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BREAKTHROUGH STRATEGIES FOR

Predicting ANY Market

CHARTING ELLIOTT WAVE, LUCAS, FIBONACCI AND TIME FOR PROFIT

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UNRELEASED MANUSCRIPT

6 | Volume Studies, Moving Averages, and the Time Element

I believe the most useful aspect of the time factor is that anyone can use it. Regardless of whether it is based on Fibonacci or Lucas, technicians from other disciplines can apply it just like anyone else. The rest of the technical analysis community looks at Elliott as a subjective methodology. I've proven within these pages they are indeed correct. I've also shown you many different ways of eliminating much of the subjectivity of Elliott.

However, no matter how much you eliminate the subjectivity of Elliott, there is an element of technicians who either don't understand or don't want to understand anything concerning the waves. I can't blame them because it takes years to learn Elliott properly. The goal of this book is to make you exponentially better at your own method in the shortest time possible.

That being said, there is a large contingent of technicians and traders that follows the William O'Neil method of technical analysis. I consider O'Neil to be one of the great innovators and technicians of the 20th century. I cut my own teeth in this industry on the *Investors Business Daily*. O'Neil has taken a lot of people who knew nothing about the stock market and

taught them a methodology that works. In this chapter, we are not going to pursue his relative strength rankings of stocks or industries. It does not really apply to what we are doing here. If you want to know which stocks or industries are outperforming the market, all you need to do is run up to the corner to get yourself a copy of the IBD. In this chapter, we will add to his existing methodologies.

The O'Neil philosophy encompasses picking strong companies with tight technical patterns. They rely heavily on pattern recognition highlighted by reliable patterns such as cup and handles (O'Neil 1995, 160–179). They also rely on good volume patterns and moving averages. These are all sound fundamental tenets of technical analysis. By adding the time factor, we are taking the O'Neil methodology into the 21st century. Just like the last chapter on divergences, we are attempting to reduce the number of times you are stopped out of positions by making a good methodology even better.

The IBD stresses the importance of the 200-day simple moving average. Many traders and money managers also add the 50-day simple moving average to their repertoire. Gary Kaltbaum has a nationally syndicated radio show and considers himself to be an O'Neil disciple. He considers the 50- and 200-day moving averages to be key gauges of whether a trend has changed (O'Neil 1995, 55). Shorter-term traders rely on the 20-period moving average. Elliotticians believe these moving averages are just lines on a chart. However, the big money crowd and the trend followers use them religiously. I've often observed that when one of these moving averages happens to line up with a Fibonacci retracement point, that there is a good place for price action to hold the line. However, this chapter is devoted to people who are not familiar with Fibonacci retracement lines and couldn't care less. Consequently, you won't see any Fibonacci price retracements in these examples.

MOVING AVERAGES AND TIME CLUSTERS

When we start a new bear trend, one of the key challenges is what will happen when we get to the 50- or 200-day average. Is it going to hold the line or not?

Figure 6.1 shows a 7-month progression off the top in Google (GOOG). So far, we've had a 40-day progression off the top and a 29-day retest of the high that failed. In May, we are trying to ascertain whether the 200-day moving average is going to hold. Up to this point, the 50-day moving average has behaved like Jell-O. On the first trip down, the 200 day was taken out slightly. The second time down, the line was tested again and held on the cluster of the 89th day off the top combined with 21 days down off the secondary high.

We can also see that on the move up in June, volume seems to be lighter than it was on the first leg down. It looks like buying volume is beginning to dry up (174). Great! That tells us that likely, we are not at the early stages of a new leg up, at least not here. But we've also gone up 60 points,

Figure 6.1
7 month progression off the top in GOOG

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and it's not a good time to be short. When do we want to get short? Be patient and wait for the time reversal. The current trend off the May low is 32 days up, 122 days off the top, and 54 days on a high-to-high cycle off the last test of resistance.

It would seem like we are getting close to a reversal. It could happen on the next bar as we would be 33 days off the last low (Fibonacci 34–1), 123 day window (Lucas) off the top, and 55 days on the money off the last high. One of two things is bound to happen. We will get our reversal on this triple cluster: a high-probability outcome. The other possibility is that if the market were to choose to ignore this excellent cluster, it would be a very bullish sign—a chart that ignores such a chance for a reversal is try-

Figure 6.2
GOOG a few days later from 6.1

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ing to tell us something. The market needs to elect this cluster as a turning point. If it's going to reverse, it has to be here. If we get a bearish candle with this setup, we have a high-probability winner.

