

1

The Birth of Pivots and the Pitchfork

The darkness of the unknown has always intrigued me. Whilst doing part of my residency in a New York City hospital, I was forever marvelling as our Emergency Medicine professor performed what seemed to be an almost magical examination on a comatose patient. He would spend only a few minutes observing the physical signs and quickly make his diagnosis. Then we eagerly waited for the results of the laboratory tests, which confirmed or negated the diagnosis. Most of the time, the professor's diagnosis was correct. Only years later have I come to understand the mechanism of his intuitive approach.

Whatever you decide to do in life, when starting from scratch you should always be aware of the 'knowledge building blocks' which will help you on your way, and trading is no different. Once you have mastered them, then and only then can you pursue more complex topics with competency. The approach given in this book guarantees a thorough understanding of the subject of pitchfork trading, and one that will shorten your learning curve, especially if you consistently practise the practical aspects. If you do so, you will be well on your way to applying intuition as part of your approach. Although it took him years of training and learning, my Emergency Medicine professor finally arrived at his goal: the planned intuition level. He could 'smell' a comatose junkie just by looking at him, or detect a potential suicide while inspecting the patient's nails, hair or clothes.

It might seem strange to associate Emergency Medicine and trading, but they both have the same strong impact on the psyche of the uninitiated person. When a person decides to take up trading, he or she will always be surprised by the emptiness of the chart, and will have the same feelings as the medical student on his first day in the Emergency Room. The emptiness, or 'nakedness', of the chart clearly illustrates the part of trading that new traders find the most perplexing (Fig. 1.1). With his eyes locked on to the vertical and horizontal axes, to the new trader the market appears to be completely motionless. At first, he is rather lost and, even if he has some idea of what trading is all about, does not know where to start.

This book will help the trader get over his initial bewilderment, and the charts are mapped in such a way that the left-to-right market movement on the time-wise horizontally oriented axis is clearly delineated.



Figure 1.1 Emptiness of the chart (Courtesy of www.pitchforktrader.com)

1.1 DEFINING THE MARKET CONTEXT AND ITS LIMITS

In order to trade, we must first become familiar with the market's flow. Second, we need to think about trading decisions. One of the best methods of understanding the market context (its layout), is to mark out its cardinal orientation:

- Where is the price coming from?
- Where does it seem to be going?
- Is the market trending or non-trending?
- What is the market's exact location within the whole context?
- How high/low is the morning, afternoon or day's apogee (highest high)?
- What is the slope like, or how did the price reach the current location?
- Was there continuous movement, or did the price jump directly towards the high/low of the chart?
- How did the day finish – at an extreme point of the chart, or was there a last gasp in pre-close with the market closing with a huge counter price bar?

As you have probably noticed, the above list only relates to the *price-related* market features. For the moment we have refrained from talking about any time-related chart factors. Why? In real trading, many traders don't use the time parameters. However, potentially this could upgrade the trading results. It is like shooting a revolver instead of firing a high-calibre machine gun from a US Navy warship. Time—price relation is dealt with in detail in Volume II (in preparation).

Let us go back to our empty chart and look at timing (Fig. 1.1). Even if the emptiness seems bewildering and mostly meaningless, closely observe the market flow and try to understand the following:

- What time length corresponds to each bar? This will allow us to calculate the time frame.
- What is the time period of the chart (duration of the chart from left to right)?
- What is the interval between two lows or two highs?
- How quickly/slowly does the price reach its morning, afternoon or day's extreme positions?
- How long does it take for the price to end its up-sloping/down-sloping tendency?
- What kind of rhythm does the price perform (cadenced, random, rapid, slow)?

The time—price relation is intricate, but it can explain much more clearly the market's movements and its random or sequential flow. In order to progress we must understand what will happen when we use a real-time chart where the price is rolling on the low time frame chart, like a small but very active mercury bubble. Ideally, we should embed the market flow energy into a hypothetical meandering river. Its winding movement will be optimal only if it takes the path of least resistance. This topic is treated in more detail in Volumes II and III (in preparation).

1.2 PIVOTS: DEFINITION, CHARACTERISTICS AND FUNCTION

The simplest concept can become the most powerful and most efficient tool.

In order to understand the meaning of the price movements, we create a map of the market with the help of landmarks, called *pivots*, which constitute the basics of pitchfork construction.

