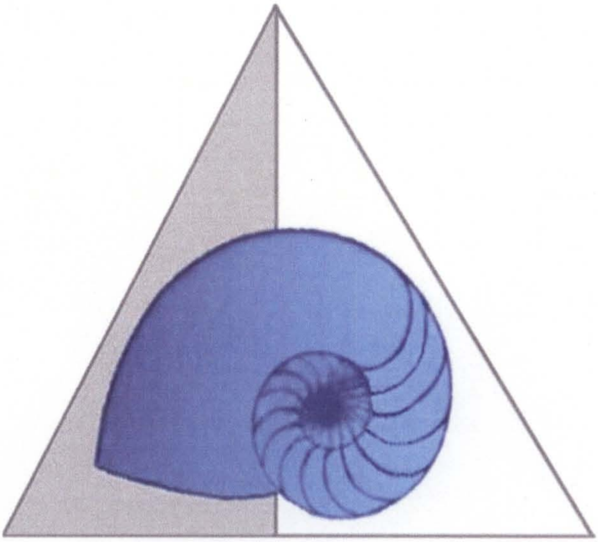
Kane Trading on:

A Pattern Trade Entry Technique



by Jim Kane

Tips, ideas and techniques for market traders

KaneTrading.com

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Acknowledgements

In my evolution as a trader I've read more material than I can even recall. The majority of this material has contributed very little to my knowledge base. That lack of value, for me, in the material, in and of itself, is important information. It's shown me, by a process of elimination, the things that don't help me, and I can use that information when formulating a trading plan.

In developing material related to Fibonacci trading, two sources have been of great help. I would like to acknowledge these sources, and recommend that readers look into their materials. See if they might be of as much help to your own trading, as they were to mine.

I'd like to acknowledge Scott Carney over at Harmonic Trader. Scott's book, The Harmonic Trader, and the material on his website (www.HarmonicTrader.com), opened my eyes to another way to view the markets. This was my first substantial introduction to the concepts of Fibonacci and harmonics in trading the markets. Scott has quite extensive information on harmonic patterns on his website and has developed several patterns of his own. Scott and I have since spent endless hours discussing harmonics and the markets. His historical knowledge of the markets is extraordinary and has contributed greatly to my own knowledge base.

I'd also like to acknowledge Robert Miner at Dynamic Traders Group, Inc. (www.DynamicTraders.com). Robert's book, Dynamic Trading™, was my next serious excursion into Fibonaccis and trading. This book is extensive beyond belief. There is so much material in Dynamic Trading™ that I would have to consider it must reading for anyone interested in increasing their knowledge of Fibonacci in trading and in Elliot wave analysis. Robert's use of the time factor is also extensive and will open one's eyes to factors outside of just price. Robert also has Dynamic Trader software available, which I use for creating charts labeled with various Fibonacci, harmonic and time factors. It is the software that I used to create the charts for this book. I would like to extend an additional thanks and acknowledgement to Robert for allowing me to use these charts in my works. Information on his products is available on his website. I recommend checking it out to see if you feel that it has information that you can use to help your trading. His contributions in the field are practically immeasurable.

Introduction

In this eArticle I will present an entry technique that I have devised specifically for triggering an entry into a pattern trade. And what do I mean by a ‘pattern trade’? The technique that I will present in this article was specifically designed for use with 5-point patterns.

The 5-point pattern can be any of the ‘named patterns’, or, as I outline in Kane Trading on: Trading ABCD Patterns, a 5-point pattern that doesn’t fit the characteristics of any of the named patterns, but nonetheless still has the structure of a 5-point pattern. I have also noticed that the technique seems to work equally well with my ‘4-Point Continuation Pattern’.

Now, why did I come up with a specific entry technique for pattern trades, as opposed to just using the techniques from Kane Trading on: Entry Techniques (which I will call ET from now on, so as to not excessively aggravate my readers)? The answer is that I didn’t set out to devise this technique. I had been using the techniques that I outlined in ET.

In the course of my endless experimenting and searching, though, I started to notice something interesting about the behavior of a fairly high percentage of the potential pattern trades that I was looking at. I started to try some things, and one thing led to another. Soon I had a technique that was working as good, or better, for me than any of the other techniques that I had for entering these types of trades.

This is not to say that I have thrown out the usual entry techniques that I use to trigger me into trades. No, far from it. What I have devised is a technique that I can apply in, perhaps, 70% of the trade setups, that I prefer over the other techniques I have.

Since I have no desire to let the other setups (where this new technique doesn’t apply) just go by, I still use my other techniques from ET in those cases. I use this ‘pattern trade entry technique’ only when I see a certain set of conditions line up.

Those familiar with my book ET know that I generally drop down to a lower timeframe from my ‘traded timeframe’, the timeframe that generally has my groupings on it, to look for an entry trigger. This new entry technique will present a new twist on that timeframe theme, almost a ‘spin-off’ on the last chapter from ET, entitled ‘A ‘Cool Trick’’. This new technique revolves around a specific use of timeframes, as well as the more typical analytical methods from the chart.

As always, I encourage the reader to experiment with what is presented, and see if it is of use to you and your ‘Trading Plan’. Try out what I present (in a simulated environment, of course), modify it if necessary, and make a decision if it can help you. I can only speak for myself, and my own ‘Trading Plan’, but it has been of great help to me.

With that, let’s move on to the technique.

The Technique

I came to this technique as part of my never-ending quest to find better methods to enter specific types of trades. When it comes to 5-point pattern trades, I really don't like to 'fade' the entry. Although I feel that there is a strong argument for doing this (better price, tighter logical stop, etc.), I don't care for the downside (the trades that just blow through the potential trade area). My 'Trading Plan' just about mandates that I keep 'fade' entries to a minimum. I do them, but only occasionally.

I'm always looking for some confirmation that the trade has now started to turn in my anticipated direction before I enter the trade. I understand that I have to pay a price for this confirmation, as nothing comes without a price in trading (or, in my opinion, in anything in this world). The price I usually pay is not getting as good of an entry price, and a logical stop that is farther away. For me, it's worth it. Traders have to decide for themselves, though, how they want to enter trades.

I bring this up now, because this new technique, like many of my entry techniques, usually *will not* give as good of an entry price as a 'fade' entry, or allow as tight of a stop placement from a technical standpoint. This article is geared towards those who have *already decided* that they want an alternative to a 'fade' entry.

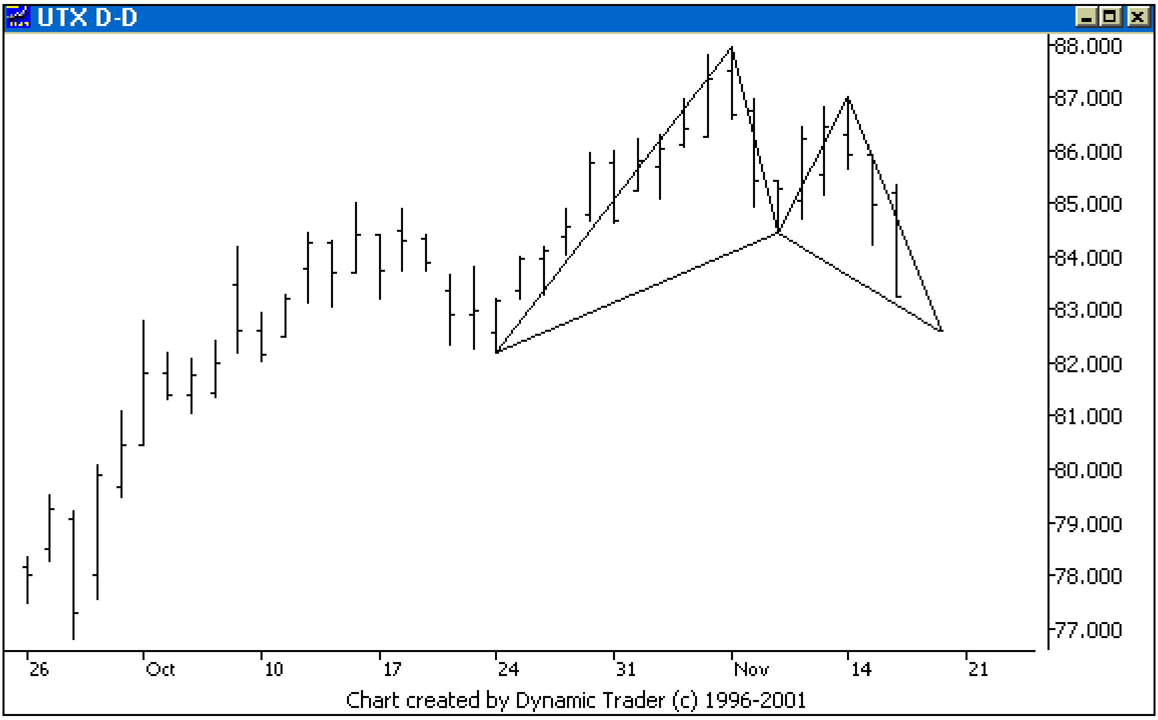
The article is *not* geared towards making the case that this entry technique (or any of my other entry techniques) is *better* than a 'fade' entry. The purpose here is to provide some options for traders who are specifically looking for alternatives that might fit into their 'Trading Plan'. As long as this is clear I feel that the article can be viewed in its proper context, and it can then be of the greatest use to the readers.

