

Drummond Geometry Applied to S&P 500

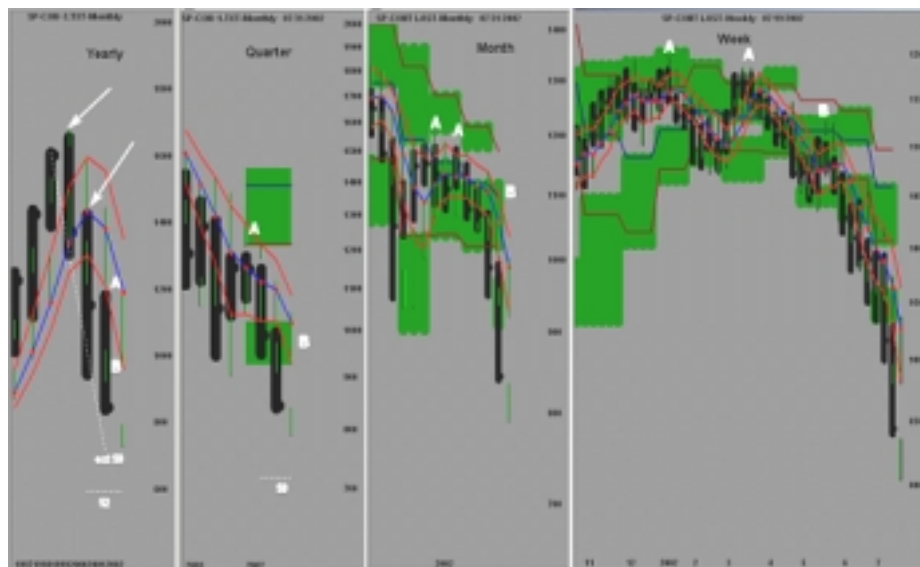
S&P trader Ted Hearne applies Drummond Geometry basics to the recent stock market activity in the S&P 500 Index

In recent months, readers of Chartpoint have read about the basics of Drummond Geometry, a method of technical analysis that permits the user to establish the most likely scenario for future market activity. In the first of the two Chartpoint articles we talked about the methods of establishing support and resistance in the near-term future, the use of the short-term moving averages and the two bar trend lines, and the all-important need to coordinate time-frames. In the second article we used the Drummond Geometry techniques to develop a method for trading exhausts, those significant market turns that can lead to major trading rewards. Exhausts can be seen in whatever timeframe we select, and exist when the market runs out of energy pushing it in one direction or the other and sharply reverses back in the opposite direction towards its own Pldot.

In this article we will take a look at the recent market crash in the S&P 500 and ask how traders might have benefitted from knowing the Drummond method of technical analysis. You will perhaps not be surprised that we believe traders could have benefitted immensely and made accurate and timely decisions that would either have let them avoid the market crash entirely, or better yet, to go short and reap rich rewards from the sharp movement downwards.

We take a look at the S&P using the standard tools of Drummond Geometry. In the accompanying illustration (chart 1) we see a typical Drummond Geometry set up with charts of the same security in multiple timeframes.

Chart 1: S&P 500



The left-most chart is a yearly bar chart, the next chart is a quarterly chart, the next chart is a monthly timeframe, and the right hand chart is a weekly chart.

Most traders look closely at very recent market activity, or look at long periods of market activity on a single timeframe. Few have developed the skills of analyzing the market in different relevant timeframes and coordinating the insights gleaned from each chart. By doing this the trader or analyst can make far better distinctions as to what is occurring and what the most likely future activity will be.

In Drummond Geometry, we use the higher time periods to establish market context and key levels of support and resistance, and the lower time period charts to monitor market action at key levels so we can confirm the market acting as we anticipate, or the reverse.

Let's take a look at the time period analysis and the tools of Drummond Geometry as they are applied to the recent market crash. Readers of this article will be helped if they recall the tools that we introduced in that article... the three-period moving average of the Pldot and envelope, and the two bar trend-lines, and the concept of time-period interrelationship.

First we examine the yearly chart and see if we can establish the market context. The context will help us establish expectations for the oncoming highs and lows. To develop an answer for the question "What can we expect in the way of a market bottom during the rest of 2002?" We need to start back a few years and take a look at the market flow using the yearly chart. When we have a sense of what is occurring on the yearly chart then the key areas of concern for the longer-term predictions in the present will come into better focus.

