7 CHAPTER

SYMMETRY—THE POWER TOOL: TRADE SETUP 2

Let's take a deeper look at the concept of *symmetry* and how we use it as a trade setup. Once again, my definition of symmetry is similarity or "equality" when comparing swings in the same direction. This is a simple, yet very powerful trading tool that should not be overlooked. I'm not going to tell you that I discovered this technique. Many market masters already use these projections. Most commonly it is also called a measured move.

Author Tip We have already applied symmetry projections in some of the prior price cluster examples. Note that a price cluster that includes symmetry tends to be a stronger price cluster zone.

To identify symmetry, I have been using the price projection tool with the 1.0 setting. (This is sometimes called an extension tool on many other analysis programs.) With projections, we are comparing swings in the same direction by using this tool, which allows you to choose three price points to make the projection. I use symmetry *most* often to project possible support or resistance in order to help me enter a trade in the direction of the trend. This is where trade setup 2 comes in. To create these setups, I project 100 percent of the prior corrective swings to help identify areas to enter the market in the direction of the trend. What I mean by *corrective swings* is the countertrend or shorter-term declines within a larger uptrend, or the countertrend or shorter-term rallies within a larger downtrend.

As far as my trading plan goes, *only symmetry that is projected from a prior corrective swing within a larger trend qualifies as a trade setup*. I define the trend by the pattern on the chart. If I'm looking at a pattern of higher highs and higher lows, I'm looking at setting up the symmetry trades on the buy side. If I'm looking at a pattern of lower lows and lower highs, I'm looking at setting up the symmetry trades on the sell side. One level is sufficient for a setup, although sometimes you will see multiple symmetry projections that overlap the same general area.

Symmetry can also be projected from swings in the direction of the larger trend to help determine areas where a trend move might terminate. I use these symmetry projections only to help in exiting trades, or as an area where I start to recommend tightening up stops on a position. Personally, I do *not* consider using these symmetry projections for a trade setup, since the projections of the main trend are actually setting up a trade that is countertrend.

Author Tip Some traders may still use these projections for a trade; however, countertrend trading is not for beginners or for those who are not nimble. Personally, I prefer to focus on the setups that have you enter the market in the direction of the main trend after a corrective move. This helps to keep the odds in your favor.

The trade targets and stops will essentially be the same for a symmetry setup as they are for a price cluster setup. We will be looking for 1.272 of the prior swing into the symmetry projection(s) or levels as a minimum target, and the maximum risk would be a few ticks above or below the symmetry projection(s).

SYMMETRY EXAMPLES

The first symmetry example, Figure 7-1, is illustrated on a three-minute chart of the March 2007 E-mini Russell contract. I have labeled the swings that are similar on this chart. Within one larger swing up in this contract from 783.10 to 790.20, we can see swings down of 1.50, 1.90, 1.60, and 1.70 points. These swings fit the definition of symmetry, as they are all similar. Since they are within the context of an uptrend, I am also considering these to be corrective swings. A trade setup could have been created in a couple of places on this chart, as the prior corrective declines would have been projected from any new high to identify a possible buy entry.

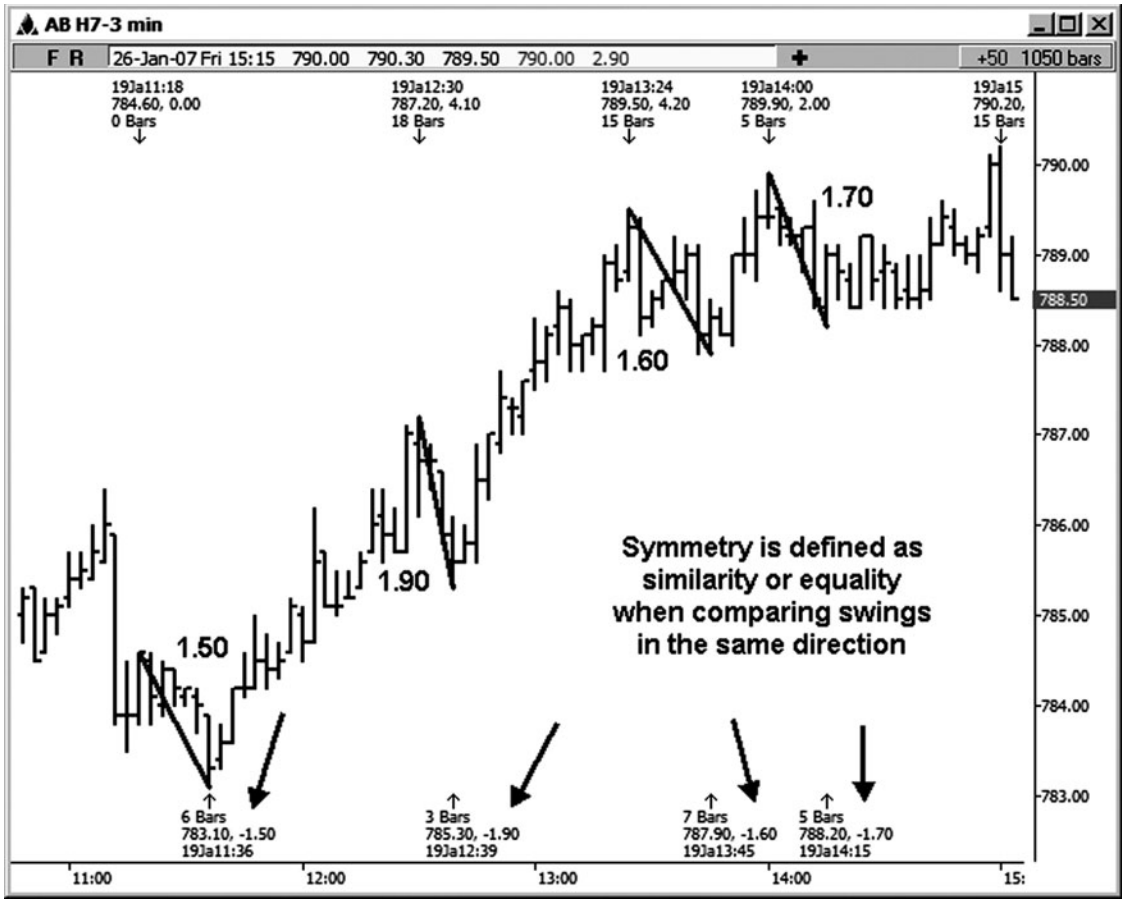

FIGURE 7-1

Figure 7-2 is a symmetry example on a daily FOREX chart of USD/CAD (U.S. dollar/Canadian dollar). I have labeled the similar swings on this chart. The swing of 211 pips is similar to the 206-point pips. The swing of 160 pips is similar to the 158-pip swing. In this case, there are two separate examples of symmetry within this chart. The swings that are compared in this chart are also considered corrective moves within the daily uptrend. An example of symmetry setup on this chart would be to use the move from the 12/18/06 high to the 12/20/06 low (160 pips) and project it from the 1/11/07 high using the 1.0 setting on the projection tool. This would have set up 1.1644 as possible support and a buy entry zone.

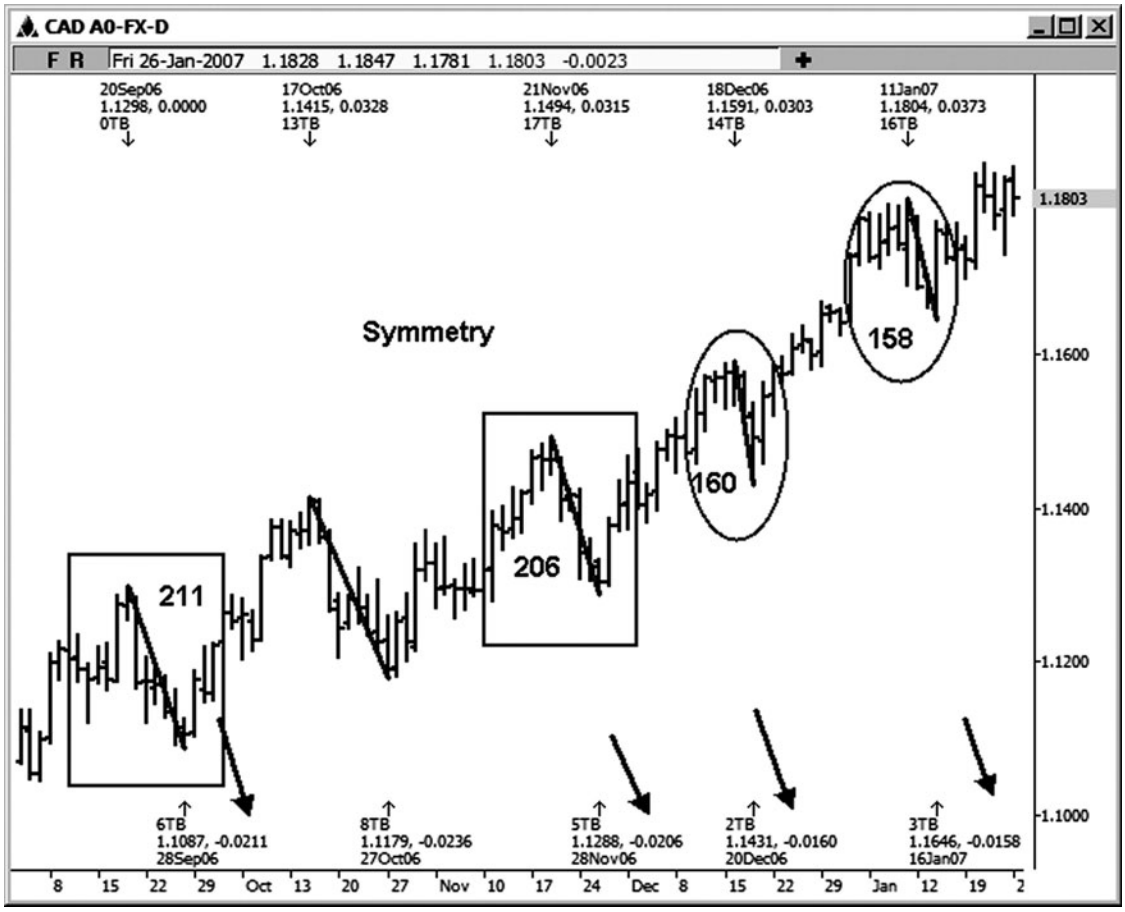

FIGURE 7-2

The actual low was made at 1.1646 and was followed by a relatively healthy rally.

In Figure 7-3, we are looking at the 60-minute March 2007 bond contract. Notice that the first swing identified on the chart was 26/32nds. Once this was projected from the 110 08/32nd swing low, it showed us possible "symmetry resistance" at the 111 02/32nd area. That was the trade setup. In this case, the rally from the 110 08/32nd low terminated *exactly* at the symmetry projection. Remember, symmetry is similarity or *equality*. The bond dropped almost 2 full points from that high.

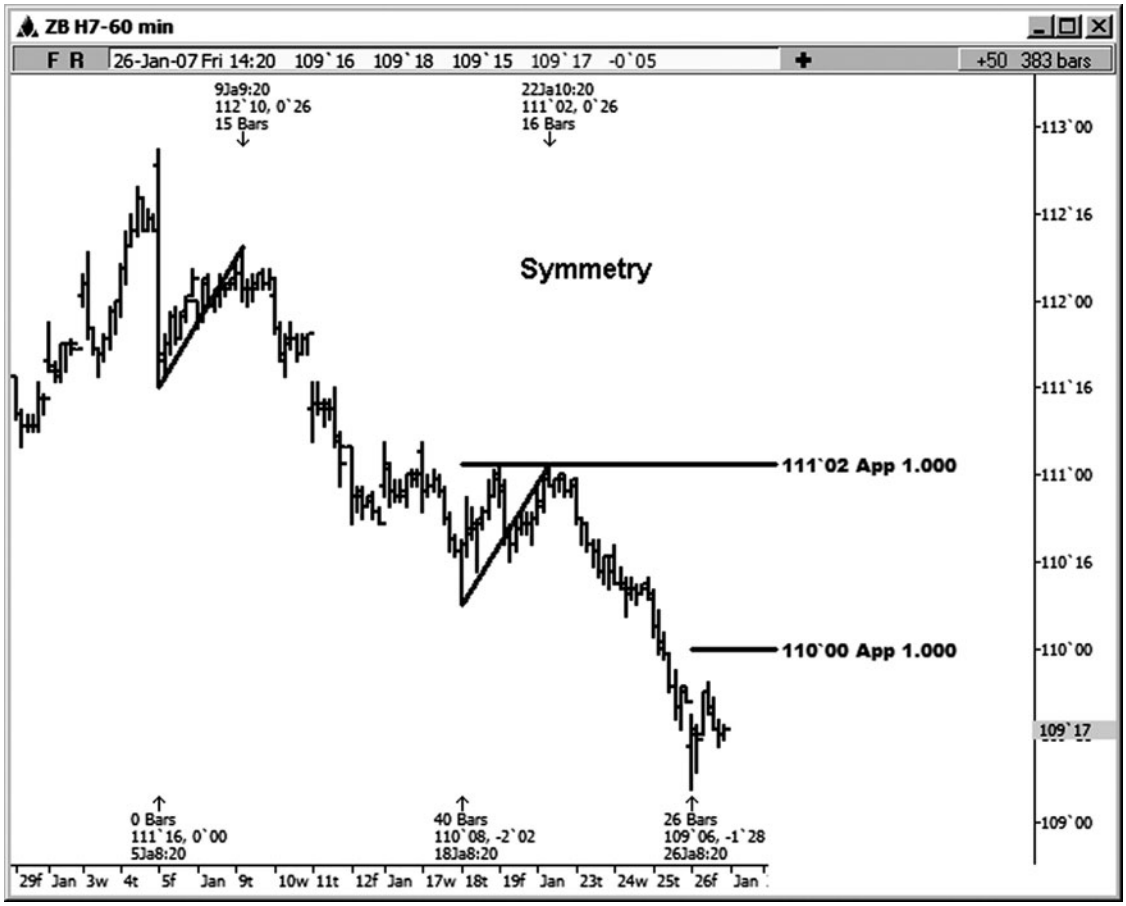

FIGURE 7-3

A major low was made on the daily Nasdaq cash on 7/18/06. After this low was made, we can find quite a few examples of symmetry in Figure 7-4. The corrections that I've labeled here are 48.08, 53.56, 42.15, 46.85, 42.96, and 52.60. Notice the similarity between some of these swings within the uptrend. There were at least a couple of potential symmetry trade setups on this chart.

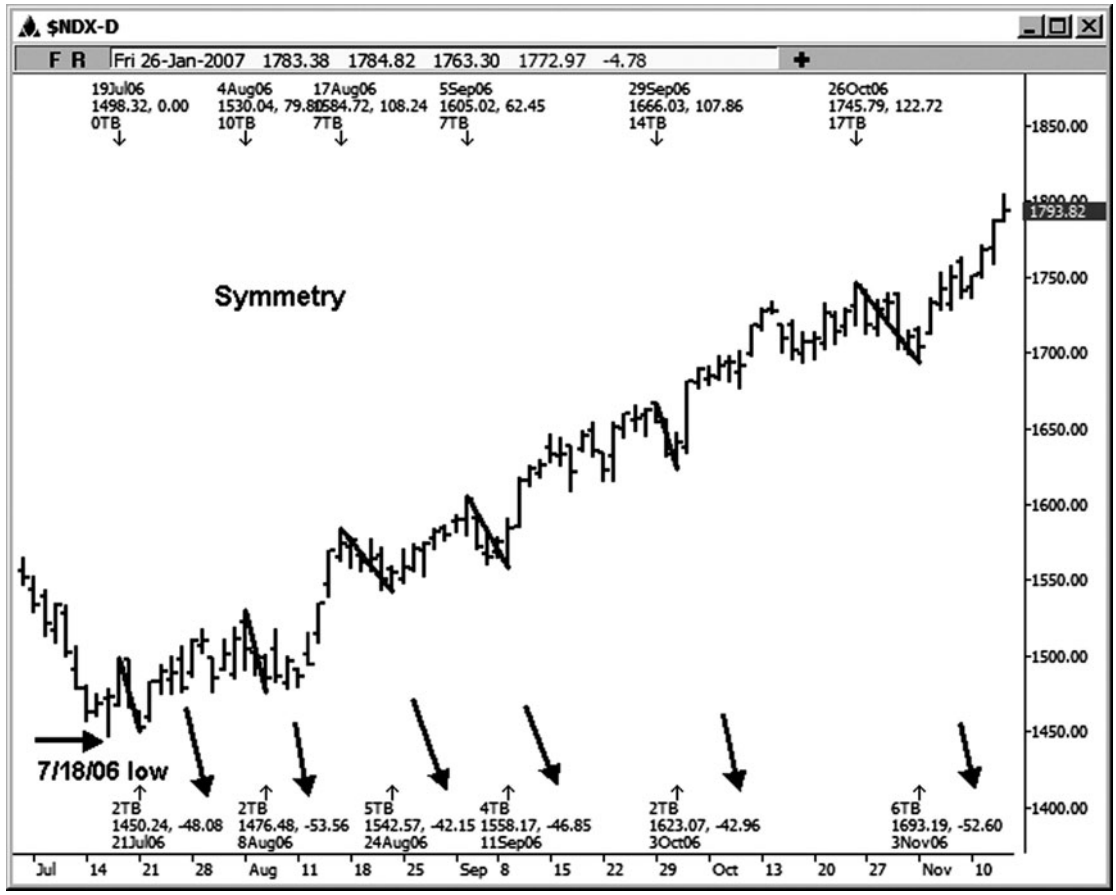

FIGURE 7-4

Let's look at one of these symmetry examples within that same Nasdaq chart. It would have proved to be a healthy trade setup in the direction of the trend (see Figure 7-5). Although there may have been other price relationships that overlapped this symmetry projection, we are just going to focus on the symmetry itself in this example. If you measure the corrective swing from the 8/4/06 high to the 8/8/06 low and project 100 percent of this swing from the 10/26/06 high, 1692.23 becomes the possible support decision and the setup. The actual low was made just a touch above this key projection. A gorgeous rally followed, with an initial runup from 1693.19 to 1824.21, or 131.02 points.

