IX
Trading Systems

43. TRIPLE SCREEN TRADING SYSTEM

The Triple Screen trading system was developed by this author and has been used for trading since 1985. It was first presented to the public in April 1986, in an article in *Futures* Magazine.

Triple Screen applies three tests or screens to every trade. Many trades that seem attractive at first are rejected by one or another screen. Those trades that pass the Triple Screen test have a higher degree of profitability.

Triple Screen combines trend-following methods and counter-trend techniques. It analyzes all potential trades in several timeframes. Triple Screen is more than a trading system, it is a method, a style of trading.

Trend-Following Indicators and Oscillators

Beginners often look for a magic bullet—a single indicator for making money. If they get lucky for a while, they feel as if they discovered the royal road to profits. When the magic dies, amateurs give back their profits with interest and go looking for another magic tool. The markets are too complex to be analyzed with a single indicator.

Different indicators give contradictory signals in the same market. Trend-following indicators rise during uptrends and give buy signals, while oscillators become overbought and give sell signals. Trend-following indicators turn down in downtrends and give signals to sell short but oscillators become oversold and give buy signals.

Trend-following indicators are profitable when markets are moving but lead to whipsaws in trading ranges. Oscillators are profitable in trading ranges, but give premature and dangerous signals when the markets begin to trend. Traders say: "The trend is your friend," and "Let your profits run." They also say: "Buy low, sell high." But why sell if the trend is up? And how high is high?

Some traders try to average out the votes of trend-following indicators and oscillators. It is easy to rig this vote. If you use more trend-following tools, the vote will go one way, and if you use more oscillators, it will go the other way. A trader can always find a group of indicators telling him what he wants to hear.

The Triple Screen trading system combines trend-following indicators with oscillators. It is designed to filter out their disadvantages while preserving their strengths.

Choosing Timeframes—The Factor of Five

Another major dilemma is that the trend can be up and down at the same time, depending on what charts you use. A daily chart may show an uptrend while a weekly chart shows a downtrend, and vice versa (see Section 36). A trader needs to handle conflicting signals in different timeframes.

Charles Dow, the author of the venerable Dow theory, stated at the turn of the century that the stock market had three trends. The long-term trend lasted several years, the intermediate trend several months, and anything shorter than that was a minor trend. Robert Rhea, the great market technician of the 1930s, compared the three market trends to a tide, a wave, and a ripple. He believed that traders should trade in the direction of the market tide and take advantage of the waves but ignore the ripples.

Times have changed, and the markets have become more volatile. Traders need a more flexible definition of timeframes. The Triple Screen trading system is based on the observation that every timeframe relates to the larger and shorter ones by approximately a factor of five (see Section 36).

Each trader needs to decide which timeframe he wants to trade. Triple Screen calls that the **intermediate** timeframe. The **long-term** timeframe is one order of magnitude longer. The **short-term** timeframe is one order of magnitude shorter.

For example, if you want to carry a trade for several days or weeks, then your intermediate timeframe will be defined by the daily charts. Weekly charts are one order of magnitude longer, and they determine the long-term timeframe. Hourly charts are one order of magnitude shorter, and they determine the short-term timeframe.

Day-traders who hold their positions for less than an hour can use the same principle. For them, a 10-minute chart may define the intermediate timeframe, an hourly chart the long-term timeframe, and a 2-minute chart the short-term timeframe.

Triple Screen demands that you examine the long-term chart first. It allows you to trade only in the direction of the tide – the trend on the long-term chart. It uses the waves that go against the tide for entering positions. For example, daily declines create buying opportunities when the weekly trend is up. Daily rallies provide shorting opportunities when the weekly trend is down.

First Screen—Market Tide

Triple Screen begins by analyzing the long-term chart, one order of magnitude greater than the one you plan to trade. Most traders pay attention only to the daily charts, with everybody watching the same few months of data. If you begin by analyzing weekly charts, your perspective will be five times greater than that of your competitors.

The first screen of Triple Screen uses trend-following indicators to identify long-term trends. The original system uses the slope of weekly MACD-Histogram (see Section 26) to identify the market tide. The slope is defined as the relationship between the two latest bars. When the slope is up, it shows that bulls are in control – it is time to trade from the long side. When the slope is down, it shows that bears are in control and tells you to trade only from the short side (Figure 43-1).

