A Three-Frame Day

For the longest time as a commodities position trader, I was confused by day trading, especially day trading the S&P 500 futures contract. The lengthy trading period of nearly seven hours was itself an impediment to understanding the price action. The day's trading behavior patterns and events often seemed strung together at random, encouraging the deceptive practice of attributing trend direction to unfolding news events. There was no making any technical sense of it from one hour to the next. But it cleared up almost immediately when I began to view the day as divided into three separate and distinct trading sessions: the *1st Frame*, the *Midday Frame*, and the 3rd or *Last Hour Time Frame*.

These are just names. In truth, the periods don't last for exactly the same time each day. The 1st Frame of the day can last about 1 hour and 45 minutes, give or take about 20 minutes. The Midday Frame can last anywhere from about three to about three-and-a-half hours. And the Last Hour Time Frame gets whatever is left over, occasionally not distinguishing itself at all. Although traders often refer to this third period as the "last hour," I have found it to begin earlier and extend longer than the last hour of the trading day.

To be of any practical use, however, these time periods should be treated as fixed. In that way, a rule-based approach can serve to compare daily action in the transition windows from one period to the next. Each of these three main periods of the trading day does, in fact, have a flavor and unique character all its own. Because price action actually changes in character from one period to the next, and does so fairly consistently, different methods to trade these different behavior periods serve better than a one-size-fits-all plan. Rules can be devised based on the differences between these time sessions, and thus can help reduce one's temptation to introduce into trade entry decisions the intuition that rules of a trade plan are designed to eliminate. So for purposes of establishing a time reminder, and a trigger to implement a different phase of a trading plan, the 1st Frame of the day for the equity indices starts from the cash opening of the New York Stock Exchange at 9:30 A.M. and lasts until 11:15 A.M. ET. The Midday Frame picks up at that point and extends to 2:30 P.M. And, thereafter, the Last Hour Time Frame of the day starts at 2:30 P.M. and extends until the futures close at 4:15 P.M. ET, 15 minutes past the NYSE cash equity close.

An important thing not to confuse about these three time periods is the association with trend. Going from one time period to another does not necessarily mean a change of trend, although it can. Instead, it is better to understand the transition from frame to frame in terms of *resolution*, *momentum*, *price action*, and *complexity of pattern.*

Often, one time period can be said to be a resolution to the one preceding it. The 1st Frame of the day is usually the more volatile, and thus the Midday Frame tends to consolidate what was accomplished in the earlier going. If, instead, the 1st Frame is corrective and overlapping in pattern, more like a consolidation pattern, it usually resolves itself early in the Midday Frame by a sharp breakout into trend. However, when analyzing the relationship between the first two frames, the latter pattern occurs less often. The 1st Frame is usually the more volatile and trending, and the Midday Frame tends more to consolidate or even just chop around. If the Midday Frame builds a consolidation pattern, it will usually resolve itself in transition to the Last Hour Time Frame, beginning around 2:30 P.M. ET. If the trend in one period is destined to continue into the next, it will often accelerate in transition. If a trend had already accelerated within one time period, the next period may see a slowdown and even become choppy. Reversals can come in the middle of any period, but the momentum and the direction of such a reversal is more likely to change around 11:15 A.M. or 2:30 P.M. Short-term reversals are especially common at 10:30 A.M. and 12 P.M., and are thus also worthy to be included as designated *Time Markers*, but the transition of momentum and price action is better represented at the specific Time Markers of 11:15 P.M. and 2:30 P.M. ET.

Marking at least these two *Transition Times* on your own charts every day is a great exercise. Watch how often the market action seems to call for either a trade exit or entry as they approach. (See Figures 1.1 and 1.2.)

