
It Can All Start with One Simple Line

A simple line can be the start of everything. In this presentation, I am going to begin a series of discussions about Action Reaction Lines and Diamonds®, a proprietary charting method I developed well over 20 years ago. Both have served me well in my own trading and this is one of the first times I have given any information publicly regarding the correct rules for using either technique--both are simple, yet powerful if you use solid money management.

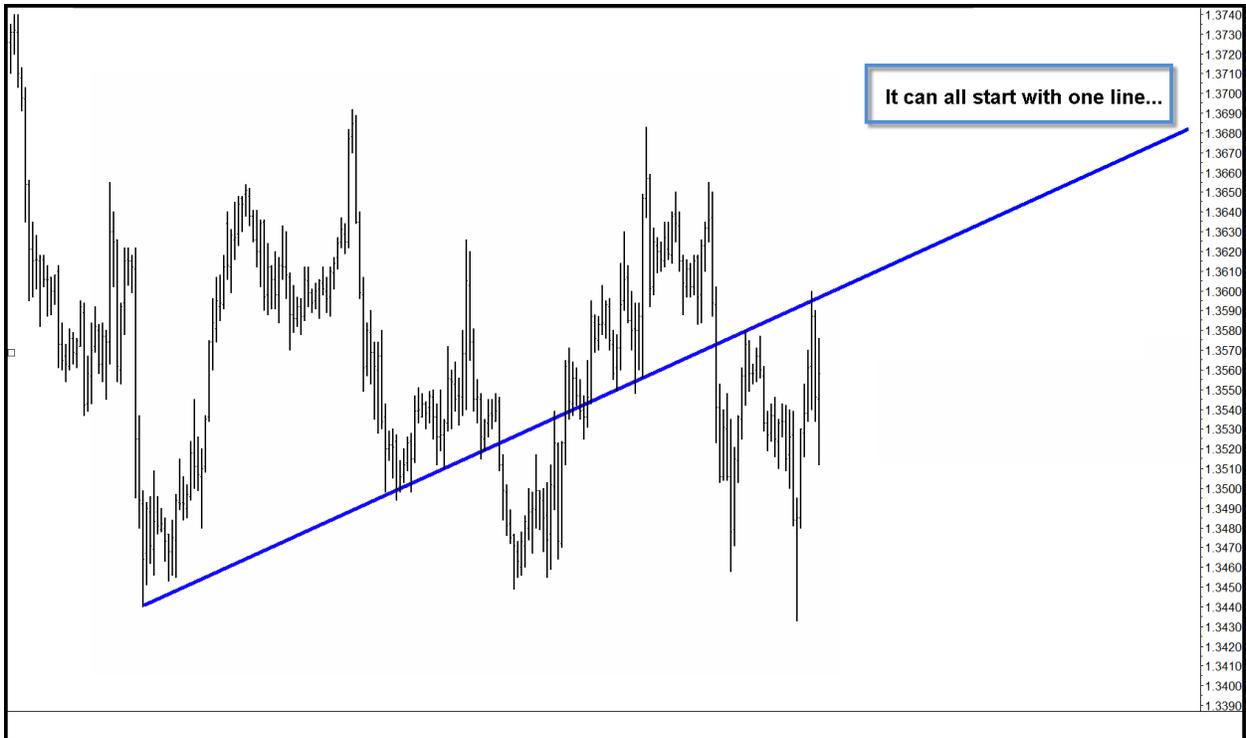
Let us begin this journey with a look towards physics.

Sir Isaac Newton is thought of as a physicist, a mathematician, and the founder of calculus. **But he** was also the 'Master of the Mint' later in his life and literally saved England's financial system by switching from the silver standard to the gold standard. Even less well known, Newton was a Master Alchemist, so heavily involved in alchemy that he eventually died from having massive amounts of mercury in his body from his many alchemical experiments.

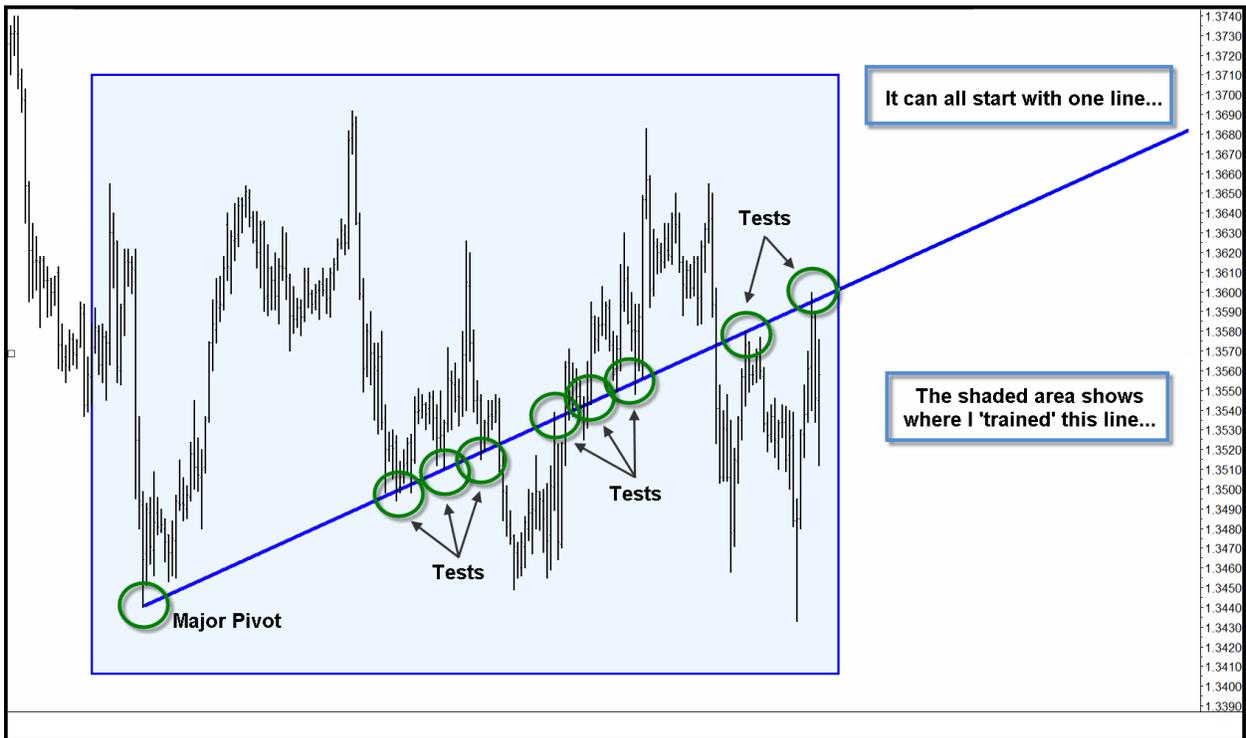
But Sir Isaac Newton's contributions to science should not be diminished; he developed the first practical reflecting telescope and his Three Laws of Motion dominated the scientific world until the early 20th century. His Third Law of Motion 'For every action there is an equal and opposite reaction', is particularly useful when applied to the trading markets. The Third Law of Motion may have had its founding in Newton's first and true love, alchemy, for he was truly one of the most important alchemists in his lifetime. His favorite alchemical manuscript was the Emerald tablet.

