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Your Personal Trading Coach



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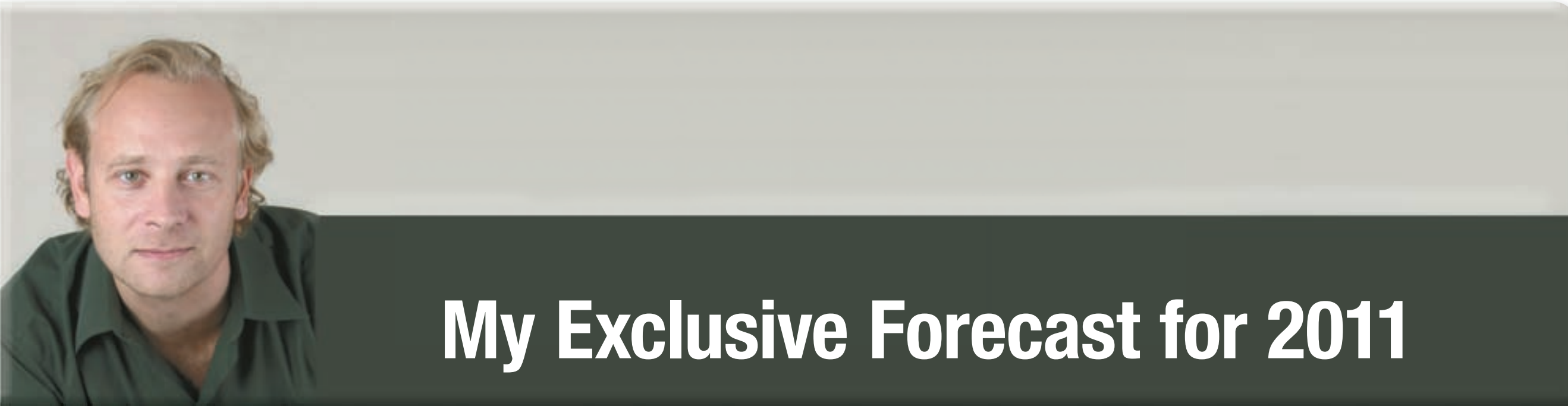
January 2011



## Trade against the Wind

When Chart Patterns Fail You Can Win

- »»» **Support and Resistance**  
That Is Why You Should Care about Them
- »»» **How to Approach Swing Trading**  
Your Way to More Accurate Trades
- »»» **Trading Diversification**  
A Free Lunch?
- »»» **Red-White-Red Pattern Trading**  
Low Risk, High Reward



# My Exclusive Forecast for 2011

On a different note: TRADERS' comes to you free of charge. This is possible because of the support of our sponsors and advertisers. So please take a good look at their messages and help them develop their business. Moreover, we are looking forward to your feedback. This is the only way to improve our magazine constantly. Please write to [feedback@tradersonline-mag.com](mailto:feedback@tradersonline-mag.com).

Every year it is the same old spiel: "In the last twelve months the markets have performed so and so, and they have done so because this or that was so and so – what else? And while we are it, that is the way it is going to be next year and so on and so forth – except if the downward scenario materialises, it's going to be the other way round." Someone out there saying all that invariably happens to be right and goes on to be the omniscient guru.

I have been exaggerating a bit on purpose in order to tell you: that you can do without that kind of show. So far the guy with the genuine crystal ball has not crossed my path yet – and even if he had he would not put his forecast in the newspaper. Or would he? Well, let us just assume a forecast does get published that everybody believes. Do you know what you could win in such a case? You guessed it: nothing!

After all, the stock market feeds on supply and demand, on buying and selling, in short on the different opinions held by all the market participants. If they are all 100 per cent sure and anticipate prices rising 20 per cent next year, it stands to reason that feelings will be running high weeks before the old year bows out. This anticipatory effect will lead to everybody pretty much agreeing around the major turning points of the market that life will go on regardless – which, thanks to the law of supply and demand, in turn causes the exact opposite to happen.

That is why my forecast for 2011 is that there will be ups and downs on the markets, that we will all have winning and losing trades as usual and once again have 20-20 hindsight. Of course! At the end of the year it will look quite simple again in retrospect – that much I can tell you today. There is

just the "tiny" problem of recognising these obvious trends just as perfectly in real time. In order to improve this skill of yours you should, above all, do one thing – trade, trade, trade and, of course, read TRADERS' because there is one forecast that already is dead certain at this stage: 2011 will see plenty of money being lost again – and won.

On this note, Happy New Year to you and may 2011 be healthy and profitable for you!

Good Trading,

Lothar Albert





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Nick McDonald is a renowned international trader. He founded [www.tradewithprecision.com](http://www.tradewithprecision.com) in 2006 to teach people his own trading strategies.





TRADERS' media GmbH is a financial markets publisher specialising in education and further education in the field of trading and stock markets. TRADERS' media was founded in April 2004. It publishes the trading magazine TRADERS' in the German (print), English (digital), and Dutch (digital) languages every month. TRADERS' magazine was founded in 2001 by market mavericks Lothar Albert and Allison Ellis. Lothar Albert is CEO of TRADERS' media GmbH and chief editor of TRADERS' magazine. Further TRADERS' editions will follow focusing on Asia (Singapore), India and Russia and coming soon in the very near future, an edition for Latin America in Spanish. For four years in a row, 2004-2007, TRADERS' has been awarded the title of World's Best Magazine for Traders by Trade2Win, an international community of traders.

TRADERS' is different and unique because we do not give any advice or recommendations on what to trade. This makes our content very different from any other market magazines. We are not interested in giving people certain buy and sell recommendations, but rather in teaching the basics of trading from the state of the beginning to the professional level.

Our magazine has established itself as a source for information and communication for elite traders in Germany, Europe and around the world. Current information about technical, mathematical and psychological aspects of the markets is discussed in professional articles and interviews. Each issue contains articles about trading strategies (for basic, intermediate, and advanced traders), risk management, technology for traders, business issues for traders, book and website reviews, and much more!

Still today, the trader-elite are interested in professional and current trading knowledge and experience. For dedicated traders, there is no need for buy and sell recommendations. Trading pros make their decisions with self-confidence and are self-contained. These people know that trading can be profitable in bull and bear markets. The question is: what are the markets and tools that lead to success? TRADERS' magazine addresses this question every month in several languages.

### Automated Trading Championship

The TRADERS' magazine is a long-term media sponsor of the Automated Trading Championship. After the previous Championships, the magazine has published a number of materials devoted to technical analysis. Methods of technical analysis are widely used in the development of Expert Advisors – programs that trade without human interference.



## MASTHEAD

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When Chart Patterns Fail You Can Win

# Trade against the Wind

Failures are the greatest teachers of any successful trader. All professional fields are replete with successfull experiences as well as failure experiences. In the trading arena, most traders are taught to build a mind-set to accept the fact that losses are as much a part of trading as winners are. Market prices rarely go straight up or straight down. Price trends experience transitional phases and consolidation periods. During these consolidation periods, prices go through trading ranges. Within these trading ranges the price fluctuates between support and resistance to form identifiable price patterns. The significance of any pattern’s success is a function of its formation size and depth. If the size and depth are not maintained then the pattern may result in a failure to achieve its projected path and price objective. Pattern analysis is one of the popular methods of projecting price movements. It also is one of the most powerful signals in pattern analysis when a setup fails to act according to its general projection. This pattern failure often triggers sharp price movements in the opposite direction of its formation. Traders familiar with pattern failures and their associated reversal trading methods, succeed more often in trading. Most chart patterns offer ways to trade their failure setups.





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**Suri Duddella**

The trained engineer and computer scientist began his trading career twelve years ago. In addition to technical analysis, he takes a special interest in market psychology. His trading approach is based on pattern trading in stocks and futures. Duddella regularly publishes his research and operates his own website. Contact: [www.surinotes.com](http://www.surinotes.com).

### Psychology behind Price Patterns

Charts show a graphical representation of historical price movements evidencing market psychology. Humans are also creatures of habit. Human emotions have massive influence in the stock market. Whether greed or want of more and fear of loss or of missing out, emotions drive the imbalance of the supply and demand equation. This imbalance of supply and demand causes prices to fluctuate. Chart patterns and technical analysis in general reflect these human emotions. Repetitive human behaviour help drive the chart patterns and therein lies price forecasting power.

### Pattern Failures

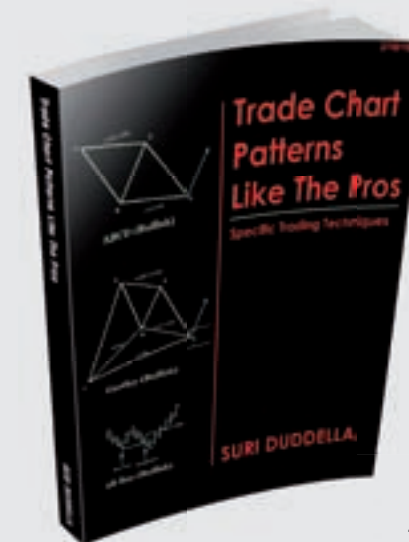
Traders use probability as a guide for chart pattern prediction. Technicians use mathematically driven pattern recognition methods, indicators, systems and great experience to predict the future price movement of an

instrument (i.e., equity, futures) chart. But most common patterns also have failure rates varying from 20 per cent to 50 per cent. For example, a well known pattern like Head-and-Shoulders only has a 70 per cent probability of making its price objective after the neckline breakout. Traders, who are familiar with its success rate, however, may use counter-trend techniques to trade pattern failures to achieve high-probability trade success.

### Pattern Types

Market prices always exhibit trend, consolidation and re-trend behaviour. They rarely reverse trends and transitional phase to turn from the previous trend on a single bar. During this transitional phase, they experience trading ranges and price fluctuations. This ranging action defines identifiable price patterns. These consolidation phases occasionally favour prevailing trends prior to their formation and continue their direction. These

## Trade Chart Patterns Like The Pros – Specific Trading Techniques



In his book “Trade Chart Patterns Like The Pros”, Suri Duddella describes a total of 65 chart patterns, including charts, entry and exit points as well as stops and targets. To provide the reader with a clearer structure and a better overall view the patterns are classified in 12 groups (bars, pivots, Fibonacci, harmonic patterns, geometric patterns, channels, bands, ZigZag, Price Action, Tops and Bottoms, exotic patterns and event patterns). All the patterns are based

on the author’s own practical experience. The book is aimed at a broad spectrum of traders – from novice to professional. This way the reader learns how to recognise a pattern and apply the appropriate techniques to open, manage and close a trade. Each of the 65 patterns includes a short and easy-to-understand summary as well as a chart illustrating the concept. For each pattern the setup and the entry and exit strategies are explained before the price targets for the profitable trades and the stop strategies for loss control are introduced. All the chart patterns, strategies and techniques are taken from outstanding books on market theories, market geometries and pattern trading which Suri Duddella has been trading and studying for many years, the results of which he has documented since 1998. “Trade Chart Patterns Like The Pros” is now the result of his years of work. It shows the specific and practical techniques as well as the way Duddella trades them. Many techniques are his own methods that are based on his own observations.



are called 'Continuation' patterns and some examples of these patterns are: Symmetric Triangle, Flags and Cup and Handle. Some phases result in reversing the prior trend and continue in reversal conditions. These are called 'reversal' patterns and few examples of reversal patterns are: Head and Shoulders, Double Bottoms and Broadening Patterns.

**Trendlines Based Patterns and Their Failures**  
In pattern analysis, the most objective way to define a breakout or breakdown is via a trend-line break. A pattern

may be surrounded by two or more trendlines connecting the successive troughs or successive peaks. If price breaks above the top trend line, it is called a breakout and if the price breaks below the bottom trendline it is called a 'breakdown'.  
Market prices tend to fluctuate between pairs of trendlines. This variation of prices between two trendlines (top and bottom) produces 'Triangles', where the two lines converge on one another (Figure 1). These triangles signal end of trends (reversal patterns like Wedges) when price trades out of the trendlines or continuation of

trends (continuation patterns like Symmetric Triangles).  
**Symmetric Triangle Formation and Its Failure**  
Symmetric triangles are continuation patterns and form when supply and demand are near equal resulting in market indecision. Symmetric triangles are identified as they form lower-high peaks and higher-low troughs. Troughs and peaks are connected by two converging trendlines forming a Symmetric triangle (Figure 2). In triangle patterns, attempts to breakout above the peaks are met by sellers and attempts to



[www.tradersonline-mag.com](http://www.tradersonline-mag.com)

F1) Trendlines Based Patterns

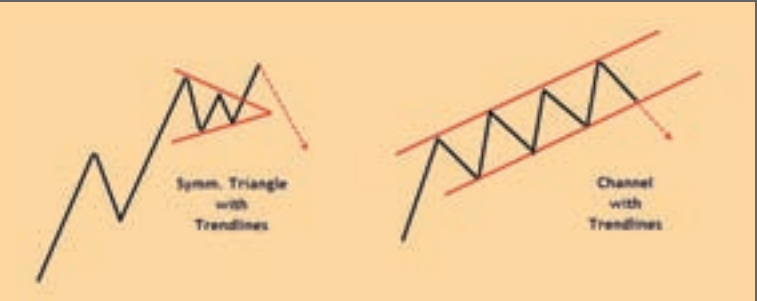


Figure 1 shows patterns surrounded by trendlines. The pattern on the left shows an uptrend rally and a pause. A series of lower-highs and higher-lows form in the consolidation are connected by two trendlines to show a Symmetric Triangle. The trendlines breakout define the price movements in the pattern. On the right a channel pattern is shown connecting higher-highs and higher-lows with upper and lower trendlines. Price trading above or below trendlines defines the next price movement.

Source: TRADERS' graphic

F2) Bullish Symmetric Triangle



Figure 2 shows the Bullish Symmetric Triangle and its targets above the trend line breakout. The swing height, vertical distance between swing 1 and swing 2 is the measured move of the pattern. When prices breakout above the top trendline, this measured move is added to the upper trendline to achieve the target. The short side goes analogously.

Source: TRADERS' graphic

breakdown below the troughs are met by buyers. Volume usually will diminish within the triangle formation. These Symmetric triangles eventually (after at least two peaks and two troughs) will result in an explosive breakout in the direction of the prior trend. Symmetric triangles in an uptrend will usually breakout to the upside. Symmetric triangles in a downtrend will usually breakdown to the downside. Symmetric triangles have at least four points (two troughs and two peaks) connected by the slanting trendlines.

**Profit Objectives in Symmetric Triangles**

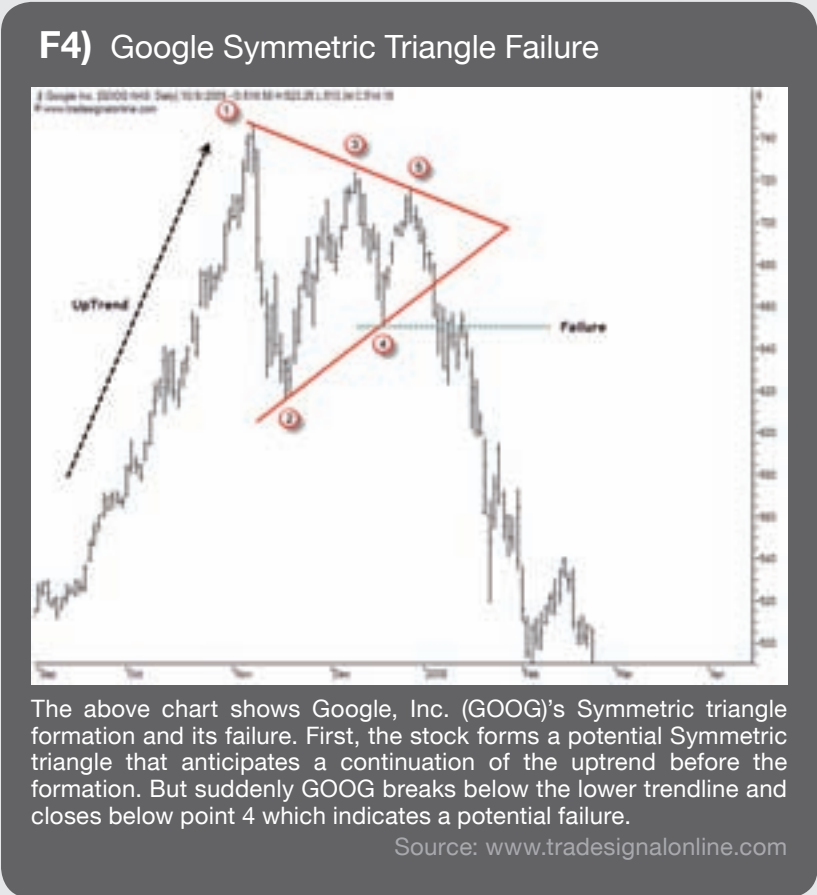
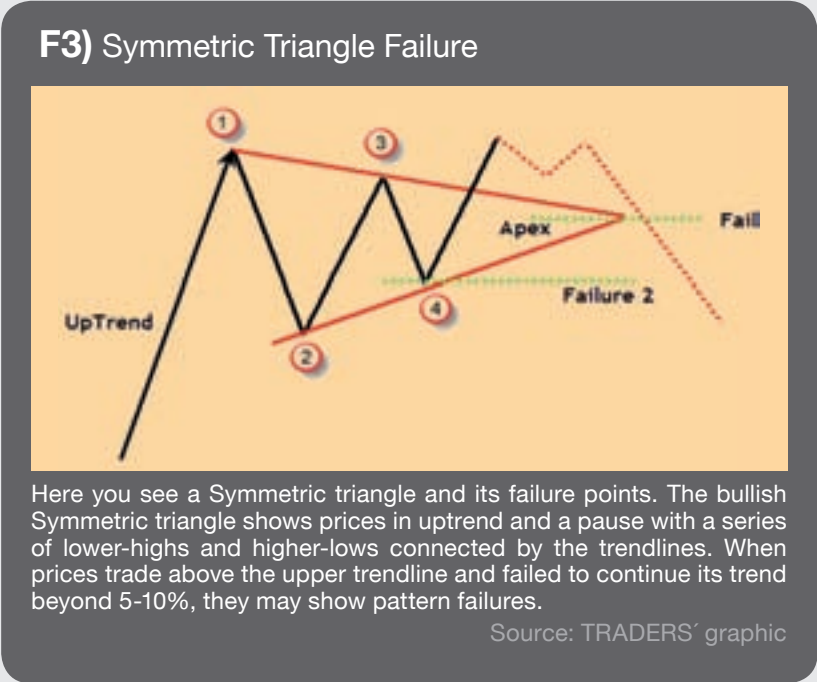
Symmetric Triangles are one of the most reliable patterns with a 70-75 per cent success rate. Symmetric triangles must be traded in the direction of their prior major trend before the pattern formation. Symmetric triangle price objectives are measured as the length of the swing (from 1 to 2) projected from the breakout or breakdown level. Symmetric triangle breakouts occur about 70-75 per cent or three quarters of the pattern distance from the left-side and they seem offer more validity.

**Symmetric Triangle Failure**  
Symmetric triangle failures occur about 25-30% of the time when the anticipated breakout or breakdown does not travel in its path. When these patterns form near tops and bottoms, they may be signaling multiple top or multiple bottom patterns.

“Symmetric triangle failures occur about 25-30% of the time.”

A bullish symmetric triangle (in uptrend) may be signaling a failure when prices break out to the upside from the upper trendline and does not follow through beyond 5-6 per cent of its price-level and trades back below the Apex level. Watch the price action around the Apex level (Figure 3). If the Apex level is broken with large-range bars and also with higher volume than breakout level, it is signaling a significant move down.  
Another form of failure occurs when many traders anticipate a triangle breakout and trade Symmetric triangles before they breakout to the upside near the trendline. In this case, the failure occurs if price closes below point 4 (for Bullish triangles) or above

point 4 (for Bearish triangles). The last level of failure points could be 2 when the entire pattern fails and may signal a flag or wedge formation. In both types of failures the targets are near major swing high or major swing low before the pattern formation (prior to 1). Figure 4 shows an example for a Symmetric Triangle Failure in Google. From September 2007 to November 2007, Google rallied in a steep uptrend from the \$500 level to \$740. Google made its first major retracement to \$620 by November 2007. A series of lower-high peaks and higher-low troughs built a potential Symmetric triangle. During December 2007, the anticipated move for GOOG was up as the prior trend before the Symmetric triangle formation was in uptrend. However, by January 2008, GOOG broke down below the lower trendline and closed below point 4 to signal a potential failure. After the Symmetric triangle failure, from breakdown level of \$640, GOOG traded around \$500 by February 2008. The measured move is its swing length (from 1 to 2) \$120. This swing length is subtracted from the failure level at point 4 (\$640) for potential target level \$520.





