Plunge or Just a Pull Back—How Do You Know?

Markets trend, congest, and then they can return to the original trend or start an entire new trend in the opposite direction. Reading the signs along, or the 'Market Maps', is interpreting the context of the market at any given time. Good traders then make decisions on the most probable path price is likely to take—and if they cannot discern a probable path, they wait patiently until the market shows them one. Once they've chosen a probable path for price, they look for high probability trade entries with acceptable sized risks and quality risk reward ratios. If they can find all these things, they enter market orders and wait to see if the market let's them in. And then the fun begins!

There are many things in a professional trader's toolbox to help them make these trading decisions. Some traders rely strictly on technical analysis, some on fundamental analysis; some use a mixture of both. And each trader has a different mix of tools. For example, my favorite technical analysis tool is the Andrews Median Line, though I also use tools like geometric retracements [most traders refer to these as 'Fib' retracements even though they were used by the Greeks in Euclid's time] and measured movements. I certainly look at the qualities of each and every price bar as it opens, unfolds and closes to detect whether buyers or sellers are in control and how each bar relates to the prior bars—I suppose you'd call this 'tape reading' these days.

And although I don't 'consciously' rely on fundamental analysis, my educational background and 37 years as a professional trader mean the fundamentals are generally there rolling around in my head, so they do come into play, whether I like to admit it or not.

I thought you might all enjoy looking at a series of charts and playing a game of deciding 'which is the real outcome'! Of course, to do this, I'll trust you won't look at current prices in this market for the past several months—do yourself a favor and just go along for the ride and see how each possibility plays out. There's no wrong answer. All of these could have happened, but one of them did and was an actual trade.

We're going to be looking at the soybean futures, so before we start, let me give you a fundamental clue that many of you don't know: When trading grains, there are two insider secrets I am willing to offer you that come directly from the Chicago Board of Trade Grain pits:

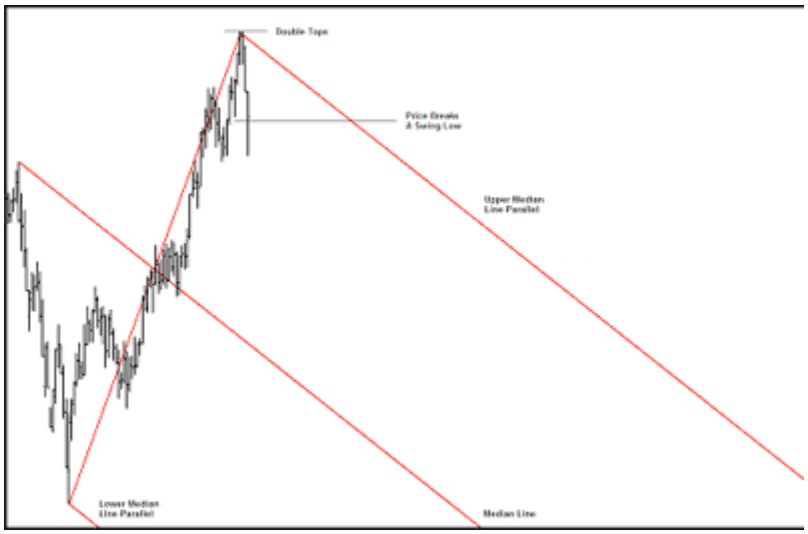
1. There is a famous weatherman on Super Station WGN [or Channel 9 in Chicago]. His name is Tom Skilling and he ALWAYS gives a 'tease' of his major noon weather forecast that starts at 12:20 pm CST at 12:06 pm. If you are ever in Chicago while the grain pits are active in the summer, you can see the pit trading come to a halt at 12:05 pm CST as the traders listen to Tommie's 'tease', hoping to get an edge on the rest of the trading world that waits for his 'full' forecast at 12:20.

1. If you have a grain position in early summer and the market is trending, always remember that once the first tropical depression forms [or the first hurricane], all bets are generally off in terms of the trend. If it's been a hot, dry summer, this generally signals the breakup of that weather pattern. So if you have a nice chunk of profit in a grain position and the first tropical depression hits, you might think about taking your money and standing aside for a bit. OR if a major trend has stretched the market out in one direction or the other, that first tropical depression may be the first crack that leads to a change in trend!

