TRADING Strategies

INTRADAY trading with the TICK

Indicators such as the TICK can reveal the internal strength (or weakness) of the market and highlight intraday turning points. Here's how one trader combines the TICK with support and resistance analysis and retracement levels.

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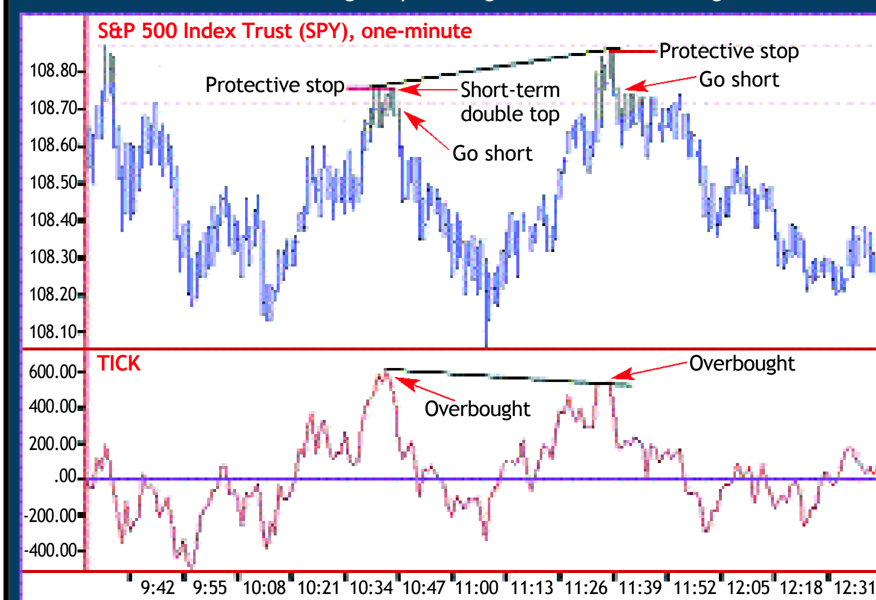
The TICK is a market breadth indicator that measures the difference between the number of New York Stock Exchange (NYSE) stocks trading on an uptick (i.e., last price higher than the previous price) and the number of stocks trading on a downtick (last price lower than the previous price).

For example, if at a given moment 5,200 NYSE stocks were trading up from their previous prices and 4,800 were trading down from their previous prices, the TICK reading would be +400 (5,200-4,800). The TICK indicator should not be confused with the term "tick," which is used to describe a minimum price fluctuation.

Positive, rising TICK readings are a bullish signal; the opposite is true for a negative, declining TICK. (However, very high or low TICK readings often indicate temporary market exhaustion.) A declining TICK in a rising market indicates stocks are beginning to trade off their highs, signifying the uptrend may reverse, at least temporarily. Likewise, a rising TICK in a declining market indicates stocks are starting to trade off their lows, and a reversal of the downtrend is possible. For more information on the TICK, see "TICK basics," p. xx.

FIGURE 1 TICK AND RESISTANCE

The TICK indicator moved into overbought territory as SPY tested its resistance zone. The combination of these signals set the stage for low-risk short trades. The second short sale was also supported by the divergence that occurred between the higher price high and lower TICK high.



Source: TradeStation Platform by TradeStation Group

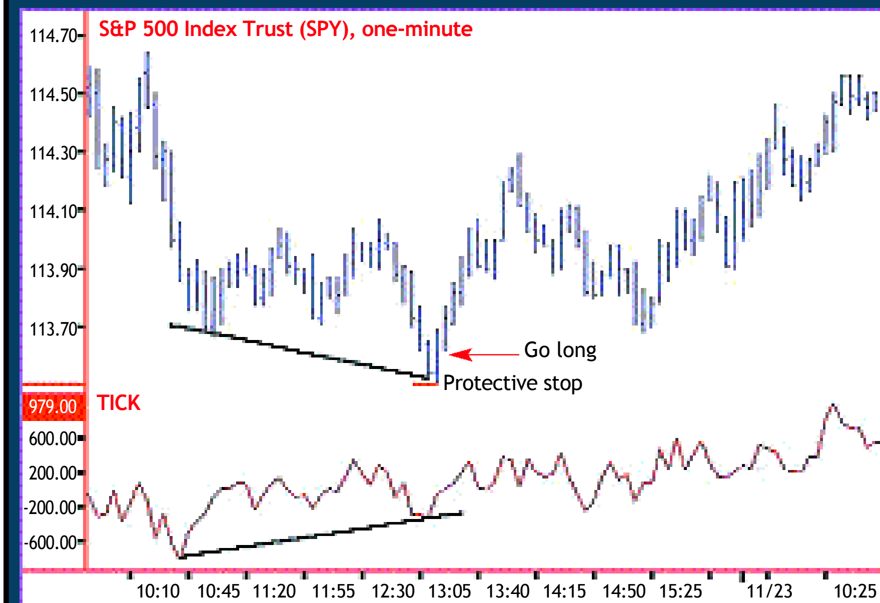
When confirmed with other tools, TICK readings can be used to identify intraday turning points. We'll look at a few examples that combine the TICK with price patterns and Fibonacci retracement levels.

