

Trading With Market Timing Intelligence

Action/Reaction – A Revelation in Market
Movements

By John Crane



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Trading with Market Timing Intelligence using Action/Reaction

It is important to note that every market movement is a function of the market moves that preceded it and all markets adhere to the laws of Action/Reaction. Even though each market has its own personality that is unique to itself, all markets will also seek balance, therefore Action/Reaction will always come into play. Reaction Point™ uses this price reality as a leading indicator to provide earlier high probability entries and timely exits.

The Reaction swing is the foundation of the entire trading strategy. Everything begins with the Reaction swing. Therefore, it is important to understand what a Reaction swing is and how to use it.

The Reaction Swing

The Reaction Swing is a price correction (counter-trend price move) within a trending market, and is used as a timing tool for predicting future reaction points in the price trend. The first Reaction Swing is the measuring point where counting and forecasting begin. A Reaction Swing should contain at least 3 to 8 periods. If the Reaction swing has more than 8 price bars it becomes a complex Reaction swing. This pattern is very important and is described later.

A prediction for a trend reversal is made by performing first a Reverse Count and then a Forward Count from a Reaction Swing. Time periods, which appear as bars on a chart, are counted, first going backward in time and then forward.

To predict trend reversals, you first need a trending market. The current trend, up or down, is usually obvious by simply looking at a chart, but a series of higher highs and lows, or vice versa, lower highs and lows, defines a trending market. A typical stock or commodities chart which appears on one page or screen will usually contain enough periods to comprise one or two intermediate trends.

A Reaction swing will always begin and end with a pivot point. A pivot point contains a minimum of five consecutive price bars where the highest closing price (for a high pivot) is preceded by two price bars with lower closes and is followed by two consecutive price bars with lower closes. A low pivot is where the lowest closing price is preceded by two higher closes and followed by two consecutive higher closes. See *Figure # 1*

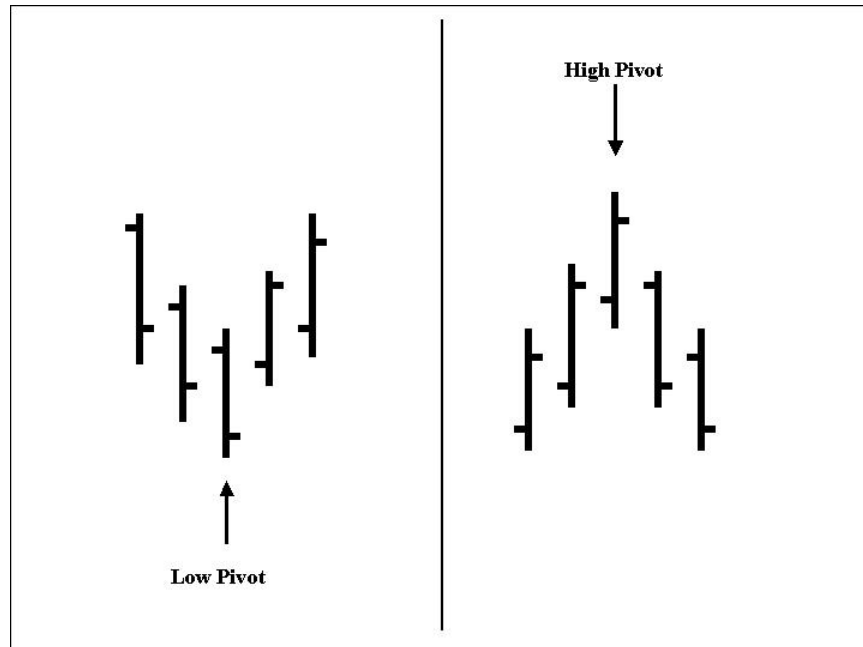


Figure # 1 –Pivot low and Pivot high

In other words, if the market is trending downward, a bearish Reaction swing forms when the market makes a low pivot and trades higher - against the prevailing trend - followed by a high pivot where the market reverses and resumes the downward trend without trading above the previous pivot high. The two pivot points mark the beginning and end of the Reaction swing

Confirming a Reaction swing

A Reaction swing will always begin and end with a pivot. This means a Reaction swing, in a downward trending market, will begin with a low pivot point and end with a high pivot point. The opposite is true for a Reaction swing in an upward trending market. The Reaction swing itself, requires a minimum of three price bars, including the price bar with the **lowest closing price** and the price bar with the **highest closing price**, and at least one price bar in between the two pivot points. The swing pattern can contain more than three price bars, but requires a minimum of three. *If there are two identical closes at the low or at the high they can be counted as part of the Reaction swing, with the first one created working as the pivot low/high. Three identical closes in a row is considered a Reaction swing.*

The first pivot of a Reaction swing must meet specific conditions to confirm the pivot. First, the low pivot point (in a downward trending market) is preceded by two price bars with higher closing prices, marked as -1 and -2 in *Figures # 2 and #3*. These two closing prices do not need to be in any particular order as long as they both are higher than the lowest closing price. However, the price bar that follows the low close (pivot low) will close higher, marked as +1. As soon as there is a close higher than the pivot low, it sets up a possible low pivot, but it is not confirmed until there is another closing price above the close of +1. In this example, the confirmation occurred two bars later when the price bar marked +3 closed above the close of +1.

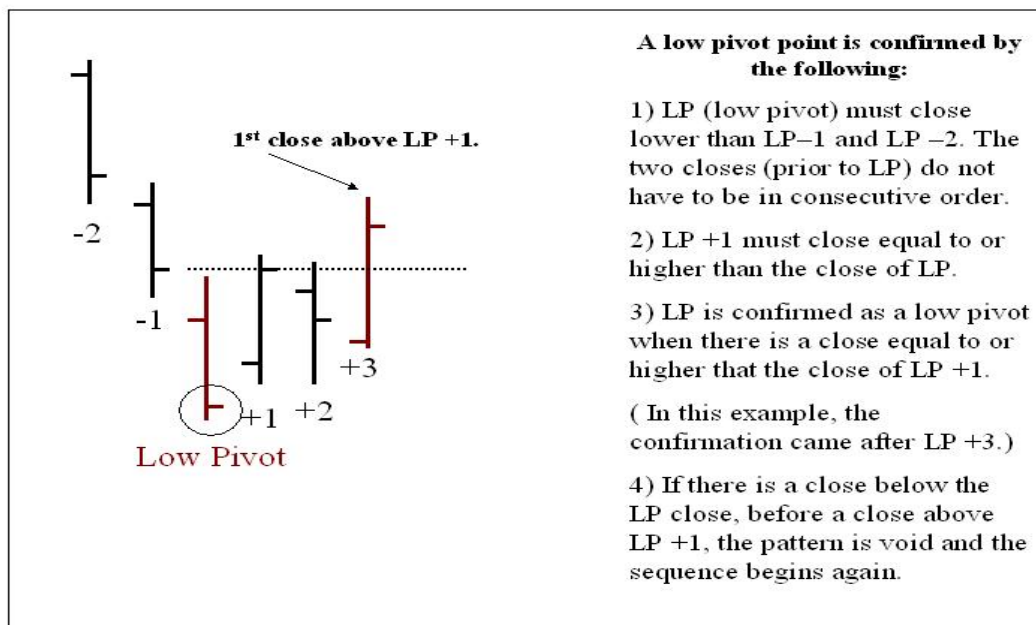


Figure # 2 – A low pivot is confirmed when there is a closing price above the LP (Low Pivot) +1.

A Reaction swing begins and ends with the *lowest* and *highest* closing prices—always use the *closing price*. For example, when a market is trending lower, it will always make a low closing price before it begins a corrective rally. This is the beginning of a possible Reaction swing. When this corrective rally comes to an end and then resumes the main downward trend, its high pivot point is the price bar with the highest closing price – and marks the end of the Reaction swing.

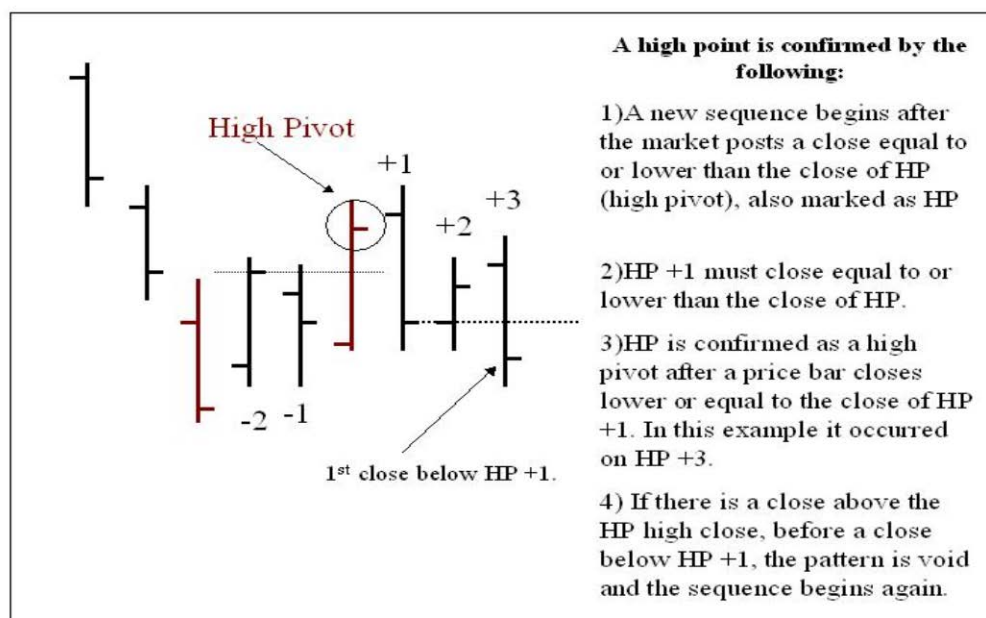


Figure # 3 –Reaction swing begins and ends with closing prices.

Since the beginning of the Reaction swing started with a low pivot point, the end of the Reaction swing is confirmed with a high pivot before the resumption of the downward trend. See *Figure # 3*. The opposite occurs during an upward trending market.

Therefore, all you need to know are the date or time of the highest closing price and the lowest closing price of the Reaction swing in order to move on to the next step - *projecting future turning points or reaction points in the market called Reversal/ Reaction dates or price bars*.

In traditional technical analysis, these chart patterns are called flags or pennants. Usually a trader will look at these patterns as a means to estimate the distance the market should move if and when it breaks out of the pattern. Although this method predicts a good target area, it is limited as it only offers a one-dimensional approach - that of price alone whereas Market Timing Intelligence using Action/Reaction provides direction, time and price.

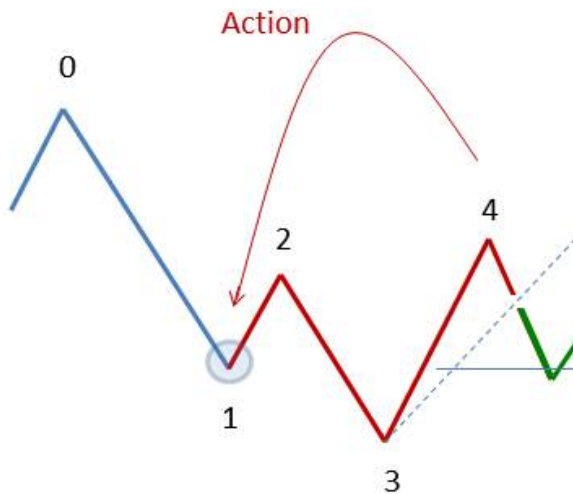
As mentioned earlier, the Reaction swing is the foundation of the Action/Reaction. However, I do not look at the Reaction swing alone. I look at how the Reaction swing interacts with the price action and price patterns before and after the Reaction swing. The entire cycle is a sequence of connected price patterns leading up to the Reaction swing. Then that sequence is used to project forward and extrapolate future direction, duration and distance of the future price movement.

There are two pattern sequences used. The first pattern sequence appears at major highs and major lows and signals a change in the existing trend. This pattern is called the Trend Reversal (TR) pattern sequence.

When a market is at a major high or making a major turn, it will typically be followed by a pullback to support. This is where bullish traders tend to enter the market expecting another bullish leg and a run past the recent high. However, if the market is forming a TR pattern it will run into resistance somewhere between the 60% and 83% retracement levels and fail to move past the recent high. This swing pattern failure is the first sign of a market losing momentum and could lead to a shift in the trend.

