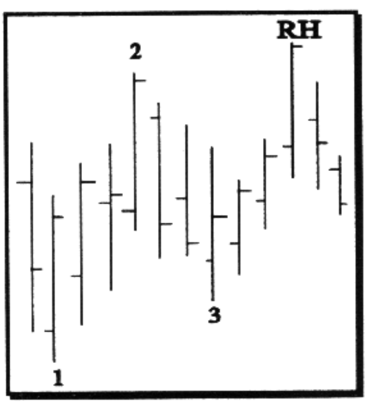
Joe Ross

TRADING BY THE MINUTE



ROSS TRADING EUROPE

Trading by the Minute

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Other books by Joe Ross:

Trading is a business • Trading by the Book
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Trading by the Minute

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To my son, Scott B. Ross, who contributed more to this book than he may ever know.

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Foreword

There are few authors in technical analyses who write with Joe Ross' clarity. The interesting thing is that when you read his manuals you feel the sense of *deja vu*. Those market features that you have seen in a vague pattern are now brought into focus as if a fog has been lifted. You can now define and hopefully anticipate market action.

This manual follows in the style of Trading by the Book. Indeed, there are many similarities in form and content. Yet Trading by the Minute has its own messages. Clearly a separate message to the day trader, but also there are many areas in which a position trader will recognize value.

Joe and I have been friends for some time. We have collaborated on trading techniques so I know of his dedication to the market. But in this book we see the other side of Joe – the instructor of the grand style. He is teaching us "How to Fish".

W. E. Dalton, MD

Introduction

PLEASE READ THIS

I have always been a rather private trader. Over the years that I've traded the futures markets, I've used family techniques and methods available only to myself, and to those taught by my family.

In my family, trading in the commodity markets goes back over 110 years.

The things I have discovered about futures trading, coupled with wisdom of old, make up my style of trading.

Several years ago, I was suddenly stricken with a lengthy and devastating illness that literally changed my life.

All my trading knowledge nearly died with me. When it looked as if I might have a little more time left, I set out to write down the way I trade. My instructional manual, Trading by the Book, was first written for my wife and children so they could, after learning the basics of trading, carry on the family tradition should they choose.

When I wrote Trading by the Book, it was the first time I had ever revealed my trading methods to anyone. I did so because, at that time, I firmly believed I had only a few months left to live, and I wanted to pass on a legacy.

It is now many years since my release from the hospital. To everyone's amazement, I am still alive — alive and back to being involved in the markets on a daily basis. Not only that, but I've found that I like to write and, even more important, I enjoy teaching about the way I trade.

Trading by the Minute, although a complete manual in its own right, is a natural sequel to another of my instructional manuals, Trading Is a Business. They are really part and parcel with each other.

The success of my trading courses has encouraged me to write this sequel. In it, I will try to show many of the things I've learned about successfully daytrading in the futures markets.

My trading is such that it has evolved over the years. I have always tried, and will continue to try, new things. I am not against any method, system, or concept that can be proven to work successfully over a period of time. I am never against anything that works for ***you*** in ***your*** own trading.

With the onset of "daytrading", and soon electronic trading as well, I have had to add many new wrinkles to my tried and true techniques of the past. Yet the good old ways, the methods that have been winners for over 100 years, are still the mainstay of my trading – even trading by the minute.

I will write this manual partly in the first person, and quite often using the collective "we." I can tell you what I do, and what I think "we" as traders should do. I cannot tell ***you*** what ***you*** should do. You're going to do what you want to do no matter what I say.

Hope lies in the extent to which you may want to emulate the success of my own trading. The wise trader will seek to incorporate my knowledge into his own method(s) and personal style of trading.

Most of the trades I show were engaged in specifically for the purposes of writing this book. Although in the past I traded larger size and at lower commissions than most, these days I have cut back on my trading and pay commissions similar to those paid by many. In the trades for this book, I used the number of contracts and computed commissions and costs according to what was in effect at the time I made the trades. I can tell you that my costs when trading large size were as low as $6/round turn. My cost for many of the examples was $15/round turn.

When trading for purposes of writing the book, I stay and even enter trades late in the day. This is not my usual way. I rarely trade as late in the day as I do when writing for a book. However, I find it necessary when writing because of the time invested. When I've spent an entire day watching a screen, I push harder to come out of that day with something to show for it. I want to earn my keep for the day, and I want to have something to show my readers. When it comes to the S&P 500, I rarely trade during the New York lunch hour.

When I trade for purposes of writing about it, I try hard to be as mechanical as I can be so that to the greatest extent possible my own instincts and intuitive feelings are removed from the trade. I want the <u>method</u> to be in the forefront of each trade. Yet I find it is not always possible to separate my feelings from what I am doing. Wherever such is the case, I have endeavored to explain my thought process. There is a reason for doing what I do. I have tried to put my reasoning into the book whenever I have deviated from the purest form of the method.

There will be instances when I stray from the method and there is no explanation. These are not intentional. I am not a perfect trader. I miss moves, miscount bars and segments, miscount points and money, fail to see various formations, etc.

In putting together this course, the emphasis is on technique, not on the overall way I trade. In order to teach a lesson, I am forced to have tunnel vision.

In actual practice, I filter every daytrade through the daily chart, and often through the weekly chart as well. I attempt to trade only in markets that are trending on the daily chart. I take only trades that are in the direction of the trend, especially when a market is correcting.

When writing, I cannot take such a broad view. In that sense, the trades shown are out of context with the reality of the broader market. In some instances, I purposely took trades that were not in trending markets, in order to illustrate a point.

In my own trading I am very selective. I choose only trades that I feel are very strong — in my mind, virtually sure things.

In addition to my technical signals, I look for unusual things in the market that might tip me off as to the very best selection. Such extraneous matters go far beyond the scope of this book. Much as I'd like to include them here, the impracticality of doing so has to be a factor. I have neither the time nor the willingness to sit down to write a ten-thousand page tome expounding every last detail of the way I trade. Perhaps some day I'll do a video of my trading so that much of what I do can be seen as well as heard.

Those readers who are familiar with my tutoring and seminars know that I'm terrible with arithmetic. When I'm trading I make severe and seemingly careless errors. I have a very bad time with fractions. My arithmetic shortcomings have been there since my earliest childhood memories. I am severely dyslexic. I make a lot of mistakes – I think I have made a profit when I haven't, I think I have taken a loss when I haven't. Often I use too many or too few contracts to cover costs because of arithmetic errors. Amazingly, it has never really affected my trading. I just plow along doing my thing, and somehow at the end of the week, my wife, who keeps my books far more accurately than I ever could, tells me I've done okay. "Whatever it is you're doing," she says, "keep up the good work."

In the parts of the book involving bar and segment counting, I allude to spreading my position overnight in a back month. This particular subject goes beyond the scope of this book, but is covered in my book Trading Spreads and Seasonals. Suffice it to say that I often hedge my positions in markets that trade overnight by spreading or by entering stops in the cash and/or foreign futures markets. This is a concept that totally confuses many of my readers and certainly many of my seminar students. As stated, it goes far beyond the scope of this book, but for the reader who is familiar with such tactics, please understand that I do this to protect my position. For the reader who does not know what I'm talking about, this should be an encouragement to attend a seminar to learn about such things before, not after, suffering large losses of capital.

ABOUT THIS REVISION

When I first wrote this book, I wanted to demonstrate a very specific way of daytrading centered around the concept of matching congestions. In practice, this has proved difficult for most of my students. They simply do not have the experience needed to perceive and trade these matching formations profitably. Yet, there are some who have done well with this way of trading. In part, matching congestions are perceived through the eye of the beholder. Trading them is somewhat intuitive. Describing how to recognize them is definitely subjective.

In this revision they are presented again for those who have the depth of experience in the markets to trade them well.

In addition, I have included methods for daytrading that leave little or no room at all for interpretation. I lead the reader step by step into the segment counting method. This method is so precise that it could be automated under some form of artificial intelligence. It has definite and consistent rules. In my opinion, it is best done in light of human reason and judgment. This method, and the steps leading up to it, take up the greater part of the manual, and follow the concepts presented for matching congestions. If matching congestions seems too difficult, then trade with the segment count method. It has proven successful for over 110 years of position trading, and is still successful regardless of time frame as long as a definitive chart is available.

ABOUT CONTRACT SETS

In the first presentation of contract sets, I suggested using multiples of three contracts. In this revision, I suggest using at least a two contract set, then three, four, or five. Beyond five contracts, I recommend using increments of five. This would give ten, fifteen, twenty, twenty-five, etc.

What must be considered is which gives the best results over all —entering the market with an odd-lot, or exiting the market with an odd-lot.

Based on my own experience, the better result comes by exiting the market with an odd-lot.

This will make more sense as the rest of the material in the book is absorbed. As the trades unfold, ask "Is it better to enter the market with a nine lot, and liquidate a four lot to cover costs, leaving an exit for profit with a five (round) lot, or is it better to enter with a ten (round) lot, liquidate a four lot to cover costs, and exit with a six (odd) lot?"

The odd lot is going to result in more slippage for the fill. It has proved better to exit on the odd-lot, and give up slippage on the profit end of a trade, than to enter on the odd-lot, and give up slippage on the cost end of the trade. In the long run, the reader will have to decide this for himself within the context of his own trading style.

ABOUT THE SECOND PRINTING

I have added a more complete description of the various ways to spot a trend in its inception.

I have made minor corrections throughout for the purpose of clarity and to correct minor publishing errors.

ABOUT THE FOURTH PRINTING

For purposes of clarity, the text has been greatly expanded in many chapters and numerous charts have been updated.

Chapter 1

THE TRUTH IS THE TRUTH

Although I have written this book from the orientation of the intraday chart, the things I do and show here can easily be extrapolated to the daily chart. Where we will examine the relationship between a daily chart and an intraday chart, those who are not daytraders can do the same thing in the context of the relationship between a weekly chart and a daily chart.

In essence, other than as concerns the magnitude of a move, a chart is a chart is a chart.

What we will see in the early parts of this book centers almost entirely around congestion areas which may be seen on any chart in any time frame. In the later parts of the book, the things we will examine center around trending formations. It is important to be able to spot the very beginning of a trend, and also be able to enter existing and established trends with great success.

The major differences between trading the intraday chart versus trading the daily chart have to do with time volatility, and the magnitude of the move in prices.

A more definitive comparison between the five minute chart and the daily chart is given just ahead.

Decisions must be made more quickly using the intraday charts, and the tradable patterns form more quickly on the intraday charts.

Other than that, trading is essentially the same. Later in the book, in a chapter entitled "Full Circle," I will demonstrate the truth of what I have just said.

It is important to realize that the use of a live data feed, in most instances, gives certain advantages to the daytrader over the daily trader, when it comes to the matter of optimizing entry and exit. When used properly, daytrading can result in not leaving nearly so much money on the table as can daily position trading without intraday entry. However, proper use of intraday data is very difficult to achieve. It takes great discipline to utilize it properly so as not to end up overtrading.

DEFINITION OF DAYTRADING

At this point, I want to define daytrading as it will be used throughout this book. My definition may be different from that of others, so I want to clarify exactly what I mean. Typically, daytrading is defined as entering a market at or after the open, and exiting at or before the close. In addition, the definition of daytrading presented here includes any method or system that uses a live, real-time data source to determine entry and exit signals to and from any market. This would include tape reading, hand-held quote devices, watching an electronic quote board, or even one of the old electrical clacker boards.

I know it is possible to "daytrade" without a live data feed. I have met some who do that. I know of two men who literally drive their brokers crazy by calling in every few minutes to find out the prices of the contracts they trade intraday. By my definition, this is not daytrading. Nor is trading from a delayed data feed daytrading, by my definition.

The most fundamental concept this book teaches is that it is essential to learn to recognize what any chart looks like just before an important move or breakout. Equally important is to be able to recognize congestion at the earliest possible time. This necessitates that a chart look a certain way. Throughout this manual, we will see charts that have that look. They must be of sufficient length of time to be well formed. A five minute bond chart is usually the exact opposite of the type of chart formations I look for. Later we will see a five minute bond chart and other charts that are untradable by the methods presented here.

COMPARING DAYTRADING WITH POSITION TRADING

When I first started daytrading in the commodity futures markets, I was unable to find books of any kind covering the subject. Everything I did was done without prior knowledge as to how to go about daytrading. I had no idea of what to expect. I did not know if the things that had always worked for me would continue to work successfully. Therefore, learning to daytrade was a new adventure and a great challenge for me.

In some respects, daytrading is not all that different from trading daily charts. Yet, in other respects, it is as different as night and day.

SIMILARITIES OF DAYTRADING AND POSITION TRADING

The similarities between intraday trading and trading from the daily chart are numerous.

Intraday charts look pretty much like daily charts, but with some notable exceptions. In part, how the charts look is a function of the data feed service we individually decide to use. I've tried different ones side by side, and there are differences in the appearance of individual price bars. They often disagree about where a price bar opens and closes, and where the high and the low occurred. There are also differences due to the particular software we may choose to use. The appearance of the charts vary from one software package to another.
I have tried several.

With some programs, the clock setting on the computer also makes a difference in how the software sees the individual price bars. There are differences in the way the data is handled from one computer program to another, and even running the same program on two computers with different clock settings will make a difference in how the individual price bars appear on the charts. When I talk about clock settings, I am referring to the time clock on the computer that shows hours, minutes, and seconds, as opposed to the internal clock that controls the hardware cycles.

Intraday charts make essentially the same formations as do daily or weekly charts. There are trading congestions connected by trends. There are retracements, sideways movements, pauses, gaps, and waves.

I suppose that if traders had the time to study intraday charts in the manner in which they have studied monthly, weekly, and daily charts, that cycles could be observed to occur as much on a one minute chart as they do on a daily chart. I know of traders who trade intraday based upon astral phenomena and ocean tides.

Intraday charts can be traded utilizing Fibonacci, Gann, and Elliot techniques, fan lines, speedlines, pitchforks, oscillators, moving averages, RSI, Stochastics, DEMA, MACD, Commodity Channel Index, Volatility Stop, Parabolic Stop, Cycle Projection, and any other of the host of technical analysis tools available for use in the market today.

DIFFERENCES BETWEEN DAYTRADING AND POSITION TRADING

Some differences are to be found in the way certain of the charts appear to the eye. The Long-bond futures contract, Eurodollars, in fact all of the interest rate contracts, usually appear flat on a five minute chart, quite different from the way they appear on daily charts. On most days, the chart formations on these do not begin to look like the daily charts until the price bars are captured on a sixty minute interval. In some instances, better yet is a 120 minute chart for seeing the interest rate contracts in the way I like to see a chart.

Differences in volatility show up in that a move on a one minute chart that covers the entire height of the screen may appear as a normal size bar on a daily chart.

Charts for the more thinly traded contracts, and some of the more volatile contracts, appear as virtually unrecognizable and untradable, losing any symmetry and formation I might want to use in trading them.

OTHER DIFFERENCES

Slippage is a greater problem in daytrading than it is in position trading. The same amount of slippage on a daytrade is proportionately greater in relation to an intraday chart than it is to a daily chart. A daytrade yields less time to absorb slippage. Therefore, holding slippage to a minimum becomes critical.
Keeping slippage at a minimum necessitates using fewer order types based on an intraday chart than we might use on a daily chart. We must know within a point or two where we are going to be filled.

Trying to have minimal slippage also affects size. We have to be careful to maintain lot sizes that are normally traded. We want to avoid odd-lots, such as twenty-three S&P 500 contracts, or nine crude oil contracts. Where will we find an opposite trade to offset such strange numbers?

Very often, we can consider liquidating a lot size to cover costs that is greater than needed just so we will be left with an easily liquidated lot size should there be a need to get out in a hurry, or to help insure the least slippage for a profit taking fill.

Fundamentals play little part in trading the intraday charts. News affects the opening calls, and, of course, it can have impact on the action during the day, but a long term position trade on a one minute chart can consist of about twenty price bars. Often a trade consists of five to ten price bars, and occasionally only one price bar is sufficient for a trading decision.

Seasonality, in the conventional sense, has virtually no manageable effect on intraday trading, other than as a possible initial entry technique.

News stories and rumors greatly affect the intraday charts, causing huge runs during the day and yawning gaps at the open.

Obtaining good fills becomes absolutely critical in intraday trading, and the problem of entry and exit on a same short term price bar can be enormous, because one doesn't yet know if the entry fill was completed prior to having to enter the exit order. In some of the more thinly traded markets, and at intervals when a market is fast, even a trade taken from a ten minute chart do not give sufficient time for knowing whether or not an entry order was filled prior to the appearance of the next ten minute bar, and having to enter the exit order for a particular trade. Execution is a major consideration in daytrading, and we will delve into it in greater detail in the appropriate places.

IF YOU ARE GOING TO DAYTRADE, YOU MUST HAVE EXCELLENT ACCESS TO THE TRADING FLOOR, EITHER BY TELEPHONE OR ELECTRONIC ORDER ENTRY. WITHOUT THAT, YOU ARE ASKING TO BE SLAUGHTERED.

The amount of commissions to be paid becomes critical in daytrading. Having less time and range of movement with which to absorb overhead means that it is vital to secure and maintain the lowest possible commissions per round turn.

The area of trade management becomes totally different in intraday trading, and the strategy and tactics involved are much different when trading intraday than when trading the daily charts. Please notice that I said <u>trade management</u>, and not risk management or money management. The main difference in trade management has to do with the hurried way in which we often have to trade intraday.

By trade management, I mean the mechanics of entering or exiting a trade. In daytrading, I often substitute trade management for money management. Instead of having an objective of a certain number of points or dollars for purposes of exiting all or part of my position, I simply exit based on what I see on the chart.

Those who have read my manual <u>Trading by the Book</u> know that I pretty much reject the practicality of fundamental trading because, as an individual, I have neither the time nor money to pursue the acquisition of sufficient fundamental knowledge from which to make trading decisions.

Also, with the exception of mentally noting where Fibonacci ratios are located so that I can fade the Fibonacci traders, along with the occasional use of the Bollinger Bands, or a 3 bar offset moving average, I reject the use of the dozens of technical trading tools in my own trading of the intraday charts.

But because I reject almost all of the technical trading tools for intraday trading doesn't mean that there are not others who use them effectively. There are! But for me they just seem to get in the way.

As regards Fibonacci ratios, I use visual retracement ratios only as a filter to tell me if a market is behaving normally, and to see where the Fibonacci traders have their stops. I do not use Fibonacci expansion ratios to help me set objectives for my trades. They are too time consuming and totally unnecessary in the way I daytrade. Besides, that is where the Fibonacci traders will attempt to exit, and there is usually a host of insiders waiting for them to make their move. By insiders, I mean those traders who are able to move the market by means of sheer volume of contracts.

Do I deny the fact that there will be buying at Fibonacci support and selling at Fibonacci resistance prices. No! There almost certainly will, especially in those markets where Fibonacci numbers have become popular.

Although I do have a sense of where the Fibonacci retracement ratios are located, in my use of these I differ greatly from the "norm", in that I do not trade from the retracement ratio points as do most who use Fibonacci. I use my perception of where they are to tell me if a market is acting as I might expect it to. In that sense, it is "nice to know" information. I also use the retracement ratios to ascertain where a move is likely to stop or pause, as knowledgeable traders take advantage of the less knowledgeable traders. Perhaps I should call them "the knowledgeably challenged" traders.

I would strongly urge anyone wanting a more complete understanding of my basic trading philosophy to purchase Trading by the Book. Better yet is to come to one of my seminars. Much of what will be found in Trading by the Minute derives from the age old truths found in Trading by the Book, and taught at the seminars. The concepts shown in Trading by the Book and at the seminars, along with many of the tips and techniques shown, are for the most part applicable to trading in virtually any time frame.

When trading intraday charts, I use no "technical" tools at all, other than very occasionally using the moving average mentioned above. This is, more specifically, a three bar simple moving average of the close set forward three bars in time. When I do use it, it's usually to provide variety in my trading so that I'm not always doing exactly the same thing.

My approach to intraday trading is based entirely upon what I see before me in the form of a bar chart showing Open, High, Low, and Close. As previously stated, I use virtually no technical tools in my daytrading. Why? Because I feel they operate only to confuse the picture, **AND BECAUSE THEY ARE WHAT THE MAJORITY OF THE OTHER TRADERS ARE USING — AND IF YOU BELIEVE THE STATISTICS, YOU KNOW THAT THE MAJORITY ARE CONSISTENTLY LOSING IN THE MARKETS!**

The closest I can get to the truth of what is happening in the markets is what I am able to see on my bar chart as prices tick up and down on the computer screen. Notice I said "closest". The bar chart is the best I can do, but even it doesn't tell me the whole truth, and what it does tell me is always history even with a live data feed.

I know of a number of traders who thought that because they had a live data feed, they could trade the markets just as a floor trader would. That is emphatically not true, although the data feed suppliers would like to convince you that having a live data feed is as though you are "right there in the pit with the floor traders."

BE AWARE THAT THE EXCHANGES CONSIDER ANYTHING UNDER 5 MINUTES TO BE LIVE DATA. I HAVE SEEN DATA FEEDS THAT RUN AS MUCH AS 4-1/2 MINUTES BEHIND THE PRICE ACTION IN THE PITS, YET THE COMPANY SELLING THE DATA CLAIMS THAT THEY ARE SUPPLYING YOU WITH LIVE DATA.

On my live data feed, I can't see how many traders are in the pits. The volume I see on my chart is tick volume, only a best guess of the actual volume on the trading floor. I can't immediately see if a market is thin, I can only guess, ask my broker, or try to come up with a reasonable assessment based on tick volume. I cannot sense the emotions or moods on the trading floor. I cannot tell if there are more buy orders than sell orders, or vice-versa.

I can only belatedly realize that a market has started to become "fast". Another handicap is that I cannot see who is doing the trading. I am unaware when a "commercial," or a large trader comes onto the floor and begins to suddenly or incrementally buy or sell. Probably my biggest disadvantage is that I cannot see the "bid", "ask" or "size" figures. Although they are available through my daytrading software, they are posted too late to do me any good. They are always way behind-times.

Another important item that's missing is that I can't hear the action as the floor traders can. They react to the noise levels – I cannot.

These limitations, of necessity, have an effect on my trading style and results. The way I trade has to compensate for the lack of "truth" or real knowledge I have to deal with when trading from a computer screen.

Another major limitation I have is that of time. I dare not use the so-called support and resistance points that the floor traders use. I dare not use the same so-called "safe-buy" and "safe-sell" points that are being used by the floor traders. The difference is that they are THERE, in the pit, and can react immediately to the price action. As stated, the floor traders have the advantage of "hearing" the action on the floor and seeing the participants. They also have the advantage of not having to place an order in the market. They simply buy from or sell to the nearest available trader who is looking for the opposite action and lot size. The floor traders can "see" the lot sizes being bid and offered, I cannot. They know immediately if they can buy a 20 lot, whereas I have to guess.

Even though my data feed is "real time", there is a minimum ten second transmission delay between when I see a price tick and when it actually ticks on the floor. Added to that is the incremental delay within the computer program that takes place between the time the data is received by the program, and the time slice given for posting to the particular market(s) in which I'm trying to trade. The refresh rate to the screen for each tick causes a tiny delay. The data feed itself causes delays. The delays are something I have to live with that the floor trader doesn't have to live with.

Another problem I have with time, which changes the whole ball game as to the way I can trade versus the way someone on the floor can trade, is that I have to deal with the inevitable delay of the telephone call for placing my order, and the ensuing clerical procedure necessary to get my order into the pit. This is true even with electronic order entry. If and when I call directly to the floor, there is a delay as the order ticket is written and then taken to or signaled to the trading pit. Even if the order is "arbed" in before it is written, I have a delay of several seconds. There are also times when the market is fast when I cannot get my order arbed in at all. The fact is that unless I have an electronic trading system, the real delay for my trades is 25-60 seconds behind the real price action. With some data feeds, as previously mentioned, it is worse than that.

The time intervals I lose, compared with the actuality that is taking place on the trading floor, amount to a tremendous handicap that has to be dealt with and overcome by the methods I use in my trading.

I also have to live with higher commissions than do floor traders. Even a low round-turn commission off the floor results in paying several times the commission that some floor traders pay.

Finally, I have to put up with the inevitable missed ticks that fail to come across my data feed and bad ticks that come all too frequently across any data feed. They love to come at critical decision times. They are a major annoyance in daytrading, especially those you cannot see because they fall within the "norm" of the current price action. Bad ticks are an especially large problem when dealing with data from the New York markets.

I stated previously that technical indicators only tend to confuse the picture. Anyone who uses them knows that a three bar version of a moving average, a momentum oscillator, a channel index, DEMA, RSI, Stochastic, etc., look and behave differently than an eighteen bar version of the same technical indicator. Which one is to be believed? All technical indicators are figments of the imagination. They are created by the trader and render different trading decisions from the same trader depending upon the length of their base.

Technical indicators tend to smooth things, when the underlying reality upon which they are based is anything but smooth. Prices tend to chop up and down, making rather large moves in spurts from time to time. The large moves and gaps tend to distort any indicator that is not smoothed to the point that it no longer has much to do with the reality of the price action.

My way of trading is to trade from the reality of what is happening to the price as reflected on the computer screen in front of me. Since what I see there is the closest I can come to the truth, for me it ***is*** the truth.

Another thing to realize when trading intraday charts is that by the end of the day there will, on the shorter term charts, be a great many bars. For instance, on a one minute chart, there may be as many as 405 price bars showing. That is the equivalent of many months of trading on the daily charts. In addition to those 405 bars, there are those that have already slid off the beginning of the chart. This is especially true of the currencies, the interest rates, and the stock index charts.

That's a lot of price bars, and it represents a lot of trading decisions. If I were to "add to my position" each time there was a trading opportunity on a one minute chart, I could go insane...and so could my broker. Of course, "adding" to a position is a fallacy which exists only in one's mind. You cannot add to an existing position. Each so-called "addition" is really a new position with all new risk, and which may have nothing to do with the factors upon which the original entry decision was made.

Therefore, I do not trade in and out all day long. I simply cannot take the wear and tear. If I did trade in and out (like the floor traders), I would simply burn out before the end of the day. In fact, I know someone who had a nervous breakdown doing that very thing.

I'm not saying that others can't do it. I'm saying <u>I</u> can't do it. It's too intense for me, and it's too much like hard work.

I'm often asked by others, "Do you daytrade?"

By now the answer should be obvious. Yes, I do daytrade. But I cannot do it all the time.
It takes great energy to daytrade. It involves a great intensity of concentration.

I have, at times, daytraded intensively for a few days, but then I had to rest and get away from the markets. The odd thing about that kind of intense trading is that I don't always know when I've had enough. I usually find out or realize I've been at it too long when I wake up to the fact that I'm losing too much money.

The intensity of daytrading has a way of hypnotizing me so that after awhile I really am not seeing much of anything. I become dull. My perception of the market action is no longer sharp. I have become saturated and my mind has become numb.

It takes great energy to daytrade and the cost in mental and physical wear and tear makes it problematic from a practical standpoint.

I am not alone in this perception of daytrading. One friend of mine, who has been a professional trader for 24 years, says that all he can stand of it is two or three days out of each month.

Another friend, who has a seat at the CBOT, told me it is easier to trade down on the floor than to daytrade from a screen off the floor. He has been trading for 36 years, and is one of the all-time greats of trading.

Because daytrading is so intense, because I personally can't handle too much of it, and most of all because the greater profits are made long term, I also position trade the intraday charts. I attempt whenever possible to turn a daytrade into a position trade. I'll be showing how I do that in a later chapter.

Position trading is a lot more relaxed. The trades more or less take care of themselves.
I don't have to pay much attention to them. Once I have turned a daytrade into a position trade, all I have to do is monitor the trade closely enough to move my profit protecting stops and get out at any objectives I have set for the trade. Typically, my profit protecting stop is one and the same with my objective, and my objective is based on trade, not money, management. I want to be stopped out with a profit. I quit trying to pick market tops and bottoms long ago.

Chapter 2

CHART READING

What is chart reading? Why is it important? What is meant by chart reading?

Chart reading involves determining the most likely direction in which prices will move based on a pictorial representation of price action. Chart readers believe that everything known about a particular futures contract is reflected in its price at the moment you are viewing it on your screen. With proper implementation and interpretation, a bar chart can reveal very powerful price patterns.

The immediate psychology of a market is reflected in the price action. What you see in price patterns would seem to be nothing more than supply and demand in action. Supply and demand and market valuation are not the only things determining price action. When you are able to accept this as fact, and appreciate the psychology behind the various patterns, you will begin to appreciate why price patterns are worthy of very close inspection and analysis. The only way to gain confidence in the price patterns is to see them in action. We will view them when they provide profitable trading signals and when the patterns fail.

It is this concept that makes trading quite different from investing. Investors, unless they are entering orders based on some "hot tip," usually trade based on their own or someone else's investigation of a company's or a futures' fundamental vital statistics. Investing is wisely done based on fundamental information about the condition of a particular company or futures market and often its standing relative to other similar underlying assets. Conversely, trading, especially daytrading, is done mostly based upon technical information. A chart showing a futures' open, high, low, and closing prices is, in the estimation of many, the best possible way to trade based on technical information. From the point of view of a chart trader, supply and demand are seldom directly related. The same is true of a futures' fundamentals. For a chart trader, a futures fundamentals are not directly related to how we as traders deal with a market. As traders we base our trading decisions on what we see on a chart. We look at the overall picture before us. We also learn to examine in minute detail the behavior of each price bar as it appears before us. We do this regardless of the time frame in which we trade. We are looking for any clue that might indicate to us what will happen next.

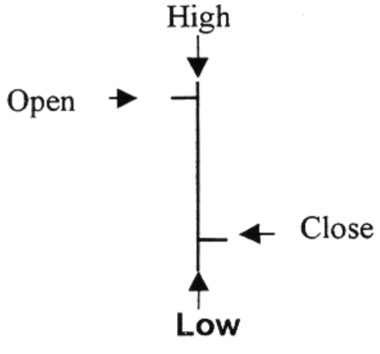
A CHART IS A CHART

To us as traders, ***a chart is a chart, is a chart***. We don't care which underlying vehicle is involved as long as we see good price action and good liquidity.

Years of looking at price charts have revealed that there is a "Law of Charts (TLOC)." The law states that anything that can be charted and displayed as a bar chart, having both high and low values for the interval represented by each bar, will always present itself as one of four definable chart patterns. These are:

- 1-2-3 high and low formations
- Ledges
- Trading Ranges
- Ross Hooks

Now let's examine these formations. Learning them is critical to what will be taught throughout this course.



First, notice the picture on the left. We will be discussing bar charts. The picture on the left is a price bar. It consists of an Open, a High, a Low, and a Close.

THE LAW OF CHARTS

THROUGHOUT THE REMAINDER OF THIS COURSE I WILL OFTEN REFER TO THE LAW OF CHARTS AS TLOC. THESE INCLUDE 1-2-3 HIGHS AND LOWS, LEDGES, TRADING RANGES, AND ROSS HOOKS.

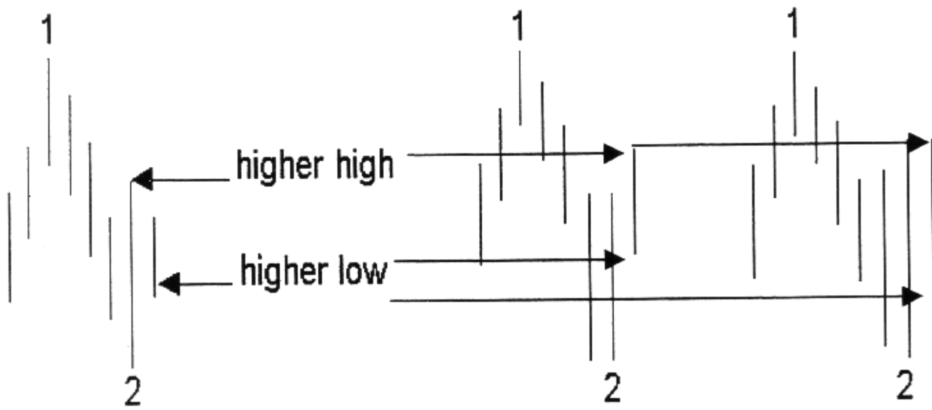
1-2-3 HIGHS AND LOWS

A typical 1-2-3 high is formed at the end of an uptrending market. Typically, prices will make a final high (1), proceed downward to point (2) where an upward correction begins; then proceed upward to a point where they resume a downward movement, thereby creating the pivot (3). There can be more than one bar in the movement from point 1 to point 2, and again from point 2 to point 3. There must be a full correction before points 2 or 3 can be defined.

A number 1 high is created when a previous up-move has ended and prices have begun to move down.

The number 1 point is identified as the last bar to have made a new high in the most recent up-leg of the latest swing.

The number 2 point of a 1-2-3 high is created when a *full* correction takes place. Full correction means that as prices move up from the potential ***number 2 point***, there must be a single bar that makes both a higher high and a higher low than the preceding bar *or* a combination of ***up to three bars*** creating both the higher high and the higher low. The higher high and the higher low may occur in any order. Subsequent to three bars we have congestion. Congestion will be explained in depth later on in the course. It is possible for both the number 1 and number 2 points to occur on the same bar.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1
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higher high
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2
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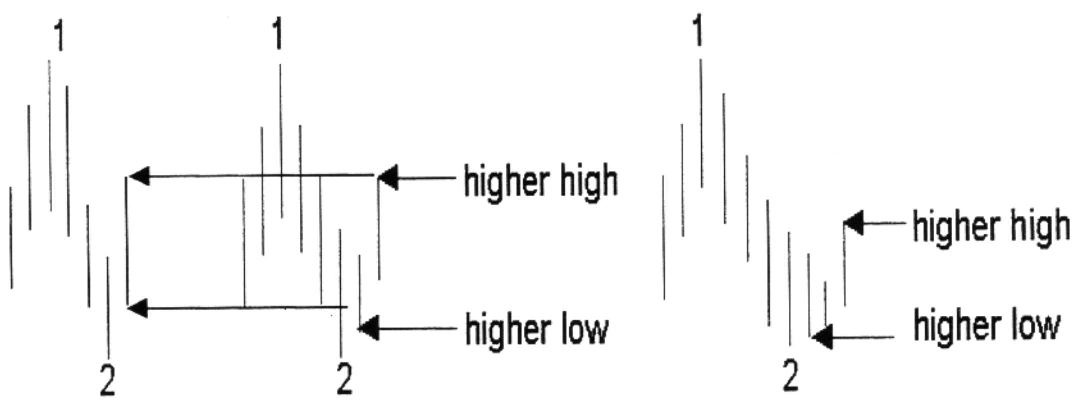
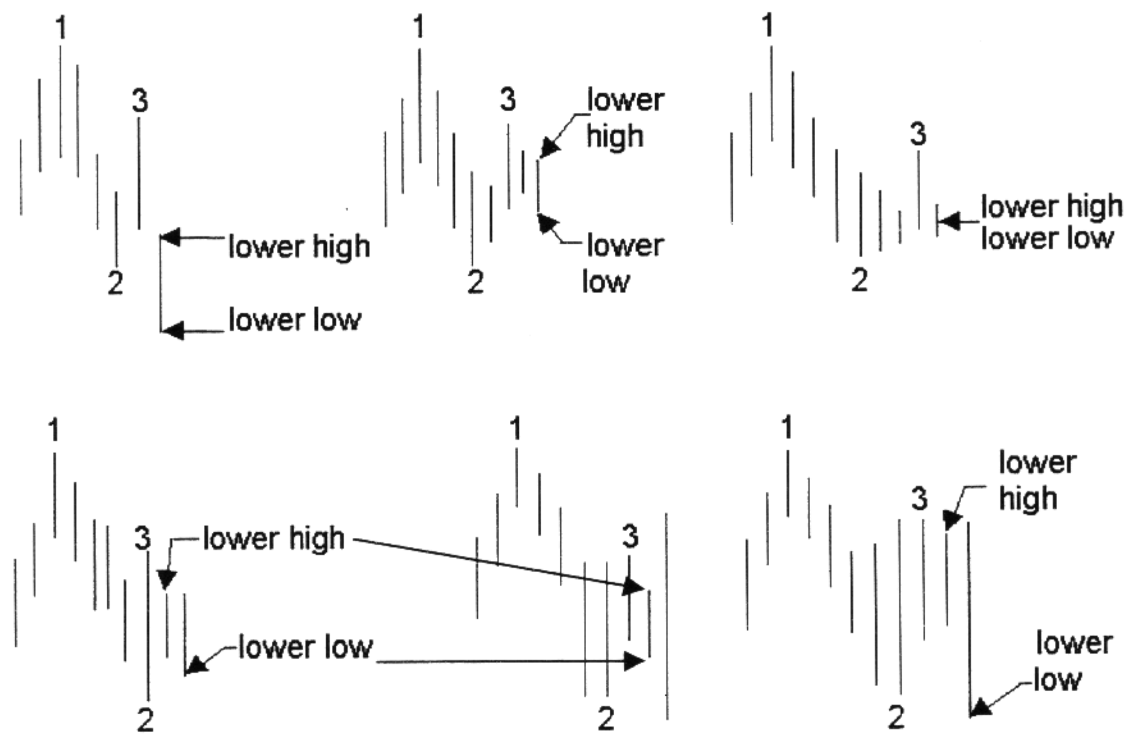
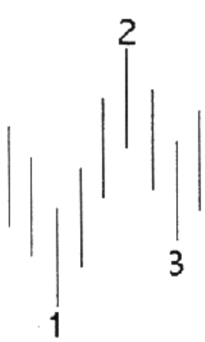
2


1
1
1
higher high
higher low
higher high
higher low
2
2
2

The number 3 point of a 1-2-3 high is created when a full correction takes place. A full correction means that as prices move down from the potential number 3 point, there must be a single bar that makes a lower low and a lower high than the preceding bar, *or* a combination of ***up to three bars*** creating both the lower low and the lower high. It is possible for both the number 2 and number 3 points to occur on the same bar.



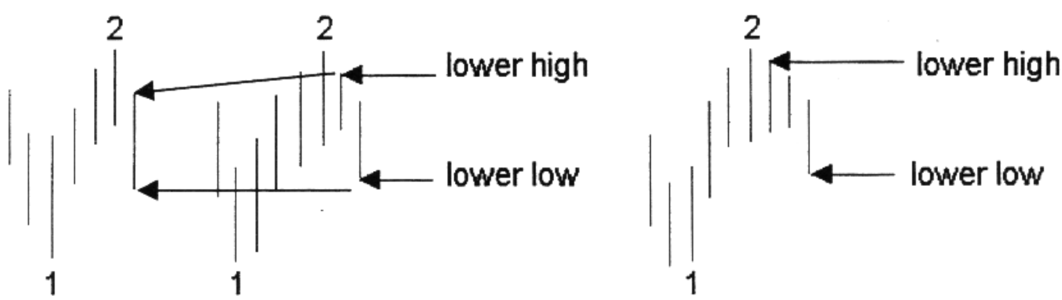
Now, let's look at a 1-2-3 low.

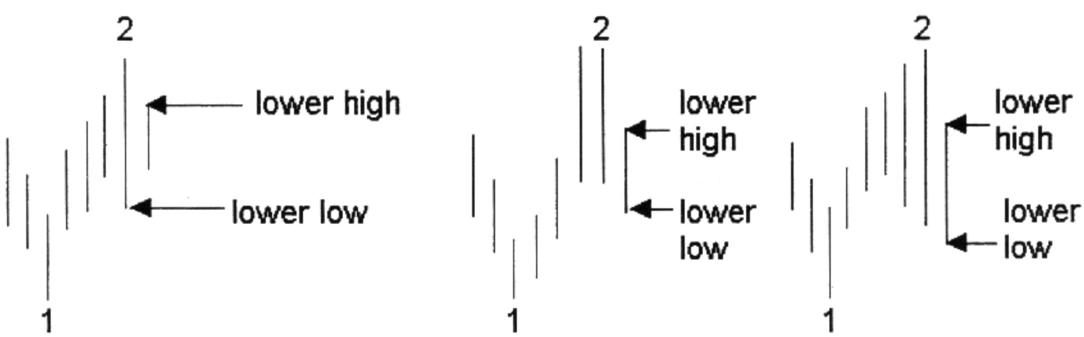


A typical 1-2-3 low is formed at the end of a downtrending market. Typically, prices will make a final low (1); proceed upward to point (2) where an downward correction begins; then proceed downward to a point where they resume an upward movement, thereby creating the pivot (3). There can be more than one bar in the movement from point 1 to point 2, and again from point 2 to point 3. There must be a full correction before points 2 or 3 can be defined.

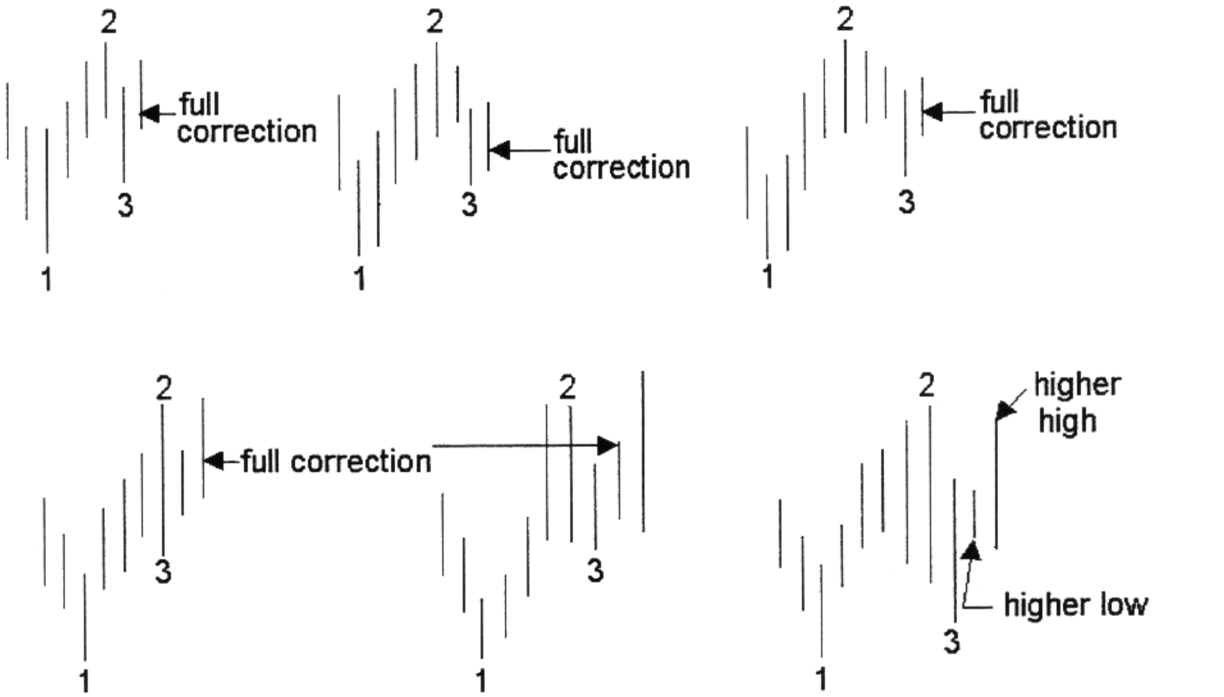
A number 1 low is created when a previous down-move has ended and prices have begun to move up. The number 1 point is identified as the last bar to have made a new low in the most recent down-leg of the latest swing.

The number 2 point of a 1-2-3 low is created when a *full* correction takes place. Full correction means that as prices move down from the ***potential number 2*** point, there must be a single bar that makes both a lower high and a lower low than the preceding bar, *or* a combination of ***up to three bars*** creating both the lower high and the lower low. The lower high and the lower low may occur in any order. Subsequent to three bars we have congestion. It is possible for both the number 1 and number 2 points to occur on the same bar.

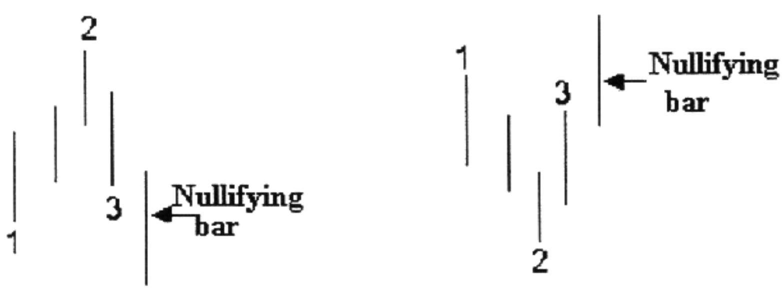




The number 3 point of a 1-2-3 low exists when a full correction takes place. A full correction means that as prices move up from the potential number 3 point, there must be a single bar that makes a higher low and a higher high than the preceding bar, *or* a combination of ***up to three bars*** creating both the higher low and the higher high. It is possible for both the number 2 and number 3 points to occur on the same bar.



The entire 1-2-3 high or low is nullified when any price bar moves prices equal to or beyond the number 1 point.

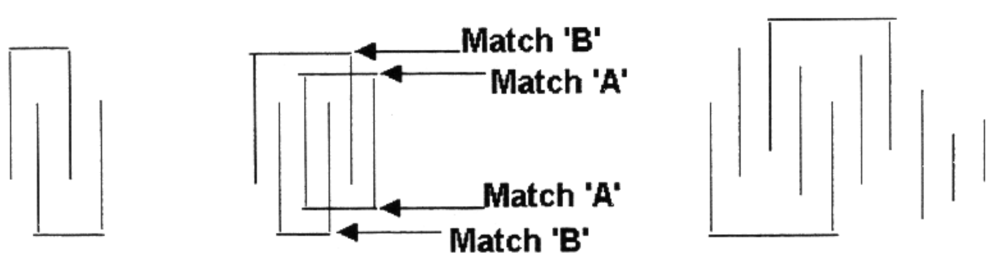


LEDGES

A LEDGE CONSISTS OF A MINIMUM OF FOUR PRICE BARS. IT MUST HAVE TWO MATCHING LOWS AND TWO MATCHING HIGHS. THE MATCHING HIGHS MUST BE SEPARATED BY AT LEAST ONE PRICE BAR, AND THE MATCHING LOWS MUST BE SEPARATED BY AT LEAST ONE PRICE BAR.

The matches need not be exact, but should not differ by more than three minimum tick fluctuations. If there are more than two matching highs and two matching lows, then it is optional whether to take an entry signal from either the latest price matches in the series (Match 'A') or those that represent the highest and lowest prices of the series (Match 'B'). [See below]

A LEDGE CANNOT CONTAIN MORE THAN 10 PRICE BARS. A LEDGE MUST EXIST WITHIN A TREND. The market must have trended up to the Ledge or down to the Ledge. The Ledge represents a resting point for prices, therefore you would expect the trend to continue subsequent to a Ledge breakout.



TRADING RANGES

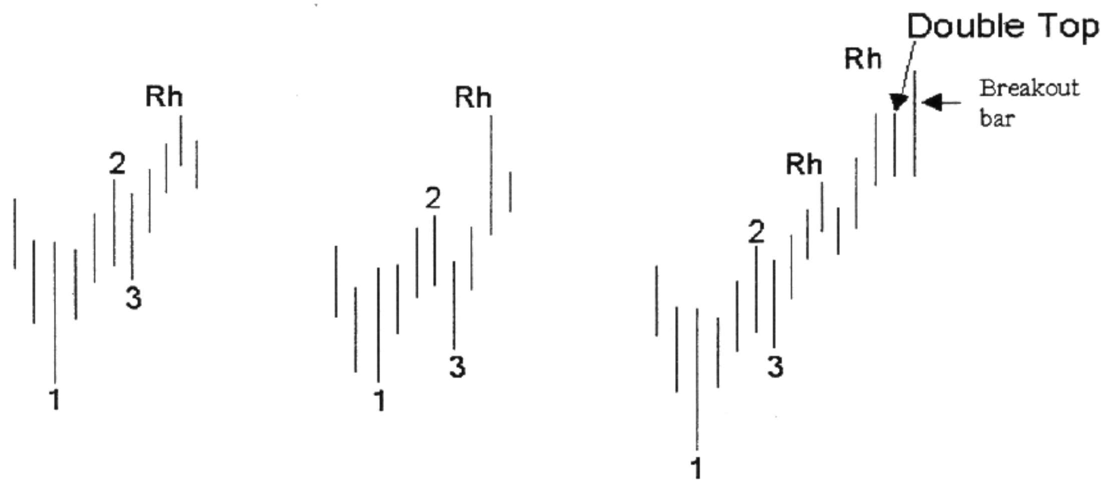
A Trading Range (See below) is similar to a Ledge, but must consist of more than ten price bars. The bars between ten and twenty are of little consequence. Usually, between bars 20 and 30, i.e., bars 21-29, there will be a breakout to the high or low of the Trading Range established by those bars prior to the breakout.

ROSS HOOKS

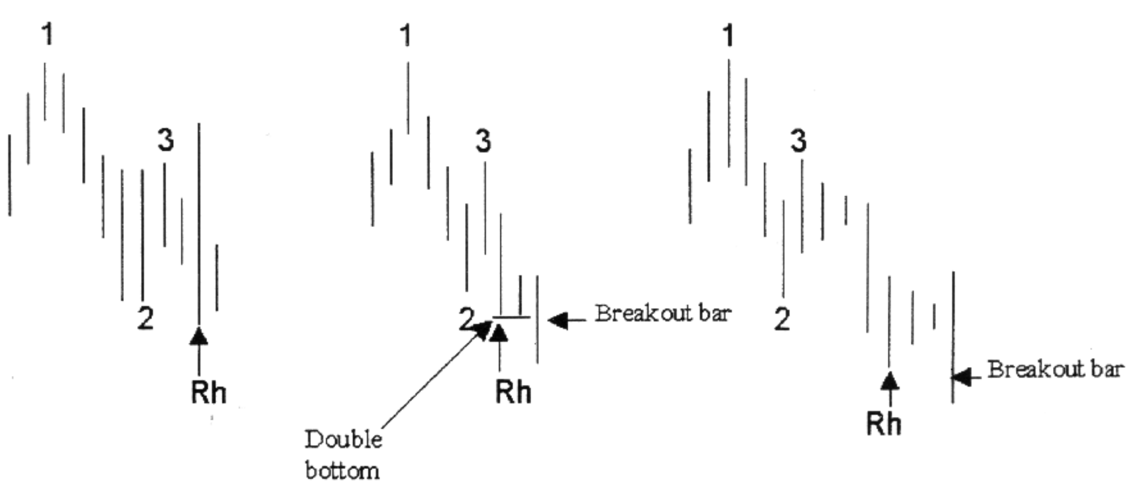
A Ross Hook is created by:

1. The first correction following the breakout of a 1-2-3 high or low.
2. The first correction following the breakout of a Ledge.
3. The first correction following the breakout of a Trading Range.

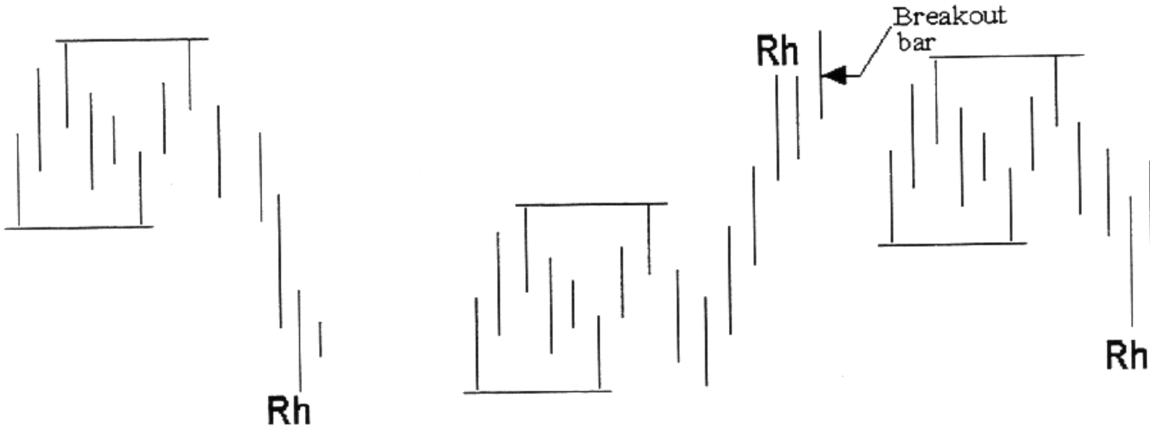
In an uptrending market, after the breakout of a 1-2-3 low, the first instance of the failure of a price bar to make a new high creates a Ross Hook. (A double high/double top also creates a Ross Hook).

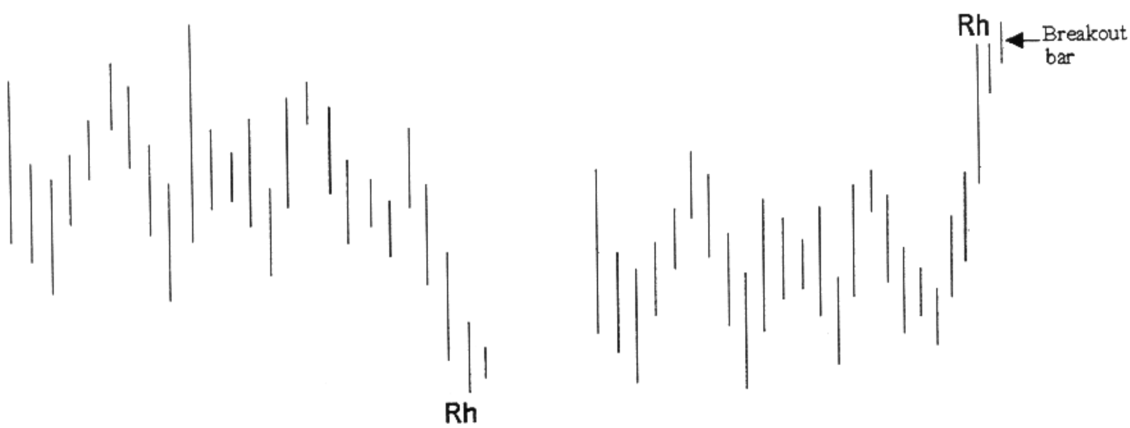


In a downtrending market, after the breakout of a 1-2-3 high, the first instance of the failure of a price bar to make a new low creates a Ross Hook. (A double low/double bottom also equals a Ross Hook).



If prices breakout to the upside of a Ledge or a Trading Range formation, the first instance of the failure by a price bar to make a new high creates a Ross Hook. If prices breakout to the downside of a Ledge or Trading Range formation, the first instance of the failure by a price bar to make a new low creates a Ross Hook (A double high or low also creates a Ross Hook).





We've defined the patterns that make up the Law of Charts (TLOC). Study them carefully. Later we'll show how to trade them.

What makes these formations unique is that they can be specifically defined. The ability to formulate a precise definition sets these formations apart from such vague generalities as "head and shoulders," "coils," "flags," "pennants," "megaphones," and other such supposed price patterns that are frequently attached as labels to the action of prices.

When one looks up into the night sky, it takes great imagination to say, "Oh, look! There is a 'bear' up there." By what definition is there a "bear" to be seen in the night sky? It is much the same with many of the so-called formations that various experts claim to see on charts. They lack definition and are seen only through a stretch of the imagination. The terms 1-2-3's, Ledges, Trading Ranges, and Ross Hooks may be names concocted from imagination, but the definition of these formations is precise.

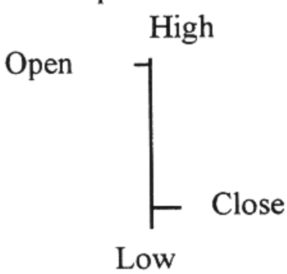
Chapter 3

TRADE SELECTION

With what has been discussed so far as a background, let's get down to some trading concepts.

MARKET ANATOMY

This represents a futures price action :



Looking at it carefully, what can be said about the price action? What can be seen here? What truth can be found in this single pictograph of price action?

We can say that prices opened near the current high and the last known price action is near the low, can't we? We can say that there is downward pressure and that the sellers are having more influence than the buyers, right? Let's agree that we can say that there is volatility in the price action – volatility being the amount of movement between the high and the low. Wouldn't you say that there is definitely momentum – a measure of the force, thrust, or energy behind the price action? We can see that prices changed direction at *least* three times. Surely we can say that there is a volume of trading, and that there was some measure of liquidity.

Are prices in a Trading Range? Truly they are in a Trading Range! They are in a Trading Range between the high and the low.

Isn't that true of all markets? Every market in existence is in a Trading Range between the highest high and the lowest low that it has ever experienced.

There is something else true about this market's price action: It either trended, stair-stepped, or collapsed from where we see the open to where we see the low.

There is a very important element missing from the knowledge of this market's price action – we have no idea of the time interval it represents. If the price bar represents a single minute of trading, the fact that it is trading down overall is of little significance. But if the price bar represents a year of trading, we would definitely conclude that this market is having a down year.

There is something else that's missing from our knowledge – we have no idea whether this contract is still trading, or whether trading has closed for the time interval it represents. Other items missing from our knowledge are: How *fast* is/was this market had we wanted to enter a trade? Were prices ticking rapidly? Could we have been filled had we wanted to enter a trade? We know there was volume, but we don't know how much. We know that there is liquidity, but again, we don't know how much.

Yet, the truths we know, along with what we don't know, are all we have upon which to base a trading decision should we choose to enter a trade in this market.

What if the pictograph represented the entire history of a market? If we look at a market and realize that it is in a Trading Range between the all-time high and the all-time low, then we can also realize that within this overall Trading Range there exist many lesser Trading Ranges. These lesser Trading Ranges occur over time at virtually every level of price activity that the market has.

But these Trading Ranges don't usually exist in a vacuum. Normally they are connected. The formations that connect them are called trend lines, stair steps, explosions and collapses.
A market, over time, has an anatomical structure. What we see are Trading Ranges, tied together by connectors. Trending formations, in turn, are made up of shorter Trading Ranges, gaps, large magnitude moves, and progressively ascending or descending price bars.

Excuse me if all this seems overly simple, but we have to start somewhere. What we're attempting to do is to lay out a basic foundation for what is to follow. What we're showing here is that price movement can be dissected – divided up into its component anatomical parts. There are ways to trade each of these component parts. There are ways to trade from Trading Ranges. There are ways to trade progressively ascending or descending trend formations. There are ways to trade from small congestion areas. There are ways to trade trend reversals, breakouts, retracements, and corrections. And there are ways to daytrade futures that, in some respects, are unique to daytrading; and there are ways to position trade futures that are, in some ways, unique to position trading.

This course is about how to daytrade the various situations that occur in a market. The methods shown are valid in any intraday time frame in which prices can be seen to form distinct trading patterns. Many of the concepts to be shown are valid in daily or weekly time frames, but the emphasis in this part of the course will be towards the intraday charts.

Trading these intraday charts requires somewhat different strategies and tactics from those that might be involved in trading daily, weekly, or monthly charts. It is possible to make a good part, if not all, of your living based upon using intraday charts.

Although these various formations are able to be traded as individual entities, and can be successfully traded in that manner, before you have finished studying this part of the course, I will show how to trade in such a way as to automatically include the individual component parts of what make up a market. That technique, when we get to it, will be called "segment counting."

TRADE SELECTION

Trade selection has two aspects: selecting a market, and selecting an entry point.

The first is easy; the second will take a bit more explanation.

SELECTING A TIME FRAME

I do not recommend trading on anything less than a chart having time intervals in which the Law of Charts is clearly visible.

SELECTING A FUTURES

The only futures which are day-tradable based upon intraday charts are:

- Those that are trending on the daily chart.
- Those that are liquid as indicated by solid price action and good movement on the intraday chart.
- Those that, because of current events, are attracting a lot of price action, regardless of whether to the long or short side.

SELECTING AN ENTRY POINT

The methods for selecting entry points are straightforward but will take some getting used to.

Entry techniques are based upon three levels of entry into a market.

These will be grouped as major, intermediate, and minor. All of them have one thing in common — THRUST!

We will not be buying or selling retracements (corrections) while they are in the process of retracing. We will not be buying or selling within a channel or Trading Range unless a single leg up or down has sufficient length to enable execution of a winning trade. If a series of trades turns out to be within a Trading Range or within a channel, it is purely coincidental and definitely not because of having drawn channel lines, or in some way having defined a Trading Range. The same thing is true of uptrend and downtrend lines; we will not use them other than for visual perception, and we will not trade retracements to them.

I can and do successfully enter markets without any signal from the daily chart. But I much prefer to enter an intraday trade based upon a significant event taken from the longer term momentum of the market. The daily chart gives us those significant events.

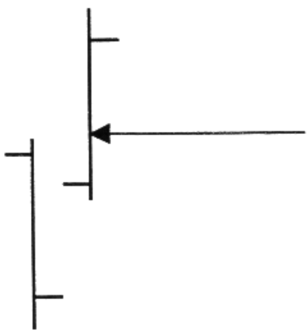
Remember the price action pictograph?

For example's sake, let's assume that this time it represents a daily price bar. What would constitute a significant event in this market? What is the most major thing that can happen?

Let's agree that the single most significant thing that can happen is a breakout of the high or low of that price bar.

Why? Because, as previously pointed out, this market is in a Trading Range between its high and low. To that extent, prices are stagnant. Unless prices make a new high or a new low, they are not really going anywhere.

But what if this market were to take out the high of the previous bar like so:



Could money have been made trading the breakout of that high? The answer to that is yes, provided the move is sufficiently great! And it is one basis for trading the intraday bar charts.

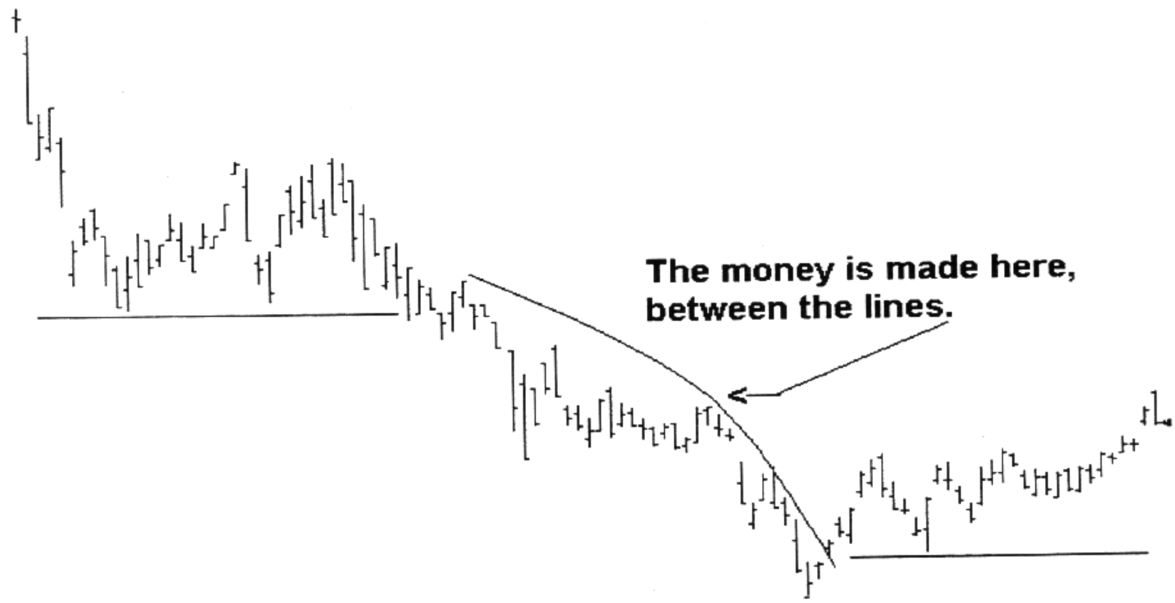
What we are talking about here is THRUST. For the time being, let's forget about where the market closed. That is of no significance whatsoever. We will have made our money and been out of the trade long before the close.

The important thing is that prices opened at a certain level, and at some time during the day the price action took out what had been the intraday high at the opening level, which was its first high for the day. When that high was taken out, it was a significant event. Profits could have been made. An even more significant event took place when the high of the previous day was violated.

IMPORTANT! **WHEN DAYTRADING AN INTRADAY CHART, WE ARE INTERESTED ONLY IN WHAT IS HAPPENING TODAY. WE ARE NOT WORRIED ABOUT THE CLOSE. THE CLOSE IS MANY PRICE BARS AWAY. WE ARE NOT WORRIED ABOUT TOMORROW – TOMORROW IS A WHOLE NEW SET OF EVENTS. WE ARE NOT WORRIED ABOUT WHAT HAPPENED YESTERDAY – YESTERDAY IS HISTORY, EXCEPT IN THAT WHAT HAPPENED YESTERDAY, OR THE DAY BEFORE, OR THE DAY BEFORE THAT, MAY BE RELATED TO WHAT OUR ACTIONS WILL BE TODAY**. More of that relationship ahead.

Although we will consider turning a daytrade into a position trade according to certain rules to be explained later, we must have a rule for our daytrade in and of itself, and this rule is absolute:
UNLESS WE ARE CONSIDERING CONVERSION TO A POSITION TRADE, WE WILL *NEVER* CARRY A DAYTRADE OVERNIGHT! We will ***always*** be out by the close of trading. That is what makes the trade a daytrade. It is not to be held overnight. If we do consider it for holding, it will have lost its status as a daytrade. We will have converted it to a position trade and will then begin to observe a different set of rules.

The truth about making money in the markets is that most of the money to be made is made when prices "pop" and then begin to trend. It is the connector trends between congestions that offer the most profit potential.



With that in mind, we will take in order major entry signals, intermediate entry signals, and minor entry signals.

Chapter 4

MAJOR ENTRY SIGNALS

In Chapter 2, we looked at the definitions of the chart formations making up the law of charts. For your convenience they are repeated in this chapter along with chart examples of each. The major entry signals which follow are derived from TLOC and are given the highest priority. They are all derived from the daily bar chart. There is a good reason for this which I will explain for your benefit now.

One of the most important times of the day for daytraders is when entry signals are generated from the larger time frame of the daily chart. For example, the taking out of a Ross Hook that has formed on the daily chart will as a rule generate far more thrust than the taking out of a Ross Hook that was formed on a five minute bar chart. It should be obvious to you that this is so. Similarly, the taking out of a Ross Hook that was formed on a weekly chart is a much more significant event than the taking out of a Ross Hook formed on a daily chart. The thrust needed to move prices beyond any of the formations described in the TLOC is greater as prices move out from the five to the ten minute chart, and from the ten minute chart to the thirty minute chart, and so forth.

If you are a daily chart trader, you cannot afford to pass up the opportunities offered by major pattern formations on the weekly charts. If you are a daytrader, you cannot afford to pass up the opportunities afforded by major pattern formations of the daily chart.

I have known highly successful traders who daytrade exclusively from daily chart signals. Therefore I have termed these daily chart patterns as major entry signals. These signals do not in any way preclude your taking entries from the five, ten, fifteen, thirty or sixty minute charts.

What we are discussing here is magnitude of movement. And the magnitude of move (thrust) from a greater time interval almost always gives us a better opportunity for a sizable win than does the move from a lesser time interval.

Major entry signals follow:

- The breakout of a 1-2-3 high or low.
- The breakout of a Ledge.
- The breakout of a Trading Range.
- The breakout of a Ross Hook.

IN ALL OF THESE TECHNIQUES BASED ON THE BAR CHART, WE WILL IGNORE ANY GAP BREAKOUTS. GAPS NULLIFY OUR ENTRY INTO THE MARKET. WE WANT TO ENTER ONLY THOSE TRADES THAT TRADE "THROUGH" OUR ENTRY PRICE.

I AM REPEATING THE DEFINITION OF 1-2-3 HIGHS AND LOWS BECAUSE THEY ARE IMPORTANT, AND THIS TIME I WILL SHOW THEM IN THE CONTEXT OF CHARTS. PLEASE BE SURE YOU STUDY THEM CAREFULLY. THEY ARE AN INTEGRAL PART OF WHAT FOLLOWS.

A typical 1-2-3 high is formed at the end of an uptrending market. Typically, prices will make a final high (1); proceed downward to point (2) where an upward correction begins; then proceed upward to a point where they resume a downward movement, thereby creating the pivot (3). There can be more than one bar in the movement from point 1 to point 2, and again from point 2 to point 3. There must be a full correction before points 2 or 3 can be defined.

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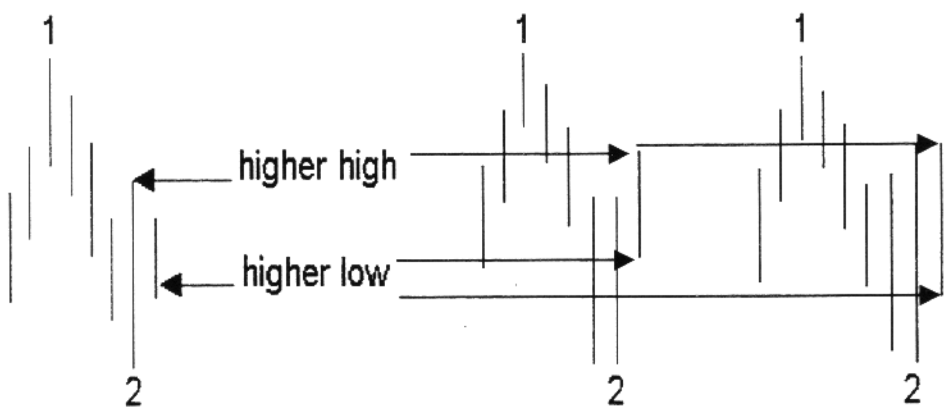
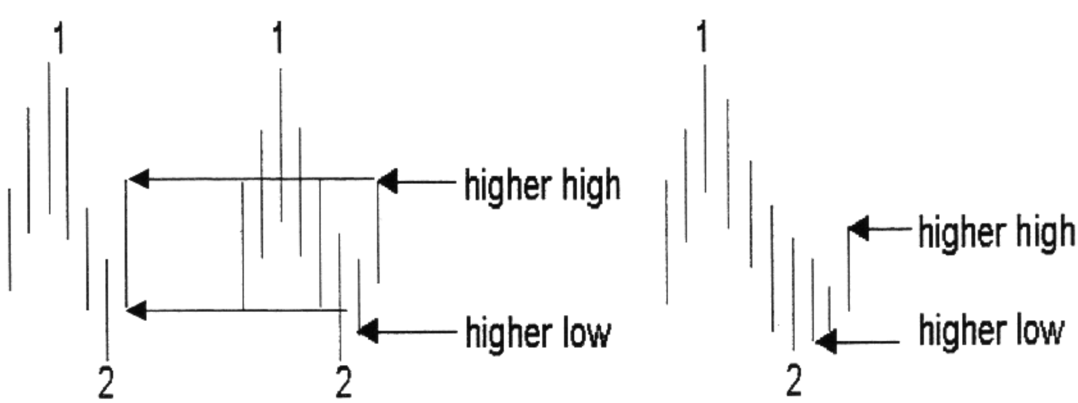
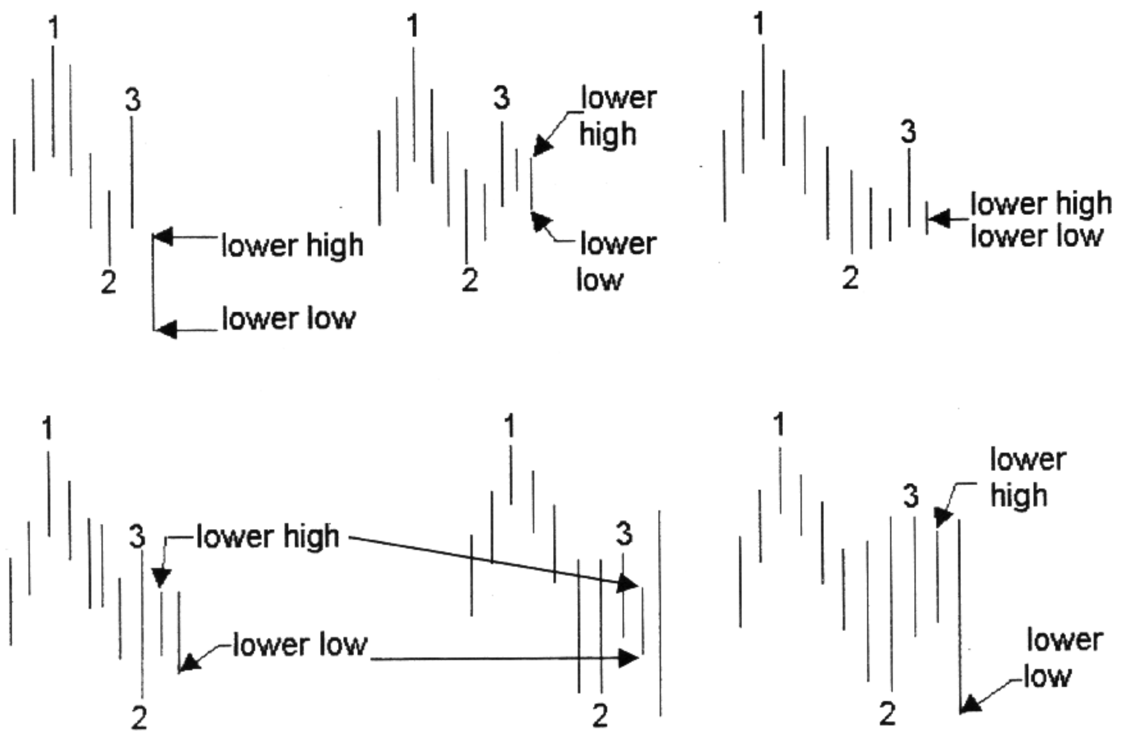
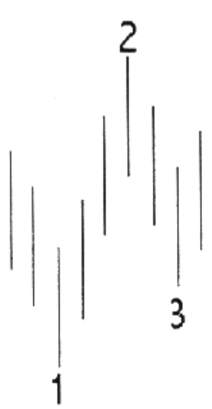




The number 3 point of a 1-2-3 high is created when a full correction takes place. A full correction means that as prices move down from the potential number 3 point, there must be a single bar that makes a lower low and a lower high than the preceding bar, *or* a combination of ***up to three bars*** creating both the lower low and the lower high. It is possible for both the number 2 and number 3 points to occur on the same bar.



Now, let's look at a 1-2-3 low.

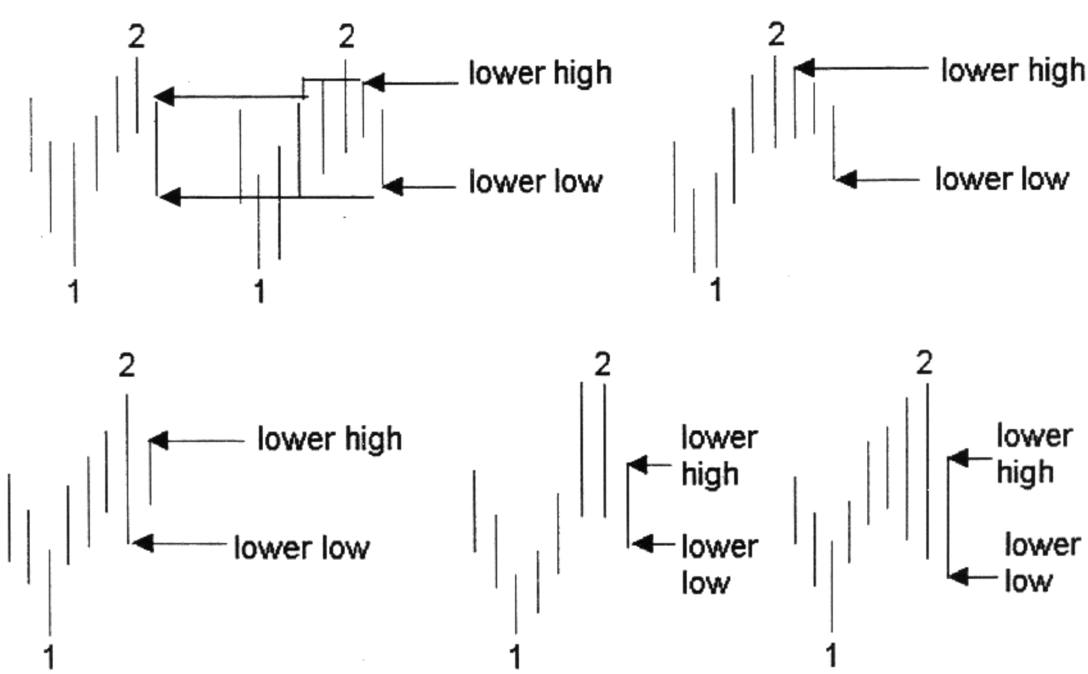


A typical 1-2-3 low is formed at the end of an downtrending market. Typically, prices will make a final low (1); proceed upward to point (2) where an downward correction begins; then proceed downward to a point where they resume an upward movement, thereby creating the pivot (3). There can be more than one bar in the movement from point 1 to point 2, and again from point 2 to point 3. There must be a full correction before points 2 or 3 can be defined.

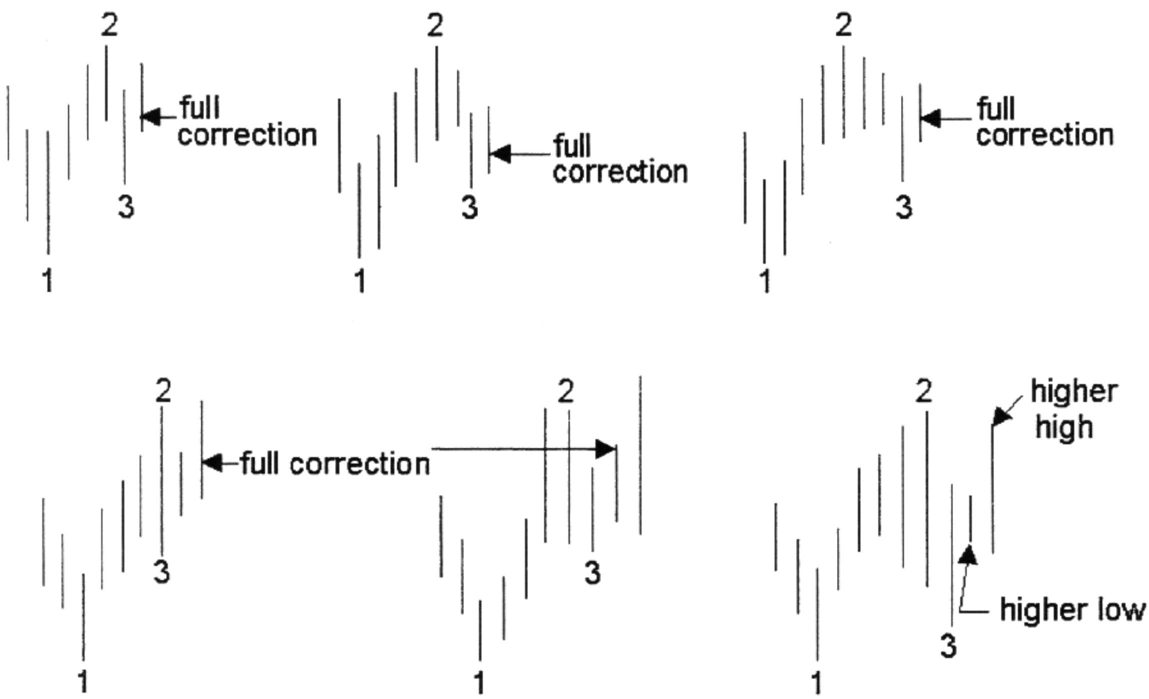
A number 1 low is created when a previous down-move has ended and prices have begun to move up.

The number 1 point is identified as the last bar to have made a new low in the most recent down-leg of the latest swing.

The number 2 point of a 1-2-3 low is created when a *full* correction takes place. Full correction means that as prices move down from the ***potential number 2*** point, there must be a single bar that makes both a lower high and a lower low than the preceding bar, *or* a combination of ***up to three bars*** creating both the lower high and the lower low. The lower high and the lower low may occur in any order. Subsequent to three bars we have congestion. It is possible for both the number 1 and number 2 points to occur on the same bar.



The number 3 point of a 1-2-3 low exists when a full correction takes place. A full correction means that as prices move up from the potential number 3 point, there must be a single bar that makes a higher low and a higher high than the preceding bar, *or* a combination of ***up to three bars*** creating both the higher low and the higher high. It is possible for both the number 2 and number 3 points to occur on the same bar.

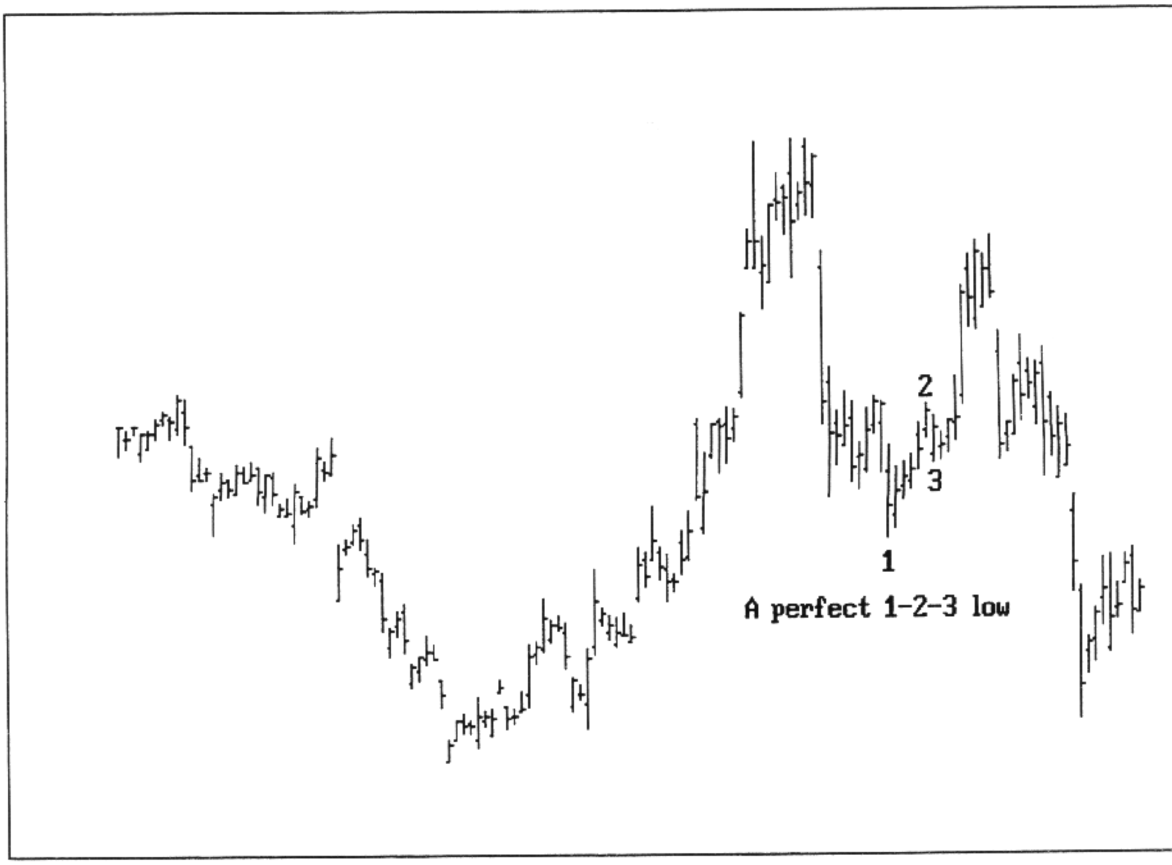


The entire 1-2-3 high or low is nullified when any price bar moves prices equal to or beyond the number 1 point. Note: The #3 point does not come down as low as the #1 point in a uptrend, or as high as the #1 point in a downtrend.

We set a mental or computer alert, or both, to warn us of an impending breakout of these key points. We will not enter a trade if prices gap over our entry price. A gap occurs when prices jump from where they previously finished to where they currently begin. A gap can occur when prices are moving up or when prices are moving down. We will enter it only if the market trades ***through*** our entry price.
1-2-3 highs and lows come only at market turning points that are, in effect, major or intermediate highs or lows. We look for 1-2-3 lows when a market seems to be making a low, or has reached a 1/3 or greater retracement of prices from a low. We look for 1-2-3 highs when a market appears to be making a high, or has reached a 1/3 or greater retracement of prices from a high.

Exact entry will always be at or prior to the actual breakout taking place. I will cover more of that concept when we discuss the Trader's Trick entry.

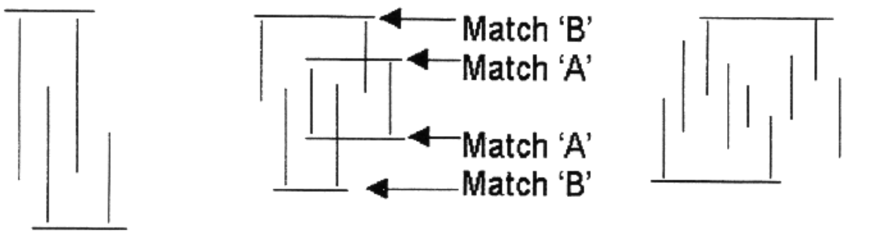
The next figure illustrates the 1-2-3 formation in action.



THE 1-2-3 LOW IS CHARACTERIZED BY THE FACT THAT THE #3 POINT DOES NOT COME BACK (RETRACE) AS LOW AS THE #1 POINT (ABOVE CHART). A 1-2-3 HIGH IS CHARACTERIZED BY THE FACT THE #3 POINT DOES NOT COME BACK (RETRACE) AS HIGH AS THE #1 POINT.

LEDGES

A Ledge consists of a minimum of four price bars. It must have two matching lows and two matching highs. The matching highs must be separated by at least one price bar, and the matching lows must be separated by at least one price bar. The matches need not be exact, but should not differ by more than three minimum tick fluctuations. If there are more than two matching highs and two matching lows, then it is optional whether to take an entry signal from either the latest price matches in the series (Match 'A') or those that represent the highest and lowest prices of the series (Match 'B'). A Ledge cannot contain more than 10 price bars. A Ledge must exist within a trend. The market must have trended up to the Ledge or down to the Ledge. The Ledge represents a resting point for prices, therefore you would expect the trend to continue subsequent to a Ledge breakout.



This is how to determine what constitutes a Ledge:

We look for a correction or congestion that is at least four bars in length, but no more than ten bars in length.

The Ledge is characterized by a "squaring off" of highs and/or lows, the flatter the better. Perfect squares are best.

We trade the potential breakout in the direction of the trend.

We can go back only as far as the first leg of the previous price swing to find a matching high or low.

What we have done here is to allow the market to tell us what it is going to do and when it is going to do it.

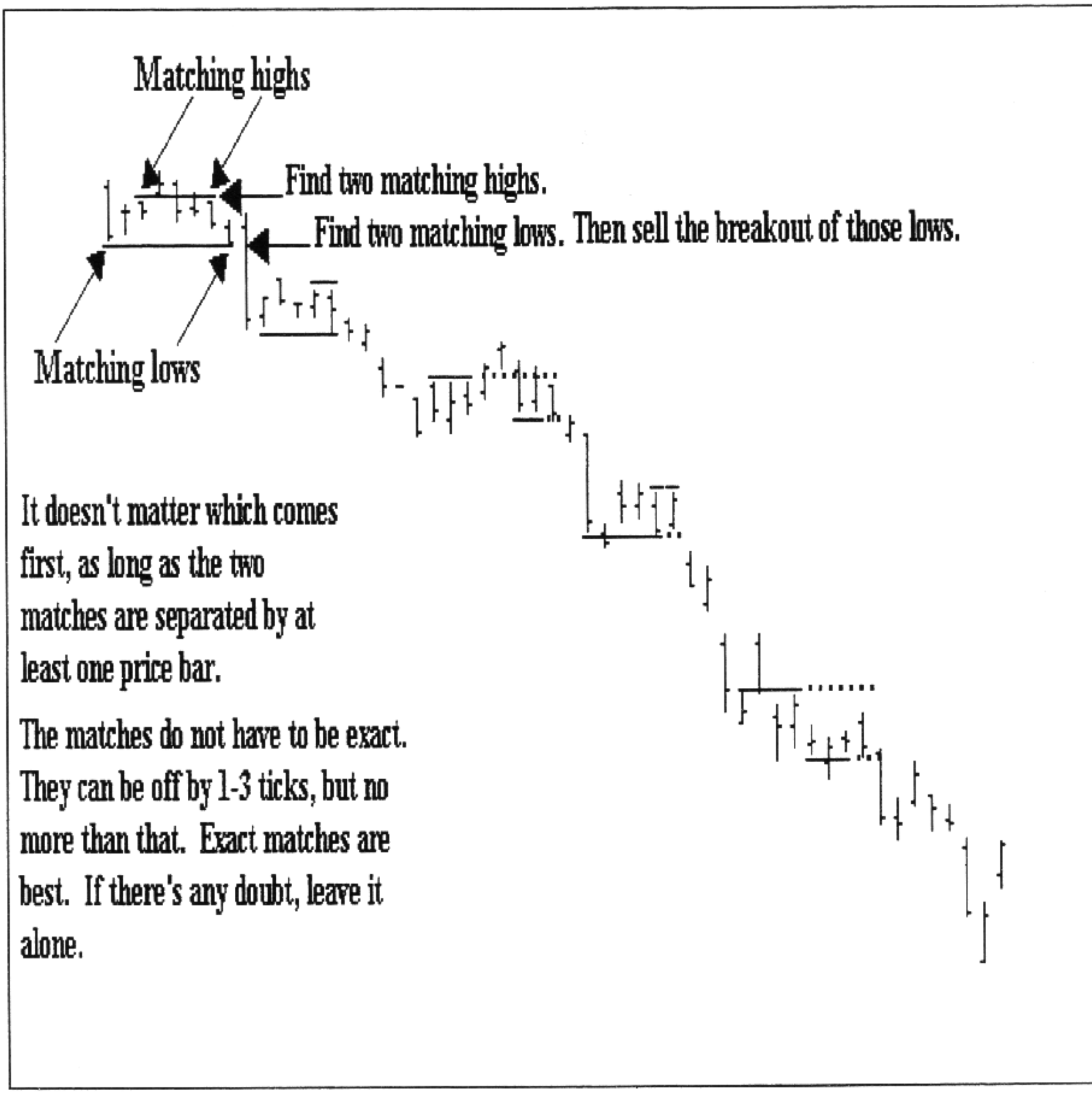
The Ledge becomes possible because the market decides to move sideways for a number of bars on the chart, thereby making it possible for us to position ourselves for an anticipated continuation of the previous price move. Our entry exists with our buy or sell orders at natural support and resistance points.

We mark these off as soon as we can draw a line across two highs and two lows, just so long as they match. We will enter a trade only if prices break out of the Ledge by trading through the high or the low. We will not enter a trade if prices gap past our entry point.

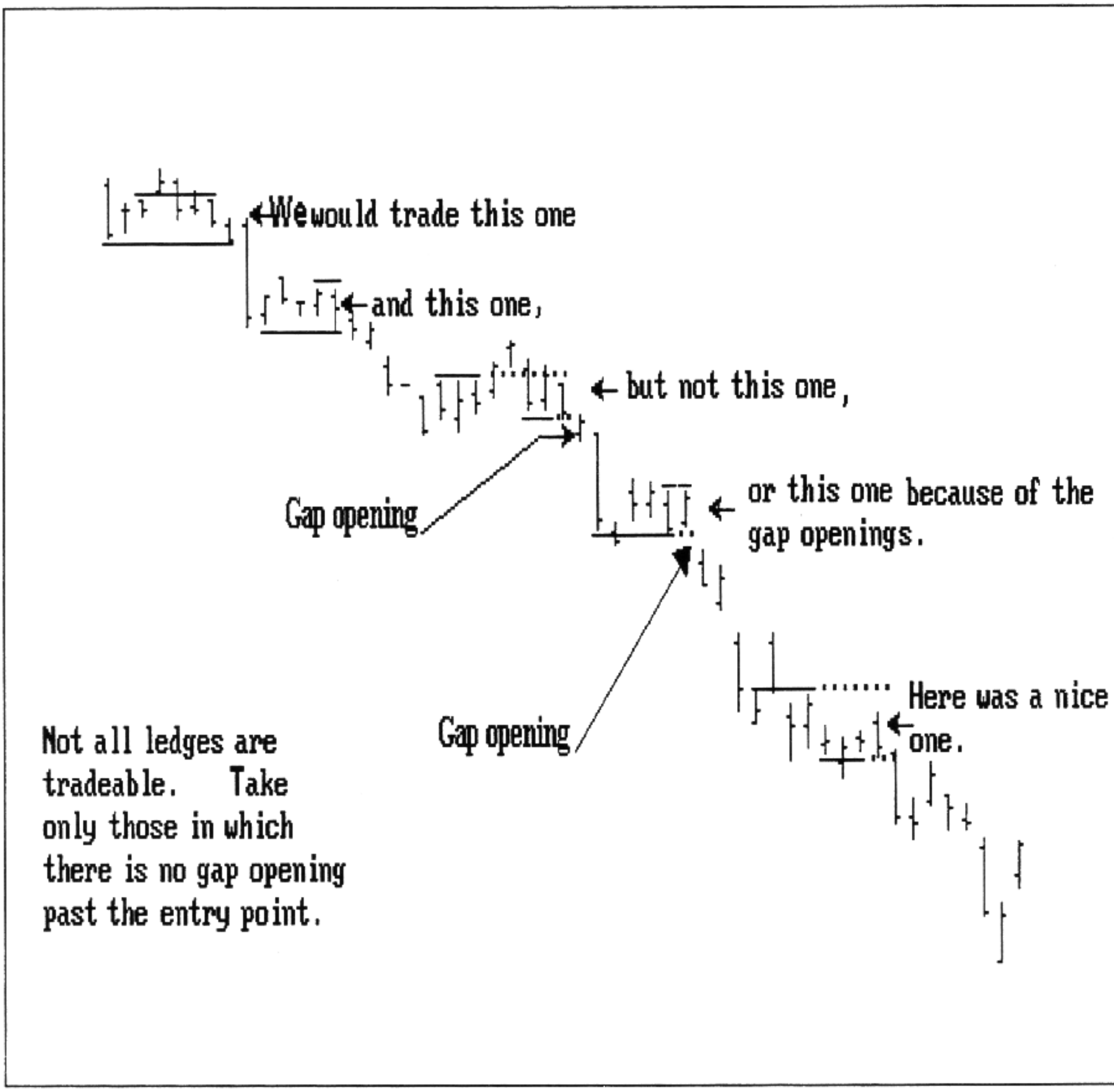
ONCE THERE ARE MORE THAN TEN BARS ON THE CHART, WE STOP TRYING TO TRADE THE LEDGES. WE WAIT FOR THE MARKET TO START TRENDING AGAIN OR FOR A FULL BLOWN TRADING RANGE TO DEVELOP.

Why does this entry technique work so well? Because it takes advantage of natural support and resistance points. A breakout of a natural support or resistance point will usually be associated with good momentum. There should be enough explosive force to give a profitable short term trade.

In order to show more clearly what we are doing with this technique, two charts containing Ledges follow:



We trade prior to or at an actual non-gap breakout of the Ledge. The entry may be prior to or at the breakout point. The breakout point is in the direction of the trend 1 tick above or 1 tick below where I have drawn the line connecting two matching highs or two matching lows. Note, this may not be the absolute high or low of the congestion on the chart.



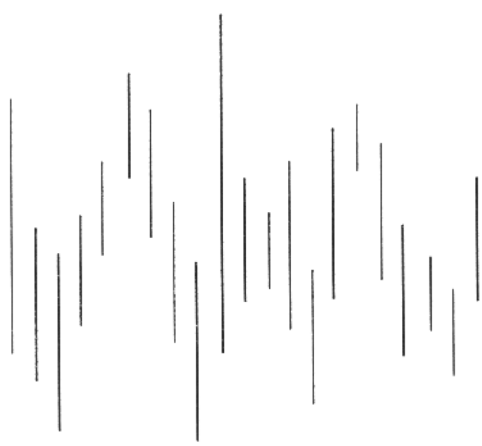
The two entries we didn't take were because the breakout bar was a gap down.

While we have this chart in front of us, please realize that, although the overall trend of prices is down, they are actually stair-stepping down. A stronger trend would have fewer stair steps and more pronounced downward connectors. There is quite a difference in the way we would trade each type of trending market. Stair-stepping markets are characterized by Ledges followed by sudden collapses in price in a down trend, or sudden explosions in price in an uptrend. After each collapse or explosion, prices rest, thereby causing the Ledge and the stair-stepping appearance of prices.

THE BREAKOUT OF A TRADING RANGE

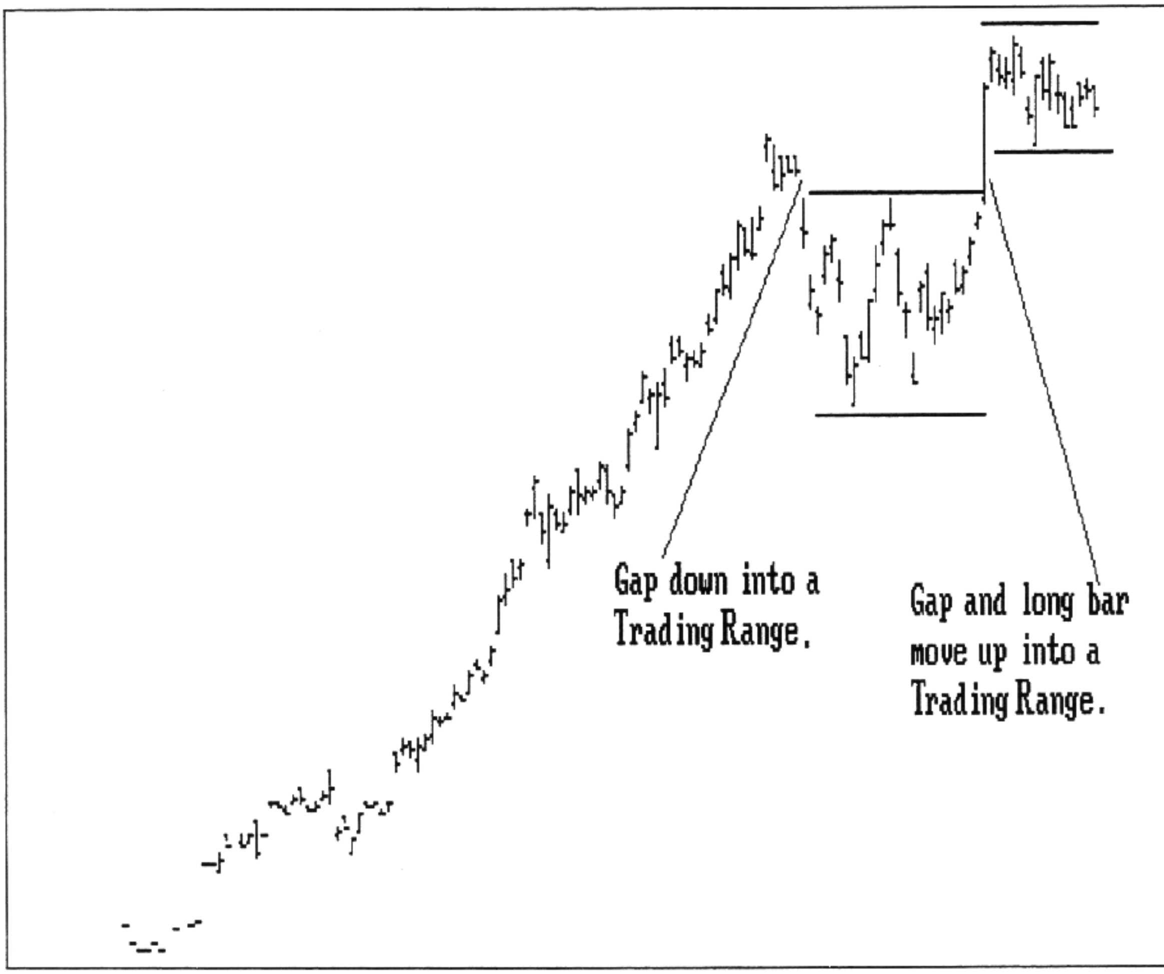
TRADING RANGES

A Trading Range must consist of more than ten price bars. The bars between ten and twenty are of little consequence. Usually, between bars 20 and 30, i.e., bars 21-29, there will be a breakout to the high or low of the Trading Range established by those bars prior to the breakout.



Most of the time a Trading Range will be preceded on the chart by either a gap or a bar which is relatively large in size from high to low. It may be any combination of the two.

The chart on the next page illustrates this point.



The first step after noting a gap or a series of gaps, or a large size price bar, is to begin to watch for a Trading Range (TR) to evolve. Here is how it will usually happen:

- There will be a gap or large single bar move up into or down into what will eventually be seen as a Trading Range (TR).

- There will be a leg counter to the thrust of the gap or large bar move.

This is a leg up →

← This is a leg down

From now on, up legs will be referred to using the forward slash symbol /, and down legs using the backward slash symbol \.

- Then there will be a second leg back in the direction of the gap or large single bar move. At that point we have a market that, in its most recent action, has legs that look like this /\, or this \/, from a bird's eye view. It is then that we draw a horizontal line across the highest high, and a parallel horizontal line across the lowest low. (See boxed in chart on previous page). It will usually take about 10 bars or so for all of this to happen. The formations /\ or \/ constitute "market swings."

- In the next few bars, a third leg will form giving us /\/, or \/\. This is the beginning of what may turn out to be a Trading Range. Again we draw horizontal lines across the highest high and the lowest low, unless the old ones are still intact. We have now established a rudimentary envelope that is delineated by drawing a simple horizontal line across the top of the Trading Range, and a parallel horizontal line across the bottom of the Trading Range.

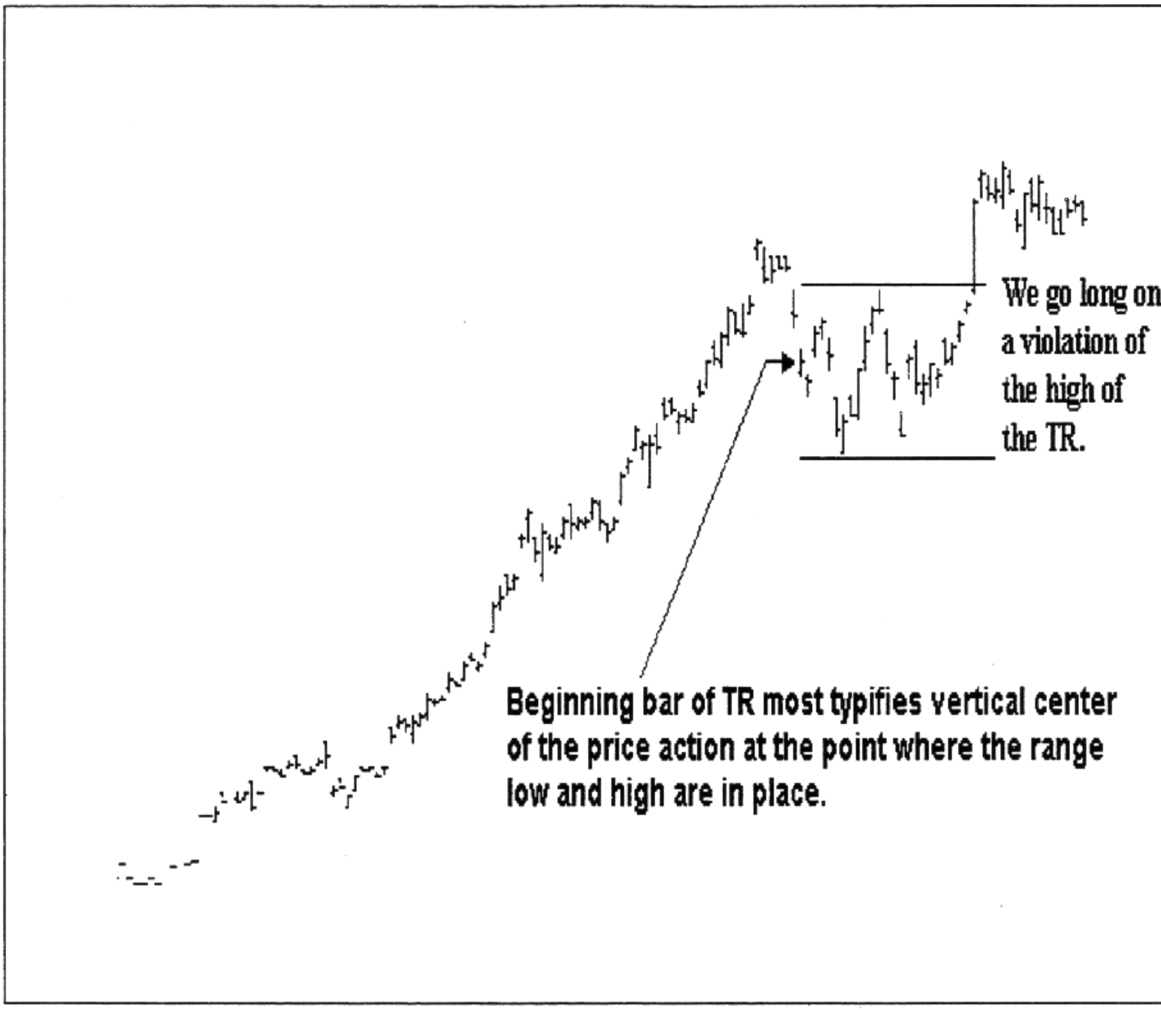
- The next step is to count the number of bars on the chart. Some time between 21 and 29 bars, a fourth leg will usually be completed. The Trading Range now looks like /\/\ or \/\/. (See box in chart on previous page). If there had been a new high, a new low, or both, during that last leg, we would have redrawn the envelope. Usually this is not necessary.

We can now set a mental alert, a computer alert, or both, to tell us when we are approaching one of the prices which represent the outer limits of the envelope. Any non-gap breakout of these prices will constitute an entry point for us to enter a daytrade.

An interesting aspect of the Trading Range is that it appears to be one of only two techniques in which looking back actually has great meaning. Generally, we cannot trade based on what is in the past, it is the current bar's or next bar's price in which we are most interested. However, with a Trading Range, the inception will always come at the end of a trend, or stair-stepping progression, or as an explosion or collapse in prices. Any time we witness what might be the end of one of the above, we immediately suspect that a Trading Range is about to ensue.

WHEN WE ARE LOOKING BACK, WE CHOOSE AS THE BEGINNING OF THE TRADING RANGE THAT PRICE BAR WHICH MOST TYPIFIES THE VERTICAL CENTER OF ALL OF THE PRICE ACTION SINCE PRICES BEGAN TO CONGEST.

This will be the least frequently occurring entry technique in our arsenal, but it will be one of the best. The thrust out of an envelope will yield many a worthwhile trade. The next figure will serve to illustrate this point.



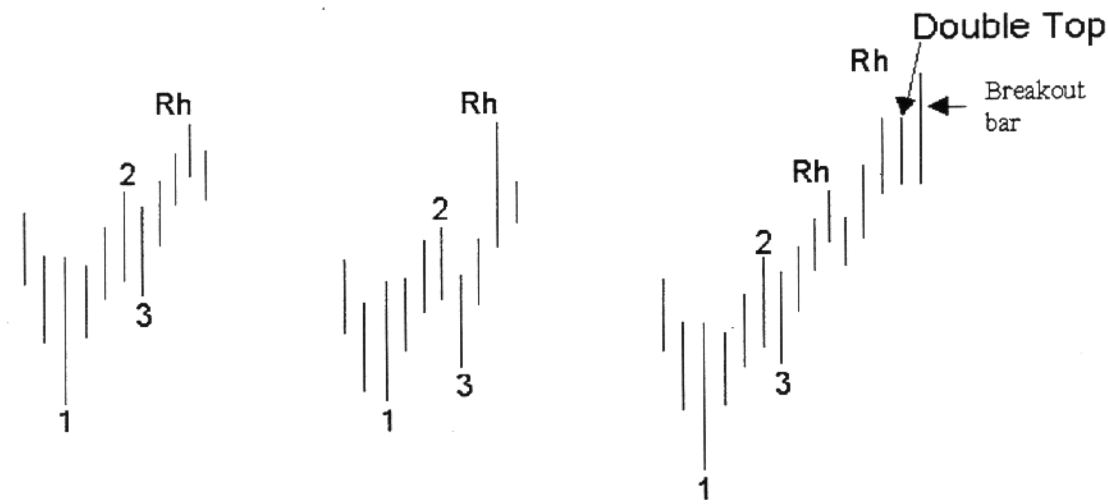
The entry point is a trade-through by prices of the breakout point. The breakout point is the highest high or the lowest low of the Trading Range. We will enter a trade at or before the breakout. We will not enter if prices gap past our entry point.

ROSS HOOKS

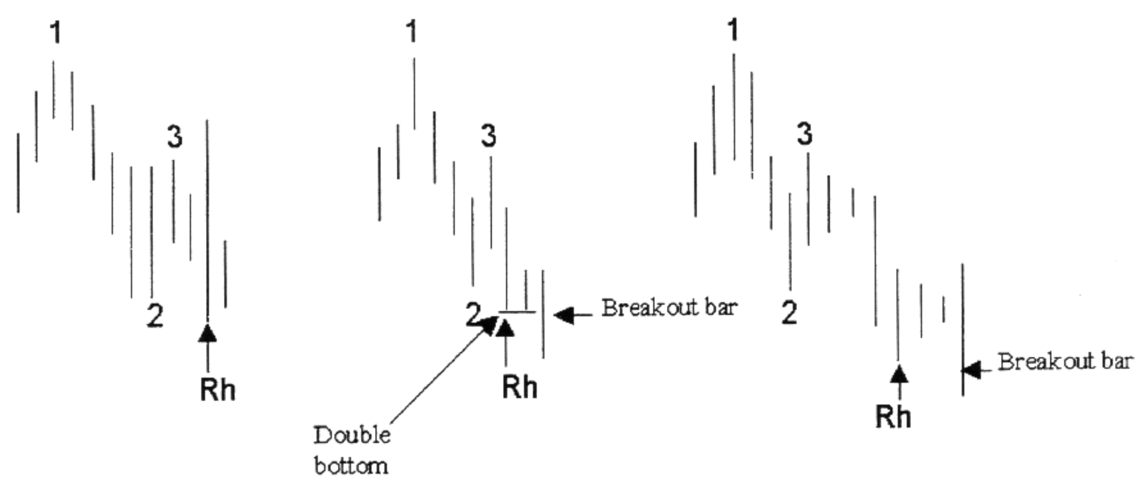
A Ross Hook is created by:

- The first correction following the breakout of a 1-2-3 high or low.
- The first correction following the breakout of a Ledge.
- The first correction following the breakout of a Trading Range.

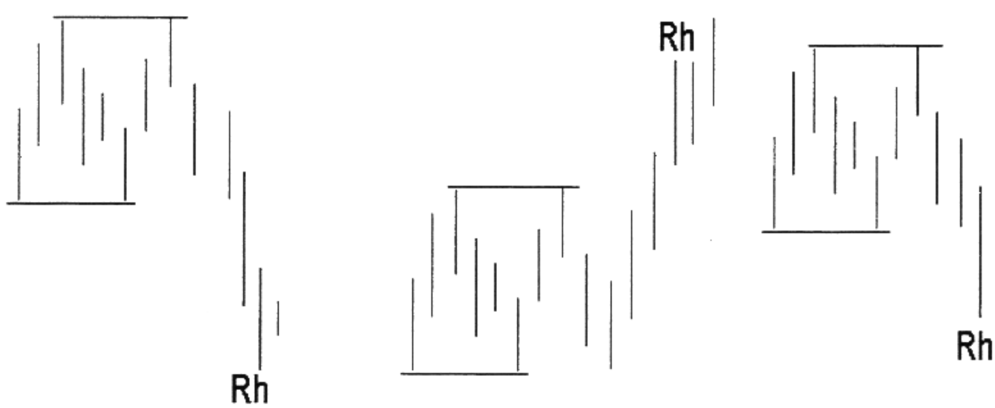
In an uptrending market, after the breakout of a 1-2-3 low, the first instance of the failure of a price bar to make a new high creates a Ross Hook. (A double high/double top also equals a Ross Hook).

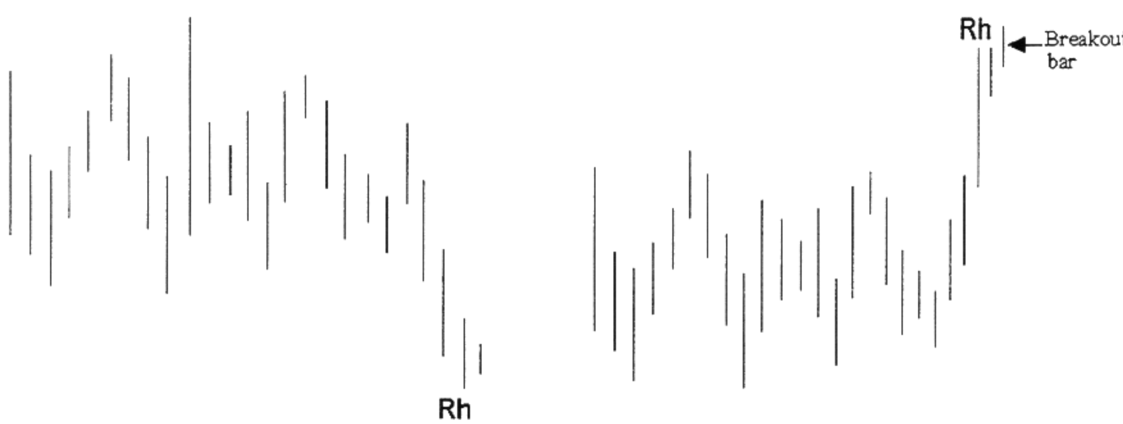


In a downtrending market, after the breakout of a 1-2-3 high, the first instance of the failure of a price bar to make a new low creates a Ross Hook. (A double low/double bottom also equals a Ross Hook).



If prices breakout to the upside of a Ledge or a Trading Range formation, the first instance of the failure by a price bar to make a new high creates a Ross Hook. If prices breakout to the downside of a Ledge or Trading Range formation, the first instance of the failure by a price bar to make a new low creates a Ross Hook (A double high or low also creates a Ross Hook).

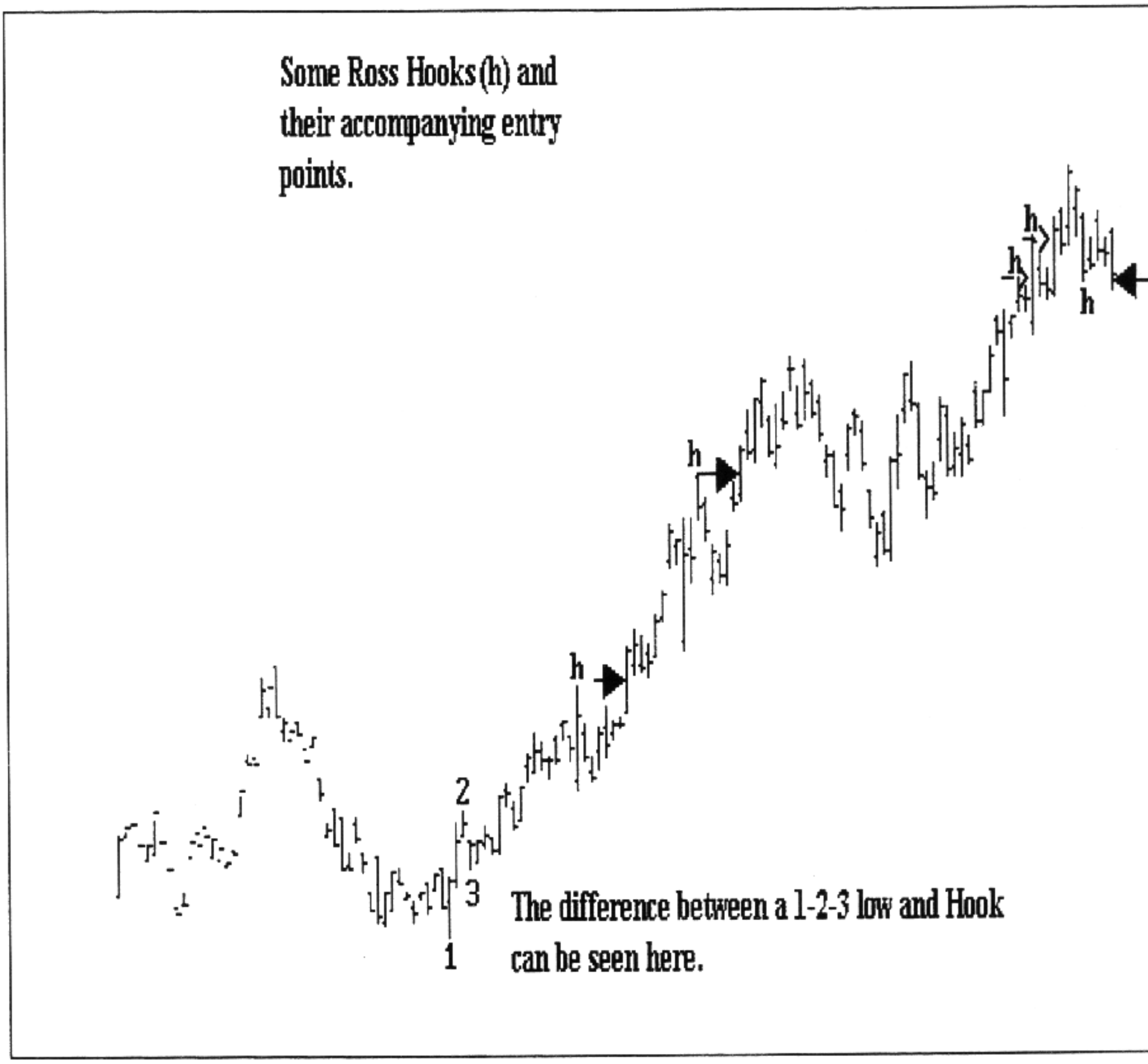




A Hook differs from a 1-2-3 because it doesn't have to have a definitive high or low and it doesn't have to have a full correction. It may pop out of a congestion area such as a Ledge or Trading Range. **ROSS HOOKS OCCUR AT ANY LEVEL, BUT ONLY IN TRENDING MARKETS, WHEREAS 1-2-3 LOWS OCCUR AT INTERMEDIATE AND MAJOR MARKET LOWS, AND 1-2-3 HIGHS OCCUR AT INTERMEDIATE AND MAJOR MARKET HIGHS.**

A Ross Hook does not need more than the failure of prices to make a new high/low in a trend. In a down market, as soon as you have an equal or higher low, you have a Hook. In an up market, as soon as you have an equal or lower high, you have a Hook.

The next figure shows what is meant by Ross Hooks.



The above Ross Hooks "h" were tradable because they had non-gap breakouts. There are other Hooks shown, but because of gap openings, they were not tradable.
The → shows where the entry would have been. **The entry points occur after the Hooks.**

Later, when we discuss the Trader's Trick, we will look at even earlier entries than the ones shown.
Also shown on the previous chart is a 1-2-3 low to demonstrate the difference between 1-2-3 lows and Ross Hooks.

An automatic alert should be placed the minute a market makes a Hook. Place the alert at a point prior to the taking out of the Hook. By "taking out" I mean a violation of the price creating the point of the Hook. Remember the Hook occurred on an earlier price bar.

Summary: Major Entry Signals

- The breakout of a 1-2-3 high or low.
- The breakout of a Ledge.
- The breakout of a Trading Range.
- The breakout of a Ross Hook.

Note: Some of these may be concurrent with one another as well as with some of the intermediate and minor trading signals which follow. Whenever there is both a congestion area and a trend forming within that congestion area, the trend always takes precedence over the congestion. Further on in the course, I will define precisely what constitutes an emerging trend, a defined trend, and an established trend. For now, suffice it to say that an established trend always exists once the breakout of a Ross Hook has taken place.

Chapter 5

INTERMEDIATE ENTRY SIGNALS

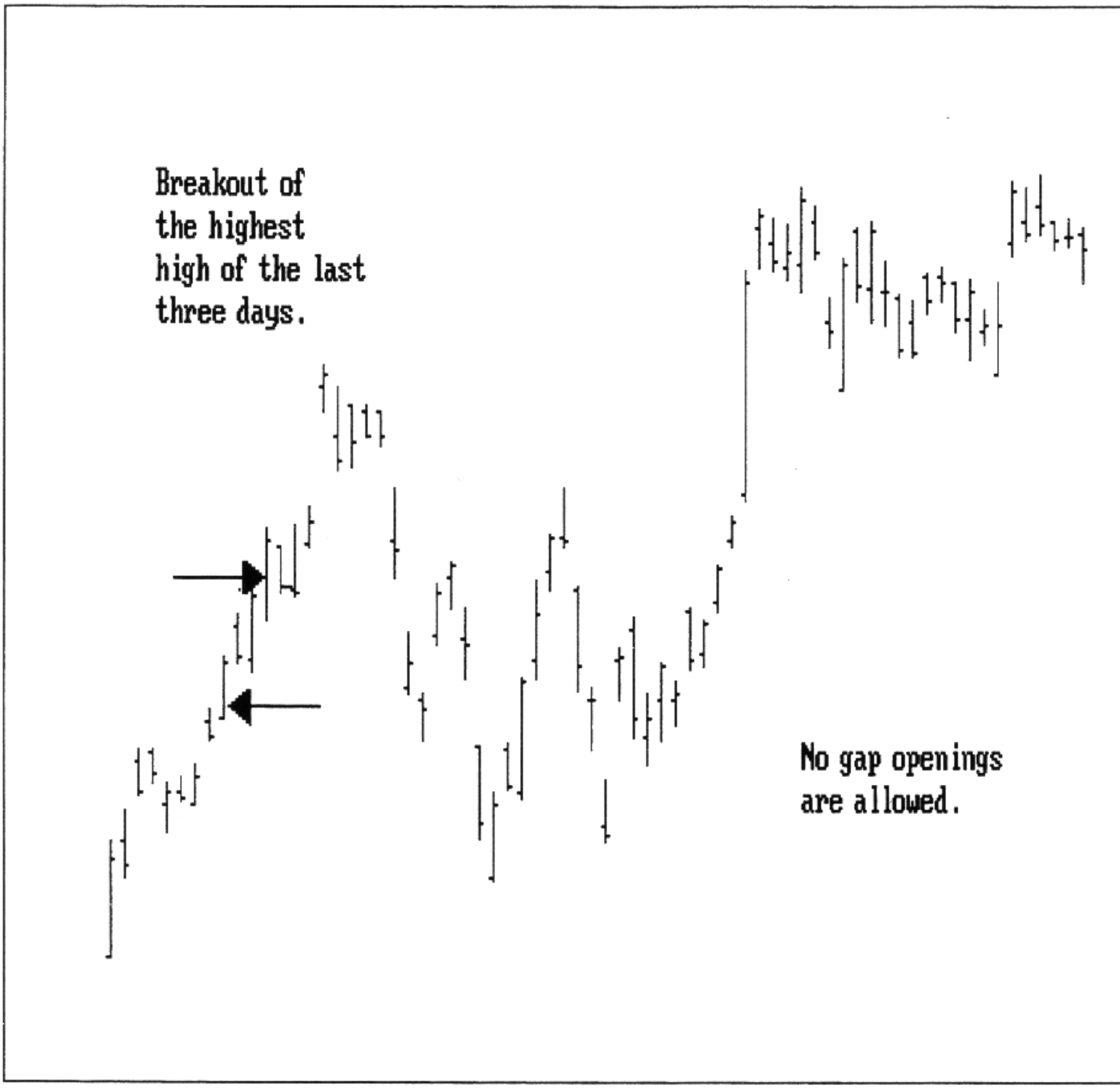
Intermediate entry signals are based on significant breakout points from daily or lesser magnitude charts such as 60 or 30 minute. They work best taken from daily or greater charts because of the magnitude of the anticipated move. If you are a daily position trader take these signals from the weekly chart. The signals are as follows, and are usually taken:

- A breakout of the highest high of the last three bars taken as a group.
- A breakout of the lowest low of the last three bars taken as a group.
- A breakout of any individual low of the last three bars. This includes a breakout of the previous bar's low.
- A breakout of any individual high of the last three bars. This includes a breakout of the previous bar's high.

The breakout must be by virtue of prices trading through the entry points. A gap opening past the entry point nullifies the trade initially.

This is a very simple technique and does not need much explanation. We will enter a trade at a breakout as described above. The stronger trade may come as a result of a breakout of the highest high or lowest low of the last three bars. At times it takes much pent-up momentum to overcome the extremes of the past three bars of trading. But this is not always the case. Sometimes the move is nearly over by the time the breakout occurs. One has to experiment with these to come to see them more clearly. The three bar breakout can act as a filter for lesser trades.

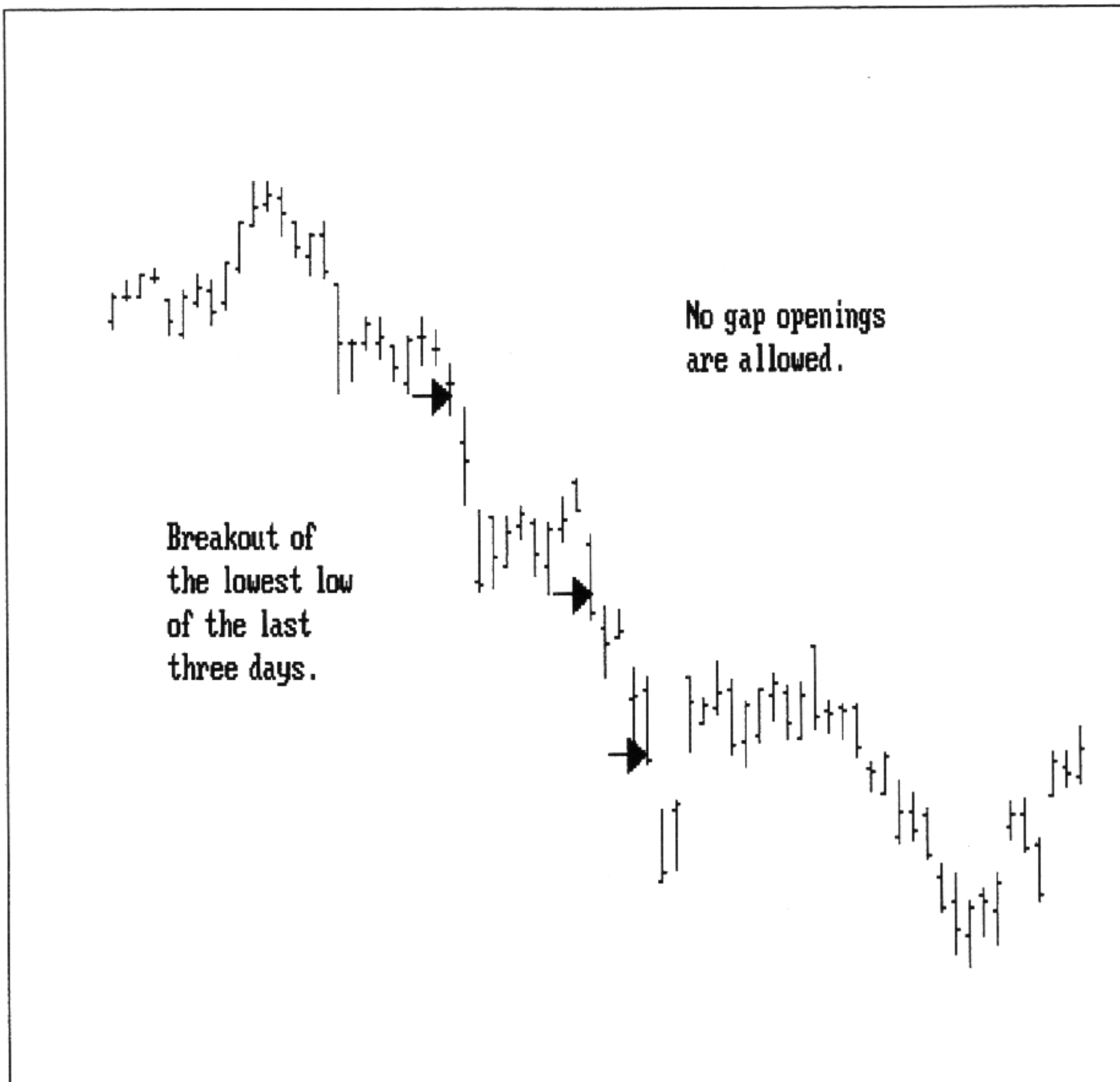
The following four pages contain examples of Intermediate Entry Signals.
A breakout of the highest high of the last three bars taken as a group.



Arrows point to the breakout points on the actual breakout day. Daytraders would attempt to enter intraday on or before the actual breakout using one or more of the entry techniques taught in this course, i.e., a Trader's Trick, or a congestion near the breakout point.

On this chart and the ones that follow in this chapter, I have not shown every single breakout day.

A breakout of the lowest low of the last three bars taken as a group.



