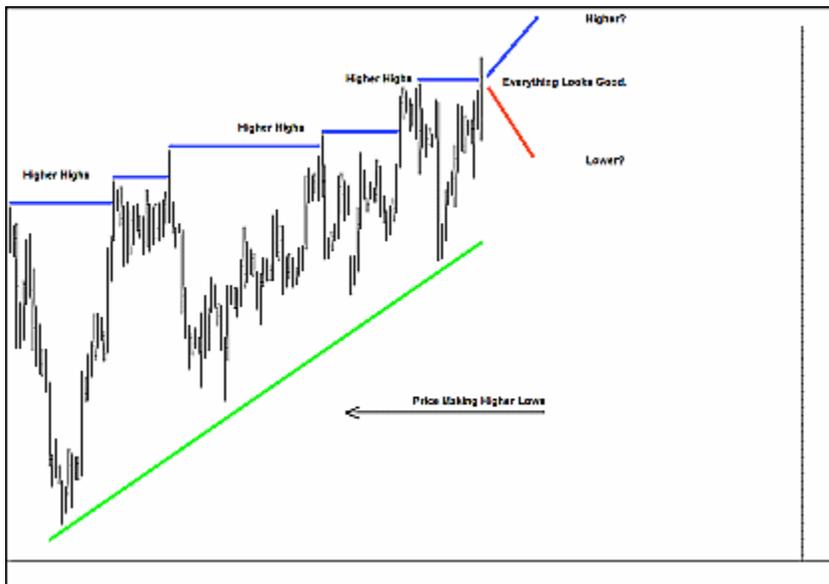


Tips for Traders | 3/9/2009 10:25:00 AM

How to Improve Your Market Direction Forecasting Skills

I am a trader. I am not an analyst or a prognosticator, but playing “What if” is an exercise that can pay great dividends if you know what to look for when evaluating a market for potential turning points. For example, I did a chart and projection of the Dow Jones Industrials for the Las Vegas Traders Expo and MoneyShow.com in November 2007, calling for a test and break of the 7500 area within 18 months and then a sharp fall to the 5500 area. And of course, this long-term projection has turned out to be eerily accurate.

Is it luck when these types of projections work out? No, there are there real signs you can look for to help identify potential turning points. Let’s look at a couple of these set ups, let you guess how the set ups turned out, and then look at some current markets that *may* be setting up for either changes away from their current trend, or accelerations in their current trend.

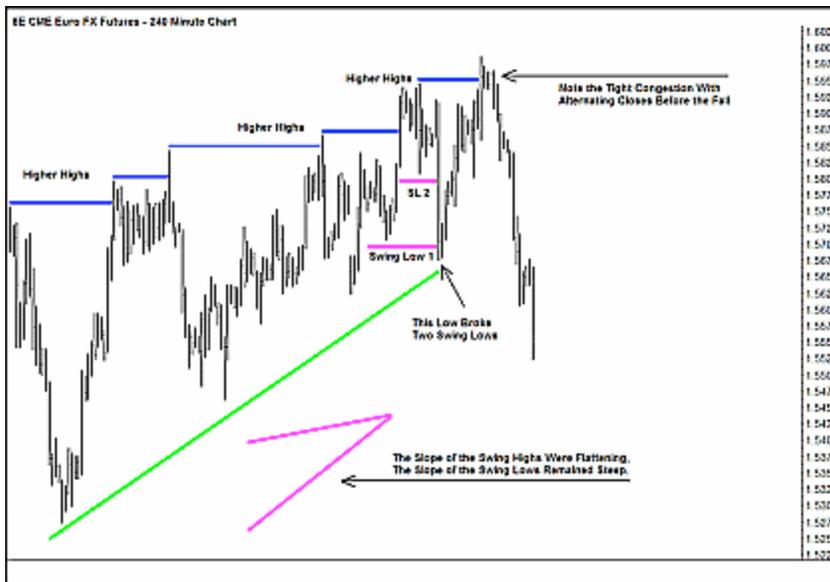


This first chart clearly shows higher highs and higher lows—strong signs of an uptrend. Everything looks good, right?

Do you think this market is going to continue higher from this point?

Do you think this market is going to change direction from this point?

Are there any clues that help you support your intuition?



