Electronic Trading

'TNT'

I

Gorilla Trading Stuff

JOE ROSS
MARK CHERLIN

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Electronic Trading 'TNT' I — Gorilla Trading Stuff™

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ISBN 976-8108-14-2

Printed in the United States of America

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Distributed by Ross Trading Inc., 1509 Jackson, Cedar Park, TX 78613

E mail: ross@rosstrading.com Telephone: 512-249-6930 Fax: 512-249-6931 Order: 800-476-7796 Office hours: 9:00 A.M - 5:00 P.M. CST Visit our Web site: www.rosstrading.com

Special Acknowledgement

It's not easy to write. It's especially difficult to write about something as subjective as how to trade profitably.

Whenever a course like this is written, it is written and rewritten, read and reread. Finally, it seems to be perfect. That's when the writing is submitted to Loretta, our own private in-house proofreader.

Loretta has a big red pencil. Editors usually have blue pencils. Blue is a lot easier on the eyes than red. But Loretta slashes through our work, making her comments in dripping scarlet all over our beautiful pages. She tears through our handiwork without mercy.

Loretta knows nothing about trading stocks. If she can make sense of what we have to say, then we know we have a chance of getting our message across to you.

Loretta is Joe's wife and lifelong partner, a beautiful person who helps in the writing of useful trading courses.

There are parts in this course where you will be corrected, just as Loretta corrects us when we write. We're going to copy her way of doing things. Loretta is very firm, very honest, and won't budge an inch. But she always does her correcting in a loving and positive way.

That's why we want to give her special mention in this trading course.

Joe Ross Mark Cherlin

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CAUTION

CAUTION: THIS IS A COURSE INTENDED TO HELP TEACH YOU HOW TO TRADE STOCKS, IMPROVE YOUR TRADING SKILLS, OR BOTH. THERE ARE SECTIONS OF THIS COURSE THAT ARE DIFFICULT TO UNDERSTAND UPON FIRST READING. IT IS A MANUAL MEANT TO BE STUDIED. THE CONCEPTS CONTAINED IN THIS COURSE TOOK MANY YEARS TO DEVELOP. MOST TRADERS WILL NOT BE ABLE TO GRASP THESE WITH JUST A CURSORY READING OF THE TEXT. IN THE PAST, MUCH OF THIS MATERIAL WAS RESERVED EXCLUSIVELY FOR PRIVATE SEMINARS WHICH COST $10,000 PER STUDENT.

Books for stock traders by Joe Ross and Mark Cherlin:

- Electronic Trading 'TNT' I — Gorilla Trading Stuff
- Electronic Trading 'TNT' II — How-to-Win Trading Stuff
- Electronic Trading 'TNT' III — Technical Trading Stuff
- Electronic Trading 'TNT' IV — Tips-Tricks and Other Trading Stuff

To the Ladies who are taking this course: We tried to write the manuals in a way that is gender neutral. Ladies, it just didn't work. So please forgive the fact that we used the masculine gender throughout. It is not our intent to offend you in any way.

DISCLAIMER

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Foreword

The first time I heard of Joe Ross, I was sitting in a bank observing the work of an individual who was introduced to me as an exceptional trader. When I asked him what made him exceptional, he said, "Following the Ross Hook." He explained that he liked the system's simplicity and the fact that it was explained in such great detail in Joe's books. "Most people don't realize Ross is giving away a million dollar system," he said, looking like the cat who ate the canary.

After that initial introduction, Joe Ross' name popped up several more times, prompting me to inquire about his reputation from people I considered knowledgeable traders. The word on the street was that Joe Ross' reputation was "squeaky clean," that he was an exceptional trader and teacher, and that he had great material circulating in books and tapes. With this kind of recommendation, I was delighted when his office called a few years ago, inquiring about my own materials. One thing led to another and eventually we collaborated on a seminar series in Boston.

Joe Ross' name was destined to continue popping up in my life. The next time was through one of my good friends and star clients, Mark Cherlin, whom I had successfully coached many years ago.

Later, when I watched Mark on television, I realized that he was a natural-born teacher. Mark's incredible, intuitive ability to trade stocks made him one of "Inside Money's" favorite guest speakers. For this reason, when Mark called me one day announcing that he wanted to write a course for stock traders, I was not surprised. Mark continued, enthusiastically. "I want to get in touch with Joe Ross, I've been reading his stuff lately." I told Mark that I did some work with Joe and would call to introduce them.

The "How to Win" series, is one of the rippling effects of that introduction. In this no-holes-barred collaboration, Joe and Mark are offering two business-success models in one powerful package. Both Joe and Mark are teachers, traders, entrepreneurs, lecturers and writers. The "stuff" that Joe adds to the mix is his life long trading experience as a businessman, and the "stuff" that Mark adds is his

trading experience, hedge fund experience and managing investment advisory expertise. What a great combination!

Together they have produced an outstanding four volume course that covers electronic stock trading from its broadest aspects down to its finest details. There is an abundance of material here for every trader – from the novice to the most advanced professional; from the plain simplicity of chart reading to the more esoteric complexities of technical analysis, all is contained in this trading course.

One of the most important aspects of the course is the fact that both Joe and Mark offer excellent models for the reader. They are both highly intuitive and they both approach markets with the realization that intuition is not only viable but vital to successful trading. But the best part is that they are able to help the reader to emulate their success.

This course teaches you that if you get caught up in arrogance, in your persona, in money for money's sake, you will become disconnected from who and what you are and you will lose as a trader. According to Joe and Mark, when you understand that trading is about expanding yourself as a human being in the process of becoming a trader, then your trading becomes, automatically, more successful. While most books teach you to trade, this course teaches you how to trade, how to run your trading business, and also teaches you how to have the mindset needed for successful trading.

One thing that makes their approach to trading instruction so valuable is the fact that Joe and Mark do a great job of hand-holding you through some of the essential details which are often overlooked by others. These are the very details which traders are too embarrassed to ask about because they feel they should already know them.

And finally, their no-nonsense approach helps you to self-diagnose your weaknesses, to find the source of your misdirection, and to turn yourself in the right direction. This process is especially true in allowing you to examine and redirect the beliefs you have about trading and about trading as a business. The model which both Mark and Joe use combined with their experience and natural gifts as traders and teachers have created a complete training course which,

studied and followed, will lead you down the path to successful trading and keep you on it.

Adrienne Laris Toghraie, MNLP, MCH

PLEASE READ THE FOLLOWING

A Special Message from the Authors

There is a different **free gift** offer located within the contents of each of our manuals. The free gift consists of a winning trading strategy that has made substantial profits for those who have used it. Since we feel it is important to read the entire manual, we are not going to tell you where it is.

You will have to read the contents to find it.

When you do, please contact Ross Trading Inc. to have it sent to you.

WARNING

This manual has certain critical pages printed in a special ink. The ink is extremely light sensitive. Copying or scanning this manual will result in total destruction of the print on those pages. If you attempt to copy the text, you do so at your own risk. Besides it is illegal. Consider yourself warned. We will not replace or honor the warranty on any books with missing print. We will also prosecute to the full extent of the law any violation of copyright law.

The Authors

JOE ROSS

Joe Ross, trader, author, and educator, has been an active trader since 1957, when he began his trading career in the commodity futures markets. In 1982, when it became possible to daytrade the S&P 500 stock index futures via a live data feed, he successfully made the transition from full-time position trader to full-time daytrader. In 1988 he formed Trading Educators for the purpose of training aspiring traders in the futures, bonds, and currency markets. Since 1988, Joe has written seven major texts on futures trading. All have become classics. An eighth text is distributed only to students who take his private daytrading course. In 1991, in addition to private tutoring, Joe began to give seminars and to write Trader's Notebook, a teaching newsletter. He did this in order to keep his students apprised of new trading techniques, and global situations that can affect all markets. Joe teaches that a trader should be able to live anywhere in the world where he can obtain trading facilities, and be able to trade any market at any time whether it be stocks, futures, currencies on the Forex, or interest rate contracts. To prove that he means it, Joe moved to the Bahamas. "The phones are lousy, and I can barely get data," Joe says. But he successfully trades from there.

Although Joe's career has centered mostly on the trading of futures, and in recent years more particularly on daytrading the S&P 500 futures, he has also been a successful trader in the stock market. In fact, many active and successful stock market traders have read Joe's books on their way to becoming profitable. As Joe likes to say, "A market is a market, and a chart is a chart. Given those two and a way to enter an order, a trader should be able to make his money."

Joe holds a Bachelor of Science degree in Business Administration from the University of California at Los Angeles. He did his Masters work in Computer Sciences at the George Washington University extension in Norfolk, Virginia.

MARK CHERLIN

Mark Cherlin, trader, money manager, and educator, began trading other people's money immediately after graduation from the renowned A.B. Freeman School of Business at Tulane University.

In addition to owning and operating an investment advisory firm and being trader for a hedge fund, Mark started a daytrading firm which quickly became one of the most successful in the country.

Mark used his trading and educational skills to develop training seminars specifically designed to teach the daytrading of stocks using various electronic trading systems. He provided this course to aspiring traders through his daytrading firm. People from all walks of life traveled from various cities in the United States to his office for trading and training.

Mark has been deeply involved with electronic trading and has himself successfully daytraded various electronic systems as well as having contributed greatly to the success of scores of daytraders.

Mark's other accomplishments are equally impressive. He has been a Vice-President/Investments with both Shearson Lehman Brothers and Oppenheimer & Co., and First Vice-President/Investments with Lehman Brothers.

His articles, views, and accomplishments have been noted or published in such leading journals and periodicals as Investors Business Daily, Barron's, The Houston Business Journal, and Institutional Investors Portfolio Letter, to name but a few. He has made numerous appearances on the national television show Inside Money, and has been mentioned or featured on radio stations around the country. He has also, upon request, written published editorials about trading and investing.

Mark is considered by many to be one of the most energetic and exciting traders / educators in the Electronic Daytrading community. He is happy to share with all aspiring traders, both beginners and experts, this, his latest venture, as co-author of this course, Electronic Trading 'TNT.'

Chapter 1

BACKGROUND

We are ecstatic about writing and teaching about the benefits of electronic trading. The ability to trade NASDAQ and NYSE listed stocks from genuinely live prices is a blessing and a boon to the trader who now can enter the market by way of a much more level playing field. Many have searched for such a situation for much of their trading lives, often despairing of ever finding it. It is here now. Thank God!!

The professionals were always able to daytrade the equity markets. Daytrading has been a profitable activity for dealers, specialists, market makers, market movers, locals, floor traders — those who have had access to real prices as they occur. But much like the futures and other financial markets are today, the equity exchanges, prior to NASDAQ's electronic systems or the NYSE DOT system, have always elected to have rules and regulations and various physical barriers in place that put the public (those traders without direct access to data) at a significant disadvantage to the professionals. Just as in futures and other financial markets, the professionals have the benefit of being able to buy the bid and sell the offer (ask). The bid is the price at which someone here and now is willing to purchase a security. The ask or offer is the lowest price at which a dealer is willing to sell a security. A dealer is an individual or firm, who as a matter of regular business, purchases or sells securities for his account and risk.

Prior to the NASDAQ and NYSE DOT electronic systems, the U.S. and other equity markets around the world suffered from a situation which was even worse for equity traders than it was for futures traders. At least futures traders had and still have the advantage of extremely low margins and quite large daily movement of prices.

However, an equities trader, besides being held to much higher margins, has had to deal with many other disadvantages. Besides having to buy at the offer and sell at the bid, until electronic trading

systems came along, a trader not having access to live prices and not directly connected to the exchanges was faced with:

- High commission costs.
- Delayed execution due to having to call a broker.
- Little movement relative to costs and margin.

WHAT DOES TRADING HAVE TO OFFER?

Why would anyone choose to become a trader? What does trading have to offer?

Before answering those questions we must explain exactly what is meant by trading. In this course, we mean daytrading or position trading in equities by means of an electronic trading and execution system in a trading office or on the Internet.

It should also be noted that these systems are not set in stone. They can change dramatically as to the names by which they are called, and the rules governing them. There have been significant changes in the past, and even as this course is being written, other changes are anticipated.

Besides unlimited earnings potential, trading, whether it be daytrading or position trading, offers prestige and an opportunity to engage in what may very well be as close to a perfect business as it is possible to encounter.

Electronic trading is a business. In our opinion it is one of the best businesses in the world — for a great many reasons! It has a very high profit potential against a very low overhead. Risk can be tremendously reduced by taking only high probability trades. In fact, electronic trading is a relatively low-risk business when approached with the right attitude and the right planning.

Trading is eclectic. You can pick and choose which equities to be in. You can choose when to be in them, and generally under what circumstances your entry will be. If traders in ABC company are

making money, you can make money in it too. If you want to trade the XYZ's shares because they are moving, you can. Any trending market is making money for someone, so you can also have a piece of the action. You can be a bull or a bear as the mood suits you. You can be a happy bull or bear if you're going with the trend.

You can earn your living in an essentially free marketplace. You can live by your wits, and reap the fruit of your labors.

You have no customer problems: no customer relations, no customer complaints, no customer theft, no customers returning anything.

There are no employee problems other than yourself. No unions to contend with, no negotiations, no strikes. No employee benefit plans other than what you give to yourself. No employees stealing from you. No collective bargaining, and no stockholders.

There are no merchandising costs, no damaged goods, no vandalism, no service calls, no repairs to make, and no guarantees to honor.

You don't have to advertise in the traditional sense, and you have no marketing headaches. There is almost always a buyer if you want to sell, and almost always a seller if you want to buy — no purchasing and procurement problems, and no salesmen making mistakes.

There are no manufacturing problems, no production schedules to meet, no shipping, no receiving, no product liability, and no insurance policies to carry.

You don't have storage problems either. No warehouse, no spoilage, no items to discontinue or mark down. No bills of lading, no freight or freight damage, no trucks to load or to unload.

You're free of invoicing, accounts payable, payroll, inventories, accounts receivable, billing, dunning, bad checks, and bad debts.

There are no salesmen to call on you, although occasionally an investment salesman will call on the telephone. As soon as you tell

him you are a professional trader doing quite nicely in the market, hopefully he will quickly excuse himself and hang up.

You will have no direct competition in the traditional sense. It's true. You have to deal only with someone who is willing to sell to you or buy from you. You settle your business transactions with money. If you're right about the direction of prices, you get paid. If you're wrong about the direction of prices, someone else gets paid. Business is resolved in a polite and courteous fashion. Both parties put their money on the line according to the rules. You don't know each other. The exchange acts as the neutral party.

The person on the other side of your trade can't offer better service, he can't scoop you in the marketplace with a new innovation on an existing product or get one-up on you with an entirely new product. He can't steal your customer lists, because you don't have any. He can't lure away your best salesman either. He can't even plant a spy to discover your trade secrets, because he doesn't know who you are. He can't seduce your top research scientist, and you can never directly be the victim of a hostile take-over. You will never worry about corporate spies.

Now ask yourself, "Self, where else can I find a business like this?" The answer is an overwhelming "Virtually nowhere! It's the most perfect business in the world!!"

WHAT IS A MARKET

Throughout this course, when the term "market," is used, apart from the usual meanings associated with the term market, it specifically means the action of an individual stock's price as it is traded over time. Each stock, as it trades, is a unique market unto itself. Therefore, there is a market for every stock in which we would be interested in trading.

MARKET DYNAMICS

In theory, share prices should change only if there is fresh news affecting the valuation of a company's shares. However, in actual practice, we see constant fluctuation in share prices. These

fluctuations have nothing to do with valuation and they have nothing to do with supply and demand. They are simply there because certain traders are able to move prices. Prices are anything but a random walk. Prices are manipulated and engineered. The sooner you realize that, the better off you will be. However, it is the price manipulations that make daytrading of shares possible.

MARKET PARTICIPANTS

The market for any stock has a variety of participants. There are, of course investors, almost everyone is familiar with them. There are also specialists or market makers, the people who make a market in one or more equity issues. Less well known are market movers or "operators." These are individuals who may trade managed money or trade strictly for themselves. Market movers are characterized by the fact that they are able, because of their size, to move the market for an individual stock. There are also individual traders who are not able to move prices at will. These traders are individuals who sit in front of a screen or call their brokers and trade shares in relatively small amounts. This course is written primarily with the individual trader in mind.

Because we want you who are taking this course to feel comfortable and at home with what we teach, wherever possible we will try to use the collective "we" when discussing various topics.

Chapter 2

WHAT IS ELECTRONIC TRADING?

There are vehicles for trade execution designed for the individual trader. They enable us as traders to have direct access to the NASDAQ National Market and NYSE markets, and consequently to its group of "market makers" and specialists through electronic trading mechanisms.

As mentioned in the previous chapter, for years market makers have enjoyed certain advantages that give them an "edge" over those aspiring to be stock traders, as opposed to being stock investors.

The edge traditionally enjoyed by market makers has been that of high visibility for their bids and offers, knowledge of "who" is doing the trading, virtually instant execution, and the ability to buy the bid and sell the offer. When dealing with a market maker, we were unable to buy or sell shares in between the "spread" (the difference between the bid and offer). We were obliged to pay the spread. Additional benefits enjoyed by market makers and specialists was knowledge of the "size" (the number of shares being bought or sold) of the bid/offer, and the ability to see/hear prices as they occurred.

With the exception of sometimes having to pay the spread, there are electronic order systems that eliminate virtually all of the edge previously enjoyed by the market maker, thereby, in all other respects, creating a level playing field for traders sitting at computer terminals away from the NASDAQ, NYSE, or other electronic trading exchanges.

Data vendors and various software developers electronically provide NASDQ Level II quotes, and other exchange quotes, as well as various electronic order execution systems. By affording us access to this kind of data, we become virtually as well-informed as the market maker about prevailing conditions and prices in the market. An individual trader is able to see current prices as they are in the process of changing, as opposed to seeing them *after* they have occurred. Because of this, trading decisions can be made more

quickly, and virtually immediate entry into a fast moving situation becomes possible. Through high visibility of our own bids and offers, we find it possible to control at least in part the trading environment in which our trades are executed.

As electronic traders, we possess knowledge of:

- The symbol of the share issue being traded.

- The "call letters" of the Market Maker who is making the bid or offer.

- The bid price.

- The offer price.

- The size of the bid/offer.

- The clock time of the bid/offer.

To that extent, trading becomes informed trading. A trader's chances for success become greater commensurate with the information available. Traders now have virtually all available information, and we have it live — as it is happening!

Based on the information available, we can execute orders in a time frame from about a half second to several seconds — rarely more than five. We do not have to take time to call a broker. A simple pressing of a button on the terminal keyboard or click of a mouse issues a buy or sell command.

Information is available to us in the form of what essentially amounts to an electronic tape, ***or*** in the form of a bar chart showing an open, high, low, and closing price for each time interval represented by the price bar.

With the inclusion of charting software, we can become more than a real-time tape reader. We can obtain a pictorial view of what is happening within a particular issue of stock.

It is with charting in mind that this course is offered. The ability to see a simple bar chart depicting price action has long been considered superior to just plain tape reading.

There are additional advantages to electronic trading, one of them being low commission costs. Depending upon account size and volume of trading done, as electronic traders we may enjoy much lower commissions than does the average trader, and certainly lower than those being experienced by most investors. However, with the advent of daytrading offices and Internet trading, commissions to all equity traders and investors have become wonderfully low.

Another advantage experienced by electronic traders is that daytrading or position trading is extremely lively and exciting, and the rewards for those of us who succeed are more than generous, to say the least.

Those of us who choose to strictly daytrade have an additional benefit, in that daytraders end the day "flat," i.e., they do not have the worry or concern of carrying a position overnight. A daytrader's job is done before the markets close for the night. His time between sessions is his own.

It is important to keep in mind that trading is not investing. The two are miles apart. Many who have been excellent traders turn out to be poor investors. The opposite is true as well; do not think for a moment that if you are a successful investor that you will automatically be a good trader. Vastly different skills and temperament are involved.

DETAILS OF ELECTRONIC TRADING

The electronic trader currently has access to the NASDAQ National Market as well as the NYSE and its body of market makers and specialists. Various execution systems were designed so that the trader, or even investor, would be able to access the market. These systems enable us to electronically trade NASDAQ and NYSE shares along with market makers and various financial institutions who are presently wanting to buy or sell shares at specific prices. Traders who use the NASDAQ or NYSE order execution systems must be

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constantly aware of the rules that govern trading on those systems. These rules change frequently. To stay abreast of what is current, contact your broker or the brokerage firm handling your account.

A few current examples are as follows:

- The maximum number of shares that may be bought or sold through one NASDAQ electronic system is 1,000. Other electronic systems have no practical limit to the number of shares bought or sold. Typical lot sizes are 200, 500, and 1,000 shares, but other sizes under 1,000 are also acceptable. Check with your broker, because these amounts are subject to change.

- Market makers advertising to buy or sell shares are required to provide liquidity.

- On one particular NASDAQ system, a trader must wait five minutes before executing an order of the same type for the same stock. If a trader issues a buy order, he must wait five minutes before another buy order for the same stock can be issued. If he issues a sell order, five minutes must elapse before a second sell order for the same stock can be entered into the system. This does not preclude the buying and/or selling of other stocks during the five minute interval. Other electronic systems have no waiting period at all.

- Short selling must be done on an up-tick.

- Members of broker-dealer organizations as well as registered representatives are forbidden to trade certain NASDAQ execution systems for their own account. The exchanges will negate any orders that are inappropriate in this regard.

- If the broker with whom you have your trading account makes a market in any stock, you cannot enter certain electronic trades for that stock.

- Some electronic systems involve mandatory execution. A market maker who is advertising to buy or sell shares must trade a

minimum number of shares at the advertised price. There are exceptions to this rule for certain stocks with small capitalization.

Small capitalization stocks are clearly indicated in various ways depending upon the software being used to trade the system. With small capitalization stocks, a market maker may be required to trade only 200 or 500 shares.

In summary, as electronic traders, we have access to a huge variety of actively traded stocks which can be monitored for trading opportunities. We can be eclectic, we can go where the action is. Electronic trading offers the trader information which has previously been available only to professionals and insiders. Commissions are low, so that overhead is not excessive. Speed is rapid so there is usually no delay in entering or exiting from a position. With electronic trading it is easy to spot the market trend, and traders usually have access to better execution.

WHAT IS NYSE (DOT) TRADING?

DOT trading is an electronic order entry system. Orders are electronically matched by computer, but if no match occurs, they are electronically placed with a specialist who then executes the order in his role as market maker.

Unlike many of the NASDAQ execution systems, there are currently no size limits to DOT trades.

A trader usually ends up paying the offer or buying the bid, but there are exceptions in which you may get better price execution. However, if you place a limit order, i.e., an order which specifies a price or better at which that order may be filled, execution will be no worse than the price specified. Market orders are also acceptable with DOT.

The usual up-tick rule applies for short sales on DOT.

WHAT IS AN ECN?

ECN stands for Electronic Communications Network. These are order execution systems using computer order matching that allow traders to place orders between the spread. That means if a stock is bid 21 and offered at 22, the trader can bid less than 22 or offer at greater than 21. Execution of orders is not guaranteed. Unless a computer match is made, no execution occurs. With most ECN's, orders are automatically timed out after certain time intervals. Check your software provider for how to set your selected time out intervals. By "time out" we mean that your order is automatically canceled if not filled within a certain amount of time.

Chapter 3

REALITY TRADING

Trading markets tends to be a rather private activity. With experience, a trader grows in his discernment.

The things a trader discovers, coupled with the wisdom of the ages, eventually make up his unique and individual style of trading. When we discuss trading stocks, let's remember that we are not referring to investing — trading and investing are absolutely different from one another.

Investing is done (should be done) by way of sound analysis of the fundamentals underlying a stock. Trading is done almost exclusively from viewing price action, whether that be from reading a tape or from looking at a chart.

As a trader's acumen evolves over the years, he will of necessity try, and continue to try, new things. A trader must keep an open mind to any method, system, or concept that can be proven to work successfully for him as an individual. The trader can never afford to be against anything that works for him in his trading. (However, this must be carefully balanced with the conventional wisdom, "if it works, don't fix it.")

With the onset of "daytrading", traders have had to add many new wrinkles to the tried and true techniques of the past. Yet the good old ways, the methods that have been winners for over 100 years, are still the mainstay of good trading.

Hope for aspiring students lies in the extent to which they may want to emulate the success of good trading. The wise trader will seek to incorporate new knowledge into his own method(s) and personal style of trading.

At the outset of trading, aspiring traders will tend to trade all day, even entering trades late in the day. This is not always the way they

should trade, but there seems to be some compelling force that causes many traders to overtrade.

Of course, sometimes, even a professional trader may find it necessary to trade heavily because of the particular opportunity which is presenting itself, or because he is in a problem trade.

One problem with trading heavily is that, when we've spent an entire day watching a screen, we push harder to come out of that day with something to show for it. We want to earn our keep for the day, and we want to have something to show for our efforts. When we trade that way, we stand the risk of losing (giving back) profits that we were enjoying earlier in the day.

Without using a mechanical system, we still need to try hard to be as "mechanical" as we can humanly be so that our own opinions are removed from the trade. As good traders, we want our method to be in the forefront of each trade. Yet, as traders, we find it is not always possible to separate our feelings from what we are doing. Wherever such is the case, we have to try to understand our thought processes. There are reasons for doing what we do.

As traders we try to understand what makes us "tick" whenever we deviate from the purest form of our methods.

Reality is that there will be instances when we stray from the method and there is no explanation. These are not intentional. No trader is perfect. As traders, we miss moves, miscount bars and segments, miscount points and money, fail to see various formations, mistakenly trade into support and resistance, enter erroneous orders into the market, etc.

Nevertheless, our emphasis must be on technique, not on the human errors we make in the overall way in which we trade. In order to avoid distraction, we are often forced to have tunnel vision.

Good trading dictates that, whenever possible, we filter daytrades through the screen of the daily chart. Good trading dictates that we have the discipline to attempt trades only in shares that are trending on the daily chart. As good traders, we know that we are much more

likely to succeed if we take only trades that are in the direction of the trend, especially when share prices are beginning to reverse a correction and once again begin to trend.

The reality of trading is this: at times we make terrible and careless errors. We are human. As humans, we are prone to making plenty of mistakes — we might think we have made a profit when we haven't. We might think we have taken a loss when we haven't. We might think we are flat at the end of the day, when in truth, we aren't. Often, because of arithmetic errors, we liquidate too many or too few shares to cover costs. Amazingly, if we are disciplined and consistent in the rest of our trading, those mistakes never really affect the ultimate outcome of our trading. If a trader can just plow along doing his thing — provided it's the right thing — somehow, at the end of the week or month, he will come out a winner.

Good trading implies being very selective. A good trader chooses only trades which he feels are very strong — those that he thinks are virtually sure things.

REALITIES OF THIS COURSE

When we first prepared this course, among the numerous methods shown, we demonstrated a very specific way of daytrading centered around the concept of matching congestions. In practice, this proved difficult for many of our students. They simply have not had the experience needed to perceive and trade these matching formations profitably. Yet there are some who have done extremely well with this way of trading. In part, matching congestions are perceived through the eye of the beholder. Trading them is somewhat intuitive. Describing how to recognize them is definitely subjective.

For those who are able to deal with the concept of matching congestions, they are demonstrated in this volume. If you have trouble understanding them, we suggest that you plow through to the point where other techniques are introduced. This is a very powerful formation. Review it carefully, don't give up.

In preparing this course, we have often had to take a narrow view in order to drive home a specific point. In that sense, some of the

trades shown are out of context with the reality of the broader market. In some instances, in order to illustrate a point, we purposefully chose trades that were not in trending markets.

It is also important to realize that the use of a live data feed gives certain advantages to the daytrader over the daily trader, especially in optimizing entry and exit. When used properly, daytrading can result in not leaving nearly so much money on the table as can daily trading without *active* (as opposed to *passive)* intraday entry. However, proper use of intraday data is very difficult to achieve. It takes great discipline to use it properly so as not to end up overtrading.

Conversely, daytraders often leave more money on the table than do position traders. This happens because the daytrader gets himself flat at the end of the day, and may have great difficulty in reentry on subsequent days. This situation occurs when prices are gapping each day, and then throughout the remainder of the day trade in congestion.

DEFINITION OF DAYTRADING

At this point, it is necessary to define daytrading as it will be used throughout this course. Typically, daytrading is defined as entering a market at or after the open, and exiting at or before the close.

Because this is a course about electronic trading, our definition needs to be more restrictive. Electronic daytrading includes any method or system that uses a live, real-time data source to determine entry and exit signals to and from any market. This would include trading terminals, home-office PC's, hand-held quote devices, the Internet, or watching an electronic quote board.

A most fundamental concept taught in this course is that it is essential to learn to recognize what any chart looks like just before an important breakout. Equally important is to recognize congestion at the earliest possible time. This necessitates that a chart look a certain way. Throughout this manual, you will see charts that have that look. They must be of sufficient length of time to be well formed. You will also see examples of lightly traded charts, as well as other charts that are not tradable by the methods taught in this course. In

brief, an intraday chart should have almost the same look as a daily chart if it is to be tradable by the methods taught here. That means you may have to expand the time interval until you see a chart that "forms up" in the same manner as a daily chart. If a chart of the stock you wish to trade looks sketchy and incomplete on a five minute chart, try a 10, 15, 30, or 60 minute chart. Keep expanding the time interval until you come up with a decent looking chart.

DAYTRADING VS. POSITION TRADING

In essence, with a few exceptions, a chart is a chart is a chart. Because of this, and because we want you to focus on the lesson to be learned, we have purposely avoided identifying the particular stock involved, or showing the prices at which it traded. They are really unimportant to what is being taught.

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

Although this part of the course is written from the orientation of the intraday chart, the concepts shown here can easily be extrapolated to the daily chart or weekly chart. Where the relationship between a daily chart and an intraday chart are shown, those who are not daytraders can do the same thing in the context of the relationship between a weekly chart and a daily chart. We want to emphasize that. **What you see on the weekly/daily chart relationship is no different from what you see in the intraday/daily relationship.**

If you are not a daytrader, you can definitely apply what is taught in this course to the daily chart or weekly chart.

The major differences between trading the intraday chart versus trading the daily chart have to do with time, volatility, and the magnitude of the moves. The entry signals are the same.

However, trade and money management can be different. Later in the course you will see a demonstration of this truth. See ELECTRONIC TRADING 'TNT' II — HOW-TO-WIN TRADING STUFF.

THE SIMILARITIES

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

Given a sufficiently great time interval for each price bar, intraday charts look pretty much like daily charts, but with some notable exceptions. In part, how the charts look is a function of the data feed service being used. Viewing different ones side by side, we see differences in the appearance of individual price bars. They often disagree about where a price bar opens and closes, and where the high and the low occurred. There are also differences due to the particular software used. The appearance of the charts may vary from one software package to another.

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

Intraday charts make essentially the same formations as do daily charts. There are trading congestions connected by trends. There are retracements, sideways movements, pauses, gaps, and waves (not Elliot).

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

Intraday charts can be traded utilizing Fibonacci, Gann, and Elliot techniques, fan lines, speed lines, pitchforks, oscillators, moving averages, RSI, Stochastics, DEMA, MACD, Commodity Channel Index, Volatility Stop, Parabolic Stop, Cycle Projection, and any other

of the host of technical analysis tools available for use in the market today, most of which we do not advocate.

THE DIFFERENCES

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

Some differences are to be found in the way certain of the charts appear to the eye. Many moderately traded shares appear flat on a five minute chart, quite different from the way they appear on daily charts. On most days, the chart formations on these do not begin to look like the daily charts until the price bars are captured on a sixty minute interval.

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

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

OTHER DIFFERENCES

Slippage of prices in fulfilling orders is a greater problem in daytrading than it is in position trading. The same amount of slippage on a daytrade is proportionately greater in relation to an intraday chart than it is to a daily chart. A daytrade yields less time to absorb slippage. Slippage refers to obtaining a price fill that is worse than the fill you expected when either buying or selling. Therefore, holding slippage to a minimum becomes critical. Although slippage is not a problem where price limited orders are concerned, slippage may be indirect in that the price desired cannot be obtained. Of course, where price limited orders are not able to be used, or in situations in which there is no guaranteed market maker, slippage can definitely be a problem.

Trying to have minimal slippage also affects size. You have to be careful to maintain lot sizes that are easily traded. Lot size is simply another way of saying how many shares you want to buy or sell. You want to avoid odd-lots, such as 125 shares of a stock.

Very often, to cover costs you will liquidate some shares that is greater than needed just so you will be left with an easily liquidated lot size in the event you need to get out in a hurry, or to help insure the least slippage for a profit taking fill.

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

The fact that a stock is cyclical, in the conventional sense, has virtually no manageable effect on intraday trading, other than as a possible entry technique.

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

Obtaining good fills on certain of the available systems becomes absolutely critical in intraday trading. A good fill means getting the price you wanted or even a better price. The problem of entry and exit on a same short term price bar can be enormous, because one may not know if the entry fill was completed prior to having to issue the exit order. In some of the more thinly traded markets, and at intervals when a market is fast, even a ten minute chart may not give sufficient time for knowing whether or not an entry order was filled before having to enter the exit order for a particular trade. Execution is a major consideration in daytrading, and we will delve into it in greater detail in the appropriate places. Please note that under normal conditions, i.e., the terminal does not crash, the problem of not knowing a fill price is something that should never happen in a brokerage daytrading office. However, if you are daytrading on the Internet, make sure you have a fast connection or there may be delays.

The commission rate paid becomes critical in daytrading. Having less time and range of movement with which to absorb overhead means that it is vital to secure and maintain optimal commissions per round turn.

The area of ***trade management*** becomes totally different in intraday trading, and the strategy and tactics involved are much different when trading intraday than when trading the daily charts. Please notice the emphasis on the term "trade management,' and not risk management or money management. The main difference in trade management has to do with the hurried way in which one has to trade intraday.

Trade management involves the mechanics of entering or exiting a trade, moving a stop, and taking profits at the right time, or realizing there is a loss and getting out on time, before losses pile up.

Daytrading pretty much ignores aspects of fundamental trading because, as an individual, there is no time to research sufficient fundamental knowledge from which to make trading decisions. If it could be done, the result would be an investment, not a trade. If you doubt this, keep in mind that market makers and specialists have been trading for years without the benefit of or real knowledge of the fundamentals behind a stock's valuation.

Also, with the exception of mentally noting where Fibonacci ratios (described on the next page) are located, along with occasional specialized use of specific indicators, it is possible to reject the dozens of technical trading tools available for trading of the intraday charts. With regard to Fibonacci ratios, visually determining approximate retracement ratios are all that is needed as a filter to indicate whether a market is behaving normally. In this course, we do not, as some do, use Fibonacci expansion ratios to set objectives for trades. They are too time consuming and totally unnecessary if you use the methods taught here.

Although we will be aware of where the Fibonacci retracement ratios are located, that knowledge is only incidental to our trading. To that extent the methods taught here differ greatly from the "norm." We do not trade from the retracement ratio points as do most who use Fibonacci concepts and techniques. If you're wondering what in the

world "Fibonacci" is, join the crowd. We're not even sure we know how to spell it!

FIBONACCI

Now we're going to really impress you with our knowledge (mostly taken from the Encarta Encyclopedia). Leonardo Fibonnaci was an Italian mathematician, who compiled and supplemented the mathematical knowledge of classical, European, Arabic, and Indian cultures, and who made contributions to the mathematical fields of algebra and number theory. Fibonacci was born in Pisa, Italy, a commercial city, where he learned the basics of business calculation. When Fibonacci was about 20, he went to Algeria, where he began to learn Indian numerals and Arabic calculating methods, which knowledge he supplemented during more extensive travels. Fibonacci used this experience to improve on the commercial computing techniques he knew and to extend the work of classical mathematical writers such as the Greek mathematicians Diophantus and Euclid. Few works by Fibonacci still exist. He wrote on number theory, practical problems of business mathematics and surveying, advanced problems in algebra, and recreational mathematics. His writings on recreational mathematics, which were often posed as story problems, became classic mental challenges as early as the 13th century. Such problems often involved the summation of recurrent series, such as the Fibonacci series ($k_n = k_{n-1} + k_{n-2}$—for example, 1, 2, 3, 5, 8, 13,. . .), which he discovered. Each term of this series is called a Fibonacci number — the sum of the two numbers preceding it in the series. Fibonacci solved the problem of calculating the value for any entry.

FIBONACCI SERIES

In mathematics, it is a series of numbers in which each member is the sum of the two preceding numbers. For example, a series beginning 0, 1 ... continues as 1, 2, 3, 5, 8, 13, 21, and so forth. Fibonacci numbers have many interesting properties and are widely used in mathematics. Natural patterns, such as the spiral growth of leaves on some trees, the spiral growth of rings noted on tree stumps, and the spiral rings one sees when tossing a pebble into a quiet pool of water, often exhibit the Fibonacci series.

Now what in world, you might ask, has all this got to do with trading? We've often asked that question ourselves! It has nothing to do with trading, except that certain mathematically oriented traders think that markets retrace .382, .500, or .618 of the most recent swing in share prices. Because of this foolishness, they tend to bunch their orders at those ratios thereby causing a self-fulfilling prophecy to sometimes take place in the price action.

Our approach to intraday trading is based entirely upon what we see in the form of a bar chart showing Open, High, Low, and Close. We also use technical tools to trade and believe they are suitable when they are used correctly. Used incorrectly they operate only to confuse the picture. **INCORRECT USAGE IS WHAT THE MAJORITY ARE DOING — AND IF YOU BELIEVE THE STATISTICS, YOU KNOW THAT THE MAJORITY OF TRADERS CONSISTENTLY LOSE IN THE MARKETS! IN ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF WE GO INTO THE CORRECT WAYS TO USE TECHNICAL ANALYSIS AND INDICATORS WITH OUR TRADING METHODS.**

The ***closest*** we can come to the truth of what is happening in the markets is what we are able to see on the bar chart as prices tick up and down on the computer screen. Notice the word "closest". The bar chart is the best tool we have, but even it doesn't tell us the whole truth.

On a live data feed, you still can't see how many traders are on the floor or in the market. The volume you see on the chart is the best that can be ascertained about that aspect of liquidity.

Liquidity is not only made up of how many shares are being traded, but also of how many traders are participating in the trading of those shares. There is quite a difference between 1,000,000 shares being traded by 100 traders and 1,000,000 shares being traded by 1,000 traders. The shares being traded by 1,000 traders are more liquid.

It's not possible to immediately see if a market is thin. The best we can do is to guess from what we see on the chart, or ask someone who is able to view the trading floor. We cannot sense the emotions or moods on the trading floor. We cannot tell if there are more buy orders than sell orders, or vice-versa, other than what we see on our

screen. Similarly, we cannot hear the noise of the trading floor that might tip us off that something really big is happening.

We can only belatedly realize that a market has started to become "fast". Another handicap is that we cannot see ***who*** is doing the trading. We are unaware of when a large mutual fund comes onto the floor and begins to suddenly or incrementally buy or sell, and yet their action affects the prices we see on our terminal screen. However, with NASDAQ electronic trading we can see the market maker identity. (See Appendix A for a list of market makers.)

These limitations do have an effect on our trading style and results. The way we trade has to compensate for the lack of "truth" we have to deal with when trading from a computer screen.

We also have to live with higher commissions than do market makers and specialists.

Finally, we have to put up with the inevitable missed ticks that fail to come across our data feeds and bad ticks that come all too frequently across any data feed. They love to come at critical decision times. They are a major annoyance in daytrading, especially those you cannot spot as faulty because they fall within the "norm" of the current price action.

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

Technical indicators tend to smooth things, when the underlying reality upon which they are based is anything but smooth. Prices tend to chop up and down, making rather large moves in spurts from time to time.

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

Another thing to realize when trading intraday charts is that by the end of the day there will, on the shorter term charts, be a great many bars. For instance, on an intraday chart, there may be over one hundred price bars showing. That is the equivalent of several months of trading on the daily charts. That's a lot of price bars, and it represents a lot of trading decisions. If we were to add shares to a winning position each time there was a trading opportunity on an intraday chart, we could go crazy, although our broker would like the many commissions he would make.

Therefore, unless we are gluttons for punishment, we do not trade in and out all day long. We simply do not need the wear and tear. If we did trade in and out as some do, we run the risk of burning out before the end of the day. In fact, more than one trader has had a nervous breakdown doing that very thing.

That is not to say that others don't do it. If you do, you may find it to be quite intense and enervating. In fact, some of the most profitable traders trade over 100 times a day. However, it will be up to you if you want to work that hard. Many traders have found that when they sit and trade all day long, after awhile it ceases to be enjoyable. They become dull. They miss good trades. They run the risk of eventual burn out.

It takes great energy to daytrade. It involves a great intensity of concentration.

Most daytraders have, at times, daytraded intensively for months, but then they have to rest and get away from the markets. The odd thing about that kind of intense trading is that you won't always know when you've had enough. Usually you find out or realize you've been at it too long when you wake up to the fact that you're losing a lot of money.

The intensity of daytrading has a way of being hypnotic. After awhile you really are not seeing much of anything. Your perception of the

market action is no longer sharp. You have become saturated and your mind has become numb.

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

Because daytrading is so intense, because many traders personally can't handle too much of it, and because sometimes greater profits are made long term, you might be wise to turn a winning daytrade into a position trade on the daily charts. We'll be showing how we do that in a later chapter. If this is part of your daytrading strategy make sure it is spelled out in detail in your business trading plan. How to develop a trading plan is covered later in this course. Position trading is a lot more relaxed. The trades more or less take care of themselves. You don't have to pay much attention to them. Once a daytrade is turned into a position trade, all you have to do is monitor the trade closely enough to move profit protecting stops and get out at any objectives you have set for the trade. You want to be stopped out with a profit. The best traders are not trying to pick market tops and bottoms.

Chapter 4

CHART READING

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

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

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

It is this concept that makes trading quite different from investing. Investors, unless they are entering orders based on some "hot tip," usually trade based on their own or someone else's investigation of a company's vital statistics. Investing is wisely done based on fundamental information about the condition of a particular company and often its standing in a particular industry or sector. Conversely, trading, especially daytrading, is done mostly based upon technical information. A chart showing a stock's Open, High, Low, and Closing prices is, in the estimation of many, the best possible way to trade based on technical information. From the point of view of a chart trader, supply and demand are seldom directly related. The same is true of a company's fundamentals. For a chart trader a company's financial statements are not directly related to how we as traders deal with a stock. As traders we base our trading decisions on what we

see on a chart. We look at the overall picture before us. We also learn to examine in minute detail the behavior of each price bar as it appears before us. We do this regardless of the time frame in which we trade. We are looking for any clue that might indicate to us what will happen next.

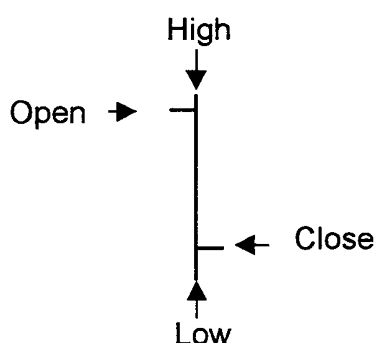
A CHART IS A CHART

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

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

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

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



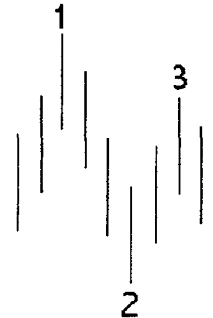
First, notice the picture on the left. We will be discussing bar charts. The picture on the left is a price bar. It consists of an Open, a High, a Low, and a Close.

THE LAW OF CHARTS

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

1-2-3 HIGHS AND LOWS

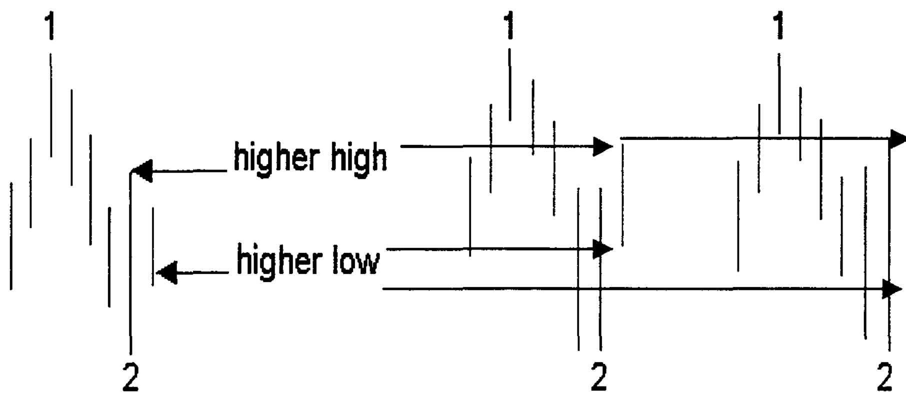
A typical 1-2-3 high is formed at the end of an uptrending market. Typically, prices will make a final high (1), proceed downward to point (2) where an upward correction begins; then proceed upward to a point where they resume a downward movement, thereby creating the pivot (3). There can be more than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

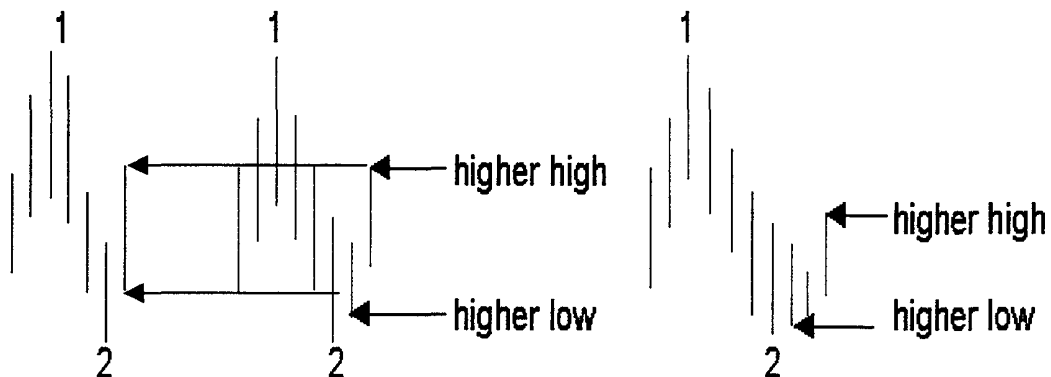


A number 1 high is created when a previous up-move has ended and prices have begun to move down.

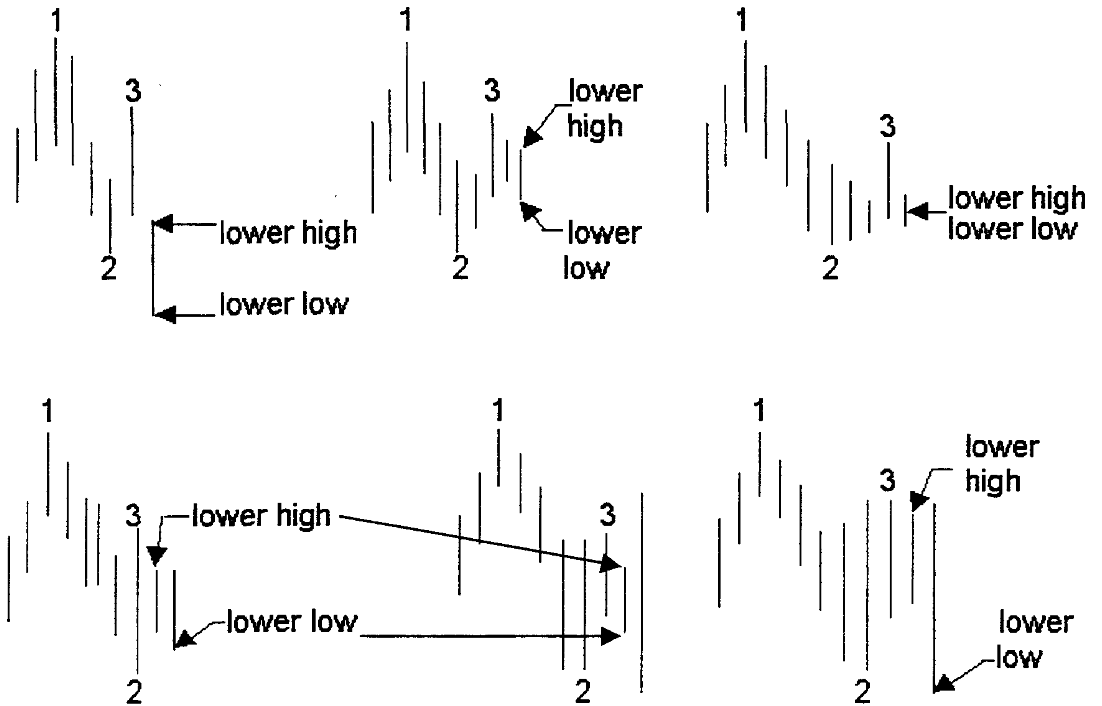
The number 1 point is identified as the last bar to have made a new high in the most recent up-leg of the latest swing.

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

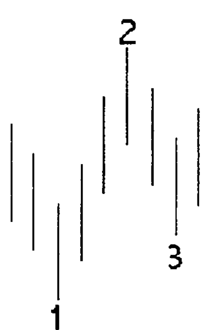




The number 3 point of a 1-2-3 high is created when a full correction takes place. A full correction means that as prices move down from the potential number 3 point, there must be a single bar that makes a lower low and a lower high than the preceding bar, *or* a combination of ***up to three bars***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



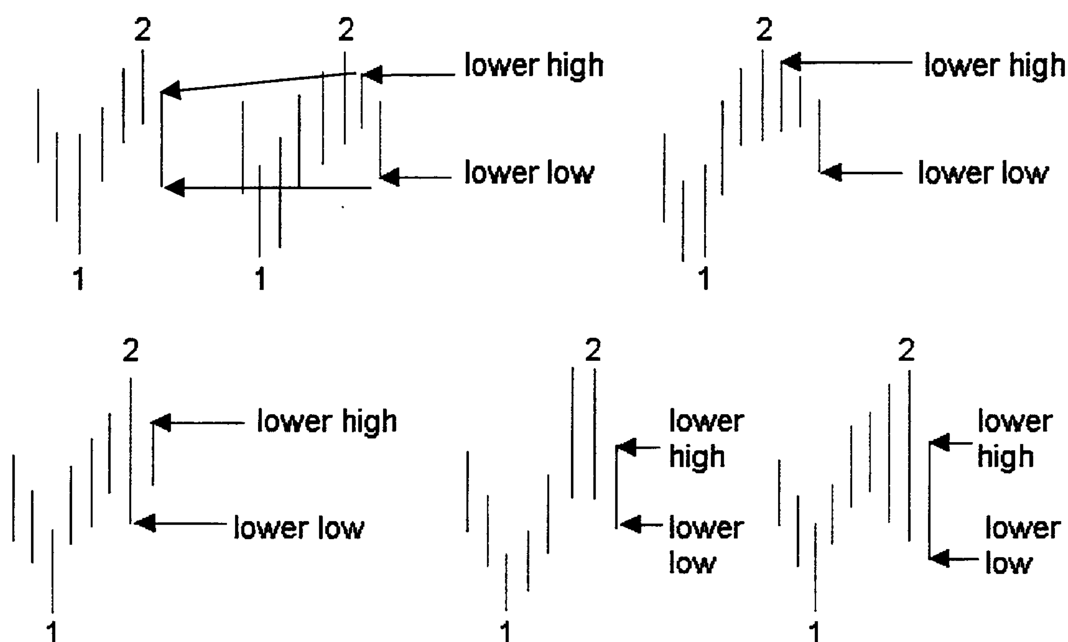
Now, let's look at a 1-2-3 low.



