Robert Krausz's Fibonacci Trader© Journal

Volume 1, Issue 5

The Balance Step™ and More FT Tools for the Tradable Trend

Dear Trader,

We wish you a happy 1999 and great trading. The year promises to be volatile in all markets. Uncertainty is the order of the day. It is more important than ever not only to be vigilant but to remember certain basic truths.

Of course, I am referring to trading and investments. The days when stocks could be classified as investments and commodities as speculation are over. We are all speculators now. Traders like us thrive in this kind of atmosphere, provided that we do not get caught up in the euphoria of 87% profit in an investment of 5 hours with internet stocks.

These kind of circumstances force me to gently lead you to some basic truths, that appear to be negated by current market action. But trees do not grow to the sky and the trend is still your only friend.

So instead of focusing on intraday bells and whistles, this issue will focus on the single most important element in any type of trading. We tend to jump off at various angles and yet if you can sum up technical analysis on one word, it would be Trend. In fact, the real words should be "tradable trend."

I do not care what time frame you are trading, I have found the simplest measure of the trend is still the Balance Point Steps – of the Next Time Period.

So if you are trading a Daily/Weekly/Monthly plan the Weekly sets up the tradable trend. For a T-bond plan that uses the 10 minute/50 minute/Daily time frames, the 50 minute will provide the tradable trend for your 10 minute intraday plan.

The calculation for the Balance Point Steps is quite simple. Add the last 5 periods (*Next*) closing prices and divide by 5. Then, project the result one period forward, as a horizontal line. At first sight this may appear as a standard moving average of the *Next* time period, but it is not.

Multiple Time Frames

Read below what Perry Kaufman has to say about multiple time frames on page 470 in his latest book “Trading Systems and Methods – Third Edition, published by John Wiley & Sons.

If you are serious about technical analysis this book belongs on your bookshelf. It is a first class reference book in great depth (700 pages). It covers virtually all aspects of trading at a very technical level. The next few charts will visually clarify the entire concept.

Once the tradable trend is established via the *Next* time frame, any other tool can used to set up a trading plan which can be trend following or contra trend trading but the frame of reference must be established first.

Let’s begin with the S&P 500 Daily/Weekly/Monthly (Chart1). This chart shows the concept at its simplest level. The weekly Balance Step is plotted on the daily bars in a step formation. There have been major complaints about the volatility of the S&P. But look carefully at points X and Y, you see that the tradable trend was down. From Y to today’s date (January 18) the trend is up.

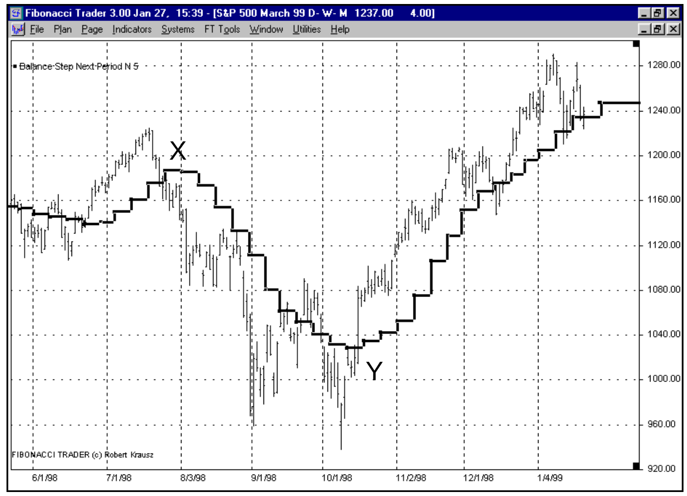


Chart 1: S&P 500 Daily/Weekly/Monthly. From point X to Y the tradable trend was down based on the Next Balance step. If the Next Balance steps are up then the tradable trend is up.

