BALANCE MAGIC

Understanding the Language of the Markets

Part 1

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BALANCE MAGIC

Before discovering ***REVERSAL MAGIC*** and like so many before me, I made a concentrated effort to be able to predict where price would go. I tried Gann, Elliott and much more, even paying nearly $3,000.00 for a course on a pattern called the Wolfe Wave. While I derived some valuable information from each, in the real scheme of things they all led to disappointments.

It was then that I went back to searching through chart after chart to find the answer for myself. What I found turned out to be something unexpected, that time could actually be determined and that knowing this gave an awesome power for trading.

Trading since then has taken a huge turn for the better and I knew that ***REVERSAL MAGIC*** was a unique advance trading tool that was more than most traders could hope for in a lifetime. Even so, when I started to teach others about ***REVERSAL MAGIC***, some still wanted a method that they could combine with it that would give a target signal for where the price would go.

So again, I went back to the charts, but this time I had the advantage of knowing how time would develop. This enabled me to see something much more clearly in the charts than I had noticed before. Like a puzzle where I had put enough pieces together to be able to know what the picture was, the key points of the markets started to come together and the subtle things that never stood out before I began to see with a whole new perspective. Like most things in life, the subtle things ended up being the most important in understanding the "puzzle" of the charts.

You see, ***BALANCE MAGIC*** is something that if you have been looking at charts for any length of time you would have had to at least subconsciously noticed, even if you could never quite put your finger on it. Perhaps this statement is giving greater credit to traders than I should, but there are many things in life I believe that we naturally see and understand. The problem is that we fool ourselves into believing that what we think we see can't be real because it is just too simple and makes too much sense and yet no one else seems to see it.

One of the greatest challenges to learning in life seems to be opening our eyes to the obvious.

Now, don't misunderstand what I am saying here. While you will indeed find parts of ***BALANCE MAGIC*** incredibly simple, it still has its complexities. The good news is that it graphically provides price target levels that are highly reliable and particularly if you are an option trader will you really appreciate how great this method is. I have never before considered trading options, but this method has started me to think seriously about it.

What exactly is ***BALANCE MAGIC***? ***BALANCE MAGIC*** is the use of balance points which are in turn, central points that balance out the markets movement. It is quite different than pivot points, balance lines, or even balancing your checkbook, which with some takes real magic (that's a joke, in case you didn't know).

To explain what ***BALANCE MAGIC*** points are, as a market makes its swings back and forth through a chart, there is a point of balance or equilibrium that exhibits itself though each swing or trend. Often it has a characteristically contrary wave where the market temporarily seems undecided as to which direction it should go. This equilibrium not only tells us how far the current trend is going, but even indicates where its next destination point will be on the next trend.

In case you missed the significance of this last statement, ***BALANCE MAGIC*** points are used to predict the destination points of two separate moves. First, The destination of the **CURRENT TREND'S MOVE** and second, the destination of the **NEXT TREND'S MOVE**. If that sounds like a very exciting prospect, being able to predict these destinations so far in advance, it is!

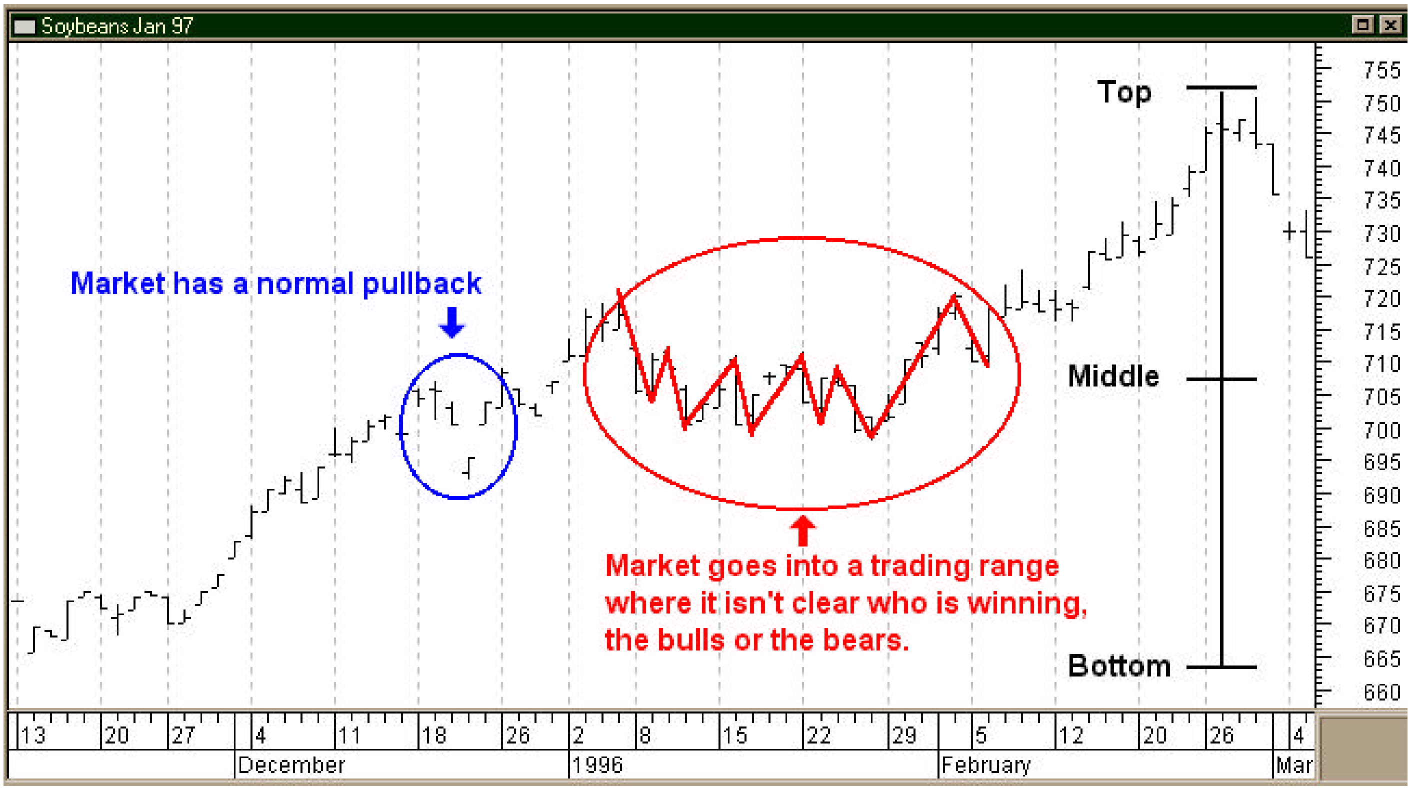
So, what’s the catch? The catch is that it doesn't work 100% of the time and it takes a developed skill. Don't let this scare you, because it does work with an amazing accuracy and the skill still follows the rule of the more you use it, the better you become at it.

Even if you are not able to master this, I am confident that anyone who studies these techniques will at minimum come away with a better understanding of the symmetry of the markets and their trading will be much more enhanced.

First, we will look at ***BALANCE MAGIC*** points as they relate to the destination of the current trend and later at the following trend.

Earlier, we considered pauses that occur during a trend. Trends, once in motion, are more likely to continue then change directions. But along the way, pauses in the market do occur to enable the market to catch its breath so to speak. Certain types of these pauses have more meaning than others and their characteristics reveal that they are much more than a temporary hesitation of the trend. What are these characteristics?

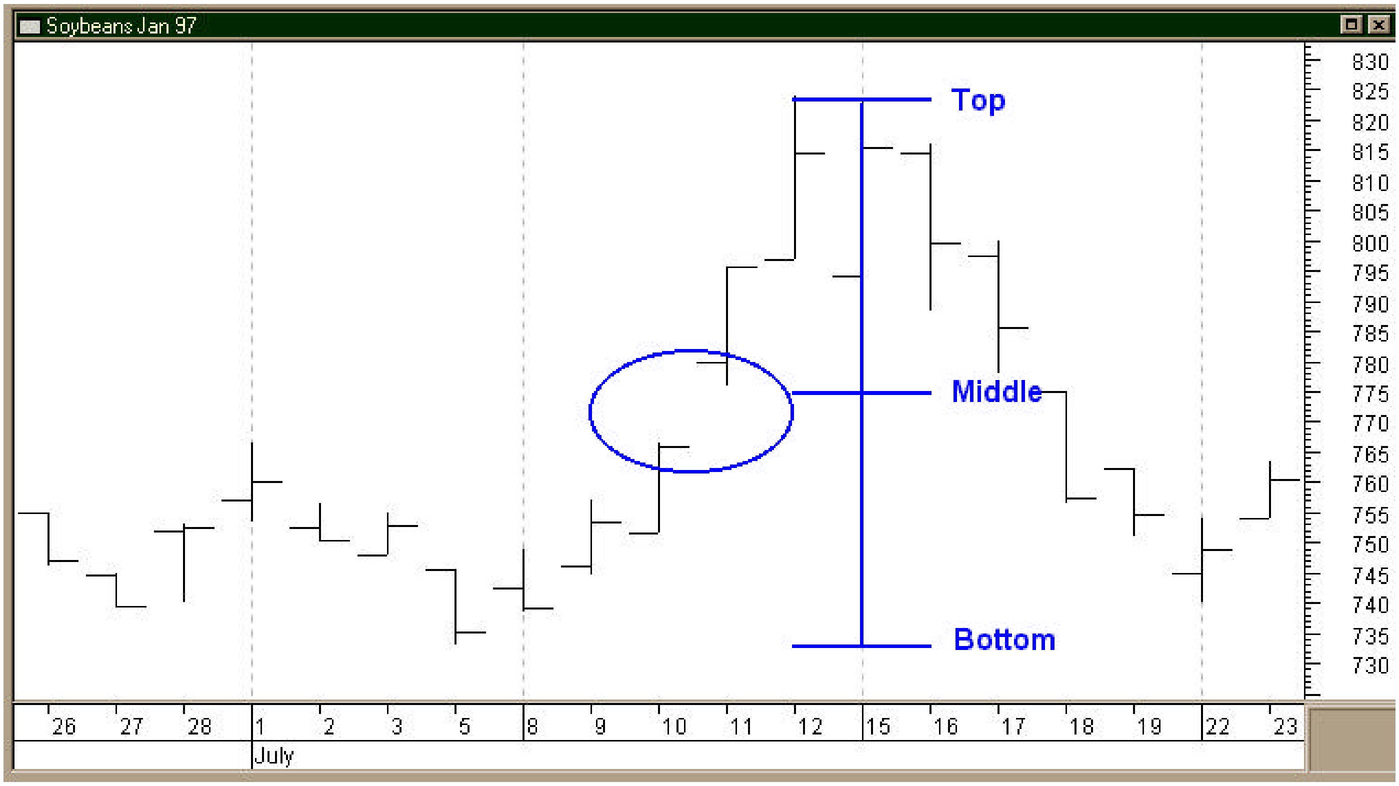
Figure 1



In these examples, the ***BALANCE MAGIC*** point has a distinct characteristic of a contrary wave (one that goes against the trend) that focuses itself around a central area. It's like a kid that has grasped onto a rope hanging from a tree and swung out above a lake and is afraid to let go. He swings back in, then out one more time before he finally gets enough courage to let go. So the ***BALANCE MAGIC*** point seems to hold the market temporarily like a magnet until it develops enough momentum to launch itself free again.

