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Go With The Flow! Find Reversals by Combining Momentum Bars with Pitchforks

Timothy Morge

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Market Maps

High Probability Trading Techniques

By Timothy Morge, Managing Director
Proprietary Trading at Spike Trading Services

Hosted by the  **Chicago Board of Trade**

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Median Lines or Pitchforks: How and Why They Work

I have been working with Median Lines and their associated lines for over thirty years now. They were originally developed by Dr. Alan Andrews as a way to easily identify where price was going and how fast it would get there. Dr. Andrews was a Thermodynamics Professor at MIT, so I've found over the years that it's easiest to think about this methodology and teach it in terms of the energy that price carries as it moves forward in time.

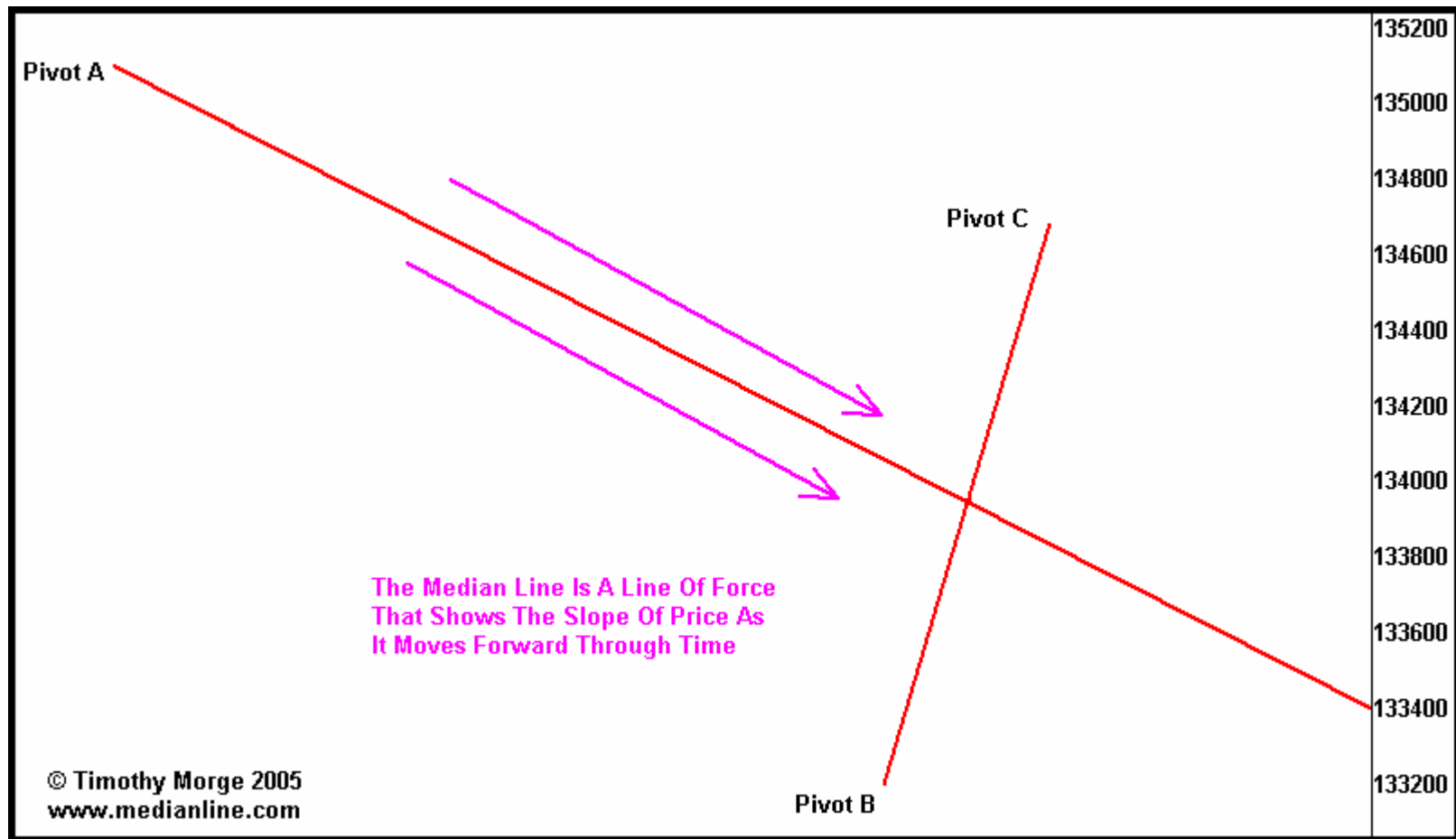
I've also spent a great deal of time, energy and money taking these techniques that were built and tested nearly 100 years ago and bringing them into the computerized era. Real-time trading hasn't invalidated these techniques—instead, it's re-energized them! By doing careful and thorough statistics on tens of thousands of actual trades, I've identified what parts of the original materials work. And I've found many new and exciting ways to use these tools now that day trading has become “the norm.”

I will begin the seminar by introducing the three parts of the Median Line and then I'll explain the role each of these three parts play when using a Pitchfork in your trading. And finally, I'll show you some of the innovations I've added to Dr. Andrews original methods, now that computers allow us to do extensive statistical analysis and rigorous real-time modeling and testing.

The three components of a Pitchfork are:

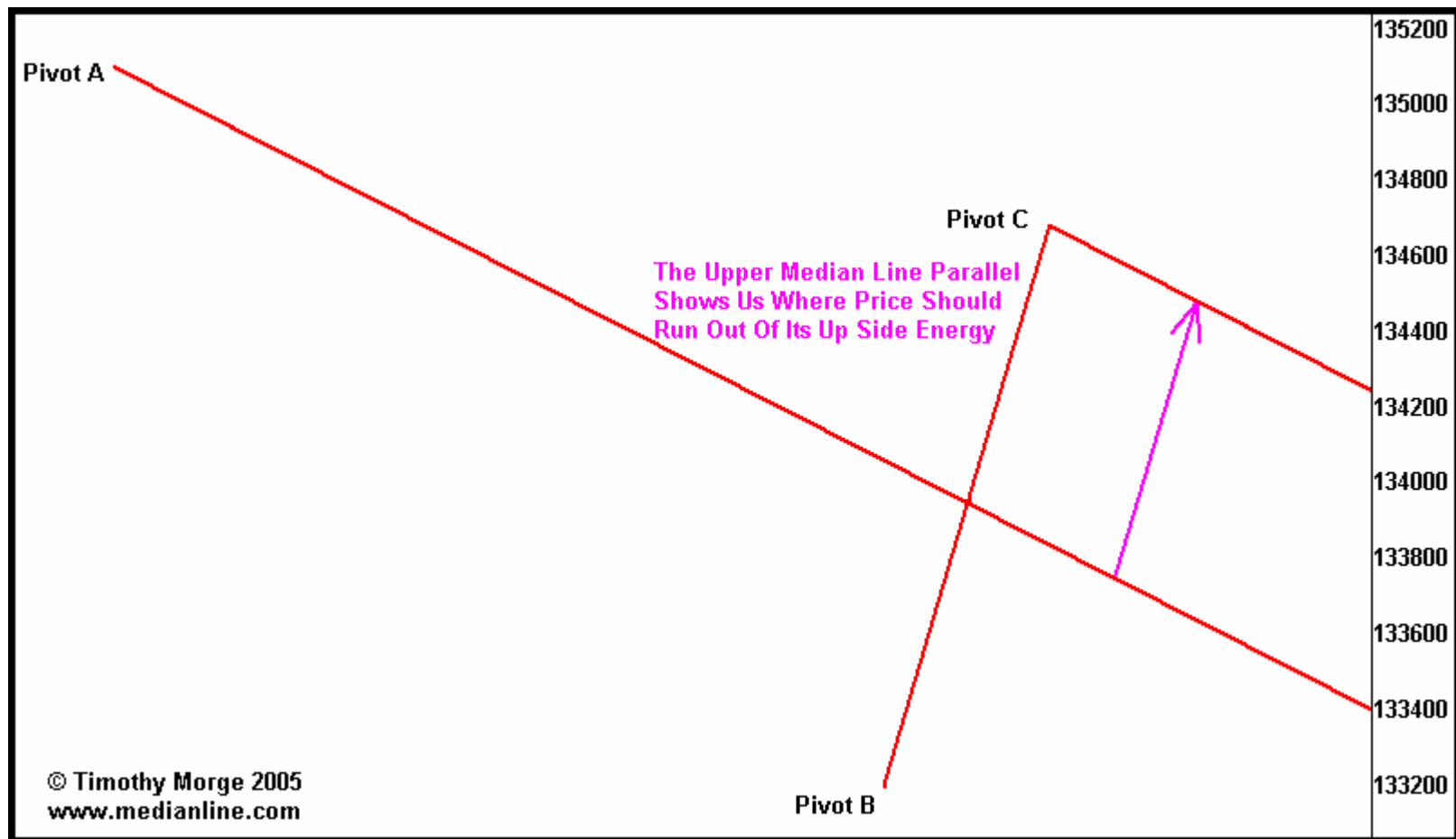
- 1. The Median Line**
- 2. The Upper Median Line Parallel**
- 3. The Lower Median Line Parallel**

Now lets take a look at each of these three components:

