Picking Tops And Bottoms With The Tick Index

by Tim Ord

As a young trader, I first used moving averages, point and figure charts and some Gann methods and then moved on to the Elliott wave fad. But none of these methods or techniques really gave me a strong signal for a top or bottom in the market. What I did learn in my early years as a trader was that running with the masses is a guaranteed subscription to failure. It is said that 80% of the people who trade the markets lose; from my experience, I'd say this is true. The losing majority fund the marketwise minority.

I wanted a trading method that kept me on the opposite side of the losing public and gave me a more absolute signal in picking tops and bottoms in the market. I also wanted an undiscovered method that the trading masses hadn't overused. That eliminated moving averages, which got me short at bottoms and long at tops, and Gann and Elliott methods, which pointed to a top or bottom *after* it occurred.

What I found was the tick index, carried by most live intraday quote services, and I have found it to accurately forecast market tops and bottoms and indicate buy and sell levels. This method uses intraday uptick and downtick readings of the New York Stock Exchange (NYSE) to forecast tops and bottoms in the Dow Jones Industrial Average (DJIA) and to generate buy and sell signals that span one to 10 days.

UPTICKS AND DOWNTICKS

The tick index is the difference between the number of issues trading with the last trade higher (an uptick) from the previous price and issues trading with the last trade lower (a downtick) from the previous price. For example, if exchange X has 500 issues trading on an uptick and 250 issues trading on a downtick, the tick index would be +500 - 250 = +250.

This is simple enough, so let's go on in our thinking. Suppose it's true that 80% of the public who trade the markets lose. If you trade opposite the public, then you should win 80% of the time, right? But the question is, how do you know what the public is doing? The tick index can provide a clue.

The uptick and downtick method is a form of contrarian trading. If everyone buys, the tick index goes extremely positive, which indicates a top. If everyone sells, the tick index goes extremely negative, forewarning of a bottom. Extreme tick index readings are the key to this method, and they will give the turning points, sometimes within seconds of market highs or lows.

Although the tick index is calculated from intraday tick readings, buy and sell signals generated from the tick index may span from one to 10 days. Using NYSE tick readings as an indicator of a high in the DJIA, I look for a double top with extreme upticks at both high points. The second extremely positive tick index reading will be my sell signal. The double top can occur the same day or, at the most, have 10 trading days between. For a bottom, I look for a double low in the DJIA with extreme downticks at both low points. A buy signal is generated on the second extremely negative tick index reading. Again, the second test of support can occur in the same day or as far back as 10 trading days.

> **I look for a double top with extreme upticks at both high points. The second high uptick reading will be my sell signal.**

VOLUME FOR CONFIRMATION

Volume is an element in determining whether the tick index is at an extreme reading. The higher the volume of trades, the more ticks are needed to be considered an extreme reading. You can see in Figure 1 how volume interacts with extreme ticks. Usually, the higher the extreme tick index reading (compared to volume), the more significant the move thereafter. This makes sense, as the public is more convinced about the direction of the market, which leads to a more powerful move opposite their bias. One example of this is the January 9,1991, reading of 890 downticks at the 2470 area on the NYSE with a volume of 191 million shares, and a January 14, 1991, reading of 880 downticks in the 2465 area with volume at 121 million. The second low was my buy signal, and a rally of 500 points followed. These extreme downtick readings signified that most participants were convinced of more downside activity, but obviously they were incorrect.

Figure 1 presents a couple of recent months of trading to illustrate my method of watching upticks and downticks for buy and sell signals. All tick readings are intraday, and volume confirmed the tick index readings as extreme. The top chart is the daily bar chart of the DJIA. The lower chart is a bar chart of NYSE intraday tick readings, where each bar reveals the day's range of tick index values. Trades were generated by buying the second test of support (double bottoms) when the number of downticks reached a second extreme, or by selling the second test of resistance (double top) during the second extreme reading of the number of positive ticks.

The tick index is not always as accurate as it was here, but when used with other techniques, the tick method can indeed help provide confirmation for buy and sell signals.

EXPLANATION OF TRADES

Trade # (First, second extreme tick index reading	Date	Tick index reading	DJIA level	Volume (Shares in millions)	Buy/sell
1	10/29	840 downticks	2413	134 million	
	10/30	675 downticks	2411	153	Buy
2	11/5	350, 325, 300 upticks	2505	147	
	11/6	290 upticks	2501	143	Sell
3	11/14	500 upticks	2572	179	
	11/19	450 upticks	2568	142	Sell
4	11/26	500 downticks	2502	126	
	11/29	560 downticks	2508	142	Buy
5	12/14	725 downticks	2580	151	
	12/17	670 downticks	2575	119	Buy
6	12/31	742 upticks	2633	115	
	1/2	375 upticks	2638	126	Sell
7	1/9	890 downticks	2470	191	
	1/14	880 downticks	2465	121	Buy

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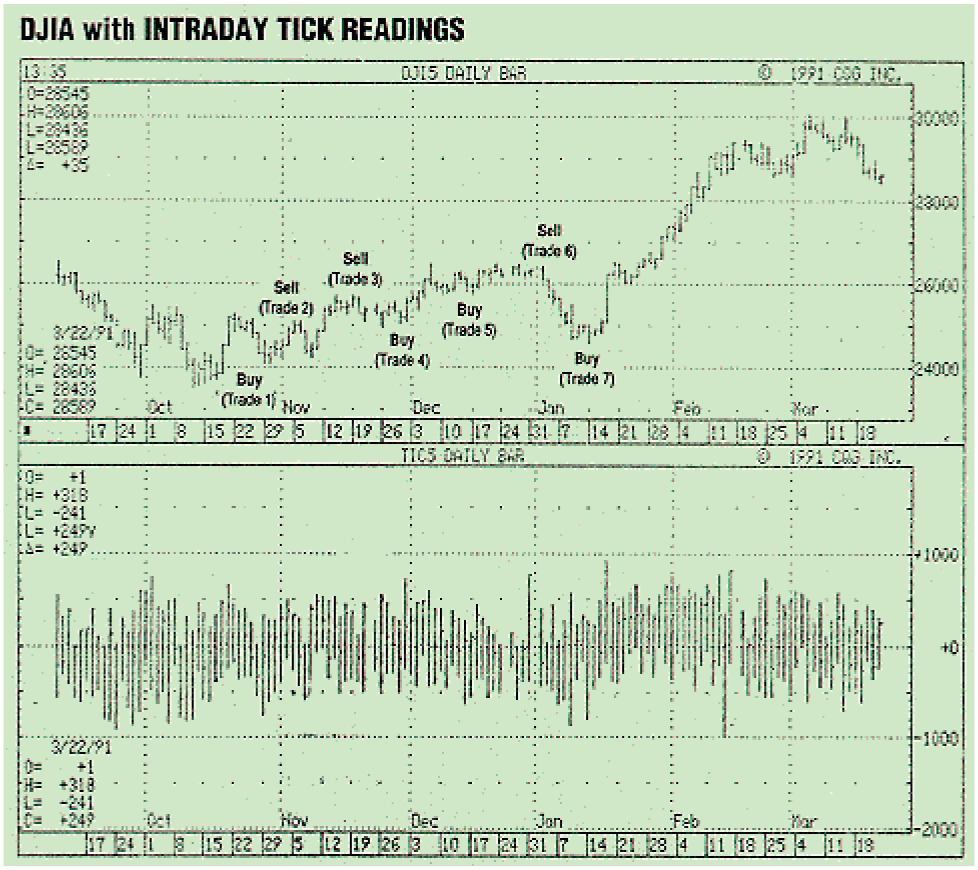

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