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Pattern, Price & Time

SECOND EDITION

Using Gann Theory in Technical Analysis

JAMES A. HYERCZYK

Pattern, Price & Time

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Preface

I'm sure you've all heard the expression, "The more things change, the more they remain the same." This is true when it comes to technical analysis. Although there have been advances in technology since the first edition of *Pattern, Price & Time* was published in 1998, the markets are still creating patterns, making percentage retracements, or hitting cycle lows just as they were in 1998 and even before then.

With each new software program there seems to be another way to analyze and trade the markets with some new oscillator or indicator in an attempt by the trader to gain an edge. Unfortunately, this theme of smoothing out valuable information like the Open, High, Low, and Close has, in my opinion, created more difficult trading conditions. Today, despite all the new technical analysis tools and equations, the definitions of an uptrend—higher tops and higher bottoms—and of a downtrend—lower tops and lower bottoms—have remained unchanged for decades. Today, while traders remain fascinated with smoothing out data in an effort to get the edge, the art of analysis of the simple basic data has been cast aside.

As I wrote in the first edition of *Pattern, Price & Time*, my intention is not to write about W. D. Gann, but instead to write a book about what I consider to be the major themes of Gann's work: pattern, price, and time. In addition, I wanted to write a book that can be used by the analyst and trader who can apply Gann's basic rules to the markets without having to learn astrology or buy Gann wheels and plastic overlays. I wanted to write a book that would introduce a trader to techniques that would allow a trader to take basic data that is available every day and through study, experimentation, and practice create sound market analysis.

My experience in the futures business has shown me that too often traders become hooked on either pattern, price, or time in their analysis. They tend to weight their analysis one way without an equal balance. The most common mistakes are systems built around time to enter and price to exit, or price to enter and time to exit. In addition, traders who use pattern often enter or exit at poor prices or with poor timing. These observations provided further evidence that a combination of all three methods is necessary for success in the marketplace. It is on this premise that I have based my book.

As I outlined this edition of the book, I decided to maintain my original objective to write about the simplest approaches that would demonstrate how each of Gann's methods worked individually, and how each method worked in combination. In *Pattern, Price & Time*, 2nd edition, I even decided to include other popular pattern, price, and time indicators to show how they can be incorporated with Gann's basic premise of balancing price and time.

After a brief introduction as to why I choose to write about pattern, price, and time, I introduce W. D. Gann and his theory. I follow this up with information on the importance of having correct data and charts. This is followed by descriptions of the key elements of technical analysis: pattern, price, and time. In the pattern chapters, I discuss trend indicators and chart formations. In the price chapters, percentage retracements and Gann angles are detailed, followed by a chapter on combining pattern and price. Finally, concepts of time analysis finish the core analysis techniques. The last chapter demonstrates the effects of combining pattern, price, and time into an analysis and trading tool.

After the last book was published, I received criticism that I was holding back on Gann's secrets. This could not be further from the truth. I stated in the book that teaching financial astrology was beyond the scope of this book and could take years to learn and apply. I stated it was not my intention to write or teach financial astrology. I can say that if you understand the basics of this book then learn financial astrology, you will have an edge over those who only know astrology because, after all, astrology is a time indicator. Remember that although Gann said that time was most important in identifying changes in trend, price and time and money management are just as important when trading. In order to appease those who feel I am keeping secrets, I will publish a few surprises in this book that will point those who want to study the metaphysical elements of Gann analysis in the right direction. This includes what I believe is the source of his Law of Vibration and a list of books that he recommended. In an effort to provide the reader with more automation I've attached a link to the TradeStation code for my trend indicator at www.wiley.com/hyerczyk. This will allow the reader to create swing charts in the same manner as W. D. Gann.