One last thought before we start with charts: I don't know why geometric retracements or progressions work—and I consider 38.2 percent, 50 percent, 61.8 percent, 1.272 percent and 1.618 percent the major retracements and projections.

One interesting suggestion was put forth in a work, *Stalking The Wild Pendulum*, by a fine theoretician named Itzhak Bentov. He pointed out that if you put two or three pendulums in a sealed room and started them at random so that they were out of synchronization, they would exert an unusual influence upon one another and would soon be swinging back and forth in perfect unison. He gives many other examples of this same phenomenon throughout the universe and even within our own bodies! Perhaps the vibrations that make Median Lines and Geometric contractions and expansions are similarly governed and so often find themselves stabilizing when buyers and sellers are about equal. And then once the market has reached its most efficient state [recovered its energy by resting once it is within this synchronized state], it then begins anew on the most probable path. I'll let you decide if this idea makes sense.

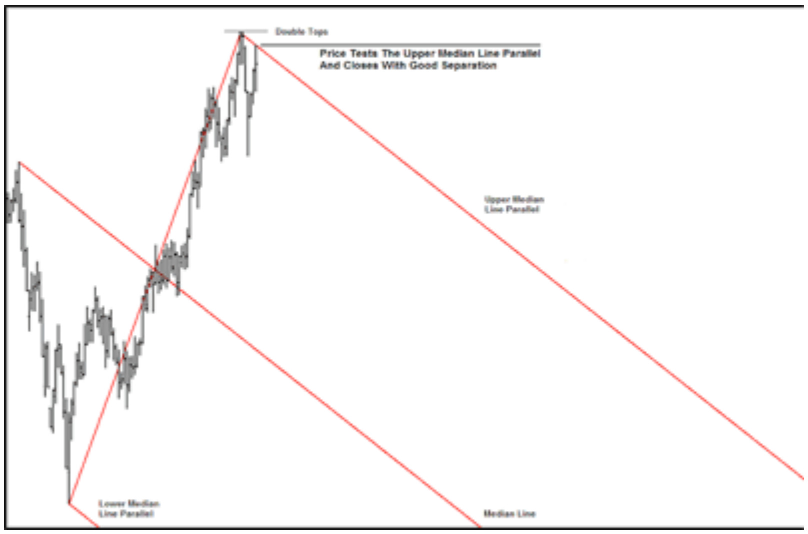
Let's look at the soybean futures market now!



You can see on the chart above, price has been in a very strong up trend, moving from just over $10.50 per bushel to a high of almost $16.37 dollars a bushel in a rather short time. I can't point to any one sign of weakness, but I see some cracks that might lead to something: Price left double tops at the high of the move and then turned lower and broke below a mini Swing Low—obviously the last two bars on this chart are very weak price action. Note also that the sell off came on wide range bars, so there are eager sellers, people that WANT to get out, either because they bought near the recent highs or because they are watching their profits vanish and they want what's left of their money NOW.

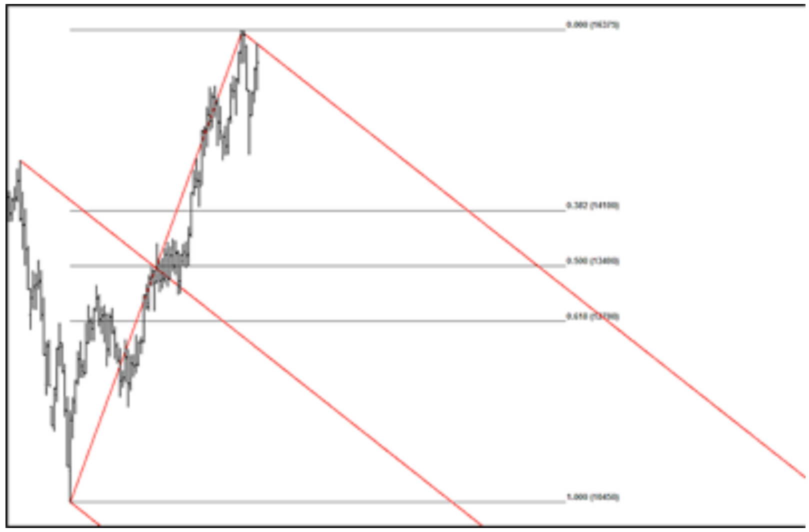
Now let me throw in another clue: The day after those double tops formed, while riding in the car with my wife, she asked me if I had any long-term grain positions on. I gave her an odd look and then asked her why she asked [my wife literally NEVER asks about my positions or how trading is going]. Her answer was simple and to the point: “Odd we haven’t had a hurricane yet, huh? I heard on the radio this morning there may be a tropical depression forming.” Sometimes you just have to admit your spouse is smarter than you are…and of course, after all these years of not asking, she had obviously been listening and watching. If she hadn’t mentioned it, I would have completely missed the news about the potential tropical depression forming—and I probably would not have been as alert for a potential trade.

