Besides stock volume, option volume is even more important. Although this is a subject requiring a book by itself and is covered in my *Geometry* book, I will mention that volume in options is both bullish and bearish depending on whether the volume on the option is reflected in the stock's price action. That is to say a large option trade such as a thousand options on IBM would be bullish if the option price is up but the stock price is quiet. This usually signifies big leveraged money racing the tape ahead of a big stock buyer asking around for stock, or it could be just illegal inside information about a takeover or upcoming analyst recommendation. This is to be compared with IBM up a dollar or so on an obvious bullish day with everyone participating, and the options are also up on heavy volume. This usually means a top as people are buying both stock and options but someone is selling the options to those people otherwise the option volume would not be seen. A light volume option day with a heavy stock volume day would be more bullish. Also keep in mind the fact that most arbitrage buy or sell programs in the market these days are preceded by big OEX or index option volume. Most firms trade for their own account and when they get a big buy or sell program the first thing they do is stock up on puts or calls. You will almost NEVER see market movement when these firms buy or sell their options because they always race the tape and *only hours later* show up with the program to execute. What you must do is constantly note large option transactions and particularly note the time and price they trade so you can refer back to those statistics later in the day or the next day when you see the big program hit. From that point on you will know that the program will not end until at least a half hour AFTER you see those same options being traded out with the same volume of contracts!

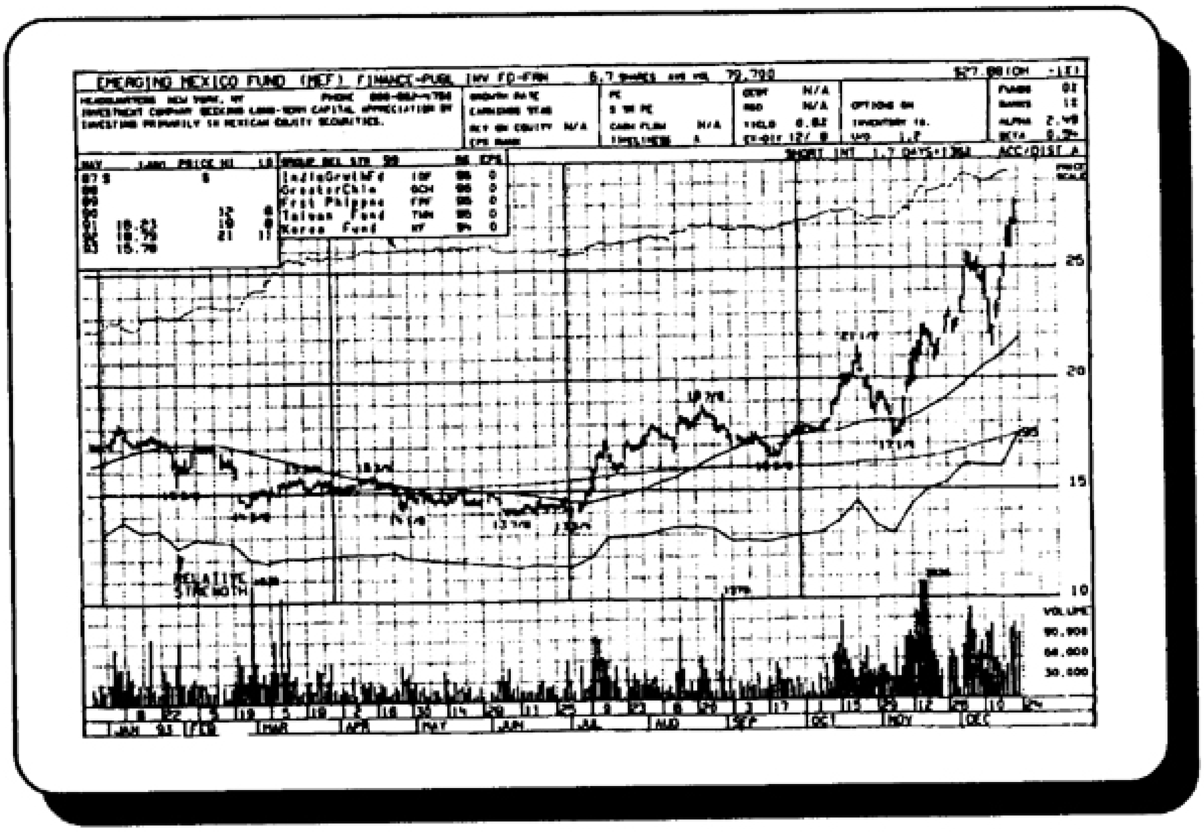
I would say that for most chart reading volume is strictly a secondary consideration. Prices are much more important and cycles in the final analysis are what cause volume to come into the market and begin and end moves. Volume is often the cyclic tip off to a change but the volume itself is not that important.

Presently volume is more important than in the past since it frequently indicates the presence of large institutional investors and this kind of sponsorship is what is needed to cause large price movements. Long term investors particularly need institutional sponsorship to keep prices rising and periodic volume spikes indicate that presence.

In the final analysis volume is needed to change direction and indicates cyclic turning points, but prices themselves are what make us money. We watch volume patterns to note the coming change but trade off the price reversal buy or sell bar. At the end of the trading day it is the price we must adjust our balance sheet to and not the daily volume.

One final important point: This point is too important to mention in a book as inexpensive as this, but I know the vast majority of you are too lazy to follow up on it anyway. For the selected few, here it is: the market always changes direction when the total capitalization of a stock turns over in proportionate increments. If a 50 million share issue trades 50 million shares, the market will turn.

In an active market this could take two months — in an inactive one, six or eight months. This is the key to success.



The chart above is the classic "perfect" chart. It shows a new bull move just starting with an initial impulse wave moving up at a near 90 degree angle accompanied with heavy volume. There are several more such impulses over the next few weeks — all on good volume and at the end of each pull back correction, the stairstep lows are all nicely higher. There is also the general appearance of a circular arc in the making with rapid acceleration to the upside. This classic chart pattern should be memorized. Whenever you see it you will make a lot of money being long on it.

Strategy

Reading chart patterns is an art. It is a lot like chess. Millions of people play chess and millions of people read charts but there are only a handful of grandmasters at each vocation. Anyone can learn common chart patterns and anticipate when a trendline will break. But, it is only the grandmaster who can think fourteen moves on the chart pattern into the future. What separates the professional from the novice is the ability to see the possible chart patterns forming *IF* such and such an event unfolds. The breaking of the trendline is irrelevant. It is the possible regaining that trendline, or the magnitude and time duration of the change in trend that is important. In this regard professional strategy is what separates winners from losers.

The average investor has no idea what strategy is. He seems to think that you buy or sell what the people on TV recommend, or what the analysts at big brokerage firms think are going to do well. He does not even conceive of the idea that for every buyer of stock there is a seller. Only one will be right on the trade. If everybody is making money, who is losing? It might be better to think in terms of entering the ancient Roman Gladiator pit and knowing only one comes out alive. Trading on a professional basis is like that. You must use strategy like an army general to trick the enemy into making a mistake if you are to steal his money.

Up to this point I have tried to train you in some basic good habits like determining the main trend and then *waiting* for a counter trend movement to enter the trade. At least this way you will not jump in emotionally without even thinking about what you plan to accomplish. What is really required, however, is an entirely different **frame of mind.** To the *Professional,* and I mean that term as it is defined — *one who makes his living doing it,* stocks or commodities, futures and options, are but mere pieces of paper in a greater fool theory, game. That is, there is no *real value* to these pieces of paper- they are only valuable if someone is willing to pay more than you did to buy them from you. It is a never ending source of amazement to me to witness the extreme confidence the public has in their government and the capitalistic system of paper money. Anyway these pieces of paper we buy and sell every day are only valuable for short periods of time, or I should say their value is only *perceived to* be constant over short periods of time.

The person who falls in love with the "investment story" will never make a success at trading. You must be like a retailer who buys cheap and sells with a reasonable markup, but sells often and changes inventory with the latest "fashion." Getting stuck with old merchandise will require a loss liquidation sale.

Stocks change in value every day based on emotional perceptions. There is no value *per se*. It is the emotions of the masses that drives the supply demand equation. The professional chart reader knows how to look at a chart and *see emotions*. Measured moves, arcs, trendlines, and a host of other tools are used to constantly redefine that emotional perception to exploit trends by buying fashionable merchandise and waiting for the store opening a few hours later or the next day when the buyers will be emotionally anxious to buy. The idea here is to turn over the inventory frequently with a small reasonable profit that will compound into significant sums over time. The grocer does not buy a head of lettuce at $1 and expect to get $3 or $4 for it. He expects to mark it up 10 cents and sell it as often as possible and in large volume. The delivery truck comes back every day. Stock speculation is no different.

This being the case, you as the retailer **and in business to make a living** cannot afford to just buy and sell every day and at every price level. You must have the patience to specialize in wholesale buying and retail selling. Charts tell us what the market will bear. Steep angles show very popular merchandise whose fashionability will not change overnight. A broken trendline shows a change in buying habits. Arcs show the culmination of a shopping spree.

When looking at a strong trending market that has a parallel channel defining the move, you should measure the average width of the channel to see the average range between high and low fluctuations. Being a humble grocer we have to frequently buy and sell at the most popular and frequent fluctuation even if that seems a small reward. It is all the market will give us. We cannot afford to make a big play and try to double our money over six months on something not seen in the chart history at present. That's an entirely different game than professional trading. We must buy dips from each high *at the average normal observed amounts*, and immediately offer for sale this merchandise on the rack at the *normal markup* fluctuation price. Trying to get more will mean fewer trades and greater chance of loss.

If you trade options you will have a choice of buying a $1 call and selling it at $1.25 or waiting and trying to get $3. Which is better? There is *no question* the better strategy is to get the 25% markup and sell at $1.25! If you put odds on it you would find that the chance of predicting the direction of the move (being right on the trend) might be 70-80 per cent. But, what about the odds once the move starts? They dramatically change! Once the move starts they start to decline so that when your option goes from $1 to $1.25 the odds of the NEXT 25 CENTS BEING UP might only be 50-50. These kinds of odds are gambling, not speculation! Remember as professional speculators we want to set all the odds in our favor. We want to choose *when to trade, what to trade, how much money to* trade with, and *what odds* of success we need. If we let the market dictate the odds we turn away from professionalism to crude gambling. Returning to the option example, if we watch our call go from $1 to $1.50, $2, $2.50, to $3, we would see the odds go from 80% down to less than 10% *on finally banking the money.* This is the whole point of this book. You are supposed to bank profits every night. If that takes lowering your sights and getting small gains, so be it. By the way making 25 cents on a $1 call is 25 per cent and if that can be compounded with ten successful trades the capital will increase nine times from $1 to over $9! ! ! And, this is with odds of 70-80 per cent. Only a fool would ignore this to wait for the one in ten chance to increase his capital to $3!

In setting the odds at which we will trade, we must consider time as well as price. We cannot get caught trading a large inventory when the markets are inactive and quiet nor can we refuse to carry a full shelf of inventory when the hordes of Christmas panic buyers surface. We trade the active markets and use the charts to show us the active ones with big volume of sales and very steep angles of ascent. We also cannot allow ourselves the emotional luxury of jumping into a trade every day in the first half hour and not having any capital left for a good midday reversal or end of day dramatic finish. We must constantly be alert for the wholesale truck making drop off deliveries.

Almost all strategies encompass the deliberate undertaking of risk. Good trades almost always occur when we think we will lose a little on the entry point because we are taking a position against the minor counter trend movement and we expect it to possibly go through us before reversing. We buy into a dip near known support or sell at resistance levels. We deliberately take on this risk because we have clearly defined it ahead of time. We know when we enter the trade what the extreme movement might be, and the normal time period for reversals. We are willing to use a one or three dollar stop loss on our entry point and we expect to face our maximum risk immediately at entry point. In interpreting our chart patterns, we have calculated ahead of time the *three or four possible outcomes from any chart reversal* and have planned accordingly. If we do not have a clear entry point or it is too far away from our pre-defined risk management point, then we do not make the trade. Remember it is our **business**, and **we** make the rules.

The most common mistake futures traders make is with stop loss points. The trailing stop should only be used for the entry point or the immediate fifteen or so minutes after that entry. This is because as professionals we buy into the countertrend decline and if we are wrong it will be painful. After a few minutes in the trade we will know if we were right and will be making money *or we are wrong* on our guess and must close out to try again later. If we are not making money on the trade after a half hour, we should close it out or try to scratch. If the trade is in the money in the first fifteen minutes, we **always** move the stop up to our entry price and try and get a "free ride" on the trade. If we do this, the odds go to well above 90% in our favor of banking money on the transaction. To arbitrarily use a trailing stop for hours or even days is just plain stupid. Then again most S&P Futures traders have sights set way too high. They usually expect to trade for 300 to 500 basis or $1500 to $2500 profit per contract so they are willing to risk $500 on a trailing stop of 100 basis. This seems logical but does not fit the facts. Most of the time the daily fluctuations in the S&P's will not reach 300-500 basis so the profit target is unreasonable. What is reasonable though, is the 100 basis trailing stop which is hit daily and most of these traders consistently bank $500 losses every day. What should be done is to lower ones' sights to scalping $500 profits with 100 basis targets and using timing stops of fifteen minutes in the trade or 30 to 50 basis trailing stops. Often by lowering ones' expectations to smaller average daily gains, the rate of successful hits rises from 50-50 to over 90% and the compounding effect is mind boggling.

Another rule that will eliminate 90% of all losses is to raise our stop immediately to our cost or cost plus commission just as soon as we have a small profit or are in a non-losing trade for more than 15 minutes. Commissions on futures transactions are practically nil compared to average profit expectations. To let a winning trade turn into a loser and get stopped out with a trailing loss stop when we could have scratched or made money is perhaps the most grievous sin any trader can make and has absolutely no reason to make.

Over the years, I have had the privilege of working with and knowing some of the worlds best traders. What I observed most of the time was that the truly successful ones were "gimmicky" traders. In other words they really treated the market as if it were a *game* and the only rules were to **lose as little as possible** and to bank a profit *every single day* no matter how small. In one case I knew a very successful trader who made millions every year, but would be scared to death to make the first trade every day and chose little ones that would only net $100 or so and to get that in the bank as soon as possible. Only after that trade was successful would he become more venturesome. Another trader watched the tape for hours on end observing basing areas where everyone knew a big breakout was coming. After a three to five hour trading range in the S&P's was broken out of, he would quickly enter the trade, and although it was obvious to everyone that an S&P breakout of that duration would yield at least a 200 basis move, he would jump in, buy and immediately offer his contracts for sale up only 30 basis higher. This had the affect of allowing him to have a success ratio of over 99% profitable trades. Although the profits were small, there were almost certain and it was like found money on the sidewalk to him. In only a few years he ran a few thousand to over 10 million with this technique. I am consistently reminded of this *strategy* almost every day when I see customers get stopped out for 100 basis losses because they insist on getting 150 to 300 basis gains and just miss cashing in before getting stopped out for a loss.

Please note that this traders' success was entirely due to **strategy** since his *game* plan was to scalp a small profit when everyone else would not even remotely want to do that. Because the market is not as predictable as most people believe, this strategy yielded 99% trades when the obvious big move only worked half the time and the losses and gains ended up in a break-even with no real net profit in the bank for the masses that expected big things.

One of the reasons most people do not take the small trades that add up to real money is the fear of commissions and "churning." In truth this is what wholesaling is all about — rapid turnover and small margins. Commissions are the same whether you bank a small profit every day, or a large loss every several days. Preconceived attitudes about what is right or fair will ruin you. Putting more money in the bank than you had the day before is the only consideration.

Chart reading can very easily pick the winners for you. You must *wait* to execute and then take the money, and patiently regroup for the next offensive. Remember we are using charts to point out the emotionalism of the masses. That is our advantage as technicians. Not to use that advantage by just "jumping in" is a waste of your intelligence. Once we see the major long term emotional situation, we plot a strategy to go opposite the minor temporary emotionalism. Hence we "buy the dips" or "sell the rallies" depending on whether we are bullish or bearish. Furthermore, once we set our strategy as to exploiting the *trend* by buying or selling, we must now have a strategy to *limit losses* if we are wrong, and we must have a strategy *as to when we take profits.* All of this requires thinking ahead of time. We are responsible for setting the odds of our play and we must be constantly aware that these odds change all the time. Without a preconceived strategy we would end up executing in an emotional fashion like all the other "also rans."

When using strategy to enter a trade, do not forget the strategy to exit the trade after entry. Many traders watch for a base breakout and jump in long knowing they will make 30-80 basis on the trade. What usually happens is that jump in and then just watches and waits to see what develops. It might be a better strategy to place a sell order 30-80 basis above the entry point at the time of entry, if indeed that was the strategy. Most people get caught up in the emotionalism of the trade after the entry and often lose sight of why they really went in and for what profit objective. As a result, they get trapped looking for more and end up with a loss, when the original strategy thought out before the trade was entered was the correct one.

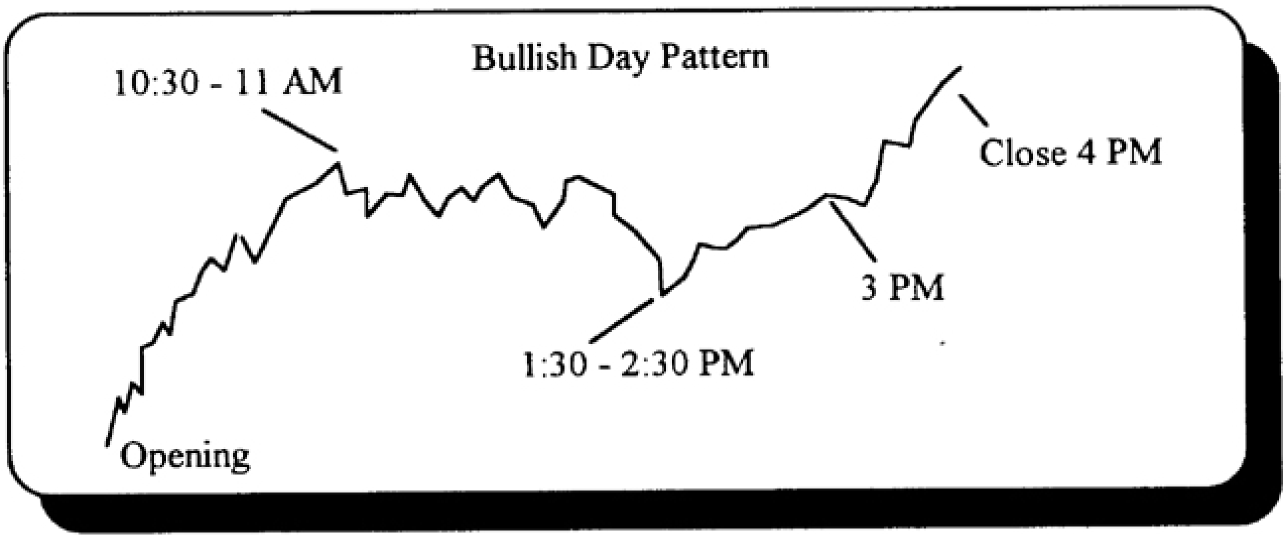
You must learn to think like a gambler. Gamblers think in terms of odds. With good technical analysis of our chart patterns we can probably be right on the trend 70-80% of the time. But, this is only one set of odds. There is also the probability of *how far a move will carry.* Betting on a $1 advance is one thing, but betting on a $10 advance is something else. In each case, the **initial odds** for getting the trend right are perhaps 80%. But, the *purpose* of trading is to *bank the profits.* These odds rapidly decrease as the move gets underway. 80% initial odds may be 50-50 when the stock is up $3 and only 10% when up $8. You should constantly be thinking **what are the odds of the next $1 move?** If you find that your answer is 50-50 or less, you are a gambler, not a professional speculator. You must stop trading as soon as you find you are no longer speculating and you have let the game dictate the odds to you.

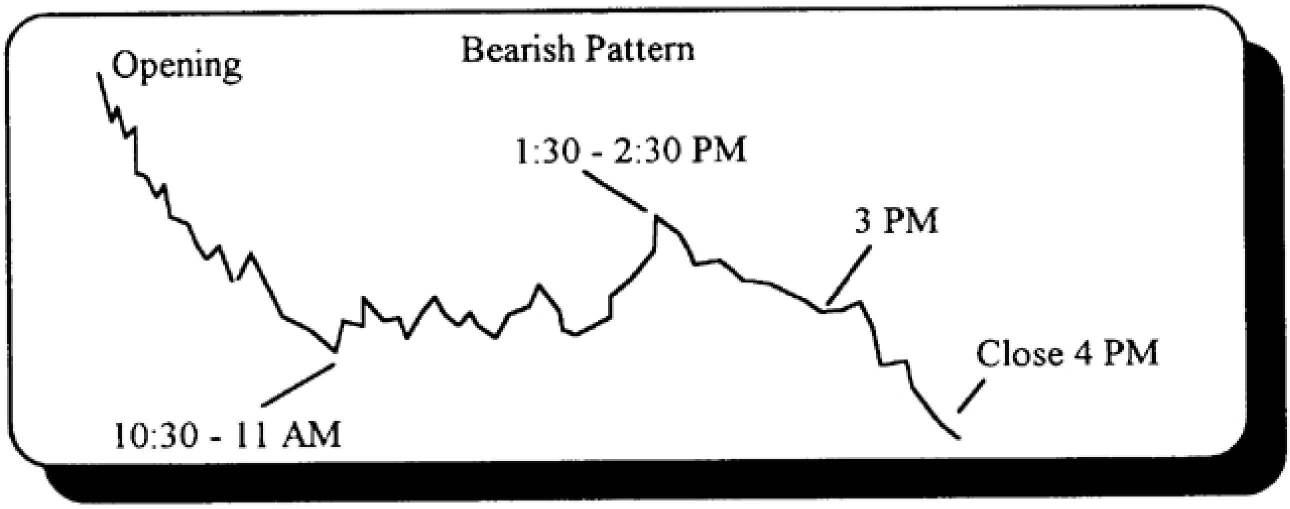
Intra Day Patterns

Most futures and options traders are day traders. That is they buy in the morning and sell by the close. The vast majority do not carry positions overnight. As a result there is a rush to get in and out in the first and last 15 to 20 minutes each day. This busy period is called the "opening bulge" or the "closing bulge." The normal pattern of day traders buying or selling with the trend of the market usually sets the daily theme right from the start. Not only are futures and options professionals better skilled at trading but in recent years there has been a tremendous amount of "front running" large orders and entering trades with illegal inside information. Front running is the practice of quickly entering orders ahead of large block transactions or in front of soon to be executed arbitrage program orders. In recent years, the rise of behemoth mutual funds and pension funds who come to market with orders for 200,000 to 500,000 shares of as many as 200 different issues at one time, have given rise to massive amounts of front running. These huge institutional orders can take several days to fill and are carefully executed secretly to maintain market order. Unfortunately, at least 50 to 100 important traders and individuals are always tipped off ahead of time when these programs are operating, since the knowledge of such orders is worth millions in the right hands and the right hands always get the information. That is just how the system works. In any event we as independent traders can easily spot such activity in our charts and trade along with the big inside money. Remember that people who have near certain information, either illegal or just in the course of executing large trades; these people do not waste valuable capital on these trades since they are virtually guaranteed. They use lots of leverage like futures and options to get the greatest return in the shortest time. As a result these trades show up in the morning bulge. Our job is to decipher from the early morning pattern if these knowledgable people are buyers or sellers so we can join them.