Here's the chart just a few days later (Figure 6.2). It topped right in the area we anticipated. The best part of this situation, and what gives this methodology so much promise, is that we anticipated the turn days ahead of time. It actually topped a day early from an ideal 34/55/123 day cluster—as you can see on the chart, the top was the 33/54/122 day cluster. It started turning down exactly at the time it was supposed to.

This time I am going to show you the scaled down hourly chart (Figure 6.3) so you can see the candle and bearish divergence situation going on

Figure 6.3
Hourly chart of GOOG

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at the time. The daily chart doesn't give you the cleanest reversal signal because the top is created by a doji and black candle that closes below the doji. There is no clear signal this was pulling away from the high and it took nearly five days to confirm. However, when we scale down to the hourly time frame, the situation is very clear. The two hourly bars at the top are creating a dark cloud cover situation at the same time that we get the bearish divergence on the MACD. What else? From the congestion zone low at 401–402 to the top, the final leg completes in exactly 46 hours. When we put all of this together, we have a turn in four degrees of trend. First, there is a cluster of three daily relationships plus the hourly turns at exactly the right moment.

ADDING VOLUME TO THE MIX

Let's take a closer look at volume's role. Figure 6.4 is a daily chart of Intel (INTC) at the end of the 2002 bear market. There are a few key points on this chart. Notice the huge buying volume within days of the bottom. A nonscientific look at this chart suggests average daily volume to be around 60–65 millions shares a day. The big day is almost 3x the average daily volume. This kicks off the new uptrend.

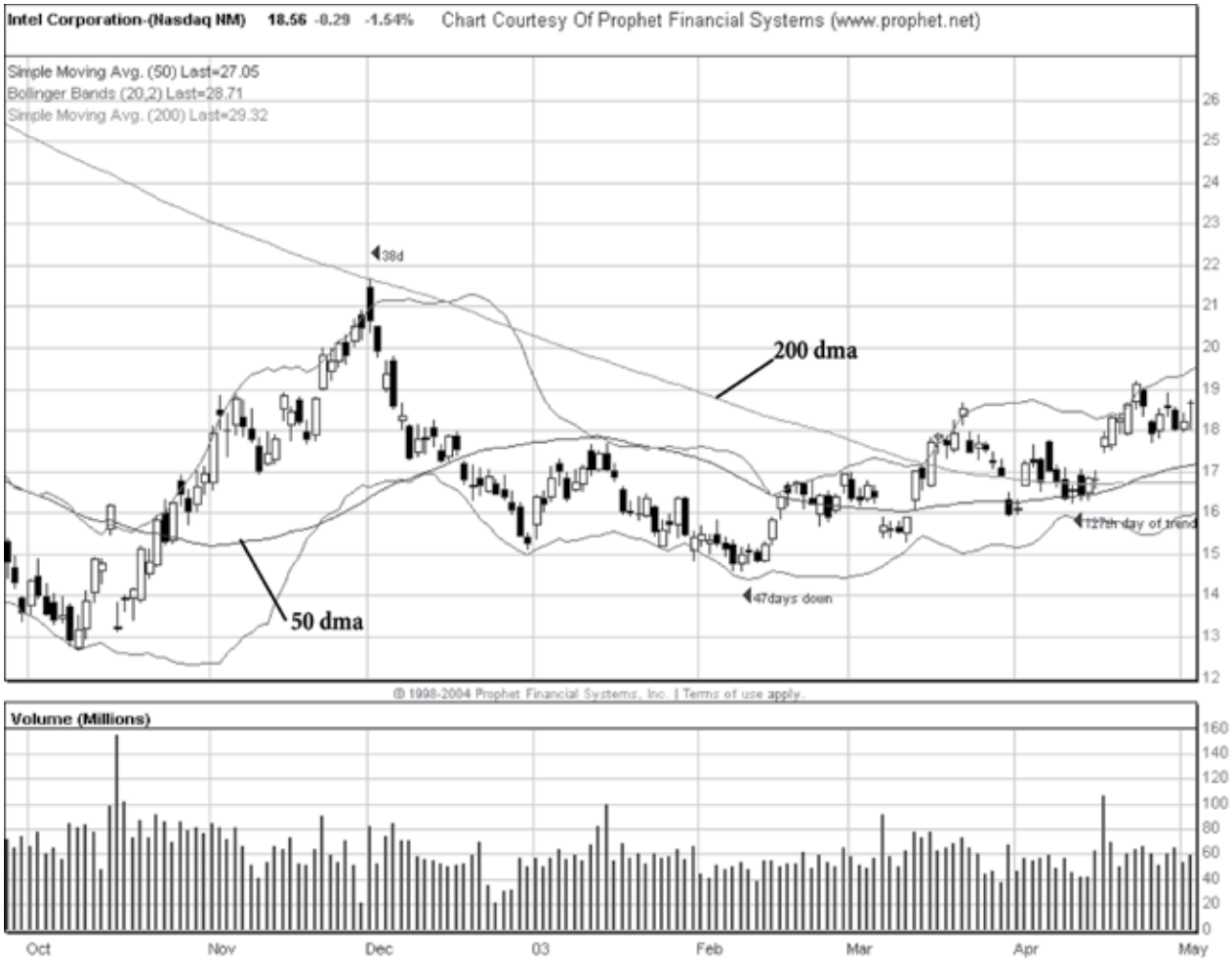
We have an uptrend that runs its course on the 38th day, which is the exact day it hits the 200-day moving average. At that point, we get a good bearish candle formation. Here we have a cluster of three reasons to go short. First, there is the 38-day cycle. Second, it reverses right at the 200-day moving average. Third, you can also make out five waves to the upside. Recall sentiment at this time was very negative, and at some point, we would anticipate a retest of the low. We discussed in Chapter 1 what happens during retests of the low waves. The sentiment after the December high was, "Here we go again: we will likely set a new price low not only in Intel but also in every situation."