As long as steps are down the trend is down, specifically if the price bars of the daily are below the steps. Yes, during the week of 9/1/98 the daily prices went above the Weekly steps, but did the steps turn up? No, therefore the trend is still down until Point Y when the trend turned up. Note when the the steps turned up for the first time at Y, it has a "bucket formation," indication of a potential uptrend

> “In thinking out the use of multiple time frames it is necessary to understand that you cannot substitute a 10-period moving average of 1-hour bars with a 40-period moving average of 15-minute bars. Similarly, you cannot substitute a 10-week moving average with a 50-day moving average. It seems natural to think that any two trends covering the same time span will give the same results, but that is not the case. Although we can average many data points, we cannot get rid of all the noise; fewer data points over the same time span will always yield a smother result. Therefore, the use of hourly, daily, and weekly time periods – multiple time frames – gives a much different picture of the market than simply using three different moving averages based on the same data. It is much easier to see the major trend using weekly data, find the short-term direction on daily data, and time your entry using hourly bars.”– *Perry Kaufman, Trading Systems and Methods – Third Edition,*

starting. Please look at point X, the steps went level and the prices went below the steps. The following week the steps turned down, forming a sort of "upside down bucket." The down trend was intact for some 10 weeks.

Moving on to Chart 2, which is the same as Figure 1, but we have added a tool, in this case the Weekly Directional Volatility (DV) set at 1.618. Notice how the retracements at both points Z are stopped by the weekly Directional Volatility line we have added. On 7/31/98 the daily prices penetrated below the DV causing it to flip. The daily prices were already below the Weekly Balance Point. At point R prices went above the weekly DV on 10/30/98, they were already above the weekly Balance Steps and the steps were showing an uptrend.

Next is Chart 3. Here we add the Daily Gann Swings. See where the Peaks and Valleys touches the Weekly Directional Volatility Line. Whenever the Gann Swing is in a downtrend (dashed lines) and prices are below the weekly down trending Balance Steps, with the weekly Directional Volatility Line above both, short positions

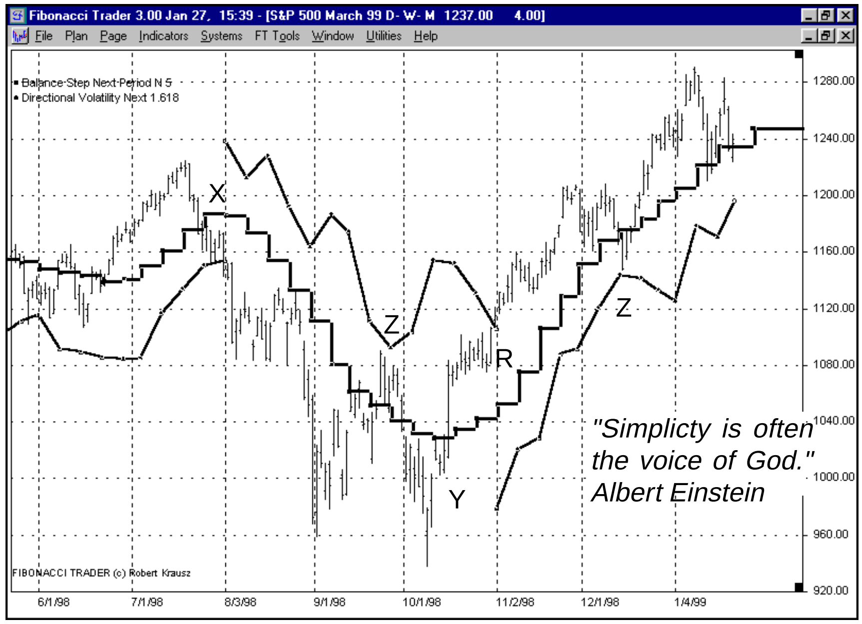


Chart 2: S&P 500 Daily/Weekly/Monthly. The Weekly Directional Volatility set at 1.618 has been added.