Hermes Thrice Greatest or Thoth, was reported to have lived around 1900 BC. The Emerald tablet is attributed to Hermes and Sir Isaac Newton's translation is perhaps the most popular alchemical work still studied today. Its essence is simple: 'As above, so below'.

Let's take a look at the chart. It can all start with one line:

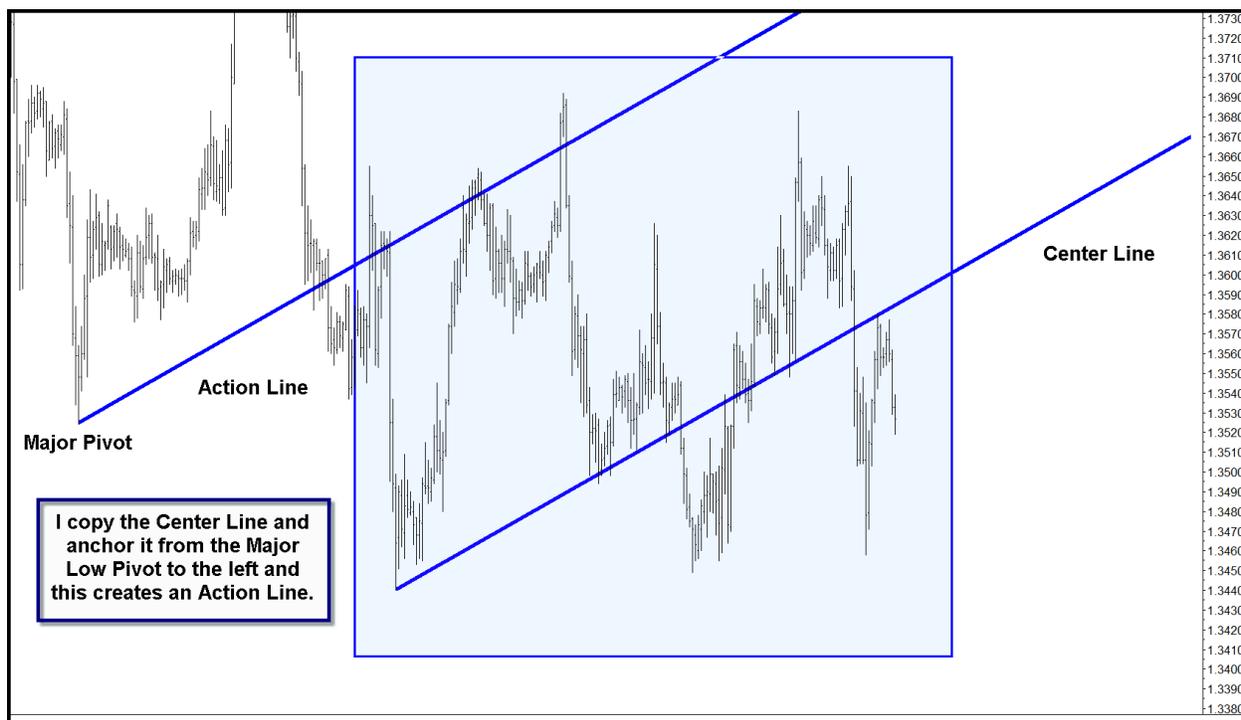


We are looking at a chart of the Euro FX futures on the Chicago Mercantile Exchange. The 60 minute bars on this chart appear in early March of 2010. I begin with a major low pivot on the left of the chart and draw a blue up sloping simple trendline that touches many smaller pivots. I call this simple trend line with many touches a multi-pivot line. Let's look at another chart and I'll show you the pivots I chose to draw this line.