Let’s see what price had in store for us over the next few days:



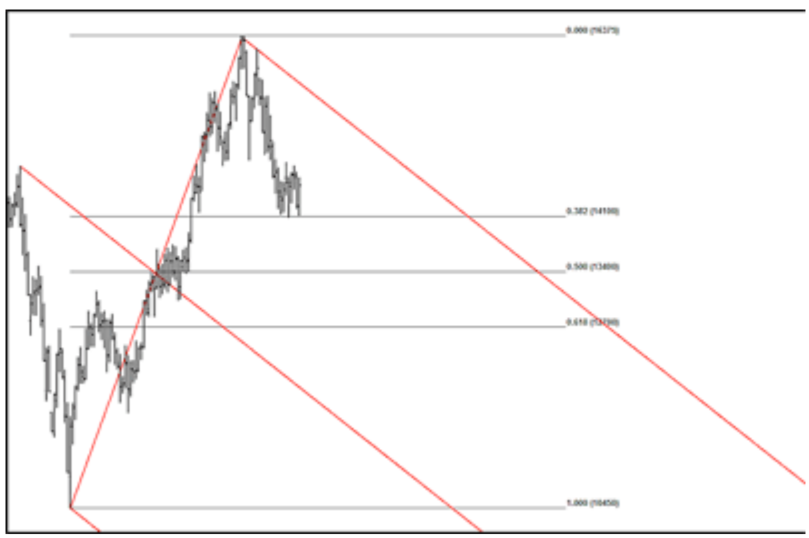
When my wife told me about the potential tropical depression, I added in this down sloping red Median Line and its Parallels. Three days later, price tested the down sloping Upper Median Line Parallel and closed below it with good separation. But note that price is still fairly close to its all time highs. Is this a pullback in a strong up trend caused by the ‘threat’ of a potential tropical depression or is it the beginning of a new down trend?

What do you think? Are there any other tools I can add to help you ‘read’ the market?



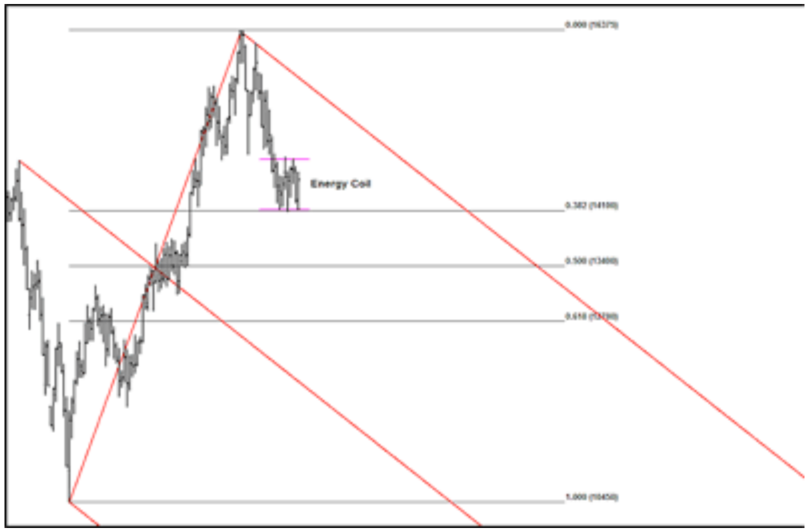
I talked earlier about the geometric contractions and expansions. These are signposts on the ‘Market Maps’ for me, because so many people use them and look at them. My first rule of thumb is very simple: If you are in an up trend, price really isn’t showing any sign of weakness until it can get through and close several times below the 38.2 percent retracement. And looking at the chart above, you can see that price is a very long ways above that area.

That’s all the clues I have for you right now. Do you have an opinion yet? Plunge? Pullback?



