By design, cycles indicate key market turning points and buying and selling opportunities. Smart application of technical analysis can help you get this right.

Market timing with cyclical analysis

BY MARK TINGHINO

Cycles are a tried and true timing mechanism to indicate turning points in futures prices. When coupling cycles with daily bar charts, the ability to improve entry and exit times grows.

Having tracked cyclical turning points on futures data going back to 1974 through today, and comparing certain daily bar charts against more than three hundred different cycles, my model appears to have held up over that time. The findings: Cycles that correlate with major market tops and bottoms, or others with intermediary turning points, are junctures with the best trade opportunities. But some cycles mark periods of market consolidation rather than the beginning of a countertrend, and those are the junctures with little or no trade opportunities.

The key to making the best use of the cyclical signals is paying close attention to simple price charts. The type of chart is best left to personal preference, but using the combination will help your trade timing.

For example, if you use candlestick analysis, these charts are useful because they identify potentially oversold conditions and where a rally is likely to occur, or potentially overbought conditions, where a sell off on profit taking is likely to occur. This insight combined with understanding the cycle of the market can improve entries or exits.

Of course, timing varies. Usually there is a short-term trend that is easily visible on the chart through two or more days. Sometimes, though, the short-term trend occurs over a single trading session. Just how big a move constitutes a significant trend to fade on the reversal day depends on the particular market you are analyzing.

For actual trade entry and exit points, one-minute and five-minute intraday charts are useful. There are various technical studies that can be utilized, but it's good to filter those through an eight-bar moving average projected three bars ahead. Look for significant divergences from either the high of the price and the moving average of the low, or from the low of the price and the moving average of the high. The minimum divergence should depend on the particular market being traded.

YELLOW MARKS THE SPOT

Source: eSignal

Another tool that is useful in conjunction with this type of cyclical analysis is Market Profile, which provides an in-depth assessment of volume at different price levels. Traders who use this tool look for various patterns to tell them when there is a higher probability for a breakout from a bracketed market, wherein prices have been trading in a narrow range for some time. It also indicates when a reversal in trend is likely imminent.

Market Profile involves a method of charting prices that differs from bar/candlestick or point and figure charting. Typically, each half-hour of the trading session is charted with a letter of the alphabet. Each price where a trade is plotted is in the first available slot to the left. The formations that are built often approximate the shape of bell curves. Bell curves are significant to statisticians because they display the typical distribution of data around a mean value. To a market analyst, these indicate levels where the marketplace of buyers and sellers finds fair value for trade.

TRADE EXAMPLES

Now let's review some examples of putting together cyclical analysis with daily charts. "Yellow marks the spot" (far left) shows an example of a cyclical turning point on Feb. 16, 2005, which shows the March 2005 contract for the S&P 500 E-mini futures. It was a four-day swing down on price. Green candles indicate where the market closed higher than it opened and red candles indicate where the market closed lower than it opened.

The candle on Feb. 16 is a doji in Japanese candlestick chart terminology, and indicates a potential reversal. The candles on Feb. 15 and 16 comprise what is known as a tweezers top and a bearish harami, which are two reversal patterns. The former is two consecutive candles with their tops aligned. The latter is a candle with a large real body followed by a candle with a small real body that falls inside that of the prior session.

A Market Profile chart for the same contract on Feb. 15 and 16 also shows some interesting market action (see "On the curve," left). The heaviest volume is marked in red time/price opportunities (TPOs) on the chart. Each letter represents a half-hour bracket of the session and is charted at the prices where trades occur in the respective brackets. A is the first half hour, B is the second half hour and so on.

The point of control is marked in green font on the chart. The value area, which describes prices in the first standard deviation from the mean, is shaded with a lighter colored rectangle. The heavier volume in the value area above the point of control indicates the presence of other time frame sellers gaining control, as opposed to intraday time frame participants. A selling tail marked by the D period TPO is also a sign of other time frame sellers participating in the market. These both constitute additional bearish confirmation for the sell signal based on the cyclical turning point.

An example of a cyclical turning point on Feb. 28 is marked with a yellow line on this candlestick chart for the March 2005 S&P 500 E-mini futures (see "Temporary slowdown," below). It was a single day swing down on price followed by three days of consolidation and sideways price movement until the rally continued.

