

THE MEJT SYSTEM

A NEW TOOL FOR DAY TRADING
THE S&P 500 INDEX

JEFFREY TENNANT

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A New Tool for Day Trading the S&P 500 Index

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First published in Great Britain in 2011 by Harriman House

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ISBN: 978-0-857190-35-2

British Library Cataloguing in Publication Data

A CIP catalogue record for this book can be obtained from the British Library.

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Preface

What this book covers

This book describes the MEJT system, which I have used for over eight years to help me trade the Standard and Poor's 500 index (S&P 500). The system identifies which moves have staying power and which moves do not. It also helps one establish price targets at which support and resistance can be expected to occur. The system is different from any I have seen on the market.

It is important to see the MEJT system as an addition to the arsenal of the technical analyst. Though the system has very useful predictive qualities, it should never be used in isolation. Use it along with other tools of market analysis.

Whom this book is for

The MEJT system is designed for use by experienced day traders who are already familiar with technical analysis of the stock market and who wish to add another tool to their trading methodologies. Since the system is used exclusively with the S&P 500, this book will be of use mainly to those who day trade this index.

How this book is structured

After an introductory chapter explaining how the MEJT system came about and its basic principles, each chapter in this book lays out a set of rules. These rules are followed by a number of examples in which the rules are applied. The final chapter – chapter 9 – is composed of trading examples only. Chapter 9 is designed so that people who want to skip ahead to the back of the book will, in many cases, be able to deduce what the rules of the system are even though the rules are not stated explicitly in this chapter.

In most cases, trading examples in this book are named simply with an example number and illustrative figures are labelled with just the date from which the respective price chart is taken. I have deliberately omitted more descriptive labels to allow readers to think about the charts and to use the MEJT rules to make a prediction, before reading my own analysis of the situation.

Part 1

Introduction

1

The MEJT System: Background, Definitions and General Principles

Introduction

Kudzu is a plant which grows in many places. It is native to Japan and China but has made an effortless transition to the United States, where it has proliferated so much that it is known as the vine that ate the South.

Most technical analysis techniques are like kudzu. They flourish everywhere. Bollinger bands and moving averages may have been developed for the stock market, but they work for commodities and futures as well. Stock traders also routinely use these and other indicators to trade the Forex market. When a new security or a new market begins trading, technical analysts use techniques they have used with other issues to analyse it. If something trades, market technicians can analyse it using techniques they already have.

The Haleakala silversword is not like kudzu. It is a beautiful plant which grows in a highly restricted range in Haleakala National Park on the Island of Maui. Move it outside of its narrow ecological niche and it dies. That pretty much describes the MEJT system I use to help me trade the S&P 500. It doesn't work for individual stocks, for other indices, commodities, Forex or anything else. But for the S&P 500 it