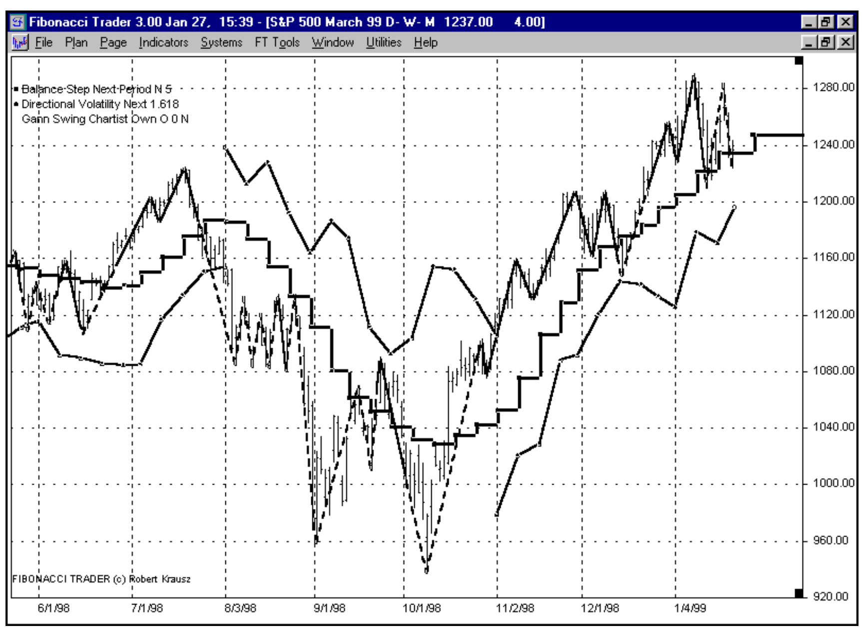


Chart 3: S&P 500 Daily/Weekly/Monthly. At this point we add the Daily Gann Swings. Notice that the peaks and valleys touch the Weekly directional Volatility Lines. Once the tradable trend is clearly defined, a refrence point is established helping the trader to act in that direction, using the tools and the time frame that suits their temperment.

should be considered.

When the steps turn up at Y and the Directional Volatility line supports the upmove, look at acting from the long side when the Gann Swing is long (solid line).

In Chart 4, we have now added the Daily Dynamic Trio. This can help to formulate a trading plan. It shows clearly what can happen if you trade with the trend or against the trend. For example, you buy at R and stay with it until P, when prices closed below the Daily Dynamic Trio. Now, if you shorted at this point, then it would be a counter-trend trade. But, buying at T would be a trade with the trend.

Chart 5 includes the Weekly Dynamic Trio. It flips to the down side at point X. An upside flip is achieved at point R. This is the way to add various indicators to back up the tradable trend direction.

Jumping ahead to Chart 6 is a Daily/Weekly/Monthly plan of Coca Cola, a nice swinging chart. I like to trade it because there is good daily volume making it easy to buy and sell. The idea is the same as the S&P 500 Daily Plan (Chart 1). Check out some

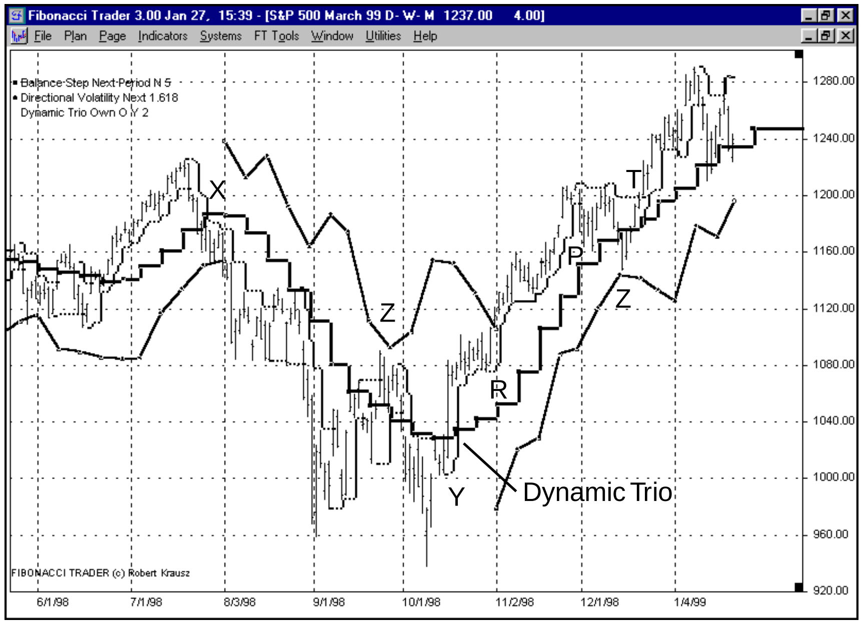


Chart 4: S&P 500 Daily/Weekly/Monthly. Now we have added the Daily Dynamic Trio. Now you can trade with the trend, in the direction of the Balance Steps or contra trend, against the direction of the Balance steps.