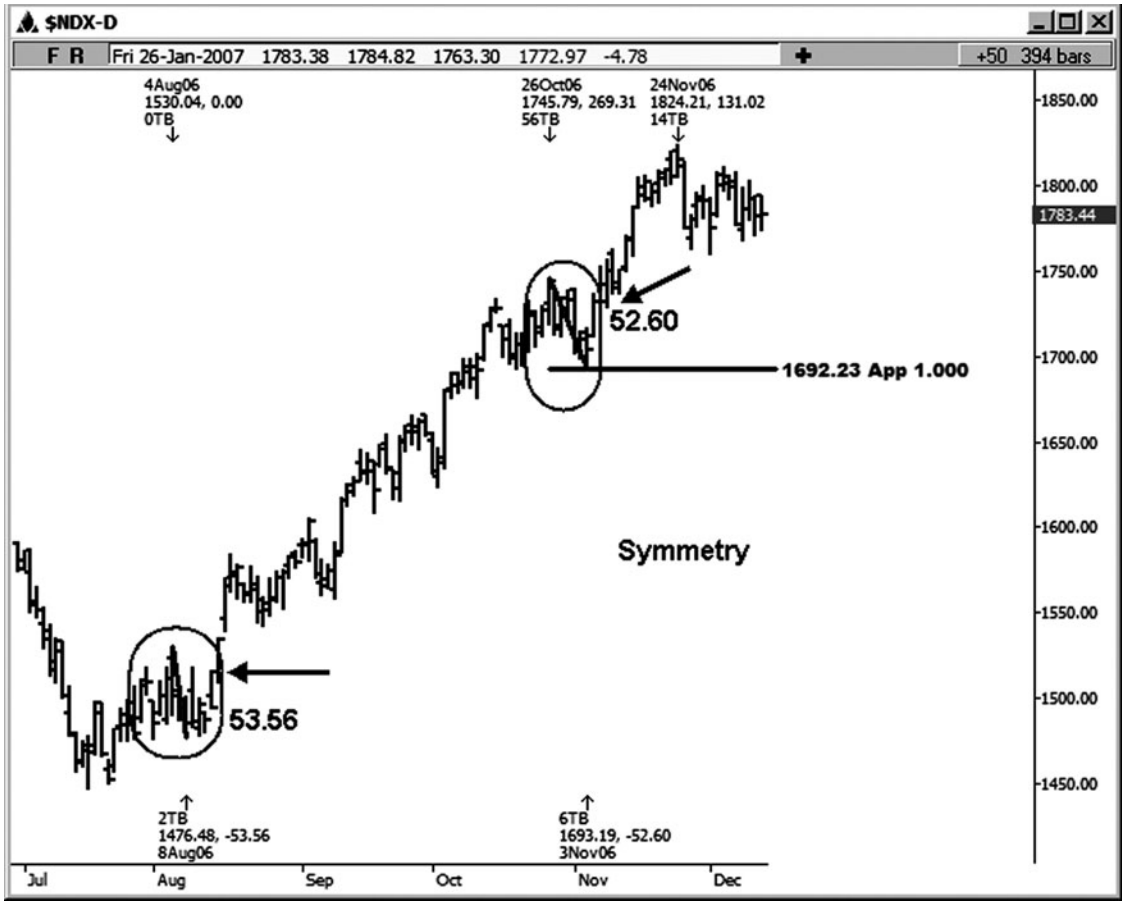

FIGURE 7-5

It is definitely worth it to keep an eye on the symmetry projections from higher time frame charts. Figure 7-6 is a weekly FOREX chart in the euro (euro/U.S. dollar). Symmetry helped to identify a major swing low in this market. The first decline labeled on the chart was an 1167 pip swing down. This 1167 pip decline was then projected down from the high made the week of 2/20/04. The result was a projection of possible support around the 1.1761 area. That was the trade setup. The actual low was made at 1.1760 within one pip of the symmetry projection. A huge rally of 1907 pips eventually followed this low.

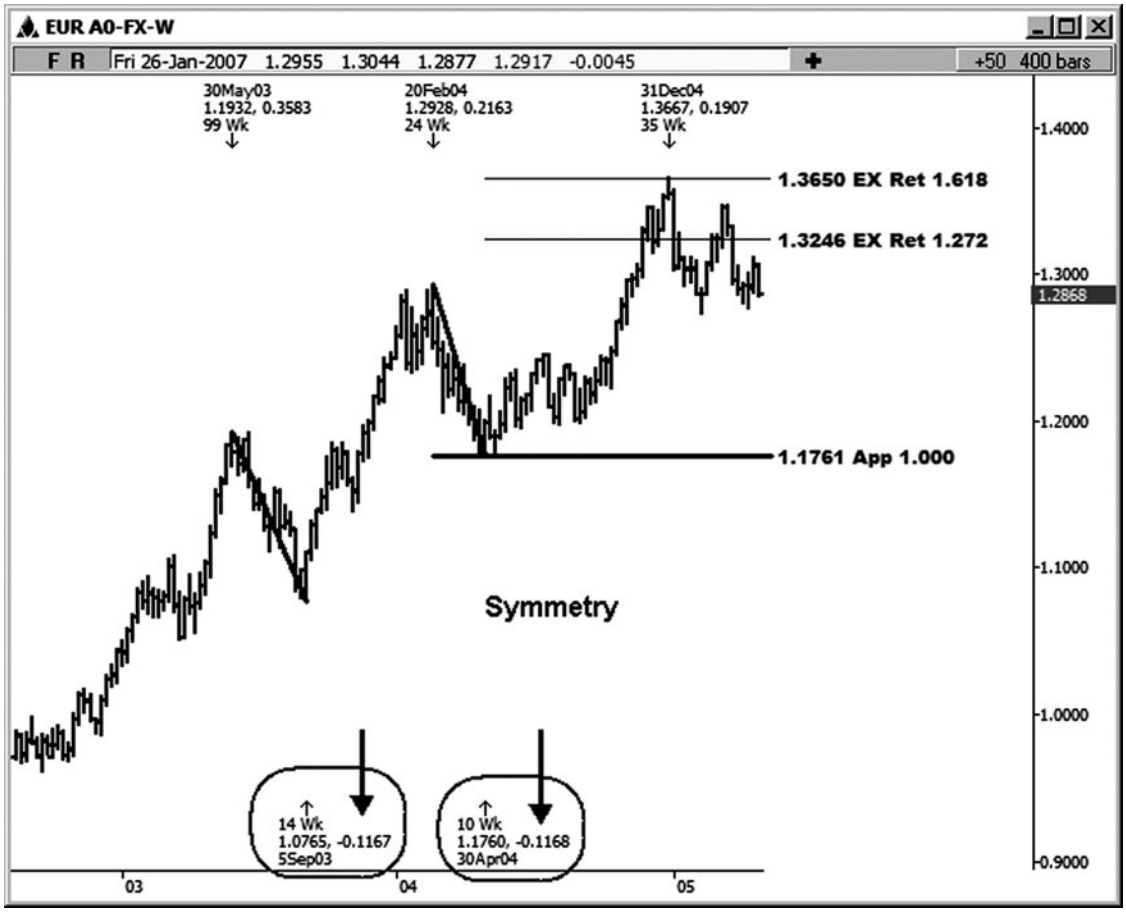

FIGURE 7-6

Figure 7-7 is a daily chart of the cash Dow Jones Industrial Average. Between the week of 3/11/05 and the week of 4/22/05, the Dow traveled down 984.00 points from the high to the low. From the week of 5/12/06 to the week of 7/21/06, the Dow traveled down 986.87 points from the high to the low. A symmetry projection from that May 2006 high helped to identify support in the Dow, from which an extremely healthy rally eventually unfolded. This projection qualified as another great symmetry setup.

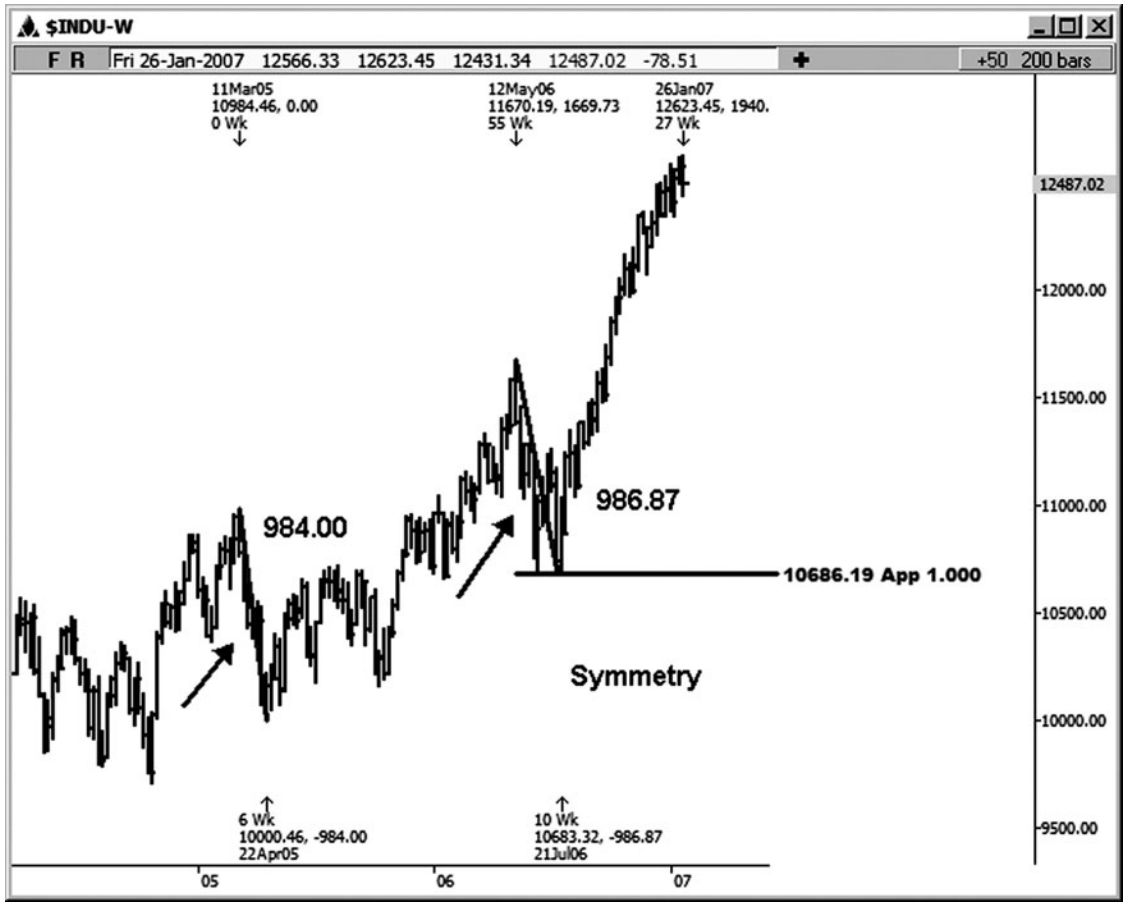

FIGURE 7-7

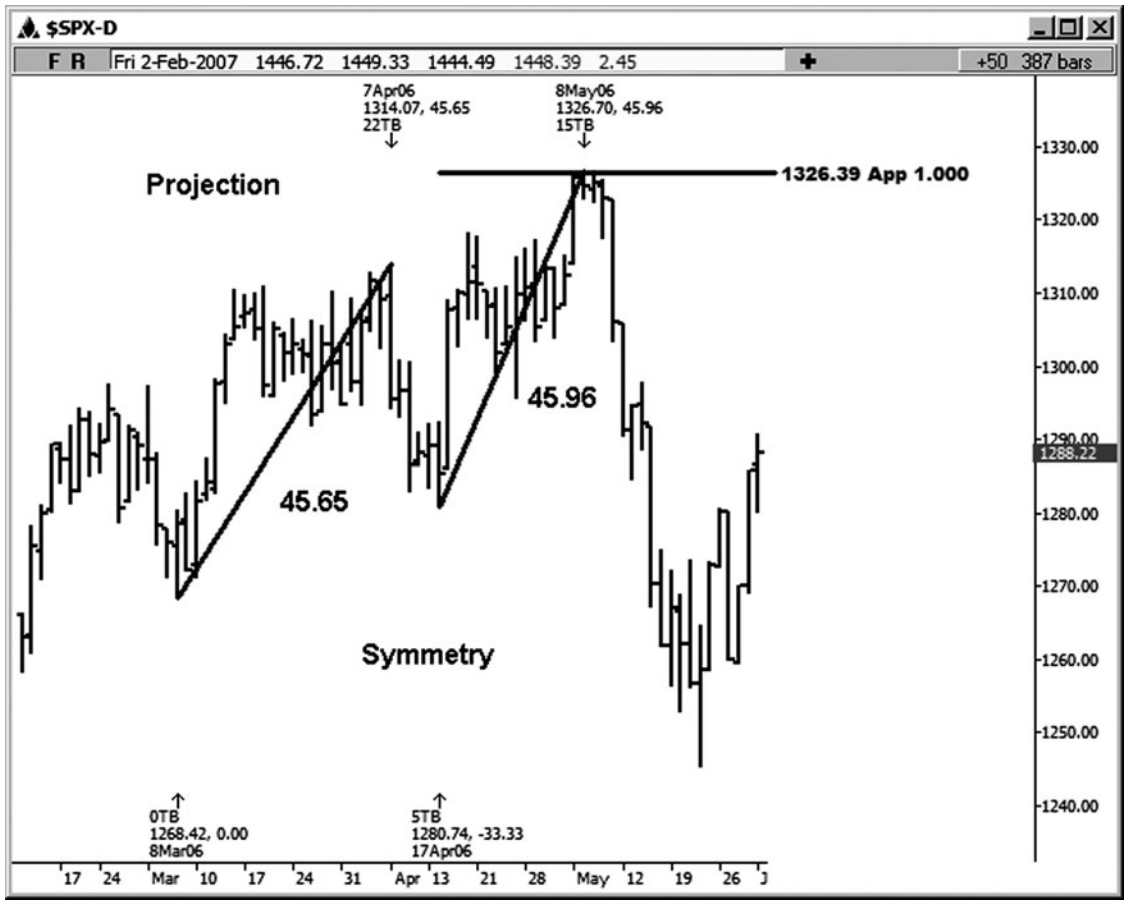

FIGURE 7-8

This next symmetry example is on a daily S&P cash chart. Figure 7-8 illustrates a symmetry projection that was made from swings in the direction of the main trend, which at that time was up. This projection identified possible resistance to the rally. Since the main trend was up into this resistance zone, looking to enter the short side of this market using this zone would be considered a countertrend trade when the resistance zone was first tested. If you measured from the 3/8/06 low to the 4/7/06 high (45.65 points) and you projected 100 percent from the 4/17/06 low, you came up with possible symmetry resistance at the 1326.39 area. The actual high was made at 1326.70.

These swings were very similar, and they indicated an area where the rally might terminate. In such a case, you would want to tighten stops on any long positions. Even though the odds for entering a trade using a countertrend projection are lower than those when you use these projections within the direction of the trend, the projections can still be extremely valuable. It is just very important to wait for clear reversal indications on a lower time frame chart so that you are not stepping in front of the proverbial freight train.

If I am looking at a daily chart zone, I like to see a shift in pattern on a 15-minute chart or higher to indicate a trend reversal. So, according to my trading plan, I am not allowed to sell short on a first test of the zone in this example. If the 15-minute chart shows me a pattern reversal however (in this case to lower lows and lower highs), then I can set up a sell entry that will be legal on my trading plan.

Figure 7-9 is a symmetry example illustrated on the March 2007 E-mini Russell contract. Here I measured from the 11/28/06 low to the 12/5/06 high, which was a 34.10-point swing. This same distance was then projected from the 1/9/07 low, looking for possible resistance. The symmetry projection came in at 807.30. The actual high was made at 807.10, making the second swing 33.90 points. This resistance did produce a tradable high. I don't consider this a trade setup according to my plan. It would have been a great place to tighten up stops or exit if you were long going into that resistance.

Again, my trading plan doesn't allow me to step in front of the freight train using that projection. Once the pattern on a 15-minute chart shifted to lower lows and lower highs, however, then I could finally look to safely set up the sell side with the 1/16/07 high in mind.

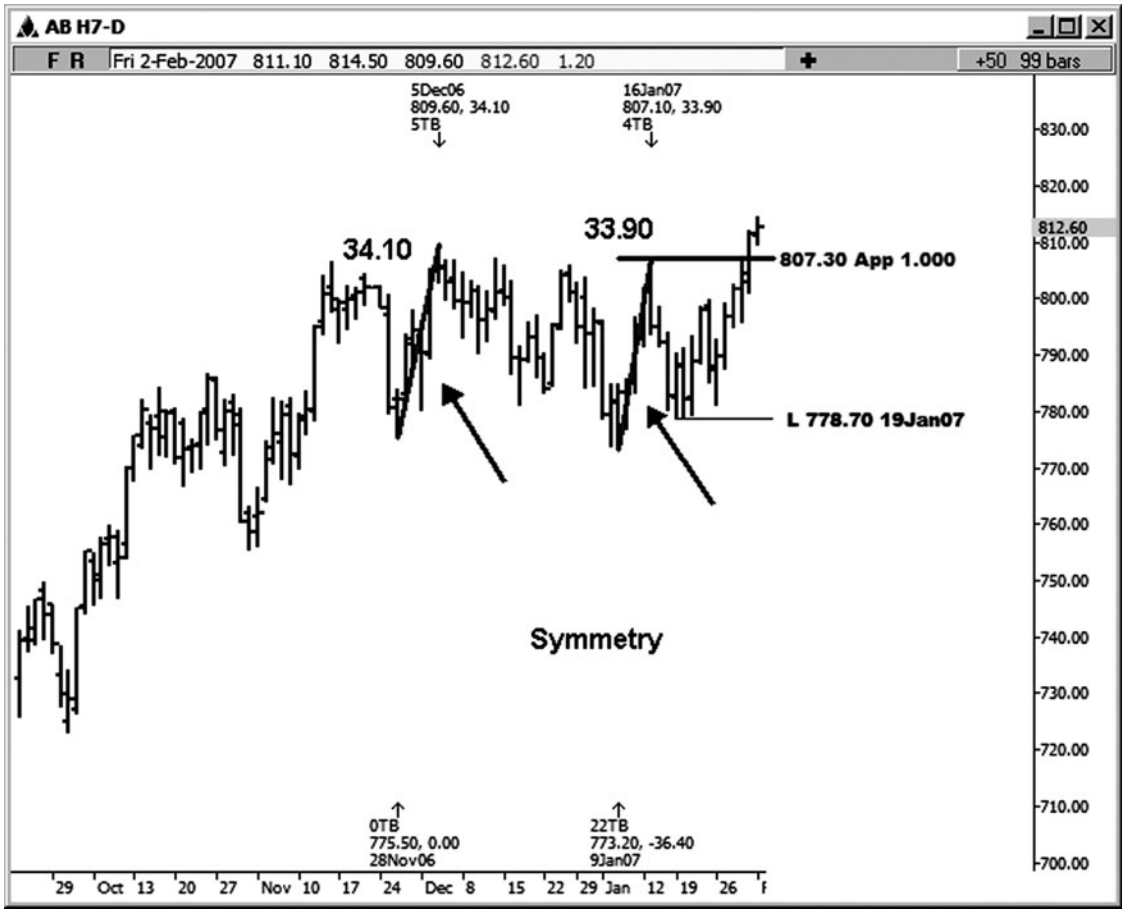

FIGURE 7-9

Author Tip Just keep in mind that using projections that are counter to the trend for trade entries has lower odds than using projections that show up in the direction of the trend.