In conclusion, this book is intended to be educational and informative. It is by no means intended to replace the books and courses written by W. D. Gann. At times the book may seem repetitive, especially in the chapters about the trend indicator. This is done intentionally because I wanted to emphasize, just as Gann did in his books, that the analyst must study, experiment, and practice these techniques over and over. If anything, this book should be used by the novice as an introduction to the subjects of pattern, price, and time. It should be required reading before computerized analysis is attempted. It is very important to learn how pattern, price, and time techniques work before using computerized trading indicators. This book will provide a good base for the analyst who wants to use more sophisticated technical analysis techniques. The expert trader could also use this book to enhance his or her analysis or trading abilities. While Gann analysis concepts are discussed in this book, it is not intended to be a book solely on Gann analysis as many original ideas and techniques are introduced throughout the text. Gann, for example, left no record on how to trade stock indices, Treasury bonds, or Forex markets. Although at times limited by page size in this book, I believe pattern, price, and time analysis is presented in a detailed but clear manner. I hope that you find the ideas in the book as useful as I have.

James A. Hyerczyk
Palos Park, Illinois
September 2008

Acknowledgments

I would like to thank my wife, Mary Colleen, and my daughters Amy, Kelly, and Erin for giving me the time and the space to pursue my passion for technical analysis. Each of you has a special place in my heart, and I love you all very much.

Pattern, Price & Time

CHAPTER 1

Why Pattern, Price, and Time?

Despite the proliferation of trading analysis programs claiming to have "new" indicators and "new" ways to analyze the markets, I've come to the conclusion that there really is not anything new under the sun and that all of these discoveries can be placed into the categories of pattern, price, and time.

Ever since the early days of trading up until today, traders have been trying to create ways to manipulate data in an effort to find an edge over everyone else. Today's sophisticated programs have the ability to smooth data and create sophisticated formulas to make the market's basic data appear to show anything the programs want to find. Some programs create moving averages, while others try to break down the markets into oscillators that move between 0 and 100. All of these new ways to look at data may be fine for some, provided that they understand how these numbers are created, and the programs create rules on how to use them, but I find working with the original Open, High, Low, and Close data to be most beneficial. In addition, while I acknowledge that using computer-generated oscillators or indicators may speed up the process of analyzing a market, I have found that all of these smoothing tools will eventually collapse to or agree with my simple analysis of the markets using the Open, High, Low, and Close.

This book, although it is concerned with the technical analysis approaches to trading Forex, futures, and equities, should not be considered the definitive answer to making tremendous amounts of money in trading. Instead it should be used as a guideline to give the trader an edge as to what is actually taking place in the marketplace. My application of pattern, price, and time analysis allows me to see and understand what is happening in the markets. It does not hide anything in complicated formulas or computer number crunching. Although this is a personal preference, I feel that the analyst who understands how pattern, price, and time work independently and in unison with each other creates an edge to trading the markets that computerized analysis cannot.

Throughout the book the reader will see the phrase "study and experiment." This is because the reader is encouraged to learn as much as he can about the movements of the markets, the characteristics of these movements, and how to make informed trading decisions once this knowledge is applied.

The basic premise behind pattern, price, or time analysis is that these three factors have not changed in the 100 or more years since Charles Dow unleashed his Dow Theory to the world. In fact, if you want to go back even further, take a look at Candlestick analysis which is said to have its roots back to the 1700s. This very popular analysis tool is a study of pattern with basic Open, High, Low, and Close the major elements. Despite the proliferation of today's "new" trading analysis tools and trading systems as a result of the personal computer and trading software, trading tools used today can nevertheless still be categorized as pattern, price, or time.

Today's pattern studies include stochastic indicators, relative strength indicators, overbought/oversold indicators, moving average crossovers, and Candlesticks. Price is categorized as moving averages, daily pivots, and retracements. Finally, time is used today in the form of seasonality, cycles, and time of day studies.

Hang around a trading room long enough, and you will often hear, "I had the right price, but was a little early" or "I've got a cycle low due at 11:00, I just don't know where the market will stop." These are the types of problems that can be created by using only price, or only time, or only a pattern. In this book I want to show the trader that there is a way to bring the factors of pattern, price, and time together in an effort to improve trading results.