The typical bull market pattern as mentioned previously is early strength (opening to 11 AM) and late strength (3-4 PM). Bear patterns are the opposite. The actual intra day pattern for a bullish day would be an up opening that goes straight up for at least 20 minutes and sometimes an hour. By 11 AM most bulls are committed and the pattern creates a consolidation trading range with some several swings up and down in a retracement zone of the mornings' advance.

These swings usually don't take out the daily high nor approach the low. Usually around 1:30 to 2:30 (EST) there is a "false breakdown" plunge to a slightly lower low than seen so far since 11 AM. After this false breakdown the big rally of the day ensues and goes straight up into the close and a new high for the day. The bearish days are nearly the same type of pattern but opposite. A rough sketch of the daily tick chart would look as follows:





These above patterns are very typical. Even so there are to my estimate about 7 or 8 basic permutations, but all usually follow the opening closing same direction, midday counter, rule. The most obvious feature of these patterns gives rise to the important "opening bulge" rule. This rule works 70-80% of the time and basically goes like this: The EXTREME HIGH **OR** LOW for the entire day is made in the first 20 minutes of trading. At first this does not seem to be worth much but if you stop to think about STRATEGY for the midday and end of day, the rule gives two very good trades and perhaps a third. The opening trade is the trickiest. We will not know if it is a high or low for at least 20 minutes, so what do we do? Cautious traders will do nothing or go with the obvious bullish/bearish daily trend. You could also guess using a timing stop of perhaps 15 minutes to make money on the guess or close it out and reverse. The more reliable information is after we see the 11 AM high or low. We now know which way the primary trend is and how the day will close. We also know now that a false counter move will occur mid-day and will fail giving rise to a good trend into the close. We may want to short the false breakout attempt on a bearish day that comes from 11:30 to 1 PM and stay short until the close.

It is the characteristics of these counter trend moves that accounts for why most S&P traders who use a 100 basis trailing stop are always stopped out mid-day for a loss and lose their positions when their early morning outlook was usually right. In the quiet mid-day lunch hours, it is easy for the pit traders to run the stops and load up on these false bottom breakdowns, at which point we double up and go long for the close. Unfortunate doctors and lawyers seem to only trade S&P's with stops and badly at that. I can say from experience that if you are not making money day trading, try NOT trading until at least 2 PM. The vast majority of people cannot because they are so emotionally involved and must be in it in the first minutes. Often those trades are not the good ones.

Reversals of trend days are more tricky. With our strong opening, strong close pattern for bull moves, we normally expect the market to open up or be up within the first 20 minutes the next day. Good reversals in trend, however, usually come by reversing the opening bulge after twenty or so minutes but first opening in the same direction as the 3-4 PM trend the day before. In other words if 3-4 was down, only a down opening that later went up would reverse the trend. An up opening following a down prior close almost never reverses a market. That is usually a specialist opening to attract short covering that will unload inventory from the night before, and once it is unloaded, the specialist goes short himself and then lowers his quotes for the rest of the day. In Bull trends, traders know instinctively to go long a strong 3-4 close and hold overnight to sell into an up opening. This can usually reverse a market back down but the trader who sells out on the opening bulge does not miss anything by doing so because even if the trend does not reverse, we know there will be a counter trend dip mid-day to get back aboard for the end of day rally. Strategy is to always remember the 3-4 closing the night before and assume a continuation by 11 AM but to then watch out for the reversal.

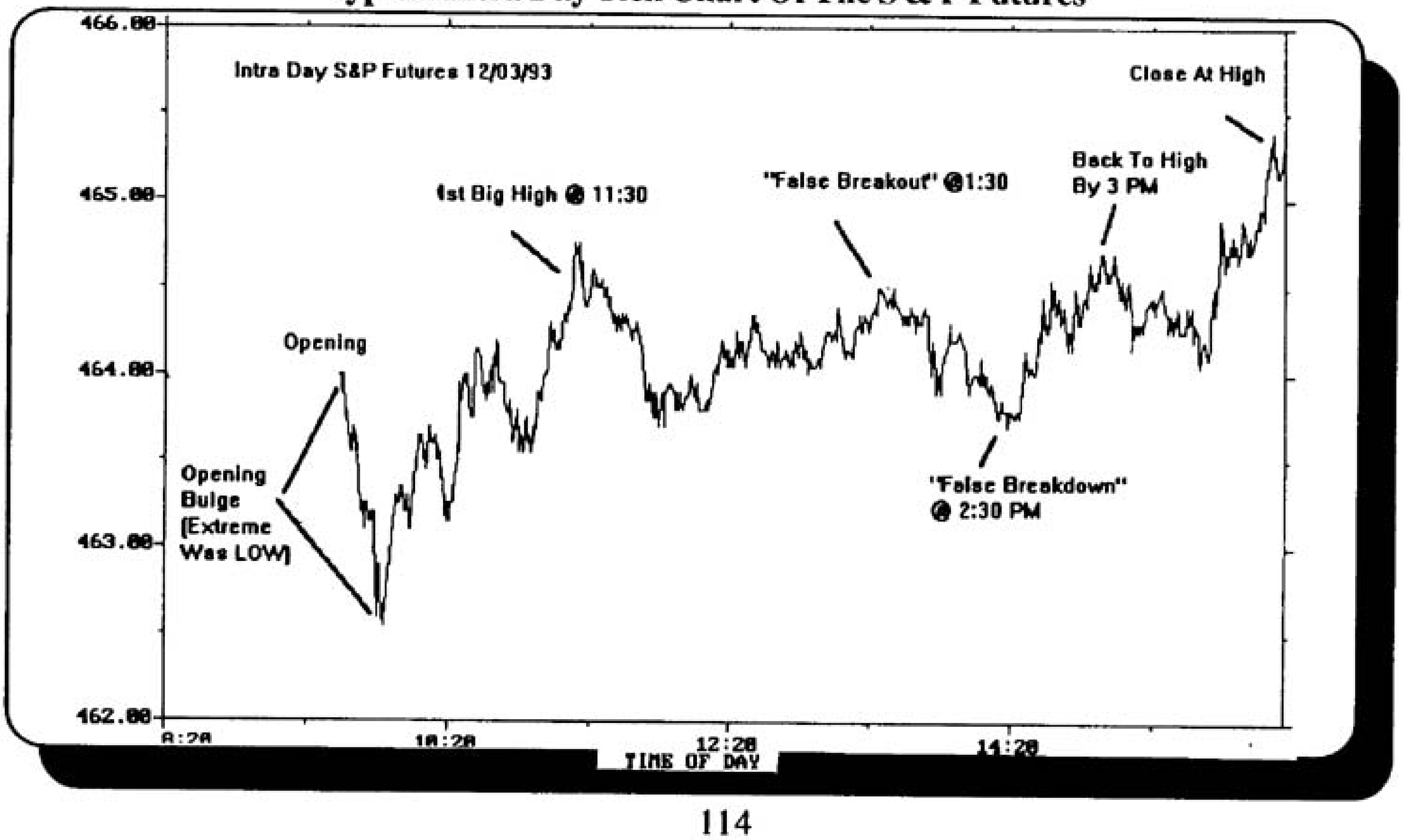
If a bullish day is going to turn into a weak close and a down next day, you usually have an abbreviated plunge by 1 PM and an immediate rally that is at a new daily high by 2 PM. This is usually a weak point of the day with the firming up part not until 2:30 to 3 PM so a 2 o'clock high is a good sign of a weaker 3 PM reading and a "busted" last hour reversing the trend.

These intra-day patterns, although ideally suited for futures and options, are also very good for stock trades. A declining issue will usually hit bottom by 11 AM and base and show good strength by 2 PM. By 3, it is usually back up on the day, then has a strong close, and follows thru the next day. It pays to watch the 2 PM reading on stocks and compare it with the 11 AM reading to see if the readings are stronger or weaker.

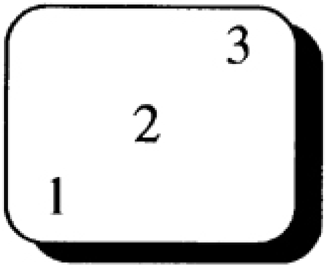
Keep in mind that the big money likes to trade with a sure thing, and will concentrate buying or selling in the last hour so as to be as close to the closing trend underway as possible. Consequently most traders start to make big commitments by 3:10 PM for the final trend. Additionally, the big mutual funds and pension funds that are always fully invested long will often hedge just after 3 PM if it looks like a weak close and a market decline coming. Many funds sell S&P futures short against longs, or sell OEX options against the portfolio to hedge. The selling of those highly leveraged futures and options in itself will often exacerbate the downward trend and make the nervousness a self-fulfilling event. Day traders should therefore keep an eye towards not only the trend at 3 PM but the action in the futures and options pit to judge whether the leveraged players are making a bet against the existing trend. It does not usually pay to go against those with big pockets.

One of the overriding keys to intra day trading is the position of the "leveraged" money such as options and futures. When trying to analyze the intra day patterns, you should know that these leveraged players will go in the same direction as the general market. If you find a possible deviation from the usual pattern as to opening and mid-day highs and lows, you should look to the option premiums to see if the calls are expanding in premium with a rising market or the puts going up with a falling market. If you see the opposite happening, be prepared for a reversal in trend. These days with the large institutional dominance of the market, almost all reversals will be forecasted first with the futures and options, and only then show up in the broader averages and stock prices.

Typical Intra Day Tick Chart Of The S & P Futures



Step By Step



Putting it into practice

Some aspects of chart reading are skills and some are subjective interpretations. I honestly think, however, that the vast majority of people are capable of successfully day trading if the principles in this book are studied. Some are obviously more important than others. In an effort to summarize the book I will attempt to chronologically list the first and most important steps you should follow when you first pick up a chart.

1 - **Look at the entire chart history and see the broad general trend,** whether flat, or sloping up or down. Imagine parallel trendlines if possible. If a very long term chart (5 or more years) is available, see if accumulation (bull market) or distribution (bear market) is going on and what strategy will be needed (buy dips or sell rallies).

2- **Note the "big bar" impulses** to make sure they follow your assumed trend direction. Note volume to see if it confirms. Make sure the weekly and daily "stair steps" that define the bull or bear patterns are evident in your assumed trend. Note the type of "personality" the chart has (spike highs and lows, rounding bottoms, *kamikaze*, etc.).

3- **Look for obvious symmetries and mirror image foldbacks.** This could be considered the first step but symmetries are often so subtle they only show up after a much closer examination. This search for symmetries should include bowls and arc patterns developing.

4- **Note the high and low ranges** to see if the pattern is volatile enough to trade and where in that range the current price is located. This also includes examining the average measured moves in the history, and noting if big potential exists such as a breakout from a large base (length of base equal to height of move).

5- **Check for time counts.** Three and one quarter week cycles, Fibonacci hours, 30, 45, 60, 90, etc., calendar and trading days from major highs and lows. This will warn us of impending cycle turns.

6- **Look for trendlines and timing angles** such as 1 x 1, 2 x 1, 4 x 1, etc. Are we breaking out or breaking down? Momentum? Is the move just starting or finishing?

7- **Wave counts and specific known patterns.** Obvious patterns are more reliable for good entry and exit points.

8- Find the most recent impulse wave and try to **locate where you are in terms of wave 1,2,3,4,5.** Note prior retracement percentages at each prior wave culmination.

9- Is the pattern obvious to everyone? **How are the masses currently reacting** to this chart pattern, and *what strategy will be employed to exploit their weakness* in interpretation? Usually the best trades are the typical "wave 4" mini crashes that look scary but always lead to spectacular up legs. Learn to exploit the masses' fears.

10- **Decide on a strategy,** chose entry and exit points. **Calculate projections and alternatives.**

11- Look at the last 5-10 reversals and **see who "won."** Traders know to do the same thing over and over until it does not work. What strategy -- buy dips, or sell rallies -- actually made the most money over the last several swings? **Trade with the winner's strategy.** The vast majority of people want to plan for future trades. Very few will take the time to examine the past. It can be very beneficial to review the last several days first, and see who did what based on what the patterns looked like at that time, and find out why the losers lost.

12- **Look for buy or sell signals that do not work.** A pattern's potential that is not exploited tells you much more than the pattern that works. Pay attention to technical signals that have little influence. This usually means a much more powerful underlying cycle is present than realized. Remember that one of the basic tenants of cyclic forecasting is that in a bull move the up parts of the cycle are exaggerated and the down parts are attenuated. In a bear move the down cycles show the stronger influence. If you are following a 6.5 week cycle and suddenly find the lows are lower than the last cyclic low, it probably indicates a bigger and longer lasting down cycle is starting to manifest. You could now predict that the up phase would be weaker than the last observation.

S&P Futures Trading

$

Perhaps the most important market for using technical analysis and chart reading is the S&P Futures market. Fundamentals mean nothing here since the average volatility is so great that by the time the fundamentals are truly known most traders would go broke. Additionally this market is driven by a great number of diverse players whose objectives may be opposite to the general market's direction or trend. Basket programs may buy stocks but sell futures making the S&P's appear to be going down when the stocks are clearly going up. At other times, ratio strategies may require either the purchase or sale of futures, while taking the exact opposite position with twice as many call or put options. In the final analysis it will usually be nearly impossible to learn the motives of the S&P traders as to why they bought or sold and these motives may be completely irrelevant to your particular objectives. The only thing that is important is the direction of the trend during the time period you will be trading. Whether it reverses tomorrow or next week or whether it is part of an elaborate hedging operation has no bearing on your decision to buy or sell -- only the price direction.

For these reasons chart reading is the only means to consistently win in this market. Since arbitrage programs are frequently active in this market, it does not pay to have a very long term perspective. Huge moves can take place in only a few hours to a day or so and be completely gone within a day. Because of this, strategy must emphasize trading and not positioning for a long term trade. Most traders who are successful in this area average three to five trades per day, and on very active days, may trade 15 to 20 times. As mentioned elsewhere in this book, you will probably do better in this market if you lower you sights and scalp small trades than insist on getting the bigger moves of 300 to 500 basis or more that at best only come once a week. Most winning strategies focus on scalping 80 to 100 basis per day, but often that total may take three individual trades. Trailing stops are only used for the first fifteen minutes when you are usually entering a counter trend movement and do not know as yet how far it will travel. After fifteen minutes, however, you should be able to tell if you are right or wrong on the trade. Either way it is usually time by then to scalp a profit or scratch or eliminate a bad trade. Holding futures for hours and not making money is a good way to lose money!

You must constantly try to avoid reasoning *why* the futures are doing something. As mentioned above, many arbitrageurs have differing motives than you and must execute orders to facilitate various strategies, and this may only be a minor temporary influence.

Nevertheless you must trade with the size orders in the pit or you will end up losing. The successful traders will therefore always follow rules and chart reading principles with a very rigid interpretation of these rules. Thinking should be limited to entry and exit point strategies and possible chart misinterpretations.

Since trades are frequent and small, elaborate sophistication is not needed to become a success at scalping, but many of the principles in this book could make you spectacularly successful due to the numerous opportunities to identify good trades when more traditional methods are confused as to the actual trend. Basic principles should be our starting point. These are as follows: trend, arcs, measured moves, bar counts, waves, and angles. These methods have been explained previously but a quick review seems in order:

1) **Trend**
Higher bottoms, or lower tops and lower bottoms? What period do these trend bars encompass? Is there a possible reversal bar signal due or just seen?

2) **Arcs**
Can we draw an arc to determine support and resistance? At least we can draw a circle around a significant low to high or high to low to get possible measured moves and radius and diameter lengths for future movements. What shape do our arcs describe? Are they just starting or maxing out? Is there an arc intersecting with an angle or support or resistance point? Where do the tops and bottoms of our circles create support and resistance?

3) **Measured Moves**
In conjunction with our arc analysis we can use a compass or ruler to "measure" normal fluctuations over the period relevant to our trading. That is if we are trading on a five minute chart, we learn the most likely 5 minute reversal patterns, but at the same time we must at least examine an hourly chart of three weeks or so to get a feel for the maximum extremes we are likely to see at some point. Remember our basic scalp should be confined to the run phase of the accumulation, distribution pattern and even on a minute scale such as five minutes, these measured moves are the run phases and once they are done we will end up in a support or resistance area and we do not trade in those areas!

4) **Bar Counts**
Numerology is extremely important. Although I cannot even begin to scratch the surface of such a subject in a simple book such as this, I will tell you that numbers themselves are alive

and live in another dimension distinct and apart from us whether or not you know it! They have the power to reverse markets. You must keep number counts from every important high and low! At a minimum, keep track of Fibonacci numbers and square outs where major highs and lows are equal in time counts to their price levels. Because human beings on a subconscious basis convert numbers into circular measure, all highs and lows in history will be proportionally related. If you believe an important turn may be at hand, you should be able to confirm it with number counts and proportions of previous highs and lows.

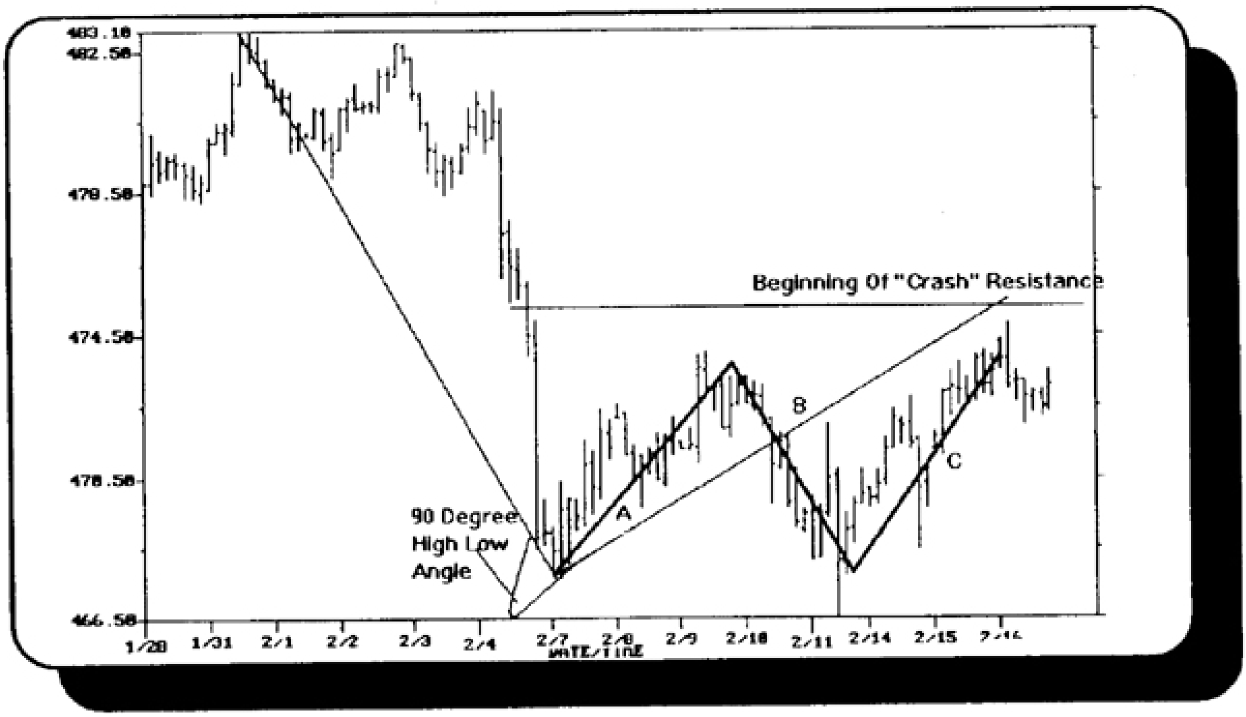
5) **Waves**

At the end of all big moves watch for wave formation and patterns. A, B, C patterns are easy transitions to large move resumptions and usually appear at the end of normal measured moves. Measured moves with clear five wave segments bear close watching. Three's, five's, and eight's are also important wave pattern segments. Remember the purpose of the wave count is to project prices for the move and our strategy should be ready for a major change in trend if such a probable projection pattern shows up.

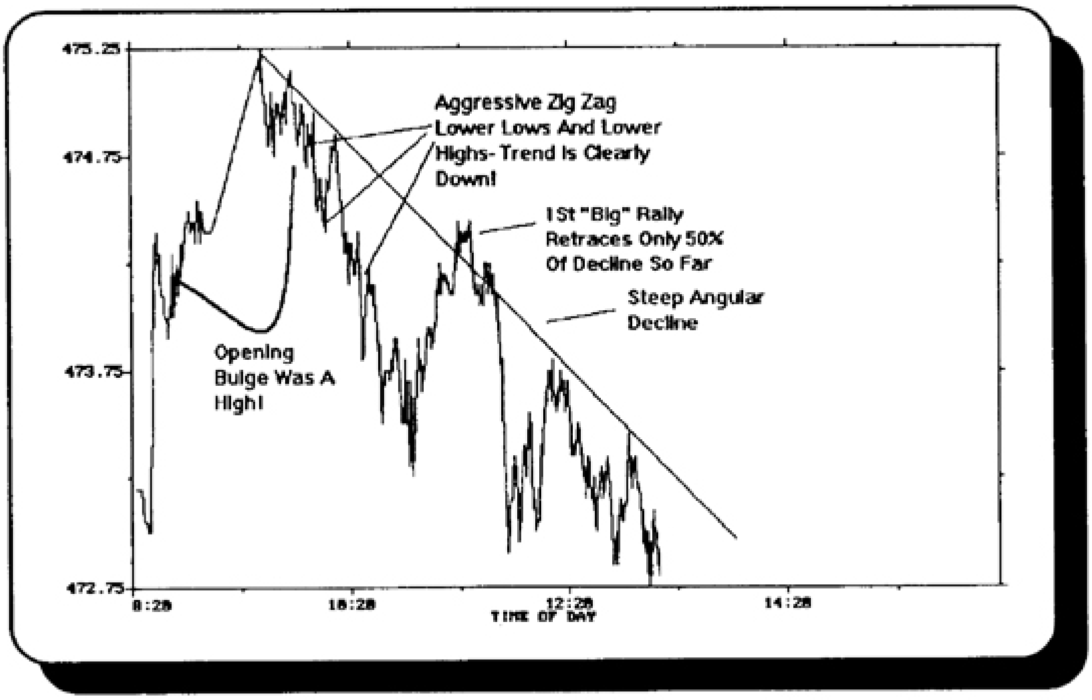
* 6) **Angles**

If we are trading a move that is some distance from its origin, we would want to watch angles closely for change in momentum and time cycle intersections. After an initial impulse wave, we can usually rely on a secondary impulse from the 45 degree angle or from an angle rising from the "zero" point. Measured moves should be apparent at these points of support or resistance also. Remember to adjust the axis of your primary angle to the major thrust vector of the movement. This is a very important point when trading on intra-day charts! Forty-five and ninety degree angles out from these adjusted axes are deadly.

