

The Dow: Projecting the Probable Path of Price

I have been doing a series of projections of the price of the Dow for MoneyShow.com in interviews since the Las Vegas Traders Expo in November of 2007. It's fascinating to look back and see how the projections worked out, and we did that in an earlier article. Given the ongoing volatility and uncertainty in the markets, and with the Presidential inauguration coming up in the third week of January, I thought it would be interesting to look forward in an article.

I am a professional trader, money manager, and mentor, not a soothsayer, but because I do keep a large library of my own hand-drawn charts, I do find myself wondering "What if" when I draw my charts each night. Let's take a look at a longer-term chart of the Dow, current through mid-day on December 11, 2008:

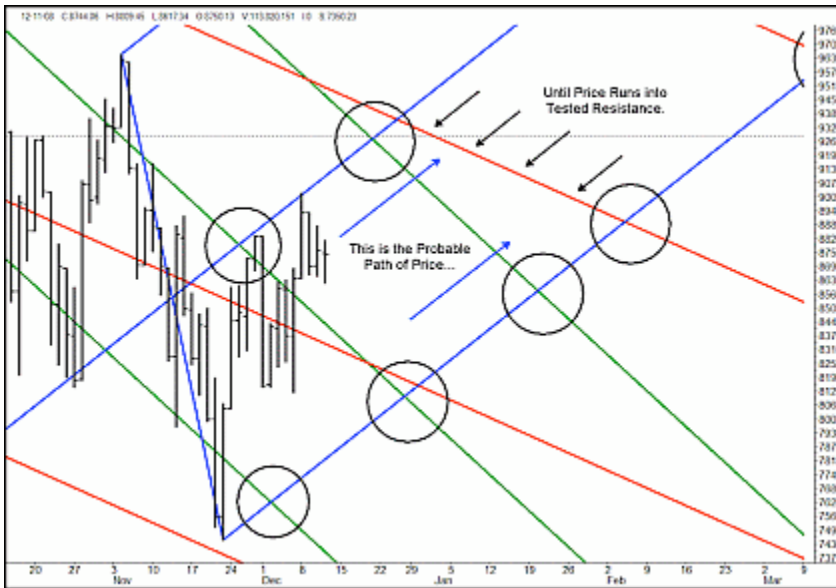


The blue up-sloping lines on the chart above were added in late November, right after price broke below the prior lows at 7800 with a wide range day lower (750 points), immediately followed by a wide range day higher that was nearly as large! When price rallied that hard, that fast "out of the hole," I wondered, "What if the two wide range bars were an important low?" The blue up-sloping lines are a Median Line and its Parallel Lines, and they should show the probable path of price-until price runs into other 'tested' lines-in this case, the red and green down-sloping Median Lines and their Parallel Lines.

Note that I also added six circles, where an up-sloping line crosses a down-sloping line. These are Energy Points, a technical analysis tool of my own invention. My research has shown that Energy Points, where two lines of opposing force meet, do two important things:

1. Energy Points act as price attractors. Price is drawn to Energy Points much like moths are attracted by a flame.
2. Energy Points are high probability areas for either a change in trend or an acceleration of trend. Price seldom congests around Energy Points. Instead, wide range bars are generally spawned once price enters an Energy Point area.

Let me zoom in on the section of the chart containing the up-sloping blue Median Line and its Parallel Lines, as well as the Energy Points.

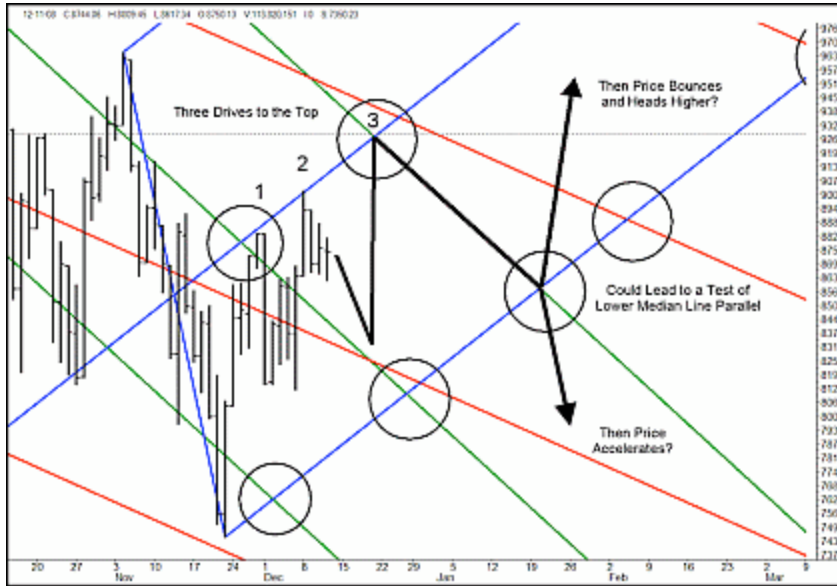


This chart clearly shows the Energy Points above and below the current price. You can see that price rallied hard and tested the first Energy Point on the up side. You can also see the wide range bar lower that resulted once price tested the area of this Energy Point—the Energy Point area marked the end of the “Thanksgiving Rally.” After the wide range day lower, price consolidated for three days and then had a steep, two-day rally.