When studying the history of technical analysis I came across several valid methodologies to analyze and trade the markets, but I found that these methods were weighted toward only one of the three main components of pattern, price, and time. This created problems for me because although at times one of these factors had control of the market, I found I did not have control of the trade. This frustration caused me to study the disciplines of Elliott and Dow, but I found personal issues with each. One relied too much on the forecast and prevented me from changing my mind while in a trade. My ego became too connected to the forecast, and I often failed to make necessary adjustments to the trade. The other analysis technique took too long to develop. I also tried to work with point and figure charts, and although I understood how to use the formations, I still felt time was necessary to help me become a better trader. When Candlestick analysis became readily available on the computer, I tried to use it, but found some of the patterns occurred too frequently and at random places on the chart, so I sensed that price and time would be necessary to improve this sort of analysis.

All of this study and experimentation of these other analysis disciplines led me back to the pattern, price, and time analysis of W. D. Gann. I chose Gann Theory as my primary source of analysis because throughout his works he wrote about the balance of price and time. This became very important to me because my work needed balance. I knew from my analysis and trading that I could not just rely on pattern, or price, or time independently. I knew that although I could use his techniques independently, I could improve

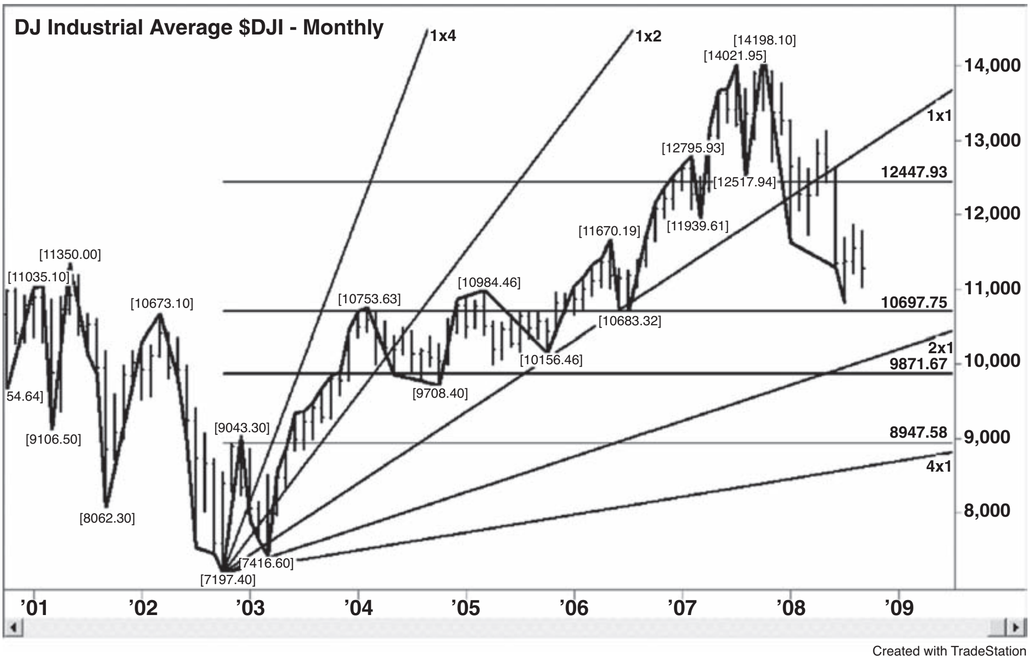

FIGURE 1.1 Gann Format Monthly Dow Jones Chart

my analysis and trading by finding a balance between his two or three key elements of pattern, price, and time (Figure 1.1).

In summary, the purpose of this book is to inform the trader of the analysis tools that are available just using the Open, High, Low, and Close. The other purpose is to teach the trader to categorize his trading tools into pattern, price, and time techniques and to apply combinations of the three to improve his analysis and trading. Finally, in an effort to jump-start the reader's study and experimentation of pattern, price, and time, I have chosen to highlight the analysis and trading techniques of W. D. Gann because he was one of the first to speak of the balance of price and time.

CHAPTER 2

Who Was W. D. Gann?