Let's move on to how I started to develop this technique. My own personal preference for trading is towards re-entry versus taking a lot of 'heat'. I would rather try to cut the entry close and keep a fairly tight (although technically logical) stop, and then re-enter if I get taken out (and I get another entry signal), as opposed to keeping things loose to keep me in.

This attitude motivated me to look down to lower timeframes, where I could 'fine-tune' an entry technique. The downside is that the 'noise' level increases the lower down you go. If I were to go down lower than my conventional one timeframe (a factor of 3-5, generally), I would need to find a way to be less sensitive to the 'noise'. I started to think about the techniques that I find a bit less sensitive, and trendlines and regression channels came to mind.

This was good, because they fit in with something that I was seeing quite frequently. Let's start with some charts, and we'll see if you can guess what I might be thinking about. I'll start out showing a pattern that formed in UTX on the daily chart. See figure 1.

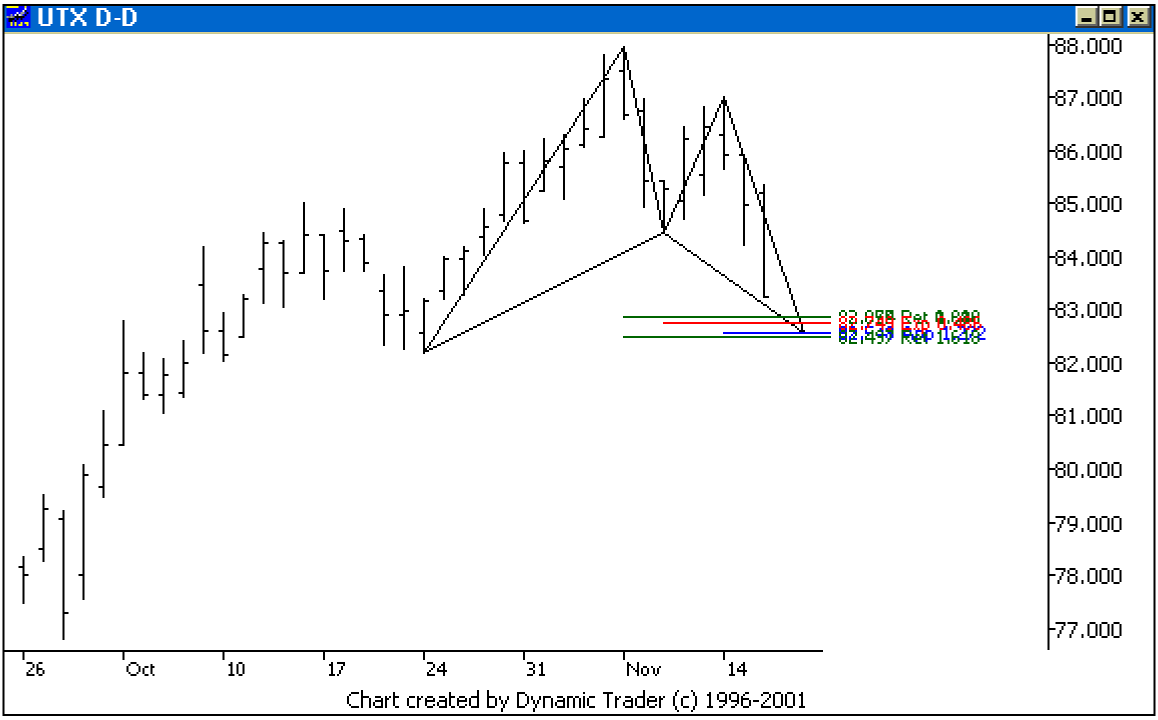
Figure 1



I particularly liked this pattern because it laid out in the manner that I prefer to trade 5-point patterns. The pattern set up to *continue* the trend, *not reverse it*. I go into extensive detail on this topic in [Kane Trading on: Trading ABCD Patterns].

Let me add a grouping onto the chart to show the potential trade area that I was focusing on. See figure 2.

Figure 2



This is the stage of the game that I begin to look for an entry technique. My normal means of doing this would be to use one of the techniques that I laid out in <u>ET</u>. Instead of doing that this time, though, I am instead going to show the process that I used to come up with yet another entry technique, one more specific to pattern trades.

Let me reiterate before I move on, though, that this does not preclude my use of my other techniques. It's just that when the setup lays out in a certain fashion (which we will discuss shortly), the technique that I am presenting here is my preferred entry technique for pattern trades, in most cases, *at this time*.

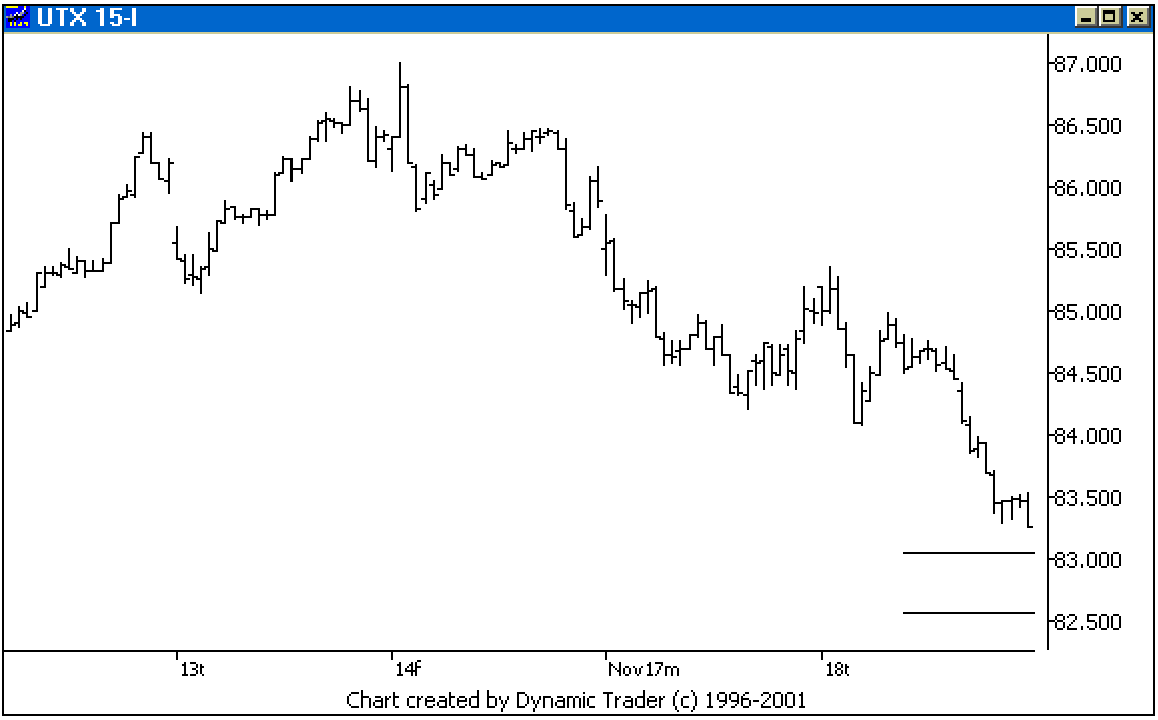
Let's do something here that is somewhat unusual as far as my 'normal' application of entry techniques. Let's drop down *two* timeframes instead of the usual one timeframe when looking for an entry technique. (In <u>ET</u> I do cover one specific entry technique called 'A 'Cool Trick'' that has the trader dropping down two timeframes. Although there are some similarities between that technique and the one that I am presenting here, they are two distinct techniques).

Generally, I space my timeframes out such that the difference in the amount of data per bar is approximately 3-5 times the amount from the other timeframe. Sometimes I vary this, such as going down to a 60-minute chart from the daily timeframe because the 60-minute chart is so commonly used. If I stuck with 3-5 times the data, I would be choosing, perhaps, 90-minute or 120-minute charts.

Traders have to decide for themselves what timeframes they want to use. For me, the overwhelming preponderance of traders using the 60-minute chart versus the 90 or 120-minute chart pushed me in that direction. From the 60-minute chart, then, the next lower timeframe for me would be the 15-minute chart. There is nothing special about the 15-minute chart, and if you prefer a 13-minute chart or whatever, you should experiment with what you are comfortable with.

