Robert Krausz's Fibonacci Trader© Journal

Volume 1, Issue 10

Multiple Time Frames Encapsulation™

Dear Trader,

This issue is entirely dedicated to a nice feature in the Fibonacci Trader program, a technique that I use regularly. A detailed approach as shown here could be helpful in your analysis, both intraday or daily as the concept is similar. The bar-by-bar analysis is a careful examination of the market action which will give you superior information. It's more work but it's worth the effort.

Last month we announced the new venture Wizard On Wall Street®, and it is proceeding very well. We want to thank all of you who replied so promptly to reserve your place for the "Multiple Time Frame Structure™" study course (the no obligation reservation on your part). Be assured that owners of the Fibonacci Trader program will be given preference, especially those of you who have submitted the "No Obligation Reservation" form included with the FTJ issue #9. If you have any questions you may phone Thom Hartle (425 481-2582). By the way, so far this year in the T-bond market, the Fibonacci Trader Expansions Plan™ is currently (as of July 18) showing a profit of well over 120% with a maximum drawdown of some 5% (after commissions and slippage).

To describe the details of this course we have sent to you in a separate E-mail, as an attachment, our Wizard On Wall Street® brochure. Anyone using snail mail will receive it via regular post. And we'll still keep publishing th Journal. In fact, in response to your requests, the next issue of the Fibonacci Trader Journal will focus on stocks and shares as we have many users who focus on those markets.

Finally, I want to say hello to members of TAOTN (Technical Analysis on the NET) that we met in Raleigh, NC in July. Thom Hartle and I enjoyed the workshops, and we hope that the information we shared will be useful.

I wish you super trading,

Robert Krausz MH, BCHE

P.S. We will be out in force at TAG XXI in Las Vegas, November 19-22, so be sure and bookmark that date. Visit our Web site for more information.

ENCAPSULATION

One special feature for traders using the Fibonacci Trader program is Encapsulation. In fact, I have been awarded a patent from the United States Patent Office for this exclusive way of viewing the market. As always, this technique is based on my Multiple Time Frame Analysis approach to the technical analysis.

Encapsulation is especially valuable because it visually gives the trader a clear picture of how the rhythm of the *Own* time frame (the time frame we are trading) is interacting with the *Next* time frame. Recall that one tenet of using multiple time frame analysis is we look to the *Next* time frame for the direction of the trend and support/resistance levels for the *Own* time frame.

In past issues of the Fibonacci Trader Journals we have primarily focused on our exclusive indicators and techniques that identify the trend and potential points where the trend can change because trader are interested in this type of approach. Traders look to indicators to smooth the price data, in hopes of removing the noise, leaving behind the trend. Traders using the Fibonacci Trader program have our favorites, including the Ergodic, the Balance Step and the Triple Switch for spotting the trend.

Encapsulation and its application, on the other hand, is really a return to classical chart analysis. That is, we'll be looking at nothing more than the prices on the charts for the trend and support/resistance levels, but based on the *Next* time frame You'll see how the uptrends are simply higher highs with higher lows, and downtrends are lower lows and lower highs. The support and resistance levels will be based on the previous week's high or low, or the week's high or low two weeks ago. You'll see why shortly. Again, the pertinent information is based on the *Next* time frame. Plus, we'll look at drawing simple trend lines on the *Next* time frame for the *Own* time frame as an early warning the trend may be changing.

The steps to applying Encapsulation are as follows. First, double click with your left mouse button on the plan to bring up the general menu (Figure 1), then select "Chart" at the bottom of the popup menu, and then select "Open Options." Click on the "Next Bar" tab and click on the "Show Next Period Bar." Figure 2 is Figure 1, the June 1999 T-bond futures contract (the *Own* time frame), Encapsulated. Now we see the *Next* time frame, the weekly bars presented with the daily bars. Let's see how we can use this.

