Chapter 3

Price Action

The movement of price in any market is called **Price Action.** This movement is caused by the beliefs and trading systems of hundreds of thousands of worldwide traders that the market is going to move in a specific direction.

Technical Analysis is the use of indicators to display this price action visually in the market.

Forces in the market:

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Price Action Technical Analysis is the use of charts and indicators to analyze time, price, and patterns. This analysis is used to project a high probability, low risk trade entry and comes to us in the form of a line chart, bar chart, or a candlestick chart.

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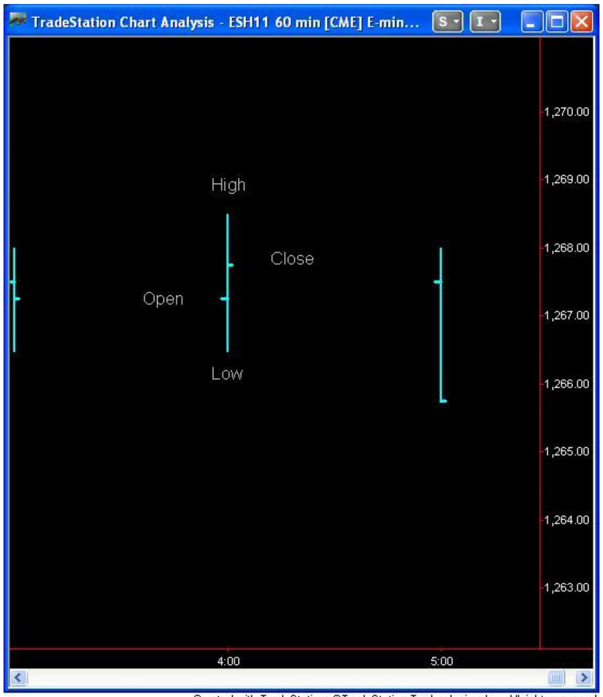
Price movement for any specific period of time is displayed by the:

≈ Open – beginning price for that time frame
≈ High – highest price during that time frame
≈ Low – lowest price during that time frame
≈ Close – ending price for that time frame

Example:
In a 5 minute chart, each candle represents price movement over a 5 minute period of time. A lot can happen in 5 minutes.

In a 50 tick chart, each candle represents price movement for every 50 trades. 1 tick equals 1 trade or transaction. Tick charts appear to have a smoother representation of price action than time charts. This is particularly true during quieter periods of trading.



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Bar Chart – clear price movement without the distraction of solid candle body or colored candle body

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Green Candle Body and wick - price movement is bullish (up)

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Red Candle Body and wick - price movement is bearish (down)

You can customize the candle chart or bar chart to whatever configuration that is comfortable for you. The primary concern is that you are able to clearly identify the data represented by the candle.

When we put this information together, price movement shows us a picture or snapshot in time. Questions we should consider are:

- ≈ How fast did price move or how slow did price move?
- ≈ How long did it take for the move?
- ≈ Did price change direction for a reversal?
- ≈ What time did the price reversal take place?

With this data, we are now gathering information to make an informed decision of where price might be heading next and how to apply our trading plan. If we knew more about what the overall market was doing, it would help confirm the direction that price action is showing us. In the next chapter, Market Internals will help us confirm our decision.

Fundamental Analysis is the use of financial strength and economic reports to help make a decision whether or not to place a trade. As a day trader we use economic news reports from www.econoday.com. We do not base our primary decision on the information in the news announcement or report. We respond based on price action after the announcement.

Price can be manipulated at any time. Our best choice is to sit and wait to see what direction, if any, the traders want the market to move. Then we attempt to move with them, not against them.

Trending or Consolidating

The market moves in one of three ways; up, down, or sideways. Some even say there is a fourth way, when the market is extremely choppy, no direction can be determined. For simplicity, use the following:

The market trends approximately 30% of the time
and
Consolidates (moves sideways) approximately 70% of the time

This causes two challenges. First, you usually cannot tell if the market is trending or consolidating until after price has moved, sometimes not until after the move is over. Second, if the market is trending, how long will it last? If consolidating or accumulating, how long until it breaks the channel?

Whether trending or consolidating, the market moves in cycles and most of the time consistent with the movement of the masses of traders. Electronic trading makes up approximately 80% or more of the current trading environment. However, most movement is based on fear and greed and still moves in a harmonic nature. The use of harmonic Fibonacci numbers to project price movement is one of our primary tools as you will see in the following pages.

Remember: Filters and triggers are meant to slow you down and prevent you from overtrading. This is necessary to help prevent overtrading.

What determines whether the market is trending or consolidating? The Bulls have a specific area they want to protect or move the market to. The Bears have a specific area they want to protect or move the market to. This brings about the battle of the Bulls and the Bears.

