



THE
FOREX
CHARTIST
COMPANION

A Visual Approach
to Technical Analysis



Michael Duane Archer and James Lauren Bickford

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to Technical Analysis*

**MICHAEL D. ARCHER
JAMES L. BICKFORD**



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Contents

Acknowledgments	xv
Introduction	xvii
PART I Forex-Specific Charting Techniques	1
CHAPTER 1 Streaming Data	3
Overview	3
Tick Chart	3
Spread Chart	4
Conclusion	5
CHAPTER 2 Activity	6
Overview	6
Activity Bar Chart	6
Composite Activity	8
Time of Day Activity Chart	8
Day of Week Activity Chart	9
Equi-Activity Chart	10
Activity Mercury Chart	10
Uptick-Downtick Mercury Chart	12
Conclusion	13
CHAPTER 3 Direction	14
Overview	14
Direction Chart	14
Direction Mercury Chart	16
Activity-Direction Mercury Chart	17
Conclusion	18
CHAPTER 4 Forex versus Futures	19
Overview	19
Pip Differential Chart	19

	Activity versus Volume and Open Interest	22
	Conclusion	22
CHAPTER 5	Arbitrage	23
	Overview	23
	Transitivity	23
	Triangular Arbitrage Chart	24
	Equilibrium	25
	Major Currencies	28
	Observation	28
CHAPTER 6	The Mundo	29
	Overview	29
	Forex Beta	29
	Mundo Line Chart	31
	Weighting	32
	Mundo Bar Chart	33
	Observation	33
CHAPTER 7	Range Charts	34
	Overview	34
	Range Bar Chart	34
	Composite Range Charts	35
	Time of Day Range Chart	35
	Day of Week Range Chart	37
	Average Interval Range Chart	37
	Observations	38
CHAPTER 8	Absolute Momentum	39
	Overview	39
	Absolute Momentum	39
	Time of Day Momentum Chart	40
	Day of Week Momentum Chart	41
	Conclusion	42
CHAPTER 9	Two-Dimensional Momentum	43
	Overview	43
	Two-Dimensional Momentum Chart	43
	Islands	45

Smoothing	47
Observation	47
CHAPTER 10 Moving Trend Analysis	49
Overview	49
Linear Regression	49
Ordinary Least Squares Method	50
Coefficient of Correlation	51
Trend Oscillators	51
Moving Slope Oscillator	52
Moving Correlation Oscillator	52
Moving Trend Index	52
Observations	54
PART II Point and Figure Charting	55
<hr/>	
CHAPTER 11 History of Point and Figure Charting	57
Overview	57
History	58
CHAPTER 12 The Point and Figure Algorithm	59
Overview	59
P&F Anatomy	59
Box Size	59
Reversal Amount	60
Unraveling Bar Quote Data	61
P&F Algorithm	61
Time Representation	62
CHAPTER 13 Trend Lines	63
Support and Resistance	63
Trend Lines	63
Buy Signals	65
Sell Signals	65
CHAPTER 14 Double Tops and Bottoms	67
Overview	67
Double Top Pattern	67

Double Bottom Pattern	68
Double Top Signals	68
Double Bottom Signals	70
False Signals	72
Signal Percentages	72
Observations	74
CHAPTER 15 Triple Tops and Bottoms	75
Overview	75
Triple Top Pattern	75
Triple Bottom Pattern	76
Triple Top Signals	76
Triple Bottom Signals	78
False Signals	79
Signal Percentages	79
Observations	81
CHAPTER 16 Triangles	82
Overview	82
Ascending Triangles	82
Descending Triangles	83
Symmetrical Triangles	83
Triangle Signals	84
Ascending and Descending Frequencies	84
Symmetrical Frequencies	87
Observation	87
CHAPTER 17 Pattern Frequencies	89
Overview	89
Box Size = One Pip	90
Box Size = Two Pips	92
Box Size = Three Pips	93
Inverse Patterns	94
Usage	94
CHAPTER 18 Breakout Analysis	96
Overview	96
Preceding Columns	97
Succeeding Columns	100
Observations	102