If not the first technical market analyst, W. D. Gann was certainly among the more successful. Creating and publicizing a new approach to analyzing markets, Gann claimed that he had set a world's record in leverage and accuracy more than once, that he had developed trading strategies for speculators, and that he could predict market moves to exact price levels.

William Delbert Gann was born on a cotton ranch on June 6, 1878, in Lufkin, Texas. He displayed a strong aptitude in mathematics during his early years, completed a high school education, and started trading in 1902 at the age of 24. By his own admission, Gann's early trading was based on "hope, fear and greed," all of which he later realized were not compatible with a successful trading strategy.

After losing significant sums of money, Gann began to observe that markets followed mathematical laws and certain time cycles. He was particularly interested in the connection between price and time, a relationship he referred to as the "square" of price and time. He began studying this interaction diligently, even traveling to England, India, and Egypt to research mathematical theory and historical prices.

In developing his theories, Gann was undoubtedly one of the most industrious technical analysts. He made thousands of charts displaying daily, weekly, monthly, and yearly prices for a wide variety of stocks and commodities. He was an avid researcher, occasionally charting a price back hundreds of years. At a time when most market analysis was strictly fundamental, Gann's revolutionary theories relied on natural laws of mathematics, time cycles, and his unshakable conviction that past market activity predicted future activity.

Gann moved to New York City in 1908. He opened brokerage offices at 18 Broadway and began testing his theories and techniques in the market. Within a year it was clear to others that Gann's success was based on more than just luck. A December 1909 article in *The Ticker and Investment Digest* explained that "... Mr. Gann has developed an entirely new idea as to the principles governing stock market movements" (reprinted in the W. D. Gann Commodities Course [Pomeroy, WA: Lambert-Gann Publishing, 178]).

In this article, Gann asserted that most traders enter the market without any knowledge or study, and that most eventually lose money. He explained that he noticed a cyclic recurrence in the rise and fall of stocks and commodities, and decided to study and apply natural laws to trading strategy. Gann indicated that months of studying at the British Museum in London revealed what he called the "Law of Vibration." This law determines the exact points to which a stock would rise or fall, and predicts the effect well before the Street is aware of either the cause or the effect. Beyond this vague explanation, Gann was reticent about his strategies and unwilling to explain his theories in any detail.

Although past success is not an indication of future results, Gann's trading was extremely successful, at least to a point. An analysis of his trading record over 25 market days revealed that Gann made 286 trades, 264 of which were profitable. His success rate of 92.31 percent turned an initial investment of $450 into $37,000. A colleague of Gann's said, "I once saw him take $130.00 and in less than one month run it up to over $12,000.00. He can compound money faster than any man I ever met." It is not surprising that the press concluded "... such performances as these.... are unparalleled in the history of the street" (Gann Course, 180). Although Gann's theories were apparently profitable at times, he was equally subject to the potentially substantial risk of loss that is inherent in commodities futures trading.

Gann issued annual market predictions of major moves and exact support and resistance levels (Figure 2.1). Newspapers around the country kept track of his predictions for 1921, 1922, and 1923, substantiating his accuracy. In January 1929, he issued an annual forecast that read:

> *September—One of the sharpest declines of the year is indicated. There will be a loss of confidence by investors and the public will try to get out after it is too late.... A "Black Friday" is indicated and a panicky decline in stocks with only small rallies.*
>
> *Truth of the Stock Tape* (reprint Pomeroy, WA: Lambert-Gann Publishing, 1976, 36).

His facility in analysis and prediction extended to areas other than the market. He predicted the exact date of the Kaiser's abdication, the end of World War I, and the elections of presidents Wilson and Harding. Gann also predicted the occurrence of World War II 13 years in advance and described the stealth bomber 61 years before its invention.

