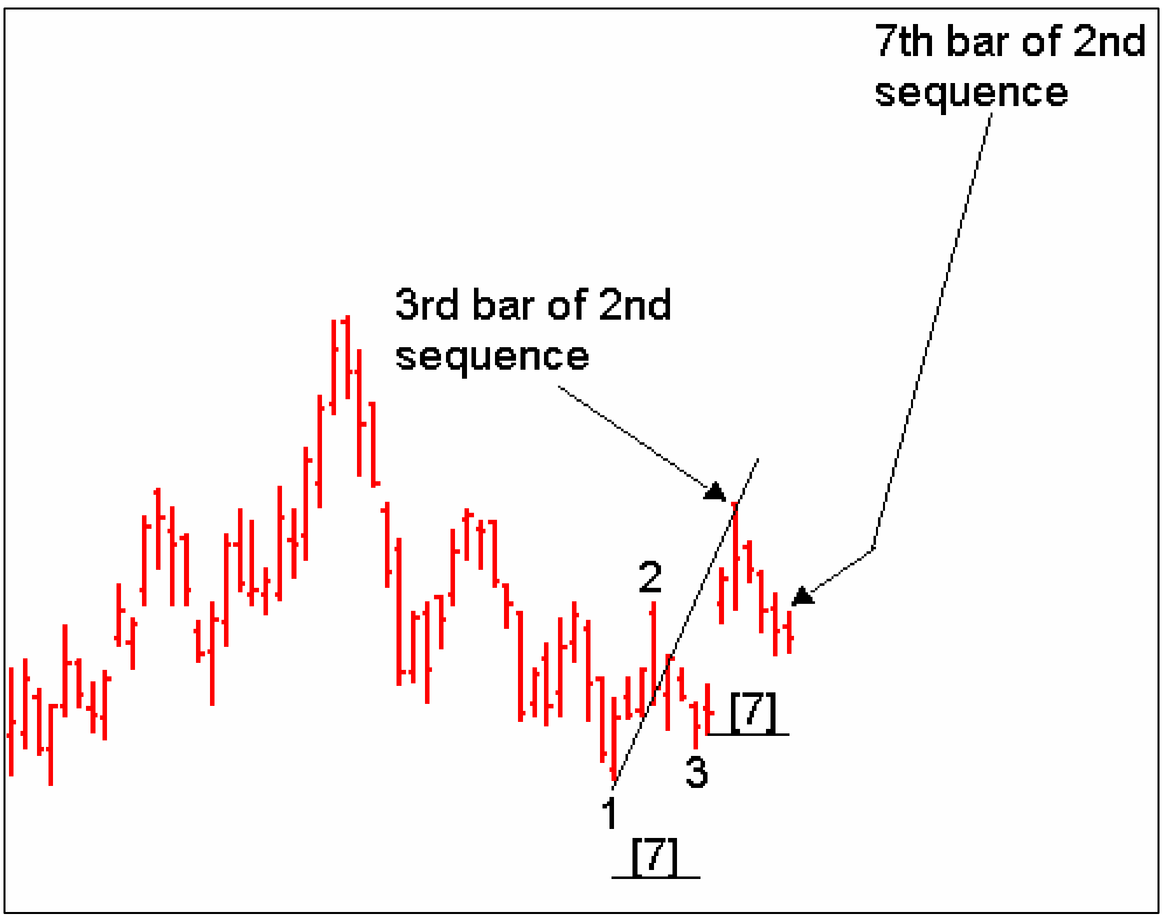
PART II

Chapter 13

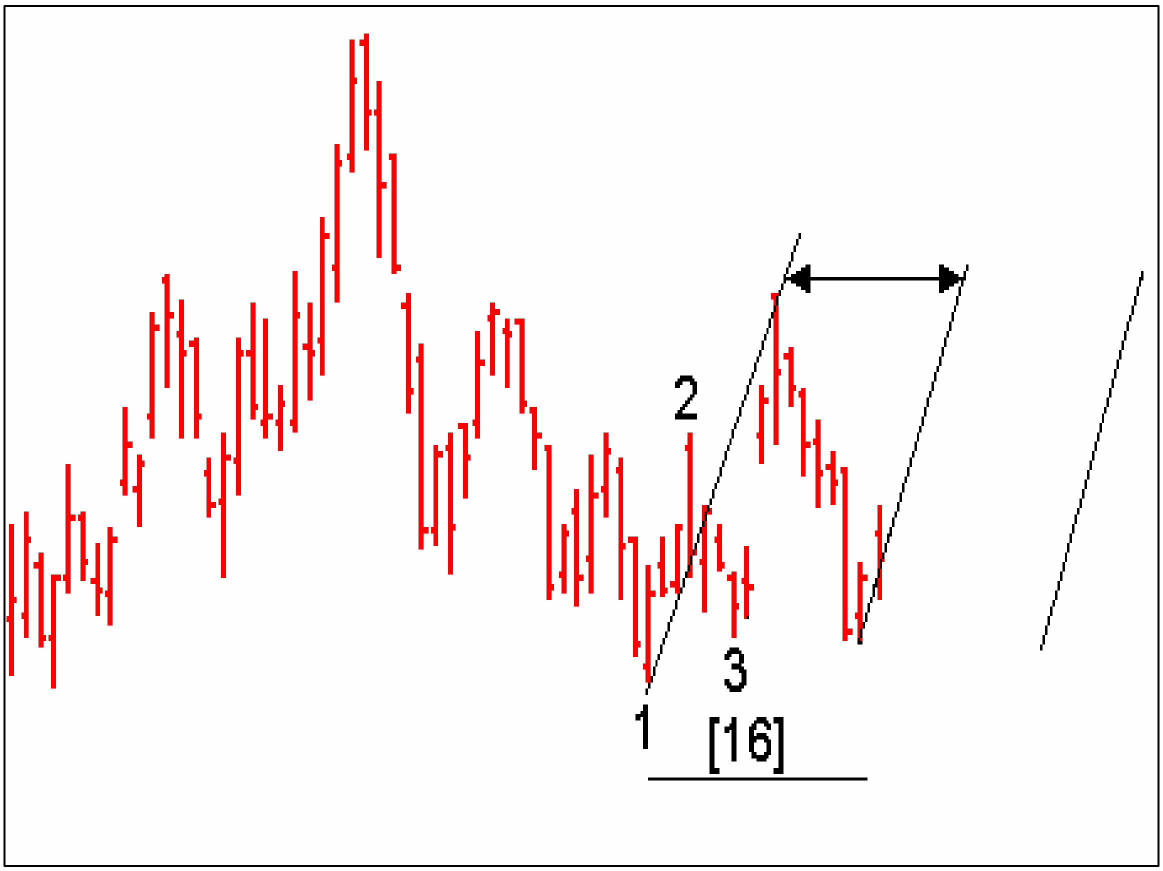
RHYTHM TRADING

We're going to show you an old-time technique that still works and is excellent in largely chopping, sideways markets. We call it "Rhythm Trading." What we will do is show you a way to know when and how to scalp a market from the chart so that you will be going in the right direction. It's a way to catch the rhythm of the price action. And by the way, you can do this in any time frame except one in which the price movement will not offer sufficient volatility for profitable trading. It does take a bit of your time.



Once you have determined, by looking back, that prices are chopping sideways, you look for a convenient low. You are looking for a 1-2-3 low formation that has 5-10 bars total width. The 1-2-3 formation on the previous contains seven [7] bars inclusive of the #1 and the #3 points.