The retest of the low continued into February and ended on the 47th day of the trend. If you continued to stay short and held on for another 21 days, you didn't get hurt too badly, but the 22nd day was about the time the market took off for good. On the 23rd day off the February low, we gapped up with a nice white candle after leaving a higher low for the first time in a long time. And, I couldn't call this setup a cup-and-handle pattern for several reasons, but the best one is selling volume really doesn't

dry up to any degree in that 47-day retest of the low. It took a contrarian to go long at this stage of the game.

However, those who follow this methodology stress moving average crossovers. Here we have a big one in April, and our timing model beats it to the punch. Many traders will use the 50-/200-day crossover as their buy signal, and that's fine. What confirms the technical situation is the gap up that occurs 4 days after the important 127th day of the new trend off the October low. If we were going to drop, that would have been a good time for it. Observe how price action touches the 50-day moving average on the 126–127 bar cycle and holds the line. Within a week, we get that crossover suggesting being long might not be a bad idea. Everything

Figure 6.4
Daily Intel (INTC) beats moving avgs at end of the 2002 bear



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points to a change in trend, and our timing model confirms it, if for no other reason than by default. Our 127-day time window beats the gap and the crossover.

TRACKING BULL TO BEAR

The moving average methodology considers a trend will stray from the mean to the upside but eventually will revert back to the mean, and for large cap stocks, this means a retracement back to the 50-day moving average. The 50-day moving average seems to work best in stronger relative strength stocks. However, in the universe of stocks, reality suggests mov-

Figure 6.5
QCOM Moving Average

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ing averages are going to be violated more often. Like the U.S. Constitution, we need a checks-and-balances system to confirm the trend is still intact. The time factor does an excellent job for us. Figure 6.5 is a chart off the secondary low back in 2003 for Qualcomm (QCOM).

Trader Tip

What happens in stronger trending stocks is price action will reverse near one of these moving averages on an important time bar. When the moving average and time bar cluster together, you have a much stronger combination.

The first real pullback and test of the 50-day moving average ends on a 46-day, low-to-low cycle. From the chapter on rotation, we can now recognize that this might be a good time for entering or adding to positions. The moving average crowd might consider buying at this point without knowing the time dimension. That's fine, but what's wrong with having a check and balance?

As you can see, the next pullback not only violates the 50-day average, but also the 200-day average. If you've been following the lessons here, you now know that a 61-day, low-to-low cycle that puts in a white candle and turns back up is a high-probability pattern recognition scheme, whether we are following moving averages or not. On day 61, the chart closes right on the 200-day moving average. I suggest allowing the two methodologies to work together. Price action does fall below both moving averages temporarily. Here we have the good fortune to look at this chart in hindsight. In real time, you won't be so lucky.