You will note that we use a thick black bar to represent price bars; these permit us to chart support and resistance zones on top of these bars for easy reference. On the yearly chart, at the point of the first white arrow, we see that the market topped out during the year 2000 at the point of the first white arrow, in the area of the thin green line which denotes the "nearby resistance zone" for that year. This resistance zone is defined by various Drummond Geometry tools, and is known before the year begins. In this case the market stopped by resistance that was defined by a two bar trend line called the "5/9 down" (not drawn.)

This move up during 1999 and the topping action in the early days of 2001 were a classic exhaust action and could have been traded using the exhaust indicators outlines in Chartpoint May/June 2002 issue. But the focus of our discussion here is on the present year and predictions or expectations of the yearly low being put in.

The second white arrow on the yearly chart shows the yearly Pldot for the year 2001; We can see that this dot is acting as resistance and thus we see that this dot is "pushing" the market down. The force of the yearly Pldot in the year 2002 pushed the market down into an exhaust and hit a low of 943 on the S&P before moving back up in a typical Pldot refresh move and closing out the year at 1153. This sets up the action for the present year.

Note that on top of each yearly bar are the "nearby resistance" and "nearby support" areas for that year. To help us in our time-period coordination of resistance and support, these areas on the yearly chart for the year 2002 have been carried over to the quarterly chart and are indicated by the two large blocks of green. Similarly, the thin lines on the quarterly bars are the quarterly nearby resistance and support, and these are carried over the monthly chart and represented by solid blocks of green. A similar convention applies to the monthly and weekly charts. Charting the higher time period support and resistance onto a lower time period chart can be very useful, as we will shortly see.

At the beginning of the year, on January 1st, 2002, the question in Drummond Geometry terms was, "Will the Pldot refresh move that began in September/October of 2001 continue upward to the level of the 2002 Pldot, or will we see the market turn and continue its down trend?" The answer to this question is resolved by carefully monitoring how the market acts at key levels. The key points for this discussion are marked as "A" and "B" on the yearly, quarterly, monthly and weekly charts of the S&P 500.

The yearly bar for the year 2001 hit a low in "further-out support" at a Drummond Geometry level called the "5/9 up." Chartpoint readers of the prior articles will recognize this as an exhaust, and know that the expected market action after hitting that low would be a Pldot refresh. At year's end, the market had refreshed itself up to the level of the yearly envelope bottom.

We know from Drummond Geometry that if the envelope bottom starts pushing down in the same way that the Pldot pushes in a trend, that the down energy is very strong. In fact we call this high-energy market thrust a "C-wave," a term that comes from the force of the sea as it washes over the harbor breakwater in a "sea-wave." And so the market action at the 1200 area, at the level of the yearly envelope bottom, becomes very critical for our prediction of what the rest of the year would look like.

If the 1200 resistance level held and was not exceeded, then we could expect much lower levels.

Why? Because we know from our historical studies the pattern of a "C-wave": when the envelope bottom or top pushes price in a trend, is a sign of strong energy on that time period. A Yearly "C-wave" is an ominous sign indeed. To see an example of strong "C-Waves," just look at the "C-wave" to the upside on the yearly chart in the years 1997, 1998, and 1999. In each year we see the top of the envelope pushing prices upwards.

As the early months of 2002 developed, the tools of Drummond Geometry gave traders a clear picture of what was happening as it happened, and gave traders the choice of taking a short position with the down-trend or standing aside from long positions and avoiding the down move, depending on their personal trading styles. The point is that it was possible to anticipate the broad market action well in advance of its occurrence. We did this by knowing the typical chart patterns in Drummond Geometry terms and monitoring price action at key decision points, using the market action as shown on multiple timeframes.

Let's look at how the market acted at the key points at "A" and "B."

Traders using Drummond Geometry were able to forecast at the opening of the year that if the year were to experience a Pldot refresh then the market would have to get through the nearby resistance located at point "A" and above. But if the market had trouble doing this, then seeing as how it is located at the yearly envelope bottom, then we could expect considerably lower prices.

As the quarter developed we saw quarterly Pldot unable to get much of an up-push going. We were not seeing the price action that would be necessary if the market were to move higher.

How did this play out on the monthly and weekly? On the monthly chart we saw the strong up-move of September-December 2001 lose energy. The monthly Pldot lost its ability to push up, and the market stalled at point "A."



Drummond Geometry Seminar Outline

Singapore - 25 Oct to 26 Oct 2002
Hong Kong - 29 Oct to 30 Oct 2002
Sydney - 7 Nov to 8 Nov 2002

Pre-seminar Evening (7.30pm - 9.30pm)

A brief introduction to Drummond Geometry and the power of time-coordinated market analysis. Questions and answers will follow Mr Hearne's presentation.