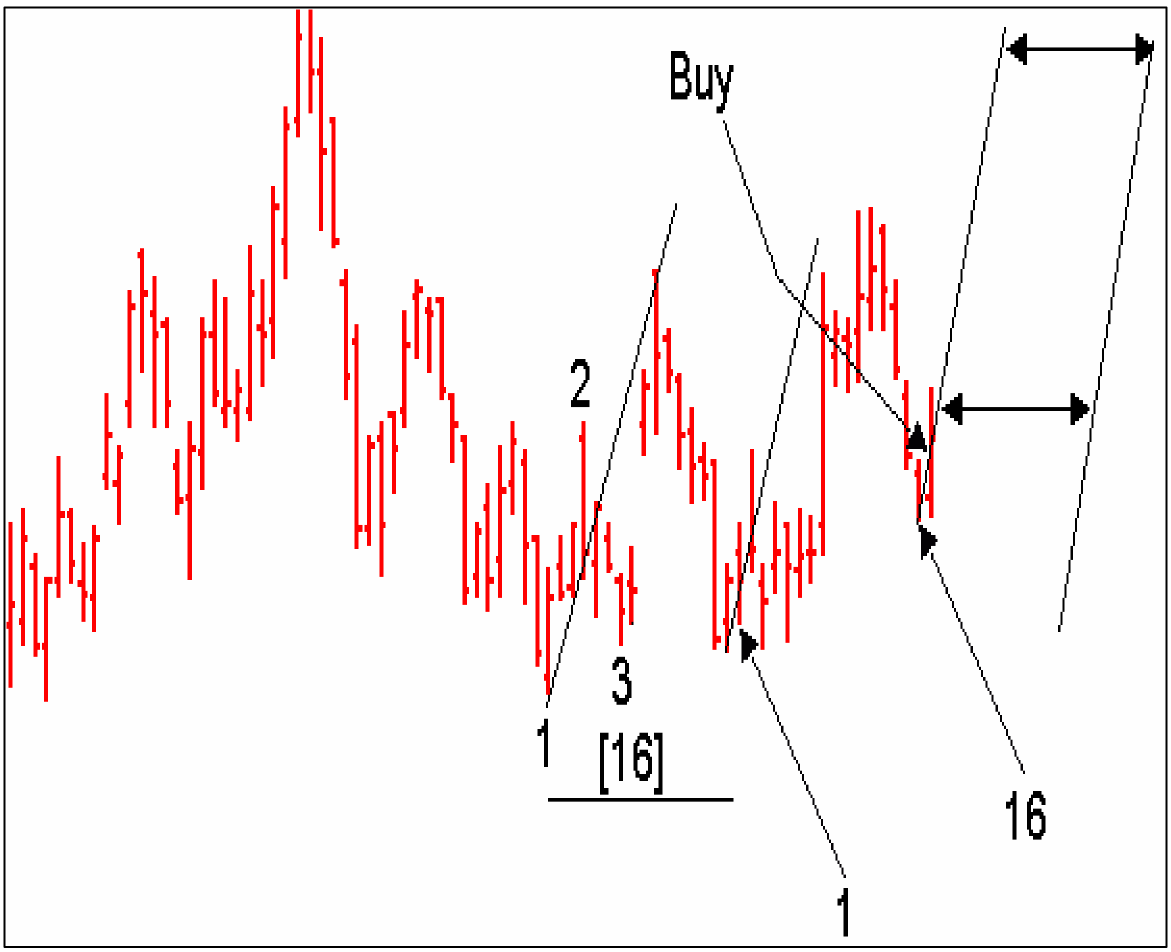
You then draw a line from the #1 point to the top of the highest bar in a sequence of the next 7 bars. We begin with the first bar subsequent to the #3 point to count our next sequence of seven bars. That produces a line from the #1 point to the top of the third bar in the second sequence of seven.



Now we must wait for the next low in prices prior to a price bar making both a higher low and a higher high. In the case above, that event occurs on the 17th price bar since we began at #1. The actual "next low" came on the 16th price bar since we began at #1. We now draw a line from the bottom of the 16th bar that is parallel to the first line we drew. It doesn't matter where it falls, as long as it is parallel. Its purpose is to enable us to measure the distance between the rhythmic lows.

We now have a complete rhythm cycle of sixteen [16] bars. We might say that prices, insofar as we can tell at this point, are marching to a 16 beat rhythm. The rhythm cycle may be thought of as consisting of the seven bars from the #1 to the #3 point, and the nine bars (total 16) that comprise the series of bars beginning with the first bar after the #3 point and ending with bar #16.

Since we know the distance between rhythmic lows, we now project the plane along which the next low is expected to fall, and draw it in as a parallel line.



