA, and the RMA also crossed above the BMA. Long and short momentum also made a bullish reversal with increased volume. A rally was likely to follow. However, no new position was added as the reward to risk ratio was about 1:3; that is to say for every 10 cents to be gained there is a probable risk of 30 cents loss. Also the weekly momentum trend remained weak and the two weekly moving averages, RMA and BMA, were converging, which did not seem to support the daily price rally. And on March 26, the last position of one lot was sold at the opening price of \$2.80, when both daily and weekly momentum confirmed the weakness of the rally. The average disposal price for the two lots was about \$2.90 per share, which captured approximately 75 percent of the uptrend move, from the low of the date of entry to the highest price reached by the stock.

After the disposal, price tried to rally as at end-of-week April 9, 2010, but failed to maintain its momentum. It finally crashed below its 50-day moving average line and its 90-day average line for another 9-week period of bearish mood.

At end-of-week June 18, price made an attempt to rally, but was stopped at the resistance level of its 50-day moving average (see point 2 circled in red). There were no buying setups

offering a 3:1 reward to risk ratio. The downward trend continued till March 9 when prices made a significant thrust above the RMA and BMA lines, supported by the positive movement of the momentum oscillator. Prices went into a trading range for one week. On September 17, the uptrend movement was confirmed when both daily and weekly charts turned positive. A buy order for two lots was entered on the next trading day, September 20, 2010, at \$2.45, which saw a breakaway gap. A protective stop would have been set at \$2.35, being the low of the preceding bar. On October 14, price spiked up to close at the day's high of \$2.57.

The preceding describes a detailed scenario of a trading system that applies the concept of using crossovers between price and its averages and the crossovers of different time spans of moving averages in weekly and daily charts. The use of weekly charts is mainly to filter out noise created by daily prices, and also to avoid overtrading. The strategy is to trade in the direction of the larger time frame (the weekly trend) and to execute the trade based on the smaller time frame (the daily trend).

Moving average is perhaps the simplest and most widely used method applied to identify the trend of price movement. Generally, moving averages are used (1) as a forecast value for the next projected time period, (2) as a means of measurement, and (3) as a supportive indicator to other trading systems.

The formulas for plotting various indicators described in this chapter are in MetaStock format. The following are the formulas for plotting the long momentum oscillator as shown in

Figure 7.4

.

{"Long Momentum"}

```
Prd1:=Input("Smooth",1,144,5);
Prd2:=Input("Average 1",1,144,1);
Prd3:=Input("Average 1",1,144,7);
x:=Input("Oscillator Multiplier",1,1000,1);
mmt1:=x*(Mov(ROC(CLOSE,21,$),prd1,S)+ROC(CLOSE,13,$))/2;
Mov(mmt1,prd2,S);
Mov(mmt2,prd3,S);
```

The basic formula for calculating the various moving average lines is as follows:

```
Period:=Input("MA Period",1,300,n);
SF:=Input("Slope Factor",-20,20,n1);
sma:=Mov(close,period,s) + LinRegSlope(close,period) * SF;
sma;
```

The formula for the volume indicator is as follows:

```
prd1:=Input("Fast Period",1,300,2);
prd2:=Input("Slow Period",1,300,10);
evp:=Input("Extreme Volume Percentage",1,500,200);
```

```

vavg1:=Mov(volume,prd1,s);
vavg2:=Mov(volume,prd2,s);
z:=If(vavg2=0,0.0001,vavg2);
VolRatio:=100*(VAvg1/z);
VolRatio;
100;
evp;

```

Here is another example on the trading concept of “Look at the weekly, trade on the daily.”

Figure 7.5

shows the weekly chart of a stock that had declined since November 9, 2007, from a high of \$25.40. It fell by approximately 86.4 percent to a low of \$3.46 on October 31, 2008. It made a three-wave rally to a high of \$11.50 at lower volume on June 5, 2009, and continued downward to a low of \$5.57 at the week ending February 25, 2011.

FIGURE 7.5

Weekly chart showing probable trading range of the stock and the interesting progression of a 30-day cycle period.



From the weekly chart, it is interesting to note that price momentum has reached its oversold zone level on three occasions: October 31, 2008, December 24, 2009, and February 25, 2011. There is a period of approximately 60 weeks between each low. And the week ending February 25, 2011, is approximately 90 weeks from the high of June 5, 2009. From the low of December 24, 2009, to October 22, 2010, prices managed to hold at approximately 50 percent to 61.8 percent of the Fibonacci Retracement support zone, as momentum moved upward to overbought zone. This reflects the improvement of the strength in price. After making a double top, momentum fell as prices failed to hold above the support levels and reached an oversold position with a low of \$5.57 at week ending February 25, 2011. The oversold position provides a setup for traders to look at probable trade opportunity on the daily.

Now let's look at the daily chart as shown in

Figure 7.6

FIGURE 7.6

Daily chart showing the interplay of moving averages and probable trade entry and exit signals (upper panel). The middle panel is the momentum indicator, with its overbought/oversold indicator. The bottom panel is the volume histogram. Note the divergence of both momentum from price and volume from price.



As early as February 1, 2011, the daily price momentum had been in an oversold position. For the next 30 days, momentum did not make any new low, which reflected the stabilization of price and depicted a divergence between price movements.

On February 24, 2011, price made a downward thrust by a wide range bar with increased volume, which became the range for the next five trading bars. This was followed by five inside narrow bars. An entry signal was alerted on March 4, 2011, when price crossed above both medium time frame moving averages and momentum also crossed above the zero line. The bullish signal was supported by the built-in-color trend indicator and increased volume. On March 7, 2011, price traded in a narrow range similar to that of the previous day, again allowing opportunity to enter a trade for two units of the stock.

On March 8, 2011, price made a strong rally, crossing above the 10 percent band of the 90-day moving average line. Price continued its uptrend for the next seven trading days. Although prices had crossed above the three longer time frame moving averages, the 50-day, 90-day, and 200-day, showing an underlying strength of the trend, the three moving averages were not in alignment. This suggested that the positive trend would be short-lived if prices failed to consolidate at this level. Average volume traded had dwindled, and the first sign of weakness in trend was shown on March 17, 2011, when the built-in-color trend indicator changed its bullish blue color to black and momentum crossed below its average line. Following that, on March 22, 2011, price made a bearish hammer pattern, and an exit signal was made for one unit of the trade on the next day.

Prices continued to fluctuate in narrow ranges. Although the 50-day moving average line crossed above the 200-day moving average line on April 15, 2011, the 90-day moving average line remained relatively flat and diverged from the 50-day and 200-day moving averages. And on April 27, 2011, the first red bearish bar appeared and signaled the exit of the remaining one unit of the stock.

TRADING WITH ICHIMOKU

The concept of the trading method and Queuing Theory can also be applied to Ichimoku charting technique. The complete Ichimoku indicator comprises five lines, Tenkan-sen, Kijun-sen, Senkou span A, Senkou span B, and Chikou span. In

Figure 7.7

, Chikou span is not plotted. Chikou span is the closing price of the current candlestick, plotted backward by the period of the Kijun-sen.

FIGURE 7.7

Using Ichimoku lines to track trade opportunities. Support of RSI and volume indicators appears in the bottom panel.

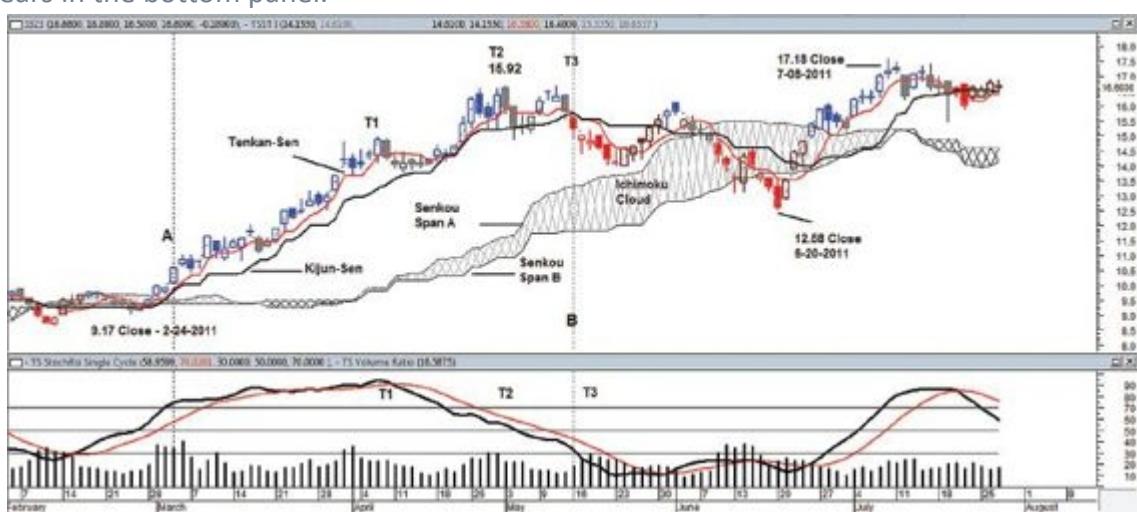


Figure 7.7

is an illustration of how the principles of the trading method described in this book can also be applied to various indicators. As an example, the chart uses the popular indicators such as Ichimoku indicator, volume, and RSI (relative strength index).

The popular Ichimoku Cloud, shown in

Figure 7.7

, is the filled space between the faster line, Senkou span A, and the slower line, Senkou span B. The Ichimoku Cloud often acts as the equilibrium zone of price movements, and it marks an area of support and resistance. When price moves above the cloud, it is said it has broken out of the resistance area, and when price moves below the cloud, it has fallen from the supporting area. When prices are trading or fluctuating in the area of the cloud, it normally indicates a tug-of-war between sellers and buyers in a trading range, where price movements can sometimes become unpredictable. Ichimoku Cloud can vary in depth and thickness. A thicker cloud indicates higher past price volatility, and a thinner and shallower cloud indicates lower volatility.

The Tenkan-sen is the faster line and the Kijun-sen is the slower line. An uptrend is triggered when price crosses above both lines and also crosses above the cloud, as marked in Point A in

Figure 7.7

. Crossing of the Tenkan-sen from below to above the Kijun-sen signifies positive signal, and crossing of the Tenkan-sen from above to below the Kijun signifies negative signal, as marked

by Point B.

The Queuing Theory, as it is described in Chapter 6, will work in Ichimoku charting technique. When a trend is positive, the various Ichimoku lines, the Tenkan-sen, Kijun-sen, and the cloud (formed by Senkou span A and Senkou span B) should also be in sequential order to price. When any of these lines is not in sequence with the price, the trend in progress may be short-lived. When prices have moved to an extreme level, a change in trend is anticipated, as marked by Points T2 and T3 in

Figure 7.7

When price is making a change in trend, its movements are often hidden in pattern formations such as divergence between the price and momentum oscillator, price and volume, price spread and volume, and convergence and divergence of various moving averages. Divergence that hints of an impending change does not necessarily take place at the exact turning point, but may have been in the making weeks ago.

Extreme levels of prices or proximity of extreme levels are often reflected in the divergence between price and momentum oscillator, as shown in Points T1 and T2 of

Figure 7.7

. Generally, momentum oscillators in an uptrend tend to rally quickly to overbought levels before price makes its peak. And as momentum starts to slow down while price catches up, it will create a divergence between the slope of price and oscillator. At T1, the momentum oscillator rallies to its overbought level, and retraces gradually to T2, where price makes its peak.

The importance of volume, covered in Chapter 5, cannot be ignored. Volume helps to confirm the validity and the strength of the trend. At Point A of

Figure 7.7

, the rally of price above the cloud was supported by increased volume. At point T2, the rally of price to its peak was not supported by volume in comparison to the volume at breakout or at point T1. The rally to point T3 also was not supported by volume comparative to T2, indicating a weakness in the rally. Although price reached a new high to \$17.18, the rally was not supported by increased volume comparative to volume at the price level of \$12.68. In addition, the Ichimoku lines and the cloud were not in sequential order, indicating a weakening or slowdown of the uptrend.

Figure 7.8

is another chart using only the Ichimoku cloud, two sets of moving averages, volume, and RSI indicators. No description of interpretation is being made, but readers are urged to see for themselves how they would have traded in this stock.

FIGURE 7.8

Chart displaying plots of Ichimoku Cloud, moving averages, RSI, and volume indicators.



CONCLUSION

The aim of reading stock charts is to track trading opportunities by identifying price behavior, which is based on recognition of past price patterns and price analysis, to anticipate the probable outcome.

The concept of the trading method described in this book is for end-of-day (EOD) traders, and the method is centered on a trend-following concept. To reduce risks, the method embodies as its main tenet the usage of two time frames to better gauge trade entries and exits. The combination of the four dimensions related to trend, as discussed in earlier chapters, will help traders to identify different market environments and to switch a trading strategy from trending mode to mean reversal mode using the momentum oscillator and Queuing Theory. The method will assist traders to differentiate between a market that is in a corrective phase and one that is in an impulse phase and to anticipate areas of support and resistance levels, so they may plan their trading strategy accordingly.

These are the basic assumptions of the methodology:

Watch the weekly and trade the daily; trade entry or exit should be looked at from the weekly chart first before making any entry or exit trade. Weekly charts should be used to support the daily charts in determining whether the current phase of the market is a trending or non-trending phase in the longer time frame, and whether the current phase of the market offers a trade entry with a lower risk or a trade exit that will safeguard investment value.

When a market is making a change in trend for the better, each of the four dimensional aspects of trend (price patterns, volume, price momentum, and interaction of price and moving averages) will also be adjusting itself in the positive direction. When the trend has developed, the four dimensions of trend will act in tandem with each other to sustain the trend.

Queuing Theory on moving averages is not confined to any particular set or group of moving averages. There are no preset numbers of moving averages to be used, nor is there any preset period to be applied to any specific moving averages. The key principle is that when a stock is in a strong trend, its various relative moving averages will move to align in sequential order until price reaches its extremes and starts to reverse the order of alignment. A price rally in which its relative moving averages fail to follow in sequential order will tend to be short-lived. Generally, it indicates the market is going into a corrective phase.

No mandatory requirements are set in regard to the use of indicators. Traders may continue to use their preferred indicator or indicators, which they are familiar with and which they have used confidently in their trading.

A good trading system is one that gives a trader an edge in executing his trades, whether in a volatile trading market or in a narrow-range market. Designing a system of trade requires patience. A good start is to write down your thoughts on what you want to achieve through the system. Just take note that there is not one single trading system that will detect precisely the price movements of every stock. Every stock has its own characteristics, business activities and prospects, earnings and dividend ratios, price movement patterns, groups of investors, and so forth. However, there is one similarity in every trading system. That is, when a stock has a strong trend, almost every trading system is good. Similarly, there is no one single oscillator with identical parameters that will fit across the board for all stocks, and though most

oscillators are momentum based, their results will differ and the visual output will also differ.

Every opportunity comes with a time element; time regulates opportunity. Many traders habitually fail at time management. Many traders may sit on nonperforming stocks for months and tie up their investment capital while good opportunities pass by, while other traders may miss major support and resistance that appears on the next higher time frame. In short, traders must acknowledge the importance of time and manage time as efficiently as price, combining price and time triggers for protective stop-loss management. It may be justified to consider using time to activate trade exits on nonperforming stocks even when price stops have not been breached. And it may even be more justified to sell at the time of a bear crunch and to enter the market when time aspects improve the odds for profit.

In investments and trading, success requires three elements: money management, trading methodology, and understanding of time. Time is the least understood. Time has great influence on the market because when the time is up, trend changes. One common issue with time is often seen in the accumulation or distribution of a stock. When such activity is over, prices will break out of the accumulation pattern upward or break out of the distribution pattern downward. Other issues with time include understanding time in trend continuation and trend correction. Time remains the hardest of the three elements to master. Chapter 9 may help traders learn more of how to use financial astrology to choose the best timing for their trades and to find the best time in their personal cycles to trade.

CHAPTER 8

Formulating Your Trading Plan

In 1992, Jack Schwager published *The New Market Wizards*. The chapter titled “The Silence of the Turtles” covers an interview with Harold Seidler, one of the many market wizards mentioned in the book. In this interview, Jack asked Harold, “What advice would you give someone in regards to being successful in the markets?” Harold replied: “I think the single most important element is having a plan. First, a plan forces discipline, which is an essential ingredient to successful trading. Second, a plan gives you a benchmark against which you can measure your performance.”

Trading is an exercise in well-planned strategy. It is said that to have good trading results, a trader needs to spend 70 percent of his time in planning and only about 30 percent in trading. He formulates a plan and follows it in a firm and disciplined way.

The ability to make decisions confidently in trading is to get rid of the fear factor. Fear arises when there is uncertainty. Fear is a hindrance to making good decisions and having a trading plan will help alleviate fear. A trading plan does not have to be complicated, but it has to be clear. It has to blend with the trader’s character and thinking.

The trading plan should include the basic elements of deciding the type of trades that suit the trader, the method of selecting stocks, the conditions for trade entries and exits, and the contingent steps to protect capital.

In this book, examples of trading are not based on real-time data, but on end-of-day data.

DETERMINING YOUR TIME FRAME

First and foremost, ask yourself, “How much time will you have to trade?” This will determine the type of trader you are going to be—a day trader or an end-of-day (EOD) trader. An EOD trader, or swing trader, can buy and hold a stock for a week or even up to a few months. Becoming a swing trader is the preferred choice for most traders who are using end-of-day data. Those who buy and hold stocks for years are known as position traders or long-term investors.

The next question is to find out how are you going to trade—will it be discretionary trading or system trading? The type of trading will define the time frame. Active traders who enjoy a fast paced style would not find much action in weekly or monthly time frames, while less active traders generally find that the extremely short time frames are too tedious or take too much of their time. Decide which style best suits your personality, and then select the corresponding time frame.

One important reminder, regardless of whatever time frame you are going to trade in, you have to do homework. You have to do your analysis outside of market hours, because when the market opens, you will not have sufficient time to think and deliberate on the course of your actions.

Since the data used in this book are end-of-day data, the book addresses issues from the view of swing traders, and the trading methodology adopted is a combination of mechanical system trading and discretionary trading, as outlined in Chapter 2 and Chapter 7. Some swing traders are discretionary; they use technical and/or fundamental analysis to evaluate each potential trade, and make decisions based on the rules they have outlined for themselves. If they have a good intuitive sense of the market, they may also use discretionary stops. Many professional traders use discretionary stops, but we would not recommend it for the novice or beginning trader.

SELECTING STOCKS

There are many methods for choosing stocks to trade. Stocks may be selected on the criteria of fundamental and/or technical analysis. The market index may be used as a benchmark to choose those stocks within a certain range of price-earnings ratios, dividend yield, and consistent earnings. But there is one universal rule: Never buy any stock on hearsay information, no matter where the information comes from, without doing a study of it prior to the purchase. More exoteric approaches on how to select stocks are provided in the next chapter; however, the methods are not exhaustive.

Whichever method you prefer in selecting stocks, do not trade a stock that has no trading liquidity. If a stock is not very liquid, it means that you may not be able to buy and sell it at the volume you want, at the price you would like, or when you want. Trading liquidity is therefore important to the relative size of your holding. Here is a simple example. If the average daily trading volume of the stock is about 10,000 shares, it would not be in your best interest to hold 100,000 shares because you will not be able to dispose of them quickly when the trend turns bearish. But, on the other hand, if the average daily trading volume is 100,000 shares, it should not be difficult for you to dispose of your holding.

After you have picked the list of stocks to trade, you then have to decide on position sizing: the number of stocks to trade and the dollar value of each stock you feel you will be able to handle without undue stress. Should you focus all your trades on one stock, or should you spread your trades to cover multiple stocks? It will depend on your capabilities and capital exposure. Some traders may not be able to handle more than 10 stocks in their trading portfolio. Having a diversified trading portfolio covering a wider selection of stocks does not necessarily mean lesser risks. In managing a trading portfolio, there is a limit to the size of portfolios each person can handle in terms of number of stocks and value; you have to find the limit that you will be comfortable with. Remember that in trading, having a large list of stocks may not necessarily give you a balanced portfolio if you are unable to focus and manage your stocks efficiently.

RISK MANAGEMENT

In trading stocks, there is no way that a trader can avoid taking losses on some trades. Some of the most successful traders are those who are willing to take a loss. The question is how much of a loss is a trader willing to take, and does he have the discipline to cut his losses. Having a trading strategy is a good start, but it will not mean anything if the trader has no idea of money management in trading. Money management planning is a very important part of trading and has one objective: capital preservation. There are many risk management techniques. It is up to each trader to form his own plan of how he will keep risk to a minimum while, at the same time, keeping his investment at a maximum level within the degree of risk he is willing to take.

