WILEY Trading

THE QUARTERS THEORY

THE REVOLUTIONARY NEW FOREIGN CURRENCIES TRADING METHOD

ILIAN YOTOV

FX Strategist and Host, *All Things Forex* Daily Broadcast

The Quarters Theory

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The Revolutionary New Foreign Currencies Trading Method

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To my wife and family

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Preface

Do you believe that everything happens for a reason? I haven't always been a strong proponent of this theory, but looking back at certain events in my life has made me a believer.

I was introduced to the "forbidden" world of foreign currency exchange in communist Bulgaria at the tender age of eight, when in 1979 my father was arrested by the communist militia because of his involvement in a black market currency exchange. My family was told that my father owned and dealt with those "evil" U.S. dollars, British pounds, German marks, and other foreign currencies that the "capitalist pigs" use to buy their "rotten" goods and services "produced with the blood, sweat, and tears of the proletariat." It was a true baptism by fire. To prove that the apple doesn't fall far from the tree, as a high school and a college student, I made money soliciting currency exchange from foreign tourists and foreign exchange students, and exchanged currencies on Magura Street (communist Bulgaria's black market version of Wall Street). Is it any wonder that I turned out to be a currency trader?

My life's experiences have taught and continue to teach me some valuable lessons that I apply in my trading. But as a trader, I will admit that nothing educates and disciplines better than the most devastating loss that a trader can ever experience in his or her career. I'm not talking about the periods when you hit the wall after you've been on a roll and are feeling invincible. One can learn to get over those fairly quickly. What I'm referring to is the *big one*, the tsunami that shatters many months of hard work and consistent profits with a violent blow that lasts only a few minutes.

My big one was planned to be exactly that—*big*. However, it was supposed to be a *winning* big one. This was to be the one that takes a trader into the stratosphere of trading greatness, delivering a life-changing 1000+% return. So, as Jesse Livermore would have said, I "took the plunge." I'd had a great sequence of several big winning months before and I felt that I was bulletproof—exactly the right mixture of self-confidence and arrogance that was enough to blur the lines between a trade and a gamble, and to make me throw almost my entire account at this trade. All went

out of the U.S. dollar and all went in Euros and Swiss francs as soon as Colin Powell made the case for the war in Iraq to the United Nations. My conceited mind was so certain about the success of this trade—after all, it's been historically proven over the past 200 years that when the United States goes to war, the U.S. dollar goes down. My ego had blindsided me so much that I didn't even bother placing any stops to protect myself. After all, why would I need any protection if I was invincible?

You've probably already figured out how this story ends. The tsunami of hundreds of PIPs against me right after the war announcement was enough to make me spend the rest of the day picking up the pieces of what was left of my trading account and licking the wounds of my traumatized trader's psyche. It was a devastating experience, but I am grateful that it happened to me, because in the days and months of soul searching that followed, I became a born-again trader with a revived mindset and a completely new trading method.

This is how *The Quarters Theory* was born. It was a result of my rigorous process of recovery from the turmoil that I had inflicted on my trading account and on myself. Whether I wanted it or not, I was taken back to Square One. From that point, there was no other way to go but back to the basics, rebuilding from the ground up. And what better way to get back to the basics than focusing on the most basic unit of information for every trader—the price? I had to get away from the clutter of charts and technical indicators, and be absent from the never-ending hunt for volatility and the scalping stampedes during news events.

The Quarters Theory was my solution to the need I had for that extra edge through an unprecedented, innovative methodology based on a fresh new approach and a deeper perception of price behavior in the daily fluctuations of currency exchange rates. I discovered during my period of trader revelation how to distinguish myself from the herd. I have strived for and I have found a simple, yet effective, unique, yet not abstract method that serves as a reliable compass to navigate me through the high waters of market volatility and uncertainty. With The Quarters Theory, I have created an orderly, familiar, systematic, predictable environment and trading methodology that allows traders to break free from the dogma of chaos and the perceptions of market randomness.

I first introduced The Quarters Theory to a large audience of traders in 2005 when I was invited as one of the FX strategists of a new startup financial network called Traders Television. In the following months, I was also asked to host the advanced Forex training program of "Trader Talk Live," an Internet broadcast focused on trader education. I knew from personal experience that The Quarters Theory is immensely helpful, but I will admit that even in my wildest dreams I did not expect the type of overwhelming response that I received when I started sharing my method with other

currency traders. My audience grew, the word of mouth was spreading, and it was only a few short months before the unsolicited testimonials from traders, whose trading results had improved dramatically as a result of my teachings, began filling my e-mail box. It was official: The Quarters Theory was helping and I was humbled and happy to be able to make a difference for thousands of traders.

In recent years, interest in The Quarters Theory has continued to grow as a result of my appearances as a speaker at educational seminars and webinars, through my weekly publications and columns on popular financial websites, as well as through my daily "All Things Forex" broadcast and my website www.allthingsforex.com.

I hope that you will enjoy what you are about to discover in this book and that you find *The Quarters Theory* to be a meaningful and substantial way to improve your methods of trading currencies on the Forex market and to experience consistently better trading results.

Ilian Yotov

An Inside Look at an Innovative Forex Trading Method

The Quarters Theory improves and simplifies the decision-making process in foreign exchange trading through the use of a revolutionary new methodology applied to the price behavior of currency exchange rates and trend developments in the Forex market. This book provides currency traders with a step-by-step guide to the unique premise of The Quarters Theory and offers many real-life market examples, variations, and innovative Forex trading strategies. Ilian Yotov, a longtime Forex strategist, delivers a new, reliable compass to help you navigate through the complexities of the daily fluctuations in the prices of currencies. He shows unique ways leading to consistently better trading decisions and helps maximize your trading results.

The Quarters Theory

- Introduces a fresh new approach to foreign currency trading
- Offers innovative trading techniques that combine the methodology of The Quarters Theory with fundamental and technical analysis
- Provides proprietary Forex strategies that investors and traders of all proficiency levels can use to reap significant returns

With *The Quarters Theory* as your guide, you will quickly gain that extra edge that will help you to make more profitable decisions in your Forex trading activities.

Acknowledgments

A special thank-you to my wife and my mother, two astonishing women, for their unconditional love, inspiration, and support in everything I do; to my father for introducing me to the world of foreign currency exchange and for planting in me at a young age the seeds of entrepreneurship; to my brother for his technological wizardry and for always being there for me.

I would also like to thank the Forex trading community and all the good folks at Wiley Trading for their assistance and for embracing The Quarters Theory.

CHAPTER 1

The Foundation of The Quarters Theory

Price is the most basic and most important unit of information available to a trader. Price represents the monetary value assigned to goods, services, and assets. In the financial markets, price is the numerical monetary value of equities, commodities, currencies, and other financial assets, determined as a result of an exchange or trade transaction between market participants. Price is measured by numbers grouped as mathematical objects in a numeral system.

Most countries in the world, with the exception of two, Mauritania and Madagascar, use the decimal numeral system. The decimal system is a *positional* numeral system; it has positions for units, tens, hundreds, and so forth. The reason for the choice of *ten* as the unit is assumed to be because humans have ten fingers (digits). In many languages the word *digit* or its translation is also the anatomical term referring to fingers and toes. In English, *decimal* (Lat. *decimus*) means "tenth," *decimate* means "reduce by a tenth," and *denary* (Lat. *denarius*) means the "unit of ten."

The writing of numbers in the base-ten numeral system is known as *decimal notation* and uses various symbols, called *digits*, for ten distinct values 0, 1, 2, 3, 4, 5, 6, 7, 8 and 9 to represent numbers. The most universally used numbers are the whole numbers as part of the real numbers. The real numbers include:

Whole numbers (0, 1, 2, 3, . . .)
Natural (counting) numbers (1, 2, 3, . . .)
Integers (. . . , –2, –1, 0, 1, 2, . . .)
Rational numbers (any integer divided by any non-zero integer)
Irrational numbers (any real number that is not rational)

TABLE 1.1 Table of Whole Numbers

•	0	1	2	3	4	5	6	7	8	9
•	10	11	12	13	14	15	16	17	18	19
•	20	21	22	23	24	25	26	27	28	29
•	30	31	32	33	34	35	36	37	38	39
•	40	41	42	43	44	45	46	47	48	49
•	50	51	52	53	54	55	56	57	58	59
•	60	61	62	63	64	65	66	67	68	69
•	70	71	72	73	74	75	76	77	78	79
•	80	81	82	83	84	85	86	87	88	89
•	90...									
	100...									

Every counting number is also a whole number; every whole number is also an integer; and every integer is also a rational number. The whole numbers include the number 0 and all of the counting numbers. Because the decimal system is a base-ten numeral system, a value of 10 in one position is equal to a value of 1 in the position to the left. For example, ten ones equal one ten, ten tens equal 100, ten 100s equal 1000, and so forth. Let us glance through the table of whole numbers in Table 1.1.

Have you noticed the first number in each row? The number 10 is the base and we know that the first number in each row of this table (except for the number 0) can be represented as a set of ten. The first number in each row of the table of whole numbers represents a critical junction that marks the end of a previous set and, at the same time, the beginning of a new set of ten numbers. For example, the number 10 marks the end of the set of ten single digits and the beginning of a new set of ten double-digit numbers known as the *teens*; the number 20 marks the end of the teens set and the beginning of the *twenties*; and so forth. Because of their significance, The Quarters Theory gives the name *Major Whole Numbers* to the first numbers in each row of the table of whole numbers.

Currency exchange rates are determined by comparing the numerical monetary value of one currency against another measured in whole numbers. Currencies are grouped in pairs: EUR/USD, USD/JPY, GBP/USD, and so forth. The first listed currency of a currency pair is the *base currency*, or the unit that is compared to the second *quote currency* used to assess the value of the base currency. The precision needed to represent currency exchange rates requires the use of decimal whole numbers. These digits have a decimal point that indicates the start of a fractional part (1.1, 1.2, 1.3, etc.). Digits are placed to the left and right of a decimal point in order to indicate a number less than or greater than 1. For example, an exchange rate of $1.35 for the EUR against the USD (EUR/USD) indicates that the

value of one Euro unit is greater than one U.S. dollar. On the other hand, an exchange rate of $0.70 for the Australian dollar against the U.S. dollar (AUD/USD) shows that the value of one Australian dollar unit is less than one U.S. dollar.

The Major Whole Numbers can be easily distinguished in currency exchange rates even with the decimal point numeral representation. The Quarters Theory considers the parity level of *one-for-one* exchange rate as the *benchmark* Major Whole Number in currency exchange rates. The Major Whole Number 1.0000 represents the par value between two currencies. For example, an exchange rate of exactly $1.0000 for the EUR/USD pair indicates a parity value of $1 for one Euro. If the EUR increases in value by ten cents against the USD, the EUR/USD exchange rate will exceed the par level and will reach another Major Whole Number at $1.1000. Additional 10-cent increase above $1.1000 will see the EUR/USD exchange rate reaching another Major Whole Number at $1.2000. Every one of the Major Whole Numbers in currency exchange rates represents a critical junction that marks the end of a previous set and, at the same time, the beginning of a new set of ten numbers. For example, if the EUR/USD pair's exchange rate reaches $1.2000, the Major Whole Number 1.2000 would mark the end of the set of ten numbers: 1.10, 1.11, 1.12 . . . 1.19 (or the *dollar teens*) and the beginning of a new set of ten numbers: 1.20, 1.21, 1.22 . . . 1.29 (or the *dollar twenties*).

Currency decimalization has caused traditional denominations of currencies to be converted to the decimal system. Through the process of currency decimalization, one unit of the main currency is usually divided into 100 subunits. For example, 1 dollar and 1 Euro are divided into 100 cents, 1 pound into 100 pence, 1 franc into 100 centimes, and so forth. For even more precision, currency exchange rates are decimalized even further by dividing the subunits (1 cent, 1 penny, 1 centime) or the main unit of some currencies (e.g. 1 yen) into 100 additional subunits, called *Price Interest Points (PIPs)*. A PIP is the smallest unit of price for any foreign currency (e.g., for EUR/USD one PIP—Price Interest Point—equals .0001 U.S. dollar). Whether the subunit is 1 cent, 1 penny, 1 centime, or 1 yen, each has 100 PIPs; 10 cents, 10 pence, 10 centime, or 10 yen have 1000 PIPs; 1 dollar, 1 Euro, 1 pound, 1 franc, or 100 yen have 10,000 PIPs, and so forth.

The Quarters Theory recognizes that when represented in terms of PIPs, the distance of 10 cents, 10 pence, 10 centimes, 10 yen, and so on between each two Major Whole Numbers establishes well-defined ranges of exactly 1000 PIPs. Each one of these 1000 *PIP Ranges* between two Major Whole Numbers has 9 other whole numbers. Increments of 1 unit (1 cent, 1 penny, 1 centime, 1 yen, etc.) equal to 100 PIPs separate each two whole numbers. The distance between two whole numbers defines a smaller range of exactly 100 PIPs.

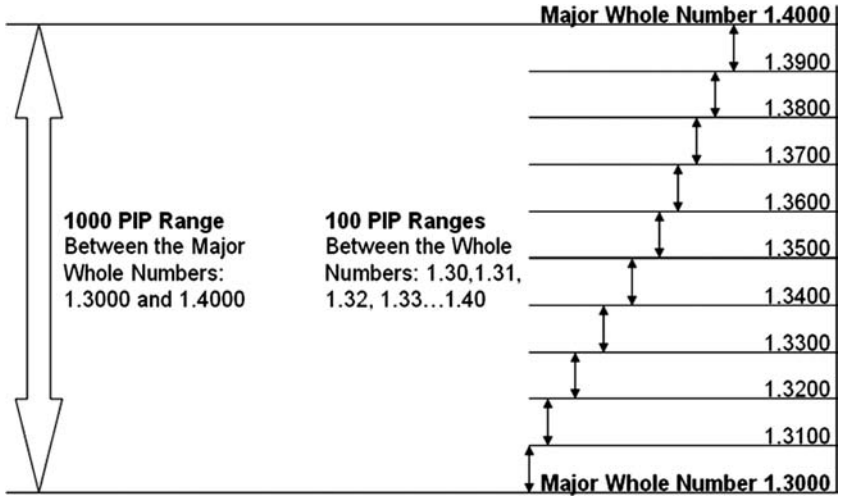

FIGURE 1.1 1000 PIP Range between the Major Whole Numbers 1.3000 and 1.4000

Consider the illustration in Figure 1.1 showing the 1000 PIP Range between the Major Whole Numbers 1.3000 and 1.4000. The Major Whole Number 1.3000 represents a critical junction that marks the end of a previous 1000 PIP Range between the major Whole Numbers 1.2000 and 1.3000 and, at the same time, the beginning of the 1000 PIP Range between 1.3000 and 1.4000. The Major Whole Number 1.4000 marks the end of the 1000 PIP Range between 1.3000 and 1.4000 and, at the same time, the beginning of another 1000 PIP Range between 1.4000 and 1.5000. Within the Major Whole Numbers 1.3000 and 1.4000, there are 9 other whole numbers: 1.31, 1.32, 1.33, 1.34, 1.35, 1.36, 1.37, 1.38 and 1.39. The distance between each one of the whole numbers 1.3000 and 1.3100, 1.3100 and 1.3200 . . . , 1.3900 and 1.4000 marks ten smaller ranges of 100 PIPs each within the large 1000 PIP Range between the Major Whole Numbers 1.3000 and 1.4000.

THE QUARTERS

A *quarter* is one of four equal parts of something. It can be one-fourth of an hour, one-fourth of a kilo or a pound, or with money, it is the U.S. or the Canadian coin equal to one-fourth of a dollar.

The Quarters Theory focuses on the 1000 PIP Ranges between the Major Whole Numbers in currency exchange rates and divides these ranges into four equal parts, called *Large Quarters*. Each 1000 PIP Range contains

four Large Quarters and each Large Quarter has exactly 250 PIPs (1000 PIP Range/4 = 250 PIPs). The numbers that mark the beginning and the end of each Large Quarter are given the name *Large Quarter Points*. The Large Quarter Points that coincide with Major Whole Numbers are also called *Major Large Quarter Points*, because they represent critical junctions that signal the end of a previous and, at the same time, the beginning of a new 1000 PIP Range. The exact half point of each 1000 PIP Range coincides with a Large Quarter Point and is also called the *Major Half Point* of the 1000 PIP Range.

The illustration in Figure 1.2 shows the 1000 PIP Range between the Major Whole Numbers 1.3000 and 1.4000 divided into four equal parts or four Large Quarters of 250 PIPs. The four Large Quarters are marked by the Large Quarter Points: 1.3000 and 1.3250, 1.3250 and 1.3500, 1.3500 and 1.3750, 1.3750 and 1.4000. Note that the Major Large Quarter Points are also the Major Whole Numbers 1.3000 and 1.4000 that define the 1000 PIP Range. The exact half point of the 1000 PIP Range between 1.3000 and 1.4000 is the Large Quarter Point 1.3500 (LQP 1.3500), which is also the Major Half Point of the 1000 PIP Range between 1.3000 and 1.4000.

The 100 PIP Ranges between two whole numbers in currency exchange rates are also divided by The Quarters Theory into four equal parts called *Small Quarters*. Each 100 PIP Range contains four Small Quarters and each Small Quarter has exactly 25 PIPs (100 PIP Range/4 = 25 PIPs). The numbers that mark the beginning and the end of each Small Quarter are

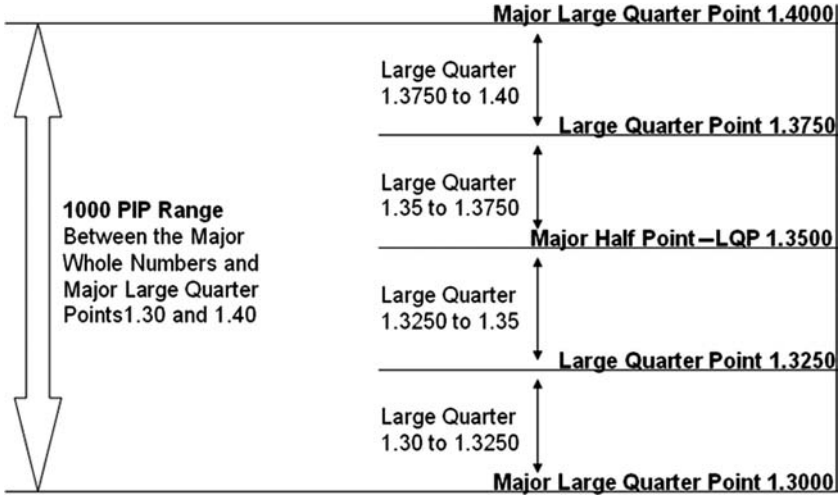

FIGURE 1.2 1000 PIP Range between the Major Whole Numbers 1.3000 and 1.4000 Divided into Four Equal Parts or Four Large Quarters of 250 PIPs

given the name *Small Quarter Points*. The Small Quarter Points that coincide with Whole Numbers are also called *Major Small Quarter Points*, because they represent critical junctions that signal the end of a previous and, at the same time, the beginning of a new 100 PIP Range. The exact middle point of each 100 PIP Range coincides with a Small Quarter Point and is also called the *Half Point* of the 100 PIP Range.

Figure 1.3 shows the 100 PIP Range between the Whole Numbers 1.3000 and 1.3100. The 100 PIP Range is divided into four equal parts or four Small Quarters of 25 PIPs. The four Small Quarters are marked by the Small Quarter Points: 1.3000 and 1.3025, 1.3025 and 1.3050, 1.3050 and 1.3075, 1.3075 and 1.3100. Note that the Major Small Quarter Points are also the Whole Numbers 1.3000 and 1.3100 that define the 100 PIP Range. The exact middle point of the 100 PIP Range between 1.3000 and 1.3100 is the Small Quarter Point 1.3050, which is also the Half Point of the 100 PIP Range between 1.3000 and 1.3100.

Two of the Large Quarter Points in each 1000 PIP Range always coincide with the Half Point of a 100 PIP Range. The two Large Quarter Points in each 1000 PIP Range that are also Half Points of a 100 PIP Range are the Large Quarter Point positioned 250 PIPs above a Major Large Quarter Point and the Large Quarter Point 250 PIPs below a Major Large Quarter Point. For example, within the 1000 PIP Range between the Major Large Quarter Points 1.3000 and 1.4000, the Large Quarter Point 1.3250, which is 250 PIPs above the Major Large Quarter Point 1.3000, is also the Half Point of the 100 PIP Range between the whole numbers 1.3200 and 1.3300. Within the

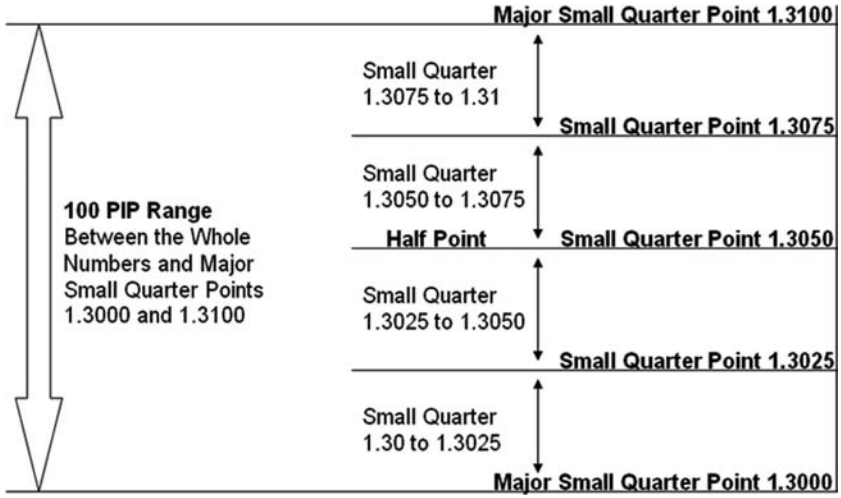

FIGURE 1.3 100 PIP Range between the Whole Numbers 1.3000 and 1.3100

same 1000 PIP Range, the Large Quarter Point 1.3750, which is 250 PIPs below the Major Large Quarter Point 1.4000, is also the Half Point of the 100 PIP Range between the whole numbers 1.3700 and 1.3800.

The Large Quarters within the 1000 PIP Ranges and the Small Quarters within the 100 PIP Ranges may be represented by different digits measuring the exchange rates in a variety of currency pairs, but the price ranges remain constant. The range between two Large Quarter Points is always exactly 250 PIPs, and the range between two Major Large Quarter Points (Major Whole Numbers) is always exactly 1000 PIPs. The same is true for the 100 PIP Ranges and the Small Quarters: The range between two Small Quarter Points is always exactly 25 PIPs and the range between two Major Small Quarter Points (Whole Numbers) is always exactly 100 PIPs, no matter which currency pair and no matter what digits represent the currency exchange rate.

For example, an exchange rate between the EUR/USD may show a 1000 PIP Range between the Major Large Quarter Points 1.3000 and 1.4000 with four Large Quarters of 250 PIPs each between the Large Quarter Points: 1.3000 and 1.3250, 1.3250 and 1.3500, 1.3500 and 1.3750, 1.3750 and 1.4000. On the other hand, the USD/JPY pair may have its exchange rate within the 1000 PIP Range between the Major Large Quarter Points 100.00 and 110.00 yen, with four Large Quarters of 250 PIPs each between the Large Quarter Points 100.00 and 102.50, 102.50 and 105.00, 105.00 and 107.50, and 107.50 and 110.00. Obviously, the Major Whole Numbers and the Large Quarter Points in the exchange rates of these two currency pairs have different digits and numeral representation. However, whether a 1000 PIP Range is between the Major Large Quarter Points 100.00 and 110.00, or the Major Large Quarter Points 1.3000 and 1.4000, the range between two Major Large Quarter Points (Major Whole Numbers) always remains a range of exactly 1000 PIPs. Whether a Large Quarter is between the Large Quarter Points 1.3500 and 1.3750, or between the Large Quarter Points 105.00 to 107.50, the range of each Large Quarter remains the same and is always exactly a range of 250 PIPs.

The Quarters Theory offers universal, constant, and familiar price ranges that allow quick and precise price analysis of any currency pair. The Quarters Theory provides traders with the ability to locate in a matter of seconds the exact 1000 PIP Range, the exact Large Quarter of 250 PIPs, and, with even further precision, the exact 100 PIP Range and the exact Small Quarter of 25 PIPs where the current exchange rate is positioned.

The following is an example of a price analysis of the exchange rates of three currency pairs using the methodology of The Quarters Theory. Table 1.2 shows the currency pairs EUR/USD, USD/JPY, and AUD/USD at specific price levels. The exact positioning of the exchange rate of each one of the currency pairs can be located within the universal, constant price

TABLE 1.2 Price Analysis of Three Currency Pairs Using the Methodology of The Quarters Theory

Currency Pair Exchange Rate	1000 PIP Range	Large Quarter	100 PIP Range	Small Quarter
EUR/USD At 1.2345	1.2000 and 1.3000	1.2250 and 1.2500	1.2300 and 1.2400	1.2325 and 1.2350
USD/JPY At 96.78	90.00 and 100.00	95.00 and 97.50	96.00 and 97.00	96.75 and 97.00
AUD/USD At 0.7134	0.7000 and 0.8000	0.7000 and 0.7250	0.7100 and 0.7200	0.7125 and 0.7150

ranges provided by The Quarters Theory, starting with the exact 1000 PIP Range, the exact Large Quarter of 250 PIPs, and zooming in with even more precision to the exact 100 PIP Range and to the exact Small Quarter of 25 PIPs.

THE PREMISE OF THE QUARTERS THEORY

The Quarters Theory is based on the premise that the daily fluctuations of currency exchange rates are not random and that currency exchange rates fluctuate in an orderly manner between the Large Quarter Points within each 1000 PIP Range defined by two Major Whole Numbers (Major Large Quarter Points). The Quarters Theory proposes that every significant price move in currency exchange rates takes place from one Large Quarter Point to another, in gradual increments of 250 PIPs, the range between two Large Quarter Points.

The Quarters Theory challenges the notion that the financial markets are chaotic and that market prices are random. With its clearly defined, constant price ranges of 250 PIPs and orderly price moves from one Large Quarter Point to the next, The Quarters Theory organizes the daily fluctuations of currency exchange rates in a systematic arrangement. The Quarters Theory provides the roadmap—the 1000 PIP Ranges divided in four equal parts or four Large Quarters of 250 PIPs each—and establishes the route with a distinct starting point and a clear destination—every significant price move begins at a Large Quarter Point and ends at a Large Quarter Point.

The Large Quarter Points serve as constant support/resistance levels, as well as familiar, invariable price targets. A bullish price breakout above a Large Quarter Point is expected to target the Large Quarter Point

above, and a bearish breakout below a Large Quarter Point is likely to challenge the Large Quarter Point below. When a targeted Large Quarter Point is reached, the Large Quarter is considered to be completed. If prices fail to complete a Large Quarter, the unsuccessful completion of a Large Quarter usually causes a reversal that takes prices back toward the preceding Large Quarter Point. The outcome of both events always leads to a price move that targets a familiar level—a Large Quarter Point. The repetitions of the series of Large Quarter completions from one Large Quarter point to the next, or reversals back toward a preceding Large Quarter Point as a result of unsuccessful completions, regularly manifest themselves as recognizable price patterns in the daily fluctuations of currency exchange rates.

Let us try to recognize these price patterns by following the daily fluctuations of the USD/JPY currency pair's exchange rate in the months of February, March, and April 2009 (see Figure 1.4). The Quarters Theory provides the roadmap, which in this real-life example is the 1000 PIP Range between the Major Whole Numbers (Major Large Quarter Points) 90.00 and 100.00 yen, divided into four Large Quarters of 250 PIPs between the Large Quarter Points: 90.00 and 92.50, 92.50 and 95.00, 95.00 and 97.50, 97.50 and 100.00. Note that on the left-hand side of the chart, in the beginning of

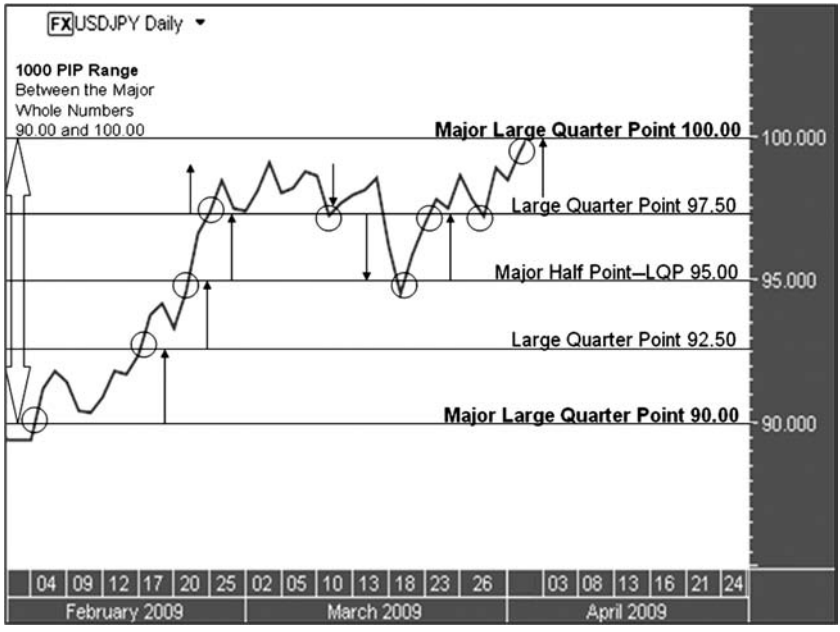

FIGURE 1.4 Large Quarter Price Pattern Repetitions

February 2009, the USD/JPY pair's exchange rate produces a bullish breakout above the Major Large Quarter Point at 90.00 yen, enters the 1000 PIP Range between 90.00 and 100.00, and begins to work on the Large Quarter between the Major Large Quarter Point 90.00 and the Large Quarter Point 92.50. The first attempt does not successfully complete the Large Quarter and prices reverse back toward the preceding Major Large Quarter Point 90.00, but after finding support above the Major Large Quarter Point 90.00, by mid-February, the USD/JPY pair manages to complete the Large Quarter 90.00 to 92.50 by reaching the Large Quarter Point 92.50.

In the following days, the pair produces a bullish breakout above the Large Quarter Point 92.50 and begins to work on the Large Quarter above 92.50, potentially targeting the Large Quarter Point 95.00, which is also the Major Half Point of the 1000 PIP Range between 90.00 and 100.00 yen. By the end of February, the USD/JPY pair successfully completes the Large Quarter 92.50 to 95.00, produces a bullish breakout above the Large Quarter Point 95.00 and begins to work on another Large Quarter above 95.00, potentially targeting the Large Quarter Point 97.50. The pair manages to complete the Large Quarter 95.00 to 97.50 without any hesitation or price pullbacks toward the preceding Large Quarter Point, and even makes an attempt to work on the Large Quarter 97.50 to 100.00 by producing a bullish breakout above the Large Quarter Point 97.50.

After several unsuccessful attempts to complete the Large Quarter 97.50 to 100.00, followed by reversals back toward the preceding Large Quarter Point 97.50, the USD/JPY pair breaks below the Large Quarter Point 97.50 and completes the Large Quarter 97.50 to 95.00 toward the Major Half Point of the 1000 PIP Range between the Major Large Quarter Points 90.00 and 100.00. The pair then fails to produce a decisive bearish breakout below the Large Quarter Point (Major Half Point) 95.00, finds support at the Large Quarter Point 95.00, and successfully completes the Large Quarter 95.00 to 97.50. A bullish breakout above the Large Quarter Point 97.50 sees the USD/JPY pair once again working on the Large Quarter above 97.50, potentially targeting the Major Large Quarter Point 100.00. After a couple of unsuccessful attempts followed by reversals back toward the preceding Large Quarter Point 97.50, the pair finds support at the Large Quarter Point 97.50 and finally manages to successfully complete the Large Quarter 97.50 to 100.00 by reaching the Major Large Quarter Point 100.00 in the beginning of April 2009. In this example, the series of price moves (Large Quarter completions and reversals back toward a preceding Large Quarter Point as a result of unsuccessful completions) between the Large Quarter Points within the 1000 PIP Range defined by the Major Whole Numbers (Major Large Quarter Points) 90.00 and 100.00 regularly manifest themselves as recognizable price patterns in the daily fluctuations of the USD/JPY pair's exchange rate.

The Quarters Theory divides each Large Quarter of 250 PIPs into ten equal parts or ten Small Quarters of 25 PIPs. The Quarters Theory proposes that currency exchange rates fluctuate in an organized manner not only between the Large Quarter Points of each 1000 PIP range, but also between the Small Quarter Points of each 100 PIP Range marked by two Whole Numbers positioned within each Large Quarter. Currency exchange rates fluctuate in orderly series of price moves from one Small Quarter Point to the next, measured in increments of 25 PIPs, in a systematic effort to complete an entire Large Quarter of 250 PIPs.

Since some Small Quarter Points are also Large Quarter Points and every significant price move takes place from one Large Quarter Point to the next, every sequence of Small Quarter price moves always begins from a Small Quarter Point which coincides with a Large Quarter Point and always ends at a Small Quarter Point which is also a Large Quarter Point. A successful completion of ten consecutive Small Quarters of 25 PIPs each would lead to the successful completion of an entire Large Quarter of 250 PIPs, but in most instances all ten Small Quarters are not likely to be completed at once without going through periods of price corrections and consolidations. Because of the importance of the Whole Numbers as critical junctions that mark the beginning and the end of each 100 PIP Range within the Large Quarters, small price corrections and consolidations may be expected in the vicinity of each Whole Number, which is also a Major Small Quarter Point, especially after a series of four Small Quarter price moves completes a 100 PIP Range between two Whole Numbers/Major Small Quarter Points. The ultimate goal of each series of Small Quarter price moves is to complete an entire Large Quarter of 250 PIPs. Any failure to do so usually causes reversals that take prices back toward the preceding Large Quarter Point.

The real-life example in Figure 1.5 shows the series of Small Quarter price moves completing the Large Quarter from the Large Quarter Point 1.1750 to the Large Quarter Point 1.1500 in the exchange rate of the USD/CAD currency pair. The Large Quarter range of 250 PIPs is divided into ten equal parts or ten Small Quarters of 25 PIPs. The sequence of downward Small Quarter price moves begins from the area of the Small Quarter Point 1.1750, which coincides with the Large Quarter Point 1.1750. Note that all ten Small Quarters are not completed at once and that there are periods of price pullbacks and consolidations, especially in the vicinity of the Whole Numbers/Major Small Quarter Points 1.1700 and 1.1600, which are important junctions marking the beginning and the end of the 100 PIP Ranges between the Whole Numbers/Major Small Quarter Points 1.1700 and 1.1600. The series of downward Small Quarter price moves resumes after each pullback and consolidation, leading to the successful completion of the Large Quarter 1.1750 to 1.1500.

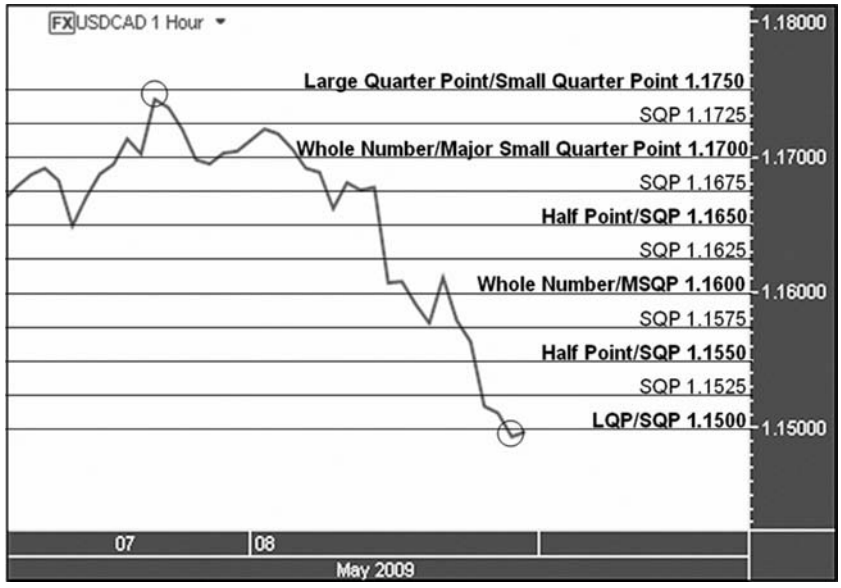

FIGURE 1.5 Small Quarter Price Moves Completing a Large Quarter Example

COMPLETION OF THE LARGE QUARTERS

How often have you seen the exact number of a Large Quarter Point being registered as a high, low, open, or close price? You probably have not often seen this because price volatility has the tendency to *conceal* the Large Quarter Points, making them difficult to recognize. Although in some cases price moves can stop when a Large Quarter Point is reached exactly up to the PIP, in most instances, prices either surpass the exact number of a Large Quarter Point by a few PIPs or stay a few PIPs short of reaching it. In periods of high volume and volatility, prices may move beyond the exact number of a Large Quarter Point, producing an *overshoot* above the Large Quarter Point, while in periods of low volatility and volume, prices may *undershoot* a Large Quarter Point, coming a few PIPs short of the exact number of a Large Quarter Point. These overshoots and undershoots disguise the Large Quarter Points under a veil of random numbers, creating the perception of chaos and lack of purpose and organization in price fluctuations.

The Quarters Theory designates the range of one Small Quarter of 25 PIPs above a Large Quarter Point as the *Overshoot Area* and the range of one Small Quarter of 25 PIPs below a Large Quarter Point as the *Undershoot Area*. Any bullish price move that surpasses a Large Quarter Point by up to 25 PIPs and stays within the range of the Overshoot Area is considered to be a *Bullish Overshoot* above the Large Quarter Point. A

bearish price move that surpasses up to 25 PIPs below a Large Quarter Point and stays within the range of the Overshoot Area is considered a *Bearish Overshoot* below the Large Quarter Point. Price moves that reach the Undershoot Area of one Small Quarter of 25 PIPs from a Large Quarter Point but come short of hitting the exact number of a Large Quarter Point are considered undershoots.

Figure 1.6 is an example of an Undershoot and a Bearish Overshoot. Note that in the beginning of the chart there is a bullish price move toward the Large Quarter Point 1.1750. Prices enter the Undershoot Area within 25 PIPs or one Small Quarter 1.1725 to 1.1750 from the Large Quarter Point 1.1750; however, they fail to reach the exact number of the Large Quarter Point and stay a few PIPs short of it, producing an Undershoot. The Undershoot is followed by a strong bearish move that sees prices falling toward the Large Quarter Point 1.1500 in an attempt to complete the Large Quarter 1.1750 to 1.1500. The strong bearish price move overshoots a few PIPs below the Large Quarter Point 1.1500 and enters the Overshoot Area of one Small Quarter of 25 PIPs (1.1500 to 1.1475) producing a Bearish Overshoot below the Large Quarter Point 1.1500.

Overshoots and undershoots occur not only around the Large Quarter Points but also when price moves target whole numbers or important support/resistance levels in an attempt to produce breakouts. The Quarters Theory requires a price move larger than one Small Quarter of 25 PIPs above (or below for bearish moves) an important price level in order to

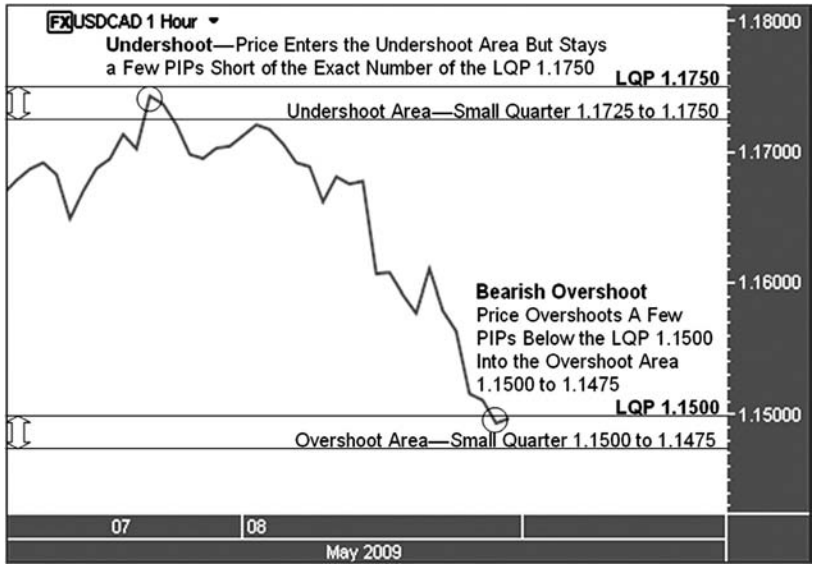

FIGURE 1.6 An Undershoot and a Bearish Overshoot

qualify a move as a decisive breakout. Price moves of 25 PIPs or less above (or below for bearish moves) a Large Quarter Point, a Whole Number, or a support/resistance level should be identified as overshoots. Proper recognition of overshoots is crucial when trying to spot and avoid fake breakouts, which will be discussed in the chapter on technical analysis.

By defining the characteristics of overshoots and undershoots, The Quarters Theory eliminates the noise and confusion caused by random numbers around each Large Quarter Point. Because of the frequent developments of overshoots and undershoots, The Quarters Theory does not require prices to hit each Large Quarter Point exactly up to the PIP when considering the completion of a Large Quarter. As long as there is a number registered as a high, low, open, or close price within one Small Quarter of 25 PIPs above or below a Large Quarter Point, The Quarters Theory would consider a Large Quarter to be successfully completed. The same rule applies for reversals that take prices back toward a preceding Large Quarter Point—as long as a high, low, open, or close price number is registered within one Small Quarter of 25 PIPs above or below a Large Quarter Point, a reversal toward a preceding Large Quarter Point is considered to be completed.

The example in Figure 1.7 shows the EUR/USD pair's exchange rate moving higher in an attempt to complete the Large Quarter 1.3250 to 1.3500. Despite the strong move, prices stay below the Large Quarter Point 1.3500

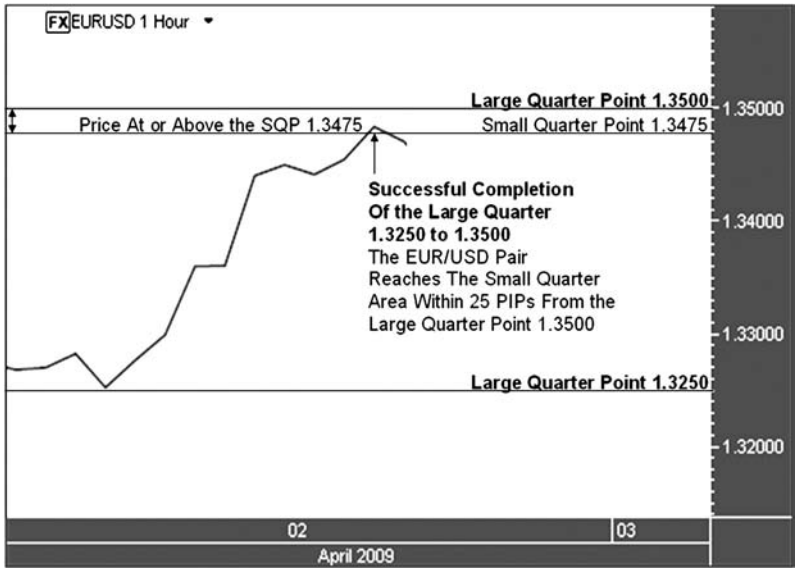

FIGURE 1.7 Successful Large Quarter Completion Example

but manage to enter the Undershoot Area of the Small Quarter 1.3475 to 1.3500. As soon as a number within 25 PIPs from the Large Quarter Point 1.3500 is registered, the bullish price move from the Large Quarter Point 1.3250 to the targeted Large Quarter Point 1.3500 successfully completes the Large Quarter 1.3250 to 1.3500.

Any price moves that reach the Undershoot Area within 25 PIPs from a Large Quarter Point would be close enough to produce a successful completion of a Large Quarter. However, if prices come short of a Large Quarter Point by more than 25 PIPs, the Large Quarter will not be considered complete. Shortcomings larger than 25 PIPs from a Large Quarter Point should be recognized as a warning sign of an unsuccessful completion of a Large Quarter that may cause prices to reverse back toward the preceding Large Quarter Point.

Consider the example in Figure 1.8, which shows the EUR/USD currency pair working on the Large Quarter above the Large Quarter Point 1.3250, potentially targeting the Large Quarter Point 1.3500. Note that the pair reaches a high in the 1.3450 region that is below the Large Quarter Point 1.3500 and outside of the Undershoot Area of the Small Quarter 1.3475 to 1.3500. The failure of the EUR/USD pair's exchange rate to reach a number within 25 PIPs from the Large Quarter Point 1.3500 leads to the unsuccessful completion of the Large Quarter 1.3250 to 1.3500, which causes prices to reverse back toward the preceding Large Quarter Point 1.3250.

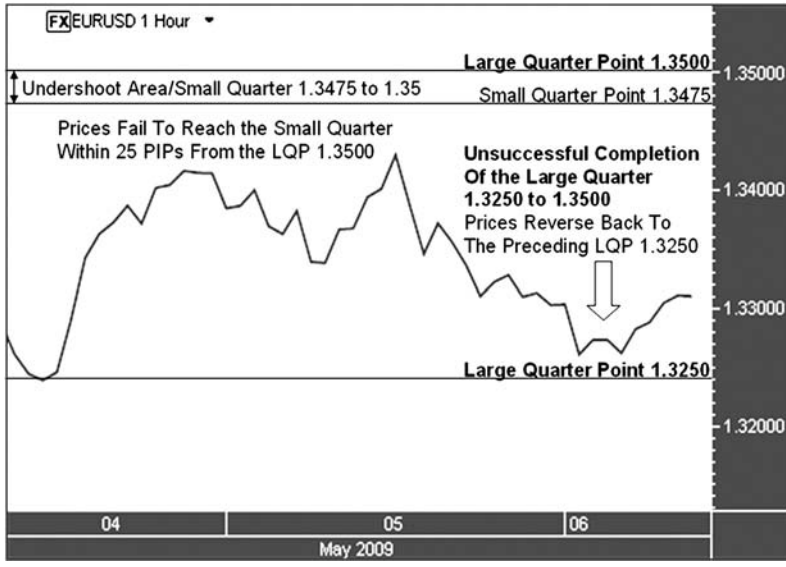

FIGURE 1.8 Unsuccessful Large Quarter Completion Example

1000 PIP RANGE TRANSITIONS

The 1000 PIP Ranges are the ranges between two Major Whole Numbers. The Major Large Quarter Points that represent the Major Whole Numbers mark the beginning and the end of each 1000 PIP Range. Currency exchange rates fluctuate between the Large Quarter Points within the 1000 PIP Ranges. Although exchange rates can remain within the same 1000 PIP Range for long periods of time, they do not stay indefinitely confined within the same 1000 PIP Range and may sooner or later leave the current and transition into brand-new 1000 PIP Ranges.

The new 1000 PIP Range Transitions usually occur as a result of major shifts in underlying fundamentals for currencies. Existing trends can either accelerate or reverse when the market realizes that the current 1000 PIP Range of a currency pair's exchange rate no longer sufficiently reflects the fundamental backdrop for the currencies in the pair. The significant price moves that occur as a result of rapid "pricing in" of market-moving fundamental developments can push currency exchange rates outside of a current and into a new 1000 PIP Range. The Quarters Theory recognizes such market moves as attempts to transition the currency exchange rates into new 1000 PIP Ranges.

The chart in Exhibit 1.9 shows an example of a 1000 PIP Range Transition. Note that the exchange rate of the EUR/USD pair fluctuates within

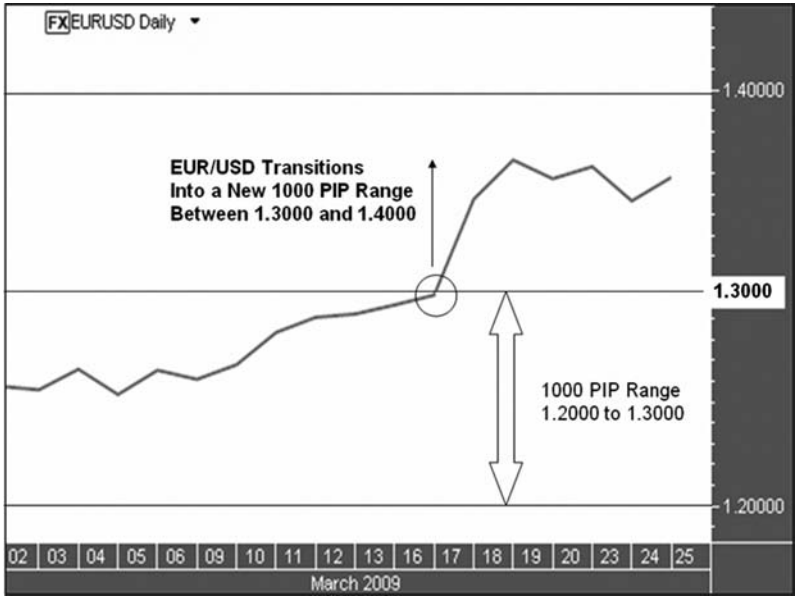

FIGURE 1.9 1000 PIP Range Transition Example

the 1000 PIP Range between the Major Whole Numbers 1.2000 and 1.3000. On March 17, 2009, the EUR/USD pair breaks above the Major Whole Number and Major Large Quarter Point at 1.3000 and transitions into the new 1000 PIP Range between the Major Whole Numbers and the Major Large Quarter Points 1.3000 and 1.4000.

Multiple 1000 PIP Range Transitions are possible in times when strong trends accelerate. The chart in Figure 1.10 shows the GBP/USD pair in a strong downtrend, rapidly moving lower. In a period of just a couple of months, October and November 2008, the pair produces multiple successful 1000 PIP Range transitions: falling below the Major Whole Number and the Major Large Quarter Point at 1.8000 into a new 1000 PIP Range between 1.8000 and 1.7000, later dropping below the Major Large Quarter Point 1.7000 into a new 1000 PIP Range between 1.7000 and 1.6000, and then falling below the Major Large Quarter Point 1.6000 into a new 1000 PIP Range between 1.6000 and 1.5000.

New 1000 PIP Range Transitions begin as an attempt to challenge and break above or below a Major Whole Number and a Major Large Quarter Point. Breakouts may not be as decisive and may fail on the first attempt. If a currency pair simply overshoots above or below a Major Large Quarter Point by an insignificant amount of PIPs (usually 25 PIPs or less), The

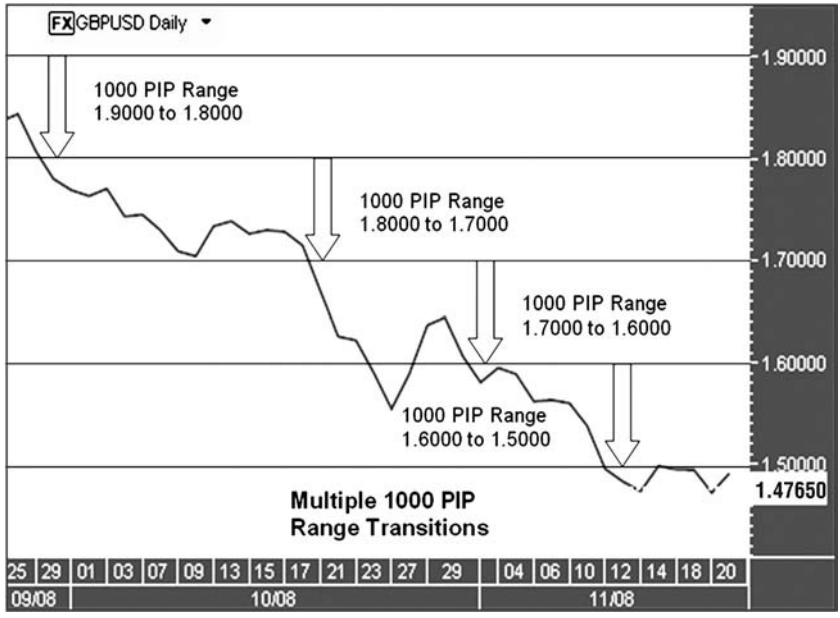

FIGURE 1.10 Multiple 1000 PIP Range Transitions Example

Quarters Theory would recognize such small overshoots as a warning sign of an unsuccessful breakout. Unsuccessful breakouts above or below Major Large Quarter Points could cause unsuccessful transitions into the new 1000 PIP Ranges and as a result, exchange rates may remain within their current 1000 PIP Range. Moreover, unsuccessful breakouts and unsuccessful 1000 PIP Range Transitions may often lead to complete reversals of previously established trends that have failed to produce a successful 1000 PIP Range Transition.

The chart in Figure 1.11 shows an example of an unsuccessful 1000 PIP Range Transition. Note that the USD/CAD is in an uptrend, making an attempt to break above the Major Large Quarter Point 1.3000 and transition from the current 1000 PIP Range between 1.2000 and 1.3000 into a new 1000 PIP Range above 1.3000. The pair overshoots the Major Large Quarter Point 1.3000 by an insignificant amount of PIPs and fails to produce a decisive breakout. The failed breakout above 1.3000 leads to an unsuccessful transition into the new 1000 PIP Range above 1.3000 and the USD/CAD pair's exchange rate remains within the current 1000 PIP Range. Please note that the unsuccessful 1000 PIP Range Transition above 1.3000 causes exhaustion of the bullish trend and leads to a complete reversal of the previously established uptrend.

Every attempt for a breakout above or below a Major Large Quarter Point coincides with an attempt from a currency pair to begin to work on

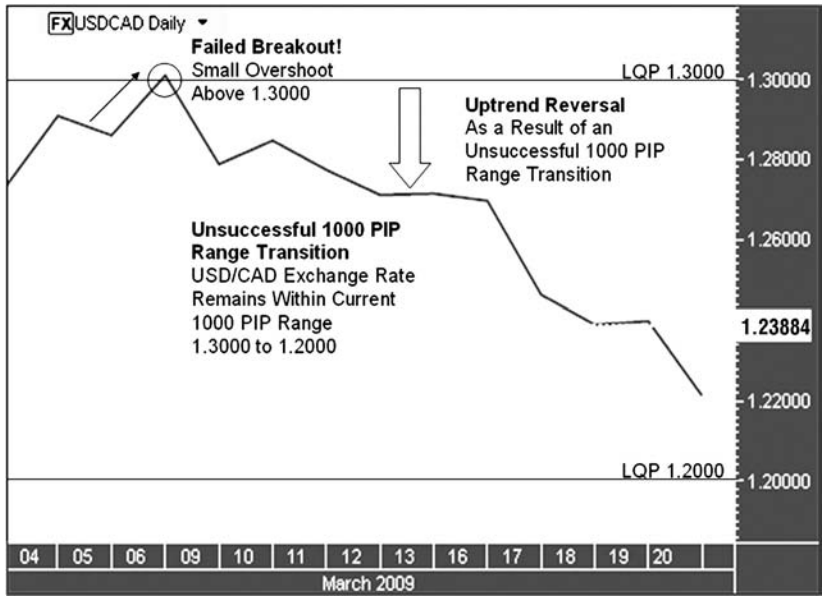

FIGURE 1.11 Unsuccessful 1000 PIP Range Transition

the first Large Quarter of 250 PIPs of a new 1000 PIP Range. A decisive breakout could produce a decisive entrance into a Large Quarter, but if the first Large Quarter of a new 1000 PIP Range is not successfully completed, exhaustion may occur, leading to a reversal back toward the Major Large Quarter Point and into the preceding 1000 PIP Range.

Consider the example in Figure 1.12 showing the USD/JPY in a strong uptrend. The pair makes an attempt to break above the Major Large Quarter Point at 100.00 and to transition from the current 1000 PIP Range between 90.00 and 100.00 into a new 1000 PIP Range above 100.00. The USD/JPY produces a successful breakout above the Major Large Quarter Point at 100.00 and makes a decisive entrance into the first Large Quarter of the new 1000 PIP Range—the Large Quarter 100.00 to 102.50. However, the pair fails to complete the first Large Quarter 100.00 to 102.50 of the new 1000 PIP Range, leading to an exhaustion of the bullish trend and a reversal back toward the preceding Major Large Quarter Point 100.00. The unsuccessful completion of the first Large Quarter of the new 1000 PIP Range also sees the USD/JPY exchange rate falling back into the previous 1000 PIP Range below the Major Large Quarter Point 100.00.

Only a completion of the first Large Quarter of a new 1000 PIP Range can serve as an indication of a successful 1000 PIP Range Transition. As usual, a successful completion of a Large Quarter would require prices to

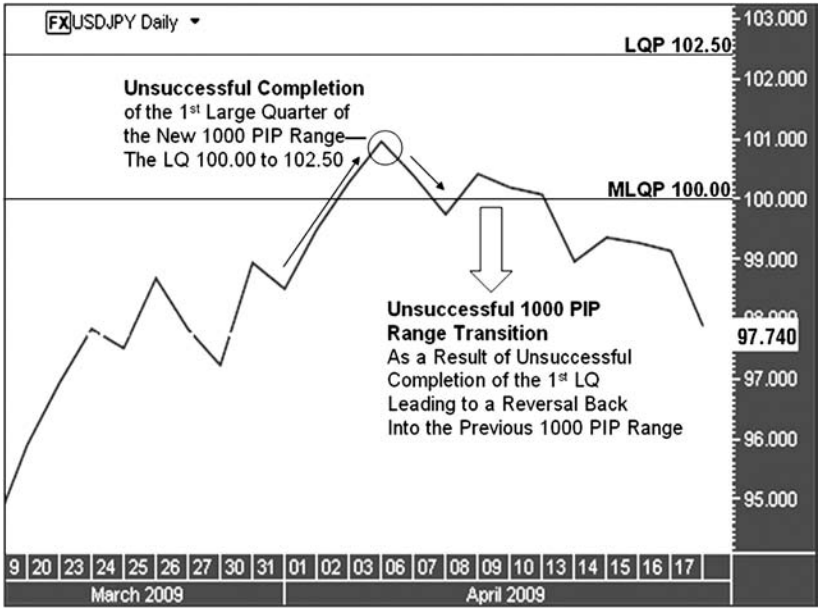

FIGURE 1.12 Unsuccessful Completion of the First Large Quarter Leading to Unsuccessful 1000 PIP Range Transition Example

reach a number at least within one Small Quarter of 25 PIPs from the Large Quarter Point being targeted.

The chart in Figure 1.13 shows an example of a successful 1000 PIP Range Transition as a result of a completion of the first Large Quarter of a new 1000 PIP Range. Please note that the EUR/USD pair is in a strong uptrend, making an attempt to break above the Major Large Quarter Point 1.3000 and transition from its current 1000 PIP Range between 1.2000 and 1.3000 into a new 1000 PIP Range above 1.3000. At the same time, the pair also makes an attempt to work on the first Large Quarter of 250 PIPs of the new 1000 PIP Range—the Large Quarter from the Major Large Quarter Point 1.3000 to the Large Quarter Point at 1.3250. The EUR/USD pair produces a decisive breakout above the Major Large Quarter Point 1.3000 and manages to complete the Large Quarter 1.3000 to 1.3250. The completion of the first Large Quarter 1.3000 to 1.3250 confirms the successful transition into the new 1000 PIP Range between the Major Large Quarter Points 1.3000 and 1.4000.

Successful 1000 PIP Range Transitions are a sign of strength and an indication of a potential continuation of an existing trend, especially if the exchange rate remains within the new 1000 PIP range and does not fall back into its preceding 1000 PIP Range by breaking above or below the

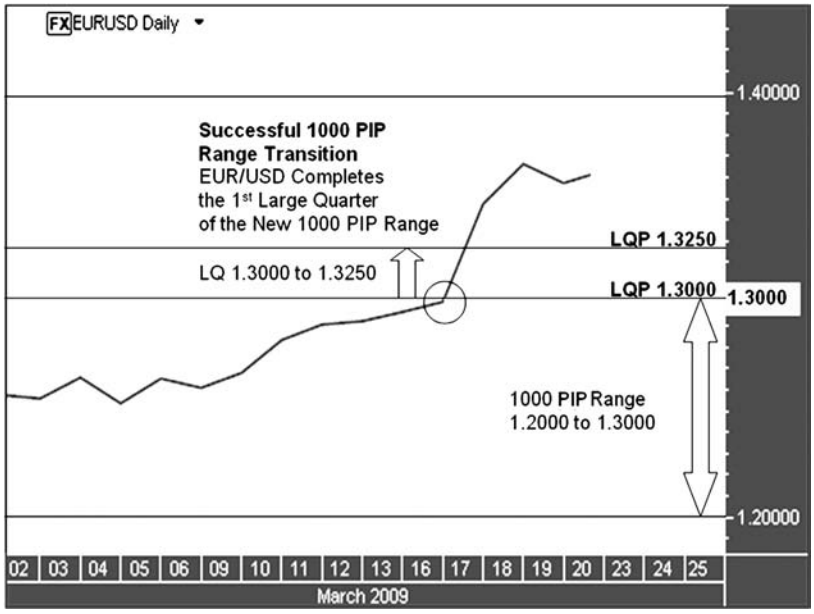

FIGURE 1.13 First Large Quarter Completion Leading to a Successful 1000 PIP Range Transition

Major Large Quarter Point. A successful, decisive transition into a new 1000 PIP Range could accelerate the trend and may often lead to further price moves beyond the first Large Quarter and into the second Large Quarter of 250 PIPs of a new 1000 PIP range. Such moves into the second Large Quarter of a new 1000 PIP Range are an indication that the existing trend is strong and that prices may continue to advance toward the exact half point of the new 1000 PIP Range—the Major Half Point.

The chart in Figure 1.14 shows an example of a successful 1000 PIP Range Transition that accelerates the existing trend, pushing prices toward the Major Half Point of the new 1000 PIP Range and leading to a successful completion of the second Large Quarter of the new 1000 PIP Range. Note that the EUR/USD pair is in an uptrend, moving above the Major Large Quarter Point 1.3000 and making an attempt to transition its exchange rate from the 1000 PIP Range between 1.2000 and 1.3000 into a new 1000 PIP Range above 1.3000. The pair completes the first Large Quarter 1.3000 to 1.3250 of the new 1000 PIP Range and confirms that the exchange rate has transitioned successfully into the new 1000 PIP Range. The successful 1000 PIP Range Transition accelerates the existing trend (note how the momentum spikes up above the Major Large Quarter Point 1.3000 on the chart) and pushes prices further toward the Major Half Point

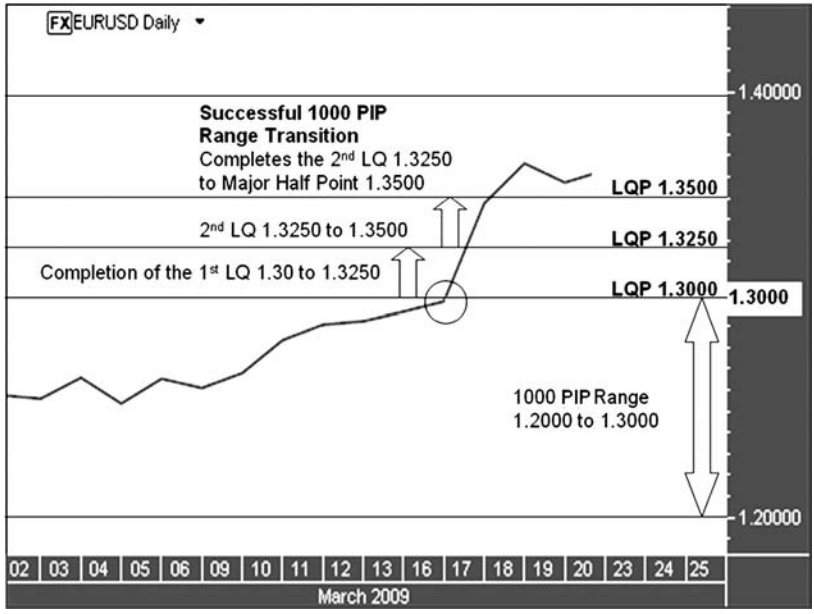

FIGURE 1.14 Successful 1000 PIP Range Transition Accelerating the Trend and Targeting the Major Half Point

1.3500 of the new 1000 PIP Range between 1.3000 and 1.4000, leading to a successful completion of the second Large Quarter 1.3250 to 1.3500 of the new 1000 PIP Range.