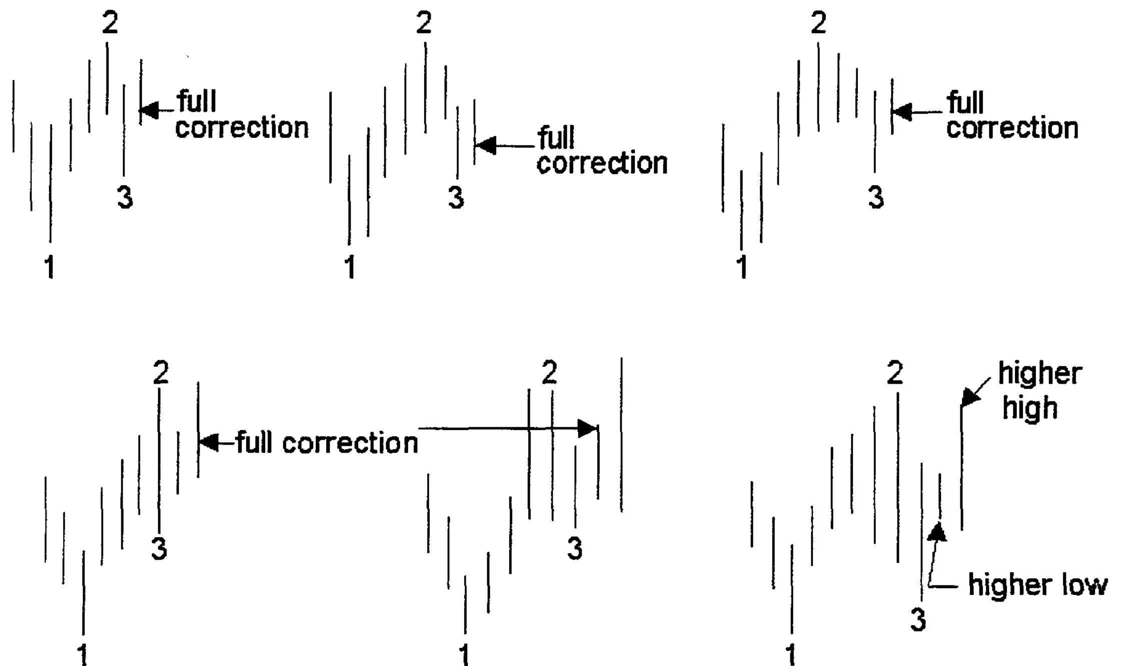
A typical 1-2-3 low is formed at the end of an downtrending market. Typically, prices will make a final low (1); proceed upward to point (2) where an downward correction begins; then proceed downward to a point where they resume an upward movement, thereby creating the pivot (3). There can be more than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

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

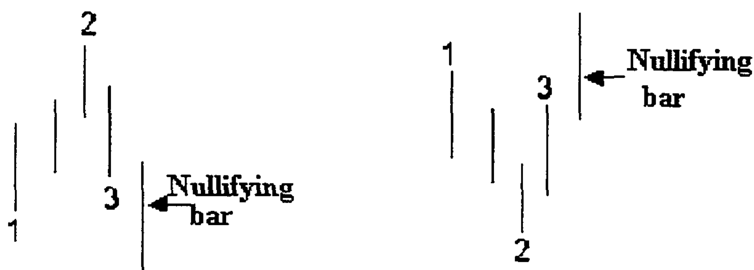
The number 2 point of a 1-2-3 low is created when a *full* correction takes place. Full correction means that as prices move down from the ***potential number 2*** point, there must be a single bar that makes both a lower high and a lower low than the preceding bar, *or* a combination of ***up to three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



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



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

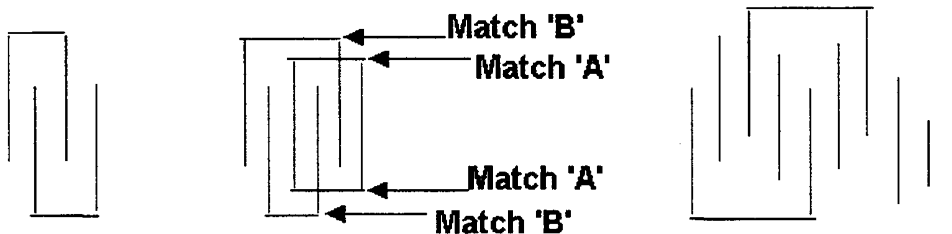


LEDGES

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

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

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



TRADING RANGES

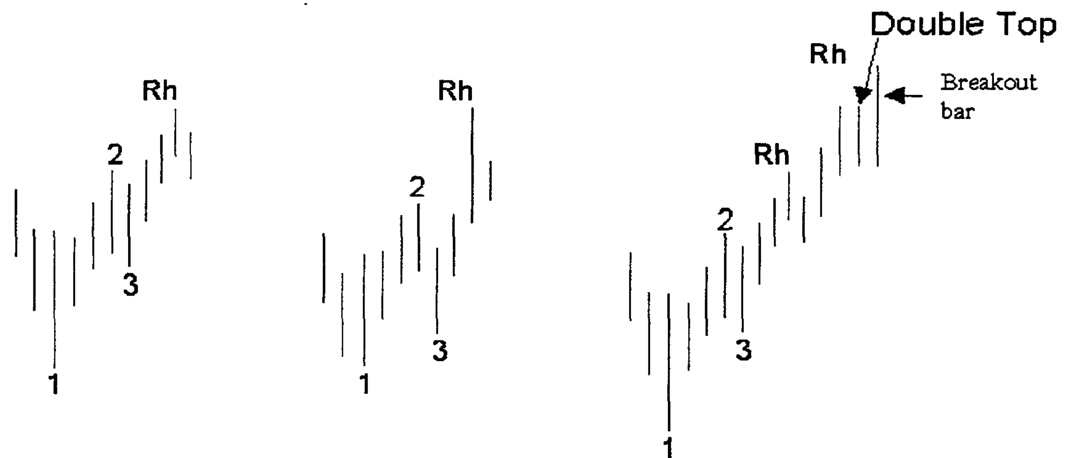
A Trading Range (See below) is similar to a Ledge, but must consist of more than ten price bars. The bars between ten and twenty are of little consequence. Usually, between bars 20 and 30, i.e., bars 21-29, there will be a breakout to the high or low of the Trading Range established by those bars prior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

ROSS HOOKS

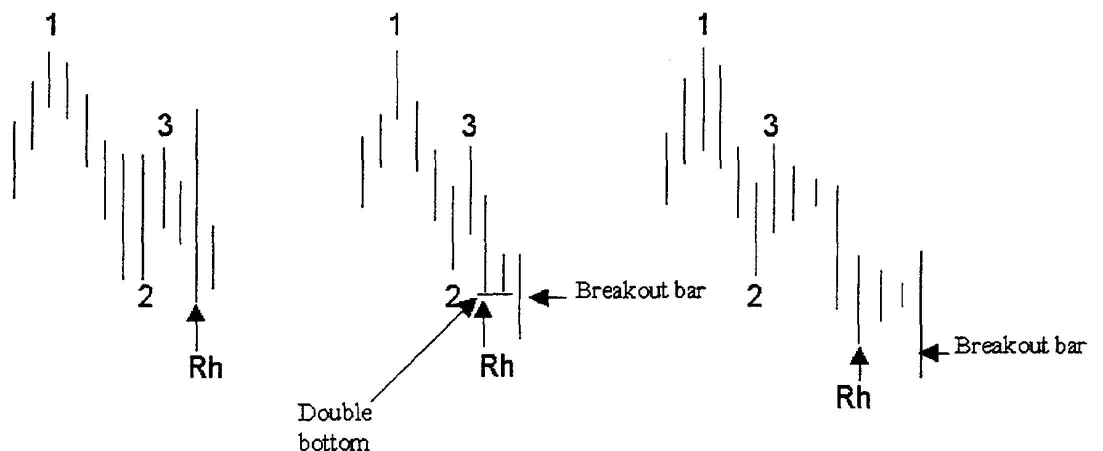
A Ross Hook is created by:

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

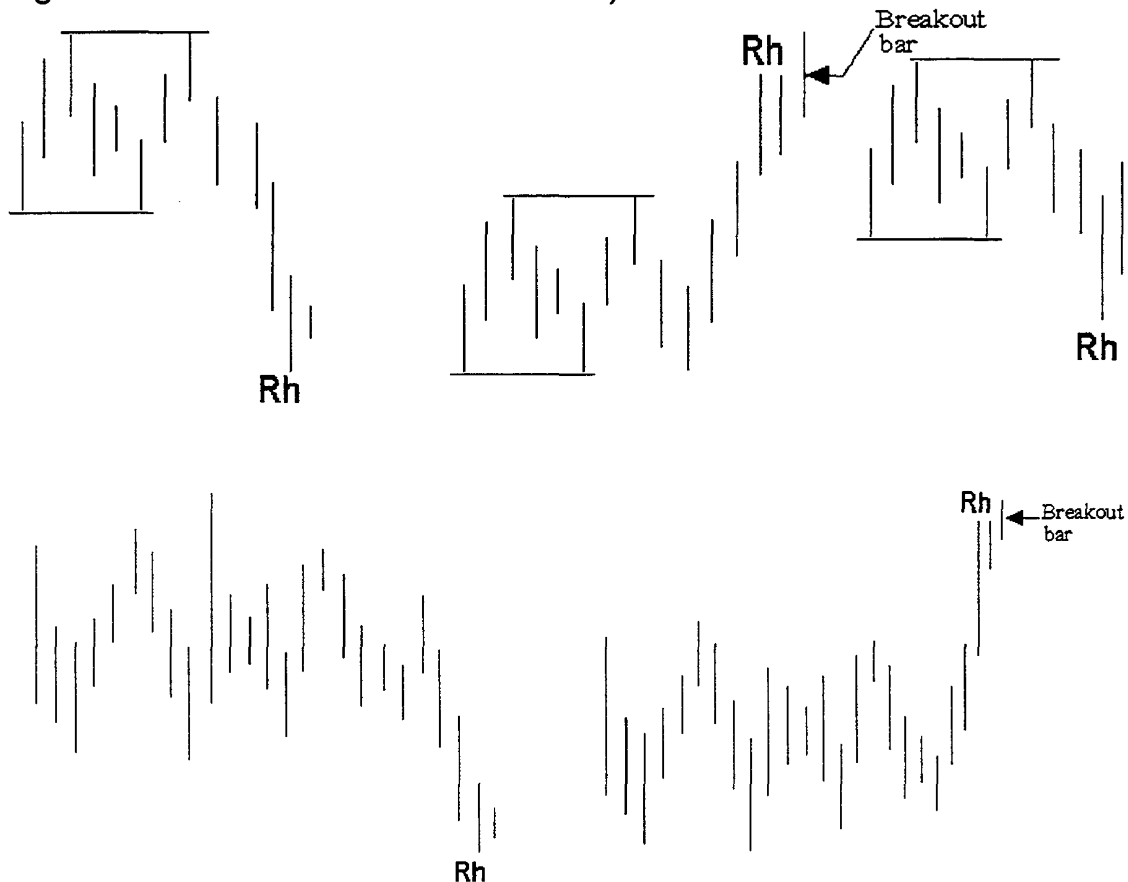
In an uptrending market, after the breakout of a 1-2-3 low, the first instance of the failure of a price bar to make a new high creates a Ross Hook. (A double high/double top also creates a Ross Hook).



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



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



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

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

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

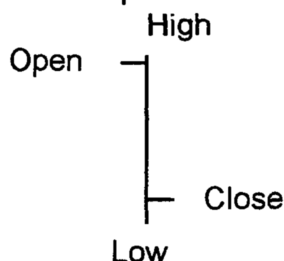
Chapter 5

TRADE SELECTION

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

MARKET ANATOMY

This represents a stock's price action :



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

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

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

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

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

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

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

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

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

But these Trading Ranges don't usually exist in a vacuum. Normally they are connected. The formations that connect them are called trend lines, stair steps, explosions and collapses. A market, over

time, has an anatomical structure. What we see are Trading Ranges, tied together by connectors. Trending formations, in turn, are made up of shorter Trading Ranges, gaps, large magnitude moves, and progressively ascending or descending price bars.

Excuse us if all this seems overly simple, but we have to start somewhere. What we're attempting to do is to lay out a basic foundation for what is to follow.

What we're showing here is that price movement can be dissected — divided up into its component anatomical parts. There are ways to trade each of these component parts. There are ways to trade from Trading Ranges. There are ways to trade progressively ascending or descending trend formations. There are ways to trade from small congestion areas. There are ways to trade trend reversals, breakouts, retracements, and corrections. And there are ways to daytrade stocks that, in some respects, are unique to daytrading; and there are ways to position trade stocks that are, in some ways, unique to position trading.

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

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

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

TRADE SELECTION

Trade selection consists of two aspects: selecting a stock, and selecting an entry point.

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

SELECTING A TIME FRAME

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

SELECTING A STOCK

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

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

SELECTING AN ENTRY POINT

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

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

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

We will not be buying or selling retracements (corrections) while they are in the process of retracing. We will not be buying or selling within a channel or Trading Range unless a single leg up or down has sufficient length to enable execution of a winning trade. If a series of trades turns out to be within a Trading Range or within a channel, it is

purely coincidental and definitely not because of having drawn channel lines, or in some way having defined a Trading Range. The same thing is true of uptrend and downtrend lines; we will not use them other than for visual perception, and we will not trade retracements to them.

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

Remember the price action pictograph?

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

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

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

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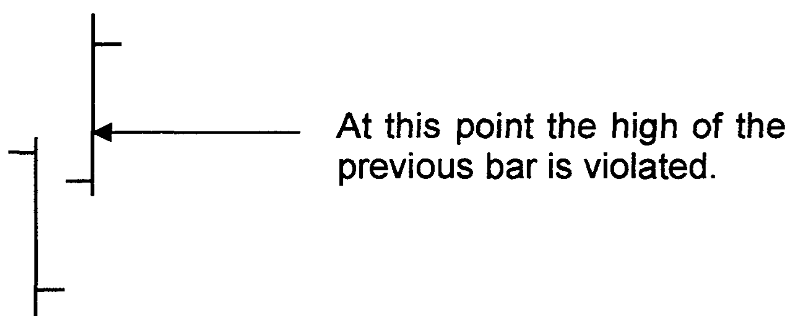
But what if this market were to take out the high of the previous bar like so:



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

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

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

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

Although we will consider turning a daytrade into a position trade according to certain rules to be explained later, we must have a rule for our daytrade in and of itself, and this rule is absolute:

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

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

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

Chapter 6

MAJOR ENTRY SIGNALS

In Chapter 4, we looked at the definitions of the major entry signals. For your convenience they are repeated in this chapter along with chart examples of each. The major entry signals which follow, are given our highest priority. They are all derived from the daily bar chart. There is a good reason for this and it will explain it for your benefit now.

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

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

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

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

Major entry signals follow:

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

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

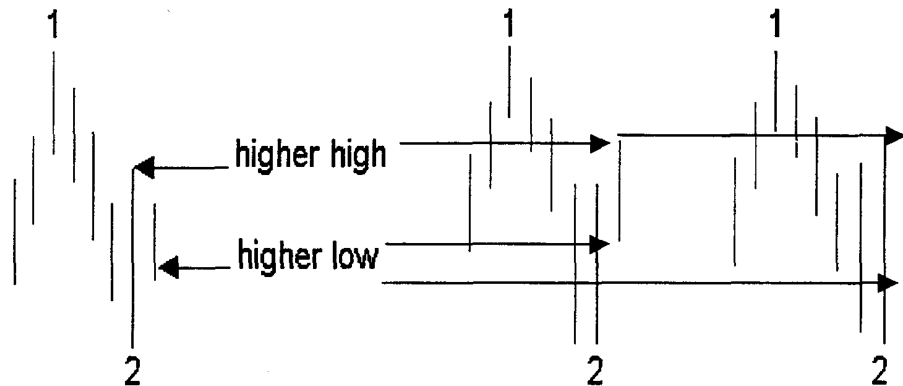
WE ARE REPEATING THE DEFINITION OF 1-2-3 HIGHS AND LOWS BECAUSE THEY ARE IMPORTANT, AND THIS TIME WE WILL SHOW THEM IN THE CONTEXT OF CHARTS. PLEASE BE SURE YOU STUDY THEM CAREFULLY. THEY ARE AN INTEGRAL PART OF WHAT FOLLOWS.

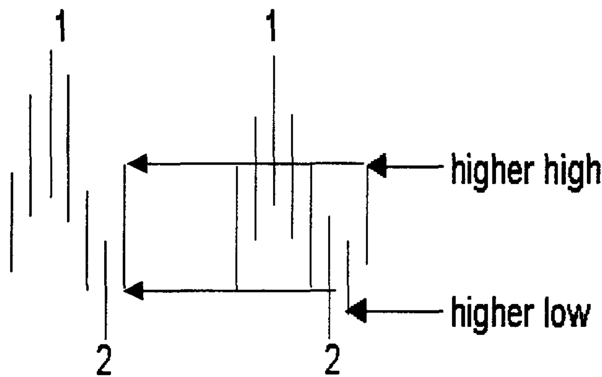
A typical 1-2-3 high is formed at the end of an uptrending market. Typically, prices will make a final high (1); proceed downward to point (2) where an upward correction begins; then proceed upward to a point where they resume a downward movement, thereby creating the pivot (3). There can be more than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

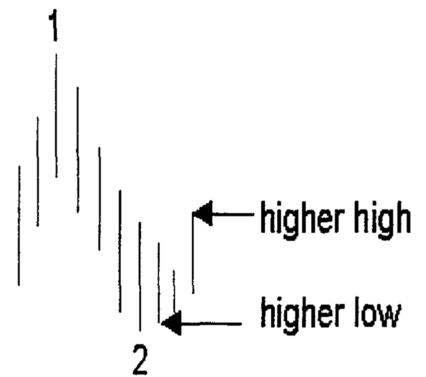
A number 1 high is created when a previous up-move has ended and prices have begun to move down.

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

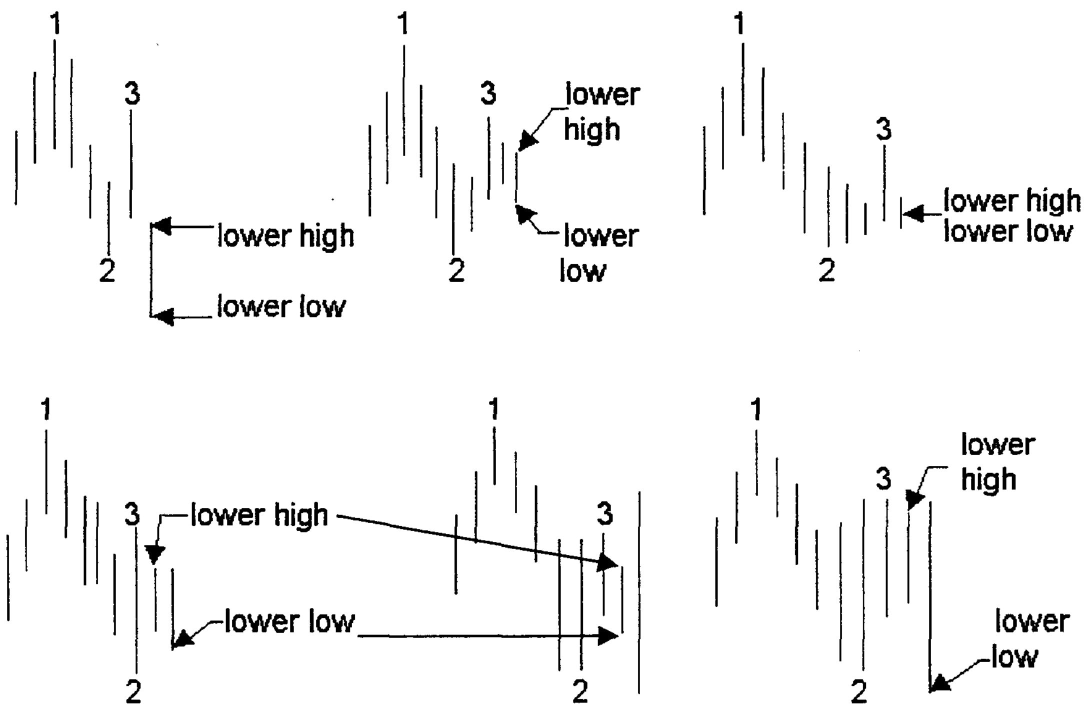
The number 2 point of a 1-2-3 high is created when a *full* correction takes place. Full correction means that as prices move up from the potential ***number 2 point***, there must be a single bar that makes both a higher high and a higher low than the preceding bar *or* a combination of ***up to three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



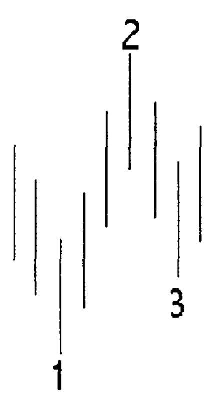




The number 3 point of a 1-2-3 high is created when a full correction takes place. A full correction means that as prices move down from the potential number 3 point, there must be a single bar that makes a lower low and a lower high than the preceding bar, *or* a combination of ***up to three bars***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



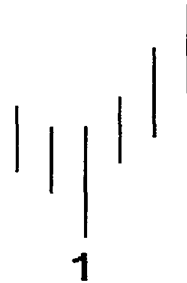
Now, let's look at a 1-2-3 low.



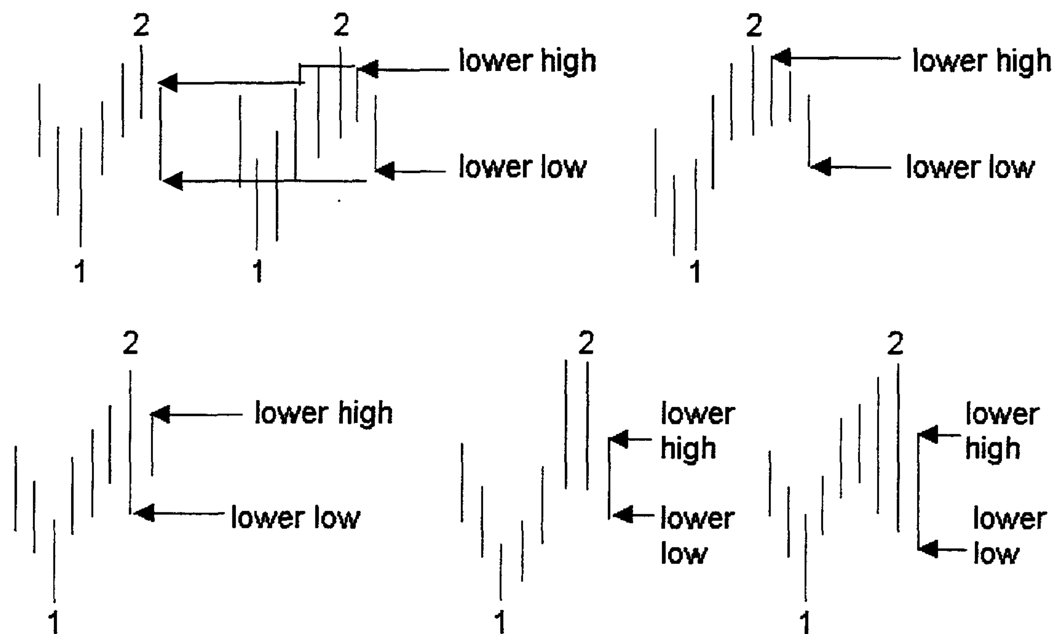
A typical 1-2-3 low is formed at the end of an downtrending market. Typically, prices will make a final low (1); proceed upward to point (2) where an downward correction begins; then proceed downward to a point where they resume an upward movement, thereby creating the pivot (3). There can be more than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

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

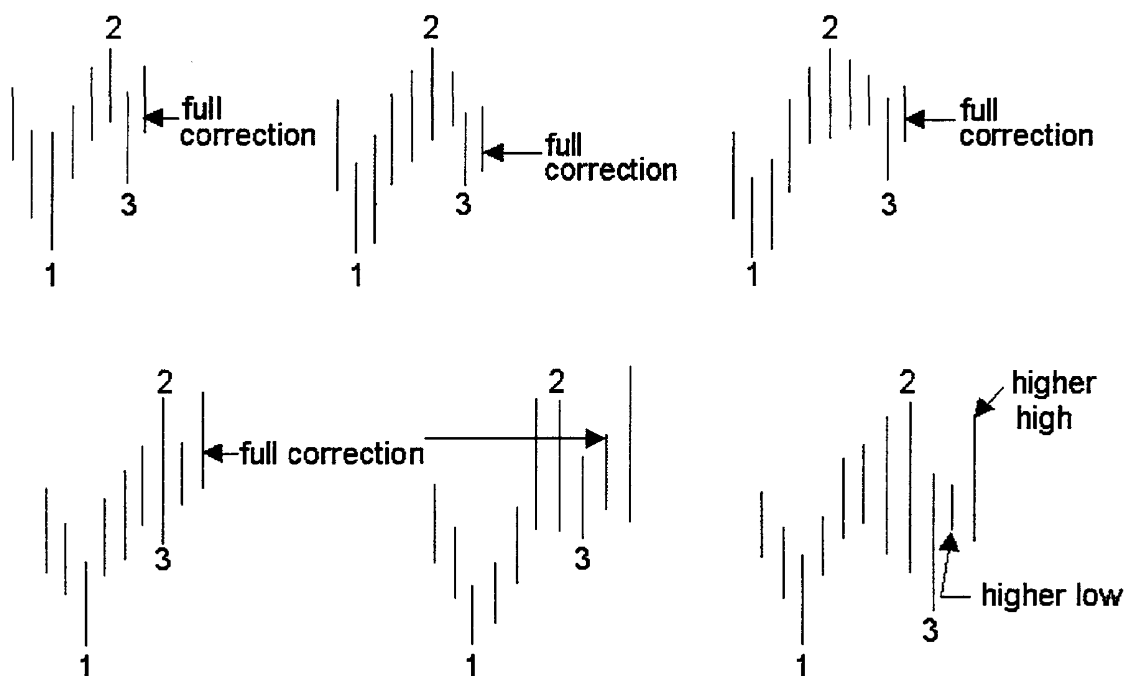
The number 1 point is identified as the last bar to have made a new low in the most recent down-leg of the latest swing.



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



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



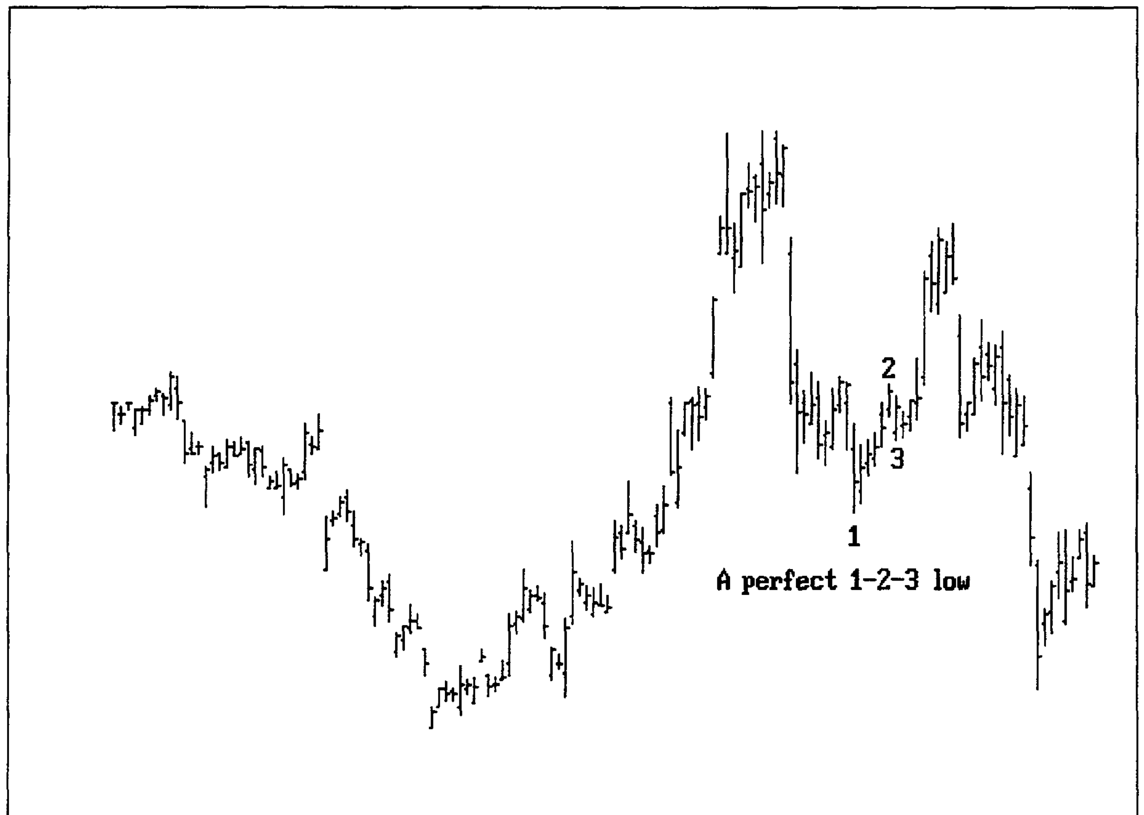
The entire 1-2-3 high or low is nullified when any price bar moves prices equal to or beyond the number 1 point. Note: The #3 point does not come down as low as the #1 point in a uptrend, or as high as the #1 point in a down trend.

We set a mental or computer alert, or both, to warn us of an impending breakout of these key points. We will not enter a trade if prices gap over our entry price. A gap occurs when prices jump from where they previously finished to where they currently begin. A gap can occur when prices are moving up or when prices are moving down. We will enter it only if the market trades ***through*** our entry price.

1-2-3 highs and lows come only at market turning points that are, in effect, major or intermediate high or lows. We look for 1-2-3 lows when a market seems to be making a low, or has reached a 1/3 or greater retracement of prices from a low. We look for 1-2-3 highs when a market appears to be making a high, or has reached a 1/3 or greater retracement of prices from a high.

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

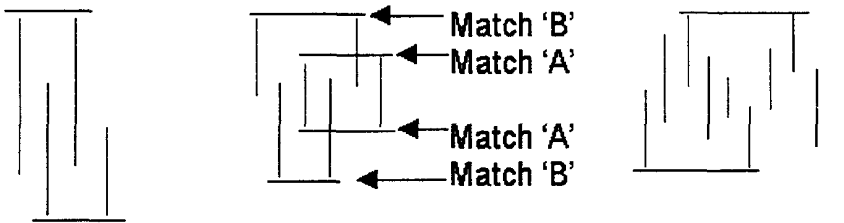
The next figure illustrates the breakout entry technique in action.



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

LEDGES

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



This is how to determine what constitutes a Ledge:

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

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

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

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

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

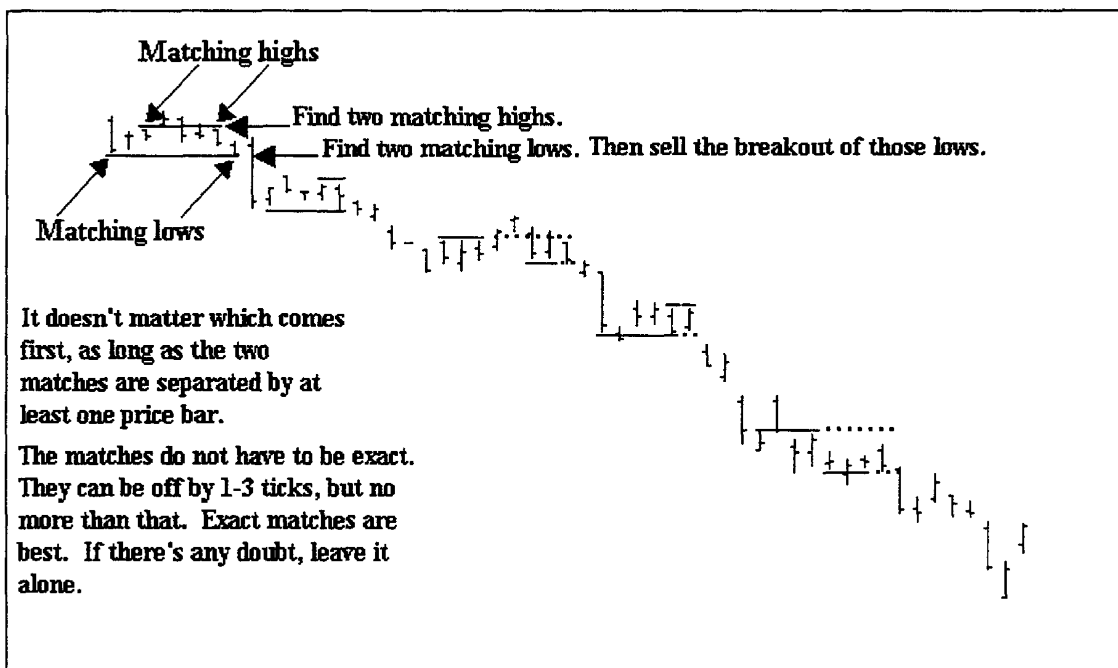
The Ledge becomes possible because the market decides to move sideways for a number of bars on the chart, thereby making it possible for us to position ourselves for an anticipated continuation of the previous price move. Our entry exists with our buy or sell orders at natural support and resistance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

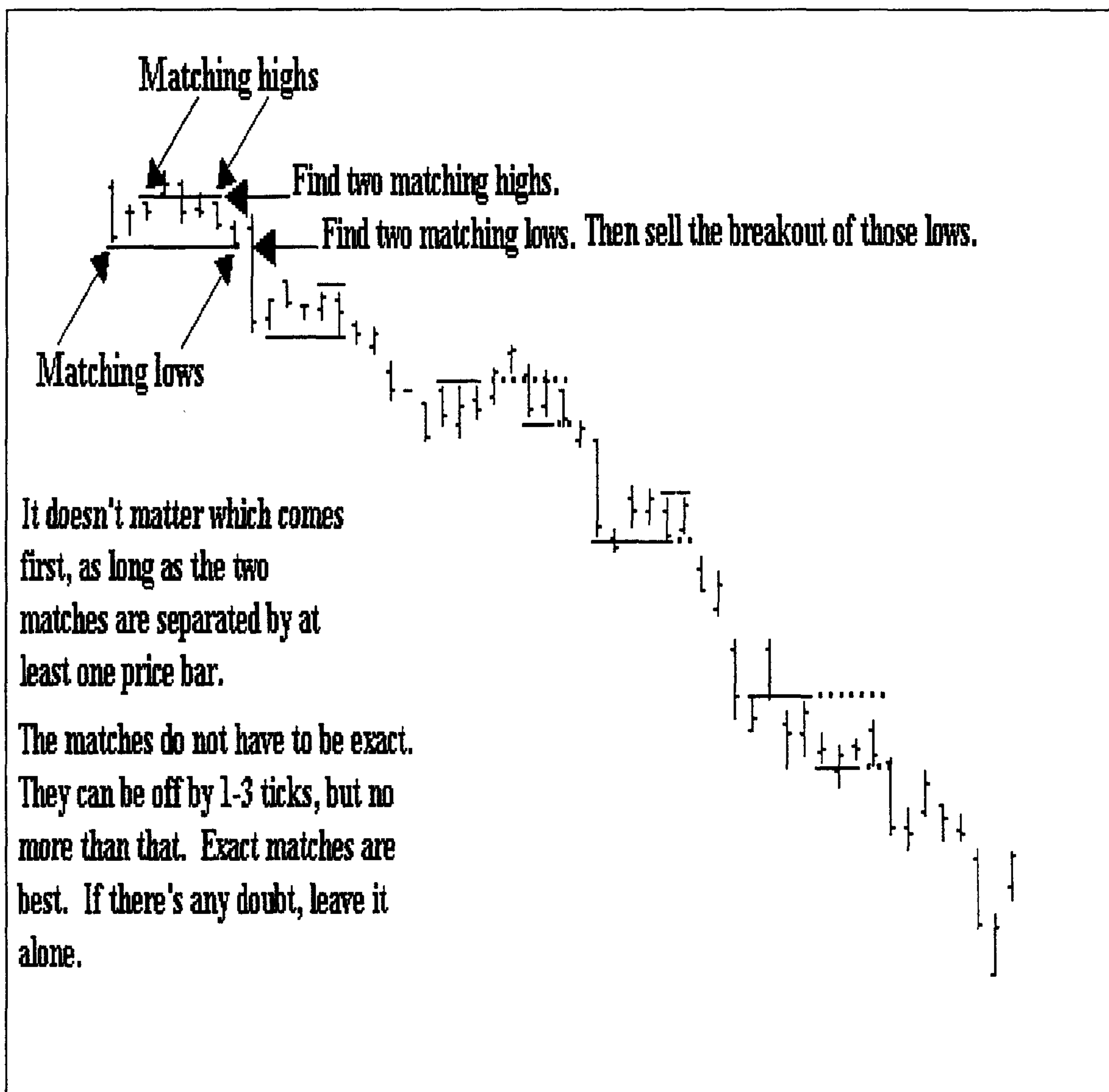
We mark these off as soon as we can draw a line across two highs and two lows, just so long as they match. We will enter a trade only if prices break out of the Ledge by trading through the high or the low. We will not enter a trade if prices gap past our entry point.

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

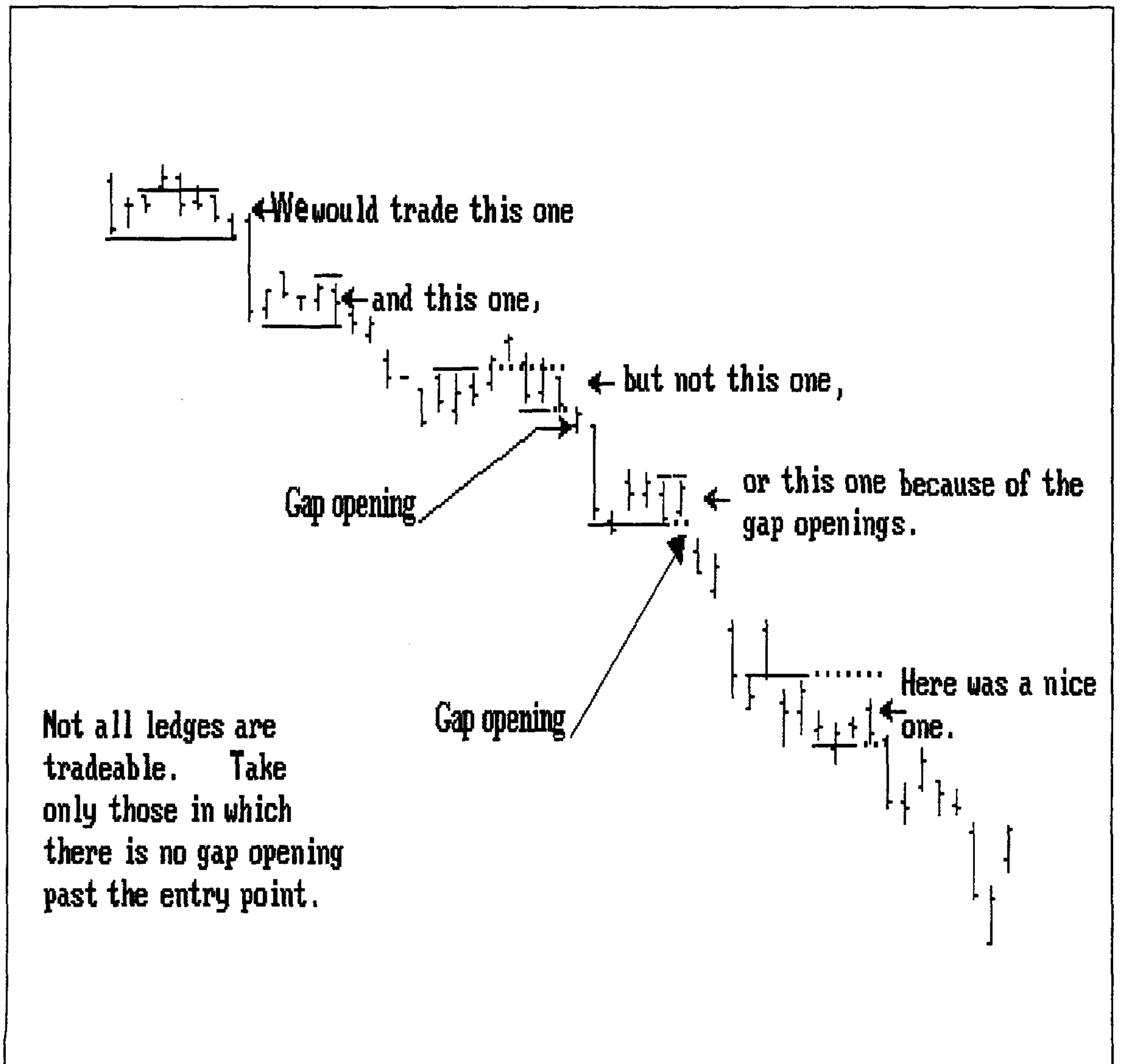
Why does this entry technique work so well? Because it takes advantage of natural support and resistance points. A breakout of a natural support or resistance point will usually be associated with good momentum. There should be enough explosive force to give a profitable short term trade.

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





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



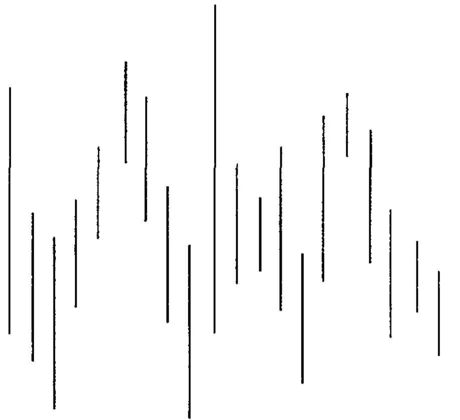
The two entries we didn't take were because the breakout bar was a gap down.

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

THE BREAKOUT OF A TRADING RANGE

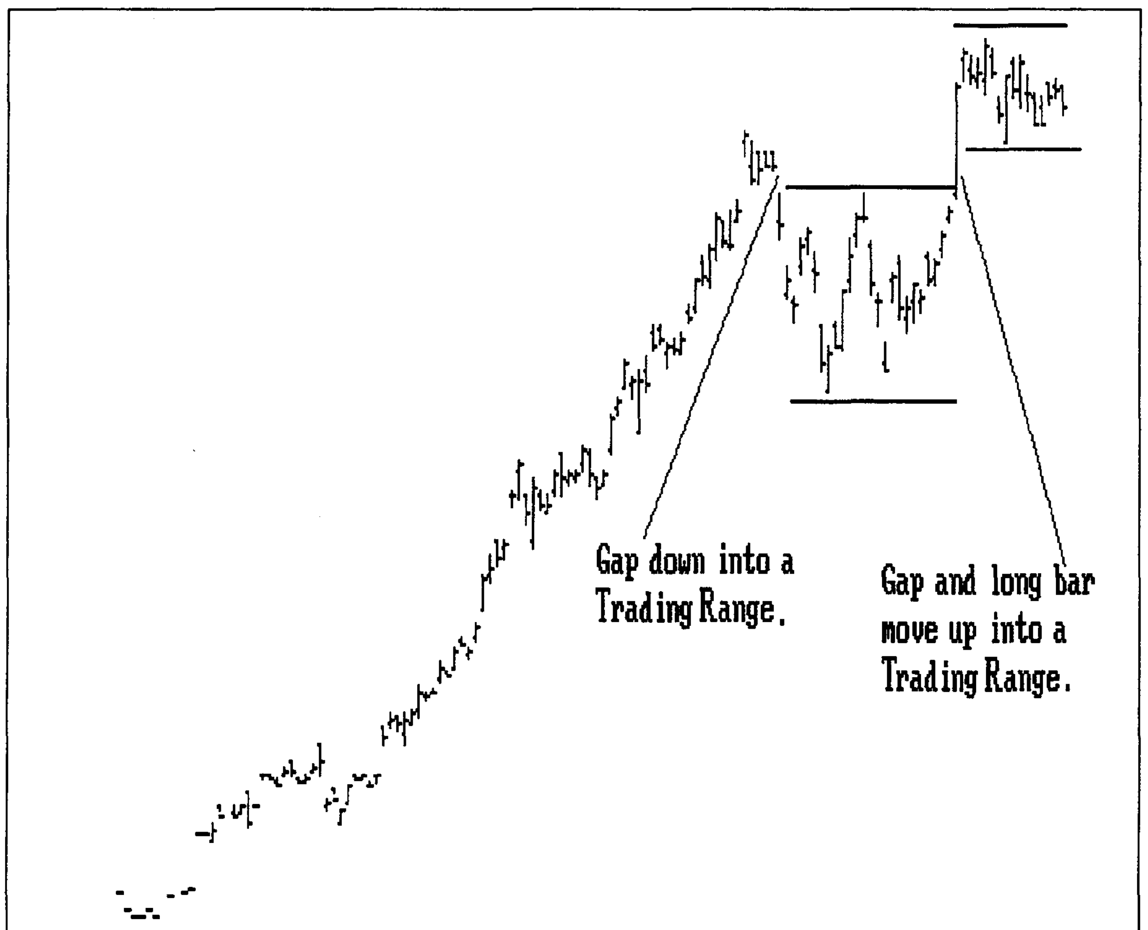
TRADING RANGES

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



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

The chart on the next page illustrates this point.



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

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

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

This is a leg up ⟶

⟵ This is a leg down

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

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

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

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

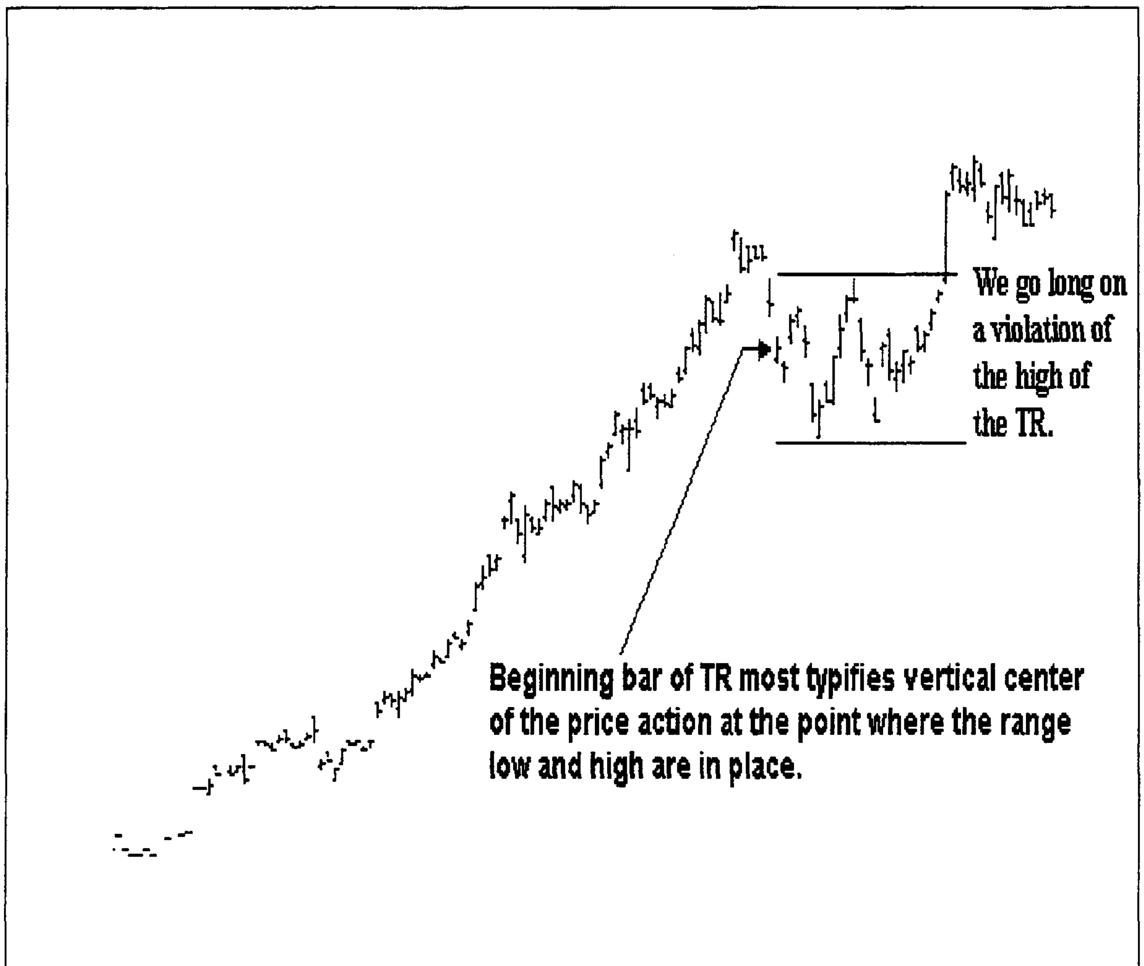
We can now set a mental alert, a computer alert, or both, to tell us when we are approaching one of the prices which represent the outer limits of the envelope. Any non-gap breakout of these prices will constitute an entry point for us to enter a daytrade.

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

the end of one of the above, we immediately suspect that a Trading Range is about to ensue.

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

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



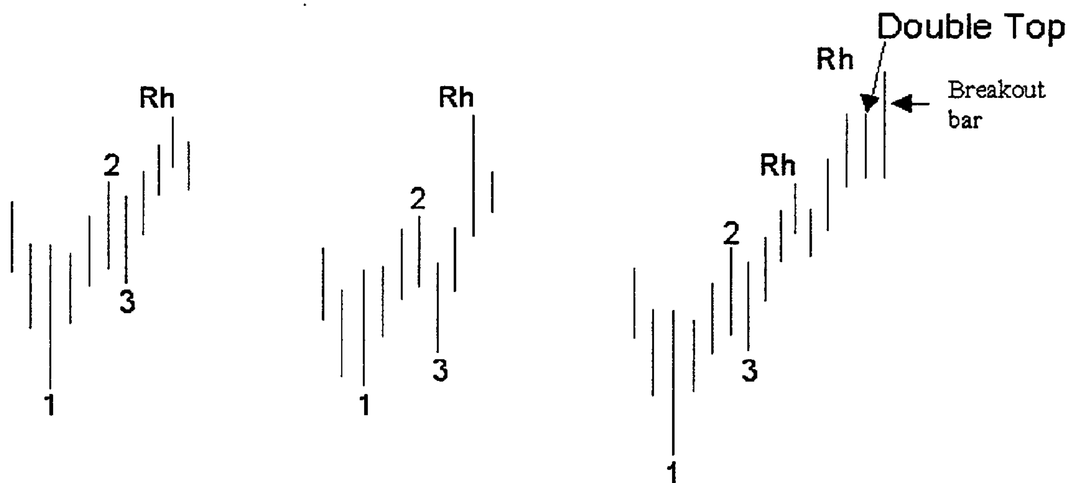
The entry point is a trade-through by prices of the breakout point. The breakout point is the highest high or the lowest low of the Trading Range. We will enter a trade at or before the breakout. We will not enter if prices gap past our entry point.

ROSS HOOKS

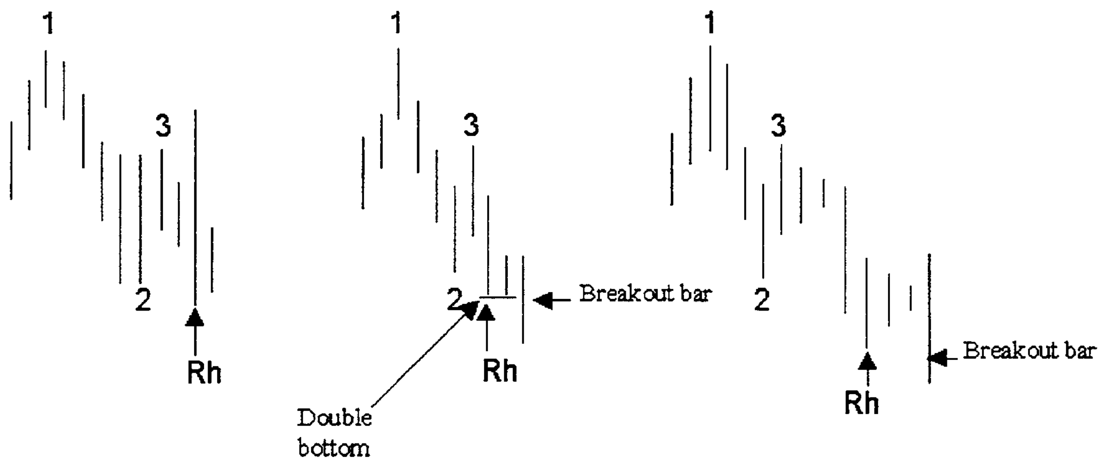
A Ross Hook is created by:

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

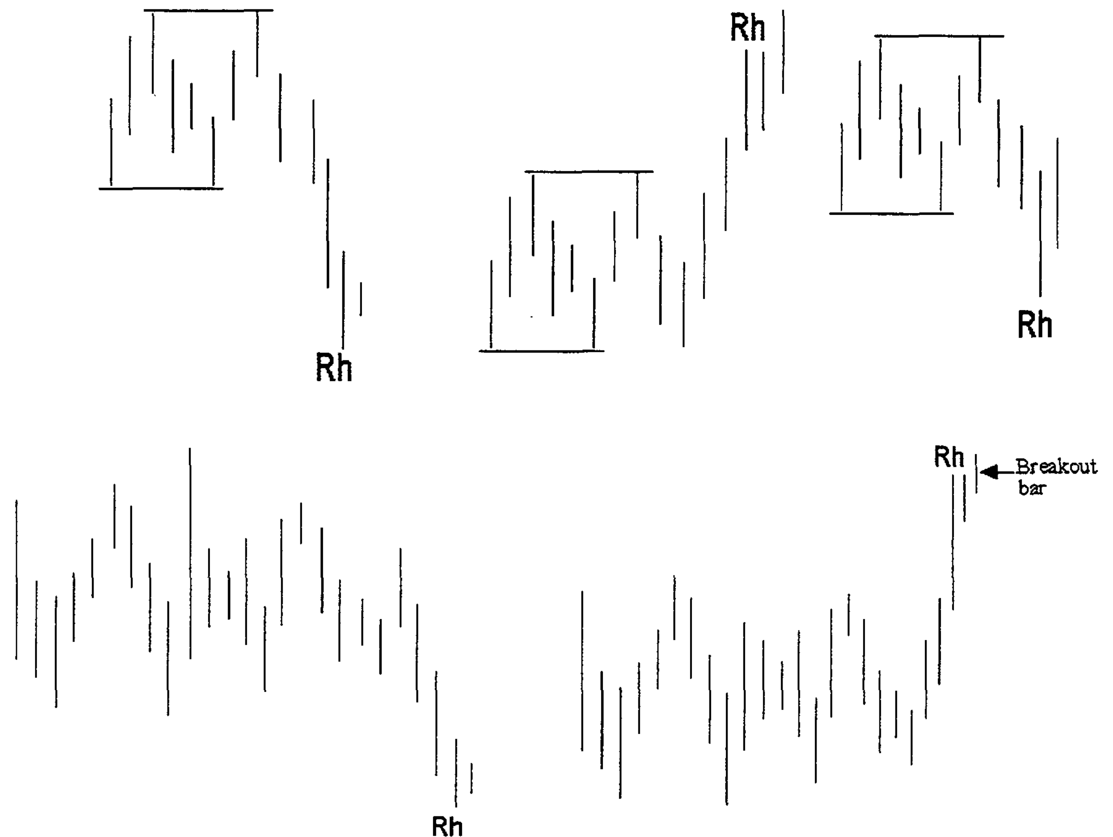
In an uptrending market, after the breakout of a 1-2-3 low, the first instance of the failure of a price bar to make a new high creates a Ross Hook. (A double high/double top also equals a Ross Hook).



