

Trading exhausts



The decisively brief and rapid price moves against the trend are scenarios that can be anticipated. The final article in this series incorporates previously explained Drummond Geometry patterns, Return to the PLdot and PLdot Push, in trading market exhausts.

By Ted Hearne

Patterns identified by Drummond Geometry work equally well in both shorter- and longer-term time frames, making this methodology an excellent tool for day-traders. The final article in this series will focus on trading a market condition known as exhausts. An exhaust is a time of high energy and is usually accompanied by panic and desperation by some, and euphoria by others. Special attention will be paid to intraday trading and how to find exhausts that terminate into daily support or resistance.

An exhaust is a quick directional price move that usually comes at the end of a trend and is followed by a significant retracement. It is generally a move that is sudden, sharp and extraordinary. We call this pattern an exhaust because when it hits the resistance or support that marks the extreme, it "exhausts its energy" then retraces

rapidly and dramatically.

A stunt flyer in an air show is a good example of an exhaust. At some point in the show, the pilot will fly into a perfect vertical climb, shooting straight up until he can climb no farther. Here, the directional movement is clearly apparent, as we have a trend in full throttle. But when gravity finally takes hold, the plane reaches an apex, turns and falls directly back to earth. Everything turns all at once. That's an exhaust. The energy that drives the move is completely exhausted, and the turn in the opposite direction is quick and decisive.

Note that in our analogy the vertical climb is not exactly flying. In flying, the wings support a plane and lift it through the air in comparatively gentle climbs and descents. But this exhaust is a powerful drive straight up, rammed through by the engine at full throttle, with the propeller

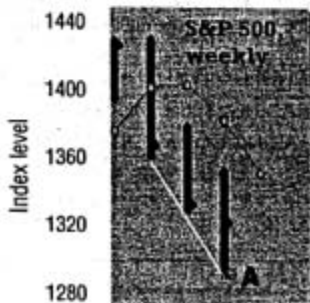
pulling the plane vertically higher and higher. The sheer power of the engine running at full blast does the work. Market exhausts are similar. They manifest the end of an exceptionally strong market energy period and not the ordinary advance and retreat of a normal market oscillation.

The key to exhausts' tradability is that they are creatures of a particular time frame. A powerful exhaust in one time frame may look like a calm and normal oscillation in a higher time frame. The first obvious characteristic of a market exhaust is that price terminates. That is, price stops, generally at an extreme, often in support or resistance areas that lie a level or two beyond the normal support or resistance for a specific day. The second characteristic is that prices don't stay in that area but immediately and dramatically retreat, most often to the PLdot or farther.

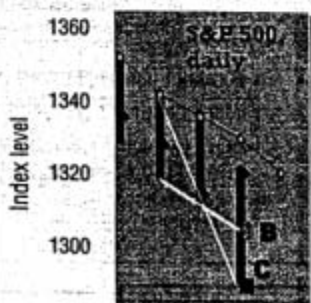
Our focus will be on extraordi-

RAPID RETRACEMENT

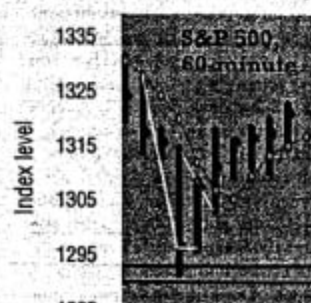
The S&P 500 exhausts through nearby daily support at point B into farther out daily support at point C. Once the market held weekly support (point A), the rapid retracement began.



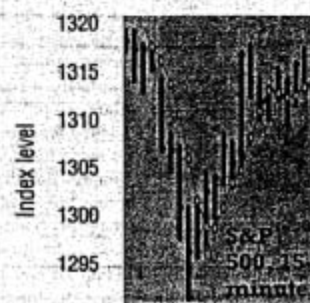
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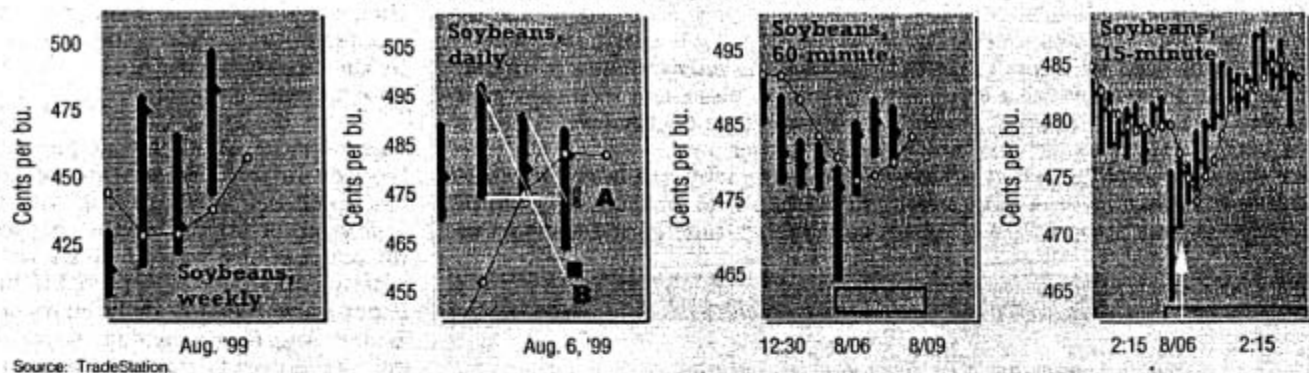