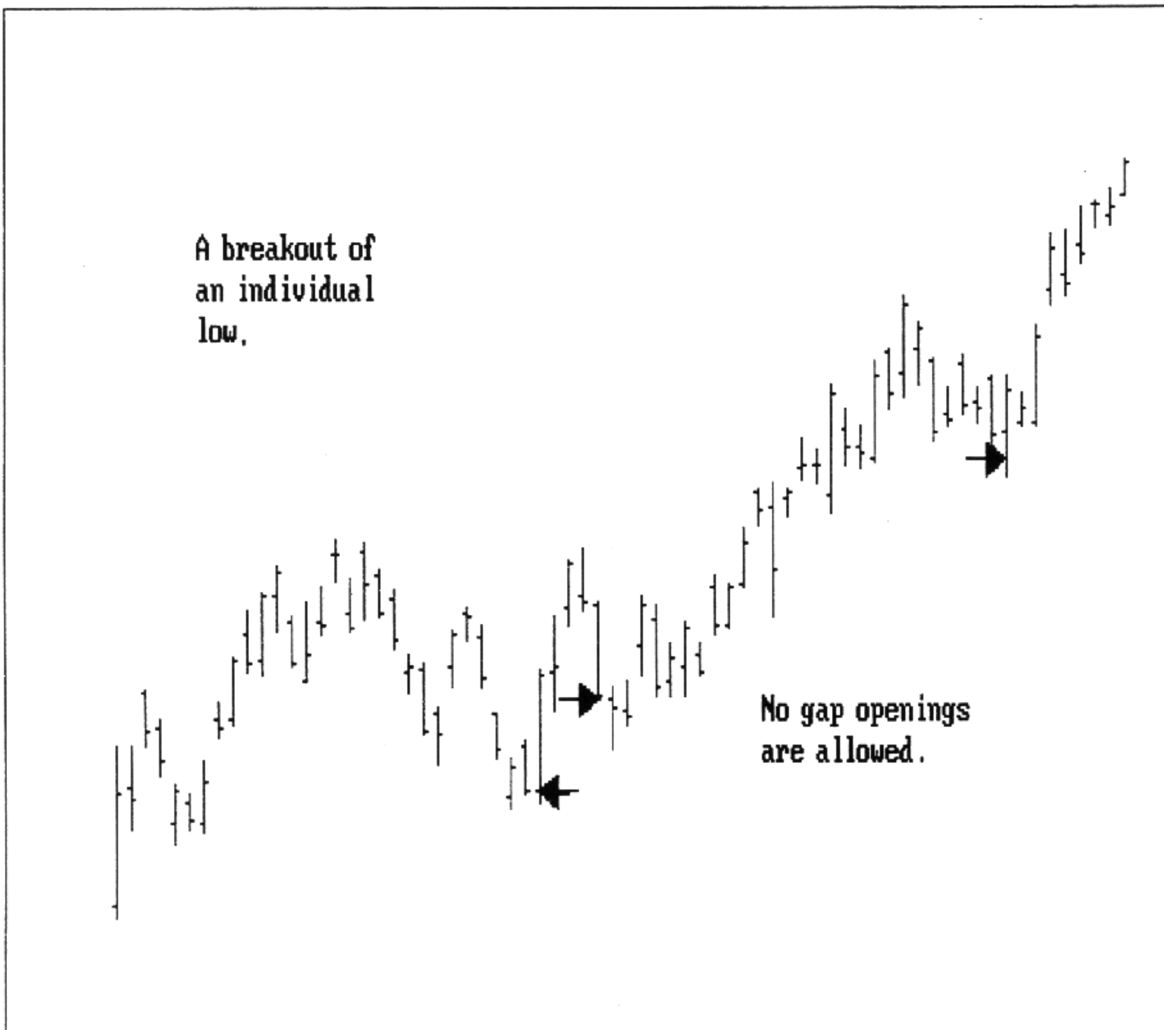
Arrows point to the breakout point on the actual breakout day.

Proceeding from left to right, the first arrow shows a probable good daytrading entry.

The second arrow shows an even better daytrading entry.

The third arrow shows one additional daytrading entry.

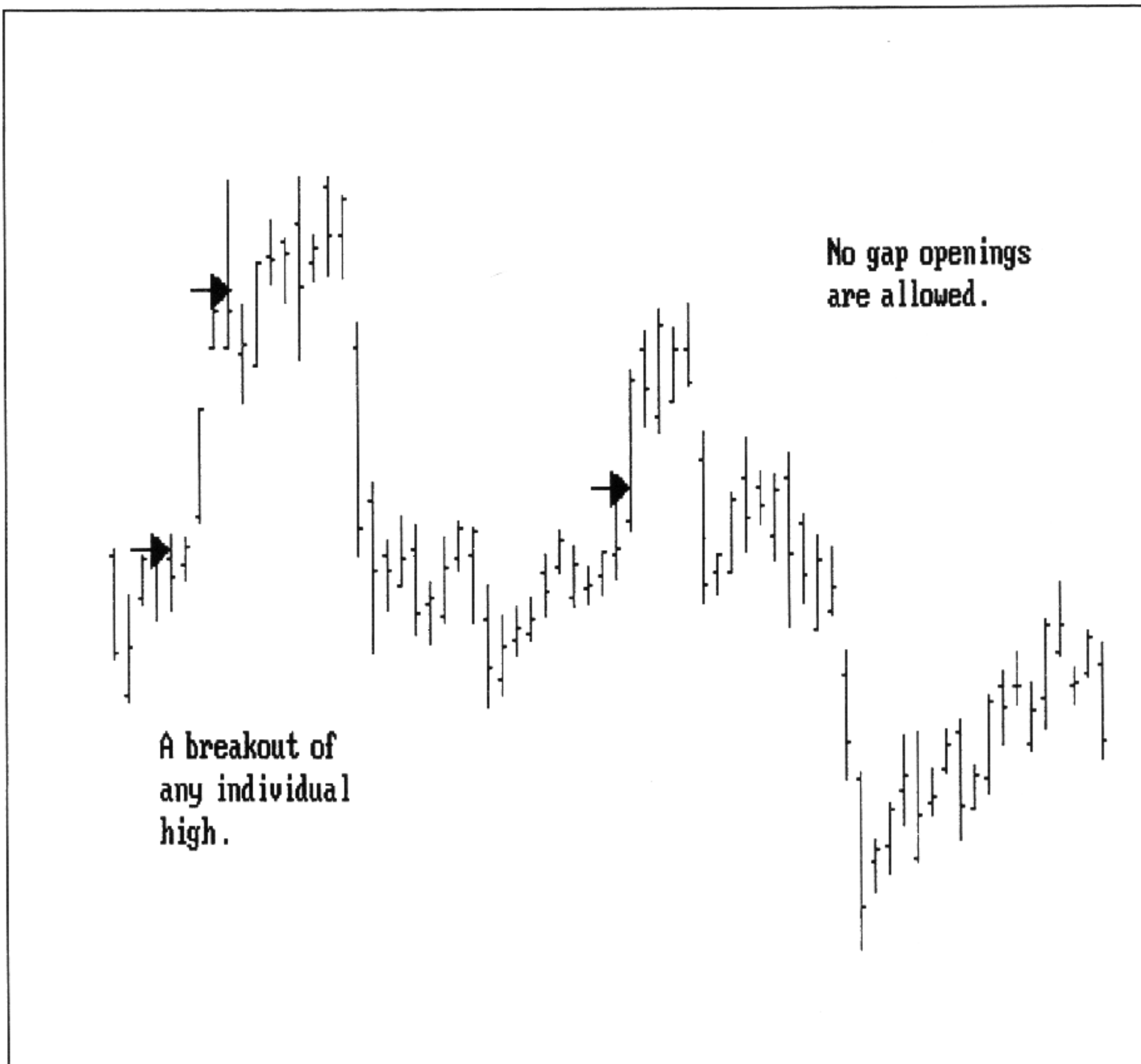
A breakout of any individual low of the last three bars. This includes a breakout of the previous bar's low.



Arrows point to the breakout point on the actual breakout day. There are many places on the chart that have entry situations. I've picked one that might have caused problems, another that was a good trade, and a third that was so-so.

Proceeding from left to right, notice on the chart above the first arrow points to a breakout of the low of the previous day that would have resulted in a poor intraday trade at best. The next arrow shows a trade that held the possibility of an excellent intraday trade. The last arrow above shows a trade entry that potentially offered a mediocre intraday trade.

A breakout of any individual high of the last three bars. This includes a breakout of the previous bar's high.



Arrows point to the breakout point on the actual breakout day. There are many of them on the chart and I chose only a few.

Proceeding from left to right, the first arrow points to a breakout that offered little room for profit to the daytrader. The second arrow offered an excellent daytrade provided a profit protecting strategy of some sort was used. The last arrow shows a trade that offered excellent profits to the daytrader.

Chapter 6

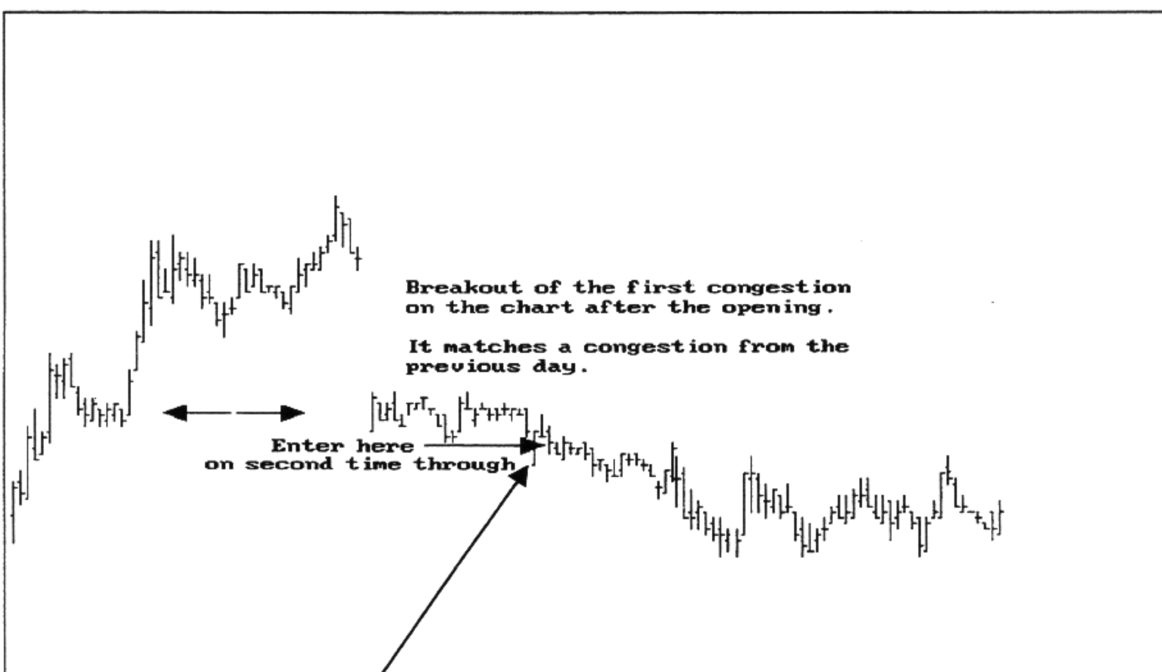
MINOR ENTRY SIGNAL

The minor entry signal is as follows.

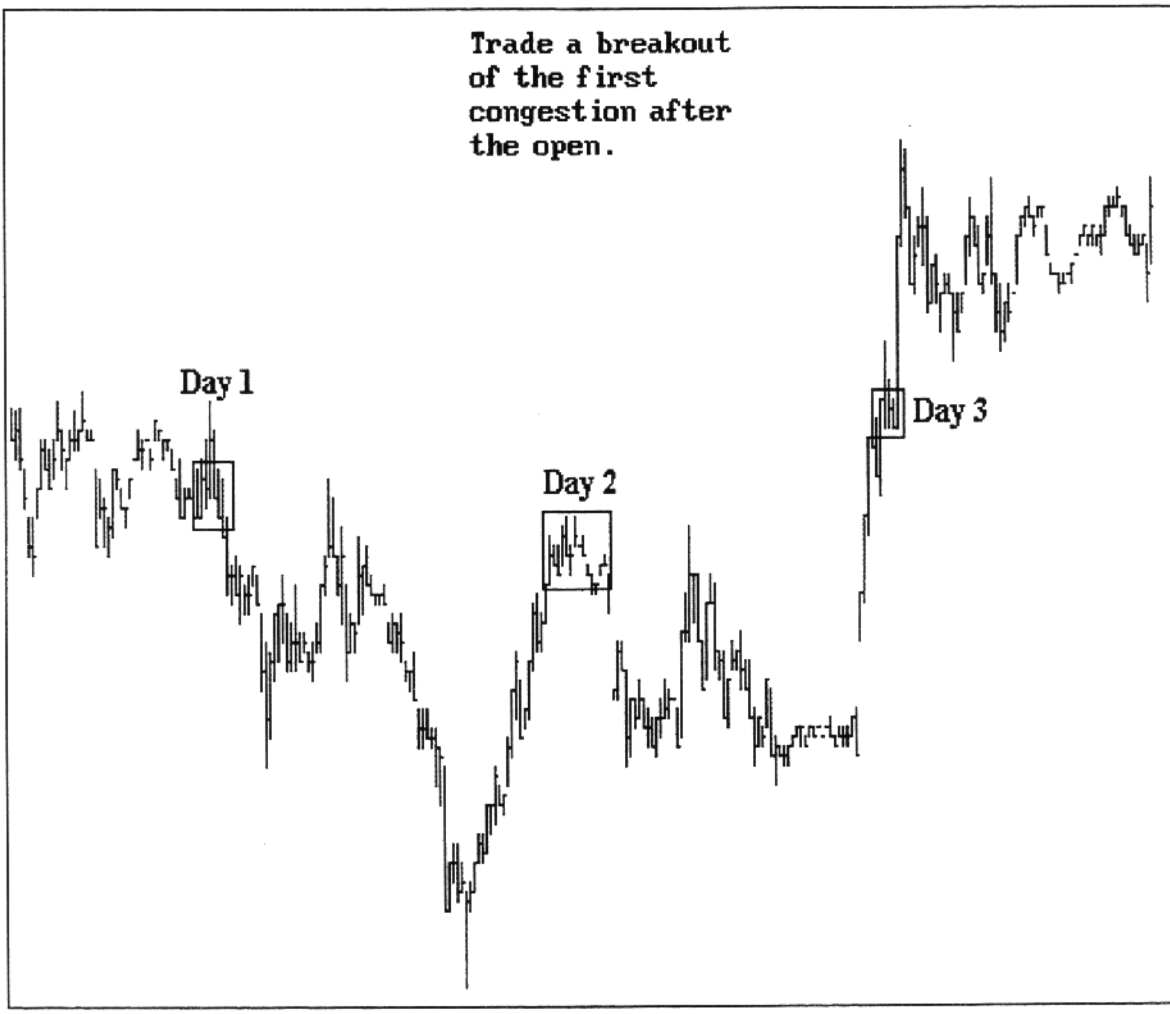
We look for a first or second breakout of the first trading congestion to form after the opening as seen on the intraday chart. This may include a congestion carryover from the previous day.

Entry is only by virtue of prices trading through the breakout point. To prevent being filled on a gap, we enter after the open.

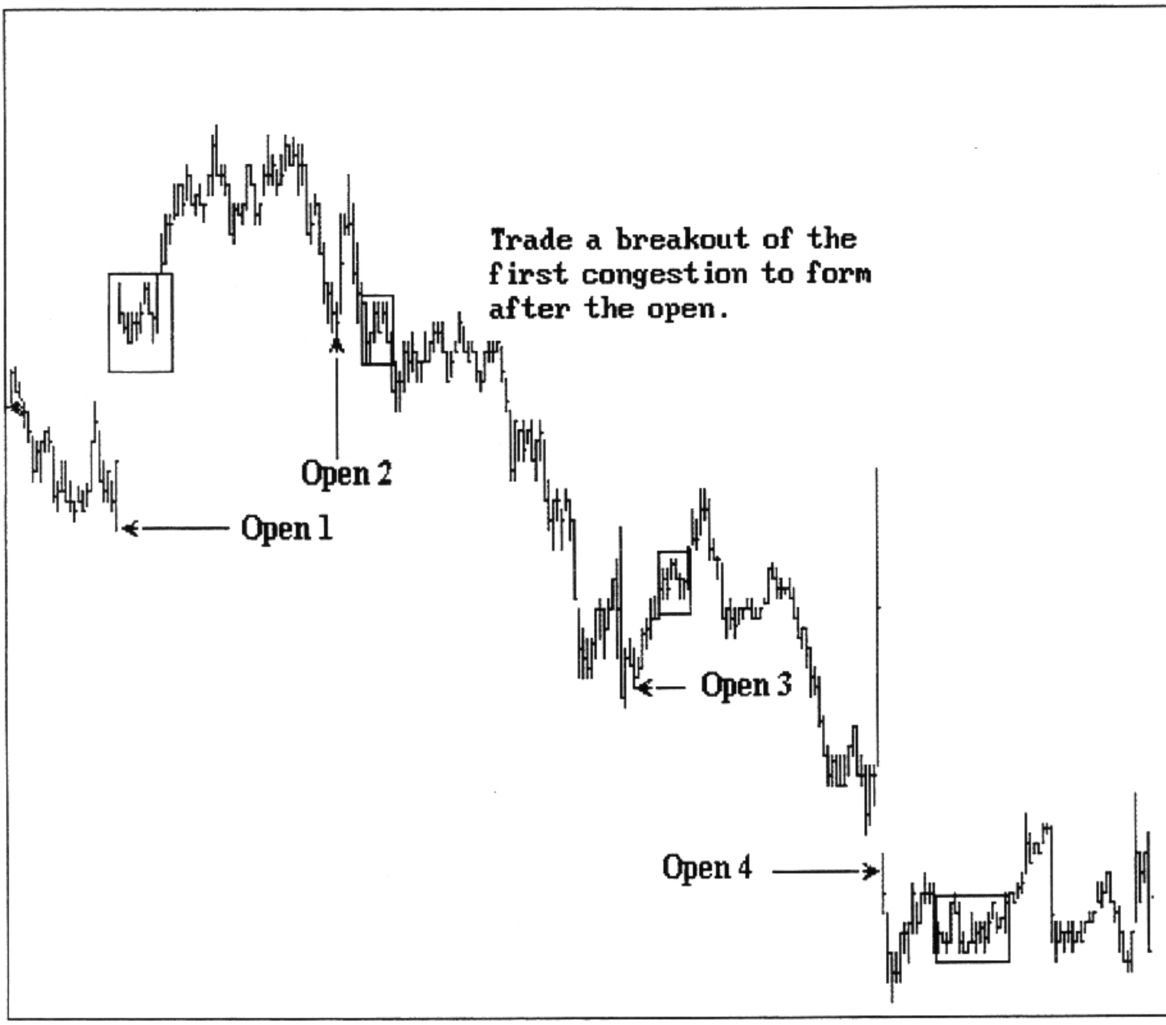
Here are examples:



Notice that the first time through congestion the trade went nowhere. There was a gap through, not taken, two bars before the second actual trade-through. We don't take gap trades. We would attempt the first and second times that prices actually trade through. It was the second time through that resulted in the good trade.



Each boxed area shows the first congestion after the open on each day shown. Trade breakouts of those congestions.



In the above chart we are trading the first breakout of congestion.

Chapter 7

THE TRADER'S TRICK

The purpose of the Trader's Trick entry (TTE) is to get us into a trade prior to entry by other traders.

Let's be realistic. Trading is a business in which the more knowledgeable have the advantage over the less knowledgeable. It's a shame that most traders end up spending countless hours and dollars searching for and acquiring the wrong kind of knowledge. Unfortunately, there is a ton of misinformation out there and it is heavily promoted. What we are trying to avoid here is the damage that can be done by a false breakout.

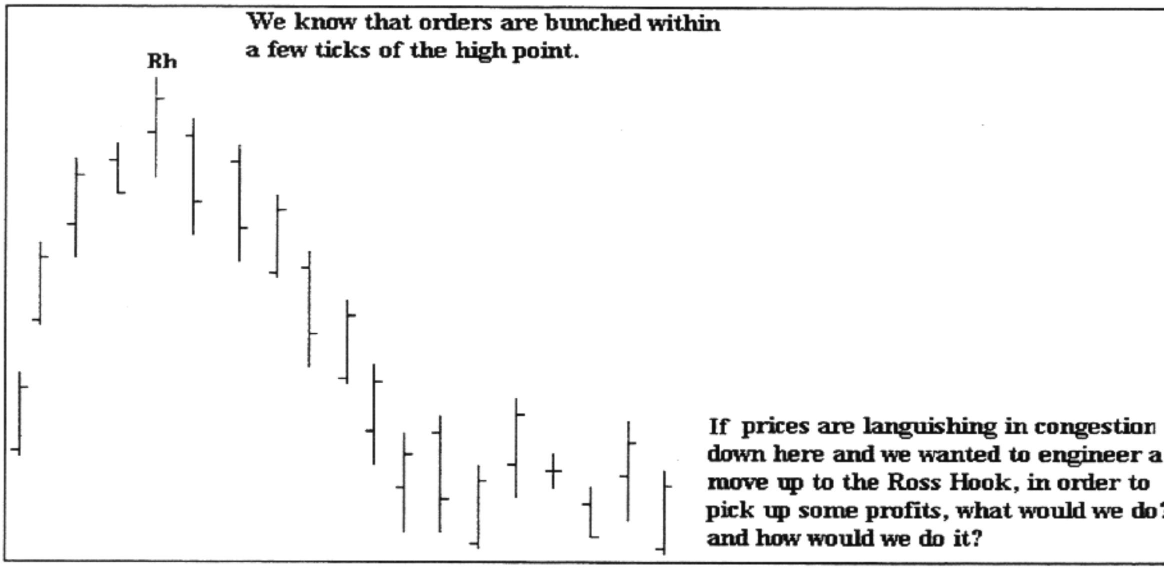
Typically, there will be many orders bunched just beyond the point of a Ross Hook. This is also true of the number two point of a 1-2-3 formation. The insiders are very much aware of the bunching of orders at those points, and if they can make it happen, they will move prices to where they see the orders bunched together, and then a little past that point in order to liquidate as much of their own position as possible. This action by the insiders is called "stop running."

Unless the pressure from the outsiders (us) is sufficient to carry the market to a new level, the breakout will prove to be false.

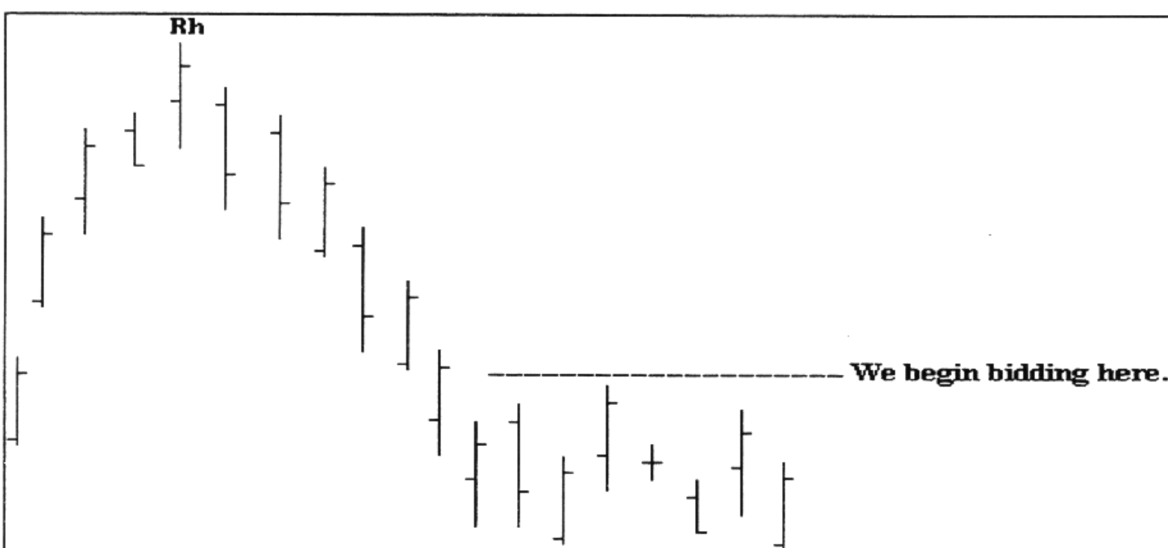
The Trader's Trick is designed to beat the insiders at their own game, or at the very least to create a level playing field on which we can trade. **WHEN TRADING HOOKS, WE WANT TO GET IN AHEAD OF THE ACTUAL BREAKOUT OF THE POINT OF THE HOOK. IF THE BREAKOUT IS NOT FALSE, THE RESULT WILL BE SIGNIFICANT PROFITS. IF THE BREAKOUT IS FALSE, WE WILL HAVE AT LEAST COVERED OUR COSTS AND TAKEN SOME PROFIT FOR OUR EFFORT.**

Insiders will often engineer moves aimed at precisely those points where they realize orders are bunched. It is exactly that kind of engineering that makes the Trader's Trick possible.

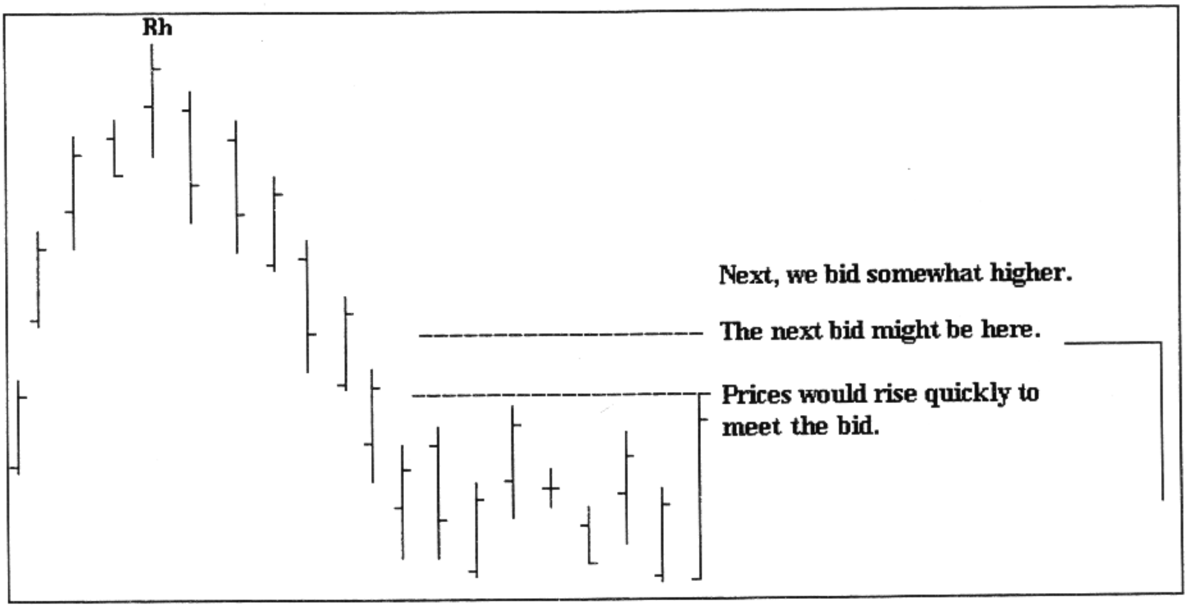
The best way to explain the engineering by the insiders is to give an example. Ask the following question: If we were large operators down on the floor, and we wanted to make the market move sufficiently for us to take a fat profit out of the market and know that we could liquidate easily at a higher level than where the market now is because of the orders bunched there, how would we engineer such a move?



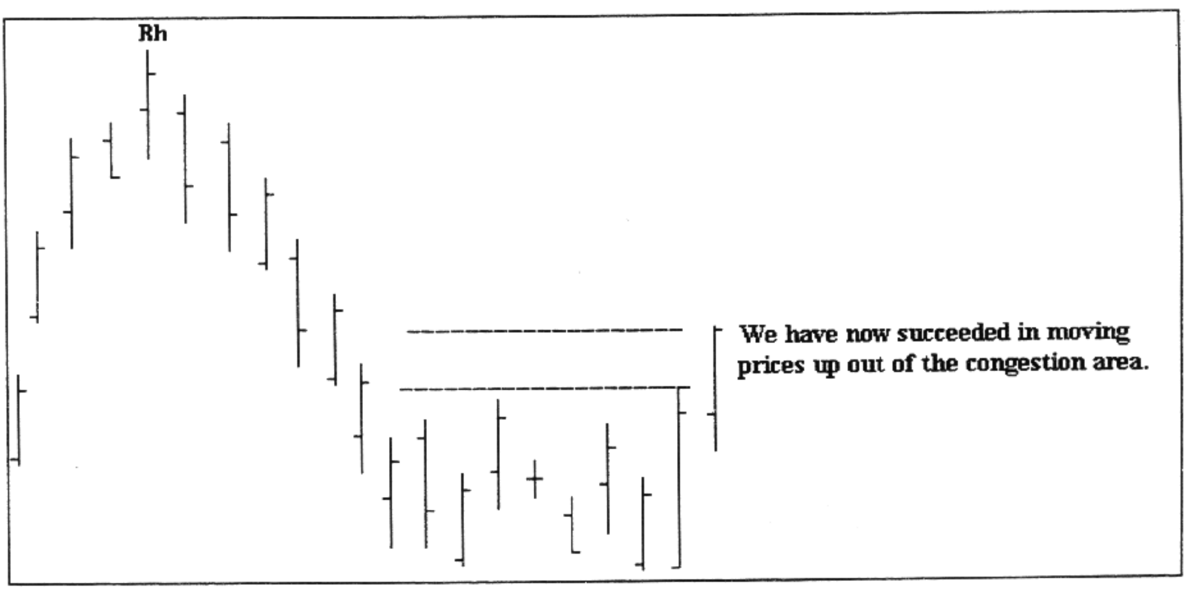
We would begin by bidding slightly above the market.



By bidding a large number of contracts above the market, prices would quickly move up to our price level.



Once again by bidding a large number of contracts at a higher level, prices would move up to that next level.

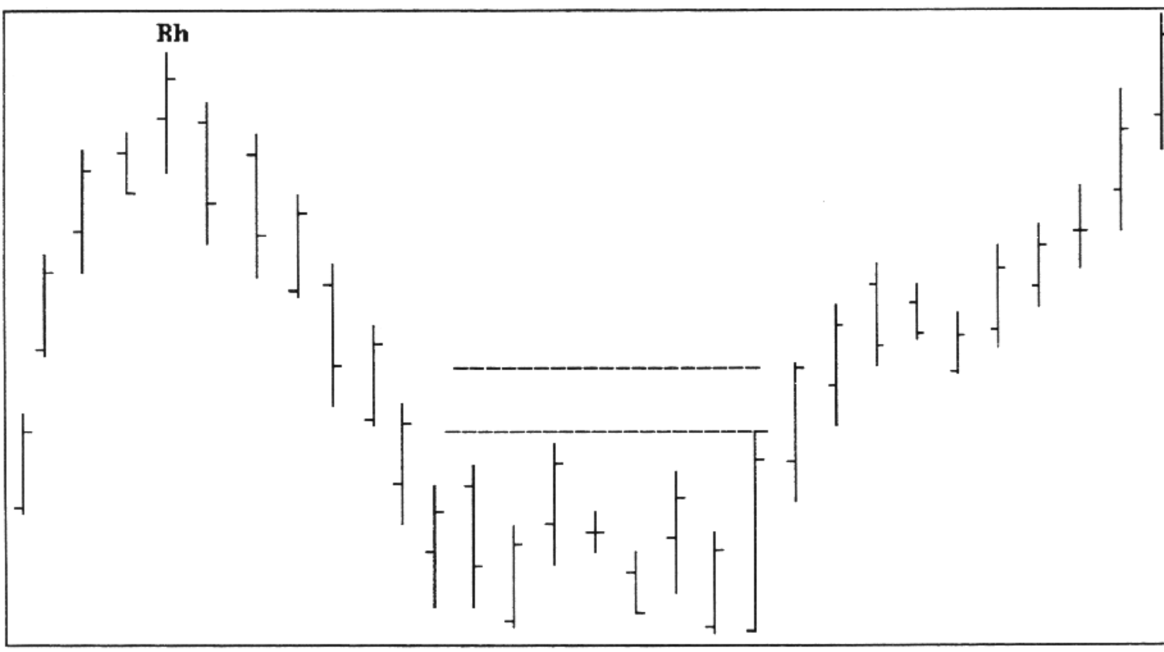


The sudden movement up by prices, to meet our large-order overpriced-bid, will cause others to take notice. The others are daytraders trading from a screen, and even other insiders.

Their buy orders will help in moving the market upward towards where the stops are bunched. It doesn't matter whether this is a daily chart or a five minute chart, the principle is the same. In order to maintain the momentum, we may have to place a few more buy orders above the market, but we don't mind. We know there are plenty of orders bunched above the high point. These buy orders will help us fill our liquidating sell orders when it's time for us to make a hasty exit.

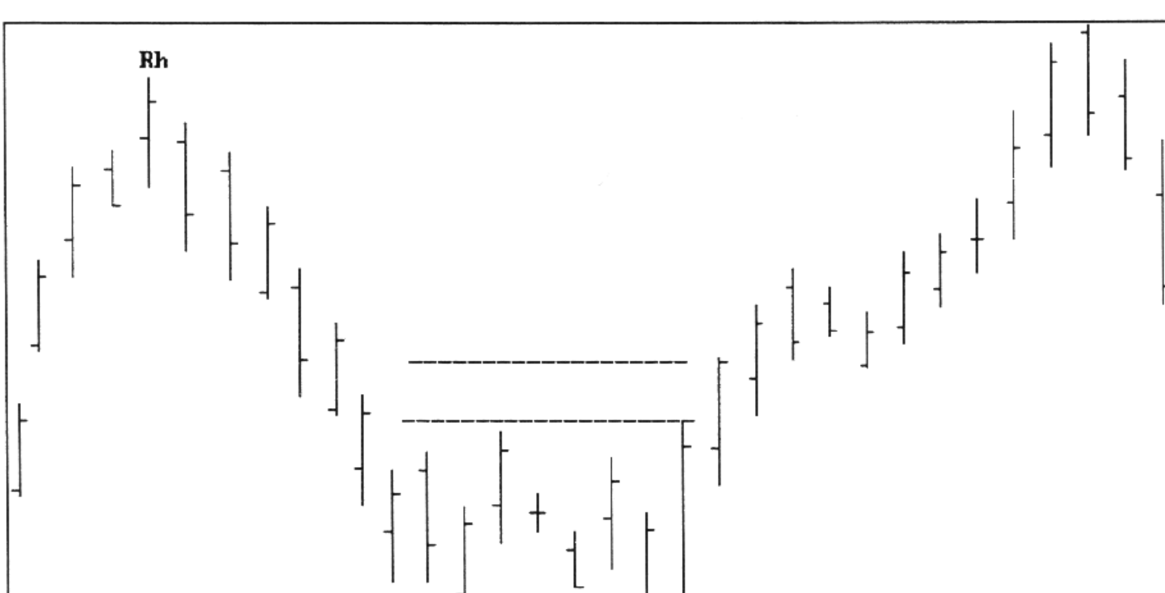
Who has placed the buy orders above the market? The outsiders, of course. They are made up of two groups. One group are those who went short sometime after the high was made, and feel that above the high point is all they are willing to risk. The other group are those outsiders who feel that if the market takes out that high, they want to be long.

Because of the action of our above-the-market bidding, accompanied by the action of other inside traders and daytraders, the market begins to make a strong move up. The move up attracts the attention of yet others, and the market begins to move up even more because of new buying coming in.



This kind of move has nothing whatsoever to do with supply and demand. It is purely contrived and engineered.

Once the market nears the high, practically everyone wants in on this "miraculous" move in the market. Unless there is strong buying by the outsiders, the market will fail at or shortly after reaching the high. This is known as a buying climax.



What will cause this failure? Selling. By whom? By us as big operators, and all the other insiders who are anxious to take profits. At the very least, the market will make some sort of intraday hesitation shortly after the high is reached.

If there is enough buying to overcome all the selling, the market will continue up. If not, the insiders will have a wonderful time selling the market short, especially those who know this was an engineered move. **NOTE: DON'T THINK FOR ONE MOMENT THAT THERE IS NOT COLLUSION BY INSIDERS TO MANIPULATE PRICES.**

What will happen is that not only will selling be done for purposes of liquidation, but also for purposes of reversing position and going short. This means the selling at the buying climax may be close to triple the amount it would normally be if there were only profit taking.

Why triple? Because if prices were engineered upward by a large operator whose real intention is to sell, he will need to sell one set of contracts to liquidate all of his buying, and perhaps double that number in order to get short the amount of contracts he originally intended to sell.

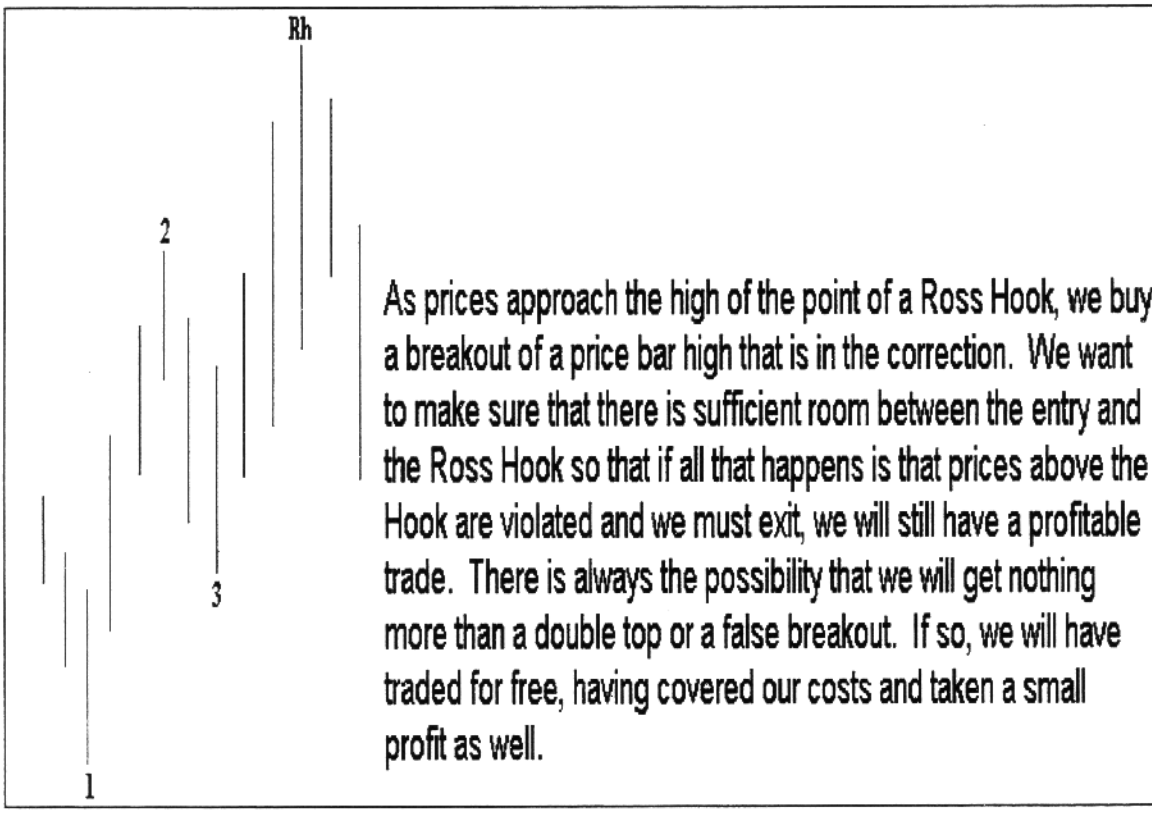
The buying from the outsiders will have to overcome that additional selling.

Because of that fact, the charts will attest to a false breakout. Of course, the reverse scenario is true of a downside engineered move resulting in a false breakout to the downside.

WARNING: MOVING THE MARKET AS SHOWN IN THE PREVIOUS EXAMPLE IS NOT SOMETHING THE AVERAGE TRADER SHOULD ATTEMPT!

It is very important to realize what may be happening when a market approaches a Ross Hook after having been in a congestion area for awhile. The prior pages have illustrated this concept.

With the preceding information in mind, let's see how to accomplish the Trader's Trick.



On the chart above the Rh is the high. There were two price bars following the high: one is the bar whose failure to move higher created the Hook, and the other is one that simply furthered the depth of the correction.

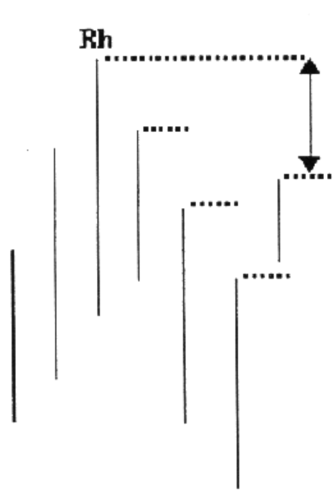
Let's look at that again by breaking it down in detail in an example.

Following the high is a bar that fails to have a higher high. This failure creates the Ross Hook, and is the first bar of correction. If there is sufficient room to cover costs and take a small profit in the distance between the high of the correcting bar and the point of the Hook, we attempt to buy a breakout of the high of the bar that created the Hook, i.e., the first bar of correction. If the high of the first bar of correction is not taken out, i.e., violated, we wait for a second bar of correction.

Once the second bar of correction is in place, we attempt to buy a violation of its high, again provided that there is sufficient room to cover costs and take a profit based on the distance prices have to travel between our entry point and the point of the Hook.

If the high of the second bar of correction is not violated, we will attempt to buy a violation of the high of a third bar of correction provided there is sufficient room to cover costs and take a profit based on the distance prices have to move between our entry point and the point of the Hook. Beyond three bars in the correction, we will cease in our attempt to buy a breakout of the correction highs.

What if the fourth bar did as pictured on the left? As long as prices are moving back up in the direction of the trend that created the Ross Hook, and as long as there is sufficient room for us to cover costs and take a profit, we will buy a breakout of the high of any of the three previous correction bars. In the example, if we were able to enter before prices violated the high of the second bar of correction, we would enter on a violation of the high of the second correcting price bar. If not, and there is still room to cover and profit from a violation of the first correcting price bar, we would enter there. Additionally, we could choose to enter on a takeout of the high of the latest price bar as shown by the double arrow even if it gaps past one of the correction bar highs.



REMINDER: ONCE THERE ARE MORE THAN THREE BARS OF CORRECTION, WE NO LONGER ATTEMPT TO ENTER A TRADE. THE MARKET MUST BEGIN TO MOVE TOWARD THE HOOK AT THE TIME OF OR BEFORE A FOURTH BAR IS MADE.

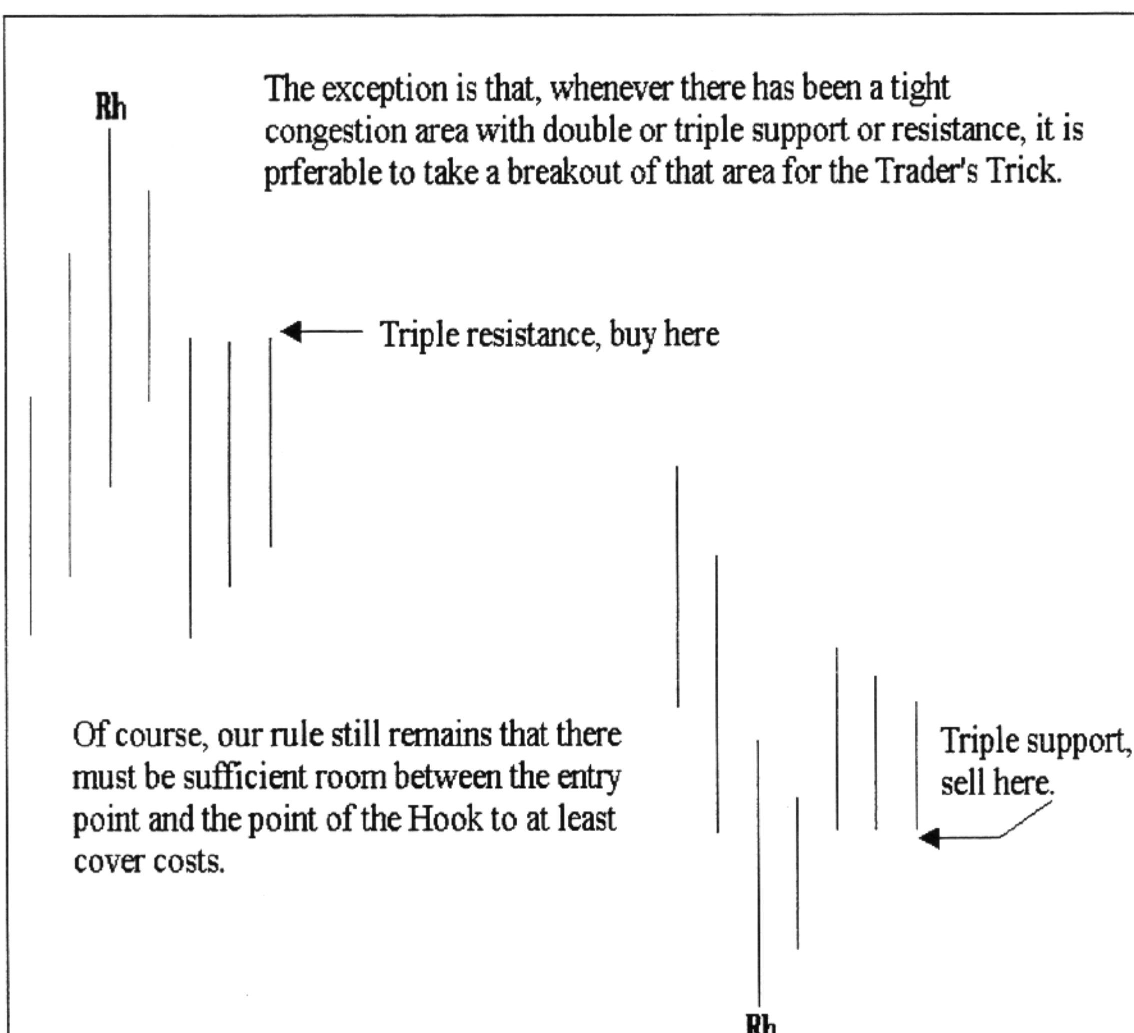
Although not shown, the exact same concept applies to Ross Hooks formed at the end of a down move.

Risk management is based upon the expectation that prices will go up to at least test the point of the Hook. At that time, we will take, or already have taken some profit and have covered costs.

We are now prepared to exit at breakeven, at the very worst, on the remaining contracts. Barring any horrible slippage, the worst we can do is having to exit the trade with some sort of profit for our efforts.

We usually limit the Trader's Trick to no more than three bars of correction following the high of the bar that is the point of the Hook. However, there is an important exception to this rule. The next chart shows the use of double or triple support and resistance areas for implementing the Trader's Trick.

Please realize that "support" and "resistance" on an intraday chart does not have the usual meaning of those terms when applied to the overall supply and demand in the market place. What is referred to here is given in the following four examples:



Any time a business can consistently make profits, that business is going to prosper. Add to that profit the huge amount of money made on the trades that take off and never look back, and it's readily apparent that enormous profits are available from trading.

The management method we use shows why it is so important to be properly capitalized. Size in trading helps enormously.

The method also shows why, if we are undercapitalized (most traders are), we must be patient and gradually build our account by taking profits quickly when they are there.

If you are not able to tend to your own orders intraday, it may be well worth your while to negotiate with a broker who will execute your trading plan for you. There are brokers who will do this, and you may be surprised to find that there are some who will perform such service at reasonable prices if you trade regularly.

When we are trading using the Trader's Trick, we don't want to be filled on a gap opening beyond our desired entry price unless there is sufficient room for us to still cover costs and take a profit. Can you grasp the logic of that? The reason is that we have no way of knowing whether a move toward a breakout is real or not. If it is engineered, the market will move forward to the point of taking out the order accumulations and perhaps a few ticks more. Then the market will reverse with no follow through in the direction of the breakout. As long as we have left enough room between our entry point and the point where orders are accumulated to take care of costs and a profit, we will do no worse than breakeven. Usually, we will also have a profit to show for any remaining contracts, however small.

If the move proves to be real (not engineered), then the market will give us a huge reward relative to our risk and costs. Remember, commission and time are our only real investment in the trade if it goes our way.

The important understanding that we need to have about the Trader's Trick is that by taking entry into a market at the correct point, we can neutralize the action by the insiders. We can be right and earn something for our efforts should the breakout prove to be false.

Some breakouts will be real. The fundamentals of the market insure that. When those breakouts happen, we will be happy, richer traders.

With proper money management, we can earn something for our efforts *even if* the breakout proves to be false.

PRIORITIES

Now it is time to show what our priorities should be. We want to trade the major breakouts and intermediate term breakouts first and foremost. This entails making a mental note or marking on the chart the points at which these breakouts will occur.

I have presented these in the order of their occurrences. There is no specific priority to the major signal trades over the intermediate signal trades as far as their priority goes. The breakout from a major entry point is not more important for entry purposes than a breakout from an intermediate entry point, nor is the breakout of the extremes of the last three days taken as a group necessarily a more important entry signal than the breakout of the individual high or low of any of the last three days. Intermediate entry signals do not take a lower priority than do major entry signals. The difference between major entry signals and intermediate entry signals as it affects other trading will be discussed in a later chapter. However, do keep in mind that the ***thrust*** to be derived from a major entry signal is generally greater than that from an intermediate entry signal

The minor entry signal does defer to the others. The major and the intermediate signals are more important than the minor. Any time we can trade a major or intermediate signal rather than a minor signal, we should.

Chapter 8

STOPS

Before proceeding with more trading, let's take time to discuss stops.

Stops are of two kinds — protective stops, and objective stops.

PROTECTIVE STOPS

It is very difficult to tell someone just where to place stops. This is because stop placement is a function of a number of variables. The size of the account must certainly dictate stop placement. The ability to withstand pain (comfort level) is a major factor. It's not practical to tell another person to place stops at a certain percentage away from the entry. That doesn't make sense. If the stops are too close, there will be losses on what might have been winning trades. If the stops are too far away, there will be larger losses on losing trades than were necessary.

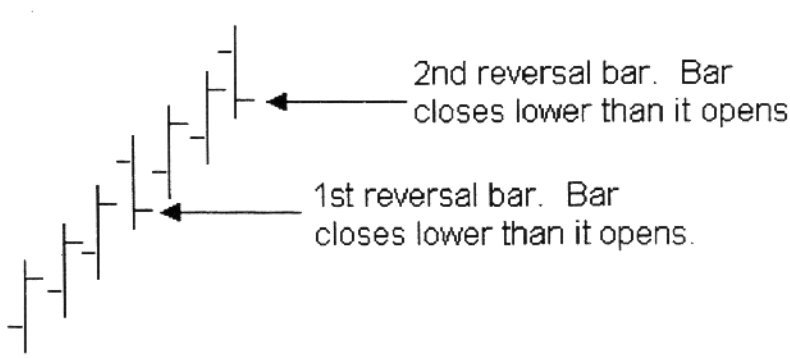
Telling someone to place his stops at a certain number of points away from entry is also impractical because account sizes vary as do individual levels of comfort.

Traders should be highly suspicious of someone who presumes to tell them where to place their stops, unless they are following a person's trades on an advisory basis. Then, of course, they must use that person's stops or they wouldn't truly be following what they've paid to find out.

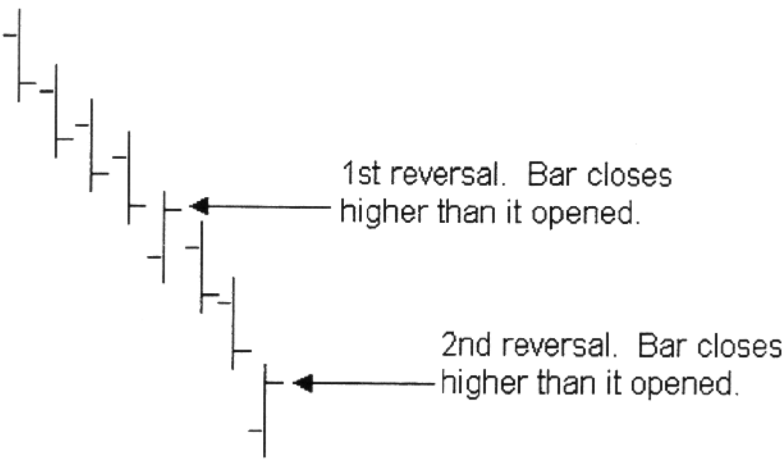
Since I will not presume to tell anyone where to place their stops, let me tell where I place mine.

When I enter a daytrade I use a mental stop. Mental stops can be dangerous. You must follow your discipline and stick with your stop price. When I trade I use a mental stop exit on one of two conditions:

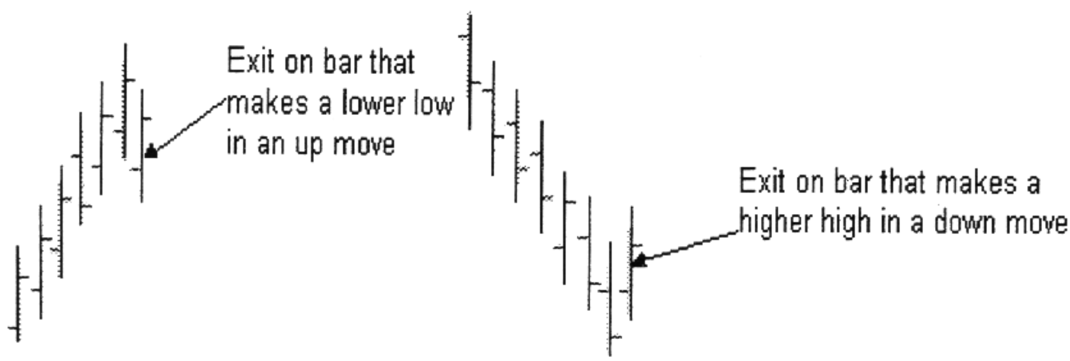
- If I see two reversal bars in a series of price bars that are moving in the desired direction away from my entry point.



Exit on 2nd reversal bar when trading with the violation method.



Exit on 2[nd] reversal bar when trading with the violation method.



- If I see a bar that makes a lower low in an up move, or a price bar that makes a higher high in a down move.

These exits are all part of the violation method.
This method of handling stops is valid for both intraday and position trading, so I'd better illustrate the point. I call this technique the "violation method."

REVERSAL BARS

It is assumed that in an up move, prices will move in such a way that each price bar will close higher than it opens. Overwhelmingly, on a percentage basis, if in a series of price bars in an up move you see two bars which close lower than they open, the indications are that the move is at least temporarily over. I take my money and run. I can almost always get back in when the move resumes. The two bars in the series do not have to be consecutive. Any two bars in the series will do. The combination of open-high/close-low price action in an up move is called a reversal bar.

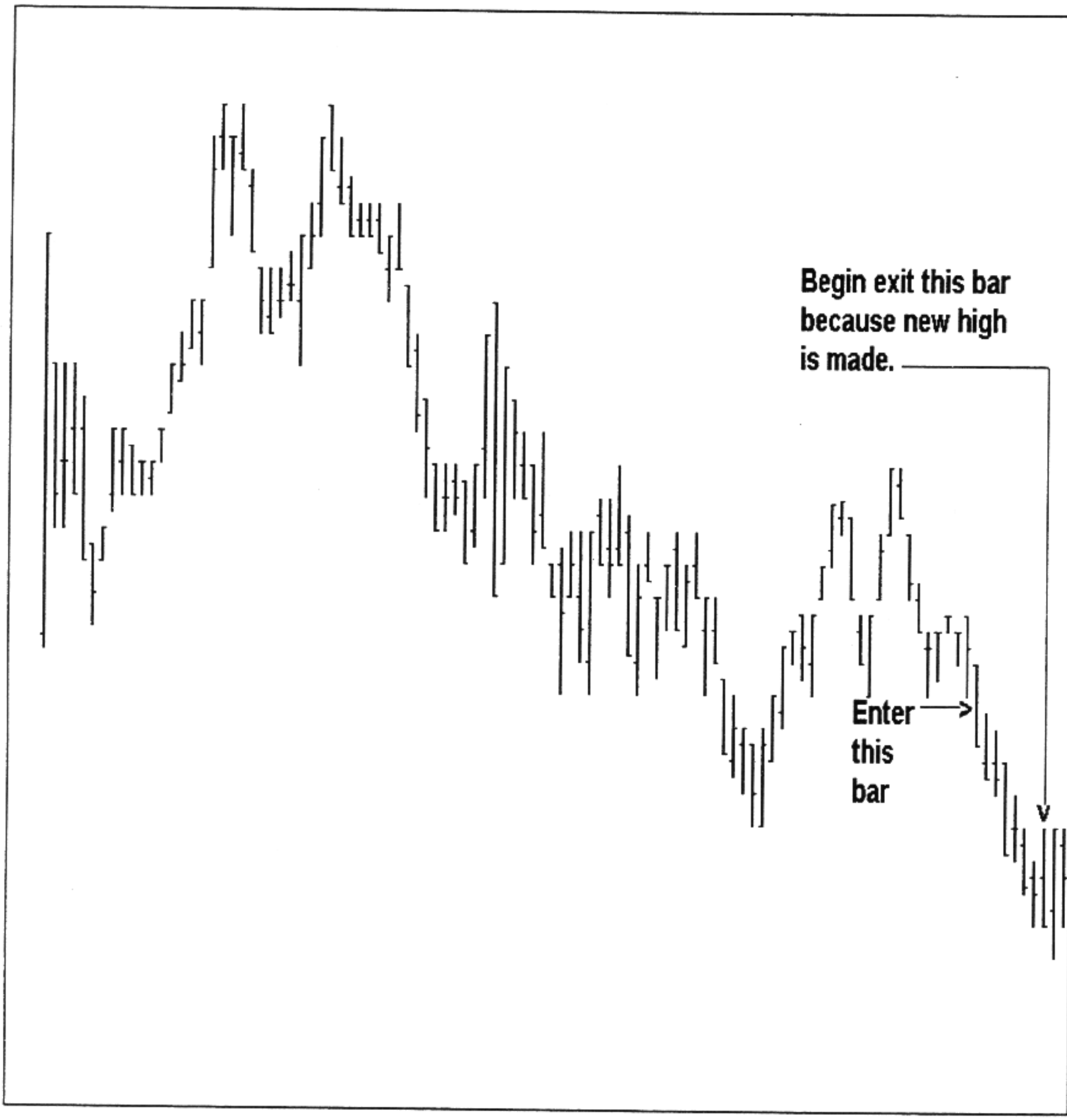
Conversely, in a down move, it is assumed that prices will continuously close lower than they open. When I see any two bars that reverse this process (i.e., open low/close high) I have two reversal bars. I exit immediately. The reversal bars do not have to be consecutive, they can occur anywhere in the series.

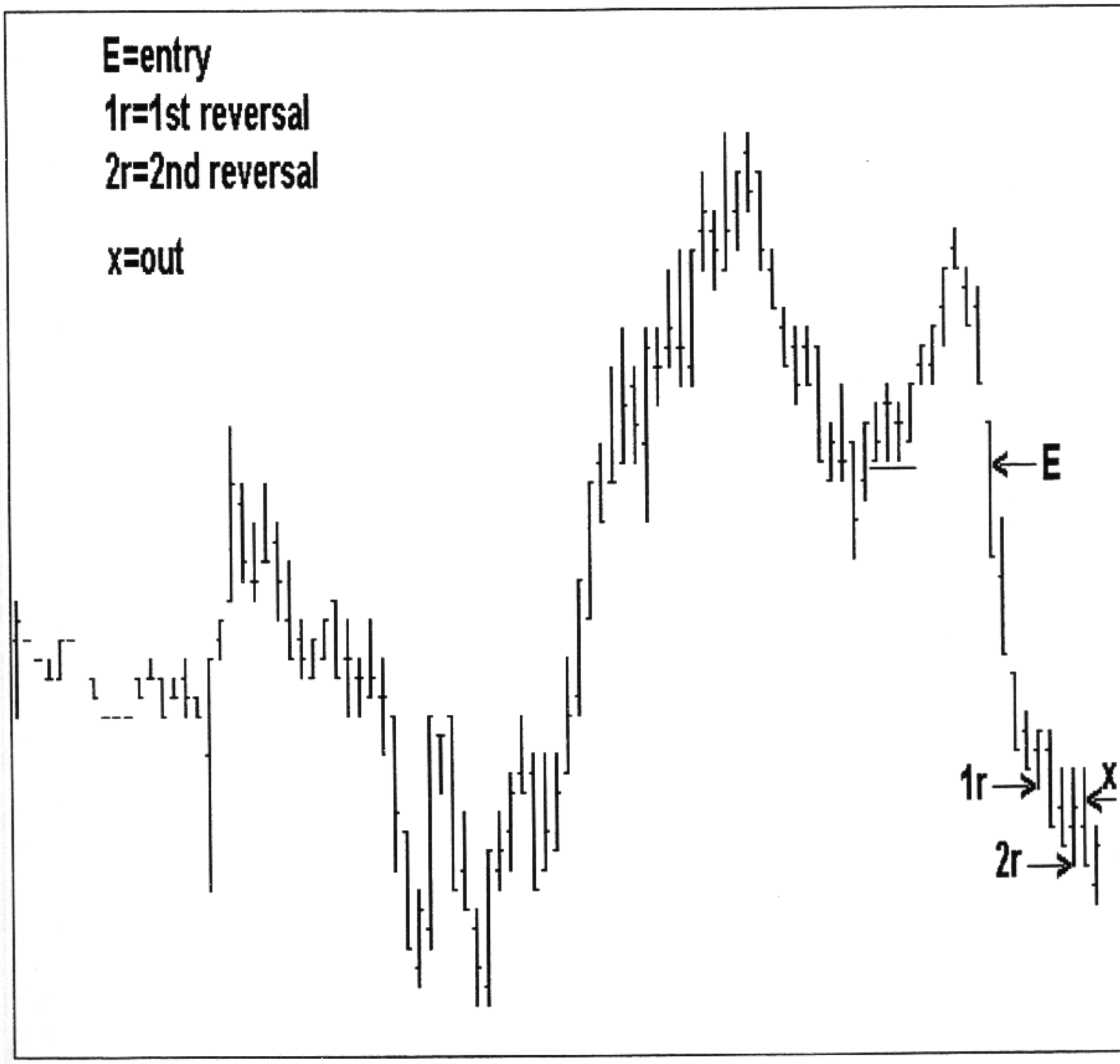
HIGH AND LOW VIOLATIONS

The presumption is that, in an up move, prices should be making higher highs and higher lows. Therefore, if a price bar should happen to make a lower low, thereby violating the previous bar's low, something is not quite right. On a percentage basis, it is a good idea to begin exiting as soon as the lower low occurs. The opposite is true in a downtrend. It is presumed that prices should be making lower highs and lower lows. If a price bar suddenly makes a higher high by violating the previous bar's high, percentages indicate that the down move is going to stop – at least for awhile. I take my money and run.

With the violation method you have a choice as to whether or not you would sell the entire position at the time of the violation, a violation being two reversal bars or the making of a higher high in a down move or a lower low in an up move. If you choose not to liquidate the entire position, you can scale out by exiting part of the position whenever you see the first violation, staying in part of the position until you see a second violation, and holding part of the position until you see anything that would cause you to take your money and run. It is entirely subjective as to what would cause you to do that. Depending on your strategy and business plan, you can decide which method is best for you and your trading.

For the present, ignore the entry technique in the examples that follow.

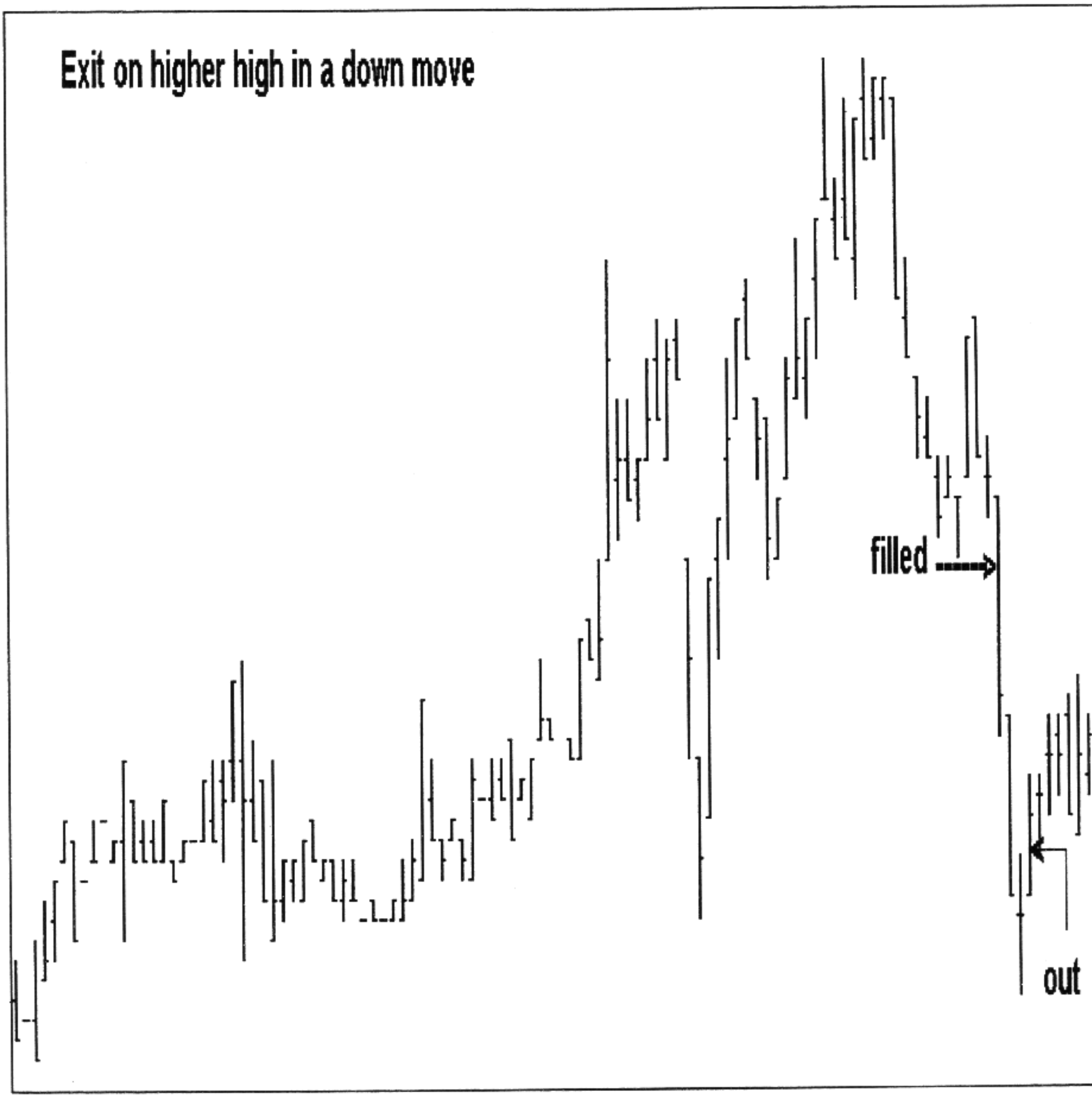




1r — bar opened lower and closed higher rather than opening higher and closing lower.

2r — bar opened lower, and closed higher, rather than opening higher and closing lower.

Begin exit on second reversal bar.



The above example shows exiting on a higher high in a down move.

Even though an example is not shown, I would also exit on a lower low in an up move.

OBJECTIVE STOPS

The following is a brief discussion presented so that you might begin to become familiar with the concept of trading with objectives.

There are two types of objective stops: one is for covering costs, and the other is for taking profits.

For most day trades, I am initially looking to cover costs and make a small profit on a part of my position.

I'm not going to tell anyone to trade a certain number of contracts at any one time. Suffice it to say that a position may be divided so that a portion of it is used to cover costs and earn a partial profit, and the position may be further divided so that portions of it are used to take additional profits as the trade progresses.

The remainder of objective stop management involves:

- Quickly placing an exit order so as to do no worse on a trade than breakeven

- Continue moving profit protecting stops every time prices break the old highs and head higher when long, and every time prices break old lows and head lower when short. At the very least, try to protect one-half of the unrealized paper profits in a trade. Paper profits are defined as the amount of money or points that could have been made had the exit been at the greatest extreme prices reached since entering.

Chapter 9

ORDERING

ENTRY ORDERS

From this point on, whenever I write about a contract-set, unless noted otherwise, I am talking about entering a market with three contracts in the set. When I trade more than three or four contracts, I trade five or multiples of five.

Whatever I do, I don't want to trade in odd lots. It's hard enough to get good fills trading in numbers that other traders utilize. Recently I spoke with a trader who had gotten a terrible fill in Orange Juice. The slippage on his exit order was fifty points. When I asked him how many contracts were involved, the answer was twenty-three. I had to shake my head in disbelief. Here he was in a thin market, trading at a time of the year (Spring) when the Orange Juice market was paper thin, and trading a twenty-three lot. Is it any wonder he had slippage of fifty points?

It's also important to enter price orders at numbers that are likely to be filled without slippage.

For instance, Orange Juice is worth $1.50 a point and usually ticks about five points at a time. This makes it extremely difficult to place orders that will not have slippage. If I were to use five dollar intervals, I will be trading at numbers that end in zero or five. Yet $1.50 will not divide into $5.00 in any way other than fractionally. A similar thing is true for Unleaded Gasoline, Heating Oil ($4.20/point each), the meats, Coffee and Lumber. All of these are thin markets to begin with. Unless a trader is aware of the digital endings that will get good fills, he is asking for trouble when he trades them. Frankly, I had to wonder why in the world anyone would want to trade in a murderous market like Orange Juice. It is a very illiquid market suitable only for those who have a commercial need to be there. You must check each and every market you wish to enter to see whether or not the order flow will sustain daytrading or even daily position trading and still yield decent fills.

Order placement is critical in daytrading. The number one thing I try to remember in ordering is to be patient and avoid greed. I place all my entry orders as BUY OR SELL STOPS at my entry price. I would like to use STOP LIMIT orders and "OR BETTER" orders. But there are times and markets where this is not possible even though the orders may be allowed at a particular exchange. Where possible, I place my entry orders as STOP WITH LIMIT. "WITH LIMIT" means I give a price range in which I'm willing to be filled. If the market rushes past me and I am filled a little differently than expected, I don't worry about it. Slippage is figured into what I'm doing. By giving a price range for my fill I'm able to control the amount of slippage I'm willing to take. However, in some markets and at certain times, I'm forced to use regular BUY AND SELL STOP orders.

Using STOP LIMIT and STOP WITH LIMIT means I miss many trades. I don't care if I do. If I can't have it my way, I don't want the trade. Stop Limit orders have low priority on the floor. They will not always get me a fill.

I generally do not place orders in the market before the open. Except at TTE and congestion entry points, I have no resting orders in the market until the market is approaching my entry point, going in my direction, on an intraday basis. Then, and only then, do I place a resting "today only" order in the market.

The market will often gap open past my entry point. So what! I miss that trade. I have tried to learn to think in this manner: "If it doesn't happen my way, then let it go." I don't sit and drool thinking, "Oh, if only I had put that in as a market order, I could have made a fortune."

The trade must trade through my price and be filled in the manner I requested, or I forget it. I go look elsewhere.

Throughout this manual I will repeatedly stress that I must have this kind of discipline. I take only those trades that happen my way, and are filled according to my instructions. I let everything else go by.

EXIT ORDERS

Just as I want to be careful about my entry order, I also want to explicitly state my final exit order. I get out AT THE MARKET. I do not issue "or better" orders for exiting. Just as soon as my objective is reached, I exit AT THE MARKET. If I want to be anticipatory, it is OK. That way I will be more assured of getting something for the risk I've taken if prices trade near my exit point. I do not use "Market If Touched orders" for my final exit order. It takes too long to cancel-replace a MIT order with an At-The-Market order. Not only that, but I could end up going the wrong way if the order is not in the pit fast enough. The only preferable way for final exit is AT THE MARKET. As soon as I see prices approach or surpass my goal, I get out AT THE MARKET. I cannot stress this enough. Yes, there will be slippage. Yes, I will not always get my price. Yes, I will find plenty of reasons to curse the market, my broker, and the !%^x*#&$_ insiders. But at least I will usually get out with something.

Of course, all of the above presumes that I am actively watching the trade via a live data feed. Allow me to point out that if my objective is reached, and I am not able to watch the price action, I can place a MIT or a buy or sell stop in the market. In the case of the MIT, as soon as prices trade at my objective, the MIT will become a market order. In the case of a stop order, as soon as prices trade through my objective price, the stop will become a market order and I will have my fill. Remember this, buy stops must be place above the current price. MIT buy orders are placed below the current price. Sell stops must be placed below the current price. MIT sell orders are placed above the current price.

I must be extremely quick at canceling out any protective stop orders when the market has moved ahead sufficiently to warrant doing so. I don't want the market to come back and hit them.

If the trade goes against me, I get out. I get out at my stop whether it be mental or physical, or, if I am unsure because the trade doesn't seem to be going according to plan, I get out NOW!

Yes, I may mumble and grumble. Yes, I may feel exasperation and frustration, but I must take the hit and get out. This was not my trade. Maybe I got a really bad fill, maybe some news hit the market and it began to move rapidly away from my trade. Whatever the reason, there is only one thing to do – GET OUT!

Will I do it? Not always, I don't have perfect discipline. Do I have the discipline to enter my orders the way I've stated here? Yes, usually! Do I want to stay among the majority who lose in the markets? No! So I must do what I've written here.

I remember: where possible stop limit, or stop with limit orders on entries. At-The-Market orders on exits. With the exception of when I have to use plain stop orders, no other way – EVER – in <u>those</u> situations!

NOTE: STOP LIMIT OR STOP WITH LIMIT TYPES OF ORDERS ARE SELDOM AVAILABLE OR PROFICIENT FOR DAYTRADERS. OR-BETTER ORDERS ARE GENERALLY AVAILABLE IN ALL MARKETS EVEN FOR DAYTRADERS.

Chapter 10

HOUSEKEEPING

Because daytrading is at times both fast and furious, I must keep accurate records of my trades. I must know the time I entered the trade, I must get a ticket number for the trade. I must keep count of the contracts I have on in each trade. Hey, nobody said that daytrading is easy. Actually, it can be quite hectic.

As soon as I see prices tick at and then through my entry point, I assume I have been filled. I call my broker. I nag that broker until he gets my fill out. I cannot wait half an hour to find out if I've been filled. I have to know NOW! This takes a lot of effort on my part. I may be daytrading in one market and trying to watch another market in which I have a position trade. I am trying to write down where I am in each market. I am waiting for the fill, and at the same time I need to call my broker and bug that broker without mercy until I know if and at which price my entry order was filled.

To do all that, I had better be one terrific housekeeper. If I am not totally organized, I will eat my shirt. I write down all my potential entry points. I must keep track of those prices. When I call in an order, I keep track of those ticket numbers. Ticket 123 bought three at a half. I write it down. Ticket 345 sold one at even. I write it down.

"Now, how many contracts am I still in?" Whoa! Wait a minute, ticket 678 to sell three S&P at a "price or better" just got missed, the market opened below me on a gap. Quick, get that order canceled. "Straight cancel ticket 678 selling three S&P's at what????" What was that figure? "Oh, there it is, selling at a quarter. Thank goodness I wrote it down." *"Now, where was I.... Oh yeah... how many other contracts am I still holding? Two!"* I write it down.

I'm not exaggerating. Not at all! Daytrading an intraday chart is some kind of a busy job. I can do it only in short bursts. Anyone who is a nervous type will be eaten alive. I must keep accurate records. I must know, and know that I know, when I am flat, or when I still have one or more positions on. I've had my broker call to tell me I wasn't flat – that I still had trades on. He was wrong. My record keeping was more accurate than his. I've had my broker call to tell me he thought I was flat. I couldn't be sure, because I got things messed up and didn't write something down. The next day I had a $2900 loss in the D-Mark staring me in the face at the open. I was wrong. His record keeping was no more accurate than mine. That's when I started tape recording my orders, and listening to the tape. Some people tape them and never listen to the tape.

I've had the broker call to tell me I was still long a Yen contract and did I want to sell it before the close? My records, and my tape recording, showed I was flat. He couldn't be sure because the market was fast and he didn't know if all the tickets were in and accounted for. What would have happened had I sold a Yen contract at the market? I would have been short one Yen contract at the close. The next morning saw a gap opening to the upside of $3,700. Thankfully, I hadn't inadvertently gone short.

Do I need to keep accurate records? Absolutely, for sure, YES! So I write it down, write it down, WRITE IT DOWN.

If I miss a ticket number, I call back and dig it out. I write it down. Whenever possible, I write out all orders in advance. Then I read them to the broker so I make fewer mistakes. I use them as a script, so I won't say "buy" when I mean "sell." I tape record every order. Sooner or later the day will come when I desperately want out of a market and will "sell" it instead of "buying" it to get out. I need to know what I said, and I need to hear what the broker said. I replay the tape just to be sure.

I time stamp every order by saying, "This is account 12345 at 8:22 a.m. on 12 July, ..."

When I'm in the heat of battle, I have to be extra careful of what I say. In the rush to exit a trade, I may say the wrong thing. If I have had time to do so, and it's not a simple market order, I will have written out my exit order.

I hate to say how many times I've been short three contracts, and wanted to add five or ten contracts, in a hurry, watching two or three other trades, and blurted "buy five D-Marks at the market" when I really wanted to say "sell."

I hate to tell how many times I've been long three contracts, added to my position with five contracts, made a bundle on the trade, and then at exit time forgot I had eight still on and said, "sell five." That's why I write it down, write it down, WRITE IT DOWN! I keep my house clean.

Chapter 11

BROKERS AND COMMISSIONS

There is nothing more important to my daytrading than to have a very responsive and accurate broker handling my account. I'll discuss some of the problems I encounter in daytrading that make this so.

At times my trading will be fast and furious. I may be long a five lot and need to load up with a fifteen lot. If this is happening while I hold a position trade in another market (which it often does), I need a broker who can help me to keep track of my trades. I need an alert broker with a very competent staff, all of whom are familiar with my trading.

I need a broker who can get the orders back from the trading floor quickly. He's got to get them out with all speed.

There will be times in fast markets when I need to get out before I know exactly where I got in.

I cannot afford to use a novice broker. On the other hand, an established broker will have other clients who are important to him/her who also need attention.

I cannot afford to use any broker who will not deal with me on a discount basis. The absolute tops I can afford to pay for commission is a lot less than many pay with a discount broker.

What I pay depends on my trading volume, the size of my account, and, to a certain extent, upon how much my broker needs the business.

I try wherever possible to be able to call directly to the floor. For daytrading I must call directly to the floor.

I need a broker who has good desk position on the floor and good representation in the pit. Such brokers are hard to come by. I know. I've looked long and hard. When I find one, I will stay with him as long as possible.

In the heat of trading, there are times when I have trouble remembering exactly where and what my various positions are. Hopefully, my broker will provide a good backup.

I also need a broker who will allow me to daytrade with 25% (no more) of minimum margin. By minimum margin I mean the minimum margin for a commodity as set out by the exchange, rather than the broker's minimum margin.

Some brokers will clear me to trade at 25% minimum margin on the S&P. That's not good enough. I want a broker who will allow me to daytrade with 25% of exchange minimum margins across the board.

In that way I can jump in and out of positions with sufficient contracts when needed. It is also the reason I must be out of the market before the close. There absolutely cannot be any overnight positions, unless I have decided to change my trade into a position trade.

This puts the burden of time on me. There is a definite time constraint. I have from the opening of trading until the close to make my money. If I have failed by then, I close my position – win or lose – and get out.

I make absolutely sure that my relationship with my broker is solid. The broker works for me. I will be delegating a certain amount of authority each and every time I issue buy/sell orders.

I prefer a broker who doesn't trade a personal account. I don't want my broker fading my trades. I also don't want a broker who gives advice. If it is offered, I politely inform my broker that I don't want to hear it. If it is offered again, I move my account. Broker advice can cause me to lose the courage of my convictions.

Also, I want a broker who can keep my activities confidential. I don't want the broker to give my trades to any other clients.

I have had brokers who were piggy-backing my trades for their own account(s). With one broker, when the fills came back, he was grabbing the best ones for his account, and giving me the lesser fills. You can tell this is happening when you start getting consistently lousy fills, or when a broker doesn't issue ticket numbers from the floor. You can also tell when the lot sizes you were using in you strategies were getting you good fills, and all of a sudden you are getting a lot of slippage. Let's say your strategy has been working fine with ten lots, and all of a sudden you are getting excessive slippage. If your broker is piggy-backing your trades, there may suddenly be 100 lots hitting the market. This extra amount of contracts coming into the market can materially change the nature of your fills.

Chapter 12

A TRADING PLAN

WARNING! No one should attempt daytrading from short-term intraday charts unless he is a decisive, quick thinker. If a person tends to panic when things go wrong, then that person should not trade the short-term charts. No one should trade any time interval of an intraday chart whose movement in the chosen time interval is less than they are paying in total commissions and costs. No one should trade a short-term intraday chart who is not able to call directly to the floor.

I've taken care of all the loose ends. I've talked about trade selection, entry points, stops, ordering, brokers, commissions, and housekeeping. Now, I'll talk about daytrading, and specifically daytrading intraday bar charts.

APPROACH TO TRADING PLAN

My approach to trading is simple: MAKE MONEY! In order to do that, I must STAY ALIVE. The other side of that statement is: DON'T LOSE MONEY! Refuse to lose.

In Trading by the Book, I offered a set of character traits that would make anyone a better trader. Those traits are worth repeating here.

Self-discipline

Knowledge

Patience

Self-control

Resourcefulness

Diligence

Flexibility

Concentration

Decisiveness

Persistence

Discretion

Perseverance

Consistency

"In addition to the above attributes, there must be total honesty and truthfulness. I must know myself and my weaknesses, be emotionally, mentally and physically fit, and ready to take action when needed – without procrastination. I must overcome greed and have an intensity about me that enables me to control not only my emotions, but my thoughts as well. That is a tall order, but it is still not enough. I must also become a top notch manager – planning, directing, organizing, controlling and delegating."

None of the above has changed. If anything, it is more true of daytrading than it is of daily position trading.

STAYING ALIVE

Preservation, of capital and self, retaining both my money and my dignity, are prime elements of successful daytrading.

I cannot afford to take a financial or emotional beating in the markets. It undermines my self-confidence, and I will not have the courage of my convictions. Without faith, without the courage of conviction, I'm better off not trading at all. I'd be better off putting my money into a stock mutual fund.

It's better to take a series of small losses ($150-$250) than to take a single big hit. It is far less demoralizing. I realize I won't win every day.
The losses will always be there. I have to get used to them. But they won't matter if I can stay alive in the markets until a big win comes along.

If taking losses can't be a part of my makeup, then I don't belong in this business.

STAYING IN THE WATER

Trading is a business of staying in the water. I trade, taking small losses and small wins, until I hit the big one, the one I can take to the bank. The one that runs.

I can't win unless I do stay in the water. I can't stay in the water if I'm demoralized. Continually losing more than I gain will undermine my faith. I'll begin to experiment. I'll change my game plan and I'll become a statistic.

PLAN THE WORK — WORK THE PLAN

One of the oldest cliches in the world is plan your work – work your plan. Daytrading is a business, therefore I must have a business plan.

Why not just trade the breakout of the open and be done with it? That takes very little planning. Why not just trade the S&P 500 after the bond market closes? Often there is lots of good action then.

My business plan should include those trades that have a high probability of being winners.

THE PLAN

Why go through the exercise of selecting trades the way I do? Here's why! My selection methods force me to take in the big picture. The big picture is always a part of good planning. By looking at the daily chart, I am able to get perspective. I want to point out that the daily chart is 60-75 times the magnitude of the five minute chart. In the currencies, for example, between 7:20 AM and 2:00 PM there will be 74± five minute bars on the chart. It's easy to lose the forest among the trees.

Breakouts of daily highs and lows usually carry enough thrust to see me through to a profit. It might seem that the more major a breakout is, the more chance that the thrust will be sufficient to transport me to a profit. However, that is not necessarily true.

I WANT IT MY WAY

I want it my way, or I don't want it at all. I don't care if the trade I missed goes on to make a million dollars, if it didn't happen the way I wanted it to happen, then I'll just miss that one. I miss plenty of super-good trades, but at least I'm still here to tell about them. I want and will take only those trades that are filled my way, according to my specifications. If I give market orders on entry, I will have too much slippage on both ends of the trade. That's not good. It doesn't fit in with the plan.

The plan must allow for slippage, and losses, and the plan must allow for missed trades. I don't worry about missing a trade. There are plenty of trades, more than I could ever handle. Wishful thinking about missed trades is no more than a manifestation of greed. If I'm greedy, I will lose.

The plan calls for getting out of at least one contract, and preferably two, as soon as I see $70 to $100 per contract in profits. Yes, the trade might have gone on to make $1,000 dollars. However, it may also go on to lose $1,000. If I don't get out at the $70 to $100 per contract that the plan calls for, then greed has gotten the better of me and overall I'll lose.
The plan allows for slippage of time. When I call in my order, the phone isn't always answered on the first ring – or even by the eighth ring.

I'm long five December T-Notes. I've just seen my trade hit the $100 per contract level. I lift the phone and punch the automatic dialer button that has my broker's number on it. The phone rings once. I see my $100 profit shrink to $60 on one quick tick of the arrow on the chart. The phone rings a second time. The arrow ticks back up to +$110.

The broker picks up the phone. I yell, "Account 1234, 9:15, 15, November, selling one deece T-Notes AT THE MARKET, I'll hold." The market arrow ticks up to $120 profit. I hear the broker say, "Ticket 128 sells one deece T-Note, market." The arrow ticks down to +$90. I hear the floor say, "Fred, sell one deece T-Note." The arrow ticks down to +$80. I hear my broker say, "Account 1234 gets it." Then I hear, "OK" My broker says, "Thanks." Then he says "Hey Joe, you got it, your price." I say to him, "Thanks." I say to myself, "Son of a gun, what a lousy fill. I saw it go up to $120 and all I made was a lousy $80 less commission."

Then I remember, the plan calls for this to happen. I'm within the parameters of the plan. At least I didn't lose. I've covered costs. In a business, I always cover costs before I think about profits. "OK, let's see what I can get out of another, maybe two other contracts."

I'm alive, I have expectations. That small win starts me out on the right foot, and I have the courage of my convictions. I now have some staying power. The plan is working, and I'm working the plan. I have persevered in staying on track so far.

Why is it so important to get that small win? Because not only does it give me a morale lift, but as stated, it covers expenses. I always have to think about covering costs before I can think about taking profits. It never fails to amaze me how many traders fail to realize this basic concept and put it into practice. Even traders who are eminently successful businessmen seem to completely ignore this when they are trading the futures markets. Yet the best traders I know try as often as possible to get that "free" trade.

Since the plan calls for having it my way, then of necessity there may be days when I don't trade at all. Will this cause me to change the plan? If it does, then I am not only greedy, but I would have no consistency.

Although it is rare, there are days when I don't trade at all because nothing falls within the parameters of the plan. Of course, if I am willing to trade a breakout of the first congestion after the opening, this will rarely happen.

The larger the time frame from which I'm willing to take my entry signals, the more potential there is for days in which I don't trade at all. This is a great time to take in an art museum, or the zoo, or an extra round of golf. I could even go fishing. Why? Because the plan calls for a little rest and relaxation now and then. I go ahead, take my wife out shopping. Why else am I trying to make a buck? I enjoy the profits I make in the markets. I don't let them build up any higher than I absolutely need for trading. I take the rest and put it into equities and interest bearing paper.

I don't have to trade every day, do I? If I do, then I've missed the whole point of trading. Trading is for making money – not creating zombies. If I trade all day every day, or even part of the day every day, I will have lost my flexibility. I will be using poor discretion. My concentration will wane. My decisiveness will lose its edge. In a word, I will have become a gambler – totally out of control. I will have turned into a trading zombie. A pair of red, greedy eyes, staring at a boob-tube. Boredom will set in. I will have depleted my source of adrenaline. I will get numb. I will not act and react the way I should, and I will lose.

My desire to make money will have become my god. I will have become a slave to trading.

My solution is to take regular breaks from daytrading. I schedule them and am sure to take them. I take at least one week a month away from the screen. I also schedule and take 2-3 vacations a year totally away from all markets. All this in addition to taking time away from my trading in order to tutor and answer questions from those wanting more help. Can I earn a living daytrading so few days out of the month, fewer than 12 months out of a year? Yes!

Let me repeat the plan to this point to include you:

- We take entries from major, intermediate, and then minor signals. We prioritize them in that order.

- We write down all potential orders. We write them out exactly the way we will give them. Some may be repeats of the previous day.

- We set alerts in any way we can. If our software allows it, we set visual and audible alerts. If we were unable to set them on the computer, we would watch prices on as many markets as we could comfortably watch and still function as traders. This might be only one or two. We set our alerts at 5 or 10 ticks prior to the entry point so we will have time to react.

- We make sure that all entry orders are buy or sell stops, limit or stop with limit and where we can't get any other type of limit we use an "or better" order. If a market gaps open beyond our entry point, we wait until tomorrow to try again in that market, or until developments today dictate that we should keep trying.

- In the event we are not able to use limiting orders when we want to, and we have to use a simple buy or sell stop order, if the market rushes through our stop order and we're filled past our entry point, we live with it. If the market hits our entry point and then retraces without giving us our fill, we don't sweat it. We're thankful.

- If we think we might have been filled, (the market has ticked at or beyond our price), then we bug the daylights out of our broker until we know for sure if and where we were filled.

- If we're filled and the market goes our way, then we exit from the market on a single contract trade as soon as we see $70 to $100/contract on the chart, but not until we know for sure we're in this trade.
- If we're trading two contracts, we exit the second one when we see the next $70 to $100/contract on the chart.

- If we're trading any amount more than two contracts-sets, we let all or some of the remaining contracts ride, moving our stops up regularly to protect profits.

- We take regular rest periods away from the screen and away from trading.

The knowledge I've given so far is far from complete. There is more to come. There is a specific way I trade the breakouts already mentioned.

In the next chapter, I will begin to explain the technique in detail.

Chapter 13

FILTERING THE TRADE

I've stated that we want to trade using the Trader's Trick ahead of the thrust of the breakout of a particular point: the breakout of a trading range, a 1-2-3 high or low, a ledge, or a Ross hook. All these events are based on the daily chart.

We must also be willing to trade ahead of the breakout of the local high or low of the last three days taken as a group, or a breakout of an individual high or low of the last three days. These, too, are based upon what is happening on the daily chart.

In all cases, we do not want to trade a gap opening that takes out the high or low.

Finally, we must be willing to trade a breakout of the first congestion after the open, even if that congestion is a continuation of yesterday's ending congestion. The breakout based upon the intraday congestion on the five minute chart is a clue to what follows.

A TRADING FILTER

A trading filter serves several purposes. It allows us to use a small stop. It helps us avoid false breakouts. It anticipates the breakout and helps us to get into the trade earlier than we might normally have done.

I'll state what it is, and then give an example.

As a market approaches one of our major or intermediate entry points, we take a breakout of the congestion that normally occurs just prior to such a breakout. We will trade only in the direction of the anticipated breakout. There are more refinements to this filter, and they will all be covered in detail as we progress through the manual. But first, let's visit another market.

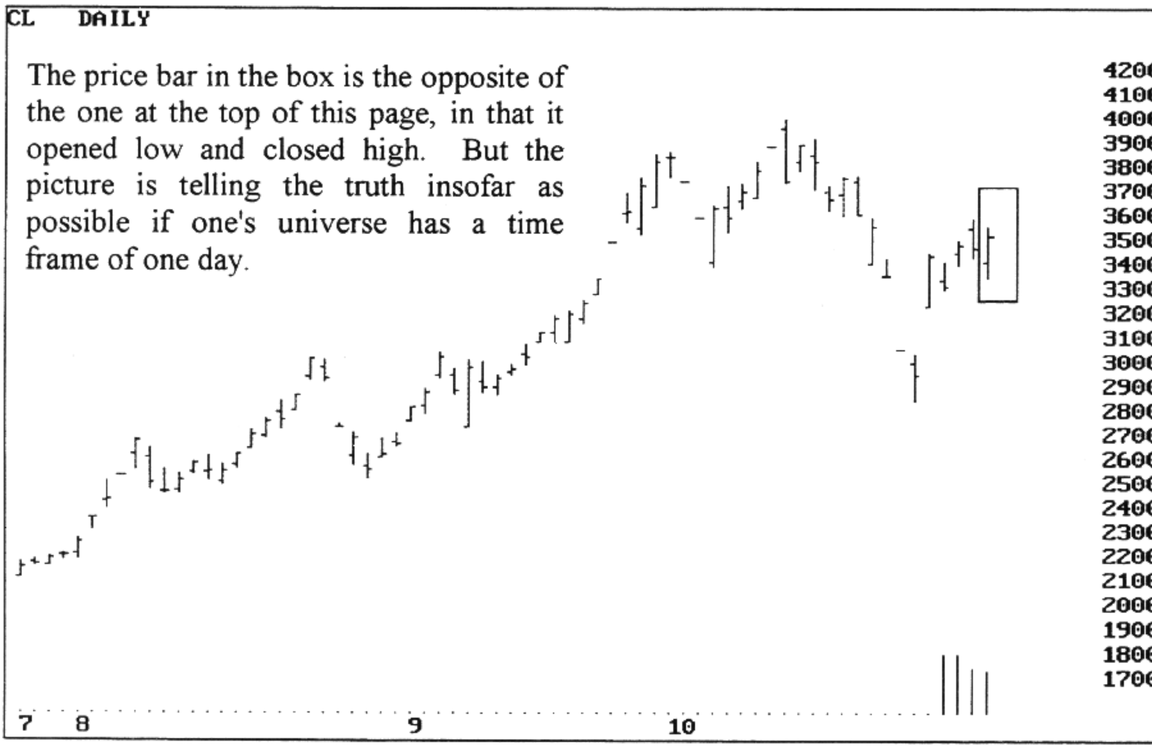
When we see a bar on the daily chart that is similar to the one on the left, representing a single day's price action, we're seeing something that has squeezed an entire day's price action into a single picture. This picture is very deceiving as to what actually happened in the market.

We see an open depicted here, but which direction did the trading take after the open? Did the market trade lower before it traded higher? Did the market initially break to the upside, make its high, and then trade lower all day only to rally to the close at the end of the day?

Did the market perhaps open as we see it, trade to its highs, reverse itself on some piece of news, then trade to its lows and finally rally again to where we see the close?

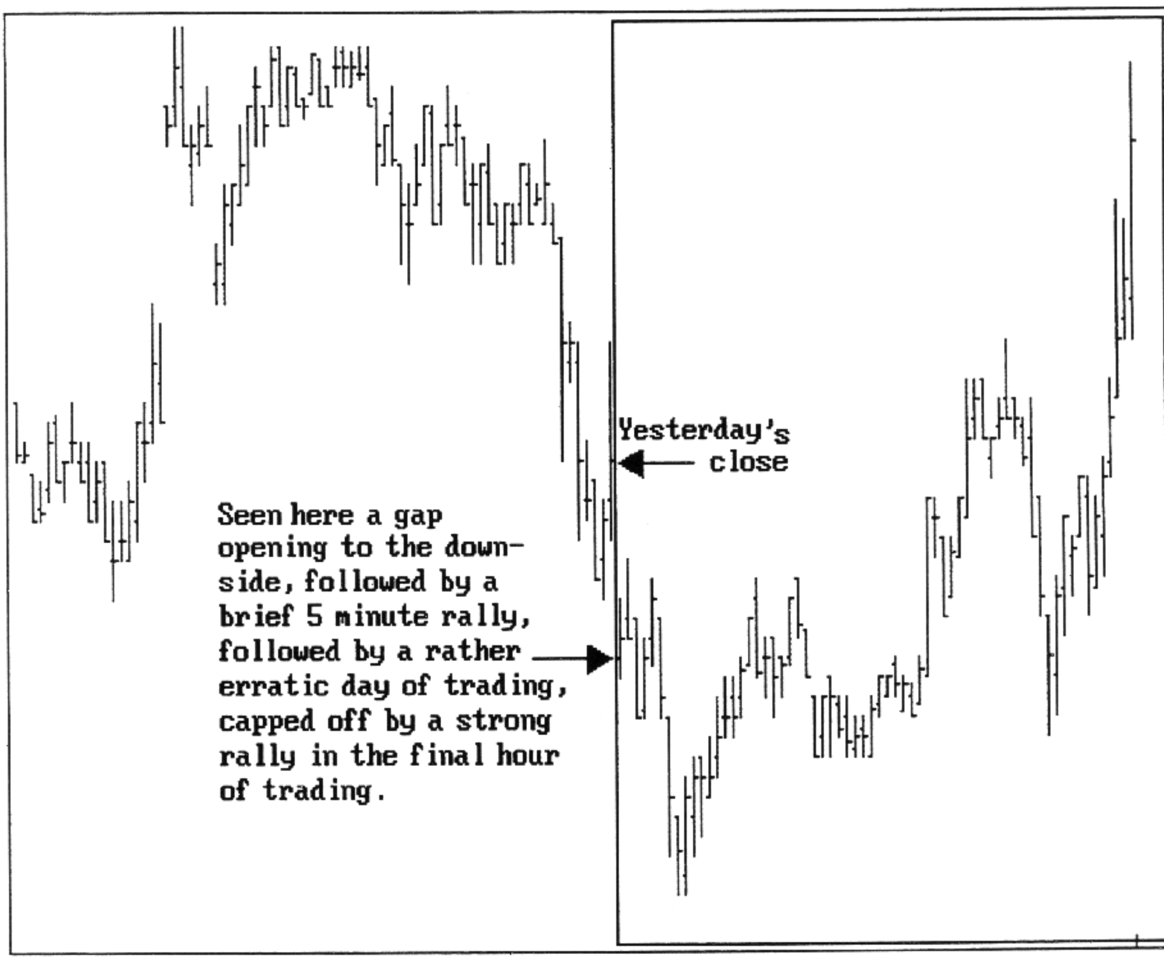
The answers to these questions are part of the reason why simulated systems based upon daily charts hardly ever work when one tries to trade them. In fact, I've never yet seen one that did work profitably over long periods of time.

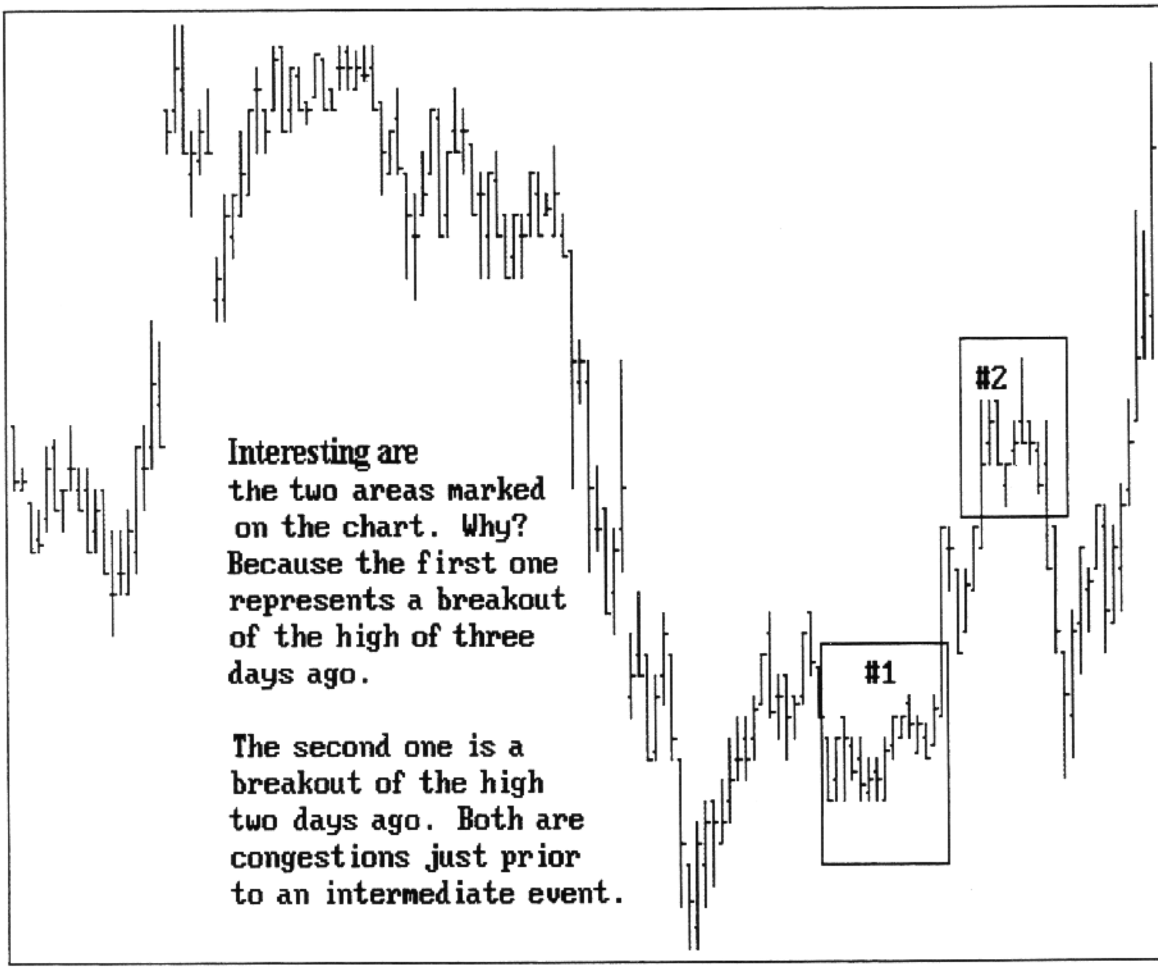
The next figure shows a picture of the daily crude oil chart.



However, if one's universe has a time frame of five minutes, then that same daily price bar is seen to consist of many price bars, and those price bars looked like the boxed off section of the figure on the next page.

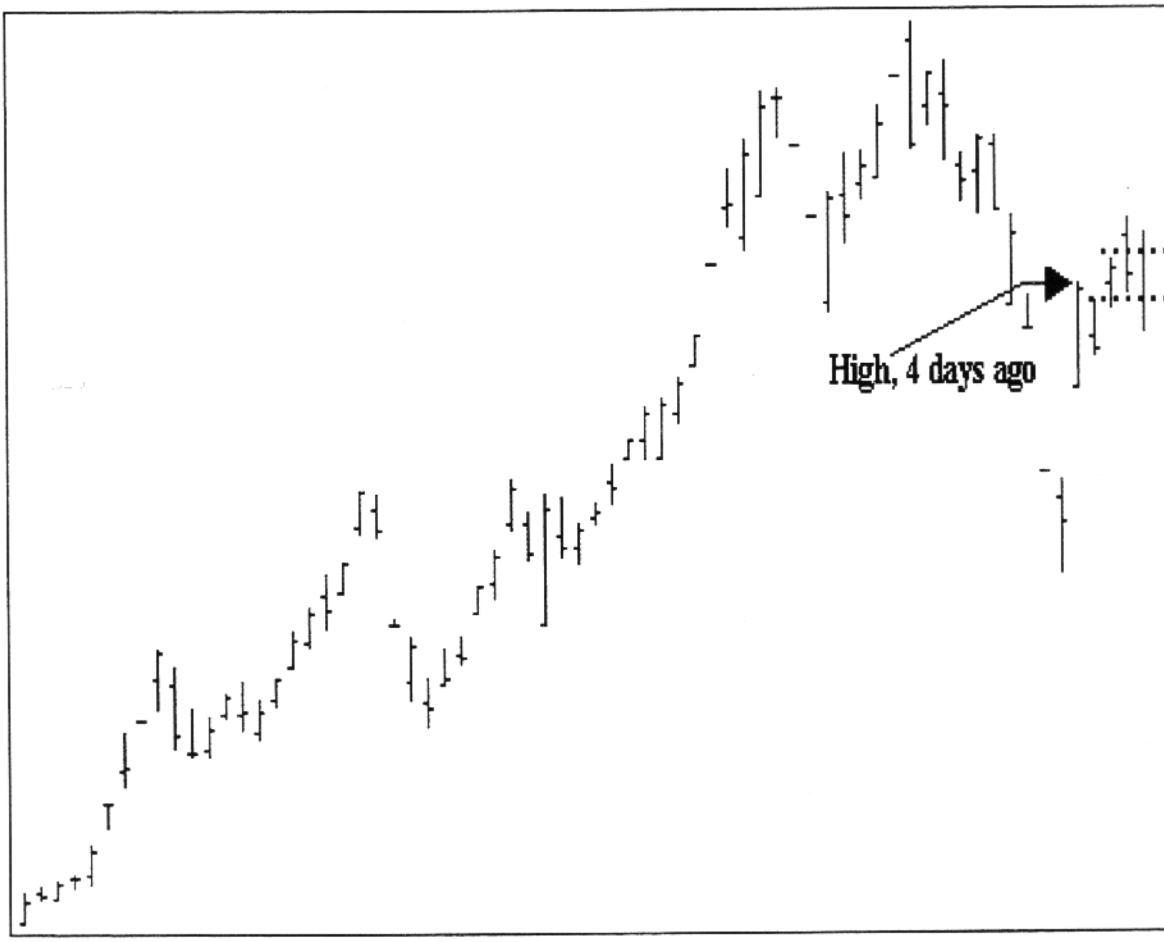
There are a couple of congestions during the day we will be looking at. Based upon what has been covered so far, is it possible to guess which ones they are and why we will be interested in them?





What is important about the earlier congestion shown (#1) is that it represents a breakout of the high on a five minute chart of three days ago (not shown). The second congestion shown (#2) represents a breakout of the high on a five minute chart of two days ago (also not shown). Both are significant events. It is significant that prices keep returning to these congestion areas made on the previous days, even though there may be intermediate highs or lows.

Let's look at that again on the daily crude oil chart.



As we can see, today's price bar (the last bar on the chart) took out the high of three days ago (an inside bar), and the high of two days ago.

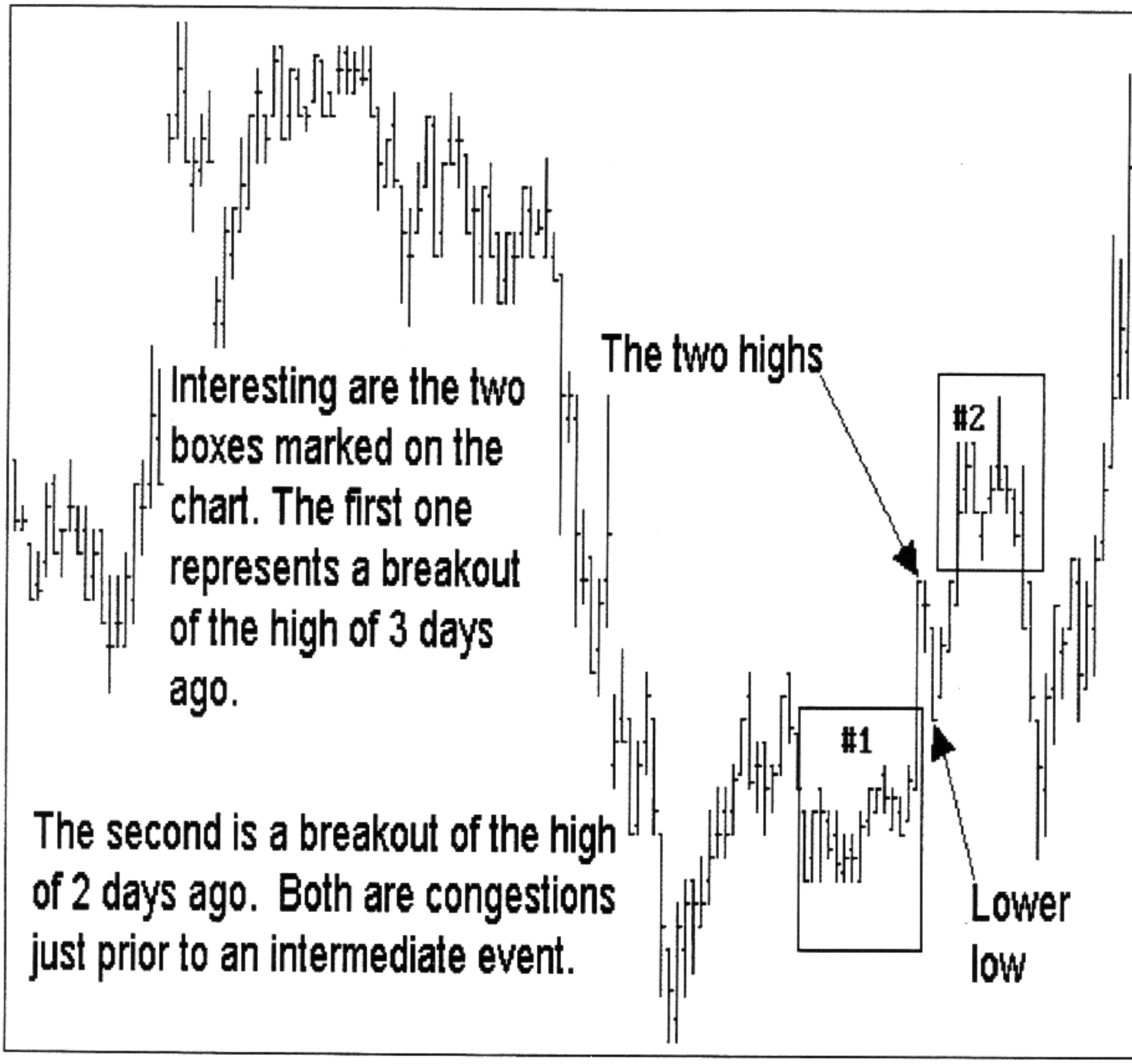
That meets with the plan and fits within the parameters of our trading signals.

The high three days ago was lower than the high two days ago. After the first big swing in prices V (vee shape) on the five minute chart, prices settled into a tight congestion (#1) on the following page.

A buy order was definitely in order for a breakout of the high of three days ago (box #1).

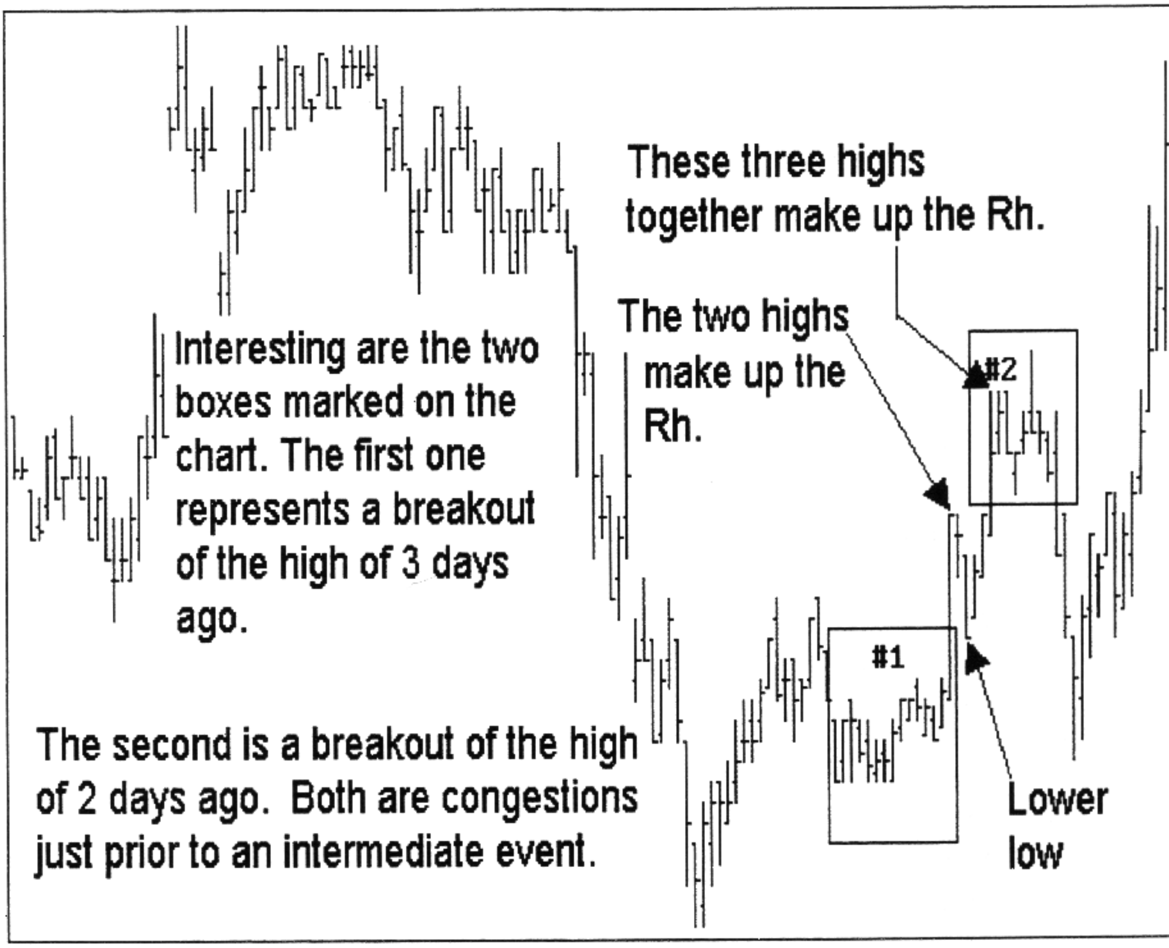
Beyond the entry would come proper trade management. An exit should be made upon seeing a bar that makes a **lower low** or upon seeing two reversal bars, in this case any two bars in a series of bars having a close lower than the open.

If need be, the trade is entered again because the prospect of a violation of **the two highs** is the driving force behind the trade.



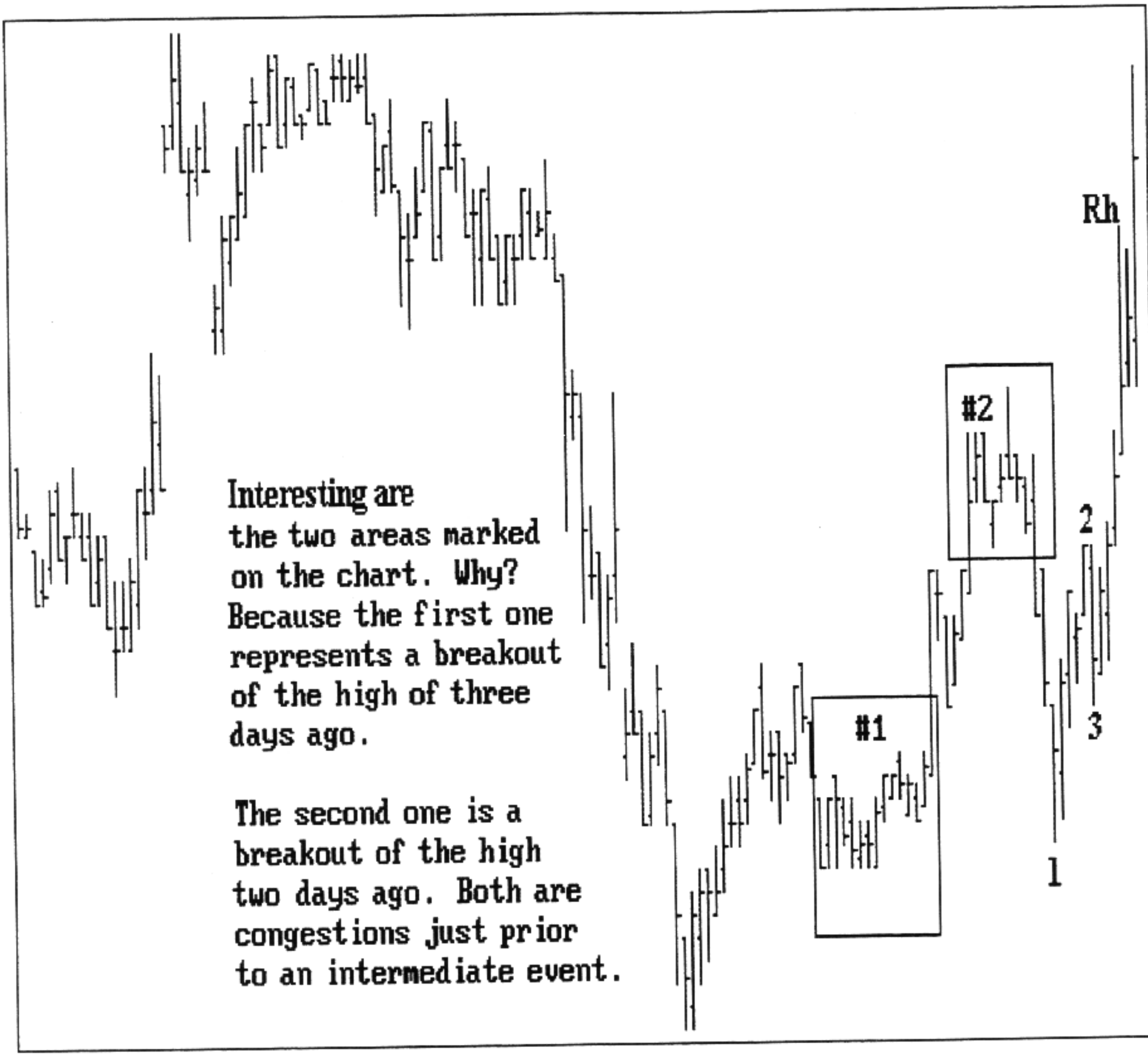
The long upward bar breaking out of box #1 represents 5 minutes, during which time an entry would have been made as prices violated the high of the congestion area as well as the high of three days ago. This trade could also have been made based solely on the fact that it broke out of congestion, but it is a much stronger trade when coupled with a breakout of the high of three days, two days or even one day ago. Depending upon our trading plan strategy, we could have taken a profit during that same 5 minute interval. If not that quickly, then as soon as any price bar made a new low. You can see that that is what happened. Please notice the long bar that broke out of box #1. Two bars later, we have a lower low than the previous bar. The same bar that gives us a lower low also gives us a Ross Hook because it makes a lower high. (See next page for the bars that make up the Rh's.)

Reentering the trade as that Hook is taken out gives a second profitable entry. Notice that three consecutive bars fail to make a new high as prices enter box #2. Many experienced traders might begin to exit right then and there. However, following the trading plan we exit again when prices on the fourth bar in box #2 make a new low.



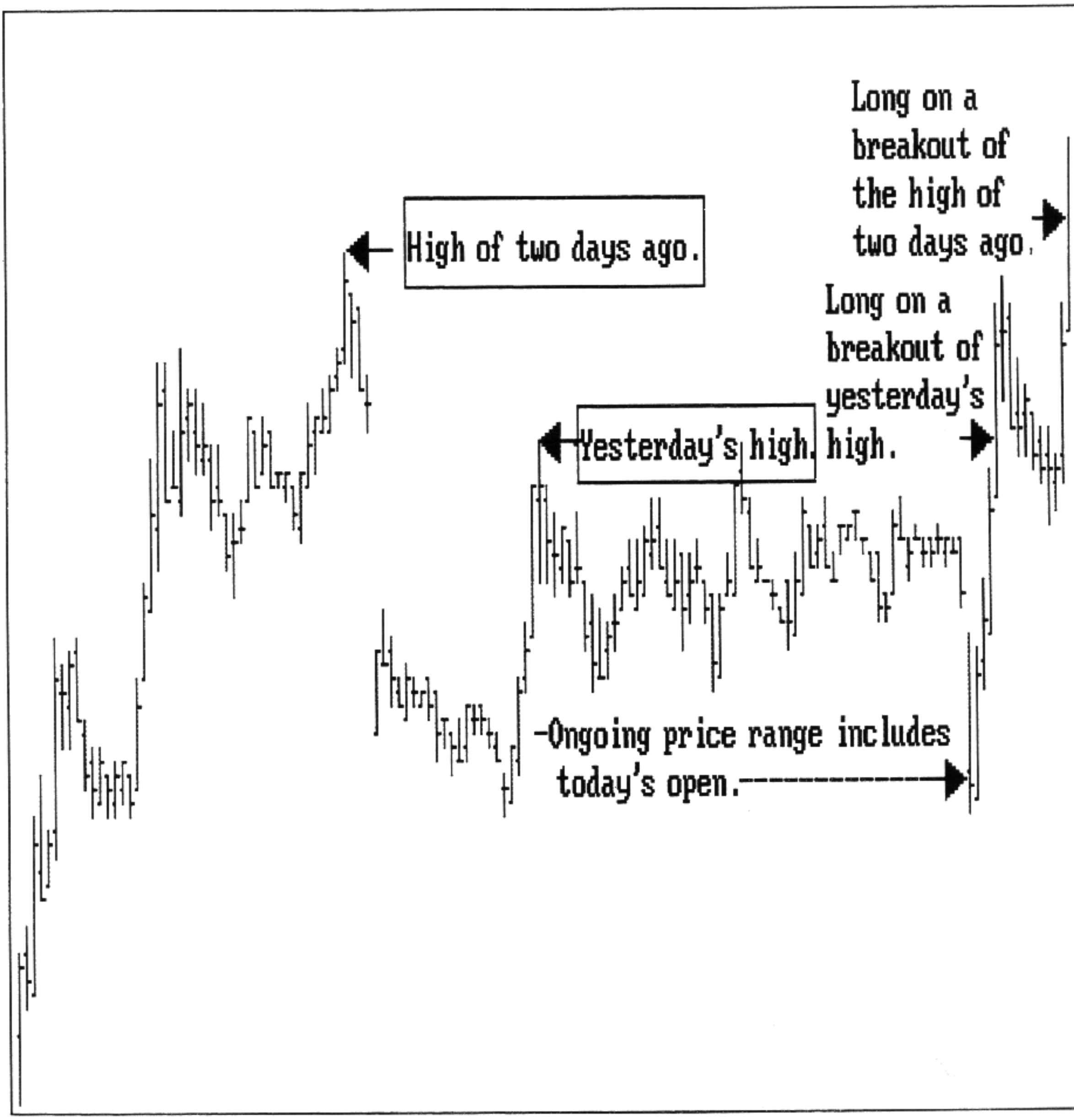
Notice that as the fourth bar in box #2 makes a lower low than the bar preceding it, it also creates a Ross Hook by making a lower high. Entering on breakout of that Hook results in a loss. The breakout bar, the highest bar in box #2, is a reversal bar. It is followed by another reversal bar. We must exit that trade with a loss.

Now, let's look at what happened in the last hour of trading.

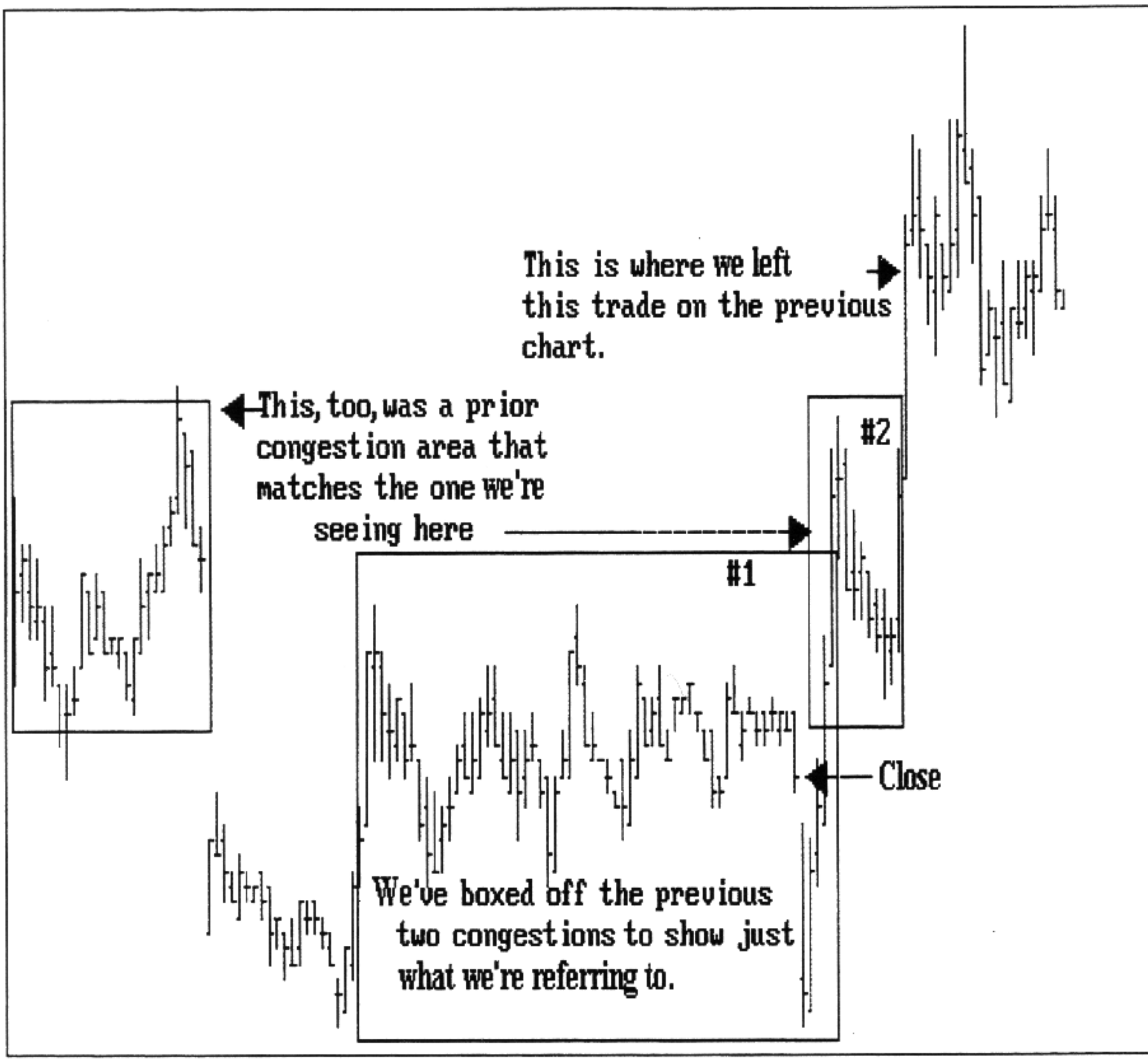


I want to draw your attention to the last assault on the high of two days ago. It is the high in box #2 on the chart. The assault begins with a 1-2-3 low formation. As the second number two point on the chart above is violated, we make our entry 1 tick above the price at number two. Prices take off and never look back. That is the kind of trade we're looking for. That trade is the one that brings home the most profits for the day.

I'll show another example. It's happening right now on my computer screens as this is being written. It's a perfect example of what I mean.



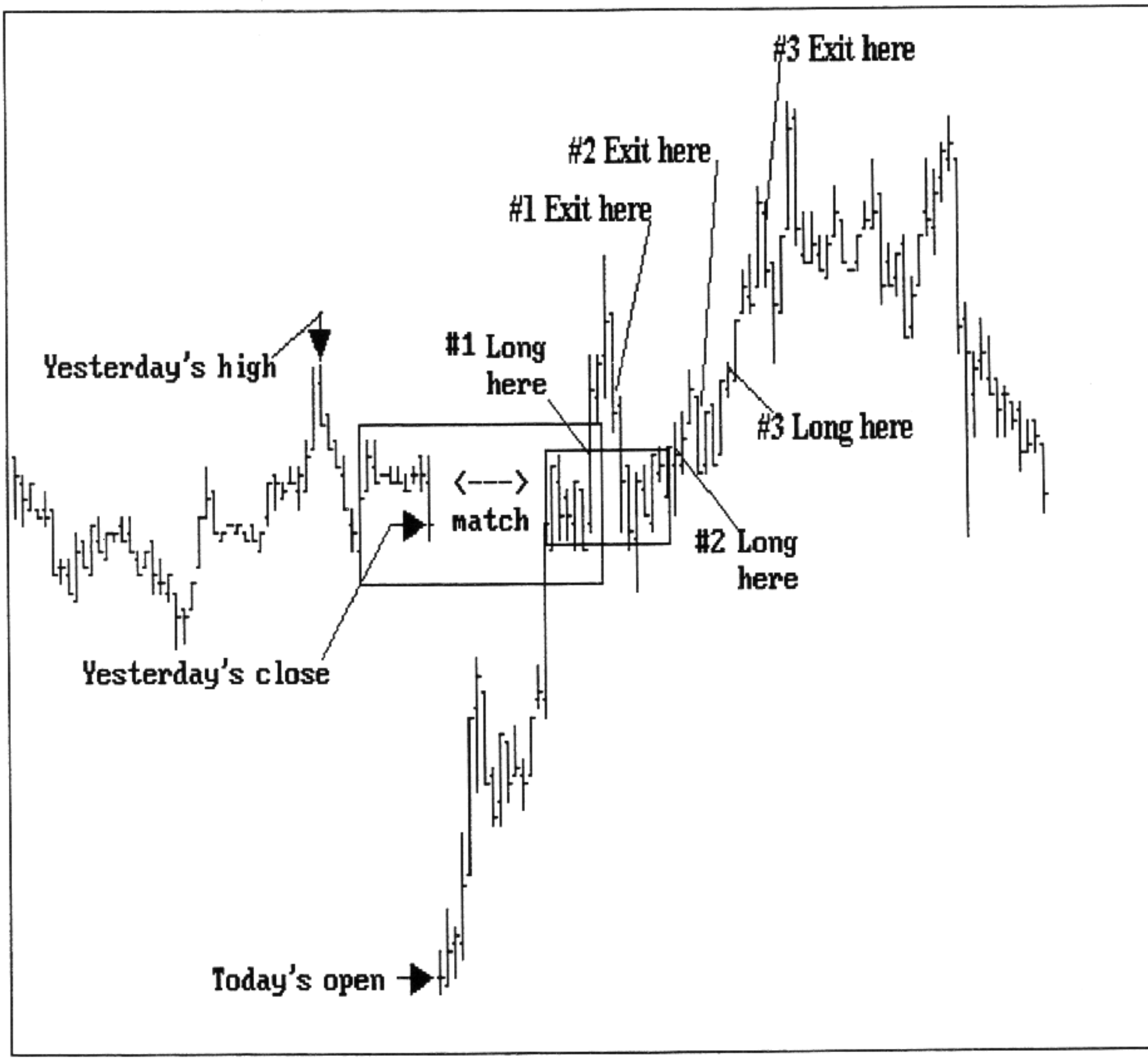
Next, we'll see how this trade developed.



Box #1 contains two days of congestion. We want to enter a long position when the high of the congestion, marked #1, is taken out, NOT just because it is the high of the previous day (that is only coincidental), but because it is a breakout of a congestion just prior to a breakout of the prior day's high.

Go long additional contracts when the high of the congestion marked #2 is taken out. This is a few ticks prior to the high of two days ago being taken out. I want to stress that, **SINCE WE ARE USING THE MINOR ENTRY SIGNAL HERE, WE GO WITH THE BREAKOUT OF THE CONGESTION PRIOR TO THE BREAKOUT OF THE HIGH OR LOW OF THE ENTRY-SIGNAL DAY**!

Does it always go this smoothly? Let's take a look.



We get long at #1. We may have taken some profits by the time we have to exit #1 because the bar labeled #1 exit makes a lower low. Next, we see another matching congestion. We get long on the breakout at #2. Before we can do much of anything except possibly cover costs, we must exit because prices make a new low at exit #2. We make a third attempt on a Ross Hook breakout at entry #3 (Rh five bars prior). We make a fairly decent profit but have to exit because of a second reversal bar – exit #3.

