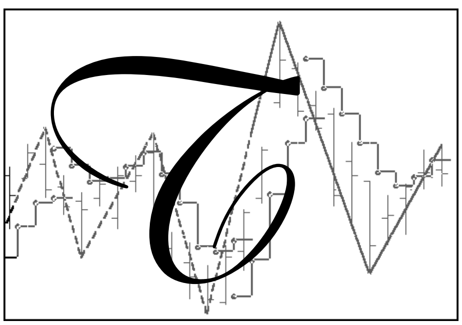
ROBERT KRAUSZ'S FIBONACCI TRADER© JOURNAL

Volume 1, Issue 11

THE ECO HISTOGRAM

✥ MAJOR INNOVATION ✥



Today, there is a nervousness in the markets worldwide as we approach the Y2K date. Most of the talk is hype. I expect that as the days march towards January 1 of 2000 the volatility will increase to a point, but then fade as many will stand aside and wait to see what happens.

After the dust has settled though, I expect the volatility to return to the markets, both the stocks and commodities, which could very well make short term trading techniques become more fruitful.

Therefore, in this the eleventh issue of the Fibonacci Trader Journal, we will focus on short term directional trading. To begin, our first example of short term trend trading will look at the S&P 500 futures contract, and follow up with some examples using Amazon.com.

One of the technical tools we will highlight is our old friend, the Ergodic Candlestick Oscillator (ECO), and once again my thanks to Bill Blau for sharing this excellent tool with us. In this issue I will show you a new way to look at this indicator.

But trading is more than just having the best technical tools available. You have to have guidelines for dealing with the realities of the day-to-day action in the market place. For example, you might be interested to know that I do not hold positions overnight in the T-bonds or S&P futures when the next day a major government economic statistic such as GDP, the Employment report, PPI, CPI and ECI will be announced. I also do not hold positions when Mr. Greenspan is giving evidence to Congress, or speaking somewhere about the economy.

The fact is the reaction to any of these economic releases creates a very sudden rise in volatility and very illiquid conditions in the markets.

I may reenter the market some 10-20 minutes after the economic numbers come out if I have a valid entry signal. This is part of my personal money management technique and I wanted to share this with you. The important point is that I have a response plan to a given situation, so I take the stress off of myself.

Lastly, Fibonacci Trader Corp., has a booth at TAG XX1 in Las Vegas November 20-22. If you are attending then please visit us at our booth, number 611. See our web site at www.fibonaccitrader.com for a special offer to attend the TAG Conference.

I wish you excellent trading,

Robert Krausz MH, BCHE

One key aspect of intraday trading using a multiple time frame approach is the increased chance for success if you trade in the direction of the daily trend and the daily momentum. So for our first topic, we'll look at the ECO as our tool for determining the direction of the daily trend and momentum.

Figure 1 is the December 1999 S&P 500 futures contract drawn as a daily/weekly/monthly plan with the ECO projected directly onto the daily bars. If you prefer, you can use the typical indicator window below the bar chart (Figure 2). Either view can be set up by clicking on the Edit button when you first add the W. Blau Ergodic Candlestick Oscillator to your plan from the Indicator menu.

When the Edit widow opens click the Sub Chart tab and select Chart 1 if you want to overlay the indictor on the daily bars as I have in Chart 1, or click on Chart 2, if you want the indicator below the daily bars.

As I mentioned in the introduction we have new settings for the ECO. Please change the length to 3.618, as well as set the ECO line and the Signal line to two different colors and thickness. I personally use white for the ECO line and blue for the Signal line, but choose whatever you like. Don't forget to select one line and add one of the symbols to make it easier to tell the ECO line from the Signal line.

So let's look at Chart 1 and a simple concept: If the Signal Line is below the ECO line then the momentum is up then we should be looking to buy. If the Signal Line is above the ECO then look to sell. For example, Figure 1, we can see that from points 1 to 2, the Signal line was above the ECO line and the S&P dropped over 50 points. Next, from points 2 to 3 the Signal Line was below the ECO and the market underwent a 30 plus point rally. Last, the Signal line moved above the ECO line and the S&P contract dropped approximately 60 plus points as of this writing. Simple, but effective!