The TR pattern consists of five pivot points occurring in a specific order with a Reaction swing being formed by the final two pivot points, as shown in *Figure # 4*. *The low pivot, that follows the #4 high pivot, is not marked in this illustration. It is not needed at this time, but it is used later to confirm the final Reaction swing of the TR sequence. That is because we do not need to know this pivot point in order to have a potential signal in place. We only need to know the #4 pivot. However, the lower pivot will become important when we are ready to make the Time and Price projections*

Trend Reversal TR pattern Sequence



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Figure #4 – TR Pattern Illustrated.

All the rules listed below are for a market completing the bearish cycle and in the process of forming a bottom leading into a major trend shift. *The same rules are reversed for a market completing a bullish cycle and in the process of forming a major top leading into a trend shift. See Figure # 5.*

- 1- The downward trending market must form a new low pivot, confirmed by the two higher closes as described in the pivot definition. (marked as #1)
- 2- The market will follow with a short-term counter-trend bounce to form a high pivot (marked as #2) before resuming the downward trend and posting a new low pivot (marked as #3) just beyond the #1 pivot low.
- 3- The market must rally off the #3 pivot low and trade above the close price of the #2 pivot. The market does not have to close above the #2 pivot, but only needs to trade equal to or above.
- 4- After trading above the #2 pivot close price, the market should pull back to confirm a new high pivot (marked as #4). When the high pivot # 4 is confirmed with the two lower

closes, the TR pattern sequence is in place for a potential buy signal. *At this juncture one of two things will happen. Either the market will continue the downward trend and trade below the #3 low or the market will fail to take out the low and reverse the trend and trade above the #4 point. Either way, the Reaction swing will have an entry in place. Either sell below the #3 pivot low or buy above the #4 pivot high.*

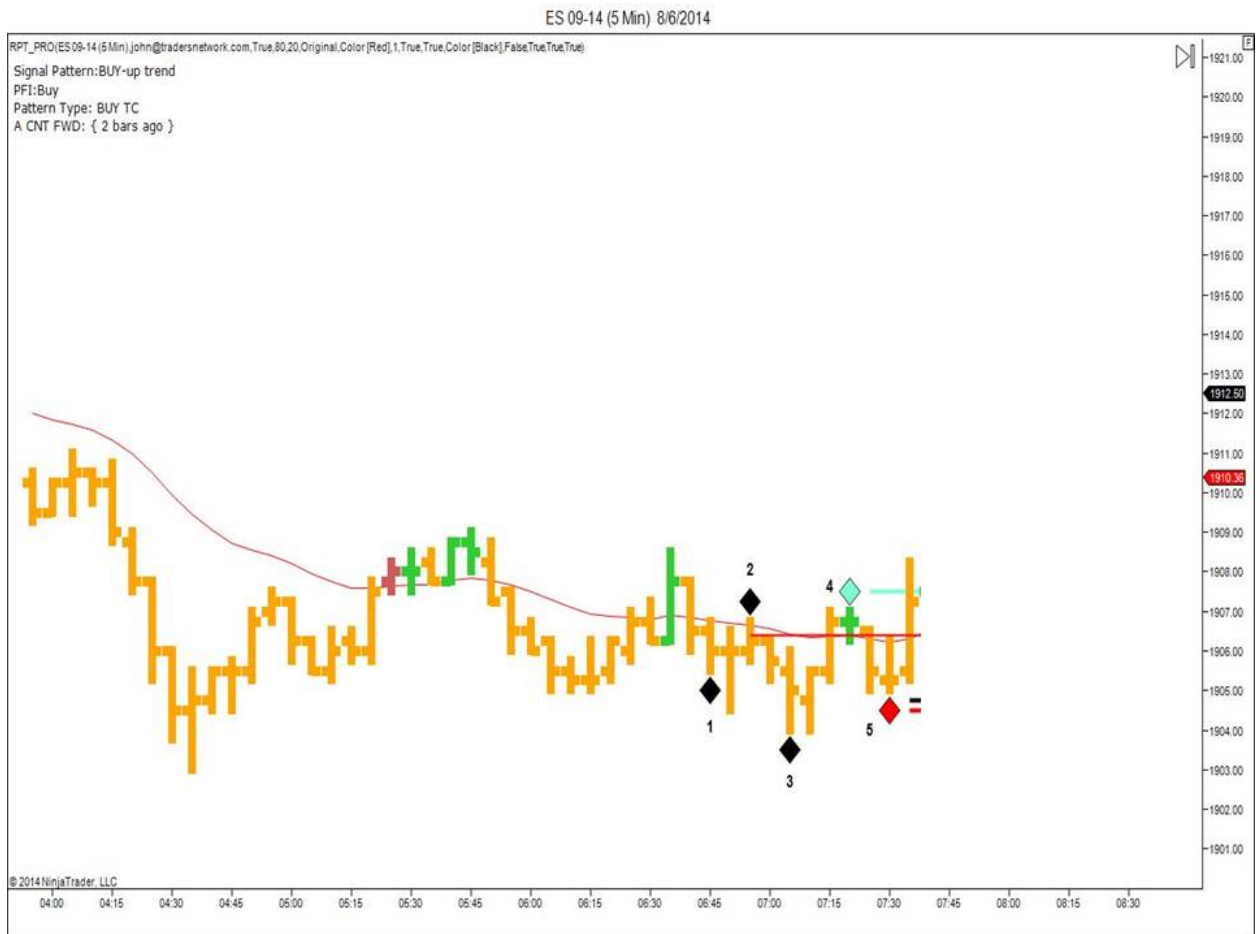


Figure #5 - This chart show a bullish TR pattern with the initial upward price thrust trading above the close of the pivot high marked #2.

- 5- A buy stop is placed 1 tick above the high (price) of the #4 pivot. The buy stop remains in place until it is elected or the market drops to a new low (below the #3 pivot low).
- 6- If the price retraces more than 60% of the distance between the highest price of the #4 pivot and the lowest low price at the #3 pivot, the buy stop is lowered and placed 1 tick above the price bar that breached the 60% retracement level. This allows for an earlier entry. The new long position is risked to 4 ticks below the low of the #3 pivot low. *See Figure # 6, #7 and #8.*

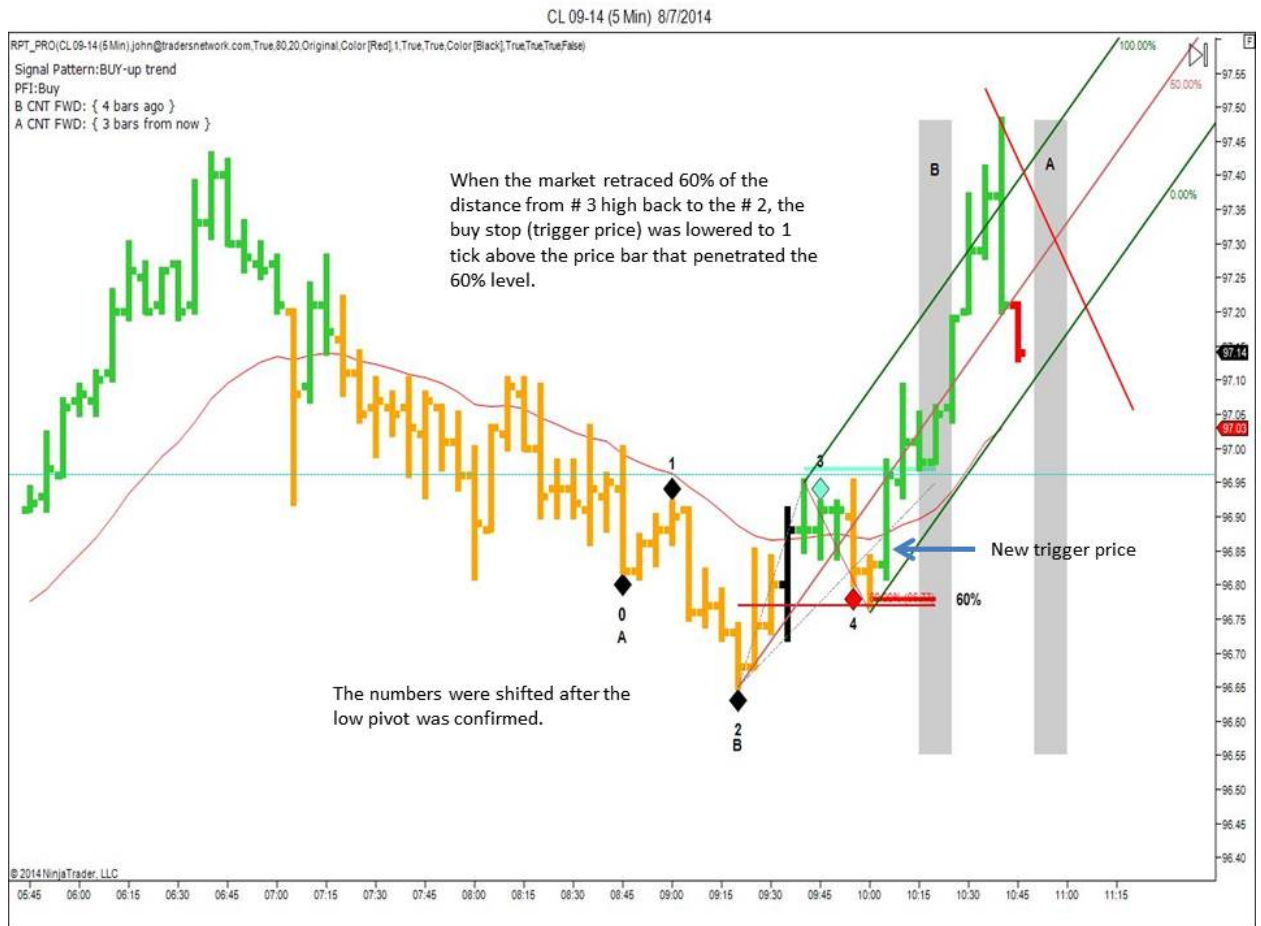


Figure #6 - Once the retracement reaches the 60% buy zone the trigger (for a long entry) can be lowered to 1 tick above the high of the price bar the entered the 60% zone. This allows for an early entry and reduces the initial risk.

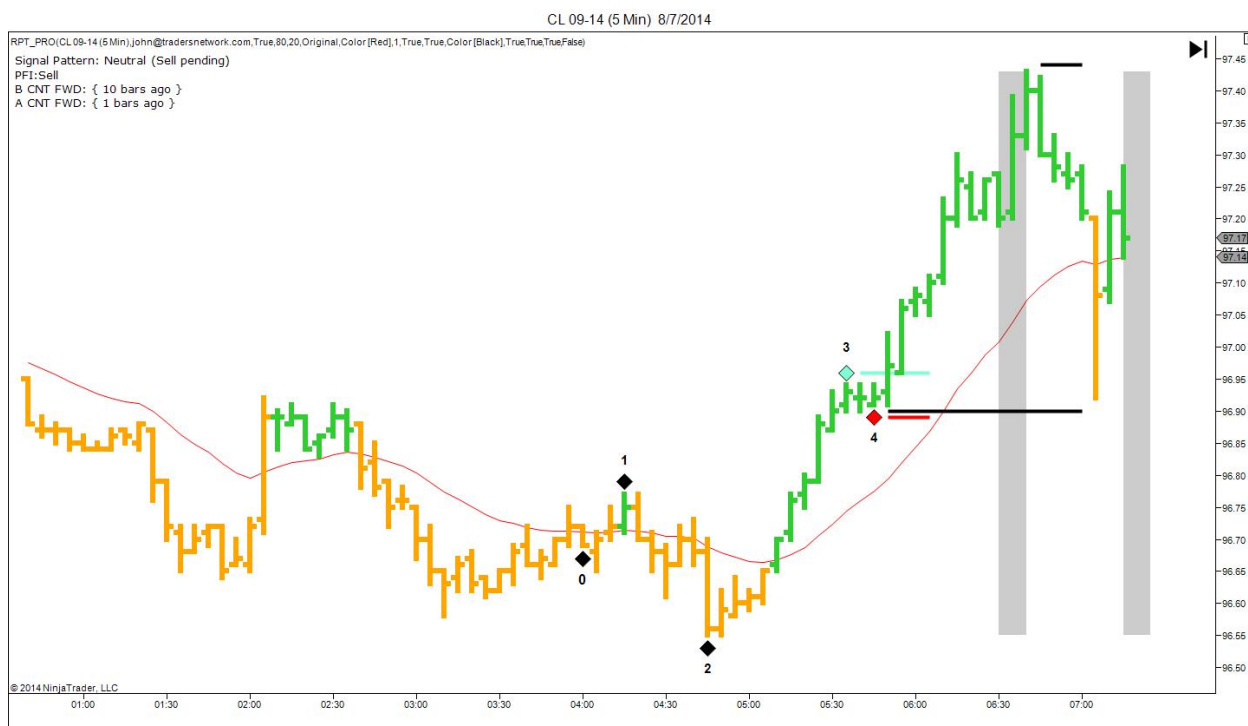


Figure # 8 Another example of a TR pattern with the 1st Reaction swing well above the previous pivot high. The numbering has been shifted forward because the end of the Reaction swing was confirmed with a pivot low (marked as #4).