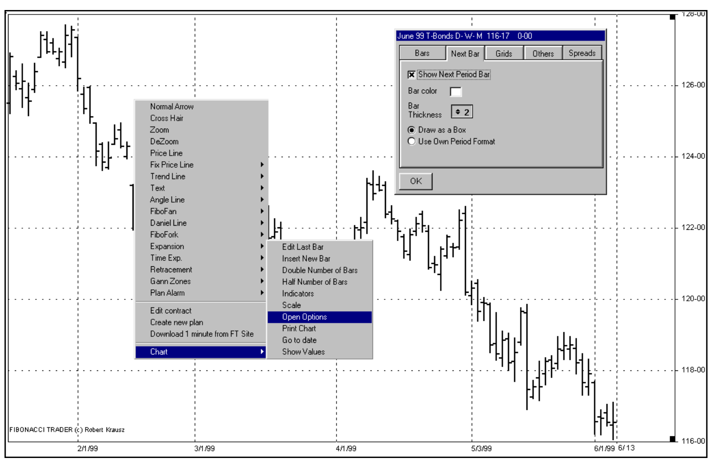

Figure 1: June 99 T-bonds Daily/Weekly/Monthly Plan. Encapsulation is found by clicking on "Open Options" and then "Next Bar."

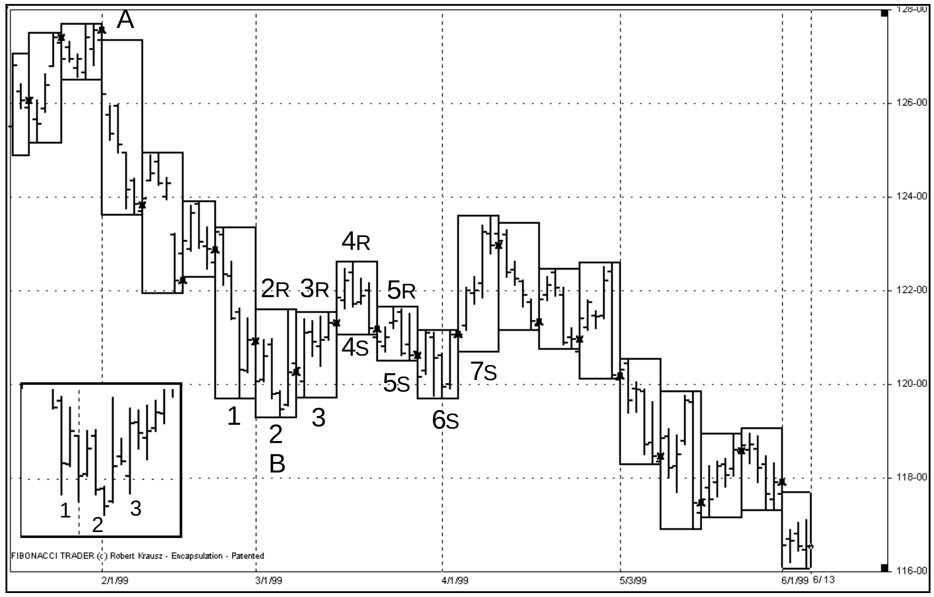

Figure 2: June T-bonds, Daily/Weekly/Monthly Plan. The Encapsulation is the High, Low, and Close bar of the weekly (*Next* time frame) bar around the daily (*Own* time frame) bars. Points 1, 2, and 3 show an MVP bottom.

First, the weekly bars accomplish the primary use of indicators, in that a weekly bar removes the noise generated in a daily bar format. For example, looking at the down trend from point A to B you can see that each week's high was lower than the previous week's high. The lower highs indicate a downward trend.

Notice what stopped the market: For three weeks, the T-bond market (points 1, 2 and 3) could not move lower. The three support points on a weekly basis (*Next*) was 119-22, 119-09 and 119-23. This pattern is called an MVP or maximum vibration point (some traders call this an isolated low). Compare this to the insert that is the daily bars for the same period without the Encapsulation. You can see the boundaries of the trading range but the Encapsulation format really highlights the important price levels.

Now that we can see that a support level was established in the *Next* time frame, if the trend is going to change direction the market has to take out a resistance level. This, in turn, will place a large number of traders on alert that the trend is changing to up.

Points 2R (121-19) and 3R (121-17) are two weeks of resistance. The Monday following the close of the weekly bar 3, the daily bar closes above these levels, signaling a breakout. However, on Friday the market closed back below the original resistance levels (week 4) indicating a false breakout.