Now, let's take a closer look at the action of the ECO line. Here, we'll follow just the slope of the ECO line and ignore the slope of the Signal line for the moment. First, we have marked key points of changes in the ECO's slope with the letters A and B. Point A is on one side of the Signal line, and point B is on the opposite side. Notice, at points 1, 2 and 3 how the direction of the daily bars tend to follow the same direction of the slope of the ECO line (points A and B) when it crossed the Signal line. Looking at point 4, we can see that the ECO line has not yet crossed (as of this writing) and therefore point B has not yet developed.

> Whether the high or low bar is point A or B it will often show as part of a Pivot High or a Pivot Low.

Please note that point A, which is the first turn in the new direction by the ECO line could be the high or low bar of the current trend. Please note that I am saying that this *could be*, not that it *will be* the high or low bar of the trend. Sometimes Point B will be the extreme, such as point 2 shown in Figure 1.

But whether the high or low bar is Point A or B, it will often occur as part of a Pivot High, such as points 1 and 3, or as a Pivot Low as in Point 2, and possibly point 4 as I write this.

Let's turn it up a notch, and look at the ECO in a new light and work more closely with the Pivot Highs and Pivots Lows. For Figure 3 we will use the same ECO indicator but discover some useful information by setting up the indicator as follows through the Edit window:

Innovation

1) Plot the ECO in sub chart 2, and keep the length at 3.618.
2) Click on the Draw Type tab and change the ECO line to a Histogram format.
3) Click on the Symbol tab and use the symbol called Circle 2.

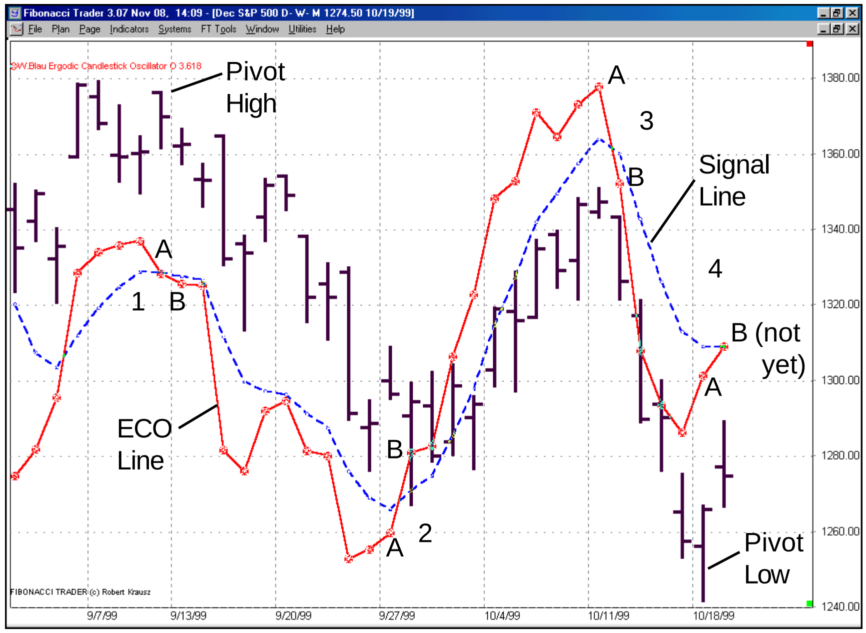


Figure 1: December 99 S&P 500 Daily/Weekly/Monthly Plan. Points A & B are chnages in the slopce of the ECO line and a crossover of the Signal Line.