Let's look at a 15-minute chart of UTX as it heads into the potential trade area. See figure 3.

Figure 3



I highlighted the upper and lower bounds of the grouping (our 'potential trade area', or PTA) with horizontal lines, so that we can clearly see where we are with respect to the grouping. What I want to focus on is the 'character' of the price action as UTX heads into the PTA.

Do you notice anything about the price action? I noticed something here, and in many other issues, as soon as I saw the charts like this. What I saw was how well the trend into the PTA followed a trendline or regression channel (or regression channel line).

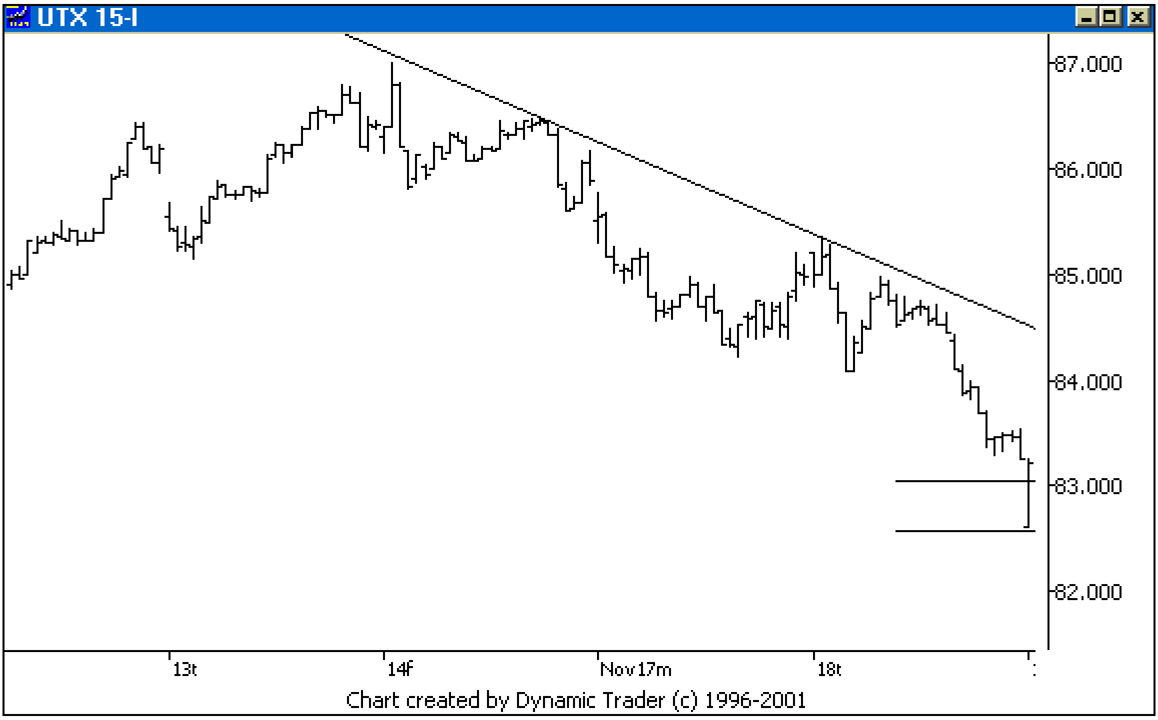
I’ll add on a trendline to show what I mean. See figure 4.

Figure 4

Until the final plunge towards the PTA, the trendline did a great job of representing the price action. Now, with the PTA getting so far from the trendline, though, does that decrease the utility of the trendline? Remember that we are *two* timeframes below our traded timeframe. Even though the distance may look great, in the context of the traded timeframe it is quite small.

Let’s advance ahead a bit, and see what UTX is doing with respect to the PTA. See figure 5.

Figure 5

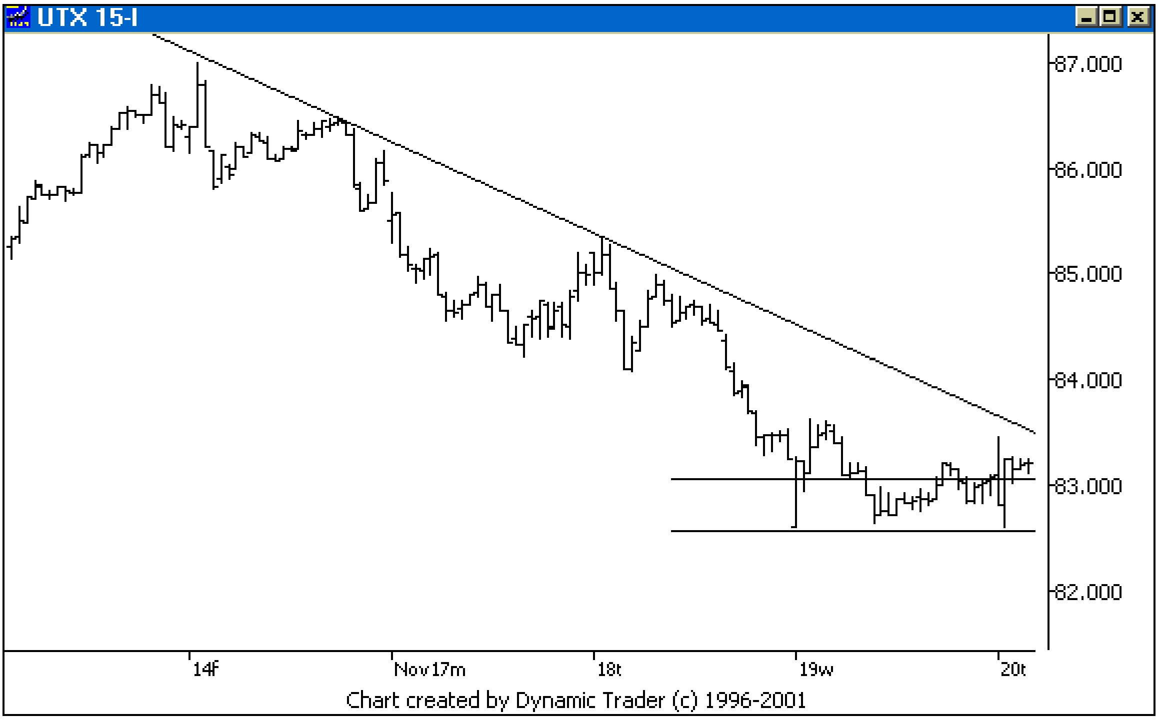


UTX has dropped almost all the way to the bottom of the grouping, and is stretched even more from the trendline. This is where the ‘fade the entry’ traders would be getting in. There is no doubt that those traders would be getting a potentially better price. If you decide to buy the bottom of the grouping, you would, by definition, be getting the best price (assuming, if you hadn’t bought already, that you would abandon considering buying once the grouping is violated).

What I want to have, though, is confirmation. I want confirmation that the issue is reversing at the PTA. I understand that I likely won’t get as good of a price, but I’m willing to trade that downside aspect for what I perceive to be a higher likelihood of the trade ‘working’. Traders have to decide for themselves if this is the route that they want to go down. All I can provide is a technique that I use, *if* a trader decides that they have the need for one.

Let's move ahead on the UTX chart, and evaluate what is happening. See figure 6.

Figure 6



UTX is trading sideways in and out of the PTA. With the trendline sloping down, the price is getting 'wedged' tighter and tighter between the PTA and the trendline. UTX has a decision to make, and it will have to be made soon. This is exactly what I have been waiting for. For me, a clear move over the trendline would be an adequate trigger for me to enter the trade.

Now, does this guarantee that UTX will then continue up? Of course not. In my opinion, though, it increases the likelihood that the PTA will 'work'. That's the theory behind waiting for some type of confirmation to trigger an entry.

Let's move ahead on the chart, and assess what is happening. See figure 7.

