CHANNEL SURFING

Riding the Waves of Channels to Profitable Trading

Written by Michael J. Parsons

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CHANNEL SURFING

In my work of researching and writing about advanced methods of trading, I was asked for a simple method for entries and exits. Because of that request, I wrote a basic outline for a method that I originally called Channeling. Since writing about Channeling, I have received a few requests to expand on this subject because many who have tried this method have found it to be a very solid and practical way to trade the market.

In one request, I was asked where one could go for more information on this subject. Much to the dismay of this person I had to admit that aside from what I had already written and some basic techniques mentioned by a few others, there were very few good sources that I could refer this trader to.

This brought home to me the fact of how much this method has been overlooked, even though it is obvious that there are many in this business that use it in one form or another. My own knowledge of this method was originally derived with some basic writings of other writers and expanded on through trial and error, and of course, experience. Today, my own use far exceeds the basics that I have seen written on the subject.

So, while Channeling is not the focus of my work when it comes to trading research (because I consider it basic), I know the value of using it and thought it would definitely be beneficial to expand a little further on this technique.

Additionally, instead of referring to this method as Channeling, I now believe it is better described as Channel Surfing.

In many ways it’s like a surfboard riding a wave. Once the wave slips away from the surfboard, it’s time to find a new wave to ride. Channel lines are your surfboard and price your wave. As long as your surfboard rides the price wave then just hold on for the ride.

Channel Surfing is simply using Channels to set parameters for the price movement. For those of us that are mathematically impaired, this is very graphical way to determine what floor traders do every day, the markets expected range. The value of this is that you have a gauge where the market is expected to go and if it exceeds that, than you are alerted to a change of a markets condition.

Here is how it works. Whatever way the market is moving and based on the highs or lows, you draw a trend line along the price bars. On the other side of the price movement, you draw a similar trend line and thereby, create a Channel. In effect you have put a fence on the price movement and have a visual range parameter. Each tick that follows should be within that Channel. Whenever the price bars exceed that Channel in either direction, then it is time to take action.
Notice in Figures 1 and 2 how a Channel is drawn and how there is an inner and outer Channel that reverses roles depending on whether you are in a bull or bear market (going up or going down)

**FIGURE 1**

**FIGURE 2**
So now that we have a basic idea as to how a Channel is drawn, how do we use it?

The Channel is our guide for making our trading decisions. As long as the market price bars remain within the Channel, then our trading decisions remain in force. But as soon as the market price bars extend outside the Channel, then it is time for a new trading decision.

For example, lets say that you were in this market and the market slows and extends outside the upper resistance line in a bear (down) trend. My plan here would be to get out as soon as it does this because this normally signals that the market has gone into a sideways pattern or reversed.

Take a look at Figure 3. In this chart, I have entered a trade by shorting (selling) a contract at the point it breaks a support line. As it drops, I draw Channel lines. Notice how the market has extended outside of the inner Channel. If you were still in a trade at this time, you would then exit.

FIGURE 3
But what if it extends pass the other Channel line instead? When it does this, in a large percentage of the time it ends up becoming what is called a spike and the market reverses direction. Therefore, I would still exit a trade. Notice Figure 4 and what happens.

**FIGURE 4**

By doing it this way we are able to lock in a higher amount of profit from our trade.

If you are able to watch a market during actual trading times and come across this situation, when it exceeds this line you can follow it up until it finally reverses or at the close of the day and lock even more profit.

Personally, I will look for a move that is at least 50% of the total range above the upper Channel. But even if you just set a stop above the line and below the lines each day, when it hits the stop it will lock in your profit without putting you at undue risk. Just make sure your broker understands that if one stop is hit that it cancels the other stop, otherwise you will end up entering the market when you do not want to.

Of course, it is true that when the market exceeds your outer Channel line that it is accelerating and from the perspective of most traders, this seems great. So why would you want to exit at this point? Won't you miss a lot of profit?
Yes, to some degree you will. But look at it realistically. What happens in the majority of instances when it exceeds the outer Channel? It ends up being a reversal. If you had tried to hold onto your position in hope that it will continue accelerating, most often you will lose much more of your profit than you could ever have gotten chasing the quick movers.