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



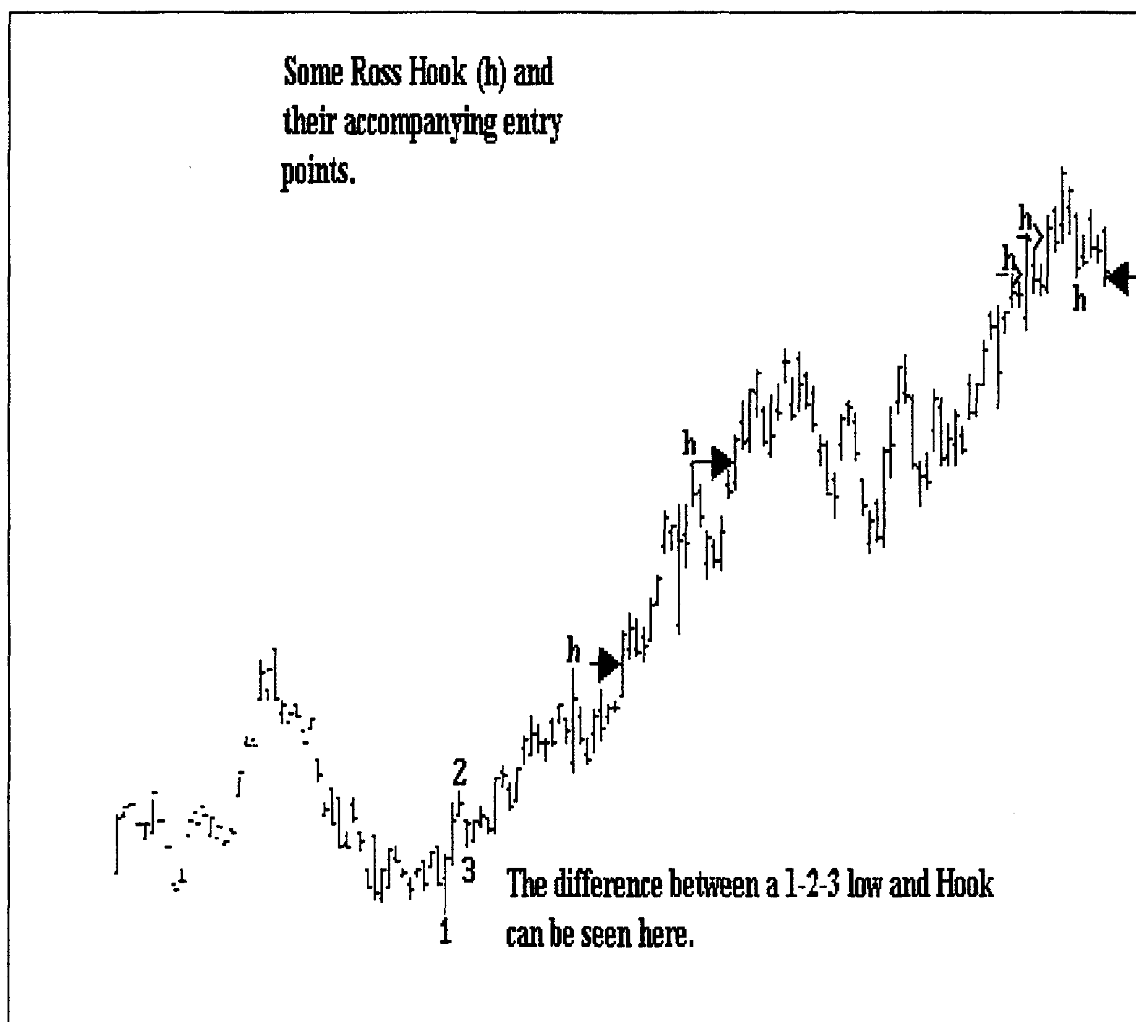
If prices breakout to the upside of a Ledge or a Trading Range formation, the first instance of the failure by a price bar to make a new high creates a Ross Hook. If prices breakout to the downside of a Ledge or Trading Range formation, the first instance of the failure by a price bar to make a new low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



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

A Ross Hook does not need more than one correction bar on the chart. In a down market, as soon as you have an equal or higher low, you have a Hook. In an up market, as soon as you have an equal or lower high, you have a Hook.

The next figure shows what is meant by Ross Hooks.



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

Later, when we discuss the Trader's Trick, we will look at even earlier entries than the ones shown.

Also shown on the previous chart is a 1-2-3 low to demonstrate the difference between 1-2-3 lows and Ross Hooks.

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

Summary: Major Entry Signals

- The breakout of a 1-2-3 high or low.

- The breakout of a Ledge.

- The breakout of a Trading Range.

- The breakout of a Ross Hook.

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

Chapter 7

INTERMEDIATE ENTRY SIGNALS

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

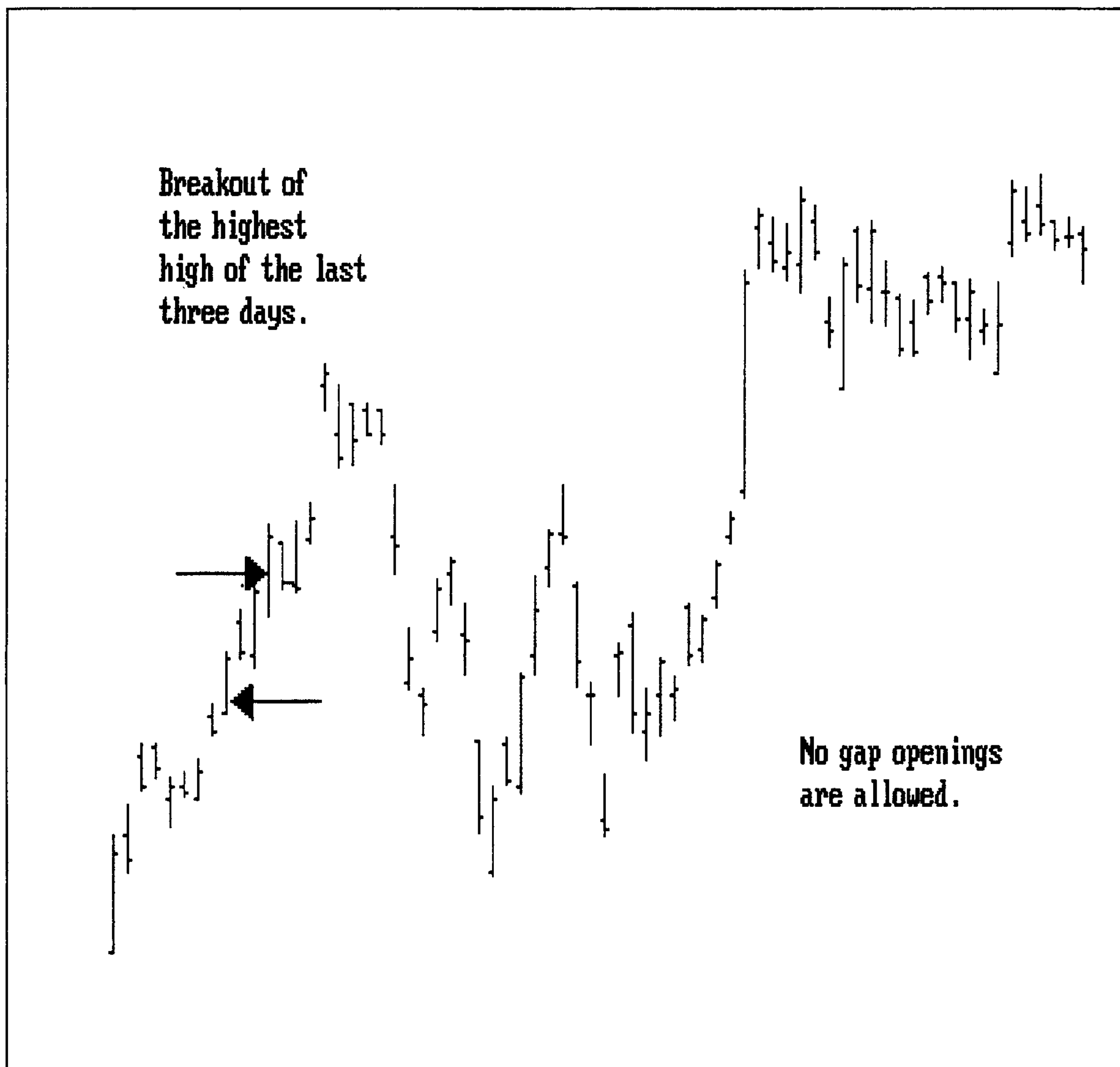
- A breakout of the highest high of the last three bars taken as a group.
- A breakout of the lowest low of the last three bars taken as a group.
- A breakout of any individual low of the last three bars. This includes a breakout of the previous bar's low.
- A breakout of any individual high of the last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

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

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

The following four pages contain examples of Intermediate Entry Signals.

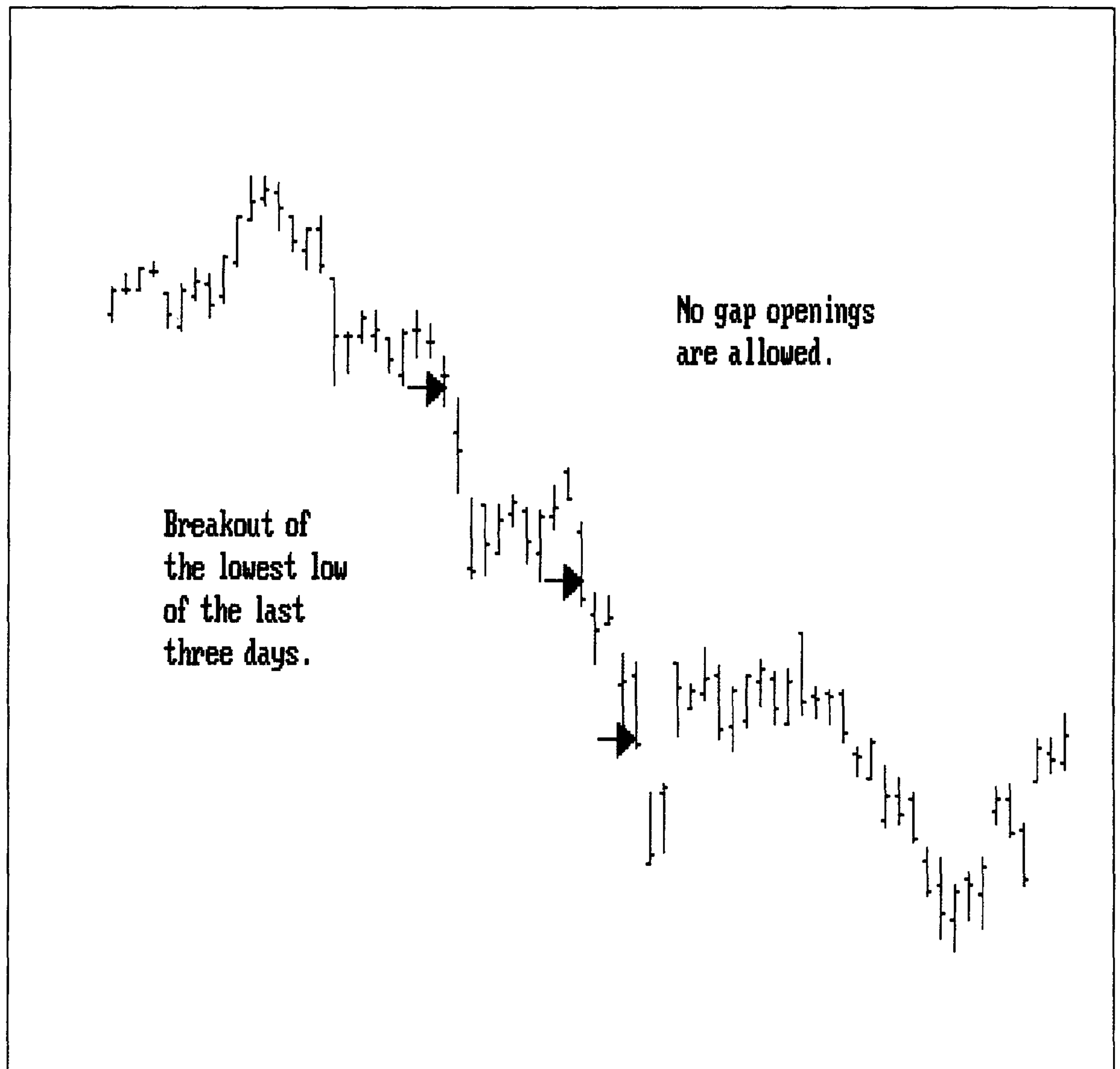
A breakout of the highest high of the last three bars taken as a group.



Arrows point to the breakout points on the actual breakout day. Daytraders would attempt to enter intraday on or before the actual breakout using one or more of the entry techniques taught in this course.

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

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



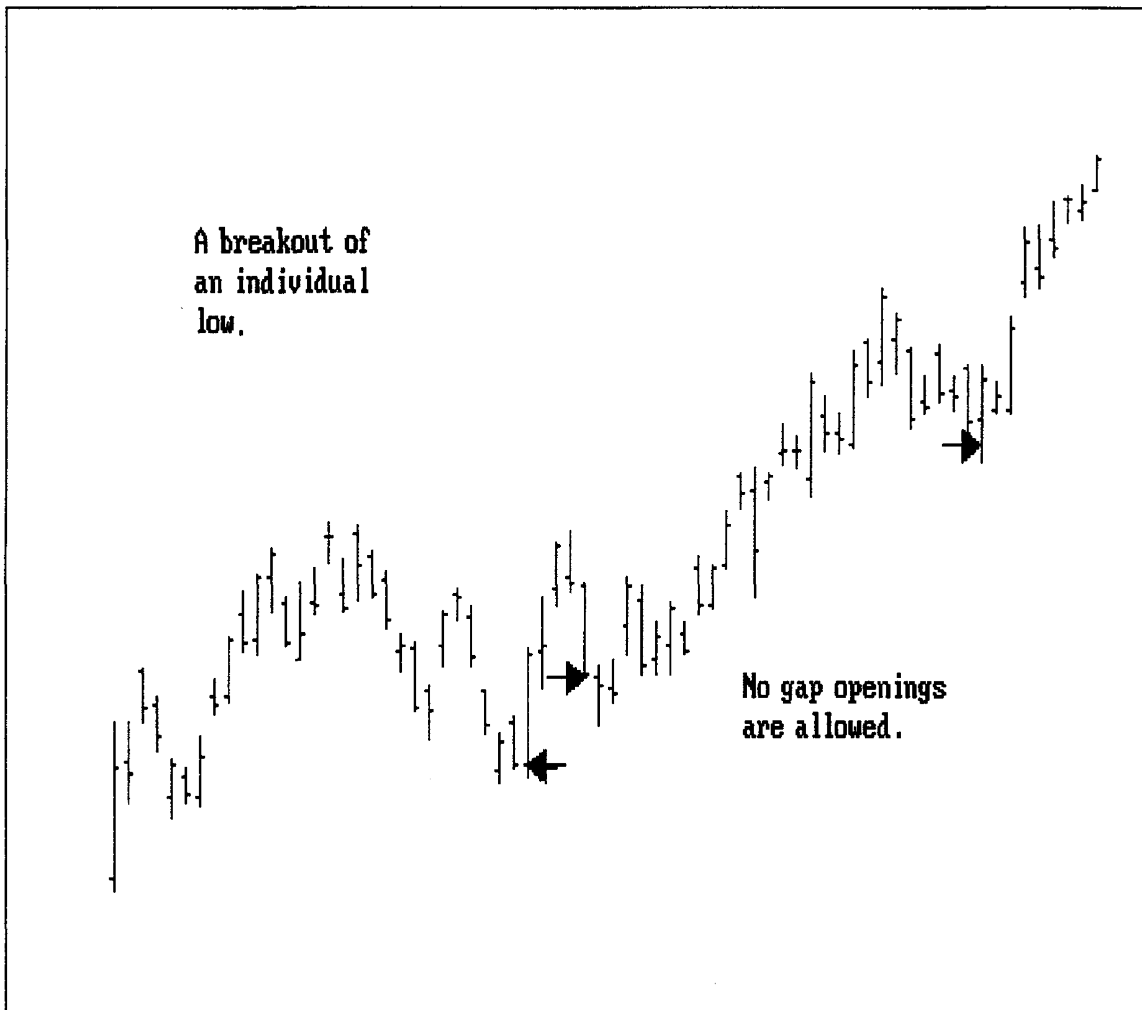
Arrows point to the breakout point on the actual breakout day.

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

The second arrow shows an even better daytrading entry.

The third arrow shows one additional daytrading entry.

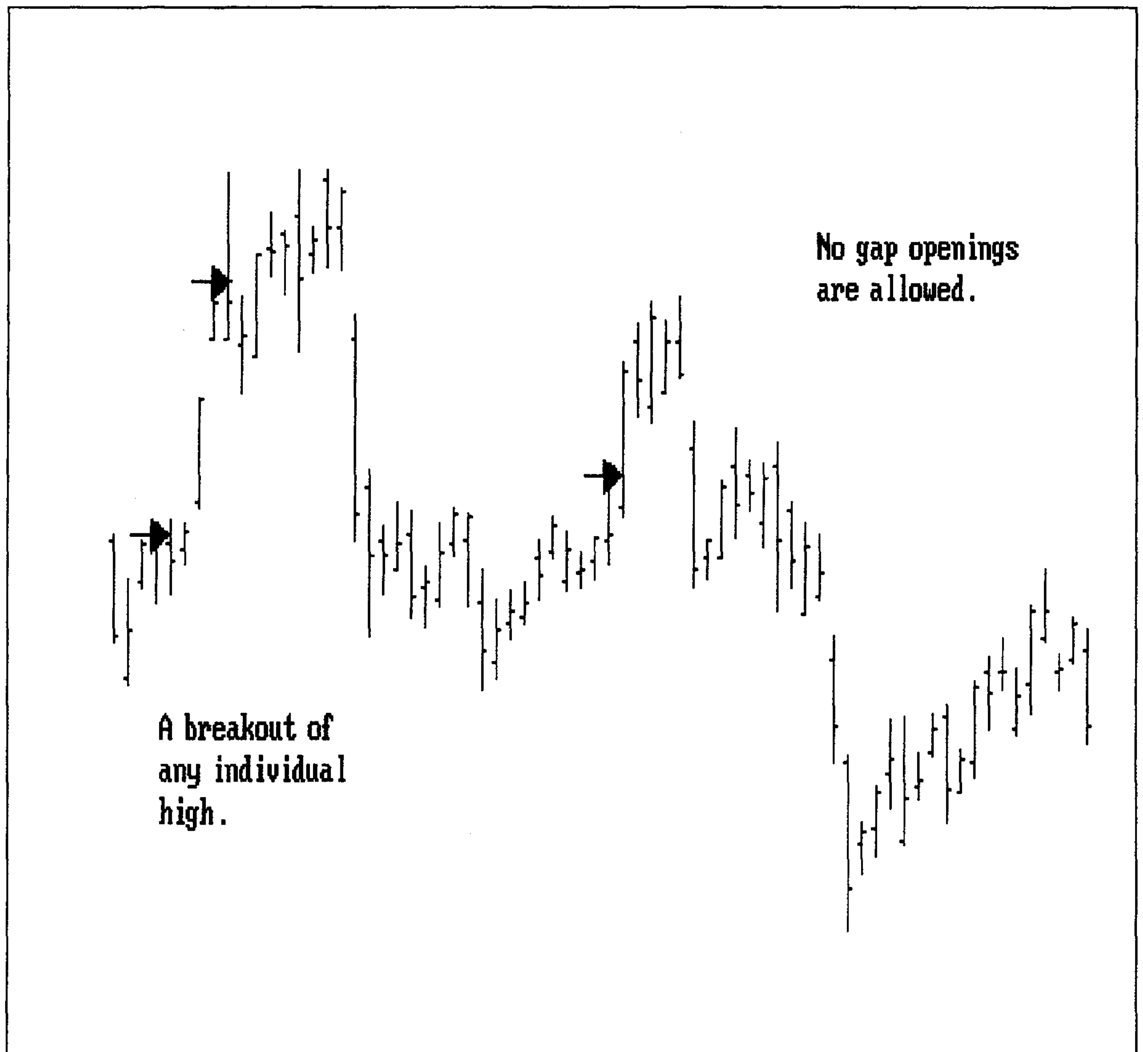
A breakout of any individual low of the last three bars. This includes a breakout of the previous bar's low.



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

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

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



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

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

Chapter 8

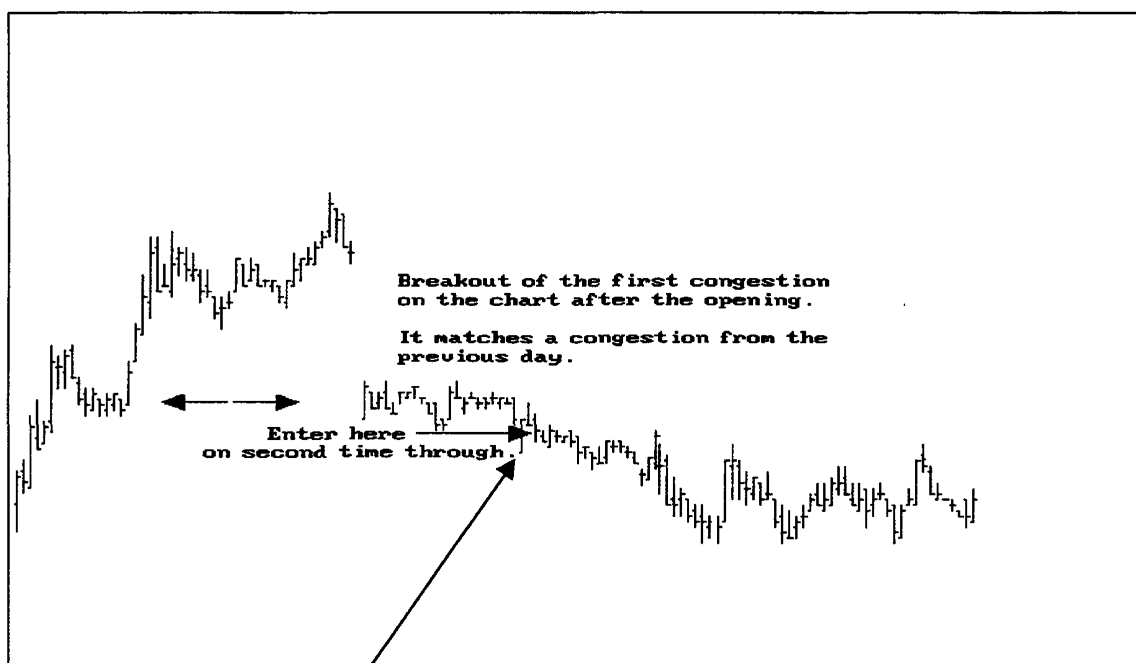
MINOR ENTRY SIGNAL

The minor entry signal is as follows.

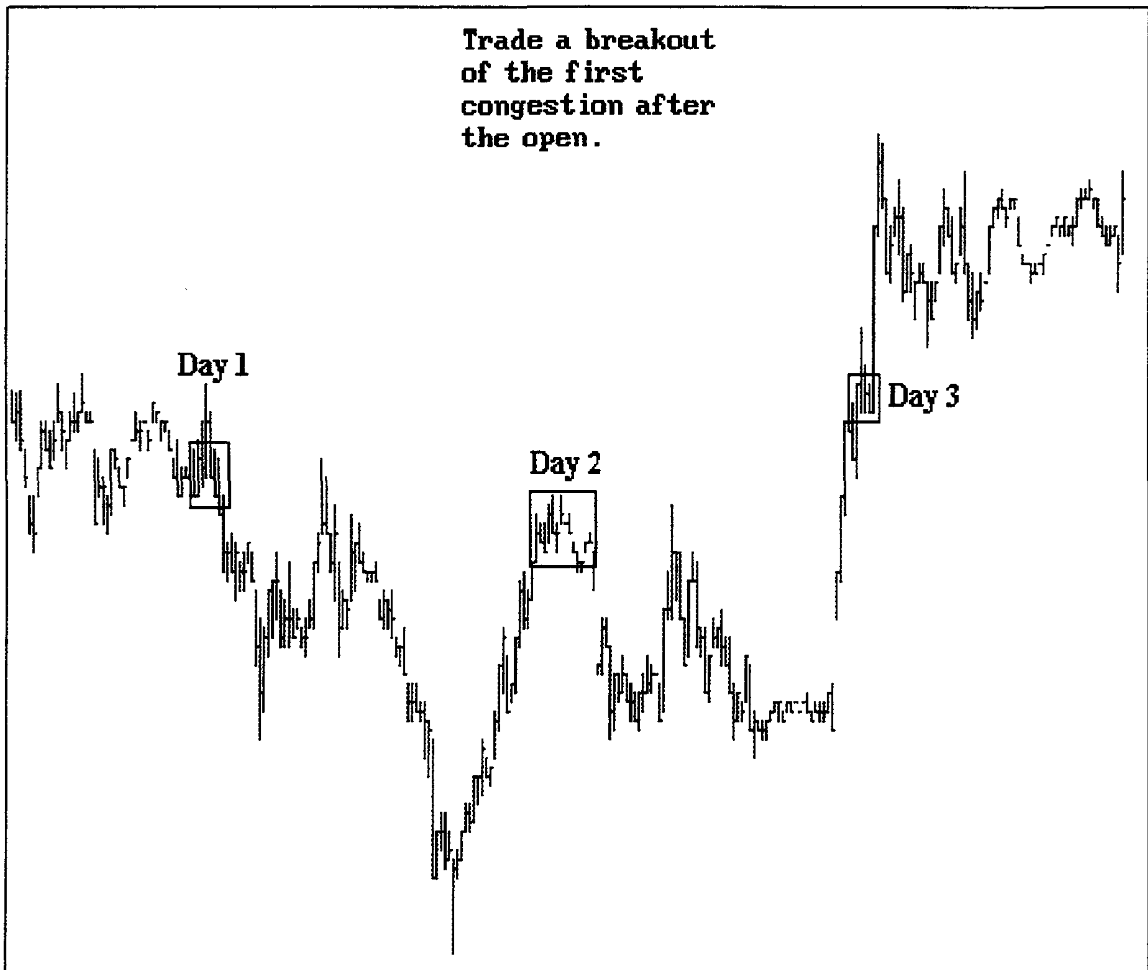
We look for a first or second breakout of the first trading congestion to form after the opening as seen on the intraday chart. This may include a congestion carryover from the previous day.

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

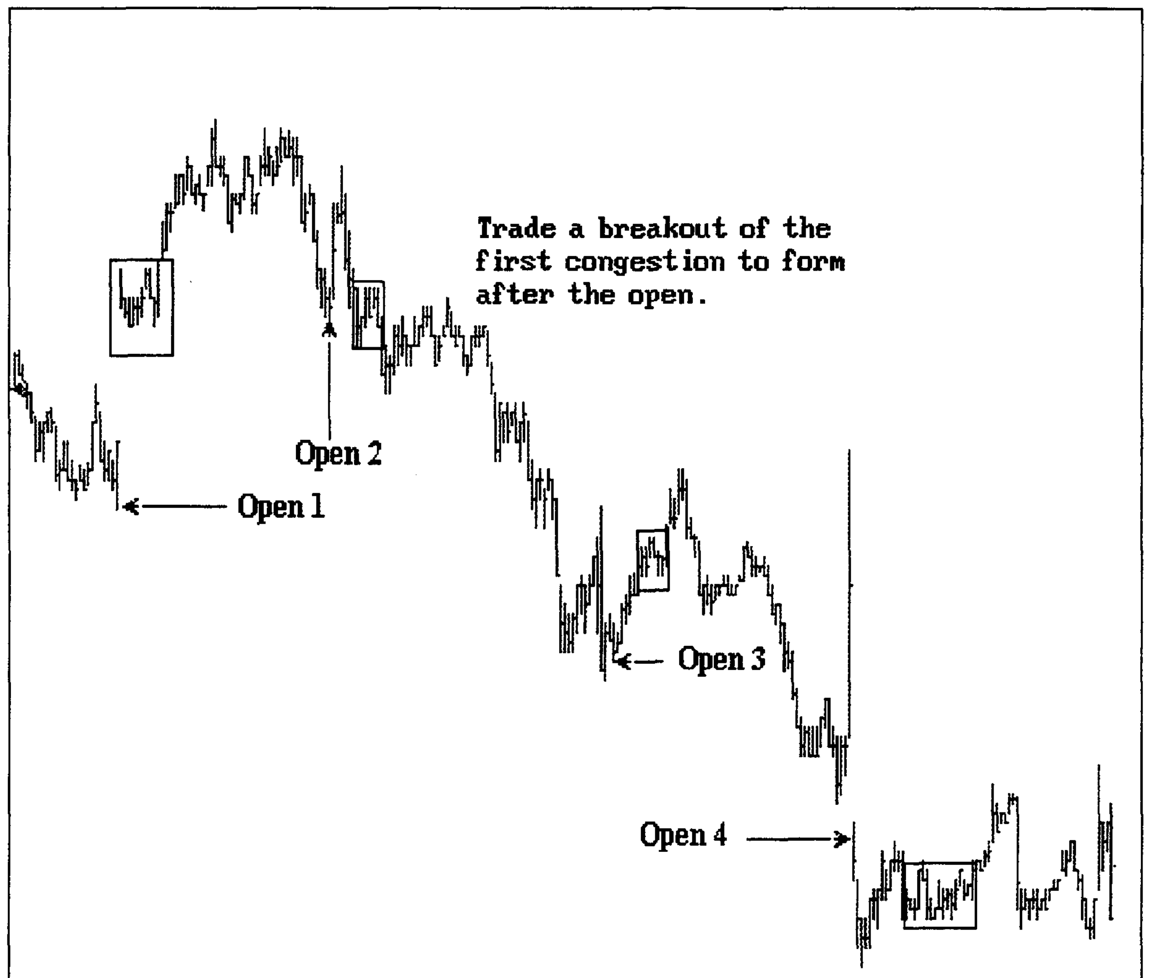
Here are examples:



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



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



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

Chapter 9

THE TRADER'S TRICK

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

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

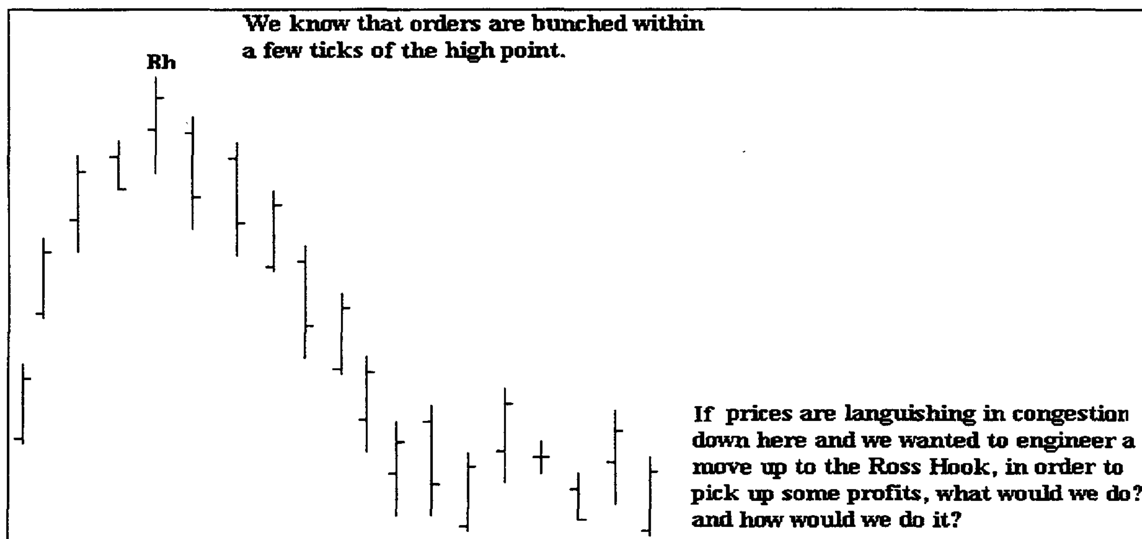
Typically, there will be many orders bunched just beyond the point of a Ross Hook. This is also true of the number two point of a 1-2-3 formation. The insiders are very much aware of the bunching of orders at those points, and if they can make it happen, they will move prices to where they see the orders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

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

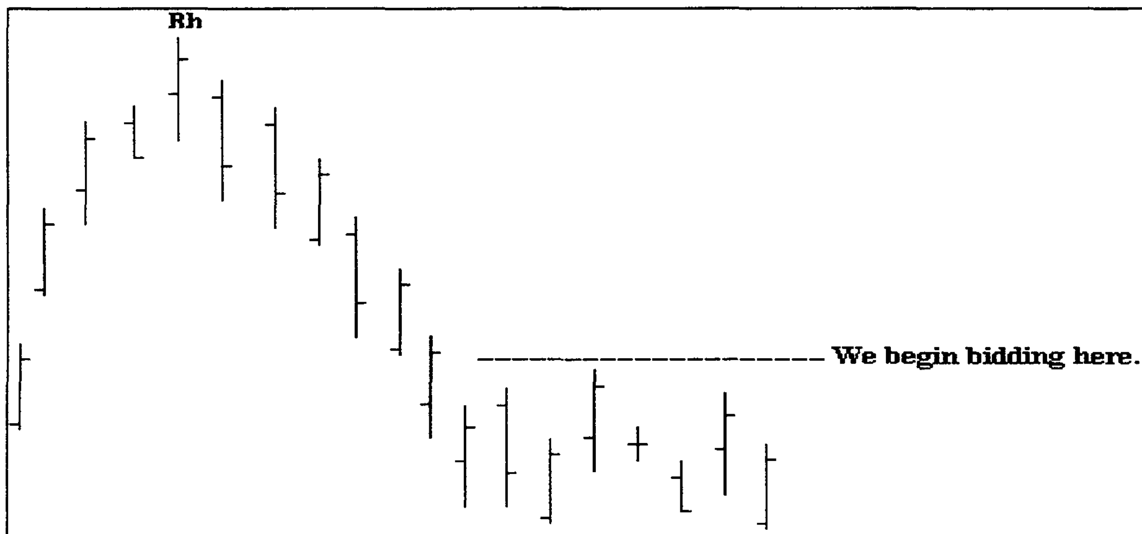
The Trader's Trick is designed to beat the insiders at their own game, or at the very least to create a level playing field on which we can trade. **WHEN TRADING HOOKS, WE WANT TO GET IN AHEAD OF THE ACTUAL BREAKOUT OF THE POINT OF THE HOOK. IF THE BREAKOUT IS NOT FALSE, THE RESULT WILL BE SIGNIFICANT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

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

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



We would begin by bidding slightly above the market.



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

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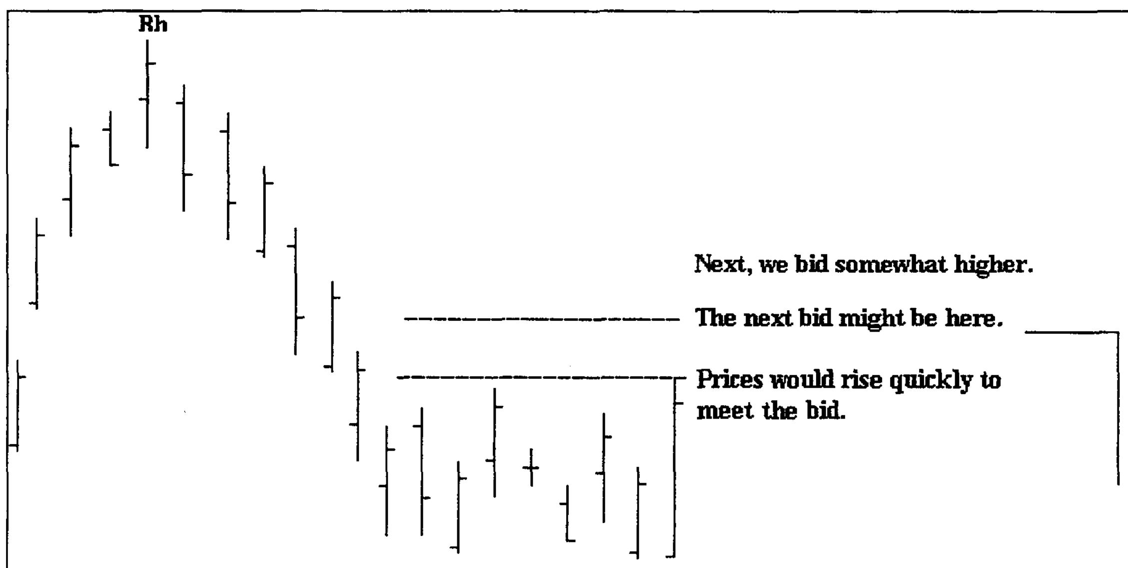
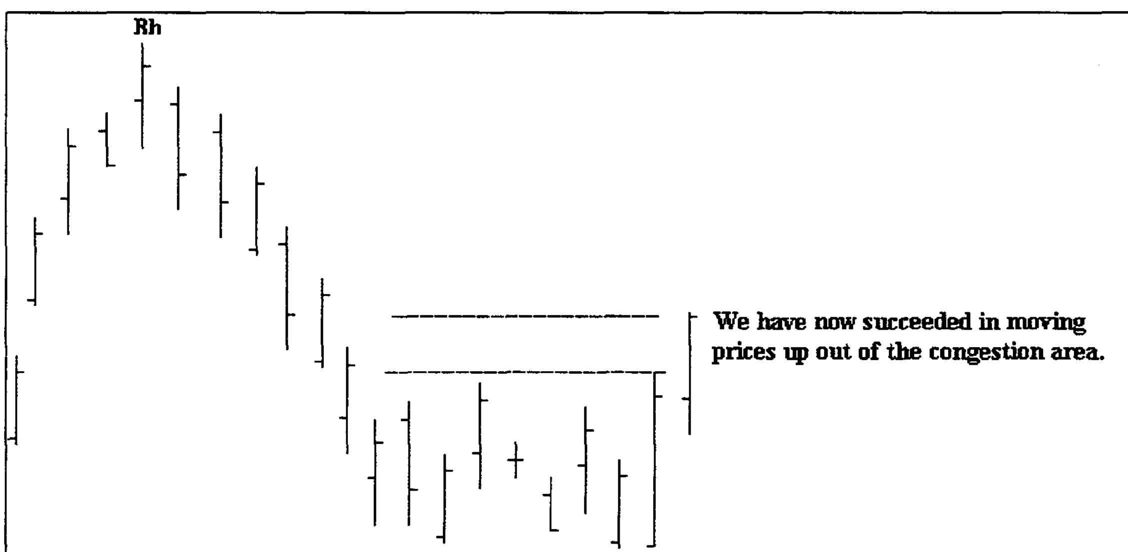


Once again by bidding a large number of shares at a higher level, prices would move up to that next level.



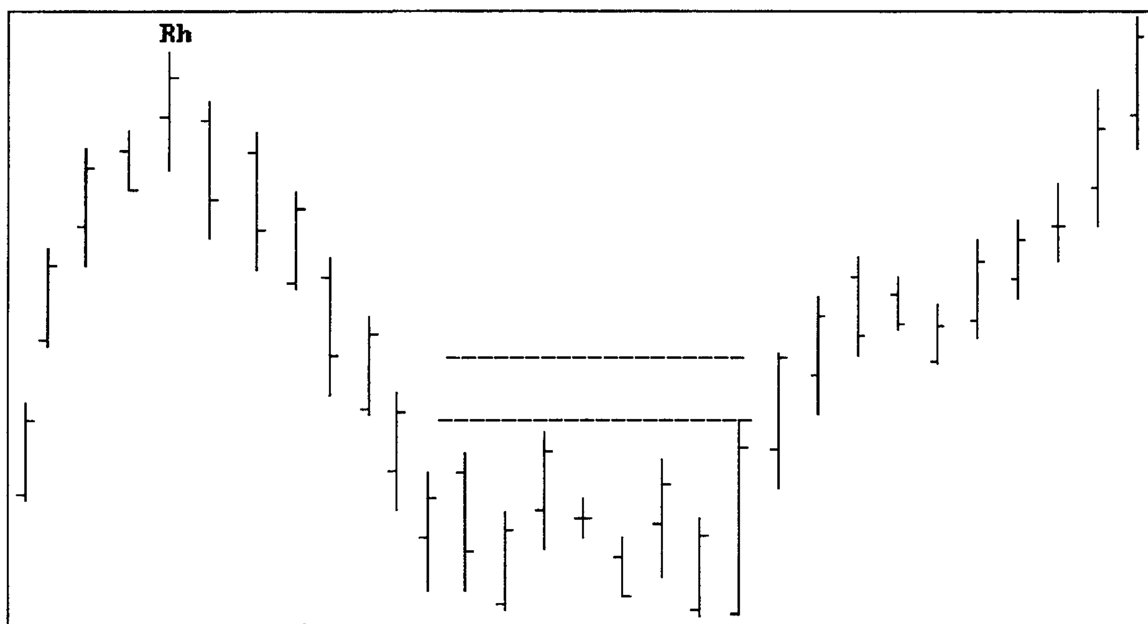
The sudden movement up by prices, to meet our large-order overpriced-bid, will cause others to take notice. The others are daytraders trading from a screen, and even insiders.

Their buy orders will help in moving the market upward towards where the stops are bunched. It doesn't matter whether this is a daily chart or a five minute chart, the principle is the same.

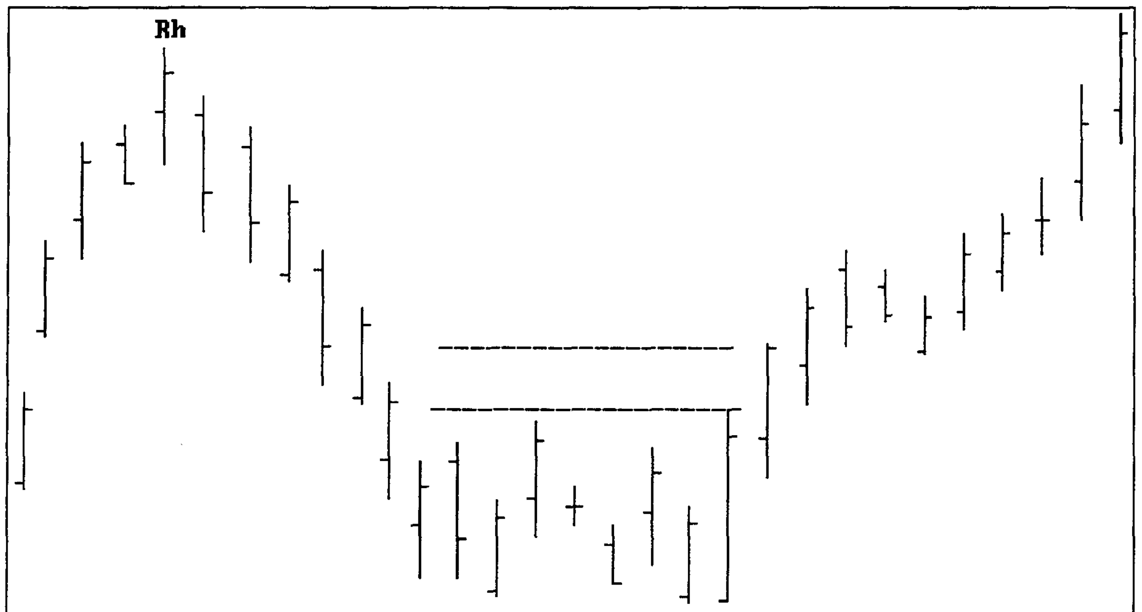
In order to maintain the momentum, we may have to place a few more buy orders above the market, but we don't mind. We know there are plenty of orders bunched above the high point. These buy orders will help us fill our liquidating sell orders when it's time for us to make a hasty exit.

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

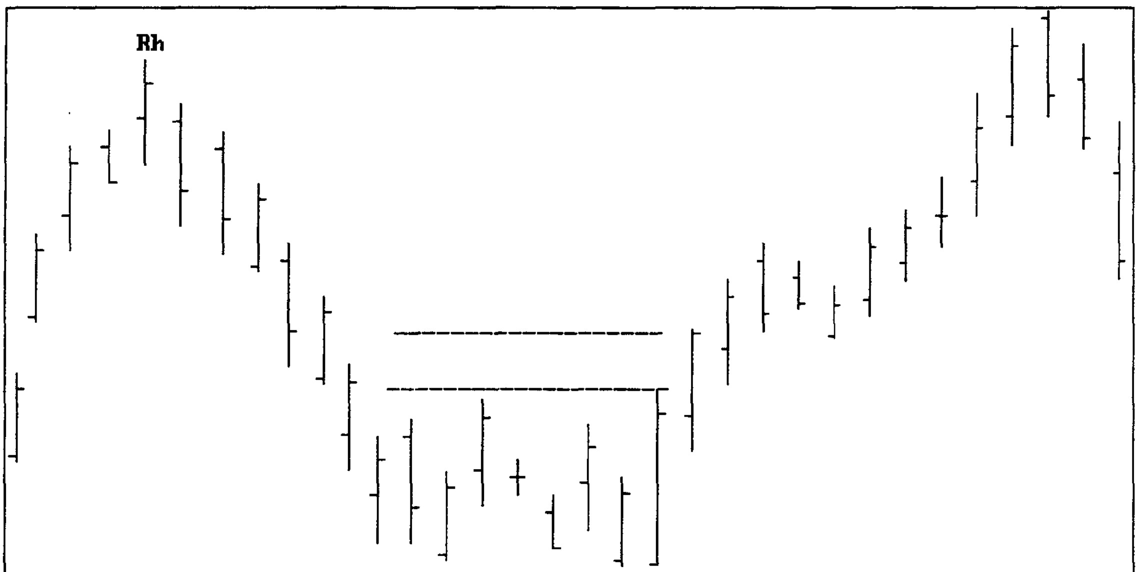
Because of the action of our above-the-market bidding, accompanied by the action of other inside traders and daytraders, the market begins to make a strong move up. The move up attracts the attention of others, and the market begins to move up even more because of new buying coming into the market.



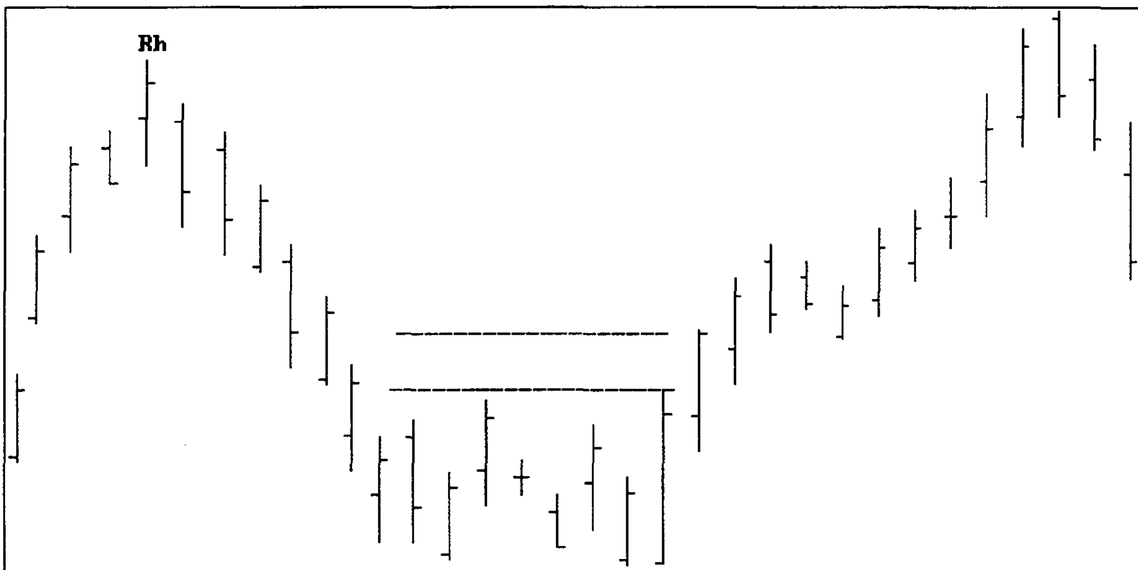
This kind of move has nothing whatsoever to do with supply and demand. It is purely contrived and engineered.



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



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



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

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

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

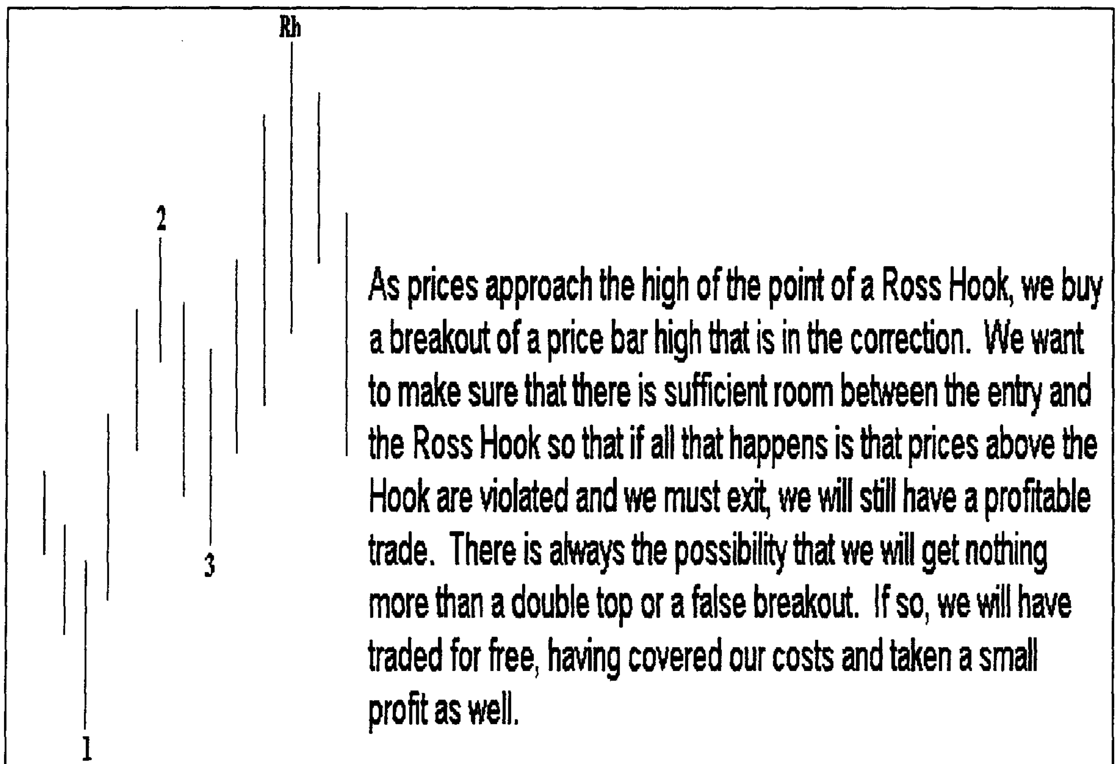
The buying from the outsiders will have to overcome that additional selling.

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

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

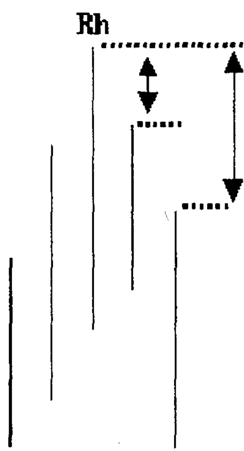
It is very important to realize what may be happening when a market approaches a Ross Hook after having been in a congestion area for awhile. The prior pages have illustrated this concept.

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



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

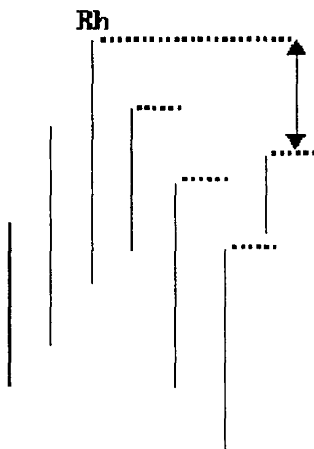
Let's look at that again by breaking it down in detail in an example.



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

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

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



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

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

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

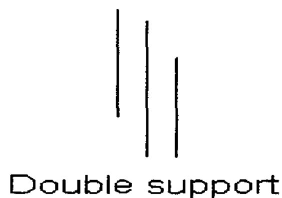
Risk management is based upon the expectation that prices will go up to at least test the point of the Hook. At that time, we will take, or already have taken some profit and have covered costs.

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

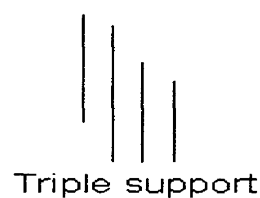
We usually limit the Trader's Trick to no more than three bars of correction following the high of the bar that is the point of the Hook. However, there is an important exception to this rule. The next chart shows the use of double or triple support and resistance areas for implementing the Trader's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

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

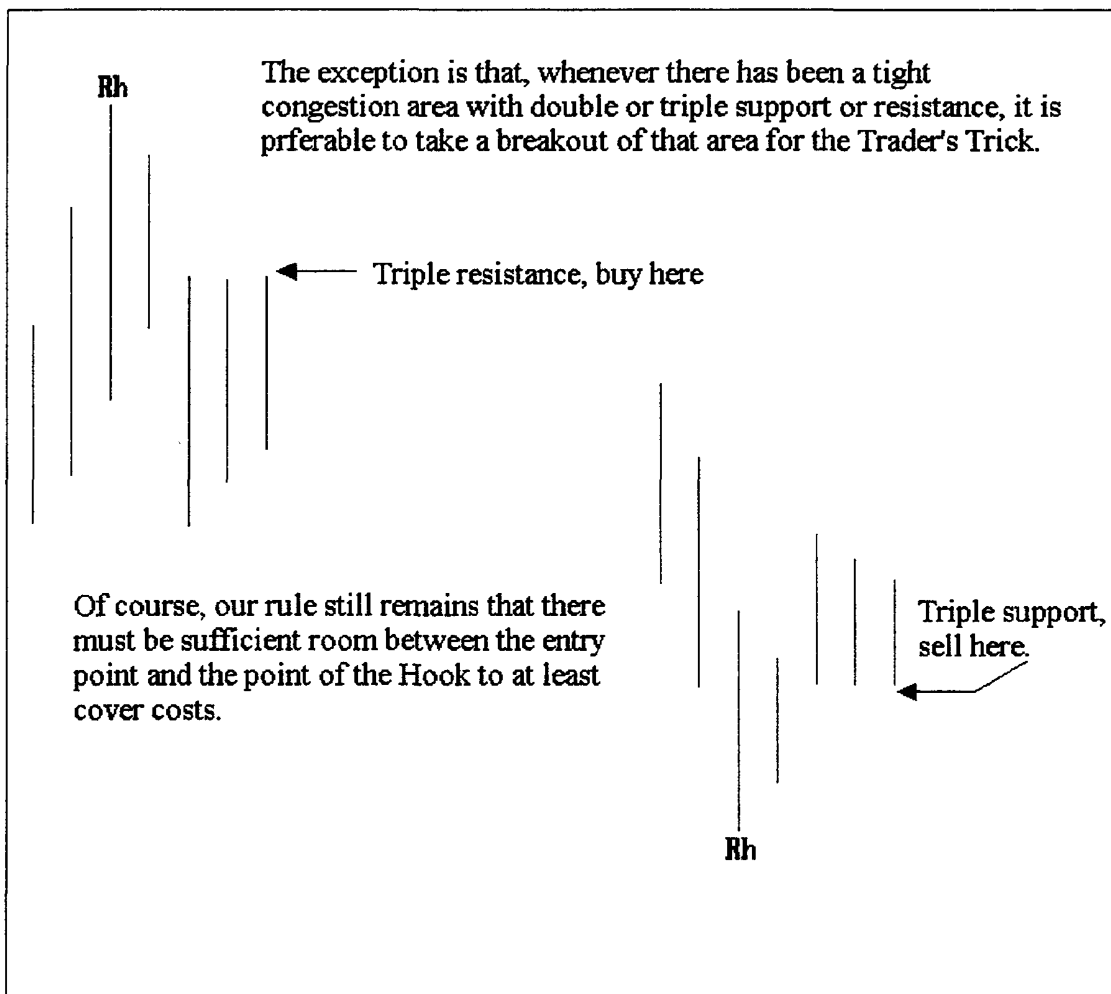
Double resistance Triple resistance



Double support



Triple support



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

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

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

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

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

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

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

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

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

PRIORITIES

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

We have presented these in the order of their occurrences. There is no specific priority to the major signal trades over the intermediate signal trades. The breakout from a major entry point is not better than a breakout from an intermediate entry point, nor is the breakout of the extremes of the last three days taken as a group necessarily a better signal than the breakout of the individual high or low of any of the last three days. Intermediate entry signals do not take a lower priority than do major entry signals. The difference between major entry signals and intermediate entry signals as it affects other trading will be discussed in a later chapter.