Another characteristic that a ***BALANCE MAGIC*** point can exhibit itself is in the form of a gap. Many who use technical analysis are familiar with the continuation gap found quite often in the middle of major trends. It is usually found right smack in the very center of entire trend, at the halfway point. A gap is a central point of a wave that is much like a picket fence. It sits in the middle of two properties, but you can't straddle it. You are either on one side or the other. So it is no surprising that a ***BALANCE MAGIC*** point will at time exhibit itself this way.

Figure 2



So now that we have a basic idea of what the characteristics of a ***BALANCE MAGIC*** point are, how do we use it?

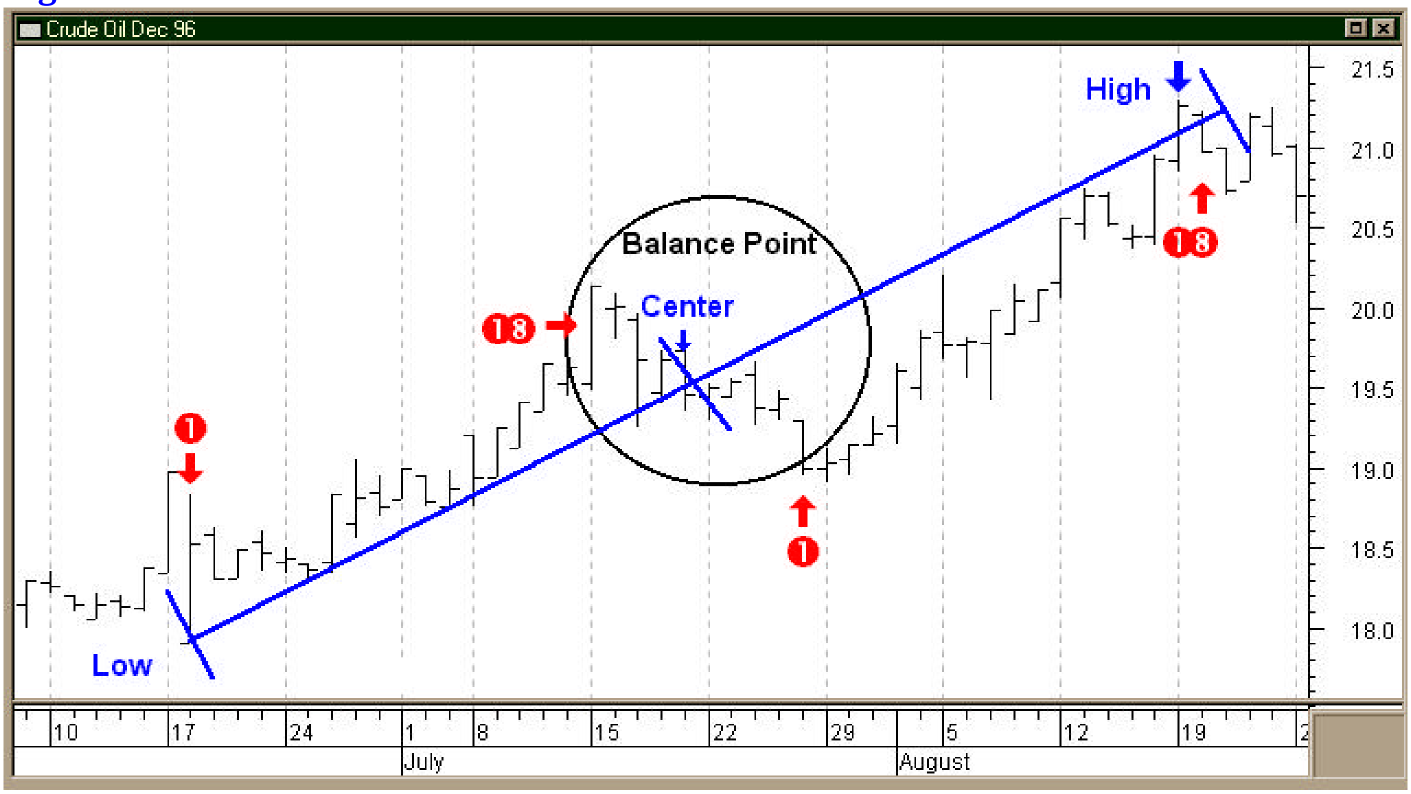
A ***BALANCE MAGIC*** point is aptly named because it is a balance or central point of the entire range. Another words, the center of the entire trend. While there are some qualifying factors that still relate to the accuracy, once you reach the ***BALANCE MAGIC*** point, you are half way through the trend. What that means is that you can calculate how far is left in the current move by simply doubling your distance.

Notice that I said there are some qualifying factors. What does that mean? Unlike ***REVERSAL MAGIC*** that is based on time, ***BALANCE MAGIC*** points relate to price and price movements. Because cycles or waves are not circular, but tend to be elliptical in nature, the price movement is skewed. Another words, it doesn't travel in a straight line from our perspective as it relates to a chart, but appears distorted.

So what that means is that a ***BALANCE MAGIC*** point may not appear centrally located from our perspective, but it still is from a price movement perspective.

Complicating this even more is the fact that there are also times (although rare) when the ***BALANCE MAGIC*** point is truly not centrally located within a trend from any perspective due to the fact that time and price are out of sync with one another. Right now though, lets just focus in on how the ***BALANCE MAGIC*** point is centrally located and how to use this to your advantage.

Figure 3

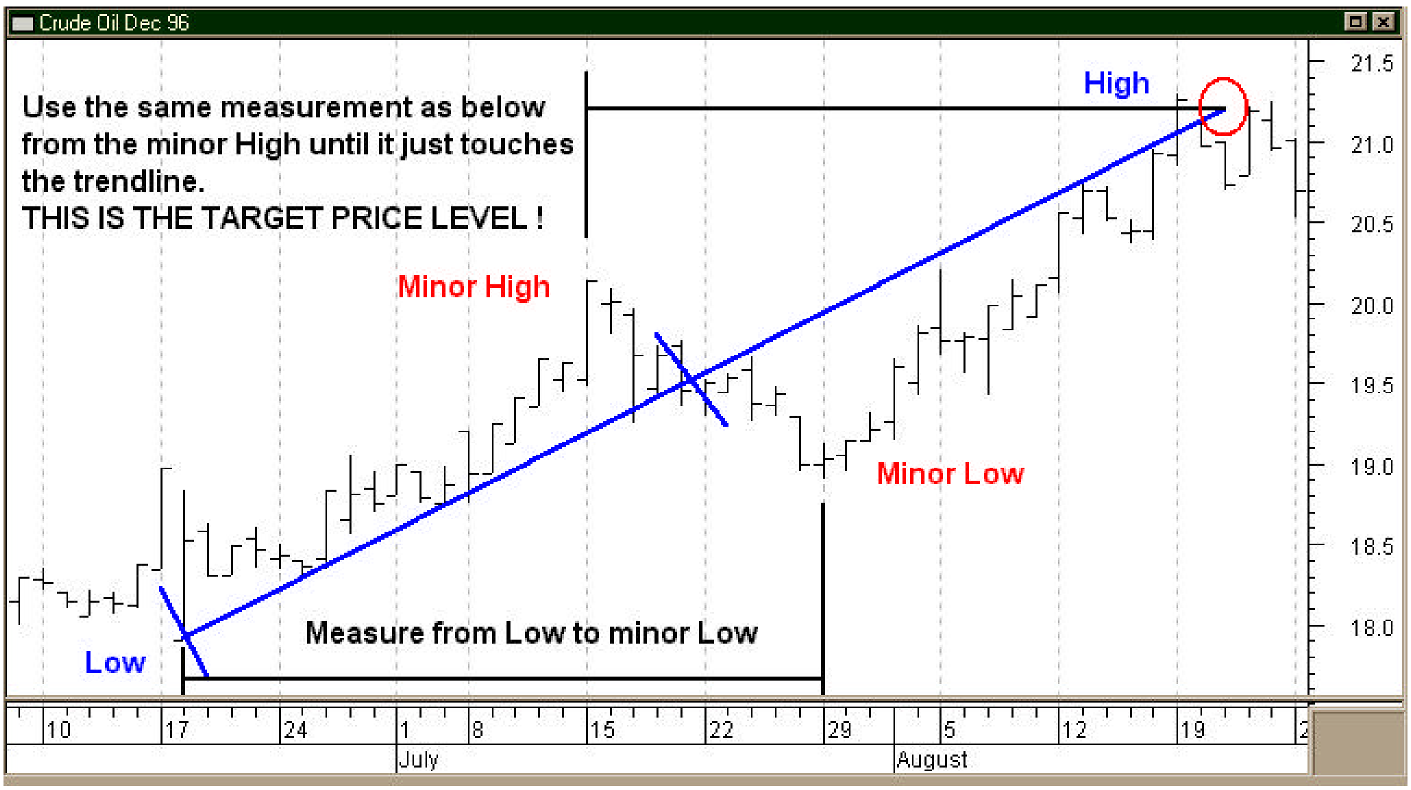


In the preceding chart, we have two ways that we can look at the ***BALANCE MAGIC*** point. The first procedure is to from a measurement standpoint. By actually taking a ruler and measuring to the ***BALANCE MAGIC*** point (The blue line from the Low point until the Center point) and extending this same line at the very same angle until you reach the same measured distance on the other side of the ***BALANCE MAGIC*** point (The blue line from the Center point to the High), you have the natural destination point where price should go.