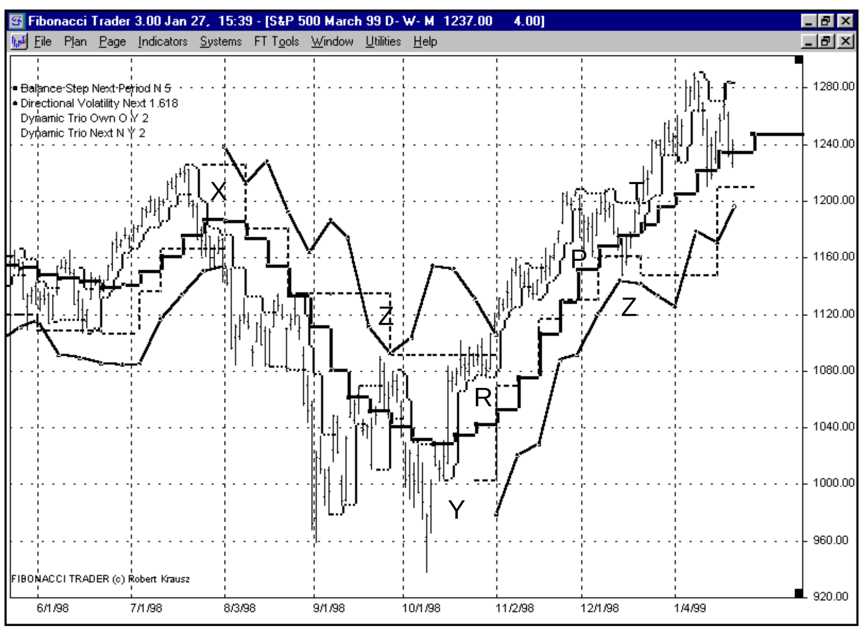


Chart 5: S&P 500 Daily/Weekly/Monthly. This chart has the weekly Dynamic Trio. Now you can trade with the trend, in the direction of the Balance Steps or contra trend, against the direction of the Balance steps.

stocks using these concepts, could be useful.

Chart 7 shows all of the trading for 1998 for Coca Cola with both the weekly and monthly Balance steps. This is an important chart if you have any interest in longer term trading. Note the effect at YY when the monthly Balance Steps turn up. At XX the monthly turns down. Although the weekly Balance Steps run up to meet the Monthly at point C1, the monthly trend is still down. So when the weekly turns down at X1 one could look for selling opportunities. Note the effect when the weekly crosses the monthly.

Chart 8 is the March 1999 T-bond futures 10 minute/50 minute/Daily plan. An interesting intraday chart that uses the Next and the Highest Balance Steps. You can see that the daily steps are down, number 1 through 7. This chart with the various tools demonstrate the usefulness of knowing the direction of the tradable trend, in this case the Balance Steps of the 50 minute time frame. Note how these steps turn down at point X and stay down until the point

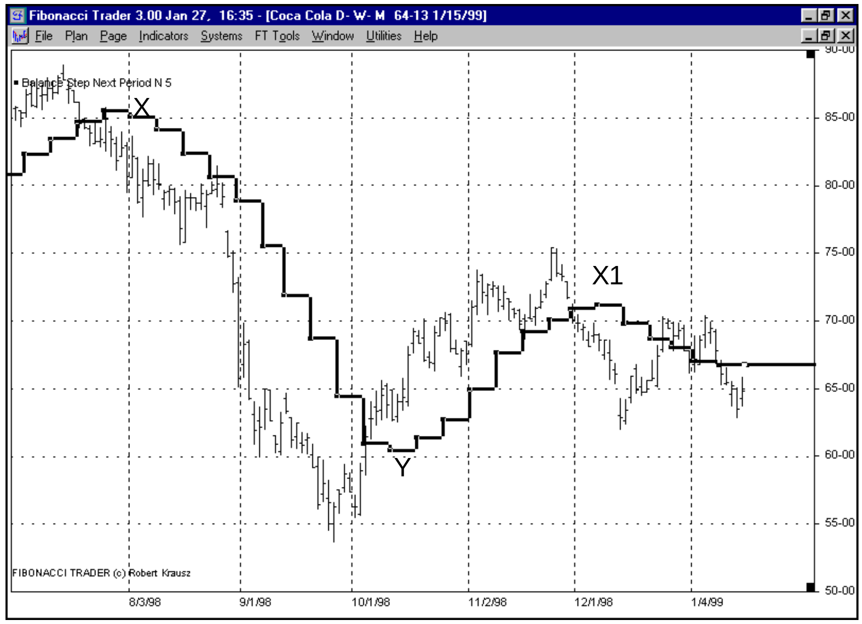


Chart 6: Coca Cola Daily/Weekly/Monthly. The same concepts apply. The trend is down when the Next Balance steps are falling and the trend is up if the Next Balance Steps are rising.

