Fractal Energy Trading Crypto MasterClass

Module Four
Market Fractals & Trends

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Introduction to Market Fractals and Trends

Everything to this point of the program has been very “Fisher-Price” as I’ve tried to paint some well-known analogies with bold, broad colors. I want you to understand how much you already know about the concepts that we’re discussing when it comes to these “Fractal” relationships.

Now we need to pull up our sleeves and get to work, ***understanding how price moves***. And we’re actually going to look at price across these multiple timeframes and show how it all fits together….first, with the basics in this module, and then we’ll tie it together across multiple timeframes in the next module.

And let’s get one thing out of the way right off the bat; this method of price action analysis is not “predicting the future.” This is no “crystal ball” method of forecasting; we are simply evaluating the price action on our “family of timeframes” and letting the trend of each timeframe show us where price is going, and where price is *likely* to go in the future. It’s a very objective, clinical system when done properly, and frankly I doubt that you’ll find anything more accurate.

I will introduce two rules that will guide us as we move through this module:

Larger Timeframes Establish and Dominate the Overall Trend

Think back to our example in the last module with the family going on vacation; the largest “timeframe” in that example set the tone for the trip and established the overall direction and trend, minus some distractions provided by the smaller timeframes along the way. The larger timeframes of a fractal family of timeframes will absolutely dominate the overall trend.

Reversals Start with the Smallest Timeframes and Propagate Upwards

Monthly charts don’t stop and reverse their trend in the opposite direction any more than an aircraft carrier can reverse its course at full speed in less than a few miles of ocean. Just like we talked about with Fractals and objects, small & imperceptible changes will occur to a larger trend, starting with the smaller timeframes first. One by one they will reverse like dominos, until the major trend finally reverses. In the case of our Monthly chart, it might take up to a full year to truly reverse, but we’ll have an early warning to watch for that reversal since we’re watching the smaller timeframes.

But the real underpinning of this entire analysis method, and the core of our system…is how we apply “Dow Theory” to the price action, and use it with multiple timeframes. Let’s do a quick reset on Dow Theory before we go too much farther with the course…

Reset on Dow Theory

What is Dow Theory? The view on how trends are analyzed are really just one of several tenets[1] that comprise the full “Dow Theory” from Charles Dow, who never actually summarized these as a system while he was alive.

The one that we really care about relates to how a trend is defined. An **Uptrend** is a series of higher highs and higher lows:

Figure 1

Notice how each “swing” of the price carries it to a new high price, before it pulls back and creates a “higher low” in the price. Each “high” is a “higher high” and each “low” on the pullback creates a “higher low.”

Conversely, a downtrend is a series of lower highs and lower lows, as shown in Figure 2:

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[1] http://en.wikipedia.org/wiki/Dow_theory

Figure 2

Notice how each “swing” of the price carries it to a new low price, before it bounces up and creates a “lower high” in the price. Each “low” is a “lower low” and each “high” on the pullback creates a “lower high.”

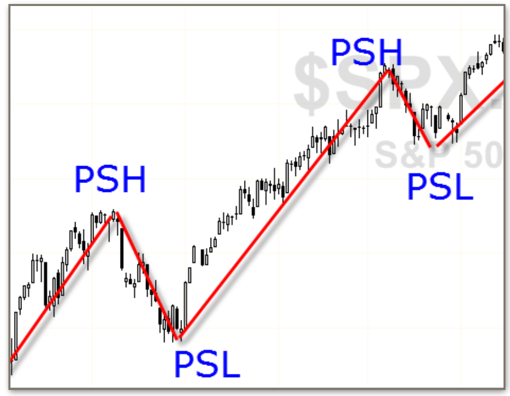
Terminology - Swing Highs and Lows

Something that will be important to us to agree on is the terminology behind these “swing” points. You can see in this diagram how the swings are marked, with “PSH” standing for “Prior Swing High” and the “PSL” standing for “Prior Swing Low.” It doesn’t matter whether we are in an uptrend or downtrend, there will be swing highs and swing lows.

Notice how the down trend shows the “next” swing highs and swing lows are LOWER than the “previous” swing highs and lows.

Conversely, in an uptrend the swing highs and swing lows will be higher than the previous swing highs and lows.

You'll hear me refer to "prior swing high" and "prior swing low" through the rest of this program; make sure that you know what this term means respective to the trend and the timeframe being examined.



[Terminology - "Taking Out" the Swing High or Low]

In the videos as I explain price action, I will constantly refer to the action of the price "taking out" a Prior Swing High or Prior Swing Low. Figure 3 shows an example of how the price "takes out" the level at the Prior Swing High at the green dotted line to create a "higher high" in price; this is significant.