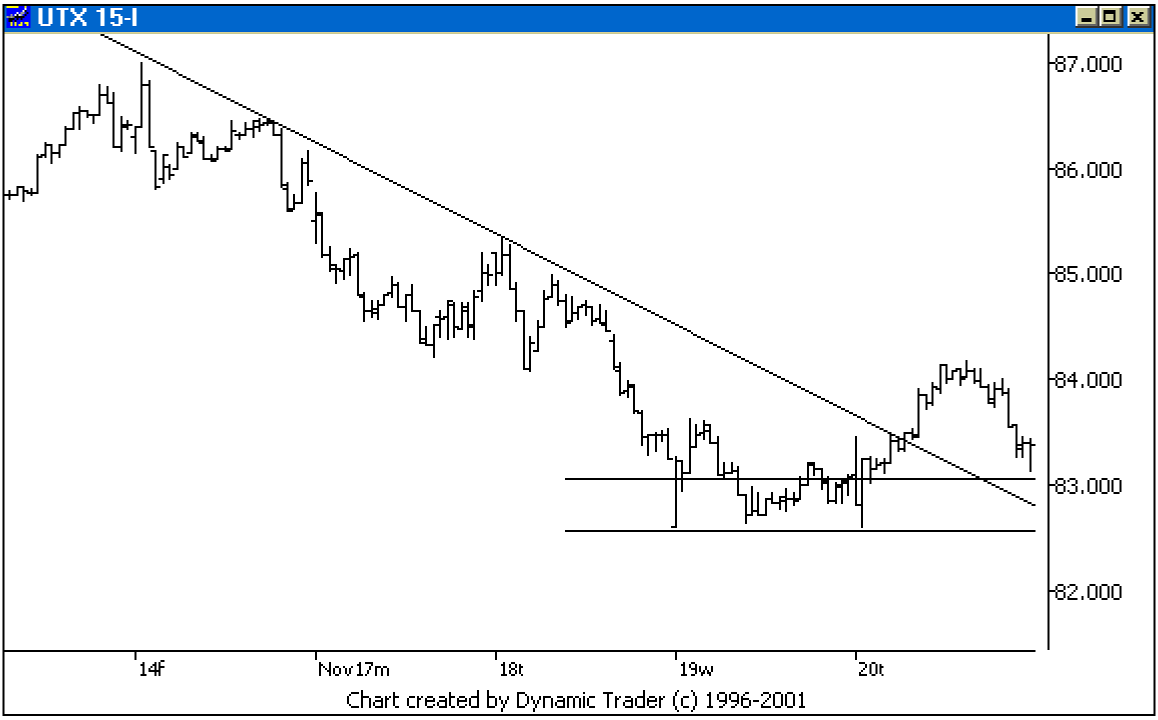
Figure 7

UTX has now closed above the trendline, and I consider this an entry trigger for *my* 'Trading Plan'. The closing price on the last bar is $83.49. Note that the lowest price traded in this down move so far has been $82.58.

The maximum price that I would be paying for this extra confirmation is ninety-one cents, and that's assuming a 'fade the entry' trader got low price for the move. Given that UTX is trading over eighty dollars at this point, the extra price paid is fairly minimal, in my opinion, for what I get in exchange.

Let's move ahead, and again evaluate what is happening with UTX. See figure 8.

Figure 8



UTX continued up after breaking the trendline, but has 'pulled back' and is sitting right on top of the PTA. It is not uncommon to see a 'test' of the PTA, or even of the trendline, in trades like this. For my trading, this is in no way a threat to my stop loss, since I usually have that placed below the grouping.

Remember, the trade is on the daily timeframe, and I am not going to get caught up in the small fluctuations in this much lower timeframe. I am in the management mode now, and I'm just letting things play out in accordance with my 'Trading Plan' at this point.

I'll add some more data onto the chart, and we'll reassess what is happening. See figure 9.

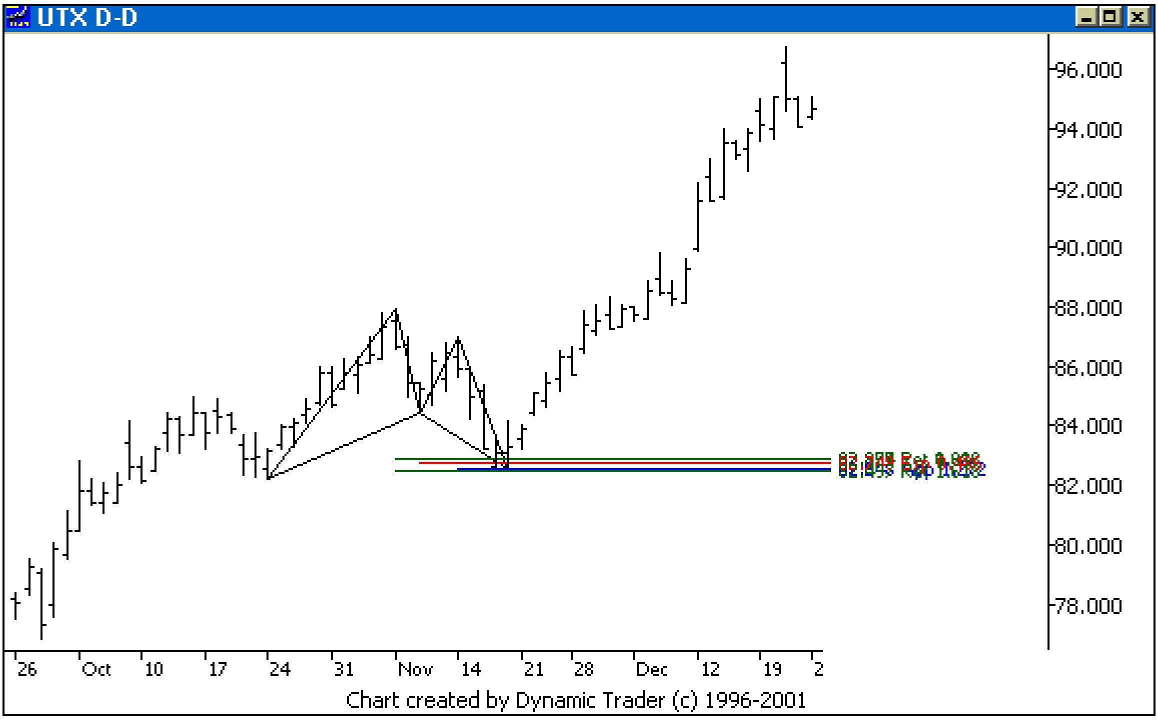
Figure 9

UTX 'tested' the PTA and has now begun to move up nicely. Notice the character change in UTX, from down to up. The trendline pointed me to the area where I felt that the character was shifting. Once the trendline was broken, I was seeing the downtrend as having ended.

Now this doesn't imply that an uptrend has necessarily started, only that, in my opinion, the downtrend was likely over on this timeframe. But remember that this was not a 'randomly' chosen area. Right below this area was my PTA, my grouping. My play was to bet that the grouping was going to reverse the trend.

I'll switch back to the daily timeframe, and show how this played out. See figure 10.

Figure 10



UTX just went ballistic off of the grouping. This trade is still in play at the time of this writing. Once the context of the traded timeframe is brought back into view, it is clear why I was not overly concerned with paying, say, fifty to ninety cents more for my entry price, in exchange for some confirmation.

Before we move on to the next example, I want to point out again just how powerful I feel it can be to play 5-point patterns and ABCD patterns when they set up to *continue* the existing trend. This trade in UTX is a classic example of what I cover in Kane Trading on: Trading ABCD Patterns, showing my unique approach to trading *with* existing trends.

I'm going to move on now to an example in MSFT. I'll start again with a daily chart and then drop down to a 15-minute chart to apply the technique.

Keep in mind, though, that this technique is in no way restricted to use with these two timeframe combinations.

I will use these timeframe combinations in my examples only because most pattern traders use the daily timeframe for their traded timeframe. I have used this technique to my satisfaction with weekly traded timeframes as well as on much lower timeframes. I have even found it helpful in my intraday trading in the ES mini.

In the latter case I have applied it when the traded timeframe is the 3-minute or 5-minute chart (with the 13-minute or 15-minute chart as the 'context' timeframe), and the entry timeframe is the 2-minute chart, and sometimes even the 1-minute chart. (I advise using extra caution and being extra thorough with your study and experimentation when dropping down to such low timeframes, though, as the noise level can become excessive and lead to a lot more false signals).

Let's start with a daily chart on MSFT, showing the pattern that I was looking at, as well as the very tight grouping that I built for the pattern. See figure 11.

Figure 11

The grouping here is very, very tight, with five distinct numbers in it, including my 1.902 retracement for the BC external retracement. The details of the derivation and use of the 1.902 retracement are in [Kane Trading on: Advanced Fibonacci Trading Concepts]().

As MSFT nears the potential trade area I am getting ready to choose my entry technique, and then I just wait and watch for it to trigger. For this example I will apply the new technique, and hence drop down two timeframes here to the 15-minute chart.

Let’s see how MSFT looks down in the lower timeframe. See figure 12.

Figure 12

This chart shows all the data from the C point of the pattern up to just under the PTA. If you step and back look at the chart in a ‘broad view’ you can clearly see that MSFT is following a straight line up as far as its path is concerned.

Let me put a regression line on the chart to show this. See figure 13.

Figure 13

Although MSFT travels above and below the line, you can clearly see that this line shows the 'motion' of MSFT as it heads towards the PTA. That motion is decidedly along a linear pathway. *This is a critical characteristic that I look for when deciding whether or not I can apply this technique to a particular trade.*

Once I have determined that the motion into the PTA is more or less 'linear', I move to creating a trendline, or possibly two trendlines. This is a somewhat subjective process. As I outline in Kane Trading on: Entry Techniques and Kane Trading on: Trailing Stops, I am looking for a line (or two) that 'represents' the price action.