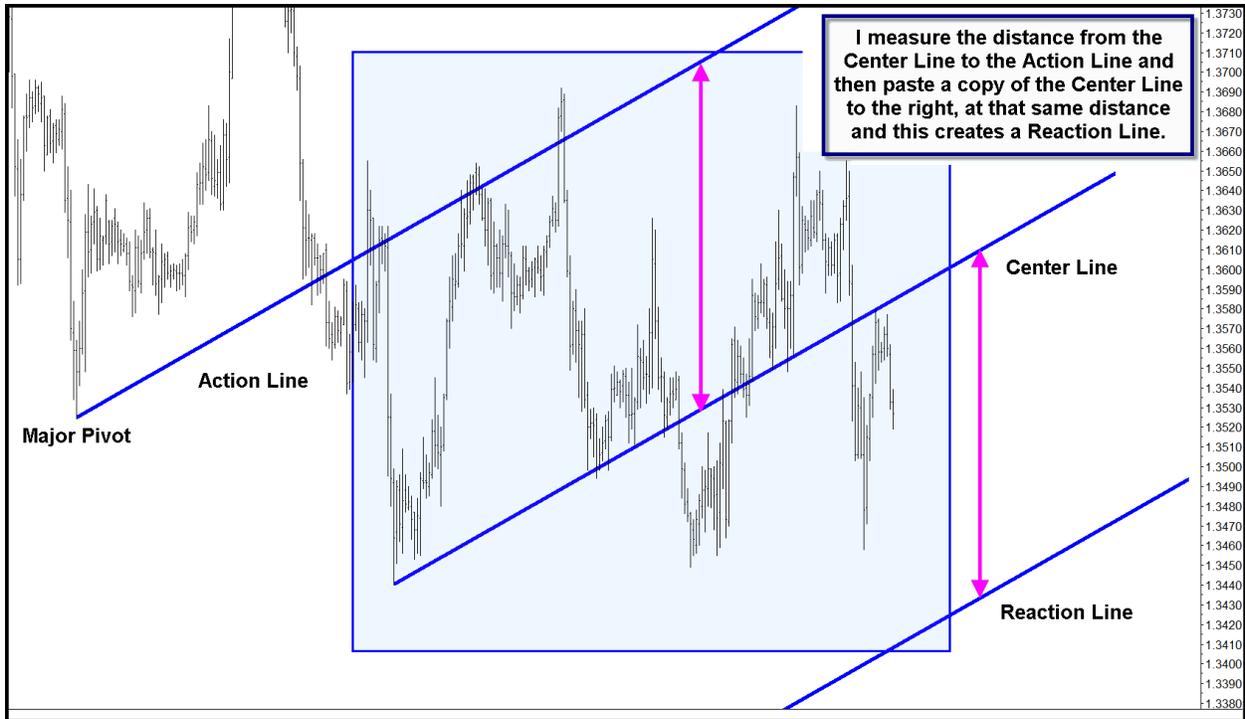
When working with charts and hand drawing lines in particular, it's important that you remember and mark where you trained or curve fit the particular line you are going to work with. Here you can see that I used many pivots and the up sloping blue simple trend line does a good job catching the highs and lows of price as it moves forward. Remember every bar within the blue box was used to train or draw the simple blue trendline.

What can I do with this simple blue trendline? Another name for this simple trendline that goes through so many pivots is a Center Line.



I look to the left and see a Major Swing Low. Starting at the Major Swing Low to the left, I copy the Center Line and project it forward. The original simple trend line is called the Center Line and the second line is called the Action Line. It carries the same slope or frequency as the Center Line. Note that the Center Line captures the frequency of Price and the pivot of the Action Line always precedes or comes before the Pivot that begins the Center Line.

Now I think back on the Emerald tablet: 'As above, so below'.



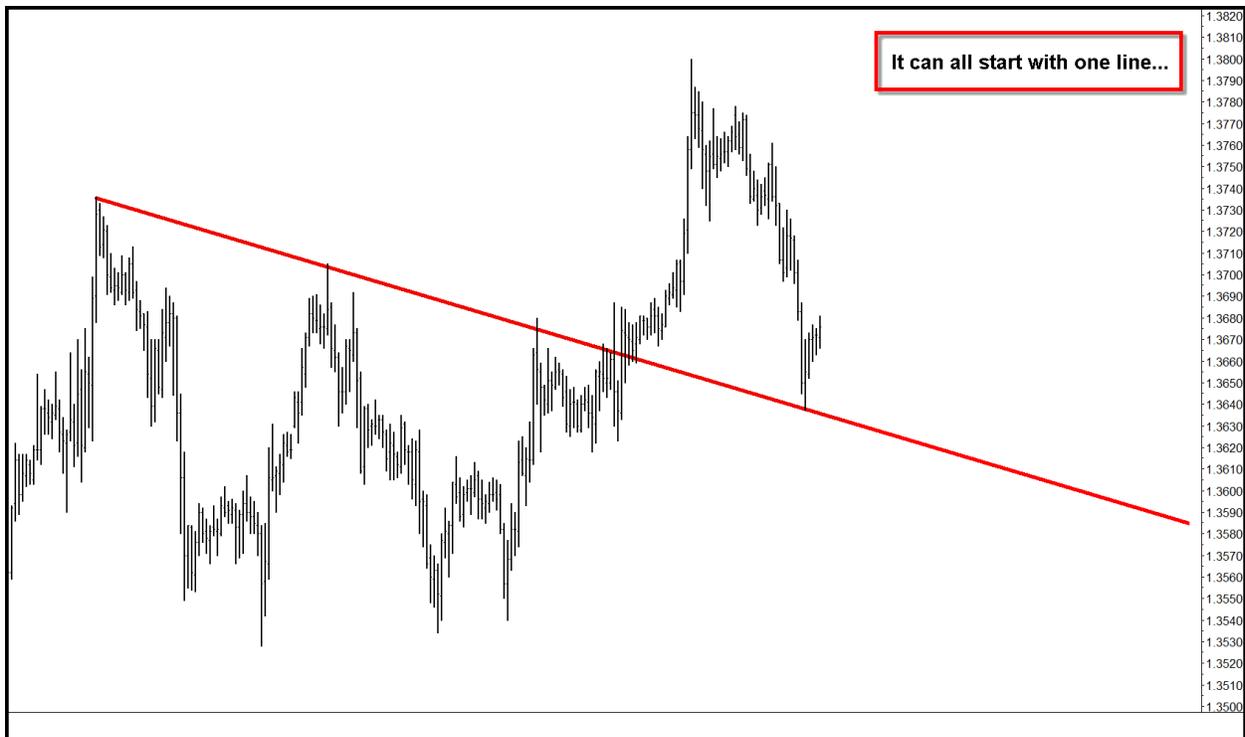
I have generated a Center Line that catches the frequency or probable path of Price and I copied the Center Line to a prior Major Pivot to generate an Action Line.