Head and Shoulders Pattern and Its Failure

The Head and Shoulders (H&S) pattern is a classic popular pattern and is considered to be one of the most reliable patterns. It is also considered as reversal pattern as an H&S pattern occurs near the top and near the bottom (inverse H&S). On rare occasions, they may act as a continuation pattern of the prior major trend if the pattern forms in the middle of the trend. An Inverse Head and Shoulders pattern is formed with an upside down H&S formation.

As the name suggests, this pattern has a Head and two shoulders on each side (left and right). A neckline is drawn connecting the bottom of the Head with the bottom of the shoulders. Volume usually diminishes in each segment and increases at the breakout or breakdown levels. After breaking out, price may retest the neckline as a throw-back and this neckline now may act as a resistance line.

Price Objectives in Head and Shoulder Patterns

The H&S pattern price targets are computed as the perpendicular distance (measured move) from the top of the head to the neckline, and subtracted from the Neckline level (Figure 5). In case of Inverse H&S pattern, this measured move length is added to the Neckline level.

Head and Shoulders Pattern Failure

The H&S pattern is one of the most reliable patterns with about 70 per cent success rate in trading below the neckline and achieving its price targets. About 25-30 per cent of H&S Patterns fail and price may break below the neckline but on its retest of the neckline it will continue trade higher. This reversal may signal pattern failure. When H&S patterns fail, the failed pattern is much more explosive and trade much higher above the high of the 'Head'. There are two ways to determine if an H&S is a failure. The first failure point is if price is trading above neckline and also above the trendline connecting the high of the 'Head' to the high of the 'right shoulder'. If price is trading above this trendline, usually it is signaling H&S Failure. The second failure is signaled when price trades above the second shoulder's high (rising from the neckline). Most H&S failure setup trades are more profitable than trading the H&S pattern itself. The profit objective is computed as the perpendicular distance from the top of the head to the neckline, which is added to the failure point (1).

Figure 6 shows an example for a H&S Pattern Failure. From December 2007, Expedia Inc. (EXPE) sold off until January 2008 from a high of \$35 to a low of

\$22. From January 2008 to May 2008, EXPE made a few attempts to rally and formed an Inverse Head and Shoulders pattern. The head was formed near \$20 while the neckline was formed around \$25. After a series of attempts to break the neckline, in May 2008, EXPE started to breakdown and closed below the low of the right-shoulder at around \$23. This is the first signal of a potential H&S pattern failure. The second failure occurred when price traded below the lowest low of the two shoulders at around \$22. By July 2008, EXPE traded below \$18.

Conclusion

In Technical Analysis, Pattern analysis is somewhat complex yet gains the most respect and promises the best results. Patterns provide a defined way to trade charts with clear objectives of its projected price movements. Patterns also fail as there are no perfect patterns or patterns that work all the time. Pattern failure also generates powerful signals as the price movement in the opposite direction is much sharper and decisive. Traders can profit from knowing the pattern failure points and their counter-trend trading techniques.



F5) Objective in Head and Shoulder Patterns

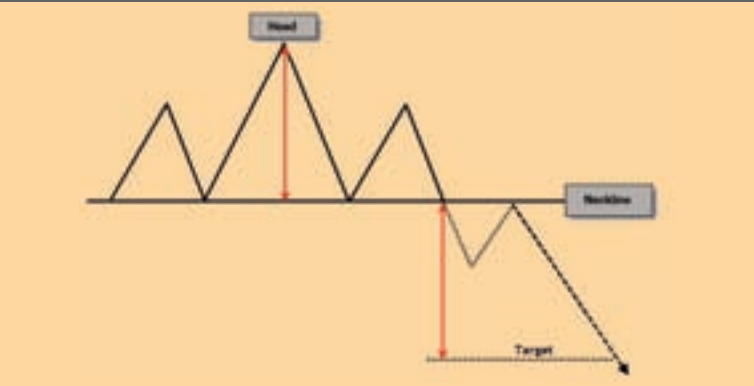


Figure 5 shows Head and Shoulders pattern and its targets. The vertical distance from the top to the neckline is the measured move of H&S. When prices breakdown below the Neckline, this distance is subtracted from the neckline level to compute the 'Target.'

Source: TRADERS' graphic

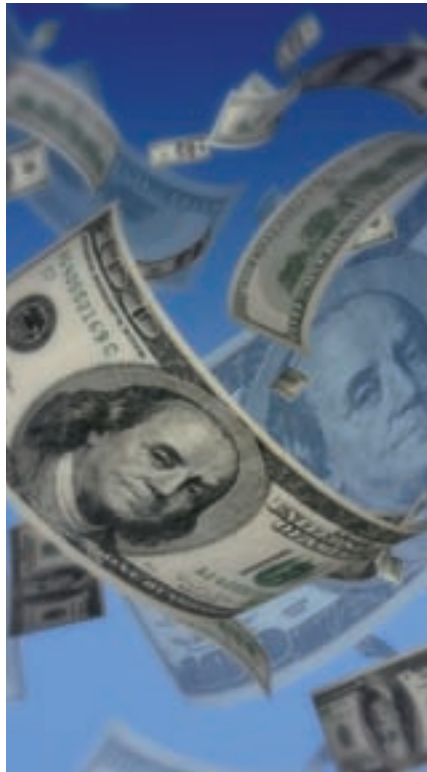
F6) Head and Shoulders Pattern Failure in Expedia



First the above chart forms an Inverse Head and Shoulders pattern. After several attempts to break the Neckline the stock drops and closes below the right shoulder's low (first failure signal). After that the price drops below the lowest low of both shoulders (second failure signal).

Source: www.tradesignalonline.com





### Daily Forex Turnover: \$4 Trillion in 2010

According to a triennial central bank survey by the Bank of International Settlements (BIS), global foreign exchange market turnover was 20% higher in April 2010 than in April 2007. The average daily turnover of the forex market has risen to \$4 trillion compared to \$3.3 trillion three years ago. According to the BIS, the growth is coming from the spot market, which surged by 48% over the period. The spot market represents 37% of foreign exchange market turnover. The center of the forex universe continues to be the United Kingdom, despite the lingering dominance of the U.S. dollar on world markets. Banks in the United Kingdom were responsible for 37% of all foreign exchange market turnover. Banks in the United States contributed 18% of forex volume.

Source: [www.futuresmag.com](http://www.futuresmag.com)

### The London Investor Show FOREX: Friday, 25th February, London Olympia



Traders around the world make big profits, day and night, trading currency. The FX markets are open, 24/7, and billions of dollars are traded every single day. Attend the London Investor Show FOREX to find out how you could make money trading currency. Whether you are already an active FX trader, or just starting out, the London Investor Show FOREX will help you build confidence and trade with success. Choose from five, independent hour-long FX workshops – from an Introduction to Forex, through to advanced Elliott Wave Theory, How to Create Your Own Forex Trading System to Psychology of Forex Trading; take a seat at the live, Lunchtime Summit

where a panel of market experts debate trading stocks versus trading forex; attend one of many free seminars running throughout the day and take some time to meet and speak to the exhibiting companies that have the products and services to help you maximise your trading potential. Speakers include Kym Watson (EzeeTrader), Alan Rich (ClicktheMarkets), Lee Sandford (Trading College), Rakesh Shah, Sandy Jadega and Alpesh Patel. The London Investor Show FOREX takes place on Friday, 25th February at London Olympia. For full details, please visit the website [www.londoninvestorshow.com](http://www.londoninvestorshow.com). Tickets to the London Investor Show FOREX cost £25 each and include your free Delegate Welcome Pack (worth over £100), plus your copy of the London Investor Show FOREX Event Guide, and your access-all-areas VIP pass. As a subscriber to TRADERS' magazine – you can claim a free ticket, and one free FX workshop, together worth £50! Simply use the special voucher code "TRADERS" when booking online at [www.londoninvestorshow.com](http://www.londoninvestorshow.com).

## The Zanger Report



- Swing Trading
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- Pivot Points
- Key Reversals
- Chart Patterns

## Dan Zanger's

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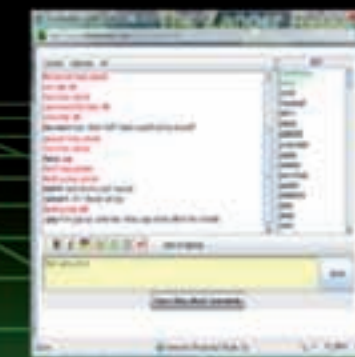
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## CME Group Launches New E-micro Forex Contracts

CME Group will launch three new E-micro Forex futures contracts: CAD/USD, CHF/USD and JPY/USD. With the addition of these new contracts, CME will now offer nine E-micro Forex futures. The three new E-micro Forex contracts along with the three previously offered U.S. denominated currency pairs (EUR/USD, GBP/USD and AUD/USD) allow for perfect offsets with corresponding standard-size FX futures on a 10:1 ratio, as well as one lot hedges with Dow Jones CME FX\$INDEX futures contracts. E-micro Forex futures are physically delivered and one-tenth the size of our standard FX futures contracts, making them attractive to Active Individual Traders, Proprietary Trading Firms and Commodity Trading Advisors (CTAs). The contracts will be exclusively traded on the CME Globex electronic trading platform. The CME FX product suite will consist of 52 futures and 31 options based on 20 currencies. CME FX volume averages 930,000 contracts per day in 2010, up 49 per cent versus 2009, reflecting an average daily notional value of \$120 billion. November E-micro Forex futures average daily volume was more than 7800 contracts, up nearly 115 per cent compared to November 2009.

Source: [www.cmegroup.com](http://www.cmegroup.com)



## EU and US Seek Stronger Regulation of Energy and Commodities Markets

Investors world-wide have invested more in commodities than ever before and politicians are now worried that this could lead to problems down the road and are considering whether stronger regulation is required. Hedge funds, pension plans and private investors have dramatically increased their investments in commodities such as natural gas, wheat and sugar. In many cases, commodities futures contracts have exceeded highs not reached since the middle of 2008 when the role and influence of speculators was hotly debated. The volume of contracts for commodities futures has grown twelve per cent since just October this year and stands at over 17 per cent of the highs reached in July 2008. Speculative investors are making up a greater share of market participants in some commodities markets, such as the \$200 billion crude oil market, than in 2008. They have increased their long positions by 24 per cent and make up a 16 per cent share of market participants as compared to 13 per cent over two years ago. Speculative holdings in copper since the same time period have increased by 58 per cent and in silver, 52 per cent. US commodities market regulator, CFTC is now under pressure thanks to the recently passed Dodd-Frank Reform bill, to set position limits for individual investors in the energy and metals markets. European regulators are also concerned and the EU commission is seeking to prevent future abuse and insider trading with clear and concise regulation. The commission recently proposed a measure to promote more transparency in the energy markets.

Source: [www.boerse-go.de](http://www.boerse-go.de)



## NFA Publishes Guide for Retail Forex Traders

The National Futures Association (NFA) announced that it has published a revised edition of its popular investor education booklet for consumers

interested in the retail off-exchange foreign currency (forex) market. The revised publication, now entitled "Trading Forex: What Investors Need

to Know", describes how the retail forex market operates, the risks involved in trading forex and how the market is regulated. The guide also includes a glossary of terms.

"We revised the publication to reflect the Commodity Futures Trading Commission's retail forex rules, which became effective on October 18," says NFA's Director of Communications and Education Larry Dyekman. "Among other things, the rules now require any retail forex introducing

broker, money manager or pool operator to register with the CFTC and become Members of NFA. We believe that consumers should learn as much as they can about the market and how it is regulated before opening a forex trading account."

Single copies of the guide will be offered free of charge to the investing public. Individuals may order a free copy of the publication by calling NFA's Information Center at 312-781-

1410 or 800-621-3570 or by emailing NFA at [information@nfa.futures.org](mailto:information@nfa.futures.org). Individuals also have the option of viewing and printing the publication by downloading it from the Investor Information section of NFA's website ([www.nfa.futures.org](http://www.nfa.futures.org)). NFA is the premier independent provider of innovative and efficient regulatory programs that safeguard the integrity of the futures markets.

Source: [www.futuresmag.com](http://www.futuresmag.com)

## US Companies Sitting on \$1.3 Trillion in Cash – Asia Leads World-Wide

According to Thomson Reuters, companies world-wide are holding up to \$4.3 trillion in cash and short term investments. Asian companies top the list with up to \$1.88 trillion. Runners-up are US firms with \$1.3 trillion followed by European enterprises at \$1.17. This represents the highest cash reserves

as a percentage of total assets held by companies in 20 years. Topping the list of cash rich firms listed by Reuters are China Mobile with \$42.7 billion followed by Microsoft at \$33.5 billion and Google at \$31.3 billion. Distantly following are Apple at \$25.6 billion and Cisco Systems at \$23.6 billion. Market observers

widely believe that firms will use these reserves to buy back shares or to finance takeovers. Although, as Senior Strategist Ad van Tiggelen of ING Investment Management in The Hague remarked, there is a noticeable hesitance to commit excess cash reserves at present.

Source: [www.boerse-go.de](http://www.boerse-go.de)



## Skyscrapers, Optimism and the Economic Crisis

What does building skyscrapers have to do with the economic crisis? A lot, according to a new study by Professor Gunter Loeffler at the University of Ulm, Germany. When architects stick their heads in the tops of the clouds, investors need to take cover. It is not the first time in modern economic history that visionary building projects been undertaken in the midst of fiscal turmoil. The best example was the 610 metre tall Chicago 'Spire' which began building in 2007 before the beginning of the present crisis. But since autumn 2008 the site has laid still, a victim of the deepest world-wide recession in decades. Taken down with another victim, the scandal plagued Anglo Irish bank.

Another example is following the ground breaking for the Singer building in New York in 1906 came the "panic of '07". Then a good 20 years later work began on the Chrysler building and the Empire State building...then came the Great Depression. And in 1998 as the Petronas Towers in Kuala

Lumpur were being built, came the Asian financial crisis.

Just coincidence? Not according to Gunter Loeffler. He sets forth a clear pattern: After the beginning of the construction of a record breaking skyscraper, yields on US stock markets dramatically decrease with clear regularity. Three to five years after ground breaking yields are down ten per cent from the year in which construction on the new skyscraper began. Loeffler views record breaking skyscrapers as an indication of excessive optimism and a lack of regard for risk. The correlation is so clear that the beginning of the construction of record breaking skyscrapers can be viewed as a very reliable leading indicator of the development of stock market performance, surmises Loeffler. Skyscrapers are even more suitable for forecasting stock markets than many other traditional key numbers such as dividend rates.

Source: [www.handelsblatt.com](http://www.handelsblatt.com)



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A Guide to Picking Stock Market Winners – Part 2

# How Stock Chat Can Be a Trader's Best Friend

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Sometimes they are called Forums, other places they are called Stock Chat Rooms, I call them Bulletin Boards or BBs. Whatever you call them; stock chat is a huge resource for the trader.





### The Popularity of Stock Chat Forums

Investors love gossip and chat. Considering stock markets were formed in coffee houses of the 17th century it should be no surprise. Investing is fun and trading more fun still. This is why even when people lose money they keep coming back for more. There are plenty of boring investments, but the reason that stocks are the subject of constant news is they are interesting. This is reflected in the popularity of stock chat forums. There should be, and there are, plenty of ways to trade chat sentiment as it provides a good insight into stock direction if you know how to read the signs.

The first thing to understand is stock chat should never be believed, at least not without a fair amount of research. Anything written should be taken with a big dose of scepticism. People post on the internet about stocks they own or are short on and will exaggerate, distort and lie in addition to being plain wrong. A bulletin board is not like a newspaper, there is no editor and no filter between the hundreds of thousands of posters and you. Like any river of gold there is a ton of dross for every ounce of gold nugget.

### Two Methods for Using Bulletin Boards in Your Trading

The following are two methods to find companies worth looking

to trade. Traders love volatile stocks and shares which have the possibility of big rises, but there appears to be a sharp split between the good prospects and the bad.

### Way 1 – Silence Is Golden

If you find that a discussion on a stock you are interested in is muted this is an extremely good sign. People talk a lot about stocks when they are unsure or when they think their investment needs a shove in the right direction. A solid stock attracts a solid kind of investor and while they like to communicate, they generally are not the manic kind of people that inhabit many of the forums internet boards have to offer.

Successful investors are also likely to be well off and this again tends to keep the noise level down. They have little to prove and are merely dipping their toes into a board about a stock they own and have no desire to cause a fuss. It takes a bit of time to get the hang of bulletin boards, but once you have spent a few hours surfing, you will note how some threads are madness and some are sedate. The more sedate the better. If you are planning to trade a stock on the long side, a calm BB is a good sign that there is a high degree of certainty coming from the company. This is particularly useful if you are



Clem Chambers

Clem Chambers is CEO of ADVFN, a financial market website ([www.advfn.com](http://www.advfn.com)).

### F1) AEterna Zentaris (AEZS)



This stock was recommended on the web as being attractive on 01 June at \$1.69.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)



trading a dividend payment where you are hoping that the share will recover quickly after the pay-out.

### Way 2 – Madness Is Badness

When you find a share which is the topic of furious debate on a bulletin board, whatever you do, do not buy it. The noisier the thread, the more virulent the language, the more colourful the debate, the worse the prospects are for the company.

Dying companies attract the attention of the worst investors. These investors buy stock in failing companies like lemmings pole vaulting off a cliff. They voice their desperate bullishness as

they plummet to the rocks below. There is some justification for this, as a disastrous stock has a tiny chance of coming, Lazarus-like, back from the dead and if it does, its share price will rocket.

This 100 to one chance of making ten times your money is what attracts the stock trader moths to the trading flame. To them, the attraction of a possible 1000 percent profit dwarfs the fear engendered of losing 99 times in a row to get one fat win. They believe that wild posting will help the company survive on the basis that bad sentiment will doom the company and as such good sentiment will save it.

They think by being ridiculously positive they can help a company make a comeback.

In some cases holders who are looking at big losses will also try ramping the stock. It is a desperate tactic and one with little chance of succeeding. Meanwhile, denigrators are attracted to the failing company to crow and 'troll'. Some people love to kick a company when it is down. The consequent uproar is guaranteed. If you are plucky, you will short the stock and watch the spectacle of dozens of dizzy stock gamblers lose their shirts. A mad BB is a very strong signal indeed that the end is nigh for a stock. At the

extreme end, when companies start suing BB operators, this is yet another sure sign that the company is in big trouble.

However it is a tricky game, because companies on the cusp of disaster can become very volatile and jump up and down by large percentages. Yet, there is no need to go in with a big position as there is always a broad selection of companies in the dog house to spread your trading across and thereby have the benefits of diversification.

### Conclusion

These are just two ways to trade internet stock chat, but there are

many more besides. In addition to the fun element of the helter-skelter of internet forums, there is the ability to use internet chat as a starting point for research. As company discussions bubble up, the chat is a good place to start your 'due diligence'.

As long as you keep all your critical functions fully engaged and treat stock chat with a huge pinch of salt then bulletin boards are a massive resource for the trader and this is why they keep growing larger with every passing day.