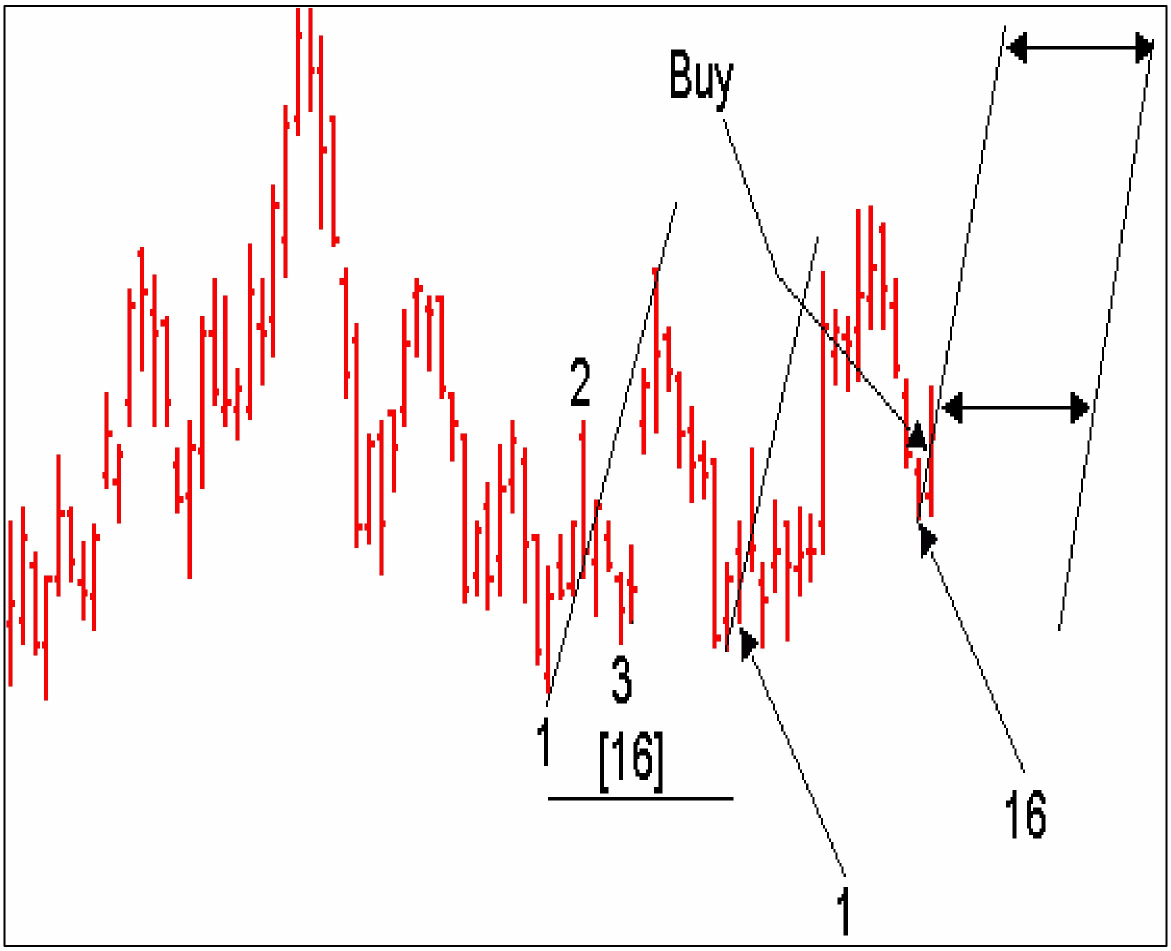
Once we have established the rhythm cycle at sixteen bars, we will then buy a breakout of the high of the bar that falls on the next expected rhythm cycle low.

If the low comes early or late, by no more than one bar, we will buy a breakout of the high of the early or late bar.

On the chart below, we would have attempted to buy a breakout of the high of the bar just ahead of the one labeled "16," the bar labeled "16", and had that not been the low, a breakout of the high of the bar just after the one labeled "16."

Since we now know where the rhythm cycle low is, we draw our next parallel line.

We continue this pattern until or unless we find that we have lost the rhythm. The rhythm will almost always be lost once prices begin to trend.



With rhythm analysis and sideways prices, we let the price action determine its own cycle rather than trying to impose some theoretical cycle on it. If the market has a rhythm, it calls its own tune. That rhythm can and does change. No sacred cows here.

Your job as a trader is to get in tune with the price action. Prices are going to go where they want when they want. If the price action is kind enough to set up a rhythm you can catch, then dance with the rhythm of the prices while you can. You never know when a market is going to change partners.