Figure 7-10 is a daily chart of the Swissy (U.S. dollar/Swiss franc). Notice the similarity of the swings on this chart. The labels show rallies of 334 pips, 324 pips, and 323 pips. This fits the classic definition of symmetry.

FIGURE 7-10

When I took a peek at the wheat market, I found some beautiful symmetry examples. These examples are illustrated on the daily March 2007 wheat contract. Who says there is no rhyme or reason to the market? Take a look at this first wheat chart (see Figure 7-11). Look at the similarity of the rallies in this contract. The labeled swings were $43^1/_2$ cents, $39^1/_2$ cents, 43 cents, 43 cents again, and 39 cents.

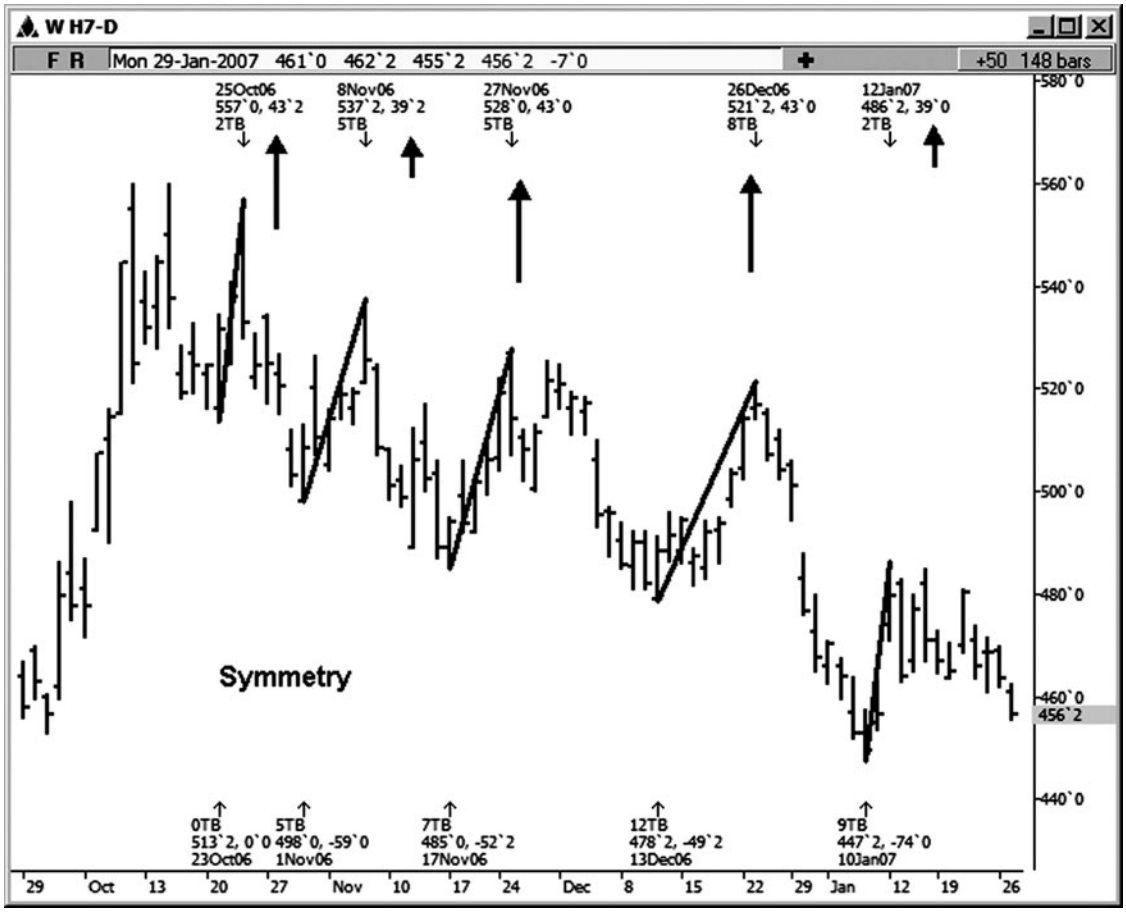

FIGURE 7-11

Let's look at another wheat chart (see Figure 7-12). Two of the prior swings in the earlier chart helped to create a beautiful price cluster setup that included symmetry at the 518–522 area. The decline that followed amounted to 74 cents in just a few weeks. That would be a huge score for a grain trader! Two of the price relationships in this cluster were simply 100 percent projections of prior rallies, one that lasted $43^1/_2$ cents and another that was 43 cents. They just happened to overlap a couple of other Fibonacci price relationships, creating a healthy price cluster. The symmetry projections by themselves would have been considered a trade setup. The addition of the other price relationships strengthened the setup.

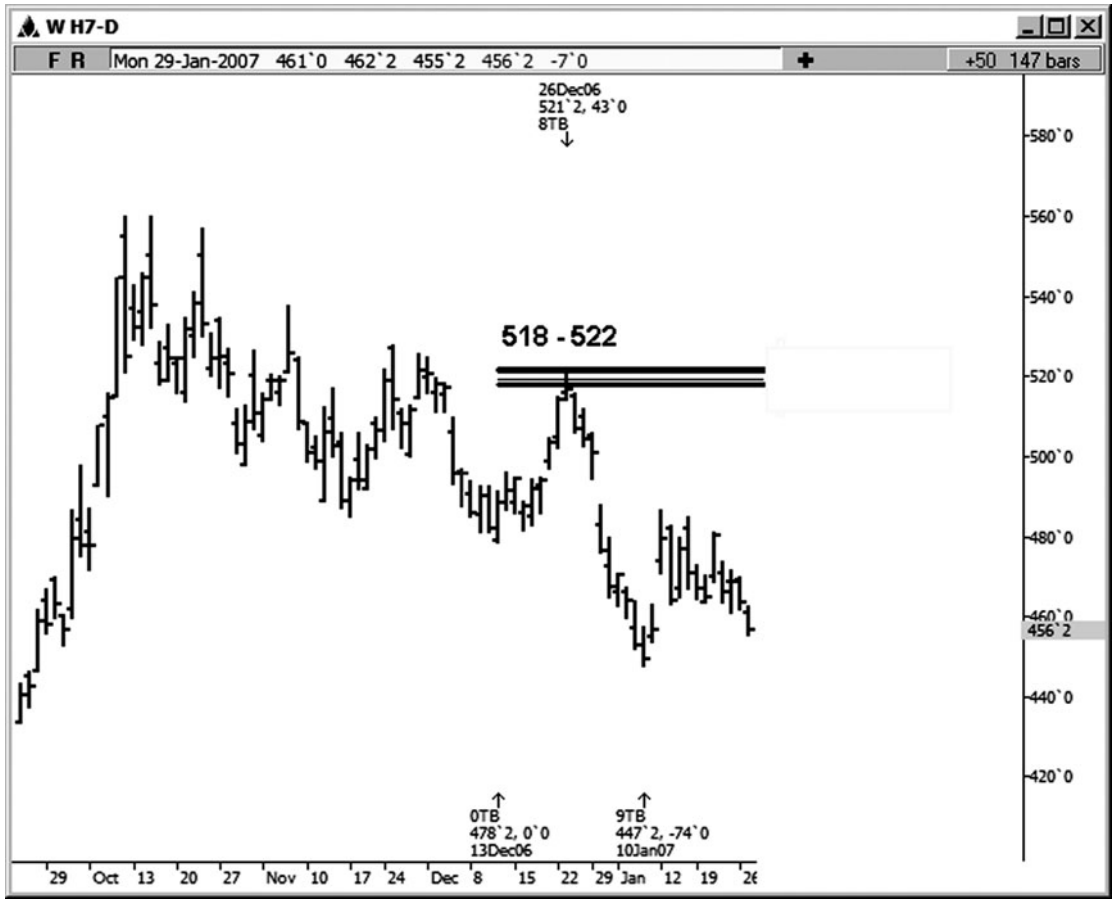

FIGURE 7-12

Figure 7-13 illustrates another simple symmetry setup that occurred on a 45-minute chart in the March 2007 miNY crude oil contract. In this example, there was perfect symmetry between the first and second swings identified on the chart. These swings both lasted $2.58. The projection told us to look for possible support at the 52.08 area; that was the setup. The low made at 52.08 was followed by a rally that was just over $3.00 per contract.

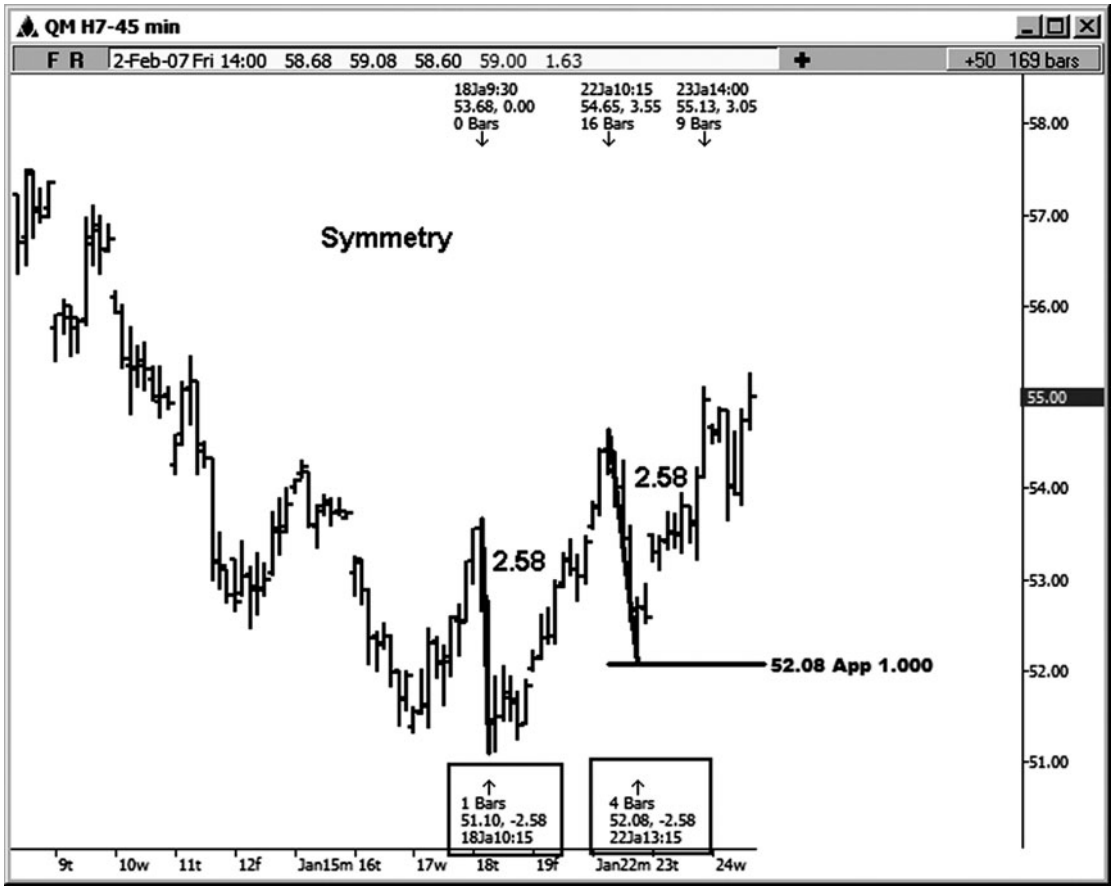

FIGURE 7-13

VIOLATIONS OR BREAKS IN SYMMETRY

Symmetry identifies some great trade setups. When it holds, it provides information to trade off of. When symmetry breaks or is violated, it also provides you with information that can help you in your trading. What I mean by broken or violated is when a market doesn't hold within a few ticks above or below the symmetry projections of prior corrective swings. The following chart examples will illustrate the importance of these violations and what they suggest will occur next in the market.

FIGURE 7-14

When symmetry is broken or violated, as in the daily chart of GM shown in Figure 7-14, a high percentage of the time you will see at least a deeper downside correction and sometimes a more important change in trend.

Author Tip Important trend changes will most often be preceded by a break in symmetry. This is something that you will want to keep in the back of your mind. There are actually traders in my room who will take a violation of symmetry on a lower time frame as a trade trigger to a higher time frame setup.

Notice in Figure 7-14 that once all the symmetry projections between 35.21 and 35.91 in GM on this daily chart were violated, a relatively dramatic reversal to the downside followed. You won't always see a dramatic reversal, but you certainly want to be aware of the possibility of this occurring when symmetry breaks.

The symmetry projections I used were made from all the obvious corrective declines since the prior major rally swing started in late November. I have identified these corrective declines in Figure 7-14. So when I'm talking about a symmetry break or violation in this case, I am saying that the market has declined more than *all* of the prior corrective declines, which were 1.59, 1.34, 2.03, and 1.33. In this case that means once we declined more than 2.03 from the 2/13/07 high by a decent margin, the symmetry of the last bull swing was violated.

In the daily U.S. dollar/Swiss franc (Swissy) FOREX chart in Figure 7-15, you can see that when the symmetry resistance projections from the prior major high-to-low swing were violated, this market started to make a deeper upside correction.

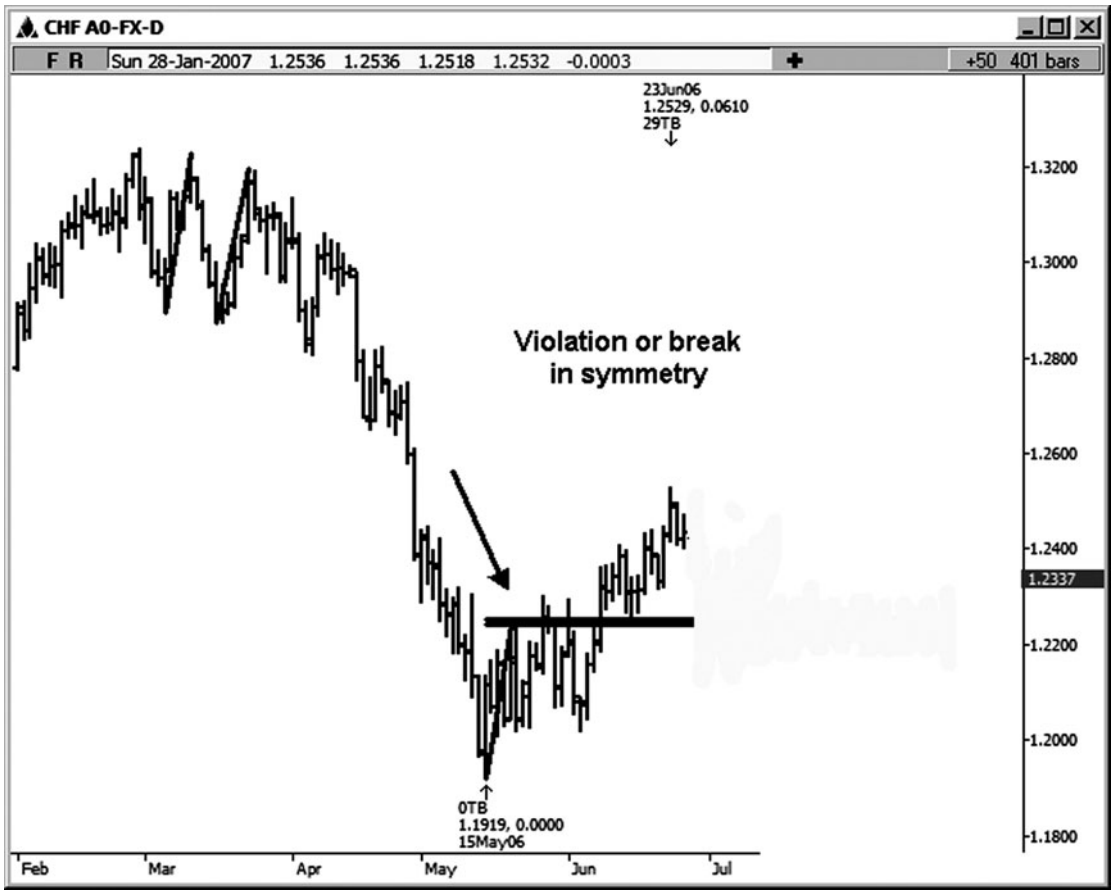

FIGURE 7-15

Figure 7-16 illustrates that the symmetry break in the previous chart was actually the beginning of a more important trend change. After the break in symmetry, you can see a shift in pattern to higher highs and higher lows. A rather healthy rally followed this break in symmetry.

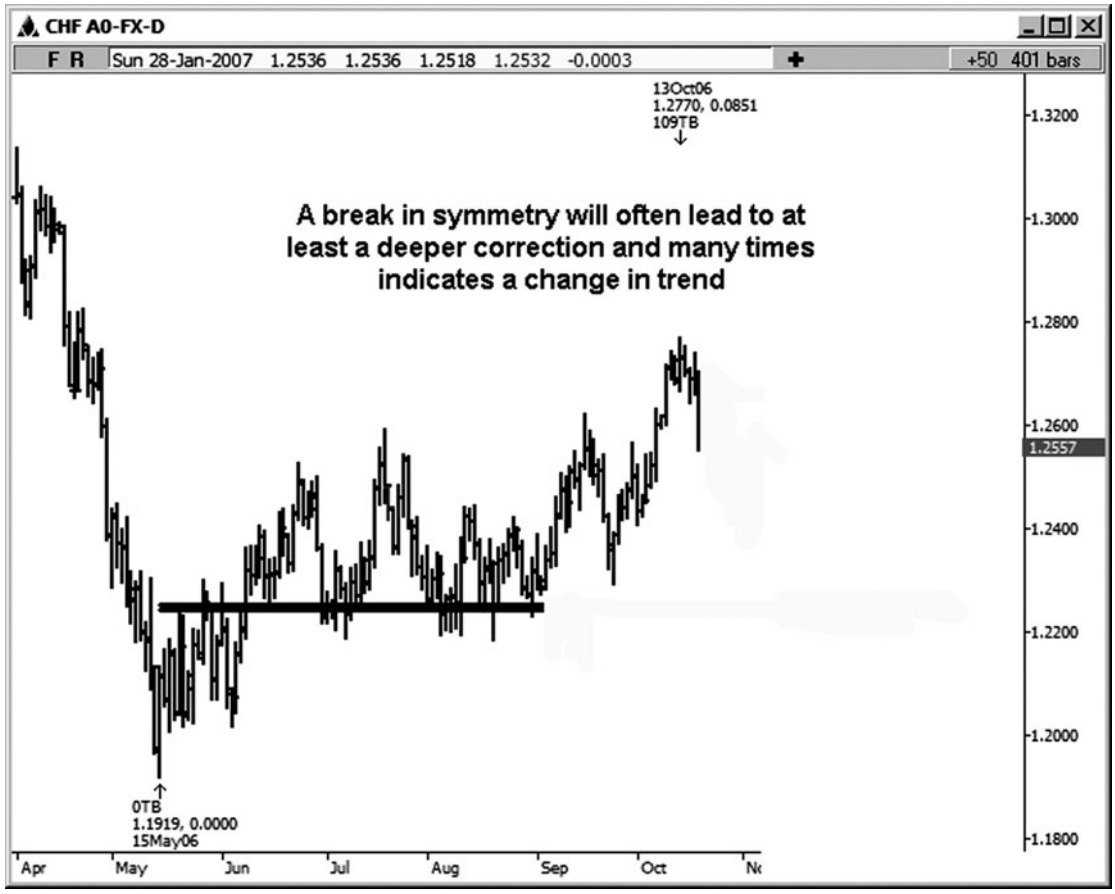

FIGURE 7-16

Let's take a look at an example of a symmetry break on a 15-minute chart of the March 2007 mini-sized Dow contract (see Figure 7-17). Note the corrective declines labeled on the left-hand side of the chart. They were 31, 25, 44, 28, and 32 points. When the new high was made on this chart, those swings were projected from that high where we would typically be looking for possible support on the pullback. Some of the projections clustered together in a relatively tight zone. One of the projections was a bit below that cluster. When all of the symmetry projections were violated on this chart of the prior major low-to-high swing, we knew that it indicated at least a deeper downside correction, and possibly a more important change in trend. (Knowing that might help a trader manage his or her positions more effectively.) A rather dramatic reversal followed this violation of the bullish symmetry projections.