A single uptick or a downtick of weekly MACD-Histogram indicates a change of a trend. The upturns that occur below the centerline give better buy signals than those above the centerline (See "Indicator Seasons" in Section 36). The downturns that occur above the centerline give better sell signals than the downturns below the centerline.

Some traders use other indicators to identify major trends. Steve Notis wrote an article in *Futures* magazine showing how he used the Directional System as the first screen of Triple Screen. Even a simpler tool, such as the

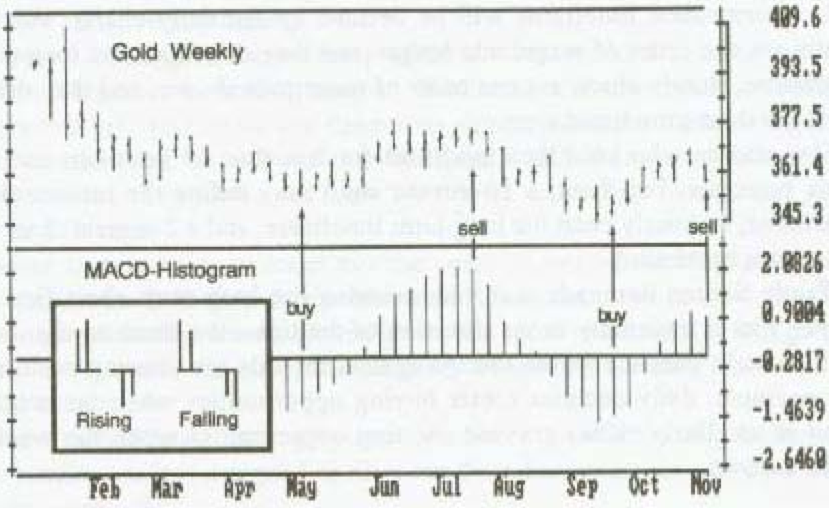

Figure 43–1. Weekly MACD-Histogram—The First Screen of Triple Screen

The slope of MACD-Histogram is defined by the relationship between its two latest bars (see inset). Triple Screen tells traders to examine weekly charts before looking at the dailies. When the weekly trend is up, it allows us to trade only from the long side or stand aside. When the weekly trend is falling, it allows us only to trade from the short side or stand aside.

Weekly MACD-Histogram gives a buy signal when its slope turns up. The best buy signals are given when this indicator turns up below its centerline. When MACD-Histogram turns down, it gives a sell signal. The best sell signals are given when it turns down from above its centerline (see "Indicator Seasons," Section 36). Once you find the trend of the weekly MACD-Histogram, turn to daily charts and look for trades in the same direction.

slope of a 13-week exponential moving average, can serve as the first screen of the Triple Screen trading system. The principle is the same. You can use most trend-following indicators, as long as you analyze the trend on the weekly charts first and then look for trades on the daily charts only in that direction.

Screen One: Identify the weekly trend using a trend-following indicator and trade only in its direction.

A trader has three choices: buy, sell, or stand aside. The first screen of the Triple Screen trading system takes away one of those choices. It acts as a censor who permits you only to buy or stand aside during major uptrends. It allows you only to sell short or stand aside during major downtrends. You have to swim with the tide or stay out of the water.

Second Screen—Market Wave

The second screen identifies the wave that goes against the tide. When the weekly trend is up, daily declines point to buying opportunities. When the weekly trend is down, daily rallies point to shorting opportunities.

The second screen applies oscillators to the daily charts in order to identify deviations from the weekly trend. Oscillators give buy signals when markets decline and sell signals when markets rise. The second screen of the Triple Screen trading system allows you to take only those daily signals that point in the direction of the weekly trend.

Screen Two: Apply an oscillator to a daily chart. Use daily declines during weekly uptrends to find buying opportunities and daily rallies during weekly downtrends to find shorting opportunities.

When the weekly trend is up, Triple Screen takes only buy signals from daily oscillators and ignores their sell signals. When the weekly trend is down, Triple Screen takes only shorting signals from oscillators and ignores their buy signals. Force Index and Elder-ray are good oscillators to use with Triple Screen, but Stochastic and Williams %R also perform well.

When the weekly MACD-Histogram rises, the 2-day EMA of Force Index (see Chapter 8) gives buy signals when it falls below its centerline, as long as it does not fall to a new multiweek low. When the weekly MACD-Histogram declines, Force Index gives shorting signals when it rallies above its centerline, as long as it does not rise to a new multiweek high (Figure 43-2).