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

Chapter 10

STOPS

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

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

PROTECTIVE STOPS

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

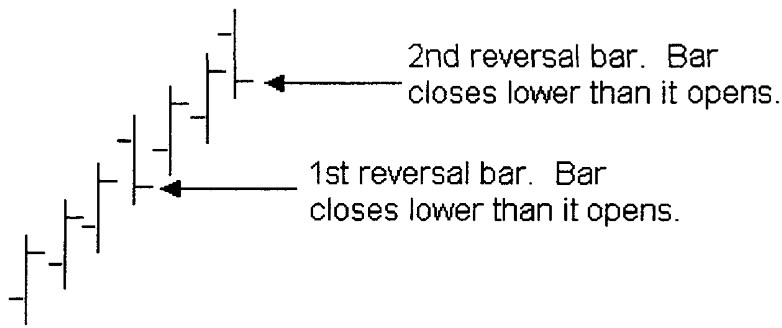
Telling someone to place his stops at a certain number of points away from entry is also impractical because account sizes vary as do levels of comfort.

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

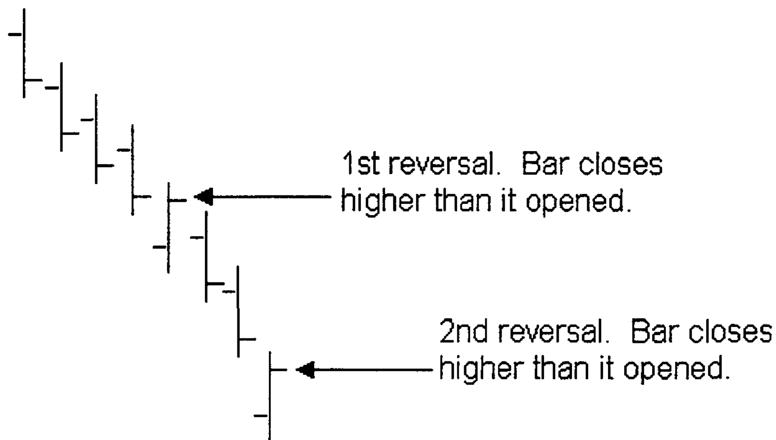
Since we will not presume to tell anyone where to place their stops, let us tell where we place ours.

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

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

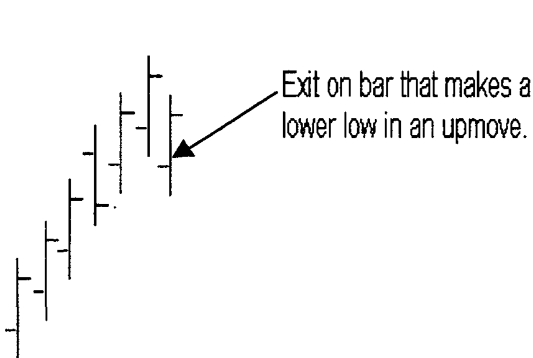


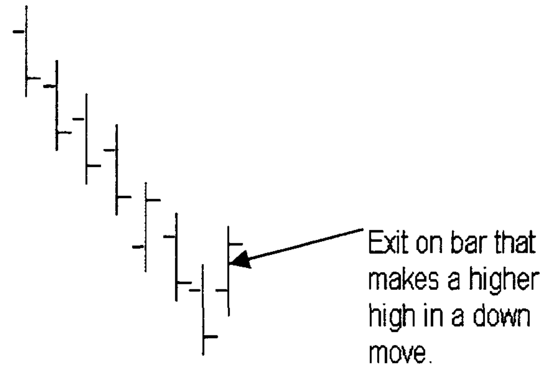
Exit on 2nd reversal bar when trading with the violation method.



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

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





These exits are all part of the violation method.

This method of handling stops is valid for both intraday and position trading, so we'd better illustrate the point. We call this technique the "violation method."

REVERSAL BARS

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

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

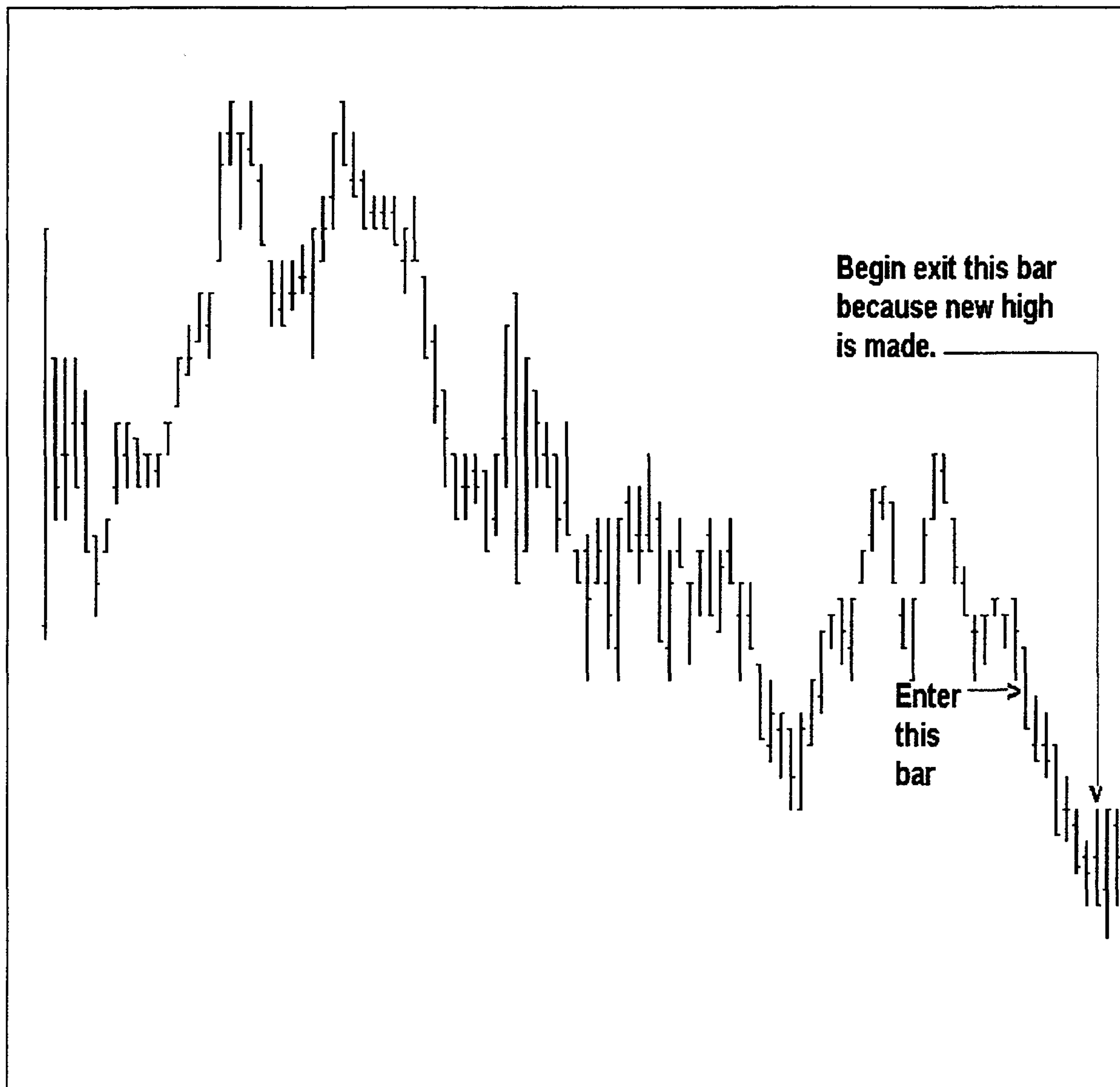
HIGH AND LOW VIOLATIONS

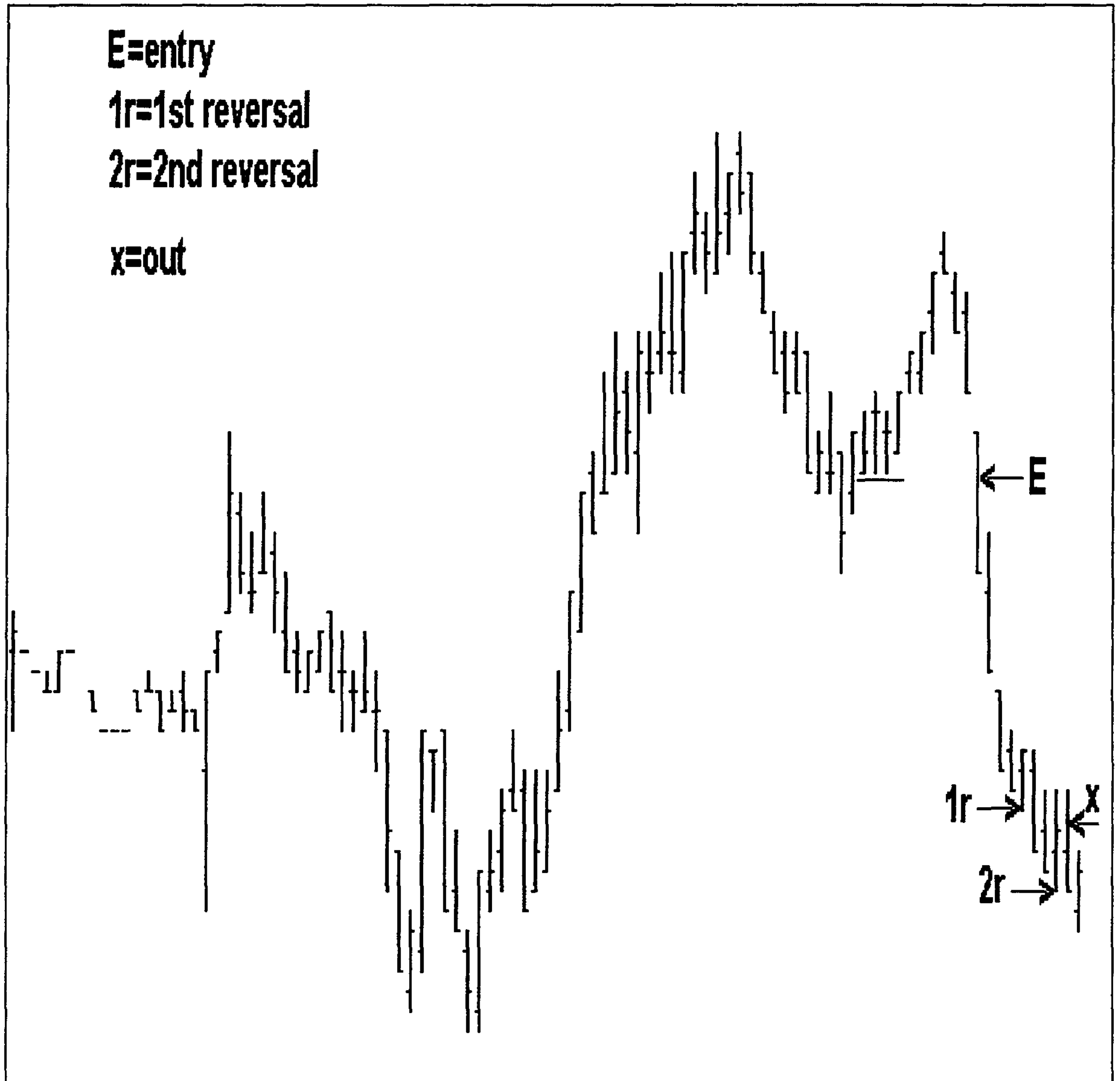
The presumption is that, in an upmove, prices should be making higher highs and higher lows. Therefore, if a price bar should happen to make a lower low, thereby violating the previous bar's low, something is not quite right, and on a percentage basis it is a good idea to begin exiting as soon as the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

With the violation method you have a choice as to whether or not you would sell the entire position at the time of the violation, a violation being two reversal bars or the making of a higher high in a down move or a lower low in an upmove. If you choose not to liquidate the entire position, you can scale out by exiting part of the position

whenever you see the first violation, staying in part of the position until you see a second violation, and holding part of the position until you see anything that would cause you to take your money and run. It is entirely subjective as to what would cause you to do that. Depending on your strategy and business plan, you can decide which method is best for you and your trading.

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

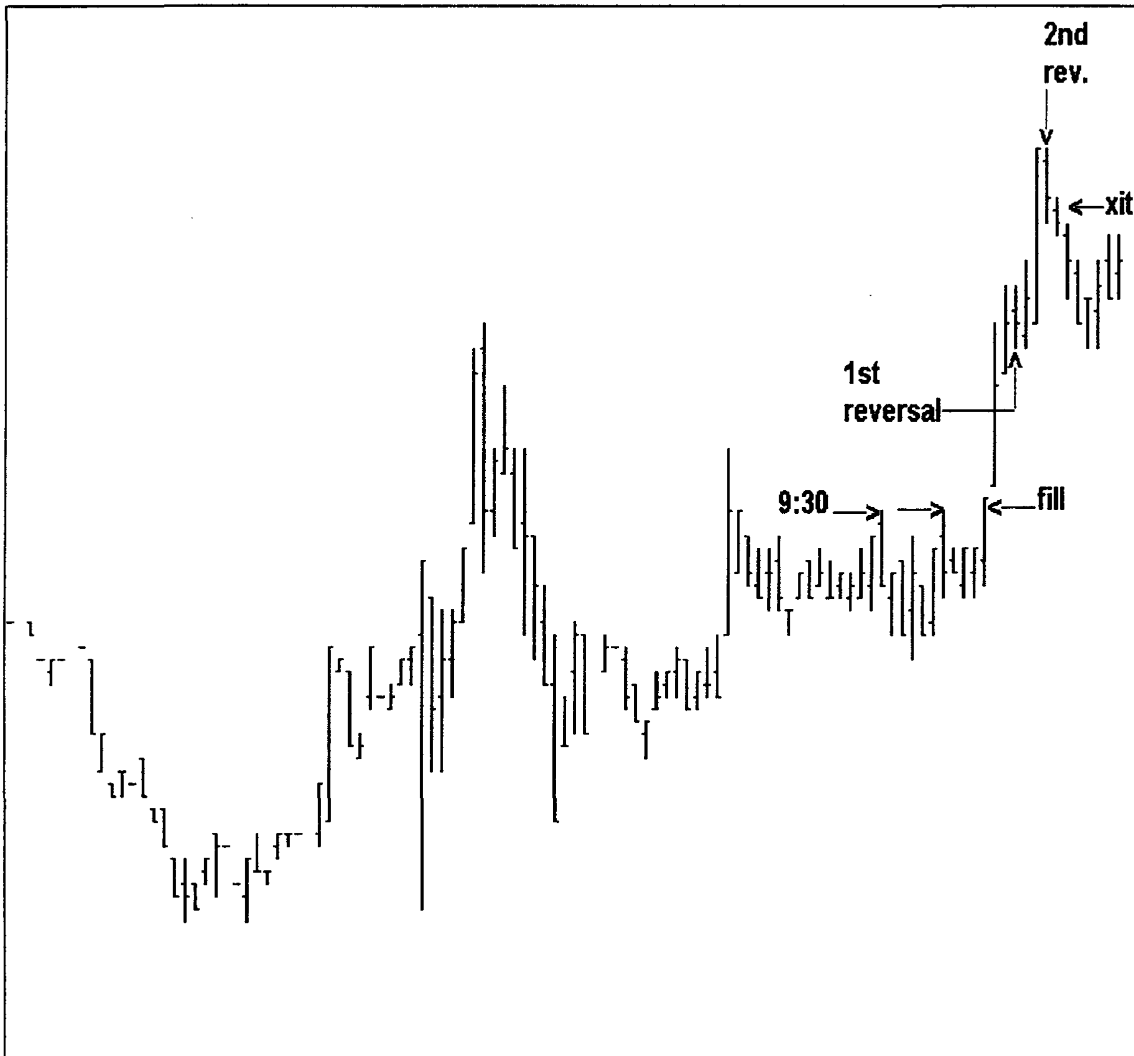


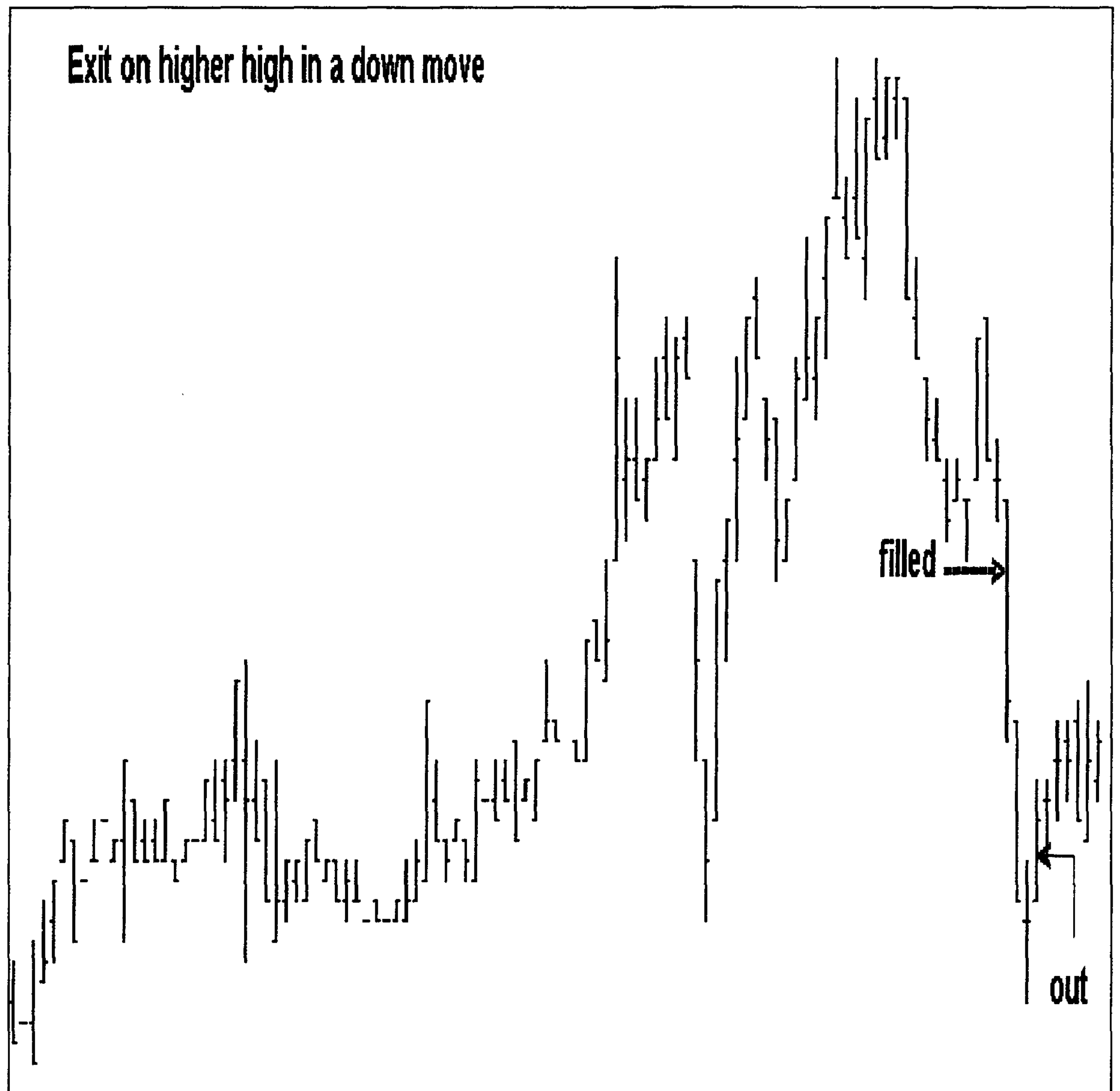


1r — bar opened lower and closed higher rather than opening higher and closing lower.

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

Begin exit on second reversal bar.





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

Even though an example is not shown, we would also exit on a lower low in an upmove.

OBJECTIVE STOPS

The discussion of objective stops will be covered in great detail further on in this course. The following is a brief discussion presented so that you might begin to become familiar with the concept of trading with objectives.

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

For most day trades, we are initially looking to cover costs and make a small profit on a part of our position.

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

The remainder of objective stop management involves:

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

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

Chapter 11

SOME VERY BASIC TRADING

Now we want to show you some very wise trading.

Over the years, trading becomes somewhat intricate, and certainly very intuitive. This will happen when you have viewed thousands upon thousands of charts, and have experience trading in every time frame from one minute charts to weekly charts.

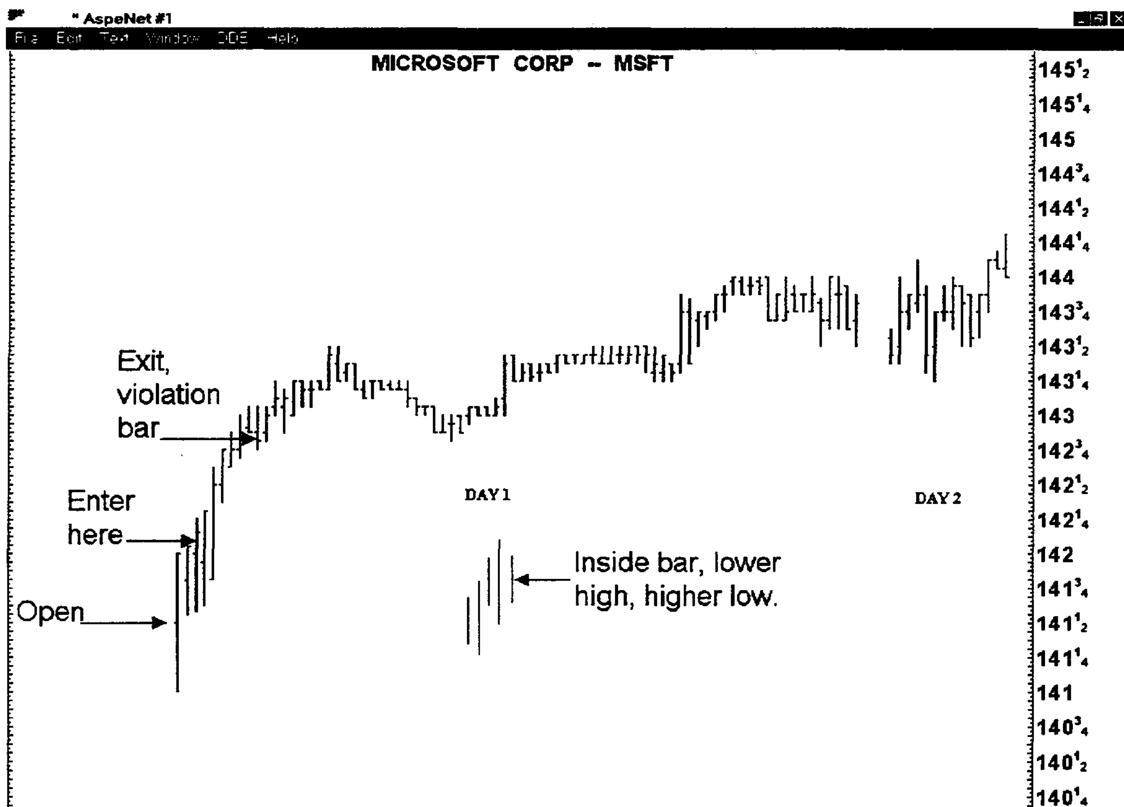
But trading doesn't have to be intuitive and intricate at all. In fact, some of the best trading ever done has been some of the most straightforward and simple trading.

In this chapter, we're going to show you some very basic trading techniques. They have served us well for many years.

This method worked for us immediately and still works today. We have no doubt that it will always work, because it is based on truth. Truth is constant, it never changes.

You have heard time and time again that the trend is your friend. With this method, we will teach you how to use the trend. You have heard that you need to keep your losses small and stay with your winners. This technique will enable you to do that. It is so simple that many of you will not believe it. You have heard that you should let the market tell you what to do. This concept is the very embodiment of that wisdom.

It will be your loss if you don't accept the sheer simplicity of the plain truth that we're about to show you.



Are you ready for this? OK, here we go!

- **RULE 1: IF THE 2ND 5 MINUTE BAR IS NOT AN INSIDE BAR, ENTER ON A BREAKOUT OF THE EXTREME (HIGH OR LOW) OF THE 2ND 5 MINUTE BAR.**

- **RULE 2: IF THE 2ND 5 MINUTE BAR IS AN INSIDE BAR, ENTER ON A BREAKOUT OF THE EXTREME (HIGH OR LOW) OF THE 1ST 5 MINUTE BAR.**

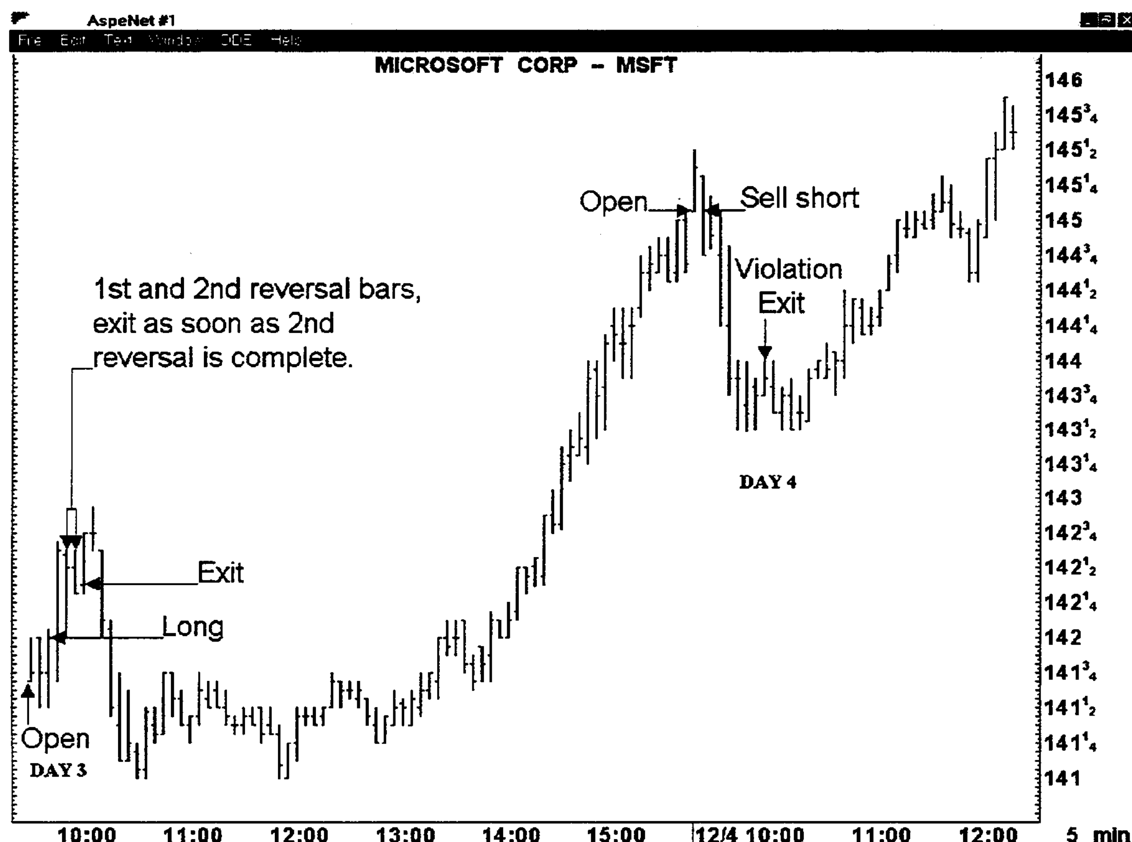
- **RULE 3: EXIT WHEN YOU SEE TWO REVERSAL BARS IN A SERIES OF BARS MOVING IN THE DIRECTION OF THE TRADE. THE REVERSAL BARS NEED NOT BE CONSECUTIVE. A REVERSAL BAR IS DEFINED AS A BAR OPENING HIGHER THAN IT CLOSES IN AN UPMOVE OR A BAR OPENING LOWER THAN IT CLOSES IN A DOWN MOVE.**

- **RULE 4: EXIT WHEN YOU SEE A "VIOLATION" BAR. A VIOLATION BAR IS DEFINED AS A BAR MAKING A LOWER LOW THAN THE PREVIOUS BAR IN AN UPMOVE, OR A BAR MAKING A HIGHER HIGH THAN THE PREVIOUS BAR IN A DOWN MOVE.**

The rules shown on the chart are simple. This is an early morning trade technique based on an entry off the open on a 5 minute chart. We'll look at several days so you can see how it works. Day 1 was satisfactory in its outcome.

What you will discover is that the most important factor in a trade is not how you get in, but how you manage the trade. So far, we have had a trade that made a decent profit (previous page) and now a trade that had a small loss, a small win, or was breakeven, depending on the entry and exit prices. If we can keep up this pace of trading, we can be consistent winners.

Day 3 gives us a winning trade, as does Day 4. We did not especially choose these days because they mostly won. We took them completely at random and they are consecutive days of a normal trading week.



So, what's the point of all this? We want you to see what trading is really like. We want you to see why you must keep your losses small.

Look at how many times we had to make trading attempts and risk small losses before we were able to really score.

That's what trading is all about. Keep in mind that losses are essentially calculated losses. There may be plenty of them, but they should all be within the parameters of the trading plan. Will such a method work in today's markets? You bet! You saw it on the preceding charts The markets have been making the same patterns year after year, day after day. Traders come and go, but the markets keep on doing their thing.

The truth is the truth. We've shown you our way to trade. Learn to be patient and to wait for the right things to happen. The method we were using forced us to wait. We never allowed ourselves to trade what we were thinking. We traded only what we saw. The truth we had to trade with was always on the chart in front of us. There was no other truth. We had no oscillator, and no moving averages. Just a bar chart. Trading this way will force you to learn many valuable lessons.

You will learn that the market is your friend as long as you honor it. You will learn that you may have to take a lot of small hits. You will learn not to fear them. You will learn to cherish the profits that you have, and to protect them. You will learn to be unwilling to give them all back. When you are wrong, the losses must come when you have little or no profit in a trade rather than allowing a winning trade to turn into a loss. The losses have to be kept minuscule in size.

You have to manage your money. You have to pinch every penny. You must run your trading as a business. This is no game. This is real. The roof over your head may be at stake.

You must learn to enter the market more than once, to make numerous attempts. To do this, you will have to conserve capital. If you allow yourself to take a big loss the first time in, there may be no way to have the courage or the capital to try again.

Can you see that? If you allow yourself to take a beating on a trade, it not only greatly diminishes your capital, but it deprives you of the will to continue trying.

Although we can be somewhat sure of the trend (it's true while it lasts), we can never be sure of the timing. No one knows exactly when a market will break and run, or when it will continue to run. Consequently, you have to be prepared to make several attempts.

It's the sort of thing where you stick your toe in the water to see if it's too hot. If you get burned, you are quick to pull that toe out of the water. So you wait. When you see that it's time to try again, you stick that toe back into the water. Perhaps this time you can climb

into the hot tub. If not, try again. But you don't just jump in and get scalded with third degree burns all over your body.

If you sit there and take a big loss, you will have been badly burned. You'll be like a whipped dog. You'll have to slink away to a corner and lick your wounds. You'll no longer have the courage of your convictions. Do you know what you will do then? You'll probably go out and buy another system.

There's an old story that says it all. "When a woman has a bad day, she goes out and buys a new hat. When a trader has a bad day, he goes out and buys a new system." If you know who first said or wrote that, let us know.

When we do a mailing for our books, do you know who sends for them? That's right, the person who just took a big hit in the market.

If we mail the same list again, we'll get the same number of sales. Why? Because next time we'll get others who have lost.

The winners almost always throw our letters in the trash. Who wants to read a book about trading when he is winning? How many of you are willing to shell out $2500 to $3000 for a new system when you are ahead in your trading?

Chapter 12

HOUSEKEEPING

Because daytrading is at times both fast and furious, it is necessary to keep accurate trading records. We must know the time we entered the trade; we must keep track of the shares we have open in each trade. Hey, nobody said that daytrading is easy.

Where possible, we write down all our potential entry points. We must keep track of those prices.

"Now, how many shares are we still in?" Whoa! Wait a minute, our order to sell 500 shares of ABBBY just got missed, prices opened below us. Quick, get that order canceled, we don't want to be filled with prices going the wrong way. *"What was our entry price?* Whew, thank goodness we wrote it down. *Now, where were we.... Oh yeah... how many shares are we still holding? 200!"* Write it down.

Is this an exaggeration? No way! Daytrading a five, ten, or even a fifteen minute chart is some kind of a busy job. Many of us can do it only in short bursts. Anyone who is a nervous type may be eaten alive. We must keep accurate records. We must know, and know that we know, when we are flat, or know for sure when we have one or more positions still live in the market. To do all that, we had better be terrific housekeepers. If we are not totally organized, we may well have the opportunity to eat our shirts.

Do we need to keep accurate records? Absolutely, for sure, YES! So, we write it down, write it down, WRITE IT DOWN. We double check what we have punched in at the keyboard. We want to be sure we are not long when we meant to be short, or vice-versa.

If we've entered an order incorrectly, we must get out. Do ***not*** make the mistake of staying in if, after seeing an incorrect order, prices move in the direction of the erroneous order. That can be suicide. The entire basis for the order is no longer intact.

When we're in the heat of battle, we have to be extra careful of what we type in at the keyboard. In the rush to exit a trade, we may think we are doing the right thing and then do the wrong thing. Every trader will at some time enter a buy order when he wants something, even though what he really wants is to be short. When the human mind wants something, it thinks "buy." This is because we buy when we want to acquire something. Sooner or later, we will think buy when we really mean sell because what we are trying to do is acquire a short position.

We hate to say how many times we've been short, and wanted to sell more shares in a hurry, watching two or three other trades, and blurted out or punched in "buy" when we really wanted to "sell."

The opposite is also true. When we want to get rid of something we say sell. But what if we are already short? It is easy to punch the sell button when we really want to buy back our position as a short seller.

Chapter 13

BROKERS

When trading with electronic order entry, you have quite a few choices of brokers. In that respect, it is no different from trading non-electronically with a broker who receives your order over the telephone and places it in the market for you.

The choices are very much the same. Some people prefer full service brokerage firms and pay higher commissions and some prefer to place the orders in the market themselves via a computer terminal. For being willing to take care of their own order entry, they enjoy lower commissions. It all depends upon your personal needs and preferences.

With Electronic trading the level of service and reliability you can receive from your brokerage firm are at both ends of the spectrum. The more expensive commission firms may suit your trading needs, but the fact is the less expensive trading firms may have faster executions because you are eliminating the middle man and taking full advantage of the benefits of electronic trading.

Your personal requirements to a certain extent will depend on whether you are trading in a daytrading office or from home over the internet. The possibilities are all important to review when picking a brokerage firm and a location from which to trade.

Let's talk about a daytrading office first. It is extremely important to find a trading office where you feel comfortable. A fertile office with a lot of activity and serious traders making money is a great place to start trading. It is important that the office has up-to-date equipment as well as backup equipment to protect your account in the event of technical difficulties.

If you are just starting out, be careful! Electronic trading brokerage is fiercely competitive and it may be foolish to go to the firm offering the lowest commissions or the "deal of the week."

Another area for caution is that of being influenced by other traders. We have seen too many people walk into an office saying, "I will trade here but I want to sit next to the best trader." To do so is usually a quick way to end up losing a lot of money. You must remember to make your own trading decisions. Don't follow anyone else in the trading office.

We can recall a situation in a trading room that came very close to becoming violent. The majority of traders noticed that one of the better traders in the office was calling out his trades as though he were just entering them, but in reality ***after*** he had already been in them awhile. The truth is that he was actually trying to get out of his position by luring the other traders into the market. Needless to say, after that he didn't have too many friends in the office, and ended up leaving for another trading office where he could find new victims upon which to prey.

Internet trading is taking the world by storm. It appears to be the future of trading. However, with all the activity, and so many companies offering different types of services, it can become quite confusing.

The commission rates vary tremendously and so do the services. Do not think because you are paying a higher commission that you are getting better service. Online trading systems vary dramatically, and it is essential that you find compatibility with a brokerage firm that is a "best fit" with your style of trading.

There are brokerage firms that offer quick and speedy NASDAQ and NYSE DOT execution systems in which you just click on a market makers call letters or price to buy or sell a stock. There are also online trading services that require you to type in your complete order entry as would a broker filling out an order ticket. Your trade is then routed to the broker's trading desk from which it is filled and then sent back to you. Of course, there would be considerable difference in the turnaround time for execution between the two types of services mentioned.

We have extensive knowledge in the area of order entry and brokerage. We have dealt with all types of electronic order entry

systems, as well as with numerous brokerage firms that provide online Internet access, daytrading offices or both. We are intimately familiar with many of the firms and the software that they provide. It could be absolutely critical, depending on your trading style, to be matched with the right broker and trading system.

With this in mind we invite you to e-mail or call us and we will be happy to help you select the best brokers and trading systems to fit your individual trading needs.

We have many firms on our list, from some of the largest in the world to some of the smallest ones you may want to know about. Once again this is a very ***important*** part of successful trading and we will be sure to highlight different brokerage firms and trading systems throughout the year in our newsletter. If you are interested in the 'TNT' monthly newsletter, please contact us at the numbers in the front of this book.

IMPORTANT NOTICE: CURRENT SEC REGULATIONS PROHIBIT US FROM SOLICITING BUSINESS FOR ANY BROKER UNLESS WE ARE LICENSED IN THE STATE IN WHICH YOU ARE DOMICILED. THEREFORE, IN THE EVENT YOU ARE DOMICILED IN A STATE IN WHICH WE ARE NOT LICENSED, WE CAN OFFER ONLY TO HAVE REPUTABLE BROKERS CONTACT YOU. YOUR CHOICE OF ANY BROKER IS ENTIRELY YOUR OWN DECISION.

Chapter 14

TECHNICAL ANALYSIS

Here is an interesting fact: Eighty percent of traders are on the right side of a trade when going in.

Throughout much of this course, we try to show you some of the reasons that ninety percent or more of you lose money, even though you enter a trade from the correct side, going in the right direction.

TECHNICAL INDICATORS

In this chapter we want to address the fallacies and weaknesses of technical analysis when done exclusively through the use of indicators. Perhaps we can pull a number of points together so you can see the big picture.

Did you know that some of the market makers and operators actually keep an eye on technical indicators in order to fade the technical trader? It's somewhat like what the gambling houses do with system players. They love them, because they know that eventually they will get all their money — they are willing to fade the system player. There are some traders who operate on the same principle — they love you because they know they are going to take you to the cleaners. My question is, if you have knowledge of that fact, why would you still walk into their trap?

Many traders in the market today are using technical analysis. Most traders in the market today are losing money — over ninety percent of them lose. Knowing that, why would you want to do what the rest of them are doing? Why would you want to follow along with all the rest of the technical analysis sheep who are going to be fleeced?

Knowing that the market makers respond to most of the details in the market, why would you want to trade with technical tools whose purpose is to smooth away the very detail that makes a market what it is?

We know you've been told to use these gimmicks because they smooth out the ripples. We know that you cannot react to every undulation of the market as do the market makers. But you must still be aware of what is going on in the market. You must pay attention to those details.

The only case that we can make for consistent and exclusive use of technical indicators is if you have very deep pockets and want to trade long term, or you are a mechanical system player, who could do much better at the track than at trading stocks.

If you want to trade a mechanical system, then you have made trading into gambling. The stock markets are not the best place to operate as a system player, although we know that some claim they do it successfully.

There are correct ways to use technical indicators. But that is a subject that is beyond the scope of this book.

We have done in depth experimentation with technical indicators and have personally traded that way exclusively many times, and with excellent results. We did it using a method of looking at indicators in a totally different way.

IF YOU ARE INTERESTED IN LEARNING MORE ABOUT TECHNICAL ANALYSIS USING INDICATORS, SEE ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF.

Chapter 15

MANAGEMENT

When a major entry signal is evident on the chart and able to be entered via a Trader's Trick, every effort within reason should be made to be aboard, even if for only a short term scalp.

Regardless of what may be happening on the intraday charts, the order to trade one tick above or below the TTE must be in place and waiting as a mental or resting order. If you have to leave resting orders because of other commitments, they should be limit orders, so as to avoid being filled on gap breakouts. A limit order specifies a price or better at which an order may be filled.

To ensure that everything is in place at the right time, ***you have to have everything prepared beforehand***.

Trade selection and adequate planning go hand in hand. This is one place where the majority of would-be professional traders miss the boat.

Much more money is made as a result of proper planning than from sitting and trading everything that comes along or "looks" good. It's hard to fully understand why people think they have to trade so much of the time. It's difficult to ever fully grasp why people think they have to take as many trades as they do.

In this chapter, we will cover just how we are going to teach you how to approach trading.

It all starts with proper management — planning, organizing, delegating, directing, and controlling.

You must learn to weave them all together in your trading — they ***do*** overlap.

Although planning is the major management function involved in trade selection, you can't possibly plan well unless you are organized.

You must have your tools at hand. Your charts, your data, the proper equipment etc. All of the rudiments for planning must be in place — this is a part of ***organizing***.

You must be physically fit when you plan: well nourished, properly exercised, well rested, etc., all part of having your life ***organized***.

You must learn to be a winning trader. To do that, you have to be the best. There can be no middle ground. There are only winners and losers out there, and to be a winner you have to be a champion. And, just like any champion, you have to train, train, train. (We discuss much more about this and other business trading concepts in TRADING 'TNT' II — HOW-TO-WIN TRADING STUFF. This book is a must for all serious traders, and if we must say so ourselves, it is sure to become a classic.)

You have to learn that there are no runners up in trading. When others are busy going to parties, you have to stay home and study. When others are playing computer games or watching TV, you have to practice trading.

It is a fact of life that we all have problems with our friends, families and spouses from time to time. Life is not always easy, and aspects of our lives tend to distract us from our trading efforts.

A friend once explained that there is a waste basket at the front door. "*Don't forget it is there when you come in to trade. You need to be 100% on your game. If you're not, it can it cost you **big** money. Leave your personal garbage at the door when you come in, and pick it up on your way home,*" he said!

It is of the utmost of importance when trading to block out all outside distractions. If not, don't even bother to trade.

There have been instances where we were in a trading room and speaking to a trader while he was in the midst of trading. His concentration was so intense that he didn't even know we were there. When tapped on the shoulder he flinched and said, "Oh I'm sorry, I was in the zone!"

There are days when traders become so intense that using the bathroom becomes too much of a chore. And lunch? What's lunch? *Here's a thought for you. If you can't make it as a trader, think of the fortune you could make marketing an ergonomic trading chair with a built in toilet facility!!*

You have to study your charts diligently. The charts, as inaccurate as they might be due to bad data, are all you have to hang your hat on. Learn to picture and imagine in your mind what makes them move and form the way they do. Ask yourself, "How does what I see in front of me relate to supply and demand?" Supply and demand are what make prices move or not move some of the time.

There is more to a chart than supply and demand. Reflected in the chart are the emotional reactions of human beings. Reactions to rumors and news; to national and world events; to government reports — these, too, are on the charts.

There is something else on the charts, something that few take into account. That something is the manipulations from and by the market makers and specialists, and also from and by holders of large inventories of the underlying shares.

Learn to look for evidence of any and all of these things when you study your charts. Come to realize that the cumulative action of these things causes patterns to form.

Look for the truths in the markets. There are only two things that are always true — ***a breakout***, and a ***trend***. Master these phenomena. Over and over, you must hammer these truths into your head. The truth is always the truth. Later you will learn that there are also extended congestions that can be traded. We will teach you some of these concepts in ELECTRONIC TRADING 'TNT' IV — TIPS-TRICKS AND OTHER TRADING STUFF.

When a market breaks out, no one can change that. It is history and it is true. It may turn out to be a "false" breakout, but nevertheless it is a breakout. It is your job to learn to tell which ones are most likely true breakouts. How can you know that? By the patterns on the chart.

The trend is the trend while it lasts. While a market is trending, it is telling the truth. The trend can change, but the truth is the truth. If a market is going up, prices are going up. If the market is going down, then the truth is that prices are going down. It is an immutable fact. Learn to make your money by trading with the trend. Learn what constitutes a trend. Learn to spot trends early so that you can make the most out of the market while it trends.

Learn to recognize when a trend will most likely begin, and just as important, learn to be even more adept at deciphering when a trend is ending.

Learn to recognize "your" trade(s), and to take only "your" trades. Trade the formations and patterns that ***you*** can easily recognize and identify.

Learn to trade using the tricks we have been showing you in this volume and the other volumes of this course. Accumulate and keep a collection of high probability tricks in your bag of tools. How can you do all this? Practice, practice, PRACTICE. Practice recognition of congestion areas. Practice recognition of high probability breakouts. Practice and more practice. Just like anyone who wants to be a champion at anything, total dedication, study, practice and more practice. Become a trading virtuoso. Practice it over and over, always realizing you will never be perfect. There will always be a way that you can do things better, more efficiently, and with greater speed and finesse.

Become proficient in the other aspects of management.

Write out a script of your orders and rehearse giving them. Tape your orders and write them down. If you're trading with a broker, calling in your orders by telephone, be extremely firm and insistent and to develop the right tone of voice. No nice guy stuff. Polite, but firm and strong, urgent and insistent is the way the orders are to be called in if they are indeed urgent. Keep in mind that you are ***directing*** those to whom you have given the authority to get your orders to the trading floor. At other times, orders are not urgent and should be given in a more relaxed manner.

Learn to be extremely intimidating in getting back the results. To be ruthless in demanding good fills, to ask for time and sales on anything suspect. This is ***controlling***, exacting back responsibility for the authority you originally delegated.

You owe your brokerage firm nothing more than a fair commission and loyalty, provided they serve you well. They are the servants and you are the master. You are paying them plenty of money for the service they render. Expect the best from your brokerage firm. Be quick to drop your brokerage firm from service if they fail to do their job. After all, you are the one picking up the tab.

The topic in this chapter has been that of management. The point in this entire chapter is that you should spend sufficient time in preparation to trade. If you do, you will be megabucks ahead of the crowd.

On every trade, you must know before you enter a trade where you want the stop. This is regardless of your opinion of what you see happening. You have a plan. Work your plan. That way, you'll end up taking your money to the bank.

You will win because you will have everything prepared beforehand. Train and practice. Be disciplined. Do what we are teaching you to do.

Proper management is vital to your trading. It takes planning and organization. You must function as a manager of your business.

The problem with many traders is that they don't even know what business they're in. Do you know what business you're in when you trade stocks? Do you really? If so, then tell yourself right now what it is. Do it now, before you read the next paragraph. The business I'm in when I trade stocks is............................?

Just in case you peeked, we're not going to start this paragraph with the answer.

Speculators are willing to provide liquidity. By trading, they are providing liquidity and efficiency to the markets.

When you are a professional trader, you are in the same business as some of the largest companies in the world, you are in the finance business.

Finance companies are among the richest and largest companies in the world. Their assets dwarf the size of the industrial giants. Some finance companies have assets in the multiple billions of dollars.

How is it that finance companies are so rich? How is it that they make such fabulous profits providing liquidity, while many speculators in the markets are losing their shirts?

Here's how! Finance companies know how to select only the best situations in which to provide liquidity. Finance companies play with a rigged deck.

If they see a bad credit rating, they won't provide the requested financing. They provide liquidity only when a company is cash rich and well capitalized, or has assets far in excess of an amount needed for collateral. Finance companies provide liquidity primarily to already liquid companies.

Finance companies won't gamble, so why do you?

Finance companies are smart enough to be very selective when providing liquidity. So how come you aren't?

Now that you know that you are in the finance business, will you become more careful in providing liquidity? Only you can answer that.

Can you imagine a finance company that handed out money only to bankrupts?

How about a finance company whose selection was such that they loaned only to people and businesses that were already in default on other loans?

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Yet some of you do the equivalent of that in when trading. We find it difficult to believe some of the trades that you call to tell us about.

How about this one: *"Hey, I've got a problem here. I was long a stock that is hardly ever traded and I just took a big hit on my exit. I had a small profit in there but prices started to go against me. When I tried to get out, by the time I could liquidate my holdings, I had lost the 4 points I had in the trade, and another 2 points to boot. Is there anything I can do?"*

Yeah, there's something you can do, but it wouldn't be nice of us to put it in writing. What in the world are you doing trading in a stock that has no liquidity? Part of your trade selection has to be liquidity.

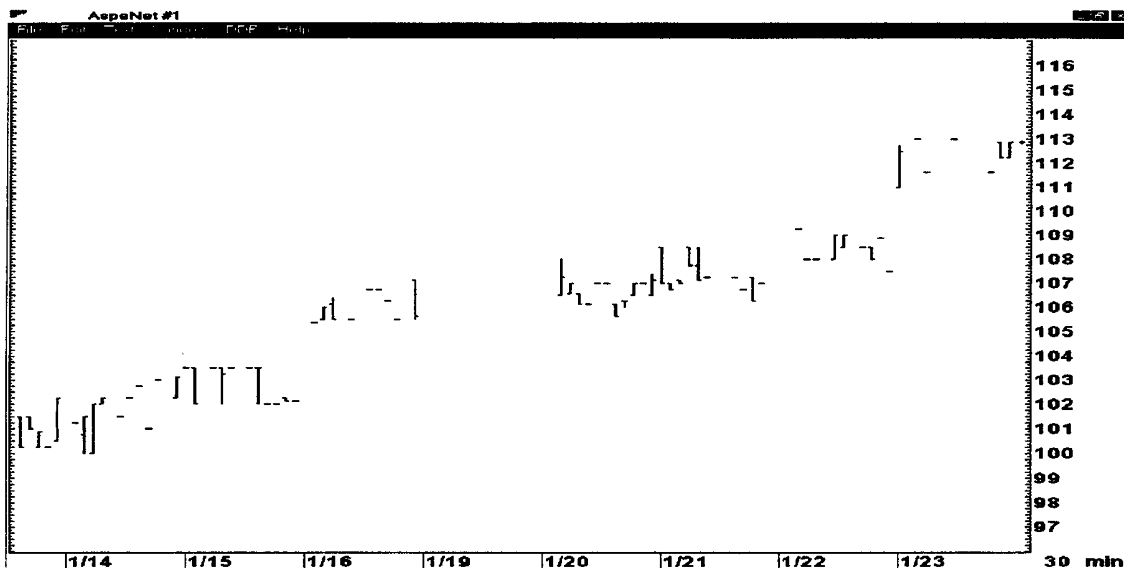
Just in case you didn't know, until you really understand what you are doing, ***trade only stocks that have good liquidity and good volume!***

If you want to trade illiquid stocks, its okay with us! You want to gamble? We can't stop you. *Here's a good gamble for you — why don't you bet an Eskimo that it won't snow in Northern Alaska this year?*

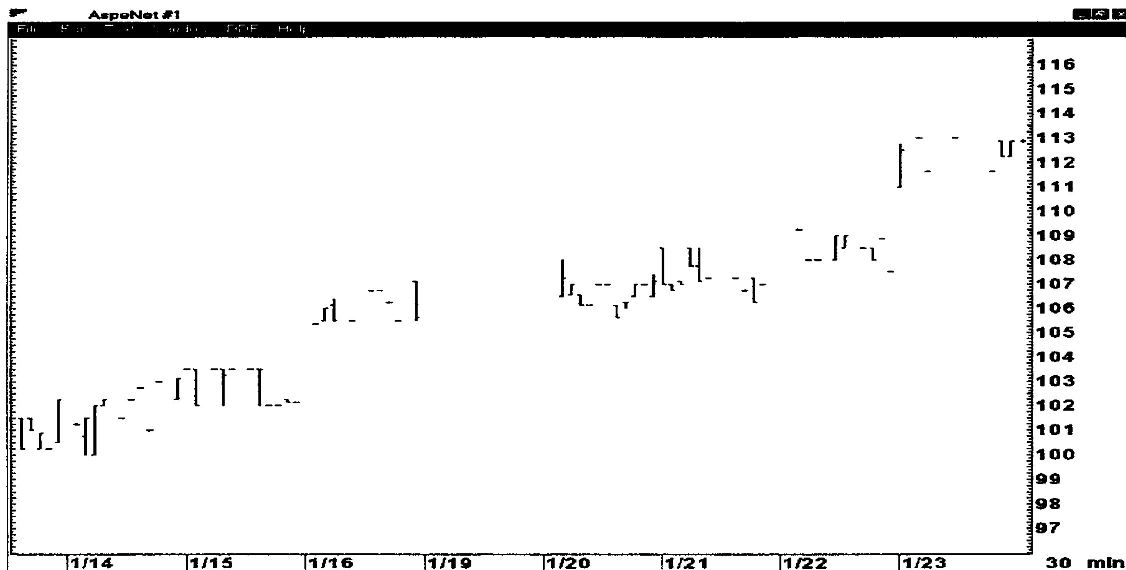
You must learn to be selective in choosing risk. Trade clear cut, well defined chart formations. Trade only with the trend. Be like a finance company which lends only to healthy well managed companies which can pass a rigorous credit checks, has a ton of money in the bank, a company with which everyone wants to do business.