Gann's original reticence about his success later turned into an almost religious fervor to share his knowledge. He had begun writing during his trading career, starting with *Truth of the Stock Tape*, written in 1923 (originally published by Financial Guardian Publishing Co.; reprinted by Lambert-Gann Publishing Co.). This book was intended to help traders analyze market activity using a standard stock tape. In 1927, he wrote *The Tunnel Thru the Air: Or, Looking Back from 1940* (reprint Pomeroy, WA: Lambert-Gann Publishing Co., 1976). This seemingly autobiographical novel provides

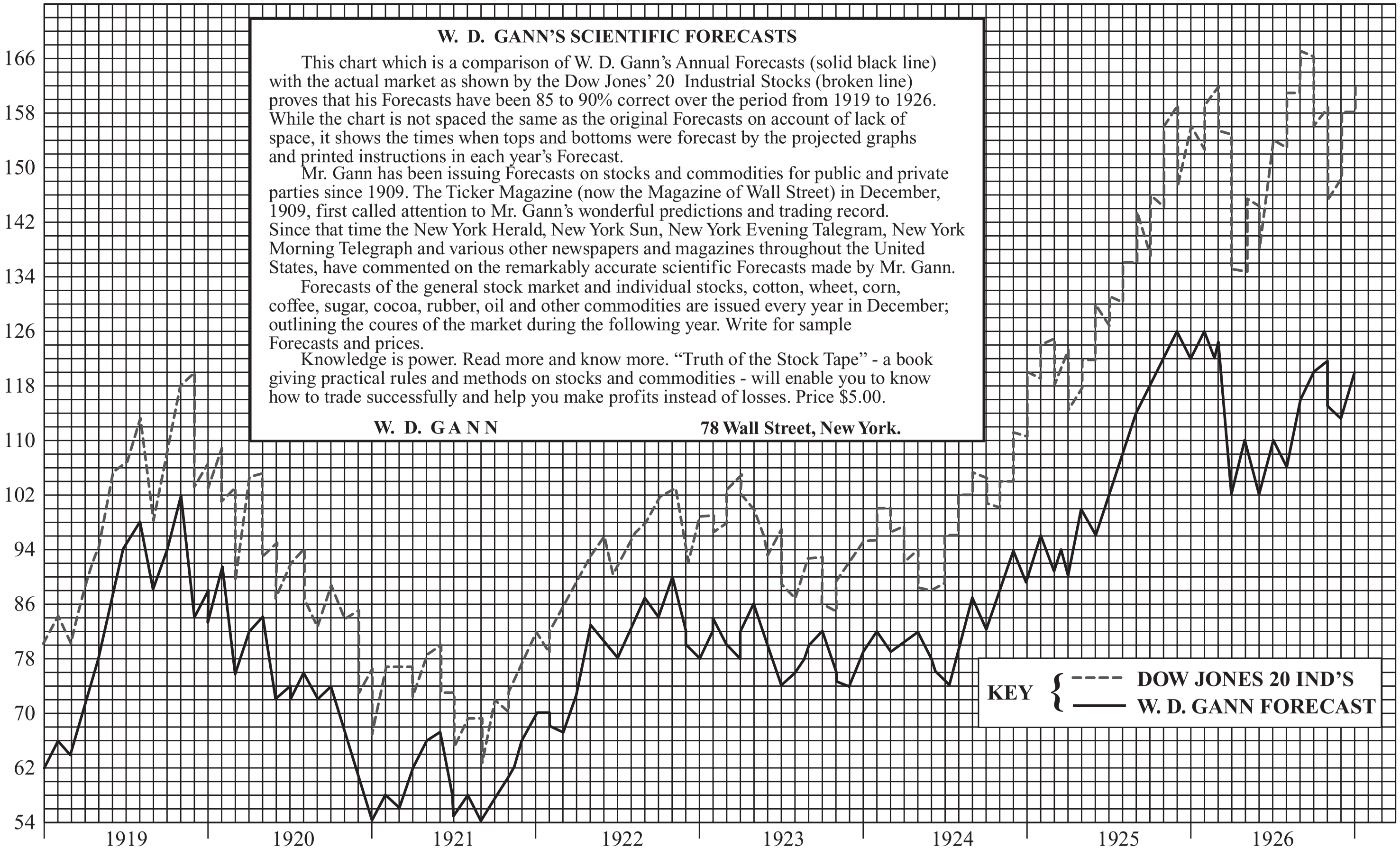

FIGURE 2.1 W.D. Gann's Scientific Forecasts 1919–1926

insight into Gann's trading theories and his morals. (It also includes his predictions of World War II and the stealth bomber.) He went on to write books and courses explaining his new discoveries, including *New Stock Trend Indicator*, *How to Make Profits in Commodities*, and *45 Years in Wall Street* (originally published in 1936, 1942, and 1949, respectively; all three books were later reprinted by Lambert-Gann Publishing Co., 1976). He also created home study courses for stocks and commodities and taught weekend seminars to explain the use of special price and time calculator tools he had invented. These materials were considered valuable enough that in 1932 people were paying $1,500 for his home study commodity course, and $5,000 for his master price and time calculator seminar.

In the late 1940s Gann published a market letter covering advice on stocks, cotton, and grain. The letter was produced weekly along with a daily version published three days a week. The letter was written in a style that combined fundamentals with chart points. There was no mention of important dates or time cycles, but it included comments such as "We expect heavy selling during the next few days and much lower prices before the end of the week."

I have included two reprints of the letter in this chapter. Because the reprints may be difficult to read I have typed the letter in full. When I studied these letters I looked for references to astrology or other timing phenomena but found none. This does not mean that Gann did not use it in his timing; it may just mean that Gann was a businessman who wanted to sell a newsletter to earn income. He may have saved his advanced price and time analysis for clients who had taken personal classes or purchased his expensive courses (Figure 2.2).

COMMODITY LETTER: April 21, 1947

Wheat