- 7- The strength of the signal can be determined by the price action of the signal bar (the price bar used to confirm the end of the corrective pullback). The more previous closes the signal bar covers seems to increase the strength of the following price move. I have found that the signal bar should trade above a minimum of the previous two closes (I call this a two-close reversal) to confirm the reversal. The more closes the stronger the signal. (Three closes is stronger than two). I do this by visual observation, but I believe this can be used as a signal strength indicator. (If the market trades below the low of the previous price bar, before turning higher and trading above the two previous closes, it adds more creditability to the signal.) See Figure # 9.

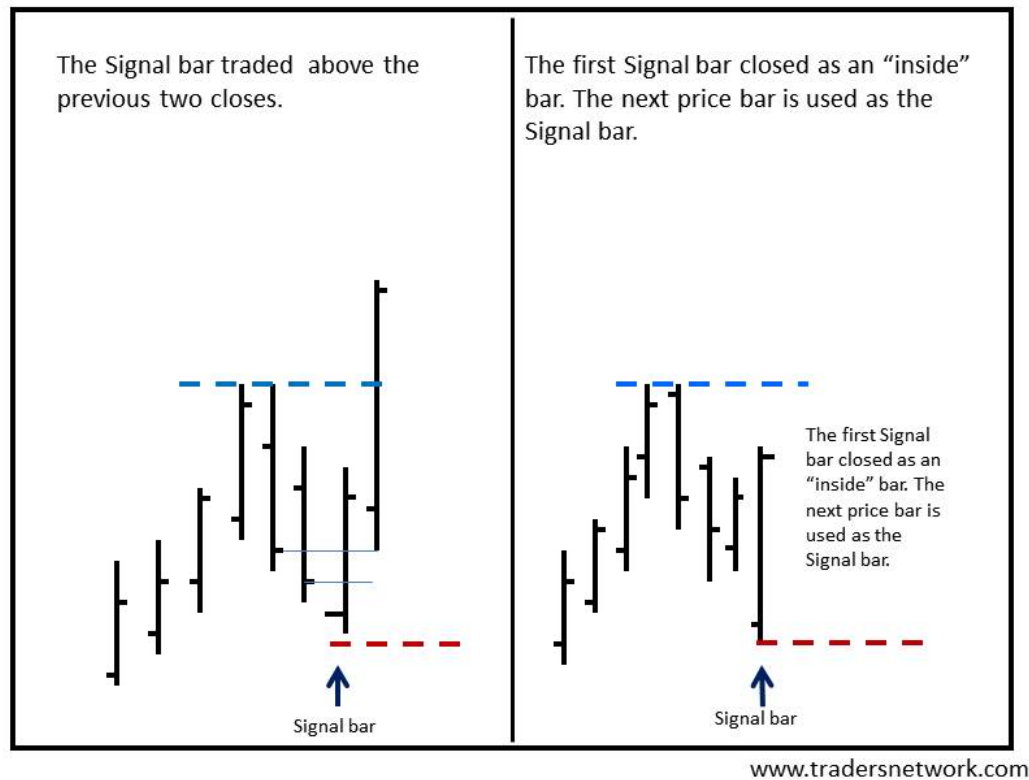


Figure # 9 – Two-close reversal.

- 8- The signal bar is the price bar that forms immediately following the pivot low (the price bar with the lowest closing price). If the signal bar is an "inside" price bar, the next price bar is used as the signal bar. (*The trader can choose to keep the buy stop in place, above the pivot high, or place the stop 1-tick above the high of the signal bar for an earlier entry.) The rules are reversed in an upward trending market.

I break the TR-pattern into two different types, based on how the initial price thrust off the low unfolds. This is important because they have different rules to confirm an entry signal. The first pattern setup (already described) needs the market to trade above the closing price of the #2 pivot. The second pattern occurs when the market fails to trade above the closing price of the #2 pivot.

In this case, the rules are as follows:

If the first upward price thrust—off the #3 pivot low---fails to trade above the highest close of the #2 pivot before the market confirms a #4 high pivot, the TR pattern sequence has not been confirmed and needs further confirmation. One of the following criteria is also needed for further confirmation in addition to the rules previously described.

- 1- If the initial price thrust, off the #3 low, does not trade above the close price of the #2 pivot, the price action of the signal bar becomes more important. To signal a new entry, the market must have retraced more than 60% of the distance between #4 to #3 and be a two-close reversal to become a valid entry signal. If this new entry signal is not confirmed, wait for a second reaction swing to form. *As shown in Figure #10.*
- 2- A second Reaction swing can occur either above or below the close of the #2 pivot high. It can also be a smaller Reaction swing that forms inside the high and low of the previous Reaction swing. The pivot high of the new (second) Reaction swing will also become the new trigger price for the long entry. The rules for the signal bar also apply here.

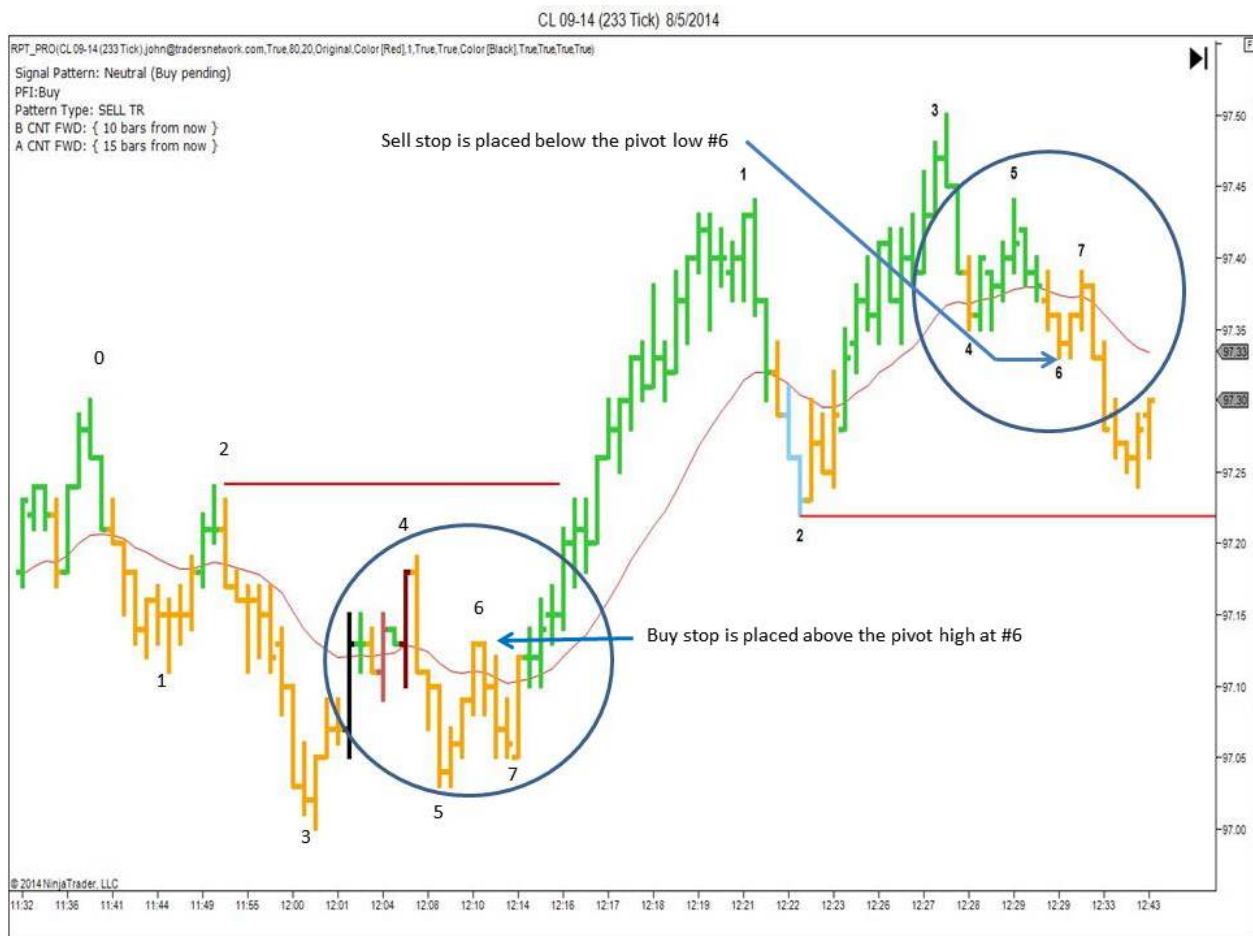


Figure # 10 – Double patterns

- 3- The trigger price, for the buy signal, is 1 tick above the highest price of the most recent pivot high. (The 60% rule can also be applied here).
- 4- If the second pattern is needed to confirm the pattern, the numbering sequence is moved forward.

Trade Strength Confirmation (after the entry)

The strength of the trade signal can be measured by observing the price action after the market has penetrated the trigger price (buy stop). The first price bar to trade through the trigger price and elect the buy stop should close above the high of the Reaction swing pattern. (If the price trades through the trigger price and reaches a new high, but pulls back to close inside the previous Reaction swing pattern – below the highest price of the Reaction swing and above the lowest low of the Reaction swing - the market is showing a loss of momentum and could be ready to fail. (This price action scenario is addressed later).

If the initial (signal bar) price bar closes at or above the higher price of the Reaction swing, the position is held with the stop loss underneath the newly confirmed pivot low. A second price bar close above the Reaction swing high, adds strength to the breakout signal with a third higher close considered a very strong signal confirmation. Aggressive traders can use the third close as signal to add to positions. (The stop loss can be raised to just below the following price bar each time the new price bar trades above the high of the previous price bar.) The three higher closes allows for aggressive stop loss movement to breakeven or placed underneath the low of the first price bar with the entire price range above the pivot high. *See Figure # 11.*

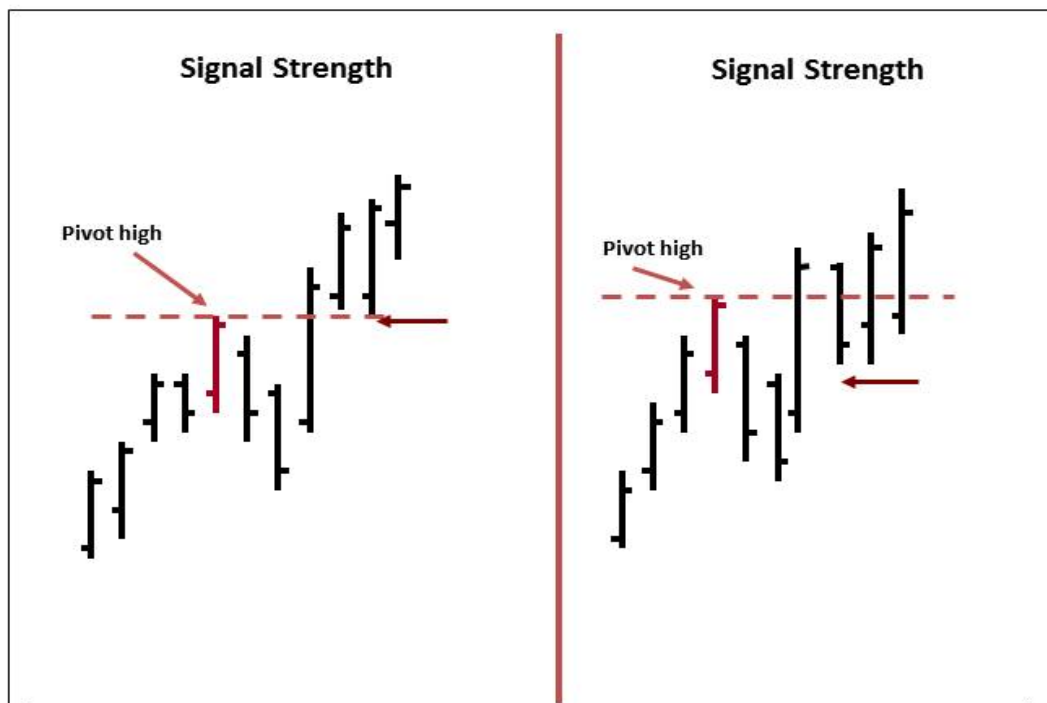


Figure # 11 – After the entry

Swing Pattern Failure

The market will also signal to the trader when it is a weak signal and setting up for a failure. If the trader is aware of this failure, they can adjust their risk management accordingly and even take advantage of the failure. This price pattern can be a very important signal pattern and should be watched carefully. Markets can make significant price moves in the opposite direction after a swing pattern failure.