(A word of caution here. When a strong market exceeds the outside Channel, it gives you a sign for exiting your position, not reversing. If the market should continue and gap, the result could be a substantial loss. Discretion is the better part of valor)

Initially, as a trend begins and the support or resistance line is established you will have a question where to place the outside channel line so you know how far it should travel. The simple solution is to use a line from the first high or low that is the same angle as the trend line. They run parallel to one another and this is way it should be anyway.

In Figure 5, I have simply taken the Channel line created by the supporting trend line and duplicated it. I then placed it at the same exact angle on the high and this completes my Channel. This gives me a start to work with and as other highs are established I can adjust my Channel line accordingly.

**FIGURE 5**

Once one line (1) is established with a minimum of two points, you can easily figure the parallel line by duplicating the angle of the first line and placing it at the point that is showing (2)
Channel lines are very flexible and can be adapted to all time frames. Later, I will show you how to adapt to various time frames, but for now take a look at Figure 6 and see how Channel lines can be adjusted for a market's change in acceleration. This is an important aspect of Channel lines that allows you to always be one step ahead of the market.

Narrowing as the market accelerates allows you to closely monitor your trading and protects your profits, as well as reducing losses.

**FIGURE 6**

Always look for multiple price bars for your resistance and support lines. By this I mean look for multiple highs and the lows to draw your Channel lines. While you can draw them from just two highs or two lows, the greater the number of bars that support a trend line, the stronger these lines will be.

The following charts will help to explain how to use Channel Surfing in determine entries and exits. As you review them, look for ways that you could apply these principles to other charts.
FIGURE 7

I would be looking to get out of a long position here because it has going beyond the trendline.

Notice how the market dropped after the break.

FIGURE 8

Even more preferable - exiting when the market EXCEEDS the opposite channel line.
FIGURE 9

But the market continues to rise!

Here the market exceeds the upper trend line and you exit

And a new trend line is established

Simply reenter!
In fact, the upper trendline often becomes support as it did in this case!

FIGURE 10

Canadian Dollar (Sep. 2001) [Delay10], 60 minute

Exit Longs and go Short

Exit Shorts and go Long
Before I cover new ground on this subject, I think it would be appropriate to review some of the key points that we have just learned. First, Channel Surfing involves the drawing of a trend line in any trend that develops. A trend line is drawn off of either a series of highs or lows. A trend line acts as a support or resistance that keeps the price moving up or down. (I refer to this as the inner line) Additionally, a line is drawn on the opposite side of the trend using the highs or lows of the price bars as your opposing trend line. (I refer to this as the outer line) These two lines act as a fence that will Channel the price in a particular direction. This direction can be up, down and in the case of a trading range, sideways.

The rules that I established previously include that when either line is broken, then any position held would be closed or exited, even if the line broken is the outer line. The reason given was because when the outer Channel line is broken it usually signals a reversal or pullback. This exit rule would apply to all styles of trading, whether aggressive or conservative. This can be accomplish relatively easy when placing orders by establishing two stops that follow both of these lines with a cancel to the other order when one is filled.

In the case of an aggressive trader, entry can be made as soon as a Channel line is broken. A more conservative trader would wait until a Channel line is established and the price returns to the inner line that is pushing the price up or down to enter then (my preference in most cases). A very conservative trader could wait until a breakout occurs with the price exceeding a previous high or low before a new entry.

In any case, in many ways it’s like a surfboard riding a wave. Once the wave slips away from the surfboard, its time to find a new wave to ride. Channel lines are your surfboard and price your wave. As long as your surfboard rides the price wave then just hold on for the ride.

Now that we have reviewed the previous points covered, we can cover new ground.

At this point it would be good to clarify something in regards to your own personal trading. You will have to choose a time frame that you feel comfortable trading with.

This is an important and necessary decision. Why?

Because in Channel Surfing, the higher time frame that you are dealing with then the larger draw down you will at times experience. However, if you try to monitor a time frame too small for your comfort level (or time that you can devote to trading), then you will not be successful. After all, how can you trade intra-day channels if you can only monitor the market at the end of the day?
Once you determine what time frames you feel comfortable trading, then it becomes a simple process of drawing your trend lines. Please understand that what I am saying in regard to choosing a time frame that you feel comfortable trading with has to do with the smallest time frame you would choose, not the largest.