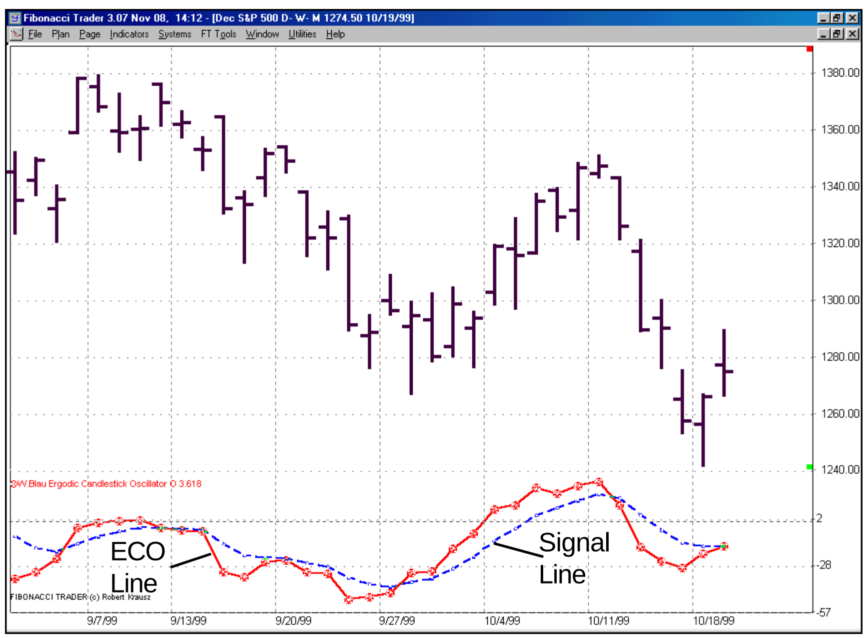


Figure 2: December 99 S&P 500 Daily/Weekly/Monthly Plan. You can plot the ECO Line and the Signal Line over the daily bars as in Figure 1, or in the indicator window as shown here in Figure 2.

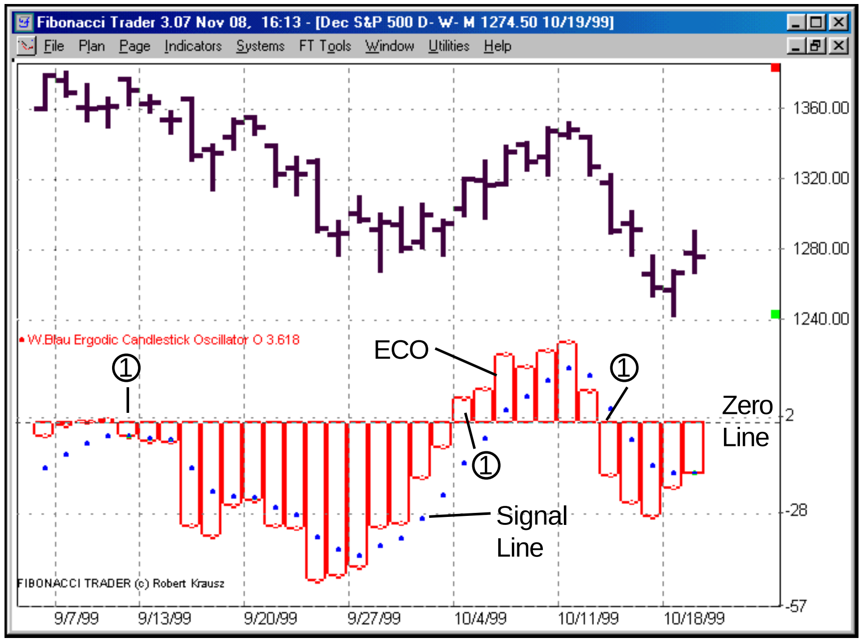


Figure 3: December 99 S&P 500 Daily/Weekly/Monthly Plan. Here the ECO is plotted as a histogram and the Signal Line is a dot.

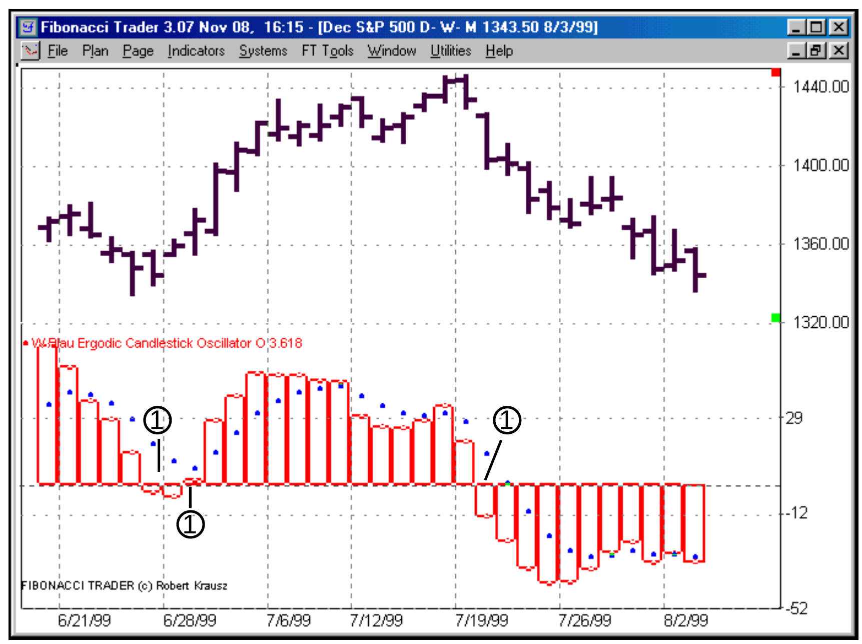


Figure 4: December 99 S&P 500 Daily/Weekly/Monthly Plan. The circled 1s are the classification 1 occurrences.