The following charts will demonstrate the analytical process for trading. We start with the hourly chart.

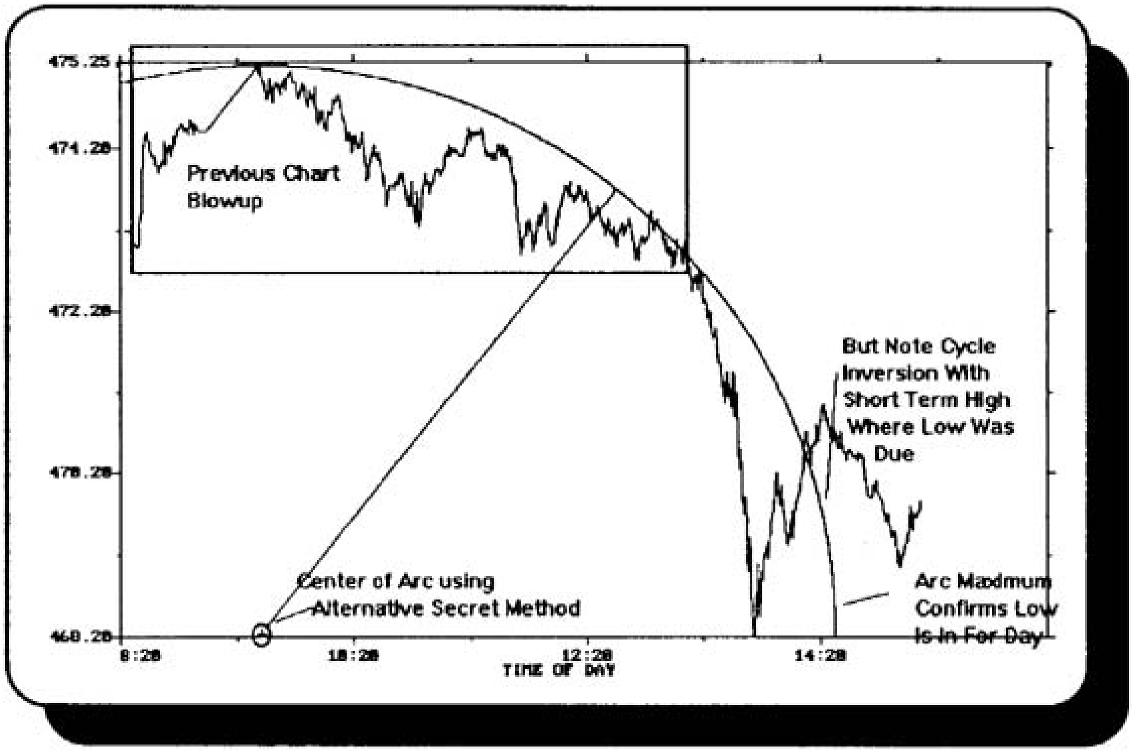


The first thing we note on this hourly chart is the trend, and that appears to be down. A major break occurred some nine days back but the price structure still has not regained the breakdown level. The top of the recent rallies at the end of legs "A" and "B" were near 38.2 percent -- a normal bearish retracement, and even if a 50% retracement goes to a slight new high above "C" it will just hit the massive resistance line labeled "crash resistance" and it will also be near the 90 degree maximum resistance rally line drawn up from the first low. The obvious A, B, C, corrective pattern is evident so we can possibly expect another big downleg once C is officially completed. As of the last bar in this chart a signal bar reversal sell signal was given 4 bars back and the current price is resting at that failure level. Strategy is to think bearish and short, but be aware that if the 50 % retracement level can be regained, then the A, B, C pattern could actually be a double bottom and a new all time high could result. Hence we want to short a *weak* market but not a *rising* one. If we do short a failure we can use the current high as the stop out point and project lower prices below anything shown on the chart because that is what an A, B, C failure implies. Usually, it occurs at the midpoint of the bigger move, so as much as the all time high was above the A leg starting point that distance will be measured down from the C ending point.



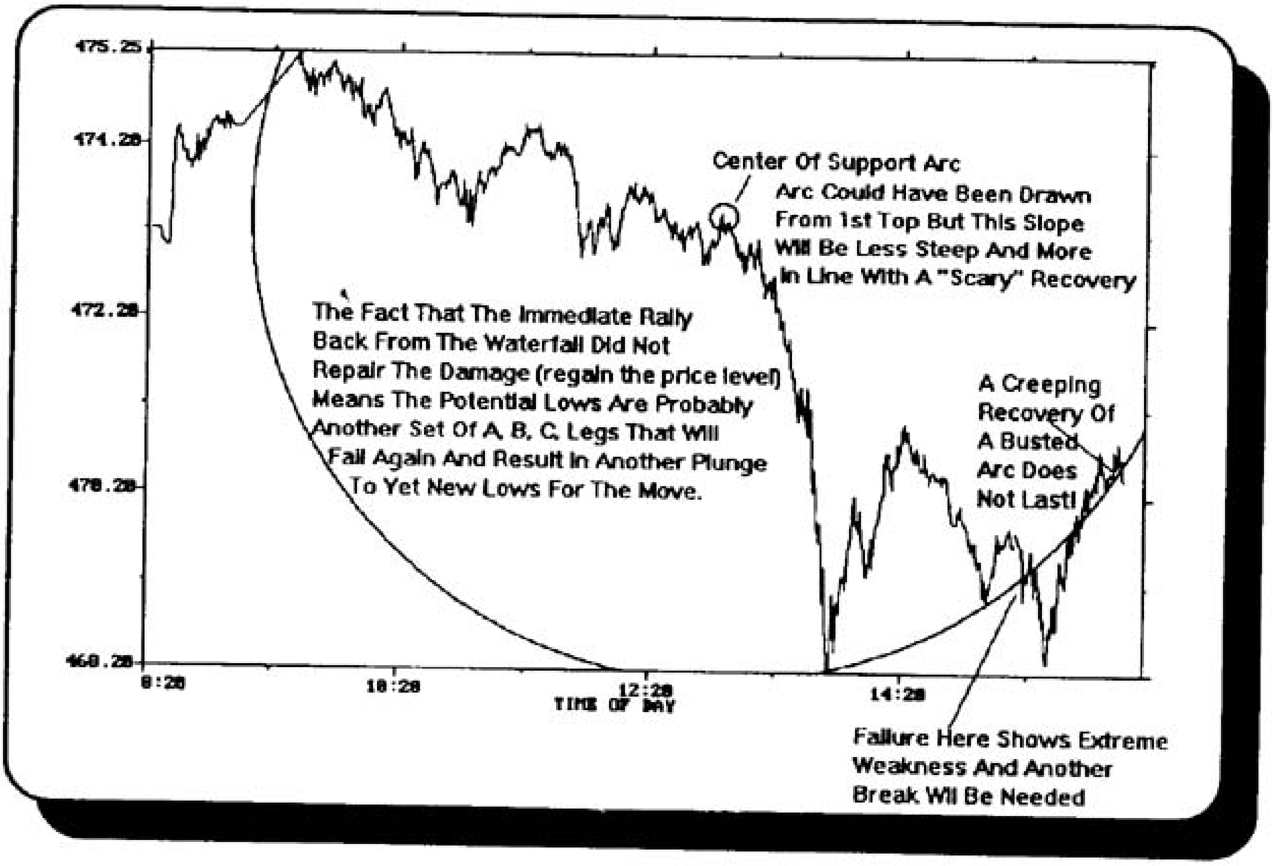
This next chart is a tick chart (every tick printed) of the S&P futures the next day. We come into the day looking for weakness to short or a rally that penetrates the 50% retracement level @476 to change to a bullish bias. We now remember the most important aspect of all of day trading -- the opening bulge rule. To repeat, this rule states that the *extreme high or low* for the *entire trading day* will be seen in the first 20 minutes of trading (with 70-80% probability). Once we can get a legitimate trend (zigzag pattern) we can trust the bulge. By 10 AM, it appears to be a top and we go short, or we have *guessed* and shorted at the 50% retracement approach looking to cover if a higher high is made after the opening bulge rule period. We can immediately see several powerful impulse waves to the downside even on this very short term chart. Those are the "plumb line" drops that break to each new low. This indicates serious selling. Indeed in the first full hour of trading we do not even see one full fifteen minute rally! If we are scalping, we cover each 80 basis and look for a 40 basis rally back to re-short. If we are very bearish and are looking for a full day to three day swing trade we will not think about taking our first profit until we get towards the low point where the first signal reversal bar buy signal was generated on the hourly chart (see 1st chart start of A). This level is near 469-470. Keep in mind that *we must take our profits at each potential reversal point and not wait to see if the market will turn.* Most of the time this kind of exit will give us the maximum profit before we see the reversal buy signal bar. That buy signal bar is usually used to go long but taking profits where we expect low probability of further progress is our discipline. Remember we are constantly thinking — is this trade for the *next 50 basis* a *50-50 trade or an 80% probability.* We close out immediately when we get a 50-50 trade. Also remember we can always re-enter the trade if it keeps going and we will always consider having a sell stop at the low of the day anytime we exit a short trade guessing about a reversal in trend.

As we enter the mid-day period we are thinking about the normal intra-day patterns for a down day which this appears to be. In these situations we expect a rally phase anywhere from 1 to 2:30 PM Eastern Time so we are thinking about a strategy to exit our short and where to re-short. We know we want to be short by the close and possibly have a big break again from 3-4 PM. Our chart, however, is not rallying and is declining in a wedge and if whose flat bottom breaks, we will see a big drop back to the lows. We also have some data now to calculate the possible low. The major high seems to be clearly in with the opening bulge at @ 475.25. We now calculate our expected Gann square of nine chart support levels by subtracting root increments from this level. The square root of 475.25 is 21.80 so we can subtract one eighth or .125 to get 21.675 and square to get 469.80 as a target. A stronger level would be the Fibonacci increment of.1459 (1.618 rose to the negative 4th power) or 21.80 minus .1459 equals 21.654, and that squared is 468.90. If these are broken, the major .236 level and the quarter (.25) would give us 465 even and 464.40. One of these should do for the current day's operation. Especially, keep in mind the next larger frame of reference. The final high was reached some two weeks prior at a level of 483.10 and the major .25, .382, and .50 ratios equal 472.15, 466.45, and 461.40. Any expected major reversal will most likely combine common harmonics of each of these swings. Our next chart shows the outcome.

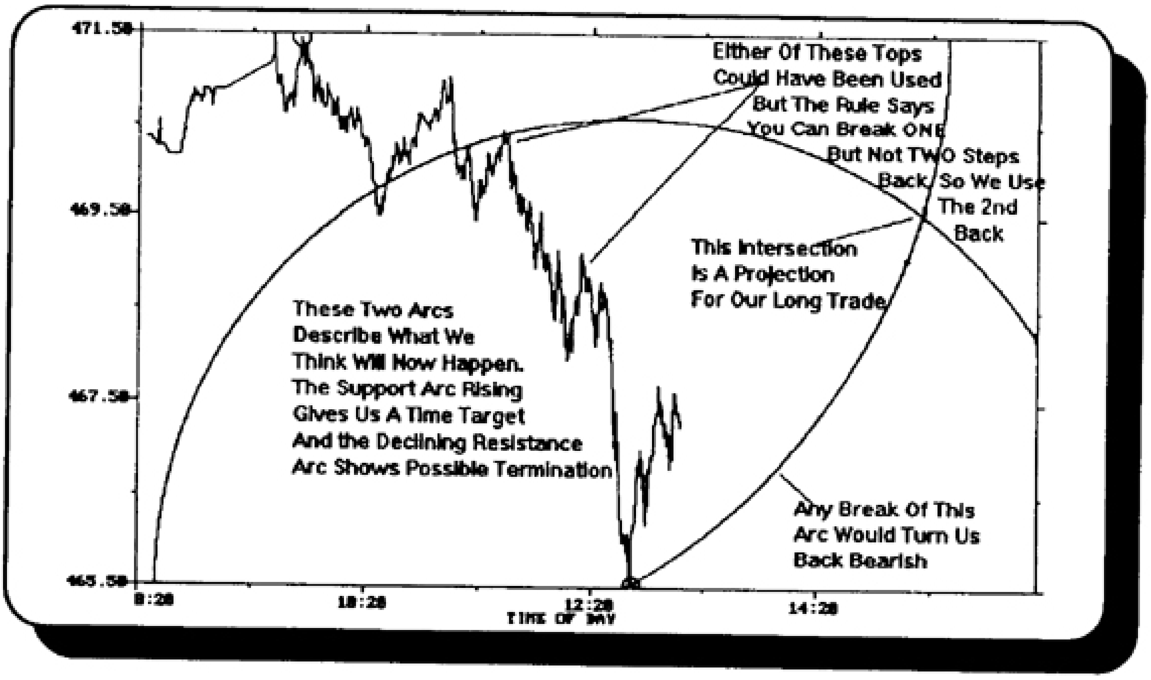


This chart shows the waterfall culmination of the day's deterioration. After such a big climax we cannot rely too heavily on the normal day pattern of a small rally and then another big break into the close. It is more likely to see a "whippy" tug of war between the super bears and the bargain hunters with several whipsaws. Strategy now must be to only trade rally spikes since a big break always leaves a "lingering memory" and the market will be quick to plunge on any future sign of weakness.

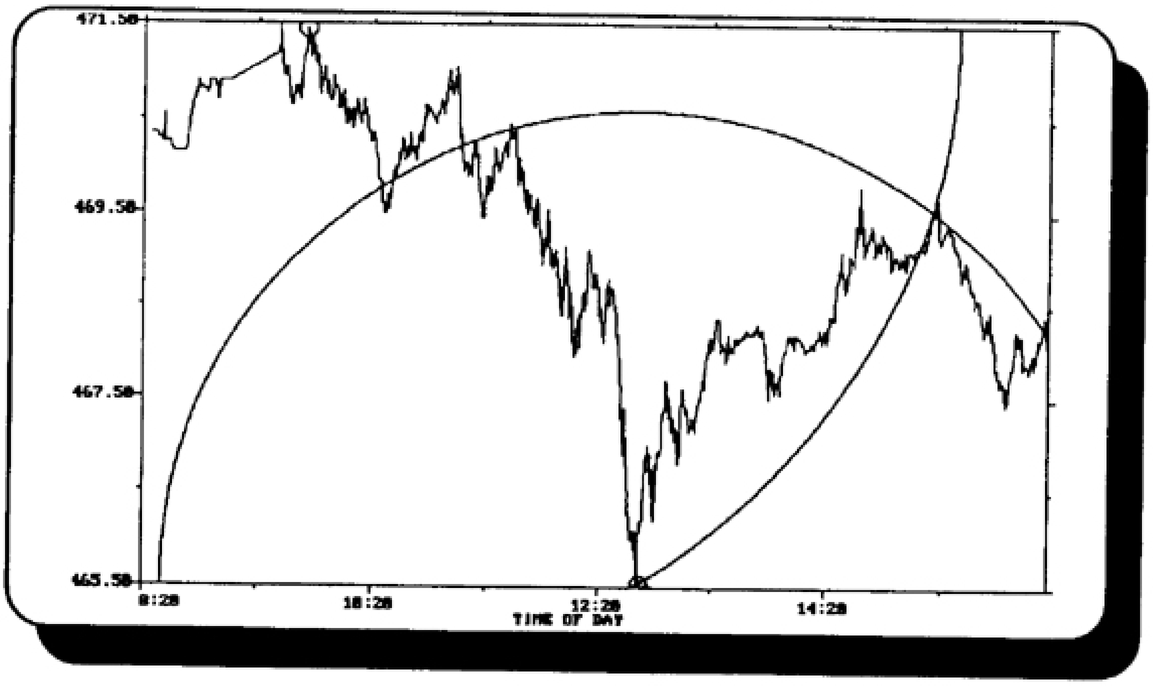
The arc drawn here is drawn after the fact using the actual low for the center point. This is merely to confirm that the arc influence is indeed dead for the rest of the day. If the arc had not gone maximum vertical down, we would expect another waterfall decline before day's end. Because it is over, we can now expect a normal retracement rally of one third to one half the distance back but most likely a one-sixteenth root up from the low, or 468.20 square root equals 21.636 plus one sixteenth or .0625 equals 21.70 squared, equals 470.90 for the expected top. Note this is almost exactly where the rally went. We would now swing some support arcs up from the low to watch for when the rally starts to fail again. The next chart shows the support arc and the markets extremely weak reaction to that support arc.



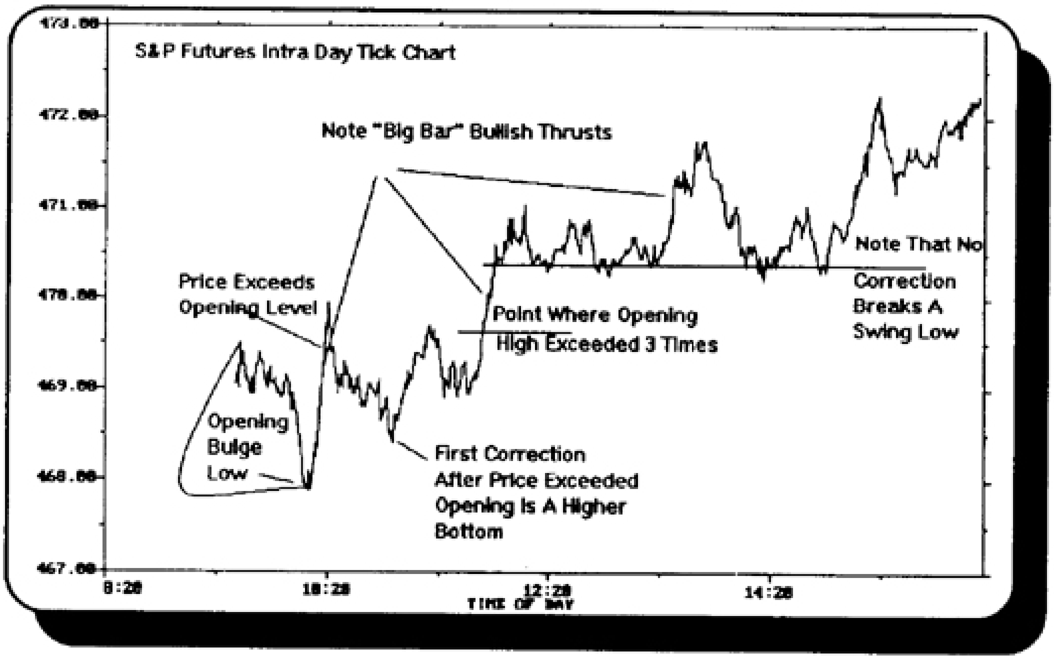
In this chart I have used a slight variation of the arc radius, measuring from the "obvious" mid-point and the last important high prior to the waterfall. This complete circle will now describe all the behavior from the final high to the final low, even if that low has not been seen yet. If it has not, it will occur as the rising arc near 4 o'clock reaches up to the maximum 3 o'clock. We now see a pattern almost identical to our first one on the hourly chart which was labeled A, B, C. Our strategy is to short the next sizable break back under the arc that the current price is climbing. Since this appears to be an A, B, C leg again we expect prices to fall to yet new lows again before we will look to take profits. Keep in mind, however, that this will be the third such breakdown and we are pressing our luck to expect the market to drop forever. Any double bottom or slightly lower or higher low from this point on could be a good stop and reverse long point for a more significant rally both in price and time duration. We also are reminded of the bigger picture that projects a possible final low near 466.45 (483.10 -.382 sq. rt.). Our plunges so far have been ugly, but, until that (466.45) number is decisively broken, we are still just in a minor correction in a long term bull move. Things could radically change, but for now we will take what the market and our arcs give us.



The next day, we see *another* opening bulge high and waterfall pattern. Clearly the market is beginning to act bearish but on a daily basis oversold. Note we hit a new low for the move but regained the old. This is a potential major buy signal crossing 466.45 and we would take it. The vast majority of big reversals go to a new low under a recent one and then reverse after the stops have been cleaned out. The chart below is the result of the projection above.

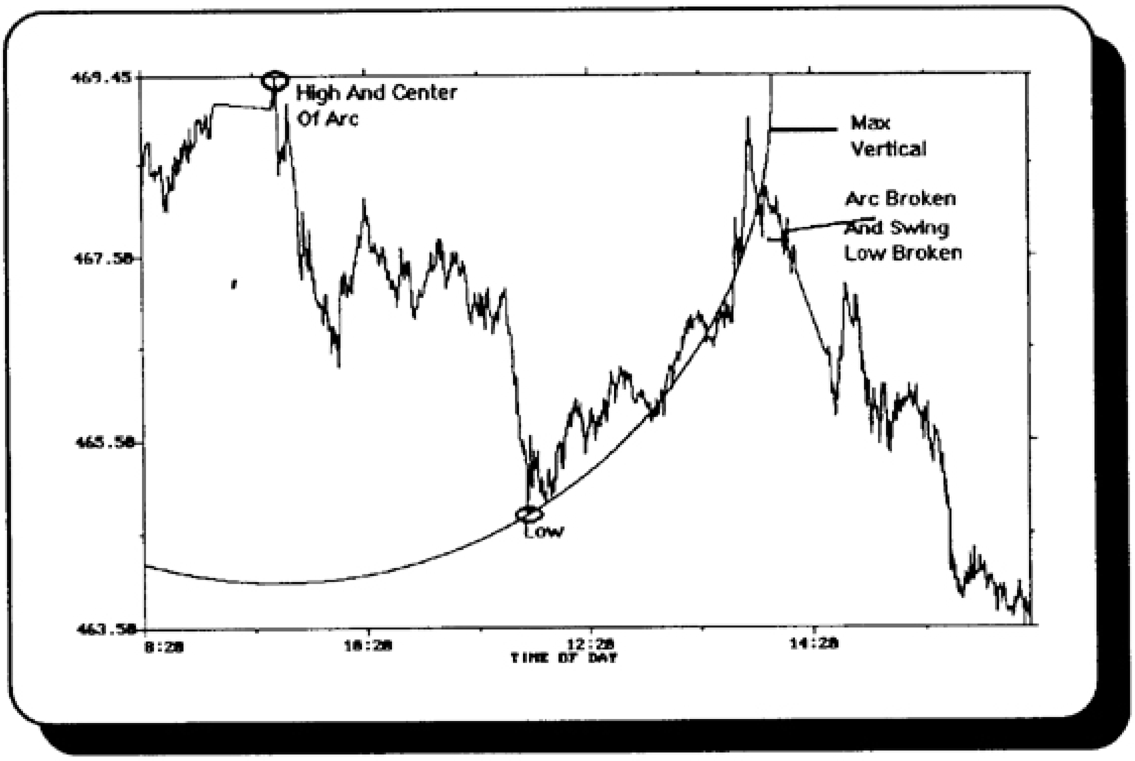


The next day, we see a typical bullish day and a very strong bullish pattern. This is a classic bullish chart and it is so basic and simple you would think no one would lose money trading that day. The problem of course is our emotionalism and rationality. We think too much most of the time and need "reasons" why something has to occur. The prior three days' action was extremely bearish so now the entire trading community is aggressively short and wants to stay short. Because of this we see a classic very bullish pattern with no pullbacks and yet everyone in this kind of environment refuses to objectively look at the pattern to see the technical strength caused by all the shorts choking to death. It may only last a day or so, but as chart technicians we do not care. We are only in this for the money! If the trend is up we should note it.