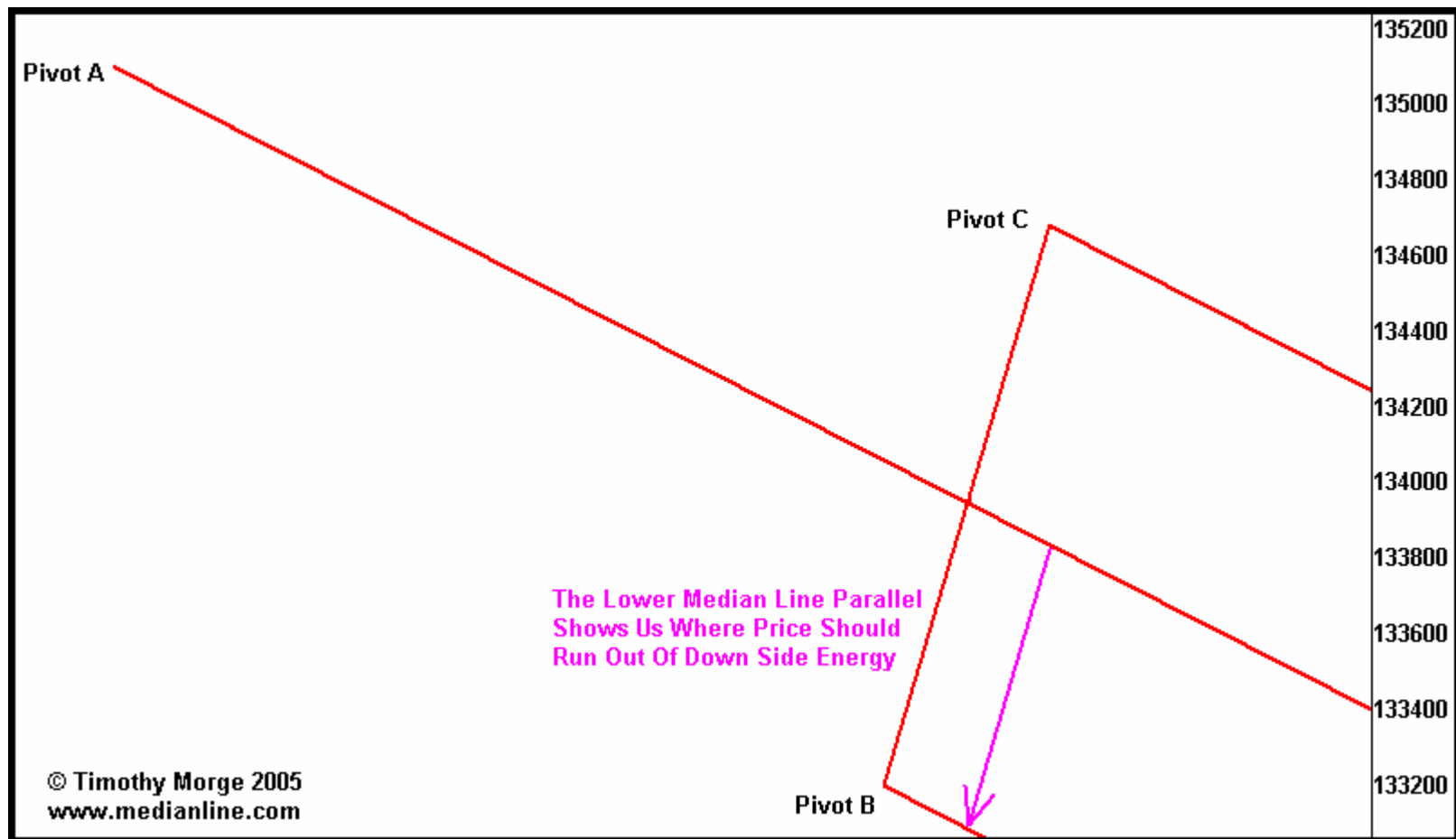


This is the Median Line. It is drawn from a set of three alternating pivots. The Median Line visually tells us two things:

- 1) It projects the slope of price as it moves forward in time. The slope of the Median Line tells us visually if price is in an up trend, in a down trend or in a range.
- 2) The steepness of the slope tells us just how fast Price is likely to move up in an up trend or down in a down trend.



This is the Upper Median Line Parallel and it marks the area where Price is most likely to run out of energy to the up side. This frequency, or measure of potential energy, is generated by the relationship between Pivots B and C as they relate to Pivot A. In later slides, you'll see how we use these lines and their ability to show us where price is likely to have expended its stored energy when trading.



This is the Lower Median Line Parallel and it marks the area where Price is most likely to run out of energy to the down side. This frequency, or measure of potential energy, is generated by the relationship between Pivots B and C as they relate to Pivot A. Again, in later slides, you'll see how we use these lines and their ability to show us where price is likely to have expended its stored energy when trading.

Now that I've explained what each part of the Median Line set does, it's important that you understand a few of the principles behind this very powerful tool. I'm going to show you some visual examples, along with some quotes directly from Dr. Andrews' original "Action Reaction Course," that he taught for many years at his homes on the East Coast as well as at his South Florida residence.

This is the single most important statement made in Dr. Andrews' original course:

Median lines and Median Line Parallels: the Median Lines enable the user to be one of the few who can tell where the prices are headed, and the place they will reach about 80% of the time, and when approximately that place will be reached.

After personally drawing and studying hundreds of thousands of charts in my thirty years of trading, I can tell you that I have done in-depth statistical validation of the above statement and indeed, price DOES reach the Median Line or its Upper or Lower Median Line Parallel [whichever line price is heading to next] about 80 percent of the time. This, in and of itself, is an incredibly powerful thing to know!

Now let's look at some examples of how price reacts around the Median Line and its Parallel Lines:



1. There is a high probability that: Prices will reach the latest Median Line.



2. There is a high probability that: Prices will either reverse on meeting the Median Line or gap through it.



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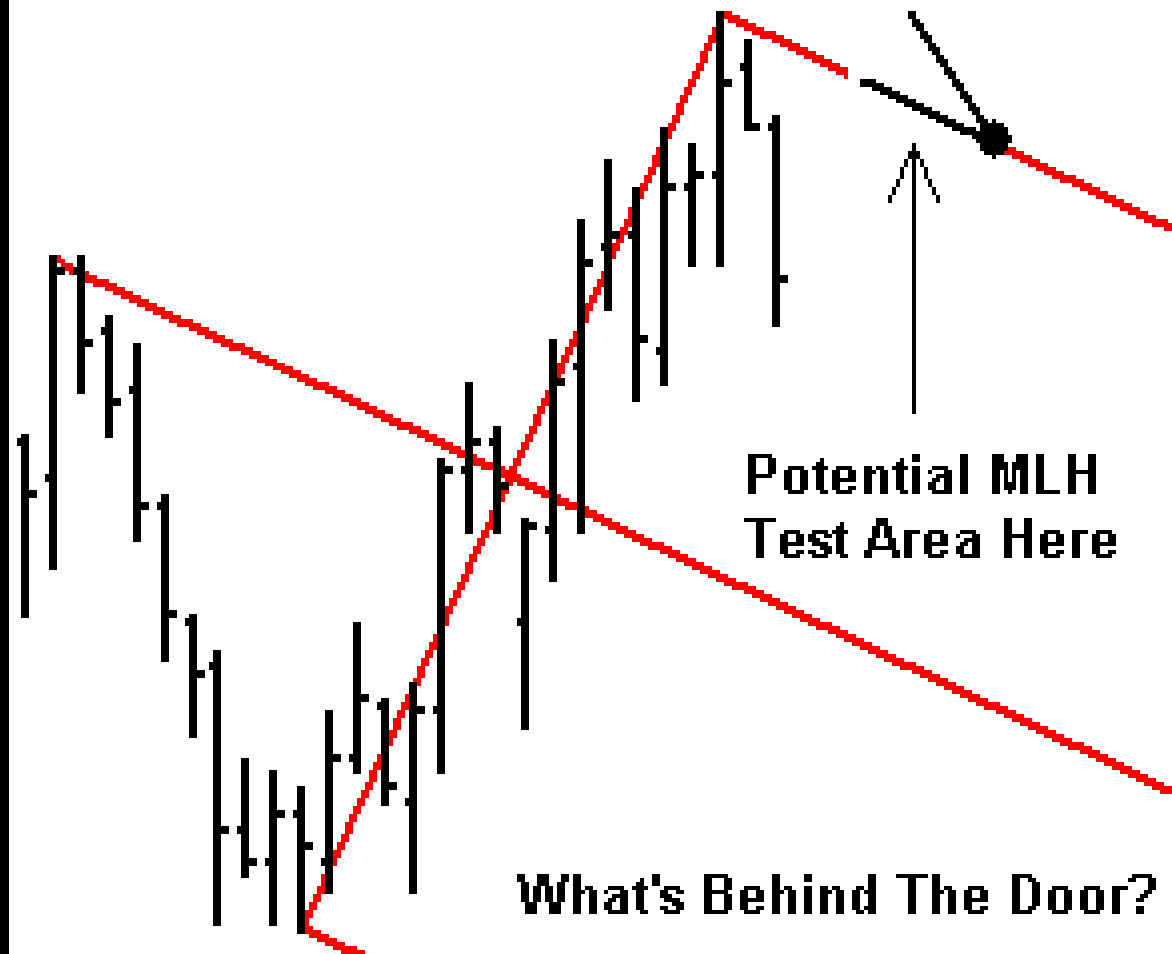
3. There is a high probability that: When prices pass through the Median Line, they will pull back to it.

Separation: What Is It and Why Should You Care?

In the course of teaching seminars to hundreds of professionals at both the Chicago Board of Trade and the Chicago Mercantile Exchange, I began to notice that something I took for granted—Separation—Or how a bar tested and then closed when it approached a Median Line or one its Parallels was an extremely important ingredient when looking for repeatable trade set ups. I was already using this concept in my own trading but it was something I had internalized and I apparently took it for granted that all traders saw what I saw when bars tested important lines. But this was not the case!