A pivot is defined as: *a critical point having a major or central role, function or effect . . . a shaft or pin on which something turns* (Merriam-Webster's Collegiate Dictionary 10th edition, 2002).

Therefore the dual role of the pivot is to both perform an important function and be a platform on which something else can turn. We could not agree more about these dual functions. Not only are they useful for trading but, in a way, they also become synergetic with each other. Whatever their degree of importance, pivots are easily-detected landmarks. They can be used to trace out both the immediate past and the current market positions, thus projecting the market price into the time—price space.

In Fig. 1.1 we can see that the price curve is not straight but resembles a sine curve. The market flow has been disturbed by small, middle-sized or very visible troughs (up-trend) or peaks (down-trend). Every time the price reaches a turning point, whether as a tiny stumbling move or a complete reversal, a pivot is formed. Its characteristics depend on the market's strength or weakness, slope and direction; in other words, how long the market maintains a particular price movement. By their shape and depth and/or height, the following four types of pivot can be identified:

- primary pivots (P), chiefly used to detect the high/low of a trend;
- major pivots (J), frequently seen immediately before the trend is completed;
- intermediate pivots (I), a kind of bridge between J and M pivots;

- minor pivots (M), called pullback pivots. They are often present at the beginning and end of the pullbacks.

The trader can mark pivots on the chart, but this requires some experience in evaluating the degree of importance of each type of pivot or by utilising ergonomic charting software (see, for example, *The Tools, the Power, the Knowledge – Tom Joseph’s Advanced GET User’s Guide* from eSignal, 1989–2003). Choosing the most optimal three-pivot set-up is not easy, especially during your apprenticeship. You should discipline yourself by keeping in mind that the whole market context (*think globally*) should be considered as an integral part of the local action of the market (*act locally*).

Figures 1.2–1.5 give examples of how and where to mark the pivots. The primary pivots (P) on Fig. 1.2 mark the most vigorous price movements while the local market is performing a counter-trend movement. As we can see from Fig. 1.3, the major pivots (J) often accompany the primary pivots (P). The former have less impact on the market tendency than the latter. Figure 1.4 indicates the position of intermediate pivots (I). The degree of impact on the market bias is less compared with that of the major pivots (J).

The minor pivots (M) perfectly integrate with the other types of pivot (Fig. 1.5 on p. 22). These pivots are the least important in terms of their impact on the market tendency. However, they ought not to be neglected because they have their role for entries and exits, especially when the trader goes to a lower time frame (optimal pivot visibility).



Figure 1.2 Primary pivots (P) (Courtesy of www.pitchforktrader.com)

The Birth of Pivots and the Pitchfork

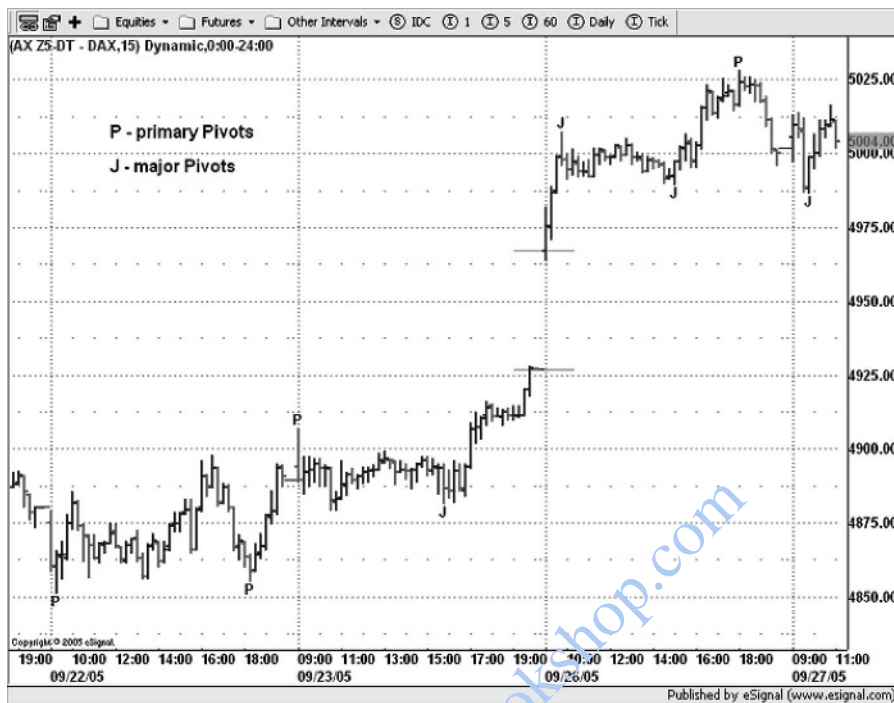


Figure 1.3 Major pivots (J) (Courtesy of www.pitchforktrader.com)