Also, don’t make the mistake of just monitoring one time frame. I personally know the value of trading multiple time frames. Larger time frames give you a much broader picture of what is happening in the market and will give you an edge on understanding what the market will do next and why. This will be one of the issues that I will cover in more detail later on.

For now, I want to show how Channel Surfing can be implemented in different situations. Look at this chart, which are taken from a daily cocoa chart. Notice how Channel Surfing is used to handle the various stages that develop.

**FIGURE 15**

What has been applied here with this daily chart will work with whatever time frame you are using. If you were trading intra-day, your trading would use the same rules with 30 minute, 10 minute, 5 minute, 1 minute or any other time frame that you prefer. So don’t let the fact that you are trading some odd or small time frame distort your thinking so that you feel these rules do not apply. They are simple and reliable.
There are a number of advanced aspects that we will now look at related to using this method. They include:

1 - Channel lines reversing positions
2 - The breaking of Channel lines at major price levels
3 - Widening and narrowing of Channel lines
4 - Multiple time frames and Channel lines
5 - Calculating the numbers and setting stops that follow Channel lines.

As you implement these methods into your own trading, I am confident that they will help you improve your success.

**Channel Lines Reversing Positions**

While Channel lines provide a fence from where to gauge price action, it is important to always keep in mind that Channels are created by price action. Channels never dictate to Price action. To understand the huge difference that exists between these two views all we have to do is look at a surfer. He may expertly surf a wave, but he can never control the wave.

This is the case with price and Channels. Price sets its own parameters, but it is free to change those parameters any time it wishes. It is price that dictates where the Channel line will be, not the other way around. Just as a wave dictates when a surfer will ride. Even so, it is not uncommon for price to stick to the parameters established within Channel lines and when it changes direction, to initially use one of those previous Channel lines as a basis to make its change.

This phenomenon of using a previous Channel line is an important characteristic that can help you make better trading decisions. There are three areas in particular that you will often see this "switch" occur.

1 - When a reversal occurs
2 - When a market accelerates or decelerates
3 - When price trends shift

Understanding how price does this is a key element in entering a market in an optimal time.

As has been discussed before, the breaking of a Channel line is a warning sign to exit a position. For an aggressive trader, it can also be used to enter a market in the opposite direction at the same time he exits his previous position. Personally, I don't like to enter a market this way unless I am confident it is a strong reversal that will move very quickly. Instead, I like to wait for an indication that the market wants to move in a new direction and catch the initial pullback at its peak.
But, how do I know where the peak of that pullback will occur? Often, it is right at the previous Channel line!

**FIGURE 15**

Will it always do this? No, it won't. But it will try to with such regularity that a pullback toward the former Channel line is something that I expect to see. What my experience has taught me is that if price fails to return back to the Channel line then it will usually travel very rapidly in the direction of the new trend, in which case you can afford to not have the best entry price because it will already prove very profitable. In any case, you can use Channel Surfing to catch your ride on the next wave.

How long will I wait before I consider it too long to make it back to the Channel line? The rule is that a pullback will not exceed the high or low of the reversing peak or trough. To put it another way, if the market has broken upward, I should not see it come back and set a new low. The current low should remain the low. When the Channel line does exceed that level, then it is beyond the point of a pullback and if price should reach it, then the market hasn't reverse direction after all. It was just a pullback of the previous trend or is in a trading range.

Using the Channel lines in this way provides a stop of sorts and is practical in all time frames to verify a change in trend.
Market acceleration and deceleration is another way that price will jump sides on a \textit{Channel} line. Price often changes its momentum and while these changes can start entirely new \textit{Channel} lines, at times they will "borrow" even if only temporarily, a previous \textit{Channel} line in one way or another.

\textbf{FIGURE 16}

The advantage of this phenomenon is that it provides a point that you can use as a stop against a market that snaps back as quickly as it moved.
Trend shifts are another common occurrence in the market. They occur when a pullback extends further than normal and it "shifts" the entire price trend range. Sometimes this shift is much further than even the current Channel lines and an entirely new Channel is required. But often, you will see that price just "flips" sides on one of the previous Channel lines.