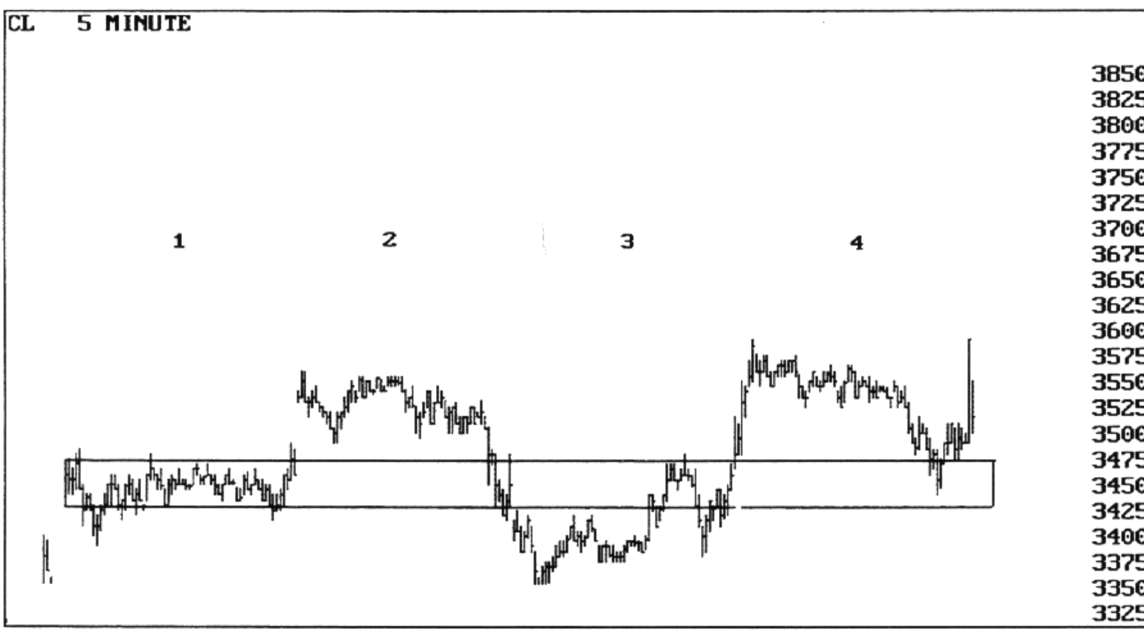
This may seem like a lot of work for not so much money, but it is the way most successful traders make their money. We want to take steady profits out the market. We are not looking for the big kill, although occasionally we will get one.

Chapter 14

RISK AND MONEY MANAGEMENT

There, I've shown it, the basic concept of one way we can trade. There are loss days, too, and I'll try to show some before we're done. However, there aren't many of them in comparison with the winning days.

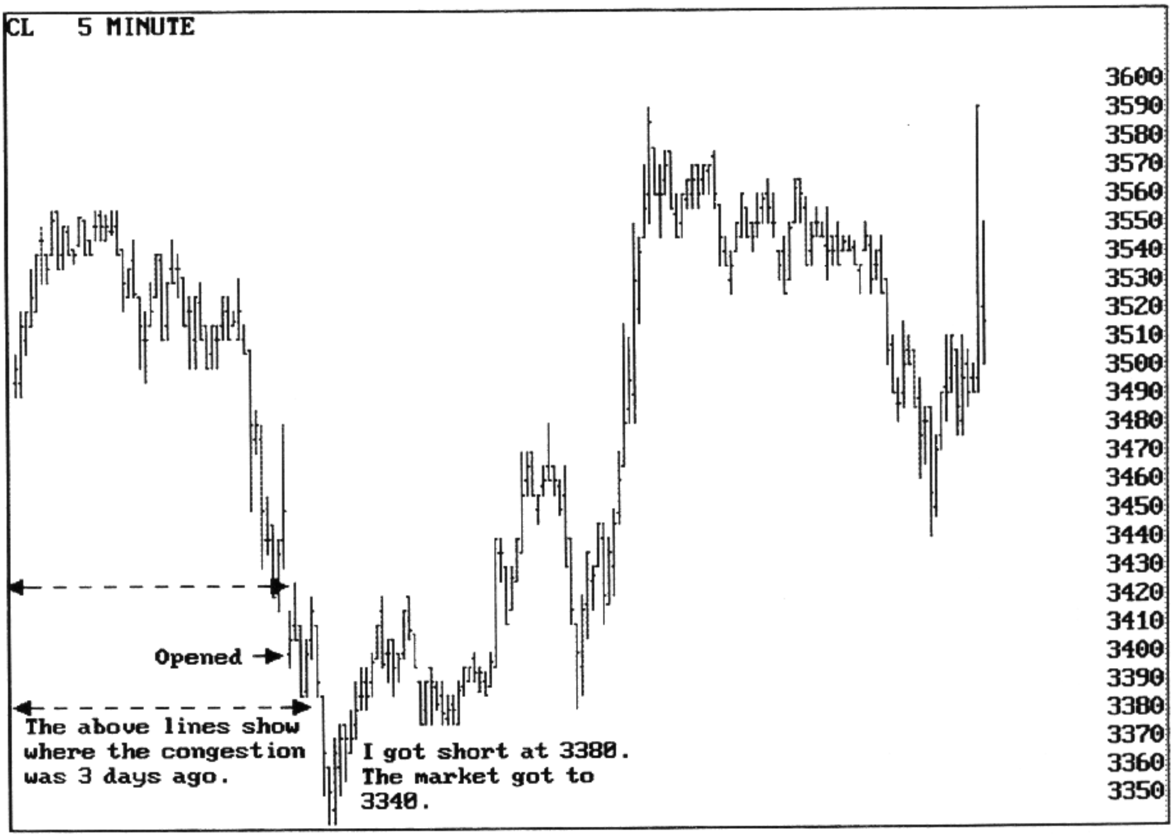
Now I want to show one of the finer points of my trading. It will serve to bring this discussion into the area of risk and money management. The crude oil chart below will serve as the vehicle.



We're looking at four day's worth of five minute charts here. I've blocked off what has turned out to be a very significant area. It should be noticed that prices entered this area at some point on every single one of those days.

But even before I saw all four days, when day two dropped into that area, I was looking to sell any breakout of the congestion low of day one. I never got my chance, as the market closed inside the congestion area. On day three I did short the minor congestion that occurred on day two (in the box), which then went on to take out the low of day one.

As we can see, day three was not the best of days for me in the crude oil, but it was more or less typical of the kind of trade I end up in. I'll show it more closely below.



The market opened at 3400, moved up slightly, then took out the low of day 1 (3390). I was waiting for it at 3389, and got filled at 3388. I took my first profit at 3377, and my second profit at 3365. I then held on with one contract to run. The oil never really ran. It went down to 3340.

Now I have developed a very firm philosophy for my "let it run" contract(s). I try to never give back more than 50% of the potential profit on my "let it run" contract(s). So when prices had reached 3340, I moved my stop to protect one half my profits. At 3340, I had 48 points per contract in the crude. I moved my protective stop to 3364, and bought it back there.

Let's review my money and risk management philosophy. They are different and need to be explained. They are both a part of the finer points of trading.

MONEY MANAGEMENT

I'm usually not willing to risk more than the average volatility per contract on anything.

Assuming the ideal of 3 - 5 or a multiple of 5 contracts upon initial entry, I want to set my initial protective stop at an amount away from my entry fill that is equal to average volatility. Let me repeat that, "away from my entry fill," NOT my entry point.

Why? If average volatility is $150 in gold and if my entry point in gold is 360.00 and I'm filled at 360.20, the stop goes at 358.70 - $150 lower than my fill.

If I place it at 358.50 ($150 lower than my entry point), I'm not risking $150, I'm then risking $170.

Now I ask myself a question. If I get filled at 360.00 and prices move up to 361.00, how much do I stand to lose?

If anyone said $150, I can tell right now that person cannot be winning in the markets on a regular basis. Let's see why.

If I'm filled at 360.00 on a gold contract with my stop at 358.70, and prices move up to 361.20, I'm now risking 25 points, or $250.

But that's not all. I've been leaving something out. What about overhead? I also have at stake the cost of commission and fees. They are not part of my risk in an accounting sense, yet I have to take them into account when I compute losses, and subtract them from my profits.

So let me restate my money management criteria: I will usually not risk more than an amount equal to average volatility on anything.

That means for gold and crude oil, my initial protective stop is going to be set at a distance that is equal to an average volatility distance away from where I get filled including commissions and fees.

Assuming I'm paying $18 per round turn in commissions, and that fees amount to $2, and that average volatility is $150, then a stop in gold must be placed 13 points away from my fill. If I'm stopped out, then I will lose $130 + $20 in commissions and fees.

I'm not saying that anyone else's stop has to go there, I'm saying my stop goes there. If someone else is willing to risk more, then he should place his stop further away. The most important thing about money management is that I'm comfortable with it. That way I can do "my thing" without worrying about being annihilated. I use comfortable stops at all times. I will modify this concept to a certain extent later on when I show you how I compute average volatility.

If I'm fat from a bunch of big wins, I may be able to or even want to increase my stop size. That's my choice. I can't tell anyone to do it or not to do it. I can only say this: when I'm feeling comfy and sleek based on some good wins, and I increase my stop amount, that is usually when I take a bath and am brought home to reality and my original lower risk. Greed will get me every time. That's when I will vow to never do it again. Those vows never seem to last very long for some reason.

RISK MANAGEMENT

Risk management is a subject that is so broad that the only thing I can do is to encourage others to read widely on the subject. The best places to look for information on risk management are the books written by successful gamblers. In general, risk management involves those actions taken by you that increase or decrease you chances of losing.

Entry into trades under the following conditions increase your chances of losing, thereby increasing your risk: 1. Fast Markets 2. Thin markets 3. Abnormal tick size 4. Day's before a holiday. 5. Staying past First Notice Day. 6. Highly volatile markets. 7. Poor brokerage. 8. Insufficient floor access.

One of the best books I have found on this subject is The Track Attack, written by Clark Gary, and available through Ross Trading for $89.95. Clark Gary is my nephew, a professional horseman, and a steady winner at the tracks since he was 15 years old. Why? He is a master at understanding risk. I can honestly say that he has never had to have a job. At age 30, he continues to make his living at the track. Now how about that for a nepotistic, patronizing plug? In his book you will see some small sections I let him borrow from Trading by the Book. Other than that, the material is all his own.

Traders should strive to become masters at risk management.

Money management and risk management are part and parcel of each other. They overlap, and yet they are different. Defining that difference is rather difficult. Perhaps they are two sides of the same coin. Risk management says, "I can afford to risk only so much." Money management asks "What can I expect to make for the risk I have taken?"

I'm willing to risk an amount equal to average volatility in gold. Now, what can I expect to make for that risk? I have to have my priorities straight here. To the best of my ability, I have limited my risk. Now I can look forward with greedy eyes to how much I might make. But first things first. Before I can make anything, I have to cover costs. Costs in this business are made up of several items.

There is slippage, there is commission, there are fees. These are obvious, direct costs. But what about indirect costs? I've got to cover the cost of my data feed, exchange fees, software, hardware, and my time. Surely my time is worth something.

The broker's time is worth something. I know that every time I see how much he butchers my earnings. How about my time as a trader? Is my time worth something? It had better be, and I had better realize that. What about the costs of all the other books, systems, paraphernalia, subscriptions, etc., that one buys to supplement his education in trading?

Others have made a fortune off of my trading – I had better do so, too. If I don't, it would be because I never learned how to really count the cost. The real cost of trading is staggering!

Yet so many I talk to, even professionals, call it a "game." If this is a game, then it is one of the most dangerous games in the world. My financial life is at stake here. Not only that, my self-respect, my self image, my whole outlook on life can be destroyed in this so-called "game."

Trading is a business. The sooner one treats it as such, the sooner one will become a winner. If I'm not a good businessman, I will not be a good trader. I have to understand risk, and I have to understand how to turn a profit.

Here is how I typically manage my money, with slight variations as to the number of contract sets I liquidate to cover costs:

- As soon as I see sufficient gain on one or two contract-sets, I liquidate those contract-sets. That covers my direct costs for the remaining contract-sets. Depending upon how fast the market is moving and the angle of ascent, I then move my stop up to one of two places – either to breakeven (my fill price – I've already covered direct costs with the first contract-set), or to a place where I'm not risking any more than what I originally risked per contract upon entering the trade.

Here's an example: I'm long gold at 360.00. My initial protective stop is at 358.50. The market moves up to 361.00. I liquidate one contract-set at 360.90. I have now earned $90 per contract in the contract-set to cover my costs. If I liquidate two contract-sets, I will have also earned a small profit.

Now it's time to move my stop(s). I can move my stop(s) on the remaining contract-set(s) to 360.00. That is breakeven. I already covered my direct costs when I liquidated the first contract-set.

I can move my stops to $150 (average volatility for gold) away from 360.90, placing them at 359.40. That way I'm still risking $150. Let me repeat that. I'm still risking $150, not the $60 that exists between 359.40 and 360.00.

I can do a combination of the above. Place a stop at 360.00 breakeven for one contract-set, and a stop at 359.40 for the remaining contract-set.

At $90 for the first contract-set, have I made a profit? No! How about at $100, $120? No and No! All I've done is covered direct costs. If my costs in commissions and fees were $60, I now have $30 left over - so I've made a profit right? Wrong! What about that data feed, software, books, systems, and subscriptions? What about my time? I haven't made a thing yet!

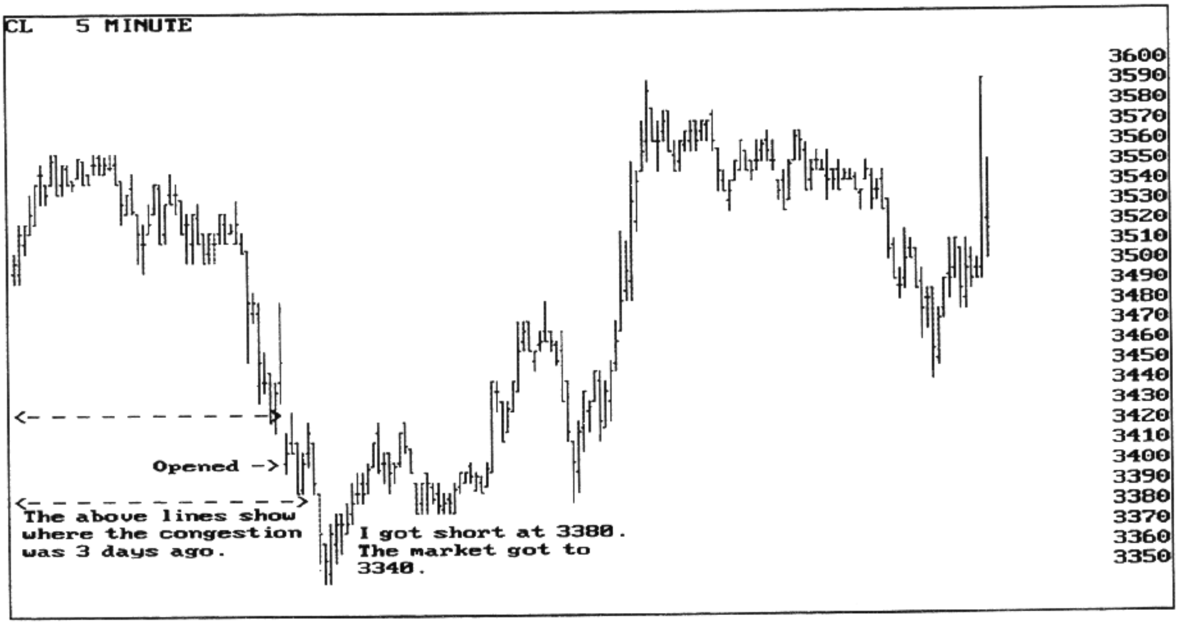
- So where does the profit come in? If gold moves up another $80-$100, I will issue a market order to liquidate the second or third contract-set. I was long this contract-set at 360.00. Gold is now at 362.00. With a market order filled at 362.00, I will make about $200 per contract in the contract-set. Now am I making a profit? Well, maybe. Maybe, just maybe, I've covered my indirect costs. A big part of that depends upon how much in the hole I am from prior losing trades. Aha! I've finally gotten around to that! The truth is, I haven't made a thing until I cover past losses. Past losses are a part of my overhead. Even the revenue service will agree with that. They let me take those past losses off against current income. For some, past losses are a mighty big hole to have to climb out of.

  "Yup!", someone will say, "I'd have to live to be a hundred and win every day to make up for all my past losses." Sorry. But it's never too late to stop playing the futures "game," and start running one's trading as a business. I sincerely hope and pray this book will help my readers to do that.

- So, what about that last contract-set? At 362.00, I have $200 of unrealized profit. Where do I put the stop? *"I want this baby to bring home the bacon. Boy, I have a lot of high hopes for this last contract-set. Maybe I should put the stop far away so this one can really run, right?"* Wrong! That's dreaming, that's playing the game. I want to do this in a business-like manner. I don't want to gamble. I'll put the stop in a place where, if I have to be stopped out, I will have at least something for the risk I've taken. I'll put the stop at 361.00 and lock in a guaranteed profit of at least $100 per contract on this last contract-set. I'll never risk more than 50% of my unrealized profits.

- Okay. Now, what if my last stop doesn't get taken out the next time the market retraces? Then I can keep moving my stop up. There are several ways to do it. I can maintain a stop that is always $150 away from the most recent high that this market has made. I can move my stop up $50 every time the market moves up $100. I can keep moving my stop to just below the low of the last market retracement prior to its continuing to move in a profitable direction. I can trail my stop at one or two ticks on the other side of a moving average that is showing containment of prices. Where I do this is a matter of choice.

With my risk and money management philosophy in mind, let me review my short trade in the crude oil.



The market opened at 3400, moved up slightly, and then took out the low of day 1 (3390). I was waiting for it at 3389 and got filled at 3388. I took my first profit at 3377, and my second profit at 3365. I then held on with one contract to run. The oil never really ran. It went down to 3340, and then began a major upward intraday recovery.

When prices had reached 3340, I moved my stop to protect 1/2 of my unrealized paper profits. At 3340, I had 48 points per contract in the crude. I moved my protective stop to 3364, and bought it back there, netting 24 points.

I want to share an amazing statistic. I have this on good authority: In any given trade in any market, 80% of the traders enter on the right side of the trade. Yet, the vast majority of those traders will end up losing money on the trade. Why? Because they will sit there stewing in their greed, and watch their profits fritter away. They will not take profits! They will try to milk just a bit more out of the market. When the market moves away from the most profit they have seen, they will hold on in the hopes that the market will move in their direction just one more time.

Instead, the market will move against them, perhaps gradually or perhaps suddenly. In any event, the traders who didn't take profits will now be on the defensive. They will be facing a breakeven or a loss. They may even commit financial suicide by moving their stop ahead to meet the onslaught of the price action. Before they know it, that fatal tick will have arrived, and they are out with a loss. If I have just described my reader, then now be aware that there is a way to circumvent these losses – they don't have to happen to anyone.

Do I do as I have said? Do I take the profits while they are there? Do I take them systematically, and on schedule? You'd better believe it. I've just shown how to do it. Need I say more?

I have a little friend. That's my friend over there on the right. I protect him as best I can. When I go to market with him, he has a tendency to wander away and get lost.

There have been times when I lost him, and it caused me great pain and grief. I don't ever want to lose him again. Most people have one just like him. Have they been losing theirs? If they have, then they'd better protect theirs as I do mine.

Chapter 15

CONGESTIONS ARE IMPORTANT

Let's review some material we've covered, and then move on to another refinement.

Upon entry into a market, I want to trade a breakout brought about by any one of my major or intermediate signals.

For actual entry into such a trade, I want to trade the breakout of any congestion that existed just prior to my entry point. That way I can get into the trade very early or somewhat early.

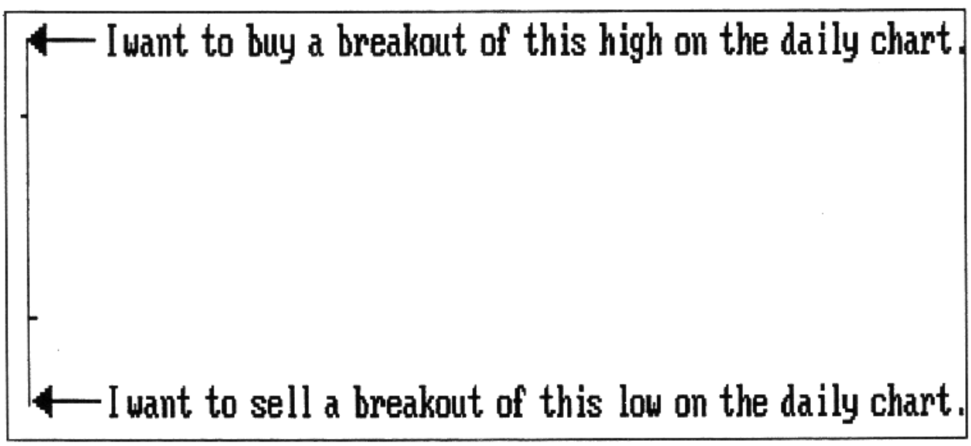
THIS BREAKOUT OF THE CONGESTION PRIOR TO THE TAKING OUT OF THE ENTRY SIGNAL <u>IS</u> MY TRADING FILTER. IT IS IMPORTANT BECAUSE IT GIVES ME A JUMP ON THE MARKET.

If I have gotten into the trade very early (the nearest congestion area was distant from the breakout point on the daily chart), prices will almost surely test the area of the high or low that was the basis for my entry signal. The thrust that carries prices from the breakout of the intraday congestion to the area of the high or low is where I will make my money – EVEN IF prices only test the high or low and NEVER actually break out.

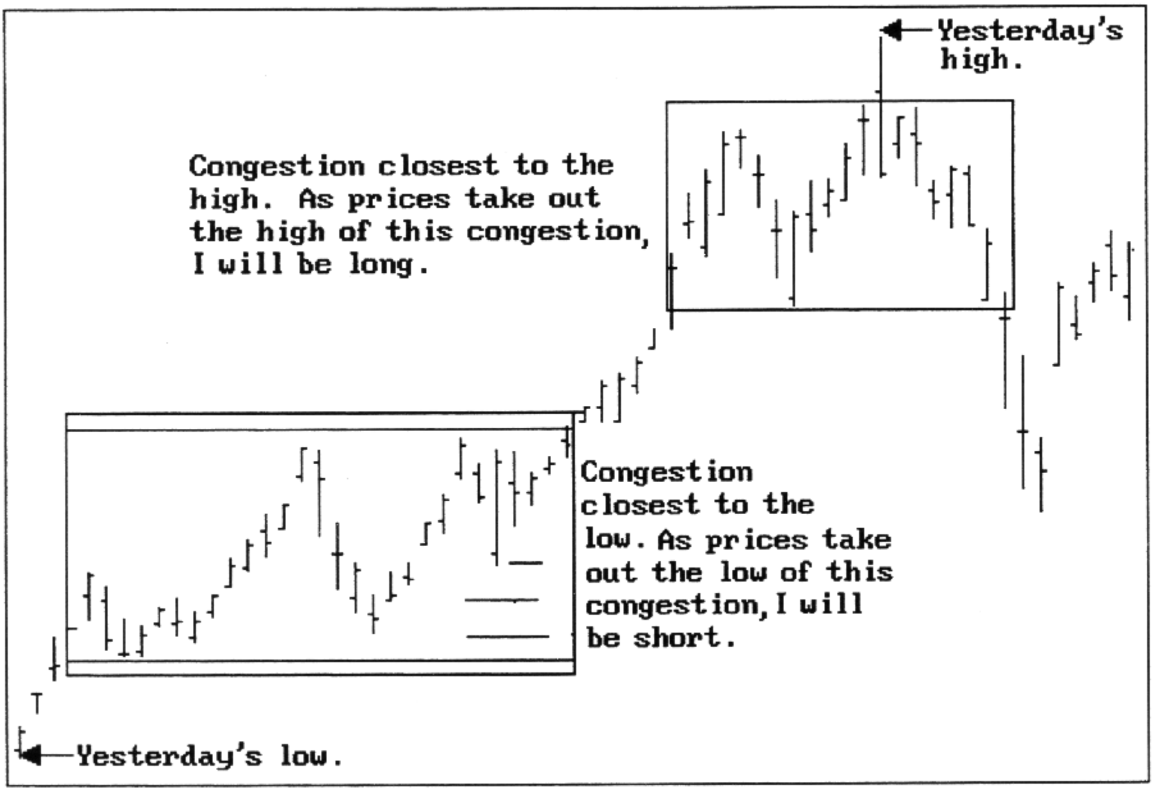
If I have gotten into the trade somewhat early (the nearest congestion is quite close to the breakout point on the daily chart), prices will almost surely make a new high or low. The thrust that carries prices from the intraday congestion to the new daily high or low is where I will make my money.

Let me illustrate this.

The daily bar for yesterday might look like this:



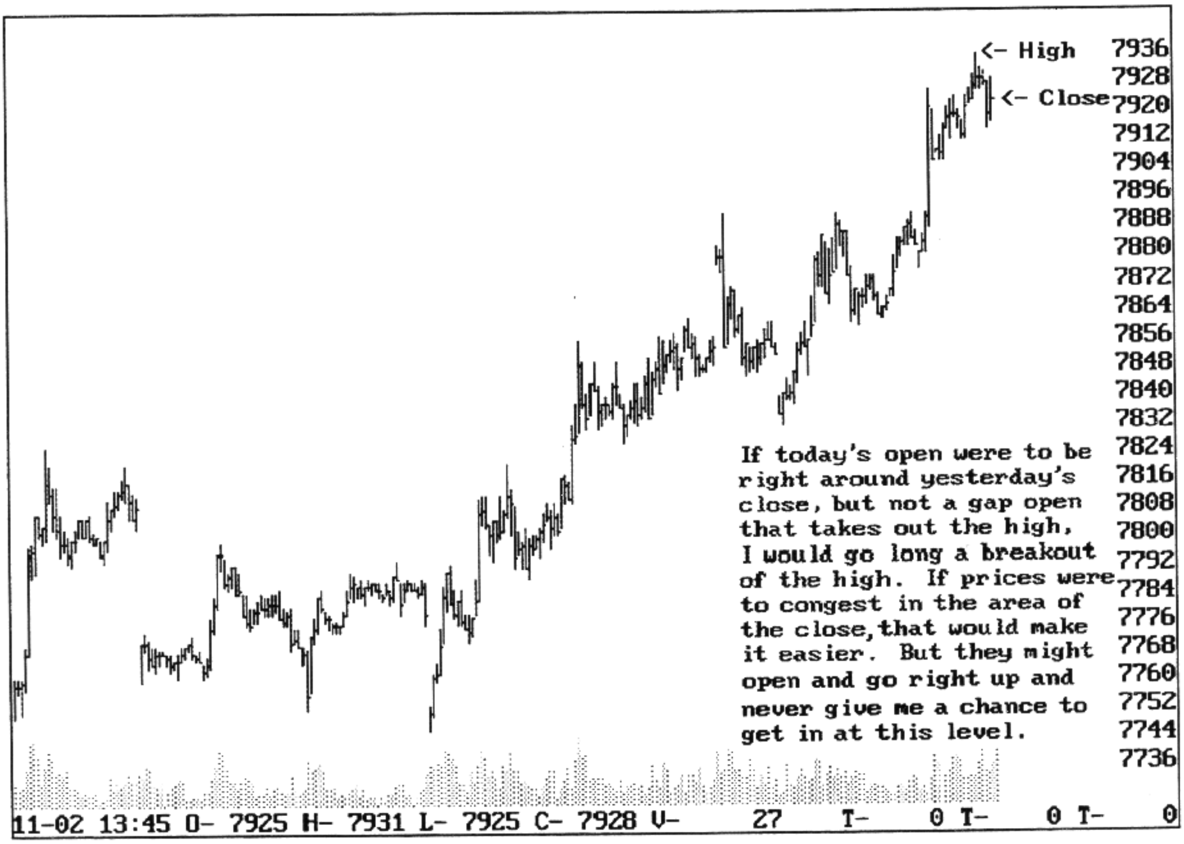
The five minute chart for yesterday might look like this:



I want to enter on a breakout of the congestion area, rather than on a breakout of yesterday's actual high or low.

But what if there is no congestion area upon which to base a breakout? Just such a situation occurred as illustrated below, and gives an additional refinement in my trading.

Here is a rule. If prices are making new highs or new lows relative to the last three days or more, I may enter based upon a non-gap breakout of yesterday's high or low. I'll show what I mean.

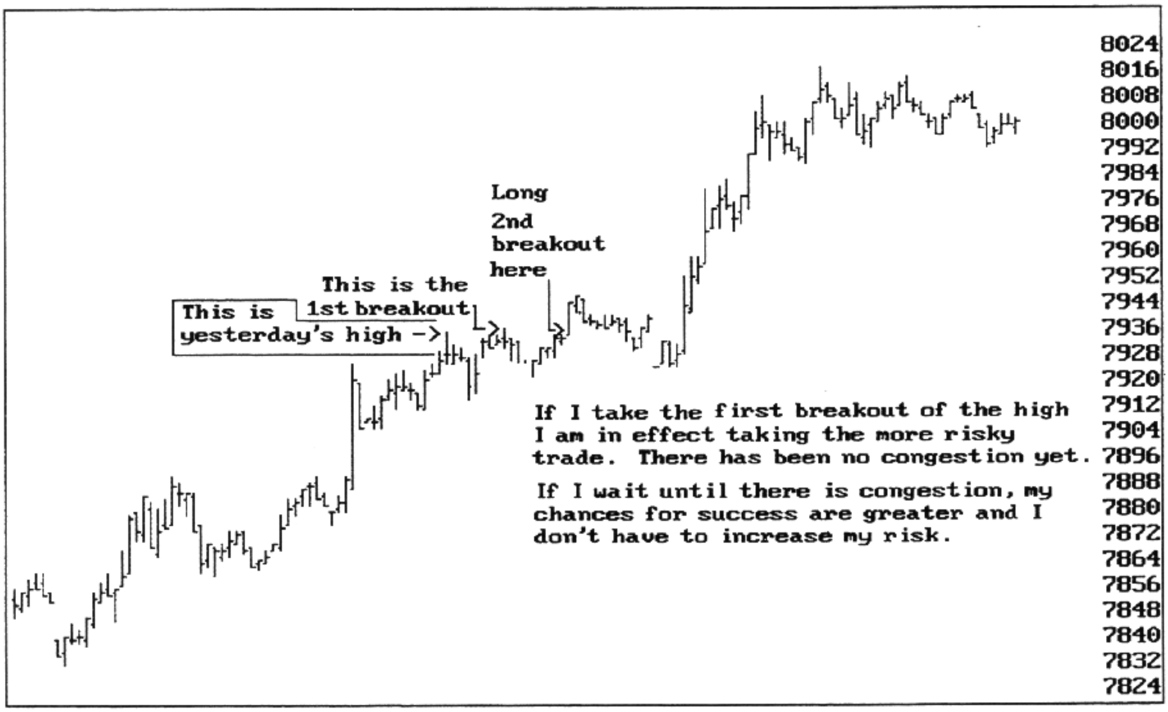


As I look back at prices, I can see that there are no prior congestions on the high side from which to base an entry. If prices open today somewhere below the high, or even at the high, I can take a breakout of this high as my entry. However, if I do, I run the risk of a quick pop followed by a retracement to test support at the high. So if I take this trade on a quick breakout of the high, I must be prepared to risk more than I normally would in order to be sure I'm on board.

A much more conservative approach would be to wait and see. If prices open below the high and continue to trade in the area of the close, then I have the congestion I am looking for as my entry signal.

If prices open and quickly take out the high, then I can wait for a possible retracement that will test support at what was the high.

By following the more conservative strategy, I can maintain my risk at average volatility per contract. Here's what actually happened



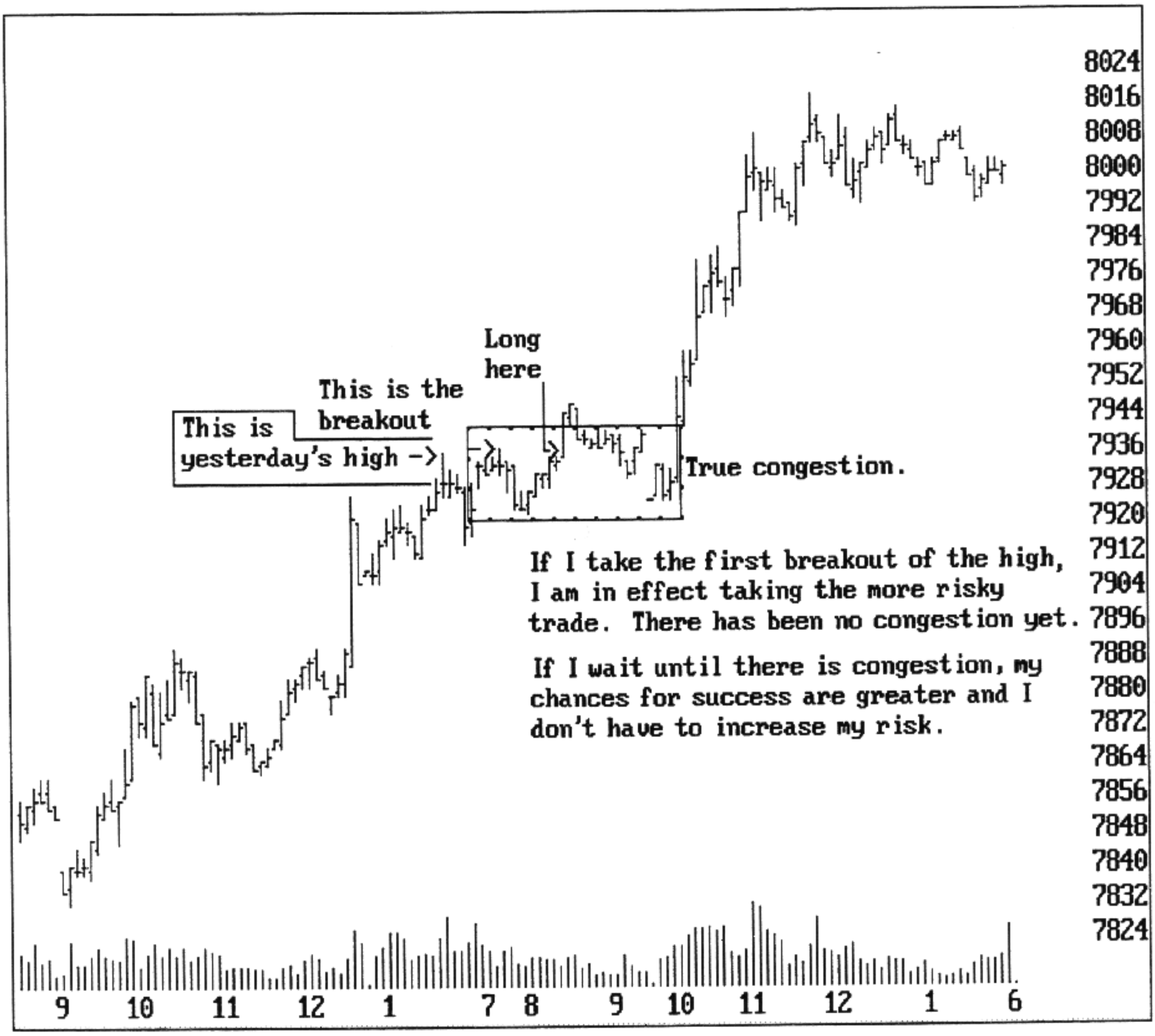
I'll take this trade one step at a time. The market opened lower, tested its uptrend line, and then moved up to take out yesterday's high at 7935, by 1 tick.

Since I do not trade bounces from uptrend lines, I waited for some kind of congestion to form. If the market were to keep on going and not congest in the area of yesterday's close, I would let that go by. I want it my way or not at all. I don't mind missing a big move if it's not my move.

The market then retraced from the new high at 7936 to form somewhat of an /V\ formation.
I figured this might be as close as I was going to get to my desired congestion, and so I entered an order to buy a breakout of yesterday's high. I was filled at 7936.

When the market started trading at 7944, I put in a market order and got filled at 7946 - which was the next high. I now had ten points in the trade, and so I moved my remaining two contract sets to breakeven at 7936 and was stopped out there.

Subsequently, prices made a true congestion by moving down into the area of yesterday's close. I've marked that boxed off area for easier viewing, on the chart that follows.



Since the breakout of the high was good for entry earlier, I went long when it broke out again. This time I had no trouble at all in making all my objectives.

Chapter 16

MIND-SET

I've been revealing my "trading secrets." Some will be skeptical of what I'm saying. After all, what kind of a nut would go around telling everyone how to make money in the markets?

Many have become somewhat jaded by the plethora of garbage that has been sold over the years claiming to show the "magic" way to trade.

I'd like to answer some of the many questions people ask me, and then make a number of comments that will show my approach and mind-set for trading the markets.

In the fall of 1987, following a couple of hours of severe abdominal pain, I became very ill. I didn't know what was wrong, so I more or less took to my bed, although I tried to continue functioning as a trader.

After about eight more days, I developed a severe case of hiccoughs and visited my doctor to see if he could do anything about it. While I was there, he did a routine blood test and took a urine specimen. The results of the tests were alarming enough that he suggested I report immediately to the emergency room at the hospital.

My wife drove me there, and after a series of brief conversations with various doctors in the emergency room, I was admitted for exploratory surgery. I have absolutely no recollection of ever leaving the emergency room. My next memory of anything other than nightmarish dreams about suffocating to death, was 2 1/2 months later someone telling me that my broker was liquidating a December corn trade I had been in because the contract was about to expire and the broker didn't think I wanted to take delivery on a load of corn.

From that point, I drifted in and out of a drugged sleep for another couple of weeks before I was made aware that no one had ever thought I would live. I was supposed to have been dead on several occasions due to complications of surgery, severe respiratory distress, Staph pneumonia, Spinal Meningitis, and Mononucleosis, following what had been a burst appendix with severe peritonitis.

I then became aware that the doctors thought that even though I had somehow survived, I would probably never walk again. They also thought that there was a distinct possibility I might never talk again.

I was starving to death, and could not retain food. I was pretty sure in my own mind I was about ready to go where my ancestors before me had gone.

If anyone thinks that an experience such as I had is anything that can be easily sloughed off, then think again. What happened to me changed my life, and it changed the way I trade. It gave me a whole new mind-set. That change in my thinking is why I was willing to publish this course.

Up until the time of my "significant emotional experience," I was totally a private trader. I was essentially unaware of other traders, their activities, the publications they read, the concepts with which they traded, or that most traders were losing most of the time.

My education in trading was derived from sources far removed from those that most traders have ever encountered. It would take far too much space in this book to go into all of that. (I do tell more about this in my book, Trading Is a Business.)

My experience was first in the long term aspects of trading from daily charts. Later, I applied the techniques and methods I had acquired to the intraday charts, modifying the tactics used in order to accommodate the differential in time.

As I began my long recovery (it's still going on), I had ample time to think about a great many things.

My children were not yet ready to trade, they simply were not mature enough. My wife didn't have the foggiest notion of what trading is. I decided to write down what I knew. That way, in case they ever wanted to use the market to earn their living, they would at least have some input from me.

Before I even had the manual finished, I mentioned what I was doing to another trader. He had called me for support on trading software I was using at the time. The programmer was going out of town, and referred the trader to me. I agreed to answer his questions as best I could, because I had been given similar support from the programmer in the past.

When the other trader heard I was writing a trading manual, he asked me for a copy of it.
I was reluctant at first, but in jest I said I would sell it to him for $750 dollars. I was sure this would blow him away. Instead, he sent me a check for the transcript – to be sent to him upon completion. Then I received another call from someone I had never met. He, too, wanted the manual, again at a price of $750. He asked me what the manual was called. I didn't have a title for it, but blurted out "Well, how about "Trading by the Book?" He said, "Send it just as soon as you finish it."

I sold a number of manuals this way. I didn't mind sharing what I knew. As I got to know some of these individuals by their calling to ask questions and the subsequent conversations, eventually tutoring some of them, I became aware of the vast wasteland of commodity trading. It hurt me deeply to find out how many traders were being taken advantage of in the markets.

I had been given a new life. I found out I didn't have to live as intensely as I had. The condition of my devastated body wouldn't allow it. For quite some time I couldn't even watch a live data feed. The excitement of daytrading was more than I could bear. The pain in my stomach when the adrenaline flowed would cause me to double over in agony. I was reduced to only casual trading of the daily charts.

Still, people were calling or writing and sending for my manual. My conversations with them were demoralizing to say the least. Here are some typical quotes.

> "Trading 27 years and only have had 1 winning year – and that by accident."
>
> "Trading for 15 years, and lost 2 1/2 million dollars."
>
> "Trading for 12 years, and have lost my entire inheritance."
>
> "I've put my family into poverty with my trading over the last 30 years – our whole nest egg is gone. Now I'll have to work in the days when I expected to be retired."

I have talked to eminently successful businessmen – men with giant incomes. Men who have succeeded in everything else they ever tried – but they have failed miserably when it comes to trading in the futures markets (the stock markets for that matter, too).

One foreign ambassador I know of had lost $700,000 in 1989 alone.

I am a compassionate man. Much of my compassion was born of excruciating physical pain and misery. Not just from my recent illness, but from past problems with my health.

The few quotes above, coupled with dozens of other similar and even worse disaster stories about the markets, made me want to reach out and help.

Yes, I have a sincere desire to help others to succeed in the markets. So I have made Trading by the Book, Trading by the Minute, Trading Is a Business, Trading the Ross Hook, Trading Spreads and Seasonals, and Trading Optures and Futions available. I've also written 4 books about the electronic trading of stocks.
Anyone who can't understand that will have to live with his skepticism. He won't get much out of this book.

The greatest single problem I encounter when I am tutoring others is unbridled greed. People cannot bring themselves to take a small profit when it is there to take. They hesitate because they want more. What's wrong with making $100 in the S&P? What's wrong with covering costs first, then seeking profits? I get out when there are profits. I can always get back in. Greed simply can't get enough, it wants more and more....

Part and parcel of this terrible greed is being in a hurry. The traders I tutor are in such a hurry to get into the market. It's as if this were the last spaceship leaving from a dying Earth. It should be just the other way around. My advice is, be slow getting into the market and in a hurry to get out!

The next biggest problem I come across as regards other traders is that they don't know how to use something that works without trying to fix it. They say they want to know how to trade, but what they really want to do is to re-invent the wheel. This lack of discipline is the ruination of many a would-be trader. If something works, leave it alone. I am sure that amidst all the rubble out there, there must be some methods and systems that work. But there are few indeed who can follow another's system.

That kind of thinking flies in the face of fact and truth. I seriously doubt that of all the people who purchased my first manual, that even 5% have consistently utilized the methods, tricks, and techniques I presented there. In fact, I doubt if 5% of them still trade the markets at all!

The same will be true of this manual. Of the thousands of traders who might buy this course, only a few hundred will actually purchase it. Of those, a tiny percent will actually do what it says. Within a year or two, most of the others will no longer be trading.

That is why I did not even attempt to present this book as a system. I know that only a few will follow it. Instead, I've tried to present the fundamental tools and understanding that are needed to win in the markets. You, then, must learn to use those tools to create your own winning methods.

Another problem that crops up when dealing with other traders is their incredible selfishness. They think that if something works, it should be kept secret. Why? Because they fear that if everyone starts doing it, it will no longer work. The problem is that 'selfish' wants it all. Selfish doesn't want to give up a single tick. Selfish is what will drive you to seek out every market top and every market bottom.

I am appalled at the lack of a business-like approach I find to be overwhelmingly prevalent among traders. I meet and speak with men who are fantastically astute businessmen. But when it comes to trading in the futures markets, they completely abandon a business approach, becoming instead reckless gamblers.

Men who are masters of good management seem to fall apart at the seams when it comes to managing risk and money. Men who are cool, calm, and collected under everyday job and business stresses, seem to turn into hysterical, raving fools when it comes to trading in the markets.

The markets are such that every weakness and flaw of character is revealed when trading. A man who is a liar, no matter how clever, will lie to himself. He will tell himself that a market is going up when any moron can see that it is going down.

A man who is avaricious will be destroyed because he will stay too long.

A man who is dishonest will end up being dishonest with himself. He will convince himself that he is breaking even and will be annihilated by the markets.

A man who is skeptical will never have the faith and confidence to trade successfully.

A man who is distrustful will never have the courage of his convictions and will soon lose his margin money. To make matters worse, most of the "professionals" he will encounter in the markets will give him little to encourage such trust. In general, traders are prey to a whole host of vultures whose only goal is to part the trader from his money as quickly as possible. Such a situation hardly encourages trust and confidence.

If I were to try to devise the most fantastic character building device ever created, I could do no better than the markets. The markets represent the ultimate challenge to self-mastery, self-discipline, and self-control.

The markets attack the greatest human failing of all – vanity. There is nothing I can think of that can quickly make a man as humble as can the markets.

The only way I know to consistently win is to humbly approach the markets with great awe and respect. Then, in the full realization of how awesome the markets truly can be, determine to master every human flaw one can find in oneself.

Sincere, deep, and thorough self examination must come before the markets, or oneself, can be mastered.

The search must be for the simplest things, not the most complicated.

It is absolutely incredible to see how complex people try to make their trading. It seems that the more complicated a formula is presented to be, the more people think that somehow "this" is the holy grail of trading. What nonsense! The truth of the markets is in the simplicity of their movement. A market is going up, down, or sideways.

If it is going up, and if I'm honest, I can see that it is going up. I don't need a logarithmic, parabolic, standard deviation band to tell me that. A child could tell me that. "Oh look, Daddy, that market is going up."

If a market is coming down, I don't care how many trend lines or moving averages I draw on my chart, they will not contain it. Does drawing a trend line underneath a trend somehow magically stop prices from coming down? When prices reach the bottom of your computer screen, does that mean they can go no further?

I've had traders tell me that if prices break through a trend line, we are witnessing a significant event. Is that true? Would we both draw the trend line in the same place? Would one of us draw it exactly the same twice? And if prices make a new low and then rally back, do we now draw a new trend line at a lesser angle? Is that now somehow the magic line drawn in the sand that says "Prices, you can't cross this line!"?

Get real! That's as bad as saying that the divergence of an oscillator from prices means something. Look, I'm no great mathematician, but I know that when you de-trend an oscillator, it is going to drift. There will be plenty of times when a market continues to trend seemingly forever, when the oscillator (any oscillator) will trend in exactly the opposite direction. If a market is trending up and the oscillator is trending down, does that prove divergence? Someday, of course, that market will start to move down. But that could be months from now. When it does, all the great prognosticators will say, "See, you could have known the market was going to come down, just look at that divergence!"

Pardon me, but I think just about any four year old child could have told you that what goes up will eventually come down. Who needs an oscillator to tell you that?

If traders spent the time mastering themselves that they spend on mastering the markets with technical indicators, there would be far fewer dropouts and many more successful traders in the markets today.

If traders spent as much energy in seeking simplicity and truth as they spend making things complicated and false, there would be more traders still with us today.

If traders spent as much time examining themselves as they spend on examining the crossover of two or three moving averages, they would make a great deal more in the markets than they now do.

To me, the height of folly is taking a moving average, de-trending it to create an oscillator, and then trading a combination of the oscillator and the moving average that was just de-trended. Isn't it obvious that those two studies will be correlated? Will they really tell you anything vastly different about the price action?

Except for very limited and appropriate use, the technical tools I find being used in the markets are for the most part worthless.

In Trading by the Book, I said something to this effect:

Would you carve a doll out of wood and then bow down before it in worship? What is the difference between doing that, and taking an oscillator of your own or someone else's manufacture, and then entering a trade because the oscillator says to do so? Who is to say that the oscillator should be set at five bars, or ten bars, or twenty bars? If we each set it differently, we will get different results and therefore different trading decisions. Do you really believe that there is some "magic" setting for any indicator that will cause it to become the "silver bullet" of your trading?

Let's face it, there is no such thing as oversold, and there is no such thing as overbought. As I wrote this section of the course, the Canadian dollar had been "overbought" for close to three years and it was still going up. Silver had been going down for about the same length of time. Who's to say when and where any market will stop rising or falling, other than that a market cannot drop to zero and still be traded?

I have a friend, a very well capitalized, big-time trader. When silver was at around $6.40 in November of 1988, he said, "Man, silver is making a bottom here. I'm looking for $12 silver inside of a year. All the fundamentals say that it has to go up. All my technicals say that it's oversold. I'm going to scale it in by buying every time it makes a new low." That was back in 1988. He has steadily bought silver because it is so "absolutely oversold." He has rolled over multiple contracts repeatedly, and is now $900,000 in the hole. When I talked to him recently he said, "Man, if you've got enough money, you can eventually always be right."

I guess that maybe he does have enough money. Rallies in silver don't do him much good because he's in too deep. Sure, one of these days silver will quit being oversold and climb to $12. Maybe by then he will be able to break even – that is if silver doesn't break him first. Hmm – I wonder how well he'll sleep tonight. Silver just made another new low. It's now well under $4.

It puts me in mind of all the people who sold the British Pound in 1991 at the $1.80 level because it was overbought. In that year, it came very close to $2.00 before it stopped rising. A lot of people got "British Pounded." Then the British Pound took a dive. It dropped and dropped and dropped. All the oscillators had it as oversold long before it finished going down somewhere around mid-year.

Hey, I'm no exception. I was crazy enough to buy $18 crude oil puts when crude went to $28 because it was way overbought. At $35 it was surely overbought. Didn't all the oscillators say so? But crude oil eventually went to $40 and my Puts expired worthless. All that time I wondered if it was overbought yet?

The closest thing anyone can hope to get that is nearest the truth is what is seen on a simple price chart, unless, of course, we are like the old-timers who could see in their mind's eye what was going on in the markets just by reading the tape or watching the clacker board.

There may still some of those blessed souls around, still making their money in the markets, still enjoying what they do. We could all learn a profound lesson or two from them. Of course, electronic trading on the NASDAQ is bringing a new era of tape readers – traders who watch the movement of prices without watching a chart.

When I think about the old tape readers, I think about a lost art. These old pros could successfully daytrade from a tape or clacker board. In a way it makes me ashamed to have to sit in front of an expensive computer, with an outrageously priced data feed, paying even more outrageously priced exchange fees, and not be able to do an ounce better than those who have gone before me did, and in some cases still do, just by reading the numbers. No fundamentals here, no technicals, no cycles, no seasonals, no astral phenomena, no oscillators, no moving averages, no parabolics, no channels, no speed lines, no heads and shoulders, no pitchforks, no Fibonacci, no Elliot Waves, no fractals, no chaos theory, no any of these things. Just profits, based on truth – the truth that is revealed in the movement of prices.

My best advice to anyone who wants to trade is to work on and learn how to understand simple price movement. Learn to read it and learn to interpret what it is saying.

The problem with most technical studies is that they smooth away the minute details that are exactly what I am looking for in my trading. I know, I know, someone will tell me that I don't want to have to react to every little fluctuation of the market.

But what are those guys down on the floor doing? They react to all the detail. They don't have any fancy studies in front of them, they just know where prices are – and they win – and most others don't!

The floor traders have to pay attention to detail. They have to watch the prices on the screen. They have to decide and react to what is happening, and most of them are taking home the bread. If they don't, they will soon not be floor traders. The floor traders make money watching prices. The old geezers who watch the clacker boards (there still are a few around – clacker boards I mean – no, I mean both) make money watching prices, and Joe Fancy pants, with all his sophisticated electronic equipment, is losing his best friend.

With that in mind, let's look at some additional refinements.

Chapter 17

SEARCH OUT THE BEST

One of the most important things that anyone who trades can learn to do is to identify the best trades.

These can differ from one person to another because we each tend to see trades differently. What looks like congestion to one looks more like volatility to another, and so forth.

But all can learn to recognize what happens in the market that results in successful trades.

Having identified the one or two methods and techniques that consistently work, it is imperative to refine the implementation of them so they result in the highest probability of winning possible within the individual's own frame of reference, his/her own mind-set, and his/her own comfort level.

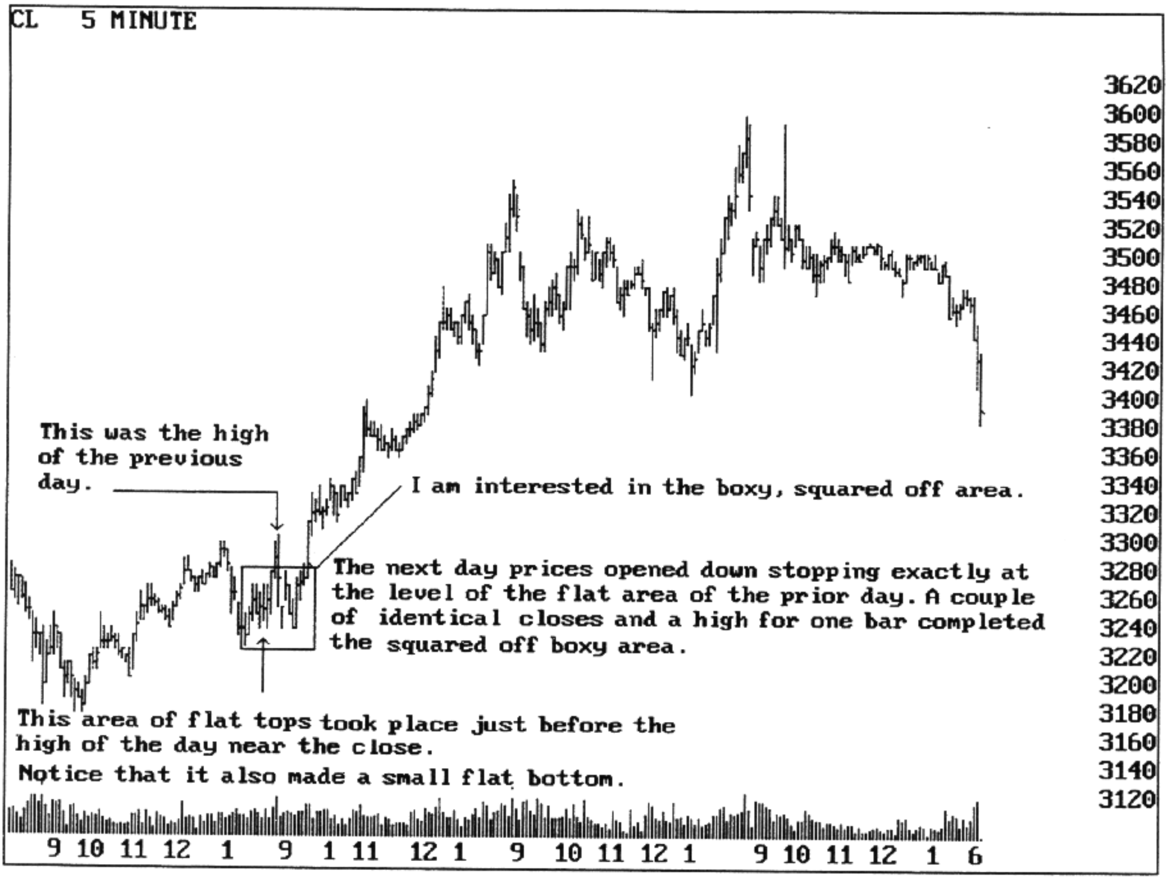
Not everyone trades the same. That it why it is patently ridiculous to worry about how many people will buy and/or use this book. Stops will not be bunched because each has a different level of risk tolerance, different size margin accounts, and feels comfortable with differing numbers of contracts. Each will likely trade in different markets to a certain extent because individual perceptions of what is tradable will differ.

The best I can do for anyone is to show exactly what I am comfortable with, then let them adapt that to their own comfort level.

The trick here is to identify success and then stick to it like glue. When it works, don't fix it. I don't experiment with something that is making money. I stay with the very best trades I can find. There is no need to chase a market. I am slow to get in and quick to get out.

If I'm not absolutely sure of a trade, I stay out. If it doesn't develop exactly to my liking, I stay out. I wait for those trades to come that exactly match my specifications. I let all others go by. I may not trade today, so what? The market may go on to make somebody a fortune – no big deal. I discipline myself to know my trade, and then take only those trades. I do not let greed get the best of me.

What does a good trade look like? Let me show what it looks like to me. It won't be exactly what someone else might like, but it will be similar.



On the crude oil chart shown above, I am interested in taking a trade based upon a breakout of the congestion that occurred closest to the high of the day. Prices had congested there briefly prior to the high, and had then fallen back to the congestion area just before the close.

The next morning, prices opened lower, and by a cluster of closes at the same level as the group of flat highs from the day before, plus the high of one bar at that level, there is a definite squared off boxy shape to the prices as they congested in the same area.

According to my plan set forth in the earlier chapters, I want to trade a breakout of the congestion that took place closest to yesterday's high. I don't want to wait for the high itself to be taken out, if at all possible.

Why? I want to already be in the market when and if yesterday's high is taken out. Why do I want to already be in the market then? There are two reasons:

1. If the congestion is taken out to the upside, there is a high probability that prices will go up and test yesterday's high. I can make a small profit if that happens. It also will have given me a head start in case prices go on and take out yesterday's high and move even higher.

2. If prices do take out yesterday's high, that is precisely where a whole bunch of buy orders will come into the market. There will be a lot of buy stops sitting in the market at that point. The momentum behind that buying will drive prices up even more, and so I have an excellent chance of cashing in on such an event.

A close look at the chart will show exactly what happened.

STAYING IN THE WATER

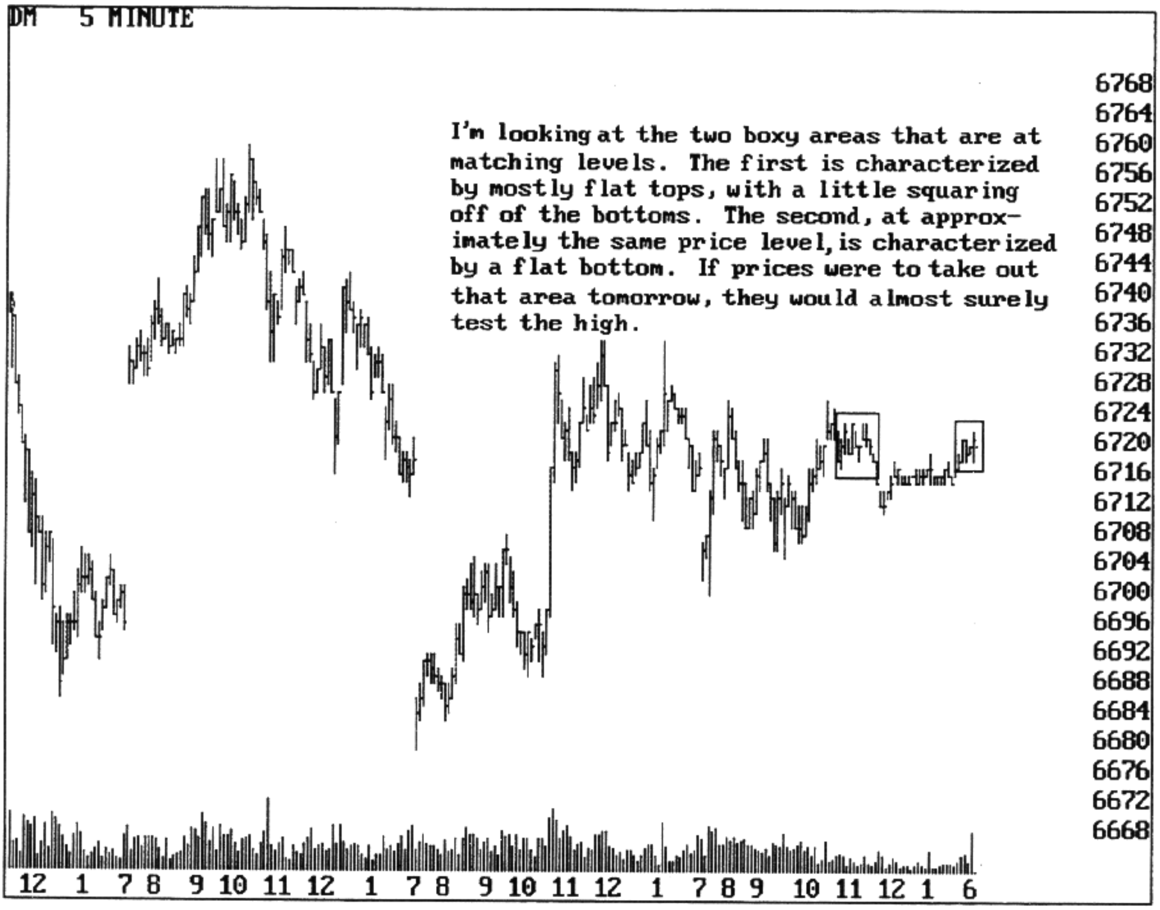
The whole idea behind my trading is that I don't mind taking a small loss, or even just making expenses, if I can be in the market when it runs.

Usually, I will not be stopped out for a loss equal to my entire risk. When market prices take out congestion areas, they usually have enough momentum to insure I will at least make expenses. At that point, I will have pulled my stops to breakeven and will not be hurt if prices come back down. If the buying or selling that comes into the market at the actual breakout is sufficient to carry prices a bit higher, I will cash my second contract-set.

If prices have sufficient momentum for the market to run, my third contract-set will see me catching my portion of the run. Do I expect to make it all, right to the most profitable point of the day? No. All I want is a piece of the action.
Sometimes I will get more, sometimes less, but at least I'll get something. A whole bunch of those pieces earn me my livelihood.

There are many times I will be stopped out with little or nothing for the risk I have taken, only to see the market then run the way I had hoped for. Will I chase that market? No! If it doesn't happen my way, I forget that trade. The trade must be my trade. It must happen my way, according to my plan, or I don't want any part of it regardless of what subsequently happens. No "but ifs", no "if only's". My way or no way!

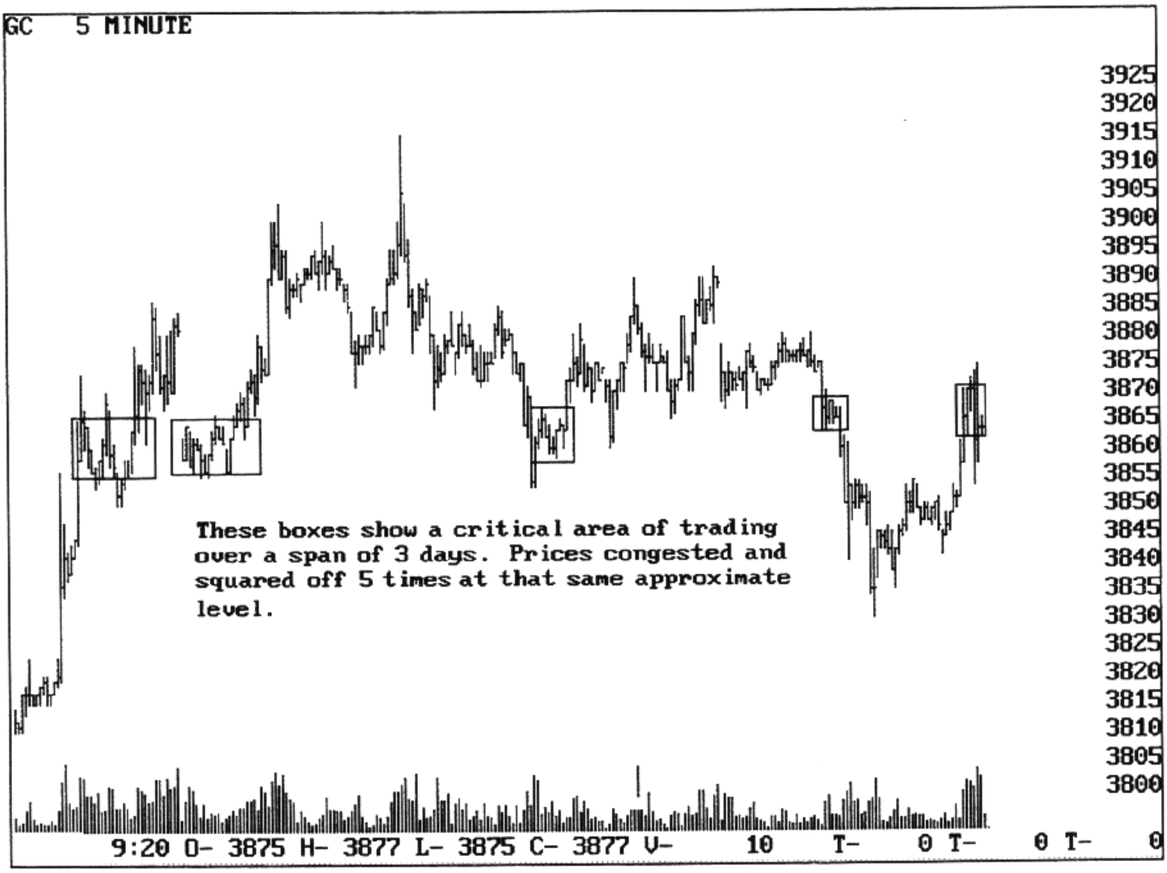
I'll show another trade now.



If prices take out the congestions to the upside in the area I have boxed off, there is a high probability that prices will test the high of the current day.

What I would like to see on the next trading day would be an open that is a bit lower, followed by some more trading at the boxed level.
A breakout would have me in the market, with enough room between the breakout and the high to at least cover costs. If prices continue upward, I might make a profit, and if the market runs, I will make my take-home pay.

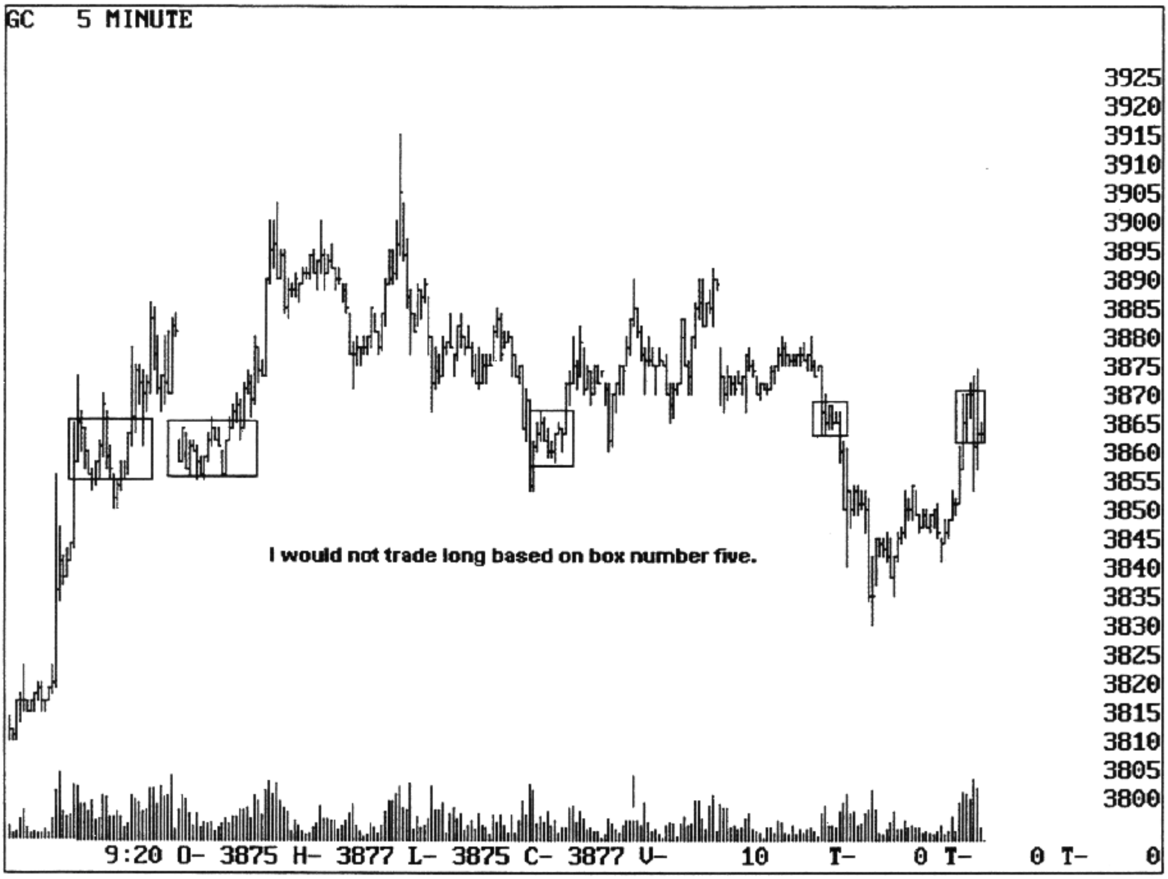
If it doesn't happen the way I anticipate, I will let the trade go by.



The boxes I've marked off demonstrate a critical area of congestion.

The first box shows that a great deal of trading took place at that price level actually causing a pennant shaped correction prior to the close.

The second box shows that on the following day, prices resumed at that congestion level right at the open. The trade was to enter long on a breakout of the congestion shown in the second box. I ignore the spike highs and/or lows. What I'm interested in is the fact that prices traded at the same level so often.

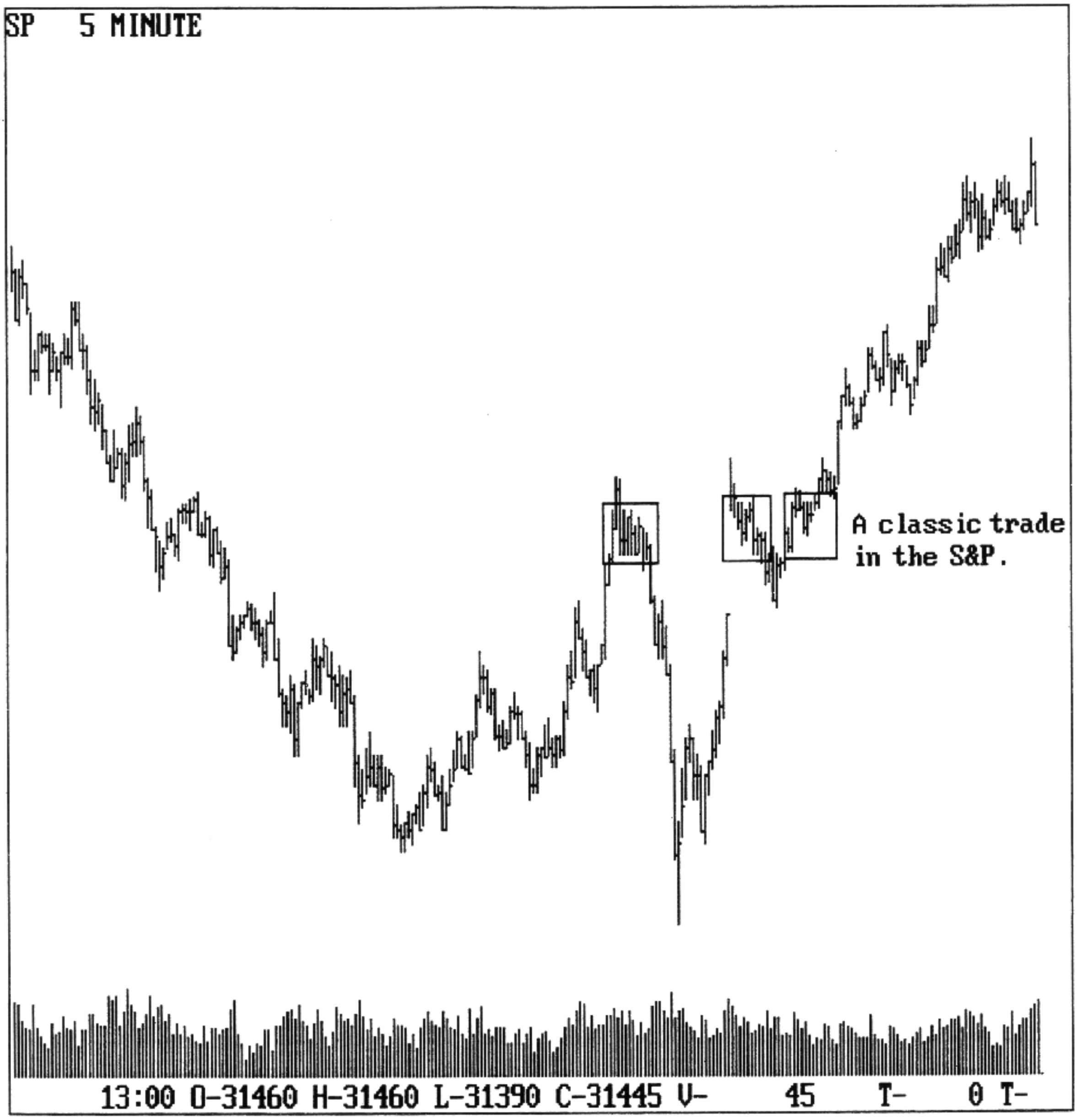


The third box shows that later that same day, prices traded there again, only this time after making the low of that day.

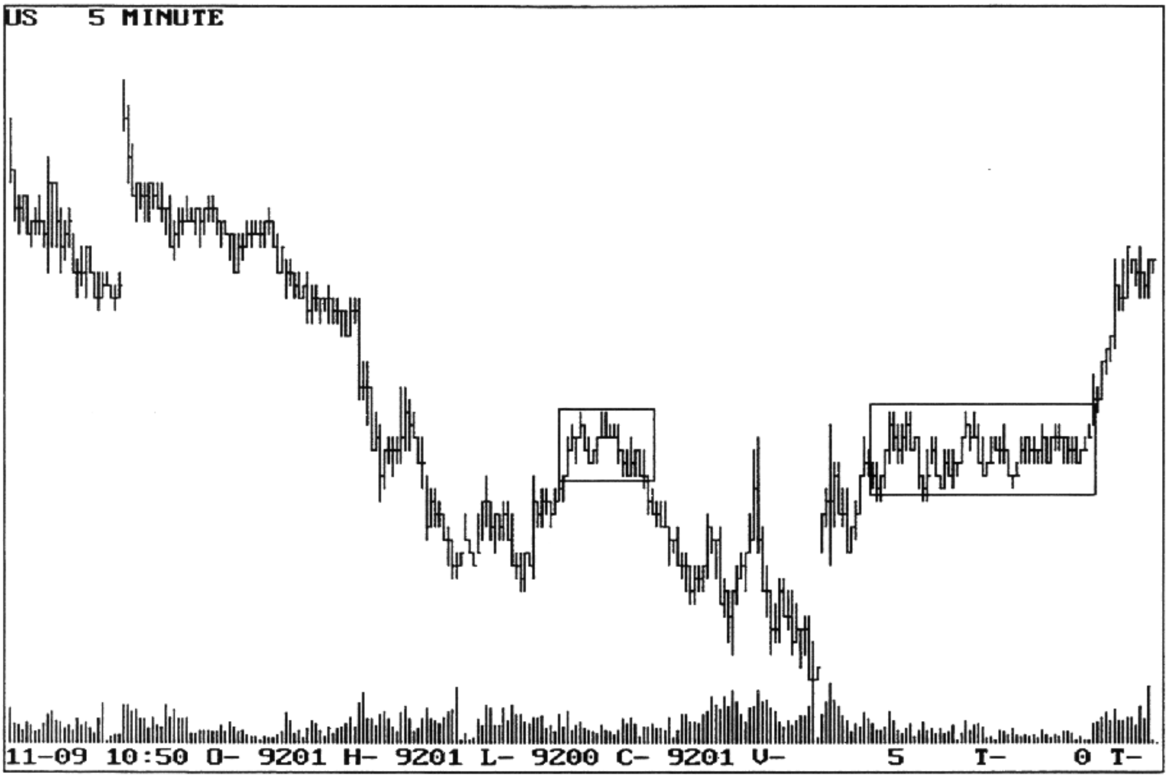
The lows of that fourth box are at just about the middle of the congestion shown in the third box. A short position was put on at the takeout of the congestion shown in the fourth box. As can be seen, prices made a nice move, and although gold didn't run, I was able to cash all three contract-sets.

The fifth box shows the congestion level at the end of the day that approximately matches the congestion area made earlier at box four. I would not trade long the following day based solely upon a breakout of the congestion in box five, because it is not the congestion closest to the high.

Instead, I would await further developments. I'd like to see it trade again at that level, and then take the most logical breakout of that area.



This chart shows an almost perfect trade in the S&P 500. Prices congested right after making the high and just prior to the close. The next morning saw a gap up open, and then prices trading right back into the congestion area. Then prices played around for awhile and finally broke out. The S&P ran all the way to the end of the day.



Although I do not trade bonds on the five minute chart, I just had to show this classic example of what I'm talking about. It just happens to be a day when there was enough activity in bonds for them to "form up" more than they normally do on the five minute chart.

PREFERRED PATTERNS

I prefer boxy, flat, squared off congestions over any other kind.

Next, I prefer repetitive congestions in the same area, such as on the S&P 500 chart and the gold chart in the previous figures.

I prefer that the boxed off section not be too high from top to bottom. I ignore spike highs or lows, and prefer clusters of opens and closes, highs and lows all within a very narrow range on the individual five minute bars. I feel it is essential to have software that will enable viewing of at least three day's worth of trading at one time. This means being able to see 240 five minute price bars on the screen at one time. That way it's possible to see where the daily highs and lows were over the last three days. Alerts can then be set accordingly.

Chapter 18

THE THIRD CONTRACT SET

When I've covered costs on the first contract set, and made a modest profit on the second contract set, what do I do with the third contract set? How do I trade it?

I want to be in the market when it runs. For the most part, the major profits I'm going to make occur when the market does run.

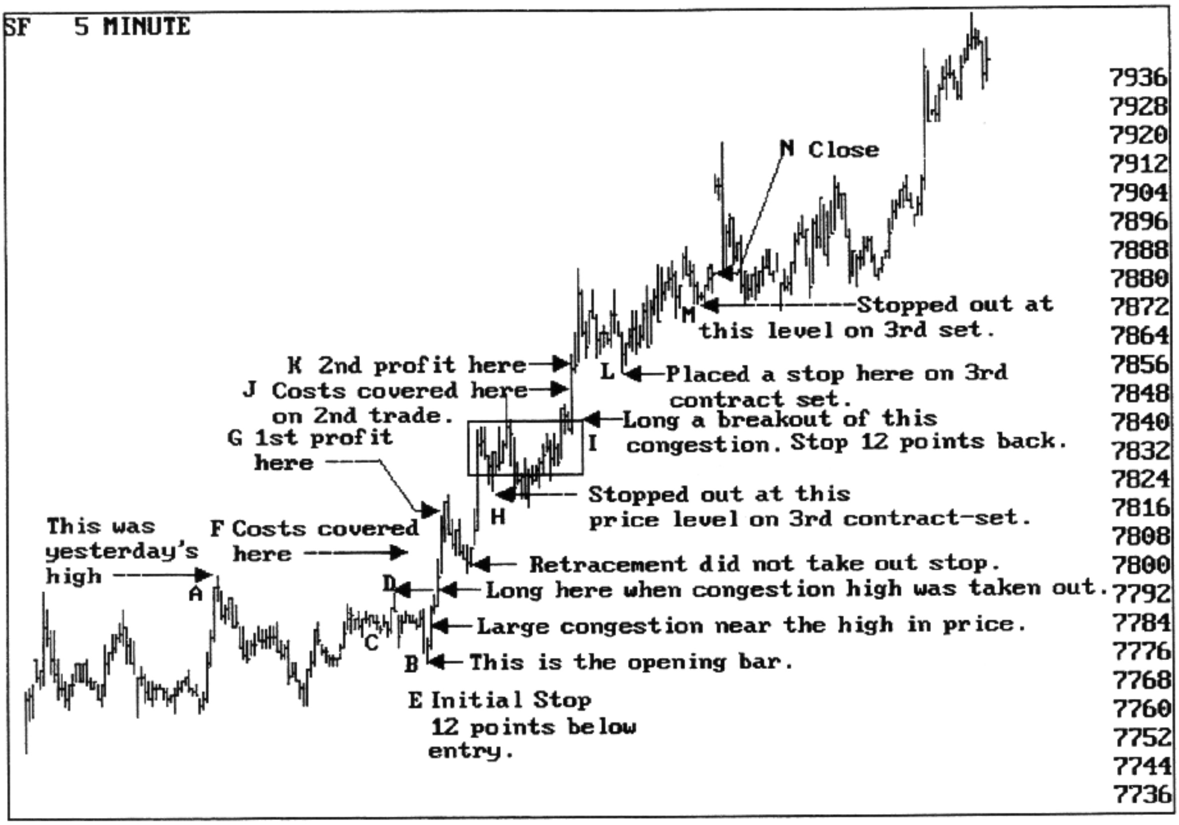
Here's how it works. I'm quick to take profits to cover my costs, picking up the phone as soon as I approach $100± on a trade. At that time I liquidate contract-set #1. I move at least one of my contract sets to break-even. Actually, I prefer moving both the remaining contract sets to break-even. It's a matter of comfort level. Often, I will liquidate contract-set number two at the same time as I liquidate contract-set number one.

If I haven't already liquidated it, as soon as I see another $100± on the trade, I liquidate contract-set #2. If the market goes nowhere, I will probably be stopped out at break-even. This will happen fairly often. The market may then go on to make fat profits without me. I don't sweat it.

I may take $100± on contract-set #2, and then get stopped out on contract-set #3. If I do, I have lost nothing. Paper profits are just that, paper. I can't take them to the bank.

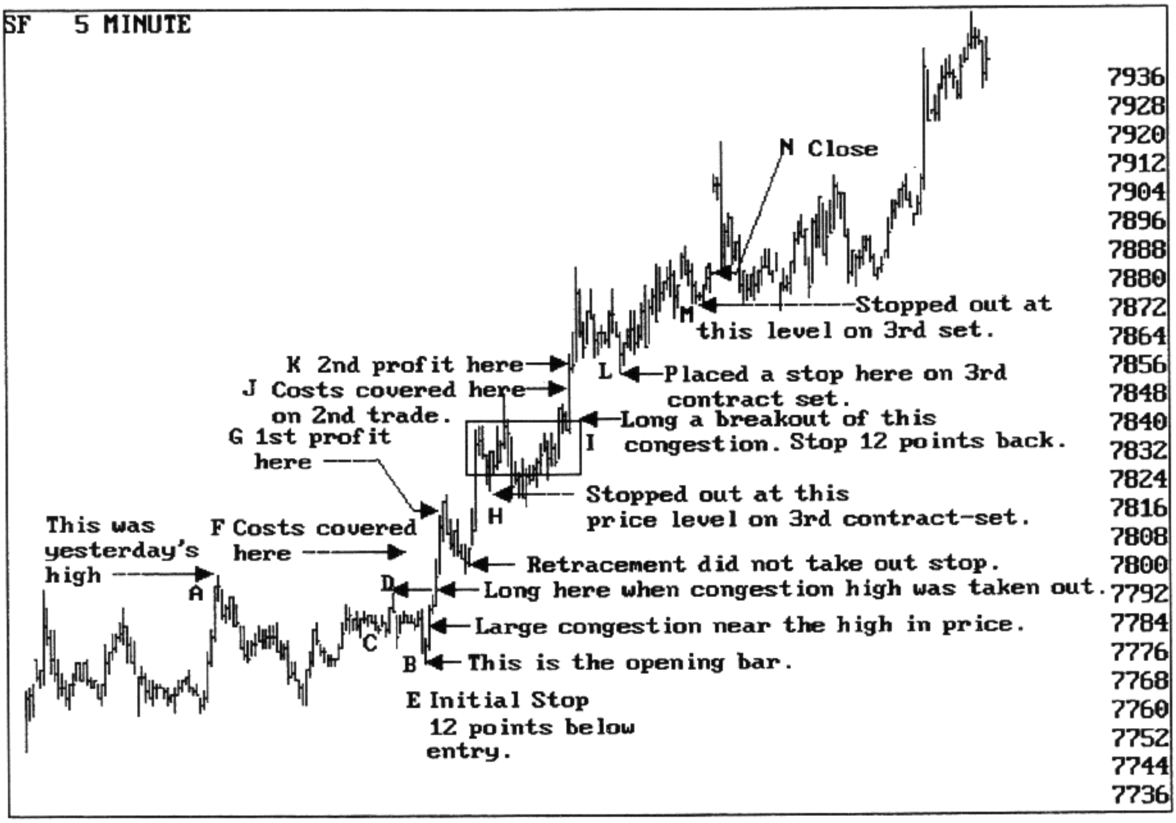
However, two or three times a month in each market, sometimes more, a market will have a good run. That's what I've been waiting for. I've been staying patiently in the water. I've been dipping my toe in each time I trade, looking to see if this is my day. It may have cost me a few bucks, or I may have made a few bucks while I wait for my day in the sun.

On the days the market runs and I'm able to stay with it, my break-even stop will have held. Now the market starts to move in a direction to make me profits.
Will I get all of the move? Probably not. Will I be able to call the top or bottom? Definitely not, I won't even try. I will be satisfied to make a profit. Making profits is the goal of my overall plan. Why am I here? To make a buck – but not to suffer while doing so. Have I made it clear? ALL RIGHT, here goes. Let me put everything in the context of another real life example.



Here it is, a step at a time.

A - shows yesterday's high. B - shows today's open. C - shows the main congestion that is nearest to the price level of yesterday's high. D - shows the price level at which I got long, just above the congestion high (it should have been a little lower but I chickened out and took the high). E - shows I put my stop 12 points per contract below my entry. F - shows the price level at which I covered costs on the first contract-set. G - shows the price level at which I took profits on my second set. H - shows the price level at which I was forced to take profits on the 3rd contract set.

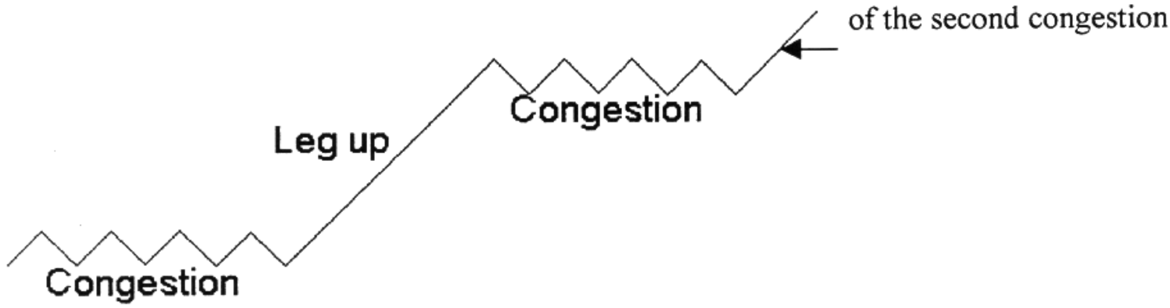


I-K is virtually a repeat of A-H and it should be fairly evident as to what happened. I-K will introduce the next thing I want to write about. Some will hate me for this.

I don't always take that add-on set of contracts that are represented by I-M. Yes, I know that's where I made a good piece of profit right? *Right!* But that's also where I incurred additional risk. When I entered that second set of contracts at point I, I stood to lose everything I made on A-H. That has to be taken into account. It's a part of risk management.

So how do I know whether to take it or not? Boy, I almost hate to say it, but it has something to do with waves. However, if it turns out that this has anything to do with Elliot waves, believe me it is purely coincidental.

I usually trade an add-on set of contracts, (i.e. a continuation set) at the breakout of the first congestion after the first leg up. But not always. I-K is a continuation set of the second leg up and I'll come back to it soon.
Here's what I mean:
I trade a breakout



However, there are exceptions to this and they are why I said "usually." I have to keep my eye on the clock. I have to make sure this is happening when there is still at least one hour of trading left in the market I want to trade. These are best when they occur early in the trading.

All right! So why might I not take the second breakout on the trade I've been showing? Here's why! I do it only if the second congestion is relatively flat, or coiled. I don't do it if there is a flag. I hate to say how many bucks I lost 'til I figured that one out. I won't tell. Just take my word for it that it was plenty. On the other hand, I should tell "why."

When a flag formation is made it looks like this:

In a down market, it looks the same. Just turn the page upside down and hold it up to a mirror.

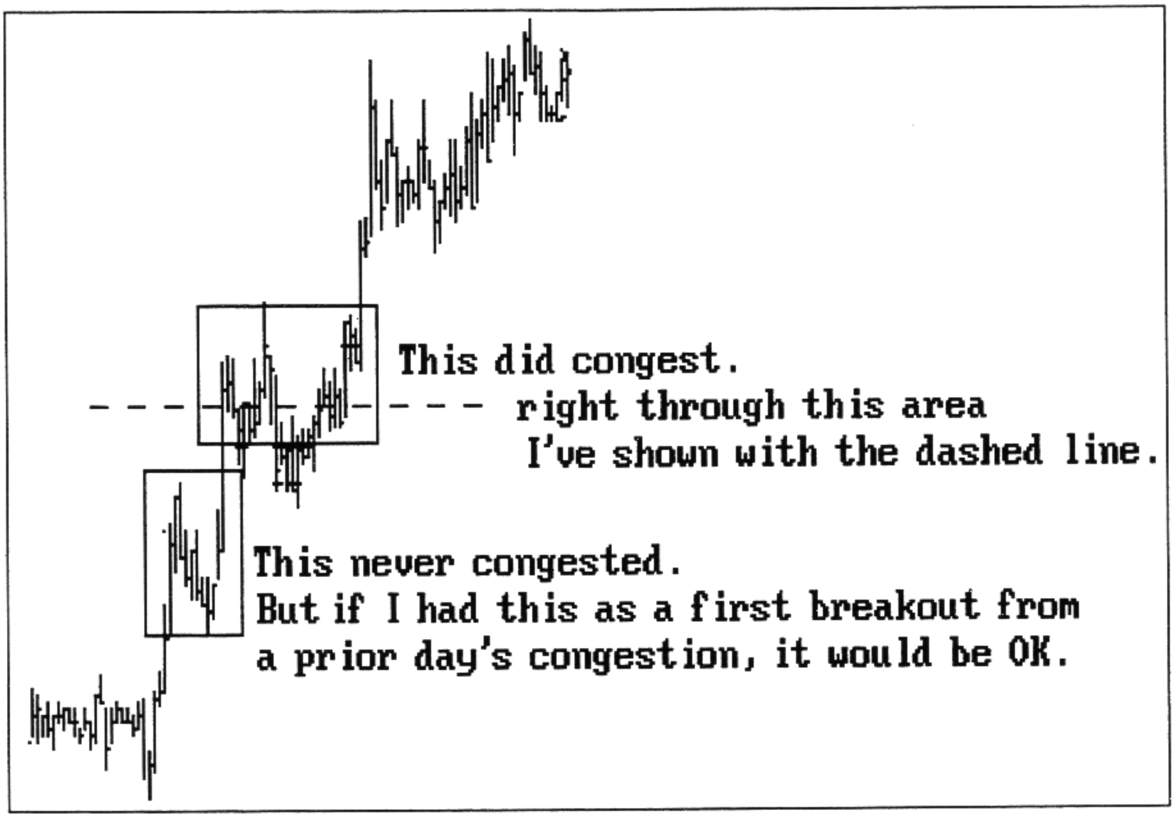
The problem is that, because it represents a serious retracement, prices are apt to spend a good part of their momentum just reaching back to the top of the flag pole. There will usually not be enough momentum to carry very far before prices congest again.

Now if prices had made a \/\/ formation or an /\/\ formation, it would have been a different story. Then prices would have been able to move a lot higher.

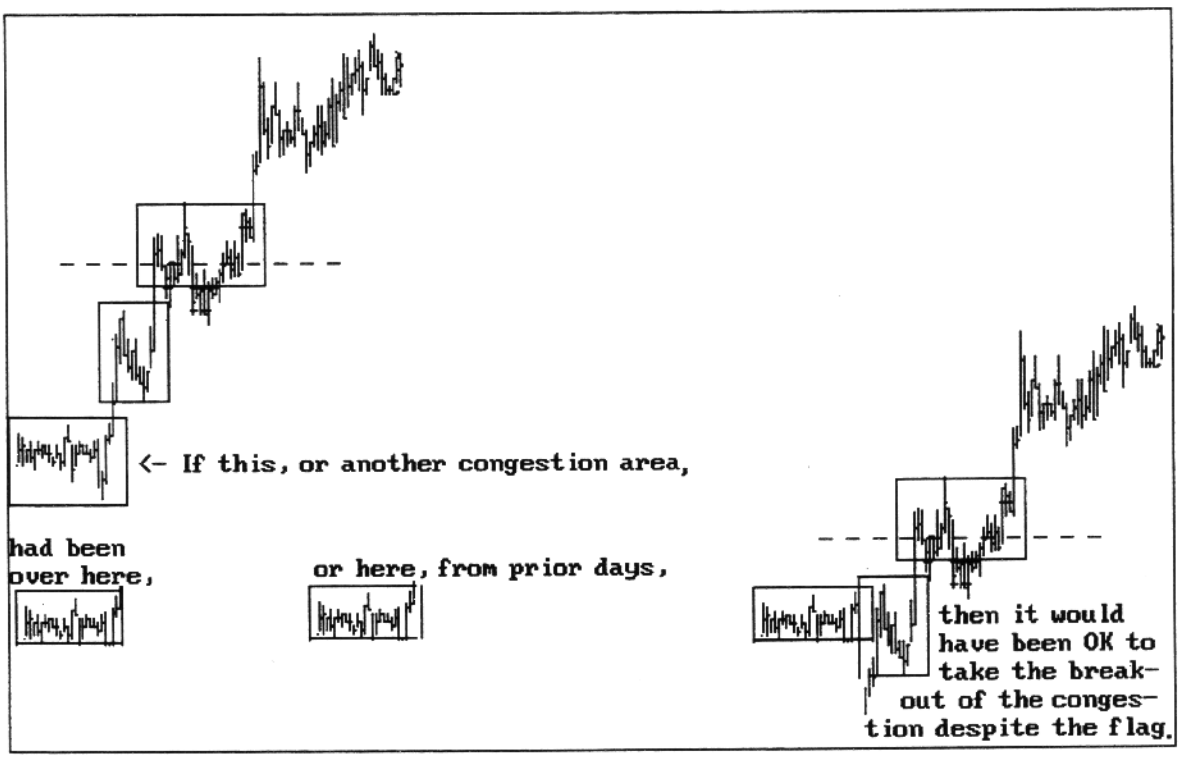
I'm saying that I want to see more congestion before I'm willing to put myself at risk once again. I especially like tight congestions. By tight, I mean lots of individual price bars with just about equal highs, lows, opens, and closes.

A close look will show that I took the very next breakout, the one above the flag, for exactly that reason.

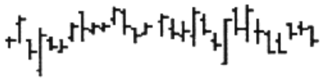
Let's talk about add-on sets on a third breakout. The rule is the same, they must come with at least an hour of trading left in the market. The breakouts must come from prior congestion.
I never, ever, take a fourth breakout no matter what. Remember that I have to be out by the close. Few are the days when a market will even offer a fourth breakout. By then, it will be too late in the day to risk it. Fourth breakouts usually don't go all that far. Elliot enthusiasts probably have some kind of explanation for all of this. Whoa! Don't tell me, I don't want to know. Looking at that again...



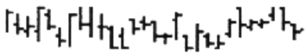
But it is OK to take a flag breakout for the first entry. Let me show what I mean.



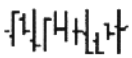
Sometimes it's best to wait patiently for the tightest congestions to occur. Tight and flat are the best. They save a lot of care and worry. Most have seen them. I have learned to spot these, they are worth a lot of money.



<-- They look like this,



<-- or this,



<-- or even this.
I love these.

Now then, everything I've been showing for the most part has been in uptrending markets. Can I help it if everything was going up when I wrote this?

The exact opposite is true for downtrending markets. To see how they look, more or less, just turn the pages upside down. The flags may be pointing to the left instead of the right, but they still convey the idea. Up market, down market, it's all the same. That's one of the reasons for trading futures, right? Up, down, it doesn't matter. I can earn my living in either one.

Now that I've shown how to trade continuation sets, I can go on to the next subject, which is really an old subject revisited – trading strategy and tactics.

Chapter 19

STRATEGY AND TACTICS

I've shown my plan. The plan represents my strategy in the markets. Strategy is the way I've planned and directed my trading operation. I've planned to take profits at certain levels. I've planned to cover my costs. I've planned to let my third contract-set run. I've planned how and where I will take continuation trades. I've directed my broker through the orders I've placed.

Tactics, on the other hand, is the way I have marshaled and maneuvered my trades in and around congestion areas. Tactics is placing myself in the best position in the markets to take advantage of price movement as seen through momentum.

Tactics are seen in the methods I used to enter my orders, place my stops, take my profits, etc.

The dictionary says that Strategy is the science of planning and directing, whereas Tactics is the science of arranging and maneuvering.

CONTINUATION TRADING

I've shown how and when I will take a continuation trade on a five minute chart. I will take a breakout of the next congestion after the first breakout which constituted my initial entry. There must be at least an hour of trading left in order for me to do this. I will take a breakout of a subsequent congestion if there is sufficient time to do so. The sum of the matter is that I will enter a market no more than three times in a single day – in a single direction.

There are a couple of additional criteria I use for continuation trades:

Normally, I will take a continuation trade only when my third contract-set is in the black and has not been taken out by a fifty percent retracement.

The best continuation trades come from pointy Ross hooks. If a hook is made which tends to have a flat top, then do not expect the continuation to go as far as it will if the Ross hook has a sharp point to it as it forms.

REVERSAL TRADING

Is there a time to reverse direction? Yes, there is. Sometimes a market will make an outside day. It might take out yesterday's high, and then turn right around and take out yesterday's low. The outside day may be so large from top to bottom as to take out the highs and lows of several days. I watch for this when there is feverish activity in the markets.

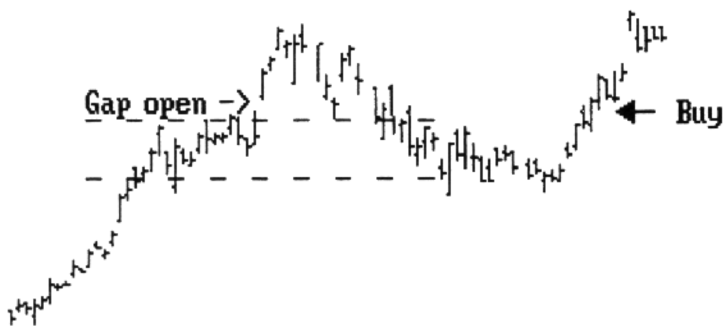
The rules for changing direction are identical with the rules for trading one way: I take a breakout of the longest, tightest, and/or best congestion that occurred prior to the extreme.

I might be long early in the day, and then sometime later I might find myself short. I may even have time to enter the market three additional times in the opposite direction from my original trade.

I'm not talking about reversing a bad trade here, that will come later. What I'm talking about is flexibility in my planning. What I'm getting at is having a mind-set that realizes that such things can occur, and a plan that allows for such eventualities. When there is an outside day, I will not change my tactics. I still enter and exit as before, but my strategy has laid out for me what to do in such a situation.

GAPS

How do I handle gaps? If prices gap past my entry congestion, I let my trade go by. BUT IF prices trade back into my congestion, then I take a breakout the same as I originally planned. Here's what I look for:



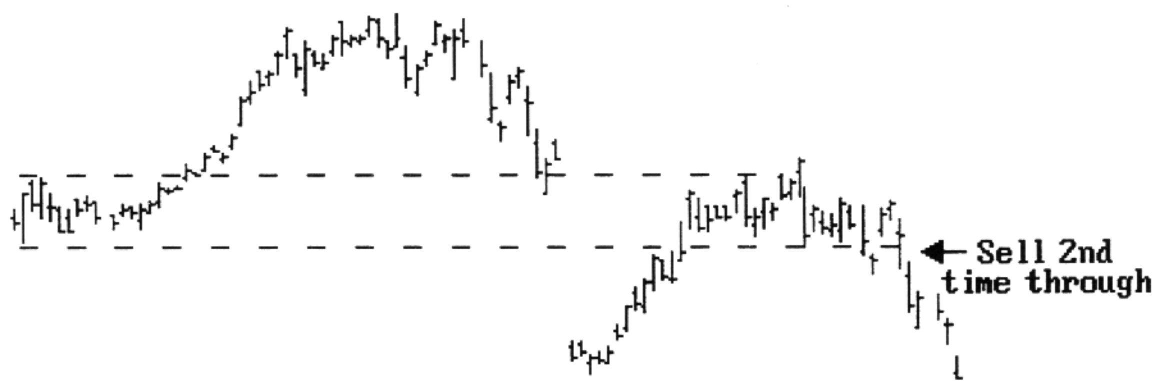
A gap opening followed by a retracement to yesterday's trading range before yesterday's high, followed by more congestion today, and then a breakout.

I take this kind of trade.

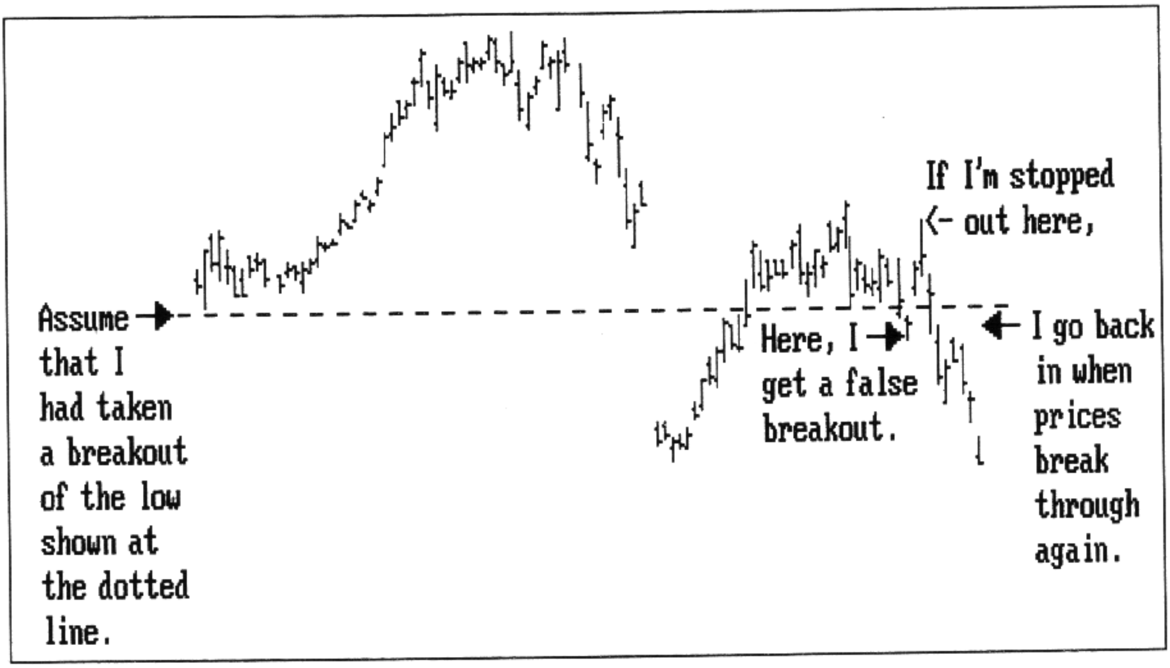
Note that prices must again congest at or <u>about</u> the same level as they did on a previous day. The previous matching congestion could have taken place up to three days ago.

There is one other way I will trade after a gap open. It is if prices gap open, then retrace through a prior trading range, and then breakout in the direction of the open.

Now, what do I do about false breakouts? I'll show that last chart again.



A gap opening, a rally back <u>through</u> prior congestion, then a breakout of that congestion in the direction of the open.



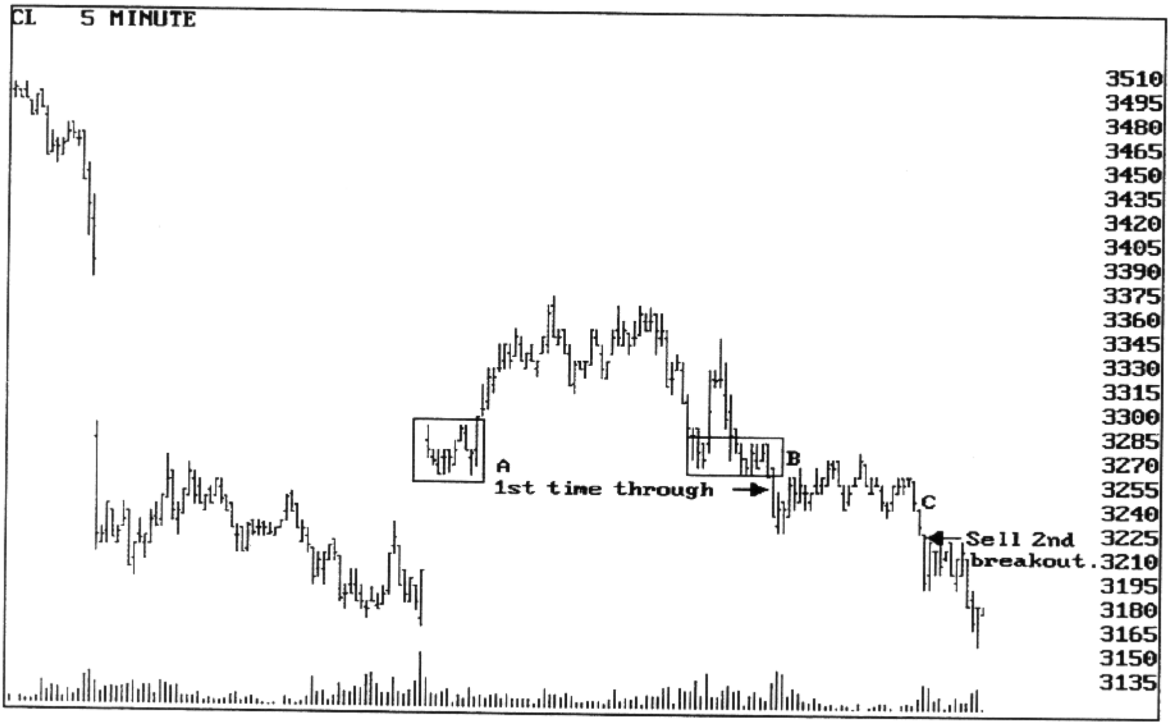
FIRST BREAK VERSUS SECOND BREAK

The second attempt at entry shown above brings up another point I need to bring out about my trading. What I'm about to show is a matter of choice.

There is a more conservative way to trade these breakouts of congestion that take place prior to the actual breakout which is based upon the entry signal. I'd better make that more clear.

I may be about to take a trade that is based upon a breakout of the congestion I anticipate will be a breakout that will fulfill the requirements of one of my entry signals. For instance, a market may be just about ready to take out the high of a trading range. I am looking for a congestion just prior to such a breakout. Up until now I've shown my technique as being that I take the FIRST breakout of the congestion prior to the actual breakout of an intermediate or major entry signal.

However, a more conservative approach, and one I now favor the most, is to take a second breakout of the congestion. By doing so, a lot of good trades will be missed. But also, a lot of shorter term fall-backs will be missed. In part it is a matter of perception.



Notice, the second time through has to take out the low of the first time through.

On the foreshortened (I removed some of the price bars in the middle) crude oil chart I've shown, prices congested around the low of the previous day at point A, and then congested there again after the open on the day shown at point B. When prices broke through the congestion lows at 3260, a short position would have made costs on the first contract-set, and another ten points or so for the second contract-set. Then a rally back would have taken out the break-even stop at 3260 and the trade would have been over. That is what actually happened the way I traded it.

However, had I waited for the second breakout shown at point C, the results would have been more spectacular for the third contract-set, even though the entry would have been at a lower point, around 3240. Sometimes there is no rally back and the trade is entirely missed. But when there is a rally back, and then a second penetration of the congestion area, the chances are higher for making profits. Trading the second breakout is part and parcel of my minor entry signal, and so the last example was a perfect lead in for the next topic.

Chapter 20

TRADING THE MINOR ENTRY SIGNAL

The last time I really mentioned the minor entry signal was clear back in an earlier chapter. Let me repeat the signal, and then I can go on to show how to trade it. It is not my favorite trade. I would rather take any major or intermediate signal ahead of it.

MINOR ENTRY SIGNALS

My minor entry signal is as follows and is optional:

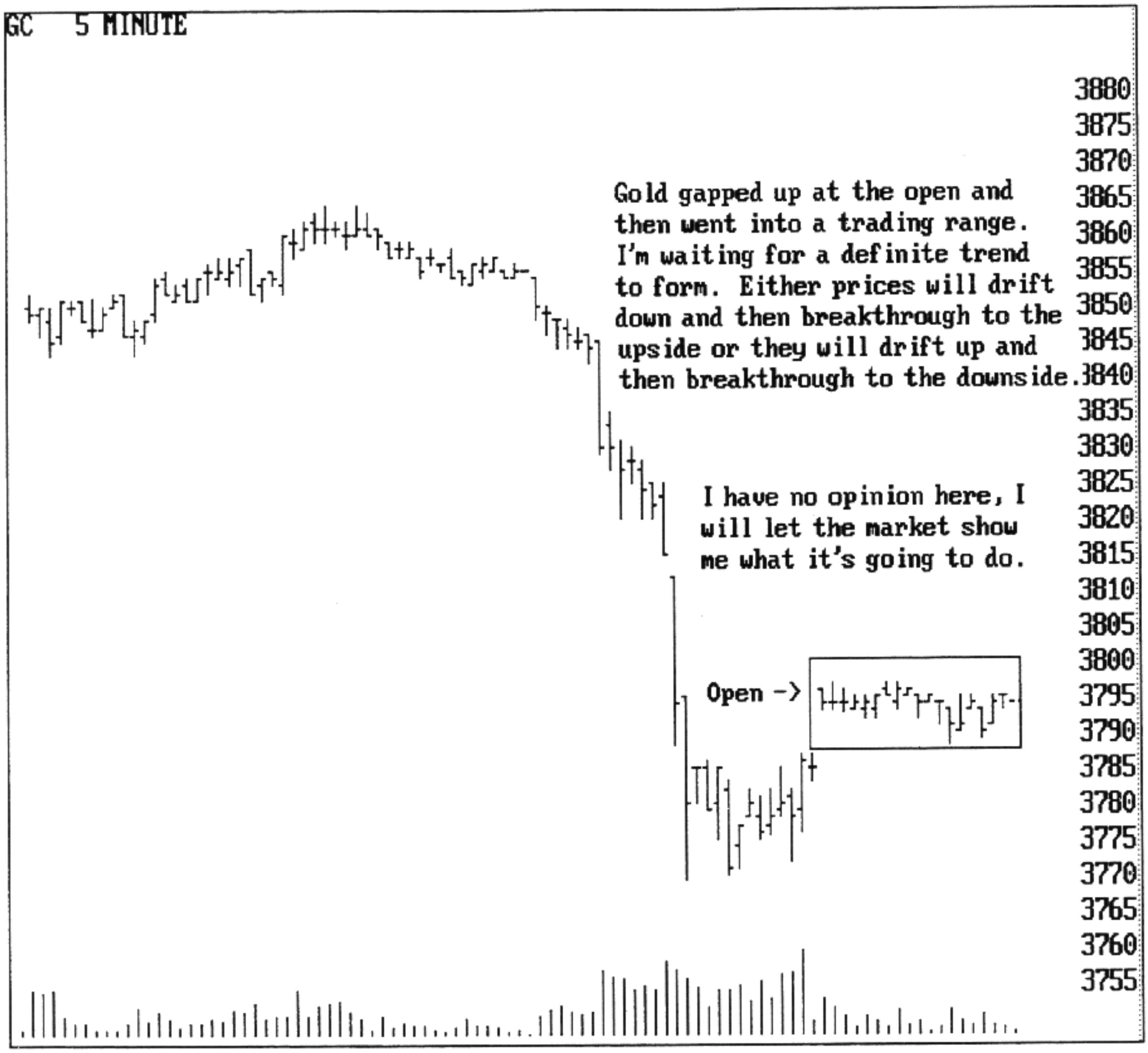
A breakout of the first trading congestion to form on the chart after the opening. This may include a congestion carryover from the previous day.

There is a matter of choice here – I can take either the first or the second breakout of this congestion. The second breakout is the more conservative of the two methods, but as with a higher priority signal, the second breakout, while safer, often results in missing the entire move.

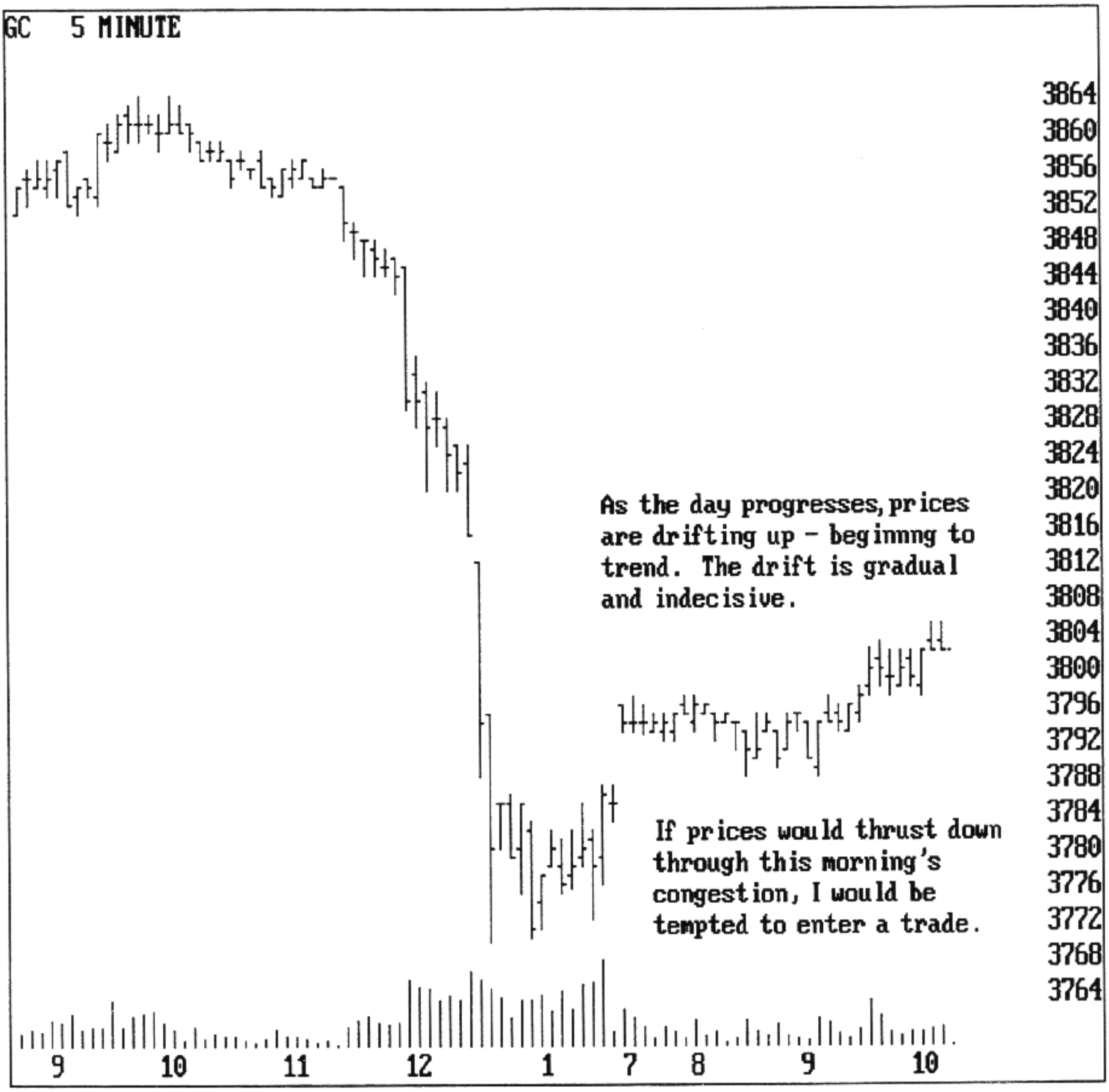
I have a tendency to take the first breakout if the congestion proves to be very long and meandering in length. Otherwise, I prefer a second breakout.

The first breakout often does not have much thrust behind it, unless it is a continuation carryover from the previous day.

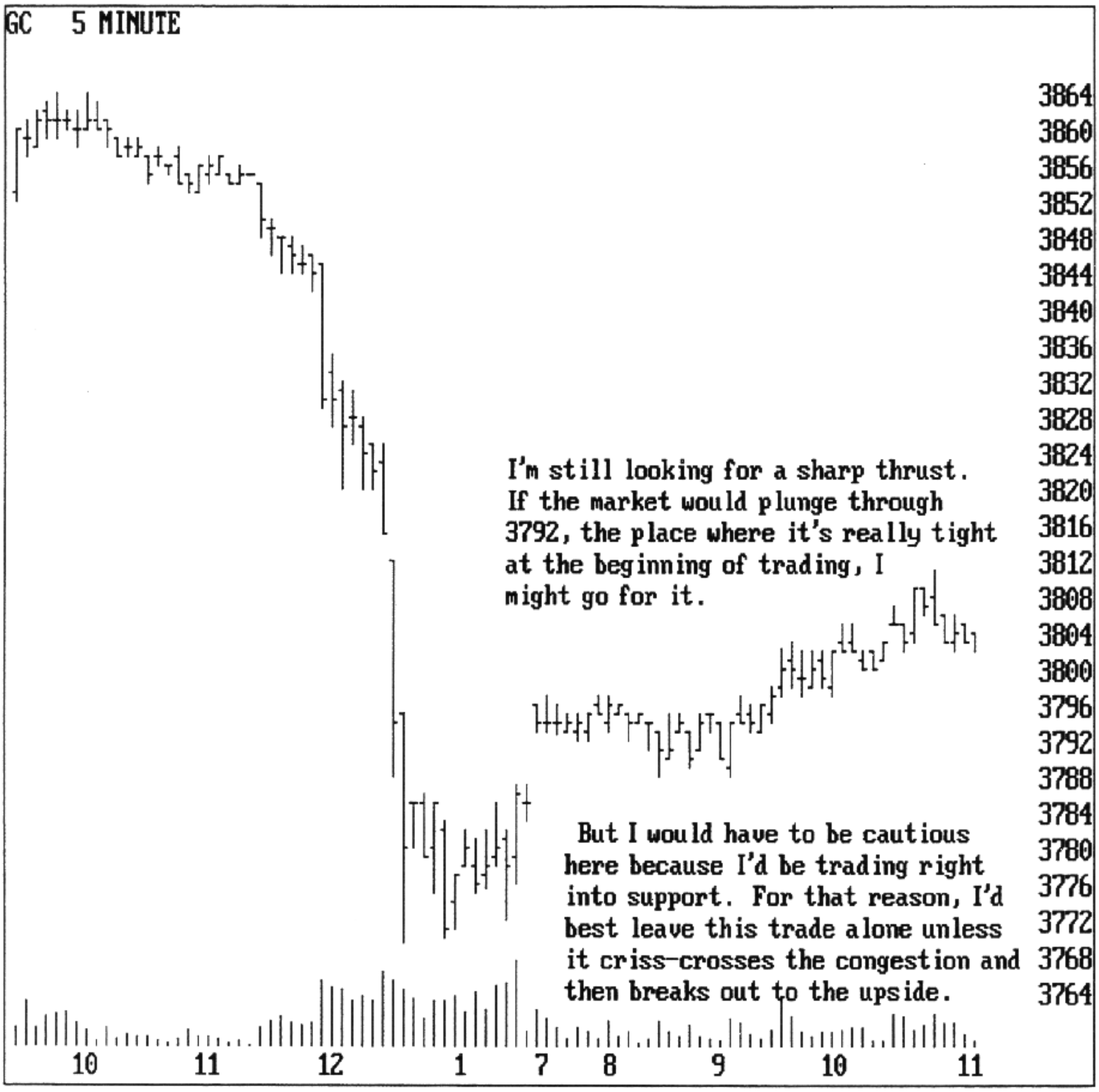
When the first congestion is coincident with a more major signal, then it is traded as such. Otherwise, it is traded on its own merit. Just such a congestion occurred in gold the very next morning subsequent to the beautiful gold trade shown in the chart above. Here's the way it looked.



It is plainly evident that nothing has happened yet. There is merely a congestion taking place. It is not the congestion nearest to the low, because that one is below the present one. At this point, I don't have a clue as to which way, if any, it will break out. It may just meander along sideways for the rest of the day. I'll show it later on so that what actually happened will be evident. But, looking at it right now, it is not very tradable. What I would hope for is a gradual climb upward, followed by a reversal breakthrough of the lows. Whether it will happen that way remains to be seen. As a prophet, I have tended to be a false one. As far as my actual trading goes, I would probably pass this one up and go looking for better situations.

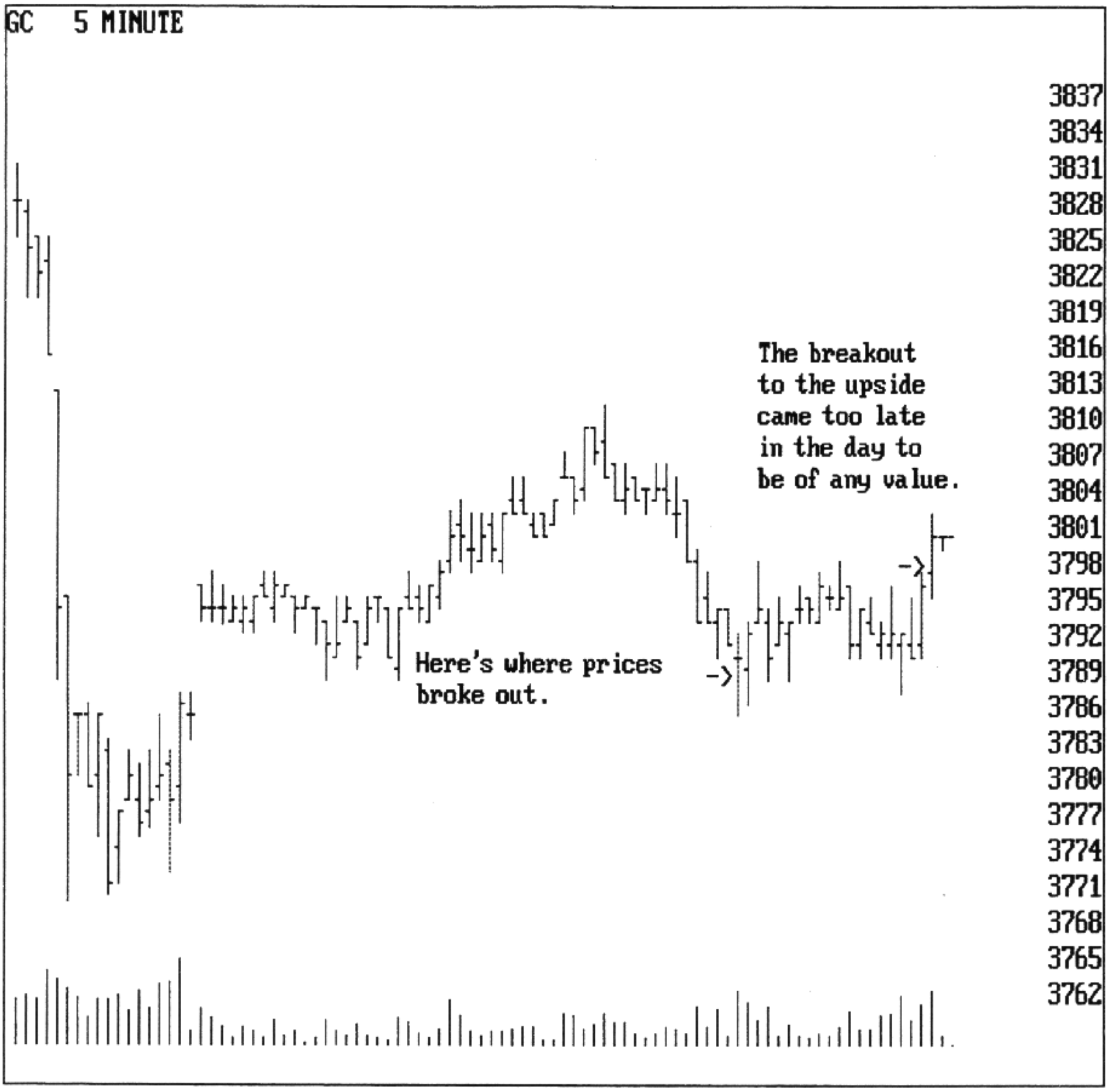


As you can see, nothing much has happened. I'm looking for thrust and haven't seen it yet.

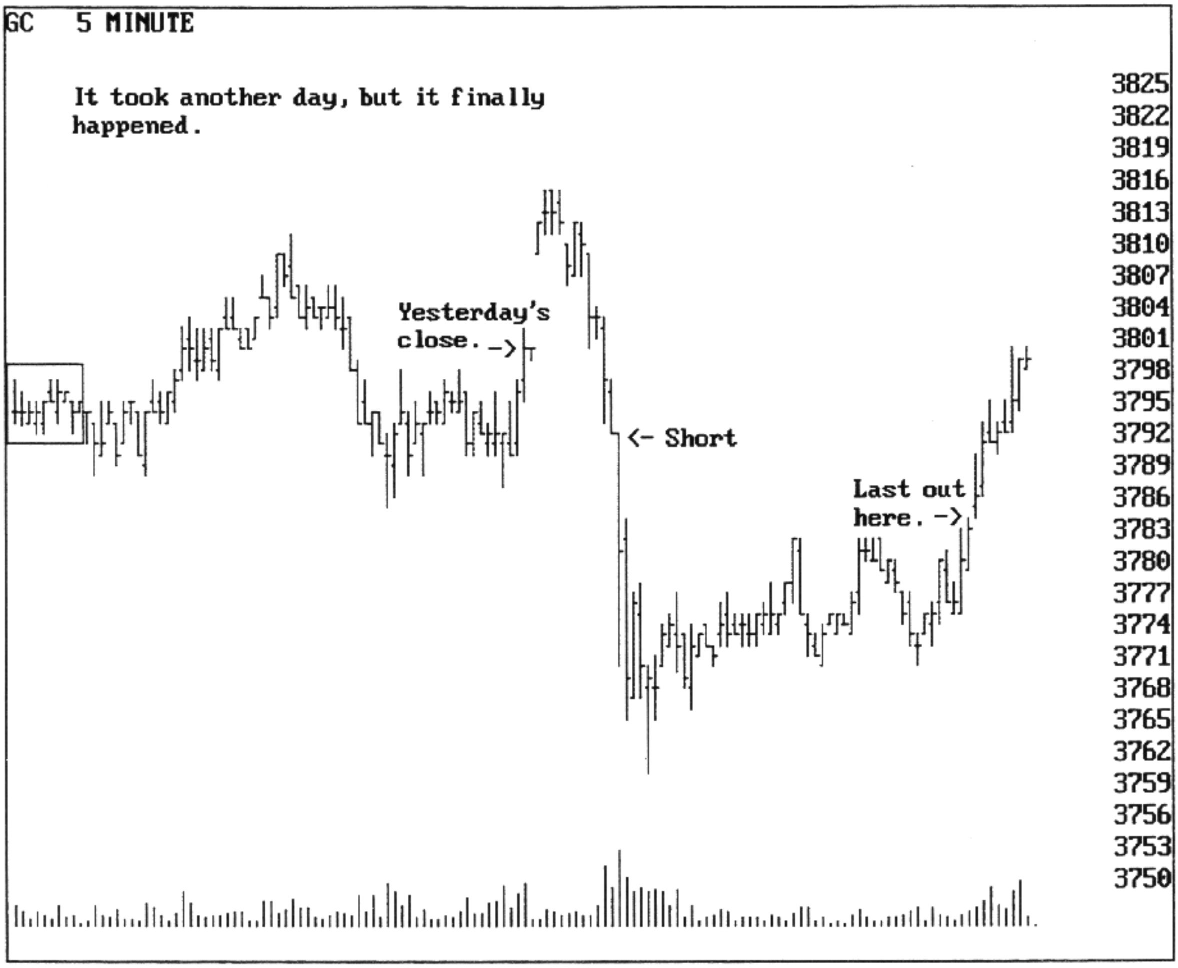


This trade might have had possibilities had it drifted down first and then taken out the congestion to the upside. A breakout to the downside would cause me to trade only if it took out the extreme lows of the congestion that is the one closest to yesterday's lows.

The breakout comes late in the day, too late to expect much out of the trade. I did not take this breakout because it was too close to 'support.' If you want to know why I place quotes around the word support, it is only because I wanted to use a standard industry term. I don't really believe in 'support' or 'resistance.' They are really misnomers, because price can blow through either one of them any time strong hands decide to take prices through. There need not be any underlying economic reason of supply or demand.



No gold trade today. But let's look at what happened the next day.



It took another day, but it finally happened.

Early in the morning, I noticed that my data feed was not working. The signal indicator was showing that any signal received was loud and clear. But there was some kind of transmission problem and so there was no signal.

The market opened at 7:20 up a few points, lower than what is shown on the chart. The data feed started coming in at 7:56, so I was missing 7 bars on the chart. I checked with my broker and he said that the market had traded up slightly since the open.

Soon after, the market started its plunge. I placed a sell stop order exactly where I would have the previous day, just under that little tight area shown in the box. The rest is self explanatory. The market didn't run, but I made profits on all three contract sets.

Chapter 21

TRADING LOGIC

There is a definite logic and reasoning behind the way I trade. I'll explain it in this chapter. Perhaps by knowing why I do what I do, it will be possible to emulate what it is I'm doing, and adapt it to your own style and comfort level.

At the very outset of this book, I mentioned that the most fundamental concept that would be shown is how to recognize what a chart looks like just prior to an important breakout. In the next chapter, I'm going to show numerous examples of that as a sort of review of the trading method I've been teaching so far. But first let me explain what I think is happening in the market, and my rationale for doing what I do.