Before you get too excited, let me stop you and remind you that we’re going to look at several scenarios. And then I’ll tell you which one really played out and which were just possible outcomes that never happened. Is this the real outcome? What do YOU think?

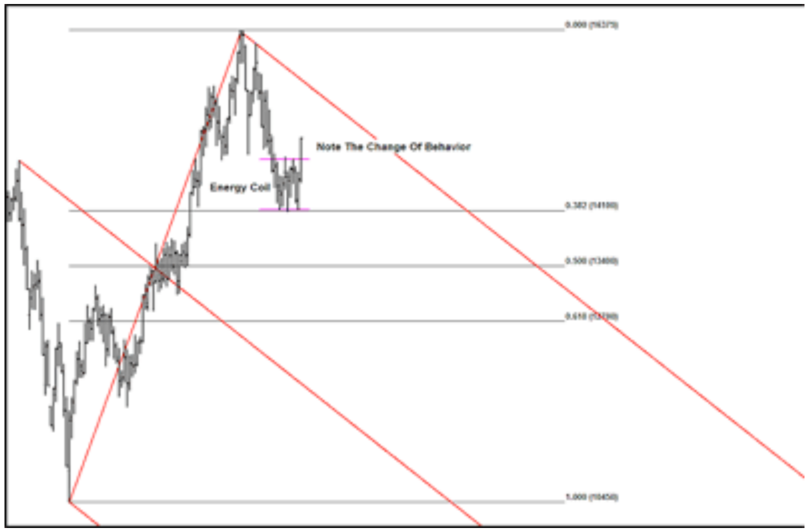
On the chart above, price came down to the 38.2 percent retracement. What else should we be noticing on this chart?



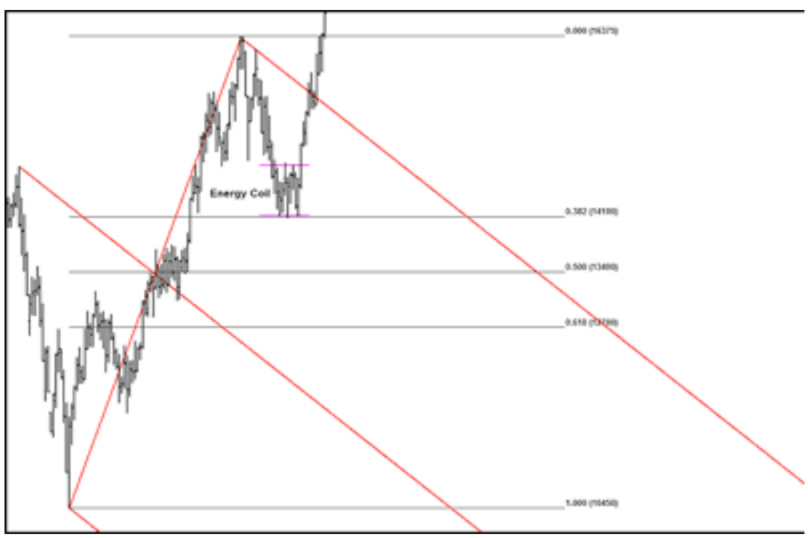
Price not only came down to the 38.2 percent retracement level, it then formed a gorgeous Energy Coil. Remember Itzhak Bentov’s assertion? The buyers and sellers are about equal at this area apparently, so price is resting, re-storing its energy before making its next move.

The NEXT move! That’s what you want to know about, right? Do you have an opinion? Is this a pullback in a strong up trend or a pause in a new down trend? What would price have to do to show us the probable path of price?

In this scenario [remember, we're going to look at a number of them and then you get to choose which was the actual price action as it played out and which were just 'alternate possibilities'], price breaks back above the top of the Energy Coil and closes above it with great separation. This is a sign of strength and just as important, after a nice sell off, it is a change in behavior. This is price giving us a clue about the probable path of price.