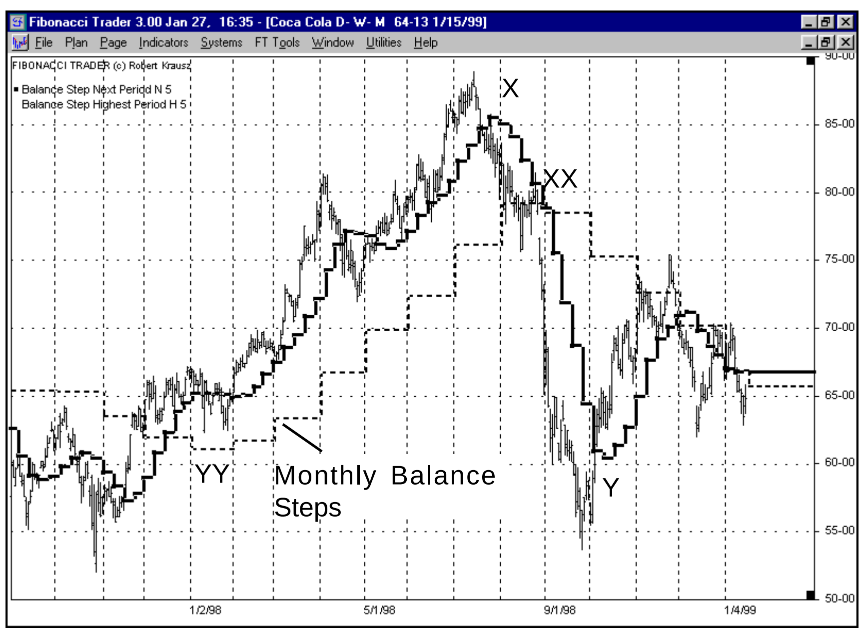


Chart 7: Coca Cola Daily/Weekly/Monthly. The Highest Balance steps are plotted along with the Next Balance Steps.

marked Y1. There is no 10 minute close above the 50 minute Balance Steps until point Y1. So the steps are down and prices are below the them, and that looks familiar. During this move obviously shorts were the way to go.

At points E, F and G the market drifted outside (below) the Daily Dynamic Fibonacci Channel (DFC) until the 50 minute channel Dynamic Fibonacci Channel pushed prices back inside the Daily Dynamic Fibonacci Channel. But only at point G did prices rise above the median line of the 50 minute Dynamic Channel and go above the 50 minute Balance steps which turned during day 4. Also note how the 10 minutes HiLo supports the move down from point K and did not flip until the start of day 4, just above point G.

When the market rose from point G to point H and penetrated the top of the Daily dynamic Fibonacci Channel in daily terms this was only a retracement against the daily trend, which was still down. Therefore, taking a short after prices reversed back down into the Daily Dynamic Fibonacci Channel was a trade with the Daily trend, especially the way the HiLo Activator supported this down move. But on the 50 minute basis this was a contra trend trade. Do you see my point?

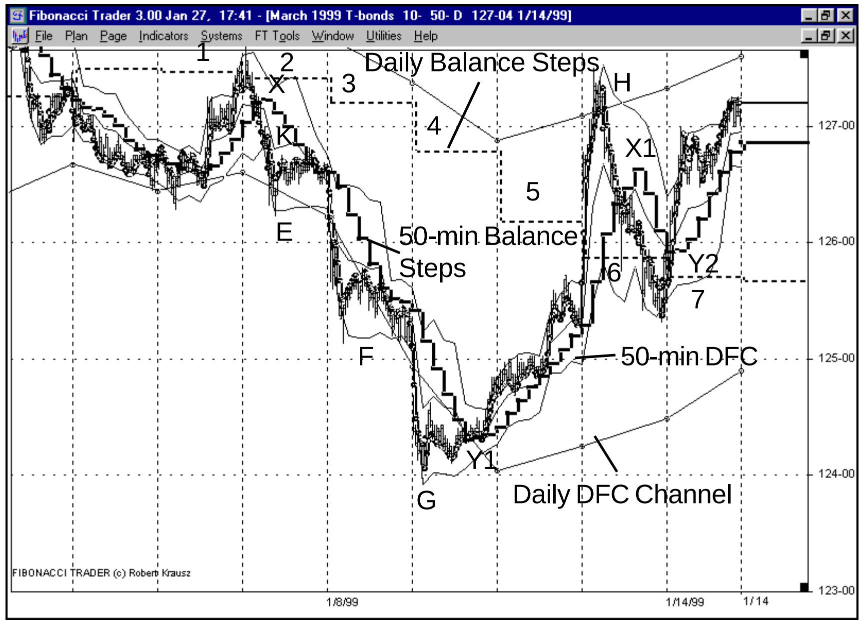


Chart 8: March T-bonds 10-min/50-min/Daily Plan. The Highest (Daily) Balance steps are plotted along with the Next Balance Steps.