CHAPTER 19	Count Methods	104
	Overview	104
	Horizontal Count (Buy)	104
	Horizontal Count (Sell)	106
	Vertical Count (Buy)	107
	Vertical Count (Sell)	108
	Observations	109
CHAPTER 20	Plotting Point and Figure Charts in Real Time	110
	Overview	110
	Tools of the Trade	110
	Trading Platform	110
	Trading Goals	111
	Starting the Process	111
	Real-Time Example	111
	Performance Evaluation	114
PART III	Forex Swing Charting	115
<hr/>		
CHAPTER 21	Fibonacci Primer	117
	Overview	117
	Fibonacci the Man	117
	Fibonacci the Series	118
	Fibonacci the Ratios	119
	Fibonacci the Equations	120
	Binet's Formula	122
	Interpretation	122
	Resources	124
CHAPTER 22	Swing Charts	125
	Overview	125
	Definitions	125
	Box Size	126
	Reversal Amount	126
	Swing Reversal Algorithm	127
	Time Alignment	128
	Practical Examples	129
	Composite Swing Charts	132
	Usage	132

CHAPTER 23	The Measured Move	134
	Overview	134
	Testing Approach	135
	Cluster Charts	135
	Average Retracement	137
	Decile Divisions	139
	Practical Examples	141
	Conclusion	146
CHAPTER 24	The Fifty Percent Principle	147
	Overview	147
	Testing Approach	147
	Initial Results	148
	Increasing Tolerance	150
CHAPTER 25	Improving The Third Wave Forecast	152
	Overview	152
	Methodology	153
	Multiple Regression	154
	Quartiles	154
	Practical Examples	157
	Fifty Percent Principle	160
	Fifty Percent Examples	160
CHAPTER 26	Forecasting The Fourth Wave	162
	Overview	162
	Testing Approach	162
	Practical Examples	164
	Improving the Forecast	164
	Three-Wave Trending Cycles	165
	Trending Example	166
	Three-Wave Nontrending Cycles	166
	Nontrending Example	167
	Extending the Forecast	167
	Estimate Charts	168
	Live Usage	170
CHAPTER 27	Cycle Frequencies	171
	Overview	171
	Two-Wave Cycles	171

Three-Wave Cycles	173
Four-Wave Bull Cycles	175
Four-Wave Bear Cycles	177
Usage	178
CHAPTER 28 Bull Cycles	180
Overview	180
Ideal Bull Cycle	180
Objective	181
Initial Results	182
Praxis	183
Caveat	185
Further Studies	185
CHAPTER 29 Bear Cycles	186
Overview	186
Ideal Bear Cycle	186
Objective	187
Initial Results	187
Praxis	188
Caveat	190
CHAPTER 30 Swing Properties	191
Overview	191
Wave Anatomy	191
Simple Ratios	192
Swing Averages	192
Swing Data Preliminaries	194
Bivariate Data	195
Swing Volatility	197
Swing Velocity	199
CHAPTER 31 Swing Summary	200
Overview	200
Selecting Swing Parameters	200
Composite Average Estimates	202
Caveat	207

PART IV Other Reversal Charts	209
<hr/>	
CHAPTER 32 Western Reversal Charts	211
Overview	211
Geometric Chart	211
Trend Outline Chart	213
Pivot Chart	215
Observation	216
CHAPTER 33 Japanese Reversal Charts	217
Overview	217
Renko Chart	217
Kagi Chart	220
Three-Line Break Chart	224
PART V Goodman Swing Count System	227
<hr/>	
CHAPTER 34 History	229
Charles B. Goodman	229
The Right Brackets	230
Later Developments	230
CHAPTER 35 Ordinal Principles	233
Ordinal versus Cardinal	233
The Measured Move	233
Congestion Phase	234
Equilibrium of Buyers and Sellers	235
CHAPTER 36 Cardinal Principles	238
Overview	238
Price Surge	238
Multilevel Matrices	239
Compensation	241
Carryover	241
Cancellation	242
Intersections	244
Five Points of a Goodman Wave	245
Double and Triple Intersections	246