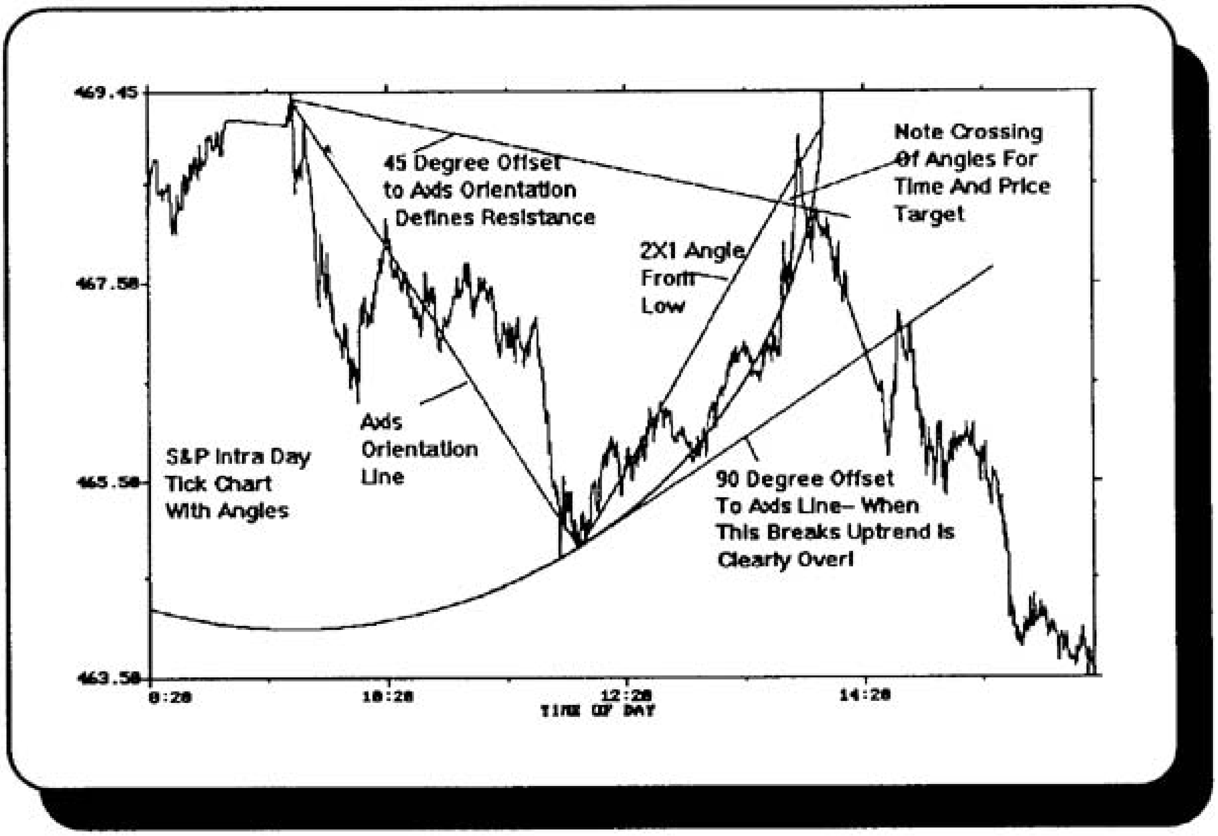
Also note the obvious "measured moves" of each impulse up move. As traders we would measure these movements each day and enter or exit trades when these normal extremes are reached. Keep in mind we do this daily to fit that particular day, but we have also previously noted the average fluctuation ranges for the past three weeks on the hourly and daily charts also so we are prepared for any surprising extremes. I have often had conversations with traders who use three or five minute moving average crossover lines to trade S&P's. What typically happens is several days to weeks of great success and then a big wipeout when the extreme hits. You must know the extremes seen over the past few months and be cautious about becoming trapped in a mechanical system based on a very short term moving average which is only working off data from the last couple of hours.

This next chart is just a beautiful example of a circular arc and how profitable a knowledge of them can be when intra day trading. This arc is simply drawn from the opening high to the mid-day low and swung up. This information would certainly have provided you with at least two good trades of significance with very close stops and little risk.

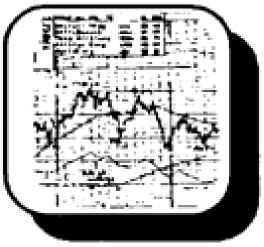


This next chart is the same tick chart but with our axis orientation technique and various angles. Remember the major axis thrusts on any chart are very significant for determining the true trend. We can take any major up or down move and draw a straight line from the high to the low to get the true axis orientation and then we apply or timing angles. The most basic angles would be the

45 and 90 degree major resistance lines. After that, you could add 2 x 1, 4 x 1, or 8 x 1 and even 30 and 60 degrees, but most of the time a few basic ones are all we need.
I am sure much of this is new to many of you and you can easily become fascinated with the aspect of exactly predicting each high and low. After having done that myself for some 23 years now and often getting the exact high or low within five minutes and 20 basis in price, I can tell you it is not worth the time to be so precise. As traders we are only interested in making the easy money and avoiding risk. Getting the exact high and low can be done but violates the basic principle of taking on more risk. The odds of success get smaller the more precise we get. In the final analysis, a few simple arcs, angles, time counts, and support and resistance numbers will make all of you rich if you do not get too emotionally involved.



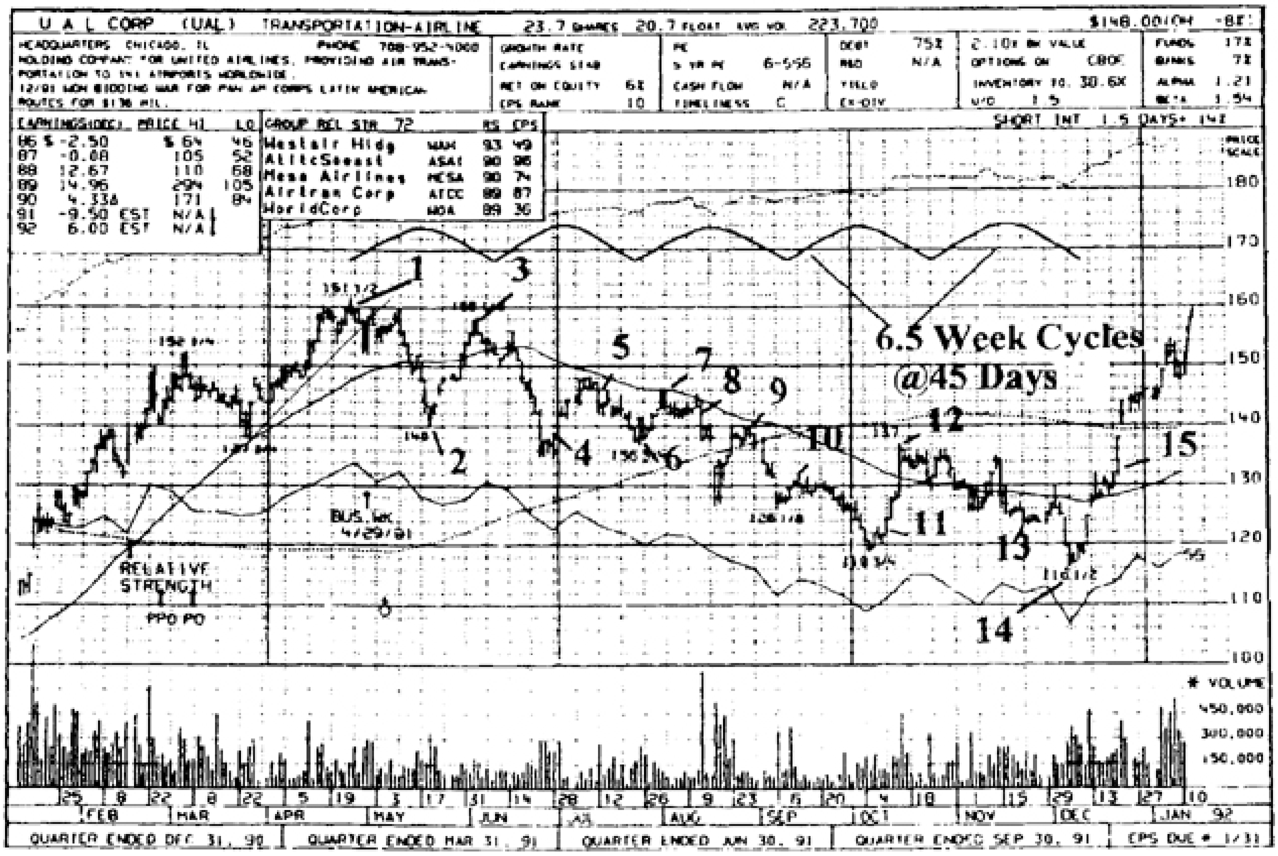
Trading Stocks



Stock trading analysis is not much different from intra-day S&P Futures trading, but since the average time horizon for trading stocks can be 3 days to 6 weeks or even six months in the case of mutual funds, time analysis is weighed more heavily than just simple buy or sell technical signals. That is to say, a daily reversal bar signal may not always be taken, depending on the long term outlook for the issue. The complete bull cycle often lasts 3 to 5 years and within the waves making up that cycle, the counter trends occur every 9- 10 months on average, and they last 90 days or so before the main trend again resumes. Our first consideration is therefore to see where the major high or low for the past twelve months has occurred and determine whether it is indeed a high or low. Once that has been determined it is a simple process to buy dips or sell rallies for 3 1/4 or 6 1/2 weeks at a time and use trendlines and resistance numbers for guidance.

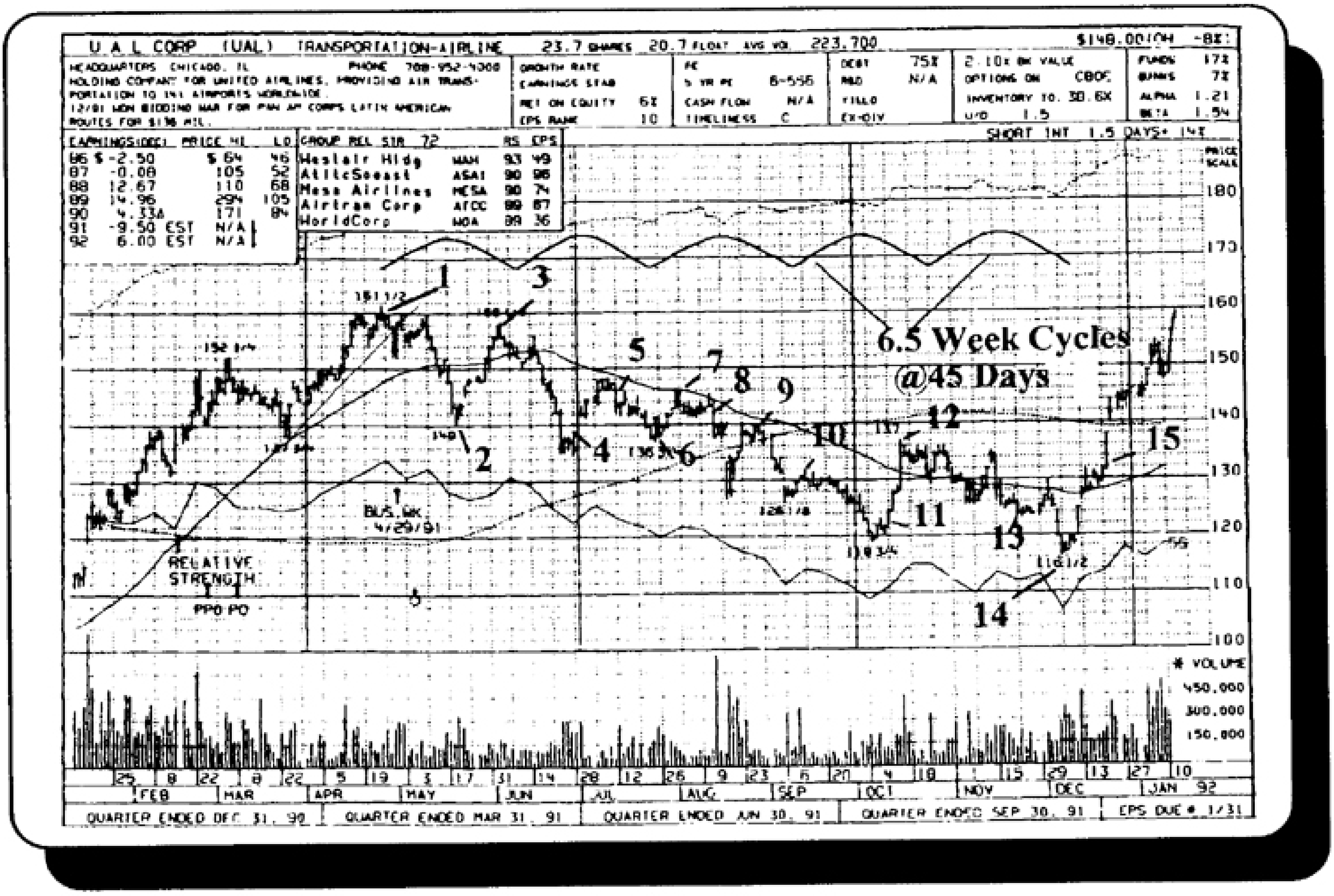
I have chosen UAL as the example for this study since it is a good trading stock. Often the higher priced stocks attract many day traders due to the frequent dollar fluctuations and these movers usually respect the common principles of trendlines, support and resistance numbers, and time cycles. In the following discussion, please follow the explanations by referring to the chart. It seems like a simple exercise and you may be tempted to skip it, but I urge you to follow along to see the reasoning behind the strategy.

The chart on the next page is a daily chart from 1991 to 1992. For demonstration purposes we have to start somewhere so we will just assume we want to start trading near the high in April. This is an obvious choice because the high price is $161.50. A little numerology and decimal point moving should quickly point out that this is the golden ratio of 1.618 or 161.80 -- a good place to find an end to a movement! Reviewing the "information box" in the upper left hand corner of the graph, we see that last year's low was approximately $84, so $160+ is a double and a good place to see a high. The actual high was due about a week before the reference point # 1 because that was the period that was exactly 3.25 weeks up from the last low and a signal reversal bar sell signal had just been given three days before the final high. But, after seeing the $161.50 false breakout price and then another reversal signal sell bar, we must now sell out and go short using

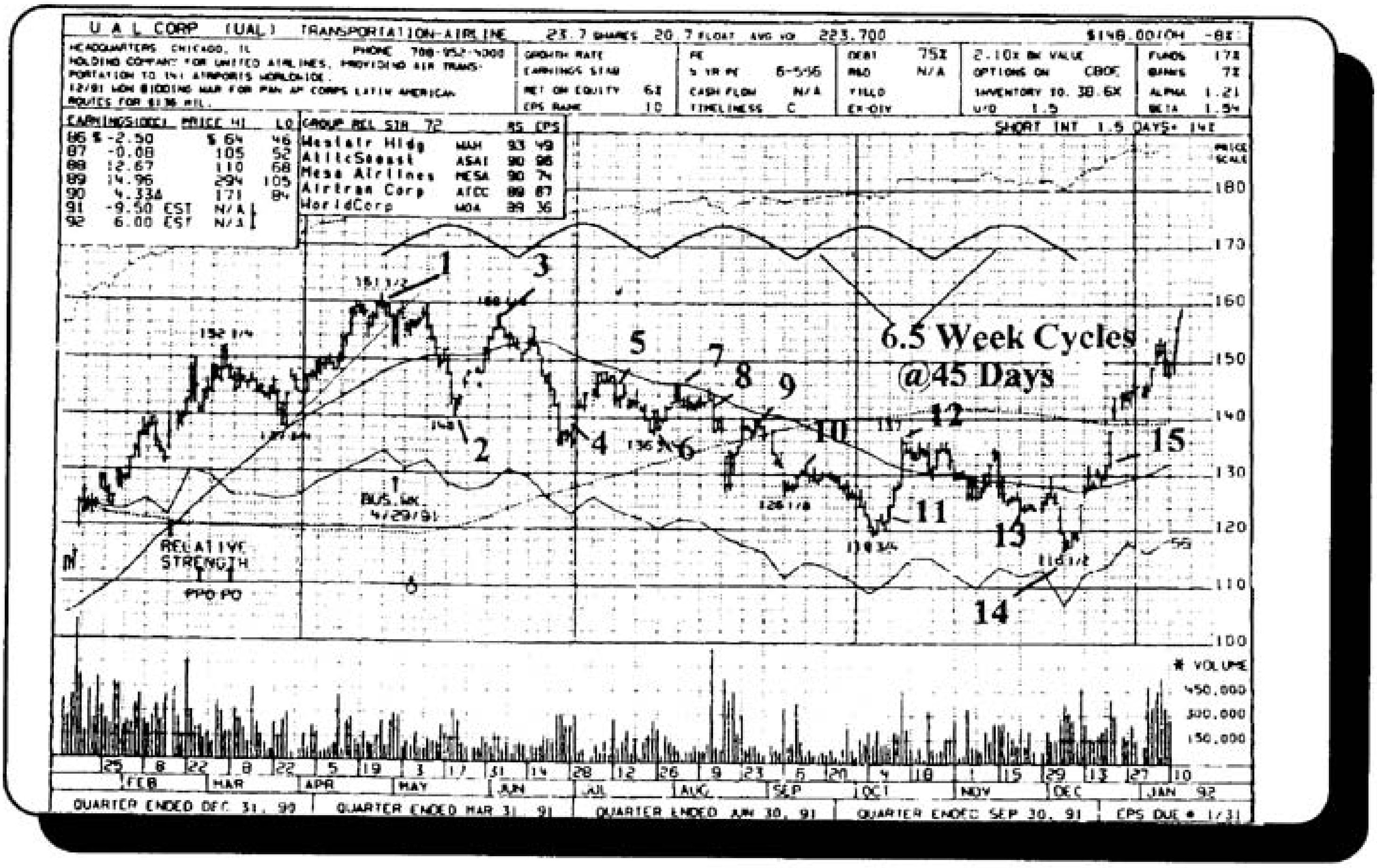


that high as our stop out point. Our minimum expectation now would be a typical 3.25 week down cycle from the high. These typical cycles of 3.25 and 6.5 weeks or about 22.5 and 45 days are the most frequent trading cycles and the larger 6.5 week component is drawn on the chart starting with the high and represented as "waves" with the low being the beginning and end of each cycle. Our minimum price targets are the square root decrements of our high of $161.50 or .50=$149, .618=$146, .75=$143, and 1=$137.

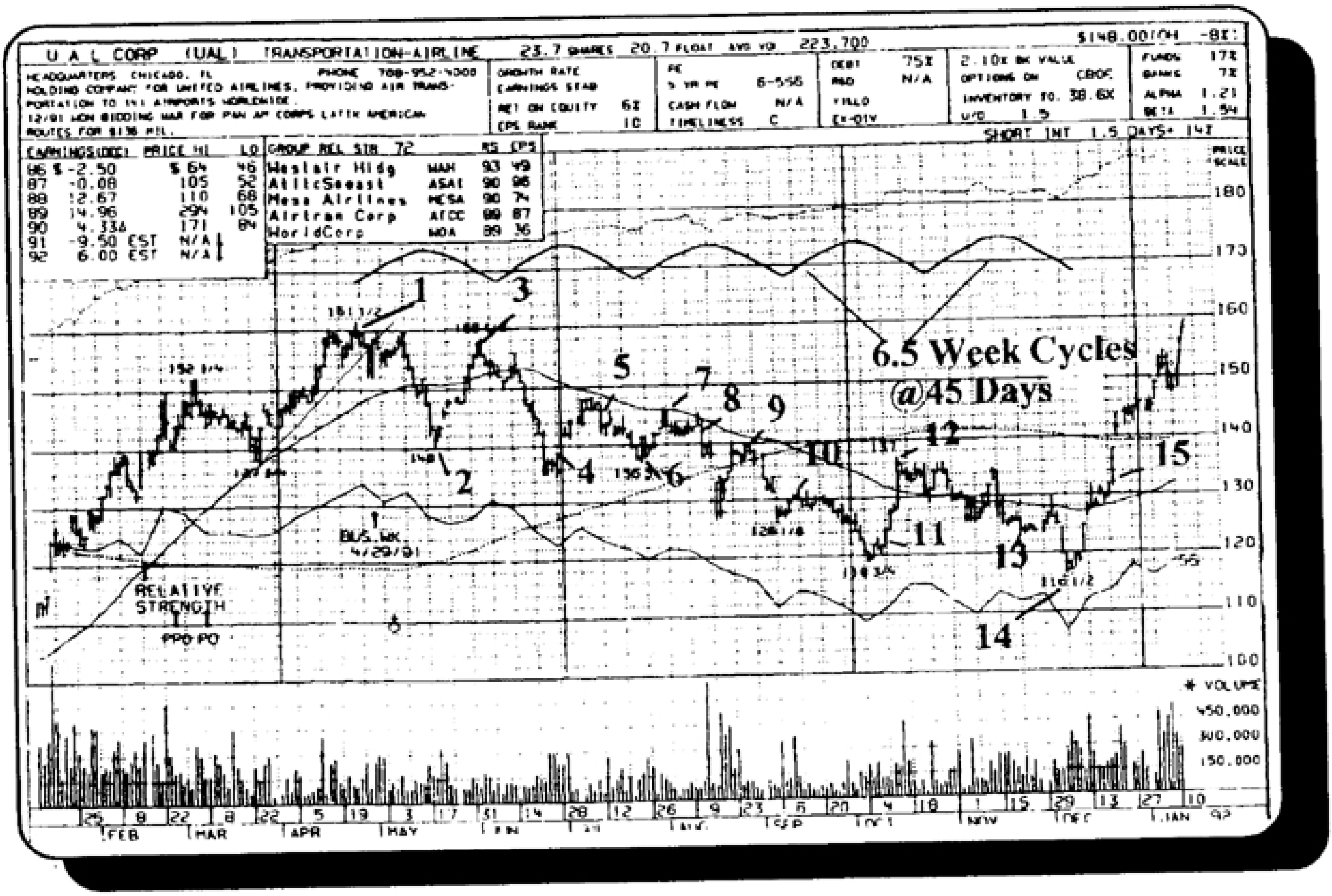
We also believe the seasonal tendency for this stock is for highs and lows in April and October since we are 3.5 years from the October 19, 1987, crash low and 18 months from the infamous UAL collapse in October 1989 which led to a 200 point Dow Jones decline. Consequently, we are now short with a stop at $161.50 and we see 5 days later a rally back attempt that fails exactly at the **low** of the **high signal reversal bar**, validating that as a good signal. Six days later we again see a last attempt to rally past the **low** of the high bar and that failure results in a swift $10 plunge for the week. We are now looking to the following week for a possible low since it will be 3.25 weeks from the top. Reference point #2 shows that low with a nice clean signal reversal buy bar that also coincides with a double bottom support area from eight weeks earlier. We can now cover and go long using this new low as our stop but will always use a trailing rising stop along a 45 degree angle coming up from any low we buy. That 45 degree angle defines the basic uptrend and at a minimum should be our stop. During this advance, not a single day's low is broken indicating a strong trend



but we expect resistance as we approach the low ranges for the week of the final top. Remember that on a weekly and monthly chart we now have a signal reversal bar too, and a rally back to the lows of those bars will most likely result in a failure and confirm another sell signal. At point #3 we hit resistance and generate a signal reversal sell bar two weeks into the trend. At the 3.25 week time mark we see one final spike up failure and another swift decline sets in. We are now short from the signal reversal price zone of @ \$156. Coming down off of that we break the price low from point #2 and now we have a long term sell validation of lower highs and lower lows spread over two months. It could yet be an A, B, C correction, but any rally that now fails and makes yet another low would confirm a long term top and a down trend for at least six months' duration from the April highs. At point #4 we cover because it's 3.25 weeks from the last high and we get a signal reversal bar coming after four days of holding the same price level of support. We cover and go long @ \$138. Please note the four day low at this price hesitated because it was 1.382 numerologically and that fit in with the top at 1.618. At point #5 we form a 3-4 day top at the exact 50% retracement of the last swing down from \$158 to \$136 or @ \$147 and we break down. The next high at point #5 is only 1 5/8 weeks from the low, or 1/2 of the 3.25 week cycle. This usually happens at the midpoint of a 6.5 week cycle down so we can expect the original sell from point #3 to last a full 6.5 weeks before we will see another rally. This low comes in as scheduled at point #6. Point #6 is also a double bottom that stops at the high of buy signal #4 confirming it as a good up trend and there is also trendline breakout from the past two week decline, so we must go long again with a stop at