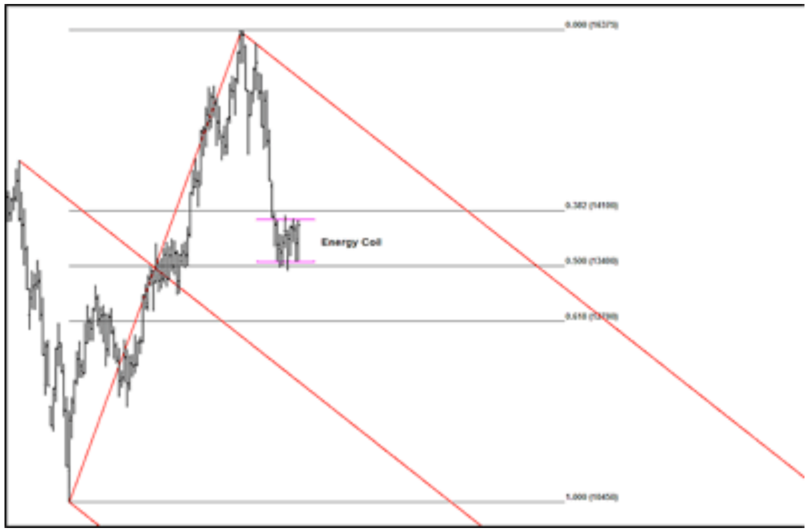


Looking at the chart above, is price likely to head higher now or head back into the Energy Coil?

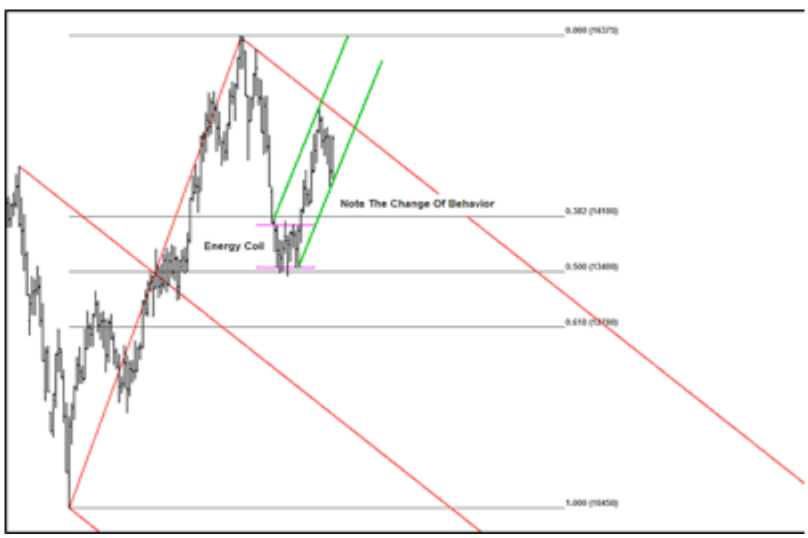


I'll bet most of you saw this one coming. Once price closed above the top of the Energy Coil—which was price's change of behavior—the buyers were completely in control of this market. Price quickly made a new high.

Was this the ‘real’ price action? Let’s see another potential way that this may have played out before I ask you to make a final choice.



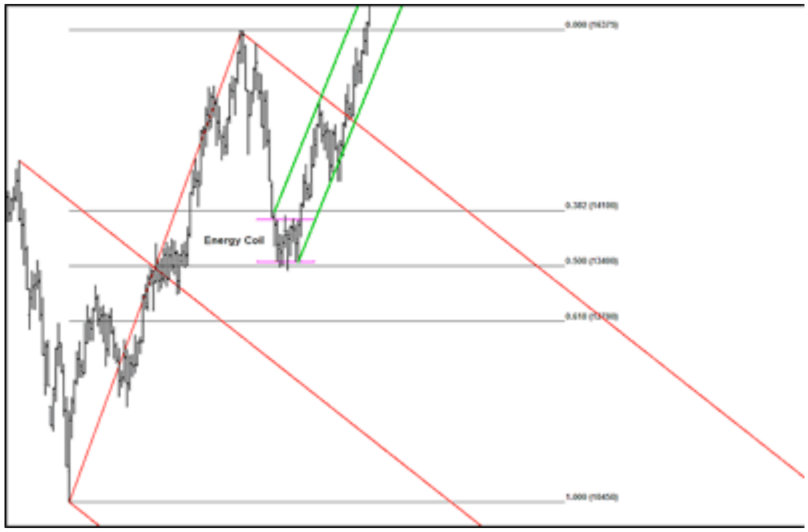
Well, this is different. Price easily broke below the 38.2 percent retracement area. It’s testing the 50 percent retracement area, actually. And once again, after a quick sprint in one direction, price has formed an Energy Coil. Price is re-storing energy. Do we have ANY clue yet about the probable path of price from this point forward?