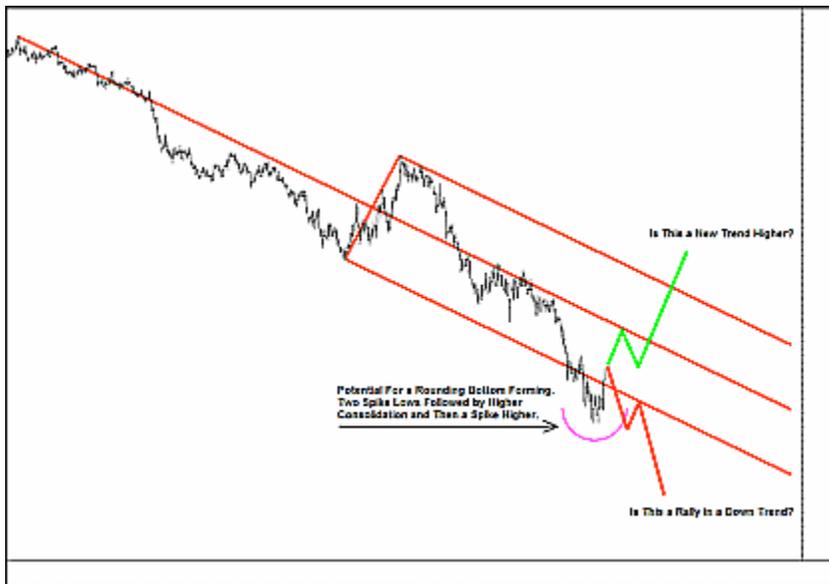
Price made one spike high and then consolidated with a set of smaller ranged bars that had alternating closes, and then price plunged lower.

Did you think the turn was near when you looked at the first image and couldn't tell the instrument, time frame, or price scale? What clues did you see?

I was looking at the noticeable difference between the slope of the line (or Line of Force) that connected the higher highs together, and the slope of the line (or Line of Force) that connected the higher lows together. The slope of the line that connected the higher highs was flattening out, while the slope of the higher lows was still quite steep.

In simple terms, it took little energy to make new highs, yet price would be able to fall quite a bit before finding any prior lows that might act as support. Once price broke below two prior swing lows, the change in direction was confirmed and the fall continued in a near vertical fashion.

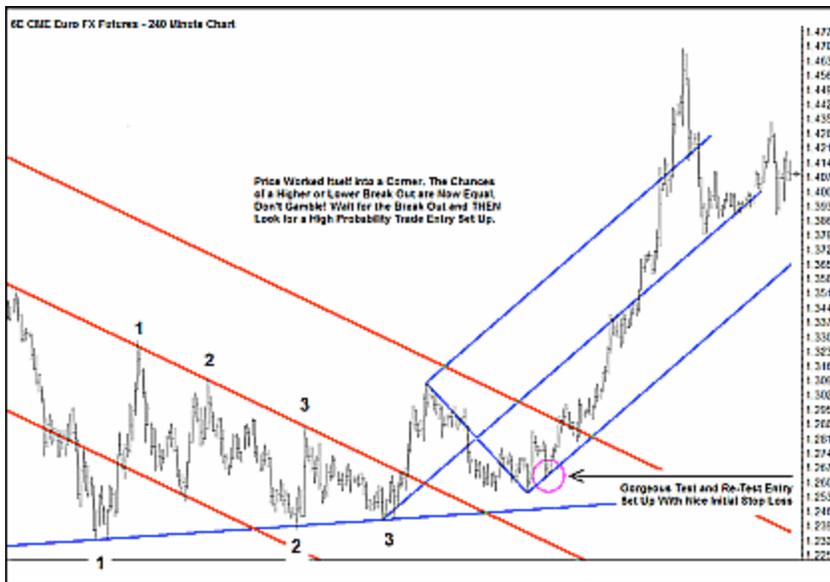
Let's look at another set and see if you see any signs that tip off the market's direction:



Price trades quite a bit lower and then leaves a set of lower bars, the first lower than the second, before beginning a nice climb out of the hole. This particular formation has an almost pleasing look to my eyes and I tend to mark it as a potential rounding bottom—but remember, it isn't anything but a group of bars until price makes a significant gain or loss.

In this case, price has come to the moment of decision: Is it a rally that will continue or a simple pullback in a downtrend?

What do you see? What does your intuition tell you? Can you “see” the probable path of price?



I zoomed this one in a bit to show you how price played out right after it had reached its moment of decision—and to show you just what it ended up doing as time went on.

