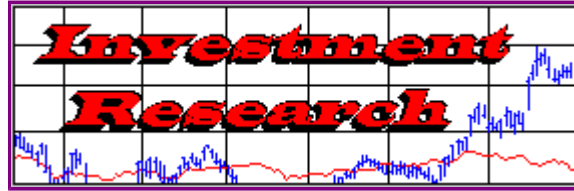


Published 5/12/95



Introducing the MIDAS Method of Technical Analysis (4) by Paul Levine

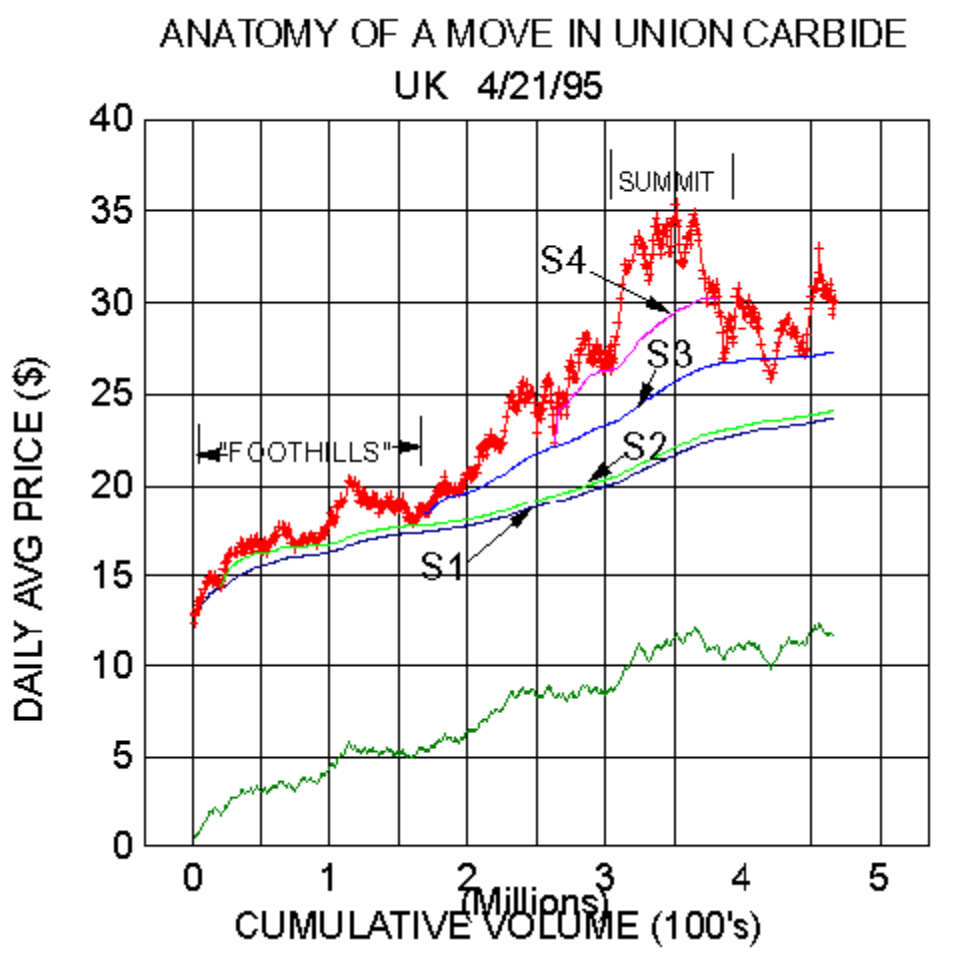
This is the fourth article in a series. Click here to go to the [first](#), [second](#), or [third](#) article.

It is worthwhile to pause for a moment at this stage of the development to delineate what it is we are trying to accomplish with the Midas method of technical analysis. Our objective is best explained by analogy to the understanding of atomic spectra as it existed in the 19th century, before quantum mechanics. Spectral lines had been observed to group into families according to their wavelengths, and numerical relationships such as the Balmer series were empirically fitted to the observations. Some order was thereby imposed on the complex spectra, but without any understanding of the underlying reason why these formulae should apply. It wasn't until the spectral lines were identified with transitions between discrete atomic energy levels, that it became clear that an understanding of the spectra would follow directly from an understanding of these levels. The levels were the fundamental reality, and the spectra a secondary consequence.

In like fashion, we view the hierarchy of S/R levels as being the fundamental reality underlying stock price behavior, and do not believe that a coherent model of this behavior is possible without them. It is therefore not surprising that extant computerized trading systems which do not include this reality are generally ineffective. Even with the powerful tools of neural networks and adaptive systems, one is in effect finding the optimum square peg for a round hole.

