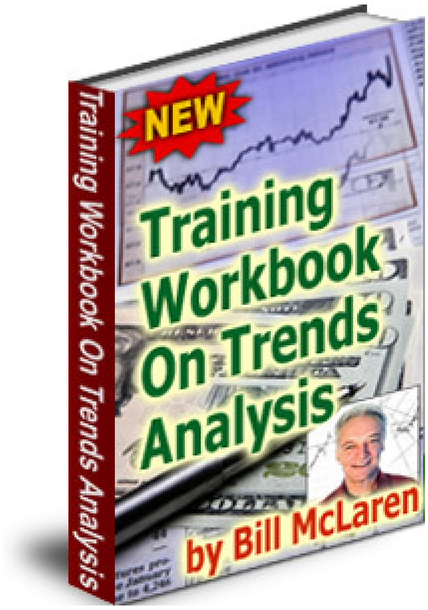

Training Workbook On Trends Analysis

By

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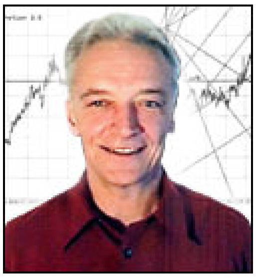
Introduction

The Trend Is Your Friend



When I first started in the financial services industry in 1966, after getting registered on the major exchanges, my current employer Goodbody & Co. thought it would be a good idea to have me work on the floor of some of exchanges to gain some experience from the "pits." I saw this as a great opportunity to learn from the well-experienced players on the floor. So while on the floor of the Mercantile Exchange I went around to all the men with gray hair and asked them for some advice. They all had the same answer; "The trend is your friend, don't forget it." You can imagine my disappointment as I thought I might get something useful as a formula to analyze volume or a time period during the day the markets might counter trend. Instead I got a cliché. It took me 20 years to truly understand the wisdom of that statement. Hopefully the reader will not be as stubborn as I.

"The trend is your friend" is the backbone to this book. And with the advent of computers and the reliance upon momentum oscillators as a dominant form of analysis for the general public, I feel this instruction is truly necessary. So we will first look at the "Pattern of a Trend." Not head and shoulders nor triangles as they are consolidation or topping formations and generally not very reliable. We are going to look at and understand how markets trend. Trends can be analyzed on intra day charts as 5 minute and 60 minutes or on an intermediate term basis using daily and weekly charts or on a long-term basis using monthly charts. The methodology in analyzing all of the time series is the same.

If we define our purpose in this business of investing and trading as "locating a trend, entering that trend with limited risk and staying with that trend until the trend becomes at risk of completing." It gives us the outline or logic behind this workbook.

Defining Trends

Let's look at a trend and define certain aspects of that trend so we're all on the same page with my terms and definitions. You can look at Chart 1 (The S&P 1982 -1983) to assist in the definitions. As a market trends there will be moves against that trend, these we define as counter trend moves. We will discuss this concept in detail later in this text. But for now you can see the last counter trend move up before the August low was two days. When the index started to trade in the other direction the first counter trend was one day, followed by a two-day move down. Eventually the index went into a three-thrust consolidation and eventually moved down 7 days to create a double bottom and resumed the trend in October. You will see that understanding counter trend moves is critical to understanding trends. After a specific number of counter trends, the trend will either reverse or go into a consolidation of the trend, so as to continue the trend. Or go into a topping distribution pattern or bottoming accumulation pattern. We must understand all of these phases of trends. You can clearly see the sideways consolidation patterns that were created during this bull campaign. I refer to them as higher double bottoms and noted as "HDB." Most consolidations within trends only have three thrusts in either direction before starting to trend again. This is also true of reversal patterns as tops and bottoms. Most consolidations of trends trend to be sideways patterns and that is an assumption we can use. As a general rule if consolidations tilt upward they can be bearish and if they tilt downward they can be bullish. This "tilting" can be synonymous with a weak move as you'll see later in the text.

Chart (2) is the same bull campaign; only it is a weekly chart. I have left the daily notations on the chart so we can identify the weeks clearly on the daily chart. If we were to count the weeks of the moves down or the counter trend moves, we would see this trend only corrected one and two weeks until the June 1984 low. It then moved down 7 weeks. There are many instances where the weekly chart will keep the proper perspective of the trend that can be lost in the daily volatility.

Now look at the next chart (3), which is the 2003-2004-bull campaign. Can you see the similarities between these trends? Notice the struggle within the midpart of the campaigns followed by a vertical or exhaustion movement into the 2004 high. Before becoming involved in a market, I believe it is *very valuable* to make copies of every bull trend and every bear trend and paste them on a board. So you can see each bull trend and the characteristics of the trends. The advantages will become apparent when we learn more about trends. You will see that the "Pattern of Trends" repeats, over and over again. If you put these two trends on top of each other and hold them up to a light, you will see they were almost identical. When this index was trending upward, I indicated on the Mclaren Report advisory service the bull trend would follow the "Pattern of Trend" that was followed by the 1983 and 1984 market.

Then there is the directional phase of the trend and the leg or wave of the trend. Elliott Wave Theory has been the best-defined methodology for studying this aspect of trends. We will look at wave theory and I'll approach it from its pitfalls.

There were a few things that were a challenge in writing this book. Most analysis is "circumstance specific." We must be able to define the circumstance, so we know what analysis applies to those specific circumstances. We must understand what is normal for a given situation or circumstance. And what would be abnormal. I didn't last over 40 years in this business by trading the abnormal. So we need to be able to define the circumstances, within trends, that specific aspects of analysis apply and don't apply. Our first task is to understand there are three basic types of trends. They all offer a very logical reason for their existence.

The first trend we will define as a "Normal" trend. Normal trends can be strong trends for obvious reasons. Chart 4 has a "normal" trending structure twice on the chart. All markets trend in the same manner; some have their own particular characteristics, which are easily defined once a trending style can be identified. This chart is of the All Ordinaries index, which is the stock index for the Australian Market. We are going to look at all world markets so we can see the subtle differences and thus the similarities or consistencies to trending. This index has a history of capitulating or panicking into lows. Capitulations are wide range "washouts" of downtrends. The history of trading for a market is critical knowledge. You must have as much of the history of trading you can acquire.

Lets take a quick look at the basic structure of the three different types of trends. Chart 5, illustrates the “Normal” and “Creeping” trends. Normal trends develop “spacing” between counter trend highs and the previous low or counter trend low and the previous high. The counter trends can also layer on the previous swing. A “Creeping” trend will move deeply into the previous swing. Creeping trends can result in fast moves if they get resolved in the direction of the trend. If a high fails to reach the previous low while trending down or a low fails to reach the previous high while trending up, the next move will either be an exhaustion if trending up or capitulation if trending down. They can also be resolved with a higher low while trending down or a lower high while trending up. The style of trend that follows is highly predictable but that depends upon the previous style of trend, as we’ll see later in this book.

Chart 6 are the examples of a blowoff trend. Three or four ascending or descending trendlines mark this style of trend. You can usually see them developing as there will be a low that develops “spacing” before the trend starts to accelerate. These fast trends can sneak up on an analysts and it is always necessary to note if a leg is starting without reaching a trendline.

Let’s go back to chart 4. We can define the first up trend that started in September as a Normal Trend due to the “spacing” that was produced while it was trending. Again, “spacing” is defined as the distance between the previous resistance and the next level of support. In an up trend, spacing indicates support coming in at a high level in relation to where the sellers were previously able to stop the advance. The larger the spacing, the stronger the trend. On many occasions the spacing can be too large and indicate a possible exhaustion of the trend is about to occur. But for now we just want to recognize the structure of a normal or fast trend. The move down in March and April was also a normal or fast trend. The rallies could not reach the previous support indicating sellers were coming into the market well before the previous support levels. A normal trend does not have to show spacing, it can bottom or top on those levels or even marginally break those levels, but that will be clear when we fully understand this form of trend and the logic behind it. You can also see the lows that came in September, January and April were capitulation lows and is a critical bit of knowledge if one were able to anticipate a capitulation or panic was necessary to complete the trend.

Chart 7 is the same index only in this instance we are going to look at the “Creeping trend” or examples of weak trends. Creeping trends are easily seen as the retracement or move against the direction of the trend goes well into the previous resistance in the case of an up trend or the previous support in the case of a downtrend. We are also going to add another concept to our analysis of trend and that is the number of thrusts to each leg of a trend. The foremost methodology to wave analysis is Elliott Wave Theory and I will not repeat that instruction but discuss the wave structure interpretation as it applies to this analysis. We can assume that three or four thrusts within a leg of advance can complete that advance. In “creeping trends” three-thrust pattern is usually sufficient to put the trend at risk of completing. This would be logical as creeping trends can be weak trends.

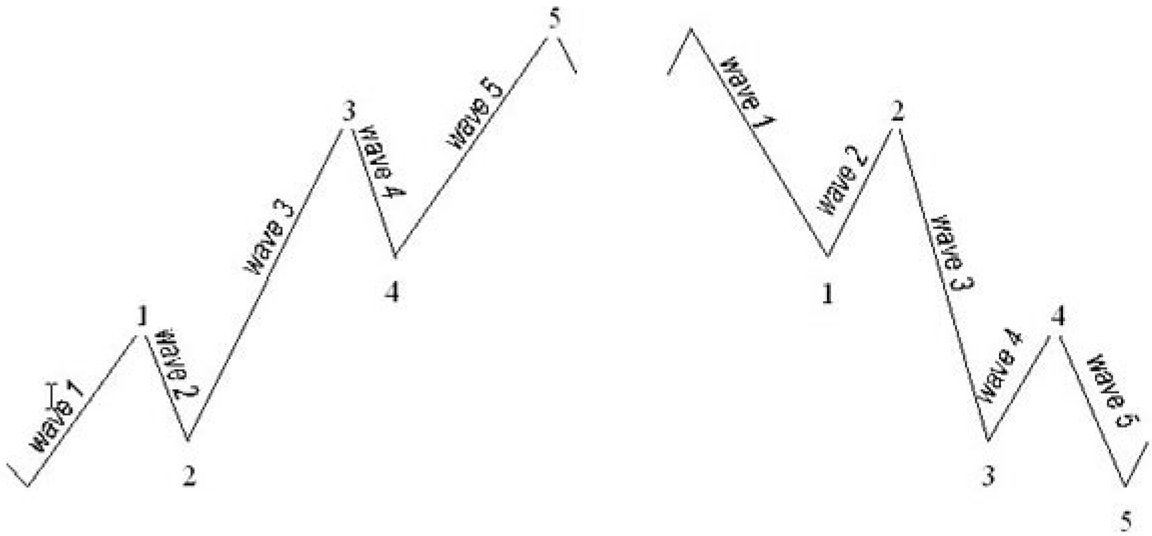
On occasion creeping trends can be methods of accumulation or distribution but we’ll look at those circumstances later in the text. But for now we want to be able to visually see the difference between these two types of trending structure. You can see the January through March trending structure could not hold a previous high when it corrected down, unlike the move up during November. You can also see the move down in May saw the rallies move above the previous support indicating the market was struggling down as February through March was struggling upward. Now look at the small creeping trend that occurred during December. It was very tight or small in its range, but it was a three-thrust structure that had every new high immediately fail to advance. Fast trends can end with a creeping or weak trend structure. Seeing a creeping trend move against a spike high or low is a very high probability of completing a larger trend up or down as occurred in May on this chart. That pattern of trading against a spike represents some very high probabilities and depending upon the larger picture can represent a change in the intermediate picture.

Wave Structure

We need to take a basic look at wave-structure, as this will give us a further understanding of trends. Defining the number of waves to a movement or legs up becomes more difficult the stronger the movement. This is due to the ability of waves to subdivide into smaller 5 wave or three thrust patterns. Even Gann noted "A bull or bear campaign runs out in three or four sections…. except in extreme cases when there can be 7 sections up or down."

