

January
2000
Volume 29
Number 1
US \$4.95
CAN \$6.95

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Using cycles to help forecast and trade currency futures

By Walter Bressert and Doug Schaff

EVERY MARKET HAS LONGER-TERM CYCLES for price forecasting and trend direction, plus a trading cycle in the time frame you choose to trade, whether that is daily or intraday. Our cycle trading approach is simple: Trade with the trend. If it's up, buy the dips. If it's down, sell the rallies.

But what is the trend? The direction of the dominant cycle in the next longer time frame than the one you are trading sets the trend. For example, if you trade based on daily chart signals, trend is set by the weekly chart, and the trading cycle bottoms in the daily chart are the "dips". If you trade a 5-minute bar chart, trend is set by the 20-minute bar chart.

Trend for the Japanese yen

The dominant cycles for the Japanese yen and their status in late 1999 are listed in the table at right. The stacked monthly, weekly and daily charts (Charts 1, 2, 3, on the next page) show the cycle tops and bottoms for the dominant cycles in each respective time frame. The black up arrows show the cycle bottoms, the red down arrows show the cycle tops.

The low at "A" is a reference point on all three charts, showing the beginning of an uptrend in July of 1999. On the monthly chart, it is the low of the 10- to 14-month cycle. On the weekly chart, it is the first swing low following the 20-week cycle bottom. And on the daily chart, it is the bottom of the 20-day cycle.

Even if you are trading the Japanese yen intraday, it's good to develop the habit of checking the longer-term

trends. Knowing the longer-term trend is like checking on upcoming weather patterns. Is this sunny day the first of many expected to come or is it the last one before the next hurricane hits? With the trend up on the monthly, weekly and daily charts, it's likely that the overall pattern in the intraday charts also is going to be one of higher highs and higher lows.

Cycle	Chart	Cycle action	Current cycle	Current trend
4-year	Monthly	Bottomed 8/98	Up	Up
10-14 month	Monthly	Bottomed 5/99	Up	Up
20-week	Weekly	Bottomed 5/21/99	Up?*	Up
20-day	Daily	Bottomed 11/5/99	Up	Up/sideways

* The direction of this 20-week cycle is not clearly defined.

The red and blue averages on all three charts are exponential moving average (EMA) trend indicators. When the red line is above the blue line and the distance between the two lines is expanding, the trend for that chart is generally up. When the red is below the blue line and the distance between the two is expanding, the trend is generally down. However, after a long trending move, a turn in the red EMA line that is opposite the direction of trend often indicates a trend reversal.

Using mechanical buy signals to confirm trends

Trading cycle bottoms on the daily yen chart are often identified by a mechanical buy signal generated by an oscillator. On the accompanying chart (Chart 4) the red oscillator is an RSI3M3 (a 3-bar RSI smoothed with a 3-bar moving average**).

An upturn in the oscillator from below a buy line of 30 creates a red setup bar. A buy signal occurs as the high of the setup bar is exceeded, as indicated by the red dot on a bar that follows. This pattern can be used to enter trades or simply to confirm a cycle bottom.

When the distance between the red and blue EMA lines is expanding, as it is on this chart, and prices drop to support at the red line or the blue line, a strong trend-following buy signal is generated by a rise above the high of the setup bar.