Before a trader commits to trading, the risk factor of managing various stocks should be included in the trading plan. Trading stocks is about keeping risks to a minimum. A trader should have a realistic profit target that meets his reward to risk ratio. What is the estimated profit of the stock against its downside risk? Many professional traders do not take a trade unless the potential profit is at least three times greater than the possible loss. How much risk is appropriate varies with each trader and may be as high as 5 percent of the total portfolio value on a given day, or as low as 1 percent of the total portfolio. Some traders may prefer having different risk ratios for each stock, but will also take into consideration the risk factor against the aggregate risk of the trading portfolio. Through trial and error, a trader has to find that comfort zone in which he can trade confidently.

DETERMINE ENTRY POINTS

Having made your selection of stocks does not mean a trade should be entered immediately. You have yet to determine the specific conditions including entry price, which allow you to execute your trade, and initial protective stops, which allow you to exit should the market turn against you. This is the challenge.

In trading, you need to know when to engage in a trade and when not to trade; you do not need to trade every day. You cannot be trading all the time, especially when the trend is against you. Catching the trend of the market is the key. However, the market does not move in trend all the time. When the market is not trending, you have to stay on the sideline. You will win when you are trading with the trend because you will have the support of the trend. You will lose if you trade against the trend, whether in a bull market or in a bear market.

Do not overtrade. Overtrading means making trades beyond your means and ability.

DETERMINE EXIT STRATEGIES

Traders have various choices when it comes to exiting trades. Some traders use “trailing” stops as their exit strategy of choice, while others choose to exit when the stock hits a certain target percentage, or breaks through a support or resistance level. Some traders will choose to exit based on expected news releases. The exit strategy is one of the most important parts of any trading plan, and it is important for traders to have an exit plan before entering a trade. In the event the market turns against you, do you have a strategy that will protect your capital?

You must be ready to take your profits and cut your losses. Do not hang on to any beliefs based on your ego or your fantasies when the market is not moving the way you expected it to.

REALITY CHECK

Success in trading takes time; it is not served on a platter. As the saying goes, the fried pigeons don't fly into a trader's mouth! Trading, like any other business, requires a plan. A trader has to develop his strategy and must evaluate and review it constantly to improve his performance and to trade in accordance with optimal risk to reward parameters. The following are three examples of checklists: (1) Additional Chart Checklist, (2) Execution of Trade Checklist, and (3) Trade Plan Summary List. The first two checklists contain certain key reminders that a trader needs in the course of his trading. The third list is a summary for keeping a trading log. The keeping of a trading log is imperative as, after a period of trading, it will give the trader an analysis of how his wins or losses are made, and it will serve as an important study of his trading style and help him adjust and improve the results.

Additional Chart Checklist

Reminders	Things to Do	Reasons
What is the market trend?	<input type="checkbox"/> Check daily trend. <input type="checkbox"/> Check weekly trend. <input type="checkbox"/> Check the sector trend. <input type="checkbox"/> Check market trend.	You have a higher probability of winning if the stock is bought in a positive weekly trend and the overall market is bullish too.
How did you select the stock?	<input type="checkbox"/> Fundamental values. <input type="checkbox"/> Technical analysis method. <input type="checkbox"/> Liquidity of stock.	Choosing the right stock will affect the performance of your portfolio.
What is the news?	<input type="checkbox"/> Check current political and economic news. <input type="checkbox"/> Check current news of the company. <input type="checkbox"/> Check stock sector news.	Local or global news will affect the movements of the general market. News regarding the company stock and its relative sector will affect its price direction.
What is the coming news?	<input type="checkbox"/> Check coming economic news. <input type="checkbox"/> Check coming news to be announced by the company.	Prices often move ahead of announcement of news. Government's regular economic news can affect the market.
When is the announcement of earnings and dividends to be made by the company?	<input type="checkbox"/> Check announcement date of earnings and dividends. <input type="checkbox"/> Check announcement date of earnings of similar sector stock, which may have certain influence.	Prices tend to move prior to dates of earnings announcement and earnings of similar sector stock may affect the stock movements.

Execution of Trade Checklist

Check	Look for:
What is the trend?	<input type="checkbox"/> Is the daily BIC trend indicator positive or negative? <input type="checkbox"/> Are the medium-term averages in tandem with BIC?

	<input type="checkbox"/> Has price crossed above the medium-term MA's? <input type="checkbox"/> What is the weekly trend indicating?
What is the longer time frame average indicating?	<input type="checkbox"/> What is QMAC indicating? <input type="checkbox"/> Is the trend indicating a short-term or long-term move? <input type="checkbox"/> Where is the probable support/resistance? <input type="checkbox"/> Where is the price relative to the longer MA's?
Where is the price position?	<input type="checkbox"/> Where is the price relative to the longer time frame MA's? <input type="checkbox"/> Is price making a new high/low for the trading time frame? <input type="checkbox"/> Is there a price break from a bullish/bearish pattern? <input type="checkbox"/> Where is the price in relation to Fibonacci retracements or projections? <input type="checkbox"/> Where is the price relative to Elliott Wave pattern?
What is the response of volume?	<input type="checkbox"/> Is the uptrend supported by higher volume? <input type="checkbox"/> Is the downtrend led by higher volume? <input type="checkbox"/> Does the volume show any irregularity?
What is the momentum oscillator indicating?	<input type="checkbox"/> Is there any divergence between the oscillator and price? <input type="checkbox"/> Where is the weekly oscillator, oversold/overbought? <input type="checkbox"/> Where is the daily oscillator, oversold/overbought?
What is the strength of the trend?	<input type="checkbox"/> Is ADX confirming the strength of the uptrend/downtrend? <input type="checkbox"/> Is ADX making a directional turn at its peak?

Trading Plan Summary List

TRADE PLAN SUMMARY LIST <i>(Summary pertaining to trading record of one stock)</i>			Date Open:		
			File Number:		
			Stock Code:		
1	TRADE CHECKS				
1.1	MANDATORY SETUP POSITION	Buy	Sell		
1.1.1	Weekly momentum	Bullish, not overbought	Bearish, not oversold		
1.1.2	Weekly moving averages	Bullish crossover	Bearish crossover		
1.2	DAILY ENTRY/EXIT REQUIREMENTS				
1.2.1	Patterns Candlestick/Classic patterns Elliott Wave positioning				
1.2.2	Volume (In tandem with price)				
1.2.3	Price Momentum	Bullish reversal	Bearish reversal		
1.2.4	Price, MA crossovers, & QMAC				
1.3	OTHER INDICATIONS				
1.3.1	Divergence (volume, momentum)				
1.3.2	ADX				
1.3.3	Planetary Indicators				
2	TRADING DECISIONS				
2.1		Date	Date	Date	Date
	Buy				
		Shares	Shares	Shares	Shares
	Number				
	Price				
	Amount				
	Total O/S				
2.2		Date	Date	Date	Date
	Sell				
		Shares	Shares	Shares	Shares
	Number				
	Price				
	Amount				
	Net Position				
	Profit/(Loss)				
	Notes				
2.3	Stop-loss procedure				
2.4	Profit methodology				
3	TRADE EVALUATION				

CHAPTER 9

Financial Astrology

This chapter deals with how to make use of the lunar cycle. The lunar cycle manifests as the most frequent and predominant cycle among the various astrological cycles. Cyclical patterns have been observed in many fields, such as biology, astronomy, agriculture, and social spheres, to mention a few. It is well accepted that the phases of the Moon influence people's behavior, and scientists established long ago their relation to the rising and falling of the tides. In July 2010, the Royal Bank of Scotland published a report on the correlations between the Moon's phases and the behavior of financial markets ("Sheer Lunacy Staring at the Heavens,"

www.rbsm.com/strategy

). The study showed a remarkable increase in profits in a lunar-based buy-sell strategy as compared to a regular buy-hold strategy.

USING LUNAR CYCLES IN TRADING

The lunar buy-sell strategy is based on buying on the new moon and selling on the next full moon (usually in 14 to 16 days). We quote here an excerpt from the Bank of Scotland report: "If an investor had invested PStg 1000 in FTSE in 1984, by now he would have approx. PStg 5,130 by holding the index, which represents index performance, whereas trading FTSE according to moon phases would make a big difference. First, consider buying FTSE on the new moon and selling on the full moon, this would result in PStg12, 116 overall figure for the same period. It means more than double the profits." It is noteworthy that the strategy would have been even more profitable for the DAX and the HSI. The result for the S&P 500 data is also higher, but that is because the strategy was applied since 1928.

Conversely, buying on the full moon and selling on the new moon would have considerably underperformed the buy-hold strategy. This supports the theory of a correlation between index prices and moon phases because the new moon traditionally symbolizes low energy or energy accumulation, whereas the time of the full moon is a period of fruition, high energy, and spending.

The influence of planetary cycles on stocks has also been well documented by Raymond A. Merriman in his seminal work, *The Ultimate Book on Stock Market Timing*, Volumes 1 to 5, in which he describes how solar and lunar phases correlate to short-term trading reversals. Similarly, Patrick Mikula, using TradeStation software back in the 1990s, tested a lunar-based buy-sell system combined with stochastic momentum on soybean futures, and found that using the new moon for the entry and the full moon for the exit had the highest correlation. For the period tested, the system produced 44 trades with an overall 66 percent profitability, with the long trades being 54 percent profitable and the short trades 88 percent profitable.

So it is quite well established that the phases of the Moon influence the prices of certain stocks and also of some commodities like wheat, corn, soybeans, and silver. For the sake of simplicity, we are only concerned with two of the various Sun-Moon phases, namely when the Moon forms a 0-degree conjunction with the Sun at the new moon (the Sun, Moon, and Earth appear in line) and when the Moon is in opposition to the Sun at the full moon, or 180 degrees apart. The Sun and Moon are in square aspect (90 degrees) during the first and third quarters, in 120-degree aspect during a waxing or waning gibbous moon, and in a 60-degree aspect during a waxing or waning crescent moon. These latter aspects do not have the same influence as the 0- and 180-degree aspects, but tend to influence the market upward during trines (120 degrees), downward during squares, and can influence the market in either direction during sextiles (60 degrees). Some traders simply add the time of the new and full moon dates to their charting tools to indicate potential turning points, and a number of chart-drawing services and programs now offer this function as well.

Figure 9.1

uses TradeStation software with an add-on module from Soulytion to show the new and full moon phases as applied to Global X Silver Miners ETF (Symbol: SIL), which is traded on the New York Stock Exchange. In astrology, the Moon rules silver, and it does seem the correlation between the spikes in blue indicating the full moons (sell), and the spikes in red at the new moons (buy), fit well with the price trends in

Figure 9.1

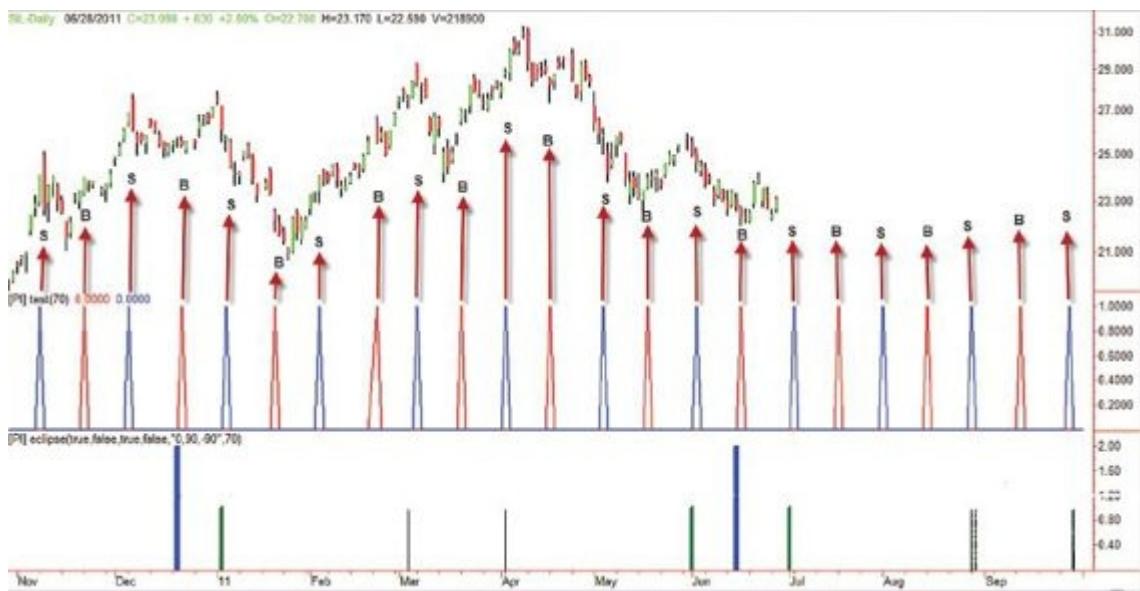
. The bottom part of the chart shows the lunar (blue bars) and solar eclipses (green bars), which, as mentioned in Chapter 2, may increase the effect of the lunations.

FIGURE 9.1

Lunar signals applied to Global X Silver Miners ETF. The eclipses shown at the bottom add strength to the lunations. In some cases, it means that an existing trend may accelerate sharply. In other cases, it increases the odds of a reversal, so the indicator must be viewed in the context of technical analysis and other signals.

Source: Steffen Peter at

www.soulytion.de



Lunar cycles are subject to the laws of accumulation and redistribution. The first half of the lunar month is a process of accumulation in which the market grows. The second half of the lunar month is often one of redistribution and weakness. This pattern works well in a rising market, but can become a trap if the market enters a bear phase, with shares falling sharply. Therefore, if there is no accumulation in the first half of the lunar month, traders should be alert to the fact that there may be a change in the larger trend.

To test the observation that lunar cycle coincides with swing tops and bottoms, it is suggested that a momentum indicator, such as stochastics, is included. Ideally, the buy signal in the new moon phase should coincide with a reading below 20 in the stochastics. A reading above 80 should coincide with a sell signal. Naturally, the correlation doesn't always manifest so clearly, but the combination is another way of filtering out those Moon-phased buy and sell signals that may be out of sync with the prevailing market.

Lunar signals can apply quite well to some individual stocks, but for the most part, it will be found that they correspond better to major indexes, commodities, and some commodity-based ETFs. This is mainly because of the Moon's known influence on mass psychology. However, one should not rely only on a lunar-phased buy-sell program for trading. What the examples are meant to show is that the lunar phase may be a useful additional indicator, and that the correlation with market moves is significant enough statistically to warrant the inclusion in one's arsenal of trading tools.

To prove the point a little more, a lunar buy-sell trading system was used in the new addition to Timing Solution software, called Terra Incognita. This advanced program optimizes models, conducts back-testing, and provides trading signals with all appropriate statistics for trades.

Figure 9.2

is based on the Moon-Sun lunar cycle, as applied to the Dow Jones Industrial Average (DJIA).

FIGURE 9.2

Lunar cycle buy-sell system applied to the DJIA. It has been optimized so that certain signals in strong up- or downtrending markets have been filtered out. The green areas at the bottom indicate profitable periods, and the red areas indicate losing periods. During the period from 2003 to 2007, the equity curve (blue line at bottom) was flat, but it turned up again in 2008.



Finally, it may be of interest to see what the pairing of the Moon with Mercury might produce in terms of cycle signals. Mercury primarily rules communication, but also commerce. It has a rotational cycle of about 88 days and, like the Moon, is a fast-moving planet.

Figure 9.3

is based on a heliocentric model, and the 120-degree aspect between the Moon and Mercury correlates well with the changes in trend.

FIGURE 9.3

The Moon and Mercury in increments of 120-degree aspects, that is, 120, 240, and 360 degrees on a heliocentric basis (as seen from the Sun). This cycle does appear to coincide with major changes in trend. The bottom shows a VZO money-flow indicator, which tends to peak or bottom at the same time as the CITs.



HOW TO PICK WINNING STOCKS

Investors nowadays have access to a large number of software programs and free online services that allow them to select stocks based on a customized set of conditions and variables. Some services apply fundamental analysis to rate thousands of listed companies, perhaps on a 10-point scale, using advanced mathematical systems to determine a stock's expected risk and return, or to simply rate it a "buy," "hold," or "sell." Other methods of evaluating securities may involve technical analysis, as described in Chapter 7, Applied Systems, and Chapter 8, Formulating Your Trading Plan. There are endless ways one can approach the process, but a combination of both fundamental and technical analysis seems to be the preferred method for most investors and fund managers. Given the plethora of choices, the overriding question is still, how does one improve one's chances of picking the stock with the best potential to go up in value? Not everyone has the stock-picking talent of Peter Lynch or Warren Buffett, or access to sophisticated quantitative stock-rating programs, so an ordinary investor or trader may often be at a disadvantage. Moreover, stock picking has almost become a lost art since the onset of the financial crisis. Sentiment has alternated between euphoria and despair, and time-proven methodologies have failed in the extraordinarily volatile environment since the financial meltdown in 2008.

This section is not meant to be a primer on how to select stocks or build portfolios using conventional value-analysis methods like the top-down or bottom-up approaches. Many other books are available on those topics. The aim is to provide some additional tools that may help in the stock-selection process through a combination of conventional and more esoteric approaches.

Before starting, it may be of interest to know how six different fundamental investment strategies have performed in Asia's stock markets since the beginning of 1997. Research was undertaken in July 2009 by strategists Daniel McCormack and Viking Kwok at Macquarie Bank and reviewed by Tom Holland of the *South China Morning Post* ("Valuations Say Buy, But the Fearful Doubt Their Validity," *SCMP Monitor*, December 3, 2008).

Some widely used techniques performed surprisingly poorly. Buying the shares of companies with the strongest balance sheets, for example, would have produced lousy returns. Macquarie's analysts ranked their universe by the Altman Z score—a common measure of financial health—and found that, over the past 10 years, the strongest 20 percent of companies significantly underperformed the rest of the market.

Buying stocks with strong earnings growth proved similarly disappointing. In this case, the Macquarie analysts ranked companies by expected earnings growth and found that the first quintile—the top 20 percent—performed just as poorly as the bottom quintile, with the second quintile doing almost as badly.

Momentum investing didn't do well either. Although momentum investing is a popular strategy, buying stocks that have performed well recently doesn't work. Macquarie ranked equities by their performance over the previous three months and found that the first quintile subsequently underperformed the market. The weakest quintile delivered the best returns.

In fact, by far the best strategies for buyers of Asian stocks over the last 12 years have been classic value-driven techniques. Buying stocks for their dividend yield works reasonably well, with the first quintile handsomely outperforming when markets are weak.

Simply buying the cheapest stocks in the market delivers the best returns, however. According to Macquarie, the 20 percent of stocks with the lowest price to earnings ratios

outperformed the overall market 63 percent of the time.

It has been even better, however, to invest in the cheapest stocks ranked on a price to book value basis. In this case, buying the first quintile—Q1, or the cheapest 20 percent of stocks—has been what Macquarie calls “a massive and consistent outperformer,” whatever the state of the wider market. In view of this information, traders might do well to incorporate price to book value into their fundamental selection criteria.

The need to hone stock-picking skills is obviously critical to the performance of any investor or fund manager, and was brought home again recently when a leading fund reported the results of their trading for the past week on October 18, 2010. The report mentioned that the model portfolio returned 1.7 percent while the underlying index gained 6.7 percent. On examining the fund’s portfolio, it turned out that although many of the stocks had been in the right sectors and had appreciated nicely, all the gains were offset by some underperforming stocks or “laggards.” Using the stock-screening procedure described below, these “laggards” might well have been excluded from the start, and the performance of the fund would have greatly improved. We shall take a closer look at two of them (151 Want Want and 828 Dynasty Fine Wines) later in the chapter.

So how to go about it? The first step is to establish a database of all those shares one has interest in and load them in a charting software program, such as TradeStation or MetaStock or any one of the many others that are available.

Yahoo! Finance, Google Finance, and quite a few others provide stock prices and fundamental data for free. One may also subscribe to a stock-screening service or use Internet sites such as Yahoo! Finance or *Financial Times* (at

www.ft.com

), where it is possible to compare the price performance with other stocks in the same sector. At

www.ft.com

, one may run a stock screen based on favorite parameters, including return on equity, P/E ratios, or preferred price range, and it will screen all the stocks listed in major markets around the world. It is even possible to use a screener that combines both fundamental and technical analysis such as the one provided by Financial Visualizations (at

www.finviz.com

). In addition to the financial ratios the screener identifies stocks based on technical patterns or specific candlestick formations.

It is assumed the reader has access to a charting program with a stock-screening function. The example shown in

Figure 9.4

was done by the Explorer screen function in MetaStock, but RadarScreen in TradeStation can do the screens as well.

FIGURE 9.4

Shows the result of the scan of 1,291 stocks at the close of the Hong Kong Stock Exchange on November 16, 2010.