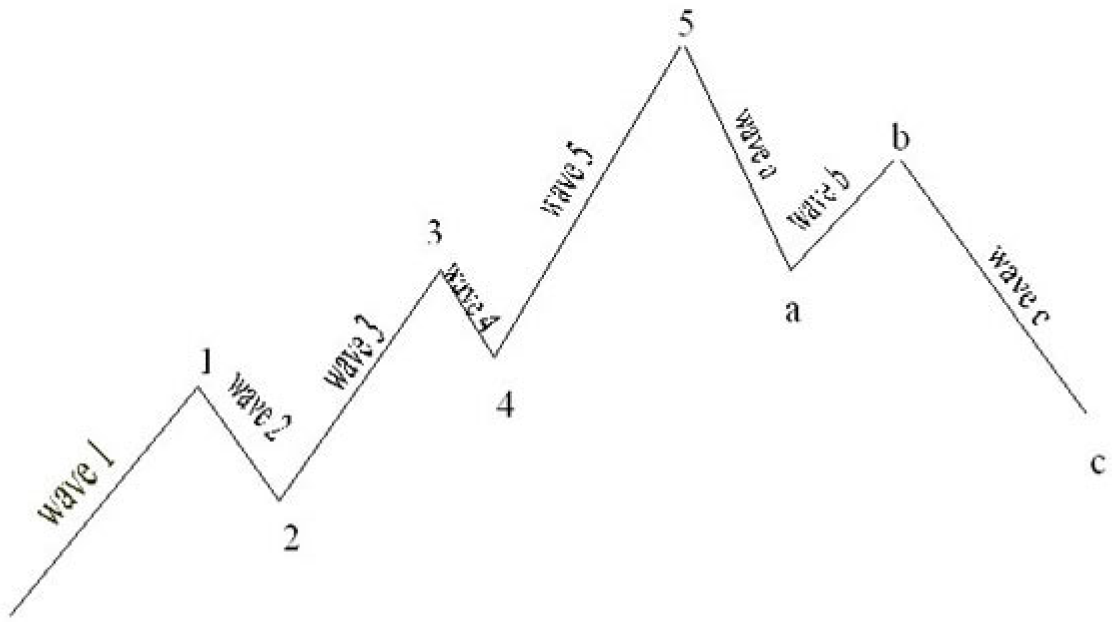
The Elliott wave theory very basically states that the markets vibrate to a basic rhythm. (Example W-1) That rhythm is three waves in the direction of the trend. Those waves - 1, 3 and 5 are called impulsive and the waves 2 and 4 are termed corrective waves.

Example W -1

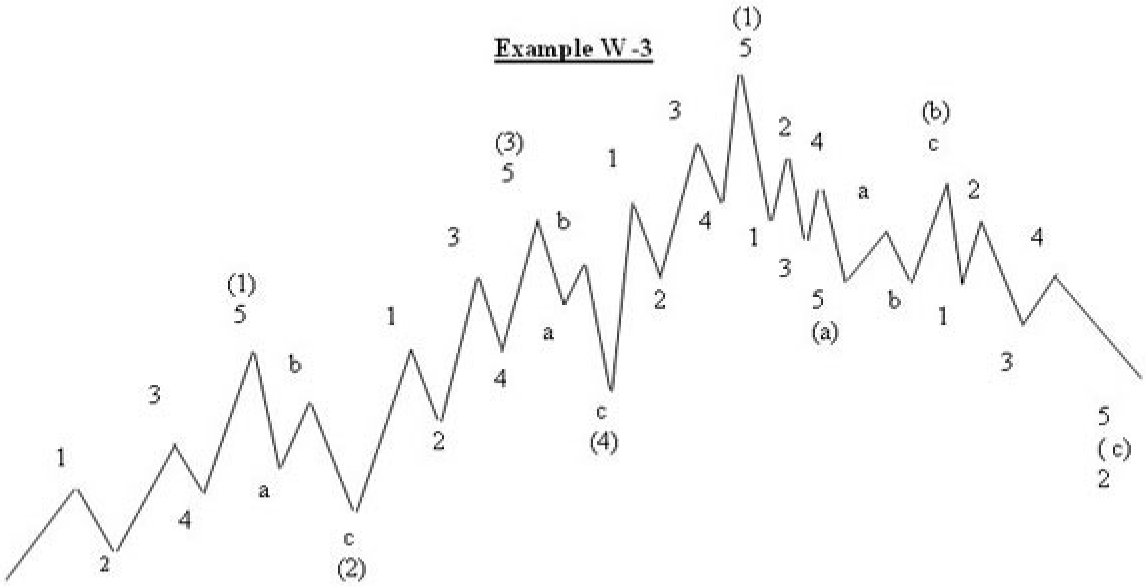


Once there is a complete wave structure, the trend will reverse and a three-wave move in the opposite direction should ensue. (Example W - 2) This corrects or consolidates the completed leg. An Elliott analyst would term this an "a-b-c-" corrections or a "three."

Example W -2



The complete leg up is referred to as a "Five." Of course, after a completed leg, price could reverse trend completely and have a five-wave move in the other direction. The question usually facing an Elliott analyst - is this a "3 of 5" or a "C"? The theory goes on to state that this basic rhythm can be subdivided into waves of lesser degree, or expanded into waves of a larger degree (Example w-3).



The ability to analyze the form of each wave and the number of waves, we can determine what the probability is for a movement (leg) to be complete. This obviously will help us determining when our positions are at risk or when to enter a new position.

There are some rules offered by Elliott to help clarify where, within the wave structure, a market may be impulsive or corrective.

1). Wave 2 cannot go to new lows.

2). Wave 3 can never be the shortest.

3). Wave 4 never goes into wave 1. (This can occur in a diagonal triangle or in futures contracts, but not in the underlying cash market).

If it were only that simple. Waves can extend in the impulsive waves and there can be a 1-2, 1-2 wave one which we'll look at later.

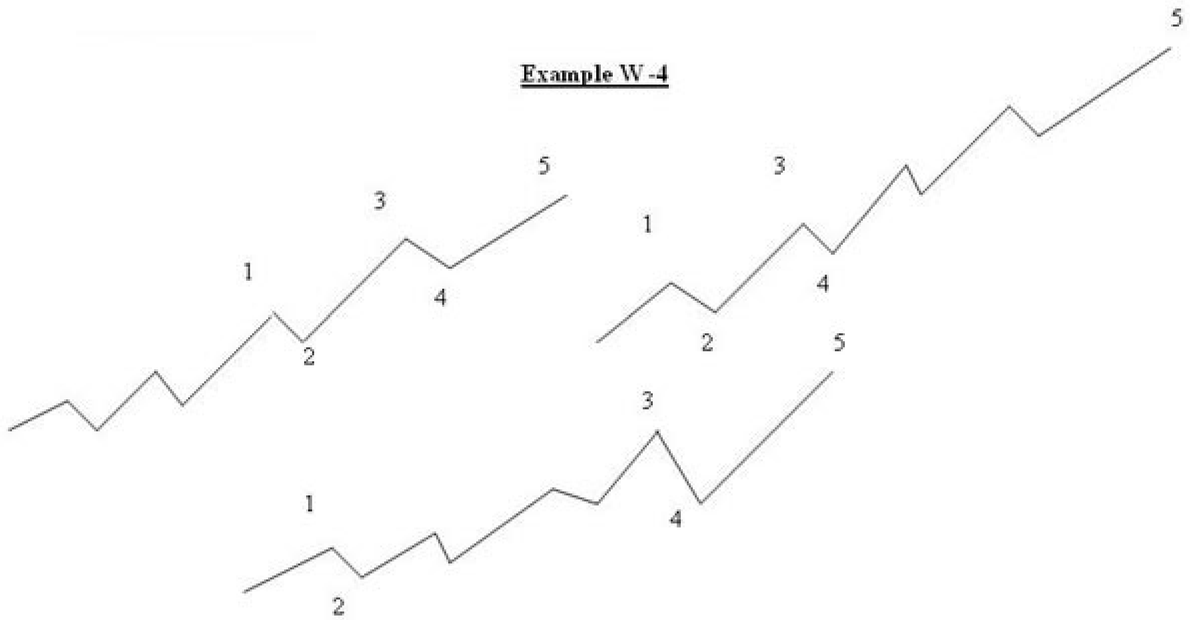


Chart number 8 is the Hang Seng Index, which is the Hong Kong stock index. It is quite volatile but trends very well. This is a difficult wave structure due to the huge amount of subdividing within the waves. I chose this so no one believes wave counting is a simple task. Since we use this analysis to help us determine if a trend is complete or has a probability of being complete. We need to understand the difficulty this analysis presents. Sometimes it is very clear but much of the time there is a probability that could have one or two other scenarios than the obvious.

If we look at the top and count backwards, the last leg is clearly a 5-wave structure with three clear drives to the leg up. So we can define that as a 5th wave or third leg up. But even with that knowledge, counting the waves up to that point to get a completion is not an easy task. One of the very helpful keys to this analysis is the rule that the third drive cannot be the shortest drive within a leg.

If we view this from the April low the first leg could have ended at the point the finger is pointing. The next drive could then be drive one of the third leg up, the following counter trend left a huge space and could be viewed as wave two of the third leg up. The next leg could be viewed as a completion as there are now 5 drives or three thrusts upward. But that would have been an incorrect count and was actually the third wave of the third wave with the 5th of the third still to come. The fifth of the third wave subdivided into 5 waves and the third wave within that 5 of 3 also subdivided. This is clear in hindsight. And on many occasions this becomes an "art" of counting backwards. The struggling move down in November was one of the indications of another probable move up as there were 6 days up and 13 days down. The thirteenth day was an "OOPS" pattern and there was also spacing as indicated by the arrows at the previous low. The "OOPS" Pattern is an indication of an exhaustion of the short-term movement. It is developed when a market gaps open outside the previous days range and then trades back into that range. Counter trend moves of one to four days can end in that manner. Or moves in the direction of the trend, usually in excess of three days can also end in that manner. The one thing to keep in mind about this short-term one-day pattern is it is an indication of an exhaustion of the short-term move. So if an exhaustion is not probable from the pattern of trend. Then it is very likely not a reliable pattern to end the movement.

I have always used another “rule of thumb” in relation to this situation. If the move in the opposite direction reaches twice the initial move in trading days and is still above or below the start of the move. The probability is the move is complete; there is some logic to that circumstance. The history of this index is one of subdividing waves so this complicated wave structure could have been anticipated. The top had also produced a broadening formation, which we’ll discuss at a later date when we discuss topping patterns. So it wasn’t an impossible situation to see in real time. But I don’t want anyone to think because they can count to 5 it indicates a completed wave structure. When momentum is not this strong, the ability of waves to subdivide is definitely limited and counting becomes a much easier task. But when there is very strong momentum with lots of “spacing” we must be cautious concerning our conclusions. As we go through the large number of examples of trends this will become much more clear and you will develop confidence. Please understand this is not an easy task when dealing with strong momentum. Or when dealing with bear campaigns.

If we convert this chart to a weekly chart (9) and leaving our entire wave counting on the chart from the previous daily chart, it could be easier to see the larger picture. The sharp move down that I am designating as a wave 4 is followed by an obvious 5-wave structure up. This took quite a bit longer to reach the March high than it took to fall away from it; in fact, it was a bit more than twice the amount of weeks. One of the strongest indications the trend was complete was the last move. You will need to look at a daily chart (10) to see this clearly. The decline in December was 7 days and it took 11 days to get back to the level of the high. This did not fit the “rule of thumb” I laid out as to being twice the number of days. But there was a clear 5 wave structure up and a creeping or weak structure to reach the old high and that was an indication of a completion especially when considering the number of drives to the leg. It offered strong evidence of further correction. The form of that correction or reversal in trend depended upon other analysis. But there was evidence enough to consider a completion of some sort. That obvious, weak, five wave structure we will see on many occasions and can be a prelude to a fast move in the opposite directions.

There are a few more points of interest on this chart. Notice the capitulation low in May and how the index gapped down into the move down and the gapped up out of the last wide range day. You can also see how support was coming in at a high level during June, July and August. Remember, three thrusts while in a sideways pattern and you can start to look for a completion. Also note the difference in the move down after the weak 11-day rally in December versus the moves down in October and August. There were 11 days up and within 5-days the index was at a new low. Now count the days to the other moves down versus their moves up. At this point on the chart all we can conclude is a complete leg and a sideways pattern.

We can finish up with this series of charts by noting the move up into December 2003(chart 8) was 37 days and the move back down to test that level that started the 37 day rally was 96 days. The 96-day trend was a creeping trend and could indicate; once it was completed a fast move up could occur.

Counter Trend Movements

If we are to understand trends, it is critical we understand counter trend movements. Counter trends are the movements that occur against the trend in force and keep the trend intact. Counter trends can be short term or intermediate term in nature. Once a trend is defined, the counter trends are easily forecast. Counter trends allow you to enter a trend with limited risk, allow you to judge the strength or weakness of a trend and determine if the trend is becoming at risk of accelerating or terminating.

Within a "normal trend" there are two basic types or styles of counter trends. The first counter trend or move against the trend in force we will define as a counter trend of "first degree" and consists of a movement of one to four trading days. The next counter trend is one of "second degree" and consists of 7 to 12 trading days. So when a trend is strong, we will anticipate the moves against the strong trend to be one to four days. Eventually the trend will need to consolidate for a longer period of time and that move could be between 7 to 12 days or could be a larger consolidation. On occasions a second-degree counter trend will run to the 13th day but that is usually an obvious reversal day.