The rules listed below are for a market that has bottomed and is in an upward trend.

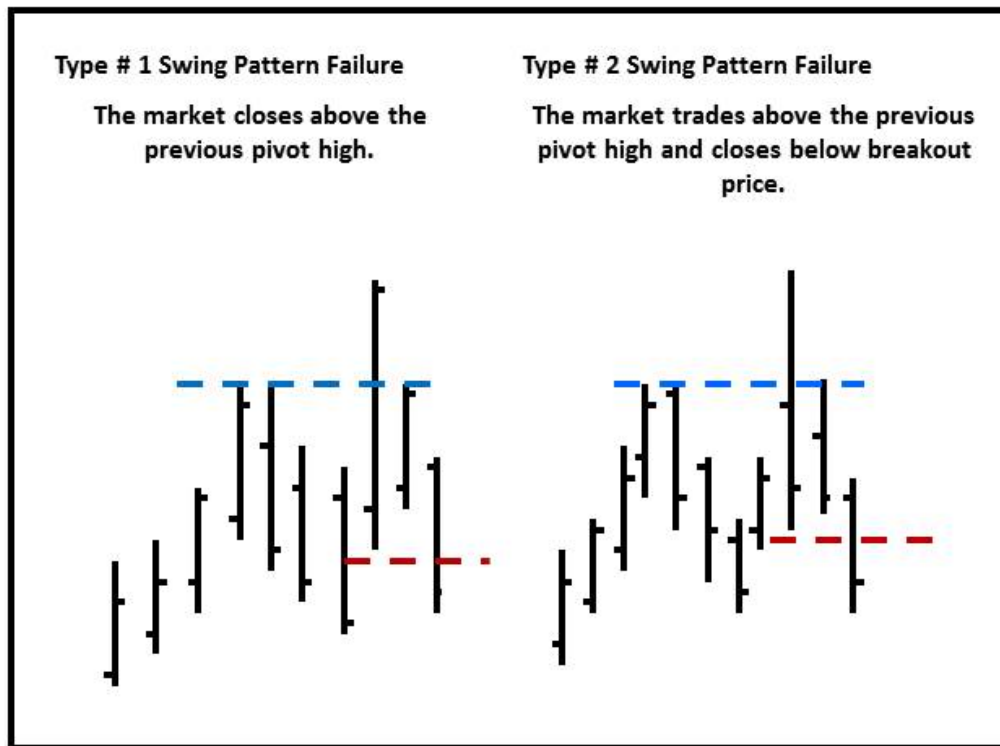
Once again, it begins with the initial price thrust through the trigger price to elect the buy stop and enter a long position. When the market pushes through the trigger price it has traded above the Reaction swing high and reached a new high of the price move. However, if the market fails to hold this new high and falls back to close lower than the Reaction swing high, the price action is signaling weakness and setting up for a failure and possible significant price movement in the opposite direction. This failure can occur on the first thrust price bar or one of the next two price bars. Here are rules for a swing pattern failure when the market is trading higher and has just triggered a buy stop to enter a long position. *As shown in Figure # 12.*

1-The initial price bar holds the gains and closes above the high of the Reaction swing, but the following price bar closes as an “inside” price bar. (Inside price bar means the high of the price bar is below the high of the previous price bar and the low is above the low of the previous price bar, therefore the entire price range remains “inside” the price range of the previous price bar.”) *(Type #1)*

2- The initial price bar needs to penetrate the pivot high and trigger the buy stop, to confirm the Reaction swing as it makes a new high for the current price move. The initial price bar fails to hold the new gains and falls back to close below the Reaction swing high. *(Type #2)*

3- If the criteria outlined in #1 or #2 are met, look for the market to trade below the low of the initial price bar to confirm the swing pattern failure. This is where the stop loss should be placed when the buy signal is first elected.

Aggressive traders can use this price level to reverse positions and enter a new short position to take advantage of continued weakness in the market.



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Figure # 12 - The Swing Pattern failure, typically appears at major turning points in the market and helps identify a TR pattern.

If you look at several TR patterns sequences you will notice that almost all of the major tops or bottoms, leading into a TR pattern reversal, begin with a failed swing pattern and the #3 point is the initial thrust price bar that either fails or is followed by an “inside” price bar. *Figure # 13.*

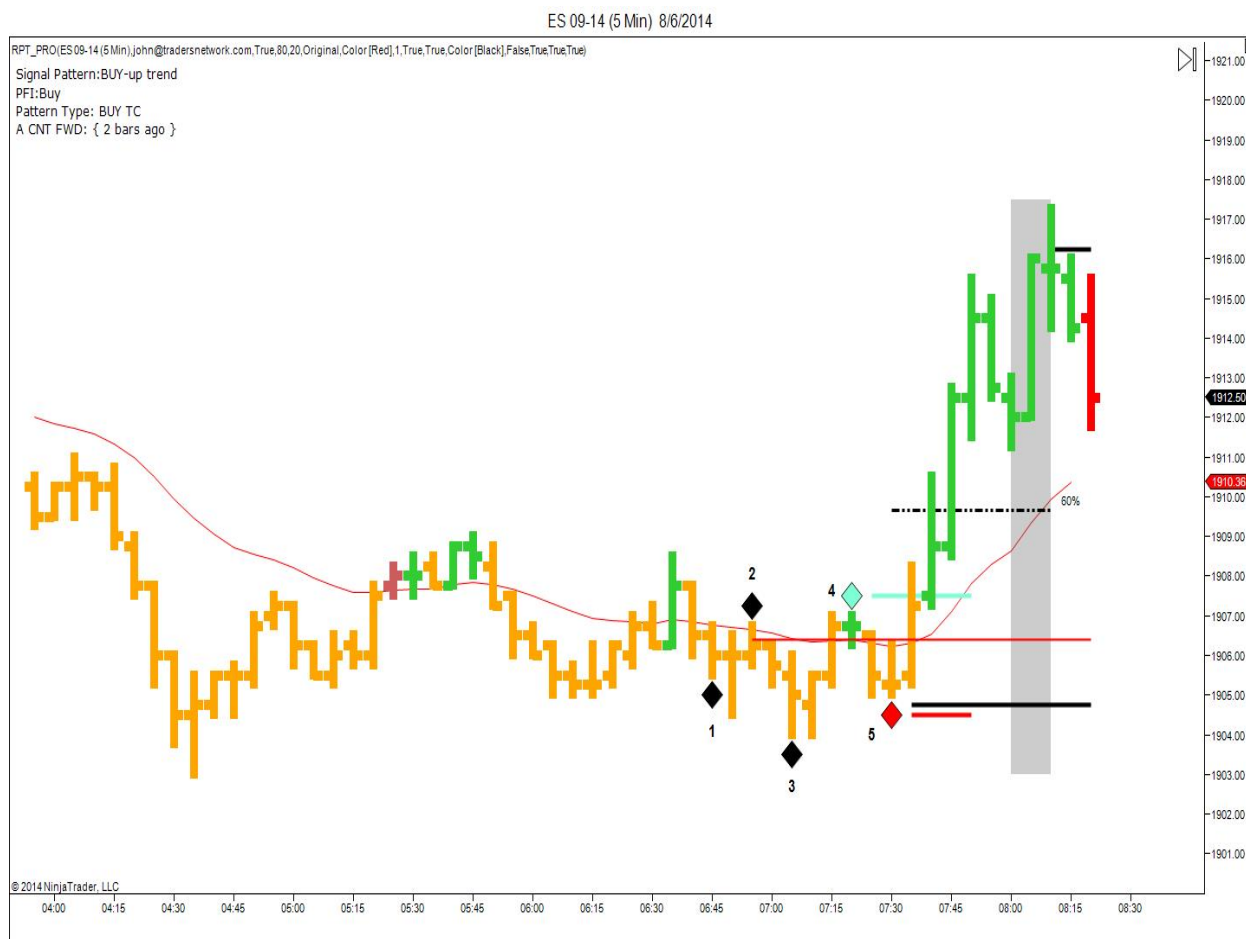
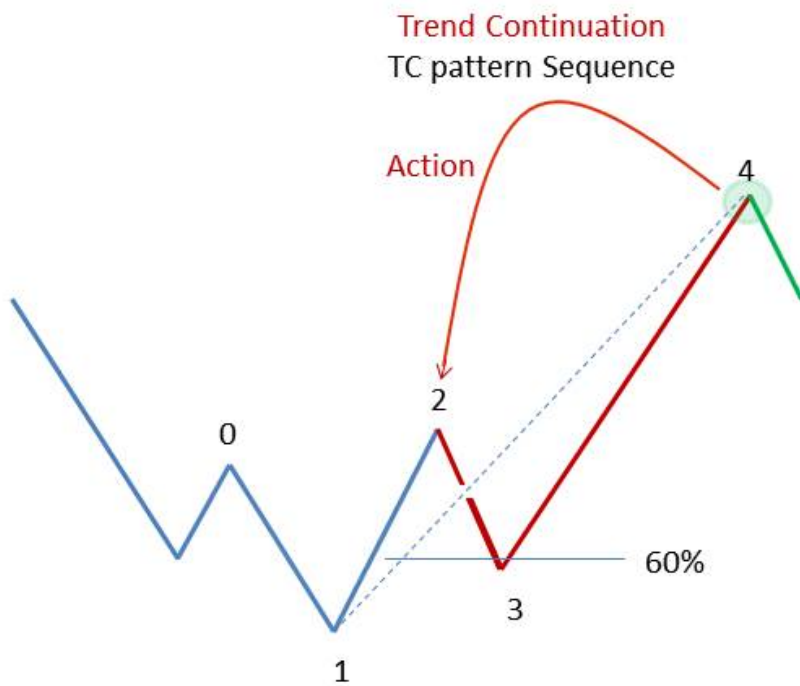


Figure # 13 - The major low and major high both began with a Swing pattern failure.

Trend Continuation (TC) Patterns

The Trend Continuation (TC) pattern sequence appears inside a trending market and adds confirmation to the trend. Understanding how to use the TC pattern allows the trader to hold a current position, enter a new position or add to a current position with added confidence. The TC pattern is simple in structure, yet can be very powerful when used properly. *As shown in Figure #14.*



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Figure # 14 – TC pattern sequence illustrated

Here are the rules to identify a bullish (upward trending market) TC pattern:

1- A TC pattern follows a TR pattern and will usually begin in the reaction zone projected from the reverse/forward count of the TR pattern.

2- The bullish TC pattern begins with a high pivot (formed as the market pulls back from a new high (marked at #3) and end with a low pivot that is formed as the market resumes the existing trend and leaves a low pivot, (marked as #4). See Figure #15 and #16.

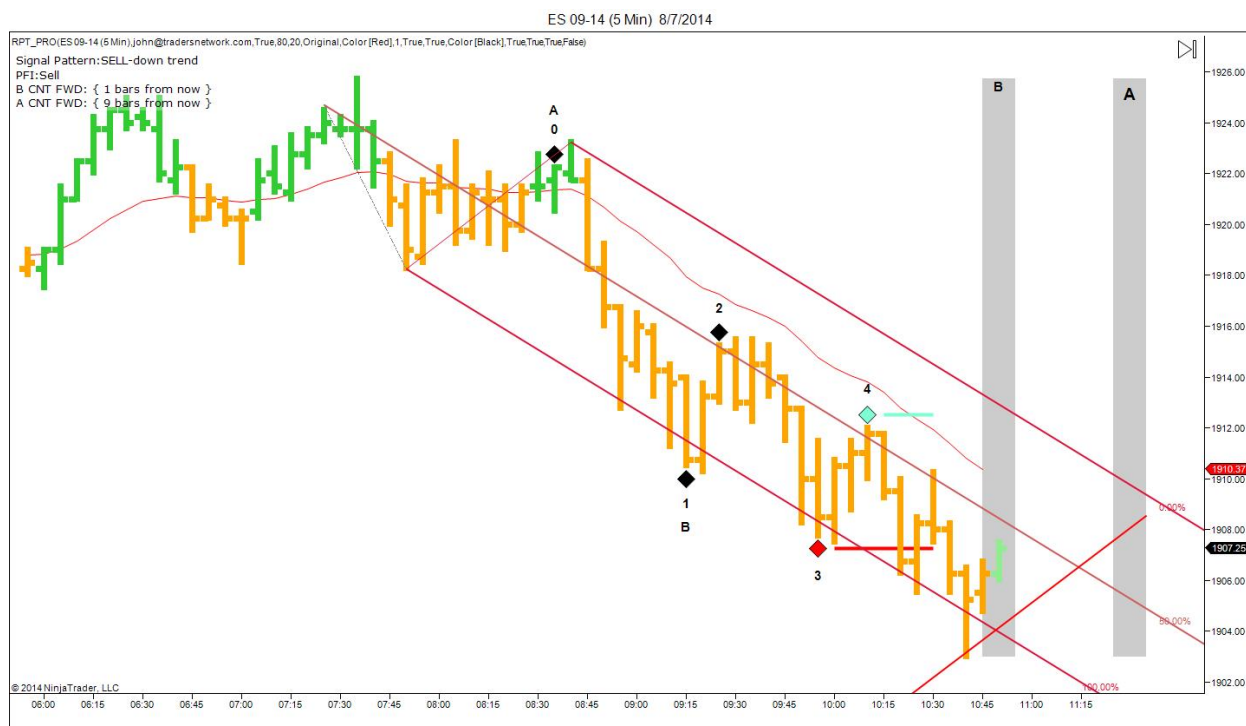


Figure #16 - This chart shows two consecutive TC patterns. The first pattern began with the #1 pivot low and ended with the #2 pivot high. The second began with the low pivot at #3 and ended with the #4 pivot. They both followed the bearish TR pattern.