CHAPTER 37 Goodman versus Elliott	247
Overview	247
Propagation	248
The Return	249
CHAPTER 38 Charting Study	251
Overview	251
Notation	251
Matrix	251
Propagation	253
Simple/Complex	254
Fat/Thin	255
Goodman and Computers	255
APPENDIXES	
A. World Currencies	259
B. Exchange Rates	264
C. Euro Currency	267
D. Global Banking Hours	269
E. Monthly OHLC and Activity Charts	271
F. Daily OHLC and Activity Charts	282
G. Time of Day Charts (Activity)	293
H. Time of Day Charts (Range)	297
I. Time of Day Charts (Momentum)	301
J. Day of Week Charts (Activity)	305
K. Day of Week Charts (Range)	311
L. Day of Week Charts (Momentum)	317
M. Comparative Statistics	323
N. Unraveling Bar Quotes	325
O. Visual Basic Source Code (Point and Figure)	331
P. Visual Basic Source Code (Swing)	338
Resources	341
Index	349
About the Authors	361

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Introduction

Trading in the foreign exchange (forex) currency markets has recently exceeded \$2 trillion a day and this figure is expected to double within the next five years. The reason for this astonishing surge in trading popularity is quite simple: no commissions, low transaction costs, easy access to online currency markets, no middlemen, no fixed lot order sizes, high liquidity, low margin with high leverage, and limited regulations. These factors have already attracted the attention of both neophyte traders and veteran speculators in other financial markets.

ABOUT THIS BOOK

Immediately following the publication of *Getting Started in Currency Trading* (also by Mike Archer and Jim Bickford, John Wiley & Sons, 2005), the authors received an overwhelming number of inquiries and requests for more detailed information on the mechanics of currency day trading, market entry timing, and which positions to initiate in forex markets.

The authors hope to fill that void with the publication of the current volume. We have concentrated our primary focus on the most lethal weapons in the technical analysis arsenal: the traders' charts, pristine in their concept and dynamic in their visual presentation of both raw and processed data. Numerous groundbreaking and innovative additions to charting theory have been included here. Also several well-known classical charting types have been updated and modified to scrutinize the unique characteristics of forex data.

HOW THIS BOOK IS ORGANIZED

There are six major divisions in this book:

Part I: Forex-Specific Charting Techniques

Much of the material in this section originally appeared in a collection of technical currency studies called *Forex Charting Companion: Innovative Charting Techniques for*

Currency Traders (Syzygy Publishing, 2005) by the same co-authors. Many of the charts along with the corresponding data have been revised to reflect the current personality of the spot currency market.

Part II: Point and Figure Charting

Point and figure (P&F) charting was invented in the 1890s and has since evolved into a highly respectable technical analysis tool for detecting market entry signals. Although P&F was originally designed for use on the stock exchange, all the examples in Part II focus directly on the spot currency markets (with some startling results). This section is actually a revised update of *The Point & Figure Chartist's Companion: The Computer-Side Reference for Currency Traders and Analysts*, also by the co-authors (Syzygy Publishing, 2005).

Part III: Forex Swing Charting

Like their sibling P&F charts, swing charts are also members of that genre of charts normally referred to as reversal charts. Their shared *advantage* is their ability to filter out minor price fluctuations and highlight the critical inflection points in a price chart. This section is also an update of an earlier work entitled *The Swing Trader's Companion: The Computer-Side Reference for Swing Traders and Analysts* (Archer and Bickford, Syzygy Publishing, 2005).

Part IV: Other Reversal Charts

Both Western and Japanese reversal charts are examined in detail in this section. Knowledge of unusual and exotic charting techniques can only benefit the currency day trader since this knowledge assists in scrutinizing the same data through a different perspective.

Part V: Goodman Swing Count System

In this section, the authors examine the actual trading system of veteran trading guru Charles B. Goodman. His unique theories and hypermodern principles are accompanied by numerous practical studies and examples.