This revelation began a great deal of research, some of which I will share with you today and all of which has gone into the new version of AutoForks2 software. In the process of this research, several other issues were dragged in by one of my partners, Stuart Miller and a very special group of traders that are lucky enough to be part of Bill Shepard's operation at the CME. One technique that we have found invaluable came about because Stuart was trying to investigate the relationship with increases in volume at turning points in the market—and although his first attempt did not yield an indicator that was particularly insightful, when the traders at the Shepard Group one day described an idea they had for a new kind of bar that would help them spot “quality separation,” the light bulb went on, as they say. I called Stuart and our programmer, Steve Buss and described what I wanted to investigate building and Steve's immediate response was: “That's Stuart's volume indicator! All I have to do is make it color the bars in real-time and then we can do research into what makes a bar representative of “good buyers or sellers.” And very quickly, our Aggressive Volume Bars were born! Let me start out by showing you what I mean by quality separation:

**Imagine The MLH Test
Area As A Closed Door...**



Imagine The MLH
As A Trend Line

Stop Loss Buyers?

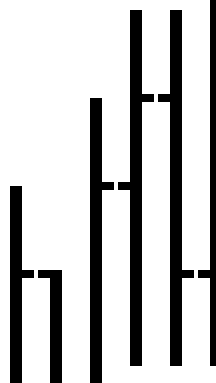
- OR -

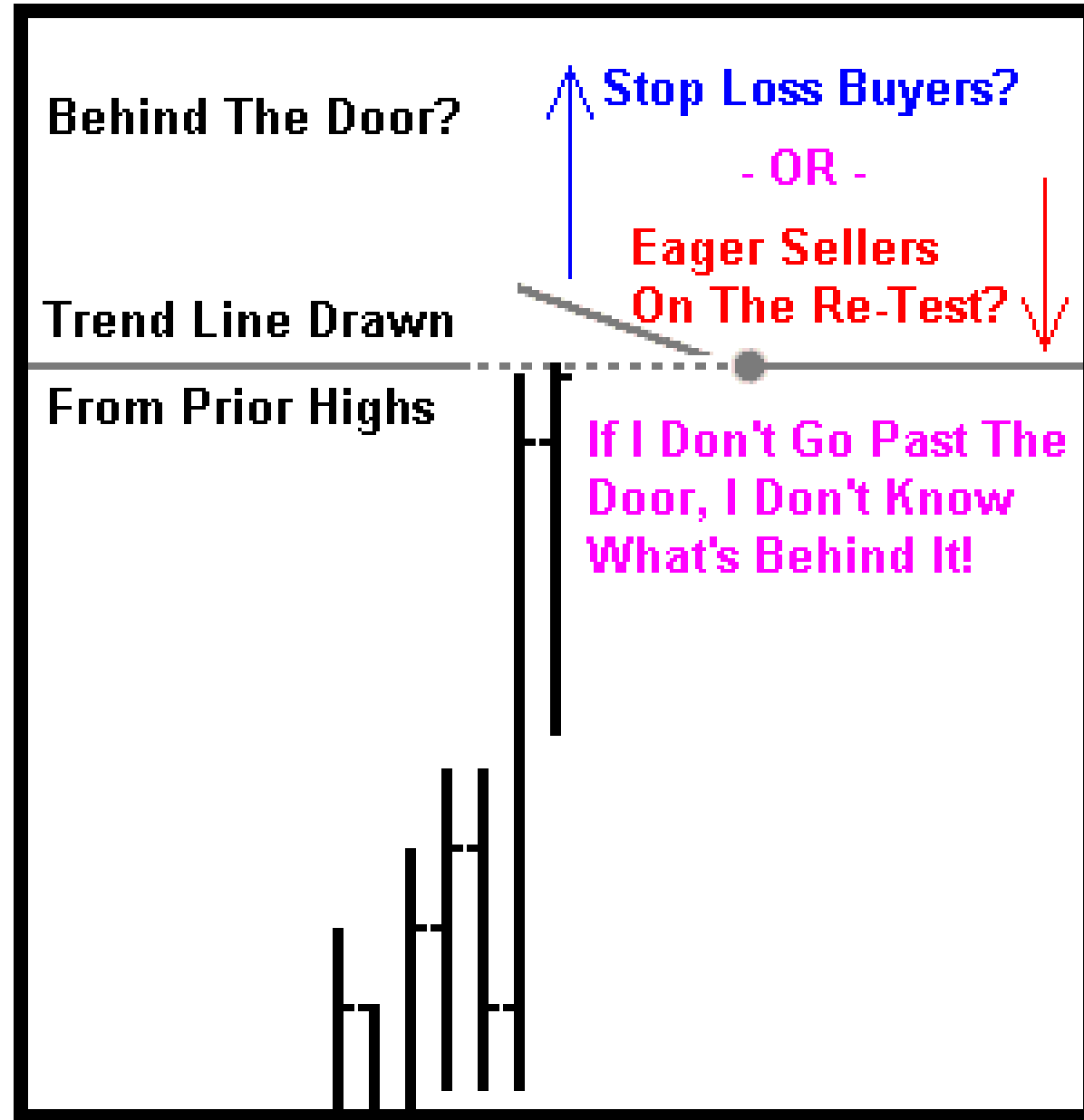
Eager Sellers
On The Re-Test?

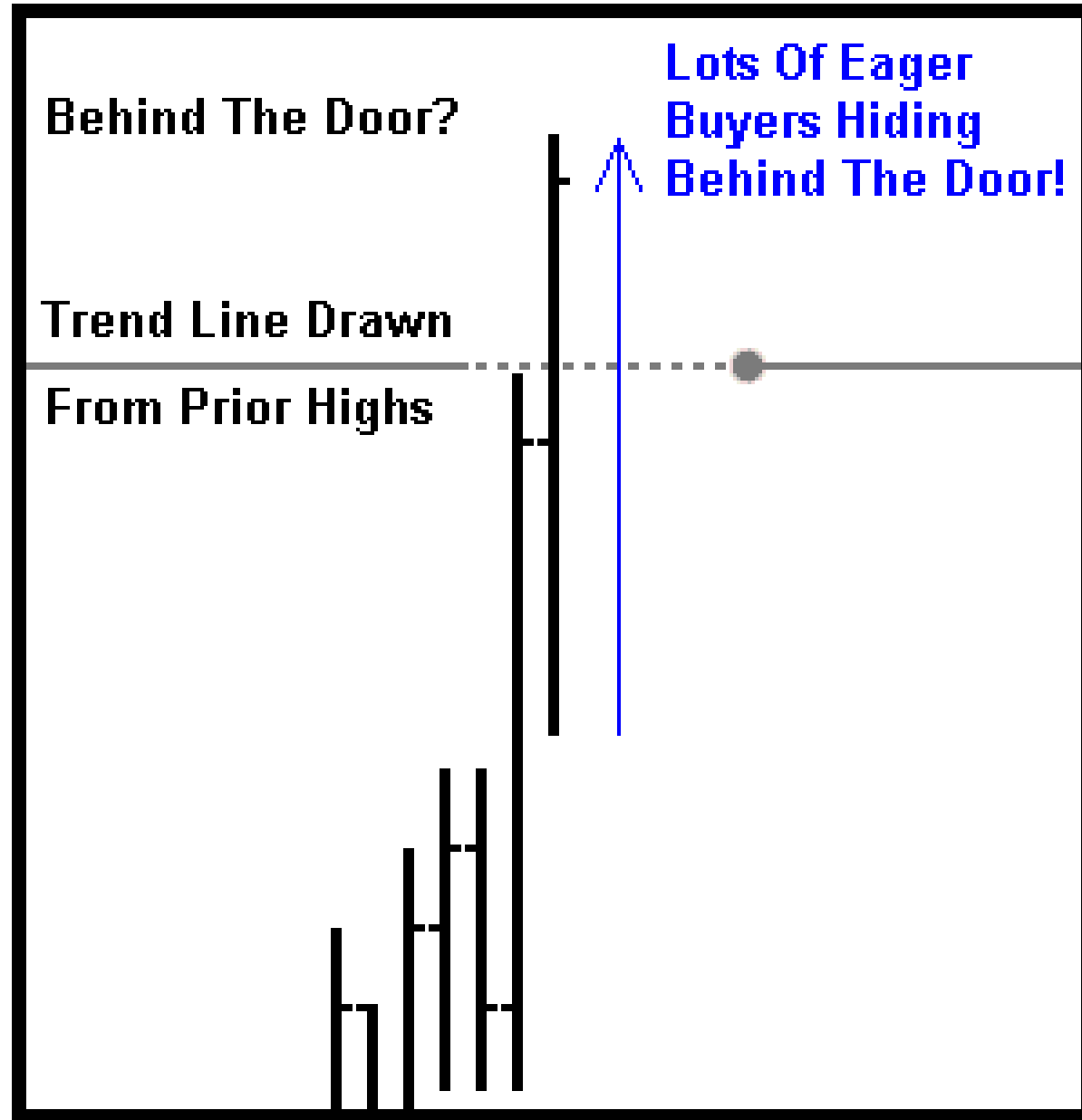
Trend Line Drawn

From Prior Highs

Buyers Or Sellers
Past The Doorway?



