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John Bollinger's Forex Letter

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Combining Time Frames

There can be little doubt that investors are becoming ever more interested in the forex markets and the interest isn't just limited to traders. For many investors the forex markets offer a new and interesting alternative to traditional investments. Consider that in the US equity market prices have been flat for better than six years and our forecast is that they may be flat for that much time again. The other major investment class used by the typical investor is bonds. These have been in a bear market since June of 2003, and show every sign of being governed by adverse circumstances for the foreseeable future. Of course there is always cash, but even though short-term interest rates have been rising for five quarters and have doubled in that time, a percent-and-a-half is still not what most investors are after. (There is some hope for this asset class over the next few years as this round of interest-rate increases proceeds.) Of course gold, energy and commodities have done well and continue to have good prospects, but these are still "alternative investments" to most people and alternative investments have the same unpleasing ring to the ear as derivatives to many. This means that the foreign-exchange markets are increasingly becoming an object of contemplation for many investors. Since most of the readers of this letter are quite short term in outlook, you may be thinking, "What has this to do with me?" In a word, everything. To list just a few, it means more participation, better liquidity, tighter spreads, better tools and greater resources.

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To shift from the theoretical to the practical: I have always been aware of the importance of multiple time frames and have taught in my seminars the strategic relevance of organizing investing/trading tasks into the time frames appropriate for them. Toward that end consider the use of three relative time frames: short, intermediate and long. Being relative concepts, these terms will have different meanings to different traders. To illustrate, for most of my operations short term is measured in hours, intermediate term in days and long term in weeks. This has everything to do with the environment I grew up in and the style to which I became accustomed. However, these concepts are relative, so for a very short-term trader short term might be ticks, intermediate term two-minute bars and long term 10-minute bars. Or, the frame of reference might be longer. A French trader/analyst and devotee of Bollinger Bands, Philippe Cahen, utilizes a “trptych” of daily, weekly and monthly charts as background for his day-to-day decision making.

There are two approaches to organizing one’s work in this manner. The first involves delegating tasks to their appropriate time frames and shifting time frames to accomplish the tasks. The second involves using different analytical time frames to aid in decision-making. We’ll explore both here.

The idea that tasks should be accomplished in appropriate time frames is central to successfully organizing your workload. In our view short term is only for execution. It is the time frame in which you strive to get your trades filled in an expeditious and advantageous manner—it is the time frame of entries and exits. Intermediate term is the time frame in which your analytics are conducted, decisions are made and portfolios managed—it is the central, most important time frame, the time frame in which the greatest portion of your time is spent. Long term is the time frame that provides the background information, long-term trends, inflation, structural change and so on—it is the time frame in which you ponder the big, macro variables that govern operations. Generally you spend most of your time on the intermediate-term tasks, somewhat less time on the long-term tasks and the least time on short-term tasks.

The most common time frame mistake is to make a decision based on intermediate-term analysis, shift to the short term to execute the trade and then forget to shift back to the intermediate term. This leaves the trader monitoring a trade in a time frame for which he or she has no tools to monitor and manage the trade. As a result they may be shaken out of the trade by noise or emotions. Another common problem is developing/holding long-term ideas/beliefs and then failing to shift to the intermediate term to find the best places to take advantage of those ideas.

The other important idea is the use of multiple time frames in analysis. I recall years ago seeing Lennox, a trading system that required similar patterns in three different time frames to generate a signal. I had used two time frames for many years; developing long-term ideas and then exploiting them in the intermediate term, but three time frames was new to me. Then some years later I visited Philippe Cahen in Paris and saw him using his triptych of daily, weekly and monthly charts while sitting on an active trading desk. Today I am always aware of what is happening in “the time frame of greater degree”, as the Elliotticians want to call it, and I always remember to shift to a time frame of lesser degree when it comes time to implement my decisions.

What are these time frames of greater and lesser degree? The concept addresses the idea that the markets are fractal in nature, so similar or complementary patterns can be found at differing levels of magnification—degree. This is a very useful concept and when we find an event being traced out in the microcosm that is also evident in the macrocosm, or when we find an idea in one time frame that is supported by analysis in another our degree of confidence is increased.

These days I always consider a time series in several different degrees before making a decision. It has become an ingrained habit and I simply would not be comfortable in a trade without the ancillary views.

Of course these two ideas need not be separate; in fact they can be combined to good effect. However, in thinking about trading methods and practices it is useful to separate them for clarity before combining them in the maelstrom that is the real-life trading arena.

What do these ideas mean in the forex markets? Everything it would seem. The discipline of keeping each task to its own time frame alone can help organize a trader's work resulting in greater efficiency and less emotional distress. The latter point is the real key, organizing one's work in a disciplined manner is a major step on the road to eliminating emotions from the trading process and emotions are first-and-always the trader's worst enemy.

There is additional utility to be gained in applying multiple time frames in one's analysis. In a trading-range market one wants to focus on reversals defined by overbought and oversold conditions, while in a trending market the definitions of overbought and oversold change in consonance with the trend and a different strategy is required for success. For example, in a bull run one wants to focus more on buying the dips and in a bear market one needs to sell the blips. So a clear picture of what is happening in the next larger time frame can help shape the strategy you deploy in the time frame you trade.

A good example of combining time frames is the Squeeze, a period in which a very low reading of BandWidth prevails. It is simply a much more interesting trade when a Squeeze is occurring in more than one time frame. For example, it is interesting to plot both the 20-day and 50-day BandWidth and then use the 20-day as leading indicator for the 50-day. So if the 20-day were to fall to a six-month low and the 50-day confirmed by doing the same thing, then one could use the 20-day to forecast the upturn of the 50-day to detect the occurrence of a big Squeeze opportunity.



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A similar trick can be worked with Bollinger Bands themselves. For example, let us again take 20-day and 50-day periods, but this time we plot both lengths of Bollinger Bands together. During sustained trends the upper or lower bands will track each other closely. See chart 3. Note how well the two upper bands track one another during the bulk of the up-trend period in chart 4. Then during a sustained downtrend note how closely the two lower bands coincide in chart 5.





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The bottom line is that most traders focus with laser-like intensity upon a single objective when it would behoove them to cast their net wider.

Taking a look at the current markets, the big idea in place at the moment is support for the euro at 1.20 on the daily charts. See chart 1. This level has been tested several times and is clearly an important level in traders' minds. But it isn't until you look at the weekly charts that you realize that at the higher time frame a massive Squeeze is taking place. See chart 2. That Squeeze is a forecast for dramatically higher volatility. So, when you have the advantage for having considered multiple time frames it doesn't take much to see that a break of 1.20 could lead to some real volatility and a waterfall decline for the euro. Of course if support holds and a rally starts the setup could mean big up move too. But without being aware of the higher time frame, the significance of the current juncture isn't. Have a look at the accompanying charts. It looks like an important setup.

Good trading,

John Bollinger, CFA, CMT

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