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Source: TradeStation

JUMPING BEANS

The sudden drop in soybeans on Aug. 6, from nearby daily support at point A, to farther out support at point B, suggests a possible exhaust. As the farther out support holds, a return to the Pldot can be expected.



nary exhausts, ones that have the greatest potential for profit. We want to identify those exhausts that occur outside the ordinary energy termination fields. We are interested in situations where price breaks through near-at-hand support or resistance (the support and resistance that marks the high and low of every bar) and moves to the next level of support or resistance that lies farther away (the "farther out" support or resistance area).

In "Rapid retracement" (left) the weekly near-at-hand support is marked at point A. On the daily chart the weekly support area is marked as a green rectangle, the daily near-at-hand support is marked at point B, and the daily farther out support is marked at point C. The support area at point B broke during the day and price exhausted lower into the higher time period weekly support at

point C. On the 60-minute chart we see this daily farther out support exhaust area shown in red, and the 60-minute support lines are shown in white. The 15-minute chart shows the daily farther out support area in red.

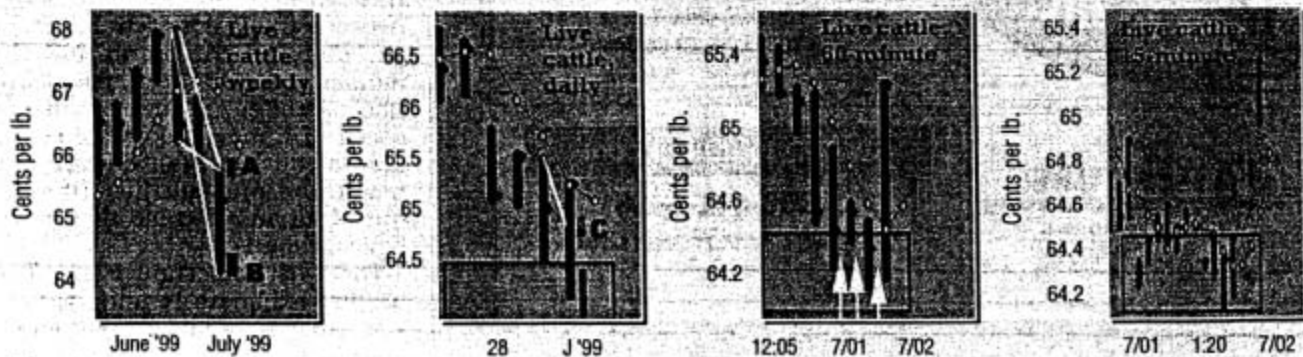
Time exhausts Looking at the market action in "Rapid retracement," note that the daily is exhausting into the nearby weekly support. On the weekly it looks like a normal oscillation, but it is apparent that the daily is exhausting into it. As price moved into this area, the trader would be alert to an exhaust and a rapid retreat. On the 60-minute chart, the 60-minute support lines start to hold on close, the first signal on that chart that an exhaust is occurring. The 15-minute chart would be already moving, ahead of the 60-minute. The 15-minute Pldot will start to

push the market up as its support lines start to map out the 60-minute exhaust and the rapid move into the daily exhaust, in nearby weekly support. The quick decline and rapid retreat can be seen on the 60-minute chart, and is especially clear on the 15-minute chart.

Price is in an exhaust when it moves beyond the normal flow of things, and is too far away from the crowd (the Pldot). Exhausts have a direct relationship to the Pldot in that they are a reflection of the strength of the Pldot's energy. If the Pldot creates enough energy as the crowd pushes price directionally, it will break through nearby support (see point B in "Rapid retracement"). In trading the exhaust, we are combining the concept of the farther out support and resistance with the concept of the Return to the Pldot (see ■

HIGH REBOUND

A big exhaust is occurring in live cattle as a return both to the daily and weekly Pldot is expected. The 60-minute chart shows that support was holding, signifying the previous move down was an exhaust.