All the Grain markets showed weakness today and from Secretary Anderson's statement today, it was evident that the Government realizes that there are going to be plenty surplus commodities later and that prices will have to come down and parities lowered. The market will not wait for the Government to do something to get prices down but will decline and discount future developments.

We are confident that the market has seen final highs and is now starting on the long down-trend. We expect heavy selling during the next few days and much lower prices before the end of the week. If you are not already short, sell short without waiting for rallies.

May Wheat—*Is showing more weakness and breaking 250 could decline quickly to 240–238. We favor selling the distant options.*

July Wheat—*Short sale at the market. Very little rally indicated before big decline takes place. Breaking 218 will indicate lower and breaking 215 will be a signal for very much lower prices.*

Supply and Demand Letter

RISING PRICES — FALLING PRICES

SUPPLY DEMAND

W.D.GANN & SON, INC. · INVESTMENT ADVISERS · 82 WALL STREET, NEW YORK 5, N.Y.

COMMODITY LETTER April 21, 1947

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May Wheat - Is showing more weakness and breaking 250 could decline quickly to 240-238. We favor selling the distant options.

July Wheat - Short sale at the market. Very little rally indicated before big decline takes place. Breaking 218 will indicate lower and breaking 215 will be a signal for very much lower prices.

Sept. Wheat - Short sale at the market. Breaking 213 will indicate lower and breaking 210 will indicate 205-203.

CORN Sold off Saturday and was weak and lower again today. It is getting into position for a fast decline as support levels have been broken. If you are short, stay short. If not, sell at the market.

July Corn - Breaking 163½ indicates 156-155.

Sept. Corn - Breaking 152 could decline quickly to 145-144.

OATS Buyers are withdrawing from the market and offerings are increasing. Today's high prices are not likely to be exceeded before a decline to much lower levels.

July Oats - Breaking 78 indicates 72 or lower.

Sept. Oats - Breaking support at 72 will indicate 68 or lower.

EGGS The market was weak on Saturday with prices recording the greatest decline for several months. There was very little rally today and the market closed weak. The buying has been overdone and the market is in a position for a sharp decline. We advise staying short.

October Eggs - Not likely to cross 49¢ and breaking 4785 indicates 4550-4500.