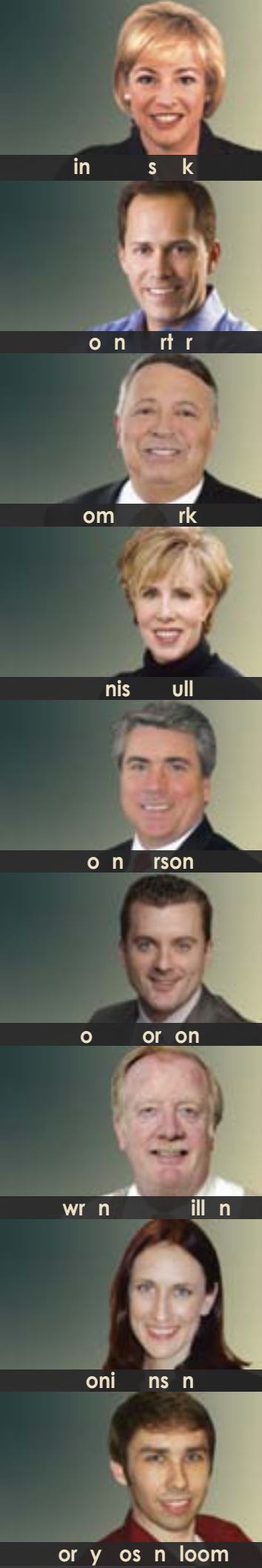
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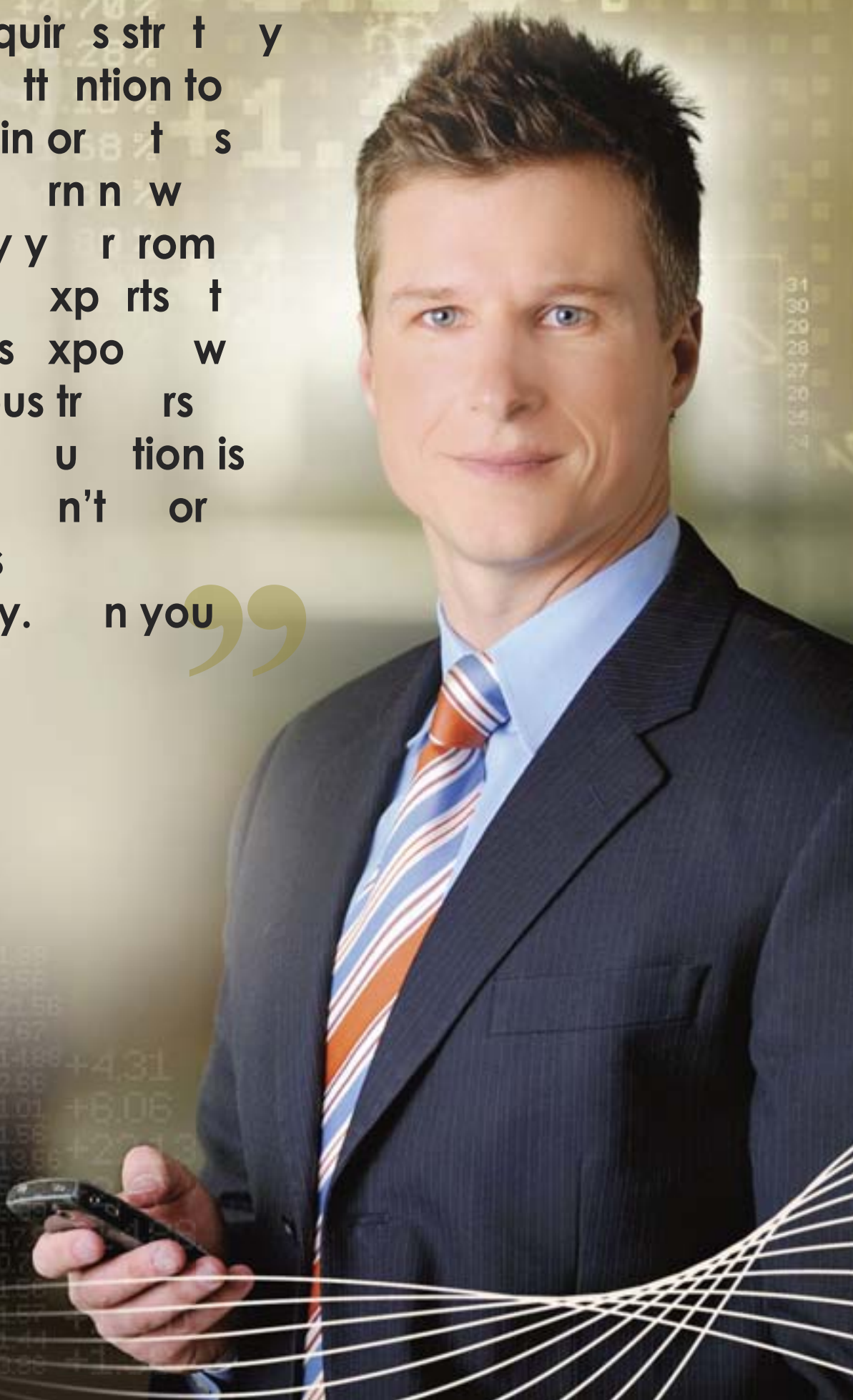
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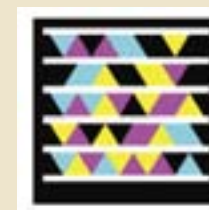
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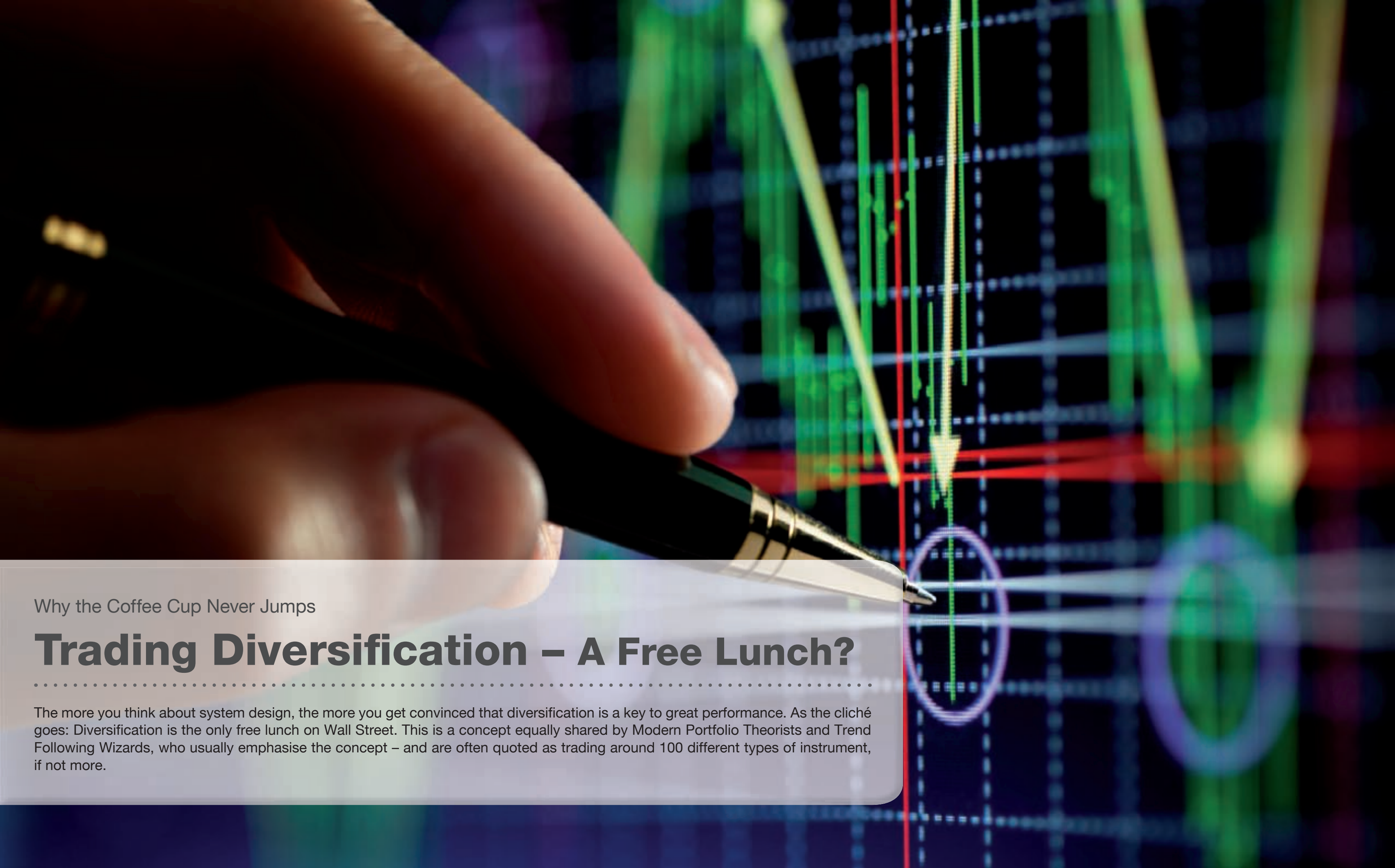
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Why the Coffee Cup Never Jumps

# Trading Diversification – A Free Lunch?

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The more you think about system design, the more you get convinced that diversification is a key to great performance. As the cliché goes: Diversification is the only free lunch on Wall Street. This is a concept equally shared by Modern Portfolio Theorists and Trend Following Wizards, who usually emphasise the concept – and are often quoted as trading around 100 different types of instrument, if not more.



### Jez Liberty

Jez Liberty is a System Trader and Developer with a keen interest on researching Trend Following from a quantitative angle. He shares his research on the Au.Tra.Sy blog (Automated Trading System – <http://www.automated-trading-system.com>). He has been living in London for the last eight years, also consulting as an IT professional for software companies and the banking industry.

A potential trend following portfolio may contain a decent level of diversification with around 50 instruments (please find a shortlist in Table 1). I wanted to use this as a base to check the impact of diversification on performance. The idea is to run the same strategy using a subset of the portfolio (i.e. less instruments = less diversification) and see how it performs.

The problem, though, in selecting a subset of instruments out of the 51 in the original portfolio is that it could affect performance in the same way as any portfolio selection can (i.e. you could obtain vastly different results in trading the same system with two different sets of instruments, just by virtue of a “lucky” pick of strong performers).

### Historical Performance

First, let's get a reference point and look at the historical performance of the system chosen for this test: the 20-50 Moving Average system. You can see the performance back-test of that system over the last 20 years with the original portfolio

of 51 instruments in Figure 1 (next page). The Compounded Average Growth Rate (CAGR) is 29.68 percent and the Maximum Drawdown 43.60 per cent. This result was achieved with 3629 trades without taking transaction costs or slippage into account.

### Tests with Less Diversification

As mentioned above, the idea is to work on a subset of instruments and compare the results with the initial portfolio. To avoid any sort of data mining/hindsight bias in the portfolio selection, I decided to run a Monte-Carlo-like approach to test the system with multiple instrument subset combinations: instead of picking a single portfolio subset of 25 instruments, I will run the system over 1000 different sub-portfolios, chosen randomly.

In order to get an idea of how gradually diversification affects the performance, I ran the test in three steps:

- Step 1: sub-portfolio of 15 instruments
- Step 2: sub-portfolio of 25 instruments

### T1) Trend Following Portfolio

Symbol	Futures Description	Exchange
BP	British Pound	CME
C	Corn	CBT
CD	Canadian Dollar	CME
CFC	Arabica Coffee	BMF
CL2	Crude Oil Light	NYMEX
CT	Cotton #2	NYCE
EBL	Euro German Bund	EUREX
EOX	OMX Helsinki 25	EUREX
ESM	Swiss Mid-cap Index	EUREX
FEI	EURIBOR-3 Mth	EURONEXT
FFI	FTSE 100 Index	EURONEXT
GC	Gold	COMEX
HG	CopperHG	COMEX
ICL	Crude Oil-WTI	ICE
IND	Ibovespa Index	BMF
JK2	Kerosene	TCE
JP6	Palladium	TCE
JTI	TOPIX Index	TSE
JY	Japanese Yen	CME
KTB	Korean T-Bond(3 Yr)	KOFEX
LC	Cattle-Live	CME
MPX	IBEX 35 Index	MEFF
MP	Mexican Peso	CME
NG2	Natural Gas-Henry Hub	NYMEX
SB	Sugar #11World	CSCE
S	Soybeans	CBT
SF	Swiss Franc	CME
SI	Silver	COMEX
STW	MSCI Taiwan Index	SGX
SXE	DJ Euro STOXX 50 Index	EUREX
US	T-Bond-U.S.	CBT
YTC	Australian Govt Bond 6%(10Yr)	SFE

This is a shortlist of the original trend-following portfolio that contains 51 instruments.



- Step 3: sub-portfolio of 40 instruments

All instruments are picked at random from the list of 51 instruments in the original portfolio (Table 1).

Each of the 3000 runs generated a full system performance record. The CAGR and Maximum Drawdown for each instance are plotted as well (Figure 2). The original system is also represented as the yellow dot. Note that the “portfolio randomiser” did not account for any logic in terms of sector allocation. The original portfolio is balanced over several sectors

(currencies, energies, rates, agriculturals and so on) and there is no account for correlation between the different instruments (obviously correlation plays a big role in diversification: there is not much point in having dozens of instruments if they are all strongly correlated). However, over the large number of simulations, the main ideas of the test still come through.

Another point is that the only difference between the different runs were regarding the position sizing of each trade (fixed fractional), which were adjusted to obtain results of similar magnitude in each test (a

portfolio with less instruments will require a slightly higher position size to match the return/drawdown rate of a portfolio with more instruments).

Looking at the plot chart, there are two main observations:

- 1) We can see the gradual effect of diversification improving the system results by “moving” the cloud of performance points towards the left (less drawdown) and up (more return).
- 2) The other observation is that the more diversification there is, the lower the deviation in the system results – therefore

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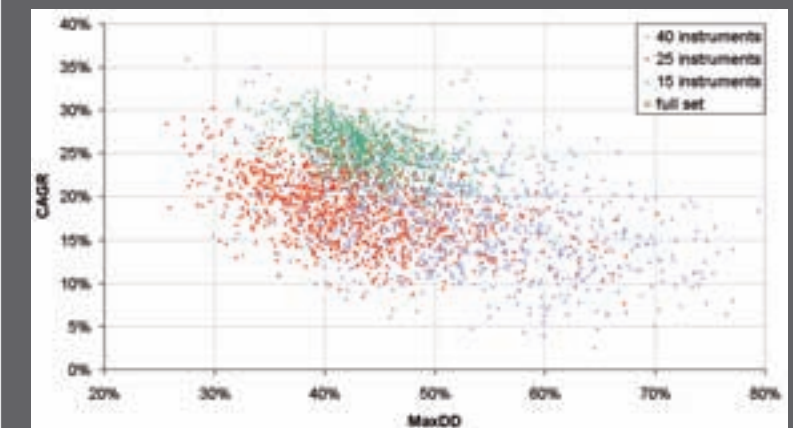
### F1) Equity Graph



This is a logarithmic equity graph of the performance back-test of the 20-50 Moving Average system over the last 20 years with the original portfolio (51 instruments).

Source: [www.tradingblox.com](http://www.tradingblox.com)

### F2) Scatter Plot



Here you can see the results of all simulated runs.

Source: [www.tradingblox.com](http://www.tradingblox.com)

providing more robustness and less chance of data mining impact from portfolio selection on your back-tests.

**Diversification or Why the Coffee Cup Never Jumps**

That last point makes me think of an example discussed by Nassim Taleb in his Black Swan book, explaining the averaging of randomness: “Yet physical reality makes it possible for my coffee cup to jump – very unlikely, but possible. Particles jump around all the time. How come the coffee cup, itself composed of jumping particles, does not? The reason is, simply, that for the cup to jump would require all of the several trillion particles to jump in the same direction, and do so in lockstep several times in a row. This is not going to happen in the lifetime of this universe.”

Every trade/instrument can be seen as a particle composed of a (large) random element and a smaller edge that we try to extract via a mechanical system. A portfolio composed of too few instruments would be like drinking your coffee or tea from a cup made up of only a few particles: cups would be jumping around everywhere, making coffee drinking a perilous venture. Same concept applies to trading.

This is the way I see diversification: by adding a large number of mostly random

elements, you can ensure that random moves have some cancelling effect on each other so that your “trading cup” never jumps. All that is left is to collect the small edge from all the instruments via your preferred trading strategy(ies). In effect, this is how casinos operate – and with diversification you somehow get to be the house!

**Other “Layers” of Diversification**

The examples presented above deal with diversification from the point of view of a diversified portfolio of instruments.

However there are different ways to implement diversification in a mechanical trading programme by trading different systems or variation of systems:

- Number and type of instruments contained in the portfolio (as illustrated above)
- Time-frames traded (the Moving Average systems can be traded on a range of different time-frames ranging from short to long-term).
- Indicators used in systems (for example a Trend Following systems can use Moving Averages as well as Donchian or Bollinger Band Channels – using different systems with different indicators will produce slightly different results).
- Types of trading systems (combining a Trend Following

system with a Mean Reversion system or Price Pattern system).

A combination of the different types of diversification identified above is probably the best way to improve performance. One problem is that diversification on all these levels brings on an increase in required starting capital (one likely reason why most successful Trend Following Funds/Commodity Trading Advisors (CTAs) have a minimum managed account size in the millions). So you might have to make a choice in how to apply diversification.

**Final Words**

As diversification is really beneficial thanks to the non-correlation it brings, diversifying across different systems could be a good idea, as systems can be more or less “engineered” to be un-correlated to each other (i.e. a Trend Following system with a Mean Reversion system).

It is also possible to “trade” a large portfolio without taking all the signals (by using filters or an overall risk/size limiter). After all, this is something that Richard Dennis’ Turtles used to do (when they were at full position size they had to skip signals).



**Why the Coffee Cup Never Jumps**

“Yet physical reality makes it possible for my coffee cup to jump – very unlikely, but possible. Particles jump around all the time. How come the coffee cup, itself composed of jumping particles, does not? The reason is, simply, that for the cup to jump would require all of the several trillion particles to jump in the same direction, and do so in lockstep several times in a row. This is not going to happen in the lifetime of this universe.”





## The Evolution of Technical Analysis

# Dow Theory Applied Intraday

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Technical Analysis has evolved from hand drawn charts to electronic direct access trading (DAT) systems. Even with DAT systems reflecting price moves, human nature may question how the Dow Jones Average can be trading over 11,000 considering the sluggish economic outlook following the Global Credit Crisis. Charles Dow's approach was developed during the financial crisis of 1890s and the Dow Theory Tenets factor in Macroeconomic Data that affects the financial markets. Understanding the past gives insight to the present.

### The Origin of Dow Theory

Technical analysis of the financial markets originated with the theories of Charles Dow (1851-1902), founder of Dow Jones and Company and the Wall Street Journal. Charles Dow described the correlation between the stock market and business cycles of the late 1800s in the midst of the financial crisis of 1893. The railroad expansion led the United States economic growth between the 1870s and 1880s. The railroad industry accounted for 15 to 20 per cent of the total national investment. The industry peaked in 1887 and fell off into a steep

decline and the growth rate of the industry could not be sustained. Unsatisfactory earnings and a low return for investors signaled an economic slowdown and affected the United States economy. Deflation, monetary policy, increasing production of domestic goods, and decreasing consumption of domestic goods, led to high unemployment and an economic recession.

During the recession of 1890, European investors withdrew from the United States markets devastating the US banking system and stock market. As the gold supply increased,





**Tillie Allison**

As an instructor for Online Trading Academy, Tillie began teaching following the financial disruption of 2007. Her goal is to educate students on the realities of the markets and to teach students how to develop a skill set to successfully trade the markets. She is a member of The Market Technicians Association, The Certified Financial Planning Board of Standards, has an Associates Degree in the Applied Science of Real Estate, and a Bachelors Degree in Business Administration.

confidence in banking and currency further declined. In response to the crisis, in 1891, the federal treasury began to redeem government bonds, putting money into circulation and improved production of agriculture, which led to a brief cycle of domestic prosperity. The efforts of the federal treasury in 1891 delayed the inevitable inflationary recession.

An average of 15,242 businesses failed averaging \$22,751 in liabilities. The contraction of credit resulted in business liabilities estimated at \$357 million. During the midst of the financial crisis of 1893, Charles Dow noted that business mergers began taking place on Wall Street, resulting in the formation of corporations and these corporations sought markets for their shares. Charles Dow developed the Dow Jones Industrial Average (twelve industrial stocks), and advised investors through editorials in the Wall Street Journal in 1896. Meanwhile, the treasury was driven four times between 1894 and 1896 to resort to bond issues totaling \$260 million. The Dow Jones Industrial Average traded at a low of 28.48 during the panics of 1896, 1901, and 1907, and rose to a high of 381.17 in 1929 following World War I earning significant gains for investors despite economic uncertainty.