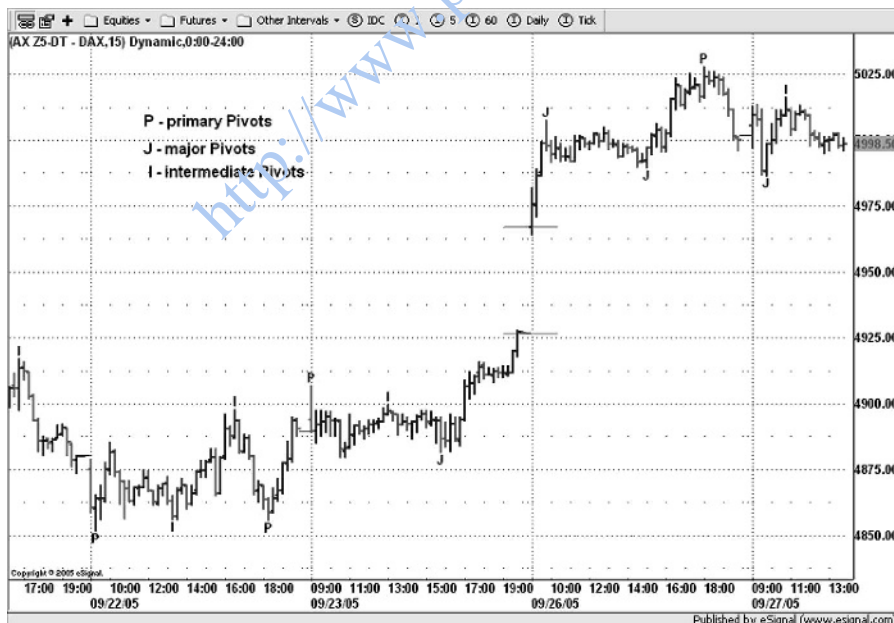


Figure 1.4 Intermediate pivots (I) position – lesser degree market impact compared with that of the major pivots (J). (Courtesy of www.pitchforktrader.com)

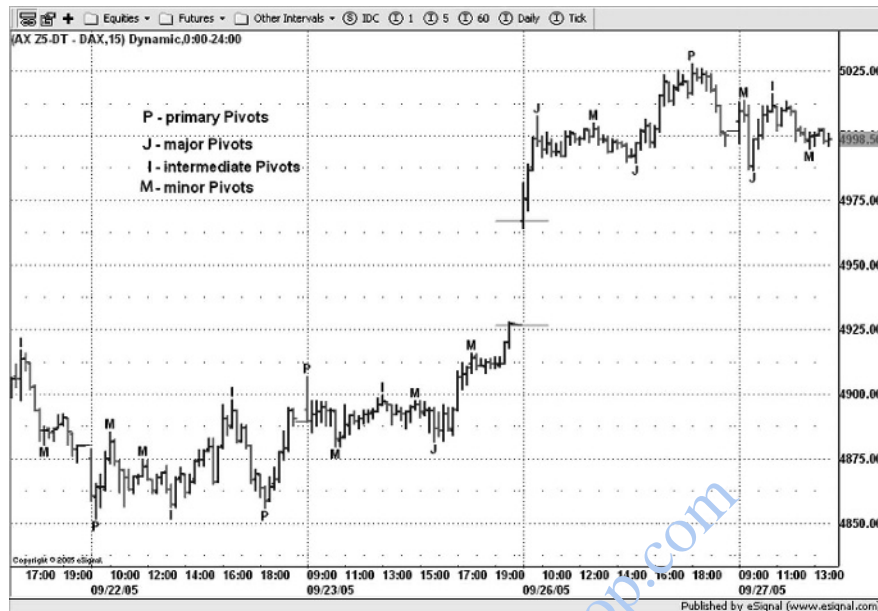


Figure 1.5 Minor pivots (M) (Courtesy of www.pitchforktrader.com)