Trend Continuation (TC) Patterns - Complex

1-The Reaction swing that forms a TC pattern contains a minimum of three price bars (including the price bar with the highest closing price and the price bar with the lowest closing price). A reaction swing can contain as many as eight price bars. (See Figures #16, #17 and # 18).

2-A TC pattern with more than eight price bars will have a zigzag (small Reaction swing pattern) inside the larger Reaction swing that forms the TC pattern. This type of TC pattern is called a complex TC pattern, also known as the A-B-C continuation pattern and can mark the center of the longer-term trend. This pattern can be a very powerful Time and Price indicator.

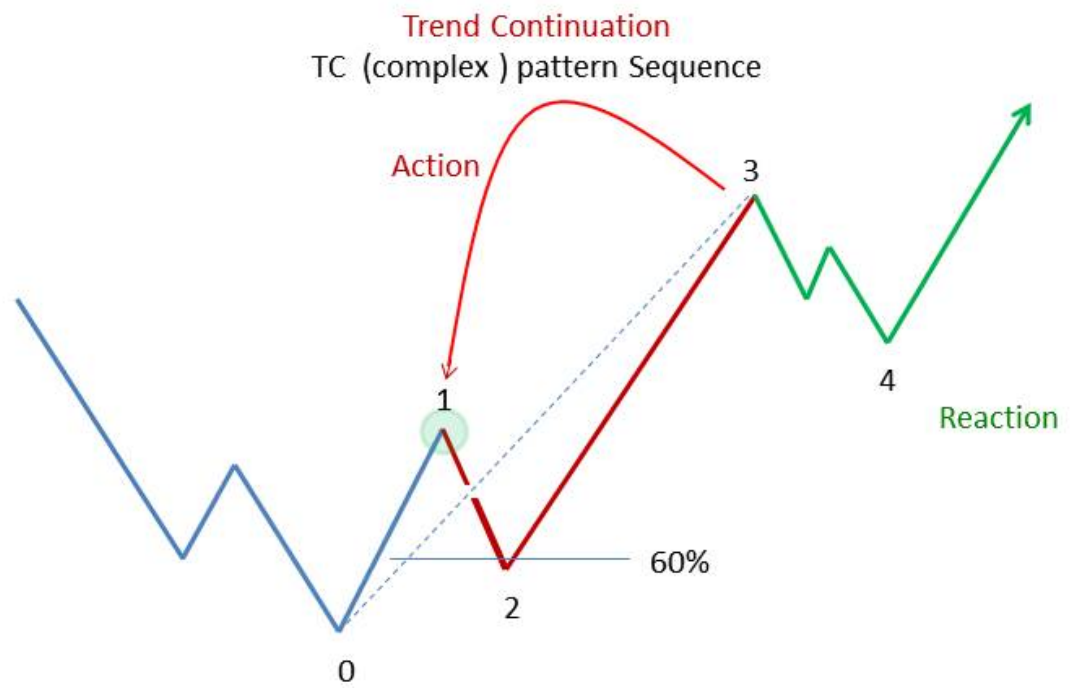


Figure #16 - A complex TC pattern will have more than eight price bars and contain a small zigzag pattern in the center of the pattern.

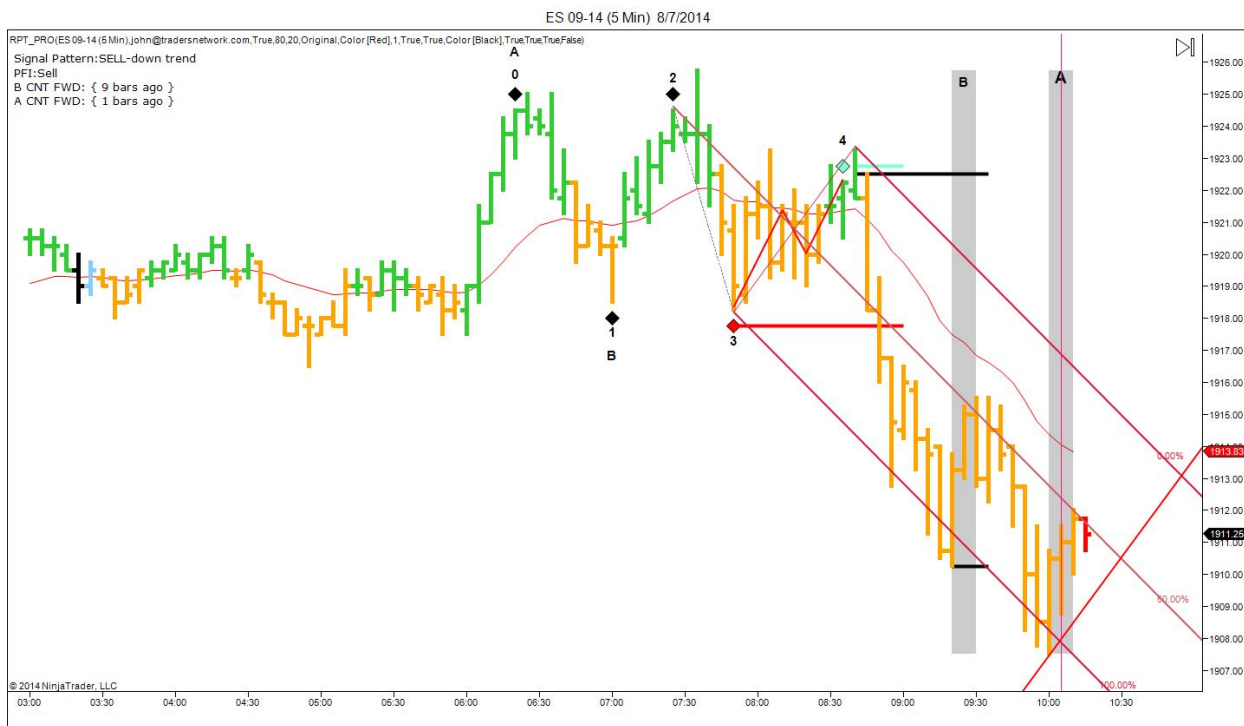


Figure # 17 - September Emini S&P – (5-minute chart) with a complex TC pattern illustrated.

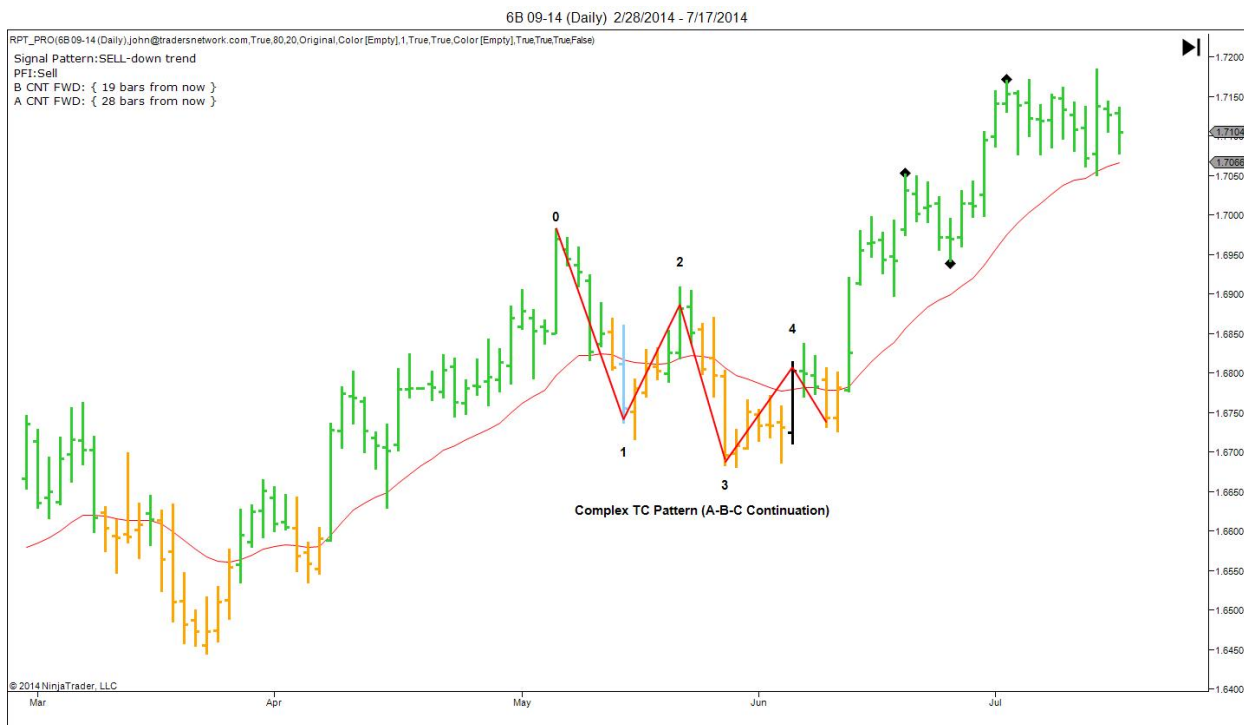
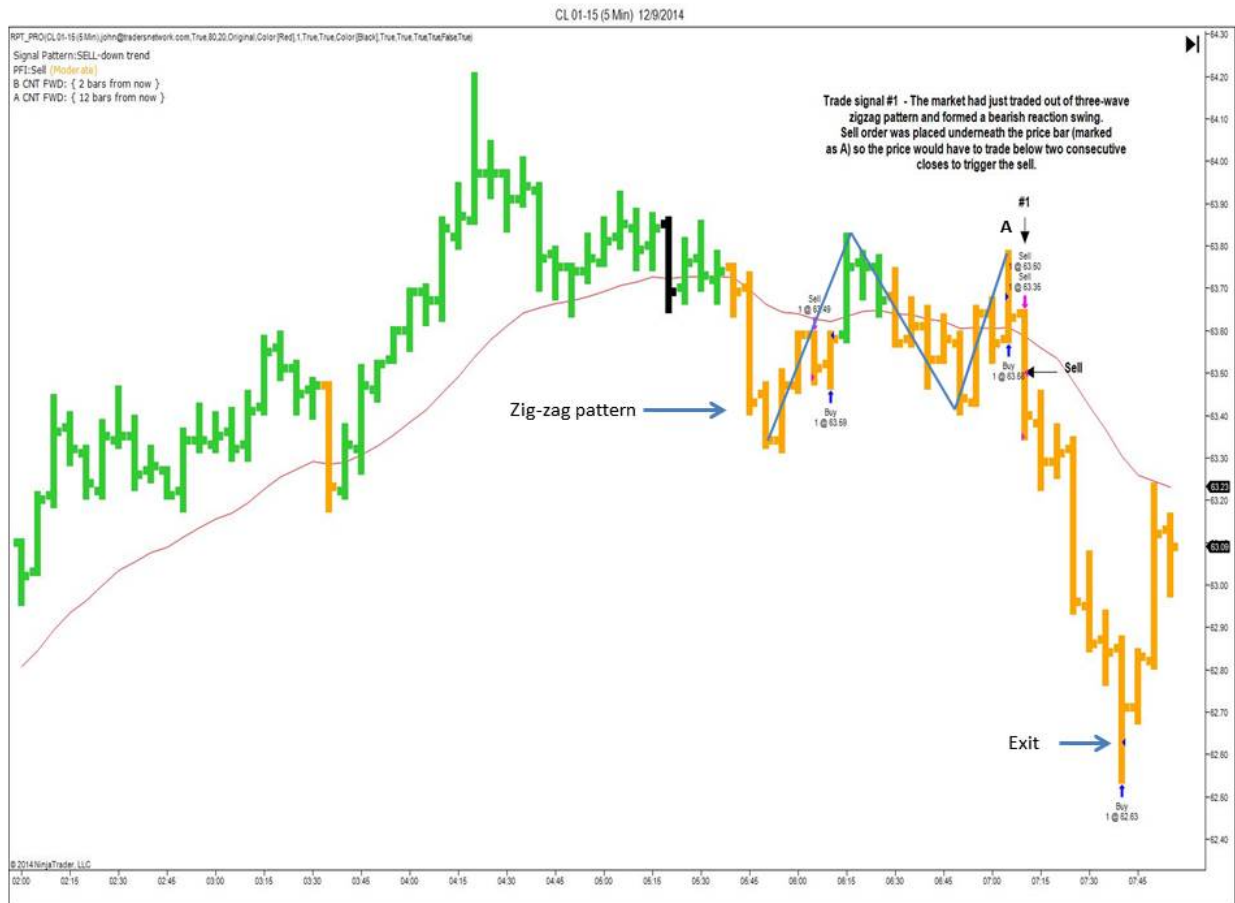
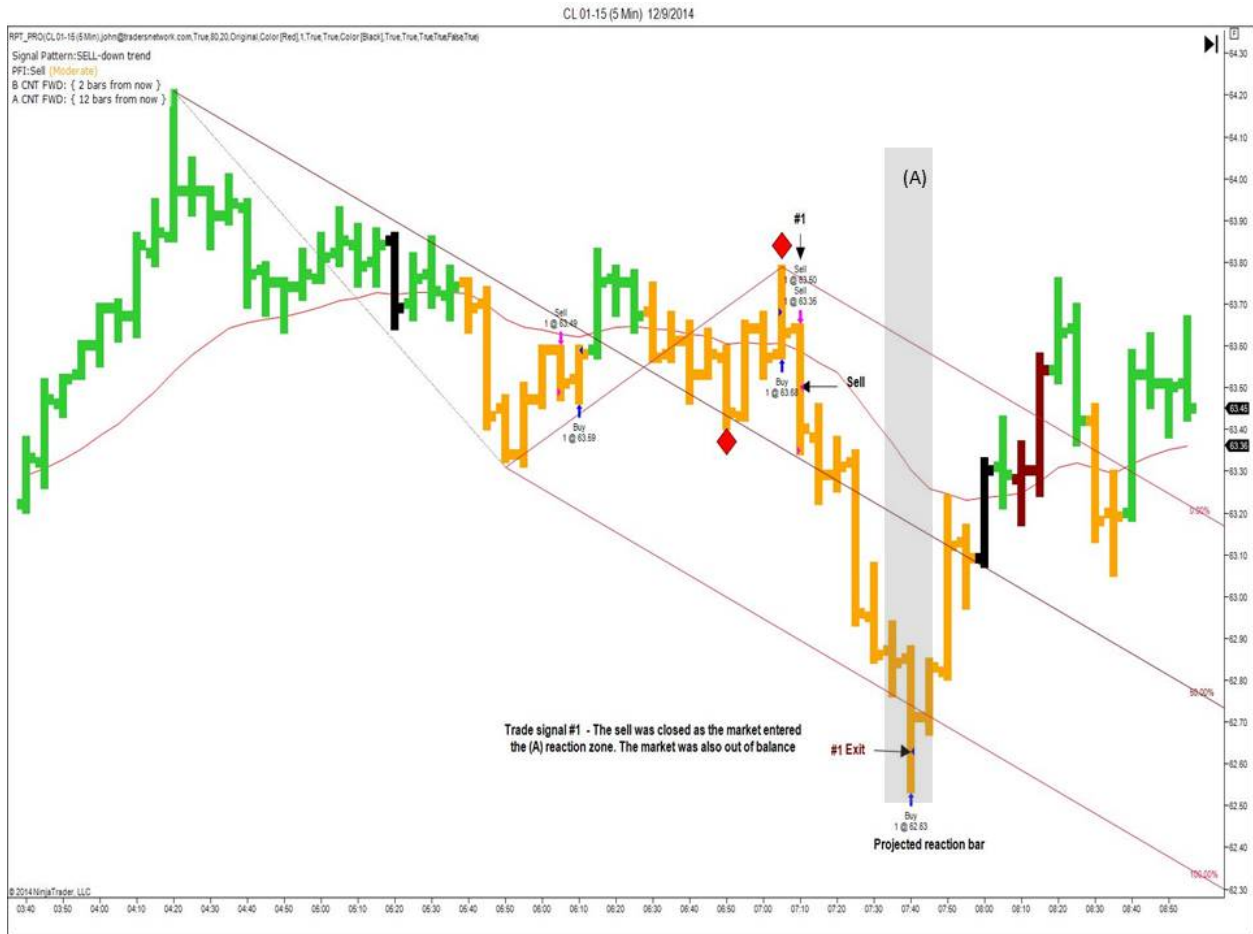