**FIGURE 17**

Remember, that once you have one line established, then the opposite line is generally a parallel of the first line. Since, in this case, your line is already well defined, it is just a matter of determining your first point for marking your opposite and new Channel line.

As you can see, Channel lines can be of use even when it seems price has left them in the past. What is even more remarkable is the many times that price will come back and use trend and Channel lines that it discarded a long time ago. It pays to not forget your old friends, the Channel lines.
Breaking Channel Lines at Major Price Levels
To keep from confusing you, I have repeating throughout my writings on Channel Surfing something that I am now going to contradict. All along I have been telling you that when price breaks a Channel line, even when it is going your way, then that is the time to exit any position that you have. I have stated that this is what I always do and this is true, except in one case.

Yes, there is an exception and this is one exception that I am sure you will be glad to know about. When a market breaks both an outer Channel line and a major price level at the same time. In essence, as the market breaks a major price level (support or resistance), greed and fear take over as price demonstrates it has enough force to break a difficult barrier and this much force usually carries price some distance. Because traders are so anxious to trade when it breaks a major price level, a flood of orders accelerates the price movement and breaks the Channel line in the process.

After all, if the market had enough force to break a major price level, then a Channel line (which has less resistance or support) is no match for this force either.

What this means is that when both actions occur at the same time, if you are in the market in the right direction, then all you have to do is hang on for a wild ride and some quick profits. Like a surfer that has been rewarded for his patience with a wave three times the normal size.

To get idea of what I mean, let's look at an example.

FIGURE 18
This situation makes for some nice moves, wouldn't you agree? So why didn't I tell you about this before?

Because, before you can do this you have to be able to determine major price levels. Without that skill, this trading opportunity is meaningless. So, do you have the skill to determine what a major price level is? It’s easy to say that it is where price has demonstrated a level of resistance or support in the past, but there is much more to determining these levels.

Here are a few rules that will help in this regard.

1 - The more times that a level has acted as support and/or resistance, the more important it becomes
2 - The very top or low of a market is always a major price level
3 - Minor tops and bottoms can also be major price levels. If these levels are broken, the next minor top or bottom becomes the next price level
4 - Somewhere in the center of the entire price movement (50% level) is a major price level. It can be identified by the several points of support and resistance it has had in the past.
5 - At the top of a large ascending triangle or the bottom of a large descending triangle is a major price level.

I am sure that there are more examples and rules for major price levels that I can refer to, but this is not an area that we need to go into detail here. There are many basic trading books that cover these areas and if you are still somewhat confused as to what a major support and resistance level are; it would be well worth you effort to consult one of them.

If however, you feel comfortable identifying major support and resistance levels, this can be a great exception to the rule to exit when the market exceeds the outer Channel.

**Widening and Narrowing of Channel Lines**

In the majority of cases when a Channel develops, two lines will run parallel to each other, maintaining the same distance apart until something changes in the market. Even when a change does occur, unless the trend changes direction, the Channel lines generally only change their distance from one another, while maintaining a parallel.

Naturally, there are exceptions to this and in this case, it’s not a rare occurrence. While it may generally follow the rules just mentioned, large percentages do alter their parallel of one another. Another words, one or both lines will angle closer or farther apart. In fact, a triangle is an example of Channel lines that are no longer parallel, but have angled themselves toward each another. The alterations in the angle of Channel lines give some added insight into where the balance of power exists in a market.
Most of us are familiar with the power of triangles, whether they are symmetrical, ascending or descending. Once the narrowing lines are broken, the price usually travels with some distance. What you may not know is that what is evident with triangles occurs with regularity in other ways that often will go unnoticed by the general trading population. But when you look at it from the perspective of Channel lines, these trading opportunities become much more clearer.

To illustrate how the unparallel lines affect the balance of power, notice the following diagrams.