These key areas of support and resistance are established ahead of time based on daily, weekly, and monthly algorithmic computations and previous levels of interest. The secret is to trade in and around these boundaries using them to our advantage.

Most indicators are unreliable during the first 15 minutes after the open. It takes time for the large amount of price data to get filtered into the market indicators. Professionals are preparing to take the market one way or another. This is a great time to watch price action and observe the market.

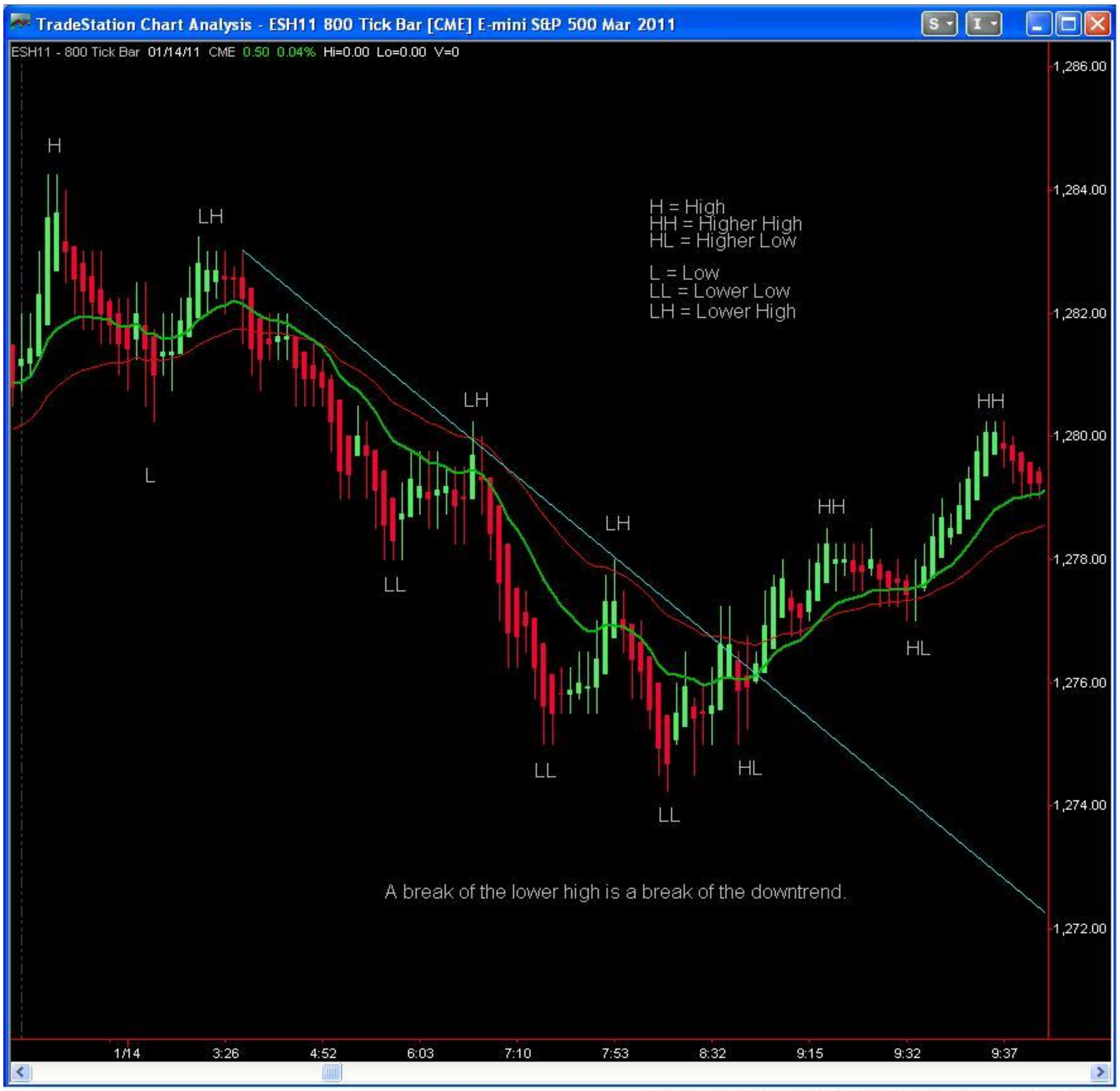
New traders should stay out during the first 15 minutes of the day.

Trending:

If price breaks out of this 15 minute range, the market may or may not be entering a trend. What you see is traders probing for a possible trend direction. Market internals should give you an edge to support a direction and whether or not it can be sustained. An up-trending market is a market having higher highs and higher lows. You can clearly see this by drawing a <u>support trend-line</u> along the bottom of the swing lows.