'As above, So below'.

Now I ponder: 'For every action, there is an equal and opposite reaction'.

I measured the distance from the Center Line to the Action Line and using the same distance, I create a line that has the same slope or frequency of the Center Line and add it below the Center Line. This is called the Reaction Line.

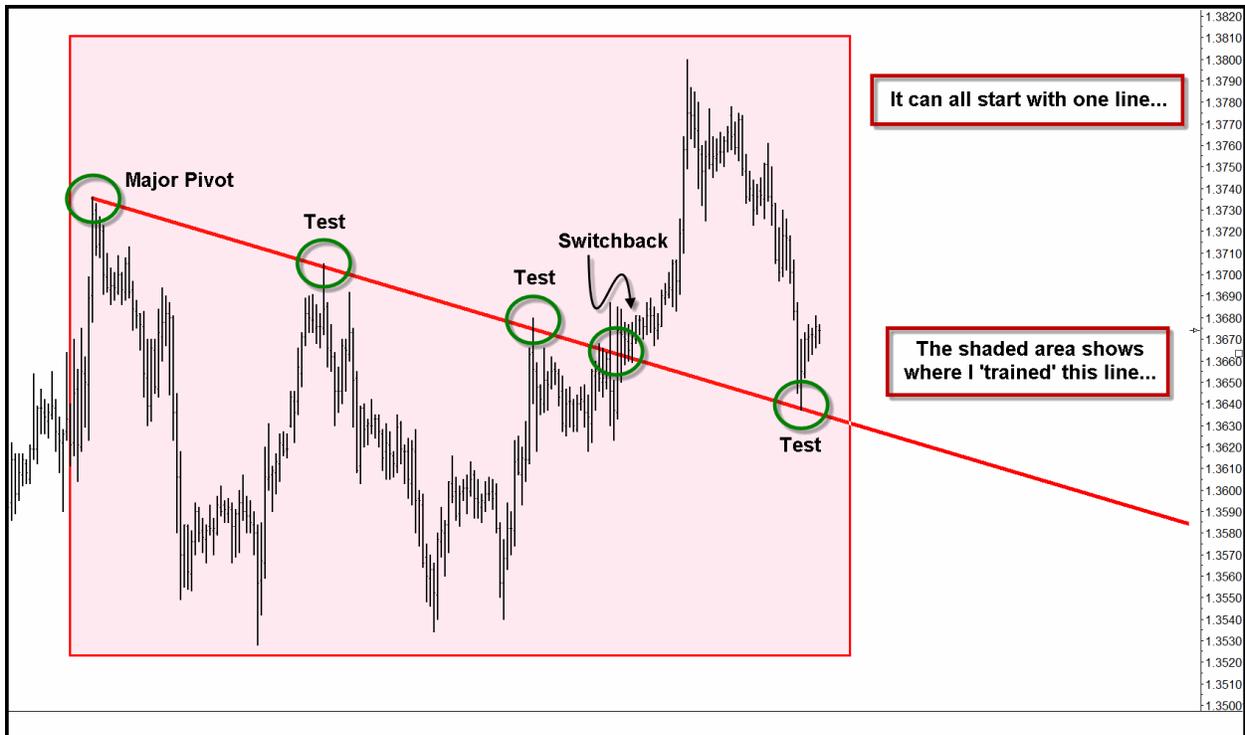
It can all start with one line. One thing passes into another.



Price has been in an uptrend but now consolidates, leaving three simple drives to the top. The three pivots, when connected, have a negative slope. But eventually, price begins its move higher again.

Using the pivot on the far left, I connect the three drives to the top and this gives me a red down sloping simple trendline. You can see that once price broke through this trendline to the upside, it switched back and retested this simple trendline from the upside and then began its climb higher; when it retraced, it tested the simple red trendline from above, and the trendline acted as support.

It can all start with one line.



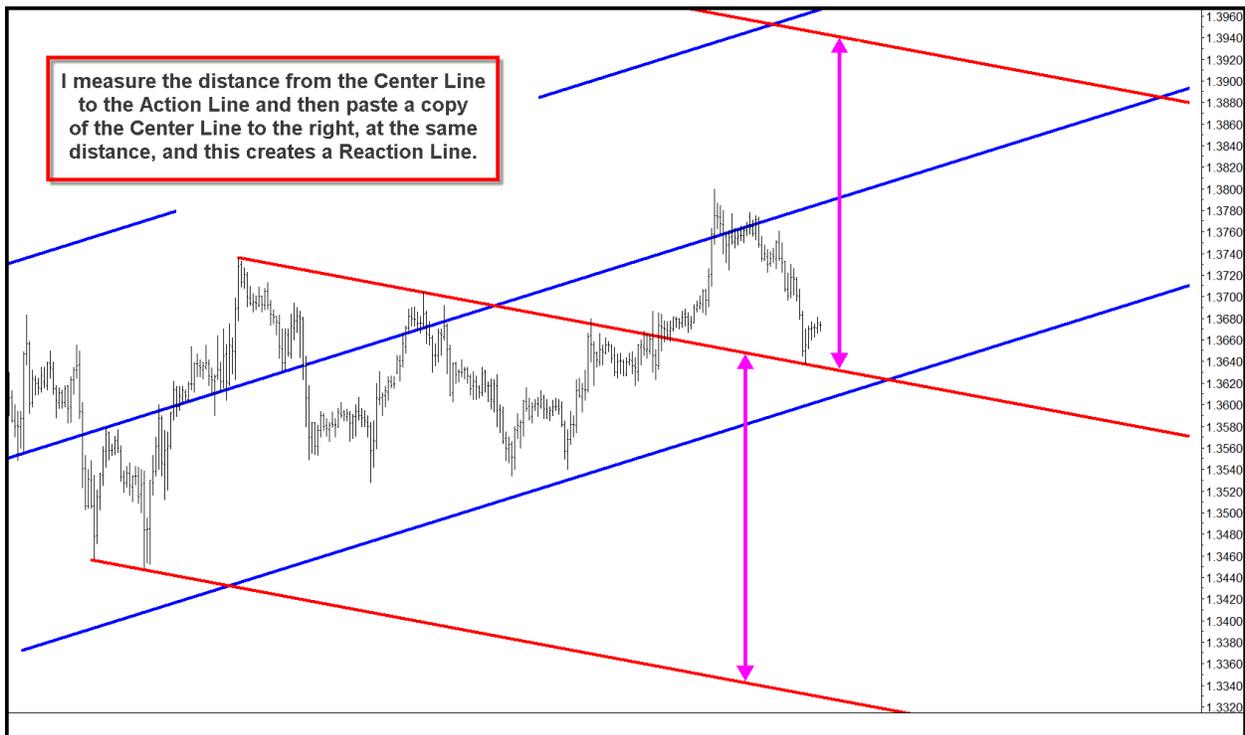
This is a down sloping Center Line. You can see the pivots and switchbacks marked with green circles that I used in defining this Center Line. I was taught Action and Reaction Lines and the theory behind them from Dr. Alan Andrews. In the mid-1920s, Dr. Andrews studied the work of Roger Babson who was a devout student of Sir Isaac Newton's Laws of Motion. Babson was particularly focused on Newton's Third Law of Motion, 'for every action there is an equal and opposite reaction'.

