The Bigger Time Frame Is Key

How to Recognise Trading Chances

How often have you traded a specific chart pattern which has consistently made you money? Most successful traders who utilise technical analysis will search for the same type of chart patterns that worked before when looking for a trade. After all, chart patterns occur and repeat due to the psychology of the people who are trading from them. In other words, when a certain pattern forms on a chart, it is the human emotion of the traders being displayed and unfolded right in front of you.

» There are many popular technical patterns on the charts that traders follow. Some well known and traditional patterns that many traders follow are called flags, consolidation patterns, head and shoulders, cup and handles, wedges, double tops, double bottoms, triangles, and more. Most technical traders will seek these type of patterns out everyday, in the hope of the pattern repeating and producing the results it is known for.

What's Your Time Frame?

These same patterns can be found on all different charting time frames. When it comes to charting, the manner in which you are involved in the markets will determine which time frame you should use. For instance, if you are a day trader or scalp trader who is looking for quick gains during the same trading day, then the intra-day chart will be the most beneficial to you. Some popular intra-day time frames include the 5-, 10-, 15-, 30- and 60-minute charts. Scalp traders can even be found utilising a 1-minute chart, while others may trade off of the extremely fast action of a tick chart.

Then there is the swing trader who is looking to buy or short a stock and hold the position for multiple days or weeks. The swing trader will predominantly trade off of the larger time from on the charts, such as the daily and weekly periods. Next, you have the position trader. This individual is looking to stay in a stock for weeks to months, with the intention of riding the position for a much larger move. Finally, you have the investors. Investors will generally look to hold stocks for years, but rarely do they use charts to do so.

Regardless of the type of trader you are, the same patterns can be found on all of the different time frames. With time frames and chart patterns in consideration, have you ever wondered why a particular chart setup which has worked before fails and costs you money? Most do not understand why chart patterns fail. They will usually say things like, the pattern just didn't work out this time around, they will blame the news or some rare event for the failure of the pattern. Wouldn't it be great to know if a pattern is going to fail before it happened? Well, there is one way to dramatically increase your odds of success.

F1) Head and Shoulders on Monthly Time Frame

This monthly chart of Lennar Corp. (LEN) shows a Head and Shoulders pattern which confirms all bearish patterns on the smaller time frames; they will likely play out.

Source: eSignal

» The larger time frame on the charts is the secret to successful trading. «

Strategy Snapshot	
Strategy Name:	Higher Time Frame
Strategy Type:	Chart Pattern Trading
Time Horizon:	Intraday, Daily, Weekly
Setup:	Bullish or bearish chart pattern needs to be confirmed on higher time frame
Entry:	Market or Limit Order as soon as setup is confirmed
Stop-Loss:	Optional
Take Profit:	Optional
Trailing Stop:	Optional
Exit:	Discretionary; as soon as shorter time frame is overextended or critical resistance/support level reached
Risk and Money Management:	1% risk/trade
Average Number of Signals:	Depends on time frame and number of securities screened

Place the Odds in Your Favour

When a chart pattern appears, the successful trader and investor understands how to place the odds in their favour. Considering the odds of a trade, and keeping them in your favour is essentially the smart traders tool for seeing the future.

Very often during the trading session, many day traders will look at a 10-minute chart pattern, which to them, looks ripe for a great trade. However, while the chart looks good on the 10-minute chart, the trade may not have probability on its side. About 90 per cent of the time this is the case, indeed. On the other hand, when you can be correct anywhere near 90 per cent of the time, in trading and investing you will do very well.

With that said, the obvious question presents itself; how do you know when a chart pattern is going to work out or fail with a very high percentage rate of accuracy?

F2) Head and Shoulders on Weekly Time Frame

The odds of this weekly Head and Shoulders pattern playing out are very good because of the larger monthly pattern (Figure 1) that is already in play.

Source: eSignal

The Larger Time Frame

In its most simple form, the larger time frame on the charts is the secret to successful trading. You see, the larger time frame is the dominant time frame. Just think about this and it will help you to understand the concept. How can a bullish 10- or 15-minute chart pattern play out if the hourly chart (larger period) is indicating something opposite, such as a bearish chart pattern? Would the strength be in the pattern with the smaller time frame or the larger time frame? As you may have suspected, the answer to this question is the larger time frame.

Take a look at Figure 1 of Lennar Corp. (LEN) utilising the monthly time frame. There you will see a head and shoulders pattern, which is a bearish formation. If you locate that chart pattern on a monthly chart, while considering a bearish pattern for a day trade on a smaller time frame, you just confirmed a higher probability trade for yourself.

The reason for this is simply due to the fact that there are more overall participants in the larger time frame than in the smaller time frame. Just look at the amount of volume in a 10-minute chart bar on a particular equity. It is always going to be less than the hourly chart for the same exact equity. It takes six 10-minute bars to fit into an hourly chart, therefore the hourly chart is dominant when compared to smaller time interval. Swing traders that predominantly use the daily chart should always check their pattern against the weekly chart. Traders that are using a weekly chart should always check their technical pattern against the monthly chart. Hence, the importance of always utilising and considering the larger time frame.

Considering the bearish monthly chart as noted above, looking at the smaller weekly time frame chart only adds more probability to the potential success of this trade. Take note of the weekly time frame chart in Figure 2.

The Bottom Line

As long as the larger time frame isn't telling you something different from the smaller time frame, then the technical pattern on the smaller time frame has a very good chance of playing out – assuming you are reading the pattern accurately.

Now, take note of the shorter daily time frame chart pattern in Figure 3. If you were considering taking a short trade on LEN, you can make a decision with high probability of whether this trade will work out or not.

As you can see in the previous chart examples, the larger monthly and weekly time frames confirm the bearish pattern shown on the smaller, daily chart. This was an actual trade and real life example. If you followed the principles of time dominance you would have easily located this trade and confirmed a great trade for yourself. If you study and scan charts in this manner, you will find yourself with high probability trades more often.

Conclusion

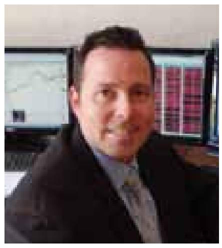
Contrasting the confirmation of larger time-frame charts, if the larger time frame is opposing the smaller time frame, or telling you something opposite of the time frame that you are analysing, then the odds of winning severely decrease for that pattern on the smaller time frame. Again, always consider the larger time frame prior to taking a trade.

Successful trading and investing is all about keeping the odds in your favour. Understanding how to utilise chart time frames properly will enable you to increase your odds and improve your trading and investing. «

F3) Head and Shoulders on Daily Time Frame

The odds of this daily Head and Shoulders pattern playing out to the downside are very good simply because the larger time-frame patterns on the weekly (Figure 2) and monthly charts (Figure 1) are bearish, as well.

Source: eSignal



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Nicholas Santiago started trading in 1991 and later became a licensed Series 7 and 63 registered representative. He successfully managed money for a large private client group. Nick is an expert in Technical Analysis, accomplished in the studies of Elliot Wave, Gann Theory, Dow Theory and Cycle Theory. Today, Nick is Chief Market Strategist at www.InTheMoneyStocks.com