ASIA PACIFIC'S PREEMINENT TRADING MAGAZINE

VOLUME 2 ISSUE 1

# The TRADER'S Journal

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## Picking a Trading Timeframe

Before You Make a Trade

Identifying the Trend

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The Thought Demons of Traders

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SG$8.80 / A$13.80 / HK$68 / RM$19.80

ISSN 1793-2149

9 771793 214905

MICA (P) 352/05/2005

TECHNICAL ANALYSIS

# Finding the Right Trend and Direction

## Ron Schelling, private trader, explains how a combination of the RSI and multiple time frames can help us clearly identify the trend.

The question is always, "what is the trend". Can we define the trend with moving averages or certain indicators? No matter what you take to measure the trend, by knowing the tradable trend should be the basis for your trading approach. Combining this approach on the same chart with multiple time frames allows you to determine in what direction you should take the next trade.

The key to profitable trading is to have a valid method of determining the right direction and tradable trend by using different time frames on one chart. Late Robert Krausz introduced the TrendFinder strategy in which used the multiple time frame approach in variable ways.

Meanwhile several standard software programs using this now in their basic software and since then multiple time frame strategies are becoming more popular.

First we must select the two time frames we are going to use, like daily bars as the bars we trade and weekly bars which we use as the trend. Of course this can be done with all kind of variations, for example intraday 1 minute bars and 5 minute bars or any other combination.

Lets look at a basic set up.

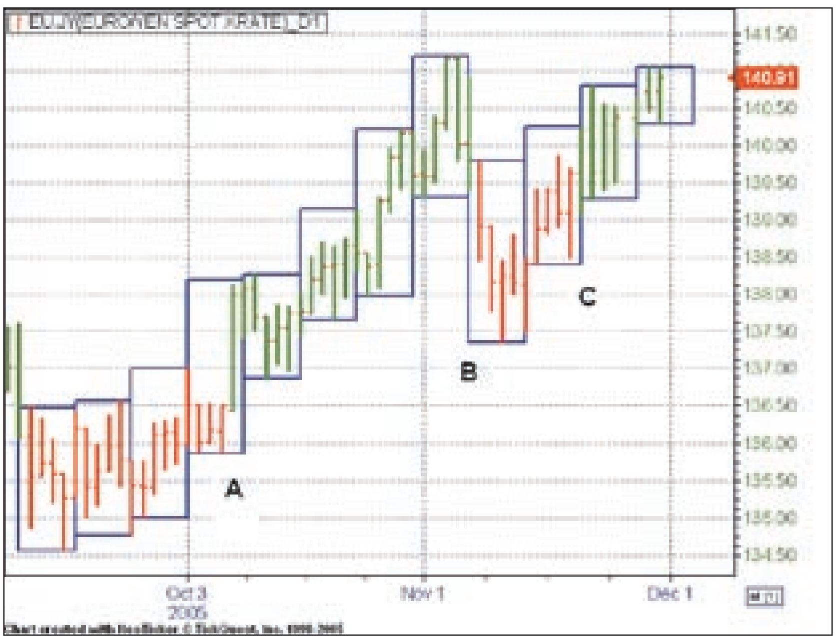

Figure 1 – EUR/YEN

Her are the rules:

– the trend can be only Up or Down

– the trend is Up when the daily bar closes above the previous weekly (blue) high, so the daily bar change from red to green on this chart

– the trend is Down when the daily bar closes below the previous weekly (blue) low, so the daily bar change from green to red on this chart

– at point A the close is above the previous weekly high, the trend is Up

– at point B the close is below the previous weekly low, the trend is Down

– at point C the close is above the previous weekly high, the trend is Up again

The multiple time frame analyses is based on the concept that every time period has it's own trend and also it's own support and resistance levels. The trend, support and resistance levels of, for example a daily bar, is different then those of the weekly bar. In this case the weekly bars takes the noise out of the daily bars. Of course you can also use this as intraday or any other usable time frames.

The next question in this strategy is if there is anything which can confirm the signal from the above time frame strategy? Let's look to the Relative Strength Index, not to be confused with a relative strength comparison of a stock to a market index or group of other stocks.