The second method is by a price bar count (Actually counting the price bars to the center of the ***BALANCE MAGIC*** point gives us the count of bars to the end of the trend). He can also use the first and last bar of the ***BALANCE MAGIC*** point to make it easier even though the center point is more accurate. (Red number 1 to red number 18 and again red number 1 to red number 18 counts out 18 bars on each side)

From this you can see why I stated earlier that pauses could be such an excellent profit opportunity. You have a gauge that will tell you how far the trend is likely to continue. However, this chart is not always typical. Remember that I said that price tends to be skewed. That means that the measurement technique is not always accurate. To put the trend in its proper view, you will have to realign that perspective. How do you do that? By measuring its box. A box measurement allows you to correct the perspective. Here is how it works.

Figure 4



By breaking down each side of the ***BALANCE MAGIC*** point, it allows us to gain a proper perspective on the other side of the ***BALANCE MAGIC*** point. We can then set a price level that we expect our price bars to reach and of course, a target for exit. As in this case, you will find that this target price level often comes extremely close to the actual high (or low if in a down market)

Another method to realign our perspective is the count method. By counting the bars to the mid point, we are given a number of bars to the end. While this method can often be accurate, it has some inherent limitations and isn't one that I would advise except to use it for confirmation.

This is not to say that it can't be used effectively. It's just you have to compensate for an distortions mathematically and this would require formulas that would complex the process as opposed to doing this graphically where it remains simple and where the process is more easily understood.

While this method is not perfect and there are times that it fails, it has a remarkable high percentage of success. I look at it as another tool that adds to my ability to forecast the market. One fact about ***BALANCE MAGIC*** points that you want to remember is that whenever you measure out to a top and the market just pulls back with the trend continuing, then the pullback itself often shows up as another ***BALANCE MAGIC*** point for a larger trend and a gauge for the next top.

Following the same line of thought, if you have a trend that has not as of yet had a ***BALANCE MAGIC*** point, it is unlikely that when it does stop that it's trend has reached a top (or bottom) but rather just a ***BALANCE MAGIC*** point. In such a case, expect the trend to continue. It is normal for every trend, no matter how small, to have a ***BALANCE MAGIC*** point.

When ***BALANCE MAGIC*** fails, there is usually a specific reason for it. This lends itself to the possibility of removing them from affecting your trading all together. Of course, we first have to understand the reasons for these failures, so let's examine a few.

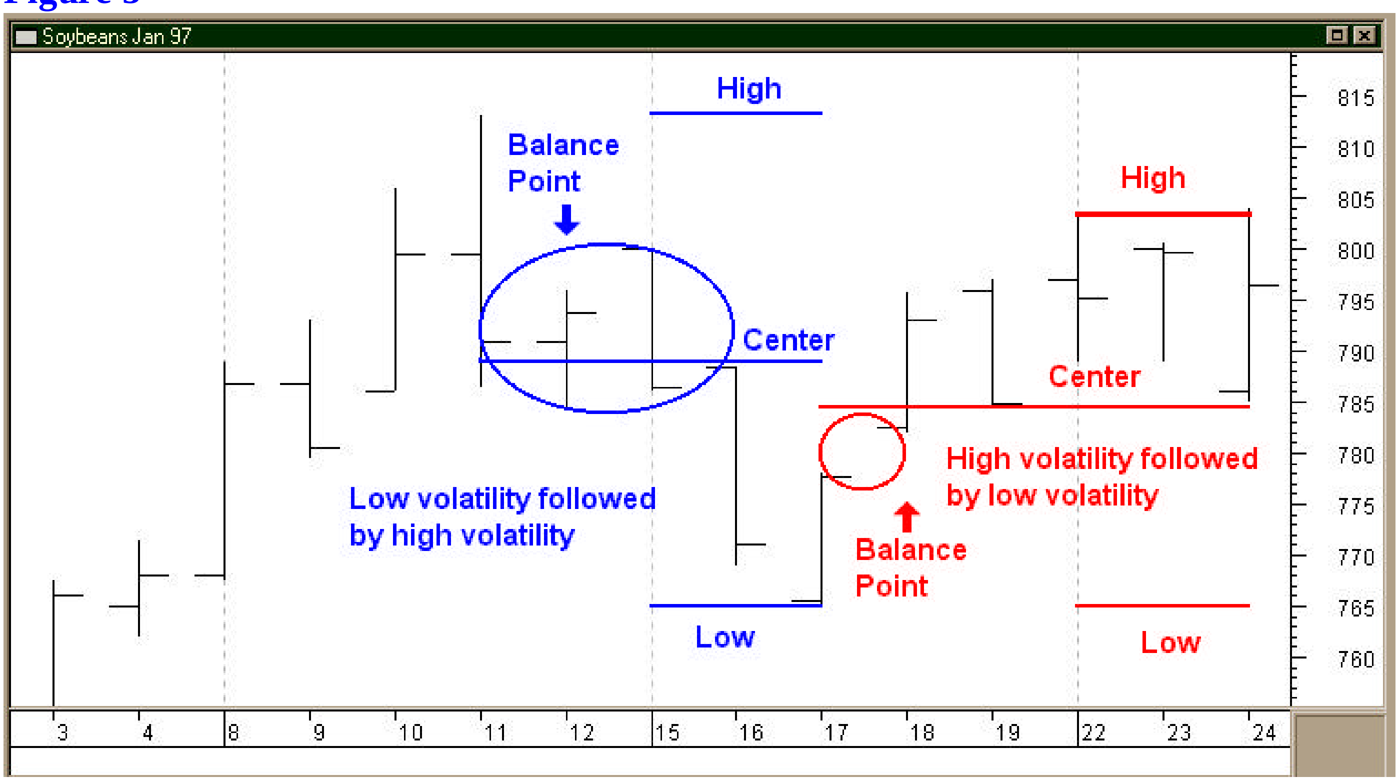
One example of a failure is what I call the "90 degree move". After moving in a trend and reaching a pause in the market, rather then continue the trend in a bullish or bearish direction, the market travels in a sideways pattern the approximate length of the first leg measurement. After which, the market resumes its trend again and moves twice the length as the first move, or at times twice the move as the length of the trend and sideways moves put together.

The reason? Basically, the sideways move ended up being the complete pause or ***BALANCE MAGIC*** point. In such a case, you would also have seen a ***BALANCE MAGIC*** point in the first leg of the trend and have expected the up trend (or down trend) to end anyway, so this is not really a failure except for determining the next trends destination point (as referred to earlier, but not covered in detail yet) Any time you see an extended pause between an up-trend and downtrend, pay particular attention to it, because you are looking at an extended move that offers a great profit opportunity for an option trader. The extended pause brings the pricing of options down because of its low volatility. But as soon as the trend resumes it results in an extended move that is very profitable.

One failure that is frequent enough to cause occasional frustration is the distorted ***BALANCE MAGIC*** point. What I mean by this is that the ***BALANCE MAGIC*** point is not centrally located in the trend. It either comes early or late in the trend and in such a case will throw you off as to how far a trend will travel and of course, when to exit. Distortions can occur for a number of reasons. One reason is because time and price fall out of sync. Followers of Gann's theories often use this expression and this is one area where I have some agreement with Gann. Sometimes price moves too fast and it simply has to pause and wait for time to catch up. Realistically, it is simply that buyers or sellers in the market have trouble accepting a new price level that has come about suddenly over a panic and it takes a little time before they are willing to trade again.

However, the biggest reason you will have for distortions has to do with changes in volatility. Volatility will often go through cycles from a very mild state to a wildly erratic one. If volatility cycles from one extreme to the other within a single trend, then naturally you will have a distortion of the ***BALANCE MAGIC*** point. In most cases you will not have volatility go from one extreme to the other, but it will quite frequently vary at least some as it progresses through a trend. In such cases, a distortion of the ***BALANCE MAGIC*** point placement in the trend can vary from extreme to totally unnoticeable. Since changes in volatility is the biggest culprit in when it comes to a distorted ***BALANCE MAGIC*** point, I want to take a little time to address how to deal with this.

Figure 5



In figure 5 we see two examples of how volatility can throw the ***BALANCE MAGIC*** point off of center. In the blue example, the trend starts with a low volatility and increases in the final half of the trend. Normally, the pullback that is our ***BALANCE MAGIC*** point would have the center of the trend at its mid-point. However, in this case the center of the trend ends up at the lower third of the pullback. In such a case, if you did not take the change in volatility into consideration you would have exited early and not profited as much.