Though Babson had his own methods of technical analysis, Andrews and a group of graduate students at MIT literally tore Babson's work apart, piece by piece, and then developed the Action Reaction method. It all starts with one line. The one line is the Center Line, which projects the probable path of Price.

'As above, so below'.



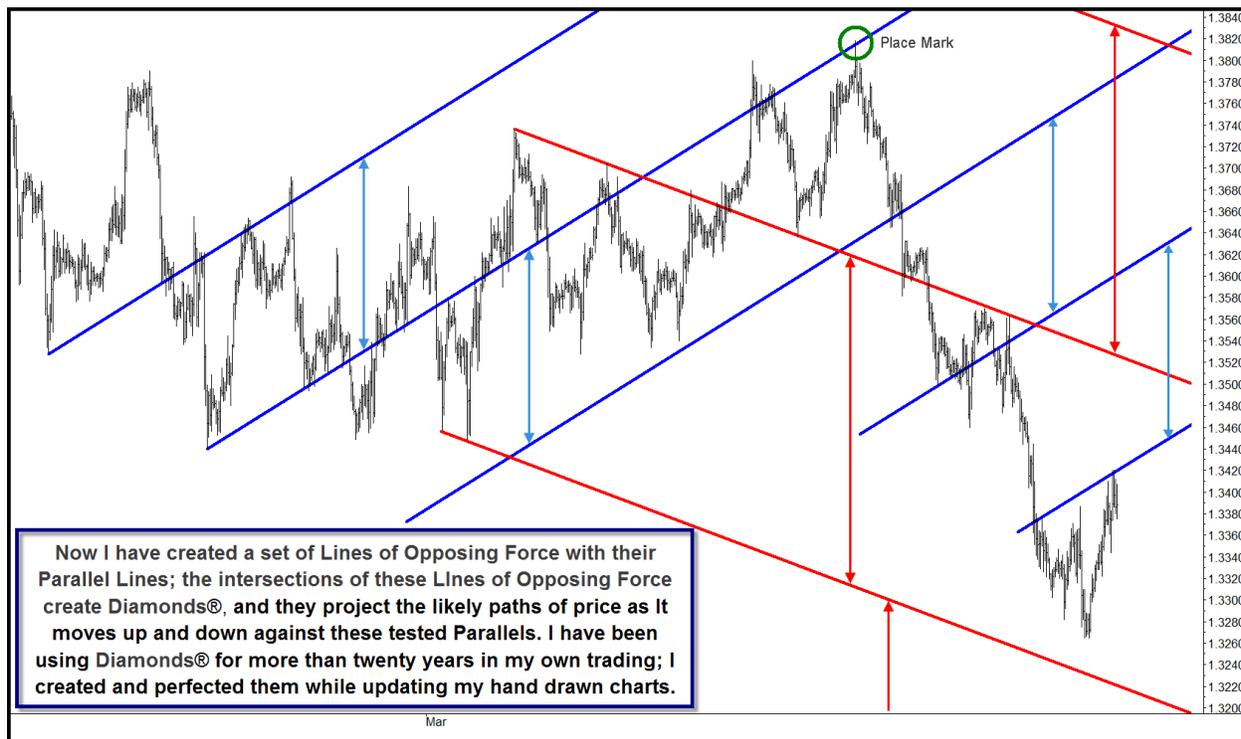
Once I find the Center Line, I simply transfer the slope, or frequency, down to the prior Major Swing Low to the left. The second line drawn always begins with a pivot before the pivot that anchors the Center Line and is called the Action Line. The distance between the Center Line and the Action Line when combined with the frequency of the Center Line is used to project a Reaction Line.



Once again, I simply measure the distance between the Center Line and the Action Line and then using the frequency or slope of the Center Line, I draw a line equidistant from the Center Line but this time above it.

You should take note that I have blue up sloping lines and red down sloping lines on the same chart. Because these lines have opposite slopes, they are lines of opposing force.

Let's take a closer look at these lines of opposing force.