PIVOTS

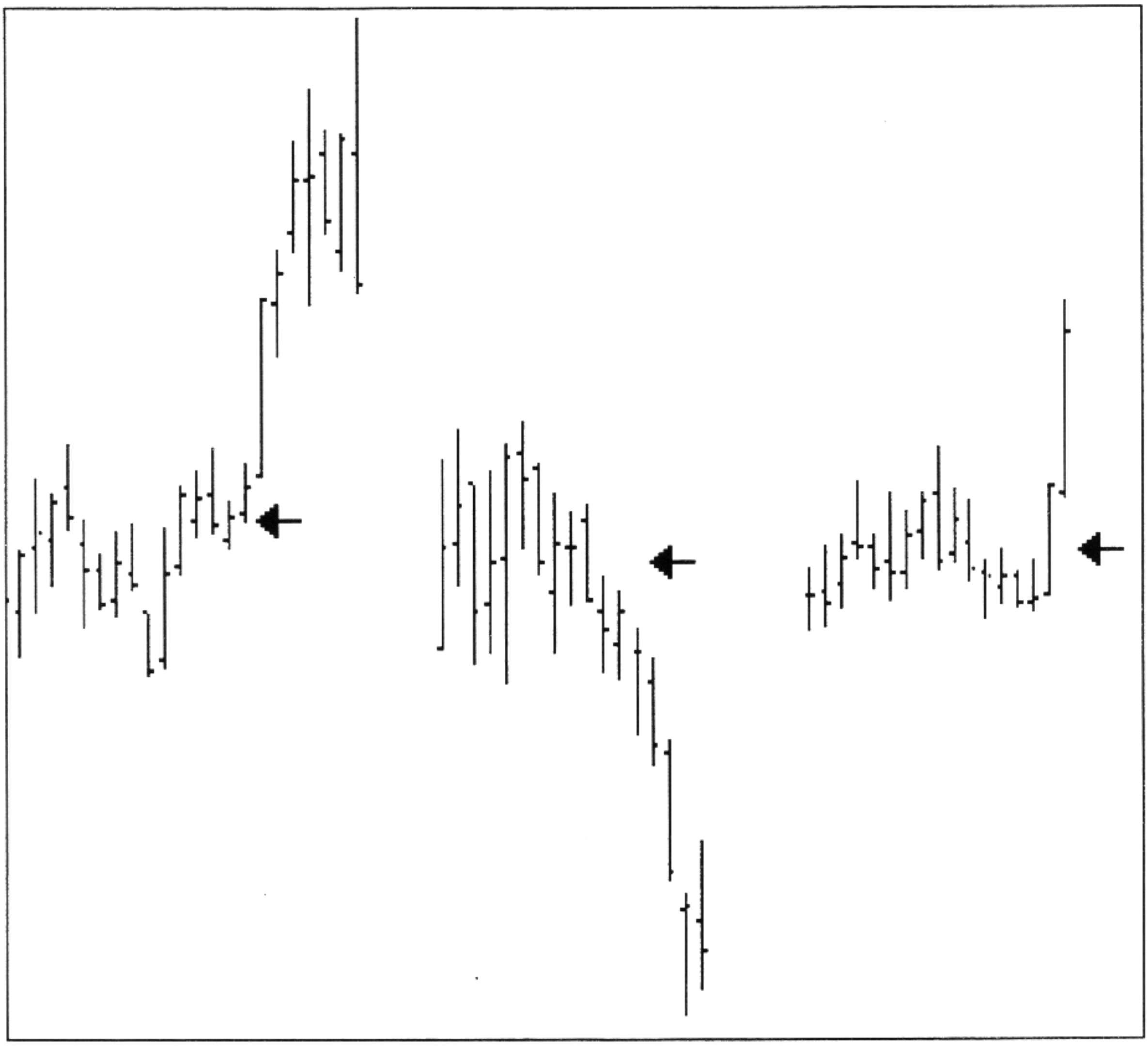
Because I do not have the advantages of trading on the floor, I am forced to compensate for the disadvantages of trading from a live data feed. I mentioned this in an early chapter of this book.

I noted I could not utilize the same pivot points that were used on the floor because of the time delay my trading must incur as opposed to the true real-time trading that takes place in the pit.

Now here is my version of what is happening – this is what I visualize is taking place on the floor.

When I see groupings of opens, closes, highs, and lows, all in the same place, at the same price level give or take a tick or two, I feel that these are the natural support/resistance points down on the floor, i.e., places where stops have accumulated. I call them pivots. However, as stated earlier, I cannot trade all of these because prices can move significantly away from these levels from the time I react to what I see, to the time my order is able to reach the floor.

Here is what those congestions look like.



Just look at all the opens, closes, highs and lows clustered a the levels shown by the arrows.

When these events take place near one of my entry signal points, I feel that one of two things is about to happen:

1. The floor will drive prices to the extreme, and then stop there. In other words, prices will test a high or low entry signal point.

2. The floor will drive prices to the extreme and then the public will drive them past the extreme. In other words, there will be a breakout of an entry signal point.
My technique is to straddle these congestions. When prices start to move, I will lose the points the floor traders can make between the center of the congestion and the outer limits of the congestion. I have to give these to the floor due to the time delay I am faced with.

If the floor drives prices up to the extreme and no further, I can expect to make a small profit on distance between the outer limits of the congestion and the extreme that constitutes the point of the entry signal.

What happens at the extreme determines any additional profitability in the trade. It's important to follow closely what I'm about to say.

There must be at least seven to ten ticks between the breakout if the congestion and the extreme for this concept to work.

At the breakout of the congestion, I will typically enter with three contract-sets. As soon as I see an acceptable gain on the trade, I call in my order to liquidate one or two contract-sets. I do this by entering a resting MIT order to take profits per contract at the price level I feel makes the trade worthwhile.

In the situation where I liquidate two contract-sets, I have covered my costs and have earned a small profit. I immediately move my stop to pull the third contract-set to breakeven.

At the breakout of what constituted the entry signal, I will make money as the public comes into the trade.

Recalling that what constitutes an entry signal is a significant event on the daily chart, there is a reasonable expectation that at the breakout of a trading range, a 1-2-3 high or low, a Ross hook, a ledge, the highest high or lowest low of the last three days, yesterday's high or low, etc., there will be an entry into the market by the public – daily traders, and daytraders. Their entry into the market will drive prices further in the direction of the trade in which I am already positioned. Their entry will give me profits on some of my contracts, provided I'm still in the trade and have not been stopped out of my third contract-set when I protect it at breakeven.

There will be a significant number of times I will be stopped out at breakeven on the third contract set. That is not a problem. I don't have to hit a home run every time I step up to the plate. I will at least have covered my costs and made a small profit. I will be alive, and ready to try again at a later time.

When I see another acceptable amount of profit on my third contract-set, I will move my protective stop to lock in at least fifty percent of my unrealized paper profits. Most times, this stop will be taken out soon after placement. I am happy with this situation. I do not fret over what I could have made had I stayed in, or kept my stop further back.

Several times a month, prices will take off and never look back. That is when the market will hand me a large profit. When that happens, I trail my stop, either according to an offset moving average that shows containment, or by placing it just outside of natural support or resistance points. I prefer the natural support or resistance points.

I consider continuation trades at well defined Ross hooks or ledges, but I always bear in mind that additional contracts entail additional risk. Continuation contracts always carry the risk of my losing everything I've already worked so hard to earn.

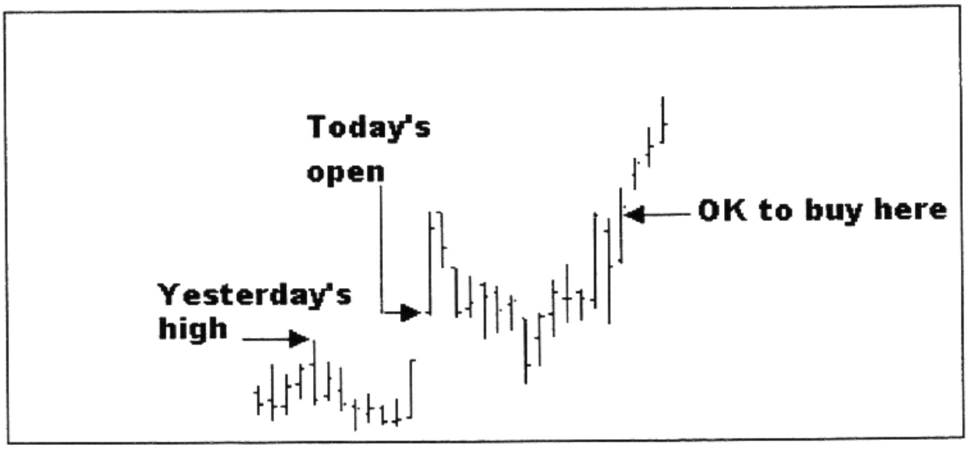
When the public enters the trade, I have achieved the same advantage over the daily trader as the floor trader has over me. By trading the breakout of the trading range that occurs just prior to the breakout of the extreme (my entry signal), I have in effect faded the daily trader. I end up selling when he is buying, or buying when he is selling. If the entry of daily traders is of sufficient magnitude to drive prices strongly in the direction of the trade, then my third contract-set will reap large profits.

Chapter 22

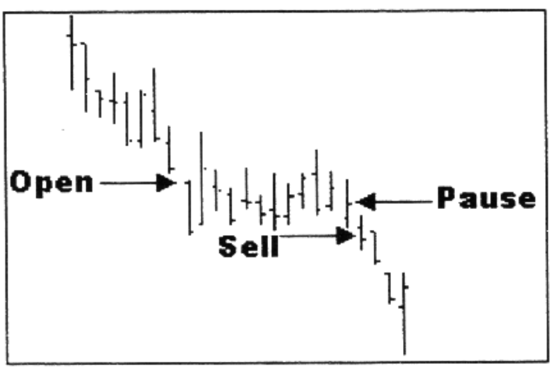
CONCRETE EXAMPLES

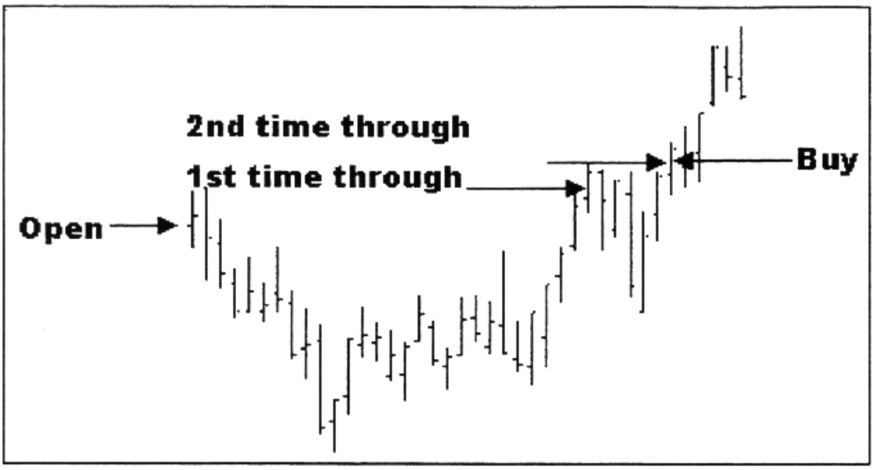
I am trading the breakout of congestion prior to one of my entry signals. What specifically am I looking for? What do those congestions look like? The answer will result in many successful trading opportunities. Watch carefully.

A market gaps and looks like this:



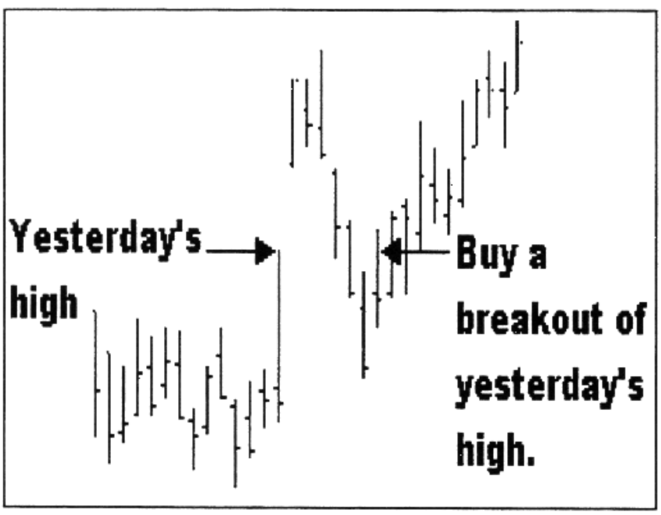
This is the intraday signal. Wait for the gap open. Wait for the pause (below) or retracement back to the level of congestion (above) closest to the high (low). Then buy (sell) the extreme of the opening range.
This is the intraday signal.





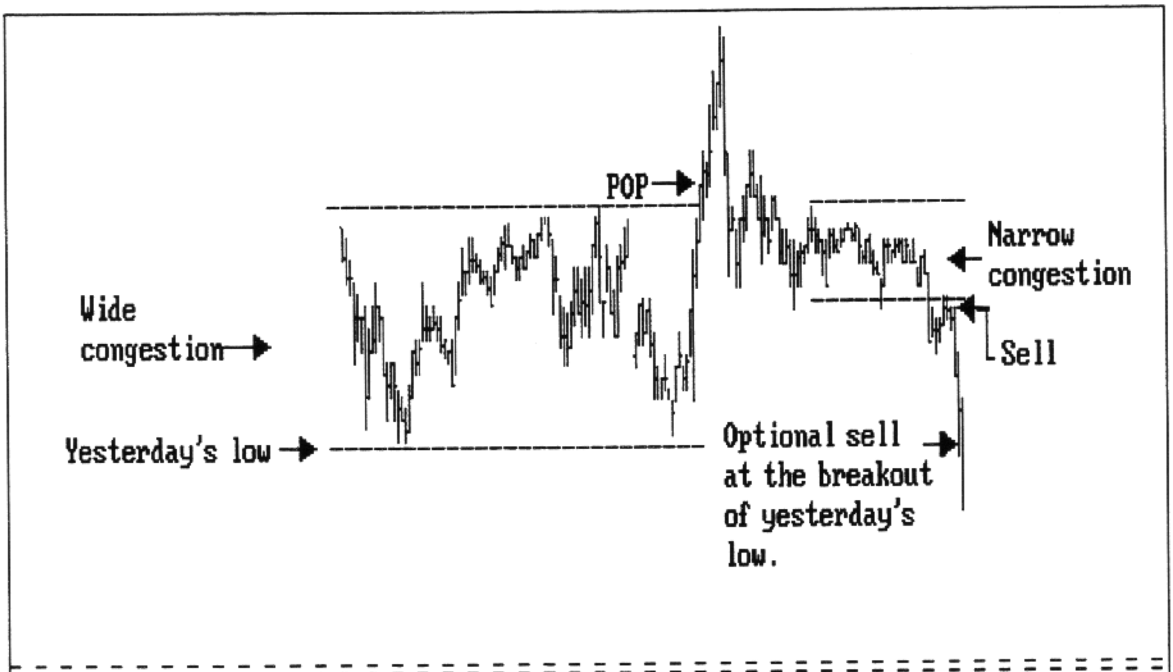
You will see the one above many times.

This next one is a valid entry for any major or intermediate signal.



Note the retracement to yesterday's congestion. There were not enough ticks available between yesterday's congestion and yesterday's high to warrant an entry prior to a breakout of yesterday's high, today.

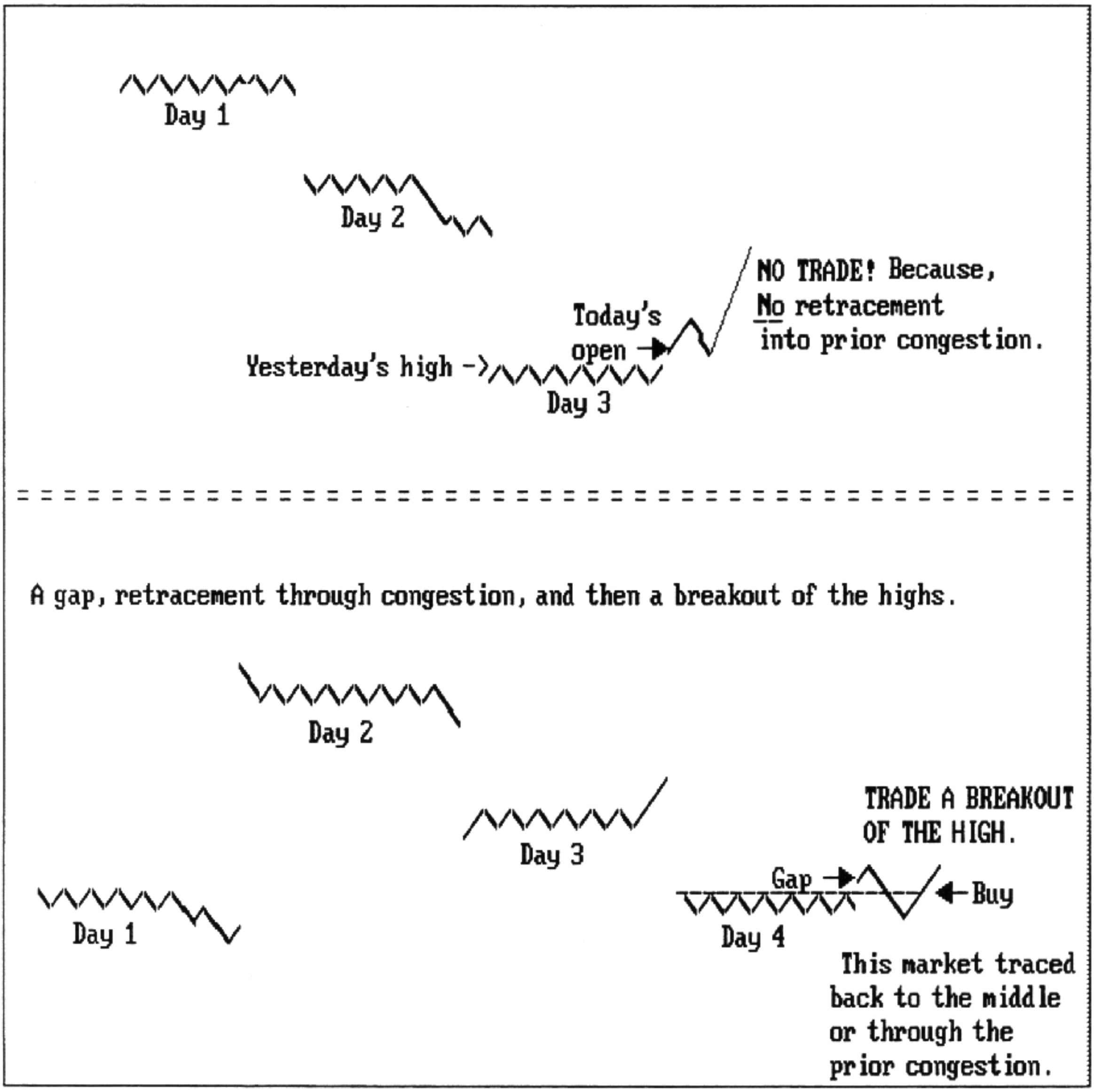
This is one of the best trades I can make: A wide congestion followed by a pop, followed by a narrow congestion. This type of signal is valid on any major or intermediate entry signal.



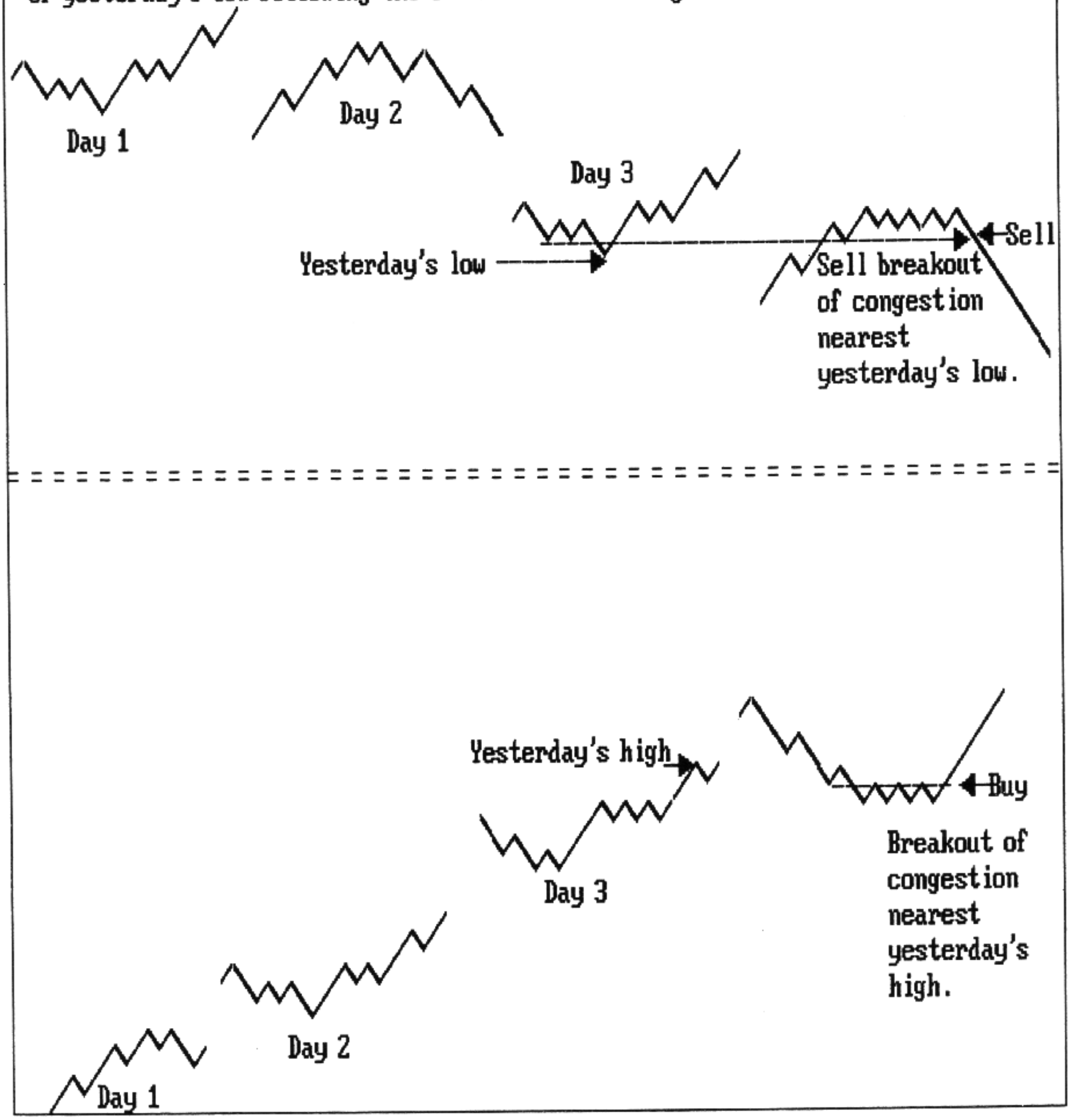
It wouldn't have made any difference as to the direction of the POP. It could have looked like this:

Here is a summary of patterns:

A gap above yesterday's high, but below one or more of the past three days' highs:



A gap, a retracement through the congestion nearest yesterday's low, and a breakout of the congestion. An entry could also be made on a take-out of yesterday's low following the breakout of the congestion nearest the low.



A gap, a retracement to the highs of the congestion nearest yesterday's high. Then a congestion today, and a breakout of today's congestion which is closer to yesterday's high than was yesterday's congestion. Trade the breakout of the higher congestion if the two congestions are equal in size from top to bottom. Otherwise trade the breakout of the tighter congestion.

When prices open at a new high above the last three days:

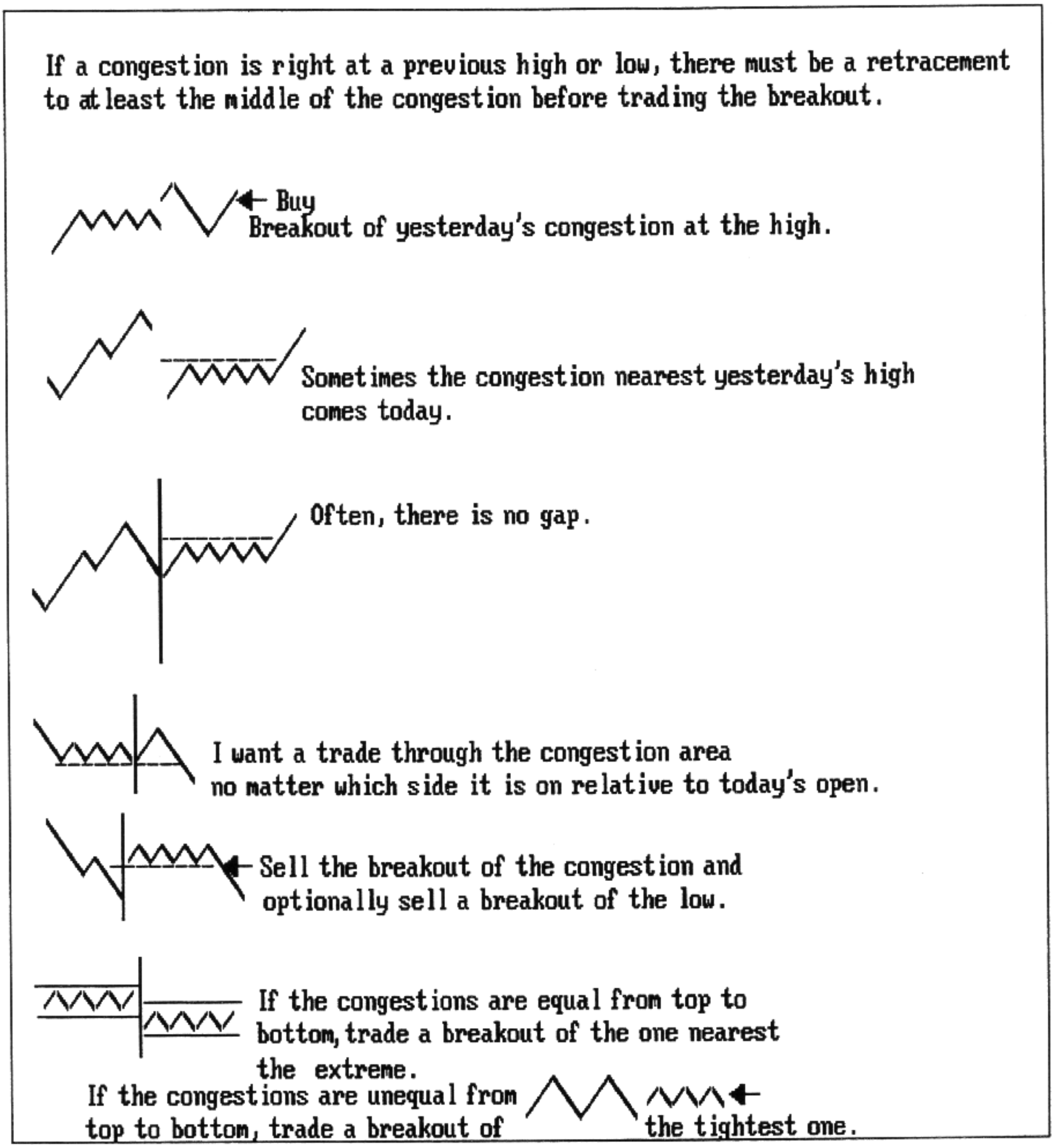
Gap open to a new high for the last three days. No retracement to any prior congestion of the last three days. NO TRADE!

Gap open to a new high for the last three days. Retracement to middle or bottom of any prior congestion of the last three days. OK TO TRADE!

Gap open to a new high for the last three days. Retracement through any congestion of the last three days with subsequent breakout back in the direction of the gap opening. OK TO TRADE!

Gap open to new high for the last three days. Retracement to middle, bottom, or through any congestion of the past three days. This followed by a congestion of equal height today. TRADE A BREAKOUT OF THE HIGHER OF THE TWO CONGESTIONS!

Do the reverse of all these when going short.



BASE ON BASE

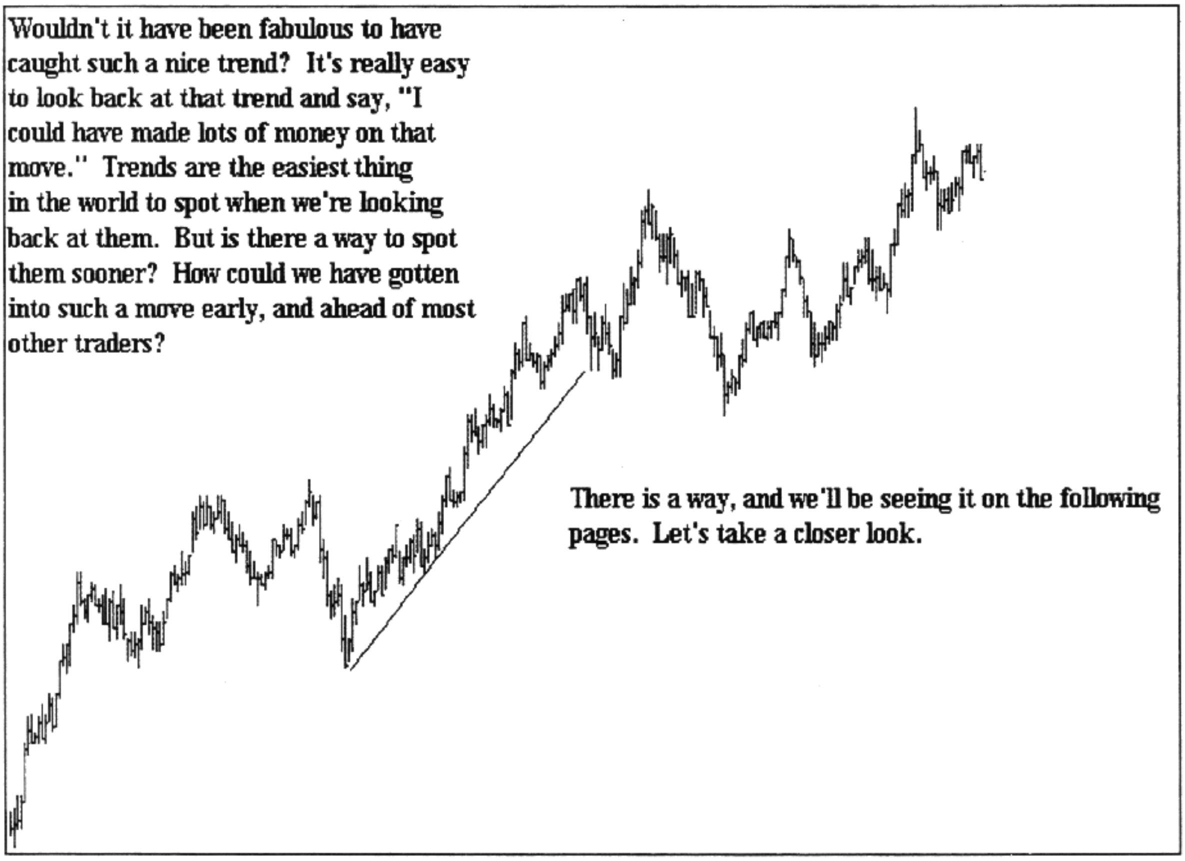
When there are two congestions of approximately equal size from top to bottom, we want to trade a breakout of the higher one when going long, and a breakout of the lower one when going short. This will allow us to avoid trading into an overhead resistance or underlying support area. However, if there are sufficient ticks separating the two congestion areas, it is OK to enter buy or sell orders with the anticipation of exiting when prices reach the second congestion area.

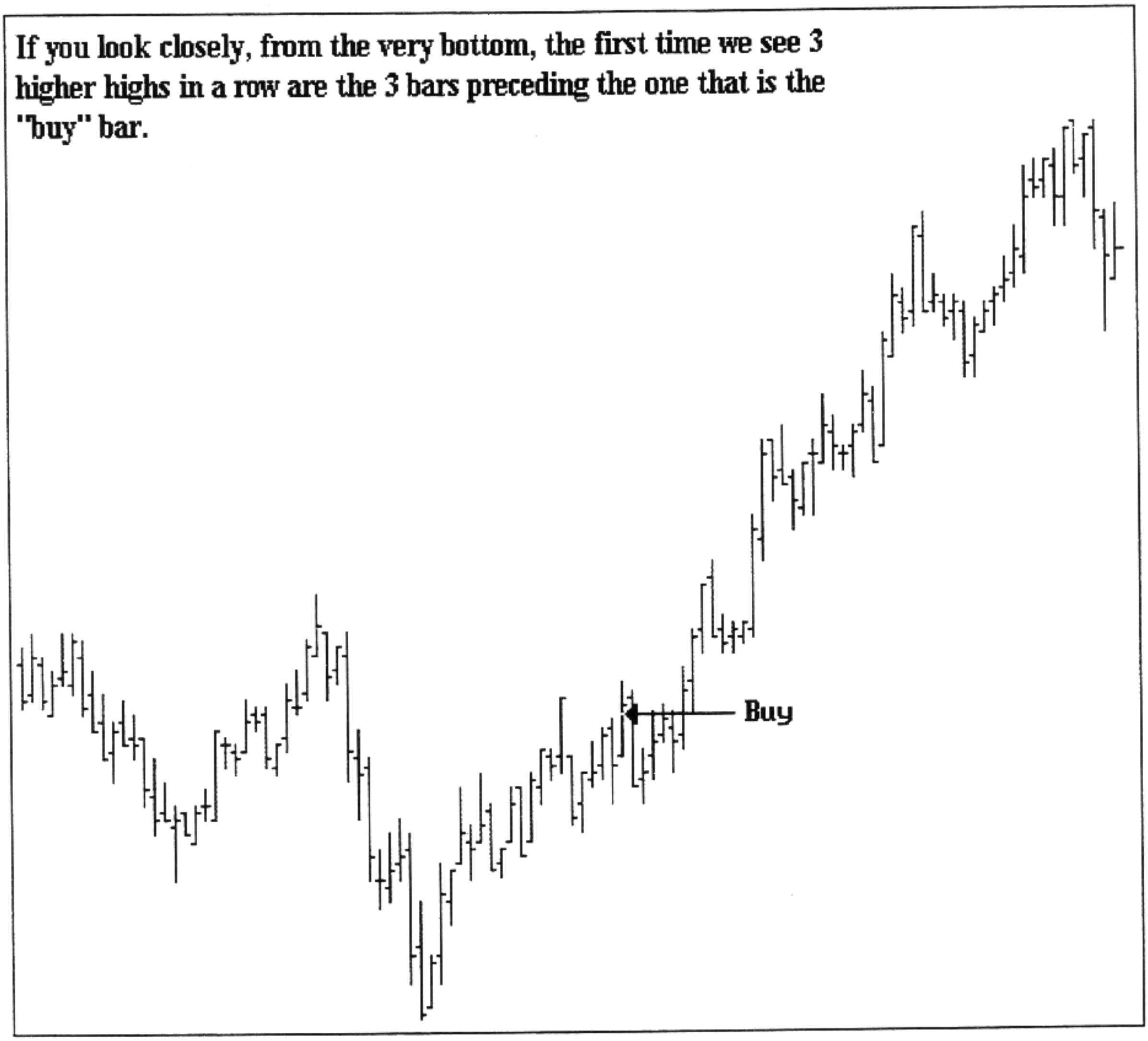
Chapter 23

TREND FINDING – 1

In finding the trend, we will begin with a theme. This chapter shows one way to find a trend in its infancy — just as it's being born. As the course progresses, we'll see variations of this theme, and build upon it. The variations exist in how we count the bars. The variations are either more or less conservative. We have started with what is the most conservative method here in this chapter. We will end, several chapters from now, with what is the least conservative method. The difference yields fewer (most conservative) or more (least conservative) trades. What I show will lead step by step into segment counting. Everything shown here is just as applicable to the daily or weekly chart as it is to the intraday chart.

Take a good look at the chart on this page.

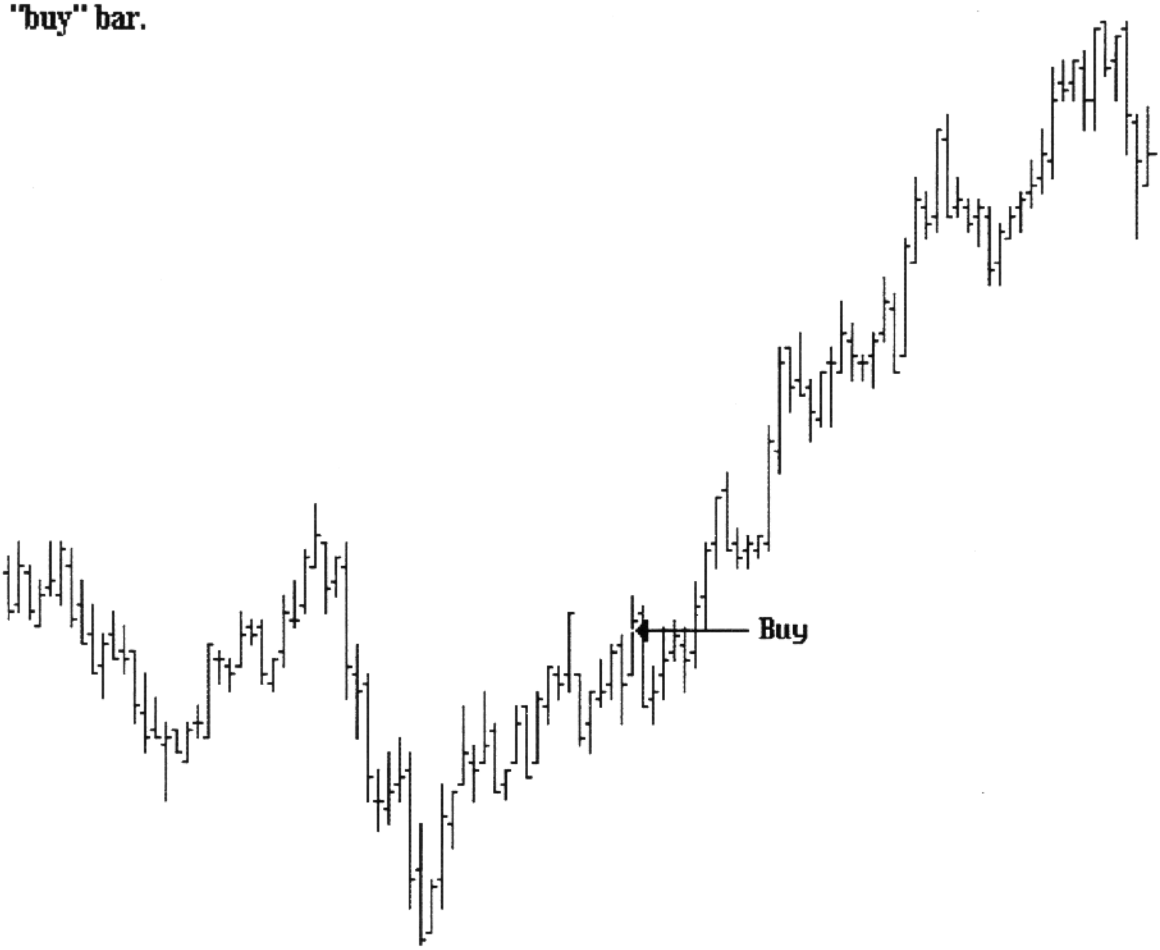




We'll begin with some very simple rules which will apply to an up move. (For down moves, the same rules will apply in reverse.) We must see three bars in a row of higher highs. When we see them, WE WILL ATTEMPT TO BUY A BREAKOUT OF THE THIRD HIGH PROVIDED THE MARKET CORRECTS ONE OR MORE OF THE BARS BY MAKING A LOWER LOW ONCE THREE HIGHS ARE IN PLACE. On the chart above, the bar just before the one that says "buy" makes both a higher high and a correction, by going lower than the bar that preceded it. Insofar as we can tell, the higher high was made before the lower low. Just a guess, but since it is closer to the open we assume this.

As we see on the chart, our first attempt would have failed. The bar after the "buy" bar makes a lower low, and by virtue of our rules, we must exit the trade as soon as we see that prices have violated a low when prices are supposed to be moving up.

If you look closely, from the very bottom, the first time we see 3 higher highs in a row are the 3 bars preceding the one that is the "buy" bar.



Notice: The bar after the "buy" bar made a lower high. We've seen this before and would refer to the correction as having created a Ross Hook. However, **HERE WE ARE CONCENTRATING ON THE FACT OF THREE CONSECUTIVE HIGHER HIGHS FOLLOWED BY A CORRECTION.**

If the "buy" is taken, we end up with a losing trade because the next bar makes a lower low. No matter, our next attempt at entering the market would be to enter at a price that is one tick above the "buy" bar because the buy bar has become a Ross Hook.

If we are filled there, we will cover costs and take a small profit as soon as we can by selling off part of our position.

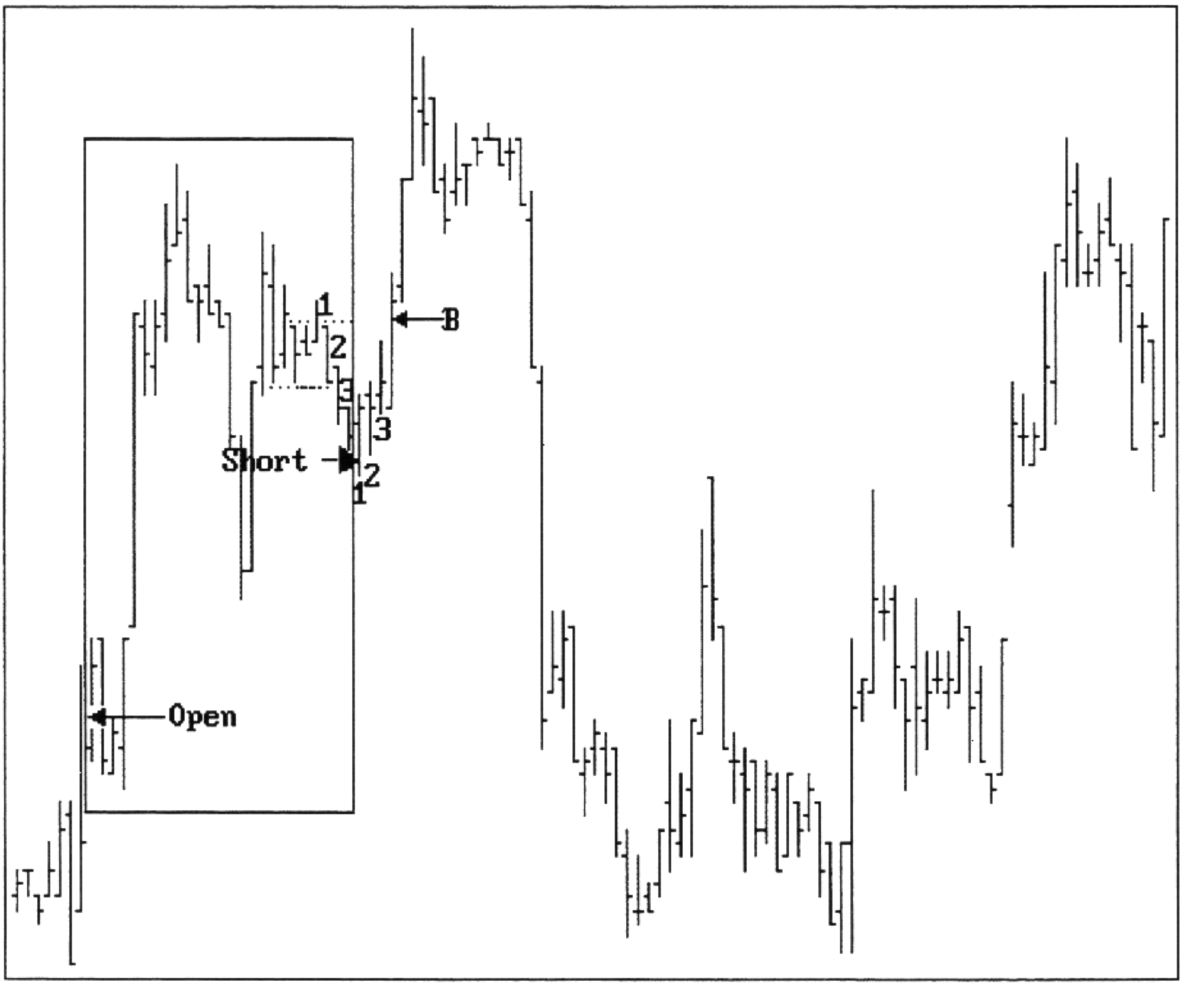
Notice that the trend continued long after any cost covering. Later, I will show two of the best ways to hang onto that trend once we are profitable.

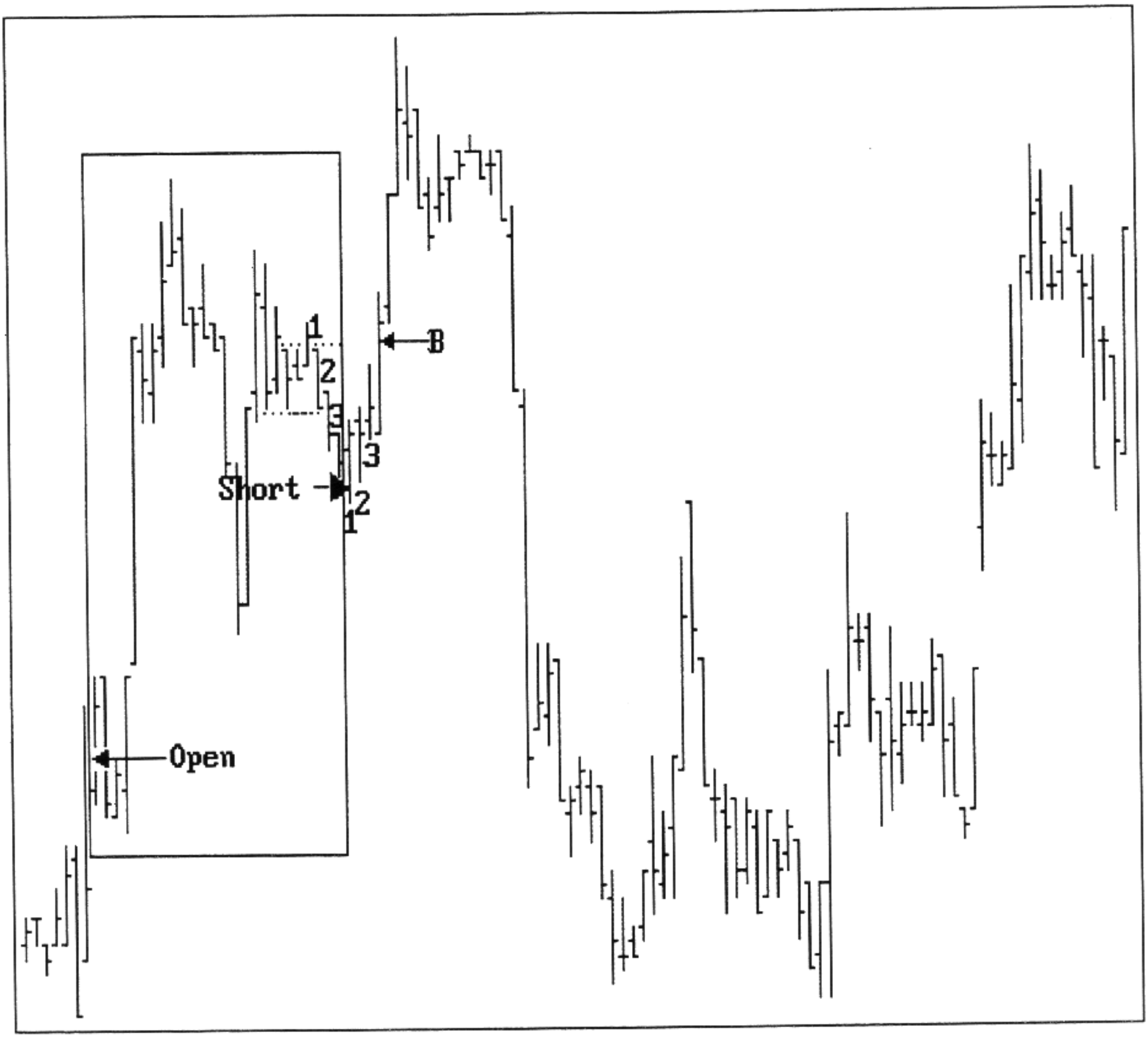
I want to point out that just because we would have to exit the trade on our first entry attempt, we do not walk away with our tail between our legs like some whipped dog. We "stay in the water" until the trend develops to the point where we could make money. Losing money is part of trading. We have no way of knowing where the trade will be over until we see that we have to exit. The very same principles would have applied had this been a daily chart, or a sixty minute chart, or a fifteen minute chart.

Chapter 24

Trend finding - 2

In this chapter we will see the simple count method in action in conjunction with The Law of Charts (TLOC) signals. What we review here is a typical series of trades. Nothing spectacular, just the normal way we expect to make money with our trading. Sometimes we will win, sometimes we will lose. Sometimes we won't make all that much. Perhaps if we see the "reality" of trading as it is actually done, we'll gain the correct perspective on trading. The chart we will be reviewing is in fifteen minute intervals. Although we will get some signals from the simple count, we will end up taking some trades based on signals from TLOC.

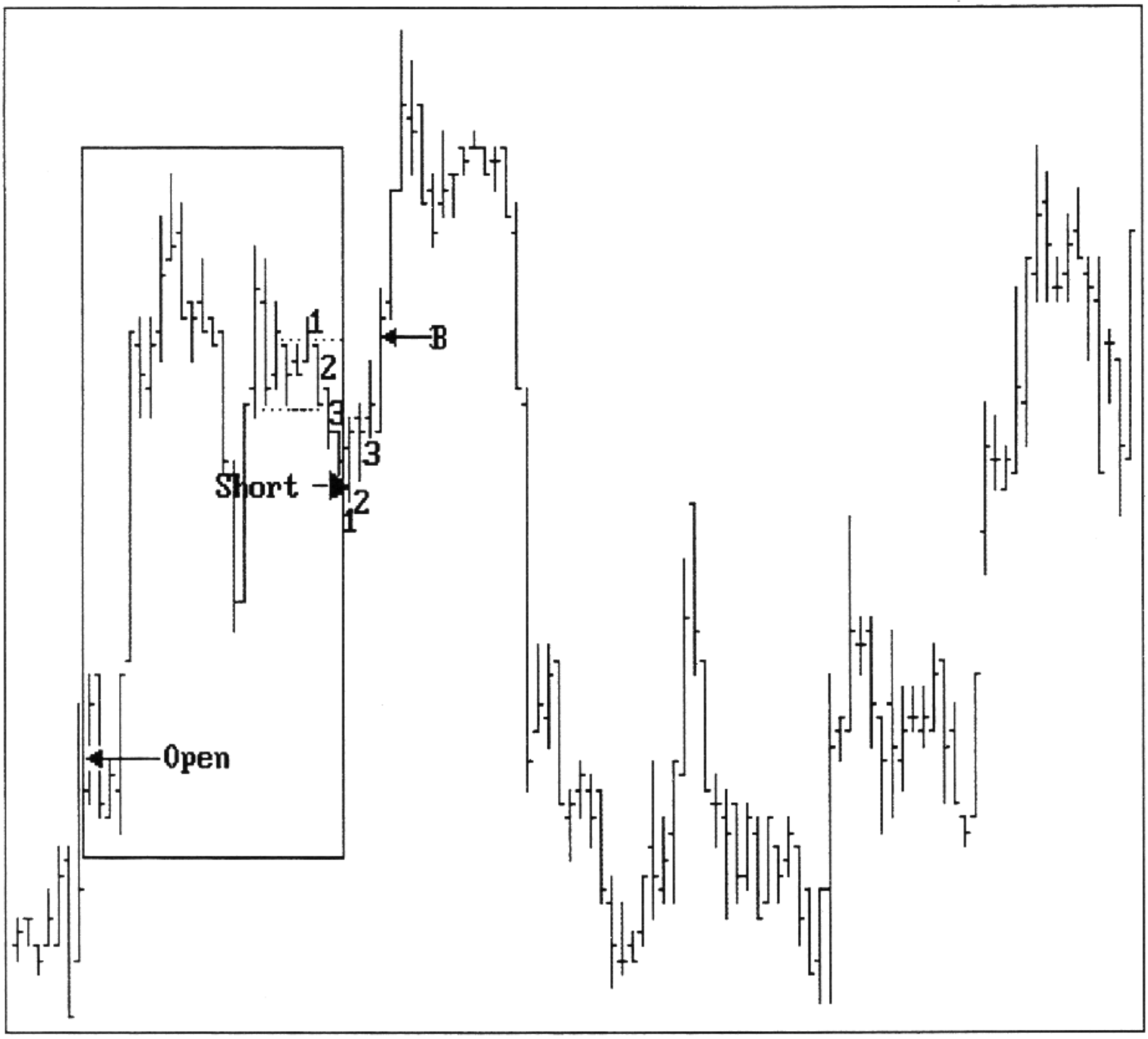




The first 15 minute bar is shown by the arrow at the lower left of the box. From that point until the bar at which I've shown the next arrow, we are never able to count three consecutive new highs, or three consecutive new lows. Therefore, there were no trades possible on that day.

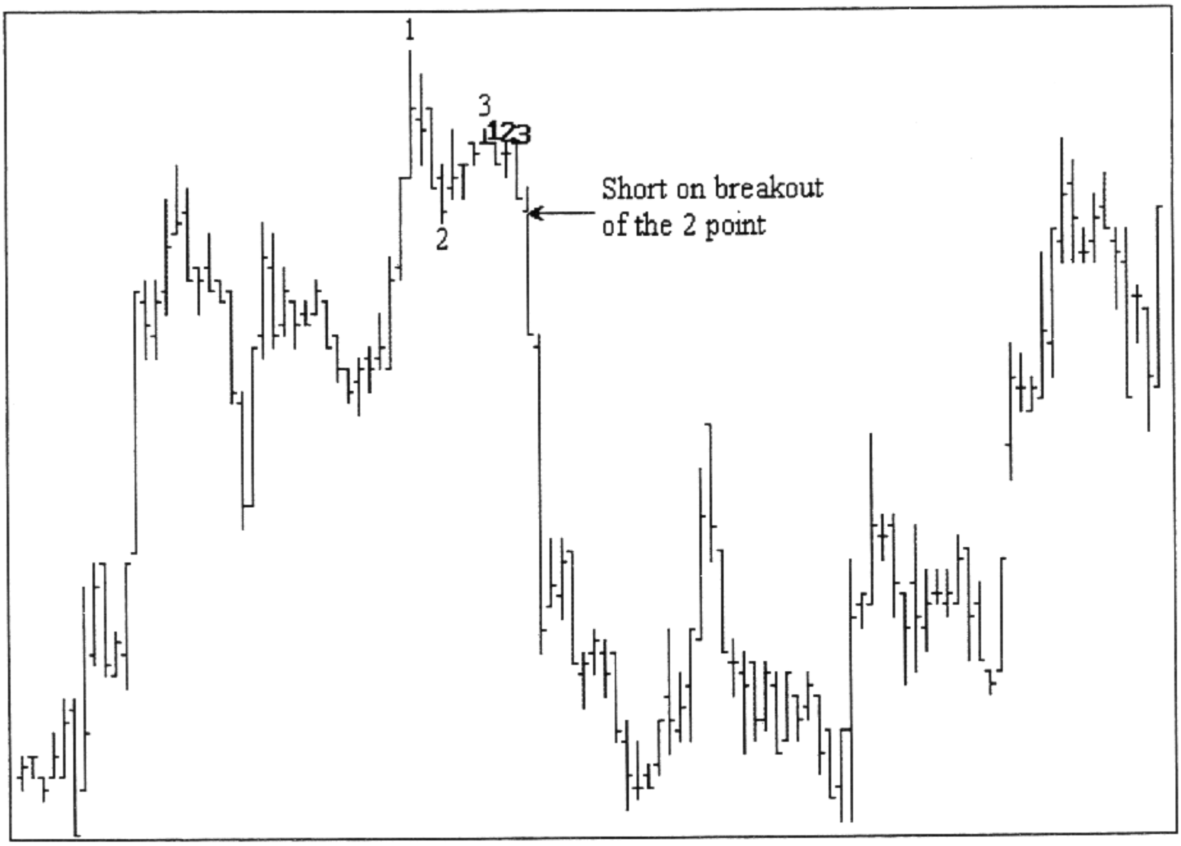
The next day, following our rules, we would go short after three consecutive new lows (those are the first set of bars numbered 1,2, and 3. At the fourth bar, we sell a breakout of the low of the third bar (Short arrow).

We see that the bar at which we go short ends up a reversal bar (open lower, close higher). Prices go almost immediately against us closing one tick above the high of the previous bar. According to our trading rules we must exit the trade, but can also begin to count the bars as they move up. We number the reversal bar up as bar 1. Then follows a bar labeled 2, which makes a higher low and a higher high. That causes us to have a Ross Hook on the second bar 1. In the event prices correct and then move down again, we would attempt to enter on or before the Ross Hook is taken out. Following bar 2 is the bar I've labeled as 3. It, too, makes a higher high. However, we must wait for a correcting bar (a bar making a lower high) before we can enter based on the simple bar count method. If you look closely, we do have an entry opportunity based on TLOCs, and that is a breakout of the congestion prior to prices taking out yesterday's high (that congestion is a Ledge — dotted lines). I've labeled the buy point as B.



Obviously, our second trade would have made money, and we would have exited based on a lower low being made on the second bar after the high of the day was made. The high of the day is the first #1 point.

Our next trading opportunity comes when we get confirmation from the simple count in conjunction with a breakout of a 1-2-3 high formation, and are able to go short on the breakout of the #2 point of the 1-2-3 high. I've shown the simple count and the 1-2-3 count on the chart. The 1-2-3 is from TLOC, shown in lighter print. The darker print is the simple count based on three consecutive lower highs.

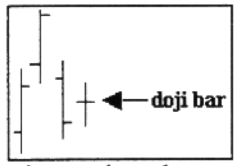


This is the second time that the simple count has shown us what was about to happen to prices. Although we never got an entry from the simple count in and of itself, it certainly let us know what was about to happen. For us to have used the simple count as an entry signal, our rule says there must first be a correction. In this instance, that correction would have been a violation of the high of the price bar that has the 3 count. Prices dropped sharply and fast.

DOJI BARS

Before we finish this chapter, let's take a second look at a price bar that has always been important. Until Japanese Candlesticks came along, there was no special name for these bars. Since the introduction of Candlestick charting they have been called doji bars. This will be the last mention of Candlestick charting, because apart from the doji bar, I don't use it.

A doji occurs whenever the open and close of a price bar are equal, or very close to being equal (seen at point "D" in chart above). It doesn't matter where on the price bar the equality occurs. It can happen at or close to the high, at or close to the low, or anywhere in between. The main thing is that a doji has meaning. It is part of the way a market talks. Our job is to listen. A doji strongly indicates that a change of direction may be imminent. A doji interrupts a trend by showing hesitation. The market is not sure which way to go. This is especially true when the doji bar is an inside bar, not as high or as low as the bar that preceded it.



We've marked the doji on the chart with the letter "D" beneath it. Our usual reaction to a doji occurring in a trend is to move our exit point to just beyond the extreme of the doji bar.

Just for fun, take a look at all the other dojis that occurred on this chart, especially the ones that are inside bars. Can we agree that trend changes or congestions usually follow a doji bar?

If we had taken the short position shown two pages back ("short on breakout of the 2 point"), and still had some contracts left to liquidate, wouldn't it have been wise to have moved our exit point to 1 tick above the doji bar?

WE'VE JUST SEEN A VERY SIMPLE AND BASIC WAY TO TRADE. THE MAIN FEATURE OF THIS METHOD IS THE COUNTING OF THREE SUCCESSIVE NEW HIGHS OR LOWS SO THAT WE CAN TRADE A BREAKOUT OF THE EXTREME OF THE THIRD IN THE SUCCESSION, OR IN CONJUNCTION WITH A FORMATION FROM TLOC.

The simple count shows us early in the game what might happen next. In a sense, it shows us the trend while it is still in the birth canal. This is just one of many successful ways to trade. It's simply a matter of realizing how to fit the various parts together.

Now if you understand how parts do fit together, and if you've read this far, you are entitled to a reward. It is in the form of a trading strategy. To get it absolutely free, please send a self-addressed stamped envelope to the address shown at the front of the manual. You must include proof of purchase, the name of the manual (so I know which gift to send you), your name, address, telephone number, fax number, and email address if you have one. I know you will be pleasantly surprised.

From here on, dojis will become important in much of the trading we review. We will also delve more deeply into reversal bars. Reversal bars, as we will learn about them, are not the same as what others call a "key" reversal. While all key reversals may be reversal bars, all reversal bars are not "key" reversals.

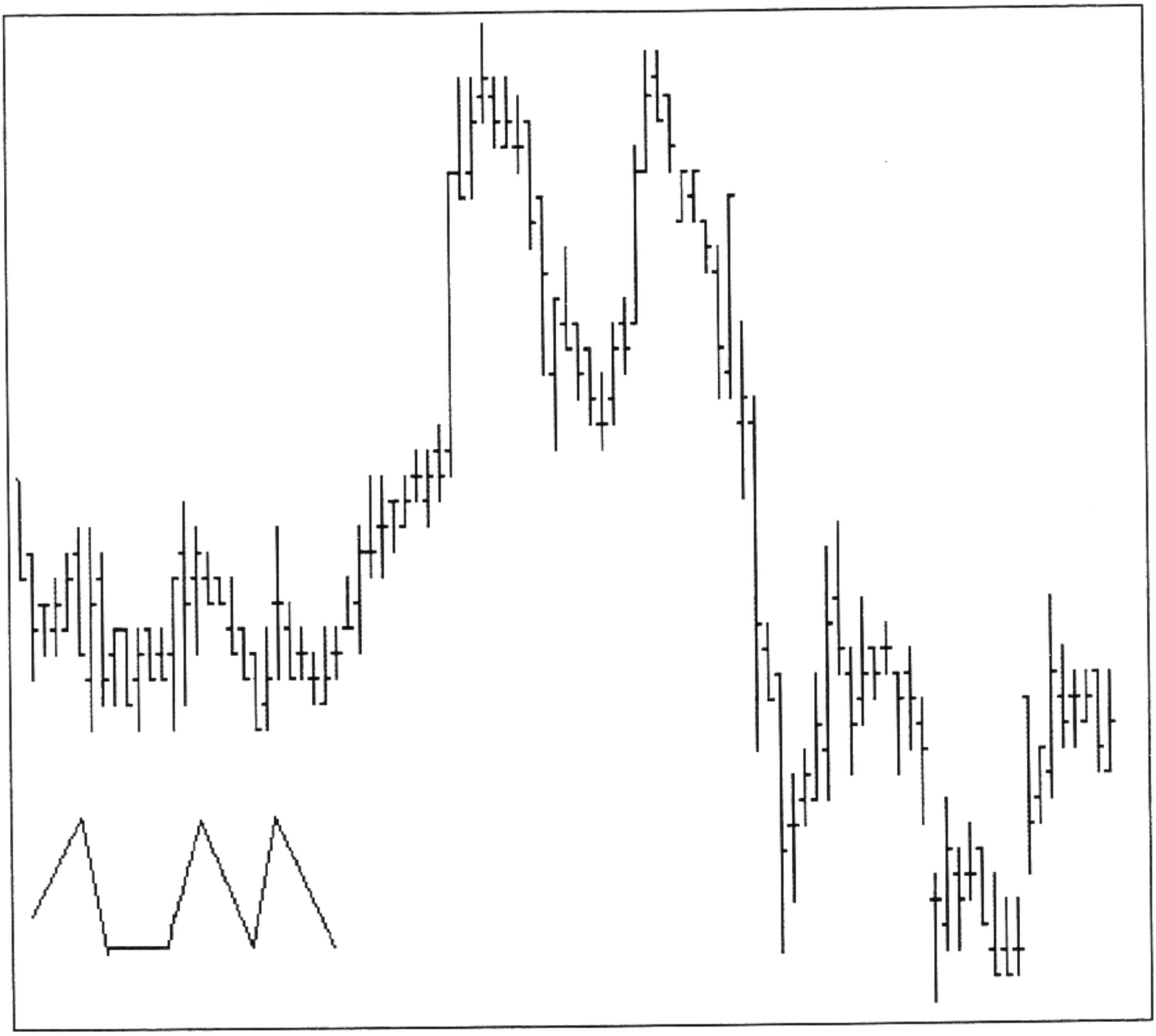
Chapter 25

INTERESTING BARS AND FORMATIONS

In this chapter, we will learn about reversal bars, sagging highs and rising lows, and how to count segments in order to find a trend in its earliest stages and to obtain additional opportunities. We'll be seeing them in conjunction with trading a thirty minute chart. However, they work just as well on any intraday chart, a daily chart, or a monthly chart. The truth is always the truth. The only difference is in the adaptation of money, risk, and trade management.

When this next series of trades is complete, along with the dojis and reversal bars, it might be profitable to go back over all the trades we've looked at to this point in order to see how differently they might come out.

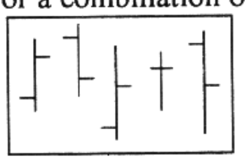
It's time now to look at some thirty minute intraday trading. Let's agree to really tear into this chart, because it is vital to show how to dissect market anatomy. There will be some valuable lessons discussed as we go through the next series of trades, and what we learn here can be applied to virtually any time frame. We'll start with a down move of two successive days into what subsequently becomes a congestion area. How can we know that this is a congestion area?



There are a number of ways, and this is a good time to point out at least two of them.

First, We'll count the swings. Two swings, consisting of four legs, always constitute congestion. They look like this: /\/\ or \/\/. I marked them on the chart. In this case, there were three swings during the congestion.

Here's another wonderful way to know when a market is in congestion. It utilizes the concept of a series of reversal bars, a series of dojis or a combination of both.

What we watch for looks like this: 

Take a close look at the boxed-off congestion area on this page.

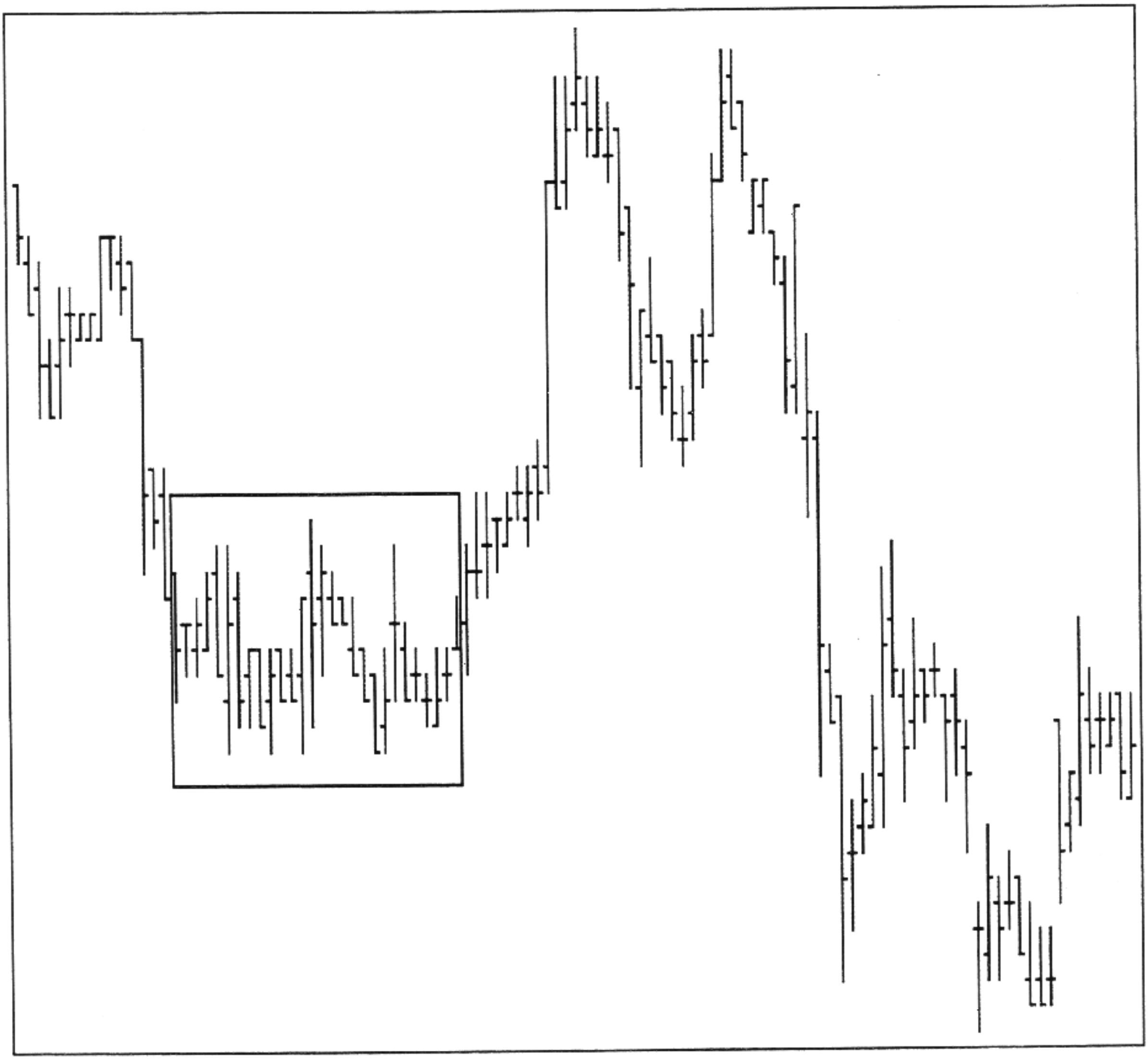
Notice the alternation of "open high-close low", "open low-close high" bars during the congestion period. Intermixed, but more often near either extreme of the congestion area, are dojis. The alternation of bars within a narrow range from top to bottom are a sure sign of congestion.

Equally as important as knowing when prices are in congestion, is knowing when they are about to break out of congestion and begin trending.

Anyone can look back and see that a market has trended, or is now in a trend. But it's a lot harder to spot when prices are going to start trending.

We've already seen how the beginning of a trend can be surmised by respectively buying or selling the breakout of the extreme of a third successive higher high, or a third successive lower low. That was a simple counting method. However, a close look at the chart on this page will quickly reveal that within the boxed area, no such opportunity occurred.

How then can it be known that prices might be about to break out?



How could we have entered this market before everyone else, and spotted the very beginning of a move that eventually took out the congestion to the upside?

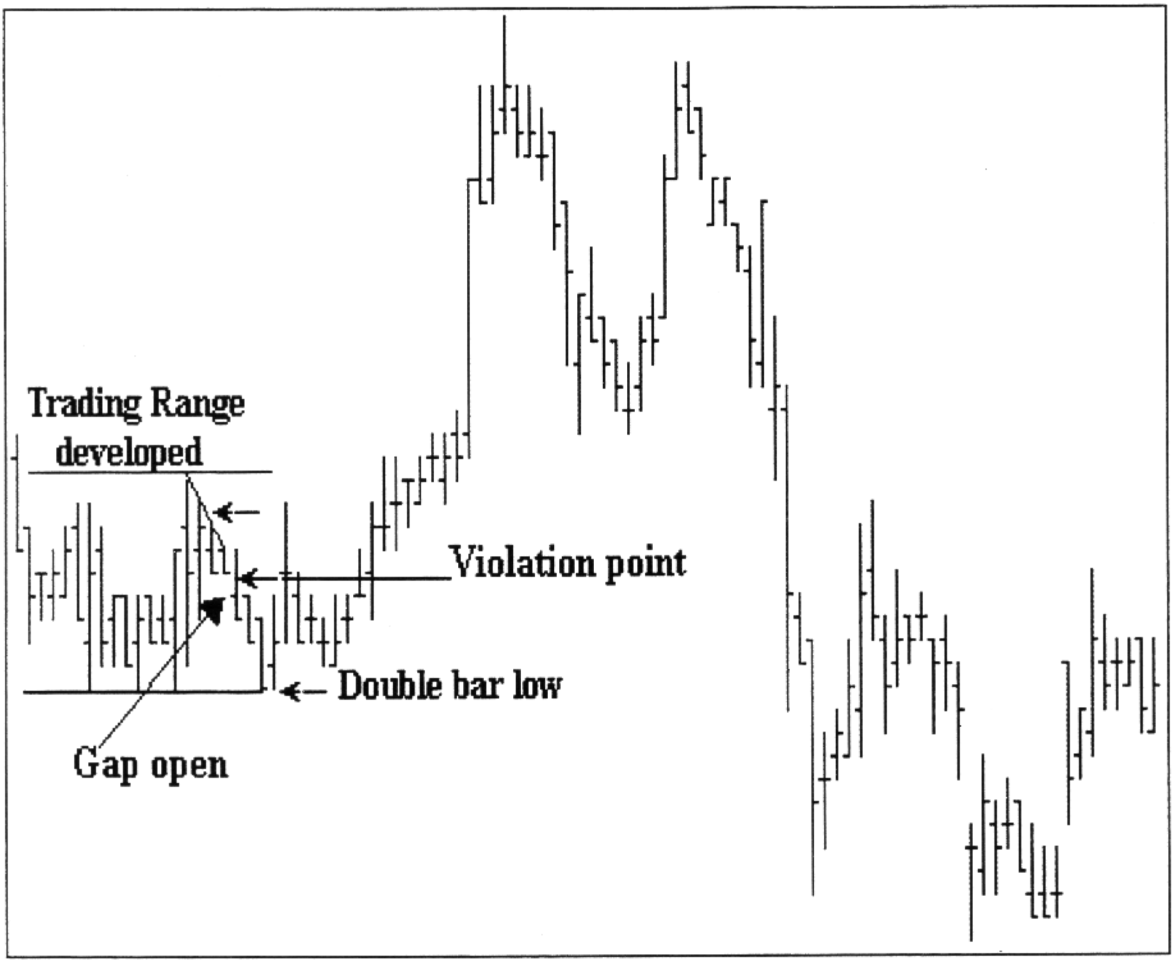
Markets speak. To those who chart, they speak a graphic language. I suggest making part of your life's work the ability to understand what the markets are telling you. By learning to understand the way a market speaks, you can better communicate and get in step with the market. You must learn to patiently and carefully listen to the markets. Let's take a look at how to read the graphic language that one market was speaking at a couple of very important points in time.

First we'll look at how we might determine that prices might break to the downside. Then we'll see how we might determine that prices might break to the upside – all from the one congestion area. The arrows, in case you are wondering, point to three successive sagging highs followed by an entry signal to be explained next.

The upper arrow shows the three successive sagging highs. The lower arrow shows the bar on which we might have shorted this market.

But why? Sagging highs, that's why! Whenever price bars make lower highs for three successive bars, prices might be telling us they are about to move lower, perhaps even trend lower.

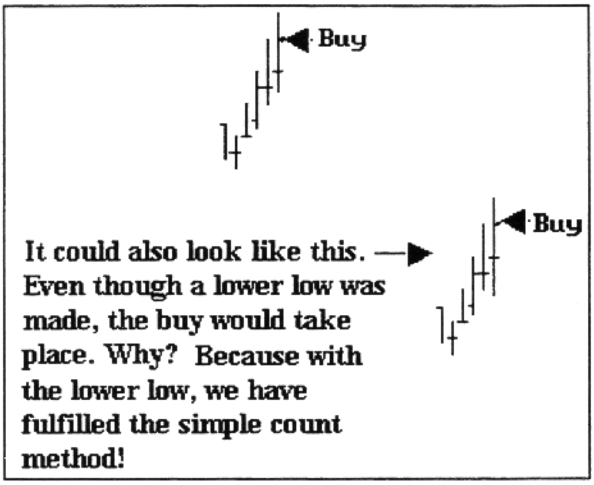
NOTICE THAT WITH SAGGING HIGHS, IT IS NOT NECESSARY FOR LOWS TO GO LOWER AS IT WAS WHEN WE DID THE SIMPLE COUNT. EACH LOWER HIGH COUNTS ONE. THREE SUCCESSIVE LOWER HIGHS YIELDS AN ENTRY SIGNAL WHEN THE LOW OF THE BAR THAT MADE THE THIRD LOWER HIGH IS VIOLATED. THE REVERSE OF ALL THIS IS TRUE FOR COUNTING RISING LOWS. IN THAT CASE, WE COUNT EACH SUCCESSIVE HIGHER LOW AND PLAN ON GOING LONG WHEN THE HIGH OF THE BAR MAKING THE THIRD HIGHER LOW IS VIOLATED.



Granted, the move down was not earth shaking. In fact, because the bar that violated the low of the third sagging high opened with a gap, despite the fact that within the time period it moved higher, we might have passed this trade opportunity entirely. I say “might have.” It’s a matter of choice as to whether or not to take the trade on the second violation of the low of the price bar preceding the gap open bar. Prices did move back above the entry point during the thirty minute interval. The gap open and the second violation occur on the same price bar. Certainly if the trade had been entered on the second violation (the first violation being the gap open), a small profit could have been made down to the point where the second low bar of a double low violated the high of the first bar of the double low. Note that the two bars created a double low which in itself constituted a possible entry point ahead of a possible downside breakout from the trading range. By the time the double low occurred, the trading range was clearly evident.

With sagging highs, we’re looking for three successive lower highs. If we find them, we can choose to sell a breakout of the low of the bar that made the third successive lower high.

The opposite of sagging highs are rising lows. If we were to go long, we would buy the high of the bar that made the third successive higher low. That situation might look like this.



However, none of the techniques we've previously examined would have solved the next problem — that of getting a jump on the breakout to the upside that came when prices failed to break out at the double low we've been looking at.

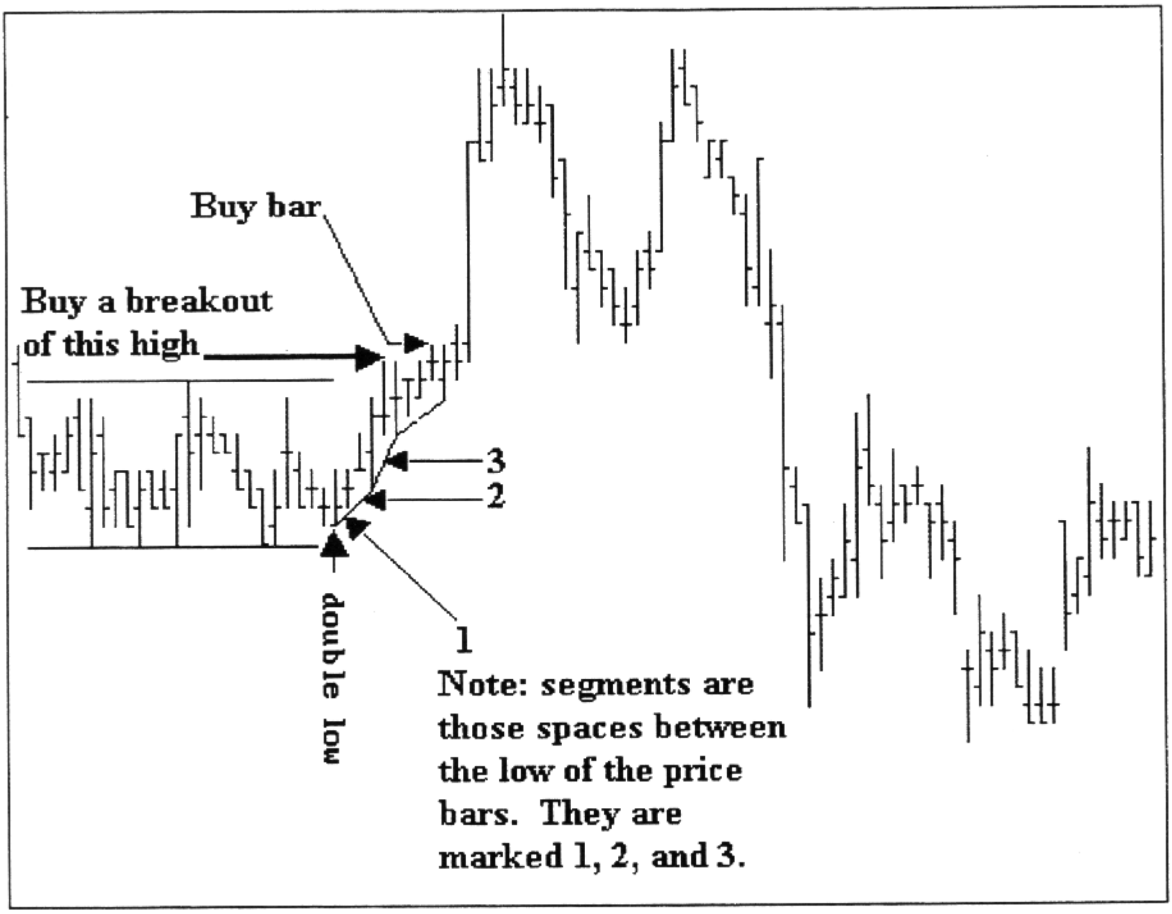
We need yet another technique, and it's called segment counting.

SEGMENT COUNTING

Here's a technique that will help you throughout your trading career. It involves connecting corrections and double bars.

This technique is a bit more difficult to perceive, but over the years it has proved to be one of the best ways to spot a move before most people even suspect it is going to happen. As we view this technique, we want to realize a ***very*** important concept which is applicable not only to segment counting, but also to the simple count method, and the sagging highs/rising lows method:

WHEN ANY TWO OF THESE METHODS ARE OCCURRING SIMULTANEOUSLY, THE SIGNAL BECOMES CONSIDERABLY STRONGER THAN WHEN ANY ONE OF THEM OCCURS ALONE. WHEN ANY ONE OF THE METHODS IS COMBINED WITH OR CLOSELY PRECEDES A SIGNAL FROM THE LAW OF CHARTS (TLOC), WE HAVE A TREMENDOUSLY STRONG INDICATION THAT A SIZABLE MOVE IS JUST AHEAD.



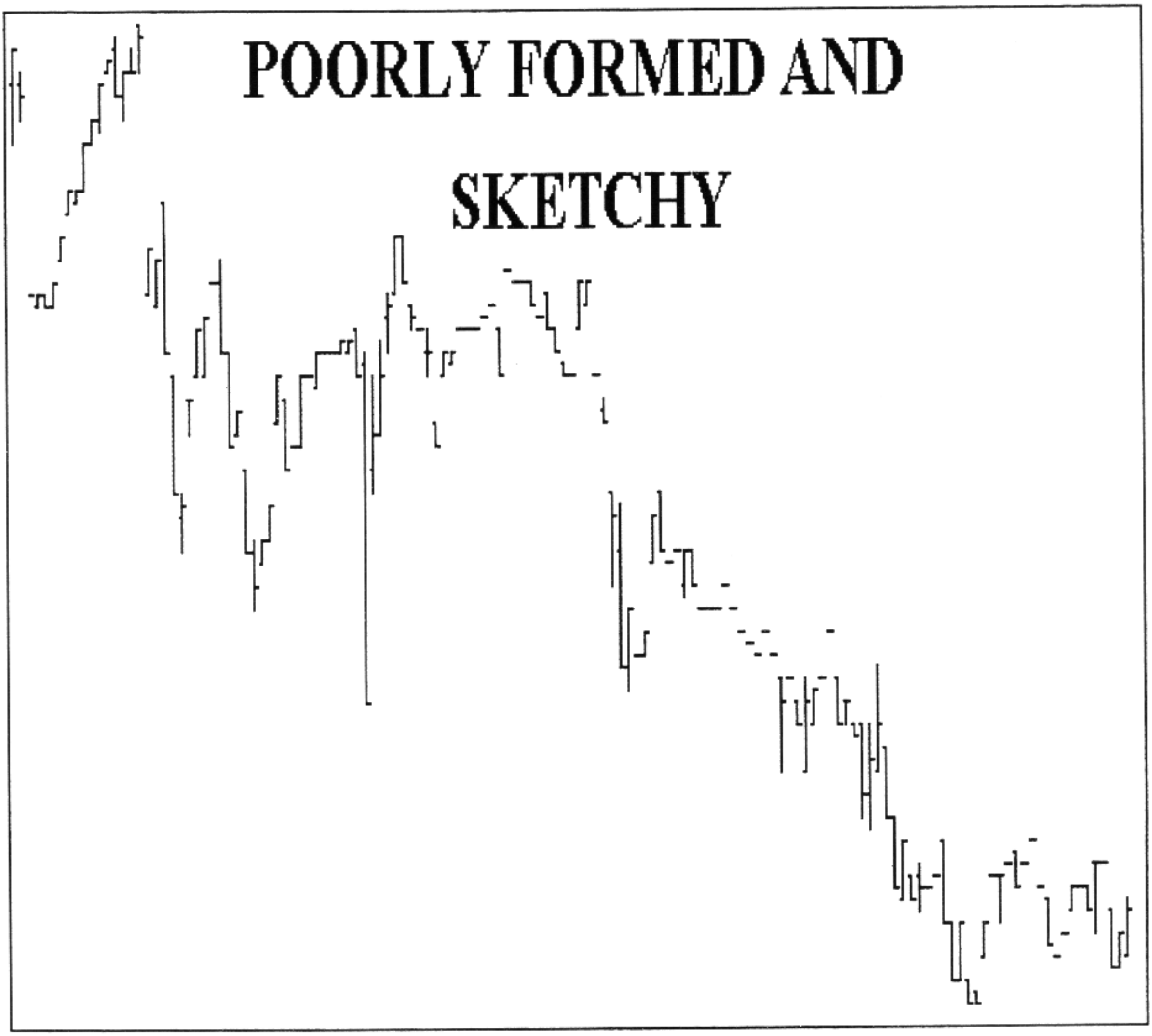
Take a close look at how we've connected the lows on the chart: **THE NUMBERED SEGMENTS ARE POSITIONED BETWEEN THE LOWS.**

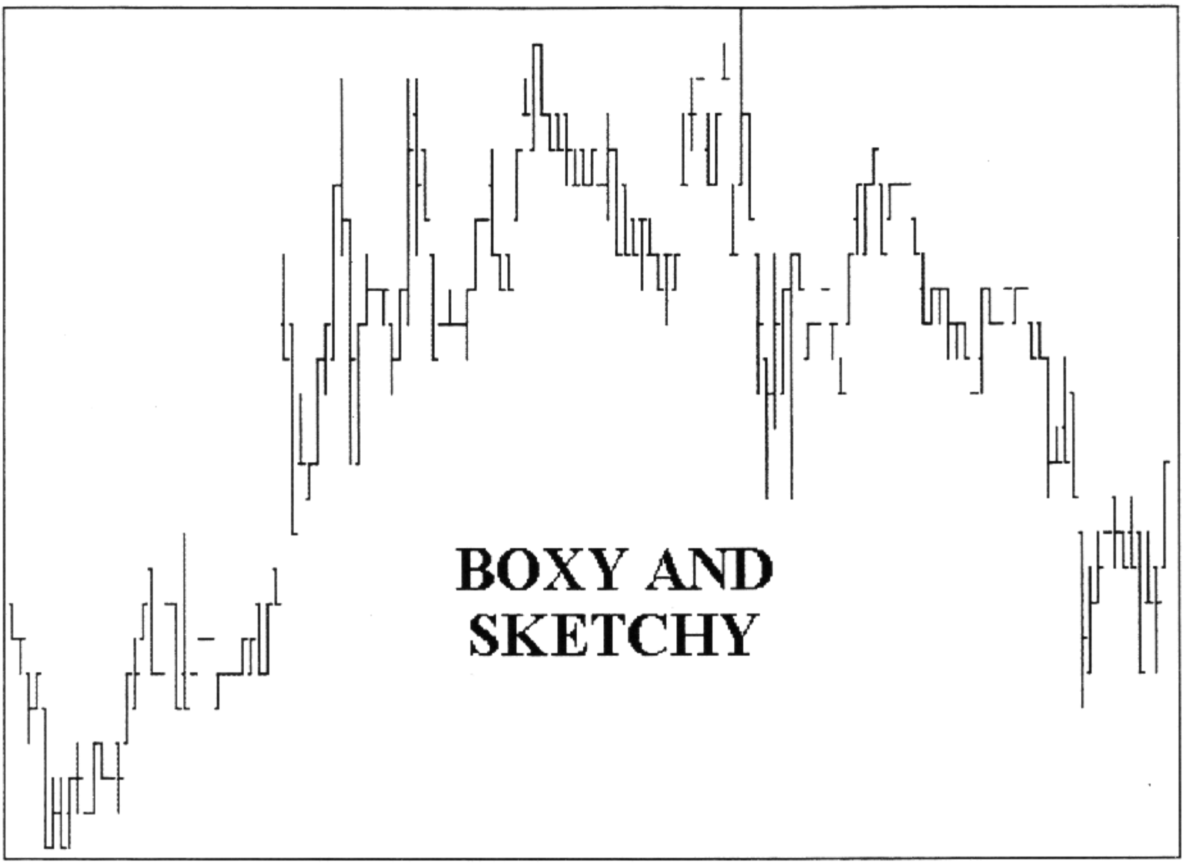
We've connected a low to a second low. We've connected the second low to a correction low, and the correction low to a double low.

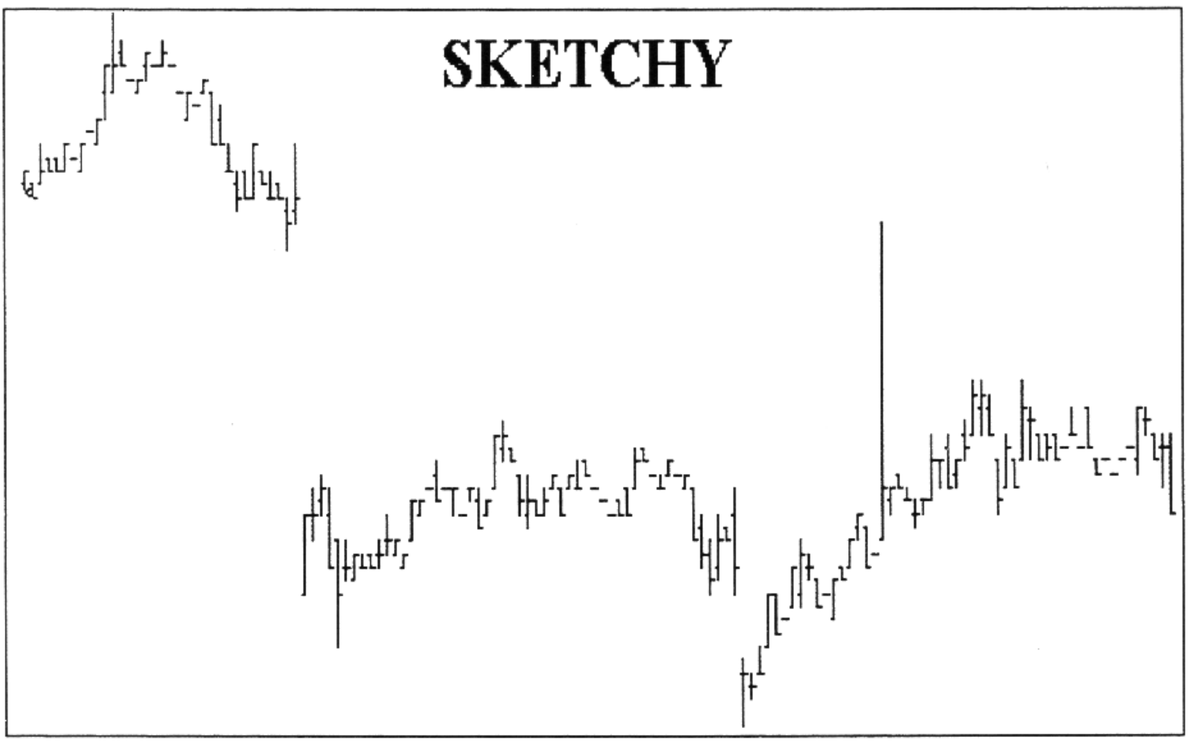
We will buy a breakout of the high of the bar whose low made the third segment.

This technique will work in any market, in any time frame, so long as you are seeing something that has well formed patterns.

We'll temporarily interrupt our close examination of this chart in order to see what is meant by <u>not</u> well formed tradable patterns. All of the following charts have formations that are too <u>FLAT</u>, too <u>BOXY</u>, or too <u>SKETCHY</u>.

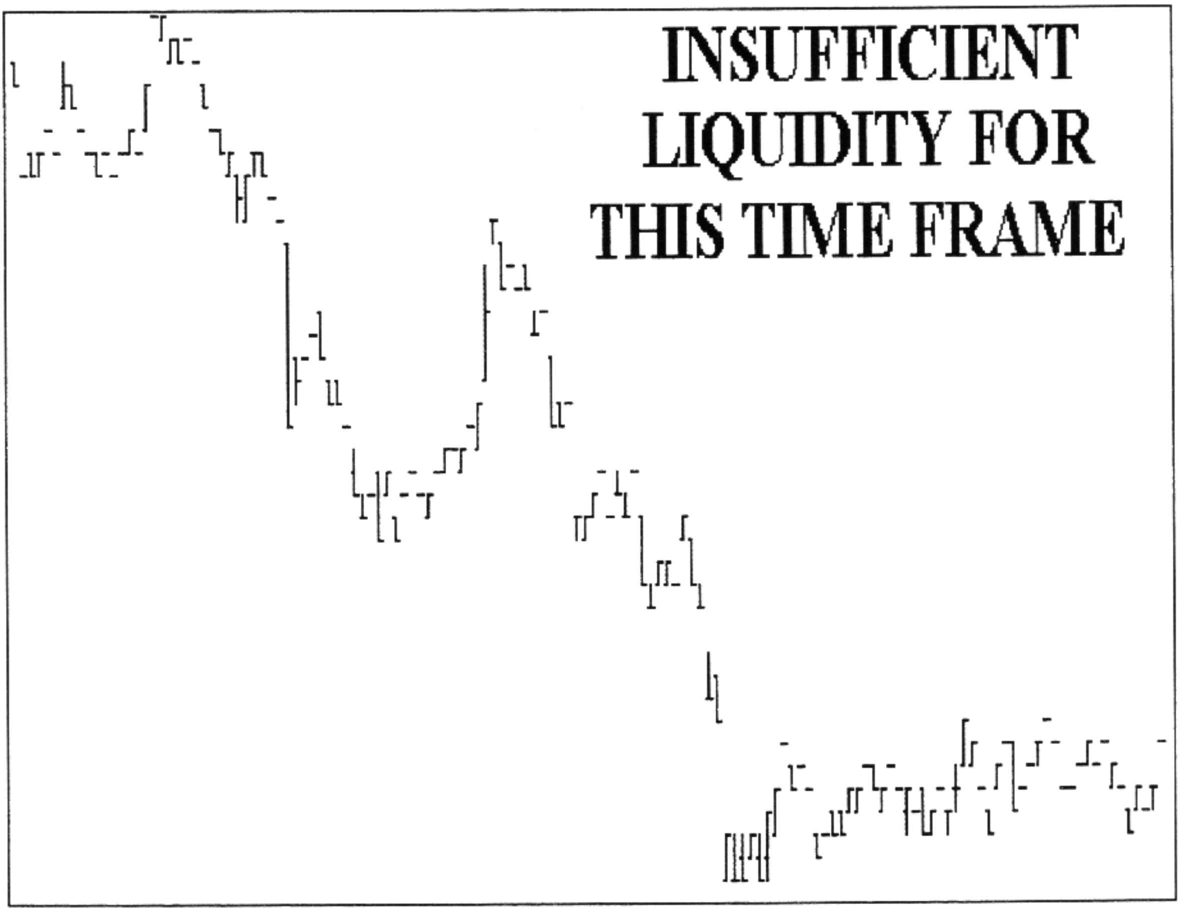

POORLY FORMED AND
SKETCHY



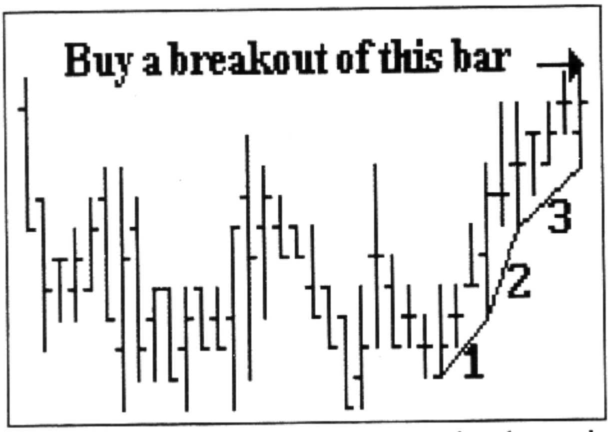


Many markets need a thirty minute or greater chart in order to see tradable formations. Others need 60-120 minutes to present decent tradable formations. However, very liquid tradable markets will show good formations on five minute charts.

The time frame to choose is the one in which you can see well formed tradable patterns. When a market is very liquid, unless it is trading very slowly, a shorter time frame can generally be used. When a market is less liquid, regardless of how fast or slow it is trading, a longer time frame should be used.

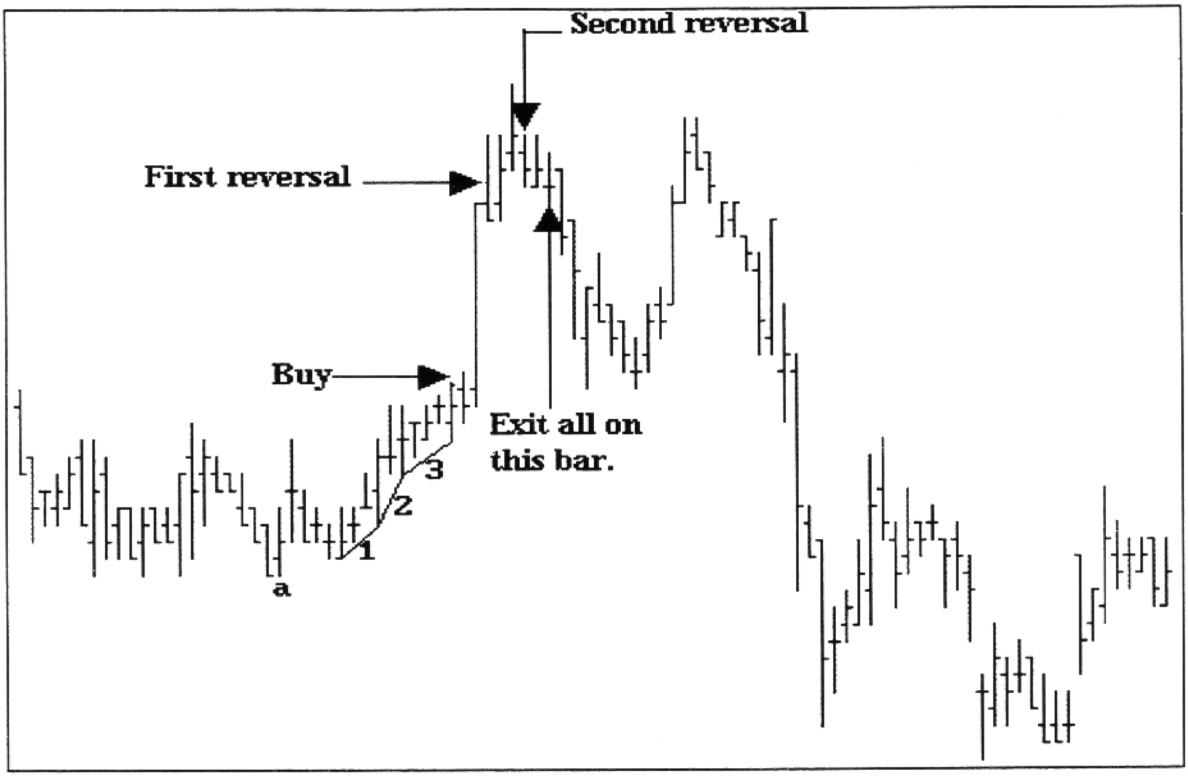


We can now resume our examination of a 30 minute chart. We left off where prices were about to breakout to the upside of a Trading Range. We had a brief look at numbering segments. Each time prices made a lower low than any previous bar since we began counting segments, we connect our last segment to the bar making the new low. If a bar ever goes lower than the original low, we can no longer count segments in the same direction.



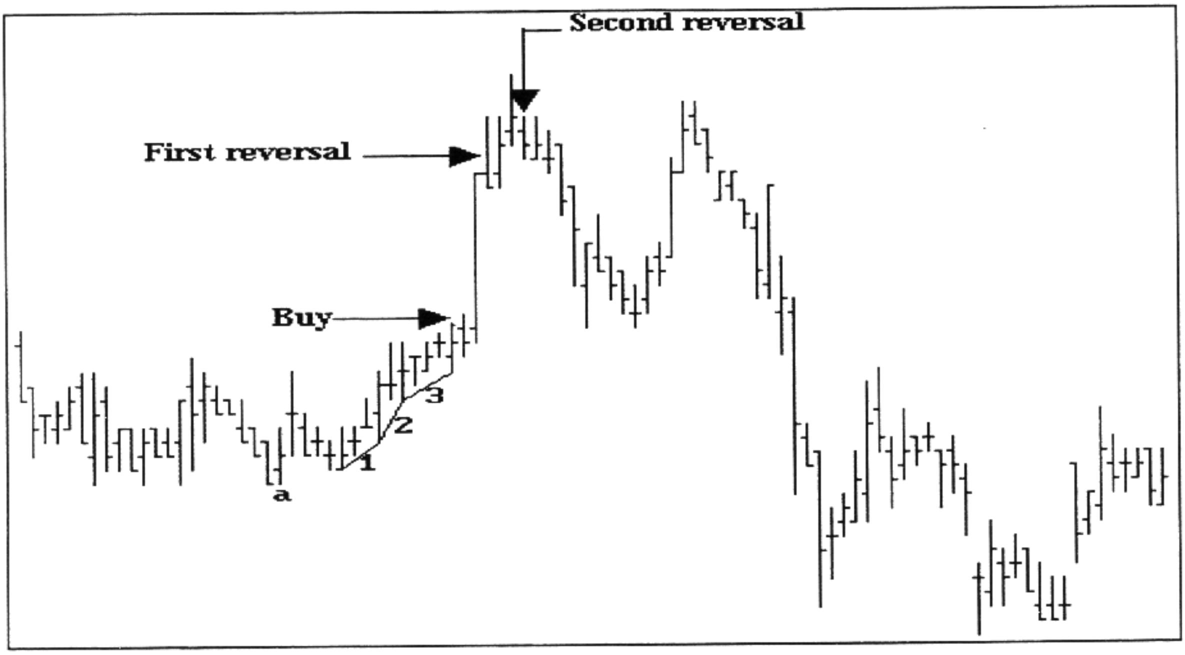
We want to get long based upon a breakout of the high of the price bar whose low completed the third segment drawn on the chart. The third segment was completed because of the correction low.

Notice that this segment is occurring in conjunction with the breakout of an intraday Trading Range. Prices have already violated a minor triple high, and if they were to take out the high of the bar making the third segment, it would constitute a take out of the double high of the last two bars. If prices were to do that, the move might be explosive.



There are two ways to handle exiting this trade. One would be to cover costs and take some profits quickly. Begin taking additional profits as soon as the second reversal bar is in place, and then hold all remaining contracts at breakeven or better until we have some reason to believe the move is over and prices are going against us, or we need to get out because it is near the end of trading. This is the "***continuation***" method discussed previously. The other is the "***violation*** method.

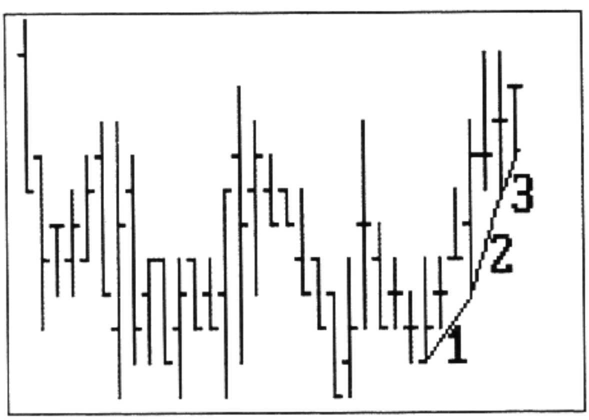
With the violation method you have a choice as to whether or not you would sell the entire position at the time of the violation, a violation being two reversal bars in any series of bars going in a single direction, or the making of a higher high in a down move or a lower low in an up move.



If you choose to not liquidate the entire position, you can scale out by exiting part of the position whenever you see the first violation, staying in part of the position until you see a second violation, and holding part of the position until you see anything that would cause you to take your money and run. It is entirely subjective as to what you do with the last portion of your position. Depending on your strategy and business plan, you can decide which method is best for you and your trading.

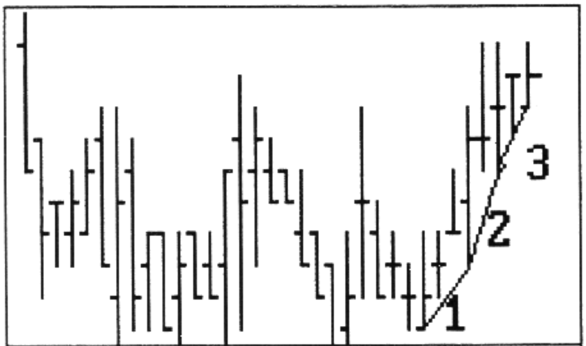
Why didn't we start the segment count a point "a?" The reason is that the market went into congestion by definition of the alternating bars that made the double low at "a," followed by a doji, a reversing bar and then two dojis.

Why didn't we enter a trade earlier, on the breakout of the doji bar that opened and closed at the high of the bar? The answer is that we could have. However, we felt it was better to wait until prices cleared the congestion. At the time the low of the doji bar occurred, the segment was connected to that bar as shown by the following chart.

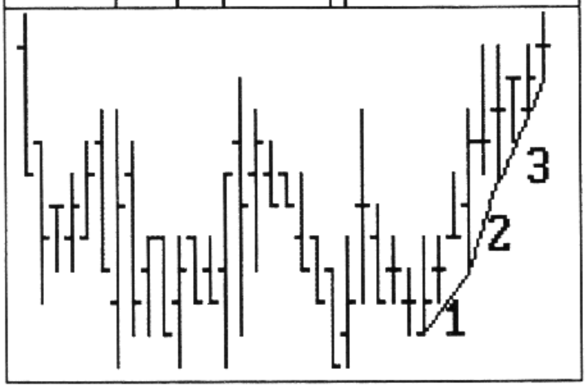


The last bar shown is the doji bar referred to on the previous page. A breakout of the high of the doji would have been a valid entry signal.

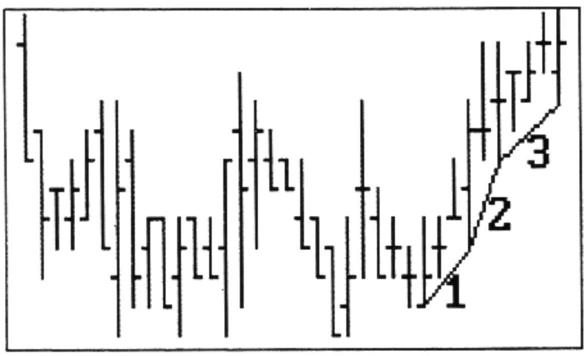
Let's understand. The segment line is drawn from bar to bar until we get a bar that makes a lower low than the previous bar. At that point, the segment line is moved from the previous bar that made a lower low to the current bar making a lower low. In the case of the chart we've been examining, the progression would have been as shown on the next three charts.



Notice that the segment line is moving along at the lows. We will not move away from hugging those lows with the segment line until we see a bar that makes a lower low than the previous bar. A breakout of the high of this last bar, or the high of the next bar, would also have been a valid entry signal.

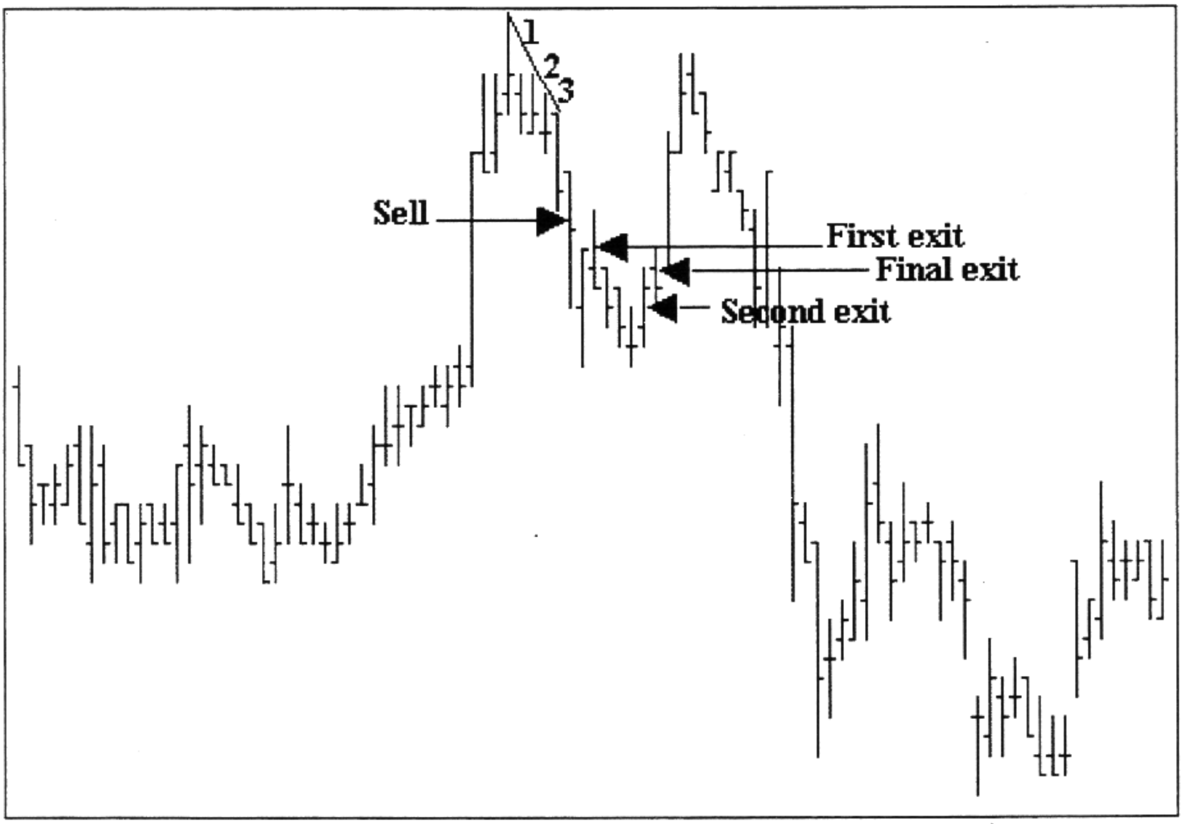


On the left was the last part of the segment prior to a bar making a lower low. Segment 3 will be finalized when we get a bar with a lower low.



The chart on the left shows how the segment line for segment 3 finally ended with a lower low.

As prices retreat from the 30 minute bar that made the high and also the close of the previous day, we begin to count and connect the diminishing highs.

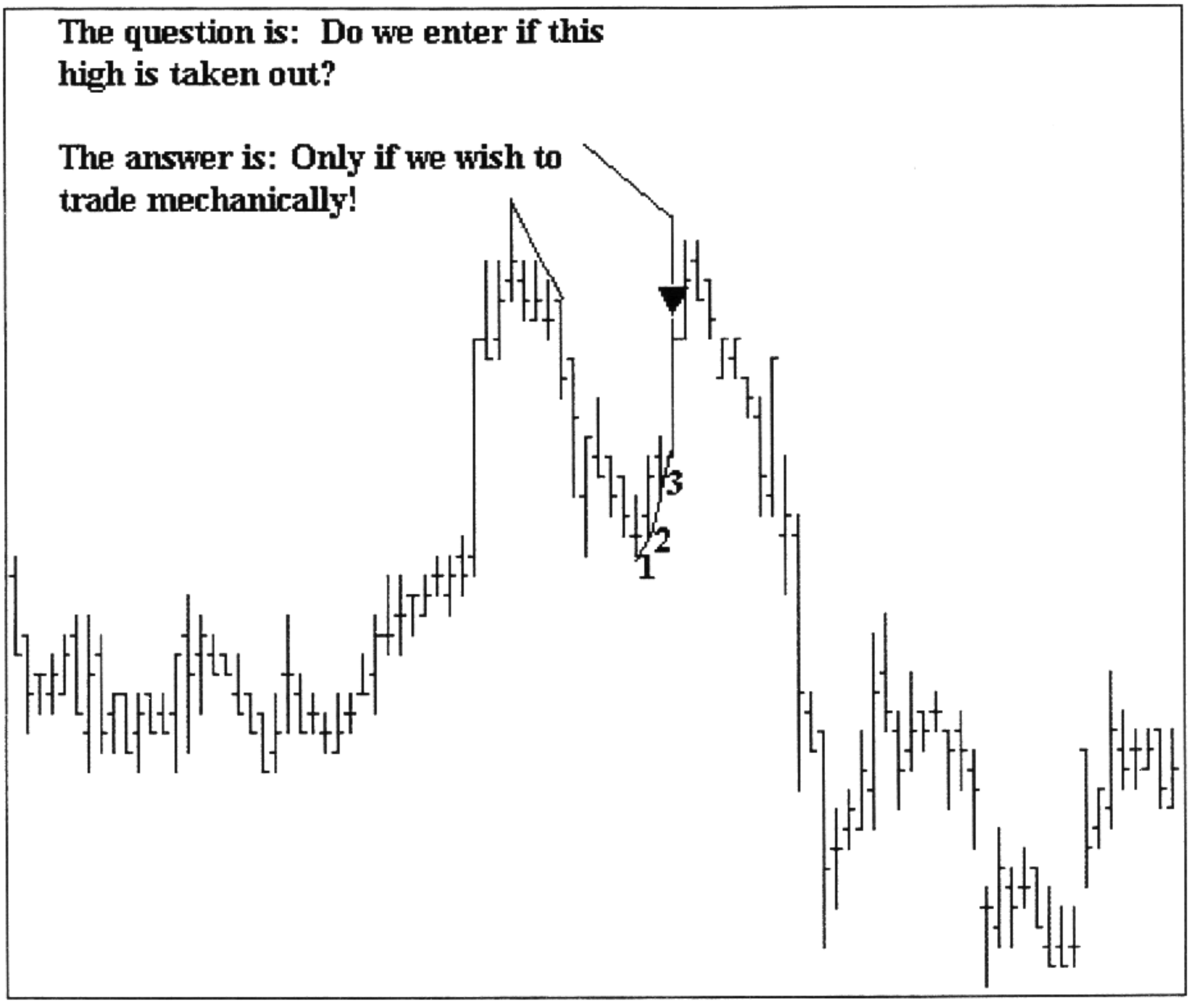


Depending upon the entry and exit prices, something, but not much would have been made on the first portion of the position. A bit more on the second portion, and a profit on any remaining contracts. Of course we could choose to exit the entire position.

What we are seeing is the reality of intraday trading. The most important thing for us is to not lose money, and to be there as often as we are able when prices run.

Continuing with the 30 minute chart, we see the final exit (above chart).

The next day (next chart), prices shoot up in the first 30 minutes of trading. Let's look at that now.

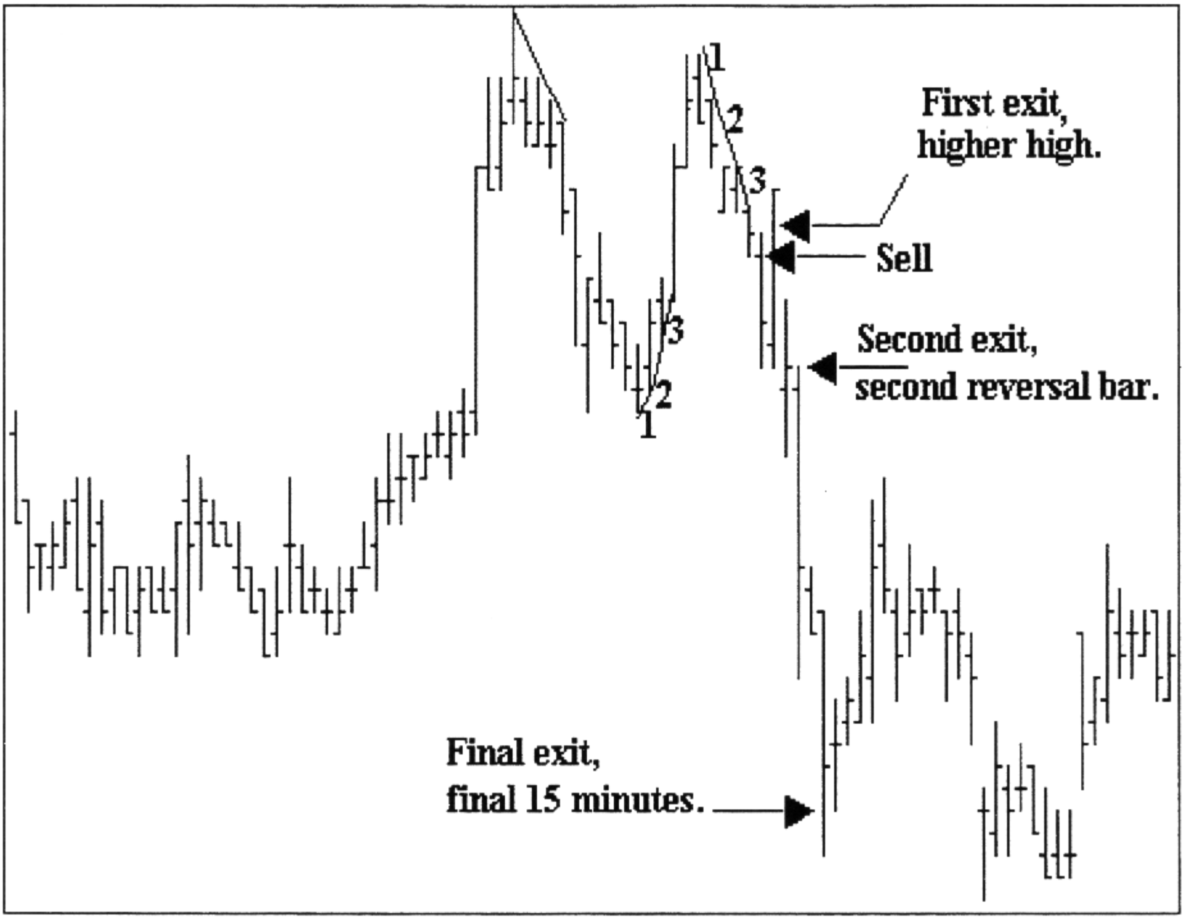


If we are determined to trade a mechanical system, then the trade must be entered. Note that our exit signal will keep us from disaster. We exit a portion of our contracts as soon as we see a bar making a lower low than the previous bar, a portion when two reversal bars are in effect, and the rest on the second bar to make a lower low.

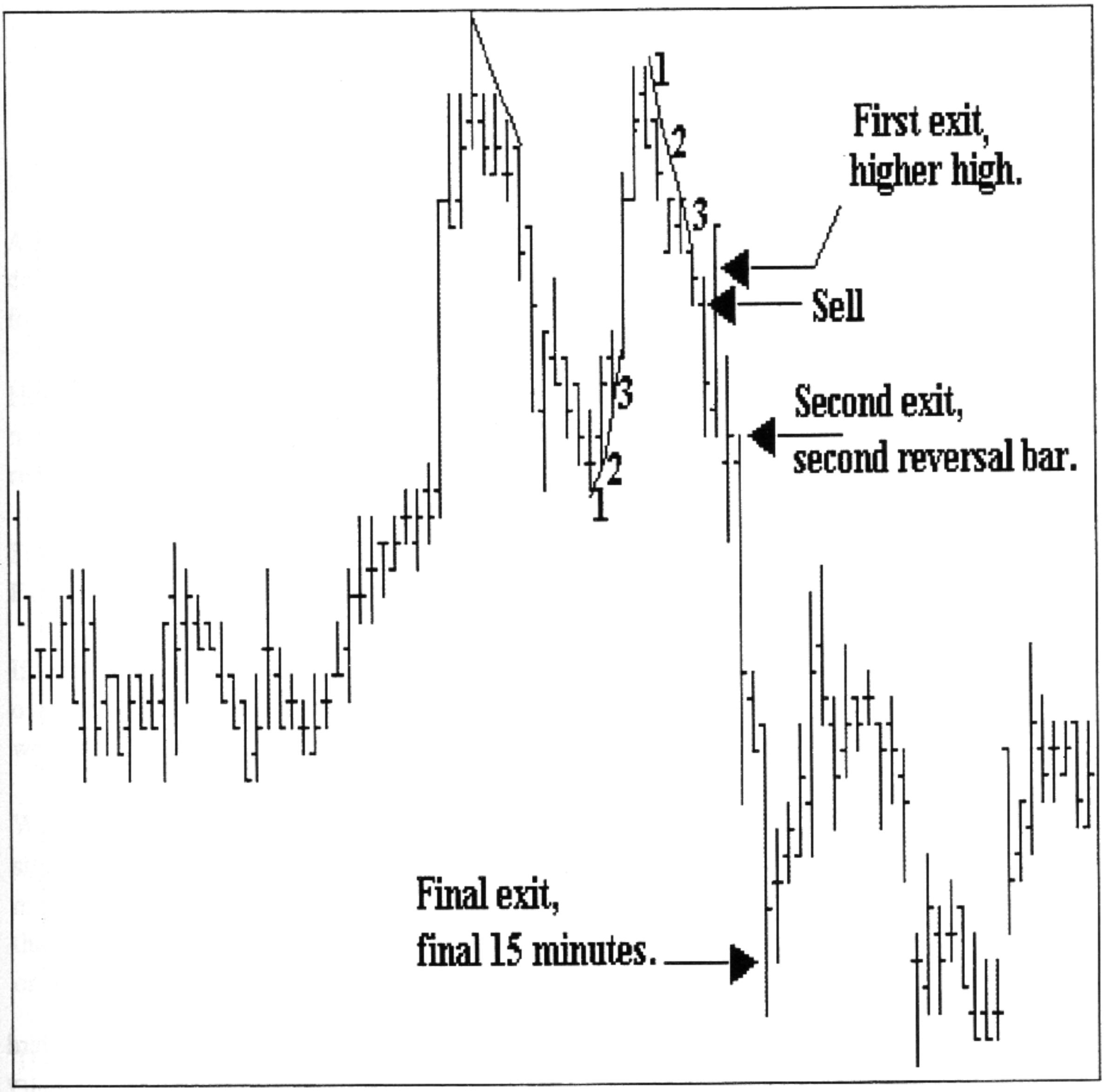
Taking it from the double top, the first bar after the double top makes a new low, liquidate one part of the contracts. That same bar ends up being a reversal bar, exit a second part of the contracts. The next bar gaps down, exit all contracts, or exit all contracts using the violation method shown earlier.

But should the trade have been entered at all? That's a tough decision and one that we each have to make on our own. There were no coordinating signals from TLOC. But then, neither were there any on the previous trade. There was a coordinating signal based on rising lows and another on simple counting. My opinion is that the trade was worth the attempt. We don't win on every trade. But we were able to keep any losses very small.

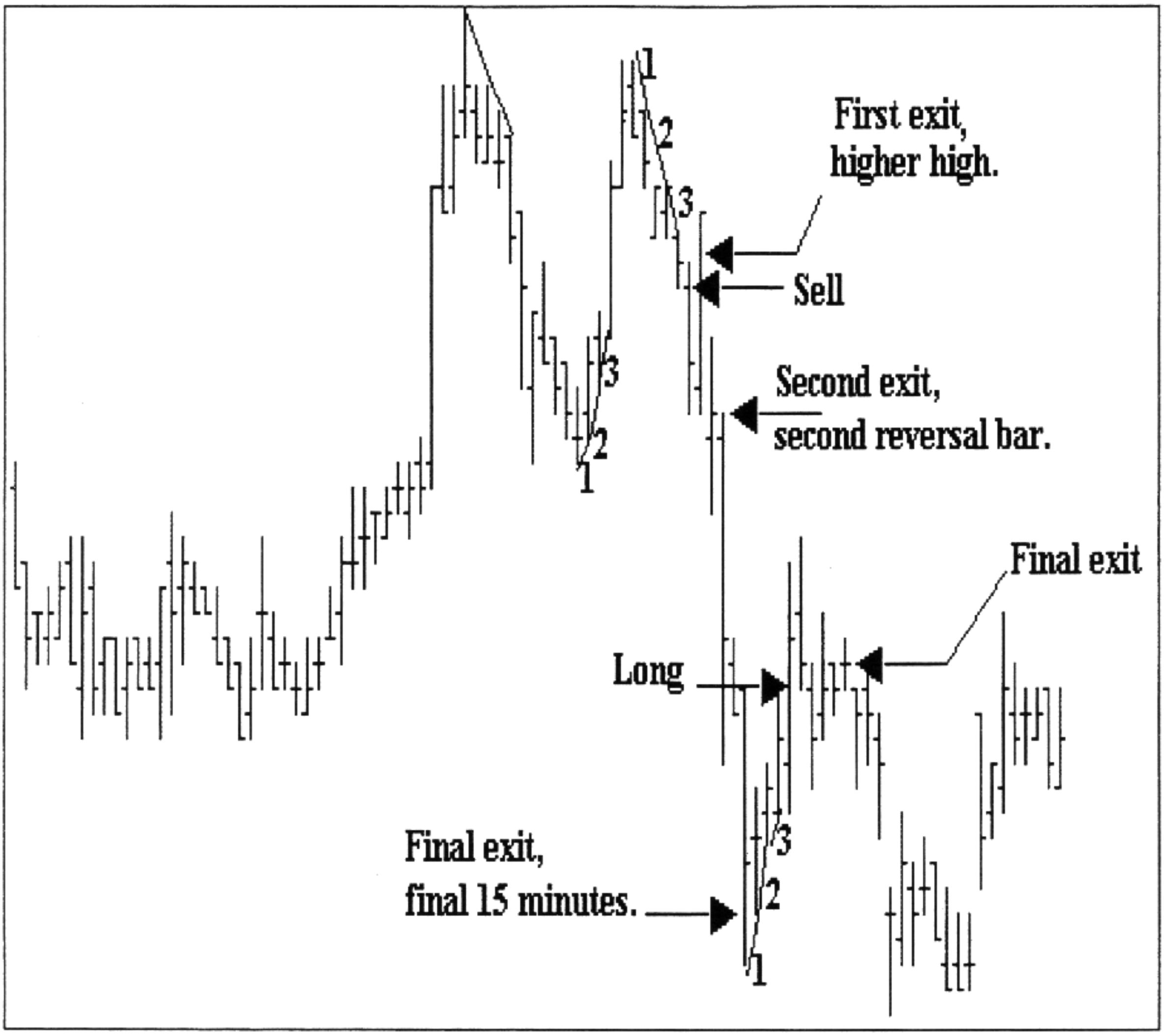
Let's continue with the next trade. It comes during the fourth hour of trading. Notice that even though we might still be long, we begin counting segments to the short side. In fact, the moment we have 3 segments to the short side might be our clue to exit any remaining part of our original position.



By now, you should be getting the idea of the segment count. So why don't you try the next one? The day begins with the bar following the final exit bar. I'll reproduce the chart on the next page and give the answer on the page following that.



Your turn! Count the segments, and figure out the entry point and the three exits. Probably one-quarter of all the trades you make will have results similar to this one.



Well, how did you do? My entry was on a violation of the high of the bar that gave the third segment. Prices moved up to the local high. My first exit is almost exactly where my entry was, and I couldn't fit another arrow in there, but it came as a result of the bar following the local high, making a new low. My second exit was right at the open of the second bar following the local high, because the bar preceding it was a second reversal bar. My final exit might have tricked you. I went out on the open of the doji bar, because the bar preceding it was a third reversal bar.

This was an early exit because I didn't like what I was seeing. If you picked the bar following the doji bar as your final exit, you made a good choice because it made a lower low that the preceding (doji) bar.

It would be very easy to load you up with nothing but examples of winning trades, but that is not the way actual trading really happens. All too many traders fool themselves when they study charts; they sit for hours looking for some magic way to trade that never shows a loss. In this course, we take the good with the bad – exactly the way it happens in real life.

Chapter 26

TURNING DAY TRADES INTO POSITION TRADES

A very important consideration in what you will learn in this course is the ability to turn a daytrade into a position trade. Perhaps position trading is not for you. However, it is difficult for many traders to resist the temptation to turn some winning daytrades into position trades.

However, this chapter is not for the beginning trader. Please use this with caution. If you're not careful, it could have disastrous results. Be especially cautious around times of earnings releases and economic data releases.

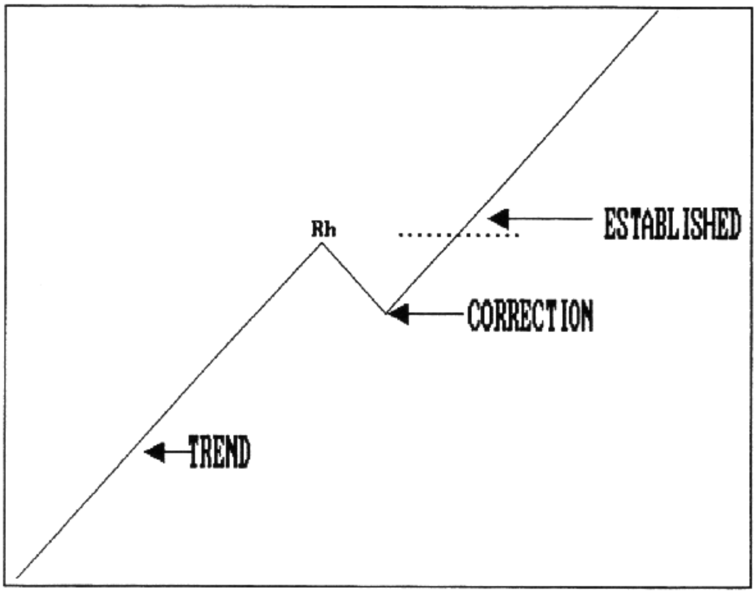
For years the only available way to trade from your home or office was to position trade. Even now, it seems to some that strictly daytrading leaves too much money on the table.

If we have a winning position in a particular contract, why shouldn't we hold onto it overnight? Isn't one of the oldest rules of trading to "hold on to your winners?" Over time we can develop an appreciation for which daytrades turn into the best position trades.

We can attempt to hold on to any daytrade entered as a result of one of our major entry signals. If we are in a daytrade when a major entry signal occurs, or enter one because of a major entry signal, we may attempt to hold that trade overnight. The major entry signals are the breakout of a 1-2-3 high or low, the breakout of a Ledge, the breakout of a Trading Range, or the breakout of a Ross Hook.

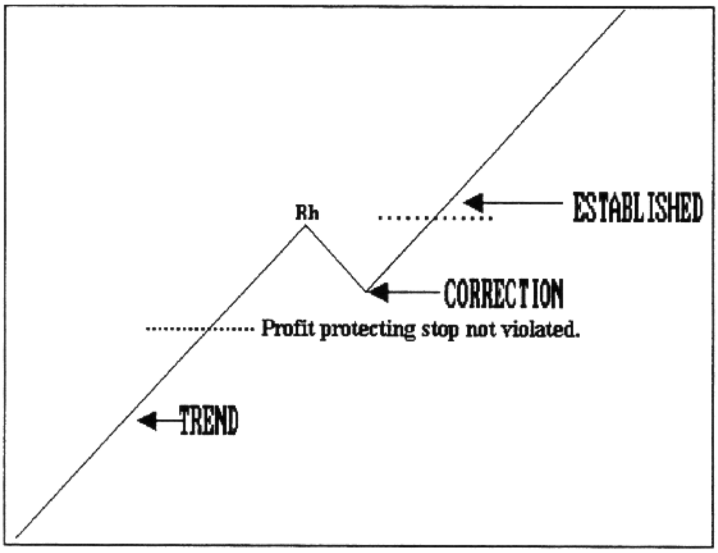
There is one intermediate term signal that can also cause us to try to hang on to a trade and convert it into a position trade. That signal is the breakout of the lowest low or the highest high of the last three days. For purposes of conversion, that intermediate signal carries the same weight as a major entry signal. Once the trade is converted, we can maintain it as a position trade. As much as possible, we monitor and keep an eye on the trade intraday, but we do not trade in and out of it as we would on a daytrading basis. We try to stay in. Therefore, the only time we will try to hang on to a trade and convert it is if it meets one of the signals mentioned, and is also in a profitable position at the time we decide to hold.