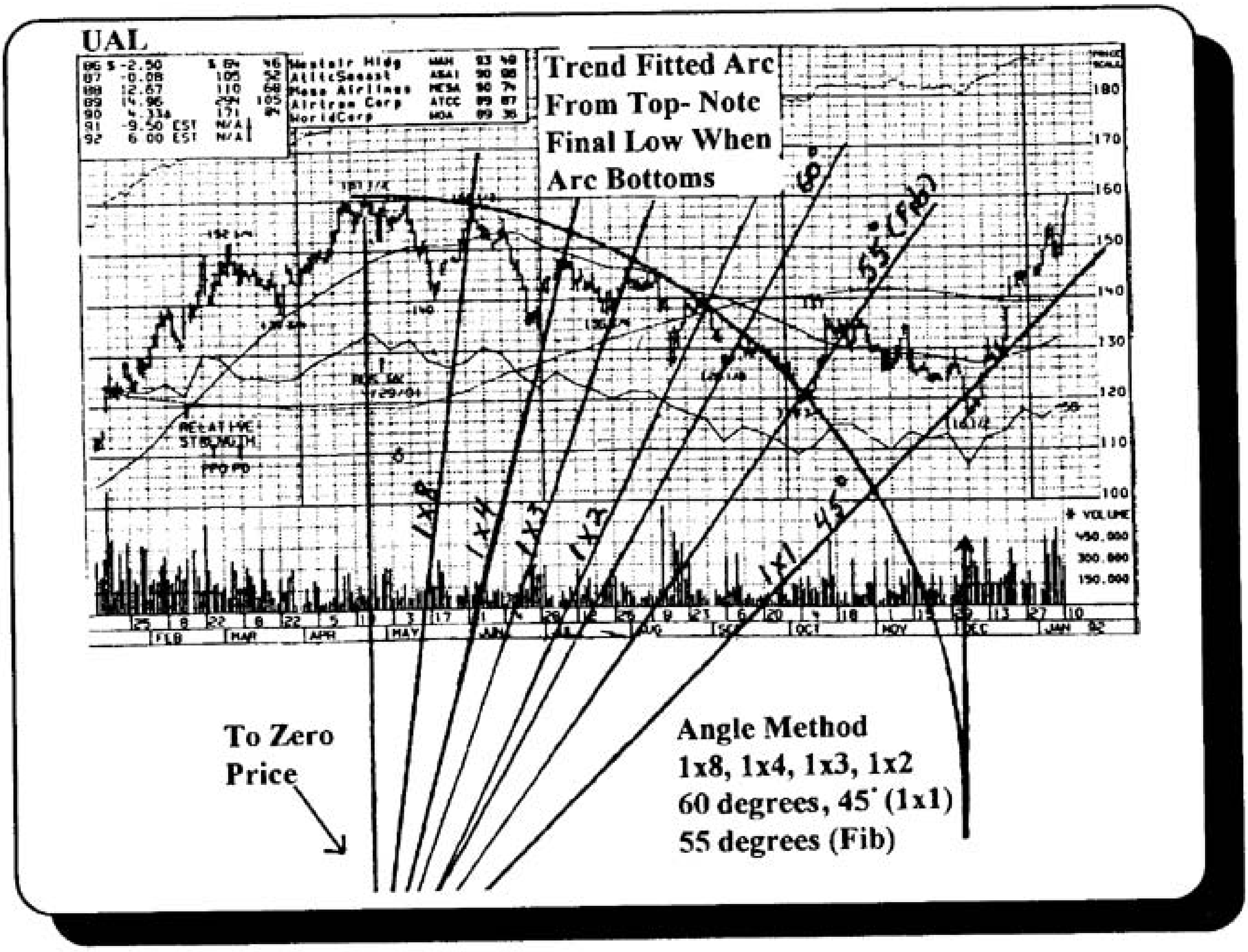


this recent low. The rally is short lived, however, because at point #7 we hit the low of the point #5 reversal sell bar and we go down. There is now a one week tug of war between the bulls and bears from #7 to #8 because the top at #7 does not exceed the low of the sell from #5 and the low after #7 does not break under the high of the buy signal bar at point #6. Point #8 resolves this for the bears and we return short once the high of point #6 is broken, invalidating that signal and indicating a new low for the move just ahead. This is the gap down and the penetration of the 200 day moving average which also validates the long term sell signal we saw at point #3 based on the weekly and monthly reversal sell bars. Point #9 is a feeble attempt to close the down gap and regain #6 but another sell is generated and we slide into the low just before point #10. We are looking for a major low here since it is 3 cycles of a full 6.5 weeks from the all time high at point 1 or 19.5 weeks. A feeble rally ensues that reverses 3 days later and we erode into the low at point #11. Point #11 generates the best looking rally so far for it regains the last top at #10 but cannot regain the 2nd one back at #9 -- which is typical bear market stair steps. Two and a half weeks of sideways trading results in a sell signal which declines to point #13 and rests on the high of the point #11 buy signal. Long before this moment, however, we should have been able to solve the puzzle and know with almost absolute certainty the day and price of the final low and the start of the new bull leg up. This is point #14. How do we know that the low on that date, at that particular price, is it? There are innumerable clues.



First the top was 161.5 and the low day indicated at #14 was *162 trading bars* later for a major Gann square based on the high. Next the price of the low was 116.5 and if we use numerology here we see that 116.5 is a transposition of the digits in 161.5! You may not want to believe in this but I have seen it too many times not to take notice. Also note the top of 161.5 divided by the Fibonacci ratio 1.382 equals 116.85 for the low. Also note 161.5 minus 45 equals 116.5. Also note that on the Gann Square of Nine chart a high of 162 would have 115 as the low, one full cycle around the chart. The date of the low is near a natural square (25) in months from the October 1989 low, and it is 8 Fibonacci months from the top. It is also 5 Fibonacci cycles of 6.5 weeks exactly from high to low. Additionally I would note that the price on the low day finally closed a *gap* left open from January when the last leg up began. There are many other reasons for the final low and date to coincide but you get the point.

On the next exhibit we look at the same decline but from the perspective of angles and arcs. You can instantly see why all the highs and lows came out where and when they did on this chart! Every time an angle was hit, we got a rally until the angle intersected the arc. These zero price angles will make you rich many times over if you just look for them! If you spend some time looking at this chart and studying the exact turns at each and every angle, you will finally grasp the realization that news items and earnings have absolutely nothing to do with investing! All human behavior is emotional



and cyclic in origin. What this chart really shows is the hopelessness of the human condition for the masses. They are constantly deluded into thinking some news item or event is *causing* the stock fluctuation. One look at this chart will tell you that is impossible. All I have done here is lift you above the crowd, for perhaps a more divine perspective.

I could have also shown a nice chart with the angles from the top of one point per week, per month, etc., and it would give the same results. This one shows them a little more elegantly.

All of these methodologies work together and you should try several to find strong correlations before you invest your money. At the end and beginning of all great cycles, all numbers and time periods come together. Only a geometric and cyclic approach will identify them for you. Vow today to throw away your newspapers and stock brokerage reports. You only need charts!

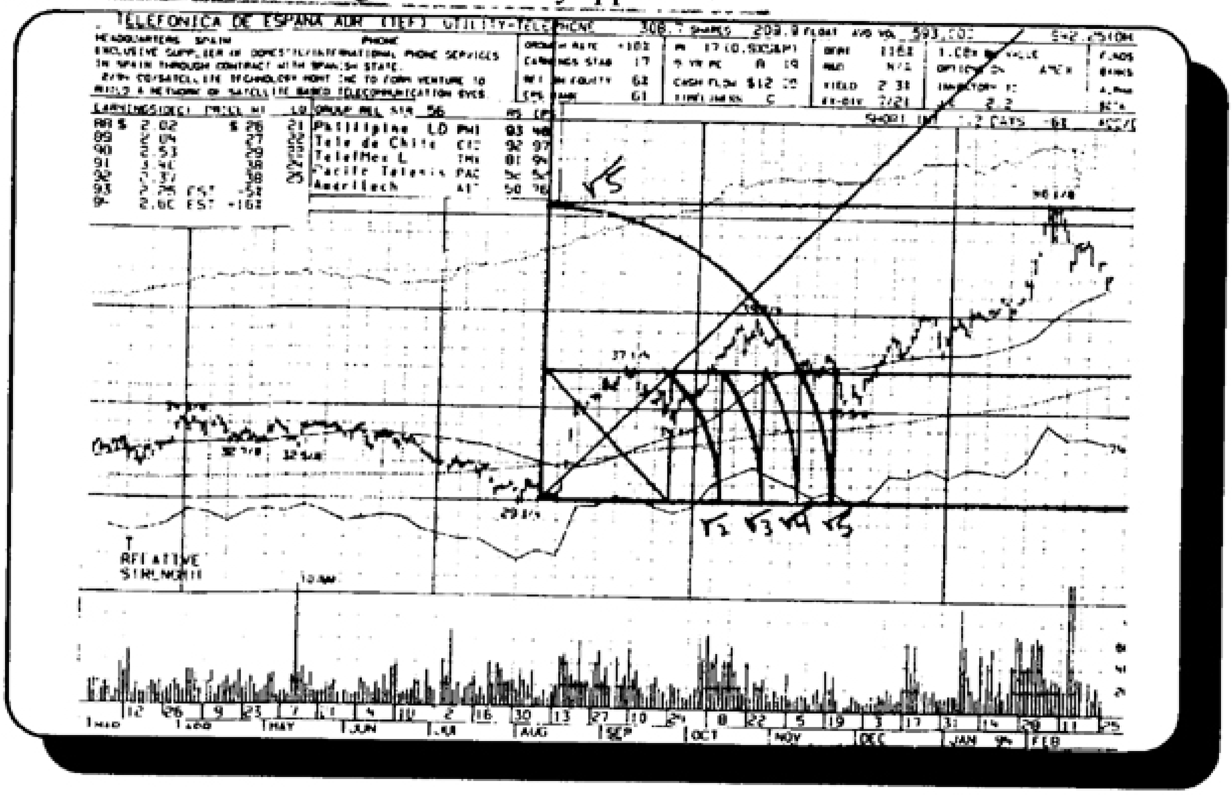
Advanced Techniques

Basic principles can be elaborated upon to acquire an infinite amount of time and price data with which to make forecasts. The natural forces operating in the speculative markets through the mechanism of human emotions can be defined with very good precision. Just as with mathematics, we can apply principles and axioms to develop theories and hypotheses that will shed light on possible outcomes to our stock market riddle. Starting with the basics of trend and impulse direction, we then use measured move vectors to get rough approximations for eventual exhaustion and price targets. Circular arcs more closely define our measured move limits and expansion of other geometric shapes like circles, squares and triangles will give us the rest. In this section we will examine some of the basic expansion techniques to define and identify points for forecasting long wave sequences.

Our basic premise of the natural cyclic movement of human emotions through the markets is analogous to the tides at the beach. In an advancing market (Bull) each thrust or impulse wave penetrates to higher and higher levels just like waves at the beach. Our higher bottoms' definition describes the low point of each wave swell prior to the next surge. Once the high tide is reached, the waves diminish or recede (Bear) but still ebb and flow in a cyclic fashion and our lower highs and lower lows' pattern describes this movement also. What we need as an additional model is something that will project the size and amplitude of the possible tide thrusts and ebbs without having measured all the moves or having a table of high tides. There are a number of ways to do this but the most natural way, and the logical corollary to our geometric analysis of time and price, is to expand our geometric structures by known natural laws of physics.

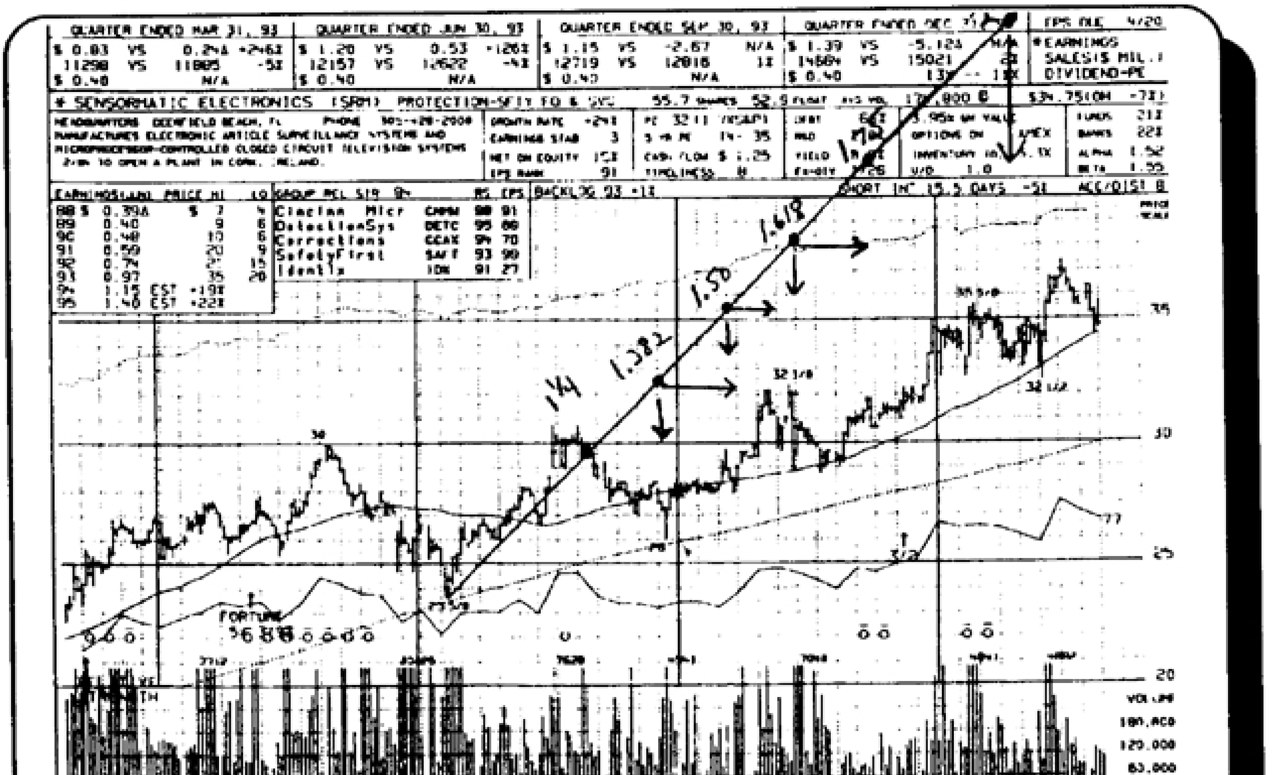
There are basically two types of cycles operating in the markets and these are usually referred to as static and dynamic. Static cycles are just fixed length cycles that repeat over and over such as every 100 hours, or every 30 days. Dynamic cycles are growth cycles where each cyclic return is elongated in time. The most well known dynamic series is the Fibonacci series of each number added to its neighbor to get a sequence like 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, etc. Another would be the natural square series of 4, 9, 16, 25, 36, 49, 64, 81, etc. When working in geometry we find another dynamic expansion cycle which equates to the roots of the geometric object. Square roots have been mentioned as the basis of the Gann Square of Nine Chart, but most common expansions used in the market can be limited to the square root of 2, 3, and 5. These are the most important. The rest work, but a knowledge of these is essential.

The best and easiest way to use these cycles is to actually construct the geometric structure they arise from over your chart. That way you will see all the key support and resistance numbers as well as the trendlines and angles that point to culminations. The other way is to simply take the natural ratios such as 1.414 (square root of 2), 1.73 (3), and 2.236 (5), and multiply these ratios by the initial impulse statistics such as the time from low to high and price increment from low to high. The following basic diagram shows my approach:

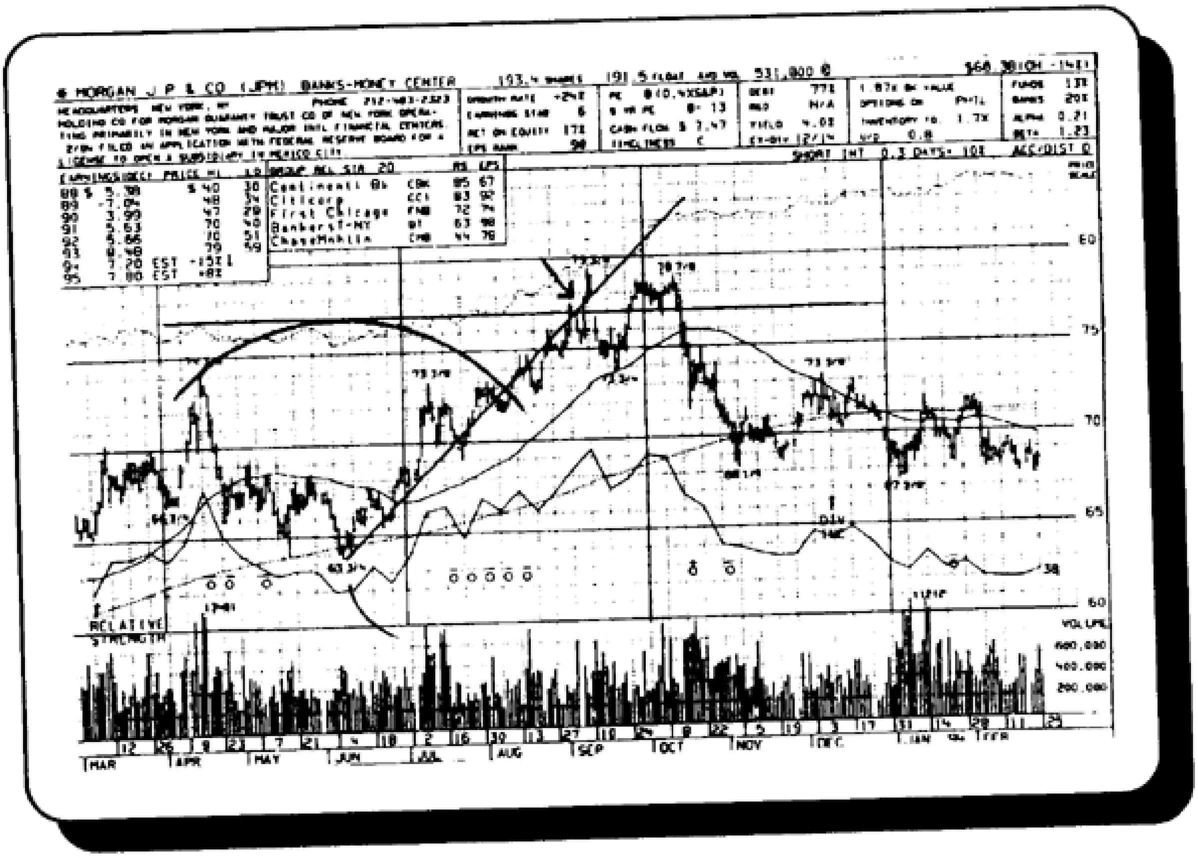


The above chart shows an initial impulse wave that is "boxed in" by drawing a square around the low and first high. That first box is our primary expansion seed. Knowing the Pythagorean Theorem states that in a right triangle the diagonal squared is equal to the sum of the squared sides, we therefore know that the diagonal of this first square of "1" unit sides will be the square root of 2. If we now swing the diagonal down to the horizontal and elongate the base of our rectangle to this length of the square root of 2 but keeping the height constant at 1, we can now see that the next diagonal of this box is the square root of three, or 1 squared plus square root of 2 squared (2) is equal to 3 so the diagonal must be the square root of three. We then continue this process by swinging down each arc in sequence, and going back up to the top and swinging down the next. Each arc will now define the squares of whole numbers. Numerology can be applied to the number of the arc swing to see if one is more important than the other. In this drawing I have emphasized the root of 5 since that is a Fibonacci number and the basis of the golden ratio. Swinging that complete arc of the root of 5 up, we see it describes the price pattern resistance and where the arc tops horizontally, it defines the eventual projected top for the move! There are many other subtleties in this technique but I cannot show you everything. Experiment! Keep in mind that circles drawn around high and lows can also be expanded by increasing the radius and diameter.