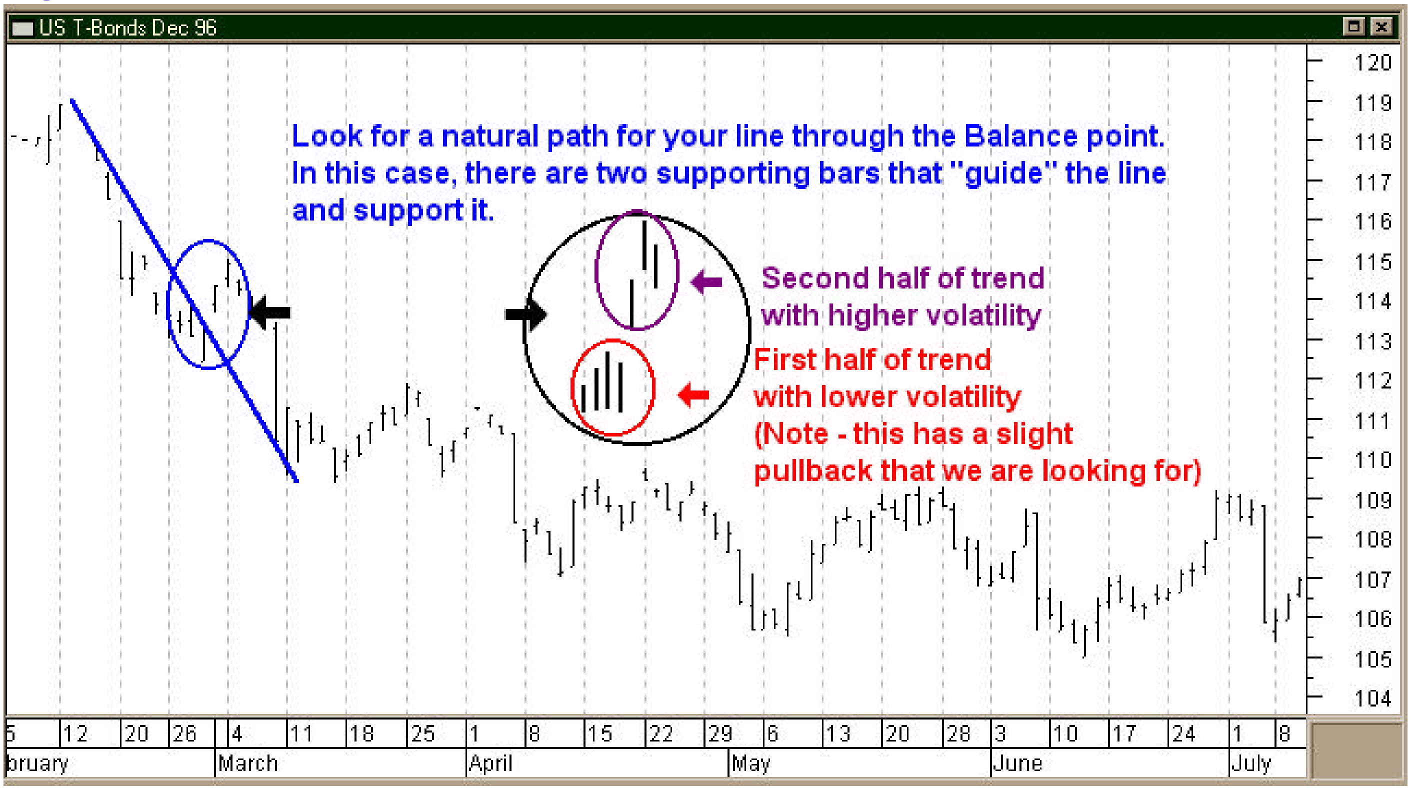
In our red example we have an opposite situation where volatility starts higher and then has a reduction before the trend is over. Again, we have the center of the trend appear to be earlier than it really is causing a trader to exit early.

Neither of these would you have been faced with a possible loss, but there are cases where the center appears to be later than it actually is in the trend and you could fail to exit in time before the market changes direction, possibly causing some loss. Fortunately, most distortions will show up in with the center of the trend appearing earlier than it really is, resulting in only a mildly premature exit. So in most cases it will not be a real worry when trading. But it certainly is the better part of discretion to take changes in volatility into consideration when using this method. Looking back at figure 5, you can easily see the difference in volatility (particularly when looking at the red example) as it develops. This difference is not an uncommon occurrence in most markets, so take note and be aware that it will throw off your center at least a little.

These so-called failures or distortions are simply changes in market symmetry that require adjustments in order to use them properly in the current trend. While they may make the current trend challenging, they often prove essential in understanding the development of the following trend. I find that patterns that leave some doubt are best traded conservatively using **Channel Surfing** to lock in my profits as soon as there seems to be any questionable development. Sometimes, it is even best to just sit on the sidelines until the next trend develops.

Because ***BALANCE MAGIC*** points are central points of waves, their uses are not limited to current trends. Waves continue to flow for some time until they dissipate. Therefore, ***BALANCE MAGIC*** points are the central points of another extension that goes beyond the current trend and into the next. Looking back and extending to the previous high or low prior to the current trend, the ***BALANCE MAGIC*** point becomes a central point to this extended wave. What this means is that if you take that high or low and draw a line through the ***BALANCE MAGIC*** point, you will come to the natural destination of the wave. It is simply a matter of determining the distance from this high or low to the ***BALANCE MAGIC*** point and you can determine this destination with amazing accuracy.

Figure 6



US T-Bonds Dec 96
Look for a natural path for your line through the Balance point.
In this case, there are two supporting bars that "guide" the line
and support it.
Second half of trend
with higher volatility
First half of trend
with lower volatility
(Note - this has a slight
pullback that we are looking for)
120
119
118
117
116
115
114
113
112
111
110
109
108
107
106
105
104
5
12
20
26
4
11
18
25
1
8
15
22
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6
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20
28
3
10
17
24
1
8
bruary
March
April
May
June
July

