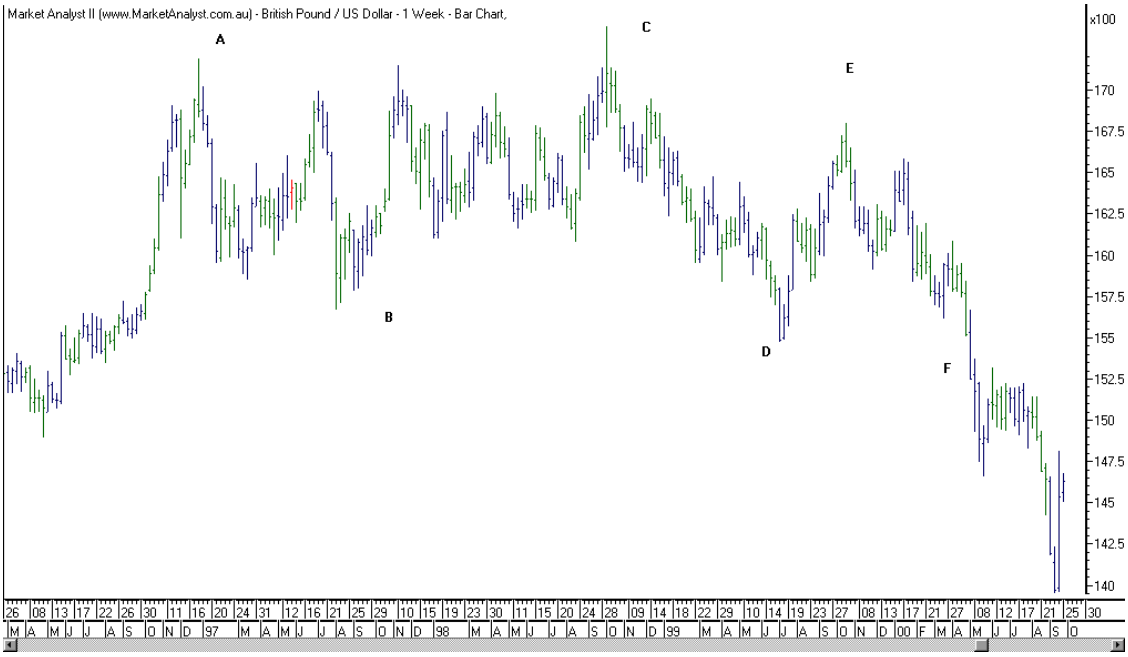
CONGESTION MARKETS - ESTIMATING A BREAKOUT TARGET



As traders, we know that markets congest much of the time - some say, markets congest as much as eighty percent (80%) of the time. We also know that a sideways market is often the quicksand into which the trader's capital, his lifeblood, drains.

To avoid this black hole, some traders have adopted the policy of trading only the breakout. If only it were so simple to make money!

As the chart above illustrates, breakouts are just as difficult to trade as congestion markets. At "C" and "D", the market apparently broke out of congestion - only to return, taking with it part of our hard earned dollars.

Yet, it is possible to trade a sideways market profitably. To do this:

1 We must have a strategy i.e. a well-conceived plan of action that clearly defines when we should initiate longs at the bottom of the congestion range and shorts at top.

2 We must an entry technique for breakouts. This involves a means of defining when a breakout is valid.

We look at these two very important issues at the seminar I am holding on November 18th, 20th and 21st.

3 We must have a strategy to take profits. Usually this means having a method of estimating a breakout price objective.

It is this aspect I want to consider.

Traditionally there are two ways of estimating a breakout target.

The first:

- For a downside breakout target, take the range of congestion and subtract it from the low of the range.

- For an upside congestion target, take the range of congestion and add to the high of the range.

In the chart below, the congestion range is 1518. The market has broken to the downside. With this method, the downside target is:

15668 - 1518 = 14150

The second method treats the time taken until breakout as the means of calculating the breakout target. If the sideways market took ten (10) days to form, the downside breakout target would be the low of the range minus 10. **With this method, I would use only trading days.**

In the chart below, the market was in congestion for 172 weeks. This translates to eight hundred and sixty-five (865) trading days. This gives us a downside target of 14803:

15668 - 865 = 14803

By combining the two methods, we have a downside target of 14803 to 14150.

A Better Method

Comparing the method suggested by Dr. Alan Andrews with the vertical and horizontal methods is akin to comparing a laser with a shotgun. The Andrews calculations, especially when combined with his median line techniques, are far more focused and precise.

To use the approach, you take six (6) steps.