Se...	Close	Previous	% cha...	Volume	M.A.	% above	Colu...	Colu...	Colu...	Tic...	Location
1173	0.4850	0.4100	18.2927	136007008.0000	19161442.0000	609.7953	0.0000	1.0000	1.0000	1173	C:\MSData\1001
122	0.7700	0.6700	14.9254	30711000.0000	11018244.0000	178.7286	0.0000	1.0000	1.0000	122	C:\MSData\0001
130	3.1500	2.6600	18.4211	15771000.0000	3684050.5000	328.0806	0.0000	1.0000	1.0000	130	C:\MSData\0001
141	1.1300	1.0600	6.6038	218000.0000	58724.8281	271.2229	0.0000	1.0000	1.0000	141	C:\MSData\0001
153	2.0600	1.9500	5.6410	30088000.0000	7192578.5000	318.3201	0.0000	1.0000	1.0000	163	C:\MSData\0001
188	0.2900	0.2650	9.4340	352353984.0000	15544477.0000	2166.7471	0.0000	1.0000	1.0000	188	C:\MSData\0001
189	4.0300	3.6800	9.5109	51152000.0000	17135222.0000	198.5196	0.0000	1.0000	1.0000	189	C:\MSData\0001
269	0.2950	0.2550	15.6863	414400000.0000	115743528.0000	258.0330	0.0000	1.0000	1.0000	269	C:\MSData\0251
2728	0.9600	0.8900	7.8652	19080000.0000	294055.2813	548.8576	0.0000	1.0000	1.0000	2728	C:\MSData\2501
319	2.5000	2.3600	5.9322	28200000.0000	1108772.2500	154.3354	0.0000	1.0000	1.0000	319	C:\MSData\0251
327	0.0150	0.0130	15.3846	206748000.0000	21750656.0000	850.5368	0.0000	0.0000	0.0000	327	C:\MSData\0251
395	0.5600	0.5100	9.8039	42204000.0000	17234062.0000	144.8871	0.0000	1.0000	1.0000	395	C:\MSData\0251
3989	0.7500	0.6800	10.2941	31416000.0000	13107572.0000	139.6783	0.0000	1.0000	1.0000	3989	C:\MSData\3751
448	2.4600	2.1600	13.8889	31401000.0000	9499819.0000	230.5431	0.0000	1.0000	1.0000	448	C:\MSData\0251
483	3.8900	3.6500	6.5753	16560000.0000	862648.5000	91.9669	0.0000	1.0000	1.0000	483	C:\MSData\0251
534	0.2040	0.1800	13.3333	1500000.0000	21410.4824	600.5914	0.0000	1.0000	1.0000	534	C:\MSData\0501
555	0.8500	0.8000	6.2500	95890000.0000	46426518.0000	106.5415	0.0000	1.0000	1.0000	555	C:\MSData\0501
557	0.9400	0.8700	8.0460	1380000.0000	76539.8047	80.2983	0.0000	1.0000	1.0000	557	C:\MSData\0501
567	0.6100	0.5400	12.9630	26300000.0000	407274.5313	545.7560	0.0000	1.0000	1.0000	567	C:\MSData\0501
575	0.3650	0.2950	23.7288	223131008.0000	32295456.0000	570.1545	0.0000	1.0000	1.0000	575	C:\MSData\0501
592	0.8000	0.7500	6.6667	29582000.0000	18855260.0000	56.8899	0.0000	1.0000	1.0000	592	C:\MSData\0501
681	0.2900	0.2600	11.5385	23198000.0000	7690685.0000	201.6376	0.0000	1.0000	1.0000	681	C:\MSData\0501
827	0.2330	0.2200	5.9091	126940000.0000	34615860.0000	266.7105	0.0000	1.0000	1.0000	827	C:\MSData\0751
980	36.1000	34.2000	5.5555	1247000.0000	472684.6875	163.8122	0.0000	1.0000	1.0000	980	C:\MSData\0751

The database in
Figure 9.4

comprises about 1,300 of the most actively traded stocks on the Hong Kong Stock Exchange. Roughly speaking, about one-third of the stocks are mainland companies listed on our local bourse. A scan of these shares therefore provides an investor or trader with an opportunity to select a stock that is tied in with the dynamic economies of China and/or Hong Kong.

Screening the stocks is a fairly simple procedure, and we find the following three methods in MetaStock's Explorer function most useful: Price and Volume Breakout, P and F Pattern Search, and Long-Term Bullish/Bearish. (MetaStock is owned by Equis International and some functions are under the prefix Equis.)

In

Figure 9.4

, MetaStock Explorer-Equis: Price and Volume Breakout displays securities where the price is increased 5 percent and the volume is 50 percent above the 50-day moving average. A total of 24 stocks meet these criteria. The purpose is to spot stocks that are breaking out of a medium-term trading range, or down from it, and then do an astro-screen of those stocks, as explained later on.

In order to spot stocks that break out of a range, the P and F Pattern Search in the Explorer can be useful as well—"P and F" meaning Point and Finger chart analysis. Usually, only a few stocks show up in this scan, but when they do, it can be an indication the stock is moving higher or reversing. Five stocks were on the list on November 16: 5 HSBC Holdings, 19 Swire Pacific A, 2828 Hang Seng H Share Index ETF, 330 Esprit Holdings, and 589 Ports Design, and all had broken down technically. The weak P and F charts indicated the overall market might be subject to more near-term selling pressure.

Stock investors may also consider using Equis: Long-Term Bullish, which identifies stocks over their 200-day moving average, and Long-Term Bearish, which identifies stocks below their 200-day moving average. As mentioned in an earlier chapter, 40 weeks, that is, 200 trading days, is a widely followed moving average indicator, but here we are only concerned with the total

number of shares above and the total number below as a sort of sentiment indicator. As of November 22, 2010, the number above, or bullish, was 780, while the number below, or bearish, was 511. The ratio has shifted substantially since the onset of the recent correction, but the reading may still be considered bullish and adds weight to the view that the decline is corrective only, and the larger uptrend is still intact.

Incidentally, when it comes to financial statistics, Asia is still far behind the United States and Europe in terms of the huge range of stock market statistics that is available in those places. One would expect a stock exchange to provide reliable statistics and historical data for independent research; however, for some Asian bourses, often the daily advance decline numbers do not tally and therefore cannot serve as a reliable gauge of sentiment. Moreover, the respective volume of advancing and declining stocks, VIX index, and daily data with no opening price can only be obtained through data vendors.

The next step necessitates having access to an astrological software program such as AIR Market Trader, Timing Solution, or Galactic Trader. These programs offer multi-search functions based on the “first-trade” date and scan the companies according to certain astrological inputs. These inputs include prevailing “good” planetary aspects, such as 60 degree sextiles, or 120 degree trines, and “bad” aspects such as 90 degree squares or 180 degree oppositions, and sometimes 0 degree conjunctions as well. A number of simple models are provided with Timing Solution, so the user doesn’t need to have extensive knowledge about astrology and may just apply the good or bad screens to stocks, similar to applying the lunar-phased indicator. The result of even a simple good or bad aspect scan can sometimes turn up “nuggets” in that the scan can alert investors to a share that has the potential to start rallying before it actually breaks out.

It should be noted that the “first trade” date charts used in multi-search are separate from a company’s date of incorporation charts. Incorporation charts are drawn up when a company starts its business, and may indicate something about the ongoing operations of the company, such as changes in management, product releases, or other internal matters. First-trade charts, on the other hand, are based on the date and time of the first trade on a stock exchange; that is, when the company launches its initial public offering (IPO), and trading of its shares to the public and institutions begins. The first-trade chart is very reliable, as the time is normally always the same as the opening of trading. It used to be 10 a.m. in Hong Kong, but on March 7, 2011, it changed to 9:30 a.m. to be in line with other exchanges. The first-trade chart relates to investor interest and concerns, and is the more important of the two charts. To find the dates for a first trade database is a time-consuming job, which may deter some investors. Hopefully, the following discussion will convince some it is worth the effort.

The first-trade database we are going to use for Hong Kong shares contains 850 stocks. Unfortunately, for about 20 or so leading shares, including HSBC Holdings, there are no known listing dates, so those stocks could not be utilized. It should also be noted that the total database of 1,300 stocks mentioned earlier was formed by adding 450 other active stocks to the 850 first-trade stocks.

Figure 9.5

shows the first scan.

Figure 9.6

shows the performance of the stock that was rated at the top of the scan, and which outperformed the Hang Seng Index (

Figure 9.7

).

FIGURE 9.5

The first scan shows how stocks rate in a simple good/bad aspect program with the 10 highest ranked first as of November 23, 2010. The top stock in the screen, 2728 Shinhint, already appeared on the Price and Volume Breakout in early October, and again in early November.

*Source: Sergey Tarassov at
www.timingsolution.com*



FIGURE 9.6

2728 Shinhint daily chart (middle panel) and weekly chart (upper panel) at the close on November 23, 2010. Considering that the Hang Seng Index dropped from a high of 25,000 in early November to around 23,000 in the middle of the month, the stock has held up well and appears to be consolidating before going higher.



FIGURE 9.7

Daily chart of Hang Seng Index as of December 1, 2010.

Source:

www.advancedget.com

(Note: original GET program is now sold by eSignal data service).



The third highest ranked stock in the scan, 833 Alltronics Holdings Ltd., has been moving up sharply since early October, and may also be poised to resume its uptrend.

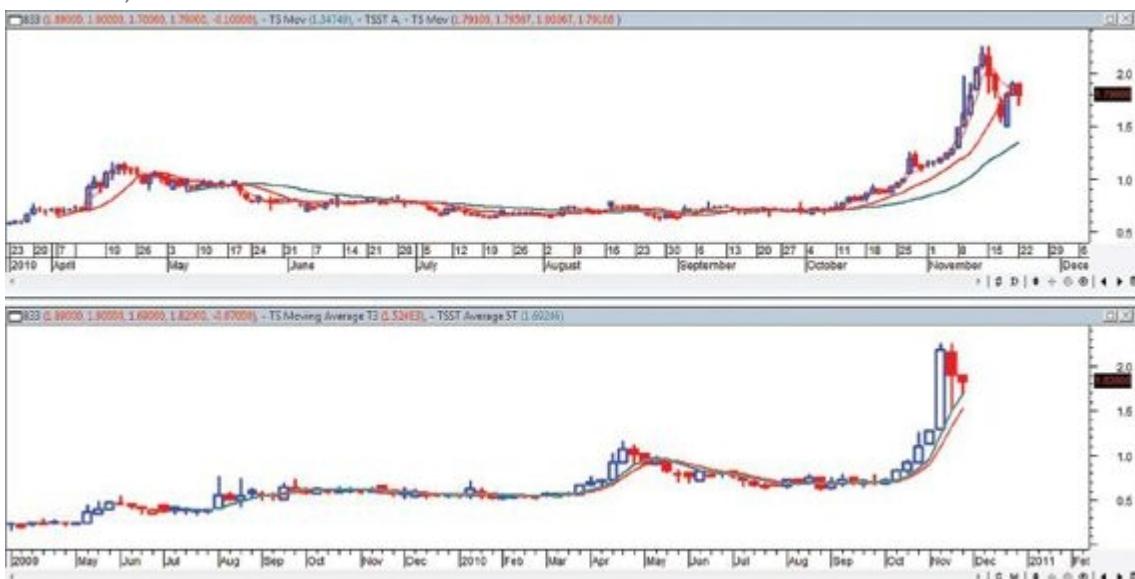
In

Figure 9.8

, Alltronics appeared frequently in the Price and Volume Breakout scans, but only after it started its sharp uptrend. Since September, it showed up repeatedly in the “good/bad” astro-scans, and investors could therefore be on alert that it might start rallying any time.

FIGURE 9.8

Daily chart (lower panel) and weekly chart (upper panel) of 833 Alltronics Holdings Ltd. as of November 23, 2010.



However, the standout performer was a relatively obscure company called PacMOS Technologies Holdings Limited. On October 19, 2010, and in the days that followed, it showed up at or near the top of four different astro-scans, one of which is shown in

Figures 9.9

and

9.10

FIGURE 9.9

"Good/bad" astro-scan from October 19, 2010.

Step #2: Transit	Results (765/841)
19.10.2010 TU	11.00
Transit	11.00
Calculate	10.00
	10.00
	10.00
	10.00
	10.00
	10.00
	10.00
	10.00
	10.00
	10.00
	9.00
	9.00
	9.00

FIGURE 9.10

On October 29, 2010, PacMOS Tech. rocketed to the upside.



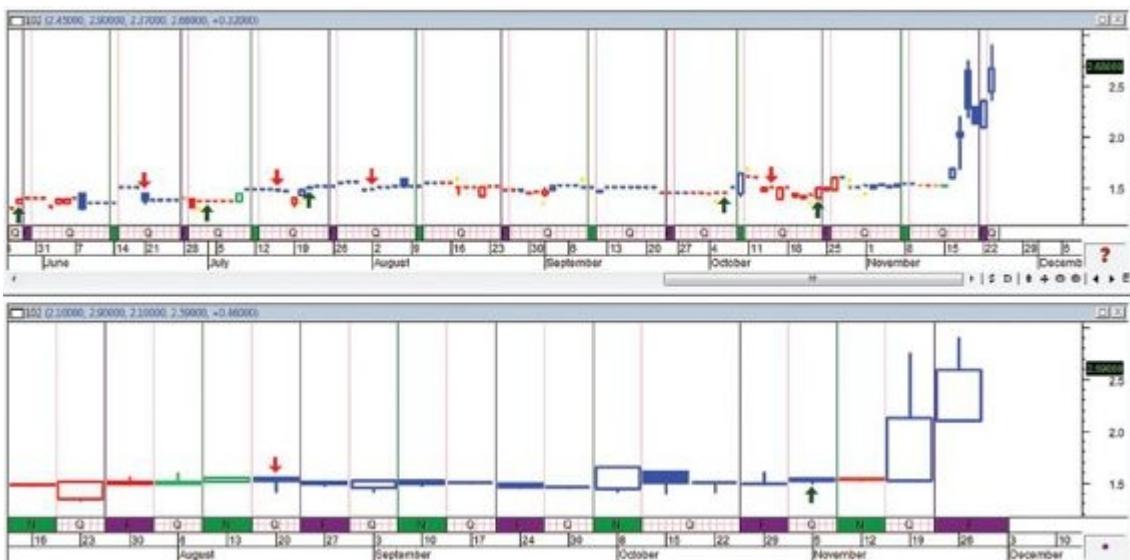
Being a penny stock with an erratic price history, PacMOS might not be a stock for everybody, but it illustrates how an astro-scan can play an important role in trading, with the caveat that sometimes the stocks that are "flagged" out in the "good/bad" scans do not make a move for several weeks. For example, number four on the list (

Figure 9.9

), 102 Arnhold Holdings Ltd., only started to rally at the beginning of November, as shown in Figure 9.11

FIGURE 9.11

Weekly chart (top) and daily chart (bottom) of 102 Arnhold Holdings Ltd. from November 23, 2010. The ribbon bar at the bottom shows the new moon (N), full moon (F), and quarter moon (Q) phases (Section 1—Using Lunar Cycles in Trading). Note the quarter moon phase often coincides with CITs.



In other cases, the selected stocks remain stagnant. However, those that do move often outperform the market by a wide margin. A case in point is 2728 Shinhint, shown in

Figure 9.6

, which rose almost 10 percent on November 24, the day after the screen date.

The following is an example of a double screening method. Based on the list of a Price and Volume Breakout scan in

Figure 9.4

, the next step is to rank these stocks with a good/bad astro-scan as shown in

Figure 9.12

FIGURE 9.12

Good/bad screen of the list of 24 stocks in the Price and Volume Breakout scan from

Figure 9.4

. Four of the stocks did not have first-trade date and four did not meet the scan criteria, so the list comprises 16 stocks only.



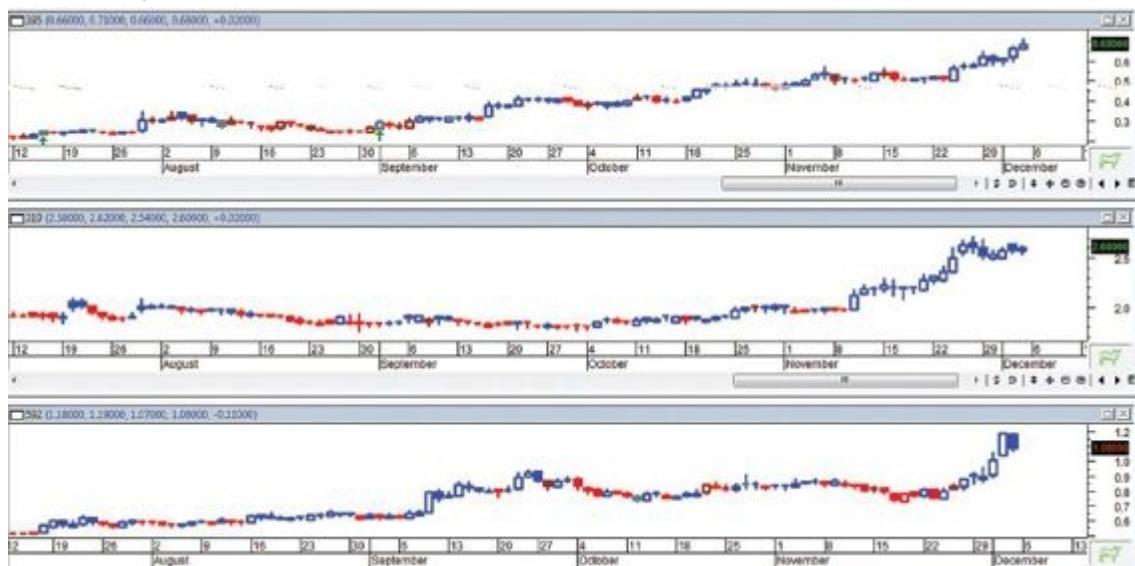
Many of the stocks on the list bucked the downtrend in the market and continued to rally in spite of the 10 percent decline in the Hang Seng Index during November 2010. Daily charts of three of the stocks are shown in

Figure 9.13

for illustration.

FIGURE 9.13

Daily charts of 395 Sino Dragon (top), 319 China Metal (middle), and 592 Bossini (bottom) as of December 4, 2010.



The five stocks at the bottom of the astro-scan in

Figure 9.12

did less well than the 10 top-ranked ones, indicating that the astro-scan proved helpful in selecting the stocks with the best potential. It may of course be argued that just buying all the stocks selected by the technical breakout screen would also have outperformed the market. Perhaps so, but for investors who do not have the means to diversify to such a wide extent, the second screening by astro-scan might be an ideal solution.

This brings us back to the portfolio with some underperforming stocks, among which were 151 Want Want and 828 Dynasty Fine Wines. In

Figure 9.14

, these stocks did in fact rally with the overall market in the first half of October, and appeared initially to be well chosen.

FIGURE 9.14

Daily charts of 151 Want Want (top) and 828 Dynasty Fine Wines (bottom).



While the stocks have reasonably good fundamentals and seemingly good prospects for growth, they declined quite sharply in October and were sold in a rebalancing of the portfolio. Had the fund manager screened them beforehand using just the simple good/bad criteria, he would have seen the stocks ranked poorly in August and again in September, as shown in

Figures 9.15

and

9.16

FIGURE 9.15

Astro-scan of 151 Want Want on August 9, 2010.



FIGURE 9.16

Astro-scan of 151 Want Want on September 29, 2010.

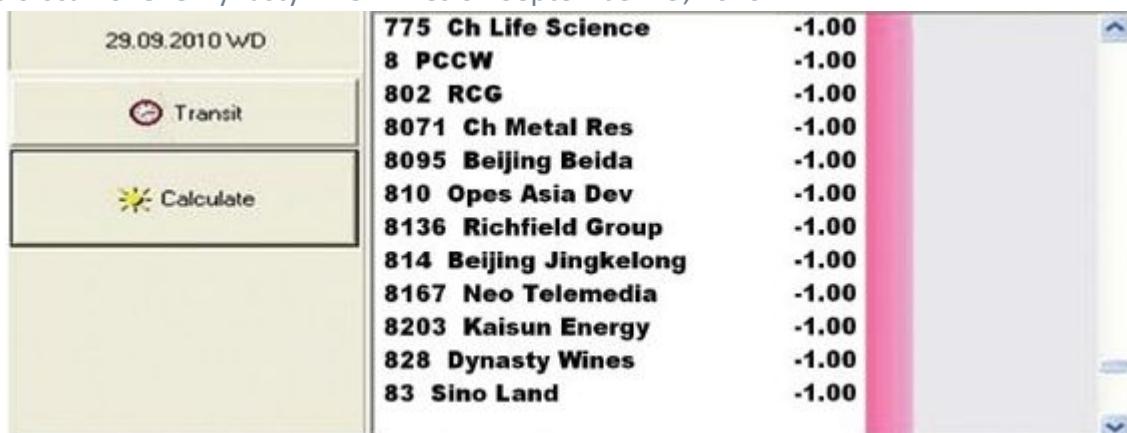


828 Dynasty Fine Wines also ranked low in several scans, the latest being at the end of September 2010, as shown in

Figure 9.17

FIGURE 9.17

Astro-scan of 828 Dynasty Fine Wines on September 29, 2010.