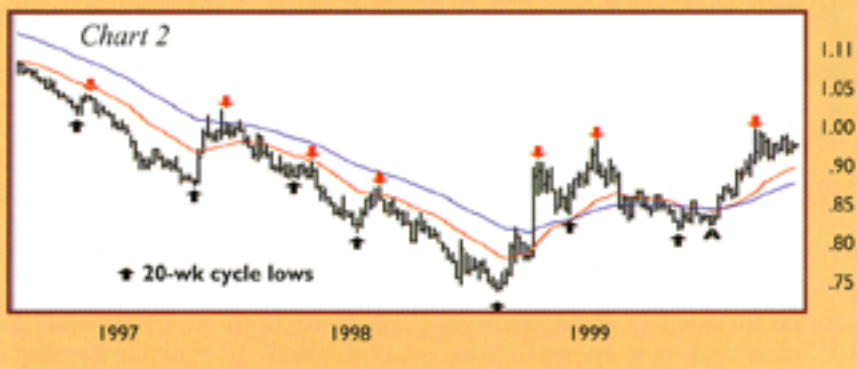
Intraday trading

Intraday trading follows the same guidelines. Use a longer-term time frame such as a 20-minute bar chart to determine trend and a 5-minute time frame to trade (Chart 5).

JAPANESE YEN, MONTHLY



JAPANESE YEN, WEEKLY



Mechanical buy signals confirm the uptrend shown. A magenta buy setup bar is created following a dip in the oscillator (not shown) and an upturn from below the buy line. A red dot marks the buy signal where the high of the setup bar has been exceeded.

The direction of the average 18-bar cycle on the 20-minute bar chart sets the trend for trading the 5-minute bar chart. The trend is up after "x," as indicated by the higher and right leaning trading cycle tops and the higher cycle bottoms (Chart 6).

The oscillator at the bottom of the 5-minute chart is an RSI3M3 Detrend.** This oscillator is an RSI3M3 (see above) detrended by running a moving average of the RSI3M3 oscillator and subtracting that moving average from the RSI3M3. The RSI3M3 Detrend generates a green setup bar and red buy signal at the bottoms of the 18-bar trading cycles. With an uptrend in force on the 20-minute charts, the RSI3M3 Detrend buy signals on the 5-minute chart represent high-probability buying opportunities

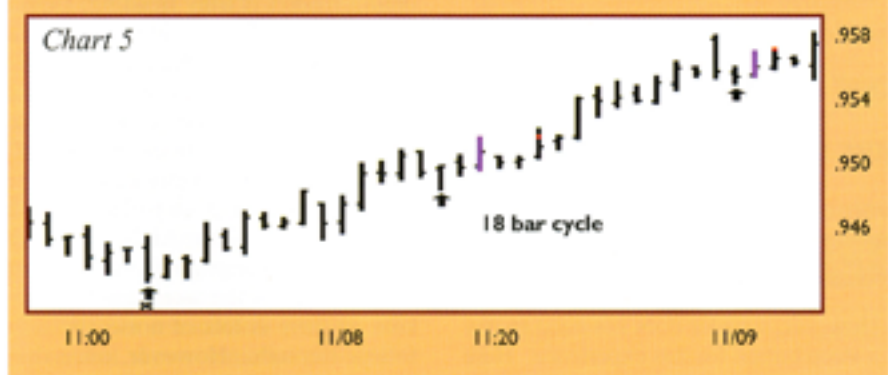
JAPANESE YEN, DAILY



JAPANESE YEN, DAILY



JAPANESE YEN, 20 MINUTE



(one false buy signal in this example).

Cycles and currency markets

Our experience is that almost all trading approaches in the currency markets can be improved with cycle timing and trading tools such as those used in this article. With cycles you can identify the

trend plus forecast and confirm trend reversals. Whether you are trading weekly, daily or intraday time frames, it is the cycle in the longer-term time frame that sets the trend. Knowing the direction of the longer cycle, you can use high-probability buy/sell signals to trade the shorter cycle profitably.

Walter Bressert's market timing analysis has been developed over more than 25 years as a trader and analyst. More information on the indicators used in this article can be found on his website at www.walterbressert.com. Doug Schaff is a professional currency trader with a background in the major and minor currencies and options. He is editor of www.fxtiming.com, a web-based currency analysis and forecasting service, published in collaboration with Bressert.

JAPANESE YEN, 5 MINUTE



** The indicators used in this article are not readily available in most software packages but are available free for Omega TradeStation and SuperCharts products at the web sites mentioned.