Chart 11 is our next project and if you will look at the end of a downtrend in September and October you can see the first rally marked on that page is a three-day rally. One of the rules to counting days for counter trends is the count doesn't start until a daily low is broken in a down trend. And a count for a counter trend in an uptrend doesn't start until a daily high is broken. The reasoning behind this is because we don't want to count days that are part of a base or distribution, rather than the actual movement. Therefore, starting the count with a move above or below a resistance level, even if it is just a previous day's high alleviates that problem. But once the count starts every day is counted until the counter trend is complete.

The chart starts with a three-day rally and a two-day move down that breaks to a new low and reverses. A three bar rally follows this move down and another move down of three days that stays above the low is the next movement. The fourth day was a small range inside day and occurs many times at the low of a three bar counter trend and I have referred to those small ranges, inside days as a gift. One could buy a move above and use a protective stop below the low of the inside day. One bar counter trends can be indicating a strong trend in progress. This chart is the S&P 500 and it tends to show some congestion while trending because this move is a fast trend. You can see the three instances where a low layered on top of a previous high and was followed by a fast move up. Before trading any market you should see if their normal counter trends adhere to our 1 to 4 and 7 to 12 trading day count.

False Break Pattern

A vast majority of reversals in trend come from a pattern that appears as a break to a new high or new low and reverses and goes in the opposite direction. Not all moves to new highs that pull back below the previous high create a "false break" pattern as there needs to be follow through. On some occasion the move will only be a first-degree counter trend and on others it will be a complete reversal in trend. So there is obviously some other knowledge necessary to qualify that new high or new low as a probable "false break" and possible change in trend. But markets going against the "obvious" resistance or support of a previous high or low do present opportunities and on many occasions, significant opportunities. This also highlights the risk of buying breakouts or selling breakdowns.

If you will go back to chart 1, I have noted a few of the "False Breaks" that occurred within that strong bull trend. The "FB" indicates a False Break. The larger FB (false break) at the August low was the final move to end a long bear campaign. The next FB started a counter trend of 7 days and the trend resumed. The November FB started a sideways consolidation pattern and the January FB could have been a top but also just gave a counter trend down. Take a closer look at the November trading. After the new high is hit there is a rally that marginally fails to reach the high creating the first counter trend up of two days. The market then spikes down and rallies two days again, creating the second two-day counter trend. The index then breaks to new lows and recovers the price level of the break. The next thing on the chart is a one bar counter trend in the opposite direction. So we can say the low was a false break of the previous spike low. This was counter to the direction of the intermediate term up trend and is usually a good probability for a low of some sort.

One of the very important aspects about qualifying the significance of a False Breaks is the position within the trend that it occurs. For this we need to go to the weekly and possibly a monthly chart. Chart 12 is a weekly chart so most of these instances were barely one week (5 trading days) above the obvious high or low. There are many more "false breaks" within this chart, but the point I am trying to make is this pattern is a very normal way for a market to reverse a short or long term trend. False breaks in the direction of the trend usually produce fast moves.

Back To Counter Trends

Let's go back to our chart 11 and the beginning of the chart. There was a three day rally, an inside day and within two days was at a new low. That new low was immediately reversed and followed by a three-day rally. This break and recovery could indicate the start of a consolidation or a "False Break" pattern that could indicate a reversal in trend. This is followed by another three-day rally that moves marginally above the previous rally - a sign of strength. The next move down is also three day but stayed above the previous low and the fourth day is a small range inside day. Inside days are days that the high and low trade inside the high and low of the previous day. On many occasions insides days are a "gift" as they allow for an entry trigger and a very tight protective stop. The short-term pattern of a "false break" followed by a higher low is a high probability pattern for a low and a rally. This rally could result in a change in trend if there was reason to believe the move down was a completion of some sort. As mentioned prior, If this was one of those situations, one could buy a move above the high of the inside day and place a protective stop below the low of the inside day. Creating an entry with very little risk to capital. Just a quick glance at the chart shows that all of the moves against the up trend until the congestion in December and January were one or two days. Indicating a fast trend in progress and all of the counter trends after the congestion or consolidation were also complete after one and three days.

We're now going to look closer into that trend and add a few more bits of knowledge to our understanding of trends. We know how "normal trend" will show spacing when they are trending from a strong position. Those strong trends can also show a consolidation and still hold their strong trend and many times that consolidation facilitates the trend continuing its advance. You can see the first 2 bar counter trend in October was higher than the high of the previous move up. But also held the previous low (higher double bottom) and was very small in the number of points it moved down. The next move stayed on top of that pattern of congestion, which was very bullish. We have discussed how creeping trends can turn into normal or fast trends so this is quite logical.

One of the other rules that we use in our analysis is "The direction of the trend indicates the significance of the pattern." We are going to come back to our counter trend study. But let's digress and look at the rule just mentioned. For this we'll use an old chart I've been using for over a decade to explain this concept- Chart 13. The downtrend into the August low was an obvious "creeping trend" down. And we could anticipate a fast move up following the completion of a creeping trend down. But the axiom concerning the direction of the trend determining the significance of the pattern is clear on this chart. We can assume that double tops are unlikely "end of trend" patterns for up trends. But can be significant patterns of distribution while trending down. And conversely double bottoms seldom end downtrends but are powerful patterns while trending up. The lows in September, although only a few days apart were strong support for a fast move. A double top would not have been something that would have been meaningful. Fast trend usually need to exhaust. At point A you can see a double top below a high and would be significant resistance. Many commodities will show lower double tops as distribution patterns. This can be spread over a month or more to develop. But when they develop quickly they can represent the first counter trend in a downtrend. You can see the double bottom against point F would not likely end a downtrend. It did take a "false break" pattern to end the trend. Now, look at point C and notice the fast move that developed. Now look at the end of the creeping trend in August at point B. The difference between those two patterns is of immense importance. That difference is the "space" between the low to the pattern at point A and the highs to the pattern at point C. Point C indicated a "continuation pattern" and very likely a capitulation in progress. You will see this many times in stocks and commodities.

Let's go back to chart 11 and look at the pattern of trend and the form of the counter trends. The pattern during the mid part of November was notable due to the spacing between the previous small ranges that indicated resistance and the level of support at the one-day counter trends. This could indicate a powerful move that might or likely need an exhaustion to complete. This is an example of a "continuation pattern" as described in the previous paragraph. Remember, this is an index and will move a bit slower than stocks and commodities. The two double bottoms within the trend up to the December exhaustion should now make some sense to the trend. At the end of the year there was a 5 day move down that was followed by an 8 day move up to retrace the 5 day down, something we will see many times at starts of consolidations or trend changes. The final move down was 12 days and could have been a second-degree counter trend and false break low.

When the index came up to the high set in by the 8-day rally, it was up to an “Obvious” resistance level. When markets are at the “Obvious” it usually represents an opportunity. Since this was a strong trend and a move up to the obvious resistance, we could assume a first-degree counter trend. This would confirm the previous movement was a consolidation of the trend and was now about to resume. But was followed by a wide range day down indicating something else was happening. The small one-day counter trend that left a “space” in February was a strong indication the trend was going to resume and would be considered a small creeping congestion that just resolved to the upside. Notice the low in January, the 12 days down. It was a false break pattern and set up the probability for a strong low. Fast moves can come from false breaks.

Let’s look closely at chart 14. There are a few important concepts we can learn from this pattern of trend. First, we can anticipate most trends will exhaust into highs. If the trend is extremely strong, we may see it creep into its highs with a three-thrust pattern that would come after a large thrust. But the normal circumstance is to exhaust into “ends of trends.” A reason why top and bottom picking a dangerous.

You can see from 1993 into June it is a nice trend but slow, as there are little in the way of spacing. In June there is the first of four small 5-wave structures down as consolidation or counter trend moves. Those small trends were creeping trends against a strong trend and are a great set-up when presented on a chart. The creeping trend up was “resolved” in July when it developed a “space” and indicated the probable start of a fast move up. This eventually exhausted into August with a vertical move up and was consolidated with a second-degree counter trend (7 to 12 days) and the second 5-wave structure against the major trend. This next leg terminated with another exhaustion and was followed by a creeping trend down. This 5-wave structure in October/November was one I like to see as a completed movement. The first leg was the largest the second leg was smaller and the third leg of the 5 wave creeping trend down was every small and resulted in a “false break” and ended on top of the previous high. The index then went into the final exhaustion leg. The 5th wave subdivided to complete the wave structure up from the November low. It is important that you understand trends will exhaust into highs. So when the markets appear vertical, it is not the time to get bullish but cautious. Understanding counter trends are key in that circumstance.

The move down after the exhaustion was very easy to read. Our first objective would be the previous high from the October/November consolidation. So it was a matter of how the index would trend down to that level and what kind of move up from that level would occur. The first move up after the exhaustion was a one bar counter trend, indicating a very weak environment or better said an indication of a strong trend-down. After the wide range day down the index consolidated for three days and rallied two day, this is highlighted with the dollar sigh ($). Within one day the index is at a new low, leaving a “space” between the rally high and the previous low, thus showing a characteristic of a strong trend. In February/March the index shows support marginally below the October high and is followed by a weak 5-wave structure up. This could also be viewed as a creeping trend against a stronger, larger trend. This allowed the downtrend to consolidate so it could resume with a wide range day capitulation. This was followed with another 5- wave move down and a false break low in April.

Before we go further into trends, there are two concepts we need to discuss. The first is a signal day or signal week. This occurs when the number of days for the move in the direction of the trend is significantly less than the days for the counter trend. If you will look at chart 1, the September move down (counter trend) was 7 days and within two days of strong rally the index was at a new high. The only caution concerning signal days is the stage of the leg of the trend. Many downtrends can end with a wide range down day that would appear as a signal day. So when they occur late in a trend, they must be viewed with some skepticism. One must also be cautious if in a sideways pattern. Now look at chart 10, the October move down was 13 days the by the 7^{th} day the index was at a new high, a signal day. The December rally was 11 days and within 5 days, the index as below the point of the start of the 11-day rally. Yes, it came all the way back to the just below the high. But what we are trying to find is a signal for a change in trend or resumption in trend from "signal" days. It is good to have a strategy to position before a breakdown to avoid being trapped in a false break pattern.

The signal day is a characteristic of a "Normal" or fast trend as you can see in Chart 4 during the October/November trend. Now look at the chart 14. The move up following the June low produce a time period I would define as a signal day and would also clearly show up on its weekly chart. The move up from both December declines would qualify. The downtrend had two obvious signal days, the second counter trend ($) and the move down from the small 5-wave counter trend up. The circumstance within the Pattern of Trend the signal appears is the critical aspect of the analysis. So "signals" are a tool to be used with our knowledge of the trend. The low at the beginning of December would not be considered a strong signal day because it was completing a 5-wave structure down that had no spacing and was against a strong trend up.

Another such tool is "trading against a spike" and is similar in concept. There are many situations where this pattern can indicate the end of a counter trend or even an end of a trend. The picture can take a few days to develop or it can take a few months to develop. Refer back to the first chart (1) and note the August low. The movement or counter trend prior to the low was a two-day rally and within one day the index was at a new low, indicating a fast move down and possible capitulation. It then spiked into a low and spent three days testing that low and could not move below it. This is a short-term version of "trading against a spike" and we'll refer to these situations on the chart as "tas." There was a spike low as the index gapped down into that low and reversed and three days of downside testing couldn't break it. Indicating that movement could be the first counter trend down in an up trend.

Chart 15 is the S&P 500 Weekly chart and shows how the bull market ended with a 5 wave "tas" against the March spike. The low in 2003 consisted of an eight-week rally off a spike low, followed by a 15 week decline against the spike that produced a higher low. So we now have another short term and intermediate term tool to help us with trends. Again, we need to understand where, within the trend, these patterns appear.

More On Creeping Or Weak Trends

Chart 16 is a bank stock (CBA) on the Australian stock market. You can see the 5 wave, weak or creeping structures that were counter trends during July and August. If you will look at the March/April pattern you will see a "trading against a spike" with a spike down followed by a rally of 6 days move up. This was followed by a 15 day down that showed a creeping trend down that stayed above the spike low. We could anticipate a fast move up following this pattern. A struggling market will produce many opportunities.

Now we are going to look at some struggling trends that resolved in the direction of the struggle. The next chart (17) is in the middle of the 2002 bear trend. The move down that established the low that produced the obvious support (early May) was a small false break followed by a higher low. When the index came back to test that "obvious" support it showed a one bar counter trend and broke to new lows. Remember the significance of a one-day counter trend. This was followed by a weak one bar rally that left a space between the rally high and the previous low within that trend down. And it is important to focus on the low within the trend rather than the low of the obvious. If you will look at the point I have labeled "max-mtm" you'll see, basically, the same pattern. A creeping trend down that eventually moves below a low and cannot get back above that same low. Thus resolving the creeping trend with a capitulation move down or the strong probability of a capitulation move down. There is another point to make here. Notice I have drawn a trendline from lows to lows going into that move down. Max-mtm stands for maximum momentum and it is seldom a marginal new momentum that will be a low. Maximum momentum lows are normally much larger in their capitulation as the next low illustrates. When this occurred I notified the traders on my service that the index had started a capitulation move down as the two reversal days up were maximum momentum lows and not scary or large enough to produce a solid low.