**FIGURE 19**

<table>
<thead>
<tr>
<th>Both Channels the Same</th>
<th>Balance of Power is Equal</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Upper Line is Dropping</th>
<th>Bears Have More Power But Bulls Are Still Holding</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Lower Line is Rising</th>
<th>Bulls Have More Power But Bears Are Still Holding</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Neither Has More Power</th>
<th>But Pressure is Increasing</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Neither Has More Power</th>
<th>And Pressure is Decreasing</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Both Channels Down</th>
<th>Bears Have More Power</th>
</tr>
</thead>
</table>

| Both Channels Up       | Bulls Have More Power |
In these illustrations, you probably recognized the rules as the same you would use in dealing with triangles. This makes sense, because as earlier noted, a triangle is in fact two Channel lines that are non-parallel. The difference here is our application of these rules by applying them on a much larger scale and a greater variety of situations.

How do you interpret balance of power? Balance of power, as the term implies, gives an indication of who has the stronger influence on a market at a given time. If the indication is that the bulls are stronger, then it is an early warning that the market is more likely to rise. If the bears are stronger, then it is an early warning that the market is more likely to drop.

This is the value of interpreting the balance of power in Channel lines. The more subtle variations in the Channel lines that you can accurately read, the earlier you are alerted to the direction of the market and enter or exit at better prices, even if the market appears to most as indecisive.

In the next couple of charts, see if you can see the subtle indications that you can use to see who is winning (Bulls or Bears) at any given time.

**FIGURE 20**
A method used in trading that has gotten a lot of attention the past couple of years is candlestick charts (a method of determining balance of power based on the difference between open, high, low, and close that originated in Japan). Some spend a lifetime mastering this method of trading and such a method has many fine attributes. However, my own experience has taught me that Channel lines can more accurately determine balance of power and is easier to interpret, use and implement. I think that you will agree too as you use this method more and more.
Multiple Time Frames and Channel Lines
I am a big believer in the power of multiple time frames. Sometimes you can be too close to the trees to see the forest. Larger time frames reveal the big picture as to what is happening in the market, and of course, the strongest forces influencing it. However, trying to trade on commodities that have limited time contract durations with charts that are based on weeks, months and even years, is unrealistic. So smaller time frames are necessary if we want to trade profitably.

What difference does it really make to use multiple time frames? At any given day, I can look at my list of commodities and find many where the daily trend is in an opposite direction than the weekly trend. This may sound contradictory, but it is absolutely true! Take a look at a number of your favorite markets and compare the weekly chart to the daily chart and see if you can't find a few that do just that. What appears to be a full-blown trend in the daily chart will be nothing more than a pullback in a weekly chart.

Now, you might be saying that it really doesn't matter, because you only trade the daily charts. But to do that would be a mistake. Just as the daily charts have Channel lines that limit the price movement and affect the intra-day charts, so too the weekly charts and their Channel lines also limit the price movement of the daily chart.

Want to know when a trend will stop, a top or bottom will occur, when a market will take off? These are some of the things that you can determine by looking at weekly and monthly charts. Even if your preference is to trade the one-minute time frame, you will still greatly benefit from monitoring the daily and weekly time frames (as well as all the rest in between).

I could write an entire book just on the many ways you can use multiple time frames to improve you’re trading. Obviously then, I can't go as deeply into this subject as it deserves at this time, but I definitely want to cover at least a few points related to the advantages of monitoring multiple time frames. The good thing about this subject is that it really isn't that hard. By looking at multiple time frames as if they were a separate commodity or stock, doing an analysis and then comparing your findings with your other time frames, you have a much greater understanding of what is happening in that particular market. It’s just that simple.

But to make it even simpler, here are some examples of how it can be used. As you review these charts, remember that there is much more that could be said about these markets, but time and space currently only allows the minimum.
I hope you will explore the advantages of using multiple time frames. It will definitely multiply your profits.
Calculating the Numbers and Setting Stops That Follow Channel Lines

When a student asks me about a particular market, a question that I am often asked is, "What would you set the stop at?" Personally, I loathe this question even though I obviously have a stop in mind. The reason is that people tend to get hung up on numbers and I know that the market is in constant change, so in turn, stops are in constant change. Really, what difference does it make what I set a stop at on a given moment when it will change as the market changes. I know that this goes against everything that everybody seems to be taught in this industry. The rule is to always to set a stop to protect your self. I agree with that statement, but people have a bad habit in dealing with stops.