3) Change the Signal line to "None" under the Draw Type tab, and use the symbol Circle 2. Keep the colors as before, then click Exit out of the Edit Indicator menu. Your chart should look like Figure 3.

Let's tackle this new layout and check each piece of new information step by step. We have three classification or setups, and each classification is labeled either 1, 2 or 3. Sorry to be so pedantic, but all of this new information needs to be classified.

Classification 1: The daily histogram unit block goes level with the zero line, or crosses below from above or crosses from below to above the zero line. This crossover of the histogram indicates the previous direction of the daily trend has changed. This change of direction can last one day or many days.

Figures 3, 4 and 5 are the December 1999 S&P 500 futures contract. Figure 3 is recent action from September through mid October, and Figures 4 and 5 are from June 20 to September. We can spot nine occasions when the histogram showed a possible change of direction for the trend of the daily bars by the histogram crossing the zero line or moving to be level with it. Of these nine observations, one was a clear failure. However, by close scrutiny of the price action of the accurate signals we can come up with a simple qualification or criteria for a valid signal.

The criteria for a valid reversal signal is the day *after* the histogram changes direction the prices must either trend in the new direction for at least one more day, or at the very least the daily high for an uptrend must match the high of the bar that caused the histogram to change direction, or if a downtrend is signaled the next day's bar must match the low of the bar that caused the Histogram to change direction. Let's look at some examples.

Starting with Figure 3, the ECO histogram on September 10th pushed below the zero line. The next four days the market made lower lows. Next, on October 4th the histogram block pushed above the zero line. Notice that the market moved higher for the five days, which is a nice trend run.

What was our failed signal, on September 7th, the histogram went level with the zero line, but instead of the market rallying, the next day the market closed down. Could this failure, or if you prefer to call it divergence between the histogram turning positive and the price action not turning positive been a warning of the decline that followed.

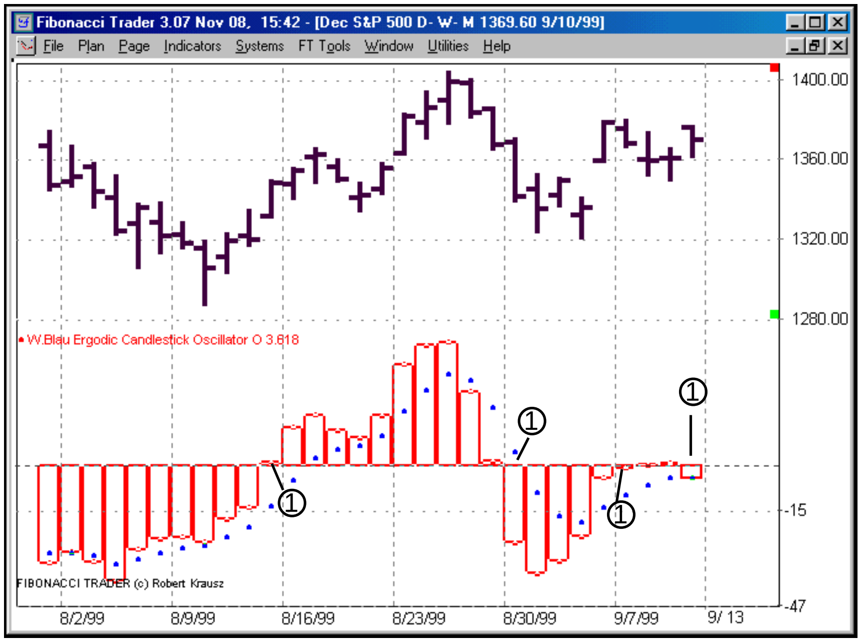


Figure 5: December 99 S&P 500 Daily/Weekly/Monthly Plan. On September 7th the ECO histogram went level with the zero line but the market failed to rally the next day.