FIGURE 1.1 Transition Times

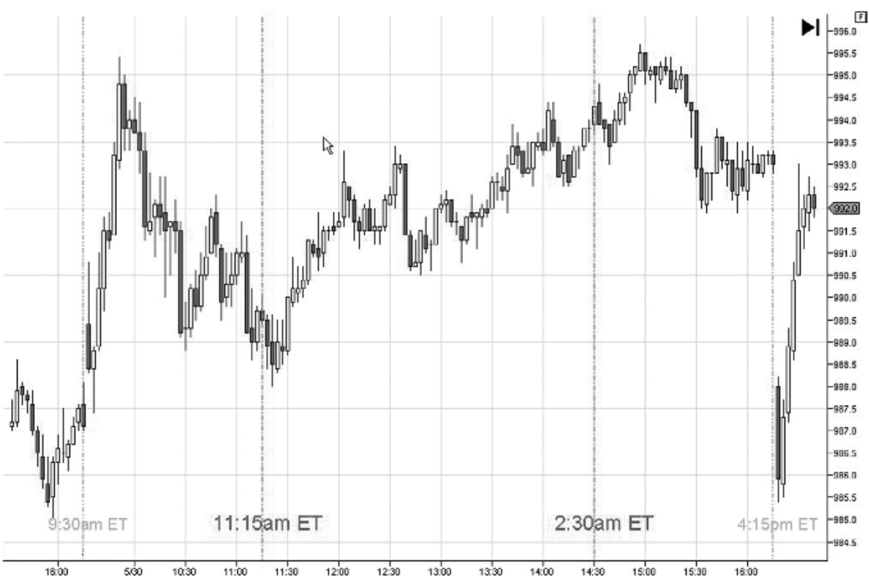

FIGURE 1.2 Transition Times

(For colorized versions of these charts, go to the Wiley companion website for this book, with instructions in Appendix A).

To be an effective trader, plotting such lines of time frame demarcation must become more than an exercise of mere curiosity. It must become habitual. And speaking from a lot of experience, traders can become lazy and complacent. Besides, in the heat of a trade entry or exit decision, many other emotional factors can take precedence over something a trader may or may not remember to check. Therefore, an indicator that automatically plots vertical lines on the screen at these critical junctures should be a standard tool in a trader's software package.[2]

The 1st Frame

While stock investors and position traders often consider the closing price of each day to be the most important for assessing performance, day traders consider the opening price as the most critical, as Grant Noble has noted in his book, *The Trader's Edge*.[3] Everything that happens for the entire day in the futures market—and especially price reaction throughout the first hour—is influenced by that opening. Volume and volatility are usually strongest in this first time period.

Pent-up orders from traders and institutions alike arrive at the floor most heavily at the opening bell, 9:30 A.M. ET. Attendance in the S&P and Nasdaq trading pits on the floor of the Chicago Mercantile Exchange is always greatest during this period. So important is the 1st Frame time period that many of these same floor traders consider the day over when the first hour and a half or so comes to an end.

For beginning traders, the opening hour presents some special challenges. Price volatility can be extreme, sometimes in a whipsaw manner. This volatility can frustrate the placement of stop-loss orders, as the market seems almost determined to take them out. Then again, on many a morning, price action seems truncated, sometimes on the very days when so much direction would have otherwise been expected.

That is why many novice traders get chopped up in the early going, and are warned to avoid trading in the first hour. Without a specific trading methodology that takes into account where the day's pivots and reversals are most likely to take place, a trader hoping to initiate a position for the early trend is not likely to survive his first stop-loss order.

Think about what was said earlier in this section regarding the S&P trading pit attendance. Some floor traders are done for the day after the 1st Frame is over. That means they've managed to accomplish their trading goals without a care as to where the market ends up for the day. When it opens again tomorrow, they'll have the same opportunity they had today. The price levels will be different, and they'll have a different set of numbers to work with, but for them, with their short-term worldview, the opportunity will be just the same.

If you come from investing in stocks, or even commodity position trading with holding periods of several days, weeks, or even months, the thought of viewing the first hour as almost an entire session unto itself is almost jarring. But if you want to be successful trading the stock index contracts, the 1st Frame should be understood exactly that way.

Think of the market hour that comes just previous to the beginning of the Midday Frame as one of testing. Only on rare occasions does the market know exactly where it is going from the very beginning. Think of this period as vying for dominance of trend direction between two warring factions.

Some of the largest players, like funds, have been compelled to commit dollars for various reasons; some have been forced to withdraw them. Some are reacting to the events of the previous day or fresh news; some are anticipating those of the day to follow. But by the end of the 1st Frame session, the result of this exchange has left the market in a position to commit to direction. By this hour's end, on a great majority of days, as was the case in Figure 1.3, one end of the entire day's trading range has already been established.

FIGURE 1.3 Midday Frame Transition

The Midday Frame

The Midday Frame starts at 11:15 A.M. ET, as the morning rush to commit funds begins to subside. Many seasoned floor traders who have been actively trading the morning's volatile swings are ready to leave for a break not long after this period begins. Some are even leaving for the day. If the market action has been volatile up to this time, action often now begins to be choppy, and that means entry signals and techniques can get sloppy for the trader who has waited till now to take a position.

