

# Futures & Options

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**FUTURES STRATEGY:**  
**Short-term CCI p. 10**

**ADJUSTING TO**  
**stock index futures shift p. 14**

**STRADDLES, STRANGLES,**  
**and volatility p. 16**

**FEAR AND LOATHING**  
**in the options**  
**market p. 20**

**TRADING IRON**  
**CONDORS**  
**in volatile**  
**markets p. 22**

**FUTURES,**  
**OPTIONS**  
**volume down,**  
**not out p. 24**





# The CCI ghost

A well-known chart pattern gets put to a new use when applied to a little-used indicator, resulting in trade setups that jump out when you least expect them.

BY KEN WOOD

*Note: A version of this article originally appeared in the May 2004 issue of Active Trader magazine.*

If asked, most people would likely say they've never seen a ghost. And chances are, the majority of traders would probably give the same response when asked if they've ever traded the Commodity Channel Index (CCI).

However, spotting a pattern in the CCI called the "ghost" can alert you to favorable trade opportunities. The setup is easy to identify and appears regularly — two helpful factors for all traders. The pattern's name is a reference to its tendency to jump out and yell "Boo" when price itself is communicating very little about what the market will do. In fact, the ghost pattern is so well defined you can base trades on it without having to directly consult price action.

For those people unfamiliar with the CCI, this indicator essentially is an oscillator (a tool designed to highlight overbought or oversold conditions) that measures the difference between the current price and the average price over a given period. However, the CCI uses unique calculations to define these aspects of price. "CCI background" explains the indicator in detail.

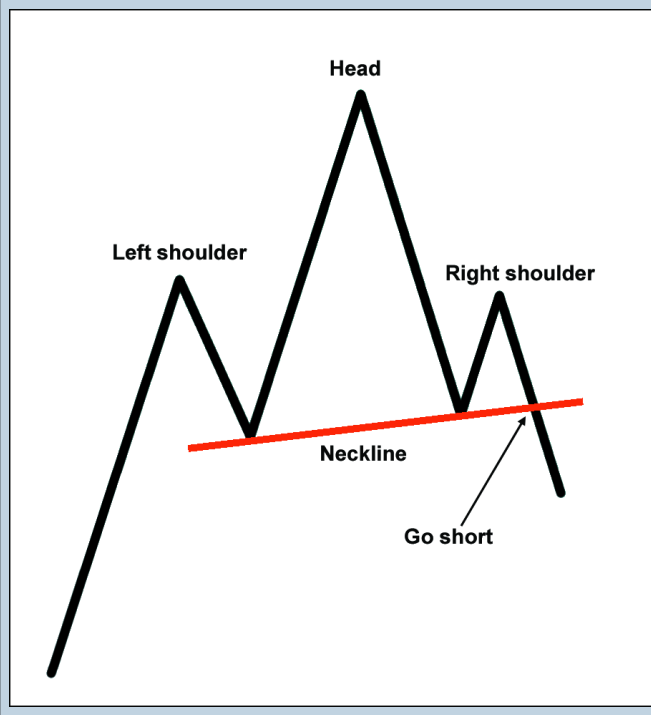
The ghost pattern is one of several CCI trading patterns that evolved from years of trading and watching the markets. The following identification and trading guidelines reflect firsthand use of this indicator.

## Pattern characteristics and trade management

The CCI ghost is the indicator equivalent of the head-and-shoulders price pattern, which is a reversal formation consisting of three peaks (at a market top) — the highest peak in the middle being the "head" and the two lower peaks on either side of it being the shoulders (see Figure 1). A move below the "neckline" (a trendline connecting the shoulder lows) is typically used to trigger a short trade or sale.

**FIGURE 1 — THE HEAD-AND-SHOULDERS (H&S) PATTERN**

The H&S pattern consists of three peaks. A move below the trendline connecting the lows of the two shoulders in an H&S top constitutes a sell signal. The pattern is reversed at bottoms.



Figures 2-6 show various intraday charts accompanied by 14-bar CCIs containing ghost patterns. Although the patterns in these figures form above or near the zero line, many form around +100/-100 as well. Like the head-and-shoulders price pattern, the entry signal for a trade is a break of the ghost's neckline. A ghost that signals an upside reversal and a long trade is referred to as an "inverted ghost."

Figure 2 shows a bearish ghost pattern on a three-minute chart that signaled a short trade when the indicator dropped below the neckline (and almost simultaneously

## CCI background

The Commodity Channel Index (CCI) came about partially as a result of an accident. The indicator's developer, Don Lambert, designed the CCI not for trading purposes, but rather to test the computing capabilities of a portable calculator.

Perhaps because Lambert never intended to use the indicator for trading purposes, relatively little has been written about the CCI compared to other trading tools. The CCI measures how much the current price (specifically, the **typical price** of a bar — the average of its high, low, and closing prices) deviates from the average of the typical prices over a specific lookback period (e.g., five bars, 10 bars, etc.).

The indicator fluctuates around a “zero line,” with a majority of its readings between -100 and +100. High readings mean the current price is unusually high relative to the average price over the lookback period. Interestingly, while the CCI is now used primarily as an oscillator, its original role was to signal breakout conditions — when the indicator moved above +100 or below -100, it signaled exceptional up or down strength and the possibility of continued price movement in that direction.