To sum up, there is little doubt that the increasingly uncertain and volatile stock market environment calls for more unorthodox methods in trading and particularly in selecting stocks. The question is, will investors be prepared to try something different and somewhat esoteric? Hopefully, this section has provided an in-centive.

CHOOSING THE BEST PERIODS FOR TRADING

The foregoing has dealt with some important tools to becoming a successful investor or trader. One aspect that is almost never considered is how to choose the best periods for trading. Traders use their skills to analyze the market, determine the best trade setups, and determine when to enter and exit trades, but few pay any attention to their own astrological cycle. Most people go through personal cycles of profit and loss, and perhaps more so those who are engaged in trading or fund management. So why not sidestep some of the risky or adverse periods and resume trading when there is a personal change in trend and a higher probability of winning?

To begin with, what is meant by the “best periods for trading”? They are, simply put, those periods when a person might benefit from favorable astro-harmonic aspects of his or her birth chart or natal chart. In the case of a company, its natal chart is the date of incorporation. However, to compile a date of incorporation chart for a company is difficult because it is hard to obtain the precise time of incorporation of most companies. Thus, for the purpose of this section, natal charts of a company are based on the first-trade charts, that is, the first day of trading in the stock of a company on an exchange.

Adverse periods are those when the aspects are stressful or inharmonious to one’s natal chart. For day traders and other professionals who trade frequently, it may be useful to know when the planetary influences are in their favor and when they are not. Knowing the influence of the planets could also be critical in situations where decisions have to be made about very large investments, whether short-term or long-term. It is already common practice among some traders to use prevailing stock market cycles to project likely change in trend dates, but they might benefit as well from incorporating astro-forecasting techniques in their analysis work.

Figure 9.18

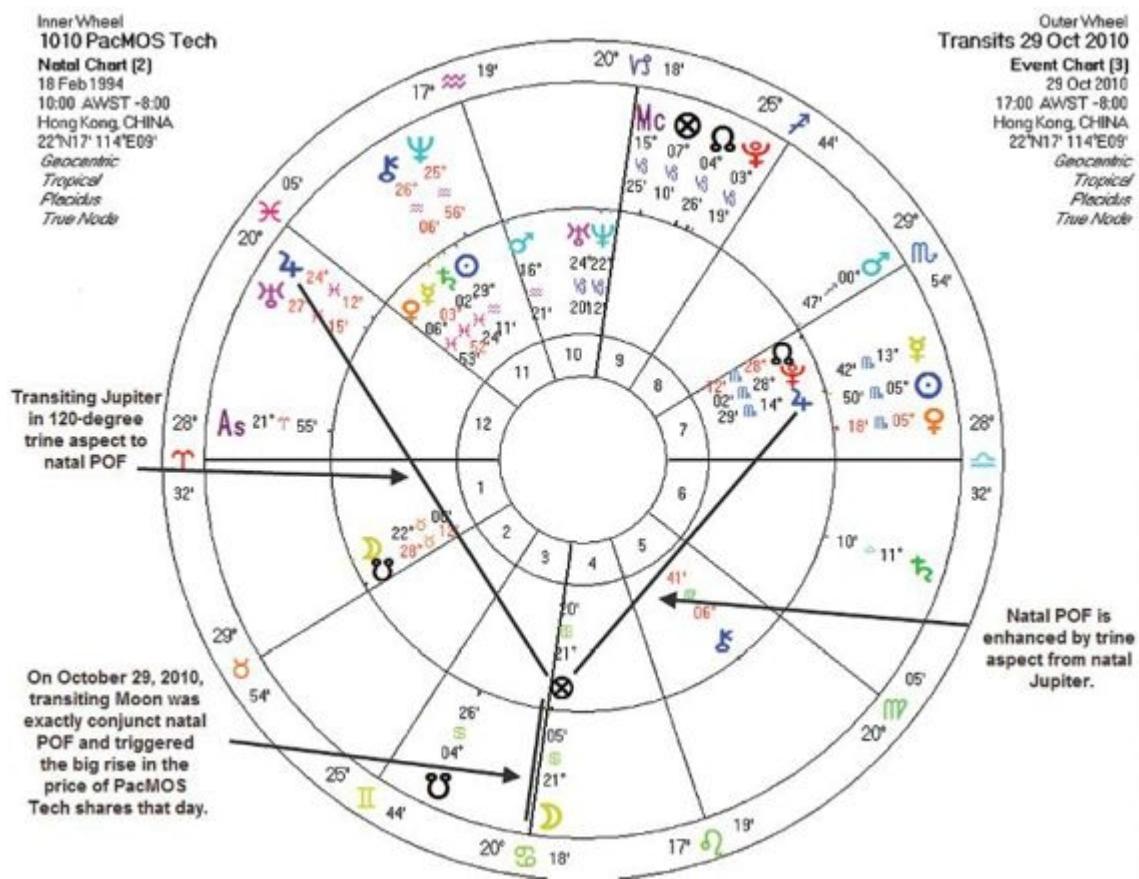
is an example of a first-trade chart of 1010 PacMOS Technologies Holdings Ltd. The inner wheel shows the horoscope of the natal chart, that is, the day of the first trade on February 18, 1994. The outer wheel shows the aspects of the transiting planets to the natal chart on October 29, 2010 when the company’s shares shot up sharply as shown in

Figure 9.10

FIGURE 9.18

1010 PacMOS Tech first-trade chart with transiting planets on October 19, 2010. The natal Part of Fortune (POF) is augmented, being on angle and favorably aspected by natal Jupiter. The chart shows how Jupiter and the Moon’s aspect to the POF helped trigger the huge move in the price of the stock. A more detailed explanation of the importance of the Part of Fortune is provided later in the chapter.

Source: SolarFire8, Astrolabe at
www.alabe.com



Although, in general, the subject of this chapter is financial astrology, the emphasis in this section is more on learning natal (personal) astrology, so that a trader or investor may identify those periods that are more fortuitous for him or her to trade. Many financial astrologers will trade based on the analysis of transits to a company's first-trade chart, but experience indicates that the focus should be more on personally favorable periods rather than more generally favorable periods for stock charts. The reason is simply that if one has unfavorable or hard aspects, such as 90 degree squares, to planets in the "money houses," or to planets ruling those houses in one's natal horoscope, it may result in losses in trading. One may pick a stock with presumably good potential, but because of the hard aspects to one's personal horoscope, one may overlook something important or circumstances may suddenly change in unforeseen ways. Trading during unfavorable transits should therefore be avoided. It is hoped that the following introduction, albeit brief, will enable traders to learn some basic astrological techniques. These techniques can help them analyze their birth charts so they can take advantage of the favorable periods and curtail trading during unfavorable ones. Once the basics of natal astrology have been mastered, many of the same principles can be applied to analyzing stock charts, although the terminology and the rulership definitions differ. For easy reference, definitions of both personal and financial rulerships are included in Appendixes 1 and 3.

It is of course possible that an investor or trader is not trading for himself but for an organization, and where natal astrology does not apply to the same extent. In such a case, it may be useful to analyze the first-trade chart on the basis of the introduction to astrology provided in the following paragraphs. However, it is recommended that traders screen their trades by the stock-selection method in the previous section, "How to Pick Winning Stocks."

Astrology is, to quite a large extent, a mathematical discipline based on astronomy. Applied properly, it will enable traders to quite accurately forecast periods of increased market volatility and financial instability. Financial astrologers chart both intermediate and long-range trends, reflecting the movement of the heavenly bodies and their influence on people on Earth. Some

may question how the planets, being so far away, can exert any influence on life on Earth, or they may simply have no interest in astrology. Nonetheless, if they are willing to study the subject a little more, they may be surprised at how often cosmic events or specific positions and aspects between the planets correlate with terrestrial events.

It used to be that traders cared more about whether a methodology was acceptable and logical than they did about the results. However, that appears to be changing, judging from the great interest shown at recent seminars when speakers introduced more esoteric methods of trading the markets. The next generation of traders seems more willing to try new approaches, perhaps spurred in part by the more advanced trading software programs that are now available.

Learning astrology, however, with all its strange symbols and terminology, can still be intimidating. This section is an attempt to shorten the learning curve, so at least one aspect of the craft can be applied. It will, of course, still take some effort, but users are almost certain to gain an edge on the market and ultimately be amply rewarded.

In fact, a trader might not need to know that much about astrology to use some of these methods. AIR Market Trader software has a module called Millennium Star Trax. Using this program, a person may simply input his or her birthplace and date and time of birth, and the program will calculate the likely future trend for certain areas of life, including financial areas. It is also possible to produce a general forecast, showing periods that are likely to be harmonious and those that may be stressful in histogram or line format.

However, to master the subject for maximum benefit, it is still necessary to learn the basics of natal and financial astrology, and hopefully the following introduction will help traders gain a quick insight into a subject that might otherwise easily take months of study.

Astrology can be baffling at first, because it involves a different kind of language or wisdom. There are four parts to any birth chart: planets, signs, houses, and aspects. The astrological use of planets, the house system, and the aspects has evolved since astrology's earliest recorded beginnings about 5,000 years ago. Archaeologists uncovered evidence that the Sumerians, as early as 2900 b.c.e., built temples in the form of ziggurats, or terraced pyramids, to observe the stars and planets. The Babylonians developed astrology further, as evidenced in their clay tablets from around 500 b.c.e. The tablets contain lists of lunar and planetary observations that were used, among others, to predict whether the most common commodities, barley, dates, and sesame would prosper. The careful recording of prices indicates the Babylonians were charting the markets and sought to predict future prices much like modern-day technicians do. However, it was the Greeks who made the biggest contributions, through their refinement of the house system and use of Ptolemaic aspects from Ptolemy's book on astrology, *Tetrabiblos*. Together, these developments enabled more accurate measurements and predictions to be made.

There are many constellations in the sky, but by tradition, Western astrologers use the tropical zodiac of the signs. Most are familiar with this zodiac, which begins each year at the vernal equinox, the first day of spring on about March 21, at 0 degrees Aries. A horoscope, or birth chart, is a diagram of the precise positions of the planets in the sky at the moment of one's birth. It is divided into 12 equal segments to reflect the 12 constellations of the zodiac.

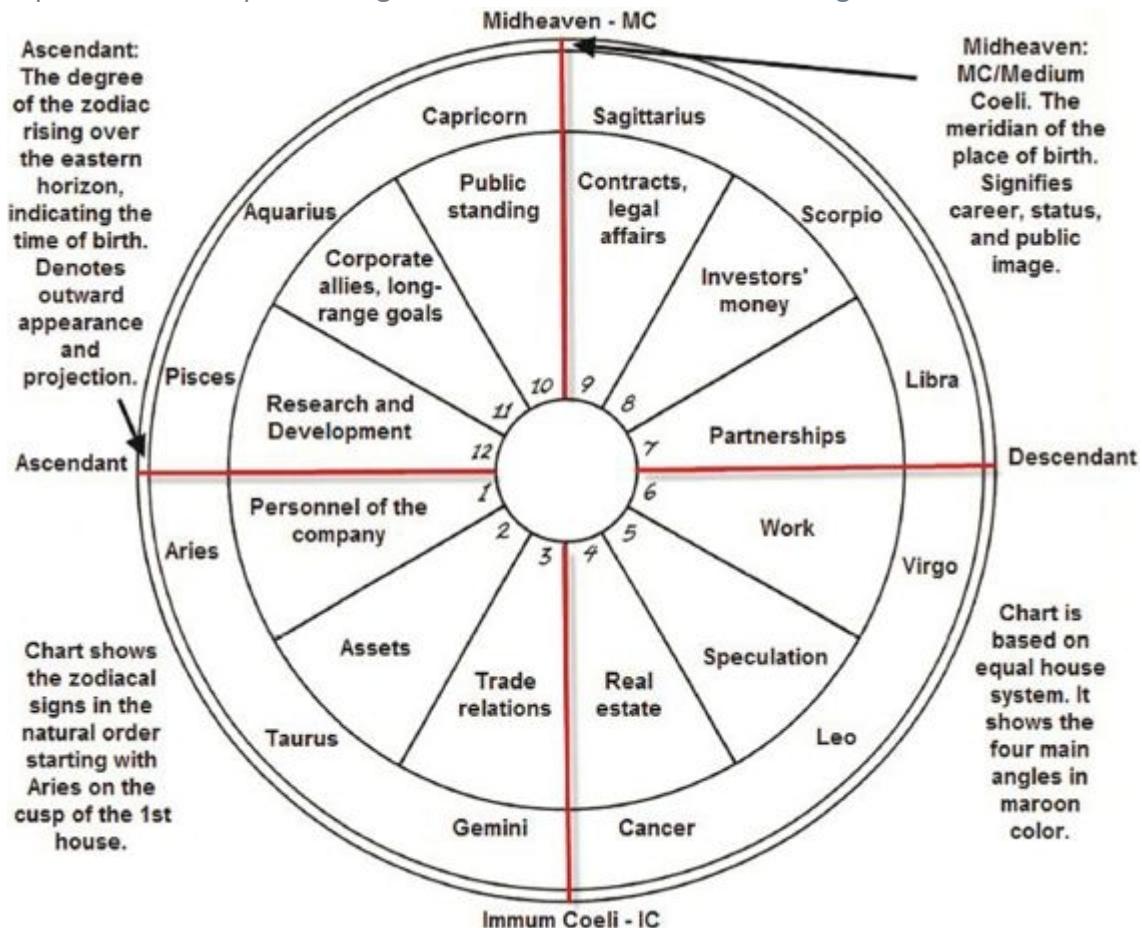
One of the 12 zodiacal signs will be on the cusp of each house, that is, the point at which it begins. In a horoscope, the Sun and planets are shown in the relevant zodiacal signs and houses for the date and time of birth. The house system can be thought of as 12 areas of influence, and its development has its origin in thousands of years of observation. Over the millennia, it was found that certain areas of the constellation in the sky corresponded to different areas of life.

Figure 9.19

is an example of a horoscope showing the 12 houses with the zodiacal signs in their “natural” order; that is, Aries on the cusp of the first house, Taurus on the second house, and so forth. In addition, there are four important points on angles: the Ascendant, Midheaven (MC), the Descendant, and Immum Coeli (IC). The Ascendant is the sign and degree of the zodiac rising over the eastern horizon at birth, indicating the time one is born or when a company’s stock started to trade. The Ascendant signifies a person’s or company’s appearance to the public. The Ascendant or “rising sign” can only be calculated with an exact birth time.

FIGURE 9.19

Example of a horoscope showing the 12 houses with the zodiacal signs in their natural order.



The Midheaven, or Medium Coeli, is the cusp of the tenth house in the chart. It reflects the location of the Sun at midday of the time and place where one was born. It signifies career, status, and public image. It is the second most powerful point following the Ascendant. Because it is on an angle as one of the four cardinal points, any planet placed near it is extremely potent, either favorably or unfavorably, depending on the nature of the planet and the aspects it makes in the chart.

The Descendant, also referred to as the “setting sign,” represents our relationship to those around us and those whom we attract into life. It may be defined in short as “relating to others.”

The Immun Coeli, or IC, on the cusp of the fourth house, is most closely associated with issues relating to home, the past, family, and domestic concerns.

There are many techniques for making predictions. However, in this discussion, we shall only be using the transiting planets and their position in the sky at any given moment relative to the natal planets. The term “transit” refers to the position and motion of the planets in the sky at

any given time.

The planets and the respective houses that they rule are most important in helping to identify favorable trading periods. This information for both natal and financial astrology is listed in the table that follows. The interpretations for the traditional house system and aspects are listed in Appendixes 1 and 2. The common interpretations for the zodiac signs are listed in Appendix 3. Some readers might need them later on because they constitute an important part of astrology.

Although the Sun and the Moon are not planets as such, they are grouped together with the eight other planets and the houses they rule.

Planet	House	Zodiac Sign
Sun	5th house of children and minors. Sports and recreation, romance, hobbies and gambling, places of entertainment. Financial: Speculation/stock markets, stockbrokers, precious metals.	Leo
Moon	4th house of family and property. Retail, health care, household products, restaurants. Financial: Trend-following, real estate, mining.	Cancer
Mercury	Co-ruler of 3rd and 6th houses. Communication, media, short-distance travel. Financial: Day-trading, stocks, agents, contracts, trucking, telecommunications, transportation, footwear.	Gemini/Virgo
Venus	Co-ruler of 2nd and 7th house. Apparel, cosmetics, fashion, recreation, retailers. Financial: Bonds, investors, financial security.	Taurus/Libra
Mars	1st house of personality. Appearance, self image, sports. Financial: Hot stocks, deals, options, startups, contrarians, steel, defense, industrial machinery, diamonds.	Aries
Jupiter	9th house of higher education, long-distance travel and communication. Foreigners, foreign affairs, publishing, the media. Financial: Investing for growth, speculation, bankers, brokers, legal matters and courts.	Sagittarius
Saturn	10th house of career and profession, public work. Financial: Value investing, shorting, farms, real estate, mines, utilities, and capital goods.	Capricorn
Uranus	11th house of projects, friends, astrology. Financial: IPO's, exploration and discoveries, telecommunications, aerospace, computers and technology.	Aquarius
Neptune	12th house of institutions, entertainment, tobacco, alcoholic beverages, and movie industry. Financial: Story stocks, rumor plays, venture capital, chemicals,	Pisces

	pharmaceuticals, natural gas, oil.	
Pluto	8th house of birth, death, sexuality, inheritance, partner's monetary concerns, investments. Financial: Big business and money, mergers and acquisitions, turnaround candidates, insider trading, mineral resources, biotechnology, insurance, nuclear power.	Scorpio

It should be noted that many industries share more than one planet and/or house. For example, telecommunications is best described as Uranus (telecommunication) plus Mercury (communication).

The astrological symbols for the planets and zodiacal signs are shown in

Figure 9.20

, together with astrological symbols for the main aspects. There are two harmonious aspects and three inharmonious ones. The harmonious are the 60 degree (sextile) and the 120 degree (trine) aspects, the second of which is the stronger. When the trine aspect is in effect, it often facilitates a favorable outcome. The inharmonious aspects are the 45 degree (semi-square), the major 90 degree (square), and the very strong 180 degree (opposition) aspects. Planets are in conjunction (0 degrees) when they occupy the same or almost the same degree. The effect of conjunction can be favorable or unfavorable depending upon the planets involved. More information about the aspects and their interpretation is included in Appendix 2.

FIGURE 9.20

Astrological symbols.

Planetary Symbols	Zodiacal Signs	Aspects	
⊕ Sun	♈ Aries	☌	Conjunction 0°
☽ Moon	♉ Taurus	⊗	Sextile 60°
☿ Mercury	♊ Gemini	□	Square 90°
♀ Venus	♋ Cancer	△	Trine 120°
♂ Mars	♌ Leo	☍	Opposition 180°
♃ Jupiter	♍ Virgo	⊗	Semi-sextile 30°
♄ Saturn	♎ Libra	⦶	Semi-square 45°
♅ Uranus	♏ Scorpio	⦷	Quincunx 150°
♆ Neptune	♐ Sagittarius		
♉ Pluto	♑ Capricorn		
⊕ Earth	♒ Aquarius		
	♓ Pisces		

The patterns change endlessly throughout life. The aspects forming between the planets allow us to know in advance when there will be difficulties to overcome and when there is a productive time to act.