Two-Day Seminar (8.30am - 5.00pm) "Predicting Highs and Lows with Drummond Geometry."

Day One

Introduction and Overview

- Who is Charles Drummond?
- Track records and history
- What we will learn in the coming days
- Overview of the key elements: the Dot, the Lines, and Time-Periods
- Demonstration
- The fundamental concepts in detail
- The Pldot
- The termination lines
- The theory and practice of multiple time period coordination
- Projected support and resistance in multiple time periods
- Application and demonstrations
- Monitoring and market progression
- The envelope system
- Single time-period envelope
- Multiple time-period envelopes
- Monitoring tools and lines "breaking" or "holding"
- The "Types of Trading"
- Review of the day, forecast of tomorrow

Day Two

- Assembling support and resistance tools into zones
- What is "nearby" and what is "further out"
- Market "flow" and how to monitor it
- Putting it all together
- Trading plans
- The simple key to trading psychology: Man as a machine
- Money management, stops and personal management
- Software issues
- Three foolproof trading plans
- Trading timeframes: day-trading, swing-trading, monthly trades, and "Grand Scheme" trading
- Future plans and current research
- Educational opportunities
- Review of the material

For registration details, refer to page 15

How about the weekly chart? On the weekly chart at the first point "A", traders saw the market stagger and lose energy, and the shift in flow was clearly apparent. The market on a weekly basis moved into a trend run down. Note that these signs were especially significant because they demonstrated to the trader exactly what was happening on the yearly chart – we were starting to see a yearly C-wave down develop.

Think about it: if the yearly envelope bottom is going to push down, we must see that action first on the weekly, and then on the monthly and then on the quarterly charts. There will be a definite and clear-cut progression. When lower time-period resistance is located at the very area where the yearly resistance is located, and that resistance held and was proven to be strong, and pushed the market down, then we know that we have yearly C-wave on our hands. There was a brief period when this interpretation was called in doubt for a time, as the monthly and weekly market action tested the resistance level at the second "A". But when this re-test of resistance held, the future market decline was no longer in doubt and the chance of a protracted move to the downside was an extremely high probability.

What is the ultimate target? If we can use the above techniques to predict the start of a down move, how do we predict the end of the down movement? On the yearly chart the first target is the nearby support level at "B". But as traders monitored the market when it moved down to the price levels of 1000-1100 on the S&P, there was only one small reaction on the weekly chart as when it exhausted up into the monthly Pldot, during the third week of May 2002, when there was a slight indication that the yearly nearby support might be starting to hold. But as it turned out, this was a most transitory twitch. The weekly, monthly, and quarterly charts all developed strong "C-waves" to the downside, and the yearly chart broke its "nearby" support leaving the yearly chart in free-fall towards further out support.

Where will this market eventually bottom? We won't know until it actually happens but the targets established by the market's Drummond Geometry currently lie between 600 and 700 on the S&P. As of this writing the S&P low for the year stands at 771, and so there is an excellent chance that there may be a test of that lower level of yearly support. As in all things market related, time will tell.

Once the yearly low is put in, what is the target to the upside? Once the move to the downside is accomplished and the market has exhausted its bearish energy, we look for a Pldot refresh move to the upside. The monthly Pldot, the quarterly Pldot, and ultimately the yearly Pldot are all possible targets if we first get a true exhaust to the downside. Market action at each key point in the charts will tell us if we are at the final target level or if there is more upside to be expected. Given the yearly exhaust, we would expect a retracement to at least the next year's envelope bottom, at the 950-1000 level. And of course it may go higher, to the "live" Pldot level at 1200 or the "static" Pldot level at 1400.

The support and resistance calculations of Drummond Geometry can establish areas of termination and targets for new moves in any timeframe. Based on this information traders can make educated guesses about the broad market move over a span of many months. This in itself is a valuable insight. But when this insight is combined with the specific monitoring tools and the knowledge that each timeframe has to play out its own dance of support and resistance within clear-cut parameters, the methodology becomes even more useful. If we are to have a yearly "C-wave," then events must unfold on each lower timeframe in a certain definite sequence. If we are to have a yearly Pldot refresh, then we will first see the up-move on the lower timeframes as they react one by one to the shift in energy.

Ted Hearne is an S&P trader in Chicago and the co-author with Charles Drummond of the P&L School of Drummond Geometry.

Ted Hearne will be conducting a two-day seminar on Drummond Geometry in Singapore, Hong Kong and Sydney in Oct/Nov 2002. Please refer to page 15 for details.