

Tips for Traders | 3/2/2009 11:03:00 AM

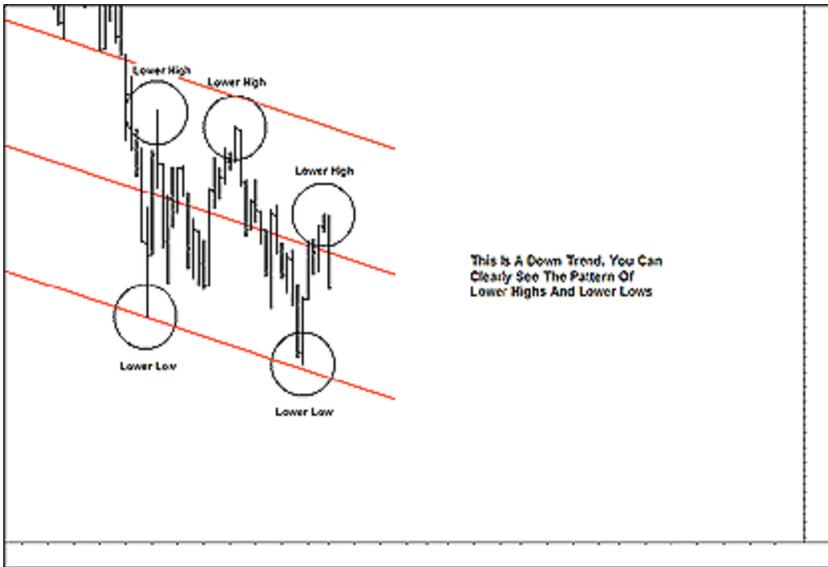
Predicting Market Behavior...Blindfolded!

I recently spoke at the New York Traders Expo, and on the flight home, I watched one of those crime lab shows (I think it was called CSI Peoria). You know the shows I mean: the lab people are called in because there are no clues and they find a single skin cell on a gum wrapper. Once they analyze that single cell using their new super computer and its special software, the name of the criminal magically appears and the case is instantly solved. That's the world we live in, right? High-powered computers running super smart software can make all our decisions simple and flawless. We are surrounded by this message, and pretty soon, we believe it in our hearts and minds.

When I give Webcasts or speak at live seminars, the most commonly asked questions are: What software do I use for charting, and what special indicators do I use to tell me where the market is going? I do my best to answer everyone's questions. I still do my long-term charts by hand drawing them, and when I use computer charting programs, I use a variety of charting packages because I mentor and write and people like to see my analysis on the charting programs they use themselves.

I don't use computer-generated indicators to tell me where the market is headed. I never use lagging indicators, and when I use leading indicators (Median Lines, geometric projections, and retracements and simple trend lines), I use them to "frame" price structure. Then I use my mind to sort through the various possibilities, to get a clear, likely path of price. Once I have the likely path of price in my mind, I look to the market to tell me where it is going. The market is always right, so I always trade what it is showing me. Computers, computer-generated indicators, and computer software always tell us what we program them to tell us—so if conditions change or if the premise is incorrect, the computer will give us a meaningless answer. The market is going where it is going, so I spend the majority of my time watching market structure to determine where the market is going.

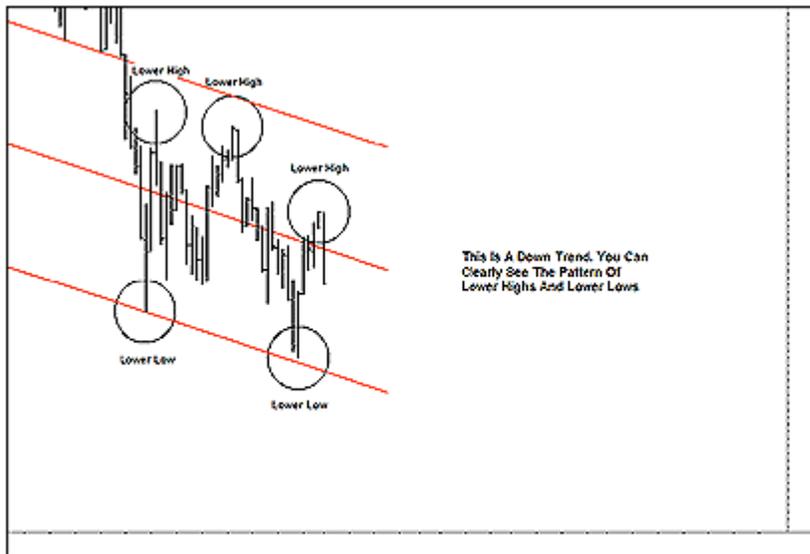
I want to show you some of my thoughts about a particular market. But to keep your mind open and clear and without opinions, I'm going to show you my work on charts that do not name the instrument, do not give a timeframe, do not give a price scale. In short, I have taken out any of the clues from these charts that would tell you what market you are looking at. If you don't know these things, maybe it will be much easier for you to see what clues I am looking at and why I think each of the market structures I am looking at are so important. Let's give it a try, shall we?