A completion of the second Large Quarter of a new 1000 PIP Range serves as a confirmation that the exchange rate of a currency pair has made a decisive transition into the new 1000 PIP Range. Successful 1000 PIP Range Transitions confirmed by the fact that the Major Half Point of a 1000 PIP Range has been reached are also an indication of potential further advances into the 1000 PIP Range beyond the Major Half Point in an effort for currency exchange rates to complete the entire 1000 PIP Range. Although moves toward the Major Half Point of each 1000 PIP Range are an indication of a strong trend, in most instances all four Large Quarters of an entire 1000 PIP Range would most likely not be completed without any major price corrections and pullbacks that could take prices back toward the preceding Major Large Quarter Point. If prices during such corrections stay above (or below) the Major Large Quarter Point and do not move back into the previous 1000 PIP Range, further advances within the new 1000 PIP Range can be expected as an attempt to complete the entire 1000 PIP Range.

Consider the example shown in Figure 1.15 where on the left-hand side of the chart the USD/JPY exchange rate makes a decisive transition into the

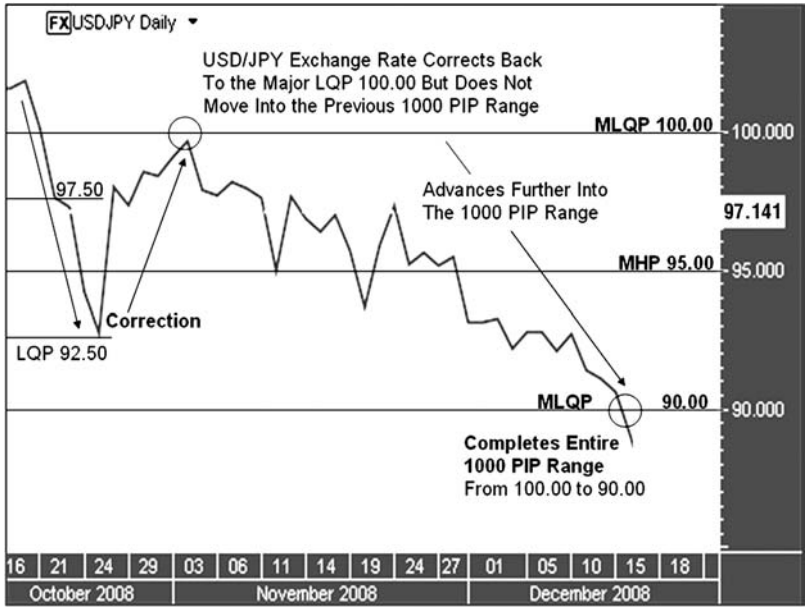

FIGURE 1.15 1000 PIP Range Completion Example

new 1000 PIP Range between 100.00 and 90.00 yen by completing the first Large Quarter 100.00 to 97.50 and the second Large Quarter 97.50 to the Major Half Point 95.00. The pair even reaches as far as the Large Quarter Point 92.50 and completes three out of four Large Quarters of the new 1000 PIP Range—the Large Quarters 100.00 to 97.50, 97.50 to 95.00, and 95.00 to 92.50. After the large move, the pair goes through a significant price correction that takes prices back toward the preceding Major Large Quarter Point 100.00. Despite the pullback, the USD/JPY exchange rate stays below the Major Large Quarter Point 100.00 and does not move into the previous 1000 PIP Range above 100.00, indicating that the exchange rate will remain within the new 1000 PIP Range. The pair then advances further into the 1000 PIP Range below 100.00, this time managing to complete all four Large Quarters (100.00 to 97.50, 97.50 to 95.00, 95.00 to 92.50, and 92.50 to 90.00) and successfully completing the entire 1000 PIP Range from 100.00 to 90.00.

The Quarters Theory recognizes the 1000 PIP Range Transitions as important events that indicate major shifts in currency exchange rates. These events are not chaotic; the 1000 PIP Range Transitions develop through orderly moves from one Large Quarter Point to the next within constant, predictable ranges of 250 and 1000 PIPs. Although a 1000 PIP Range may be new to a currency pair's exchange rate, the number of PIPs in the range is not foreign; it is always exactly 1000 PIPs, and each 1000 PIP Range always has the familiar four Large Quarters of exactly 250 PIPs each. Successful 1000 PIP Range Transitions do not occur randomly, without a purpose. They represent necessary adjustments in exchange rates made by the market in order to reflect more accurately any considerable changes in the underlying fundamentals of a currency pair.

LARGE QUARTER TRANSITIONS

The fluctuations of currency exchange rates do not stop after completing a Large Quarter; they continue into perpetuity. As prices fluctuate from one Large Quarter Point to the next, multiple Large Quarters may be completed as long as currency exchange rates regularly transition from one Large Quarter to another Large Quarter. The Large Quarter Transition is the process of transfer in prices from the 250 PIP Range of one Large Quarter into a new 250 PIP Range of another Large Quarter.

The chart in Figure 1.16 shows the EUR/USD currency pair's exchange rate producing multiple Large Quarter Transitions, followed by successful completions of five consecutive Large Quarters. As the EUR/USD pair moves higher, prices transition into the Large Quarter 1.3000 to 1.3250 and complete it successfully. After completing the Large Quarter 1.3000 to 1.3250, the pair continues its upward move, the EUR/USD exchange

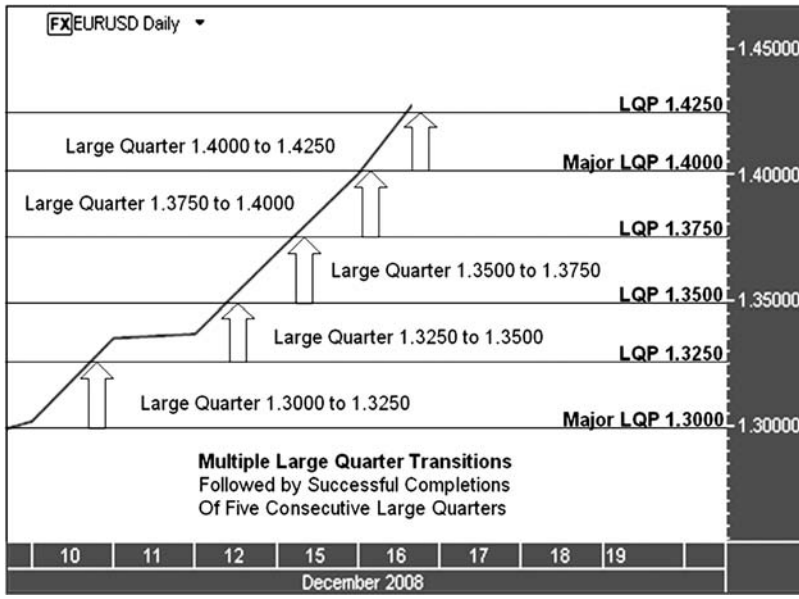

FIGURE 1.16 Multiple Large Quarter Transitions Example

rate transitions into the new 250 PIP Range of the Large Quarter 1.3250 to 1.3500, and, despite the temporary flattening and hesitation, prices move higher, completing the Large Quarter 1.3250 to 1.3500. The remarkable sequence of Large Quarter Transitions and Large Quarter completions continues, further resulting in the successful completion of five consecutive Large Quarters—1.3000 to 1.3250, 1.3250 to 1.3500, 1.3500 to 1.3750, 1.3750 to 1.4000, and 1.4000 to 1.4250—in a period of only five trading sessions.

The outcome of a Large Quarter Transition is vital to the completion of each Large Quarter. Unless there were a successful Large Quarter Transition, there would not even be an attempt to complete a new Large Quarter. So what constitutes successful Large Quarter Transitions, and how can traders distinguish them from the unsuccessful ones?

As prices surpass a Large Quarter Point, the first area that they enter is the Overshoot Area 25 PIPs above or below a Large Quarter Point. By reaching a number within the Overshoot Area, prices have already entered the new Large Quarter; but if prices remain within the Overshoot Area of one Small Quarter of 25 PIPs above or below a Large Quarter Point and never continue further into the range of a new Large Quarter, The Quarters Theory will recognize such development as an Overshoot. Overshoots are *price inertia* left over from the significant price move that has targeted a Large Quarter Point. They are not indicative of a decisive entrance of prices into the new Large Quarter. This is why overshoots of up to 25 PIPs above

or below a Large Quarter Point are not considered to be successful Large Quarter Transitions. Overshoots should be recognized as warning signs of unsuccessful Large Quarter Transitions, which usually cause prices to remain within a previous Large Quarter.

The example in Figure 1.17 shows the GBP/USD currency pair's exchange rate completing the Large Quarter 1.5250 to 1.5500 and surpassing the Large Quarter Point 1.5500 in an attempt for a Large Quarter Transition into the new Large Quarter 1.5500 to 1.5750. However, prices only produce an Overshoot of 25 PIPs or less above the Large Quarter Point 1.5500 and never exit the Overshoot Area of the Small Quarter 1.5500 to 1.5525. The Overshoot signals unsuccessful Large Quarter Transition followed by a reversal as prices fall below the Large Quarter Point 1.5500 and remain within the range of the previous Large Quarter.

Unsuccessful Large Quarter Transitions are easier to recognize in cases when prices do not overshoot a Large Quarter Point and stay within the Undershoot Area of a Large Quarter Point. The Quarters Theory considers undershoots as an indication of shortcomings of price moves targeting Large Quarter Points that may serve as warning signs of unsuccessful Large Quarter Transitions. Unsuccessful Large Quarter Transitions as a result of undershoots usually cause prices to remain within the current Large Quarter.

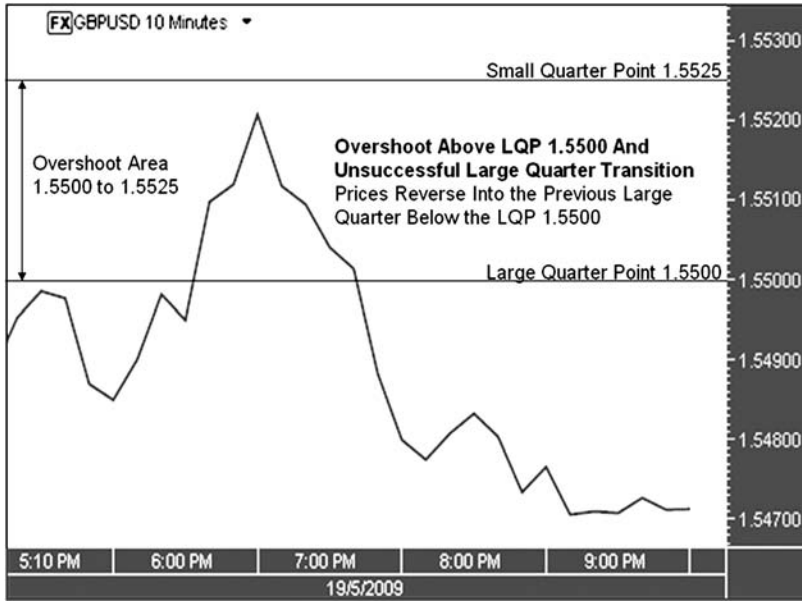

FIGURE 1.17 Overshoot Signaling Unsuccessful Large Quarter Transition

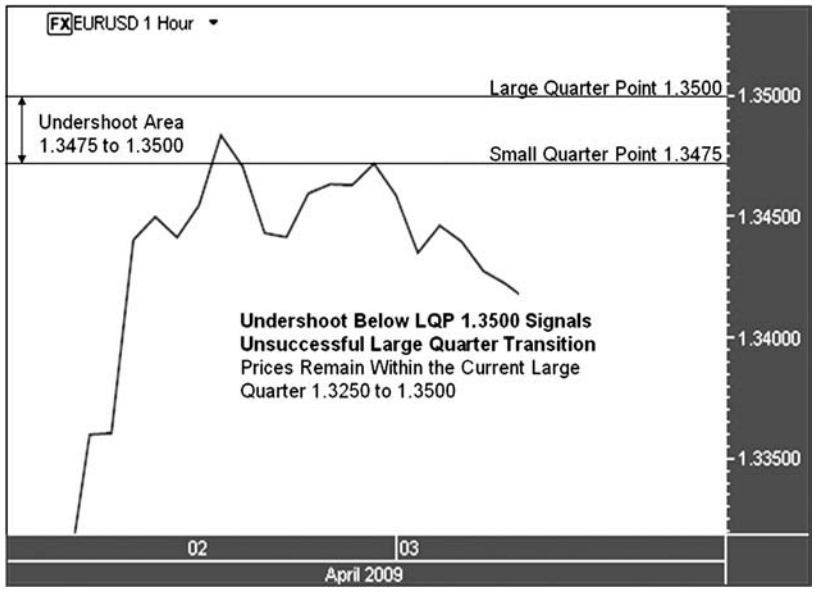

FIGURE 1.18 Undershoot Signaling Unsuccessful Large Quarter Transition

The example in Figure 1.18 shows the EUR/USD currency pair's exchange rate completing the Large Quarter 1.3250 to 1.3500. Prices reach the Undershoot Area of the Small Quarter 1.3475 to 1.3500 but do not surpass the Large Quarter Point 1.3500. The Undershoot of 25 PIPs or less below the Large Quarter Point 1.3500 signals unsuccessful Large Quarter Transition, which causes prices to remain within the range of the current Large Quarter 1.3250 to 1.3500.

Price moves that attempt a Large Quarter Transition above or below a Large Quarter Point see currency exchange rates enter an important area called the *Hesitation Zone*. The Hesitation Zone is the range of 75 PIPs above or below a Large Quarter Point. The Hesitation Zone is formed by the first three Small Quarters of 25 PIPs of each Large Quarter. The positioning of the Hesitation Zone depends on the direction of the price move: If prices move above a Large Quarter Point, the Hesitation Zone will be 75 PIPs or three Small Quarters above a Large Quarter Point; if prices move below a Large Quarter Point, the Hesitation Zone will be 75 PIPs or three Small Quarters below a Large Quarter Point.

The end of each Hesitation Zone always falls 25 PIPs or one Small Quarter above or below the closest Whole Number to a Large Quarter Point. The end of the Hesitation Zone never coincides with an actual Whole Number, but rather indicates either shortcomings or overshoots of the price moves that target the Whole Number closest to a Large Quarter Point.

The Quarters Theory uses the Hesitation Zone to identify successful or failed Large Quarter Transitions by distinguishing between decisive and indecisive entrance of prices into a new Large Quarter. The Overshoot Area above or below a Large Quarter Point is part of the Hesitation Zone but moves of 25 PIPs or less above or below a Large Quarter Point that remain within the Overshoot Area are considered simple overshoots and do not constitute a successful Large Quarter Transition. Only decisive price moves that target the end of the Hesitation Zone and do not break above (or below) the preceding Large Quarter Point on pullbacks are considered to be an indication of a successful Large Quarter Transition. Prices are likely to remain within a new Large Quarter as a result of a successful Large Quarter Transition, increasing the probability for further advances into the range of the new Large Quarter in an attempt to complete it.

The example in Figure 1.19 shows the anatomy of the GBP/USD currency pair exchange rate's Large Quarter Transition into a new Large Quarter 1.5250 to 1.5500. Note that as prices move above the Large Quarters Point 1.5250, they make a decisive entrance into the new Large Quarter by targeting the Whole Number 1.5300, which is the closest Whole Number 50 PIPs above the Large Quarter Point 1.5250. As prices reach the Whole Number 1.5300, they pull back toward the preceding Large Quarter Point 1.5250 but remain above it. After the pullback, prices make another decisive move toward the end of the Hesitation Zone 1.5325—three Small

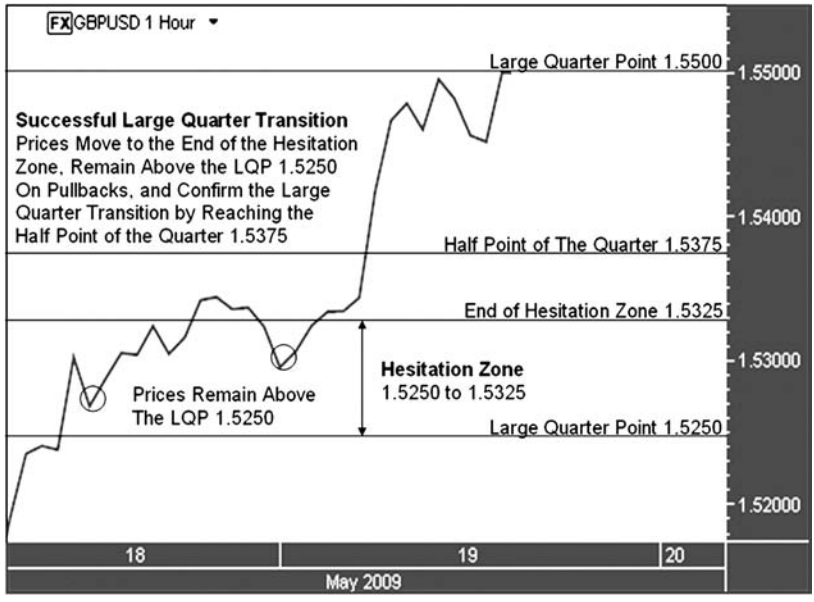

FIGURE 1.19 Successful Large Quarter Transition

Quarters of 25 PIPs above the Large Quarter Point. The GBP/USD pair's exchange rate overshoots above the end of the Hesitation Zone and pulls back but, once again, it remains above the preceding Large Quarter Point 1.5250. The decisive price move toward the end of the Hesitation Zone and the fact that the exchange rate remains above the Large Quarter Point 1.5250 on pullbacks indicates that the Large Quarter Transition into the Large Quarter 1.5250 to 1.5500 is successful. The successful Large Quarter Transition leads to price moves advancing further into the range of the new Large Quarter, targeting the Large Quarter Point 1.5500 and ultimately completing the Large Quarter 1.5250 to 1.5500.

The Quarters Theory considers decisive price moves that stretch outside of the Hesitation Zone and reach the Half Point of a Large Quarter as a confirmation of a successful Large Quarter Transition. The Half Point is the exact middle price point of a Large Quarter. The Half Point is positioned 125 PIPs from each one of the Large Quarter Points that define a Large Quarter. Price moves that reach the Half Point of a Large Quarter and do not break above (or below) the preceding Large Quarter Point on pullbacks provide confirmation that a Large Quarter Transition is successful.

The example in Figure 1.20 shows the Large Quarter Transition of the USD/CAD currency pair's exchange rate into a new Large Quarter

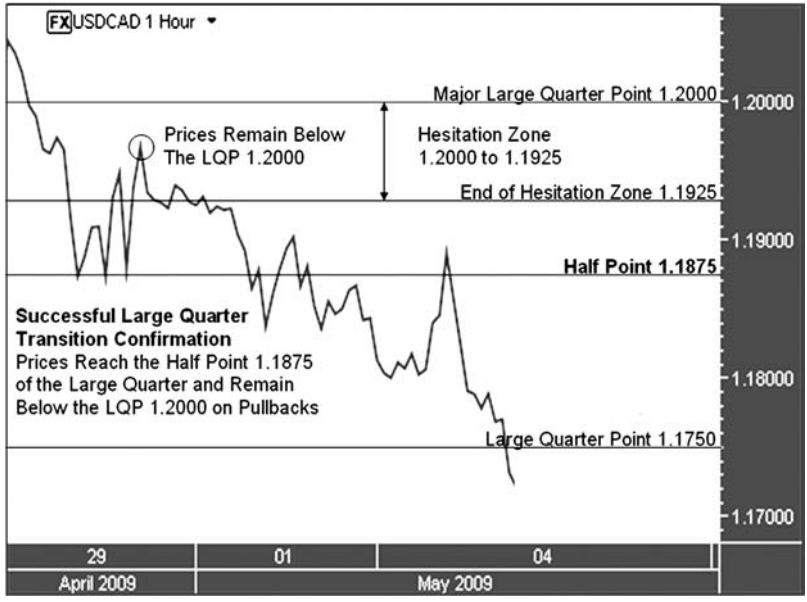

FIGURE 1.20 Price Move Targeting the Half Point, Leading to a Successful Large Quarter Transition

1.2000 to 1.1750. As prices attempt to transition below the Major Large Quarter Point 1.2000, they make a decisive bearish move, stretching beyond the end of the Hesitation Zone 1.1925 and reaching the Half Point 1.1875 of the Large Quarter 1.2000 to 1.1750. Prices touch the Half Point 1.1875 three consecutive times and pull back toward the preceding Large Quarter Point 1.2000, but remain above it on all three of the pullbacks. The decisive price move toward the Half Point 1.1875 and the fact that the exchange rate remains below the Large Quarter Point 1.2000 on the pullbacks confirms that the Large Quarter Transition into the Large Quarter 1.2000 to 1.1750 is successful. The successful Large Quarter Transition ultimately leads to the completion of the Large Quarter 1.2000 to 1.1750.

LARGE QUARTER CORRECTIONS

Although possible in some cases, in most instances multiple consecutive Large Quarter Transitions and Large Quarter completions may not be likely to occur at once without any price consolidations and pullbacks. Successful completions of two or more consecutive Large Quarters equal moves of 500+ PIPs, and such significant price moves are susceptible to Large Quarter Price Corrections. In periods of Large Quarter Corrections, prices remain within the current Large Quarter, pull back toward a preceding Large Quarter Point, or may even transition into a previous Large Quarter.

Consider the example in Figure 1.21 showing the GBP/USD currency pair's exchange rate moving higher, completing three consecutive Large Quarters: 1.3750 to 1.4000, 1.4000 to 1.4250, and 1.4250 to 1.4500, transitioning into a fourth Large Quarter 1.4500 to 1.4750, and producing a large price move of almost 1000 PIPs. The inability to complete the Large Quarter 1.4500 to 1.4750 signals exhaustion and triggers a price correction. During the correction, the GBP/USD pair's exchange rate remains within the same Large Quarter 1.4500 to 1.4750 and pulls back toward the preceding Large Quarter Point 1.4500. The price correction becomes even more significant, producing a Large Quarter Transition below the Large Quarter Point 1.4500 into the previous Large Quarter 1.4250 to 1.4500, and leading to the successful completion of the Large Quarter 1.4500 to 1.4250.

The price correction described in Figure 1.21 is triggered by the unsuccessful completion of the Large Quarter 1.4500 to 1.4750. Note in the illustration shown in Figure 1.22, that the correction sees the GBP/USD pair completing the Large Quarter 1.4500 to 1.4250, but prices remain above the Large Quarter Point 1.4250 and do not transition into another Large Quarter. The unsuccessful Large Quarter Transition into the new Large Quarter 1.4250 to 1.4000 signals the end of the correction and the bullish Large

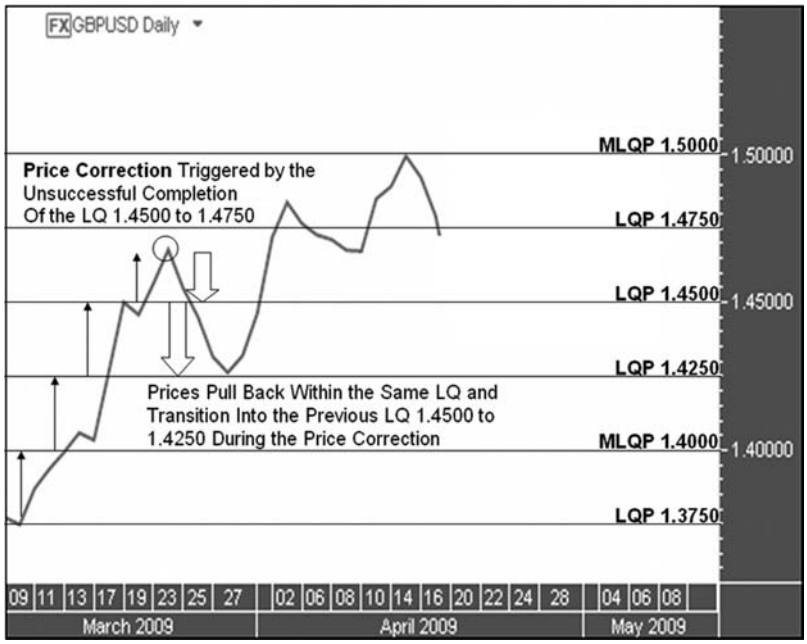

FIGURE 1.21 Large Quarter Correction Example

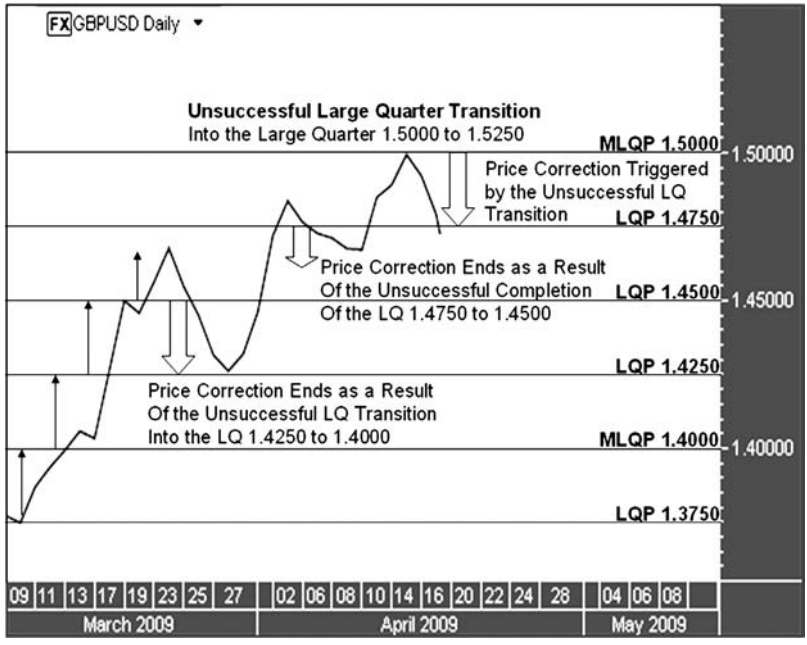

FIGURE 1.22 Large Quarter Correction Example

Quarter sequence resumes, leading to the successful completion of two Large Quarters: 1.4250 to 1.4500 and 1.4500 to 1.4750. As prices continue to move higher, there is also a Large Quarter Transition into a third Large Quarter 1.4750 to 1.5000; however, that Large Quarter is not completed. The unsuccessful completion of the Large Quarter 1.4750 to 1.5000 signals exhaustion and once again triggers a price correction. During the correction, the GBP/USD pair's exchange rate remains within the same Large Quarter 1.4750 to 1.5000, pulls back toward the preceding Large Quarter Point 1.4750, and even transitions into the previous Large Quarter 1.4500 to 1.4750. However, the Large Quarter 1.4750 to 1.4500 is not completed and the correction ends as a result of the unsuccessful completion of the Large Quarter 1.4750 to 1.4500. The end of the correction is then followed by a Large Quarter Transition into the Large Quarter 1.4750 and 1.5000. The Large Quarter 1.4750 to 1.5000 is completed, but prices remain below the Major Large Quarter Point 1.5000 and do not transition into the new Large Quarter 1.5000 to 1.5250. The unsuccessful Large Quarter Transition triggers a price correction, during which prices remain within the same Large Quarter 1.4750 to 1.5000 and pull back toward the preceding Large Quarter Point 1.4750.

The examples above demonstrate the two causes that trigger the beginning and the end of each Large Quarter Price Correction: unsuccessful completion of a Large Quarter or unsuccessful Large Quarter Transition. Either one of these two factors can end a sequence of significant Large Quarter price moves and result in a price correction, or can cause a Large Quarter Correction to come to an end.

CHAPTER 2

Forecasting the Large Quarter Price Moves

ANALYZING PRICE BEHAVIOR AT THE LARGE QUARTER POINTS

The Quarters Theory recognizes that the direction of each Large Quarter price move from one Large Quarter Point to another and the completion of a Large Quarter are dependent on the success or the failure of the Large Quarter Transitions. Every transition into a new Large Quarter always begins at a Large Quarter Point that serves as a critical junction, marking the end of a current and at the same time the beginning of a new Large Quarter of 250 PIPs. Each significant price move starts at a Large Quarter Point and always ends at a Large Quarter Point; therefore, when these important price levels are reached, The Quarters Theory requires close examination of the price behavior of currency exchange rates for signs of strength or weakness that can be useful when attempting to forecast the outcome of each attempt for a Large Quarter Transition and the direction of the next Large Quarter price move.

The Large Quarter Points serve as constant and reliable support and resistance levels. A Large Quarter Transition cannot occur unless the support or the resistance of a Large Quarter Point is broken. The failure of an attempt for a breakout above or below a Large Quarter Point is usually the first sign of an unsuccessful Large Quarter Transition. Unsuccessful Large Quarter Transitions are an indication that the currency exchange rate is likely to remain in its current Large Quarter. When prices move higher and manage to complete a Large Quarter but encounter resistance at the Large

Quarter Point targeted, there would be a greater probability that the next Large Quarter move may be more likely to target the Large Quarter Point below the Large Quarter Point that has served as resistance. The same is valid for bearish price moves when currency exchange rates move lower and produce a successful completion of a Large Quarter but encounter support at the Large Quarter Point targeted. In such instances, there would be a greater probability that the next Large Quarter price move may be more likely to target the Large Quarter Point above the Large Quarter Point that has served as support. Based on this premise, The Quarters Theory establishes a set of two simple rules to identify signs of strength or weakness in the price behavior of currency exchange rates in the vicinity of each Large Quarter Point that may signal unsuccessful Large Quarter Transitions:

Rule #1—Sign of Strength: Prices Sustaining at or above a Large Quarter Point

This is the type of price behavior indicative of the unwillingness of the market to see prices continuing to decline, diminishing the likelihood of a breakout below the support of the targeted Large Quarter Point. Without a breakout below a Large Quarter Point, there will be no Large Quarter Transition of the currency exchange rate into a new 250 PIPs Range of another Large Quarter below the current Large Quarter. A failed breakout below a Large Quarter Point and a failed Large Quarter Transition cause the exchange rate to remain within the current Large Quarter, normally leading to a bullish price move in an attempt to complete the current Large Quarter from the bottom up by targeting the Large Quarter Point above the Large Quarter Point that has served as support.

Figure 2.1 shows a bearish price move in the GBP/USD pair's exchange rate, completing the Large Quarter 1.4500 to 1.4250 by reaching the Undershoot Area/Small Quarter 1.4275 to 1.4250. Note that prices come short of and never touch the exact number of the Large Quarter Point 1.4250, diminishing the probability for a breakout below the Large Quarter Point 1.4250. Prices sustain above the Large Quarter Point—a sign of strength that causes the exchange rate to remain within the current Large Quarter. The lack of a breakout leads to an unsuccessful Large Quarter Transition into another Large Quarter below the current Large Quarter 1.4500 to 1.4250. The unsuccessful Large Quarter Transition below the Large Quarter Point 1.4250 is followed by a bullish price move in an attempt to complete the Large Quarter from the Large Quarter Point 1.4250 that has served as support, targeting the Large Quarter Point 1.4500.

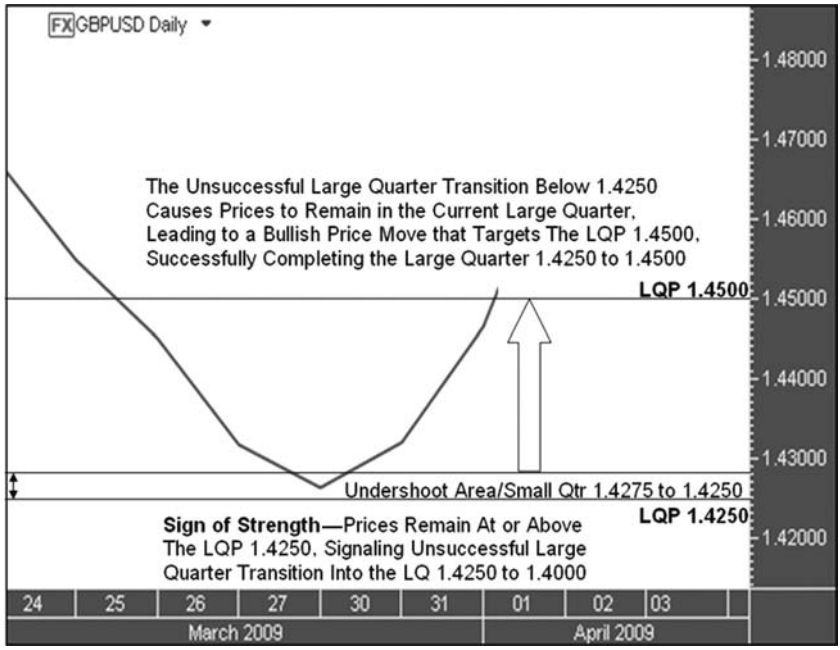

FIGURE 2.1 Sign of Strength: Prices Sustain above a Large Quarter Point

Rule #2—Sign of Weakness: Prices Remaining below a Large Quarter Point

This is price behavior that signals exhaustion and lack of strength in a price move, reducing the likelihood of a breakout above the resistance of the targeted Large Quarter Point. An unsuccessful breakout above a Large Quarter Point would indicate an unsuccessful Large Quarter Transition into a new 250 PIPs Range of another Large Quarter above the current Large Quarter. As a result, prices would be likely to remain within the current Large Quarter, normally leading to a bearish price move in an attempt to complete the current Large Quarter from the top down by targeting the Large Quarter Point below the Large Quarter Point that has served as resistance.

Consider the example in Figure 2.2, which shows the GBP/USD pair's exchange rate moving higher, completing the Large Quarter 1.4750 to 1.5000. Note that although the Large Quarter is completed successfully, prices remain below the Large Quarter Point 1.5000, a sign of weakness signaling exhaustion and reducing the likelihood for a bullish breakout above the Large Quarter Point 1.5000. As prices stay below the Large Quarter

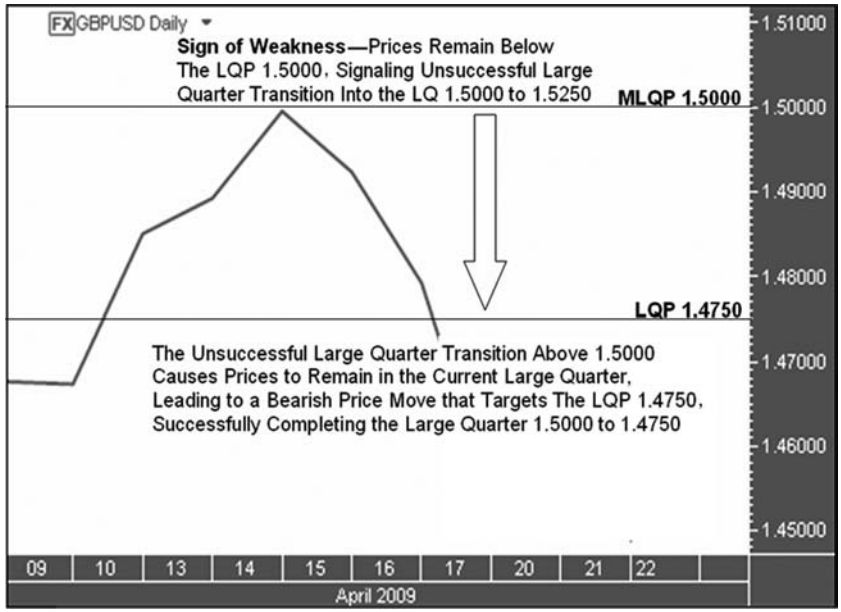

FIGURE 2.2 Sign of Weakness: Prices Remain below a Large Quarter Point

Point 1.5000, the exchange rate remains within the current Large Quarter 1.4750 to 1.5000. The lack of a bullish breakout above the Large Quarter Point 1.5000 leads to an unsuccessful Large Quarter Transition into another Large Quarter above the current Large Quarter 1.4750 to 1.5000. The unsuccessful Large Quarter Transition above the Large Quarter Point 1.5000 leads to a bearish price move in an attempt to complete the Large Quarter from the Large Quarter Point 1.5000 that has served as resistance, targeting the Large Quarter Point 1.4750.

Analyzing Price Behavior at the Important Price Points within the Large Quarters

The most important price levels for each Large Quarter are the two Large Quarter Points that define it. Every significant price move begins from a Large Quarter Point and also ends at a Large Quarter Point. The main question when forecasting the Large Quarter price moves is whether prices will reach the targeted Large Quarter Point and successfully complete a Large Quarter, or whether due to unsuccessful completion of a Large Quarter, prices will reverse and target the preceding Large Quarter Point. The next Large Quarter price move is much easier to forecast in the previously described instances when prices remain above or below a Large Quarter

Point and, due to unsuccessful Large Quarter Transitions, remain within the same Large Quarter. But what if prices actually break above or below a Large Quarter Point and transition into a new Large Quarter? Does a Large Quarter Transition mean that the new Large Quarter will be successfully completed?

The Quarters Theory recognizes that Large Quarter Transitions do not guarantee the successful completion of a Large Quarter and that price behavior of currency exchange rates within the actual Large Quarters should be closely analyzed for signs of strength that could lead to the successful completion of a Large Quarter, or signs of weakness and exhaustion that may cause unsuccessful Large Quarter completion and reversals back toward the preceding Large Quarter Point. In order to monitor the price behavior of currency exchange rates within the range of each Large Quarter, The Quarters Theory establishes three important price levels within each Large Quarter: (1) the End of the Hesitation Zone, (2) the Half Point, and (3) the Whole Number preceding a Large Quarter Point. These three important price points within each Large Quarter serve as major support and resistance levels that may prevent further price progression and may cause unsuccessful completion of a Large Quarter.

The End of the Hesitation Zone The first important price level within each Large Quarter is the End of the Hesitation Zone. As described in previous chapters, the Hesitation Zone plays a key role when determining Large Quarter Transitions. Decisive price moves that target the End of the Hesitation Zone and do not break above (or below) the preceding Large Quarter Point on pullbacks are considered to be an indication of a successful Large Quarter Transition. On the other hand, prices may also hesitate to continue further into a new Large Quarter within the area of 75 PIPs or the first three Small Quarters of 25 PIPs above or below a Large Quarter Point, hence the name *Hesitation Zone*. If prices stay confined within the Hesitation Zone, the End of the Hesitation Zone can prove to be a difficult support or resistance level to overcome and may prevent further progression of prices beyond the range of the Hesitation Zone, leading to price exhaustion and unsuccessful completion of a Large Quarter. Strong support or resistance met at the End of the Hesitation Zone usually leads to a reversal that takes prices back toward the preceding Large Quarter Point. If currency exchange rates have difficulty breaking outside of the Hesitation Zone and remain within it for extended time periods, prices may not only reverse back to the preceding Large Quarter Point but may also pull back into the range of a previous Large Quarter.

Figure 2.3 shows the GBP/USD currency pair's exchange rate completing the Large Quarter 1.5500 to 1.5750. The pair then makes an attempt for a Large Quarter Transition into a new Large Quarter 1.5750 to 1.6000 by

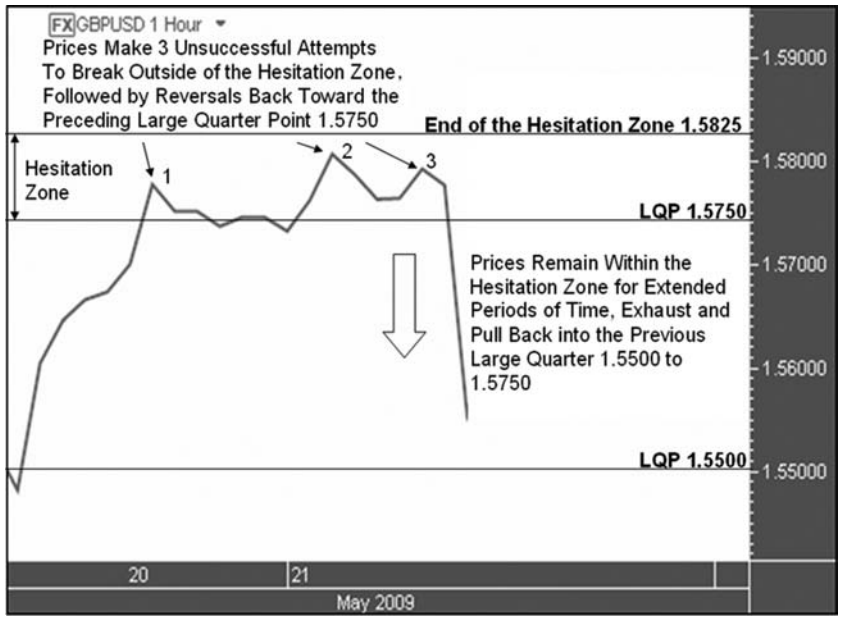

FIGURE 2.3 Price Behavior in the Hesitation Zone

entering the Hesitation Zone 75 PIPs above the Large Quarter Point 1.5750. Three attempts for a breakout above the End of the Hesitation Zone 1.5825 meet resistance and after each unsuccessful breakout attempt, prices reverse back to the preceding Large Quarter Point 1.5750. Prices have obvious difficulties breaking outside of the Hesitation Zone. The GBP/USD pair's currency exchange rate remains within the Hesitation Zone for an extended period of time and prices not only reverse back to the preceding Large Quarter Point 1.5750 but also pull back into the range of the previous Large Quarter 1.5500 to 1.5750.

The Half Point The Half Point is the second important price level within each Large Quarter. The Half Point is the exact middle price point of a Large Quarter. Price moves that stretch outside of the Hesitation Zone and reach the Half Point of a Large Quarter provide confirmation of a successful Large Quarter Transition. The Half Point, however, can also become a difficult support or resistance level to overcome and may prevent further progression of prices beyond the Half Point, leading to price exhaustion and unsuccessful completion of a Large Quarter. Strong support or resistance met at the Half Point of a Large Quarter usually causes reversals that take prices back toward the preceding Large Quarter Point.

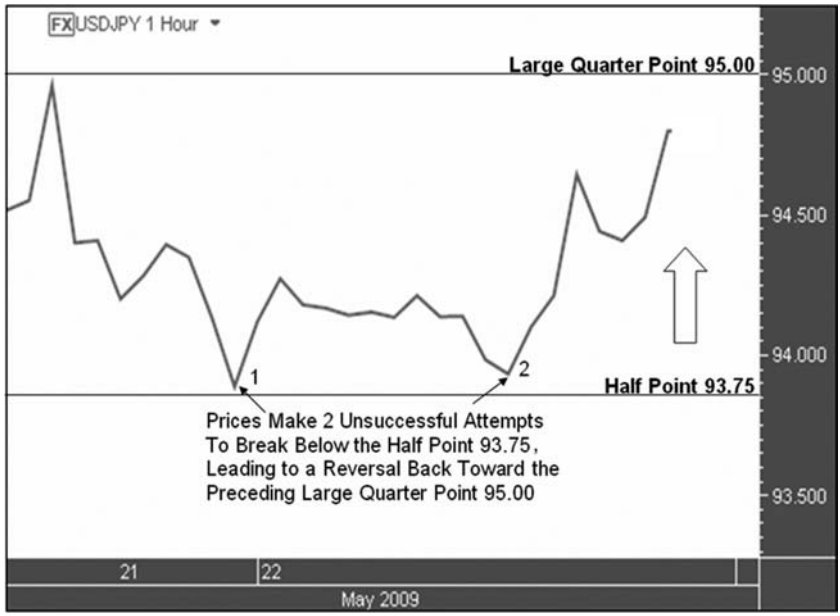

FIGURE 2.4 Price Behavior at the Half Point of a Large Quarter

Figure 2.4 shows the USD/JPY currency pair's exchange rate falling below the Large Quarter Point 95.00 in an attempt to complete the Large Quarter 95.00 to 92.50. Prices make a decisive move into the Large Quarter but encounter strong support at the Half Point 93.75. Two unsuccessful attempts to break below the Half Point 93.75 prevent prices from continuing further into the Large Quarter and lead to exhaustion and a reversal back toward the preceding Large Quarter Point 95.00.

Whole Number Preceding a Large Quarter Point The third important price level within each Large Quarter is the Whole Number preceding a Large Quarter Point. The Whole Numbers define the 100 PIP Ranges and coincide with the Major Small Quarter Points. As prices fluctuate between the Whole Numbers/Major Small Quarter Points and complete the 100 PIP Ranges from one Whole Number/Major Small Quarter Point to the next, a targeted Whole Number that marks the beginning and the end of a 100 PIP Range could become a support or resistance level that may be difficult to break. When strong support or resistance is met at a Whole Number preceding a Large Quarter Point, such a Whole Number can play a key role as the last problematic price point that may prevent the successful completion of a Large Quarter. Failure of prices to break the support or resistance

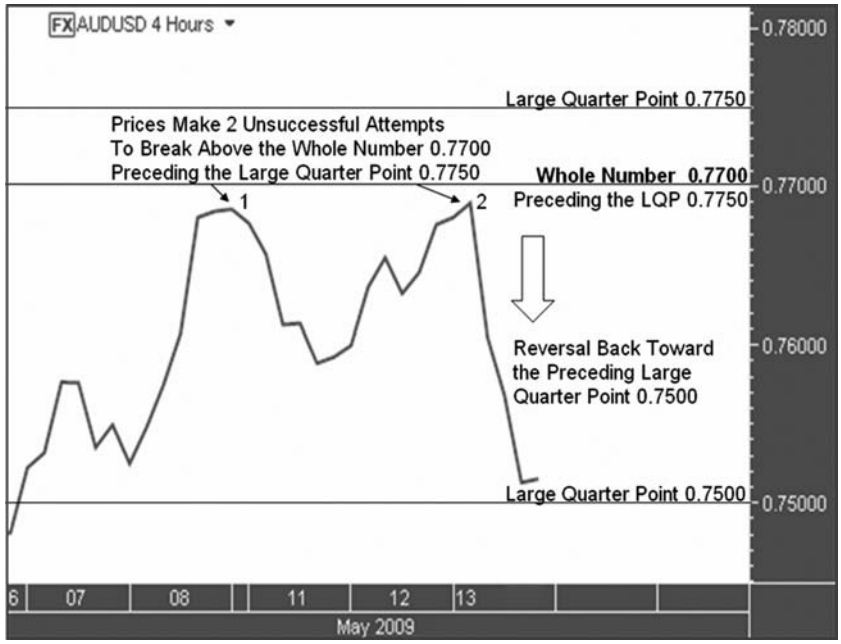

FIGURE 2.5 Price Behavior at the Whole Number Preceding a Large Quarter Point

of a Whole Number preceding a Large Quarter Point usually causes exhaustion and unsuccessful completion of the Large Quarter, leading to a reversal back toward the preceding Large Quarter Point.

Consider the example in Figure 2.5, which shows the AUD/USD currency pair's exchange rate moving above the Large Quarter Point 0.7500 in an attempt to complete the Large Quarter 0.7500 to 0.7750. Prices make a decisive move into the Large Quarter but encounter strong resistance at the Whole Number 0.7700 preceding the Large Quarter Point 0.7750. The two unsuccessful attempts to break above the Whole Number 0.7700 prevent prices from advancing further, causing unsuccessful completion of the Large Quarter 0.7500 to 0.7750, and leading to exhaustion and a reversal back toward the preceding Large Quarter Point 0.7500.

Major Short-, Mid-, or Long-Term Support/Resistance Levels

The Quarters Theory requires careful examination of each Large Quarter for certain major Short-, Mid-, and Long-Term support and resistance levels that may be positioned within the range of a Large Quarter. In instances when a Large Quarter contains a major Short-, Mid-, or Long-Term support or resistance level, there may be four (or more) important

price levels that can be used to analyze the price behavior of currency exchange rates within the Large Quarters: the End of the Hesitation Zone, the Half Point, the Whole Number preceding the Large Quarter Point, and any Major Short-, Mid-, or Long-Term support/resistance levels. These well-established Short-, Mid-, and Long-Term support and resistance levels are respected by the market and may prove difficult to overcome. Failure to break the support or resistance of a Major Short-, Mid-, or Long-Term support/resistance price level positioned within a Large Quarter usually causes exhaustion and unsuccessful completion of the Large Quarter, leading to a reversal back toward the preceding Large Quarter Point.

Figure 2.6 shows the USD/JPY currency pair's exchange rate finding support below the whole number 94.00 in March 2009. Prices bounce off support and the USD/JPY currency pair moves higher, but prices fall a couple of months later in May 2009 and the pair moves below the Large Quarter Point 95.00 in an attempt to complete the Large Quarter 95.00 to 92.50. As prices transition into the quarter, they approach the major multi-month Mid-Term Support Level below 94.00 positioned within the Large Quarter 95.00 to 92.50. The unsuccessful attempt to break below the Mid-Term Support Level below 94.00 prevents prices from advancing further,

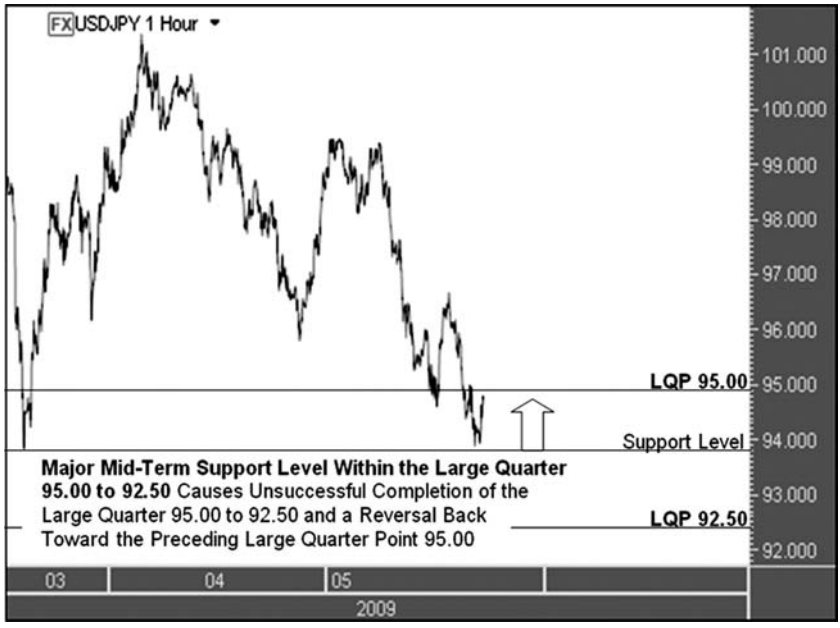

FIGURE 2.6 Price Behavior at a Major Support Level Positioned within a Large Quarter

causing unsuccessful completion of the Large Quarter 95.00 to 92.50 and leading to exhaustion and a reversal back toward the preceding Large Quarter Point 95.00.

Major Short-, Mid-, or Long-Term support/resistance levels often coincide with The Quarters Theory's three important price points within the Large Quarters: the End of the Hesitation Zone, the Half Point of a Large Quarter, and the Whole Number preceding a Large Quarter Point, or with the actual Large Quarter Points. In such instances, these levels become price points of *double significance* that may be even tougher to break. The main consequence of a failure to break the support or resistance of a double-significance price level positioned within a Large Quarter is exhaustion and unsuccessful completion of the Large Quarter, leading to a reversal back toward the preceding Large Quarter Point.

Consider the example in Figure 2.7, which shows the EUR/USD currency pair's exchange rate meeting resistance at the Whole Number 1.3700 in March 2009. After three unsuccessful attempts to break above the Whole Number 1.3700, the EUR/USD currency pair moves lower. A couple of months later in May 2009, prices move above the Large Quarter Point 1.3500 in an attempt to complete the Large Quarter 1.3500 to 1.3750. As

FIGURE 2.7 Major Resistance Level Coinciding with One of the Important Price Points within a Large Quarter

prices transition into the quarter, they approach a *double-significance* price level—the major multi-month Mid-Term Resistance Level that coincides with the Whole Number 1.3700 preceding the Large Quarter Point 1.3750. The failure to break above the double-significance level (the Mid-Term Resistance/Whole Number 1.3700 preceding the Large Quarter Point 1.3750) prevents prices from advancing further, causing unsuccessful completion of the Large Quarter 1.3500 to 1.3750, and leading to exhaustion and a reversal back toward the preceding Large Quarter Point 1.3500.

Overshoots of the support/resistance levels of the Large Quarter Points, the important price points within the Large Quarters, or the major Short-, Mid-, or Long-Term support/resistance levels within a Large Quarter should not be considered as decisive breakouts. Indecisive price moves of 25 PIPs or less above or below support or resistance levels indicate overshoots and could serve as early warning signs of exhaustion and breakout failure, leading to the unsuccessful completion of Large Quarters and reversals back toward the preceding Large Quarter Point.

Figure 2.8 shows the AUD/USD currency pair's exchange rate moving above the Large Quarter Point 0.7500 in an attempt to complete the Large Quarter 0.7500 to 0.7750. Prices make a decisive move into the Large Quarter but encounter resistance at the Whole Number 0.7700 preceding the

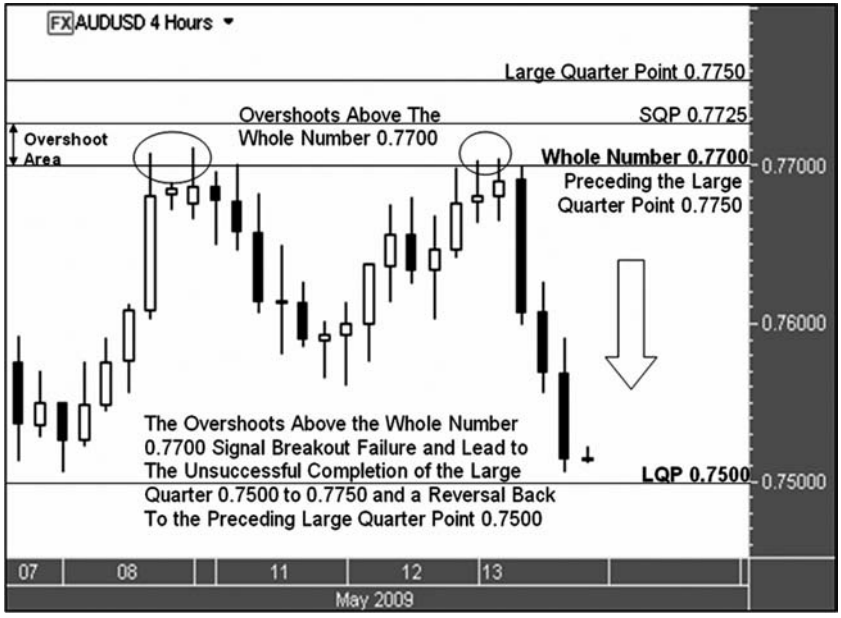

FIGURE 2.8 Overshoots Signaling Breakout Failure and Reversal

Large Quarter Point 0.7750. There are several attempts to break above the resistance of the Whole Number 0.7700 preceding the Large Quarter Point 0.7750; however, neither one of them produces a decisive breakout. Multiple overshoots of less than 25 PIPs above the Whole Number 0.7700 see prices contained within the Overshoot Area/Small Quarter 0.7700 to 0.7725, and signal indecisive price moves and exhaustion, leading to breakout failure, unsuccessful completion of the Large Quarter 0.7500 to 0.7750, and a reversal back toward the preceding Large Quarter Point 0.7500.

THE THREE-DAY RULE OF THE QUARTERS THEORY

The *Three-Day Rule* of The Quarters Theory requires that a Large Quarter is completed in a time period lasting no longer than three trading days. Although price moves of 250 PIPs or more may be produced in a matter of hours, or even minutes during highly volatile trading sessions, in most instances, a currency pair with an average trading range of 80 to 100 PIPs per day would normally take at least three trading days to complete a Large Quarter. The Quarters Theory allows three 24-hour trading sessions on the global foreign exchange market as a sufficient time period for the completion of a Large Quarter. A failure to complete a Large Quarter in three trading days should be considered a sign of price weakness and potential exhaustion that could lead to the unsuccessful completion of the Large Quarter, resulting in a reversal back toward the preceding Large Quarter Point.

To properly monitor the Large Quarter price moves from one Large Quarter Point to the next and the price progression along the range of each Large Quarter, the Three-Day Rule of The Quarters Theory calls for the following minimum price move requirements to be met on each one of the three trading days that it would normally take to complete a Large Quarter:

- *First day:* Large Quarter Transition into the range of a new Large Quarter confirmed by a decisive price move targeting at least the End of the Hesitation Zone. Since price pullbacks may follow each entrance into a new Large Quarter, prices should not break above or below the preceding Large Quarter Point during pullbacks.
- *Second day:* Further price progression is required toward the Half Point of the Large Quarter or toward the Whole Number preceding the targeted Large Quarter Point. Decisive price moves on the second day that challenge at least the Half Point of the Large Quarter would confirm a Large Quarter Transition as successful and prices should not break above or below the preceding Large Quarter Point on any pullbacks.

- *Third day:* Prices should successfully complete the Large Quarter. As long as there is a number registered as a high, low, open, or close price within one Small Quarter of 25 PIPs from the targeted Large Quarter Point by the end of the third trading session after a Large Quarter Transition, The Quarters Theory would consider a Large Quarter to be successfully completed. If the Large Quarter is not completed by the end of the third day, the unsuccessful completion of a Large Quarter may lead to a reversal that could take prices back toward the preceding Large Quarter Point.

Figure 2.9 shows a Large Quarter completion in line with the requirements of the Three-Day Rule of The Quarters Theory. The EUR/USD currency pair's exchange rate climbs above the Large Quarter Point 1.3750 in an attempt to transition into and complete the Large Quarter 1.3750 to 1.4000. On May 20, 2009, the first day of the entrance into the new Large Quarter, the EUR/USD pair produces a Large Quarter Transition by making a decisive move targeting the End of the Hesitation Zone 1.3825. Not being able to break outside of the Hesitation Zone in the first half of the second trading day, prices pull back toward the preceding Large Quarter

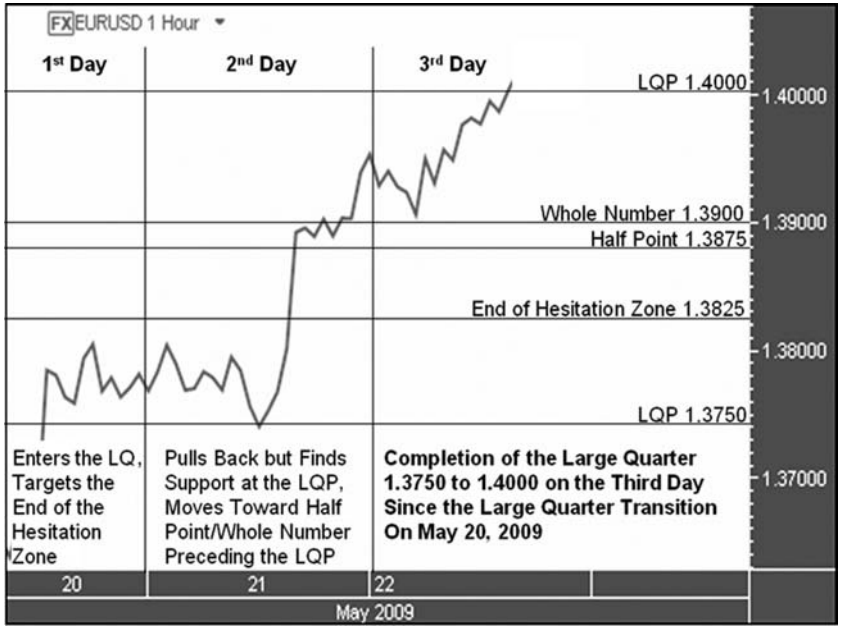

FIGURE 2.9 Large Quarter Completion in Line with the Requirements of the Three-Day Rule of the Quarters Theory

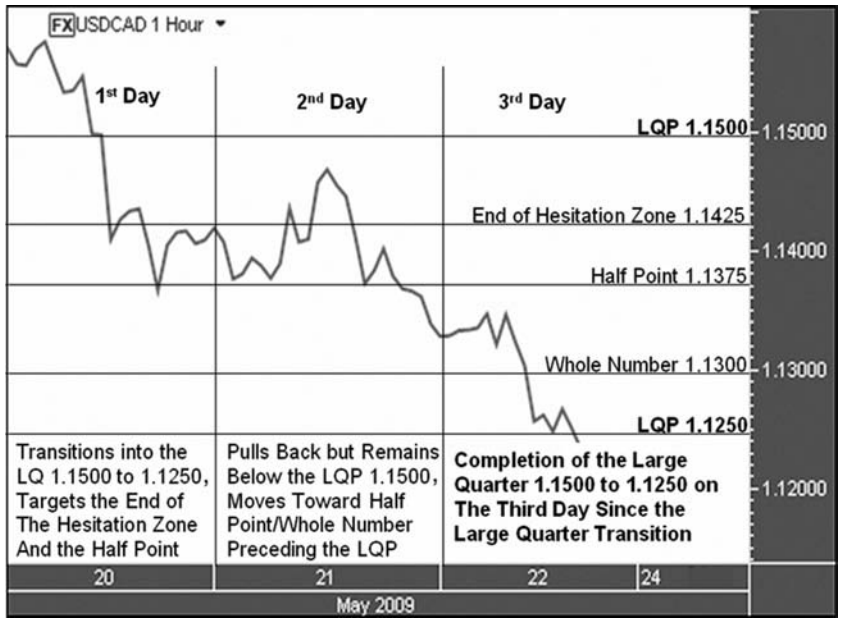

FIGURE 2.10 Large Quarter Completion According to the Requirements of the Three-Day Rule of The Quarters Theory

Point 1.3750 but do not break below it and remain within the new Large Quarter 1.3750 to 1.4000. After finding support at the Large Quarter Point 1.3750, in the second half of the trading session on May 21, 2009, the second day since the Large Quarter Transition, prices progress further into the Large Quarter by making a decisive move, targeting the Half Point 1.3875 and the Whole Number 1.3900 preceding the Large Quarter Point 1.4000. On May 22, 2009, the third day since the Large Quarter Transition, prices complete the Large Quarter 1.3750 to 1.4000.

Figure 2.10 is another real-life example of a successful completion of a Large Quarter accomplished in the exact time period required by the Three-Day Rule of The Quarters Theory. The USD/CAD currency pair's exchange rate moves below the Large Quarter Point 1.1500 in an attempt to transition into and complete the Large Quarter 1.1500 to 1.1250. On May 20, 2009, the first day of the entrance into the new Large Quarter, the USD/CAD pair produces a Large Quarter Transition by making a decisive move, targeting the End of the Hesitation Zone 1.1425 and also the Half Point 1.1375, confirming the Large Quarter Transition of prices into the Large Quarter 1.1500 to 1.1250. Not being able to continue further into the Large Quarter beyond the Half Point 1.1375 in the first half of the second trading day, prices pull

back toward the preceding Large Quarter Point 1.1500 but stay below it and remain within the Large Quarter 1.1500 to 1.1250. In the second half of the trading session on May 21, 2009, the second day since the Large Quarter Transition, prices progress further into the Large Quarter by breaking below the Half Point 1.1375 and targeting the Whole Number 1.1300 preceding the Large Quarter Point 1.1250. On May 22, 2009, the third day since the Large Quarter Transition, prices break below the Whole Number 1.1300 preceding the Large Quarter Point 1.1250 and complete the Large Quarter 1.1500 to 1.1250.