The next chart (18) is the 2001 bear campaign and the end of August showed how the index had moved into a capitulation mode when the trend was resolved to the downside with the one day counter trend that couldn't reach the previous low. You wouldn't have known that for sure until the next day. Remember, "The direction of the trend determines the significance of the pattern." There are some good examples on chart 19. Double tops are strong distribution patterns while in down trends, but are seldom meaningful in up trends. Double bottoms are strong lows in up trends, but very, very seldom end downtrends. Remember, when a creeping trend or weak trend is resolved in the direction of the trend it creates a fast move no matter the direction. Although downtrends trend to create more momentum as they are based upon fear. A lower double top below a high is a common distribution pattern on many commodity charts but where it comes within the trend is significant. If you will go back to chart 1 all of the "HDB" notations indicate "higher double bottom." You an also see that the double tops meant very little during this phase of the up trend.

The next chart (20) is the All Ords index and is the daily time period of the previous weekly chart. Notice the lower double tops that formed before the trend down materialized. I was able to see these form in real time on the service. So double tops, below a high can be significant as a distribution pattern. You can also see a classic counter trend rally that formed a creeping trend. The rally into the high took 13 weeks and you'll find many instances where this exact pattern will show up in other markets and also be at or very close to 13 weeks (90 calendar days). The daily chart of this circumstance (chart 20) has some "pattern of trend" and opportunities that you should be able to recognize. The rally off the obvious low in August was a first-degree counter trend of three days, followed by a "signal." The one-day counter trend that followed was a setup for the subsequent capitulation move down.

Now we're going to look at a couple of situations that I was able to find in real time. And we'll go from Weekly or Monthly charts down to daily to see the opportunities. The next chart (21) is a monthly chart of a major drug stock in the U.S. You can see the pattern developing below the spike high was a very volatile struggling trend upward. Creating an obvious weak pattern below a spike. Tops tend to have volatility associated with them. And when you look at the Monthly ranges, this was quite volatile and the pattern completed with a false break, as would be anticipated.

Chart 22 is the daily chart of the bear trend after the top had completed. Because of the size of the decline the top appears as a flat pattern and it wasn't. But this is one of the disadvantages of a computer screen. After the false break to new highs in April the first counter trend was very small and appear flat. The market then started to trend down in April. After four days down (notice the exhaustion on the fourth day), the index rallied two days and within one day was well below the low. This signal day that followed was a good indication of starting the trend down. The May counter trend came off "Obvious" support of a previous low. Notice the 5 wave weak structure as the form of the counter trend. There was a one-day counter trend that also set up within the move down and was a significant opportunity. The final capitulation was signaled with a weak counter trend move that stayed below the low of the previous two bar rally from another "obvious" support in June. Notice how these are failures of double bottoms while trending down.

The next series of charts are Lumber (23) and again, if you are going to trade any item. It is necessary to look at the history of trading so you know what type or style of daily and weekly counter trends to anticipate. During the end of 1999 and early 2000 we can see the three-thrust pattern, which is also a creeping trend that was a 5 wave structure below a spike and was a high probability candidate for a counter trend of intermediate term nature.

If you now look at the daily chart (24), you can see there was a "signal" and a counter trend that left spacing and if you count that counter trend as 4 days, we could see another "signal." Chart 25 is the NASDAQ. We would all recognize the low in the NASDAQ in March of 2003 with the 67-day struggle down (creeping trend) versus the 37 days up and indicated the bear trend could be complete due to this pattern of trending.

Creeping Trend And Rounding Bottoms

We've seen how creeping trends against resistance or support can reverse the trend and also allow for a fast move in the opposite direction. We've seen how a creeping trend can go from a struggling trend into a fast trend in the same direction. Now we're going to combine creeping trends and trading against a spike to find the start of rounding bottoms or tops. Rounding bottoms are one of the most powerful basing patterns we can use and indicates accumulation.

Big spikes are easily identified and we can wait and to see the patterns that develop after the capitulation (spike) move down. Chart 26 is a daily chart of ENZN a US stock. The spike and the capitulation size volume are easily identified. The rally was 7 days and the move back to test the low was 17 days. This was followed by a 4-day rally and a sell off of 5 days. By the time the move down had hit the 8th day (twice the move down) a higher low was becoming obvious. Notice the price level of the support at the 5th day down was the same as the support during July, prior to the final move down. It is that symmetry in support levels that helps to produce the rounding appearance of these bottoms or accumulation patterns. When the index ran up to the obvious resistance in the end of August, it showed a two bar counter trend and "spacing" to confirm the fast trend up. Also, note the struggling or creeping trend below the high in October or almost the same picture only in reverse.

The next chart is 27, a daily chart of General Electric a US Blue Chip stock. You can see the exhaustion low that was set in with an "island" reversal and an 11-day rally. This was followed by a 22-day decline. By the time the 22nd day had arrived there was sufficient wave structure to assume a completed trend down. When the three-day counter trend appeared, the up trend was confirmed. There was no set up at the "obvious" high in June.

CHART 28 is a daily chart of Microsoft. Here we don't have the advantage of a spike or exhaustion down to highlight the pattern as the exhaustion came two months earlier. You can see the congestion in May, followed by the small higher double bottom. Followed by another higher double bottom, which could also be read as a three bar counter trend and the final one bar counter trend that left a space and did not go back into the base. Please note the exhaustion that was followed by the distribution in the end of July. Please keep in mind the market came down within a bear trend into the March low. It is dangerous to look for this pattern while trending upward. Much of the time it can be confused with a weak rally if looking for this pattern while well into an up trend. This is an accumulation pattern.

Chart 29 is a daily chart of Pfizer. The was an obvious exhaustion move down in August that was highlight by the large gap down. There rally that followed was 17 trading days and by the time 17 trading days had expired in October it was working on a higher low. The creeping trend that developed in October and November did not allow for an easy entry. There was also, no easy entry at the "obvious" horizontal resistance. The only entry in this circumstance is to assume a low will not be broken and buy on a run to the previous low with a protective stop below it. You can see the struggle up in December. This was resolved with the double bottom and the 3-day counter trend down to set up the double bottom in an up trend. That would not have been known until the 5th or 6th day of rally up from the 3-day move down.

Blowoff Trends

Now that we can recognize a Creeping or Struggling trend and a Normal trend. Let's look at the third and last style of trend, the "Blowoff" trend. There are some minor variations to the pattern of trend but they all have 3 or 4 ascending or descending trend lines. A blowoff trend indicates an exhaustion of the trend on an intermediate term basis. Again, the market could follow a blowoff with a consolidation. But there will be a reversal when it is complete. Whether that reversal is part of a consolidation or a reversal in trend will need to come from other analysis and further trading. Once a blowoff trend is identified we will know that it won't end without an exhaustion or capitulation. The counter trends will be first degree <u>only</u> while trending. This is also one of the instance where you will know in advance the trend will only end with an exhaustion.

The Dollar Index has been in a bear trend down for years so we'll take a look at that index. The next chart (30) shows the 173-calendar day trend into a July low, the descending trendlines are clear. The first pointing finger is where the creeping trend down was resolved to the downside with a two bar counter trend with "spacing" and a "signal." At this point the index went into a fast trend down and in May showed a 6 day rally that was at a new low in 3 days, again offering a "signal" and the 3rd descending trendline. The next rallies failed to reach the trend line so we could assume a 4th descending trendline. When the index gave the Maximum Momentum set up, we could assume a 5th descending trendline. When rallies cannot reach the overhead trendline, it is a good indication a blowoff might be in place. Most of the time blowoff moves will start from creeping or struggling trends that get resolved in the direction of the trend and is another clue there could be a blowoff trend in progress.

The 31 chart is AA or Alcoa. When you look at these charts representing blowoff moves, keep in mind the trendlines can be changed when the index moves though a trendline. One might have thought the rally in August exhausted the downtrend but turned out to be a lower double top and the final thrust down occurred. This is not as easy as it appears in hindsight. One of the purposes in identifying a blowoff trend is the knowledge that the final thrust down or the last two thrusts down will be capitulation style moves. Or how to make the most money in the shortest amount of time. The horizontal lines designated as "low" indicate previous, significant lows in this market. So the July low was a bounce up from the "obvious."

The T-Bond chart (32) indicates the possibility of resolving the trend to the upside with the first arrow. You can see the exhaustion in August didn't end the trend. Price came back to the critical support of the previous high and held for a further exhaustion move up. You can also see the key level of support was not the spike high in most instances in this market.

The NASDAQ Blowoff trend was a classic example-chart 33. We will see this style of blowoff in commodities and stocks but in the index, we may have to wait a few more decades. The Monthly Chart clearly shows the exhaustion and the three ascending trendlines. The Weekly chart (34) shows a large creeping trend during 1999 that was eventually resolved to the upside. The key to that probability was the space between where support was coming into the market and the previous high in 1998. That large spacing left the probability the creeping trend during 1999 would or could be resolved to the upside. You can also see the lower double top below the high. The daily chart (number 35) did not give an easy entry in November when it resolved the creeping trend to the upside. September could have been a bearish setup with a weak 5 wave structure below or at a previous high, but the bigger picture still indicated a high probability of resolving the trend to the upside. The last move started with a false break (arrow) and a one bar counter trend. The day the high was hit, I was on CNBC and said that was the end of the bull campaign. I said I would be proven correct if the index could put on a three-day rally (need to move above a daily high before starting the count) and not reach a new high during that three days. Notice the 5 of 5 move down into the May low.

The next three charts are the Australian Dollar and a great example of why the bigger picture is always necessary. You can see the three ascending trendlines and the obvious exhaustion into the high (chart 36). The fact that the second ascending trendline was only marginally higher is normal. The dollar even left an "island" at the top to cap off the exhaustion phase. This looks like a completed trend. But notice the form of the downtrend during July and August. Definitely a struggle down and at the point marked "4" there is a 5 wave structure and a "false break." If this was still in a blowoff move, let's see what we could have anticipated with the next chart (37). Another exhaustion trend complete with first-degree counter trends and spacing.

Notice at the high there is a count to 5 in small red letters. This is a topping pattern called a broadening top or broadening pattern. Since most tops exhibit volatility, this is an identifiable pattern of volatility. A high is established at "1" followed by a low at "2." Then a higher high "3" and lower low "4," establishing the volatility. Followed by a new high that fails. This is an example of a 5 point broadening pattern and there are 7 point broadening patterns that would show a low below point "4" and another new high. Seven point patterns are fairly rare. There is another example of a broadening pattern for a top on the Hang Seng Chart (chart 8) and brought in the last top. A broadening pattern is one that ends fast trends.

The last chart in this series is the weekly chart (38) of the entire movement. From this perspective the correction following the exhaustion during 2003 looks weak and is even recognizable as a creeping trend down. It went 9 weeks down and within three weeks it was back to the previous high. Yielding a possible "signal" of a strong trend. You can also see how each wave exhausted. It is important to not believe an exhaustion has completed the long-term trend until there is evidence. If there is another leg up, it could be faster than the previous exhaustion leg.

Gold

Gold is one of the better items for short term trading and position trading. In other words, it trends very well. The chart 39 is an exhaustion leg, which was a third ascending trendline. The final run up was forecast on the service and the written notations on the chart were put on in real time. The beginning of December saw the market come down 12 days (second degree counter trend) in a very weak manner. From that point it went into the exhaustion leg of this trend. Notice the creeping trend that I have titled “mid-point consolidation.” This was an exhaustion leg and the probabilities were for an exhaustion completion. It was also unlikely the exhaustion would end so quickly in time if the larger picture were viewed. So I was able to say this was a consolidation that would eventually be resolved to the upside for the final exhaustion. When that situation exists, the rule of thumb is the congestion will likely be the midpoint of the trend. That is why I refer to them as “Mid-point Consolidations.” The gap up out of the congestion indicated the start of the final exhaustion move up. The high day was an obvious exhaustion day. This was followed by a large break in the trend and a distribution pattern that I have noted shows up in most commodities - a lower double top. You can see the next counter trend after the lower double was an exhaustion day with a huge gap up. This was followed by an island exhaustion and a strong “signal” of weakness. Since this was well into the trend, the “signal” could drive the index into a capitulation low of some sort. You can see the low day was an exhaustion day with the huge gap down. By mid April it is obvious the trend is no longer down.