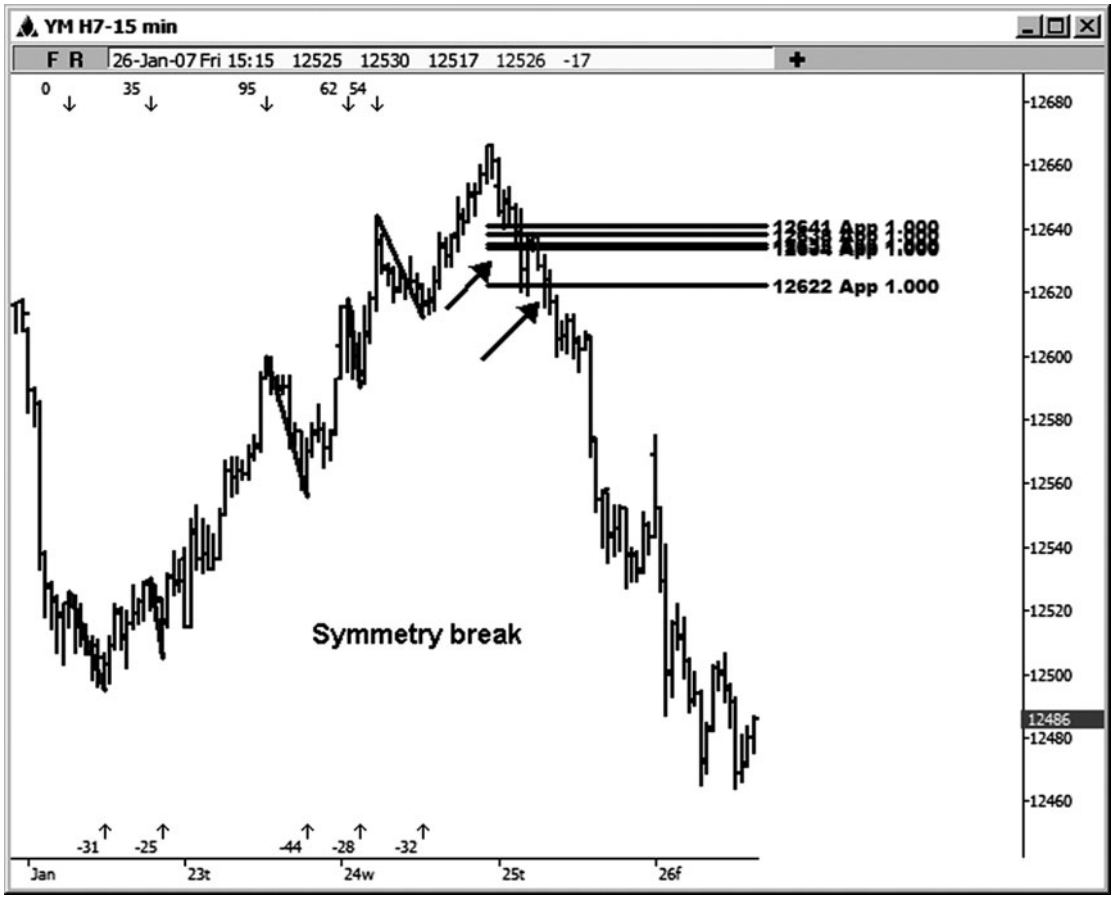

FIGURE 7-17

This next symmetry example is illustrated on a 15-minute E-mini S&P chart (see Figure 7-18). In this case, we saw only a bit of a deeper correction before the original trend resumed. The first decline was 4.00 points. The second decline, after the break in symmetry, was 6.50 points. So keep in mind that these breaks do not *always* indicate a more important change in trend.

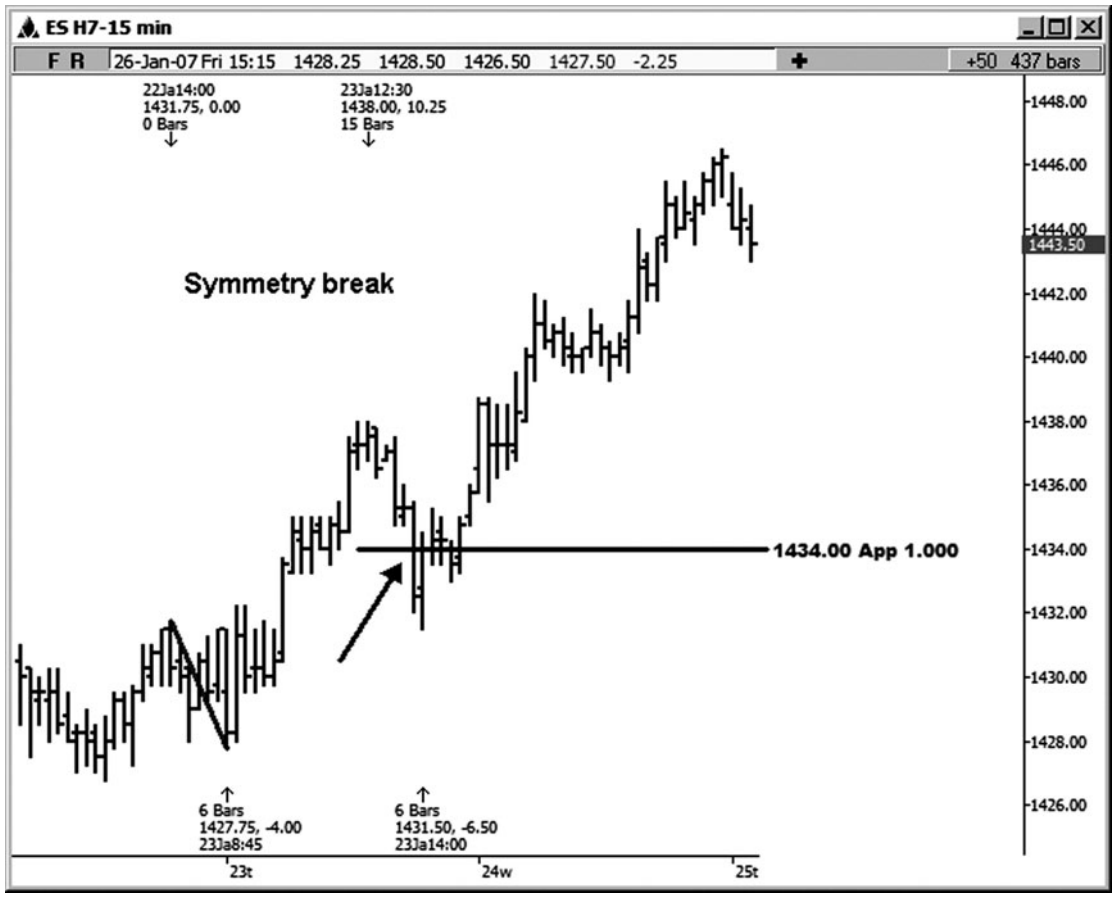

FIGURE 7-18

FIGURE 7-19

In the daily chart of Harley Davidson in Figure 7-19, you should be able to see, by just eyeballing the chart, that symmetry was violated after the 11/22/06 high was made. We were running these symmetry projections of the corrective declines of the prior major swing up from the 6/7/06 low to the 11/22/06 high. In this case, I also included a swing down just prior to the 6/7/06 low. I find that sometimes including a swing just before the new major trend begins can be a valuable projection. To define this violation of symmetry mathematically, once this stock corrected more than 3.57 down from any high, all the symmetry projections made on this chart were violated. Note that the largest corrective decline was 3.57. The other swings were similar, with 3.36, 3.55, and 3.32 declines. I consider symmetry to be violated once the largest symmetry projection was violated by a decent margin.

Even though this stock retraced nicely back toward that high, a rather healthy decline eventually ensued after this symmetry break. After symmetry is violated and the market pulls back, you want to watch for a possible failure and entry in the direction of the symmetry break.

Author Tip Although most of the symmetry projections made in this analysis are of prior corrective declines, as in the HOG chart example, there are times when I will include a projection from a swing just prior to development of the new trend. On that particular chart, the swing in question was from the 5/26/06 high to the 6/7/06 low. The projection was still a comparison of a similar swing in the same direction, though it was not considered a corrective swing of the move from the 6/7/06 low to the 11/22/06 high because it occurred prior to the new trend that started from the 6/7/06 low.

On this daily Nasdaq futures chart (see Figure 7-20), notice that I have labeled two prior declines. One of the declines was 50.50 points, and the other was 46.75 points. I projected both of these declines from the high made on 2/22/07, which showed me the possible symmetry support from which a rally could have resumed. Instead of holding above the key support of these projections at 1807.00–1810.75, symmetry support was violated, and this was followed by a relatively dramatic decline. Again, this won't happen every time symmetry is violated, but it is important to be aware of the possibilities at all times.

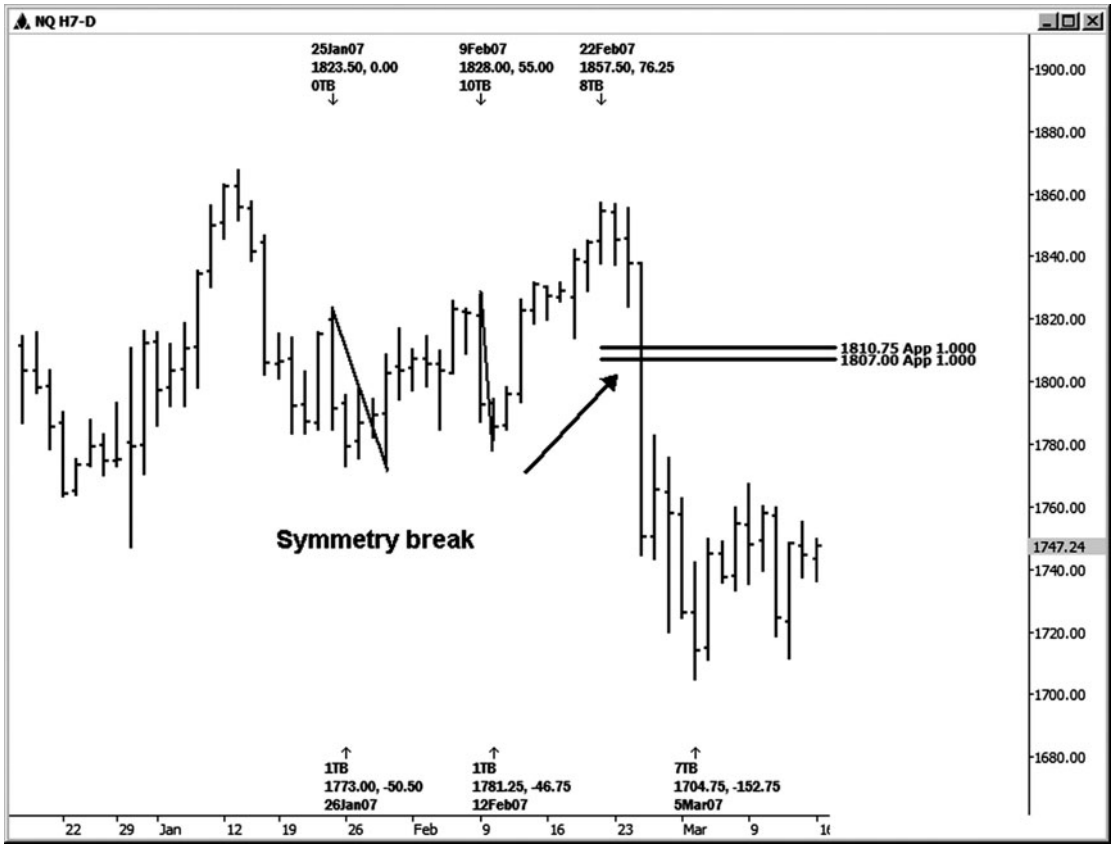

FIGURE 7-20

This next example illustrated on a daily chart of the electronic bond contract, shows another symmetry violation (see Figure 7-21). The initial violation was not by a huge margin, but it was visible enough to then watch for a possible change in the downtrend from the 12/1/06 high. After symmetry is violated, I will often start watching the next pullback for a possible market entry, since a change of trend is often seen after a symmetry break.

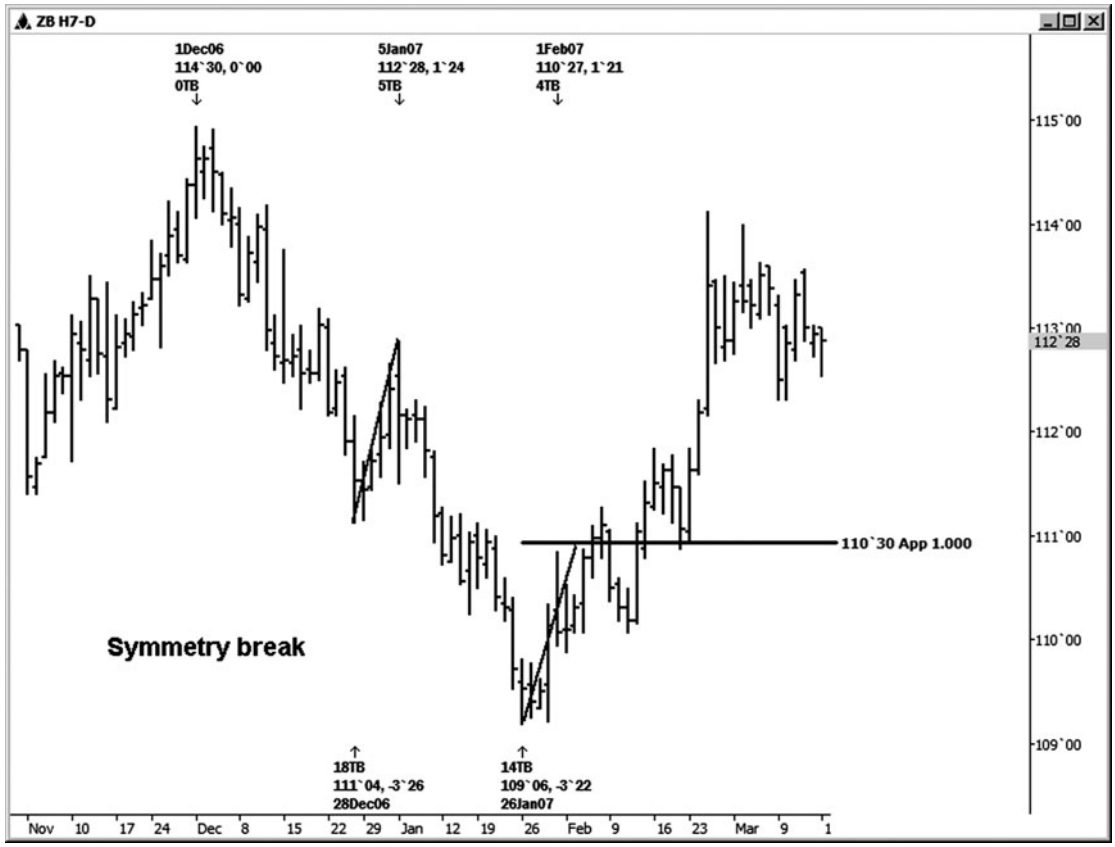

FIGURE 7-21

The next bond chart (see Figure 7-22) shows you where you could have watched the pullback after the symmetry break for a possible buy entry. In this example, the bond pulled back to just a couple of ticks above the .618 retracement. This was the beginning of a healthy trend reversal in the bond when the rally resumed from above this retracement.

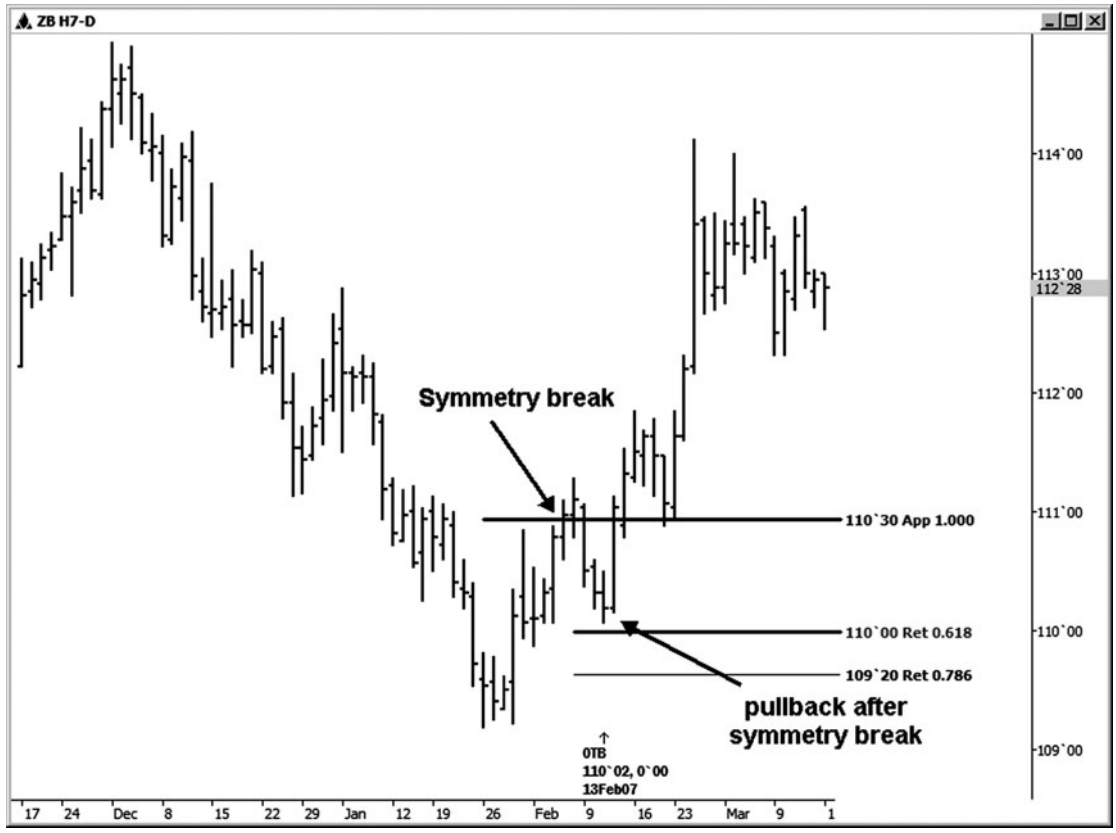

FIGURE 7-22

This chapter on symmetry showed you how to use these symmetry or 1.0 price projections as a simple yet powerful trade setup. It also discussed what we should look for when the symmetry of a market swing is violated. Along with price cluster setups, symmetry trade setups also offer relatively low-risk trades with a healthy risk/reward ratio.