Figure 3

This means that a new "high" has been made in the price, and the uptrend is confirmed again after printing a new "higher high." Conversely, "taking out the prior swing low" means the opposite thing, as we can see in Figure 4:

Figure 4

When the price “takes out” the prior swing low by making a “new low,” then the downtrend is confirmed, or actually established if we see a reversal from a recent high.

Terminology - “Change of Polarity”

This is a more concise phrase which indicates that the trend at a particular timeframe has “flipped” from a downtrend to an uptrend…or an uptrend to a downtrend. Its “polarity” has changed. This is one of the most important changes that any trader will want to be able to identify, because depending on the signal that we get…we’ll either have a full confirmation that the trend has changed at that timeframe, or we’ll get an early warning that we have a very high probability that it’s about to change. Both of these events create potentially massive trading opportunities that we’re always on the hunt for.

In Figure 5, we can see how an uptrend…with a series of higher highs and higher lows….fails to make a new high at the PSH near the beginning of April, instead putting in a “lower high and then confirming the trend change, or “change of polarity” as the price “takes out” the PSL blue line and creates a “lower low” by doing so. This is a change of polarity to a downtrend.

Figure 5

In Figure 6, we see the opposite occur:

Figure 6

The price is in the middle of a downtrend starting in early April, with lower lows and lower highs. That starts to change in mid-June as the price "takes out" the PSH to the upside, creating a "higher high." The change in polarity is complete after the price puts in a "higher low" near the end of June. The price has just completed a change in polarity to the upside…from a primary downtrend to a primary uptrend on the daily chart.

Processing Trend Changes with Dow Theory

What we're going to do is for every timeframe, mark the "swing highs" and "swing lows." In time it will become obvious when a PSH or PSL can be marked on the chart, and you'll see that doing this with multiple timeframes will help us sort out the real moves from the false ones.

As we mark the swing highs and lows, we'll know what level must be "taken out" in order to perpetuate that trend, or give us a warning that it's about to fail and perhaps head in the other direction - a change in polarity.

With this terminology and process in mind, the best learning tool from here is to watch the video and see how we evaluate trend on a single timeframe basis using the swing highs/swing lows, and what levels it would take for us to claim a polarity reversal.

Now that we've done our reset on Dow Theory, we need to progress to talking about the two major rules that we introduced at the beginning of this text:

- **Larger timeframes dominate the trend, and**
- **Reversals start from the inside-out and propagate higher.**

Larger TimeFrames Dominate The Trend

OK, recall our "family of four" discussion, especially the family going on vacation. (Those of you that are not, or never were parents, bear with me a minute.) Let's say that we have the Father and the youngest child making a pit stop during their trip. Remember, the Father is on a mission to get to the destination that evening because he's already paid for the hotel and it's too late to cancel and receive a refund. "I MUST MAKE IT" is what's going through his head.

The youngest child, barely a fraction of his size at 3 years old, is unaware of this obligation and frankly would not even care if they knew about it. All they care about is that little frog that they just saw hopping in a pond at the rest stop. "Daddy, let's look at that froggie!" she commands. "OK, but just for a second…" he grumbles.

Well, I think you can see where this is going. Before long, the Father's obligation to execute on his plan will override his child's need to bond with the frog. He finally pulls her along by the hand, with the child protesting and crying the entire time, desperately trying to bond with the frog.

In this case, the "trend" was FORWARD, and the "larger timeframe" was eventually going to dominate the trend direction. When there is a conflict between these different timeframes, the larger timeframe will eventually dominate the trend and the price will continue going in the same direction.

We see the same thing happening in the Markets all the time; Figure 7 shows a very strong Monthly trend in red:

Figure 7

Now, note the daily chart in Figure 8, which is the same chart and essentially the same length of time as shown in the monthly chart:

Figure 8

Look at the three red downtrends in this daily chart; notice these sharp pullbacks which are “counter” to the main Monthly uptrend. ***How long do they last?***

These short pullbacks are similar to the detour that the Father and Daughter take to visit the frog; short and quick. Think of the Monthly chart as an aircraft carrier barreling along at 35 knots in the open sea, and then suddenly hearing the command “ALL STOP!!!” I’d bet that the carrier will coast for hundreds if not thousands of meters before coming to a stop.

And larger timeframe charts “dominate” the trend in this manner. A strong Monthly trend will make quick work out of a pullback on the Daily chart. When both of the Monthly and Weekly timeframes are pointed in the same direction with respect to trend, expect any countertrend price movement to be short before the dominant trend asserts itself again.

Reversals Start From the Inside-Out

In earlier texts of this program we discussed how physical objects typically change from the inside-out. A virus might start to replicate inside of you and you'd never know it until your immune system finally is overwhelmed. Houses begin to fail from the foundation-up as termites eat the structural wood until the loads shift and the house begins to sag. You'd never see that change from the outside until the damage has already been done.