Appendixes

We have gone to extreme measures to ensure that readers will have more than ample study materials to assist them in their daily trading sessions. To this extent we have supplied a very exhaustive appendix, which essentially mirrors the contents of the book. This section is intended to be a computer-side reference guide to be used while traders are working online in their currency platforms. We have also included some Microsoft

Visual Basic 6.0 source code in the appendixes for those traders who home-brew their own forecasting programs.

DISCLAIMER

We wish to emphasize that spot currency trading may not be suited to everyone's disposition. All investors must be keenly aware of the risks involved and of the consequences of poor trading habits and/or mismanaged resources. Neither the publisher nor the authors are liable for any losses incurred while trading currencies.

PART I

Forex-Specific Charting Techniques

Streaming Data

OVERVIEW

The smallest time unit between changes in the price of any currency pair is called a single *tick*, and a sequence of consecutive ticks is referred to as streaming data. During periods of heavy trading, there may be as many as three hundred ticks in a single minute. Conversely, during periods of low trading (such as in certain minor currency pairs over the weekend), several hours can elapse between individual ticks.

Tick data does not have an open, high, low, or close quote—it simply tells the prevailing price. The OHLC quotes occur only after tick data has been collected and coerced into interval data, such as one minute, one hour, one day, or any other selected duration.

TICK CHART

By definition, interval data is represented along the x-axis as equally spaced time segments. By contrast, tick data almost always distorts the representation of time along the x-axis, although it does remain continuous. Between January 1, 2000 and December 31, 2005, the number of ticks in a single minute in the EURUSD currency pair ranged from zero to three hundred. These variations produce an accordion effect on the x-axis. (See Appendix A for a list of world currency codes.)

In the tick chart of the euro/U.S. dollar currency pair shown in Figure 1.1, a continuous line represents the price, while the time scale at the bottom of the chart fluctuates by the number of ticks per time interval. This is the sole criterion that distinguishes tick charts from other line charts. The chart clearly shows a variation in the number of ticks per minute as time progresses.

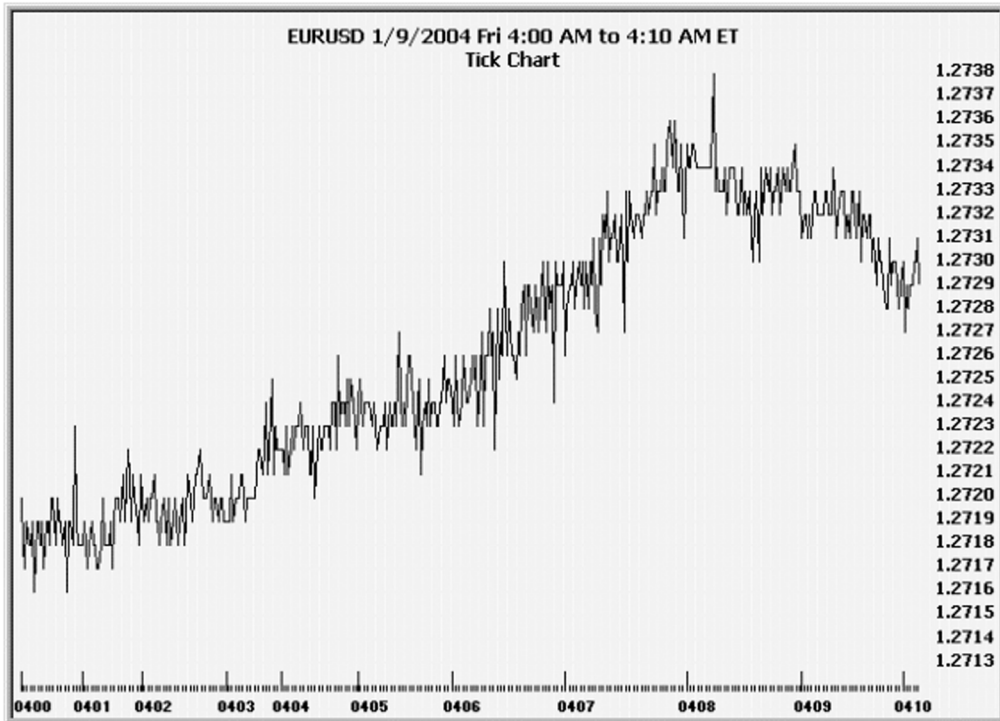


FIGURE 1.1 EURUSD Tick Chart

SPREAD CHART

Nearly all financial vehicles can be plotted as some form of a spread chart based on some unique properties of the underlying instrument. In futures markets, a spread chart usually implies the comparison of a forward expiry month with a distant expiry month in the same commodity. Within spot currency markets, a spread chart is defined specifically as the difference between the bid price and the ask price, which currency dealers use as the transaction cost for a round-turn trade in that currency pair.