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8 CHAPTER

THE TWO-STEP PATTERN SETUP: TRADE SETUP 3

Patterns tend to repeat themselves, both in life and in the marketplace. There is one particular pattern that I like to look for in all markets—a two-step pattern. I was first introduced to this pattern when I was studying the basics of Elliot wave analysis, where this pattern is considered a corrective or countertrend move that is seen before a trend resumes.

A two-step pattern can also be called a Gartley pattern, depending on the ratios that show up within it. The definition of a Gartley pattern is a bit more specific in terms of the ratios that show up within the pattern. For this reason, not all two-step patterns will fit the definition of a Gartley pattern, although all Gartley patterns are considered to be two-step patterns. (For more information on the Gartley pattern, check out *Fibonacci Ratios with Pattern Recognition* by Larry Pesavento.)

The two-step trade setup is a zigzag pattern that corrects a prior trend move. If we identify this pattern correctly, it should eventually resolve itself in the direction of the trend prior to the evolution of the zigzag. Within this pattern we will be looking for specific Fibonacci price relationships to overlap or *cluster* to make sure it falls within the definition of a proper two-step. These price relationships will be defined in this chapter.

(A two-step pattern can be a bullish setup, as in Figure 8-1, or a bearish setup, as in Figure 8-2.) So trade setup 3 is essentially a price cluster, with the addition of the zigzag pattern that strengthens the setup.

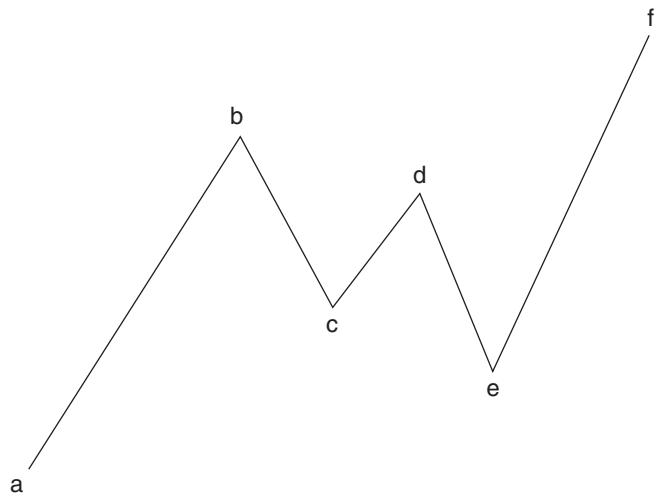

FIGURE 8-1

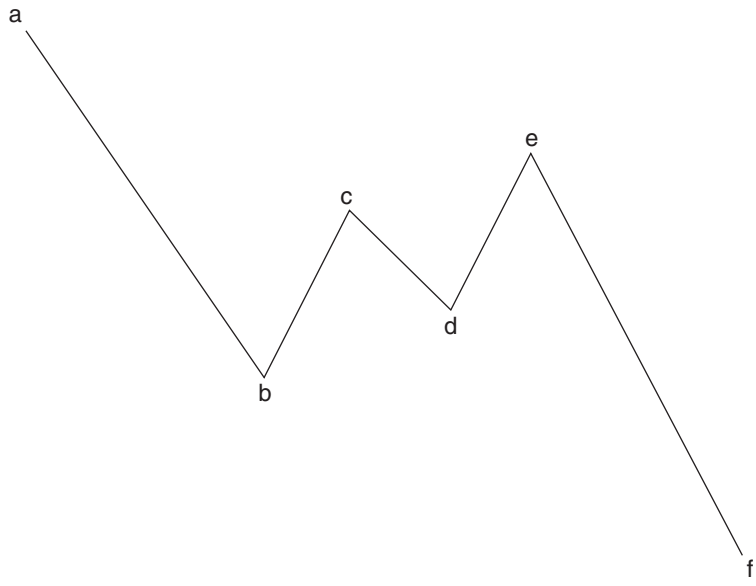

FIGURE 8-2

The actual zigzag pattern we are looking to identify occurs between points b and e. The ratios that we are going to run to look for a cluster will come from:

Running the retracements of a to b (.382, .50, .618, and .786)

Running the price extensions of c to d (1.272 and 1.618)

Running the price projection of b to c, projected from d (1.00)

The same ratios are applied to both bullish and bearish two-step patterns (see Figures 8-1 and 8-2).

Running these numbers will typically produce a price cluster of three Fibonacci price relationships that overlap each other nicely. Any of these price relationships can overlap; however, the two-step patterns that set up the ideal situation typically have a retracement ratio of either .618 or .786 from a to b that overlaps either a 1.272 or a 1.618 extension of the move from c to d that *also* overlaps a 100 percent projection of the first swing of the zigzag, which would mean that bc = de. I believe this ideal two-step fits the more stringent definition of a Gartley pattern. You might also see a two-step pattern develop in the market in which de = 1.618 of the b-to-c swing. I've found this to be a lot less common, so I have chosen not to include it in the definition of what I look for in my two-step pattern setups.

After these initial price relationships have been run, there may be additional Fibonacci price relationships that show up from other swings on the chart. This will just add strength to the setup and identify it as an important price decision.

WHY IS THIS A GOOD PATTERN?

My best explanation of why this pattern can be so lucrative comes from general swing theory. When we study basic technical analysis, we are generally taught that violating or taking out a prior swing low indicates weakness and/or a change in trend back to the downside. It would also follow that violating or taking out a prior swing high indicates strength and/or a change in trend back to the upside. Let's keep these basic technical concepts in mind as we examine the two-step pattern.

Within the zigzag pattern, when you take out point c, you are taking out either a prior swing high or a prior swing low. As discussed earlier, *this often signals a trend change*. For example, if point c was a low and the market traded below it, traders who follow swing theory might sell to exit long positions as a result of this violation. They might also sell to enter new

short positions. In many cases, the market will just continue down, as the break of the prior swing low does often signal a trend change as swing theory suggests.

If you run the two-step price relationships, however, and the price ends up holding *above* them, you have to consider the possibility that the pattern may be a two-step and that the original trend will resume instead of a trend reversal unfolding.

So when you start to see a zigzag pattern, you have to ask yourself the question, is this a trend reversal or a two-step pattern? Initially you won't know the answer. The bottom line is, you will know the *levels* that will *need to hold* if the two-step pattern is going to play out, but not whether or not they will hold. The biggest clues as to whether or not a two-step pattern will play out are going to come from your trade filters and triggers which will be discussed later.

Now remember in this example all the traders who either exited their long positions or went short when the prior swing low was violated. If the two-step price support parameters end up holding and the bulls regain control, those who exited might buy to reestablish long positions, and those who sold short should be buying to get out of an unsatisfying short trade. This will hopefully drive up the prices and *pay* you on the two-step pattern setup that you correctly identified.

The maximum stop on a two-step pattern setup is the same as that on a price cluster setup (a few ticks above or below the extreme of the price cluster). The initial price target for the two-step pattern is a bit different, however. The initial trade target is always the 1.272 extension of the whole zigzag, which is represented by the swing of b to e.

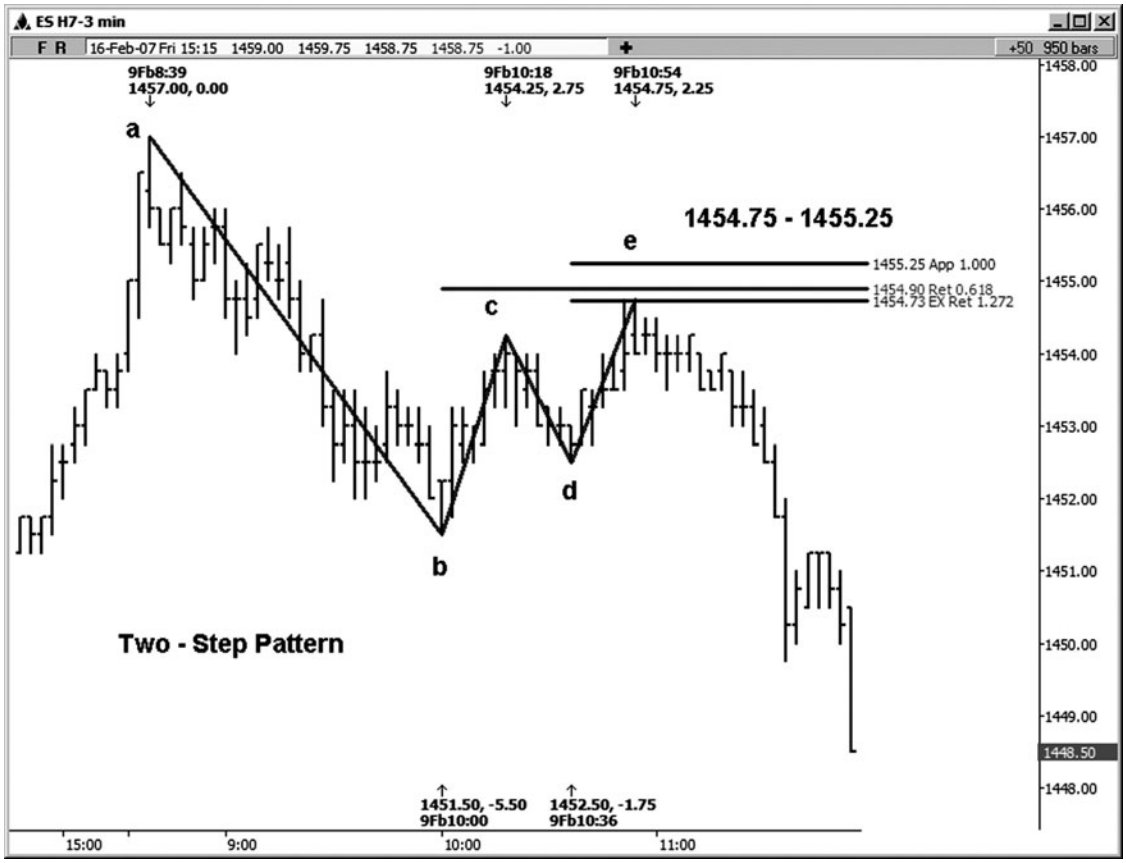

FIGURE 8-3

If you are a little *fuzzy* on the concept of the two-step pattern setup, the following examples should set you straight on what to look for. Let's start with an example of a bearish two-step pattern. Figure 8-3 is an example that was actually set up in my chat room on 2/9/07 on a three-minute E-mini S&P chart. The price relationships that made up this two-step pattern cluster included the .618 retracement of point a to point b, the 1.272 extension of point c to point d, and the 1.0 projection of b to point c, projected from point d:

.618 retracement of 1457.00 high to the 1451.50 low
(point a to point b) = 1454.90

1.272 extension of the 1454.25 high to the 1452.50 low
(point c to point d) = 1454.73

1.0 price projection of the 1451.50 low to the 1454.25 high, projected from the 1452.50 low (point b to point c, projected from point d) = 1455.25

I rounded the numbers from these projections to the closest futures price and labeled this cluster 1454.75–1455.25. The actual high was made at 1454.75, which was at the low end of the cluster. The initial downside target, which was the 1.272 extension of the move from point b to point e, came in at 1450.75. This first target was met along with the second and third targets of 1.618 and 2.618.

Figure 8-4 shows that an eventual decline of 17.75 points was seen from this first example of a two-step pattern high. It also illustrates what I mean by the zigzag pattern.

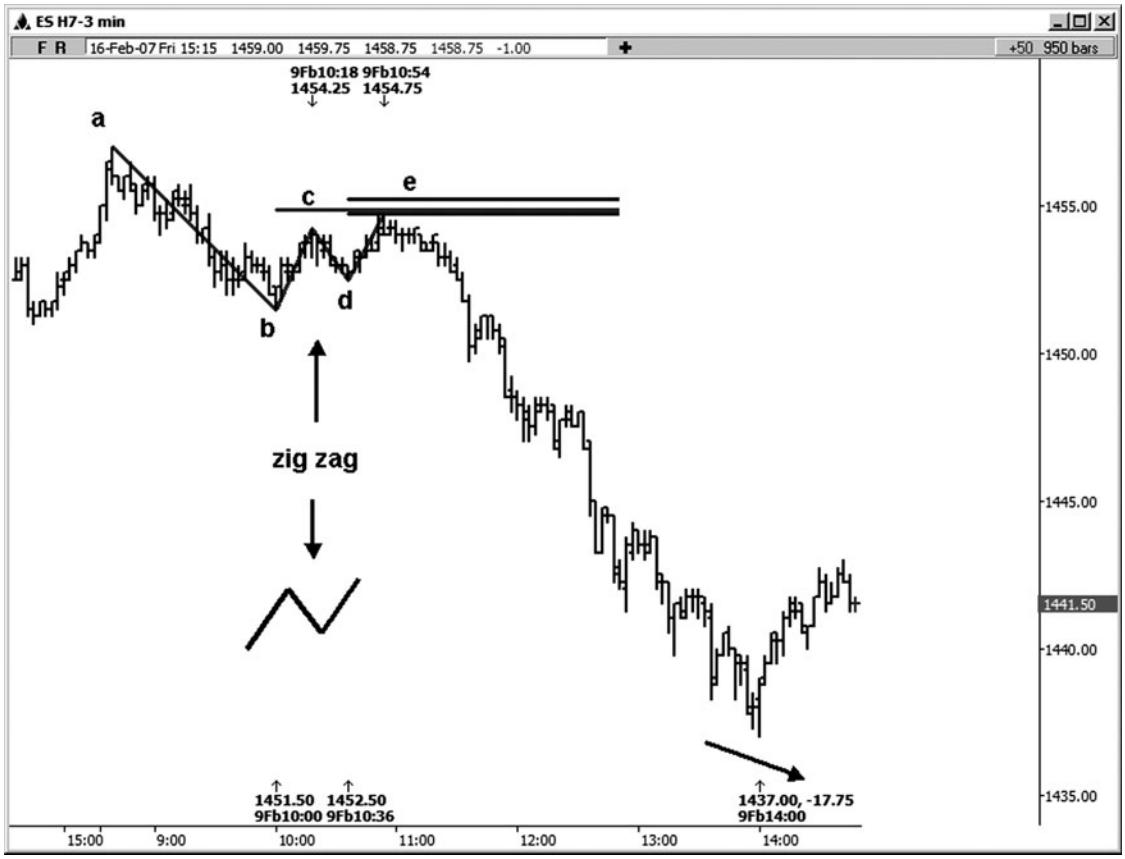

FIGURE 8-4

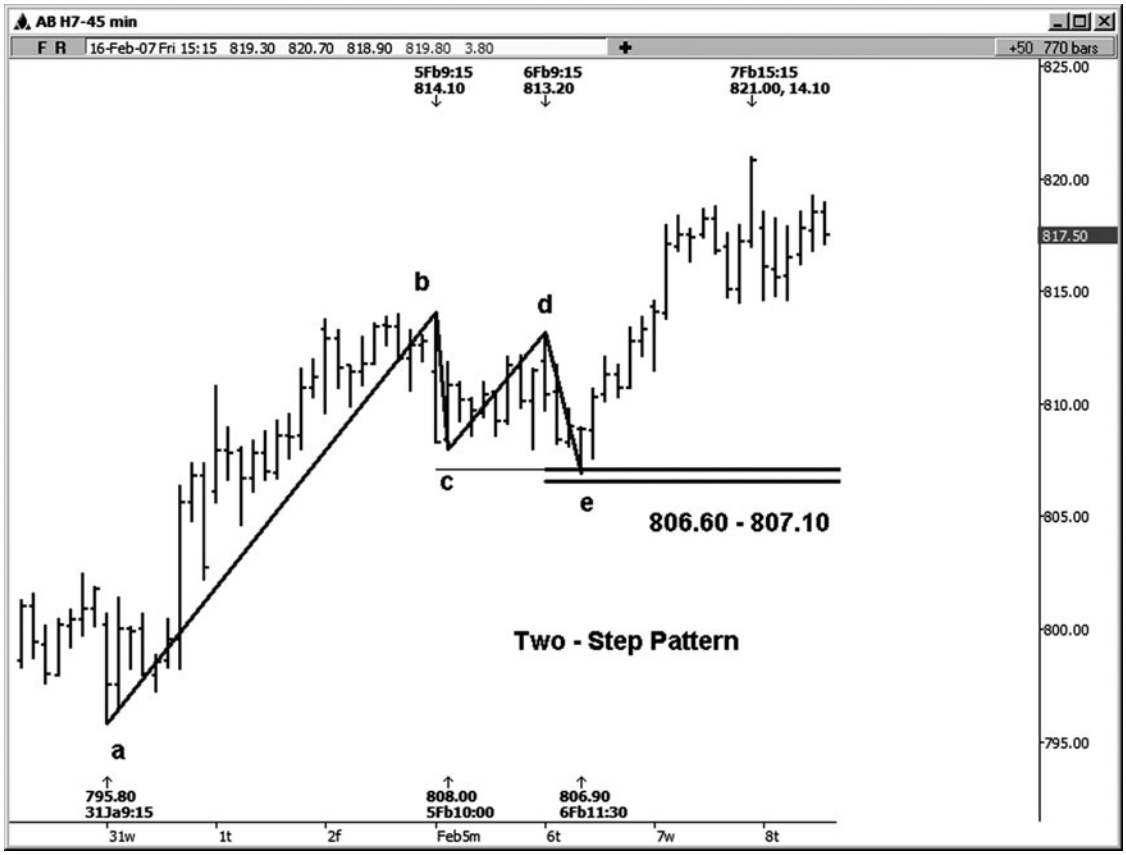

FIGURE 8-5

Figure 8-5 is an example of a bullish two-step pattern setup on a 45-minute chart in the E-mini Russell contract. The price cluster included the .382 retracement of point a to point b, the 1.272 extension of point c to point d, and the 1.0 projection of point b to point c, projected from point d:

.382 retracement of the 795.80 low to the 814.10 high (point a to point b) = 807.11

1.272 extension of the 808.00 low to the 813.20 high (point c to point d) = 806.59

1.0 projection of the 814.10 high to the 808.00 low, projected from the 813.20 high (point b to point c, projected from point d) = 807.10

Again I rounded the numbers from the program to the closest futures price available and came up with a cluster zone at the 806.60–807.10 area. The actual low was made at 806.90. The initial rally from the two-step pattern low lasted 14.10 points. Also note that this two-step example is not as symmetrical as some of the other examples you may see develop in the markets. The swings from point b to point c and from point d to point e are rather short in time compared to the swing from point c to point d. Generally these swings are a bit more similar in time.

