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Pivot Magic Trading

What are Pivot Points?
Why Should You Care?

Contents

Introduction

The second section in virtually every "Technical Analysis of the Markets" textbook (following the section on Trends) is a detailed discussion of Support and Resistance. (Next normally come sections examining such things as Patterns and Formations, and finally, Indicators.)

Often, metaphoric models are used to elaborate on various approaches to trading. Among them are, Gambling: "The Casino", Military: "The Battlefield", and Business: "Money Management". When introducing Support and Resistance (S/R), I like to use the Military model referring to S/R as the basic "topographical grid of the trading battlefield". Whole schools of trading are built around capitalizing on the edge of S/R topographical awareness. The battle tends to halt, ebb, and flow within this grid.

S/R studies take many forms. Among them:

- **Historical S/R**
  Past (historical) levels of S/R tend to reassert their influence on current price action. Hence, the oft repeated trading axiom, "Look left to trade right." Identifying and prioritizing Historical S/R is an art, which until mastered will turn your charts into a confusing mass of useless lines.

- **Price**
  It seems that people like round numbers. Whole dollar levels tend to become trading targets. Price action tends to pause to test them. Five dollar and ten dollar levels are even more vigorous levels of S/R.

- **Moving Average (MA)**
  Numerous trading systems are based on this indicator. I've seen the MA picturesquely described as a dynamic Pivot level.

- **Projected S/R Levels**
  Methods of calculating theoretical S/R abound. They come in many flavors: time, price, static, dynamic, incremental, ratio, etc. (For more on this subject CLICK here and follow the links appearing under "Features".)

Projected S/R Levels

Some calculations, like Fibonacci and Gann, yield amazingly accurate projections. Really, there is nothing magical about this (possibly excluding the more esoteric Gann work). Even if Fibonacci ratios weren't something found everywhere in creation, the very fact that everybody in the trading world is aware of them, and has expectations at .382, .50, and .618 levels, causes mob behavior to react at these levels. Sort of a self-fulfilling prophecy.

Pit Pivot Points are a sub-set of Support and Resistance (S/R). This special form of Projected (S/R) form the base trading methodology used by the locals (traders on the floor of the exchange).

The skeleton for defining expectations for today's trading is the Historical Support/Resistance, High, Low, and Close, of yesterday's day session. Crunching these prices in an embarrassingly simplistic, non-proprietary formula, floor traders project the most powerful anticipated Support/Resistance level for today's trading, called the fulcrum or "Pivot Point".

Again using simple formulae, based on yesterday's Historical S/R, floor traders next extrapolate how far the market is likely to move, up or down from the Pivot Point. The first projected/anticipated level of Resistance above the Pivot Point (fulcrum) is "R1". The next higher calculated Resistance levels are "R2" and "R3", respectively. Similarly, the first level of projected Support under the Pivot Point is "S1". The next lower levels of Support are "S2", and "S3", respectively.

During the upcoming trading session, unless the Price Action is influenced by non-quantifiable outside forces, such as economic reports or news, locals will trade up and down rather strictly between these calculated points.

Off-floor traders too can make use of this information. Obviously, knowing how these market-makers will be trading affords a substantial edge.

Pit Pivot Points Calculation

There exist several variations for calculating Pit Pivot Points. Below is the most commonly accepted set of formulae:

Pivot Point Fulcrum:

Pivot = (H + L + C)/3

Pit Pivot Resistance Points

R1 = (2 * Pivot) - L

R2 = (Pivot – S1) + R1

R3 = (Pivot – S1) + R2

Pit Pivot Support Points

S1 = (2 * Pivot) - H

S2 = Pivot - (R1 – S1)

S3 = Pivot – (R2 – S1)

Pivot Points in a Nutshell

Pivot Points are calculated Price Levels that the floor traders, and those who read the tape, like to watch during the trading session. In general, if the day's Price Action starts above the "Pivot", it will tend to stay above the Pivot (also called the "fulcrum" of the day's activity).

On such a day, Resistance will be met at Price Level R1. Should R1 be broken, further Resistance will be expected at R2. The story is all reversed, of course, if the price action is below the Pivot. Support will be met at Price Level S1. Should S1 be broken, further Support will be expected at S2.

If, after starting the day above the Pivot, the Price crosses back through the Pivot, the Pivot will act as a Resistance area. Pivot Points and Levels are Support and Resistance levels, and behave exactly like any historical Support and Resistance level.

That's Pivots in a nutshell !

From the above, it is quite obvious that Pivot Levels are quite useful as an index/tool, for both daytrading, and for selecting and exercising entries/exits for longer-term traders.

Pivot Points Exercise
Develop a Trading Methodology

To make the discussion a bit less abstract, let's take a most superficial look at some simple trading methodology employing Pivot Points.

Step A

In the previous section we presented the first General Rule of Pivot Points, "In general, if the day's Price Action starts above the Pivot, it will tend to stay above the Pivot.

This simple observation provides the basic rules for two of the simplest Pivot trading systems.

> **System 1:**
> Open is above Pivot: Buy
>
> Open is below Pivot: Sell
>
> **System 2:**
> Place Buy and Sell stops bracketing the Pivot. Whichever is not filled acts as safety stop for the other.

These "systems" are very much too raw for my tastes. Too much chance of getting whipsawed. Let's take it one step deeper. Let's refine these simple systems just a bit more:

Step B

First Fundamental Of Pivot Trading

After the opening range (first 30 min. to one hour), if price is above/below the Pivot, Price Action will strongly tend to remain above/below the Pivot for the session.
(Pivot Magic Trading Course)

Although this rule bids us to wait out the Opening Range and thus avoid much of the wildness and whipsawing, overlooking the next Fundamental Of Pivot Trading could be disastrous:

Step C

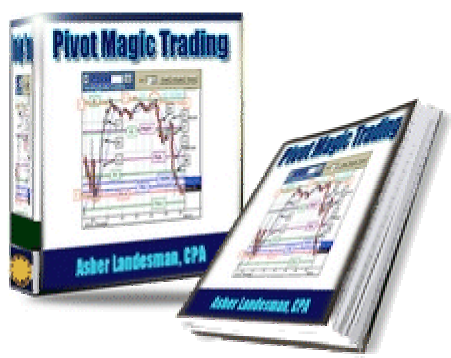
Second Fundamental Of Pivot Trading

If the market opens, or later trades at the extremes (R2, R3 or S2, S3), it will exhibit a tendency to trade back toward the Pivot. Thus, the general rule, 'Avoid buying the High or selling the Low', becomes increasingly more stringent as price moves farther from the Pivot. (Pivot Magic Trading Course)

Now our over-simplified system has started to define set limits, enabling us to both buy or sell, both above or below the Pivot. We have also very roughly begun to define the basis for determining entry, exit, and safety stop rules.

Step D

The methods that these few additions suggest are still a long way from satisfactorily refined for me! (The Pivot Magic Trading Reading the Tape approach requires a high percentage of profitable trades, and insists on much more secure risk-conservation and money management.) Nonetheless, there are those that actually do successfully trade Pivot Points utilizing just these few simple rules.



CLICK for more about Pivot Point Trading and Reading the Tape