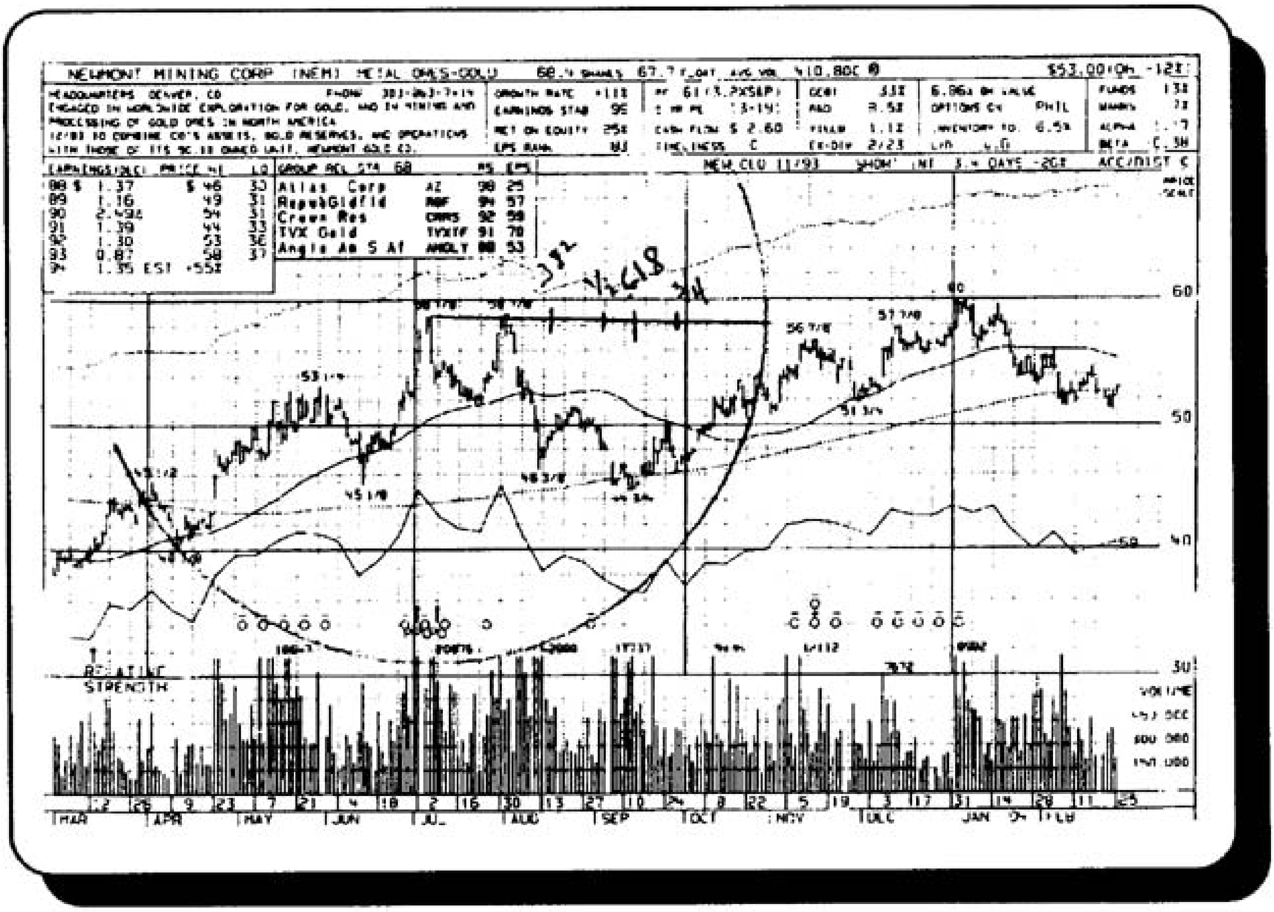
The next technique is an offshoot to the 45 degree timing line analysis. Since a 45 degree diagonal equally divides time and price, it stands to reason that if a timing angle is placed at a major high or low and extended, we should be able to see ALL turns that are harmonically related to that origin price and time. In this chart I have drawn an angle upwards and put "dots" on the angle line where harmonics (fractions) of the low price intersect that particular price on the graph. For example the low was 23 5/8 so 1.25 times that price is 29.53 and at that price we place a dot. The other expansions are noted along the timing line. The important thing to note is that at the point of intersection of the timing angle and a strong price harmonic (50%, 100%, .382, .618, etc.) we see a cyclic turn in direction of the price and that area also defines future support or resistance levels. Please note the little "arrows" going both to the right and down to point out this time cycle turns and the price level areas. Obviously this technique can be expanded to include other angles. This technique is one of the only ones that will work on a chart that is "flat" or having few fluctuations, or not enough data to draw arcs or other trendlines. In those cases this is quite handy.



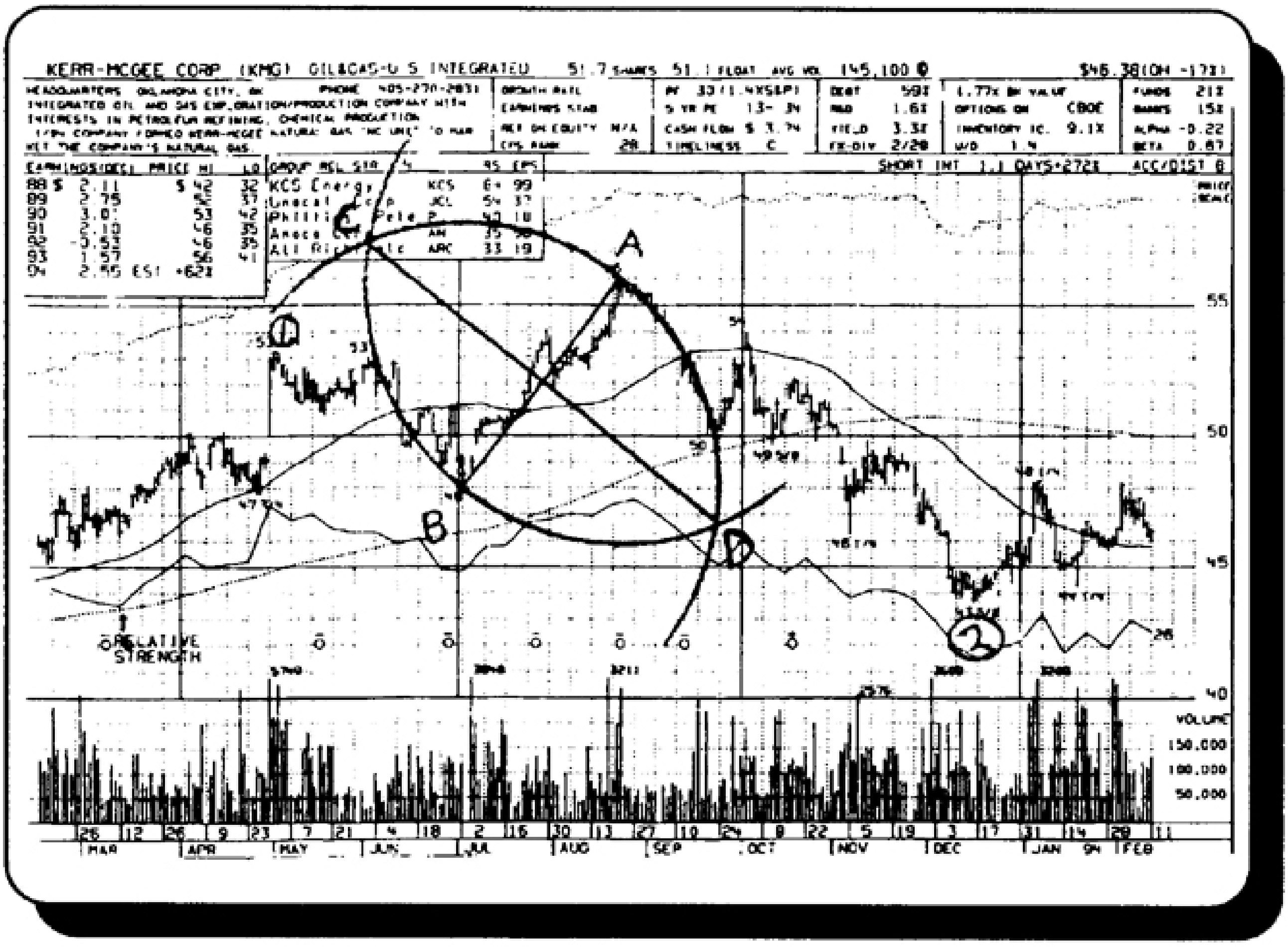
This next technique simply demonstrates the fact that circular arcs drawn from every major swing will create the major high and low resistance price areas to watch for when the stock reaches that price level at a later date. Here we swing an arc from the low to the previous high to find out just how high our target will be if that first top is ever exceeded. In this case the final high actually "overshot" the arc target (which is rare) but came close enough to warn us of an impending drop. But, note that the 45 degree timing line from the low intersected the arc target price level almost at the exact high. That would give us added confirmation that the major time cycle had run out and we would look for lower prices as soon as we saw a good technical sell signal to confirm the projection. Not shown, but just as important (especially in Bear Markets), is the case of drawing an arc from the high down through the prior low to give us the next breakdown bottoming target. On this chart you would draw it from the high at 79 3/8 in September down through the low in June near 63 3/4 and down under that final high. That approximate level would be 58 3/4 for the correction low. Please practice this technique with your charts as it is very simple and *always works!*



Our next exhibit requires a little more thinking and logical reasoning about the implications of circular arcs. Since we know that arcs drawn from major swings will exhibit price reversals at their ends, we can theorize that once we determine the radius of an arc (horizontal measurement), we will be able to section off that radius into fractions and proportions, and see many minor but valuable trend changes prior to the big change at the arc's termination point. In the drawing below, I have swung an obvious arc from the first major high to the previous low and then around and up to the right. (This is the same as the bear technique just explained but not shown.) What we want to measure is the distance from the high to the 3 o'clock point where the arc goes maximum vertical and ends. On this chart I have divided the radius at the .382, .50, .618, and .75 segments. These are common harmonics but you could use others. Please note the price action directly below each of these segments. This technique could give you numerous trades depending on the length of the arc. This technique is particularly deadly on intra-day hourly charts! Please understand that this chart is completely shows the final results for you to compare, but the beauty of the method is that you can identify all the future turns while you are still at the first top point and have no knowledge of any future price possibilities. The implications of this idea are staggering and I cannot afford to say more, but you could experiment!



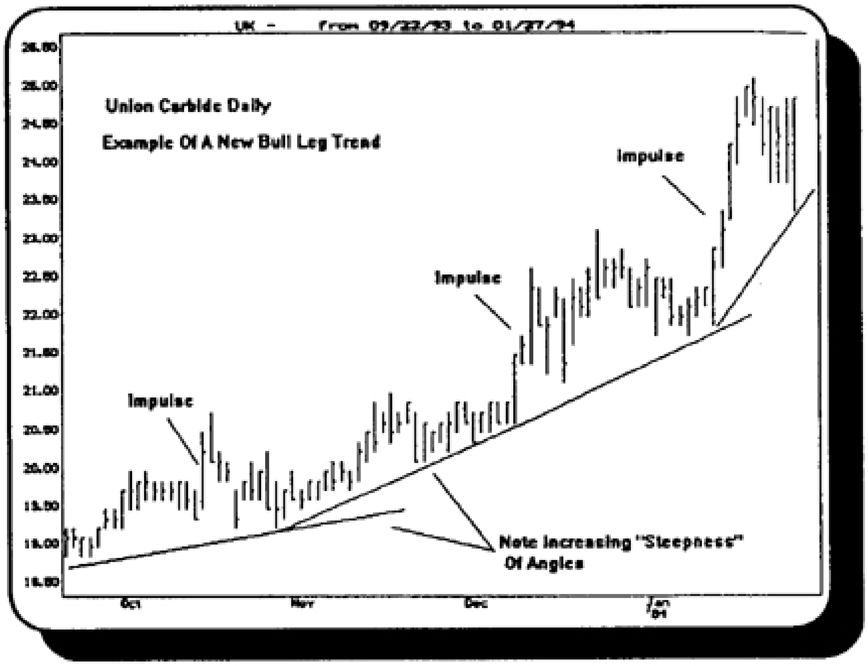
The next chart is the foundation of all analysis. I will keep it simple so you will just see the basics and not become confused with the elaborate details that are spawned from this structure. Basically, we swing two arcs, one from A to B, and one from B to A. We connect lines between A and B and between C and D. We now have four primary fundamental chords from this pattern. These are lengths A-B, A to mid-point B, C to D, and C to mid-point D. Note that these arise from a major swing AB. What we have are the *theoretically perfect measured moves for this particular stock!* We need only one swing observation to get them all. Note that segment length C to D is *exactly* equal to the distance A to point 2. This was known before that length was ever seen! Measure it to prove it to yourself. Also note the up impulse just before number 1 and culminating at 1. That length is mid-point A-B. Much more could be said, but this is a very advanced technique and reserved for special students.



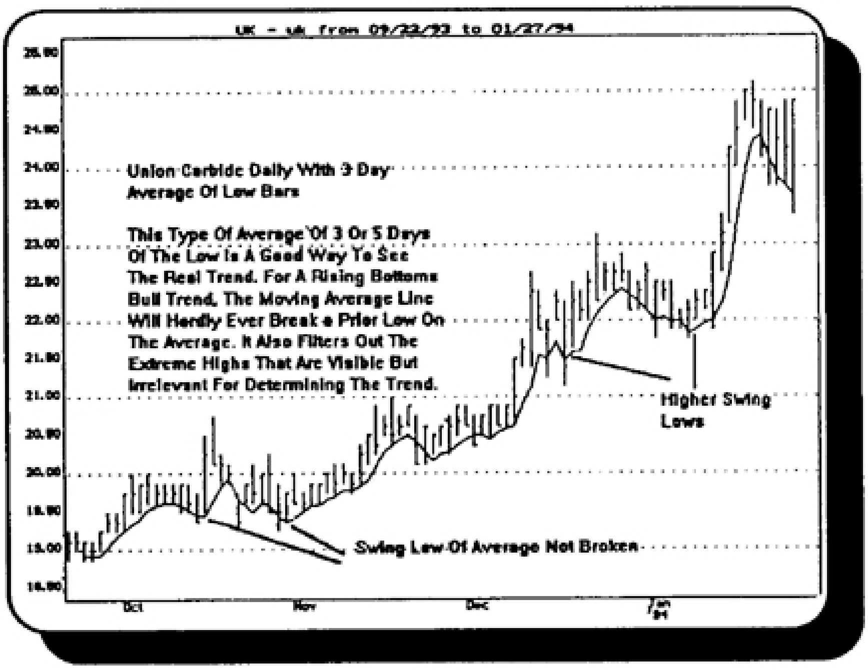
The above techniques are only a few of the ones I find useful, but they should give you enough ideas to follow up this analysis and find more uses of your own. In the final analysis, chart reading *is* a science, but this science pays good wages!

Appendix A Examples

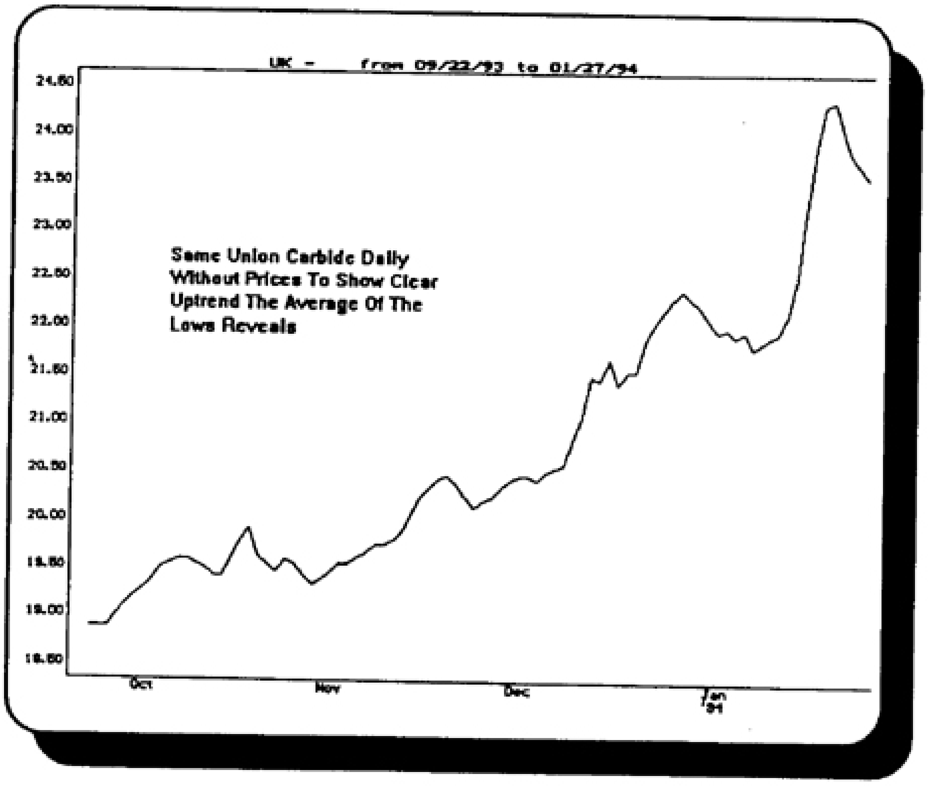
The chart at the right is the basic pattern of an uptrend. Note the "big bar" impulse thrusts showing emotional buying. After each impulse the ensuing correction drifts sideways to end at a higher bottom just before the next impulse. Volatility increases as the size of the trading bars increase and the stock moves up in price. Trendline angles connecting the lows increase in steepness and start to form a circular arc.



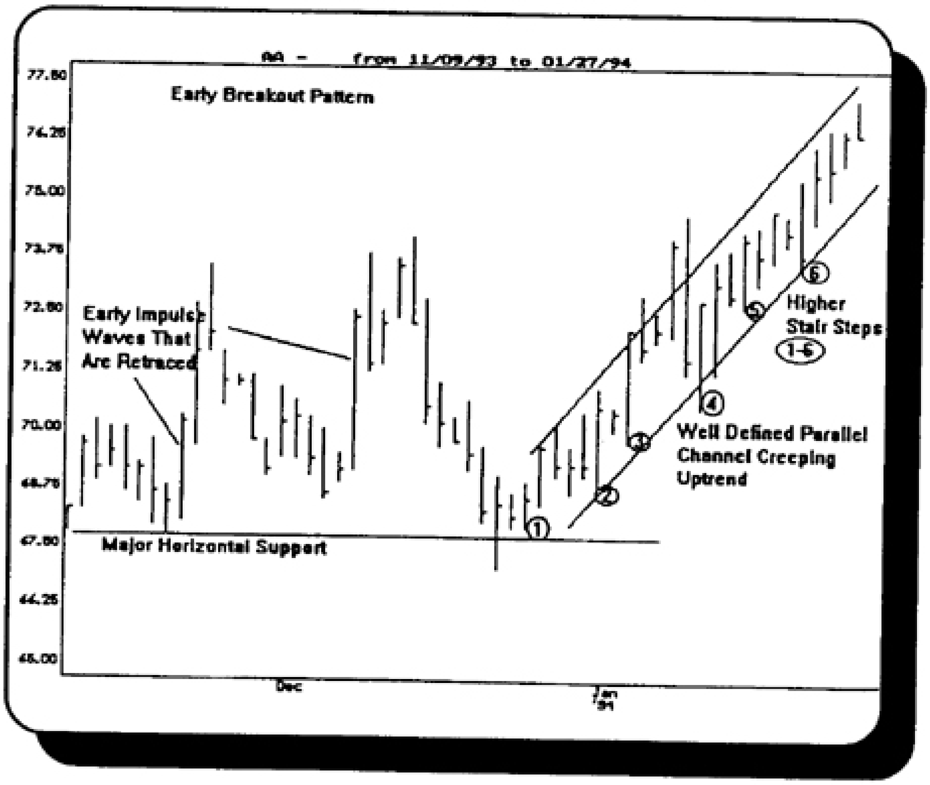
If you have a computer, you can use three or five day moving averages of the LOW to get a quick feel for the trend.



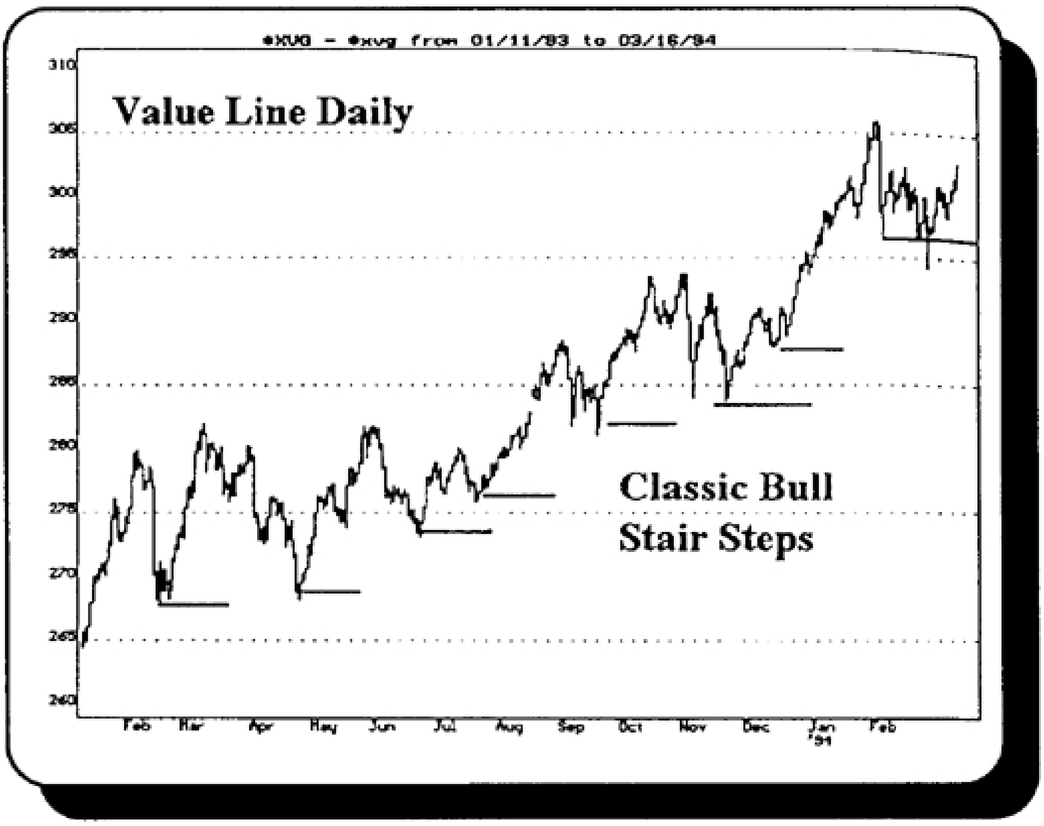
These averages of the lows can point out trends more objectively without as much confusion.