After day 7 or 1/14 the daily steps turned level, which showed that the Daily downward momentum was really slowing down and the market could be entering a congestion phase or that it may in fact be the trend is turning up. The 50 minute Balance steps had already turned up at point Y2. Of course, the 50 minute trend will change before the Daily. Let's see what happened in the next chart.

Chart 9 is the March 1999 T-bond Futures contract 10 minute/ 50 minute/ Daily plan. On days 7 and 8 the daily steps are level and the market entered into congestion. Nevertheless, note that on day 9 the Daily steps turned up, forming a bucket. You knew this on the close of day 9 because the Daily Steps are projected one day forward. From that day until the day I wrote this (1/23/99) the daily Steps were rising, thus informing you that inspite of the congestion of the 50 minute steps, the Daily pressure was up. So it was not a total surprise that on Day 12 prices hit the upper band of the Daily Dynamic Fibonacci Channel.

Anything else of importance? Yes, three things:

1) After the daily bucket formed on the close of day 9, the base of the bucket, i.e., the level daily steps 7 and 8 became the support when prices dropped as the base of the bucket held on day 10.

Chart 9: March T-bonds 10-min/50-min/Daily Plan. The Highest (Daily) Balance steps are plotted along with the Next Balance Steps.

2) Note how at the end of day 9 the top and bottom bands of the daily Fibonacci Channel started coming closer together (narrowing), a sign of congestion. But the bottom line of the channel was rising at a steeper angle then the top band was coming down, thus hinting at the eventual direction.

3) Check out the HiLo Activator set at length of 13 periods for the 10 minute (own) bars (normally the HiLo Activator is set to a length of three). Note how smoothly it follows the 10 minute bars, especially if combined with the direction of the 50 minute Balance steps.

I hope that you grasp what I'm showing you in these few pages. Without the direction of the Balance steps trading becomes very tricky, especially if you are trading very short-term time frames. In that case you may need not only the Next time periods Balance Steps but also the Highest. Such as we looked at the 10/50/Daily set up on the T-bonds. If nothing else, this should help you set up a frame of reference – that is imperative to trading.

If you are considering buying, wait for the appropriate Steps to turn up for the time frame that you have back tested. This kind of patience and discipline is crucial. Actually the three elements required are Method (your trading plan), Discipline, and Work for Profit not for Action. Of course, there is more to trading than that, but nevertheless without these, success is hard to come by.

The next chart, number 10, is due to some questions concerning my article on Gann Swing Channels from

Fibonacci Trader™ *News:* Our Italian Website is functional and we welcome the Italian traders. I find it interesting that our first foreign language Website should be Italian, considering that Fibonacci was an Italian mathematical genius. More international websites are coming.

We have cone to an agreement with Bill Blau to program his most important indicators into the Fibonacci Trader – in multiple time frames. His original work is featured in his book "Momentum, Direction and Divergence," published by Wiley (from the Traders Advantage Series). Bill Blau is an old friend, whose work I respect and it will be a very useful addition to our program. I have persuaded him to write some trading ideas for Fibonacci Trader Journal readers. Stay tuned, the free upgrade will be available from the Fibonacci trader website this spring.

I note with interest that my name is being used in some advertisements by KCI Seminars without my written permission. The statements in their advertisements is just plain silly and rather sad.

Finally, we are moving our office to St Augustine, Florida. The new mailing address is:
Fibonacci trader Corporation, 1835 US1 South 19, Suite 352, St. Augustine, FL 32086. The telephone, fax and E-mail stays the same. This information will be posted at the Fibonacci Trader website.— *RK*

the January 1999 issue of Technical Analysis of Stocks & Commodities magazine. What is the current situation? Let's take a look.