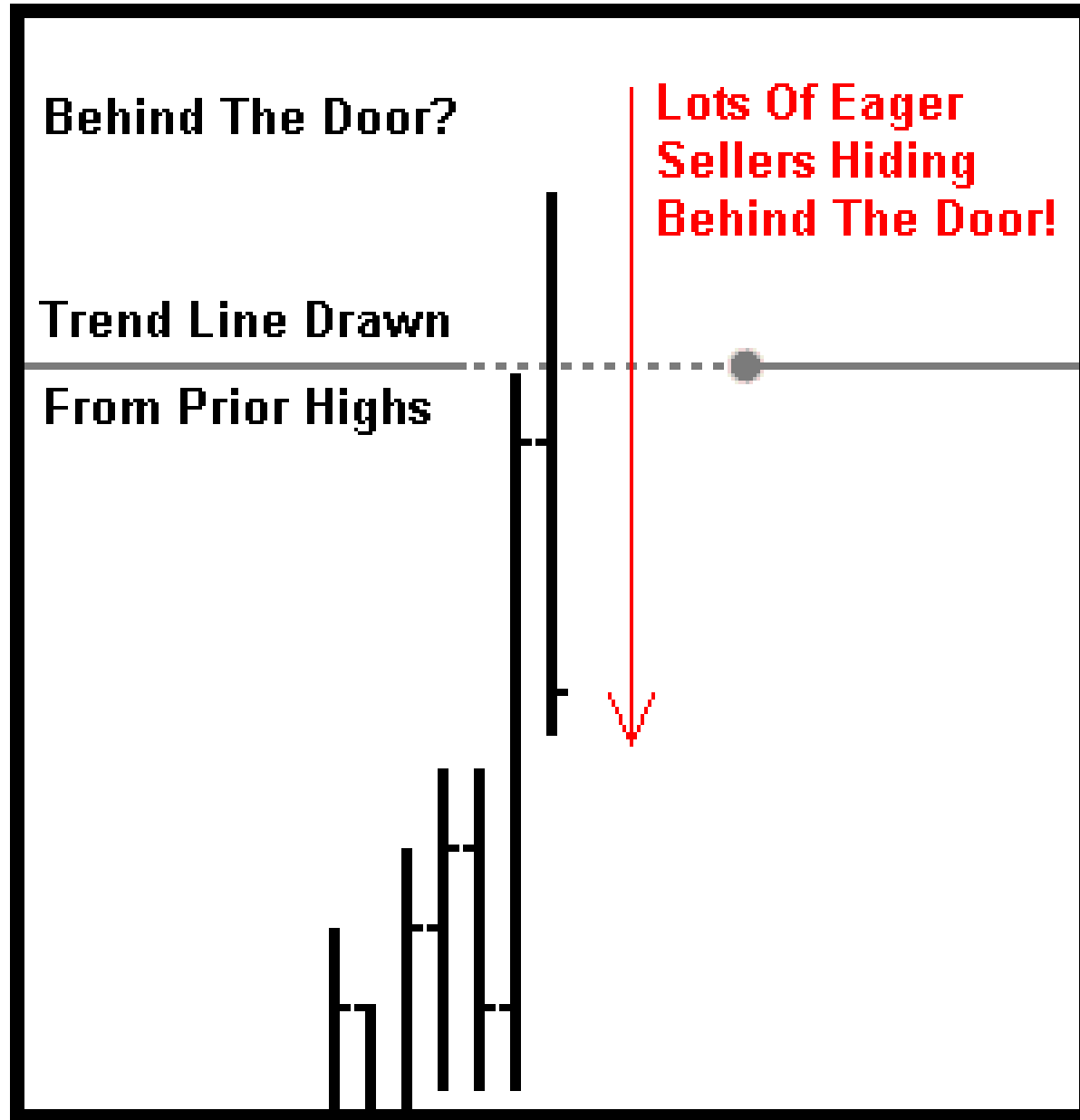




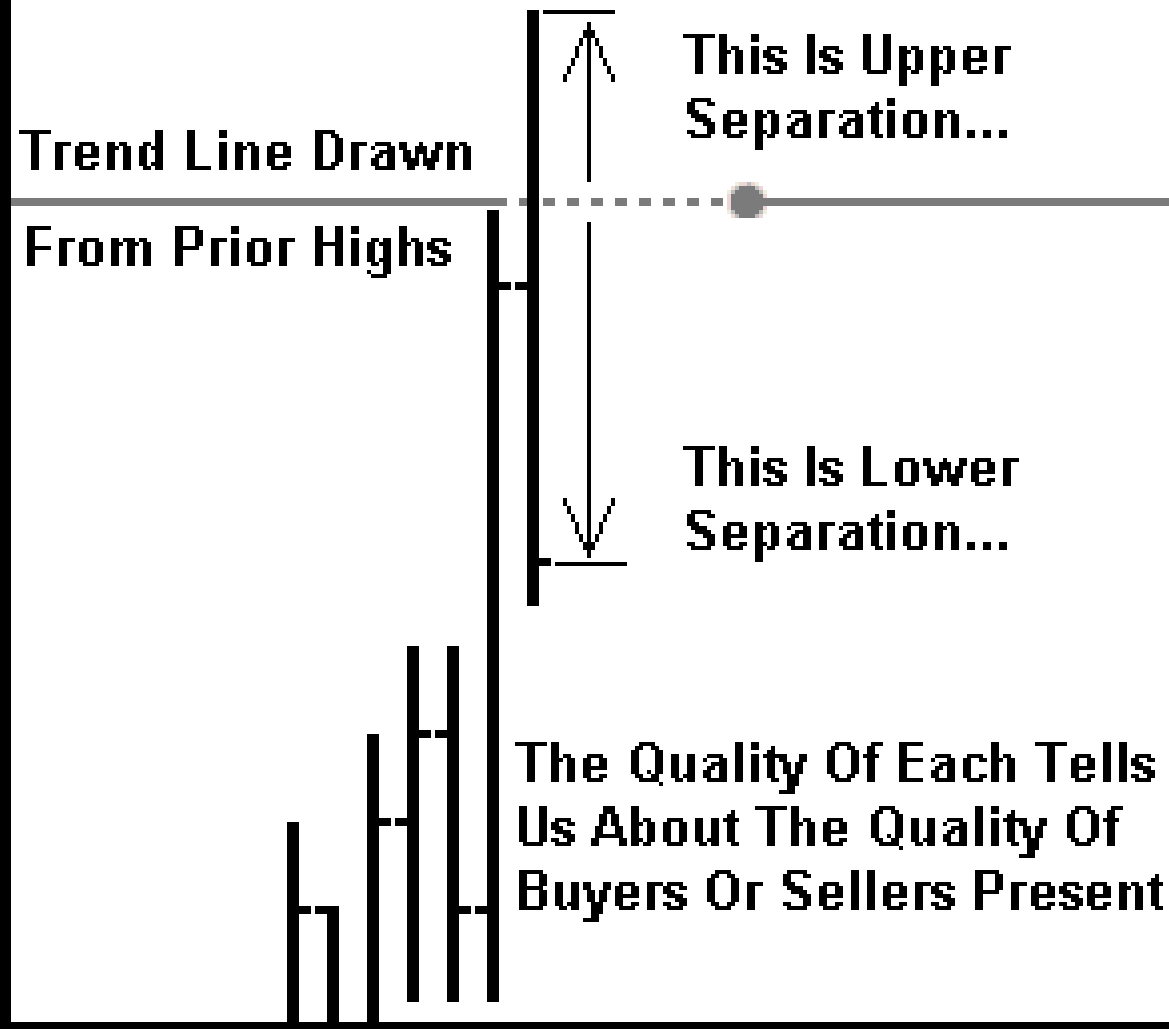
Behind The Door?