What I'm not looking to do is follow (or set up) some complicated rules scheme when it come to determining lines that represent the price action. I will move the line(s) until I feel they represent what it is that I want represented. I just can't state it any more clearly than that. Given that, what do I notice on the MSFT chart?

Well, the first thing I notice is that the dip on August 14 is deeper than rest, and likely would 'skew' my line quite a bit. Let's look at what a trendline using that dip would look like. See figure 14.

Figure 14

See how that trendline is quite far away from the price action? Recall, also, that I said I don't get too worried about that because we are two full timeframes below the 'traded timeframe'. Nonetheless, I think that trendline doesn't represent the price action as well as I'd like it to.

I am noticing how the price action seems to be on a higher, 'second straight line', from about August 15 onward. So one thing I'm thinking about is using that price action for my line. I'm also thinking about cloning the line on this chart and moving it up to the next peak, and seeing what that line looks like.

I'll start by doing the latter, adding a cloned line onto the chart. See figure 15.

Figure 15

That helps a little, but it still doesn't represent the price action very well, especially the more pertinent recent price action going into the PTA.

At this point I will try a line from the upper price action. Let's see how that would look. See figure 16.

Figure 16

Now that's a much steeper line, and seems to do a pretty good job representing the latest data. But I need to zoom in on the recent data to get a better feel, and perhaps wait until a bit more price action is available. Recall that I am not going to consider taking an entry trigger *until* the price action has entered the grouping, and that happens around $26.60.

Let's add in some more data until MSFT just penetrates the grouping, and zoom in a bit closer. See figure 17.

Figure 17

Now it becomes clear that this latter line does, in fact, do a much better job representing the price action heading into the PTA. I would make one small adjustment and move the second contact point of the trendline down just a little so that small bit of data doesn't penetrate the line, but otherwise, I have my line.

I'll make the small trendline adjustment, and then we'll see what happens. See figure 18.

Figure 18

I think that is just right now. The line represents the latter price action quite well, in my opinion.

Let's move ahead, and see when/if this triggers an entry. I will leave the other two trendlines on the chart for later reference. See figure 19.

Figure 19

MSFT has now triggered an entry for me with that close below the trendline (depending on your trendline and your eye, it may have triggered on that bounce several bars back). This close is fifty-seven cents below the high for the move. Since very few 'fade the entry' traders would have sold the high tick for the move, the 'cost' for this confirmation entry is some fraction of the fifty-seven cents from the high to my approximate entry point.

Now, notice how much further down the other two lines are from this entry point. It is clear that neither of those would have been a feasible choice for an entry trigger line. They represented the entirety of the price action up from point C of the pattern quite well, but not the latter part of the action. (This will lead to a very important observation that I have made about this technique, which I will get to a bit later). What is important to determine is the best line for representing the price action going into the PTA. I will have more to say on this after we finish the examples.

Let's look at how this trade played out on the daily chart, and then I'll make some observations. See figure 20.

Figure 20

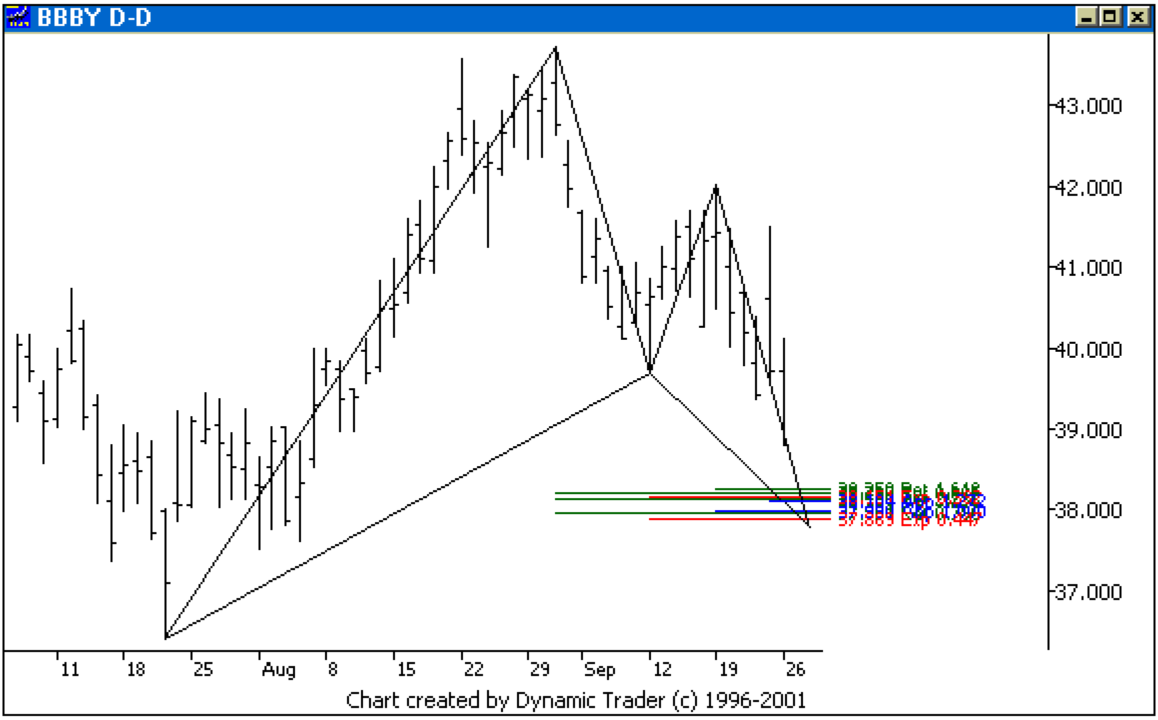
MSFT was rising almost 'straight up' to the grouping. In fact, it gapped up nicely the day it hit the grouping, and closed strong. It then gapped down the next day and proceeded to trigger my entry. I don't know about you, but with an issue going almost straight up, then gapping up and finishing strong, I'm not about to short that without any hint of a reversal.

The gap down the next day and then the price action below my trendline was enough to confirm, for me, that the character of the price action may have changed. Look at the chart and visualize a fraction of the fifty-seven cents paid for confirmation, and how it looks compared to the potential profit in this trade.

For me, that is a very small price to pay for confirmation that this thing isn't just blasting off. Remember, if a PTA fails to hold, it can be the site of a significant move (which is why I have heavily incorporated trading failed patterns/groupings into my ‘Trading Plan’). Traders have to decide for themselves if the extra price that you usually have to pay for some confirmation is worth it to them. For me, it is.

Let’s look at one more example, this time in BBBY, again on a daily chart. I’ll highlight the pattern that I am looking at, and the groupings I set up for the pattern. See figure 21.

Figure 21



Two very tight, very close groupings came together for this pattern. Once this stage is reached, I drop down *two* timeframes (in this case to the 15-minute chart, again) and start to observe the price action.

I'll show the 15-minute chart, with the data right up to the point where the top of the first grouping is about to be penetrated. See figure 22.

Figure 22

In case I haven't made this clear enough, I don't accept any entry trigger until the price action has penetrated at least the first part of the grouping(s). If I draw in a trendline and it is violated *before* the price action has entered the grouping(s), I do nothing. In fact, I will use that new swing-point (if the trend resumes) to calculate a better trendline, if possible, since that is valid data for a trendline calculation.

Let's look at a possible entry trigger trendline on this chart. See figure 23.

Figure 23

This trendline does a pretty fair job of representing the price action as it heads into the PTA. I would like it better if the data didn't 'bow out' from the trendline in the middle, but this is BBBY, and it's a tricky one at best. That's why I chose it for an example.

The only other choice would be to use the last three small swing-highs in some manner for the trendline calculation. I don't like that because it only represents about one day of price action, and that's just not enough for me. Let's try the trendline that we have, and see what happens.

I'll add more data onto the chart, and we'll assess what happens. See figure 24.

Figure 24

BBBY has traded into the grouping (the top of which was at approximately $38.25), allowing me to accept an entry trigger. It then triggered an entry on the last price bar here with a close above the trendline. The closing price on that bar was $38.55, so we'll use that price as our reference price. I'm not saying, of course, that anyone could or did get filled at that exact price, but we need to have a price for comparison purposes.

Let’s move ahead a bit, and see what is happening. See figure 25.

Figure 25

BBBY started up nice, but has now pulled back to below the entry price trigger. Am I panicked? Not at all. Keep in mind that we are *two* timeframes down from the traded timeframe. My stop would likely be somewhere below the lowest part of the groupings, and that’s not even close.

Don’t get fooled by tiny little movements down on this timeframe. I use this to trigger me in, and then I get away from this timeframe. If I try to micromanage down here I’ll get pummeled.