Once again, this price scenario leads to a break above the top of the Energy Coil. And although the price action is not as vertical as it was in the prior scenario, it IS making higher highs and higher lows, a sign of strength. Once again, price gave us a change of behavior that was easy to spot IF you were looking for it. Once you start paying attention to what price is doing while it forms each and every bar, you’ll begin to see these changes in behavior.

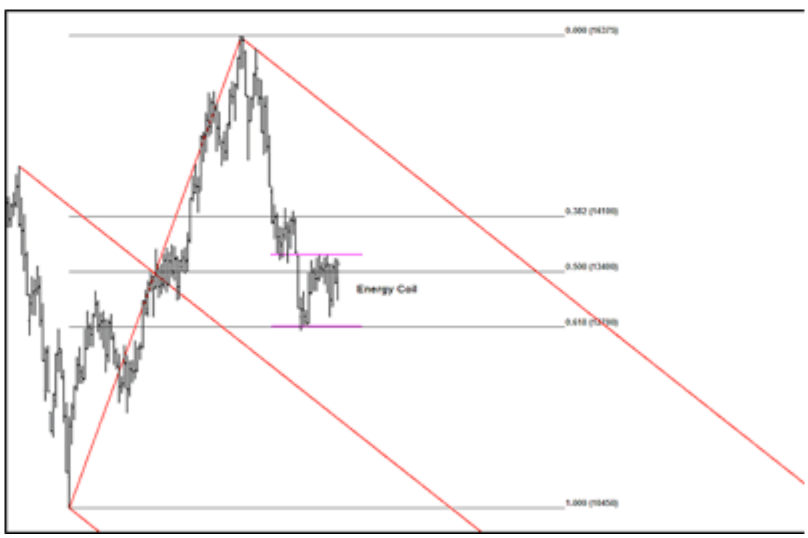
Alright, let’s take another vote: Is price headed higher from here or back to the Energy Coil? It’s come off its highs quite a bit. Do you have an opinion? Will it trade lower and break back into the Energy Coil or head higher from this point?

Price congests a bit and then heads higher, again making a new high for the move. The change in behavior was there for all of us to see if we were looking.



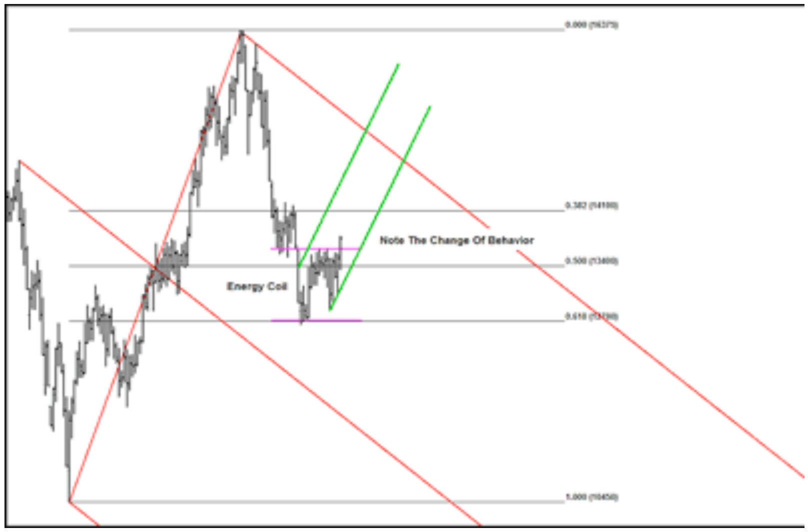
I'll remind you again: This is ONE potential price scenario. Let's see another. Can you tell which is real and which was just a potential price scenario?

Just as important, see if you can see the change in behavior in this next scenario before you I point it out.



Price isn't looking as bullish in this scenario. It's cascading lower and had no trouble trading below the 38.2 percent retracement. Once it re-stored its energy, it spiked lower, easily breaking the 50 percent retracement area and trading right to the 61.8 percent retracement area before forming another Energy Coil.

Do you see a change in behavior? Plunge? Pullback?