Although it's not necessary, it is best if the trade is in an ***established*** trend. Prices trend upward on a daily or weekly basis because there is a real demand for the underlying. They trend downward on a daily or weekly basis because no one wants the underlying. Why should we have to fight our way in and out numerous times a day if a market is trending and the underlying fundamentals, whatever they are, cause prices to behave in a trending manner?



"Established" means that a trend has had a leg up (or down), a correction, and then has taken out a Ross hook.

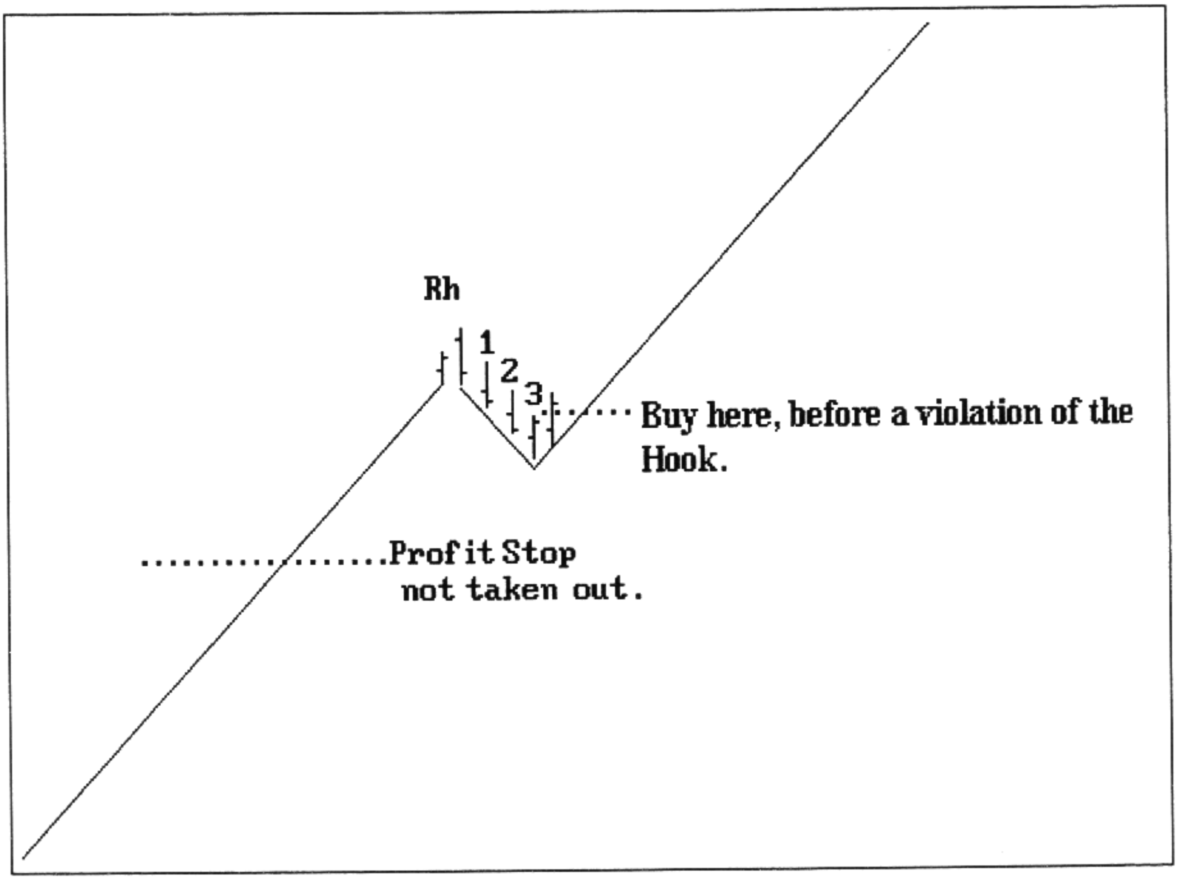
It's it even better when we are in a profitable position with a stop that has not been violated by the correction as shown in the diagram below.



We like it best when we're nursing a profitable position on the first leg and are able to add to our position during the correction prior to the hook's being taken out.

RULE: A CORRECTION CAN LAST FOR A DURATION OF ONLY THREE PRICE BARS. THEN THE POSITION MUST BE SOLD.

The next chart will give us a glimpse of the beginnings of the Trader's Trick entry.



If we're holding overnight, we place a stop in the market so as to protect any profits we have already earned in the trade. If we're not in a profitable position just prior to the close, there's no point in holding overnight even if the prices formed an entry signal that would cause us to want this to be a position trade.

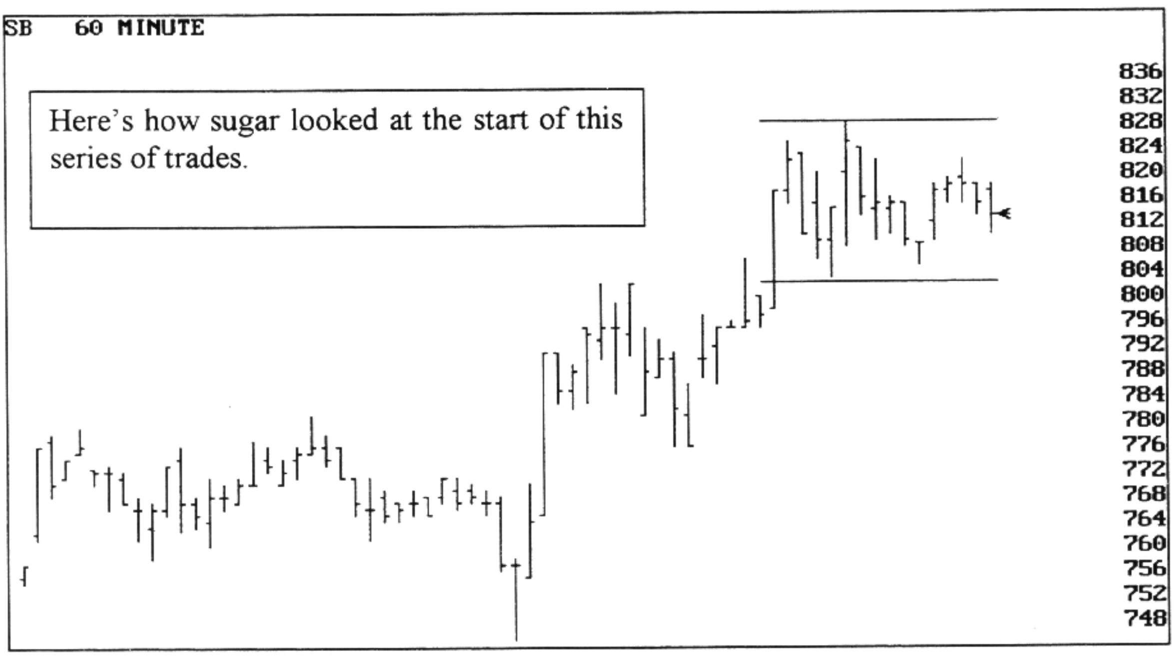
Once conversion has been made to a position trade, we hang on to it as long as we possibly can by placing stops just below natural support points. A natural support point for a long position is that point where the correction stops moving lower and prices resume moving higher. The longer we're able to stay in the trade, the less we need to look at it intraday. If the trade lasts past the first correction on the daily chart, we quit monitoring it intraday.

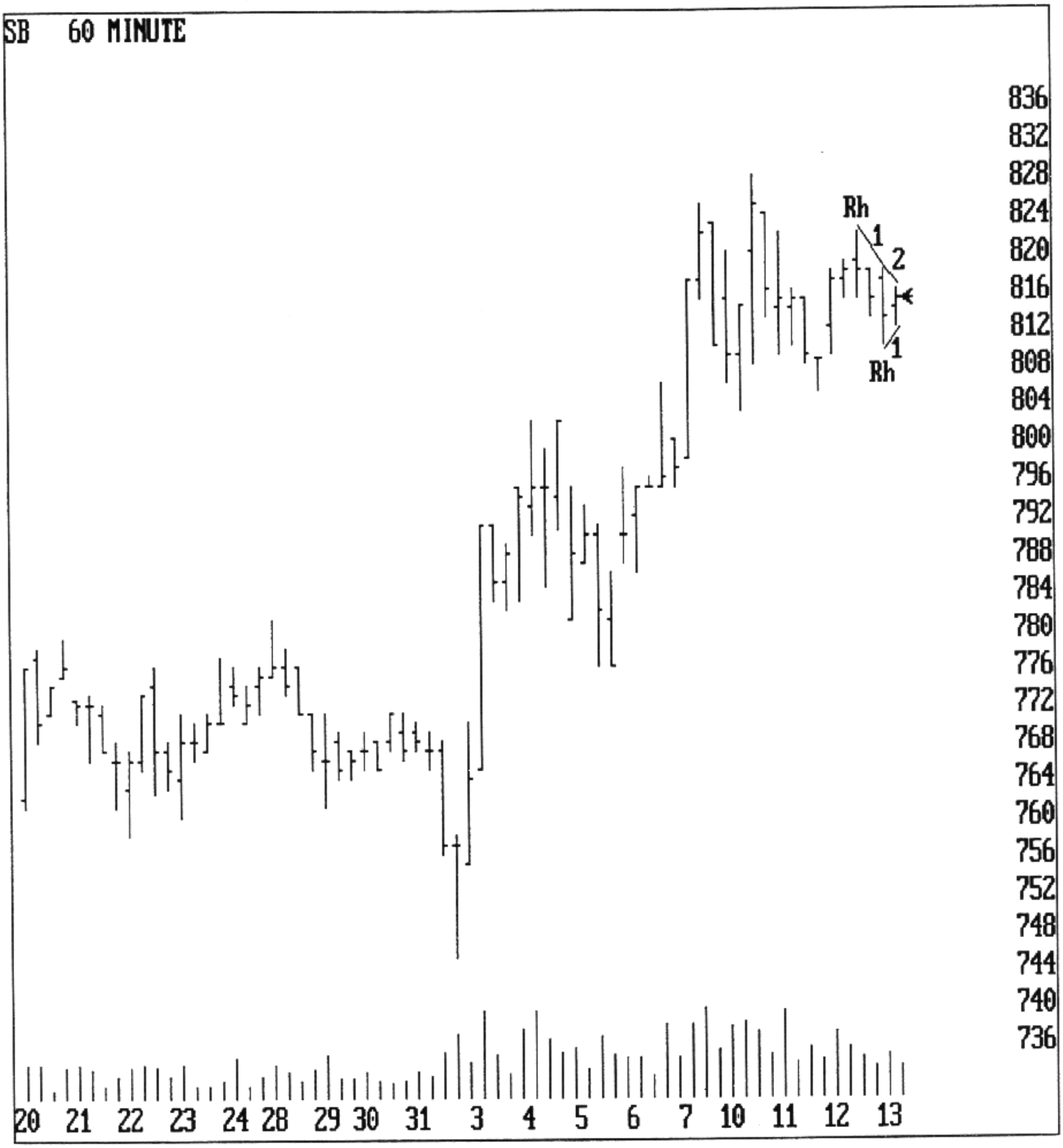
Chapter 27

SIXTY MINUTE DAYTRADING

We've seen how to trade charts ranging from five to thirty minutes. Next, we'll see that the same techniques can be used profitably on sixty minute charts.

There is probably nothing more difficult to trade than sugar when it's in a trading range. It has to be one of the more treacherous contracts around. What makes it especially difficult to trade is the annoying problem of the bad ticks that come from the New York exchanges. You're never quite sure of where price really is. I did this series of trades for the purposes of writing this book. The New York exchanges should be ashamed of the garbage data they put out. That, coupled with the rotten fills obtained when trading there, make trading there all the more difficult. I can only hope some of the powers that be in New York will read this book. In my opinion, one of the best things that could happen would be for all traders to boycott the New York exchanges until they get their act together. To add insult to injury, the fees in New York are higher than in Chicago both for trading and for live data.

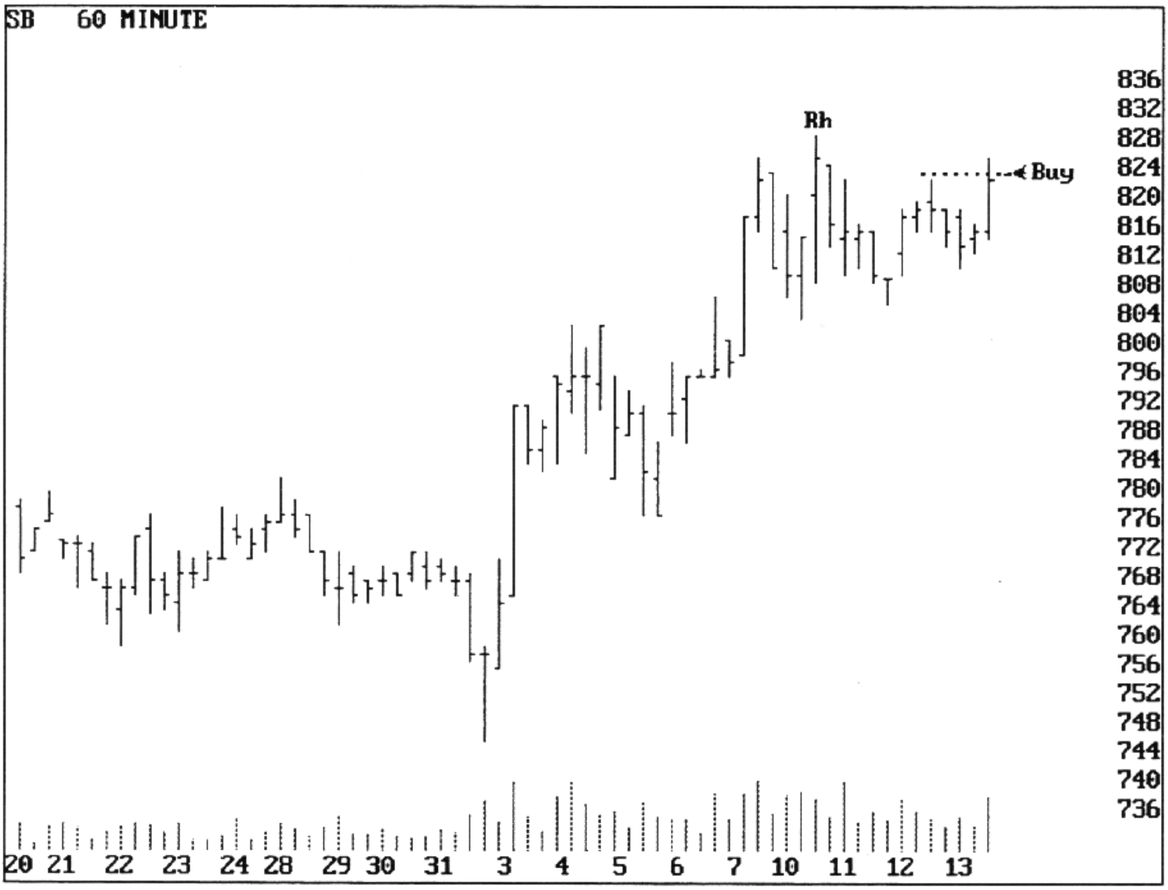




I started out by connecting the segments going in each direction and marking the Ross hooks on the chart. Connecting segments is a very important part of charting. As we go along, more detail will be explained. Hopefully, by the time this manual is done, you will understand it completely. The first thing to notice is that there was an intervening lower high between the first two highs that I connected. In the case shown above, two segments were achieved by connecting three highs. There may be more than one intervening bar between the highs (lows for an uptrend) connected.

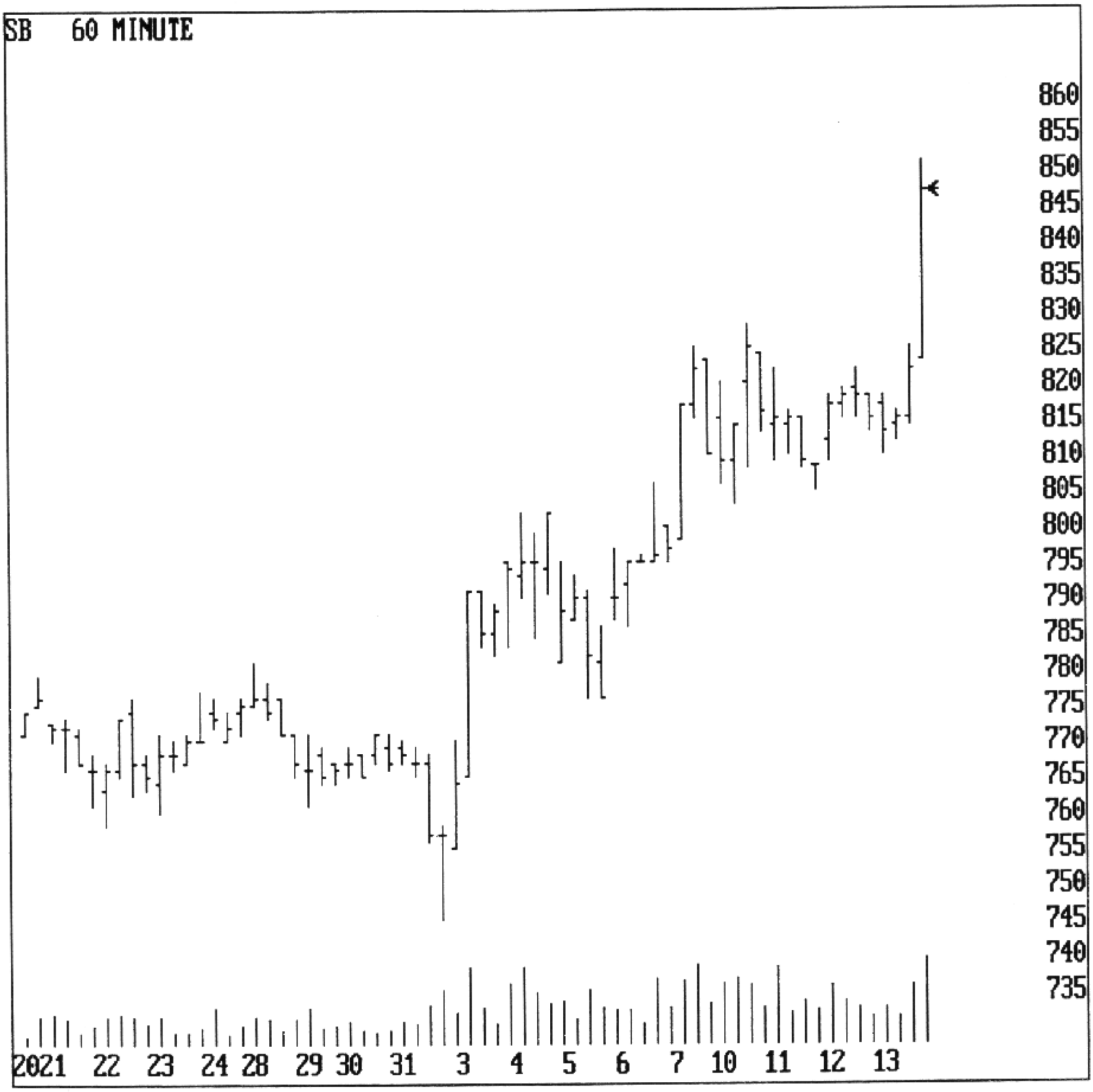
An important difference to notice is that there was no need to start out with three successive lower highs and lower lows. All that is needed to initiate a trade is three successively lower lows. For an uptrend, we need three successively higher highs, each segment created by connecting two not necessarily successive lows.

Before a definitive trend could be established through either a bar count or a segment count, prices took out a local high hook and I got long a ten lot at 823. I placed a MIT order at 829 on ½ my position in order to cover costs ($25/round turn) and take a small profit, and placed a protective stop at 817.

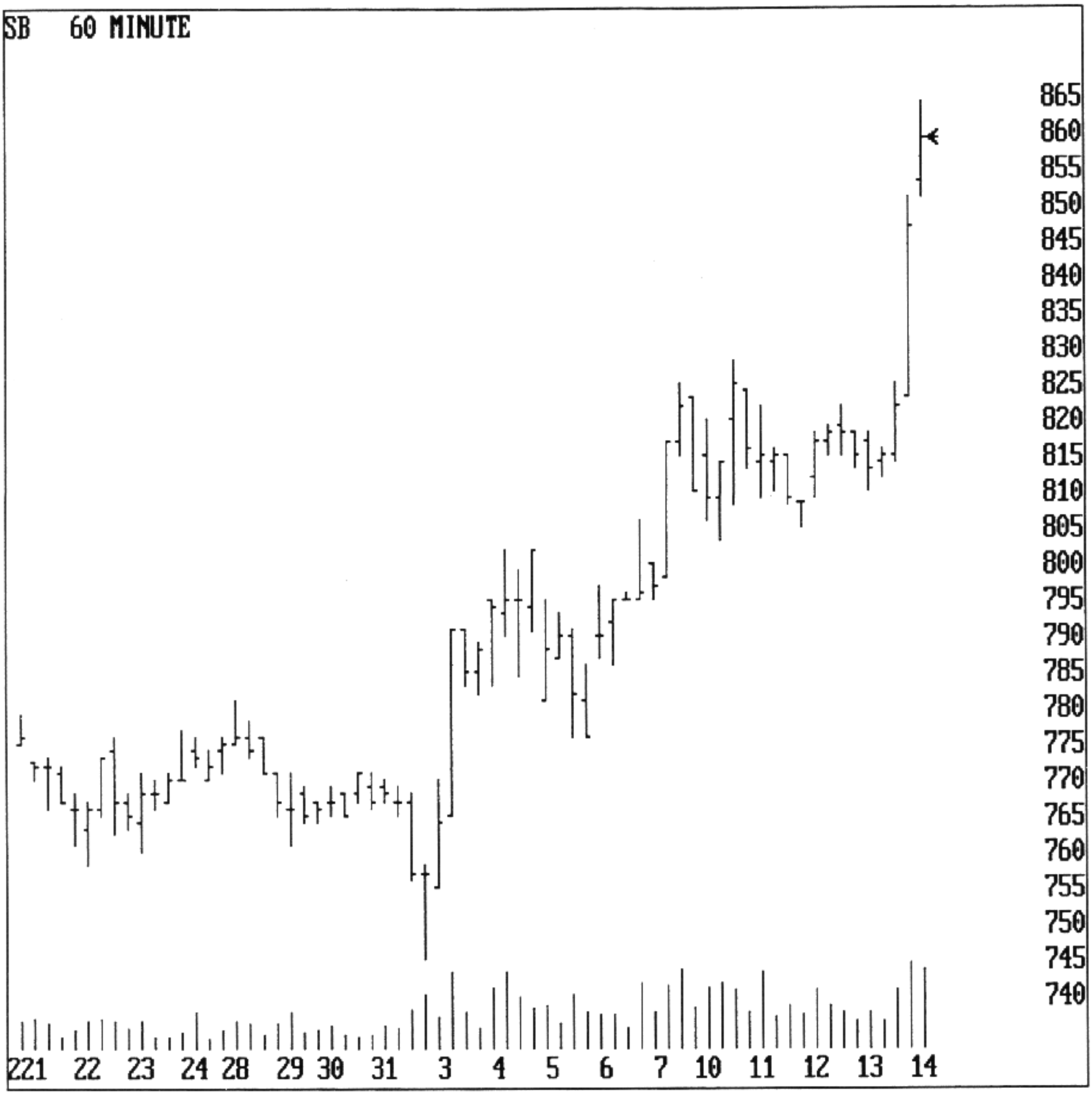


The reason I went long where I did is that I wanted to get a jump on the breakout of the Ross hook located at the highest high on the chart. Hopefully, the public's entry into the market at that breakout would drive prices even higher. An entry at 823 offers seven points to the point of the Ross hook, sufficient to cover costs and take some profit in case prices top out there.

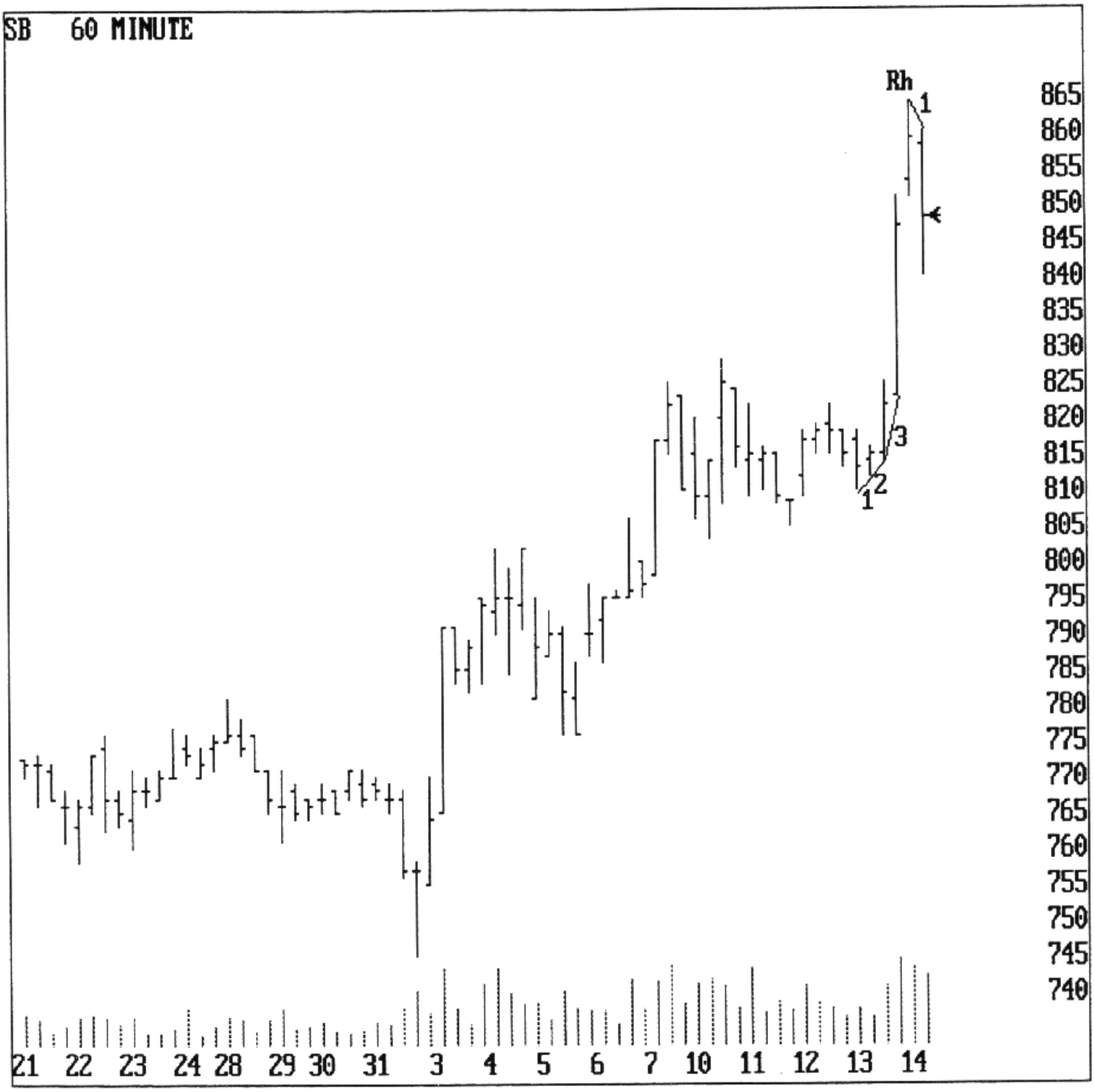
The trade easily made costs. I liquidated five contracts with a windfall extra profit of one tick at 830.



Prices moved up to a high of 851, so I moved my stop to protect at least half my unrealized paper profits. My profit protection stop was set at 837. Because the breakout took out the highest high of the last three days, I considered holding the trade overnight as a position trade. By the time the market was ready to close, I had made up my mind to stay in the trade.



The first bar on the next day brought even greater profits. I moved my stop to take advantage of that. My stop was now at 844, protecting at least half the unrealized paper profits in the trade.

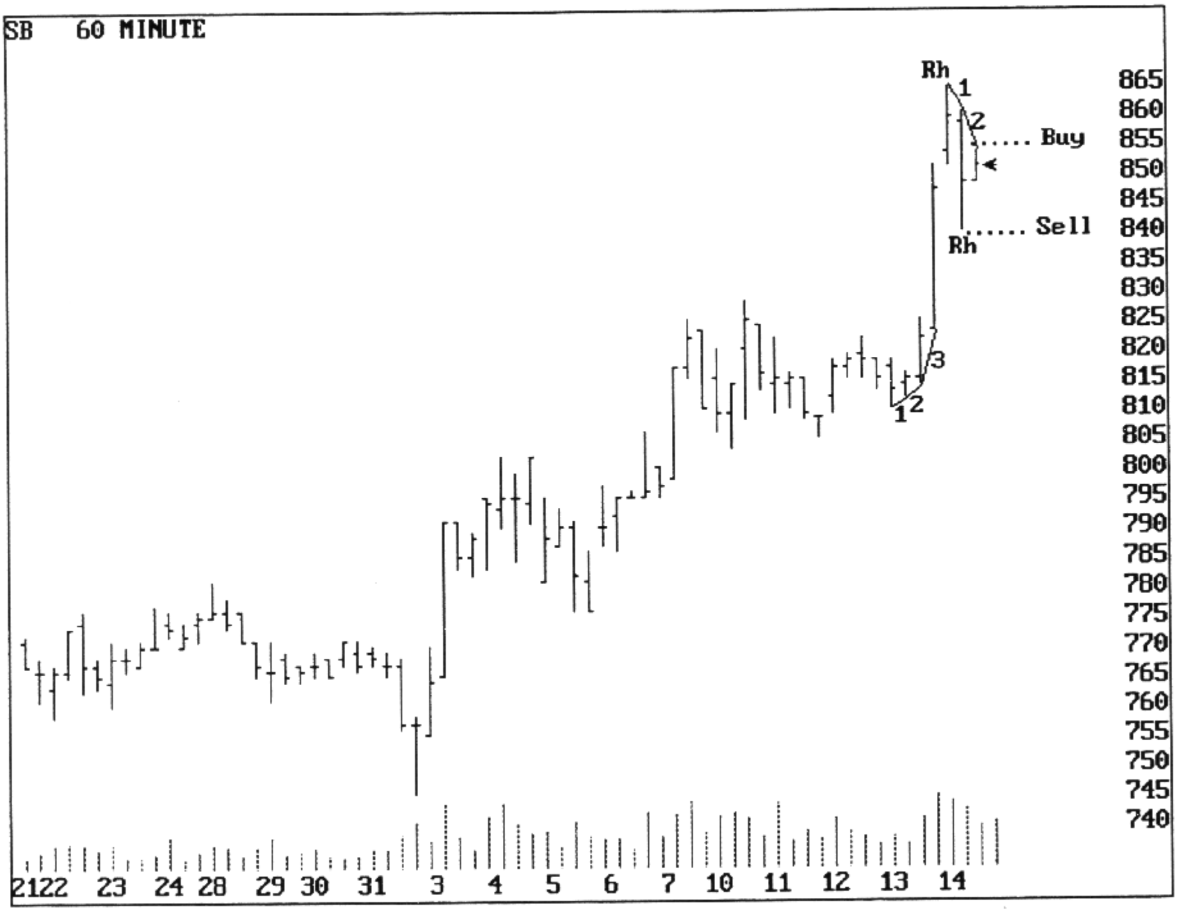


The next bar took out my stop at 844. I had costs of $250 in the trade, but had covered those with $142 to spare. Add to that the 1064.00 I made on the last 5 contracts, and I had a total of $1206.00.

I placed an order to buy a breakout of the high of the correcting bar.

I considered this bar a correcting bar, because the trend is still in effect due to fact that there was a breakout of the high of the bar that made the third segment of the segment count.

Notice that as soon as I get a correction, I begin numbering the segments of the correction. I also identify the hook.

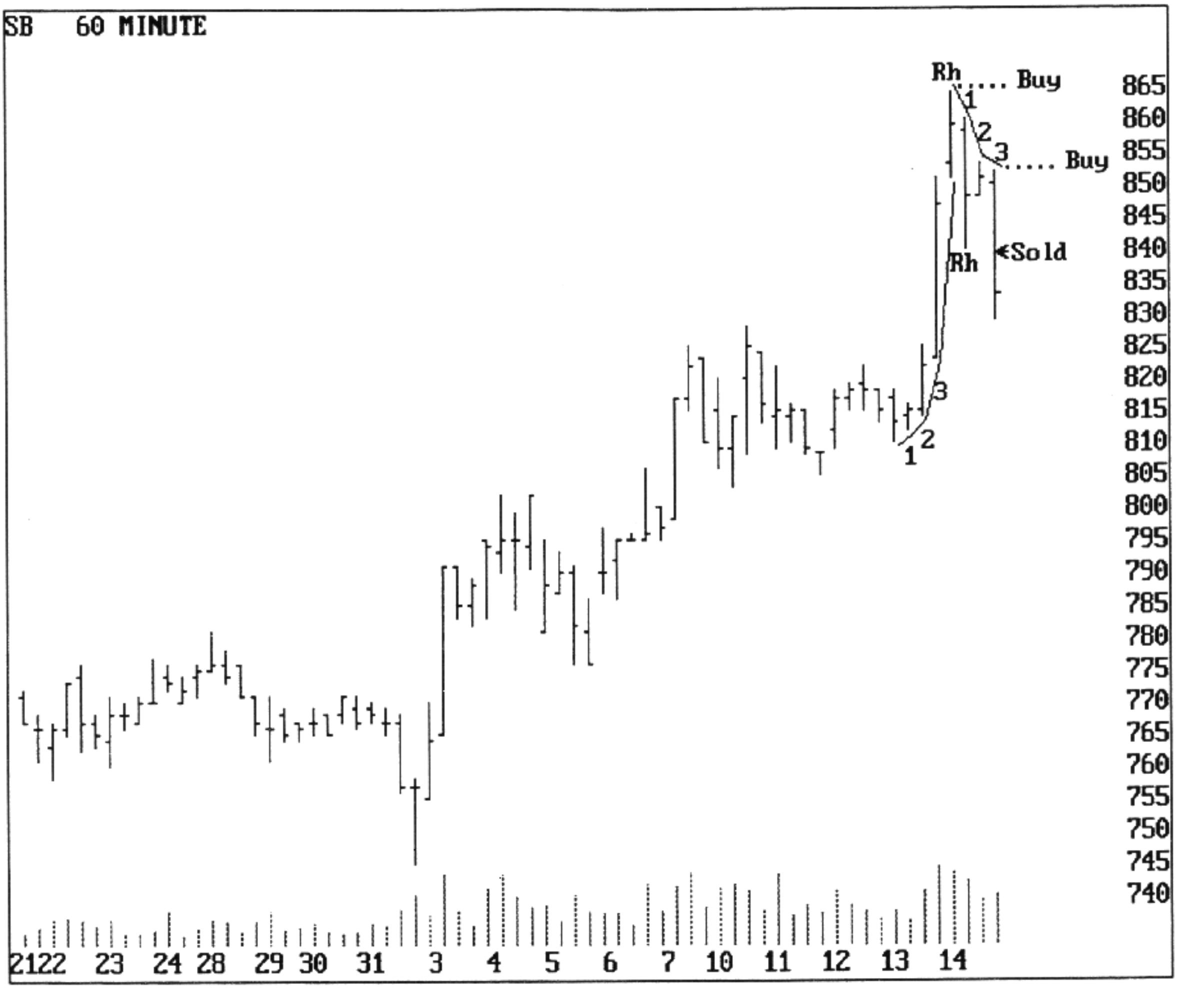


The next bar didn't amount to a hill of beans, yet it was important because it made the picture change. When the market talks, I listen.

I now had two segments going down. The market was still correcting. The new inside bar established a Ross hook at a breakout of the previous low.

I placed an order to buy a breakout of the high of the inside bar. I also placed an order to sell a breakout of the Ross hook created by this inside bar.

Some who have seen my style of trading would say I'm an aggressive trader. They are correct. When the market is speaking, I get very close so I can hear what it is saying. I want to trap every word. By doing that I also trap its moves. As the chart shows, I was willing to go with the market in whichever way it wanted to go. I want to dance with it; I go where it goes.

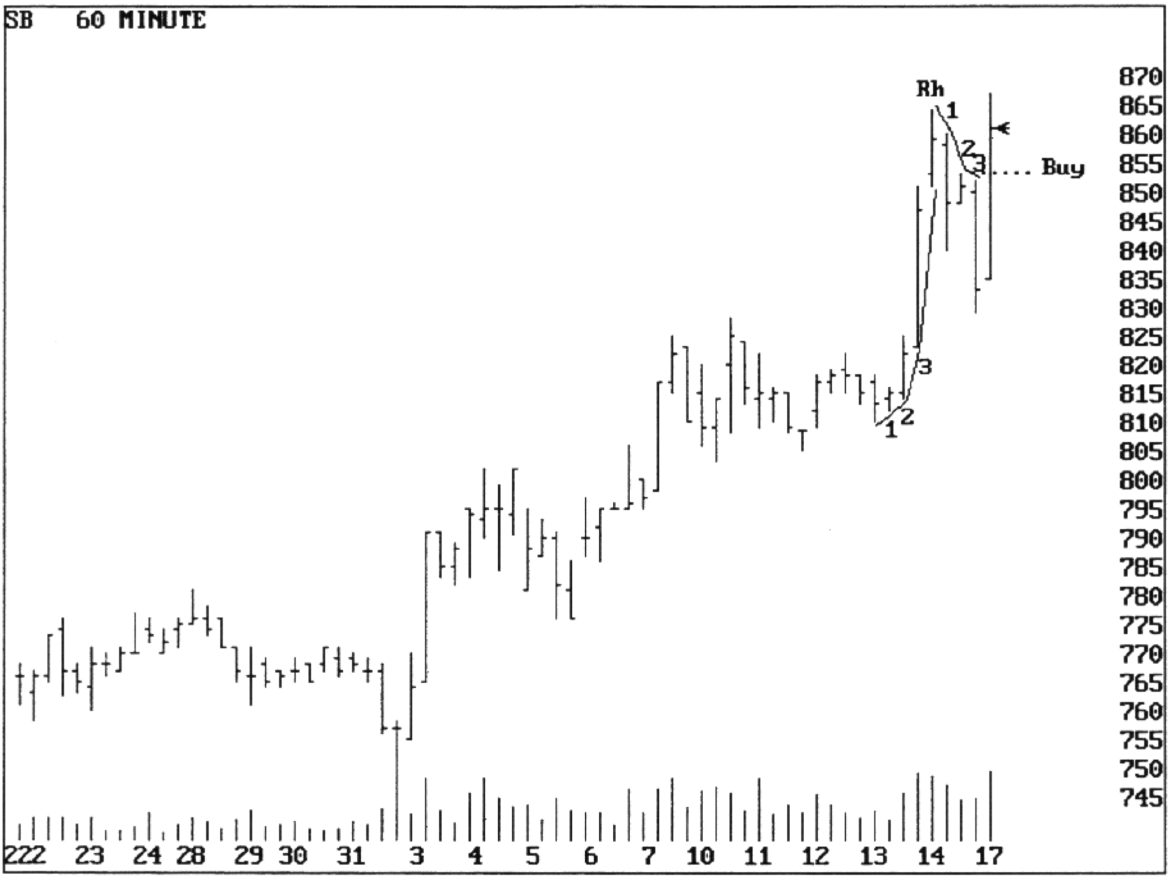


I was short a ten lot at 839. I was looking for 10 points with which to cover costs and take a profit on three contracts at 829.

I placed an order to liquidate three contracts at 829 MIT. Prices hit 829 exactly at the low of the price bar on which I got short. I was filled at 830, which covered costs with 52.40 to spare. As the bar closed, I liquidated the remainder of my position at 834. I had made 5 points per contract on seven contracts for additional profits of $392. My net profit for the day was $444.40

I assessed the situation as I planned for tomorrow's trades.

Since this was only the third bar of correction to an uptrend, I would place an order to buy a breakout of the high if the opportunity presented itself. I didn't really expect to be filled. Discipline also dictated I try to buy a breakout of the Ross hook.



I got long a ten lot at 853 as prices took out yesterday's high. I got long an additional five lot at 865 as prices also took out the Ross hook. Since the Ross hook was a breakout of the highest high of the last three days, this trade was a candidate for holding overnight. Average volatility was far too great for me to use it for either my stop loss or my cost liquidation objective. Therefore, I used a 10 tick stop for each.

Once I was long the ten lot at 853, I covered costs at 863, cashing three of my contracts. I moved my stop loss to breakeven at 853.

Next, I was filled at 865 on a five lot. I placed my cost liquidation objective at 875 and my stop loss at 855. I waited for the next tick.

Perhaps this entry will strongly point out the need for discipline and poise while trading. I go with the market, wherever it takes me. I refuse to prejudge a market or what it will do.

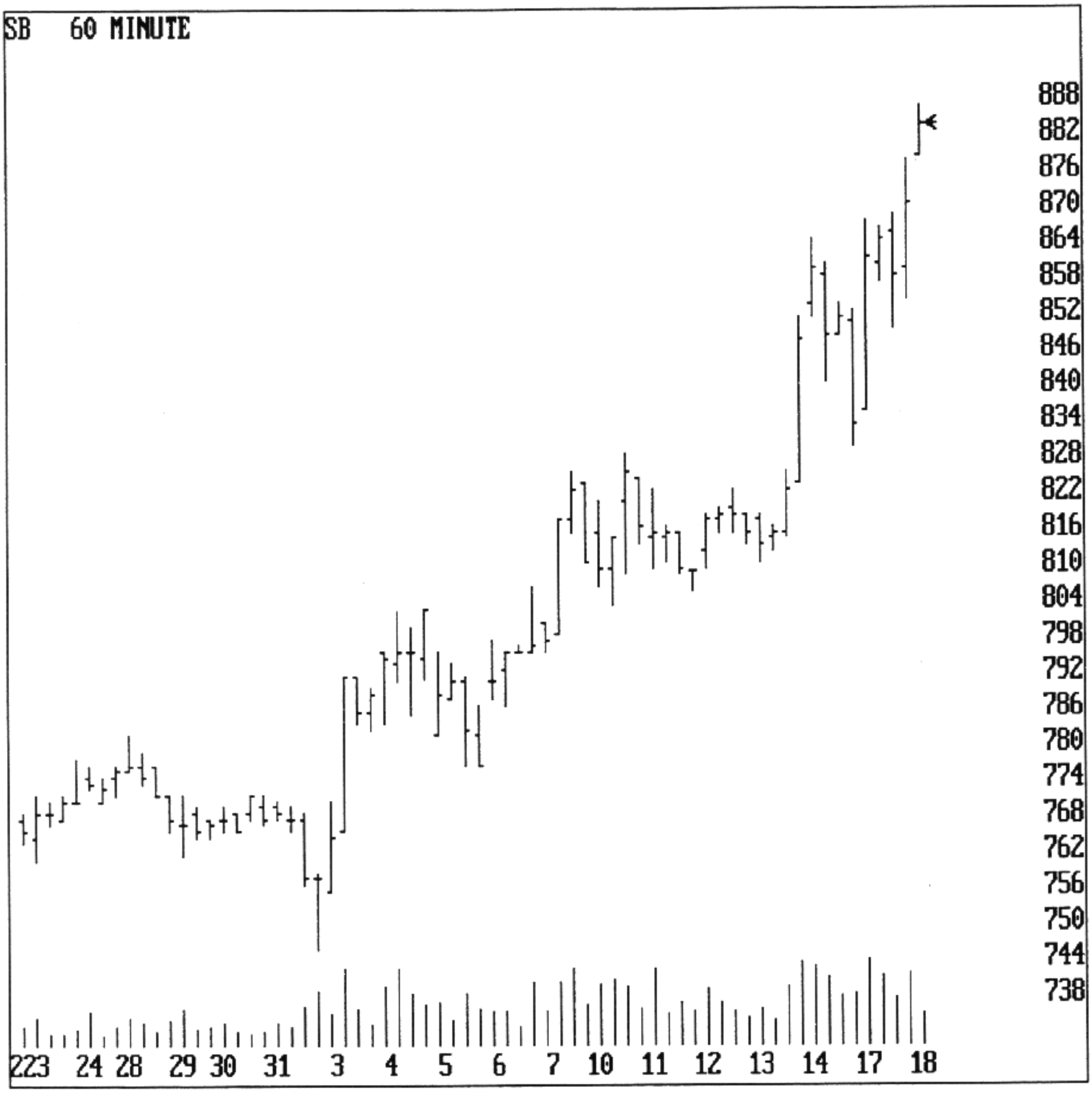
When the price bar closed, and the above price bar opened, I moved my 853 stop to 860 to protect profits on my ten lot. I was stopped out there with a 7 tick profit. My ten lot trade had made $86.00 when I cashed the first three contracts. The other seven had made $548.40, for a total of $634.40.

I had been unable to liquidate and cover costs on my five lot, and because this bar closed with a lower high, I decided to move my stop up to one tick below the low at 856.

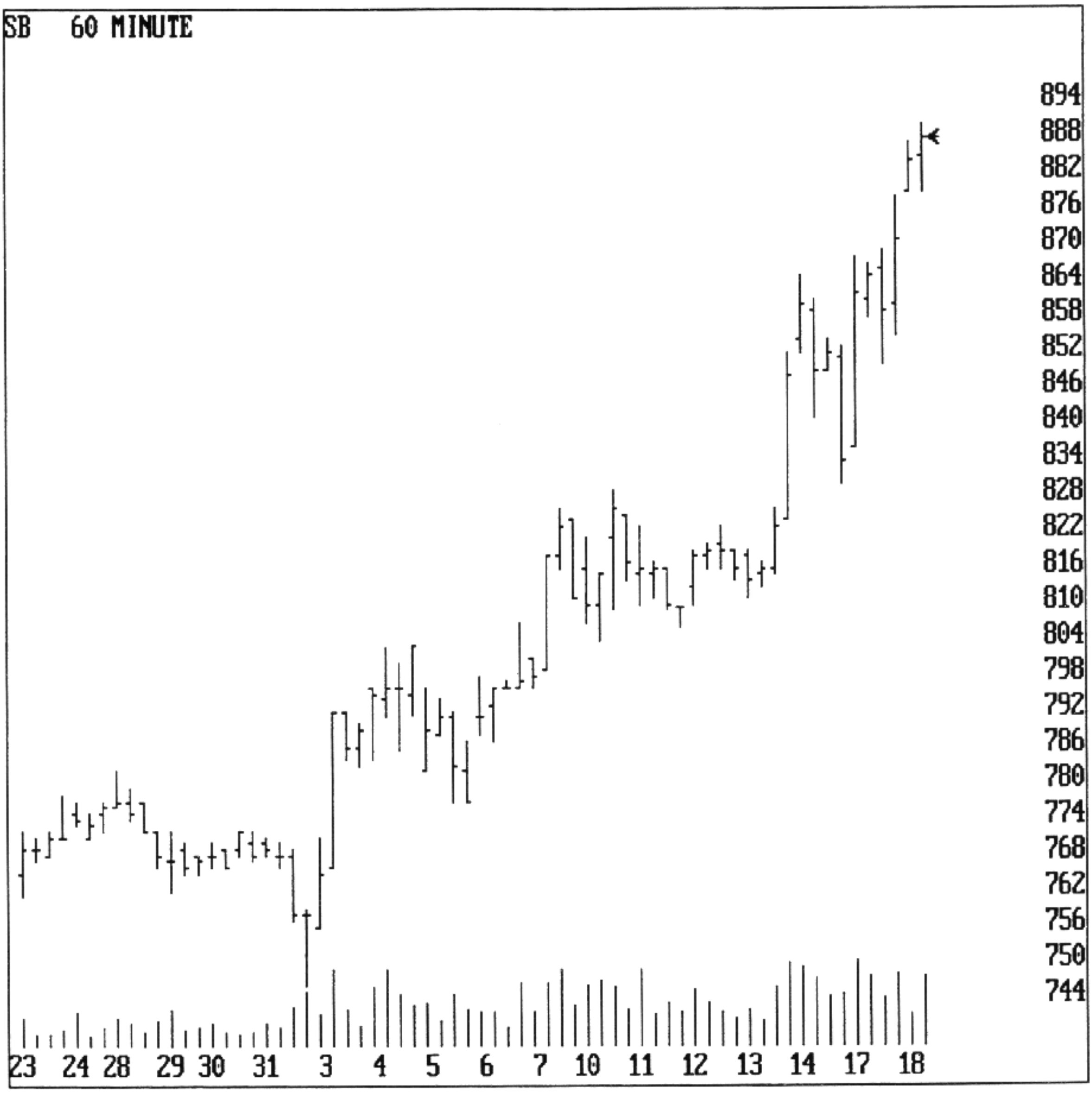
I was stopped out at 856 on my five lot. I had lost a little more than half of my costs, or $629.00. The bar that took me out of the trade was a reversal bar.

The close being lower than the open represented a correction, and so I placed a buy stop above the high of the bar.

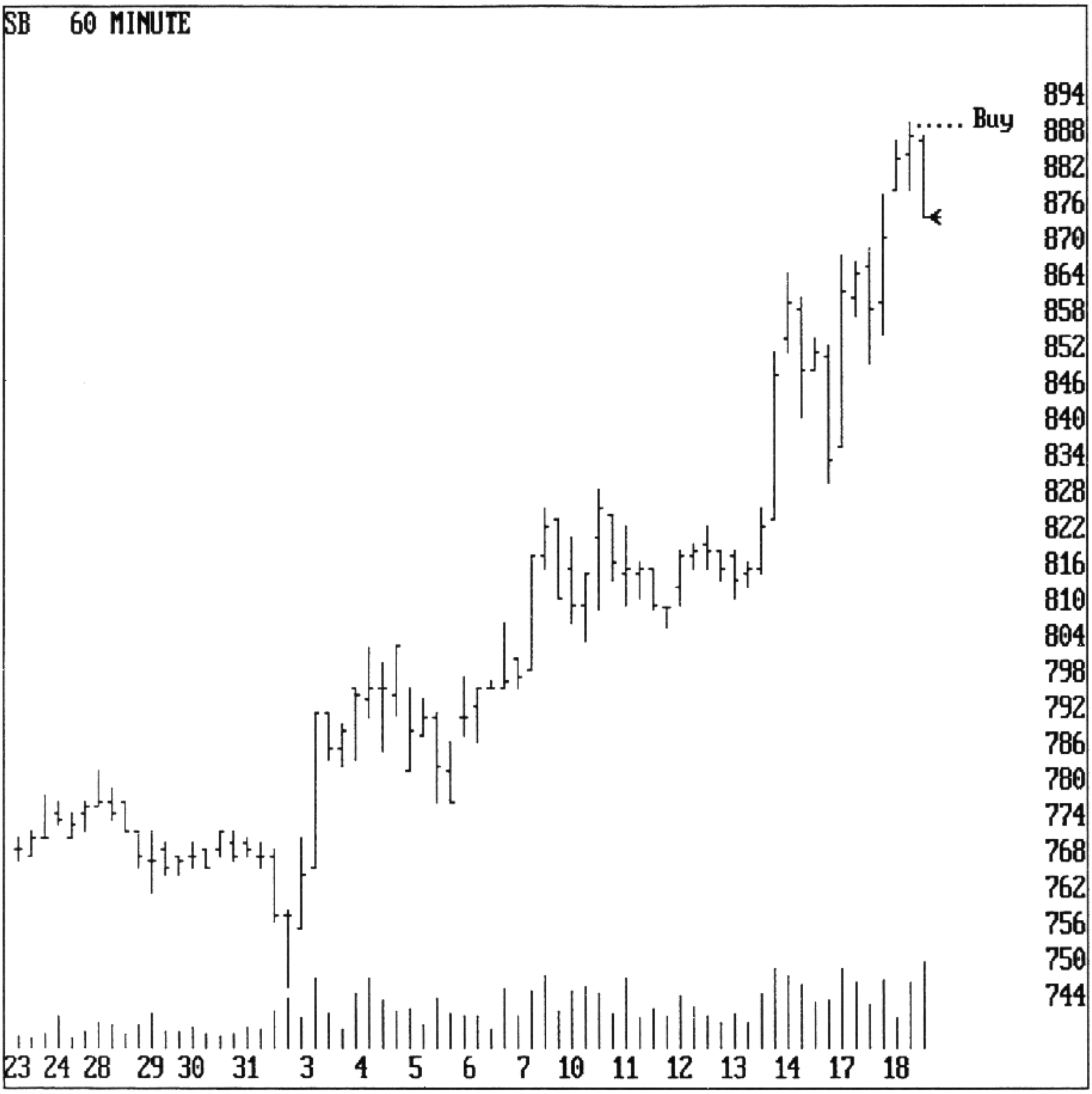
I was filled on a ten lot at 869. I placed my protective stop at 859 and my cost liquidation stop at 879. As the close neared, I decided to hold overnight. Prices had been making new highs, and I felt it was worthwhile to stay with the trade.



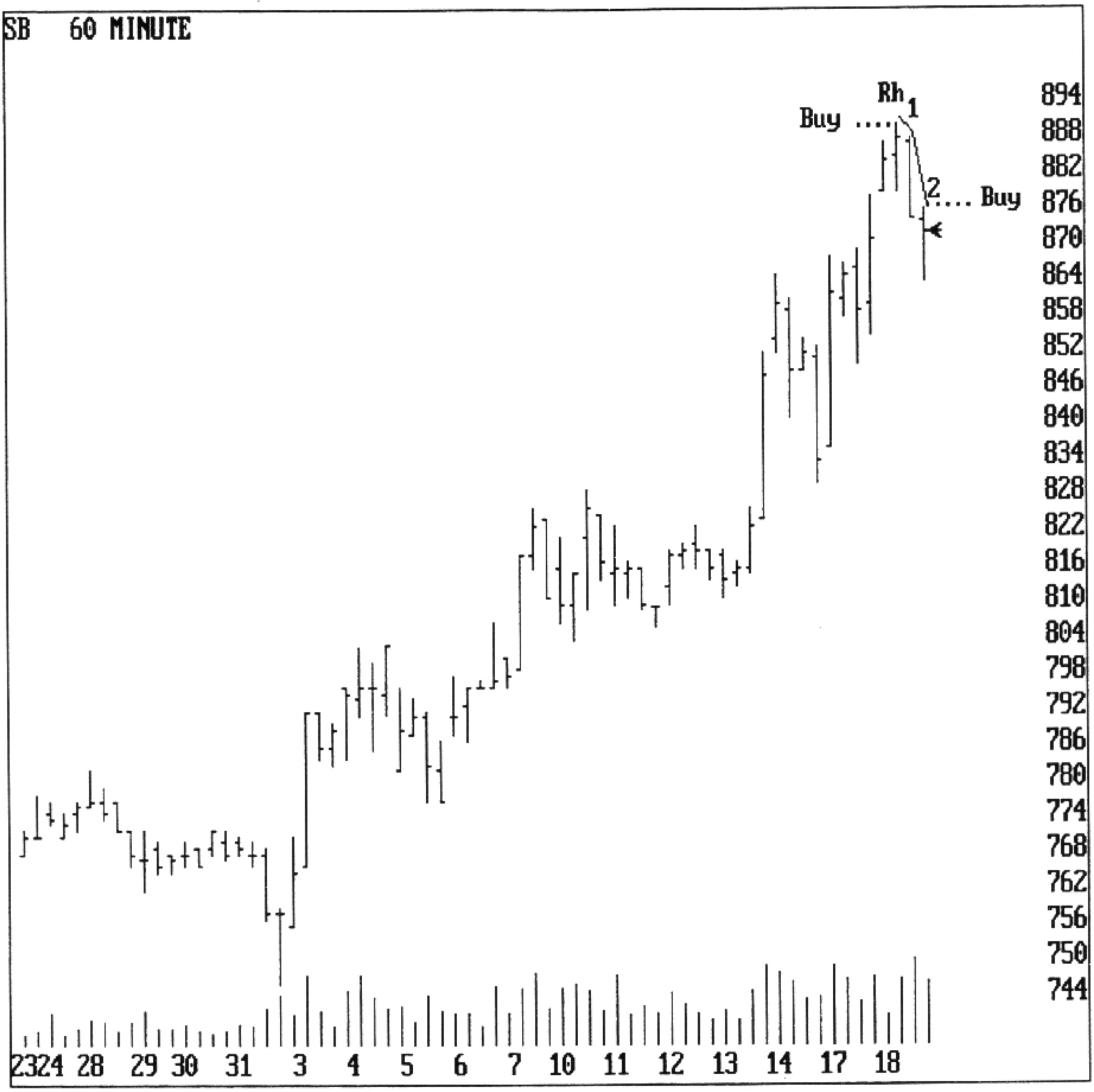
Some time after the market opened, I was able to cover costs with a three lot. I pulled my stop to 877 to protect approximately half the unrealized profit in the trade.



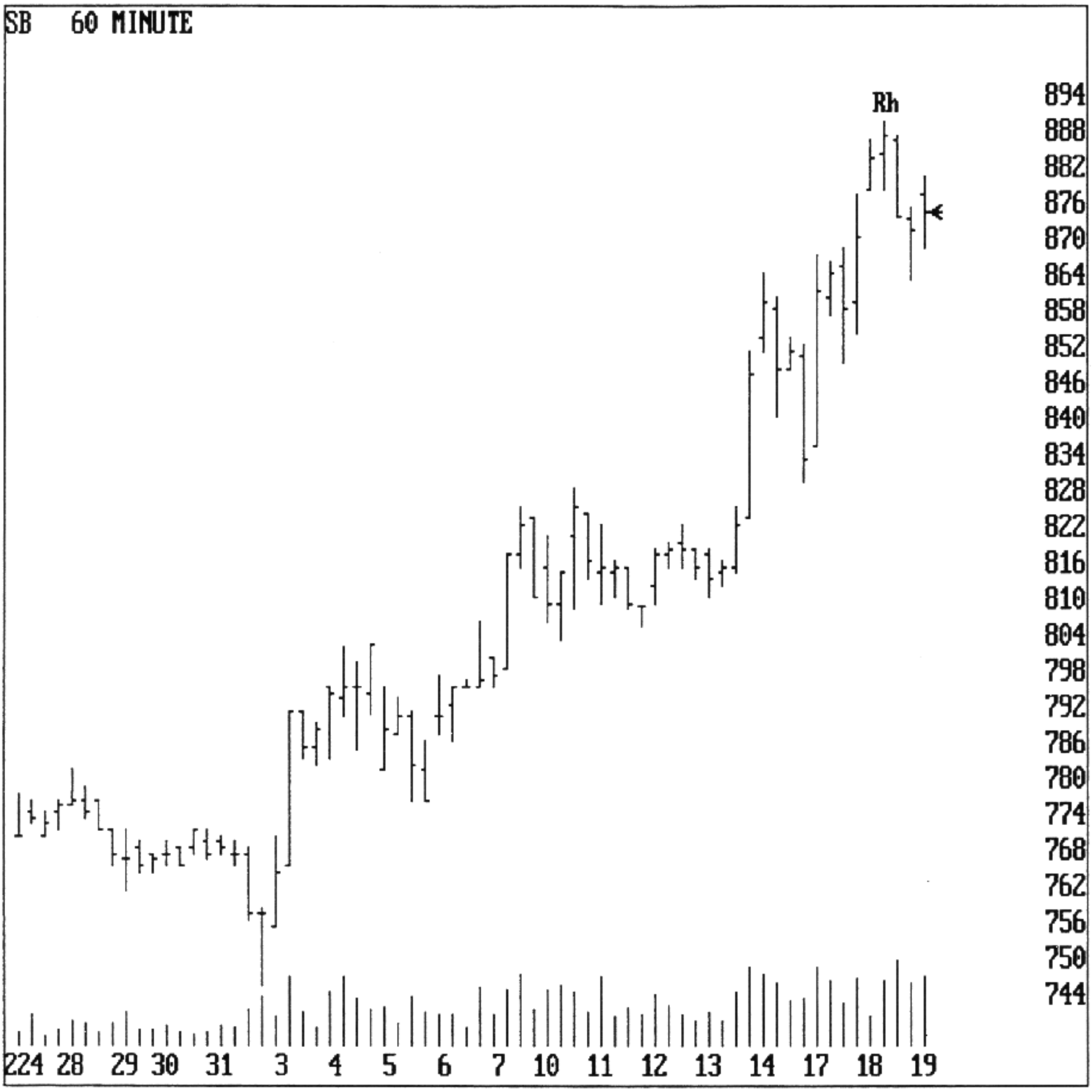
When the next bar closed, I inched my profit protecting stop up another notch to 878.



I was stopped out at 878. Since this was a correction bar, I placed a buy stop just above the high and got ready for the last bar of the day.



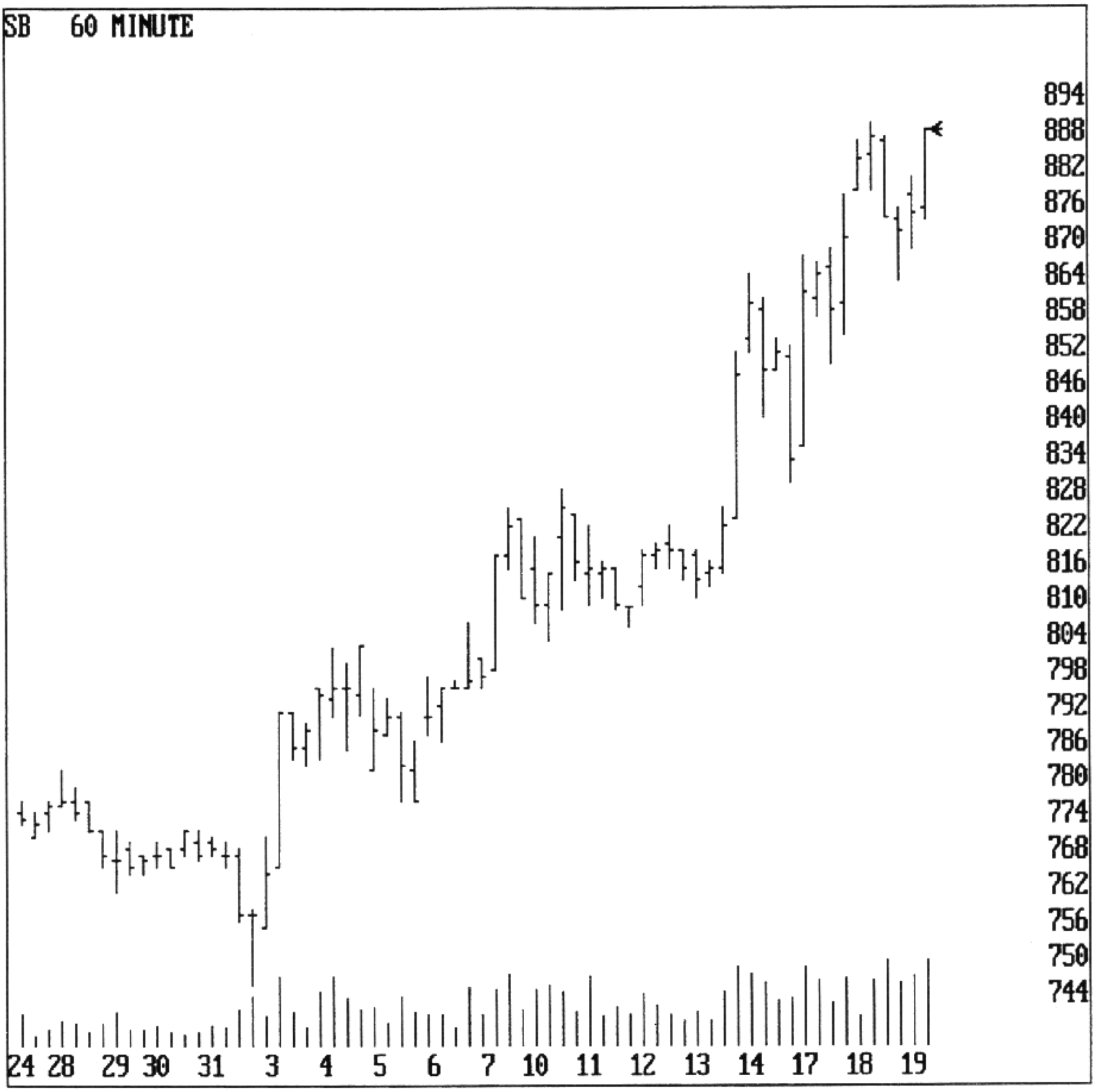
The last bar of the day was also a correction. I marked my chart as you see above. I would wait for the open tomorrow and buy a breakout of the high of the last bar, and also a breakout of the high of the bar that was the point of the Ross hook.



When prices opened above my buy point but were still within yesterday's price range, I decided to enter the market at 875 if given the chance. That meant I would try to enter if prices traded back up through the previous bar's high.

I have to admit I was pushing this trade, but I didn't want to miss getting in early on a breakout of the Ross hook in the event it took place.

I placed my cost liquidation objective at 875, and my stop loss at 865. Prices went on to a low of 868, so I had to hold my breath for awhile.

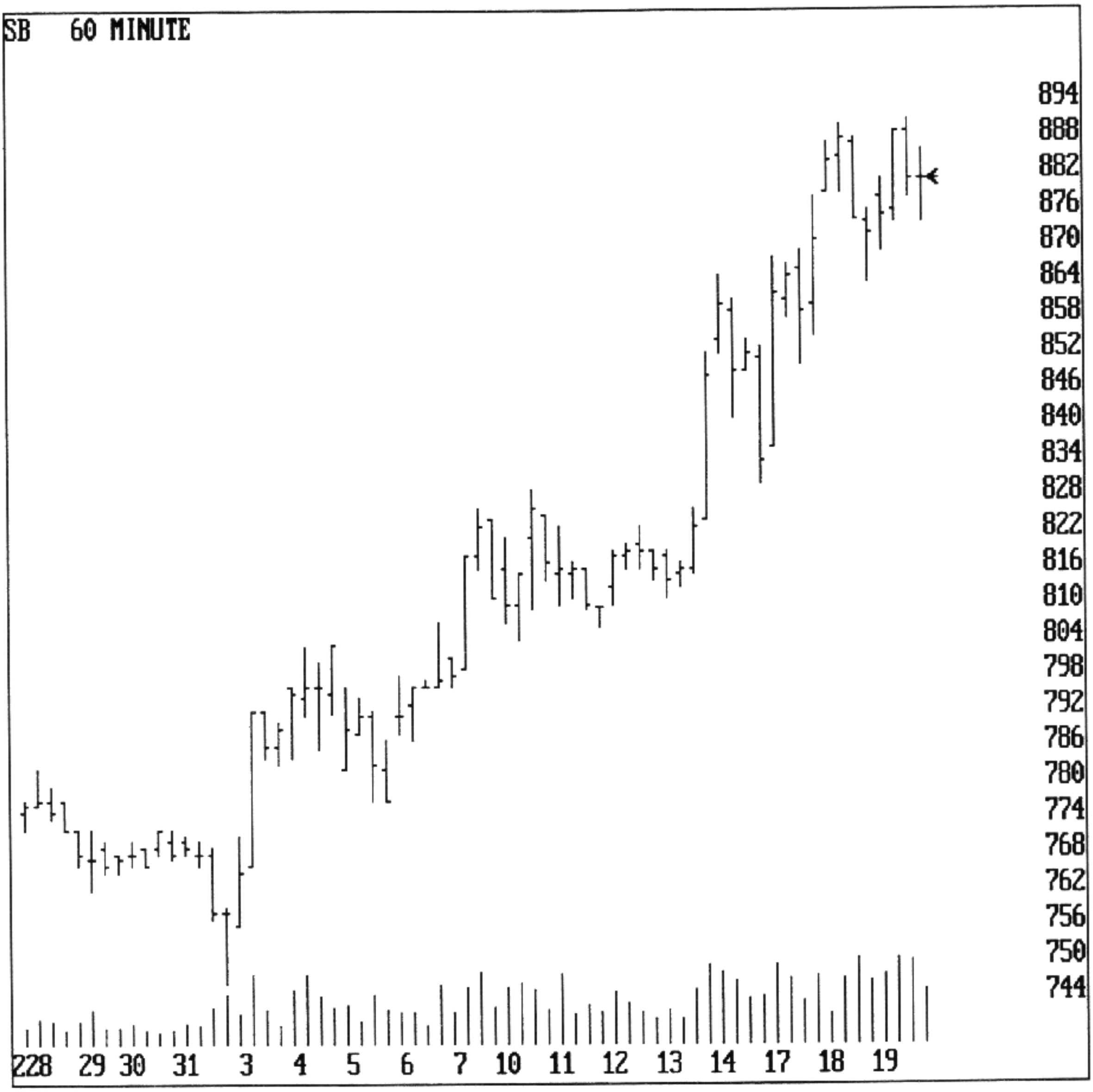


The next price bar brought vindication as prices moved up and closed at the high. I was able to liquidate three contracts and made $86.00 over costs. I moved my stop to 881 to protect six points of profit.

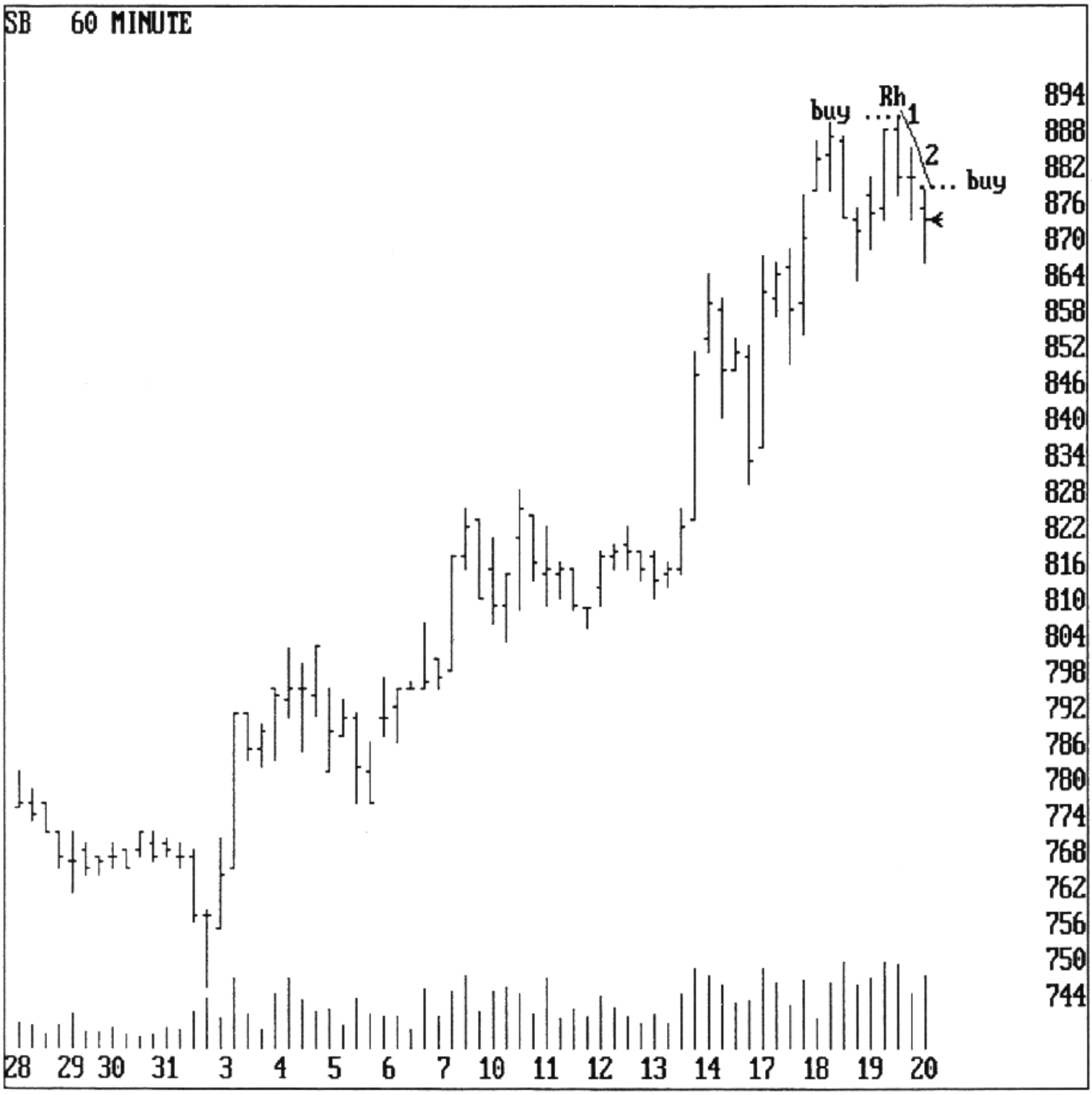
When the next price bar opened, I was soon filled a five lot on my Ross hook breakout at 890. This proved to be the high of that price bar. I hate when I get filled by one tick and then prices go immediately against me.

I placed my stop at 881, along with my other stop.

I was stopped out of both trades at 881. I had lost $250 in costs, and $504 in points. Offsetting that was $86 from my first contract set and $470.40 in profits. My net loss this day was $177.60. I don't always win.



When the last bar of the day made a corrective doji, I decided to place a buy stop at the new Ross hook, as well as at the high of the doji bar as soon as I saw the open.



The following day, prices opened lower. I've shown above what my chart looked like. This was the second bar of correction. I would try to buy its high and a breakout of the Ross hook.

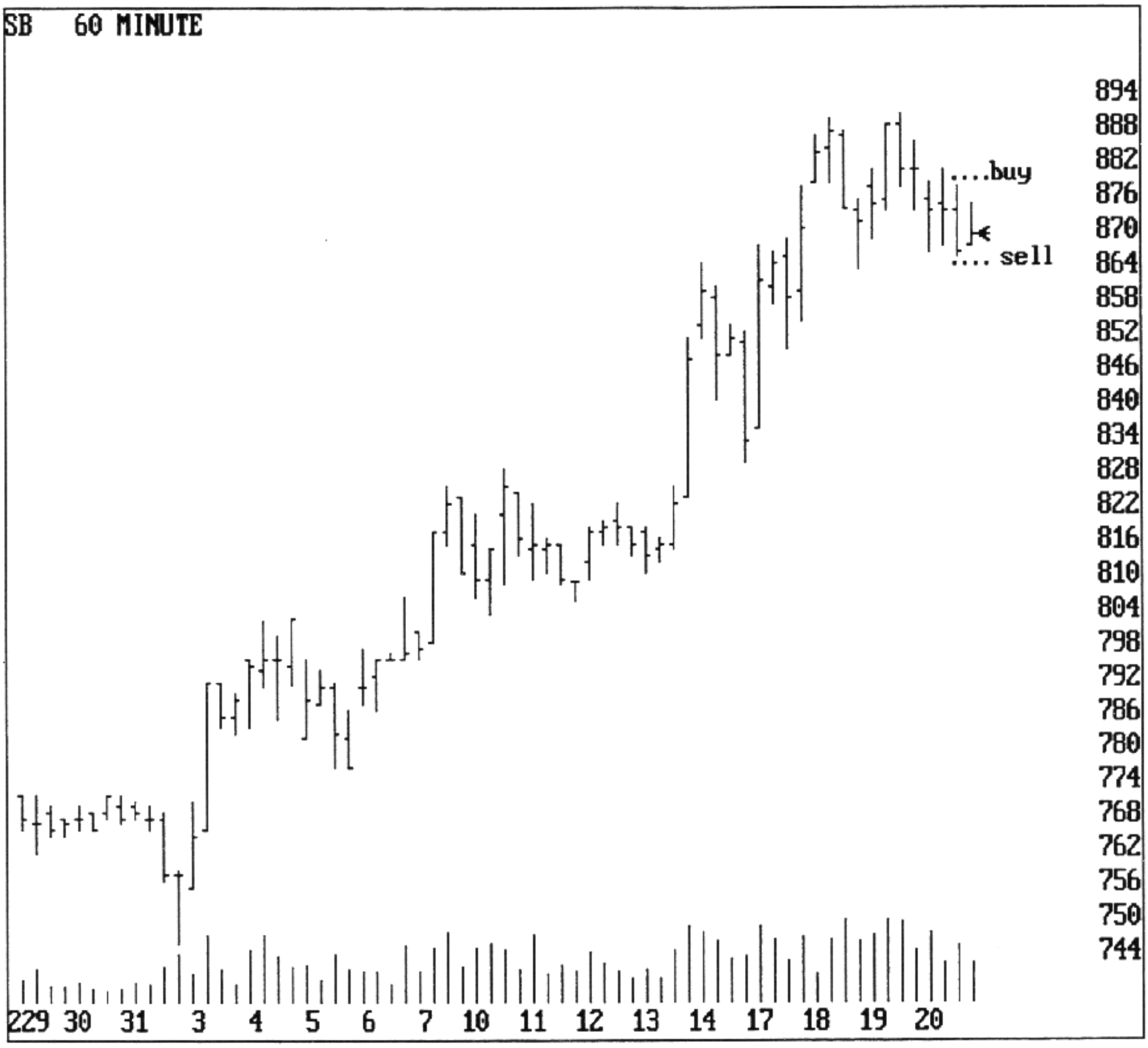
I was filled a ten lot at 879. Average volatility was running consistently around 12 points. It was still outside the amount I'm willing to risk on a sugar trade on the sixty minute chart.

I placed my liquidation objective at 889 and my stop loss at 869.

When this price bar closed lower than it had opened, I placed an order to exit the trade at the market. Why did I do that? Because I was looking at (from left to right starting 3 bars back), a reversal bar, a doji, and two consecutive bars that closed lower than they opened.

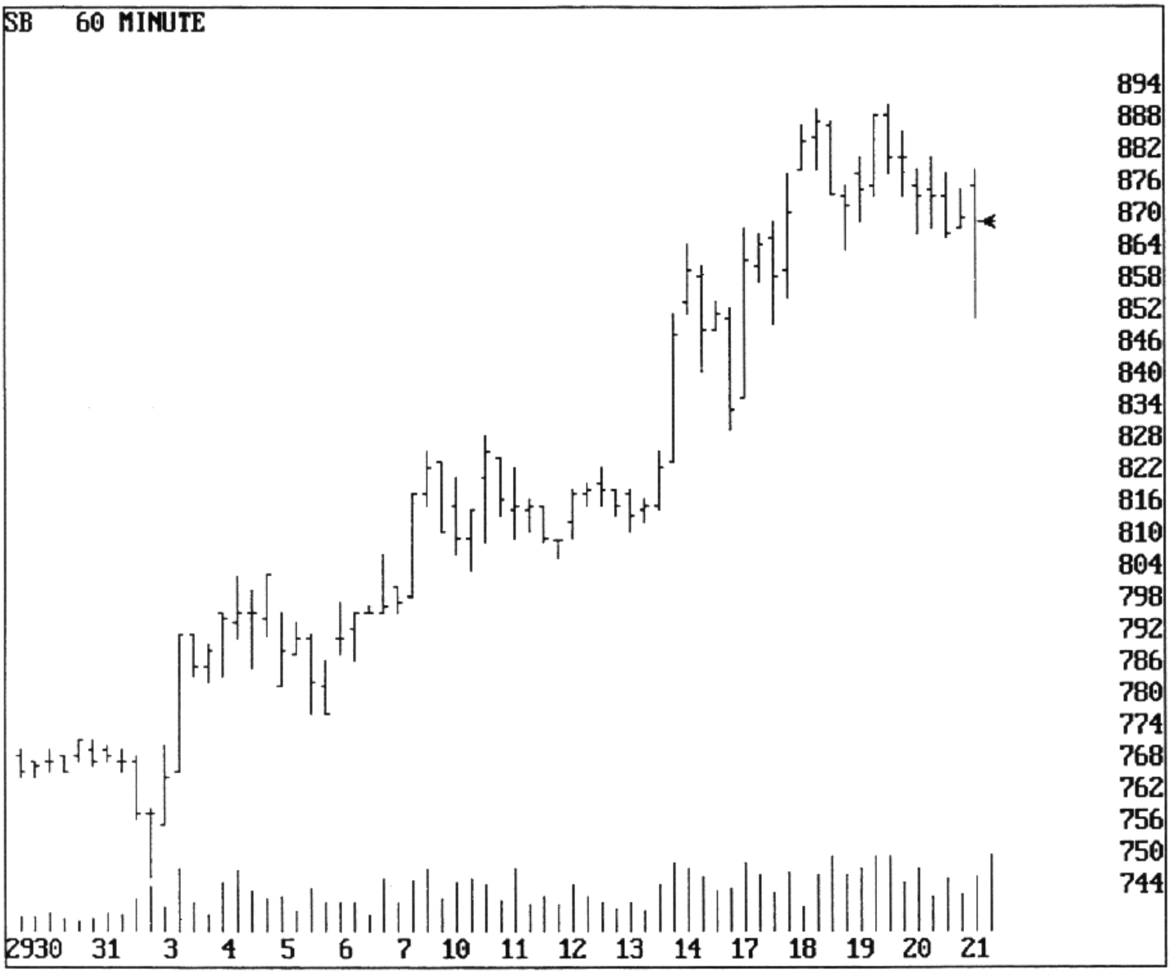
I was able to liquidate my ten lot at 877 for a loss of two ticks per contract. Add to that my costs of $250 and I was down on this trade by $474.

As soon as I was out of the trade, I marked my chart as shown above. Prices were now at a critical juncture. If the high was taken out, I would assume that the three segments of correction were over. If the low was taken out, I would assume that a new trend was in effect.



The following price bar, the last of the day, was an inside bar. When it completed, I marked my chart as shown above. For the reader who is familiar with my work, and as shown earlier in this book, the above formation also was a ledge.

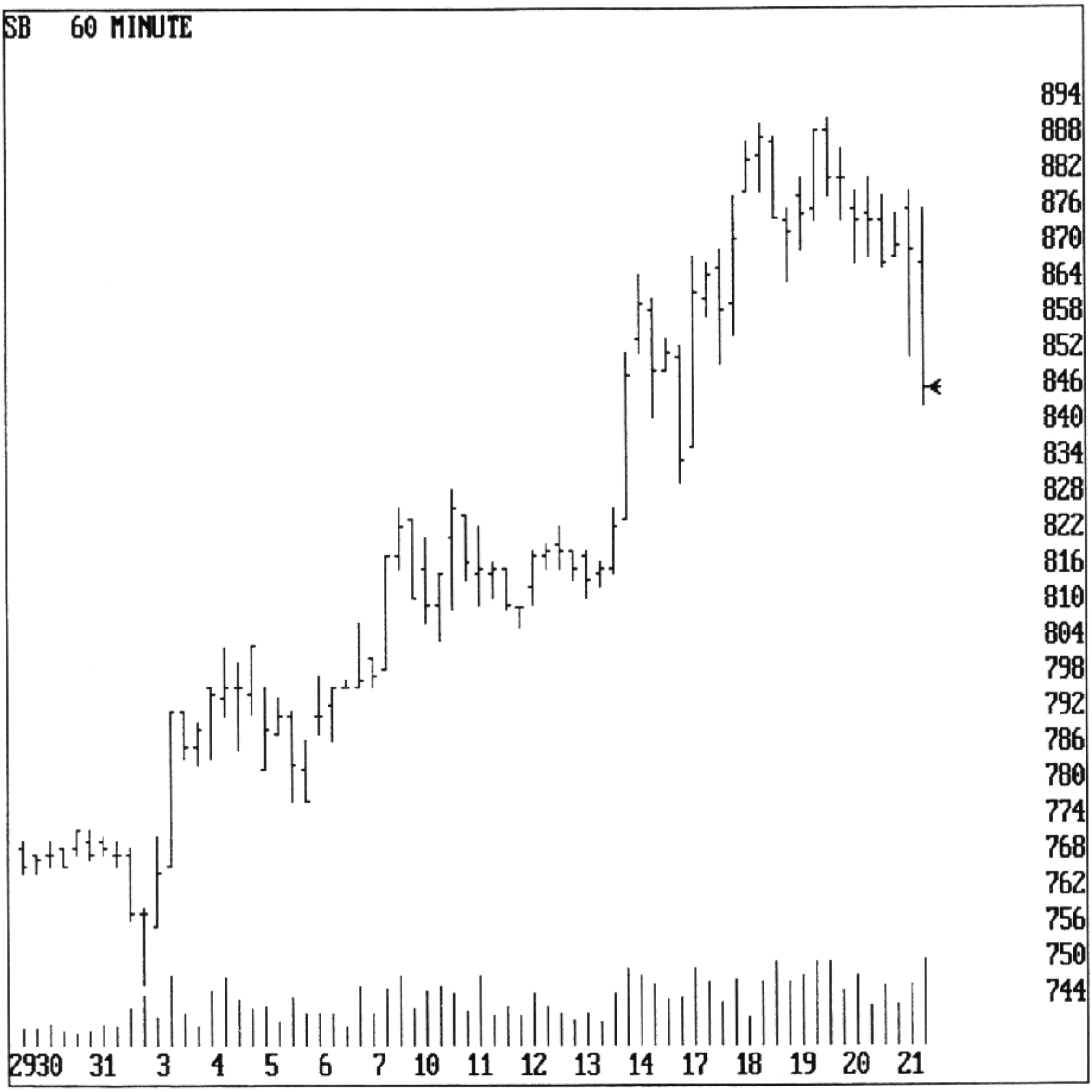
In all honesty, I was again pushing for a trade. I tend to do that when I trade for my writing. This is over trading, and very aggressive. I'm virtually forcing myself into the trade by trapping the market. I want to emphasize that such tactics are not necessarily good. Normally I would be looking elsewhere for much better trading situations. But when I trade for my writing, and make a commitment to pursue a series of trades to the bitter end, I trade as if this market were the only market in town. I apologize for that, and hope my readers will realize that such trading is unbalanced and not sufficiently selective.



I was short a twenty lot on a breakout of the Ross hook. I used a twenty lot here because I rarely take more than two hits in a row. I play the probabilities on trades like these. I know a lot of statistics experts who would say that my chances of losing on this trade were the same as for any other trade. I emphatically do not agree with that kind of thinking. They may be able to prove it mathematically, but arithmetic doesn't always accurately describe real life. In this case, I'm dealing with sequential rather than random probability.

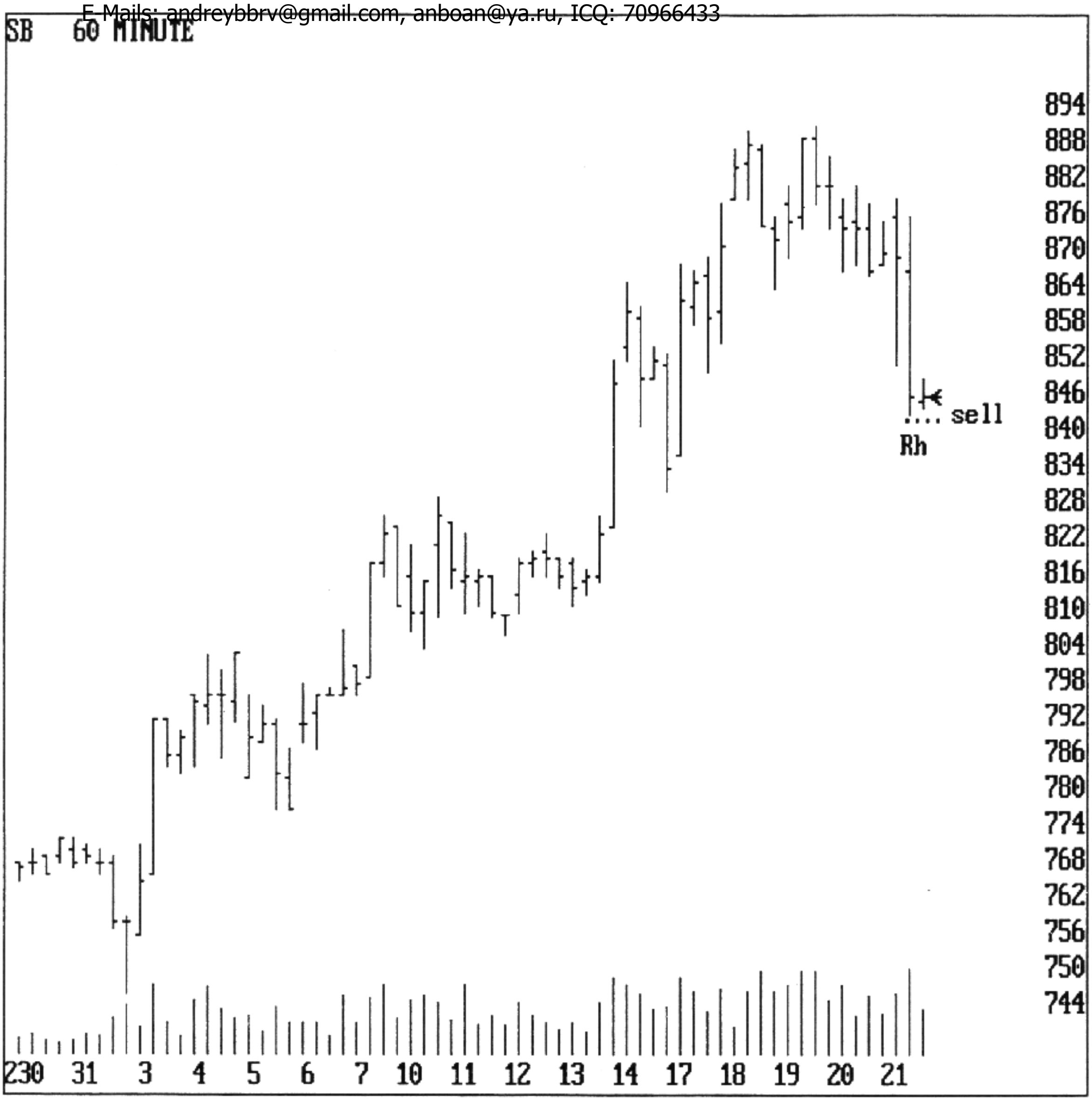
I was filled at 864. I liquidated six contracts at 854 and moved my stop to protect 7 points of profit. I was stopped out of fifteen contracts at 857 and four contracts at 856.

I made $172 profit when I covered costs, $784 profit on ten contracts, and $224 on four contracts for a total profit of $1314.40. I had redeemed my previous losses.

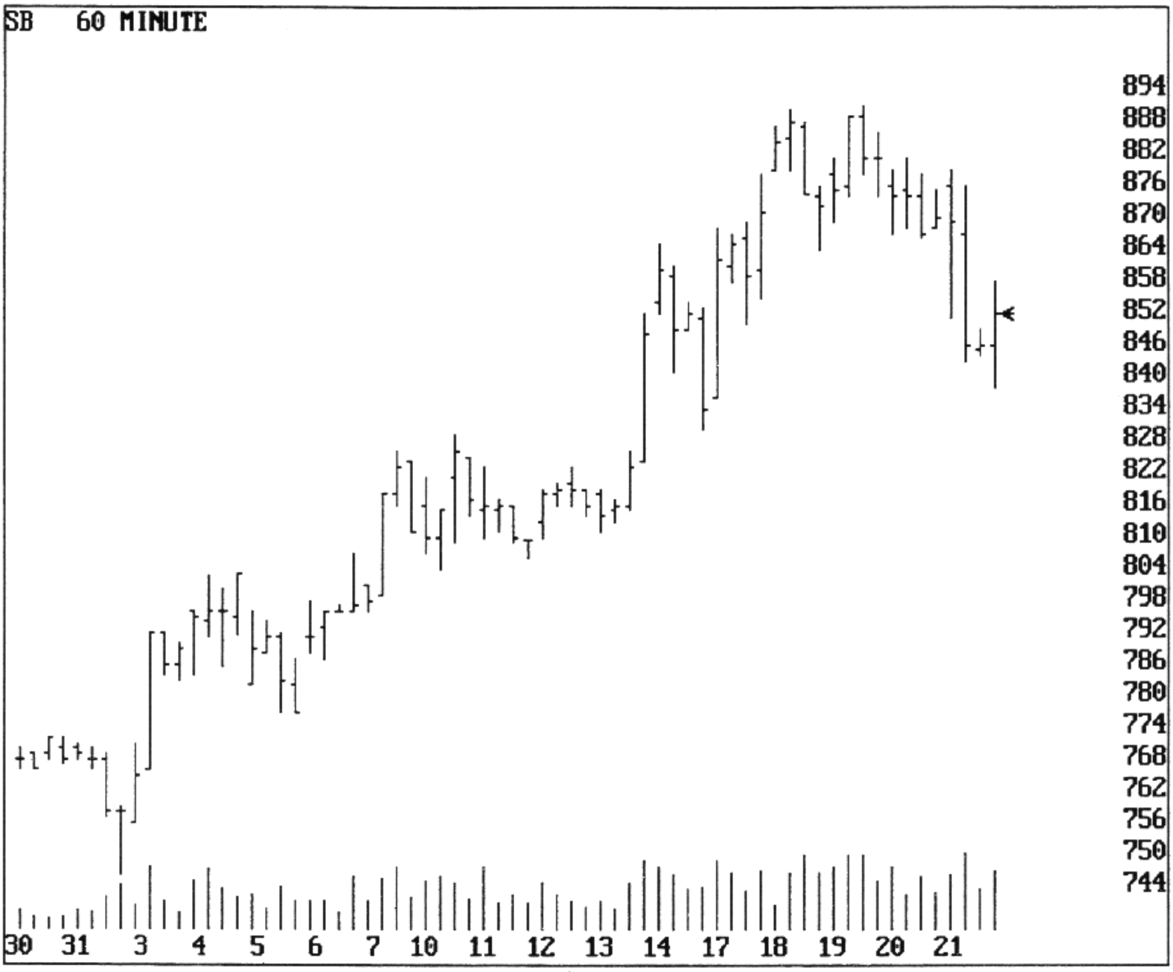


Since prices closed back into the congestion area, I decided to place a sell stop where I had previously placed it. I would short another ten contracts at 864. This represented a second time through entry at the edge of congestion.

The following bar saw prices open at 866, trade up for awhile, and then take out the Ross hook. I was filled with a ten lot at 864. I placed a buy stop to protect against loss at 874. I covered costs with three contracts at 854. When the bar closed lower, I moved my stop loss to protect profits at 853. That was one-half of the twenty-two points of unrealized profits showing in the trade.



With the next bar being a reversal bar, I moved my stop to just above the high. I also placed a sell order just below the low in case the trend continued.



I shorted a five lot at 842 with a stop at 849 where the stop was for my ten lot. Prices dropped down at first, but I was unable to cover costs. When prices came back through where the price bar had opened, I cashed all twelve contracts at the market. Amazingly, all were filled at the same price – 846.

The results were a win and a loss. The seven contracts from earlier made eighteen points, or $1411.20. Add to that the $86.00 I had made when I covered costs, and I had at total of $1497.20

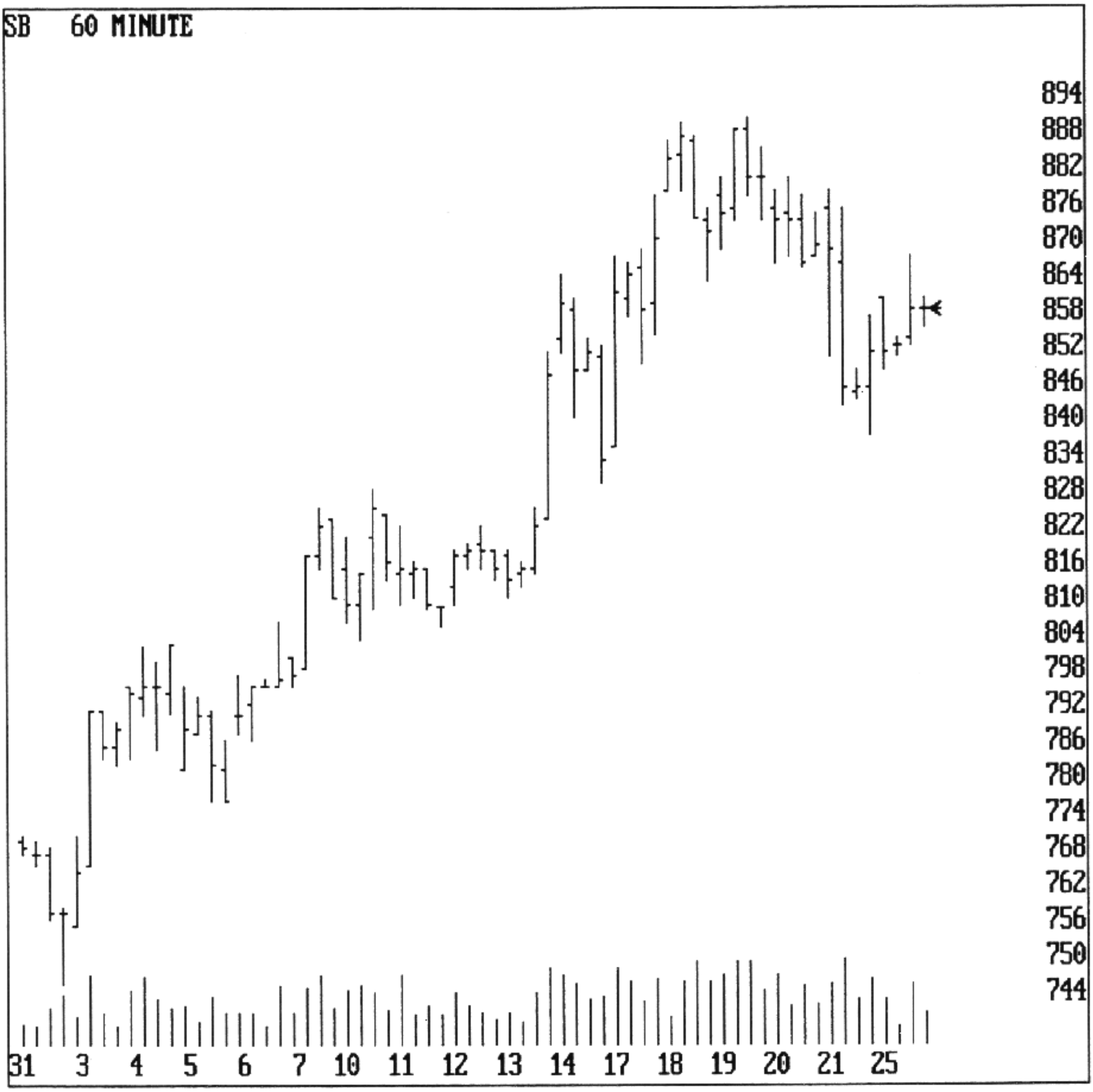
The five lot had costs of $125. Added to that was a four point loss which resulted in a loss of $224. My total loss was $349. Taking that against my win of $1497.20 left me with $1148.20.

I was now anticipating placing a sell stop below the low of this outside bar. Tomorrow would see whether or not it could be done.

The opening bar the next day brought another day of correction. I connected the two lows. I also placed an order to sell both a breakout of the low of the correcting bar and the Ross hook.

An inside doji bar was not much help, other than allowing me to identify a Ross hook and connect a line across the lows of the correction. I now had two corrective bars. I moved my sell order up to below the little doji bar and waited for further developments.

I was long a ten lot at 861 when prices took out the Ross hook. Average volatility was high enough that I used a 10 point stop and a 10 point liquidation objective.

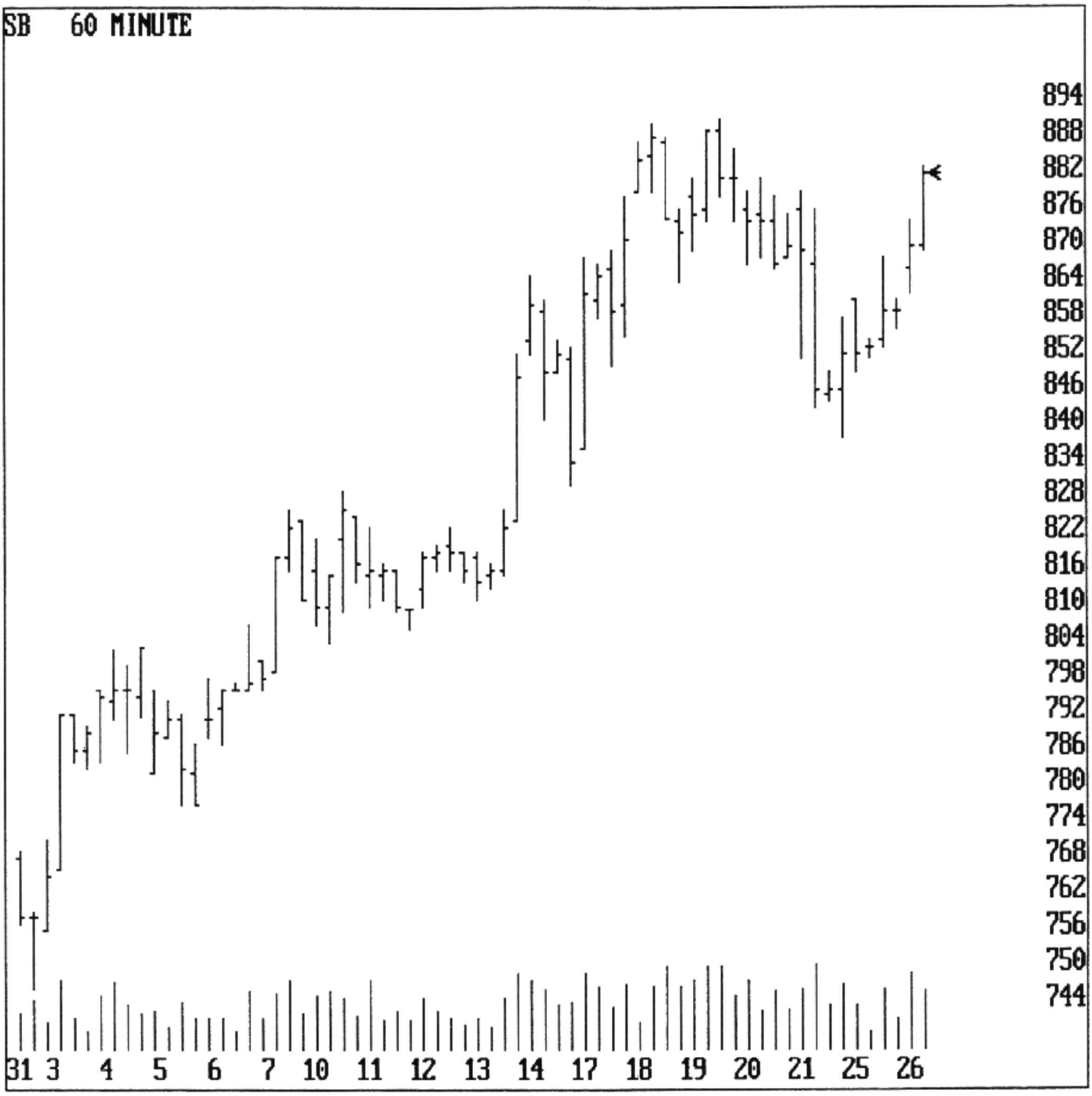


Neither stop was filled going into the doji closing bar. Just prior to the close, I decided to spread the trade off against the March contract if only to give the trade more time. I was down 3 points at the close. It cost me another $250 to find out what would happen tomorrow.

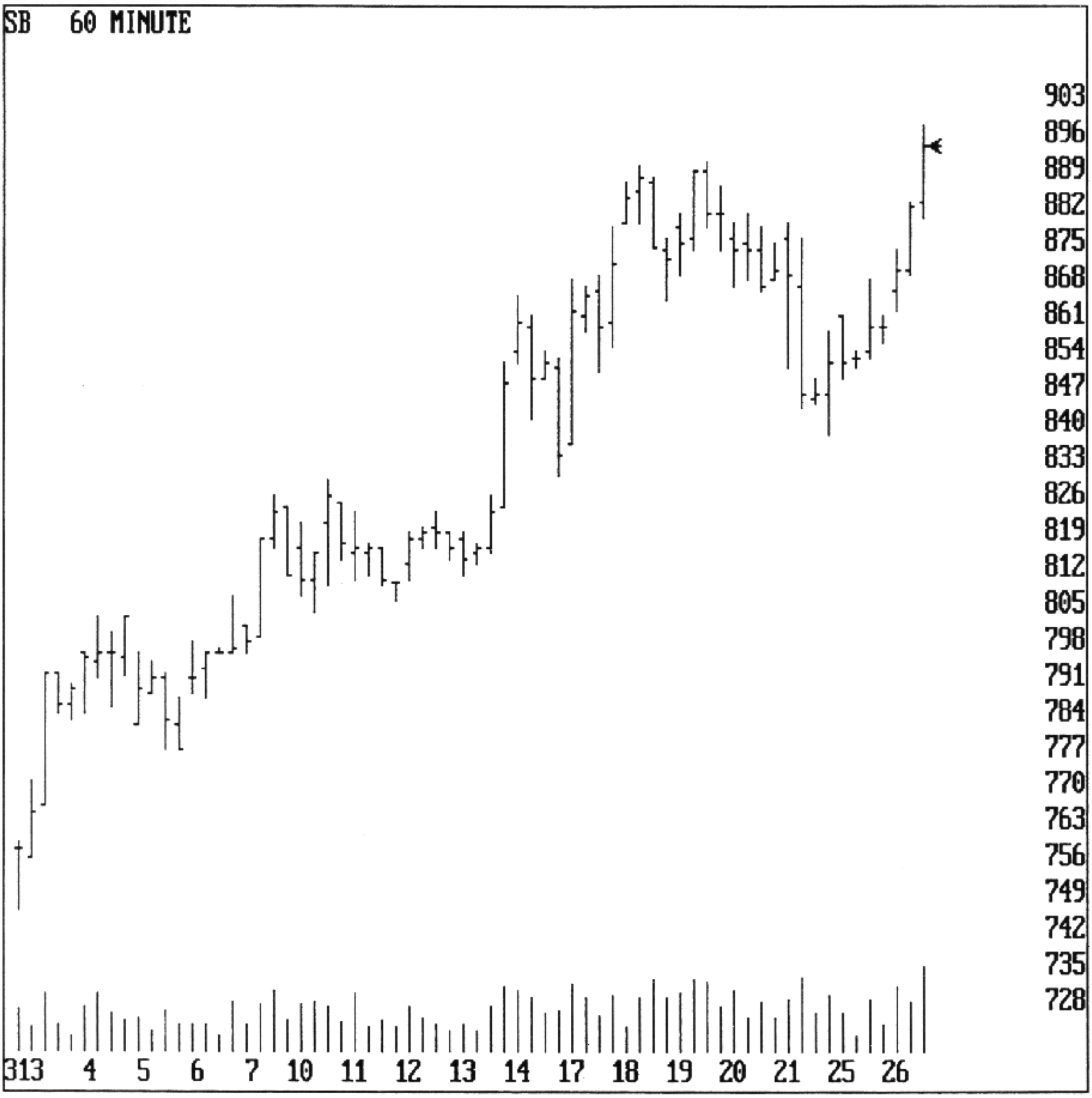
The inside doji had made another Ross hook, so I would place a buy order there, too, if the market didn't go against me overnight.

Next day, the market opened higher moving up to 873 on the opening bar. I waited on pins and needles while prices traded down and away from the open. I dropped the short side of my spread when prices traded back through the open. I was able to cover costs for my ten lot with three contracts. I had a surplus of $86. I moved my protective stop to breakeven at 861.

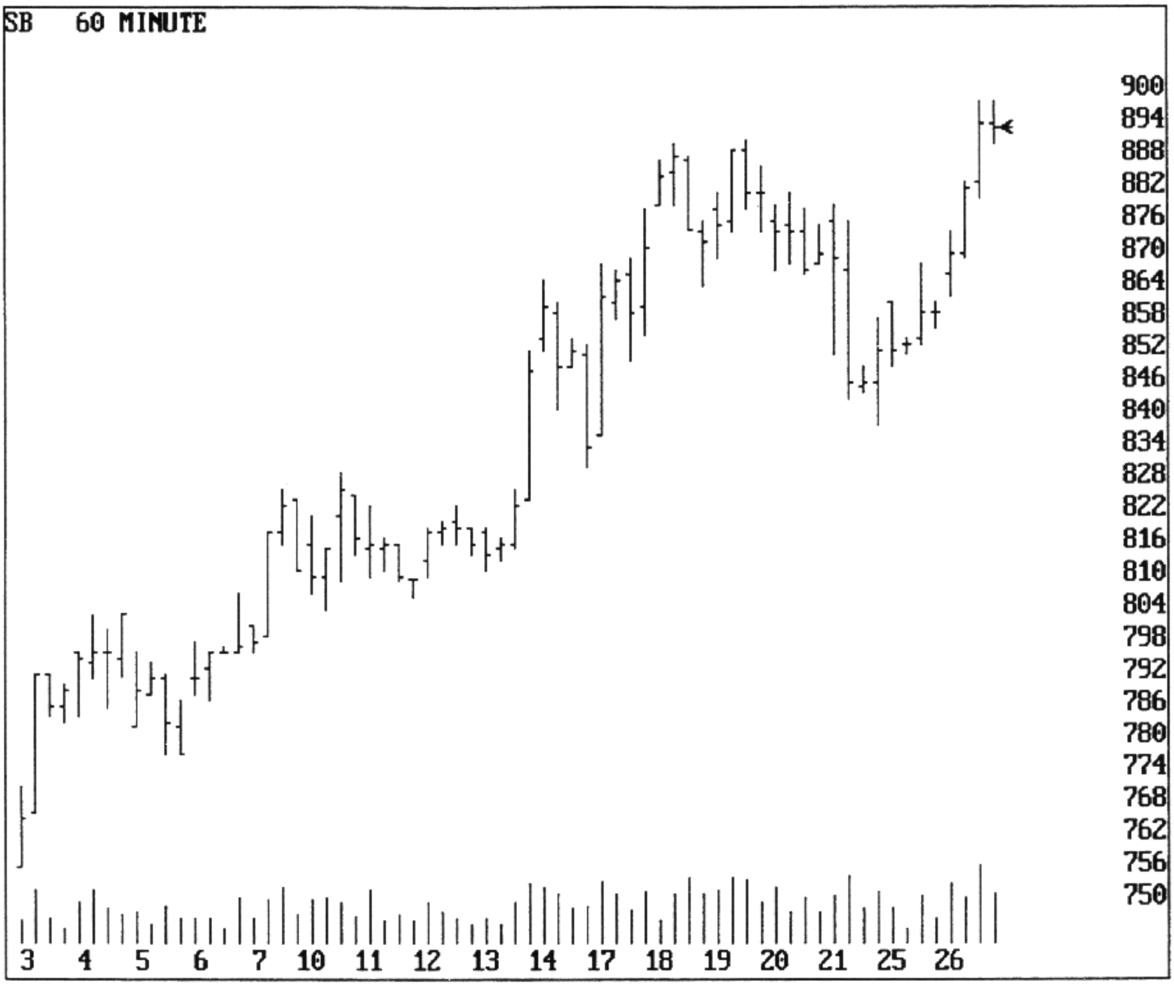
On the way to 873, the market filled my buy order for a five lot on a breakout of the Ross hook. I was long at 868. I placed a stop loss at 861 with the stops for the seven contracts I had left from my ten lot. Because average volatility was up, my cost covering objective was twelve points, or one contract at 880.



Prices pushed higher. I was able to cover costs on my five lot, and I pulled all stops to 872. Now everything was in a profitable position.



Prices rose even higher on the next price bar. I moved all stops to 878 to protect profits.

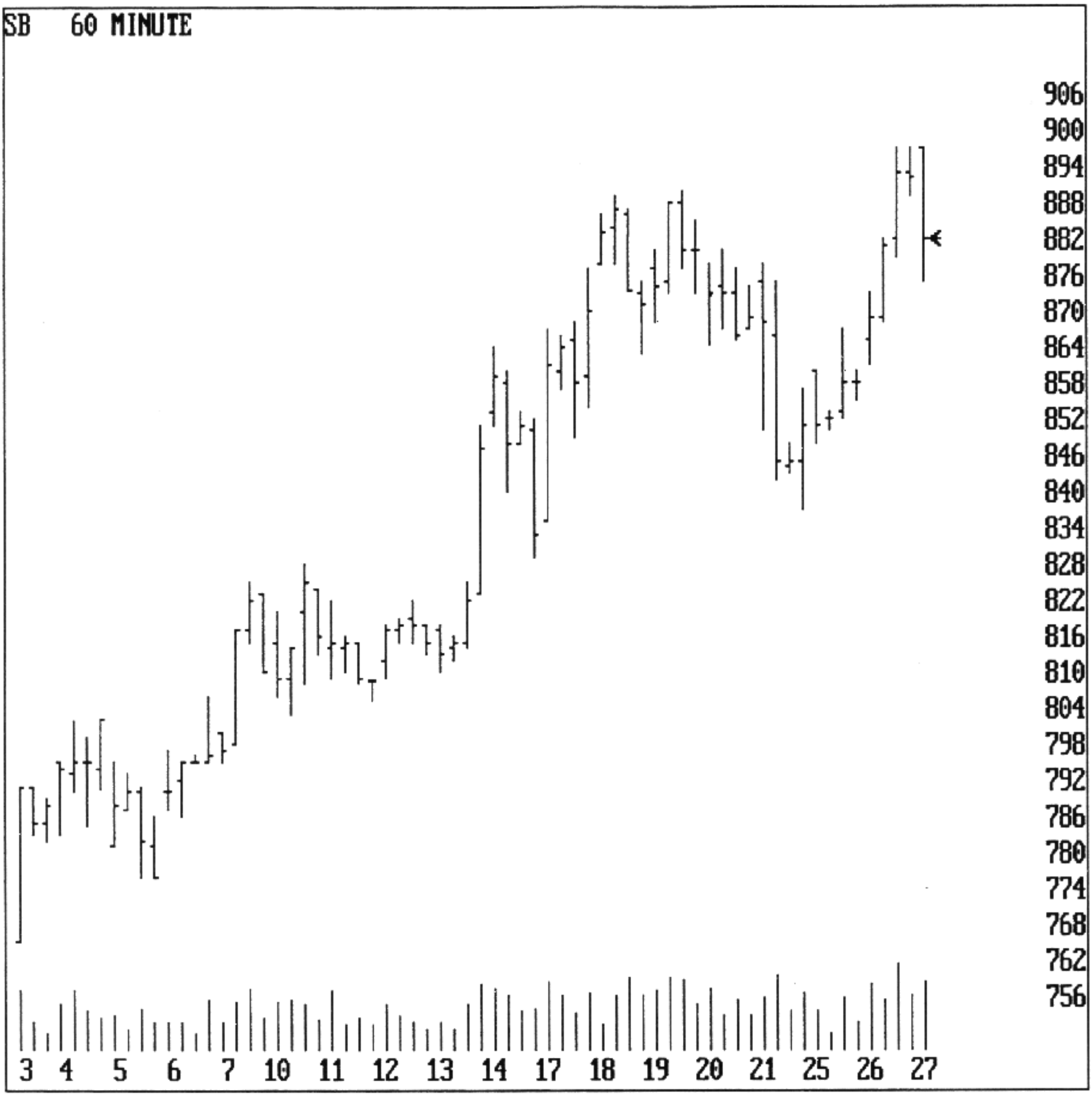


With prices making a double top and a reversal on the last bar of the day, I exited my entire position one minute before the close at 891.

I feared a gap down opening for the following day, and did not like the alternatives that were available. A stop in the London market didn't make much sense because I wouldn't know exactly where to put it unless I watched the London opening. That meant getting up in the middle of the night.

I didn't want to spend another $375 for insurance by using a spread against March. The easiest thing to do was to get out, so I did.

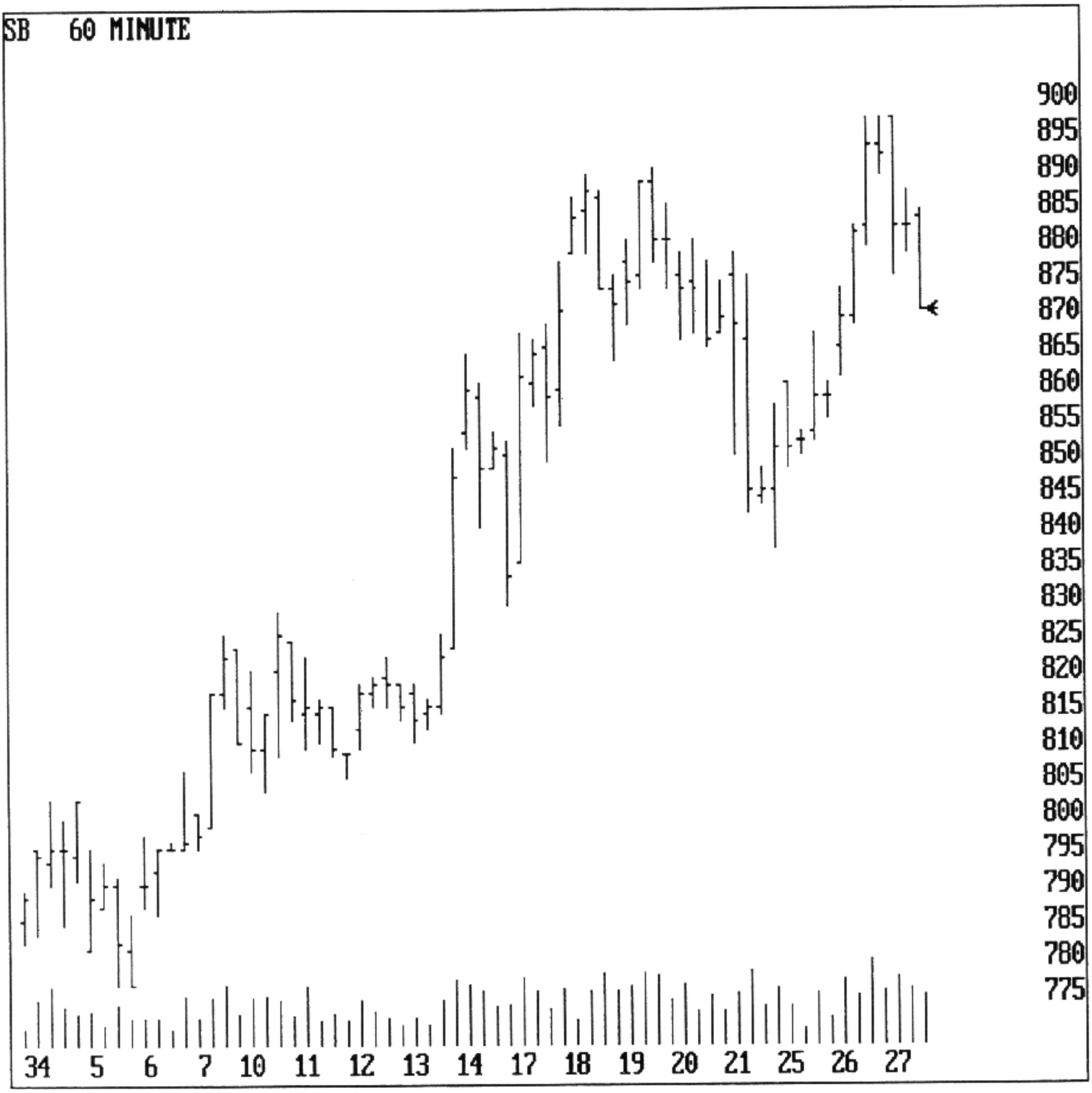
Profits were $3,852.80 based upon one contract making 12 points, three contracts making 10 points, seven contracts making 30 points, and four contracts making 23 points. Costs of $625 gave net profit of $3,227.80.



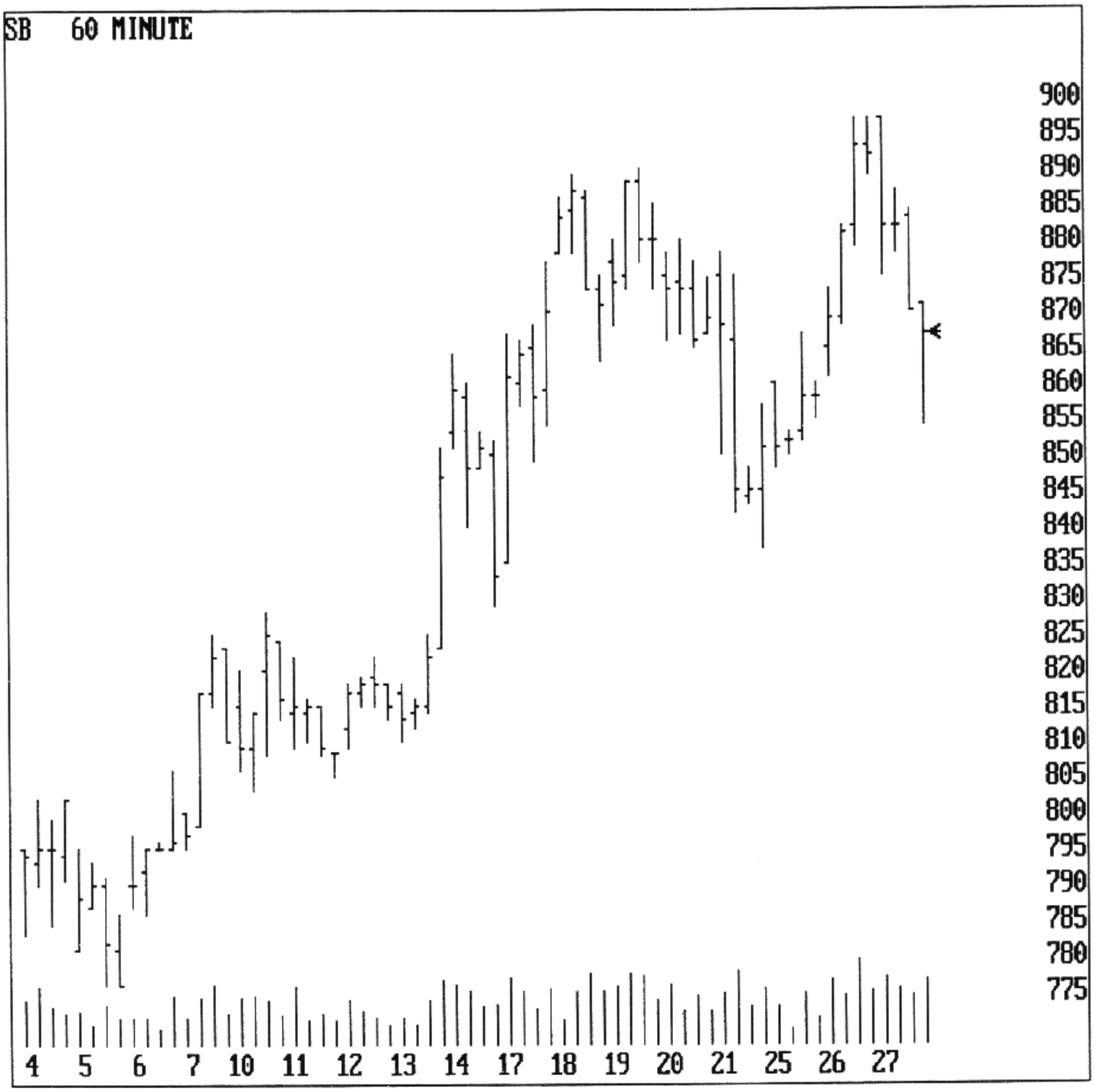
Although I lost some points on the open, I was glad I had gotten out of the trade the day before. Prices plunged all through the day.

I placed a buy stop above the triple top and waited for further developments.

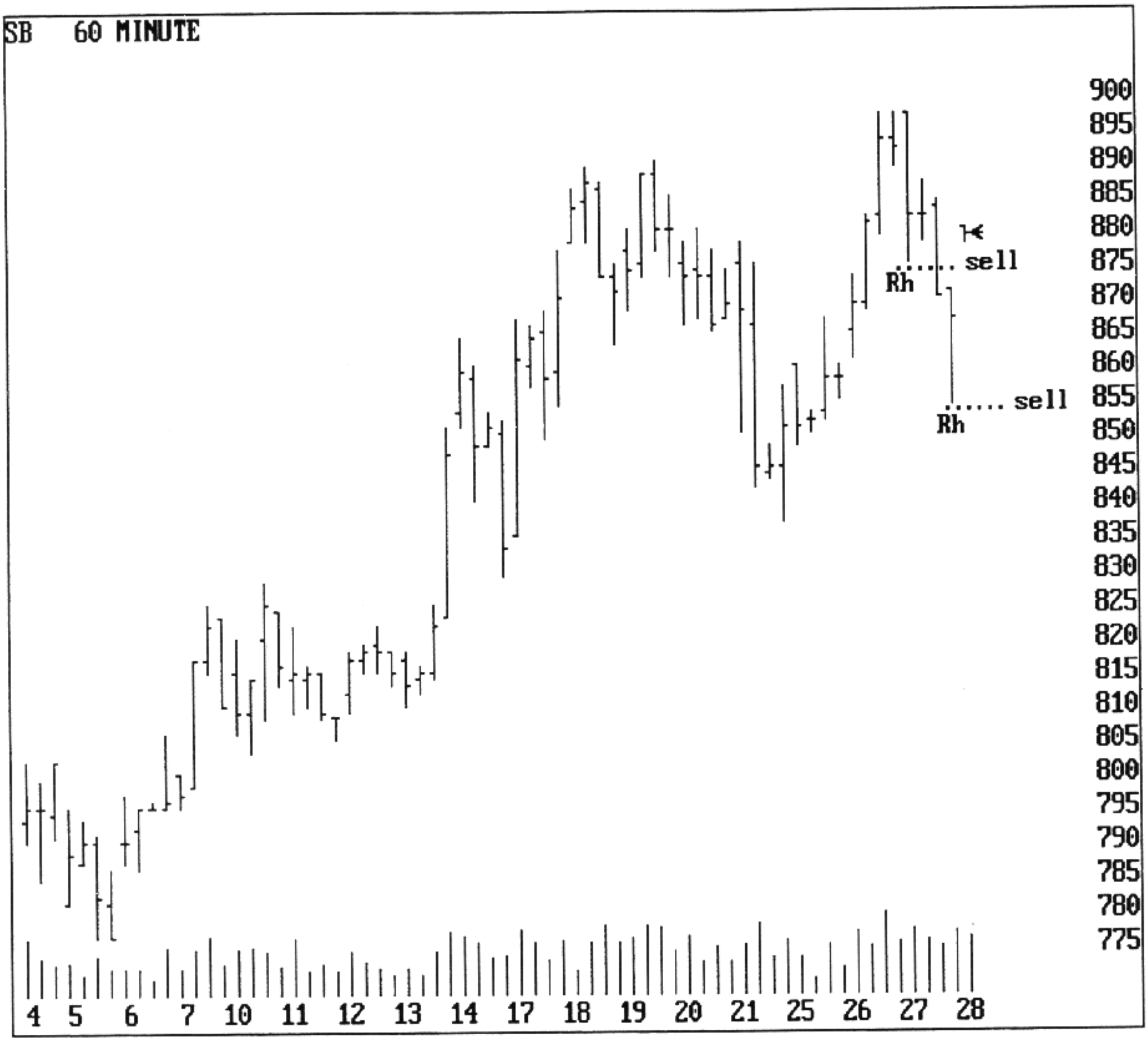
At the next bar, I placed a sell stop below the Ross hook and a buy stop above the high of the inside bar.



I was short a ten lot at 876 on a breakout of the Ross hook. My stop loss was at 886, and my liquidation objective was 866. Prices did not reach 866 on this bar.



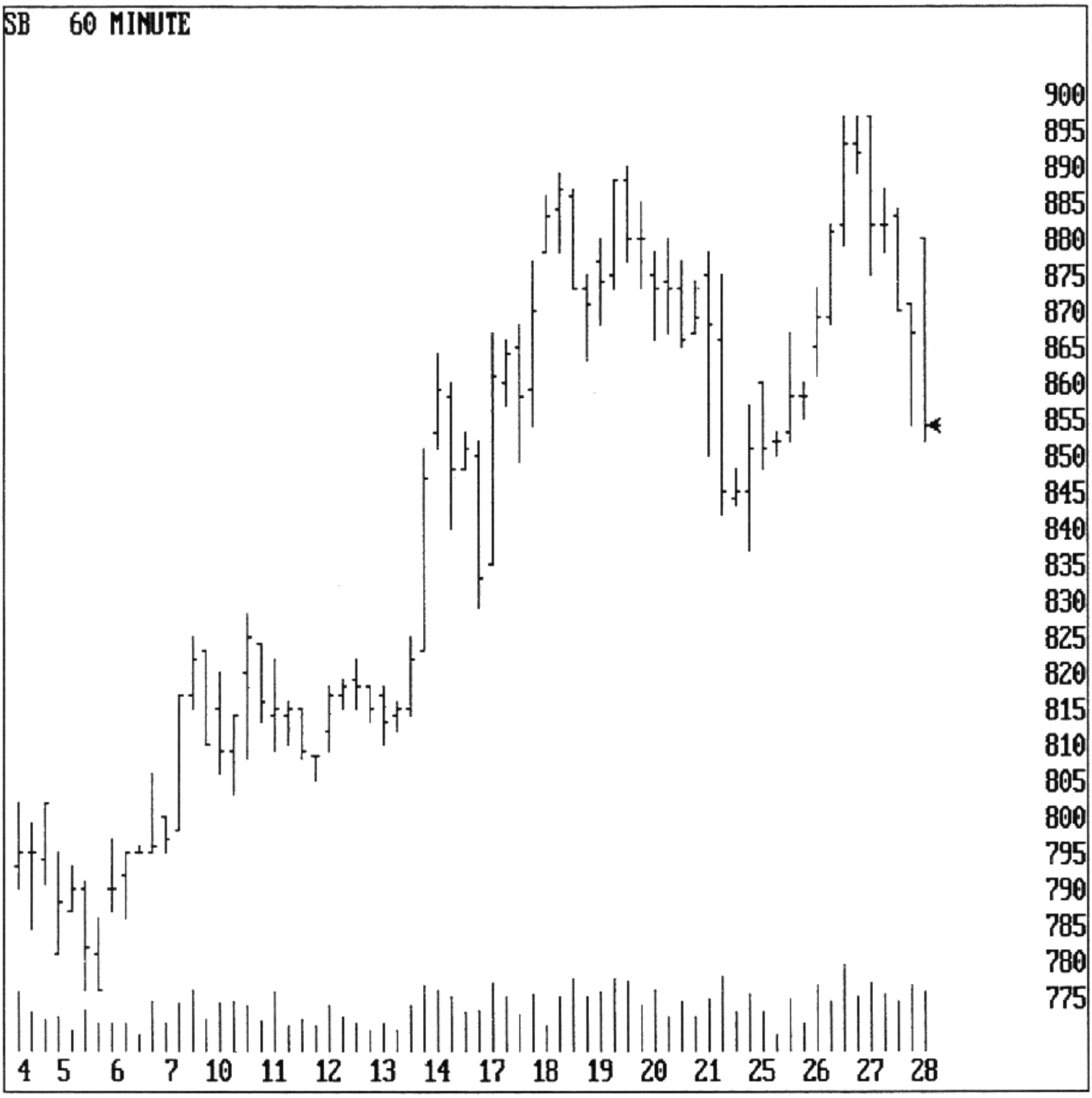
Prices did reach my liquidation objective, and I cashed three contracts to cover costs. I then moved my stop to breakeven. Prices went down pretty hard, but then began to work their way back up. Shortly after prices reached their low for the day, I computed what one-half of the unrealized paper profits in the trade would be. I moved to save 11 points of the 22 I had made. I was stopped out just before the close at 865.