Let's move ahead, and see what is happening since this entry trigger. See figure 26.

Figure 26

Now that's more like it. That little pullback was just that, a little pullback. BBBY went straight up from there. I tend to 'trust' my entries using this technique. I set my stop and once triggered, I let it play out however it does. I adamantly avoid watching closely on the two times lower timeframe, as far as considering taking any action at that level.

Before I finish up this example let's take a quick look at using those last, small swing-highs as a possible trendline entry trigger. See figure 27.

Figure 27

The arrow points to the trendline that I added using the latter data from the two small swing-highs before BBBY dropped into the PTA. Notice that the entry would have been triggered a bit later, but not all that far from the entry trigger that I chose to use.

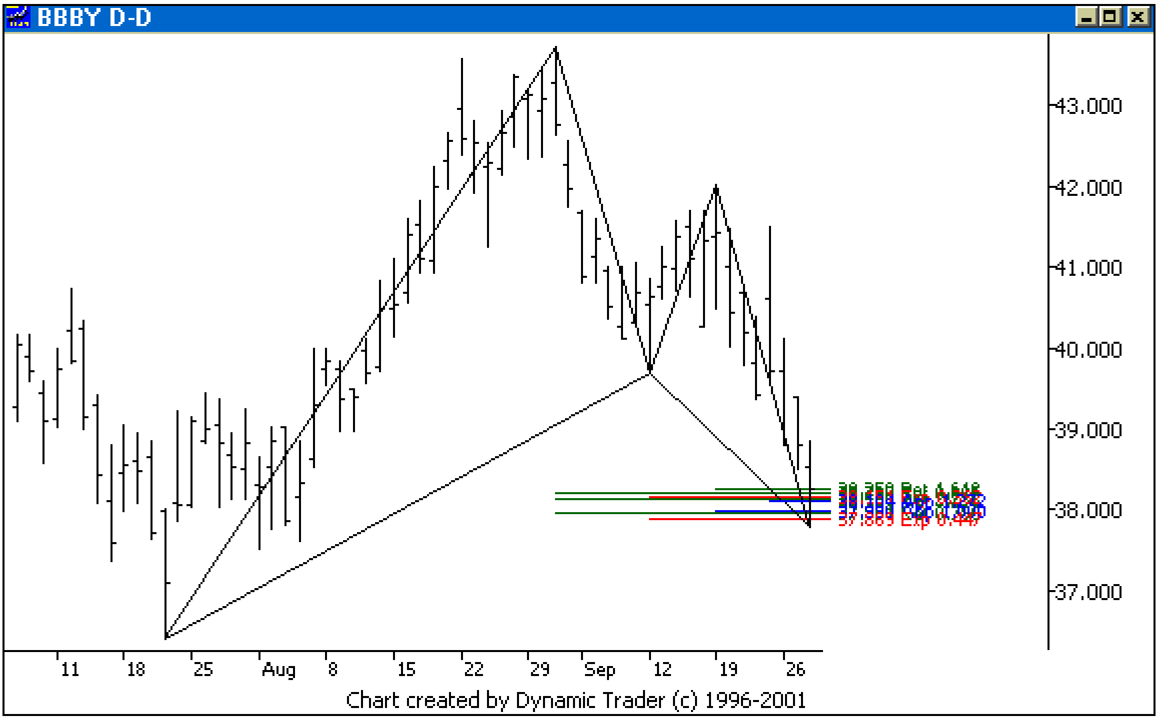
Although the difference in entry price in this case would have been fairly small, I just don't feel that the latter trendline represents very well what it is that I am trying to accomplish here. I am looking to see when the trend into the PTA has stopped. This latter line only represents a small amount of that trending data. Hence, even if it turned out to do a better job, I would not set up my trigger like this.

My point is that this technique requires a bit of decision-making and discretion on the trader's part, but it should be fairly obvious what trendline represents the price action that one is looking at. And what if no line looks to represent the price action all that well? Then I don't use the technique.

I use this technique when an obvious line almost jumps out at me. That's when I have found this technique to work well for me. I will sum this up later when I go over the criteria that I look for, as well as cover some tips and hints that I have found helpful to me when using this technique.

Let's finish up this example by taking a look at what happened with BBBY on the traded timeframe. I'll start by showing the daily chart just as BBBY hits the groupings. See figure 28.

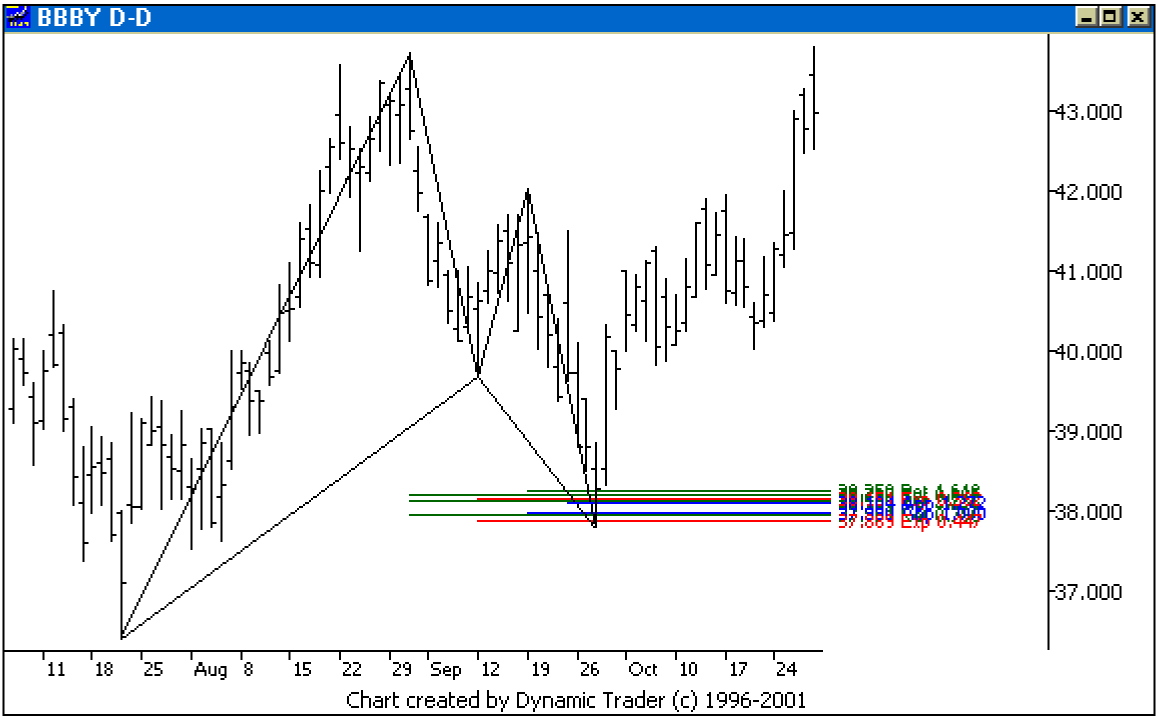
Figure 28



BBBY drove right through the first grouping, and right to the bottom of the second grouping. Once the top of the first grouping was penetrated, though, I was waiting to take my entry trigger. Recall that the entry price that we are using as our reference price is $38.55. Look at the scope of the pattern and see how small that extra confirmation is with respect to the larger scale context.

Let's see how this played out on the traded timeframe. See figure 29.