### The Basic Tenets of Dow Theory

The Charles Dow analysis of price was derived from 255 Wall Street Journal editorials. Dow Theory is the analysis of stock market trends. There are six basic tenets of Dow Theory:

- There are three classifications of trends.
- The averages discount everything (except “acts of God”).
- The principal of confirmation.
- Volume goes with the trend.
- Only closing prices are used.
- The trend persists.

Technical analysts consider Dow Theory’s definition of a trend, as the main premise of modern technical analysis. Dow Theory has since been applied to the S&P 500 and over 5000 rules have been applied to actively trade the S&P 500. The principles of Dow Theory are simple to understand and multiplicities of technical indicators have been developed to confirm trend analysis including a variety of indicators of trend and oscillators of price to identify oversold and overbought market conditions.

### Dow Theory Tenets and Short-Term Trading

Dow Theory is the foundation of chart interpretation and applies



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to stocks, financial markets, commodities, and investment products. Dow determined that the market moves as an ocean in three waves, called primary (tides), secondary (waves), and daily fluctuations (ripples). Short-term intraday traders seek to profit from short-term moves which are inherent price movements of the larger timeframes. The long and short-term price moves have been defined in the study of the Wave Principle. The Wave Principle has gained popularity and intraday short-term traders trade in the direction of the underlying longer term time frame.

To increase the probability of success, many intraday traders specialise in index funds to avoid the “unusual” moves in a single stock recognising the theory that the averages discount everything. The S&P 500 E-mini Futures Index is popular among active intraday traders (average daily volume exceeds two million contracts).

The principal of price confirmation is applied intraday to the S&P 500 E-mini Futures Index in comparison to the NASDAQ E-mini Futures which usually lead the S&P 500 E-mini Futures. See Figure 1, an intraday five-minute chart of the S&P 500 E-mini Futures (red line chart, symbol ES)

and the NASDAQ E-mini Futures (black line chart, symbol NQ). The NQ is making higher highs at 12:40 CST and led an eight point end of day rally for the ES as seen in Figure 2, recognising the principle of confirmation.

**Dow Theory is the foundation of chart interpretation**

In addition to price confirmation as seen in Figure 1, volume confirmation and volume divergence is used intraday to confirm trends. The volume surge at 8:30 CST led a three point rally for the ES. As price continues to rise, the declining volume (negative divergence) after 8:35 CST warns intraday traders to take profits and prepare for a reversal at 9:00 CST, recognising the fourth principle of Dow Theory, Volume goes with the trend.

When making decisions intraday, the intraday trader must have a defined set of rules to increase the probabilities of success and interpret price correctly. The closing price of the period analysed prevents intraday traders from reacting prematurely to the fluctuations of price. When analysing a five-minute chart,

wait for the five-minute period to close. Consequently the analysis made for the ES and NQ were made at 8:30, 8:35, 9:00 and 12:40, recognising the fifth principle of the Dow Theory: Only closing prices are used.

The impulse uptrend from 8:30 CST to 9:00 CST is the primary trend which will persist. The trend from 9:05 CST to 12:40 is the corrective phase of a trend. The end of day rally from 12:40 CST

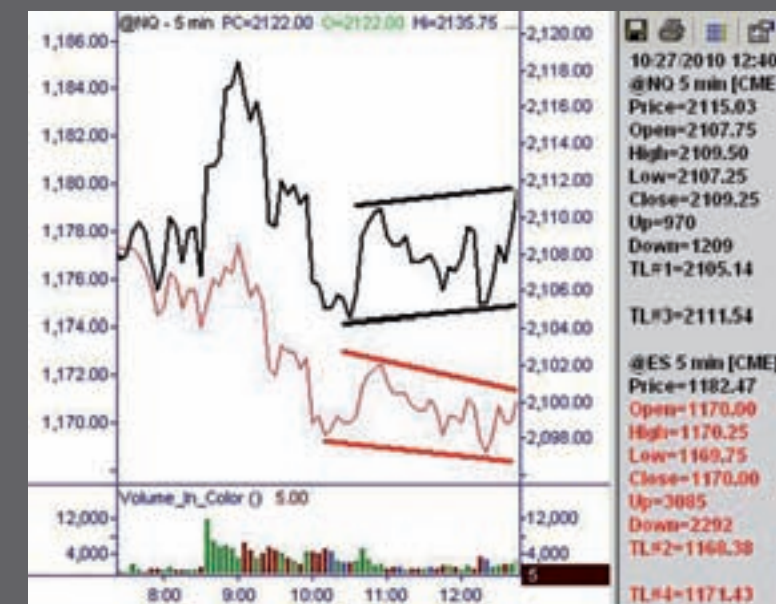
is a continuation of the primary trend, an uptrend recognising the sixth principle of the Dow Theory, trends persist.

### Conclusion – Interpreting the Dow Theory

Charles Dow used the price of a market to determine if it was undervalued or overvalued and if the trend would continue. Although his research and conclusions were published over 100 years ago and the charts were drawn long hand for long-term analysis, it is clear that his discoveries are applicable to today's financial markets and offer short-term traders a competitive edge.



### F1) Dow Theory Applied Intraday



The NASDAQ (black line) makes higher highs at 12:40 CST leading the S&P 500 (red line).

Source: www.tradestation.com

### F2) Dow Theory Applied Intraday



The NASDAQ (black line) led the S&P 500 end of day rally (red line).

Source: www.tradestation.com



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**Market Technologies** has released VantagePoint 8.3, which offers trend forecasting performance with several improvements and new capabilities. Among other features, the software offers newly updated and retrained neural networks. It now predicts the market trend direction for more than a dozen of the most popular short and ultra short exchange traded funds (ETFs) and now offers the Predicted Bar, a chart addition that displays a visual representation of the predicted high and predicted low for the next trading day. For those who trade Indian markets, version 8.3 now predicts the market trend direction for more than 600 Indian stocks traded on the National Stock Exchange of India. Additional details can be found at [www.vp.tradertech.com](http://www.vp.tradertech.com)

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[www.equitytrader.com](http://www.equitytrader.com), a charting and stock picking service, has been relaunched utilising the latest web technologies. The new **EquityTrader** offers state-of-the-art equities charts with interactive and highly customisable features to clarify and simplify traders' investment decisions. EquityTrader was designed by John Bollinger, the developer of Bollinger Bands.

The charts include Bollinger Bands and a wide array of technical indicators to help investors evaluate the market. A unique feature of EquityTrader is a 54-rule fuzzy logic model that evaluates stocks in two dimensions: how they have performed in the past and how they are expected to perform in the current market. Also unique to EquityTrader is the graphic presentation of a stock's potential and past performance using trademarked "traffic lights". This intuitive visual presentation allows traders to survey the status of any stock with a quick glance. Underlying the 5000+ US equities in the EquityTrader database is a proprietary group structure that allows investors to compare stocks in the same industry group and evaluate the performance and potential of stocks, industry groups and sectors. A unique navigation tool allows easy reviews of stocks within a group/sector. Groups and sectors are presented graphically so their relative strength is readily apparent and mini charts show performance for the last week, month and year. Additional details can be found at [www.equitytrader.com](http://www.equitytrader.com)

# Stop Orders

A Practical Guide to Using Stop Orders for Traders and Investors

by Tony Loton

At first glance stop orders seem very simple – a stop order allows you to stop a loss, which of course must be a good thing. But there are various types of stop loss, which can all be used in various ways, and this is what Tony Loton explores in his latest book 'Stop Orders: A practical guide to using stop orders for traders and investors'.

Aimed at both amateurs and professionals, the book begins with a thorough examination of the various orders available, starting with market orders and limit orders before turning to stop orders and their various 'flavours'. Loton looks first at the common stop order to sell; an order designed to execute sometime in the future when

the price of a stock has fallen to a level that you have set. Conversely, the stop order to buy is designed to execute sometime in the future when the price of a stock has risen to a level that you have set.

Part One continues with a look at the trailing stop order to buy and sell, as well as the guaranteed stop, the stop with limit, the good until order, and the OCO. The breakdown of each is concise and straightforward, providing a vital introduction for beginners and a great reference for the more experienced trader.

This is followed by a more comprehensive breakdown of each order and how they should be used, with details on exactly what needs to be specified in

each case, when each will work and when they will not. For example, the author looks at the stop-with-limit order, which combines the features of both a stop order and a limit order so that it either executes at the limit the trader sets or not at all. Loton shows that this order can be successful when the market price gaps beyond the limit level, or if it falls continuously towards the stop level and executes correctly between the stop level and the limit level. However, Loton cautions: "This stop-with-limit order protects you from price gaps that subsequently close – as they often do. But these orders expose you to gaps that do not close."

Part Two of the book – 'Stop Orders in Practice' – is dedicated to the use of stop orders in real-life scenarios and real market conditions. This section is much more hands on, and as the author explains: "If this was a motor vehicle manual, Part One would tell you what the various controls do and Part 2 would teach you how to become a better driver."

Loton begins this section by describing the subtle differences between stop orders for the different types of traders, e.g. day and swing traders, plus different types of investors and spread bettors. This section also covers some trade maintenance, such as pyramiding and part-closing.

He also looks at the financial instruments that will allow stop orders as well as mental/manual stops.

Chapter Nine looks at price gaps and whipsaw losses, specifically how to avoid both and how this will lead to making better decisions about when and where to place the stop orders. Using 'The Tale of Three Traders' Loton examines how price gaps can affect traders and what the trader can do to avoid this situation. These realistic scenarios are very useful when learning how to use a stop order to your best advantage.

Chapter 15 is Loton's 'Top Tips for Using Stop Orders'; ten key points to bear in mind when trading, plus the bonus tip 'Always respect your stop orders' – something traders would be well advised to remember when in the markets.

Tony Loton's 'Stop Orders: A practical guide to using stop orders for traders and investors' is an essential book, covering everything needed to make a stop order work, whether you are a trader, investor or spread bettor. The stop order is an essential tool in the trader's armoury and Tony Loton's book shows exactly how to use it.



## BOOKREVIEW



**Title:** Stop Orders

**Subtitle:** A Practical Guide to Using Stop Orders for Traders and Investors

**Author:** Tony Loton

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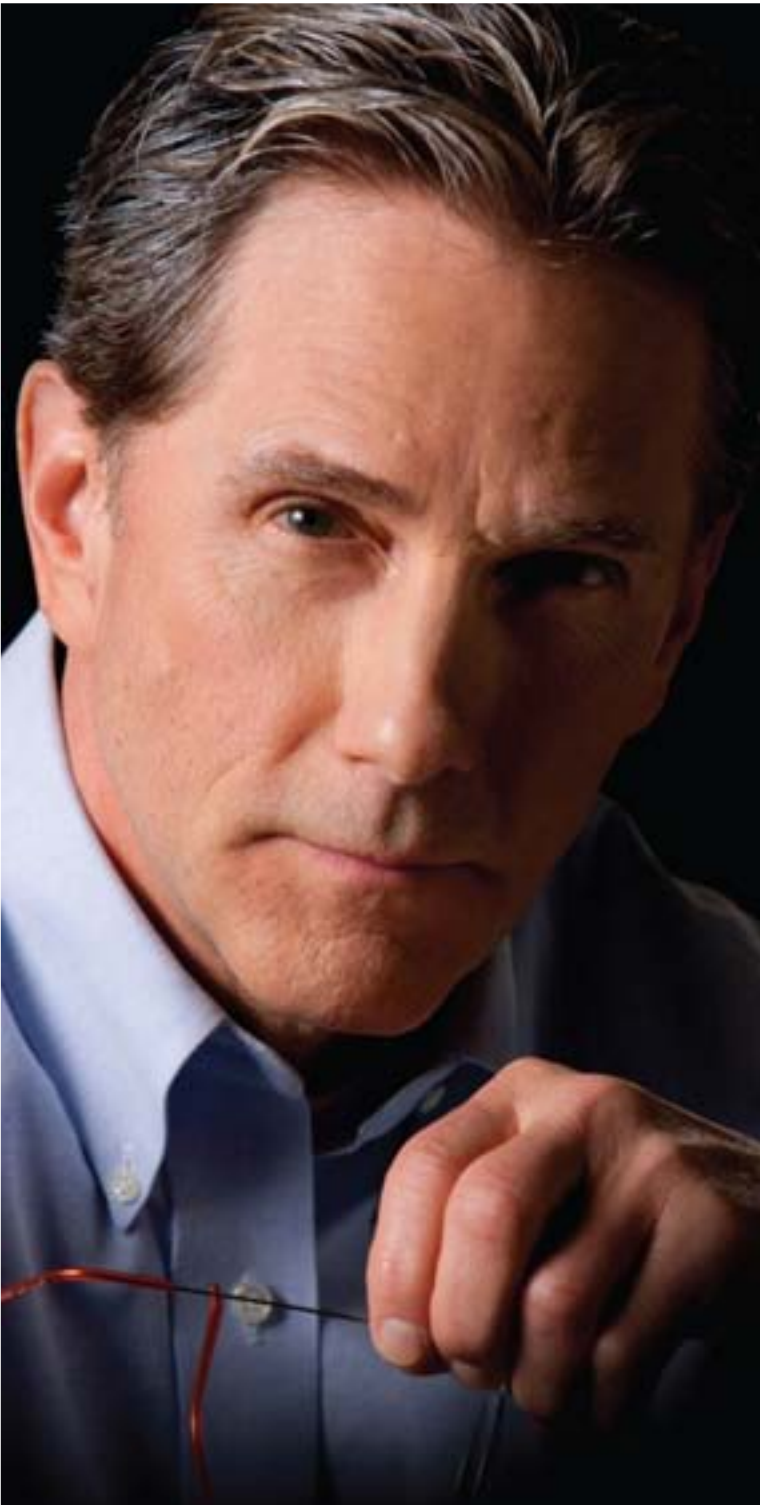
**Price:** £14.99

**Publisher:** Harriman House

### About the author:

Tony Loton trades a range of financial instruments including equities, exchange traded funds, covered warrants, and spread bets on his own account. Tony has written regularly for the Barclays Stockbrokers Smart Investor magazine and its associated email programme, and has previously written and published financial titles including Don't Lose Money! (in the Stock Markets), Financial Trading Patterns, and Stock Fundamentals On Trial: Do Dividend Yield, P/E and PEG Really Work? In October 2008, Tony was featured as a day trader in the Money section of the UK's Sunday Times.





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Free Trading Platform for Advanced Charting, Market Analytics, System Development, and Trade Simulation

## NinjaTrader 7

With NinjaTrader you can trade futures, forex, and equities through any of the hundreds of supported brokerages worldwide. The recently released NinjaTrader 7 is a feature-rich flagship trading platform including powerful tools for traders of all types. For the discretionary trader, revolutionary trading tools within NinjaTrader such as Chart Trader and SuperDOM allow you to trade with superior speed and precision. For the systems trader, NinjaTrader comes with a state-of-the-art system development environment based in Microsoft C#, allowing programmers to create practically anything they want.

### Architects of Electronic Trading Innovation

The NinjaTrader team has made the above mentioned features readily available to new and experienced traders alike. You can download NinjaTrader completely free and use it for as long as you desire ([www.ninjatrader.com](http://www.ninjatrader.com)). This platform is a unique opportunity for beginning traders because it allows you to vastly decrease your costs while learning to trade. For experienced traders, this opportunity allows you to

spend as long as you need familiarising yourself with the platform before purchasing. With all of NinjaTrader's power under the hood, users are offered unlimited free reign and play over the platform with no risk and at their own pace. When you are ready to trade live, you can either purchase a lifetime NinjaTrader software license outright for a one-time fee of \$995 or you lease the software on a quarterly basis with rates starting as low as \$50/month. Purchasing or leasing a live NinjaTrader license allows

placement of live trades to your brokerage account, whereas the fully-featured free license enables simulated trading only.

### System Requirements

The following are the minimum system requirements for using NinjaTrader:

- Windows XP, Windows Vista, Windows 7 or Windows 2003 Operating System
- Screen resolution of 1024x768 or higher
- Intel Pentium 4 processor equivalent or higher

- 2 GB RAM or more
- Microsoft.NET Framework 3.5 (pre-installed on most PC's or can be freely downloaded)

Along with these system requirements, you will need to supplement it with a data provider to fully utilise NinjaTrader. NinjaTrader supports all leading market data services and can even use data supplied by supported brokerages. It is also currently the only platform to provide support for the inexpensive data feed Kinetick



([www.kinetick.com](http://www.kinetick.com)); end-of-day data is free through Kinetick. For new traders looking to further minimise trading-related costs, Kinetick is directly integrated into NinjaTrader.

### Simulated Trading Is Great for New Traders

Once you have data in NinjaTrader, you can begin to utilise the extensive simulated trading features it has to offer. The platform provides you with the ability to setup as many simulation accounts as you like, each with its own performance report. NinjaTrader provides an in-depth analysis and breakdown of each trade placed within each individual account. Performance reports provide an effective tool to determine your trade tendencies and improve your trading technique. You may realise you consistently enter a trade too early or exit too late. Only such detailed account performance reports, provided in NinjaTrader, can equip you with trading insight unavailable anywhere else.

Along with performance reports, the platform also offers Market Replay. Market Replay allows you to play, pause, and speed up real market data from any day. This invaluable tool empowers you to experiment with different techniques as you analyse live market data over

and over again. Market Replay is especially valuable for those traders who work during market hours and do not have time to watch the markets when they are open.

### Tools for Discretionary Traders

Another useful aspect of NinjaTrader is the full suite of tools available for discretionary trading. You get access to utilities like Market Analyzer, an advanced scanning and alert window allowing you to easily keep a pulse on multiple instruments at once, or the Level II window which visually displays the buy/sell pressure building up in the market.

For traders who primarily rely on charts, NinjaTrader charts come preloaded with a plethora of different bar types and indicators. You are able to chart tick bars, minute bars, daily bars, and even more exotic bar types such as Kagi or Point-and-Figure. These charts can all then be enhanced by any indicator installed on your platform. The indicator suite provided out-of-the-box includes over one hundred indicators common to trading literature from MACD to RSI to Stochastics and more. This library can be further extended by purchasing commercial indicators from the extensive list of 3rd party providers or even custom programming your own.

A favourite feature that sets NinjaTrader charts above the rest is called Chart Trader. As an order entry window integrated into the chart, you have the power to trade directly from the chart instead of struggling to punch orders into numerous order entry windows. For example, if you wanted to submit a limit order at a specific price you simply right click on the chart at the desired price and select the limit order. Once orders are submitted they will be painted on the chart at their respective price levels, allowing you to visually manage your open positions and orders. Modification and cancellation of orders is similarly effortless, taking only one or two clicks of the mouse on the chart.

If you prefer to work with Depth-of-Market (DOM) information, NinjaTrader offers its innovative SuperDOM order entry window. The SuperDOM, designed with quick order submission in mind, allows you to just click on any price cell to swiftly submit orders at that price level. For example, if you want to place a limit order at 1185, simply left click on the 1185 price row. The SuperDOM's convenient display and functionality give any trader the speed and precision he or she demands.

One of the most powerful discretionary tools NinjaTrader

F1) S&P 500 E-mini Future (ES)



Figure 1 shows an ES 1-minute chart with Chart Trader depicting the position's entry price of 1219 and its stops and targets. The trade lines can be quickly moved to modify the orders directly on the chart.

Source: [www.ninjatrader.com](http://www.ninjatrader.com)

offers is known as the Advanced Trade Management (ATM) feature. Pioneered by NinjaTrader, ATM strategies allow you to pre-define your targets and stops, effectively representing your trading strategy. In the platform you can setup ATM strategies that define automated management features. Executing strategies such as whether or not to raise your stop loss to breakeven after price begins to move in your direction, or even custom managing a trailing stop are a cinch. When you create and submit an order with a particular ATM Strategy in NinjaTrader, all of your trade management philosophies will be put into play without manual supervision the moment your entry order fills. The ATM tool saves you incredible amounts of time, freeing you to focus on the trade rather than issues with submitting and managing your protective bracket.