1.3 CONSTRUCTING THE PITCHFORK

Whilst on the subject of embedding the energy flow of the market, there probably isn't a better way to guide this tremendous power than the pitchfork invented by Dr Alan Hall Andrews. Inspired by a course taught by Roger W. Babson, another entrepreneur from the first half of the 20th century, Andrews explained the mechanism of the median line (ML) closely guarded by two parallel trend lines (see Appendix 1: Historical Basis). These median lines are present on almost all charting software under the name of *Andrews pitchfork*.

It is not our intention to treat in detail the work of Babson or Andrews; the former was working over 75 years ago, and the latter in the early 1960s. Rather, we focus on how their pioneer work has evolved into the technical market concepts integral to everyday trading. Although Fundamental Analysis flourished during their time, both of them struggled and succeeded in creating the foundation of modern Technical Analysis. Even though much time has gone by (rather quickly for some of us), their work is as valid today as ever.

The geometrical structure of the pitchfork closely resembles a channel made out of three equidistant parallel trend lines, where the median is anchored farther away from the channel's main body. The cardinal orientation is usually slanted; otherwise it would have been called a rectangle. Most of the time the pitchfork is optimally drawn by suitable software and the trader only has to choose the best landmarks, which could be a single pivot or a mixture of the pivots already described: primary, major, intermediate and minor.

If you had to retain just one concept from these three volumes (over 1000 pages and more than 1200 charts), it would be the following:

The choice of pivots underpins the efficiency of pitchfork trading, which in turn is expressed by how well the market is described.

I call this principle ‘the Holy Grail of the pitchfork’. Please keep it in mind while you read on.

The physical construction of the pitchfork is easily understood and carried out, even manually. Each pitchfork needs three physical or virtual pivots and the construction sequence is usually as follows: High–Low–High or Low–High–Low except in the case of specific pitchforks using virtual pivots or midpoint pivots of a virtual (or not) swing (for instance, the ‘suspended’ anchor pitchfork, the T-pitchfork, the straight alignment pitchfork described further). The initial pivot, usually marked P0, firmly fixes the structure into the market, and is therefore named the *anchor*. The other two pivots are usually marked P1 and P2. After selecting the optimal three-pivot set, draw a *trend line* (median line or ML) joining the anchor (P0) to the middle of the swing formed by the P1–P2 duo. Once the current market builds a pivot, you should look for a possible location for the next one.

Very briefly, we mention here the *warning lines* (WL) which run parallel to the extreme upper and lower parallel lines (U-MLH and L-MLH), which in turn are parallel to the ML. The WL is parallel to the MLH at the same distance as that of the MLH to the ML. The space between the ML and each MLH, or between the WL and any neighbouring MLH, may be divided following a Fibonacci ratio measure, thus creating the *Fibonacci trend lines*. You will find more information on these topics in Chapters 5 and 14.

Now for a brief word about whether or not to mix the four types of pivot (primary, major, intermediate and minor). We would say it does not really matter how you choose these pivots as long as you keep in mind the ‘Holy Grail of the pitchfork’. There is more on pivot choice criteria in Chapter 2.

1.4 CREATING PIVOTS: CASE STUDIES

German Dax Futures Index Charts

Constructing a pitchfork is carried out with only one denominator in the trader’s mind: an ideal market description (Fig. 1.6). As you can see, whatever its type, each pivot is marked in the same fashion; its relationship with the others ideally embeds the market flow and converts a seemingly random market into a railroad-like structure, less random than it first seems.

The choice of all the primary (P) pivots seems to be workable for the first part of the chart (Fig. 1.7). On 26 September 2005, the strength of the market creates a very large market interruption (*gap*), which translates the market flow from inside the body of the pitchfork farther upwards, to over 100% of the pitchfork’s height.

Drawing lines parallel to the U-MLH reveals once again the position of the optimal primary (P) pivot (Fig. 1.8). The market rides perfectly on these trend lines. The gap opens right on the upper warning line, above the upper 150% Fibonacci line and U-MLH. Even a 100% upward market translation cannot disturb the optimal market description (‘the pitchfork’s Holy Grail’).