For example, stressful aspects of planets in transit to the planets ruling the signs of the "money" houses, that is, the second, fifth, eighth, and eleventh houses, and/or planets occupying those houses in one's chart are nearly always a warning not to trade, or to at least reduce trading. Traders will find that the most profitable times for trading are when the right aspects align favorably with the position of their money planets. The aspects of transit planets

have been listed in

Table 9.1

Table 9.1

Favorable Aspects of Transit Planets

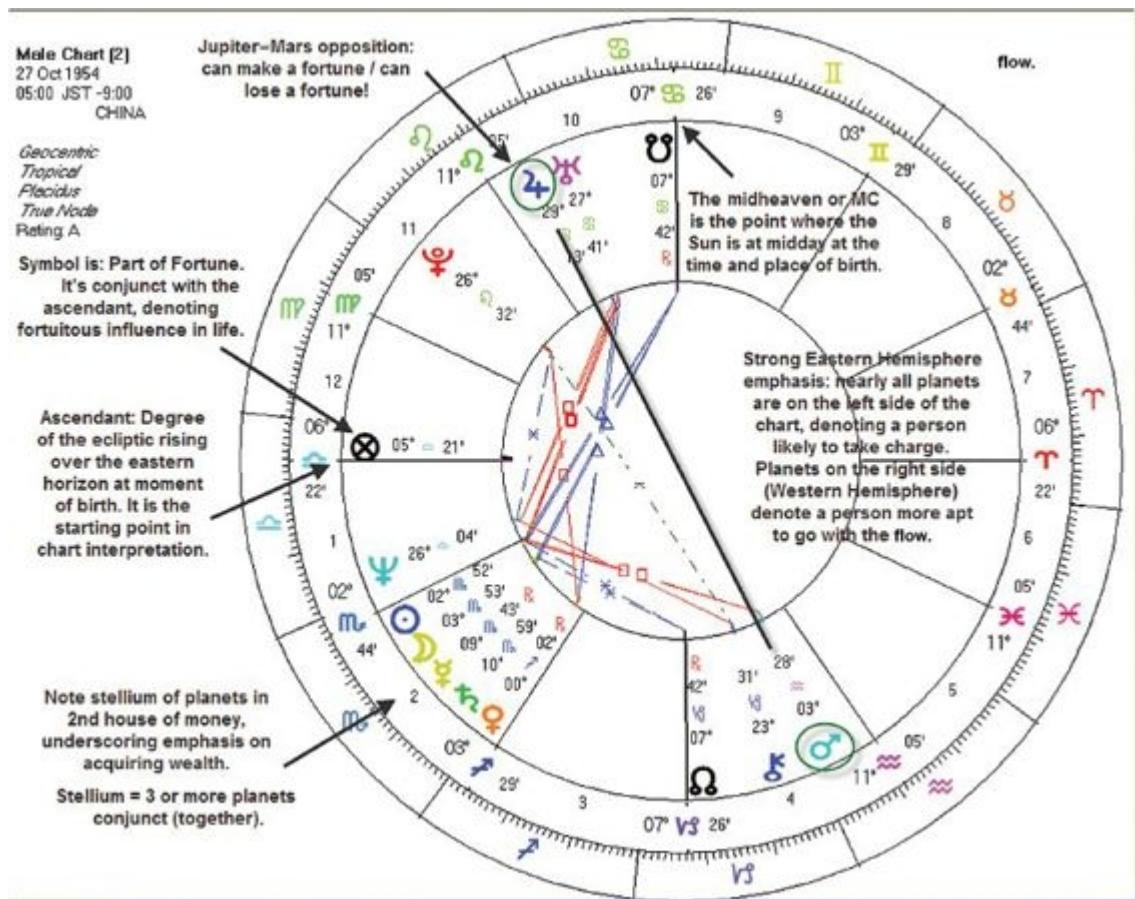
Checkin g Order	Aspects of Transit Planets	Comments
1	Transiting Venus and Jupiter in sextile or trine aspects to either natal Sun, Jupiter, or Pluto.	Either one of these aspects may be favorable and trading can be more aggressive.
2	Transiting Sun conjunct Ascendant or natal Jupiter or Pluto.	Can be favorable, but mostly for day trading.
3	Mars trine natal Venus or Jupiter.	Favorable usually for day trading.
4	Transiting Uranus, Neptune, or Pluto in favorable aspects to natal Venus or Jupiter.	Favorable and may enhance trading results.
5	Transiting Jupiter in conjunction, sextile, square, trine, quincunx, and opposition aspect to Part of Fortune (POF) can be very favorable. POF will be dealt with in more detail at the end of this section.	Favorable. Even the square and opposition aspects, which are considered hard aspects, may trigger beneficial developments.

Figure 9.21

is a native's hypothetical birth chart, drawn up for the time and place he was born in China. In interpreting the chart, note first that the Sun and the Moon are conjunct in the sign of Scorpio in the second house of money. Next, take note of the Ascendant or rising sign, being the most important point in the chart. In this case, it is in Libra, and provides clues as to the personality of the native and how he may appear or project himself outwardly. Proceed to the Midheaven, in Cancer, and note the key characteristics of that sign. Next, look at planets or points that are close to one of the four main or cardinal angles, as any angular position always has greater importance. In the chart shown, the point called Part of Fortune (POF), to be dealt with in greater detail later, is almost exactly conjunct the Ascendant, reinforcing the influence of this fortuitous point.

FIGURE 9.21

Natal chart of a trader who has made and lost several fortunes.



Next, note the heavy Eastern Hemisphere emphasis in the chart; that is, nearly all the planets are to the left side of the chart, denoting a person who is more likely to exert control over his life, or shape his own destiny. Planets on the Western Hemisphere side (right side) often indicate a person who depends more on approval from others and who tends to go with the flow.

There is a stellium (three or more planets conjunct) of planets in the second house of money, underscoring an emphasis on acquiring wealth.

Finally, pay close attention to the aspects between the various planets in the chart. Note the 120 degree trine aspect between Jupiter in the tenth house of career to Venus in the second house of money, which is very favorable for acquiring wealth. Jupiter, however, is also in opposition to Mars, which in the author's experience often signifies: can make a fortune, can lose a fortune!

There is, of course, much more to delineating a chart. Some of the books listed in the Bibliography deal extensively with the subject, and may be of further help.

On December 7, 2010, the transiting planets were in aspects with the planets in the chart shown in

Figure 9.21

. The trader's natal chart is displayed in the inner wheel, and the transiting planets are in the outer wheel. The equal house system has been used to divide the chart into 12 even houses. Other popular systems include Placidus, Koch, and Topocentric, to mention a few, but to start with, it is recommended that readers use the equal house system. There are, in all, about 10 different systems, but the "angles" of the natal chart, such as the Ascendant and Midheaven, are always the same, regardless of which house system is being used.

In general, the outer planets, Uranus, Neptune, and Pluto, when in favorable aspect to Venus and/or Jupiter, can bring wealth. Transiting Uranus to Jupiter or Venus can lead to a sudden,

unexpected windfall. The person charted in

Figure 9.22

may be the recipient of some financial reward or may advance in his career when both transiting Jupiter and Uranus, in Pisces in the sixth house, move forward to make a 120 degree trine aspect to natal Jupiter/Uranus in the tenth house in the third week of January 2011. At that time, the aspect will be exact, and this can be projected by any astro-program or looked up in an ephemeris, as explained further on. The favorable aspects of transit planets are shown in

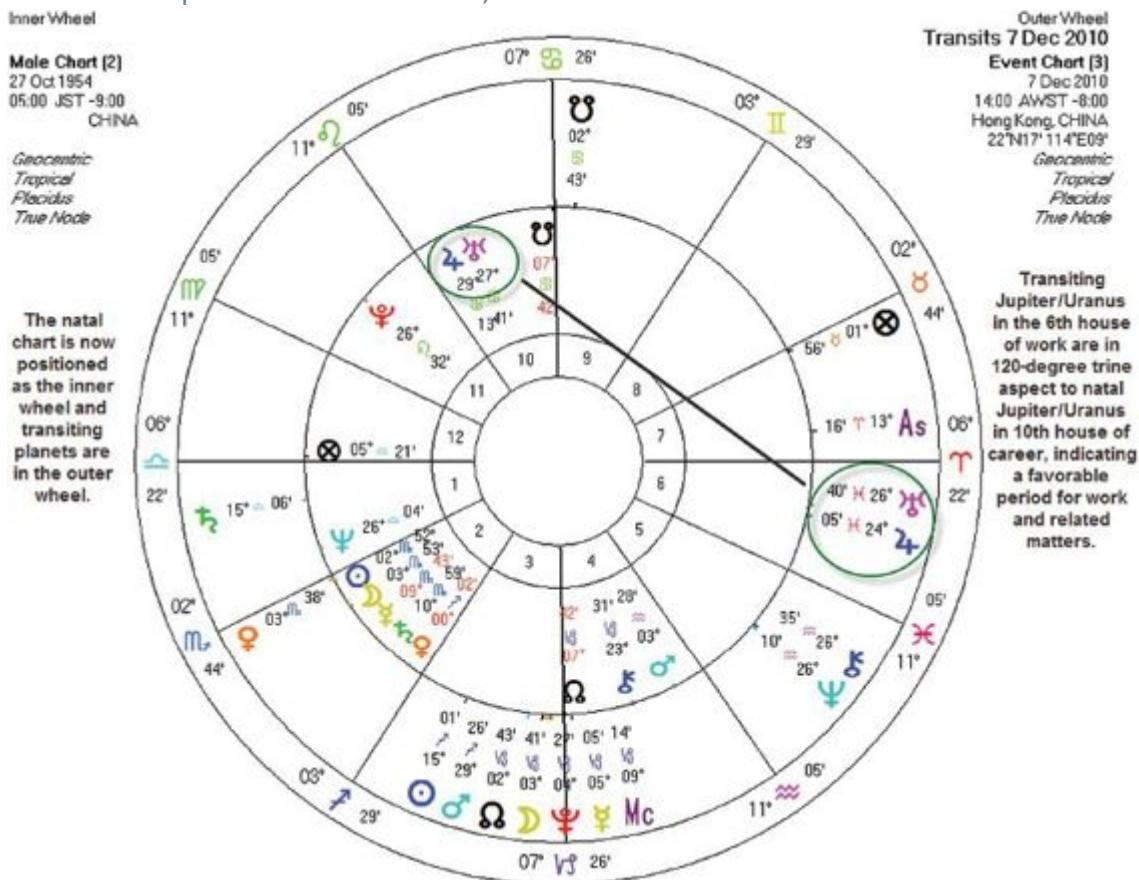
Table 9.1

. However, the outer planets move very slowly, and favorable or beneficial aspects from them will not happen often. It is therefore important to also follow the transits of two of the faster moving planets, Venus and Jupiter. When they are in harmonious aspects to natal Sun, Jupiter, or Pluto, there is a higher probability that trading activities will be profitable. Sometimes transiting Sun conjunct our Ascendant, or Pluto and transiting Mars trine to natal Venus, can have the same effect. It might be helpful to make a checklist, as shown in

Table 9.1

FIGURE 9.22

Transits to natal planets on December 7, 2010.



The planets' movements, as mentioned before, can be looked up in an ephemeris, which is a set of tables that list the "ephemeral" or changing positions that each solar-system body will occupy on each day of the year. The ephemeris contains a phenomena section that explains how to read the different signs and glyphs. In time, many will find a manual ephemeris to be an indispensable tool for identifying in advance potential favorable aspects to a certain chart point. For beginners, however, it may be easier to just use an astrological software program

that lists the transiting planets automatically to a certain chart point, and which provides interpretations of aspects by clicking on the planets involved.

Let's proceed now to the last part of the birth chart, the Part of Fortune.

The Part of Fortune, or POF, can be traced to ancient times. But it was a text written by Al-Biruni, an Arab astrologer that made the so-called Arabic parts more known. Al-Biruni lived in the late Middle Ages, when the most interesting research and uses of astrology occurred in the Arabic world. There are historically 32 different Arabic parts including parts of death, illness, marriage, journeys, and so on. They are points constructed on the mathematical calculations of two or three components, such as planets or house cusps.

However, only the Part of Fortune, which can be calculated on most computer programs, is now in common use. Since POF is based on the longitude degrees of the Sun, Moon, and Ascendant, three of the most important places in the horoscope, it becomes as important as they are, a fact that is sometimes overlooked. Only the Midheaven is as important, but because the POF is based on three components only, the MC is excluded from the calculation.

The POF symbol is the circle around a cross, shown in the previous figures, and is placed in the natal chart according to this formula:

Day births (a.m.): Fortune = Ascendant's longitude degree position plus Moon position minus the Sun's degree position. For night births (p.m.), the Moon and Sun's position are reversed.

POF is interpreted as being a primary indicator of prosperity, and its position in the natal chart shows where and how a person may gain honors, make money, or be lucky during his life. Transits to POF bring opportunities for gain, as the following examples will illustrate. When transiting Jupiter conjuncts POF in the natal chart, it is often a time when a person may benefit materially or advance in his or her career. The synodic cycle (one complete orbit relative to the Sun) for Jupiter is about 12 years, so it will not be of much interest for those who trade frequently. However, the other aspects mentioned in the checklist in

Table 9.1

have been found to trigger fortunate events as well. So, in reality, there is a beneficial aspect between transiting Jupiter and POF about every two years. Of course, not all may be as fortunate as when there is a conjunction between Jupiter and POF, which is the strongest aspect, but traders may still find it worthwhile to make a note in their calendar when any of these events occur.

To work out their own horoscope, traders may want to use a freeware astro-program, or go to

www.astrodienst.com

, which provides a comprehensive chart service that includes a function to plot Arabic parts. Write down the sign and the degree position of the POF, as well as the degree position of transiting Jupiter, and use a software program or an ephemeris to determine when the aspects culminate or become exact.

It is also possible to plot important astrological events with Timing Solution. For instance, aspects can be plotted with Timing Solution and exported to Excel, or a special calendar format, and it is then easier to follow the periods when a good influence might manifest. As users progress, they may wish to include other favorable aspects, such as transiting Venus and Jupiter in sextile or trine aspects to Pluto, or some of the other aspects mentioned in the checklist in

Table 9.1

.

It should be noted that when a transiting planet approaches an aspect to a natal planet, it is

said to be “applying.” Conversely, after it has reached conjunction and is moving away it is said to be “separating.” The applying effect is usually stronger than the separating one, but in the case of transiting Jupiter to POF, the effect is often the opposite, so the beneficial effects of Jupiter’s contact may only manifest after the exact conjunction, not before. The orb (sphere of influence of an aspect) should be set fairly tight at no more than 2 degrees.

The native in the chart in

Figure 9.23

received large orders for his business when transiting Jupiter was conjunct his natal POF and natal Jupiter on November 19, 2007, as is shown in

Figure 9.24

. When the natal POF is conjunct natal Jupiter, the chances of lucky breaks are greatly enhanced to begin with.

FIGURE 9.23

Natal chart of a person engaged in trading.

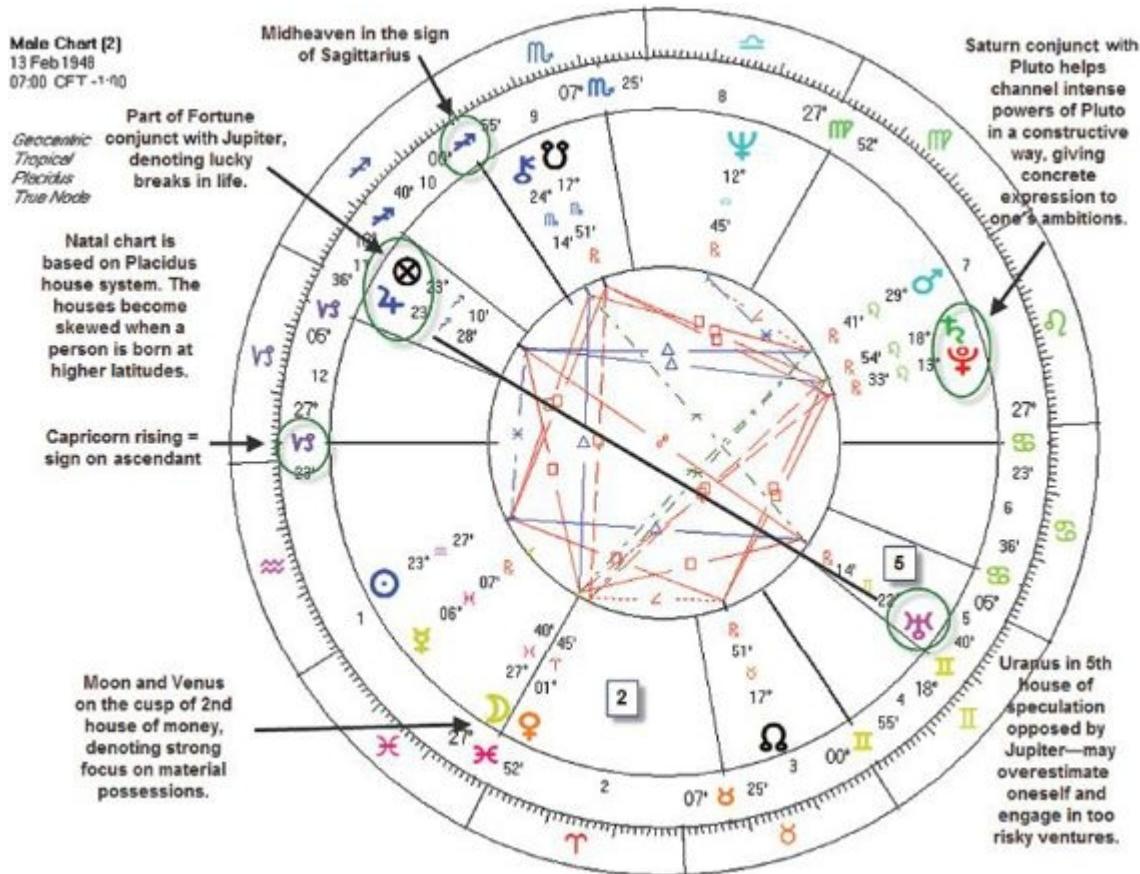


FIGURE 9.24

Transiting Jupiter conjunct with the natal Jupiter and natal POF on November 19, 2007.

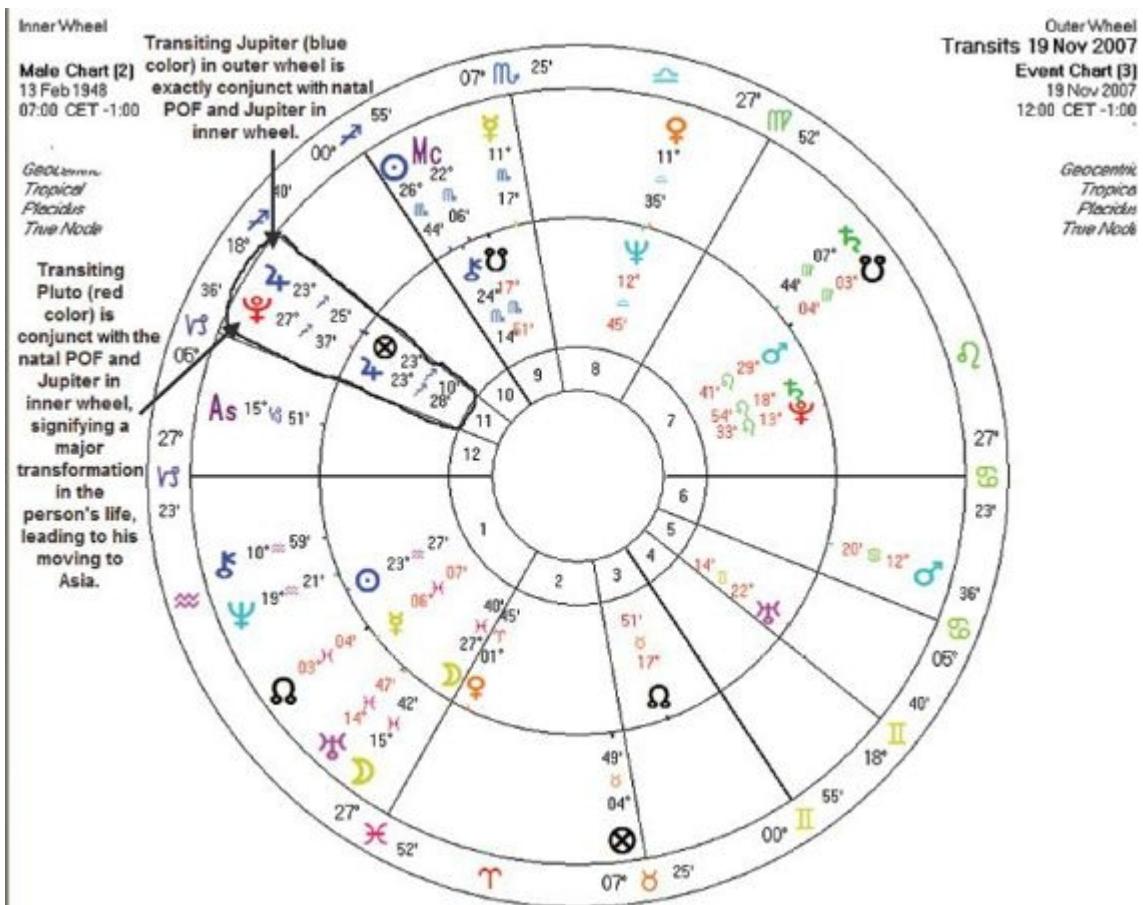


Figure 9.24

has been drawn up using the Placidus house system, which causes the angles to become somewhat skewed when the subject is born at higher latitudes, but this house system reflects the person more accurately. Note that the Moon and Venus are at the cusp of the second house of money, denoting a strong focus on material possessions. Uranus is in the fifth house of speculation opposed by Jupiter, which may at times manifest in overestimating oneself and engaging in risky ventures.

The same natal chart is shown in

Figure 9.25

with the transiting planets in the outer wheel as of December 7, 2010.

FIGURE 9.25

Transiting Jupiter and Uranus are moving to exact conjunction with natal Venus in the second house of money around the person's birthday on February 13, 2011. Because the synodic cycle of Uranus is about 84 years, it is a rare event for transiting Jupiter and Uranus to both conjunct with natal Venus at the same time. It is likely to result in a large financial boost.