When dealing with commodities I use Gann Format charts. This format strings like contract months together. So chart 40 is a monthly chart made up of all the June contracts in gold. There would be a difference between this chart and one of a continuous contract. Viewing this from the most recent time. The current trend is one that we would anticipate the highs being exhaustion in form. The low in April 2001 was a creeping trend running down to a spike. The move up was two months and the move down into the low was 18 months. The previous significant high was a creeping trend below a spike and took 29 months to form. You can see the three waves to complete. If you will look at the 1985 low, you’ll see a creeping trend up for over a year that was eventually resolved to the upside. That gave the indication that the highs would be exhaustion moves. Once you know the high or low will be an exhaustion, it makes the daily chart much easier to understand and also builds one’s courage to enter on counter trend moves.

You can also see the move down into the 1993 low was a creeping trend down that was resolved to the upside. Remember, fast moves follow creeping trends, whichever way they are resolved.

Price Support And Resistance

We're now going to add another tool to our analysis. This will be done in conjunction with our continual analysis of the different types of trend. There are a huge number of ways to analyze price. Everything from moving averages to the Fibonacci sequence. Like everything else in the markets, price analysis is "circumstance specific" so projections of support and resistance must be done in relation to what is transpiring on the chart. The best form of price analysis I have found is quite simple. I have found the following statement to be true. "All highs and lows are exact proportions of previous moves." Those proportions are eighths and thirds. We take the range of movement and divide it into 1/8th and 1/3rd. As we go through this analysis each of those divisions will develop meaning. When a market goes outside that range of movement, we simply extend the range to find the next support or resistance. All highs and lows are exact proportion of previous movements. So all we need to know are which ranges and what proportions?

I am going to use Gold again to explain the basics of the analysis there are a lot of large swings in both directions and makes for an easier initial explanation. Chart 41 is the first major range using the 1976 low up to the all time high in 1980. The range is broken into 1/8th and 1/3rd. The first support was at 50% of that range. The next high was at ¾ of the major range, which would also be a 50% retracement. This would make a harmonic relationship. The next low, in 1982, was a 100% extension of that rally from ½ to ¾ extended down to ¼.

The chart number 42 is also monthly chart. The first range is the all time high down to the 1982 low and is broken into 1/8th (red) and 1/3rd (green) with the 50% mark a dash red line. You can see the first low in 1982 was at 1/8 and the high in 1983 was at 3/8th of the entire range. When ranges are this large one could break that range into 1/16 but for this exercise we will stay with 1/8th. Stopping at 3/8ths of a range is a normal support or resistance retracement and keeps the trend intact. Actually there is a zone between 1/3rd and 3/8th that will support most retracements and leave the probability of a normal counter trend and thus keeps the trend intact. Unfortunately, a market can temporarily bounce off that level and eventually go through. But the form of the trend getting there is usually sufficient to answer that question. The gold market then trended down for two years into the February 1985 low. Remember, this support was ¼ of the major range. Notice the higher double bottom or what would be seen as a creeping trend down into the higher low at the end of 1985. The rally into the 1988 high was 5 dollars short of the 1/3rd retracement level of this range and 4 dollars short of 50% of the major range.

Now we'll look at the range from the 1983 high, down to the 1985 low (chart 43). The market traded within that range until May 1999. Also, keep in mind that within the large ranges are smaller ranges that are giving projections of support and resistance. The rally in 1987 and 1988 stopped at 7/8th of the range and the subsequent decline went to 1/8th of the range. If you will look at the move down from the 1988 top, you'll see ¼, 3/8, 1/3and ½ all had an effect upon the downtrend. You can see the last high in 2005 was at 5/8 of that range. I also noted the 1/8 extension down of that range on the chart. The 1999 and 2001 lows were just marginally through that level.

Chart 44 is the range from the 1988 high down to the 1992 low. You can see the low was a 1/3rd extension of that range down and the last high was at 2/3rds of that range.

There is one last range to deal with and that is the range of the high price. This is only a bear market phenomenon or only to be used in a bear market. Many bear campaigns will fall to 50% of the high price. And when dealing with individual stocks and commodities that can move significantly through that level it is best to keep looking at 50% of the next lower high and if that is significantly broken, then look at the next lower high and 50% of that price. You would view this along with the range extensions and the range of the highest price. The next chart (45) is the high price of 1988 divided into 1/8th and 1/3rd and you can see the low was

50% of the high price. Chart number 46 is the S&P and the high divided into 1/8th and 1/3rd and the bear campaign low was 50% of the high. This is not at all uncommon.

Let's take a look at a bull trend and see how this vibrated through price - Chart 47. The run from the 1982 low up to the 1983 high, corrected back to the 1/3rd to 3/8th support level. This retracement is very common in all markets that hold a trend intact. We could call this the normal counter trend support level for a trend. Dropping down to 50% is more severe and doesn't give a high probability of resuming the trend, as does the 1/3rd to 3/8ths level. Of course, a ¼ retracement is an indication of an even stronger trend but is more likely in bear trends than bull trends. Unfortunately, markets can bounce off of any of the retracement values with a counter trend and then resume the trend. So we need more than just price level.

After the 1/3rd to 3/8ths retracement we could extend that range upward to find the next resistance for the next leg up. You can see there was some resistance around the 1/8 and ¼ extensions of that range but were temporary. When 5 waves became apparent, the index was at a 1/3rd extension. Matching the move down with an equal move up is not unusual and is a harmonic relationship. The subsequent correction or intermediate counter trend in 1985 stopped before hitting the trendline. This set up the possibility of the next drive up becoming an exhaustion drive or the third ascending trendline.

Chart 48 is the next leg up. If you look closely, you can see the last leg subdivided. This also corrected to the 1/3rd to 3/8th level. Giving an objective of 1/3 to 3/8 extension. But there is another element to consider. Because the last move down was starting up without hitting the previous trendline (chart 47), this leg up could be an exhaustion style of trend. The index pushed through the old high without much problem and gave a vertical rise to the objective. If this was a blowoff or exhaustion style of trend, this would produce another higher trendlines. If this was a very strong trend it would also bottom above the previous high. We could also assume the correction would not be in excess of the 1/3rd to 3/8th retracement level and could be at 1/4.

Chart 49 shows that retracement to be 1/3rd and the index made a vertical move to a 3/8th extension. This would make little sense for a high when considering the momentum and status of the trend. The index moved down one week for the high and started a creeping or struggling pattern up. This could have produced a high of some significance. There was a lot of volatility, which is indicative of tops.

But as Chart 50 shows the correction was, again, 1/3 to 3/8 and held the trend intact and produced another higher trend line and continued the exhaustion. You can see there was still a leg missing to complete the wave structure and turned out to be a 5 wave subdivided 5th wave into the August 1987 high. One thing I have noticed over time and use in my analysis is old 50% marks will come into play if tested. So once a market produces a range of movement, the 50% mark of that movement needs to be kept on the chart. In this instance, the low to the 1987 crash was at, among other things, 50% of that range. Once the market proved it was trending up from the 1986/1987 low, the current trend we are now viewing. We could assume another exhaustion leg up, as this would be starting from another ascending trendline. The April/May correction was exactly at 3/8th of the leg up and indicated another drive probable to complete a 5-wave structure.

Chart 51 is the entire range of the move up we have been studying. You can see the correction of the 1987 crash was down to 50% of the entire range. You can see as that range was extended upward and the index hit the price levels of the extension, a correction followed. This is a monthly chart so each bar is 30 days so the corrections where significant in time on a daily chart. This is all normal for price vibration.

One of the aspects of analysis we need to add to our analysis is the minimum price movement to anticipate as normal for a particular circumstance. This is necessary so we have the confidence to not react to the market. So we have the courage to sit through a counter trend. As we continue with this workshop, we will determine the minimum objective for drives. Chart 52 is a weekly chart of the S&P index. After the 1987 crash, I continued to look for another sharp trend down to test the 1987 low. So each time there was a false break pattern, I expected to see a fast trend down. There was no reason to believe that scenario, other than the emotions of living through the crash and emotionally looking for the same thing to reoccur. I did know if the index moved past 180 days there would not be a further move down. I also knew that the eighth year of a decade has a very high probability of being an up year. But emotionally I still kept looking for another big decline. Then in the beginning of 1989 the index moved above the previous high and within a 4-week decline could not move back below the previous high. This created a space between the previous creeping trend up and the low to this correction. Indicating the start of a fast trend up was a strong probability. This would indicate a minimum move to the next significant resistance. In this instance that would be the 1987 top. The index moved above that previous top and showed a three-thrust pattern to end the trend. But one would have felt very confident of testing the 1987 top (the first high on the chart) once the "spacing" was confirmed. If you go back and look at chart 51, the most logical extension would be 1/8 , ¼ or ½. The bull trend was only interrupted by the 90-day (intermediate term counter trend) move down in 1990.

There is another aspect of range analysis we can find very useful. Important highs and lows can become 50% marks into the future. This can be used in projections and to confirm the completion of a leg and I have found this to be extremely helpful. Chart 53 is the All Ords index and the 2001/2002 bear campaign. You can see when the index came down to the October low, the previous high became a 50% mark and helped to confirm a significant low. The index then showed a classic counter trend pattern of a weak 5-wave structure up into the 1/3 to 3/8 resistance level. And did so in 90 days, adding to the probability the move up was an intermediate counter trend rally. The normal extension to end a trend is ¼ of the previous vibration; in this instance it would have been the 1/3 to 3/8 extension. The index showed a "V" bottom, just like the previous bottom on the chart in 2001. The momentum of the move down carried the price through the ¼ support but it immediately recovered. If we take the high of the last counter trend and make it a 50% mark (chart 54), the low is confirmed as a probable complete leg.

Let's do some further study on this index. Once it was established the index was in an exhaustion leg up, we determined the top to the exhaustion leg and therefore the end to that leg of the bull campaign would be between 4193 and 4288 based upon extension of previous ranges. The first chart in this series is 55 and is the range from the 1982 low up to the 2002 high. The index corrected ¼ of that range and therefore gave the objective of a ¼ extension at 4193. The correction went through the ¼ mark by 20 points, so there is a window for price and not an exact number. I thought this was the primary range for resistance. You can see the 1/8-retracement level was resistance, which became the 50% mark in chart 54 now makes even more sense.

Chart 56 uses the range from the 1991 low up to the 2002 high. The retracement was in between 1/3 to 3/8 and the extension was also the 1/3 to 3/8. You can also see an important high became a 50% and would have helped to confirm the 2002 high as a complete leg. Chart 57 shows a 5/8 retracement followed by a drive to marginally above a 5/8 retracement. The low before the range starts (Sept 2001) was also a 50% mark and would have helped to confirm the 2002 high. Chart 58 is the entire range from the 1982 low up to the current high. You can see an important high became a 50% mark and has helped to confirm the importance of the last high. Now if we look at the entire range (Chart 59) on a weekly chart, you can see the previous price zone of a high and a low became the 50% mark and was also the previous 2001 all time high. So an important price level became a 50% at the price of the high and helped to confirm the significance of the high price. The lower high would also be 1/16 of that range. When ranges are this large it is acceptable to divide the range into the next smaller increment. But this range and its divisions should be the dominate price support and resistance levels. The index corrected 45 calendar days and 369 points. This correction held ¼ of the major range and 3/8 of the last leg up and held the trend intact.

Let's look at the S&P 500 Index and see the price vibrations for the past few years. Chart 60 is the range from the 2002 low up to the March 2004 high. You can see the July/August 2003 lows became the 50% mark and helped to confirm the high as important. There are a few more things we can add to our tools of analysis. I was able to call the exact high to that leg up and forecast the move down would have three thrusts down to complete the consolidation before the next leg up. We'll look at how that was able to be done, but first let's look at these S&P ranges. The correction was ¼ of the range and held the index in a strong position for the next rally. And also gave a projection of a ¼ extension as a minimum. The index found resistance at 1/8 with a 5-wave structure. Chart 61 is the range of the bear campaign and the support and resistance levels are easily seen. The black horizontal lines came from the last lows before the final high to the bull campaign. The low before the last high to a bull campaign is almost always resistance the first time against it. The move down can be a counter trend, but a reaction can usually be counted upon the first time against it. This low is also a very powerful place to run cycles from.