In spite of their different degrees of importance, the primary (P) and the major (J) pivots perform nearly the same role of stopping the upward market move, right above the upper 350% Fibonacci line (Fig. 1.9).

Two of the best qualities of the pitchfork are its flexibility and versatility. Figure 1.10 demonstrates that, by slightly changing the location of the anchor and the P1–P2 swing alignment (from P–P to P–J), the market is described even better.

Changing the anchor location and the P1–P2 swing alignment enables the creation of a dual set of interdependent pitchforks (PF). The most recent PF better embeds the market with the help of the older PF (Fig. 1.11).



Source: www.futuresource.com

Figure 1.6 Pitchfork construction (Courtesy of www.pitchforktrader.com)



Figure 1.7 Choice of primary pivot (P) (Courtesy of www.pitchforktrader.com)



Figure 1.8 Optimum primary pivot choices (Courtesy of www.pitchforktrader.com)

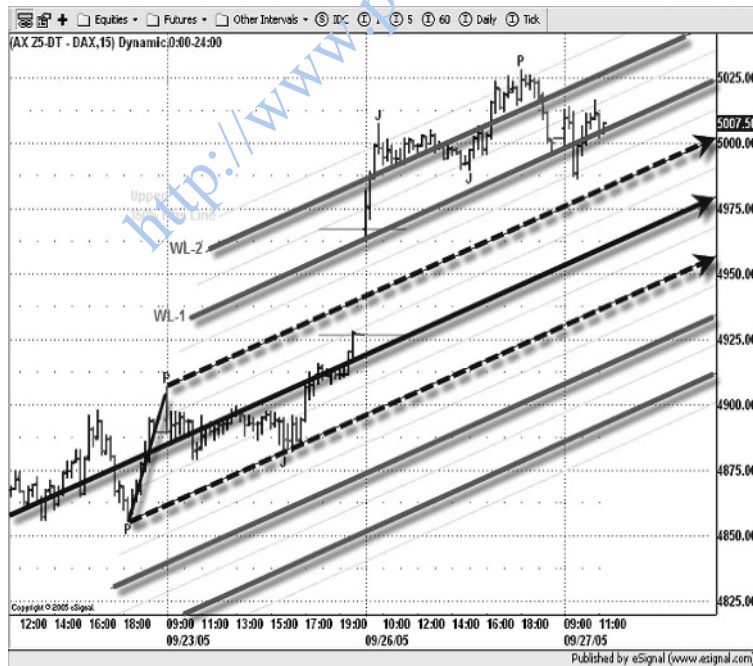


Figure 1.9 P and J pivots stopping the upward market move (Courtesy of www.pitchforktrader.com)

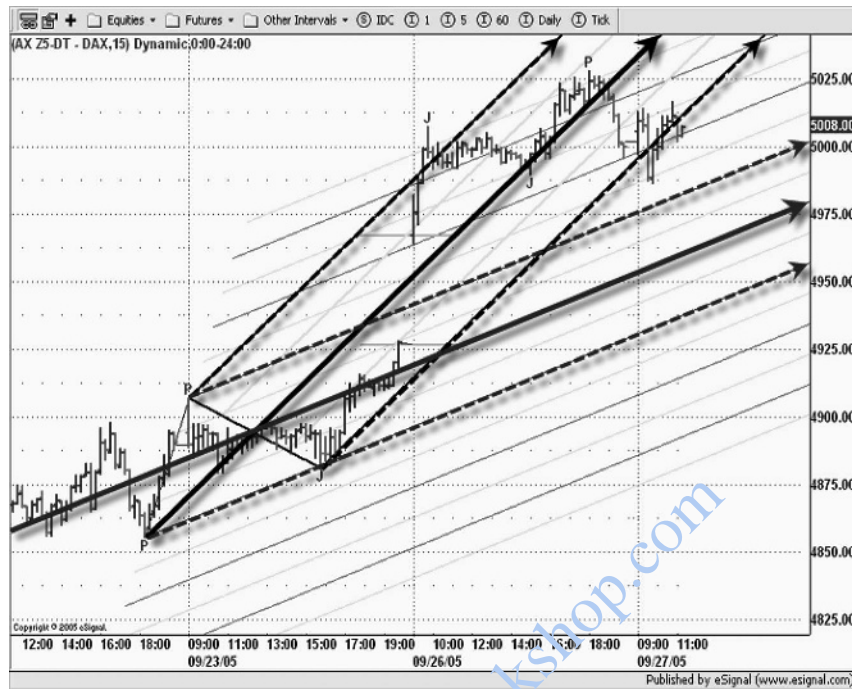


Figure 1.10 Flexibility and versatility of the pitchfork (Courtesy of www.pitchforktrader.com)