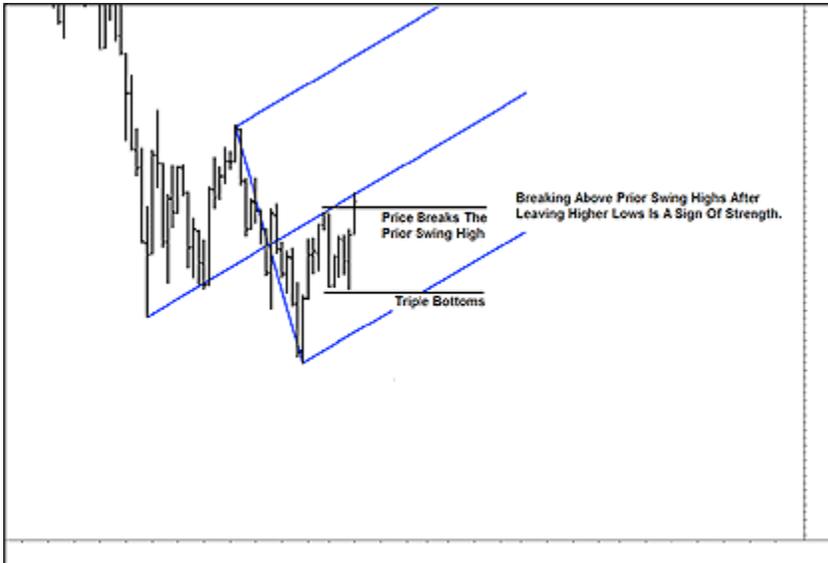
This market is clearly in a downtrend. If you look closely at the upper-left portion of the chart, you can see it was in a strong downtrend before it made the current series of lower highs and lower lows.

You can see I have a red, down-sloping Median Line set on this chart, and it's doing a good job showing me where price should run out of downside directional energy. Price is heading lower, and this leading indicator has marked the probable path of price for me.

Price is trading right in the middle of the current down-sloping trading range. Price has just left a lower high and I have no indication that this pattern of lower highs and lower lows is likely to be broken.



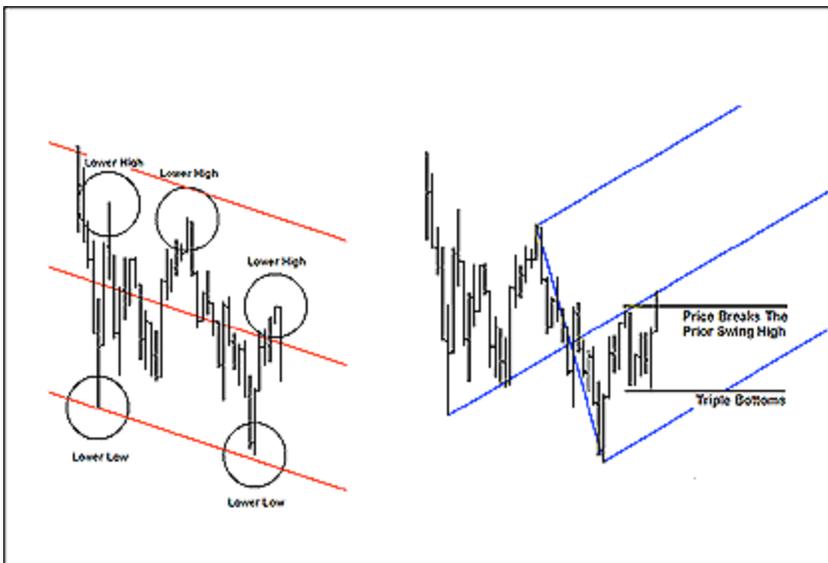
Then, price breaks above a single minor swing high. To ponder the probable path of price, I make a fresh chart and add a blue up sloping Median Line and its Parallel Lines. You can clearly see price has left triple bottoms below where it is currently trading.



It's important for me to emphasize that this chart covers the same market action as the prior chart, although five bars have now gone by.

If I completely forget the first chart, it is quite easy for me to ignore the series of lower highs and lower lows that are on this chart. By simply replacing the red, down-sloping lines with blue, up-sloping lines and marking the break above a single minor swing high, I have completely changed the psychology of this chart. If I step back and compare the two, the red chart makes me feel bearish and the blue chart makes me feel bullish.