Figure 7

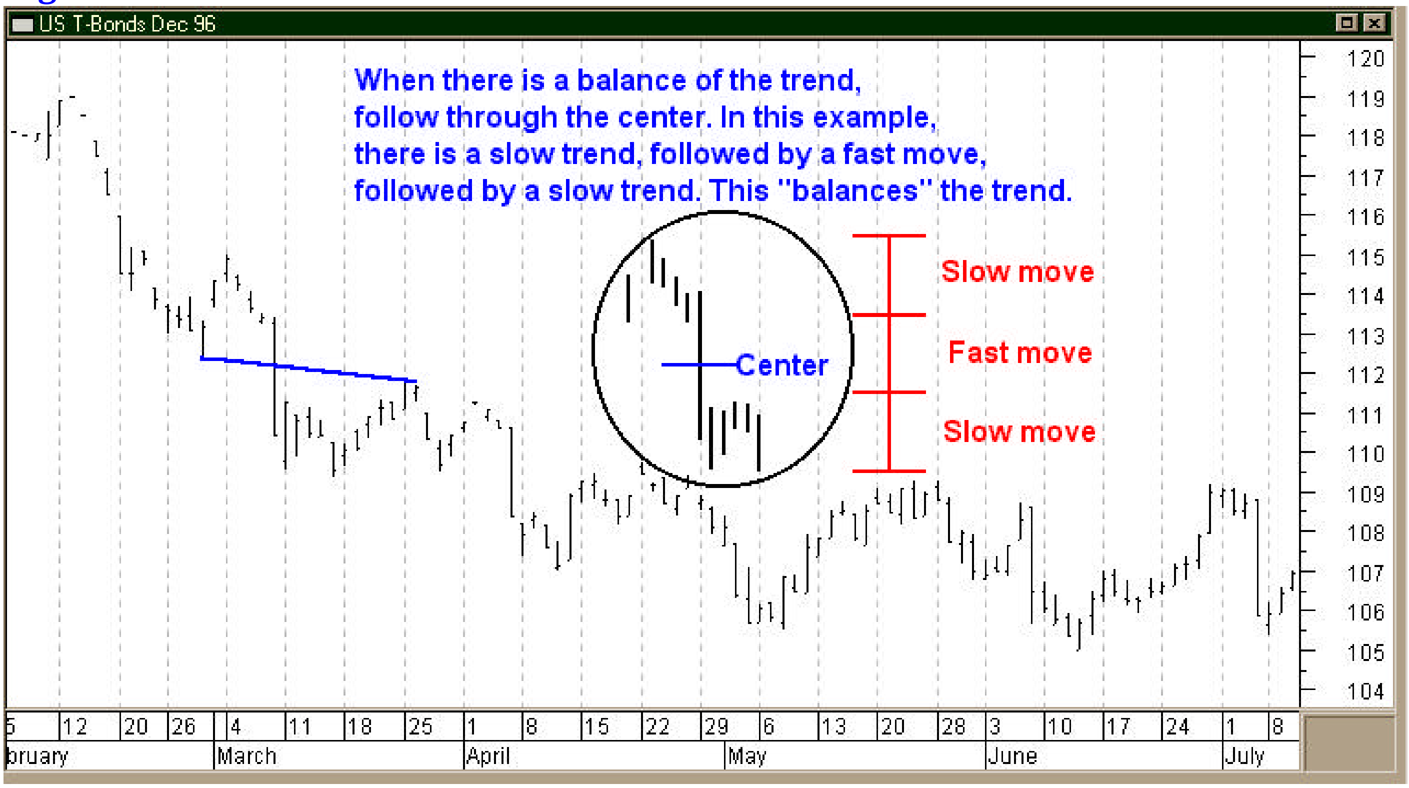


Figure 8

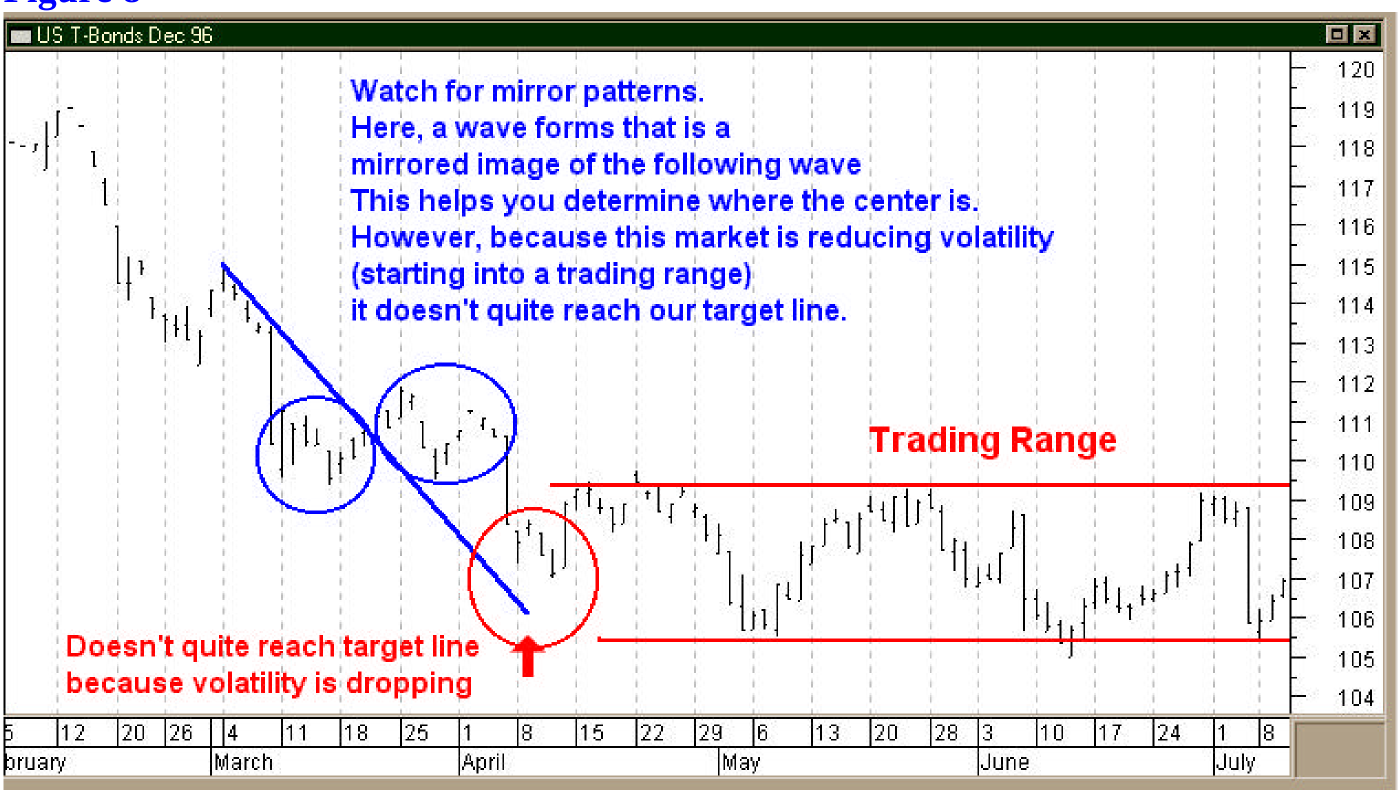


Figure 9

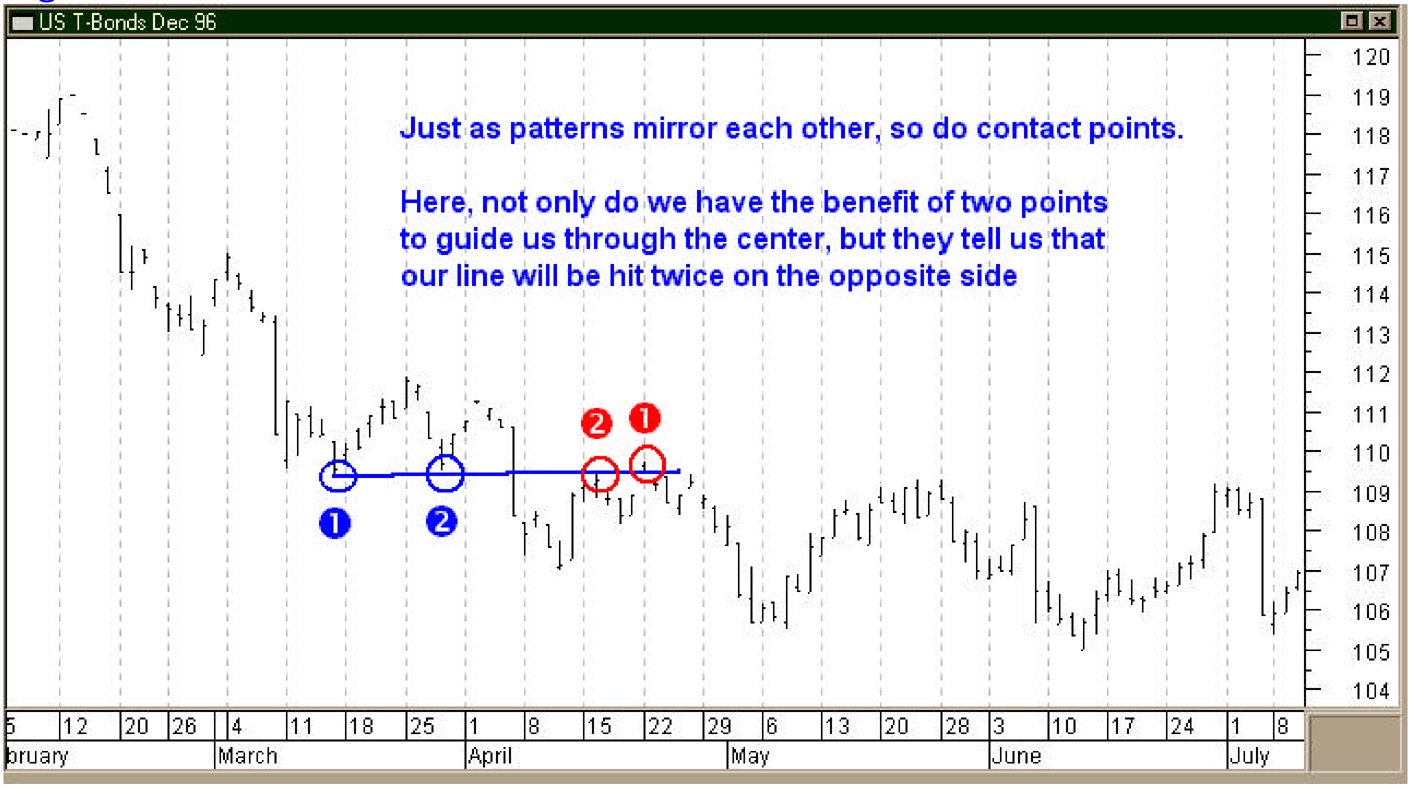


Figure 10

Figure 11

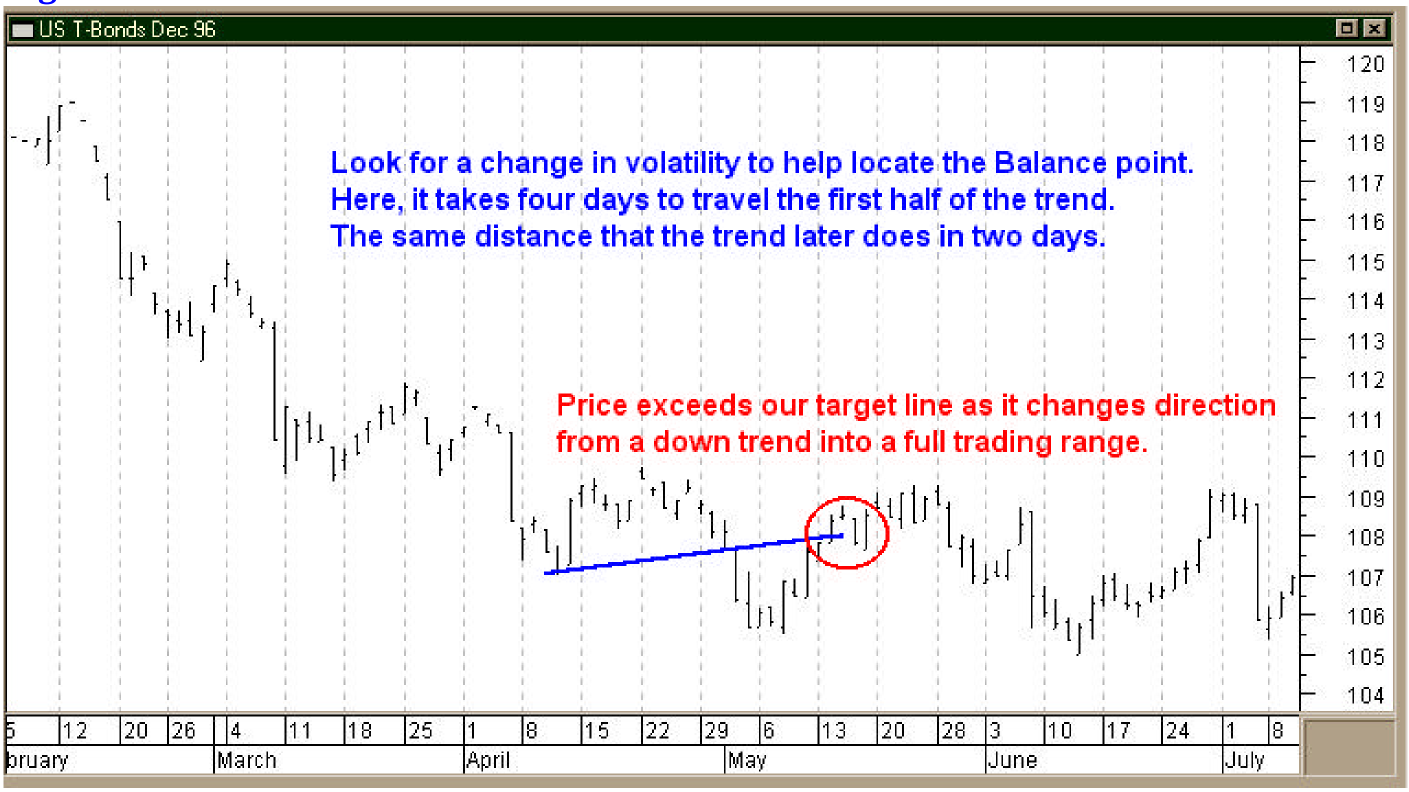


Figure 12

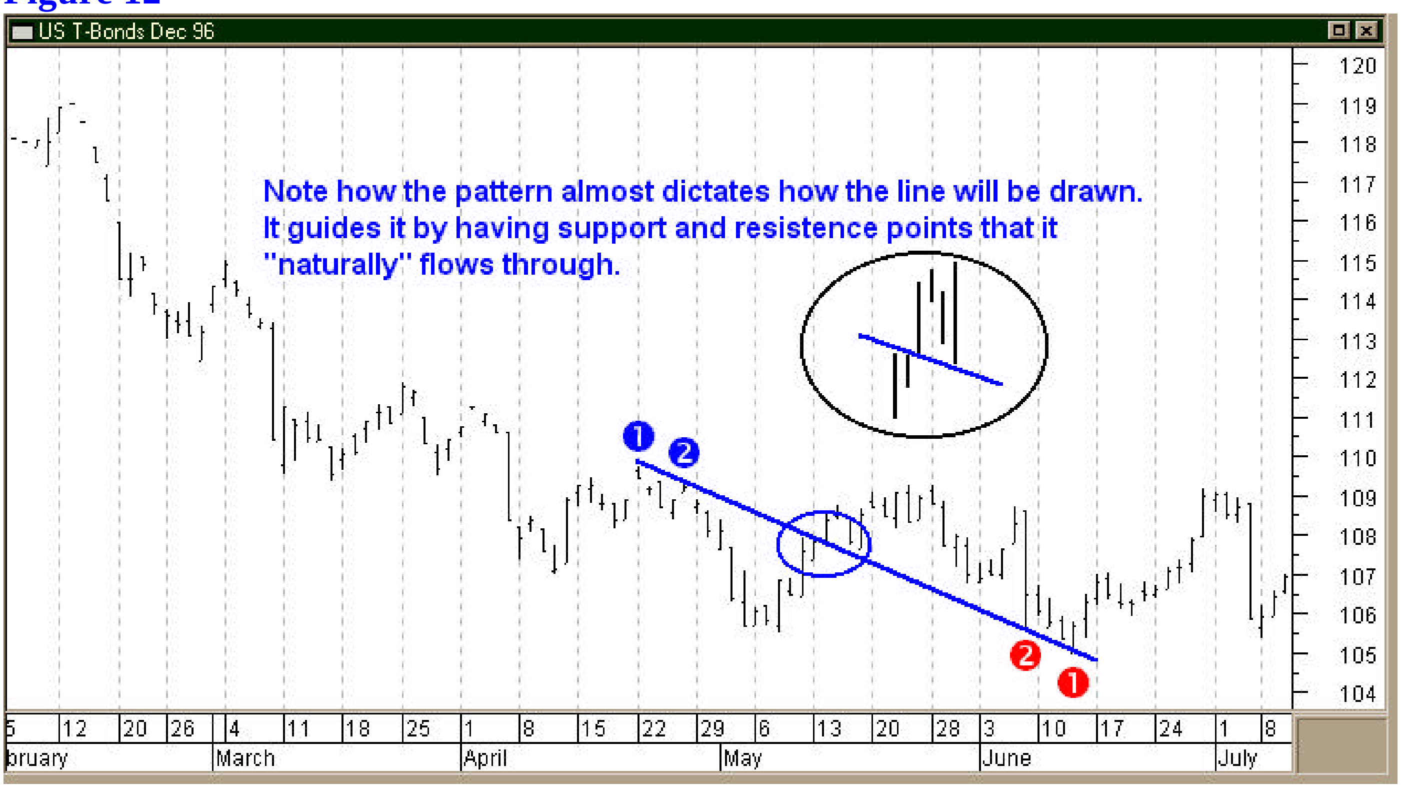
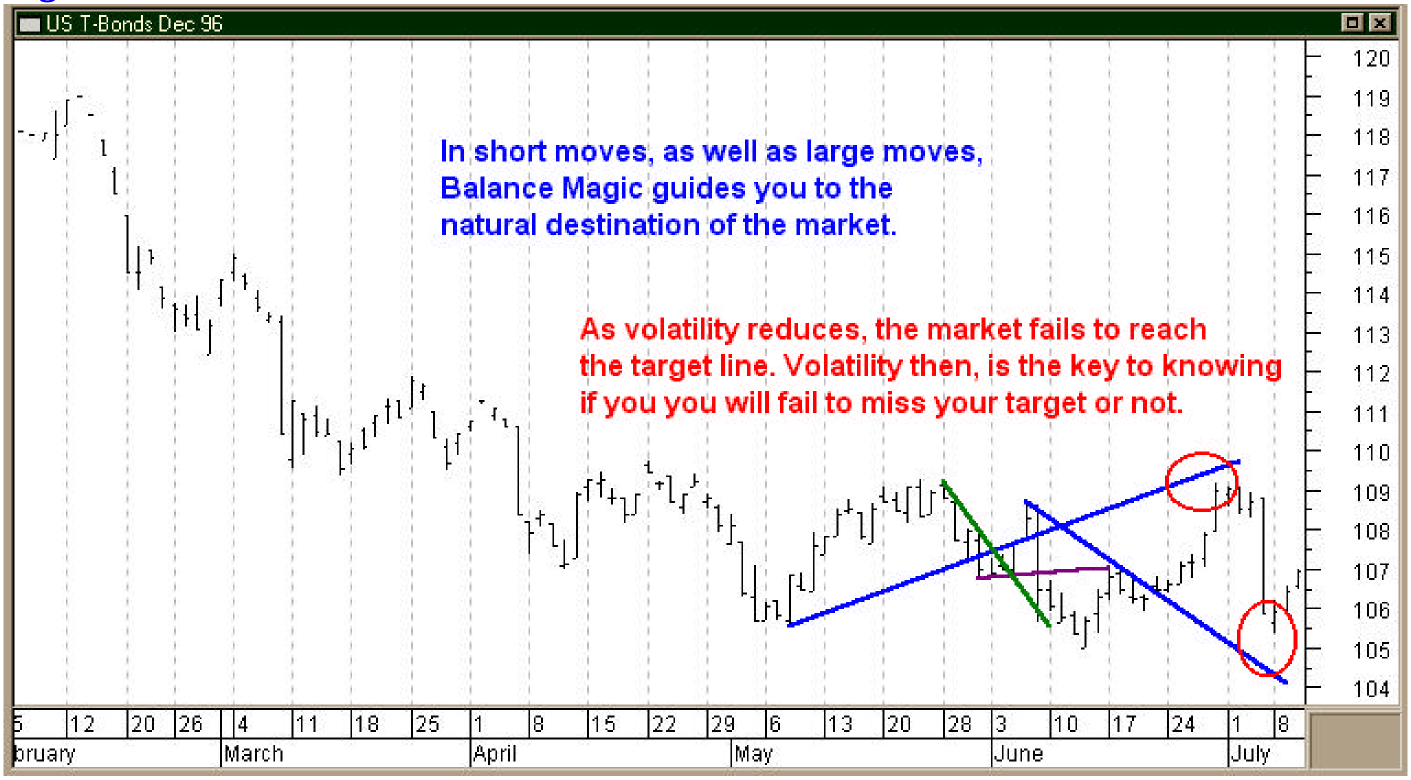


Figure 13



How long will it take for the market to reach its natural destination point and how do you determine this? Similar to the way we calculate the destination of a trend; the distance of these swings can be calculated by using a "box method". Measuring from high-to-high or low-to-low