It's as if the price action of the 1st Frame has left a kind of watermark on the page, a footprint pointing in the sand, a pencil rubbing of the struggle just beneath the surface. The task for the Trader in this period of transition is to recognize that the first of the day's major battles is probably over, and even if the current trend is not over, to consider taking no fresh trades while this transition period takes hold. A new trend or even a major reversal may be at hand, but at the very minimum, it's time to take a fresh appraisal of the situation.

After that, as shown in Figure 1.4, a trend has completed. The pace begins to slow down, and price patterns become more complex. The Midday Frame has then begun to develop. Breakouts usually begin to lose their

FIGURE 1.4 Midday Frame Transition

energy and often fizzle. What might have been a simple 3-bar pause pattern in the 1st Frame now shows up as a 10-bar Elliott *abc* pattern. Where price can—and often does—pivot on a single bar in the first hour, it is apt to form more complex, even classical chart reversal patterns later in the day. This is the time when the market usually begins to consolidate, and trade strategies that don't account for this potential change of pace and pattern are usually doomed to failure.

A beginner trader often finds the opportunity of the first hour irresistible, but the pace so furious that it's already over before he even has a sense of the trend that finally takes place. So, he waits until things slow down in the Midday Frame. Too often, the less experienced trader comes into the market at that point intending to capture in the Midday Frame what he missed in the 1st Frame's trend. This is usually disastrous. The character of the action following the Midday Frame transition begins to settle down. The position he takes in the Midday Frame with the 1st Frame's action in mind proves mismatched to the change of pace and market behavior that has begun to occur as the Midday Frame takes over.

The Midday Frame is usually a new ball game altogether. You can't capture what was missed in the 1st Frame with trades taken in the Midday Frame. The 1st Frame period is over. The Midday Frame models are different. Strategies for the Midday Frame must take into consideration a change of pace and an added complexity to the setups. Since each period stands on its own merits, each period must be traded by its own models and corresponding rules.

Although this change in volatility is fairly consistent, nothing is without its exceptions. This one, however, is consistent enough that its absence becomes an important signal of its own. Section Two, about Day Model Patterns, covers trend signals that can occur by just observing the character of transition from the 1st Frame to the Midday Frame.

The Last Hour Time Frame

The 3rd period, or Last Hour Time Frame, begins at 2:30 P.M. and lasts until the futures markets close at 4:15 P.M. ET, 15 minutes after the close of the New York Stock Exchange cash market. By 2:30 P.M., many traders who were away for the Midday Frame have returned to the floor. The corrective patterns that defined the Midday Frame have now possibly consolidated into an identifying whole.

It is here that many a day's trend either reasserts the direction of the morning, or is slaughtered by a reversal of the day's early action. The beginning of this time period is usually the resolution to the consolidation or coiling of the previous frame. So consistent is the change of action between the Midday Frame and the Last Hour Time Frame that this Time Marker warrants a name of its own: the *2:30 Transition Time*.

When fast-breaking action again ensues, patterns that took 30 minutes to set up in the Midday Frame now barely take five or six in Last Hour action. And if this period sounds like it might be the easiest to act on—following the methodical setup of a familiar Midday breakout pattern—the trader should keep one thing in mind. The outcome of any given day's Last Hour Time Frame is often the biggest surprise to the majority of traders. Note the chart in Figure 1.5 continues the day shown in Figure 1.3.

If, on the other hand, it was the Midday Frame that did the trending instead of the more usual consolidation, then the yin yang flips again and the 2:30 Transition Time can bring an end to the Midday Frame trend and serve to consolidate or reverse.

Notice how the chart in Figure 1.6 is a continuation of the day in Figure 1.4.