All markets repeat previous price action. "That which has been is that which will be. And that which had been done is that which will be done. So there is nothing new under the sun" - Solomon. The form of bull trends will repeat within individual markets and the form of bear trends will repeat within those same markets. These repetitions can be related to long-term cycles of 10, 15, 20, 30, 50, and 60 year. During 2003 I indicated the S&P index was repeating the trend from the 1983/1984 market or the 20-year cycle was repeating. If we take chart 1 and compare with chart 3 by holding them up to a light, the correlation is almost exact. Chart 62 is the 2003/2004 market. If we compare the pattern of this trend with the pattern of the 1983 trend there are 4 glaring similarities. They both start off with a normal fast trend up. This was then consolidated with a sideways pattern. The market came out of the sideways pattern with a creeping trend that was eventually resolved with an exhaustion move into the top. This is a very common form of the pattern of a strong trend. The repeating of "Patterns of Trend" is not just a common occurrence it is what markets do. Commodities and interest rates repeat these patterns and cycles on a regular basis.

While markets are struggling in a sideways pattern an opportunity can present itself once a third move against support or resistance is complete. Chart 63 is a US stock BMY. After a third attempt at support or resistance a market can start to trend in either direction. The fourth attempt at support or resistance caries a probability of breaking through. The only problem comes in trying to determine which thrust to start the count. The higher low in mid 1994 would not be considered a test because the previous rally didn't get anywhere near the highs of the sideways pattern so that is still the same thrust down. But many times that last thrust down prior to the start of the consolidation can confuse the count if the next low is just marginal. In this case it is OK and easy to read. A classic volume pattern at the 1994 low.

Three drive consolidations are not as easy as it may sound. Chart 64 is KO another US stock. The 1993 test (s) of the high could be a bit confusing. Because there was not a deep run down I could assume both runs to 22+ were part of the same test. The same would be true of the runs down indicated by the arrows. The run down with the question mark was not a true test of the low. Yes, many of the conclusions concerning three or four tests will change with hindsight. The higher double bottom in 1994 would have been something to get ones attention. The "spacing" (pointing finger) that developed in July 1994 was a sure sign the market was coming out of the 2 year long sideways pattern to the upside.

Let's review a few concepts and add some knowledge related to distribution (tops) and accumulation (bottoms). Chart 65 and 66 are the contract on the ASX 200 Index. The small zeros indicate the OOPS pattern, the counts indicate the number of days to counter trends. At first glance you can see the OOPS pattern, which is indicating a possible short-term exhaustion, does not stand on its own. On occasion it does indicate the exhaustion of the trend, but nothing that can be relied upon. It is a bit more reliable indicating the exhaustion of a counter trend. But unless one is adept at understanding trends, the OOPS pattern can be very confusing. Although if one keeps in mind that it is only a short-term indication of an exhaustion, it can be helpful. There is a common distribution pattern during the June high. Notice the exhaustion day the mid part of June. Followed by a down day and two inside days. If volume was drying up, it could be a small distribution pattern. The next day was a wide range outside day up. The next day shows a huge gap down from the previous days close. The gap is so large the OOPS pattern could be a natural movement to consolidate the large gap. But the important thing on the chart is the spike and four days on the side below the spike, followed by the down day. There needs to be an exhaustion day, a sideways pattern below the spike and the move below the pattern to indicate the exhaustion was important.

The little distribution pattern was followed by a 10-trading day move down that eventually created a base pattern. The market traded 7 days on the side after the spike down on the 10th day down. It traded 7 days against the spike (tas) and moved above the pattern in mid July. I would view that as trading 7 days against the spike. The index then struggled to get back to the high and in August managed to spend 6 day marginally holding a high and moved up. This is a creeping trend up and we could assume it will either exhaust into a high or roll over creating a high. At the end of August it gave a small exhaustion move that could be seen by the trendline and the small "false break" pattern. Notice how the OOPS patterns that were at counter trend lows were valid and the exhaustion (oops) at the highs were bogus except at the last high.

Chart 66 is a continuation from the previous chart and you can line up the "exhaust" indication in September. You can see the vertical move up in October. There were no counter trends so it is either exhausting or starting a very powerful move up. It eventually goes into a small distribution pattern. If you could see an intra day chart, that would be a creeping trend up. That is obvious since the highs and lows are just marginally above or below the previous day. So this would be resolved as any "creeping trend" and was resolved with a downside move. The move up was 15 trading days and the move down into the November low was 19 trading days and some obvious counter trends and OOPS indications at those counter trend highs. On the 28th day from the high the index showed three days down into a higher low. The index then struggled back up to the old high.

In the early part of January the contract showed a wide range OOPS pattern down for a low and then traded 7 days against that spike down. It actually created three moves against that spike. Remember, the fourth move carries a high probability of breaking the pattern. The index then broke to new highs and the next day showed a huge outside day down and another OOPS pattern. This fooled me as I though the market was going to move higher. The index then fell three days and rallied two days but on the third day down which was also 8 days from the high, the contract showed an OOPS pattern and within two day was above the swing high and created a "signal" of strength by moving down three days and within two days was above the swing high. The index trended to the old "obvious" high and corrected 4 days (normal counter trend) and within two days was at a new high. Again, creating a "signal" of strength and an indication of trending.

Chart 67 is one that was developed on the Internet service. All of the notations, except for "signal" where put on while the index was trading. The 3466 level of resistance was calculated using extensions of previous ranges and was an objective. The February/March trend was normal and when it started to trend down we set up the "objective" for the move down as the previous high. Notice when the index came up to the "obvious resistance in June there was a 4 day consolidation and within two days was at a new high. The index moved sideways July and August and when the move hit the "Obvious" resistance of the old high it represented an opportunity. The reaction was very small and when it got above the resistance it gave another very small move down that left a small "Space." If you looked back at the consolidation, it was an obvious struggle down with the large 6-day rally that went deeply into the move down and was not held back by a range division. When it sold down from that rally it bottomed marginally above the 50% mark and showed a false break on top of the previous high, all bullish indications. This is the point where the index went into a huge exhaustion leg up. Notice the "exhaustion" followed by a retest and an 8-day move down that gave up very few points in 8 days. There was an exhaustion move down at the low, that was completely reversed the next day and the following day (day two of the rally) was at a new high. Thus showing a "signal" of strength after a small false break and indicating a strong trend up.

We are now going to look at some larger basing patterns and how they form. Chart 68 is of a volatile US housing stock. The trend down is normal, although there was a congestion that started to look like a possible low during May and June but the fourth move down broke. Eventually (July) the market showed a "trading against a spike" or "tas" and that slowed the downtrend. After a false break the market rallied 8 days and struggled back towards the low in 19 days, possibly signaling the start of a base pattern. The market then showed a very small and weak 5-wave structure up and corrected with a series of higher lows. If those higher lows are at the same level as low within the previous move down, that symmetry is a valid sign a base is forming. The higher lows themselves will indicate that probability. But when there is symmetry present, it adds to the strength of the probability.

Volume was easy to read on this chart. The large down volume in April coming off the high was a warning for the up trend. The large capitulation volume in May either ended the move or would slow the move down. August showed too much volume for a low, but dried up as the base formed. My general rule on volume is large volume will either stop or slow down a trend.

Chart 69 is a picture of another base forming after a strong move down. There was the big volume spike that brought about a counter trend, then a spike low in the middle of July. The move down in the beginning of July created a signal of weakness. The July Spike low was followed by a two bar rally, a very small inside day and four days down versus the two-day rally, indicating possible support coming into the market. This was followed by three days up and six days down to create a possible "higher double bottom - HDB" and a base pattern. One of the things we are now have added to the analysis is the determination as to the minimum move a market will make. Eventually we will also determine the minimum "time" for an advance or decline in the next book on "Time." The following week after the HDB showed a higher low or what could be titled a one-day counter trend the mid part of August. If the index was still in a hard move down the rally would likely only go to a ¼ retracement of the fast move down. Considering the base pattern that is unlikely. The next resistance is the 1/3rd to 3/8ths retracement level and would be a good minimum target. Even if the trend were down, it should still hit that level due to the base pattern. The market then did a vertical move up with only one-day counter trends until it gapped up into the 3/8th resistance. The index then drifted downward until it left an island reversal pattern. Giving an indication of an exhaustion the move up. The movement down in November and December would have gotten my attention. The creeping trend down could be setting up for a significant low of some sort.

If we look at chart 70 and take a closer look at this creeping move down. It starts to smell a bit for a low. In November there was a large three day move down followed by a 12 day rally up into December, three down and 12 up and no where near the start of the three day move down is definitely struggling upward and also within the time window of a second degree counter trend. The index then went to a new low within 5 days and gave a signal of weakness or better said, a signal of the strength of the down move. But there was no follow through so the market rallied two day and sold off one day in Mid December. This was followed by another weak move up of 7 days and within 4 days it was at a new low. This is not the manner in which a market finds a low. It should be 4 days up and 7 days down to the low if looking for a low. The low was a capitulation followed by a marginal false break and a "signal" on the second day up. You can also see the struggle up in April.

Now let's look at some lows that produce high probability fast moves up. Many of these tend to be "rounding bottoms" as we'll see. Symmetry is usually present but not necessary. The next chart 71 is the S&P 500 Index for the same time period as the next few stocks. This way you can get a feel for how these stocks were performing against the general market.

The next chart is MSFT 72. There was a capitulation move down that started and ended in March. This was followed by a huge gap up in April. After the initial five days down the market went into a creeping structure down. What price action would be necessary to indicate a solid low and the start of a fast move up? Draw a couple scenarios that would be bullish.

The next chart is GE 73. You can see the signal days in December and January. In this instance we have the advantage of a spike low that left an island as punctuation for the low. If this is going to be a strong higher low. What would this market need to do to indicate that probability? Please draw two scenarios.

The last chart in this series is INTC (chart 74). You can see the signal days while in a hard trend down and one in October that signaled the exhaustion move up. There is no spike low to give us the probability of a creeping trend down and "tas." What would be necessary to indicate the probability of a fast trend up? I can look for a fast trend because of the nature of the move up and the nature of the last move down. If this is a creeping trend down, we could anticipate a fast trend up. Please draw two scenarios for the start of a fast move.

Chart 75 is the continuation of the MSFT chart 72. There was a 4-day move up at the end of May, followed by 3 weak days down. The third day down closed on the low, if the index could hold that low the next day it would present the probability of ending the first counter trend down in an up trending market. It would also represent the 3rd higher low. This three or four higher low pattern can produce fast moves up but it needs to be developed during a base pattern. One must be sure you are not confusing a weak rally with a three higher low pattern. The same is true of a three or four lower high pattern. If it is a valid pattern there would immediately start a fast drive. The is also the opportunity of finding a low that layers on top of a previous high, as indicated by the arrow. You can also see the index struggling against a spike (tas), although more than the normal three or four days. You can see the same struggle in July, only in this circumstance it was below an exhaustion move and there had a good probability of becoming a lower high and the start of move down of some sort.

Now let's see how the GE pattern was resolved on chart 76. The previous chart ended with a pair of higher lows. There was a huge gap up and reversal followed by a small range day at the end of the first chart. If there was no follow through, that could represent another higher low. The market then rallied and came back three days to marginally break and recover the spike high and give an indication of starting the trend. It still gave a congestion with another three-day counter trend that could have put some doubt into the strength of the trend.

The last chart in the series is a continuation of the INTC chart 77. You can see the fingers pointing to signals of strength of the trends. Once the higher double bottoms were confirmed, I indicated on the service that I didn't know where INTC was going but a low was definitely in place. I could say this because there was a creeping trend down that had two higher lows after a low. By itself would be meaningless, but following the creeping trend down and the 5-wave structure is a valid indication of ending the downtrend. The large 5 day move down was a warning this trend could have a problem. From a strong pattern for low there should be a strong move up and not violate the timing of a first-degree counter trend.

Now we're going to look at some consolidations that turned into bottoms - chart 78. You can see these can take a year or two or three to form. And can represent major opportunities. The market drove up into this pattern and could have been a top. One of the keys to finding the resolution of the pattern is the three thrusts toward the base of the pattern. When the market goes into the third test is the time to pay particular attention. One of the indications of a top is extreme volatility and this sideways move has been fairly docile. It has also been a 1/3 to 3/8 retracement of the trend up. You can also see the continuation signal in early 1995.

If we look at the daily chart for that time period (chart 79). You can see the higher double bottom in October and December was duplicated in miniature during July and August. Considering the nature of the trend into August, that circumstance was excellent for a rally of some significance. Once the index started to trend in 1995 and easily moved above the previous highs, the indications of strength were clear. There was a signal of strength followed by a very strong one-day counter trend and then a consolidation above the highs that left a large space. All indications of much higher prices. One of the very significant points here was the fact that once there were three or four downside tests on the weekly chart. You would have had a lot of confidence a fast trend was starting.