Figure 29



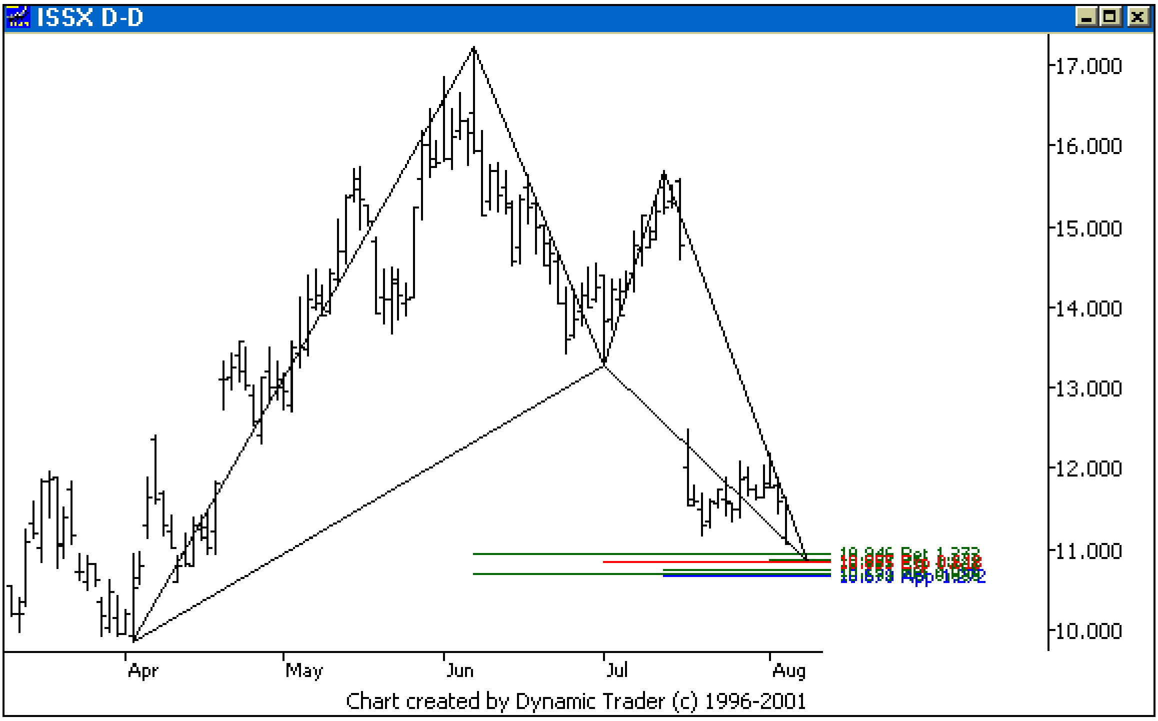
BBBY really blasted off of the pattern completion and lower grouping. This was an outstanding pattern trade. But now think back to that little pullback on the 15-minute chart, and how I said that I don't get caught up in such moves. Look at this chart and think if that move looks significant in the context of the traded timeframe.

Look, also, at the $38.55 entry price, and the price a 'fade the entry' trader might have gotten, and see how insignificant that difference is in this context. I feel that I pay a small price for that confirmation. It's easy to look at the examples that I have presented and think that the fade entry would have been a better deal every single time.

Yes, it would have, because these examples are ones that produced a reversal in the PTA. It didn't take many experiences with blown-out PTA's to convince me that I wanted some confirmation before entry.

I'd like to show one more example (a brief one), to point out something that I see fairly frequently when using this technique. Let's start with a pattern in ISSX. I'll show the daily chart, with the grouping that I built for the pattern. See figure 30.

Figure 30



This is a great looking pattern to me, but just look at that gap down. It would seem almost impossible to believe that ISSX is setting up as a bullish trade. But the pattern is pointing to just that. At this point ISSX is getting close to entering the grouping, and I'd be setting up my 15-minute chart trendline.

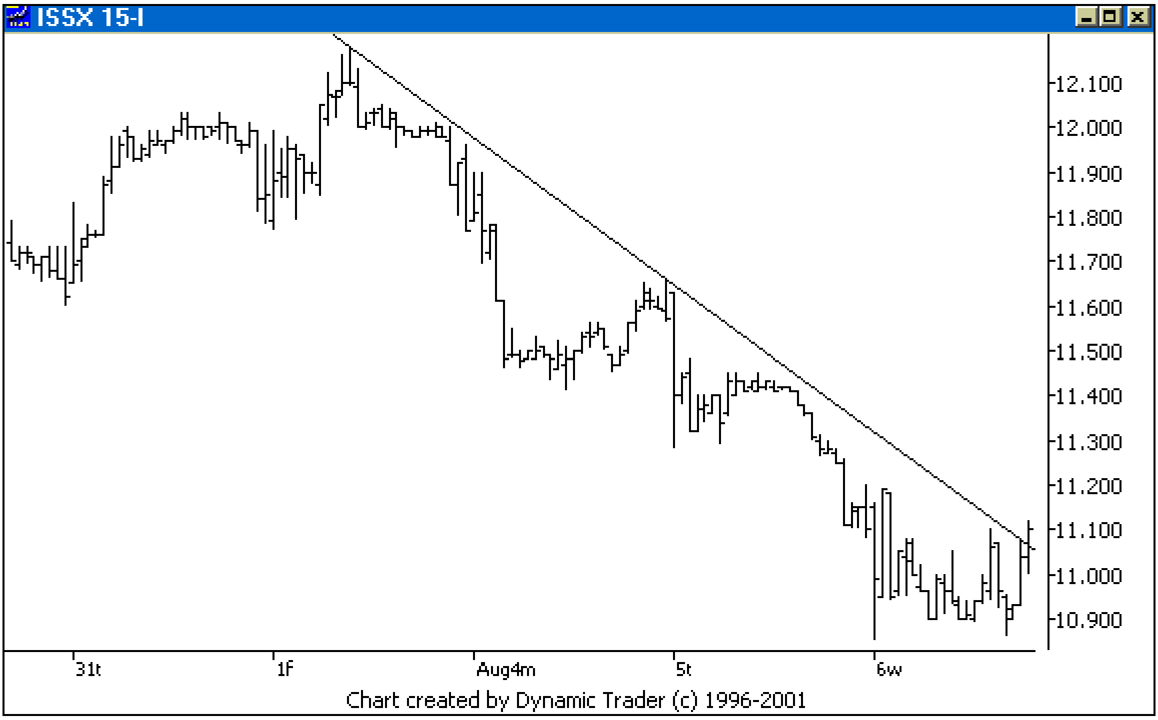
Let's take a look at how ISSX looks on the 15-minute chart, with the trendline that I have chosen. See figure 31.

Figure 31

ISSX has now entered the top of the grouping, and I'm willing to take an entry trigger. I'd prefer that ISSX wasn't quite so far away from the trendline, but I feel that the line is doing a great job at representing the downtrend into the PTA, so I'm going to go with it.

Let's move ahead to the trigger point. See figure 32.

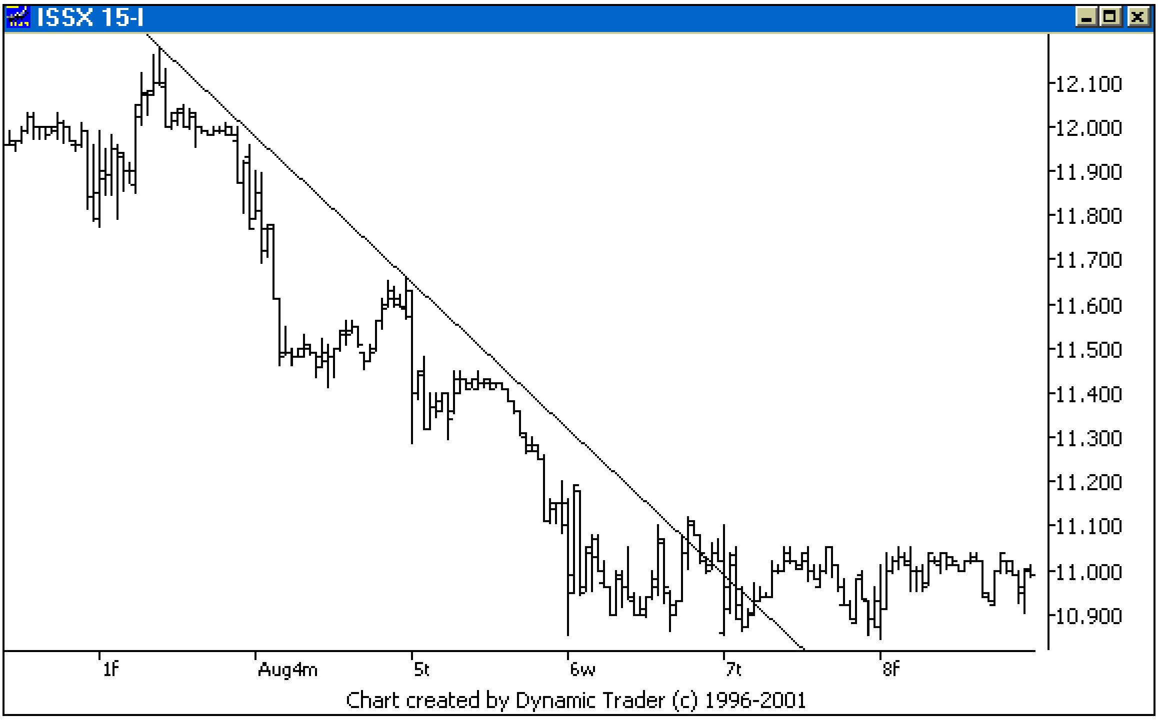
Figure 32



ISSX has now given me an entry trigger at this point. Here's where the interesting thing begins to happen.

Let's move ahead a couple of days, and assess what is happening. See figure 33.

Figure 33



Take a look at that. ISSX has gone nowhere at all, in fact it rolled back down and 'tested' that low three times! Now readers familiar with my trading style know that, for me, I'd be long gone, even though my stop wouldn't have been hit. If I don't get the reaction I expect, that's it, I move on. But not now. I would stay with this trade.