Range trading with the TICK

TICK overbought and oversold levels can vary depending on conditions. For the purposes of this article, a reading above +500 indicates an overbought condition and a reading below –500 indi-

FIGURE 2 **BULLISH TICK DIVERGENCE**

SPY made a lower low but the TICK made a higher low, indicating growing internal strength. This divergence was followed by a quick rally.



Source: TradeStation Platform by TradeStation Group

cates an oversold market. Readings above +1000 or below –1000 are extreme conditions.

A simple trading approach is to place trades when the TICK signals an overbought or oversold market as price is testing the support or resistance levels of a trading range.

Figure 1 (opposite page) is a one-minute chart with a resistance zone around 108.72 to 108.90 (established by the two highs at the far left of the chart). As the market traded into this resistance zone around 10:40 a.m., the TICK moved above +500, signaling an overbought market. Price then traced out a very short-term double top, and the TICK indicator turned down. A short sale would have been placed when price dropped back below the 108.72 resistance level. A protective stop would be placed just above the high of the double top, which is the top of this swing move.

TICK divergence

TICK divergence setups (as described in the book *Street Smarts* by Laurence Connors and Linda Bradford Raschke) are probably the most popular use of the TICK indicator. Divergences between price and the TICK occur when price makes a higher high (or lower low) and the TICK makes a lower high (or higher low). These signals often accompany market reversals or corrections.

Approximately an hour after the first trade in Figure 1, price again retested its intraday highs at the upper end of the resistance zone, and the TICK exceeded +500. However, this TICK overbought high was lower than the previous TICK overbought high. This divergence between price and the TICK meant the market was rallying with fewer stocks making upticks — a sign of internal weakness — and set up another short sale opportunity when price dropped back below the lower resistance level.

In the case of a long TICK divergence signal, price makes a new low but the TICK indicator makes a higher low. In Figure 2 (above), price fell to a new low at approximately 1:05 p.m. but the corresponding TICK low was higher than its previous intraday low at 10:45 a.m. A long trade would have been entered when price traded back above the first low just below 113.70, with a stop placed below the most recent low.

Zero-line crossings

In addition to its usefulness in trading ranges, the TICK can also set up trades in trending markets. In a strong uptrend, any countertrend movement is usually marked by the TICK fluctuating between –100 and +100. In these situations, –100 becomes the oversold level. More often than not, the TICK tests the zero line. These tests offer opportunities to enter in the direction of the prevailing

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Key terms

Breadth: The "internal" strength or weakness of the market — that is, the strength or weakness not immediately reflected in price. Breadth is typically derived from some calculation of the number of advancing stocks vs. the number of declining stocks, the volume of these stocks, or some combination of the two. In addition to the TICK, breadth is reflected in such indicators as the advance-decline line and the TRIN (Arms Index).

Fibonacci retracement: Percentages based on ratios of numbers from the Fibonacci sequence (see Technical Tool Insight, p. xx) that some traders use to determine likely retracement levels and profit targets. The most commonly used Fibonacci retracement percentages (rounded off) are 38, 50 and 62 percent.

FIGURE 3 PULLBACK 1

A move by the TICK below zero coincides with a 50-percent retracement of the earlier upmove. The TICK then moves back above zero, and a long trade is triggered when price breaks above the upper channel line.

Source: TradeStation Platform by TradeStation Group

trend.

At the beginning of Figure 3 (left), SPY was in an uptrend and the TICK reached an overbought level of +600, which indicates a strong, uptrending market. In such a situation, the goal is to buy on a pullback.

Countertrend channel lines are drawn as price turns down a little after 10 a.m., forming the pullback. As the TICK dropped below zero twice between approximately 10:11 and 10:30 (and below –100 the second time), price tagged the 50 percent Fibonacci retracement line. The combination of the TICK oversold signal and the 50 percent retracement made the odds good for an up move.

This next development to look for is a move above the upper channel line, which would indicate the pullback has ended and price could continue in its previous direction. When the upper channel line is penetrated, go long with a stop below the low of the entry bar. Take profits at the previous high.

TICK basics

The TICK is a very short-term (intraday) indicator that measures the bullish (upticking) or bearish (downticking) activity in NYSE stocks throughout the day. TIKI is the symbol for the same indicator calculated on Dow Jones Industrial Average stocks; some data services also supply the TICK calculated on Nasdaq stocks.

The TICK is a breadth indicator that gives traders an intraday look at the "internal" strength or weakness of the market — that is, the strength or weakness beyond whether the overall market is up on a point or percentage basis. By comparing the number of stocks advancing to stocks declining, the indicator reflects the market's up or down momentum at a given moment.