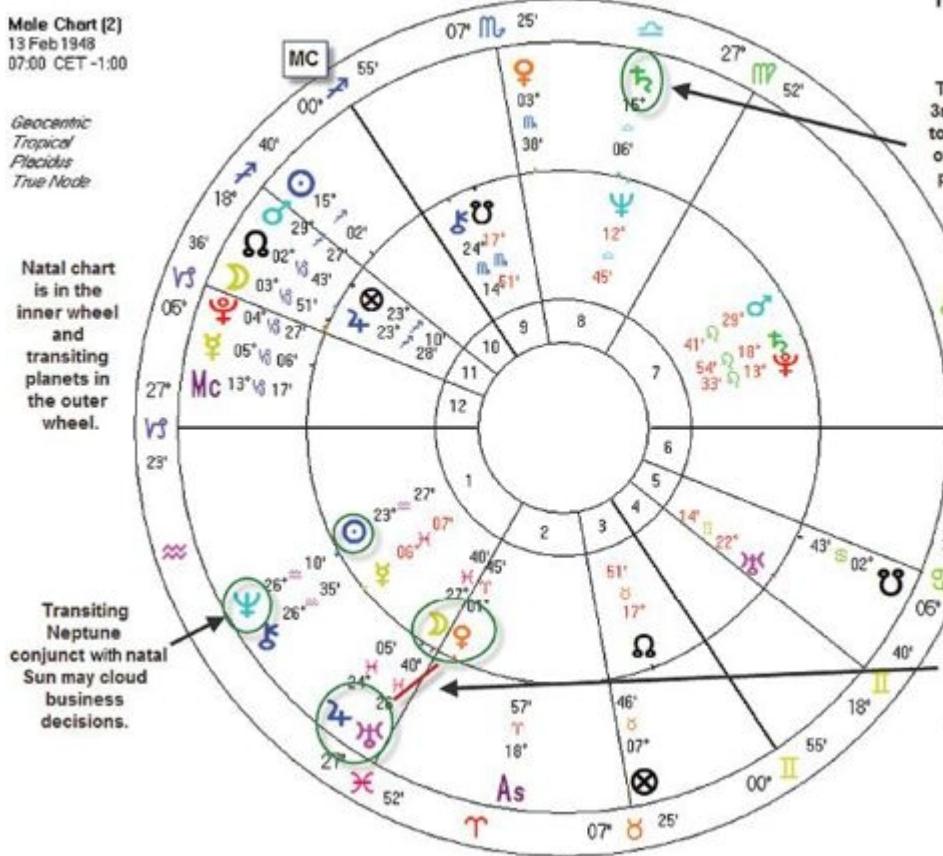
Inner Wheel

Mole Chart (2)
13 Feb 1948
07:00 CET -1:00

Geocentric
Tropical
Placidus
True Node

Natal chart
is in the
inner wheel
and
transiting
planets in
the outer
wheel.

Transiting
Neptune
conjunction with natal
Sun may cloud
business
decisions.



Outer Wheel

Transits 7 Dec 2010
Event Chart (4)
7 Dec 2010

Transiting Saturn in
3rd quadrant moving
toward Midheaven. It
often coincides with
progress in career.

Transiting
Jupiter/
Uranus moving
to conjunction
with natal
Venus in 2nd
house of
money on
person's next
birthday. Both
transiting
planets in
conjunction with Venus
is a rare event.
Finances may
receive a
boost.

MARKET PROJECTION

Can we predict the market using astrological methods? Forecasting the probability of market direction has been the primary goal of every trader since early times. When will the market make a peak? Or when will it make a trough? These are everyday questions in the mind of every trader. The age-old market prediction method of using advanced mathematical calculations and historical economic data, sector data, and price data has been the cornerstone of making market forecasts. And it is still the most acceptable method. But the method works well only when the market is not subject to so much volatility. The world today is plagued with uncertainties caused by natural disasters, man-made disasters, military conflicts, political unrest, and corporate fraud and scams, occurring at unexpected frequent intervals, seemingly without end. Therefore, the old methods seem inadequate to make a reasonably reliable prediction of market movements today.

The stock market is too sensitive, too erratic and chaotic for such basic forecasts. The change of value of the shares is always related to future expectations, not the supposed correct value at the moment of trade. It is in these challenging circumstances that prediction using financial astrology adds its value as a complement to the traditional method by revealing another dimension. Forecasts made using the planetary movements through the zodiac can increase the odds in favor of the trader significantly. While some traders continue to use traditional methods and scoff at financial astrology, astro-harmonic analysis is nevertheless gaining more widespread acceptance. Since the turmoil in the markets that began in 2008, a growing number of traders, including some at large institutions, have adopted astrological analysis to boost the results of their trading decisions. They realize that combining fundamental and technical analyses with financial astrology can improve the performance of their trading. The advantages of knowing in advance probable major price reversals for a stock through astrological methods are incalculable.

Moreover, today, using financial astrology for reading markets has become easier for users. The phenomenal development of software applications, especially in the last decade or so, has helped spur wider use by traders. It is now possible to undertake complex analysis of economic cycles and examine the extent to which planetary constellations correlate with movements in financial markets, including the Forex and commodities markets. Even phenomena such as sunspot activity, tidal flows, and other factors can be studied to see if they correlate with terrestrial events. Still, of course, the main purpose is to measure the relationship between planetary movements and the markets and make use of them in trading.

In this regard, the expanded capability of computer programs adds a new dimension to technical analysis. They offer a hybrid of common technical analysis techniques (charting tools and indicators) and modern math methods (neural networks and applied statistics), measuring astro-cycle correlations and providing the opportunity to model the market. A few examples of these techniques are shown in

Figures 9.26

through

9.34

. For the examples shown, the advanced version of Timing Solution has been used.

FIGURE 9.26

Projection chart from December 30, 2009, showing the simple projection line for the Dow for

the first quarter of 2010.

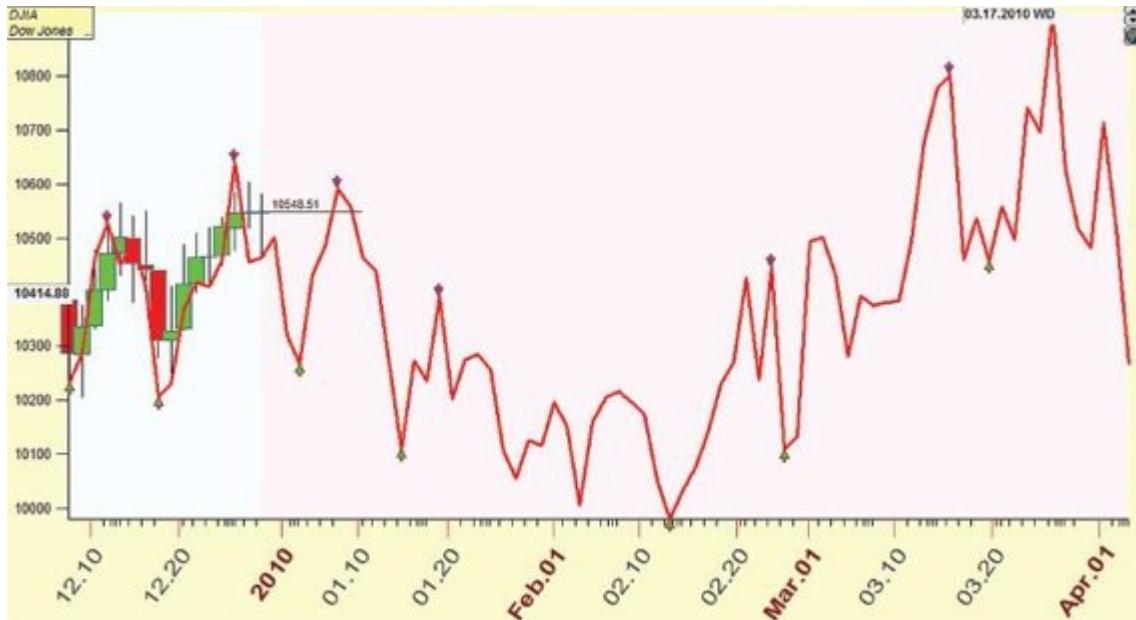


FIGURE 9.34

Planet aspects as well as the ingresses of the Sun (dark green), Mercury (dark red), Venus (dark blue) and Mars (cyan) into new zodiacal signs, as applied to the Hang Seng Index. At the end of July, three planets enter into new signs, which may correlate with a CIT in the Hang Seng Index.



Figure 9.26

shows a market projection as of December 30, 2009. Briefly, the composite module calculates the projection line based on how various astro-cycles relate to the first-trade chart and the historical data on a daily basis. It includes optimizing the correlation between the projection line and the relative price oscillator (RPO) to ensure the closest possible match. RPO is similar to RSI, but has been de-trended in order to smoothen the price swings over a longer period. The optimized composite result is loaded into the Neural Network module, which takes all the criteria that were part of the setup and analyzes the historical price data again, using artificial intelligence and fuzzy logic math to educate itself. The results are used to make future projections.

Figure 9.27

shows a bar chart of the ensuing market action for comparison with the projection. In this chart, the market made its low according to the time and value of the forecast, and a change-in-trend followed. The market forecast is not an execution of trade entry or exit signals. It merely projects the direction in which the market is likely to move and where there are areas of risk to traders. It helps traders better plan their trade and money management. The accuracy of a hybrid market forecast will, to some extent, depend on the amount of historical data and other information available. Some traders find that the larger the database, the better the projection. However, because cycles change, a four-year period seems to yield the most consistent results. It should also be noted that the scaling of the projection line is rarely 100 percent accurate, but can only serve as an indication of the likely future trend of the market.

Figures 9.28

-

9.33

show examples of projection lines applied to a stock, Gold, and the S&P 500, respectively, compared with the subsequent market action.

FIGURE 9.27

Daily price chart of the DJIA. The interim low was on February 8, 2010, a few days before the projected low of February 12. The forecast correctly projects a subsequent trend change to the upside. Using technical indicators, a trader would be prepared to go long as soon as the buy signal was triggered; for example, when the price crossed the green line (18-DMA).



FIGURE 9.28

Projection chart as of October 23, 2010, for 255 Lung Kee Holdings Ltd. The subsequent actual market prices are shown in

Figure 9.29

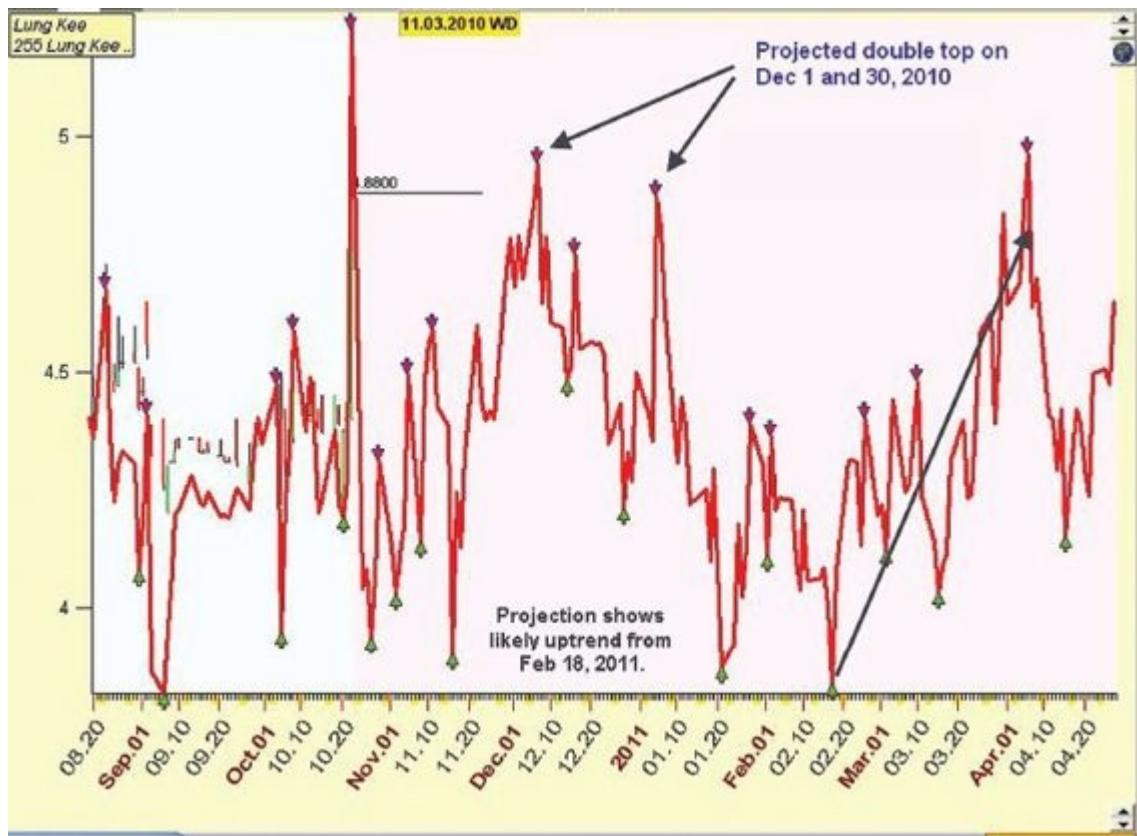


FIGURE 9.29

Daily chart of 255 Lung Kee Holdings Ltd. The forecasted double top did take place, but the scaling of the second peak in the red projection line is marginally off.



FIGURE 9.30

Projection chart of Gold, showing astro-cycles (blue and green lines).

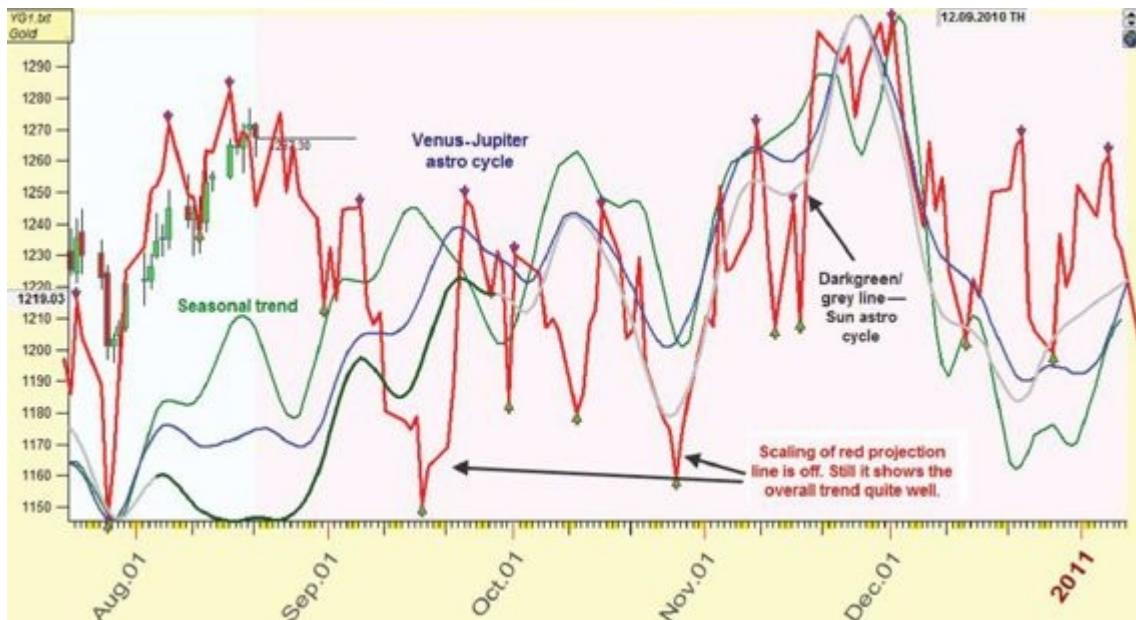


FIGURE 9.33

Daily price chart of the S&P 500.



In the final chart,

[Figure 9.34](#)

, the planetary aspect bars are again shown for the Hang Seng Index. In addition, the chart shows the ingress, or entrance, of the Sun, Mercury, Venus, and Mars into a new zodiacal sign. When the Sun left the sign of Gemini on June 21, 2011, it then entered into Cancer at 00 degrees, 00 minutes. As can be seen, when the Sun makes its ingress into a new zodiac sign, it often correlates with CITs, although occasionally it is one of the other planets that correlates.

Readers who are interested in studying the subject further may find more information at:

www.astro.com/swisseph/swephae.htm

. Scroll down to the “Sun sign ingresses” section and select the year range (

www.astro.com/swisseph/ae/isun2000.pdf

). It lists the exact dates and times for the ingresses that year, calculated in Greenwich Mean Time.

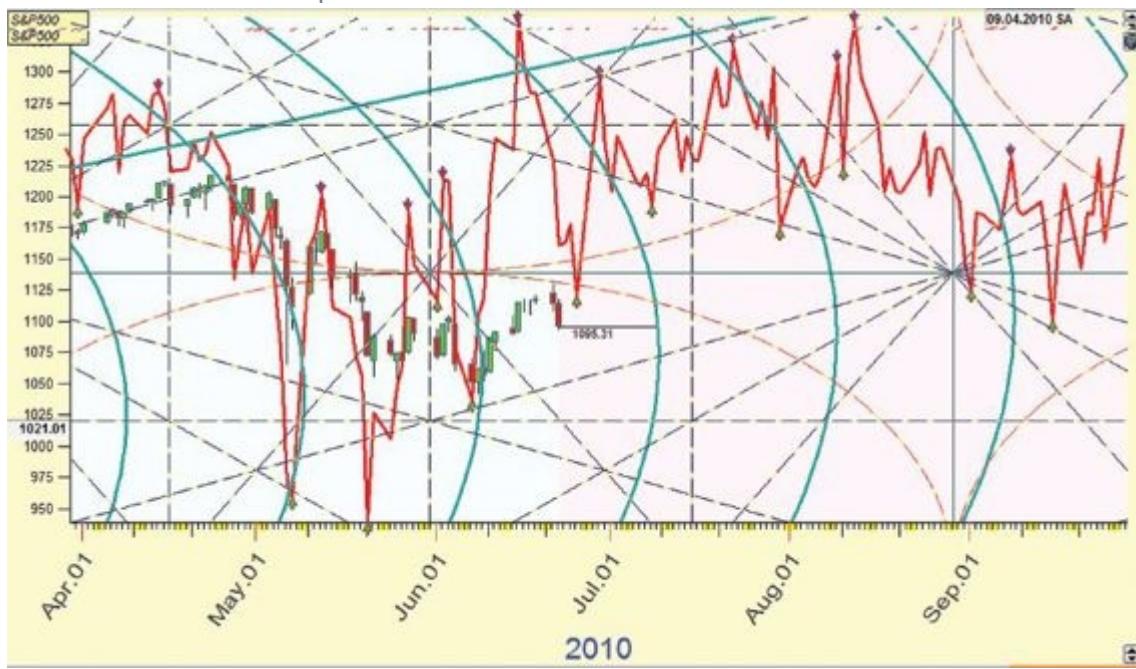
FIGURE 9.31

Daily price chart of Gold.



FIGURE 9.32

Projection chart of the S&P 500 made on June 22, 2010. Includes Gann squares as well as ellipse lines. Note the completion of a Gann square coincides with the interim low in price on August 27, 2010. The red projection line did also match the high on August 6, but the projected low around the middle of September was off.



CONCLUSION

The charts in this chapter have shown the correlation between the planetary cycles and the financial markets. Nevertheless, some may still ask, what is the underlying physical mechanism by which astrology works? In other words, how does a celestial object from as far away as 9 billion miles exert influence?

Australian astrologer Alice McDermott suggests that, instead of looking at it from the perspective of a tiny little life form on a smallish planet in a solar system on the edge of a galaxy, we should try to see the question from a solar system perspective.

The Earth is a part of a solar system. From the Earth's point of view, it is part of the structure of this solar system, just as our gall bladders are part of our overall physical structure. What we see as very long distances, millions of miles, are actually quite small from a solar system perspective. All the planets in this solar system are all part of the same life force and all influence each other.

As we are all part of the Earth, naturally we are all affected by what goes on in our own solar system, and by the planets that are part of that structure.

In essence, astrology works through harmonic resonance. Everything resonates with everything else and a variety of individual energies (certain stars, planets, people, animals, plants, insects, etc.) can resonate along the same vibrational lines, thereby having a strong connection.

So, as the cosmos moves, so does life on Earth. The task faced by astrologers since early times has been to correlate the symbolic language of astrology with events here on Earth. It is a daunting task. But anyone practicing astrology in earnest realizes after a while that we humans have in fact been given the tools, ancient tools that have withstood the test of time, to advance in our understanding of the universe. For the financial astrologer, the job has been made easier to some extent by powerful software programs. It might be imprudent, however, to rely only on a mechanical computerized system to try to decipher the influence the planets have on Earth. With experience, one learns to use various forecasting techniques, which each in their own way yield pieces of the puzzle, and ultimately to synthesize all the information to come to a conclusion as to the likely direction of a stock or of a market.

Some say it is impossible to forecast the trend of any commodity or financial instrument. But tests measuring correlation of various market predictions with complex astro-cycle analysis are steadily improving. Astro-cycle analysis is expected to improve in the coming years, given the accelerating pace of efficiency testing and ever more powerful back-testing programs.

