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THE JOURNAL OF TRADING & INVESTING

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UNDERSTANDING MULTIPLE TIMEFRAMES

THE JOURNAL OF TRADING AND INVESTING

I have found over the years the most valuable tool I have is my trade journal. It is here that I recognize important aspects of trading and investing that include understanding the environment of the markets, economic and political influences on those markets, and most importantly, the failures and success of my strategic decision process and my tactical entries. I have decided to publish my analysis, my successes and yes, my failures. It is my goal to teach others to trade and invest for themselves. Too often I have found people looking for that one person who can give them all of the answers, the magic methodology and the path to riches. My hope is that I can show you that you are that person. It simply takes work. The greatest compliment I receive is when a subscriber cancels a service and tells me they can do it on their own now. Or, they tell me they are doing their own analysis successfully but want to stay with me as a check on their own work. I am hopeful you will gain from the knowledge and experience I will offer in these issues. At times and with their permission I will also add experiences from my clients.

MARKET DELTA

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Understanding the development of a market in multiple timeframes is critical to developing both a strategy and tactics. I cannot stress with clients enough how important this aspect is. The premise is that the market finds value between areas in different timeframes. You can build a Balance Area that is several days to several weeks in duration. Once you have done that you have found where unfair prices are and where value is. The Key Reference Areas (KRA) become visible and you now have areas in which to look for trades.

Each day of trading gives us areas in which to look for trades and tells us there traders have found value and unfair price for each trading day. What most traders do not realize is that those Areas of Balance can also be found on a 30 minute bar chart, a five minute bar chart or a 1 minute bar chart. In fact, you can find Balance Areas on any chart you want by simply looking for rotational patters. After all, a Balance Area is simply an area of rotation where price is rotating between two points. Those two points are the extremes of the Balance Area.

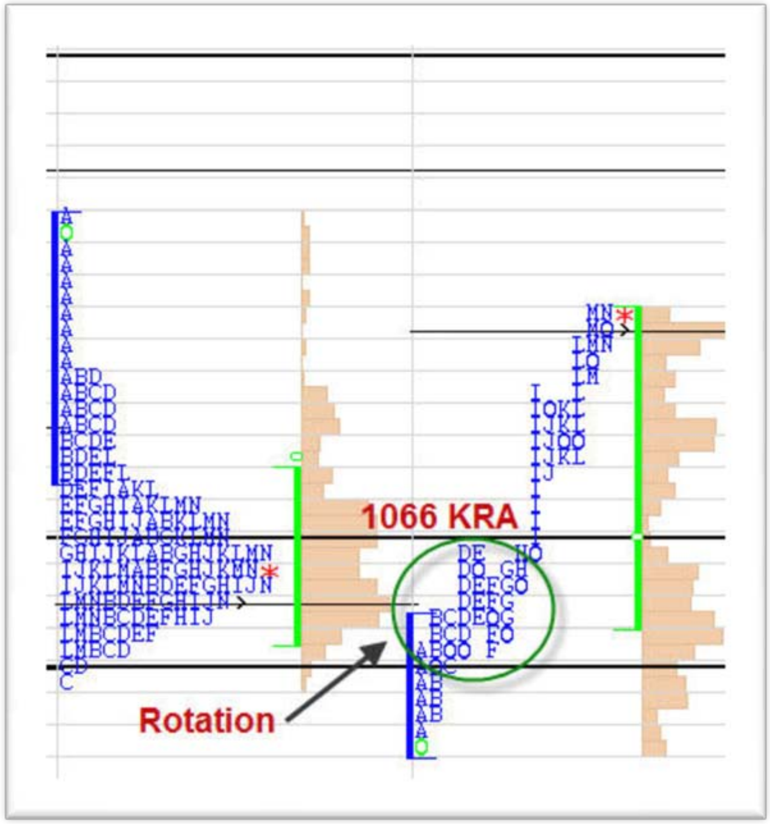
I trade all markets including equities. Some of my best trades were when I have found an equity to be at an extreme in an Area of Balance. Typically, I will bring an equity up on a bar chart first. I will then look for Balance. If I find Balance, then I have a place in which to look for a trade. A simple review of volume will give me a good indication as to the direction of the next move in that stock.