Some time ago I bought a rotisserie (a rotating cooking appliance) that was heavily advertised on television. The catch phrase that was used over and over was to, "Set it and forget it". People must love this type of convenience, because this became one of the best selling appliances ever of its type. Even I fell victim to this advertising campaign and bought one.

To be honest, the only person for whom this is truly a "Set it and forget it" appliance is my wife who refuses to learn how to use it and so all she has to do is "set" me up to using it and then SHE can "forget it". I think the catch phrase should have been "Set up your husband to cook the meals and you can forget about dinner and relax". That would have been a more honest advertising campaign and probably would have had all the wives in the United States buying one for their husbands to use.

What does this have to do with stops? People have a bad habit of "setting" a stop and "forgetting it". Maybe when it comes to stops we just have this vision of a stop sign that is planted into the side of the road at an intersection (Because it has to be at an intersection) and think that moving it would be breaking the law. Traders have the tendency to place stops at obvious locations and leaving them there and moving them much too slowly. Floor traders know the obvious locations for stops (They are at the trading intersections at key highs and lows) and if they can, will force a run on these stops.

This is a big mistake that traders habitually make. By handling stops in the commonly taught method, it is regularly costing traders by either missing profits that could have made and by having excess losses that they didn’t have to have. But what other way is there to place and move stops, you ask?

Stops should follow your Channel lines and move as your lines do. That means that in a trend, stops change regularly with every tick. Another words, if you trade using daily charts, your stops would change every single day. On top of this, you have an upper and a lower Channel line, which means that you have two stops to set, not just one. This is another area where you differ than most traders.
While may sound like a lot of work to figure out where to place your stops, in reality, with Channel Surfing it becomes a very simple process. You simply set your stops just outside of your Channel lines. With position or short-term trading, you would simply send in your stop orders everyday to your broker based on where your Channel lines are.

What if you are day trading and using a lower time frame such as 5-minute charts? In such a case, it would be redundant to send your broker a number for a stop, because any number that you would call in will be obsolete before it is activated. The simplest method in this situation would be to just watch your Channel lines and when it exceeds a line then take action. In essence, your Channel lines act as "stop lines".

Watching Channel lines may be great for the day, if you can't monitor the market action as it happens, then stop numbers become a necessity. So how do you set you stops if they are changing every day? It is a simple calculation that can be done by hand or more conveniently, by using a spreadsheet to calculate the numbers for you. While you can apply this method to any time frame, for simplicity we will just demonstrate how to do this with a daily chart.

First, the only daily bars that we will be using are the ones that are used for drawing your Channel lines. Looking at our example chart, we have a trend where the Channel lines are already drawn. I have taken the liberty of writing the highs and lows (H=high & L=low), as well as the dates (month & day), of the bars that are touching either Channel line. (If a high or low is not touching a Channel line, there is no need to make a notation).

**FIGURE 27**
What we are after is the price change on the Channel line per day. Once we have this figure, then all we have to do is add (or subtract) this figure to know the limit of the Channel line for the next day.

For example, in the case of a supporting Channel line, we would take the lows that have touched the line and calculate the difference between the low and the date. The elements of the calculation look like this:

A=1st low's price  
B=2nd low's price  
X=1st low's date  
Y=2nd low's date  
Z=Amount to add or subtract per day

Based on these elements, the calculation is: \( Z = \frac{(B-A)}{(Y-X)} \)

Another words, I would subtract the 1st low's price from the second low's price, giving me the difference in price. The subtracting the 1st low's date from the second low's date gives me the difference in days between the two lows. I would then divide the point difference by the days and come up with the points to add or subtract from each day to continue the Channel line.

The upper Channel line would be calculated the same way, only using the highs that touched the upper Channel. Of course, if you were dealing with a Channel that was bearish, then subtraction would be reverse. The calculation would look like this: \( Z = \frac{(A-B)}{(X-Y)} \). So the only difference would be reversing the order of A and B and also switching the order of X and Y. (Note: You are always subtracting the lowest number from the highest to obtain the difference)

Having established the calculation of the Channel lines and using the highs, the lows and the dates from our previous chart (Figure 27), let us determine what the stops will be for the next several days.