Figures 4 and 5 cover the periods mid June up to September 10th, and show the remaining signals based on our first classification. I am aware that nine observations is a not enough examples to make any blanket statements of a statistical nature, that's where you have to do a little home work to test this concept more thoroughly. The real benefit to you though, is if you follow through on researching this concept is you'll gain much more confidence from having worked through this yourself.

We have two other classifications of setups using the ECO, but let's change horses for a moment because classification 1 can tie in nicely as a confirmation tool when used with another favorite, the HiLo Activator. Plus, I know how interested everyone is in trading stocks so let's use Amazon.com for this next concept.

Figure 6 is a daily/weekly/ monthly plan for Amazon.com using the ECO with the HiLo Activator set up with the following settings: set "Length" to 13 periods, the "By number of ticks" to 8, the "Real Time" is Yes, and "Wait for the Close" is

Figure 6: Amazon.com Daly/Weekly/Monthly Plan. The daily bars are tracked by the HiLo Activator. Notice how the ECO histogram dropped below the zero line in September and yet the HiLo Activator supported prices.

Yes. These are parameters that suit me but you may experiment with the settings as you like. Also, please note that these settings are not universal to all stocks. Individual stocks have their own level of volatility, so you have to set your indicators accordingly on a case by case basis.

Now I will propose a simple application. We will qualify signals from the HiLo Activator, which is you would go *long* if the market closes *above* the falling HiLo Activator and it flips, or go *short* if the market closes *below* the rising HiLo Activator and it flips, by a confirmation from the ECO.

Our confirmation or filter for the HiLo Activator is the ECO is in a new direction by having recently crossed the zero line from the previous direction. On Figure 6 each valid entry is marked with an arrow pointing in the direction of the trade. If the HiLo Activator does not show a buy or sell signal we can ignore the ECO histogram signals.

Let's turn our focus onto most of the trading activity in September. First, notice how the ECO dived below the zero line the first of September while the 13 period HiLo Activator remained long. The 13 period HiLo Activator was supporting the market the entire time. This shows that the ECI is not a stand alone indicator, and is used to confirm the 13 period HiLo Activator.

There was one instance when the ECO moved above the zero line on September 22nd, but when Amazon took off the ECO confirmed the rally by a real jump above the zero line the last two days of September.

For those of you that are trading real time and have the real-time version of the Fibonacci Trader then set the HiLo Activator to not wait for the close of the market. Also, the ECO histogram is live in the real-time program so if the zero line was crossed after the opening then day traders will have an early opportunity. For our work here, we'll be basing our decisions on the close. Figures 7 and 8 cover Amazon.com from December of last year up to October where Figure 6 picked up.

Let's return to the December 1999 S&P 500 futures contract (Figure 9) and I'll explain the other two classifications. The second classification is labeled as point 2 on the chart and indicates that the Signal Line (the dot) is equal to the ECO histogram. This can be a handy warning just before the direction changes. The dots do not have to be exactly

Figure 7: Amazon.com Daly/Weekly/Monthly Plan. Here are the daily bars beginning from the first of the year.

Figure 8: Amazon.com Daly/Weekly/Monthly Plan. Here are the buy and sell signals for late March to the end of June.

equal to the top or bottom of the histogram but must be touching such as October 19th (as well as June 22nd and July 16th in Figure 4). Once again this does not work every time, but it can be a handy tool.