**Lots Of Eager
Sellers Hiding
Behind The Door!**

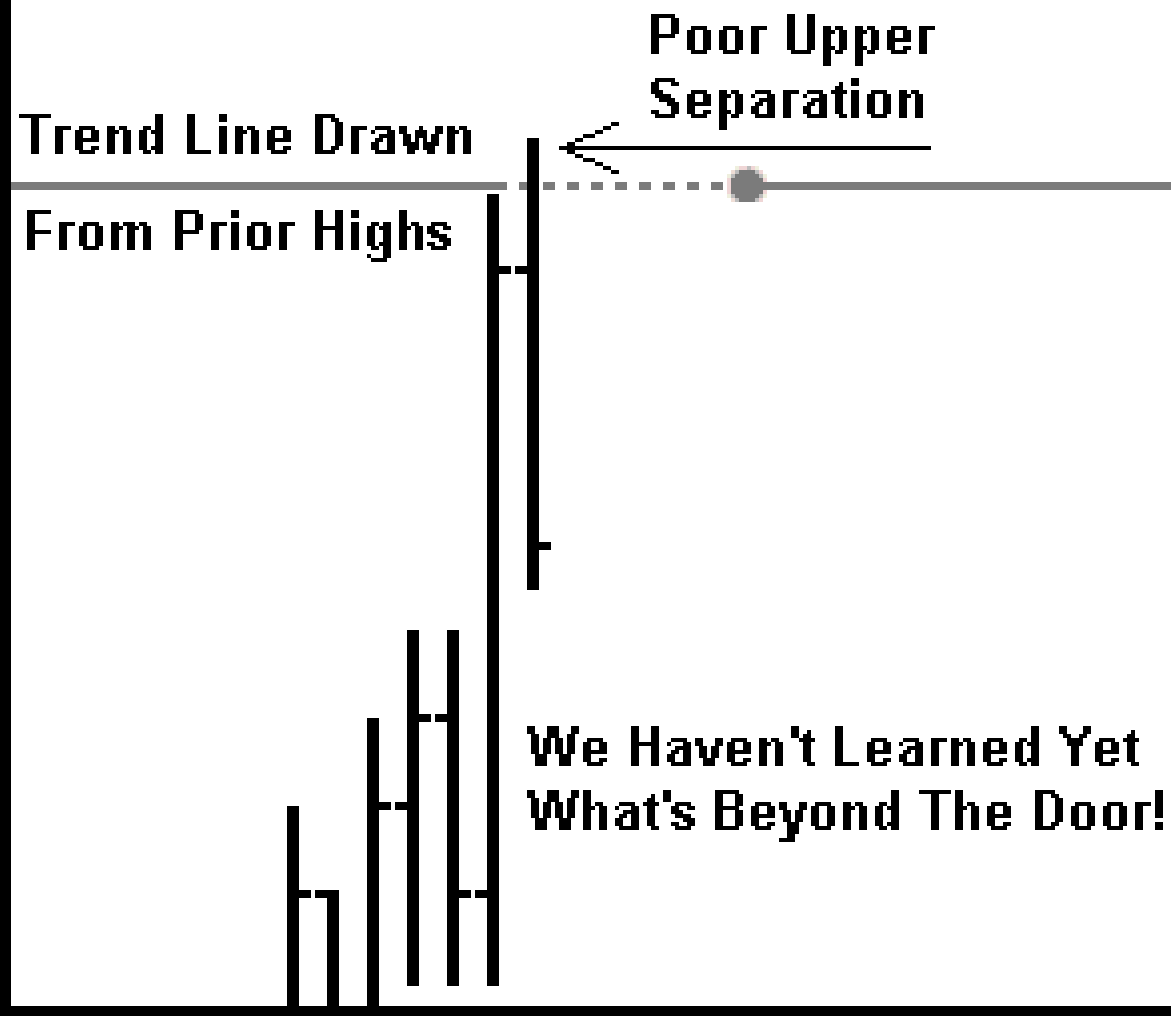
**Trend Line Drawn
From Prior Highs**



**Price Was Rejected
Above The Trend Line**



**Price Was Rejected
Above The Trend Line**



Price Was Rejected Above The Trend Line

**Trend Line Drawn
From Prior Highs**

Poor Lower Separation

Price Failed Above The Door But We Don't know Much About The Sellers

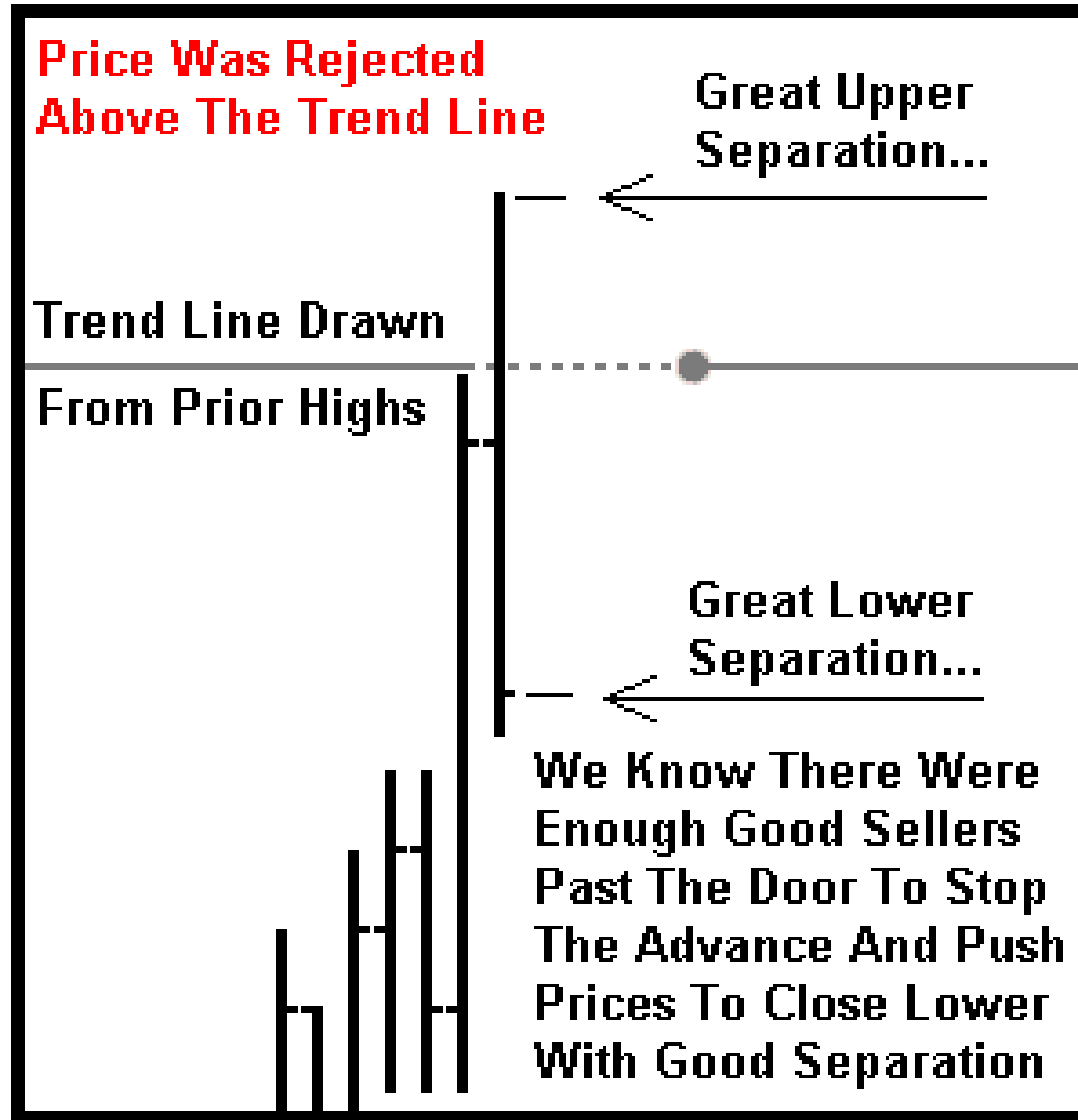
**Price Was Rejected
Above The Trend Line**

**Great Upper
Separation...**

**Trend Line Drawn
From Prior Highs**

**Great Lower
Separation...**

**We Know There Were
Enough Good Sellers
Past The Door To Stop
The Advance And Push
Prices To Close Lower
With Good Separation**