(As long as you can see the zigzag and the price relationships overlap to create the cluster, however, it is good enough for a trade setup in my book!)

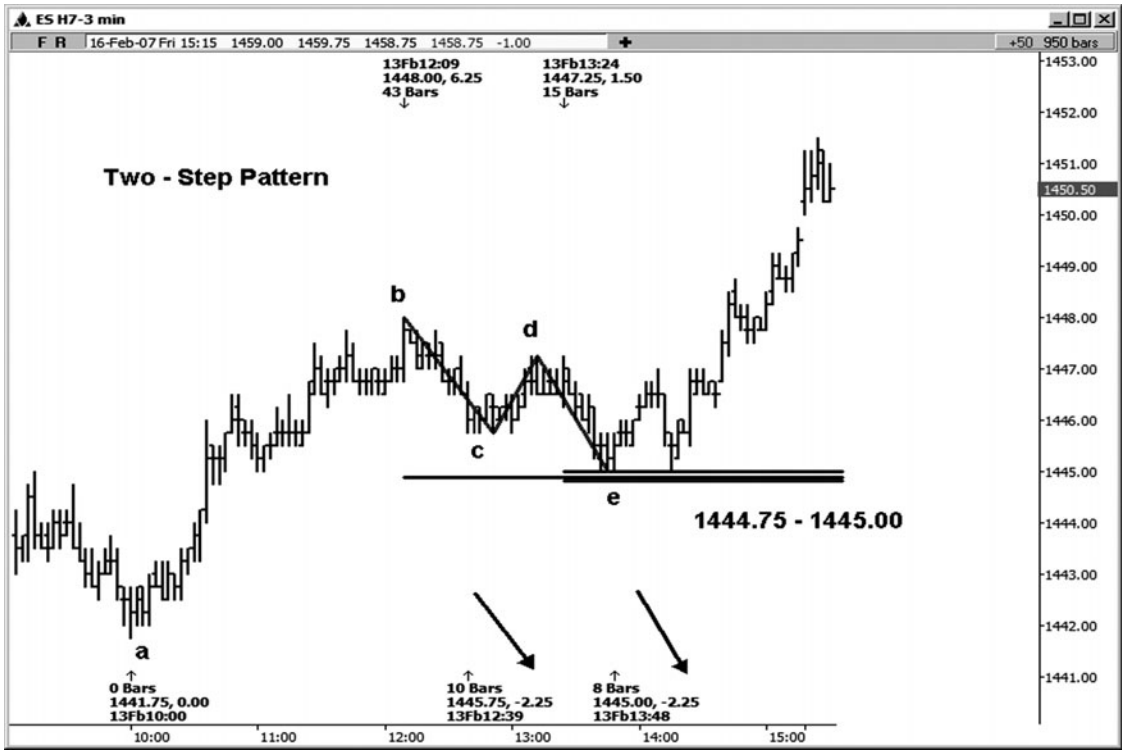

FIGURE 8-6

Let's look at another two-step pattern that developed in the E-mini S&P March 2007 contract on a three-minute chart (see Figure 8-6). The zigzag is labeled on the chart. The two-step pattern cluster developed from a 50 percent retracement of point a to point b, a 1.618 extension of point c to point d, and the 1.0 projection of point b to point c, projected from point d. This created a cluster in the 1444.75–1445.00 area.

.50 retracement of the 1441.75 low to the 1448.00 high (point a to point b) = 1444.88

1.618 extension of the 1445.75 low to the 1447.25 high (point c to point d) = 1444.82

1.0 projection of the 1448.00 high to the 1445.75 low, projected from 1447.25 high (point b to point c, projected from point d) = 1445.00

Notice the equality of the swings from b to c and from d to e. Both of these swings were exactly 2.25 points. Symmetry is a big part of the ideal two-step pattern.

The actual low was made at 1445.00, as shown in Figure 8-7. This trade setup attained all three targets on the upside and continued even higher. A rally of 13.50 was seen from this low pretty quickly. There are many times when the market will surpass all trade targets. For this reason, I recommend using a trailing stop on at least part of your trading position so that you can fully take advantage of some of these extended moves that start with a very low risk trade setup.

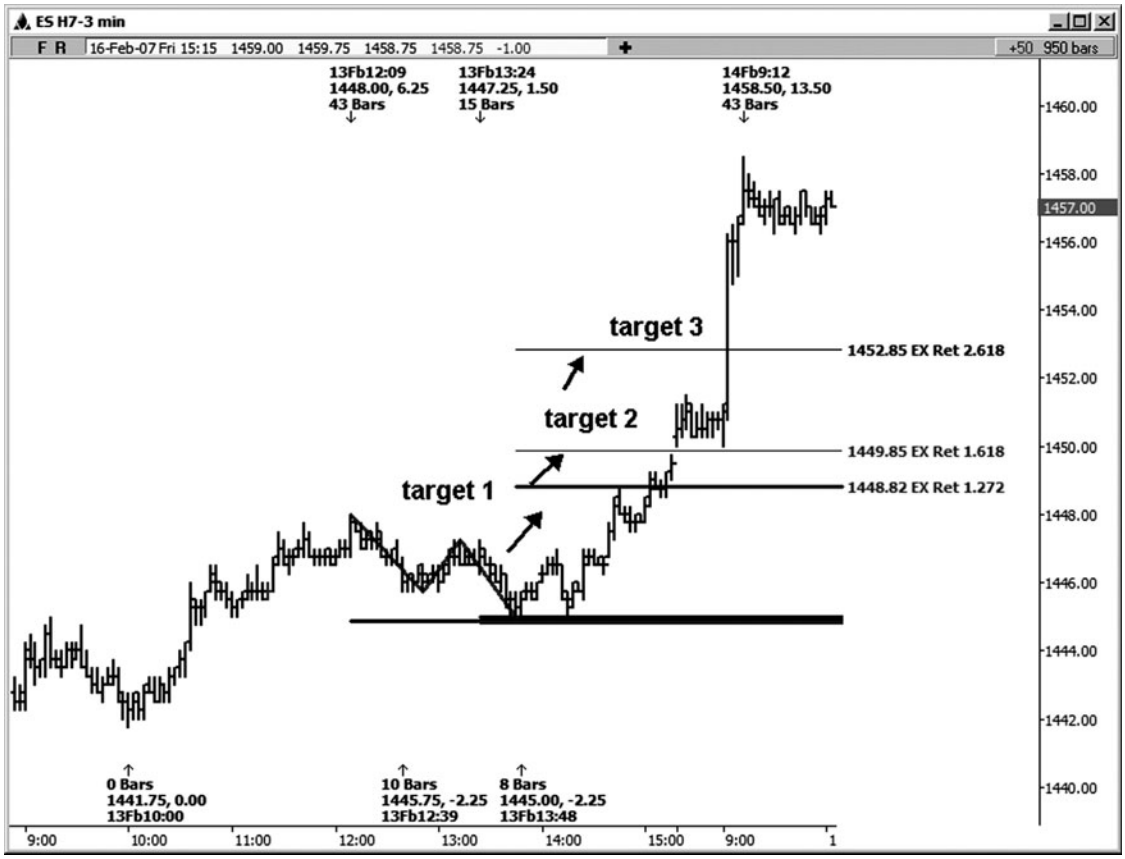

FIGURE 8-7

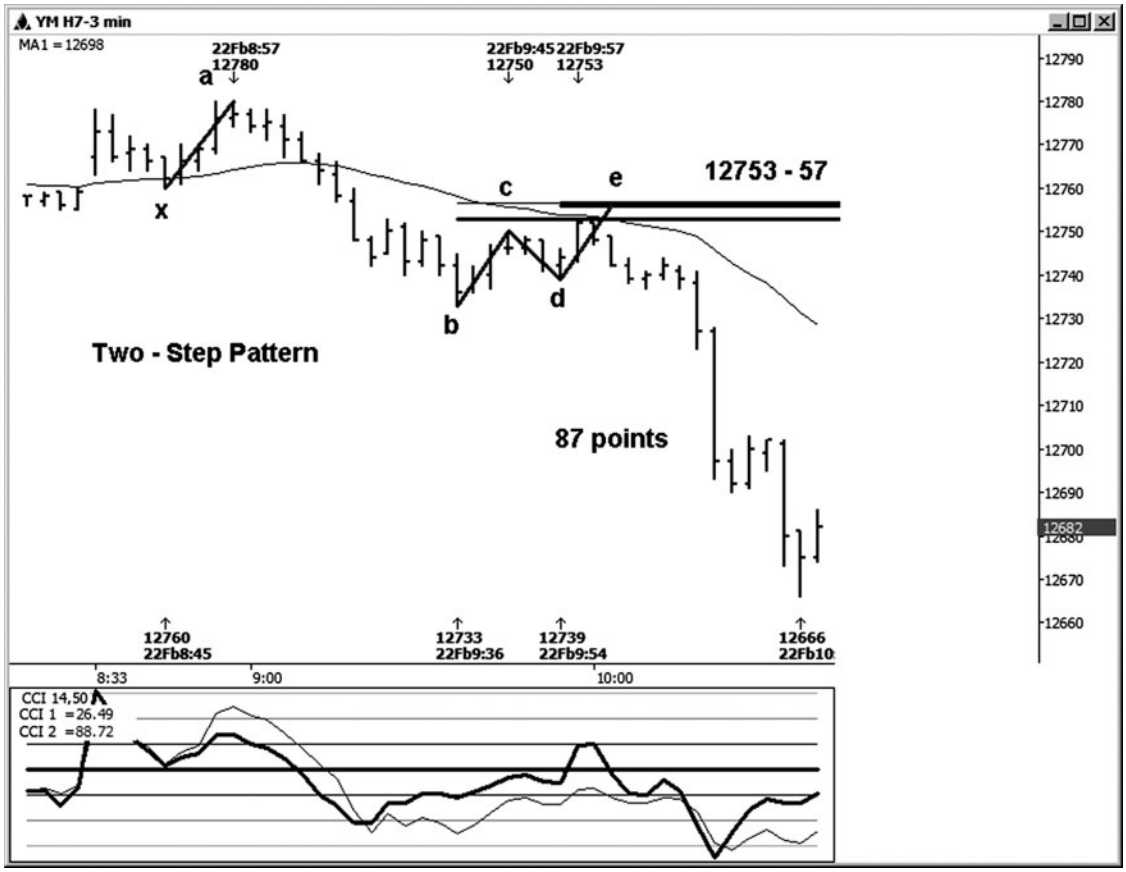

FIGURE 8-8

In Figure 8-8, we are looking at a two-step pattern on a three-minute chart of the mini-sized Dow contract. The price cluster came in at the 12753–12757 area.

The price relationships were:

.50 retracement of the 12780 high to the 12733 low (point a to point b) = 12757

1.272 extension of the 12750 high to the 12739 low (point c to point d) = 12753

1.618 extension of the 12750 high to the 12739 low (point c to point d) = 12757

1.0 projection of the 12733 low to the 12750 high, projected from the 12739 low (point b to point c, projected from point d) = 12756

1.0 projection of the 12760 low to the 12780 high, projected from the 12733 low (point x to point a, projected from point b) = 12753

In this example, not only did we have the typical price relationships that we look for in a two-step pattern, but we also had another symmetry projection from a prior low-to-high swing that just happened to overlap the other relationships. Also, the swing from point c to point d was only 11 points. Since the difference between a 1.272 extension and a 1.618 extension of an 11-point move was minimal, both the 1.272 and the 1.618 extensions of point c to point d ended up overlapping the other price relationships. It does strengthen a setup when other price relationships also overlap the two-step pattern plan, especially if they are symmetry projections. A decline of 87 points was seen from the high into this two-step pattern cluster.

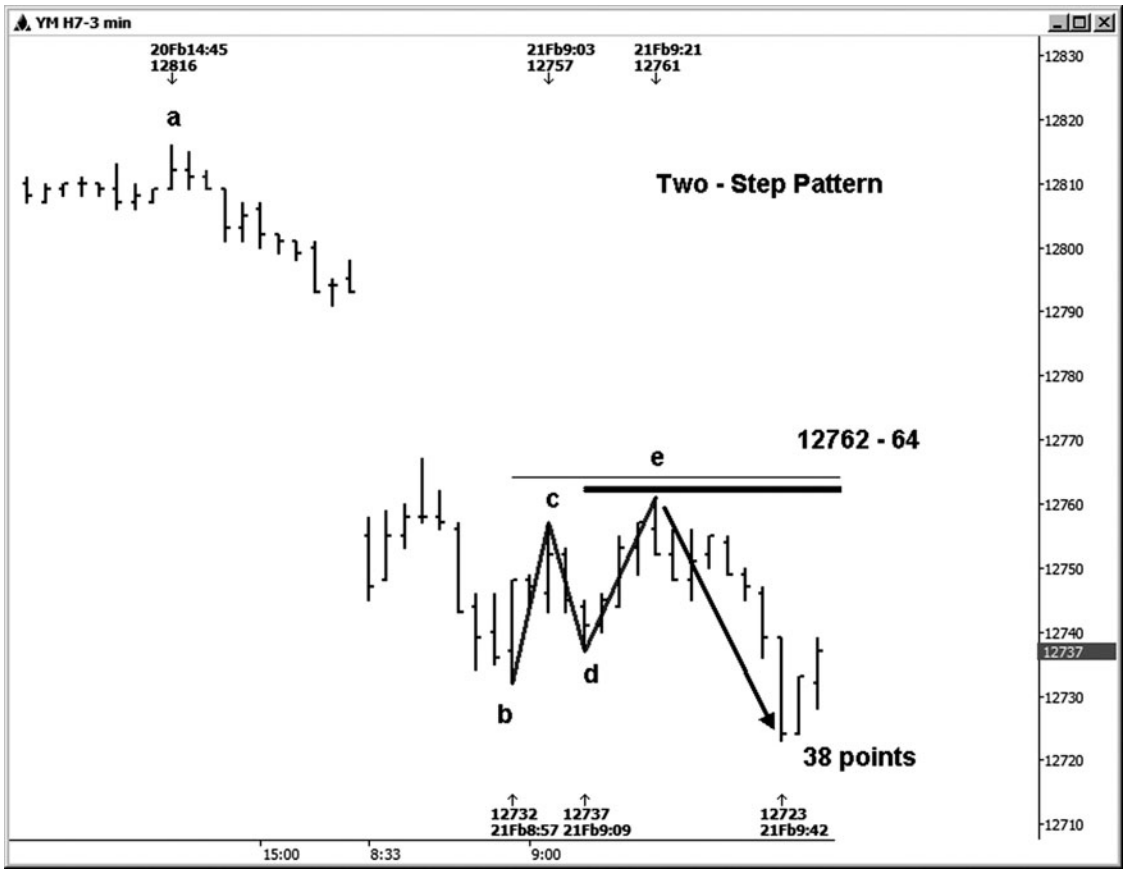

FIGURE 8-9

Figure 8-9 is a two-step pattern that showed up on a three-minute chart in the mini-sized Dow. A price cluster was formed at the 12762–12764 area.

The price relationships were:

.382 retracement of the 12816 high to the 12732 low (point a to point b) = 12764

1.272 extension of the 12757 high to the 12737 low (point c to point d) = 12762

1.0 projection of the 12732 low to the 12757 high, projected from the 12737 low (point b to point c, projected from point d) = 12762.

The actual high was made at 12761, just one tick below the cluster zone. This was followed by a pretty quick decline of 38 points.

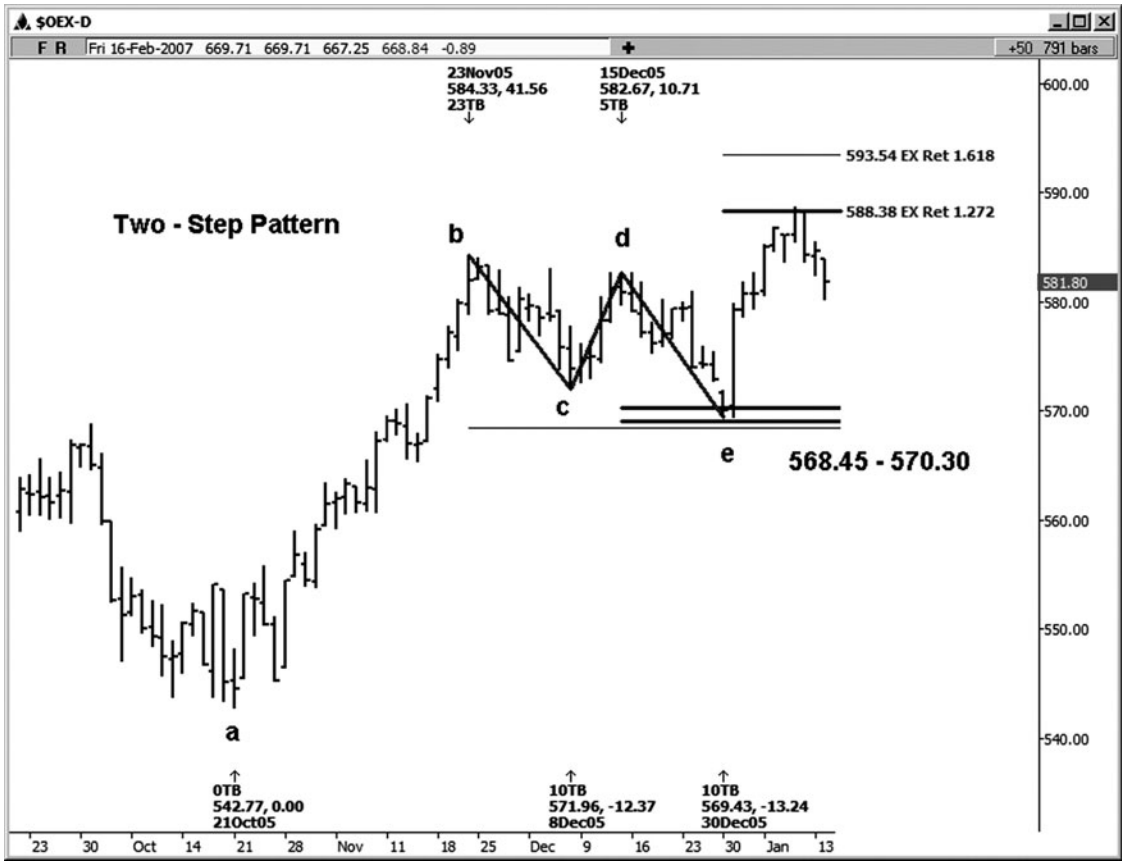

FIGURE 8-10

The next two-step pattern example (see Figure 8-10) is on the daily OEX cash chart. Here we had the coincidence of a .382 retracement from point a to point b, a 1.272 extension of point c to point d, and a 1.0 price projection of point b to point c, projected from point d.

