Trading Techniques using the "Secret" Floor Trader's tool!
Author: John L Person III, CTA
September 23, 2003

The subject of combining pivot point analysis with Fibonacci Correction and extension levels is a powerful leading price indicator. Many people have labeled Pivot Point analysis strictly for day traders and specifically used by floor traders. The truth is, it can be used for multiple time frames and not just for day trading or exclusively for floor traders. This article will highlight the many benefits that leading price indicators like Fibonacci price extensions and Pivot Point analysis can offer you.

Applying the Pivot Point calculations to predict Support and Resistance levels can be used for calculating the Daily, the Weekly and even the Monthly price ranges. These calculations are an extremely powerful price-predicting tool especially when applied with Fibonacci correction or extension numbers.

This article cover:

1. Which Pivot point formula to use and why.
2. How to account for market opening Gaps in the analysis
3. The background of Fibonacci ratio and series numbers

Below is the most common formula used by traders. There are other variations that some traders use to help offset the difference between Night and Day trading sessions. I use the variation below and account for all trading sessions in my calculations beginning from the night session's open until the day session's close. If I am trading the mini-stock index futures like the CBOT mini-Dow contract I take the close at 4PM CST.

Including the all session data for markets that trade twenty-four hours accounts for "gaps" in the market prices. The formula below is still the most widely used. One variation that one can use is to include the Open in the calculation. The formula changes to reflect this, for example P=(O+H+L+C)/4. The reason I do not use this method is one needs to wait until the open to make the series of calculations and does not allow a trader to be prepared before the open of the market. In any case to use the open, High, Low and Close method just incorporate that Pivot Point number to the remaining steps shown below.

For the Weekly calculations take the Open from Sunday night or Mondays day session open and then use the close on Friday. For the Monthly data take the opening of the First day of the month to the close of the last day of the month.

Here is the mathematical formula:
P= Pivot point; C= Close: H= High: and L= Low.

The Pivot point number is the high, low, close added up and then divided by three.
P=(H+L+C)/3= pivot point
First resistance level take the pivot point number times two and then subtract the low.
(Px2)-L= Resistance 1
Second resistance, take the pivot point number add the high and then subtract the low.
P+H-L= Resistance 2
First support take the pivot point number times two and then subtract the high.
(Px2)-H =Support 1
For the second support, take the pivot point number subtract the high and then add the low.
P-H+L= Support 2

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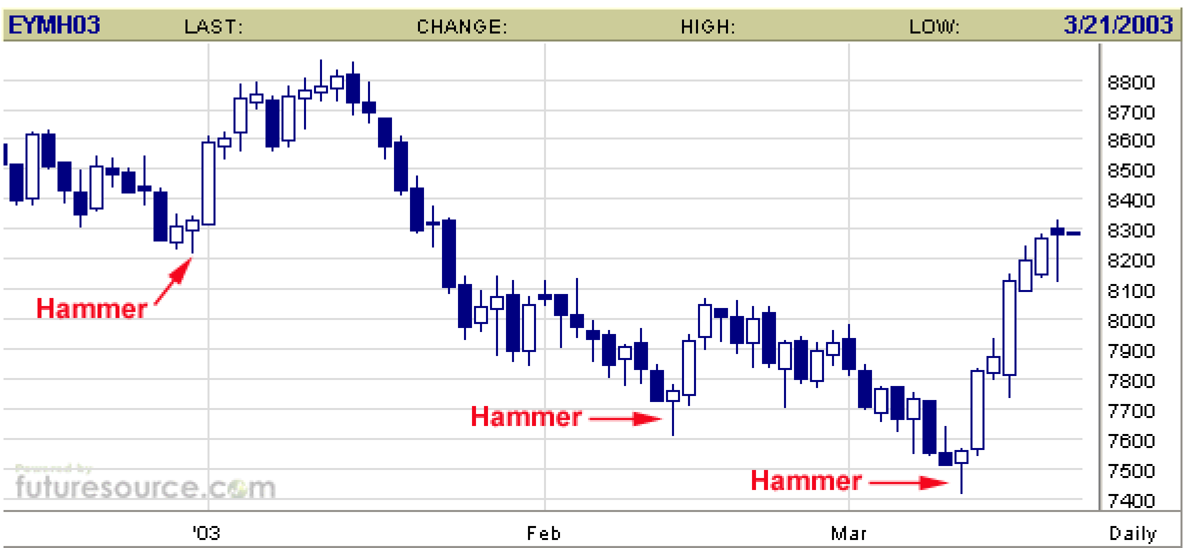
I also incorporate Candlestick Charting techniques to help me uncover market reversals. Bearish Reversal Patterns such as Bearish Engulfing, Evening Doji Stars, Bearish Piercing and Bearish Harami formations are indeed powerful set up chart patterns.