Figure # 18 – Complex TC (A-B-C Continuation) marked the center of the longer-term trend.

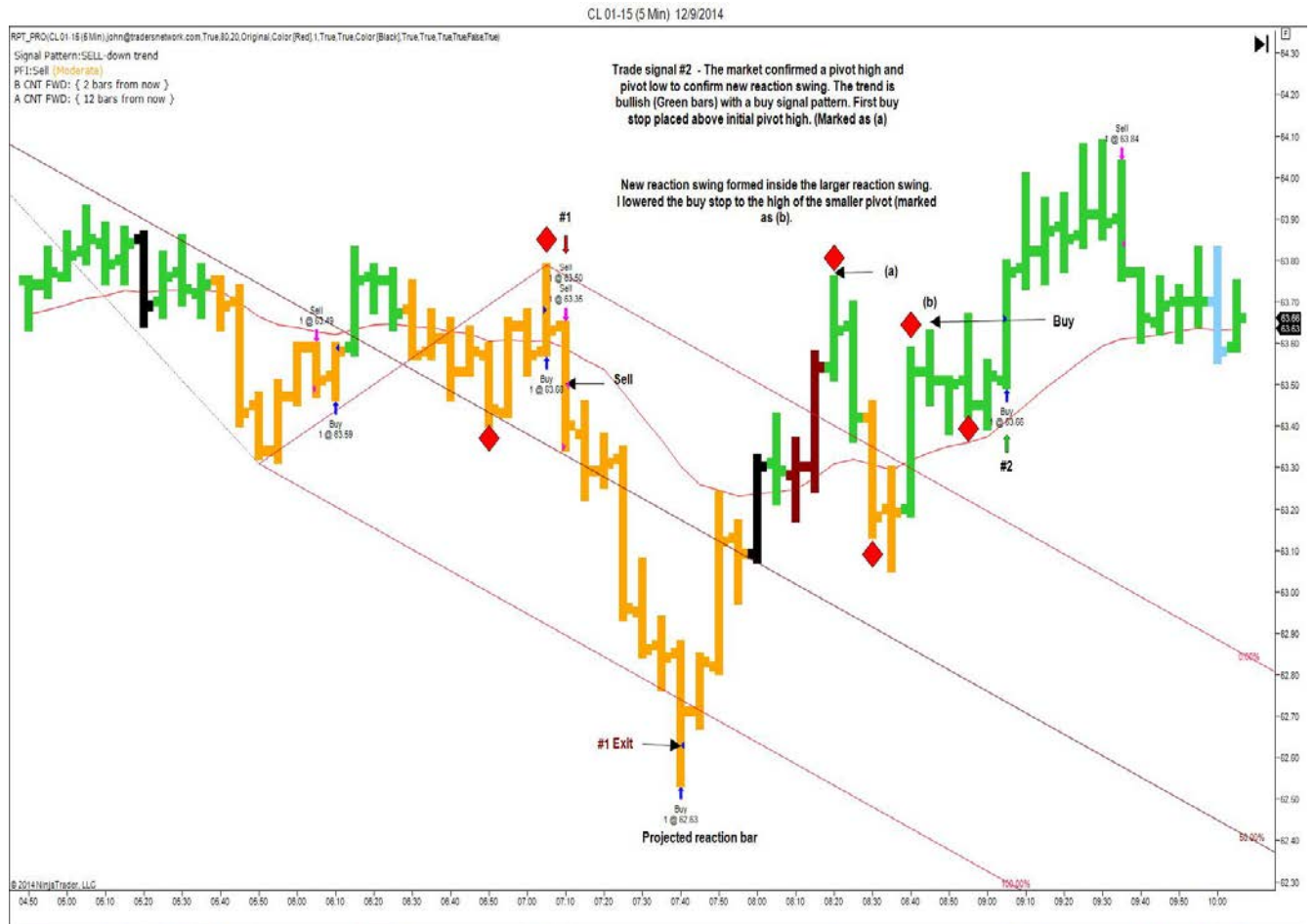
Live trade examples



Crude Oil Trade Sequence Signal #1– The market had just traded out of the three-wave zigzag pattern and formed a bearish reaction swing. A sell stop was placed underneath price bar so the market would trade below the previous two consecutive closes to trigger the sell.

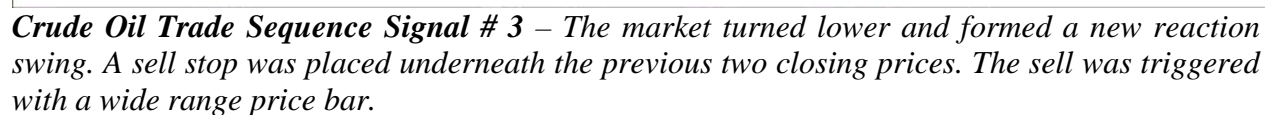


Crude Oil Trade Sequence Signal #1 – The short position was closed when the market entered the projected reaction zone.

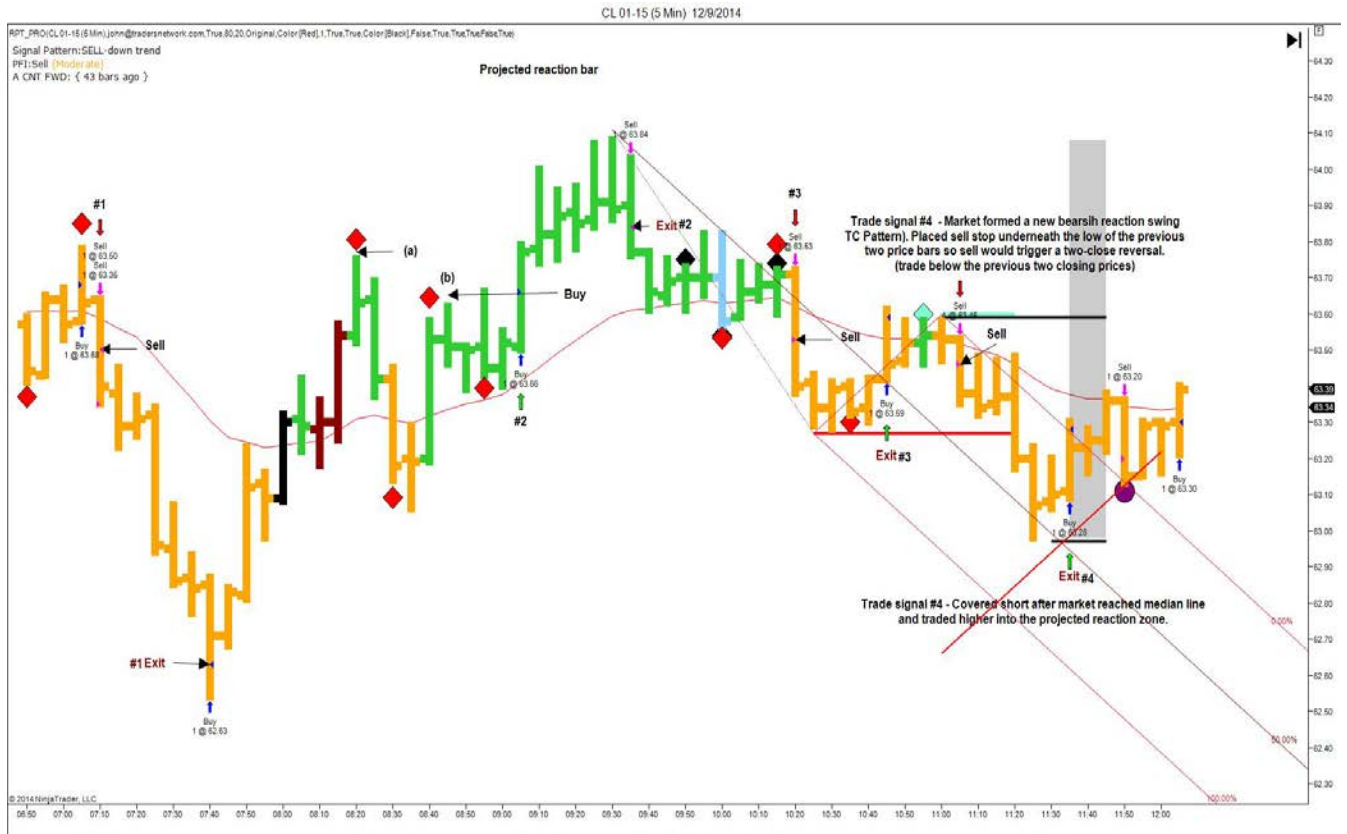


Crude Oil Trade Sequence Signal #2 – The market has formed a bullish TR pattern and confirmed a high pivot (marked as (a)). The trend is bullish (green bars) The (a) pivot marks the beginning of a reaction swing so a buy stop is placed above the (a) pivot high.