You can follow these steps to calculate the CCI in a spreadsheet:

1. Calculate the “typical price,” which is the sum of the high, low, and closing prices, divided by three, for each bar in the desired look-back period (e.g., 14 bars).
2. Calculate a moving average of these typical prices over the desired look-back period.
3. Calculate the difference between each typical price over the look-back period and the moving average of the typical price for the respective bar.
4. Sum the absolute value of all the differences from step 3 and divide by the look-back period.
5. Subtract the value calculated in step 2 from the last bar's value as calculated in step 1, and divide it by the value calculated in step 4 times 0.015. (The factor 0.015 will force most readings to fall within +/- 100.)

Figure A shows an example of an Excel spreadsheet containing the calculations for a five-day CCI (row 1 identifies the data in each column). Repeat each formula for every row that contains price data in columns C through E.

- Calculate typical price: In cell H3: =SUM(C2:E2)/3
- Calculate moving average of typical price: In cell I7: =AVERAGE(H3:H7)
- Calculate the CCI: In J7: =(H7-I7)/((ABS(H7-I7)+ABS(H6-I7)+ABS(H5-I7)+ABS(H4-I7)+ABS(H3-I7))/5\*0.015).

Theoretically, there are no limits to how high or low CCI values can go. Because of their construction, however, most markets will have a large majority of their CCI values between the +/- 100 levels, and very seldom should you see readings above or below +/-300.

For more information on the CCI, see “Indicator Insight: The Commodity Channel Index,” *Active Trader*, December 2001.

fell below the zero line).

In Figure 3 an inverted ghost signaled a long trade shortly before the market moved out of a consolidation. Again, the penetration of the neckline and the move above the zero line were almost concurrent.

The CCI provides exit targets in addition to entry triggers. The target for the ghost pattern is calculated by subtracting the distance from the neckline to the top of the head (in CCI points) from the neckline break point (again, the same “classic” method used to calculate a price target with the head-and-shoulders price pattern).

Several exit techniques can be used with the CCI ghost pattern. The first is to exit the entire position at the target level. Alternately, you can take partial profits at that point and leave some of your contracts to run until an extreme CCI reading of +200 (following a long trade) or -200 (for a short trade) occurs. Another approach would be to exit when price breaks out above a down trendline connecting the head and right shoulder of the pattern. A stop-loss should be placed as soon as your entry is filled. Once profits have been taken at the target level, move the stop-loss to the breakeven level. Reverse the rules for inverted ghost patterns and buy setups.

Figure 4 shows a short trade example with the initial price target occurring just below the zero line and the second target being reached when the indicator fell to -200.

### Time frames

The ghost pattern forms on different time frames, in all markets. You should experiment by looking at different charts to see how and when the pattern appears. For day trading, three- and five-minute charts are a

*continued on p. 12*

**FIGURE A — CALCULATING THE CCI**

The CCI's rather complex calculation can be performed easily in Excel. This spreadsheet is available at [http://www.activetradermag.com/index.php/c/Strategy\\_code](http://www.activetradermag.com/index.php/c/Strategy_code).

	A	C	D	E	G	H	I	J	K	L
1	Date	High	Low	Close		Typical	Average	CCI		
2	4/22/99	271.5	266.5	267.5						
3	4/23/99	269.5	262	265.75		268.5				
4	4/26/99	265.5	262	263		265.75				
5	4/27/99	267	259.5	260		263.5				
6	4/28/99	264	258.5	263.5		262.1667				
7	4/29/99	266.25	261.75	263.5		262	264.3833	-72.4417		
8	4/30/99	269	262.25	268		263.8333	263.45	23.37398		
9	5/3/99	269.5	262	264		266.4167	263.5833	153.1532		



**FIGURE 2 — SHORT-SIDE GHOST**

*The CCI forms a bearish ghost pattern and signals a short trade immediately before a sharp down move.*