Here is another example of the same pattern (chart 80). Again, the opportunity comes from the third test of support. You can, in both moves out of the base pattern, see the indication of strength being show by the “spacing” that develops after the move to new highs. The second example is indicated by the dollar sign ($). If we turn this chart upside down, we can see a very important difference between the two charts. In the downtrend the testing is all to the upside and produces tops. In the bull trend the testing is to the downside. This is factual and is the way markets trade a majority of the time. The second pattern of three drives against resistance and no downside testing of the lows a classic intermediate term counter trend within a bear trend. Notice how the last move was vertical, in both charts. Once that exhaustion was complete, it should have exhausted the move for some period of time. So which direction being tested is significant?

The next chart is VZ (81) and is another US stock. Notice all of the upside testing during August. It had a great chance to break from that pattern to the downside but didn’t do it and came back up for a false break top. The October spike low was followed by a 14-day rally. By the time 14 days had expired while moving down it was at a higher double bottom. It then rallied four days and by the time it had moved down 4 days, it was still above the low that started the rally and was producing low number two. It then rallied two days at the start of December and three days down was producing another and third higher low. When the market broke above the October/November high it consolidated. Keep in mind the high we want to measure the counter trend against is the high that is within the move up and not the October high. So the high of the early two-day December rally is the important high and that did not get broken. Once it broke above the obvious resistance there was a wide range day down, actually an outside day down that had 4 days against the spike and came out of the pattern with a “signal of strength.” Notice the small, lower high in March as that is a common pattern and the following wide range day would be significant considering the previous three months style of trend. The April high was again, something that is typical for this stock. Notice the last failed drive was a 4-day rally. A great many times when the market is going to fall out of a pattern as this April pattern, the last move will be three or four days or the time period of a first degree counter trend. We could again, turn this chart upside down and the patterns would be just as valid.

The next two charts are a daily and weekly chart of NAB an Australian bank stock. In 1997 and 1998 the stock went into a broad sideways movement and could have produced a top. If you look at the weekly chart 82 this pattern was quite volatile and could have been a top. The big spike down in October was a 50% retracement of the last range up and the subsequent lows were at a 1/3 retracement and could be viewed as holding the trend intact. When the index came down for the third test of the low, the move up was vertical and was at a new high within 4 weeks of the low. If we look at the daily chart (83), you can see the move up started with a higher low and a one-day counter trend. When considering the probabilities for a move up from the third test of the low, we need to consider the manner in which the market move down into that low. The trend was creeping and therefore we could anticipate a fast trend up. The beginning of November (1998) offered an entry with a one-day counter trend and spacing. January gave another trading entry by moving down 4 days and staying on top of the previous high. The fourth test of support or resistance carries a strong probability of going through. This would also mean that the third test could start a trend. This trend was an exhaustion leg up and a swift correction back to the highs of the 1998 pattern would be reasonable.

So what do tops look like? A lot depends upon what market and how the market goes into what could be a top. Most markets exhausts into highs and this can create spike or exhaustion highs that don’t produce a period of distribution. When looking at intermediate term tops or even long-term tops in indexes or other heavily traded items. The tendency is for a period of large distribution before reversing the trend. We have looked at the creeping trend below a spike as one method to development of a top. This can take the form of an obvious creeping trend up as occurred April through August 2000 Chart 15 or it can be a wild volatile affair below a high as occurred with WYE on chart 21.

Chart 84 is another such instance and clearly shows the difference between the two previous patterns. When the move up is very strong there could also be a "three thrust pattern" or a broadening pattern, which are both easy to see developing. If you go back to chart 71, the daily S&P chart. When the index was exhausting into the beginning of the year I could identify the high marked as "Start of distribution pattern" the day it occurred. The time period was actually forecast in advance. When that spike was confirmed by the wide range decline, I was able to forecast two more marginal new highs to set in a top and be followed by a larger three-thrust consolidation down before resuming the trend. But the three-thrust pattern through January and February was a high probability for this index to end the drive up. Basically the index struggled to go up and created the distribution pattern. This same type of pattern shows up often in stocks and commodities at both tops and bottoms. This style of movement could also be consolidating a move for further move in the direction of the trend. So, as always, one needs to look for some confirmation. In this instance, there was a "signal" of weakness. This pattern can take months to form or it can take seven days to form. It is basically indicating a struggle in the direction of the trend. So the analysis need to take into account the type of trend.

Another topping pattern that shows up at the end of strong trends is the broadening pattern. Since tops will usually display some volatility, this is a pattern that displays volatility. Chart 85 is the Hang Seng Index and the broadening top that ended that leg of the bull advance. It first established a high (H) or point 1, followed by a low (L), point 2. It then showed a higher high (HH), point 3 and then fell to a lower low (LL), point 4. Then market then drove up to a new high (HH) point 5 and established a false break high and reversed trend. This was a 5-point broadening top and there are 7 point tops but are unusual. In order for this pattern to develop there usually needs to be a strong exhaustion style of trend.

Chart 86 is INTC daily chart and is another example of a broadening pattern and unusual as it is part of a weak move against the March high. You can see the weak trend down into the May low. Instead of getting a fast trend up, the trend started to struggle and gave a deep correction to establish point 4 within the topping pattern. The last exhaustion move up that was capped off with a very small three-thrust pattern. You can also see that volume, noticeably, dried up in the final move up, as you would expect. The next chart is also INTC (87). You can see the exhaustion trend or blowoff trend developing. It should have become clear in June and August at the latest. Points I and 3 are a double top and that is acceptable for this pattern. Point 5 is a marginal and that is also acceptable. Notice the last drive up was also exhaustive in nature with no counter trend moves to consolidate the drive.

A majority of tops form after a spike up. So the trading after a high is when a top forms. A majority of tops are false breaks of some sort. But many are also lower highs as described in chart 19. Many commodities will show this type of lower double top as a distribution pattern.

Chart 88 is a chart of an exhaustion move up in Wheat. The exhaustion is obvious and the last down day was a large gap down. Let's say the next day is an inside day indicating some stabilization in the move down. What could we look for as an opportunity? What type of patterns could show up to assists us? Please take a few minutes to draw up a continuation of the trend and two types of tops. Please do not turn your chart page (chart 89) without putting a piece of paper over that next chart and slide the paper to the first September low. The market rallied three days and the third day was a outside day down. The next three days went nowhere and was capped off with an outside day up. Three up versus three down and no damage done is not how an market would trend down from this circumstance. You might expect something as occurred in June, a signal of weakness. So we can tell it may be going for a lower double top. But the market pushed through that high and after 7 days down has produced no damage. I then rallies four days (remember that last rally can be a first degree counter trend. Now there is a weak 5-wave structure below a high and a possible or highly probable topping pattern. At the end of October the index shows a three-day rally and in three days is at a new low. So there is now an exhaustion spike, a creeping 5-wave structure to complete a topping pattern and a three-day counter trend. In November, while trading inside a wide range early November day. The market showed a three-day rally that went to a new low within a day and a half giving a "signal of strength (S)" for the downtrend. This was repeated again in December and again in January when it exhausted (notice two big gap down days) into a temporary low.

Time

We're now going to attempt something that is very difficult and that is to add the dimension of time to our analysis. We have been doing that already with our first and second-degree counter trend counts. Also, understanding that the normal counter trend on a weekly chart is also one to four weeks and on a monthly chart is 3 months, is applying time to the analysis. Then there is also the timing of "trading against a spike" which is also adding "time" to the analysis. We want to keep this time analysis to a minimum at this point, as there is a psychological problem adding time. But it is very helpful to know in advance how long a trend or counter trend should run. Just as it is very helpful to know a minimum price advance for a move.

The normal counter trend on a monthly chart is 3 bars or 90 calendar days. This is one of the more reliable time periods and is repeated in all markets all the time. The intermediate counter trend that is against a strong trend will likely be 90 days.

If we look at the S&P 500 index and count the number of days to counter trend moves that were 30 days or longer. The first date we'll start with is 1960, the date is the start of the counter trend and the next column is the number of calendar days to the counter trend movement.

5/60 =42	2/84 =69
1/61 =45	9/84 =60
5/61 =60	3/85 =60
12/61=190	7/85 =72
8/62 =62	4/87 =42
6/63 =47	87 crash=56
1/65 =60	7/90 =87
5/65 =45	1/92 =86
5/66 =60	3/93 =44
9/66 =240	1/94 =59
11/67=64	8/94 =101
3/69 =58	2/96 =58
7/69 =90	7/96 =54
2/70 =60	2/97 =54
10/70 =45	7/98 =80
8/71 =60	7/99 =90
9/71 =30	1/00 =54

5/72 =47	4/00 =140
8/72 =56	5/00 =101
8/73 =68	12/00=42
12/73=99	3/01 =90
7/75 =77	9/01 =179
11/76=47	12/02=101
6/77 =49	
9/78 =63	
9/81 =66	

So we can assume counter trend moves of greater than 30 days, in the S&P, will be 45, 60, 72, 90, 101, 180. There are lots of 30-day counter trends and accounts for the 4-week corrections that show up on the weekly charts. So we can look for counter trends to be very close to one of those time periods. The difficult aspect of this is "look for" and can present a psychological problem. Understanding that "time" presents a probability and how a market is trading is reality, we must use "reality" to confirm the probability and that can be difficult.

So before trading or positioning a market, we need to know the time periods of counter trends. It is also helpful to know the length of time to final legs up and down. Almost all of these will be exhaustion moves or legs. And the length of time for bull and bear trends is also helpful for determining a minimum move, but they do vary greatly. There may also be a reaction to anniversary dates or one-year cycles and multiples of those one-year time periods. The S&P is a dominate 90's vibration, there are other vibrations that will show up in other markets. There are only two daily vibrations, 90's and its divisions and 144 and it's 1/8 and 1/3rd divisions. The important increments within that vibration for counter trends are 36, 54, 60, 72 and 99. This would take another book or two to explain and we'll need to put that off until another time. Believe me, it will take years to assimilate what you are being taught today. And a majority of the circumstances, "time" in regards to the length of time of trends can be detrimental to positioning. It definitely falls into the cliché of "a little knowledge can be dangerous." But the exercises we go through from here will include our understanding of these time periods for counter trends.

Let's do a quick review of first and second-degree counter trends before we go on. Chart 90 is the S&P while it was in the correction or consolidation from the 2003 large leg up. History told us this would be a creeping trend down with three thrusts to the completion of the pattern because that is what occurs following the style of trend up if the trend is to be maintained. You can see that while even in an overall weak move down the index is still conforming to the pattern of first and second-degree counter trends. I have also put volume and the demand index on the chart. There is a seasonal factor in volume in the US Market; it is not as significant as it used to be. But there is a seasonality during the summer months of June, July and August where there is a tendency for volume to lighten up. Especially towards the end of August. So this must be taken into account, just as you would take into account the fact that Monday's are usually the lightest volume day of the week and Friday can also be a light volume day.

I have always used the rule that big volume tends to slow down or stop a move. Volume trends to dry up at both highs and lows, on a relative basis. At lows it is also good to see the market narrow its trading range. There can be volume "capitulations" that can end trends and need to be studied on each individual market. All volume oscillators as the Demand Index are all prone to failure against strong momentum. Getting to understand a volume oscillator is valuable, as they will bring your attention to a specific situation. Divergence in the index should correspond to a divergence in volume between lower lows and higher highs. You can see in the beginning of June volume started to decline compared to April and May and continue, while the market advanced, until the wide range down day that closed on the low towards the end of June. That volume spike was a clue to the coming decline as it was followed by a one bar counter trend and another wide range down day. Volume patterns in indexes can be different than individual items as stocks and commodities. Most of the time, counter trend rallies and selloffs will show less volume but it is not a rule. You can see the very strong divergence in the oscillator in the index during July and August. And during the October low there was no divergence. So a divergence signal can be valid, but a non-signal can also be a low. This can be difficult to use and the whole volume analysis can be that way. You can see the volume divergences continued on from the end of November, until the top the first trading day of January. The glaring drop off in volume during the holiday trading at the end of December and the subsequent decline has occurred in the past.

The October low did show a dramatic decline in volume the last two days of the declines (day 12 and 13) but was also a Friday and Monday, normally light volume days. But the subsequent two wide range days up showed large volume and really confirmed the low. The bigger picture represented a higher low following a three thrust or creeping pattern down. It is also true that against very strong momentum, volume may not be reliable in both the oscillators and basic reading of the volume chart. Many times when a low comes in on big volume, it can indicate the only reason the market has stopped the decline was a capitulation of some sort and the decline will resume when the volume spike gets worked off in a few days. This is "circumstance specific" and we'll need to look at this in relation to the position within the trend. Volume is best used to confirm other activity on the chart.