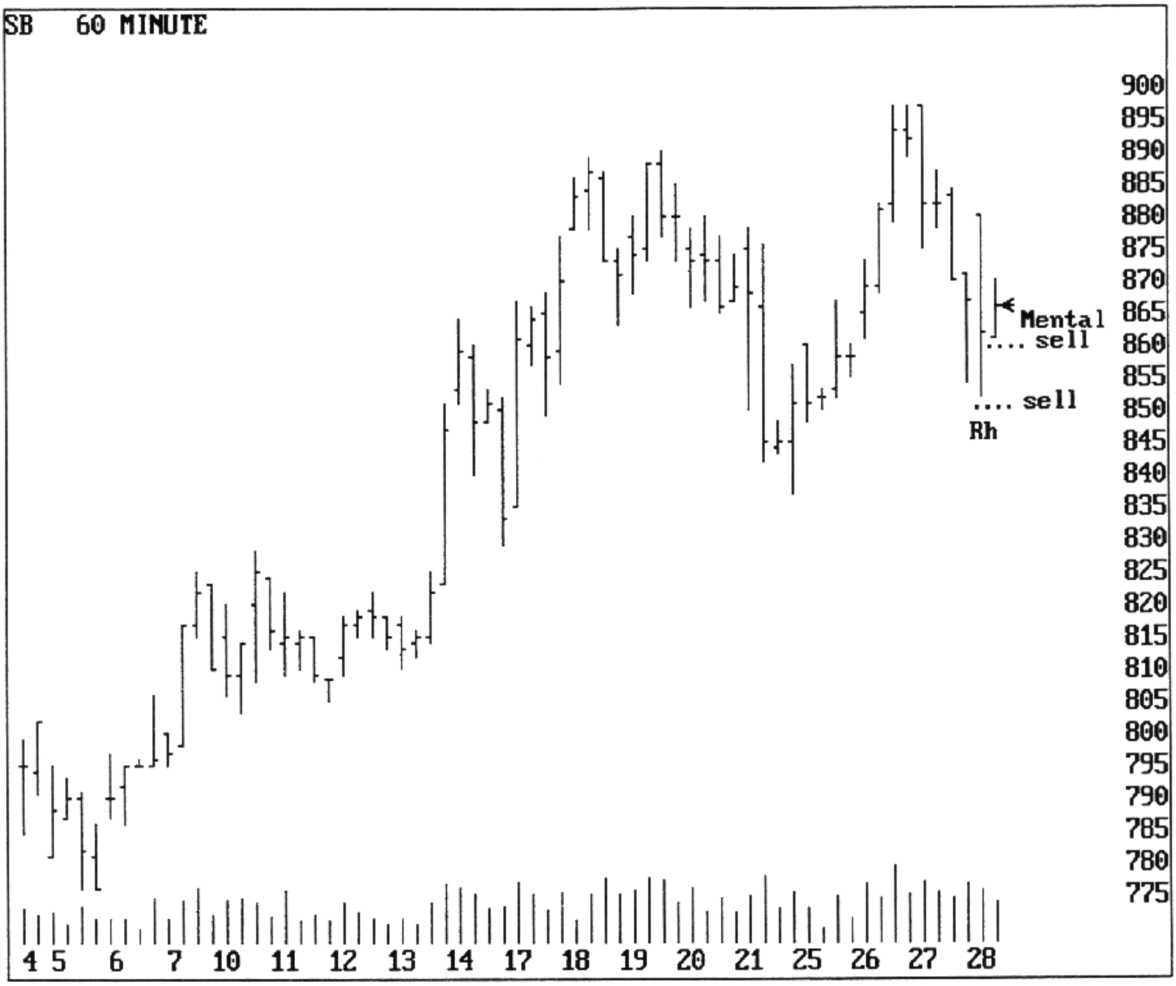
Next morning, sugar opened higher. Prices were now above the Ross hook of the previous day. The open had created another Ross hook as well. By opening above the low made by yesterday's last price bar, I now had two hooks staring at me. Here's how things looked shortly after the open:

Over the years, I've learned an important lesson. If an entry signal was good for profits once, it is good for profits twice. I have to admit I was a bit nervous about taking the old Ross hook. I was afraid prices might retrace after the open just enough to give me a fill and then take off the wrong way. But I've learned to trade what I see, not what I think. If that older Ross hook was good once, then it ought to be good again. I placed an order to sell a ten lot if prices broke below.

Prices broke below the old Ross hook and I was filled on a ten lot at 874. It wasn't too long before my cost liquidation objective was reached at 864. I cashed three contracts there on a MIT. I ended up being filled at 863, so I got a bonus of one point. Prices kept working their way down, so I moved the stop on seven contracts to breakeven.



I was filled on a five lot at 853. As soon as I was filled, prices began to move up. I quickly moved the stop on seven contracts to protect half the profits I had made. I protected 11 ticks at a price of 863. The trade called for me to place the stop on my five lot at 863 as well. I had a cost covering objective at 843. The hour closed at 862.

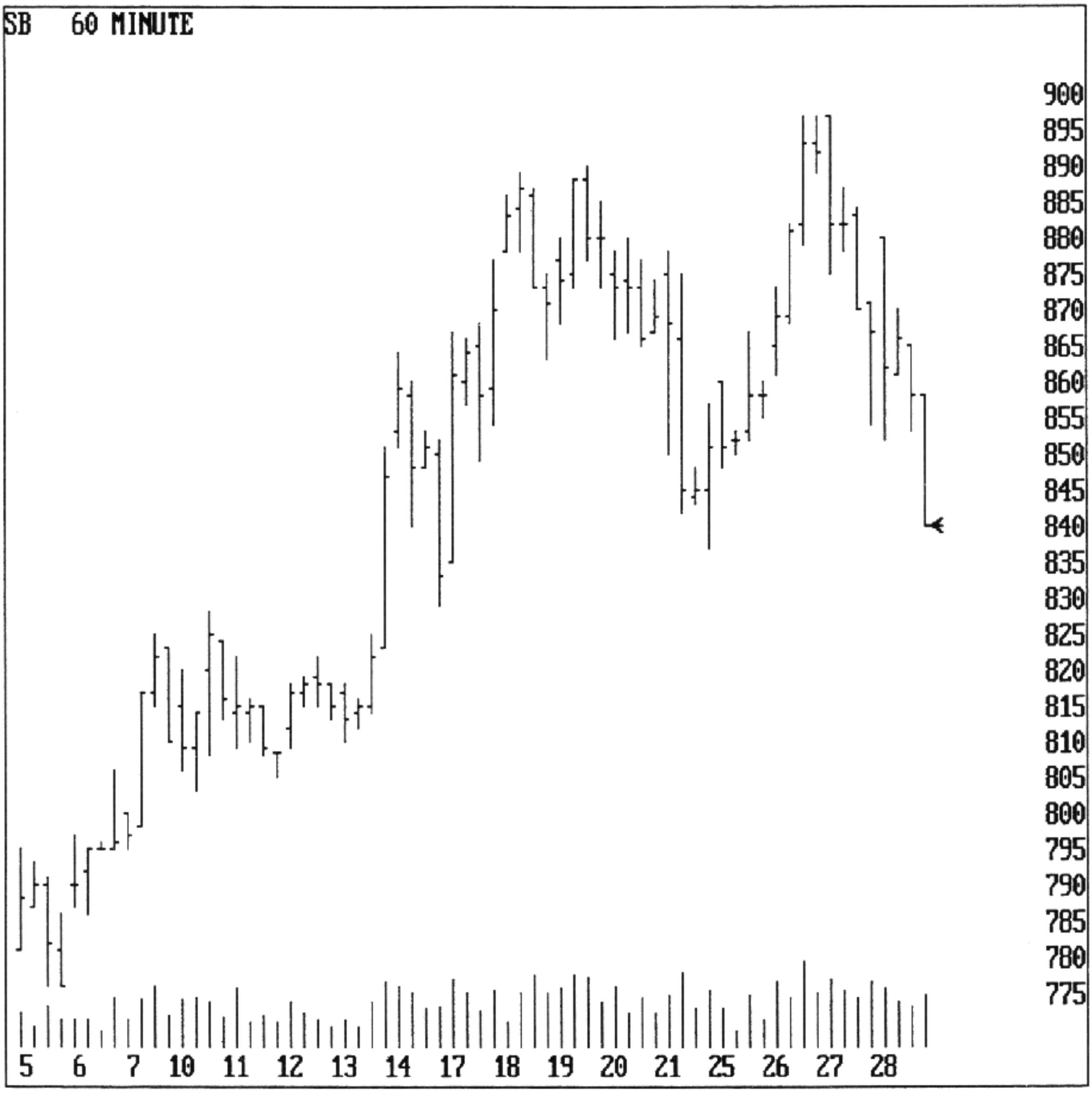


The next bar opened at 861, and I had hopes of prices moving even lower. My expectations were dashed when prices ticked to 863. It was time to place an order below the new Ross hook. While I waited for things to develop, I toted up the score. I had made eleven points on my entire ten lot at 863 - first when I covered costs on three contracts at that price, and then again when I took profits on seven contracts. I had total costs of $250, so my net profit was $1,232 - $250 = $982.

I had lost $560 on five contracts plus $125 in costs, for a total of $685.

When prices opened and then traded up sharply, I placed a mental sell stop below the open. If prices were to take out the open, they might test the area of the Ross hook which would give me a chance to scalp out a piece of the market.

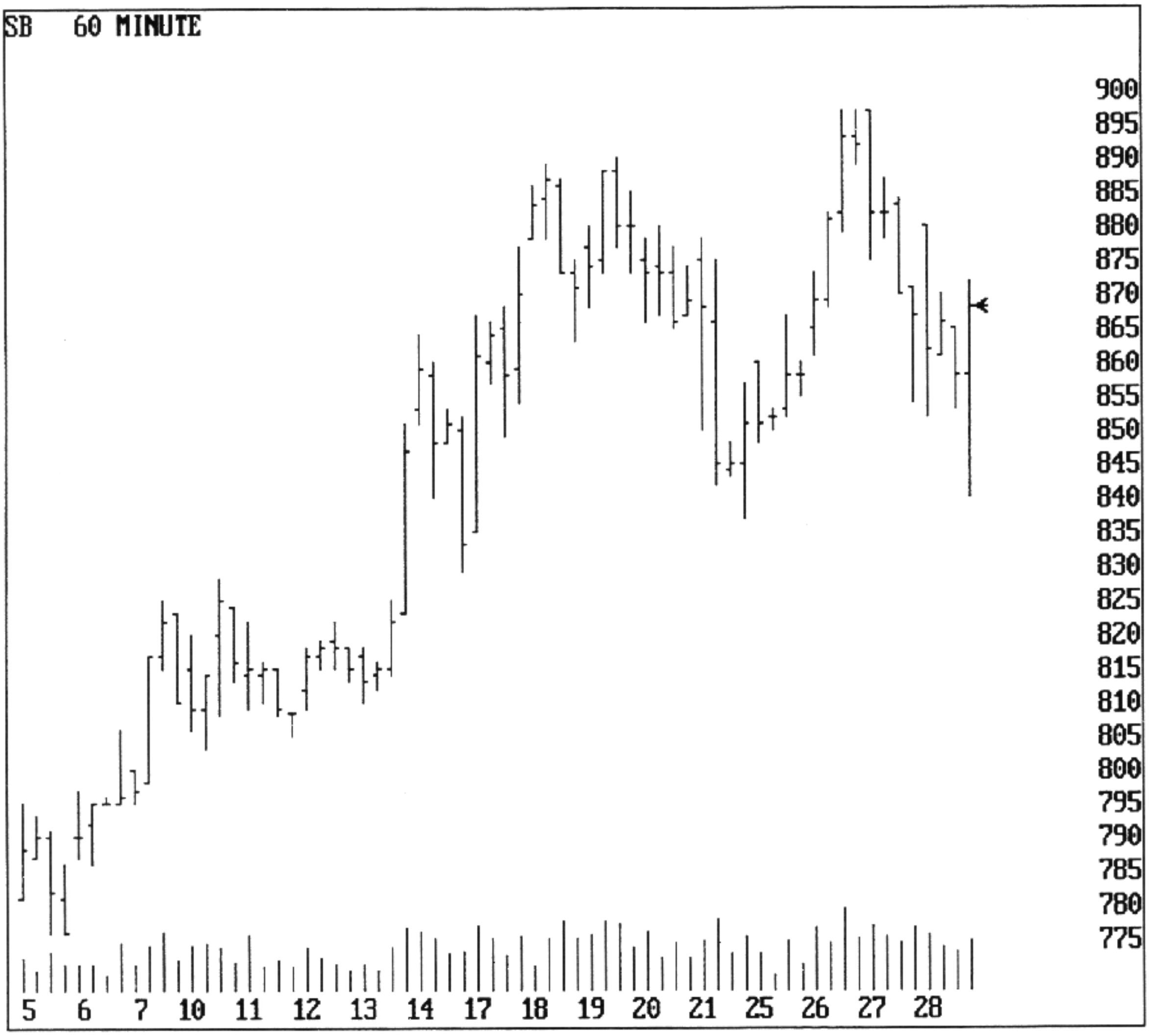
I was filled on a ten lot at 860 with a liquidation objective of 850 to cover costs. The hour closed below my entry, but failed to reach 850. My stop loss was at 860.



The next hour, the last of the day, opened where the previous bar closed. It stayed in a very tight trading range between 858 and 855 for thirty minutes, and then proceeded downward, reaching a low of 840 during the next ten minutes.

On the way, it gave me my cost liquidation objective at 850, and filled a five lot on a breakout of the Ross hook at 851. By reaching 840, I was also able to cover costs on the five lot at 841. I cashed two contracts. At 840 the market looked like this:

Too late to do me any good, I realized I could have simply liquidated fewer contracts, and avoided paying extra commissions.

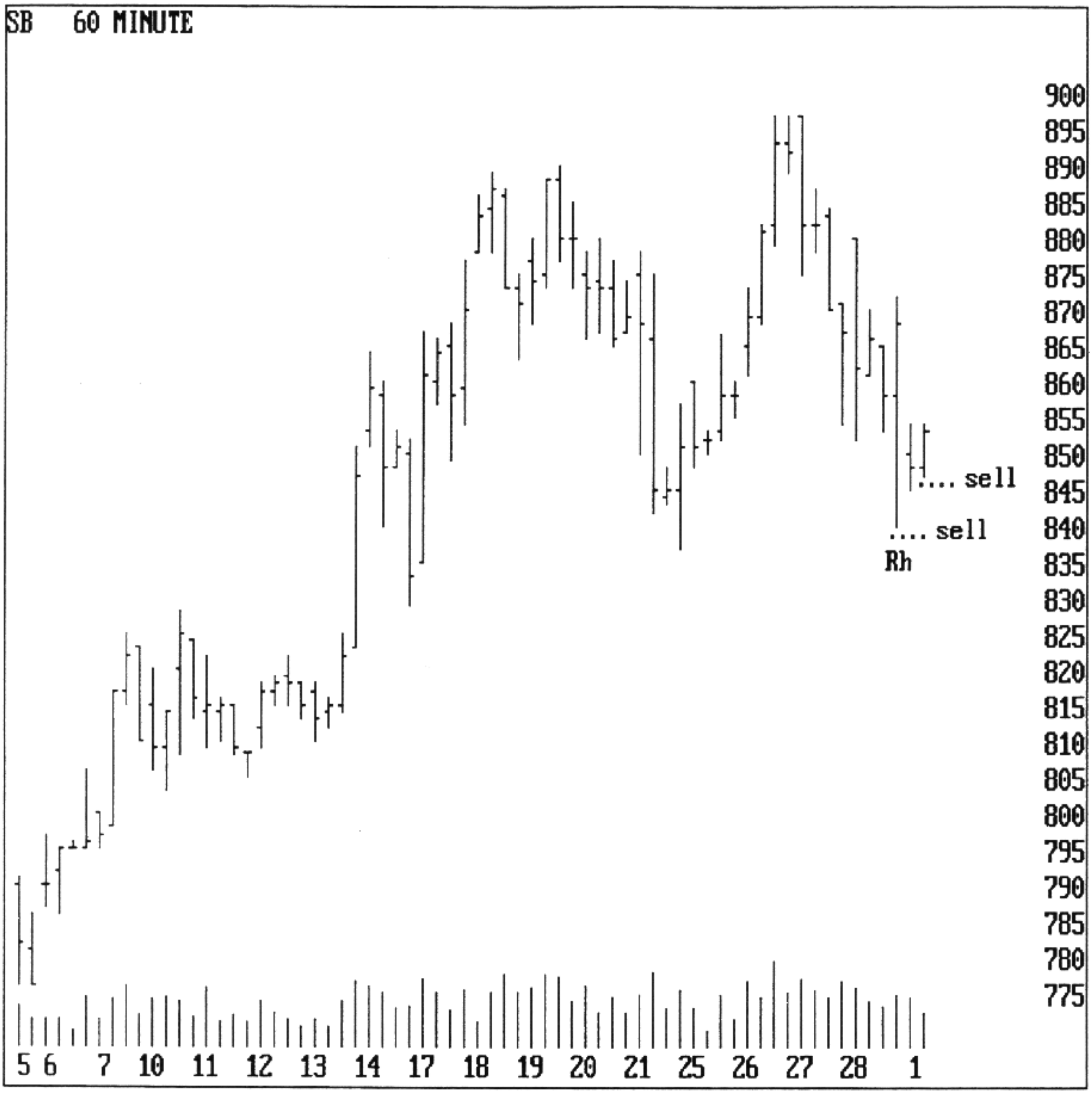


Then, just before the final five minutes of the day, sugar started flying up, and in a fast market. I barely had time to save my neck. I moved all stops to 851. I was filled on all contracts at 852 as the market roared past my position and moved all the way up to 872, closing at 868. I could hardly believe my eyes. "What in the world happened?" I wondered.

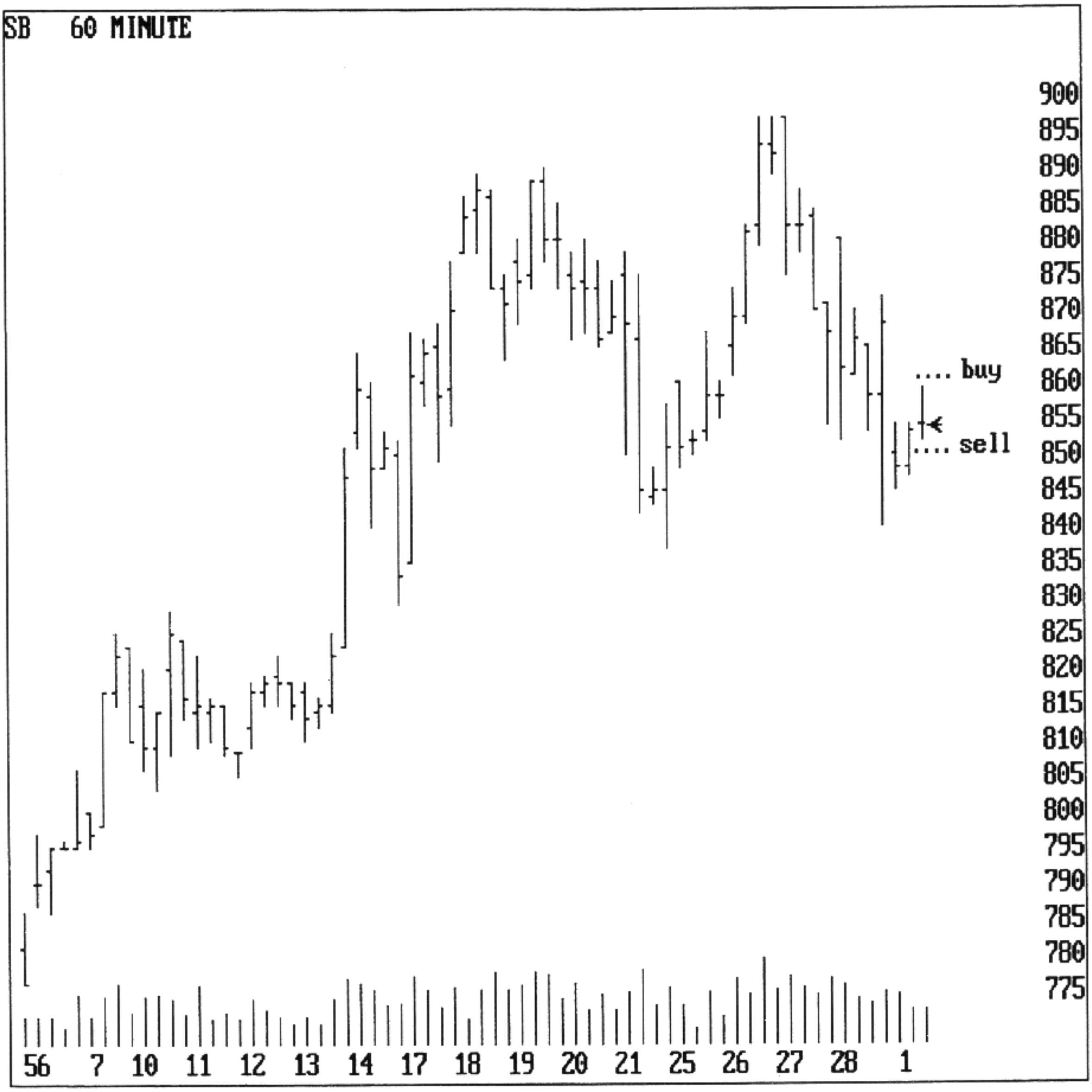
The day was over, so I started doing my score-keeping arithmetic. I was short a ten lot at 860, had covered costs at 850, and was stopped out at 852. That gave me $710.40 for my ten lot.

On my five lot, I was short at 851, I had covered costs with two contracts at 841 netting $99 for the two, and was stopped out at 852 on three contracts, losing 1 tick apiece. My loss was $33.60. My five lot had made $65.40 to add to the $710.40 I had made on my ten lot.

The next day, prices opened lower. I placed an order to short a breakout of the Ross hook. When the opening price bar closed, I placed an order to short a breakout of the correction low.

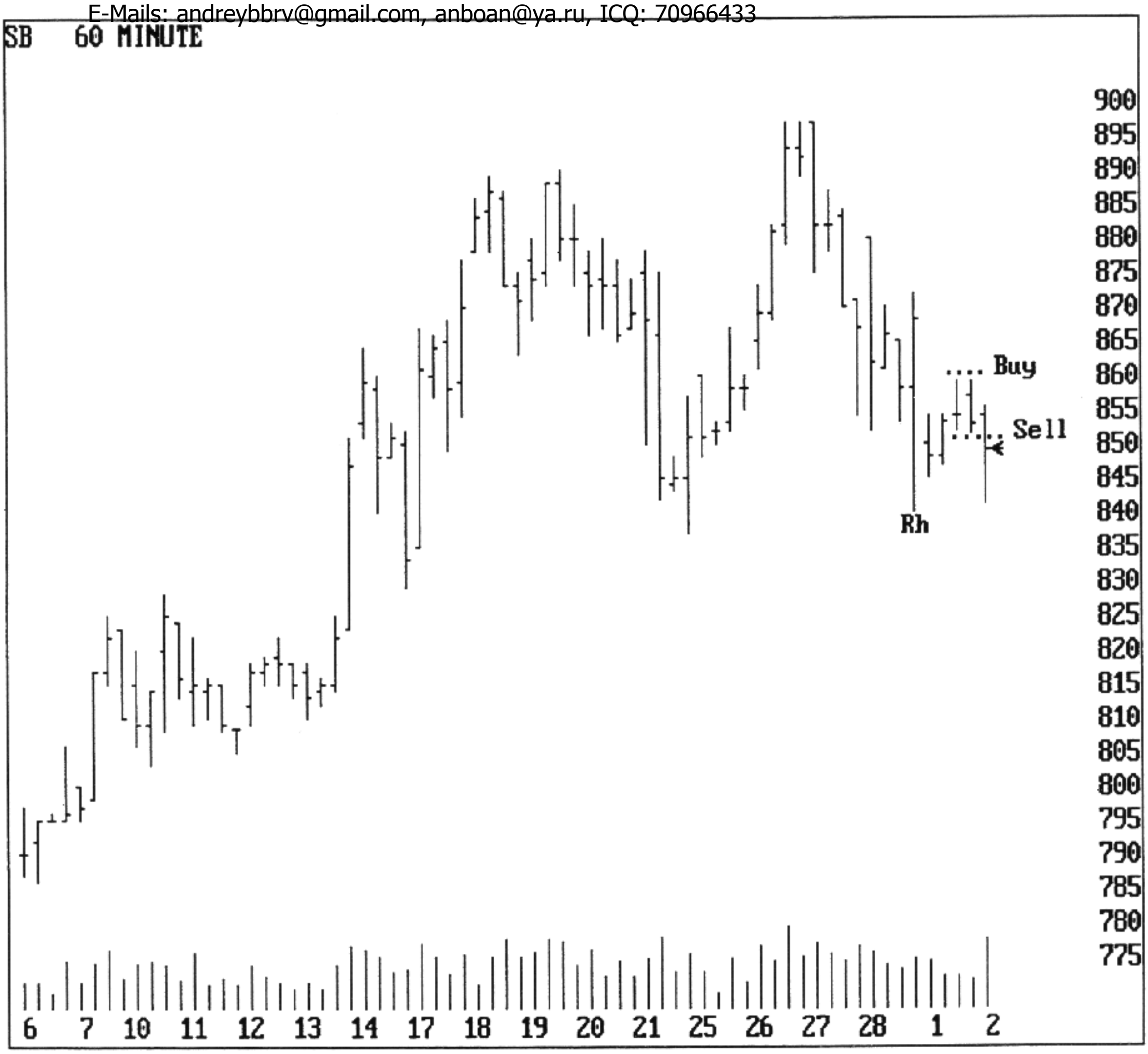


At the close of the second hour of the day, I cancel replaced my order, and moved it up to short a breakout of that low.



The third bar of the day made a higher high and a higher low, closing on a doji.

The last bar of the day was a small reversal, so I let everything stand as is.



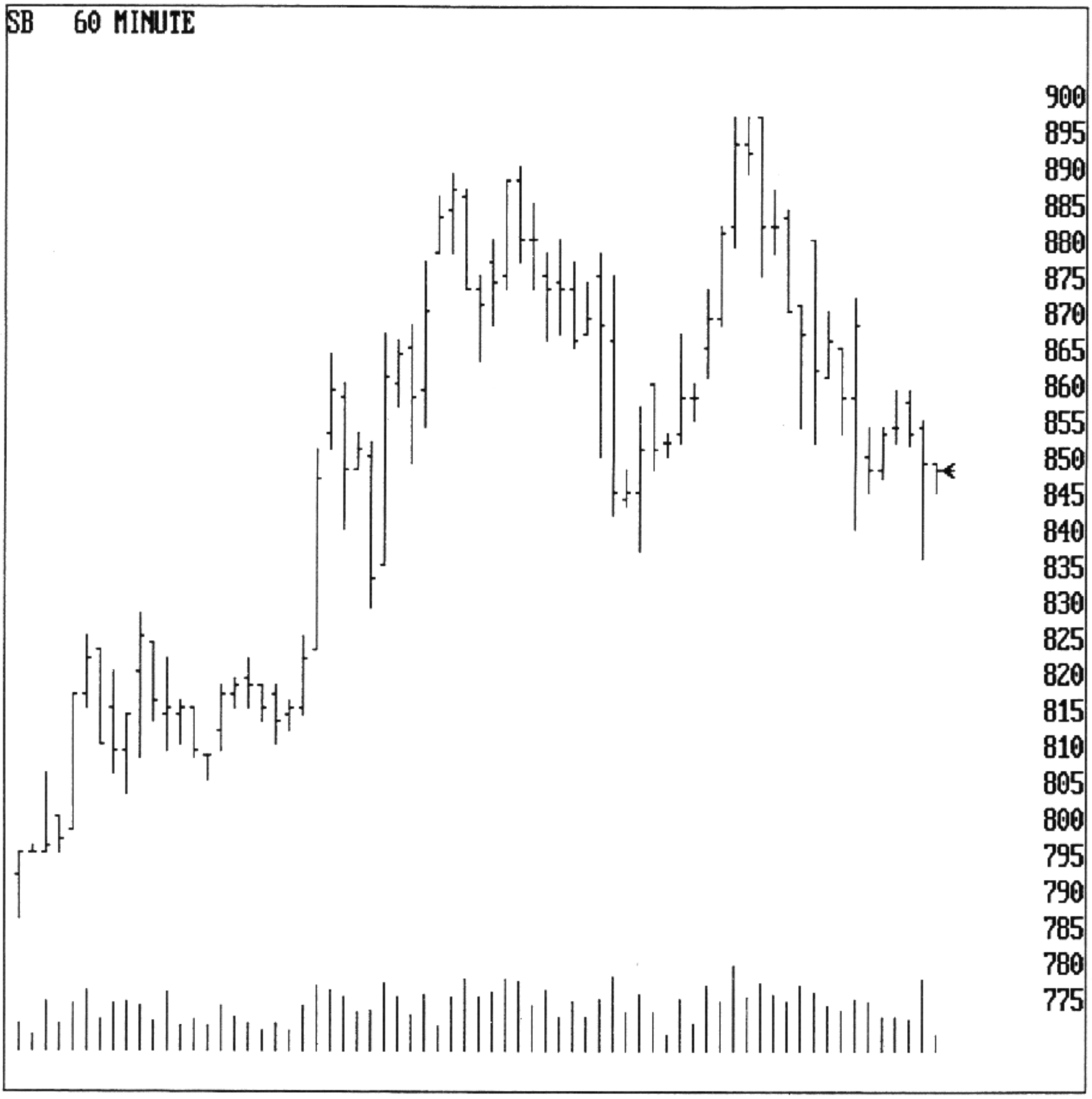
The first bar of the day opened just above where the previous day had closed. It traded up a few ticks in the next ten minutes, and then began to move down.

I had placed a buy order above the high of yesterday's closing bar, and a sell order just underneath the low. The Ross hook was still in effect, so I had a sell order there, too.

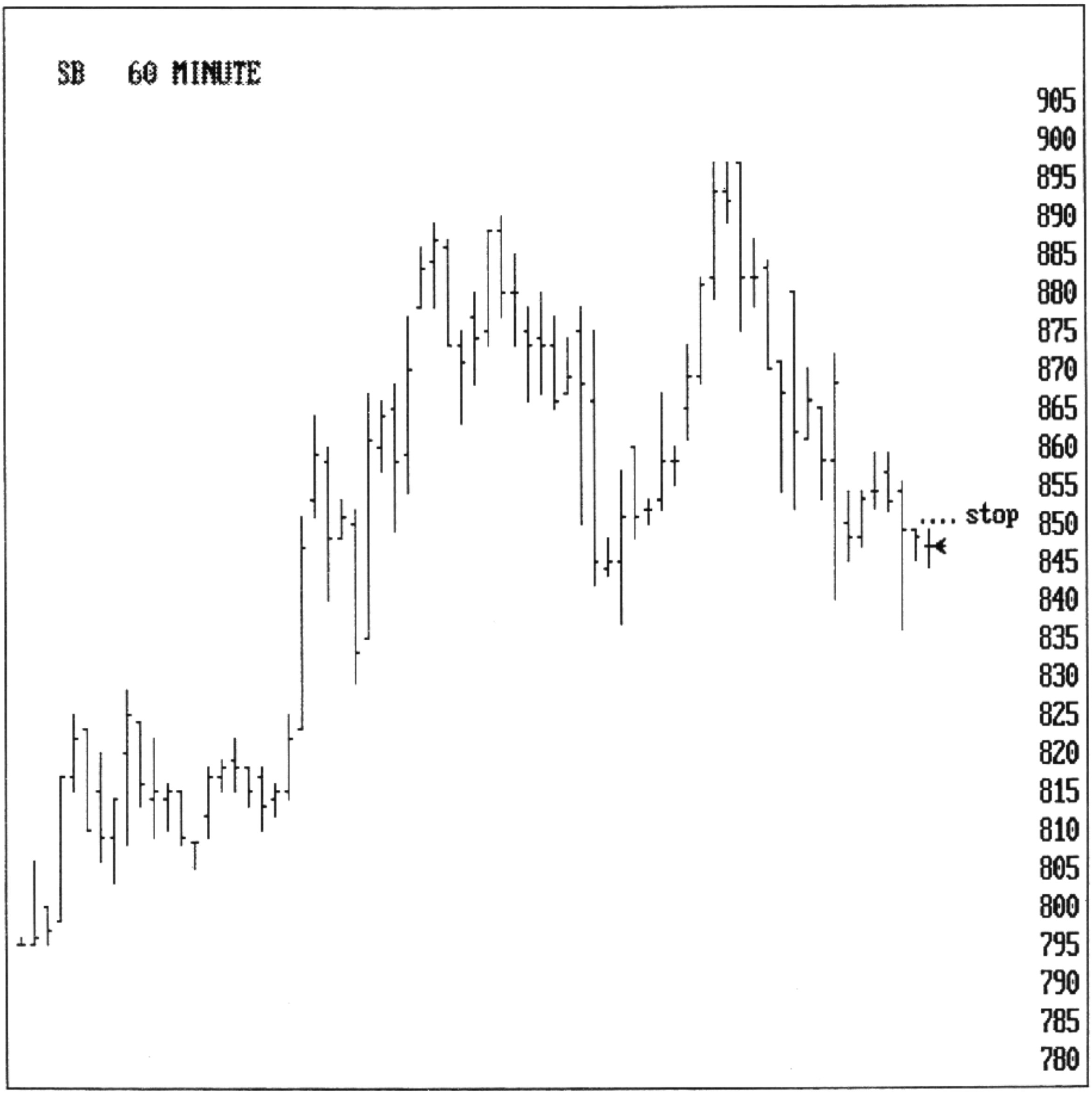
Prices took out my sell stop at 851, and I was short a ten lot. My cost covering objective was 841 MIT. I was filled at 842 on a bounce off the low at 841. I pulled my stop to breakeven.

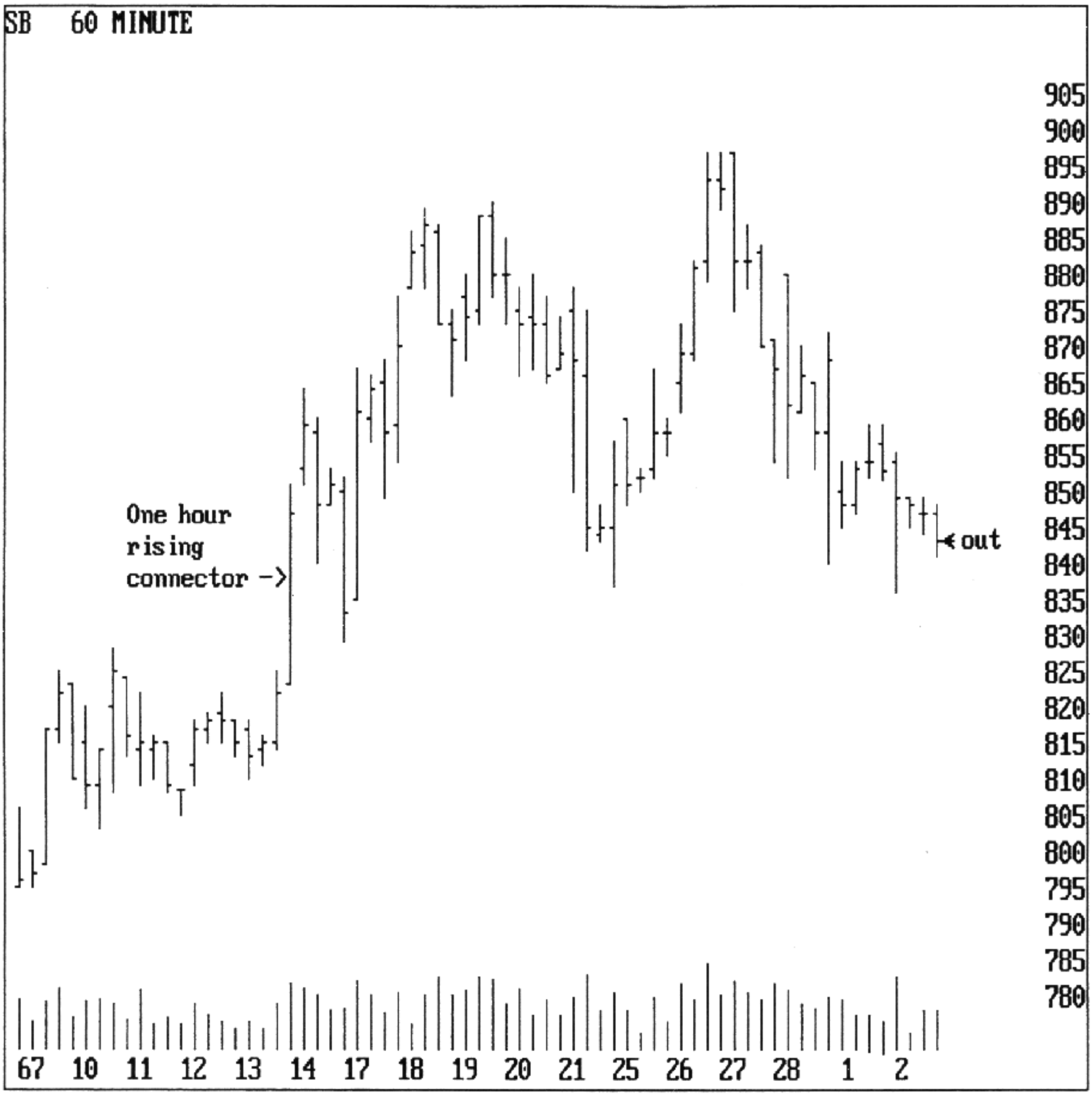
The market then began to move up, but closed below my breakeven stop.

The next hour didn't bring much action, so I left everything in place.



The third bar of the day was a doji, so I brought my protective stop to just above its high.



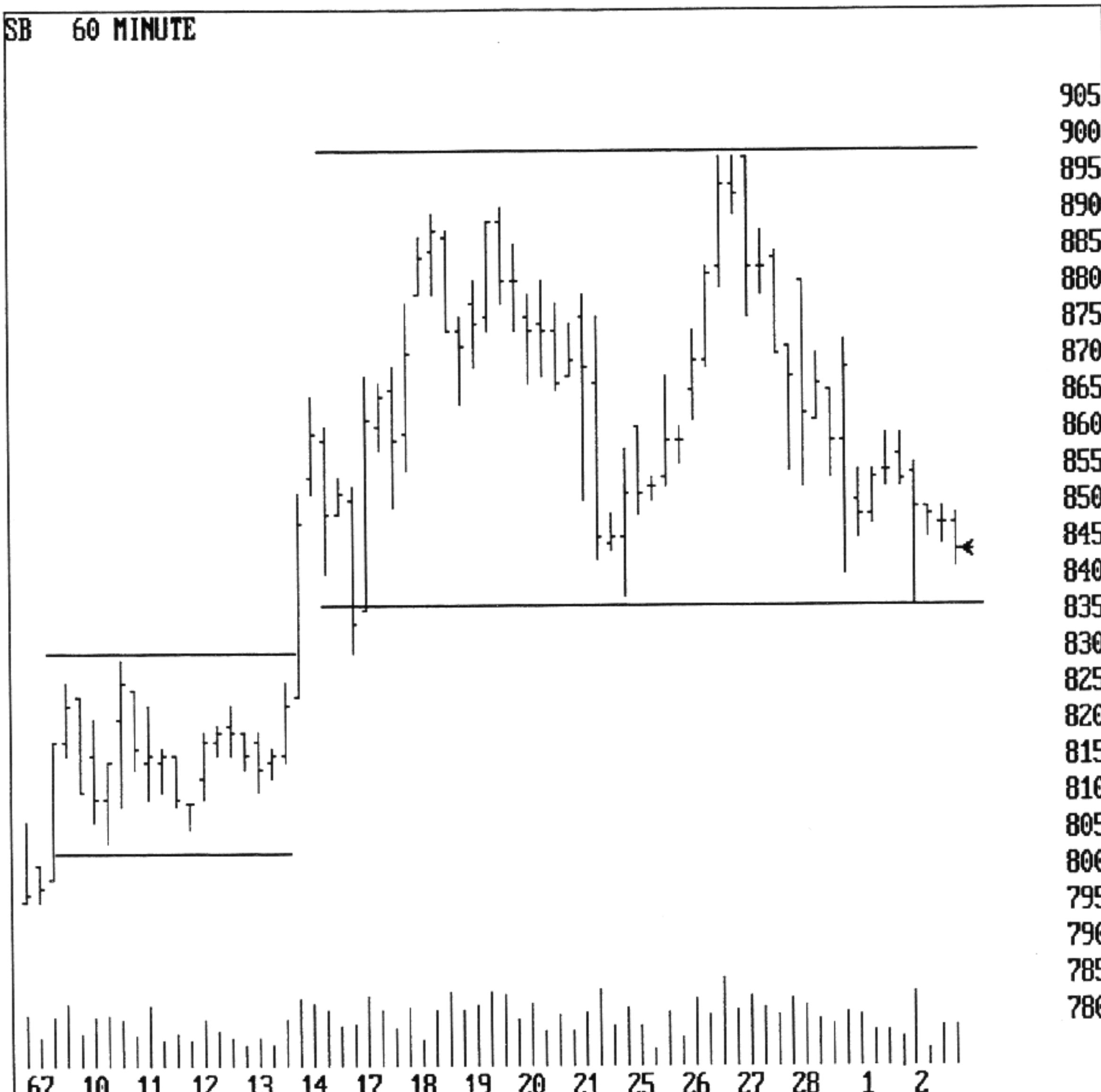


The last bar of the day didn't do much, either. I got out just before the close at 843.

That completed my series of sugar trades on the sixty minute chart.

I hope that, in looking back, my readers will see that this market was not particularly splendid in its actions. Taken as a whole, other than a one hour rising connector from one trading range to another, the sugar market was moving sideways in a trading range!

I've marked off the congestion areas and shown them on the next page.



I suppose no book on daytrading would be complete unless it included a full day's trading in the S&P.

I'll show how I do that in the next chapter.

Chapter 28

S&P TRADING

The S&P 500 Index (S&P) trading shown in this chapter was done in 1989. Since then the S&P has split in half. It has gone from $500 per full S&P point down to $250 per full S&P point. In 1989 the minimum tick value for the S&P was $25 dollars. In 1999 the minimum tick value for the S&P is $12.50. Writing this in 1999, I rechecked the validity of these trades. I have not changed the way I daytrade the S&P when using the segment counting technique shown. However, in 1989 I was still paying a commission of $6.00/round turn. That is no longer true. I now pay $15/round turn to daytrade the S&P. Due to very high volatility and uncertainty, today the margins for the S&P are about 2/3rds of what they were in 1989 when an S&P point was $500. The trades shown here are just as they were when I did them. The method still works, which is the true test of its validity. Of course, the management would of necessity be different. At $15.00/round turn and 12.50/minimum tick you need more movement or more contracts to accomplish the equivalent in profits shown in this example. However, today the volatility is much greater then it was in 1989, so all in all, daytrading the S&P is not that much different from what is was in 1989. The chart formations remain the same. A chart is a chart, is a chart. Although the S&P didn't trade in 1899, the segment counting I will show works in all futures in 1999 just as it did in 1899, 1989, 1999, and I have no doubt will be the same in 2089.

Chart formations, and TLOC have remained the same throughout history. The same is true for segment counting. The fact that they do not change is due to the fact that human nature, both in the form of human action and human reaction, has not changed since the advent of homo sapiens on this planet.

There is little difference in the way I trade the S&P on a five minute chart and the way I trade, say, bean oil on a daily chart. The only exception is that I will trade a gap open from one intraday bar to the next on the S&P, and will usually not do that on a daily chart.

But there is an enormous difference in execution. I want to caution my readers on a number of things, because I have seen otherwise good traders destroyed by trading the five minute S&P.

Getting into the S&P is like stepping into the ring with a rattlesnake. You can be bitten quickly and when you least expect it. The S&P futures move fast, are volatile, and often do the unexpected.

If I were not trading at very low commissions and receiving excellent turnaround calling direct to an arb desk on the floor, I would not dare to trade the S&P on a five minute chart. It is far too dangerous. It's better to trade the S&P on a ten or fifteen minute chart if it's not possible to obtain low commissions and speedy turnaround.

Another criteria is being fast on your feet. I must be a nimble and agile trader to trade the S&P on a five minute basis. Fortunately, my trading habits are so well ingrained that I trade correctly almost by instinct. My habit patterns are well formed. I know, and know that I know, I will follow my method and my plan. If that were not the case, I would be better off trading the S&P in a larger time frame.

When daytrading the S&P there is little time to think. Reactions have to be virtually automatic.

I have no way of knowing how mentally spry any reader of this course might be. But again I warn you, trading the S&P is no place for the trader who is faint of heart, or one who does not have sufficient capital to be in this business. Certainly, it is no place for the trader with a small account, one who can trade only one contract at a time, or who is trading with money needed for living.

With these warnings in mind, I present a typical day of S&P trading on a five minute chart. I intentionally chose a day when the market was not trending because I want to show that segment counting will work intraday in the S&P whether it's trending on the daily chart or not. On the daily chart, I was trading an outside day following an inside day. The outside day took place well within the bounds of an even larger day that took place before the inside day. These days took place at almost dead center of what had been a trading range that lasted for five months. I also chose a day when I was not holding a seminar, and one on which I accepted no outside phone calls.

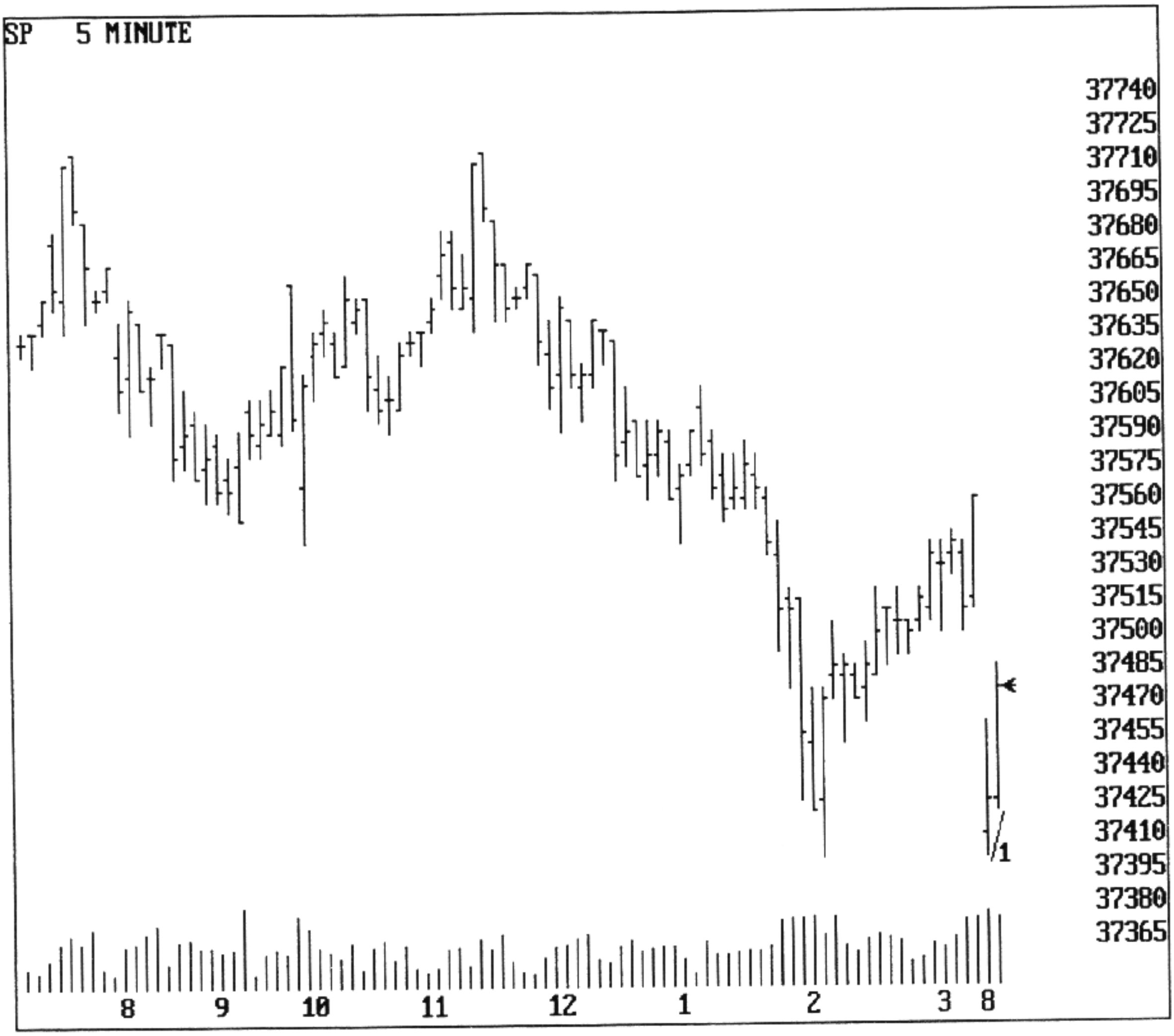
When I trade the S&P, I do not entertain thoughts of holding overnight. For me, it is strictly a daytrade.

The day started down at the open, but within the trading range of the previous day. The previous day had been spent mostly in a long trading range, and had opened gap down from the close of the prior day.

In this chapter, I will take the concept I've been showing a little bit further in that every time I connect two points, I will refer to it as a segment.

There's more than one way to use the concept of segments. These charts should show enough for anyone to get the hang of it, and at the end I'll show how to drop an old segment and pick up a new one. In segment counting, an inside bar is counted as part of a correction. This differs from the concept shown previously, where I had to have three higher highs or three lower lows before I could enter the market.

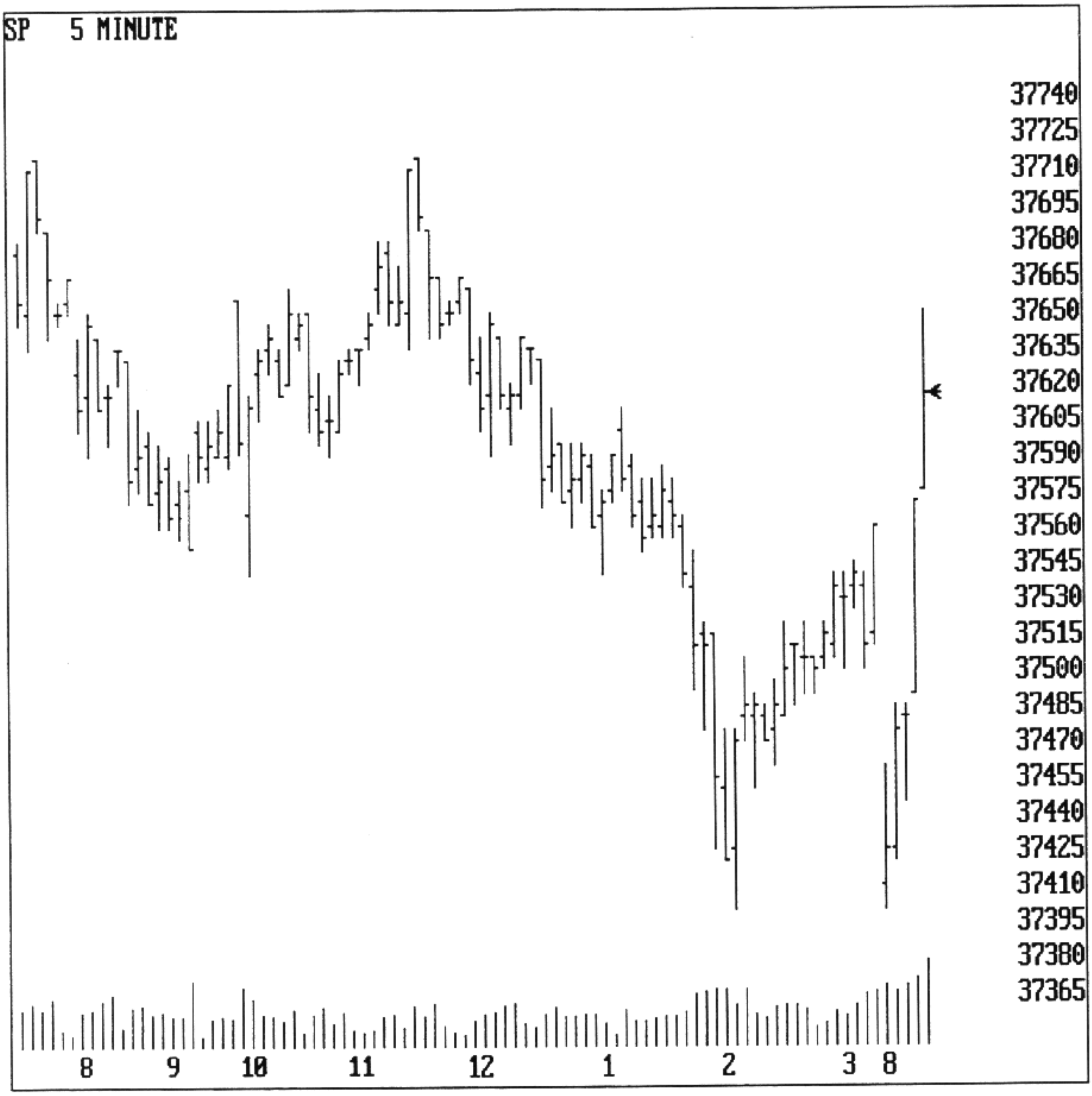
The second bar had a higher low and a higher high. I started my count.



When the next bar made a higher low and closed on its highs, I increased my count.

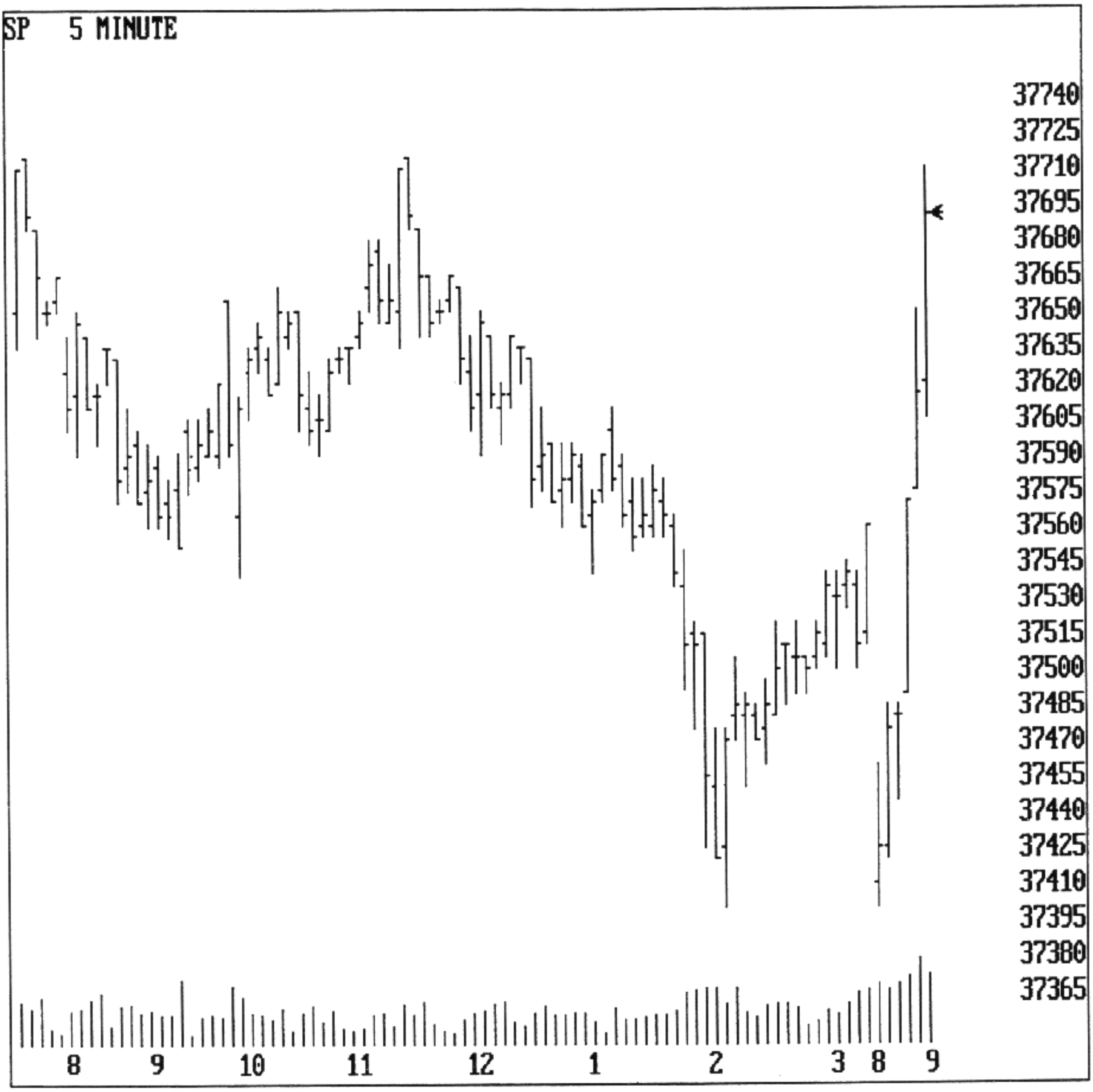
The next bar made a higher low and closed on its highs. I increased my segment count again.

All of a sudden, prices really started climbing. The next bar gapped open, and took out a good part of the previous day's trading range. I placed an order to buy just above the high.



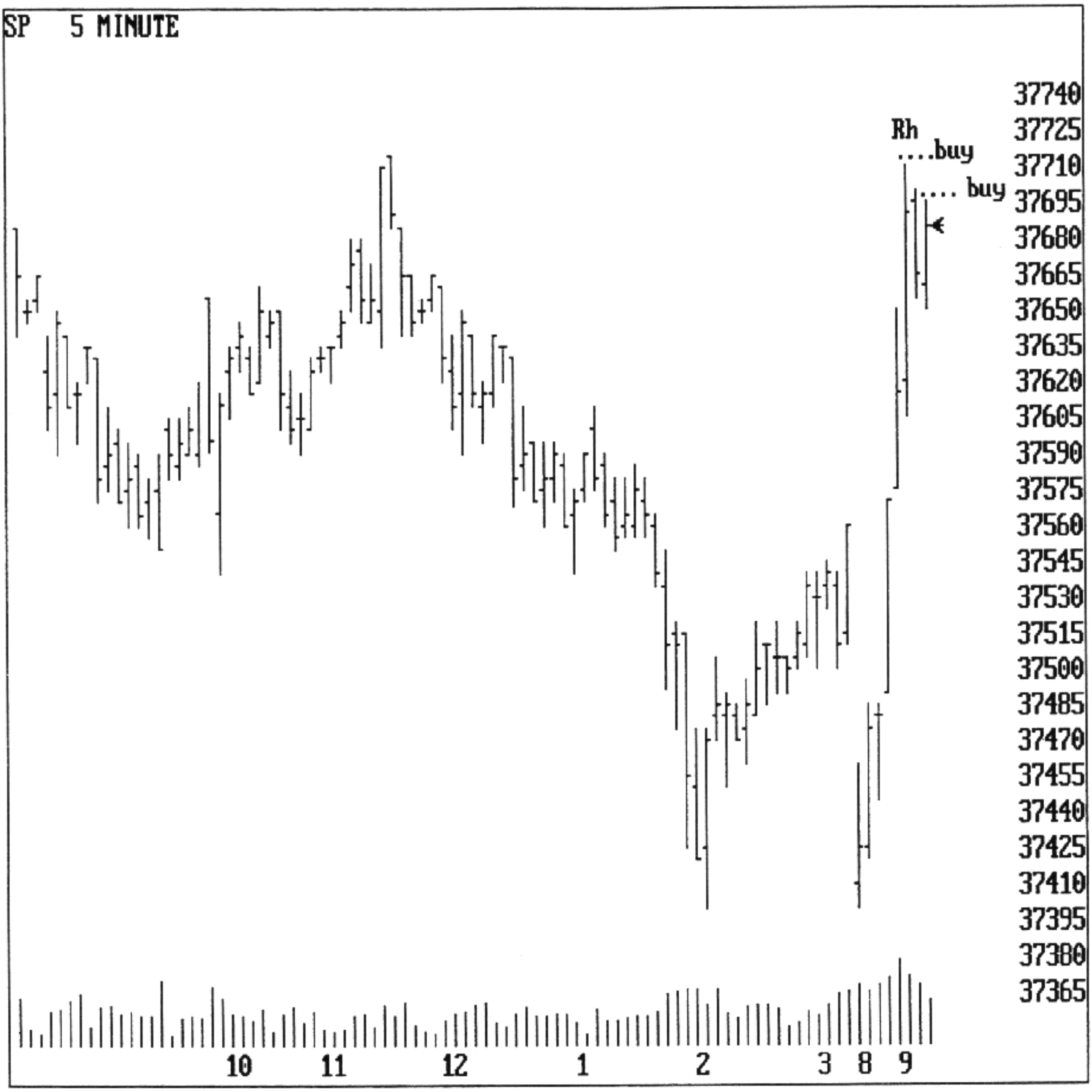
I was filled at the open with a 25 lot. The price was 37575. Since I can cover costs with $150, and the S&P almost always gives me a two tick move, I cashed five contracts at 37585 to cover costs and put me ahead in the trade. I had $250 less the $150 direct costs, which gave me the mental satisfaction that helps me to trade the S&P. My stop loss, which had been $250 per contract away, was pulled up to breakeven as the bar closed.

I like to start my trading on a positive note. One way to do it is to be happy with two ticks in the S&P.

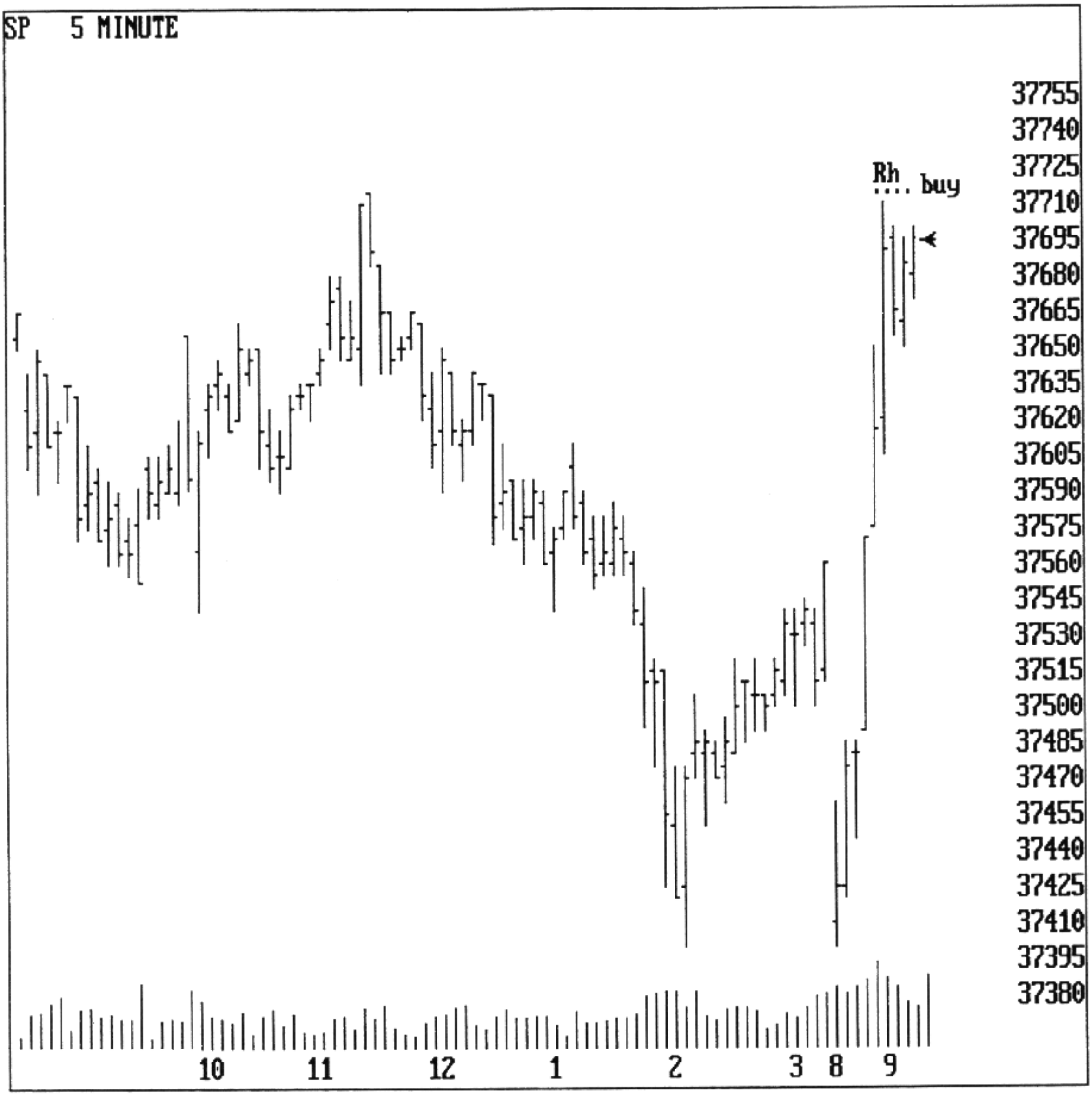


Prices continued to climb, but began to slow down as they reached the highs of yesterday's trading range. I moved my stop up to protect half the unrealized profits in the trade. My stop was at 37645 to protect 70 points.

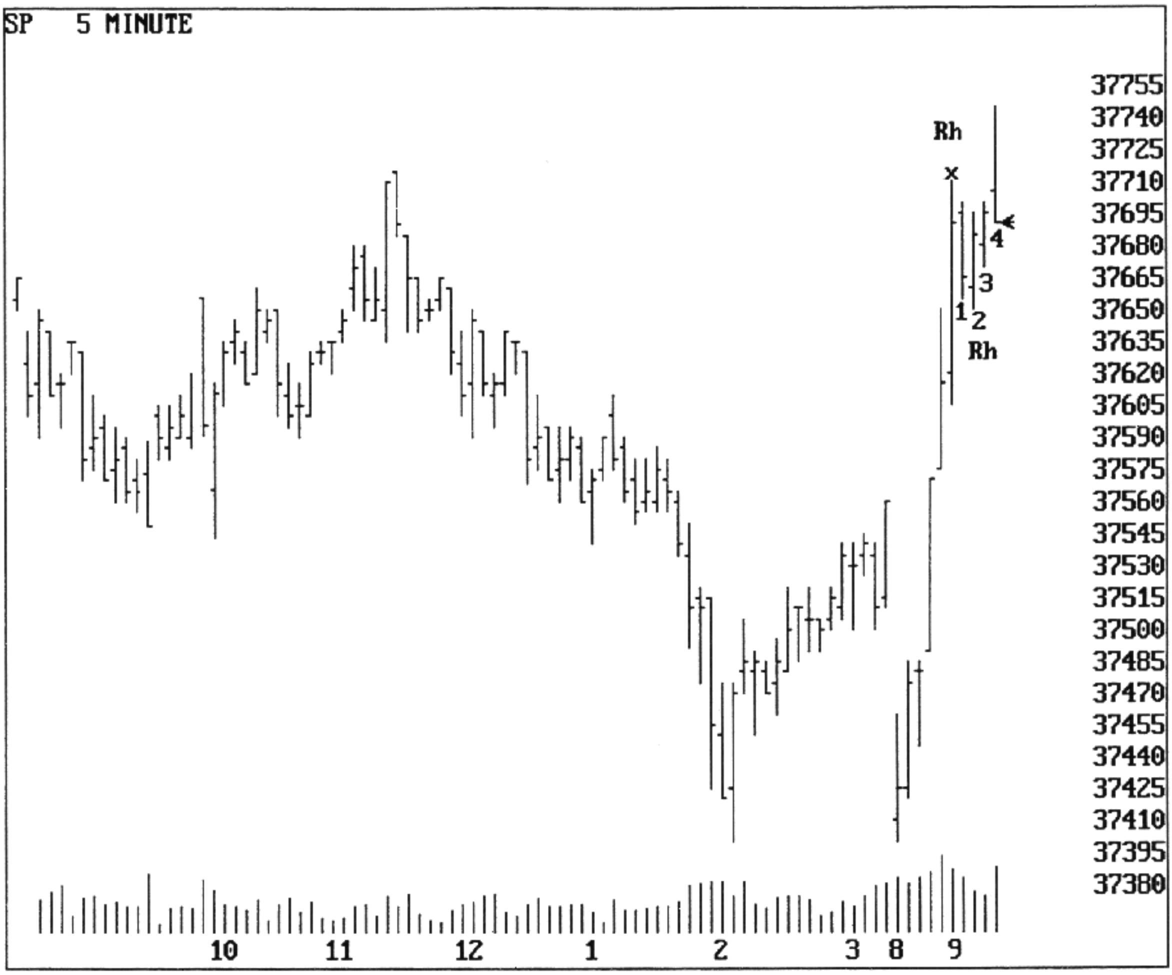
The next price bar was an inside reversal bar creating a Ross hook. Since I had enough room to cover costs on a breakout of this bar, I placed a buy stop for a fifteen lot above the correcting bar at 37505 and a ten lot above the hook at 37715, and pulled my stop up to just under the low at 37650. The point of the hook was 37710.



When prices corrected again, I was stopped out with my profit of 70 points each for 20 contracts. I placed a buy stop to purchase a twenty-five lot just above the high, and left the buy stop above the Ross hook in place.

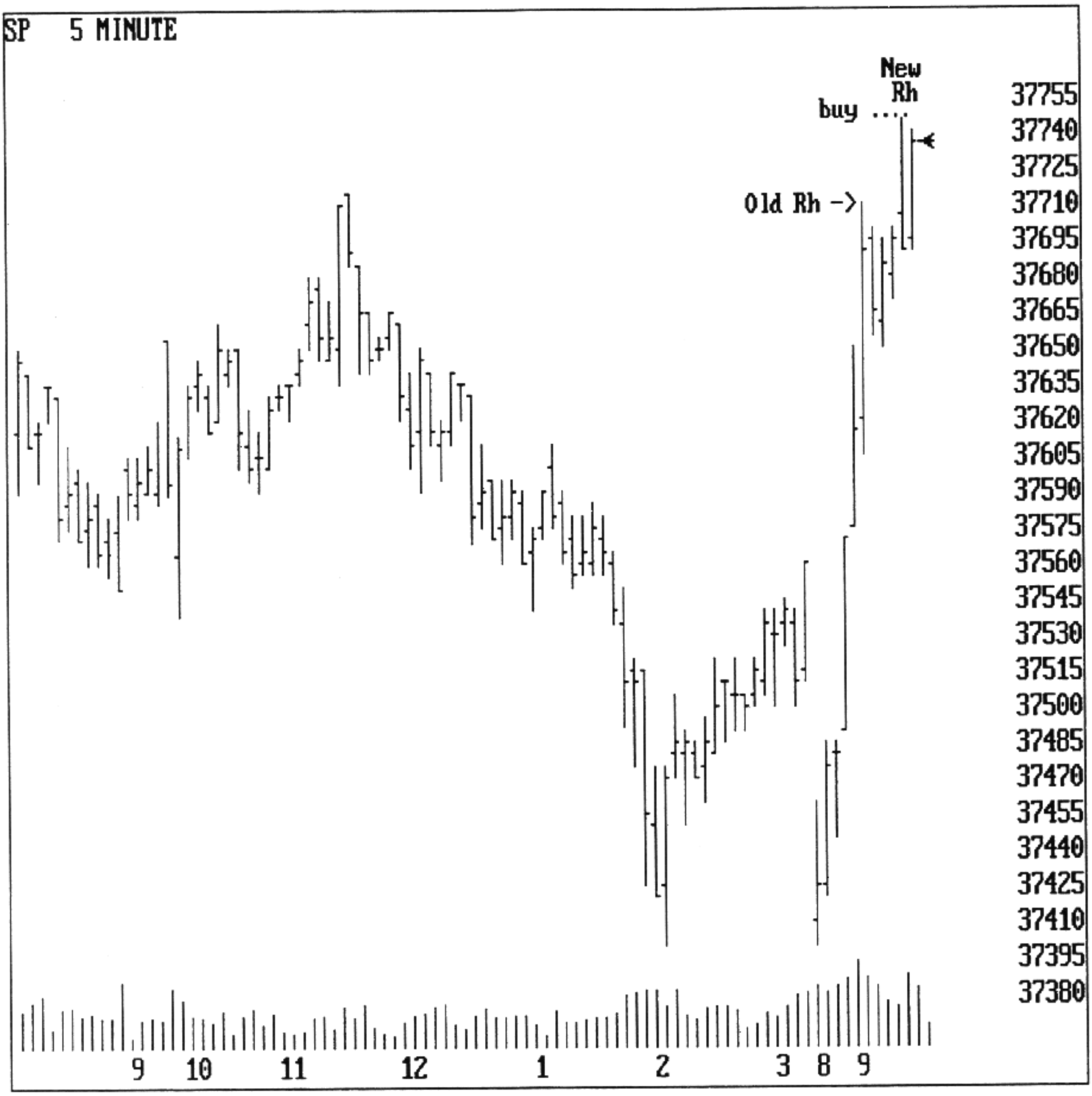


I was filled a twenty-five lot on my buy stop above the previous high at 37700. Prices closed a tick below me. My stop loss was $250 per contract back, and my cost covering stop was two ticks above at 37710.

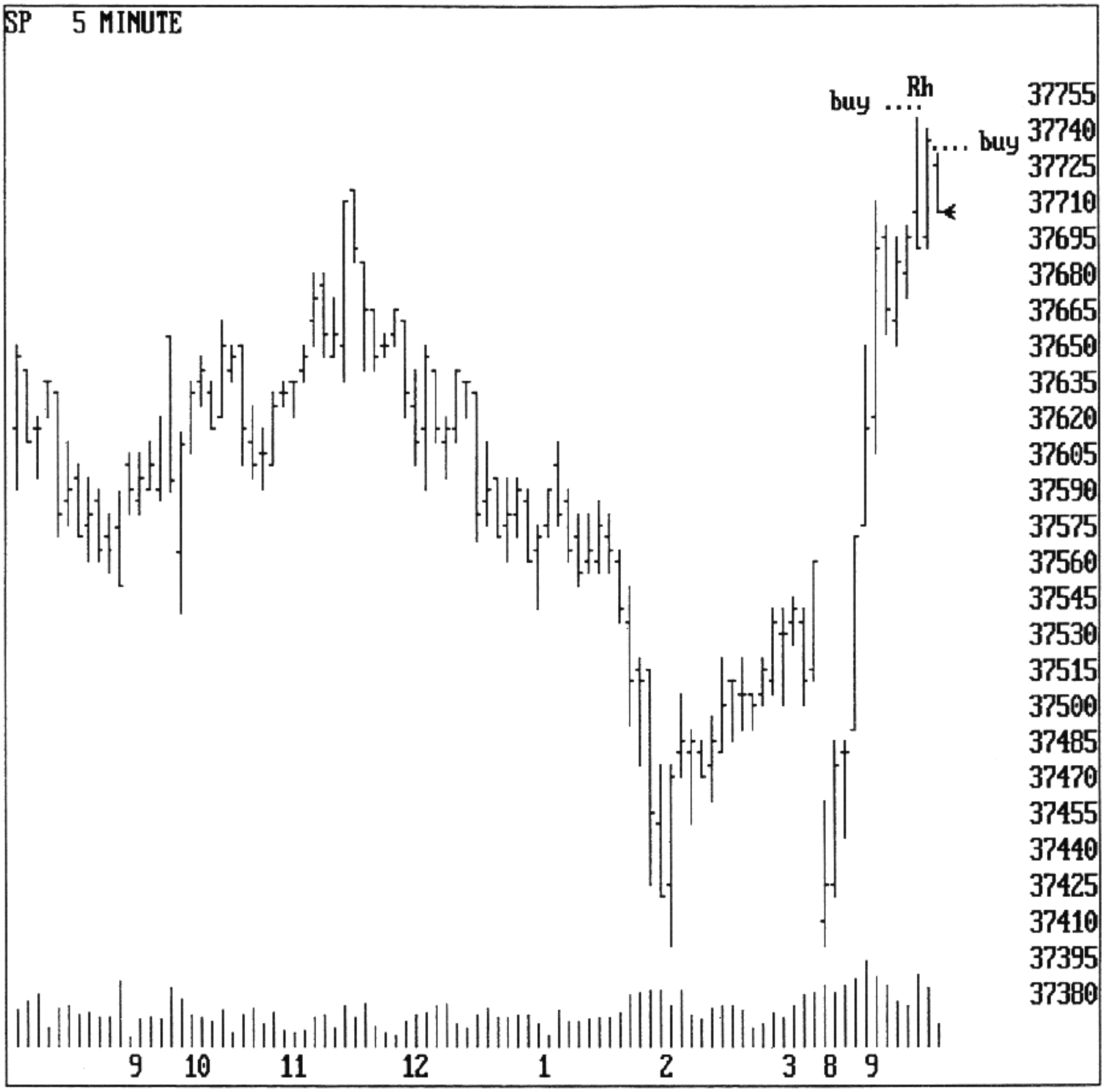


Prices gapped open on the next bar and raced higher. I covered costs on my twenty-five lot by selling a five lot, and pulled my stop to breakeven. I also got filled on my Ross-hook fifteen lot, and covered costs for it by selling another five lot. When I covered costs on my fifteen lot, prices were still moving up. I moved my protective stop up to cover half the profits on my twenty lot. While I was at it prices moved up a tad more, and I protected my ten lot. Within seconds, prices started to race back down.

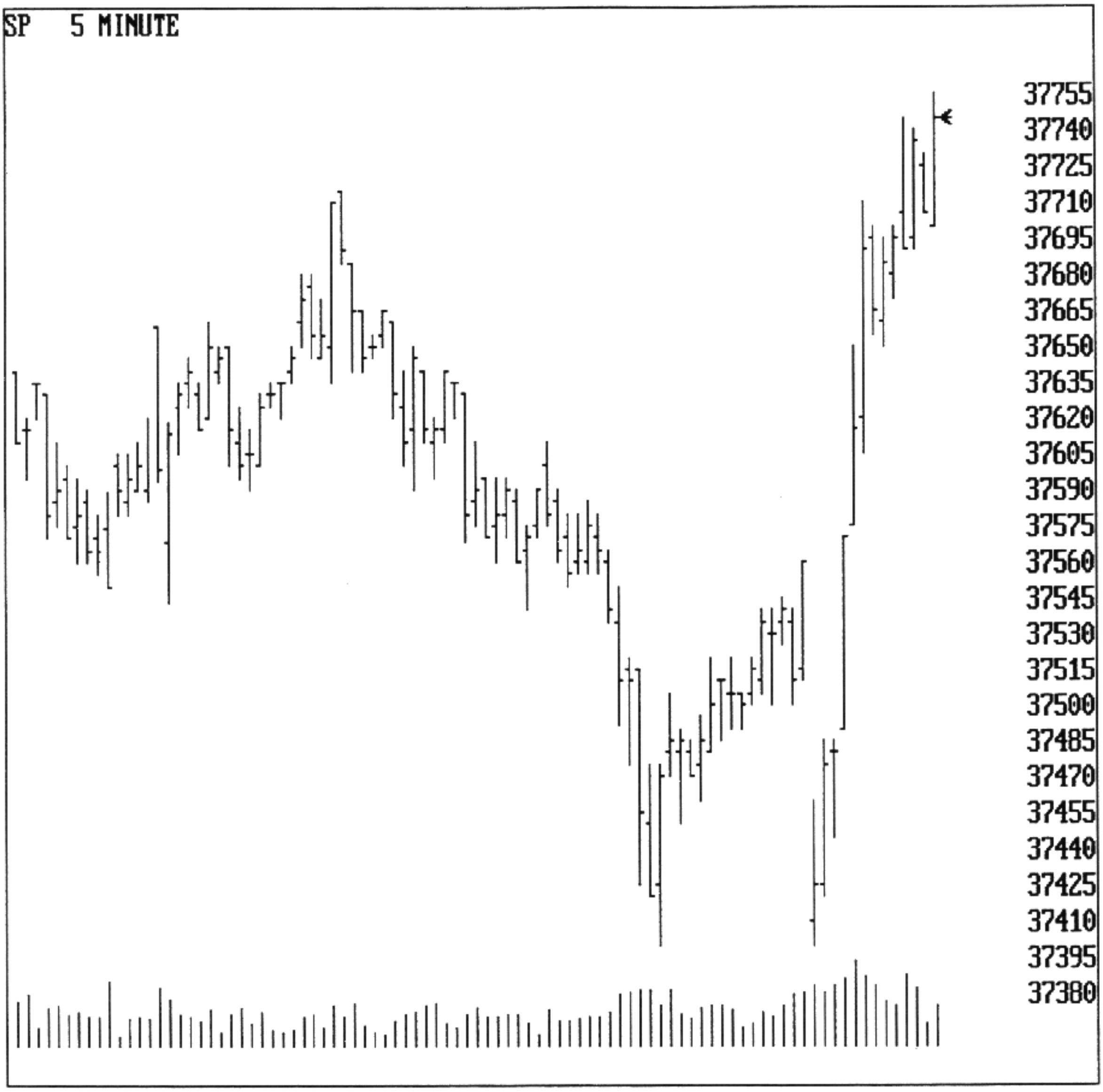
This market was now, by my definition, in congestion. I had four closes within the price range of the bar I've marked with an "x." The lower limit of the congestion is bar number 2, which is also a Ross hook. The upper limit of congestion is bar x, also a Ross hook.



I was stopped out and had to wait during almost the entire next bar to find out where my fills were. I had dumped twenty contracts at a 20 point profit, and ten contracts at a 15 point profit. I also had to take a restroom break while I waited for the phone to ring. Once the broker called with my price, I was able to place my order above the new Ross hook.

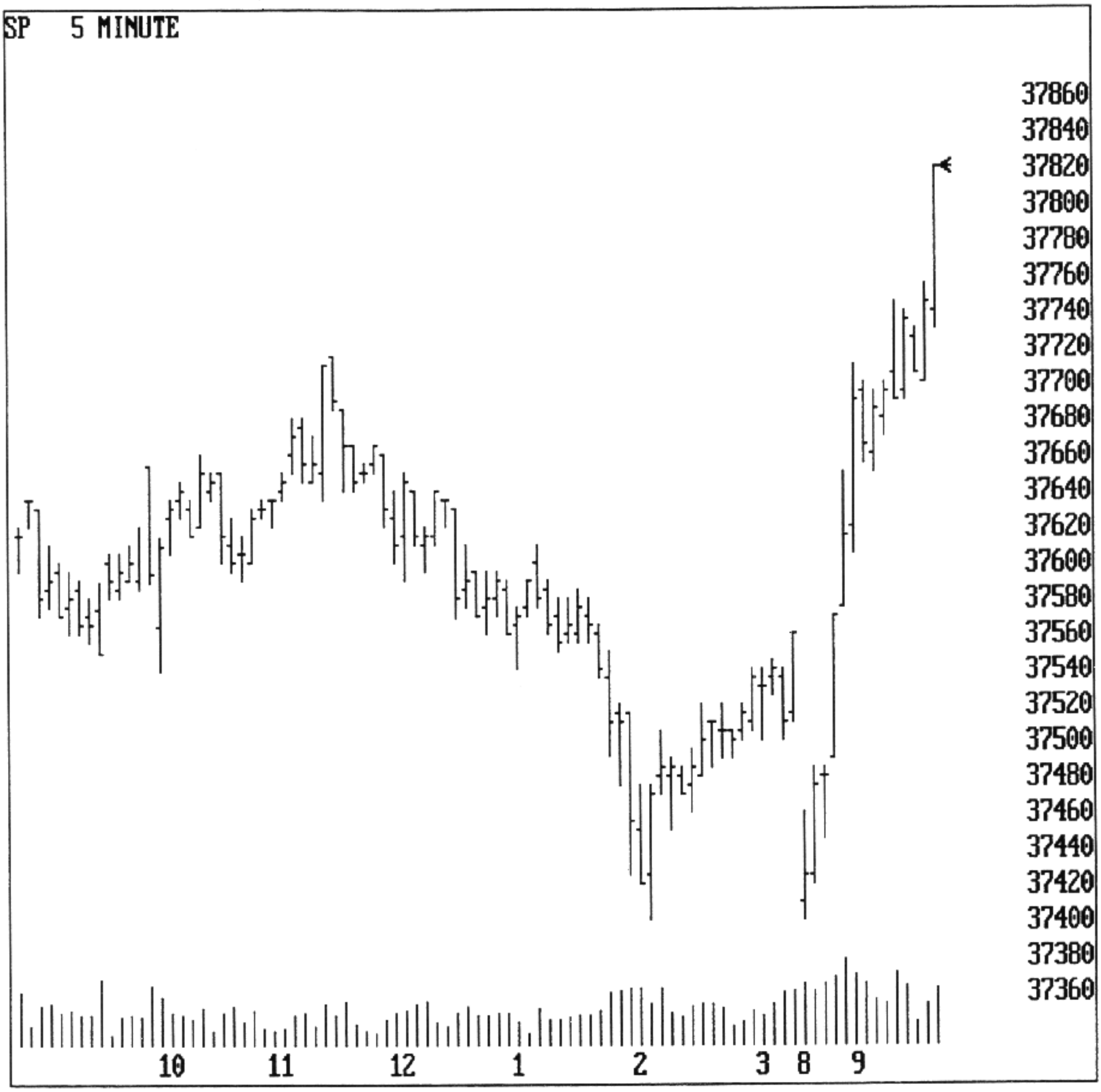


Since prices were correcting, I placed a buy stop above the correcting bar's high, as well as above the Ross hook.

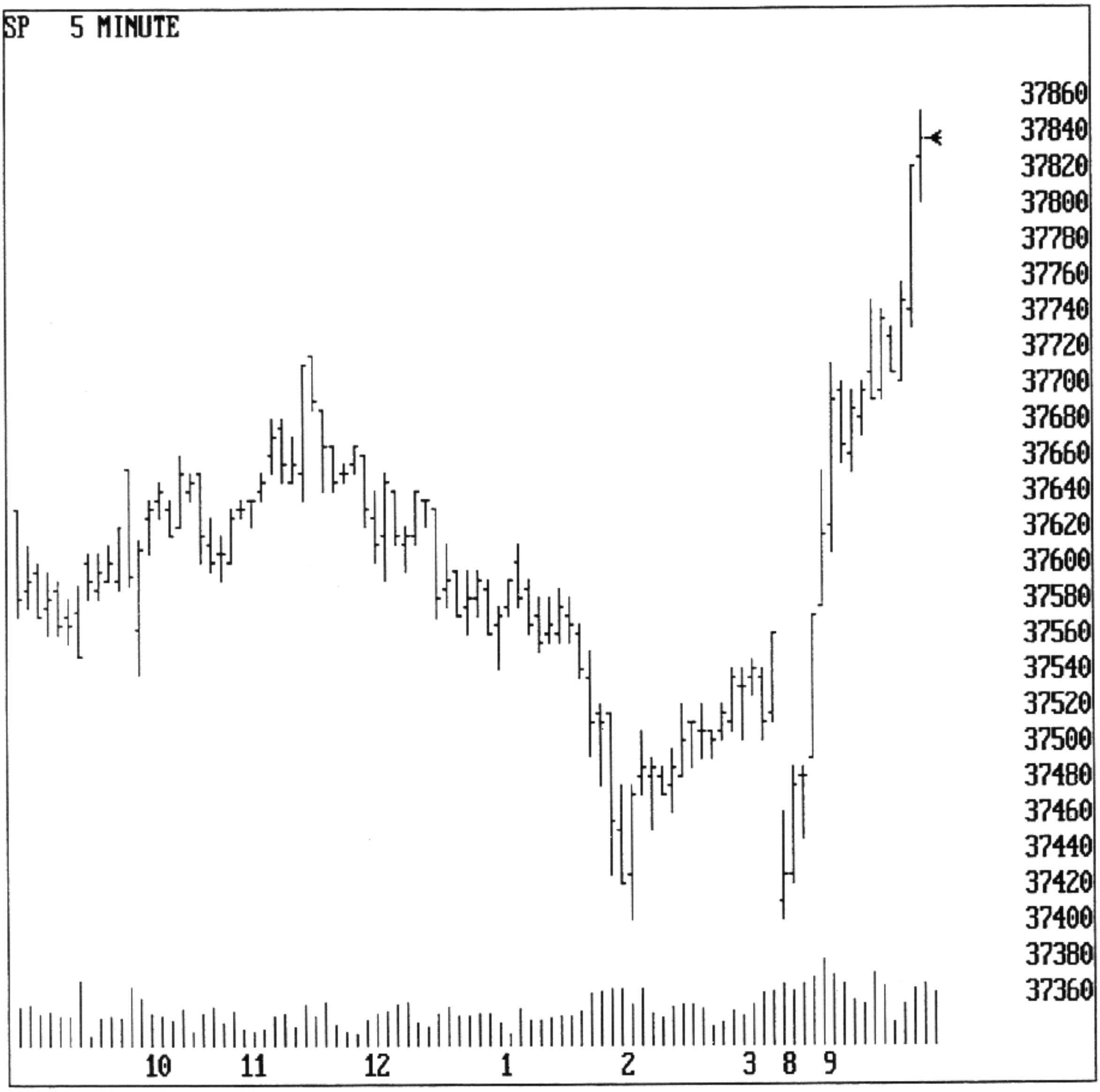


Once again I was long a twenty-five lot with a stop $250 away. I was able to cover with five contracts at 2 ticks. That put me $100 to the good. I was in the market at 37735; I covered at 37745. The market moved to 37755, so I moved my stop up to 37740 so as not to lose on the twenty contracts I had left.

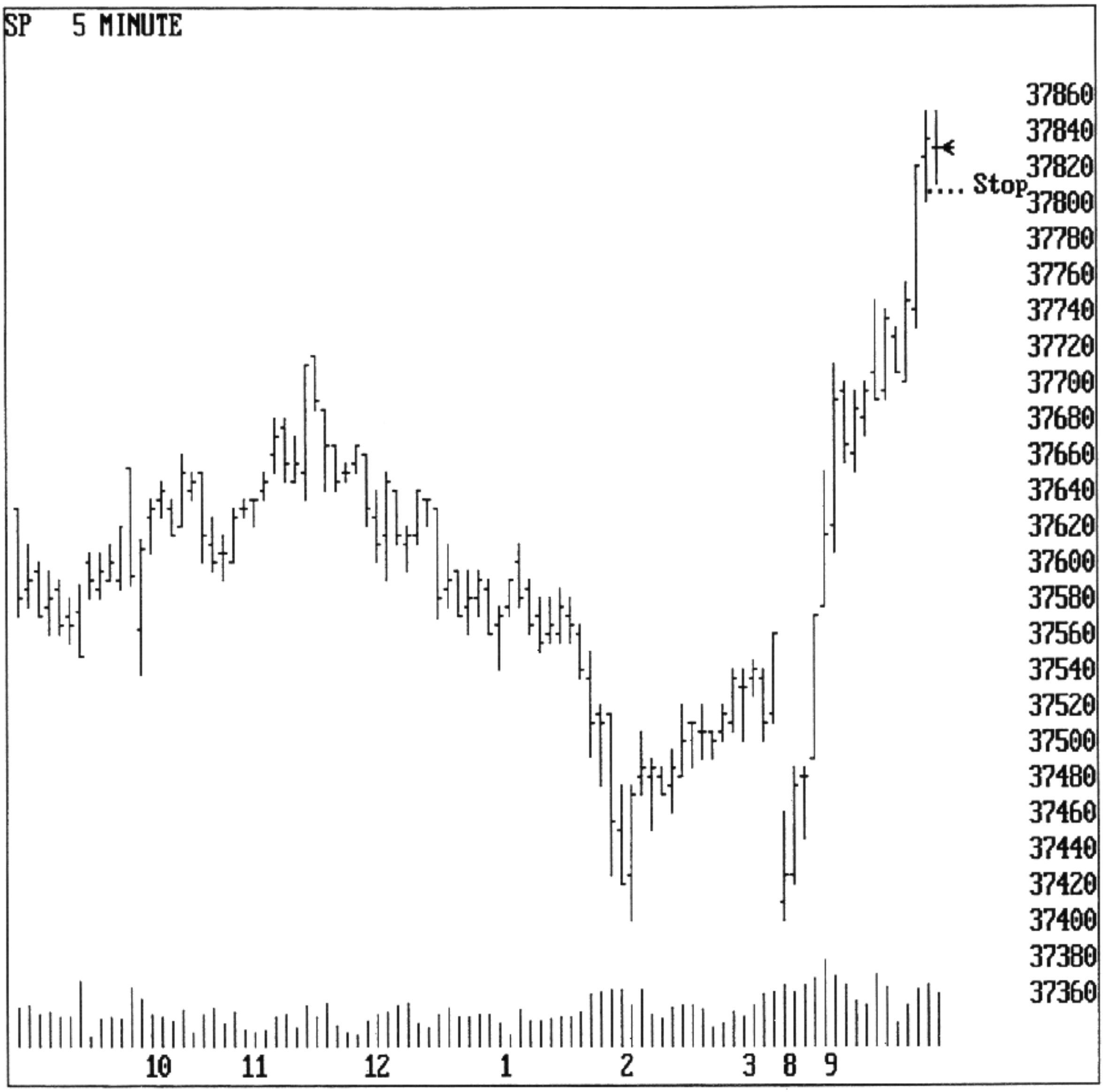
I was also long a fifteen lot at 37750, with my stop loss for those contracts $250 away at 37700. I had covered costs early with two ticks, just in case prices didn't clear the Ross hook of three bars earlier. I also wanted to be in the clear on costs for this set in case the breakout of the Ross hook was filled.



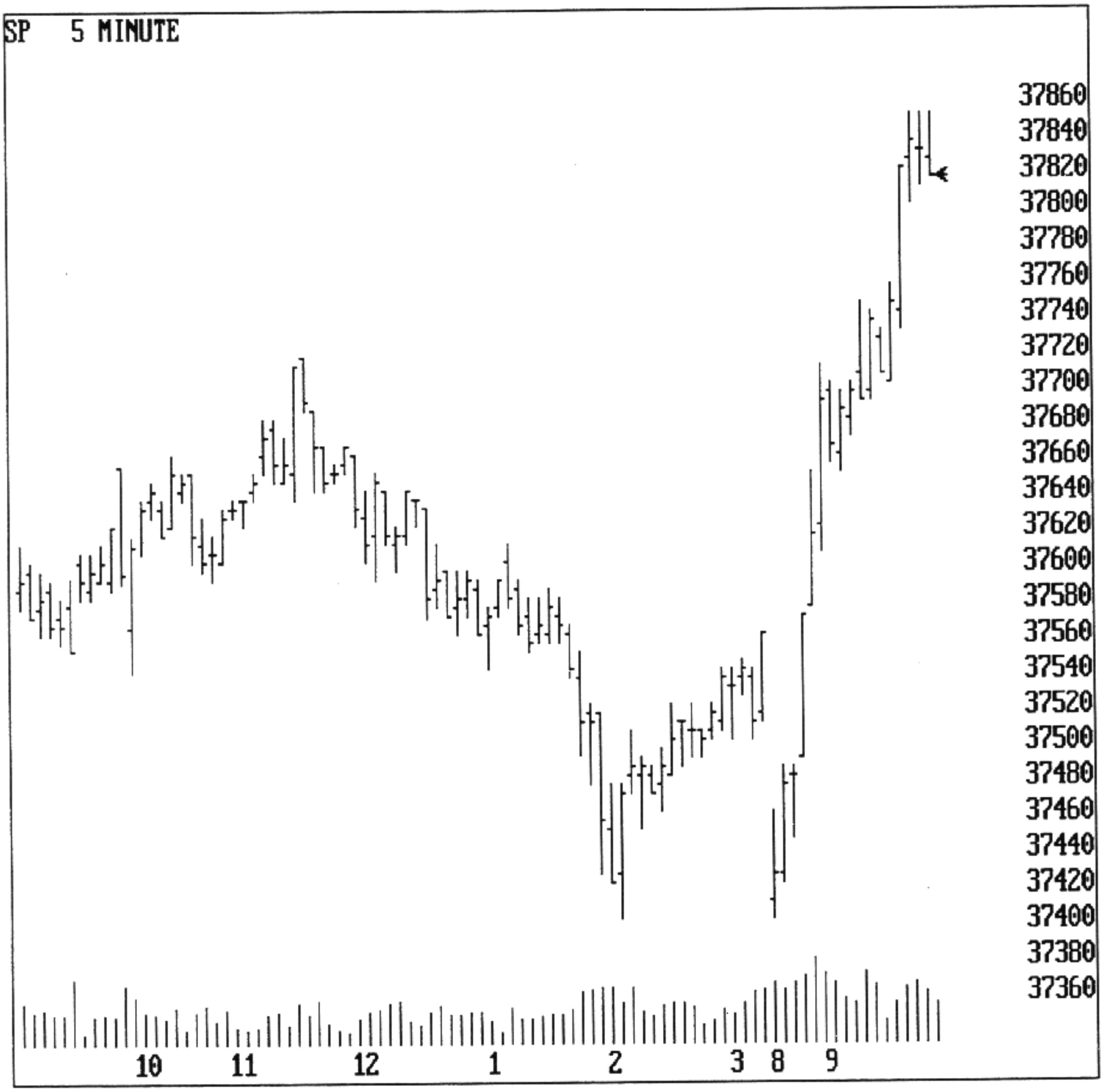
The next bar opened at 37740, taking out the twenty contracts I had left from the first trade of this set. That gave me $500 in additional profits. Prices dipped down to 37730 before they took off for new highs. I was able to cover costs on my fifteen lot by cashing five contracts for a net $100 profit. That left me with ten contracts as prices closed at new highs for the day.



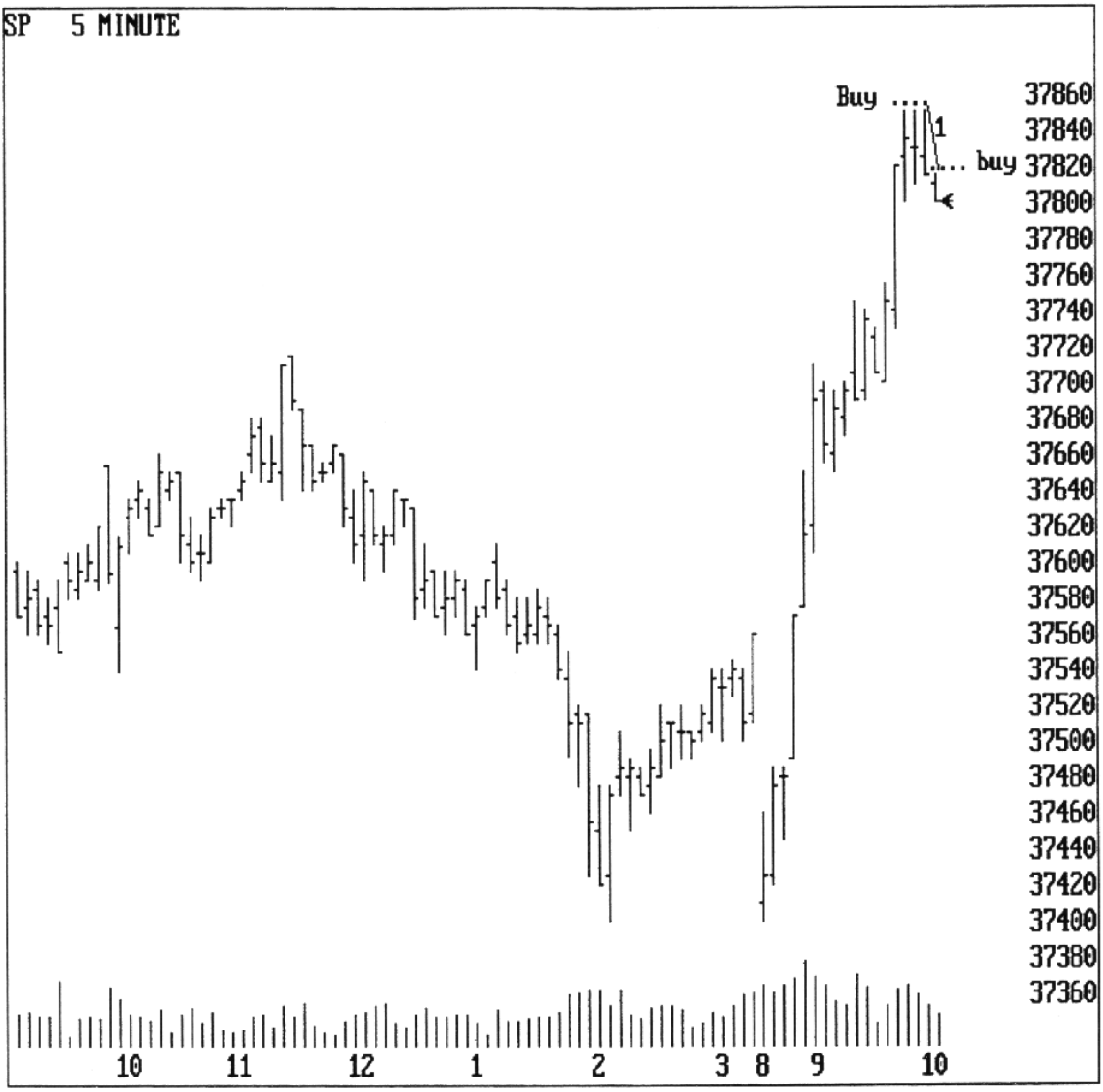
As prices moved up, I moved my stop to protect half of the unrealized paper profits in the trade.



Prices made a double top and a doji. I pulled my profit stop to just below the low of the bar.



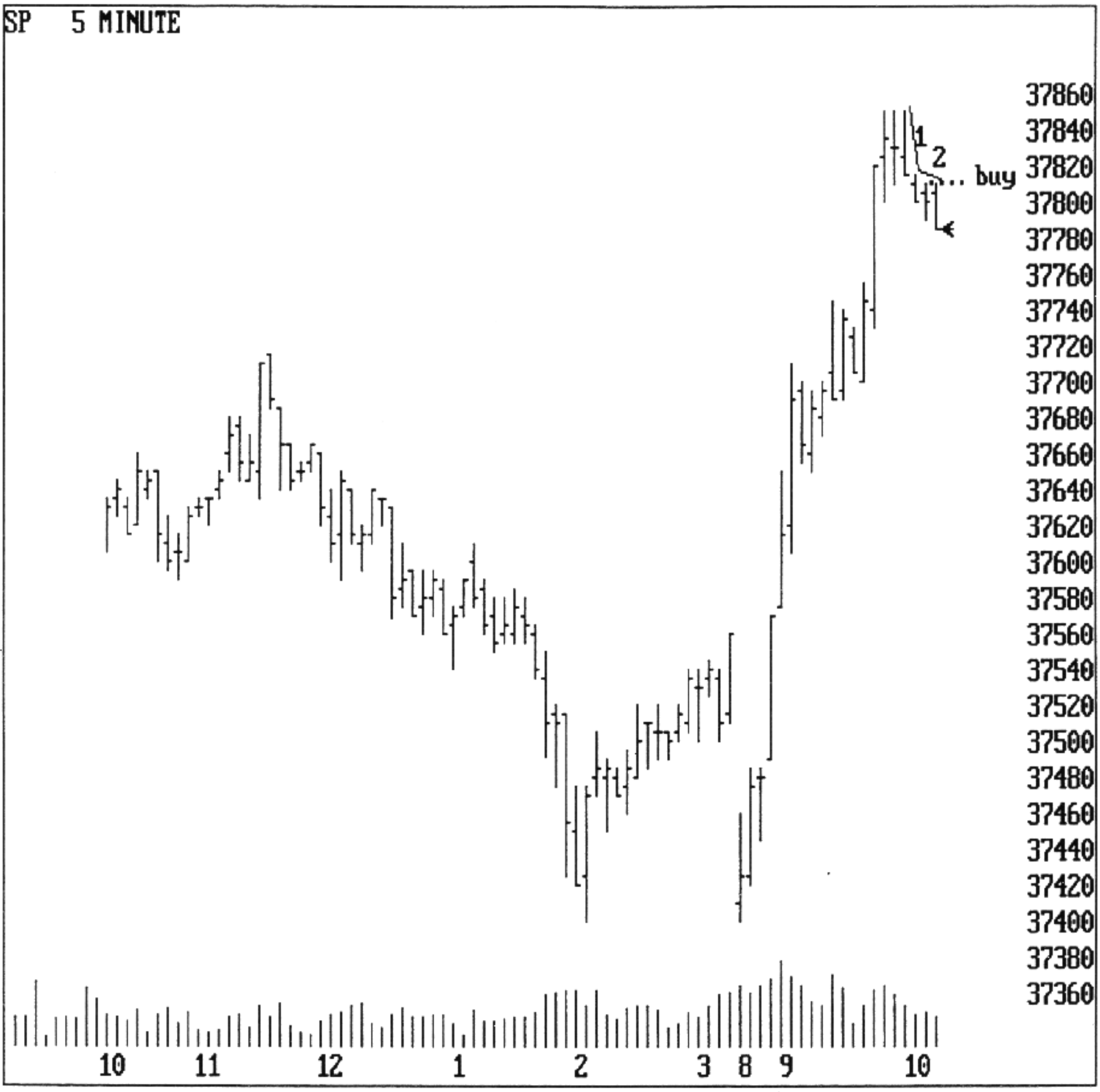
When I saw that prices were going to close lower than they had opened, I called in a sell order to liquidate all contracts.



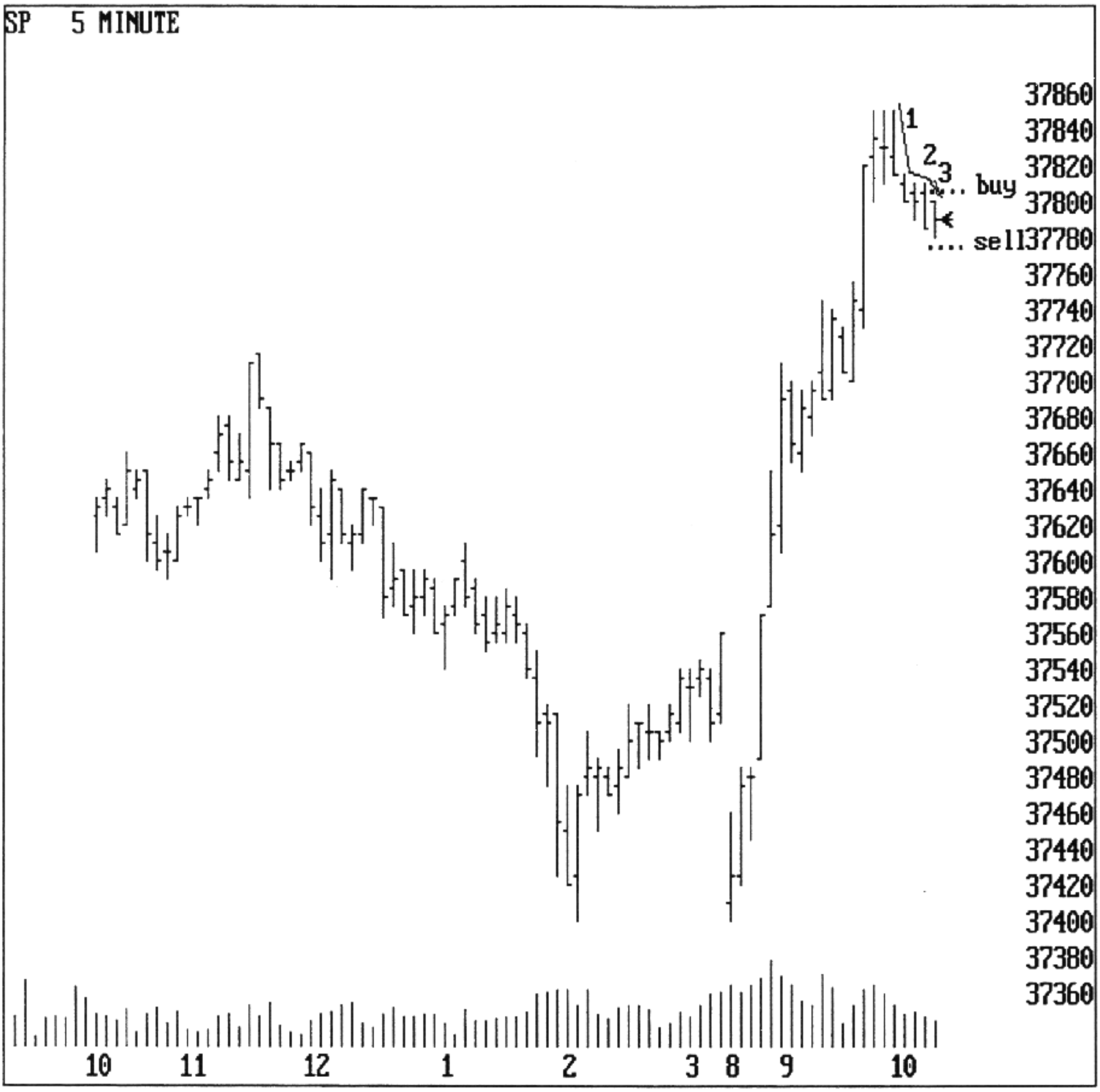
I was filled at the open of the next bar. So far I was doing well this day. I had made 60 points on a ten lot for $3,000 to go with my earlier profits.

I placed a buy stop above the triple top and the high of the correction bar, and began to count the correction.

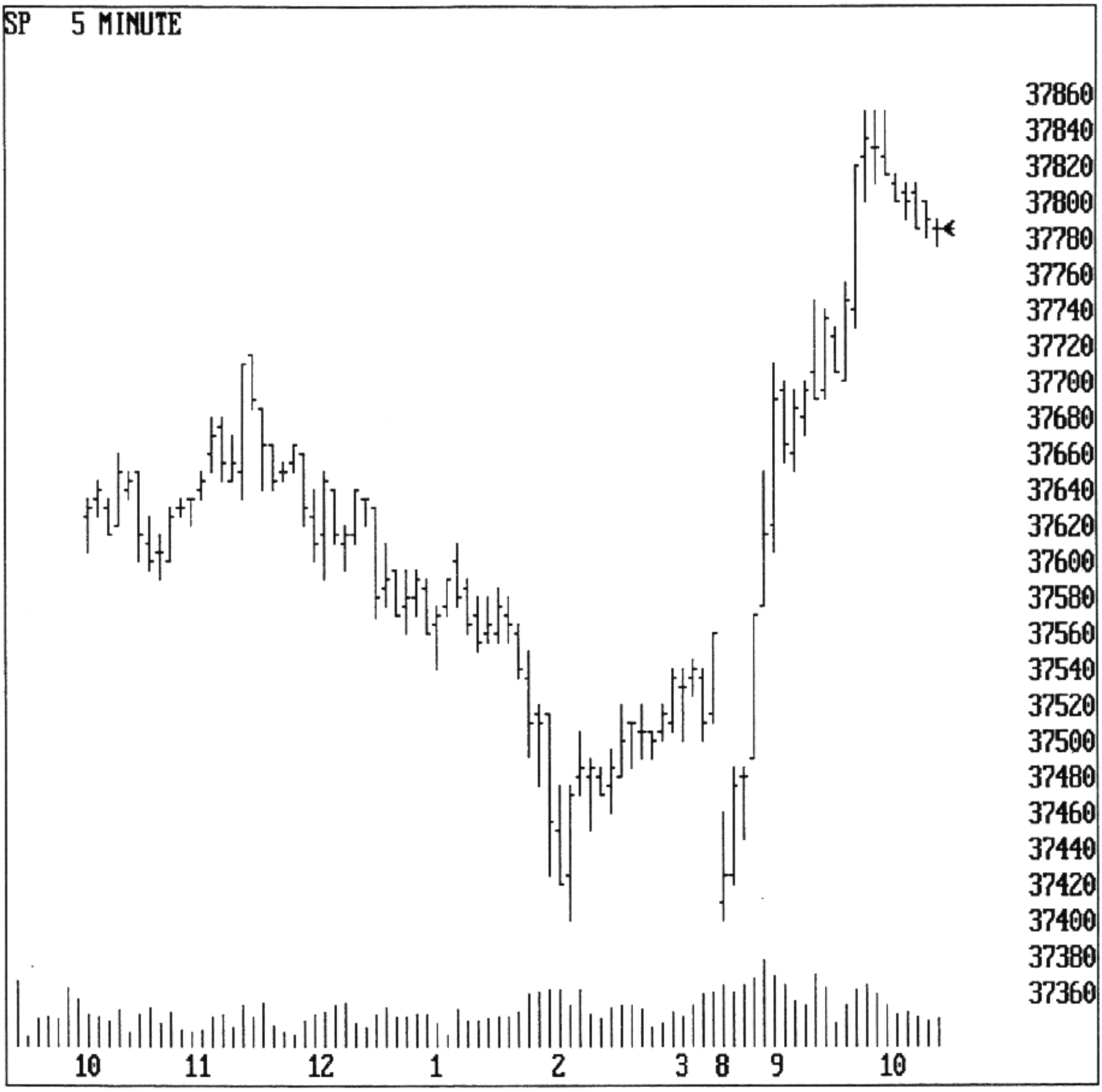
The next bar corrected some more. I moved my buy stop to just above it. My chart looked like this:



When the next bar made a double top, I kept my buy stop in the same place, but I moved my segment count over to the second bar.

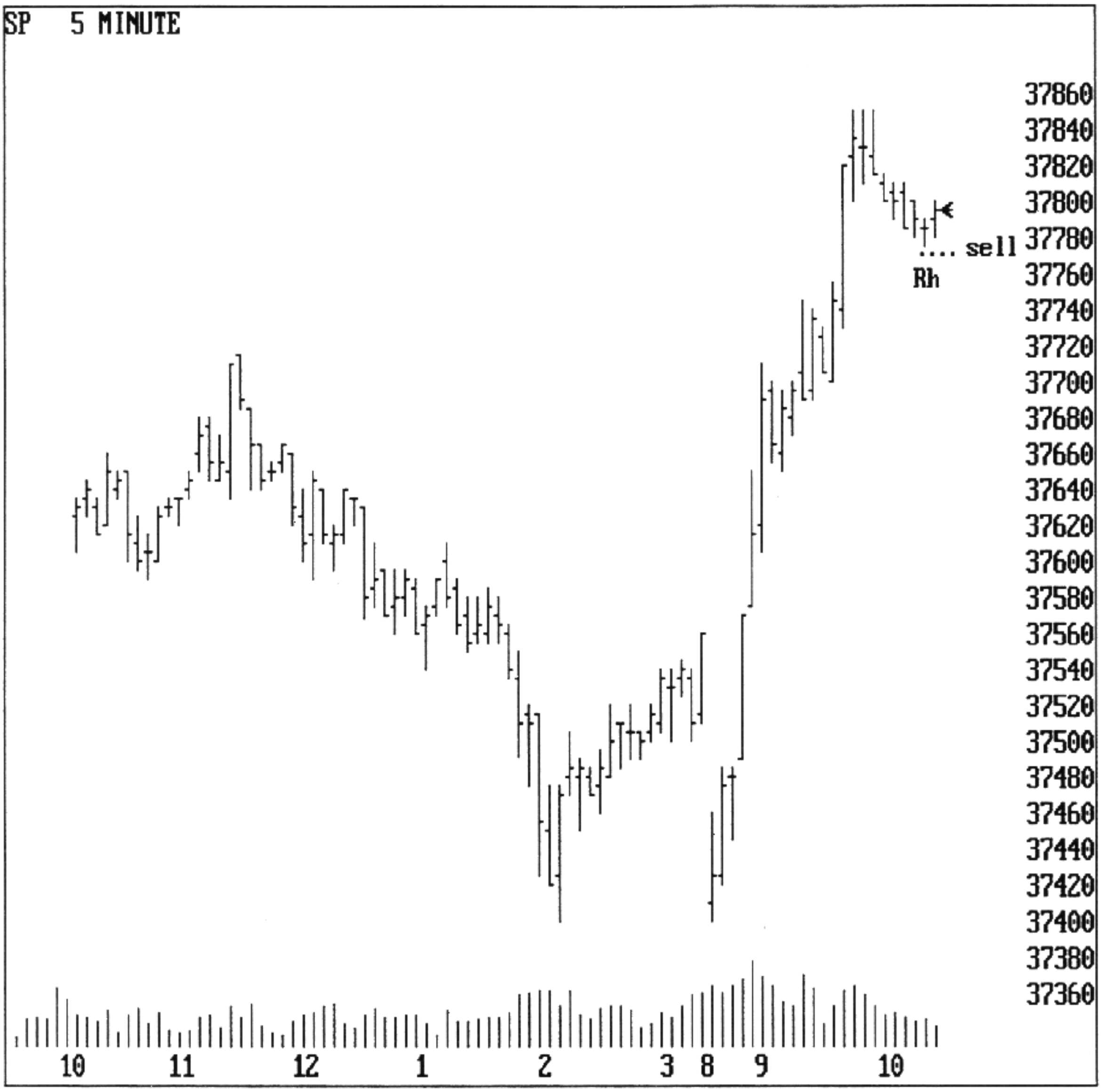


I now had three segments down, so I placed an order to buy a breakout of the high of the current bar, and also a sell order to sell a breakout of the low of the current bar. A new low would constitute a potential trend change from up to down.



I was filled short on a twenty-five lot at 37775. Prices then formed a doji. I didn't like that, so I moved my stop to just above the high of the doji bar.

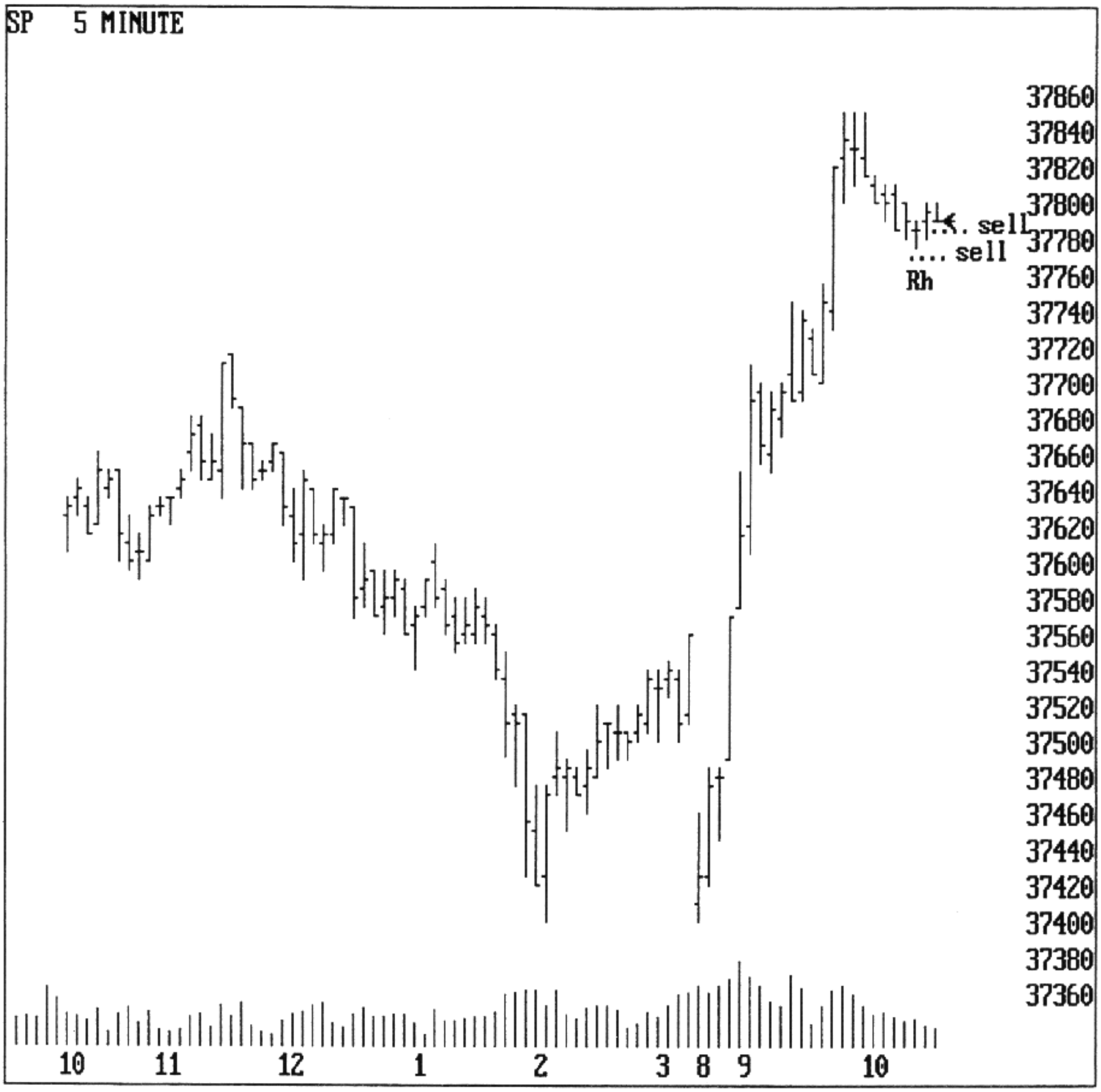
Once the third segment has broken out, I consider truth to be that I'm in a new trend. As far as I was concerned, I was now in a downtrend, despite the doji finish of the last price bar. This concept is vital to my trading.



I was stopped out of all twenty-five contracts at 37790. My loss was $2025 including costs. Prices had now formed a Ross hook. I placed a sell stop below the hook.

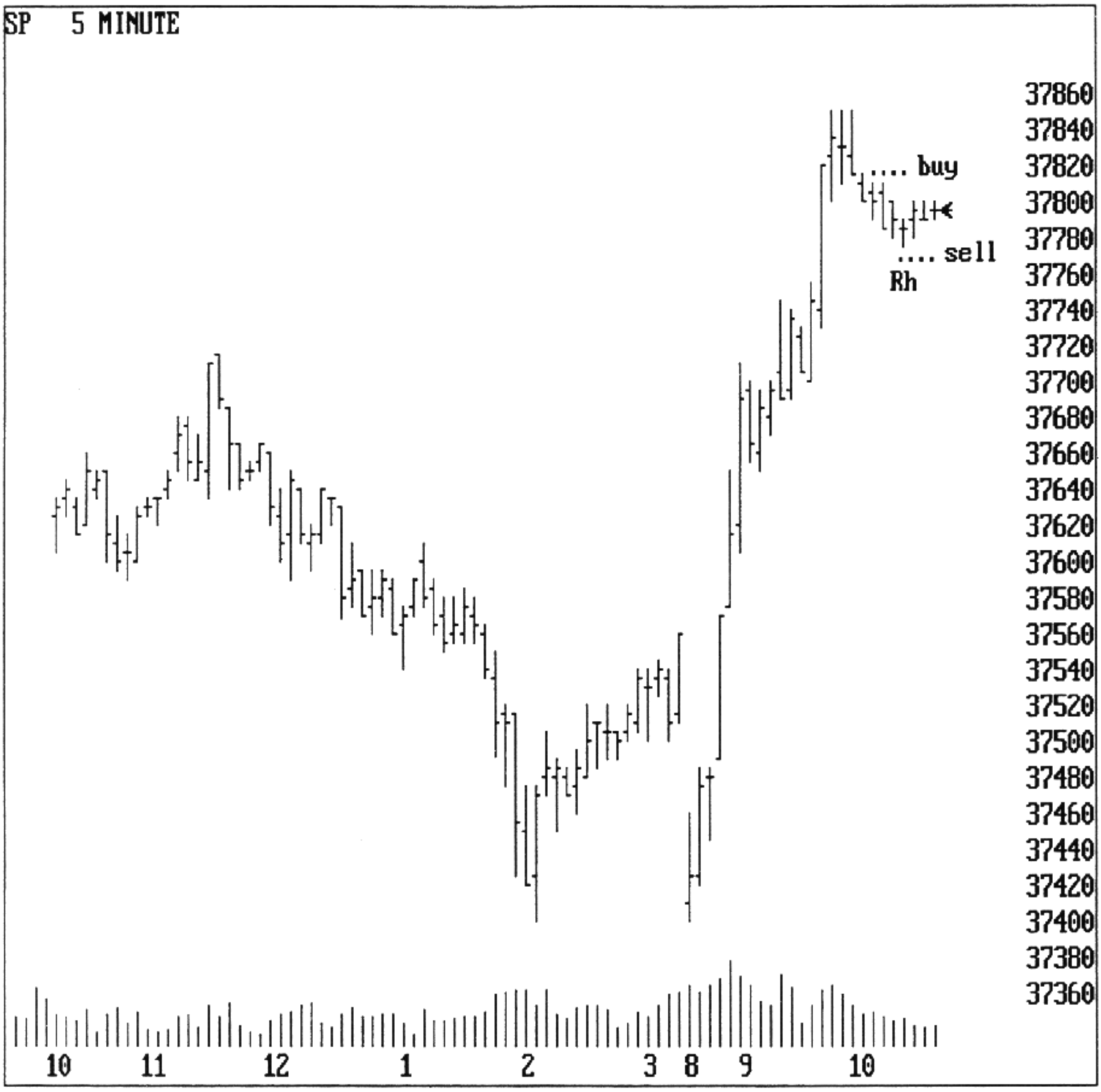
I did not place a sell stop below the correcting bar because I needed 2 ticks (ten points) to cover costs between the point of the hook and one tick below the correcting bar.

When there is not enough room to cover costs, I refrain from taking the trade.



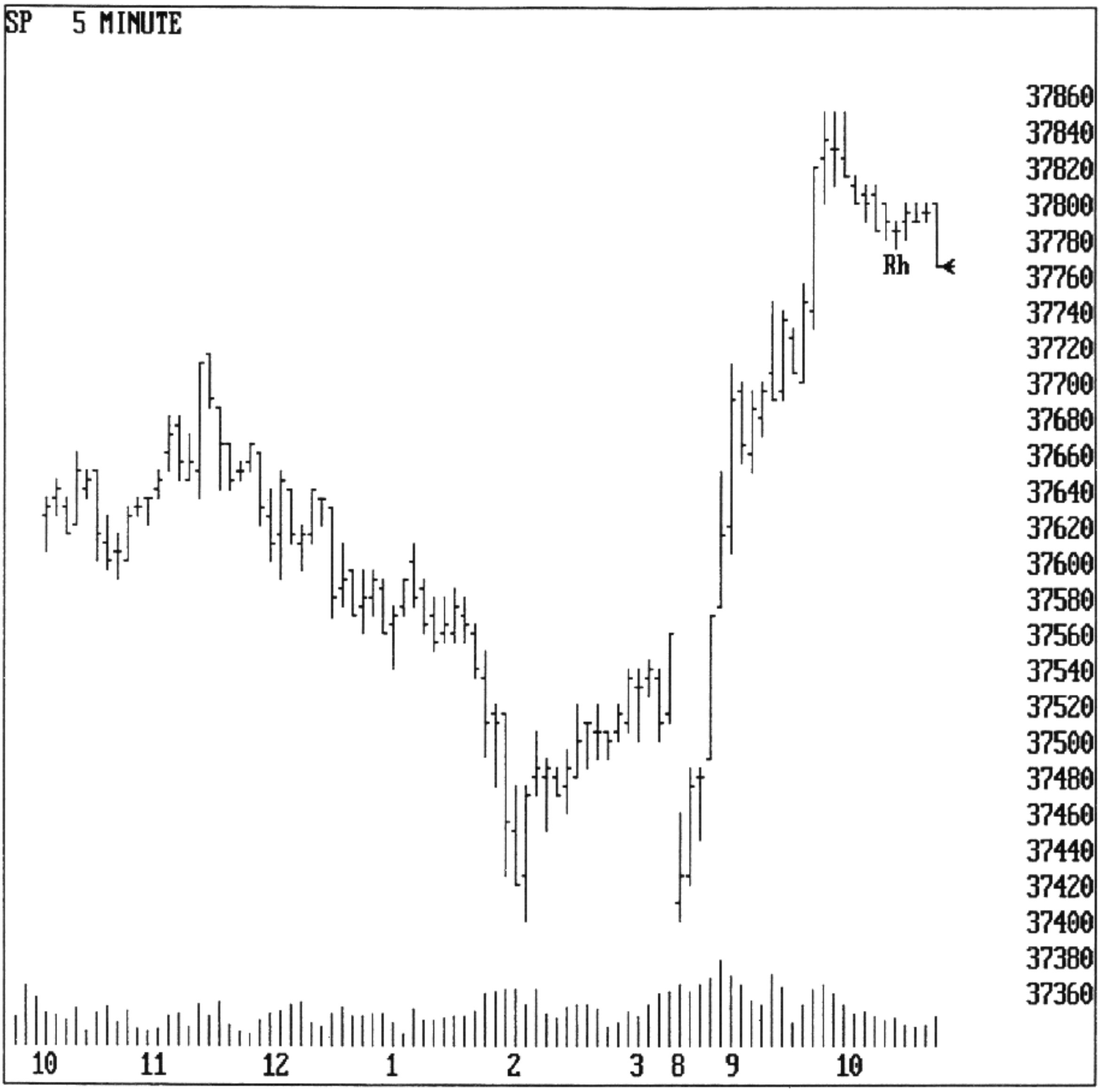
Prices made a doji on the next bar, so I placed a sell stop under it just as it was closing. This was the second bar of correction.