and then using that measurement to determine the opposite side of the ***BALANCE MAGIC*** point.

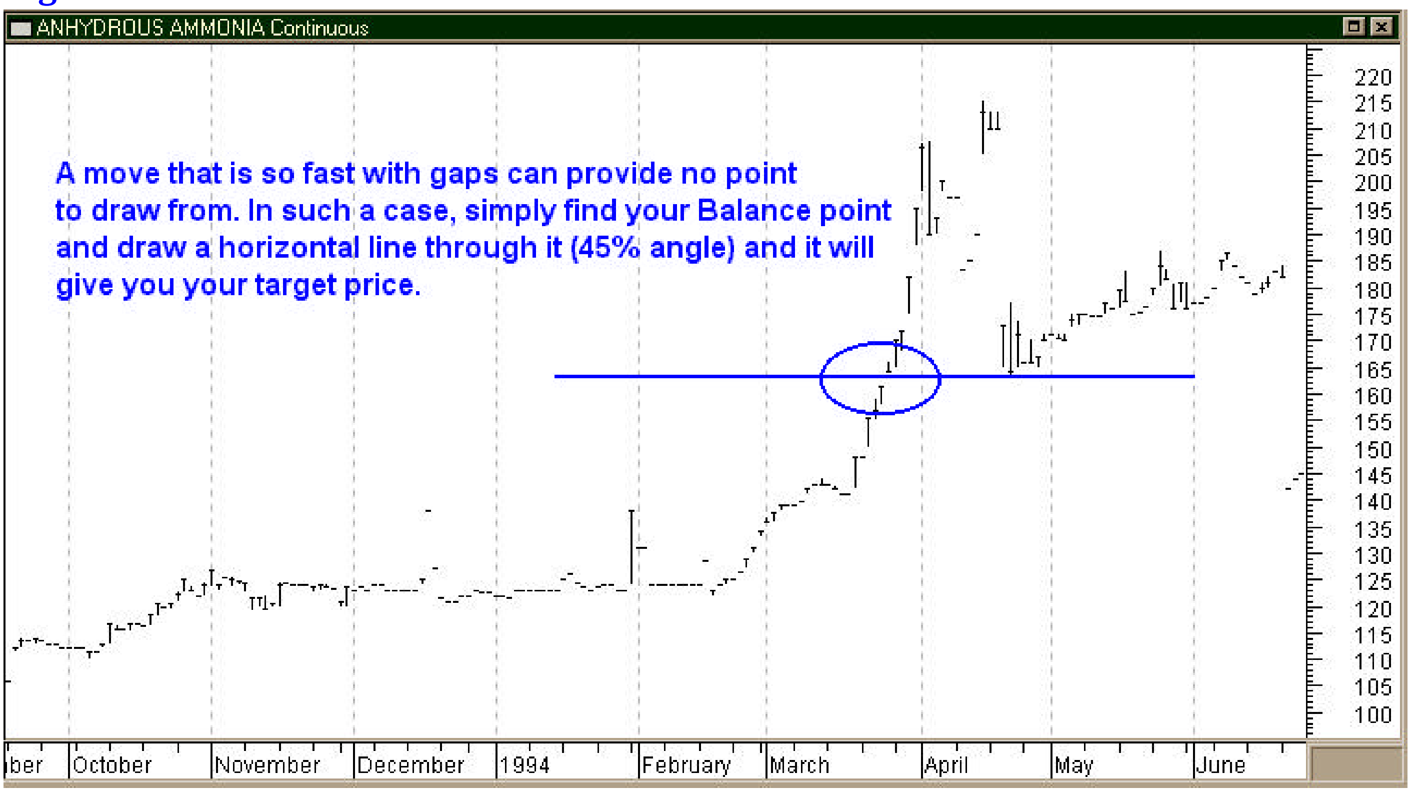
What you have seen here amazingly reoccurs over and over again. As exciting as this is, there are some factors that cause it to fail to reach its natural destination. Also, seeing this phenomenon, understanding it, and interpreting it properly takes some skill. But rest assured that the more you seriously look at this unique aspect of the markets, the more you understand not only the language that the markets are speaking to you, but actually be able to interpret it.