The reverse of these are Bullish bottom pattern formations such as Bullish Piercing, Bullish Harami, Morning Doji Stars and even Hammers which the mini-Dow seems to form with more and more consistency.

A great example of a Hammer candlestick formation comes from the low established at 7420, which was made on March 12th of 2003. This was a textbook Hammer formation and of course the market responded quite well. For future reference the characteristics required to form a hammer candlestick are that the lower shadow should be at least two times the length of the body. The body is the are formed between the open and the close. There should be little or no upper shadow and the color (meaning a lower close than the open or a higher close than the open does not matter.

However, I believe a higher close than the open, which will be a white, or hollow body is a better and more reliable indication that a bottom has formed.



This chart also was used to help illustrate why combining candlestick charting and Pivot Point Analysis can be effective in market analysis. Using the Monthly Pivot Point calculations, we were alert to a few possible support targets well in advance. Based off of the prior months data in February with the High of 8133, low 7617 and close of 7920, and then applying these figures to the math formula we came up with the S-2 price target of 7374

The weekly Pivot Point target price projection S-1 was 7535 and the S-2 was calculated out as 7336. That was based off of the data from the week ending on 3/07/03. The high was 7975, the low was 7556 and the close was 7735.

The monthly price target for S-2 was 7374; the weekly price target for S-1 was 7535. The actual low was 7420. Not exact, but not a bad margin of error either. Granted one may not have bought the exact low but armed with these three methods of analytical tools one most likely would not have gone short at that low either.

The mini-Dow responds well with Pivot Point Analysis as indicated above. The mini-Dow has been a valuable trading vehicle that offers traders another avenue to invest their risk capital.

Another great feature is that it affords my clients and individual investor's additional leverage since it offers one of the lowest margins more than any other Stock Index Future product. Liquidity is also a plus as it is provided not only by other traders but also by CBOT Market Makers! Two-sided trading, nearly 24-hour access, Global name recognition and only 30 stocks to follow make this a superb trading vehicle.

Fibonacci Studies

Looking at the e-mini S&P 500, it is one of the highest volume traded stock index futures contact and a popular day trading vehicle. It attracts many technically savvy orientated traders. Fibonacci analysis is a popular but yet complex study. Most traders are familiar with the most common correction or retracement number, which is 50 %. There is a lot more to Fibonacci than just that. S&P traders know this as well.

Fibonacci analysis recognizes that there is a relationship by adding numbers together and then there is also a relationship by dividing the numbers together. By doing this one comes up with certain repetitive percentage figures.

First of all lets go over what the Fibonacci summation or "series" numbers are. Simply put they are an infinite series of numbers that adds each number to the previous. An example is 1,2,3,5,8,13,21,34,55,89,144, 233, 377, 610, 987 and so on. If you take 1 + 2 you get 3, then if you take 2+ 3 you get 5, and if you take 3 + 5 you get 8 and so on.

Fibonacci ratios are numbers derived from the calculations within the Fibonacci series numbers. The most common numbers are .382%, .50%, .618%, .786%, 1.00%, 1.272% and 1.618%.

The "Golden ratio" number is often referred to for the number .618% due to the many coincidences that reoccur with that number. For example 89=+/- .618 of 144, 144 divided by 233 + .618, .382 + .618 = 1.00, .786 = the square root of .618%.

More importantly if you divide any number of the Fibonacci summation series by the number that follows the sum will be close to .618. For example 13 divided by 8 = @. 618, 21 divided by 13 = @ .618

With that information we have established that here are certain reactions with nature and as many great analysts in the past have pointed out that we can apply these math figures in our trading analysis. The most common approach is to use the Fibonacci calculations as a retracement tool. To do this we measure price retracement levels from point "A" to point "B". Take that figure and multiply it by the Fibonacci percentage number to get a "pullback" level. Here is an obvious trading tip.

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Have you ever had an experience that a market retraces all the way back beyond your purchase price level, then stop you out and the next thing that happened, the market went in the direction you wanted but without you?

Corrections can extend beyond 100% of the move. In fact 100%, 1.272% and 1.618% are the most often stopping points for full correction moves. Figure "1" shows the Fibonacci ratio correction levels.