Strong price moves may be capable of completing a Large Quarter in less than three trading days. Consider the example in Figure 2.11, which shows a Large Quarter completion in just two days. The GBP/USD currency pair's exchange rate moves above the Large Quarter Point 1.5250 in an attempt to transition into and complete the Large Quarter 1.5250 to 1.5500. On May 18, 2009, the first day of the entrance into the new Large Quarter, the GBP/USD pair produces a Large Quarter Transition by making a decisive move, targeting the End of the Hesitation Zone 1.5325. By the end of the first trading session, prices pull back toward the preceding Large Quarter Point 1.5250 but do not break below it and remain within the new Large Quarter 1.5250 to 1.5500. On May 19, 2009, the second day since the Large

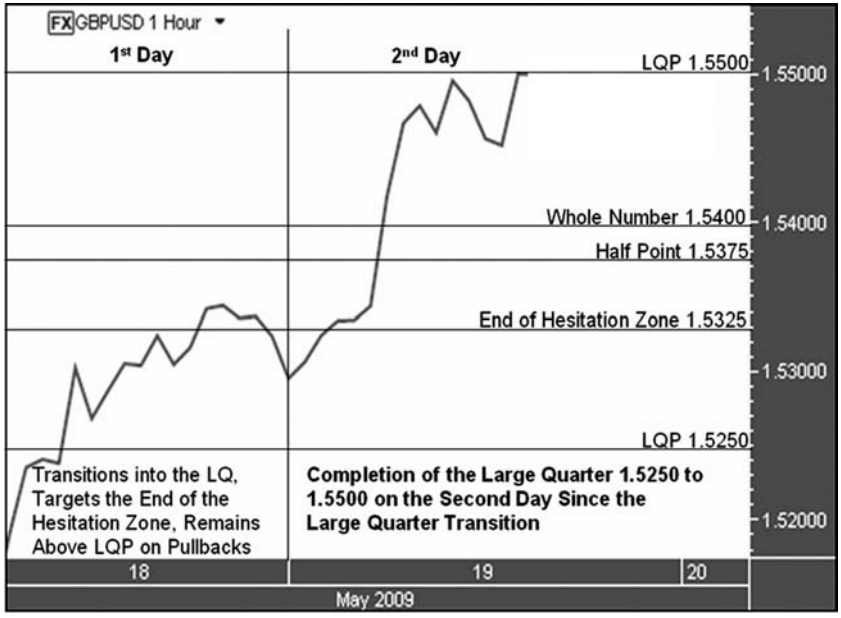

FIGURE 2.11 Large Quarter Completion in Less than Three Trading Sessions

Quarter Transition, prices make a strong move further into the Large Quarter, straight through the Half Point 1.5375 and the Whole Number 1.5400 preceding the Large Quarter Point 1.5500, and complete the Large Quarter 1.5250 to 1.5500 in just two trading sessions.

While some Large Quarters may take longer than three days to complete, others may end up not being completed at all even if the required period of three days were to be extended. The Quarters Theory recognizes that allowing more than three 24-hour trading sessions does not guarantee the successful completion of a Large Quarter. Moreover, if a Large Quarter is not completed in three days, prices may be more likely to lose steam and may begin to hesitate to continue further into the Large Quarter by encountering support or resistance levels that could become much more difficult to overcome as prices lose strength. In such instances, the Three-Day Rule of The Quarters Theory provides the early warning signs of potential unsuccessful completion of a Large Quarter that can prepare traders for possible reversals toward a preceding Large Quarter Point.

Figure 2.12 shows the EUR/USD currency pair's exchange rate transitioning above the Large Quarter Point 1.3500 in an attempt to complete the Large Quarter 1.3500 to 1.3750. On May 8, 2009, the first day of the entrance into the new Large Quarter, the EUR/USD pair confirms a Large

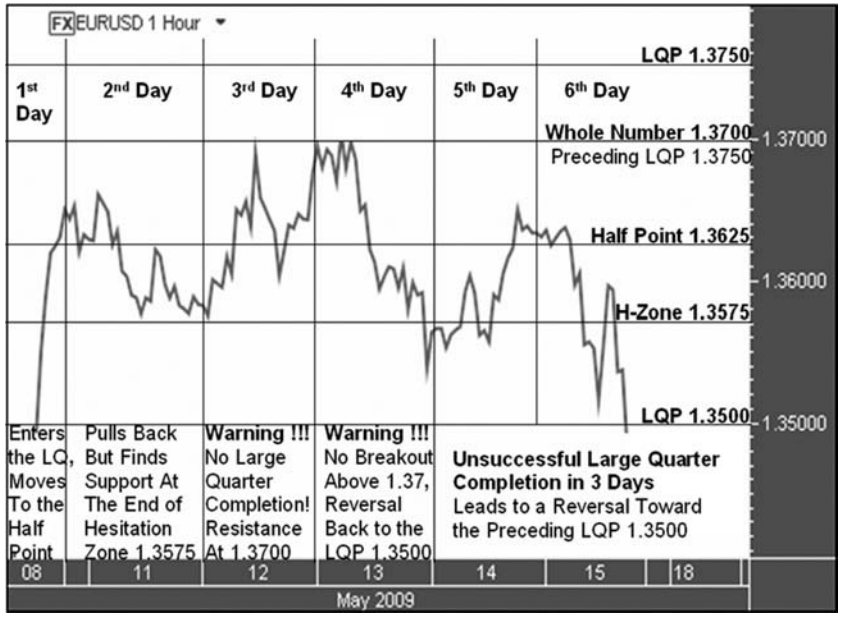

FIGURE 2.12 Failure to Complete a Large Quarter in Three Trading Sessions

Quarter Transition by making a decisive move, targeting the End of the Hesitation Zone 1.3575 and the Half Point 1.3625. On the second trading day, May 11, 2009 (after the weekend), prices pull back toward the preceding Large Quarter Point 1.3500 but find support at the End of the Hesitation Zone 1.3575 and remain within the new Large Quarter 1.3500 to 1.3750. On May 12, 2009, the third day since the Large Quarter Transition, prices move toward the Whole Number 1.3700 preceding the Large Quarter Point 1.3750, but encounter resistance there and do not complete the Large Quarter 1.3500 to 1.3750 on the third day. The fact that the Large Quarter is not completed within the required three-day time period sends the first warning sign of price weakness and potential unsuccessful completion of the Large Quarter 1.3500 to 1.3750. On May 13, 2009, the fourth day since the Large Quarter Transition, prices make several attempts to break above the resistance of the Whole Number 1.3700 preceding the Large Quarter Point 1.3750 but are not capable of producing a breakout, sending another warning signal of price exhaustion and failure to complete the Large Quarter in four consecutive trading sessions. The failed breakout attempts, coupled with the unsuccessful completion of the Large Quarter 1.3500 to 1.3750, lead to a reversal that takes prices back toward the preceding Large Quarter Point 1.3500.

The Three-Day Rule of The Quarters Theory serves as a time stop. *Stops* or *stop-loss orders* are orders to close a trade at a predetermined price level in order to avoid or to limit losses. Stops can be set not only by using prices, but also by time. *Time stops* provide a clearly defined period of time for each trade to reach its objective. If a trade does not accomplish its goal in the specified time period, the trade may be closed either to lock in profits or to protect against losses or to limit them. The objective of The Quarters Theory Trade is the successful completion of a Large Quarter. The Three-Day Rule of The Quarters Theory sets a clearly defined time period of three 24-hour trading sessions on the global foreign exchange market for each Quarters Theory Trade to reach its objective. If prices fail to complete a Large Quarter and a Quarters Theory Trade does not achieve its goal in the required three trading days, the trade may be closed to lock in profits, or to protect against or limit losses that may be realized should prices exhaust and reverse back toward the preceding Large Quarter Point as a result of the unsuccessful completion of a Large Quarter.

CHAPTER 3

Preparing The Quarters Theory Trades

The Quarters Theory Trades are based on the premise of The Quarters Theory that currency exchange rates fluctuate in an orderly manner between the Large Quarter Points within each 1000 PIP Range. The objectives of The Quarters Theory Trades are to take advantage of the significant price moves in currency exchange rates from one Large Quarter Point to another, or to capitalize on the smaller intraday price fluctuations between the important price points within each Large Quarter.

Great trades originate from great ideas, but trades should not be based on ideas alone, no matter how great these ideas may seem. In preparation for The Quarters Theory Trades, each trade idea should be carefully examined by applying thorough analysis of all fundamental and technical information available. A trade idea is not to be confused with an actual trade: Trading opportunities should be considered only if the fundamental and technical factors support the initial trade idea.

In the *retail foreign exchange* market, currencies are traded in pairs by comparing the value of one currency against another. The first listed currency in a currency pair is the *base currency*, or the unit that will be compared to the second *quote currency* used to determine the value of the base currency. The base currency will be stronger than the quote currency if it takes more of the quote currency to buy one unit of the base currency. The base currency will be weaker than the quote currency if it takes less of the quote currency to buy one unit of the base currency.

The exchange rate of the currencies in each currency pair fluctuates daily in the global market and is affected by fundamental factors such as economic data and geopolitical events that serve as catalysts for the

supply-and-demand market forces to determine the true price value of currencies. Certain technical developments—trends and trend reversals, overbought/oversold market conditions, breakouts of important support and resistance levels, and so forth—can also spark significant price moves. These major price fluctuations, triggered as the market prices into the currency exchange rates the outcome or future expectations of the market-moving fundamental and technical events, should be used as the catalyst and the driving force for The Quarters Theory Trades.

The Quarters Theory Trades must have a clear *edge*, or advantage of one currency over the other. The preparation for each Quarters Theory Trade should involve careful research and analysis of each one of the currencies in the currency pair that is being considered as a trading opportunity. The edge of each trade should be based on solid underlying fundamentals and favorable technical factors. Since *fundamentals* usually direct the technical developments, *technicals* such as trends, price patterns, technical indicators, and so forth should not contradict the underlying fundamentals. An environment where there is perfect alignment between fundamentals and technicals is the best environment for The Quarters Theory Trade.

The chapters ahead provide information that will assist traders when preparing The Quarters Theory Trades by applying fundamental and technical analysis, combined with the methodology of the Quarters Theory. Thorough research and trade preparation improves trading performance by reducing the element of the unknown, considered in some psychological studies as one of the main causes of fear, and contributes to the process of making objective trading decisions by allowing traders to gain control over the negative impact of trading based on emotions.

DISCOVERING THE FUNDAMENTAL EDGE

To this day, in spite of severe financial crises and economic recessions in recent decades, the United States continues to be the largest economy in the world and the U.S. dollar still maintains its status as the world's main *reserve currency*. Approximately two-thirds of the total foreign exchange reserves of countries around the globe are held in U.S. dollars.

The illustration in Figure 3.1, based on data from the International Monetary Fund and the European Central Bank, shows the percentage of major currencies held in the world's foreign exchange reserves from 1995 until 2005, and demonstrates the dominance of the U.S. dollar as a reserve currency.

The story of how the U.S. dollar became the most important currency in the world dates back to the final months of World War II, when

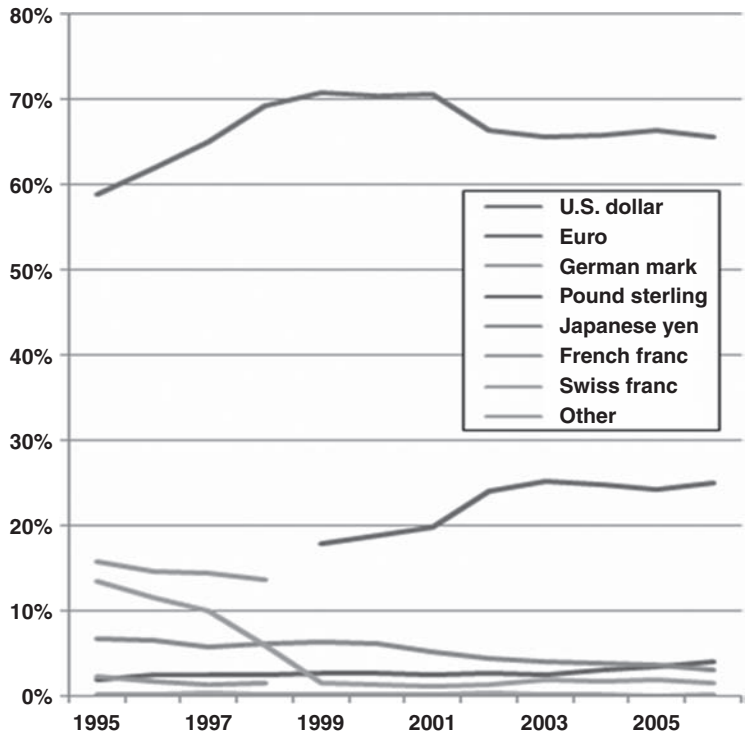

FIGURE 3.1 Percentage of Major Currencies Held in the Global Foreign Exchange Reserves from 1995 to 2005

delegates of 44 nations led by the Big Three Allied powers—the United States of America, the Union of Soviet Socialist Republics, and the British Empire—met in the Bretton Woods area of the U.S. town of Carroll, New Hampshire for the United Nations Monetary and Financial Conference. The main focus of the conference was the rebuilding of the postwar international financial system by creating new procedures and regulations, as well as two new global financial institutions—the International Monetary Fund and the International Bank for Reconstruction and Development.

The *Bretton Woods Agreement* was signed in July 1944, creating the *Bretton Woods financial system*, establishing a gold standard that required a commitment from each country to maintain a fixed value for the exchange rate of its currency in terms of gold. Under the Bretton Woods system, the U.S. government stepped up to offer a guarantee to other countries and their central banks that, if needed, they would be able to exchange their U.S. dollar reserves for gold at a fixed rate. The country's currency exchange rate was eventually pegged to the U.S. dollar with the perception

that the U.S. dollars were "as good as gold." This is how the world's financial power was transferred to the United States and the U.S. dollar took center stage as the most important currency in the world, pushing aside the United Kingdom's currency, the sterling.

With inflationary pressures rising and gold reserves running dry, the Bretton Woods system collapsed in 1971 when the United States ceased to let U.S. dollars be pegged and converted to gold. Currency exchange rates were allowed to float freely in the open foreign exchange market and, despite gold's rally from $35 to about $850 per ounce and the U.S. dollar's considerable decline against other currencies in the years following the collapse of the Bretton Woods system, the U.S. dollar continued to maintain its status as the world's main reserve currency.

After World War II, the reconstruction and emergence of Germany as an economic power helped the Deutsche mark to become the second most important reserve currency in the world. The reserve currency status of the deutsche mark was directly transferred to the Euro with its launch as a single currency of the Euro-zone on January 1, 1999, and since then the Euro has become the second most powerful reserve currency in the world.

The U.S. dollar and the Euro make up approximately 90% of the global foreign exchange reserves. Even though in recent years many countries have increased their purchases of Euros in order to diversify their reserves, about 64% of the global foreign exchange reserves are still held in U.S. dollars, compared with approximately 30% of the total reserves held in Euros.

For 200 years, throughout the eighteenth and the nineteenth centuries, the currency of the United Kingdom, the British pound, maintained the status of the world's primary reserve currency. After World War II, as a result of the gold standard, and the transfer of economic and financial power to the United States, Germany, and later to the Euro-zone, the pound had become the third most popular reserve currency in the world, after the U.S. dollar and the Euro.

Over the past several decades, due to the resurgence of the Japanese economy as the second-largest economy in the world, the Japanese yen has managed to push the pound from third place as one of the main reserve currencies. However, in recent years, a monetary policy of extremely low interest rates in Japan has fueled the *carry trade* and has caused significant Japanese yen weakness, allowing the pound to reclaim its previous position as the third most widely held reserve currency in the world.

The strength and stability of a country's economy and financial markets determine its currency's attractiveness and ability to be a reserve currency. The U.S. dollar, the Euro, the Japanese yen, and the British pound, along with other major industrialized nations' (Canada, Switzerland, Australia) currencies—the Canadian dollar, the Swiss franc, and the Australian dollar—make up the list of the world's major currencies.

When paired with each other, the major currencies form the major *currency pairs*, such as EUR/USD, GBP/USD, USD/JPY, USD/CHF, USD/CAD, and AUD/USD. The most traded currency pairs on the spot Forex market are: the EUR/USD pair, with 27% of total transactions; the USD/JPY, with 13%; and the GBP/USD pair (also called "the cable"), with 12%. The U.S. dollar has been part of over 80% of global daily foreign exchange transactions since April 2007.

At the helm of the global financial system are the *central banks* of the world's biggest industrialized nations. The Federal Reserve (the Fed) is the central bank of the United States, the European Central Bank is the central bank of the Euro-area, the Bank of England is the central bank of the United Kingdom, and Japan's central bank is the Bank of Japan. Other major central banks are the Swiss National Bank, the Bank of Canada, and the Reserve Bank of Australia.

The key objective of central banks is to determine monetary policies that assure price stability and sustainable economic growth. Central banks set the official interest rates at which they lend to financial institutions. Interest rate decisions and monetary policy announcements from major central banks are some of the most important economic events that every currency trader should pay close attention to.

The interest rate, or the price of money, is a tool used by the central banks to influence the overall economy and control inflation. Low interest rates normally lift the prices of assets (houses, stocks, etc.), increasing corporate and individual wealth and causing more willingness to spend. Low interest rates tend to increase economic activity and output by stimulating consumer and corporate borrowing and spending, helping employment, new jobs creation, and economic growth. However, inflation can occur if the volume of economic output grows less quickly than the actual money spent.

Inflation is an increase in prices of goods and services that reduces the value and the purchasing power of money. High inflation can be damaging not only to currencies but also to the entire economy. The role of central banks is to protect the value of their currencies by controlling inflation. The central banks in most industrialized nations prefer to contain inflation in a target range around 2%. If inflation rises above the normal level, central banks can decide to raise interest rates, increase the cost of borrowing, and slow economic growth, in order to curb rising inflation.

Central banks take into consideration a number of economic and financial indicators to gauge economic conditions and determine an appropriate monetary policy. These indicators are released daily around the globe and currency traders pay close attention to them, because positive or negative changes in a country's economic condition can have a significant impact on the exchange rate of the country's currency. Listed below are the

most popular economic indicators preferred by the Fed and other major central banks.

The Real Gross Domestic Product (GDP) is the main gauge of economic activity and growth, measuring the total value of goods and services produced within the United States. The term *real* means that the output growth is measured in real terms by removing any increases in output caused by inflation. The Real GDP, combined with employment and inflation data, provides an overall picture of economic conditions and trends, and helps policymakers to determine monetary policies in order to assure sustained economic growth and price stability. The official GDP report is released each quarter, but preliminary, advanced estimates are issued in the final week of the months immediately following the end of a calendar quarter.

The Consumer Price Index (CPI) measures the changes in prices of a fixed basket that includes typical goods and services normally purchased by consumers. Changes in the CPI show the rate of inflation. The CPI is the main gauge of inflation preferred by many central banks. The CPI is released monthly and always follows the Producer Price Index (PPI).

The main measure of inflation in the Euro-zone is the Harmonized Index of Consumer Prices (HICP). It is used by the European Central Bank as its preferred gauge of inflation. The HICP is the Euro-zone's equivalent to a CPI that has been harmonized as a weighted average of changes in prices across all member countries of the Euro-zone. The U.K. CPI also uses a harmonized methodology to measure inflation across the countries of the United Kingdom. The U.K. CPI is the main measure of inflation used by the Bank of England.

The Producer Price Index (PPI) measures changes in the average sale prices received for the output of domestic producers. The PPI measures the level of inflation experienced by manufacturers and producers, also called *wholesale inflation*, which normally is passed from producers onto the consumers. Therefore, the PPI is considered to be a leading indicator of consumer inflation measured by the CPI.

Non-Farm Payrolls Employment, also known as Employment Situation, is a comprehensive report of labor market conditions, covering employment, jobs creation, and unemployment rate of workers on non-farm payrolls. Besides estimating the number of non-farm payroll jobs from 150,000 private businesses and government agencies, the employment situation report also shows the rate of unemployment, the average hourly and weekly earnings, and the number of work hours per week. The Employment Situation report is crucial for gauging the overall condition of the economy and is usually released on the first Friday of each month. The Employment Situation is one of the key economic reports that have

historically proven to have the strongest potential to serve as a catalyst for significant market moves.

Housing Starts, Existing Home Sales, and New Home Sales are important gauges of housing market conditions. The Housing Starts measure new residential construction of housing units authorized to be built by a building or zoning permit; housing units authorized to be built, but not yet started; housing units started; housing units under construction; and housing units completed. The Existing Home Sales measure current total sales and prices of existing single-family homes, town homes, condos, and co-ops. The Existing Home Sales are the main gauge of conditions in the residential real estate market and are released on or around the twenty-fifth day of each month. The New Home Sales are a measure of the total sales and prices of newly constructed single-family homes, town homes, condos, and co-ops. The housing market is very dependent on interest rates. The close connection between housing wealth and consumer spending makes housing one of the most important sectors of the economy.

Industrial Production and Capacity Utilization are gauges of conditions in the industrial sector of the economy. Industrial Production measures the total output of industries like manufacturing, mining, utilities, consumer goods, intermediate goods, business equipment, and materials. Capacity Utilization measures the level of utilization of industrial resources. The industrial sector represents approximately 20% of the Gross Domestic Product (GDP). Changes in Industrial Production and Capacity Utilization are useful indicators of trends in economic growth.

Retail Sales are an important gauge of consumer spending, measuring the total sales of goods sold at retail establishments. The Retail Sales data is released monthly and does not include sales of services. Retail Sales are a leading indicator of personal consumption expenditures.

Personal Consumption Expenditures (PCE), also known as Personal Income and Outlays, measure income, expenditures, spending characteristics, and buying habits of consumers. The data is released each month along with a very important Personal Consumption Expenditures Deflator Index, also called PCE Deflator, which measures price changes of a variable basket of goods and services, as apposed to the CPI, which measures the changes in prices of a fixed basket that includes typical goods and services normally purchased by consumers. The PCE Deflator is currently the Federal Reserve's preferred measure of inflation. The PCE combined with retail sales data are key measures of consumer spending and leading indicators of future economic growth because approximately two-thirds of the U.S. GDP is represented by personal consumption expenditures.

Durable Goods Orders, Shipments, and Unfilled Orders provide data that track new orders, shipments, and unfilled orders for durable goods

like machinery, primary and fabricated metals, electricity-generating equipment, computers and other information processing equipment, civilian and military aircraft and ships, automobiles, and trucks and other transportation equipment. The Durable Goods Orders are an indicator of business investment demand and economic conditions. An increase in durable goods orders can lead to rising production and employment, and can stimulate future economic growth.

The Business Sales and Inventories report measures the ratio between total sales and existing inventories held by wholesale, retail, and manufacturing businesses. Business Sales and Inventories are used as an indicator of current and future economic conditions. Rising business inventories coupled with declining sales can lead to cuts in production and slower economic growth.

In order to assess current and future economic conditions, central banks and monetary policymakers also pay close attention to the following financial indicators and factors.

- *Bond yields:* These are yields on short- and long-term bonds issued by the governments of major industrialized nations—U.S. Treasury bonds, U.K. gilts, German bunds, and so forth. Government bonds, also called *government paper*, are debt securities issued by governments to borrow funds in order to finance current and future government expenditures. The bond issuer offers a predetermined rate of interest and promises to pay back the purchaser on the day that the bond will mature.
- *Ten-year U.S. Treasury bond yield:* Closely watched by the Fed is the yield on the ten-year U.S. Treasury bond, the current interest rate for government paper maturing in ten years. Changes in the ten-year Treasury bond are an indicator of moves in the long-term interest rates that could affect sectors of the economy that are sensitive to interest rates, especially the housing sector. Mortgage interest rates often move in conjunction with the interest rate of the ten-year Treasury bond and the relation between the two can be used to predict future housing market activity. Higher yields could cause an increase in demand from foreign investors for U.S. government bonds and other U.S.-dollar-denominated securities and financial derivatives, which in turn could strengthen the U.S. dollar.
- *M2 money supply:* The M2 money supply is a key measure of the amount of money available in a nation's economy. The M2 money supply is a combination of M1 (the total currency in circulation, checking deposits, and traveler's checks), plus savings deposits, less-than-$100,000 time deposits that cannot be withdrawn for a certain period of time, and noninstitutional money market funds deposited

by individuals. The M2 money supply is used as a gauge of future inflation and economic conditions, as increases in the supply of money can stimulate lending and the economy but could also cause a significant rise in inflationary pressures.

- *The Beige Book:* The Beige Book is a report on economic conditions in the 12 Federal Reserve Districts of the United States, based on anecdotal information gathered from reports by bank directors of the district branches, as well as from interviews with economists, market experts, and other sources. The Fed's interest rate and monetary policy decisions are influenced by the data from the Beige Book combined with economic and financial indicators.

When determining the appropriate monetary policy, central banks also keep an eye on price changes and conditions in the world's equity markets, as measured by the main stock market indices: S&P 500, the Dow (Dow Jones Industrial Average), and NASDAQ in the United States; Nikkei in Japan; FTSE 100 in the U.K.; Dow Jones Stoxx 50 and DJ Stoxx 600 in Europe; DAX 30 in Germany; CAC 40 in France; S&P/ASX in Australia; Hang Seng in Hong Kong; and so on. The Fed uses the S&P 500 Stock Index as a preferred gauge of stock market performance and as a component of the Leading Indicators of economic activity. Rising stock markets can be a sign of an increase in business investment, consumer spending, and robust economic growth.

Consumer spending plays an important role in the economic growth of the major industrialized nations. For example, consumer spending accounts for two-thirds of the U.S. Gross Domestic Product, compared with the industrial sector, which holds only about 20% of the U.S. GDP. With consumer spending, industrial production, and business expenditures composing the majority of the GDPs of major economies around the globe, several notable consumer and business surveys are released monthly to determine the economic situation of consumers and businesses and how they feel about current and future economic conditions.

Consumer Confidence and Consumer Sentiment are surveys of households on their personal financial situation, their intentions to make purchases, and their assessment of overall conditions in the economy. Both surveys are not only gauges of the current views and economic situation of consumers, but they also provide an outlook for future consumer spending and economic trends.

There are also three popular surveys in Europe, issued by the IFO Institute for Economic Research, the ZEW Center for European Economic Research, and the GfK Market Research Group, that have the potential to move the European markets. The IFO Group Business Climate is a survey of German manufacturers and businesses on their current economic

situation and their expectations of future conditions in the German economy, which is the largest economy in the Euro-zone. The ZEW Economic Sentiment is a survey of 350 financial experts and analysts on their current views and future expectations for the economic situation in Germany, the Euro-zone, the United States, and the United Kingdom. The ZEW Economic Sentiment survey is used as a leading indicator of the German economy. The GfK Consumer Confidence is another popular monthly survey used to gauge consumer confidence in the U.K. and Germany.

In Japan, the Tankan survey is considered to be one of the most important indicators of business sentiment. The Tankan survey questions thousands of large and small companies and businesses on their current economic activity and future expectations, and is issued every quarter by the Bank of Japan.

The Leading Indicators are indexes that help to predict future changes in economic conditions in the world's industrialized nations. The Index of Leading Indicators in the United States includes ten economic indicators: the yield curve (the rate spread between short- and long-term interest rates), consumer expectations, jobless claims, average weekly work hours by manufacturing workers, M2 money supply adjusted for inflation, new residential building permits, nondefense new capital goods orders, new orders for consumer goods and materials by manufacturers, new merchandise deliveries from suppliers to vendors, and the S&P 500 stock market index.

Issued in the United States by the Institute for Supply Management (ISM) are two popular surveys, the ISM Manufacturing Index and the ISM Non-Manufacturing Index. The ISM Manufacturing Index is a monthly survey of purchasing managers on economic conditions and activity in the manufacturing sector. The ISM Non-Manufacturing Index is a survey of purchasing managers on economic activity in industries like agriculture, mining, construction, transportation, communications, wholesale trade, and retail trade. In both, the ISM Manufacturing Index and the ISM Non-Manufacturing Index, the level of 50 serves as the dividing line that signals economic contraction if the reading is below 50, or economic expansion if the reading is above 50.

Similar to the ISM surveys in the United States are the Manufacturing PMI (Purchasing Manager's Index), the Services PMI, and the Construction PMI, which measure the level of activity of purchasing managers in the manufacturing, services, and construction sectors of the economies in the Euro-zone, the United Kingdom, Switzerland, Canada, and Australia.

Several notable indexes of economic activity are also issued in Japan. The Tertiary Index tracks the activity and economic conditions in the services industries: utilities, transport and telecommunications, wholesale and retail, finance and insurance, and real estate. The All Industries Activity Index is used to determine the level of activity in all sectors of the Japanese

economy: the services industry combined with activity in the construction, agricultural, public, and industrial sectors of the economy.

Because of the close connection between housing wealth and consumer spending, market participants tend to pay attention to indices that track home prices in the major industrialized nations. In the United States, the S&P/Case-Shiller National Home Price Index tracks the monthly changes in the average price of single-family homes in 20 metropolitan areas. The U.S. House Price Index measures the price changes of homes with mortgages backed by the two mortgage giants, Fannie Mae and Freddie Mac.

Several important gauges of changes in home prices and housing market conditions in the U.K. include the RICS (Royal Institution of Chartered Surveyors) House Price Balance, the Nationwide House Price Index, the Rightmove House Price Index, and the British Bankers' Association Mortgage Approvals, used as a leading indicator of housing market activity.

Although not as crucial for central banks when determining interest rates and monetary policy, the following economic indicators may affect currency exchange rates significantly.

The International Trade Balance, also called *balance of trade*, measures the difference between imported and exported goods and services in a nation's economy. Imbalances in trade can cause a trade deficit when a country imports more goods than it exports or a trade surplus if a country exports more than it imports. Increases in a country's exports leading to trade surplus can cause more demand for its currency. On the other hand, a high trade deficit can weaken a country's currency.

The TIC (Treasury International Capital) is a reporting system that collects monthly data for cross-border investment flows and positions between U.S. and foreign residents. The TIC data is often used as a measure of the attractiveness of the U.S. dollar and U.S.-dollar-denominated securities and financial derivatives for foreign investors. A similar report, called Foreign Security Purchases, is issued in Canada as a measure of the attractiveness of the Canadian dollar for foreign investors.

An important first step when preparing The Quarters Theory Trade is to identify a clear fundamental edge by considering whether one currency has any fundamental advantage over the other in a currency pair. Careful examination of fundamental factors such as economic indicators, interest rates and yield differentials, central bank policies, and geopolitical events can reveal that the underlying fundamentals may be in favor of certain currencies and may be negative for others.

A good example of how an economic indicator can affect the price of a currency is the relationship between inflation and interest rates. If a country's main measure of inflation, usually the CPI, rises, higher inflation can prompt a country's central bank to raise interest rates in order to curb inflation. Higher interest rates can increase the yield differential and the

yield advantage of the currency over other lower-yielding currencies, and could create more demand for the higher-yielding currency.

A comparison between interest rates and central bank policies in different countries can show significant yield differentials between certain major currencies. In recent years, the Bank of Japan's low-interest-rate policy has been the main driver of the *yen carry trade*, or borrowing in Japanese yen at very low interest rates and using the loans to buy higher-yielding assets in other countries, bringing years of Japanese yen weakness against other higher-yielding currencies. In such an environment, considering a trade that capitalizes on the negative for the Japanese yen fundamental factors may be a great first step on the road to producing a winning trade.

For many years, changes in yield differentials have created a 95% correlation between the yield gap of the two-year German and U.K. government paper and the EUR/GBP exchange rate. A spread of 160 basis points advantage in favor of the German two-year treasuries over the similar U.K. government paper has fueled a Euro rally by 36% against the British pound since early 2007.

Another recent example of a major fundamental factor that could reveal a clear fundamental edge is the massive risk aversion and unwinding of carry trades as a result of the global financial crisis of 2008/2009 that has benefited lower-yielding currencies such as the Japanese yen. The financial crisis has triggered repatriation and the *flight to safety* that has also increased demand for the U.S. dollar because of its status as a safe-haven currency, leading to the strengthening of the U.S. dollar against other currency majors.

Besides becoming familiar with the most important economic indicators and their meaning, currency traders should pay attention to economic reports and prices pertaining to commodities, especially oil and gold.

Major currencies such as the Canadian, the Australian, and the New Zealand dollar are called *commodity currencies* because the economies of these countries are closely related to producing and exporting commodities. Changes in commodity prices affect how the commodity currencies are traded. For example, the Canadian dollar could strengthen if the price of oil rises, as the Canadian economy would benefit from higher energy prices because Canada is one of the main producers of oil and one of the biggest exporters of energy in the world. Prices of metals such as gold and copper, as well as changes in prices of agricultural products, can affect the Australian and the New Zealand dollar because over 50% of Australia's and New Zealand's exports come from the mining and agricultural sectors of their economies.

In the process of discovering a clear fundamental edge and underlying fundamentals of a currency, traders should also pay close attention to

major geopolitical events that could increase the *geopolitical risk*. Changes in a country's government, political instability, acts of war, terrorist attacks, and natural disasters could have major impact on a country's currency. Other geopolitical events include G7 industrialized nations and central bank meetings, statements and press conferences by central bank policymakers and government officials, and so forth.

The key role of a central bank is to maintain price stability by constantly monitoring and identifying potential problems and vulnerabilities, and taking the necessary measures to reduce risks and ensure the resilience of its financial system. A country's central bank is in charge of setting the official interest rates and monetary policy, controlling the supply of money, regulating the banking sector, lending money to other banks, and managing the country's currency and assets.

Although normally considered to be a last-resort option by central banks, a major factor that can dramatically change the underlying fundamentals of a currency is the act of a currency market intervention. The central bank of a country has the authority to intervene in the market in order to increase or decrease the value of its own currency. A central bank can also agree to participate in an organized effort with other central banks around the world in order to influence the price of a particular currency that may be the object of an organized intervention by multiple central banks.

Some examples of currency intervention include the events of September 16, 1992, also known as *Black Wednesday*, when the British government was unable to keep the sterling above its agreed lower limit and was forced to withdraw the pound from the European Exchange Rate Mechanism, leading to the collapse of the British pound. The U.K. treasury and the Bank of England were forced to intervene by pouring in 27 billion of currency reserves in order to support the pound. One of the biggest currency investors in the world, Mr. George Soros, is famous for correctly forecasting these historic fundamental developments, selling short the British pound and profiting over 1 billion U.S. dollars.

In June 2003, the Bank of Japan began a 15-month-long intervention to weaken the Japanese yen against the U.S. dollar, in an attempt to help the Japanese exports and elevate the Japanese economy from 14 years of deflation. At that time, the Bank of Japan increased the supply of Japanese yen by "printing" over 35 trillion yen, purchasing 320 billion U.S. dollars, and investing it into U.S. Treasuries.

The Bank of Japan's actions, described in the above example, were a direct result of a monetary policy called *quantitative easing*, or creating new money and increasing the supply of money, while at the same time easing the pressure on the banks caused by the risk of liquidity shortage by providing them with excess liquidity and reserves, and stimulating bank

lending. Some quantitative easing tools used by central banks include purchasing government debt, lending money to banks, and buying banks' assets. Historically, the policy of quantitative easing is perceived as negative for currencies because increasing the supply of money can create inflation and devalue a country's currency. In recent years, there have been some arguments that quantitative easing doesn't necessarily have to be completely negative for currencies, and that there are benefits to quantitative easing when it is used as a tool to create inflation in order to avoid deflationary periods in the economy, leading to quicker economic recovery after prolonged recessions. In an effort to tackle the financial meltdown of 2008/2009, the U.S. Federal Reserve announced a new monetary policy of close to zero interest rates target band between 0% and 0.25% combined with aggressive quantitative easing that included plans to buy up to $300 billion in U.S. Treasuries and purchasing up to $750 billion of mortgage-backed securities in an effort to take these "toxic assets" off the balance sheets of troubled financial institutions. The Fed's aggressive quantitative easing announcement on March 18, 2009, was met with a steep U.S. dollar selloff. On that day, the EUR gained over 500 PIPs against the U.S. dollar in a single trading session—the biggest one-day gain for the EUR since its inception as a currency.

In light of the recent credit crisis and economic recession, fundamental factors such as government debt and credit debt ratings of individual countries have also impacted the exchange rates of certain currencies. Several member countries of the European Union and some Eastern European countries have seen their credit ratings slashed as a result of increased risks in the ability of these countries to repay their debt, which has weighed on the Euro. Years of tensions between the United States and China on the issue of currency manipulation and monetary policy may continue to pose danger for the future strength of the U.S. dollar if China, the largest buyer of U.S. Treasuries, decides to significantly reduce its purchases of U.S. government debt.

Understanding the current fundamental environment and identifying a clear fundamental edge is a crucial first step for currency traders who would prefer not to rely solely on technical indicators when making their trading decisions. Creating a habit of building trades based on solid underlying fundamentals is an excellent way for traders to increase their probabilities of success and generate consistent profitability.

COMBINING THE QUARTERS THEORY AND FUNDAMENTAL ANALYSIS

In the process of combining The Quarters Theory methodology with *fundamental analysis*, favorable underlying fundamentals should be discovered

and used to serve as a catalyst for significant price moves from one Large Quarter Point to the next, leading to the successful completion of Large Quarters.

In spite of the common perception that fundamental analysis is only suitable for long-term investors, the economic and geopolitical news events that take place daily around the world affect how the major currencies are traded in the Forex market and can produce large price fluctuations in a short period of time. When positive, the outcome of news events and economic releases can increase a previously existing fundamental advantage of one currency over the other in a currency pair and could accelerate the process of completing a Large Quarter that the currency pair may be working on.

Economic releases or news events that have a negative outcome may change the underlying fundamentals and tilt the advantage that one currency may have in favor of the other in a currency pair. Negative for certain currencies, economic or geopolitical events can cause trend reversals and could lead to unsuccessful completion of Large Quarters.

Some technical analysis traders often disregard even the basic fundamental research because of the tendency to believe that all fundamental data has already been priced into and reflected in the current price. When trading currencies, however, neglecting the fundamentals when preparing for a trade, or not being aware that important economic data may be released while holding a position, could have severe adverse effects on the actual trade.

For the duration of each Quarters Theory Trade and while the traded currency pair is working on completing a Large Quarter, traders should make sure that any current or upcoming economic or geopolitical events are not expected to cause changes in the underlying fundamentals.

Because of the tendency of the market to price in advance the expectations for future developments, currency traders should have a clear understanding not only of the current fundamental environment but also of expectations and consensus forecasts for any upcoming economic reports and geopolitical events.

If a certain currency pair is considered to be a trading opportunity, it is important that the trader is aware of what economic reports are scheduled from the countries that the two currencies in the pair represent. Traders should know the exact times when the upcoming economic data will be released and should research in advance to find out whether the issued consensus forecasts for the outcome of the economic reports could cause changes in the underlying fundamentals of the currency pair.

Here are some examples of how to combine the methodology of The Quarters Theory with fundamental analysts. Listed below are two examples of potential Quarters Theory Trades based on a solid fundamental advantage of one currency over another that also uses negative forecasts and

the buildup leading to upcoming important economic reports to serve as catalysts for the successful completion of Large Quarters.

Let us assume that a trader looking for trading opportunities notices on Monday, February 9, 2009, that the EUR/USD pair is falling below the Large Quarter Point at 1.3000. After careful examination of all fundamental information available, the trader discovers that a negative market environment has triggered risk aversion, leading to the flight to safety into safe-haven currencies, increasing the demand for USD and causing the USD to strengthen. The trader's plan is to take advantage of further continuation of the down markets/risk aversion correlation by shorting the EUR/USD pair. The trader notices several important economic reports coming up from the Euro-zone in the next few days that could serve as catalysts for a significant price move and that could lead to the successful completion of the Large Quarter below 1.3000 toward the Large Quarter Point at 1.2750.

Considering that risk aversion is likely to occur in a down market, in this example there is an opportunity for a Quarters Theory Trade that takes advantage of a clear fundamental edge as long as the trader makes sure that there will be no expected changes in underlying fundamentals for the duration of the trade. In this case, a trader will need to examine the economic calendar, prepare for the upcoming important economic reports from the Euro-zone, which could directly affect the Euro and the EUR/USD pair, analyze the consensus forecasts for the outcome of these economic events, and make sure that the upcoming economic data is expected to show deteriorating economic conditions in the Euro-zone. The trader intends to use the negative forecasts and the buildup leading to upcoming important economic reports to serve as catalysts for the successful completion of the Large Quarter toward 1.2750.

Please note in the chart in Figure 3.2 that on Monday, February 9, 2009, the trader notices that the EUR/USD pair remains below the Large Quarter Point at 1.3000, which, according to The Quarters Theory, is considered a sign of weakness, and that as long as the EUR/USD pair stays below 1.3000, there would be an increased probability that the pair will continue to work on the Large Quarter below the Large Quarter Point at 1.3000, potentially targeting the Large Quarter Point at 1.2750. The market is expecting three important economic reports from the Euro-zone: the Industrial Production on Thursday, February 12, 2009; the Euro-zone GDP on Friday, February 13, 2009; and the German ZEW Business Expectations Survey on Tuesday, February 17, 2009. Two of the reports are expected to be negative with the exception of the German ZEW survey, which is expected to show improvement in the German business sentiment. The consensus forecast for the Industrial Production expects a decline in industrial output by −2.5% m/m (month over month) compared to the previous reading of −1.6% m/m, and −9.5% y/y (year over year) compared to previous reading of −7.7%. The

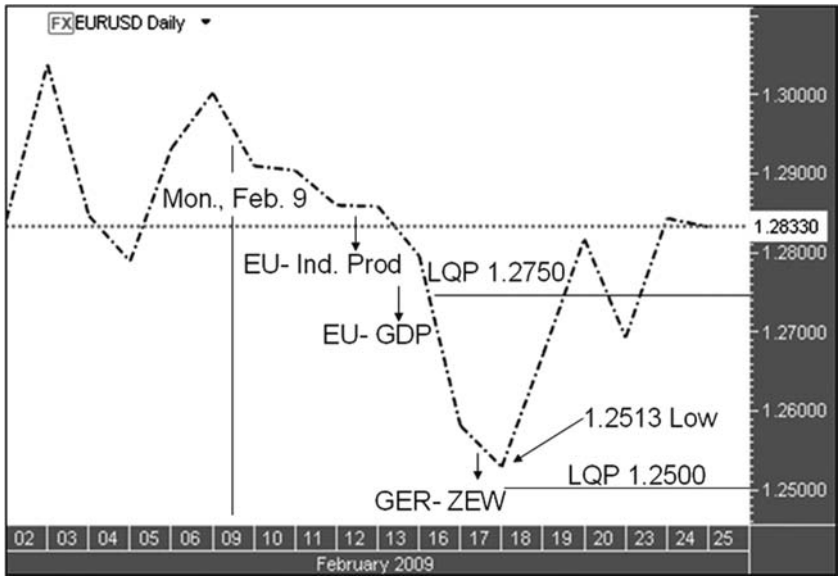

FIGURE 3.2 Using Economic Events as Catalysts and Drivers for The Quarters Theory Trades: Example 1

consensus forecast for the Euro-zone GDP is −1.3% q/q (quarter over quarter) compared to −0.2% q/q. The only positive consensus forecast is for the German ZEW survey, which is expected to show −27.5 compared to the previous month's reading of −31.0.

The actual numbers reported when the events took place showed the Euro-zone Industrial Production at −2.6% m/m compared to the forecast of −2.5% m/m and a previous reading of −1.6% m/m. The actual year-over-year reading for the Euro-zone Industrial Production was also worse than expected: −12.0% y/y compared to the consensus forecast of −9.5% y/y and a previous reading of −7.7%. The actual reading for Euro-zone GDP showed a worse-than-expected decline in economic growth at −1.5% m/m compared to the forecast of −1.3% q/q and a previous reading of −0.2% q/q. The actual year-over-year reading for the Euro-zone GDP was also worse than expected at −1.2% y/y compared to the consensus forecast of −1.1% y/y and a previous reading of +0.7%. The only positive economic data as expected was the German ZEW survey, which came up to −5.5% m/m compared to the forecast of −27.5% m/m and a previous reading of −31.0% m/m. However, the better-than-expected month-over-month reading was offset by a further decline in the German ZEW current conditions index to −86.2, the weakest level since October 2003.

In this example, the EUR weakens since the first trading session of the week, Monday, February 9, 2009, throughout the entire week as the market prices in the negative expectations for the outcome of the upcoming economic events: the Euro-zone Industrial Production on Thursday, February 12, 2009; and the Euro-zone GDP on Friday, February 13, 2009. For the majority of the trading week, the equity markets in the United States and the Euro-zone trade under pressure; there is a reduction in investors' appetite for risk, triggering more risk aversion and increasing the demand for U.S. dollars. The negative fundamental environment and the anticipation of the negative outcome of the upcoming reports (the buildup), combined with the worse-than-expected actual outcome of the reports, accelerate the EUR/USD pair's downtrend and serve as a catalyst for the anticipated significant price move below the Large Quarter Point at 1.3000, not only leading to the successful completion of the Large Quarter toward 1.2750, but also pushing the EUR/USD pair even lower and leading to the successful completion of another Large Quarter of 250 PIPs—the Large Quarter below 1.2750 toward the Large Quarter Point at 1.2500—as the EUR/USD pair reaches the low of 1.2513 on February 18, 2009.

Here is another example. Let us assume that it is Monday, February 9, 2009, the first trading session of a new trading week, and we are considering a potential trading opportunity with the USD/JPY pair in the days ahead. The market is expecting important news from Japan—the GDP (Gross Domestic Product) on Sunday, February 15, 2009, and the Japanese Trade Balance on Tuesday, February 24, 2009. Both reports show negative consensus forecasts: The Japanese GDP consensus forecast expects a significant decline in economic growth of −2.9% q/q (quarter over quarter) compared to a decline of −0.5% q/q in the previous quarter. The year-over-year forecast is also expected to be dismal, with a consensus showing −3.7% y/y compared to a previous −0.3% y/y. The Japanese Trade Balance consensus forecast expected another fourth consecutive month of increase in the trade deficit of −450B (billion) yen, compared to a previous reading of −320B.

Obviously, the market is expecting what could be rather dismal GDP and Trade Balance reports coming up from Japan in the trading sessions ahead. We notice that the USD/JPY pair is at or above the Large Quarter Point at 90.00 yen, which, according to The Quarters Theory, is considered a sign of strength, and that as long as the USD/JPY pair stays at or above 90.00, we could see the USD/JPY pair working on the Large Quarter above the Large Quarter Point at 90.00, potentially targeting the Large Quarter Point at 92.50. Considering that the market in the days ahead is likely to continue pricing in the expectations for the negative outcome of the upcoming important economic events, we see an opportunity to use this as a catalyst in order to take advantage of the buildup that could continue to cause JPY weakness and a significant price move that could lead to the

successful completion of the Large Quarter above 90.00 toward the Large Quarter Point at 92.50.

The actual numbers reported when the events took place were even worse than the forecasts. The Japanese GDP showed the Japanese economy shrinking by −3.3% q/q, compared to the consensus of −2.9% q/q and previous reading of −0.5% q/q. The year-over-year reading also came in worse than expected at −4.6% y/y, compared to the consensus of −3.7% y/y and previous reading of −0.3% y/y. On an annualized basis, the main gauge of economic activity and growth, the Japanese GDP, plunged by 12.7%. The actual Japanese Trade Balance report was also dismal. The Japanese Trade Balance showed an actual reading of −952.6Bn, compared to the consensus forecast of −450B and a previous reading of −320B. Japanese exports declined by a record 45.7% y/y. The Japanese deficit showed a new multi-year high of JPY 952.6Bn, breaking the previous record deficit of 824.8Bn yen that was set in January 1980. Exports to the United States dropped by 52.9% y/y while exports to Asia shrank by 46.7% y/y. Japanese automobile exports showed a dramatic drop by two-thirds from a year earlier.

As you will note in Figure 3.3, the negative fundamental environment and the anticipation as the market prices in the negative outcome of the upcoming reports (the buildup), combined with the worse-than-expected actual outcome of the reports weaken the JPY significantly and accelerate

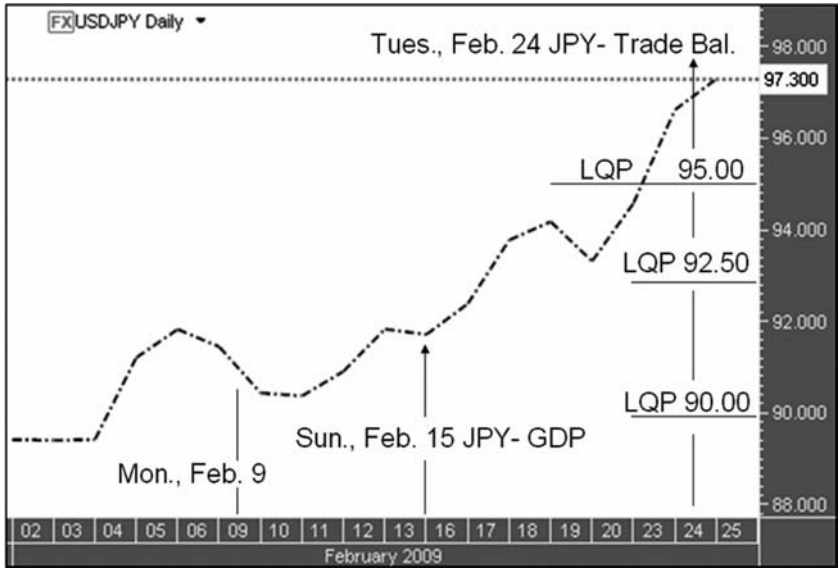

FIGURE 3.3 Using Economic Events as Catalysts and Drivers for The Quarters Theory Trades: Example 2

the USD/JPY pair's bullish trend and serve as a catalyst for the anticipated significant price move above the Large Quarter Point at 90.00, not only leading to the successful completion of the Large Quarter toward 92.50, but also contributing to the successful completion of two more Large Quarters of 250 PIPs each—from the Large Quarter Point at 92.50 to the Large Quarter Point at 95.00, and then from the Large Quarter Point at 95.00 to 97.50 yen. The high on February 24, 2009, at 97.30 is 20 PIPs from the Large Quarter Point at 97.50, which is a number within the vicinity of one Small Quarter of 25 PIPs from the Large Quarter Point at 97.50—close enough to consider the Large Quarter toward 97.50 yen to be successfully completed.

The Efficient Market Hypothesis states that all known information is already reflected in current prices. On the other hand, supporters of the Inefficient Market Hypothesis would argue that true price value cannot always be achieved because market forces in some instances cause excessive price moves, leading to over- or underpricing and surpassing or coming short of the true price value.

Assuming that the market is efficient more often than not, efficiency is normally achieved when the market prices in advance the expectations for the outcome of all future events. It may sound like a paradox, but when an actual economic event hits the newswires and the outcome of the event is in line with the consensus forecasts and expectations, the event may become old news or simply a *nonevent*. Moreover, such nonevents could trigger profit-taking and significant price moves in the opposite direction of a previously established trend. Hence the familiar saying, "Buy on the rumor, sell on the fact."

Of course, not all outcomes of economic data and geopolitical events always end up being in line with expectations. Better- or worse-than-expected economic reports or unexpected geopolitical events could surprise the market, leading to an increase in volatility, sometimes to extreme levels. In times like these, the market realizes its inefficiency and market forces could produce large price swings as the market continues the process of the discovery of true price value by continuing to price in the unexpected outcome of an economic or geopolitical event.

Because of the *advanced pricing* tendency of the market, trading opportunities for a Quarters Theory Trade as described in the example above should preferably be considered ahead of an important economic or geopolitical event, rather than trading the event at the time of its actual release. I call this the *buildup*, or taking advantage of the anticipation of the event, while market forces are still pricing the expectations of the outcome of an event into the exchange rates of currencies. The ideal Quarters Theory Trade is the one that achieves its objective (a successful completion of a Large Quarter) before an important event is released. In a trade like this, the event risk will be reduced to a minimum.

The practice of using economic releases and geopolitical events as catalysts for a trade is also known as *event-driven strategy*, or in some instances, trading based on *special situations*. Some most recent examples of special situations impacting currency exchange rates are the collapse of Iceland's financial system and the risk of debt default for Russia and other Eastern European countries as a result of the global financial crisis of 2008/2009.

Besides trading the buildup ahead of an event, trading the actual news is also an event-driven strategy very popular with active traders. Although trading the news may not be the preferred environment for a Quarters Theory Trade, big market-moving events such as interest rate announcements from major central banks or the U.S. Non-farm Payroll Employment report could cause significant price moves that could produce successful completion of Large Quarters in a short period of time. Figure 3.4 uses the historic move in the EUR/USD pair after the FOMC monetary policy announcement on March 18, 2009. As described earlier, on that day, the Fed announced that it would combine a monetary policy of close to zero interest rates target band between 0% and 0.25% with aggressive quantitative easing that included plans to buy up to $300 billion in U.S. Treasuries and purchase up to $750 billion of mortgage-backed securities in an effort to take these

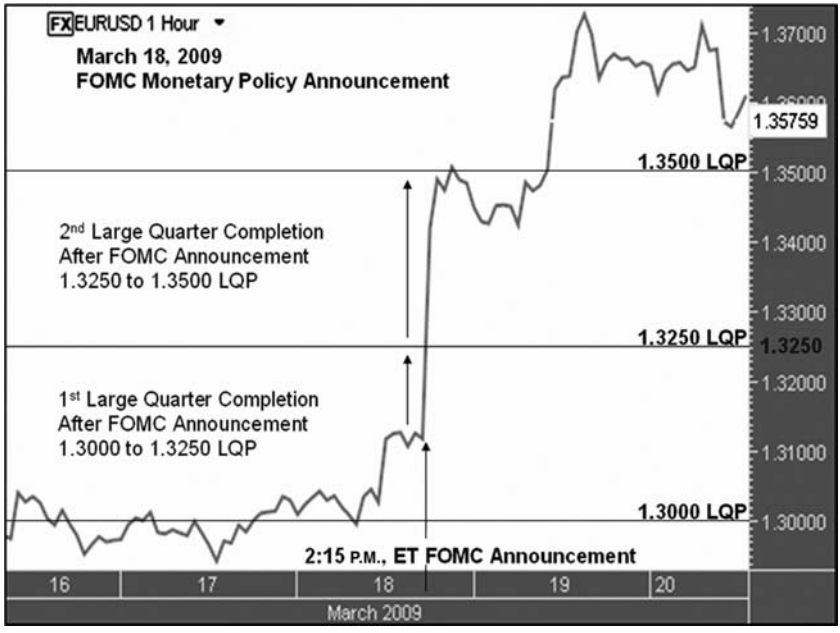

FIGURE 3.4 News Event Triggering a Significant Price Move

"toxic assets" off the balance sheets of troubled financial institutions. The Fed's aggressive quantitative easing announcement was met with a steep USD selloff, and shortly after the Fed's announcement at 2:15 P.M., ET, the EUR/USD pair successfully completed the Large Quarter from 1.3000 to 1.3250. Immediately after that, the EUR/USD pair also completed another second Large Quarter from 1.3250 to 1.3500.

The FOMC monetary policy announcement served as a catalyst for a significant price move, leading to the successful completion of two consecutive Large Quarters. The EUR gained over 500 PIPs against the USD in a single trading session—the biggest one-day gain for the EUR/USD pair since the Euro's inception as a currency.

Inexperienced traders should be careful about trading the news because of the danger of becoming a victim of the increased volatility and sometimes erratic whipsaw price swings that can trigger stops and cause frequent losses. Although moves producing a large number of pips and successful completion of multiple Large Quarters as a result of news events are possible, they do not occur in most instances; therefore traders should remain conservative and realistic in their expectations. It is impossible to completely eliminate the event risk, because the element of the unknown will always exist in trading. No matter how extensive the research and analysis a trader performs, there will always be the possibility that the outcome of an event or a trade will be different than expected. However, the risk can be managed by establishing realistic price targets, using proper stops to limit losses, and applying proper money management.

Structuring Quarters Theory Trades based on solid underlying fundamentals by discovering a clear fundamental edge is a crucial first step in the process of advanced trade preparation that helps mitigate risk, improves traders' performance, and contributes to achieving consistent profitability. In the following chapters you will find out how to mitigate risk and increase the odds in your favor even more by combining fundamental with technical analysis.

IDENTIFYING THE TECHNICAL EDGE

Technical analysis plays a key role in The Quarters Theory methods for trade preparation. By using price charts and technical indicators, traders can identify trends, breakouts, and price patterns that may reveal a certain technical edge.

The opponents of technical analysis would argue that because of the chaotic nature of the markets, price behavior is impossible to predict. On the other hand, some technical analysis traders believe that all fundamental data has already been priced into and reflected in current prices, and

therefore they would disregard any fundamental research. For The Quarters Theory method of trading, the combination of fundamental and technical analysis is important for the discovery of a clear advantage of one currency over another in a currency pair.

The *technicals* (technical indicators) are sets of quantitative measurements based on price and/or volume fluctuations. There is nothing mystical about technical analysis—it is not a magic crystal ball and it does not offer 100% accurate prediction of the future. The technical indicators are projected into charts studied by traders, so that past price patterns are identified in order to gain perspective and forecast with a greater probability of success the direction of the next price move.

In technical analysis, market data is plotted on a chart as a representation of the changes in price over a period of time. The most basic price charts, the *line charts*, have a simple linear representation, or line segments connecting a series of time intervals. The open-high-low-close (OHLC)-type charts, also called *bar charts*, provide more information about the price action by showing the open, high, low, and close for each time interval. The *candlestick charts* are probably the most popular OHLC-type charts; these show the open and closing price in a rectangle, called the *body*, plus the high and low prices represented by an upper and lower shadow—the *candlewick*.

As shown in Figure 3.5, for each time interval, if the close price was higher that the open price, the body of the candle would show a lighter color (white, green, blue, etc.), indicating that the candle is bullish. On the other hand, if the close price was lower than the open price, the body of the candle would be in a darker color (black, red, etc.), indicating a bearish candle. The longer the body of the candle, the bigger the bullish or bearish price move is. The price range for the entire time interval is represented

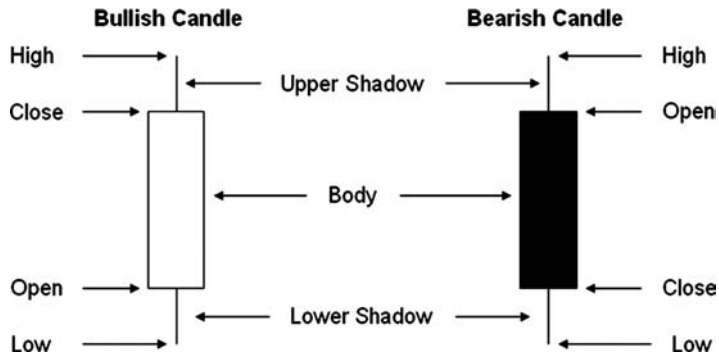

FIGURE 3.5 Bullish and Bearish Candles

by the upper and lower shadows, or candlewicks. The bottom of the lower candlewick shows the lowest price point or the low reached during the time interval, and the top of the upper wick shows the highest price or the high for the time period. Sequences of several bullish or bearish candles can reveal the direction of the trend. Shown in Figure 3.6 is a candlestick chart where a sequence of bearish candles reveals a bearish trend, followed by a sequence of bullish candles indicating a bullish trend.

The staple of technical analysis is the assumption that moves in prices tend to maintain the same direction over periods of time, leading to the development of trends and trend cycles. According to the *American Heritage Dictionary*, the definition of *trend* is: (1) a general tendency or course; (2) a direction or movement; flow. In trading, *uptrends* are defined as a sequence of higher highs and higher lows registered for at least two consecutive time intervals. As long as the market produces a higher high and a higher low in every new time interval as compared to the previous time interval, the uptrend would still be intact. However, if a bullish sequence of consecutive higher highs and higher lows ends when the market registers a lower high and lower low in a new time interval, a trend reversal can occur and may cause a new bearish downtrend sequence to follow. A *downtrend* is a sequence of lower highs and lower lows registered for at least two consecutive time intervals. A bearish trend sequence continues as long as the market produces a lower high and a lower low in every new time interval

FIGURE 3.6 Candlestick Chart Showing Bullish and Bearish Trends

as compared to the previous time interval. As shown in Figure 3.6, traders can visualize the direction of the trend by drawing trend lines that connect the highs or the lows of different time intervals.

When both the highs and the lows registered in a sequence of time intervals are connected with two parallel trend lines, traders can establish the *price channels* of a trend (see Figure 3.7). In price channels, the upper trend line serves as a level of resistance and the lower trend line as support. Support levels are price levels that are difficult to break below. Resistance levels are certain levels at which prices may have difficulty overcoming and climbing above. Channel traders normally look for opportunities to enter long positions at lower trend line support levels and exit (or consider going short) at upper trend line resistance.

In some instances, the market simply moves sideways without any strongly developed up- or downtrends. In such cases, by drawing trend lines traders can identify horizontal channels indicating a trendless environment, also called *range* (see Figure 3.8). Horizontal channels are price ranges that normally occur if two identical highs and a low, or two identical lows and a high, are established. Similar to up or down price channels, the upper trend line in horizontal channels is also used as resistance and the lower trend line is considered support. Range traders usually enter long positions at the bottom of the range and exit (or enter short positions) when resistance is reached at the top of the range.

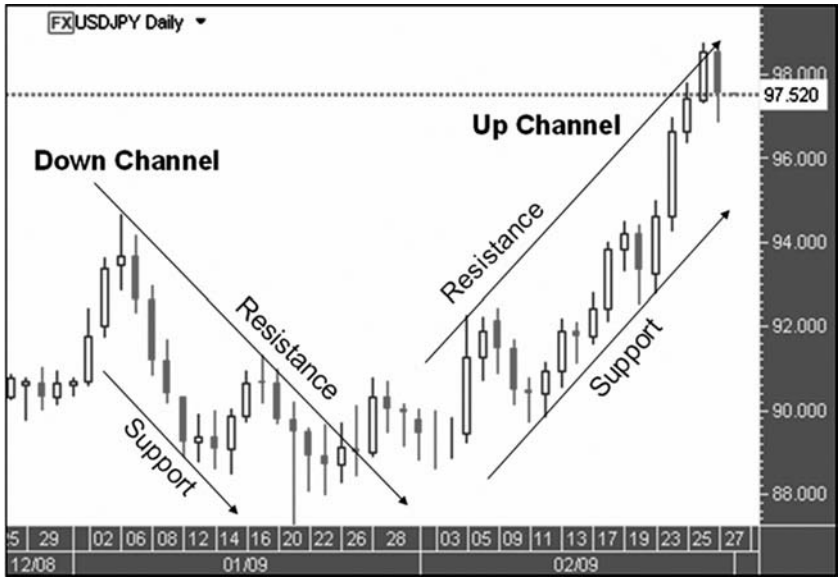

FIGURE 3.7 Up and Down Price Channels

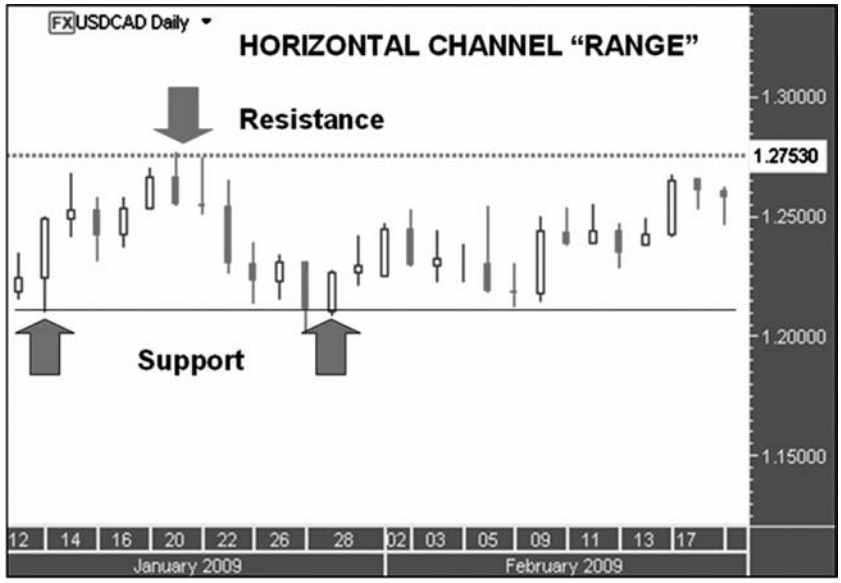

FIGURE 3.8 Horizontal Channel

Support and resistance levels are not only helpful when trading price channels. They are also crucial when identifying bullish or bearish breakouts. Bullish breakouts occur when prices break above resistance levels. Bearish breakouts (or breakdowns) occur when prices break below levels of support. Previously broken support or resistance price levels have the tendency to become support/resistance all over again. Most traders would consider a resistance level that has been broken above as a potential level of support if prices were to head lower toward the previous level of resistance, which in this case will become a level of support. The same is also valid for broken support levels when after a breakdown prices head back higher, causing a previous support level to become a level of resistance.