### Tools for System Traders

System development in NinjaTrader is also extremely powerful. Because the platform uses a true programming environment for indicator and strategy development, you are not constricted by the limits of a scripting language and can actually program exactly what you want. You can

expect incredible flexibility in development and speed in code execution from NinjaTrader's development environment.

Traders not only demand advanced automated strategy development, but a robust strategy testing tool to complement it. This goal is realised in NinjaTrader through the powerful Strategy Analyzer window. You can run backtests, genetic parameter optimisations, and even walk-forward optimisations on any strategy you program for NinjaTrader. Backtests show you information on how a particular parameter set for your strategy would have affected its performance over time. Parameter optimisations help you determine the best parameter settings to achieve your desired performance, while walk-forward optimisations provide you with more realistic results by reducing some of the curve fitting issues common when you over-optimize a strategy.

These advanced features and tools are designed to provide you with performance reports that allow you to analyse and improve your strategy. You can use the Strategy Analyzer's Chart tab to review your trades and isolate areas where you may want to revise your trade logic or you can use some of the graphs in the 'Graphs' tab to determine

relationships between strategy performance and factors like draw down or adverse excursion. To analyse your strategy from another point of view, you can run a Monte Carlo simulation, which helps determine if your strategy runs the risk of wiping out your trading account before your strategy can turn a profit.

### Conclusion

NinjaTrader is a complete end-to-end trading platform that enables you to analyse the markets, design trade ideas, and place trades to your brokerage efficiently and confidently with the software's powerful features. In addition to phenomenal out-of-the-box functionality, the NinjaTrader experience is enhanced by over 150 commercial 3rd party add-ons. Seeing as the platform is offered for free for advanced charting, market analytics, system development, and trade simulation, there is every reason to use NinjaTrader no matter what kind of trader you are. You are bound to find some aspect beneficial. Last but not least NinjaTrader offers free online product training sessions every day coupled with stellar customer support.



F2) SuperDOM Window

BUY	PRICE	SELL	
	1223.25		
	1223.00		
	1222.75	1	X
	1222.50		
	1222.25		
	1222.00		
	1221.75		
	1221.50	1	X
	1221.25		
	1221.00		
	1220.75	2022	
	1220.50	2032	
	1220.25	1690	
	1220.00	1722	

This figure shows a SuperDOM with an active Advanced Trade Management (ATM) strategy on it. The SuperDOM allows for efficient order management based on Depth-of-Market information.

Source: [www.ninjatrader.com](http://www.ninjatrader.com)

F3) Strategy Analyzer – Optimisation



Figure 3 shows an optimisation run on the ES. Near the top contains a list of top performers with the first one being from the optimal parameter set. On the bottom we can analyse the results with graphs like the cumulative profit over time graph being displayed.

Source: [www.ninjatrader.com](http://www.ninjatrader.com)



www.swing-trade-stocks.com

## Step by Step to Being a Successful Swing Trader

The www.swing-trade-stocks.com web site is an elaborate trading course for swing traders – both for beginners and advanced learners. Founder Craig Ferguson, a passionate swing trader himself, explains in simple and understandable terms how to develop and apply a successful trading strategy on a step-by-step basis. His goal is to help others on their way to becoming a consistently successful trader. And Mr Ferguson does not want a single cent for that service since the use of his web site is completely free. Sounds promising. We wanted to see for ourselves and have been testing swing-trade-stocks.com for you.

### What You Can Learn on this Web Site

Right on the start page (Figure 1) Craig Ferguson explains what users can expect to find on his web site. In contrast to many other web sites, they do not learn many different strategies on swing-trade-stocks.com but merely one which they are meant to work with in future. Beyond that, they learn the truth about action trading and discover numerous trading secrets, giving them a genuine edge over other traders. But first things first.

### How to Use this Web Site

Swing-trade-stocks.com is designed like a trading seminar

and must therefore be read in its proper sequence. The web site includes four chapters that build on each other and that you can see listed chronologically in the left-hand column (Figure 1).

“Trading Basics” is the title of Chapter 1: As the name suggests, this is where you get to know all the important principles of swing trading. The topics range from trends to price and volume right down to strength and moving averages: This section provides the basis for the following three chapters – and for becoming a successful trader. After all, no trader can be successful without having a deep understanding of how and why stocks move.

F1) Start Page



Figure 1 shows the start page of www.swing-trade-stocks.com. In the left-hand column there are four chapters which build on one another, which are listed one below the other (here you can only see Chapter 1). Via the upper navigation bar you get to the additional features “videos”, “Ebooks”, “blog”, “your tips”, community”, and “store”.

Source: www.swing-trade-stocks.com



In the second chapter “Trading Strategy”, Craig Ferguson presents his successful swing-trading strategy, which is a short-term one designed to buy and sell stocks in the so-called Traders Action Zone. The Traders Action Zone is a buy and sell zone on

the chart that swing traders can use to spot possible

trading, candlestick patterns, and much more. The fourth and final chapter “Trading Reviews” includes some of Craig Ferguson’s reviews of various trading products and services such as, brokers, software programs, web sites, or books. All four chapters are explained in great detail, but in simple and understandable terms. Mr Ferguson uses numerous charts

and learning videos for purposes of further visualisation. Beyond that, the users also have

the opportunity to put their own trading tips, ideas or strategies on the web site, helping other traders in the process.

### Additional Services

Besides that elaborate trading course, swing-trade-stocks.com offers a large network of numerous traders worldwide. On [www.chartwatchers.com](http://www.chartwatchers.com), a linked daughter site of swing-trade-stocks.com, users may exchange opinions, form groups, and create their own sites to download contributions, blogs, videos, charts etc. on (Figure 2). All you need to do to use [chartwatchers.com](http://chartwatchers.com) is simply register free of charge, and off you go.

Beyond that, Craig Ferguson operates his own blog [www.learnswingtrading.com](http://www.learnswingtrading.com), which is also linked to the swing-trade-stocks main page (Figure 3). Here the user can find more professional analyses, news and suggestions revolving around the subject of swing trading.

### Conclusion

Our test has shown that swing-trade-stocks.com is a professional and very helpful trading course for swing trading. Its operator Craig Ferguson explains the principles not only of swing trading but also of trading and technical analysis in general and in great detail and yet in an easy-to-understand manner. Here the user learns on a step-by-step basis how to develop and profitably use a strategy. Numerous articles, videos, blog entries and discussion forums provide the opportunity to find additional suggestions and exchange opinions with other swing traders via the linked networks [chartwatchers.com](http://chartwatchers.com) and [learnswingtrading.com](http://learnswingtrading.com). This combination of training, practical application and networking will indeed allow Craig Ferguson to achieve his aim: to help others become a consistently successful trader.



## Craig Ferguson

Founder of all three websites



reversals in a stock. Using his strategy, Mr Ferguson shows you on a step-by-step basis how to develop a permanently successful trading strategy – from making the necessary preparations to your stock pick right down to entry and exit. You also learn in this context how to use charts and technical analysis. For example, Mr Ferguson explains how to deal with pullbacks, develop the right market timing or manage one’s money and one’s position sensibly.

In the following chapter “Top Articles”, you find out about helpful swing-trading tips and tricks in order to optimise your trading. Here you find articles on Fibonacci retracements, gap

### F2) Community



Via the “community” link you will get straight to the daughter site [www.chartwatchers.com](http://www.chartwatchers.com). Here you can exchange opinions with other swing traders and create your own site with your own contents.

Source: [www.chartwatchers.com](http://www.chartwatchers.com)

### F3) Blog



The “blog” feature links the user directly to the other daughter site [www.learnswingtrading.com](http://www.learnswingtrading.com). Here operator Craig Ferguson regularly makes available current analyses and news on the subject of swing trading.

Source: [www.learnswingtrading.com](http://www.learnswingtrading.com)





Low Risk, High Reward

## Red-White-Red Pattern Trading

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Pattern Trading can be a low-risk and highly profitable style. Ever-returning formations are easy to describe, and can be easily tested for their profitability. The pattern introduced here does not only awaken associations with the Austrian flag but might also fill up your cash box for vacationing. This article will show how we can use it to our advantage.





**Philipp Kahler**

Philipp Kahler studied Electrical Engineering and has worked in finance for many years. After working as proprietary trader at Bankgesellschaft Berlin he now develops and oversees quantitative portfolios for institutions. He lives in Graz and Berlin, and can be contacted at <http://quanttrader.com>.

### Price Patterns

In general, price patterns count as highly profitable investment strategies. You will hardly find a trading professional who does not in some way or another integrate the conclusions he draws from recurring formations in his trading decisions.

The most famous pattern is probably the candlestick pattern “hammer”. It describes the behaviour of the markets in one day, and shows where and how the open/high/low/close is arranged in the price scale. This in turn allows us to draw conclusions about the market behaviour of the following day.

A hammer is a day in the downtrend, which might lead to a trend reversal. The day begins weak, but then the change comes. The market compensates for the lost terrain and closes near the opening. The chartist does not care about what introduced the reversal in the market direction. The only important thing is that the market removes itself from the daily low and closes where it had already opened. Figure 1 shows this candlestick pattern.

For the next day, this means the following: If the market is

able to continue rising and pass the high of the previous day, this is a strong bullish sign and we can think about a long position. If, however, the market begins to fall again and reaches new lows, the intraday trend reversal of the hammer was, after all, a premature strengthening of the bulls. In case we are already long, we should close our position at the latest at the low of the hammer.

Therefore, a pattern presents a good possibility of indicating exactly where to place the entry and exit stops. With known stops, it is possible to choose the correct position size – and, as we know, this is the key to a successful trade.

### Red-White-Red

The red-white-red pattern includes three days total. It does not describe the market behaviour of one day only, but determines the precise sequence of the development of three successive days. The first day of the pattern is a falling day, represented as a red candle in the chart. This negative day is followed by new lows and a short break; the market closes above its opening on day two of the

**F1) Hammer**



Figure 1 shows you two occurrences of one of the simplest price patterns – the hammer. The market makes new lows in the course of the day, but recovers and closes near the opening. After the first hammer, displayed in red, the market could build neither a new high nor a new low. The pattern therefore remained without consequence. The second hammer clarifies how the idea should work. The market rises further on the day after the hammer and we go long on the high of the hammer and place the initial stop on the low of the hammer.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)



pattern. This day has to be the lowest low of the three days. On the last day of the pattern there is another negative day. The correction of the previous day is over, though the bears are not strong enough to push the price under the previous day's low; the market has to trade above the low of the white candle, however close under its opening. In Figure 2 we see several examples of this pattern. The two upper charts show the DAX30 index, both lower charts show the S&P500 index.

The idea behind the pattern, as we can see in the chart, is that a trend reversal is imminent after these three days of indecision and today's higher low. Whether this pattern is significant enough, and how you could trade it, is what we will discuss next.

### Entry

With this definition of the pattern, we know its setup. However, to be able to make money with such a pattern we have to decide exactly where the position should be opened, how large it should be, and when the position should be closed – hopefully with an appealing profit. The pattern itself (and this is true for all sorts of patterns) is not a sufficient reason to jump into the market immediately and build a position. First of all, the market has to

confirm the idea. It has to show that the expected uptrend will follow the red-white-red pattern, which we have discovered.

Only when the market exceeds the high of the last two candles, in other words when the bulls clearly have taken over, is it your time to enter the market.

When the market rises above this point and therefore makes a new high, one can no longer talk about selling pressure. The market seems to have made up its mind about direction after three days of indecision. In addition, the low of the white candle of the formation was confirmed by the new high as a "swing low".

In practice, you can make this entry with the appearance of this pattern by sending a valid stop-buy order to your broker on the high of the last two days for the following day. However, you should only enter the market if it has not already opened with a gap above the formation.

### Position Size

Paracelsus knew that the dose decides whether it is poison or medicine, and it is similar for us traders when we have to determine the size of the next position.

Before we think about how many stocks we should buy, we have to consider the point at which our trading idea proves

false and we have to close the trade at a loss. Hence, we have to define our initial stop and therefore determine the point loss which is the maximum possible for this trade.

As an entry point we decide to enter the market as soon as it is clear that new highs are forming. If this new high proves a bull trap, and the market falls below the low of the white candle, it is clear that in this case the pattern has not worked, and we have to close our positions again.

Therefore, the span between the high of the last two days (= point of entry) and the low of the formation (= worst-case exit) is the risk that we take when trading this formation.

To determine the number of stocks we should buy from these two values, we remember the old money management rule stating that one should never risk more than one percent of one's trading account in a single trade. The number of the stocks we should buy therefore results from the equation: number of stocks =  $0.01 \times \text{trading account} / (\text{entry level} - \text{exit level})$ . This approach is visualised in Figure 3.

This ensures that we do not ruin our portfolio with several successive losing trades. On the other hand the position size is large enough to promote the development of our portfolio in case of a win.

### F2) Price Pattern Red-White-Red



Figure 2 shows the appearance of the price pattern in the DAX30 and S&P 500 indexes. The red-white-red pattern is made up of a total of three days. The first and the last day close below its opening, the middle day builds the lowest low of the triplet and closes above the opening rate. If the high of the previous two days is exceeded, another breakout to the upside can be expected after three days of indecision.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

### F3) Position Size



A possible entry into a long position at the high of the two last candles of the pattern. The worst-case scenario for the first day is when the market takes the old highs, then turns and falls under the low of the formation (= stop point for the long trade). The position size results from the risk of the trade ( $28.60 - 28.04 = 0.56\text{€}$ ) and the account size. In case you want to trade this pattern e.g. with a trading account of 10,000€, you would risk 1% of your capital when you trade  $10,000 \times 1\% / 0.56 = 180$  stocks.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)



### Exit

So far I have shown how to recognise the red-white-red pattern, how large the position should be, when to enter the market, and where the initial stop should be placed. However, this will not have made us any money, but merely controlled our risk. In the next step I will show how to minimise our losses, let our profits run, and thereby trade this formation with a positive result.

The entry is usually only a very small step on the way to a successful trade: the money is made with the exit, and therefore the most consideration has to be put into this exit. When testing this

approach yourself, you will quickly see that you can combine this exit with different patterns and entries.

We can see successful patterns in the chart immediately ex post, so I want to show a few examples in Figure 4 where this pattern would not have worked. These examples are far more important for the development of the exit than those in which the pattern works as planned. From these we can learn what may happen, and we can then decide on the method by which we can get out of such negative examples with the least possible damage.

In cases where the market explodes after the appearance

of the pattern it is not difficult to trade further (see Figure 2), we merely wait and count the money. More challenging are the cases where the market does not go up after all. Should we always wait until we are stopped at the low of the formation, or should we stop, with small losses, when we realise that it does not work this time, and that we had better wait for the next opportunity?

We have already talked about the first exit: the initial stop at the low of the formation. The next exit deals with the scenario where we do not see the low of the formation, however neither does the market begin to rise. In this



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### F4) When It Does Not Work



Figure 4 shows you four examples where the expected sustainable uptrend did not follow the price pattern. Clockwise: In the first example, the market could only take the high only one day after the appearance of the pattern. Thereupon, it stagnated on a high level. Example 2 shows the case that the market did get above the formation in the first day, then however turned around and fell under the low of the formation. Example 3 presents a similar problem like in example 1: the market cannot decide for the uptrend. Example 4 is comparable to example 2, where the market turns after two days and starts to fall. An intelligent exit should be able to limit losses in such situations.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)



case we close the position if it is not in the plus two days after the entry towards the trading end.

The purpose of this is to eliminate the time risk. The longer we are in the market, the higher the risk that something will happen to our disadvantage. Originally the idea was that the market rises sharply after this formation. If this does not happen, our analysis may have been wrong. It is often better to close the trade, realising small losses, than to wait for our luck and be exposed to the risk of being stopped out with the worst-case scenario loss at the low of the formation.

Tests with the stock basket from the Dow 30 and the DAX30 show that with these two exits we will at the very least survive. This strategy does not generate money, but the losses are kept within a limit. However, this strategy can be improved.

With the second exit, the risk was further reduced and those cases where the market does not go up further were dealt with. However, one more risk remains to be considered before we think about making profits.

What if the market rises for a few days, but then turns, and starts to sink? This is what exit number 3 is made for. It is activated from the third day onward, and closes the trade when the market falls back to the entry price. Although nothing

is won by this strategy, nor is anything lost, and this is often a small victory in itself.

With these three exits, and the correctly chosen position size, we have risk under control as much as possible, and can turn our attention to how and when to take profits.

The first exit to profit taking is a simple profit target. Here, the profit is realised automatically when the trade has brought in three times the amount of the initial risk. The initial risk was the distance from the low of the white candle to the high of the last two candles of the formation.

We can also work with a lower target. This raises the hit rate in sideways markets, as the target is repeatedly triggered by accidental movements. This does, however, prevent larger profits during trend phases. This can be a clever method when we already have a trend-following strategy in use, otherwise choose a target no smaller than double the original risk.

If the target is not reached within about six days, I try the exit at the high of the previous day. This usually brings a few extra points of profit compared to the possibility of closing the trade after a fixed time. It is also possible to not wait for a fixed number of days for this exit, but rather try and get out at the high of the previous day as soon as

no new high has developed for one to two days. The exit at the entry price always stays active – just in case. In Figure 5 you can see what these exits look like in practice.

### Review and Outlook

This article shows us a potentially significant price pattern and a technique to use this pattern in trading. The technique can be expanded in many ways, and can be combined with other formations and entry ideas. The exits introduced show the importance of bringing the risk of a trade under control as quickly as possible. We have to close all those trades which do not develop as intended. Not only does this apply to the losers, but also to all those cases in which the market only tends sideways after the expected breakout. Time is also a risk, and if the trade does not develop as intended, it is often best to accept small losses and wait for the next chance.

By now do you really still believe that the Austrian flag can predict the behaviour of the markets? Or is it rather the consolidated exit plan and the correct position size which are responsible for the profits?



### F5) Exits



Figure 5 shows you different possibilities of getting out of a position. In the first case, the position is closed after four days at the entry price. This prevented the exit at the low of the formation. Example 2 shows the lucky case of a time exit. Since the position was not in the win two days after the entry, it was closed. Example 3 demonstrates how reasonable a profit target can be. The high opening was used for the exit since it was more than three times the original risk above the entry. In example 4, the position is closed after six days at the high of the previous day. The position size was chosen in a way that in every trade the same amount of money was at risk.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)





Measuring Your Way to More Accurate Trades

## Swing Analysis

Many of you have been attracted to the Forex market because of the hours, and the leverage that is available. Couple these two things with volatility and you can have a nice part time job in the evening working from home. While trying to learn that market you have you probably looked at a chart and said, “Man! I wish I had bought that low, and sold that high”? I know many of you have, and if you are reading this article then you know what I am talking about.

### Swing Analysis Logic

Many traders, including myself, have turned to some momentum indicators, such as Rate of Change, Commodity Channel Index, RSI, or Stochastic, and have spent countless hours staring at charts attempting to find the perfect setting that would allow us to capture a majority of the swings that we see in price on that chart. The reason why we all do this is because as we have all looked at historical charts we take note of all of the “good” signals generated by these indicators coinciding with key pivot points in the currency pair leading to large swings providing the potential in the future for large gains. The problem, as I am sure you will agree, is that the market changes and transitions from trend to sideways environments generating many false signals which get you in too late as it relates to the entry price and the previous pivot point or gets you out too soon before a big move. An important fact that some of you have forgotten is that indicators do not move price, price moves indicators. Which begs the question, “If indicators are a derivative of price and move as a result of price change over a specific period of time being measured (14 periods is most common on trading and charting platforms) and prices move the indicators over a relative period

of time, why not study price to determine which signal is the most appropriate signal to choose?” This is exactly what Swing Analysis allows you to do. As I have become more familiar with using swing analysis in my trading I have become less reliant on momentum indicators, however, there are scanning tools that allow you to find Forex pairs that are trading in these overbought and oversold territories which could lead to trading opportunities; the only thing that you need to do is conduct a simple analysis to determine if the market is, what I refer to as, naturally overbought or oversold.