As you may have noted in the examples above, it will take some practice to learn to identify the proper center of the ***BALANCE MAGIC*** point. However, there is a natural flow of placement of a centerline that will intersect the center of the ***BALANCE MAGIC*** point. It just simply takes a careful examination of the natural flow and symmetry of the market to determine where this is.

Sometimes you will find that there doesn't appear to be any self-evident point that gives the flow of the intersecting line away. One case in point is when the market changes direction and no previous high or low seems to line up with the ***BALANCE MAGIC*** point. In such cases, you can use a direct 45-degree angle from the trend lined up with the center of the ***BALANCE MAGIC*** point to give you your natural destination.

A word of caution, although a 45-degree line does an amazing job of lining up with the natural destination point, it is still not a perfect method of calculating this it is only a substitute. So naturally, there are times when the price movement will fail to reach this point.

Figure 14



If this is the markets way of naturally telling you where it is going, then why would it fail? To understand why the market has the phenomenon of not always following through with what it is saying, all we have to do is look at the reasons for these failures.

Remember, that we are dealing with markets that are in a constant state of change. There are new waves born and old ones that die. Volatility increases and then decreases. Participation in a specific market rises and falls. So lets look at some of the scenarios that give rise to the markets apparent change of mind.

The first consideration is the fact that this is caused by the waves that are running through the market. Like waves on a lake, their wake eventually dissipates. When a wave in the market losses its momentum, you will normally see that it fails to make the complete trip to its natural destination point. Another words, it comes up short. The same appearance occurs when a newer and stronger wave appears with a contrary bias.

How this will appear then is if the natural destination is a new high, such as the S&P with the expected point of 1400, but it only rises to 1300, then it becomes evident that the wave is losing its momentum. Expect the market to develop in a bearish direction.

One of the other major causes of failure in this regard is a stronger wave bias in the opposite direction, as mentioned earlier. There is a good possibility that this is a new wave and is one that you will want to pay close attention to, because its full effect on the market is not known yet.

As a traders note, when a market fails to reach its natural destination point then the market is bias in the opposite direction. In simple terms, if it didn't rise up as high as it was suppose to, expect the market to continue going down, and of course, vice versa. The exception to this rule is if volatility is decreasing which would reduce the extent of the markets swings.

But what does it mean if it goes further than its natural destination point?

There are a number of reasons why this can occur. For example, a contrary wave in the market may have dissipated and now the current wave has less resistance, or a new wave bias toward the current direction has formed, giving it added impetus. Whatever the cause of it traveling further than its natural destination point, the indication is that the market is now bias in that direction. Another words, if the S&P natural destination is 1400 and the market rises past it to 1500, expect the market to develop a bull market.

Figure 15

Another cause to the market going further than its natural destination is when a wave does a flip. I refer to this action as an inverse. If a wave does this, this is something that you definitely do not want to miss because of the great trading opportunity it creates. But before I go into trading this, let me explain what an inverse is.

Imagine a wave from the sea as it travels toward shore. Whenever a wave reaches a point where it cannot go any further, something must happen. If a wave hits a beach, it dissipates by rolling over top of itself and exhausting most of its own energy. However, when a wave hits a sea wall, it doesn't have this opportunity. In such a case the wave "flips" and heads back out to sea with very little of its energy terminated.

Something very similar happens with the waves within the market. While we may not be able to differentiate between a market "beach" and "sea wall", we can see how it reacts and take advantage of the times it hits the "wall" and bounces back with its full force. Putting that view of the waves in the market in perspective, what that means is that at times you will see a market not only reach its natural destination, but extend pass it to a distance of twice the amount, and at times even more.

There are several examples where this occurred in a market that had been in a bearish trend and created a bullish explosion that skyrocketed a market.

Figure 16

How do you recognize an inverse? Most inverses have a unique characteristic when they reach the limit of their cycle. (By reaching the limit of their cycle, I am referring to the extreme high or low of that cycle) They "flip" at their end. One form has the appearance of that of a W or M at a high or low. Another common type looks like what I refer to as the bump on the head and is sometimes referred to as an Adam and Eve pattern. The price makes a somewhat out of place extended movement up or down and returns within a normal range. It is somewhat like a cartoon character that has been hit on the head and an elongated lump extends out, looking like a hotdog. And as seen in the previous chart, they also appear as a contrary wave that you can recognize as a regular ***BALANCE MAGIC*** point within a trend.

All of these forms can be very self-evident or very subtle. They can range from the very small intra-day versions to very large that can be seen on weekly and monthly charts. At times they are recognized as "double bottoms" or "V patterns".

To get an idea of what I am referring to, look at some chart examples of inverses and note how the market makes an M or W in its pattern at the high or low and then the bump on the head pattern.

Figure 17

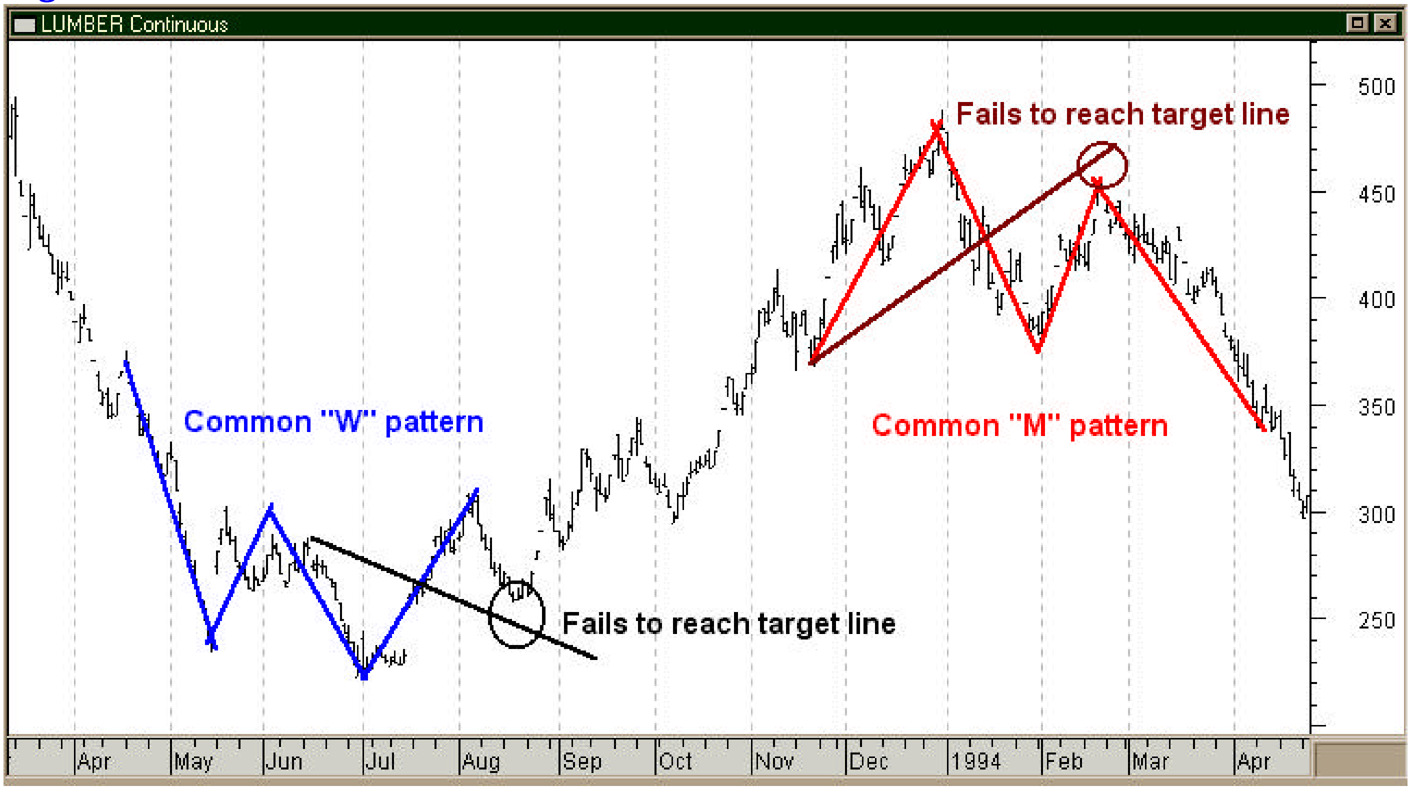
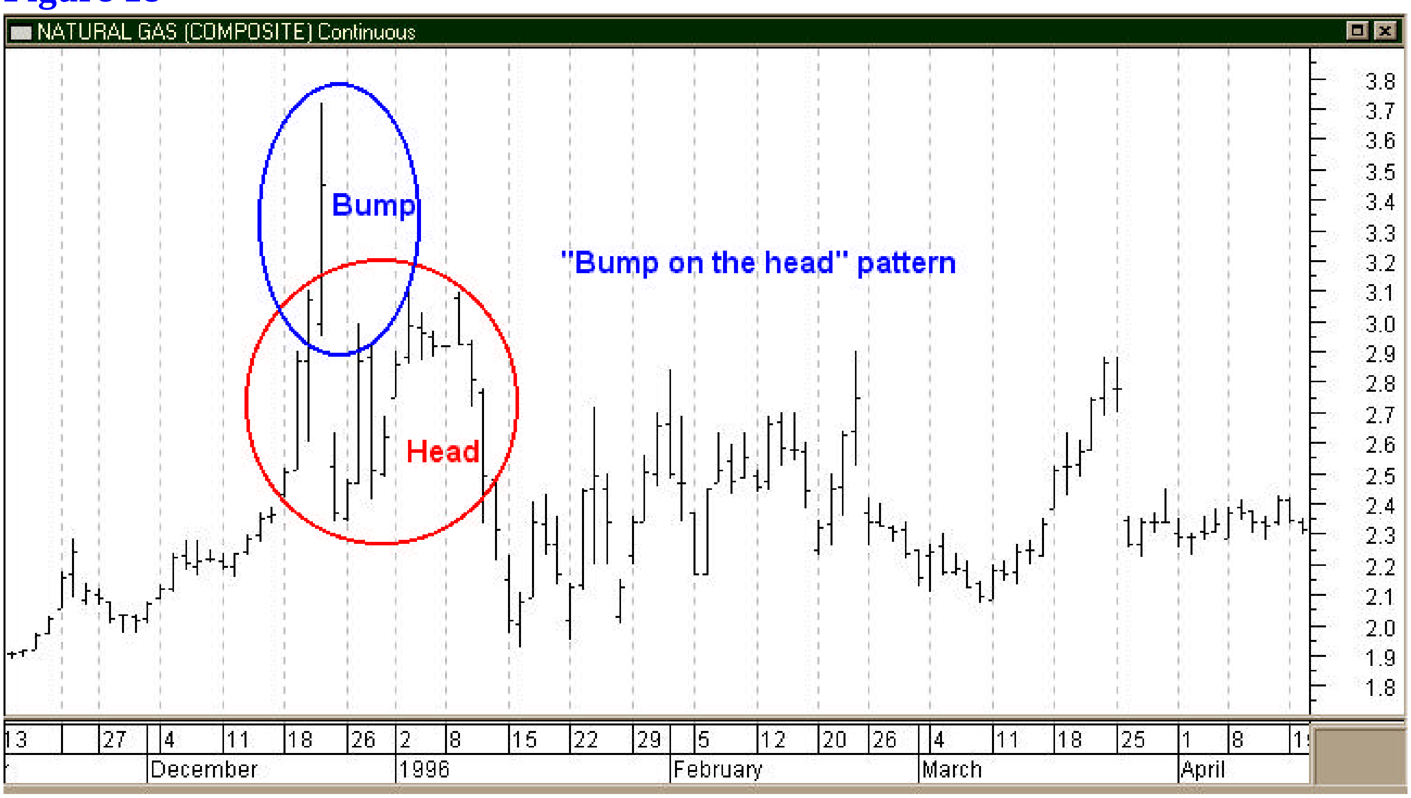