Decisive bullish or bearish breakouts can produce significant price moves, providing great trading opportunities. The example below shows a bullish breakout leading to a strong up move with an opportunity for a long trade as soon as the resistance level is broken. Decisive breaks below support levels may also be considered potential short trade opportunities. A rule of thumb for many traders who trade price channel breakouts is to use the ranges between support and resistance levels of the price channels as guidelines when looking to establish price targets that may be reached as a result of breakouts above or below price channel support or resistance. See Figure 3.9.

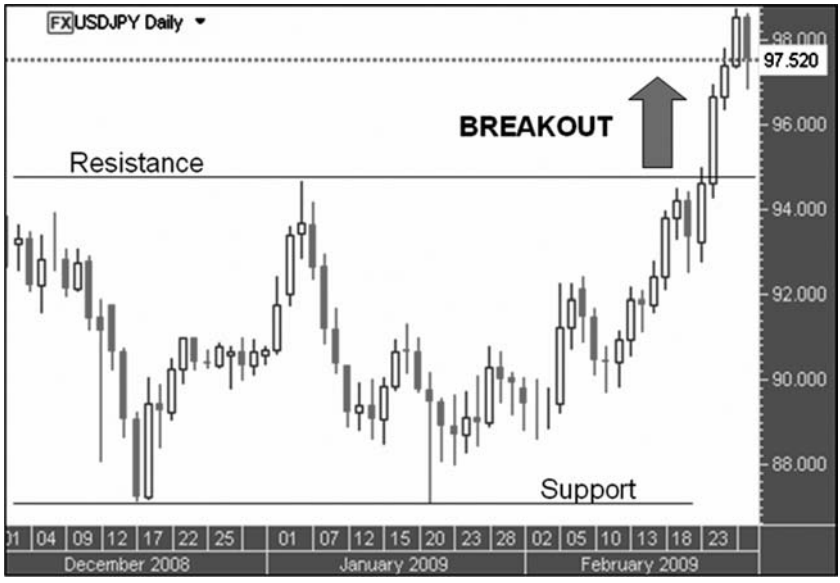

FIGURE 3.9 Channel Breakout

Traders who prefer to take advantage of trading opportunities based on bullish and bearish breakouts should be careful not to become victims of *head-fakes*. Head-fakes are deceptive price moves that actually have the look and feel of genuine breakouts. Head-fakes, much as *breakouts*, tend to register new highs higher than a previous resistance price or new low prices lower than a targeted support level. The problem is that head-fakes are not decisive breakouts and often produce insignificant price moves that simply overshoot above resistance or below support. Such insignificant overshoots are quickly followed by reversals in the opposite direction of the breakout.

Because they are difficult to recognize, head-fakes remain one of the biggest dangers for breakout traders. There are several remedies that I have found useful that may help mitigate the negative impact of head-fakes. The easiest way for a trader to completely avoid becoming a victim of head-fakes is simply to try not to participate in the initial attempts for a breakout. Instead, a trader can choose to sit on the sidelines until there is a clear indication that the breakout was indeed a decisive breakout and not just a head-fake. In this case, a trader has to be willing to forgo some of the profits that can be made on what could be a significant price move during the initial breakout, in exchange for more time that may be needed for objective observation. By doing so, a trader may be able to better assess whether the breakout was successful without guessing the outcome while

trying to participate in the initial breakout. No matter how significant the price move is as a result of a decisive breakout, sooner or later there will be a pullback that could create another opportunity for a trader to enter a trade. Patience is a virtue in this strategy, especially considering that in a lot of instances decisive breakouts above major resistance or below support levels do not occur on the first attempt and may require additional attempts before a decisive breakout is produced.

Here is a helpful tool that traders can utilize when trying to recognize head-fakes. The *Overshoot Rule* of The Quarters Theory states that any moves above or below an important price level (Large Quarter Points, Support or Resistance Levels, Whole Numbers) that are less than one Small Quarter of 25 PIPs are not to be considered decisive breakouts, but rather simple overshoots. The idea behind this rule is that insignificant price moves, especially moves of 25 PIPs or less above or below Large Quarter Points or any other important support/resistance levels, would indicate an Overshoot and not a decisive breakout.

Figure 3.10 shows a real-life example of how this simple Overshoot Rule can be applied. The GBP/USD pair makes several attempts for a breakout above resistance at 1.4750 (which, in this case, is not only a resistance level but also a Large Quarter Point). On the third attempt, the

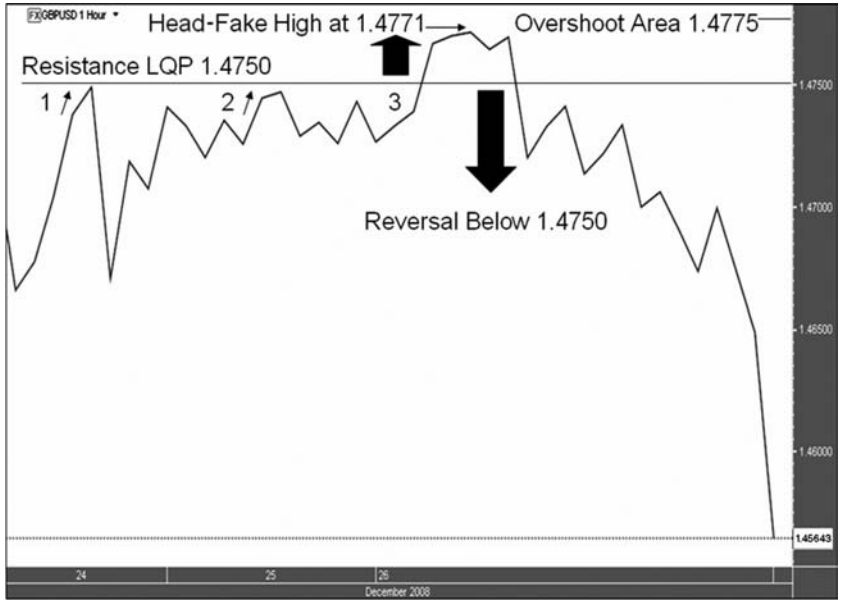

FIGURE 3.10 Overshoot Signaling Failed Breakout

resistance is finally broken. The GBP/USD pair moves above 1.4750 and reaches a high at 1.4771—a number that is 21 PIPs above resistance at 1.4750. By applying the Overshoot Rule of The Quarters Theory, a trader would consider this move as a simple 21 PIPs Overshoot above resistance at 1.4750. As long as the price move does not exceed one Small Quarter of 25 PIPs, a trader would also recognize that the Overshoot does not indicate a decisive breakout and would be able to prepare in advance to avoid a powerful reversal that follows the Overshoot head-fake in this example.

In technical analysis, proper recognition of certain price patterns can provide traders with better perspective when forecasting the direction of the next price move. Chart price patterns can be classified in two main categories: trend-continuation patterns and trend-reversal patterns.

TREND-CONTINUATION PATTERNS

The most popular of the *trend-continuation* patterns are the *triangles*, *wedges*, *flags*, and *pennants*. The triangle chart formations include ascending, descending, and symmetrical triangles. As shown in Exhibit 3.11, the walls of the triangles are formed by connecting the highs and the lows reached in different time intervals with trend lines. The flat wall of an

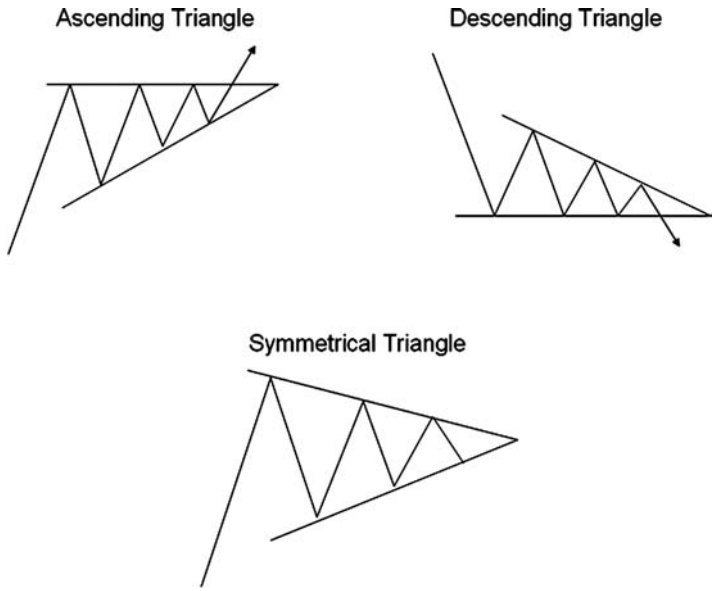

FIGURE 3.11 Ascending, Descending, and Symmetrical Triangle Patterns

ascending triangle is formed by connecting a series of identical highs with a horizontal trend line serving as resistance. In an ascending triangle formation, a rising trend line that connects a sequence of higher lows forms the ascending wall of the triangle. Ascending triangle patterns are considered as early signs of potential breakouts above the resistance of the horizontal wall of the triangle. Ascending triangles normally occur during periods of consolidation within a bullish trend and ascending triangle breakouts often indicate a continuation of a previously established uptrend.

The descending triangle patterns are the bearish counterparts of ascending triangles. The flat wall of a descending triangle is formed by connecting a series of identical lows with a horizontal trend line serving as support. In a descending triangle formation, a falling trend line that connects a sequence of lower highs forms the descending wall of the triangle. Descending triangle patterns are considered to be early signs of potential breakdowns below the support of the horizontal wall of the triangle. Descending triangles normally occur during periods of consolidation within a bearish trend and descending triangle breakdowns often indicate a continuation of a previously established downtrend.

Unlike the ascending and descending triangle formations, the symmetrical triangle patterns have both—an ascending and a descending wall. The descending wall of a symmetrical triangle is formed by connecting a series of lower highs with a trend line serving as resistance. The ascending wall of a symmetrical triangle is a trend line connecting a series of higher lows serving as support. The symmetrical triangles are also considered to be trend-continuation patterns. They are a bit more universal as compared to ascending or descending triangles, because symmetrical triangles can occur not only in periods of consolidation within bullish trends but also in periods of consolidation within bearish trends. Proper trend recognition is crucial when preparing for the outcome of breakouts after symmetrical triangle formations, because symmetrical triangle breakouts normally occur in the direction of the previously established trend. Figure 3.12 shows a real-life example of a symmetrical triangle pattern during a period of consolidation within a strong positive trend, leading to a bullish breakout that continues the previously established uptrend.

Pennant Pattern

Identical to the symmetrical triangles, the *pennant chart* formations are also considered to be trend-continuation patterns. Strong trends form the *flagpole* and the pennant patterns usually occur in periods of consolidation within a trend. The pennants, much as the symmetrical triangles, have two converging ascending and descending trend lines. Bullish or bearish

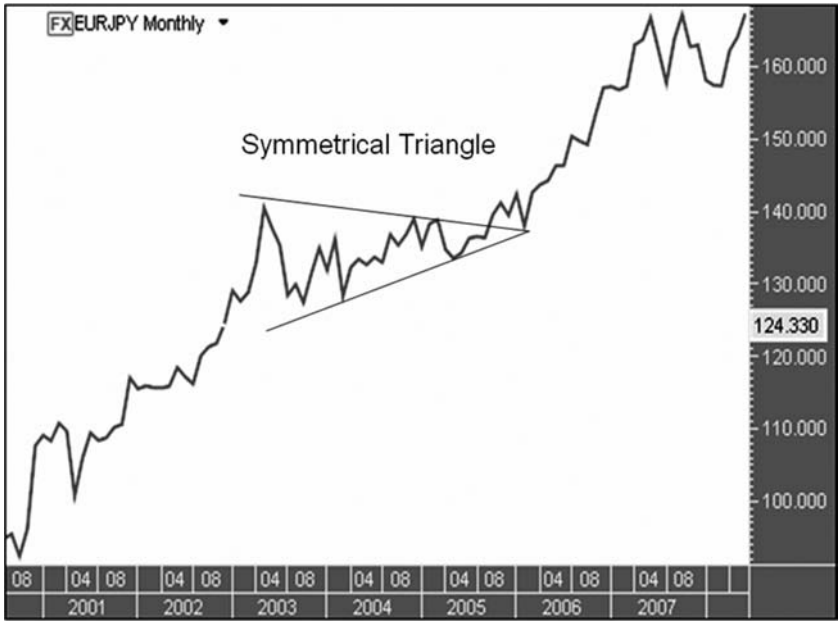

FIGURE 3.12 Symmetrical Triangle Pattern

pennant breakouts normally would depend on the direction of the previously established trend. As shown in Figure 3.13, the flagpole indicates a strong bullish trend, followed by a pennant trend-consolidation pattern (similar to a symmetrical triangle), leading to a bullish breakout that continues the previously established uptrend.

Flag Pattern

The *flag chart* patterns are similar to the pennant formations because the direction of the trend in both is indicated by a flagpole. However, unlike the pennant formations, the flag chart patterns have two parallel ascending, descending, or horizontal trend lines forming either bullish, bearish, or sideways price channels. Flag chart formations are also considered trend-continuation patterns and normally occur in periods of consolidation within a trend. Flag patterns would usually produce breakouts in the direction of the previously established trend. Figure 3.14 shows a real-life example of a flag chart pattern during a period of consolidation within a strong positive trend (as indicated by the uptrend flagpole), leading to a bullish breakout above the resistance trend line of the flag that continues the previously established uptrend.

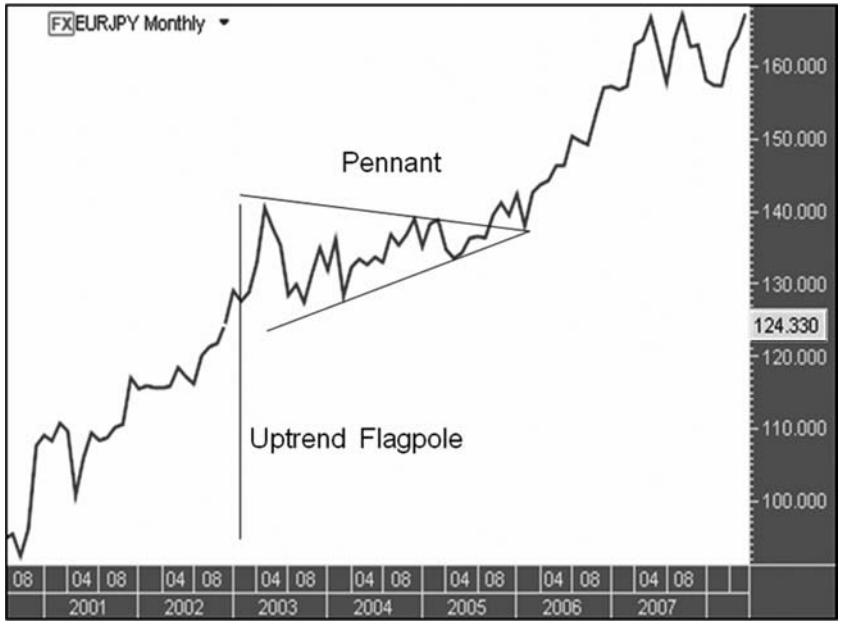

FIGURE 3.13 Pennant Pattern

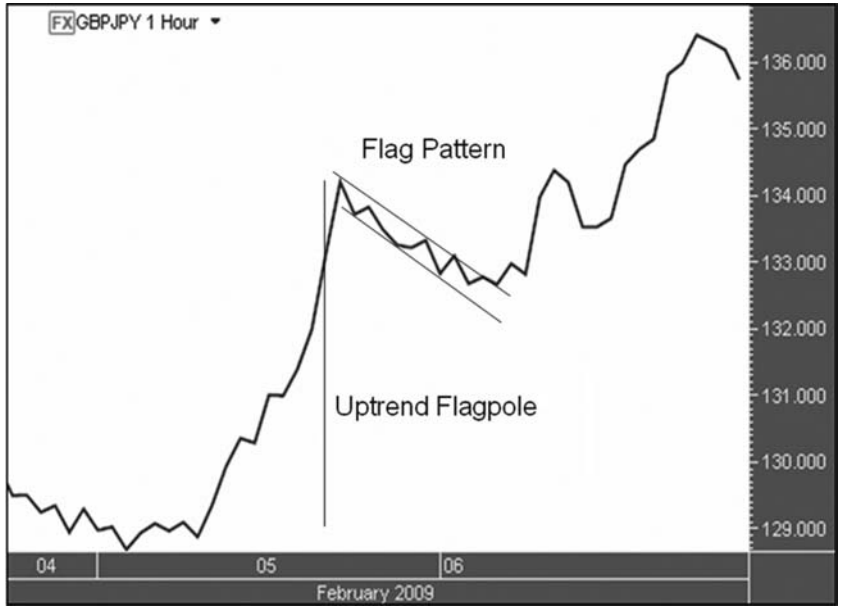

FIGURE 3.14 Flag Pattern

FIGURE 3.15 Rising Wedge

Rising and Falling Wedge

Other trend-continuation price patterns, similar to the triangle chart formations, are the rising or falling *wedges*. The rising wedge patterns are characterized by two converging ascending trend lines connecting a series of higher highs and higher lows. Rising wedges normally occur in periods of consolidation within a bearish trend. The falling wedges have two converging descending trend lines connecting a series of lower highs and lower lows. Falling wedge patterns usually form in periods of consolidation within a bullish trend. Figure 3.15 shows a real-life example of a rising wedge pattern during a period of consolidation within a strong negative trend, leading to a breakdown below the support trend line of the rising wedge that continues the previously established downtrend.

TREND-REVERSAL PATTERNS

Chart price patterns can give traders not only an indication of potential trend continuation, but also some early warning signs of possible trend reversals. The most popular trend-reversal patterns are double tops and

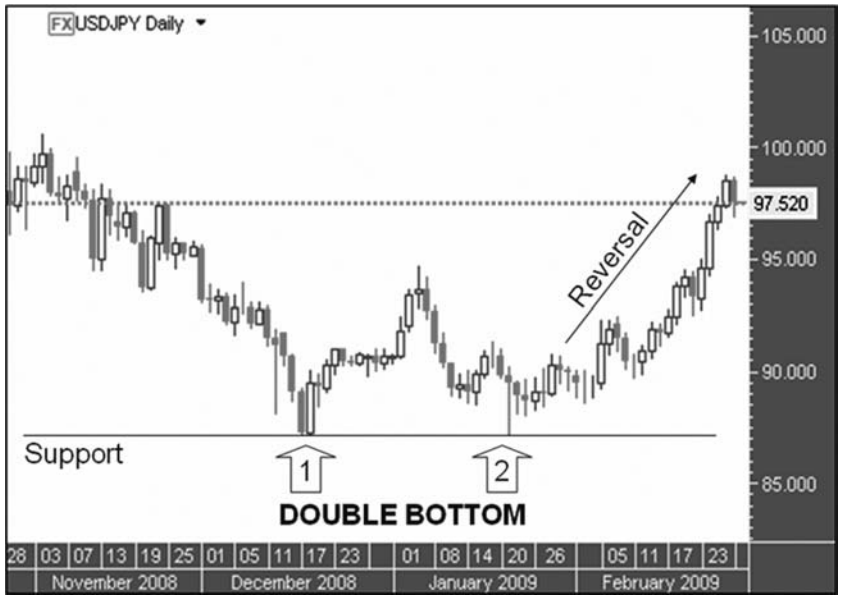

FIGURE 3.16 Double Bottom

double bottoms, head and shoulders, rounding tops and bottoms, and cup-and-handle formations.

Double Tops and Bottoms

The *double top* pattern can occur when a resistance level is met within a bullish trend, followed by a pullback in prices, then followed by a second unsuccessful attempt to break above the previously established resistance, leading to a sharp downward move and a possible reversal of the uptrend. *Double bottoms* usually take place within a bearish trend when a support level is reached, followed by a bounce off support, and then followed by a second attempt that fails to produce a break below support. A sharp upward move normally occurs as a result of a double bottom, leading to a possible reversal of the downtrend. Figure 3.16 shows the USD/JPY currency pair establishing its first bottom when a support level is reached within a strong downtrend. A pullback in prices off support is then followed by a second attempt to challenge and break below the previously met support. However, the second breakdown attempt is unsuccessful, which causes a double bottom that is quickly followed by an upward move in an attempt to reverse the previously established downtrend.

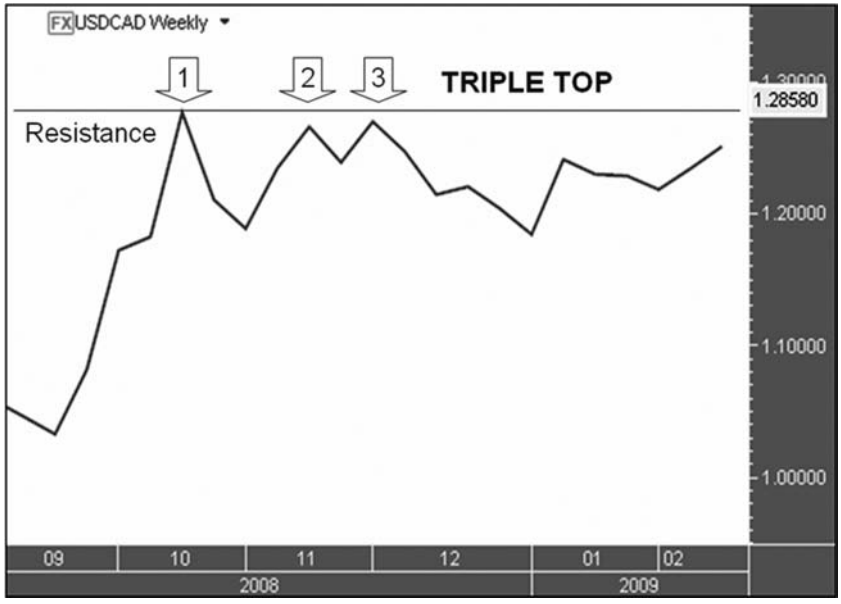

FIGURE 3.17 Triple Top

In some instances, double tops or bottoms are followed by a third consecutive attempt to break double bottom support or double top resistance levels. If such third attempts are unsuccessful, *triple tops* or *bottoms* could occur. Triple tops or triple bottoms are also considered trend-reversal patterns. Figure 3.17 shows a third consecutive unsuccessful attempt from the USD/CAD pair to break above a strong double top resistance, leading to the development of a triple top and sharp move lower in the opposite direction of the previously established uptrend.

Although rare, there are some instances when more unsuccessful attempts to break triple bottom support or triple top resistance levels can lead to the development of quadruple tops or quadruple bottoms. Triple, quadruple, and more tops and bottoms are also considered trend-reversal patterns. The more unsuccessful breakout attempts are made at certain support or resistance levels, the stronger these levels would become, and the harder they would be to break. On the other hand, traders should keep in mind that if the market does not give up and if after each unsuccessful attempt for a breakout there is no actual trend reversal, the more consecutive attempts for breakouts of such levels, the greater the probability for a successful breakout to occur sooner or later as a continuation of the previously established trend.

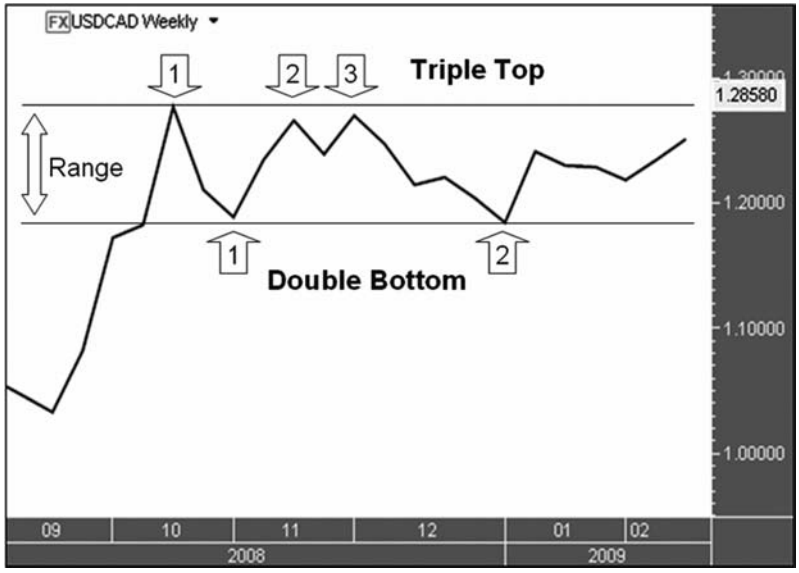

FIGURE 3.18 Triple Top and Double Bottom Forming a Channel

Figure 3.18 uses the same USD/CAD chart. Please note that even after the triple top, the pair does not completely reverse its uptrend. Support is found for a second time at a previously established low, leading to a double bottom, followed by a bullish move in an attempt to continue the previous uptrend. In this example, the combination of a triple top and a double bottom creates a well-established range. A trader who is able to recognize these developments is likely to anticipate a move toward the top of the range that may occur as a result of the double bottom.

Head-and-Shoulders Pattern

Another popular trend-reversal pattern is the *head and shoulders*. The head-and-shoulders pattern is a sequence of three peaks in prices within a bullish trend. The first peak (left shoulder) is followed by a pullback that establishes a support level (neckline) from which another move higher takes prices to a new, second peak (head) that is higher than the first one. The second peak (head) is then followed by a pullback toward the previously established support level reached on the pullback after the first peak. The trend line connecting the lows of both pullbacks is called the *neckline*. When support is met, a third consecutive peak (right shoulder) follows, reaching a height identical to the height of the first peak (left shoulder). Once the third peak (right shoulder) is established and the pullback after the third peak begins, the head and shoulders pattern would be

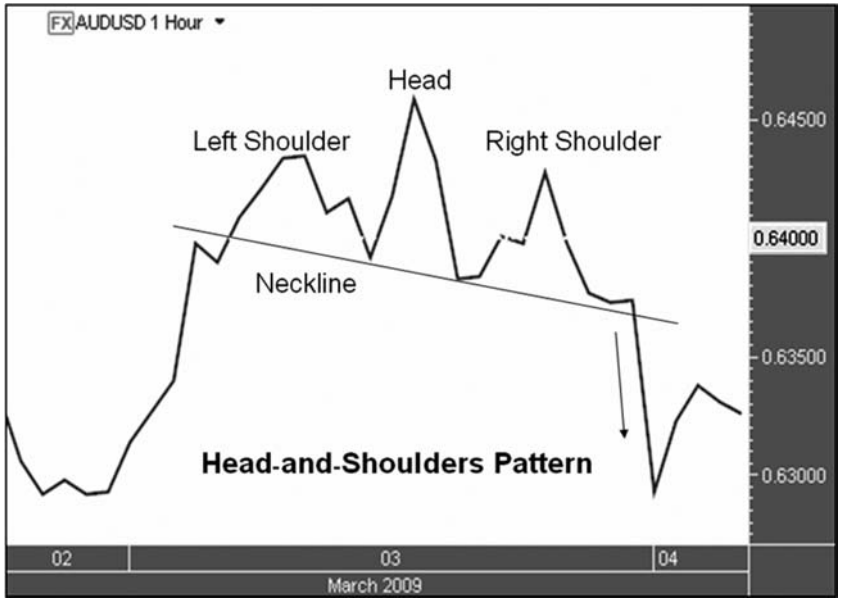

FIGURE 3.19 Head-and-Shoulders Pattern

clearly visible and traders can begin to prepare for a likely break below the support of the neckline. The development of a head-and-shoulders pattern is an early sign of potential trend reversal. Figure 3.19 shows a head-and-shoulders pattern leading to a break below the neckline support and a reversal of the previously established bullish trend.

Inverse head-and-shoulders patterns can occur within bearish trends. They resemble a reversed head-and-shoulders formation, but instead of three peaks in prices, the inverse head and shoulders would have three *valleys* or three consecutive price drops, followed by pullbacks that would meet resistance and establish a neckline (the trend line connecting the highs of the pullbacks). The development of an inverse head-and-shoulders pattern is an early sign of exhaustion and potential reversal of a previously established downtrend. Figure 3.20 shows an inverse head-and-shoulders pattern within a strong bearish trend.

* * *

Even though they may not occur as often as the patterns mentioned previously, the rounding tops, rounding bottoms, and cup and handles are important trend-reversal patterns that can give traders early warning signs of exhaustion of a previously established trend and the potential for a trend reversal.

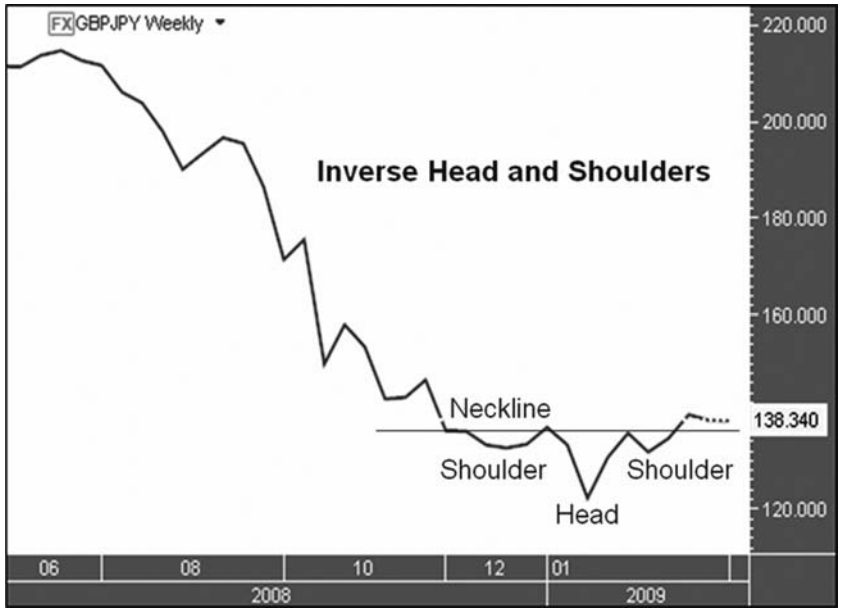

FIGURE 3.20 Inverse Head-and-Shoulders Pattern

Rounding Top Pattern

The *rounding top* is a pattern that resembles an arch connecting the highs usually reached in the final overbought phase within a bullish trend. The development of a rounding top is an early warning sign of exhaustion and a possible trend reversal that may follow. The *rounding bottom* pattern is a reversed version of a rounding top. Rounding bottoms usually form as bearish trends become exhausted and can signal bearish trend reversals. Figure 3.21 shows an uptrend that becomes extended where the highs begin to form a rounding top exhaustion pattern, followed by a trend reversal of the previously established bullish trend.

Cup-and-Handle Pattern

The *cup-and-handle* pattern resembles the inverse arch of a rounding bottom, the cup, followed by a gentle move in price toward the bottom, forming a small price channel, the handle. The handle forms as a result of a pullback when prices meet the resistance at the top of the cup. The price channel of the handle can be either downward or horizontal, indicating a sideways market. The cup-and-handle pattern is usually followed by a breakout above the upper trend line resistance of the handle's price

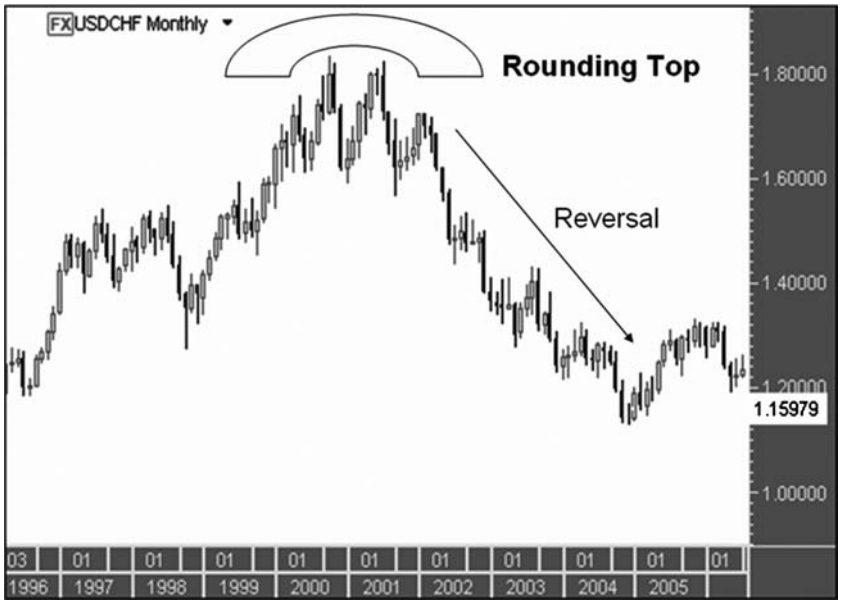

FIGURE 3.21 Rounding Top Pattern

channel, leading to a potential trend reversal. Figure 3.22 shows a bearish trend developing a cup-and-handle pattern, followed by a breakout and an attempt to reverse the previously established downtrend.

TECHNICAL INDICATORS

Technical indicators are important tools of technical analysis. They are applied to price charts in order to better identify trends, volatility, momentum, and certain price patterns serving as entry and exit signals. The technical indicators represent sets of quantitative measurements based on price and/or volume fluctuations. There are many different technical indicators, but in general they can be classified as leading and lagging indicators. The *leading indicators* usually show certain price behavior or market conditions that are used as a signal to predict future price moves. The *lagging indicators* trail the actual price moves and are normally used to verify trend direction and potential trend reversals. Some of the most popular and reliable technical indicators are moving averages, MACD (moving average convergence/divergence), stochastics, RSI (Relative Strength Index), and so forth.

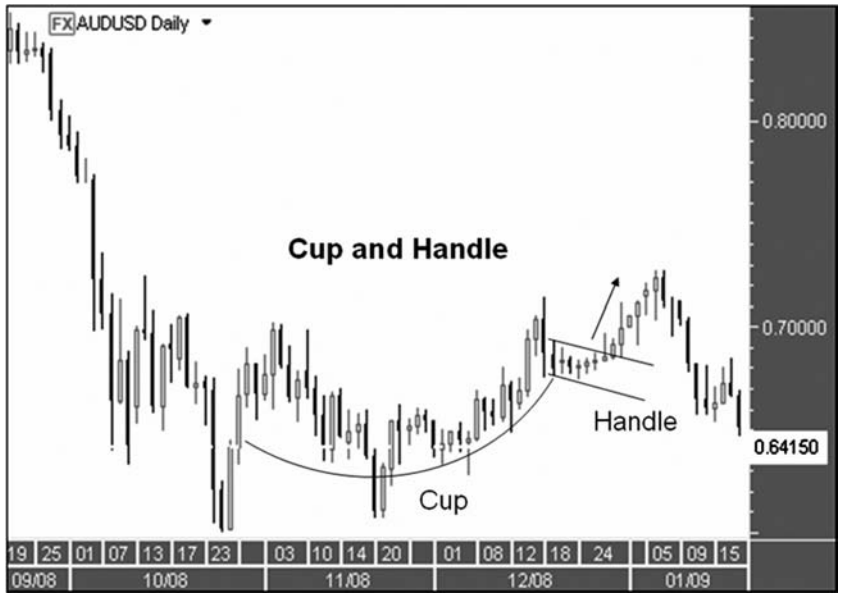

FIGURE 3.22 Cup-and-Handle Pattern

Moving Averages

The *moving averages* represent a set of average prices in different time intervals. Traders can choose the amount of time intervals based on whether they want to analyze short-, mid-, or long-term trends (e.g., 20-day, 50-day, or 200-day periods). Depending on a trader's preferences, moving averages can be calculated for open, high, low, and close prices. Most commonly used are the moving averages of closing prices. Moving averages smooth out price fluctuations and are used to better identify trends. They also serve as support or resistance levels within trends. For example, moving averages are generally considered to be support within bullish trends or resistance within bearish trends. The crosses (breakouts) of the price above or below the moving average line can be considered to be buy or sell signals. Figure 3.23 shows bullish and bearish crosses of a 20-day moving average that can be interpreted as entry and exit signals.

Moving averages can be simple, weighted, or exponential (exponentially weighted). The *simple moving average* is a set of average prices represented as the sum of prices divided by the total number of time intervals chosen to be analyzed. For example, the 20-day simple moving average of closing prices, shown in Figure 3.23, would represent the sum of closing prices for each day, divided by 20—the number of days over the 20-day

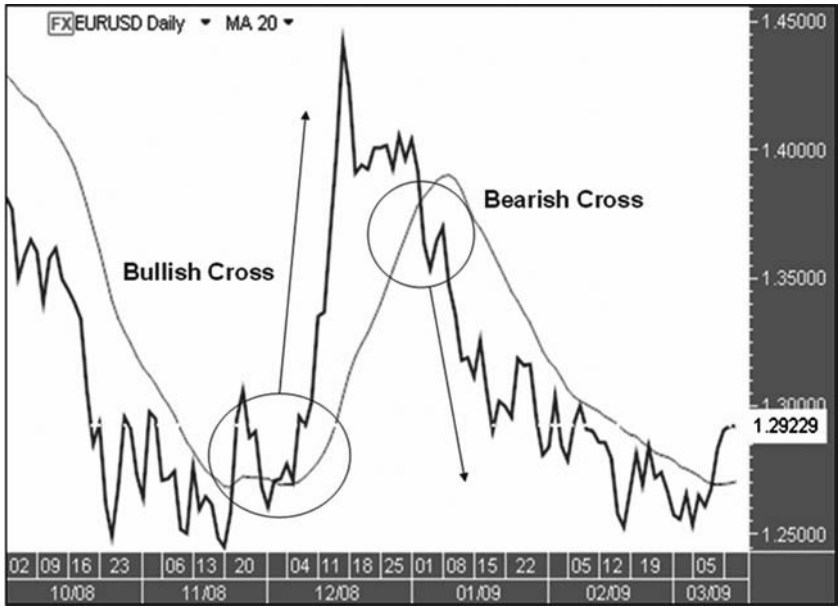

FIGURE 3.23 Bullish and Bearish Crosses of Price and the 20-Period Moving Average

period. When calculating moving averages, for each new time interval, old time interval values are dropped out of the average calculation. This can lead to a lack of proportion that causes the simple moving average to lag behind current prices—this is why it is considered a lagging indicator.

The *weighted and exponential moving averages* mitigate the lag in simple moving averages by giving weight or more importance to prices in the most recent time intervals. The weighted and exponential moving averages are computed *centrally* by using both past and current data at the time when the actual calculation takes place. Compared to the simple moving averages, the weighted and exponential moving averages would react more quickly to price changes, leading to crosses above or below the simple moving average that some traders also prefer to use as entry or exit signals. Figure 3.24 shows a strong bearish cross of a 20-day exponential moving average (MAE20) below the 20-day simple moving average (MA20), indicating potential reversal of a previously established bullish trend.

Traders use the momentum of the cross and the divergence between actual prices and moving averages, or between two moving averages crossing each other, as crucial factors when determining buy or sell signals. In general, crosses with sharp momentum in prices can be used as early signs of changes in the direction of the trend and strong signals to enter or exit

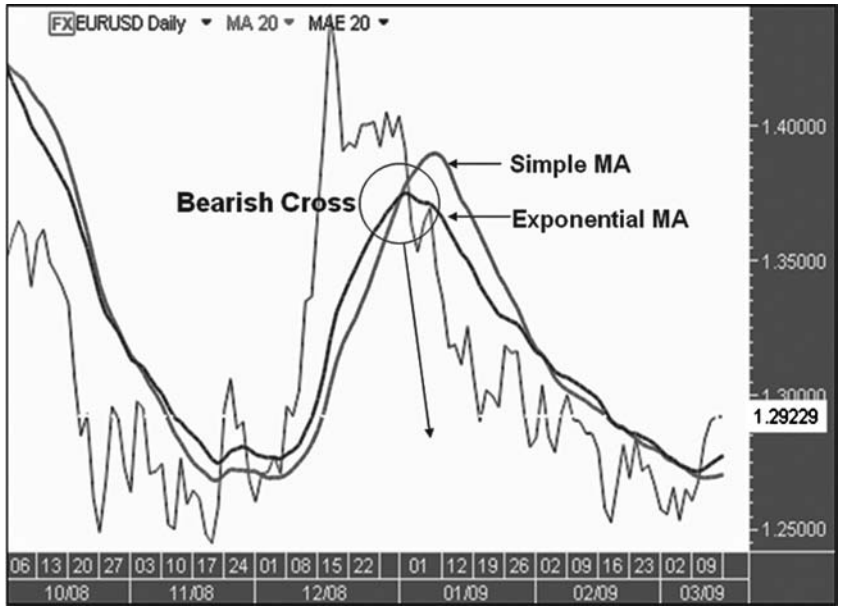

FIGURE 3.24 Bearish Cross of a 20-Period Exponential MA below the 20-Period Simple MA

a trade. The divergence or distance between prices and a moving average, or between two moving averages, can indicate stronger trends when there is significant divergence, or can give early warning signs of possible trend reversals when there is a convergence. Please note in Figure 3.25 the sharp upward momentum after the bullish cross, as well as the significant divergence between prices and the 20-day simple moving average, indicating a strong bullish trend. When the uptrend becomes exhausted, the convergence between prices and the 20-day moving average shows the early warning signs of a potential trend reversal. The convergence is then followed by a cross below the 20-days moving average with strong downward momentum and significant divergence between prices and the 20-day moving average, leading to a reversal of the previously established bullish trend.

The combination of shorter- and longer-time-period moving averages is a popular tool used by traders to generate entry and exit signals. For example, combining a 10-period moving average that would react more quickly to price changes with a 20-period moving average can create crosses between the two that can be used as buy and sell signals. Traders should pay close attention to the momentum of the cross and the divergence between the two moving averages. Figure 3.26 shows a bullish cross of a 10-day moving average above the 20-day moving average with a strong upward

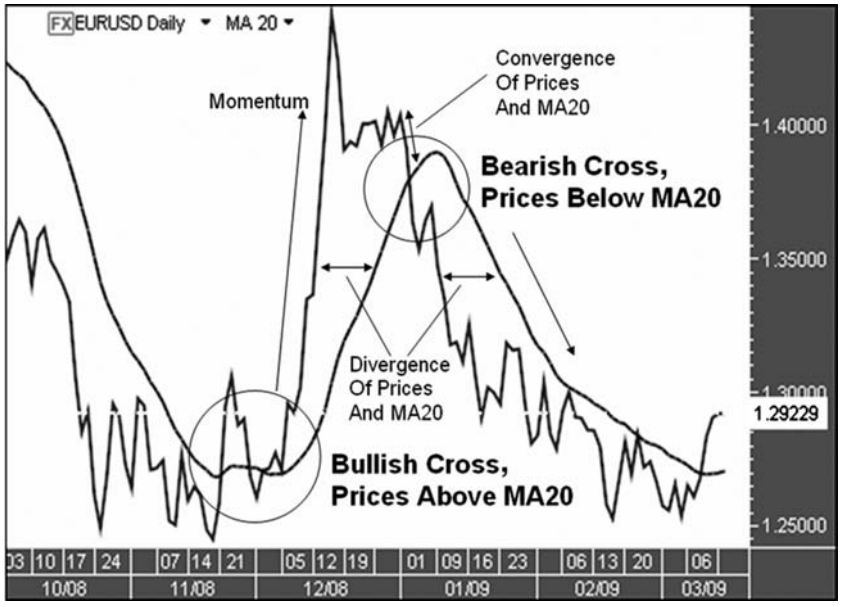

FIGURE 3.25 Bullish and Bearish Crosses Momentum

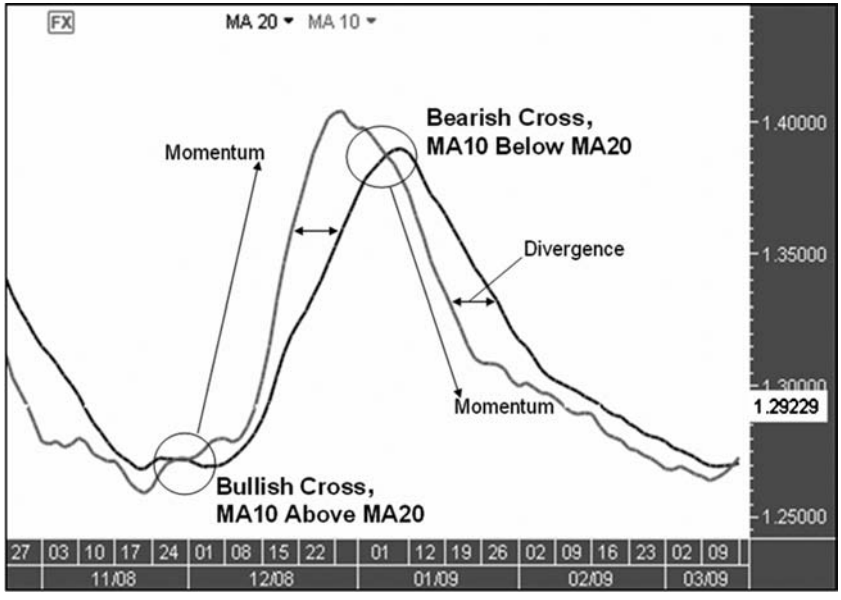

FIGURE 3.26 10-Period and 20-Period Moving Average Crosses

momentum and significant divergence between the two moving averages that can be interpreted as a sign of a trend reversal and a buy signal. The uptrend exhaustion is followed by a bearish cross of the 10-day moving average below the 20-day moving average with a strong downward momentum and significant divergence between the two moving averages that can be interpreted as a sign of reversal of the previously established bullish trend and a sell signal.

Moving Average Convergence/Divergence

The moving average convergence/divergence (MACD) is a technical indicator based on the combination of a shorter-time-period exponential moving average and a longer-time-period exponential moving average. The shorter-time-period exponential moving average is faster and reacts to price changes more quickly than the longer-term exponential moving average. The MACD time period settings recommended by the creator of the MACD indicator, Gerald Appel, and most commonly used by traders are: 12-period as a faster exponential moving average and 26-period as a slower exponential moving average. The MACD indicator also has a signal *trigger* line, usually represented by a 9-day exponential moving average of the actual MACD indicator that smoothes the MACD values. The MACD indicator shows momentum and changes in the direction of the trend by subtracting the 12-period minus the 26-period exponential moving averages and comparing them against the signal line of the 9-day exponential moving average of the MACD values. When the MACD indicator shows a cross above the signal line, traders consider it a sign of change in momentum and a buy signal. On the other hand, the MACD indicator can show a sell signal when there is a cross below the signal line. Convergence between the lines is interpreted as an early warning sign of a possible trend reversal. Figure 3.27 shows bullish and bearish MACD crosses above and below the signal line, indicating shifts in momentum and changes in the direction of the trend that can be used as entry or exit signals.

When the MACD exponential moving averages are equal to each other, they meet at a point called the *centerline* or *zero-line*. The centerline is an important part of the MACD, especially when the indicator is represented in a MACD histogram. The MACD histogram shows bars that represent the difference between the MACD and the signal line. Each bar begins at the centerline and can be either above or below the centerline, depending on the direction of the momentum and the strength of the trend. The stronger the momentum, the longer the bars of the histogram will be. The bars can change their direction above or below the centerline, depending on whether there is a bullish or bearish cross between the MACD lines. In general, if there is a reduction in the size of the bars moving closer and

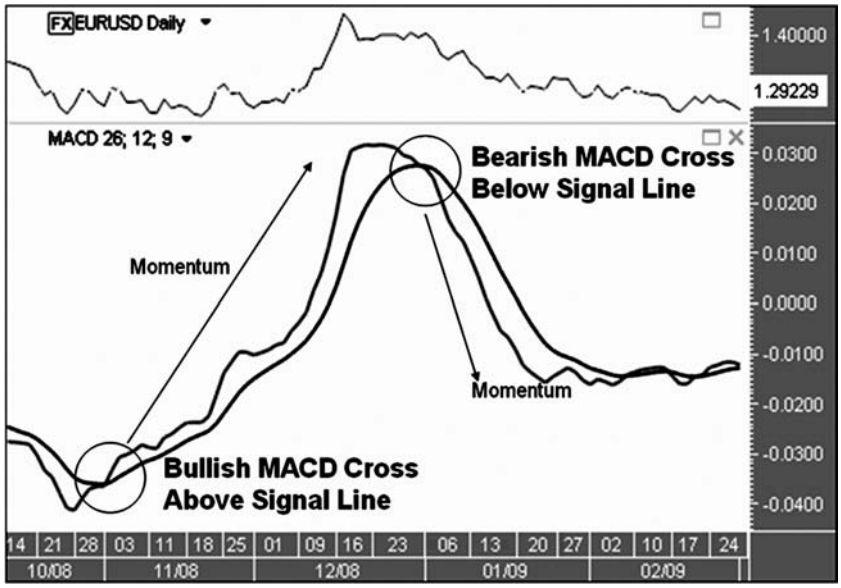

FIGURE 3.27 MACD Crosses

closer toward the center line of the histogram, this can be considered an early warning sign of a potential cross between the MACD lines that could lead to shifts in momentum and reversals of the trend. Figure 3.28 shows a MACD histogram that helps visualize bullish and bearish MACD crosses and trends represented as bars located above or below the zero-line of the histogram.

There are three popular strategies to generate entry and exit signals using MACD indicators. As explained in earlier examples, the most common strategy uses crosses of the MACD above the signal line as buy triggers and crosses below the signal line as sell triggers. MACD crosses above the zero-line can also be interpreted as buy signals, and crosses below the zero-line as sell signals. The third most popular strategy capitalizes on the divergence, or the differences, between the actual prices and MACD indicator, or divergence between prices and the MACD histogram. *Positive divergence* can occur within a bearish trend when actual prices continue to produce new lows, but the MACD indicator remains at previous levels and does not move lower. Traders usually interpret such positive divergence between prices and the MACD indicator as an early sign of exhaustion of the bearish trend and a potential shift in momentum to the upside. *Negative divergence* can develop within bullish trends when actual prices continue to make higher highs; however, the MACD indicator remains at

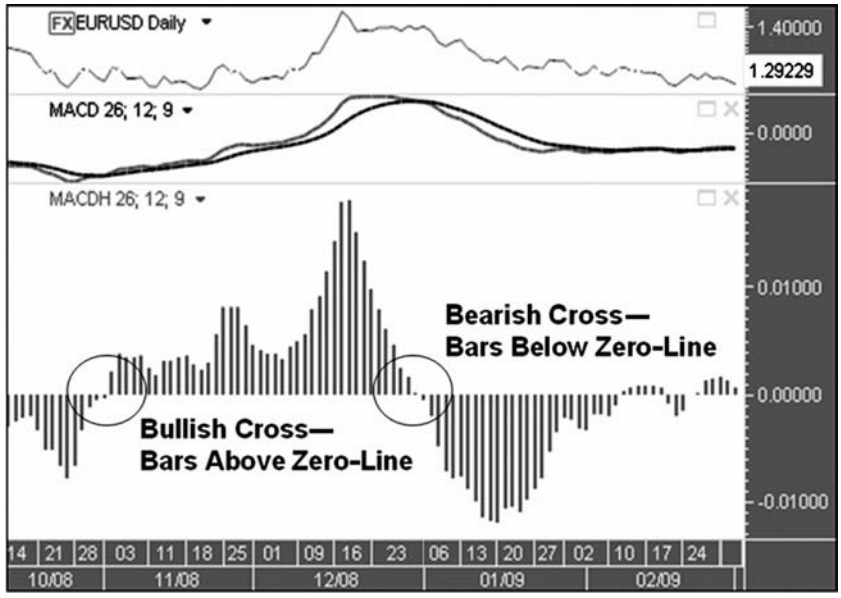

FIGURE 3.28 MACD Histogram

lower levels and does not follow prices any higher. Traders who spot negative divergence between actual prices and the MACD indicator may use it as an early sell signal based on the expectation that the bullish trend may exhaust, leading to a shift in momentum to the downside. The same positive and negative divergences can occur between actual prices and the MACD histogram. Figure 3.29 shows positive divergence within a strong bearish trend. Please note that the actual prices continue to produce new lows as the bearish trend lasts from approximately June 1998 until January 2001. However, since January 2000, the bars of the MACD histogram no longer follow the lower prices. Despite the new lows in prices, the bars of the MACD histogram begin to shrink in size and get closer and closer to the zero-line, and at the lowest point in prices, the bars of the MACD histogram are actually almost at the zero-line. In Figure 3.29, there is a positive divergence between prices and the MACD histogram from approximately January until December 2000 that can be interpreted as an early sign of trend exhaustion that leads to shift in momentum to the upside and a reversal of the previously established multiyear bearish trend.

As shown in the previous example, positive/negative divergences can serve as leading indicators of trend reversals. However, despite technical improvements made to moving averages throughout the years and the addition of the MACD histogram, moving averages and MACD are still

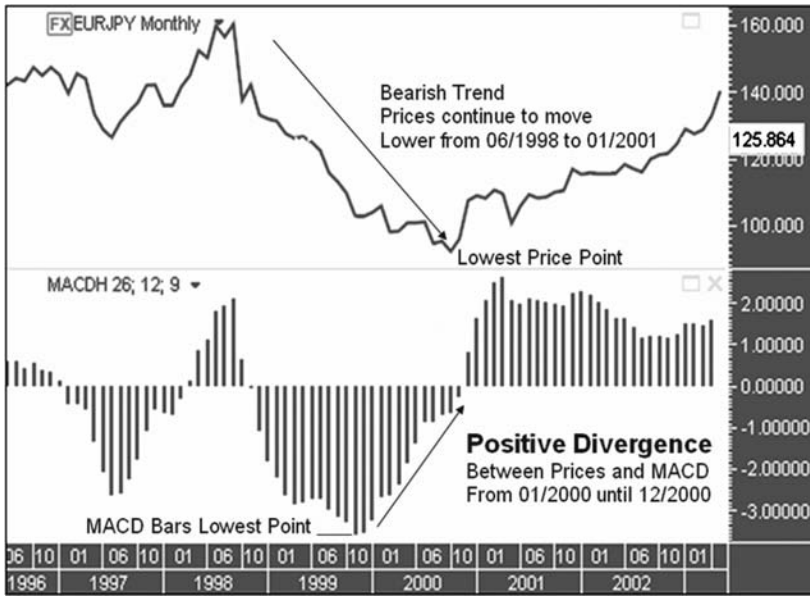

FIGURE 3.29 MACD Histogram Positive Divergence

considered to be lagging indicators that trail actual prices. This means that moves in prices may take a while to be confirmed by the moving averages or MACD; therefore, it may be necessary to wait several time periods or wait for price pullbacks before entering trades based on the moving averages or MACD crossover signals. For example, one strategy suggests confirming bullish MACD crossovers by waiting to see whether the MACD line stays above the signal line for least three time intervals after the crossover before entering the trade at the end of the third time interval. Traders should remember to confirm moving averages and MACD signals with actual movements in prices, as well as with signals from other technical indicators, such as the stochastic oscillator and Relative Strength Index.

Stochastic Oscillator

The *stochastic oscillator* and the *Relative Strength Index* are two of the most popular technical indicators. They are called *oscillators* because they move within a range, usually between 0 and 100. The stochastic oscillator is a momentum indicator that compares prices within a specific period of time. Traders can chose the amount of time intervals to be analyzed as well as the type of prices: open, high, low, or close prices. Most commonly used are the stochastic oscillators of closing prices. The stochastic oscillators

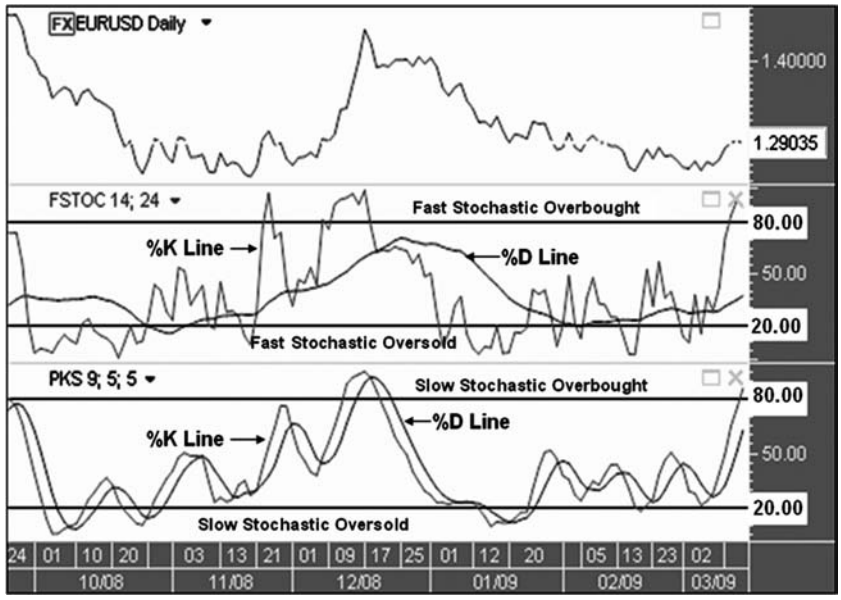

FIGURE 3.30 Fast and Slow Stochastic Oscillators

can be fast or slow. The *fast* and the *slow* stochastic oscillators have a shorter-time-period exponential moving averages %K line, and a longer-time-period exponential moving averages %D line, which is an exponential moving average of the %K. The shorter-time-period exponential moving average %K is faster and reacts to price changes quicker than the longer-term exponential moving average %D. As with the MACD indicator, the fast and slow stochastics also have a signal line that is represented by the %D exponential moving average, and crosses above or below the signal line %D are used as entry or exit signals. The slow stochastic oscillator is usually preferred because it is smoother (see Figure 3.30) and shows fewer crosses of the signal line, compared to the fast stochastic oscillator, which can show erratic price moves and more frequent crosses that in some instances may produce false entry/exit signals. Both the fast and the slow stochastics oscillate in a range between 0 and 100. When there is a strong bullish trend, prices should move toward the top of the range, and within strong bearish trends, prices should move toward the bottom of the range. However, if the stochastic oscillator shows a reading above 80, this indicates overbought conditions, which is normally interpreted as an early warning sign of a bullish trend exhaustion and potential reversal. On the other hand, a reading below 20 indicates oversold conditions as a sign of potential exhaustion and reversal of a bearish trend.

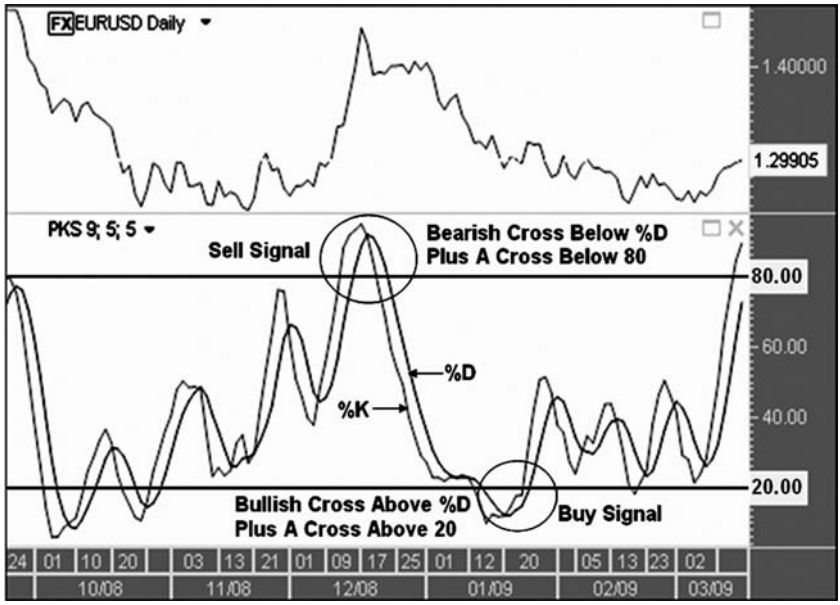

FIGURE 3.31 Entry and Exit Signals Shown by Stochastic Oscillator

There are several ways to generate entry and exit signals using the stochastic oscillator. Traders can monitor the indicator for crosses above the %D signal line, which indicate a shift in momentum to the upside and can be interpreted as buy triggers. Crosses below the %D signal line indicate a shift in momentum to the downside and can be used as sell signals. This strategy can be a bit problematic in a volatile trading environment, when crosses can develop very frequently and some of the frequent crosses may produce fake entry/exit signals followed by quick reversals that can trigger stops and cause losses. Therefore, some experienced traders tend to wait until the crosses above the %D signal line are accompanied by a cross above the 20 mark of the stochastic oscillator, which indicates oversold conditions and a potential exhaustion and reversal of a bearish trend, as well as waiting until a cross below the signal line is accompanied by a cross below the 80 mark of the stochastic oscillator, which would indicate a potential exhaustion and reversal of a bullish trend (see Figure 3.31).

A popular strategy when using the stochastic oscillator is to take advantage of divergence, or the difference between actual prices and the stochastic oscillator. Divergence can occur when prices trend in the opposite direction from that of the stochastic oscillator. Such divergences are normally considered to be early signs of extended overbought/oversold trends that may soon be followed by a trend reversal. The following

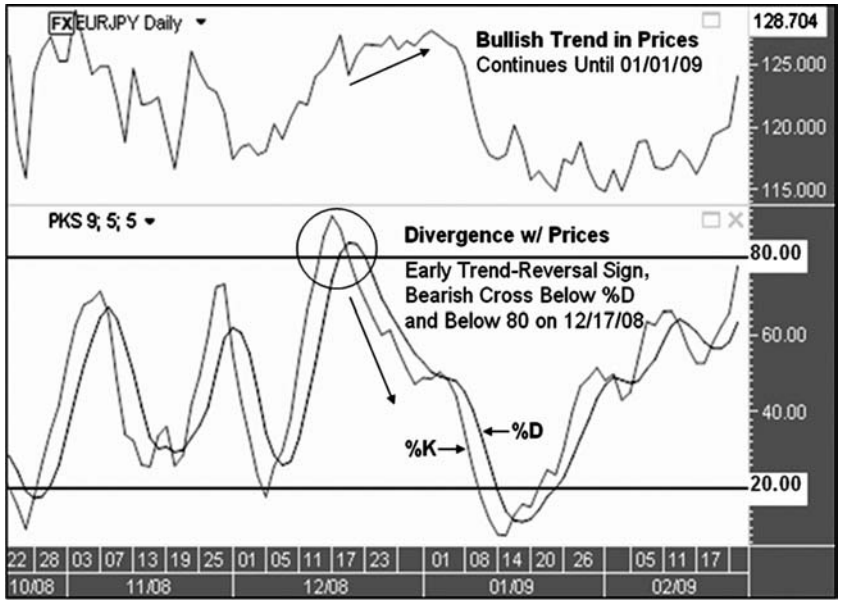

FIGURE 3.32 Stochastic Indicator Divergence with Price

example shows divergence between actual prices and a slow stochastic oscillator. Please note in Figure 3.32 that the bullish trend in prices continues until approximately 01/01/09. However, on 12/17/09, almost two weeks earlier, the slow stochastic oscillator gives an early trend-reversal sign with a bearish cross below %D and also a cross below 80. In this example, the divergence between actual prices and the stochastic oscillator, along with the bearish cross below %D and below 80, may be considered an early sell signal based on the expectation that the bullish trend is overbought and may soon exhaust, leading to a shift in momentum to the downside and a potential reversal of the previously established bullish trend.