The ask price is the price that the trader pays when entering the market in a long position; the bid price is used when the trader enters the market short.

The currency spread chart is plotted as a channel chart in which the upper boundary is the bid price and the lower boundary is the ask price. (See Figure 1.2.)

The importance of the spread chart is that it is the most common method used to display streaming data in online trading platforms. The trader can readily see the buying price (the lower boundary) and the selling price (the upper boundary).

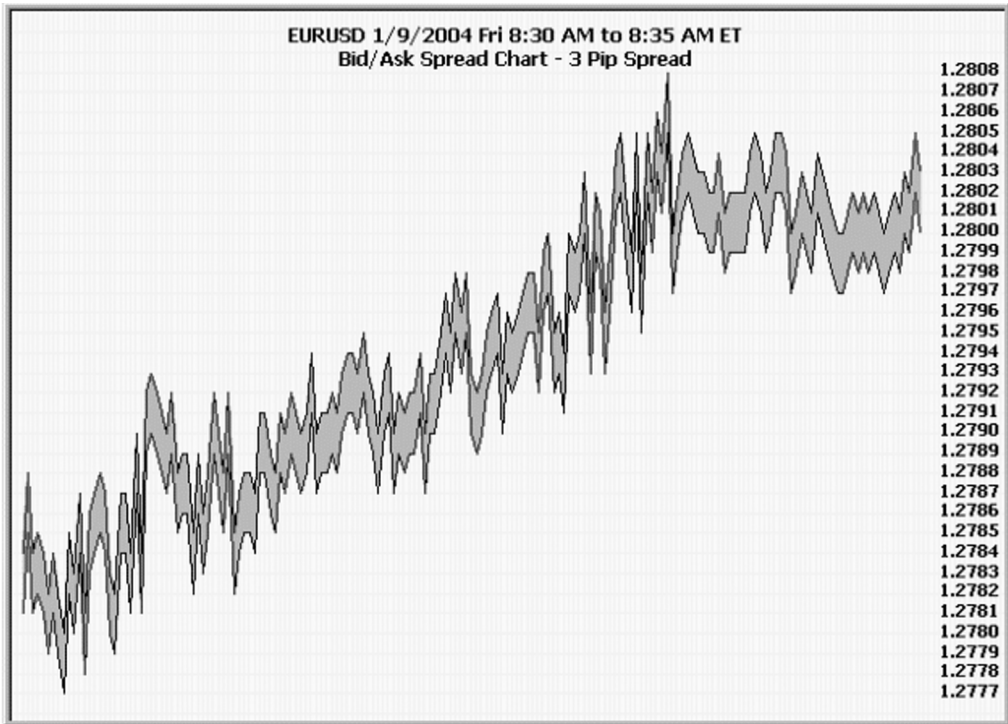


FIGURE 1.2 EURUSD Spread Chart

CONCLUSION

Understanding the nature of spot currency data in its most primitive form (raw streaming tick data) is requisite knowledge for all traders.

Activity

OVERVIEW

When analyzing spot currency interval data, it should be noted that all six quote fields (open, high, low, close, upticks, and downticks) can be derived directly from the streaming tick data. An uptick occurs every time the current price exceeds the magnitude of the previous price within the prescribed interval. Similarly, a downtick occurs whenever the current price is lower than the previous price.

ACTIVITY BAR CHART

Given the two fields upticks and downticks, we define activity as shown in Figure 2.1, where x is the array index in the time series.

Activity is displayed as vertical bars in the lower portion of the five-minute chart in Figure 2.2. The empty rectangles are upticks, while the shaded rectangles are downticks.