What happens in stronger trending stocks is price action will reverse near one of these moving averages on an important time bar. When the moving average and time bar cluster together, you have a much stronger combination. The challenge is for stocks that are not as powerful. They will tend to violate the moving average yet reverse on the correct time bar. In this case, price action explodes to the upside once again, and the 50-day line is not tested again until we make another 54-day rotation off the 61st bar of the move. We violate the 50-day average again just below price point 22, but we are bailed out by the time cycles right on the 134-day bar off the low.

To make a long story short, this chart ends up going much higher as does the rest of the market. However, nothing lasts forever. The next chart (Figure 6.6) shows what happened later near the end of the move at the top. As you can see, we finally get a bearish

divergence on the daily time frame, but it does not cash in until the final leg hits 33 days. At that point, we get a perfect evening-star pattern and the trend changes. Now let's track the downtrend.

After the gap down, we slip below both the 50- and the 200-day moving averages. What we are looking for is a bounce up to the moving average territory with a potential for failure so we can short the rally.

The question is where and when the price action will top. It could choose to top exactly on the 50- or the 200-day average. The answer is it chooses to top in the general price target, but not until it hits the time cluster of 56 days, high-to-high and 16 days up to the bounce. In addition, it tops exactly at the bottom of the gap down in January, which is acting as very strong resistance. In this case, I would say you have four excellent reasons

Figure 6.6
QCOM Failure At Moving Avg and Cycles

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for a reversal right there: the two moving averages, the resistance line created by the gap down, and finally, the time factor.

TIMING CUP AND HANDLE PATTERNS

I am in agreement with the O'Neil philosophy in that we are both keen fans of excellent pattern recognition systems (O'Neil 1995, 160–179). The cup-and-handle pattern is nothing more than a tight move off a low followed by a benign retracement that can also be characterized as a tight base building period. The best handles are bases that move down slowly on declining volume. As volume dries, which implies an absence of sellers, the chart explodes to the upside. I'm not here to give you an education on cup-and-handle patterns or claim to be the definitive expert on the

Figure 6.7
Hologic complete 2 year progression

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subject. What I am here to do is to show you how to take your cup-and-handle watch list and be ready for the most precise time to enter the trade. As we discussed before in this book, the best time to enter a trade is on conclusion of the B or second wave position because the biggest move is then directly in front of you. The cup generally is wave 1 of the pattern and the handle is the B or second wave. Here we are combining the terminology for Elliotticians, Fibonacci traders, and the part of the trading community that subscribes to the *Investors Business Daily*.

Hologic Inc. (HOLX)

The first case study is of the stock Hologic Inc. (HOLX). We have a complete two-year progression (Figure 6.7), which takes us from a price point

Figure 6.8
Hologic first part of the move

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just under $4 to over $19 per share. The next two charts (Figures 6.8, 6.9) illustrate the cycle patterns from the inception. What you can glean from Figure 6.7 is a fairly tight move from 4 to 12 and a pullback back down to the 9 area on declining volume. This would be the cup and handle part of the pattern. In Elliott terms, this can also be considered waves 1–2. As you can see, the most exciting part of the move kicks in after the handle correction.

Figure 6.8 highlights the first part of the move off the bottom. Clearly illustrated is the first pullback, which completes on the 17th day, and as we hit Lucas 18, the chart never looks back. After another small base building period, which can also be interpreted as a smaller degree cup and handle, the chart takes off in earnest on the 47-day cycle as we've been discussing throughout this book in all degrees of trend. Between day 17 and day 47, we build a base on top of a base on relative light volume. This implies a base-building period right in the middle of filling the gap down at the beginning of February, which turns out to be the exhaustion gap. Notice how on day 48 we fill that gap and take off. *Investors Business Daily* people, note the big white candle. The next two pivots are on day 83 and day 112, which are approximately in a rotation of a 35-day, low-to-low cycle (off day 47) and followed by a 29-day (112–83), low-to-low cycle. This progression also tops in 129 days.