Starting with our inner Channel line (Supporting trend line), we have the following:

\[ 36.05 - 34.4 = 1.65 \]

\( (2^{nd} \text{ L})-(1^{st} \text{ L})= \text{Price Difference} \)

\[ 7/9 - 7/2 = 4 \text{ Days} \text{ (Take out any non-traded days. Here, July 4}\text{th [a holiday] and two weekend days mean 3 days had to be subtracted)} \]

\[ 1.65 / 4 = .4125 \text{ (Daily Price Difference)} \]
Based on these calculations, simply add .4125 to each day and you have your Channel line calculated. The day following your last date (7/9) should have no lower low than:

\[36.05 + .4125 = 36.4625\]

Simply add .4125 for the following days, which would be: 36.8750, 37.2875, 37.700 and so on.

Simply set a stop just below this number and follow it with a new calculated stop each day.

Calculating the upper Channel line is just as easy.

\[39.45 - 38.1 = 1.35\]
\[\frac{7/9 - 7/6}{3} = .45\]

Based on these calculations, simply add .4125 to each day and you have your Channel line calculated. The day following your last date (7/9) should have no higher high than:

\[39.45 + .45 = 39.90\]

Simply add .45 for the following days, which would be: 40.35, 40.80, 41.25 and so on.

In this particular case, you will notice that the numbers are slightly different. That is not unusual, because even though the Channel lines are parallel, quite often they are not perfectly so.

Now that we know how to calculate the numbers for our Channel, we need to determine our stops. Why would we not just simply use the numbers we have already calculated? Because these are the numbers of the Channel lines and we are expecting price to return to this line. So it will naturally hit our numbers. Price has to actually break a Channel line (or exceed our numbers) to signal a change in trend. So how much breathing room do we allow?

This depends on how aggressive you want to trade. You can set your numbers at the very minimum price movement above or below your Channel lines. In the T-Bond for example, the minimum price movement allowed is 1/32 of a point. So if you have a supporting Channel line number at 36 7/32, then you could set a stop at 36 6/32 (This would actually be entered as 36 3/16).
In the case of a market that becomes volatile at times, you may want to allow a little extra room. For example, with the S&P you may want to allow a full one point or more above or below your Channel numbers.

So how do you determine which is right for you. You may want to do what I normally do when approaching a market that I don't normally trade. Set your stops at the previous day or following day Channel numbers (Depending on whether you are in an up trend or down trend and which Channel line you are looking at) and adjust as needed. So that you are not confused by the way that I just explained this, lets look at the numbers based on our previous calculation.

Since our inner Channel line has a next day low of 36.05 + .4125 = 36.4625, then our stop could be set at the previous day’s low which just happens to be, you guessed it, 36.05. It can’t get any simpler than that.

For our outer Channel line, we take our calculation 39.45 + .45 = 39.90 and add for the next day .45. So the calculation becomes: 39.90 + .45 = 40.35. That wasn’t too hard either, was it?

Setting your stops by this method is a good way to start out and allows you to gauge a market to see which way you might need to adjust them in the future. Just remember that this method is not written in stone and you will still need to gauge a market based on the current conditions and your tolerance to risk.

**Repetition of Channel Lines**

Years before the advent of computer trading, there was a great deal of research in repetitive geometric patterns in the markets. Much of this research has long been forgotten by the generally public, although a few tidbits have survived and are used even today. While many know the names of Gann, Elliott, and Wyckoff, most would have no idea who Richard Ney, James West, J. D. Hamon, Dr. Andrews or a host of others who have come and gone were, much less their contributions to trading.

Incredibly, some of these contributions still remain remarkably effective today even against many-advanced computer trading programs. Yet, aside from a few books from Hamon and of course, Dr. Andrews well-known pitchfork (although there still is a course presently available on the internet of Dr. Andrews works) practically all has been forgotten or ignored by the majority of traders today.