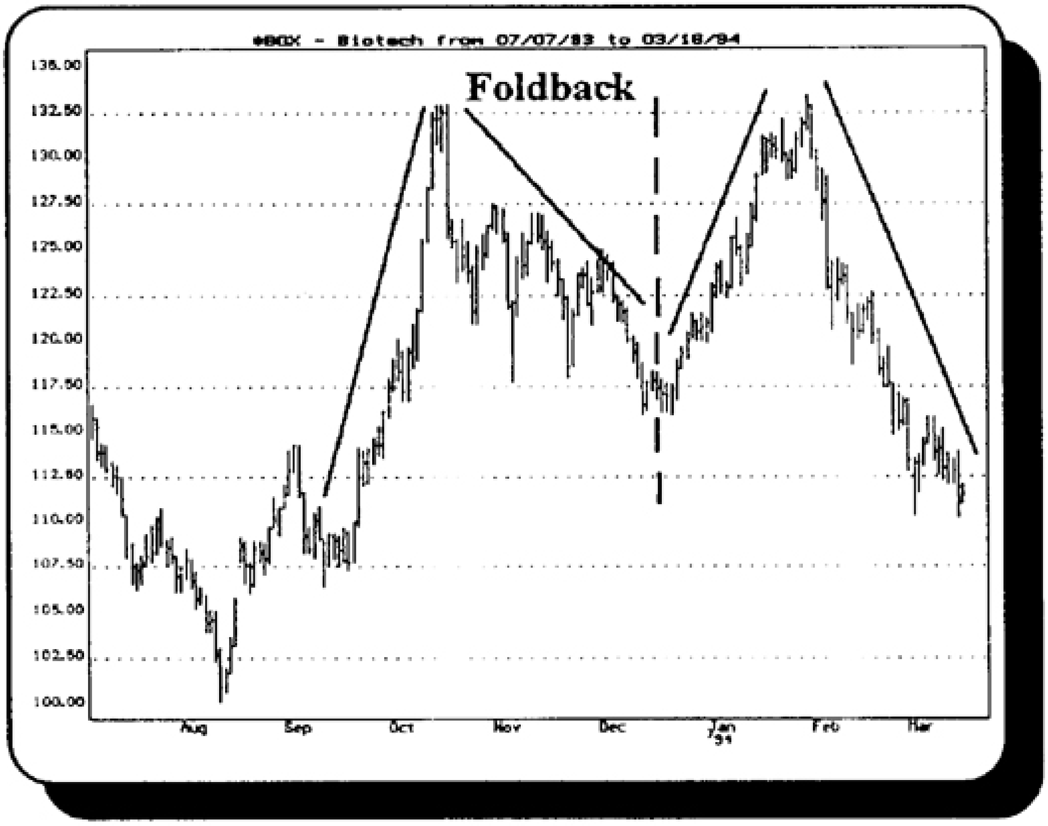
This chart of Alcoa follows a three year sideways pattern. Note the two big impulse thrusts that gave early warning before any discernible trend developed. After the last bottom, see how a tight "creeping" pattern developed showing nervousness, but this held a very angular parallel channel. This type of pattern will usually double or triple the base price within a year or so.



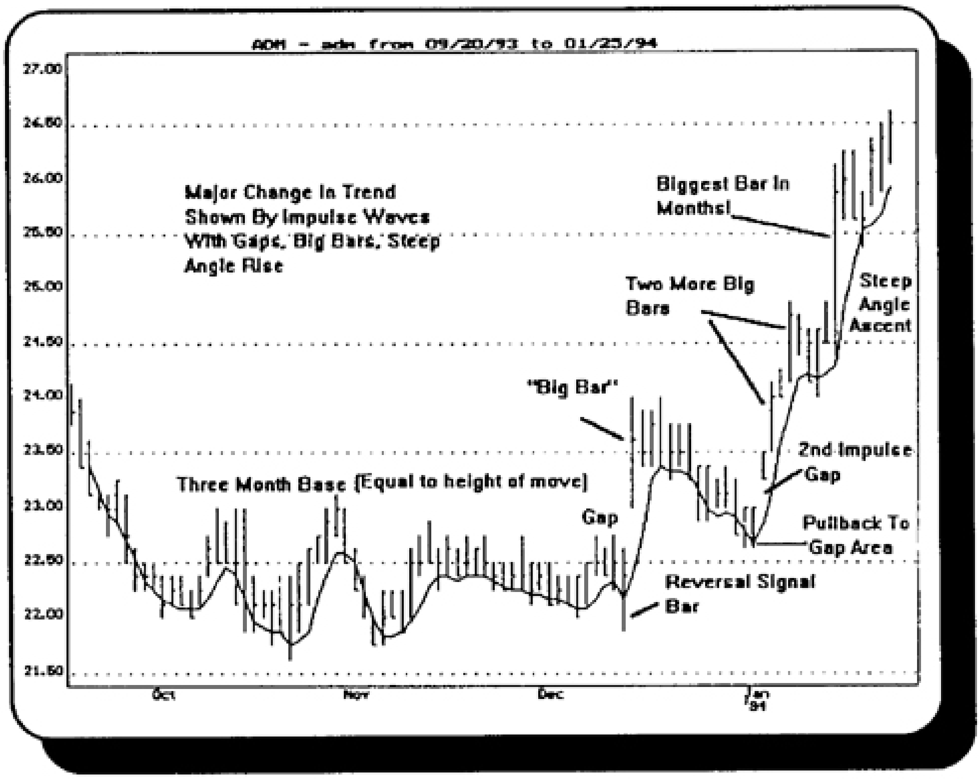
This example is the classic Bull Trend. Although very advanced in terms of the number of stair steps, it is still bullish until at least one step is broken. Even then we would know that, "You can break one step back but not two." Until we break two, the trend would generally be considered up.



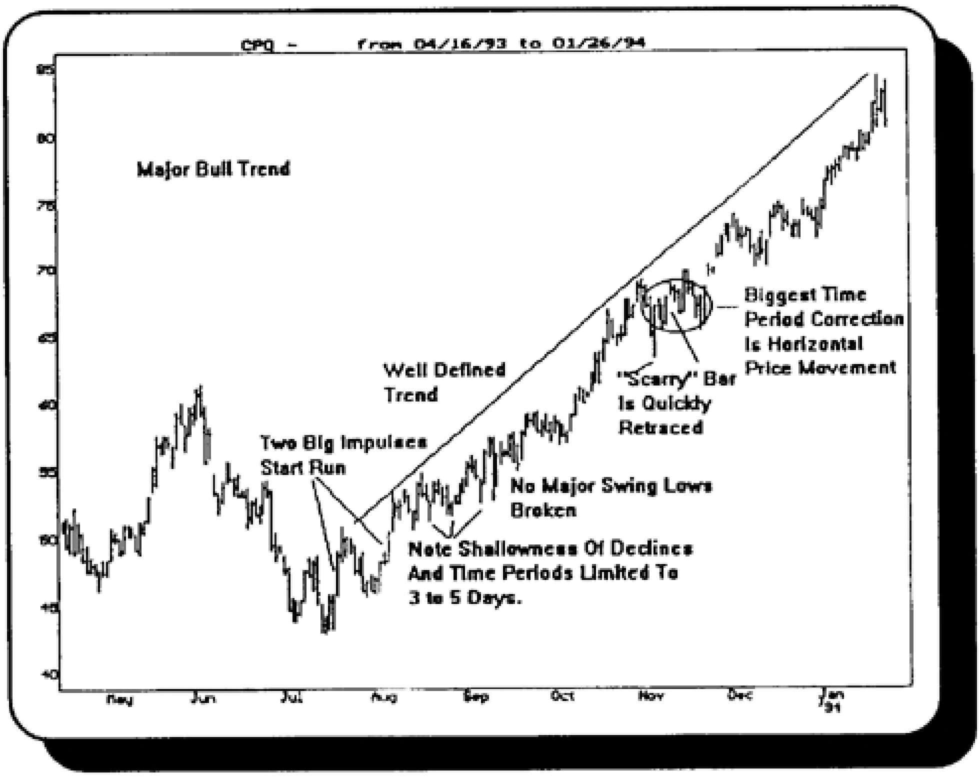
This is an obvious example of a foldback pattern. Once you see the beginnings of a very symmetrical foldback you can trade until you come to each potential foldback point. Usually if the pattern is going to fail, it will do so only at the foldback points and not in the middle of the pattern. For this reason, "long legs" are ideal for trading because of the length of time before a change can occur.



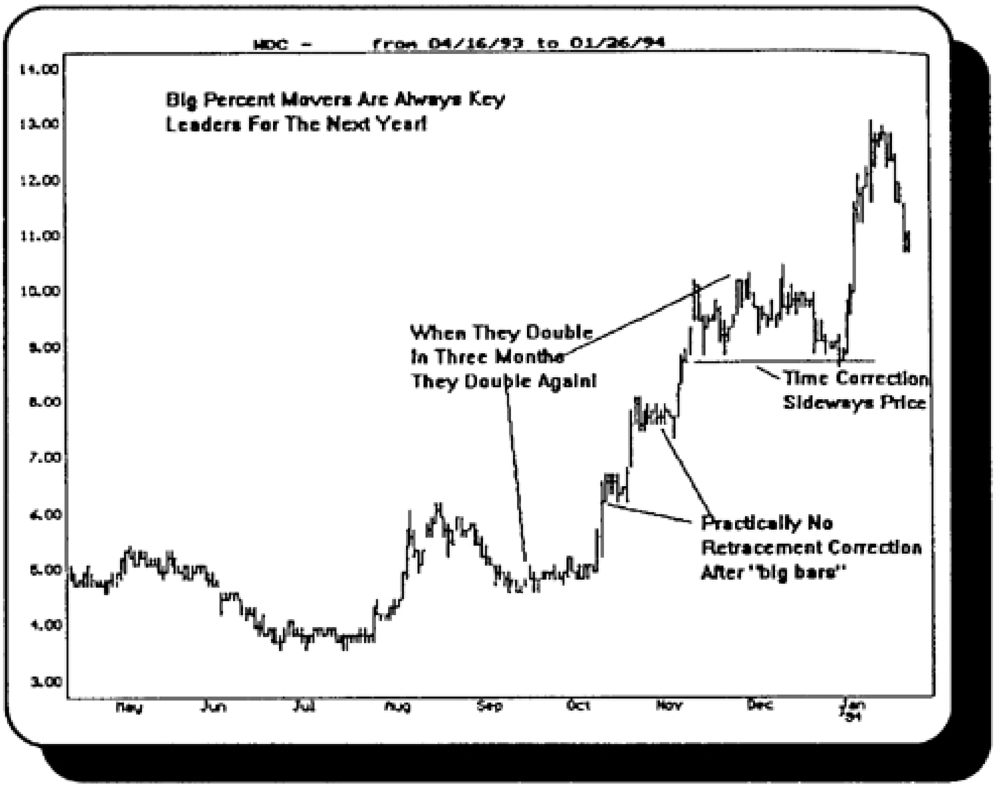
Here we see a breakout from a base starting with a I gap impulse wave. Gaps are often closed as this first one was but the second one in succession shows tremendous strength and will not likely be closed for weeks to years. Volume is not shown on this chart but this is the type of pattern you would want to see huge advancing volume to confirm a new bull move with institutional sponsorship.



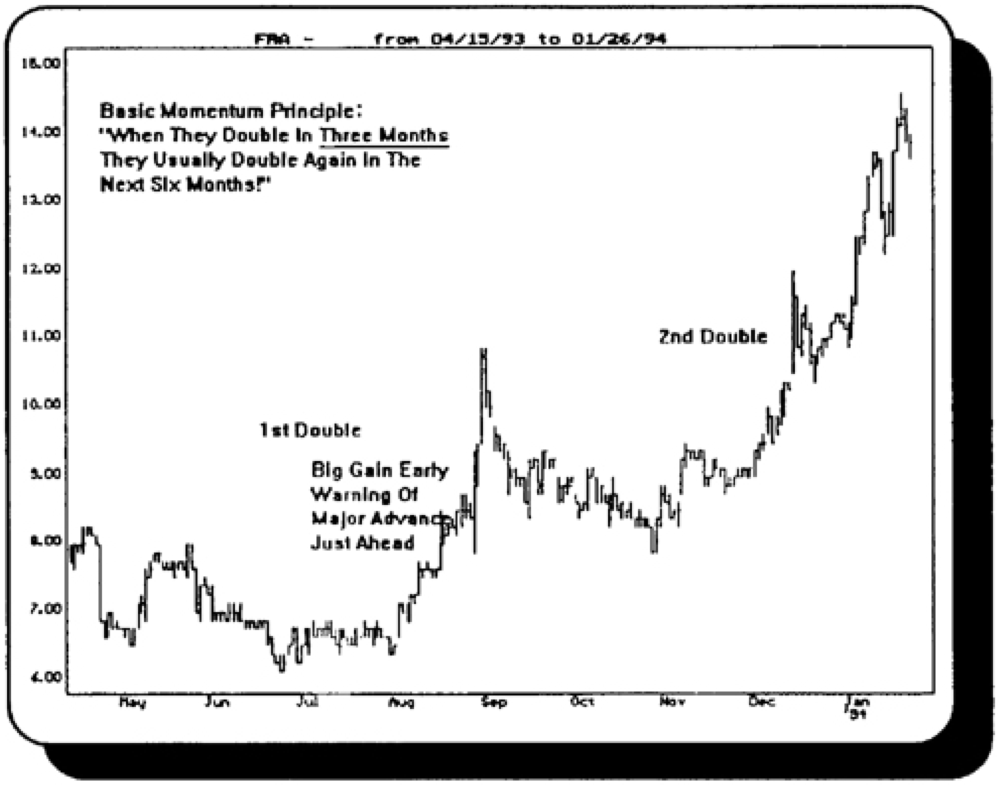
This chart of CPQ shows one of the most difficult patterns to trade -- a simple uptrend! Traders are always quick to look for tops and "extended" patterns. If you can identify this as a "fifth" wave from prior monthly charts you can make a multiple estimate of leg one or three to approximate the upside. The best approach is to look for TIME corrections such as three days or five days. When you see a larger time correction than the norm, the end could be near.



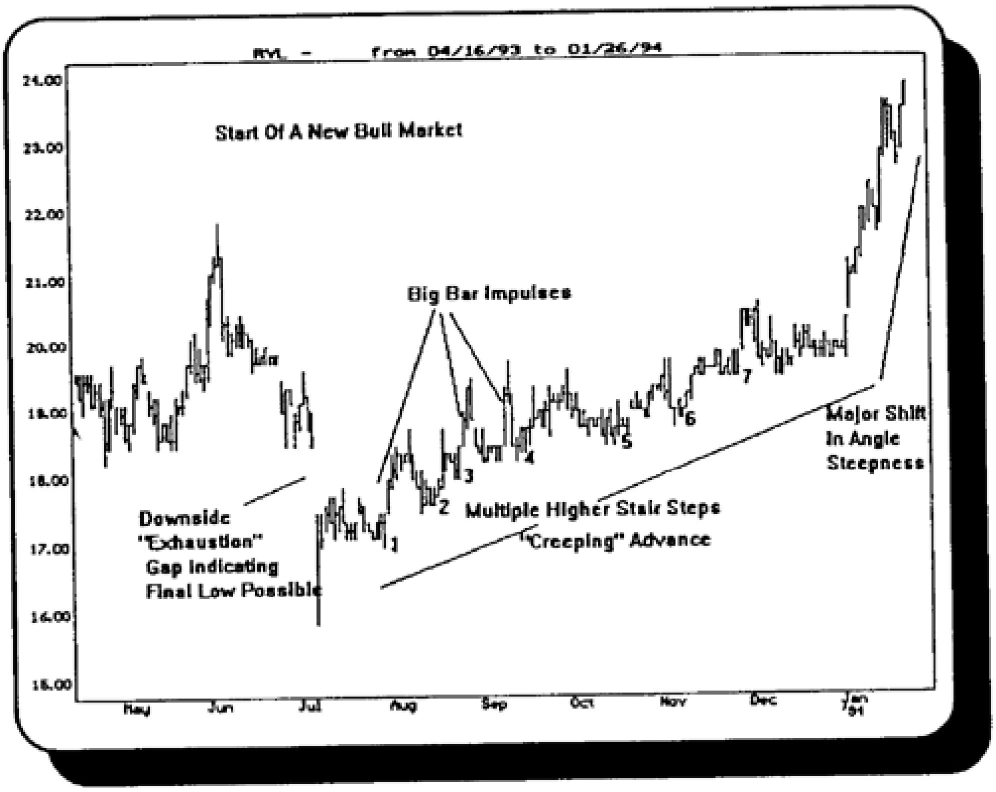
Big winners always show big momentum and most double within six months of a fundamental turn around. These situations usually go up 3 to 6 times their low prices. Volume is also necessary with these patterns to confirm institutional sponsorship, without which no big advance is ever possible.



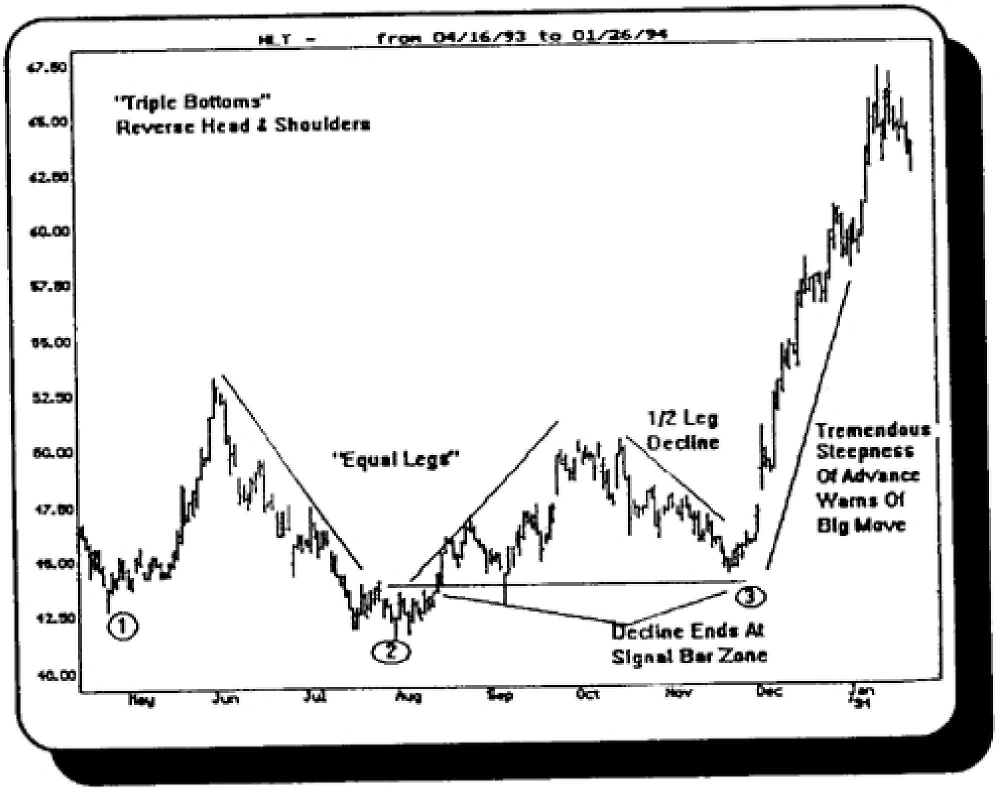
This is another big momentum play, but also note the possible mirror image foldback forming around the 1st top spike. If the low in July and August was the bottom of a many month decline, then the left foldback going towards June, May, April, etc... confirms a many month advance that the initial impulses project.



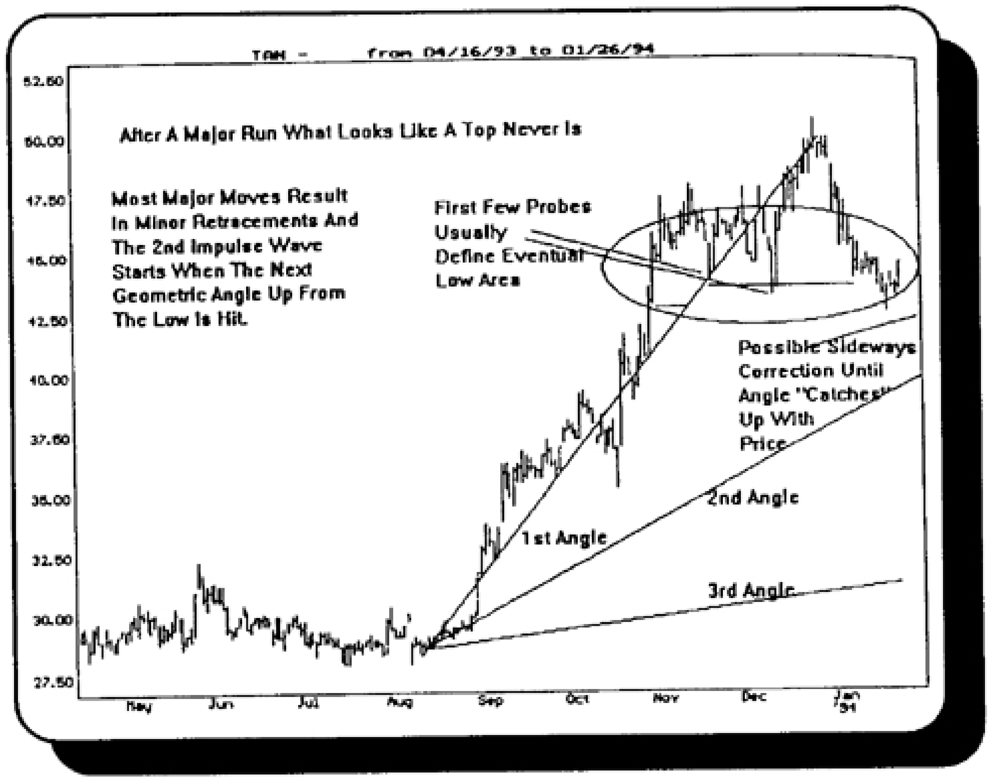
Here we have an exhaustion downside climax during the June to July period. Even though the low was made at that time and a "creeping" advance started, the basing period required had to be commensurate with the size of the break. If you measure the June high spike down to the July low and swing that sideways from July, you will see the base was equal to the decline and the uptrend could finally begin in earnest.



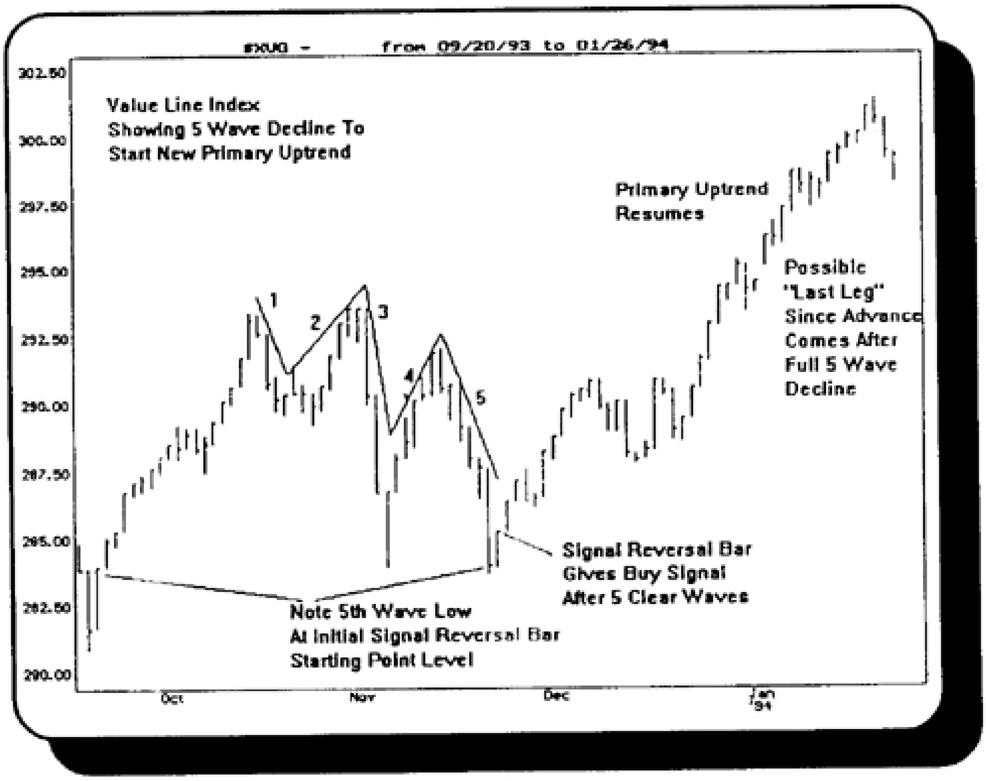
This is a typical triple bottom, reverse head and shoulders formation. The key is the secondary decline after the first impulse a following the lowest low. That decline was only half the first and it ended at the signal reversal bar buy point confirming that as a legitimate buy signal. Not shown on the drawing is a beautiful arc swung from the low at 2 up through the prior high and then down where it hits bottom at point 3 to time the up move.