Figure 18



One other point that I want to make has to do with what is illustrated in Figure 9 and multiple points. When you have multiple points on one side that hit the ***Balance*** line, you will likely have a corresponding amount of points hitting the ***Balance*** line on the opposite side of the ***BALANCE MAGIC*** point. However, experience has taught me that the more points you have, the less reliability you have that this phenomenon will succeed. I confidently look for two, if two are expected. If there are three expected, then I expect the third cautiously. If there are more than three, for the most part I will ignore the extra points and not trade in expectation of them. They often will still hit the target line, but they become more erratic in doing so.

(Please note - they must touch the ***Balance*** line on your original side in order for you to count on them touching on the opposite side. If they do not touch, then do not count on them doing so in the upcoming side)

Aside from these few exceptions, you can generally find the market reaching its natural destination point time after time like clockwork.

Because of this, ***BALANCE MAGIC*** points provide option traders an invaluable tool. Imagine the value of knowing when a market will turn (***REVERSAL MAGIC***), knowing where the market will go and when it will arrive (***BALANCE MAGIC***), and buying an appropriate option based on that knowledge (not to mention selling an option for the opposite direction). For a very low option price (Buy option price minus sell option price) you have a profit opportunity that is low risk and high profit. All you have to do is wait for the market to go to where it naturally wants to go.

Taking ***BALANCE MAGIC*** a step further, I would like you to focus in on another area of balance that exists in the markets. Running through the center of the price action there exists center-balanced lines. Unlike support and resistance lines, these lines don't restrict price movement (the price action readily jumps across these lines), but act as magnets that the price dances around.

What makes them unique and of great value is how the price clings to these lines. If the price bars drift too far away in either direction, the tendency is for it to snap back like a rubber band. Even more, if they drift too far on the wrong side of the price trend (against the trend), the snap back often forces the price to extend the same distance on the right side of the line.

Figure 19

These center ***Balance*** lines also have a tendency to "flip" at the end of trends and are among the first lines that can be identified in the start of a new trend. This proves invaluable for determining channel lines.

Figure 20

Center ***Balance*** lines exist in every time frame and you will find that in one time frame they can be bullish while in another time frame bearish. Even so, there is no contradiction in this and it is because of this phenomenon that you can use them to more accurately determine the price action.

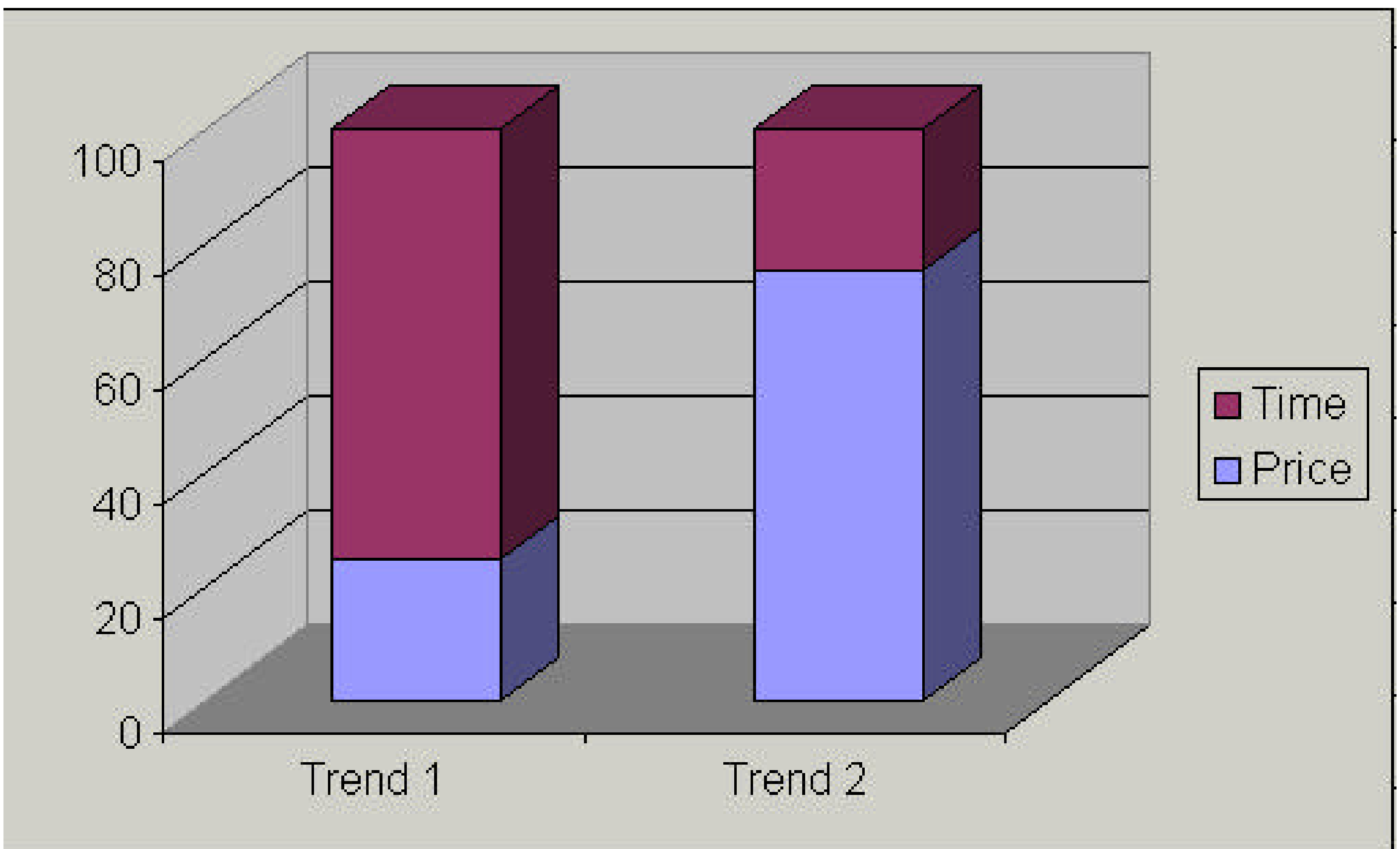
The swings of a market follow a natural flow or rhythm and have a unique way of telling us where it wants to go. Like the waves of an ocean that may appear to be chaotic, order still takes precedence. For example, waves terminate on the shoreline. They can not rise above predetermine limits, even though the ocean repeatedly stretches its waves up on the beach.

To see how this is true in the markets, take a moment and notice how the waves or trends in the charts match one another. Dominant waves are of the same size. Initially, this doesn't appear to be so because a trend will raise a certain amount in points or cents and drop a different amount. This is how many look at relationship. But this is looking at this in a two-dimensional view. Remember, that we are dealing with something that is really three-dimensional, like the waves of the ocean and so two-dimensional charts can distort and limit our perspective and view.

The three-dimensional view connects time and price. If you were to use a compass on a chart to compare waves, then a whole different picture is revealed. While one part of a wave may move fast up the price scale and the other wave slower with less of a price change, they both are equal when you compare price and time inversely.

To put it another way, if I were to draw a circle around the movement of one trend, I can place that circle around the next trend and have it fit within that circle perfectly. How is this possible? Because if you shorten the price movement of a trend, you extend or lengthen the time it will use. By the same note, if you have a trend that extends further in its price movement, you will shorten the time used. These elements of time and price have an inverse relationship with one another. Shorten one, then you extend the other and of course, vice versa.

Figure 21



BALANCE MAGIC

Continued in Part 2