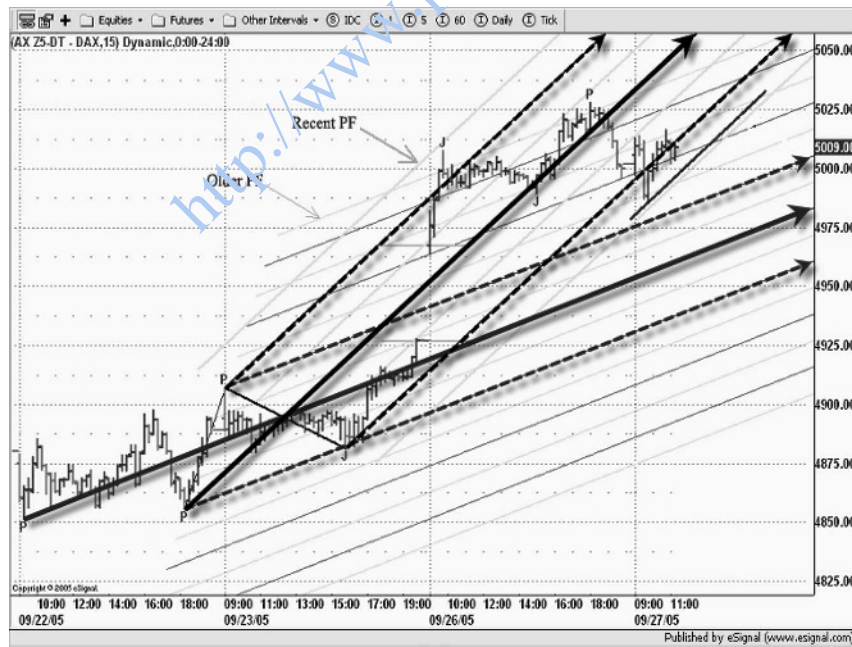


Figure 1.11 Interdependent pitchforks (PF) (Courtesy of www.pitchforktrader.com)

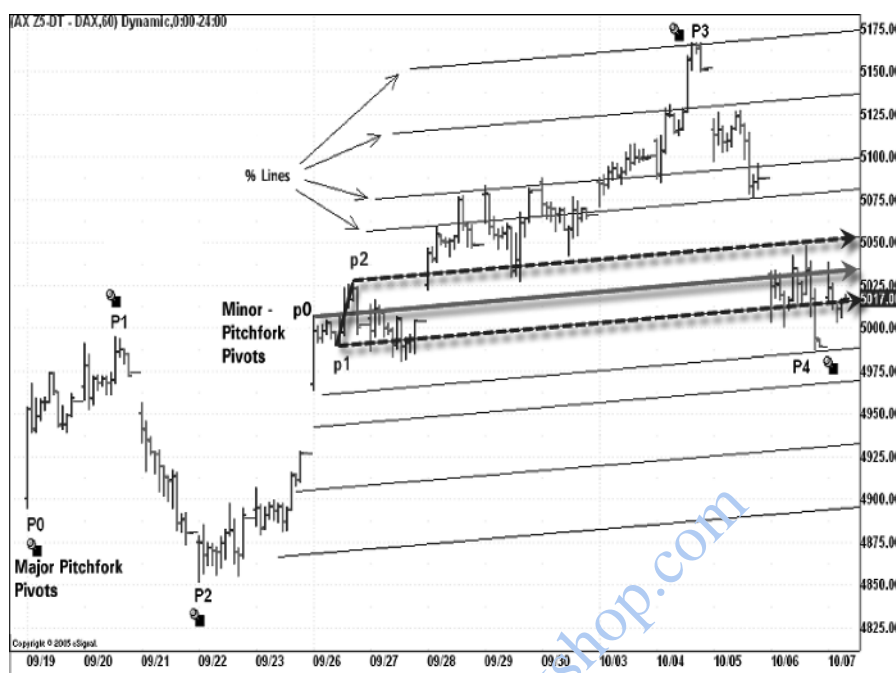


Figure 1.12 Major and minor PF pivots working together (Courtesy of www.pitchforktrader.com)