Relative Strength Index

The *Relative Strength Index (RSI)* is another popular technical indicator similar to the stochastic oscillator. The RSI determines the strength of price moves by comparing up and down price changes from the time of closing of the previous trading session until the close of the following day's trading session. The recommended minimum period to be analyzed is usually 14 days, although traders can customize the indicator for longer or shorter time periods. The RSI also oscillates in a range between 0 and 100. A Relative Strength Index reading above 70 indicates overbought conditions and

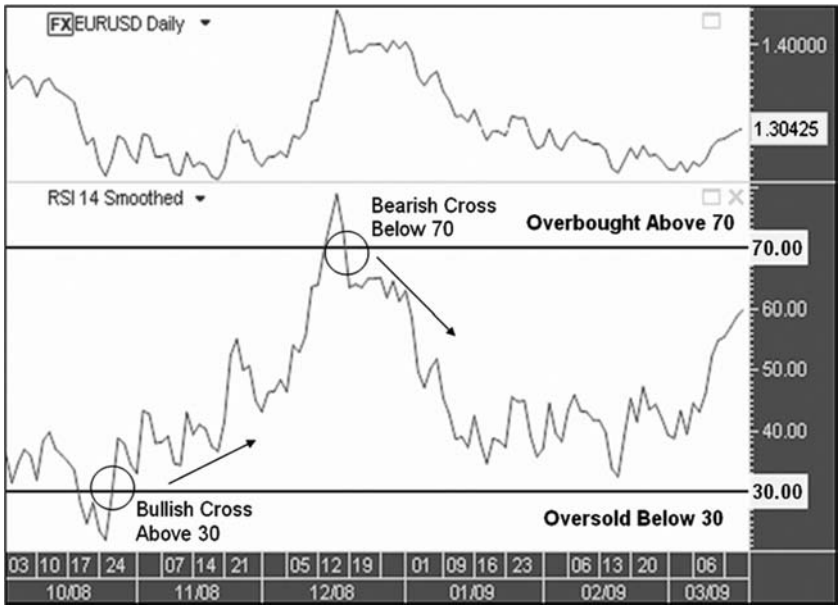

FIGURE 3.33 Relative Strength Index

may be interpreted as an early warning sign of an extended bullish trend that may be followed by exhaustion and potential trend reversal. On the other hand, an RSI reading below 30 indicates oversold conditions as a sign of potential exhaustion and reversal of an extended bearish trend (see Figure 3.33).

As shown in Figure 3.33, bearish RSI crosses below 70 show shifts in momentum to the downside and can be used as early signs of potential reversal of overbought bullish trends. Bullish crosses above 30 show shifts in momentum to the upside and can be used as early warning signs of potential reversal of oversold bearish trends. Big up or down price spikes can easily push the RSI above or below the 30 and 70 marks, and may cause false buy or sell signals. Therefore, traders should remember that the RSI might not be best used as a standalone buy/sell signal indicator. The Relative Strength Index is mainly a momentum and trend-confirmation tool, and is recommended to be used in conjunction with other technical indicators.

FIBONACCI RETRACEMENT

In his book, *Liber Abaci* (*The Book of Calculation*), one of the most talented mathematicians of the Middle Ages, Leonardo Pisano Fibonacci,

first introduced the benefits of the Hindu–Arabic 0 to 9 numeral system to Europe and the western world. Besides explaining the practical advantages of this "new" numeral system, Fibonacci's book explained a sequence of numbers used for centuries by mathematicians in India that is now known as the *Fibonacci numbers*. The Fibonacci sequence of numbers begins with the numbers 0 and 1, and each new number is the sum of the previous two numbers:

0, 1, 1, 2, 3, 5, 8, 13, 21, 34, 55, 89, 144, 233, 377 . . .

As the sequence grows and the numbers become larger, they approach the *Golden Ratio*, where each number divided by the number that precedes it (for example, 89/55) will have a constant value of approximately 1.618, and each number divided by the number that succeeds it (for example, 55/89) will also have a constant value of 0.618. When a number is skipped, for example, if we skip 89 and divide 144/55, the value will be a constant 2.618; and if we were to skip a number, for example, 89, and divide 55 by the next number 144 that follows 89 in the sequence, the value will be a constant 0.382. In the Fibonacci series of numbers, when the golden ratio is reached, the growth ratio in the sequence will be 1.618 and we can determine the next number by multiplying N times 1.618. If a line X is divided by 1.618, the division, called the *golden section*, will produce two lengths: 0.618X and 0.382X. The Fibonacci sequence can be found in nature as many animals and plants reproduce and grow in harmony with the golden ratio growth function. The Fibonacci golden ratio and the golden section division continue to fascinate modern mathematicians, scientists, astronomers, and artists.

Traders also have found some practical applications of the Fibonacci sequence and golden ratio, the most popular of which is the use of the *Fibonacci retracement measures*. The Fibonacci retracement levels are determined by using the Fibonacci ratios to calculate 23.6%, 38.2%, 50%, 61.8%, and 100% retracements of any pullbacks in prices during periods of consolidation. These measures of retracement percentages are based on previously established price ranges between highs and lows. The Fibonacci retracement levels help traders to identify important price points that may serve as support/resistance levels during pullbacks. If prices find support/resistance at certain Fibonacci retracement levels, there is a strong probability that the previously established trends may continue further. Traders use the Fibonacci retracement levels as a strategic tool to determine price targets that may be reached while prices pull back in periods of consolidation, to set stops, and to generate entry/exit signals.

Figure 3.34 shows a pullback in prices as the USD/JPY pair consolidates within a strong bullish trend. Once traders determine that the

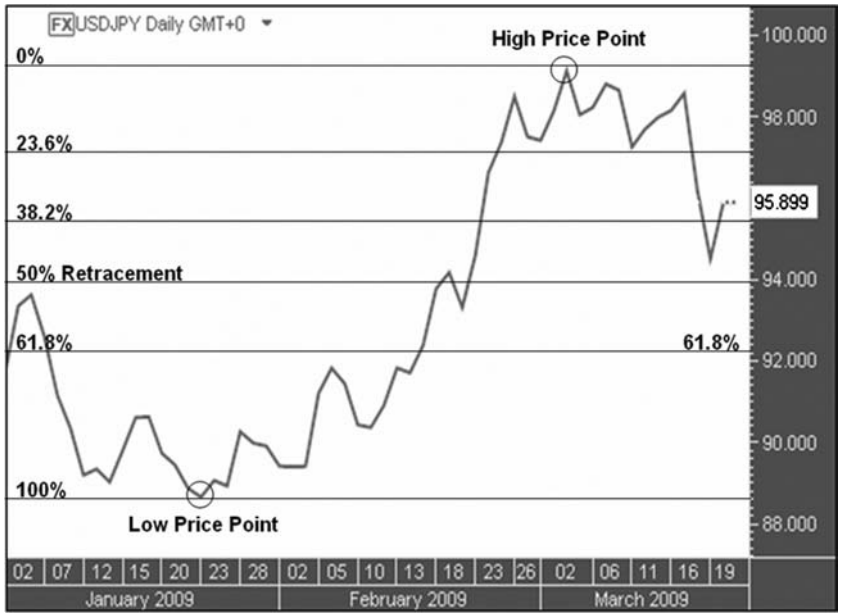

FIGURE 3.34 Fibonacci Retracement

consolidation has begun, they can calculate the Fibonacci retracement percentages based on the price range represented by the total number of PIPs produced from the lowest to the highest price point registered during the entire bullish trend's price move. The two trend lines running through the lowest and the highest points define the range. In consolidations occurring within bullish trends, the 0% retracement will be the level of the highest price point and the 100% retracement will be the level of the lowest price point. The 0% retracement within bearish trend consolidations will be the level of the lowest price point and the 100% retracement will be the level of the highest price point. The distance between 0% and 100% is divided using the Fibonacci ratios to determine 23.6%, 38.2%, 50%, and 61.8% Fibonacci retracement levels.

Some popular trading strategies are based on using Fibonacci retracement levels. As a countertrend strategy, traders may take advantage of price pullbacks in the opposite direction of previously established trends. Countertrend traders use the Fibonacci retracement levels as price targets that may be reached during consolidations. A trend-continuation strategy can be utilized if a Fibonacci retracement level establishes itself as a strong level of support or resistance, providing opportunities for traders

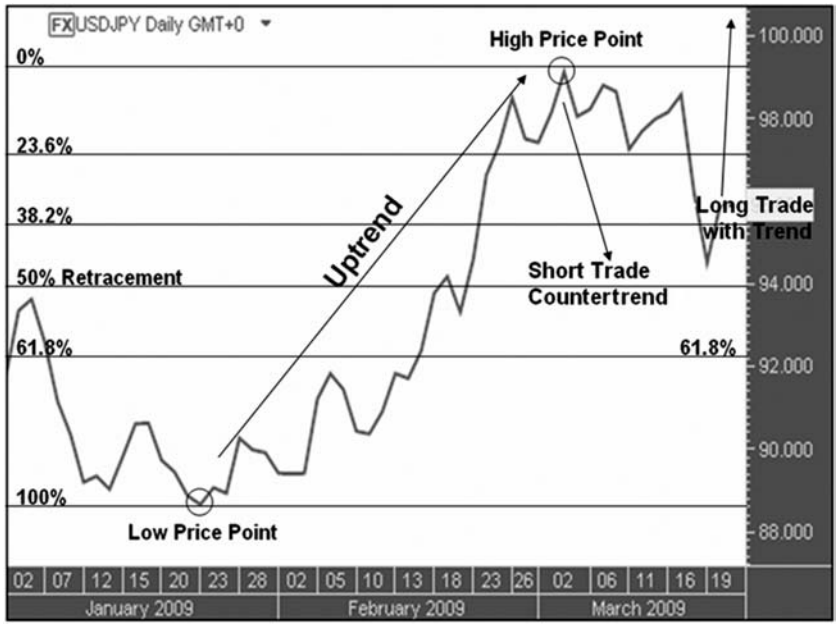

FIGURE 3.35 Fibonacci Retracement Trading Strategy

to take advantage of the potential for further continuation of previously established trends.

Figure 3.35 shows a countertrend short trade based on the pullback in price occurring during a consolidation within a strong uptrend. Conservative profit targets may be placed at price points a few PIPs before either the 23.6% or 38.2% Fibonacci retracement levels are reached. Asking for "perfect" 50% or 61.8% retracements might be a bit more aggressive of an approach, as such larger retracements might be more difficult to accomplish consistently. In this example of a countertrend trade, stops can be placed above the 0% retracement level (the highest price point).

As shown in Figure 3.35, if strong support is found above the 50% or 61.8% Fibonacci retracement levels, the consolidation may end and this could create an opportunity for a long trade based on the expectation for further continuation of the previously established uptrend. In this example of a trend-continuation trade, stops can be placed below either the 50% or 61.8% Fibonacci retracement levels. A more conservative profit target could be the previous high that may be challenged as a resistance level in an attempt to continue the previously established bullish trend. Traders who are convinced that there will be a successful breakout above the resistance of the highest point and that the uptrend will continue further can

place profit targets based on other resistance levels or may use Fibonacci extensions to determine how far the trend may extend if the breakout is successful.

FIBONACCI EXTENSIONS

Fibonacci extensions are used as a technical analysis tool to determine potential support/resistance levels that may be challenged if previously established trends continue as a result of successful breakouts. Since certain trend-continuation chart patterns such as ascending or descending triangles can show early signs of potential breakouts, traders often apply Fibonacci extensions to see how far previous trends could continue if trend-continuation pattern breakouts were successful. The Fibonacci extensions are based on the 1.618 golden ratio. The Fibonacci extension beyond 100% will be 161.8%, and the Fibonacci extension beyond 200% will be 261.8%. These 161.8% and 261.8% Fibonacci extension levels are used to determine future support or resistance.

Figure 3.36 shows a pullback in prices as the USD/JPY pair consolidates within a strong bullish trend. The two trend lines running through

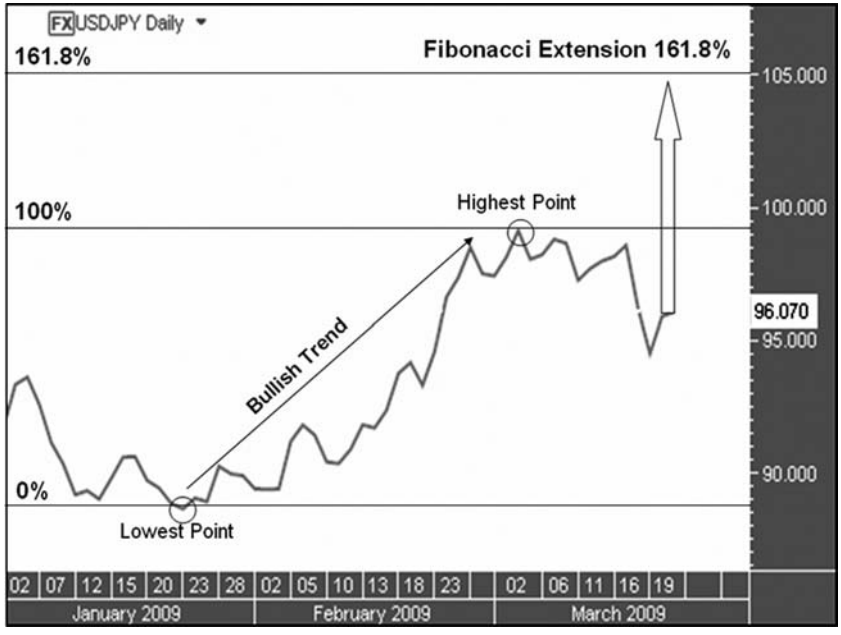

FIGURE 3.36 Fibonacci Extension

the lowest and the highest price points define the range of the uptrend. The 0% level is represented by the lowest price point and the 100% level is the highest price point of the bullish trend. Traders who anticipate that the uptrend may continue after the price pullback/consolidation ends can determine future resistance levels by using Fibonacci extensions. In this example, the 161.8% Fibonacci extension level may serve as the next resistance level if the bullish trend continues further as a result of a successful breakout above the 100% level resistance of the highest point.

ELLIOTT WAVES

Since the late 1930s, when Ralph Nelson Elliott published *The Wave Principle*, the *Elliott Waves* have remained one of the best tools used by traders to identify trend cycles and patterns.

There is a connection between the *Elliott Wave Theory* and fractals in mathematical science. A *fractal* is an object or quantity that displays self-similarity, in a somewhat technical sense, on all scales. The object need not exhibit exactly the same structure at all scales, but the same *type* of structures must appear on all scales (Eric W. Weisstein, "Fractal," from MathWorld—A Wolfram Web Resource, http://mathworld.wolfram.com/Fractal.html).

Fractal mathematical structures repeat themselves on smaller scales. The pictures in Figure 3.37 show fractals known as the Gosper Island, Koch Snowflake, Box Fractal, Sierpiński Triangle, Barnsley's Fern, Dragon Curve, and Mandelbrot Set.

The rhythm of repetition of patterns and cycles in nature led Elliott to propose that human behavior also has rhythmical cycles and that future human behavior can be predicted based on the repetition of such cycles. He was able to look beyond the perception of the chaotic nature of the financial markets and discovered the repetition of market cycles based on optimistic and pessimistic patterns of human behavior. Elliott divided the financial market cycles into fractional patterns, called *waves*.

Elliott gave the main trend the name *impulse wave cycle* and divided it into a pattern consisting of five smaller waves. Each impulse wave cycle is followed by a *corrective wave cycle* consisting of three smaller waves. The perfect Elliott Wave pattern has impulsive and corrective cycles consisting of eight waves: three *motive* waves 1, 3, and 5 up in the direction of the main trend, and three *corrective* waves 2 and 4 down, followed by a corrective wave cycle that has two motive waves A and C down, and one corrective wave B up (see Figure 3.38).

The same pattern applies when the main trend is bearish. In a bear market, the impulse trend cycle would consist of three motive waves 1, 3 and

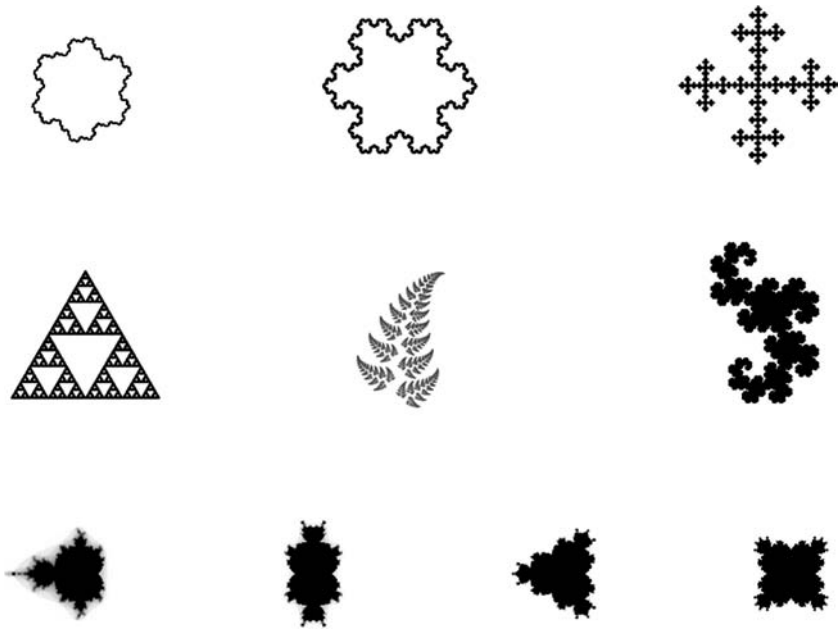

FIGURE 3.37 Fractals

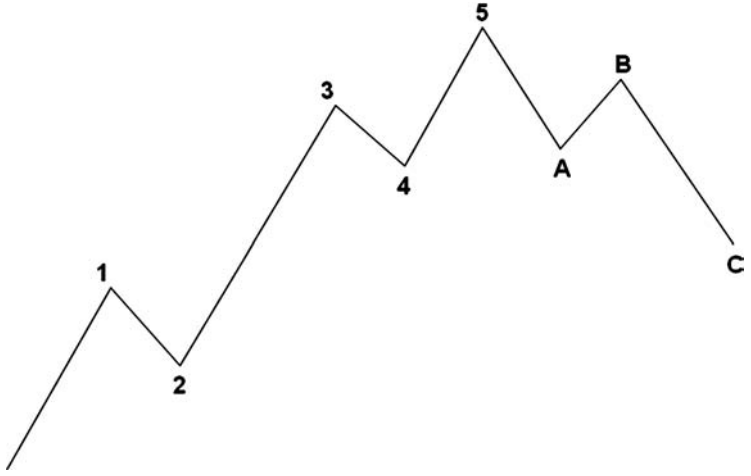

FIGURE 3.38 Elliott Wave

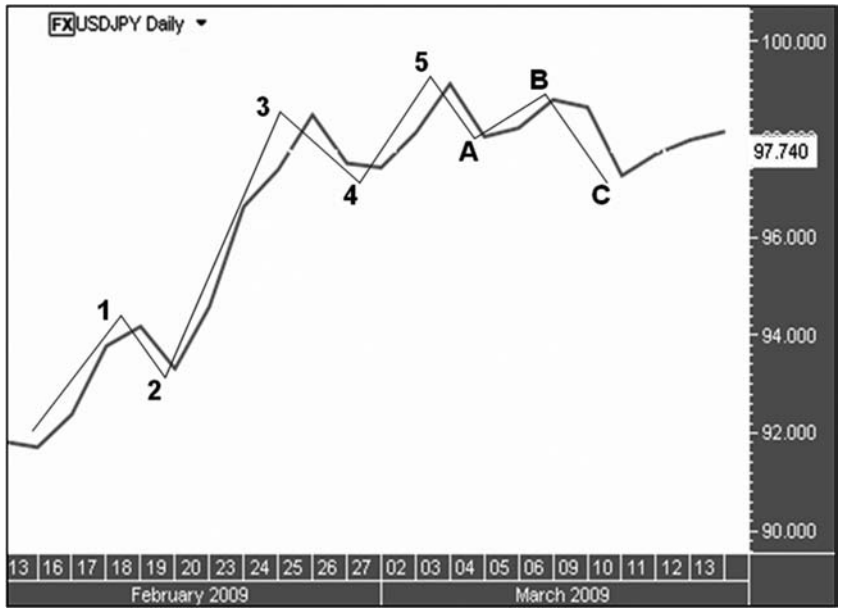

FIGURE 3.39 Elliott Wave Pattern

5 down in the direction of the main trend and three corrective waves 2 and 4 up, followed by a corrective wave cycle that has two motive waves A and C up, and one corrective wave B down.

Figure 3.39 shows a real-life example of an Elliott Wave pattern within a bullish trend in the USD/JPY currency pair.

Each wave in the Elliott Wave pattern has its own distinctive features:

- *Wave 1* may be difficult to recognize as it normally begins when a previously established trend is still intact and the sentiment among investors is predominantly bearish.
- *Wave 2* is a corrective wave to Wave 1. Because sentiment during Wave 2 is still bearish, prices may even retest the previous low point of Wave 1, but Wave 2 should not register a lower low than the low of Wave 1 and should not have longer length than Wave 1.
- *Wave 3* is usually the strongest and largest wave in the pattern. Investor sentiment normally turns more and more positive during Wave 3 and prices rise fast. By the middle of Wave 3, the majority of market participants have realized that a strong bullish trend has been established and they jump in on the action, driving prices higher and extending the length of the wave.

- *Wave 4* is the corrective wave to Wave 3. The pullback in price during Wave 4 may not be as significant as the pullback in Wave 2, in many instances not larger than 50% of Wave 3, because many traders who expect the trend to continue look for opportunities to take advantage of the pullback in anticipation of Wave 5.
- *Wave 5* is usually the final stage of the main trend. By the time Wave 5 develops, even the most inexperienced investors have finally noticed the strong trend and decide to participate in it, often buying at the top or selling at the bottom, and ending up with a loss because of the significant price correction that usually follows Wave 5.
- *Wave A* is the first wave of the countertrend corrective pattern. Wave A begins as a corrective wave to Wave 5. Because the sentiment is still predominantly bullish, Wave A may not register a lower low than the low of Wave 4, but it may test the low of Wave 4, establish a double bottom, and lead to a push higher with Wave B.
- *Wave B* may seem to many market participants as an attempt to continue the previously established trend; however, the bullish investor sentiment may become increasingly more bearish. If the high of Wave B is identical to, and not higher than, the high of Wave 5, traders may recognize this development as a double top trend-reversal pattern. If the high reached during Wave B is identical to the high of Wave 3, many may recognize Wave B as the right shoulder of a head-and-shoulders formation that could be the first sign of potential trend reversal, leading to Wave C.
- *Wave C* is an attempt to reverse the previously established trend. By the middle of Wave C, most market participants have already identified the shift in momentum and have decided to participate in the new bearish trend, pushing Wave C farther than Wave A. If Wave C does not completely reverse the previously established trend, another sequence of impulsive waves could follow.

According to Elliott, these five- and three-wave patterns can repeat themselves, forming a complete cycle of 89 impulse waves and 55 corrective waves that actually develop in close connection with the Fibonacci growth ratio. Although when Elliott first discovered the *Wave Principle* of market trends he claimed, "I've never heard of the Fibonacci series," later when he analyzed the waves from a mathematical standpoint, Elliott came to the conclusion that "The Fibonacci Series is the basis of The Wave Principle." The Fibonacci series of numbers is evident in the 1, 3, 5 impulsive waves, the pattern of 5 waves up and 3 waves down for a total of 8 waves—the following number after 3 and 5 in the Fibonacci sequence—and also the complete cycle of 89 impulse and 55 corrective waves growing by the 1.618 Fibonacci growth ratio from $55 \times 1.618 = 88.99$,

to approximately 89 impulse waves, then followed by $89/1.618 = 55.00$, to 55 corrective waves, and so forth.

The Fibonacci retracement is an important tool for traders who follow Elliott Wave patterns. Since pullbacks in price normally occur within the corrective waves of the pattern, many traders use the Fibonacci retracements in order to identify future support/resistance levels at which a corrective wave may end. If prices find support/resistance at certain Fibonacci retracement levels, there is a good probability that the price pullback of the corrective wave may be over and another impulse wave may develop, continuing the previously established trend. Traders may look for countertrend opportunities within corrective waves using the Fibonacci retracements to determine price targets that may be reached while prices pull back. Fibonacci retracement levels are also used to generate entry/exit signals and to set protective stops.

Let us consider the following examples of different strategies using Fibonacci retracements within Elliot Wave patterns. The chart in Figure 3.40 shows a countertrend short trade based on the pullback in price occurring within a corrective Wave 2. A conservative profit target may be placed at price points a few PIPs before either the 23.6% or 38.2% Fibonacci retracement levels are reached. Wave 2 is a corrective wave to Wave 1, and, because sentiment during Wave 2 is still predominantly bearish, larger retracements are possible during Wave 2 and prices may even retest the previous low of Wave 1. However, asking for larger 50% or 61.8% retracements or complete 100% retracements might be a bit more aggressive of an approach, as such larger retracements might be more difficult to accomplish consistently. In this example of a countertrend trade, stops can be placed above the 0% retracement level, which is the high of Wave 1.

As shown in Figure 3.40, if strong support is found above the 38.2%, 50%, or 61.8% Fibonacci retracement levels, Wave 2 may end and this could create an opportunity for a long trade based on the anticipation of further continuation of the previously established uptrend with Wave 3. In this example, there is also an opportunity for a trend-continuation trade. Depending on the size of the pullback, the 23.6%, 38.2%, 50%, or 61.8% Fibonacci retracement levels may be used as entry points for trend-continuation trades and protective stops can be placed below the 38.2%, 50%, or 61.8% Fibonacci retracement levels. A more conservative profit target could be the high of Wave 1, which may be challenged as a resistance level in an attempt to continue the previously established bullish trend. Traders who anticipate that there will be a successful breakout above the high of Wave 1 and that the uptrend will continue further with Wave 3 can place profit targets based on previous resistance levels above the high of Wave 1 or may use the 161.8% Fibonacci extension of Wave 1 to determine approximately how far the trend might extend if Wave 3 were successful (see Figure 3.41).

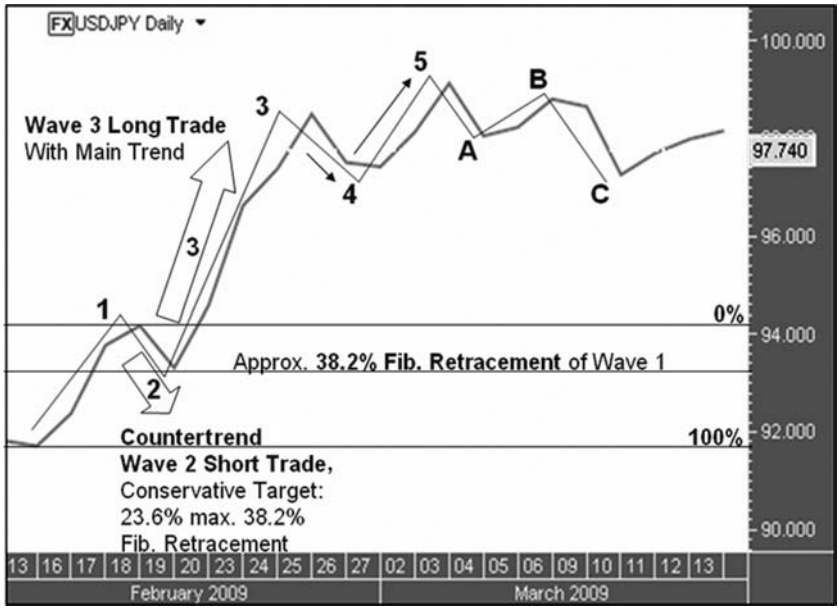

FIGURE 3.40 Elliott Wave Trade Using Fibonacci Retracement

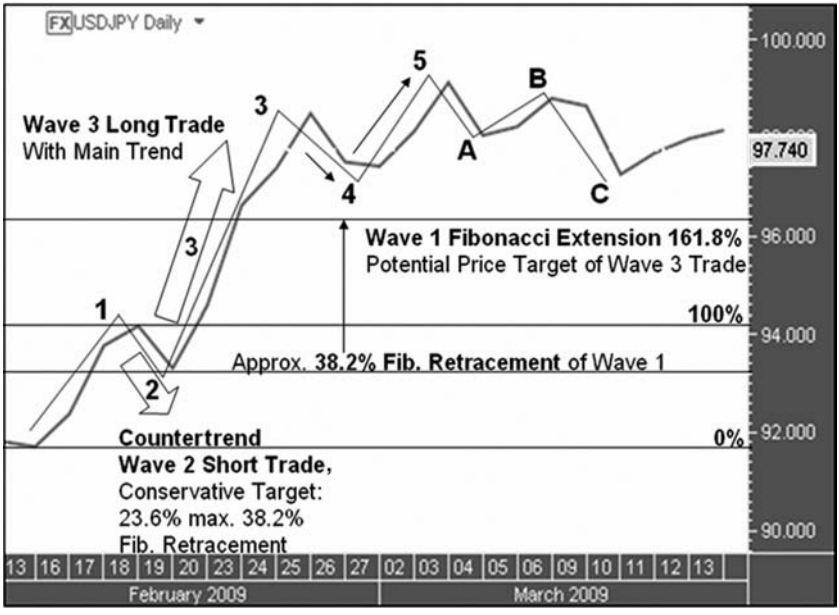

FIGURE 3.41 Elliott Wave Trade Using Fibonacci Extension

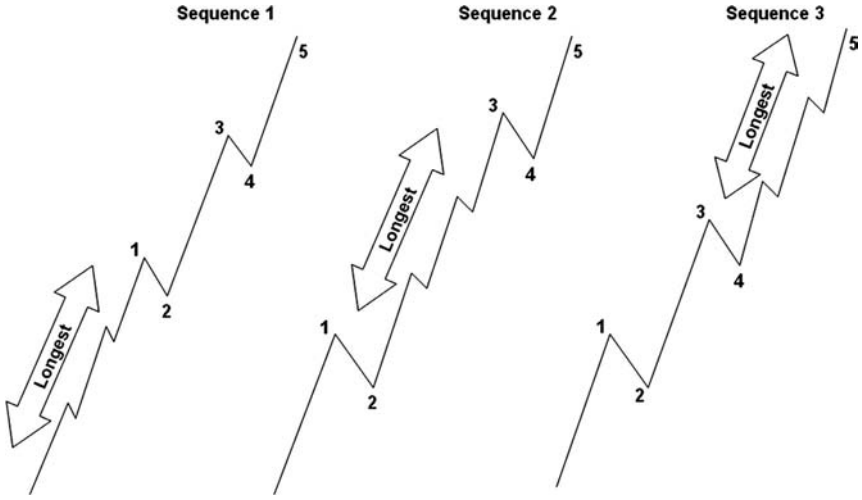

FIGURE 3.42 Complex Elliott Wave

One of the most common variations of the classic Elliott Wave pattern is the complex wave cycle, consisting of the so-called "waves within waves." These are versions of the ideal Elliott Wave pattern where one of the five impulse waves consists of three smaller "subwaves." Figure 3.42

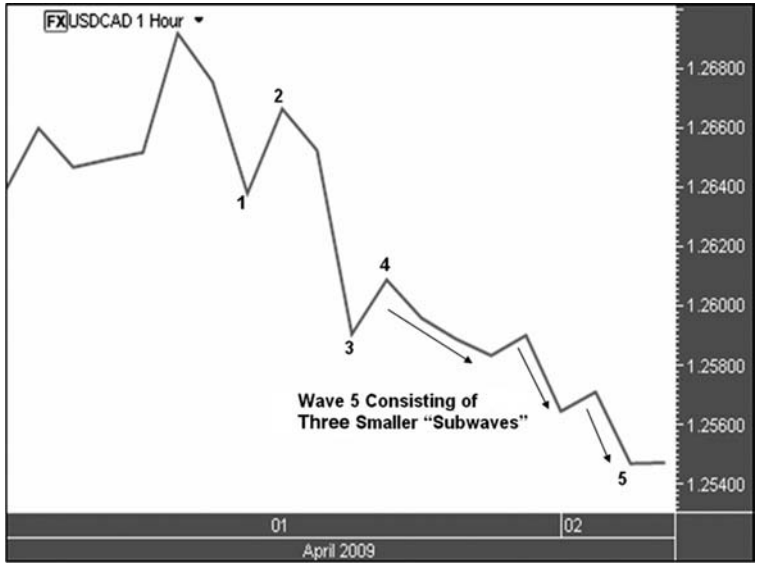

FIGURE 3.43 Complex Elliott Wave Pattern

shows three variations of waves within waves in the classic five-Elliott-Wave impulse pattern. Note that in the first sequence, Wave 1 is the longest, consisting of three smaller subwaves. In the second sequence, Wave 3 is the longest and has three smaller subwaves, and in the third sequence, Wave 5 is the longest one, consisting of three smaller subwaves.

The chart in Figure 3.43 shows a real-life example of waves within waves in a complex Elliot Wave bearish impulse pattern of five waves. Note that Wave 5 is the longest, consisting of three smaller subwaves.

The Elliott Wave Theory gained popularity in the late 1970s, when A.J. Frost and Robert Prechter Jr. published the classic book, "Elliott Wave Principle: Key to Market Behavior," predicting the bull market at the end of that decade. Using the Elliott Wave principle, Robert Prechter Jr. also correctly forecasted the stock market crash of 1987.

CHAPTER 4

The Quarters Theory Trend Waves

One of the main problems of the classic Elliott Wave Theory is subjectivity. When Elliott Wave technical analysts are asked to collectively determine the number of waves in a trend cycle and give their prediction of future price moves, it is not unusual for them to have contradicting views. The reason for that in most instances is the subjective interpretation when the waves in each cycle are counted. To this day, proper wave count is considered to be the most challenging issue for Elliott Wave traders.

Consider the following scenario. Let us assume that a trader is under the impression that she is trading uptrend Wave 3, the strongest wave in the classic Elliott wave pattern, anticipating a significant price move, when in actuality she is trading Wave 5, which normally is limited and is the last wave in the bullish impulse cycle. Let us say the trader gets lucky this one time—Wave 5 extends longer than usual and the trader makes a winning trade. What happens if after the corrective wave she enters a long trade again, expecting the trend to continue further with another bullish Wave 5, only to find that a corrective wave pattern has begun, producing Wave A instead of Wave 5? In this case, the trader will likely end up with a losing trade. Had she actually counted the trend waves properly, she would have been able to determine the exact phase of the trend progression and as a result would have made a better trading decision and an unnecessary losing trade would have been easily avoided. Losing trades will always be part of trading, but losing trades due to pure ignorance or negligence are absolutely unnecessary. We should try our best to avoid unnecessary losses

because they can hurt our bottom line by tilting the scale between winning and losing trades.

Some experts favor the notion that proper wave count is not crucial as long as a trader correctly identifies the direction of the trend and then uses proper stops and realistic profit targets. This is a valid point, because the element of the unknown will always exist in trading. Even if one knows the proper wave count, that still does not guarantee that the trend will develop exactly, according to the classic Elliott Wave pattern. No one can predict the outcome of future events with 100% success. But is avoiding the problem of proper wave count the best way to deal with it? Having experienced the tremendous benefits associated with understanding the different stages of trend progression, I have decided to tackle the issue by developing a proprietary method of counting trend waves, which, for lack of a better name, I call The Quarters Theory *Trend Waves*. The method follows a strict set of rules and procedures, and as with The Quarters Theory, uses the most important units of information for every trader—the actual prices.

The Quarters Theory Trend Waves combine the premise of the Elliott Wave Theory with the premise of the Dow Theory, which defines the *three-trend market* and divides the primary trend into *three phases*. The *ideal* Quarters Theory Trend Waves cycle has three phases, consisting of trend waves numbered 1, 2, and 3. They are identical to the impulse cycle waves 1, 3, and 5 in the classic Elliott Wave Theory. However, The Quarters Theory Trend Waves cycle has a different numerical representation, because the classic Elliott Wave Theory corrective waves 2 and 4 are simply given the name *Correction* rather than the numbers 2 and 4. Each Correction occurs after the end of either trend wave 1, 2, or 3, and in the examples that follow you will see the corrections noted as C1, C2, or C3, so that traders would know the actual trend wave that each Correction follows. This provides continuity in the process of counting actual trend waves 1, 2, and 3, without skipping a number with waves 1, 3, and 5, which is the practice in the classic Elliott Wave principle. The reduction in wave count also helps traders to better recognize and focus on the waves that actually progress the trend, not regress it.

In order to identify the different stages of trend development, I have chosen to give The Quarters Theory Trend Waves the following names based on the individual characteristics of each trend wave:

- *Reversal-Trigger Wave 1* marks the beginning of each new trend cycle. I call it the *Reversal-Trigger* wave because it normally occurs as an attempt to reverse a previously established trend. This trend wave can trigger not only a corrective trend pattern, but it could be the

beginning phase of a complete trend reversal, especially if it is followed by a Progressive Wave 2.

- *Progressive Wave 2* is the trend wave that extends the trend and "progresses" it further. This is the equivalent to Wave 3 in the classic Elliott Wave principle.
- *Conclusive Wave 3* is expected to signal the final phase in the trend cycle. The Conclusive Wave 3 is the equivalent to Wave 5 in the classic Elliott Wave principle. The Conclusive Wave 3 may be shorter in length compared to the other trend waves and price moves may be limited.

In a bullish trend wave cycle, each new trend wave will have to produce a higher high than the high of the previous trend wave and the low of each Correction will have to remain at or above the low of the preceding trend wave. In a bearish trend wave cycle, each new trend wave will have to produce a lower low than the low of the previous trend wave and the high of each Correction will have to remain at or below the high of the preceding trend wave.

Figure 4.1 shows an ideal bullish Quarters Theory Trend Waves cycle consisting of Reversal-Trigger Wave 1, followed by Correction 1; Progressive Wave 2, followed by Correction 2; and Conclusive Wave 3, followed by Correction 3.

Note that in the ideal Quarters Theory Trend Waves pattern there are no corrective waves A, B, and C. The Quarters Theory Trend Waves method leaves future possibilities open and lets the market indicate whether it

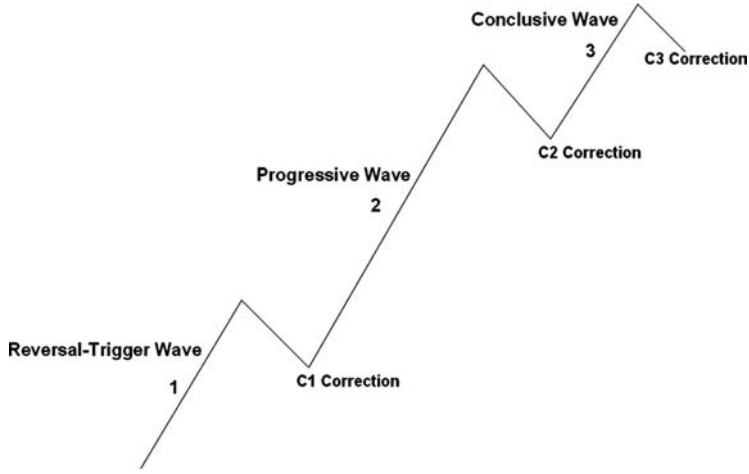

FIGURE 4.1 Ideal Quarters Theory Trend Wave Cycle

wants to reverse the previously established trend or simply continue it further. The Quarters Theory Trend Waves method anticipates that the Conclusive Wave 3 may be the final phase of the trend cycle. But as long as the Correction following the Conclusive Wave 3 does not produce a lower low than the low of Wave 3, the bullish trend sequence could continue with an attempt for another consecutive bullish Wave 4. If the Consecutive Wave 4 produces a higher high than the high of Wave 3, the bullish trend will progress further. As long as the Correction following Wave 4 remains at or above the low of Wave 4, there may even be an attempt to continue the bullish trend with another consecutive Wave 5. Although this scenario does not occur very often, we should not ignore the possibility that more than three trend waves could develop, especially in instances when the main trend is very strong.

Each new trend wave that follows an ideal sequence of three Quarters Theory Trend Waves is given the name *Consecutive Wave*, followed by the number 4 or 5, and so on. Figure 4.2 shows a real-life example of an Extended Quarters Theory Trend Wave sequence. The bearish trend waves in the beginning of the chart are followed by a strong bullish trend wave sequence, where the Conclusive Wave 3 is followed by two more trend waves—Consecutive Wave 4 and Consecutive Wave 5.

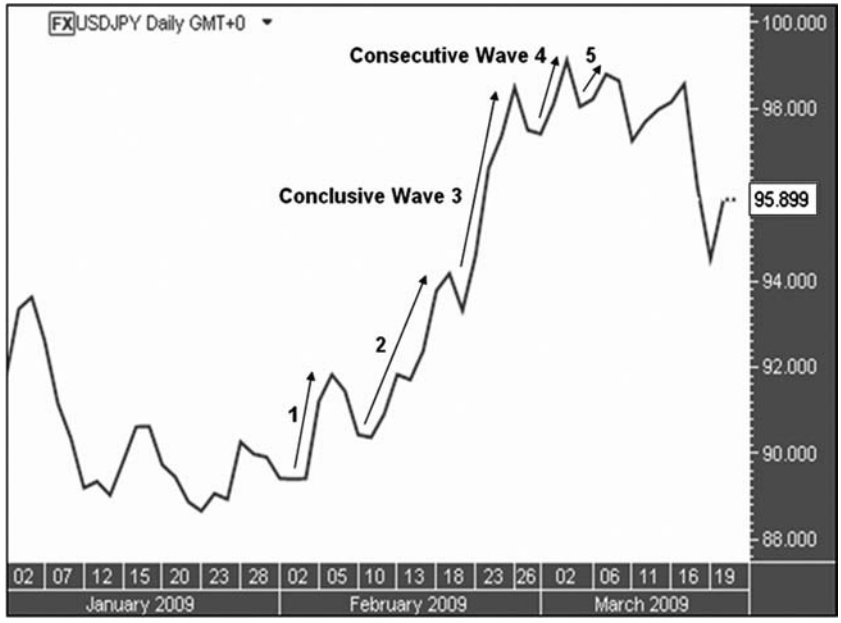

FIGURE 4.2 Consecutive Waves in an Extended Trend Wave Cycle

TREND WAVE FAILURE

The Quarters Theory Trend Waves cycles can be *ideal* (consisting of a perfect three-trend wave pattern), *extended* (having more than three trend waves), or in some instances, *short* (consisting of less than an ideal pattern of three trend waves). Trend wave cycles usually end as a result of an event called *Trend Wave Failure*. To understand the causes of Trend Wave Failure, one needs to follow the basic definitions of *uptrend* and *downtrend*. An uptrend is a sequence of higher highs, and a downtrend is a sequence of lower lows. Bullish trends are likely to fail to continue further if each new high is lower than a previous high. On the other hand, bearish trends would fail if each new low is actually higher than a previous low.

Trend Wave Failure can be easily recognized as long as traders pay close attention to prices. A bullish trend wave cycle would continue to progress the uptrend further as long as each new trend wave produces a new high that is higher than the previous trend wave's high. Bearish trend wave cycles would continue further as long as each new bearish trend wave is successful in producing a lower low than the low of the previous trend wave. Trend Wave Failure occurs either when a follow-up bullish trend wave fails to register a higher high than the high of a preceding bullish trend wave, or when a bearish trend wave fails to produce a lower low than the low of a preceding bearish trend wave in the sequence. The unsuccessful trend progression as a result of a Trend Wave Failure usually leads to an attempt for a trend reversal with the development of a Reversal-Trigger Wave in the opposite direction of the previously established trend. This is the main consequence of a Trend Wave Failure.

Figure 4.3 shows a short trend wave cycle consisting of two trend waves: an extended bullish Wave 1, followed by an attempt to continue the bullish trend sequence with a Progressive Wave 2. Note that Wave 2 fails to produce a higher high than the high of Wave 1. The bullish trend wave sequence ends and as a result of the Trend Wave Failure of Wave 2, a Reversal-Trigger Wave 1 develops in the opposite direction of the bullish trend waves in an attempt to reverse the uptrend.

No individual trend wave in a trend cycle is immune from the danger of failing; therefore, traders should monitor each wave carefully and should watch for signs that may signal Trend Wave Failure. Some helpful early warning signs of Trend Wave Failure may be given by certain trend-reversal patterns, especially double tops, double bottoms, or head-and-shoulder formations.

Let us analyze the trend developments throughout the entire chart used in the previous example. As you will note on the left-hand side of Figure 4.4, the perfect three bearish trend waves are followed by an

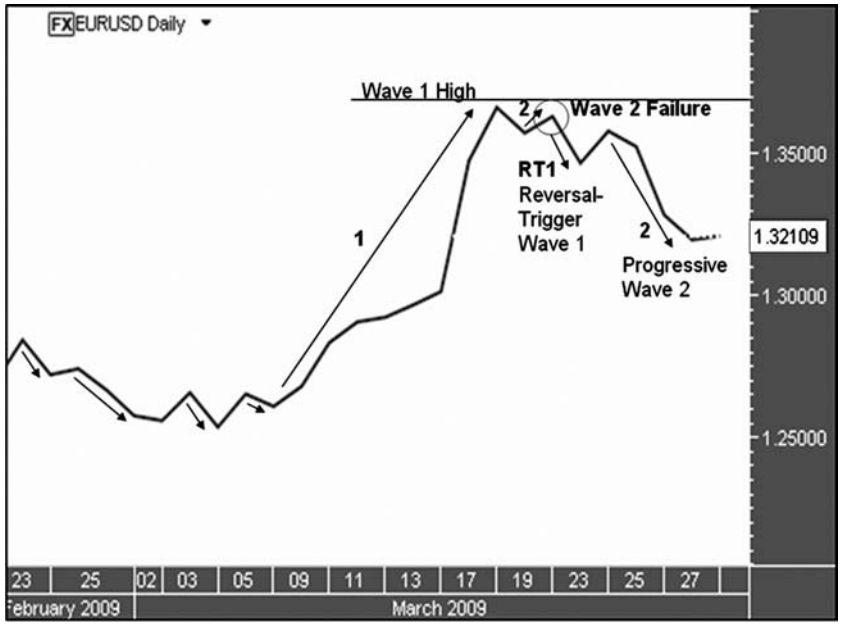

FIGURE 4.3 Trend Wave Failure Shortening a Trend Wave Cycle

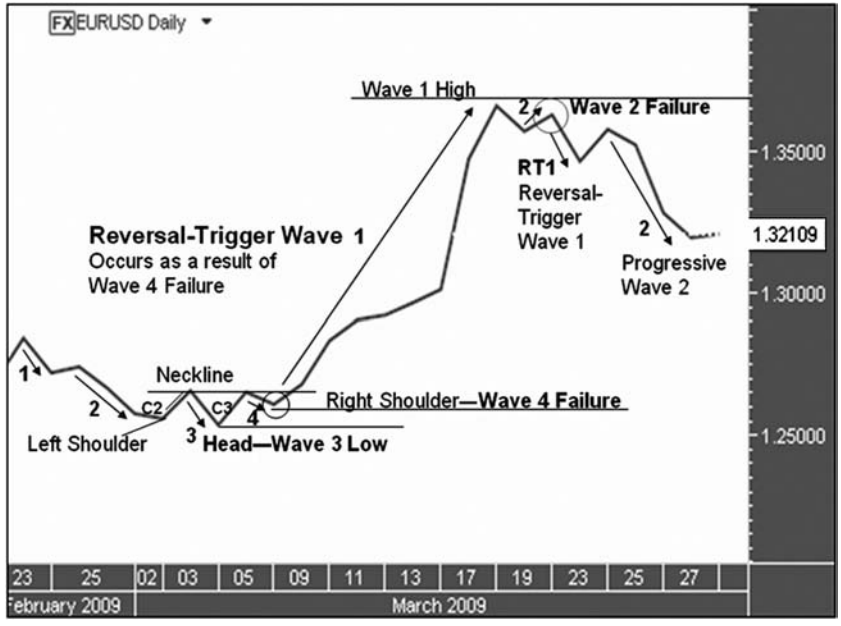

FIGURE 4.4 Trend Wave Failure Followed by Reversal-Trigger Waves

attempt to continue the bearish trend wave sequence with another bearish Consecutive Wave 4. However, Wave 4 fails to produce a lower low than the low of Wave 3. Moreover, a reverse head-and-shoulders pattern occurs within the bearish trend. The low of Wave 3 is the head, the low of Wave 2 is the left shoulder, the low of Wave 4 is the right shoulder, and the trend line connecting the highs of Correction 2 (C2) and Correction 3 (C3) form the neckline resistance. The development of a reverse head-and-shoulders pattern is not only an early indication of exhaustion and potential reversal of the previously established downtrend, but also an early signal of a Trend Wave Failure. The Trend Wave Failure of the bearish Consecutive Wave 4 leads to the development of a bullish Reversal-Trigger Wave 1 in the opposite direction of the bearish trend wave sequence.

Understanding Trend Wave Failure and its consequence, which, in most instances, is the development of a Reversal-Trigger Wave, can be a helpful tool that assists traders to recognize the end of the previous trend wave cycle and at the same time prepare in advance for the beginning of a new trend cycle. The following chapter will reveal more details on the close relationship between Trend Wave Failure and Reversal-Trigger Waves, as well as the distinctive features of each trend wave in The Quarters Theory Trend Waves cycle.

THE REVERSAL-TRIGGER WAVE

The Reversal-Trigger Wave 1 is the most important trend wave because each Quarters Theory Trend Waves cycle always begins and ends with a Reversal-Trigger Wave. The occurrence of a Reversal-Trigger Wave marks not only the end of the previous trend wave cycle, but also the beginning of a new one. This is why proper recognition of the Reversal-Trigger Waves is absolutely necessary for the process of proper wave count. Failure to correctly identify a Reversal-Trigger Wave in a trend wave cycle not only leads to inaccurate wave count but also causes a lack of clear perspective of the different stages of trend progression.

Contrary to the popular belief that the first trend waves in each cycle might be difficult to recognize and prepare for, The Quarters Theory Trend Waves method makes proper identification of Reversal-Trigger Waves easier by defining the factors that cause their establishment. There are two main factors that lead to the development of Reversal-Trigger Waves: Trend Wave Failure and Corrections exceeding 100% retracement of their preceding trend waves.

As discussed previously, Reversal-Trigger Waves in most instances occur as a consequence of a Trend Wave Failure. Let us apply our knowledge

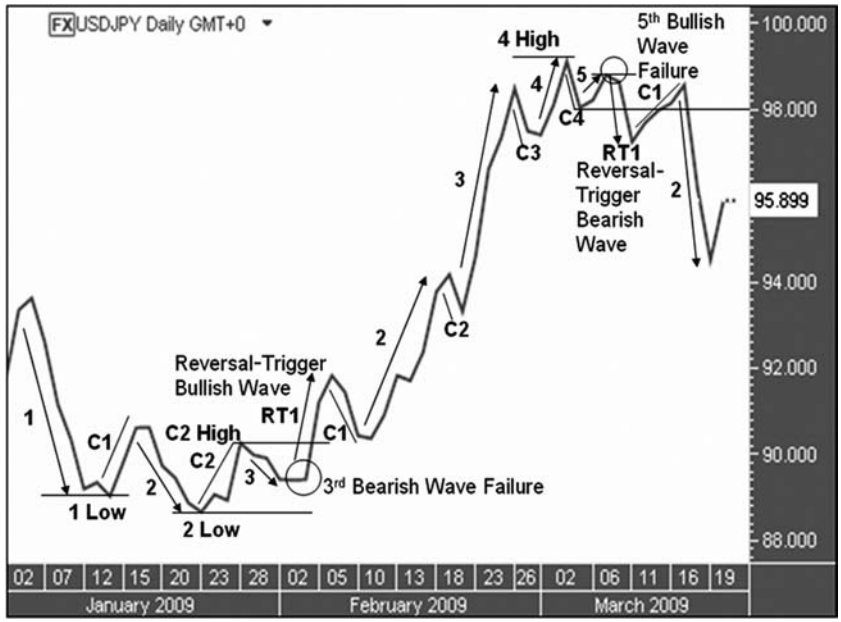

FIGURE 4.5 Reversal-Trigger Waves

of Trend Wave Failure and try to identify the Reversal-Trigger Waves in the next example. Figure 4.5 shows the daily trend wave cycles of the USD/JPY currency pair for a period of three months. Note that two important Reversal-Trigger Waves have occurred in that period. The first bullish Reversal-Trigger Wave 1 (RT1) develops as a result of a Trend Wave Failure of the Conclusive Wave 3, which fails to produce a lower low than the low of the bearish Progressive Wave 2. The bullish Reversal-Trigger Wave 1 (RT1) confirms itself as successful by breaking above the high (C2 High) of Correction 2, which follows after the bearish Progressive Wave 2. The bullish Reversal-Trigger Wave 1 (RT1) ends the bearish trend wave sequence and marks the beginning of a new bullish trend wave cycle. The bullish Reversal-Trigger Wave 1 is followed by a sequence of additional bullish trend waves, leading to a complete reversal of the previously established bearish trend. The bullish trend wave cycle is strong, but it also becomes *extended* (consisting of five bullish trend waves). The bullish Consecutive Wave 5 makes an attempt to continue the bullish trend wave cycle further; however, it fails to produce a higher high than the high of the bullish Consecutive Wave 4. The Trend Wave Failure of Wave 5 leads to the development of a bearish Reversal-Trigger Wave 1 (RT1) in the opposite direction of the previously established bullish trend wave cycle. The bearish

Reversal-Trigger Wave 1 (RT1) confirms itself as successful by breaking below the low of Correction 4 (C4), which follows after the bullish Consecutive Wave 4. The bearish Reversal-Trigger Wave 1 ends the five-bullish-trend-waves cycle and marks the beginning of a new bearish trend wave cycle that continues further when the bearish Reversal-Trigger Wave 1 is followed by a bearish Progressive Wave 2. Both of the Reversal-Trigger Waves in the three-month period of this example have occurred as a result of a Trend Wave Failure.

The second main factor that causes the development of Reversal-Trigger Waves is corrections exceeding 100% retracement of their preceding trend waves. These are instances when a Correction that follows a trend wave exceeds the complete 100% Fibonacci retracement level of the range between the high and the low of its preceding trend wave. Corrections that produce larger than 100% retracements break below the preceding bullish wave's low or above the preceding bearish wave's high, and become Reversal-Trigger Waves.

Figure 4.6 shows a strong trend sequence consisting of four bullish trend waves. The Correction 4 (C4) following the bullish Consecutive Wave 4 reaches the complete 100% Fibonacci retracement of the range between the high and the low of Wave 4, which is marked by the Low of

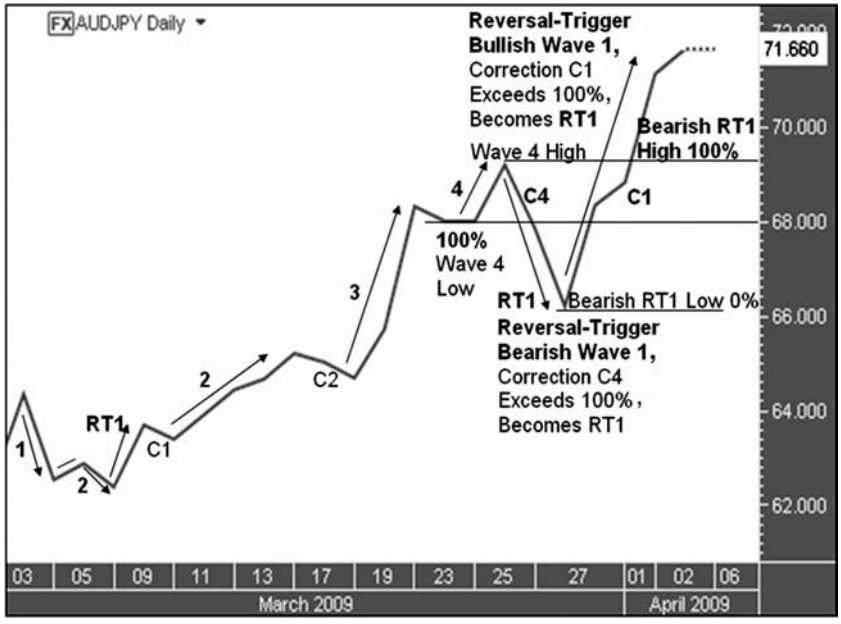

FIGURE 4.6 Correction Becoming a Reversal-Trigger Wave

Wave 4. When Correction 4 (C4) exceeds the complete 100% Fibonacci retracement and breaks below the low of Wave 4, Correction 4 becomes a bearish Reversal-Trigger Wave 1 (RT1). The development of the bearish Reversal-Trigger Wave 1 confirms the end of the strong bullish trend wave sequence, and leads to a more significant price correction than the simple Correction following the bullish Consecutive Wave 4. Please note in the example that follows that the Correction 1 (C1) that follows the bearish Reversal-Trigger Wave 1 also exceeds the complete 100% Fibonacci retracement, marked by the high of the bearish Reversal-Trigger Wave 1 (same as the high of Wave 4). As Correction 1 (C1) exceeds the complete 100% Fibonacci retracement and breaks above the high of the bearish Reversal-Trigger Wave 1 (RT1 High), Correction 1 (C1) becomes a bullish Reversal-Trigger Wave 1 (RT1). This is an example of a real-life market situation where a bearish Reversal-Trigger Wave 1 happens to be immediately followed by another bullish Reversal-Trigger Wave 1 in the opposite direction. The Quarters Theory Trend Waves method considers such a development to be an attempt to continue the previously established strong bullish trend with the bullish Reversal-Trigger Wave 1, which follows immediately after the more significant price correction produced by the bearish Reversal-Trigger Wave.

Although they may not occur very often, there are some complicated instances when sequences of three or more bullish and bearish Reversal-Trigger Waves following each other may develop. The Quarters Theory Trend Waves method considers such cases to be a sign of a nondirectional, *trendless* market. These are consolidation periods of volatile but sideways price action that normally occur after extended trend wave cycles have ended. The sequences of two or more bullish and bearish Reversal-Trigger Waves following each other often lead to breakouts that come as attempts to either continue or reverse previously established trends.

Figure 4.7 shows three Reversal-Trigger Waves that follow each other. The first bullish Reversal-Trigger Wave 1 occurs as a result of a Trend Wave Failure of the bearish Conclusive Wave 3. The first bullish Reversal-Trigger Wave 1 is then immediately followed by Consolidation 1 (C1), which exceeds the 100% retracement, breaks below the low of the first bullish Reversal-Trigger Wave 1, and becomes a bearish Reversal-Trigger Wave 1. The bearish Reversal-Trigger Wave 1 is then immediately followed by a second bullish Reversal-Trigger Wave 1 in the opposite direction. Note that Consolidation 1 (C1) does not exceed the complete 100% Fibonacci retracement of the second bullish Reversal-Trigger Wave 1. Finally, the second bullish Reversal-Trigger Wave 1 is followed by a bullish Progressive Wave 2 that produces a decisive breakout above previous highs and confirms the reversal of the bearish trend cycle consisting of the three bearish trend waves shown in the beginning of the chart.

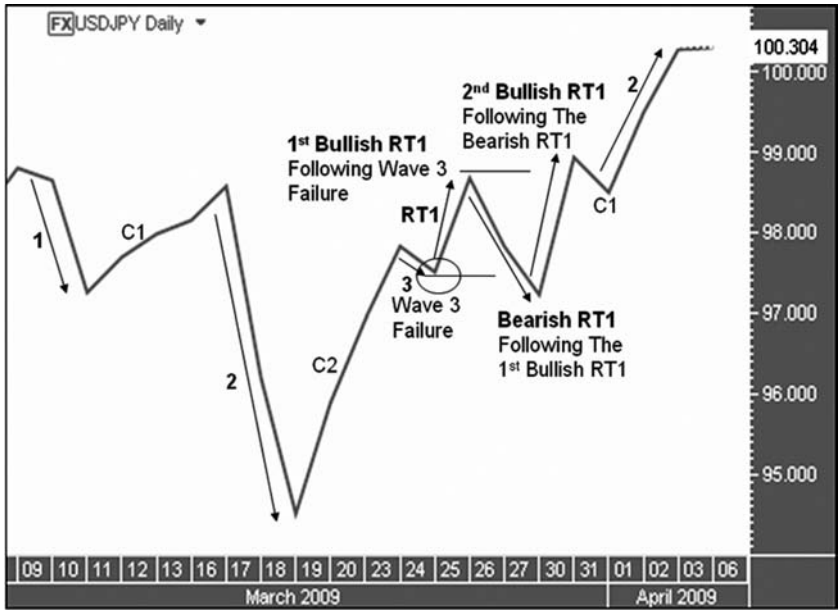

FIGURE 4.7 Reversal-Trigger Waves Following Each Other

Corrections that produce 23.6%, 38.2%, 50%, or up to 61.8% Fibonacci retracements are considered normal. As long as the retracements during corrections do not exceed these Fibonacci retracement levels, traders can anticipate such corrections to be followed by another trend wave that will attempt to continue the previously established trend. However, if a Correction exceeds the 61.8% Fibonacci retracement, the larger retracement should be used as an early warning sign that the Correction might reach and possibly exceed the complete 100% Fibonacci retracement and become a Reversal-Trigger Wave.

The Fibonacci retracements are helpful not only when monitoring corrections for signs of future trend continuation or potential trend-reversal signals that may lead to the development of Reversal-Trigger Waves. Fibonacci retracements of entire trend wave cycles can also be used to indicate support or resistance levels that may be challenged during countertrend cycles of more significant price corrections. The Quarters Theory Trend Waves method does not require the development of a classic Elliott Wave principle corrective cycle consisting of Waves A, B, and C. Corrective countertrend cycles can have a single Reversal-Trigger Wave, or may consist of several trend waves that follow a countertrend Reversal-Trigger Wave. The more trend waves in a corrective countertrend cycle, the

bigger and more significant the price correction. On the other hand, traders should be careful if a corrective countertrend cycle exceeds the 61.8% Fibonacci retracement level of a previous trend wave cycle, as this could signal complete 100% retracement and potential trend reversal.