Chart 91 is the first thrust up in the bull market after the March higher low and was a high momentum trend. Every high was an exhaustion, which you can see by the accelerated trendlines and the daily bars with their large gaps up. The counter trend moves down in April and May were all light volume affairs. The June exhaustion also had a volume exhaustion to go with price exhaustion and stopped the advance for almost one month. The next exhaustion (7th wave) brought in a lower high and a new low, so we could assume a larger counter trend and it would exceed 13 days. So our price objective for a move down would first be ¼ retracement and if that failed then the 1/3 to 3/8th level. We could also assume 30 days or less or within the 4th week. When the index got down to the ¼ retracment, the ranges narrowed and volume dried up and by the 3 day off the low the index was moving past 30 days. The volume pattern for August would not have given a lot of confidence the move up was going anywhere but the last half of August is usually a light volume seasonal time for the US Indexes so not significant unless compared to previous late August time periods. The index eventually moves into a creeping pattern but stays above the July high.

The next chart (92) is a continuation of the previous NASDAQ chart. October, November and December became a sideways pattern that was tight and eventually came out of that pattern from a higher low (hl) and gave a final exhaustion move up. This is not to be confused with the higher low or possible higher low in July. When a market shows a higher low while trending down, it could indicate a second-degree counter trend. A higher low in an up trend is usually resuming the trend, but the <u>follow through</u> will tell the story. There were no counter trends within that last move up, indicating it could be an exhaustion leg. Notice the big burst in volume that dried up at the high and the rally against the high. If one studies the NASDAQ, after an important high is hit, it almost always comes off that high point with a wide range day as occurred in January. It doesn't limp down from important highs.

The next chart is BHP weekly (93) and has some very good points on it. During the beginning of 2002 the index exhausted into a high and showed a creeping trend down into an exhaustion low during August. This was followed by a high double bottom. But the trend was a weak 5-wave structure and was resolved to the downside. This was followed by another creeping trend down of 5 waves. In this circumstance the index shows a normal trend up that eventually shows a three-thrust pattern and puts the market into a sideways pattern and a dramatic drop off in volume during the April high. The market then hugged an accelerated trendline until it started an exhaustion leg up in 2005. At the top was a volume spike. The week this high was being hit I saw a technical analysts on CNBC recommending this stock. He is a bloke who has over twenty years in the business, written many books and he doesn't know a normal trend from an exhaustion leg. So don't feel badly about not having this knowledge as few do.

Let's look at the daily chart during that time period - chart 94. The October through December consolidation gave a clue to being resolved to the upside. Each decline was approximately the same number of days. But the number of points was less in each decline. The index eventually gapped up on a huge volume print. At the end of February it fell off leaving an island but rallied back three days on very light relative volume. It fell one day and came back up to a marginal new high on a significantly less volume. The low that came in showed some volume and the first day of the rally was also heavier volume. The high day to the counter trend was a very light day as was the next. The next few days were increased volume. The next counter trend showed light volume on the rally and is typical of the second counter trend off a high. Can you imagine looking at this situation the beginning of March and claiming it was a buy. Of course you wouldn't. If you looked at this chart upside down, would you say that March was a good sell? Of course not because you understand exhaustion legs of trends. It is at this time one would look to exit positions.

The next chart is chart 95 and is another US big cap stock. This is a typical downtrend with the third wave the longest and fastest wave. There was a lower double top that showed up in the pattern during June and most lows came in on volume spikes. The May high was on a volume spike and can occur close to the high. The July volume would have indicated a low of some sort. The counter trend that had a 5-waves structure in August was also "trading against a spike" as the last leg was getting started. There was a four-day counter trend that exhausted and gave a strong signal of strength to the downtrend in early September. You can see the last drive at the end of September into October subdivided into a small 5, for a 5 of 5. When we look at the lower double top in October, you can also see the volume drying up. But there is a completed trend and this was a strong rally.

If we turn this chart inside out (chart 96) the pattern of trend is very typical of an up trend. The double bottom in June is very typical of an up trend. Remember the significance of the pattern is determined by the direction of the trend. The move down in August looks like a very strong bottom due to the time it took to get there from the 4-day rally. The double bottom in November does not look very appealing from this perspective.

If we look at the range of this move down (chart 97) from the high into the July low, the rally went to the 1/3 to 3/8-retracement zone. Again, the normal retracement to keep the downtrend intact and should have given a lot of confidence the rally was a counter trend. The low was a ¼ extension of the range and is very typical of trends, both up and down.

The next chart (98) is the same stock only this instance is a weekly chart for 1984 through 1986. You can see the large volume in October 1984, followed by a marginally lower low for a low. This is normal for a trend. This was followed by a higher double bottom and a series of higher lows. There was a move down in September of 1985 that left another higher double bottom. All this could have been a weak trend up, although the large number of higher lows and the volume were making that suspect. You can see the highs came in the same way in regards to volume. First the big prints, followed by marginal new high with significantly less volume.

If we look at a daily chart for that time period (99) you can see a very weak rally in September and October that appeared to possibly end the pattern. But it dropped down and volume dried up in the end of October and in early November there was a sell off from the "obvious" that left spacing and indicate a possible move out of the pattern. There were a few more similar indications as the market trended upward. Until it eventually broke a swing low and was point 4 to a 5-point broadening pattern for a top. You can see volume spiked at the first high and was followed by marginally higher highs on less volume, creating a top.

One of the situations we must be aware of is the recent history in stocks is a once a generation move up and move down. Part of the reason I am not using all recent examples, is this run up in the indexes and subsequent multi year bear trend will not occur for another 30 or 60 to 70 years. Individual stocks and commodities can behave that way, but it will be unusual in stock indexes. Commodities appear to be in a long-term bull trend or at least the CRB index looks that way and long-term cycles indicate a possibility of a 10-year bull campaign in progress. But stocks and the indexes need to be tempered with some history at this point. After the 1987 crash many traders kept looking for another big move down and every time they got short properly, they overstayed their positions. This same thing could occur the next few years. We need to keep a historic perspective on stocks and stock indexes. We will see blowoff moves in both directions, it just won't be hundreds of stocks at the same time. The blowoff that occurred between 1995 and 2000 will not reoccur other than in individual items or groups. There will be bull campaigns as the 1930's, 1970's and 1980's but note like the exhaustion of the late 1990's.

We want to move between the next two charts (100 & 101), the first is the daily chart of BSC a US stock. The second chart is the same stock only a weekly chart. I left the daily notations on the weekly chart so we could easily identify the period of time we are studying on the weekly chart. During July and August the index was showing a creeping trend down. The last move down to complete the pattern was three days up and 6 days down. The last day was a "false break" low and an exhaustion day indicated by the OOPS pattern. The indication there was a solid low was the first time the market showed a counter trend that stayed on top of the previous high as occurred at the arrow. That was an ideal circumstance due to the "obvious" resistance at the low. One of the things I wanted you to take away from this chart is the ability to see exhaustion moves. Notice how the high weeks during this multi year bull trend are all exhaustion moves. This can be seen by the wide range weeks on the weekly chart and if we look at the daily chart and understand we are looking for an indication of an exhaustion, then the day of the high becomes much easier to see.

Now let's look at the time period of February and March. Notice how the market went up 11 days and within 4 days it was at a new low. That is a sign or signal of a very weak market (or maybe better said a strong down trend) and should indicate a fast move down. But it starts to rally and the first few days have some increased volume behind the rally. By the sixth day up it is obvious this is not a counter trend as it had passed 4 days and actually consolidated the move up. So this was a failure in the "signal" the trend down was strong. The rally turned out to be a counter trend rally or part of a topping pattern. But it is an example the not all things work all the time. Also, when dealing with "Signals or strength or weakness" you must be aware of how far into the trend this occurs as many times that can produce a false break, but almost always occurs deep into the trend. Many capitulation moves down end with a two or three day rally and a wide range to new low that doesn't go lower. If it is operating from ascending or descending trendlines then it is usually telling you the trend is in the process of accelerating. It is unusual to see a failure of a "signal" that close too a high, but it can occur.

Chart 102 is the same stock and is a good example of volume in a bull market. You would anticipate the August low to show a reduction in volume as it did. The September high was an exhaustion and the previous volume spike where building up to the high day. The next low was also an exhaustion. The light volume on the one-day counter trend would have been helpful. The November move down on a spike could have indicated a significant high due to the volume spike on the down day. The high was not an exhaustion and the lack of follow through was a warning, but it is a failure. The next high in November was an obvious exhaustion and was followed by a huge spike and a huge down day and should have been an indication of lower prices. On the 11-day rally in February the volume was light at the top as it should have been. The low came in at the end of February with volume. And was an exhaustion of some sort and the volume kept up through the first few days of rally and not the way a counter trend should look. The large volume low is not unusual for a counter trend, but moving past 4 days was significant. The volume spike on the down day in March should have been an indication of lower prices. Coming that close to the high is bearish. Many times a volume spike will be followed by a few inside days, just as a price spike will be followed by a consolidation of some sort. On intra day charts volume spikes do stop moves but that must be considered in conjunction with the time series.

The next two charts are a US stock weekly (chart 103) and daily (chart 104-BNI). You can see, as it went into 2005 there had been three ascending trendlines and an exhaustion at the high in December. But knowing that there could be another leg up that would be at an even faster, meant one would look for both directions out of the consolidation in 2005. The February pull back was 6 days and volume dried up versus the pervious larger volume up move up that was 6 days. Six days up and six days down and still above the 50% level of the advance. The move at the "obvious" was helpful. The exhaustion high on the 5th wave up followed by two day inside days and a two-day rally that was capped off with an outside day down. A move down on increased volume at the end of March would signal possible further weakness. The subsequent 4-day counter trend rally was easy to see especially as volume dried up on the rally in early April. Looking very much like the rally after the wave 4 correction. I've tried to make two points. First if there is a blowoff, we can't look for it to end until there is an exhaustion and some evidence of trending in the other direction. Looking for an indication of trending down before being convinced it was over would have been helpful in March during mid March. Unless one were positive of the wave count. The first counter trend was evidence.

Chart 105 is another US stock - KBH. You can see the capitulation volume in mid September. Followed by the early October large volume move down. Price eventually found a light volume low in October (notice the struggling move down) and when it moved up to "obvious" resistance. Where it showed a first-degree counter trend and was an indication of further trend up with a "signal." Notice at the end of November the market came down to test the previous breakaway point. When it started up there was sufficient evidence by layering on top of the previous one-day rally and not on top of the previous swing. Remember we want to view this on the basis of a trend and where would the trend have started. The volume spike in December caused a consolidation that became a creeping 5-wave structure against a strong trend. Followed by a 5-wave structure up that ended with a two-day wide range exhaustion movement. After the low in March, there was another five wave creeping structure only this time it is up, below a high.

We're going to look at a few commodities and there is a significant difference in the chart data I use. I attach the same months together as this June contract is all the previous June contracts. I do not use continuous contracts for reason we'll now discuss. I have been comparing the Gann format (combining only like months) with the continuous formats and find the former far superior. Everyone would agree that you wouldn't wont to compare December wheat with other wheat contracts, as that is a separate crop. But I have found this to be true of all futures contracts, even currencies and metals. If we use Crude Oil (Charts 106 & 107) as an example, you can see in the next two charts, there is a noticeable difference in the price levels. This is for the June contract, some of the other contracts the different is even more significant.

The next chart (108) is a daily chart of Cotton. Draw some lines on the chart and tell me the probabilities for the next move. Now turn to the next chart (109). If the last high (3-day rally on chart 108), which showed a possible exhaustion gap, was a high within the downtrend it indicated the possible start of a capitulation move. It layered against the previous low after a creeping trend took it to that location. It was below a sideways pattern (January through March) and it would have started down from an accelerated trendline. There was a new low within 2 days, all indicating the probability. The same situation occurred 10 days later with a move that failed to reach the trendline and layered against the previous low and showed a wide range day down. The distance between the high in October 2003 and the counter trend rally high in early 2004 was an indication of the strength of the downtrend. Currently (January 9, 2007) copper is in a capitulation mode from the exact same pattern of trend.

Conclusion

Trading and positioning is not an easy task. You need to be prepared with lots of research related to how an individual market trends. I cannot emphasize enough that you are trading your knowledge and to avoid the mindset of trading a market. You may attempt to trade every movement that market makes and that would be a mistake. Success is a matter of looking for opportunities based upon what you truly understand. The bigger picture of daily to weekly to monthly is always very helpful. The more history the better. Understanding the three different types of trends is great knowledge but seeing them develop in real time makes the undertaking worthwhile.

One of the easiest opportunities to see develop is the weak counter trend against a strong trend. The one that has 5 little waves. There are many examples; chart 14 is a good example. Since this pattern of trending should be followed by a fast trend or something is wrong. You will know where to set your protective stops based upon your knowledge of a fast or normal trend.

The following statement keeps it pretty simple. Finding the start of a trend, entering that trend with limited risk and exiting when the trend becomes at risk of completing. At risk can mean while a market is exhausting. Learn everything there is to know about trends and trade or position from a foundation of that knowledge.