When the weekly trend is up, daily Elder-ray (see Section 41) gives a buy signal when Bear Power declines below zero and then ticks back up toward

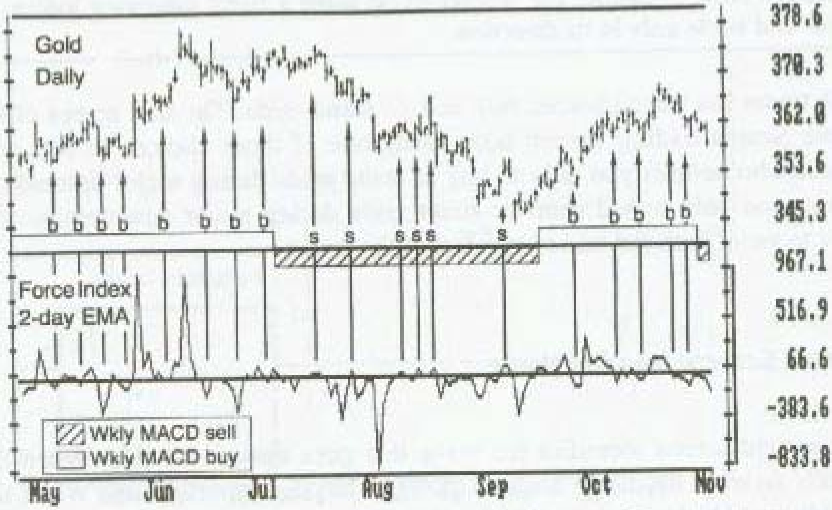

Figure 43–2. Daily Force Index—The Second Screen of Triple Screen

The 2-day EMA of Force Index is one of several oscillators that can work as the second screen of the Triple Screen trading system. Force Index marks buying opportunities when it falls below its centerline. It marks selling opportunities when it rallies above its centerline.

When the weekly trend is up, take only buy signals from the daily oscillator for entering long positions. When the weekly trend is down, take only sell signals for entering short positions. At the right edge of the chart, the weekly trend has turned down. Wait for a rise in Force Index in order to sell short.

the centerline. When the weekly trend is down, daily Elder-ray signals to go short when Bull Power rallies above zero and then ticks back down.

Stochastic (see Section 30) gives trading signals when its lines enter a buy or a sell zone. When weekly MACD-Histogram rises but daily Stochastic falls below 30, it identifies an oversold area, a buying opportunity. When the weekly MACD-Histogram declines but daily Stochastic rises above 70, it identifies an overbought area, a shorting opportunity.

Williams %R (see Section 29) needs a 4- or 5-day window to work with Triple Screen. It is interpreted similarly to Stochastic. The Relative Strength

Index does not react to price changes as fast as other oscillators. It helps with overall market analysis, but is too slow for Triple Screen.

Third Screen—Intraday Breakout

The first screen of the Triple Screen trading system identifies market tide on a weekly chart. The second screen identifies a wave that goes against that tide on a daily chart. The third screen identifies the ripples in the direction of the tide. It uses intraday price action to pinpoint entry points.

The third screen does not require a chart or an indicator. It is a technique for entering the market after the first and second screens gave a signal to buy or sell short. The third screen is called a trailing buy-stop technique in uptrends and a trailing sell-stop technique in downtrends (Figure 43-3).

When the weekly trend is up and the daily trend is down, trailing buy-stops catch upside breakouts. When the weekly trend is down and the daily trend is up, trailing sell-stops catch downside breakouts.

Triple Screen Summary

Weekly Trend	Daily Trend	Action	Order
Up	Up	Stand aside	None
Up	Down	Go long	Trailing buy-stop
Down	Down	Stand aside	None
Down	Up	Go short	Trailing sell-stop

When the weekly trend is up and a daily oscillator declines, it activates a trailing buy-stop technique. Place a buy order one tick above the high of the previous day. If prices rally, you will be stopped in long automatically when the rally takes out the previous day's high. If prices continue to decline, your buy-stop will not be touched. Lower your buy order the next day to the level one tick above the latest price bar. Keep lowering your buy-stop each day until stopped in or until the weekly indicator reverses and cancels its buy signal.