Channel 1 is history. Channel 2 is formed by peaks X and Z and valley Y. As you can see, when Y and Z are projected they hold the low at point A and the peak that follows Z.

A-B-C allows us to plot channel 3 and the trend changes to up when the peak B is taken out.

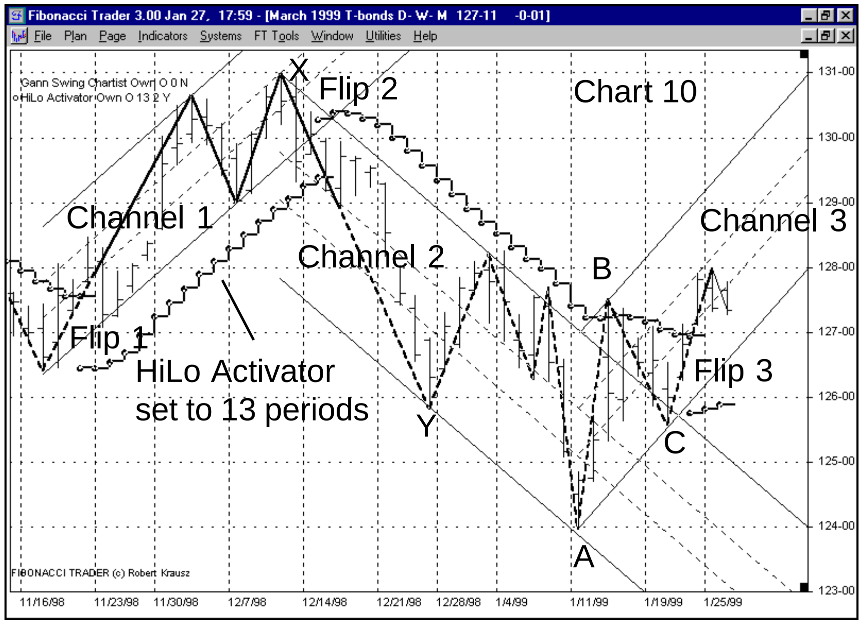
Of course A and C are rising valleys which usually commences some kind of an up move. I am always on the alert for these set ups.

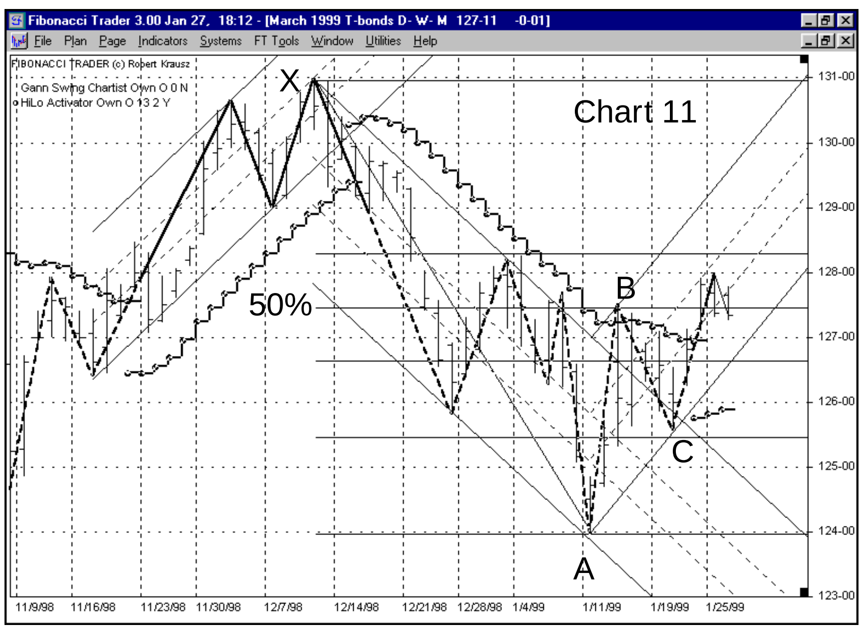
Now checkout Chart 11. The peak at B is a 50% retracement of the move from point X to point A. The valley that sets up at C is a resting on the .786 line of the entire move from X to A.

Such is the magic of Fibonacci. In chart 10, I introduced you once again to the 13 period HiLo Activator (same as we had on the 10/50/ Daily Chart 9) Please note what happens on the "flip." Thirteen is the fifth harmonic in the Fibonacci number series. A useful tool, check it out.

Wishing you super trading,

Robert Krausz, MH, BCHE





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