Uptrend

A down-trending market is a market having lower highs and lower lows. You can clearly see this by drawing a resistance trend-line along the tops of the swing highs.



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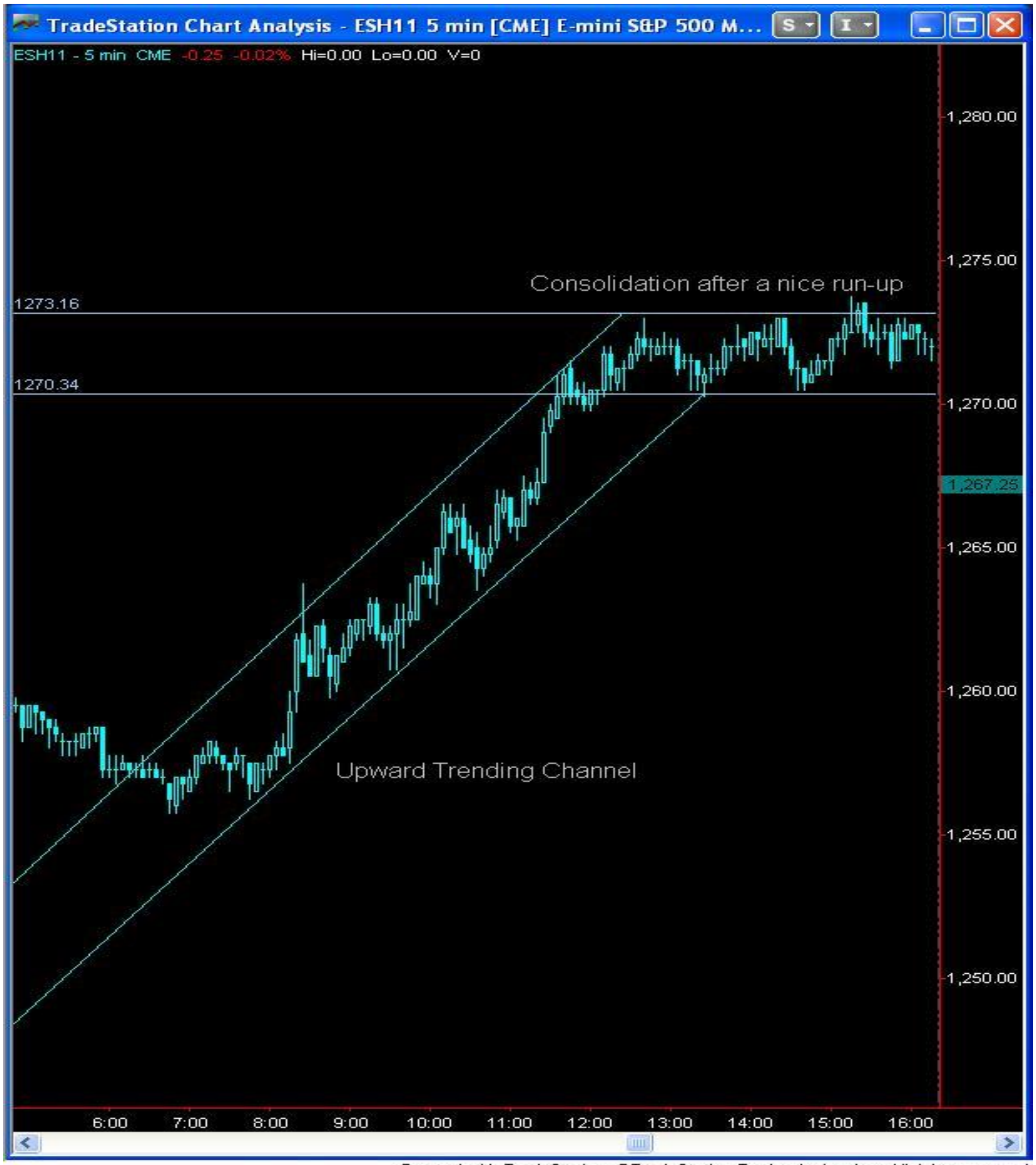
Downtrend

A trending market will continue on a trend until it runs into an area of major support or major resistance that either slows it down or forces it to change direction.

"An object in motion remains in motion until acted upon by an outside force."
– Sir Isaac Newton

Consolidation:

After the open, the range between the 15 minute high and the 15 minute low is established. Mark the high and the low of the first 15 minutes on your chart with a yellow line. As long as price action remains between these two lines, the market is considered consolidating or indecisive and non-trending. Consolidation is when price action travels between an area of support and an area of resistance for an extended period of time.



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Bullish Trending Channel with Consolidation

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12 additional pages with specific charts and patterns