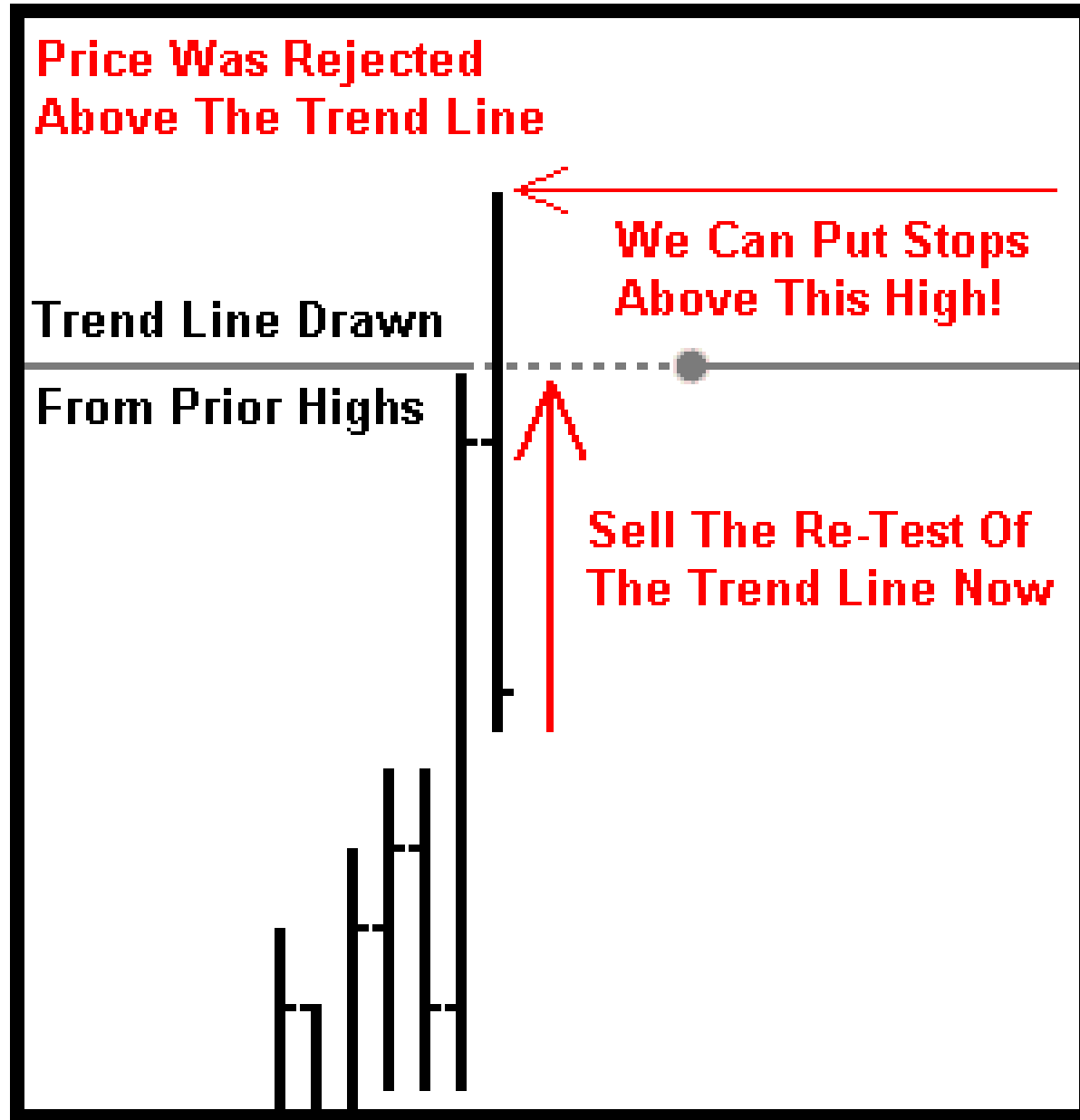


**Price Was Rejected
Above The Trend Line**

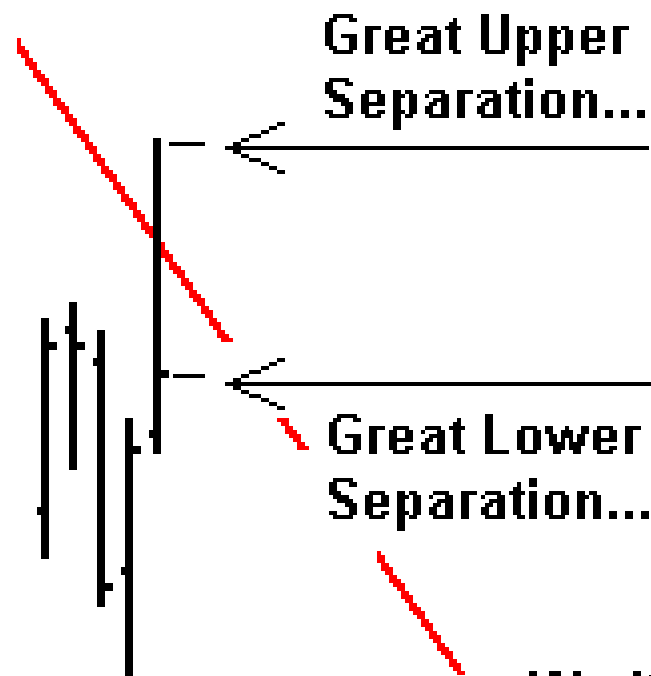
**Trend Line Drawn
From Prior Highs**

**We Can Put Stops
Above This High!**

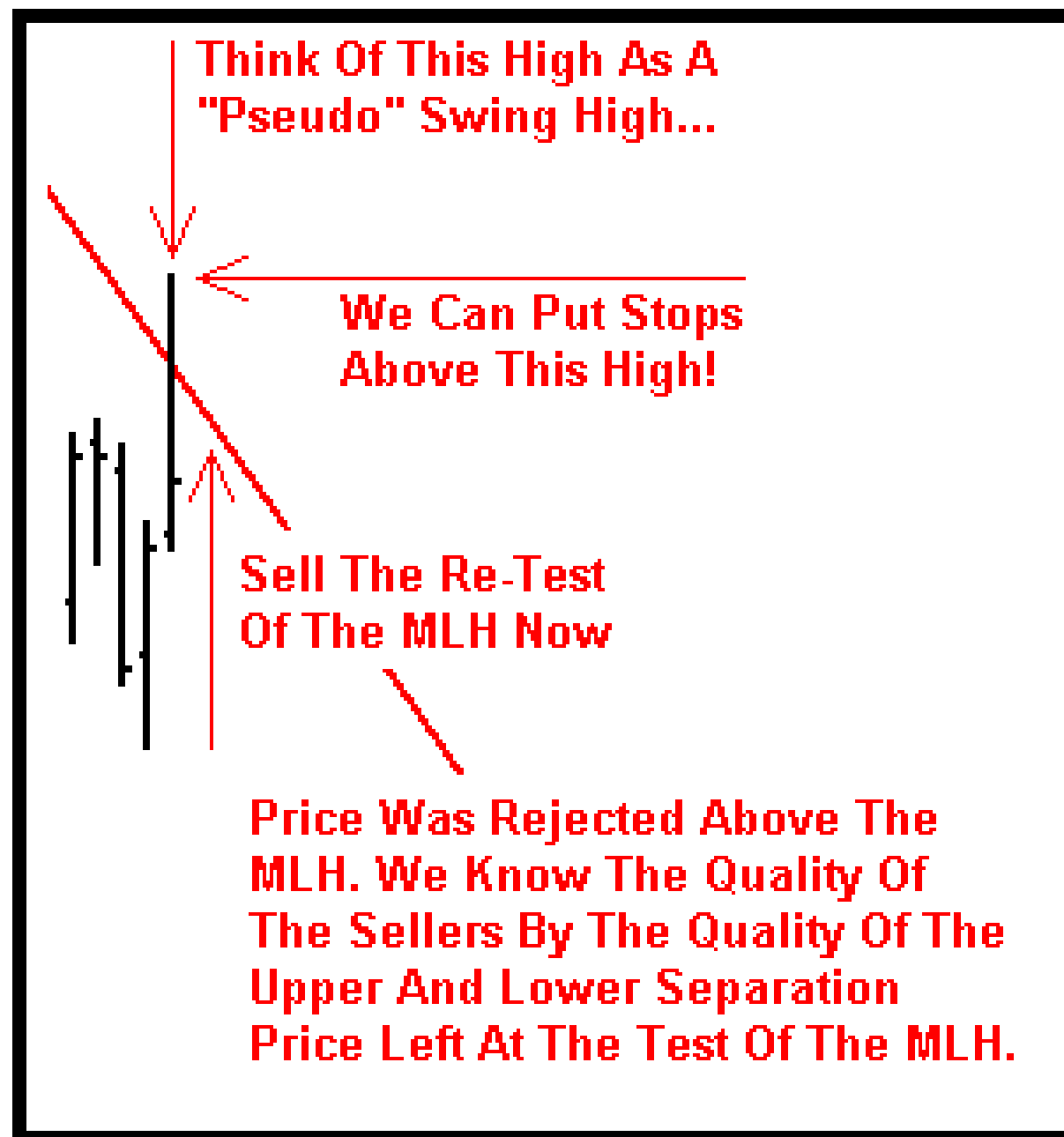
**Sell The Re-Test Of
The Trend Line Now**



**Now Let's Make The Simple
Trend Line An MLH Again...**



**We Know There Were
Enough Good Sellers
Past The Door To Stop
The Advance And Push
Prices To Close Lower
With Good Separation**



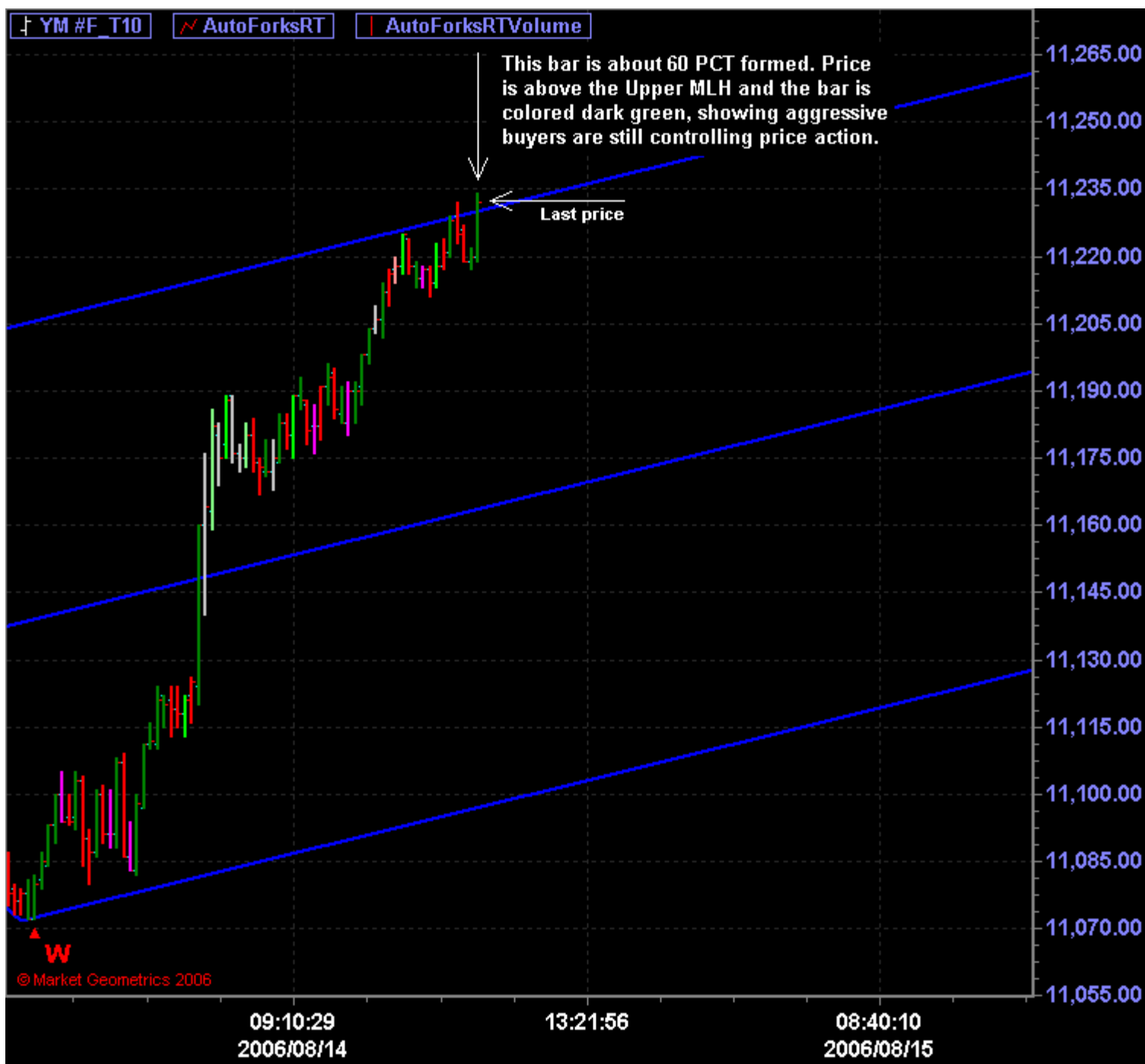
Now that you know what quality separation looks like, I bet you're wondering what all this has to do with momentum? Well, when we see a price bar go to and even past a potential area of resistance and then pull back, failing to hold above it, that is generally a sign of momentum slowing down or even changing. And though I have little trouble visually seeing these changes in momentum in simple price action charts, I've found that most traders have trouble seeing these changes in momentum in real time—Unless they are given a visual aid.