Figure 4.8 shows a strong uptrend consisting of five bullish trend waves. The range of the bullish cycle is defined by the low of Wave 1 and the high of Wave 4 (since the bullish Consecutive Wave 5 fails to produce a higher high than the high of Wave 4). The Trend Wave Failure of Consecutive Wave 5 leads to the development of a bearish Reversal-Trigger Wave 1 that ends the bullish trend wave cycle and begins a corrective countertrend cycle. Traders who look for an opportunity to capitalize on the countertrend move during the bearish Reversal-Trigger Wave 1 may find a conservative price target and a potential support level by calculating the 23.6% Fibonacci retracement of the total number of PIPs accomplished during the entire five-bullish-trend-waves cycle. In the next example, the bearish Reversal-Trigger Wave 1 finds support at the 23.6% Fibonacci retracement, ends, and goes through Correction 1 (C1), followed by another bearish Progressive Wave 2 that challenges and finds support around the 50% Fibonacci retracement level of the entire five-bullish-waves cycle. The bearish trend wave sequence does not continue further because the bearish

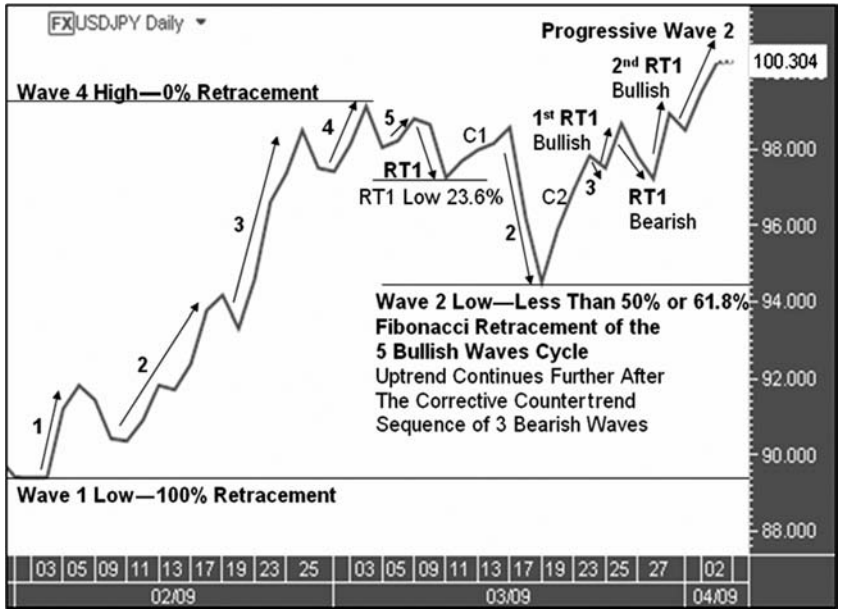

FIGURE 4.8 Reversal-Trigger Waves in Bullish and Bearish Trend Wave Cycles

Conclusive Wave 3 fails to produce a lower low than the low of the bearish Progressive Wave 2. The Trend Wave Failure of the bearish Conclusive Wave 3 is followed by a volatile trendless sequence of bullish and bearish Reversal-Trigger Waves following each other, ending the corrective countertrend cycle of three bearish waves. Since the significant price correction during the countertrend cycle of three bearish waves does not exceed the normal 50% to 61.8% Fibonacci retracement, there is a good probability that the previously established uptrend could continue once the corrective trend wave cycle is finished. This exact scenario takes place in Figure 4.8, where the second Bullish Reversal-Trigger Wave 1 followed by a successful bullish Progressive Wave 2 produce a new bullish trend wave sequence that continues the previously established uptrend.

The Reversal-Trigger Waves can create great countertrend- or trend-continuation trading opportunities, as long as traders are able to recognize the early signs that signal their development. Traders who have missed catching a Reversal-Trigger Wave on time may choose to sit on the sidelines, let the Reversal-Trigger Wave play out, monitor the Correction that follows it, calculate the Fibonacci retracement levels that may be targeted during the correction, make sure that the Correction does not exceed the 61.8% Fibonacci retracement level, and decide whether there is a good probability for the Reversal-Trigger Wave to be followed by another Progressive Wave 2 that could extend the trend further.

THE PROGRESSIVE WAVE

The Progressive Wave is the second phase in the ideal Quarters Theory Trend Waves cycle. Since this trend wave is the equivalent to Wave 3 in the classic Elliott Wave principle, the Progressive Wave is likely to have the same distinctive features as the classic Elliott Wave 3. In an ideal pattern, the Progressive Wave is expected to be the strongest and longest lasting, capable of producing the most significant price moves compared to all other trend waves in The Quarters Theory Trend Waves cycle. Because of these characteristics, some traders call the Progressive Wave "the meat of the trade."

The Progressive Wave is considered the easiest trend wave to anticipate and trade. Once again, the Fibonacci retracement provides a helpful tool for traders looking to take advantage of the Progressive Wave. The familiar 23.6%, 38.2%, 50%, or 61.8% Fibonacci retracements can offer reliable price points of reference that may serve as support or resistance levels during corrections following Reversal-Trigger Waves. As long as a Correction that follows a Reversal-Trigger Wave does not exceed the 61.8%

Fibonacci retracement level, there is a good probability that another Progressive Wave 2 may follow the Reversal-Trigger Wave. On the other hand, a Correction that exceeds the 100% Fibonacci retracement of a preceding Reversal-Trigger Wave will become a Reversal-Trigger Wave in the opposite direction, rather than develop as a Progressive Wave 2.

Corrections that exceed the 61.8% Fibonacci retracement of a Reversal-Trigger Wave can serve as early warning signs of a possible complete 100% retracement that might lead to a potential trend-reversal attempt with the development of a Reversal-Trigger Wave.

Figure 4.9 shows an example of an ideal Progressive Wave 2 in a Quarters Theory Trend Waves cycle. The bullish trend wave sequence begins with a Reversal-Trigger Wave 1 (RT1). The Correction 1 (C1) following the Reversal-Trigger Wave 1 does not exceed the 61.8% Fibonacci retracement; it finds support around the 38.2% Fibonacci retracement level and is followed by a strong Progressive Wave 2. The Progressive Wave 2 extends the bullish trend further and produces a significant price move.

To calculate approximately how far a Progressive Wave may extend and to determine future support/resistance levels that could be targeted during a Progressive Wave, traders may use the Fibonacci extension of the Reversal-Trigger Wave that precedes a Progressive Wave. The 161.8% or

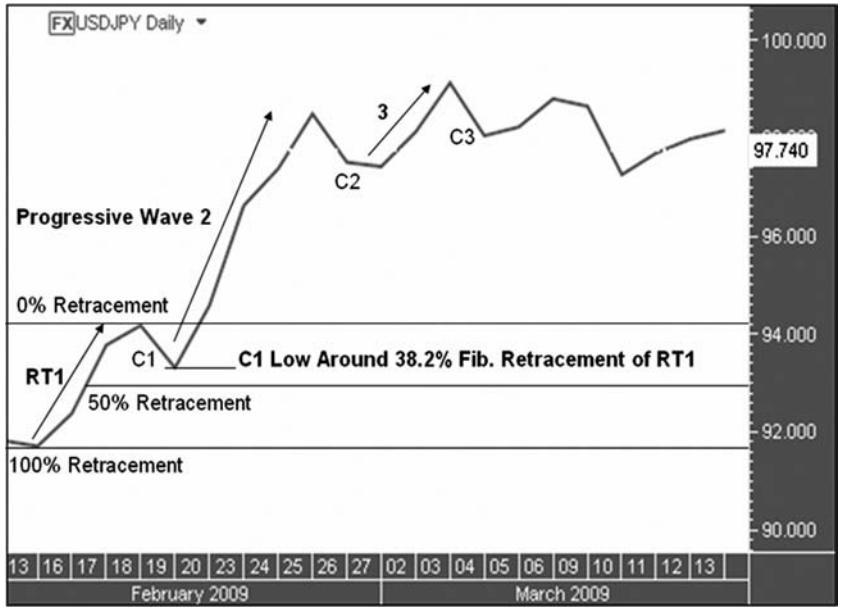

FIGURE 4.9 Ideal Progressive Wave 2

200% Fibonacci extensions would basically mean that a Progressive Wave may extend as far as 1.618 times or even double the size of the Reversal-Trigger Wave. This is provided that the Progressive Wave not only is successful and produces a higher high (or a lower low in downtrends) than the high (or the low) of the Reversal-Trigger Wave, but also is strong enough to be able to target these Fibonacci extension levels.

Figure 4.10 shows a perfect Progressive Wave 2 that successfully reaches both the 161.8% and the 200% Fibonacci extensions of the Reversal-Trigger Wave 1 (RT1). Anticipating that each Progressive Wave would double in size compared to the preceding Reversal-Trigger Wave might be a bit unrealistic; therefore, the 161.8% Fibonacci extension could serve as a more conservative profit target during Progressive Waves. In this example, a protective stop may be placed below the previous support level found at the 38.2% Fibonacci retracement of the Reversal-Trigger Wave 1 (RT1). When using Fibonacci extensions to determine future Progressive Wave price targets, traders should make sure that there are no previously established support/resistance levels in the way of the Fibonacci extensions, because such support/resistance levels may prevent a Progressive Wave from extending further and reaching the Fibonacci extensions of a Reversal-Trigger Wave.

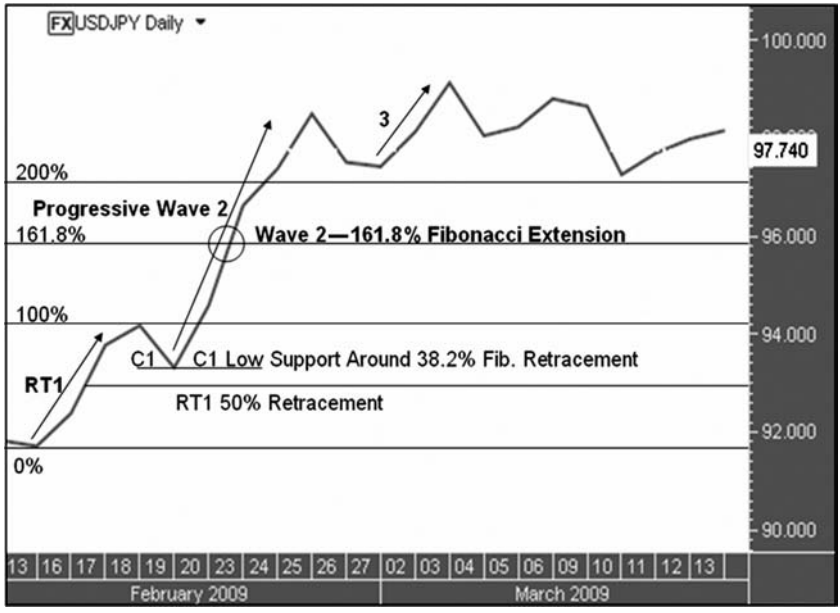

FIGURE 4.10 Progressive Wave 2 Targeting Fibonacci Extensions

The Progressive Waves are capable of producing significant price moves and may provide excellent trading opportunities; however, as with the rest of the trend waves in The Quarters Theory Trend Waves cycle, the Progressive Waves are not exempt from the danger of Trend Wave Failure. The only way a Progressive Wave would be able to develop further is if it were to *confirm* itself as successful by breaking above the high (or below the low) of its preceding Reversal-Trigger Wave. If a Progressive Wave does not provide such confirmation, the signs might be there that the wave could fail and another Reversal-Trigger Wave in the opposite direction of the Progressive Wave could develop as an attempt to reverse the previously established trend.

THE CONCLUSIVE WAVE

As long as the Correction following a Progressive Wave does not exceed the wave's 100% Fibonacci retracement, a third Conclusive Wave may continue the trend wave sequence. Conclusive Wave 3 is the equivalent to Wave 5 of the classic Elliott Waves and could become the wave that concludes an ideal Quarters Theory Trend Waves cycle. The name *Conclusive Wave* reflects a trend wave that might produce limited price moves and might be shorter than other trend waves.

Figure 4.11 shows a typical Conclusive Wave 3. Consolidation 2 (C2) following Progressive Wave 2 does not exceed the 100% retracement; it finds support around 23.6% Fibonacci retracement of Progressive Wave 2, and a third Conclusive Wave 3 develops. Conclusive Wave 3 confirms itself as successful by breaking above the high of Progressive Wave 2 and continues the bullish trend sequence. However, note how limited and how much shorter Conclusive Wave 3 is compared to Reversal-Trigger Wave 1 and Progressive Wave 2 in this example.

Conclusive Waves should always be approached with extra caution, not only because they could be the final stage of a trend wave sequence, but also because they tend to have increased probability to fail. The consequence of a Conclusive Wave failure in most cases will be the development of a Reversal-Trigger Wave in the opposite direction of the Conclusive Wave. A Reversal-Trigger Wave is also likely to develop if the Correction following a Conclusive Wave exceeds the 100% Fibonacci retracement. In both instances, the development of a Reversal-Trigger Wave would mark the end of the previously established trend wave sequence. At the same time, the Reversal-Trigger Wave will indicate the beginning of what could become a strong corrective countertrend cycle.

Figure 4.12 shows an example of a short-lived Conclusive Wave 3 that does not produce a lower low than the low of the Progressive Wave 2. The

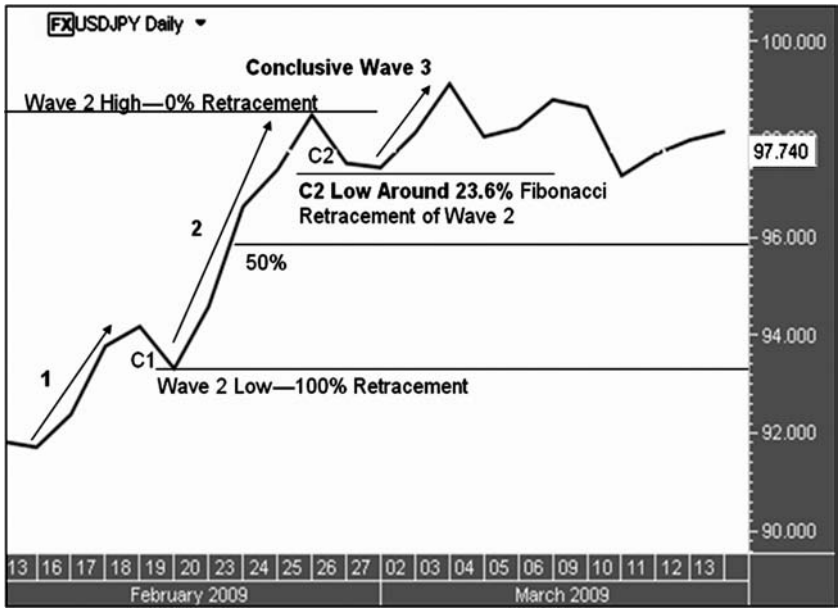

FIGURE 4.11 Typical Conclusive Wave 3

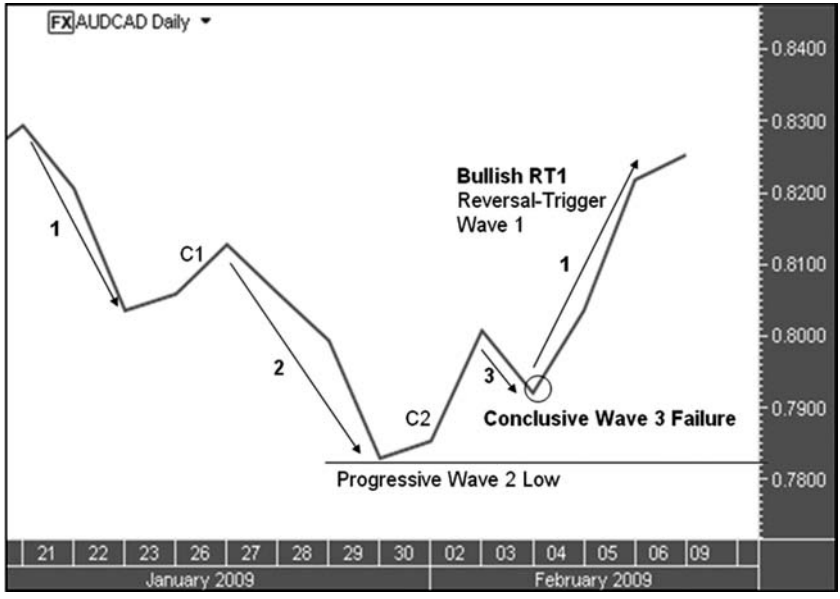

FIGURE 4.12 Conclusive Wave 3 Failure

Conclusive Wave 3 fails to continue the bearish trend wave sequence. The Trend Wave Failure of the Conclusive Wave 3 is immediately followed by a bullish Reversal-Trigger Wave 1 that ends the bearish trend wave sequence and makes an attempt to reverse the downtrend.

CONSECUTIVE WAVES

In the classic Elliott Wave pattern, the ideal five-wave *impulse* uptrend sequence is followed by three *corrective* waves A, B, and C down (see Figure 4.13). But what if the corrective Wave A does not produce a lower low than the low of Wave 4, and instead Wave A is followed by Wave B, which breaks above the high of Wave 5?

Let us assume that the previous scenario simply means that we might see the development of a complex Elliot Wave pattern where Wave 5 consists of three smaller *subwaves*. In this case, the pattern would look like Figure 4.14: Wave 5 becomes the longest in the pattern and has three smaller subwaves.

But what if the trend continues even further beyond the three smaller subwaves of the complex Wave 5? Consider the following real-life example, where a bearish trend wave sequence continues beyond Wave 5, consisting of three smaller bearish subwaves in a complex Elliott Wave pattern. What is an Elliott Wave trader to do then?

Figure 4.15 illustrates some of the main problems for Elliott Wave traders. When complex Elliott Wave patterns of *waves within waves* occur and the trend wave sequences extend beyond complex Elliott Wave

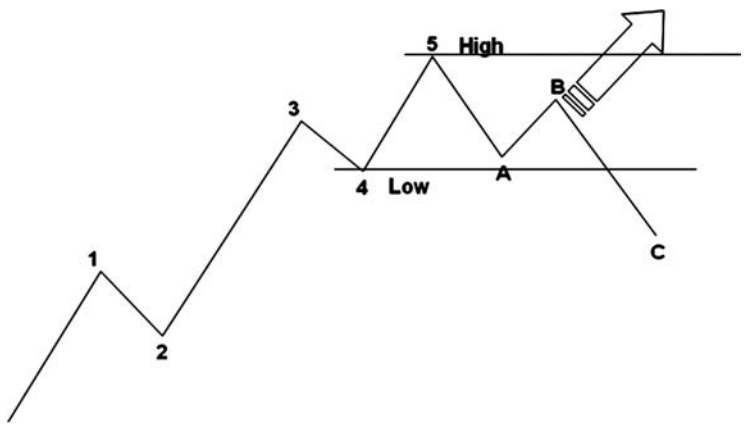

FIGURE 4.13 Classic *What-If* Trend Wave Scenario

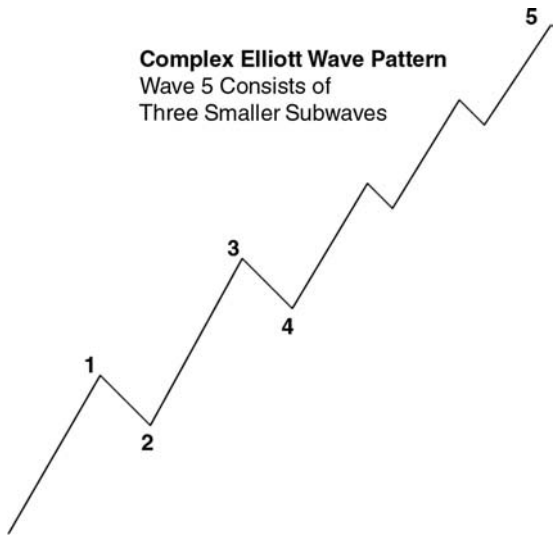

FIGURE 4.14 Complex Elliott Wave Pattern

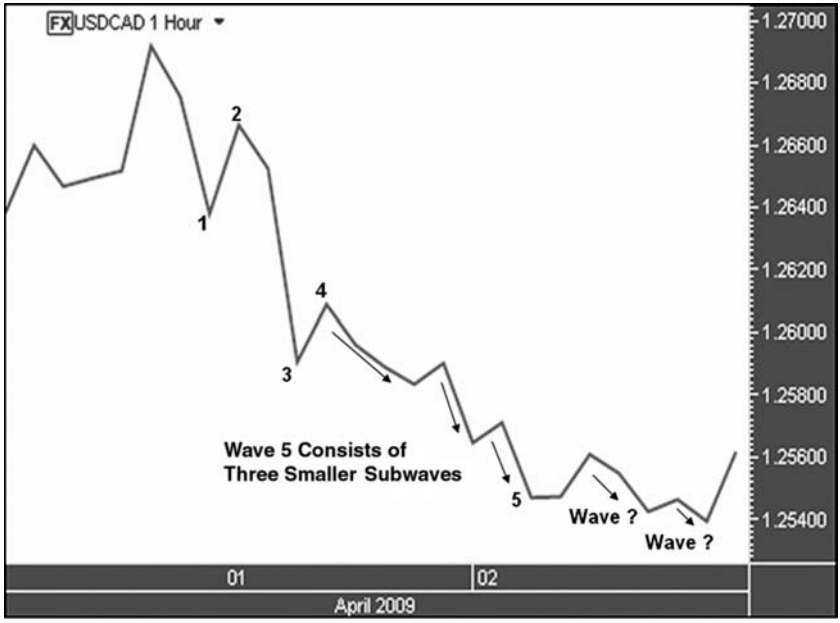

FIGURE 4.15 Trend Waves Extending beyond the Complex Elliott Wave Pattern

patterns, traders can easily get confused and end up losing track of the proper wave count.

The Quarters Theory Trend Waves method addresses this issue by completely eliminating the need for recognition of complex Elliott Wave patterns. The Quarters Theory Trend Waves method simply provides for additional trend waves in order to properly quantify the progression of the trend in each cycle. The Quarters Theory Trend Waves method acknowledges that in real market conditions, each trend wave sequence does not always end exactly after the ideal classic Elliott Wave pattern of five impulse waves, even when one of the waves in the pattern becomes complex, consisting of three smaller subwaves. This is why there are no complex waves and no corrective waves A, B, and C in The Quarters Theory Trend Waves cycle.

The Quarters Theory Trend Waves method leaves the future possibilities open and lets the market indicate whether there will be a continuation or a reversal of the previously established trend. Depending on market conditions, The Quarters Theory Trend Waves cycles can be *ideal* (consisting of a perfect three-trend wave pattern), *short cycle* (having less than the ideal three trend waves), or *extended* (consisting of more than three trend waves). Conclusive Wave 3 could become the final phase of an ideal Quarters Theory Trend Waves cycle, but The Quarters Theory Trend Waves method does not require a corrective pattern of two waves in the opposite direction to follow each Conclusive Wave. Instead, The Quarters Theory Trend Waves method simply considers that each trend wave, including Conclusive Wave 3, is followed by a Correction. As long as the Correction following the Conclusive Wave 3 does not exceed the 100% Fibonacci retracement by producing a lower low than the low of the Conclusive Wave 3, the bullish trend sequence could continue with an attempt for another trend wave number 4. If the new trend wave 4 produces a higher high than the high of the Consecutive Wave 3, the bullish trend progresses further. The same is valid for bearish trends. As long as the Correction following a bearish Conclusive Wave 3 does not exceed the 100% Fibonacci retracement by producing a higher high than the high of the Conclusive Wave 3, the bearish trend sequence could continue with an attempt for another bearish trend wave number 4. If the new bearish trend wave 4 produces a lower low than the low of the Consecutive Wave 3, the bearish trend progresses further.

Each new trend wave that follows the Consecutive Wave 3 in an ideal sequence of three Quarters Theory Trend Waves is given the name *Consecutive Wave 4*. Figure 4.16 shows a real-life example of an Extended Quarters Theory Trend Wave sequence consisting of four bullish trend waves. Note that Correction 3 (C3) does not exceed the 100% Fibonacci retracement and does not produce a lower low than the low of Conclusive Wave 3;

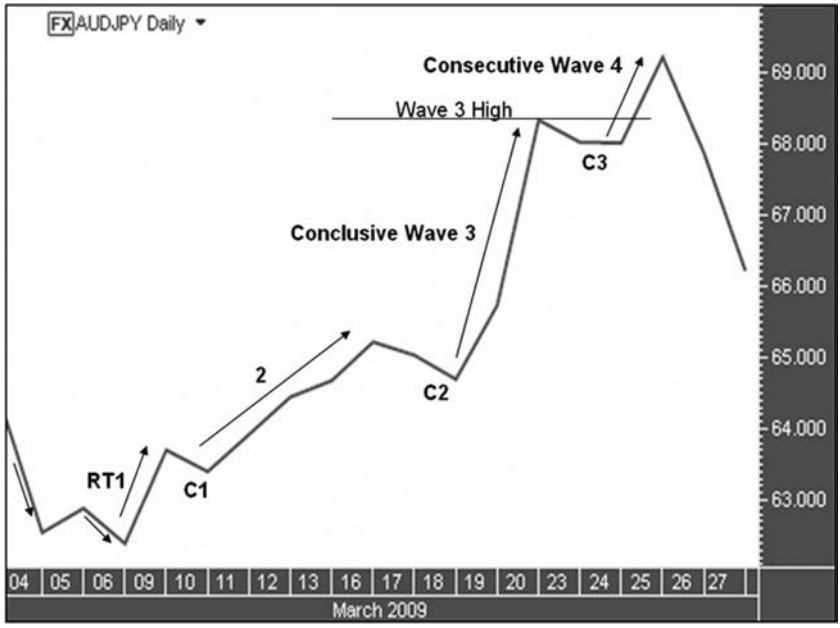

FIGURE 4.16 Consecutive Wave 4 in an Extended Quarters Theory Trend Waves Sequence

another bullish Consecutive Wave 4 confirms itself as successful by breaking above the high of Conclusive Wave 3 and continues the bullish trend wave sequence.

As shown previously, in some instances an extended trend wave sequence may consist of more than four trend waves. If a Correction following a Consecutive Wave 4 does not exceed the 100% Fibonacci retracement and remains at or above the low (or the high in bearish trend wave sequences) of the Consecutive Wave 4, there may even be an attempt to continue the trend with another Consecutive Wave 5. Consecutive Wave 5 might even be followed by more Consecutive Waves 6, 7, and so forth. Even though this scenario does not occur very often, we should not ignore the possibility that more than three, four, or even five trend waves could develop, especially in instances when the main trend is very strong. Figure 4.17 shows an example of an Extended Quarters Theory Trend Wave cycle consisting of seven bearish trend waves.

The development of one or more Consecutive Waves is an indication of a strong trend. Although strong trends have the tendency to continue beyond the ideal three trend waves of The Quarters Theory Trend Waves cycle, it is important to remember that the Consecutive Waves are not only

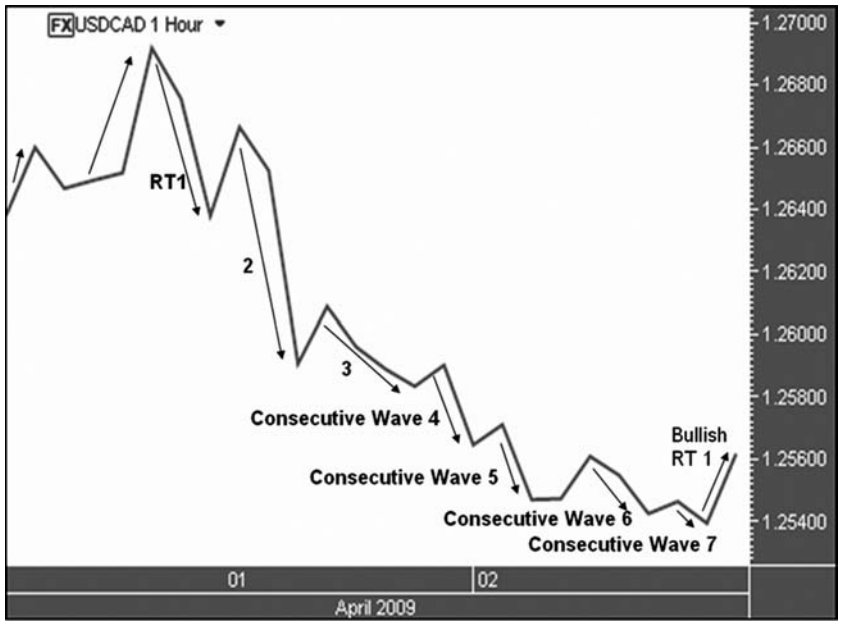

FIGURE 4.17 Multiple Consecutive Trend Waves Producing an Overextended Trend Wave Cycle

indicative of a strong trend, but they are also a warning sign that the existing trend has become extended and that a more significant price correction may occur soon. As usual, such significant price correction would come in the form of a Reversal-Trigger Wave that would end the extended trend wave sequence and could produce a corrective countertrend move in the opposite direction of the previously established trend wave cycle. Traders should be very careful when trading during Consecutive Wave periods. Because of their extended nature, Consecutive Waves have the highest likelihood to fail compared with any other trend waves in The Quarters Theory Trend Waves cycle.

EXTENDED TREND WAVES

The Quarters Theory Trend Waves cycles become extended when they consist of more than three trend waves. Not only the trend wave cycles, but also any of the individual trend waves in a trend wave cycle may become extended. The Extended Waves in The Quarters Theory Trend Waves cycle are not to be confused with the *waves within waves* in a complex Elliott

Wave pattern. The Extended Quarters Theory trend waves do not consist of smaller *subwaves*. The Extended Waves in The Quarters Theory Trend Waves cycle are elongated trend waves that last for prolonged periods of time (at least five or more consecutive time periods of five months, weeks, days, minutes, etc., depending on the time intervals chosen to be analyzed).

The Extended Waves are an indication of a strong trend. They can advance the trend further, produce significant price moves, and create great trading opportunities. Figure 4.18 shows a strong trend wave cycle consisting of four bullish trend waves. Note that the Extended Progressive Wave 2 that normally is expected to be the longest-lasting trend wave in the sequence is followed by another Extended Conclusive Wave 3 that is just as long as Progressive Wave 2. Progressive Wave 2 and Conclusive Wave 3 both last for a period of six days and become Extended Waves. The development of an Extended Conclusive Wave 3 indicates a strong trend. In this example, the entire trend wave cycle becomes extended when another bullish Consecutive Wave 4 progresses the trend further.

Although the Extended Waves are indicative of strong trends, The Quarters Theory Trend Waves method recognizes that the Extended Waves can also have some adverse effects on the trend waves that follow them. One of the ways that the Extended Waves can affect other waves is by

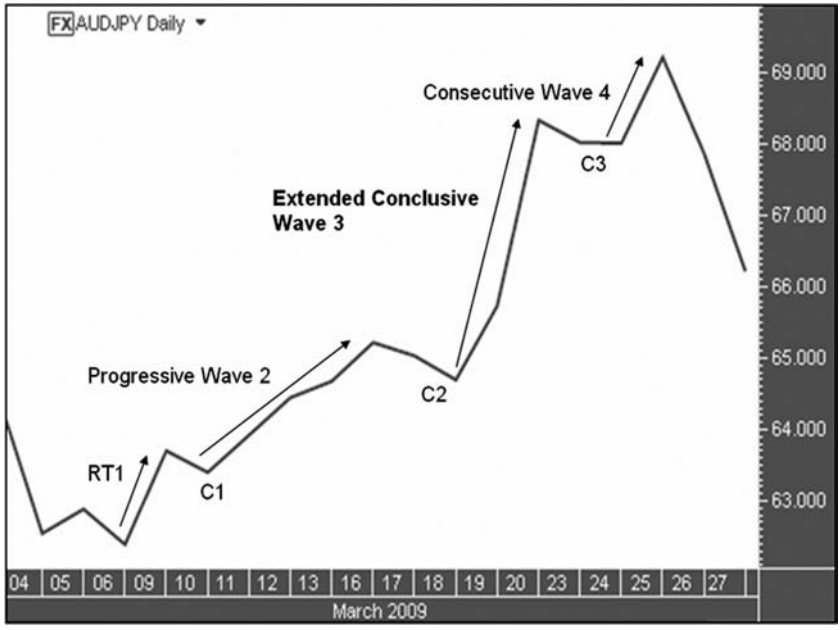

FIGURE 4.18 Extended Trend Waves

shortening the length of the trend wave that follows an Extended Wave. For example, in the ideal Quarters Theory Trend Waves cycle, Progressive Wave 2 is extended and the Conclusive Wave 3 that follows it is shorter in size compared to Extended Progressive Wave 2. Please note in Figure 4.19 that the Extended Conclusive Wave 3 is followed by a shortened Consecutive Wave 4.

An even more dangerous effect of the Extended Waves is that they tend to increase the potential for a Trend Wave Failure of the trend waves that follow Extended Waves. The Extended Waves are not only indicative of a strong trend, they should also be considered a sign of extended, overbought, or oversold trend conditions that may be long overdue for a significant price correction. This is why trend waves that follow Extended Waves might not only be shortened but might also experience a Trend Wave Failure followed by a corrective countertrend move in the opposite direction of the previously established trend.

Figure 4.20 shows an example of a Trend Wave Failure caused by an Extended Wave. Note that the bullish Reversal-Trigger Wave 1 completely reverses the previously established bearish trend and produces a significant price move. However, the Reversal-Trigger Wave 1 lasts ten days and becomes overextended, increasing the probabilities for a Trend

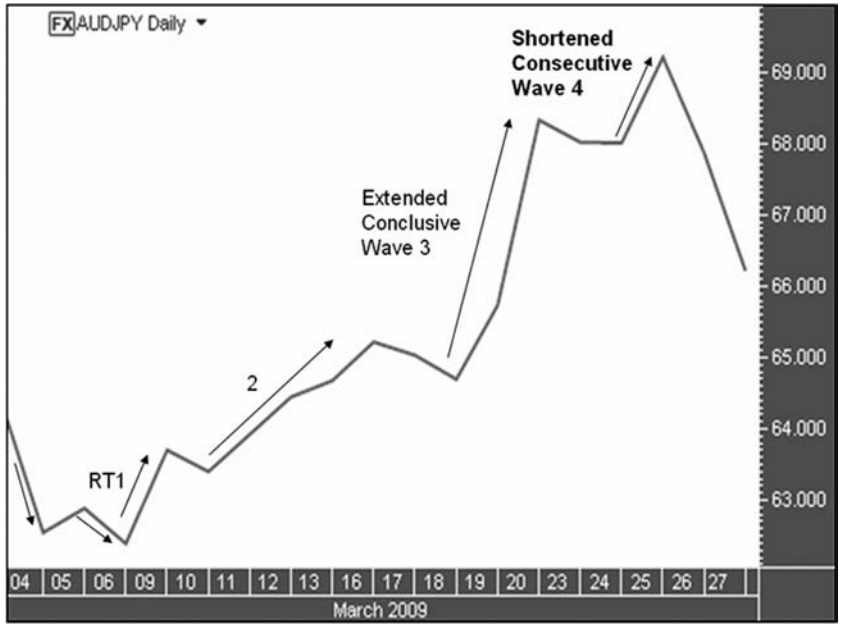

FIGURE 4.19 Extended Trend Wave Shortening the Following Trend Wave

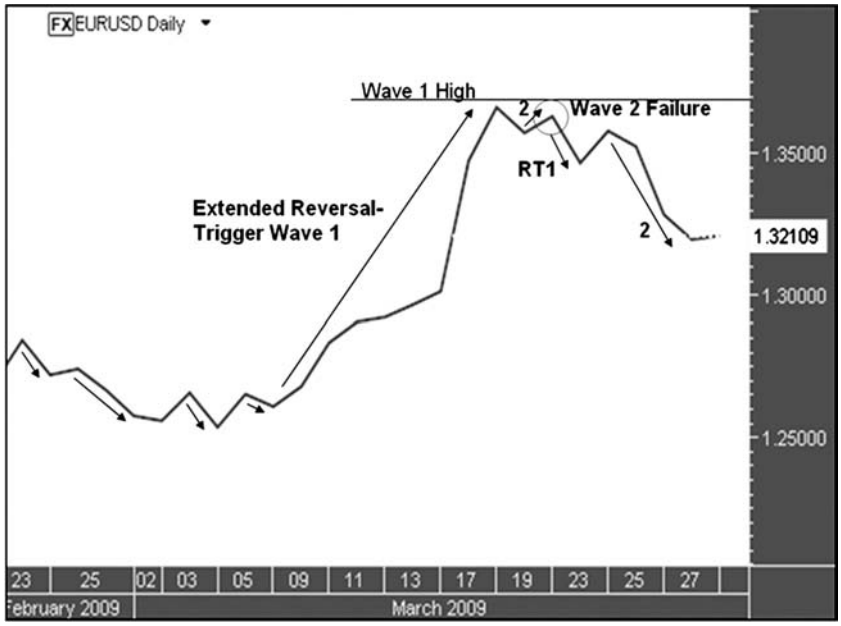

FIGURE 4.20 Trend Wave Failure Caused by an Extended Trend Wave

Wave Failure of Progressive Wave 2. There is an attempt for continuation of the bullish trend wave sequence; however, the follow-up trend wave—Progressive Wave 2—fails to produce a higher high than the high of the bullish Extended Reversal-Trigger Wave 1. The Trend Wave Failure of Progressive Wave 2 is followed by a bearish Reversal-Trigger Wave 1, producing a corrective countertrend move in the opposite direction of the previously established trend.

COMBINING THE QUARTERS THEORY AND THE QUARTERS THEORY TREND WAVES

The Quarters Theory, which is based on the premise that the daily fluctuations of currency exchange rates are not random and that currency exchange rates fluctuate in an orderly fashion from one Large Quarter Point to the next, provides constant and reliable, never-changing ranges of 250 PIPs. The Quarters Theory Trend Waves method, based on the Elliott Wave principle, offers predictable cyclical repetitions of market patterns

consisting of a series of trend waves. The percentages of Fibonacci retracements provide clearly defined measurements to determine support or resistance in periods of price correction. When used together, The Quarters Theory, The Quarters Theory Trend Waves, and the Fibonacci retracements deliver better perspective and predictability; well-known, constant price ranges of 250 PIPs; reliable measures of price correction percentages that are respected by market participants, and predictable cycles of trend waves to identify the different stages of trend progression. Combining them reduces the element of the unknown and increases the probability of success when forecasting the direction of future price moves.

The Quarters Theory Trend Waves method considers it an ideal combination when a new trend wave coincides with a new Large Quarter. In such instances, a currency pair starts to work on a new Large Quarter of 250 PIPs at the same time that a new trend wave begins. This is a perfect scenario, recognized by The Quarters Theory as the stage of the trend progression and trend wave development that increases the probabilities for successful completion of Large Quarters.

The following example shows the GBP/USD pair in a bullish trend wave cycle. The Correction 1 (C1) following the Reversal-Trigger Wave 1 (RT1) produces a significant price pullback but finds support above the Large Quarter Point at 1.4250. Note that Progressive Wave 2 perfectly coincides with the GBP/USD pair, beginning to work on the Large Quarter above 1.4250 toward the Large Quarter Point at 1.4500. The strong Progressive Wave 2 not only completes the Large Quarter between 1.4250 and 1.4500, but also manages to successfully complete a second Large Quarter of 250 PIPs between the Large Quarter Points at 1.4500 and 1.4750. After completing the Large Quarter toward 1.4750, Progressive Wave 2 makes an attempt to work on yet another third Large Quarter above 1.4750 toward 1.5000. However, Progressive Wave 2 exhausts and the Large Quarter from 1.4750 to 1.5000 is not successfully completed. Progressive Wave 2 ends and is followed by Correction 2 (C2).

Trend waves that do not produce a successful completion of a Large Quarter may come to an end and go through a period of Correction. After the Correction, if another trend wave develops in the same direction as the previous one, the new trend wave would be likely to make an attempt to work on the same Large Quarter that the previous trend wave has not completed. If they are successful in progressing the main trend further, such new, follow-up trend waves may have a better chance of completing the same Large Quarter that was not successfully completed during the preceding trend wave. In the same example, after Correction 2, the bullish trend wave sequence continues further with Conclusive Wave 3, which successfully completes the Large Quarter 1.4750 to 1.5000 that the preceding Progressive Wave 2 was not capable of completing.

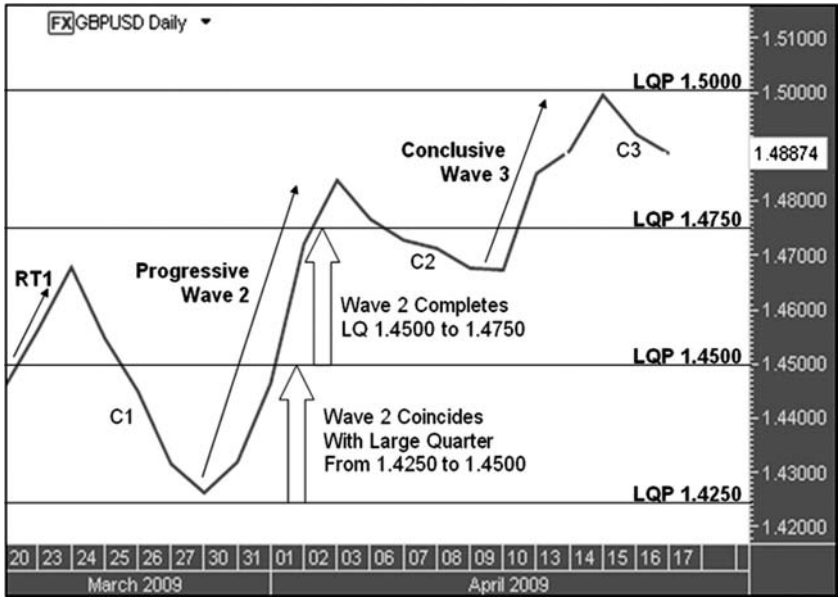

FIGURE 4.21 Trend Waves Coinciding with Large Quarters

Note that in Figure 4.21 Progressive Wave 2 produces a successful completion of two Large Quarters of 250 PIPs each. Theoretically, since the Progressive Waves usually have the tendency to become extended, they are the trend waves that would be most likely to complete multiple Large Quarters. On the other hand, The Quarters Theory Trend Waves method acknowledges that any one of the trend waves in the cycle could become extended and may be capable of producing significant price moves leading to the successful completion of multiple Large Quarters. In Figure 4.22, the Reversal-Trigger Wave 1 becomes extended and manages to complete successfully three consecutive Large Quarters of 250 PIPs each: 1.2750 to 1.3000, 1.3000 to 1.3250, and 1.3250 to 1.3500.

The development of Extended Waves that produce a successful completion of multiple Large Quarters is an indication of a strong trend, but it should also be considered a warning sign that a large price move may have occurred "too fast, too soon" and that a more significant countertrend price correction might follow at any time. Realistically, it should not be anticipated that every trend wave will be capable of completing multiple Large Quarters. The main premise of The Quarters Theory offers a more conservative approach, allowing traders to monitor each trend wave's progression one Large Quarter at a time. Since The Quarters Theory considers every significant price move to be a move from one Large Quarter Point

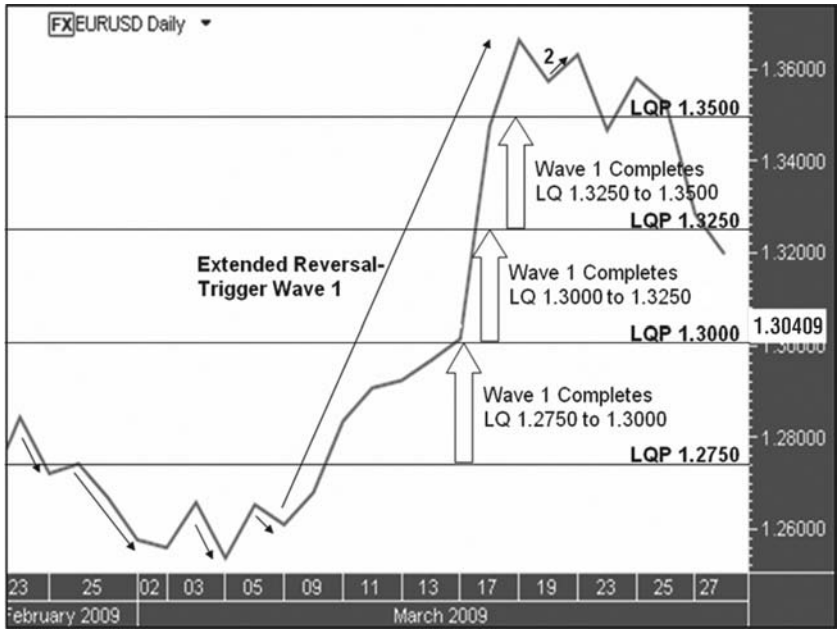

FIGURE 4.22 Extended Trend Wave Completing Multiple Large Quarters

to the next, once a trend wave produces a successful completion of one Large Quarter of 250 PIPs, even if the trend wave continues further, traders should be on the lookout for signs of exhaustion and unsuccessful completion of each following Large Quarter. The unsuccessful completion of a Large Quarter can often cause the end of a trend wave.

Note in Figure 4.23 that the bullish Progressive Wave 2 successfully completes one Large Quarter from 65.00 to 67.50. Progressive Wave 2 then continues further and makes an attempt to work on another Large Quarter above 67.50 toward 70.00, but fails to complete the quarter successfully. The unsuccessful completion of the Large Quarter 67.50 to 70.00 leads to the end of Progressive Wave 2 followed by a price correction. After Correction 2 (C2), the bullish trend wave sequence continues further with Conclusive Wave 3, which also makes an attempt to work on the same Large Quarter 67.50 to 70.00 that Progressive Wave 2 has failed to complete. Conclusive Wave 3 attempts to work on the same Large Quarter that was not successfully completed by Progressive Wave 2; however, Conclusive Wave 3 is also not capable of producing a successful completion of the Large Quarter 67.50 to 70.00. Both trend waves end as a result of the unsuccessful completion of the Large Quarter 67.50 to 70.00.

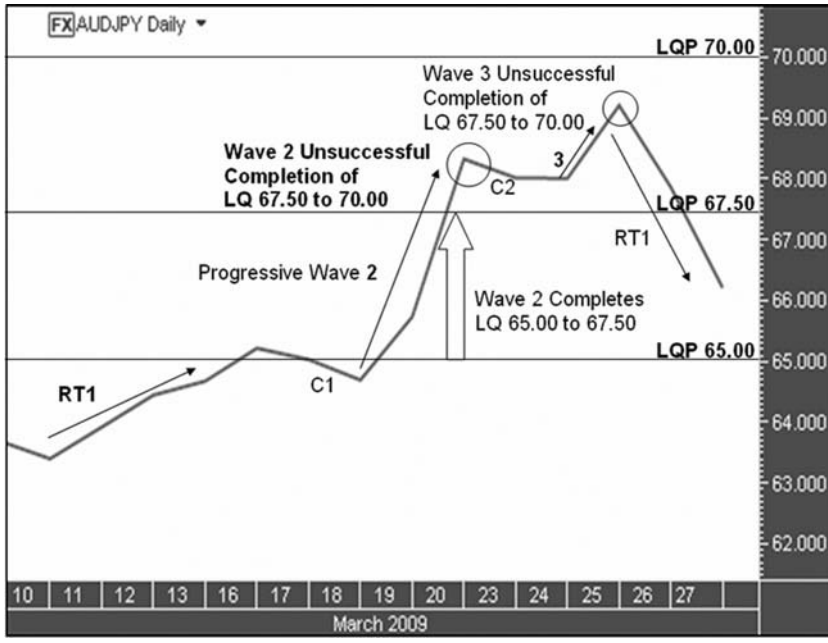

FIGURE 4.23 Unsuccessful Completion of a Large Quarter, Causing the End of Trend Waves

The inability of two trend waves in a row to complete the same Large Quarter of 250 PIPs is a sign of exhaustion of the existing trend and is often a contributing factor to the ending of an entire trend wave cycle. Note in the previous example that the unsuccessful completion of the Large Quarter 67.50 to 70.00 by Progressive Wave 2 and the following Conclusive Wave 3 leads to the development of a bearish Reversal-Trigger Wave 1 that ends the bullish trend wave cycle and makes a strong corrective countertrend move.

Corrections that follow trend waves can also coincide with Large Quarters. Because the corrections produce countertrend moves, the Large Quarters likely to be worked on during a Correction normally are in the opposite direction of the Large Quarters that were worked on during the trend wave that preceded the Correction. In Figure 4.24, a bullish Reversal-Trigger Wave 1 completes the Large Quarter from 132.50 to 135.00. Correction 1 (C1), following the bullish Reversal-Trigger Wave 1, works on the opposite Large Quarter and produces a successful completion of the Large Quarter 135.00 to 132.50.

Each Correction is closely related to its preceding trend wave. Extended, strong trend waves that have produced significant price moves are

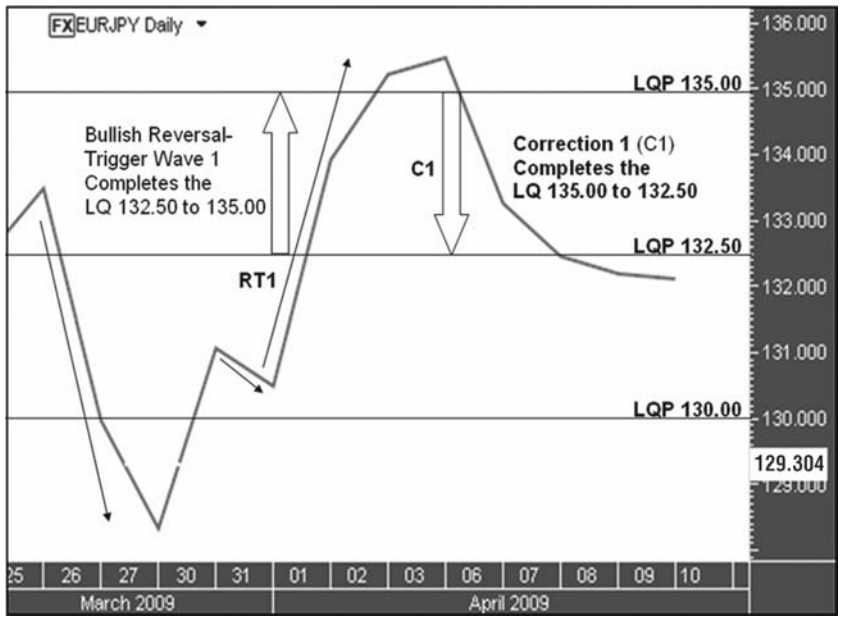

FIGURE 4.24 Correction Coinciding with a Large Quarter

likely to have larger corrections that would be more likely to complete a Large Quarter. On the other hand, corrections that follow shorter trend waves might not be capable of completing a Large Quarter. In general, corrections following trend waves result in price moves that go against the main trend, so there is always a risk that a Correction may not be able to complete a Large Quarter. Because of their countertrend nature and because they may be short-lived when the main trend is strong, corrections following trend waves might be less likely to produce successful completions of Large Quarters than the actual trend waves.

The price moves and the number of Large Quarters that realistically can be expected to be successfully completed during a Correction can be determined by calculating the Fibonacci retracement percentages of the range, or the total amount of PIPs produced during the trend wave that precedes the Correction. The familiar 23.6%, 38.2%, 50%, and 61.8% Fibonacci retracement levels provide predictable future support or resistance levels that may be targeted during periods of corrections following trend waves. In Figure 4.25, by calculating the Fibonacci retracement percentages of the bullish Reversal-Trigger Wave 1, we can determine whether we should realistically anticipate that Correction 1 (C1) would be able to successfully complete the Large Quarter 135.00 to 132.50. In order for that Large Quarter

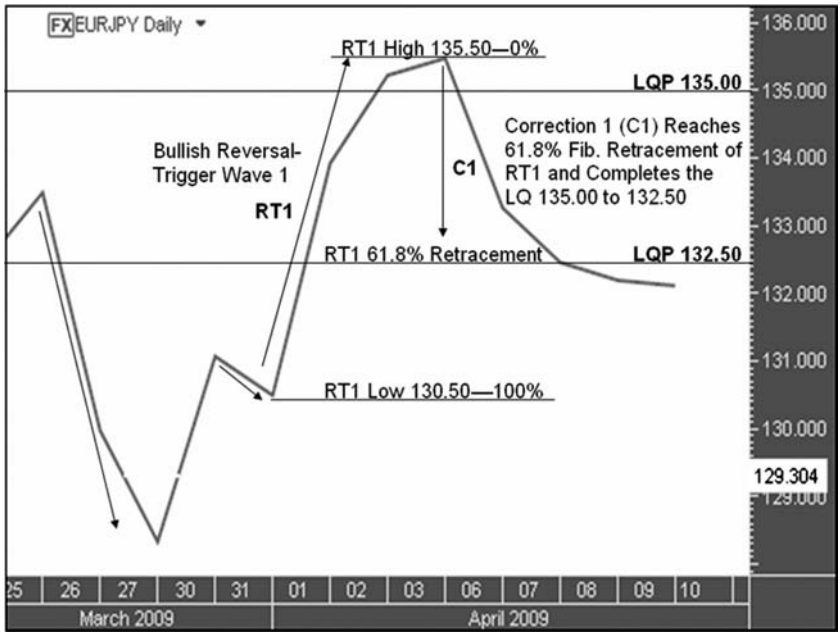

FIGURE 4.25 Correction Completing a Large Quarter

to be successfully completed, we will have to see the Correction being capable of reaching at least the vicinity of one Small Quarter of 25 PIPs from the Large Quarter Point at 132.50. Considering that the range of Reversal-Trigger Wave 1 is approximately 500 PIPs (from about 130.50 to 135.50), the only way that Correction 1 (C1) will be able to complete the Large Quarter 135.00 to 132.50 is if Correction 1 (C1) reaches the 61.8% Fibonacci retracement level, which would be about 300 PIPs below 135.50—the high of Reversal-Trigger Wave 1.

Since corrections can be shortened when the main trend is strong, a more conservative approach would be to not anticipate larger corrections up to the 61.8% Fibonacci retracement level or complete 100% retracements. Corrections of 23.6% to 38.2% Fibonacci retracement may be a bit more realistic and easier to accomplish consistently.

In Figure 4.26, the extended bullish Progressive Wave 2 produces a very significant price move of approximately 1400 PIPs—from a low around 1.3000 to the high around 1.4400. Correction 2 (C2) of 23.6% to 38.2% Fibonacci retracement of the large price range of 1400 PIPs accomplished during Progressive Wave 2 should see prices decline from the high around 1.4400 by about 330 PIPs for the 23.6% retracement or by 534 PIPs if Correction 2 (C2) reaches the 38.2% Fibonacci retracement level. In this case, it

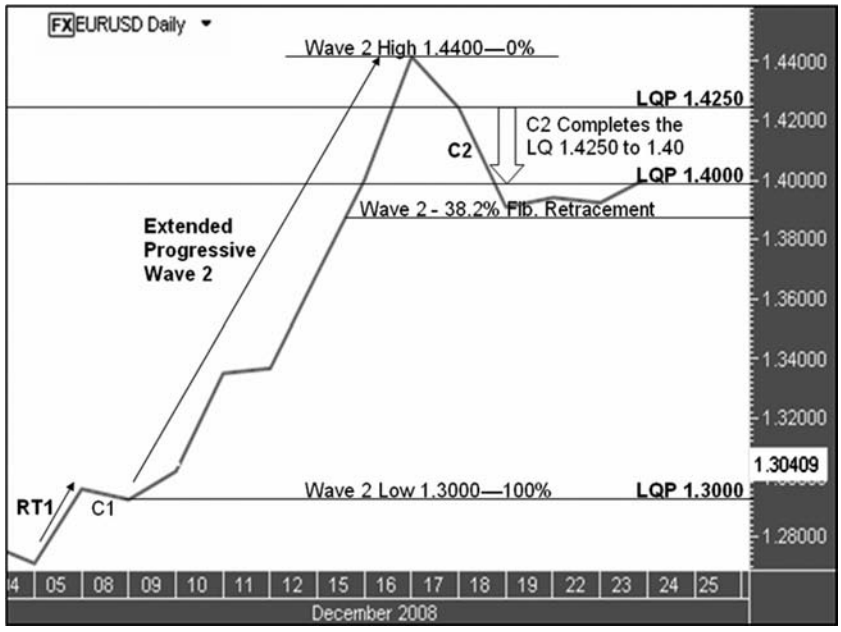

FIGURE 4.26 Combining Corrections and Fibonacci Retracements to Estimate Large Quarter Completions

would not be unrealistic to anticipate that Correction 2 (C2) should see the EUR/USD pair pulling back from the high around 1.4400 toward the preceding Large Quarter Point at 1.4250 and that a price correction between 23.6% and 38.2% Fibonacci retracement could deliver a downward move of approximately 400 PIPs from the high around 1.4400, which should be enough to produce a successful completion of the Large Quarter below 1.4250 toward the Major Large Quarter Point at 1.4000 during Correction 2 (C2).

CHAPTER 5

The Quarters Theory Trades

STRUCTURE AND TYPES

The Quarters Theory and The Quarters Theory Trend Waves method have a common premise—*order*. The Quarters Theory arranges what some might consider random price moves into an organized system by proposing that currency exchange rates fluctuate in an orderly fashion from one Large Quarter Point to another within the constant 1000 and 250 PIP Ranges. The Quarters Theory Trend Waves method is based on the Elliott Wave principle of predictable cyclical repetitions of market price patterns consisting of series of waves that represent stages of trend progression. The notion of chaos is foreign to the methodology of The Quarters Theory and The Quarters Theory Trend Waves, and that concept is reflected in The Quarters Theory *Trades*.

Each one of The Quarters Theory Trades take place within the familiar, constant Large Quarter ranges of 250 PIPs. Every trade idea is carefully analyzed and no aspect of The Quarters Theory Trade is left to chance. Each Quarters Theory Trade is built on the solid foundation of a clear fundamental and technical edge, or advantage of one currency over another, combined with the methodology of The Quarters Theory and The Quarters Theory Trend Waves. The risk in each Quarters Theory Trade is meticulously calculated: Every Quarters Theory Trade has a clear objective and type, as well as a predetermined *entry point* and *profit target*, and a *stop* that limits losses. The Quarters Theory Trades adhere to the structure shown in Figure 5.1.

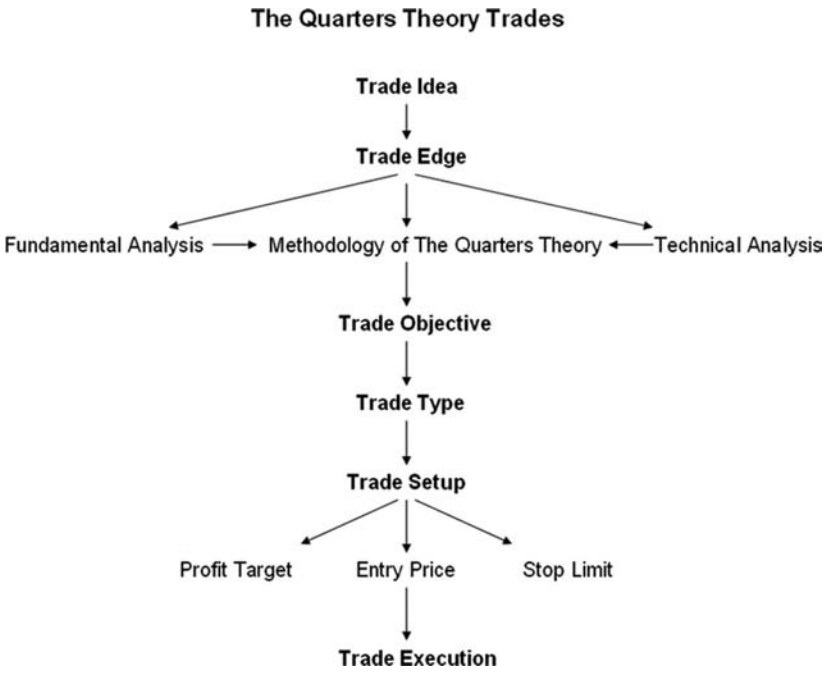

FIGURE 5.1 Structure of The Quarters Theory Trades

The Quarters Theory Trades originate from trade ideas that are thoroughly explored by applying fundamental and technical analysis, combined with the methodology of The Quarters Theory and The Quarters Theory Trend Waves, in order to identify the trade's edge and a clear advantage of one currency against another in a currency pair. The *trade edge* coupled with a perfect alignment between favorable fundamental and technical factors serve as the foundation of The Quarters Theory Trades, opening the door to the next step in the process of preparing The Quarters Theory Trade—determining the *trade objective* and using the methodology of The Quarters Theory.

The trade objectives of The Quarters Theory Trades can be classified in two categories: Large Quarter Completion trades that take advantage of the significant price moves in currency exchange rates from one Large Quarter Point to another, and intra–Large Quarter trades that capitalize on the smaller price moves between the important price points within a Large Quarter. Each trade objective category includes different types of trades. The *trade type* is chosen depending on the trade objective, as shown in Figure 5.2.

Certain trade types have a supplemental *reversal trade* that is based on potential reversals that may occur in cases when prices encounter strong

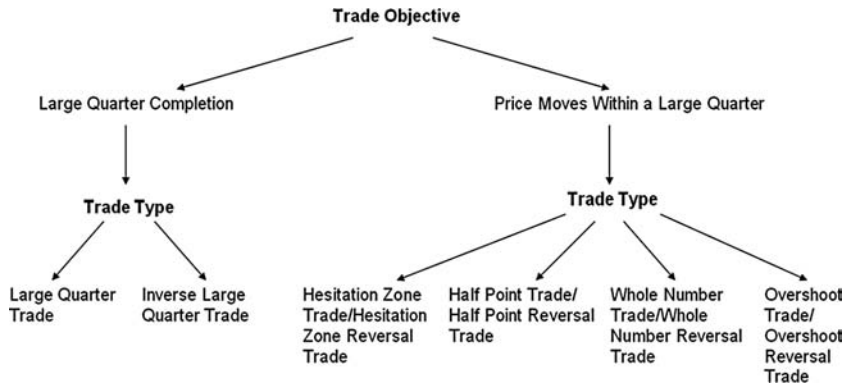

FIGURE 5.2 Quarters Theory Trade Objectives and Trade Types

support or resistance at any one of the important price points within a Large Quarter. Once a trade type is chosen, the next step would be to proceed with the actual *trade setup*, which involves calculating risk, determining exact entry price, profit target/exit price, and a stop price to limit potential losses. The final *trade execution* step administers the placement of the trade orders at the predetermined *entry*, *exit*, and *stop-limit prices*.

This chapter will reveal the different types of Quarters Theory Trades, with their individual characteristics and similarities. Many practical examples will offer an inside look at the systematic structure of each one of The Quarters Theory Trades.

THE LARGE QUARTER TRADE

The main trade of The Quarters Theory method is the *Large Quarter Trade*. The objective of the Large Quarter Trade is the successful completion of a Large Quarter. The Large Quarter Trade is based on the premise of The Quarters Theory that currency exchange rates fluctuate in an orderly manner between the Large Quarter Points within each 1000 PIP Range, and that every significant price move in currency exchange rates takes place from one Large Quarter Point in an attempt to target another Large Quarter Point.

The Large Quarter Trades are designed to take advantage of the successful completion of a Large Quarter. The Quarters Theory considers a Large Quarter to be successfully completed as long as there is a number registered as a high, low, open, or close price within one Small Quarter of 25 PIPs above or below a Large Quarter Point. The same rule applies for reversals that take prices back toward a preceding Large Quarter Point—as long as a high, low, open, or close price number is registered within one

Small Quarter of 25 PIPs from a Large Quarter Point, a reversal toward a preceding Large Quarter Point or an inverse Large Quarter price move is considered completed. These Large Quarter completion rules of The Quarters Theory are taken into consideration in order to establish a realistic profit target for each Large Quarter Trade. Since The Quarters Theory does not require prices to reach each Large Quarter Point exactly up to the PIP to consider a Large Quarter completed, both of the ranges of the Small Quarters that precede each Large Quarter Point (25 PIP $\times$ 2 = 50 PIPs) can be deducted from the total range of each Large Quarter: 250 – 50 = 200. This is how a more conservative, but also easier to achieve, profit target of 200 PIPs is determined for each Large Quarter Trade.