Swing analysis is a simple process that you can use to identify key turning points on any time frame that you trade and in any market. Once identified, these points can then be measured and applied to the right hand side of the chart. The benefit of using this method is that you are allowing the market to tell you how far it typically moves, whether during a motive or a corrective phase. Motive and corrective are simply qualitative terms applied to market swings that move in the direction or in the opposite direction of the larger trend. For instance, if the EUR/USD is trending up, then the motive swings would be up and the corrective swings would be down. The opposite is true for

a downtrend. If the EUR/USD is trending down then the motive is down and the corrective swings would be up. Upon making these measurements you will be astonished as you will most likely find that the currency (or other security being analysed) will provide you with an average motive swing and corrective swing distance. This information can be invaluable as you are now in a better position to enter a trade or exit a trade as the market has provided you with the information for you to set the proper expectations. Meaning, if you find that every time the EUR/USD rallies it rallies 25 pips, do not expect it to run 100, and every time the EUR/USD declines it declines twelve pips do not enter long after a five pip decline. Exercise some patience! As a disclaimer there are times when the market being traded will move farther than expected, but what is nice about conducting swing analysis is that you know how far it should move. If it moves farther, then that is better for you because you are capturing a larger profit than what you expected, or you are sitting on the sidelines watching other people get punished for entering too early!

### Swing Analysis Rules

To begin this process of swing analysis you have to determine what Forex pair and time frame





### Scott McCormick

Scott is a Chartered Market Technician, and holds the Series 7 and 66 licenses. He began his career in the year 2000 with Charles Schwab as a Registered Representative. In addition to those markets, Scott began trading foreign currencies in 2004. As an instructor for Online Trading Academy, Scott teaches his students the use of technical analysis to identify high probability trading opportunities controlled with proper risk management.

you are going to trade as this analysis will work on any time frame. Once you have chosen your pair and time frame you have to identify where the previous three trends have reversed. Due to the fractal nature of markets this can be confusing, so a tip to clarify what you should focus on would be to compress the chart to a point that it filters out all of the smaller swings so all that is left are the key pivot points. Another process, which is a little more precise, is to identify the low of the lowest close, and the high of the highest close. Doing so will relate the price movements (if using a candle chart) to that of a closing line chart. As silly as it may sound ask yourself the questions “Where did the market stop going down and start going up?” and “Where did the market stop going up and start going down?” Next step is to measure the amplitude and duration of each swing. After the measurements have been made you now have a historic reference of the average motive and corrective swings that have been made in that pair. Now determine which phase the current swing is in. Is it corrective or motive? You do this because the market will move in the opposite direction of the previous swing. So if the current swing is corrective, you know the last swing was motive, and the next swing will

be motive as well. If you are not sure when looking at the chart which swing is motive and which is corrective, look for the largest swing. Whichever direction it is moving in is the direction of the trend. Therefore anything moving in the direction of the larger swing is motive, and anything moving in the opposite direction of corrective. Remember that as you measure these swings that the market can extend beyond the minimum expectation which is based on historic measurements. In the case this happens this typically indicates that a Fibonacci multiple of the previous swing is unfolding (this is a topic for another article).

Figure 1 shows a 15-minute chart of the EUR/USD from October 8, 2010 to October 24, 2010. Three complete swings and one partial swing have been identified as AB swing, BC swing, CD swing, and DE swing. In addition to the labels you will note that amplitude and duration was included in each. The observations that you want to make are that the current swing DE seems so far to be moving in the direction of the larger swing labeled on this chart which is swing BC. Because swing BC is the longest of the swings shown this makes it a motive swing, which means that swing CD is corrective. If the market transitions from motive

**F1)** Euro/USD 15-Minute Chart – Longer Term



October 12 to October 22, Swings AB, BC, CD, and the forming of DE.

Source: [www.tradestation.com](http://www.tradestation.com)



to corrective, and corrective to motive then this would imply that swing DE should be motive. Since the distance of swing BC is known, assuming that the new trend is down based on the fact that swing BC has been the longest swing, then the trend should make a lower low. To calculate the target for point E simply subtract the difference of the BC swing from the high of point D; so E is equal to  $1.4049 - .0461 = 1.3588$ . Now that you know what the major trend is (down), and now that you have a target for the current motive swing DE (1.3588) you have to determine how you are going to enter the trend. If the strategy is to short, then do you just short now with a buy stop above point D, and a buy limit at or just above the target for point E assuming entry at the last trade in this case 1.3929? Considering that the risk in this trade is 120 pips (the difference between your entry price 1.3929 and your buy stop 1.4049), and the reward is 341 (the difference between your entry 1.3929 and buy limit 1.3588) you do have a good reward to risk ratio, but due to the leverage in this market it can represent a significant loss should the market move in the opposite direction of the anticipated move. So how do you reduce your risk? The solution: repeat the same swing analysis but of the DE swing this time.

In Figure 2 you will see how the fractal nature of the markets comes to light. The EUR/USD clearly demonstrates smaller swings within the larger swing DE. Just like the larger alphabetic swings were identified, numeric labels were applied to the smaller swings in an effort to identify which price levels could represent a future level of supply where the EUR/USD would stop moving higher and begin to move in the direction of swing DE. The idea would be to sell the corrective swings short as a reversal pattern is given in the candles (i.e. shooting star, dark cloud cover, bearish Harami, etc.) near the levels at which the corrective waves reach a similar distance as the previous swings, and not before. As an example in Figure 2 on October 22 in the EUR/USD the swing 5-6 was being formed, which as it related to the previous swings was clear that it was a corrective wave. Since the previous corrective swings had been identified, and the distances are known, then you can add these amounts to the low of point 5 to identify the objective for point 6. At this projected supply level you would then look for a reversal pattern in the candles identifying a shorting opportunity. Your profit target remains the same if you are attempting to enter the DE swing, and your stop will go just above that newly formed swing high at

point 6, or if you want to be more conservative above, point 4.

### Conclusion

You have now seen just one of many examples that are available within the universe of not just the currencies markets but also stocks, and futures. This process is fractal in nature, meaning that it can be applied in any time frame, and it works just the opposite in bull markets as it does in bear markets. The keys to remember are: once you have properly drawn and measured the swings you list the amplitude and duration of each corrective wave and motive wave and compare corrective to corrective, and motive to motive. This way you can anticipate how far and how long a move may last as it relates to previous swings providing you beneficial information for profit taking and entry of positions.

Once you know where you are going to get in and where you will take your profits, the last thing you have to do is identify your risk. This will always be a level just below or just above the previous swing low or swing high. With this method you are in a better position to know which momentum signal you may want to take, and which ones to leave alone.



F2) Euro/USD 15-Minute Chart – Shorter Term



Smaller swings within the larger swing DE, not yet completely formed.

Source: [www.tradestation.com](http://www.tradestation.com)

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Support and Resistance

## Gap Trading – Part 2

As a rule, gaps constitute a major risk for overnight traders. But what is a risk for one side, may open up great opportunities for the short-term-oriented trader. In this part of the series, gap trading will be explained by elaborating on supports and resistances.

### Support and Resistance

First of all, one needs to find out how support and resistance areas manifest themselves psychologically. Supports are areas where an increased demand can be expected in market action. This demand is likely to become all the stronger when new highs were formed based on the original support level. Renewed approaching can cause the original area to be watched much more closely by market participants after the formation of the high (human emotions/greed).

Things are similar as far as resistances are concerned. These are areas where supply outstrips demand. If the market or the underlying moves from the supply

point to new lower lows, this area will become more significant by renewed approaching (human emotions/fear).

### Market Price

On the basis of this knowledge and the market anatomy you already have two strong indicators capable of making everyday gap trading somewhat easier. In the final analysis, the market price shortly after opening is key. Especially in short-time intraday trading, the price, in this case the entry point, is the most important thing. Besides the entry, a look at the broad-based indices is very nearly a must. The broad-based indices frequently serve to reinforce movement in the individual underlyings.





### Peter Soodt

Peter Soodt has been a full-time day trader since 2001. He learned about the principles of trading from his father and later attended various seminars at renowned institutions. In 2005 he founded "PS Trading Seminars", an online-education school. In early 2009 Mr Soodt won the trading competition of [www.termintrader.com](http://www.termintrader.com) with flying colours.

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For intraday trading this means that there must be a minimum of two time units in the underlying and, of course, a broad-based index. In addition, one should take into consideration which ETF is selected. For Dow Jones stocks it is best to place the DIA in the 5-minute chart on one's trading desk, for NASDAQ the QQQQ, and for the S&P stocks the SPY.

### Description of the Strategy

Requirements that need to be met by the market: The search is on for situations in the daily chart in which the market has formed new highs for the long side from previous support areas and new lows for the short side from previous resistance areas. If the market starts testing these areas again, you look for down gaps on the long side and for up gaps on the short side. Why is it necessary to watch out for these kinds of gaps in particular? Because these setups best indicate exhaustion in the market which was usually initiated by neophytes who entered the market late.

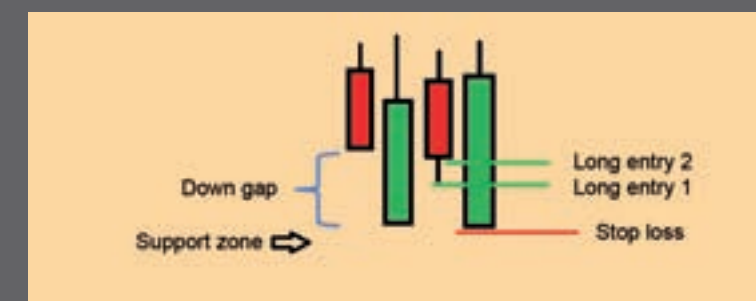
An example of a textbook-like chart pattern on the long side can be found in Figure 1. A total of four candles can be seen there, two red ones and two green ones. Each of the two green candles opens with a down gap and immediately moves upwards

upon opening. The main focus in this kind of gap trading is on the second green candle with the down gap. Here confirmation of a stabilisation can be found. The market opens with a down gap – and you have exactly 15 minutes to watch this stock and become active. In some cases the stock moves upwards after the break of the first 5-minute high.

Here the market reflects a very substantial Relative Strength. If you have a strong 5-minute candle, the entry point is the high of the first 5-minute bar. The safety stop is 0.01 cents below the 5-minute low. As soon as the market has reached the previous day's low or the close, the stop will be placed from the negative to the positive, i.e. break-even. In such intermediate corrections very large movements are possible. That is why it would be best here to work with the pivot trail stop method, which is certain to deliver the bigger profits. The target for the trade should always be the relative high of the previous day or of the day before the previous day.

Let us now turn to an example of the textbook-like chart pattern on the short side (Figure 2). In the first candle you can see a narrow range bar showing a marked decrease in momentum. In the next candle there is a down gap, and there are sellers going into the market

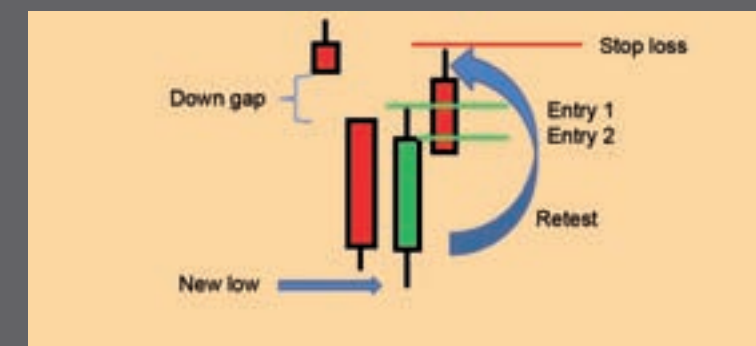
### F1) Textbook Pattern for the Long Side



You can see four candles. The main focus is on the two green candles. These are stabilisation candles each of which opens with a down gap reflecting belated entries which are made by neophytes and countered immediately. As soon as the low or the closing price of the previous candle is approached, that will be the entry for the long side. The stop is placed below the trade-triggering candle.

Source: TRADERS' graphic

### F2) Textbook Pattern for the Short Side



The second candle opens with a large down gap. There is a high degree of probability that a great deal of bearish follow-through will enter the market in intraday trading. In the following green candle the weak hands are corrected out of the market by a shakeout. In the subsequent candle the opening is made with an up gap in the area of the gap's lower edge of the first candle.

Source: TRADERS' graphic



immediately. The following green candle forms a new low and immediately moves upwards. The next candle opens with an up gap within the range of the gap's lower edge and breaks down immediately. As a rule, these are much better short opportunities than in normal resistance areas when new lows are formed. The entries must be made from the daily chart as soon as no entries can be had from candlestick pattern formation in intraday trading. Here the high and the closing price of yesterday's trading day are the most important items. Care should be taken to ensure that enough downward momentum originates from the area of the entry point.

If you cannot get a trade from the pattern, the safety stop will be placed above the trade-triggering candle, i.e. the daily high to date is decisive. Please remember that the daily chart's stops are significantly larger. It is therefore better to look for entry opportunities from pattern trading in smaller time frames.

### How to Find Stocks That Meet these Criteria?

It is well-nigh impossible to find such stocks if you have to look for individual ones manually. Fortunately, there are computers and special scanning tools here that can take over this work.

However, many free scanners can only be had, if at all, with the standard settings which you can do very little with. I personally use MadScan but other software programs, as well, like Trade Ideas, eSignal or TradeStation have their own scanners in their program. The two settings for scanning the strategies described are as follows:

For the long side the following scanning rules apply:

- Minimum downward gap: \$0.20.
- Minimum position in today's trading range: 95 per cent.
- Minimum average volume per day: 1.5 million.
- Significance of new highs: after ten seconds.
- Approaching of previous day's low: Gap of \$0.1; for neophytes \$0.2 to \$0.25; the more time you have to look at the share.

For the short side the following scanning rules apply:

- Minimum upward gap: \$0.20.
- Minimum position in today's trading range: five per cent.
- Minimum average volume per day: 1.5 million.
- Significance of new lows: after ten seconds.
- Approaching of previous day's high: Gap of \$0.1; for neophytes (as with the long side) \$0.2 to \$0.25.

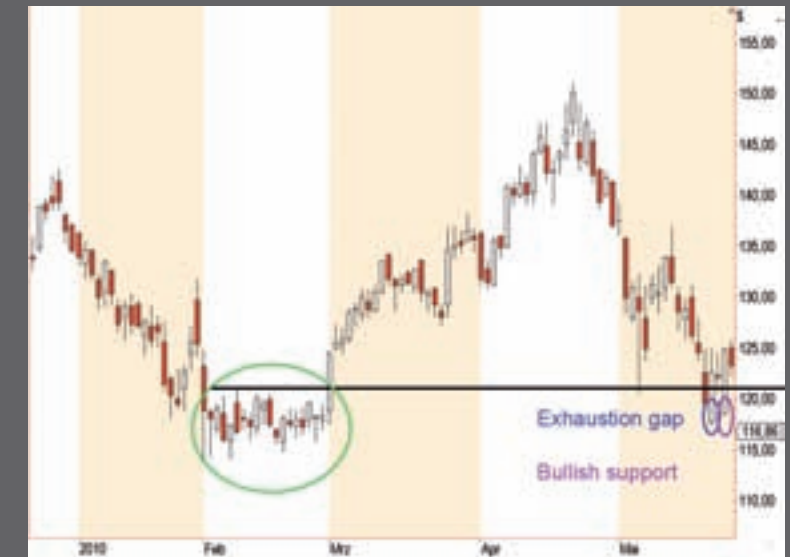
The differences between the scanner settings are only of a minor nature but in the scan itself they are key. On the long side the stock must move upwards 95 percent, but on the short side only five per cent. As a result, your evaluation of the scan will tell you what momentum is like in the market. The same is true of the new highs and new lows: To scan for strength or weakness, the best solution is to observe how long the highs and lows are held. This provides information on how strong momentum is in the current movement.

However, the most important thing about this scan is the approaching of the previous day's high or low. Here neophytes who still do not have much experience ought to take the time to tell the scanning tool that you need more time than \$0.10 and therefore change to \$0.20 to \$0.25.

### Example of Amazon

Starting from a sideways consolidation within the \$120 range (Figure 3, green circle), Amazon has formed a new all-time high at approximately \$152. From that level Amazon made a correction back to the starting point. Within the \$117 range Amazon began to stabilise for the first time. This stabilisation manifests itself by a down gap of approximately two dollars (blue circle). This is indicative

F3) Amazon Daily Chart



After a sideways consolidation at 120 dollars (green circle) Amazon formed a new all-time high at approximately 152 dollars in April. After a correction as far as the starting point the stock stabilised again (down gap in the blue circle). After a Doji-like follow-up candle the stock opened with another down gap (purple circle), confirming its relative strength.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

F4) Amazon 5-Minute Chart



Amazon stabilises after a strong down gap within the first 5-minute candle. After a Doji-like candle a Bull 85 candle is formed. This means that this candle has formed a new low within the trading session and was then bought up gradually by the buyers. This appears to be very bullish in terms of market behaviour.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

of the first signs of exhaustion among market participants. After a Doji-like follow-up candle the stock opened with another down gap (purple circle), confirming its temporary strength. At that point you have to change to the 5-minute time frame in the chart. You have exactly the first 15 minutes to interpret the market. What kind of a candle originates from the smaller chart unit, and above all: How is the overall market developing?

The overall market, here in the form of the QQQQ (the exchange-traded fund of NASDAQ, Figure 5), forms a Bull 85 after two red candles. This is a very potent long setup that distinguishes itself by a low being formed during the trading session. This low was gradually bought, forms a high in the very same session and closes in the upper 15 percent part of the candle. The broad-based index forms a reversal setup, which is why Amazon should also run in the direction of the overall market. At 3.45 pm the stock is also – with a very bullish reversal pattern – ready for a strong upward movement. Two red lines can be seen in the chart (Figure 4). These are alternative entry opportunities if you have not received a setup from the patterns. Should you receive a strong pattern from the candlestick formation, this is obviously always preferable since

you can operate via the price here and the stops are not so large.

### Example of AIG

On 26th April 2010, AIG forms a Bear 85 (Figure 6 blue circle) in the daily chart. This candle already is a very aggressive reversal pattern and a very bearish sign, similar to the Bull 85. It must be borne in mind that in this session the stock has formed a new high and was sold from the high down. The next morning AIG opens with a down gap of just under two dollars. This is the opening for a break of several natural support areas in the daily chart. In early May, the stock returns to the Bear 85 range and there forms a non-follow-through (NFT) pattern on a day's basis. An up gap can be seen in the third necessary candle for the non-follow-through pattern.

The market opens higher, again forms a new daily high and then collapses. In order to be able to participate in this up gap, you have to be active while the third candle is developing. Knowing that the market has already fully formed two out of three candles of a possible NFT pattern and that these are located in the resistance area, you expect the next day's opening in the 5-minute chart. In order to be able to participate in this NFT pattern from the daily chart, you

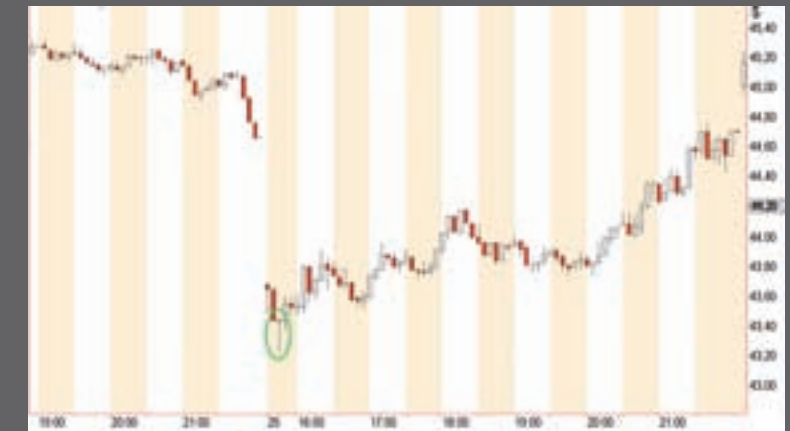
obviously need to closely watch the stock the previous day. This is where the scanner function helps "Gapup making new lows". From a pattern point of view you do not get a good entry. Here the high and the closing price of the previous trading day need to serve as entry points. Naturally, the stop is very large, which is why care should be taken to place the stop either above the daily high or at the swing high at the \$43.60 mark.