We want to tell you about a call we received the other day.

"Hello? You got a minute to put up a chart? Could you take a look at the ABC chart?



"Do you see anything I oughta be doing here? Where should I be drawing the trend lines? Should I be worrying about all those little dashes?"



Why would anyone look at junk like that? Does that look like a well formed, healthy 30 minute chart, or does it look more like it has some sort of disease? Is that what you're examining to see if you want to provide liquidity? What about all the stocks that are trending and making well defined price patterns?

What about the stocks that are liquid? — not like some stocks, where at times you're lucky to get a fill without paying a 3 point spread.

They say there are only three things to consider when you are investing in Real Estate: location, location, and location.

There are only three things to consider when you are preparing to provide liquidity through your trading company: trade selection, trade selection, and trade selection.

Chapter 16

KEEPING LOSSES SMALL

We cannot say this enough times, you must learn to keep your losses small. It is the single greatest concept that we can show you that will help you make profits in the market.

This principle is of such magnitude that it dwarfs all other principles for trade, money, and risk management.

Did you know that if you keep your losses small, you can flip a coin for go long–go short, and you will make money in the markets? Yes, without even the benefit of trade selection you will make profitable trades if you learn to control your losses.

That means getting out as soon as you see that the trade is not doing what it should.

We know that losing is contrary to human nature. We know how much you hate to take those losses. We know how much you detest admitting you are wrong, especially when you've put a lot of work and planning into a trade. But consider this: If the trade doesn't almost immediately go your way, then you have made a mistake! Either your planning was wrong or your timing was bad. The good trades almost always immediately go your way.

We can usually spot which of our students will become good traders. How can we tell? They are the ones who are concerned with getting out fast and not losing money. They keep tight stops. They are anxious to protect profits — even small profits. They don't give a trade "room" until they have locked in some profits. They are the ones who realize that many trades will result in little or no profits, but they realize that the market is going to hand them a sizable profit from time to time. Therefore, they conserve their capital waiting for the big windfall to be handed to them.

They are the ones who exert patience in waiting for such an event to happen. They know that they have to score big only a few times to get rich in the markets. In effect, they do not overtrade.

We can tell from what you say at our seminars and what you say when you phone us, that most of you trade far too often. You think that you have to constantly trade. You are so greedy to take every opportunity that comes along, that you end up making lots of bad trades. *If you are interested in a* 'TNT' *trading seminar or private tutoring, contact information is at the front of this manual.*

Trades must be planned ahead of time. They must meet every criteria for a good trade. They must be easily seen, and clear cut. There can be no guess work.

If you flipped a coin whether to go long or short, presumably, over time, you would go long 1/2 the time and short the other 1/2 the time. My guess is that half the time you would be correct giving you 1/2 of 1/2 correct trades. It has been statistically shown that a 25% trader can make money in the markets with proper risk management.

So for some of you, those unwilling to do the proper planning that results in good trade selection, you would be better off flipping a coin, taking small losses on 75% of your trades, and then milking the 25% winners for all they are worth, while making sure that your winners do not turn into losers. ***Think about it***! Spend some time working on what is wrong with ***you*** that causes you to lose consistently. There are chapters in ELECTRONIC TRADING 'TNT' II — HOW-TO-WIN TRADING STUFF that specifically deal with tools that can help you to become more consistent.

STAYING WITH WINNERS

As traders, each day we face situations that demand buy or sell decision making. If we are daytrading, we may be faced with more trading decisions than are position traders.

It's as though we never run out of decision making opportunities. When we decide correctly, we should make money. When we decide incorrectly, we usually lose money.

If we constantly make decisions in order to satisfy some inner need, or because we get some kind of "rush" from decision making, then we are our own worst enemy. Trading for the "attack" or "flight" adrenaline high is almost a sure way to consistently lose.

We use trade selection and planning to increase the chances of entering a trade correctly. How many times have you entered a trade, had it go against you, gotten out with a loss, and then seen it do exactly what you had planned on its doing? What was wrong? Your timing was wrong! That is why you have to get out right away — take your hit and get out ***now!*** You can always get back in when you see the trade begin to go according to plan.

Once in a trade, the chances of exiting it correctly are even less than they were for entering the trade correctly.

This fact is the best reason we know for having mental or physical stops for both entry and exit. Stops allow the market to come to you. Entry stops allow the market to sweep you in when the market is moving your way: If it keeps on moving then you will make money. If the market doesn't keep on moving, then something is wrong and you must get out quickly. On exit, resting stops, where available, take away the need for a decision in the heat of battle, when you are most apt to make the wrong decision.

How often do you get to buy at the bottom or sell at the top? Occasionally, by pure chance, it happens. Usually, you are forced to go with the trend. You must be a buyer in bull markets and a seller in bear markets. You must let the market tell you what to do. If you don't, then you have some kind of ego problem that makes you think you can control the markets. You want to be God!

Now to get to the main point of this chapter, keeping losses small. Keeping losses small is part and parcel of staying with winning trades, which is the same as staying with the trend. To stay with winning trades, you must drop from your thinking any and all reasons for getting out other than what the market itself is telling you.

You must rid yourself of total dependence on technical indicators All too often they will lie to you. Technical indicators may tell you that the market is overbought or oversold, when indeed it is not. This will cause you to become nervous and bail out too soon.

Oscillators will begin to drift, even change trend, while the market goes merrily on its way making profits for others. These contrivances may even show divergence long before the market makes its extreme, thereby influencing you to get out before you have a need to get out.

You must quit counting waves, Elliott or others. How to properly use wave energy and other trading "goodies" are covered in ELECTRONIC TRADING 'TNT' IV — TIPS-TRICKS AND OTHER TRADING STUFF (*THIS IS REALLY GOOD STUFF!*). There is no law that says because this is the fifth wave, that it is time to get out, or that there will not be another wave that will push prices even further along in your direction. Remember, the name is "Elliott Wave Theory," not "Elliott Wave Fact." The same is true for cycle "theory," it is not factual.

These nonsensical doodads will cause you to get out too soon, to get out before you've realized all the possible profits from the trade.

The most sound basis, besides simple chart reading, that we've ever found for exiting a trade is the trailing stop behind natural support or natural resistance. Granted it keeps you from getting out at the market extreme. When you are too busy to constantly track every trade all day long, the trailing stop makes more sense than anything else.

Almost any logical method for trailing a stop is good. You can draw a trend line and keep moving your stop just outside the trend line. You can curve fit a moving average to the trend and keep your stop just outside the moving average. It doesn't much matter whether the moving average is simple or exponential, or whether it is offset or not offset. You can chart volatility and use the "Volatility Stop" study (explained in ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF) for trailing your stop.

You can trail your stop just beyond the extreme of the last market correction. The main idea here is that once a position is in the money, you don't give back more than 1/2, or 1/3, or 1/? of what you've already seen in unrealized paper profits, and besides protecting that 1/? of what you've seen, you ***do not crowd*** the trade. Give it room. If you are using a 3 x 3 offset moving average and it shows good containment of the trend, then at the point at which there are ample profits, you may even switch over to say a 7 x 5 offset moving average containment, to give the trade plenty of room to continue its trend. This, too, is explained in ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF.

Another way to help you to stay in winning trades longer is to view corrections as opportunities not to unload your position, but rather to buy or sell more shares. A good way to do this is to consider liquidating part of your position at corrections — thereby taking some profits, with the idea that as soon as the trend is underway again, you will take on additional shares. Remember, when you buy or sell short additional shares you are adding all new risk and you must trade additional shares in the same way that you would trade any new position: carefully, and with tight initial stops.

When you are riding a winner, avoid looking at it all the time. Search out new trades in other stocks. Absorb yourself with looking for opportunities elsewhere. Diversification is the key word here. But remember, you can afford to take only the very, very best trades elsewhere when you are riding a winner. Don't blow away the profits you are making on your winner by maniacal trading in other stocks.

The best, and perhaps the only way to make money in the markets, is to cherish and succor your winning positions. Stand back and admire them, appreciate them. Let them develop, unfold, and make you money.

One final bit of wisdom and perspective before the close of this chapter.

Please don't confuse staying with winning trades with long term trading. They are not the same. In our own case, most of our long held winners start with a short term daytrade held overnight because

we were trading the breakout of a major entry signal, such as a Ross Hook, or a 1-2-3 high or low.

For many traders, because they don't have the deep pockets, the patience, or both, to be long term traders, shorter term trading is best. It is in the shorter term that even the trader with the small account can profit.

There's a saying in poker that you should think about from time to time. It goes something like this: "If you've been in the game for twenty minutes, and haven't yet figured out who the patsy is, then it's ***you***!"

Think about that when you run your business of trading. Don't let the market make a patsy out of you. If you don't know which segment of the traders you are fading, then you are probably the one being faded.

Take your time, be patient, let the markets show you what to do. Let the markets come to you, fill your positions, and then take you for the supreme joyride of making a year's pay in a single day. The ride is worth the wait.

TRAPPING TECHNIQUE

The Trapping Technique is a way to enter an established trend. It is quite effective and simple and takes a lot of the analysis chores out of trading. It is based upon simple 4 bar moving average of the lows in an uptrend or the highs in a downtrend. But before we can show you the technique, you must be shown the definition of what we call an established trend.

AN ESTABLISHED TREND

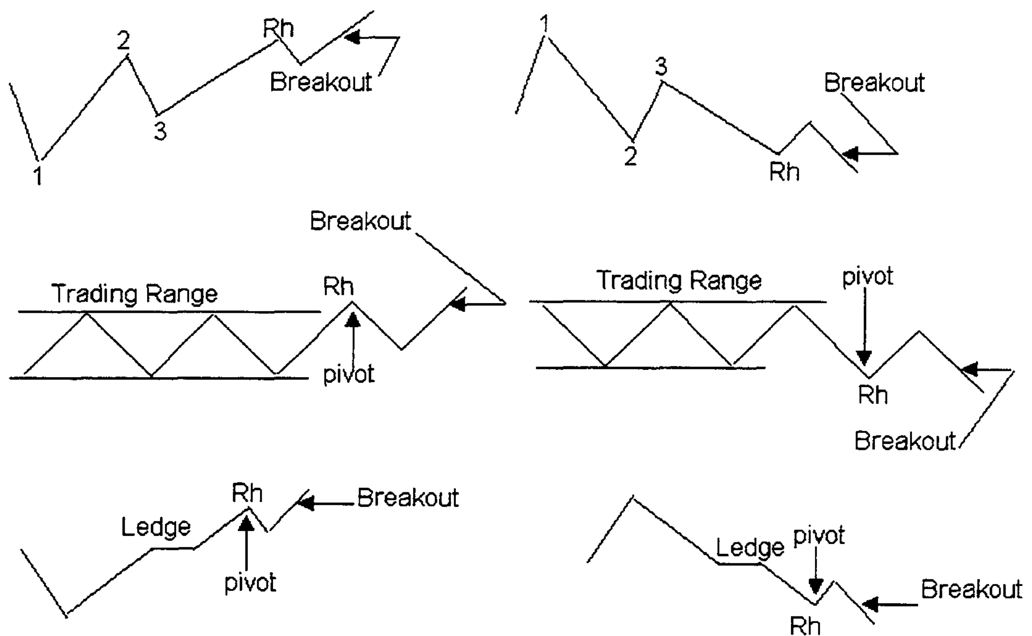
What constitutes an established trend? How do you know when one is in effect? Is it possible to recognize one when you see it? Our definition of a trend goes a little further than the ones you may have typically seen in trading literature, because we are more interested in a trend once it has become "established."

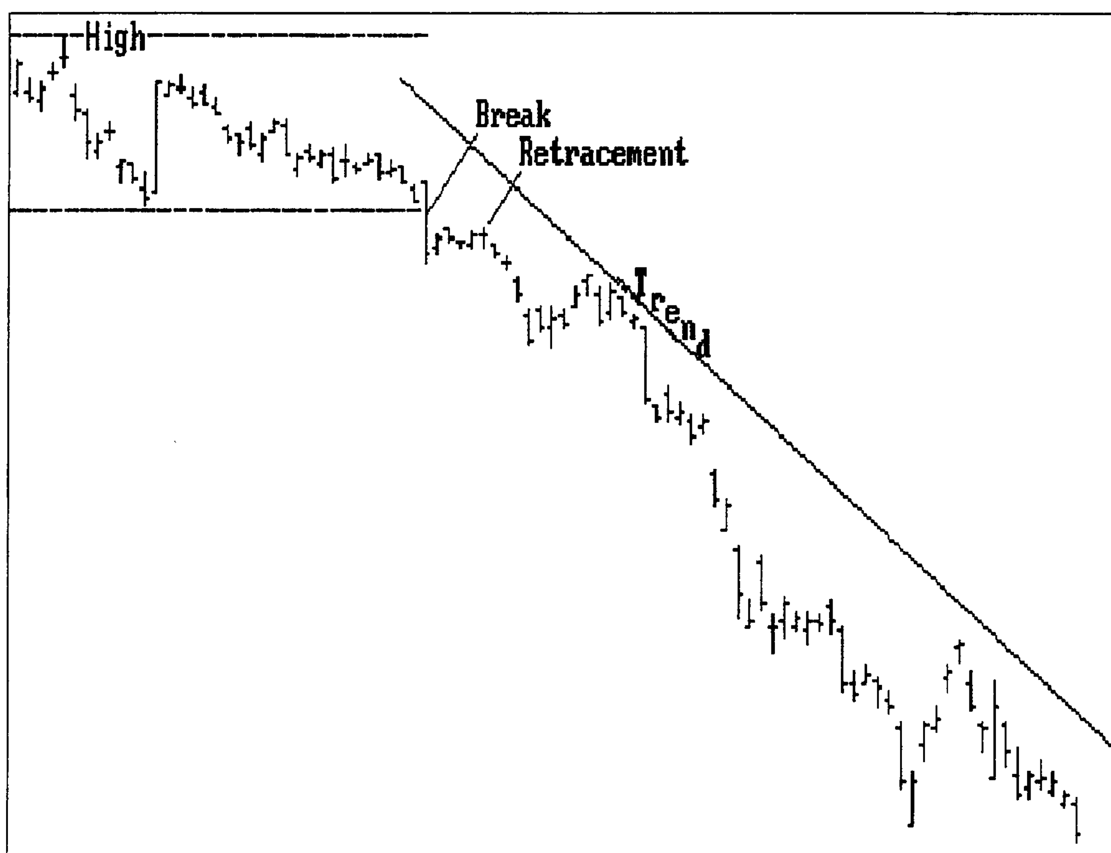
THE USUAL DEFINITION OF A TREND IS THAT IF YOU HAVE HIGHER HIGHS AND HIGHER LOWS, THEN YOU HAVE AN UPTREND. CONVERSELY, IF YOU HAVE LOWER HIGHS AND LOWER LOWS, YOU HAVE A DOWNTREND.

That's fine so far, but we want to take it further because we're interested here in defining established trends.

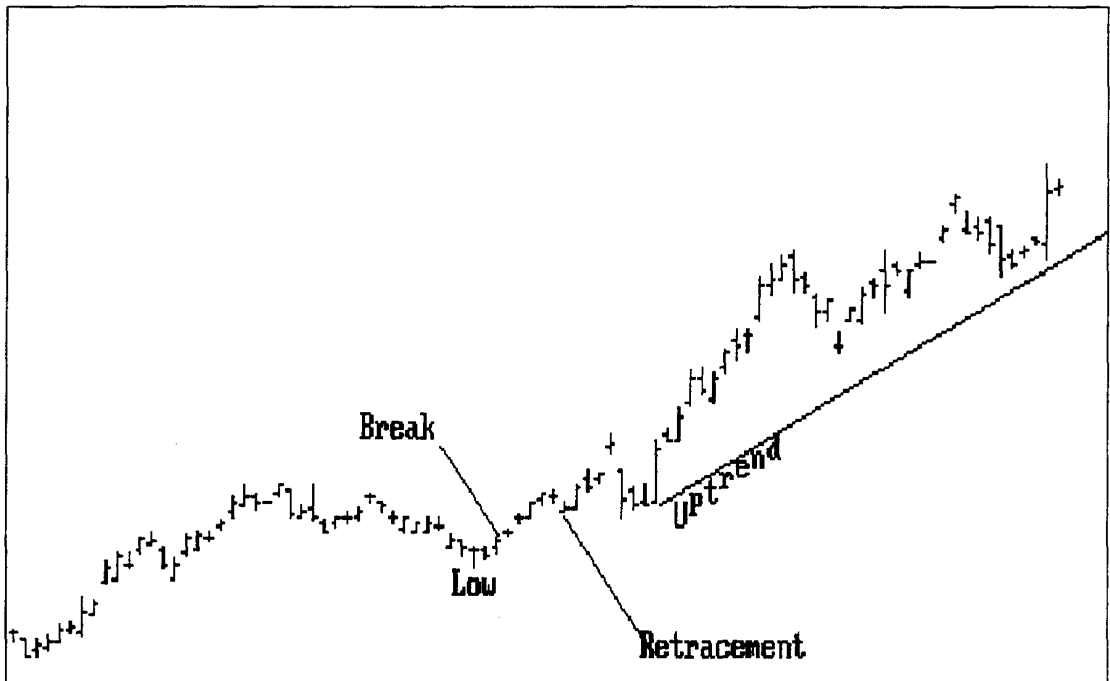
We define an Established Trend as:

- A breakout of the first Ross hook following a 1-2-3 high or low.
- A breakout of the first pivot point following the breakout of a trading range or a ledge.





The above figure shows a trending market. There was a breakout from a Trading Range ("break" on chart above) and prices began going down. Then there was a recognizable retracement, followed by more downward pressure and a small congestion. All of a sudden it dawned on you that prices were on their way down. Was there a good way to get into the downtrend other than just jumping in?



The above figure shows an uptrend. There was a low, then prices broke to the upside, then a retracement followed by another break to the upside and then another retracement. Prices then started strongly up. What was a convenient way to enter this market?

Obviously, it was only by looking back that you could see that prices were in an established trend. That's what part of this chapter is about. ***Looking back***, you realize that prices are in an established trend, and you want a piece of the action. You don't want to be left behind! Should you chase this market? Should you just jump in and hope that it keeps going, or is there an intelligent way to enter?

OUR ENTRY TECHNIQUE

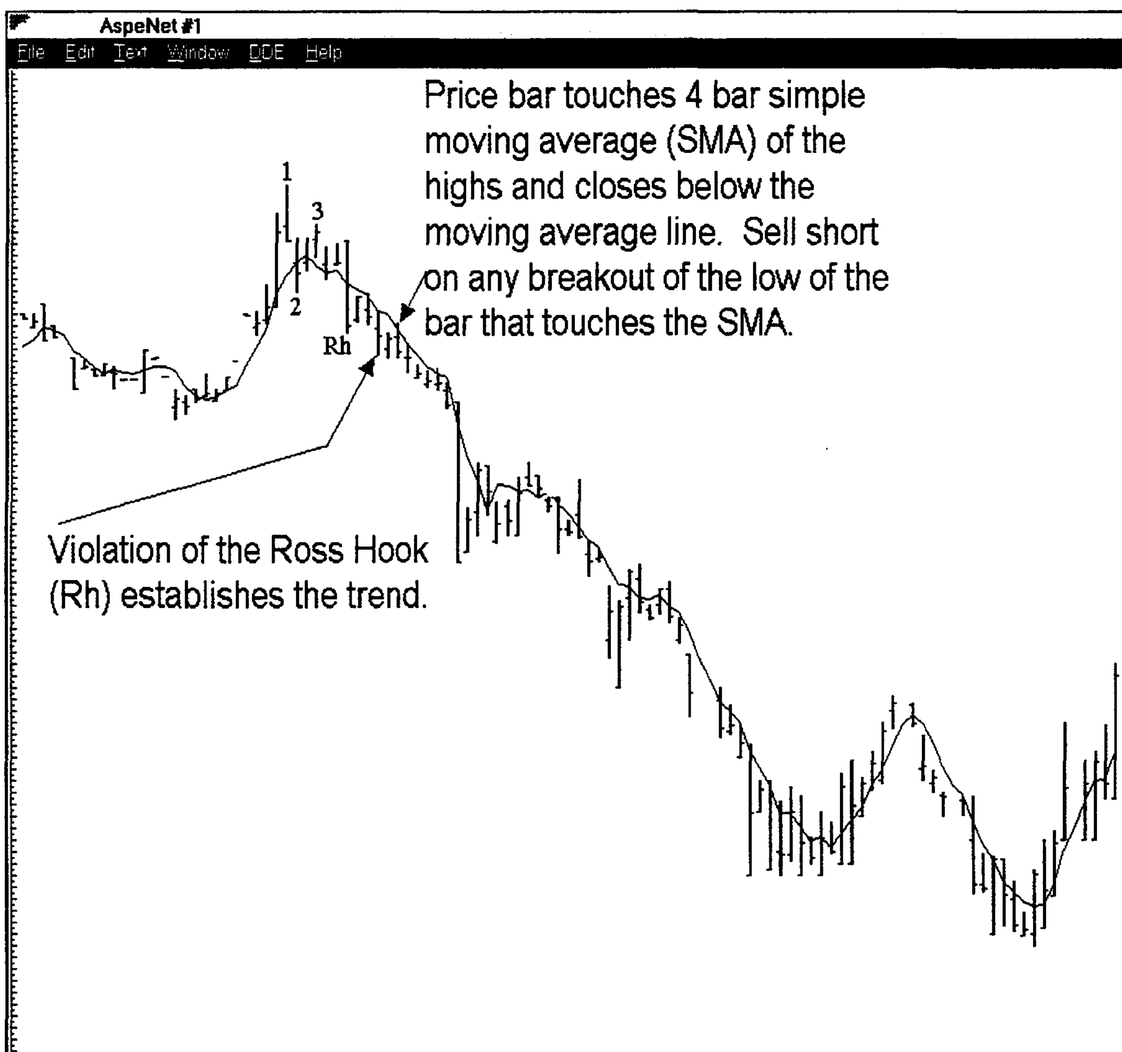
Wisdom has shown that you should never chase a market or just jump in.

Here's a way to enter an established trend using the trapping technique. Each day of an uptrend, take a 4 day simple moving average of the low (last 4 lows / 4), or in a downtrend, a 4 day simple moving average of the high (last 4 highs / 4).

Because you want to get into the action and go with the trend, you will have to monitor the market until you can optimize your entry, so make a mental or written note for order entry at a retracement to the trend line.

HOWEVER, IF PRICES RETRACE AND CLOSE BEYOND THE TREND LINE, SCRATCH THE TRADE FROM YOUR MIND. SOMETHING IS WRONG AND THIS MARKET IS BEHAVING TOO ERRATICALLY.

This technique works very well. It gets you into an established trend about 80% of the time. Those you miss you don't worry about. Once in a trade, use a tight stop.



In the chart above, if the price bar touches the 4 bar simple moving average of the lows and closes above the moving average line, go long on any breakout of the high of the bar that touches the moving average. The breakout of the Ross Hook establishes the trend.

Chapter 17

GET REAL

Throughout this book we've been writing about mindset — having the right frame of mind for your trading so you become a winner.

We've stated that it is our job to trade "what is yet to come," not "history."

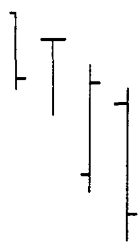
The "what is yet to come" is the next bar on your chart. You can't possibly know how it will develop, how fast prices will move, or where it will end up. Since none of us knows where the very next tick will be, it's impossible to know where the tick after that will be, or the tick after that, etc. All we know at any one time is what we're seeing. Interestingly, what we're seeing may not be true.

What we mean is that, if we are daytrading, we are not sure if what we're seeing is a bad tick, especially if it is not too far astray from the price action.

The daily bar chart doesn't always tell the truth either. The open may not be where the first trade took place. The close sometimes is merely a consensus, and may be quite a bit distant from where the last trade took place. The high may not have been the high, and the low may not have been the low.

If the open may not be the open, the close not the close, the high not the high, and the low not the low, then what do we have to work with? When we look at the last price bar, what we are seeing may be nothing more than a lie.

And, when we look at a whole series of price bars, we may be looking at nothing more than what?



You've got it right (we hope), a whole pack of lies. However, there is one thing true in this whole pack of lies. Do you know what it is? Right! The trend is true. There is no denying the pack of lies next to this paragraph is trending. Prices are going down. That's why we trade the trend, the trend is true...while it lasts.

Now you know the problem with back testing. Back testing and simulated testing are based on nothing but lies. That's why they don't work when you actually put them to the test with real data.

In fact, there are many of reasons why backtesting and simulation won't work. We gave you a few of them in an earlier chapter. We may as well dump the rest of them in your lap right here.

Because you don't really know where the high or low were, or if the market ever really traded there, you don't know if your simulated stop was taken out or not.

If you say you have a system in which 82% of the time, when you get three up days followed by a down day, the market will be up twelve days from now, then your whole statistical universe may have been based on a pack of lies.

When you see a bar on a chart, you have no idea which way prices moved first. You don't know if they moved down first or up first. You don't know whether or not prices opened and then moved to the high, went down to the low, and then traded in the lower half of the price range until the close at which time prices soared up to the high and closed there. You have no idea of the overlap. We've seen prices trade from one extreme to the other more than once at each extreme.

In any of those instances, your protective stop could have been taken out intraday.

You know nothing of the market volatility on any given day. Were prices ticking normally, or were they ticking two or three times the norm every time prices ticked?

For instance, just by looking at chart you don't know if it was ticking one tick at a time or five ticks at a time. You don't know, and anyone who tells you that their simulated system works based on such phony baloney, is mistaken.

Even if you purchased tick data for your simulation, showing every single tick the market made, you don't know what the volatility was.

Why? Because you don't know how thin the market was at the time you would have traded it. You can't go by the reported volume, because there is no way to know what the volume was at the time your price would have been hit. So here again, you have no idea of what slippage you might have encountered.

Another thing that you have no way of knowing is how fast the market was. The faster the market, the greater the slippage. You can sit there and say that you would have gotten in at a certain price or that you would have exited at a certain price, but if you don't know the market volatility, and how fast the market was, you do not know enough to say that you would have done such and such. Not knowing how fast the market was, you have no way of knowing how much slippage there would have been on your entry or your exit.

That is also true of volatility, you don't know the extent of slippage you would have encountered because of volatility.

If you want to spend your money on trading systems based upon the unknown, then you must assume the risk of doing so. Since, in part, this is a business of assuming risk, you are entitled to underwrite prices in any market that you care to — even based upon faulty statistical data as comes from back testing.

Insurance companies spend a lot of money to make sure that the risks they take are actuarially sound. That is the equivalent of finding good well-formed, liquid markets to trade in. But any market can become totally chaotic. Markets can become extremely fast, and

they can become quite volatile. So even if your system was back-tested in a liquid market, when that market becomes fast and/or volatile, your back-tested, simulated system will not be able to cope with it and you will lose. It's like going out to write insurance on a battle front.

If your back-tested, simulated system does factor in some room for fast and/or volatile markets, then you will be trading in slow, non-volatile markets with the built in factor. How can you possibly expect to compete with traders who are acting and reacting to the reality that is in the market at the time?

Back-testing is for historians, not traders. It is the wrong view of the markets. Your trading must be forward looking without being ridiculous about seeing into the future.

If you don't know where the next tick is, how can you possibly know where the market turning point will be? Can you see into the future? Maybe you like to trade astrologically. Those people are always trying to peer into the future.

In the auto business they have a saying, "There's an ass for every seat." Likewise, in trading, there's a fool for every fortuneteller who claims he can see into the future.

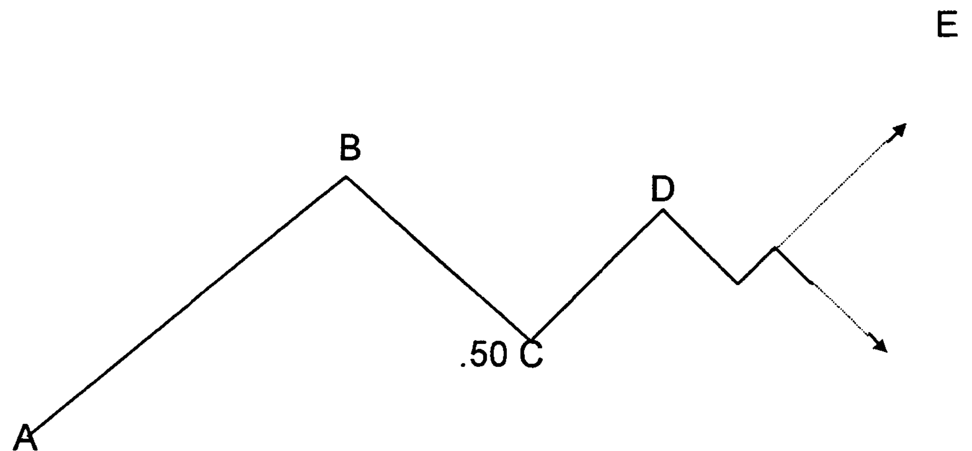
We guess you can always go out to your local coven and hire a witch to tell you what a particular stock will do tomorrow. She may even be right from time to time.

You could always do as one charlatan did and run the biorhythm for each stock based on the day it first started to trade. Or, you can cast the stock's horoscope based on the company's birth date. With the biorhythm, you'll *know* what time of day the stock should be on its highs, and what time of day it will be on its lows.

You'll *know* which day the market will be ecstatic and reach a new high, and which day it will be down in the dumps and make a new low. However, you'll find that from time to time, the market will reach new lows on the day it was supposed to reach new highs. Well, that's easy enough to explain. You can tell everyone *"We've had an*

inversion. Until the market inverts again, the lows will be the highs, and the highs will be the lows!"

That kind of thinking goes along with what some of the Fibonacci traders do. With them, it's not that the market inverts, it's that the market has failed. Let us show you what we mean.



Point A, is the beginning of a nice, long move up. Point B is the beginning of what turns out to be a 50% retracement of the move from A to B.

If you follow certain of these trader's ideas, you would have been long when prices reached the .382 retracement area, so when prices reach the 50% retracement area, prices are pretty close to your stop which is hiding just beneath the .50.

At that point, which is C, prices start to move up. Being the good Fibonacci trader that you are, you project that prices should head on up, take out the high at point B, and then head for point E.

Just about the time you are ready to break even on your trade, prices reach point D, and cease going up. Fibonacci traders call this a failure. From that point, the market makes a series of "failures." It keeps retracing 50% of its latest leg in either direction. When you ask a Fibonacci trader what to do, he says, "You'd better go the other way, the market has had a failure." It never did break out in the example shown, which is a very typical market pattern.

However, the market didn't fail, neither did prices. They did whatever they needed to do. The failure is in the trader and in the method he is using.

If you had traded the above market using some of the Fibonacci methods that are being sold today, you would have had to reverse, and reverse, and reverse,...

Chapter 18

SITUATIONAL TRADING

One of the best ways we've ever seen for trading and making money is to be a situational trader. You see a situation, and you trade it. You equip yourself with a bag of tools that lets you trade clear-cut market patterns. You ***anticipate*** situations and you jump all over them when they take place. You discipline yourself to trade what you see, not what you think. You learn to never trade opinions–even your own–in the markets.

The minute you catch yourself saying "I think the market is going to do this, or I think the market is going to do that," you use discipline to go ahead and trade what you are seeing rather than what you are thinking. Your thoughts are nothing more than another opinion.

If you can't handle self-discipline, then you will have to become a gambler and trade an automated system. Good luck!

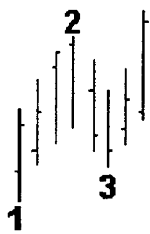
People trade systems because they will not exert the discipline necessary for proper self-control. It takes great effort to do that, and most people are not willing to make such an effort. They say they are, but they are not.

Self-discipline takes more work than most are willing to perform. It takes sacrifice, and determination.

It takes getting your ego, your pride, and your greed out of the way.

How do you trade on anticipation? Let us show you. We'll lead you to the water, but you're going to have to do the drinking.

As prices trended upward from the number 1 point to the number 2 point, we have the first leg of a trend. From the number 2 point to the number 3 point, we have a correction.

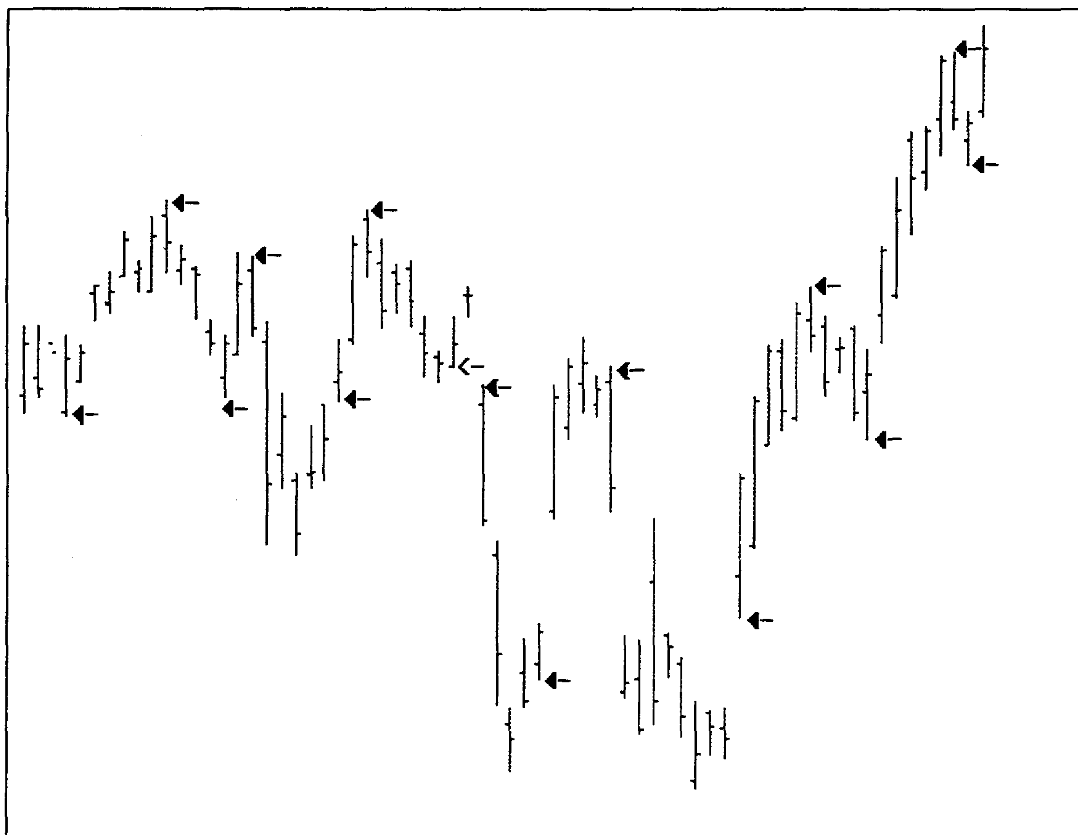


Since we've established that the trend is from number 1 to number 2, then the move from number 2 towards number 3 must be a correction. We will have to assume that it is until prices show us differently. As long as the 1-2 move is greater than the 2-3 move, we must consider the move from 2 to 3 as constituting a correction. In other words, the move from 2 to 3 is the trend that goes counter-trend to the main trend.

The situation is that we ANTICIPATE that prices will correct and then resume the main trend. With that anticipation in mind, we attempt to buy a breakout of the high of the first correction bar. When that fails, we attempt to buy a breakout of the high of the second correction bar. On that attempt we would be filled and on our way to potential profits. Had there been a third correction bar, we would have attempted to buy a breakout of the high of the third correcting bar. As described earlier, the attempt to buy a breakout of the high of as many as three correcting bars and no more is the basis for the Trader's Trick entry (TTE) whether it be in an upmove or a down move. If there were a fourth correction bar we ***would not*** attempt to buy a violation of its high. Instead, we would anticipate that prices are now either moving into congestion or that we are experiencing a possible change of trend. This is anticipatory trading.

Don't go away, there's more.

Here's another anticipatory situation.



On the chart above, please notice where we drew the arrows. What do you see that is "different" about the price bars we've pointed out?

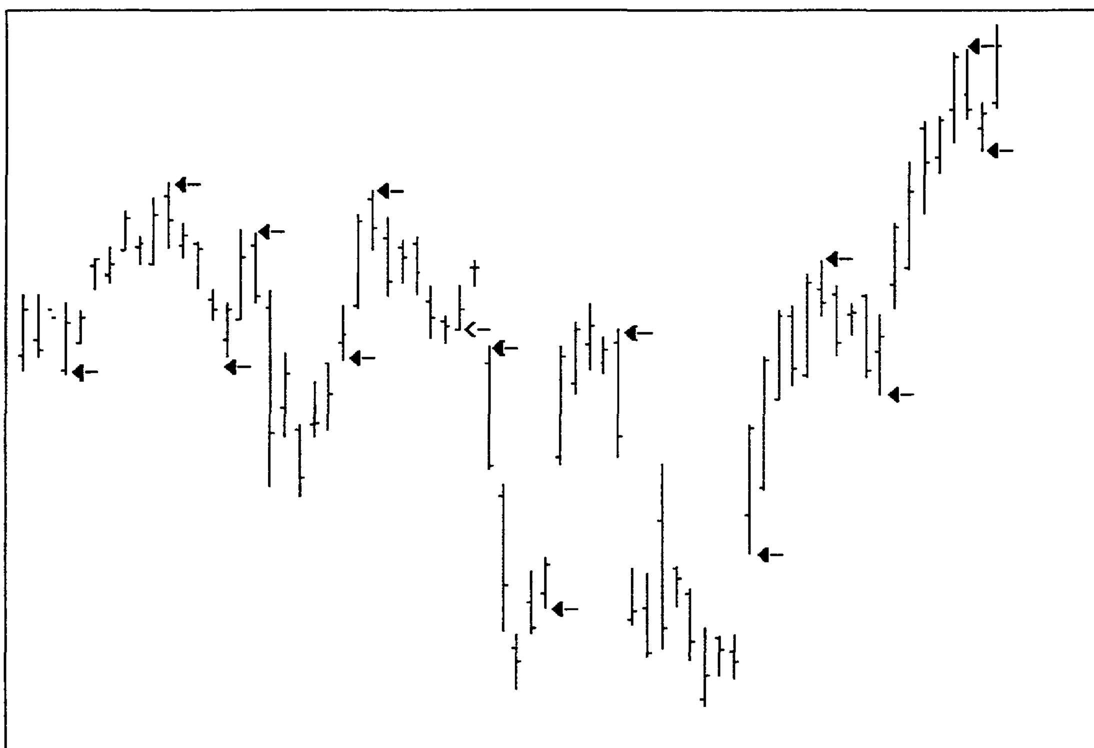
We may have missed a few, but be aware that most of the time when one of these "special" bars occurred, prices moved strongly in a direction opposite to the way they were previously going. Have we found the holy grail of turning points in the market?

No! we have merely pointed out what we call "reversal bars." In a down trend, most of the bars preceding the reversal bars have opens higher than closes, and in an uptrend, most of the bars have opens lower than the closes. But isn't it rather amazing how the market tips its hand by suddenly reversing the open and close relationship just before making a good sized move in the other direction?

There are a number of things that could have been done utilizing such information, but here is just one.

If a market that has been making a series of price bars with closes higher than the opens suddenly makes a higher open and a lower close, short a breakout of the low of the reversal bar for a short term scalp. You can also do the opposite.

If a market that has been making a series of price bars with opens higher than closes suddenly makes a lower open and a higher close, buy a breakout of the high of the reversal bar for a short tem scalp.



Now check out that chart again. If you can't see a way to make money on reversal bar anticipation, then you should close out your account and apply for a seeing eye dog.

Here's another way you could have used the simple fact of a reversal bar and a way that we regularly do use them.

Whenever you are holding a position in a trade, tighten your profit protecting stops as soon as a reversal bar occurs or is in the making. Either protect a portion of your profits, or move your stop to within one tick of the extreme of the reversal bar.

Now if you care to, look at the chart again. You will realize how to get into each trade and the criteria for exiting each trade.

Could you have done the same? Surely you could. But if you are looking for your trading to be a complicated mess of oscillators, moving averages, Bollinger bands, cycles, Elliot waves, and who knows what else, how in the world would you have ever seen the pure simplicity of how to make trades such as these?

You must learn to trade only the truth, and then only as you see it. Otherwise you won't be comfortable with your trading.

If you want to do something very profitable right now, pick up your charts and see what would have happened to you in ***any*** stock, in ***any*** time frame, simply using the concept of the reversal bar to get into a trade and to get out of a trade. There is only one caution:

IN A TRADING RANGE, YOU WILL FIND THAT THE PRICE BARS WILL REVERSE EVERY OTHER BAR OR EVERY TWO BARS. IN MOST CASES, YOU WILL NOT BE ABLE TO GET IN USING THE TECHNIQUE BECAUSE PRICES WILL NOT TAKE OUT THE EXTREME IN THE DIRECTION YOU ARE SEEKING.

THE BEST RESULTS WILL BE FOUND WHEN PRICES BEGIN TO TREND. HOW WILL YOU KNOW WHEN PRICES ARE BEGINNING TO TREND? YOU WILL CEASE GETTING ALTERNATING REVERSAL BARS. AS SOON AS YOU SEE THREE BARS IN A ROW THAT HAVE NOT REVERSED, START TRYING TO TAKE A BREAKOUT OF THE EXTREME. HOW TO DO THAT WAS SHOWN IN A PREVIOUS CHAPTER.

Chapter 19

TRADING PLAN

WARNING! No one should attempt daytrading from very short term charts unless he is a decisive, quick thinker. If a person tends to panic when things go wrong, then that person should not trade very short term charts. No one should trade a five or ten minute chart who is paying more than $50 per round turn in total commissions and costs.

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

APPROACH

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

There exists a set of character traits that would make anyone a better trader. Those traits are:

- Self-discipline
- Knowledge
- Patience
- Self-control
- Resourcefulness
- Diligence
- Flexibility

- Concentration
- Decisiveness
- Persistence
- Discretion
- Perseverance
- Consistency

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

All of the above is true for both daytrading and position trading.

STAYING ALIVE

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

We cannot afford to take a financial or emotional beating in the markets. It undermines self-confidence, and if that happens we will not have the courage of our convictions. Without faith, without the courage of conviction, we're better off not trading at all. We'd be better off putting money into utility stocks or bonds.

It's better to take a series of small losses than to take a single big hit. It is far less demoralizing. We have to realize that we won't win every day.

The losses will always be there. We have to get used to them. But they won't matter if we can stay alive in the markets, and keep taking out small profits until a good size win comes along.

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

STAYING IN THE WATER

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

We can't win unless we do stay in the water. We can't stay in the water if we're demoralized. Continually losing more than we gain will undermine our faith. We'll begin to experiment. We'll change our game plan. The result? We will have become a statistic — just another loser who tried and failed.

PLAN THE WORK — WORK THE PLAN

One of the oldest cliches in the world is plan your work — work your plan. Electronic trading is a business, therefore we must have a business plan.

Why not just trade the breakout of the open and be done with it? That takes very little planning. Why not just trade shares after 2 PM central time when the bond market takes pressure off of stocks? Often there is plenty of good action then.

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

THE PLAN

Why go through the exercise of selecting trades? Here's why! Our selection methods force us to take in the big picture. The big picture is always a part of good planning. By looking at the daily chart, we are able to get perspective. We want to point out that the daily chart is many times the magnitude of a five minute chart, and some heavily

traded shares are tradable on a five minute chart. Between the opening of trading and the close of trading there will be only one daily bar, but many intraday bars according to the interval we choose to view on the bar chart. We can lose perspective because it's easy to lose the forest among the trees.

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

WE WANT IT OUR WAY

We want it our way, or we don't want it at all. We don't care if the trade we missed goes on to make a million dollars, if it didn't happen the way we wanted it to happen, then we'll just miss that one. We miss plenty of good trades, but at least we're still here to tell about them. We want and will take only those trades that develop our way, according to our specifications. Any trade that doesn't fit in with the plan is not good and is therefore not our trade.

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

Let us tell you about Hurried Harry. He was so anxious about not missing a trade, that when one did come along, he hurriedly and repeatedly pushed the buy button. The result was a frantic buying of the high of the day — more than once, in fact 36 times. He ended up buying 36,000 shares rather than the 1,000 he intended to buy. The stock then proceeded to plummet, but of course he didn't sell right away (if you ever have an error in a trade you should sell immediately. Praying never seems to help and mistakes never seem to go in your favor) He couldn't meet the margin call he received, and his broker liquidated him for a $69,000 loss. Needless to say, Harry isn't trading with us anymore.

The plan calls for getting out of at least some shares when we can cover costs and take a small profit. Beyond that, we look for reasonable profits. Yes, the trade might have gone on to make $50,000 dollars. However, it may also go on to lose $50,000. If we don't get out with the reasonable profits that the plan calls for, then greed has gotten the better of us, and overall we'll lose.

The plan allows slippage of time. When we enter our orders, they are not always filled immediately, especially those trades done on some ECN's, or trading via the Internet.

Let's say we're long 1,000 shares. We've just seen the trade hit the $500 profit level. Before we can even key our exit order, we see our $500 profit shrink to $400 on one quick tick of prices on the chart. We hold back, we hesitate. Prices tick back up to $500 in profits. We key in our order. It is unable, prices have moved again. Finally, we exit with $250 in profits. We have experienced time slippage.

Then we remember that the plan calls for this to happen. We're within the parameters of the plan. At least we didn't lose. We've covered costs. In a business, we always cover costs before we think about profits. "OK, let's see what we can get out of those remaining shares."

We're alive, we have expectations. That small win starts us out on the right foot, and we have the courage of our convictions. We now have some staying power. The plan is working, and we're working the plan. We have persevered in staying on track so far.

Why is it so important to get that small win? Because not only does it give morale a lift, but as stated, it covers expenses. We always have to think about covering costs before we can think about taking profits. It's amazing how many traders fail to realize this basic concept and put it into practice. Even traders who are eminently successful businessmen seem to completely ignore this when they are trading equities.

Since the plan calls for having it our way, then of necessity there may be days when we don't trade at all. Will this cause us to change the plan? If it does, then we are not only greedy, but we are inconsistent.

Although it may be rare, there are days when we don't trade at all because nothing falls within the parameters of the plan. Of course, if we are willing to break the plan or change it to trade hot tips or our opinions, this will rarely happen. However, a good plan may allow for this in accordance with successful experience.

The larger the time frame from which we're willing to take our entry signals, the more potential there is for days in which we don't trade at all. This is a great time to take in an art museum, or the zoo, or an extra round of golf. We might even go fishing. Why? Because the plan calls for a little R & R now and then. We go ahead, take the wife or girlfriend out shopping. Why else are we trying to make money? *You know she can spend it as fast as we earn it.* We learn to enjoy the profits we make in the markets. We don't let them build up any higher than we absolutely need for trading. We take the rest and put it into a blue chip equities and interest bearing paper.

We don't have to trade every day, do we? If we do, then we've missed the whole point of trading. Trading is for making money, not zombies. If we trade all day every day, we will have lost flexibility. We will be using poor discretion. Concentration will wane. Decisiveness will lose its edge. In a word, we will have become gamblers — totally out of control. We will have turned into trading zombies. A pair of red, greedy eyes, staring at a screen. Boredom will set in. We will have depleted our source of adrenaline. We will become numb. We will not act and react the way we should, and we will lose.

Our desire to make money will have become our god. We will have become slaves to trading.

The solution is to take regular breaks from daytrading. Schedule them and be sure to take them. Take at least couple of days a month away from the screen. Schedule and take 2-3 vacations a year totally away from all markets. Is it possible to earn a living daytrading fewer than 12 months out of a year? Yes!

Let's repeat the plan to this point:

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

- We make note of all potential entries, based upon which share prices are giving us the best daily charts.

- We set alerts in any way we can. If our software allows it, we set visual and audible alerts. If we were unable to set alerts, we watch prices on as many markets as we are able to comfortably watch and still function as a trader. At first this might be only one or two. We set our alerts at 5 or 10 ticks prior to the entry point so we will have time to react.

- If a market gaps open beyond our entry price, we wait until tomorrow to try again in that market, or until developments today dictate that we should keep trying.

- If prices hit our entry point and then retrace without giving us our fill, we don't sweat it. We're thankful.

- If we're filled and prices go our way, then we exit from the market on a portion of our position as soon as we see reasonable profits on the chart.

- We exit all or part of our position based on the violation method.

- If we're able to trade more than a minimum amount of shares, we let some of them ride, moving our exit price regularly to protect profits.

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

The knowledge given so far is far from complete. There is more to come in this and the remaining volumes of the course.

IMPLEMENTING THE PLAN

Most traders never have a plan. They take a course or seminar, paper trade for one or two weeks, and start to trade. This is a quick way to failure. It is essential to have a business plan before starting to trade. This can include anything that you think will help make you a more successful trader. It might contain an outline of how you will continue to expand your knowledge by reading certain books, going to certain seminars, or reading various publications or newsletters. (*If you are interested in our private or group seminars, or our monthly newsletter, please contact us at the numbers in front of this manual.*)

Your plan might include information about your eating, exercise and sleep habits. It should include a section about profit objectives, and a schedule in which you will meet those objectives. For example, you may want to make at least $100 a day for your first two weeks. After that is accomplished, you may say to yourself, "Now I want to make at least $250 a day for the next two weeks." Once that's accomplished, you may want to try to average $500 a day for the next month, and so on. It is imperative that you have a plan and stick with it. Constantly review your plan and make changes if necessary. This business is just like any other business. Who goes into business without a plan? Usually those who fail!

The next page contains the items we feel you might want to include in a trading plan. Yours doesn't have to be the same. There may be items you wish to keep track of that differ from the ones we've shown. The important fact is, that no matter how you do it, you must have a trading plan.

You may want to keep the items of your trading plan on a spreadsheet. A columnar pad will do just as well. You might want a column for each item you track.

Tabulate and maintain statistics on the items in the trading plan so that, as the manager of your trading business, you know what is working for you and what is not.

DAILY TRADING LOG

TRADE ENTRY

Why are you making this trade? Code these as Breakout of a 1-2-3=1, Ledge=2, Trading Range =3, Ross Hook =4, Breakout of highest high or lowest low of last three days=5, Breakout of high or low of two days ago=6, breakout of yesterday's high or low=7. Intraday signals are also coded with numbers so they can be tabulated.

Did you trade a Major Entry Signal, an Intermediate Entry Signal, or a Minor Entry Signal? Code these 1, 2, or 3.

Was there room to cover costs upon entry? (1=yes 2=no)

How much room was there in terms of ticks?

How much slippage was there in terms of ticks?

How much windfall was there in terms of ticks?

How many times did you try to enter the market on this trade?

What type of order did you use?

COST COVERING LIQUIDATION

How many shares did you liquidate in order to cover costs?

How much slippage was there in terms of tick?

How much windfall was there in terms of ticks?

What type of order did you use?

CONTINUATION AND CLOSE-OUT

Did you put on a continuation trade? (1=yes 2=no)

Maximum unrealized paper profit in the trade?

How much slippage was there in terms of ticks?

How much windfall was there in terms of ticks?

Profit or Loss before Costs?

Costs?

Final Profit or Loss?

AUDITING THE PLAN

TRADE ENTRY

Why are you making this trade?

ACTIVITY: On your order form draw a small picture or attach a chart showing what it is you saw that makes you want to take this trade. On your spreadsheet, or columnar pad, enter the code for the type of trade you are making.

PURPOSE: To tabulate which formations are giving you the most winning trades. This can be tabulated as to both number of winners and amount of money won.

ACTIVITY: Print out your charts at the end of the day and diligently review them.

PURPOSE: To ascertain the validity of your entry technique, and to see whether or not you exited too soon, or not soon enough.

ACTIVITY: On your spreadsheet or columnar pad enter the code for the type of entry signal you are taking, Major, Intermediate, or Minor.

PURPOSE: To tabulate which types of signals are giving you the most winning trades. This can be tabulated as to both number of winners and amount of money won.

ACTIVITY: On your spreadsheet or columnar pad, enter a 1 for yes or a 2 for no if there was room to cover costs upon entry?
PURPOSE: To prove to yourself whether you do better covering costs or not covering costs.

ACTIVITY: On your spreadsheet or columnar pad, enter the number of ticks you allowed in terms of ticks.

PURPOSE: To keep tabs on how many ticks you usually need to cover costs when using the Trader's Trick. Are you allowing enough ticks for covering costs whenever you trade?

ACTIVITY: On your spreadsheet or columnar pad, record the amount of slippage you are getting on your entries.

PURPOSE: To help you control your broker, and yourself. If you are getting a lot of slippage at any point in your trading, at entry, liquidation for cost covering, liquidation for profit, or final exit from a trade, you need to know why. You must find the source of slippage. Is your data, computer, or Internet provider too slow. Are your trades being handled honestly by your broker? That is the purpose for getting time and sales. Are you giving the right kinds of orders? Are you using proper size and correct price? Is it your timing? Are you entering too soon or too late? Find out ***why*** you are getting slippage. You may need to change brokers or systems.

ACTIVITY: On your spreadsheet or columnar pad, record the amount of windfall (overage) you are getting on your entries.

PURPOSE: Overage is almost as bad as slippage. It indicates that there is a timing problem. You are getting in too soon or too late.