I placed a sell stop there because if I were to be filled 1 tick below the low, there would be enough room for me to cover costs by the time I reached the point of the Ross hook.

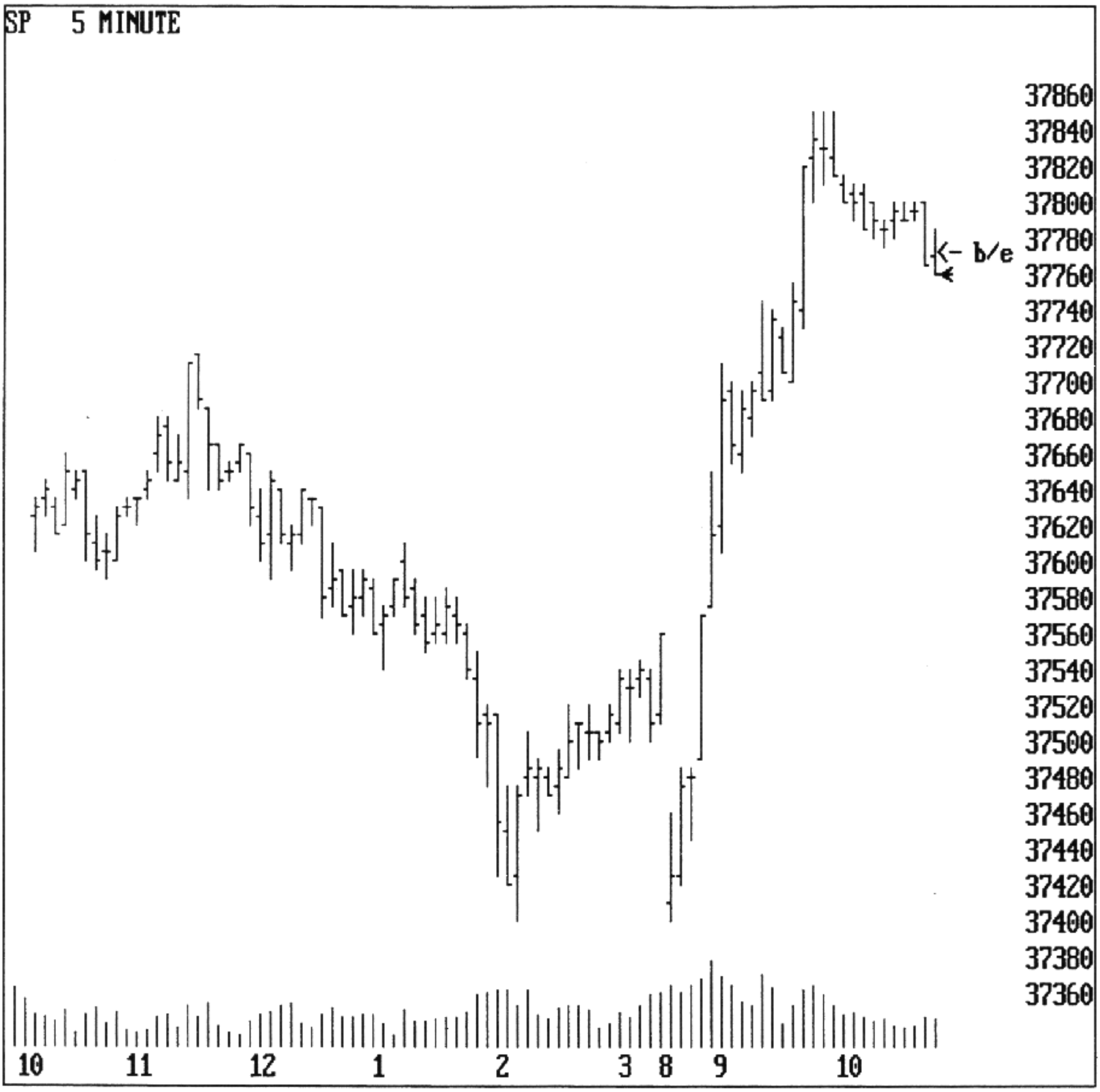


When prices made another doji, I could clearly count four out of the last five bars in congestion, with the last four closes within the price range of the fourth bar back. I canceled the sell order under the previous bar's low, but I kept a sell order under the Ross hook. I also placed a buy order above the small double top made earlier.

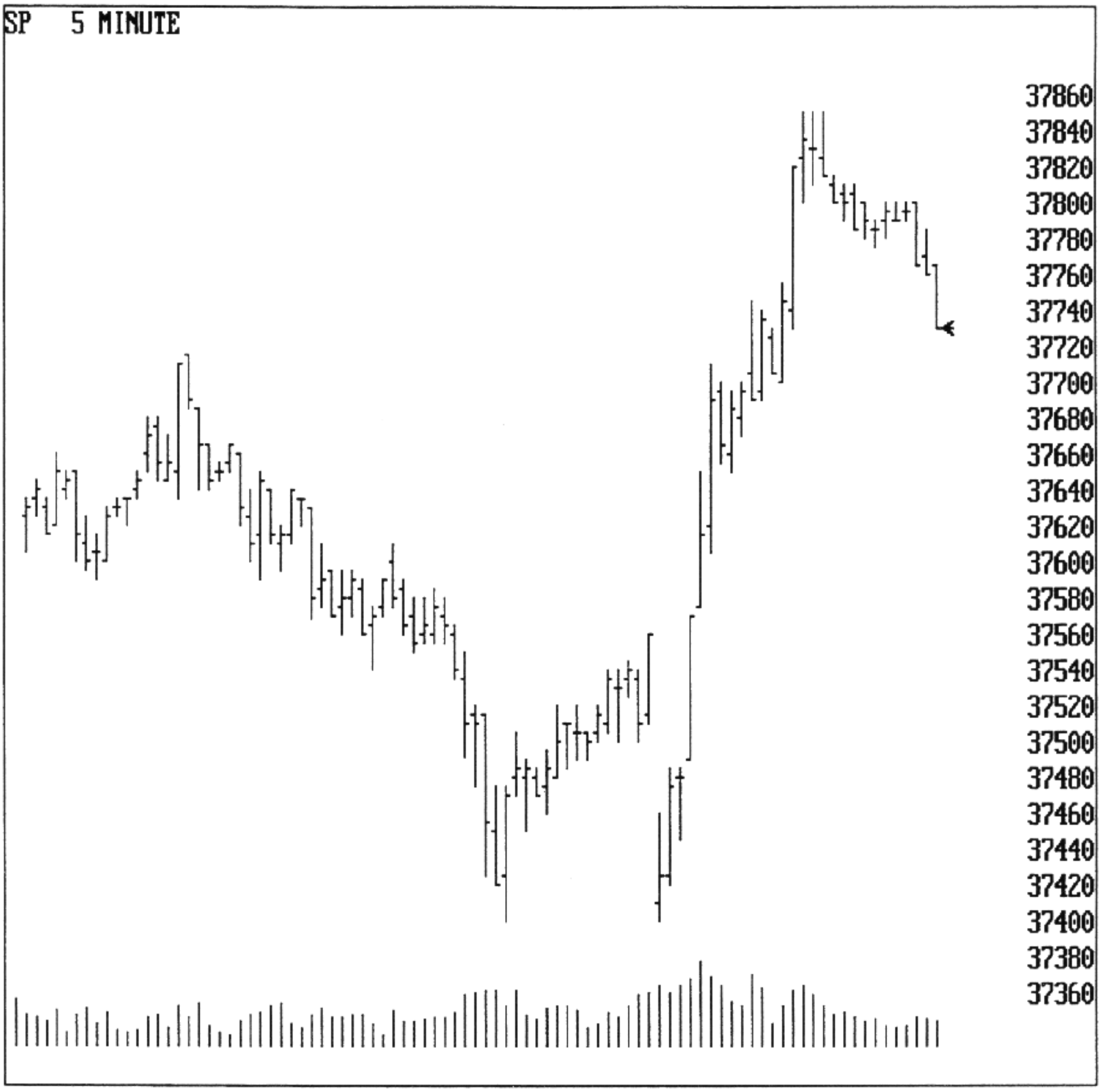
The downtrend was no longer intact. I was looking at congestion. The Ross hook formed the lower limit of the congestion, and the small double top formed the upper limit. A breakout of either would give me a trading entry.



I was filled short on a twenty-five lot at 37770. My stop loss was $250 per contract away, and my cost covering objective was 37760. Prices went as low as 37765.

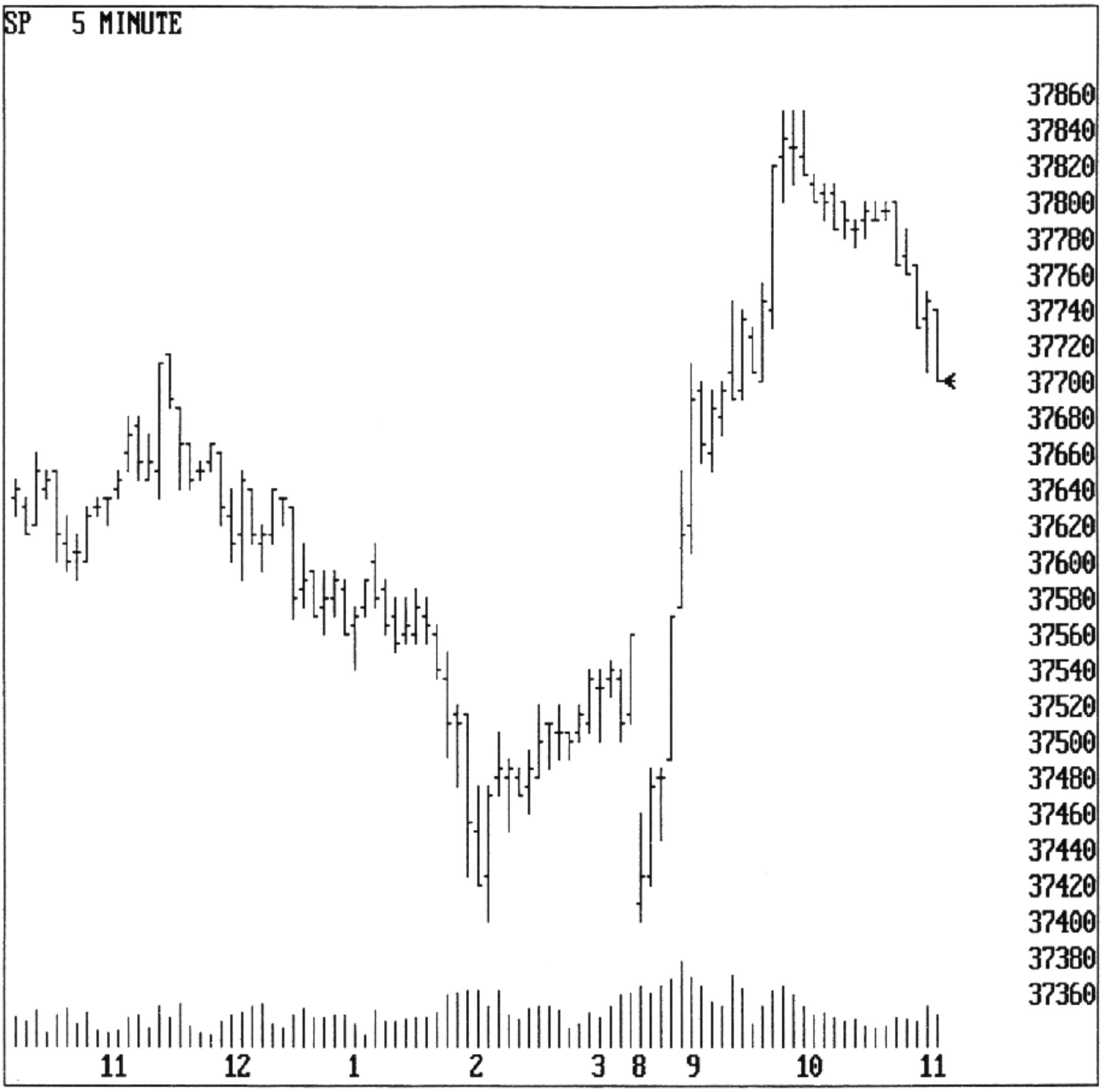


The next bar went a bit lower, enabling me to cover costs with five contracts at 37760. I netted $100 for my trouble, and pulled my protective stop to breakeven (b/e) as the bar closed.

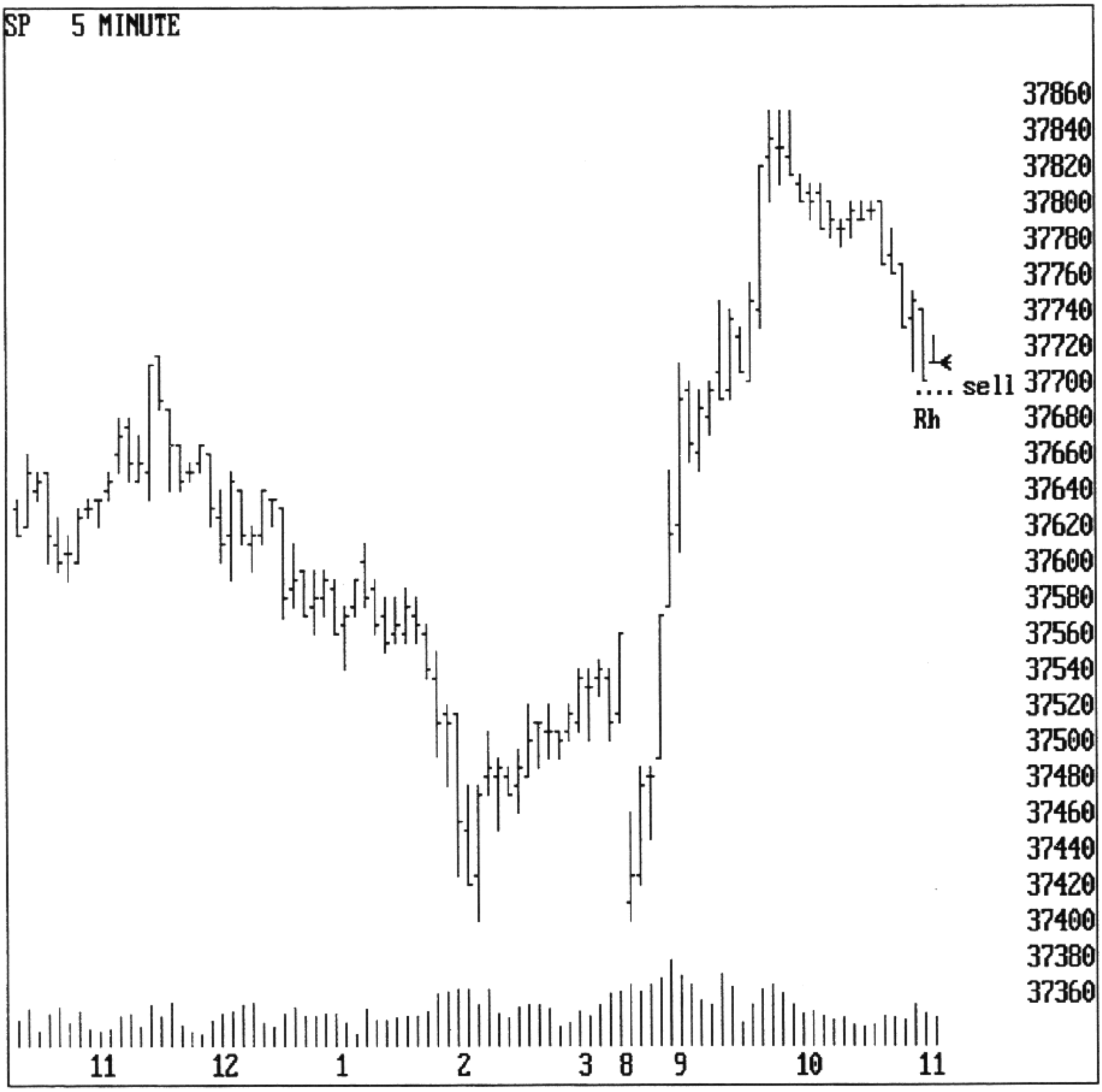


Prices dropped even further, making it possible for me to begin to protect half of the unrealized profits. I placed my stop at 37750.

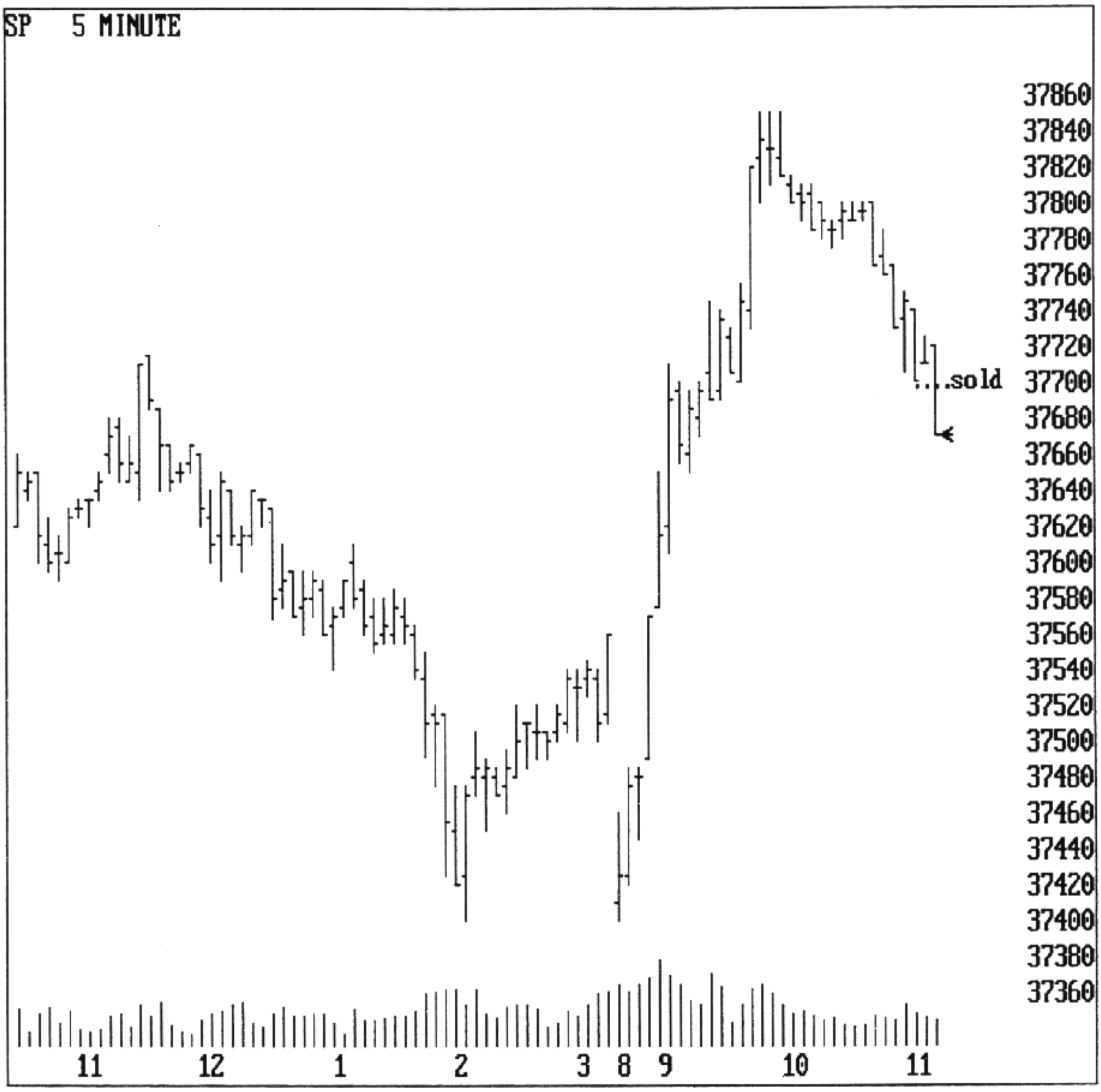
Prices dropped some more after the next bar opened. Then they started to rally back. I made a quick calculation of the unrealized profits, and moved my stop to 37730. I was stopped out there as prices closed at 37745. I had made 40 points on twenty contracts.



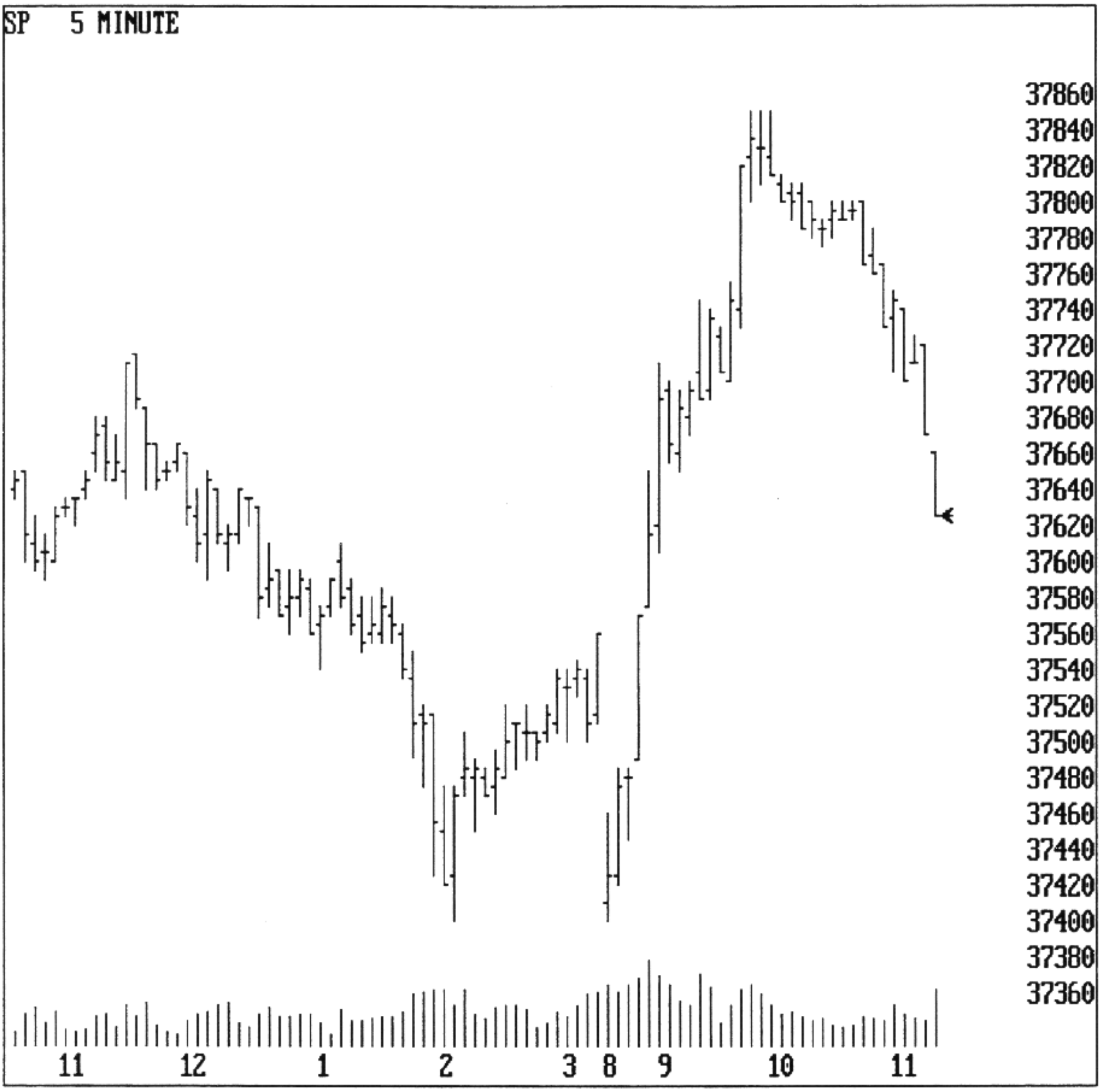
The next bar saw prices go lower. I was hoping I would soon get a chance to get back in.



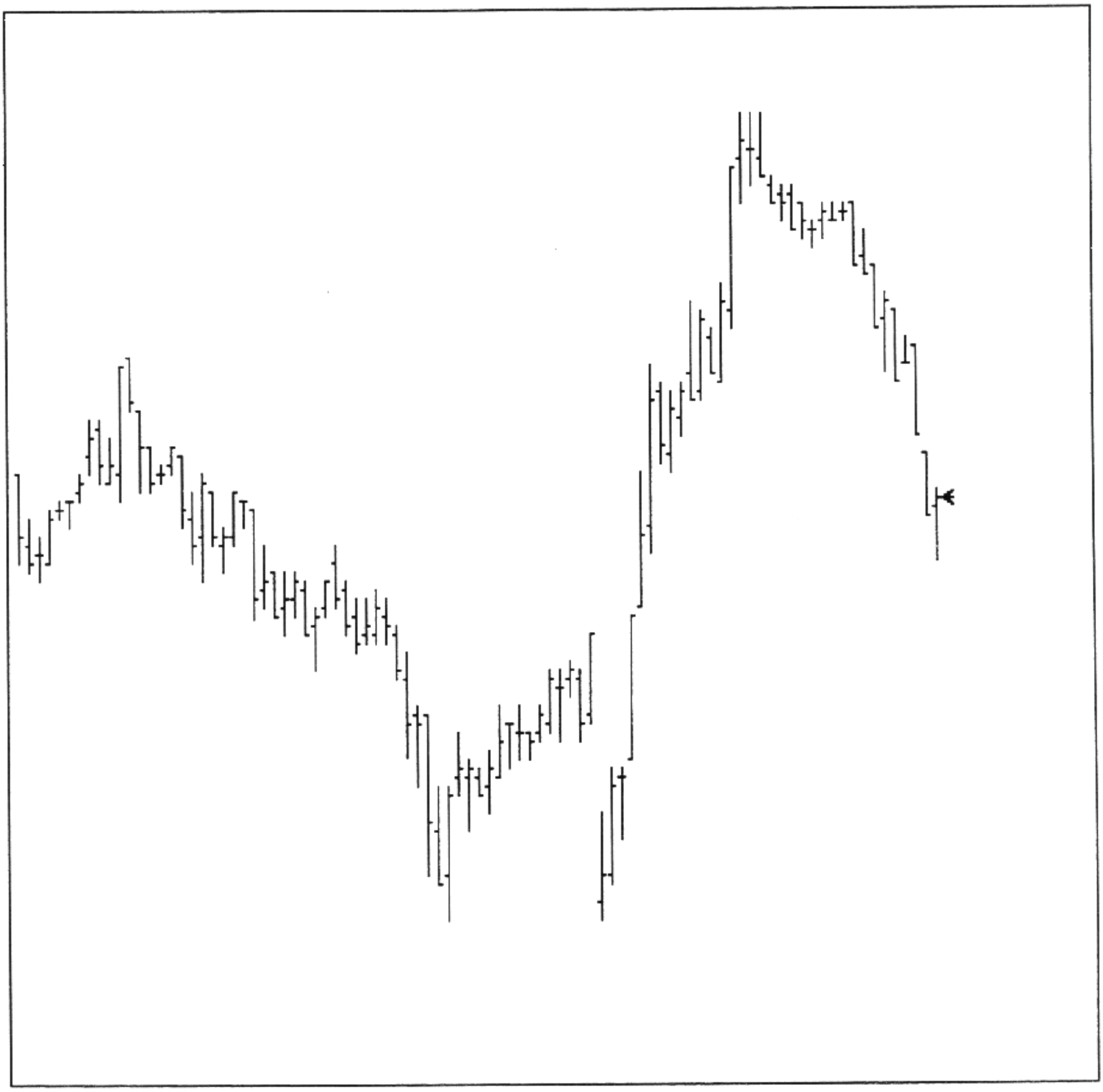
Then came an inside doji. It gave me a Ross hook to trade, so I placed a sell stop beneath the hook, but not beneath the doji. The doji represented the first bar of correction, but there was not room to cover costs prior to taking out the Ross hook in the event of a fill.



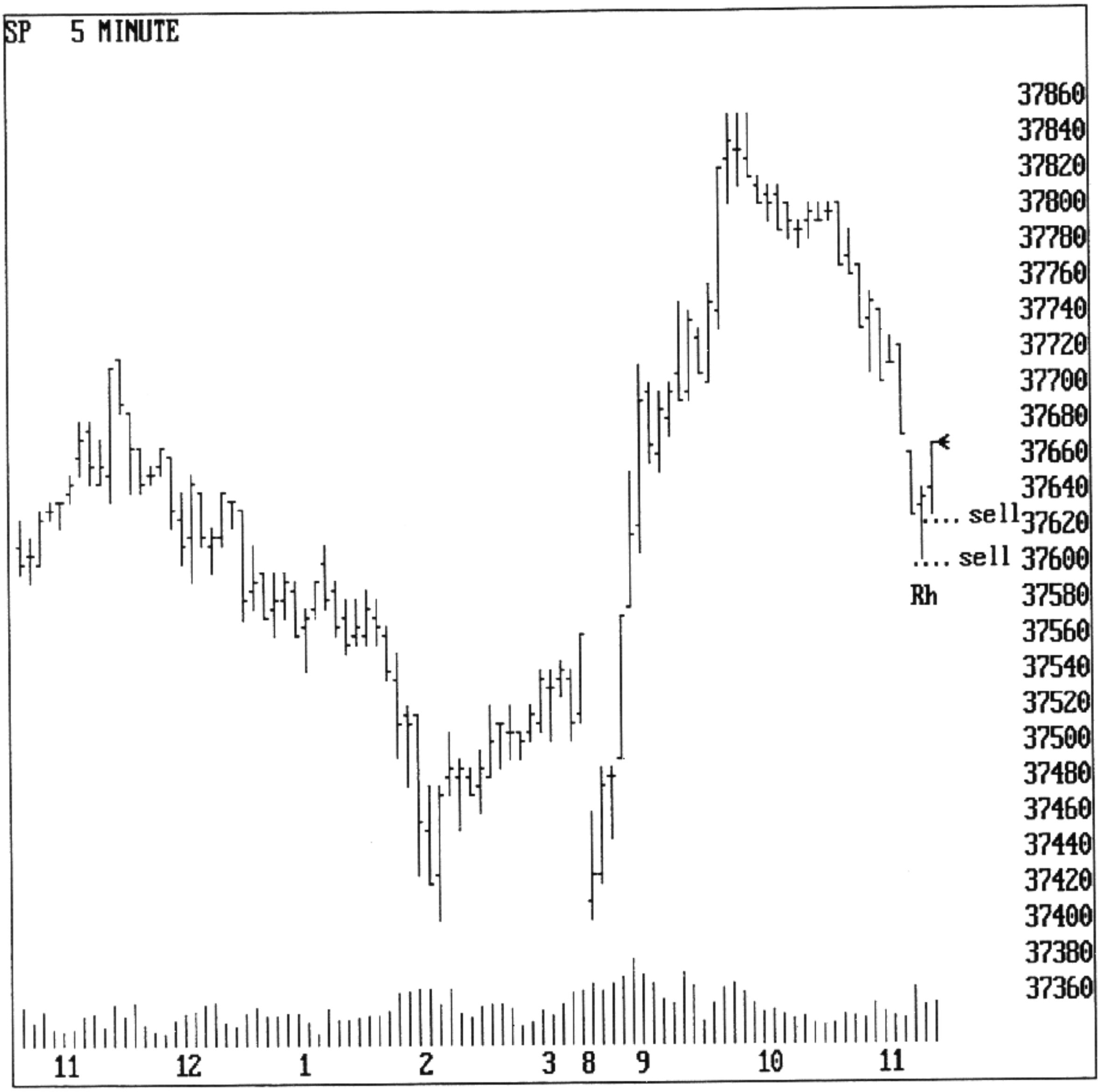
I was filled short a twenty-five lot at 37695. My stop was $250 away, and my cost liquidation objective was 37685. I was able to cover costs with a five lot and netted $100. I then moved my protective stop to breakeven.



The market became very fast, and all of a sudden prices broke loose. The next bar gapped down, and by the close, I was protecting 35 points of profit on twenty contracts. My stop was at 37660.



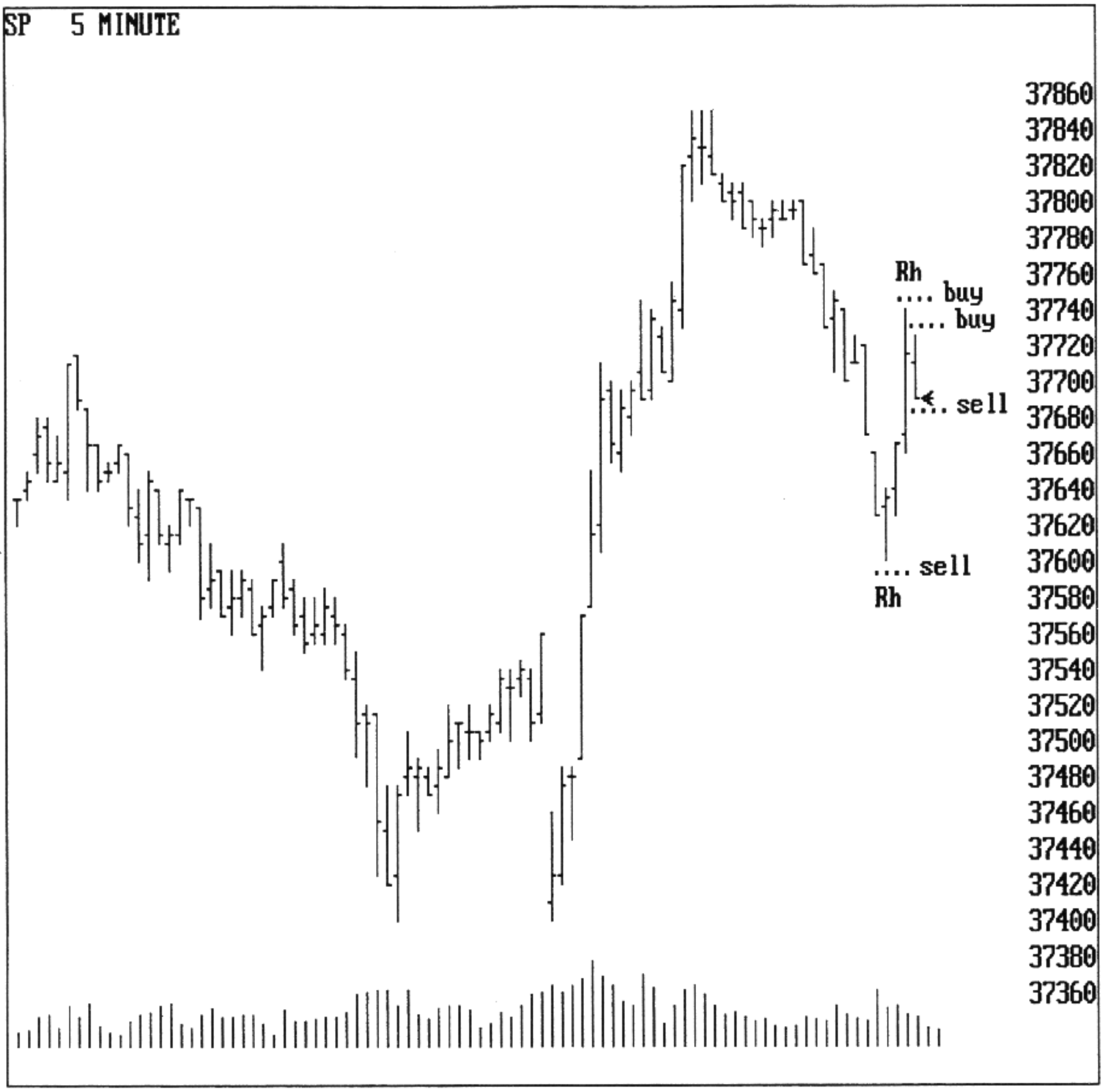
Prices went on to make a new low. When they began to rally back, I calculated the amount of unrealized profit in the trade, and moved my stop to protect an additional 15 points. I moved my stop to 37645.



I was stopped out at 37645 with profits of 50 points on twenty contracts.

The correction left behind a Ross hook and sufficient room for cost covering to sell the low of the corrective bar. I placed orders to sell them both.

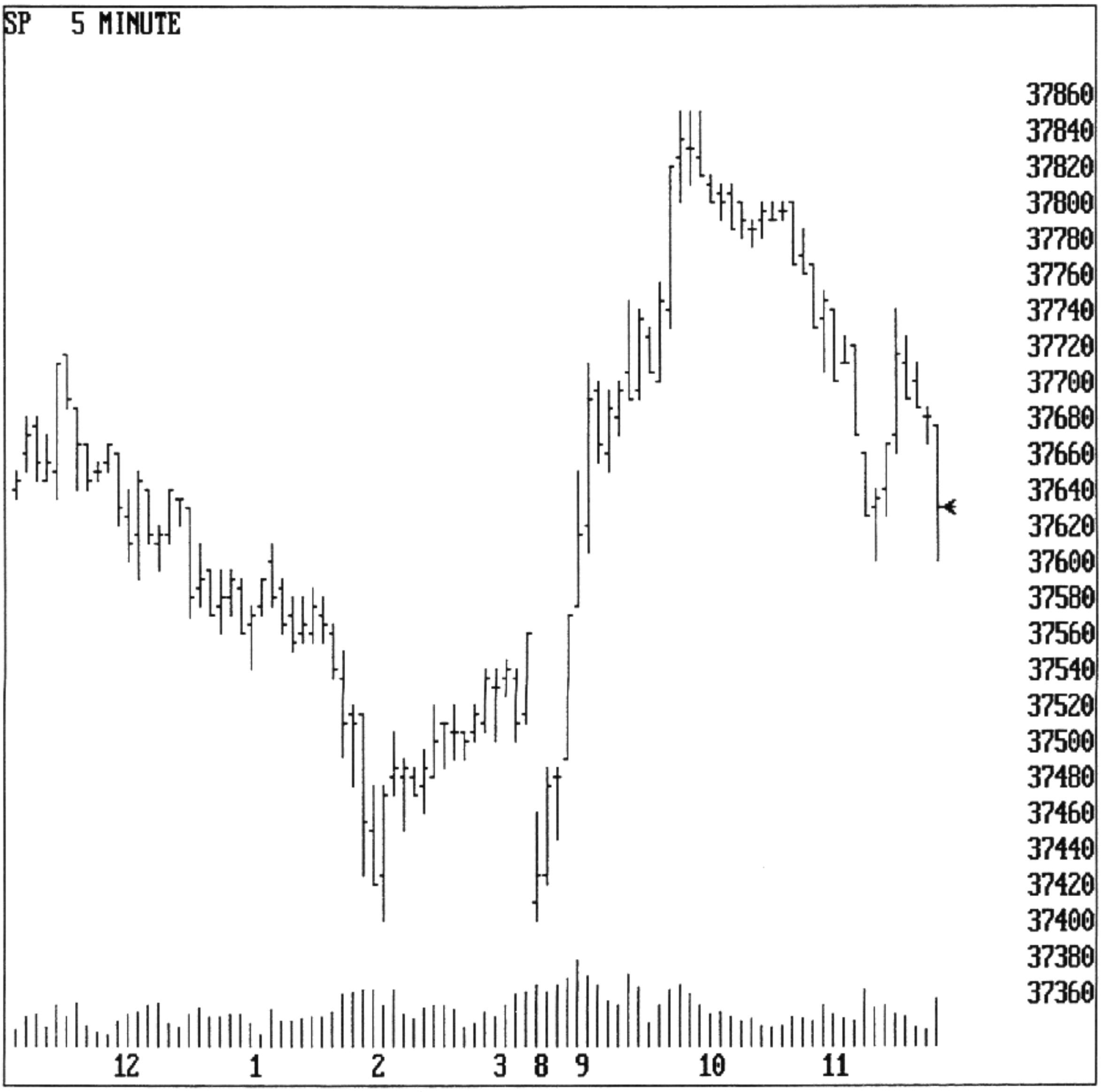
Prices corrected sharply. I began my count. I also moved my sell order to below the correction low.



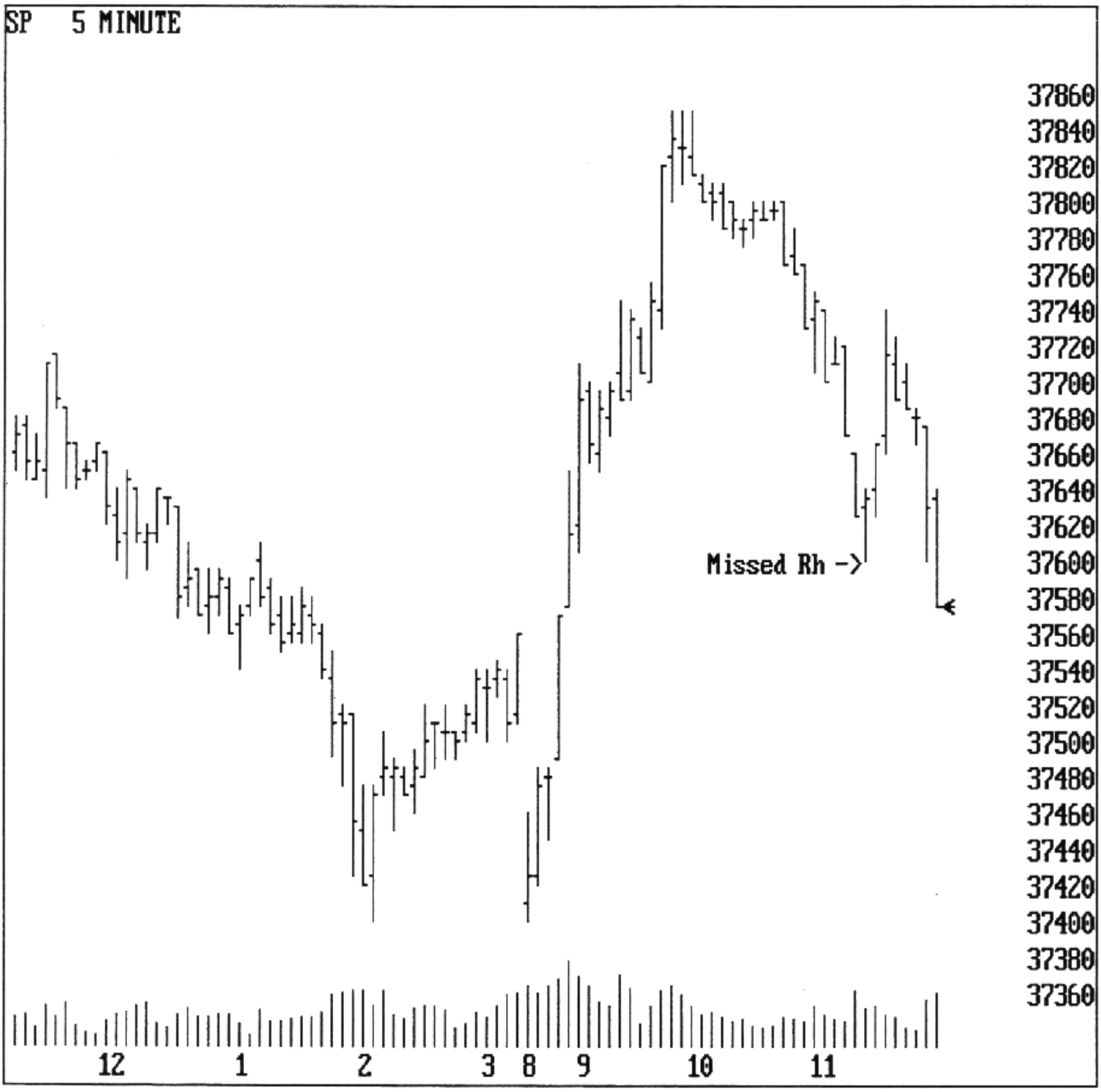
Prices made an inside reversal bar. I moved my sell stop up to the low of that bar, and also placed a buy stop above the high of that bar as well as the new Ross hook.

I was filled short on a twenty-five lot at 37685. My stop loss was $250 away, and my cost covering stop was at 37675.

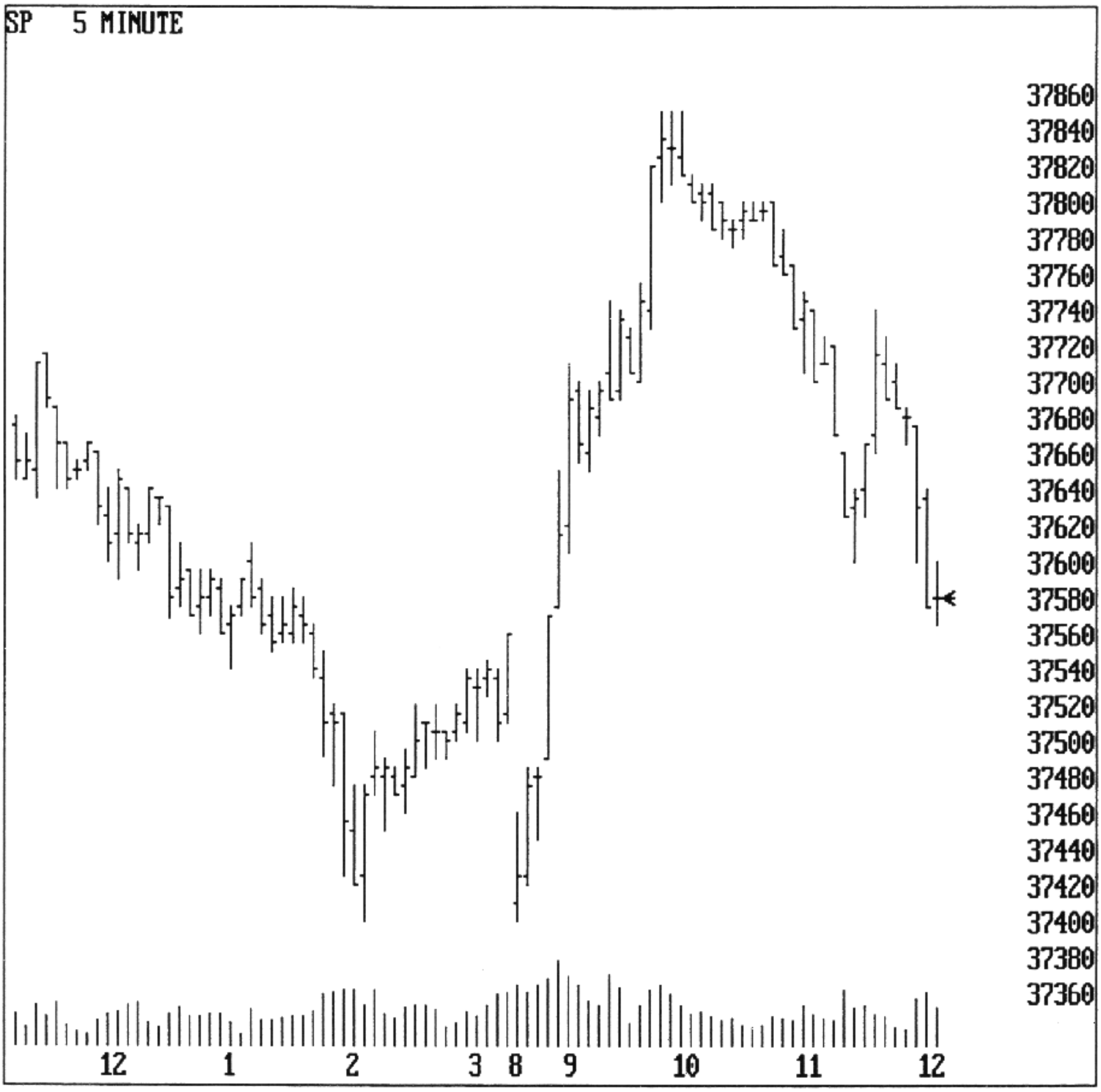
Prices dropped lower enabling me to cover costs and make $100 at 37675. I attempted to move my stop to breakeven at 37685, but was unable to get the order in as soon as I would have liked. Prices ticked at 37685 before closing on a doji.



It turned out to be a lucky break for me that I wasn't stopped out at breakeven, but dojis don't always mean reversal. The next bar opened lower and didn't look back until it hit 37600. It bounced there and recovered somewhat. I moved my stop to 37645, and the bar closed at 37630.

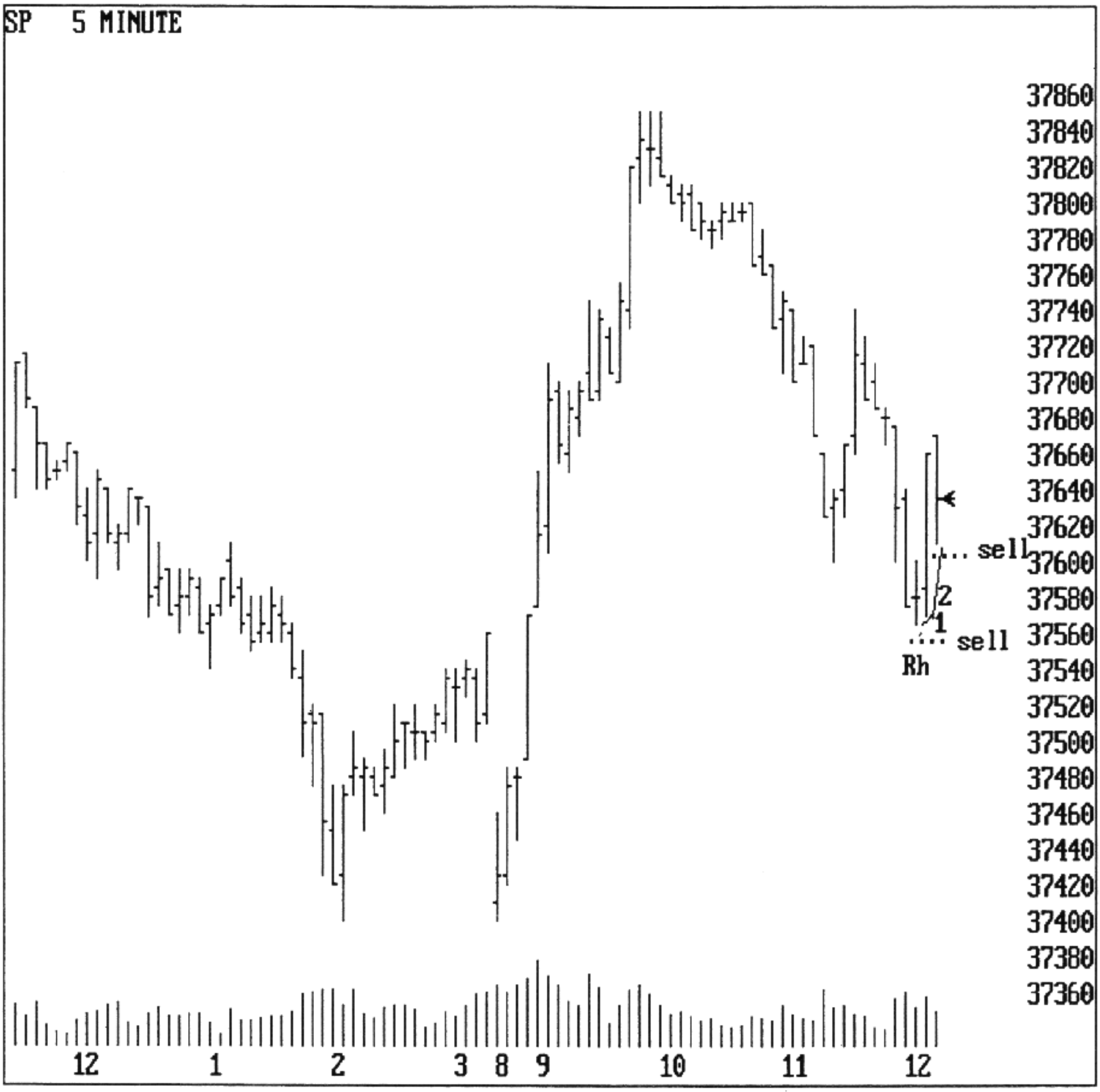


The next bar opened, and prices nipped up to 37640. I thought for sure they would come and get my stop, but they never did. Prices plunged again. I moved to cover more profits. As I did, I realized I'd missed a Ross hook from earlier in the day. My stop was now at 37630.

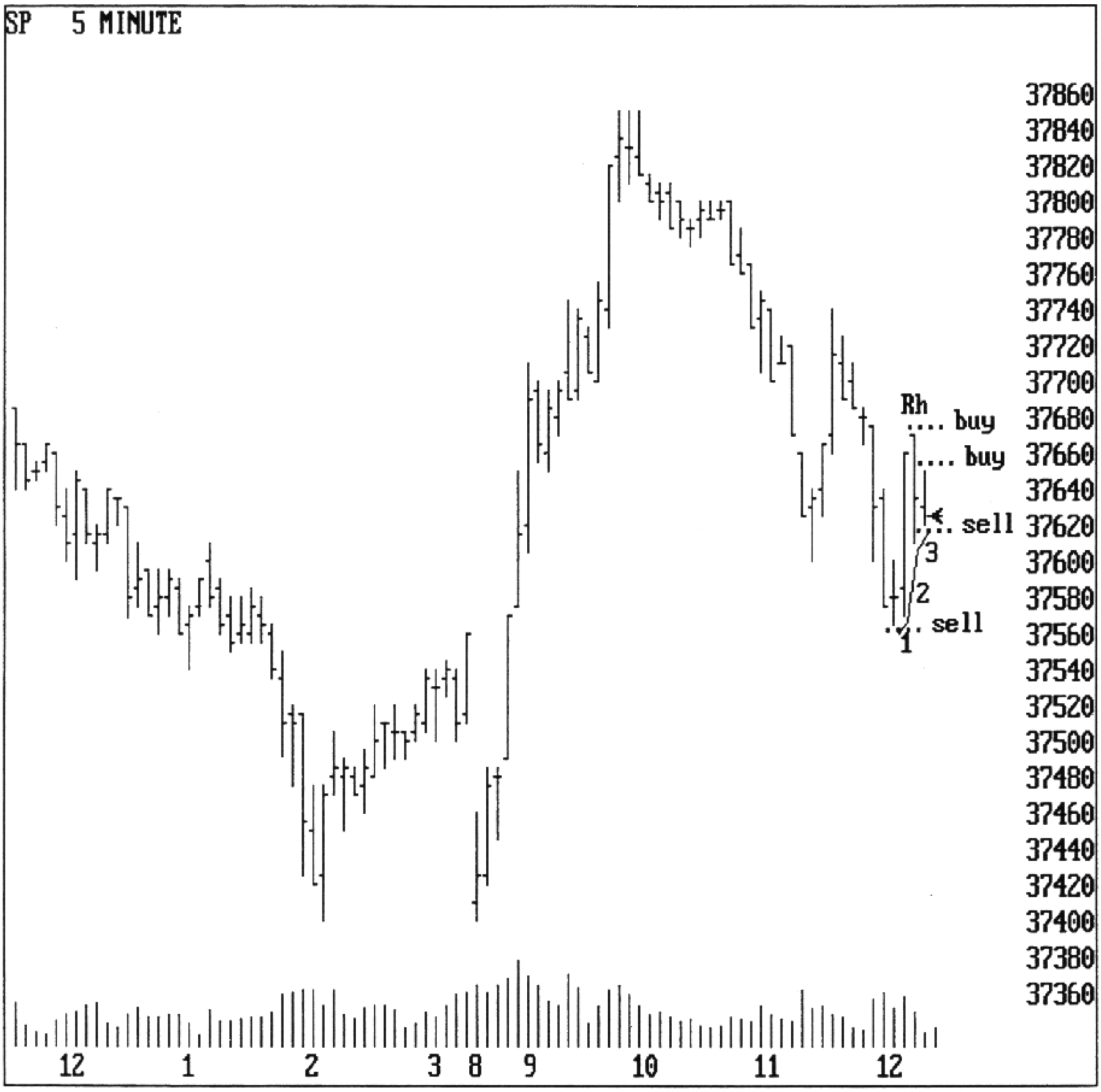


Prices went a bit lower and closed on a doji bar. I placed my stop just above the high. Whenever I see a doji or reversal, I know there is indecision in the market. When the market can't make up its mind which way to go, I start getting ready to get out.

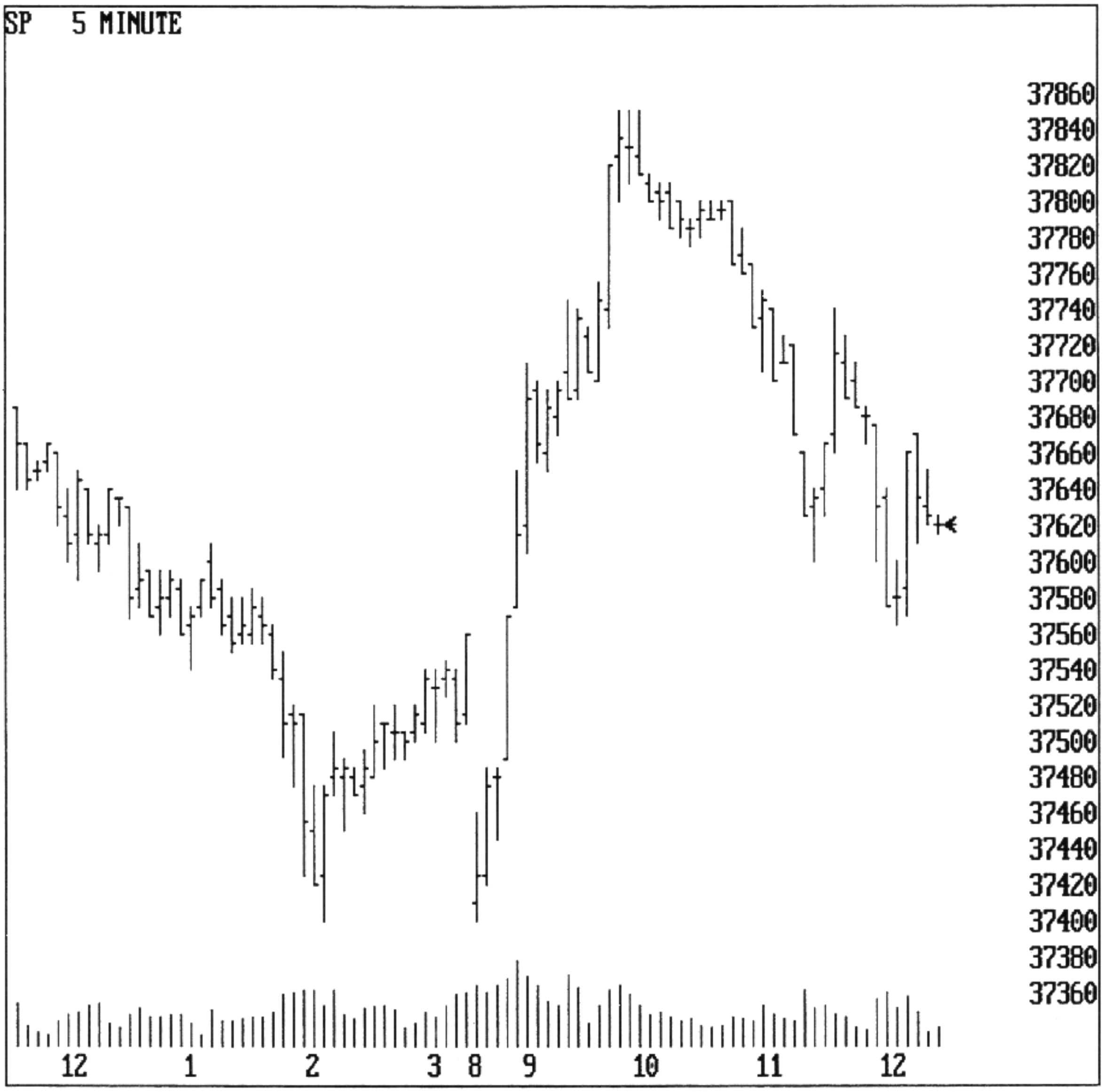
The market made up its mind on the next bar, as prices moved right on up in a strong correction. My stop was taken out and I ended up with 75 point on twenty contracts. I then did what I have trained myself to do, I placed a sell order under the Ross hook.



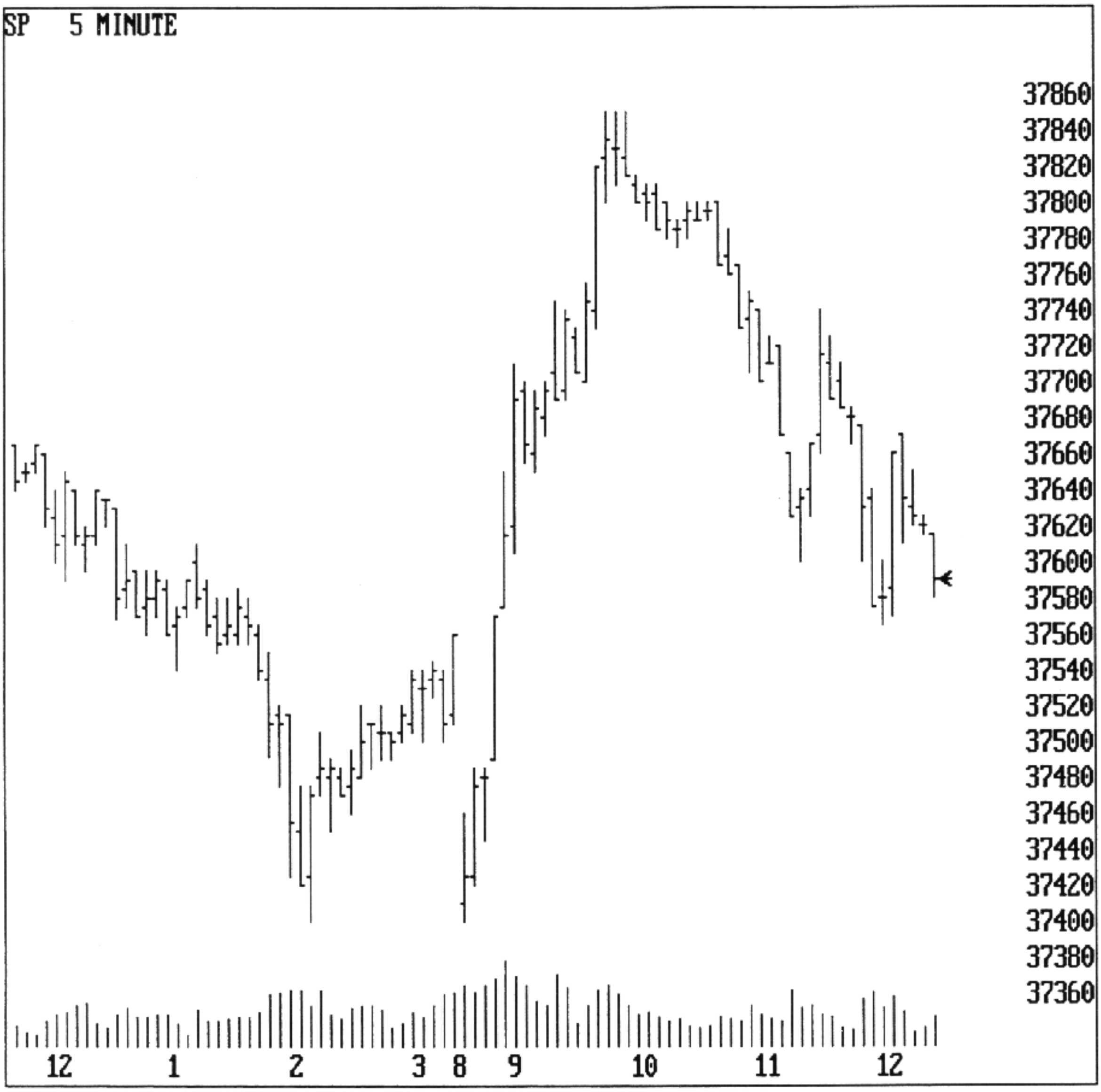
Prices made a reversal bar. I placed my count on the chart, called in a sell order under the low, and waited. I am very consistent when I trade, but do on occasion miss a hook or fail to seize a trading opportunity.



I've shown this so many times now, I hope the reader will know exactly what it is I did. But just in case, I now had a count of 3 segments going up. I placed a buy order above the high, and moved my sell order below the low.

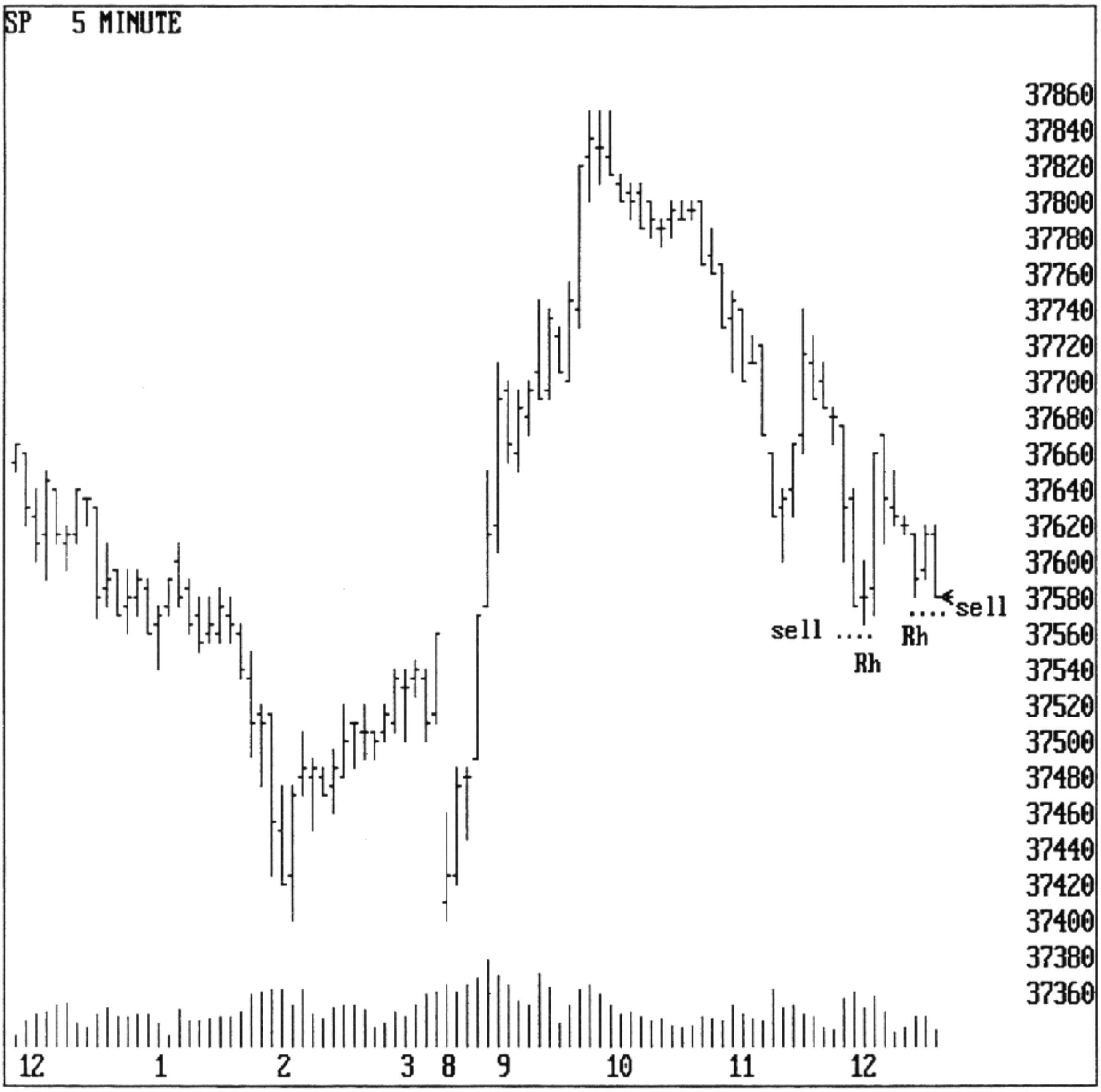


I was short a twenty-five lot at 37615 on what turned out to be a tiny doji bar. My stop was $250 above my entry, and my liquidation goal for covering costs was at 37605. With about one minute to go on the bar, I called in and moved my protective stop to one tick above the previous bar's close. I didn't like the hesitation I was seeing in the market.

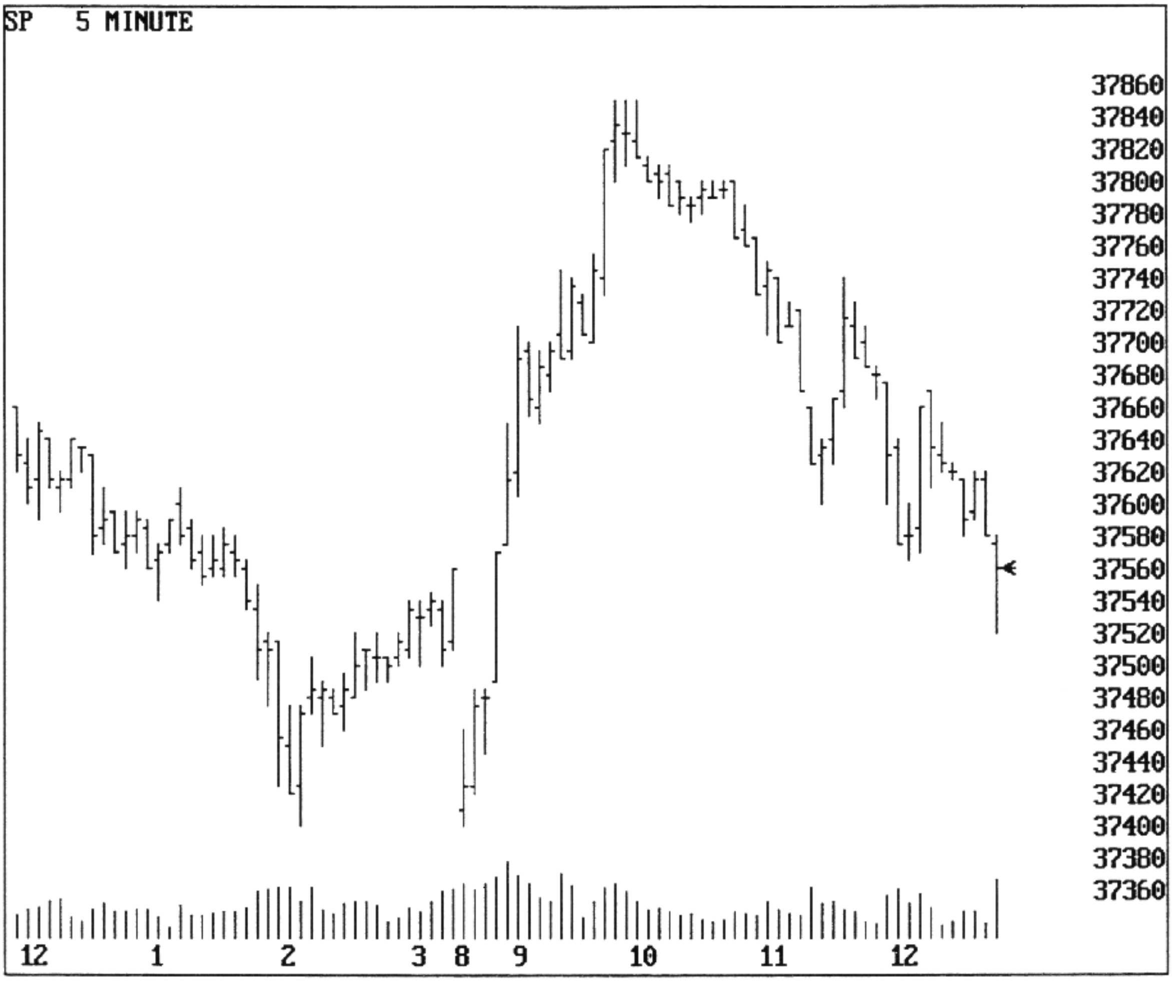


I didn't have to worry for too long. The next bar opened a tad lower and then dropped enough for me to cover costs. After covering, I moved my stop first to breakeven and then, as the bar closed, to protect half my profits. My stop was at 37600.

I was stopped out at 37600 as prices corrected. I made 15 points on twenty contracts. Being a disciplined trader, I did my usual thing. I placed a sell stop below the Ross hook. When there is enough room to cover costs, I also place a sell stop below the low of the bar that is making a correction. In this case there was not enough room for the second sell order.



I came within one tick of being filled on the next price bar as prices closed on a double bottom. Looking back, I determined that this time I wouldn't miss the old Ross hook made earlier in the day.

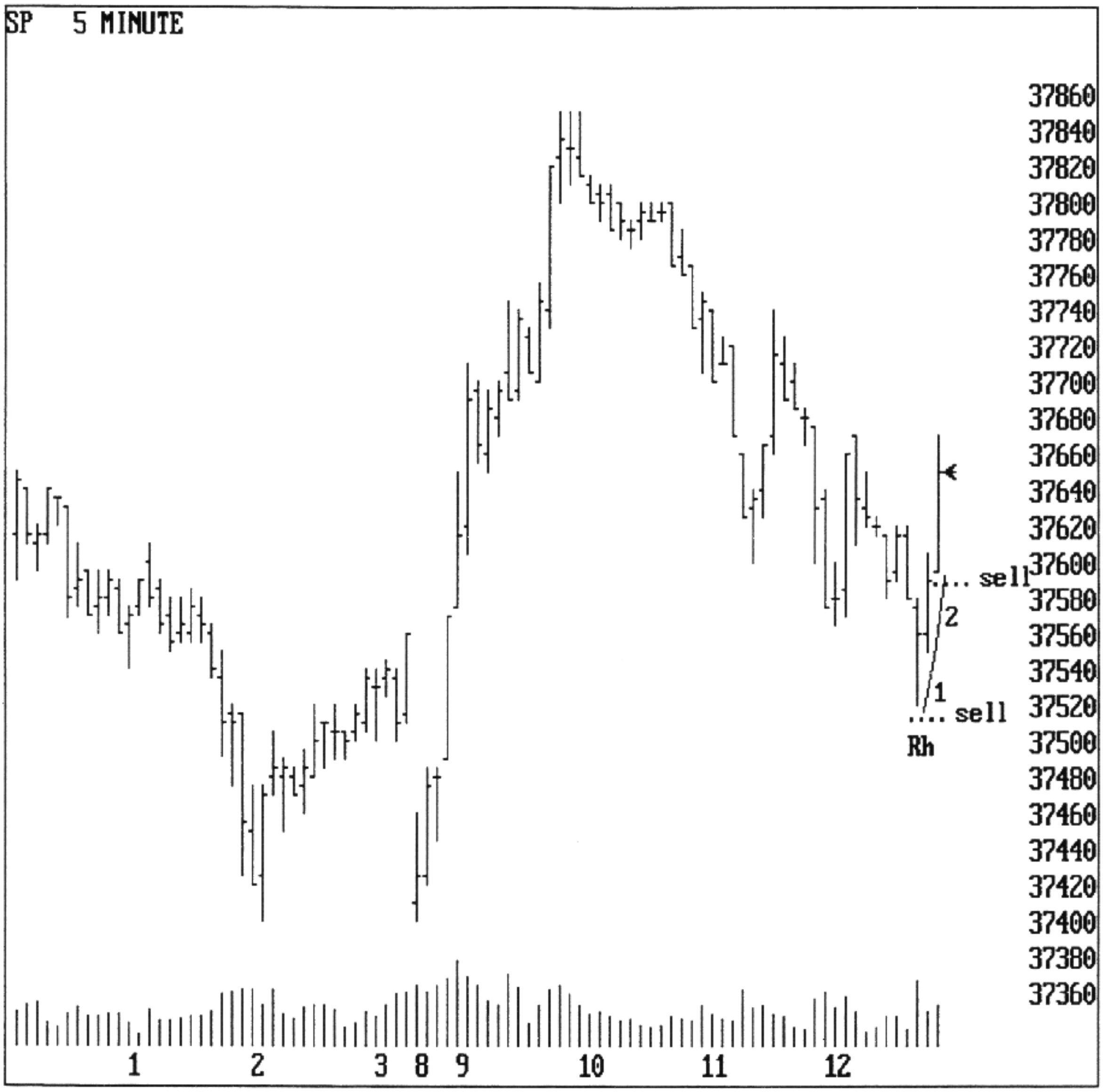


I was filled with a twenty-five lot at 37580. This was a break because the prices opened at 37575. They immediately ticked up and I was filled. I placed my protective stop $250 per contract above my entry. I should explain here that my stop goes into effect contingent upon my being filled. I don't call it in separately. As prices went down, I was able to cover costs with five contracts and pulled my stop to breakeven.

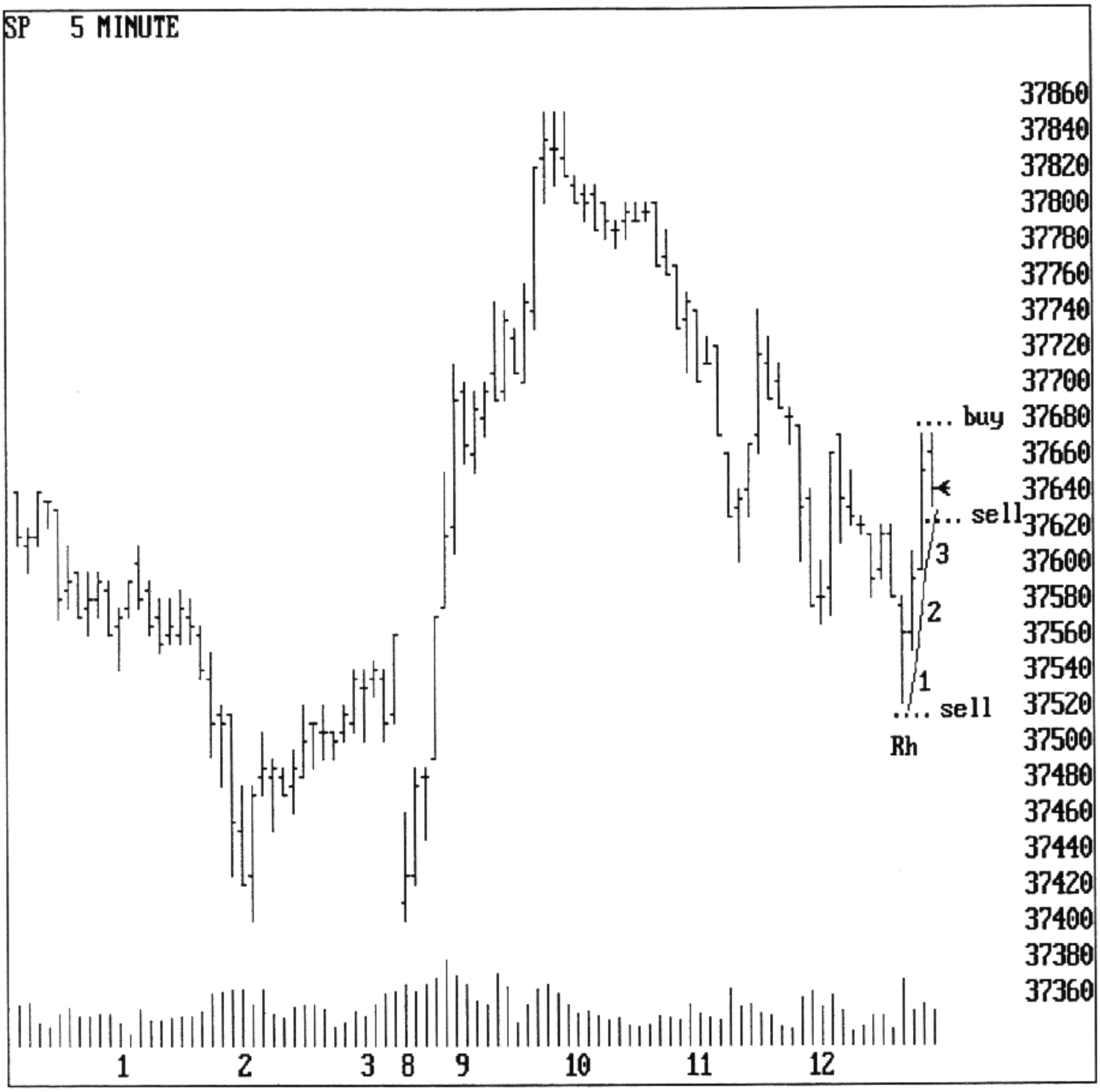
Also on the way down, I was filled with a fifteen lot at 37560 based on a breakout of the older Ross hook. My protective stop was placed $250 above my entry, and I was able to cover costs on this contract set. I cashed five contracts here as well. I pulled all stops - from both contract sets - to 37560. I was stopped out there as prices rose to the close. I had made 20 points on twenty contracts.

Cost covering had added a couple of hundred bucks to the kitty.

As prices corrected, I did my usual thing. I placed a sell stop underneath the Ross hook. I placed a sell stop beneath the corrective bar's low because this time there was room to cover costs. I waited patiently for developments.



The next bar brought more correction. I started my count and moved my sell stop up to the low of the new corrective bar.

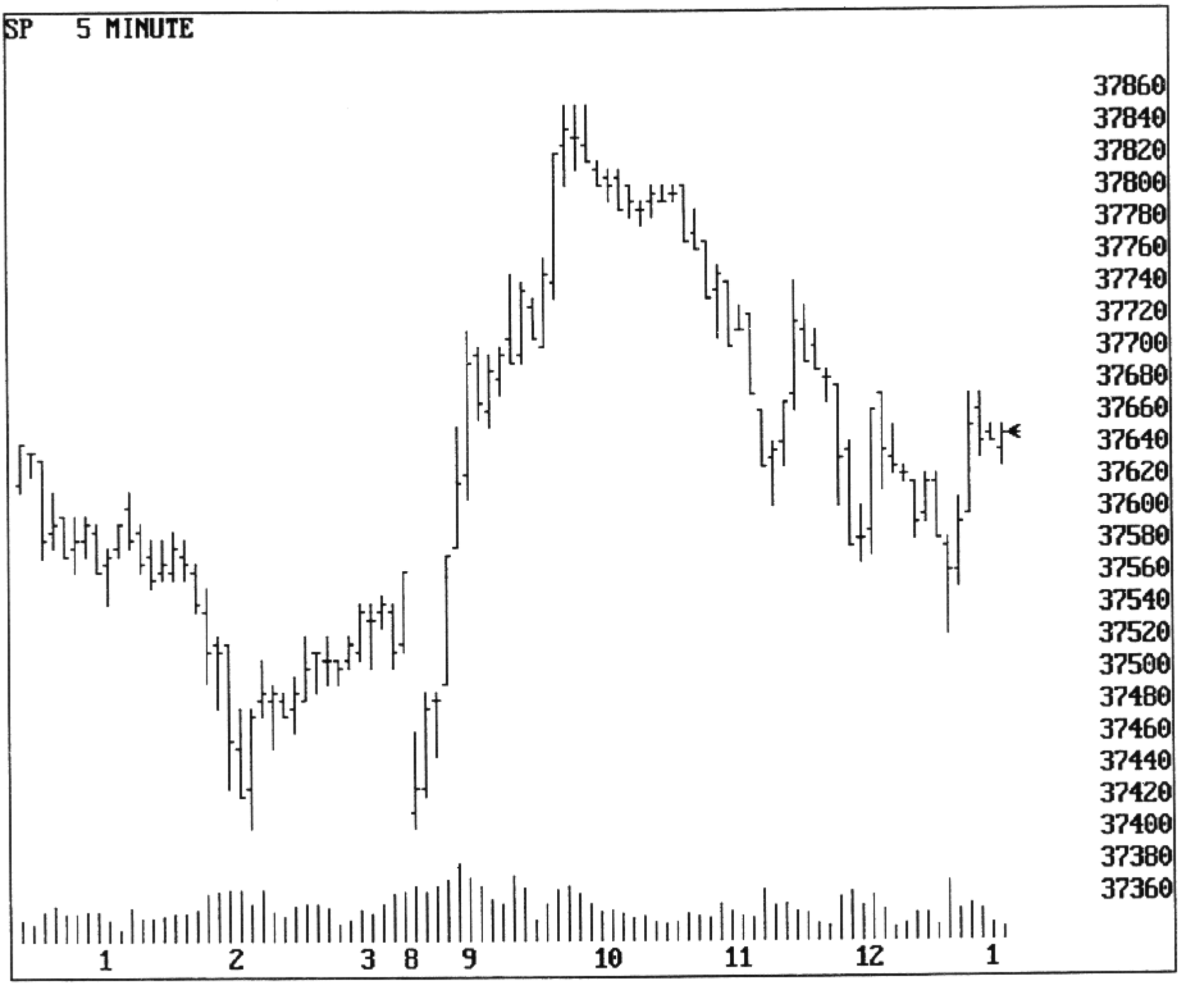


The next bar brought a reversal, but a higher low. I connected my third segment and moved my sell stop to below the low. Since I would consider a breakout to the upside of the double highs the beginning of a new trend, I placed a buy order to get long if a breakout should happen that way.

The mark of a good method is that it keeps a trader out of the market when it's going sideways. I know of no mechanical method that can do that. When the next bar developed as an inside bar, the market was, by my definition, not going anywhere.

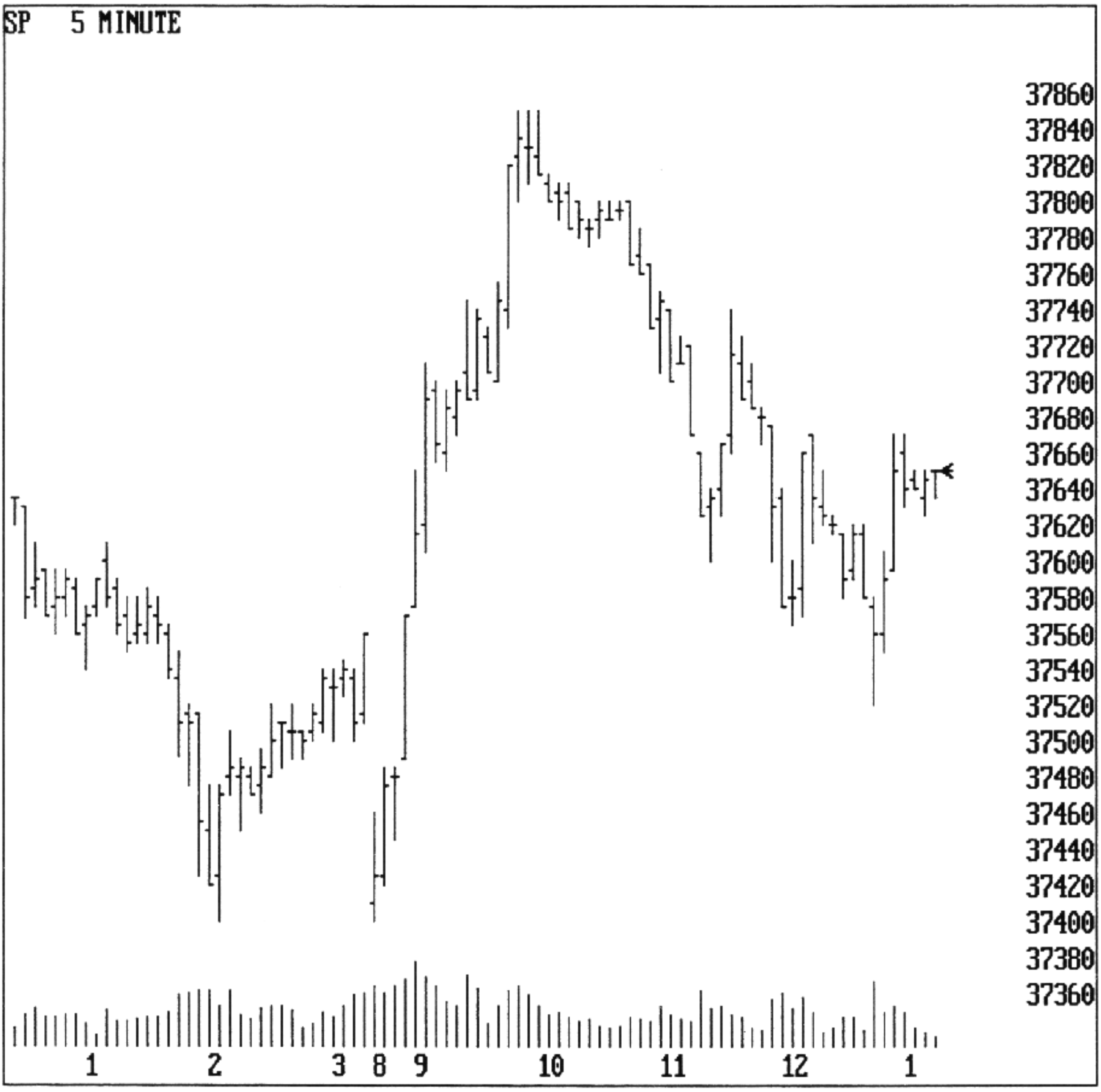
Notice: There had now been four higher lows, thereby breaking the downtrend. The developing uptrend had failed to mature. The previous bar did not make a new high and was a reversal bar. The current bar not only failed to make a new high, it too was a reversal bar. Based on the fact that there was no longer an identifiable trend, I did something I was hoping I would get to show on this series of trades. I rephrased the segment count. I've shown how I do it on the next chart.

I move the segments up one notch so they are then numbered as I've shown on the chart. With the new segment count in place, I then called in an order to buy a breakout of the high of the bar completing the third segment.



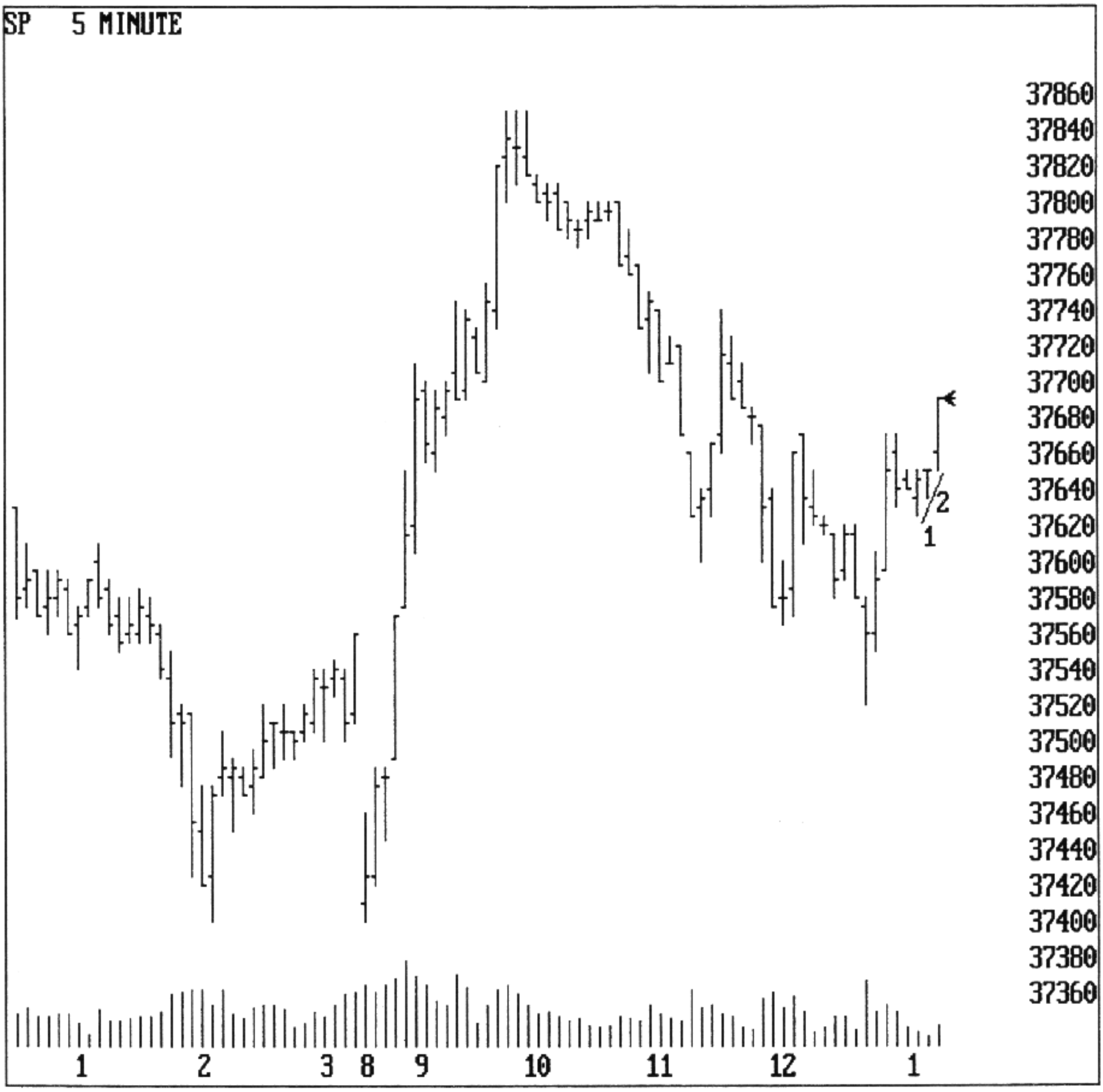
The next bar gave more evidence of a non-trending market by dipping lower, and then reversing the direction of the previous bar.

As stated earlier, it is essential to know and recognize when a market is in congestion. When it is, I don't want to be in it. Such a market belongs to the floor traders, not to me. They love when a market goes sideways. They can safely scalp to their hearts' content. I cannot compete with them, because I can never match the speed with which they can react to the action on the floor and place their orders. The markets they hate – trending markets – are where I make my money. There's a piece of the market for everyone, according to their trading style. When a lion kills a zebra, he eats the organs. Then the vultures come, and they tear at the flesh. When the hyenas come, they eat the bones. The ants and beetles get what's left. There's something for each of them. So it is with the markets.

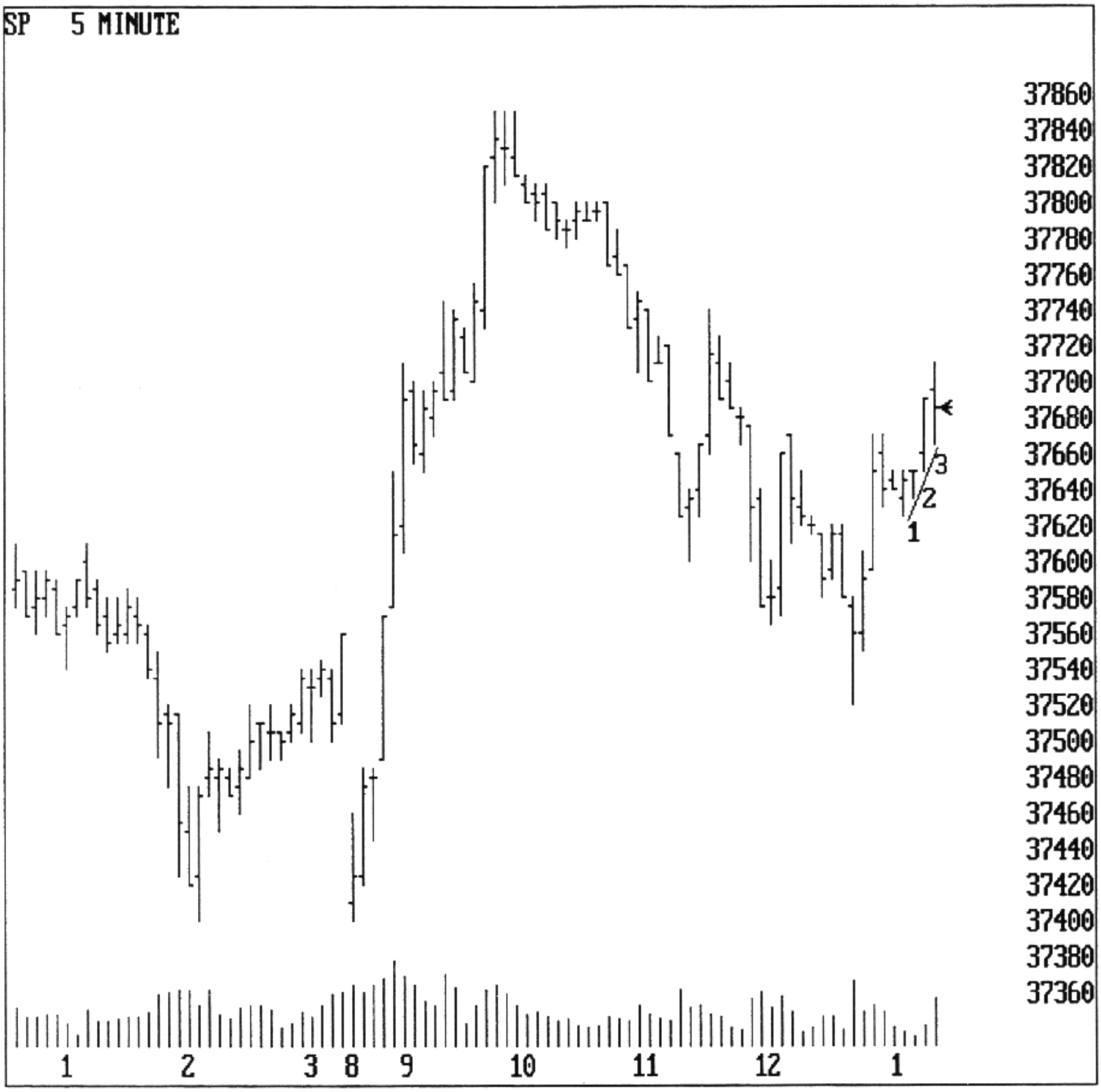


Further confirmation of a non-trending market came with the doji bar that materialized next. The market was now in congestion by every definition I could think of.

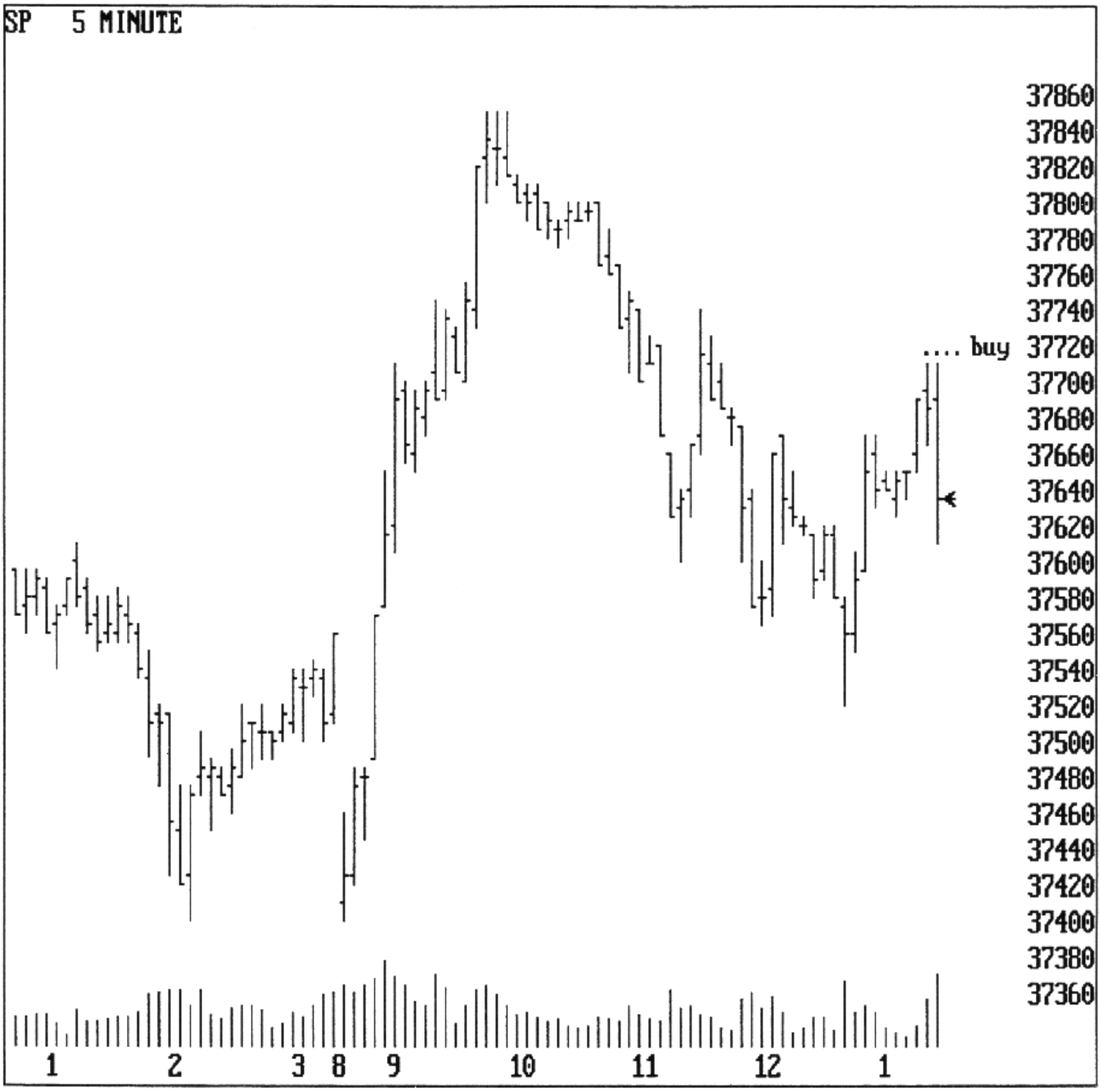
When a market goes into a congestion, I will not trade it until I can define and count a new trend.



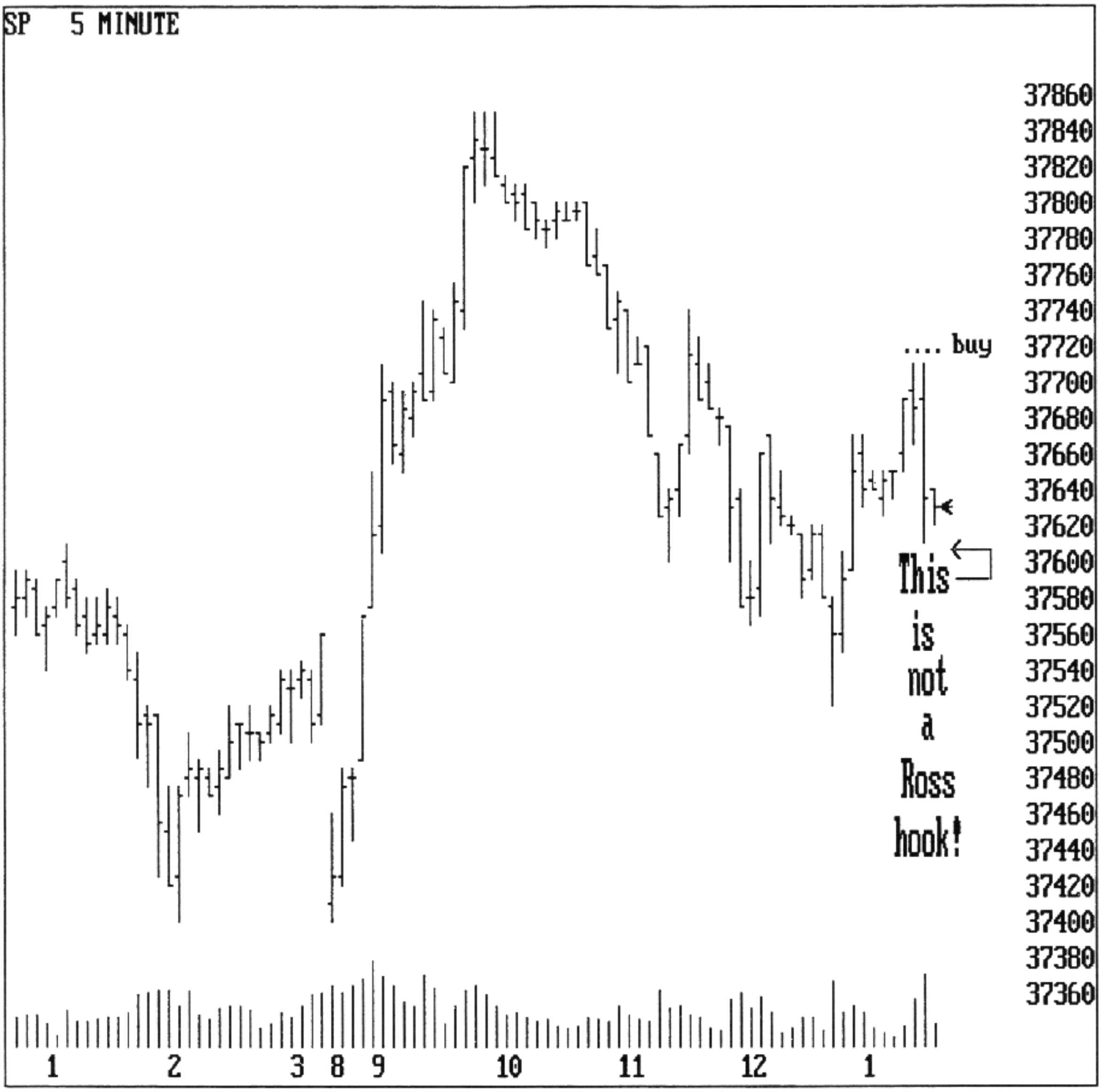
I went ahead and did my thing. I started a count. If the market was going to go anywhere, sooner or later I would catch up with it.



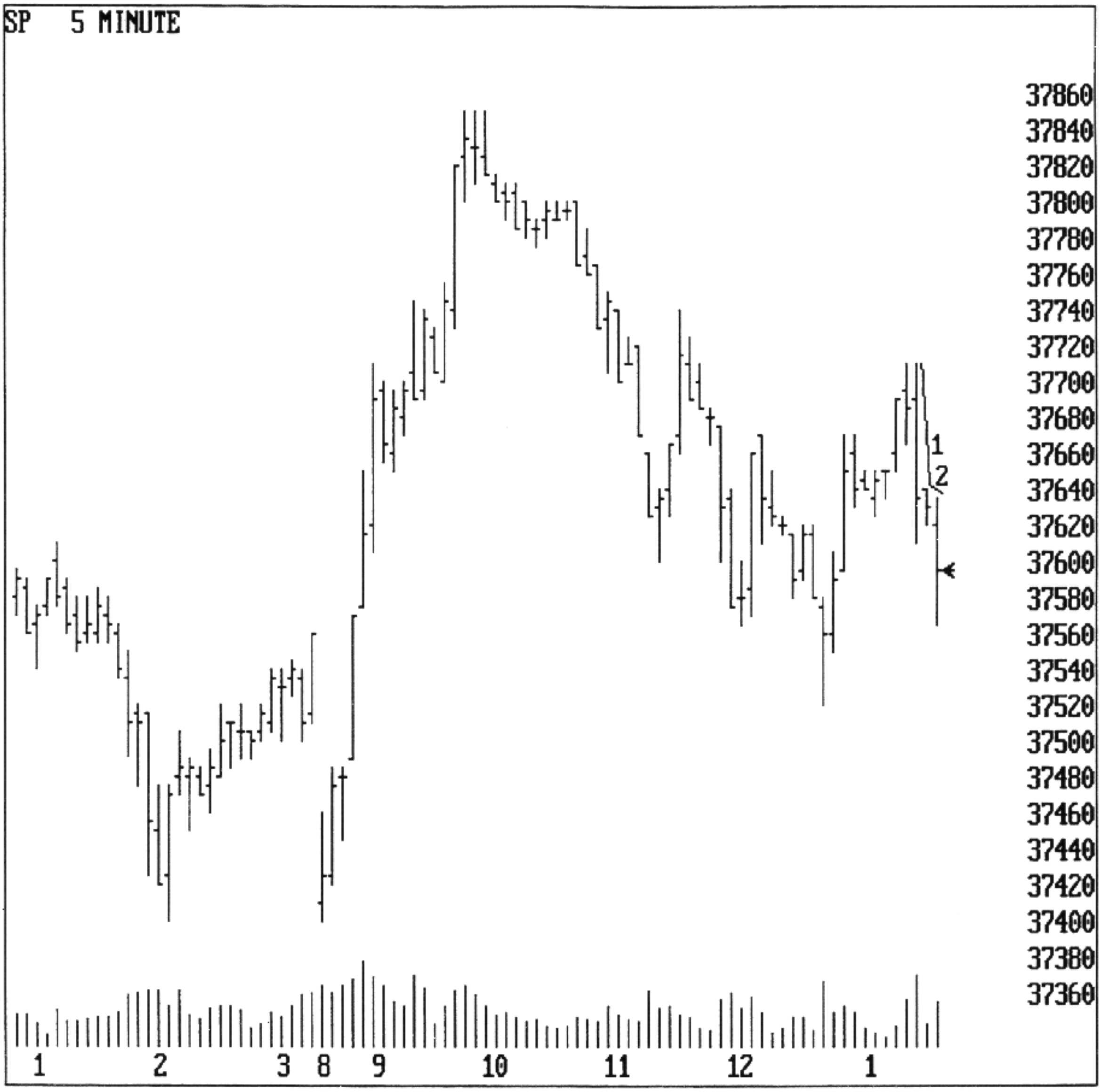
Prices moved a bit higher, but ended up making a reversal bar. This is not unusual for a market in congestion. Since I could now count three segments up, I placed a buy order above the high of the bar, and waited to see if there would be a breakout.



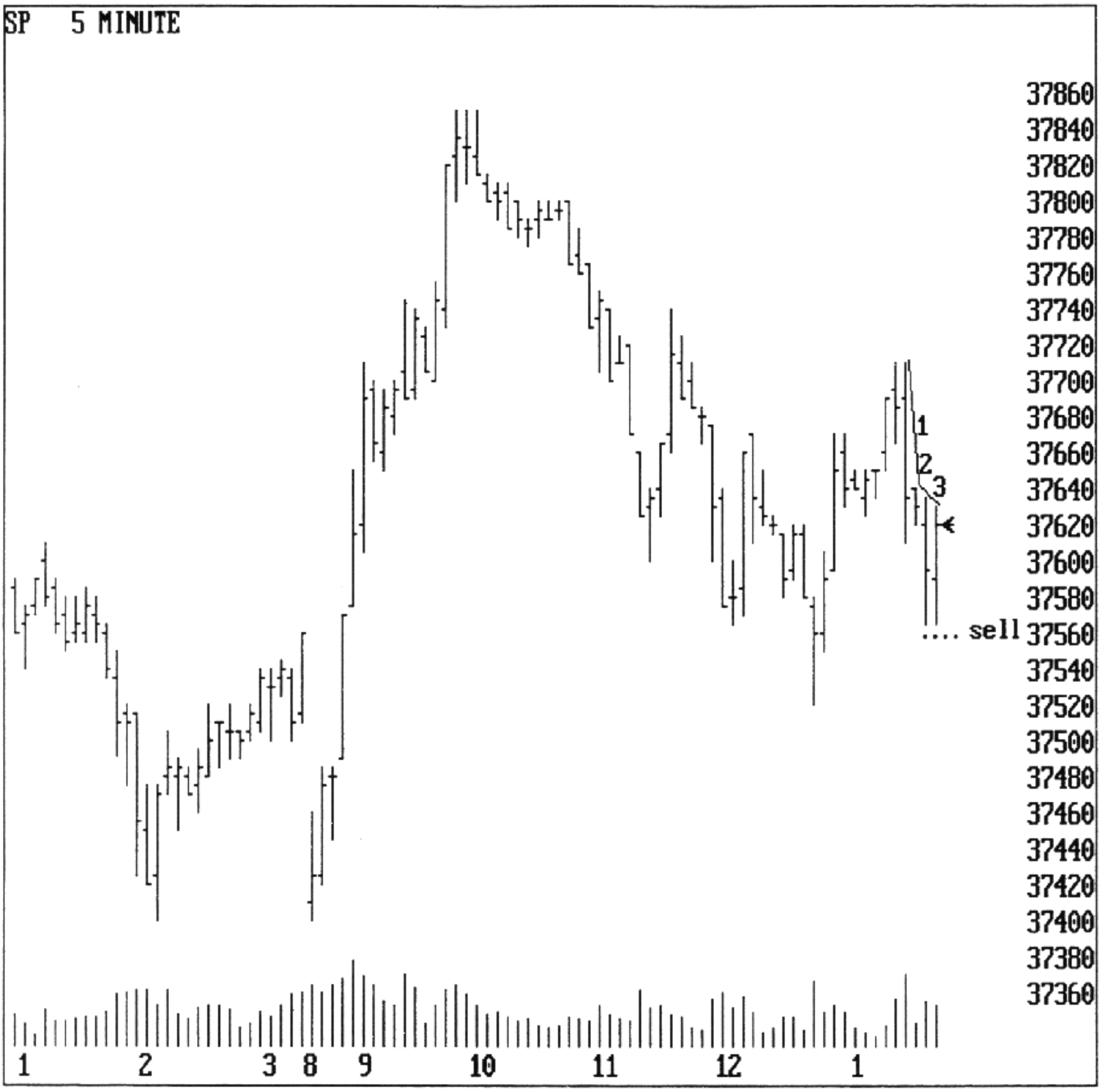
The next bar completely demolished the emerging uptrend. I marked the double high as a place to buy, and went back to waiting.



Next there was an inside bar at about the same price level as the previous congestion area. I was still waiting. Notice that the correction to the down bar did not constitute a Ross hook. ROSS HOOKS COME ONLY IN TRENDING MARKETS. This market, by my definition of a trend, is still in congestion. Prices have risen above the last two downside Ross hooks. The correction bar does not even constitute a 1-2-3 formation.

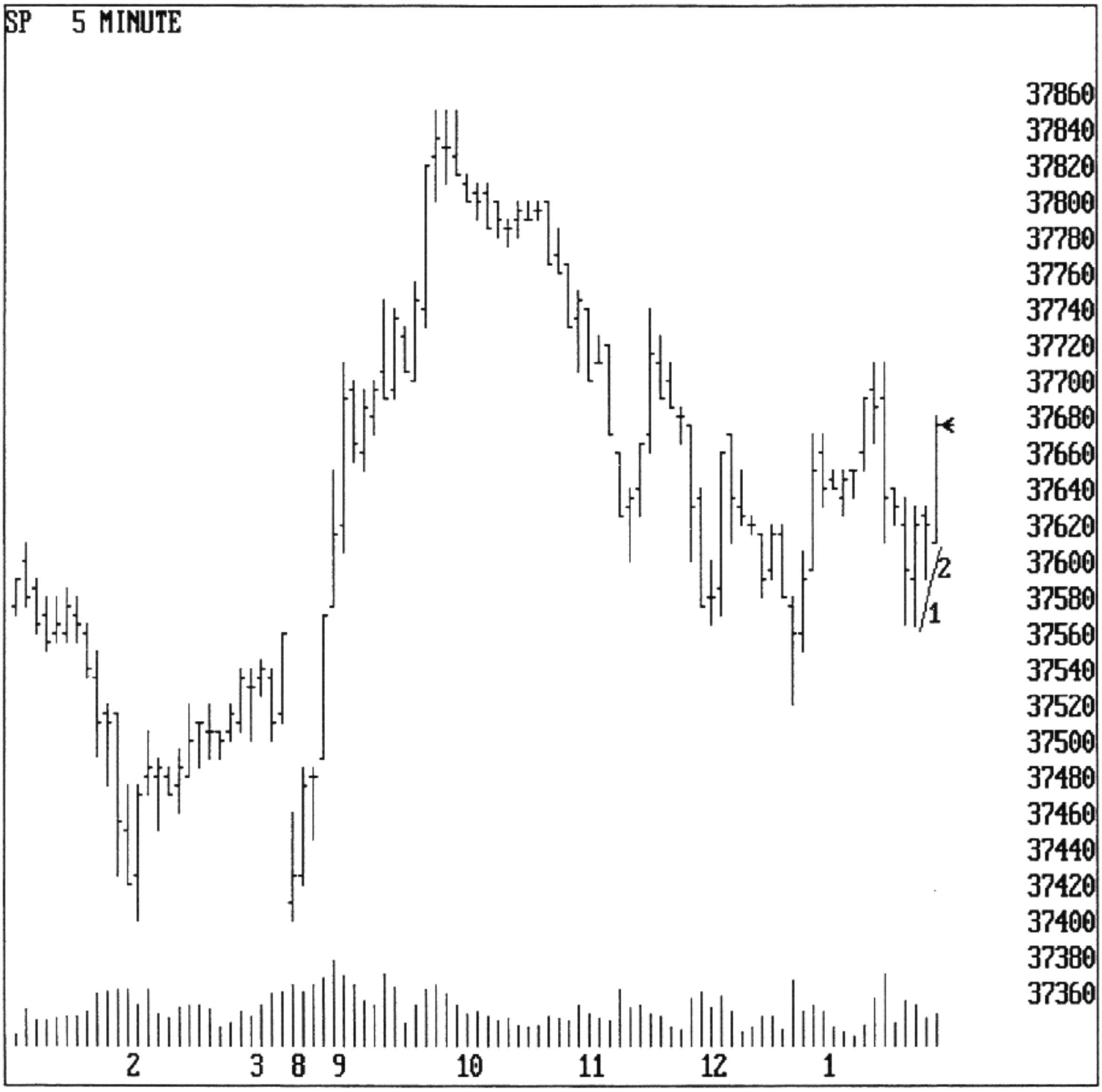


The following price bar headed south, so I placed a count on my chart.

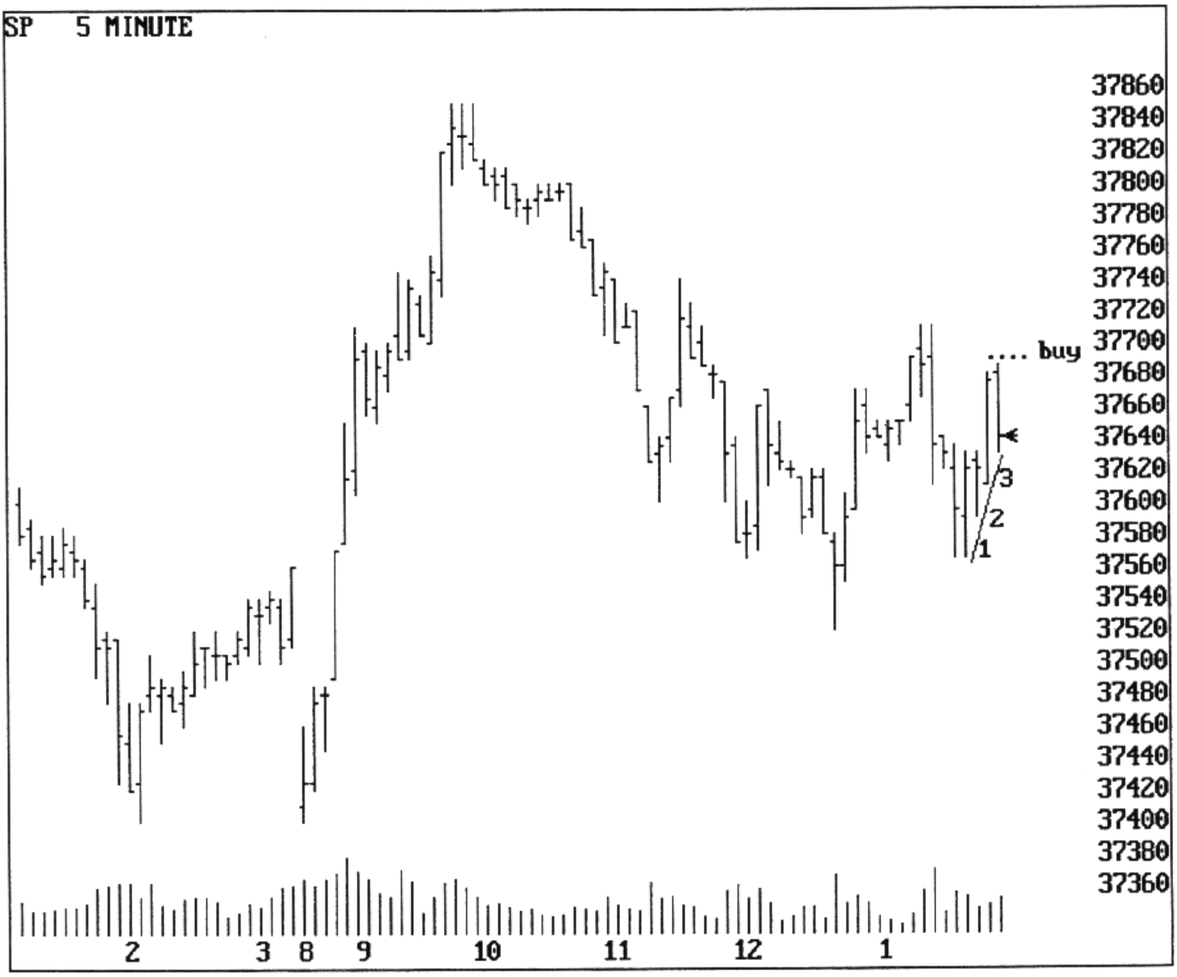


No downtrend materialized. The next bar failed to make a new low and closed higher than it opened, creating a reversal bar and a double bottom.

The following bar reversed again. What had happened was that the trading range was still there, only it was getting wider. To me, that means a weakening market. If it were getting tighter, I would expect an explosive move. However, when a congestion widens, I expect short non-tradable trend legs until the market widens out enough to make the legs worth trading.



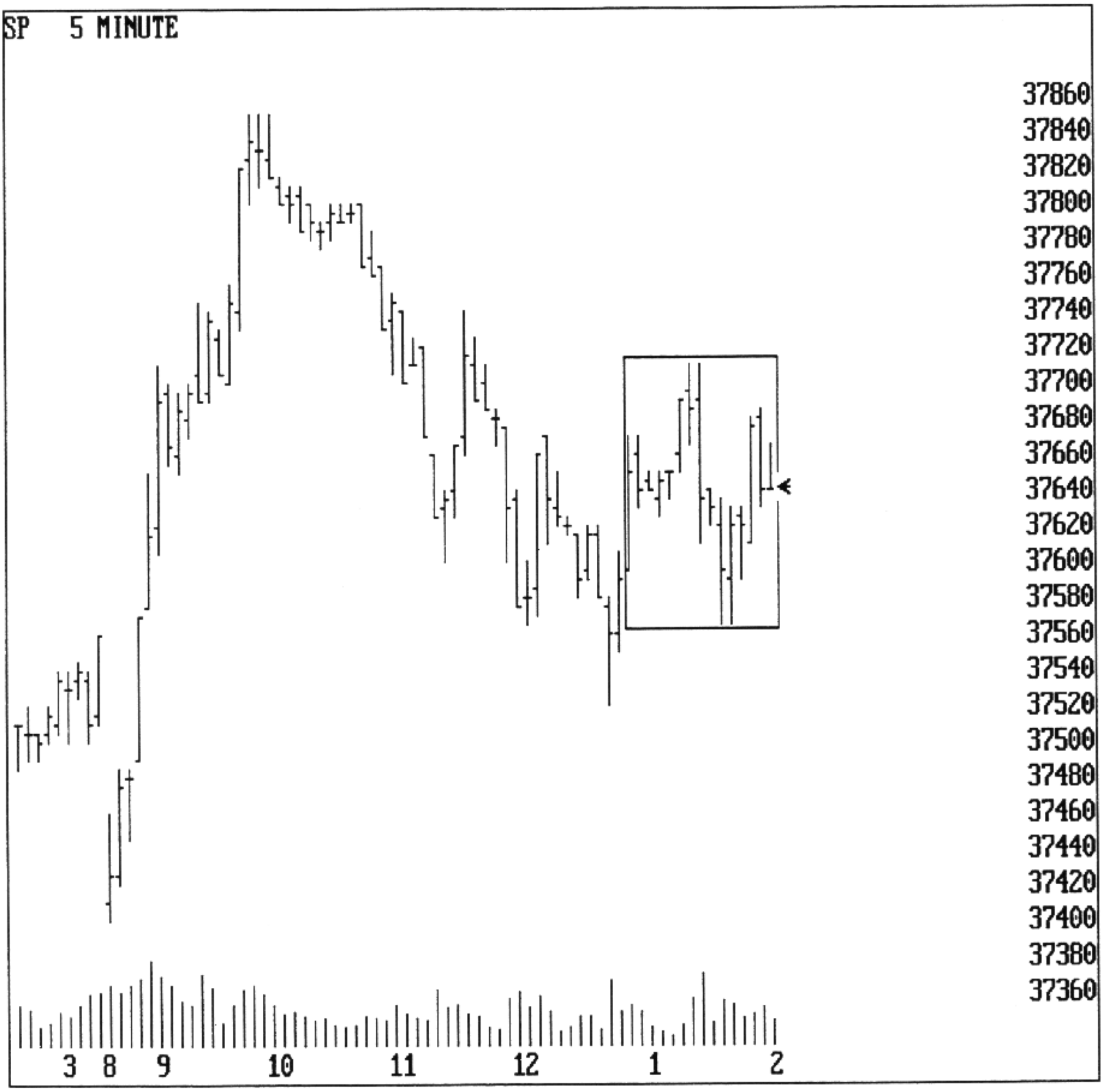
Prices broke a bit, but I wasn't expecting them to really break out of the trading range. It usually takes from 21-25± bars before a breakout can be expected. I could now count two segments up, so I marked them on the chart.



As might be expected in a trading range, the next bar reversed, closing near its lows. Although it doesn't work perfectly, this method of counting segments to identify a trend, and understanding when a market is in congestion, has wonderfully kept me out of untradable trading ranges and congestion areas for many years.

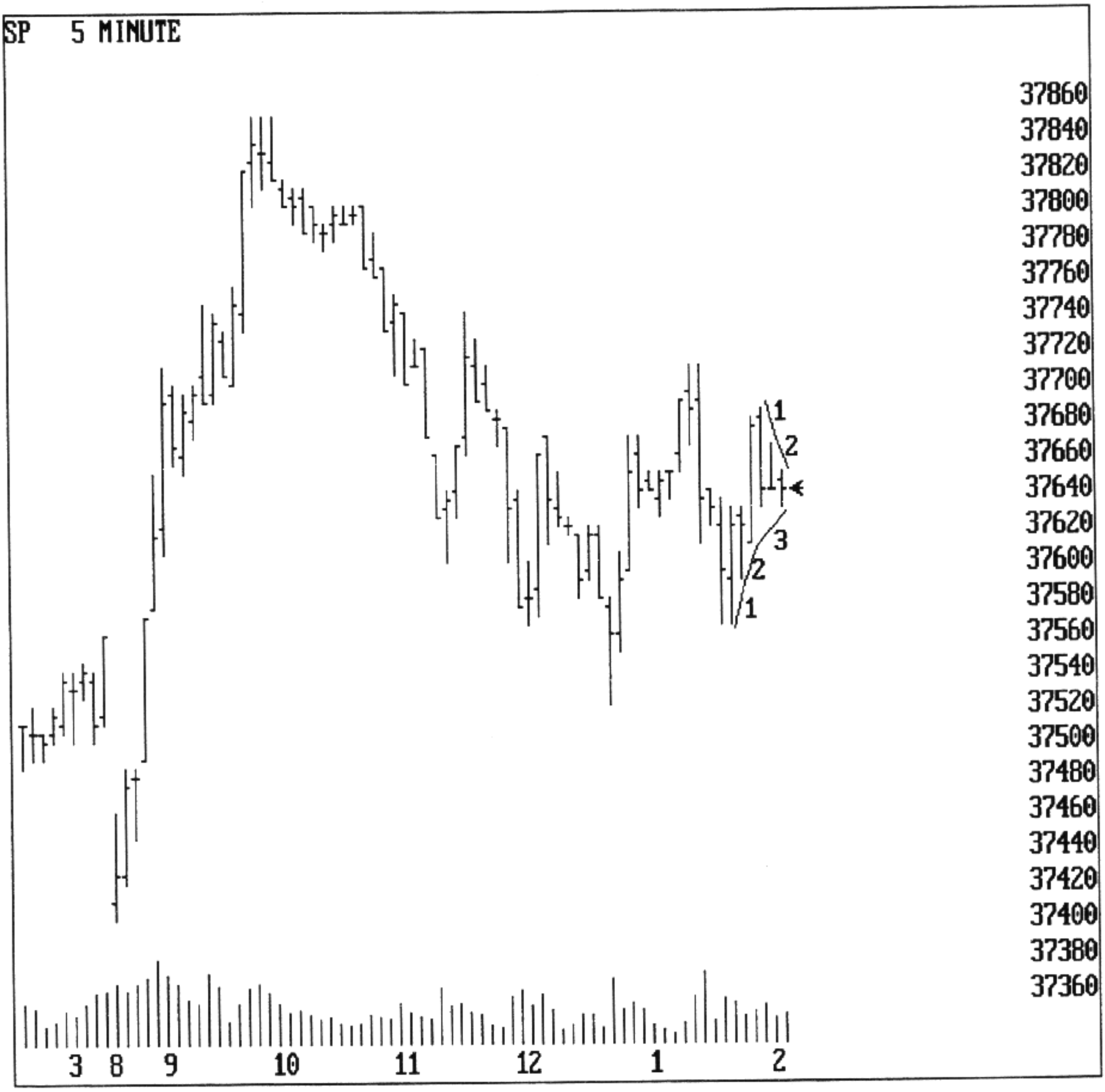
So, although this part of the book may be not as exciting, the wise trader will pay great heed to what I'm showing here. Knowing when to trade and when to sit and wait is worth a fortune - it has been for me.

Still, because I will not prejudge a market – I let it tell me what it wants to do – I dutifully drew my trend line and numbered my segments. I called in a buy order above the high and waited.