The market forms a lower pivot high (b) so the buy stop is lowered to the (b) pivot high. A smaller reaction swing forms inside the larger reaction swing. The buy is triggered.

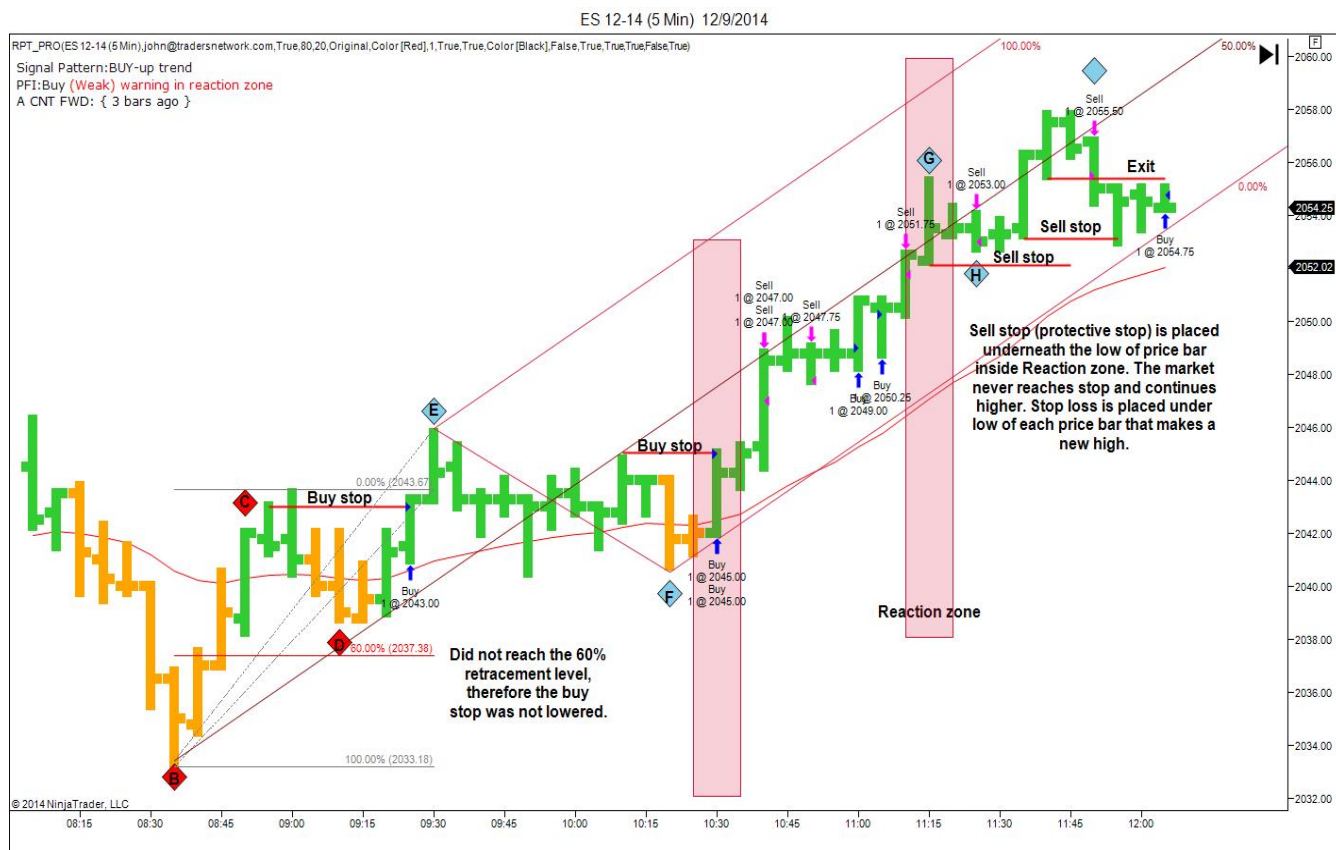


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Crude Oil Trade Sequence Signal #4 – Entered new short position when market traded below the previous two closing prices. Protective stop is placed above the swing high.

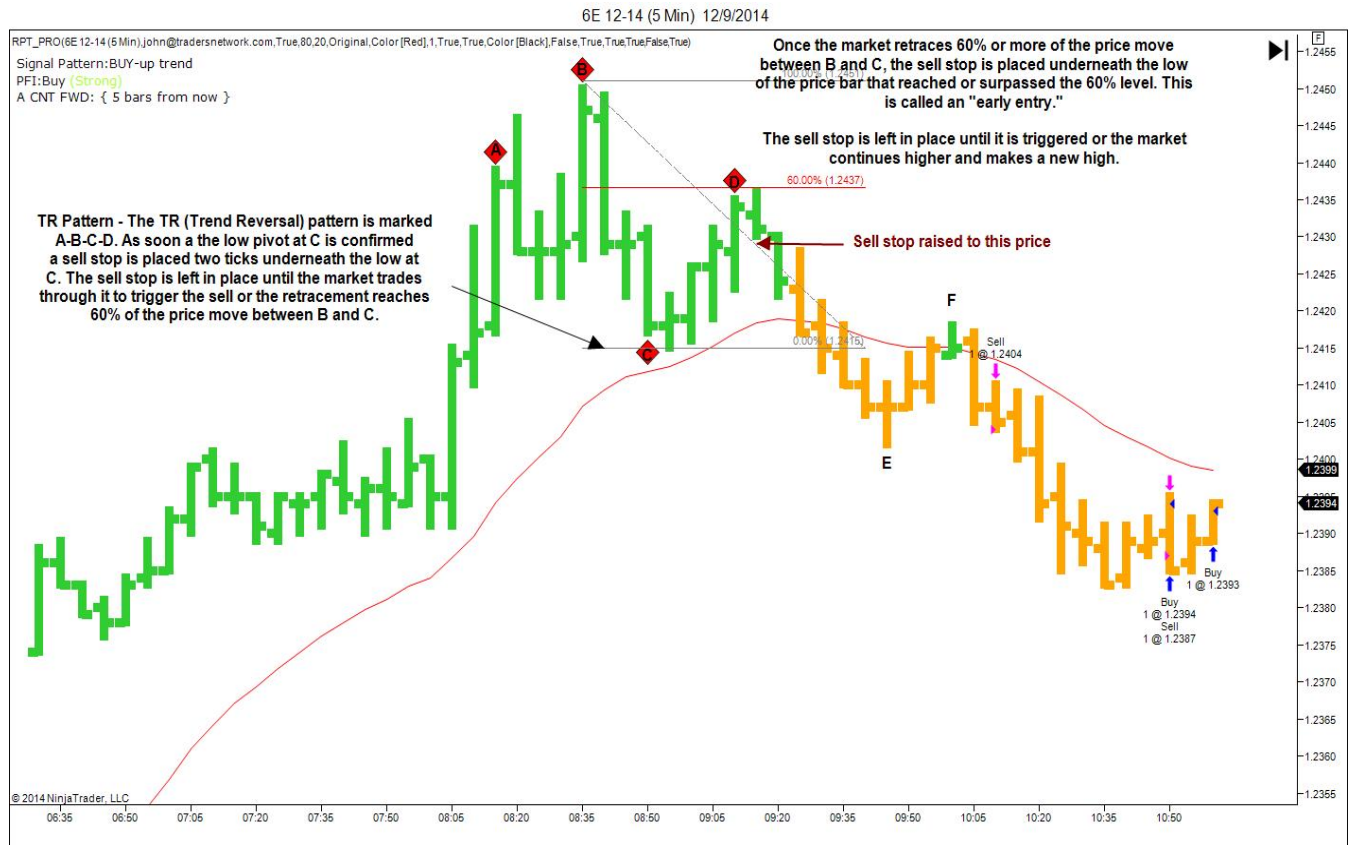
The short position was closed after market did not make a new low inside the reaction zone and traded up to the buy stop that had been lowered.



E-Mini S&P Trade Sequence – The market posted a low at (B) and traded to a high at (C), to form a bullish TR pattern. A buy stop was placed at the (C) pivot high. (The buy stop was not lowered because the price did not pull back to the 60% level before trading higher.) The long position was entered and protective stop placed underneath the (D) pivot low.

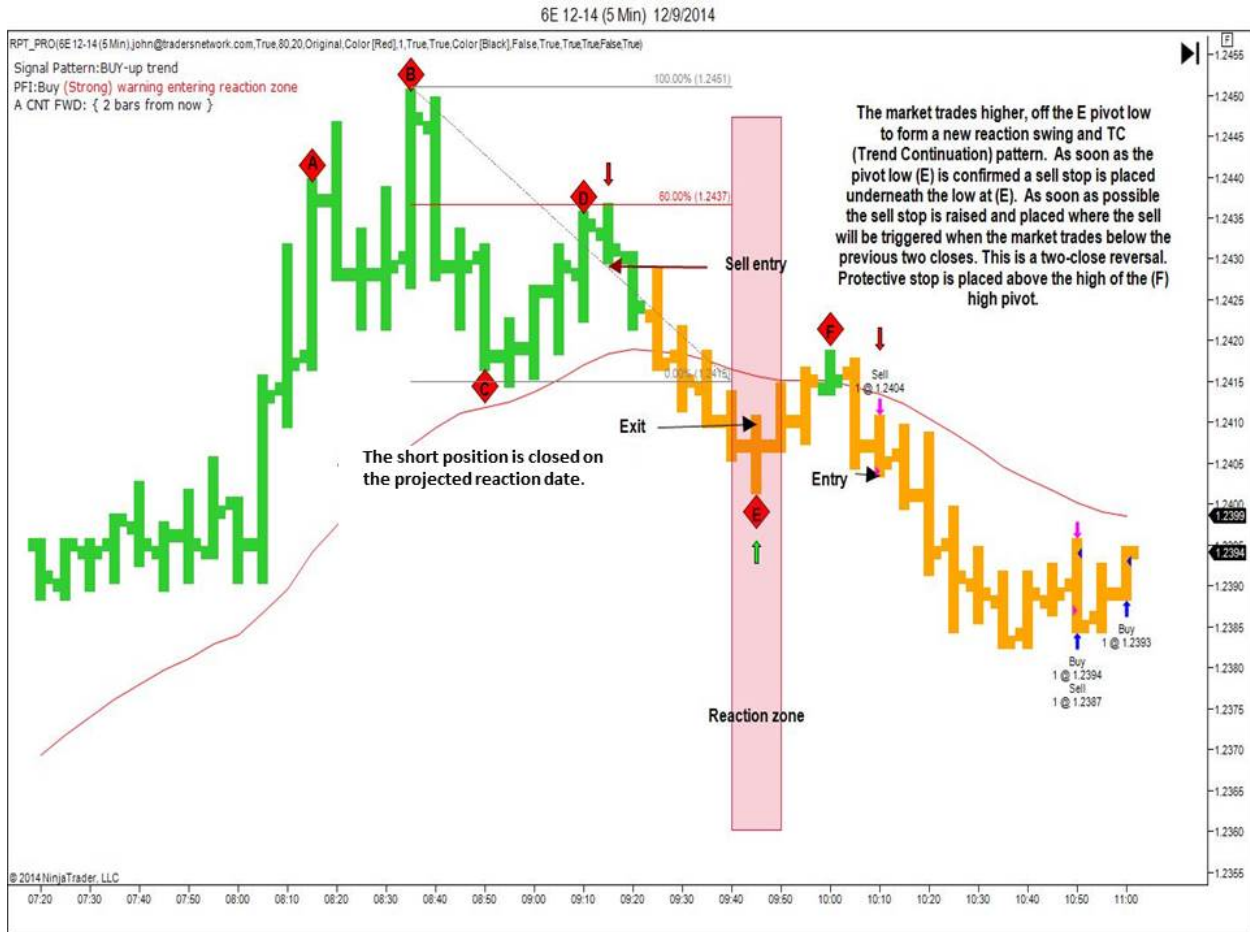
A new TC pattern formed between (E) and (F) so a buy stop was placed above price bar of the previous two closes. The PFI is bullish and market structure is bullish (green bar), suggesting the market should advance. The long position was entered when the buy stop was triggered and the protective stops placed underneath the (F) swing low.