ACTIVITY: On your spreadsheet or columnar pad, record the number of times you attempted to get into this market.

PURPOSE: To find out whether you are entering too soon, or if you are giving the wrong kinds of orders so that you are not getting filled. To find out how many attempts overall you are trying to enter.

ACTIVITY: On your spreadsheet or columnar pad, record the code for

the type of order you used.

PURPOSE: To find out which orders are giving you the best results in various markets and situations.

COST COVERING LIQUIDATION

ACTIVITY: On your spreadsheet or columnar pad, record the number of contracts you liquidated in order to cover costs.

PURPOSE: To help determine if your trade selection is adequate. Are you selecting trades that enable you to cover costs? This also helps you to see if your costs are too high in relation to market volatility. If you are consistently having to liquidate most of your position simply to cover costs, then you are entering trades in markets that are not sufficiently volatile. They are not moving enough distance on average to allow you to cover.

ACTIVITY: On your spreadsheet or columnar pad, record the number of points of slippage in liquidating to cover costs.

PURPOSE: Same as above concerning entry slippage.

ACTIVITY: On your spreadsheet or columnar pad, record the number of points of overage in liquidating to cover costs.

PURPOSE: Same as above concerning entry windfall.

ACTIVITY: On your spreadsheet or columnar pad, record a code for the type of order you used to exit and cover costs.

PURPOSE: To determine which type of exit orders work best for you within the time frame in which you trade.

CONTINUATION AND CLOSE-OUT

ACTIVITY: On your spreadsheet or columnar pad, record "yes" or "no", as to whether or not you put on a continuation trade. Continuation trades are covered in Chapter 23 of this manual.

PURPOSE: To determine if continuation trades work for you and your style of trading. Continuation trades involve additional risk. Within the framework of the way you trade, are they paying off for you?

ACTIVITY: On your spreadsheet or columnar pad, record the greatest amount of profit that was available to you at any point in the trade.

PURPOSE: To determine whether or not you are leaving too much on the table.

ACTIVITY: On your spreadsheet or columnar pad, record the amount of slippage you had upon your final exit.

PURPOSE: The same as for entry slippage.

ACTIVITY: On your spreadsheet or columnar pad, record the amount of overage you had upon your final exit.

PURPOSE: The same as for entry windfall.

ACTIVITY: On your spreadsheet or columnar pad, record the amount of profit or loss you had in the trade.

PURPOSE: To determine your gross profit dollars.

ACTIVITY: On your spreadsheet or columnar pad, record the amount of costs you had for the trade. You can include whatever you feel are direct costs of trading. They must include commissions. Anything else is optional.

PURPOSE: To help you to see and grasp the totality of your direct costs.

ACTIVITY: On your spreadsheet or columnar pad, record the amount of net profit/or loss you had for this trade. If you had a gross loss, add costs to your loss. Ghastly isn't it? If you had a gross profit, subtract costs from your profit. Amazing how they eat into your profits.

By capturing this kind of data, you can begin to analyze your trading operation. Auditing is part of your managerial function as a controller.

There are numerous combinations of the above data that can be put together to tell you how effectively you are running your business. Once you have tabulated the various columns, you can then begin to combine tabulations to determine ratios among them.

Remove any columns of information you feel are not needed in your trading. Add any columns of information you would like to have. You can express various ones as percentages of each other. You can relate them as profits over costs, profit per trade, wins versus losses, etc.

You can get quite complicated if it suits your trading style. For instance, you can derive the percentage of profits over costs on single attempt entries using stop limit orders.

It's up to you to determine what you want to see and what you need.

What do you do during 85% of the time markets are in congestion? Now you know. You maintain your trading plan and your order sheets in addition to other things you do as you trade. There's plenty to keep you busy. The business of trading isn't all fun. Some of it is work. Sounds the same as many other businesses, doesn't it?

Chapter 20

FILTERING THE TRADE

We've stated earlier that we want to trade the thrust of the breakout of a particular point: the breakout of a Trading Range, a 1-2-3 high or low, a Ledge, or a Ross Hook. All these events are based on the daily chart. Carefully study the charts shown in this chapter. They are extremely important. You may have to look at them numerous times.

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

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

Finally, we're willing to trade a first or second time through breakout of the first congestion after the open, even if that congestion is a continuation of yesterday's ending congestion.

A TRADING FILTER

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

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

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

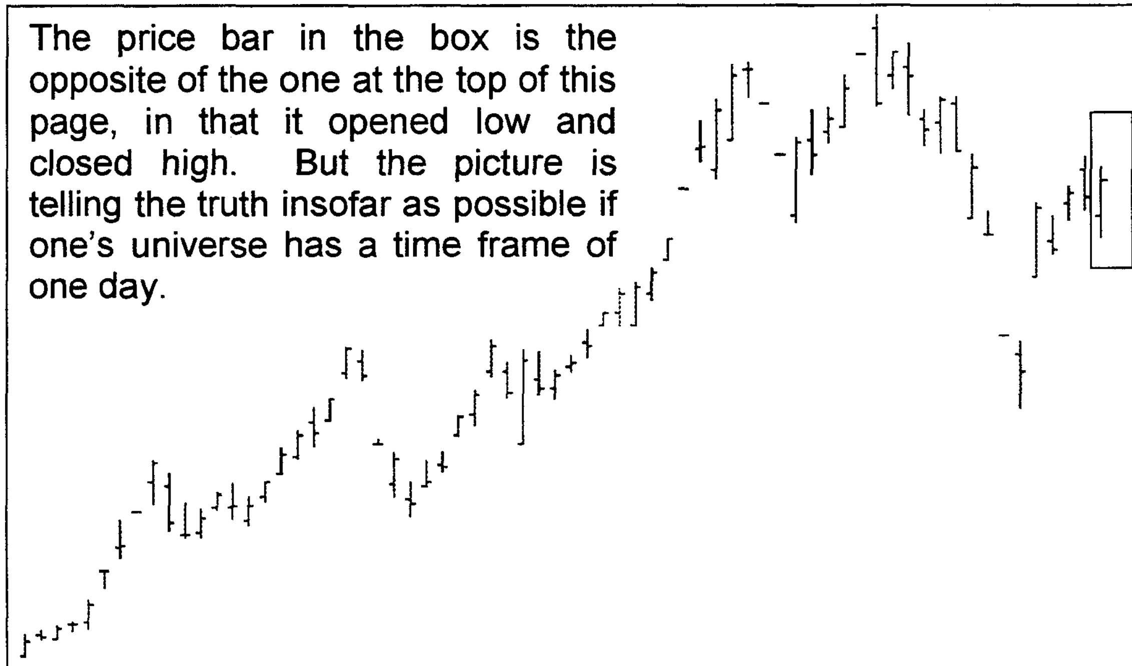
When we see a bar on the daily chart that is similar to the one on the left, representing a single day's price action, we're seeing something that has squeezed an entire day's price action into a single picture. This picture is very deceiving concerning what actually happened in the market for these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

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

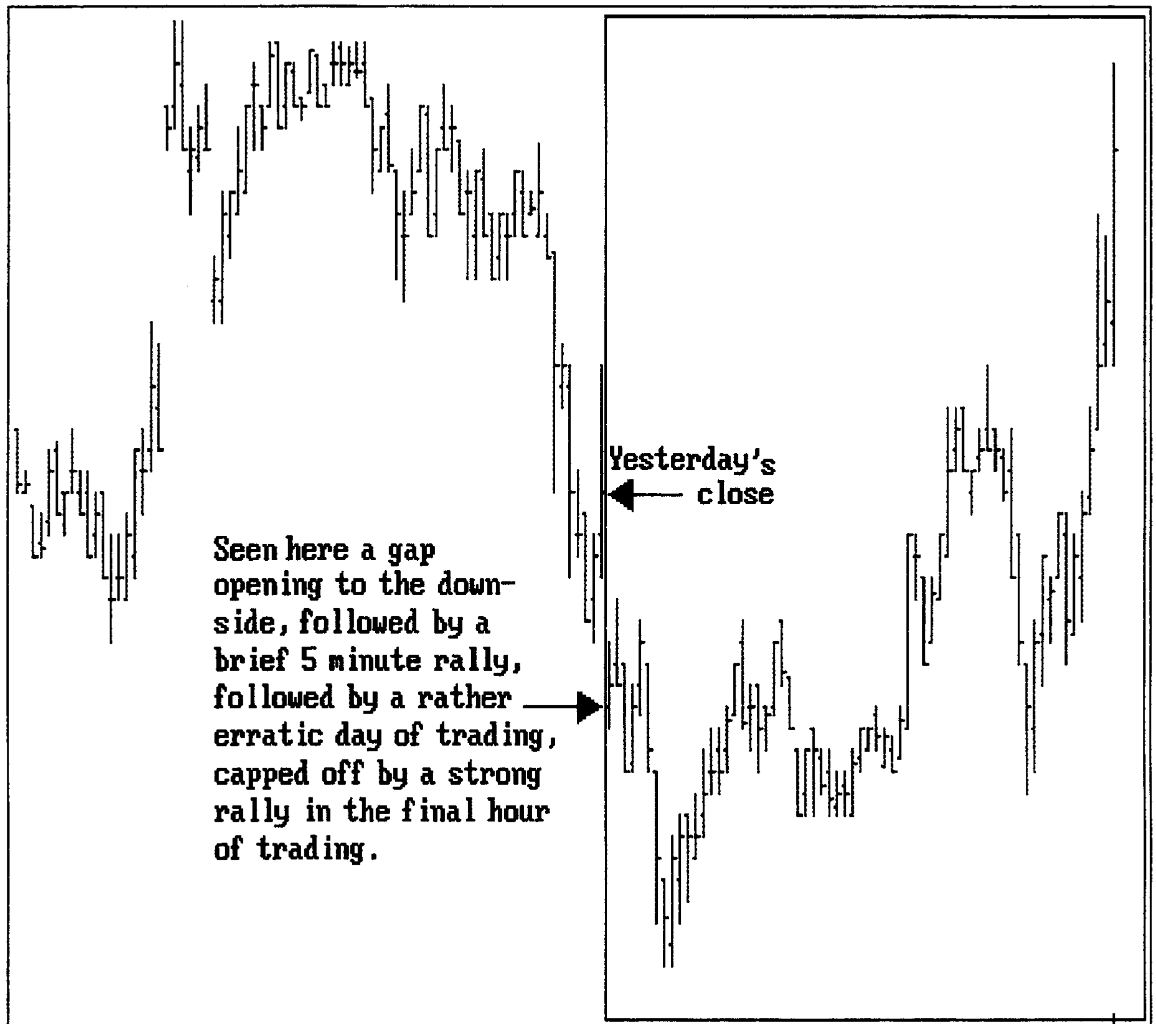
Did prices perhaps open high, trade to their lows, reverse themselves on some piece of news, then trade to their highs and finally trade down again to where we see the close?

The answers to these questions are part of the reason why simulated systems based upon daily charts hardly ever work when one tries to trade them. In fact, we're not sure that any successful systems are in existence.

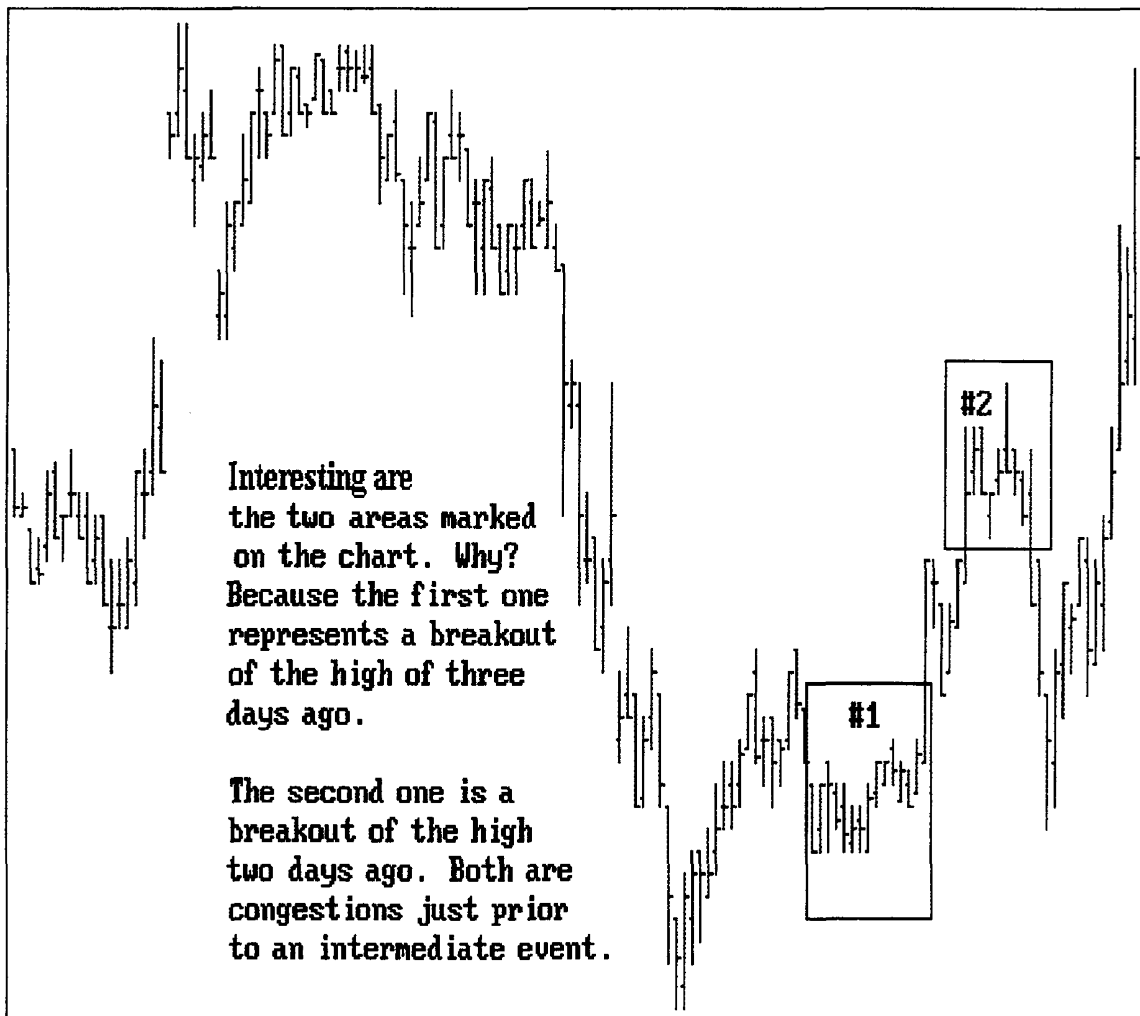
The next figure shows a picture of a daily price chart.



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

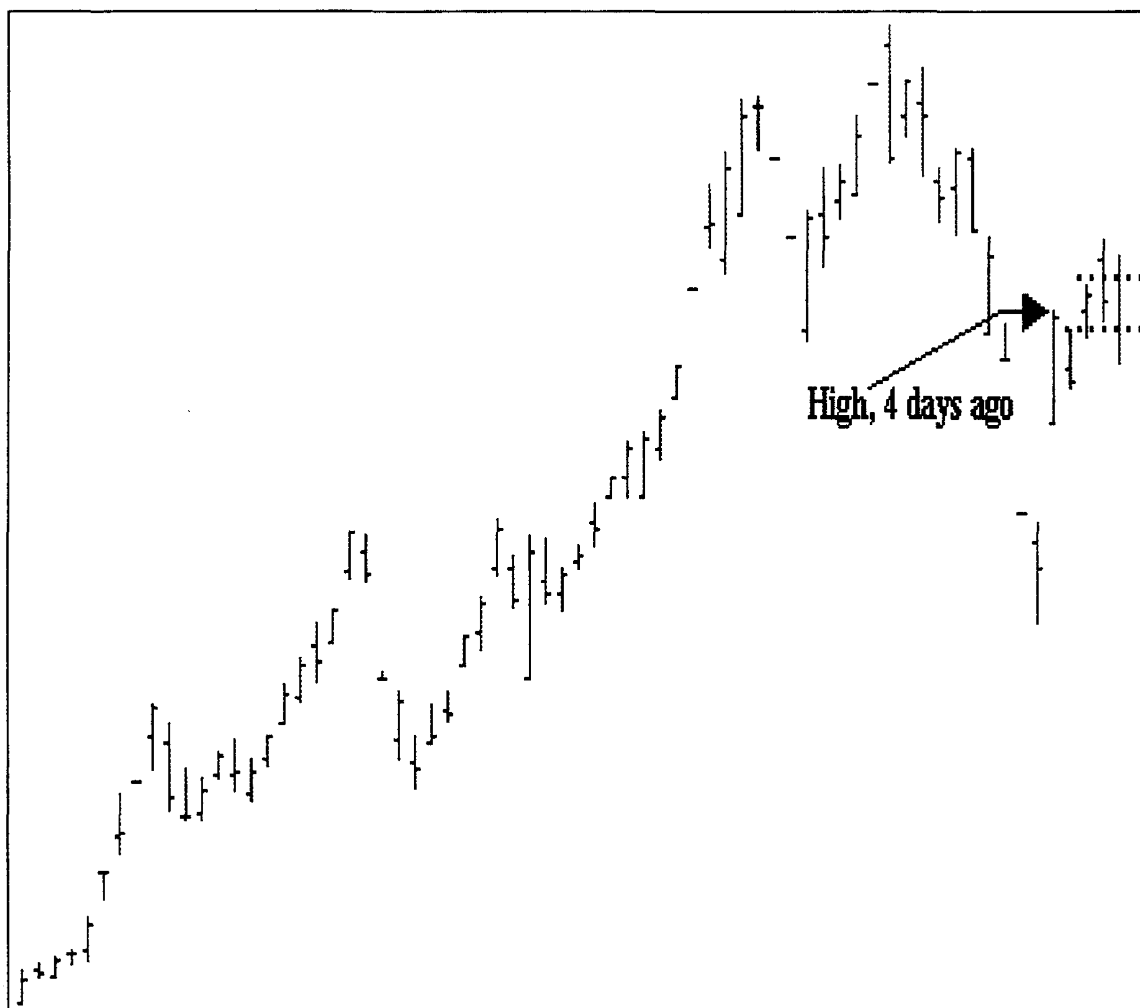


There are a couple of congestions during the day we will be looking at. Based upon what we've covered so far, is it possible to guess which ones they are and why we will be interested in them?



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

I'll show that again on the daily price chart.

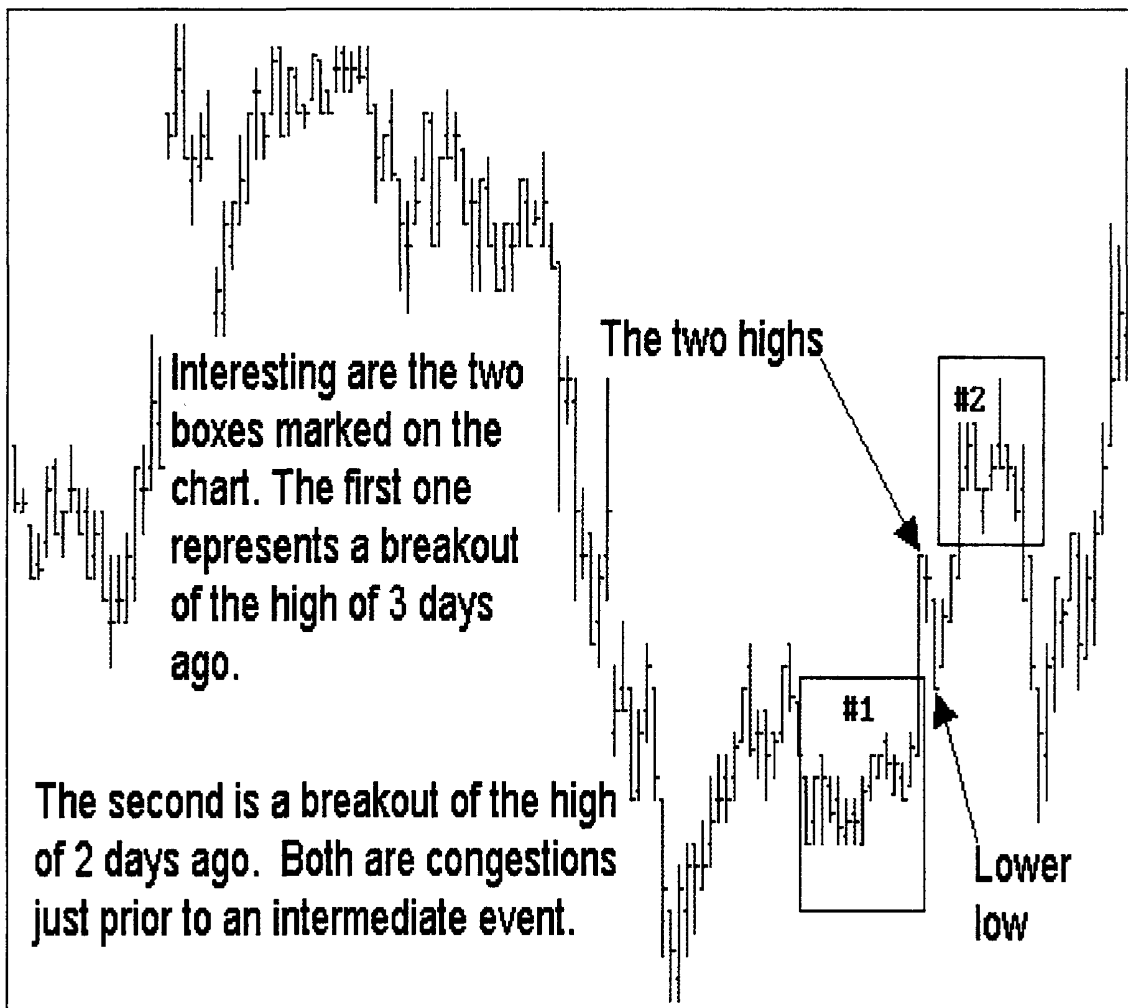


As can be seen, today's price bar (the last bar on the chart) took out the high of three days ago (an inside bar), and the high of two days ago.

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

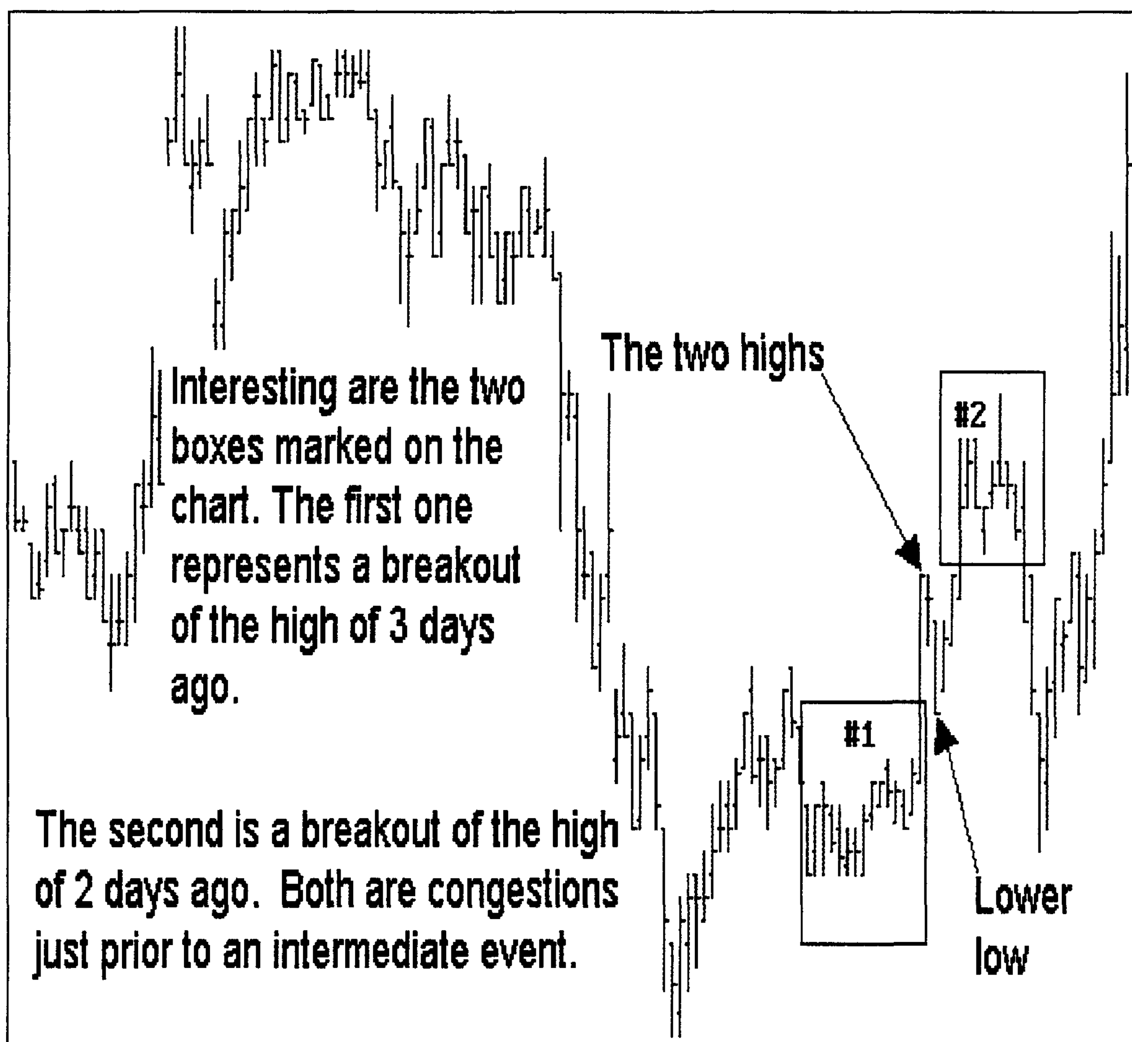
The high three days ago was lower than the high two days ago. After the first big swing in prices V on the five minute chart, prices settled into a tight congestion (#1) on the following page.

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



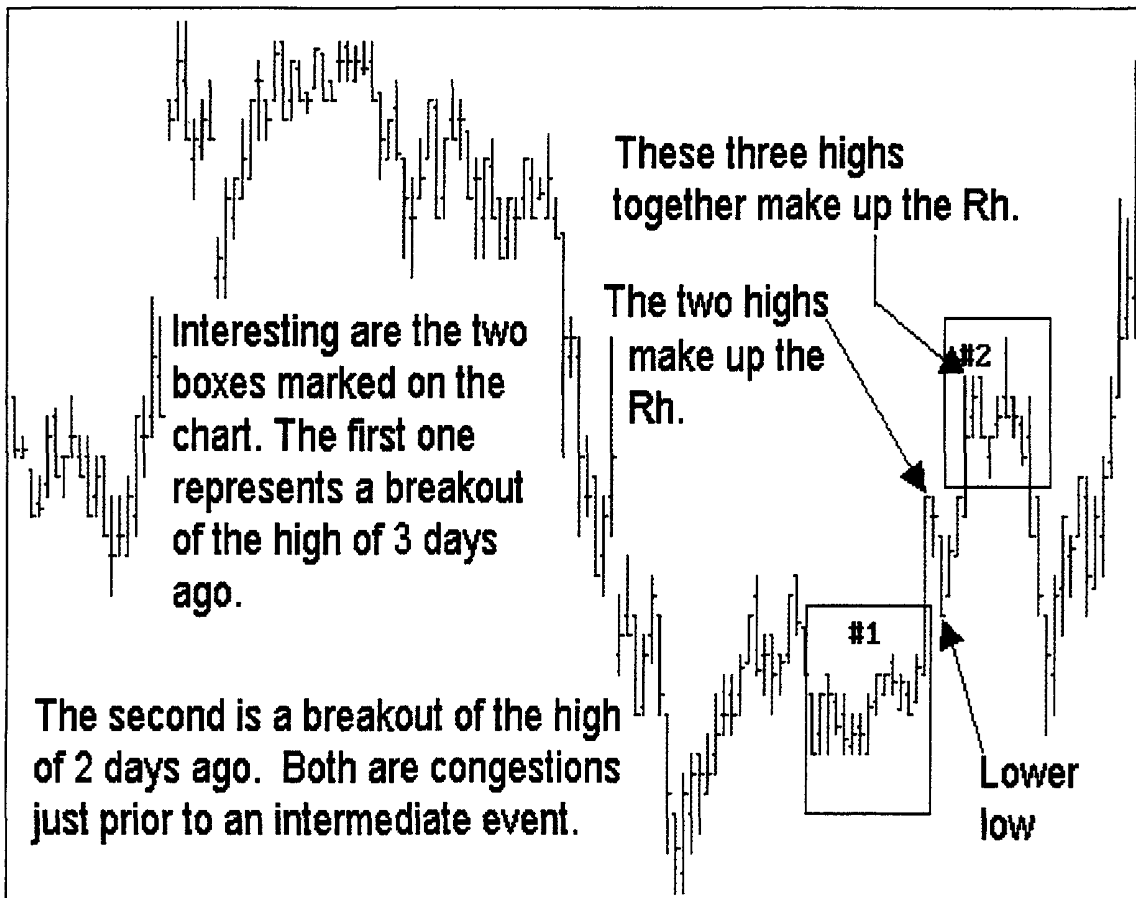
Beyond the entry would come proper trade management. An exit should be made upon seeing a bar that makes a **lower low** or upon seeing two reversal bars, in this case any two bars in a series of bars having a close lower than the open.

If need be, the trade is entered again because the prospect of a violation of **the two highs** is the driving force behind the trade. In TRADING 'TNT' III — TECHNICAL TRADING STUFF, we'll look at the concept of average volatility and how to use it to know how many shares and at what price we might want to liquidate to cover costs.



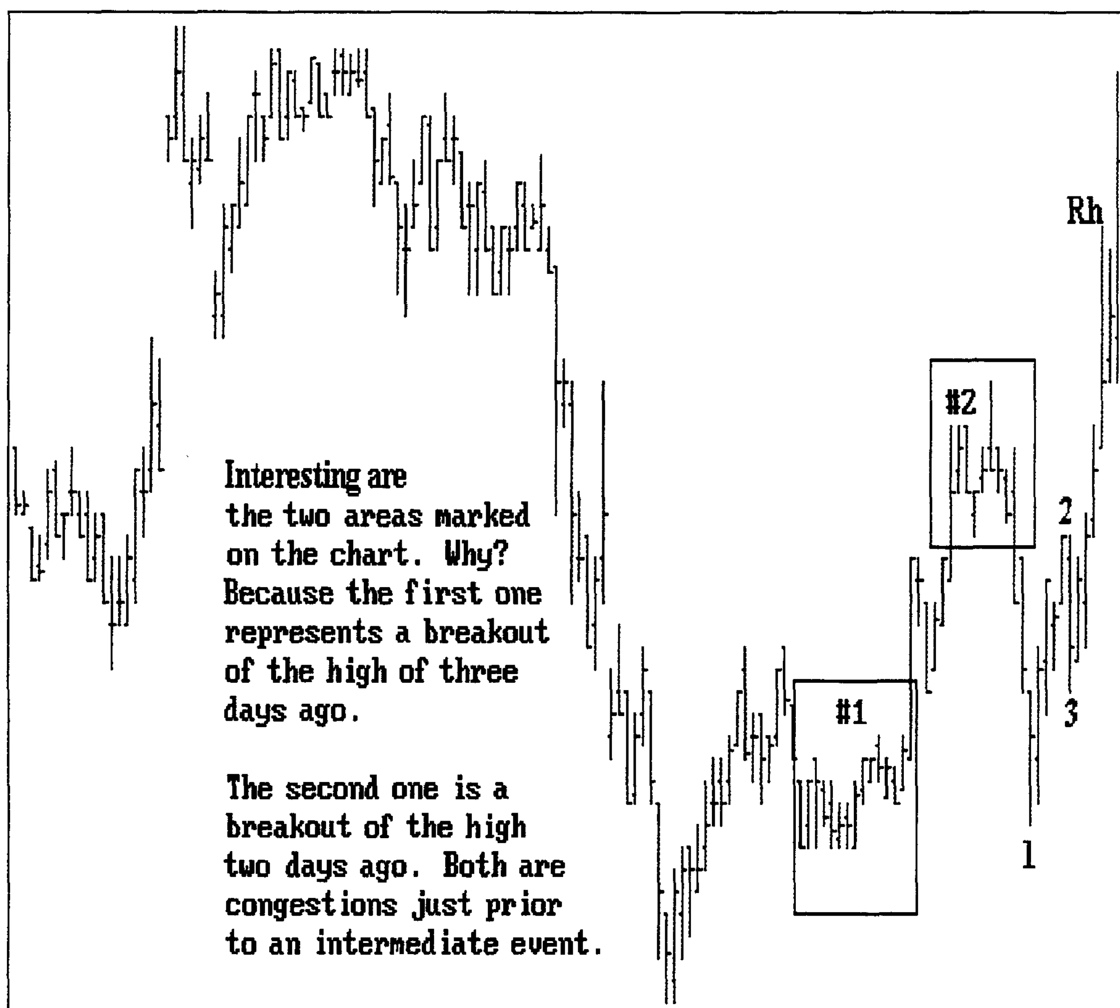
The long upward bar breaking out of box #1 represents 5 minutes, during which time an entry would have been made as prices violated the high of the congestion area as well as the high of three days ago. This trade could also have been made based solely on the fact that it broke out of congestion, but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

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



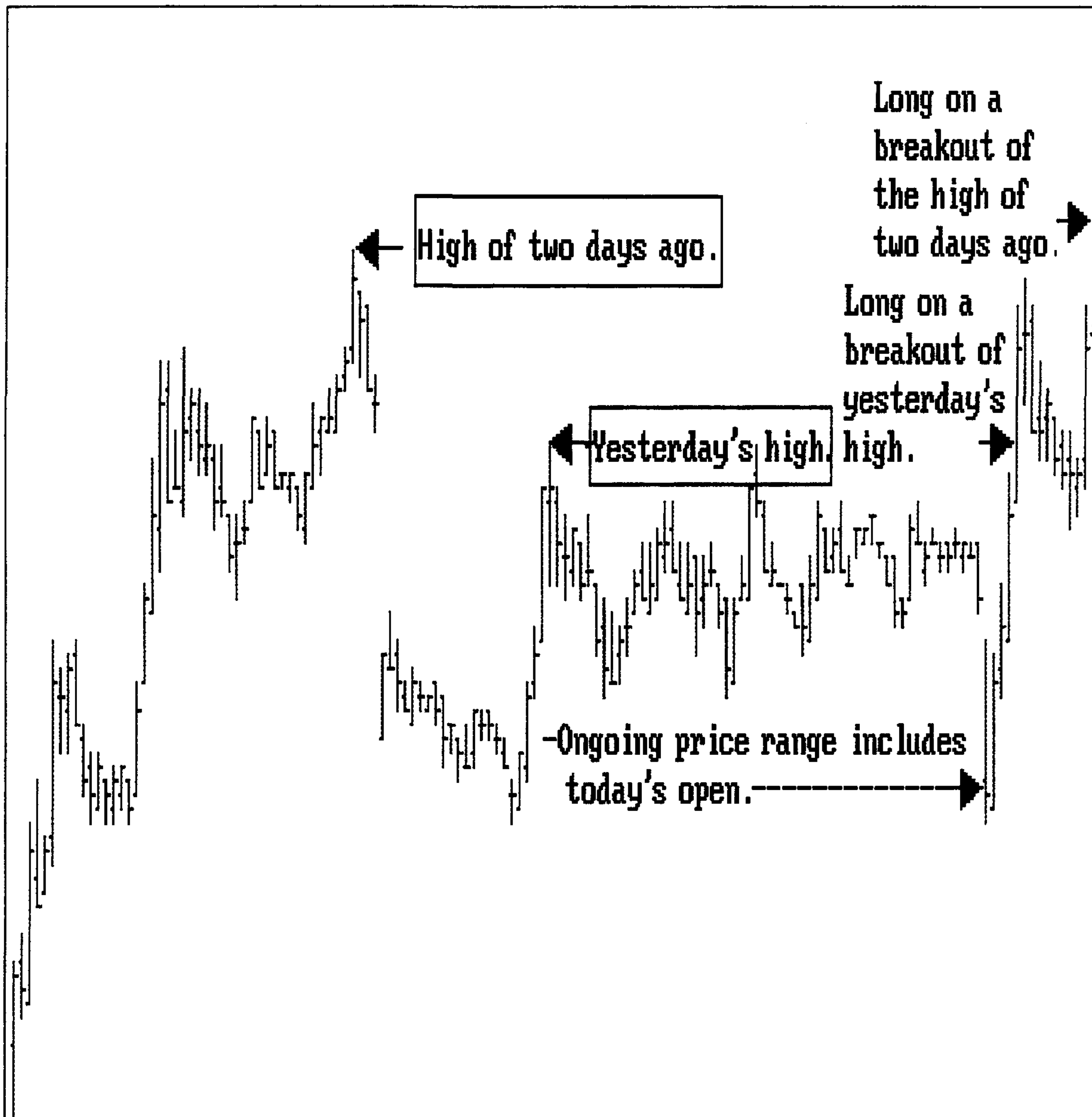
Notice that as the fourth bar in box #2 makes a lower low than the bar preceding it, it also creates a Ross Hook by making a lower high. Entering on breakout of that Hook results in a loss. The breakout bar, the highest bar in box #2, is a reversal bar. It is followed by another reversal bar. We must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

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

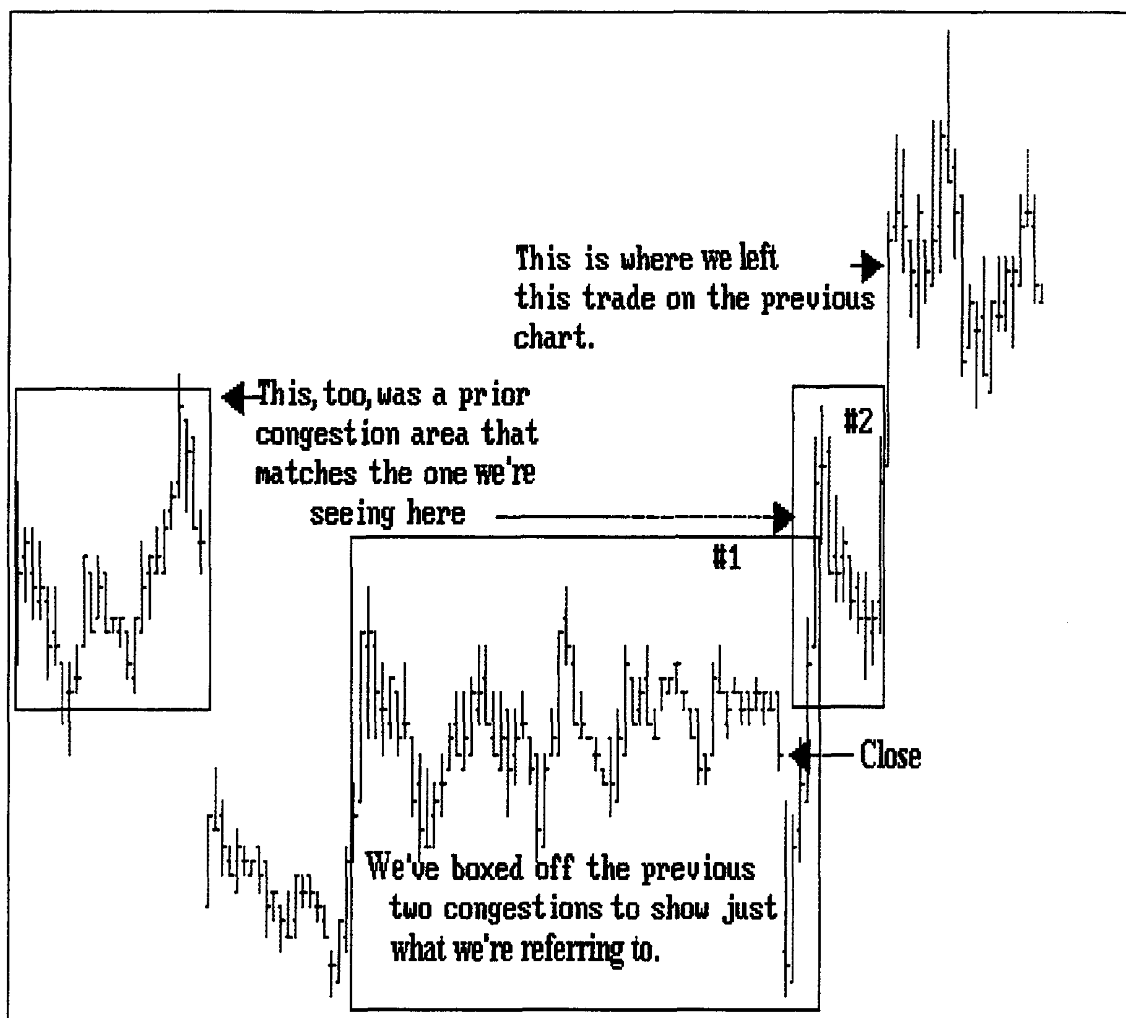


We want to draw your attention to the last assault on the high of two days ago. It is the high in box #2 on the chart. It begins with a 1-2-3 low formation. As the second number two point on the chart above is violated, we make our entry 1 tick above the price at number two. Prices take off and never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

We'll show another example. It's happening right now on our screens as this is being written. It's a perfect example of what we mean.



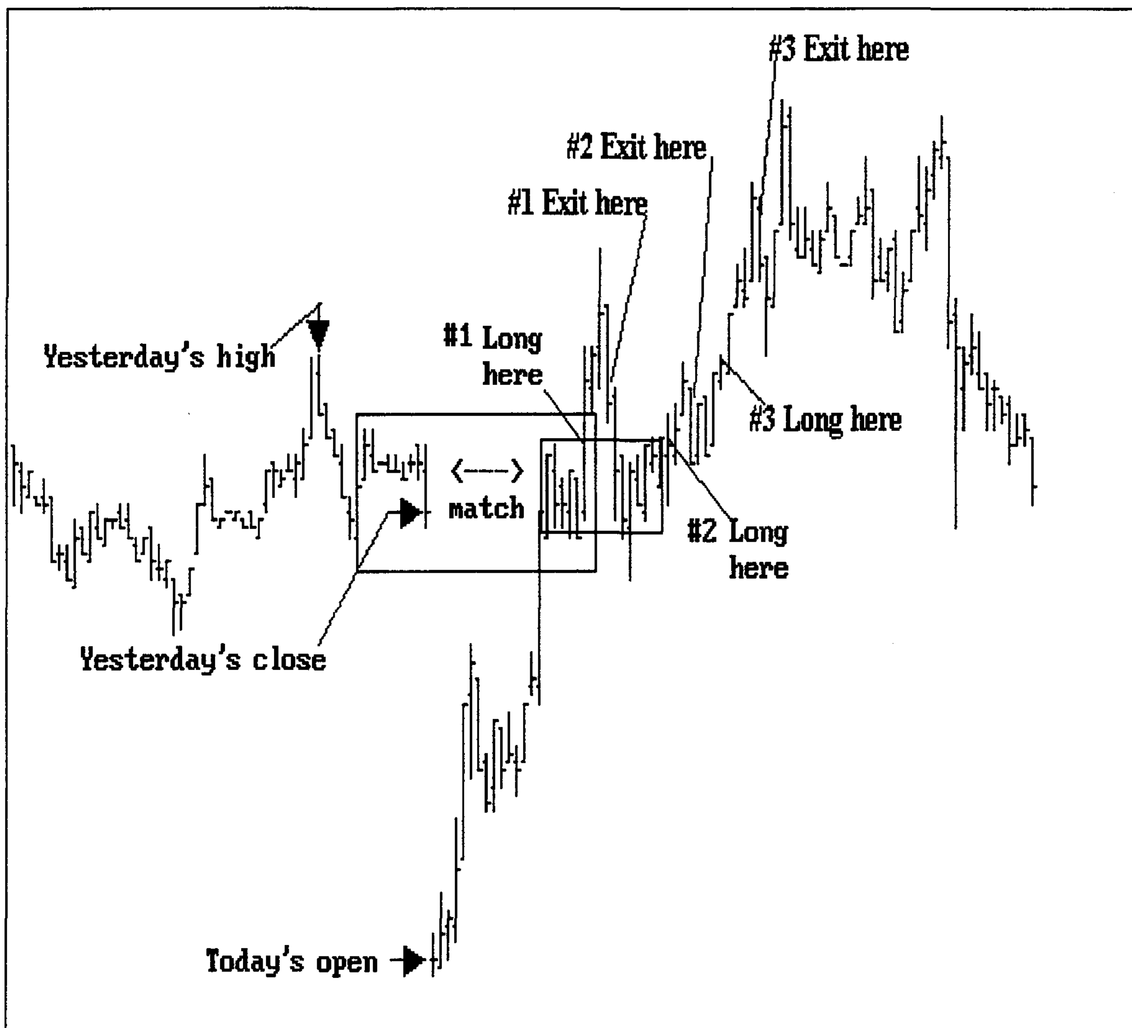
Next, we'll see how this trade developed.



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

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

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



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

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

Chapter 21

CONGESTIONS ARE IMPORTANT

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

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

For actual entry into such a trade, we want to trade the breakout of any congestion that existed just prior to our entry point or the breakout of the extreme of any bar that constitutes the Trader's Trick entry. That way we can get into the trade ***very*** early or ***somewhat*** early.

WHEN TRADING FROM CONGESTION, THE BREAKOUT OF THE CONGESTION PRIOR TO THE TAKING OUT OF THE ENTRY SIGNAL IS OUR TRADING FILTER. IT IS IMPORTANT BECAUSE IT GIVES US A JUMP ON THE MARKET.

If we have gotten into the trade ***very*** early (i.e., the nearest congestion area is **distant** from the breakout point on the daily chart), then prices will almost surely test the area of the high or low that was the basis for our entry signal. The thrust that carries prices from the breakout of the intraday congestion to the area of the high or low is where we will make our money — ***even if*** prices only test the high or low and ***never*** actually break out.

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

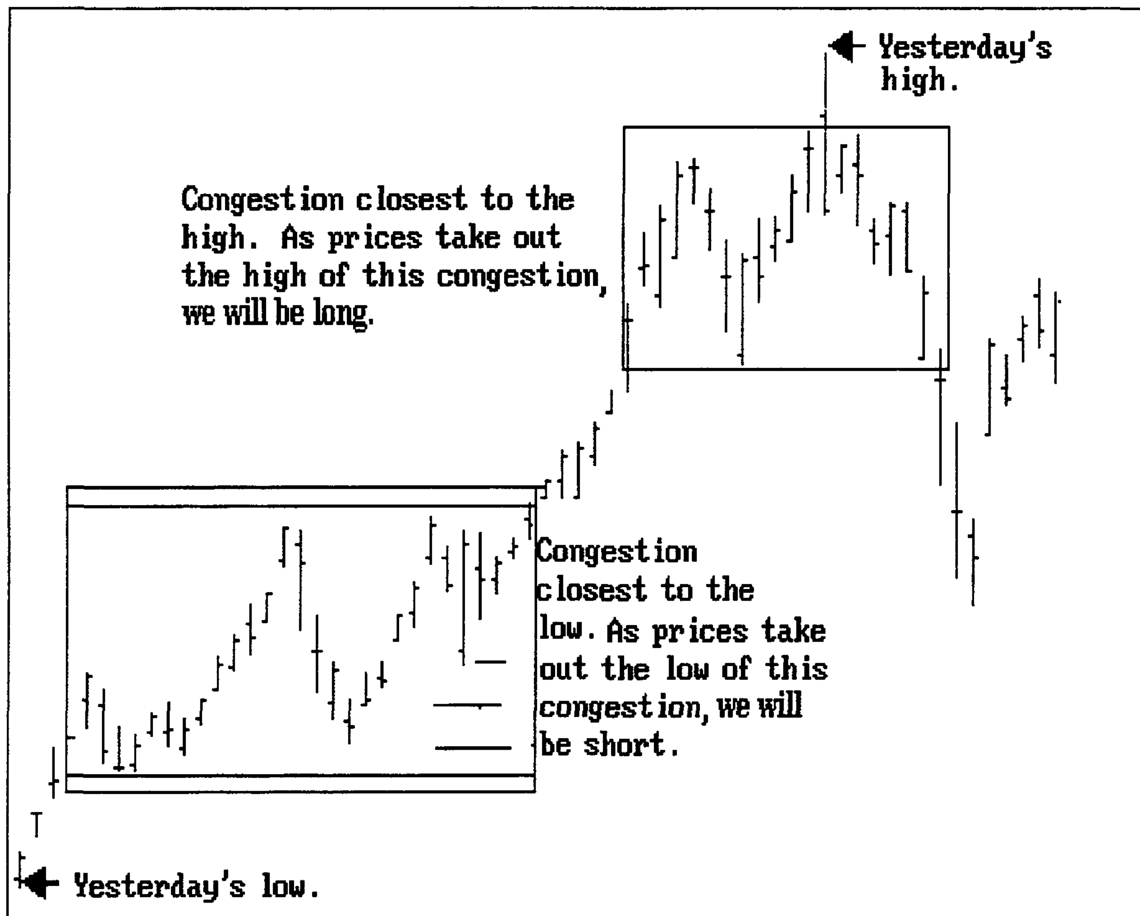
Let's illustrate this.

The daily bar for yesterday might look like this:

We want to buy a breakout of the high of this daily bar.

We want to sell a breakout of the low of this daily bar.

The five minute chart for yesterday might look like this:

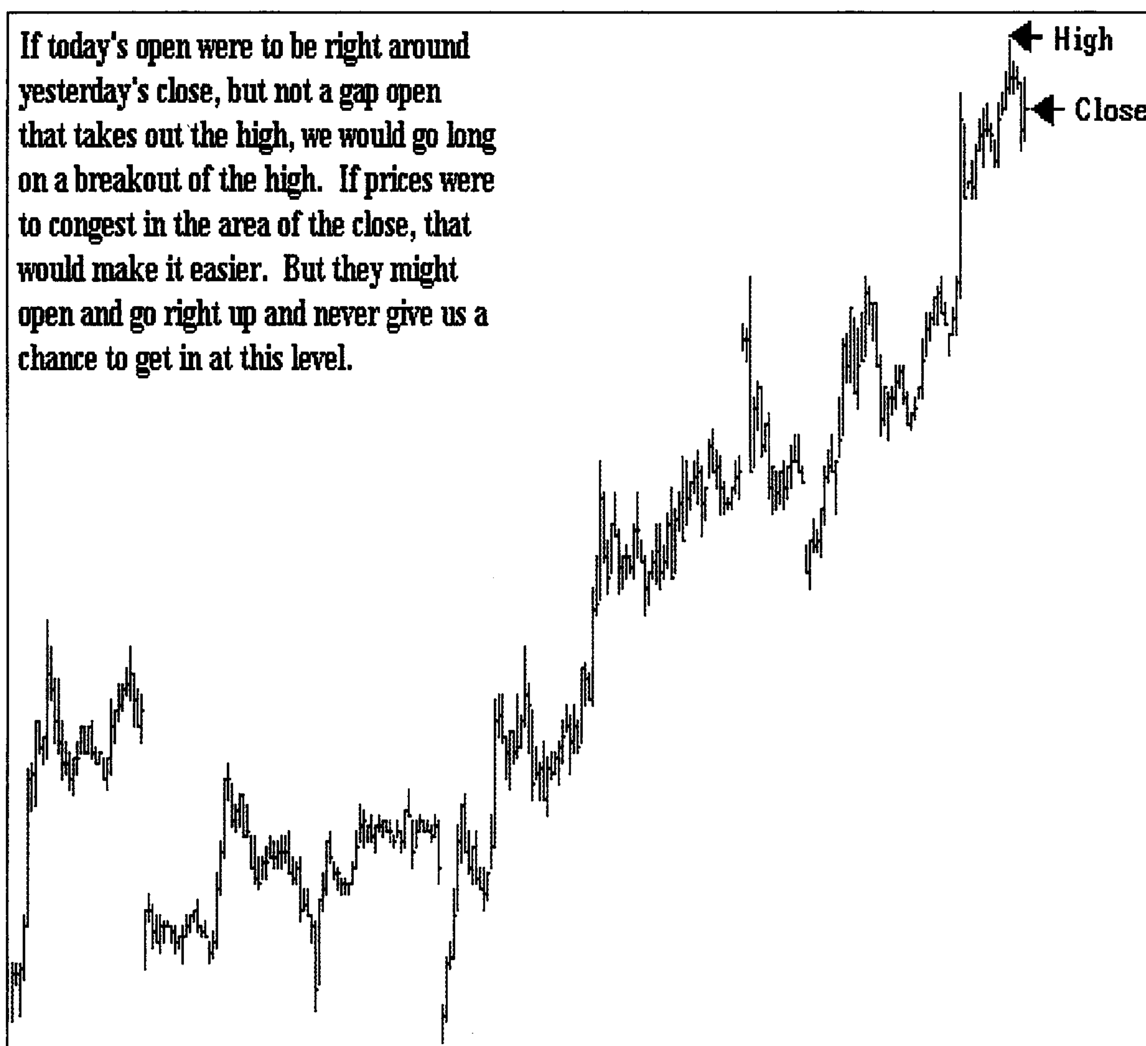


We want to enter on a breakout of the congestion area, rather than on a breakout of yesterday's actual high or low.

But what if there is no congestion area upon which to base a breakout? Just such a situation can be seen on the next chart.