In the long-term chart (Figure 2.3), note that activity in the EURUSD currency pair nearly tripled during the 2000–2004 period.

$$\text{Activity}_x = \text{Upticks}_x + \text{Downticks}_x$$

FIGURE 2.1 Activity Formula

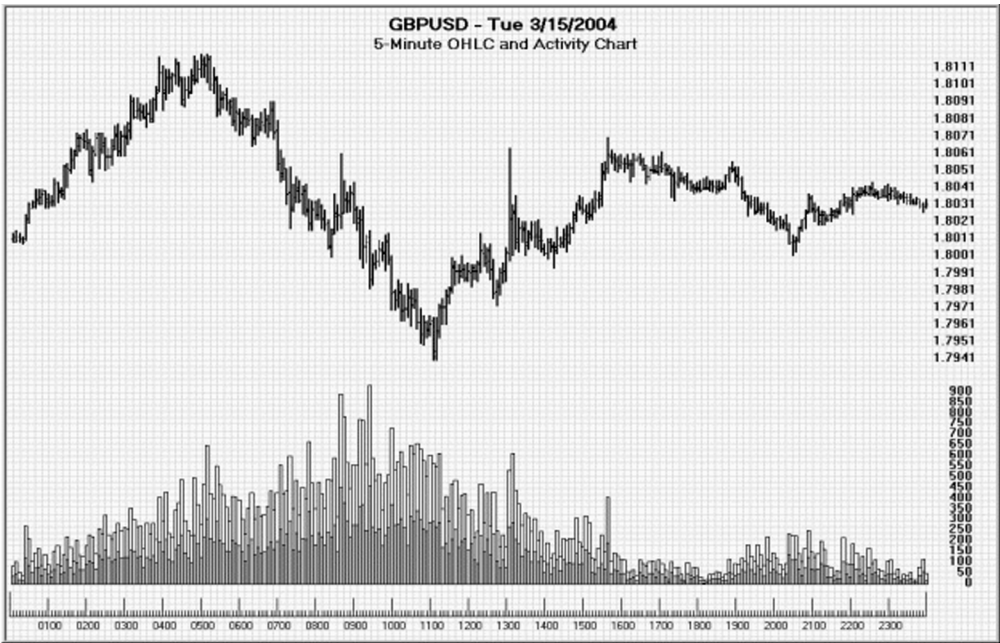


FIGURE 2.2 Activity Expressed as Vertical Bars

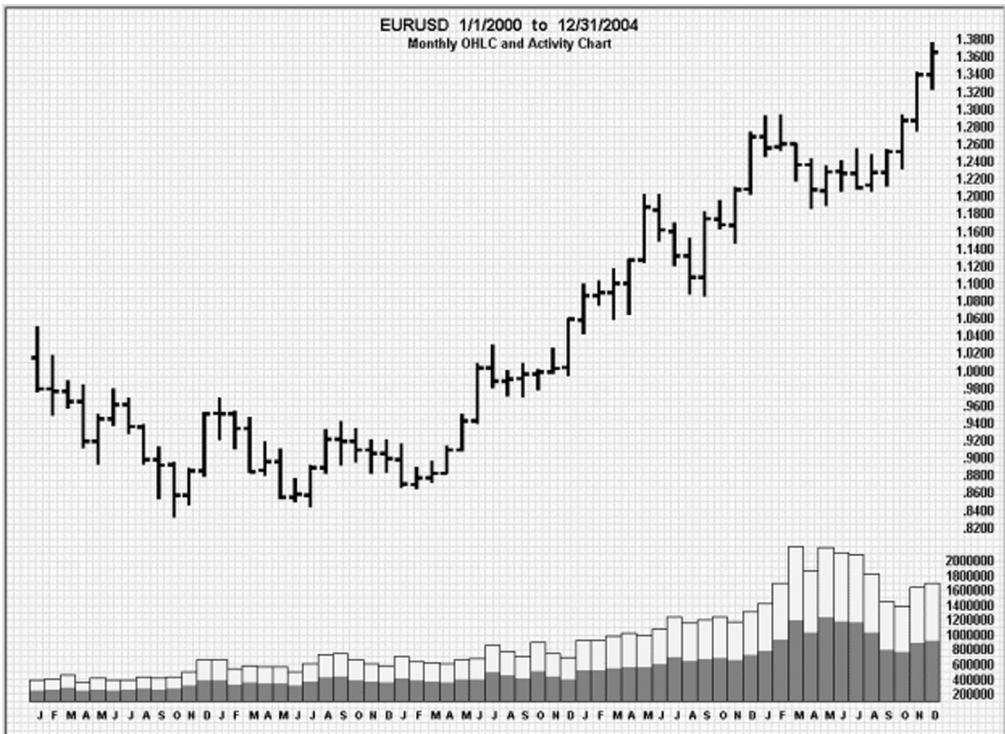


FIGURE 2.3 Long-Term Activity

COMPOSITE ACTIVITY

The foreign exchange is a 24/7 global market (with reduced liquidity on Saturdays and Sundays, of course). The importance of activity is extremely useful for traders in determining when to trade. For this purpose, we developed two composite charting