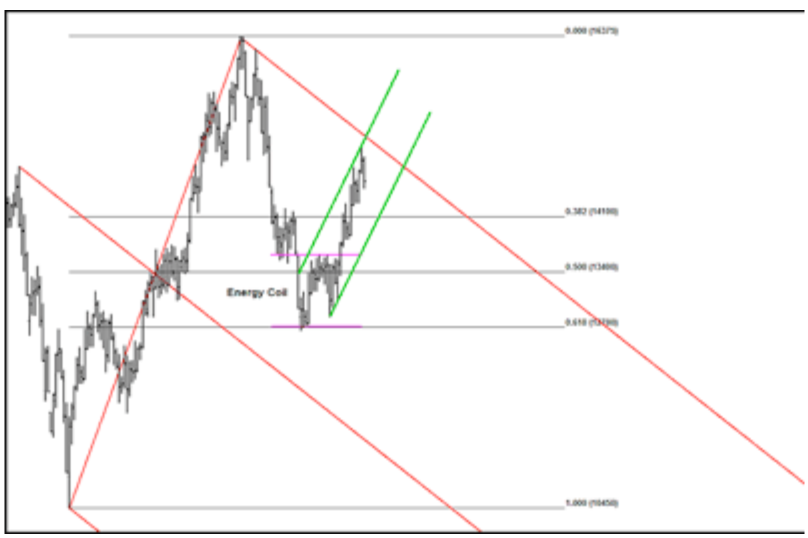
I may have tricked you on this scenario! I think there are two changes of behavior, although it's the second one that really sets the tone for the probable path in price.

The first change in behavior comes in the form of higher lows and the failure of price to retest its low at the 61.8 percent retracement area. But that's not enough to go on.

The second change of behavior, once again, is the break above the top of the Energy Coil.

But we have two nice cascades lower here and quite a nice pullback in price. Do you think you know the probable path of price going forward?

Plunge? Pullback?

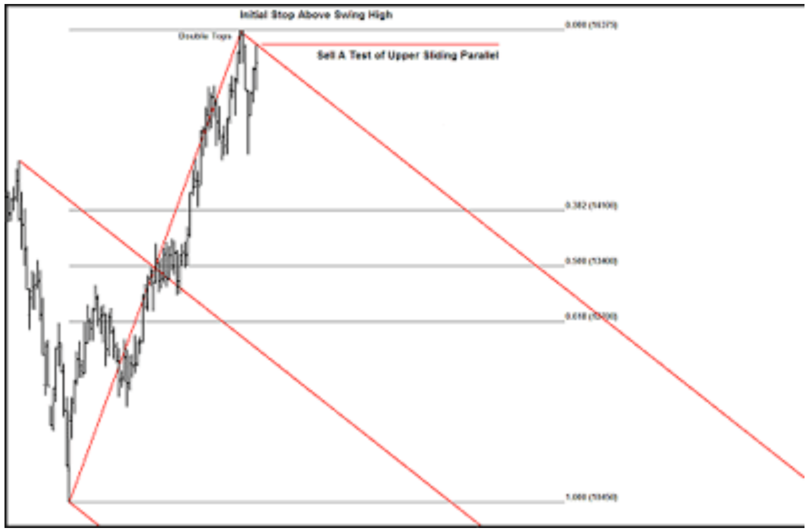


Once again, the change in behavior gave us all we needed to know IF we paid attention and saw it. Price had no trouble climbing back higher. Will it make it above the down sloping Upper Median Line or is that an area to look for a high probability short entry? From this point forward, do you think price is going to plunge or keep trading higher?

Have you decided which scenario really happened? Not sure yet? Let me throw you one last curve!

What if you took the double tops and the potential forming tropical depression and used them as your ‘change in behavior’? Are those two enough to entice you to sell a test of the down sloping Upper Median Line?