Week 5 shows an interesting aspect of paying attention to the *Next* time frame while looking at the daily bars. Notice how the market moved up during the week, but traded only to the original resistance levels points 2R and 3R. The right hand side (5R) of a bearish MVP is shaping up.

So where does the market go? Right back down to challenge the major support levels from points 1, 2, and 3 (point 6S). But this level holds for a second time with Friday the market closing near the high of the week, a bullish indication. And again, the next Monday's low

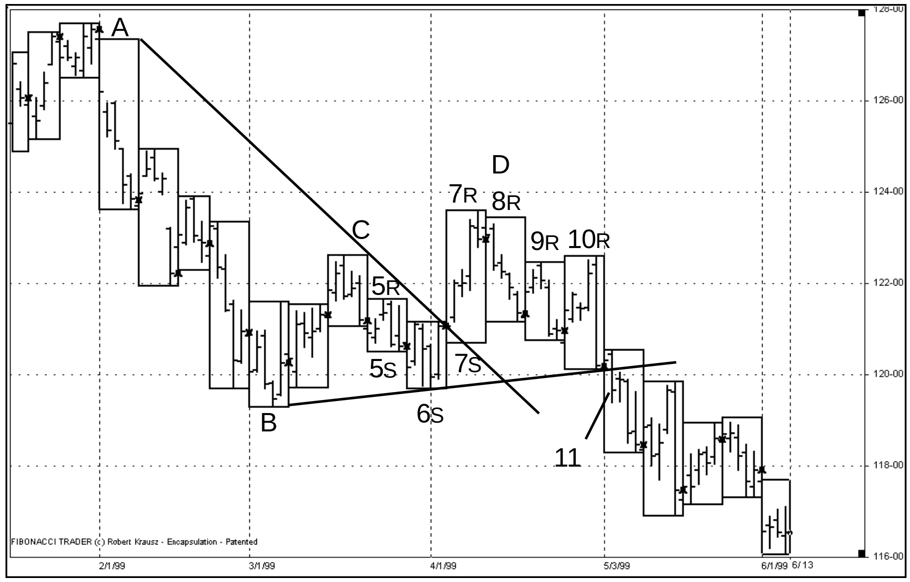

Figure 3: June T-bonds, Daily/Weekly/Monthly Plan. Draw trendlines based on the *Next* time frame. Use pentration by the daily bars for signals.

Figure 4: June T-bonds, Daily/Weekly/Monthly Plan. Peaks C and D were 38.2% and 50% retracements of the down trend.

(Figure 3, point 7S), the same support MVP pattern repeats itself as the low at point 7S is the right hand side of the support MVP compared to the low below weekly bar 5, point 5S.

The market then advances sharply for the week, closing above the highs established three weeks before. But the market fails again. Why?

Take a look at Figure 4. Here we use the Fibonacci Trader's Retracement Tool. The first top (C) that formed after the bottom B is a 38.2% retracement of the decline A-B. The second top (D) forms as the market hits the 50% retracement. Peaking at these levels after a downtrend is bearish.

Returning to Figure 3, we can see that the market forms a two week top at this 50% retracement level (points 7R and 8R), and closes at the low for the week. The next two weeks forms a lower top (points 9R and 10R) at the same level of resistance as the top labeled point C. This continues to be bearish market action. The final signal comes next.

On Tuesday (point 11) the market closes below an uptrend line drawn from point B through point 6S. Notice that we are focusing on the close of the *Own* time frame bar below the trend line based on the *Next* time frame and the important support at point 6S. We don't wait for the close of the week to act. This was your final signal that the trend run to the down side was clearly underway. The market trend continued with lower weekly highs, and two inside weeks before another new low was established. A move of nearly four points.

INTRADAY TRADING

Can this same concept of watching for penetration of MVPs be used for trading on an intraday basis. We'll look at an example using a 10-minute/50-minute/ Daily plan (Figure 5).

It turns out that there is a major difference in the way a market behaves on an intraday basis compared to daily and weekly bars.