Making a rediscovery of these important works and expanding on them is where I find my own research constantly returning. In many cases, there is no need to reinvent the wheel, just improve the design. Many of these past researchers have developed some wonderful techniques for analyzing the markets and it is a shame that they and their work seem to have been all but forgotten.
What were some of these great contributions? One example comes from Richard Ney, who made the observation that trend lines tended to repeat the same angle, axis and spacing in a market over and over. To some degree, his work was an extension of Gann's, but had certain differences as its focus.

Like Gann, he recognized that the market had a geometry that repeated itself. This wasn't just a linear repetition either. Often this repetition shows up as diagonal pattern where Channels crisscross each other from two equal directions. While it is not necessary to point out what made Ney's work different from Gann's, it is well worth pointing out what both researchers revealed.

Before seeing Gann or Ney's works, I myself had made an observation thanks in part to a neat little indicator provided in Metastock (Metastock is a charting program) called a Gann grid. Because you could adjust the angles of this grid, you could easily see what Ney and Gann did. In the markets there often exists repeating Channels.

Take a look at one example of how this proves true by the use of a Gann grid. If you look closely at this chart you will see numerous examples of price following similar Channels.

FIGURE 28
This phenomenon of a repeating angles and spacing provide another valuable tool that are derived from the use of **Channels**. While there is a definite advantage to having a "Gann grid", all this really is a repeating set of **Channels** that can be drawn with the tools that are already available with most charting programs and can also easily be done by hand on printed charts.

Can you see the advantage of using these repeating **Channels**? So how do you draw them on your charts?

There are two ways that repeating angles show up. In the preferred way they are spaced evenly apart. This makes your trading decisions much easier and reliable. What this means is that when any two matching angle lines show up, you can literally draw line after line with the same exact angle and spacing apart.

**FIGURE 29**

This occurs more often then you may think. The process of drawing these lines is very easy. Once one line is drawn, simply copying the line and pasting them will bring the same angle up in most charting software. Then you just move the line to the appropriate location.

How do you determine this? Simply draw a horizontal line and count the days (or ticks) between each line. Once the count is known, then you simply draw another line at the same angle at equal intervals. The same process can be employed with the opposing lines.
While this symmetrical pattern occurs quite often, an unsymmetrical pattern occurs even more often. By this I mean that the price will often advance at the same repetitive angle, but not at the same spacing or distance apart. While this is a little more difficult to figure and anticipate, it is not hard and still proves very effective in helping you to make profitable decisions in your trading.

Again, we are looking for similar angles in price movement and even though they may not be the same distance apart, the mere fact that they are at the same angle gives you a guide for your Channel lines, entries and exits that are way ahead of normal indicators. Further, once these Channels are established, even if they are not equally spaced apart, they tend to remain in force throughout the market action.

**FIGURE 30**

Monitoring Channels and their extensions can be of great value. It is amazing how often some Channels will reappear later on even though price action may have left off using them for some time. Channel Surfing is a trading tool that keeps on giving!

As simple as Channel lines are, they provide a world of information regarding a market's balance of power. They simplify trading decisions and many times provide immediate notification of changes that either is occurring or about to occur. Make no mistake; there are many professional traders that know all too well the power of using these lines. Occasionally I will see a post on a trading forum from a trader that has "discovered" trend lines or some basic version of Channel Surfing and will encourage others to use this method. Usually, a post such as this never gets much of a response.
Channel Surfing remains among one of the least talked about and little used methods by a large percentage of traders. Perhaps, with the exception of the very basic elements, it is because so little is written about them or they are so misunderstood.

Whatever the reason, be glad so few know how to or care to know how to use Channel Surfing. This gives you an edge. And this can make all the difference in your trading success. Don't expect a lot of excitement from your peers about your new trading method, either. It doesn't sound as exciting as Gann, Elliott, Wyckoff, or any of the other latest and greatest systems or books being pushed by vendors. But what it is, is an effective method that can get you excited because of the profits that keeps rolling in.

I encourage you to test out this method to your hearts content. I am confident you will be amazed at how effective it is. Whether you adapt it to your current trading methods or use it as your sole means of trading decisions, may your trading prove profitable and vastly rewarding!

Trade well and be happy!