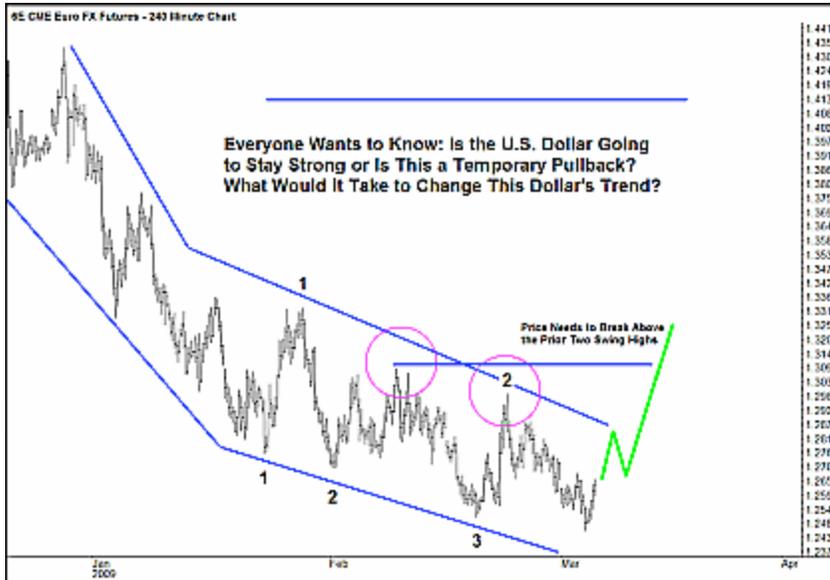
Price did climb further—but it didn't do what I thought it would do. Once it climbed above several swing highs, it ran into the red, down-sloping Median Line and it turned down hard—in fact, you can see it left three lower highs! And to make things even more interesting, it left three higher lows! Price made three drives to the top and three drives to the bottom. I certainly never saw that coming. Did you?

Price did eventually take off to the upside, but it was quite a battle until it broke above the line connecting the three drives to the top (which also happened to be a red, down-sloping Median Line). And if you look at the blue, up-sloping Median Line I added after price broke out to the upside, there was even an opportunity to use my favorite trade entry set up—the test and re-test—to get long with a quality initial stop loss.

We can draw, we can plan, our intuition can tell us where price is headed, but in the end, the market is always right! That's why I trade what price shows me, not what I think!

Let's look at some current markets now and see if we can identify what it would take for each of these markets to change their trends.

The strength of the US dollar is puzzling. The Secretary of State was recently in China asking the Chinese government to invest in US Treasury bonds and assets. Our stock market is plummeting, our unemployment is skyrocketing, and the US dollar is..well..strong!



Looking at the chart, you can see that price has made three drives to the bottom and the slope of the trend of the US dollar against the euro currency has begun to flatten out. We've had two distinct drives to the top but so far, there is no clear sign that the dollar is about to experience a change in trend.

What would it take for the up trend to be declared dead? Price would have to climb above the prior two major swing highs-somewhere above 1.32000 on the CME Euro FX futures.

Do you see that move? Or do you see a stronger dollar continuing?



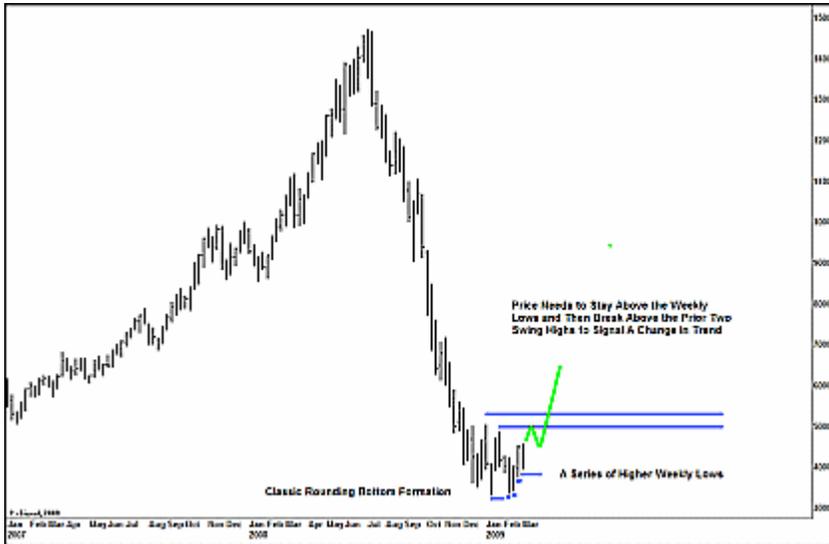
The Canadian dollar made a spectacular run last year to break and trade well above parity against the US dollar. But with the recent fall in energy prices, the Canadian dollar suffered a sharp sell off and is now mired in a 10 point range.

What would make the Canadian dollar strengthen and break above the top of this trading range at 8600 and further, above the prior major swing high at 8700-8800?