The market profile chart "Confirming the point" (page 58) shows once again heavier volume above the point of control than below it. This is bearish market action. On the day of the cyclical turning point, Feb. 28, the buying tail marked by TPO in the J period indicates other time frame buyer presence, and in this

ON THE CURVE

The high volume in the upper area of the value area tells us that sellers, possibly those with trading strategies in other time frames, are coming into the market.

Source: WINdoTRADEr

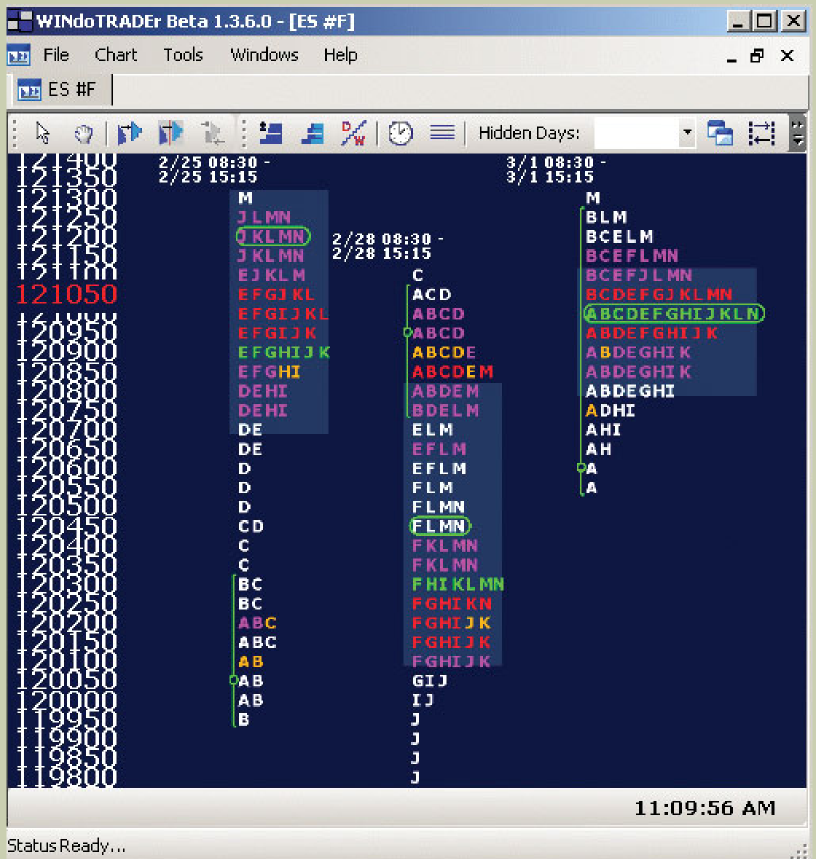
TEMPORARY SLOWDOWN

Sometimes, would-be cyclical turning points simply mark slowdowns in an ongoing trend.

Source: eSignal

CONFIRMING THE POINT

J-period time/price opportunities indicate that the bearing trend may be turning.



Source: WINdoTRADEr

case marks the end of the downswing of prices.

KEEP IN MIND

While combining daily charts with cycle analysis, remember a few things. First, as with any trading methodology, it is not realistic to expect 100% accuracy on the buy and sell signals. It is more of a question of probabilities. Therefore, it is prudent to apply careful money management strategies to minimize equity drawdown. Not trading too many contracts at once and not risking too much money on any single trade are just plain common-sense approaches. It should be easier to stay in a move on a profitable trade the more contracts you have in a position.

Mini-sized contracts make that more realistic for the more modestly-sized trading account, although the tradeoff is higher transaction costs as a percentage of trading profits because the dollar amounts realized per contract are a fraction of what they would be on a full-sized contract.

Also, cyclical turning points are more effective on some markets than others. For example, they appear to work better on stock indexes than they do on grains. There is something to be said for trading across market segments that are non-correlated. On the other hand, it behooves you to assess overall potential results and narrow down your selection of markets accordingly. FM

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