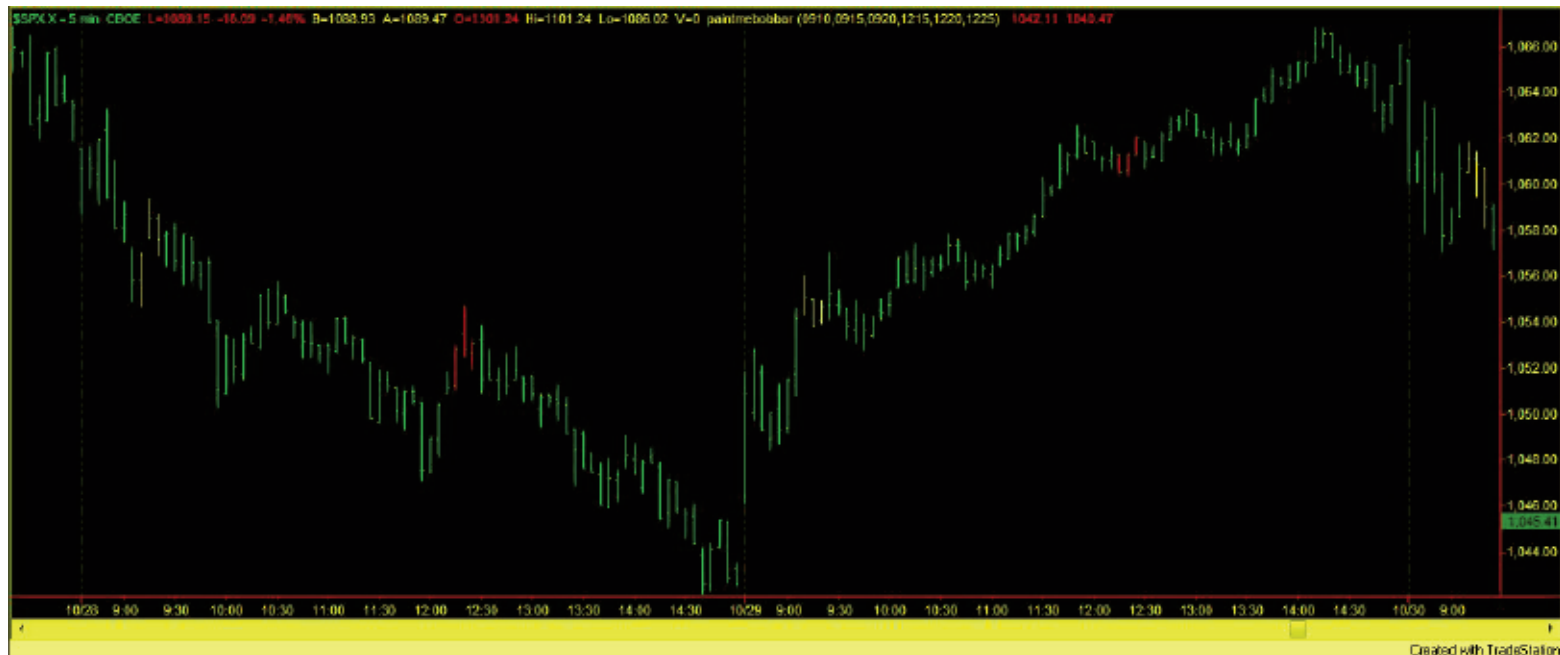
is a very useful tool. Like the Haleakala silversword, give the MEJT system the right environment and it blossoms.

The uses of the MEJT system

The system's main use is to help one day trade the S&P 500. However, less frequently, it can help one make long-term predictions.

- In March 2003 a multi-year rally in stocks began. MEJT predicted that, ultimately, all of the gain would retrace.
- In October 2007 the market made a major top. MEJT predicted, soon after the top, that the S&P 500 was going to circle the drain for a long time.
- And, as far as short-term calls are concerned, take a look at Figure 1.

Figure 1 – S&P 500 28-29 October 2009



There was a big drop on 28 October 2009. MEJT predicted, well in advance, that the drop would retrace, most likely before a little over a trading day had passed.

Basic principles of the MEJT system

The fundamental principle of the MEJT system is that market action during certain times of the day has predictive power over future price action. Were it not for the internet, I might never have learned that.

In early 2002 a member of an internet chat room acquainted me with the characteristics of the five-minute bar beginning at 9:05am Central Time (CT). He said that another trader had discovered that, if the market were to trend sustainably during the morning (and perhaps during the day) its retraces, if any, would not go through this bar. This is the bar I call **am** MEJT, or **am** for short. Unbeknownst to me, the person who had discovered this fact had developed an entire trading system based on it. Perhaps it was just as well that his system was unknown to me; his system turned out to be totally different to mine and I think mine is superior.

The am sequence

The sponsor of the same chat room routinely made a prediction for the day's action at 9:15am CT, five minutes after the **am** bar printed. I thought there must be something special

about the bar after **am** MEJT as well. It soon became obvious that, while those bars were important, it was the following bar (the five-minute bar beginning at 9:15 CT) that had the most predictive power.