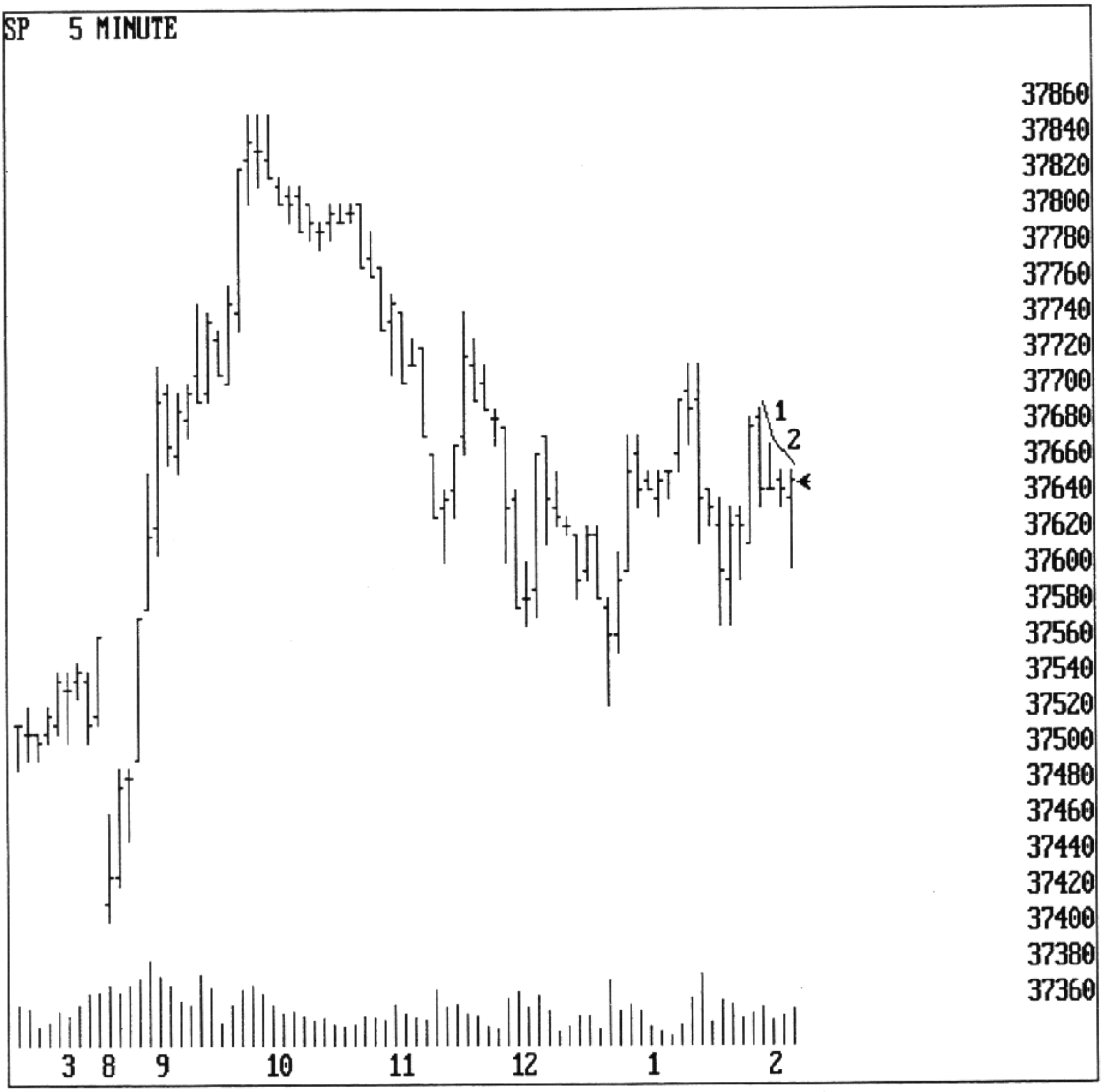
The next bar again confirmed the trading range, and killed the uptrend. Just for grins, I counted the bars in the range so far. There were fifteen. I've drawn a box around the bars.

I like to test my methods to see if they still work. To make it a bit easier for me to finish this series, I'm going to change the chart scaling a bit. You may not even notice.

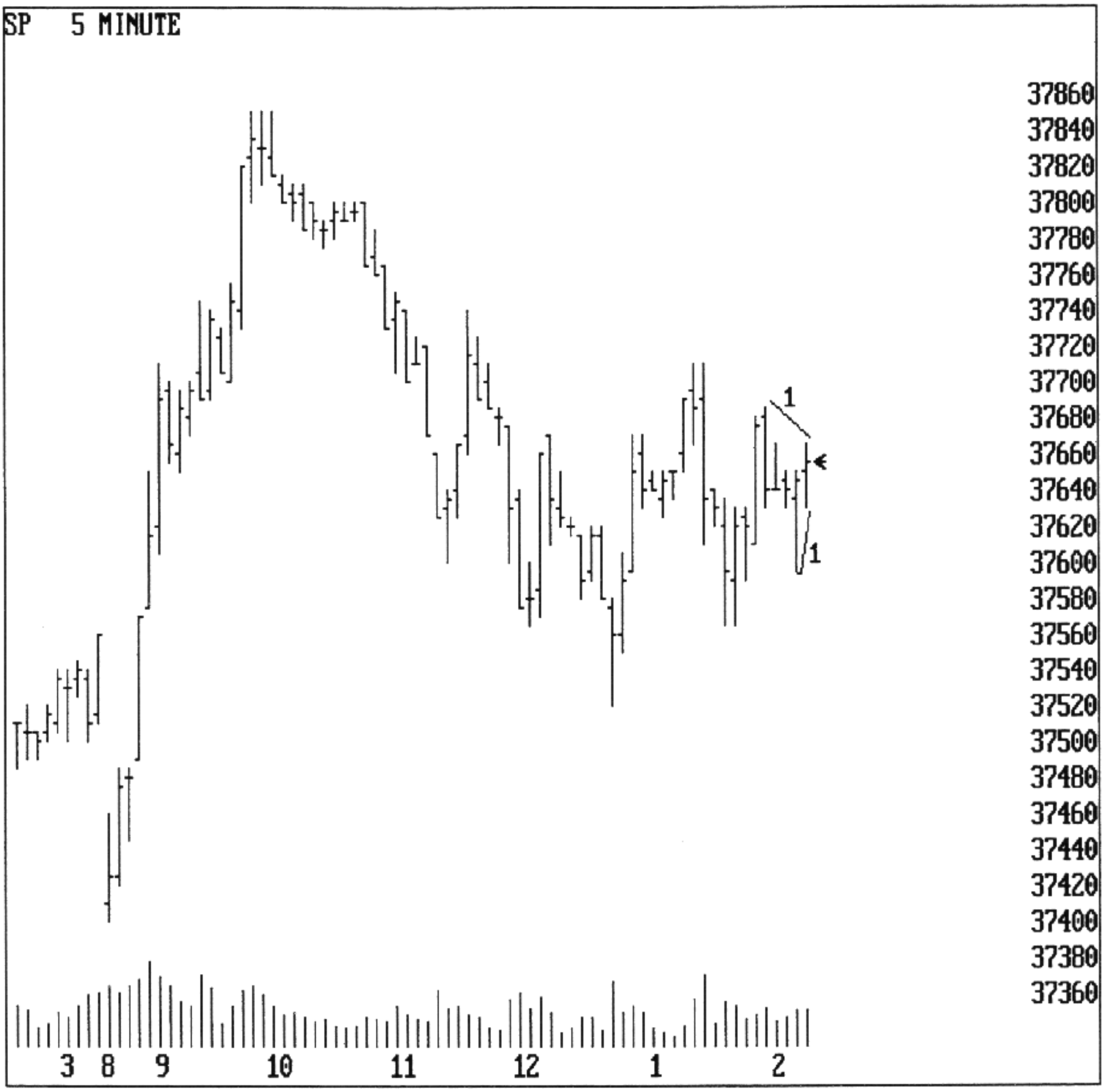


The following bar confirmed the congestion once and for all. I most certainly was looking at an /\/\. It was the sixteenth bar of the range. I moved the segment on the "up" count as shown.

Just in case I was wrong, I numbered the segments going down.



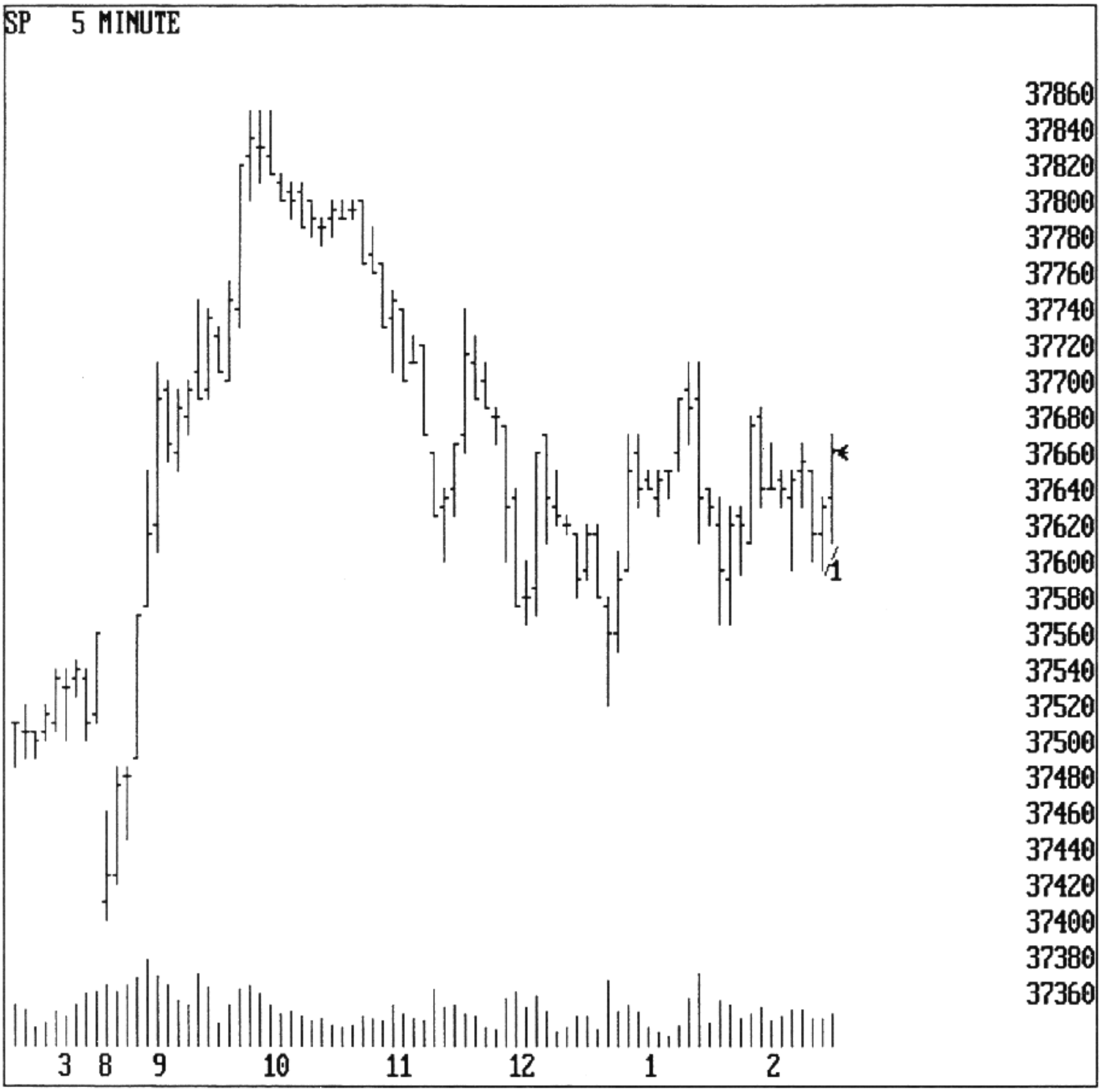
The next bar stayed in the trading range making a double high. I changed the segments identifying the trend by swinging the trend lines over to the latest high. At this point the up count was dead.



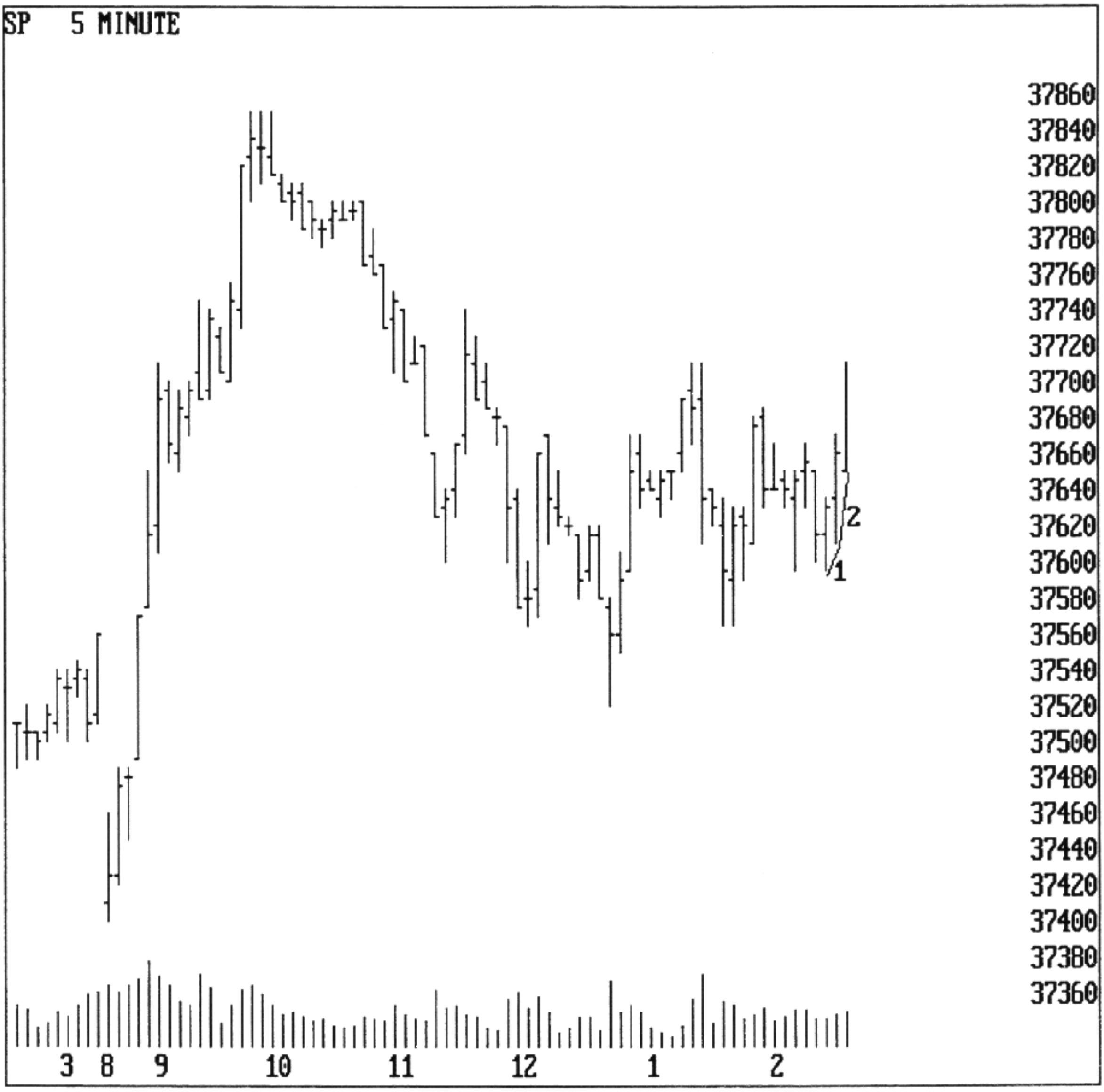
Alternating reversal bars continued to identify congestion. This was the eighteenth bar. It was also 2:15 in the afternoon. Quite often the S&P will make a significant move between 2:00 and 2:50 p.m. I wondered if this was a day in which it wouldn't. I redrew the segment of the trend.

By now watching the S&P was getting boring. It seemed as if the excitement was over for the day. However, I was determined to grind this out for purposes of writing this book. I didn't know but that there was a great lesson just ahead.

As the bar closed, I began drawing my segment lines. I quickly identified them. This was the twentieth bar of congestion. The next bar might get something started.



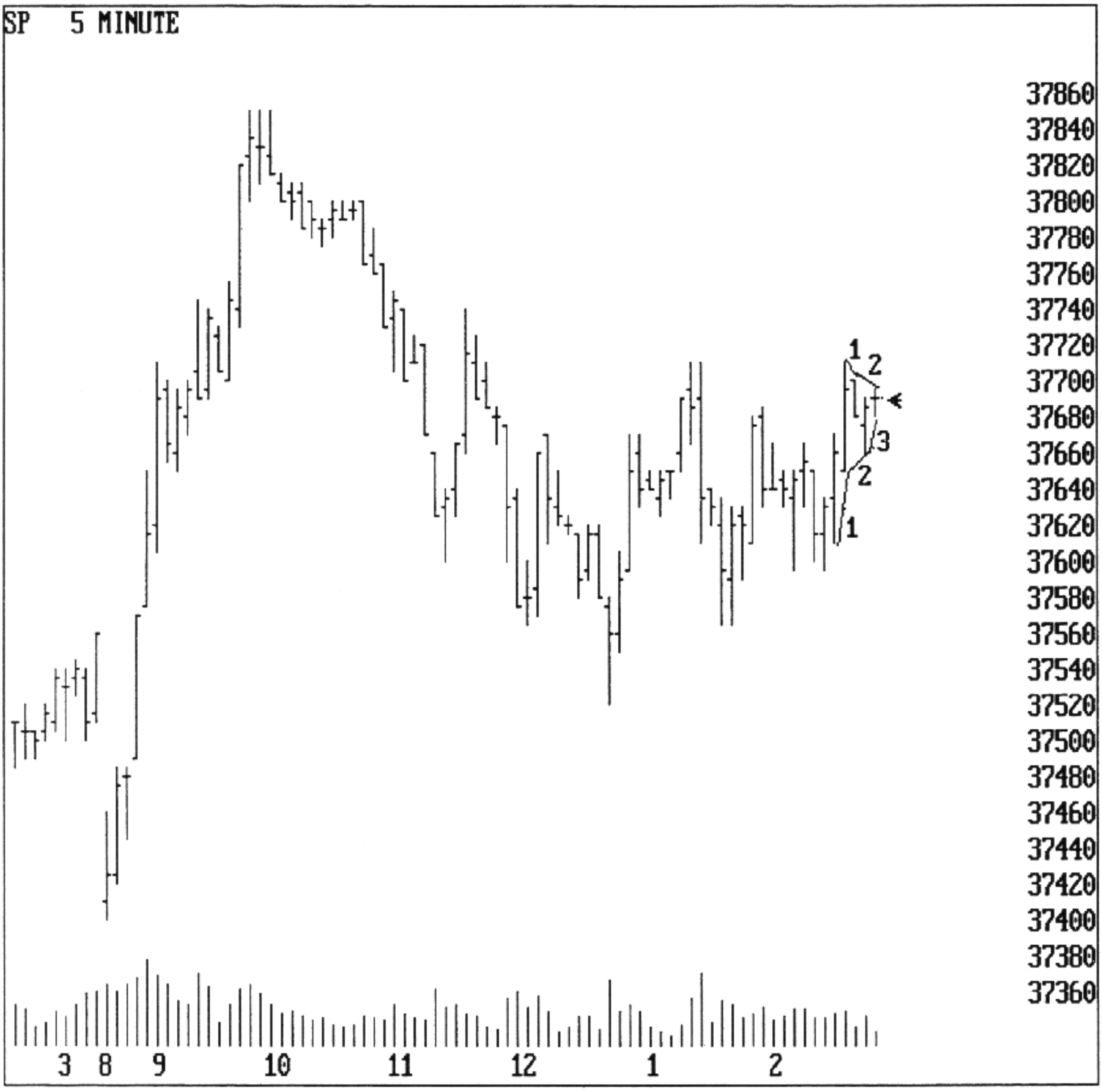
The twenty-first bar of congestion didn't exactly shake the earth, but it had good momentum. Maybe this was the beginning of an uptrend?



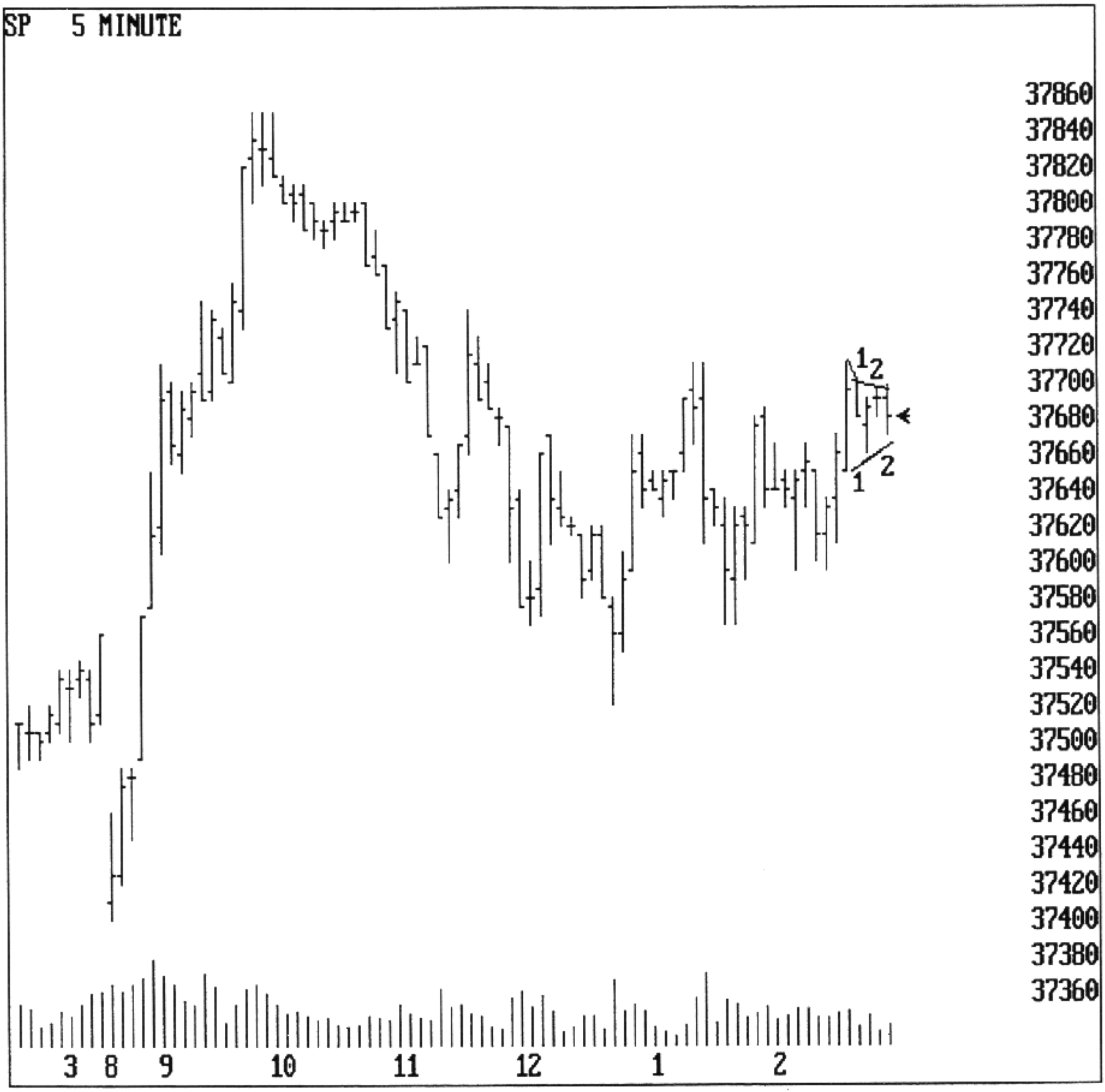
The twenty-second bar of congestion moved up nicely. It had good momentum, and I thought to myself, "maybe this is <u>it</u>!" One more bar and I could place my buy order in the market.

Well, it wasn't "it." I would have to be patient. The reversal bar had broken the uptrend. I had to rephrase my segment count.

I was a bit disappointed, but my training and discipline caused me to draw the segments and number them on the chart. If I got a breakout of the highest high, I would buy it. Otherwise I would still, by definition, be in congestion. However, it was getting late in the day. I decided to trade only a five lot.

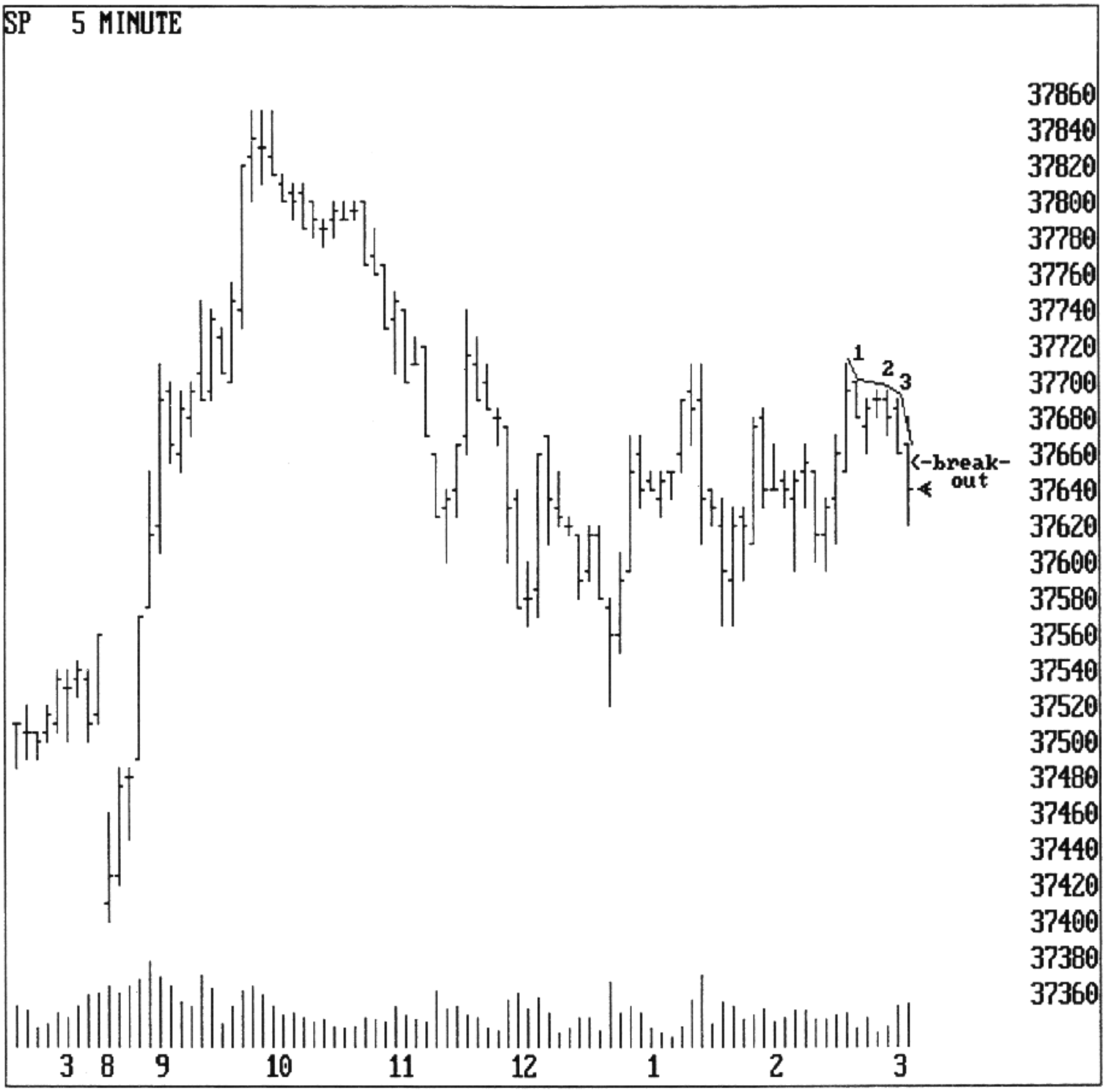


Once again prices proved to be in congestion. To show that the market had no idea of which way to go, prices formed a doji. Despite the fact I now had a shifted three count to the upside, I wouldn't dare enter a trade that failed to take out the highest high.

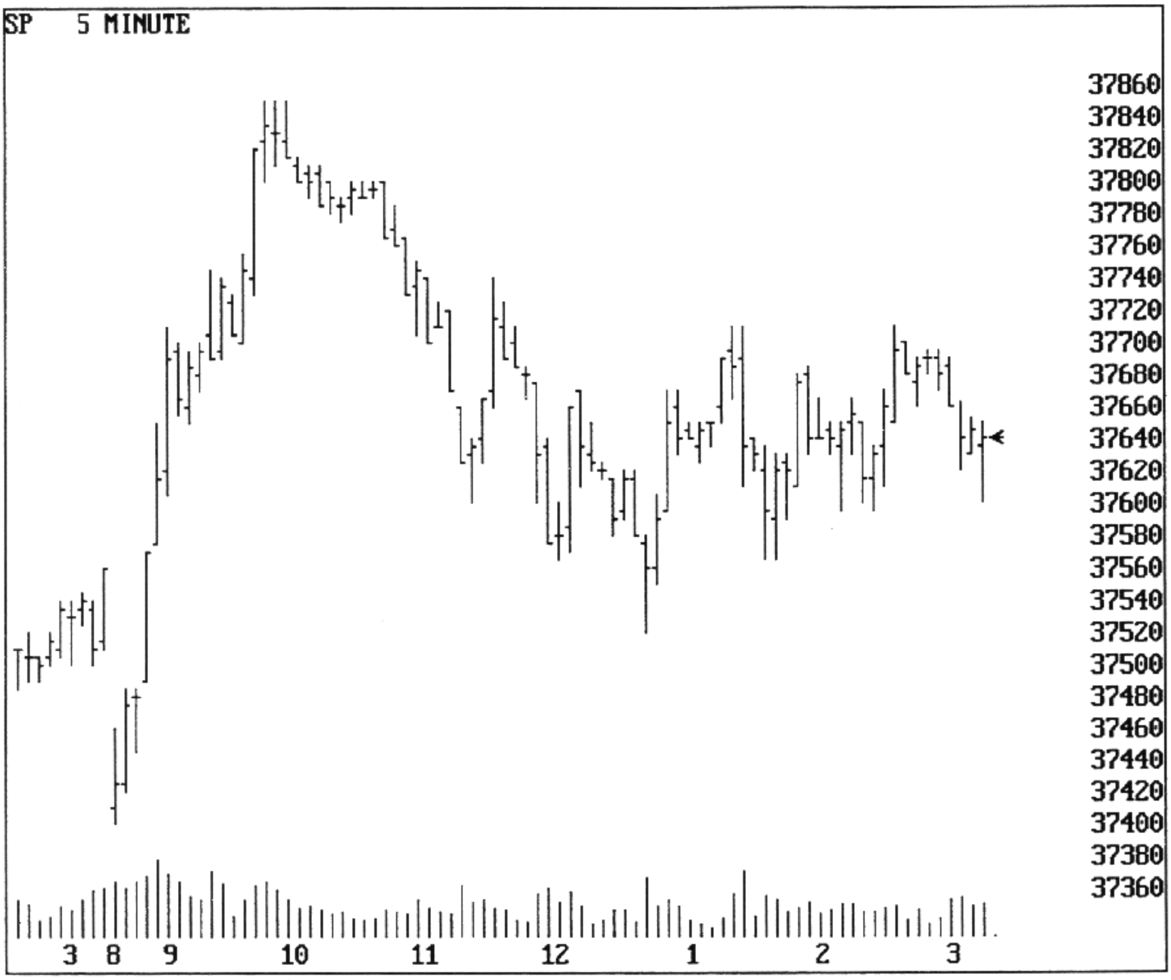


The S&P was still in a trading range. I would wait to see if prices took out that highest high. My only other choice was if I could get a breakout of a three count to the short side before the market closed.

The next bar killed the uptrend once again. I could now number only three segments going down. Sometimes the S&P makes a big move right at the end of the day. It was too late in the day to catch it. There would not be enough bars to suit me.



I had a three count going two bars before the last bar of the day. Even if I were to get a breakout going into the last bar, I would not chance it.



I didn't feel too bad about not taking that last trade. The market ended up looking like this:

I was glad it was over. I had enough risk for one day. I thought to myself, "Next time, I'll trade the NYFE. An important advantage to trading the NYFE is not having to put up with the program traders.

This was a good day for me in the S&P. I did not go through dozens of charts looking for a day in which I would be a winner.

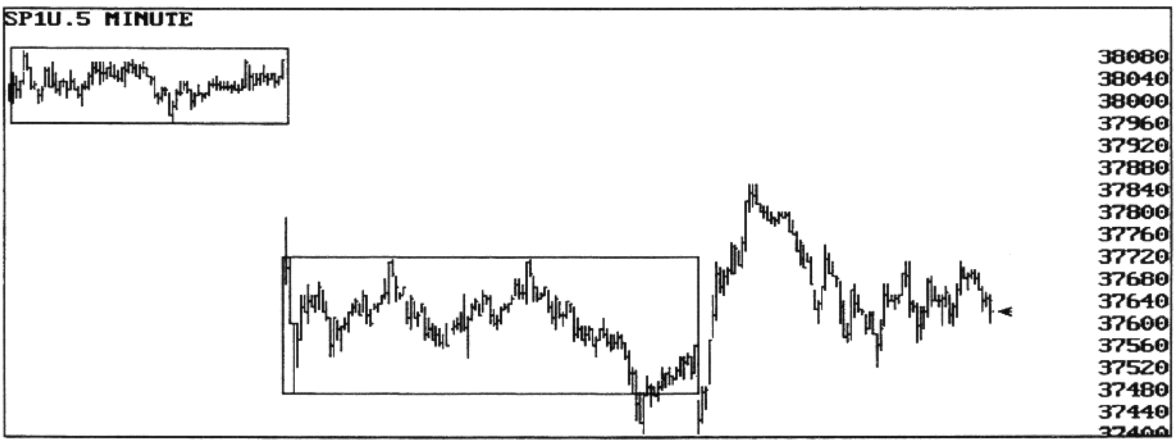
What I've shown here is a day of trading almost exactly the way it happened. In actuality, there were a couple of trades on which I came out ahead, that I shouldn't have taken. I felt that to show them would be a disservice to my readers. You have plenty of bad habits without acquiring some of mine.
I pushed too hard on those trades, and although I made a small profit on them, I was overtrading when I took them. They were inconsistent with what I've been trying to teach. One of these days, I will videotape a day of trading. Then you will see and hear some of the stupid things I do. There are plenty of days when I lose amounts greater than I made this day. Overall, I come out ahead.

I do not trade the S&P every day. In fact, most of those who read this book who are familiar with my trading know I don't trade nearly as often as others. I'm quite content to take a living out of the markets. I collect data on most markets, keep an eye on some of them, and do most of my trading in about eight. I make most of my money in the currencies and the S&P or the NYFE. Given the choice. I actually like the NYFE better than the S&P. There is less competition and less of a frantic feeling trading the NYFE. It is only about sixty percent as volatile. The fills are a tick or two worse.

When I do trade, I am extremely finicky about trade selection. I like to win. I hate losing. I will not trade just to trade. I refuse to trade every day as though I were under some obligation to do so - except when I'm writing a book.

Most traders I have met feel they have to trade every day. Each day they pick out something and put on a trade. How their brokers must love them!

I trade for me, not to make my broker happy. The next chart I show is how the S&P looked overall. Perhaps the reader can come to see why I selected to enter a stock index trade.



I reasoned that the stock index futures could not go on and on doing nothing for very long. I felt that an explosive day or part of a day was due. Although prices were antsy for only part of the day, it was enough to make some bucks in the S&P. After the initial trading frenzy, the S&P simply chopped around in the same trading range it had the previous day.

It's interesting to note that money can be made in a trading range if the market is volatile enough and the trading range from top to bottom has sufficient distance to allow it.

Looking at the previous chart, it should be obvious that overall the market was going sideways. When a five minute chart is going sideways, how much trend can there possibly be on the daily chart?
I look for potentially explosive situations to trade.

I've shown them in this book. A breakout from matching congestions, my four major entry signals, my intermediate and minor signals - all are explosive situations.

My own preference is major entry signals. They don't happen every day, and that is one of the main reasons I will not trade every day. I want the greatest chances for success when I trade. Explosive situations give me that chance.

When I began trading this day, I had no idea how well it would turn out. Not all my trading days do as well. Yet I find I have trading days like this quite often. *I HONESTLY BELIEVE IT IS MY TRADE SELECTION THAT IS IN LARGE PART RESPONSIBLE!!* Ninety to ninety-five percent of traders overtrade. They trade too often and too much.

I have seen many futures contracts make beautiful one day moves on the daily chart, yet had I traded them intraday, I would have been chopped to pieces. Conversely, I have seen "nothing days" like the one I just completed in the S&P, where on the daily chart the whole thing amounted to not much of anything, yet intraday I've made a lot of money.

This is not an uncommon occurrence when daytrading. If a nice move on the daily chart occurs gradually intraday, I often lose because I get whipsawed by the shallowness of the ascent or descent. On the other hand, if the market moves steeply while still giving me a chance to get in, I may have a great day intraday, while the daily chart shows a "nothing day". Such was the case with this last S&P trade.

A significant lesson I hope I have taught here is the importance of size, and correspondingly taking just a few ticks out of the market on a portion of the position. If the market runs, the remainder of the position will take care of the big profits.

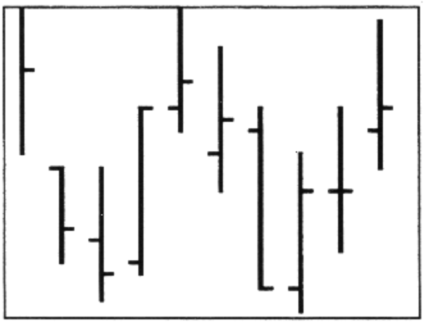
Chapter 29

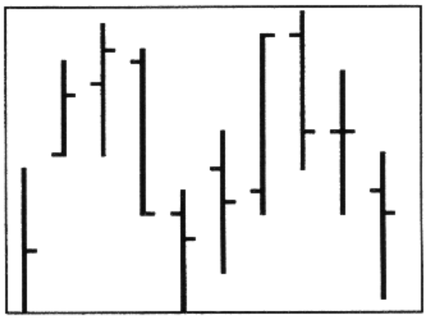
SOMETHING OLD – SOMETHING NEW

Before moving into the final chapter, I'll give a recap of the techniques I've shown for identifying congestion.

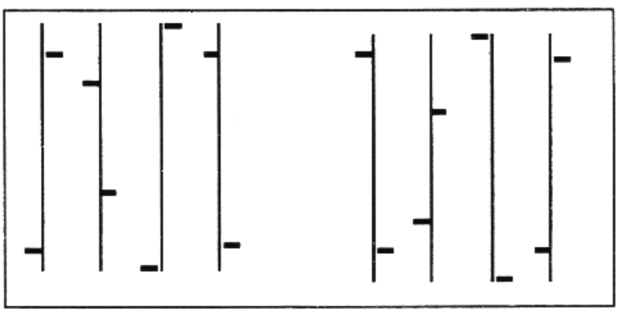
IDENTIFYING CONGESTION

Congestions are spotted when /\/\ or \/\/ is on the chart.

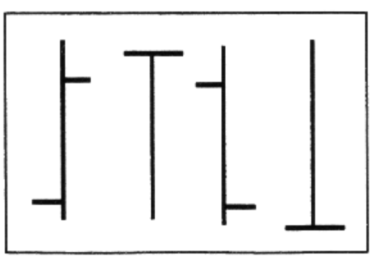




The smallest possible /\/\ or \/\/ is found when there is a series of reversing open-high-close-low or open-low-close-high bars. Such a series would involve at least four bars.

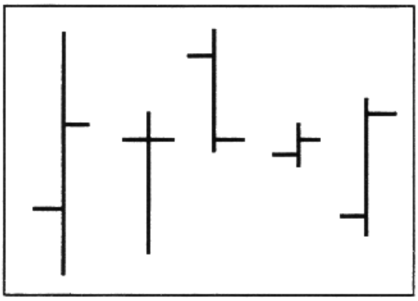


Any series of four or more price bars involving reversing opens and closes, dojis, or both, constitute congestion.



Congestion exists when there are any four price bars with closes inside the trading range of a single preceding price bar even if one or more of those bars have highs or lows outside the range of the bar containing the closes.

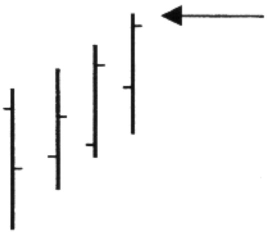
IDENTIFYING TRENDS



I've shown several ways to identify a trend. I'll recap those and add more.

SUCCESSIVE NEW EXTREMES

The first way is, I wait until I see a breakout of a high of a third successive higher-high series of price bars.



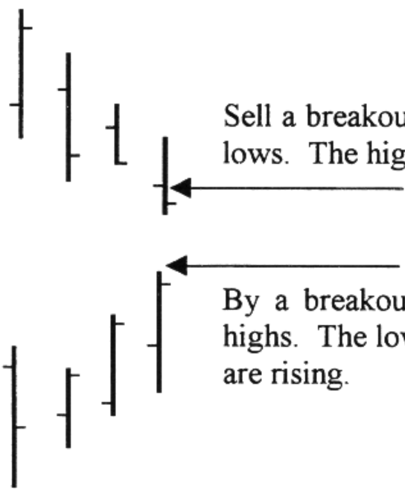
Buy breakout of the high

Or, I wait until I see a breakout of a low of a third successive lower-low series of price bars.

Sell breakout of the low

SAGGING HIGHS AND RISING LOWS

A second way to find the trend is by watching for sagging highs and rising lows.

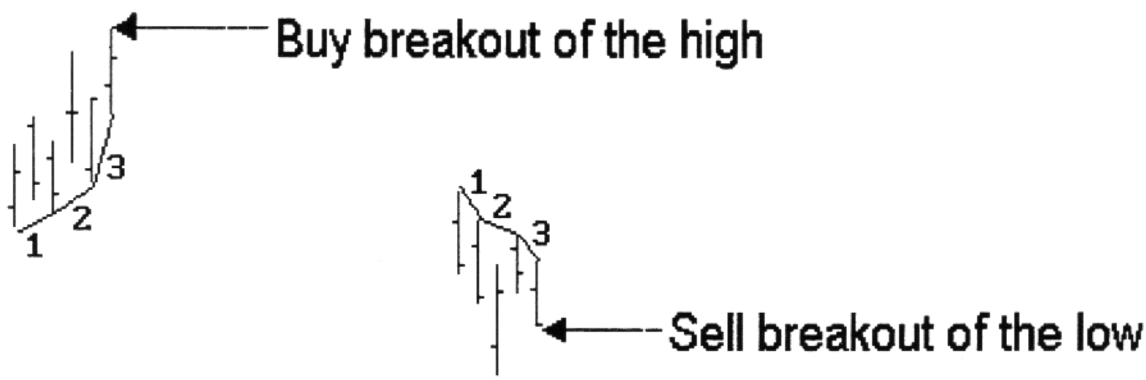


Sell a breakout of the third low even though not all three bars made new lows. The highs are sagging.

By a breakout of the third high even though not all three made new highs. The lows
are rising.

SEGMENT METHOD

The third way is to connect segments until there are three segments defining the trend. Here is the segment method:



The next way is the one I have traded the longest. It's the one I was originally taught. I traded with this method for three years at the beginning of my career, and have never abandoned it. I'll show it here just as it was shown in the sixth issue of my newsletter <u>Traders Notebook.</u> If you've read <u>Trading Is a Business</u>, it's in there too. I apologize for repeating it, but it is important.

TRUE TREND METHOD

"Some Very Basic Trading"

"Over the years, my trading has become somewhat intricate, and very intuitive. This is due to viewing thousands upon thousands of charts, and trading in every time frame from one minute charts to weekly charts.

"But trading doesn't have to be intuitive and intricate at all. In fact, some of the best trading I've ever done has been some of the most straightforward and simple trading of my entire career.

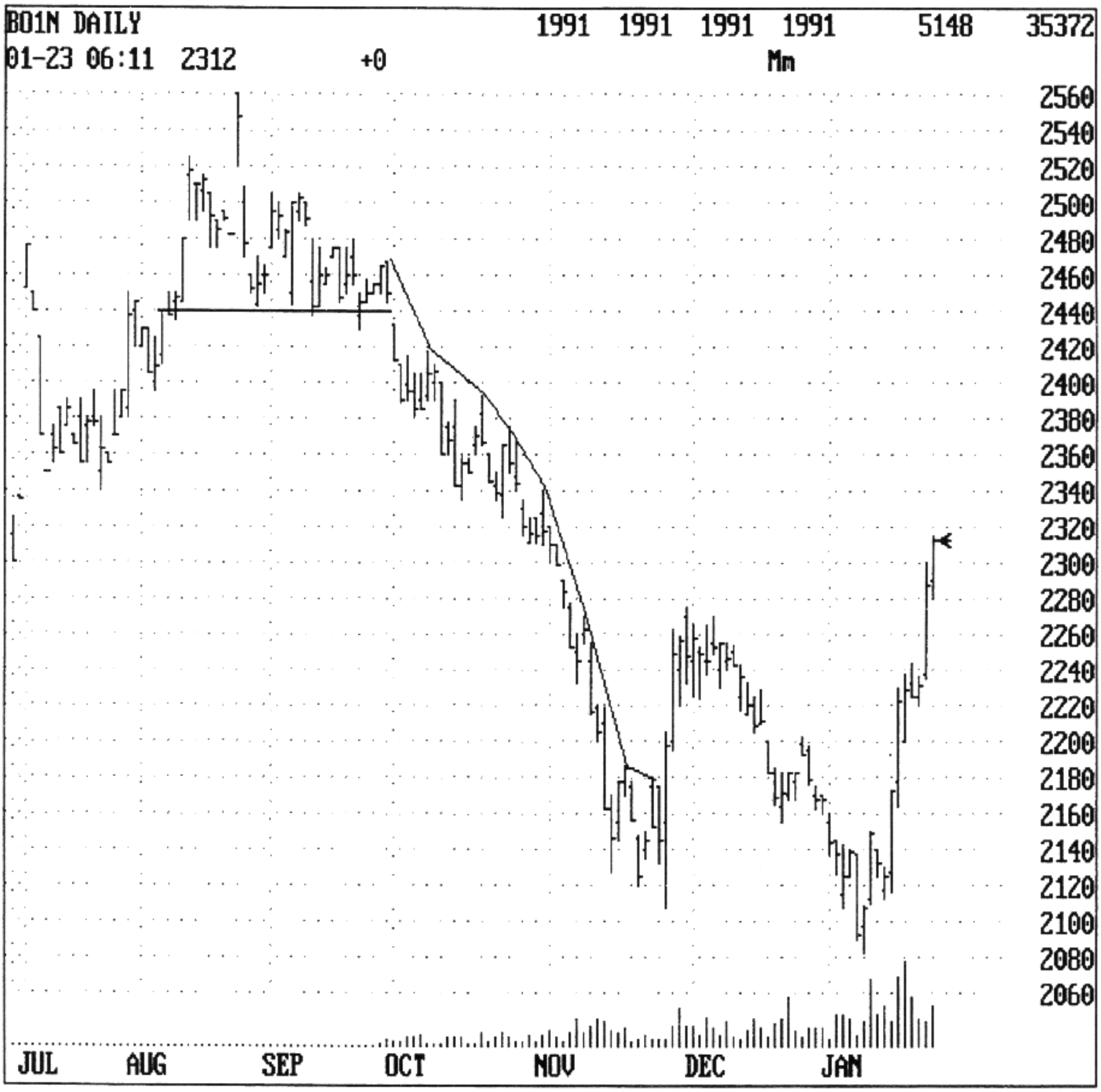
"In this issue, I'm going to start showing you some very basic trading techniques. They have served me well for many years. I will start out with the very first method I ever learned. I traded successfully with it from the very outset of my trading, and in fact, I ran a $5,000 account up to $28,000 in the first five months I used it.

"This method worked for me immediately and still works today. I have no doubt it will always work, because it is based on truth. Truth is constant, it never changes.

"You have heard time and time again that the trend is your friend. In this method, I will teach you how to use the trend. You have heard that you need to keep your losses small and stay with your winners. This technique will enable you to do that. It is so simple that many of you will not believe it. You have heard that you should let the market tell you what to do. This concept is the very embodiment of that wisdom.

"It will be your loss if you don't accept the sheer simplicity of the plain truth I'm about to show you. I can tell you this, I made my living for the first three years I traded with this one simple way to trade. I did nothing else except wait until the right event took place.

"Are you ready for this? OK, here we go!



"The situation I was looking for was the ability to draw a trend line in a trending market. When I first started trading, I had no computer. I traded from a set of purchased charts that came out once a week. I had to keep them up to date by hand. I drew in the bars each day showing the open, high, low, and close. I can't draw a straight line with a ruler, so I hated every minute of it.

"Once the daily bars were drawn, I drew in the trend lines. I connected highs to highs in a down trending market, and lows to lows in an uptrending market.

"On a trade such as the one shown above, my job was to trade only when I could draw a clear trend line. This forced me to wait for my first trade until a market corrected so I could connect the previous high to the current correction high. When I could do that, I had an established trend.

"My first duty was to connect the highest high of the latest leg to the first correction high. After that, I was allowed to connect the last correction high to the current correction high only if the angle of the trend line remained in the same overall direction or steepened its angle of descent.

"Once I had established a trend line, I was to try to sell a single contract upon a breakout of the low of each day in which the market moved upward towards the trend line. I was not to trade if prices gapped below my sell point. I was to trade only if prices traded through my sell point. My sell point was always one tick below the low of the previous day, which represented a breakout of yesterday's low.

"When I was in a trade, I was to stay in it as long as prices moved away from the trend line by making a lower high, and/or a close lower than the open. My initial stop was to be 10 ticks away from the price action.

"I was to add to my position as prices moved away from the trend line by selling trade-through breakouts of the low.

"I was to have a resting sell stop one tick below every Ross hook. A Ross hook is a pivot point, created when a market changes direction for even one day. In the case of a down trending market, this would be created just as soon as prices had a day upon which they failed to make a new low. In an up trending market, a Ross hook is established on any day in which prices fail to make a new high.

"At no time was I to allow a correction to go beyond the previous day's high, nor was I to allow a correction to go beyond reducing my profits for the latest leg to an amount greater than 50% of my unrealized paper profits once I had $100 of profits in the trade. Furthermore, once I had $50 of profit in a trade, I was to pull my stops to breakeven by the time of the close.

"I was to be on my guard and to tighten stops on any day in which the market closed higher than it had opened.

"Of course, just the opposite of my criteria for handling opens, closes, and lows was true in an uptrending market. In a market that was moving up, I would be on guard if the close was lower than the open. I would start trying to buy when prices were moving downward against the grain of the upward trend. I would buy trade through breakouts of the high of the previous day. My trend lines would be drawn from low to low. With these simple rules in mind, let's look again at the bean oil chart."

"Point A on the chart is placed just below a horizontal line showing a congestion area. Prices were supporting at or near that line.

"Point B on the chart shows a gap down out of the congestion area. Prices moved down to point C, and then corrected on the following day, marked E. The failure to make a new low on day E created a Ross hook at point C.

"Since point D was the high of the previous correction, I would have chosen that as the highest high for my trend line.

"C-D would have been the first time I could have drawn a trend line. E represents a one day correction. I would have tried to sell a breakout of the low of that correction day. I would have been filled twice on the next day - once when prices took out the low of day E, and once when prices took out my resting sell stop at day C, the location of the Ross hook. At the close, I would have been showing a small profit on two contracts, a total of five ticks on the first and a total of four ticks on the second. Since nine ticks represented $54, I would have placed my protective stops to breakeven.

"The following day I would have been stopped out at the open. I would have lost one tick on my first contract and two ticks on my second. I would have been down $68.

"The subsequent correction broke through where the trend line would have been, thereby ending the series, but leaving behind a Ross hook at point F.

"I would now have been without a trend line, but day G would have taken out the Ross hook at point F, and so I would have been short one contract. At the close I was showing profits of $120. I then would move my stop to a point at which I would be able to salvage at least 50% of my unrealized paper profits.

"I would have been stopped out the following day at the open with a five tick profit, or $30. Subtracting costs would have left me with a $20 loss. I would have then been down $88.

"Day H would have seen me short again as prices took out the Ross hook created by the failure of the previous day to make a new low.

"By the time of the close, I would have had $103 in profits, so I would have moved my protective stop to protect 50% of those profits.

"I would have been stopped out the next day (I), having salvaged nine ticks. Subtracting costs, I would have made $4 on the trade, and so would then have been down a total of $84.

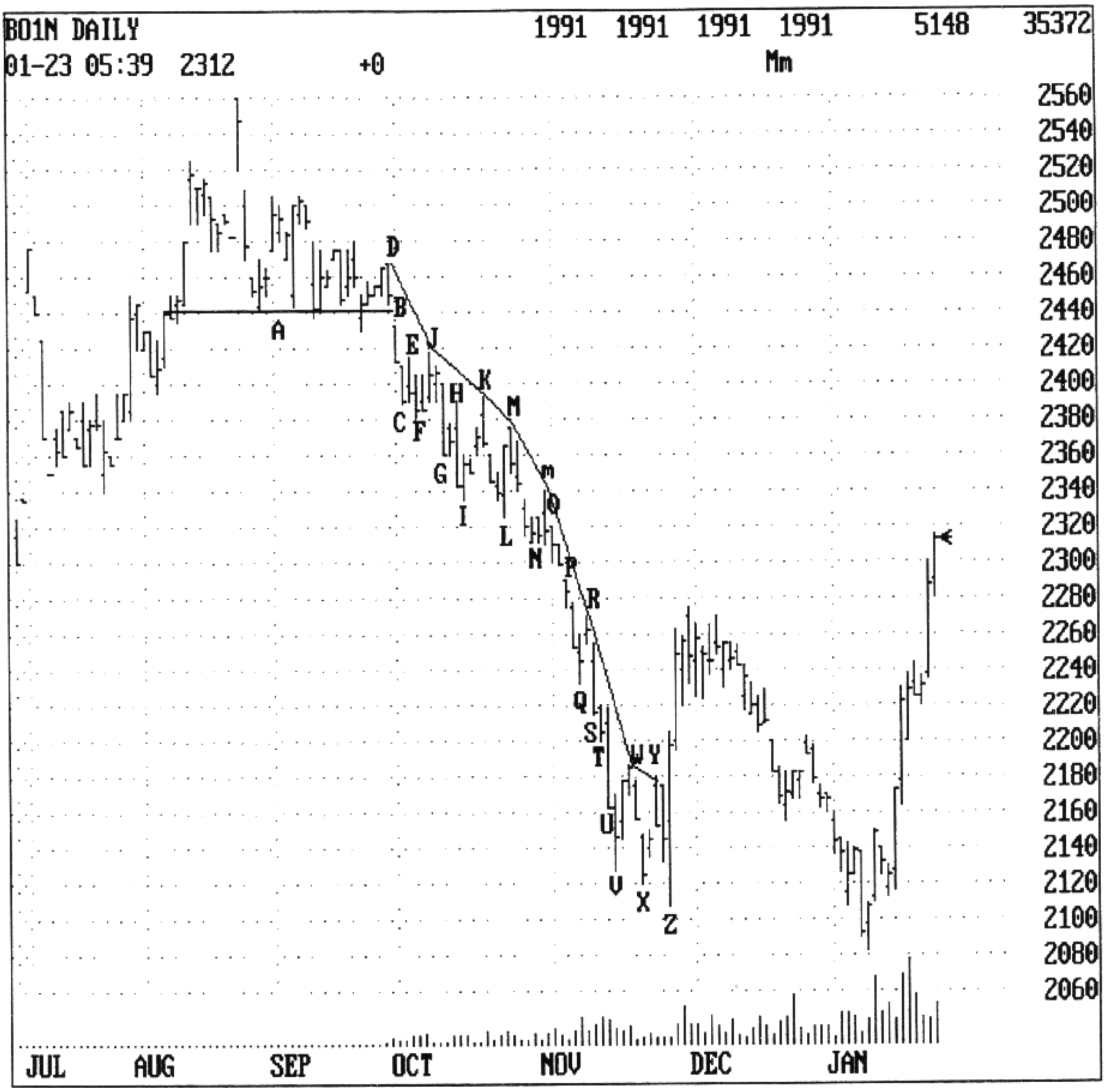
"I-K was a correction. I would have tried each day to sell a breakout of the low.

"When the market finished correcting at K, I would then have been able to establish a trend line from point J to point K.

“I would not have been able to enter a trade the day following day K, nor the next day, because of gap openings below the low of the previous day.

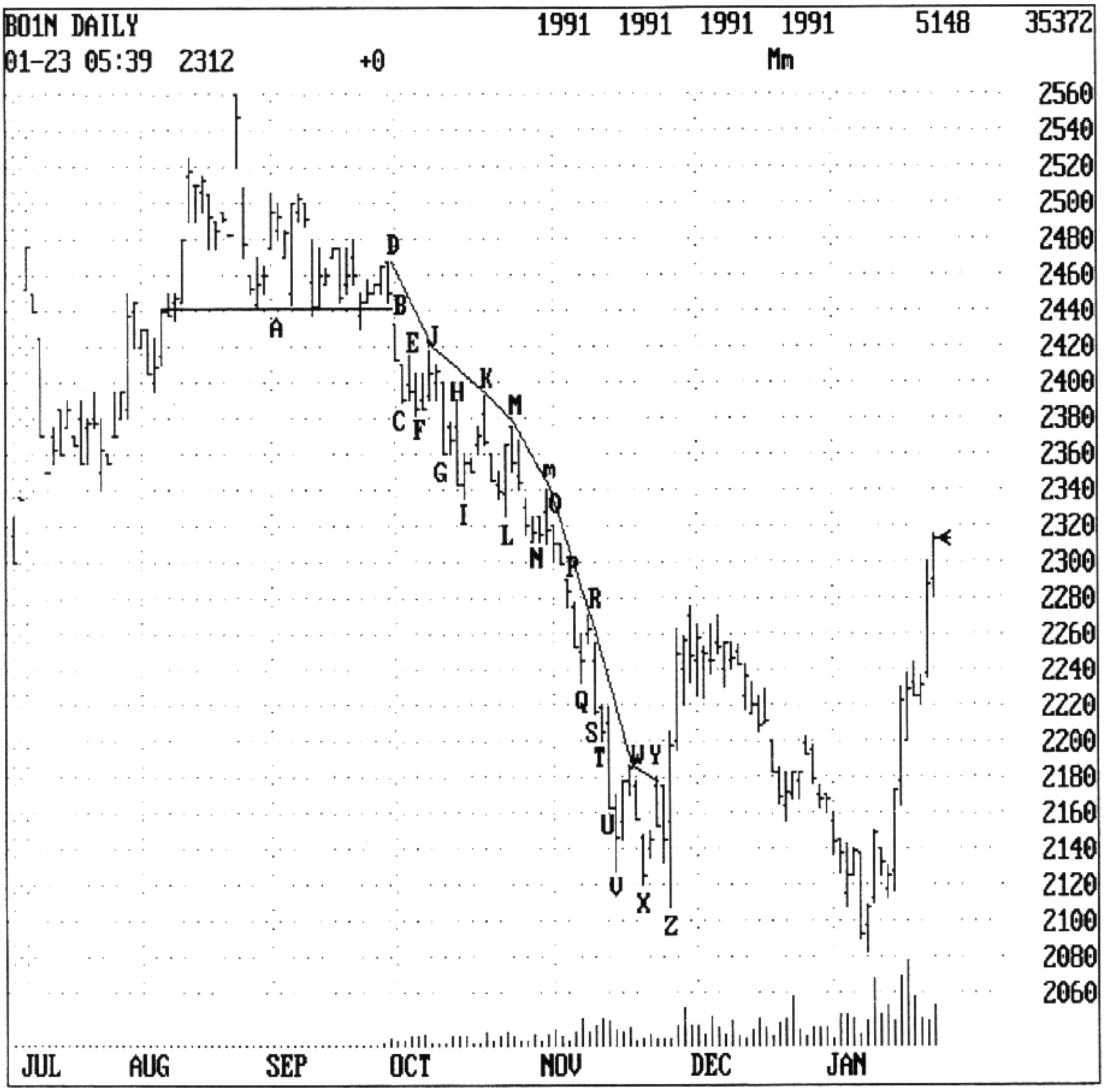
“I would have gone short on day L as it took out the low of the previous day. I would have been stopped out for a loss of $85. That, added to my existing loss of $84, would have put me in the hole by an amount of $169.

“Day M would have seen the high of the correction, and so I would have connected day K to day M. My trend line would have been intact, and so I would have kept trying.



"I would not have been able to sell short on any of the five days following day M.

"Day N created a Ross hook by failing to make a new low. The following day, m, prices made a higher low by one tick, and reached the height of the correction. I would have drawn my trend line to connect M to m.



"On day O, I would have sold one contract as prices took out the low of the previous day, and another contract as prices took out the Ross hook. At the close of day O, I would have had no profits to show for the trade. The following day, prices moved lower, and by the close I had 18 ticks of profit between the two contracts. I would have moved my protective stop to salvage at least one-half of those ticks.

"From that point on, until my exit at day Z, my two contracts were never in trouble. My 50% trailing stop would never have been hit.

"Let's continue, because there's more.

"Day P opened one tick above where I would have had a resting sell stop to short a breakout of the previous day's low. I would have been short a third contract on day P, and been showing a profit of 22 ticks at the close. I would have protected 11 of those ticks with a buy stop.

"On day Q, prices moved down even more, and by the close I would have been showing an unrealized paper profit of 29 ticks. I would have protected 15 of those ticks and been stopped out the following day, R, with a profit of $90 less costs of $25, for a net profit on that contract of $65. That would have reduced my losses to $104, with two contracts still open and making money.

"Prices corrected to point R, and so day R would have become the next point for connecting my trend line.

"On day S, prices traded through the Ross hook of day Q. I would have added contract number 3 at that point. At the close, the position would have been showing a 16 tick profit. I would have protected one-half of that.

"The protective stop would have held, and on day T, I would have added a fourth contract as prices took out the low of day S.

"At the close of day T, I would have moved my stop on contract number three to protect 14 ticks of profit (1/2 of 27 ticks made), and would have pulled my stop on contract number four to breakeven, as I had nine ticks of profit in it.

"On day U, I would have been stopped out of contract number 4 at breakeven. All my other positions were safe. I would have been down $154 less the value of my open positions.

"Day U also would have seen me short a breakout of the low of the previous day. By the close I was protecting 50% of 37 ticks. This was now contract number four.

"Day V would have seen me protecting 50% of an additional 16 ticks for a total of 27 ticks of profit.

"The following day would have seen me cashing that profit for $162. From that, I would have had to subtract $25, leaving me with $137 to apply to my debit of $154. That would have left my actual cash at a loss of $17. Place against that the value of my three open positions and I would have been doing well.

"Prices corrected to day W, and the following day I would have been short as prices took out the low of day W. By the close of the day I would have moved my stop to breakeven with $78 of profit showing. This was now open position number 4.

"Day X would have seen me move my protective stop to protect 22 ticks of profit, or $132. The following day I would been stopped out, netting $107 on the trade. My cash position would have been plus $90.

"Prices corrected to day Y. I would have shorted a breakout of the low of day Y, and been stopped out the following day with a loss of $85. My cash position would have been up $5.

"At the time of day Z, I was protecting 50% of 108 ticks made from the breakout of day Q down to the close of day X. I would have been stopped out of trade number three with a profit of $324 less $25, or a net profit of $299. My cash position would have been plus $304.

"At the close of day Z, a blow off day, I would have moved my stop to just one tick above the high. I would have been stopped out there the following day on my remaining two contracts. I would have made 105 and 106 ticks respectively on each of those positions. The total dollars would have been $1266, less $50 costs, for a net of $1216. Add to that my previous winnings of $304, and I would have had $1520 dollars to spend.

"So, what's the point of all this? I want you to see what trading is really like. I want you to see why you must keep your losses small.

"Look at how many times I had to attempt this market and take small losses before I was able to really score.

"That's what trading is all about. Keep in mind that the losses were all calculated losses. There were plenty of them, but they were all within the parameters of my trading plan. Would such a method work in today's markets? You bet! The series of trades I just showed you could have been made starting with a chart of July 1991 Bean Oil, and going back to July of 1990. The first trades shown were the short positions on day F, which was October 4, 1990.

"Did I actually make these trades? No! Why? Because I was trading elsewhere at the time. But the truth is the truth. I've shown you how I learned to trade. I traded that way exclusively for three years. I supported myself and my family with my trading. I learned to be patient and to wait for trending markets.

"The method I was using forced me to wait. I was never allowed to trade what I was thinking. I had to trade only what I saw. The truth I had to trade with was always on the chart in front of me. There was no other truth. I had no oscillator, and no moving averages. Just a trend line, and a straight edge with which to draw it.

"When I looked back at the chart, I saw I had missed a connecting point. Since I had already used all the letters of the alphabet, day M connects to day m.

"Is this the only way to have traded Bean Oil? I'm sure it isn't, but trading this way forced me to learn many valuable lessons.

"I learned that the trend was my friend as long as I honored it. As long as prices were below the trend line, I traded only to the short side. If prices were above a trend line, I took only long positions.

"I learned I had to take a lot of small hits. I learned not to fear them. I learned to cherish the profits I had, and to protect them. I learned to be unwilling to give them all back.

"The losses had to come when I had little or no profit in a trade. The losses had to be kept minuscule in size. My first account was $5,000, not my own money. I had to borrow it, and I had to protect it. I had to put up my home as collateral. I dared not lose that money.

"My arrangement with my lender (my great uncle) was strictly business. It had to be, and now I appreciate the reason why. If I had been given that money, I would have soon lost it. It would not have been the same if it were money I could just throw away.

"I had to manage that money. I had to pinch every penny. I had to run my trading as a business. This was no game. This was real. The roof over my head was at stake.

"I was forced to learn to enter a market more than once, to make numerous attempts. To do this, I had to conserve capital. If I were to take a big loss the first time in, I would in no way have the courage or the capital to try again.

"Can you see that? If you allow yourself to take a beating on a trade, it not only greatly diminishes your capital, but it deprives you of the will to continue trying.

"Although we can be somewhat sure of the trend (it's true while it lasts), we can never be sure of the timing. No one knows exactly when a market will break and run, or when it will continue to run. Consequently, you have to be prepared to make several attempts.

"It's the sort of thing where you stick your toe in the water to see if it's too hot. If you get burned, you are quick to pull that toe out of the water. So you wait. When you see that it's time to try again, you stick that toe back into the water. Perhaps this time you can go swimming. If not, try again. But you don't just jump in and get scalded with third degree burns all over your body.

"If you sit there and take a big loss, you will have been badly burned. You'll be like a whipped dog. You'll have to slink away to a corner and lick your wounds. You'll no longer have the courage of your convictions. Do you know what you will do then? You'll probably go out and buy another system.

"I don't know where I read this, but it says it all. "When a woman has a bad day, she goes out and buys a new hat. When a trader has a bad day, he goes out and buys a new system." If you know who first said or wrote that, let me know.

"When I do a mailing for my books, do you know who sends for them? That's right, the person who just took a big hit in the market.

"If I mail the same list again, I'll get the same number of sales. Why? Because next time I'll get others who have lost.

"The winners almost always throw my letter in the trash. Who wants to read a book about trading when he is winning? How many of you are willing to shell out $2500 to $3000 for a new system when you are ahead in your trading?"

TRUE CORRECTION METHOD

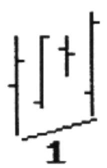
A method I often use is one I call the "True Correction" method. It's similar to the segment method but it differs in that a line connecting two segments cannot be drawn until a true correction has taken place.

I'll show the difference between the two methods side by side.

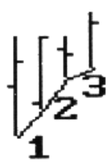
TCM SM

The difference is that under the True Correction method I cannot count a segment until there has been a takeout of the low. A segment cannot be counted until a new low is made.

No difference here because the correction has taken out the intervening lows.



But look at the difference in the count when there are progressively higher lows. Obviously, the True Correction method is more conservative.
Ranked in order from most conservative (top of the list) to most liberal (bottom of the list) they are:



True Trend method
Successive New Extremes
Sagging Highs and Rising Lows
True Correction method
Segment method

It's best to pick out ***one*** that fits your temperament and style of trading and stick with it. When you become proficient in using one, begin to master another. Eventually you will become extremely good at detecting a trend just as it is being born. Don't become entirely mechanical in using these methods. Mix and blend them with good judgment. Always look at the big picture. Get perspective. Move to a greater time frame. Step back and view the entire chart. Squeeze the price bars closer together and take a broader outlook on the entire situation.

VERBAL SUMMARY OF METHODS

Here is a verbal recap of the various methods for identifying the very beginnings of a trend:

TRUE TREND METHOD (TTM): DOWNWARD

The True Trend Method does not require counting or shifting. It only requires the ability to draw a trend line in an already trending market. The method involves connecting highs to highs in a downtrending market, and lows to lows in an up trending market. When analyzing downward, you connect the highest high of the last up leg to the current correction high. After that you repeat the process by connecting the current correction high to the next correction high.

When applying downward, you are allowed to connect correction bar tops only to correction bar tops. The method needs only a single higher high (correction bar) in a downtrend in order to create a connection. That is to say you need only ONE connection (one correcting bar) to draw a trend line. Once you have an established trend line you try to sell a breakout of the low of each day in which the market moves towards the trend line. The sell point is 1 tick below the low of the previous day, which once trading begins, represents a breakout of yesterday's low. You stay in the trade as long as prices move away from the trend line by making a lower high, and/or a close lower than the open. You add to your position as price moves away from the trend line by selling trade-through breakouts of the low of each correction bar. You also are to place a resting sell stop below every Ross hook. The True Trend method is not considered a counting method. You aren't counting anything; you're simply connecting correction extremes to correction extremes.

TRUE TREND METHOD (TTM): UPWARD

The True Trend Method does not require counting or shifting. It requires only the ability to draw a trend line in an already trending market. The method involves connecting lows to lows in an up trending market, and highs to highs in a down trending market. When analyzing upward, you connect the lowest low of the last down leg to the current correction low. After that you repeat the process by connecting the current correction low to the next correction low. When applying upward , you are allowed to connect correction bar lows only to correction bar lows. The method needs only a single lower low (correction bar) in an uptrend in order to create a connection. That is to say you need only ONE connection (one correcting bar) to draw a trend line. Once you have an established trend line you try to buy a breakout of the high of each day in which the market moves towards the trend line.

The buy point is 1 tick above the high of the previous day, which once trading begins, represents a breakout of yesterday's high. You stay in the trade as long as prices move away from the trend line by making a higher low, and/or a close higher than the open. You add to your position as price moves away from the trend line by buying trade-through breakouts of the high of each correction bar. You also are to place a resting buy stop above every Ross Hook. The True Trend method is not considered a counting method. You aren't counting anything; you're simply connecting correction extremes to correction extremes.

SUCCESSIVE NEW EXTREMES METHOD (SNEM): DOWNWARD

The Successive New Extremes Method requires counting but does not require shifting. The method needs 3 consecutive bars of Lower Lows when considering a downtrend; you must see 3 bars of Lower Lows in a row. You need focus on only one side of the bar; lows when you're counting downward, and highs when you're counting upward. The method does not require that you wait for a correction bar. You simply sell one tick below the low of the bar representing the #3 segment.

The Successive New Extremes Method is considered a counting method. It requires a three count before entry. There is no shifting of the count involved with this method. You sell a breakout of a low of the bar that makes a third successive lower low.

SUCCESSIVE NEW EXTREMES METHOD (SNEM): UPWARD

The Successive New Extremes Method requires counting but does not require shifting. The method needs 3 consecutive bars of Higher Highs when considering an uptrend; you must see 3 bars of Higher Highs in a row. You need focus on only one side of the bar; highs when you're counting upward, and lows when you're counting downward. The method does not require that you wait for a correction bar. You simply buy one tick above the high of the bar representing the #3 segment.

The Successive New Extremes Method is considered a counting method. It requires a three count before entry. There is no shifting of the count involved with this method. You buy a breakout of a high of the bar that makes a third successive higher high.

SAGGING HIGHS AND RISING LOWS METHOD (SHM & RLM)

SAGGING HIGHS (SHM): DOWNWARD:

The Sagging Highs Method requires counting but does not require shifting.

Sagging highs require 3 consecutive bars of Lower Highs. Three consecutive bars means exactly that, three consecutive bars; no intervening bars are allowed. You need focus on only one side of the bar; Lower Highs when you're counting downward and Higher Lows when you're counting upward. With Sagging highs, it is not necessary for new lows to occur; you need only for Lower Highs to occur. Each lower high counts one. Three successive lower highs yield an entry signal at the point where the low of the bar that made the third lower high is taken out. With Sagging Highs, look for three successive lower highs. Sell a breakout of the low of the bar that made the third successive lower high.

The Sagging Highs Method is considered a counting method. It requires a three count before entry. There is no shifting of the count involve.

SAGGING HIGHS AND RISING LOWS METHOD (SHM & RLM)

RISING LOWS (RLM): UPWARD

The Rising Lows Method requires counting but does not require shifting.

Rising Lows require 3 consecutive bars of Higher Lows. Three consecutive bars means exactly that, three consecutive bars; no intervening bars are allowed.

You need focus on only one side of the bar; Higher Lows when you're counting upward and Lower Highs when you're counting downward. With Rising Lows, it is not necessary for new highs to occur; you need only for Higher Lows to occur. Each higher low counts one. Three successive higher lows yield an entry signal at the point where the high of the bar that made the third higher low is taken out. With Rising Lows, look for three successive lower highs. Buy a breakout of the high of the bar that made the third successive higher low.

The Rising Lows Method is considered a counting method. It requires a three count before entry. There is no shifting of the count involved.

TRUE CORRECTION METHOD (TCM): DOWNWARD

The True Correction Method requires both counting and shifting. When analyzing downward, the True Correction Method must have a Lower High AND a Lower Low on the same bar before beginning the count. Thus beginning from the last high in price, any bar having both a Lower High AND a Lower Low, on the same bar, becomes the bar representing segment number one.

After the first segment has been labeled this method is similar in every respect to the Segment Counting Method; meaning you need only Lower Highs for segments 2 and 3. If the bar representing segment 3 isn't taken out by the very next bar, you shift the count 1 segment to the right and begin the count again.

The True Correction Method is a counting method. It requires a three count before entry. In a downtrend you try to sell 1 tick below the low of the bar representing the #3 segment.

It is important to note that there may be several intervening bars between the segments.

To repeat, the True Correction Method does require both counting and shifting.

TRUE CORRECTION METHOD (TCM): UPWARD

The True Correction Method requires both counting and shifting. When analyzing upward, the True Correction Method must have a Higher Low AND a Higher High on the same bar before beginning the count. Thus beginning from the last low in price, any bar having both a Higher Low AND a Higher High, on the same bar, becomes the bar representing segment number one.

After the first segment has been labeled this method is similar in every respect to the Segment Counting Method; meaning you need only Higher Lows for segments 2 and 3. If the bar representing segment 3 isn't taken out by the very next bar, you shift the count 1 segment to the right and begin the count again.

The True Correction Method is a counting method. It requires a three count before entry. In an uptrend you try to buy 1 tick above the high of the bar representing the #3 segment. It is important to note that there may be several intervening bars between the segments.

To repeat, the True Correction Method does require both counting and shifting.

SEGMENT COUNTING METHOD (SCM): DOWNWARD

The Segment Counting Method (SCM), like the True Correction Method, requires both counting and shifting. When analyzing downward, the Segment Counting Method needs only 3 Lower Highs. You attempt to sell the breakout of the low of the bar representing the #3 segment.

The segment highs do not need to be successively lower highs. There may be several intervening bars between the connected highs. The method does require 3 segments AND a breakout by the very next bar or you must rephrase the count by shifting 1 segment to the right and begin a recount.

When applying downward, breakout means a takeout of the low of the bar representing the #3 segment. You do not need to wait for a correction, you simply sell the low of the bar representing the #3 segment.

This method works well on the S&P intraday. You use the SCM to count your way out of congestion; once you have a breakout you trade the trend and stop counting.

SEGMENT COUNTING METHOD (SCM): UPWARD

Segment Counting Method (SCM), like the True Correction Method, requires both counting and shifting. When applying upward, the Segment Counting Method needs only 3 Higher Lows. You attempt to buy the breakout of the high of the bar representing the #3 segment.

The segment lows do not need to be successively higher lows. There may be several intervening bars between the connected lows. The method does require 3 segments AND a breakout by the very next bar or you must rephrase the count by shifting 1 segment to the right and begin a recount.

When analyzing upward, breakout means a takeout of the high of the bar representing the #3 segment. You do not need to wait for a correction, you simply buy the high of the bar representing the #3 segment.

This method works well on the S&P intraday. You use the SCM to count your way out of congestion; once you have a breakout you trade the trend and stop counting.

General Comments

The True Correction Method (TCM) and the Segment Counting Method (SCM) are both counting methods that require shifting. The only difference is **when** you begin to apply the count.

In the True Correction Method, when counting up, you **must** have both a Higher Low AND a Higher High on the same bar before you can begin the count, after that you need only Higher Lows; while in the Segment count, you need only Higher Lows for all three segments.

When counting down, you **must** have both a Lower High AND a Lower Low on the same bar before you can begin the count, after that you need only Lower Highs; while in the Segment Counting Method you need only Lower Highs for all three segments.

When applying either method, True Correction or Segment Counting, whenever you fail to take out the extreme of the bar representing the third segment, you have to shift the count and begin recounting from one segment to the right.

Note: The terms segment counting and segment method are one and the same, and are used interchangeably throughout this book.

Chapter 30

FULL CIRCLE

I've been showing how I trade intraday charts.

However, despite my daytrading escapades, I have never left off position trading of the daily charts. This is something I mix in with my daily trading. In fact, since my illness in 1987, I do far more position trading than I do daytrading. Here's how I do it, and it takes me right back to the earlier parts of this book.

Whenever a trade derives from one of my major entry signals, I then have a perfect candidate for a position trade.

For instance, when prices break out of an envelope or from a ledge, when prices take out a 1-2-3 high or low, or a hook, I have an opportunity to add contracts to the trade. These additional contracts will be held overnight along with any others that are still open.

I'm not going to go into how I trade them here, because how I do it is/was the subject of Trading by the Book. But clearly, my positioning in the trade based upon the optimization I can get from the intraday entry make these position trades better and more profitable than they are just trading them from a daily chart.

By optimization I mean that, because I'm able to enter from a Trader's Trick entry or the breakout of the intraday congestion that comes before the actual breakout point on the daily chart, I am usually in the trade earlier than I would have been using just a daily chart. That means that when the other traders enter on the breakout of these significant major entry points, they often give a boost to my already positioned contracts, driving them further ahead in the direction in which I'm trading.

By optimization, I mean not leaving any more money on the table than I have to.

It's rather like what some of the pros and floor traders I know do with moving averages. Some of them are mindful of where nine and eighteen day moving averages will cross, and position themselves in the market ahead of time in order to be there when the sheep who take these signals as gospel truth all dive into the market driving it to profits for the pros. Believe me, the pros will soon bail out, undermining the market and leaving the sheep to wonder what happened to the trade.

Other professionals watch other things they know will bring the "suckers" (their word - not mine) into the markets. Among their favorites are Stochastics and RSI.

I'd like to take what's left of this book to talk about some of these things in general – things I hope are of interest.

When I'm trading, if I don't know what is going on, I don't trade. This is a rule of trading I'm sure you have heard before.

Yet I know that many ignore this rule. I can tell by what is said to me on the phone and in letters.

The reason for not knowing what is going on is an unwillingness to make the effort necessary to become a good trader.

Trading is hard work. It's not easy. I spend 85% of my time getting ready to trade and only 15% of my time trading.

That means doing my analysis work before I trade. How else can I know what's going on? I can't judge from the news. I can't listen to the opinion of others. I have to analyze the market and then trade from what I see.

I try to never trade what I think, only what I see. My opinion is worthless, and what I think is my opinion and nothing more.

Here's how I was taught to do my analytical work.

First, I went through all my charts to get an overview of the markets. During that time, I looked for trending markets. Trend lines were placed on the charts as long as they had a 30° or greater angle. Until I became used to what that looked like, I used a protractor to determine the angle. This action got me used to identifying the trend.

Next, I went through all my charts again looking for against the grain moves – the intermediate trend that went against the longer term trend. This alerted me to markets that might soon resume trending.

Then I went through all my charts looking for Ross hooks. I marked each hook with a bright red "h". Then, in light of the size of my margin account, I tried to select those markets that appeared to have the greatest potential, and I placed order entry stops just above or below the hooks. These were resting orders in the market. I tried to never miss a hook. I phoned my orders in daily.

How did I know which markets had the greatest potential? The answer is simple. I selected those markets which had the strongest trend lines.

Now there was a trick to this. I didn't want too steep an angle, because in an up market that often signals that the end of a move is near. Markets that break out too fast and go straight up rarely give an opportunity for entry before they start to chop around in congestion. Markets that have been going up at a steady angle, and suddenly that angle steepens, are giving a warning that the move may soon be over.

In down markets I was willing to allow a steeper angle, because often a market will move down three times faster than it moved up.

What I most wanted was trending markets that were making a retracement. Then I could attempt an entry as the market retraced, when it reached the proximity of the trend line, and then seemed to resume its trend, and when it took out the Ross hook created by the retracement.

Sometimes I had to wait for weeks before the markets started trending. The same is true today, nothing has changed. There will usually be at least a couple of markets in that condition, but there are times when there are none.

Yet I did my homework every day. There was no way to know when an important breakout, the beginning of a trend, would occur, unless I performed my daily analytical work.

Finally, I would set my work aside and take a break for dinner. After dinner, when my head had cleared a bit, I would look at them again. I would then do my best to come up with a trading plan. I would try to think through what I was going to do. I would ask myself a million "what if's." I tried to anticipate what might happen in the market.

Often, that kind of thinking would cause me to eliminate some of my potential trades. Also, a second look at times resulted in "Why didn't I see this before?"

For instance, what if I was looking at a market and it was approaching its trend line. Wouldn't it have been reasonable to ask myself, "If this market breaks the trend line, what should I do?" I asked myself how such an event would change the picture. If I had a position, I asked myself if I still wanted to hold it. If I had no position, I asked myself, "Is this an event that will cause me to take a position opposite what was the trend?" If it was such an event, then should I place an order entry stop with limit, just outside of that trend line? Very often, when prices approach a trend line from what has been a trending channel, they are already in a counter trend within the channel. That means a breakout of the trend line would be a continuation of this newly formed trend.

Finally, I would put my work aside and go to bed. In the morning I would look at my charts once again. Then I would write out scripts for the orders I wanted to place.

I would rehearse how authoritatively I was going to give these orders.

All this and more I did <u>before</u> I entered a trade. But most traders do their analysis after the trade is made. Too often, they do it when the trade is already going against them.

Many times traders go into a trade, and then when they are in it, they say to themselves, "Oh no, why didn't I see that before?" How could it have been seen before if they hadn't looked, and looked again, and thought about it, and then perhaps looked one more time?

Also, many traders do their analysis after entering the trade in search of a justification for having entered. "Now I'm in the trade, let's see if I can find a couple of good reasons as to why!"

If I want to continue as a successful trader, I have to be hard. Hard on myself and hard on my broker. I don't mean I have to be a rat, or be impolite, or be contemptuous. I just have to be firm in all I do. I can't afford to be "Mickey Mouse" about the way I do things. This is a business. I must be businesslike in conducting my affairs.

As a business person, I must manage my business. One of the main functions of management is planning. I have to plan my trades. Other things I look for as I go through my charts are: One-two-three formations, cups with handle, matching congestions, reversal bars and dojis. These are all part of my plan.

I have to have good reason(s) for getting into a trade. But, too often others get into a trade, and then look around to see if there was a good reason for having done so. That way they justify to themselves that they did the right thing, when in fact they did the wrong thing.

The horrible thing about not doing analysis work and researching a trade is that they give more thought to choosing which flavor ice cream they will eat than they give to which market to enter and how and when to do it.

By not taking the time for preparation, they end up not having enough time to weigh the pros and cons or really familiarize themselves with what they are getting into.

They don't have time to realize that prices have supported two ticks away from their entry about forty times in the past. They don't have time to see that they are trading right into overhead selling. They don't have time to notice that if prices break out of yesterday's high, they will also probably take out a Ross hook. They don't have time to see where prices are in relation to the trend line. They don't have time to really grasp the overall trend, or the wave that is going counter trend. They don't have time to really consider where they will place their stop. They don't have time to read the market and to see what it might be telling them.

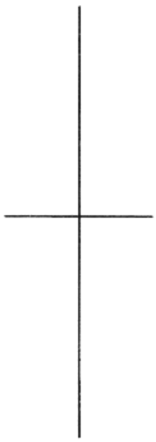
All these things could be anticipated, but if they have not done their homework, they will end up chasing markets in a desperate attempt to get into "the big move."

Here's one item I look for when I am in a trade. It's a piece of information I was taught a long time ago. Amazingly, it is now coming into vogue via the Japanese candlestick charts. It has to do with what I have always called a "reversal bar."

I'll show an example of what I look for.

Essentially, there are two forms of reversal bars. Singly, one is more important than the other; in combination, they are just about equally
important.

The least important is what the Japanese call a "doji." I love that term and have adopted it into my trading lingo. It looks like this:

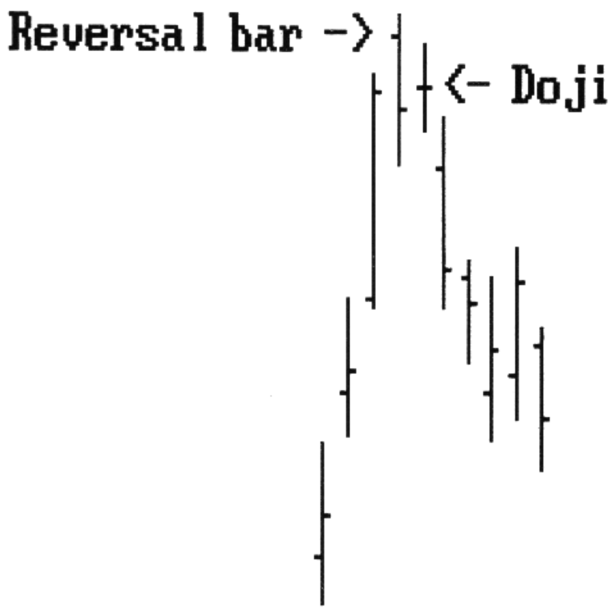


The main thing to notice about a doji is the fact that the open and the close are about the same.

The open and close do not have to be exactly the same, just very near to each other.

A high percentage of the time, when I see a doji and a market is trending, I'm alerted that the market is going to go the opposite way on the following price bar.

A more important reversal bar is seen when in a down market I get a close that is higher than the open, and in an up market I get a close that is lower than the open.



An even stronger indication of an imminent major trend change comes when there is a combination of a doji and a reversal bar.

The very best indicator of a trend change comes when there is a combination of two or even three successive reversal bars, or a combination of dojis and reversal bars mixed in with one or two bars that fit the pattern of the trend.

Note: I do not confuse the mix of bars in a trending market with those in a congestion. A look at congestion areas on most any chart will show that there are usually reversal bars almost every other day

When I see a series of reversing bars, (open higher than close on one day, and close higher than open) the next day, I get out of the market. If I were not in I'd stay out until I see a breakout or come to the realization that the market is trending.

These reversal bar, doji combinations occur in a downtrend while I'm still seeing lower highs and lower lows. Conversely, they occur in an uptrend while I'm still seeing higher highs and higher lows. In other words, to the casual viewer, it still looks as though the trend is intact. But if a trader knows how to read a market, as I was taught, these reversal bars and dojis are powerful signals.

If I have a position when these combinations occur, it is time to really tighten up my stops. I get ready to bail out.

I would say that dojis work singly about 55% of the time; in combination with a reversal bar, about 70% of the time. A single reversal bar will indicate a trend change of at least one bar about 65% of the time. A pair of reversal bars will indicate a counter trend move from 70-75% of the time. These figures are just estimates based on experience. I've never actually counted to see the exact percentages. All I know is that they work. They are an example of letting the market tell you what it is going to do.

When a trader knows how to read a market, and has a pretty good idea of what it is going to do, then he is able to get in step with that market and go along for a ride.

THE FLOOR

Many "at home" traders wonder, "What in the world is going on down on the floor? How is it that floor traders always manage to successfully fade those trading off the floor? Does it have to be that way? Why is it that floor traders can trade against the trend and get away with it?

Floor traders certainly appear to have the advantage over the rest of us. But do they really?

It's important to know the truth. It's vital to daytrading to know where and when the floor traders have the advantage and where and when they do not.

Let's get a few things straight.

Floor traders as a rule don't do any better than anyone else as far as succeeding in this business. The mortality rate is very high. They come in with their money and go out broke just as daytraders and position traders do. They constitute trading casualties in the markets the same as others.

They have some advantages. Here are a few of them. 1. They can trade at a much lower round turn cost than I can. They pay somewhere around $1.50 - $2.50 for a round turn. 2. They can see the bid/ask prices and the size. Because they can sell at the ask price and buy at the bid price, floor traders may <u>seem</u> to be able to trade against the trend. 3. They can see who is coming onto the floor. 4. They can "hear" the market. They can react to the noise of a busy market. They can move with the market as soon as they sense the excitement. 5. They do not suffer the terrible time delays we have in getting our orders to the floor. They are there and can react as fast as is humanly possible.

I can sell only at the bid price and buy only at the ask price. I also pay much higher commissions. I've always wondered just how unfair are the commissions that are charged? Does it cost the broker any more to buy or sell a fifty lot than it does a one lot? Why do I have to pay the same price per contract when I order ten, as I do when I order one? Wouldn't it be more fair if I paid a single commission regardless of how many contracts are in a lot? In addition, I would pay the exchange fees per contract, same as the floor.

I have the inevitable time delay of dialing the telephone, waiting for someone to pick it up at the other end, recording my order, calling the trading desk, waiting while they record the ticket, and waiting for the order to be arbed over to the pit via hand signal or sent in by runner. To make matters worse, I have to pay atrocious commissions, several times as much as do the floor traders. Even though I call straight to the floor at each exchange where I trade, it takes time to do the paper work.

Because of these disadvantages, I must trade with as much in my favor as possible.

How do I do this? Notice carefully what I'm going to show.

Because I cannot see the bid/ask, I must trade only with the trend. I must be a buyer in up markets and a seller in down markets. Once a bull trend is definable, then I must buy every time I feel it is right. That means buying retracements by trying to buy breakouts of the highs as prices move away from the trend and buying breakouts of highs when prices are moving towards the trend. Once a bear trend is definable, I must sell at every opportunity. That means trying to sell breakouts of lows on the retracement days, and on the days where prices move in the direction of the trend.

As crazy as it may seem, statistics show that as prices approach a trend line due to a correction, the odds become two to one in favor of a successful trade if I enter in the direction of the trend. The best place to do so is when prices have changed direction back towards the trend direction.

I must not attempt to trade in sideways markets. It is in the sideways markets, called trading ranges, that I get myself killed.

Trading ranges are just what the term says. They are an area that is strictly for floor traders. They are a "trader's range." They are strictly for those traders who have the shortest term view of the market. This is true whether I am trading a daily chart or a five minute chart. Trading ranges are for traders – floor traders, those down in the trading pits. I stay out of them.

How can I neutralize the time advantage the floor trader has? I can do this only by having resting stop orders for entry into or exit from a market. That way, my order is down in the trading pit when prices reach my target and can be executed as quickly as is humanly possible.

The only way I can ever pay lower commissions is to call my own shots, and patronize the discount brokers. I pressure them constantly to give me lower rates. I bug the blazes out of them for lower commissions. Of course, traders could bombard the exchanges with letters telling them how they feel about being raped on every trade.

There is not much I can do about seeing who comes in to trade, and I cannot hear the trade as they do on the floor. Hopefully, that disadvantage will disappear if and when they place the floor traders in front of a screen and out of the pits. I look forward to the era of all electronic trading.

I've often wondered what would happen if traders with live data feeds demanded to see the bid/ask on their screens. Surely if they can provide the floor traders with such information when they remove them from the pits, then such information could be provided to those with live data feeds.

The next question arises: Do I have any advantages at all over the floor traders? You bet I do. I can go for the long pull, I can trade the trend!

A floor trader who is a scalper (most are) is looking for a few ticks and then out. Quite often, after the scalpers get out, the market goes on to make a bundle of additional ticks. The scalper leaves those lying on the table for me to take.

How can I take advantage of that situation? When the scalpers start cashing their profits, the market will retrace somewhat. It is the liquidation by scalpers and short term floor traders that create minor retracements in markets. Great! I wait for the retracement. As soon as prices move back in the direction of the trend, I jump in.

The floor trader can actually lose his shirt when a market makes a big, sudden move as did the stock market in 1987, and again in 1989. In these instances, the public took hold of the market.

There are some real horror stories that came out of the markets during those times.

Let me quote from some material written by William F. Eng, a professional trader. I made a copy of this for my files. It's quite interesting.

"The quandary posed to the professional when the public takes hold of the market applies not only to bull markets, but also to downside markets. Horror stories abounded after the October 19, 1987, worldwide market crash. Friday, October 16, was the first day of the massive downdraft. Many professionals who were still in business on that day told me that they had substantial profits on Friday's close. They came into the markets Monday opening short and made embarrassingly huge amounts of money immediately at the opening bell. As one professional told me: 'I couldn't help myself. The market just handed me fistful's of money.' It was what happened during the rest of that Monday, October 19, that did these professionals in. The market opened much lower, rallied, and then sold off dramatically. On the opening, some pros covered shorts. As the market went lower, they started to go long at 150 point lower, then 200 points lower, then 300 points lower, then 400 points lower. It looked as if the lows of the century were going to be tested. At the bottom they sold all their positions."

Such was also the fate of the Fibonacci traders. Fibonacci traders buy at the .382, .50, and .618 retracement levels. They expect the market to reverse there. Imagine how badly they ate their shoes during the crashes of 1987 and 1989? When the market started down, they would have bought at those levels, expecting a reversal to be imminent. When they finally decided to sell their long positions, who would have been there to buy them? They would have eaten those positions big-time. Most of the ones I know received margin calls and went bankrupt. They simply couldn't sustain a loss like that.

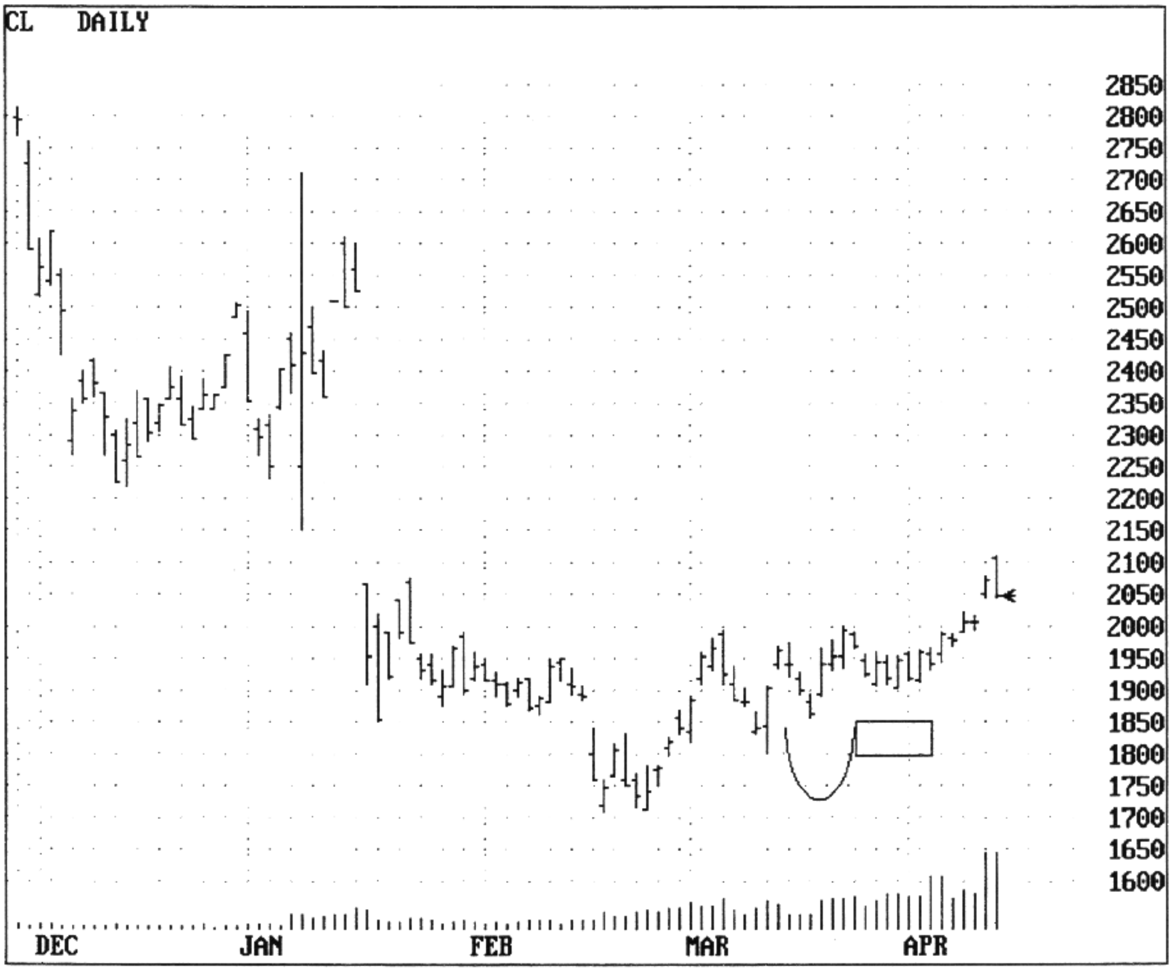
CUP WITH HANDLE

Several years ago, when I first subscribed to Investor's Daily, my subscription came with a free book written by the publisher of that newspaper.

In the book was described a formation termed a "cup with handle." I picked up on that formation, and it has stood me well ever since. I'll share that with you.

On the next page is a chart of crude oil. It shows the cup with handle formation. It also turned out to be a matching congestion formation, just as can be seen on an intraday chart.

As I've noted before, matching congestions occur on intraday charts, daily charts, and on weekly charts as well.

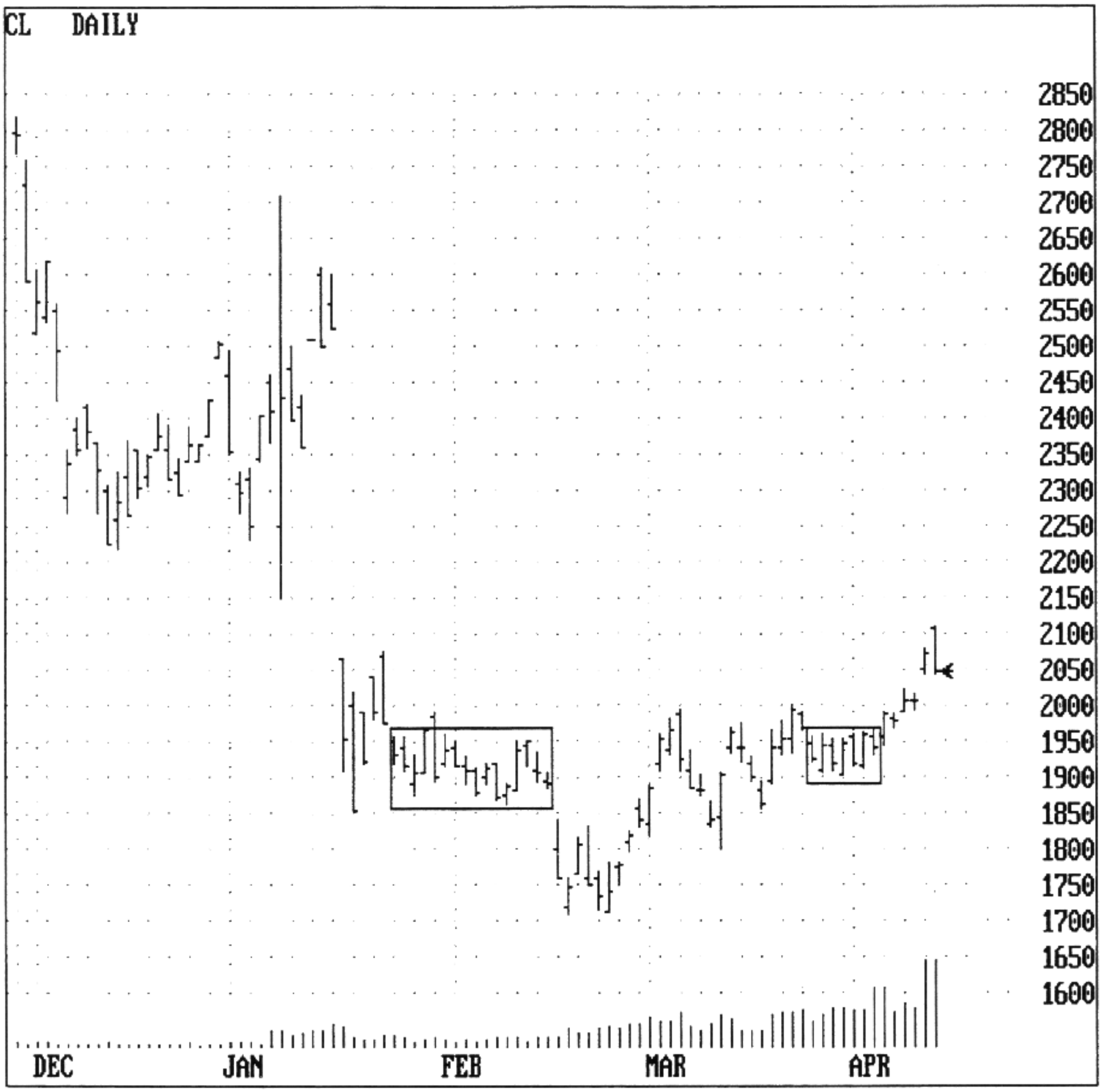


The cup with handle formation is created by a dip in prices followed by a congestion that towards its end begins to have rising lows.

When trading the cup with handle in the stock market the anticipation is for the market to go up. When trading futures, the anticipation is for a breakout in either direction. That is a significant difference.

Notice carefully that whenever there is a tight congestion with rising lows, it will usually break and will have a strong move to the upside.

The reverse is also true. A tight congestion with falling tops will usually go down sharply, very soon.



The matching congestion areas are also an excellent way to enter a market. The upward bias of the rising lows gives a pretty good clue as to which way prices are going to break out. The chart above gives me an opportunity to offer another concept - hedging a position.

HEDGING

On the day shown by the arrow, the close was sharply lower than the open.

I was long June crude oil and hedged my position by selling an equal number of July crude oil contracts at the close.
If prices were to gap down on the next day's open, I would have a chance to make back on the July what I would lose on the June. That would preserve the profits I had made to that date.

The hedge works like this: Long June crude at 1951 per contract. The close was 2048. I had 97 points per contract of profit in the June.

If prices were to gap down on the open, because crude oil trades in London overnight, I would be able to preserve most of my profits.

As of the close, May crude had the strongest contract, June was next strongest, and July was the weakest.

My reasoning was that if prices moved down, I would make more on the weak July than I lost on the stronger June. If prices should turn and move up, I would make more on the stronger June than I lost on the weaker July. All in all, it beat placing a stop in a market that was hovering above a gap.

If I were to place the stop just below the low, and it got taken out there, I would have been Okay and would have salvaged 95 or 96 points. Then I would have been out of the market and have had to reenter at a higher level. But if prices would have gapped past my stop, I stood to lose a healthy portion of what I'd already made. So what I did was to hedge my own position in the market. This enabled me to give crude oil every chance to resume its upward trend.

PROTECTIVE STOPS

Stop placement is where we separate the kids from the adults. Stop placement is the sole responsibility of you as the manager of your trading business. It is one buck you cannot pass. You are the end of the line when it comes to placing stops.

Let me show you why you, and only you, can decide where to place the stop. There are several considerations:

The size of your margin account has the greatest effect on stop placement. When you look at a trade and see where the stop should go, or where you would like it to go, you then have to look at the size of your margin account and determine whether or not you can even consider the trade.

Your comfort level. Although you may have sufficient margin to place the stop where you would like to, and although the stop is logical for the trade, you may not feel comfortable with the stop being so far away (or even so close), and so you will decide not to take the trade with the stop far away, or move the stop back if it appears too close.

Volatility. You must take into account market volatility when placing your protective stop. If a market that normally ticks five points at a time suddenly begins to tick twenty points at a time, you must certainly take that into consideration. You may find out that you have to place your stop too far away for the size of your bank or your comfort level.

When you use mental stops, there are two other considerations which you must ponder when placing your protective stop. They are: Your speed in placing the order, and the speed at which your broker can place the order. Let's look at each.

The speed at which you can place the order. This depends upon how fast you think on your feet. There are three factors here: Perception, decision, and action. How long does it take you to perceive that NOW is the time to pick up the phone and place your stop in the market?

Then, once you make the perception, how long does it take you to decide to do something about what you have perceived? Are you quick to decide upon your perceptions? Finally, are you quick to act once you have made a decision?

Some of us are very quick in all three areas. Some of us are too slow to utilize mental stops. Only you can tell from the experiences you are having in the market whether or not you are quick enough to use mental stops.

Other factors that can enter in are based upon your trading environment. Whether you trade at home or at the office, if you are subject to interruptions, you dare not use mental stops.

The speed at which your broker can place the order depends upon his organizational setup.

If you have a broker who is a "chatty Charlie", watch out. Even though he may not be chatty with you, he may fool around with getting your order in while he chats with one of his other clients.

If your broker is one who trades a lot, he may be taking care of his own before he gets around to taking care of yours.

Other considerations are: Whether or not you are able to call directly to the trade desk on the floor, and better yet, whether you can call directly to someone stationed next to the pit.

If you are using mental stops, you should time your orders. Find out how long it takes from the time you reach for the phone until you hear that you are filled. Test this procedure in several markets on several occasions.

Then you may want to use my "tick-in-half" rule. For every 1/2 minute your order takes – from the time you reach for the phone until you get your fill – add one tick to your mental stop. If this is satisfactory slippage, then it's okay for you to use mental stops. Time these as flash fills since your mental stops should be market orders.

The number of trades you already have on in other markets can have an effect upon where you place your stop. If you are already pretty well margined-up, you may not be able to financially, or comfortably, afford to put on another trade with the protective stop in the place you feel right in having it. In that event, it's best to pass this trade, or liquidate another trade so that you can comfortably enter the one you are contemplating. Remember, if you overtrade, put on too many trades, you will get into trouble and have to place your stops too close.

There are other considerations that may be involved in special situations which affect where you will place your protective stop, and whether or not you want to take the trade when you see where that stop will be.

The main point is, if you can't place the protective stop where it should be, don't enter the trade.

I think that from the previous discussion, you should be able to see that protective stop placement takes a good deal of planning and thought. It's part of what you do 85% of the time you are a trader.

Why? The markets trend only 15% of the time. You should be trading only 15% of the time in any of the markets that you trade. The other 85% of the time you should be planning, organizing, delegating, directing, and controlling. That is what a good manager does. Inherent in owning and operating your trading business is proper management. When I spend the proper amount of time preparing to trade, administering and managing the trade, I don't have time to sit and watch a screen all day. I don't have time to overtrade. I'm busy keeping track of what is going on. I'm filling out order sheets, I'm almost constantly on the phone directing my broker, I'm listening to the playback of my tape recorded orders. I'm one lively dude, and I look as if someone speeded up the film. I'm busy, busy, busy. I'm thinking ahead - what if, what if, what if? "What if prices take out that low? What will I do then?" "What if this is a reverse hook, what then?" "This looks like congestion, what do I do next?" I plan, I anticipate, I call in orders, I cancel orders. I move stops. I bug my broker for fills. I check to see if I'm making enough points. I manage my trading business.

FIBONACCI FALLACY

In my teaching, I have often mentioned the use of Fibonacci techniques and concepts. You should know by now I utilize them in only two ways: I use them to make very rough projections of where the market might go so I can set profit objectives. I restrict this to one situation only: The breakout of a Fibonacci envelope placed around a trading range (Part I, Trading by the Book) – which is an expansion concept; and to determine where I might expect support or resistance in a market – which is a retracement concept.

I place absolutely no credence in any sort of "magic" involving Fibonacci numbers and ratios. I would NEVER, EVER, consider trading retracements to them with one exception – trapping prices between a Fibonacci ratio and a 4/1 offset moving average when I want to enter an established trend (Part II, Trading by the Book).

I might look for a bounce at a Fibonacci retracement, but I would never trade it solely because it was a bounce from such a retracement. It has to be coupled with something else, in this case the 4/1 moving average. I would never, under any circumstances, set an entry order at a Fibonacci ratio level other than by mere coincidence.

To me, with the exceptions mentioned above, the use of Fibonacci ratios is restricted to the level of telling me whether or not a market is acting normally.

Now I want to explain exactly why Fibonacci trading is wrong – a false god – a deceiver that will allow a trader to win sometimes, only to suck that same trader in and strip him of his wealth at other times. When a trader trades the "golden ratios", he is doomed to continually give back what he has worked so hard to gain. I'm going to call this section…

CAPITAL PRESERVATION

In Trading Is a Business, I taught a number of the things I'm going to say next.

To operate one's trading as a business, sufficient capital with which to trade must be available. This capital will give control over the trading opportunities that present themselves. The more capital available for trading, the more opportunities there will be to make that capital go to work. In that way the trader can guide his career as a business-like trader.

When trading, there are a number of ways to control risk. Stop placement is one of them. There is, however, only one way to preserve capital – trades must be planned. A trader must learn to think them through, so that he can ascertain where in the trade the risk exists. The risk to capital lies somewhere within the life of the contemplated trade.

In my book Trading Is a Business, I talked extensively about how so many traders have a wrong perception of the market. I also lit into traders for having a wrong anticipation of what a trade will bring. Typically, traders are always stepping up to the plate to try to hit a home run, instead of being satisfied with getting on base, which is the equivalent of taking home steady profits. The market, and only the market, can hand a trader home runs.

I also tried to show in Trading Is a Business, that most traders are intelligent, well-educated professionals or retirees with years of life experiences from which to draw, and yet they go on losing money in the markets.

It is the very high level of intelligence traders possess that attracts them to highly mathematical concepts for trading markets. There is nothing mathematical about markets, and therefore trading them that way dooms one to failure. *Yes, I know that so many of the ads say that markets are cyclical, astrological, mathematical, symmetrical, geometrical, and all kinds of other "ical's", but don't you believe them!*
Fibonacci trading is mathematical, and therefore appeals to the highly intellectual trader. In reality, as can be seen, it turns out to be another false god.

Suppose the Crude Oil market is seen by a trader to trend upward, begin to falter, and then head down toward a Fibonacci support level. The first commonly accepted support level is composed of a .382 retracement of the previous move. A resting order to buy is placed at that retracement level.

Let's imagine that there's a $15,000 margin account involved, and that the margin for Crude Oil is $1500 per contract. Now the trader, enters a trade long for one contract. The trader anticipates a "magic" Fibonacci bounce. Nothing happens. The trader decides to hold overnight.

Now imagine the trader also has placed a resting order to buy one more contract at the .500 retracement level. Fifty percent is the so called "golden ratio." The trader and most of the other worshipers of this idol will have resting orders at the "golden ratio," and so there should be adequate support, sufficient to cause a bounce.

Of course, the floor traders, who also know about the "golden ratio," are there to help them fill their golden orders.

As stated, with the trader's and others' entry into the market at that point, there may even be somewhat of a bounce, and the market may rally for a few ticks. However, if the fundamentals that are driving the market down remain in place, the rally will not last long, and so the market will re-cross the "golden ratio", and head south toward the next magic number. At that point, traders will be waiting with eager anticipation for the expected bounce at the .618 retracement. If they don't get it, may their "god" help them!

Now let's look at what would have happened to the trader's account. With the first contract, he had to put up $1,500 to control the trade. At the "golden ratio", he had to cough up another $1,500 in margin. But he also had to risk the amount of money that he is losing by the mark-to-market distance between the .382 retracement and the .500 retracement.

Let's assume such distance was worth an additional $2,000. When he enters the trade at the "golden ratio", it requires $5,000 to control the trade.

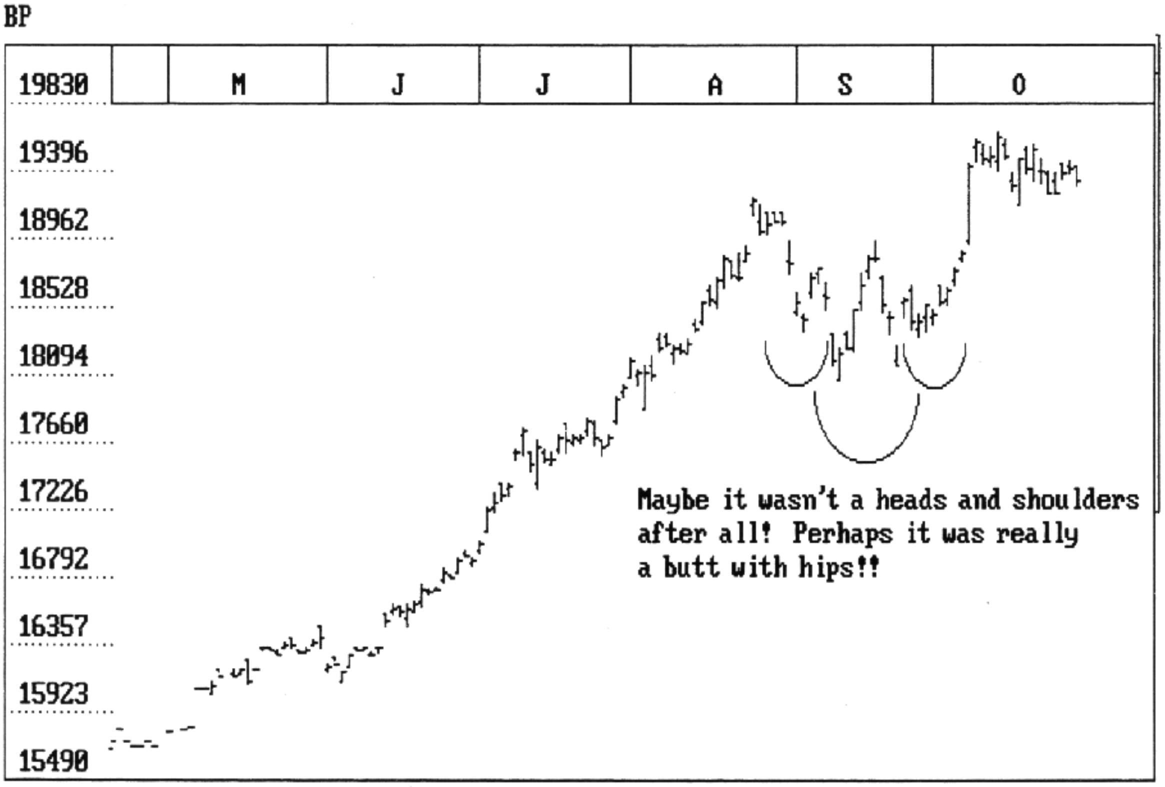
At the .618 retracement, the market has moved down another $2,000. He has an order to buy another contract, thereby adding another $1,500 needed to control the trade. In addition, he has $4,000 of baggage to carry from the first contract, and an additional $2,000 to carry from the second contract. This mark-to-market baggage consists of the losses he now has in the trade.

				A		B		A + B	
TRADE	MARKET LOSS				CONTRACT COST	TOTAL CONTRACT	MARGIN CALL	COST TO CONTROL	NET MARGIN
	#1	#2	#3	Total Loss					15000
#1 @ .382					1500	1500	-	1500	13500
#2 @ .500	2,000	-	-	2,000	1500	3000	1500	5000	10000
#3 @ .618	4,000	2,000	-	6,000	1500	4500	3000	10500	4500
- @ .750	6,000	4,000	2,000	12,000	-	4500	4500	16500	[1500]

It is now taking $10,500 to control this trade. He is rapidly running out of margin. He has no more room left to buy. The next retracement is at .750. To carry the trade there, he will need a bigger margin account. If the market goes against him, down to the .750 Fibonacci number and he has to liquidate there, he will end up with a margin call. 'Nuff said? The whole thing is shown below:

HEADS AND SHOULDERS

Another piece of mythology is the so called heads and shoulders formation. The formation itself is real, at least in the eye of the beholder. What is wrong is the expectation. Anyone who thinks he knows which way a heads and shoulders formation is going to break needs to have his own head (and maybe even his own shoulders) examined. To prove my point, I submit the following very common example.



Please pardon the pun, but sometimes this is the way I feel about some of these figments of the imagination that some people claim to trade from. Some of these formations are strictly in the eye of the beholder. Now, don't blame me for what I see. Not only can't I do math, but I'm also dyslexic. Dyslexia may be the secret of my trading success. Perhaps I can write a book about how to become dyslexic.

If I can trade from a chart seeing things all wrong, then the reader should surely be able to do it seeing things straight side up.

I TRADE WHAT I SEE

Here is something that comes up time and time again. I'll mention what it is. It's something I had to learn to think about with all my might, and as often as I could. I used to write this one down. I placed it where I would have to read it every day, and made sure I read it and thought about it every day. The majority of traders will understand it academically, but not from the depth of soul I eventually came to. I had to come to the point where I really understood what I'm about to say; the understanding came to be deep. Here's the poster I made for myself.

JOE, NEVER TRADE WHAT YOU THINK, TRADE ONLY WHAT YOU SEE!

What I think is merely another opinion – mine. Most have learned that their own opinion is as good as anyone else's opinion. That is right, but it is also wrong. I came to see it as being that my opinion is as bad as anyone else's opinion.

It's the old viewpoint of the cup being half full or half empty. In the case of trading, the cup is half empty. My opinion is bad, it stinks.

As long as I try to trade based on what I think, I will be trading on opinion.

When prices broke out on a gap up and I'd missed a trade, I'd think that it was too late to get in now. That is what I thought. The fact was that prices were going up. Then, when prices started coming back down, I'd think that prices are not really going to go up. Again that was my opinion. The truth is I didn't and couldn't really know which way prices would go. Therefore, when I saw prices begin to go up again, I learned I had to try to buy. In a bull market, I learned to buy every chance I got. I look for reasons to buy. I buy the minute a retracement starts to go back up again. I buy when today's prices take out yesterday's high. I buy at the breakout of the Ross hook that was created when the retracement began. I buy, buy, buy. That is the only way I've learned to make money in this business when prices are going up.

When I see prices going down, I sell! When prices break out of congestion and move down, I wait for a correction. As soon as prices are moving down again, I sell a breakout of the low. In fact, I try to be selling breakouts of the lows the entire time prices are correcting. Once prices start moving down and the trend is established, I sell every chance I get. I sell a breakout of yesterday's low, every day. I have resting sell orders below every Ross hook. I sell and sell some more. That's how I make money in bear markets.

I trade what I see. I trade with the trend. I buy bull markets. I sell bear markets. I can see when a trend is in force. A little child can see that. I don't need an oscillator to tell me which way the trend is going. I draw a trend line on the chart. If the trend is up, I buy. If the trend is down, I sell. I trade what I see.

If I think the market can't go any higher, and the trend is up, I buy. I trade what I see, not what I think. If I think that surely this is the bottom, and the trend is down, I sell. What I think doesn't matter. It's what I see that counts.

In growing up, I had become so used to doing what I thought that it was hard to divorce myself from my own opinion. After all, I'd lived by my wits most of my life. In the markets, that will kill a trader. Trading is simple, but it is harder than all get-out to separate what is seen from what is thought. I work at doing that. I let this concept sink deeply into my thoughts. It has become a part of every fiber of my being. It took a lot of effort on my part.

STRANGE DATA

A piece of data I've come across is that upon initial entry into a market, 80% of traders are on the right side of the trade. Yet they end up as net losers. Why? When I first learned of this, it boggled my mind. How could such a thing be?

Here is the answer: Apart from the flat-out gamblers who are in the markets, many, many traders have read and studied intently everything they could afford to buy or send off and receive for free. They have been diligent about getting their education in every aspect of trading but one - they haven't learned how to make money.

That's right! They have learned how to trade. Indeed, they know how to trade! What they don't know is how to make money. Believe me, there is a world of difference between the two.

I've shown some of how to do it in this book. The rest you will find in Trading Is a Business,

Knowing how to trade is a different animal from knowing how to make money from trading. Apart from Trading Is a Business, I've never seen or heard of such a book. If there is one, I'd like to hear about it.

Many of my readers know how to trade. They are actually pretty good at it. But when it comes time to reel in a profit, they don't seem to know how or when.

I would venture to say that many of the traders and would-be traders I teach are better and more astute at trading than I am. But they are consistent and/or overall net losers in the markets. Trading Is a Business addresses in detail the reasons for this and explicitly shows how to turn a profit in the markets.

I firmly believe that we are soon coming to the point when almost everyone who trades will have to take up some form of daytrading to survive.

With the advent of computerized trading, the markets will be traded continuously, twenty-four hours a day round the clock. Traders may be forced to enter and exit a trade on the same day, or be faced with yawning gaps the following day as world and market events continue to flow while they sleep. Already, the more knowledgeable traders are placing stops in the Forex markets to avoid multi-thousand dollar overnight losses in the currencies. Such stops will become commonplace for anyone who wants to hold a position overnight.

There will be some advantages, too many to go into here, but for instance, a trade could be put on early in the morning upon awakening and taken off later that night upon retiring. The floor trader, as he exists today, will disappear. He will be relegated to a screen and have to trade much as the rest of us do.

Already a move is on that is thinning the trading pits. The costs to trade on the floor and the requirements to trade on the floor are rising, causing a gradual flow of traders out of the pits and upstairs to a trading screen. These traders are having to relearn how to trade. I know, because I've been teaching many of them.

Their exodus, a trickle now, but eventually a flood, is already causing increased volatility down on the floor. Not that the open interest is affected by their leaving the floor, but that as the floor thins out it is much more apt to be driven by emotion and hysteria. This is already happening, and will increase.

The competition from foreign commodity markets, coupled with the age of the computer, may sound the death knell for what is probably the last vestige of free capitalism in the world – open outcry trading.

Whether this will be good or bad is purely philosophical. I suspect it will be a mixture of both. The important thing is that a lot of adjustments will have to be made. Many of the things that worked in the past will no longer work in the future.

I'm not talking about entry or exit signals. I'm not talking about technical analysis or chart patterns. Those will remain the same. A chart is a chart is a chart. The charts will look the same. They will give the same signals as before. It is the trading tactics, the expectations at each level, and the risk and money management that may be different.

The "locals" will be impacted more than anyone else with having to learn a new way to trade. They will have to learn to trade from a chart, or a tote board, or whatever way they want to see prices. Some of them have never done it that way.

They may be subject to the same delay I have to live with vis-a-vis the telephone. That's unclear to me at the moment. Again, they may be able to enter their trades directly into the system.

It is also possible they may be able to see as much or more of what is going on than they did before.

All of us may find ourselves placing our orders with a computer, or calling a broker who will place our order on the computer. A computer will match up the buy/sell pairs.

I can surmise that those having seats, and perhaps the locals, may be able to call the computer directly. The rest of us will still have to go through a broker, who will in turn call the computer. To a certain extent, that will maintain the same relative degree of unfairness in the market that exists today. It will also keep the brokers rich as they will be allowed to continue to suck our blood in much the same way they do now.

I'm not talking about the broker who does research and gives trading advice or manages accounts – that broker is entitled to a commission. What I'm talking about are the discounters and even full service brokers who leech off traders who are calling all their own shots.

It would be nice, but not likely, for traders who don't need or want a broker to be extended the same trading privileges. It would be nice if any trader who was computerized and had telecommunications equipment were able to directly place an order without the need for a broker. Perhaps a write-in campaign is needed here.

Systems and methods that do not take into account the changes that are now in the making will fall apart at the seams. No one now knows the full extent of the changes that are coming or the impact they will have. But when they happen, I intend to take whatever time is necessary to adjust my personal trading to the new order. I especially feel that timing and fills will be the critical areas. I intend to trade very gingerly until I know what kind of fills will come out of the new order, and how to time my market entries and exits.

I would suggest to any full-time trader that he begin to bank a greater portion of his earnings against that time when we may all have to trade quite lightly, with reduced incomes, while we all learn how to trade in a new world.

Only partially answered at this time are questions like, will there be sessions that open and close, or will trading be continuous, and around the clock? If there are no sessions, what will happen as concerns the close? Will there be a close? If not, what will happen to all of the technical indicators that depend upon the close? What about all of the mechanical systems that focus on the close for their trading parameters? Ditto for those that rely on the open?

There are gobs of traders who look to the breakout of the open to tell them what to do. If there is no close, will there be an open?

I don't really think there will be no open or close. There will almost surely be trading sessions or segments. Certainly there must be a cut-off point at which there will be accountability.

What will happen to such staple commodities as corn, beans, and wheat? Are there suddenly going to be more traders of those commodities? That's hardly likely. But, whereas now all of the corn trading is done in one approximately five hour session, all those who trade it will be strung out over a twenty-four hour period.

There probably won't be a greater amount of more corn, and there won't be any greater amount of corn traders, but the volume of corn trading traffic will be spread out by a factor of almost five. That may make it very difficult to get good fills, as the volume will be thin.

Markets that are already thin will become paper thin if and when the trading is spread out over a twenty-four hour period. What sort of hysteria will rule the trading in these markets? What will the slippage be like? Will those off-the-floor ex-floor traders be able to run the markets – first one way and then the other?

What will happen to the volume from all the traders who now figure out their trades, call in their orders, and then go off to work? Will they still behave that way, or will they wait until they come home from work, have dinner, and then sit down in front of their screen to trade – what? – a night session, or a continuous session? Any one who has traded the night session in the bonds knows how awful it can be. Currently, it is characterized as a thin market that rarely goes anywhere.

Beyond the scope of my current thought is what will happen to such things as commercial TV while those who used to watch it sit down to trade instead of watching Monday night football. Will we turn into a world of gamblers? Who needs the lotteries when he can throw his money away on a chance to get rich in the markets?

Will the average age of traders become lower as our youth, watching their parents trade all evening, become addicted to the markets?

The impact of twenty-four hour trading has yet to be realized or measured.

When the bar chart, as we know it today, first came into existence, it revolutionized trading. Who would have thought at that time it would have so great an impact?

It brought many into the market who would never have been there at all. It made possible all of the charting services. It was indirectly responsible for all of the technical analysis that we see today, as chart watching went from merely pattern recognition to the charting of technical indicators as used today. Even candlestick charting derives from the concept of the bar chart.

Think of all the books, newsletters, advisories, and magazines that have derived from the concept of the bar chart and how to analyze it. What would followers of Andrews, Gann, and Elliott do without the bar chart?

Are we about to see a similar revolution in trading?

Because of the constant shifting and changing that concerns the trading world, and because it's impossible to place everything into a book, or even a series of books, I have started an electronic newsletter.

It is not totally an advisory, but it does offer daily trades when appropriate and a means of learning how to trade. One of its purposes is to keep my readers informed of what is happening in the markets and how it affects their trading. In the newsletter I show more trading techniques than I'm able to show in my books, and they are shown in the context of actual trades. I get into the nitty-gritty of trading. It is a teaching newsletter, and it is called Traders Notebook. 'TN' is an email newsletter, and if you don't have email, it is available by subscription and password only at www.profits.co.za Having not lived in the U.S. for several years, but if you do live there, I am not aware of whether or not it is lawful for you to take the trades described in 'TN.' I am not a registered advisor and don't claim to have ever been a CTA.

If you want to see concepts that go above and beyond my books, you should become a subscriber. You have made an investment in the books I write. The newsletter keeps that investment current and up-to-date.

Unless you want to sign up for longer, subscriptions are sold on a month-to-month basis with payment to the nearest full week. That way whenever you order you will receive that week's issues to date, and subsequent issues as long as you maintain your subscription. Prior to 1999 each year's issues are available only on paper, starting with 1991.

In this book, as in my previous book, I continue to offer my services at seminars as a tutor and educator. In a typical seminar session I teach you how to trade and how to make money from your trades. You can shortcut the slow and painful method of learning to trade by losing. You will learn to trade correctly from the beginning. You'll have fewer bad habits to break. Of course, some of you can write a sequel to this book. You can call it "Trading by the Seat of your Pants."

If you already have them (bad habits), I will show you how to break them and get your trading onto the right track. In most cases, it takes me less than an hour to figure out what you are doing wrong.

If you are interested in becoming a professional in the business and want to become licensed (you should), our offices offer the Series Three examination course at a substantial discount to what many other are charging. Ditto, if you would like the course on computer disks.

I will end this book with a piece of advice. In a sense, it will serve as a lead in for Trading Is a Business: Don't overtrade!

Don't think you have to take every trade that comes along. Wait for the very best. Wait for the pre-breakout trading congestions that are small and tight, or long and skinny. Be selective in trading. Be patient. Be very cautious in getting into a market and very easily convinced to get out. Just because you've learned a new trick or two doesn't mean that you have to trade it every time you think you see it.

When trading congestions, keep in mind that the best of the best trades come when there is a wide congestion, followed by a POP or spike, followed by a tighter congestion. Trading only those would give a winning record in the high 90's percentile.

When trading other than congestions, above all, find and stay with the trend.

Resolve to do it that way. Resolve to establish sound trading habits.

For orders, phone 1-800-476-7796

If you have any questions or comments, call (512) 249-6930 for information on how to reach me. You may fax me messages or request information by fax by dialing (512) 249-6931. I can also be reached via ross@rosstrading.com or at the Ross Trading Webb site – www.rosstrading.com

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I welcome any and all comments and criticisms of my work. I want to learn and to grow as much as anyone else. When you write nice things, it encourages me to do more for you. When you point out my mistakes, I rush to correct them and it makes it better for the next person who buys one of my courses.

If you want to further your education under the tutelage of Ross Trading, we give three day private seminars. Call our offices for seminar dates and places. These are given quarterly. Attendance is limited. A prerequisite for taking the seminar is that you must have read Trading Is a Business and either Trading by the Book, Trading by the Minute, or Trading the Ross Hook.
The first day of the seminar, my entire methodology will be presented. You will see put together as a continuous whole all the bits and pieces revealed in my books. We offer a money back guarantee: If you are dissatisfied with what you are being taught or what you feel you can learn by the end of the first day of attendance, you will receive a full refund of any money you have paid for the seminar, no questions asked.

You will receive personal attention, and time will be made for a free one-on-one consultation with you while you are here – remember to ask for it.

Once you have taken the seminar, you may take it again as often as it is given and in any place it is given for to two years. There will be no additional charge.

At the seminar, you will be shown a great many things that are impossible to get into a book. Here are some of the novel concepts you will be taught: How to neutralize the advantages the floor has over you; Several techniques for getting into a market ahead of everyone else so that their entry pushes along your position; Several techniques for taking the risk out of a trade; Techniques for buying more time for a trade without getting hurt; How to safely hold overnight positions in volatile markets; How to figure the true risk in a trade; How to engage in "Tick Banking"; how to find the trend before everyone else; and, much, much more in the way of tips and tricks to help your trading. Call Ross Trading (800) 476-7796 or (512) 249-6930 to sign up.

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