Entry or exit orders placed at the exact number representing a Large Quarter Point may be difficult to get filled consistently because prices may fall short of reaching the exact Large Quarter Points; even if prices do reach them, such orders still may not get executed because of the spreads between bid and ask prices. This is the reason why the entry and exit price points of Large Quarter Trades should not be placed at the exact Large Quarter Points, but rather at the closest Small Quarter Point 25 PIPs to a Large Quarter Point, or within the 25 PIP Range of each Small Quarter next to a Large Quarter Point. To secure the best possible entry price and to take full advantage of the projected profit target of at least 200 PIPs, the entry orders of the Large Quarter Trades should not be placed farther than 25 PIPs from the Large Quarter Point that serves as the starting point of the Large Quarter price move. Considering these requirements, the Large Quarter Trades should comply with the structure shown in Figure 5.3.

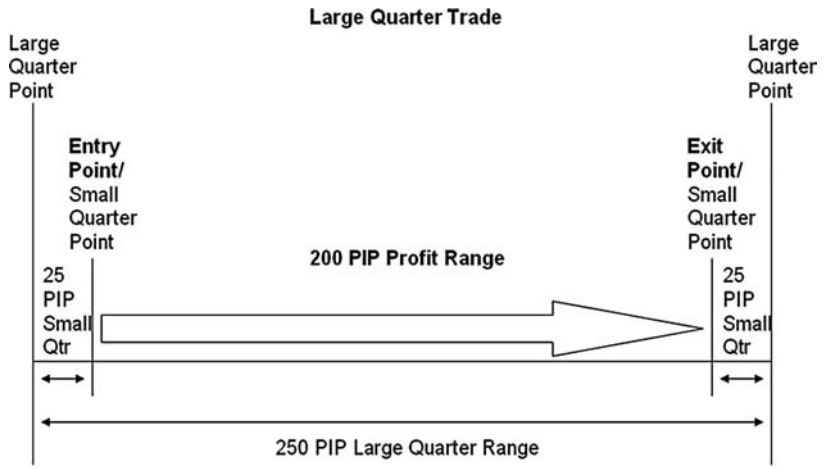

FIGURE 5.3 Structure of the Large Quarter Trade

Each Large Quarter Trade has a predetermined risk and an exact stop price in order to limit losses. The stops of the Large Quarter Trades are established by comparing the size of the realistic profit target, or the reward of the trade, in relation to the amount at risk of being lost should the trade reverse in the opposite direction. The Large Quarter Trades follow the simple risk/reward ratio of 2:1. Since the reward of each Large Quarter Trade is a gain of at least 200 PIPs, the measured risk of each Large Quarter Trade would normally be a loss of 100 PIPs. If the entry price is no further than 25 PIPs from the starting Large Quarter Point and the exit/profit target is placed 25 PIPs before the targeted Large Quarter Point, the profit target would be at least 200 PIPs, and at 2:1 risk/reward ratio, the stop should be placed at least 100 PIPs from the entry price. However, in instances when the entry price is exactly at the Small Quarter Point 25 PIPs from a Large Quarter Point, if the stop were to be placed 100 PIPs below the entry price, the stop-limit price would fall exactly at the number representing the End of the Hesitation Zone, 75 PIPs from the Large Quarter Point. In such cases, the stops should be expanded by 10 PIPs for a total of 110 PIPs in order to avoid the stop-limit price from being positioned exactly at the End of the Hesitation Zone. These stop expansions are necessary to make sure that the stops of the Large Quarter Trades are always placed outside of the Hesitation Zone to prevent the stop-limit orders from getting triggered while prices fluctuate within it. The stops of the Large Quarter Trades should be determined by using the 2:1 risk/reward ratio as a guideline, but each stop should be carefully examined to make sure that the exact stop-limit price does not coincide with any of the important price points within the Large Quarters, or with any major support/resistance levels positioned within a Large Quarter. In general, the entry, exit/profit target, and stop prices of all Quarters Theory Trades should not coincide with any of the important price points within the Large Quarters or with any major support/resistance levels positioned within a Large Quarter.

Consider the following example of a Large Quarter Trade (see Figure 5.4). The EUR/USD pair currency exchange rate enters the Large Quarter 1.3750 to 1.4000 on May 20, 2009. Let us assume that the entry price in this trade is at 1.3775—exactly 25 PIPs above the Large Quarter Point 1.3750. In this case, the realistic profit target will be 200 PIPs and the exit price should be set at 1.3975—exactly 25 PIPs below the Large Quarter Point 1.4000. Since the expected profit is 200 PIPs, by using the 2:1 risk/reward ratio, the stop should be 100 PIPs below the entry point. However, considering that the stop of this Large Quarter Trade should not be placed within the Hesitation Zone, 75 PIPs below the Large Quarter Point 1.3750, and that the stop should not coincide with the End of the Hesitation Zone 1.3675, the stop may be expanded by up to 10 PIPs for a total of 110 PIPs. This means that the stop-limit order should be set at 1.3665, outside of the

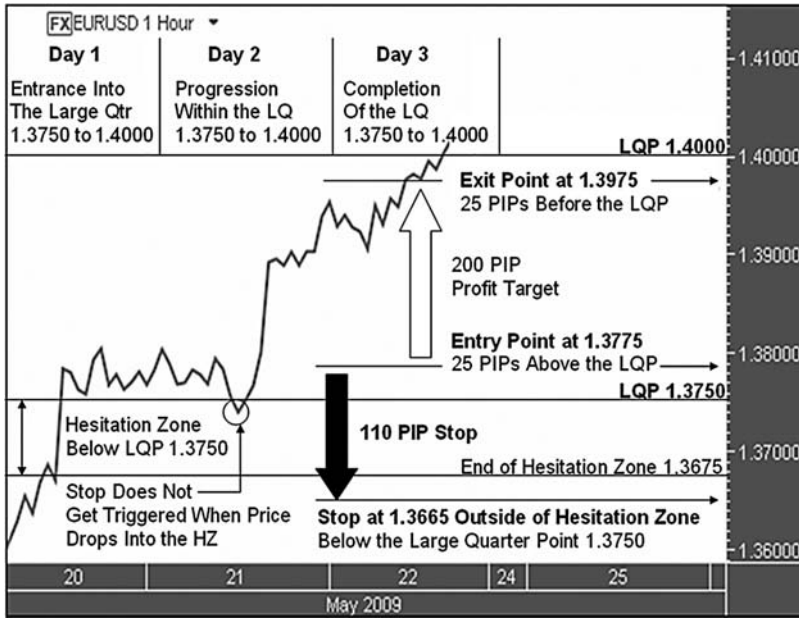

FIGURE 5.4 Large Quarter Trade

Hesitation Zone, 10 PIPs below the End of the Hesitation Zone 1.3675. Placing the stop outside of the Hesitation Zone assures that the stop will not be triggered and the position will be sustained, even if prices drop below the Large Quarter Point 1.3750 and remain within the 75 PIP Range of the Hesitation Zone 1.3750 to 1.3675. Although on May 21, 2009, prices dip into the Hesitation Zone below the Large Quarter Point 1.3750, the stop at 1.3665 does not get triggered and the trade remains open. As the bullish trend progresses further, prices complete the Large Quarter 1.3750 to 1.4000; the Large Quarter Trade achieves its objective and produces a profit of 200 PIPs as the exit point/profit target at 1.3975 is reached on May 22, 2009.

Besides a predetermined stop price, each Large Quarter Trade also has a designated Time Stop based on the Three-Day Rule of The Quarters Theory. Large Quarter Trades must accomplish their objective in the time period required by the Three-Day Rule of The Quarters Theory of three 24-hour trading sessions on the global foreign exchange market. If prices fail to complete a Large Quarter and a Large Quarter Trade has not achieved its goal in the allowed three trading days, either the trade may be closed by the end of the third day or the take-profit limit price may be changed to lock in any smaller profits. Also on the third day, the stop price should be moved to a breakeven level at the initial entry price to protect

the trade against losses. If it is too late to take the aforementioned steps, the trade may simply be closed at a smaller loss to prevent prices from reaching the predetermined 100 to 110 PIP stop-limit order that may get triggered during trend reversals as a result of the unsuccessful completion of a Large Quarter.

Figure 5.5 shows the EUR/USD pair currency exchange rate transitioning into the Large Quarter 1.3500 to 1.3750 on May 8, 2009. Let us assume that the entry price in this Large Quarter Trade would be at 1.3525—exactly 25 PIPs above the Large Quarter Point 1.3500. The exit price then should be set at 1.3725—exactly 25 PIPs below the Large Quarter Point 1.3750. Since the expected profit is 200 PIPs, at 2:1 risk/reward ratio, the stop should be 100 PIPs below the entry point. However, considering that the stop of this Large Quarter Trade should not be placed within the Hesitation Zone 75 PIPs below the Large Quarter Point 1.3500, and that the stop should not coincide with the End of the Hesitation Zone 1.3425, the stop may be expanded by up to 10 PIPs for a total of 110 PIPs. This means that the stop-limit order should be set at 1.3415—outside of the Hesitation Zone, 10 PIPs below the End of the Hesitation Zone 1.3425. On May 8, 2009, the first day since the Large Quarter Transition, prices make a decisive move into the Large Quarter 1.3500 to 1.3750. On May 12, 2009, the third day since the Large Quarter Transition, prices reach the Whole Number 1.3700

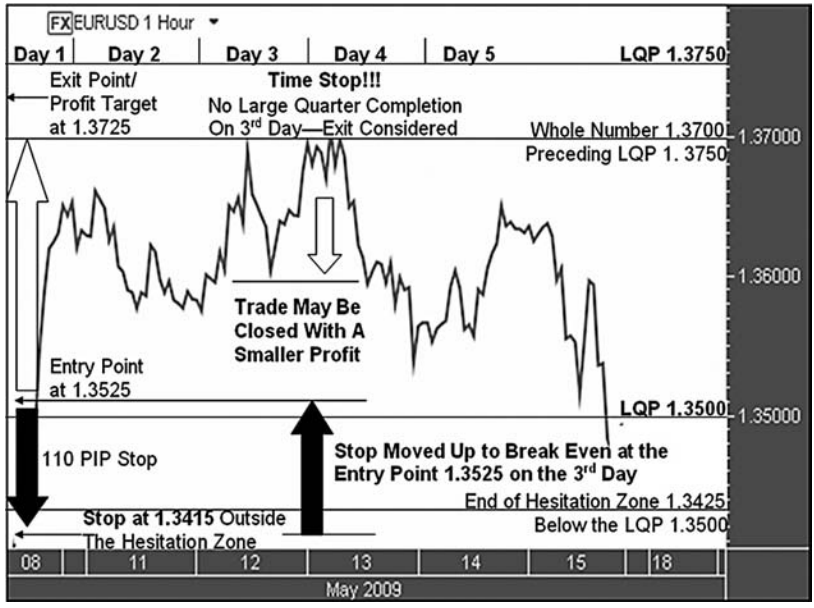

FIGURE 5.5 Three-Day Rule of The Quarters Theory Serving as a Time Stop

preceding the Large Quarter Point 1.3750 but encounter resistance and fail to complete the Large Quarter in the required three 24-hour trading sessions. The inability to produce a decisive breakout above resistance at the Whole Number 1.3700 preceding the Large Quarter Point 1.3750, the last problematic price point that may prevent the successful completion of the Large Quarter, coupled with the three-day time stop of this Large Quarter Trade, based on the Three-Day Rule of The Quarters Theory, serve as warning signs of potential reversal and signal the need for an exit strategy. Closing the trade should be considered no later than by the end of the trading session on May 12, 2009, the third day since the Large Quarter Transition. This Large Quarter Trade may be closed on the third day at a smaller profit anywhere between the Whole Numbers 1.3600 and 1.3700, or the take-profit limit price may be lowered to around 1.3600 to lock in a profit. Also on the third day, May 12, 2009, the stop price should be moved to a breakeven level at the initial entry price 1.3525. These measures would be necessary to protect the trade against any losses that may have been realized during the reversal back to the preceding Large Quarter Point 1.3500 as a result of the unsuccessful completion of the Large Quarter.

Certain small variations are allowed as far as moving the stops of the Large Quarter Trades, depending on the advancement of prices into the Large Quarter. For example, if there is a decisive Large Quarter Transition on the first or second day and prices have already advanced deep into the Large Quarter to the Whole Number preceding the Large Quarter Point targeted, the stop can be moved to a breakeven level at the initial entry price of the trade to protect against any losses, without having to wait until the third day to do so. Another variation allows reducing the size of the stop in half from 100 or 110 PIPs to 50 or 55 PIPs in cases where there is a decisive Large Quarter Transition on the first or second day that has seen prices advancing beyond the Half Point of a Large Quarter. However, when it comes to the Three-Day Rule of The Quarters Theory, any variations are prohibited. The Three-Day Rule of The Quarters Theory should not be bent by allowing more than three days for a Large Quarter completion, and the three-day time stops of the Large Quarter Trades should be enforced very strictly to prevent or minimize losses and to assure consistent trading results.

IDENTIFYING AND TAKING ADVANTAGE OF LARGE QUARTER TRADE OPPORTUNITIES

Fundamental and technical analysis, combined with the methodology of The Quarters Theory and The Quarters Theory Trend Waves, come

together in the process of identifying and taking advantage of Large Quarter Trade opportunities. It is absolutely imperative that the Large Quarter Trades have a clear fundamental and technical edge to increase their probability of success. Each Large Quarter Trade should be built on solid underlying fundamentals and favorable technical developments. There should be no contradictions between fundamentals and technicals. Considering that a Large Quarter Trade is expected to last for up to three trading days, consensus forecasts for any upcoming economic and geopolitical events scheduled to take place during the trade's three-day period should be examined to make sure that they are in line with the current fundamental backdrop and trend direction, and that the outcome of recent economic reports or geopolitical events has not caused any shifts in the fundamental edge of the trade or any reversals of the existing trend.

Large Quarter Trades should be meticulously timed so that they take advantage of the most favorable stages of trend development when a trend wave coincides with a Large Quarter. These are the instances when a currency pair would work on a Large Quarter at the same time that a trend wave develops. Strong bullish or bearish trend wave cycles can produce successful completions of multiple Large Quarters, providing the ideal environment for Large Quarter Trades. The daily and the one-hour charts are the instruments of choice when identifying trend waves and Large Quarter Trade opportunities using the methodology of The Quarters Theory and The Quarters Theory Trend Waves. Each Large Quarter Trade should be aligned with the proper trend wave. The strength of a trend wave should be used as the driving force that could deliver the completion of a Large Quarter and could accomplish the objective of a Large Quarter Trade.

Figure 5.6 demonstrates how to recognize the trend waves that coincide with Large Quarters and how to spot and take advantage of Large Quarter Trade opportunities. The individual trend waves or the stages of trend progression are identified using the methodology of The Quarters Theory Trend Waves combined with technical analysis of price patterns, breakouts, technical indicators, and so forth, which may be utilized for confirmation and early warning purposes. In Figure 5.6, a careful analysis of the daily chart of the EUR/USD currency pair can reveal that a bullish breakout above the high of a previous trend wave's Consolidation leads to the development of a bullish Reversal-Trigger Wave 1 that begins a new bullish trend wave cycle consisting of two trend waves—the bullish Reversal-Trigger Wave 1 and Progressive Wave 2. Correction 1, following the Reversal-Trigger Wave 1, sees prices pull back to a familiar level—the 38.2% Fibonacci retracement. The 38.2% Fibonacci retracement serves as support, ending Correction 1 and leading to the development of Progressive Wave 2. By the end of the Progressive Wave, the head-and-shoulders reversal pattern signals potential trend reversal. A bearish breakout below

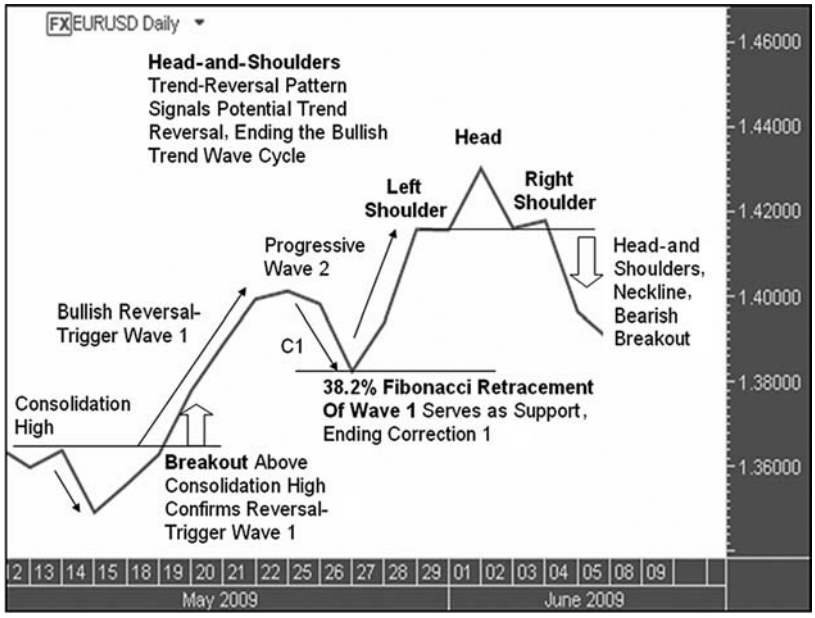

FIGURE 5.6 Trend Wave Cycle Analysis to Identify Large Quarter Trade Opportunities

the neck of the head-and-shoulders pattern leads to the development of a bearish Reversal-Trigger Wave 1, which ends the bullish trend wave cycle.

Adding technical indicators can provide early warning and confirmation signals in the process of identifying Large Quarter Trade opportunities. As shown in Figure 5.7, the bullish Reversal-Trigger Wave 1 begins at the time when price finds support at its 10-day moving average. The Relative Strength Index (RSI) shows normal conditions with price just above 50 at the time when the bullish Reversal-Trigger Wave 1 starts to develop. Please note that during the pullback of Correction 1, prices remain above the 10-day moving average—a development that signals that Correction 1 may be coming to an end as it approaches potential support at the 10-day moving average mark, and that if prices do not break below the 10-day moving average support, a second bullish Progressive Wave 2 may establish as an attempt to continue the bullish trend wave cycle. Note also that Reversal-Trigger Wave 1 and Progressive Wave 2 end shortly after the RSI breaches above 70—the level signaling overbought conditions, which can be used as an early warning sign that the trend waves may be coming to an end.

Now, let us see whether the trend waves described earlier coincide with certain Large Quarters. The daily chart of the EUR/USD currency pair shown in Figure 5.8 reveals that Reversal-Trigger Wave 1 perfectly

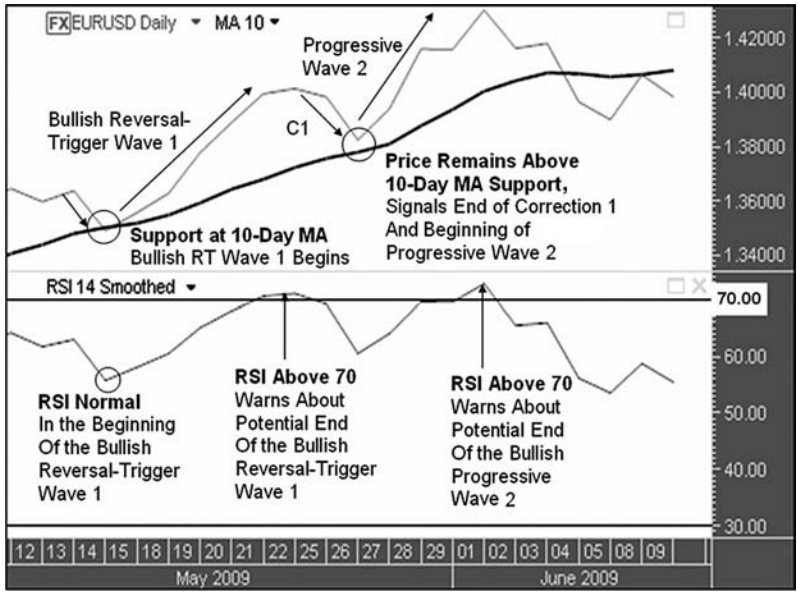

FIGURE 5.7 Technical Indicators Analysis to Identify Large Quarter Trade Opportunities

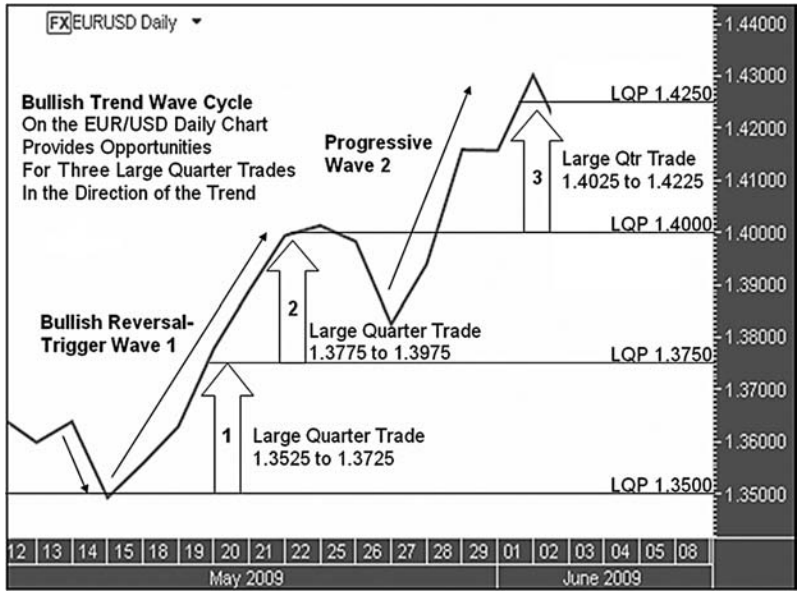

FIGURE 5.8 Trend Waves Coinciding with Large Quarters, Providing Opportunities for Large Quarter Trades

coincides with the Large Quarter 1.3500 to 1.3750 and the Large Quarter 1.3750 to 1.4000. After both Large Quarters are successfully completed during the strong Reversal-Trigger Wave 1, Correction 1 (C1) that follows the trend wave sees prices pull back below the Large Quarter Point 1.4000. When Correction 1 ends, the bullish trend wave cycle continues with another Progressive Wave 2, which moves prices back up to the Large Quarter Point 1.4000. As prices continue above the Large Quarter Point 1.4000, Progressive Wave 2 coincides with and completes the Large Quarter 1.4000 to 1.4250. Reversal-Trigger Wave 1 and Progressive Wave 2 of this example's bullish trend wave cycle provide opportunities for three Large Quarter Trades that can be set up according to the Large Quarter Trade entry, exit, and stop guidelines, in order to take advantage of the strength of the trend waves, leading to the completion of the Large Quarters 1.3500 to 1.3750, 1.3750 to 1.4000, and 1.4000 to 1.4250.

The individual trend waves identified on a daily chart can be dissected using a one-hour chart. The one-hour charts can provide an even closer hour-by-hour look at the price behavior before, during, and after each trend wave. Certain price patterns, pullbacks, and breakouts can also be spotted on the one-hour charts as their most important role is to assist when monitoring price behavior for the duration of each Large Quarter Trade and to provide potential early warning signs that may signal reversals and unsuccessful completion of the Large Quarters that coincide with the individual trend waves.

Figure 5.9 shows Reversal-Trigger Wave 1, identified earlier using the daily chart of the EUR/USD currency pair dissected into smaller time periods using a one-hour chart. Note that on the left-hand side of the chart, the Falling Wedge pattern signals a bullish breakout that takes prices back to the Large Quarter Point 1.3500. The breakout serves as the beginning phase in the development of the bullish Reversal-Trigger Wave 1, which causes prices to transition above the Large Quarter Point 1.3500 on May 18, 2009, the first day when the bullish Reversal-Trigger Wave 1 begins to work on and coincides with the Large Quarter 1.3500 to 1.3750. Recognizing that the Reversal-Trigger Wave 1 presents an opportunity for completion of the Large Quarter 1.3500 to 1.3750, a Large Quarter Trade can be set up with an entry price at 1.3525. Based on the entry price, a realistic profit target/exit price would be 1.3725—25 PIPs ahead of the Large Quarter Point 1.3750. Comparing the entry price and the 200 PIP profit target using the 2:1 risk/reward ratio, the stop-limit price of that trade should be 100 PIPs, but to prevent it from being positioned within the Hesitation Zone 75 PIPs below the Large Quarter Point 1.3500, the stop can be extended by 10 PIPs for a total of 110 PIPs. In that case, the stop price would be 1.3415. With the exact entry, exit, and stop prices established, the Reversal-Trigger Wave 1 takes off, completing the Large Quarter 1.3500 to 1.3750 in exactly

three days: May 18, 19, and 20, in line with the Three-Day Rule of The Quarters Theory. As a result, the Large Quarter Trade accomplishes its objective and reaches its profit target at 1.3725 by taking full advantage of Reversal-Trigger Wave 1 and the successful completion of the Large Quarter 1.3500 to 1.3750.

As shown in Figure 5.9, the strong bullish Reversal-Trigger Wave 1 continues even further, and after completing the Large Quarter 1.3500 to 1.3750, prices begin to work on another one—the Large Quarter 1.3750 to 1.4000. Prices enter the new Large Quarter above the Large Quarter Point 1.3750 on May 20, 2009, but never exit the Hesitation Zone 75 PIPs above the Large Quarter Point 1.3750, pull back toward it, and even dip briefly into the previous Large Quarter below the Large Quarter Point 1.3750. During this pullback and consolidation period, prices form a Flag trend-continuation pattern that serves as an early signal that the bullish trend wave might continue further and that the Reversal-Trigger Wave 1 might work more decisively on the Large Quarter 1.3750 to 1.4000. Based on these developments, a Large Quarter Trade can be established to take advantage of the opportunity if the Reversal-Trigger Wave 1 were to continue further and complete the Large Quarter 1.3750 to 1.4000. As prices reenter the Large Quarter 1.3750 to 1.4000 on May 21, 2009, the Large Quarter

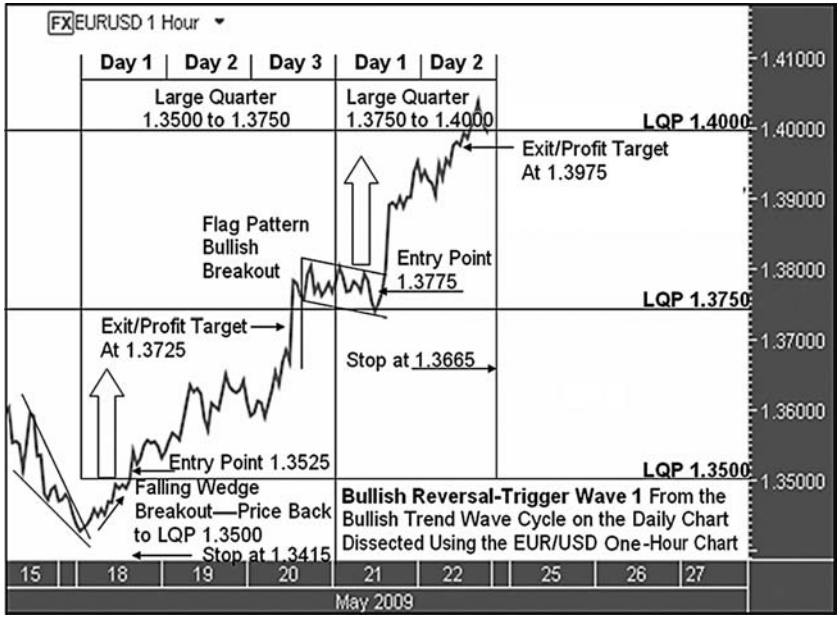

FIGURE 5.9 Large Quarter Trades During a Bullish Reversal-Trigger Wave

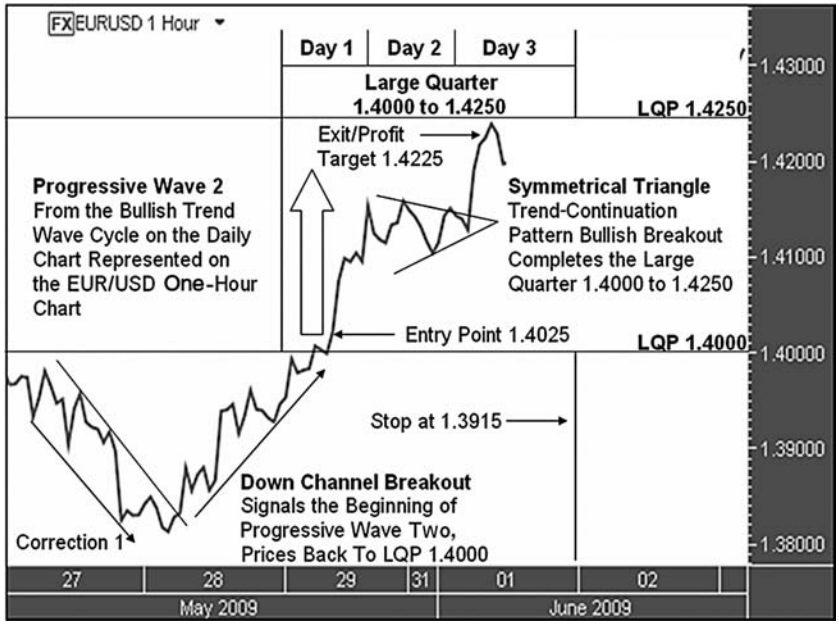

FIGURE 5.10 Large Quarter Trade During a Progressive Wave

Trade can be set up with an entry price at 1.3775, a profit target/exit price at 1.3975, and a stop at 1.3665. The strong Reversal-Trigger Wave 1 completes the Large Quarter 1.3750 to 1.4000 in two days: May 21 and 22, within the timeframe allowed by the Three-Day Rule of The Quarters Theory. The Large Quarter Trade takes advantage of the Reversal-Trigger Wave 1 and the successful completion of the Large Quarter 1.3750 to 1.4000. The trade reaches its profit target at 1.3975 and accomplishes its objective.

As noted earlier, Progressive Wave 2 also presents an opportunity for a Large Quarter Trade, based on Progressive Wave 2 coinciding with the Large Quarter 1.4000 to 1.4250. Figure 5.10 shows the Progressive Wave 2 of the bullish trend wave sequence identified earlier using the daily chart of the EUR/USD currency pair represented on a one-hour chart. Please note on the left-hand side of the chart that a bullish breakout above resistance of the downward channel of Correction 1 takes prices back to the Large Quarter Point 1.3500 and marks the end of Correction 1 and the beginning of Progressive Wave 2. Based on the characteristics of the Progressive Waves, the new trend wave may be expected to continue the previously established trend and push prices higher. This creates an opportunity for a Large Quarter Trade based on the anticipation that, if successful, Progressive Wave 2 should coincide with and work on the Large Quarter 1.4000 to 1.4250. Prices transition into the new Large Quarter above the Large

Quarter Point 1.4000 on May 29, 2009, the first day when the Progressive Wave 2 begins to work on the Large Quarter 1.4000 to 1.4250. To capitalize on the opportunity for completion of the Large Quarter 1.4000 to 1.4250 during Progressive Wave 2, a Large Quarter Trade can be established with an entry price at 1.4025, a profit target/exit at 1.4225, and a stop at 1.3915. In spite of a temporary pullback halfway through the Large Quarter, prices do not reverse but consolidate, forming a Symmetrical Triangle trend-continuation pattern. A bullish symmetrical triangle breakout signals further trend wave progression, leading to the completion of the Large Quarter 1.4000 to 1.4250 in three trading days: May 29, May 31, and June 1 (the market was closed on Saturday, May 30, 2009). The Large Quarter Trade reaches its profit target at 1.4225 and achieves its objective as a result of the successful completion of the Large Quarter 1.4000 to 1.4250 by Progressive Wave 2.

THE INVERSE LARGE QUARTER TRADE

The Inverse Large Quarter Trade is another type of Quarters Theory Trade that has as its objective the successful completion of a Large Quarter. The Inverse Large Quarter Trade is essentially a Large Quarter Trade taken in the opposite direction of an existing trend. Inverse Large Quarter Trades are designed to take advantage of countertrend price moves that may lead to the successful completion of a Large Quarter. Because of their countertrend nature, Inverse Large Quarter Trades may be associated with a higher degree of risk compared to Large Quarter Trades.

The Inverse Large Quarter Trades have the same structure as the Large Quarter Trades. Each Inverse Large Quarter Trade has a realistic profit target of at least 200 PIPs. To secure the best possible entry price and to take full advantage of the projected profit, the entry prices of the Inverse Large Quarter Trades should not be any farther than 25 PIPs from the Large Quarter Point that serves as the starting point of the Large Quarter price move. The exit points of the Inverse Large Quarter Trades should be positioned at or before the closest Small Quarter Point 25 PIPs ahead of the targeted Large Quarter Point.

Similar to Large Quarter Trades, a predetermined stop price is essential to limiting the risk of Inverse Large Quarter Trades. Each Inverse Large Quarter Trade has an exact stop price calculated according to the size of the realistic profit target based on the 2:1 risk/reward ratio. The stop-limit orders of each Inverse Large Quarter Trade should be placed no less than 100 PIPs from the entry price, but the stops of the Inverse Large Quarter Trades may also be expanded by up to 10 PIPs for a total of 110 PIPs in instances when the entry price is exactly at the Small Quarter Point 25 PIPs from a Large Quarter Point, in order to prevent the stop-limit price from

coinciding with the exact number representing the End of the Hesitation Zone 75 PIPs from the Large Quarter Point. These stop expansions are allowed so that the stops of Inverse Large Quarter Trades are always placed outside of the Hesitation Zone to protect stop-limit orders from being triggered while prices fluctuate within it. The entry, exit, and stop prices of Inverse Large Quarter Trades should be carefully examined to make sure that these prices do not coincide with any of the important price points within the Large Quarters or with any major support/resistance levels positioned within a Large Quarter.

The Three-Day Rule of The Quarters Theory serves as a time stop for each Inverse large Quarter Trade. If prices fail to complete a Large Quarter and an Inverse Large Quarter Trade has not accomplished its goal in the time period required by the Three-Day Rule of The Quarters Theory of three 24-hour trading sessions on the global foreign exchange market, the trade may be closed by the end of the third day, or the take-profit limit price may be changed to lock in any smaller profits. Also on the third day, the stop price should be moved to a breakeven level at the initial entry price to protect the trade against losses. If it is too late to take the above-mentioned steps, the trade may simply be closed at a smaller loss to prevent prices from reaching the predetermined 100 to 110 PIP stop-limit order that may get triggered during trend reversals as a result of the unsuccessful completion of a Large Quarter.

Identical to Large Quarter Trades, Inverse Large Quarter Trades also allow changing the stops in certain situations, depending on the advancement of prices into the Large Quarter. For example, if there is a decisive Large Quarter Transition on the first or second day and prices have already advanced deep into the Large Quarter to the Whole Number preceding the Large Quarter Point targeted, the stop can be moved to a breakeven level at the initial entry price of the trade to protect against any losses, without having to wait until the third day to do so. Another variation allows reducing the size of the stop in half from 100 or 110 PIPs to 50 or 55 PIPs in cases where there is a decisive Large Quarter Transition on the first or second day that has seen prices advancing beyond the Half Point of a Large Quarter. On the other hand, when it comes to the Three-Day Rule of The Quarters Theory, any variations are prohibited. The Three-Day Rule of The Quarters Theory should not be bent by allowing more than three days for a Large Quarter completion, and the three-day time stops of the Inverse Large Quarter Trades should be enforced very strictly to prevent or minimize losses and to assure consistent trading results.

Opportunities for Inverse Large Quarter Trades are most likely to occur in a countertrend environment in periods of price corrections following a trend wave, or during consolidations in trendless, range-bound price channels. The individual trend waves and the price corrections following

them can be identified using the methodology of The Quarters Theory Trend Waves combined with technical analysis of price patterns, breakouts, technical indicators, and so forth, which may be utilized for confirmation and early warning purposes. The Fibonacci retracement levels are an important tool when attempting to establish Large Quarter Trades that take advantage of the countertrend price moves during corrections following trend waves. The Fibonacci retracement levels are determined by using the Fibonacci ratios to calculate 23.6%, 38.2%, 50%, 61.8%, and 100% retracements of any pullbacks in prices during correction periods. These measures of retracement percentages are based on previously established price ranges between highs and lows of the trend waves preceding the price correction. Future support and resistance price levels are determined by calculating the Fibonacci retracements and can be used as potential price targets during corrections following trend waves. The lower-range percentages of 23.6% to 38.2% Fibonacci retracements are usually easier to reach and can provide more realistic future price targets that serve as practical guidance to determine whether a Large Quarter stands a chance to be successfully completed during a price Correction following a trend wave, and based on that, whether there would be a realistic opportunity for an Inverse Large Quarter Trade.

Consider the familiar daily chart of the EUR/USD currency pair in Figure 5.11, which shows the bullish trend wave cycle consisting of two trend

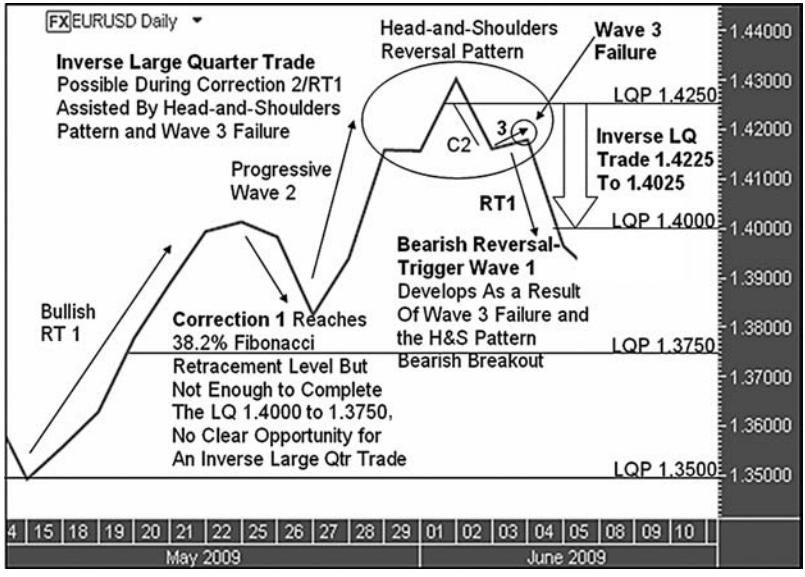

FIGURE 5.11 Inverse Large Quarter Trade During a Reversal-Trigger Wave

waves: the bullish Reversal-Trigger Wave 1 and Progressive Wave 2. Calculating the lower-range Fibonacci retracement percentages up to 38.2% would help to determine whether there is potential opportunity for an Inverse Large Quarter Trade during Correction 1 following Reversal-Trigger Wave 1. If a retracement up to 38.2% of the range of Reversal-Trigger Wave 1 is enough to see prices drop from the Large Quarter Point 1.4000 to the Large Quarter Point 1.3750, there may be a realistic opportunity for a Large Quarter completion and for an Inverse Large Quarter Trade. However, in this example, a 38.2% retracement should bring prices toward the 1.3800 level—50 PIPs above the Large Quarter Point 1.3750, and therefore, the retracement would need to exceed the 38.2% Fibonacci retracement of the Reversal-Trigger Wave 1 in order for the Large Quarter 1.4000 to 1.3750 to be completed successfully. Based on these calculations, we can conclude that, realistically, there may not be an ideal opportunity for an Inverse Large Quarter Trade because it may be difficult to complete the Large Quarter 1.4000 to 1.3750 during Correction 1 following the bullish Reversal-Trigger Wave 1. A better opportunity for an Inverse Large Quarter Trade in this example might have been presented during Correction 2 following the Progressive Wave 2. After the end of Correction 2, there is an attempt to continue the bullish trend wave cycle with another Conclusive Wave 3. The head-and-shoulders trend-reversal pattern gives the early warning sign of the potential for a Wave 3 failure. Conclusive Wave 3 fails to produce a higher high than the high of Progressive Wave 2, and as a result, a bearish Reversal-Trigger Wave 1 develops, helped by the breakout below the neckline of the head-and-shoulders pattern. The development of the bearish Reversal-Trigger Wave 1 opens the door for prices to target the Large Quarter Point 1.4000, raises the probability for completion of the Large Quarter 1.4250 to 1.4000, and creates, although not ideal, a better opportunity for an Inverse Large Quarter Trade compared to the one considered during Correction 1.

The best opportunities for Inverse Large Quarter Trades usually occur during corrections following extended trend waves. Extended trend waves that have produced large price moves are most likely to be followed by corrections where even the lower-end, up to 38.2% Fibonacci retracement, may be sufficient to complete a Large Quarter in the direction opposite to the previously established trend wave. Consider Figure 5.12, which shows the EUR/USD currency pair in a bullish trend wave cycle consisting of a Reversal-Trigger Wave 1 and an Extended Progressive Wave 2. Extended Progressive Wave 2 produces a significant price move of about 1400 PIPs from the low around the Large Quarter Point 1.3000 to the high around 1.4400. A price pullback of up to 38.2% Fibonacci retracement of the total 1400 PIP Range of Extended Progressive Wave 2 should bring prices down by about 535 PIPs from the high around 1.4400, close to 1.3900. In

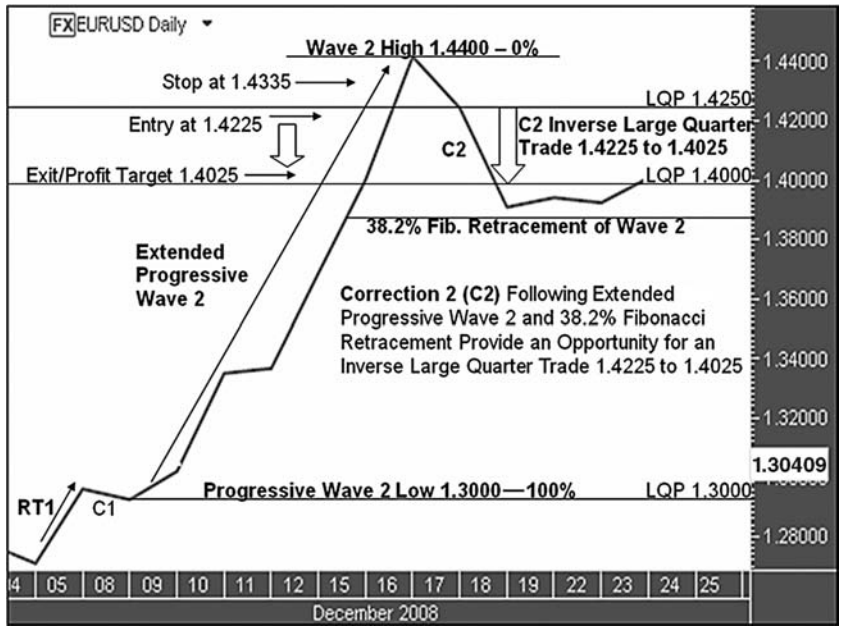

FIGURE 5.12 Inverse Large Quarter Trade During a Correction Following an Extended Trend Wave

that case, Correction 2 following Extended Progressive Wave 2 should coincide with the Large Quarter 1.4250 to 1.4000 and, if prices pull back to the 38.2% Fibonacci retracement, the price move would be sufficient to produce a successful completion of the Large Quarter 1.4250 to 1.4000. By doing these simple calculations, one can determine whether there would be a clear opportunity for an Inverse Large Quarter Trade that could take advantage of the potential completion of the Large Quarter 1.4250 to 1.4000 during Correction 2. The Inverse Large Quarter trade in this example may be set up with an entry point no lower than 1.4225, an exit/profit target at 1.4025, and a stop at 1.4335—110 PIPs above the entry price—so that the stop is positioned outside of the Hesitation Zone 75 PIPs above the Large Quarter Point 1.4250.

Periods of consolidation, when sideways price channels and ranges are formed, may also present some opportunities for Inverse Large Quarter Trades. In such instances, the range of the price channel must be large enough to include a Large Quarter, so that the price fluctuations between the top and the bottom of the channel would be sufficient for the successful completion of a Large Quarter. Figure 5.13 shows the EUR/CHF currency pair in a sideways channel with a range perfectly positioned between

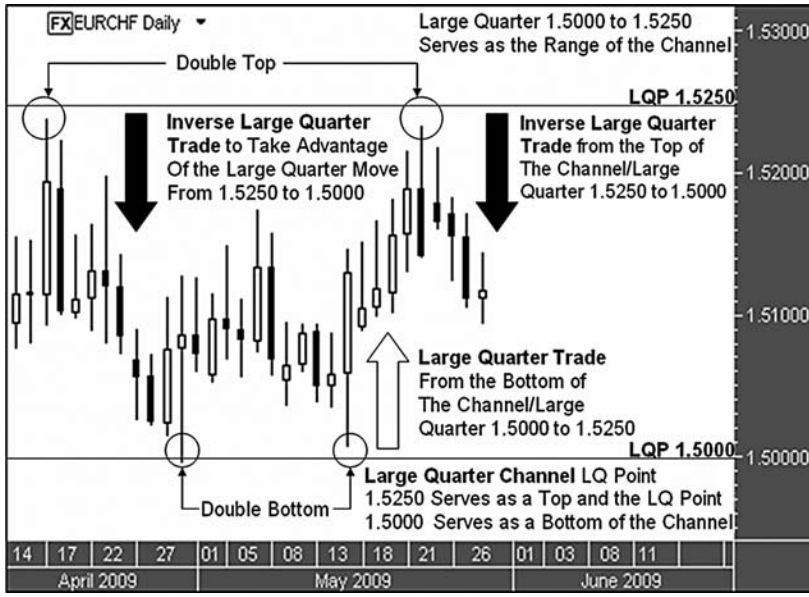

FIGURE 5.13 Inverse Large Quarter Trade Opportunities in a Channel

the Large Quarter Point 1.5000, serving as the bottom of the channel, and the top of the channel within at least one Small Quarter of 25 PIPs ahead of the Large Quarter Point 1.5250. Double-top and double-bottom patterns confirm the range and signal price reversals from top to bottom and bottom to top. The price fluctuations between the top and the bottom of the channel may create an opportunity for a sequence of Large Quarter and Inverse Large Quarter Trades. In this range-bound channel-trading example, Large Quarter Trades may be established with an entry point no higher than 1.5025 (close to the Large Quarter Point serving as the bottom of the channel), an exit/profit target at 1.5225 (at least 25 PIPs from the Large Quarter Point 1.5250 serving as the top of the channel), and a stop that may be placed at 1.4915—110 PIPs below the entry price—so that the stop is positioned outside the channel and outside the Hesitation Zone, 75 PIPs below the Large Quarter Point 1.5000. As prices approach the top of the channel, Inverse Large Quarter Trades may be set with an entry point no higher than 1.5225 (at least 25 PIPs ahead of the Large Quarter Point serving as the top of the channel), an exit/profit target at 1.5025 (at least 25 PIPs ahead of the Large Quarter Point 1.5000 serving as the bottom of the channel), and a stop that may be placed at 1.5335—110 PIPs above the entry price—so that the stop is positioned above the top of the channel and outside the Hesitation Zone 75 PIPs above the Large Quarter Point 1.5250.

HESITATION ZONE TRADES

The Hesitation Zone Trades are Quarters Theory Trades whose objective is to capitalize on the price moves within the Large Quarters. The Hesitation Zone Trades take advantage of the price fluctuations within the Hesitation Zone 75 PIPs above or below a Large Quarter Point. The Hesitation Zone represents the first three Small Quarters of each Large Quarter. Prices enter this important range when they make an attempt to transition into a new Large Quarter. Decisive price moves toward the End of the Hesitation Zone are the first signs of potential Large Quarter Transitions. However, prices often break above a Large Quarter Point and enter the Hesitation Zone but halt their progression into the Large Quarter, especially when they encounter support or resistance close to the End of the Hesitation Zone. In such instances, prices lose their momentum; they become reluctant to continue farther into the Large Quarter and stay confined within the range of the Hesitation Zone, hence the name. While this price behavior may jeopardize the Large Quarter Transitions, it could also create opportunities for "round-trip" types of trades based on the moves toward the End of the Hesitation Zone as well as on the reversal moves that often bring prices back toward the preceding Large Quarter Point. The Hesitation Zone Trade and the Hesitation Zone Reversal Trade are designed to take advantage of these fluctuations between the top and the bottom of the price channel defined by the Hesitation Zone.

The Hesitation Zone Trade capitalizes on the entrance of prices into a new Large Quarter and the initial push above a Large Quarter Point toward the End of the Hesitation Zone. Because the Hesitation Zone has a constant range of 75 PIPs, the Hesitation Zone Trade follows a systematic structure based on the conservative objective to capture approximately 2/3 of the range of the Hesitation Zone. This conservative model is established due to the fact that in certain Large Quarters, the closest Whole Number to a Large Quarter Point is positioned within the Hesitation Zone ahead of the price point that indicates the End of the Hesitation Zone. Since the Whole Numbers are also Major Small Quarter Points and serve as important junctions marking the end of a previous and the beginning of a new 100 PIP Range, the Whole Numbers/Major Small Quarter Points often serve as support or resistance levels when prices attempt to transition between the 100 PIP Ranges. If support or resistance is met at the Whole Number/Major Small Quarter Point preceding the End of the Hesitation Zone, prices may not be able to continue further and reach the End of the Hesitation Zone; therefore, any take-profit orders placed in the area of the Small Quarter or the 25 PIP Range between the Whole Number/Major Small Quarter Point and the End of the Hesitation Zone may have difficulties getting filled. To

capture the majority of the 50 PIPs between a Large Quarter Point and the Whole Number/Major Small Quarter Point preceding the End of the Hesitation Zone, and to make sure that the order has a better chance to be filled before any potential support/resistance is encountered at the Whole Number/Major Small Quarter Point preceding the End of the Hesitation Zone, each Hesitation Zone Trade should have an entry point exactly 1 PIP from a Large Quarter Point and an exit point 5 PIPs ahead of a Whole Number/Major Small Quarter Point preceding the End of the Hesitation Zone, or basically 5 PIPs ahead of the final Small Quarter of the Hesitation Zone. These requirements also take into consideration the standard bid-and-ask spreads of the major currency pairs (provided they do not exceed 5 PIPs) and assure a conservative and easier-to-accomplish profit target of exactly 44 PIPs for each Hesitation Zone Trade.

The Hesitation Zone Trade has a fixed stop of 30 PIPs that limits losses. Although the preferred risk/reward ratio for the Large Quarter Trades is 2:1, based on the 44 PIPs profit target, the stop of the Hesitation Zone trade falls within the lines of the 1.5:1 risk/reward ratio because of the need for the stop to be extended to make sure that each stop of the Hesitation Zone Trade is large enough so that it is always positioned outside of the 25 PIP Range of the Overshoot Area above or below a Large Quarter Point.

Consider the Hesitation Zone Trade shown in Figure 5.14. The EUR/USD exchange rate makes an attempt to transition into the new

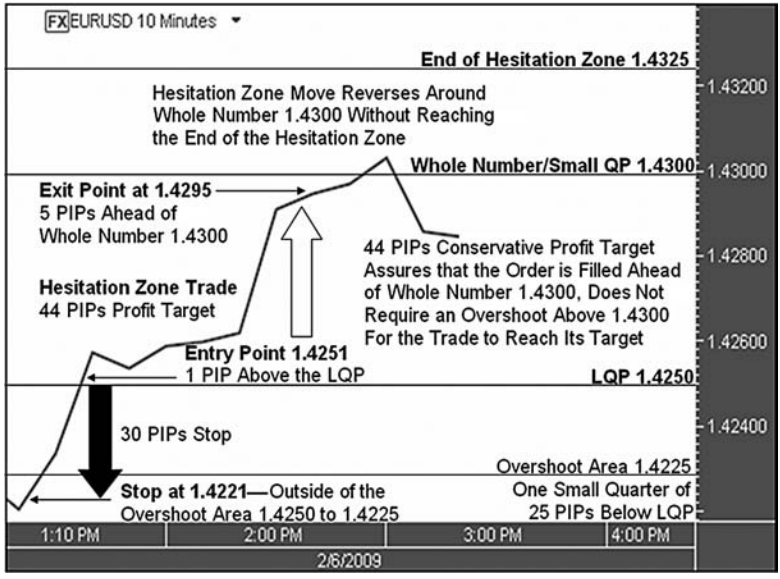

FIGURE 5.14 Hesitation Zone Trade

Large Quarter 1.4250 to 1.4500 and enters the Hesitation Zone between the Large Quarter Point 1.4250 and the End of the Hesitation Zone at 1.4325. The Large Quarter Transition creates an opportunity for a Hesitation Zone Trade that would capitalize on the price move toward the End of the Hesitation Zone. The Hesitation Zone of the Large Quarter 1.4250 to 1.4500 contains the Whole Number/Major Small Quarter Point 1.4300, creating a risk that, if prices were to encounter resistance at the Whole Number/Major Small Quarter Point 1.4300 preceding the End of the Hesitation Zone, the End of the Hesitation Zone might not be reached. To capture the majority of the 50 PIPs between the Large Quarter Point 1.4250 and the Whole Number/Major Small Quarter Point 1.4300 preceding the End of the Hesitation Zone 1.4325, and to make sure that the order has a better chance to be filled before any potential support/resistance is encountered at the Whole Number/Major Small Quarter Point 1.4300, a Hesitation Zone Trade in this example may be set up with an entry point at 1.4251—1 PIP above the Large Quarter Point (the closest price point next to the starting Large Quarter Point of the new Large Quarter 1.4250 to 1.4500)—and an exit point at 1.4295 (5 PIPs ahead of the Whole Number/Major Small Quarter Point 1.4300, or 5 PIPs ahead of the final 25 PIPs Small Quarter of the Hesitation Zone). These conservative parameters would establish what could be an easier-to-accomplish profit target of 44 PIPs that would not require prices to reach the End of the Hesitation Zone 1.4325 by producing a breakout above the Whole Number/Major Small Quarter Point 1.4300 and overshooting it by up to 25 PIPs. Based on the profit target, the stop price may be placed at 1.4221—30 PIPs below the entry price—which would be a sufficient amount of PIPs to position the stop outside of the Overshoot Area 25 PIPs below the Large Quarter Point 1.4250. Note in Figure 5.14 that since prices indeed encounter resistance at the Whole Number/Small Quarter Point 1.4300, fail to reach the End of the Hesitation Zone 1.4325, and reverse back toward the preceding Large Quarter Point 1.4250, a Hesitation Zone Trade with a larger, more aggressive profit target placed above the Whole Number/Small Quarter Point 1.4300 in this example might have ended up being unsuccessful.

The opportunities for Hesitation Zone Trades are identified using the methodology of The Quarters Theory and The Quarters Theory Trend Waves combined with technical analysis of price patterns, breakouts, technical indicators, and so forth, which may be utilized for confirmation and early warning purposes. Naturally, the first and most obvious signs of the potential for Hesitation Zone Trades are always the price moves approaching a Large Quarter Point in an attempt to produce a new Large Quarter Transition. Since the Hesitation Zone Trade's realistic objective is to capture 44 PIPs profit, such price moves could occur within minutes; therefore, smaller, faster-reacting time-period charts, such as the Ten-Minute

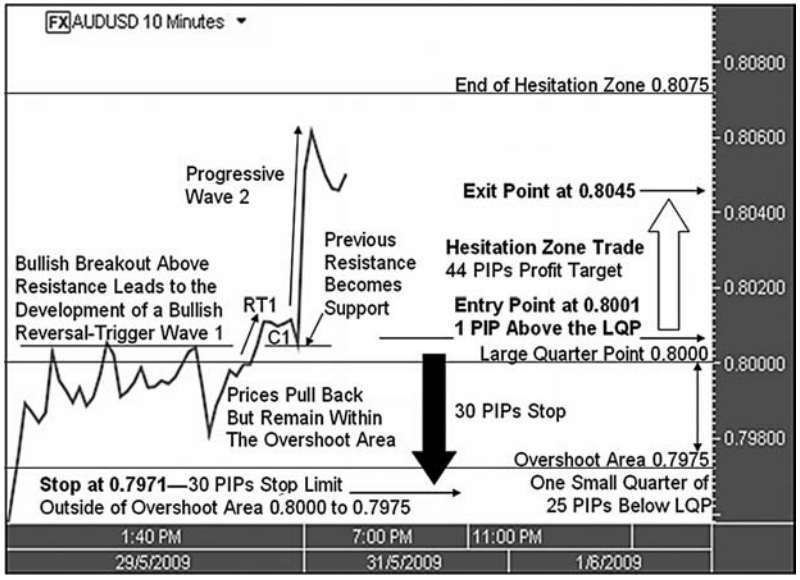

FIGURE 5.15 Hesitation Zone Trade Opportunity

chart, should be used to analyze Hesitation Zone trading opportunities. In Figure 5.15, a careful analysis of the ten-minute chart of the AUD/USD currency pair reveals that a bullish breakout of a triple top resistance a few PIPs above the Large Quarter Point 0.8000 causes a decisive attempt for transition into a new Large Quarter 0.8000 to 0.8250. The breakout leads to the development of a bullish Reversal-Trigger Wave 1 during which prices reenter the Hesitation Zone 75 PIPs above the Large Quarter Point 0.8000, after pulling back and consolidating within the Overshoot Area 25 PIPs below the Large Quarter Point 0.8000. The transition of prices above the Large Quarter Point 0.8000 creates an opportunity for a Hesitation Zone Trade that might take advantage of the price move toward the End of the Hesitation Zone 0.8075 that could occur during the bullish trend wave cycle. As prices pull back during Correction 1 following the bullish Reversal-Trigger Wave 1, they find support at the previous triple top resistance. The support signals the beginning of another bullish Progressive Wave 2, which continues the bullish trend wave cycle and makes the push toward the End of the Hesitation Zone 0.8075. Using the familiar conservative parameters, a Hesitation Zone Trade in this example may be established with an entry point at 0.8001—1 PIP above the Major Large Quarter Point 0.8000—and an exit point at 0.8045 (5 PIPs ahead of the final 25 PIPs Small Quarter of the Hesitation Zone). The stop in this instance may be placed at 0.7971—30 PIPs below the Large Quarter Point 0.8000—to make sure that the stop is positioned outside the Overshoot area 25 PIPs below the Large Quarter

Point 0.8000. Note that despite prices failing to reach the exact end of the Hesitation Zone at 0.8075, the conservative parameters would have, once again, contributed to the success of this example's Hesitation Zone Trade.

Instances when prices encounter support or resistance close to the End of the Hesitation Zone and reverse back toward the preceding Large Quarter Point can create an ideal environment for Hesitation Zone Reversal Trades. Hesitation Zone Reversal Trades are basically inverse Hesitation Zone Trades that take advantage of the reversal price moves from the top (or bottom) of the range of the Hesitation Zone targeting the preceding Large Quarter Point. Hesitation Zone Reversal Trades have the same conservative profit target of 44 PIPs as Hesitation Zone Trades. The optimal parameters that warrant a realistic objective and more consistent results require each Hesitation Zone Reversal Trade to comply with the following: entry point 20 PIPs from the End of the Hesitation Zone to make sure that the entry orders do not require prices to reach the exact End of the Hesitation Zone, exit point 11 PIPs above the targeted Large Quarter Point to assure an easier order fill without the need for prices to reach the actual Large Quarter Point, and a stop 30 PIPs above (or below) the End of the Hesitation Zone, so that the stop is always placed outside of the Hesitation Zone.

Figure 5.16 shows a Hesitation Zone Reversal Trade. Let us analyze the same AUD/USD currency pair ten-minute chart. As explained previously, the bullish trend wave sequence that starts as a result of a bullish

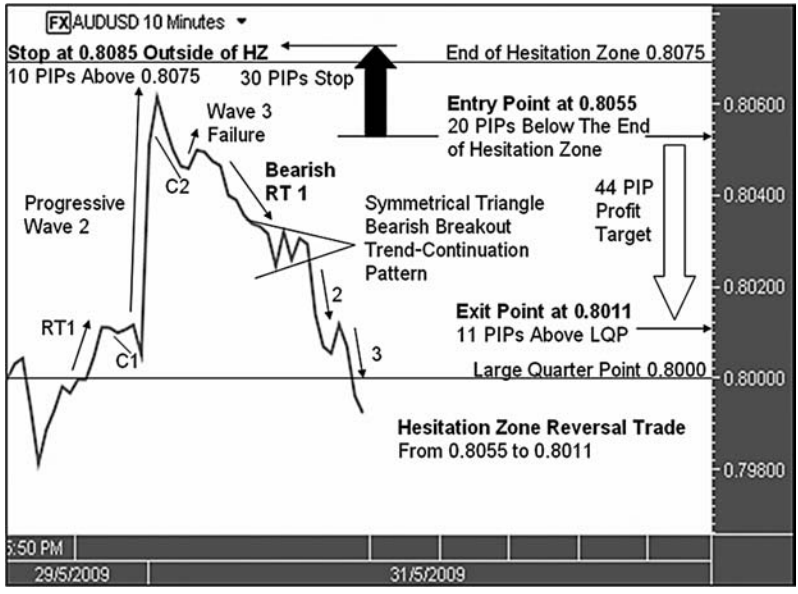

FIGURE 5.16 Hesitation Zone Reversal Trade

breakout presents an opportunity for a Hesitation Zone Trade that takes advantage of the price move from the Large Quarter Point 0.8000 toward the End of the Hesitation Zone at 0.8075. However, prices encounter resistance ahead of the End of the Hesitation Zone, which creates an opportunity for a Hesitation Zone Reversal Trade that could capitalize on the reversal price move that could take prices back toward the preceding Large Quarter Point 0.8000. The failure of Conclusive Wave 3 to break above the high of Progressive Wave 2 and to continue the bullish trend wave cycle leads to the development of a bearish Reversal-Trigger Wave 1, which confirms the reversal. The bearish Reversal-Trigger Wave 1 is then followed by a Correction sequence shaped like a symmetrical triangle trend-continuation pattern, signaling further progression of the decline toward the preceding Large Quarter Point 0.8000. A potential Hesitation Zone Reversal Trade that capitalizes on the aforementioned developments may be set up with the following conservative parameters: entry point at 0.8055 (20 PIPs below the End of the Hesitation Zone), exit point at 0.8011 (11 PIPs above the targeted Large Quarter Point 0.8000), and a stop at 0.8085 (30 PIPs above the End of the Hesitation Zone 0.8075, so that the stop is placed outside of the Hesitation Zone).