techniques to show traders when trading activity is at its highest and lowest for each currency pair: the time of day chart and the day of week chart. Composite charts are simply the average activity for each time interval sampled over a long time frame.

TIME OF DAY ACTIVITY CHART

In Figure 2.4, multiple time intervals have been plotted where each average value has been centered. That is, the three-minute average for 10:00 A.M. is the mean of the activity for 9:59 A.M., 10:00 A.M., and 10:01 A.M. rather than front-based averaging (9:58 A.M., 9:59 A.M. and 10:00 A.M.).

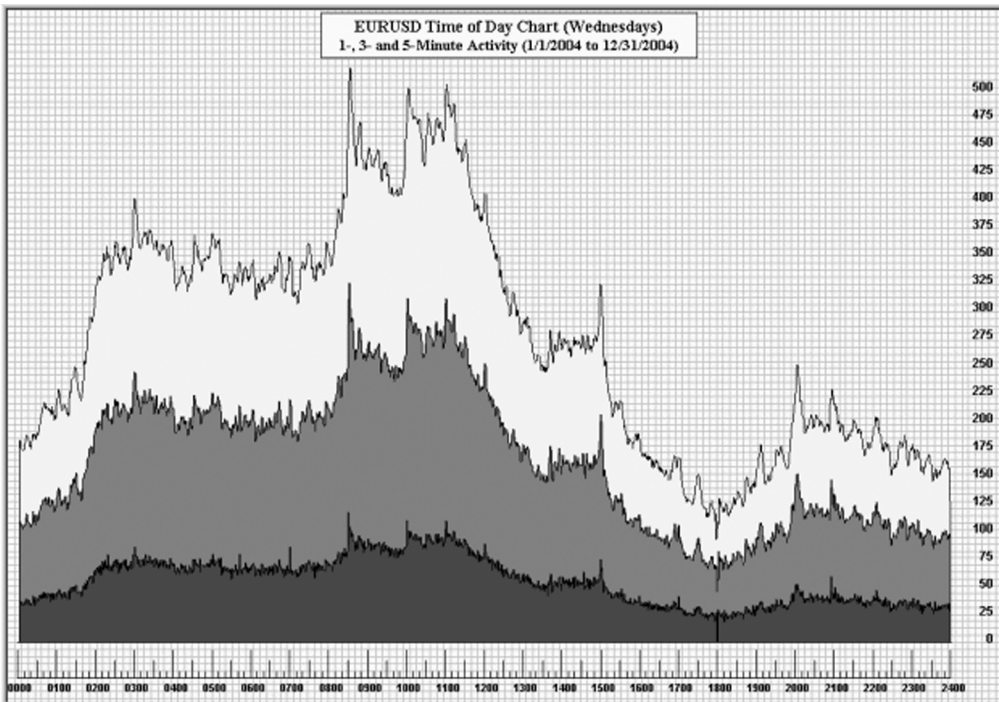


FIGURE 2.4 Time of Day Activity Chart