Take this a step farther. You have found through your work a market that for the last few weeks has a KRA at a certain price. This would be a longer term KRA. Then you notice for the last few days that KRA has held. That same KRA has now become an intermediate term KRA. As you are watching the market trade, you notice that intra-day it is forming a Balance Area at that same level. Finally, you pull up a 5 minute chart and see a 5 minute consolidation, again at the same price level. You now have found a market that is at a KRA in at least four different timeframes. Certainly, it is an area of good trade location. This is exactly what happened in the ES last week.

I had developed two longer term KRAs and had written about them in The Markets in Development Newsletter. They were the 1066 area and the 1058 area. Two days prior to the 20th the ES traded down to test the 1058 area and then spent the rest of the day and the next consolidating or rotating basically between the two KRAs. This formed a “b” pattern that suggests exhaustion on the part of sellers. 1058 was the more recent KRA and therefore the more relevant. That is not to mean you should ignore the longer term KRA. It was still important.

On the 20th the market opened with a gap down and through the 1058 area. The gap was quickly retraced and the market traded above 1058 and below 1066. This was signaling the fact that sellers were not strong enough to drive price lower and buyers overwhelmed them by coming in a driving price higher. In other words, sellers tried to put the market in vertical development down, but buyers were too strong and drove the price back up again creating a false breakout.

The exhaustion pattern from the last two days and the quick fill of the gap suggested the market had an underlying strength to it that simply had not surfaced yet.



In the chart on the right you can see that for almost half of the day buyers and sellers could not decide on whether value was higher or lower, so price rotated between 1058 and 1066. Both of these areas were KRAs and important. However, a break of one of those areas would give a pretty good indication as to the immediate direction of the market.

Since trading is an assessment of probabilities, we now have probabilities beginning to line up for a potential move up. However, we do not have enough to yet commit capital to the market.

A review of the market internals show that moving up into the area between 1058 and 1066 showed volume falling off, which is typical in an area of rotation. But, breadth was increasing. This was another indication of a potential move higher.

Having identified the market was in an area of good trade location in the longer term and intermediate term, it was then time to look to what was happening in the short term. Looking at the 5 minute chart on the left, you can see there was a 5 minute rotation or Area of Balance between about 1061 and 1065. The upper extreme of this 5 minute rotation was at the 1066 extreme from the longer term development of the market. I have shown this with the larger green circle.

Finally, you can see for about ten to fifteen minutes (easier seen on a 1 minute chart), the market rotated between about 1063 and 1065. Again, the upper extreme was at the upper extreme of the 5 minute rotation, which was at the extreme of the rotation that occurred after the gap fill, which was at the 1066 area that was a KRA and happened to be an extreme from a previous day and a longer term composite.

I happened to be working with a client as this was developing. I was explaining the importance of understanding the market in multiple timeframes and how you can expect a great move when a market is at a KRA in multiple timeframes. I pointed out the candle that broke above the 1066 KRA and said that it was a signal to go long. An initial stop could be placed just below 1063, the lower extreme of the shortest timeframe Balance Area. The trade was a vertical development trade and therefore, you would not want to see the market back below 1063 because then it would be back in rotation in all degrees of time.

As the ES began to trade up it was important to then see the market internals begin to confirm the move. With each tick up breadth increased and volume began coming in supporting the move up. With all of the probabilities now on our side, the key is stop management and trade management.

The ES closed the day at 1080.75. Assuming an entry at 1067, this would have been a move of 13.75 points in the ES. While the entry may not have been exactly at 1067, nor the exit exactly at 1080.75, you can see this would have been a move for a profit of about 10 points at a minimum. That is about what my client took out of the trade.

The important educational aspect of this is as follows:

1. Understand the development of the market in multiple timeframes.
2. Look for other clues as to what the potential direction of the market will be.
3. Analyze the market on the shorter term charts when looking for trade entry.
4. Trade the development of the market even on a one minute chart.
5. Have patience to watch the market reach the KRA and then move through it before entering the trade.
6. Look to the market internals to confirm your trade.

I have found when any market reaches a KRA in multiple timeframes as the above example; the higher probability is for a larger move in one direction or another. I hope this helps in your understanding of how important it is to view the market in multiple timeframes.

Thanks,
Joe

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