Guess what? The same thing happens in financial markets. The "Crypto Bear Market of 2018" didn't happen all at once; erosion had been occurring in the smaller timeframe trends well before it suddenly "let loose." Just like everything else that we encounter, change comes "from within."

And we'll find the same thing as we study price action…that changes in trend actually start from the smallest timeframes going in a counter-trend direction, before those changes actually start to propagate to larger timeframes making a counter-trend move as well. Where the "change" actually stops…depends on how deeply the "foundation" of the market was corroded. If conditions are no longer adequate to support growth going forward for the next year or two, a full monthly trend change might be in order. Can you see why we'd want to be in FRONT of that and not BEHIND like the rest of the Herd?

Let's see how this Bear started with the four-hour chart starting with Figure 9:

Figure 9

Note how the price printed a lower high and then a lower low, breaking the rising trendline; this occurred on December 20th, WELL BEFORE anyone suspected that a Bear was afoot. That was our warning shot over the bow.

This series of four-hour lower highs/lower lows soon “propagated” to the Daily chart as its own series of lower highs and lower lows, seen in Figure 10:

Figure 10

If you look carefully, you can see the four-hour chart waves “embedded” in the Daily chart swings. A full series of lower highs and lower lows are picked up on the Daily chart and just one single swing lower, without the detail.

The BTC market could have recovered from this point, and made an attempt as you can see with the “higher low” on the daily chart that led to a “higher high.” But this is the propagation of the Bear to the next timeframe, as it printed a “lower high.”

When that “lower high” hit the Weekly chart, it was all over for Bitcoin’s rally, as we can see by the Weekly chart in Figure 11:

Figure 11

Lower highs and lower lows on the Weekly chart. That was in the second week of January 2018, yet few saw that move coming and the first wave down was exceedingly destructive, as you can see. This all unfolded in about eight weeks, further underscoring crypto's ability to move like nothing else. No chart study/indicator would have shown that rapid change in polarity any faster or more accurately than reading price swings changing from the inside-out.

And upside reversals will be just as strong and just as dramatic, as we've seen time and again with this market. Study that transition again and again on your own charts until you can see how the reversals start "small" and propagate to higher timeframes, which is where the BIG moves come.

Watch for the Transition

A question that I often get is, "Your two rules are a contradiction! Aren't they saying different things?" Well, perhaps. You see, the first rule says that "larger timeframes dominate" which basically says that the majority of the time, smaller pullbacks are swept up in the wake of a larger trend, and ignored. The second rule is contrary to the first, saying that *IF* the larger trend is to fail, it will START with the lower timeframes first, and propagate upwards. So, the rules are different yet consistent with each other. 99% of the time a daily chart pullback will not lead to anything serious. It's the 1% of the time when a daily chart pulls back, and then the larger timeframes follow suit…that we need to be aware of and take action with or against.

Summary - Market Fractals and Trends

If you can begin to understand and apply the concepts in this module, you're done. Seriously. You'll never have to learn another technical analysis system ever in your life, for as long as you trade. That isn't hype, it's the truth, because nothing else really matters besides PRICE.

And while PRICE movements will change over time - we've certainly seen different movement in the charts over the last couple of years - being able to "frame in" the price movements to identify high-probability setups will never, ever stop working.

Let's recap some of the points that we made:

Dow Theory Terminology and Function

- **Understanding where the "swing highs" and "swing lows" were**
- **Understanding the price point where it "takes out" a prior swing low or prior swing high**
- **Understanding the flow behind "change of polarity."**

Larger Timeframe Charts Dominate the Trend.

The major swings that we see on a larger timeframe chart like the Monthly chart…will overwhelm and "dominate" the smaller timeframe "child" trends, meaning that pullbacks on the daily chart will usually be reversed quickly back towards the dominant trend.

Trend change starts from smaller timeframes and propagates upward to larger timeframe charts.

Change starts from the inside-out, and what starts out as a simple reversal/pullback on the smaller timeframe charts can start to "propagate" to the larger timeframe charts, eventually causing a major reversal. These major reversals on the Monthly chart don't occur very often, but represent huge opportunity when they do.

Homework and Next Steps

Please complete the following tasks before moving to the next module:

- [ ] Watch the associated video for this module.
- [ ] Spend at least one hour marking out “swing highs” and “swing lows” on charts; follow through on the trend to understand when each of those trends reversed, and what price levels had to be reversed to show the Change of Polarity.
- [ ] Find a chart with a strong Weekly trend; now pull up a daily chart on that same stock and note how the daily pullbacks are abbreviated, and eventually reversed in the direction of the Weekly trend again.
- [ ] Identify a chart with a Weekly reversal, and starting with the daily chart, identify the price levels on a day-by-day basis that had to be “taken out” in order for that chart to change polarity on the Weekly chart.