➔ "Ahead Of The Crowd," *Futures*, June 1999). These two concepts together will accommodate 90% of all exhaust trading.

This principle applies to both an up move that breaks through resistance as well as support that breaks in a down move. For example, once the nearby support gives way, because there are few buyers, price can drop rapidly. When price reaches the next level of support (the farther out support), we are

alerted to the possibility that the move will terminate its energy there and become an exhaust. (See point C in "Rapid retracement.") If the push of the crowd is strong enough, it even can cause these farther out energy fields to break, in which case the exhaust will occur at some energy level that lies even farther away.

Once nearby support or resistance has broken, look for significant higher-time period support or

resistance. (See point A in "Rapid retracement.") When support or resistance areas from a higher time period overlap with the farther out support or resistance on our focus time period, then we are in the area where we can anticipate an exhaust occurring.

Soybean move Another example can be seen in the soybean market in "Jumping beans" (page 45). In the first week of August as the market hit a peak, the weekly chart was starting to make a Return to the PLdot move. On the daily chart on Friday, Aug. 6, nearby daily support (the green area at point A) broke on the opening and moved toward the farther out daily support (the red area at point B). The 60-minute chart shows an excellent upward close on the first hour, which signified that the first hour was indeed an exhaust. If it is exhaust driven by the higher time periods, then the 15-minute bars will show excellent accumulation and a sustained upwards move can be expected, with the 15-minute nearby support continuously holding as the move progresses. The target of this move will be a daily Return to the PLdot in the 485 area.

There are two things that we will examine here. The first is the price-stopping activity of the support and resistance that is farther away than normal from the day's activity. We need to know when an exhaust is likely. The second is the strength of the refresh activity. We need to know where prices are likely to retreat to when they stop their rapid directional activity.

The difference between an exhaust and an ordinary move is that the speed of the move is fast, as the nearby support or resistance gives way and price breaks through to a new area. The space between the PLdots gets larger, as the slope of the trend and the momentum increases. (Use caution on this sign however, as the speed of a move taken alone can also mean the high energy of a new trend and not just the last hurrah of an old trend that is the typical exhaust.)

The most important element in trading exhausts is anticipation; you must be able to take action on short notice. That means knowing when you are in the ➔

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area of the anticipated exhaust and knowing what to expect — that energy against the move will hold and push price back into the retracement. There will be a PLdot Push (see "Ahead Of The Crowd," *Futures*, June 1999) on the lower time period in the direction of the retracement. All of this will happen rapidly. If it does not happen rapidly, then it may not be an exhaust.

Once an exhaust is identified, we then take a position against the move. We are looking for a market retracement that will at least carry us back to the PLdot level, but may move much farther. Watchful monitoring on the lower time period (15-minute) chart can help us to identify an exhaust correctly. The market should retrace to the 60-minute PLdot. If it is not an exhaust, then the market will continue in that direction, as the lower time period exhibits a characteristic PLdot push pattern that continues through any support or resistance levels in the higher time periods.

Why use them? There are several good reasons to trade market exhausts. First, exhausts represent unusual activity when the market moves in a more volatile and emotional manner. The bar that shows the exhaust has a greater range with more unusual activity. This unusual activity normally has high potential — if we are going to see a retracement, then we want to see one that will carry us a long way.

Second, exhausts present an opportunity to go against the crowd and to pick off the tops and bottoms of a move. Taking action at the apex of the move ensures the best possible price for the return ride.

A "big exhaust" can occur when multiple time frames line up. Big exhausts can represent especially productive trade opportunities. Because the move to the Return to the PLdot can occur on several time frames, the refresh driven by the higher time frame can be a very substantial move. "High rebound" (page 45) illustrates a

big exhaust. Price in live cattle's weekly chart breaks through its nearby support and continues to its farther out support. This has a dramatic effect on the chart patterns for the lower time periods, especially the hourly and the 15-minute charts.

An exhaust is a rapid market movement in one direction that is followed by a sharp retracement. Exhausts exist in all time frames and in all markets, and they are a reflection of a fundamental pattern of human behavior. Exhausts can be extraordinarily profitable and Drummond Geometry is especially well-suited to help you take advantage of this market phenomenon. **FM**

Ted Hearne is a Chicago-based writer and trader. The material in these articles is adapted from the 30 Lessons of the P&L School of Drummond Geometry (Copyright © 1999 Ted Hearne and Charles Drummond). Contact Hearne via www.tedtick.com and www.PLdot.com. Drummond Geometry is a registered trademark.

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