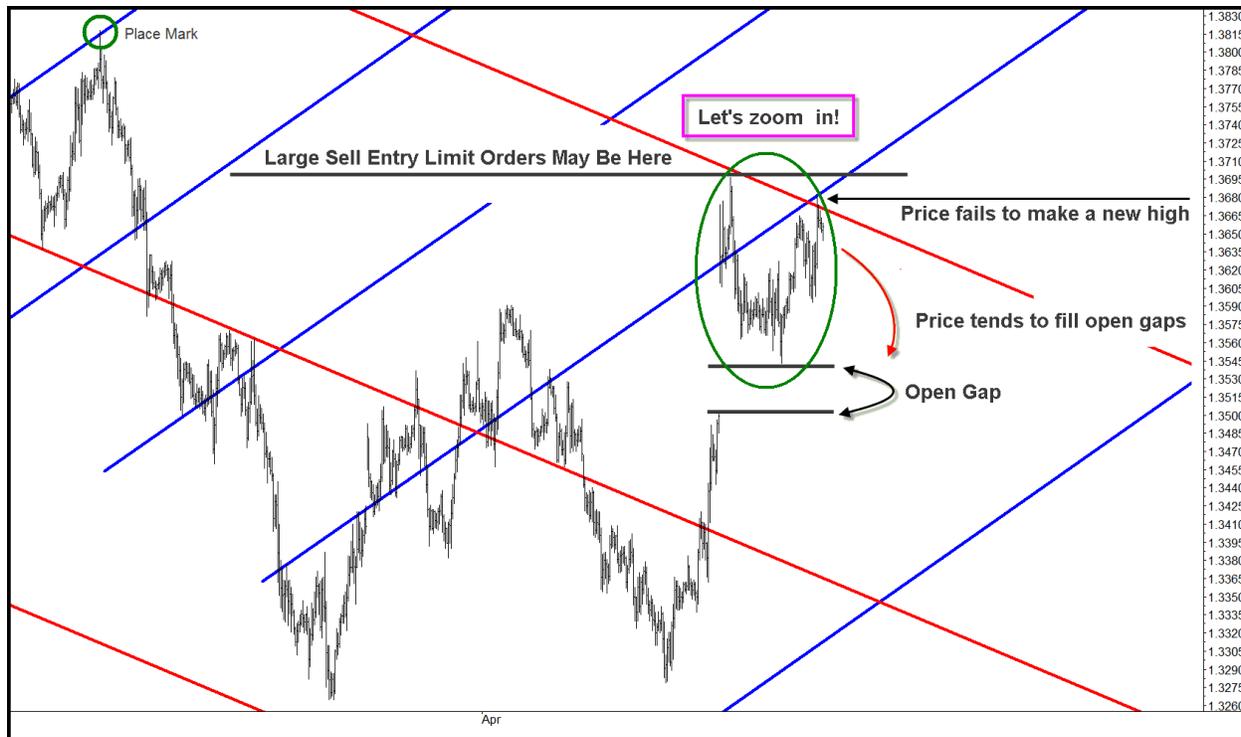
I have been a professional trader for nearly 40 years now. When I began trading, the personal computer not been invented, so software charting packages were not available. In the early 1970s, there were a handful of companies that published comprehensive chart books that came out every Friday afternoon. Most professional traders either subscribed to the services and had them delivered by mail on Saturday or picked them up at a bookstore late Friday afternoon.

Some traders kept their own charts by hand; I was taught to hand chart at a very early age by one of my older brothers that traded commodities. I continue to hand chart to this day. It's one of the routines that I use in my preparation each day.

More than 20 years ago, I began to notice that some of my more effective charts had both up sloping and down sloping lines and both sets of lines had important roles in defining the probable path of price. I did extensive research on these lines of opposing force and they quickly became one of my tools of choice. I named them Diamonds® because of the space formed when lines of opposing force are overlaid on the same chart. Though I have been using them successfully for more than 20 years, this is one of the first presentations of my proprietary work with Diamonds®; in fact, this is also one of my first public presentations of Action Reaction Lines and the theory behind them.

When using Diamonds®, you can project support and resistance from two different sets of lines, lines of opposing force, well into the future. These two sets of lines were defined in early March and by simply measuring the distance from the Center Line to the Action Line and projecting it forward above and below the Center Line numerous times, Diamonds® were formed that project far into the future.

If you look carefully at the top of the chart, you'll see that I marked a pivot that touches the up sloping blue Center Line with a circle. This will help us keep track of where price and time is as we move on to the next chart.



Now orient yourself by finding the place mark on the top left corner of the chart; This place mark coincides With the place mark on the prior chart.

You can see that price sold off hard and looking closely at the large swing down, you should be able to tell that price found support and resistance T both Lines of Opposing Force and their projections. In essence, using Diamonds® adds a fourth dimension to traditional three-dimensional charting. Diamonds® will give you a very accurate probable path of Price if your Center Lines reflect frequencies of price; once you've set up your Diamonds®, look for repeatable entry setups that you know have likely profitable outcomes.

Action Reaction Lines and Diamonds® require the use of strict money management. When you add the second layer of Action Reaction Lines, you will find many more interactions of Price with tested lines. At times, you will be buying against down sloping lines and selling against up sloping lines--something I rarely do when using Median Lines. It is imperative that you master these tools before using them with real money in your trading account--and more important, you must use surgeon-like money management skills to limit your risk. I was taught many of my money management skills by Bruce Kovner, while I was a money manager and mentor at