The major and minor pitchfork concept is treated in detail in Chapter 9. For our present purpose, the chart in Fig. 1.12 shows how the two different sets of pivot, the minor PF (p0, p1 and p2) and the major PF (P0, P1, P2, P3, and P4), are working together. Pivots P3 and P4 halt the market cold, upwards and downwards respectively, and are well embedded within the outer limits of the p0-p1-p2 pitchfork.

Figure 1.13 shows the two different sets of pivots creating two pitchforks. The larger PF encloses the market price movements (the market context); the smaller PF, which is the more recent, is right on top of the immediately developing market. It is interesting to note that they share a common pivot (p0 = P2). We will see later that this feature is very common when the trader tries to embed the ongoing correction of a just-finished positive trend. This is done right after the confirmation of the bottom.

Look at the two sets of pivots in Fig. 1.14. One set describes the contextual pitchfork (P0, P1 and P2) and the second (p0, p1 and p2 – not drawn here) belongs to the pitchfork which is closer to the market's ongoing downward movement. For clarity and learning purposes we have drawn only the corresponding MLs.

The pattern in Fig. 1.15 (on p. 29) completes the contextual pitchfork of Fig. 1.14 where only the first set of pivots, the median line with its accompanying lines and the P1 – P2 swing are drawn.

1.5 KEY LEARNING POINTS

- The most simple concept can become the most powerful and efficient tool.
- Pivots can be easily used to trace out both the immediate past and the current market positions, thus projecting the market price into the time–price space of the immediate future.

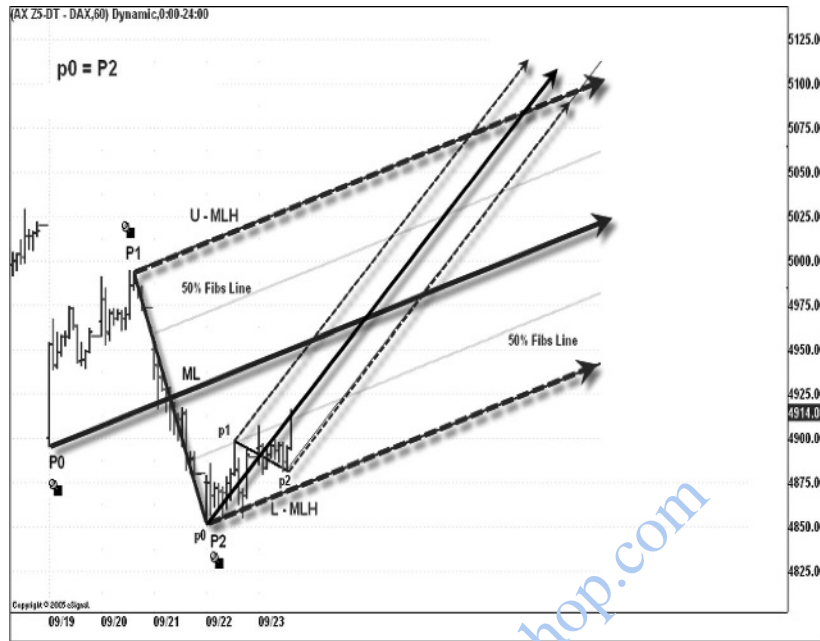


Figure 1.13 Creation of two PFs (Courtesy of www.pitchforktrader.com)