The RSI is a ratio - the numerator is a moving average of the up closing prices divided by a moving average of the down closing prices. Then the number is normalized to a value between 1 and 100. Readings above 50 indicate that the average net difference in closing prices is positive. A downward force is indicated when the reading is below the 50 level because the average net difference in closing prices is

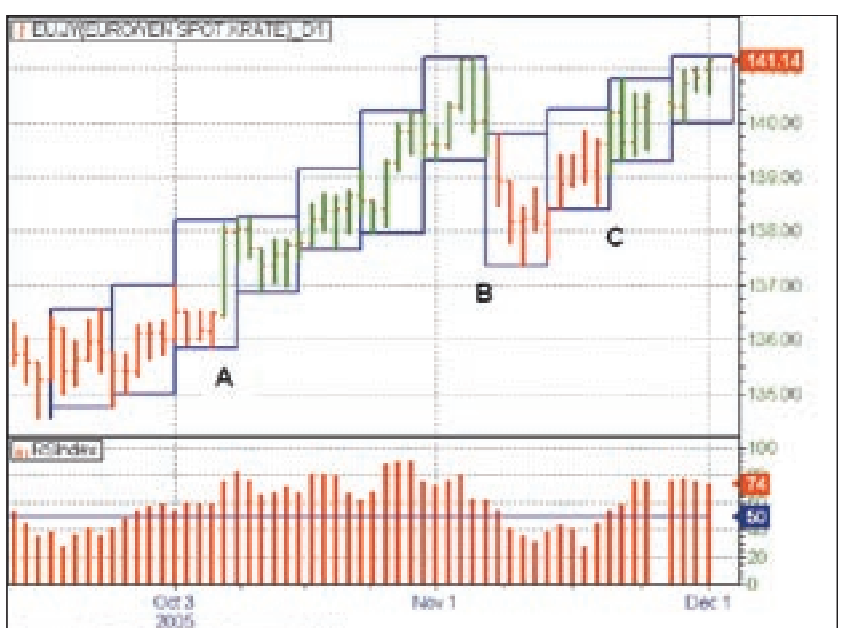

Figure 2 – EUR/YEN

negative. It is not important to look at peaks or bottoms of the RSI at this time.

Looking at the next chart we see the same YEN against the EURO but now we have added the RSI to it at the bottom of the chart.

At point A the close was higher the previous weekly high so the trend was up, while at the same time the RSI reading was above 50 confirming the strength. At point B the close was below the previous weekly low and almost confirmed by the RSI reading below 50, actually it was the next day. At point C see we got a change to up trend again because the close was above the previous weekly high and the RSI reading above 50 was confirming this signal.

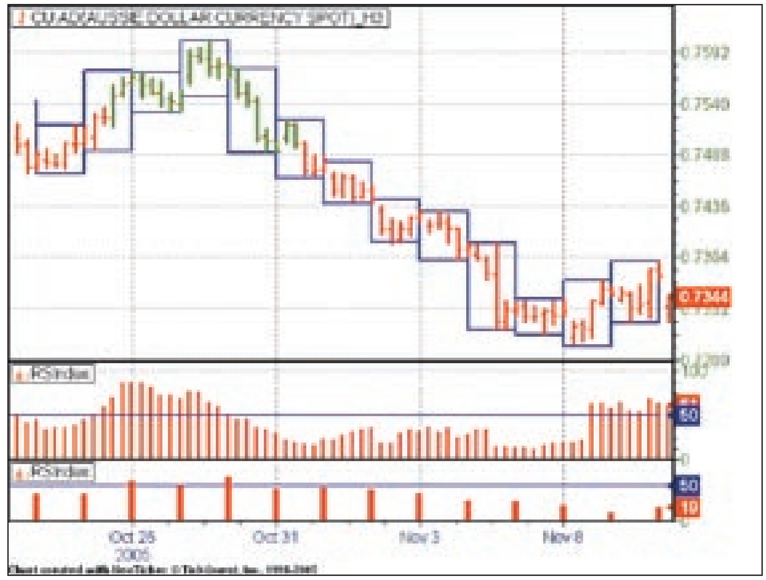

Figure 4 – AUD/USD

Now let's have a look to another sample, the Singapore Dollar (Figure 3). This chart shows daily bars (red) and weekly bars around them (blue). At the point A the new down trend was confirmed by the RSI reading while at point B the up trend got confirmation from the RSI as well. Around point C the net result was actually zero after getting first a down trend followed by a quick trend change to a new up trend. At point D we got a nice downtrend signal again with clear confirmation by the RSI.

Of course many combinations are possible including intraday, like 1 minute bars and 5 minute bars of 1 hour/5 hour bars.

Figure 3 – SGD/USD

Figure 4 is the Australian Dollar/US Dollar using 3 hour bars and daily bars. The daily bars are based on a 15 hour time frame, so therefore we see intraday bars per trading day. On October 31 we see the intraday 3 hour bar closing below the previous daily low and the 3 hour RSI below the 50 level, so a first indication to close all long positions and take a first step for a short position.

At the close of October 31 we see for the first time that both RSI indicators, the one on the 3 hour bars and the one on the daily bars, are both below the 50 RSI level, so the trend has fully changed to down here.

Of course you can use another indicator for confirmation instead of the RSI, like the standard MACD or Ergodic Candlestick Oscillator. Also you can add several indicators to on the bars itself to get even a more clear picture.

Think about the Swing on the bar highs and lows or moving averages, however the combination of RSI and multiple time frames is very simple and useful.


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