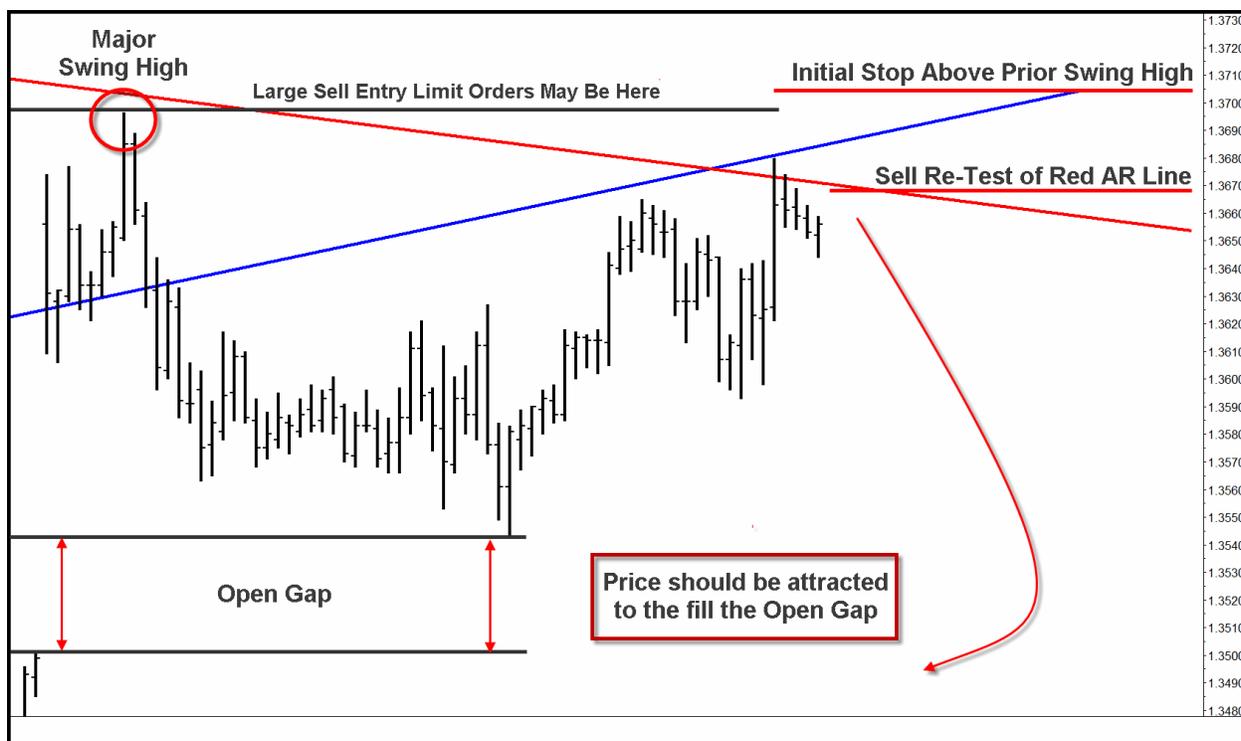
Commodities Corporation--and I urge those that would try to master these tools to work hard on their self discipline and money management skills.

Once the long wave lower is finished, Price corrects and begins to move higher but then it heads lower again; note that it does not make a lower low. Price then begins a vertical move higher and gaps significantly higher one weekend when the markets are closed. Price tries to trade lower but is unable to fill the gap. Once it fails to fill the gap and turns higher, I start to pay particular attention, because an open gap is an unusual event on a long-term chart. Price generally comes back to fill gaps.

The last Major Swing High tested the red down sloping Reaction Line and then traded lower. Price is now testing the intersection or confluence of a red down sloping Reaction Line and a blue up sloping Reaction Line. I call these areas where Lines of Opposing Force meet Energy Points, and find that when price interacts with these Energy Points, either a change in trend occurs or an acceleration of the ongoing trend occurs.

Price stopped at the Energy Point and then turned lower; note that Price failed to break above the prior Major Swing High. Just as the unfilled gap caught my attention, the inability of price to climb above the prior Major Swing High alerts me that there are probably significantly large limit sell entry orders, meaning large traders are looking to enter short positions in this market and have left their orders at or near the last Major Swing High.

As a place marker, note that I've drawn an ellipse. Let's zoom in on this area and take a closer look.



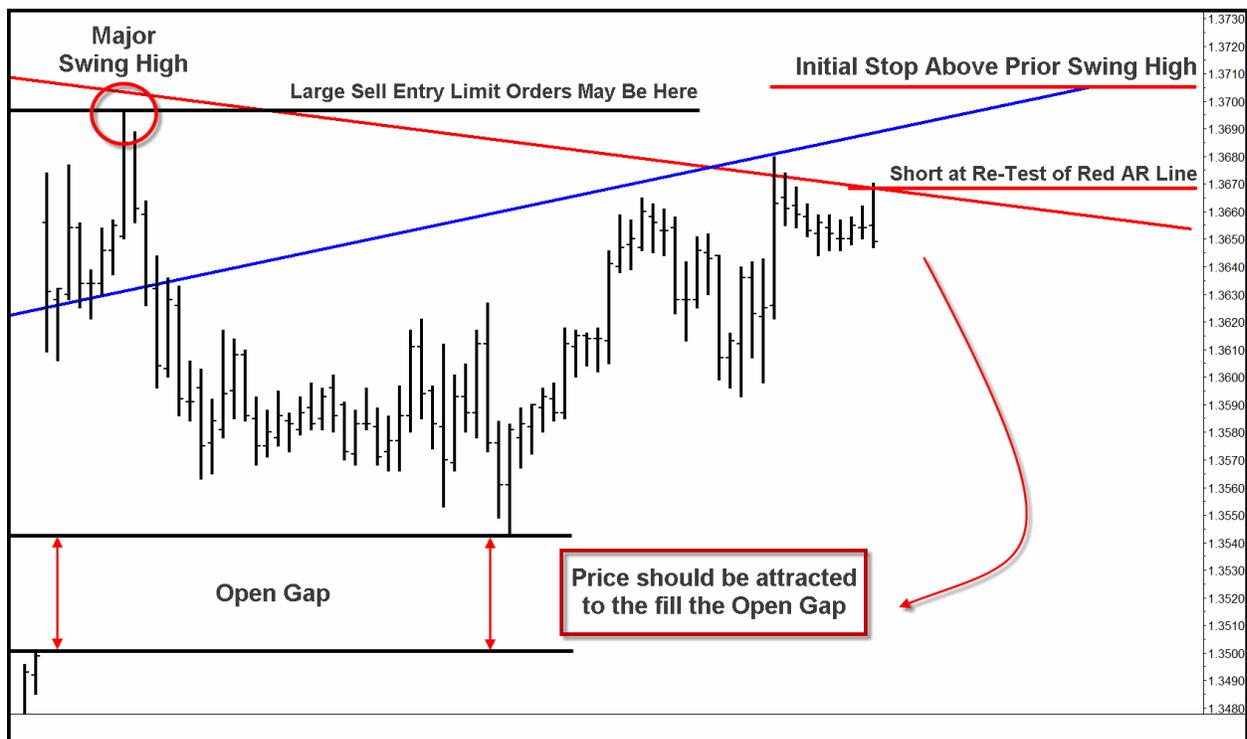
I have zoomed in on this chart to make easier to analyze the significant areas as well as show what entry set up pattern I have spotted. I have also marked in my limit sell entry order as well

as my initial stop loss order; both will be entered on my electronic platform at the same time. Never trade without 'hard' stops; stops protect your capital from ruin.