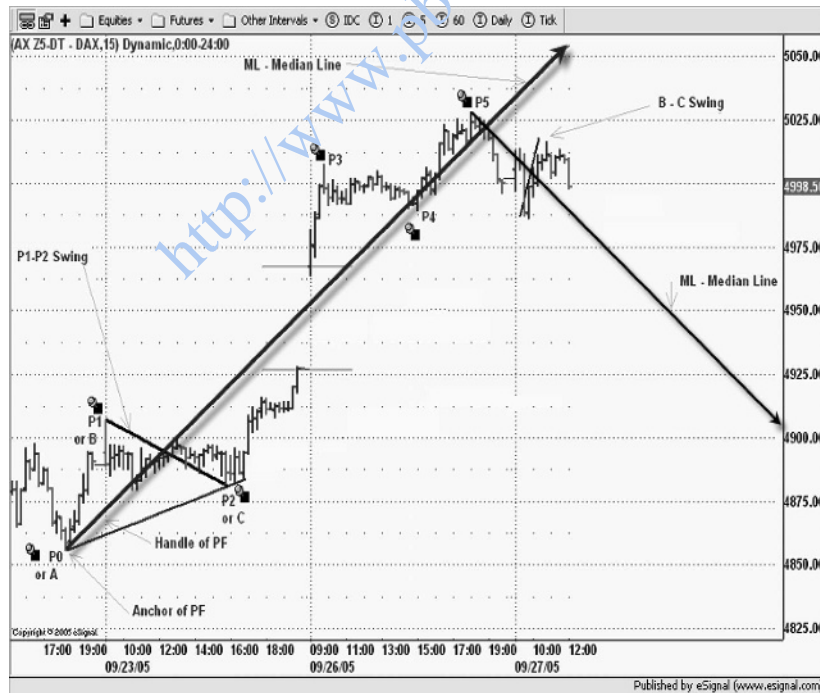


Figure 1.14 Stripped PF: MLs drawn only (Courtesy of www.pitchforktrader.com)

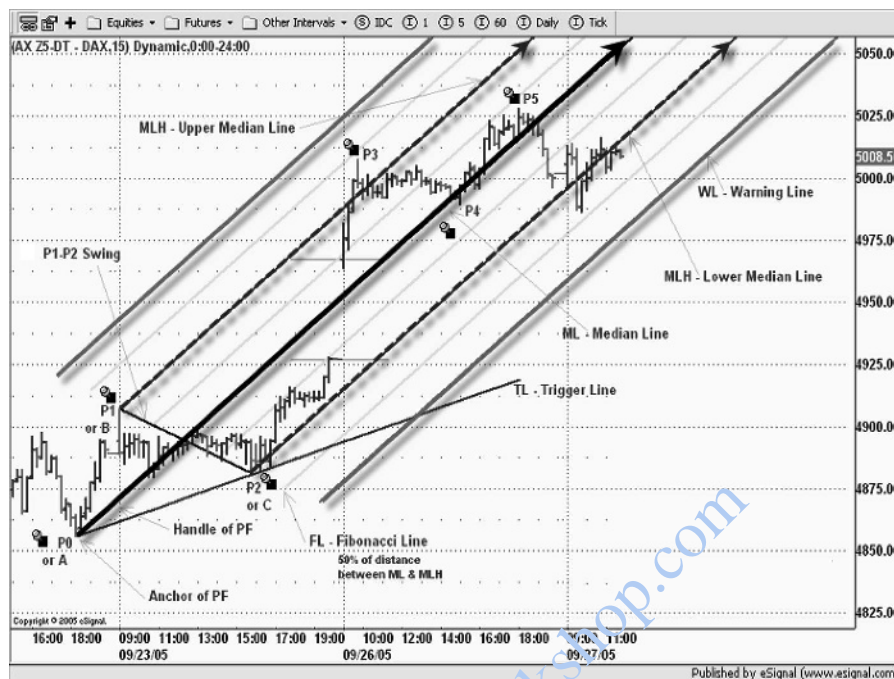


Figure 1.15 Complete set-up of an up-sloping pitchfork (Courtesy of www.pitchforktrader.com)

- The whole market context (think globally) should be considered in conjunction with the local action of the market (act locally).
- The choice of pivots underpins the efficiency of pitchfork trading, which in turn is expressed by how well the market is described. We call this principle ‘the Holy Grail of the pitchfork’.
- The quality of a pivot should be always observed:
 - a bigger swing with a big reversal bar (*shooting star*) gives the best pivot;
 - the cleanness of the bars within a swing;
 - the pivot range indicates market volatility at that moment.
- The pitchfork construction procedure is fully realised when there is only one denominator in the trader’s mind: an ideal market description. Whatever the type of pivot used, their compatibility ideally embeds the tortuous market flow, converting a seemingly random market into a railroad-like structure, less random than it first appears.

<http://www.pbookshop.com>