Without doubt, as the competition intensifies in the coming decades, investors and traders will seek more tools to help them outperform the market. It is not beyond the realm of possibility that financial stock quote companies, including leading ones like *Financial Times*, Bloomberg, Reuters, and others, may one day publish lunar cycles and other astrological cycles for investors who wish to augment their trading strategies with the input of such data.

It is often said, "the stars impel, they do not compel," meaning that we have free will. In the same vein, the foregoing is not meant to imply that our lives are wholly governed by the planets. The purpose is only to show that, when used wisely, astrology can provide valuable clues in trading. Combined with the technical analysis methods presented earlier, investors and traders will have at their disposal unequaled tools to achieve consistent profits in trading.

APPENDIX 1

Ruling Planets of the Natural Horoscope

The following is a list of the traditional astrological ruling planets of the natural horoscope, which starts with Aries on the cusp of the first house. The characteristics of each house for both personal (see Keywords) and financial astrology are included.

1st House: Aries and Mars. Personnel of the corporation, including stockholders, how the stockholders see the company, relationship to the public, business objectives.

Keywords: Physical self, personality, motivation, well-being

2nd House: Taurus and Venus. Liquid assets, earnings.

Keywords: Possessions, earning abilities, self-esteem

3rd House: Gemini and Mercury. Relations with competitors, transportation and communications, some advertising, financial and trade relations with adjacent countries.

Keywords: Siblings, transport, environment, early education

4th House: Cancer and the Moon. Real estate investment and holdings, tangible assets of the corporation, direct competition.

Keywords: Home and family, foundations of life

5th House: Leo and the Sun. Speculation, income from capital, the place of deposit of capital such as safes, vaults, and banks.

Keywords: Risk-taking, creativity, fun, romance, children

6th House: Virgo and Mercury. Workers or employees, work and equipment, work schedules, inventories, corporation contacts with hotels; agriculture and agricultural products.

Keywords: Routine work, health, diet

7th House: Libra and Venus. Partnerships, relationships with other organizations, sales appeal: trading volume—how much stock is being bought, public accounting, trade agreements, mergers, lawsuits and legal affairs, competitors and their activities.

Keywords: Primary relationships, partnerships

8th House: Scorpio and Pluto. Investors' money, credits, international/business finance, losses or gains due to demise of corporation, financial responsibilities, private conferences.

Keywords: Joint resources, investments, inheritance, sex, death

9th House: Sagittarius and Jupiter. Completion of contracts, legal affairs, audits, activities abroad, insurance, shipping, philosophy of company, long-distance communications, publicity and public relations, officials.

Keywords: Higher education, long-distance travel, philosophy, religion, law, ideals

10th House: Capricorn and Saturn. Public image of company, president or chairman of the board, general business conditions, relations with government and associations, administrative department.

Keywords: Reputation, career, social responsibilities, ambitions

11th House: Aquarius and Uranus. Corporate allies, long-range goals of the organization, completion of projects, the good-will and intangible assets; indebtedness in bonds, mortgages, and so forth.

Keywords: Goals, groups, friends

12th House: Pisces and Neptune. Research and development, trade secrets and formulas, limitations through secret enemies that might involve inefficiency, secret assistance.

Keywords: Seclusion, institutions, escapism, faith

APPENDIX 2

Effects of Various Aspects

The effects of the various aspects are as follows:

0 degrees (Conjunction). Major aspect. In fact, it is more a position rather than an aspect, but for simplicity's sake, it is classified as an aspect. It entails a close gathering of two or more planets, ideally with the same zodiac degree. Conjunction symbolizes the cooperation of the planets, which combine their potentials and reinforce each other. Whether this has positive or negative results depends largely on the nature of the relevant planets.

60 degrees (Sextile). Major aspect. The sextile aspect involves two or more planets at an angle of 60 degrees from one another. It denotes the ability to turn intellectual understanding into productivity, to develop one's talents, and to make use of opportunities for growth and for the fulfillment of one's hopes and wishes. Such opportunities often arise under sextile transits.

90 degrees (Square). Major aspect. An aspect between two or more planets positioned at an angle of 90 degrees is called a square. Modern astrology regards the square as an aspect of constant inner tension, urging the individual toward action in order to relieve it. Success is frequently delayed or thwarted, either by circumstances or by inconsistent behavior, and often demands great efforts over long periods. On the positive side, the square offers numerous opportunities for learning and personal development, which are usually lacking in more harmonious aspects.

120 degrees (Trine). Major aspect. The trine is one of the classic Ptolemaic aspects, consisting of two or more planets at an angle of 120 degrees from each other. The relevant planets are said to cooperate in the most harmonious way, which is why traditional astrology calls it a "benefic" aspect. The trine can bestow fortunate circumstances on a person, and positive results on the matter at hand.

180 degrees (Opposition). Major aspect. The opposition consists of two or more planets or horoscope points separated by an angle of 180 degrees; that is, on opposite sides of the zodiac. As the name indicates, the opposition is mostly an aspect of conflict.

30 degrees (Semi-sextile). Minor aspect. The semi-sextile is an aspect of 30 degrees; the relevant points are one sign apart. The opinions differ as to its effects, with some viewing them as beneficial and providing good opportunities. Others call the semi-sextile "dissociate" and connect it with disturbing, albeit minor, incidents.

45 degree (Semi-square). Minor aspect. The semi-square is an aspect of 45 degrees and may be compared to the effects of a square, only weaker. It tends to promote self-criticism and may indicate an inner feeling of irritation and/or friction developing.

150 degrees (Quincunx or Inconjunct). Minor aspect. The main characteristics of this aspect are adjustment and uncertainty. It often manifests itself as a crisis in which several urgent and contradicting demands are placed upon the individual, who is forced to set priorities and choose between desire and necessity. When approached positively, this may lead to a redefinition of the person's goals or to a reassessment and improvement of working methods.

APPENDIX 3

Characteristics of the Twelve Zodiac Signs

The following is a list of the characteristics of the 12 zodiac signs.

Aries: defense, machinery, steel, tools, weapons, non-precious metals. Start-ups.

Keywords: pioneering, leading, new beginnings, strong willed

Taurus: bank accounts, tellers, and all things to do with banks, savings and loans.

Banking and financials. Bonds.

Keywords: ownership, dependability, sensuality, seeks harmony

Gemini: telecommunications, writing, speech, letters, mail, phone calls and phones, documents, computers, cars, equipment and travel, truckers. Trading.

Keywords: mentality, versatility, communication, curiosity, dualism

Cancer: property, home, home products, home appliances, home furnishings, restaurants, hotels, nurses, silver. Real estate.

Keywords: feeling, sensitivity, nurturing, quick to hurt, seeks security

Leo: investments, stocks, investment banks, people in charge, gold, biotechnology.

Large caps.

Keywords: willpower, creativity, expressing the heart, leader

Virgo: health services and health care plus items related to these, problems with workers or personnel. Retail/department stores, vitamins, food. Technical analysis.

Keywords: service, self-improvement, purity, perfection, practicality

Libra: lawyers, lawsuits, negotiations, public relations, partnerships, cosmetics, and jewelry. Investing.

Keywords: balance, harmony, justice, concern for others, relationships

Scorpio: pollution control, insurance, salvage operations, bioterrorism, mining, seismology, plumbing supplies, environmental cleanup. Debt. Hostile takeovers. Stockbrokers. Mutual funds.

Keywords: desire, transformation, power, intense, probing, passionate relationships, power struggles

Sagittarius: publishing, teaching, universities, colleges, overseas travel, sports equipment, casinos. International affairs.

Keywords: need to understand, exploration, enthusiasm, searching for truth

Capricorn: real estate, government, people in authority, bosses, management.

Mega corporation. Blue chips. Savings.

Keywords: achievement, structure, organization, ambitious, cold

Aquarius: computers, electrical equipment, appliances, radios, TV, planes, organizations and clubs, airlines, aerospace, high technology. Contrarian investing.

Keywords: humanitarian, unique, revolutionary, idealistic, inventive

Pisces: drugs, medication, hospitals, institutions, alcohol, oil and gas, shoes, plumbing, water, photography, chemicals, windmills, paint, bottled water, nurses, rubber, X-ray, poisons, greeting cards. Socially responsible investing.

Keywords: compassion, universality, inclusiveness, dreamer, intuitive

APPENDIX 4

Formulas in MetaStock Format

*

MOMENTUM TIMING OSCILLATOR AS USED IN

FIGURE 2.3

```
Length1:=Input("Base Unit",2,100,21);
Length2:=Input("First Period",2,100,13);
Length3:=Input("Second Period",1,100,8);
Length4:=Input("Third Period",1,100,8);
Cycle:=Input("Cycle",1,100,21);
plot:=Input("Select Plot, 1=OB Lines, 2=AutoLines 3=Cycle Zones", 1,3,3);
n:=(RSI(Length1)-LLV(RSI(Length1),Length2));
k:=(HHV((RSI(Length1)),Length2)-LLV(RSI(Length1),Length2));
k2:=If(k=0,0.000001,k);
Osc:=100*n/k2;
OscAvg1:=(2*Mov(Osc,Length3,S)-100);
OscAvg2:=Mov(OscAvg1,Length4,S);
StdP:=1.2*Stdev(oscavg2,89);
StdM:=Neg(1.2*Stdev(oscavg2,89));
n2:=(Fml("frhlc")-LLV(Fml("frhlc"),Cycle));
k2:=HHV((Fml("frhlc")),Cycle)-LLV(Fml("frhlc"),Cycle);
k22:=If(k2=0,0.000001,k2);
OscAvg12:=(2*Mov((100*n2/k22),Length2,S)-100);
RwUp:=(45+Stdev(OscAvg12,2));
RwDn:=Neg(45+Stdev(oscavg12,2));
Zone:=If(oscavg12>0,RwUp,If(oscavg12<=0,RwDn,RwUp));
If(plot=1,50,If(plot=2,StdP,Zone));
If(plot=1,Neg(50),If(plot=2,StdM,Zone));
OscAvg1; OscAvg2; 0;
{Frhlc: Function referred to in the formula Momentum Timing Oscillator}
```

```
frhlc:=(((RSI(HIGH,13))+(RSI(LOW,13))+(2*(RSI(CLOSE,13))))/4);
```

```
frhlc;
```

VOLUME ZONE OSCILLATOR AS REFERRED TO IN

FIGURE 2.10

AND

FIGURE 5.8

VZO was developed by Walid Khalil and David Steckler. The following VZO is modified for merging of plots of volume ratio compressed indicator and planetary aspects indicators.

```
prd:=Input("Period",1,200,13);
avg:=Input("Average",2,200,8);
y:=Input("Select Price 1=MP(),2=Typical(),3=Close",1,3,1);
plot:=Input("Select Plot, 1=vzo, 2=sma, 3=All",1,3,3);
y:=If(y=1,MP(),If(y=2,Typical(),CLOSE));
Change:=ROC(y,1,$);
x:=If(Change>0,VOLUME,-VOLUME);
vp:=Mov(x,prd,E);
tv:=If(Mov(VOLUME,prd,E)=0,0.000001,Mov(V,prd,E));
vzo:=(100+(100*vp/tv))/2;
vzo1:=Mov(vzo,avg,S);
If(plot=1,vzo,vzo1);
If(plot=2,vzo1,vzo);
70; 50; 30;
```

VOLUME RATIO COMPRESSED INDICATOR AS REFERRED TO IN

FIGURE 5.3

```
Period1:=Input("Period1",1,144,2);
Period2:=Input("Period2",1,144,10);
x:=Input("Compressed",0,100,0.2);
VAvg1:=Mov(Abs(VOLUME),Period1,E);
VAvg2:=Mov(Abs(VOLUME),Period2,S);
z:=If(vavg2=0,0.0001,vavg2);
VolRatio:=100*(VAvg1/z);
VolRatio*x;
```

MOVING AVERAGE LINE WITH UPPER AND LOWER MIRROR LINES AS REFERRED TO IN

FIGURE 7.8

```
Period:=Input("Period",1,500,89);
PCent1:=Input("Upper Percentage",1,200,7);
PCent2:=Input("Lower Percentage",1,200,7);
x:=Input("Select Price, 1=mp(),2=typical(),3=close",1,3,3);
plot:=Input("Select Plot,1=RMA+Mirror, 2=Mirror,3=RMA",1,3,1);
x:=If(x=1,MP(),If(x=2,Typical(), C));
RMA:=Mov(x,Period,E)+LinRegSlope(x,Period)*(1);
MirrorP:=RMA+(RMA*PCent1/100);
MirrorN:=RMA-(RMA*PCent2/100);
Mirror:=If(LOW>RMA,MirrorP,If(HIGH<RMA,MirrorN,RMA));
{Plot PMA on price chart, signals in own window}
If(plot=1,RMA,If(plot=2,Mirror,RMA));
If(plot=1,Mirror,If(plot=3,RMA,Mirror));
```

MID-TERM PERIOD MOVING AVERAGE LINES AS REFERRED TO IN

FIGURE 2.5

```
Fast:=Input("Fast MA",1,300,9);  
  
y:=Input("Select Price 1=MP(),2=Typical(),3=Close",1,3,3);  
  
plot:=Input("Plot [1]Disparity [2]Two Lines [3]All",1,3,2);  
  
y:=If(y=1,MP(),If(y=2,Typical(),C));  
  
Ind1:=Mov(y,Fast,S)+LinRegSlope(y,Fast)*3;  
  
Ind2:=Mov(y,9,S)+LinRegSlope(y,9);  
  
iDiff:=(1.382*(Ind1-Ind2)+0.618*Ref(Ind1-Ind2,-1))/2;  
  
Ind3:=If(Cross(Ind1,Ind2),(Ind1+iDiff),If(Cross(ind2,ind1), (Ind1-iDiff),ind1+idiff));  
  
If(plot=1,Ind3,If(plot=2,Ind1,Ind3));  
  
If(plot=2,Ind2,If(plot=1,Ind3,Ind2));  
  
If(plot=3,Ind1,If(plot=1,Ind3,Ind1));  
  
*
```

For educational purposes only and not for the purposes of encouraging trading.

Glossary

A-B-C correction Alphabetical labeling for a three-wave structure in a correction pattern. Wave A is the first wave moving against the prevailing trend of the five-wave structure. Wave B is a corrective wave to Wave A. Wave C is the final wave to complete the three-wave structure movement. In a zigzag, Wave C exceeds the extreme of Wave A, but not in an irregular A-B-C correction.

alternate count An alternate interpretation of wave counts that is equally applicable to a given market situation.

Alternation, Rule of The alternation of patterns between Wave 2 and Wave 4 in a five-wave structure. If Wave 2 is a simple pattern, then Wave 4 is expected to be a complex pattern. In a complex correction, if the preceding corrective pattern is a flat, then the pattern following will be of another formation.

confirmation Refers to two different factors agreeing with one another. Volume is said to confirm the price action if volume is rising together with the price.

continuation pattern Refers generally to a corrective pattern such as a triangle, wedge, pennant, or flag. Indicates a pause in the prevailing trend.

divergence Divergence occurs when the directional movement of the price disagrees with that of the oscillator. Divergence generally indicates trend reversal.

dividend yield Dividend per share divided by the current price per share expressed as a percentage.

double top/bottom Refers to a price pattern in an uptrend showing two conspicuous peaks. In a downtrend, the price pattern is a double bottom, showing two distinct troughs. Double top is generally caused by flats, double bottom by failures. Also known as "M" and "W" patterns.

Equality, Rule of When one impulse wave is extended in a five-wave structure, the remaining two waves tend to be equal.

extended wave The longest wave in one of the three impulse waves of a five-way structure.

failure The inability of price to reach a new high in an uptrend or a new low in a downtrend. A five-wave structure in which impulse Wave 5 fails to move above the end of Wave 3, or a correction in which Wave C fails to move below the end of Wave A.

Fibonacci ratios The ratio between any two successive numbers in a Fibonacci sequence. After the first four numbers of the sequence, the ratio of any number to the next highest number is approximately 0.618 (known as the "Golden Ratio"), and to the next lower number approximately 1.618. The important ratios are 0.382, 0.618, and 1.618.

Fibonacci sequence The sequence of numbers (1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377, etc.), discovered by Leonardo de Pisa, where each successive number in the sequence is the sum of the previous two numbers.

gap Refers to a trading day in which a daily range is completely above or below the previous day's range, displaying a gap between today's low and yesterday's high or today's high and yesterday's low.

head and shoulder A price pattern that takes its name from the fact that it looks like the head and shoulders of a person, either upright or inverted. The pattern often indicates a coming move away from the established trading range.

hybrid oscillator An oscillator that is constructed by merging two kinds of components to produce the result.

impulse wave Refers to Wave 1, 3, or 5 of a five-wave structure; a wave that takes an existing trend further in the same direction.

inside day A day in which the range of price is within the range of the previous day's price range. It is a sign of consolidation while the market waits for more signals for a direction. If it occurs after a market has had a big move, it is a signal that momentum is waning for that move.

irregular flat A corrective A3-B3-C5 pattern in which Wave B terminates beyond the start of Wave A.

noise Price fluctuations that can confuse interpretation of the directional movement of the market.

non-trending Price movements that lack any discernible movements in either direction.

outside day A day in which the previous day's price range is within the range of today's price range. This is often a signal that the market is about to make a move in the direction of the close.

overbought A market is said to be overbought when an oscillator reaches above the upper limit.

oversold A market is said to be oversold when an oscillator reaches below the lower limit.

parameter A rule or condition that establishes the format for a trading system or indicator.

P/E Ratio Price/earnings ratio is a test of a stock's risk and demand, and is reported as a multiple calculated by having the price per share divided by earnings per share.

protective stops A risk management technique in which the trade is liquidated to stop further loss.

Queuing Theory of Moving Average Crossovers A bullish market is initiated when price crosses above its respective averages (e.g., 50-day, 90-day, and 200-day moving average lines) and the moving averages also follow in a sequential order with the shorter period moving average crossing above the longer period. A bearish market is initiated when price crosses below its respective averages and the moving averages also follow in a sequential order with the shorter period moving average crossing below the longer period. If price and its respective moving averages are not aligned in a sequential order, any short term rally or retracement will be short-lived.

range The difference between the high and low price during a given period.

rectangle A price pattern formed in a relatively narrow horizontal price range. Rectangles are usually complex corrections of double flats or triple flats.

resistance Refers to a price level at which prices stopped rising.

retracement A price movement in the opposite direction of the previous trend.

saucer A pattern depicting a stock whose price has reached bottom and is moving up. Similar to a cup-and-handle formation, but the saucer base is shallower and rounder in shape. An inverse saucer shows a top in the stock's price and signals a downturn.

support Refers to a price level at which prices stop declining.

trading range Refers to the difference between the high and low prices traded during a period of time.

trend Refers to the directional movement of prices, as in an uptrend when prices are making higher highs and higher lows, and as in a downtrend when prices are making lower highs and

lower lows.

trend line A straight line that connects a series of highs or lows in a trend. An uptrend line represents support and a downtrend line represents resistance. Horizontal trend lines generally represent consolidation.

triangle Refers to a continuation pattern or sideways price pattern in which prices fluctuate within two converging trend lines. There are contracting, ascending, descending, and diagonal triangles. In an expanding triangle, the two trend lines will diverge.

true range The largest of the following: (1) Today's high minus today's low; (2) today's high minus yesterday's close; or (3) today's low minus yesterday's close.

volatility A measure of the degree of price change from price in the previous period.

wedge A continuation price pattern that consists of two diverging trend lines, both of which slope against the prevailing trend. In a bearish pattern, both trend lines slope upward. In a bullish pattern, both trend lines slope downward. A wedge is generally a diagonal triangle.

whipsaws Losing trades on both sides of a price swing.

zigzag A correction that is subdivided into an A5-B3-C5 pattern. Wave B in a zigzag is noticeably lower than the start of Wave A.

ASTROLOGICAL TERMS

applying aspect This term refers to a planet that is moving toward an exact aspect with a slower-moving planet. An applying aspect can also take place as a planet applies toward a fixed point, such as the Midheaven or Ascendant.