Once again, looking at the chart, price retested the red down sloping Reaction Line. The Reaction Line acted as solid resistance and note that price was unable to break above the prior Swing High. Large traders are aware that markets tend to fill gaps and are looking for a relatively high probability area to enter new short positions. On the test and retest of the red Reaction Line, I note that both tests were made with large range bars that closed with good separation below the Reaction Line; this is another clue that there may be a good amount of sell orders above the market.

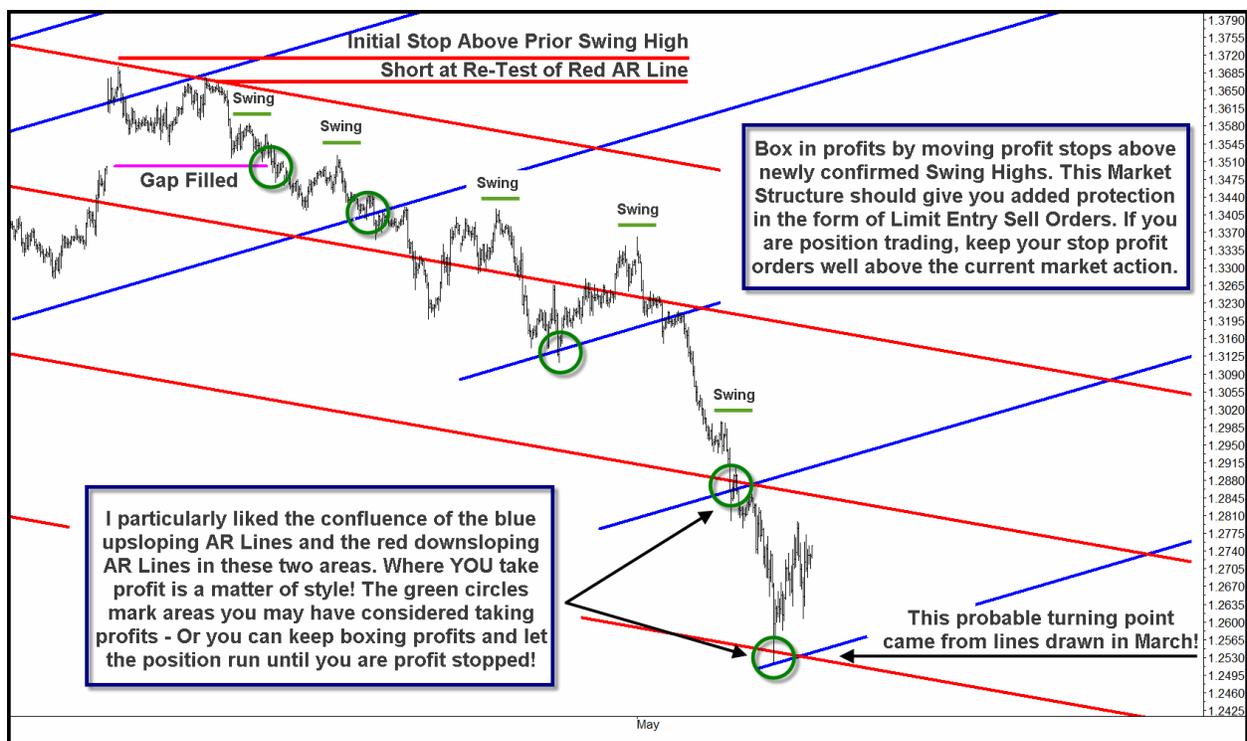
Four bars after the retest of the red Reaction Line, I put my orders in the market. I'm risking 40 ticks and even if price only makes it to the retest the top of the open gap, I should make 125 to 140 ticks of profit, giving me a potential risk reward of better than 3 to 1.

Now that the orders are in the market, let's see what price does.



Four or five bars later, price rallies and retests the red down sloping Reaction Line; my limit sell order is filled, so I'm short this market. I immediately check to make sure that my initial stop loss order is in the market and being worked on the exchange server.

Let's see how this trade plays out.



You can see that once I was short this market, my initial stop loss order was never threatened; in fact, price never re-tested the red down sloping Reaction Line again.

Now it's a matter of style and money management: I marked five areas with circles that were potential profit targets. You could have taken profits as early as the area where price filled the gap, or you could have taken profits when price tested either the first or second up sloping blue Reaction Line. Or you could have chosen to take profits at either of the two energy points where down sloping and up sloping Reaction Lines [Opposing Lines of Force] met.

I also marked the new swing highs that were left as price continued to ratchet lower. If you are position trading, you can simply work lower and lower stop profit orders as price leaves new swing highs at lower and lower levels until you eventually get stopped out. If you followed this method strictly, you'd probably still be short the Euro FX futures, with a stop profit order above the prior Swing High. This is called boxing in profits and is generally how I position trade, although I usually do have a logical profit target in mind - some significant level - in this case around the area of confluence or Energy Point just below 126 in the Euro FX futures [There are some Major Lows in the 1.25 to 1.27 area from March and April of 2009].

Whether you are a Physicist, an Alchemist, a Greek or Egyptian God or just simply a trader, it can all start with one simple line.

I wish you good trading!

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