When the weekly trend is down, wait for a rally in a daily oscillator to activate a trailing sell-stop technique. Place an order to sell short one tick below the latest bar's low. As soon as the market turns down, you will be stopped in on the short side. If the rally continues, keep raising your sell order daily. The aim of a trailing sell-stop technique is to catch an intraday downside breakout from a daily uptrend in the direction of a weekly downtrend.

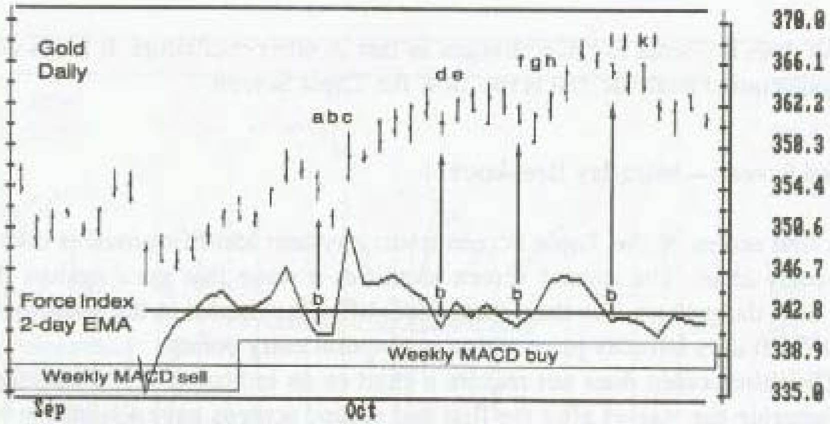

Figure 43–3. Trailing Buy-Stop—The Third Screen of Triple Screen

Weekly MACD-Histogram has turned up in mid-September. When the first screen points up, every decline of the second screen–the 2-day EMA of Force Index–marks a buying opportunity.

a. Force Index falls below its centerline. Place a buy order for tomorrow 1 tick above the high of day *a*.
b. The decline continues. Lower the buy order to 1 tick above the high of bar *b*.
c. Bought at the opening. Place a stop at the low of bar *b*. The new high in Force Index shows that the rally is strong, likely to continue.
d. Force Index falls below its centerline. Place a buy order at the bar's high.
e. Bought when prices rallied above the high of *d*. Place a stop at the low of bar *d*.
f. Force Index falls below its centerline. Place a buy order at the bar's high.
g. Decline continues. Lower the buy-stop to within 1 tick of the high of bar *g*.
h. Bought when prices rallied above the high of *g*. Place a stop at the low of bar *g*.
i. Force Index falls below its centerline. Place a buy order at the bar's high.
j. Decline continues. Lower the buy-stop to within 1 tick of the high of bar *j*.
k. Bought at the opening. Place a stop at the low of bar *j*.
l. Gold opens lower and hits the protective stop. It is important to use stops because no indicator is perfect.

Screen Three: Use the trailing buy-stop technique when the weekly trend is up and the daily oscillator is down. Use the trailing sell-stop technique when the weekly trend is down and the daily oscillator is up.

Stop-Loss

Proper money management is essential for successful trading. A disciplined trader cuts his losses short and outperforms a loser who keeps hanging on and hoping. The Triple Screen trading system calls for placing very tight stops.

As soon as you buy, place a stop-loss order one tick below the low of the trade day or the previous day, whichever is lower. Once you sell short, place a protective stop-loss one tick above the high of the trade day or the previous day, whichever is higher. Move your stop to a break-even level as soon as the market moves in your favor. Afterwards, the rule of thumb is to move your stop to protect approximately 50 percent of paper profits (see Section 48).

The reason for using such tight stops is that Triple Screen trades only in the direction of the tide. If a trade does not work out fast, it is a sign that something is fundamentally changing below the surface of the market. Then it is better to run fast. The first loss is the best loss—it allows you to re-examine the market from the safety of the sidelines.

Conservative traders should go long or short on the first signal of the Triple Screen trading system and stay with that position until the major trend reverses or until stopped out. Active traders can use each new signal from the daily oscillator for pyramiding the original position.

A position trader should try and stay with a trade until the weekly trend reverses. A short-term trader may take profits using signals from the second screen. For example, if a trader is long and Force Index becomes positive or Stochastic rises to 70 percent, he may sell and take profits, then look for another buying opportunity.

The Triple Screen trading system combines different timeframes and several types of indicators. It uses a trend-following indicator with the long-term charts and a short-term oscillator with the intermediate charts. It uses special entry techniques for buying or selling short. It also uses tight money management rules.