COTTON The market rallied on Saturday and had a further rally early today, and the distant options sold off about 50 points while the old crop options held up, and closed strong. We advise short sales of October and December. These options are not likely to rally to today's highest before going much lower. The weather is improving and planting is making good progress. Price cutting is going on in the textile industry, and the old crop options are much too high but might hold up a while longer while hedge selling depresses the new crop options. We consider this a real opportunity to go short of October and December.

Oct. Cotton - Breaking 2940 will indicate lower and breaking 2900 indicates 2800 or lower.

Dec. Cotton - Breaking 2860 indicates lower and breaking 2800 will be in a very weak position and could decline fast.

W. D. GANN & SON, Inc.

The information contained herein is the editor's personal opinion, and while we believe it to be correct, we do not guarantee it.

FIGURE 2.2 Supply and Demand Letter, April 21, 1947

Sept. Wheat—*Short sale at the market. Breaking 213 will indicate lower and breaking 210 will indicate 205–203.*

Corn
Sold off Saturday and was weak and lower again today. It is getting into position for a fast decline as support levels have been broken. If you are short, stay short. If not, sell at the market.

July Corn—*Breaking 163½ indicates 156–155.*

Sept. Corn—*Breaking 152 could decline quickly to 145–144.*

Oats
Buyers are withdrawing from the market and offerings are increasing. Today's high prices are not likely to be exceeded before a decline to much lower levels.

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Oct. Cotton—*Breaking 2940 will indicate lower and breaking 2900 indicates 2800 or lower.*

Dec. Cotton—*Breaking 2860 indicates lower and breaking 2800 will be in a very weak position and could decline fast.*

W.D. Gann & Son, Inc.

Gann also published a weekly market letter. In this letter he provided more information on support and resistance for the reader as well as buy/sell recommendations and stop loss suggestions (Figure 2.3).

COMMODITY LETTER: January 26, 1948

Grain
All grains declined near the close today in anticipation of a bearish Government report on stocks of grain in trade channels. This report was not foreshadowed by prior reports from the Southwest to the effect that elevator stocks had about been "cleaned out" by Government purchases. It is too early to say for sure, but if today's action was caused by factors other than the Government report there is substantial evidence that the end of the long bull market in grains is not far off. And, if May wheat is unable to close above $298^1/_2$ *very shortly, we expect lower prices for all grains. Corn behaved the best. It was followed by oats and wheat, which were cleaned out yesterday, in that order.*

We recommend short sales of May wheat on rallies with a stop that will reverse your position it closes above $298^1/_2$.

May Wheat—*Will meet resistance on rallies at* $296^1/_4$–$8^1/_2$, $300^1/_4$–2 *and 305–07. Watch the market closely at these resistance points for indications of a change in trend. After such points have been penetrated on the way up, they become support points on subsequent declines. Move stops up under them after they have been penetrated as protection against a reversal of trend.*

Will meet support on declines at 293–$^1/_2$, $289^1/_2$–$90^1/_2$ *and* $286^1/_2$–8. *Watch the market closely at these support points for indications of a change in trend. After such points have been penetrated on the way down, they become resistance points on subsequent rallies. When short, move stops down over them after they have been penetrated as protection against a reversal of trend.*

July Wheat—*Will meet resistance on rallies at* 264–$5^1/_2$, $267^1/_2$–$9^1/_2$, *and 272–4. Will meet support on declines at* $260^1/_2$–2, $257^1/_2$–9, *and* $253^3/_4$–5. *Closing below* $253^3/_4$ *indicates lower. See* May Wheat *for comment on use of support and resistance points.*

May Corn—*Will meet resistance on rallies at 268–9 and* $269^3/_4$–$71^3/_4$. *Will meet support on declines at* $264^1/_4$–5, 262–3, $258^1/_2$–60. *Closing below* $258^1/_2$ *indicates lower. See* May Wheat *for comment on use of support and resistance points.*

July Corn—*Will meet resistance on rallies at 256–7 and* $258^1/_2$–$60^1/_4$. *Will receive support on declines at* $251^1/_2$–$2^1/_4$ *and* $248^1/_2$–50. *Closing below* $248^1/_2$ *indicates lower. See* May Wheat *for comment on use of support and resistance points.*