I define the three five-minute bars beginning at 9:05am CT as **am** MEJT, **am** MEJT+1 and **am** MEJT+2; for short I usually refer to them as **am**, **am+1** and **am+2**. The three bars as a whole are called the *am pattern* or *am sequence*.

The basic principles of the *am* sequence are these:

- In general, the **am** bar is the default reference bar. Attempts to trend, if sustainable, should not correct through this bar. Under some conditions the reference bar changes.
- The action of the **am+1** and **am+2** bars determines whether there will be an attempt to trend.
- The action of the **am+2** bar determines whether or not the attempt to trend will succeed.

To be sustainable, any attempt to trend during the morning must show an attempt to trend (in the same direction) by the

am+1 and **am+2** bars. In addition, action of the **am+2** bar must indicate that the attempt will succeed, i.e. that the attempt is sustainable. If the rules for sustainability are not met, prices should retrace to the reference bar. The specific rules are discussed in chapter 2.

Thinking about why the MEJT system works

I did not know why the system worked, but I had a theory. I assumed that, after the rush of public orders had been taken care of during the first 35 minutes of trading, big money players began to get down to business, and that they did so at a very consistent time. If the market trended strongly enough during that time, the trend could continue. If not, I felt there was no institutional support for the move and that prices would retrace back to the **am** bar. Whether or not that assumption was true, trading based on it proved profitable for me.

The MEJT sequence

Trading the **am** sequence proved so rewarding that I wondered if big money players had a similar consistent pattern of behaviour after they returned from lunch. Assuming they had

lunch in the Eastern Time Zone (ET), it did indeed appear that there was a similar pattern after lunch. Market action from 1:10-1:25pm ET (12:10-12:25pm CT) has predictive powers.

The three five-minute bars beginning at 12:10 CT are defined as **MEJT**, **MEJT+1** and **MEJT+2**. As a whole, they are referred to as the *pm pattern*, *pm sequence* or *MEJT sequence*.

The basic principles of the MEJT sequence are these:

- In general, the **MEJT** bar is the default reference bar. Under some conditions the reference bar changes.
- The action of the **MEJT+1** and **MEJT+2** bars determines whether there will be an attempt to trend.
- The action of the **MEJT+2** bar determines whether or not the attempt to trend will succeed.

The rules for trading these principles are similar to the rules for trading the **am** pattern, but there are some significant differences. For example, trending moves during the morning should not penetrate the **am** **MEJT** bar. During the afternoon, however, a slight penetration of the **MEJT** bar does not preclude a sustainable move. Furthermore, such a slight penetration is not rare. Also, prices predicted by the **MEJT** pattern are more likely to print within their preferred time frames.

To be sustainable, any attempt to trend during the afternoon must show an attempt to trend (in the same direction) by the MEJT+1 and MEJT+2 bars. In addition, action of the MEJT+2 bar must indicate that the attempt will succeed. If the rules for sustainability are not met, prices should retrace to or through the reference bar. The specific rules are discussed in chapter 4.

Targets

When a MEJT signal is given, a target for ensuing price action is established. Different patterns have different targets, and these will be explained in the course of the text. In general, if the am sequence or the MEJT sequence indicates that an attempt to trend will succeed, a target is created either at a prior high, a prior low, at the prior day's close, or at a given price level. If the am sequence or the MEJT sequence indicate a trending attempt will not succeed, a target is created at or just past the reference bar of the sequence which made the prediction.

Targets will be discussed in detail in chapter 7.

Using TradeStation to identify the bars of the am sequence and MEJT sequence

Before discussing the rules of the systems, it is useful to have TradeStation identify the bars of the am sequence and the MEJT sequence for us. One can get a clearer picture by seeing the bars on one's computer than one can get from illustrations. In addition, one can identify prices by right-clicking over or under the price bars.