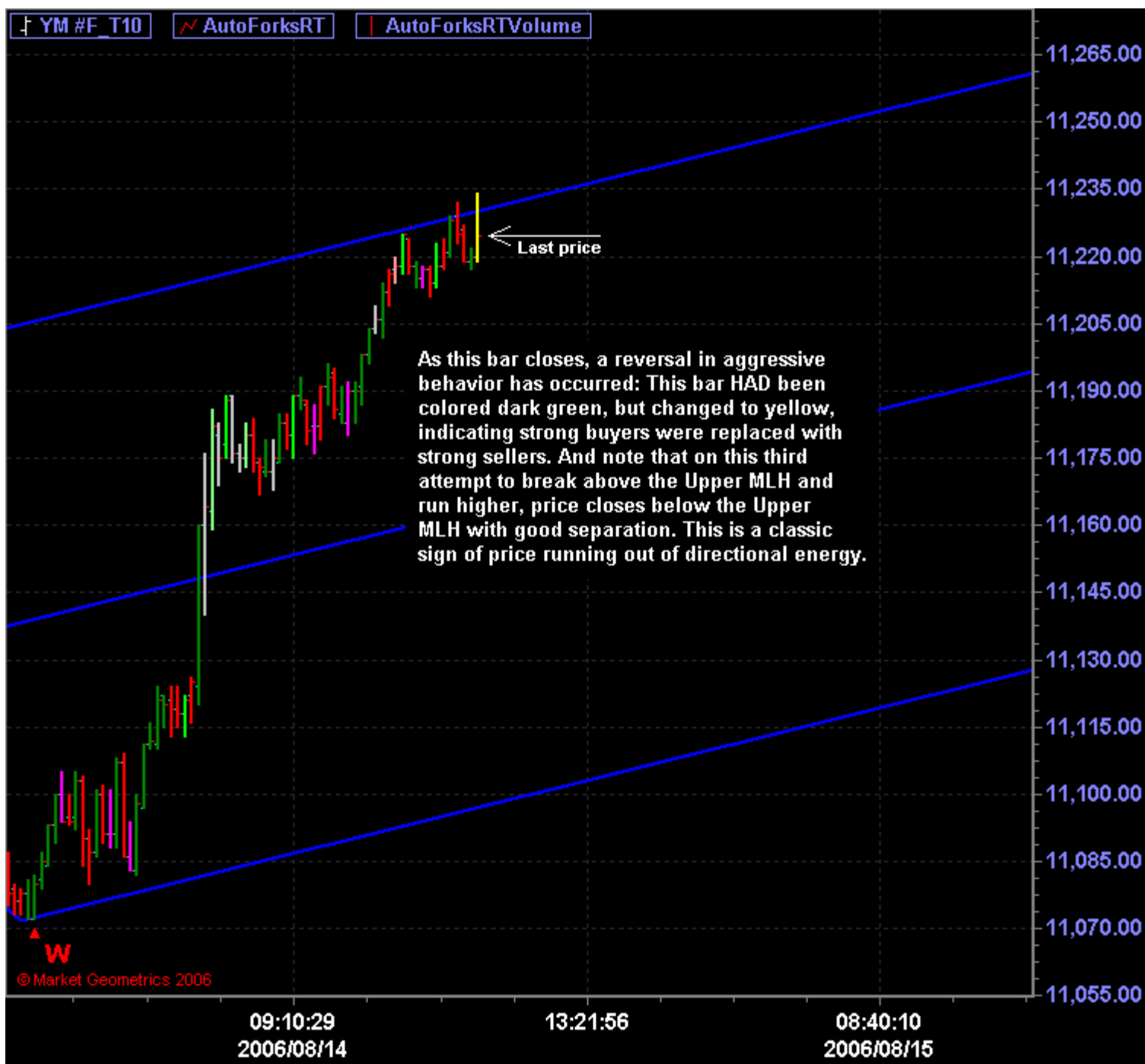
Before I go any further, I want to credit Danton Long with the body of work he has produced regarding momentum and potential change in trend areas. To the best of my knowledge, he was the first to represent data in “momentum” bars that you'll see in my second example. Momentum bars are similar to range bars, but I find the subtle difference can be telling when combined with the Aggressive Volume Bars in AutoForks2.

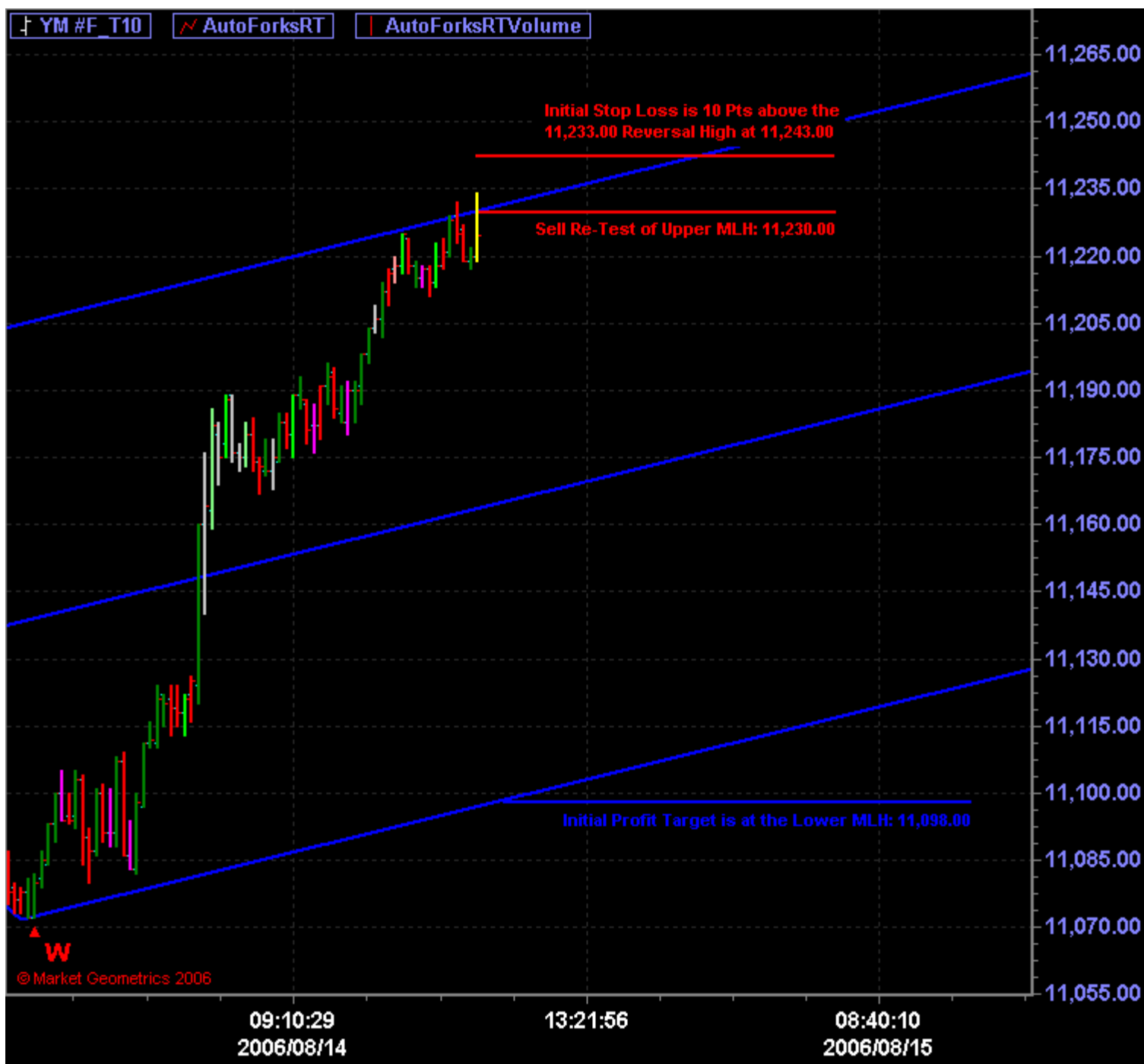
Here's how the Aggressive Volume Bars work: The AutoForks2 software measures how many buyers buy at the offer and how many sellers sell at the bid—since they are the aggressive traders in the bunch—and as the bar is built in real-time, it will change in color as that mix changes. And the real importance of the coloring can be seen, for example, when a string of dark green colored bars in an up trend reach an area of resistance. Generally the bar testing the resistance will also begin as a green bar and as it tests and perhaps breaks through the area of resistance, it may stay green, because stop loss buyers are also brought into the mix—and by definition, they are aggressive buyers. But once these last aggressive buyers are “through the door,” the buying sometimes dries up and if you are watching a string of green colored up bars and the bar currently testing the area of resistance is now turning from green to yellow, watch out! The software has just told you that the number of aggressive buyers is now being swamped by aggressive sellers! As I just showed you, this is a classic top forming, where the buyers walked through the door and triggered all the stops but then found so many sellers they were then chased back through the doorway and down the hall, running for their life!