If I show these two charts to 1,000 traders, a good 90% of them will switch from being bearish to bullish when I replace the red, down-sloping lines with the blue, up-sloping lines, especially after pointing out that price just broke above a minor swing high. Why do these minor changes on the same chart alter their opinion? Let me show you these two charts of the same action side by side so you can see that bringing your opinion to any chart can completely change what you draw, feel, and see.



It almost hurts your eyes to try to see the same visual cues on both charts. That's how powerful the slope and color of the lines can be!

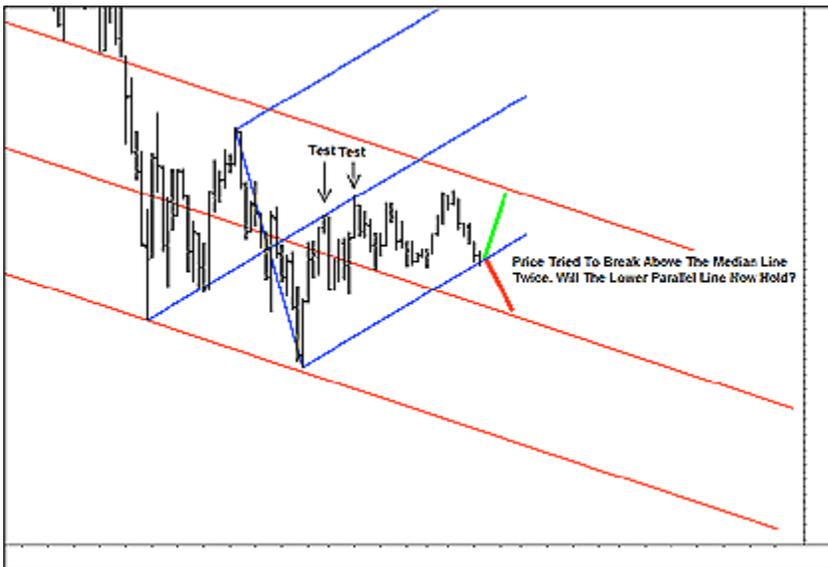
Humans are visual in nature, and we see what we want to see, so it is vitally important to do our analysis with as clean and clear a mind as possible.

Now let's go back to looking at the charts one at a time.



Price has tested the blue, up-sloping Median Line twice. It has also left triple bottoms that will act as support below where it is currently trading.

Where is price headed? Is the probable path of price higher from here or lower from here?

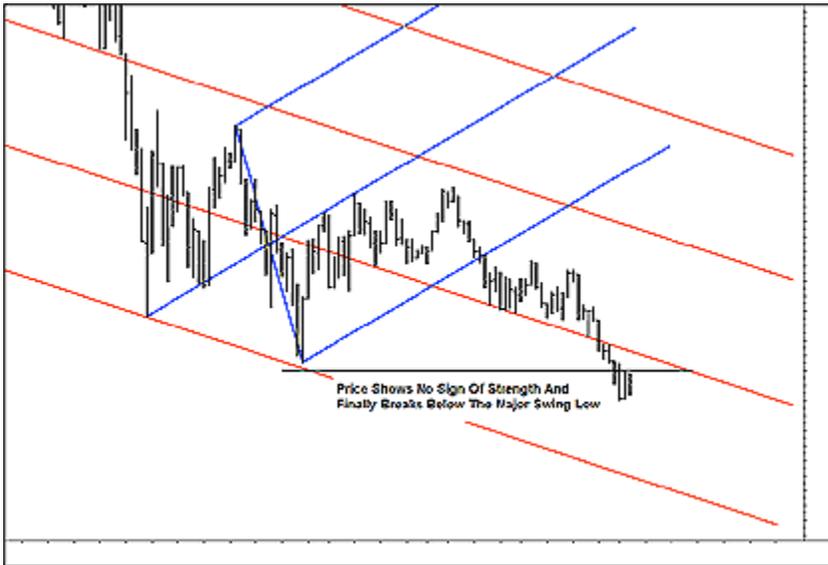


Price was unable to break above the blue, up-sloping Median Line, and after consolidating, it traded lower.