Note that the top of both of these rallies tested the blue up-sloping Median Line—which I marked clearly on the first chart. This tells me that the blue set of lines I added in late November is indeed showing me the probable path of price. Does that mean that the Dow has now begun a long- term rally? Hold that thought...

The area marked by the six Energy Points is called a “hallway,” and this particular hallway does indeed have an upward bias to it. We can expect price to follow this probable path of price until it either, 1) trades above or below the boundaries of the hallway; or 2) price runs into a stronger, tested line, and this more powerful line acts as resistance to price. There is a down-sloping red major Median Line, originating from pivots set out in 2007, ahead of price as it travels up this hallway. This down-sloping red Median Line and its Parallels have stopped the advance of price many times over the past year. And if you look at the last two major lows on the first chart carefully, it has also done a great job marking where price should run out of down side directional energy. If price is still trading within the boundaries of the hallway when it approaches the down-sloping red Median Line, I'll be very curious to see if it is able to trade through this major down-sloping line.

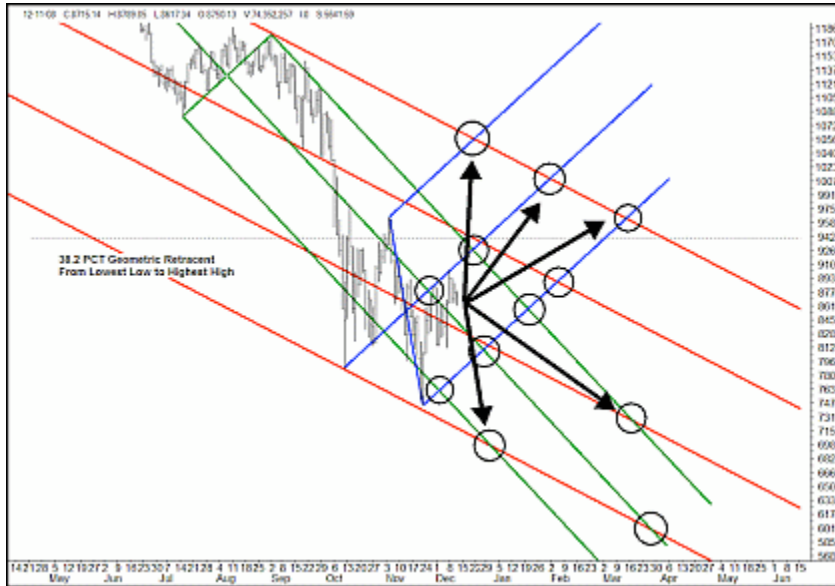
Let's look at how price *may* trade within this hallway, and how it *may* eventually break out:



You can see I added a potential path that price *might* take. To draw this route for price, I looked at the existing chart and saw that price had already tested the blue up-sloping Median Line twice. If price came back up and tested this same Median Line a third time and failed to break through, the chart would then show a formation commonly called “Three Drives to the Top.” This formation often marks major highs if price then begins taking out swing lows. You can see I have price topping out right at a test of one of the Energy Points—thus completing the third “Drive to the Top.” Then I have price trading lower, right into the Presidential inauguration.

I mark both a sharp rally and a sharp decline right after the inauguration because the Energy Point marks this as an area where price will either change trend or accelerate. It should not surprise you to see an Energy Point coinciding with the Presidential inauguration. Many wonderful traders have concluded that price and time contain all you really need to trade successfully. I'll let you decide whether the Dow is more likely to rally or sell off immediately after our next President takes office.

Let's take a look at one last chart:



Here is a chart showing straight-line paths to Energy Points, either where the hallway meets the down-sloping red Median Line, or Energy Points above or below the hallway. You can think of these Energy Points as the likely attractors pulling on price as it moves along the hallway. I did not add an arrow showing the possible path of price ending at the Energy Point in the 5800-5900 area; in truth, it was an omission on my part when I marked up the four charts for this article.

Does that mean I think price won't be attracted by the Energy Point down there?

Even though I spend many hours a day charting and pouring over charts, I am a trader, not a prognosticator. I play "What if" throughout the trading day, but the truth is always the same: The market is *always* right. Price will go where it is going, no matter what line I draw or what price I circle.

I wish you all good trading!

Timothy Morge

timmorge@gmail.com

www.medianline.com

www.marketgeometry.com