.382 retracement of the 542.77 low to the 584.33 high (point a to point b) = 568.45

1.272 extension of the 571.96 low to the 582.67 high (point c to point d) = 569.05

1.0 projection of the 584.33 high to the 571.96 low, projected from the 582.67 high (point b to point c, projected from point d) = 570.30

The actual low was made at 569.43. It was followed by a rally of over 19 points, reaching the initial upside target of the pattern at the 1.272 extension.

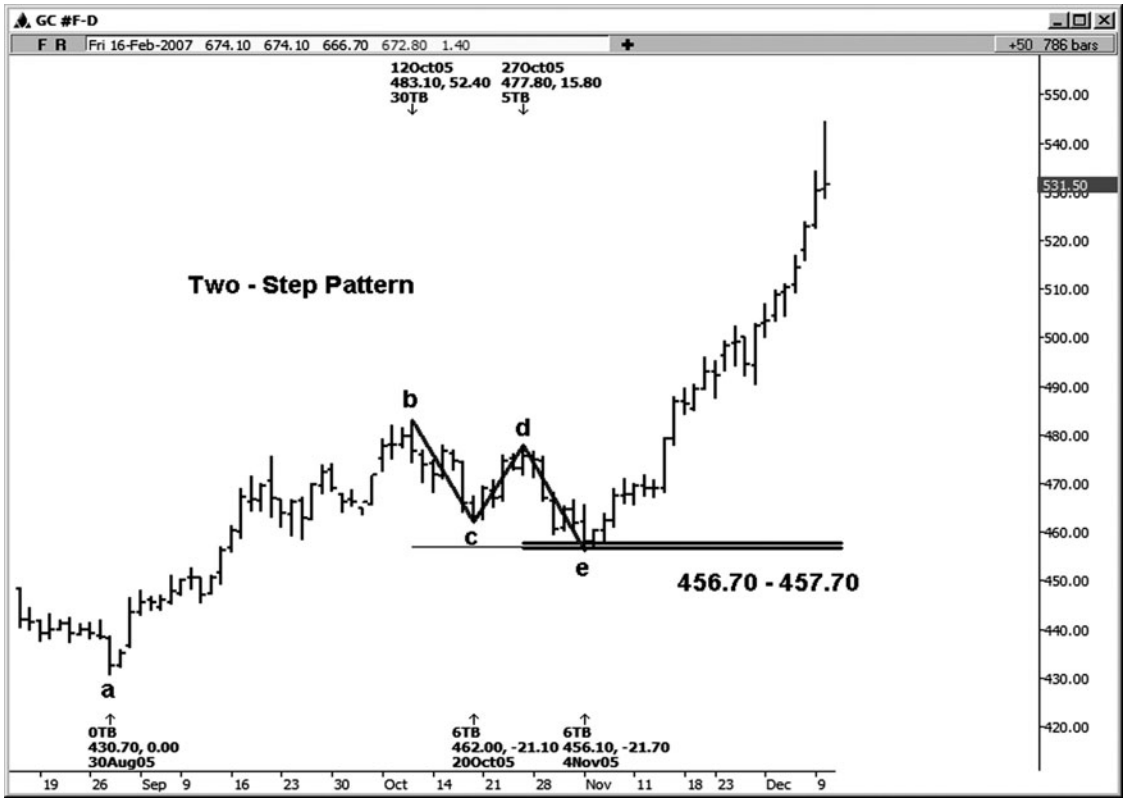

FIGURE 8-11

The next example of a two-step cluster was found on a daily continuous chart in the gold market (see Figure 8-11). It included a 50 percent retracement of point a to point b, a 1.272 extension of point c to point d, and a 1.0 projection of point b to point c, projected from point d. The zone came in between 456.70 and 457.70.

.50 retracement of the 430.70 low to the 483.10 high (point a to point b) = 456.90

1.272 extension of the 462.00 low to the 477.80 high (point c to point d) = 457.70

1.0 projection of the 483.10 high to the 462.00 low, projected from the 477.80 high (point b to point c, projected from point d) = 456.70

The low in this case was made at 456.10. This was just a bit below the low end of the cluster at 456.70 (60 cents). Remember not to always expect perfection in this work. An $88 rally followed this low.

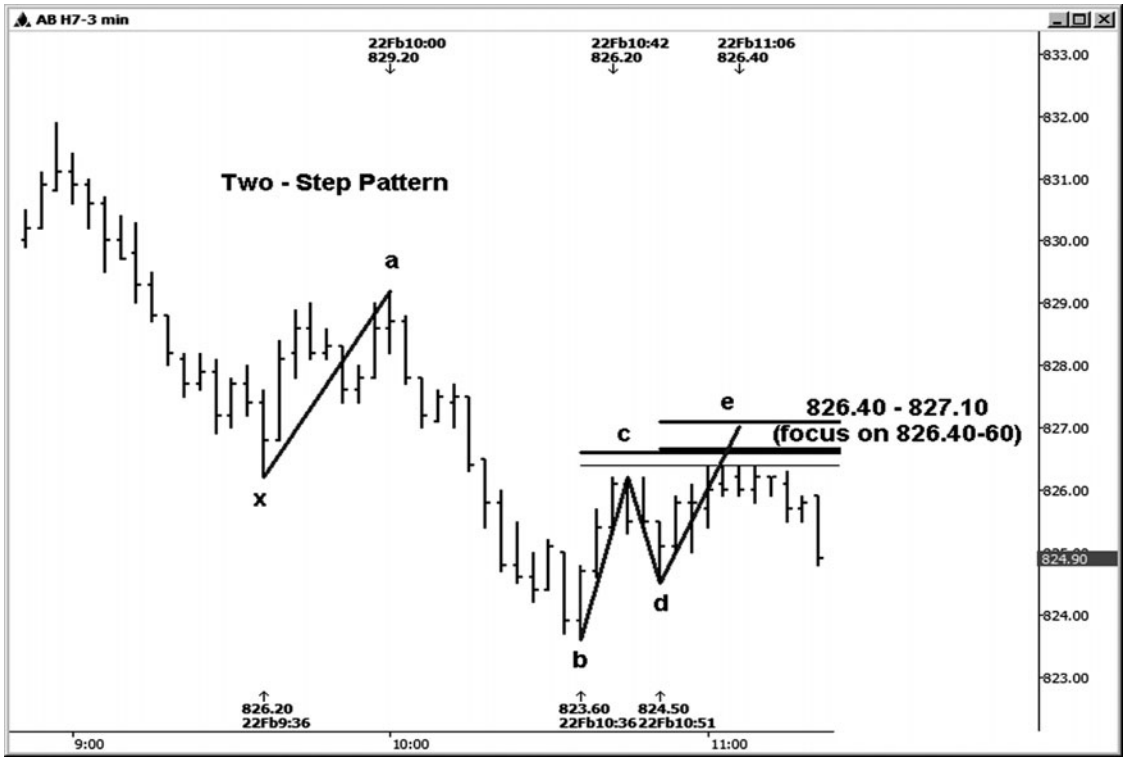

FIGURE 8-12

Not every two-step pattern plays out. As a matter of fact, many of them are violated every day, just like regular price cluster setups, and some of them play out only partially. Let's look at one of those examples where the pattern did not play out fully. This example occurred on a three-minute chart in the E-mini Russell contract (see Figure 8-12). The two-step cluster zone came in at 826.40–827.10, with a focus on the 826.40–826.60 area (three of the price relationships came together within that tighter range).

The price relationships were:

.50 retracement of the 829.20 high to the 823.60 low (point a to point b) = 826.40

1.272 extension of the 826.20 high to the 824.50 low (point c to point d) = 826.66

1.0 projection of the 823.60 low to the 826.20 high, projected from the 824.50 low (point b to point c, projected from point d) = 827.10

1.0 projection of the 826.20 low to the 829.20 high, projected from the 823.60 low (point x to point a, projected from point b) = 826.60

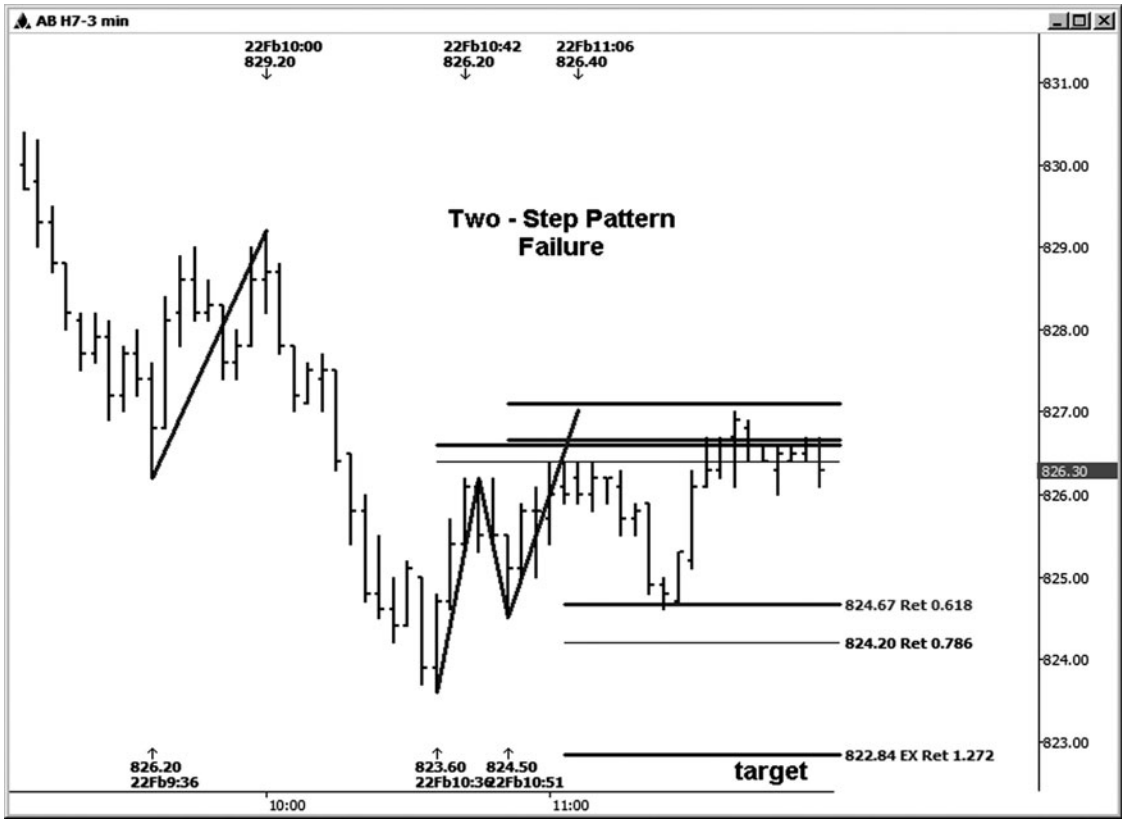

FIGURE 8-13

A high was made at the low end of this two-step cluster, and we did start to see a bit of a decline. Figure 8-13, however, illustrates that the pattern never fully played out. After a bit more than a .618 retracement back to the low at 823.60, the rally resumed, rather than heading for the typical downside target at the 822.84 area, which was the 1.272 extension of point b to point e. (Points b and e are illustrated in Figure 8-12.)

Author Tip Sometimes these two-step pattern setups play out in a textbook fashion as far as reaching at least the initial trade target of 1.272 of the whole zigzag. Don't get stuck believing that this is always the case, however. Although many two-step patterns do make the initial target and then some, there are plenty that don't play out fully. For this reason, I recommend using a trailing stop just in case.

FIGURE 8-14

Let's look at an example in the cash Dow $INDU that set up on a 15-minute chart (see Figure 8-14). A two-step pattern and price cluster setup developed at the 12384.20–12396.92 area. It included four key price relationships.

.50 retracement of the 12510.81 high to the 12257.58 low = 12384.20

.618 retracement of the 12470.52 high to the 12257.58 low = 12389.18

1.618 extension of the 12355.23 high to the 12287.78 low = 12396.92

1.0 projection of the 12257.58 low to the 12355.23 high, projected from the 12287.78 low = 12385.43

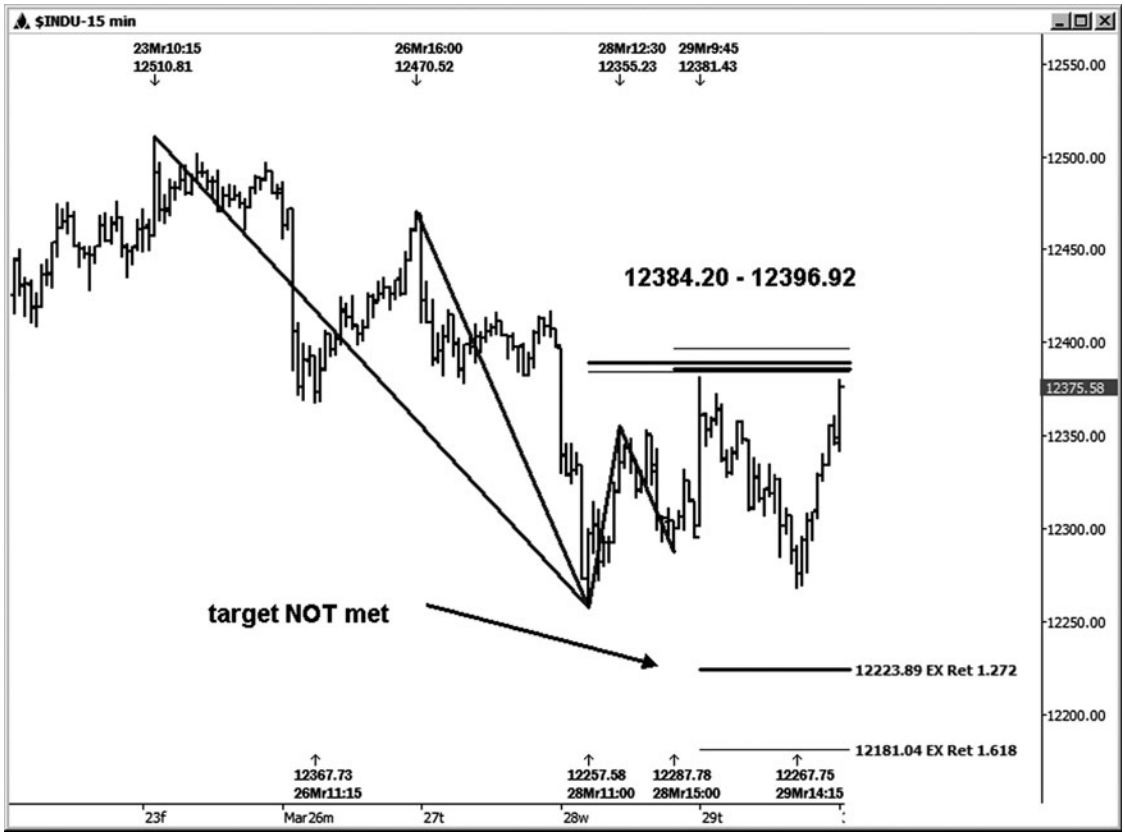

FIGURE 8-15

A high was made just a touch below this two-step cluster at the 12381.43 level, as shown in Figure 8-15. A healthy decline did start from this pattern, but after trading a touch below the .786 retracement back to the 12257.58 swing low, the rally resumed, and the 1.272 target was never met. It was *still* a great trade setup. It just didn't give us the target that we typically look for.

Author Tip If you see a zigzag pattern start to develop on the particular chart you are analyzing, run the price relationships and see if you get the clustering effect. When these setups do play out as planned, they can be rather lucrative.

In this chapter, you learned about the two-step pattern setup, which is sometimes also called a Gartley pattern. This setup, along with the price cluster and symmetry trade setups, offers another trading opportunity with well-defined risk and the potential for some healthy profits.

You now know the basics of how to create a type 1, 2, or 3 trade setup if you have gotten through the first eight chapters of this book. (Note that not all of these trade setups will result in tradable reversals.) Many of these trade setups will be violated or negated. To raise your percentage of winning trades, these setups need to be *filtered* by a good set of indicators and/or price triggers, and ideally should be set up within the direction of the trend. The triggers and indicators that I like to use in my trading plan, along with a few others, will be discussed in a later chapter.

9 CHAPTER

CHOOSING THE SWINGS FOR ANALYSIS

A question that my students always ask is: which highs and lows or price swings do you use to run the analysis from? Beyond learning from the following examples, I'll ask you to use a little bit of common sense. When you are looking at a chart and considering which highs and lows to run the price relationships from, ask yourself whether the results from the highs and lows you are using are relevant to the current market.

CHART EXAMPLES

This first example, Figure 9-1, is on a 15-minute chart in the E-mini Russell. The highs and lows that I would use for both time and price analysis are labeled on the chart. The points I have chosen are all well-defined swing highs and lows that will help me identify my trade setups. I can see in my mind's eye the opportunities for running multiple price retracements, price extensions, and price projections using the highs and lows I have identified on this chart.