The intraday volatility of most markets is driven by many factors, ranging from large money managers moving in and out of the market to the locals on the floor attempting to push the market through key levels to discover if more buying or selling is uncovered. We'll continue with the same concepts to identify support and resistance, and the trend as well as bring out one

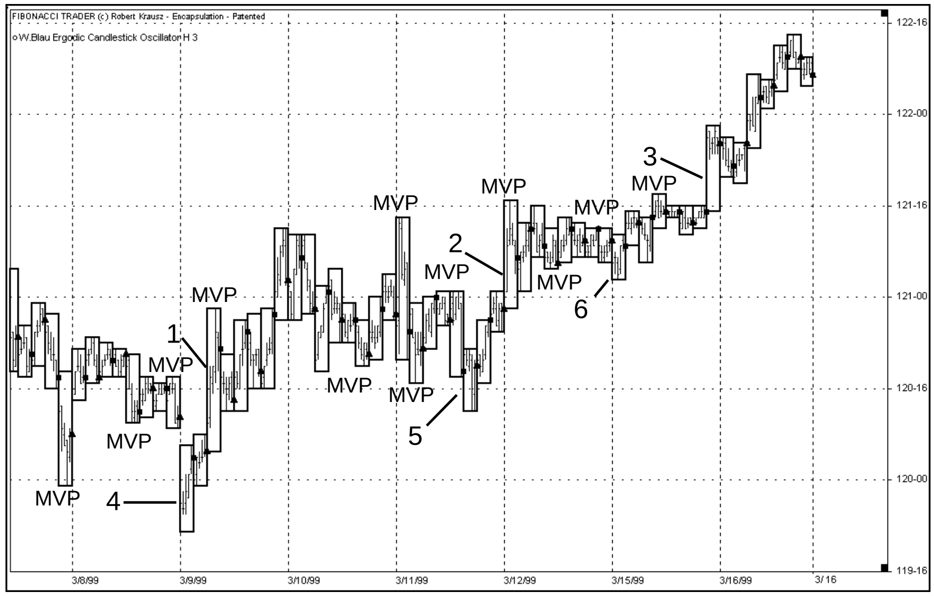

Figure 5: June 99 T-bonds 10/50/Daily Plan. Points 4, 5, and 6 are examples of false breaks of support MPVs. Points 1, 2, and 3 are examples of successful breaks of resistance MVPs.

of our favorite indicators as a support tool to aid to identifying the trend.

Looking at Figure 5, we can see that there are numerous MVPs that represent support or resistance points, and the price penetration of these support or resistance points, generally, signals a trend was underway (points 1, 2 and 3). The best uptrends are a series of rising MVPs, supported by rising MVPs, and the best downtrends are falling MVPs with lower MVPs.

But, when the market moves into congestion intraday, there are many false breakout signals. Points 4, 5 and 6 are examples of false breakouts. Is there a way to filter the breakouts, perhaps with a higher time frame indicator to use as support for the trades? Let's take a look at using William Blau's Ergodic Candelstick Oscillator.

Set the ECO to the *High* time frame, and a period of 3. Our guidelines are to only buy if a resistance MVP is taken out to the upside by two ticks, and the ECO is signaling the trend is up (the ECO is above the Signal line). Use a trailing stop and go flat, if a support MPV is broken by two ticks. Our sell signals use the opposite signals. If short, go flat if a resistance MPV is broken by two ticks.

Looking at Figure 6, we can see that the High ECO works as a nice filter to keep us from getting on the wrong side of the trend. It's not the perfect, but a good indicator of the daily trend.

Look at how the 3 period daily ECO was in an uptrend this entire view even though the market broke down though numerous support points such as points 1, 2 and 3, while penetration of resistance points 4, 5 and 6 had more follow through buying. So there is opportunity here, how can we best use it?

Recall in the Fibonacci Trader Journals 8 and 9 we talked about using a set approach based on the Dynamic Trio Next and the Dynamic BP Step High for the 10-minute/50-minute/Daily plan of the June T-bond.

We would take a signal to go long two contracts based on the Dynamic Trio Next if the Dynamic BP Step High is below the prices (the trend is up).