Technical indicators can provide early warning and confirmation signals when exploring Hesitation Zone Trade and Hesitation Zone Reversal Trade opportunities. In Figure 5.17, the bullish Reversal-Trigger Wave 1 begins the bullish trend wave cycle at the time when the RSI shows

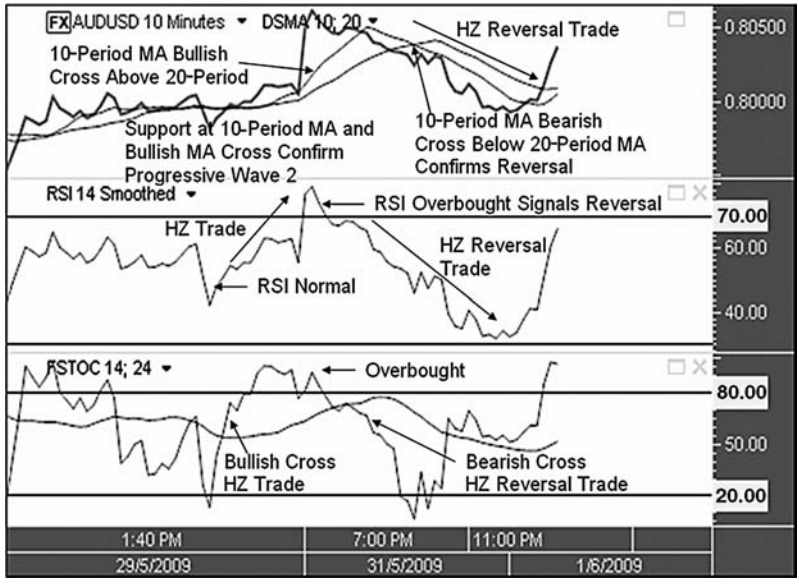

FIGURE 5.17 Technical Indicators Signaling Hesitation Zone Trade Opportunities

normal conditions and the 10-period moving average sends a bullish signal by crossing above the 20-period moving average. During the pullback of Correction 1, prices find support at the 10-period moving average—a development that signals that Correction 1 may be ending and that another bullish Progressive Wave 2 may develop in an attempt to continue the bullish trend wave cycle. Note also that the bullish trend wave cycle ends shortly after the RSI and the fast stochastic indicators breach above 70 and 80—the levels signaling overbought conditions, which can be used as early warning signs that the bullish trend may reverse.

OVERSHOOT TRADES

The *Overshoot Trades* are highly speculative, active trades that are designed to take advantage of overshoots. The Quarters Theory considers price moves of 25 PIPs or less above or below a Large Quarter Point, the important price points within a Large Quarter, Whole Numbers, or any major support/resistance price points to be overshoots. Overshoots usually occur as a result of attempts by prices to break above or below these significant price levels. One of the main characteristics of overshoots is that they are often followed by reversals toward the preceding price point above or below which the overshoot has developed. The overshoots and the pullbacks that follow them provide opportunities for Overshoot Trades and Overshoot Reversal Trades.

Overshoots of Large Quarter Points, Whole Numbers, and the important price points within a Large Quarter create the most favorable environment for Overshoot Trades and Overshoot Reversal Trades. Overshoots of major support/resistance levels may present some good chances also, but there is a greater risk for violent, erratic price moves to occur as the market attempts to challenge and break the support or resistance of these price levels, leading to much greater volatility that could easily trigger the stops of Overshoot Trades and Overshoot Reversal Trades. No matter the price point at which an overshoot develops, the amount of PIPs that is likely to be produced during overshoots is very difficult to predict, because the overshoots are not exactly decisive price moves, but rather either "price inertia" from a previous move, or simply "wiggle" price moves with short irregular motions around an important price level. The unpredictability factor of overshoots is much greater compared with other trading opportunities, as an overshoot can bring forth a few or sometimes a single PIP and can be immediately followed by a reversal. This is why Overshoot Trades are highly speculative, "scalping" trades with tight stops and very conservative profit targets.

The Overshoot Area of a Large Quarter Point, the important price points within a Large Quarter, the Whole Numbers, or any major support/

resistance price points have a clearly defined range of up to 25 PIPs implemented by The Quarters Theory so that overshoots are properly identified. To capture the majority of that range without requiring an overshoot to reach the end of its 25 PIPs range, Overshoot Trades should comply with the following conservative parameters. Considering the characteristics of overshoots, to ensure the best possible entry price, each Overshoot Trade should have an entry point 1 PIP from the price point above or below which the overshoot is expected to occur. The exit points of Overshoot Trades should be set 10 PIPs ahead of the end of the Overshoot Area, which results in a conservative profit target no greater than 14 PIPs for each Overshoot Trade. In order to allow some wiggle room, the stops of the Overshoot Trades should be placed as far as possible from the price point that is being overshot, without negatively affecting the risk/reward ratio of the trade. The most suitable risk/reward ratio in the case would be approximately 1.5:1, which means that the stops of Overshoot Trades may be positioned no farther than 10 PIPs from the entry point. Overshoot Trades should not be left unattended—they are scalping trades and require close monitoring and the ability to react quickly in the event of a sudden price reversal that might occur before an Overshoot Trade has reached its target.

Opportunities for Overshoot Trades are identified using the methodology of The Quarters Theory and The Quarters Theory Trend Waves combined with technical analysis. Technical indicators can be applied, but some of them, especially lagging indicators such as moving averages, may not be able to give fast enough signals as they could lag behind the rapid price moves or spikes during overshoots. Because Overshoot Trades are very quick in-and-out speculative trades, time is of the essence; therefore, fast-reacting time-period charts (e.g., five-minute or even smaller timeframe charts such as three- or even one-minute charts) should be utilized to analyze and spot Overshoot Trading opportunities. Price behavior in the vicinity of a targeted price point—breakouts, support/resistance, trend wave continuation or reversals, chart patterns, and so forth—can provide the necessary signals for Overshoot Trades.

For example, as shown in Figure 5.18, a quick analysis of the five-minute chart of the EUR/USD currency pair reveals that prices flatten a few PIPs ahead of the Major Large Quarter Point 1.4000 as they approach it. Knowing how important the Large Quarter Points are, especially the Major Large Quarter Points, it would make sense to anticipate that the Major Large Quarter Point 1.4000 might serve as a significant level of resistance and that a breakout above 1.4000 might not be successful on its first attempt. This means that prices may wiggle around the Major Large Quarter Point 1.4000 for a while and may produce overshoots above or below this important price level until a decisive breakout is finally accomplished. The expected overshoot above the Major Large Quarter Point 1.4000 could

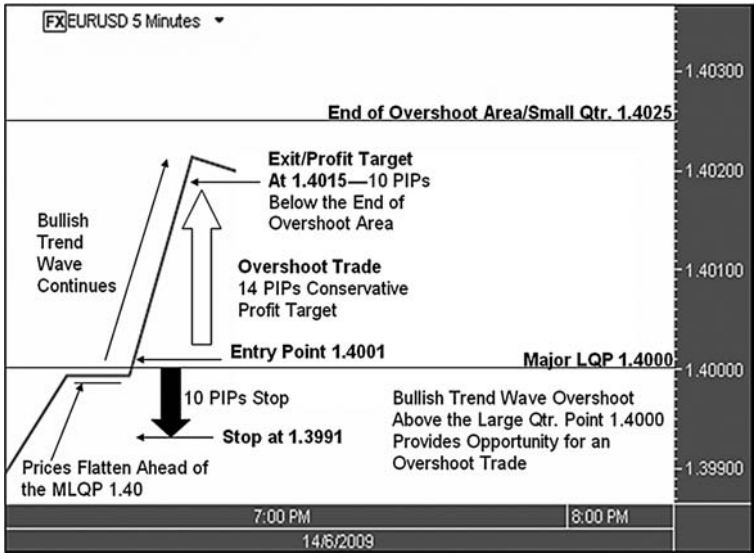

FIGURE 5.18 Overshoot Trade

continue the five-minute chart's bullish trend wave cycle and could create an opportunity for a quick Overshoot Trade. Complying with the conservative parameters of Overshoot Trades, in this example, a trade with a realistic profit target no higher than 14 PIPs may be established with an entry point at 1.4001 (1 PIP above the Major Large Quarter Point 1.4000) and an exit point no further than 1.4015 (10 PIPs ahead of the end of the Overshoot Area at 1.4025). Based on the profit target and the 1.5:1 risk/reward ratio, a stop may be placed no further than 1.3991 (maximum 10 PIPs below the entry point).

Overshoots that do not evolve into decisive price breakouts can provide excellent opportunities for Overshoot Reversal Trades. The name of the Overshoot Reversal Trades says it all: They rely on the reversals that occur during overshoots as prices pull back toward the preceding price point above or below which the overshoot has developed. The requirements that must be met when spotting Overshoot Reversal Trade opportunities are that an overshoot must occur, and that during the overshoot prices must remain within and must never exit the Overshoot Area. The essence of Overshoot Reversal Trades is that they are based on the premise of pure speculation that an overshoot is not going to lead to a decisive breakout that would cause prices to move over 25 PIPs above or below the targeted price level, and that the overshoot is likely be followed by a reversal. Identical to Overshoot Trades, Overshoot Reversal Trades are quick scalping trades and should be monitored closely.

Considering the characteristics of overshoots, to ensure the best possible entry prices and realistic profit targets that are easier to reach consistently, each Overshoot Reversal Trade should comply with the following parameters. The entry points of Overshoot Reversal Trades should be placed within 6 PIPs from the end of the Overshoot Area. The exit points of the Overshoot Trades should be placed at least 5 PIPs ahead of the important price point that has been overshot. These parameters generate a conservative profit target of 14 PIPs for each Overshoot Reversal Trade. In order to make sure that the stops are always placed outside of the Overshoot Area, without negatively affecting the risk/reward ratios, the stops of the Overshoot Reversal Trades should be positioned up to 10 PIPs from the entry point.

Let us analyze the same five-minute chart of the EUR/USD currency pair used in the previous example. The Overshoot above the Major Large Quarter Point 1.4000 takes prices a few PIPs away from the end of the Overshoot Area. As a result of the failure of the bullish Wave 2 to break above the previous high of Wave 1, prices remain within and never exit the Overshoot Area. A double top trend-reversal pattern is established, signaling a reversal and the potential for a bearish Reversal-Trigger Wave 1 to take prices back toward the overshot Major Large Quarter Point 1.4000. The anticipated reversal creates an opportunity for a quick Overshoot Reversal Trade. Complying with the conservative parameters of Overshoot Reversal Trades, shown in Figure 5.19, a trade with a realistic profit target no higher

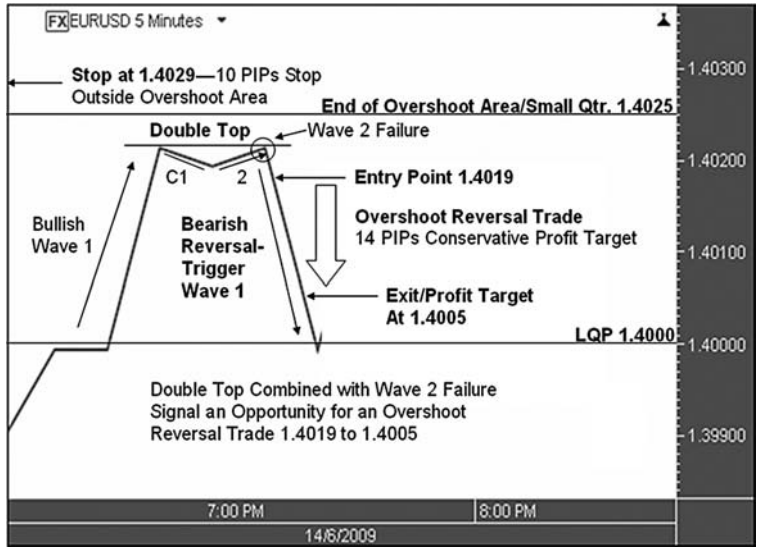

FIGURE 5.19 Overshoot Reversal Trade

than 14 PIPs may be established with an entry point at 1.4019 (6 PIPs ahead of the end of the Overshoot Area 1.4025) and an exit point at 1.4005 (at least 5 PIPs ahead of the Major Large Quarter Point 1.4000). Based on the profit target and the 1.5:1 risk/reward ratio, a stop may be placed at 1.4029 to position it outside of the Overshoot Area, a maximum 10 PIPs above the entry point.

HALF POINT TRADES

The Half Point Trades are Quarters Theory Trades whose objective is to capitalize on the price moves within the Large Quarters. The Half Point Trades take advantage of the price fluctuations between a Large Quarter Point and the Half Point of a Large Quarter. The Half Point is an important price level that marks the exact middle price point of each Large Quarter. Price moves that stretch outside of the Hesitation Zone and reach the Half Point of a Large Quarter provide the confirmation signal of a successful Large Quarter Transition. On the other hand, the Half Point can also play the role of a problematic price point that may avert the successful completion of a Large Quarter. Instances when the Half Point becomes a difficult support or resistance level to overcome and prevents further progression of prices beyond the Half Point could lead to price exhaustion and unsuccessful completion of a Large Quarter. Strong support or resistance met at the Half Point of a Large Quarter might cause a reversal that could take prices back toward the preceding Large Quarter Point. The Half Point Trade and the Half Point Reversal Trade are designed to take advantage of these price moves from a Large Quarter Point to a Half Point and the reversals targeting a Large Quarter Point.

The Half Point Trades at a first glance may seem to take place within the context of Large Quarters Trades, but there is a significant difference between the two. While Large Quarter Trades anticipate the successful completion of a Large Quarter, Half Point Trades are based on the expectation that support or resistance met at the Half Point may be difficult to break, may avert further progression of prices, and may lead to the unsuccessful completion of a Large Quarter. What validates such expectations even more are instances when major support/resistance levels coincide with the actual Half Points or the close proximity of up to 25 PIPs around them. To anticipate the successful completion of a Large Quarter that contains major support/resistance levels coinciding with the Half Point or its vicinity might not be the most realistic high-probability proposition in such cases, and therefore opting for a Half Point Trade instead of a Large Quarter Trade may be the better, more conservative alternative.

The success of a Half Point Trade depends on whether a Large Quarter Transition will produce a decisive price move targeting the Half Point of a Large Quarter. There is a constant price range of exactly 125 PIPs that separates a Large Quarter Point from the Half Point of a Large Quarter. Half Point Trades are designed to capture the majority of that range without the need for an overshoot of a Whole Number that may precede a Half Point. In order to consistently accomplish their objectives, Half Point Trades should comply with the following conservative parameters. To ensure the best possible entry/exit prices and order fills, each Half Point Trade should have an entry point no farther than 15 PIPs from a Large Quarter Point that serves as a starting point of a Large Quarter price move, and an exit point set 30 PIPs ahead of the end of the targeted Half Point. This exit point assures that the exit price will always be positioned at least 5 PIPs ahead of a Whole Number preceding a Half Point. These parameters would produce a conservative profit target no greater than 80 PIPs for each Half Point Trade. So that they are always positioned outside of the Overshoot area 25 PIPs above or below a Large Quarter Point, the stops of Half Point Trades should be placed up to 45 PIPs from the entry point. Based on the profit target and stop ranges, the Half Point Trades approximately comply with the 2:1 risk/reward ratio.

Half Point Trade opportunities are identified using the methodology of The Quarters Theory and The Quarters Theory Trend Waves combined with technical analysis. The one-hour charts are the preferred timeframes to help monitor price behavior and recognize breakouts, support/resistance, chart patterns, trend wave development, reversals, and so forth. Figure 5.20 shows the one-hour chart of the AUD/USD currency pair. A bullish trend wave on the left-hand side of the chart pushes prices to an overshoot above the Large Quarter Point 0.8000. As prices reverse after the overshoot, the bullish trend wave sequence ends, but instead of a bearish cycle establishing, prices find support twice above the Large Quarter Point, developing a double bottom. The double-bottom reversal pattern signals the potential for prices to continue higher with a new bullish trend wave cycle that begins with the development of a bullish Reversal-Trigger Wave 1. The fact that prices remain above the Large Quarter Point 0.8000 during the pullback and form a double bottom is a sign of strength and increases the probability that prices will make an attempt to produce a decisive Large Quarter Transition into the new Large Quarter 0.8000 to 0.8250. The Half Point of the Large Quarter may be targeted during such a Large Quarter Transition attempt and therefore a Half Point Trade as a conservative alternative to a Large Quarter Trade may be considered in this example. A Half Point Trade with a realistic profit target no higher than 80 PIPs may be established with an entry point at 0.8015 (no further than 15 PIPs above the Major Large Quarter Point 0.8000) and an exit point at 0.8095

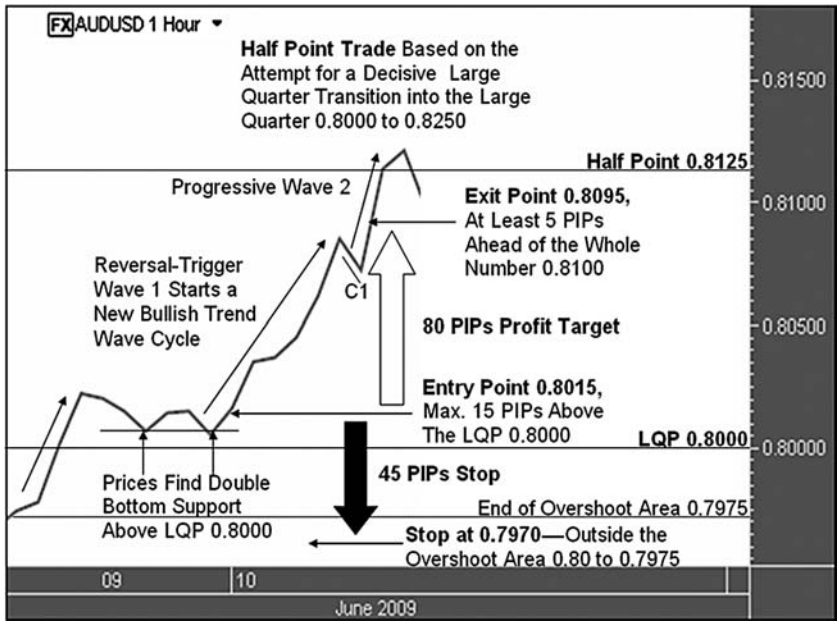

FIGURE 5.20 Half Point Trade

(at least 5 PIPs ahead of the Whole Number 0.8100 preceding the Half Point 0.8125). Based on the profit target and the 2:1 risk/reward ratio, a stop may be placed no further than 0.7970 (up to 45 PIPs below the entry point so that the stop is positioned outside of the Overshoot Area 25 PIPs below the Major Large Quarter Point 0.8000).

Even better and less likely to be confused with the Large Quarter Trades are the opportunities created by reversals at or around a Half Point. These reversals lead to the unsuccessful completion of a Large Quarter and result in price pullbacks toward the preceding Large Quarter Point, creating an ideal environment for the Half Point Reversal Trades. The objective of Half Point Reversal Trades is to capture the majority of the up to 125 PIPs reversal moves from a Half Point to a Large Quarter Point. Considering that in some Large Quarters the Half Point is positioned only 25 PIPs ahead of the Whole Number preceding the targeted Large Quarter Point, the stops of Half Point Reversal Trades must always be placed outside of the 25 PIPs area between these two important price points within the Large Quarter. This means that the entry price of Half Point Reversal Trades must be placed ahead of the Half Point and that the stops of Half Point Reversal Trades must be placed far enough from the entry point to assure that the stops are positioned not only past the Half Point but also beyond the

Whole Number preceding a Large Quarter Point. To meet these requirements, the entry point of Half Point Reversal Trades may be placed up to 10 PIPs ahead of the Half Point and the stops of the Half Point Reversal Trades may be placed up to 50 PIPs from the entry point. As an attempt to resolve the need for an exit point that would be easier to reach consistently, Half Point Reversal Trades may have their exit points set up to 25 PIPs ahead of a targeted Large Quarter Point. These parameters result in a conservatively estimated profit target of 90 PIPs, close enough to comply with the preferred 2:1 risk/reward ratio for Half Point Reversal Trades.

The methodology of The Quarters Theory and The Quarters Theory Trend Waves combined with technical analysis should be utilized when identifying Half Point Reversal Trade opportunities. Early warning signs of potential reversals can be recognized by examining the one-hour chart for trend-reversal patterns—double or multiple tops/bottoms, head and shoulders, and so forth—as well as for signs of a Trend Wave Failure in close proximity to a Half Point. Let us take a look at the same one-hour chart of the AUD/USD currency pair used in the previous example (see Figure 5.21). The double-bottom pattern signals and upward price move and the development of a new bullish trend wave cycle that sees the bullish Reversal-Trigger Wave 1 and the bullish Progressive Wave 2 targeting to the Half Point 0.8125. A small overshoot above the Half Point 0.8125 is followed by

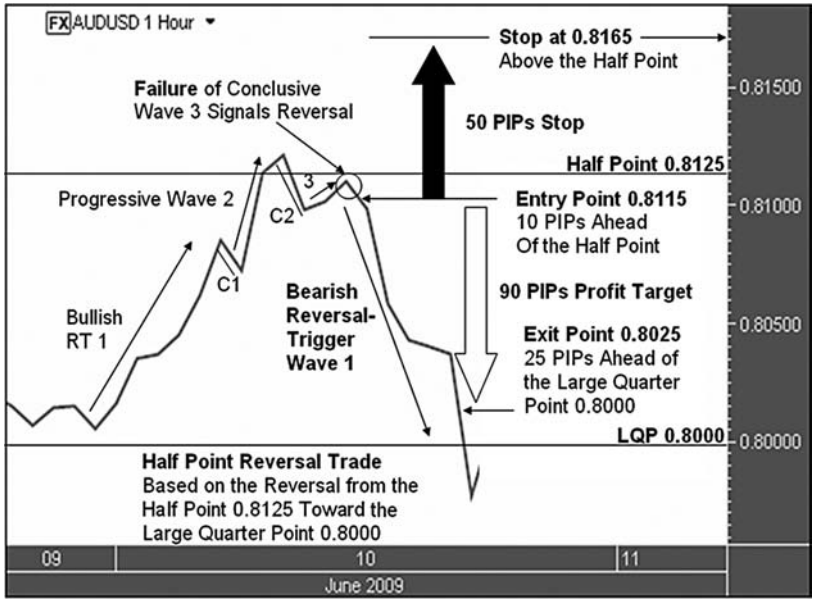

FIGURE 5.21 Half Point Reversal Trade

a price Correction 2 (C2) that ends Progressive Wave 2. After Correction 2 (C2), another bullish Conclusive Wave 3 develops; however, Conclusive Wave 3 meets resistance at the Half Point and fails to break above the high of Progressive Wave 2. The failure of Conclusive Wave 3 signals potential reversal and leads to the development of a bearish Reversal-Trigger Wave 1. The bullish Trend Wave Failure and the inability of prices to continue farther into the Large Quarter beyond the Half Point creates an ideal environment for a Half Point Reversal trade that may take advantage of the unsuccessful completion of the Large Quarter and the reversal that could take prices back toward the preceding Large Quarter Point. Such a Half Point Reversal Trade may be established with an entry point at 0.8115 (10 PIPs ahead of the Half Point 0.8125) and an exit point at 0.8025 (25 PIPs ahead of the Large Quarter Point 0.8000) for a conservative profit target of 90 PIPs. To position the stop above the Half Point, complying with the preferred 2:1 risk/reward ratio, a stop may be placed at 0.8165 (up to 50 PIPs above the entry point).

Technical indicators can offer useful confirmation and early warning signals of reversals that may create opportunities for Half Point Reversal Trades. In Figure 5.22, a bullish cross of price above the five-period exponential moving average confirms the development of the bullish Reversal-Trigger Wave 1, beginning the new bullish trend wave cycle that challenges

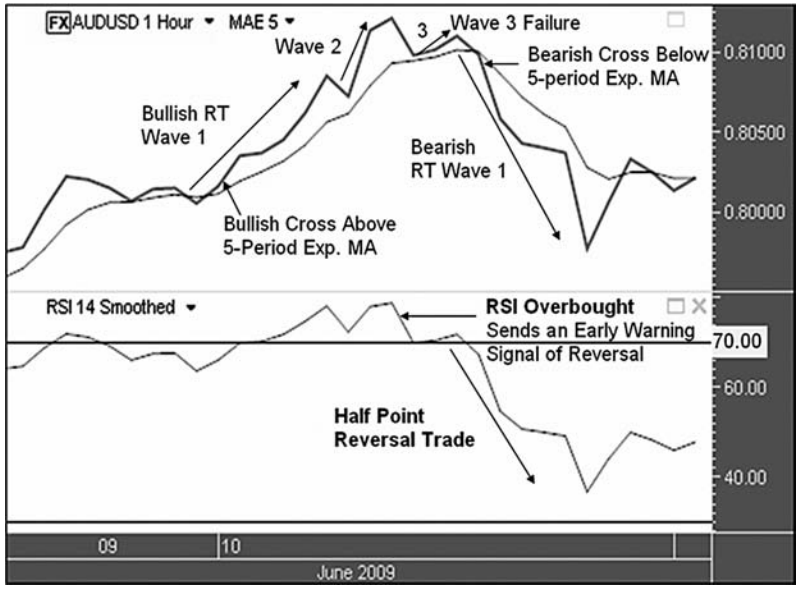

FIGURE 5.22 Technical Indicators Signaling Half Point and Half Point Reversal Trade Opportunities

the Half Point 0.8125. On the other hand, an RSI reading above 70 signals overbought conditions and gives the early warning sign of a potential reversal. The bearish cross of price below the five-period exponential moving average confirms the reversal and the development of a bearish Reversal-Trigger Wave 1 that takes prices back toward the preceding Large Quarter Point 0.8000.

WHOLE NUMBER TRADES

The name "Whole Number Trades" is short for the Whole Number preceding a Large Quarter Point Trade. The Whole Number Trades include the Whole Number Trade and the Whole Number Reversal Trade. The Whole Number Trade capitalizes on the price moves within a Large Quarter that target the Whole Number preceding a Large Quarter Point. The Whole Number Reversal Trades take advantage of the reversals that may occur when the Whole Number preceding a Large Quarter Point plays the role of the last problematic price point that prevents the successful completion of a Large Quarter. Support or resistance encountered at the Whole Number preceding a Large Quarter Point have the potential to avert further progression of prices and may lead to price exhaustion, unsuccessful completion of a Large Quarter, and a reversal back toward the preceding Large Quarter Point. These reversals targeting the preceding Large Quarter Point create the ideal environment for Whole Number Reversal Trades.

Whole Number Trades are designed as a more conservative alternative to Large Quarter Trades in instances when a major support/resistance level coincides with a Whole Number preceding a Large Quarter Point or falls within the close proximity of 25 PIPs around it. Major support/resistance levels positioned within the range of a Large Quarter lessen the odds that such a Large Quarter will be successfully completed. Based on the anticipation of unsuccessful completion of a Large Quarter that contains major support/resistance levels coinciding with the Whole Number preceding the Large Quarter Point, a Whole Number Trade may be chosen to take advantage of the Large Quarter move that may not produce the successful completion of the Large Quarter, but may be sufficient enough to reach the vicinity of the Whole Number preceding the Large Quarter Point and challenge a previously established major support/resistance level near it.

Figure 5.23 shows a Major Mid-Term Resistance level near the Whole Number 1.3700 preceding the Large Quarter Point 1.3750 on the one-hour chart of the EUR/USD currency pair dating back to March 2009. Two months later, in May 2009, prices approach the Large Quarter Point 1.3500 and make an attempt to transition into the Large Quarter 1.3500 to 1.3750.

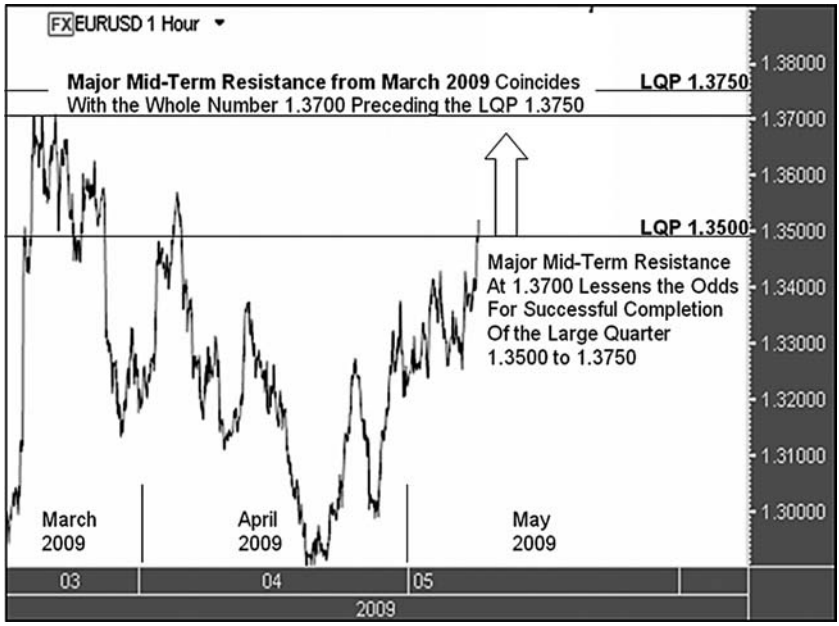

FIGURE 5.23 Major Resistance Level Coinciding with the Whole Number Preceding a Large Quarter Point

The fact that the new Large Quarter 1.3500 to 1.3750 contains the Major Mid-Term Resistance level that coincides with the Whole Number 1.3700 preceding the Large Quarter Point 1.3750 increases the likelihood that steep resistance encountered at the Whole Number 1.3700 or the area around it may prevent the successful completion of the Large Quarter 1.3500 to 1.3750. In this instance, there is a great probability that although prices may not complete the Large Quarter 1.3500 to 1.3750 on the first try, at least they might produce a decisive move within the Large Quarter in an attempt to challenge the previously established Major Mid-Term Resistance level that coincides with the Whole Number 1.3700 preceding the Large Quarter Point 1.3750. Based on these circumstances and expectations, a Whole Number Trade rather than a Large Quarter Trade may be the more realistic and conservative option to capitalize on any significant price moves above the Large Quarter Point 1.3500.

Whole Number Trades are designed to capture the majority of the range between a Large Quarter Point that marks the beginning of a Large Quarter price move and the Whole Number preceding the Large Quarter Point that is expected to be targeted. A major factor to consider when establishing the parameters of the Whole Number Trades is the variable

positioning of the Whole Number preceding a Large Quarter Point in different Large Quarters. In some Large Quarters, the distance between the Whole Number preceding a Large Quarter Point and the actual Large Quarter Point is 100 PIPs, while in others the distance is 50 PIPs. The Large Quarters that have only 50 PIPs distance between the Whole Number preceding a Large Quarter Point and the actual Large Quarter Point may be easier to complete. Moreover, Whole Number Trades taken within the range of such Large Quarters would have larger profit targets because the range between the Large Quarter Point that marks the beginning of these Large Quarters and the Whole Number preceding the targeted Large Quarter Point is 200 PIPs. The Large Quarters where the distance between the Whole Number preceding a Large Quarter Point and the actual Large Quarter Point is 100 PIPs would have smaller Whole Number Trade profit targets because the range between the Large Quarter Point that marks the beginning of these Large Quarters and the Whole Number preceding the Large Quarter Point that is expected to be targeted is 150 PIPs—50 PIPs less than the other type of Large Quarters.

Despite the smaller profit targets in some Large Quarters, all Whole Number Trades should comply with the same conservative parameters. In an effort to accomplish easier order fills and more consistently obtainable and realistic objectives, each Whole Number Trade should have an entry point no farther than 15 PIPs from a Large Quarter Point that serves as a starting point of a Large Quarter price move, and an exit point set 35 PIPs ahead of the end of the targeted Whole Number preceding a Large Quarter Point. Such an exit price ensures that the exit point of the trade will always be positioned at least 10 PIPs ahead of a Half Point in certain Large Quarters where the Half Point is only 25 PIPs ahead of the Whole Number preceding the Large Quarter Point, without the need for prices to reach or overshoot the Half Point in order for the trade to reach its target. These parameters result in a conservative profit target of 150 PIPs for each Whole Number Trade. Since the entry point would be no further than 15 PIPs from a Large Quarter Point, all stops must be positioned outside of the Overshoot Area 25 PIPs above or below the Large Quarter Point that serves as the starting point of a Whole Number Trade. To ensure that, the stops of the Whole Number Trades should be placed up to 50 PIPs away from the entry point. Based on the profit target and the stop ranges, Whole Number Trades offer an attractive 3:1 risk/reward ratio.

Whole Number Trade opportunities are identified using the methodology of The Quarters Theory and The Quarters Theory Trend Waves combined with technical analysis. The success of the Whole Number Trades is dependent on significant price moves of approximately 150 to 200 PIPs (depending on the type of Large Quarter), which may take a few days to produce. This is why day-to-day price behavior, trend waves, and trend

cycles should be analyzed using the daily charts of the currency pairs being monitored. The individual trend waves and trend wave cycles recognized on the daily charts can be dissected for a closer look using the one-hour charts, which may be also utilized to provide some early warning signals of trend reversals, breakouts, support/resistance, chart patterns, and so forth.

As shown in the previous example, the EUR/USD currency pair's exchange rate enters a new Large Quarter 1.3500 to 1.3750, containing a Major Mid-Term Resistance level that coincides with the Whole Number 1.3700 preceding the Large Quarter Point 1.3750. Assuming that a Whole Number Trade is considered based on the expectation that prices may not be able to complete the Large Quarter 1.3500 to 1.3750, but may try to challenge the previously established Major Mid-Term Resistance level that coincides with the Whole Number 1.3700 preceding the Large Quarter Point 1.3750, let us try to discover more pros or cons for this potential trading opportunity by examining the individual phases of trend development and progression during which such a Whole Number Trade would take place. The left-hand side of the daily chart in Figure 5.24 shows the EUR/USD pair beginning a new bullish trend wave cycle that starts with a bullish Reversal-Trigger Wave 1 developing as a result of a previous bearish wave's failure. The bullish Reversal-Trigger Wave 1 completes the Large Quarter 1.3000

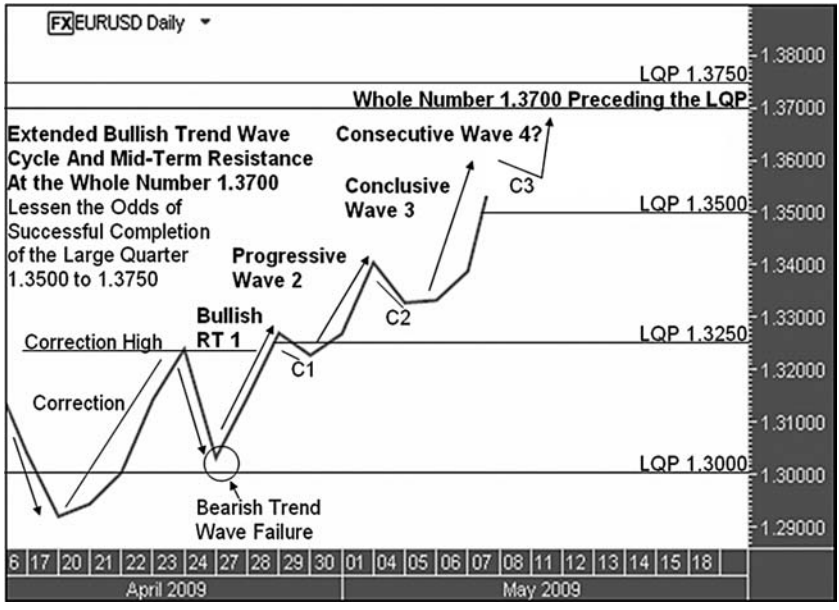

FIGURE 5.24 Identifying Whole Number Trade Opportunities

to 1.3250 and is followed by Progressive Wave 2 and Conclusive Wave 3, which complete another Large Quarter 1.3250 to 1.3500. Conclusive Wave 3 also makes an attempt to work on the Large Quarter in question—the Large Quarter 1.3500 to 1.3750. Several factors may cause concern in this instance. First, there has already been a completion of a previous Large Quarter during Conclusive Wave 3 and, realistically, Conclusive Wave 3 may not be capable of completing another Large Quarter, which in this case would be the Large Quarter 1.3500 to 1.3750, especially when there is a Major Mid-Term Resistance at the Whole Number 1.3700 preceding the targeted Large Quarter Point 1.3750 that could cause exhaustion and end Conclusive Wave 3. Second, if Conclusive Wave 3 is not able to complete the Large Quarter 1.3500 to 1.3750, any additional Consecutive trend waves that may follow Consecutive Wave 3 would indicate that the bullish trend wave cycle is becoming extended, which raises the probability of a Trend Wave Failure looming over the Conclusive trend waves. This means that the odds that the Large Quarter 1.3500 to 1.3750 would be completed during any Consecutive trend waves may also be rather slim. Moreover, the Major Mid-Term Resistance at the Whole Number 1.3700 preceding the targeted Large Quarter Point 1.3750 could very well cause price exhaustion and contribute to the failure of such Consecutive trend waves. Based on this analysis, a Whole Number Trade that could take advantage of the price move that might challenge the resistance coinciding with the Whole Number 1.3700 preceding the targeted Large Quarter Point 1.3750 would be a better, more conservative choice than choosing a Large Quarter Trade.

Now let us take a closer look at the bullish Conclusive Wave 3 using the one-hour chart of the EUR/USD pair. In Figure 5.25, prices approach the Large Quarter Point 1.3500, pull back a little, and then enter the Large Quarter 1.3500 to 1.3750. To capitalize on the anticipated Large Quarter Transition and the price move that might target the Major Mid-Term Resistance level that coincides with the Whole Number 1.3700 preceding the Large Quarter Point 1.3750, a Whole Number Trade may be established with the following conservative parameters: an entry point at 1.3515 (no further than 15 PIPs above the Large Quarter Point 1.3500) and an exit point at 1.3665 (35 PIPs ahead of the major resistance level coinciding with Whole Number 1.3700 preceding the Large Quarter Point 1.3750). Based on the profit target and the 3:1 risk/reward ratio, a stop may be placed no further than 1.3465 (up to 50 PIPs below the entry point so that the stop is positioned outside of the Overshoot area 25 PIPs below the Large Quarter Point 1.3500).

The reversals that occur when prices encounter support or resistance at the Whole Number preceding a Large Quarter Point and cause the unsuccessful completion of a Large Quarter followed by price pullbacks toward the preceding Large Quarter Point, create the ideal environment for Whole

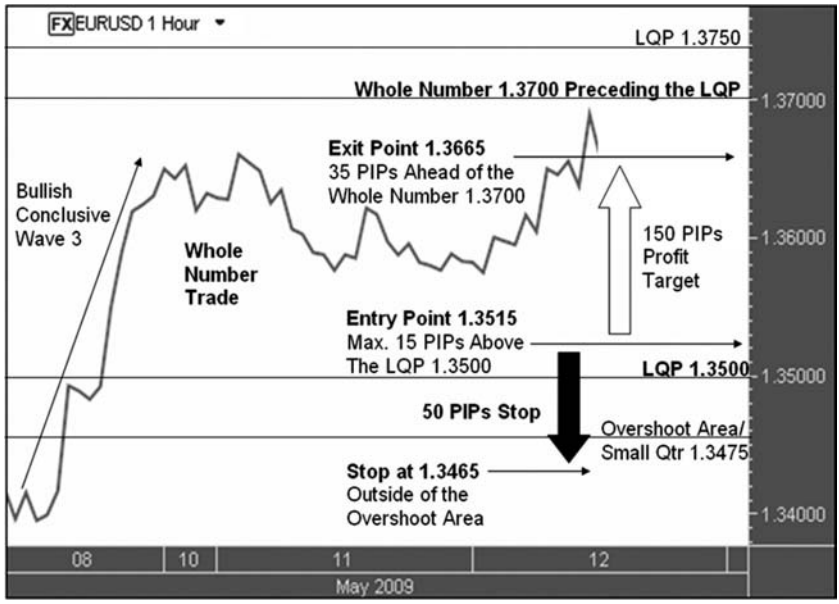

FIGURE 5.25 Whole Number Trade

Number Reversal Trades. The objective of Whole Number Reversal Trades is to capture the majority of the reversal price moves. Although the profit targets of Whole Number Reversal Trades may differ depending on the type of Large Quarters, all Whole Number Reversal Trades follow the same conservative parameters. Each Whole Number Reversal Trade should have an entry point no farther than 15 PIPs from a Whole Number preceding a Large Quarter Point that serves as a starting point of the reversal preventing the successful completion of a Large Quarter. To achieve more consistent results and easier order fills, an exit point should be set 35 PIPs ahead of the targeted Large Quarter Point during the reversal. This equals a conservative profit target of 150 PIPs for each Whole Number Reversal Trade. To avoid being triggered during overshoots of the Whole Number preceding a Large Quarter Point, the stops must be positioned outside of the Overshoot Area 25 PIPs above or below the Whole Number preceding a Large Quarter Point that serves as the starting point of a Whole Number Reversal Trade. To ensure that, the stops of the Whole Number Reversal Trades should be placed up to 50 PIPs away from the entry point. Based on these parameters, Whole Number Reversal Trades are designed to offer a 3:1 risk/reward ratio.

Opportunities for Whole Number Reversal Trades are identified using the methodology of the Quarters Theory and The Quarters Theory Trend

Waves combined with technical analysis. Major support/resistance levels coinciding with the Whole Number preceding a Large Quarter Point and early warning signs of potential reversals can be recognized by examining the daily and the one-hour charts for trend-reversal patterns—double or multiple tops/bottoms, head and shoulders, and so forth—as well as for signs of a Trend Wave Failure in close proximity to the Whole Number preceding a Large Quarter Point. For example, let us use the same daily chart analyzed previously, which shows the EUR/USD in a strong bullish trend wave cycle that challenges the major Mid-Term Resistance coinciding with the Whole Number 1.3700 preceding the Large Quarter Point 1.3750 during Conclusive Wave 3 (see Figure 5.26). While Conclusive Wave 3 and the following Consecutive Wave 4 manage to target the resistance at the Whole Number 1.3700 preceding the Large Quarter Point 1.3750, they both fail to produce a breakout and respectively fail to complete the Large Quarter 1.3500 to 1.3750. Moreover, the short-lived Consecutive Wave 4 is followed by another Consecutive Wave 5, which fails to break above the high of the previous wave. The failure of Consecutive Wave 5 ends the bullish trend wave cycle and signals a corrective reversal that begins with a bearish Reversal-Trigger Wave 1. Another sign that confirms the reversal is the development of a head-and-shoulders pattern where the high of Wave 3

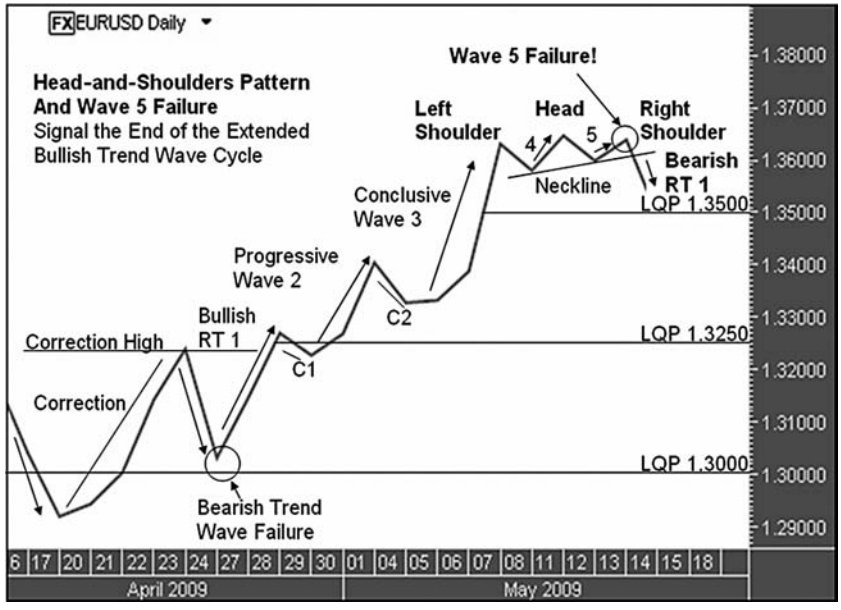

FIGURE 5.26 Identifying Whole Number Reversal Trade Opportunities

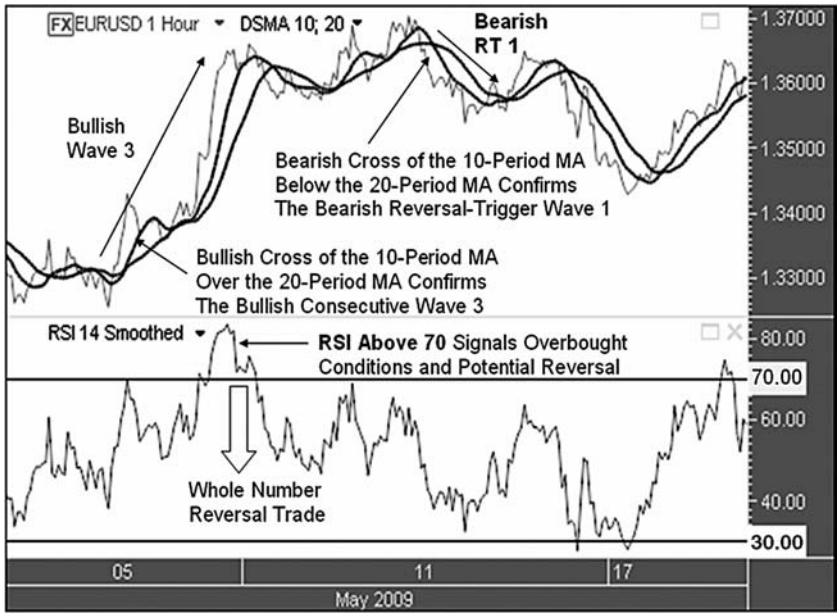

FIGURE 5.27 Technical Indicators Signaling Whole Number and Whole Number Reversal Trade Opportunities

serves as the left shoulder, the high of Wave 4 is the head, and the high of Wave 5 is the right shoulder. The reversal and the bearish Reversal-Trigger Wave 1 are also confirmed by the bearish breakout below the neck of the head-and-shoulders formation.

Technical indicators can offer useful confirmation and early warning signals of reversals when analyzing potential opportunities for Whole Number Reversal Trades. In Figure 5.27, while a bullish cross of the 10-period moving average over the 20-period moving average confirms the strength of the bullish Conclusive Wave 3, a bearish cross of the 10-period moving average below the 20-period moving average offers the necessary confirmation of the reversal as a result of the resistance encountered at the Whole Number 1.3700 and the development of the bearish Reversal-Trigger Wave 1. The RSI indicator reading above 70 signals overbought conditions and provides the early warning sign of potential reversal.

An even closer look, using the one-hour chart of the EUR/USD pair in Figure 5.28, shows multiple failed attempts for a breakout above the major Mid-Term Resistance coinciding with the Whole Number 1.3700 preceding the Large Quarter Point 1.3750. Another important warning sign of a possible reversal that could occur as a result of the unsuccessful completion

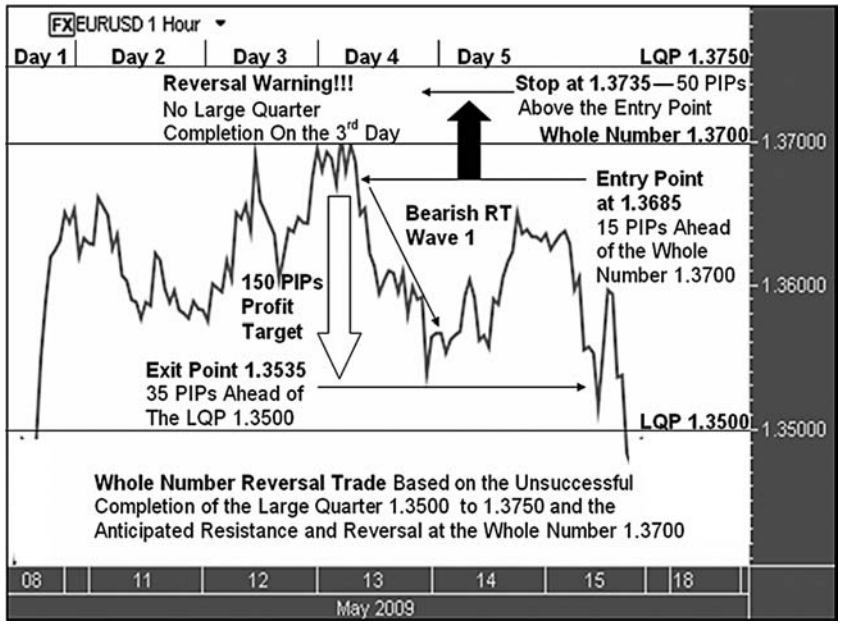

FIGURE 5.28 Whole Number Reversal Trade

of the Large Quarter 1.3500 to 1.3750 can be recognized by applying the Three-Day Rule of The Quarters Theory to confirm that the Large Quarter has not been completed by the end of the third trading session since the transition of prices into the Large Quarter 1.3500 to 1.3750. All of the above examined trend developments, price patterns, and technical indicators reveal the potential for a Whole Number Reversal Trade that may be established with the following conservative parameters. An entry point may be placed at 1.3685 (15 PIPs ahead of the Whole Number 1.3700, which serves as the starting point of the reversal after the unsuccessful completion of the Large Quarter 1.3500 to 1.3750). The exit point could be set at 1.3535 (35 PIPs ahead of the target during the reversal Large Quarter Point 1.3500). These parameters would result in a conservative profit target of 150 PIPs. The stop may be placed at 1.3735 (50 PIPs above the entry point, outside of the Overshoot Area 25 PIPs above the Whole Number 1.3700). This would prevent the stop from being triggered during overshoots of the Whole Number 1.3700 preceding the Large Quarter Point 1.3750.

Glossary of Terms

3-Day Rule of The Quarters Theory The 3-Day Rule of The Quarters Theory requires a Large Quarter to be completed in a time period lasting no longer than three trading days. The Quarters Theory allows three 24-hour trading sessions on the global Foreign Exchange market as a sufficient time period for the completion of a Large Quarter. A failure to complete a Large Quarter in three trading days should be considered as a sign of price weakness and potential exhaustion that could lead to the unsuccessful completion of the Large Quarter, resulting in a reversal back towards the preceding Large Quarter Point.

100 PIP Range The range between each two Whole Numbers equal to 1 cent, 1 penny, 1 centime, 1 Yen, and so forth, represented in terms of Price Interest Points.

1000 PIP Range The range between each two Major Whole Numbers equal to 10 cents, 10 pence, 10 centime, 10 Yen, and so forth, represented in terms of Price Interest Points.

1000 PIP Range Completion Series of price moves from one Large Quarter Point to another, producing multiple Large Quarter Completions in a systematic effort to complete an entire 1000 PIP Range between two Major Large Quarter Points/Major Whole Numbers.

1000 PIP Range Transitions Price moves that transition currency exchange rates from one 1000 PIP Range to another.

Bearish Overshoot A bearish price move of up to 25 PIPs below a Large Quarter Point that remains within the range of the Overshoot Area below the Large Quarter Point.

Bullish Overshoot A bullish price move of up to 25 PIPs above a Large Quarter Point that remains within the range of the Overshoot Area.

Conclusive Wave The third trend wave in The Quarters Theory Trend Waves Cycle. The Conclusive Waves may be shorter in length compared to other trend waves and price moves may be limited. The Conclusive Waves may signal exhaustion and may become the final phase of a bullish or bearish Quarters Theory Trend Waves Cycle.

Consecutive Wave Each new trend wave that follows the Conclusive Wave and extends the trend beyond an Ideal Quarters Theory Trend Waves Cycle. The Consecutive Waves are indicative of a strong trend, but they are also a warning sign that the existing trend has become extended and may be due for a more significant price correction.

Correction (Trend Wave Consolidation) A corrective price pattern in the opposite direction of a previously established Quarters Theory Trend Wave.

Currency Decimalization The process of dividing one unit of the main currency into 100 sub-units. For example, 1 Dollar and 1 Euro are divided into 100 cents, 1 pound into 100 pence, 1 franc into 100 centime, etc.

Decimal Whole Numbers Digits that have a decimal point which indicates the start of a fractional part (1.1, 1.2, 1.3). Digits are placed to the left and right of a decimal point in order to indicate a number less or greater than 1. The precision needed to represent currency exchange rates requires the use of decimal whole numbers.

Elliott Wave Theory A theory by Ralph Nelson Elliott which proposes the repetition of market cycles based on optimistic and pessimistic patterns of human behavior. The Elliott Wave Theory divides the financial market cycles into fractional patterns, called “waves”.

End of the Hesitation Zone The price point that marks the end of the Hesitation Zone, exactly 75 PIPs above or below a Large Quarter Point.

Extended Quarters Theory Trend Waves Cycle A Quarters Theory Trend Waves Cycle consisting of more than three bullish or bearish trend waves in the same direction.

Extended Trend Waves Bullish or bearish Quarters Theory Trend Waves lasting for more than five consecutive time periods (minutes, hours, days, weeks, months).

Half Point The exact middle point of each 100 PIP Range that also coincides with a Small Quarter Point (Ex.: 1.2950, 1.3050, 1.3150 . . .).

Half Point of a Large Quarter The exact middle price point of a Large Quarter. The Half Point is positioned exactly 125 PIPs from each one of the Large Quarter Points that define a Large Quarter.

Half Point Reversal Trade The Half Point Reversal Trade is a Quarters Theory trade that capitalizes on the reversal price moves that take prices from the Half Point of a Large Quarter back to the preceding Large Quarter Point.

Half Point Trade The Half Point Trade is a Quarters Theory trade based on the price moves from a Large Quarter Point targeting the Half Point of a Large Quarter.

Hesitation Zone The range of 75 PIPs above or below a Large Quarter Point. The Hesitation Zone is formed by the first three Small Quarters of 25 PIPs of each Large Quarter. The positioning of the Hesitation Zone depends on the direction of the price move - if prices move above a Large Quarter Point, the Hesitation Zone

will be 75 PIPs or three Small Quarters above a Large Quarter Point, if prices move below a Large Quarter Point, the Hesitation Zone will be 75 PIPs or three Small Quarters below a Large Quarter Point.

Hesitation Zone Reversal Trade The Hesitation Zone Reversal Trade is a Quarters Theory trade based on reversal moves that take prices from the End of the Hesitation Zone 75 PIPs above or below a Large Quarter Point back to the preceding Large Quarter Point.

Hesitation Zone Trade The Hesitation Zone Trade is a Quarters Theory trade that takes advantage of the price moves targeting the End of the Hesitation Zone 75 PIPs above or below a Large Quarter Point.

Ideal Quarters Theory Trend Waves Cycle A Quarters Theory Trend Waves Cycle consisting of three bullish or bearish trend waves in the same direction.

Important Price Points within the Large Quarters The important price points within the Large Quarters are: the End of the Hesitation Zone, the Half Point of a Large Quarter, the Whole Number Preceding a Large Quarter Point, as well as any major Short, Mid, or Long-Term support/resistance levels positioned within the range of a Large Quarter.

Inverse Large Quarter Trade The Inverse Large Quarter Trade is a Quarters Theory trade that capitalizes on counter-trend reversal price moves from one Large Quarter Point targeting another Large Quarter Point, leading to the successful completion of a Large Quarter.

Large Quarters The Quarters Theory divides the 1000 PIP Ranges between the Major Whole Numbers in currency exchange rates into four equal parts, called "Large Quarters". Each 1000 PIP Range contains four Large Quarters and each Large Quarter has exactly 250 PIPs (1000 PIP Range / 4 = 250 PIPs).

Large Quarter Completion A price move from one Large Quarter Point to another that reaches the vicinity of at least 25 PIPs (one Small Quarter) from the targeted Large Quarter Point.

Large Quarter Corrections Reversal Large Quarter price moves triggered by over-bought/over-sold conditions as a result of series of multiple Large Quarter Completions.

Large Quarter Points The numbers that mark the beginning and the end of each Large Quarter (Ex.: 1.3000, 1.3250, 1.3500, 1.3750, 1.4000 . . .).

Large Quarter Reversal A reversal price move that develops as a result of an unsuccessful completion of a Large Quarter, taking prices back towards the preceding Large Quarter Point.

Large Quarter Trade The Large Quarter Trade is a Quarters Theory Trade that takes advantage of the price moves from one Large Quarter Point targeting another Large Quarter Point, leading to the successful completion of a Large Quarter.

Large Quarter Transitions The transfer of prices from the 250 PIP range of one Large Quarter into the 250 PIP range of another Large Quarter.

Major Half Point The exact middle point of each 1000 PIP Range (Ex.: 1.15, 1.25, 1.35 . . .). Each Major Half Point is also a Large Quarter Point.

Major Large Quarter Points The Large Quarter Points that coincide with Major Whole Numbers (Ex.: 1.00, 1.10, 1.20, 1.30 . . .). The Major Large Quarter Points represent critical junctions that mark the end of a previous, and at the same time, the beginning of a new 1000 PIP Range.

Major Small Quarter Points The Small Quarter Points that coincide with Whole Numbers (Ex.: 1.31, 1.32, 1.33 . . .). The Major Small Quarter Points represent critical junctions that mark the end of a previous, and at the same time, the beginning of a new 100 PIP Range.

Major Whole Numbers The Quarters Theory gives the name "Major Whole Numbers" to the first numbers in each row of the table of whole numbers (10, 20, 30, . . . 100 . . .) The Major Whole Numbers represent a critical junction that marks the end of a previous, and at the same time, the beginning of a new set of ten numbers.

Overshoot Area The range of one Small Quarter of 25 PIPs above or below (for downward price moves) a Large Quarter Point.

Overshoot Reversal Trade The Overshoot Reversal Trade is a Quarters Theory trade that takes advantage of the reversal price moves that take prices from the end of the Overshoot Area 25 PIPs above or below a Large Quarter Point back to the preceding Large Quarter Point.

Overshoot Trade The Overshoot Trade is a Quarters Theory trade that capitalizes on overshoot price moves targeting the end of the Overshoot Area 25 PIPs above or below a Large Quarter Point.

Price Price represents the monetary value assigned to goods, services, and assets. In the financial markets, price is the numerical monetary value of equities, commodities, currencies, and other financial assets, determined as a result of an exchange or trade transactions between market participants. Price is measured by numbers grouped as mathematical objects in a numeral system.

Price Interest Point (PIP) A PIP is the smallest unit of price for any foreign currency (e.g., for EUR/USD one PIP- Price Interest Point equals .0001 US Dollars). Whether the sub-unit is 1 cent, 1 penny, 1 centime, or 1 yen- each has 100 PIPs. 10 cents, 10 pence, 10 centime, or 10 yen have 1000 PIPs. 1 Dollar, 1 Euro, 1 Pound, 1 Franc, or 100 Yen have 10,000 PIPs, etc.

Progressive Wave The second trend wave in The Quarters Theory Trend Waves Cycle. The Progressive Waves are capable of progressing and extending an existing trend further.

Reversal-Trigger Wave The first trend wave that marks the beginning of each new Quarters Theory Trend Waves Cycle. The Reversal-Trigger Waves usually develop in an attempt to reverse a previously established trend. These trend waves can "trigger" a corrective trend pattern or could signal the beginning phase of a complete trend reversal.

Shortened Quarters Theory Trend Waves Cycle A Quarters Theory Trend Waves Cycle consisting of less than three bullish or bearish trend waves in the same direction.

Sign of Strength Bullish price behavior that causes prices to sustain at or above a Large Quarter Point.

Sign of Weakness Bearish price behavior that causes prices to remain below a Large Quarter Point.

Small Quarters The Quarters Theory divides the 100 PIP Ranges between two whole numbers in currency exchange rates into four equal parts called "Small Quarters". Each 100 PIP Range contains four Small Quarters and each Small Quarter has exactly 25 PIPs (100 PIP Range / 4 = 25 PIPs).

Small Quarter Points The numbers that mark the beginning and the end of each Small Quarter (Ex.: 1.3000, 1.3025, 1.3050, 1.3075, 1.3100 . . .).

Small Quarter Price Moves Currency exchange rate fluctuations in an orderly series of price moves from one Small Quarter Point to the next, measured in increments of 25 PIPs, in a systematic effort to complete an entire Large Quarter of 250 PIPs.

Stop (Stop-loss) Order An order to close a trade at a predetermined price level in order to avoid or limit losses.

Sub-Unit Decimalization The process of dividing the sub-units (1 cent, 1 penny, 1 centime) or the main unit of some currencies (e.g. 1 Yen) into 100 additional sub-units, called "Price Interest Points" or PIPs.

The Quarters Theory A theory based on the premise that currency exchange rates fluctuate in an orderly manner between the Large Quarter Points within each 1000 PIP Range defined by two Major Whole Numbers (Major Large Quarter Points). The Quarters Theory proposes that every significant price move in currency exchange rates takes place from one Large Quarter Point to another, in gradual increments of 250 PIPs - the range between two Large Quarter Points.

The Quarters Theory Trades Trades based on the methodology of The Quarters Theory. The Quarters Theory Trades that take place within the familiar, constant Large Quarter ranges of 250 PIPs.

The Quarters Theory Trend Waves A trend recognition method based on the Elliott Wave Theory that focuses on proper recognition of bullish and bearish market cycles and patterns, called "trend waves".

The Quarters Theory Trend Waves Cycle Bullish or bearish trend pattern consisting of recognizable series of Quarters Theory Trend Waves and price Corrections.

Time Stops Stop-loss orders that can be set not only by using time. Time stops provide a clearly defined period of time for each trade to reach its objective. If a trade does not accomplish its goal in the specified time period, the trade may be closed to either lock in profits, or to avoid or limit losses.

Trader Objectives of The Quarters Theory Trades The Objectives of The Quarters Theory Trades can be classified in two main categories: Large Quarter Completion Trades that take advantage of the significant price moves in currency exchange rates from one Large Quarter Point to another, and Intra-Large Quarter Trades that capitalize on the smaller price moves between the important price points within a Large Quarter.

Trade Types The Trade Types of The Quarters Theory Trades are chosen depending on the Trade Objectives of The Quarters Theory Trades. If a trade has as its objective the completion of a Large Quarter, the trade types chosen may be: Large Quarter Trade or Inverse Large Quarter Trade. If a trade's objective is to capitalize on the price moves within a Large Quarter, the suitable trade types would be: Hesitation Zone Trade/Hesitation Zone Reversal Trade, Overshoot Trade/Overshoot Reversal Trade, Half-Point Trade/Half-Point Reversal Trade, Whole Number Trade/Whole Number Reversal Trade.

Trend Wave Failure The inability of a Quarters Theory Trend Wave to progress the existing trend further. Trend Wave Failure usually leads to an attempt for a trend reversal with the development of a Reversal-Trigger Wave in the opposite direction of the previously established trend.

Undershoot A price move that reaches the Undershoot Area within one Small Quarter of 25 PIPs from a Large Quarter Point but comes short of "hitting" the exact number of the targeted Large Quarter Point.

Undershoot Area The range of one Small Quarter of 25 PIPs ahead of a Large Quarter Point.

Unsuccessful Large Quarter Completion A price move from one Large Quarter Point to another that fails to reach the vicinity of at least 25 PIPs (one Small Quarter) from the targeted Large Quarter Point.

Whole Numbers The whole numbers include the number zero and all of the counting numbers.

Whole Number preceding a Large Quarter Point The Whole Number ahead of a Large Quarter Point that could become the last support/resistance price point that may prevent the successful completion of a Large Quarter.

Whole Number Reversal Trade The Whole Number Reversal Trade is a Quarters Theory trade that capitalizes on the reversal moves that take prices back to the

preceding Large Quarter Point as a result of a reversal at the Whole Number preceding a targeted Large Quarter Point.

Whole Number Trade The Whole Number Trade is a Quarters Theory trade that takes advantage of the price moves within a Large Quarter, beginning from a Large Quarter Point targeting the Whole Number preceding another Large Quarter Point.

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Praise for

THE QUARTERS THEORY

"Having a trading plan is essential for every trader. Reading Ilian Yotov's *The Quarters Theory* and understanding its unique premise could help you formulate better your own trading plan for the currency markets."

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An inside look at an innovative Forex trading system

The Quarters Theory improves and simplifies the decision-making process in foreign exchange trading through the use of a revolutionary new method applied to the price behavior of currency exchange rates and trend developments in the Forex market. This book provides currency traders with a step-by-step guide to the unique premise of *The Quarters Theory*, and offers many real-life market examples, variations, and innovative Forex trading strategies.

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