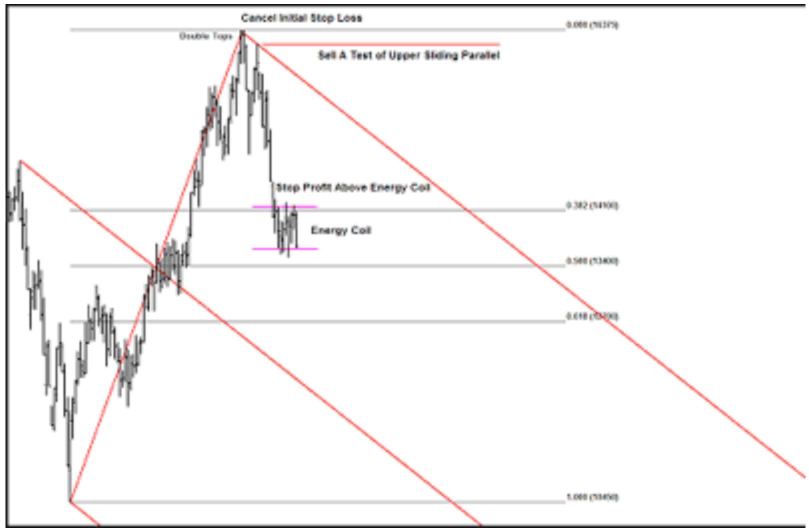
Remember, price still hasn’t traded down to test the 38.2 percent retracement, so it’s still very strong. Price DID trade below a mini Swing Low, but it hasn’t traded below any major Swing Lows.



Would you take this short entry in the soybeans? Or are the other scenarios more enticing?

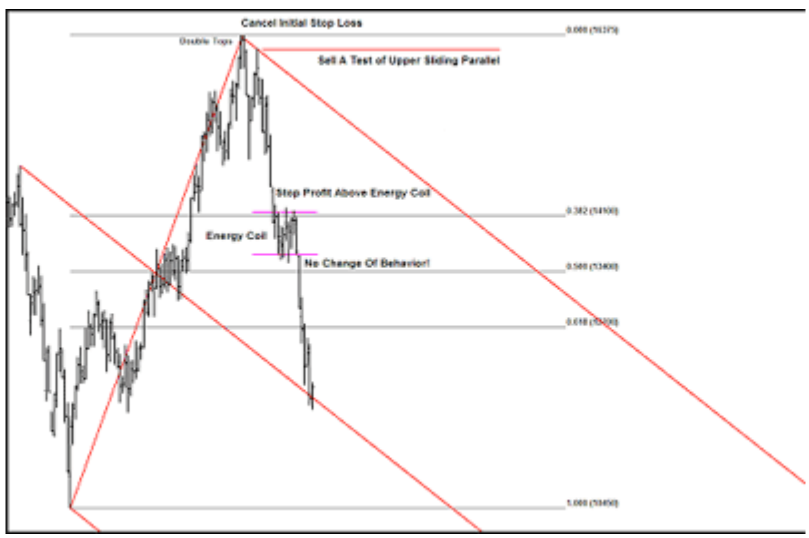
What would you have to risk on this trade? You would have to place your initial stop loss order above the all-time highs, in my opinion. That’s about $1000 a contract away!

Is this a plunge or a pullback in an up trend? Have you decided?



In this scenario, price continued to spike lower, through the 38.2 percent retracement and then consolidated in an Energy Coil just below it. Price is resting now, re-storing energy.

Do you see a change in behavior? Do you think you know the probable path of price going forward? Is this the pause in price before it heads back higher or is this the pause before the plunge? What will it take for you know?



In this scenario, price didn't change behavior. It caught its breath and then headed lower again. None of the geometric retracements were of any help. Price simply headed lower and after a brief pause continued lower.

Now the tough question is at hand: Which scenario was real? Don't peek! Choose before you read further!

This last set of three charts is from an actual trade that was just closed out this week. I got short at the test of the Upper Median Line Parallel, at 1619 ¾. My initial stop loss order was indeed above the prior Swing High. I risked $1000 a contract because my initial profit target was a test of the Median Line. In 21 trading days, price moved from my initial entry at 1619 ¾ to my profit target at 1184 ½, a move of over 435 points, which is well over $21,000 a contract before brokerage. I was also short soybean oil, which had a similar move.

For those of you that just trade stocks and stock indices, you'd be shocked just how fast commodities move when they trend. I think we are in a period where the big moves are going to be in commodities, currencies and interest rates. I've been speaking about this at the Traders Expos for the past several years and I hope some of you are starting to take a peek at commodity charts as well as the E Mini S&Ps.

Before I close, let me point out that even in the 'potential' scenarios, the key was waiting for price to make a change in behavior. And of course, that means that if you have a position in the direction of the trend and have a nice profit, by all means protect your profits. But until you see a change in behavior, the trend is probably intact.

I hope you found these various scenarios interesting enough to get you to look for changes in behavior in the markets YOU trade.

I wish you all good trading.

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