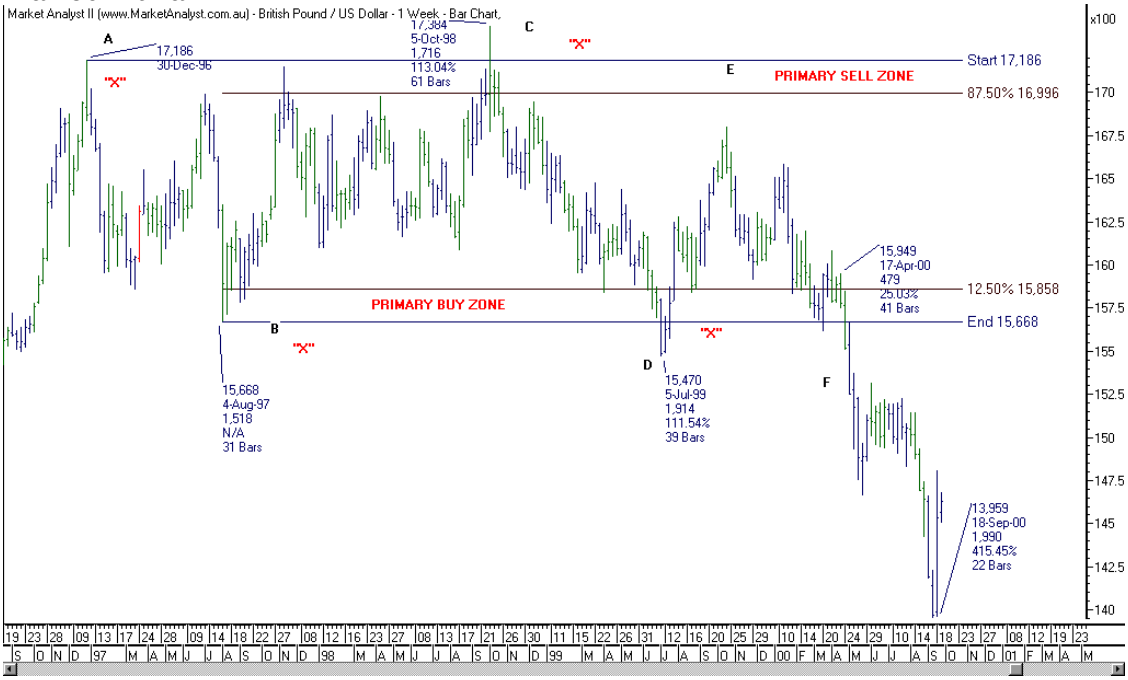
First, define the boundaries of congestion. This is best described with an example.

In the chart below, "A" and "B" marked the boundaries within which prices traded until the false breakouts at "C" and "D". By false breakouts, I mean the market broke out above "A" and below "B" and then returned to congestion. Therefore, for this market, "A" and "B" formed the range of congestion (i.e. "A' and 'B" marked the boundaries of congestion). This range was 1518 points.

Second, divide the congestion range by eighths. Subtract from "A" one-eight; add to "B", one-eight. "A" to "A" plus one-eight defines the Primary Sell Zone and "B" to "B" plus one-eight defines the Primary Buy Zone.

The chart below illustrates the Primary Sell and Primary Buy Zones.

Third, once the market enters a Primary Zone, mark the prices in the opposite zone with an "X". In the chart above, when the market entered the Primary Buy Zone at "B", "A" was marked with an "X".



We have applied this process to the chart above. Notice that we would not have marked the high at "C" until "D". The intervening highs between "A" and "C" are **NOT MARKED** with an "X" as the market did not enter the Primary Buy Zone before proceeding north. Applying the rules, we find that "X" marks two highs and two lows.

Fourth, mark the breakout with a X. In this example, this gives us three "X"s at the Primary Buy Zone and two "X"s at the Primary Sell Zone.

Fifth, multiply the congestion range by the number of "X"s at the Primary Buy Zone (for a downside breakout target. For an upside breakout target, multiply the congestion range by the number of "X"s at the Primary Sell Zone).

In this case:

Congestion Range:	1518
Number of "X"s:	3
Price Objective:	1518 x 3 = 4554

Finally, calculate the principal and secondary targets.

For a downside target, the principal price objective is:

"A" minus Price Objective: 17186 - 4554 = 12632.

The secondary price objective is:

"B" Minus Price Objective: 15470 - 4554 = 10916

You are looking for change in trend once the Primary Target is reached. The Secondary Target is not often reached; it is a supplemental objective if there is no price reversal at the Primary Price Objective.

In the case of an upside breakout, reverse the procedure.

SUMMARY

Apply these steps to calculate Andrews Price Objectives in a breakout from a congestion zone.

1 Determine if you have an upside or downside breakout. In the example I used, we had a downside breakout.

2 Define the congestion range.

3 Count the number of "X"s.

4 Multiply the congestion range by the number of "X"s at the Primary Buy Zone. (Had we had an upside breakout, we would have multiplied the "X"s at the Primary Sell Zone"). This gives us a 'Product'.

5 For the Primary Price Objective, subtract from "A", the 'Product". A change in trend usually occurs at this price level.

6 For the Secondary Price Objective, subtract from "B", the 'Product'. This price is not often reached and is considered only if the Primary Price Objective does not result in a change in trend.

7 Reverse the procedure for an upside breakout.

Friday, September 29, 2000

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