Figure 6.9 shows the larger handle area. The condition that stands out the most is the decline in average volume from April all the way to September. In Elliott terms, we have a typical ABC pullback that ends in a virtual double bottom. In wave terms, the leg that drops until the end of September is exactly .618 of the first A wave drop. In bull markets, the C wave in corrections typically completes in the shortest period of time. A bear phase does the opposite since the C wave would take the most time and would take up the most territory. This could even be considered a running correction because the second spike down at the end of September actually misses taking out the August low by 1 cent. In other words, this can be considered the best bullish setup you can get.

The idea of this chapter is to determine the most precise entry to a 5-month period of declining volume. The handle finally completes 61 days off the high and turns up on a good size white candle with a slight pickup in volume. As you can see, average daily volume increases until such time

as we get the gap in the heart of the parabolic move north. In review, we have a pullback on declining volume with a tight base where, in Elliott terms, C terminates at the earliest possible point at the .61 percent price relationship to the A wave. All we need is the time factor to tell us when to buy.

IBD Case Studies: Keithley Instruments and Skechers

The next two stocks were regular features of *Investors Business Daily* in the early part of the decade. Each stock exhibits many if not all of the technical characteristics necessary for greatness. The moves are not as spectacular as many tech stocks of the NASDAQ bubble, but are more representative of a normal bull market.

Figure 6.9
Hologic, larger handle area

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The first case study is the 1999–2000 moves by Keithley Instruments. Here is a company that went from penny status to over 100, and that included a 2-for-1 stock split along the way. I suppose many came to expect this type of performance based on the bubble years where a super bull market was mistaken for brains. However, one can do the right thing and get lucky every now and then. What is interesting about this stock is that the parabolic part of the move came after the markets made their historic peaks in January and March of 2000. Leaving many of the top NASDAQ names out of the discussion, Keithley has to be considered one of the best stocks ever featured in IBD.

When you look at the whole advance, what is lost in the discussion is the period right at the start where you can't really make out what is going on (Figure 6.10). Furthermore, when we zoom into the early phase of the action, we can see the distinct time cycles taking shape.

We pick up the action in July 2000 (Figure 6.11) after a long base-building process. Even on what is still considered a penny stock, the move-

Figure 6.10
Keithley Instruments, whole advance

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ments are not random. What likely differentiates the time cycles from Elliott waves is that in lighter volume environments, it is very difficult to count good waves. As we can see here, we are still in a lighter volume environment, but the real move finally starts up as we complete the first Lucas 76 days off the April 1999 secondary low.

Elliotticians would call the move off the bottom a series of small-degree first and second waves. Volume enthusiasts would refer to this period as a series of small bases built on top of each other. What everyone must agree on is that each base is characterized by declining volume. I'll add to the mix that each base completes on some time cycle sequence. The first base, which leads up to the large white candles, completes in 18 days. The next base completes on the 126th day of the move off the April 1999 secondary low. The 127-day window is characterized by a sharp spike up in volume. The third base finds its low during the week of 10/18 on that large black candle on the 17th day off the last pivot low. It is a congestion period, and

Figure 6.11
Keithley Instruments, Close-up

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it isn't exactly clear what pushes the chart higher, but we do have a 3-day window from day 144 to day 147, where the chart finally achieves liftoff. Whatever the case, we never do come back down to touch the support area created on the 126- to 127-day windows.

If you look at the first chart of the entire move (Figure 6.10), you'll see three major pivots. The first one came in at 76 days; the next, at 126; and finally the last one, at 180 days. The 180th day can be interpreted as Lucas 18 times 10, but more important would be the difference between the 126th and 180th day, which implies a 54-day, low-to-low cycle. On the 55th day of the rotation off the 127-day cycle, Keithley starts a run that triples in value over the next 61 trading days. It pulls back for another 25 days, and on the 26th day goes parabolic until the 319th day of the move, which makes the parabolic wave exactly 54 days.

The final case study of this chapter first appeared in IBD, January 2001. Skechers came to prominence during the spring rally of 2001 when other

Figure 6.12
Skechers, whole progression on the daily

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shoe companies were doing the same thing. I'm not big on fundamentals, but they did have a unique product that made sneakers and workout gear fashionable. I think that was the factor that caught the attention of investors. In any event, this was a case of another penny stock rising nearly 1300 percent!

The first two charts (Figures 6.12, 6.13) show the entire progression on a daily and weekly basis. The second, Figure 6.13, is the weekly chart with daily annotation superimposed. You can see how these two time frames cluster to create the various buy signals along the way.