Source: TradeStation

**Pattern snapshot**

**Strategy/pattern:** CCI ghost

**Markets:** All

**Time frame:** All (intraday examples used in this article).

**Setup:** A 14-bar CCI must form a head-and-shoulders (top or bottom) formation.

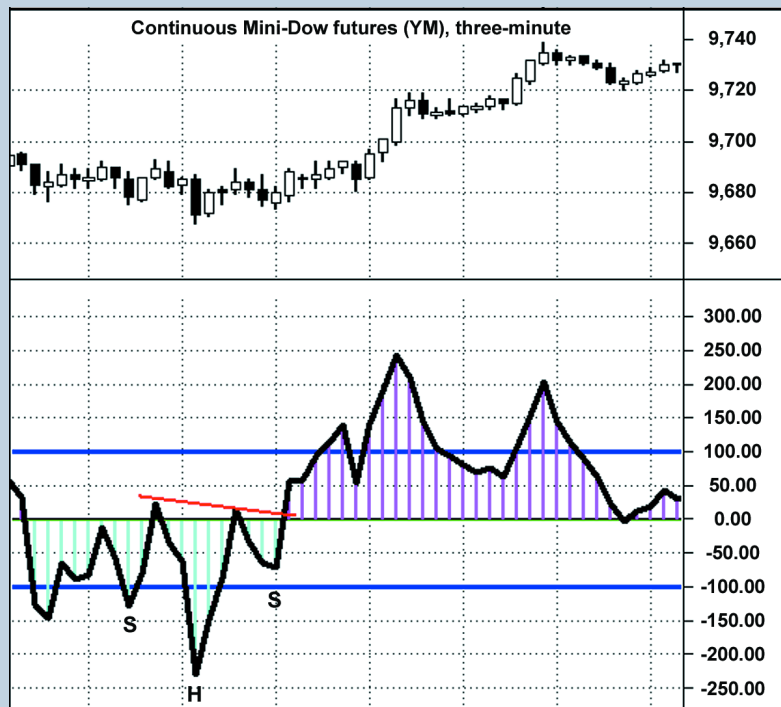
**Entry:** Enter on a penetration of the pattern's neckline.

**Stop:** Set initial stop per your personal money-management parameters. (On a pattern basis, a move above the shoulder of the ghost would negate the pattern; a stop a little above this level is a logical place to experiment with this parameter).

**Exit:** The initial trade target for a CCI ghost top pattern/short trade is the difference between the head and the neckline subtracted from the neckline penetration point. Liquidate the entire position at this point, or take partial profits and move the stop up to breakeven. An example of a secondary target is a CCI move above +200 or below -200.

**FIGURE 3 — INVERTED GHOST**

*This bullish ghost pattern triggered a buy that caught an up move out of a consolidation.*



Source: TradeStation

good place to start. Those who prefer swing trading might want to consider a 30-minute (or 233-tick) chart. For position trading, daily charts (and a 20-period CCI) can be used.

Figure 5 shows a slightly longer-term trade than the previous examples — a swing trade setup on a 233-tick chart. A short trade would have been triggered at the CCI neckline break, resulting in an entry price around 9,575. The market gapped down on the open the following day. The distance from the neckline and the head was 220 CCI points and the neckline break occurred around +50, making the price target -170 on the CCI. This objective was reached in 10 bars at a price of 9,520.

Figure 6 shows a ghost pattern in the Eurocurrency (EC) that failed to meet its objective. Using a CCI trendline break to exit resulted in a small loss.

**“Priceless” trading**

One thing you may have noticed about these chart examples is they discuss trades in terms of

### FIGURE 4 — PRICE TARGETS

This chart shows how the CCI ghost can generate two simple price targets: The first target is determined by subtracting the distance between the head and the neckline penetration from the neckline penetration level and the second is a move to an extreme CCI reading in the opposite direction — in this case, -200.



Source: TradeStation

CCI points rather than price points. Most traders are accustomed to focusing exclusively on price bars when executing trades. However, the fluctuation on a chart can create false impressions of what the market is going to do and lead to conflicted trading. This could cause you to exit a trade early, just as the market is about to move your way.

For more experienced traders, an essential aspect of trading the ghost pattern is using the CCI, not price action, to identify trade opportunities. Trading is nerve-wracking enough without the extra stress of bouncing price bars; focusing on the CCI enables traders to eliminate the noise on a price chart and concentrate on entries and exits.

Trading without prices — by hiding or covering the price bars — eliminates fear and conflict. The ghost pattern will still be there in the CCI. This “priceless” trading is certainly far removed from typical technical trading approaches — which is ultimately something of an advantage. 📍

For information on the author see p. 6.

### FIGURE 5 — OVERNIGHT POSITION

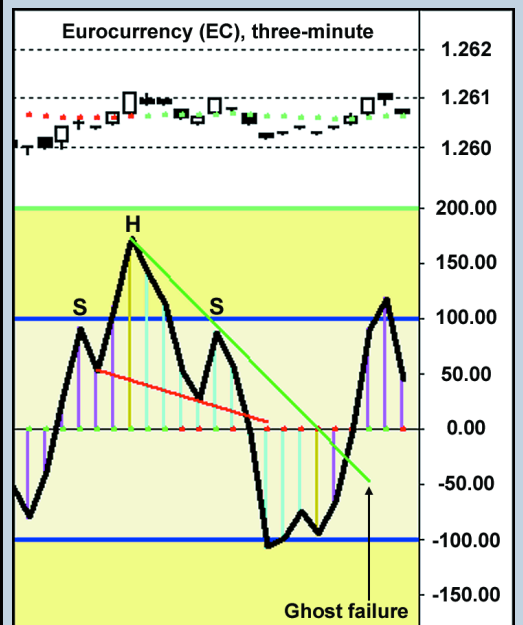
A longer-term swing trade is shown on this 233-tick chart. A short trade would have been triggered by a CCI neckline break, corresponding to an approximate price level of 9,575 (upper red arrow). The market gapped lower the next morning.



Source: TradeStation

### FIGURE 6 — FAILED PATTERN

This bearish ghost pattern failed to produce much downside follow-through, and a move back above the trendline connecting the head and the right shoulder was used to stop out the trade.



Source: Sierra Charts