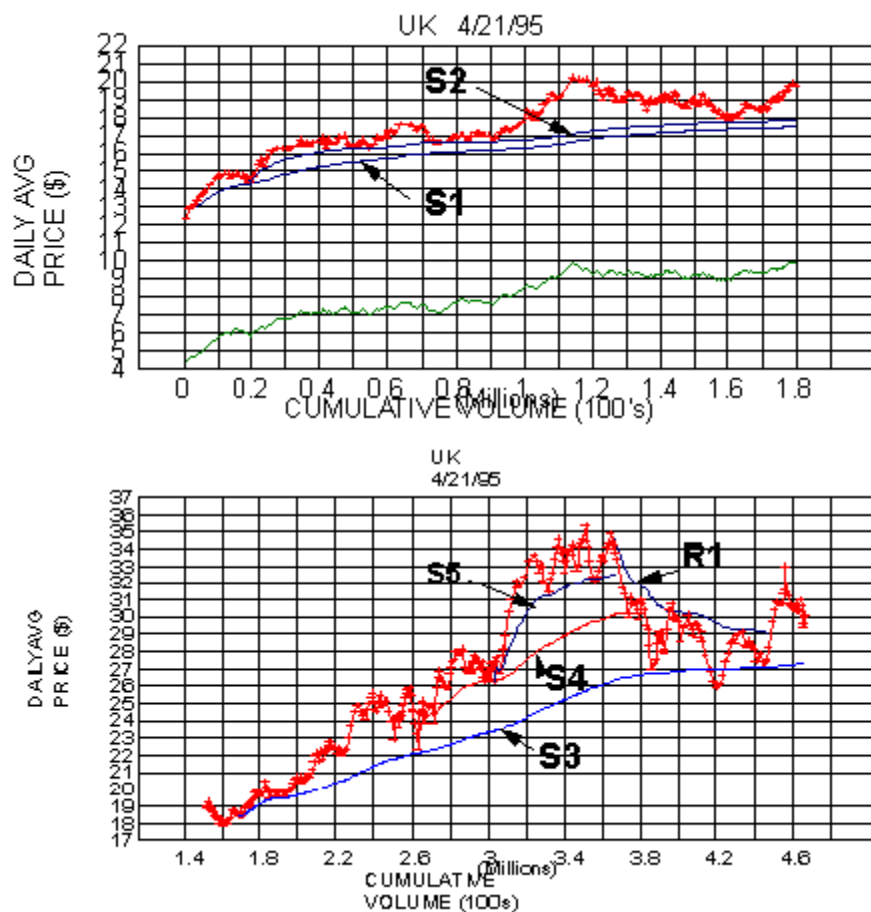
With our focus on the relationship between price and the S/R hierarchy, we have a powerful taxonomic tool to identify universal patterns of behavior exploitable for trading profit - patterns that would not be discernable from a consideration of the prices alone, i.e. without reference to the S/R hierarchy.

We can illustrate this by a detailed consideration of the anatomy of a complete bull move in a stock. The first figure shows the Midas chart for such a move in Union Carbide (UK). The chart covers 638 trading days ending on April 21, 1995, or about 2.5 years. Plotted on the chart are four support levels S1..S4 (a numbering shorthand we will henceforth use for simplicity).



We turn first to the start of the move and have identified what I call the "foothill" pattern. Anyone who has approached the Sierras in Calif. from the west has noticed that one first traverses a series of gently rolling hills whose rate of rise is quite gradual compared to those of the mountains ahead. Clearly if one can identify a stock move in the foothill stage, one can capture the bulk of the price appreciation.

In the top half of the second figure we therefore put a magnifying glass to the foothills, a period covering about 230 trading days. Note how beautifully the prices ride along the secondary support S2, and how the obv is poised to break out into new high ground. Referring back to the first figure we see this is just prior to the start of the sharply climbing price "mountain".



THIS FOOTHILL PATTERN HAS PROVEN TO BE THE MOST USEFUL TOOL FOR SPOTTING LOW RISK/HIGH REWARD ENTRY POINTS FOR INTERMEDIATE TERM LONG POSITIONS. It is noteworthy that without reference to the support levels, very little seems to be going on in the foothills. For months at a time the price is confined to a very narrow range and it is only if one is trained to look for a pattern of repeated bounces from a theoretical support level that the situation can be recognized. Imprint this graph firmly in your mind, for we will see this behavior over and over again. Indeed, in future articles I will call attention to such occurrences in real time, as they are unfolding!

The lower half of the second graph focuses on the summit of the price mountain. What I wish to emphasize here is that in the final push to the summit, the applicable support level was of FIFTH ORDER. As a general rule, when one observes such high-order support levels holding up prices, the end is known to be near. One then pays particular attention to ancillary indications of topping behavior, such as the head and shoulders formation evident at the UK summit, to time one's selling. (We will present other tools for identifying selling points in future articles).

Note how the drop off from the summit is bounded by the resistance level R1 for several months until it in turn is penetrated by the recent bounce from S3. What does the future hold from this point on? Our best guide is the obv curve of the first graph, where we see that obv is still quite close to its high. This would tend to indicate that there is still some life in the bull move yet, and that another leg to new high prices may be in the offing, perhaps after one more pullback to and bounce from S3 at about 27 1/2. Indeed, the penetration of R1 makes this the likely scenario. We'll revisit UK in a future article to see how things work out.

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Paul Levine first became interested in technical analysis when he was a "runner" on Wall Street as a high school student. After graduating from MIT and gaining a PhD in theoretical physics from CalTech, he took a fresh look at the problem some

thirty years ago and stumbled upon what has now evolved into the Midas method. Following retirement as Chief Scientist and a co-founder of Megatek Corporation in 1981, he developed further elaborations of the method and is now in his fourth year as a professional trader. He can be reached at: winmidas@winmidas.com or visit the [WinMidas website](#).

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