Why would I do that? I would do that because my experience with this technique has shown me that this happens quite a bit. Many, many times I see this sideways action on the two lower timeframe chart. In the context of the traded timeframe it is barely noticeable, but it is very distinct on the *entry* timeframe. It has compelled me to ride these out and just stick with my stop.

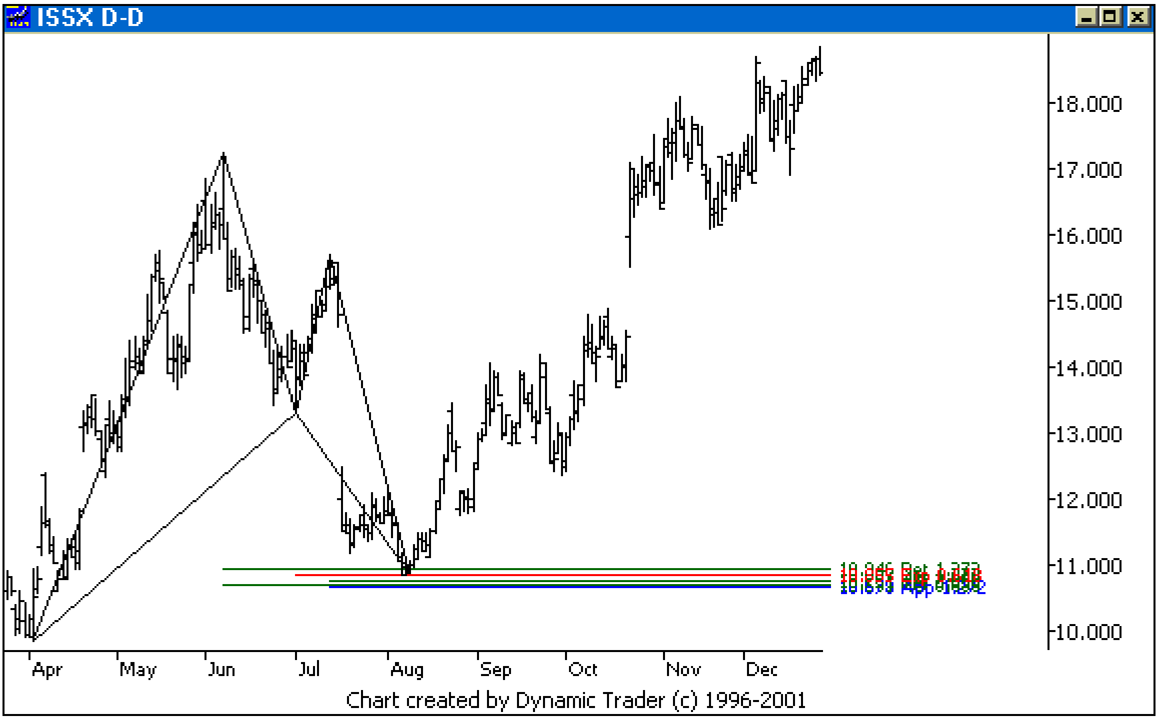
I wanted to show this here because it is something that I have seen a lot, and I want the reader to expect to see this. Granted, most readers are not going to be as ‘jumpy’ as I am. My habit is to get out, regardless of whether my stop has been hit or not, if I don’t see the expected reaction just about right away. I prefer to do that, and enter a second (or even third) time, if necessary.

Most traders will just set their stop and ride out the bumps. I don’t encourage traders to do it the way that I do, as I have chosen that method to fit *my* style and *my* ‘Trading Plan’. I point this out here to make it clear that although it was very helpful for me to see the way many of these pattern trades act on the two times lower timeframe, that observation may only have practical use to traders that have a ‘jumpy’ style like mine.

A trader who sets his or her stop below the grouping (in a long trade example like this) will just wait out this sideways action, regardless of whether or not it appears to be common, and that will be that. I wanted this observation to be noted for those who may be able to make use of it, like I did.

Let's see what ISSX did after this point. See figure 34.

Figure 34



ISSX just went crazy after that pattern completion. Look at the traded timeframe chart here and see if it looks like it went sideways in the PTA. It looks to me like it just exploded. Sure, if you look close up you can see that it, perhaps, slightly hesitated before rocketing off. But it sure looks different in this timeframe.

Imagine if I had gotten in and then took the trade off because it started back down to the lows or because it was just going sideways, without giving it the breathing room of a reasonable stop. Look at what happened with ISSX and imagine how that would feel. Sure, I likely would have gotten in again at a higher price on a re-entry, but that's not the best way to trade, if it can be avoided.

What all this boils down to is that I go off of 'jumpy mode' when I use this technique. I give it the room to my stop, and if it goes sideways on the twice-lower timeframe, I just let it. I keep the context in mind, and just let it do its thing. I have found that doing that works the best for my trading. Readers should experiment with this and find out what, if anything, works for *their* 'Trading Plan'.

Let me sum up some points here about this technique as we conclude. One of the best observations that I have made about this technique has to do with the trend into the PTA. I have noticed something about the trend that I think is very significant. I have never seen this mentioned in any other material that I have encountered.

Take a look back at my examples (and if you really want to better your learning experience, chart some of your own examples before you read on), and see if you can notice anything about this twice-lower timeframe trend. Here's what I figured out. If the pattern is a pattern with an ABCD that is close to an AB=CD pattern, up to just about an AB·1.272=CD, the twice-lower timeframe trend into the PTA will almost always be the entire CD leg.

If the pattern is such that AB·1.272=CD or greater, the CD leg will almost always break down into two thrusting legs itself, and the twice-lower timeframe trend into the PTA will be the 'second half' of the CD leg. This observation really helps guide me when trying to determine what the best trendline to use is, especially as I do this on various timeframes.

I also want to reiterate that I have used this technique on many other timeframes and have found it to be quite useful to me. I chose the daily timeframe for my examples here because I feel that it is the traded timeframe for the overwhelming number of traders that trade 5-point patterns (and hence they are the main readers of this article).

There is nothing more to applying the technique to other timeframes than just following the same procedure that I have outlined here. Just be sure, as always, to test and/or modify the technique to suit your own needs.

I feel that the critical aspect for applying this technique is in choosing the trendline to use, and that requires discretion and choice. I avoid being trapped by 'classical' concepts for trendlines when I do this. I am looking for a line that I feel represents the consensus of the price action going into the PTA.

If the swing-points don't point me to a line that does this for me, I will make one up based on other swing-points, or by cloning and moving a regression channel line. All this is not as imprecise and random as it sounds. I can tell when I see it that I have a line that 'statistically' shows me the price action, and shows me when/where the issue is likely to have changed character.

That's what I am looking for here. This is not like using a trendline or trendline break from 'classic' analysis. This is using a line to determine when the immediate character of an issue has changed, *in an area where it is highly suspected that a change in character is about to take place*. Keep that in mind, as you look this technique over.

And as I mentioned earlier, this technique is only used with those potential trades that set up indicating its use. The main criteria that I look for is the smooth, linear trend into the PTA on the two times lower timeframe. Not all pattern trades set up with this type of a trend into the PTA. Some gap down into the area, others chop all over before hitting the PTA in what looks likes a haphazard manner. And some get there by means that I can't even find words to describe.

For those potential trades, I simply don't use this technique. That's not to say that those trades don't work out just as well. They just don't fit the necessary form for setting up the use of this entry technique. I need the linear move into the PTA and the ability to form a representative trendline on the two times lower timeframe, or I just don't try to apply this technique. I either pass the trade, or, more often, simply use one of my other techniques from <u>ET</u>.

All in all I find this technique quite easy to apply, as long as I follow the general guidelines that I have just laid out.

Conclusion

I hope that I have presented a technique that will be as useful to the readers as it has been to me. Keep in mind that I am not trying to convince any readers that they should abandon fading the entry on pattern trades, *if* that is their style of trading. What I have attempted to do here is present an alternative that I use, for those traders that have decided that they don't want to fade the entry.

In my opinion, everything in trading is some kind of a trade-off. I feel that I get a better chance of my trade 'working out' when I use this technique. That comes at a price, though. I generally don't get as good of an entry price, and I have to set my stop further way, resulting in a larger loss when I do get stopped out. So why would I do that?

I feel that although my stop losses may be greater and my profits slightly smaller (because my entry price isn't quite as good), I have fewer stops hit and hence more winning trades. If I didn't feel that there was a net positive benefit to making this trade-off, I wouldn't do it. Traders need to determine for themselves if they also get a net positive benefit for their trading by applying this technique, or a variation of it.

My goal with this eArticle was to not only present a new technique for entering pattern trades, but also to stimulate the readers into thinking about the aspects and implications of their choice of entry techniques. I wanted to get the readers to think about trade-offs in trading, and in the 'Trading Plan'. I feel that I have done a worthwhile job in this respect, and met my goal.