Open TradeStation. Then, on the tools menu on the left side of the page, go to <easy language>, click on <new easy language document> and scroll down to <paint bar>. Give the paint bar indicator a name, like <paintMEJTbar> and copy the program shown in Program Excerpt 1.

Program Excerpt 1

```
[LegacyColorValue = true];  
Inputs: time1(0910), time2(0915),  
time3(0920), time4(1215), time5(1220),  
time6(1225);  
if time = time1 or time = time2 or time =  
time3 then  
begin  
Plot1(high, "5 min chart", yellow);  
Plot2(low, "5 min chart", yellow);  
end;  
if time = time4 or time = time5 or time =  
time6 then  
begin  
Plot1(high, "5 min chart", red);  
Plot2(low, "5 min chart", red);  
end;
```

Verify the program. Create a five-minute chart. Right-click on the chart and choose <insert analysis technique>. Open <paintMEJTbar> under the paint bar menu.

The program will paint the **am** MEJT sequence in yellow and the MEJT sequence in red for computers set for the CT zone.

All the charts in this book are in United States Central Time – those living in other time zones can change the times listed on the <Inputs> line in the program above. Those who live in states such as Hawaii or Arizona, which have no daylight savings time, or in countries whose daylight savings time changes on dates other than those used in the United States, will need to make adjustments. One option is to make a second paint bar indicator and to change things manually on the appropriate dates. When I lived in Arizona, I just left my computer on CT.

A word of caution here is that I cannot verify whether or not programs other than TradeStation will work. Specifically, I have tried programs which are available for free on the internet or at lower cost elsewhere. For some reason, the providers I tried had slightly different data than TradeStation's. When those data were used, the system did not work. Unlike many other indicators, slight changes in the data can have big consequences in the MEJT system's predictive ability. Think of it as like the Haleakala silversword: if the environment is changed just a little the plant will not grow.

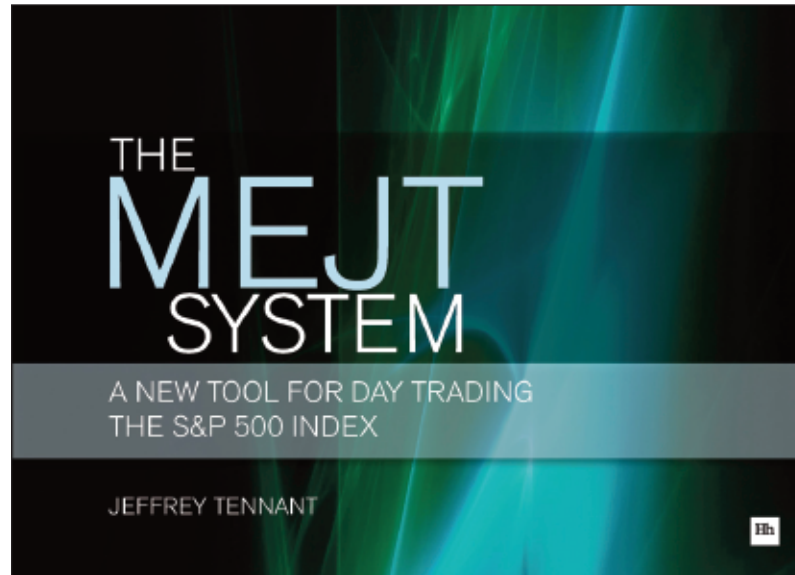
Naming of the MEJT system

For the sake of completeness, I would like to go over the reason I named the system MEJT. The trader who originally discovered the bar I call **am** MEJT had a different name for it. When I discovered the pm pattern I named it MEJT with *ME* being borrowed from his name for the bar from the am pattern and *JT* being my initials. I have been asked not to use the name the other trader gave to the bar he discovered, but he says he is happy for me to use MEJT.

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