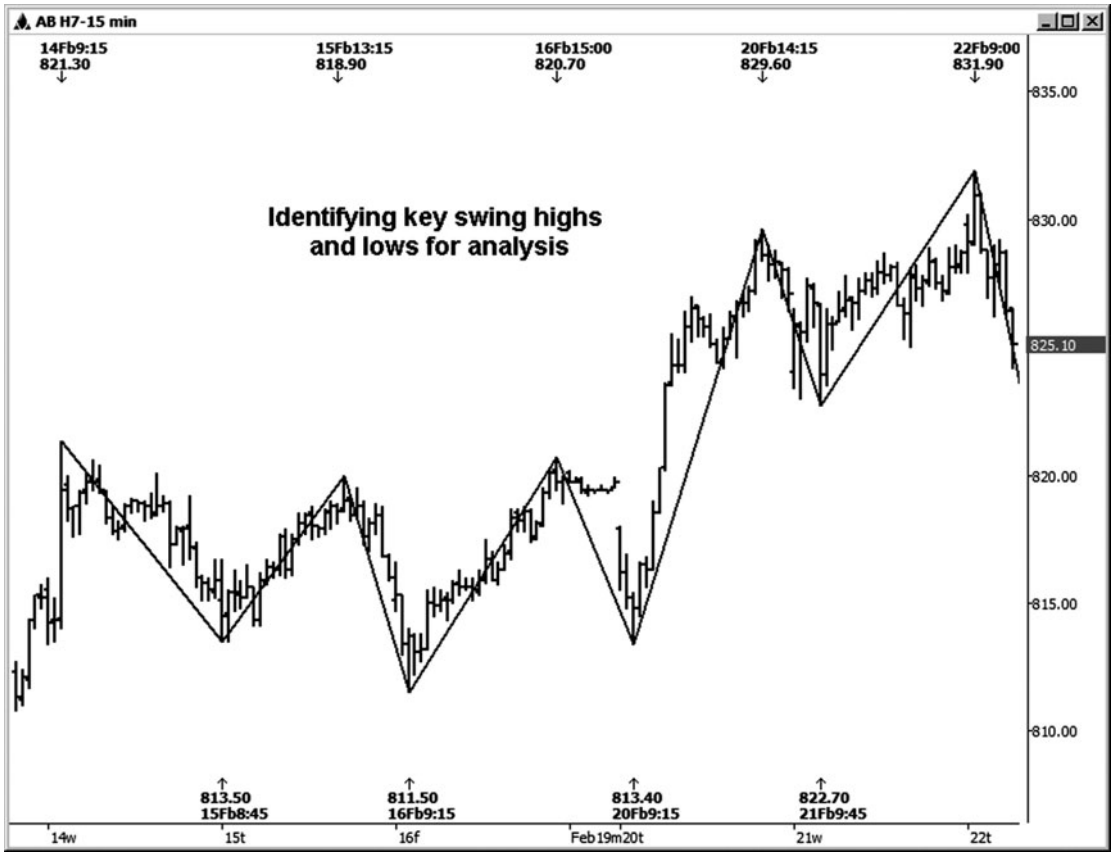

FIGURE 9-1

On the daily euro FX chart (EUR/USD) shown in Figure 9-2, the swings that are obvious to me to use in my analysis are labeled. In this example, I would also use the swing between points a and b as long as it still made sense. For example, projecting symmetry using that swing from the 12/4/06 high made sense until the market declined by more than 100 percent of that prior swing down. At that point, the market would have violated the symmetry support that would have been projected from that swing.

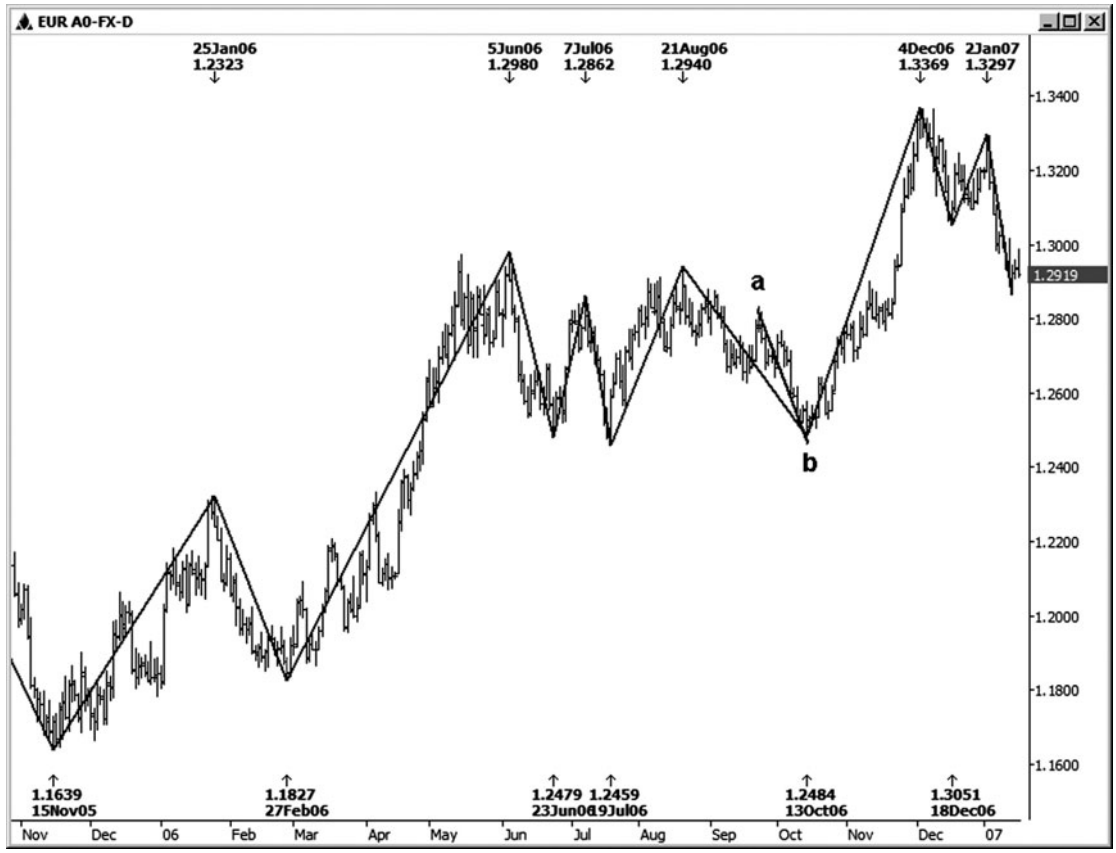

FIGURE 9-2

Figure 9-3 is an example of a daily chart of General Motors (GM). I've labeled the swings I would use for both price and time analysis on this stock.

FIGURE 9-3

Figure 9-4 is a daily chart of Google. I've labeled the swings that would make sense for the analysis. To me, the highs and lows to use for analysis are obvious.

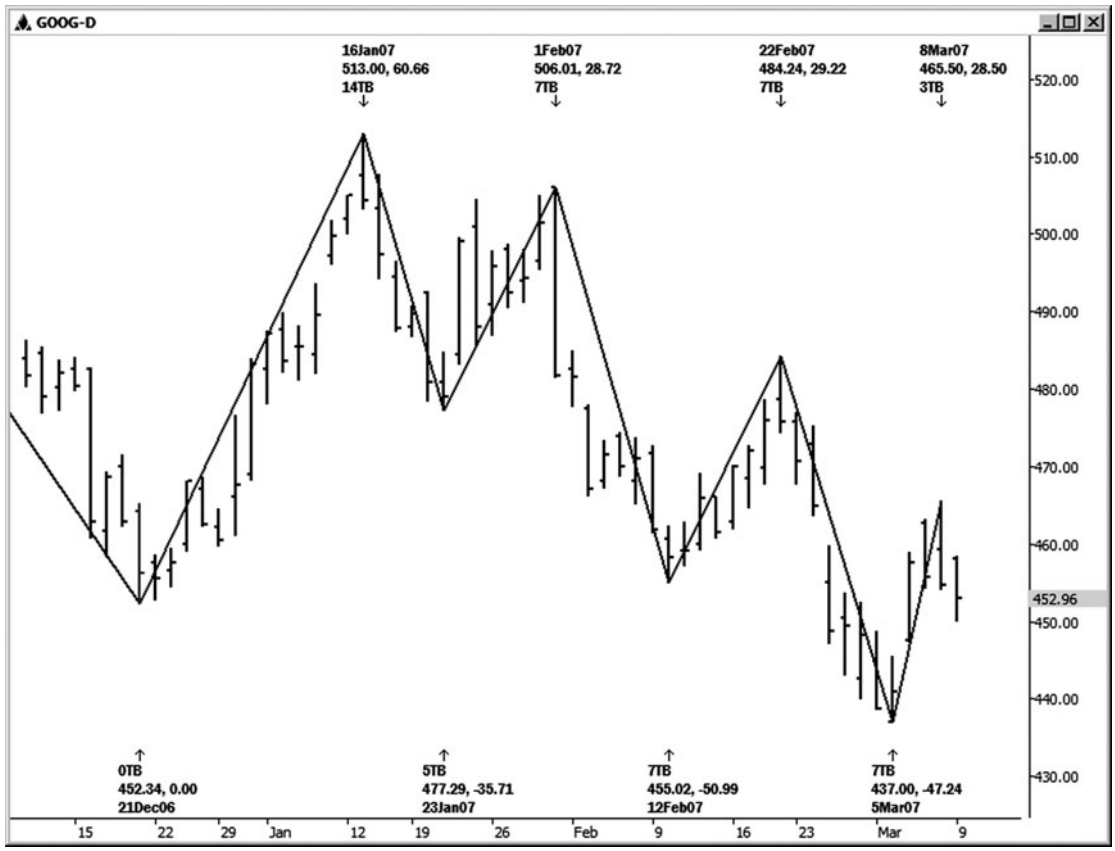

FIGURE 9-4

On the 240-minute euro FX chart (EUR/USD) shown in Figure 9-5, the swings labeled are the ones that stand out for use in both time and price analysis of this chart.

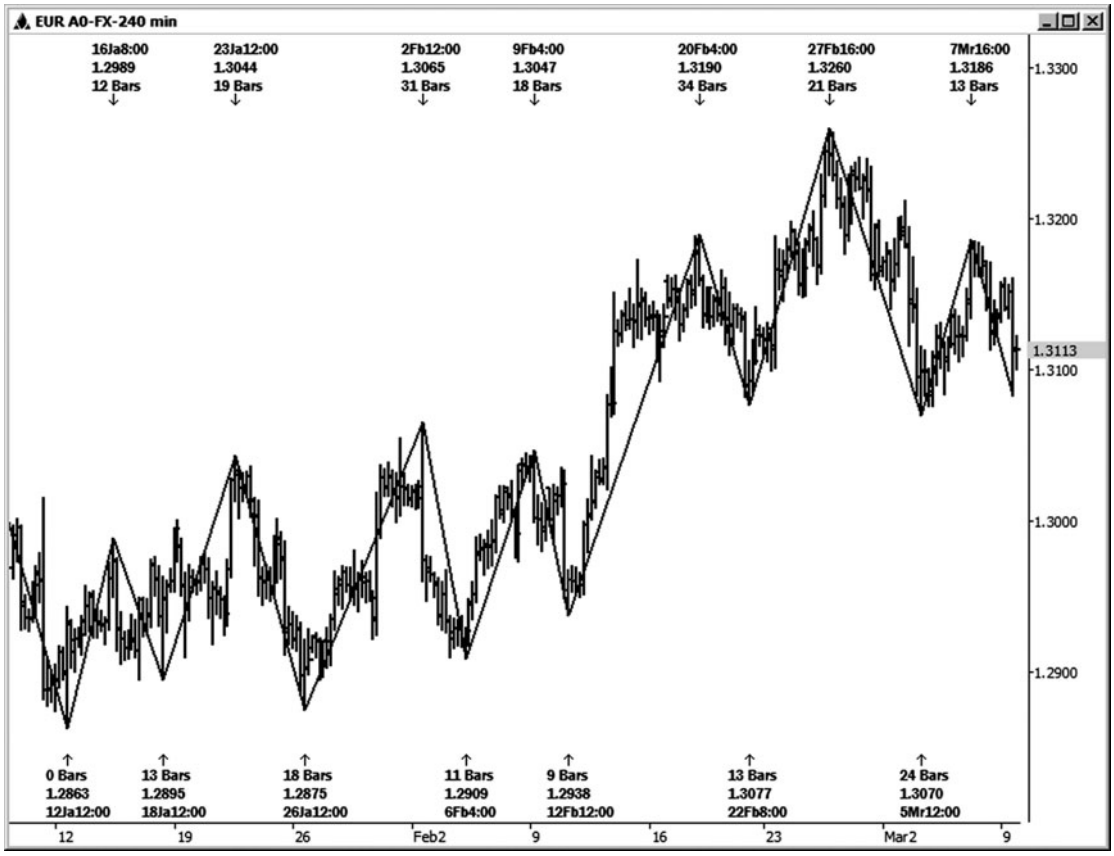

FIGURE 9-5

In Figure 9-6, the swings on the daily "Cable" (GBP/USD) chart that should be used for analysis are labeled on the chart.

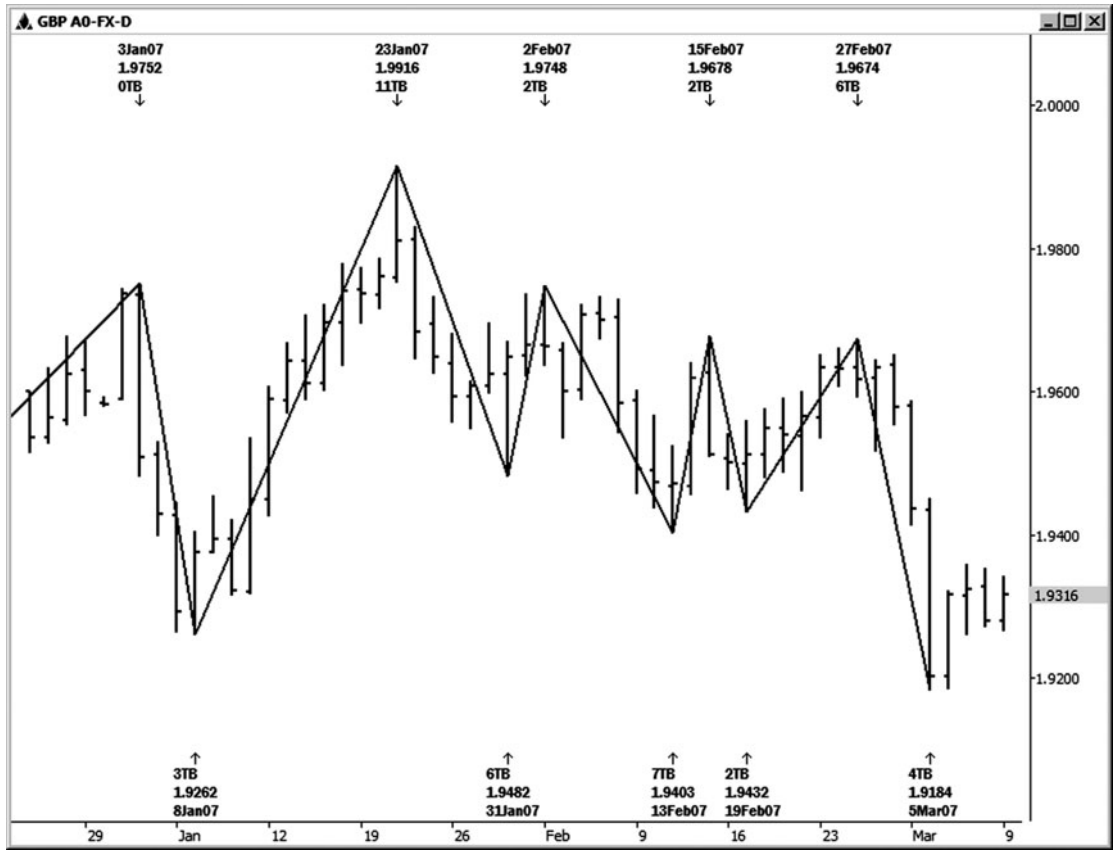

FIGURE 9-6

Figure 9-7 shows a 15-minute chart of the April 2007 mini-sized gold contract. I have labeled the swings that I would have used for my analysis.

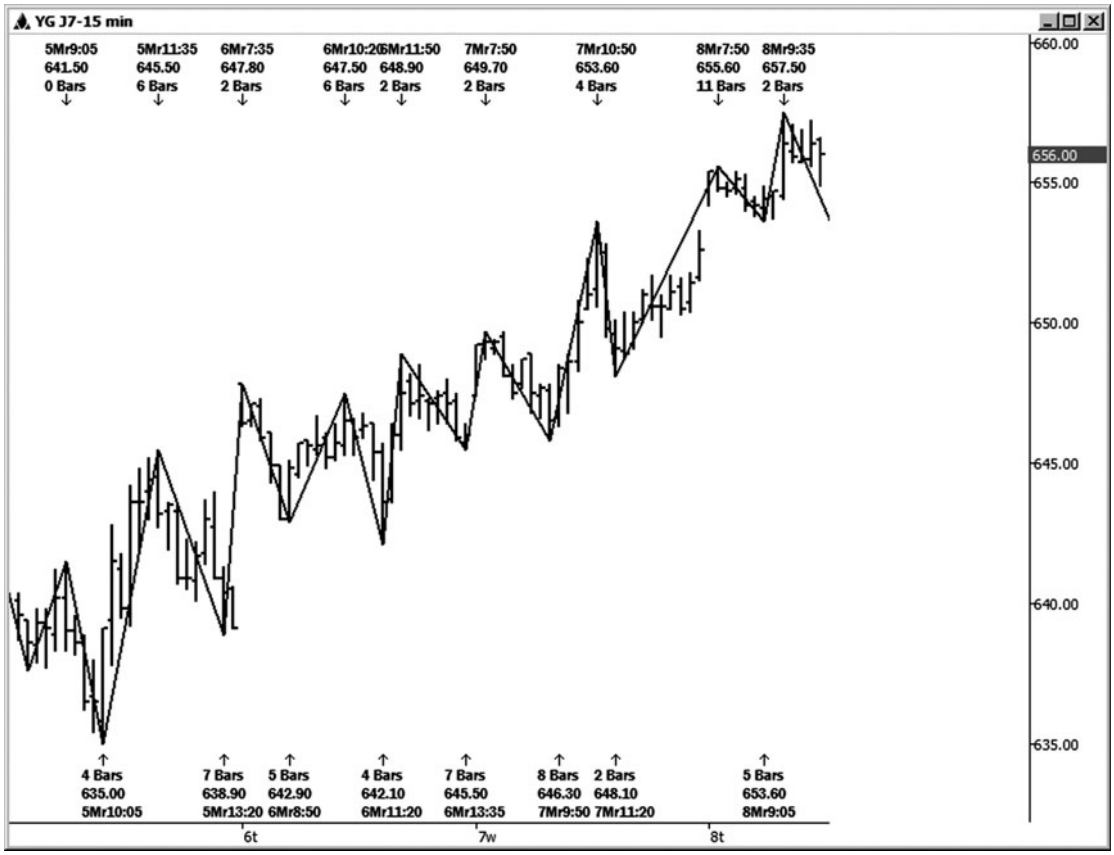

FIGURE 9-7

This chapter was meant to give you a visual guide to the types of swings or highs and lows you should be choosing for your analysis. Once you have a good idea of where to run your price relationships from, with a good analysis program the rest is relatively easy.

You've heard me mention timing or time analysis. Now that we've gone through all the steps to run our price analysis, it is time to focus on *time.* Let's look at how we can apply Fibonacci ratios on the time axis of the market, which can increase the odds of a trade setup playing out if these time cycles coordinate with your price work.