### Conclusion

Familiarising oneself with this kind of gap requires a great deal of experience. One challenge is that trading is done against the short-time trend. However, this also creates greater opportunities since the principal trend is still completely intact and only in a correction mode. Consequently, it is important to familiarise oneself with the anatomy of a trend. Strict adherence to risk and trade management (pivot trail stop method) is of special importance. Moreover, a high degree of precision is called for when making an entry. Pattern entries are preferable, otherwise the previous day's high and/or the previous day's close are possible.



F5) QQQQ 5-Minute Chart



Here you can see the QQQQs on the same trading day as the Amazon example (Figure 4). It can clearly be seen how big the influence of the broad-based index is on Amazon. Nearly simultaneously, both underlyings form identical bullish reversal signs (green). This is evidence of relative strength, also causing confirmation to be given by the broad-based index.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

F6) AIG Daily Chart



At the end of April AIG forms a Bear 85 candle (blue circle). The next trading day opens with a large down gap, and there is an immediate follow through on the short side. The market briefly tests the break once more and then forms a new low within the \$33 range. Based on this low, AIG takes corrective action and forms a non-follow-through pattern in the green circle, a top reversal setup.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)



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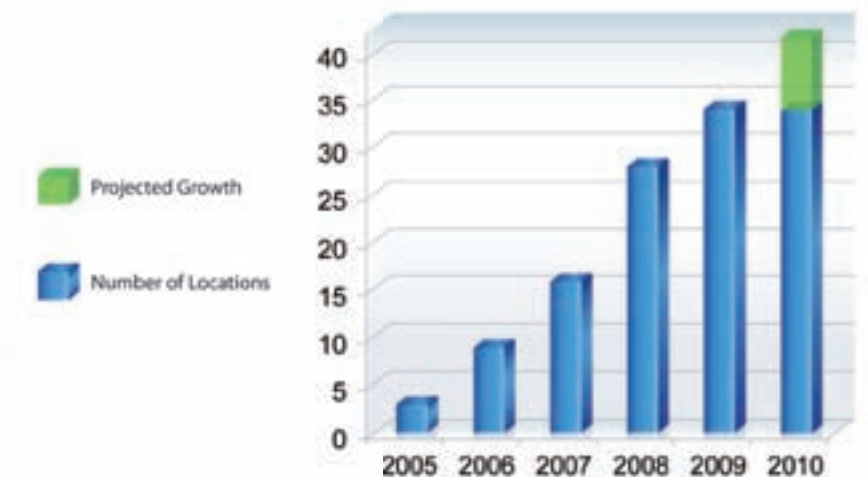
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Secondary Indication of Major Market Shifts

# “Too Much Bull” or Is It “Un-Bear-able”

.....

Today’s Market Place is swamped with contradictions in advice, news, and even the hard facts get skewed by opinion. Some of the “Gloom and Doomers” say we are going to hell in a hand basket while others – less vocal right now, say that we are doing well – creeping slowly out of the malaise and into the sunlight of prosperity. Advertisements are equally shouting “buy gold” or “sell us your gold” – Dizzying at best and anxiety ridden at worst. The psychology of the media is to create enough disturbance in the minds of the common people that they consistently make bad financial choices for themselves – therefore, the uncommon people, the professionals, profit.

## How Can the Populace Know Which Way the Market Will Go?

There are always, at least, two levels of involvement – the retail and the wholesale. There are two kinds of player, the uneducated, who invariably pay – and the educated, who invariably reap.

To move from one side of the table to the other requires enlightenment – and the lumen

of that understanding is realising that everybody has “blind spots” – things they do not know that they do not know – and then actively trying to fix it. Here is a method that may help light our paths.

Being a contrarian in the market is often difficult on one’s psyche. As we start to understand that we wish to trade at the extreme limits





**Mike McMahon**

Passion and enthusiasm are the “watch” words of Mike McMahon. He brings both to his trading and his teaching, with over 20 years of experience in the market, as an investor, a trader and a licensed Commodities broker. Graduated from UCLA with a Bachelor’s Degree in Political Science, Mike brings a blend of academia and experience to the classroom. His ability to communicate this blend is the rare talent that allows an active trader to be a successful trainer. His students are always well-schooled – with passion and enthusiasm.

of either demand or supply, we are always looking for some sort of confirmation that we are near a reversal point.

### Bull/Bear Ratio

One of the most important contrarian signals is the Bull/Bear ratio. This is basically determined by the primary sentiment of major market analysts, as opposed to the opinions of the talking heads on TV, leaning towards the bullish side of the market or the bearish side in their commentaries and forecasts offered at great expense to the institutions.

As we look at a variety of different charts we can see that there is a ratio that signals the market’s current trend. The first ratio mode we will talk about is the bull/bear ratio in itself. As of this writing we are currently running 2.05 (see Figure 1) which is a little bullish despite all the rhetoric that we hear on television and in the news services. Generally, once we reach about 2.0 or higher on this ratio we are looking at “too much bull” and, therefore, we are running out of buyers and are looking for a supply area and a market reversal. The flipside, of course, is a situation that is “un-Bear-able.” In other words, there’s too much negative sentiment in the market and, generally, this will occur at about 0.60 or less in the ratio.

### Bullish or Bearish Sentiment

We can also look at the Bearish or Bullish sentiment by itself. If the bullish sentiment is running at about 60 per cent then you will probably find that most of the indexes are at either their highs or even record highs, which, of course, is an extreme level. The actual reversal is caused by any number of things – profit-taking, geopolitical problems, or simply a higher amount of supply than demand (see Figure 2).

Too much bearish sentiment (see Figure 3 ) in the market occurs right after a major market decline which again could be caused by any of the above noted items to include volcanoes or bad economic report numbers. These kinds of events will often cause a lot of money to sit on the sidelines waiting for a good opportunity to put it back to work. Again we would be at an extreme and, therefore, the Bulls – who are the buyers – would step in and start to pick up the leftovers of the catastrophe or other problem.

### Big Money Steps in

At this juncture, we have learned that when the pro analysts start advising their clients that the market is favourable for buying (or selling) then the big money steps in. The people who are involved with other things beside finance have to wait on the

#### F1) Bull/Bear Ratio



This is the Bull/Bear Ratio over the last five years. As you can see we are at 2.05 where 2.0 or greater may result in a market reversal.

Source: Investors Intelligence, [www.market-harmonics.com](http://www.market-harmonics.com)

#### F2) Percentage Bulls



The current Bull Sentiment is running at 45.1%

Source: Investors Intelligence, [www.market-harmonics.com](http://www.market-harmonics.com)

#### F3) Percentage Bears



The current Bearish Sentiment is running at 22%. Note October 2008 to January 2009 Bearish Highs – this was just 60 days before the March 2009 run up.

Source: Investors Intelligence, [www.market-harmonics.com](http://www.market-harmonics.com)

“trickle down” effect and hear “what to do” on the TV or other delayed media. Of course, the market has moved by this time and the novice population are the last to buy (or sell) while in the throes of their bullish passion. This is recognised easily by the amount of volume at any given juncture. As seen in Figure 4, the March/April bottom of the SPY (ETF for the S&P 500 Index) is turned by enormous volume which tapers off until the top is reached in April 2010. Again, the volume of the institutions comes back in a selling wave which tapers off yet again as the market moves to July, 2010 lows.

### Using the Bull/Bear Relationship

Understanding the bull/bear relationship also offers us a variety of short-term opportunities when the sentiments are very close together (see Figure 5). That is to say when the ratio only has a spread of about 15 per cent between up bullishness and down bearishness, Options traders can really take advantage of the sideways market. Even directional players, whether in Options or another asset classes will often find a short strong pop when the percentages move

outside the 15 per cent area. The prepared trader seeing this knows that, within a short period of time, there is going to be a spike in one direction or the other. Therefore a Pairs play or Spread play becomes quite profitable to those who are anticipating that move.

“There must be a buyer for every seller or the markets would collapse,”

### What Does this Mean for the Immediate Future?

So, for all those people who are pulling their hair out over what to do, start looking at the Sentiment of the Market Place. It does not matter whether it is equities, indices, commodities or currencies. What truly matters is whether we have too much zeal as a group to continue in one direction or another. After all, there must be a buyer for every seller or the markets would collapse – which, on a micro scale, is essentially what happens whenever we top out or hit the proverbial bottom. Timing is important but anticipation is key. Many things will skew the timing. As an example, this article basically says “we are

approaching a “top” with a 2.05 Bull/Bear ratio” but at the same time we are going into the U.S. elections and a possible Christmas rally which might hold off the drop until the New Year. On the other hand, anticipation may lead some to see that preparing to protect what they

have through hedges or harvesting some of the profits in the very near future may prove the wiser of the moves. We cannot “know” in the absolute what the markets can and will do, but we can learn

to be prepared for the possibility of a change in the “weather.”

### Conclusion

At the top of this article I mentioned that the uneducated invariably pay the educated. This is not meant as an insult or arrogance but as a “flash light” of change. If there are terms and concepts you do not understand here, then you may have a “blind spot.” Learn to Earn – the emotional state of the market is a reflection of the people and it can be measured to a degree. If you are “in the markets” you must understand them.



F4) SPY 1-Year Chart with Volume



The amount of volume heavily varies at any given juncture.

Source: [www.tradestation.com](http://www.tradestation.com)

F5) Bull/Bear Spread



Bull/Bear Spread is currently at 25%. Note the closeness of the Spread in July to August, 2010.

Source: [www.tradestation.com](http://www.tradestation.com)





What Are Support and Resistance and Why Should I Care about Them?

## Support and Resistance

A question I have for someone who is trading but is not identifying support and resistance prior to making their trades is, “What is it like trading blind?” In reality, that is what you are doing if you are not identifying potential “turning points” in the market. If you are not attempting to identify support and resistance, ask yourself if you have ever noticed a stock (or whatever financial instrument you are trading) inexplicably stall or reverse and you just cannot figure out why. Why make life more difficult than it has to be? Let’s return to the basics and define what support and resistance are and how to use them in our trading.

### What Is Support?

Think of support as a floor. I have always used the analogy that if I took a ball and dropped it – what would happen? Well, it would “bounce” off the floor, right? Of course... assuming gravity is still intact. The key word there is “bounce.” It would hit the floor and then “bounce” off it. If a stock (or whatever financial instrument you are trading) is hitting a certain price level again and again and each time it “bounces” off of it and reverses, would you agree that there is something significant to that price level? The answer, of course, is “more than likely.” So, how can we use that bit of knowledge to our advantage? Well, in the simplest sense, ask yourself if you would want to open a short position directly above support (or the floor, in other words)? Probably not – because there would not be far to go before the trade might stall. Could you also perhaps

consider opening a long position directly above the support level? Possibly, assuming that everything else is lining up (i.e. whatever indicators you are using as confirmation).

So, we have established that identifying a “floor” in price can be helpful in determining a potential entry. What about the exit? What if, for example, you are in a short position and you want assistance in determining a logical location to exit the trade? In other words, at which point will this short position begin to stall – or run out of steam? Well, knowing something about support and having a basic understanding of human psychology – which is essentially what technical analysis is all about anyway – meaning that what happened in the past has a great likelihood of happening again. We are able to pre-determine in what general zone our short trade may run out of steam, at support.



**Eric Waddell**

Eric Waddell has been trading for over 10 years and teaches with Online Trading Academy. He has developed various strategies in the equities and Forex markets, which he has shared with students in various parts of the world. Eric truly considers it an honor to instruct with Online Trading Academy and encourages his students to stay in touch with him.

### What Is Resistance?

You have probably already figured this out, but if we are going to consider support as being a floor, then, you guessed it; resistance would have to be the ceiling. So, let's go back to my bouncing ball analogy. If I take that same ball and lob it up to the ceiling, what will happen once it hits the ceiling? Well, assuming I was somewhat gentle with it and not throwing it with great velocity toward a weakly constructed ceiling, it would more than likely hit the ceiling and then come back down. Now, once again, if your financial instrument is consistently hitting a particular price area and stalls or reverses, would you agree that there is something significant to that price level? As was argued with support, the answer is a resounding "yes." How can we use this information to our advantage? Well, would you want to open a long position directly below an area of resistance? Probably not, especially if there is a good chance that as soon as it hits that price level we have identified as resistance, it will stall or reverse. Sound familiar? It is, of course, a similar philosophy as "support." Would you want to enter a trade whereupon almost as soon as you enter, the trade will stall or just go against you? You see, we want to place high probability trades

– not high risk trades. I prefer lower-risk, potentially higher reward trades – as I am certain you do as well. Now, could you also use resistance as an entry and exit? Of course. Would it make sense to consider a short under an area of resistance and a long once it breaks through it so that the resistance is now support? Possibly, assuming that everything else is lining up (i.e. whatever indicators you are using as confirmation). What if you were considering a long trade and you noticed that if the trade moves in your favour that you will run into difficulty breaking through a particular price level (because historically that has been the case), would you want to set a price target under that area of resistance? That would definitely be a logical place to consider your exit.

### Tying It Together

Now, just because price has stalled or just flat-out reversed at a particular price level in the past, does that mean it is guaranteed to happen again? (The dreaded "g" word). No, unfortunately, there is no guarantee that price will stall or reverse at a particular price level simply because it has happened in the past. But you see, we want to place high probability trades and put the odds in our favour. Is there at least a good chance that if it has

#### F1) Support



General Zone above which to consider going long or to exit a short position.

Source: [www.tradestation.com](http://www.tradestation.com)



happened numerous times in the past it could happen again? The “odds” are that it could. All we are attempting to do is put the odds in our favour for making a positive trade. To summarise the philosophy behind support and resistance, I like what Dr. Alexander Elder wrote in his classic book “Trading For A Living” regarding support and resistance: “Support is a price level where buying is strong enough to interrupt or reverse a downtrend. When a downtrend hits support, it bounces like a diver who hits the bottom and pushes away from it. Resistance is a price level where selling is strong enough to interrupt or reverse an uptrend. When an uptrend hits resistance, it stops or tumbles down like a man who hits his head on a branch while climbing a tree.”

### The Wrecking Ball

I am always looking for trading analogies. I was watching a children’s video with my son some years ago, and in it there was a wrecking ball truck hitting a wall numerous times before the wall finally crumbled. If you think about it, that is how support and resistance works. Did the wall come down on the first swing of the ball? No. All that happened initially was some dust going everywhere and the building shook a little. Eventually,

however, the foundation became weaker and weaker until at last it came tumbling down. It is the same thing in the financial arena. Rarely does price simply blow right through support or resistance. Usually, it takes a few attempts before finally, definitively breaking through. That price level – whether it be support or resistance – is like a wall – eventually, with enough “hits” it may get weaker and price can more easily get through it. Does it happen every time? Of course not. But again, it is all about odds. Sure, there are cases where a stock has hit \$40 per share once in the past and then reversed; now it is at that area again and what happens – it blows right through it like it was a screen door as opposed to a “wall.” However, the odds are that if it had difficulty breaking through a particular price area in the past, it may at a minimum, stall – before finally breaking through. If a stock (or whatever financial instrument you are trading) has stalled several times at a particular price area, then it serves as validity that that area is “major” support or resistance as opposed to a “minor” area – which may get hit once or twice and then break through rather easily.

### Old Becomes New

Let us say that you are in a multi-level building. Is your ceiling the

same as the people on the level above you? No. Your ceiling is their floor and vice versa. When the instrument you are trading breaks above an area of resistance, what is that area now known as? Of course, that ceiling is now the floor. So what used to be old resistance is now new support. It works the other way as well, naturally. Now, once an area of support or resistance has been broken, does that mean that area is no longer of importance? Usually not. In fact, many times that area of support or resistance will be tested before moving toward the next area of support or resistance. Once again, that is nice information to know, but how can it help my trading? Well, would you want to place your stop directly on support or resistance or would you rather place it around support or resistance? For example, if you are long a stock based on a break through of resistance – so that now that resistance has become support – would you place your stop directly on that area or would you place it below that area, just in case that price level is tested? Rarely do stocks (or whatever you are trading) go straight up or straight down; usually they “stair step” one direction or another. Once an area of support or resistance has been broken, there is a good chance – based on human

### F2) Resistance



General Zone below which to consider going short or to exit a long position.

Source: [www.tradestation.com](http://www.tradestation.com)

### F3) Old Resistance Becomes New Support



Once the old ceiling is broken through it will frequently become the new floor.

Source: [www.tradestation.com](http://www.tradestation.com)

behaviour and odds – that the area will at a minimum, be tested again.

### Drilling Down

One of the most effective and beneficial habits in your trading is the act of “drilling down” on various time frames in order to identify potential areas of support and resistance. You do not want to stay focused in one time frame and you want to examine the time frames most relevant to your trading style. For example, if you are a “position trader” – meaning you might be in a position for weeks or months – do you care about the 3-minute chart? No. Would you care about the

monthly, weekly and daily charts? Absolutely. So what would you do? Always begin with the highest time frame most relevant to your trading style and drill down to the smallest time frame most relevant to your trading style. If you are a day trader, do you care about simply looking at the monthly, weekly and daily charts? Of course not. There is nothing wrong with identifying those longer term areas of support or resistance, but you would want to pay most attention to the daily, 60-minute and even 3-minute charts (or whichever “minute” charts you traditionally prefer). Now when you identify

multiple areas of support and resistance, which areas are you most concerned with? The answer: the areas which will have the most immediate impact on your trading. Do you care so much about a resistance level – assuming you are long – that is \$5.00 away, or do you care about the resistance level that is \$.30 away? I think you get the idea. You are most concerned about the areas which will have the most immediate impact.

Also, one of the biggest reasons for not focusing on just one time frame when identifying support and resistance is being able to see the “big picture.”

What if you were day trading a long position for example and only focused on the 3-minute chart – with no apparent resistance anywhere. Because you did not look at the daily chart, you did not notice the major resistance you were about to hit; and because it is “daily” resistance, it is a lot more powerful than resistance found on a 3-minute time frame due to a lot more data being taken into consideration.

### Summation

Remember, once again, that the study of technical analysis is essentially the study of human behaviour: what has happened

in the past is likely to happen again. It is not guaranteed to repeat itself – but there is a good chance it could be repeated. If we know going in that price may stall or test a particular area prior to placing our trade, we can begin to build a case for placing a trade and utilising logical money management. Without the benefit of identifying support and resistance, we are making our trading a lot more difficult than it should be. I hope this helps and good trading!



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## Nick McDonald

# In Forex Anything Is Possible

Nick McDonald is an international trader in the truest sense of the word. Moving between opposite sides of the globe for the last three years, chasing sunshine and speaking at prestigious conferences from New York, Las Vegas and Los Angeles to Frankfurt, Auckland and London is standard practice for Nick. Best of all he trades the same way in all of these locations with just a laptop and a broadband connection. Nick founded [www.tradewithprecision.com](http://www.tradewithprecision.com) in 2006 to teach people precisely how he trades the markets, day in and day out with his simple yet intricate trading strategies. Throughout his career, he has passed on knowledge to clients of some of the largest names in the financial world including the CME Group, Intercontinental Exchange (ICE), NYSE Liffe, TRADERS' Magazine plus many others.

### How did you become a professional trader?

Nick McDonald: In London during 1999/2000 I was working for various investment banks and there was a lot of hype around the markets during the internet boom, strangely enough I did not start trading then but it caught my interest. I returned to Auckland, New Zealand in 2001 and decided I wanted to be a stockbroker. I worked in a support role alongside some of the best full service brokers that the country had to offer and they put me through various training courses. I learnt a lot about the markets but the problem was I

learnt how to 'talk about' rather than how to 'profit from' the markets.

Upon taking the investment advice of the brokers that I worked with I quickly learnt that they too simply had an ability to 'talk the talk'. In fact, it was their job to do so and they had little clue on where the market was headed. One of the stocks that they were heavily pushing to clients as a long-term investment was then trading at around \$5 and today is at \$1.85. This lack of real market knowledge on their part was one of the reasons I decided that broking was not for me. The other reason was

that I started working there just as many brokers were returning to work having given up work to trade for themselves in 99/00. They thought they were great traders during the boom but quickly found out they were not when the dot-coms collapsed. Funny thing is, they proved they could not trade and yet the corporations so readily gave them their jobs back to trade for others! I wanted to become a trader who could make money for myself and after leaving that job I set off on my own path. It was a move back to London where I discovered technical analysis and I started trading full time for myself in 2004.