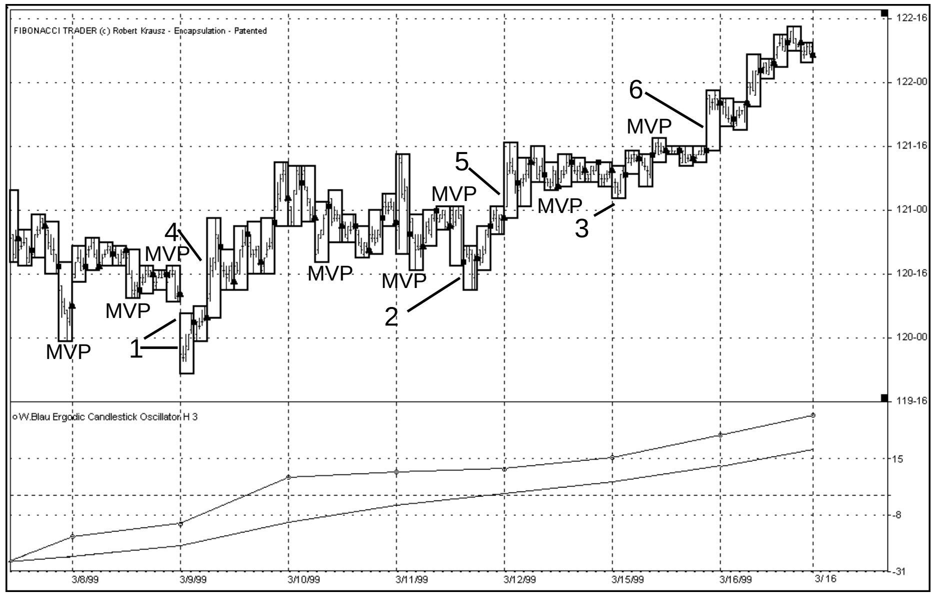

Figure 6: June 99 T-bonds 10/50/Daily Plan. The bottom indicator is the Daily 3-period ECO and Signal Line. The indicator was bullish during this period.

Sell short signals based on the Dynamic Trio Next would only be taken if the Dynamic BP Step High is above the prices (the trend is down). Any other signals would be an exit and go flat scenario.

The first contract would be exited if the target price of 20-ticks (based on the MFE analysis) was hit and the second contract would be exited based on one of the system's indicators flipping direction. Through the MAE analysis we also determined a 10-tick stop loss exit.

With what we have just learned let's add another wrinkle to this plan, a pyramiding rule. If the system goes long and the Daily 3-period ECO is bullish and a resistance MVP is taken out by, or after, the buy signal then we will add one extra contract to the Target plan of the system. If the systems issues a sell signal and the ECO is bearish and a support MVP is taken out then add an additional contract to the Target plan. Otherwise trade the two contract plan.

Figure 7 shows a couple of trades. Point A the system goes flat because the 50-minute bar closed below the Dynamic Trio Next but the 10-minute bar closed above the Dynamic BP Step High. At point B the sys-