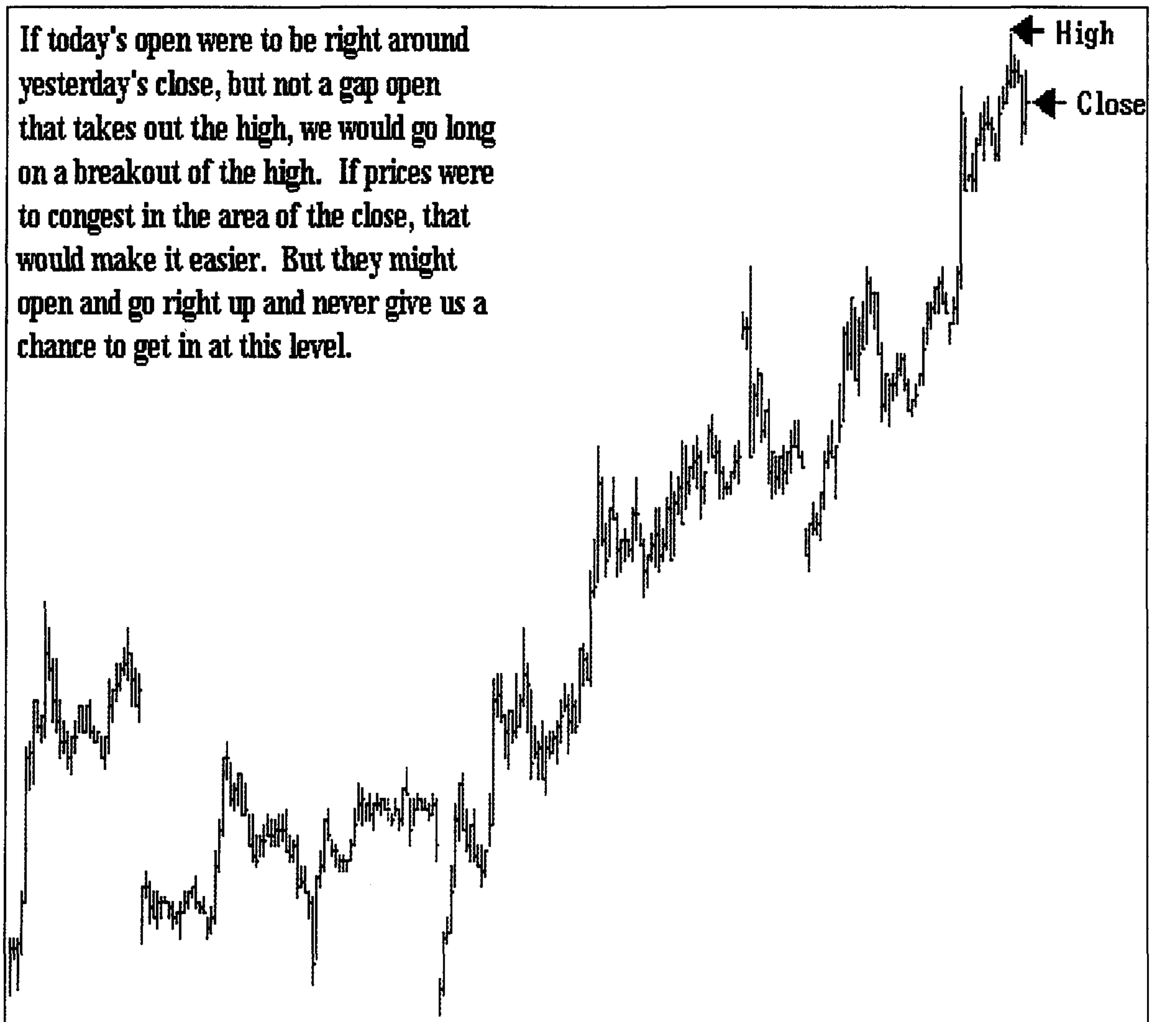
Dealing with it constitutes the refinement mentioned at the beginning of this chapter.

Here is a rule. IF PRICES ARE MAKING NEW HIGHS OR NEW LOWS RELATIVE TO THE LAST THREE OR MORE TRADING DAYS, WE MAY ENTER BASED UPON A NON-GAP BREAKOUT OF YESTERDAY'S HIGH OR LOW. Let's look at that now on a daily chart.



As we look back at prices, we can see that there are no prior congestions on the high side from which to base an entry. If prices open today somewhere below the high, or even at the high, we can take a breakout of this high as our entry. However, if we do, we run the risk of a quick pop followed by a retracement to test support at the high. So if we take this trade on a quick breakout of the high, we

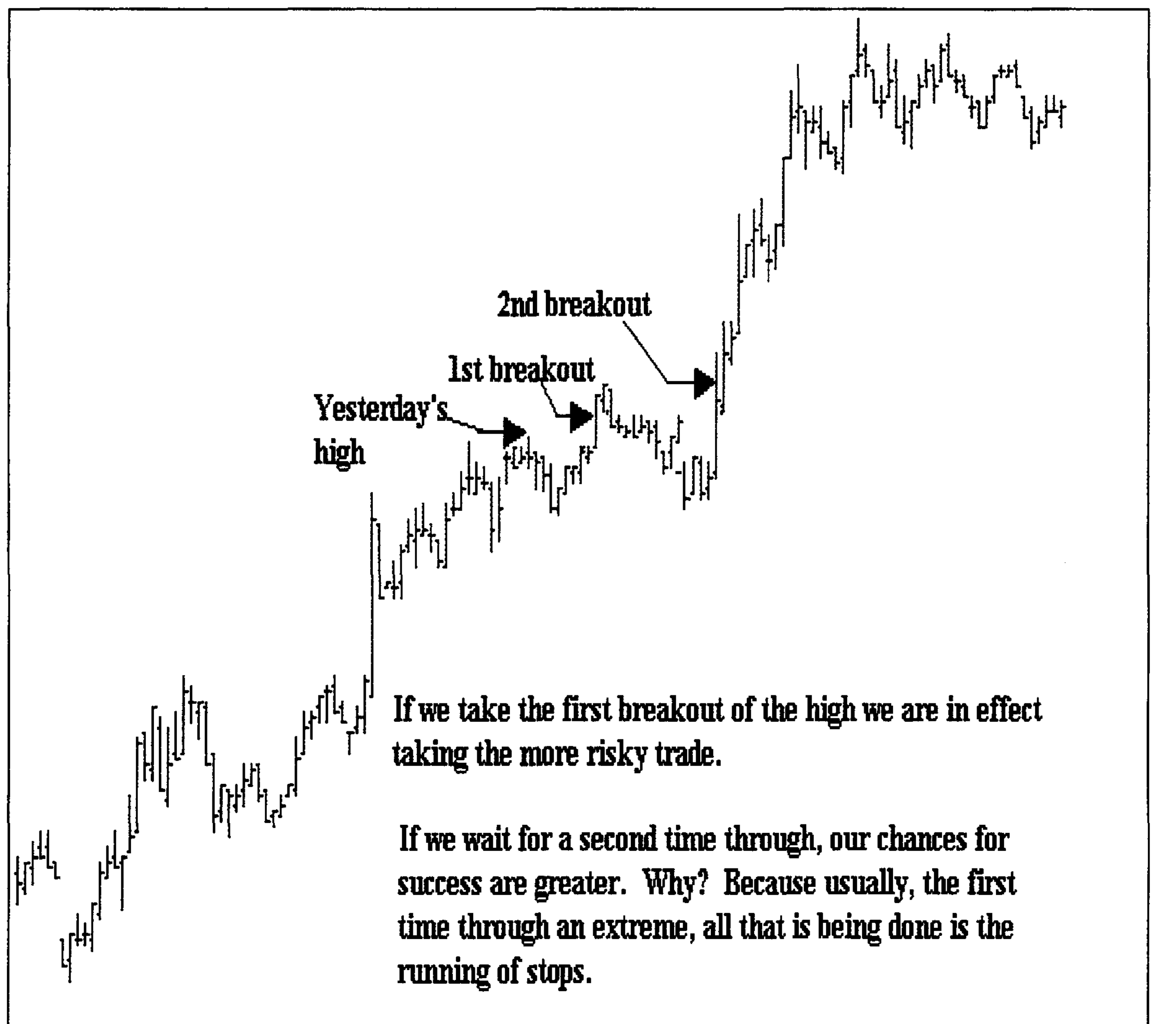
must be prepared to risk more than we normally would in order to be sure we're on board.



A much more conservative approach would be to wait and see.

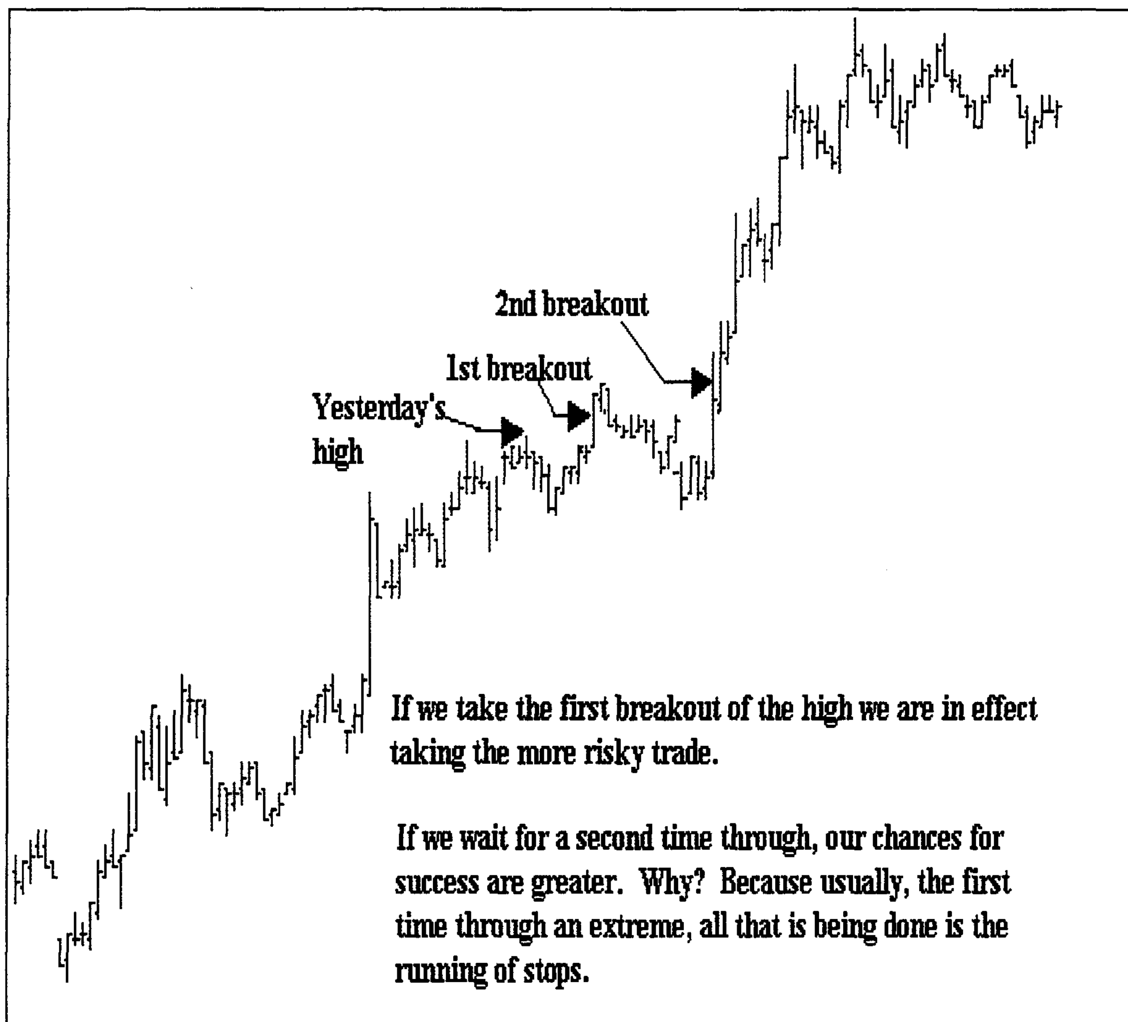
On the chart above, if prices open below the high and continue to trade in the area of the close, then we will have the congestion we are looking for as our entry signal.

If prices open and quickly take out the high, then we can wait for a possible retracement that will test support at what was the high. By following this more conservative strategy, we can maintain risk at a low level. The next page shows what actually happened on a five minute chart.

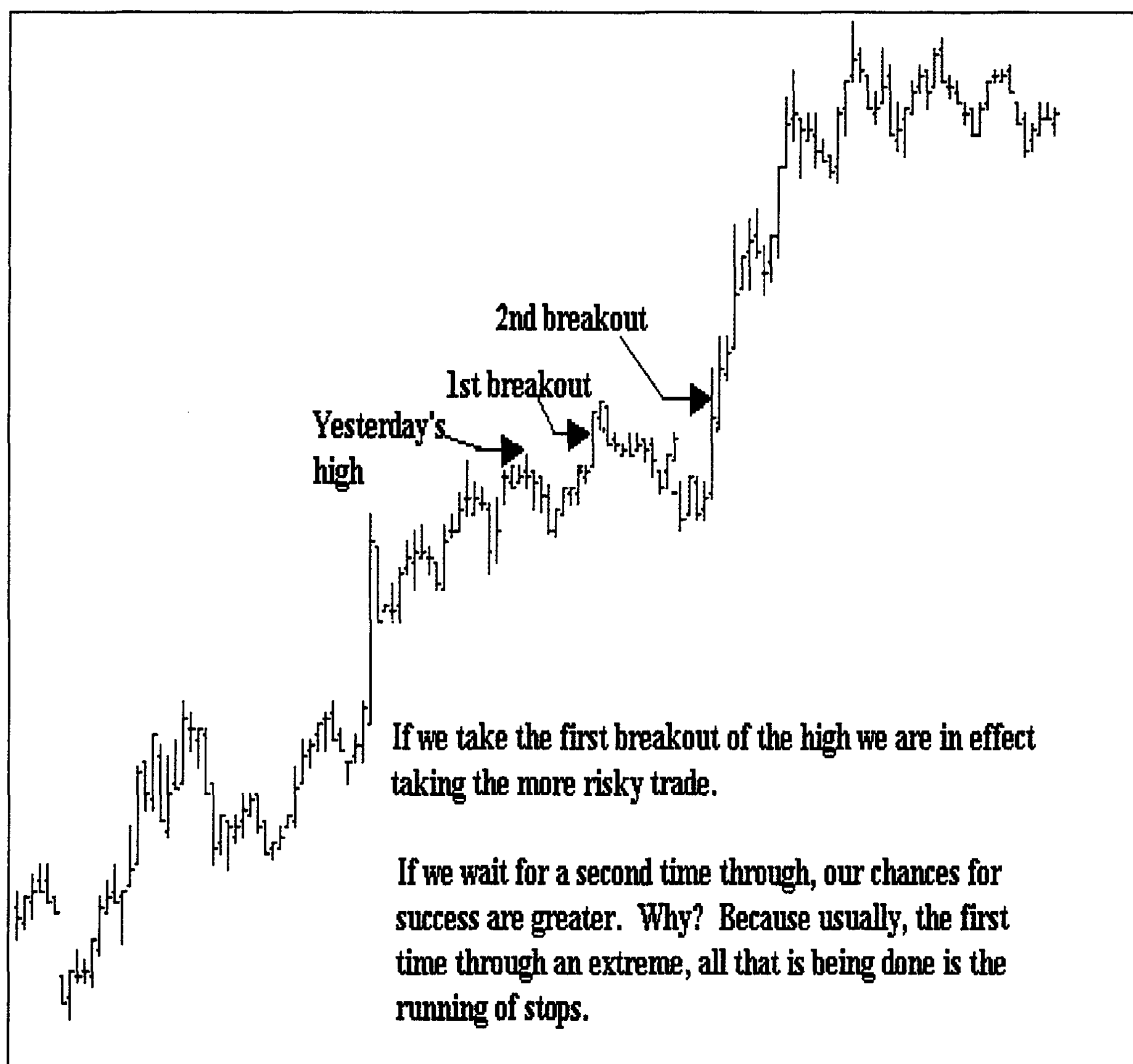


Let's take this trade one step at a time. Prices opened lower and then moved up to take out yesterday's high. That move was a first time through, and usually consists of nothing more than stop running.

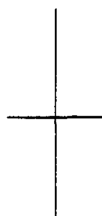
We wait for a correction and then some kind of congestion to form. If the market were to keep on going and not congest in the area of yesterday's high, we would let that trade go by. We want it our way or not at all. We don't mind missing a big move if it's not our move.



The market then retraces from the new high (the high created following the 1st breakout bar) to form somewhat of a four-bar congestion (the four bars at the extreme low of the correction just ahead of the 2nd breakout bar). This might be as close as we are going to get to our desired congestion, and so we plan to go long on a breakout of yesterday's high.



Once the second-time-through breakout occurred, the trade made a nice profit. Did it make all of the profit available? No! Our exit, inclusive of the long breakout bar, should be the eighth ("doji") bar. (See below.) Why? Because it was the first bar to violate the low of another bar.



The main thing to notice about a doji is the fact that the open and the close are about the same. The open and close do not have to be exactly the same, just very near to each other.

Chapter 22

SEARCH OUT THE BEST

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

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

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

Having identified the one or two methods and techniques that consistently work for us, it is imperative to refine them so they result in the highest probability of winning possible within our own frame of reference, our own mindset, and our own comfort level.

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

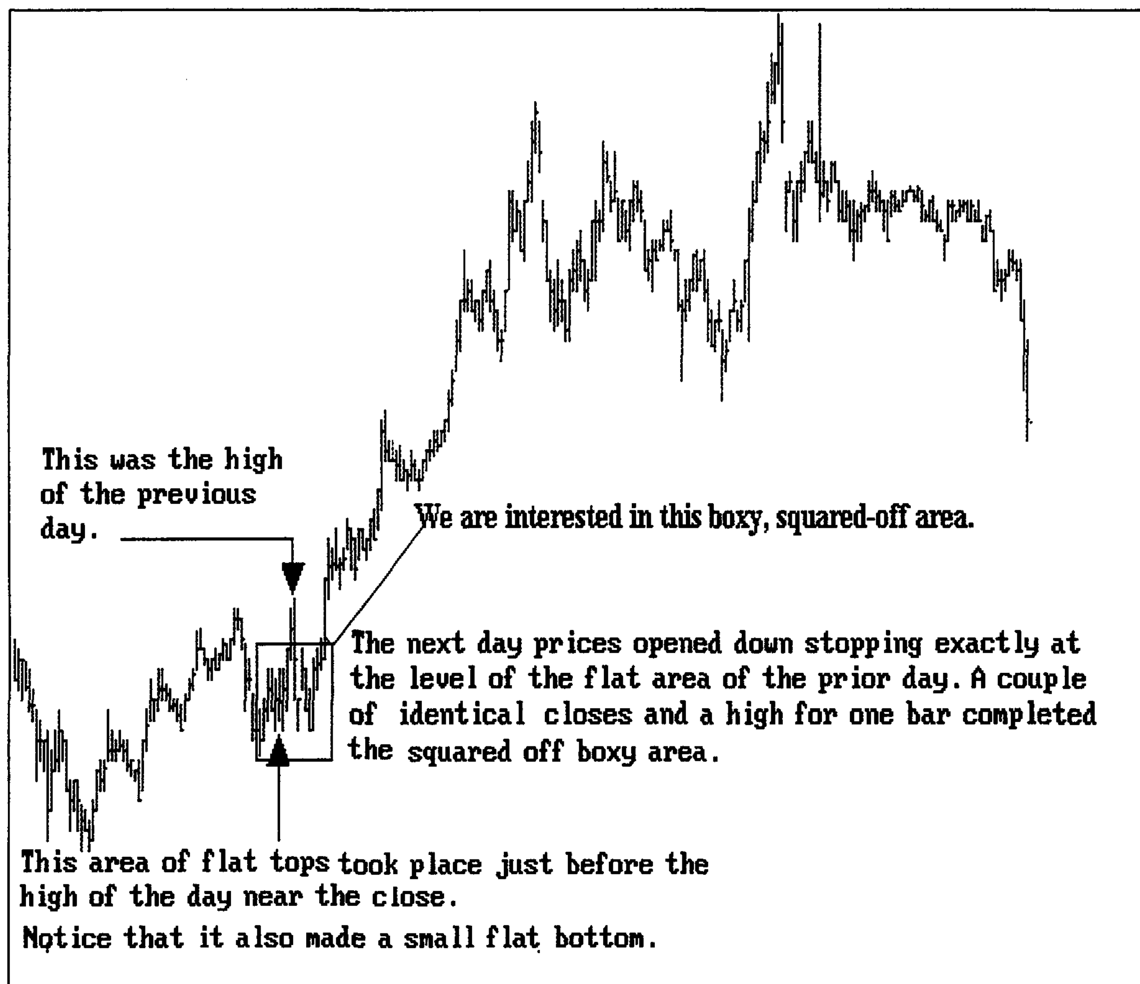
The best we can do for our students is to show exactly what we are comfortable with, then let them adapt that to their own comfort level.

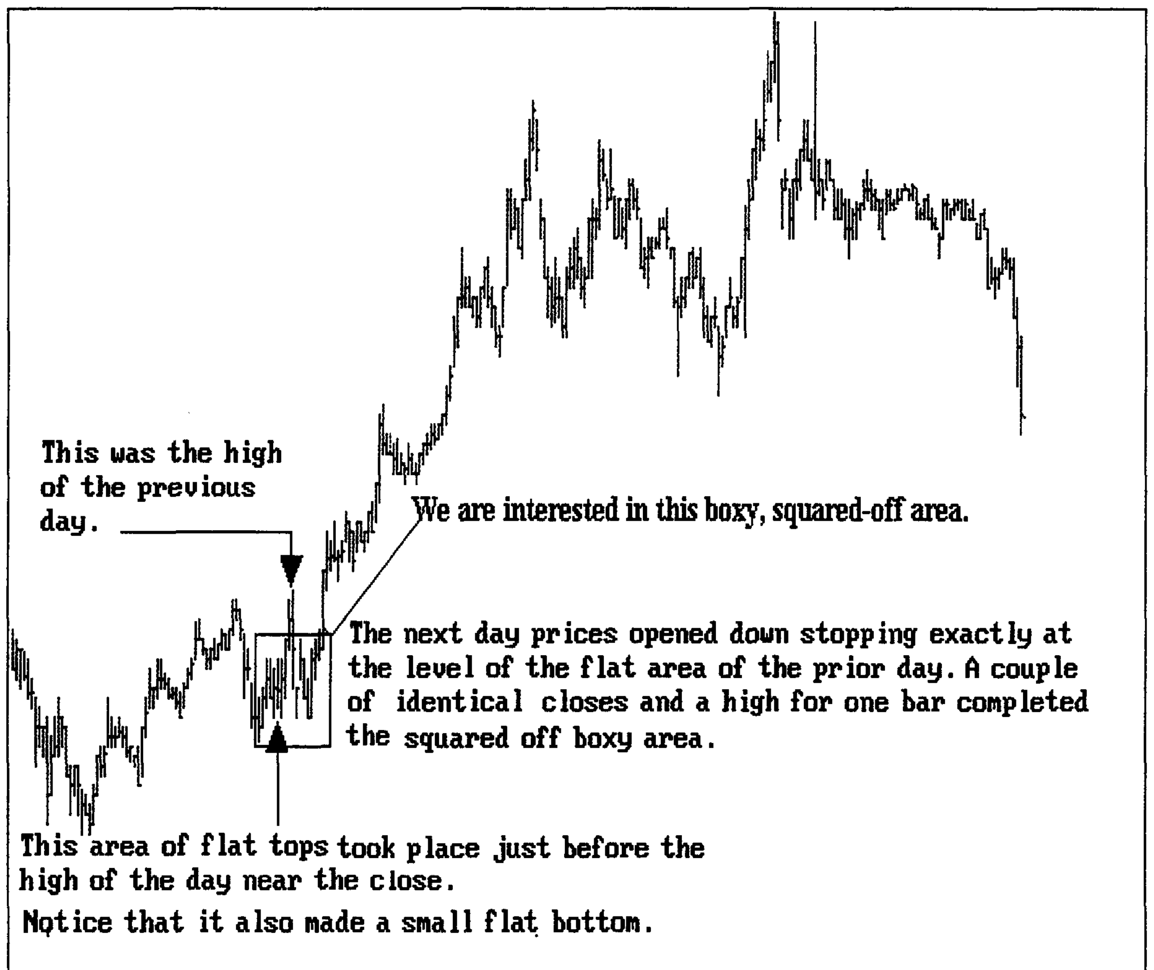
The trick here is to identify success and then stick to it like glue. When it works, don't fix it. We don't experiment with something that is making money. We stay with the very best trades we can find. There is no need to chase a market. We are slow to get in and quick to get out.

If we're not absolutely sure of a trade, we stay out. If it doesn't develop exactly to our liking, we stay out. We wait for those trades to come that exactly match our specifications. We let all others go by.

We may not trade today, so what? The market may go on to make somebody a fortune — no big deal. We discipline ourselves to know which trades are ours, and then take only those trades. We do not let greed get the best of us.

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

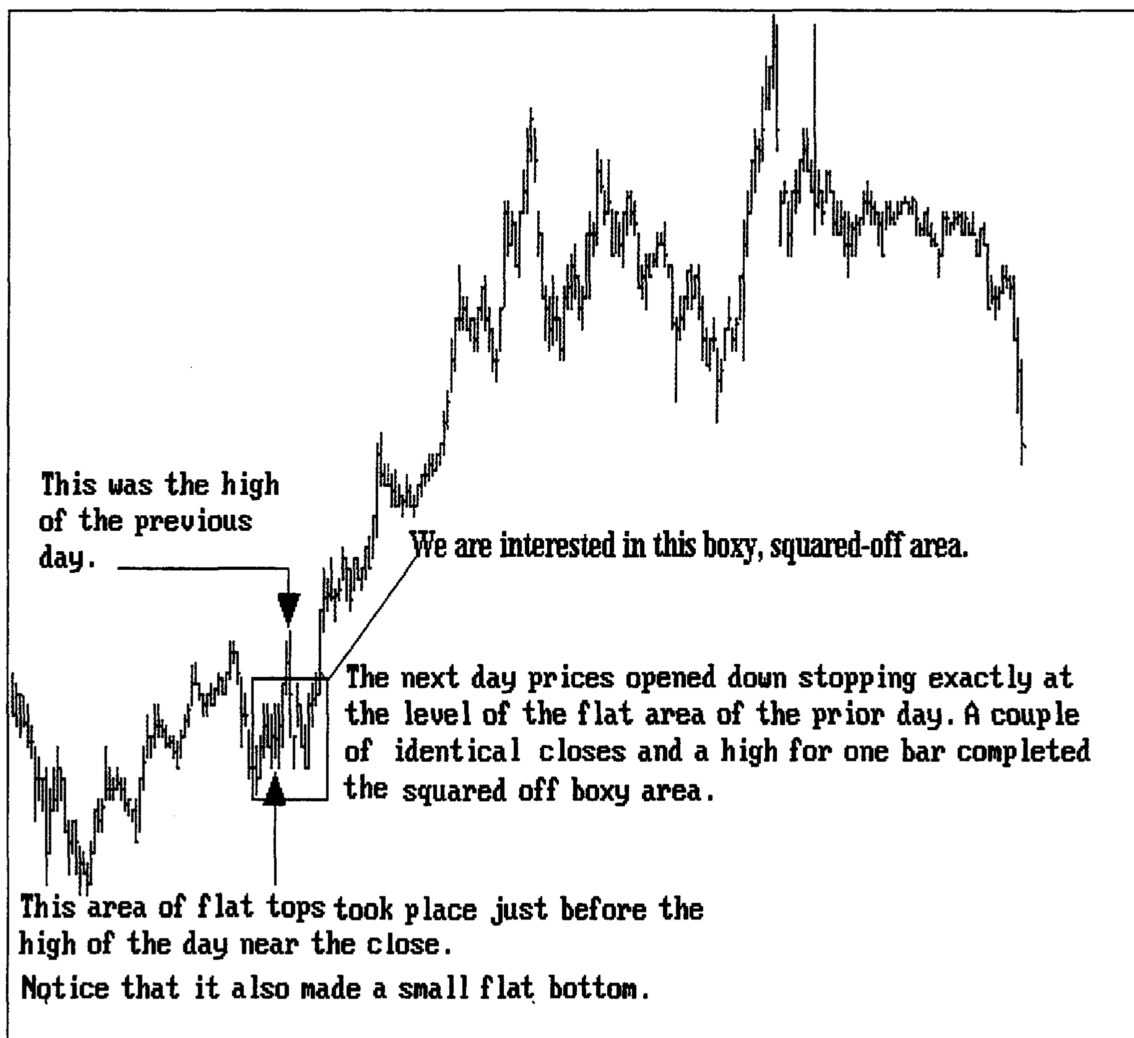




On the chart shown above, we are interested in taking a trade based upon a breakout of the congestion that occurred closest to the high of the previous day. Prices had congested there briefly prior to the high, and had then fallen back to the congestion area just before the close.

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

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



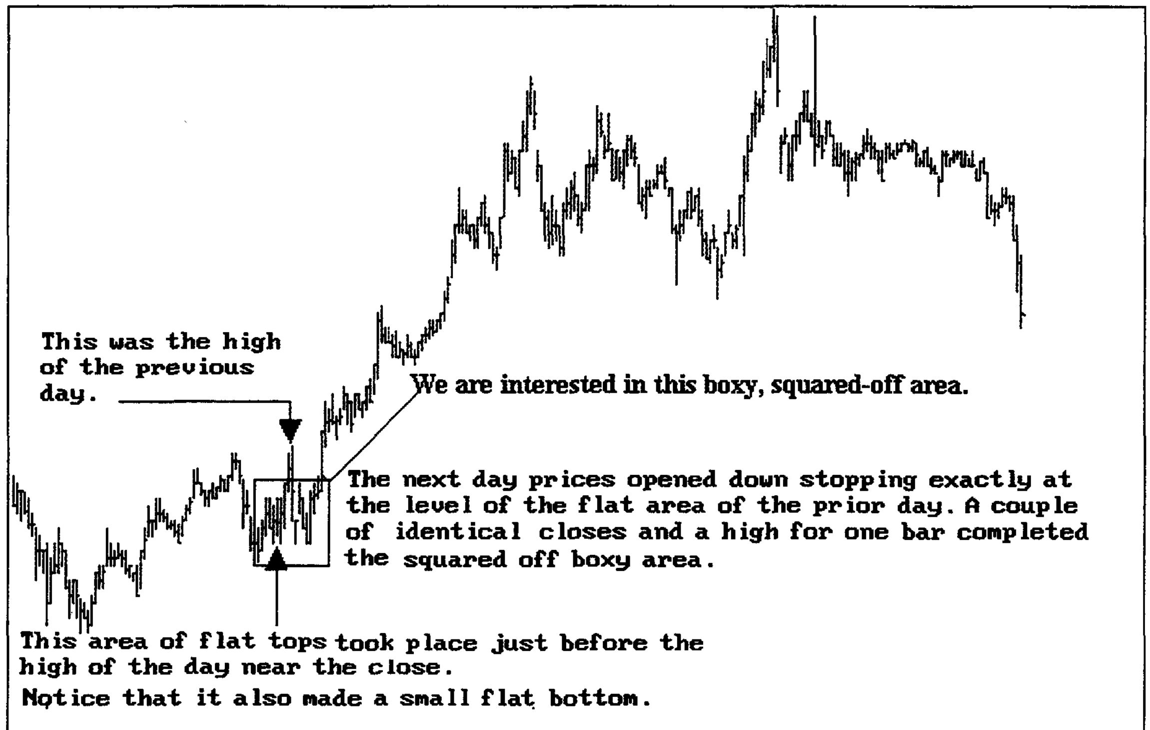
Why? We want to already be in the market when and if yesterday's high is taken out. Why do we want to already be in the market then?

There are two reasons:

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

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

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



STAYING IN THE WATER

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

Usually, we will not have to take a loss equal to our entire risk. When prices take out congestion areas, they usually have enough momentum to insure we will at least make expenses plus a small profit. At that point, we will have pulled our stops to breakeven and will not be hurt if prices come back down. If the buying or selling that comes into the market at the actual breakout is sufficient to carry prices a bit higher, we will liquidate additional shares.

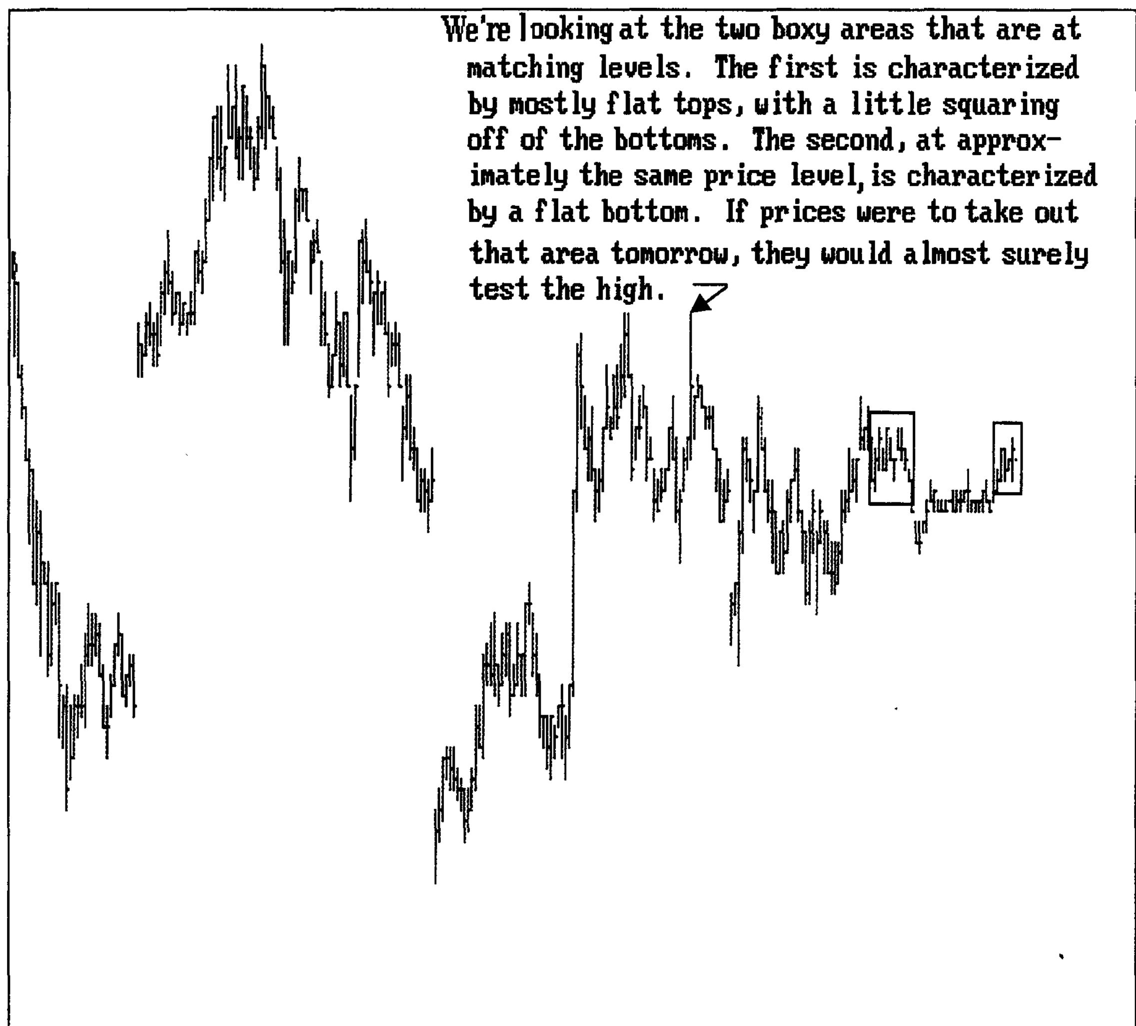
If prices have sufficient momentum for the market to run, our final share holding will see us catching our portion of the run.

Do we expect to make it all, right to the most profitable point of the day? No. All we want is a piece of the action. Sometimes we will get more, sometimes less, but at least we'll get something. A whole bunch of those pieces earn us our livelihood.

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

Notice that had we entered the trade on the previous page using our trading plan, we may have had to exit shortly after entry because of a bar making a lower low. Later in the course we will discuss reentering the market. For now, let's just say that once prices begin to trend, we can use the concept of the TTE even on an intraday chart. ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF will go into this concept in greater detail.

Let's look at some more trades.

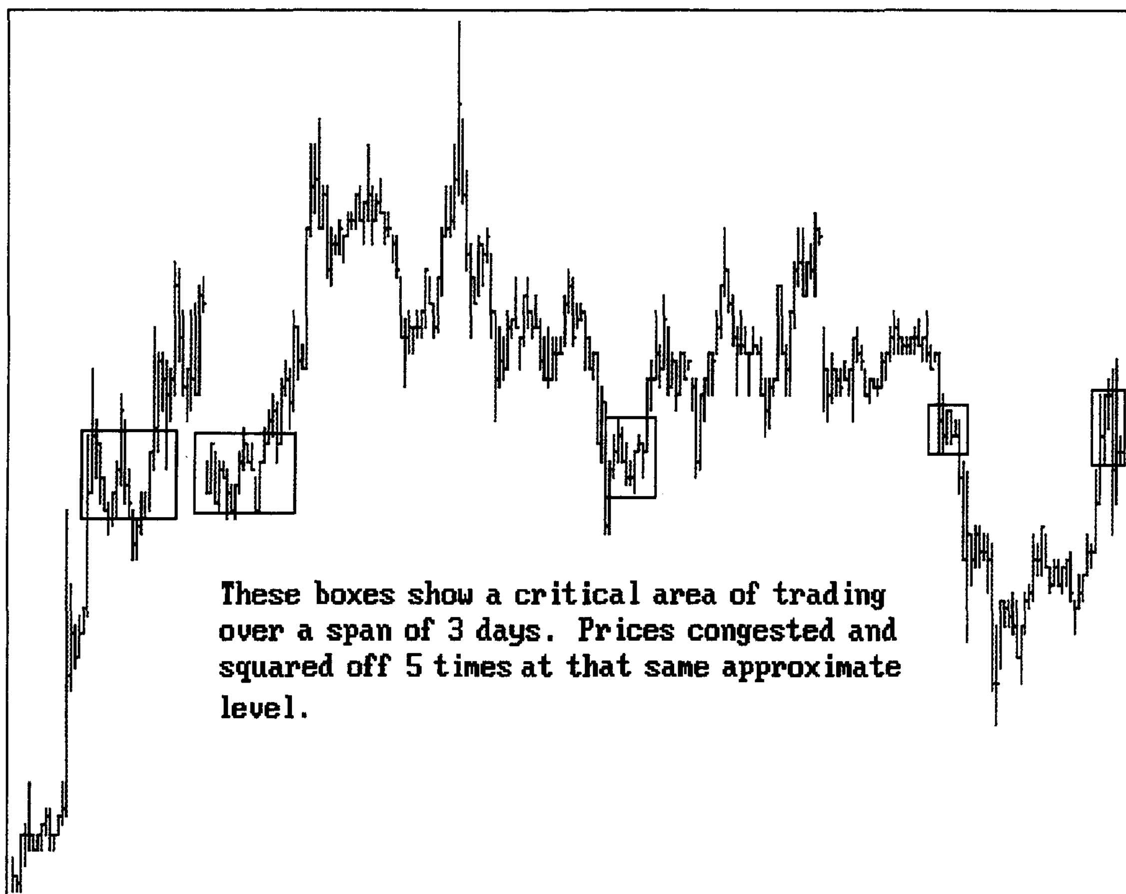


If prices take out the congestions to the upside in the boxed off area, there is an excellent probability that prices will test the high.

What we would like to see on the next trading day would be an open that is a bit lower, followed by some more trading at the boxed level.

A breakout would have us in the market, with enough room between the breakout and the high to at least cover costs. If prices continue upward, we might make a profit, and if we get a run, we will make our take-home pay.

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



The marked-off boxes demonstrate a critical area of congestion.

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

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

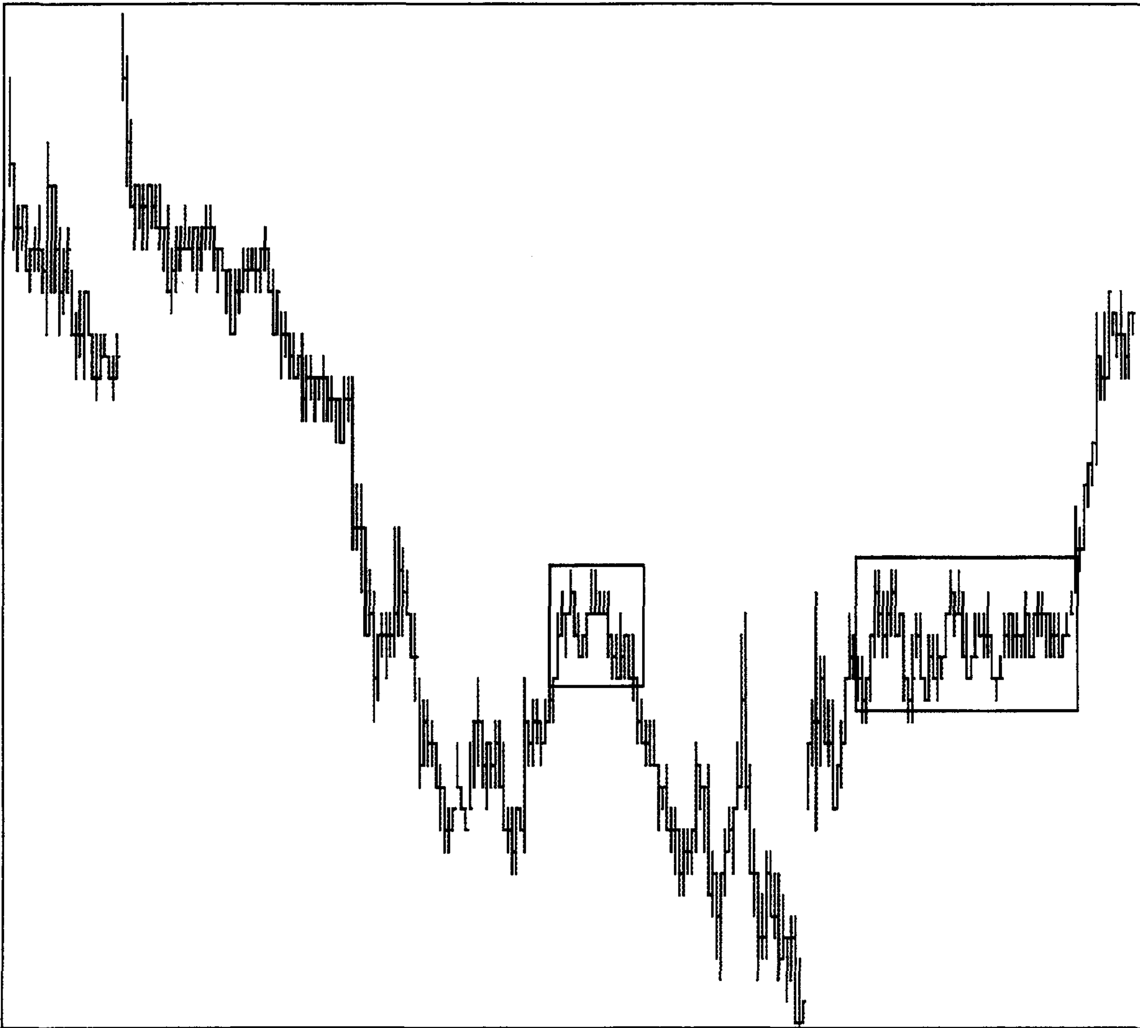
The third box shows that later that same day, prices traded there again, only this time after making the low of that day.

The lows of that fourth box are at just about the middle of the congestion shown in the third box. A short position should be put on

at the takeout of the congestion shown in the fourth box. As can be seen, prices made a nice move.

The fifth box shows the congestion level at the end of the day that approximately matches the congestion area made earlier at box four.

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



Here's another classic example. It's a day when there was enough activity for share prices of a normally less liquid stock to "form up" on a five minute chart.

PREFERRED PATTERNS

We give preference to boxy, flat, squared off congestions over any other kind.

Next, we give preference to repetitive congestions in the same area, such as on the charts in the previous two figures.

We prefer that the boxed off section not be too high from top to bottom. We ignore spike highs or lows, and prefer clusters of opens and closes, highs and lows all within a very narrow range on the individual price bars.

We feel it is essential to have software that will enable viewing of at least three day's worth of intraday trading at one time. This means being able to see three days of the smallest interval price bars on the screen at one time. Normally, share prices seldom form up in fewer than five minute intervals. But when they do, it's possible to see where the daily highs and lows were over the last three days. Alerts can then be set accordingly.

Chapter 23

CONTINUATION TRADING

In a previous chapter we talked about reversal bars, and bars that make lower lows or higher highs. Once you have perfected those trading techniques, and if your trading is profitable, you may want to try continuation trading to increase returns. When we've covered costs and taken some profit on a portion of our position, what do we do with the remaining shares? How do we trade them?

We want to be in the market when it runs. For the most part, the major profits we will make are going to occur when the market does run.

Here's how it works. We're quick to take profits to cover costs and net a small gain. At that time we liquidate a portion of our shares. We then move at least another portion, if not all, of our shares to a price that, if it is reached, will enable us to get out at least at breakeven. Exactly how many shares to move to breakeven is a choice every trader must make on his own. It's a matter of comfort level — both mental and emotional, and also a matter of what our margin account can handle. Often, we will liquidate half of our shares as soon as we are able to do so profitably, and plan to exit the market at no worse than breakeven on the remaining shares.

Once we have liquidated a portion of our position, if the market goes nowhere, we will probably have to exit at breakeven. This will happen fairly often. The market may then go on to make fat profits without us. If it happens that way, we are not overly concerned. The worst thing we can do is to dwell on what we would or could have made had we given the trade more room.

Remember, profits not taken are paper profits and they are just that, paper. We can't take them to the bank.

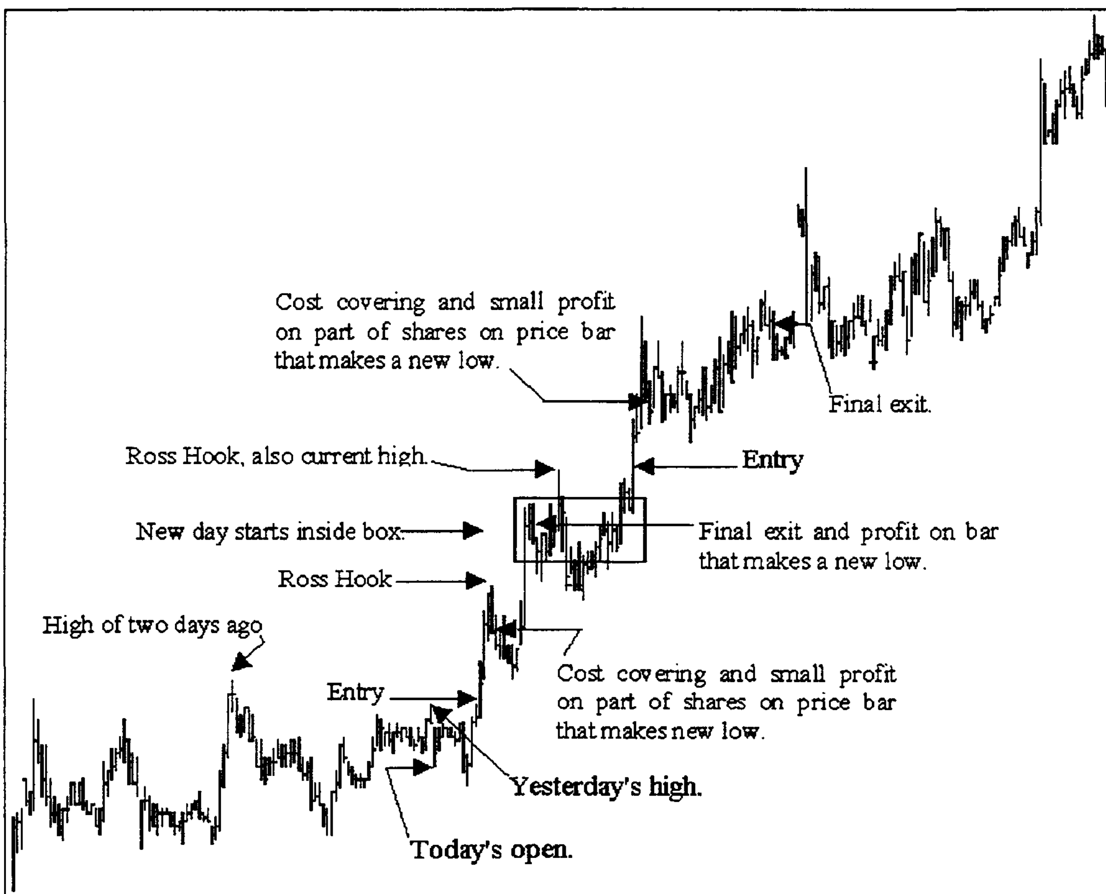
However, many times a month we will discover share prices that will have a good run. Those are the trades we've been waiting for. We've been staying patiently in the water. We've been dipping our

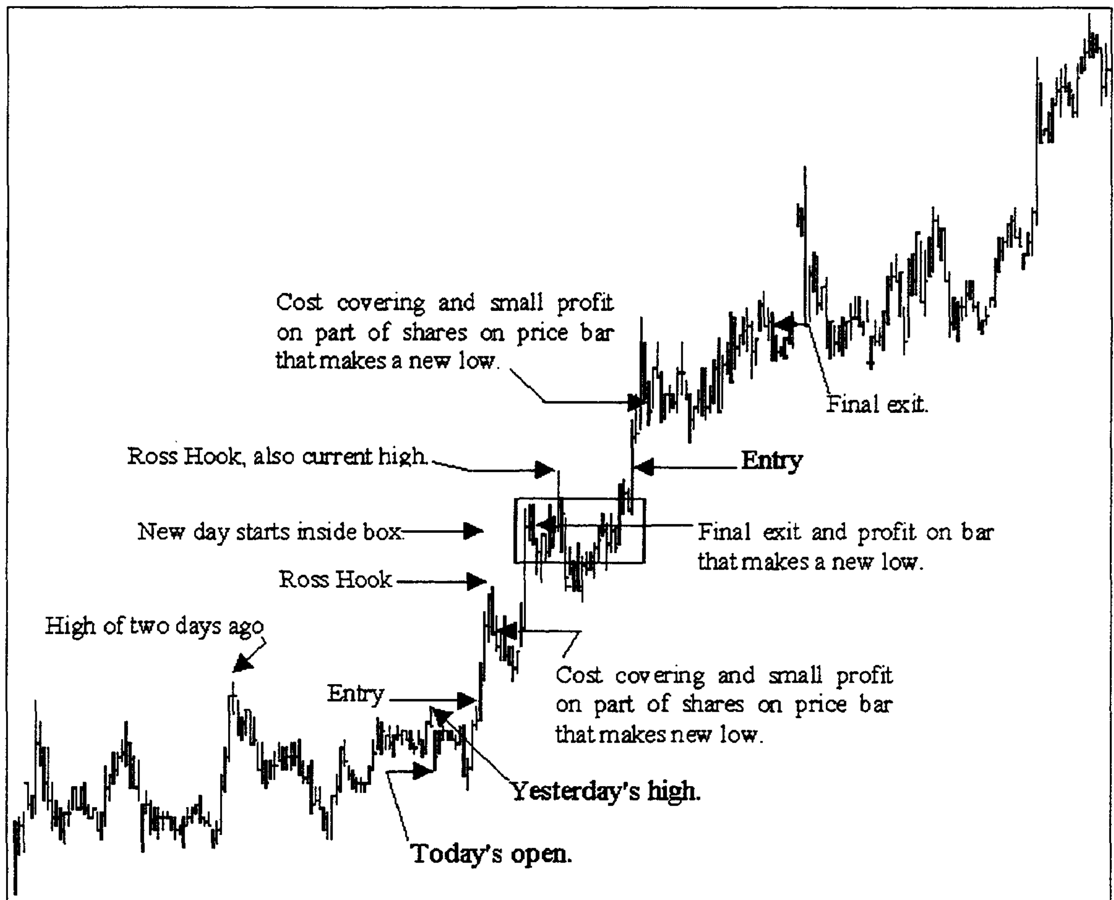
toes in each time we trade, looking to see if this is our day. It may have cost us a few bucks, or we may have made a few bucks while we waited for our day in the sun.

On the days share prices run and we are able to stay with them, our breakeven stop will have held. Then prices move in a direction to make us profits.

Will we get all of the move? Probably not! Will we be able to call the top or bottom? Definitely not, we won't even try. We must be satisfied to make a profit. Making profits is the goal of our overall plan. We ask ourselves, "Why are we here? To make a buck — but not to suffer while doing so." Have we made it clear? ALL RIGHT, here goes. Let's put everything in the context of an example.

The following 10 minute chart covers more than one day of prices in a stock that was moving on news of higher than expected earnings.