### How long did it take you to become successful?

Nick McDonald: Within three months of a switch from fundamental to technical analysis I left my day job. However I won't claim instant success as there were tough times and many lessons to be learned in the early days of trading for a living. After around six months of full time trading I was pulling a steady income from the markets and considered myself fairly successful. Looking back I was also a little naïve and took on a lot of risk but it worked out and built the foundations to get me here today. I am much more conservative now and take on much less risk.

### Were there any specific stumbling blocks?

Nick McDonald: There were many small obstacles but the biggest one of my trading career to date came about in January 2008. I was on top of the world and I now realise, largely overconfident, following three years of very successful full time trading. I set some goals for the new year during the Christmas break and my overconfidence led me to going out there and trying to achieve them in a month. The market dished up all the lessons that most traders get at the start of their careers, mine was just delayed a few years. I broke my

money management rules, traded outside my risk profile, moved stops too tight, took profits too soon, started changing my strategy and started listening to others opinions when the going got tough. I lost a lot of money and there were moments when I doubted myself. The biggest thing that happened when I look back is that I started to behave like a loser behaves. I did not want to get out of bed in the morning, I did everything I could in the mornings to avoid looking at the markets. When I did I had the nagging thought of "what's the point of trading, you will just lose more money". Then low and behold, I place a new trade, it loses and I the voice in my head then said "I knew it"!

### How did you get your trading back on track?

Nick McDonald: Two things happened to get me back on track. First I went on holiday and got out of the markets completely to clear my head. Second, before I traded again I thoroughly dissected what had happened and discovered it was largely a mindset and nothing to do with my technical skills. Significant overconfidence led to my biggest patch of under confidence. I became a much better trader from it and also a much better mentor to others as I can first hand relate to what so many go

through. I tell a slightly longer version of this story at every seminar that I conduct. I did not wipe out but I saw it was possible if I did not change things soon. I consider this a learning (not losing) period and now welcome learning periods with open arms. Thankfully though, I have not had one that large again!

### What kind of trader are you?

Nick McDonald: I am a discretionary trader with a 95% technical system. I used to say 99% technical yet slowly a little bit of fundamental analysis has crept back into my trading. Not much, but just keeping an eye on the headlines and identifying opportunities that may come from factors such as carry interest on forex trades or recognising potential highs and lows based on media hype. Not sure if you can call that fundamental? It is non-technical at least.

### Please explain your trading approach to us.

Nick McDonald: My approach remains unchanged since the day I learned to trade profitably – combine as many reasons as possible for every single trade that you enter. I still see new traders come to me for help who are trying to trade with just a MACD (Moving Average Convergence Divergence) or just a double top or just a doji. They



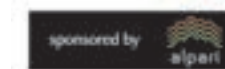
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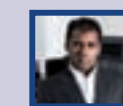


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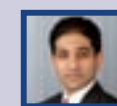
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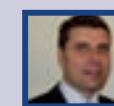
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wonder why it is not working and where they are going wrong. I explain that this is the equivalent of trying to bake a cake with just a cup of sugar or just a bag flour. Each technical aspect is just one ingredient and you need to combine the ingredients into a proven recipe. In trading terms a trading strategy is the equivalent of a recipe. A good cook has mastered the ingredients and can use many possible combinations to make many different recipes. I approach trading in this way. I have set strategies (recipes) which I trade and teach that make up the bulk of my trades, but with thousands of potential scenarios for the market to throw out, I am largely looking for multiple reasons to enter a trade with a precision entry point, a protected stop which is unlikely to be hit and an unprotected target which is very likely to be hit.

### Which instruments do you trade?

Nick McDonald: Spot forex, some currency futures and US index futures with a few stocks thrown in for good measure. I like the CME listed mini-Dow and have a fond preference for the ICE listed Russell contract (TF) also. I trade forex every single day and trade stocks when markets are trending and conditions suit.

### Why did you become a forex trader?

Nick McDonald: It is the one market where a trader can establish his or her risk parameters with 99% accuracy and certainty. Due to the 24 hour market and extremely high liquidity, slippage and surprise gaps are virtually unheard of... provided of course a few simple rules are followed such as not holding short-term positions through major fundamental news like non-farm payrolls or interest rates. Forex is also a market where anything is possible financially – there really are no limits on an individual trader. It is the biggest market in the world by far!

### What possibilities does the forex market open up for traders?

Nick McDonald: Unlimited financial upside as mentioned above but also having near certainty on the downside risk is a huge benefit. The ability to trade 24 hours a day from anywhere in the world is also a big one. Traders dream of being able to trade from anywhere but the truth is most markets will still require you to be in a certain time zone. For example I recently moved from London to Auckland which has had an effect on my US futures trading as the market now opens at 3:30am. This is not sustainable for me to continue trading the open so I now trade

the close instead and had to adjust my style somewhat. My forex trading is unaffected and always will be, regardless of my chosen location. All I need is broadband and a laptop.

### How many setups do you use?

Nick McDonald: I have core strategies which I teach on my training courses named Precision Expansion, Fade, PLT, PFX, Scalp, Precision Index and Trend Formation. Other than these I am looking for a combination of technical ingredients setting up together for a high probability trade as I discussed earlier.

### Can you please introduce one or two of your strategies?

Nick McDonald: Sure, have a look at Figure 1 which is what we call a PLT (Precision Lifestyle Trade) on CADJPY which is a unique combination of price, trend, candles, moving averages and indicators. We name the setup after lifestyle as it is a trade that sets up regularly and does not require a trader to be glued to the screens. The trade is a live screen shot and I am going long as price breaks the high of the 60-minute candle i.e. right now. At Trade with Precision (TWP) we take live screenshots of all our trades, hindsight helps no one.

In Figure 2 you will see a Precision Scalp trade on a 1-minute YM (mini-Dow futures)

#### F1) Precision Lifestyle Trade on CADJPY



I enter a long position as price breaks the high of the 60-minute candle – right now with the current candle I am doing so.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

#### F2) Precision Scalp Trade on mini-Dow (YM)



NYSE tick (not shown here), the candles and the relationship between price and averages all show us that price is about to change direction. The pivot points clustering with the 11,300 level gives the precise entry point to buy.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

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Last year the WhichWayToday LIVE trading made 8000 pips. Each day between 0630 and 1100 GMT two experienced financial traders operate the live trading room which specialises in making money from short term trades in stock indices and Forex.

The room is run by Tom Hougaard and David Paul. The room has a one year, transparent profit history, which is clearly displayed on the [www.whichwaytoday.com](http://www.whichwaytoday.com) website. Each trade is relayed to each room member instantaneously and is complete with stop loss level and profit target.

In the room the trades are classified into two main categories. These are intraday and swing trades. When a new customer signs up for the service, they are immediately sent a document which details the money management principles upon which all winning traders agree, that success is built. During the trading sessions, this concept is reinforced and many have concluded that the WhichWayToday live room is like going

on a course in trading in each day that someone else (the markets) pay for.

In the last week of each month WhichWayToday run a two day workshop. Here the emphasis is on quickly explaining the various setups and applying them to real markets WHEN the market is open.

The setups are simple, but unique. They are taught in an open and friendly environment by two excellent speakers who trade each day themselves. Although many setups are taught the aspiring trader just needs one to be successful. Each seminar student is allowed to repeat the seminar at a nominal cost if it is required.

In summary the WhichWayToday seminar teaches the setups and techniques necessary for success in short term trading. The WhichWayToday live trading room shows how to apply these techniques each and every morning as the market is moving. It is an unequalled learning experienced.



chart. A new trader would think I was trying to catch a falling knife. An experienced trader will spot multiple 'leading' indicators that price is overextended and about to rise. NYSE tick, the candles and the relationship between price and averages all show us that price is about to change direction. The pivot points clustering with the 11,300 level gives the precise entry point to buy.

### Which time frames do you use?

Nick McDonald: For forex my intraday trading is largely focused on 15- and 60-minute charts. Swing trading focuses from four hour to weekly and sometimes even monthly. On index futures I trade as low as 1- and 2-minute charts.

### Do you have some favourite currency pairs?

Nick McDonald: I do yes but they change depending on conditions. Trends come and go in FX so my favourite pairs tend to switch to the best trading conditions.

### Do you trade cross rates?

Nick McDonald: Absolutely but I am strict on the crosses I trade and if they have low liquidity and/or wide spreads then I won't touch them. Traders often underestimate the cost of spread in FX trading and how well they must trade to simply recoup their

costs before they even have a chance to make money.

### Do you use indicators or chart patterns?

Nick McDonald: If you mean chart patterns like head & shoulders and double bottoms then quite frankly I think they are a waste of time. There is just one pattern – a trend. If this trend continues I will trade it, if it reverses I will trade that too. Every continuation and reversal pattern is covered by the trend and I teach people the way I trade – focus on what you need to know, not fancy names for things. The exact same thing is true for candlesticks – knowing a doji, hammer and shooting star won't help you make a single cent.

As for indicators I have a few on my chart but I do not use them in their traditional lagging sense. I only use indicators in a leading fashion which predict market moves rather than giving a hindsight signal. Convergence and divergence between the price and indicators fall into this leading indicator category. I am very careful to always 'predict' and never 'chase' market moves.

### What does your risk and money management look like?

Nick McDonald: two per cent maximum open risk at any one time and one per cent maximum risk on any one trade. If anything

I have become more conservative lately and usually risk less than one per cent, that is simply my maximum.

### Can you show us some of your trades?

Nick McDonald: Of course. I predicted the coming bull market in stocks in April 2009 while the world was still amazingly bearish, I bought the turning of the kiwi dollar at 50c to the USD before a 50 per cent rally and also recently bought the near low on the USD on 2nd December 2009. It was funny actually, I put that USD call out on my free newsletter which goes to thousands of people around the world. I received a barrage of emails telling me that I would 'get hammered' trying to pick the bottom of the USD like all other traders' (clearly themselves included). My response was simply "I don't pick bottoms, I trade turning points". It turned out that I got that turning point correct.

Have a look at the trade on the ICE listed US Dollar index contract from 2nd December 2009. Figure 3 shows the all time lows on the contract which provides major support and a potential turning point back up. Figure 4 is the monthly chart and outlines bullish divergence between price and indicators, another very strong indication of a move higher. It shows an

F3) \$Index Weekly Chart



\$Index weekly chart is at all time lows since 1973 plus the round number of 74.00 is key. Price has also extended away from the moving averages. All of these are bullish signs on their own but combined together its very bullish.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

F4) \$Index Monthly Chart



Monthly chart showing how the Dollar Index rejected exactly as expected and has continued much higher since the trade idea made live on 2nd December.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

ideal entry on the break back up through the line drawn in where price has rejected in the past and the more than ten per cent rally the DX had from the day I put that idea out there to today.

### What does your typical trading day look like?

Nick McDonald: It varies from day to day. Trading is a lifestyle choice among other things and it gives the freedom and flexibility to work around other things. For this reason I do not have a set routine. My office is at home and I have a two year old son there whom I love to spend time with whenever I wish. That alone was one of the things that drove me to be a successful trader, well before my little man came along I was determined not to be a Dad who left at 7am and got back at 7pm or even later.

I also have a successful business with staff and clients who need my time, this has its own challenges of course but I would not change it for the world. The thing about trading and my structured approach to it is that I only need 15 minutes spare in my day to do a thorough forex market scan and make any trading decision that I need to make. I do this 5-6 times a day most days and that is pretty much my routine... have a look at the market when the time in my schedule is right.

### What is the relation between your winning and your losing trades?

Nick McDonald: I risk one per cent maximum to make one per cent or more. I like to leave the upside potential to be unlimited for when I get on the right side of a big move. I do not have a crystal ball to see the big moves coming but by nature of being in the market and taking consistent, small winning trades I tend to end up on the right side of the big ones often enough. Actually one trading example to illustrate this occurred on 6th May 2010 when the Dow fell nearly ten per cent intraday and many blamed it on an electronic trading collapse or 'flash crash'. I did not see this coming and just the day before I had said publicly that I did not expect anywhere near the volatility of 2008 only for it to arrive within 24 hours! Yet I still had trades and orders in place on various currencies and woke up in the New Zealand morning to one of my most profitable nights sleep in a long time.

### Can you show us another trade?

Nick McDonald: Of course. The other trade I am showing was a break lower through a flat level (Figure 5) in the direction of the higher timeframe trends (Figure 6). I put the video with

the entry out there to Precision perspectives newsletter subscribers on the 4th May and the trade triggered on 6th May for a very tidy profit.

### How do you handle emotions?

Nick McDonald: In the early days I would have made a tidy sum that day and start booking the best restaurants and finest wines and the next day having given it back I was down in the dumps. I realised I had to eliminate this emotional response and I started to reward myself for good trading, not profit or loss.

I also noticed that the best traders I knew personally were the most humble and I learnt a lot from them on managing emotion. I used to talk about my successes and rarely discuss my losses, exactly like amateurs tend to do. I now treat it in a professional way and am neutral on profit and loss. The main time I get emotional is if I break my rules. Losing money from trading badly upsets me the most as I know I should not have done it. Losing money from trading well I can easily accept.

I could talk all day about emotions in trading and there are a whole host of topics. Mindset as compared to ability or intelligence is what separates the winners from the losers. The same could be said for many professions.

#### F5) EURCHF Breakdown



This was a very profitable trade during the 'flash crash' on May 6th 2010.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

#### F6) EURCHF Higher Timeframe Trend



The higher timeframe shows a clear downtrend.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)



**For what kind of traders is the forex market appropriate? And what advice do you have for them?**

Nick McDonald: My advice is start as you plan to go on. If you have a dream of one day trading a large account and make a fortune then do not trade penny stocks and stay away from all small caps. Trade big liquid markets where you can make as much money as your reasoning allows you to dream you can – and then start to expand your reasoning! Many markets fit this bill but none is as big, as liquid and offers as much flexibility and opportunity as forex.

It is also ideal for beginners right through to the most seasoned professionals, with very small or very large accounts, those with full time day jobs or those who are already full time day traders, it is ideal for everyone. So again... start as you plan to go on.

**How do you estimate the current and future development of the forex market?**

Nick McDonald: More and more traders are getting involved due to the benefits we just discussed. Liquidity and risk protection are vital and traders cannot be at their screen 24 hours a day so they are trading the forex market which can work for them 24 hours

a day and manage their downside with unlimited upside.

**Any words about carry trades?**

Nick McDonald: Yes, the carry trade is underused outside of institutions and perhaps because it is largely unknown to smaller traders. Any position held longer than a few days should have carry interest taken into account. For example it can be expensive to hold AUDJPY (Figure 7) short or GBP NZD long because of the interest charged overnight. However, position yourself in a good trade in the opposite direction and you are getting paid interest on a leveraged position every day. The costs can add up if not known and the benefits can be immense when used correctly. Some of the longest lasting trades I have taken in recent years have been taken with carry interest payments in mind, matching up with a sensible technical trade.

**How do you see the current and future development of the EURUSD?**

Nick McDonald: I do not have a crystal ball for price direction but there will be money to be made either way. Having a long-term view on the market is detrimental to success as a trader. If I had to take a stab at it now in November I would say that we are about to start a new leg down on most

major Euro pairs – EURUSD, EURJPY and EURCHF. My money is not behind that trade yet for the long term but in the short term the direction is down and I am positioned as such. The charts will start to tell me the full story.

**Do you think that the USD could be replaced as base currency? If so, by which currency? And what would that mean for the world?**

Nick McDonald: I do not see it happening in the near future. In 2008 the dollar was low before we had a financial crisis and what did the rest of the world do? Buy dollars. As we talk now Ireland and other European nations are on the verge of bankruptcy and there is a lot of tension between North and South Korea. What is the world doing? Buying dollars. Like it or not the US and the US dollar are still the place we look for help and safety when the going gets tough. I cannot see that changing in the short term. With all the Euro troubles it is very hard to see that taking over from the USD anytime soon. As and if it does happen down the track it will be a slow and drawn out process. Perhaps we are already in the start of that process but it will be a long one.



**F7) AUDJPY**



It can be expensive to hold AUDJPY short overnight and long-term as there is a huge interest differential of currently more than four per cent annually against this position.

Source: [www.tradesignalonline.com](http://www.tradesignalonline.com)

## SEMINARS

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07.01.2011	Stock Market Training	WIN Investing	Cardiff	<a href="http://www.wininvesting.co.uk">www.wininvesting.co.uk</a>
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11.01.2011	Stock Market Seminar	Knowledge To Action Ltd.	Belfast	<a href="http://www.knowledgetoaction.co.uk">www.knowledgetoaction.co.uk</a>
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Stefan Salomon

Mr Stefan Salomon has been a technical analyst since the mid-nineties. Since then his positions have included that of head of technical analysis of wallstreet: online AG, financial adviser of Hornblower Fischer AG, and management board member and Berlin-based regional manager of the German Association of Technical Analysts (VTAD). Mr Salomon's special fields are trend and formation analysis as well as candlesticks. He regularly conducts seminars as well as mental-training and trader-coaching courses. Contact: [www.candlestick.de](http://www.candlestick.de)

## To Make Losses Is Human

Surely you are familiar with this: lots of small profits and one major loss putting paid to all the efforts made in the course of many trading days or even weeks. This is what happens to many traders who subsequently often give up sooner or later. Most of the traders are not successful in the long run. But why is this?

The answer is quite simple: Failure on the stock markets is innate. For instance, fears of yet another loss following a series of losses and the resulting avoidance strategies are just as profoundly human as increasing one's risk to recoup earlier losses by taking the sledgehammer approach. While this behaviour rationally is not particularly sensible in trading, it does seem to be automated since it is innate. For example, the gyrus cinguli, a small area in everybody's brain, makes sure that people run higher risks after suffering a series of losses. So please ignore that impulse that may tell you to take

the sledgehammer approach after a series of losses – just turn off your computer!

However, much more important than the gyrus cinguli is the innate human need of control

in order to be on the side of the market winners over the long term. According to Abraham Maslow, the need for security is one of man's basic needs. Human beings prefer a secure, calculable, and controllable environment to one that is perilous, uncontrollable, and not very calculable. In addition, people learn in the course of their lives that any control over their lives and over their own and other people's circumstances is positive and raises their self-worth as well as their positive self-image. And what are we shown by the markets then? Insecurity! The real problem on any stock market is that both the acquired and the innate need for control has been suspended. It is not we as individuals that control the market, but it is the market that is always right. All we can do is subject ourselves to the market action, but we exercise no control whatsoever. In my job I often meet seasoned men in their prime of life – with their own family, home, company, career. They have made it on all

four counts and everything is running smoothly. But it is these very "doers" who have incredible problems being successful on the stock market. Why? They have learned how to move and achieve something with ambition, perseverance, and their own action. The "doer" usually has clear goals – but also a certain opinion of how something has to develop. By contrast, on the stock market that self-image of the successful "doer" disappears into thin air. "Opinions" and "goals" are being traded, and a certain "opinion" is stuck to even when making losses. It is this very group of people that finds it difficult to accept the fact that they have no power over the market, and their loss of control will be ignored for as long as possible.

So the first step on the way to success is to accept that the trader is no superman, but just a human being with all the innate and acquired automated behaviour patterns that are downright counterproductive in trading. The second step would then be to find out how you yourself are programmed and what kind of personality structure you have. And that is what will determine your trading style. Are you more the intuitive doer or the rational analyst? Or the "jovial fat guy" who sticks to his decisions and cannot let go of his commitments? Only when you

know yourself should you choose the trading strategy that suits you.

The "jovial fat guy" is miles away from being a successful day trader. Trading may, but does not have to become an expensive self-awareness course. Before you do any serious investing, try and find out which mental pitfalls await you personally in trading. Practice with a small account. It cannot be reiterated often enough: Keep a trading diary! Jot down your thoughts and emotions. Get to know yourself! Question your thoughts. Ultimately it is all about recognising and changing old behaviour patterns that are either innate and/or acquired but not sensible for your trading.

Practice new desired behaviour patterns in your mind (for example: let profits run secure, limit losses quickly and strictly). A large number of mental training techniques can support you in everyday trading. Not until the third step will you perfect the trading style that suits you. In conclusion, we can confirm our assertion that losses are profoundly human. Stock-market profits will be made and accrue whenever the trader does his job in harmony with himself and the market.





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