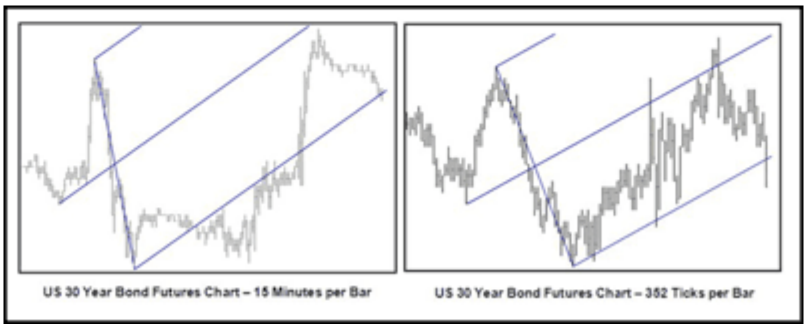
Tips for Traders | 1/11/2008

Take Time Away From Your Trading to Increase Your Profits

Reading the title, did you think I was going to offer vacation tips? No, that's not what I meant at all. Almost all traders that look at charts of currencies, futures, and stocks use time-based charts. On the vertical [or right] axis of the chart, price is clearly marked and on the horizontal [or bottom] axis of the chart, the date and time is generally marked. For about 99% of those of you out there, your charts are always price and time based. But I've got some different ways for you to look at the markets that may give you more opportunities for profitable trades and will also give you a bit of an edge, since very few traders look at the markets using these types of charts.

Let's start out by looking at a pair of charts, side by side, of the US 30 Year Bond Futures:



Many years ago, after electronic futures trading became well established, a good friend of mine sent me a US 30 Year Bond chart. He researched the number of ticks that occurred in each trading day over a two-year period and then found that on average, 352 ticks occur on a chart of the US Bond 30 Year Bond futures in a 15 minute period. And so rather than look at 15 minute bar charts, he began looking at 352 tick bar charts.

After studying his charts, I noticed that he had only been charting the day session of the bonds, so I tried adding in the overnight trading as well, so these new non time-based charts would also exhibit the overnight extremes. That's when I began to see the real potential of these charts. Looking at the chart on the left, you can see that when price quiets down, it 'drifts' to the right of the chart, even though nothing is happening in the market. That happens because the charting program is forced to put out a new bar every 15 minutes, exactly like clockwork, even if the market is dead. This drifting 'skews' the charts and distorts most all types of indicators and lines. In effect, time-based charts very frequently give false signals that are generated purely because 'time marches on'. How can you get away from these false signals and from the drifting? You can look at charts that are based on price and something other than time.

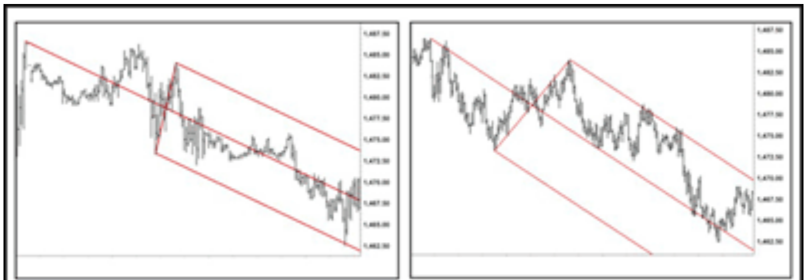
By the way, don't be fooled: the Median Lines [or Pitchforks] on both charts are drawn from the same highs and lows!

Let's turn to the CME Euro FX futures and see a different charting technique that doesn't use time:

Once again, you can see that even though these two Median Lines [or Pitchforks] are drawn from the same pivots, the time-based chart on the left suffers from drifting: note how quickly price moves outside the Median Line. Yet the Median Line on the non time-based chart on the right stays with price and gives some very tradable signals.

The chart on the right is made up of eight tick range bars. That means that each bar, measured from its high to its low, is eight ticks in height. Once price makes a tick above or below the current eight tick range, a new bar is started. I have found that eight ticks give me enough signals to day trade most currency futures without generating too much noise, but you can experiment with different ranges once you give eight ticks a try.

Now let's look at the CME E Mini S&P Futures and my favorite chart type in that market:



CME E Mini S&P Futures – 15 Minutes per Bar

CME E Mini S&P Futures – 10,000 Contracts per Bar

Looking at these two charts, you can see that the even though the Median Line [or Pitchfork] on both charts are drawn from the same pivots, the 15 minute chart on the left gives no entry opportunities, while the chart on the right gives you two gorgeous sell opportunities and also gives you a very good measurement of where to take your profits on these potential short positions.

The chart on the right is very interesting because it literally combines price and volume and traders throughout the years have been trying to find a useful way to incorporate volume measures into their trading. This type of chart shows bars that contain exactly 10,000 electronically traded contracts; when the next contract trades, a new bar is begun.

Another very useful type of non time-based chart in the E Mini S&P Futures is the 2,000 tick chart, where each bar contains 2,000 ticks. Remember, a 'tick' is not the same as a contract trading, because there is also a specific volume associated every time price ticks up or down. Price may trade up and 55 contracts may trade at once. To a tick bar-based chart, that's one tick. To a volume bar-based chart, that's 55 contracts towards filling up a volume bar of the size you specified in your charting program.

So there are three different types of charting styles you can use to take time out of your trading and potentially improve your bottom line. I generally find these types of charts give me more trade set ups and the trade set ups they generate are more reliable. But don't take my word for it. Give one or all of them a try! Or you can try out the 'granddaddy' of non time-based charts, point, and figure charts. And if you trade stocks or ETFs, it's a simple matter to find a volume-based chart frequency: find the average daily volume traded in a stock you follow and then do the simple math to find how many shares generally trade in five, ten, or 15 minutes on an average day. Then set your volume-based charts to that size volume bar and try your hand at taking time away from your trading!

I wish you all good trading!

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