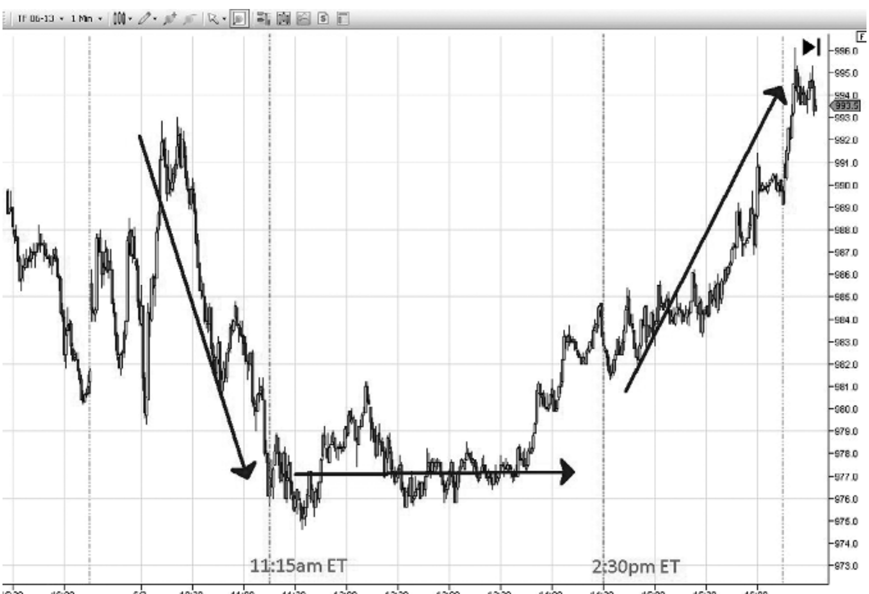

FIGURE 1.5 **Last Hour Transition**

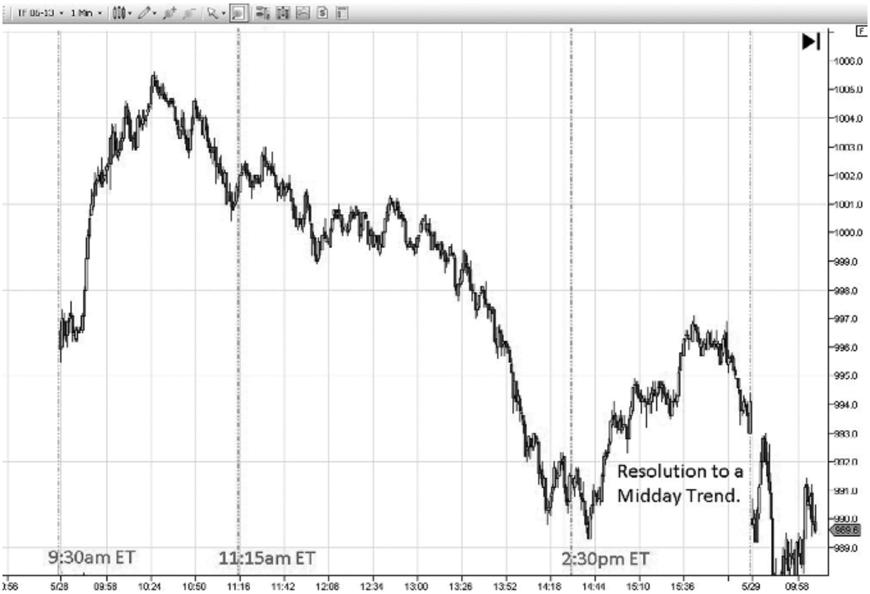

FIGURE 1.6 **2:30 P.M. Transition Time**

Summary

Dividing the day into separate time frames or sessions would seem arbitrary and without authority. No bells are rung, nor are any exchange notifications published at the above-designated times. But the experience of daily observation teaches that there are definitely transitions of price behavior at certain times day after day. The novice trader wants an explanation for these phenomena: end of the bond market, end of the energy markets, muscle memory from the occasional Federal Reserve interest rate announcements, and so forth. The novice trader wants logic. But the market is not driven by logic. None of these proposed reasons really fit. The experienced Trader doesn't care. He is only interested in market behavior that repeats itself with enough regularity to give him an edge to his trading. Leave the logic for the Analyst. Be the Trader.

Notes

1. Among the stages in his lifetime career as a trader, Randy was a floor broker at the New Orleans Cotton Exchange and, in his final years, my mentor while I was but a young man. For a more complete biography of Randolph Newman, see Appendix F.

2. There are so many charting software packages in use among the huge pool of traders worldwide that it's impractical to offer code for such indicators within this book. However, the code for automatic vertical plots of these two frame Transition Times, as well as auto-plot lines for the 10:30 A.M. and 12 P.M. times, is available as a Time Marker indicator in the ValhallaFutures Indicator Package, valhallafutures.com.
3. Grant Noble, *The Trader's Edge* (Chicago, IL: Probus Publishing, McGraw-Hill, 1994).