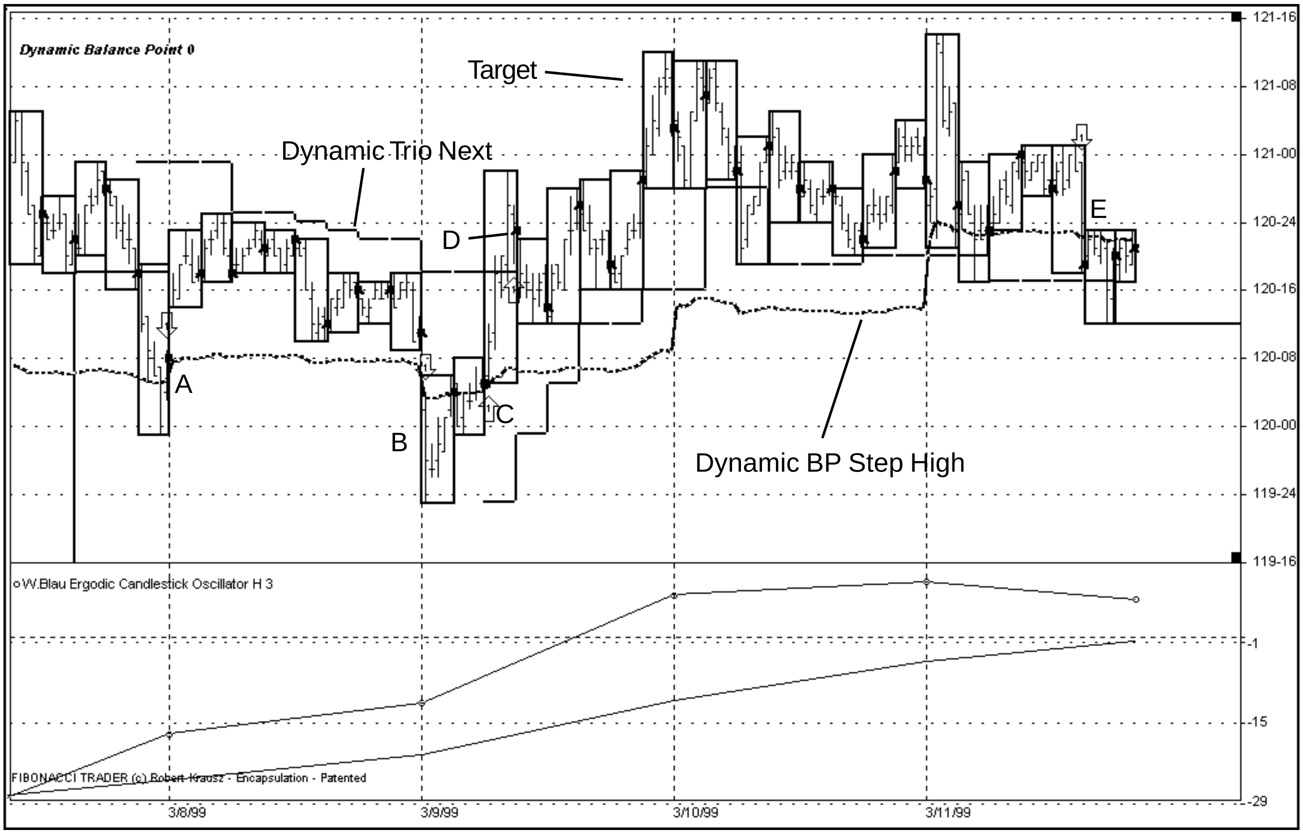

Figure 7: June 99 T-bonds 10/50/Daily Plan. Don't sell an extra contract on Bar B becasue the Daily ECO is bullish. Add an extra contract to the buy signal at D because the ECO is still long.

tem goes short two contracts, we do not add an additional Target contract because the ECO is bullish. This trade is stopped out for a ten tick loss at C. Point D the system goes long on the close of the 50-minute bar and an additional Target contract is added. The twenty tick target is hit near the close of the day. At point E the system goes flat because the 10-minute bar closed below the Dynamic BP Step High.

There is one point to keep in mind when using the *High* ECO for a plan such as a 10-minute/50-minute/Daily plan because the *High* ECO is calculated on a dynamic basis, that is the *High* ECO is live, as if the close of each 10-minute bar is the close for the day.

Therefore, the ECO could during the early time of the day signal to be short, but late in the day the price action could reverse the ECO and say to be long.

The way to handle this is as follows: Watch the close of the *Next* time frame bar (the 50-minute bar) which you will see due to the Encapsulation format to manage the extra target contract. For example, if the *High* ECO is above the Signal line, then hold the extra long target contract. If the ECO is below the Signal line then sell the extra contract. In other words, use the ECO to confirm holding an extra contract based on the action of the Next time frame with the High time frame.