The market advances into the reaction zone and makes new high. The protective stops are moved and placed underneath the low of the reaction bar inside the zone. (At this level, I will make the decision to exit at the market or let the market be stopped out). In this case, the stop loss is raised each time the market makes a new high.



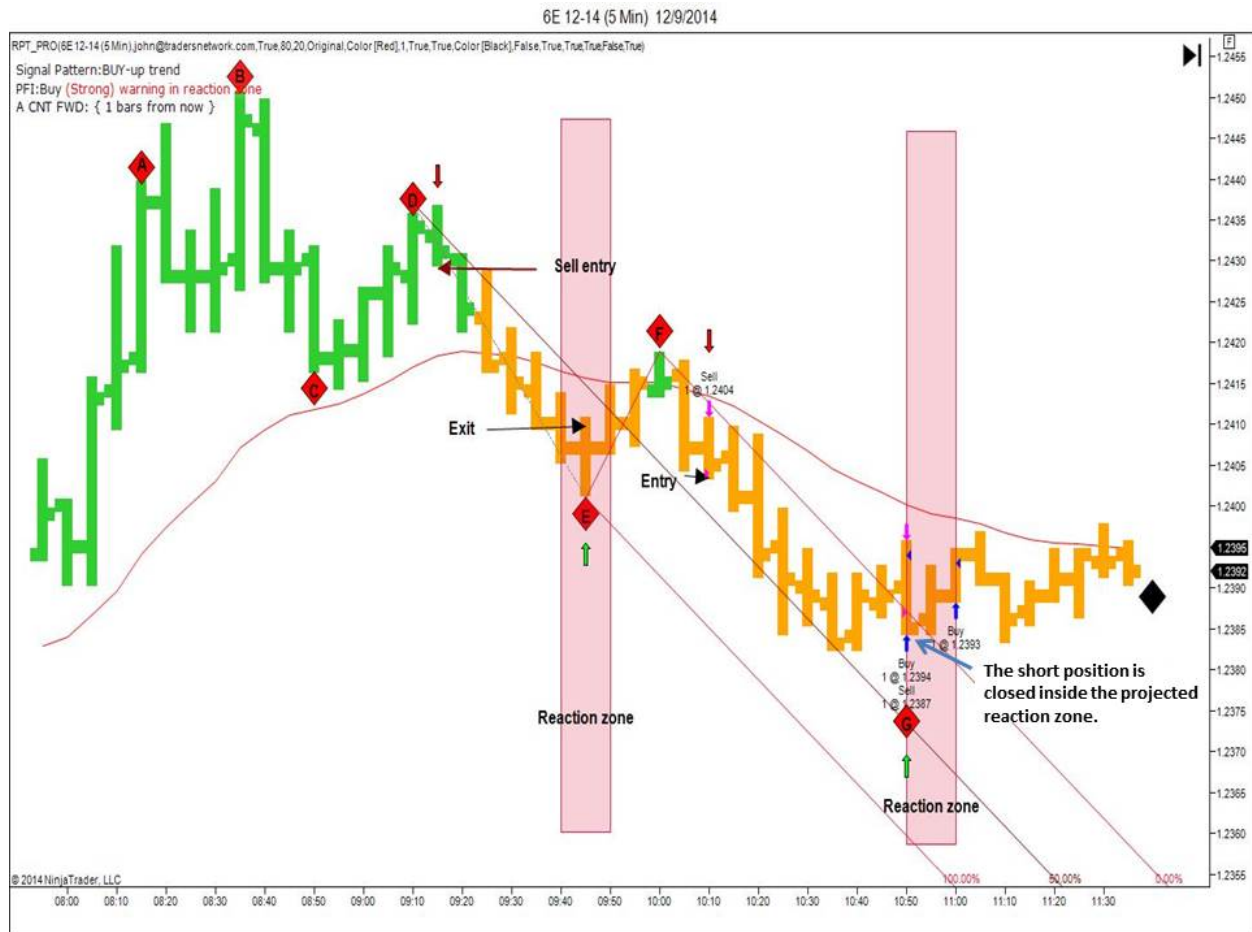
Eurocurrency Trade Sequence – Market posts a high (B), followed by a low (C) below the previous swing low to confirm a TR pattern. The original sell stop was placed underneath the (C) pivot low. The sell stop was raised and placed underneath the low of the price bar that reached the 60% retracement level between the (B) high and the (C) low.

A short position was entered as the sell stop was triggered.



Eurocurrency Trade Sequence – The market trades lower and posted a pivot low (E) inside the projected reaction zone. The short position is closed as it triggered the buy stop placed above the reaction bar high.

The following counter-trend price move stalls at the downward sloping PFI and confirms the (E) pivot low as the beginning of a new reaction swing (TC pattern.) A sell stop was placed and a new short position entered when the market traded below the previous two-closes. (This is called a two-close reversal.)



Eurocurrency Trade Sequence – The short position is closed as it enters the reaction zone (G) when it fails to make a new low. (This was a market order to close the position. However, it could have also been closed with the buy stop.)

The market closed higher on the following six price bars before pulling back and confirming a second pivot high to mark the beginning of a new bullish TC pattern. A buy stop was placed above the pivot high, at the beginning of the TC pattern, but it was later lowered and placed above the high of the first price bar that reached the 60% buy zone. The buy stop was triggered four bars later to enter a second long position.

A target objective (sell limit), to cover the 1st position, was placed where the reaction zone intersects the upward sloping median line inside the (B) reaction zone. A protective stop was also placed near the pivot high.

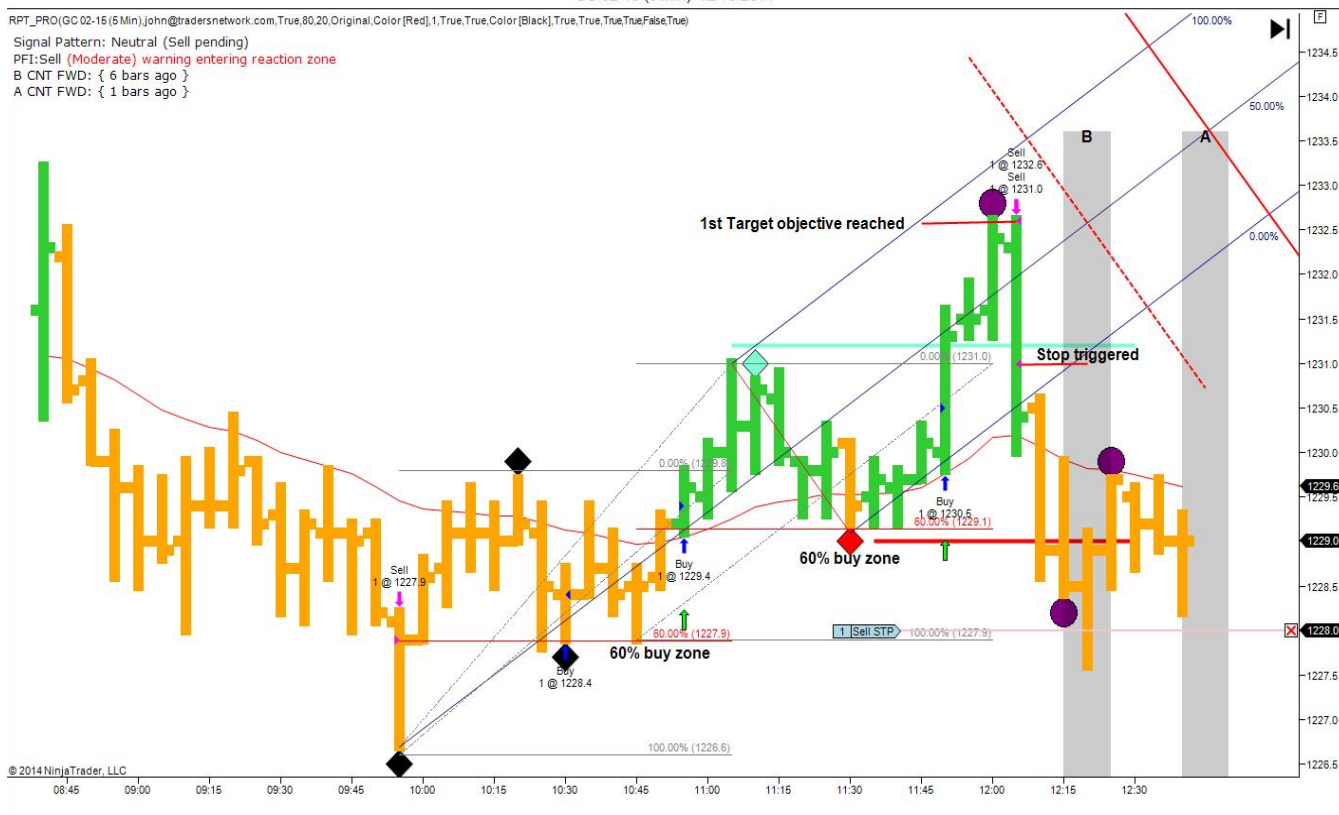
RPT PRO(GC 02-15(5 Min))john@tradersnetwork.com True 80 20 Original Color [Red] 1 True True Color [Black] True True True True False True

Signal Pattern: Neutral (Sell pending)

PFI: Sell (Moderate) warning entering reaction zone

B CNT FWD: { 6 bars ago }

A CNT FWD: { 1 bars ago }



Gold Trade Sequence – The market advanced into the 1st target objective to close one long position, but the market failed to continue the price advance into the reaction zone. After reaching the 1st target objective, Gold reversed and dropped through the protective stop to close the second long position.

After trading below the previous swing low, Gold posted a two-bar corrective rebound that confirmed a low pivot and the beginning of a bearish reaction swing. The market has shifted from a bullish mode to a bearish move and identified a new trigger price to enter a sell stop.

This instructional manual is an introduction to *Trading with Market Timing Intelligence using Action/Reaction*. If you would like to learn more about this trading approach you should consider John Crane's four-session educational series. [Go here to learn what is included in the educational series and check the schedule for the next series to begin.](#)



All charts in this e-book are made using the [Reaction Point™ Timing Indicator](#) featured on the NinjaTrader™ trading platform. Reaction Point™ is the only indicator featuring Market Timing Intelligence. [\[Click here\]](#) to learn more about Reaction Point™ and request your free trial.



John Crane is a veteran futures trader and best-selling author. John Crane combines his highly acclaimed “Action/Reaction” market timing methods with a selective set of Elliott Wave and Fibonacci principles to analyze the market action and future market swings. The methodology is designed to identify a “sweet spot” where markets are building energy inside a trend that precede explosive market moves and capture the entire price move.

John Crane has over 35 years of experience as a futures trading professional as well as being best-selling author. He is a founding owner of Traders Network – a firm providing brokerage services, educational training products and technology for today’s intelligent investor. Articles on his trading concepts have been published in Consensus, Barron’s, Technical Analysis of Stocks and Commodities as well as The Wall Street Journal, Investor’s Daily, and Traders World. John has taught numerous seminars and has been a guest lecturer at several national and international trade shows. He has also served as a consultant to professional traders and fund managers throughout the world as well as a contributing market analyst to the Pacific Research Center and the International Business Times. John served on the Board of Directors and as president of the National Introducing Brokers Association as well as the NFA Introducing Brokers Advisory Committee.

He is the author of several books on swing trading concepts. “A Traders Handbook: The Reversal Day Phenomenon” is currently out of print, but remains in high demand and has been offered for sale at over \$1,600 on Amazon.com. His book “Advanced Swing Trading – Strategies to Predict, Identify, and Trade Future Market Swings” has sold in over 40 countries and has recently been translated into Chinese. His latest book “Unlocking Wealth – Secret to Market Timing” was released in January, 2007. It is listed as one of the top 12 All Time Best Trading Books by www.E-mini-watch.com. John is the creator of the highly acclaimed Reaction Point™ Timing Indicator. He is the editor of the Traders Market Views Swing Trading Report newsletter, now in its 28th year of publication.

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