Figures 6.12 and 6.13 exhibit bullish rotation as we hit important pivots on days 35, 62, and 96 (a 34-day, low-to-low cycle). The final pivot is on the 118th day, which is a common relationship. The 96th day corresponds to the 21-week, low-to-low cycle. This stock appeared in IBD, January 2001, just as it completed an 11-week pullback that clustered with the 46- to 47-week, low-to-low cycle.

Figure 6.13
Skechers, whole progression on the weekly

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The first half of the move (Figure 6.14) is when this stock was first featured to the public. On this chart, the 50-day moving average is incorporated to give you an idea of how to compare and contrast where the time bars turn in relation to the moving average. Different moving averages will net varying results. We had a 164-day leg where we were 46 days off the 118-day bar when a multi-month bearish divergence finally cashed in. The pullback is not a classic volume drying up sequence, but average volume did lighten until the stock found a bottom after a pullback of 56 days, which clustered with the 2 weekly time cycles (11/46). We have three really good clusters, and this caused the stock to go parabolic in the next few weeks. You can see from the weekly chart that volume went from under 1 million to over 3 million a week.

As we progressed off that low, we formed yet one more base that completed on the 29th day off the pivot (Figure 6.15), and the rest is history. The only thing I can add is that the final high is created when we get the

Figure 6.14
Skechers, with 50 dma

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last bearish divergence, and it cashes in as the chart tops on the 39th day of the big wave or 338th day overall.

As we wind down this chapter, I want to make it obvious how anyone can use this methodology. It is not limited to those who understand Elliott waves. As a matter of fact, in the trading community, those who don't understand the waves outnumber those who do.

A large segment of the trading community uses the 50- and 200-period moving average. Another segment uses the 20 and 50. It is probably better to use the 20 if your time frame is smaller. But, the challenge is still the same. When you use moving averages, they are not always going to be lines in the sand. Only the strongest moves will validate them to the point where whipsaws are minimized. Moving averages do work best when they line up near a common Fibonacci retracement point. The problem is that many traders who use Fibonacci retracements pay no attention to moving averages. Conversely, many traders who use moving averages pay

Figure 6.15
Skechers 50dma II

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little or no attention to common Fibonacci retracement points. I advocate that those of you who use moving averages and are being introduced to this methodology for the first time become aware of these tendencies. Sometimes the time bar will line up with the moving average, sometimes it won't.

The best setups happen when you get the time bar right on the moving average with a good candle reversal bar. This doesn't always happen. If we are pulling back into the moving average and fall short (or spiking in a bear phase) but we get the time bar, that's where the turn is going to be. If we are overshooting the moving average and reverse on the time bar, that's where the turn is going to be. Now you have another tool in your arsenal other than waiting for the moving average. Being aware of these tendencies will permit you to get into moves you may otherwise overlook.

These case studies represent how you can add greater precision to moving average crossovers, moving average support/resistance, volume studies, and time-tested patterns such as the cup and handle.

In prior chapters, we applied candlesticks, support/resistance, and momentum indicators with their divergences. The principles that we apply to intraday charts on the indices are exactly the same as those applied to patterns on stocks. As a matter of fact, we don't even need these stocks to be the heavily traded big caps because most great stocks that become leaders start out small.

The only thing I'm not covering in this chapter is stock selection. If you use IBD methodology, you will find ratings systems for relative strength and the accumulation or distribution by the big money mutual fund players. The idea behind stock selection is generally a game of sector rotation. You want to find a sector that is emerging and pick the strongest stocks of the group. Mind you, I'm not talking about the fundamental picture. I suggest riding the coattails of the better stocks the big money players believe are the best stocks. What you will find is that, fundamentally, these stocks will be one and the same. You have enough work keeping track of the technical picture with your new skill without worrying about the profit and loss statements of companies.

Trader Tip

The best setups happen when you get the time bar right on the moving average with a good candle reversal bar.

We have completed most of our study of how the time factor can be combined with contemporary technical analysis. The next factor on which we are going to focus is more future-driven. Now that we have the non Fibonacci/Elliott people on board, I'm going to show you how to project high probability price targets either for the end of bull moves or where a correction is likely to complete.

To read more of Jeff Greenblatt's ground-breaking new book, click here and RESERVE YOUR COPY TODAY! ***Breakthrough Strategies For Predicting Any Market*** **releases on July 2, 2007.**

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