Can you see anything that tells you this is likely? Or do you see the down trend resuming for the Canadian dollar?

Let's look at another market that may give us some further clues into this market:

The Canadian dollar's movement is closely tied to the price of energy. Canada produces three times as much energy as it consumes! When the price of oil plunged from \$147 dollars per barrel, the Canadian dollar sold off hard against all the major currencies.



Let's focus in on this weekly crude oil futures chart. Let's face it—the price of oil fell off a cliff! Although it's been consolidating recently, there are no signs of strength yet.

Or are there?

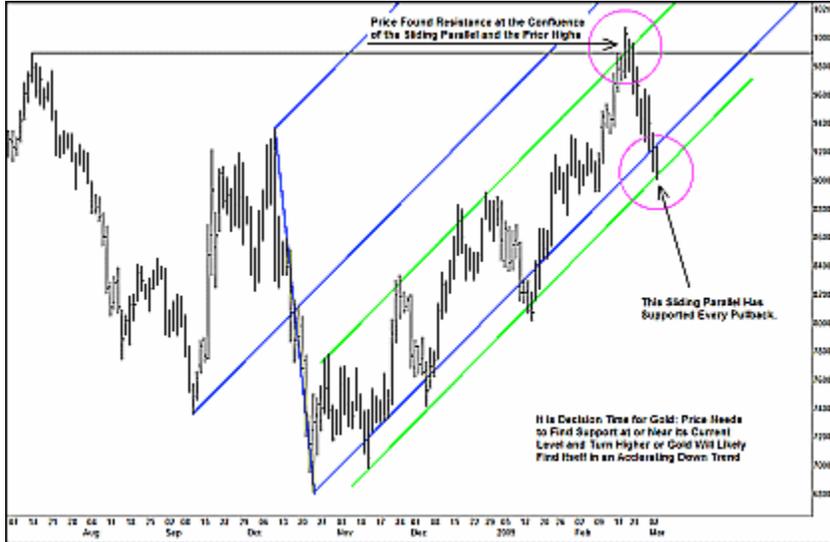
I see a series of higher weekly closes. That's a small victory for oil prices, but to really get things going to the upside, prices will have to break and close above the prior two swing highs. Crude will have to have several weekly closes above the \$52 per barrel price before I can start thinking about being bullish on crude oil futures.

Do you see it happening? Or is crude oil more likely to break the \$30 a barrel level and continue lower from here? The fate of the Canadian dollar probably rests with the future price of crude oil.

Like the Canadian dollar, the Australian dollar was flying high in early 2008! But the sell off of commodities—and the metals in particular—brought the Aussie back down to earth.

Let's turn to another commodity chart to see if we have any clues to add to the picture.

Gold futures briefly climbed back above \$1000 an ounce this year, but they are currently pulling back—hovering right below the \$900 an ounce area as I write this article on March 5, 2009. Price is currently testing the green, up-sloping Sliding Parallel that has acted as support throughout the run up in gold futures prices.



Will price find support in at this up-sloping Sliding Parallel, as it has in the past? Or will gold prices continue lower to test the prior swing low at \$800 an ounce? What do your eyes tell you? Remember, the Australian dollar will probably follow gold's lead...

I see that price is in an area where it may find support, but only gold prices can tell me that and show me that. I can want to see something, but only when it happens is it meaningful. Remember, the market is always right! If you think something may happen, let price show you it has begun to happen before executing a plan of attack! If you are right, there will be plenty of profits left in the move and you will have significantly improved your chances of a successful trade.

Let's look at one more market:



We've all heard about the massive amounts of money the US government has pumped into the banking and lending industries to lower interest rates. Have you seen any benefits from the lower interest rates?

Truth be told, longer-term interest rates spiked lower last November and have been climbing higher since. If you read the newspapers and listen to the advertisements for mortgage refinancing on the radio and TV, you'd think rates were at all-time lows. In fact, long-term rates are at least one percent higher than they were last November.

What does this chart tell us? I think we are nearing the moment of truth in the US bond market. Prices are either going to turn around and head higher—meaning yields will head back to test their lows—or there are no quality buyers of US Treasury bonds and other US assets and interest rates are headed quite a bit higher.

In many ways, the outcome of this current chart will determine the direction of the US dollar, gold, and crude oil. Let's face it, interest rates may be the key to the US economy for the next three to four years!

Looking at the current chart, how do you vote on interest rates? Are they headed higher from here or lower from here?

My thoughts go out to all of you struggling in these difficult times.

Best,

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