Our third classification is

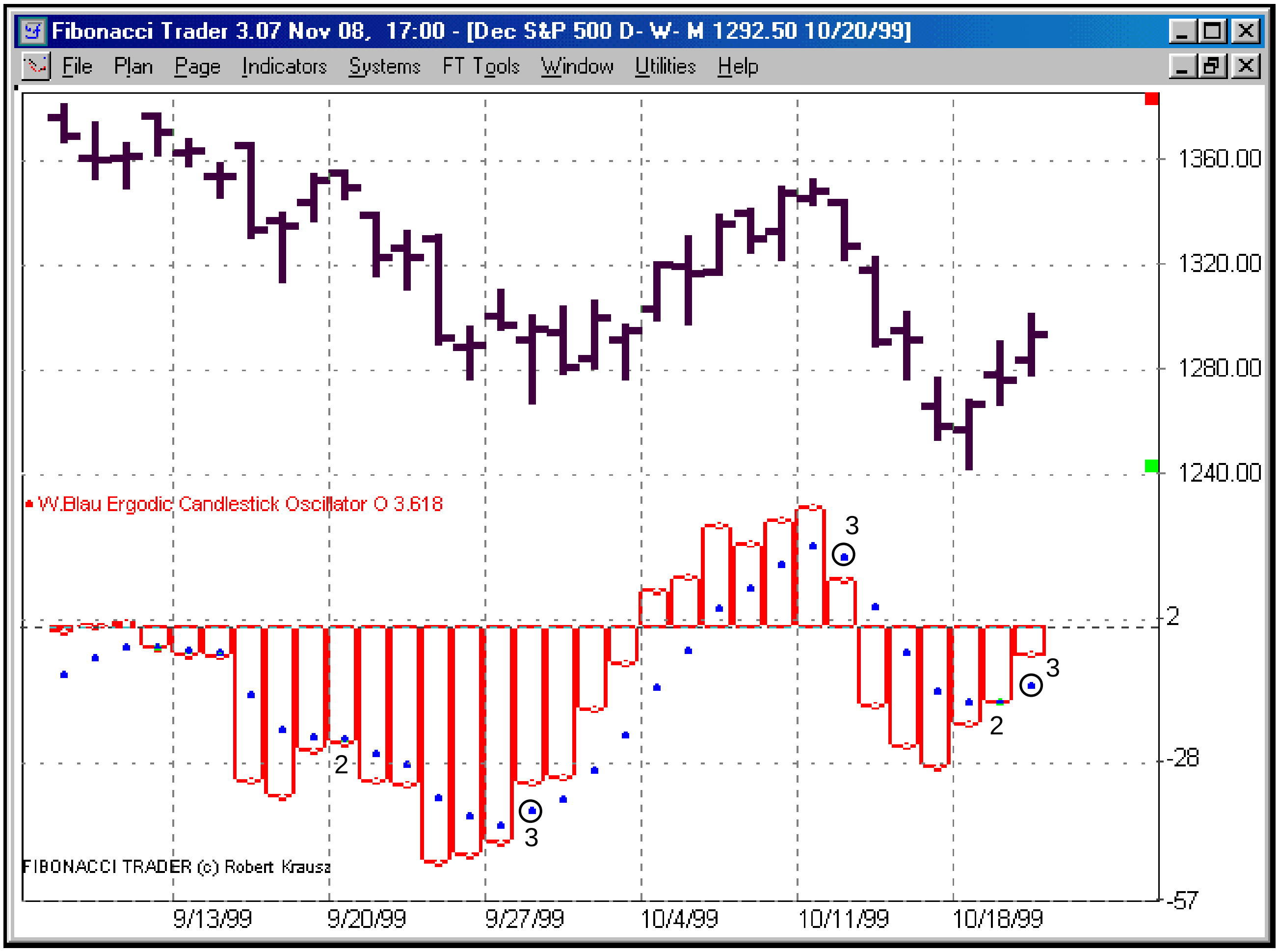


Figure 9: December 99 S&P 500 Daily/Weekly/Monthly Plan. The occurence of the Level is signified by the number 2, and the Flip is labled by the number 3.

what I call a "Flip" of the ECO dot and the occurrence is labeled point 3 with a circle around it.

The Flip occurs when the Signal line dot jumps out of the ECO histogram block. This is often a warning that the previous trend run may be ending and a new direction is emerging. In some cases it can be tricky to see but often the flip is obvious.

Go back and review Figure 6, which have the dots circled when the classification 3 or Flip occurs. As an experiment circle the Flip situations yourself on Figures 7 and 8 and you'll see the leading nature of the Flip for the direction of the trend of the daily bars.

In the next issue, we'll look at using this same concept with America Online, both daily and intraday plans, plus some suggested money management rules.

I wish you excellent trading,

Robert Krausz, MH BCHE

The FIBONACCI TRADER JOURNAL is copyrighted and published by the:
FIBONACCI TRADER CORPORATION
1835 US1 South 119, Suite 352, St. Augustine, FL 32086.
Phone: 512-443-5751, Fax: 512-443-7119, www.fibonaccitrader.com