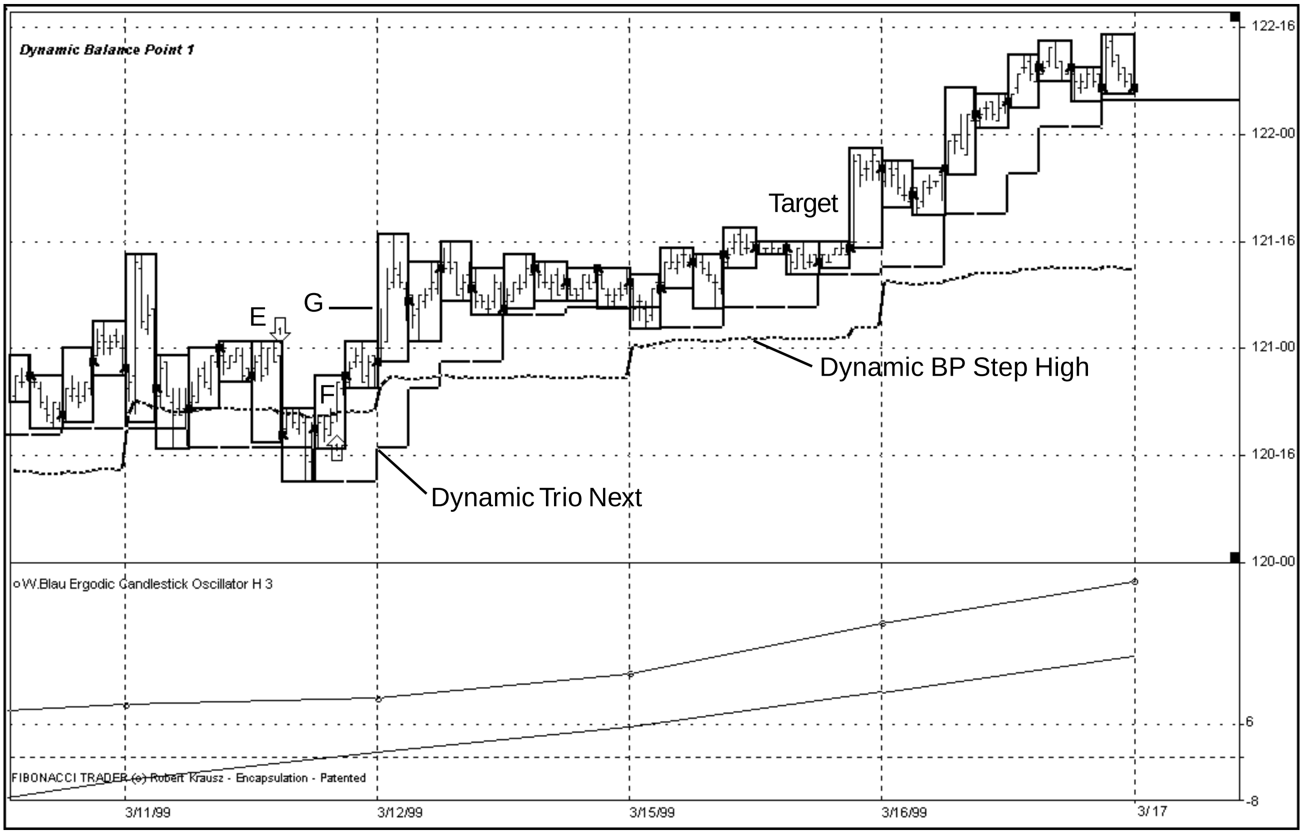

Figure 8: June 99 T-bonds 10/50/Daily Plan. The buy signal occured at F, but it was not until Point G that the resistance MPV was taken out. Add the extra contract at point G.

Figure 8 picks up from point E. Point F, the system goes long because the 10-minute bar closes above the Dynamic BP step High and the Dynamic Trio Next is already long. We add a contract at point G because the ECO is bullish and the resistance MVP to the left is taken out. The target is hit late during the next day.

SUMMARY

Encapsulation is another exclusive technique available in the Fibonacci Trader. Use the *Next* time frame to identify important support and resistance levels, and the penetration of these levels to signal the trend.

Using any of the concepts discussed here should be reviewed on your own with a thorough back test.

After all, there is no *Holy Grail*, just sensible tools to aid us as technical traders. Once again, you can see the how the multiple time frame approach gives you your best opportunities.

I wish you excellent trading,

Robert Krausz, MH, BCHE

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