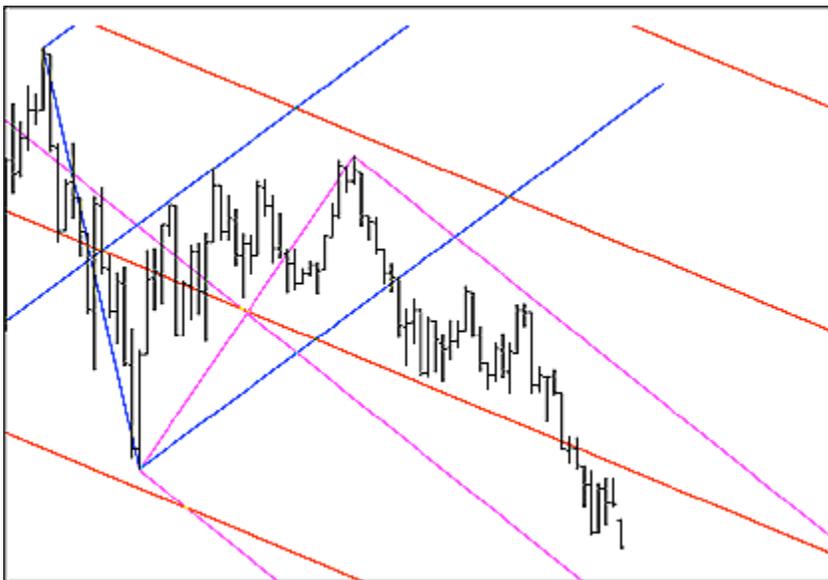
To make it easier for you to see both the up and down side potential of this market, I added back in the red, down-sloping lines and left the blue, up-sloping lines as well.

Price is testing the blue, up-sloping lower Median Line parallel. You can see by the two tests of the blue, up-sloping Median Line that this line has shown us where price should run out of directional energy. Will price stop now at the blue, up-sloping lower Median Line and turn back higher, or will it break through the blue lower parallel and trade lower?

Price had no trouble breaking below the blue, up-sloping lower Median Line. In fact, every rally seems to be met with fresh sellers. Thirty bars later, price has broken below the prior major swing low and shows no sign of climbing back above it.



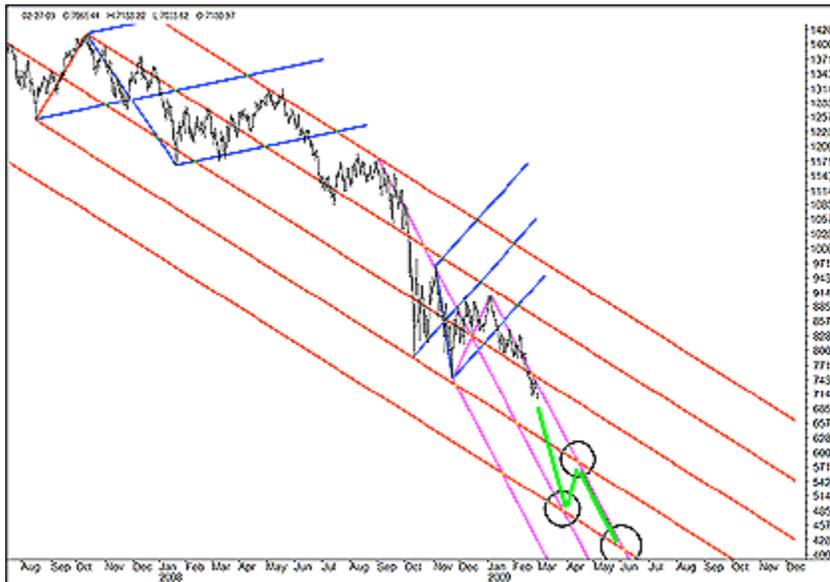
What is the probable path of price? Is price more likely to head higher or lower?



Price accelerates to the down side. This is a very weak market.

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Many of you have probably guessed that this was a series of daily bars of the Dow Jones Industrial Index. This last chart shows the action through Friday, February 27, 2009. You can see I marked what I consider to be the probable path of price with a set of thick green lines.



When I speak of the Dow falling to 5500, I can see the fear and shock in people's eyes. At a recorded interview at the November 2007 Traders Expo, with the Dow right at the 13,000 area, I told Tim Bourquin of MoneyShow.com that my charts showed the Dow would likely break 7,500 within 18 months. Fifteen months later, we are closing just above the psychological 7,000 level on the Dow.

I know what I see in the charts I have presented here. I think it would be best for this country and the world economy for all of our worst fears to be realized quickly. The governments of the world should stop throwing good money after bad and let the Dow and other major indices fall until they find a sustainable level. And then I believe the stock markets around the world would begin a period of range trading, while investors slowly began examining stocks around the world for some signs of stability, and then for stocks that might be undervalued. This purging process is necessary—and once it happens, and once our worst fears are realized, the healing and rebuilding can begin.

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

Best,

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