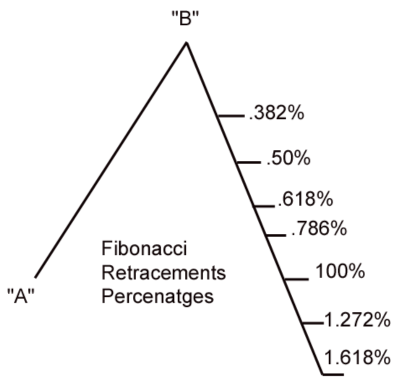

Figure "1"

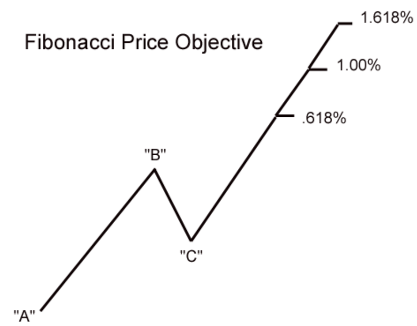

Figure "2"

Fibonacci numbers are widely used to predict market turns or price objectives on extended trends. Figure "2" above shows the way to calculate projected target resistance levels by taking the measurement of the range between point "A" and "B". Once that distance is determined multiply that number by .618%, 100% or 1.618% to get the projected resistance points.

In the example below in figure "3" we identify the low as indicated by Point "A". The first major high is identified by point "B". The distance is 53 points. Once we are certain that point "C" is a probable pullback support point we can take the distance from point "A" to "B" which we determined was 53 points. Now take that figure and multiply the Fibonacci ratio numbers and then add those figures to the low. Point. As Illustrated below point "C" is 980 and then by taking the 100% ratio number of 53 points an expected target of resistance point would be 1033. The actual high was 1030.30. This was a great method to help determine a possible turning point in the market. In fact the market did decline to a low of 1005.50, within two trading days, as the chart below shows.

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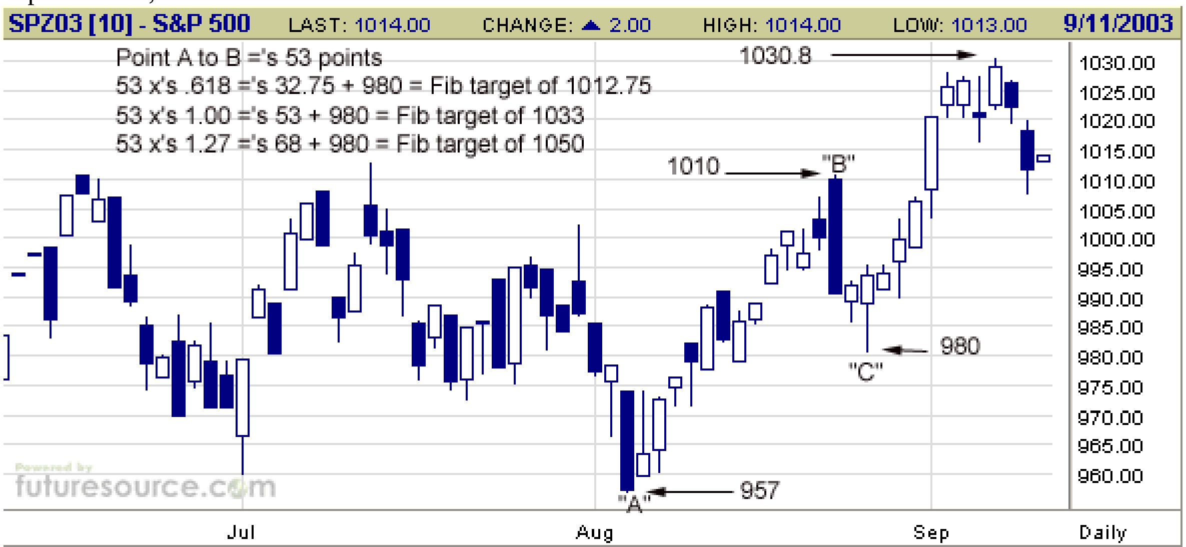
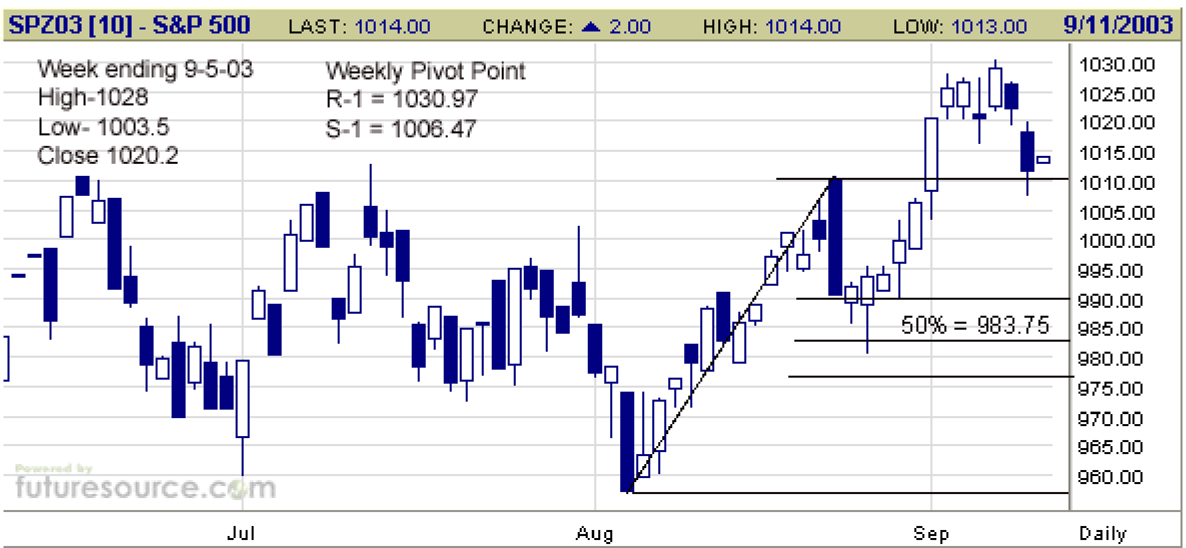