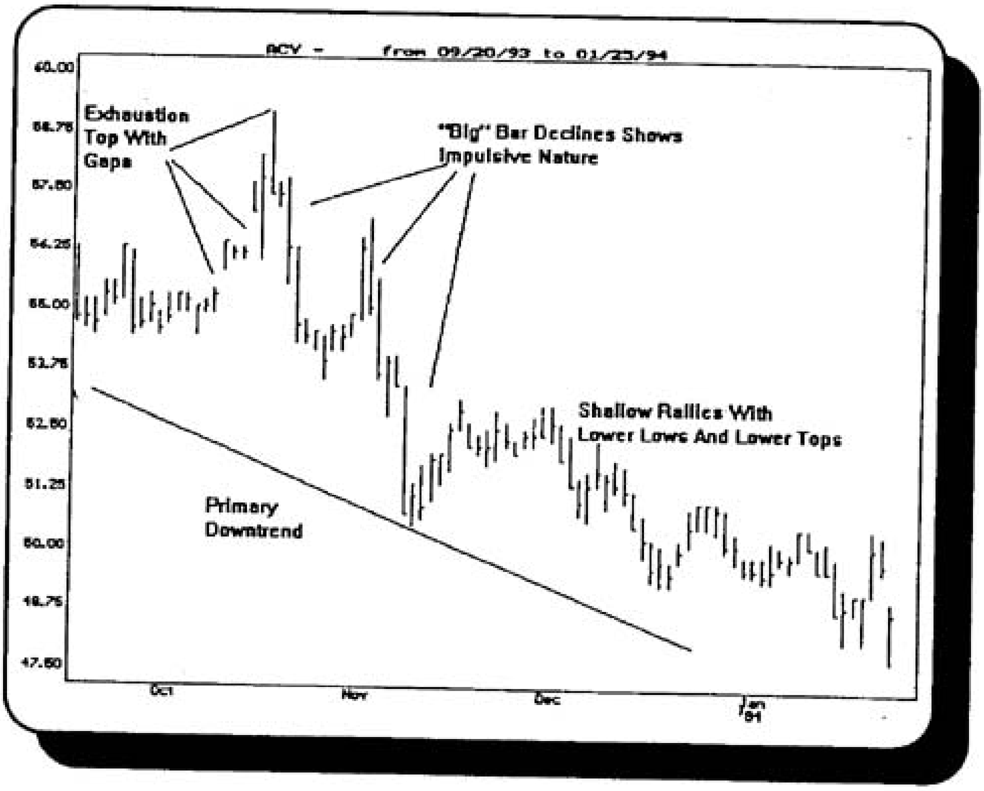
This chart of Tandy is typical of early impulse moves and usually creates an atmosphere of fear of heights. Most traders want to short such a big run up, but these rarely decline, or at lease take several weeks to months before a reasonable short is indicated. Strategy should concentrate on calculating retracements' areas to buy into dips for the next upward impulse wave.



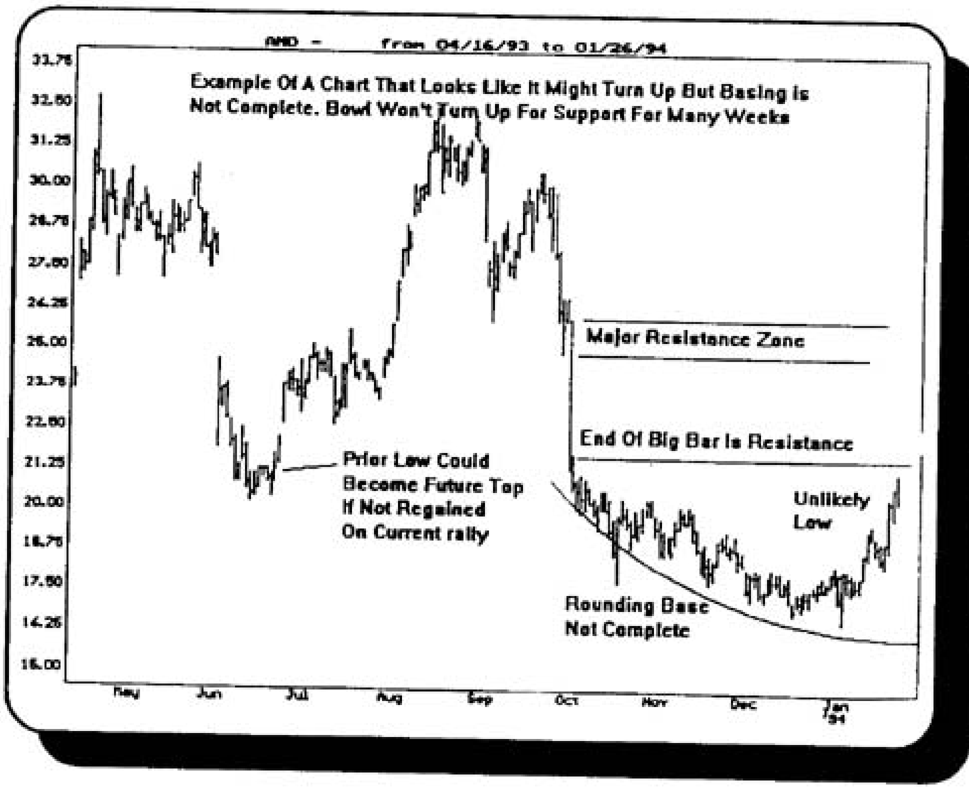
Here I have labeled a 5 wave sequence to show that the usual meaning of five waves is completion of the current trend. After 5 waves of correction, a new impulse wave starts after the 5 wave low stops at the prior signal reversal bar buy point. Note the first small top in December after the 5th wave low. At the time almost everyone was terrified of a break, but there is no such thing as 4 tops! Waves 1,3,5 are all you will get, and you must be ready to buy after the next.



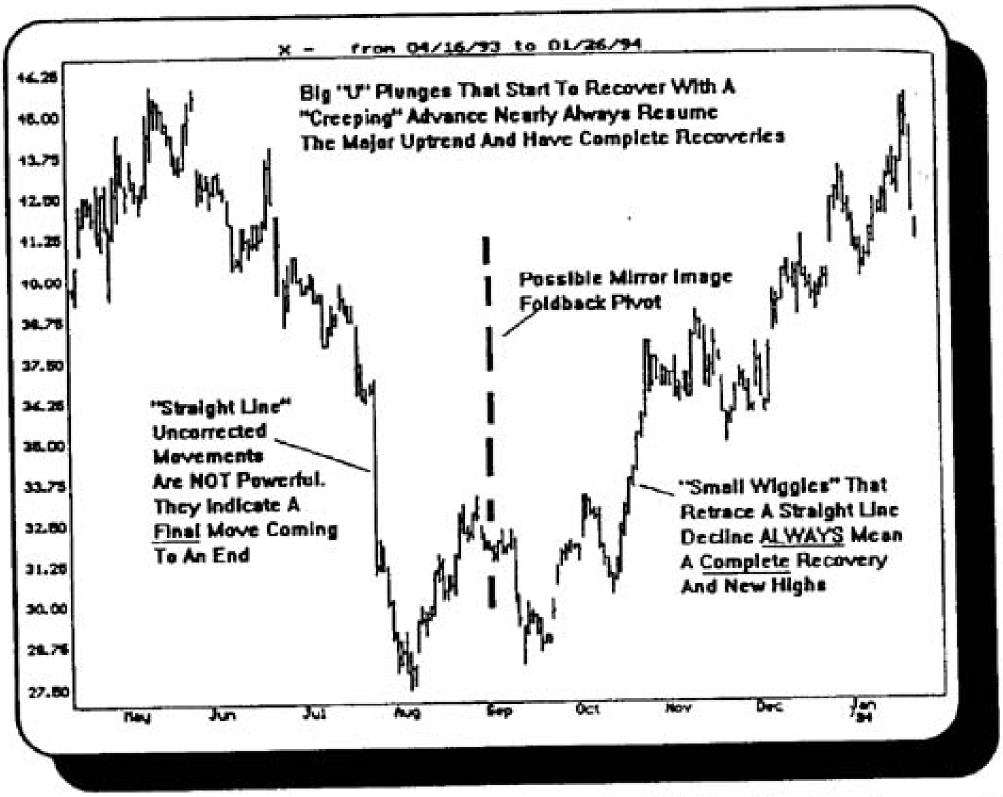
Here we see the early signs of a **reversal in trend**. A last impulse wave up with gaps is *completely erased* with big bar downward impulses. A 50% retracement is then quickly erased with more big bar liquidations. At this point we would expect at least 6 weeks to three months of price decline just ahead.



This pattern is a typical "busted chart" or one that has a sudden break of large magnitude. The momentum of such a break will last months. <u>Never</u> bottom fish in such patterns! Expect the basing pattern to last as long sideways as the downward price break vector. Busted patterns show a change in institutional thinking and can completely reverse the outlook for a stock for a long time to come.



This is a key chart to study. It shows the typical breakdown pattern often seen culminating in long bar "crashes." It is the "creeping" uptrend after the decline which should be noted. The more "wiggles" in that pattern, the more likely a complete recovery will be seen. In the vast majority of times when a complete recovery pattern is seen, the subsequent advance will go **twice** the distance from the low to the high. Or, as much as the price goes below the old high, it will subsequently go that much above the old high!



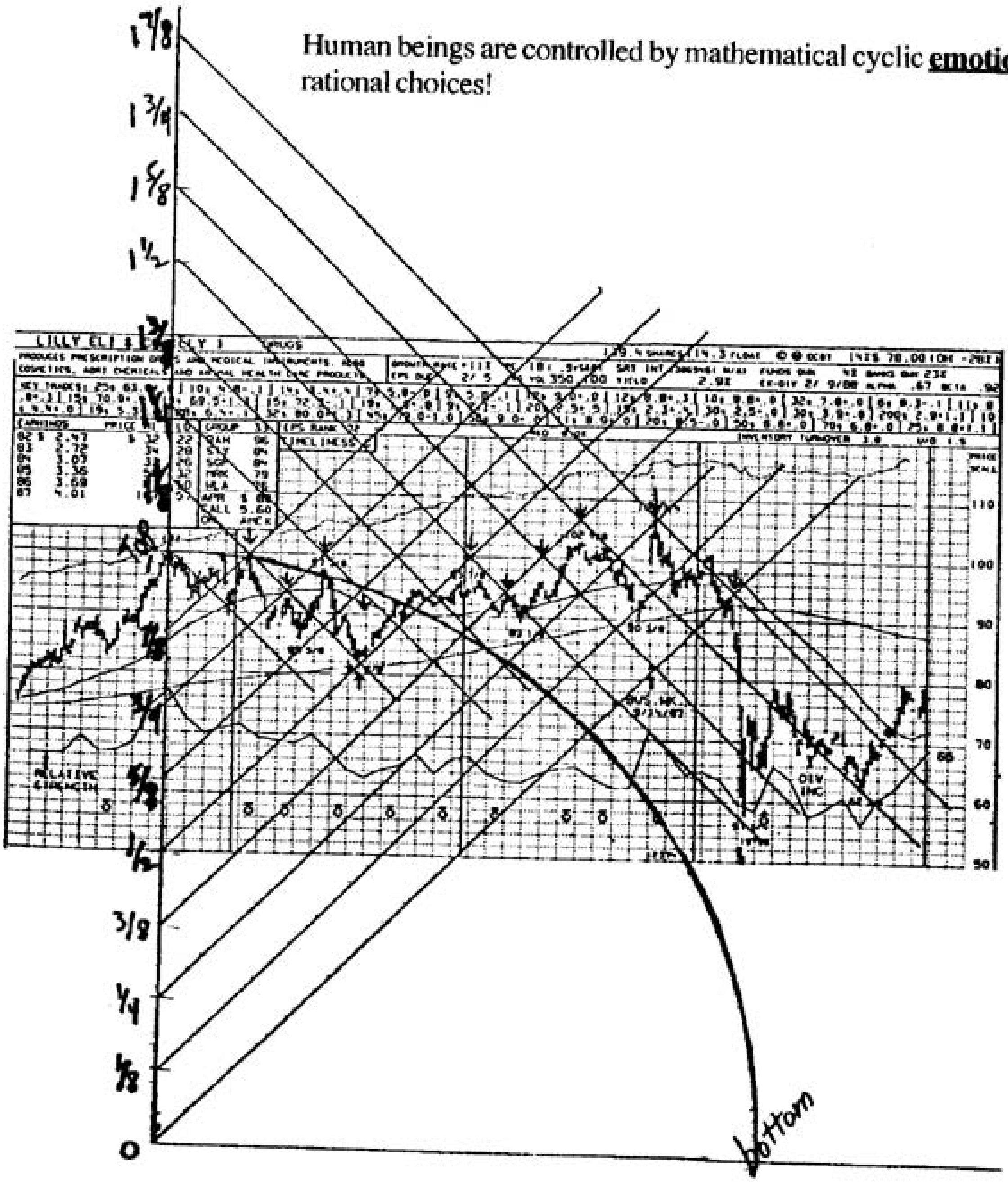
SECRET OF FRACTIONAL HARMONIC TRENDLINES

*(Gann's secret of why **Time and Price** are the **same thing!**)*

This chart clearly demonstrates better than words the helplessness of the human condition and why people lose in the markets — **Reality** is completely different from **perceptions** — i.e., news items, brokerage recommendations, etc. have no bearing on stock price movement.

See how the top near $100 spins out support and resistance angles at 1/8 increments. The intersections of these angles (down and up) give rise to **all** reversals in the price pattern and cannot possibly be related to random news or recommendations.

Human beings are controlled by mathematical cyclic **emotional** behavior — not rational choices!

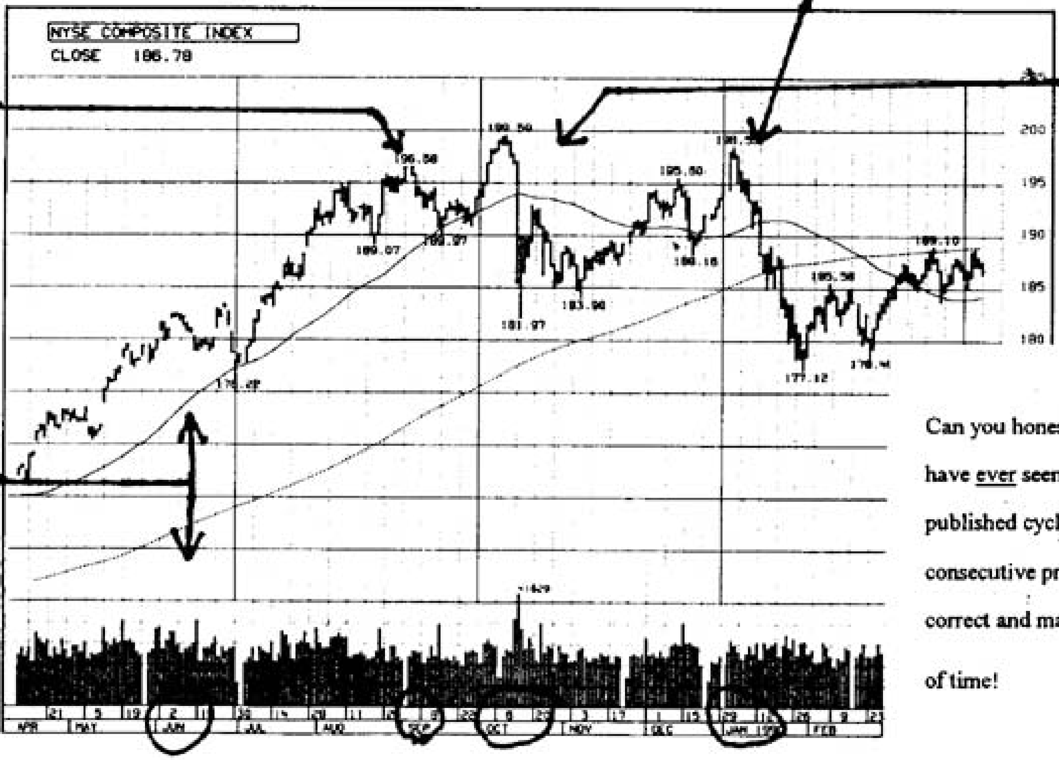


June 14, 1989

Dow 2503

As of today's date, the market has still not exceeded my resistance number of 2520 mentioned in the last report. If we exceed it in the next few days, we will probably go to 2580 for the top, otherwise the correction will start when we break 2480 and take us down to perhaps 2371, the gravity center and pivot of this year's move. The correction should take three weeks to complete. Should we start the correction from the higher level the low will be 2442. Please remember that if we are in a truly gigantic up move(2800 to 3200), we may not see a correction at all. So do not jump the gun unless we break at least 40 Dow points from any extreme high price reached.

From a cycle's perspective, I can now give you some valuable information as to the most probable outcome for the rest of the year. First, IF we get into the second week of July AND we get to or are above 2500, the odds overwhelmingly favor the FINAL TOP being made August 31, 1989, or September 5 with a price of at least 2800. Second, a crash like 1987 will again take place in October and not bottom until the second week of November. Third, another important top and the last place to get out on before the massive liquidation begins will be January 1990. This top in January could be a double top all the way back to the highs.



Can you honestly say you have ever seen such an accurate published cycle prediction? Four consecutive predictions that were 100% correct and made six months ahead of time!

Date of letter

Cyclic Top

October Crash like '87

Last Top

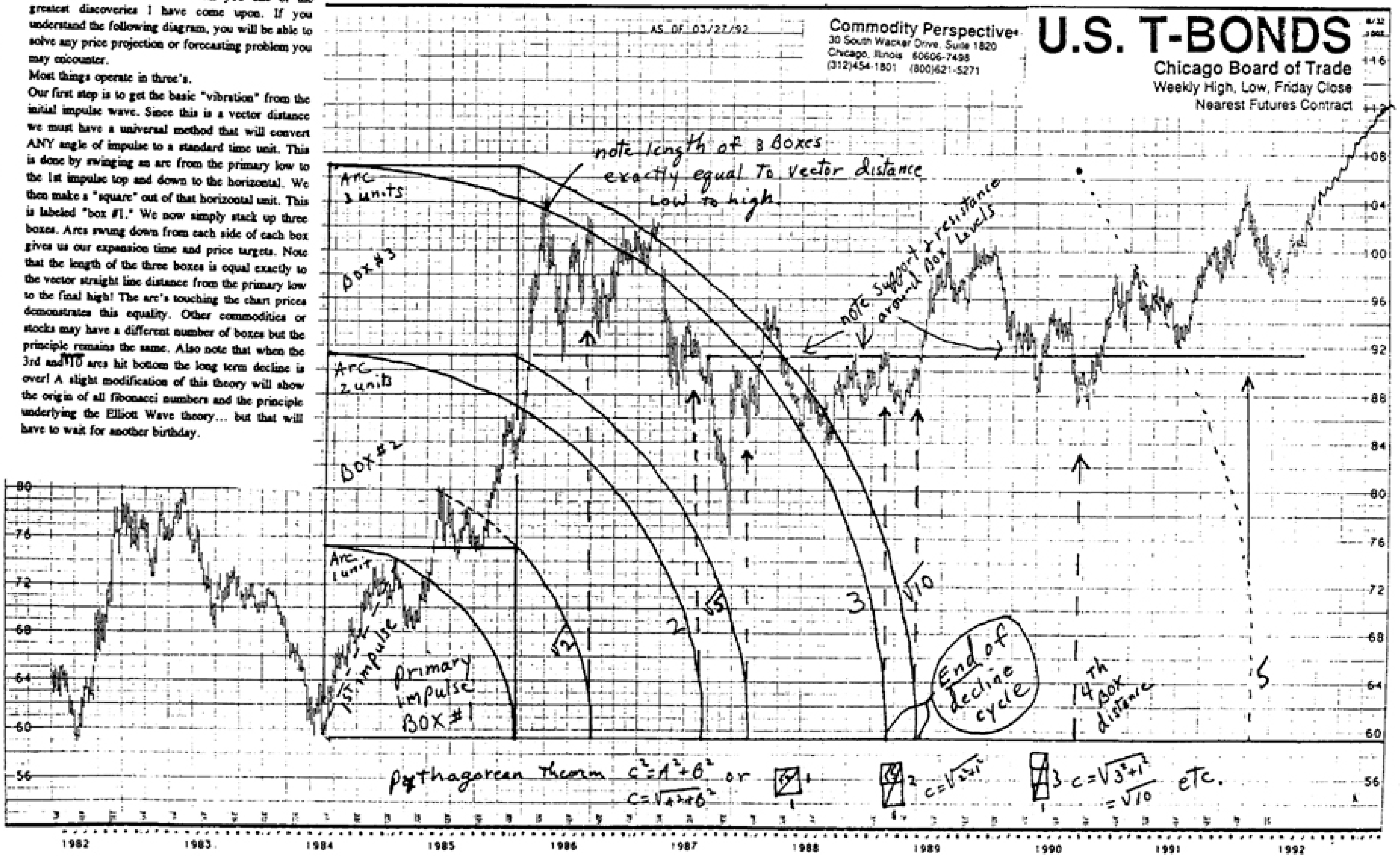
Reprinted from Mr. Jenkins' Newsletter, ***Stock Cycles Forecast***
Volume 8, Issue 15 dated March 11, 1993

Trader's Tip -"Simple Geometry"

I have been fortunate enough in my life to have been born with the special visual faculty to "see" geometric shapes in nature and thereby get a glimpse of the divine movements of WILL in action. On the occasion of my 44th birthday and the birth of my son this week, I wish to share with you one of the greatest discoveries I have come upon. If you understand the following diagram, you will be able to solve any price projection or forecasting problem you may encounter.

Most things operate in three's.

Our first step is to get the basic "vibration" from the initial impulse wave. Since this is a vector distance we must have a universal method that will convert ANY angle of impulse to a standard time unit. This is done by swinging an arc from the primary low to the 1st impulse top and down to the horizontal. We then make a "square" out of that horizontal unit. This is labeled "box #1." We now simply stack up three boxes. Arcs swung down from each side of each box gives us our expansion time and price targets. Note that the length of the three boxes is equal exactly to the vector straight line distance from the primary low to the final high! The arc's touching the chart prices demonstrates this equality. Other commodities or stocks may have a different number of boxes but the principle remains the same. Also note that when the 3rd and √10 arcs hit bottom the long term decline is over! A slight modification of this theory will show the origin of all fibonacci numbers and the principle underlying the Elliott Wave theory... but that will have to wait for another birthday.



S&P Futures Daily Tick Chart