For example, if the S&P 500 index is up marginally but downticking stocks are consistently outnumbering upticking stocks (and the number of downticking stocks is increasing, reflected by a downtrending TICK indicator), it is likely that only a relative handful of strong stocks are propping up the overall market. When buying completes in these stocks, a down move may result.

Two contrarian uses of the TICK indicator are to look for divergence between price and the indicator, and to use high or low TICK readings to identify momentum extremes (similar to how many traders use oscillators like the relative strength index or stochastics to locate overbought and oversold points).

A divergence occurs when price makes a new high (or low) but the TICK makes a lower high (or higher low), failing to confirm the price move and warning of a slackening of momentum and potential stall or reversal. A similar phenomenon would be a steady trend in the TICK that runs counter to the trend of the market. Extreme high or low TICK readings sometimes accompany market climaxes.

Because the TICK is a snapshot of the market at a given moment (and is thus very volatile), it can be deceptive. Because of this, the TICK is commonly smoothed with a 10-period moving average to remove some of the "noise" and better reveal the indicator's direction and patterns. For a more detailed discussion of TICK indicator basics, see Indicator Insight, *Active Trader*, March 2001, p. 112.

However, patience is required when trading this setup. The TICK should be given time to bottom out in an uptrend or top out in a downtrend; don't expect a sudden price reversal when the TICK indicator simply hits the zero line. Other technical factors should be consulted before entering any trades, such as employing a price pattern, as presented here.

Figure 4 (top, right) provides a similar example. It shows a very high TICK reading of +900, although price continued to move higher. At around 2:20 p.m., price retraced approximately 38 percent (another Fibonacci retracement level) and a countertrend channel formed. A buy signal occurred after the TICK crossed back above the zero level and price broke out above the upper channel line. After that, the stock resumed its uptrend, including a gap-up open the next day.

However, there are times when the market is trending and the TICK does reach the overbought (+500) or the oversold (-500) levels. In Figure 5 (bottom, right), SPY and the TICK both made new lows around 10:15 a.m. The TICK broke below –200, at which point a slight countertrend rally ensued in SPY.

A combination of bearish indications signaled a short trade: The countertrend rally reversed after approaching the 38-percent retracement level, and the TICK rose to just below +500 (on a one-minute close basis; it exceeded +500 before the bar closed), indicating an overbought condition. Go short on a breakdown of the lower channel line, with a stop at the high of that bar. During an uptrend, look for the same setup, in reverse, if the TICK drops to –500.

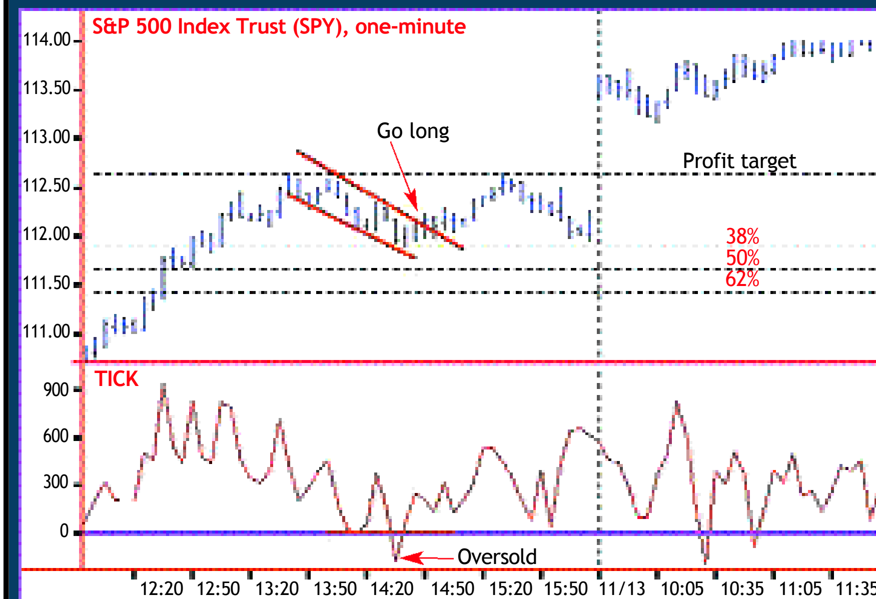
A helping hand

As these examples suggest, the TICK indicator should be used to set up or confirm a trade, not as a stand-alone tool. By utilizing the TICK in conjunction with price patterns, technical indicators, and in the context of the overall trend and market environment, you can make better buy and sell decisions.

For more information on the author see p. xx.

FIGURE 4 PULLBACK 2

In this pullback, price retraces to the 38 percent line. The previous high provides a price target for the trade.



Source: TradeStation Platform by TradeStation Group

FIGURE 5 GOING WITH THE TREND

A retracement close to the 38-percent Fibonacci level and an overbought TICK reading around +500 set up a short trade in the direction of the longer-term trend.

Source: TradeStation Platform