(Figure"3")

How do we determine what a significant pullback level is and why did we choose the low of 980 in the chart above as shown by point "C"? Simple, by using the Fibonacci retracement levels. We see in figure "4" below that the .50% Fibonacci pullback number calculated out to 983.75, which coincided with the 980 low. Notice that the day the market established that low a Hammer Candlestick was formed.



(Figure "4")

Taking the same chart and combining Pivot Point Analysis we see a much better confirmation of Support and Resistance levels that collaborate with the Fibonacci numbers. Using the Weekly Pivot Point analysis

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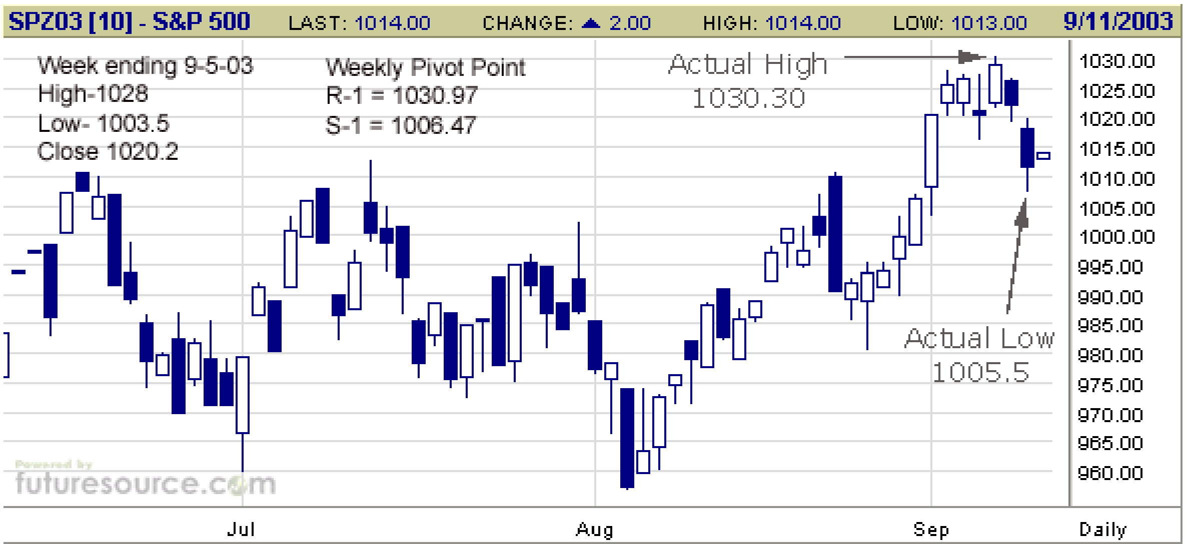
Rather than just Daily as I pointed out in the beginning of this article, we have a much better outlook on the potential High and low for the next weeks trading time frame. The cart below in Figure "5" shows how we extracted the priors weeks data which is High 1028, Low 1003.5 and Close of 1020.2. Applying this to the formula above our Weekly First Resistance point was 1030.97 and the First Support target was1006.47. The actual High was 1030.30 and the actual low was 1005.5.

As a short-term trader using the Fibonacci price Corrections and Extension methods combined with the Pivot Point Analysis from the Weekly Analysis you were armed with very powerful target numbers.



(Figure "5")

If you are interested in learning more on this subject matter I have a free 18-page booklet on this fantastic method of trading. Go to www.nationalfutures.com and click on the "Articles by John " tab.

Good luck in your trading and I sincerely hope this article helped.

Sincerely,

John L. Person, CTA