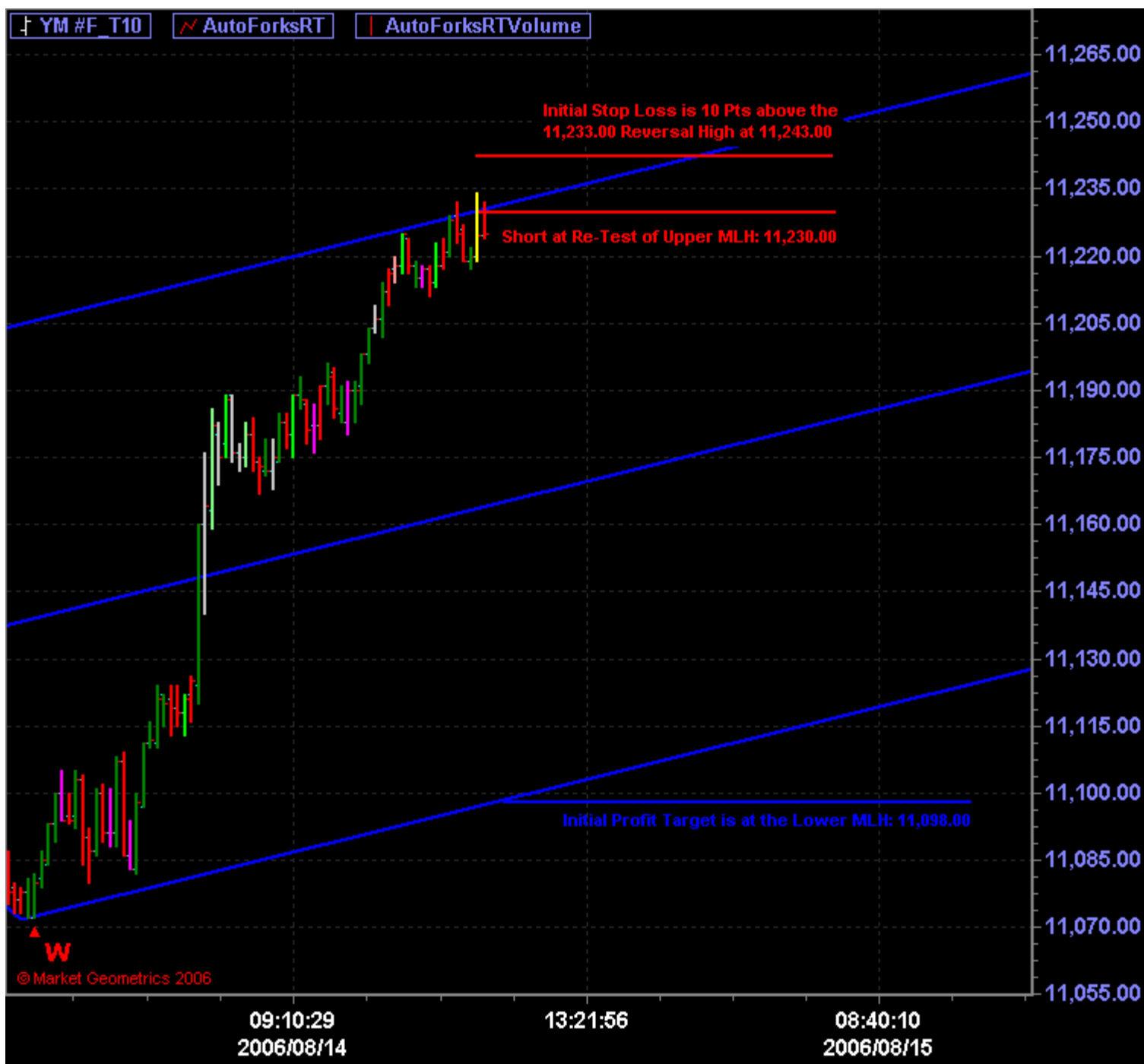
These Aggressive Volume Bars work on time based bars, tick bars, range bars and of course, momentum bars. Let me give you an example of this really powerful tool by showing you an example of a trade from last week in the CBOT mini-Dow futures:

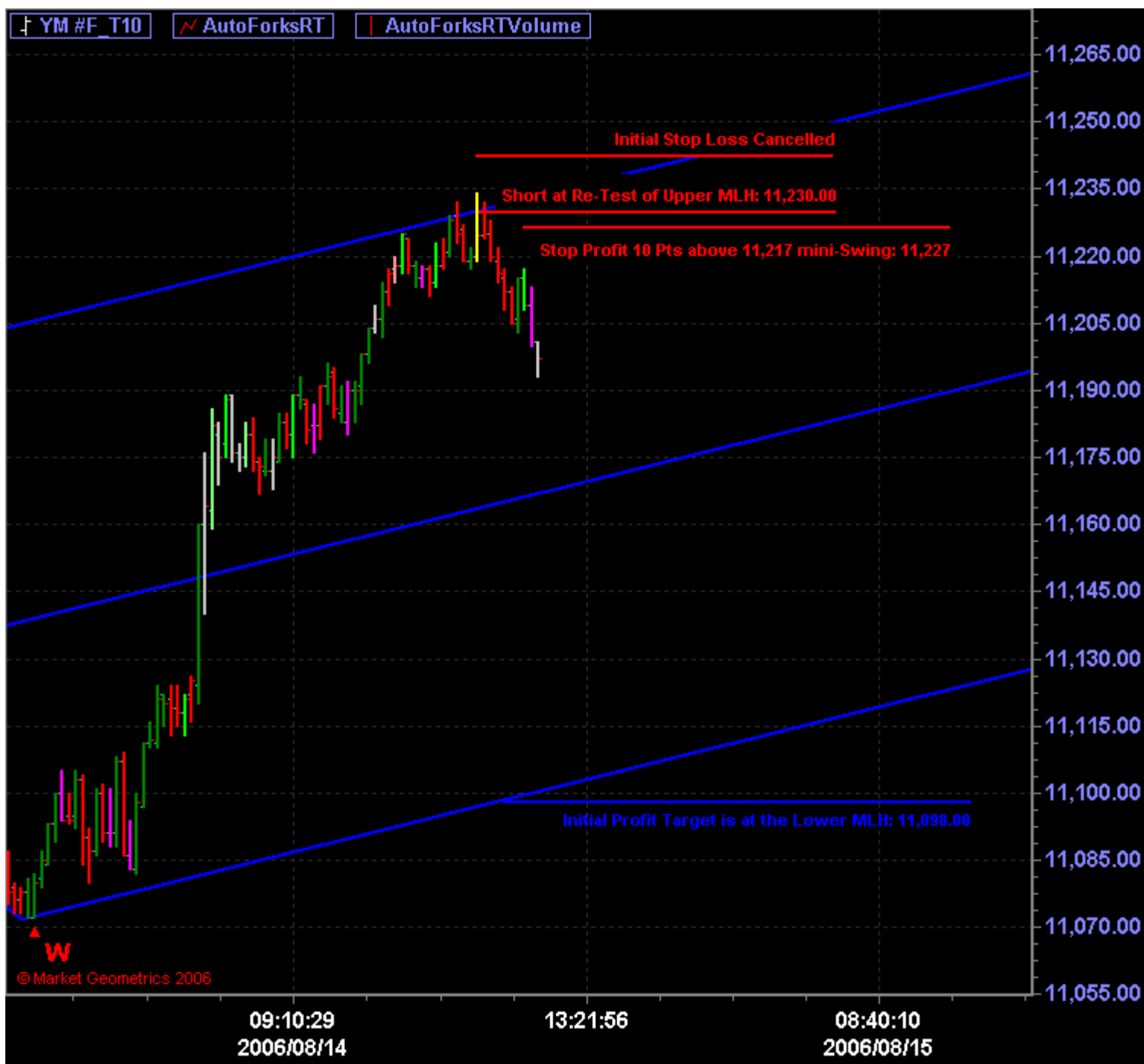






















That was a nice clean day trade in the CBOT mini-Dow contract that netted 120 points, which netted me \$600 per contract before brokerage. And now that you've seen the Aggressive Volume Bars in action, I think you can see why it is easier to see if price is running out of energy or just taking a pause before the next push. In the last example, we saw a classic "three drives to the top" or "Three little Indians" formation before the sell off began. Sometimes you get multiple tests, each one higher and other times, the first test fails. This, of course, depends on the quality of the sellers or buyers you find when price gets through the door!

In this next example, I'm going to use momentum bars, which were invented by Danton Long to help visually aid traders in determining momentum in various markets. Now that I've added Aggressive Volume Bar coloring to them, these bar types really "sing" to me in some markets—specifically the currency markets, bean meal and oil and any other markets that tend to have periods of very orderly trading, followed by nice trending moves after a change in momentum.

Let's take a look at one of the newest changes at the CBOT: Electronic Traded Agriculture Futures! Besides adding volume from traders that generally only trade what they can execute using an electronic platform, these new markets bring something new to all of us that the CBOT probably never considered: There is now information available to you and me that was never available before: Each actual trade is recorded with an attached volume and bids and offers are also transmitted, so if you know how to sift through the data in real-time, there is now a wealth of information waiting for you! And so this next example is going to feature the electronic December Bean Oil futures contract [ZL Z6]. And note that to get an adequate historic price picture, prior to the beginning of the electronic trading on August 1st, I added pit traded data [which obviously has no recorded volume or bids and asks recorded, so does not trigger the Aggressive Volume Bar coloring]. The Bean Oil and Soy Meal are nice contracts that allow you to range trade day in and day out and if you pay attention, you can catch a nice large move if you are willing to hold positions overnight.

























This was a pair of nice trades in the December Electronic Bean Oil futures—One a day trade and the other a position trade. The day trade netted me 16 ticks a contract, which is \$96 per contract before brokerage and the position trade netted me 127 ticks, which is \$762 per contract before brokerage. Try trading these new electronic AG contracts! You'll love them!

I hope you enjoyed these examples. This is just a glimpse of the power you'll find if you master these extremely simple yet powerful trading tools. By coupling them with non-time based bars and adding some new twists like Aggressive Volume Bar coloring, we're making it easier for all traders to see turns as they happen in real-time. And that should translate into more profitable traders in the future.

I wish you all good trading!

Act, don't Re-act!

Timothy Morge

President

MarketGeometrics, Maker of AutoForks2

Feel Free to Ask Questions Now!

Here are some links with special savings to “Thank You” for attending this seminar:



For information about buying either of my books or attending a full-length Market Maps Seminar via the internet, go to:

<http://www.marketmaps.org>

or email me at:

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I'll gladly try to answer any questions you may have now.

Thank you for attending!

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