Arabic parts Arabic parts (or lots) are points that are arithmetical constructs of two or more components such as planets or house cusps. They are used when a specific issue is being examined in a chart. There are historically 32 different parts, but only the Part of Fortune is in common use today.

ascendant The sign of the zodiac that is rising in the east at the moment of birth, and placed on the cusp of the first house. Also referred to as the rising sign of a horoscope. One of the four personal points in astrology, along with the Sun, Moon, and Midheaven. All are key indicators of individual expression.

aspect The relationship between two planets, or the relationship between a planet and the Ascendant or Midheaven. It is the angular distance between these two points.

birth chart The birth chart is also referred to as the horoscope or natal chart. The birth chart is a circle divided into 12 parts, or houses, each of which describes a different area of life experience. In financial astrology, they are referred to as first-trade charts.

conjunction Two or more planets are said to be “conjunct” when they are in the same part of the sky. Their energies are combined.

cusp The cusp of a sign or house is the point at which it begins.

cycle A cycle is the planetary movement around the entire circle of signs. Pluto is the slowest moving planet, and takes 248 years to cycle the entire zodiac. The Sun’s cycle takes one year.

degree The horoscope has 360 degrees and each sign has 30 degrees. Degrees are used to measure exact positions of planets and other astrological factors.

eclipse An eclipse occurs when one celestial body obscures another; the term is generally used to refer to the relationship between the Sun and the Moon. In this book, the Sun and the Moon are referred to as planets, while in fact they are luminaries.

ephemeris A book of tables showing the exact positions of the Sun, Moon, and planets on a daily basis.

financial astrology Financial astrology has been around for centuries. Nowadays, it often refers to the practice of predicting cycles in the stock markets by correlating them with planetary cycles, or by casting a first-trade horoscope for listed companies and financial markets and analyzing them in terms of planetary influences to project future trends.

full moon The opposition between the Sun and the Moon. The time when the Moon is 180 degrees from the Sun.

geocentric The universe, as seen from the Earth. Astrologers are perfectly aware that the Earth orbits the Sun. However, a geocentric (earth-centered) frame of reference often makes good sense because we humans live on the Earth.

hard aspect Planets that are 90 degrees apart are called square aspects. Planets that are 180 degrees apart are called opposition aspects. These aspects are considered difficult and create tension. Planets in conjunction can be considered either soft or hard, depending on the planets involved.

heliocentric The universe, as seen from the Sun. It is the true picture of the solar system.

horoscope Another term for birth chart. The word horoscope comes from a Greek word meaning “map of the hour.” A horoscope is also called a natal chart, which references the unique time and place of an event, inauguration, first trade of a company, or the birth of a person.

house cusp The first degree of any house in a horoscope or birth chart.

ingress In astrology, an ingress is when any planet enters a new sign and is 00 degrees, 00 minutes of that sign.

lunation A complete cycle between two new moons; also known as a synodic month. Lunations may also refer to solar or lunar eclipses.

major aspect The major aspects in astrology are conjunction, sextile, trine, square, and opposition.

midheaven The sign on the cusp of the tenth house of the horoscope is referred to as the midheaven or medium coeli. It is the point at which the Sun is at midday at the time and place the subject of the horoscope is born. It is one of the four cardinal points in a horoscope and the second most powerful following the ascendant.

minor aspect Some minor aspects in astrology are the semi-square (45 degrees apart), the semi-sextile (30 degrees apart), and the quincunx (150 degrees apart).

new moon The conjunction of the Sun and the Moon. The time when the Moon is at the exact same degree as the Sun.

orb Refers to the range of degrees within which an aspect is considered to be operating. The closer the two planets are in degree, or orb, the stronger or more potent the aspect will be. The farther the two planets are in degree, the weaker the effect will be.

Part of Fortune An important Arabic part which benefits the house in which it is located at birth.

ruler Certain planets have been given rulership over certain signs. For further details please refer to Appendixes 1, 2, and 3.

separating aspect A separating aspect refers to a planet that is moving away from an exact aspect with a slower-moving planet or a fixed point in a chart.

soft aspect These aspects are comfortable and harmonious, bringing ease and opportunity. Sextiles and trines are considered to be soft aspects. Some conjunctions are considered soft aspects, depending on the planets involved.

stellium Multiple conjunction of three or more planets in the same sign or house. A conjunction describes the combined forces of the planets involved; therefore, the stellium indicates a massive concentration of energies in the sign and house in question.

synodic period The term refers to the length of time during which a body in the solar system makes one complete orbit of the Sun relative to the Earth; that is, it returns to the same elongation.

transit Astrologers use a wide variety of timing techniques and a “transit” is the primary tool of predictive astrology. Transits are the day-to-day movements of the planets and the aspects they form to one another. They vary a great deal in their effect depending upon which planets are involved.

Bibliography

SUGGESTED READING

- Appel, Gerald. *The Moving Average Convergence-Divergence Method*. Great Neck, NY: Singalert, 1979.
- Elder, Alexander. *Trading for a Living: Psychology, Trading Tactics, Money Management*. New York: John Wiley & Sons, 1993.
- Gartley, H. M. *Profits in the Stock Market*. Pomeroy, WA: Lambert-Gann, 1981.
- Khalil, Walid, and David Steckler. "In the Volume Zone." *Technical Analysis of Stocks & Commodities* (May 2011).
- Magee, John J., and Robert D. Edwards. *Technical Analysis of Stock Trends*. New York: New York Institute of Finance, 1966.
- Murphy, John J. *Technical Analysis of the Futures Markets*. Englewood Cliffs, NJ: Prentice-Hall, 1986.
- Prechter, Robert R., and Alfred John Frost. *Elliott Wave Principle: Key to Stock Market Profits*. Gainesville, GA: New Classics Library, 1978.
- Pring, Martin J. *Technical Analysis Explained*. 3rd ed. New York: McGraw-Hill, 1991.
- Raschke, Linda Bradford, and Laurence A. Connors. *Street Smarts, High Probability Short Term Trading Strategies*. Jersey City, NJ: M. Gordon Publishing Group, 1995.
- Schwager, Jack D. *The New Market Wizards: Interviews with Top Traders*. Columbia, MD: Marketplace Books, 2008.
- Wee, Chow-Hou. *Sun Zi Art of War: An Illustrated Translation with Asian Perspectives and Insights*. Upper Saddle River, NJ: Pearson/Prentice Hall, 2003.
- Wilder, J. Welles, Jr. *New Concepts in Technical Trading Systems*. Greensboro, NC: Trend Research, 1978.

ASTROLOGICAL BOOKS

- Farnell, Kim, ed. *Astrology*. London: Foundry Creative Media Company, 2002.
- McEvers, Joan, ed. *Financial Astrology*. Woodbury, MN: Llewellyn Worldwide, Ltd., 1991.
- Meridian, Bill. *Bill Meridian's Planetary Stock Trading—III*. New York: Cycles Research, 2002.
- Parker, Julia, and Derek Parker. *Parkers' Astrology*. New York: DK Publishing, 1991.
- Stathis, Georgia Anna. *Business Astrology 101: Weaving the Web between Business and Myth*. Pleasant Hill, CA: Starcycles Publishing, 2001.
- Michelsen, Neil F., and Rique Pottenger. *The American Ephemeris for the 21st Century: 2001–2050 at Noon*. Rev. ed. Epping, NH: ACS Publications, 1996.

CHARTING SOFTWARE PROGRAMS

MetaStock, Equis International, 90 South 400 West, Suite 620, Salt Lake City, UT 84101.

www.equis.com

TradeStation, Omega Research, 9200 Sunset Drive, Miami FL 33173.

www.tradestation.com

See also

<http://fc-cd.com/omega.htm>

ASTROLOGY SOFTWARE PROGRAMS

SolarFire8, Astrolabe

www.alabe.com

Astrowin123

www.astrowin.org/astro123.php

FINANCIAL ASTROLOGY SOFTWARE PROGRAMS

AIR Software—The Market Trader/Titanium	www.alphhee.com/
TimingSolution—Advanced/Terra Incognito	www.timingsolution.com/
Fibonacci Trader/Galactic Trader Vers. 4	www.fibonaccitrader.com
TradeStation—ProSuite 2000i Astro Add-on	www.soulytion.de

OTHER RESOURCES

Websites

AstroDienst	www.astro.com/
Astrology for Gann Traders	www.astrologyforganntraders.com.au/main.html
Barton's Global Market Trends	www.asiachart.com/
Timing Solution	www.timingsolution.net

Sources for First-Trade Charts

Yahoo! Finance	http://finance.yahoo.com/
Yahoo! Stock Screener	http://screen.finance.yahoo.com/newscreener.html
Magi Astrology	www.magia astrology.com/index.php
NYSE First-Trade Dates	www.nyse.com/about/listed/listed.html
Hong Kong Stock Exchange	www.hkex.com.hk/eng/index.htm

Magazines

<i>Trader's World</i>	www.tradersworld.com/
-----------------------	--

Newsletters

<i>The Merriman Market Analyst</i>	www.mmacycles.com/
------------------------------------	--

About the Authors

Robert T. H. Lee has over 50 years of experience in the financial industry and over 35 years of experience in securities and investment banking. In 1960, he joined Malayan Banking Berhad, Malaysia, and in 1964 he was transferred to its Hong Kong branch as a member of the senior management. From 1977 to 1987, he served as the senior manager of another international bank, now known as Development Bank of Singapore and, concurrently, as general manager of its two subsidiaries, where he was responsible for all securities trading and investment counseling. He then went into private practice where he provides corporate finance and portfolio advisory services. Drawing from his experience in securities trading, he published a book on technical analysis in 1997, *Power Tools for Traders*. For the past 15 years, he has privately tutored many of his associates and fellow technicians, and he has been sharing his views on trading psychology, money management, and trading methodology with his students. Drawing on his insights from years of securities trading, Robert concludes that a trader should, firstly, maintain a healthy mind and, secondly, that a trading method should be pragmatic. He emphasizes that the most important thing of all is to know when to take a break from trading. Currently, he is an Independent Non-Executive Director of Tingyi (Cayman Islands) Holdings Corp., a publicly listed company on the Stock Exchange of Hong Kong Limited. He is also a Senior Business Consultant for Henny Wee & Co., certified public accountants, Hong Kong, in corporate governance and mergers and acquisitions. He is an associate of the Chartered Institute of Bankers, London, a member of the Hong Kong Institute of Bankers, and a member of the Hong Kong Securities and Investment Institute.

Peter A. Tryde joined Merrill Lynch, Hong Kong, in 1981, and has spent over 20 years in the investment industry as a securities and futures senior dealing director. He has also worked with Robert T. H. Lee in the research and development of technical analysis, portfolio management, and project financing. They co-authored *Winning in the Markets*, which described the development of computer trading systems, and which became the precursor for *Power Tools for Traders*. In recent years, Peter has been engaged in the raising of capital for various "green" projects, as well as trading the markets based on the advanced neural network projection features of Timing Solution software programs. The interest in astrology arose because a senior colleague used astrological forecasts in his trading back in the nineties, and since then, Peter has been studying astro-harmonics with the main focus on how planetary cycles correlate with trends in the financial and commodities markets.

Index

AB=CD patterns
A-B-C (three-wave structure), in Elliott Wave Theory
A-B-C correction
Accumulation and redistribution, in lunar cycles
Active traders
AIR Market Trader
Al-Biruni
Alltronics Holdings Ltd.
Alternation, Rule of
Appel, Gerald
Applied systems
assumptions of methodology
built-in color trend indicator and
designing of system
supporting moving averages
trading on daily signals
trading with Ichimoku technique
trend basics and
Arabic parts
Arnhold Holdings Ltd.
Ascendant angles
Aspects
effects of various
identifying good and bad in astrological software
Astro-cycle analysis. *See* Financial astrology
Astrodienst
Astro-harmonics. *See* Financial astrology
Astrological software programs
Average Direction Index (ADX)
Average true range
Bearish diagonal patterns
Bearish divergence patterns
Bearish engulfing patterns
Bearish reversal patterns
Birth charts. *See* Natal charts
Blau, William

Body of candle
Bollinger, John
Bollinger on Bollinger Bands (Bollinger)
Box (rectangle) patterns
Breakaway gaps
Built-in color (BIC) trend indicator
Bullish diagonal patterns
Bullish divergence patterns
Bullish engulfing patterns
Bullish reversal patterns
Caginalp, Gunduz
Candlestick patterns
in built-in color trend indicator
price range and
types of
Chande, Tushar S.
Change in trend (CIT) points, financial astrology and
Chart checklist
Chikou span, in Ichimoku charting technique
Close
Common gaps
Complex corrections, in Elliott Wave corrective 5-3-5 patterns
Confirmation
Conjunction, in financial astrology
Continuation patterns
Corrective 3-3-5 patterns, in Elliott Wave Theory
Corrective 5-3-5 patterns, in Elliott Wave Theory
Corrective waves, in Elliott Wave Theory
Crossover signals, price momentum and
Cup-and-handle patterns
Cusp
Daily range
Daily signals, trading on
Dark cloud cover pattern
Dead Cross
Descendant angles
Diagonal patterns
Discretionary trading
Divergence patterns
Dividend yield
Doji
Double tops/double bottoms ("M" and "W" patterns)
Douglas, Mark

Dragonfly doji
Dynasty Fine Wines
Earnings per share (EPS), fundamental analysis and
Eclipse, in astrology
Edwards, Robert D.
Elder, Dr. Alexander
Elliott, Ralph N.
Elliott Wave Theory
AB=CD patterns
application of
corrective 3-3-5 patterns
corrective 5-3-5 patterns
count identification difficulties
cycles and
emotions and
extended waves
Fibonacci ratios and
Fibonacci Retracement and Projection and
five-wave structure
guidelines for
purpose and aim of
rectangle patterns in
Rule of Alternation
three-wave structure
volume and
Emotions, effects on trading
Elliott Wave Theory and
Engulfing patterns
Entry points, determining
Ephemeris
Equality, Rule of
Equilibrium zone
Evening star pattern
Execution of trade checklist
Exhaustion gaps

Exit strategies:

determining of

trading advice

Extended Elliott waves

Fibonacci ratios

AB=CD patterns

Elliott Wave Theory and

Fibonacci Retracement and Projection:

applied systems and

Elliott Wave Theory and

Financial astrology

basics of

checklist for

choosing best trading periods

computer programs combined with

cycles and

lunar buy-sell strategy

market projection with

other methods compared

picking stocks using

Sun-Moon aspects

Financial crisis of 2007–2008

Financial statements, timing of and changing financial position

Financial Times

Financial Visualizations

“First trade” date charts

Five-wave structure, in Elliott Wave Theory

Wave 1

Wave 2

Wave 3

Wave 4

Wave 5

Flats, in Elliott Wave corrective 3-3-5 patterns

Frame of mind, of investor

Full moon
Fundamental analysis:
accessing data for
basics of
Galactic Trader
Gann, W. D.
Gaps
Gartley, H. M.
Gartley Pattern (AB=CD pattern)
Geocentric planet position
Golden Cross
Golden Ratio
Google Finance
Gravestone doji
Group patterns
Hammer candlestick pattern
Hangman candlestick pattern
Harami patterns
Hard aspect, in astrology
Harmonic resonance
Harmonious aspects
Head and shoulders patterns
Heliocentric planet position
Hidden bearish divergence pattern
Hidden bullish divergence pattern
High
Holland, Tom
Hollow candle
Honma, Munehisa
Horoscopes, in financial astrology
ruling planets of
House system, financial astrology and
Hybrid oscillator
Ichimoku charting technique
IFTA Journal
Immun Coeli (IC)
Impulse waves, in Elliott Wave Theory
Incorporation date charts, for financial astrology
Indicators. *See* Key indicators
Information, importance to investors
Inharmonious aspects
Inside day
Intrinsic value. *See* Fundamental analysis

Irregular flats, in Elliott Wave corrective 3-3-5 patterns

Japanese Candlestick Charting Techniques (Nison)

Jupiter

Key indicators

Average Direction Index

momentum oscillator

moving average convergence/divergence

planning chart layout

protective stops

Queuing Theory of Moving Average Crossovers

suspended trading and

Khalil, Walid

Kijun-sen line, in Ichimoku charting technique

Koch system

Kroll, Stanley

Kwok, Viking

Laurent, Henry

Linear patterns

Liquidity, importance of stock's

Long-term moving averages

Long-term patterns

Low

Lunar cycles, financial astrology and

Lunations

MACD Histogram

Macquarie Bank, financial astrology and

Magee, John

Major aspect, in astrology

"M" and "W" patterns

Market price action, technical analysis and

Market projection, with financial astrology

Martin Pring on Market Momentum (Pring)

Martin Pring on Price Patterns (Pring)

McCormack, Daniel

McDermott, Alice

Medium Coeli (Midheaven)

Mercury, pairing of Moon with

Merriman, Raymond A.

MetaStock

formulas

Midheaven (Medium Coeli)
Mid-term moving averages
Mid-term period moving average lines formula
Mikula, Patrick
Millennium Star Trax
Minor aspect, in astrology
Momentum
Momentum, Direction, and Divergence (Blau)
Momentum indicator
including in financial astrology

Momentum oscillator
plotting of
time frame and

Money-flow indicator
Money management planning
Morning star pattern
Moving average convergence/divergence (MACD)
Moving average line formula
Moving averages. *See also* Queuing Theory of Moving Average Crossovers
in built-in color trend indicator

formula for
as lagging indicators
sideways markets and

Multicollinearity, in three oscillators
Natal charts, in financial astrology
Neptune
New Concepts in Technical Trading Systems (Wilder)
New Market Wizards, The (Schwager)
New moon
New Technical Trader, The (Chande and Kroll)
Nison, Steve
Nontrending market
1-2-3-4-5 (five-wave structure), in Elliott Wave Theory
Wave 1
Wave 2
Wave 3
Wave 4
Wave 5

Open
Orb (sphere of influence)
Oscillators. *See also* Momentum oscillator
generally

multicollinearity in

Outside day
Overanalysis, avoiding
Overbought/oversold condition
Elliott Wave Oscillator and

oscillators and

Overtrading, avoiding of
PacMOS Technologies Holdings Limited
P and F (point and finger) chart analysis
Part of Fortune

Patterns

AB=CD patterns

candlestick patterns

diagonal patterns

divergence patterns

gaps

head and shoulders patterns

“M” and “W” patterns

price range and

rectangle patterns

saucer patterns

short- and long-term patterns

Penny stocks

P/E ratio, fundamental analysis and

Phi (Golden Ratio)

Piercing line pattern

Placidus system

Planets:

planetary positions

ruling planets of natural horoscope

Planning chart layout

Pluto

Position sizing, determining

“Predictive Power of Price Patterns, The” (Caginalp and Laurent)

Price action, trading advice

Price and moving averages

Price directional movement, technical analysis and

Price momentum:

trend and

volume and

Price range, patterns and

Price reversal, volume and

Pring, Martin

Profits in the Stock Market (Gartley)

Programmed system trading. *See* Applied systems

Protective stops

Ptolemy

Queuing Theory of Moving Average Crossovers

eight principles of interpreting

Ichimoku charting and

period groups

reading probable trends with

using to trade

Range, price direction and

close

high

low

open

Raschke, Linda

Rectangle (box) patterns

Relative price oscillator (RPO), financial astrology and

Retracement. *See* Fibonacci Retracement and Projection

Return on equity, fundamental analysis and

Revenue, fundamental analysis and

Reversals

new high or low and

price momentum and

Risk and reward:

definitions

managing of

Royal Bank of Scotland

Rule of Alternation

Rule of Equality

Rule-based trading system

Runaway gaps

Saucer patterns

Schwager, Jack

Seidler, Harold

Senkou spans A and B, in Ichimoku charting technique

Shadows, of candlesticks

“Sheer Lunacy Staring at the Heavens” (Royal Bank of Scotland)

Shinhint

Short-term moving averages

Short-term patterns

Sideways markets

Solar cycles, financial astrology and

Steckler, David

Stellium

Stock, selecting for trading plan

Stock-screening services

Street Smarts (Raschke)

Sun Zi

Supply and demand. *See also* Technical analysis

Suspended trading

Swing traders

Synodic period, in astrology

System trading

Technical analysis

basic assumptions of

basics of

object of

scorecard for

Technical Analysis of Stocks & Commodities magazine

Technical Analysis of Stock Trends (Edwards and Magee)

Tenkan-sen line, in Ichimoku charting technique

Terra Incognita (software)

Tetrabiblos (Ptolemy)

Three black crows pattern

Three-wave structure, in Elliott Wave Theory

Three white soldiers pattern

Tillson, Tim

Time frame:
momentum and
trading advice
in trading plan

Timing Solution software
Topocentric system
TradeStation software
Trading for a Living (Elder)
Trading in the Zone (Douglas)
Trading plan, formulation of
additional chart checklist

determining entry points
determining exit strategies
determining time frame
execution of trade checklist
managing risk
selecting stocks
summary list
value of

Transit, in astrology
Trend indicator
Trend line
Trend-related dimensions
cautions

combining of
patterns
price momentum
volume

Trends:
basics of
deciphering with volume
never-trade-against rule
price movement n
trading advice

Triangles, in Elliott Wave corrective 5-3-5 patterns
True range
Ultimate Book on Stock Market Timing, The (Merriman)
Uranus
Venus
Volatility
Volume
basic plots
deciphering trend with
Ichimoku charting and
as indicator of price move validity
money-flow indicator and
reading of
Volume indicator:
applied systems and
formula for
trading advice
Volume ratio compressed indicator formula
Volume zone oscillator (VZO)
Want Want
Weekly charts, supporting moving averages and
Weekly momentum
Weekly range
Whipsaws
Wilder, J. Welles, Jr.
Wolfe, Bill
Wolfe waves
Yahoo! Finance
Zigzags, in Elliott Wave corrective 5-3-5 patterns
Zodiac signs:
characteristics of each
financial astrology and