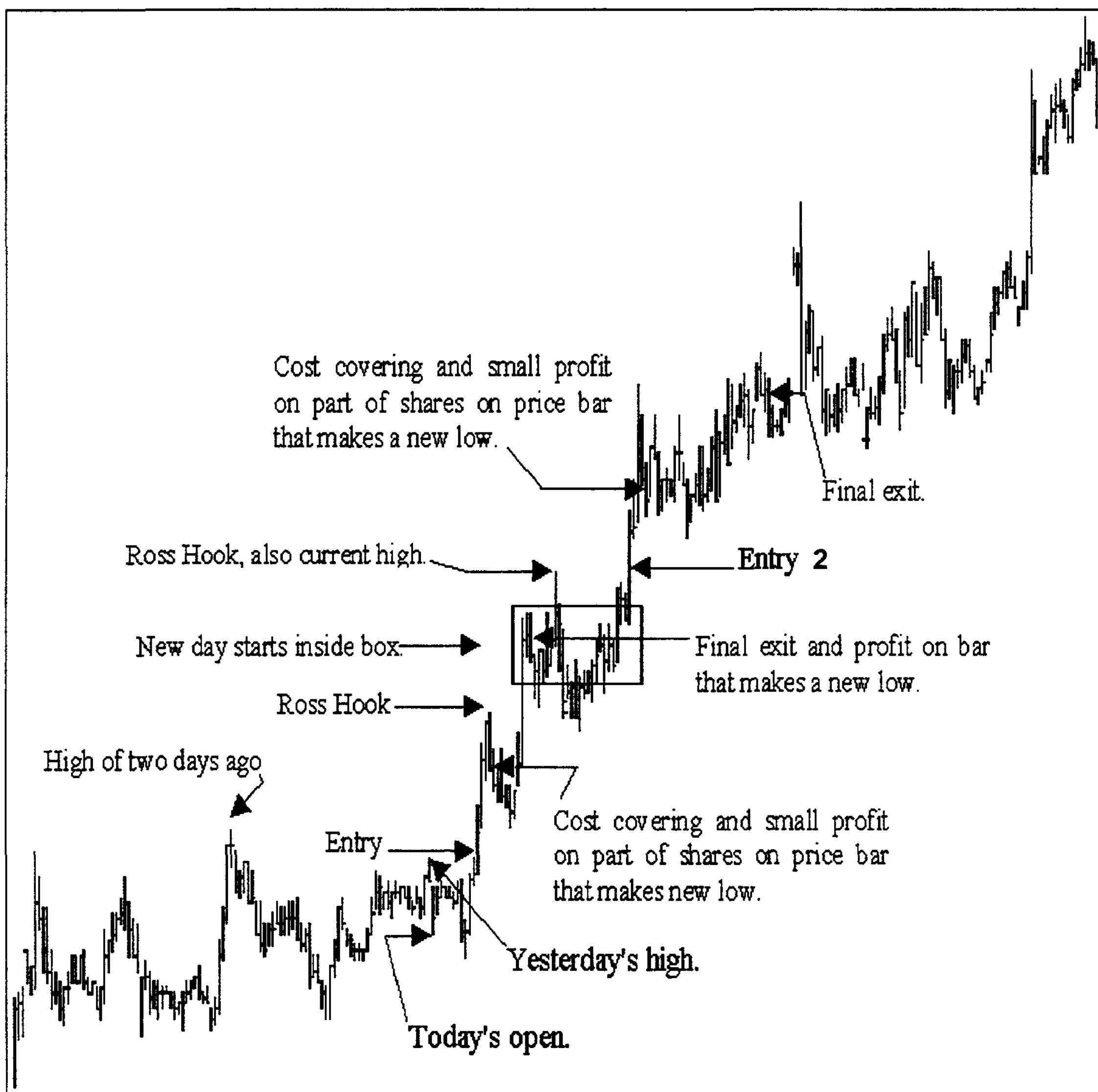
Let's make sure we've got this right. Our first entry is an attempt to get in on a breakout of the congestion that occurs prior to prices taking out yesterday's high or even the high of two days ago.

We exit part of the position using the continuation method, covering costs and taking a profit on the first price bar that makes a lower low than a previous price bar. The remainder of our position is kept at breakeven or better. If we are daytrading, we want to exit our trade before the end of the day. Since the end of day occurred inside the box, we like to be out at least 15 minutes before the close of trading. A spike higher followed by a bar making a lower low is enough of a signal to exit the trade (final exit and profit on bar that makes a new low).

Prices open the following day inside the box. Prices are in congestion. This congestion is below what is now yesterday's high

labeled the "current high." We want to enter below that high, being taken out if we can.

In the case of the chart we've been working with (on the preceding and following pages), we are not able. Instead, we enter on a breakout of yesterday's high (Entry 2). As soon as we have a bar that makes a lower low than the previous bar, we exit covering costs and taking a small profit on the price bar that makes a new low. We then can hold on at breakeven, or better, until we have some reason to believe the move is over and prices are going against us, or we need to get out because it is near the end of trading. You can see that this method differs from the violation method of exiting a trade.



Chapter 24

STRATEGY AND TACTICS

We've shown our trading plan. The plan represents our strategy in the markets. Strategy is the way we've planned and directed our trading operation. We've planned to take profits at certain levels. We've planned to cover costs and take a small profit. We've planned to let part of our position run. Much more will be said about taking profits and money management in ELECTRONIC TRADING 'TNT' II — HOW-TO-WIN TRADING STUFF.

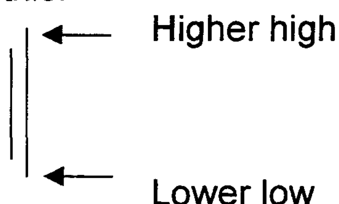
Tactics, on the other hand, relates to the way we have marshaled and maneuvered our trades in and around congestion areas. Tactics involves placing ourselves in the best position in the markets to take advantage of price movement as seen through momentum.

Tactics are seen in the methods used for entry, and methods used to both protect and to take profits. In short, tactics deal with trade management — from what we do once we've decided to enter a trade until we are actually out of the trade. Trade management deals with how we trade the trade!

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

REVERSAL TRADING

Is there a time to reverse direction? Yes, there is. Sometimes prices will make an outside day. An outside day or outside bar looks like this:



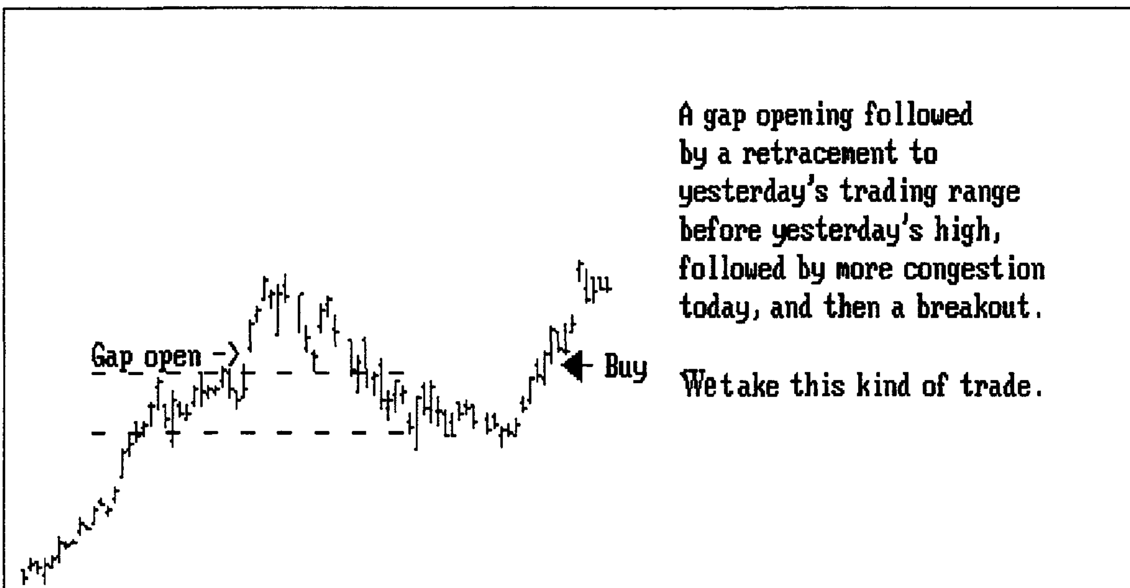
They might take out yesterday's high, and then turn right around and take out yesterday's low. The outside day may be so large from top to bottom as to take out the highs and lows of several days. We watch for this when there is feverish activity in the markets.

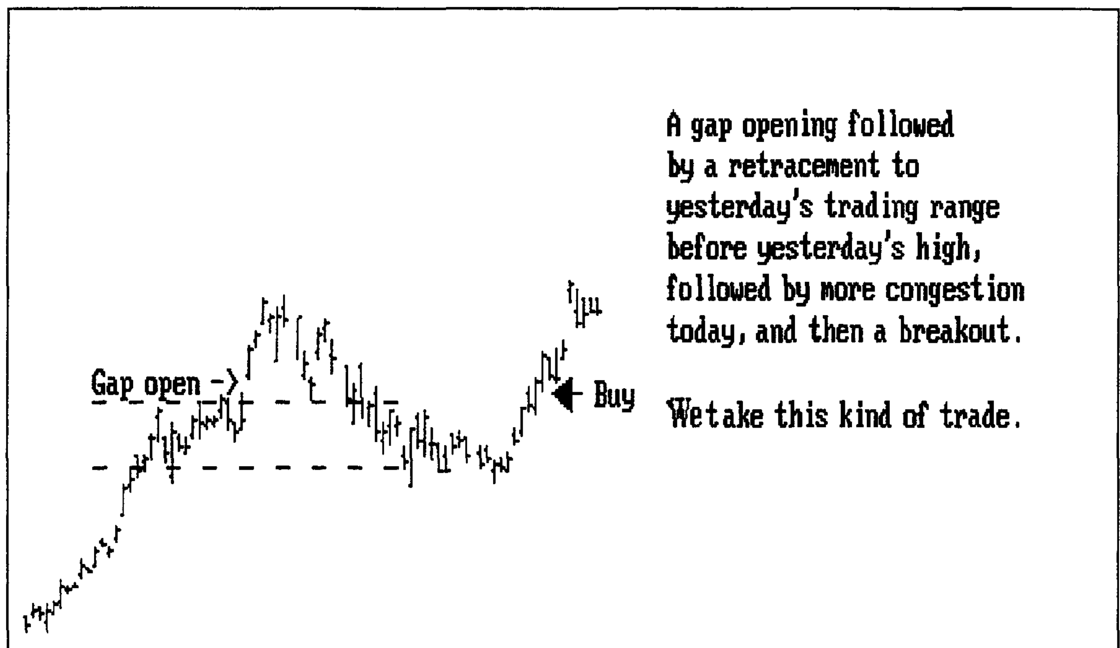
The rules for changing direction are identical with the rules for trading one way: We take a breakout of the longest, tightest, and/or best congestion that occurred prior to the extreme. We might be long early in the day, and then sometime later we might find ourselves short. We may even have time to enter the market three additional times in the opposite direction from our original trade.

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

GAPS

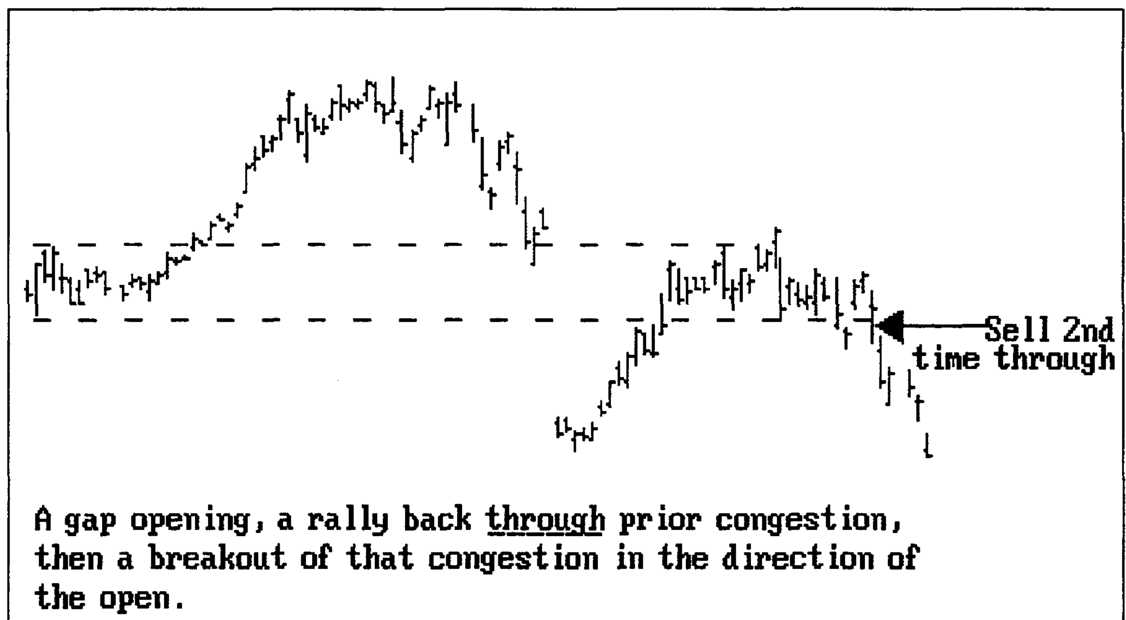
How do we handle gaps? If prices gap past our entry congestion, we let the trade go by. BUT IF prices trade back into the congestion, then we take a breakout just as we originally planned. Here's what we look for:

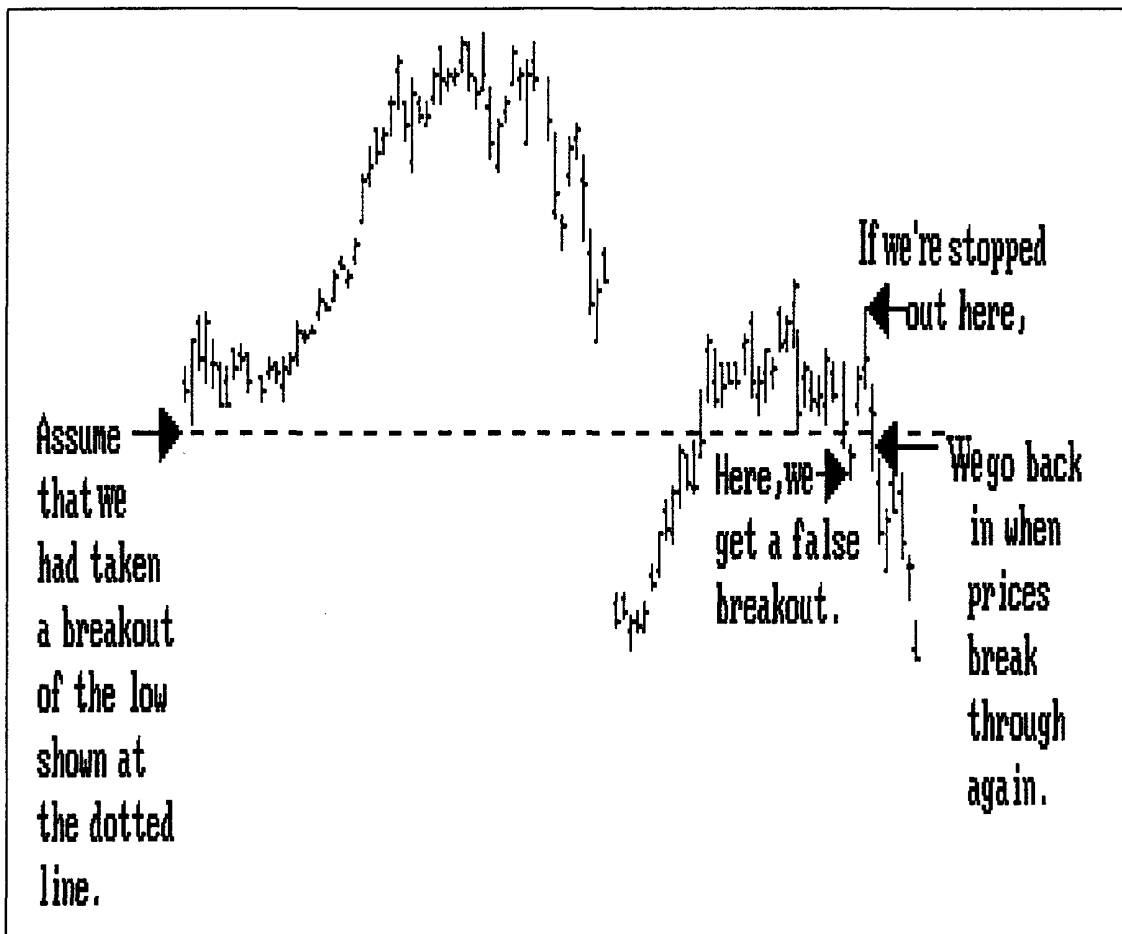




Note that prices must again congest at or <u>about</u> the same level as they did on a previous day. THE PREVIOUS MATCHING CONGESTION COULD HAVE TAKEN PLACE UP TO THREE DAYS AGO.

There is one other way we trade after a gap open (TRY THIS, IT WORKS GREAT). It is if prices gap open, then retrace through a prior trading range, and then break out in the direction of the open.





Now, what do we do about false breakouts?

FIRST BREAK VERSUS SECOND BREAK

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

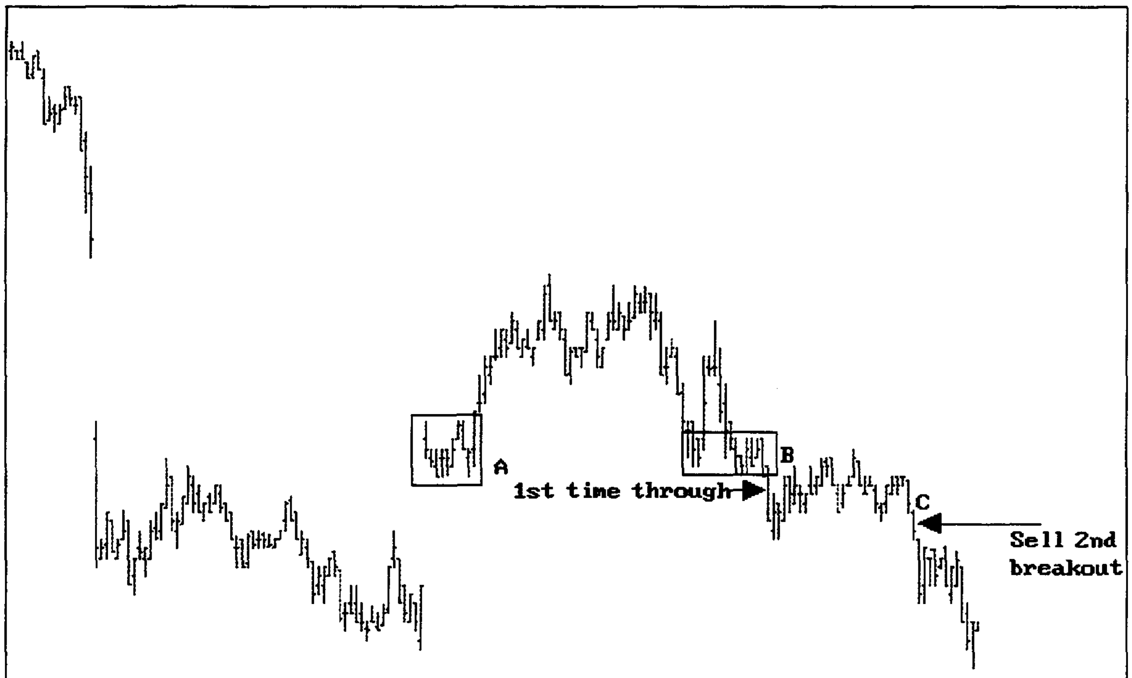
There is a more conservative way to trade these breakouts of congestion that take place prior to the actual breakout which is based upon the entry signal. Let's make that more clear.

We may be about to take a trade based upon a breakout of the congestion we anticipate will be a breakout that will fulfill the requirements of one of our entry signals.

For instance, a market may be just about ready to take out the high of a trading range. We are looking for a congestion just prior to such a breakout.

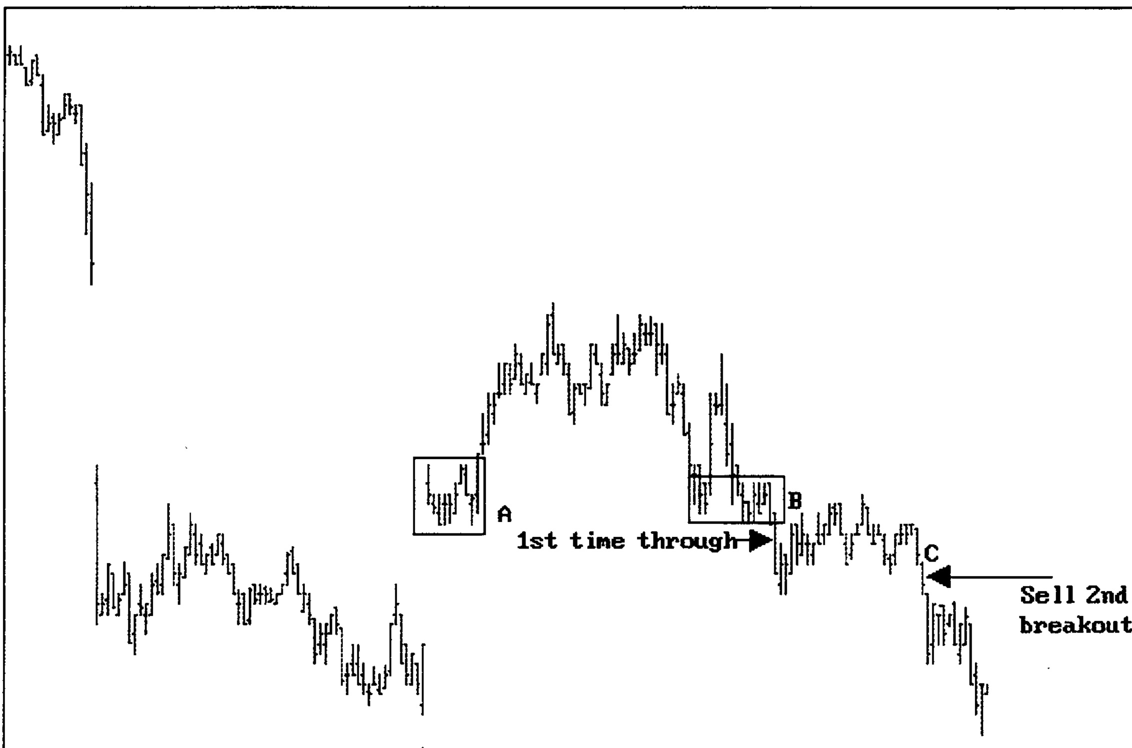
AN EVEN MORE CONSERVATIVE APPROACH IS TO TAKE A BREAKOUT OF THE EXTREME OF THE FIRST TIME THROUGH. BY DOING SO, SOME GOOD TRADES WILL BE MISSED. BUT ALSO, A LOT OF SHORTER TERM FALL-BACKS WILL BE MISSED.

Let's illustrate this concept. In part it is a matter of perception.



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

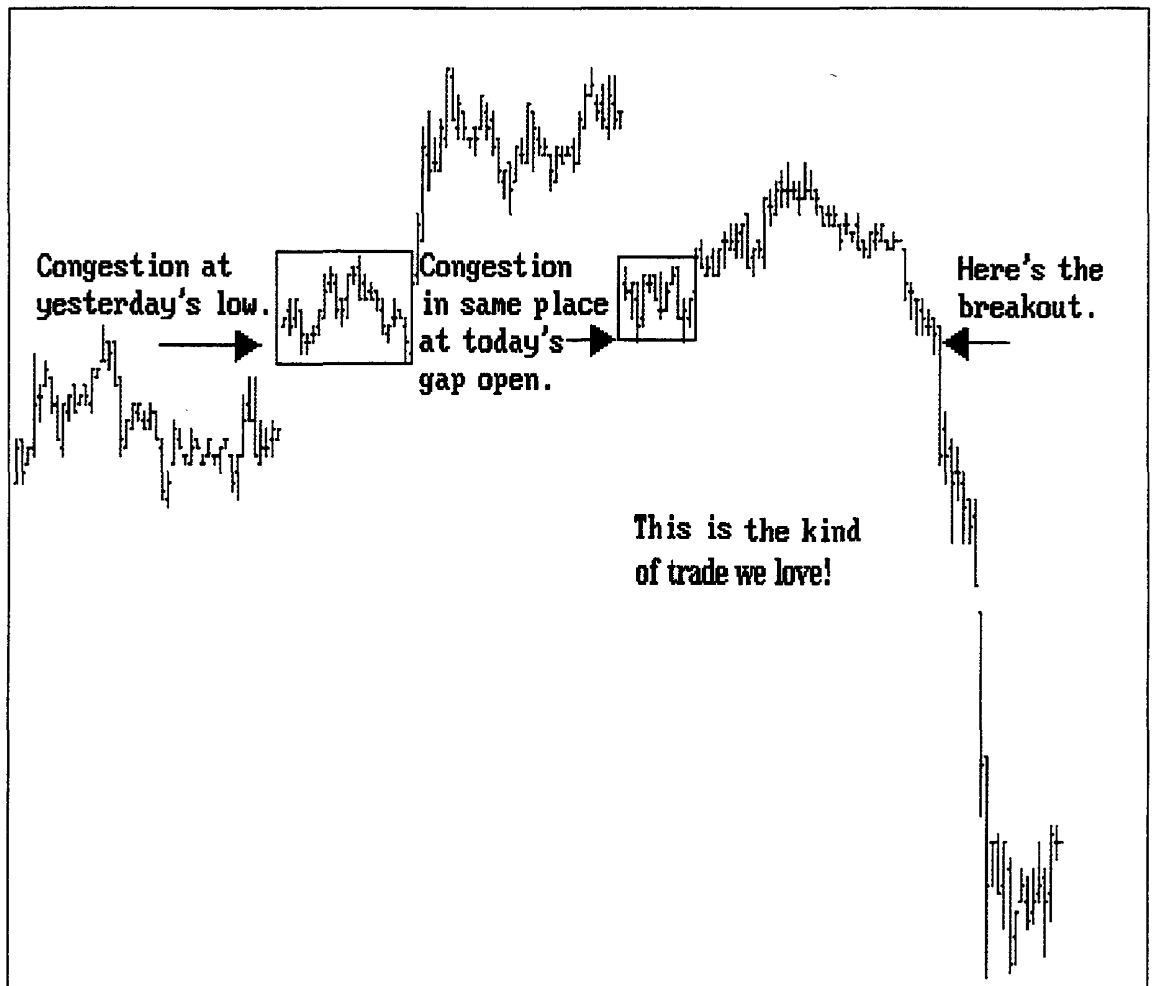
On the foreshortened (we removed some of the price bars in the middle) price chart we've shown, prices congested around the low of the previous day at point A, and then congested there again after the open on the day shown at point B. When prices broke through the congestion lows a short position might have made costs and a profit on our first liquidation, and maybe more for the second set of shares liquidated. Then a rally back would have taken out the break-even stop and the trade would have been over.



However, had we waited for the second breakout shown at point C, the results would have been more spectacular. Sometimes there is no rally back and the trade is entirely missed. But when there is a rally back, and then a second penetration of the congestion area, the chances are higher for making profits.

Trading a breakout of the extreme of the first time through is part and parcel of our minor entry signal, and so the last example was a perfect lead in for the next topic.

But before we get fully into it, we've just got to show this absolutely picture perfect trade in some hi-tech shares.


Congestion at yesterday's low.
Congestion in same place at today's gap open.
Here's the breakout.
This is the kind of trade we love!

Chapter 25

ANOTHER LOOK AT THE MINOR ENTRY SIGNAL

We mentioned the minor entry signal in an earlier chapter. Let's repeat the signal, and then we can go on to show how a bit more about it.

MINOR ENTRY SIGNALS

The minor entry signal is as follows.

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

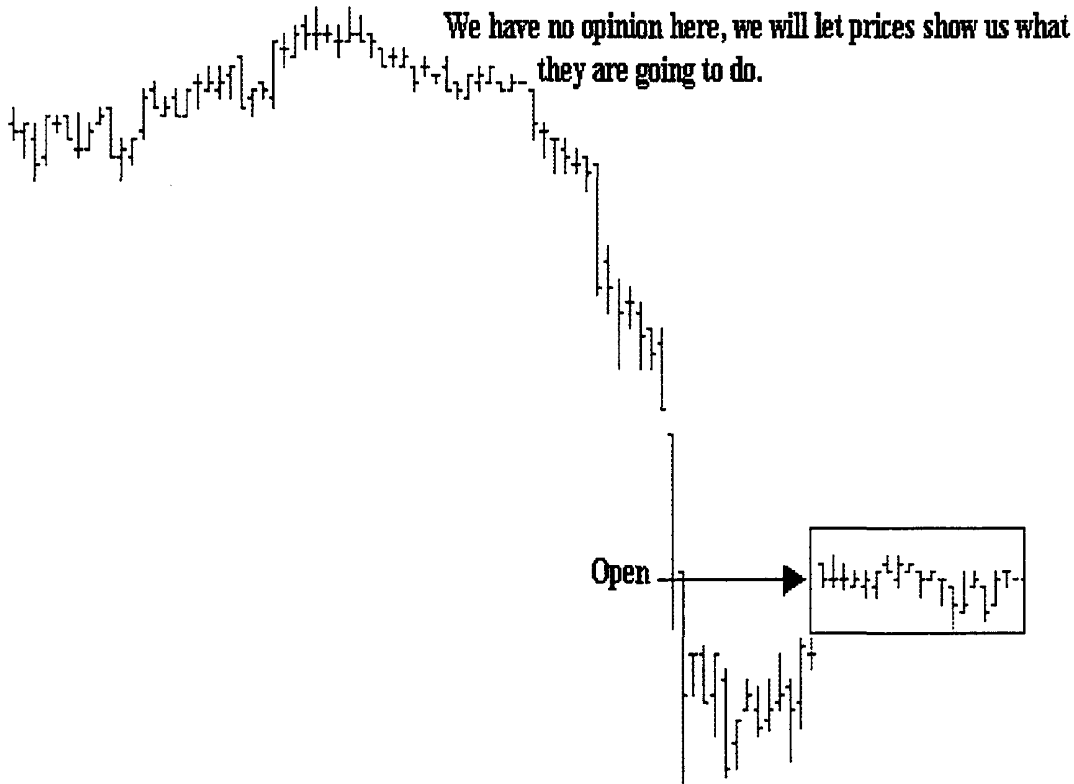
There is a matter of choice here — we can take either the first or the second breakout of this congestion. The second breakout is the more conservative of the two methods, but as with a higher priority signal, the second breakout, while safer, can result in missing the entire move.

An even more conservative approach is to take a breakout of the extreme of the first time through. By doing so, some good trades will be missed. but also, a lot of shorter term fall-backs will be missed.

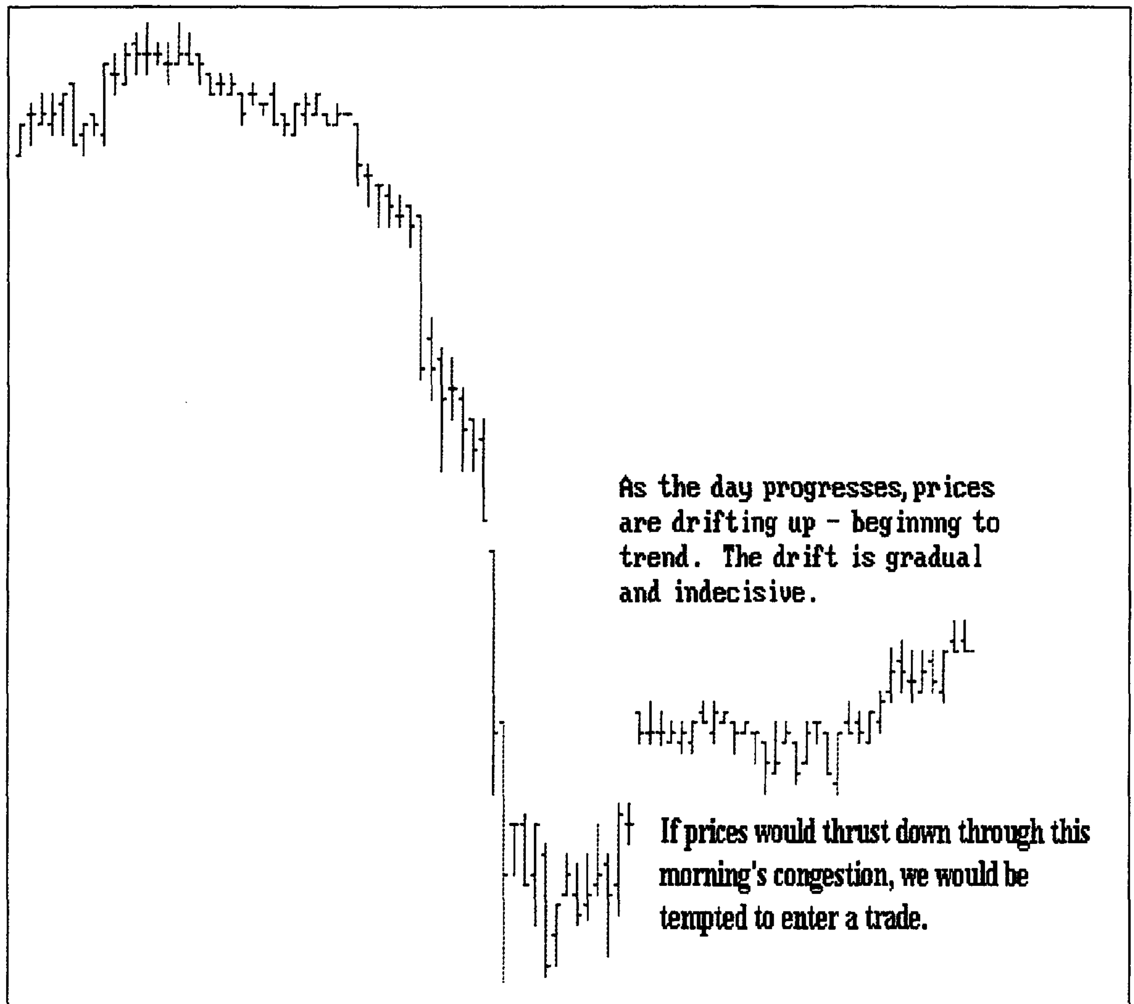
We have a tendency to take the first breakout if the congestion proves to be very long and meandering in length but then becomes very tight. Otherwise, we prefer a second breakout.

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

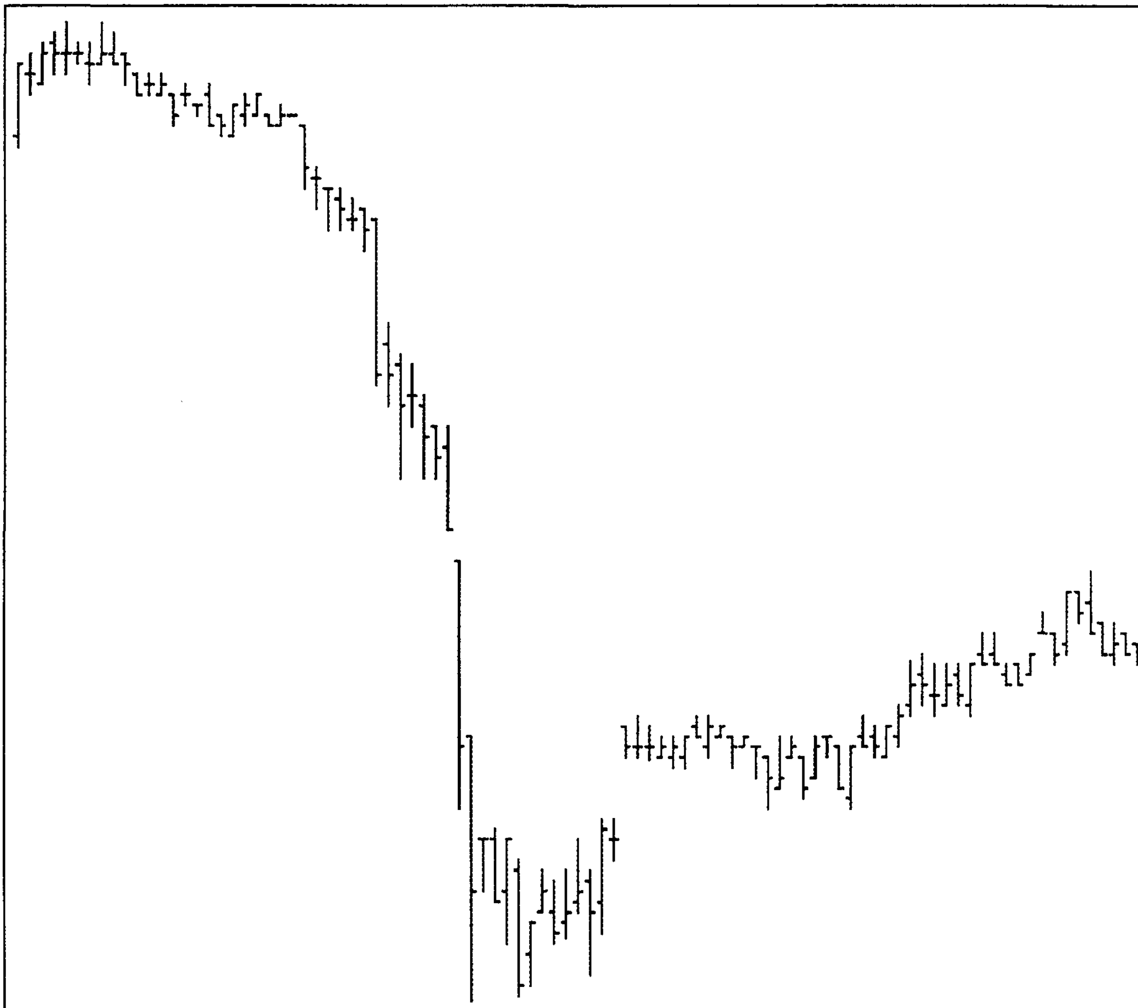
When the first congestion is coincident with a more major signal, then it is traded as such. Otherwise, it is traded on its own merit. Just such a congestion is shown on the following page.



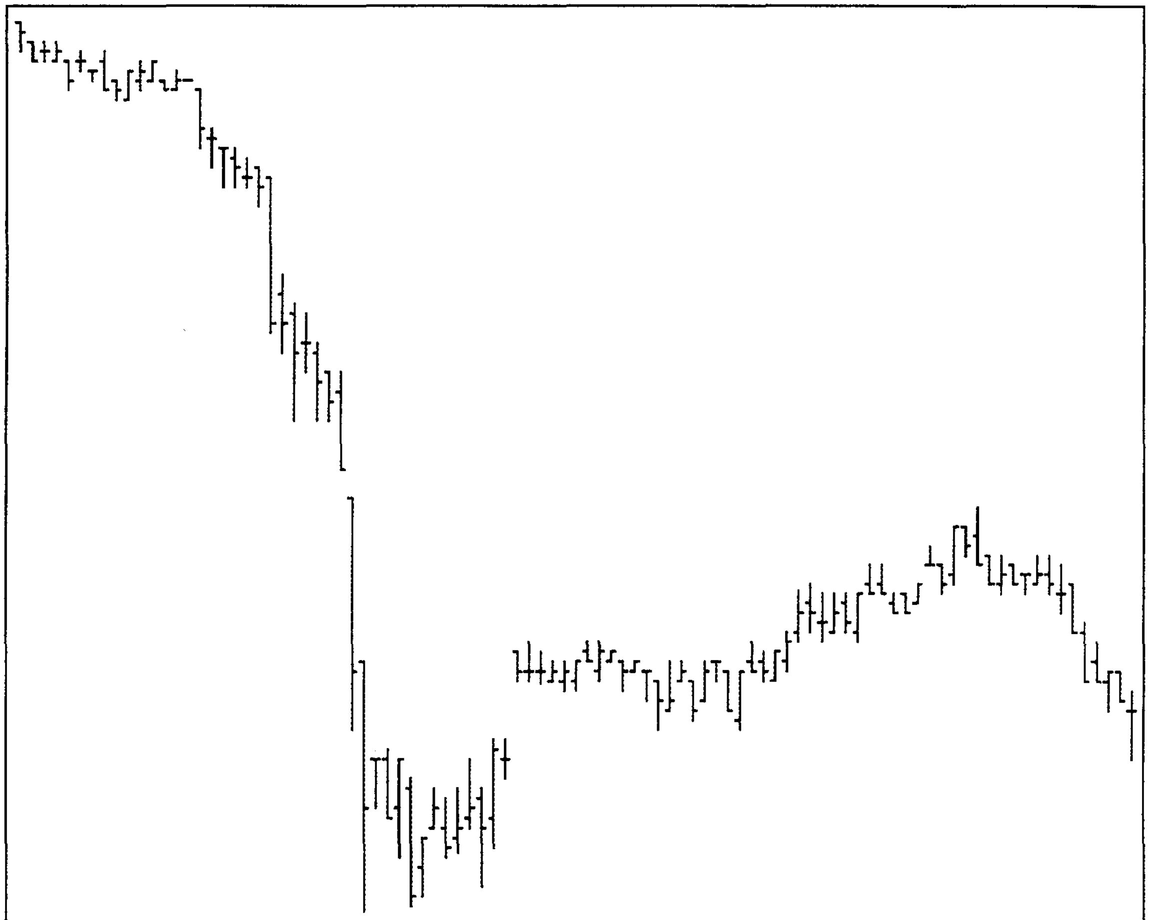
As is plainly evident, nothing has happened yet. There is merely a congestion taking place. It is not the congestion nearest to the low, because that one is below the present one. At this point, we don't have a clue as to which way, if any, it will break out. It may just meander along sideways for the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



As can be seen, nothing much has happened. We're looking for thrust and haven't seen it yet. However, prices did do as anticipated earlier. They pulled upward. Such price action is quite common when a market mover is trying to take prices upward, ahead of a downward thrust. We quite often see this sort of move. Had prices trended upward the previous day, we might see just the opposite with the market mover pushing prices downward ahead of an upward thrust. In the case above, it is to the market mover's benefit to begin his selling from higher prices. In fact, it may be the market mover's own buying that begins the upward move in prices. Once prices are sufficiently high, he may sell three or more times as many shares as he purchased when he caused the market to move up.

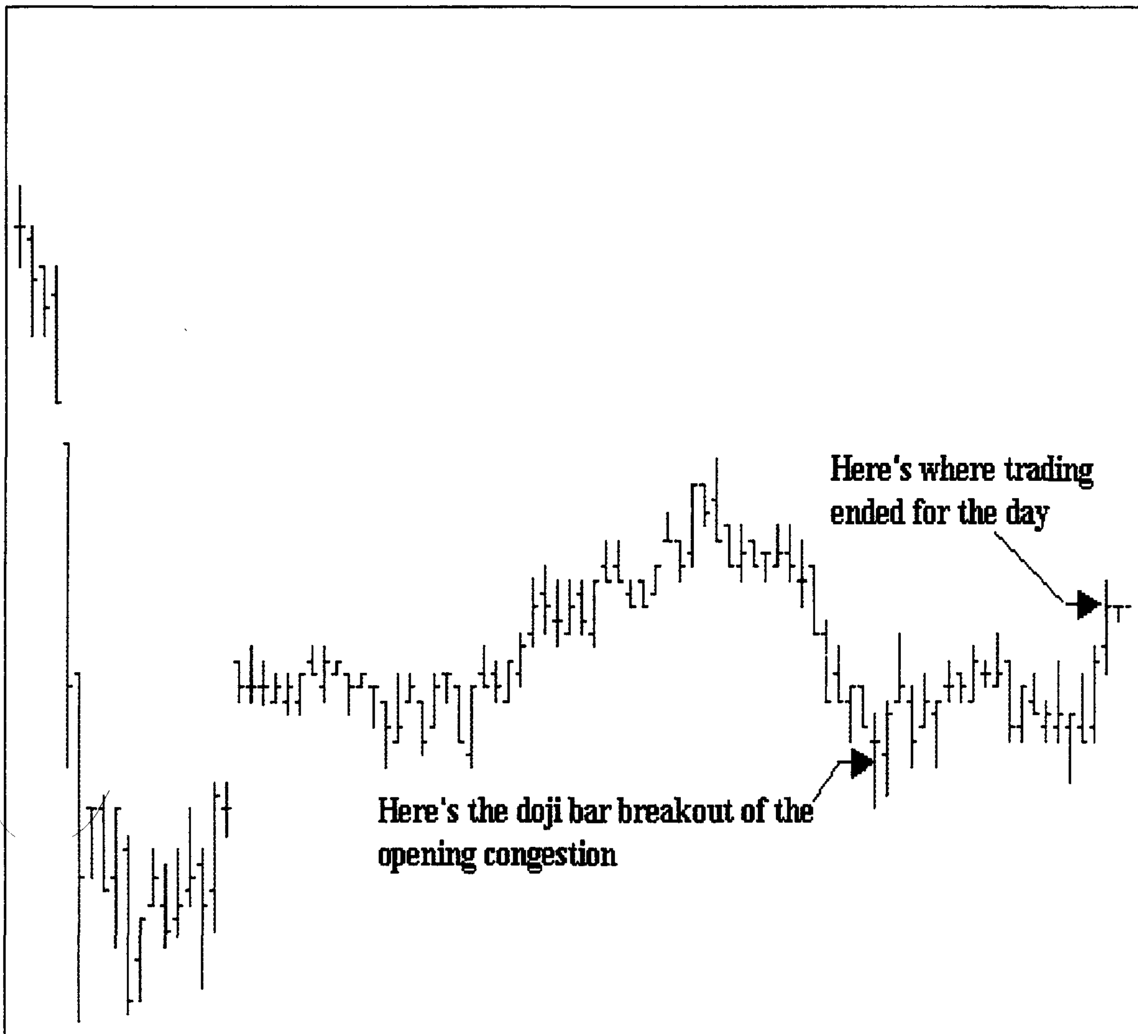


As prices progress throughout the day, they seem to have finally risen to a point where if a market mover were to short the market, he would be able to pick off the sell orders of all the shorts below where prices currently are, plus the sell orders of anyone who might have placed their shorts below yesterday's low. Think for a moment. Had you gone long this market at yesterday's low, where would you have placed your stop? The stop may be protecting loss or profit, but isn't it logical that some traders have placed sell orders below both today's and yesterday's lows? A market mover, seeing those orders, can pick up a nice profit by selling at the current high and running the sell stops below.



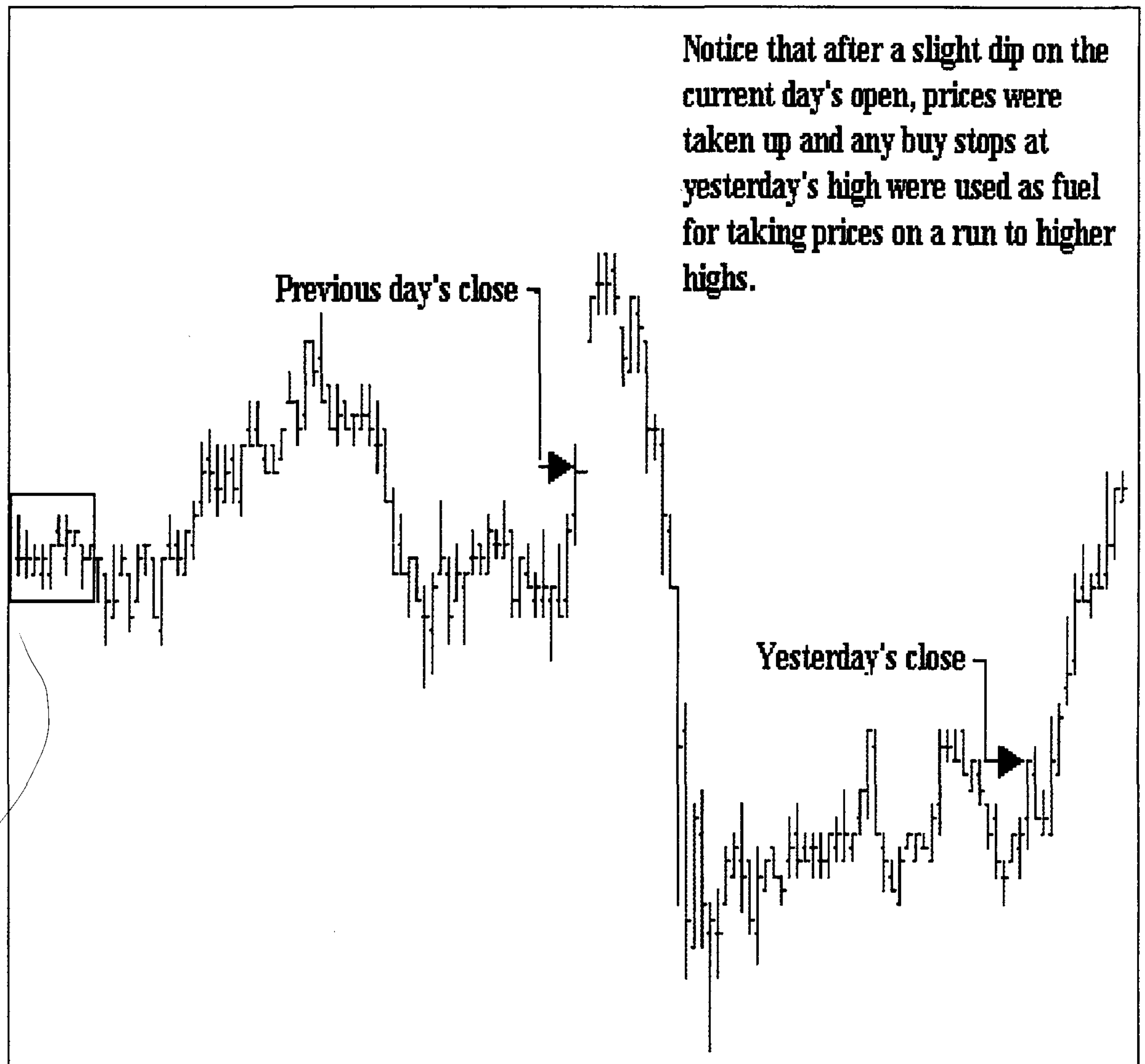
It looks as if the anticipated downward thrust finally came. Notice the open and close of that last bar. It is significant. Prices opened in the upper part of the bar. They also closed where they opened (a doji bar). Buying overcame selling at the point where the sell orders at the intraday low were scooped up. Could the buying possibly have been that of a market mover? We believe it was, and that, for the present at least, the down move is over. But what about the traders who shorted the market as prices moved down? At this point, it is a toss up as to whether prices will move down to take out yesterday's low, or whether they will move back up to take out the buy orders that are accumulating above the intraday high and all along the length of the move downward. Again, think! Had you gotten short, where would you have tried to protect against an outright loss, or a loss of profits?

Here's how the day ended!



When you are trading, you must keep in mind that because the market makers are able to buy at the bid and sell at the offer, and also because they are able to do thousands of shares at a time, they do not need to make very many ticks in price to realize superb profits. They can make money at much lower cost than a trader sitting at a computer terminal.

Let's look at what happened the next day.



The concept being presented here is an introduction as to how the market makers and market movers operate. We must realize that these participants are there to make money. And that, although supply and demand rule the market overall, as far as short term moves are concerned, these people do not have to worry about supply and demand for a stock. All they have to know is where they can buy when they need to buy, and where they can sell when they need to sell, in order to scalp a few ticks out of the market.

Chapter 26

TRADING LOGIC

There is a definite logic and reasoning behind the way we will trade. We'll explain it in this chapter. Perhaps by knowing why we do what we do, it will be possible to emulate what it is we're doing.

At the very outset of the course, we mentioned that the most fundamental concept that would be shown is how to recognize what a chart looks like just prior to an important breakout. In the next chapter, we're going to look at numerous examples of that as a sort of review of the trading methods we've been looking at so far. But first let's go into some of the reality that faces us as traders.

FACING REALITY

PHYSICAL REALITIES

As a trader sitting in front of a screen, you have certain disadvantages. If you are trading electronically where you may have to pay the spread, having to do so is a disadvantage. If you're trading electronically where you are not guaranteed a fill, you are at a disadvantage. If you're trading electronically where you have to abide by certain exchange regulations to which the market maker or specialist are not subject, you're at a disadvantage. Somehow you have to overcome the obstacles that you face that are not faced by the market maker or specialist.

There are other things which can work against you as well.

TACTICAL REALITIES

In his book THE SOES BANDIT'S GUIDE, Harvey I. Houtkin wrote the following information. We've altered it slightly to better fit the context of this course:

"What separates the men from the boys in the trading arena? Why do some people do well while others do extremely well? Some say

it's instinct, others say focus and still others luck. I say it is all of the above but that skill is most important. The skill that develops upon being able to read the ticker tape and really understand what it is telling you.

"The changing numbers alone do not tell the whole story. While you might think you have identified a trend by seeing many price changes in a particular stock, the highly skilled trader might see an entirely different scenario. The experienced, skilled trader is familiar with not only identifying price movements, but is also very knowledgeable about 'who' is making those price movements. Distinguishing between the multitude of market makers who change their prices and analyzing what the changes mean is a skill that separates the men from the boys (and women from girls).

"All market makers are not created equal. As the trader soon learns, being able to differentiate between the significant market makers and the market makers who just go along for the ride is a skill that must be developed. The fact is that most market makers are not very interested in making markets and taking risk. In all too many cases, a market maker is in a particular stock only in the hope of 'catching an order', an order he can trade against. What I mean by 'trading against' is that the market maker will quote a price for a stock based only on the premise that he can turn around and fill an order he already has in hand ***without risk***. If the market maker has a buy order, he can buy stock against that order knowing he can always sell that stock to its buyer ***without risk***. Alternatively, if the market maker has a sell order, he can offer stock 'short' knowing he can buy the stock back from the seller ***without risk***. It's a 'no brainer' and almost always profitable. These market makers have no desire to position stocks (keep an inventory) and are only a factor in a particular stock when they have an order. Their influence is temporary and they very seldom quote the inside market.

"Other market makers, though few in number, are the movers and shakers in the NASDAQ market. These firms usually handle many institutional orders and commit significant capital to the positioning of various stocks. They are many times called the 'Ax' in the stock. If not the Ax, they are at least 'real' market makers. The trader soon learns to respect their movements and pay attention to their actions.

I do not believe there are more than a dozen market making firms that meet this criterion."

While many firms are the Ax in a particular stock from time to time, very few have significant influence on most electronically traded stocks (stocks often traded by traders like you and me) on a continuous basis. Stocks traded by individual small traders tend to be the better capitalized, actively traded, higher priced NASDAQ stocks.

"Who are the market makers? How do they differ? Who exercises power and who runs away? Your ability to answer these questions will ultimately determine how successful you become in your trading career."

Market makers contribute considerably to the problems we have as traders, yet without them there might be no trading at all! What we must do is to learn to get around them and to compensate for the disadvantages we face as traders.

We've already shown some of the things that market makers and market movers do. Because they are able to singly or even jointly move prices, they are able to move prices up when their real intention is to take prices down. They are able to move prices down when their real intention is to take prices up.

They are able to generate sufficient momentum in the price action to cause prices to reach the order accumulations they can clearly discern to be above and below the current price action. As stated previously, this type of engineering has nothing whatsoever to do with share valuation, supply, or demand. It is pure and simple price manipulation and it gives the market mover, if he is also a market maker, an additional advantage besides the edge he normally enjoys in being able to pay the bid and receive the offer.

IMPORTANT: Picture it in your mind or draw it on a piece of paper. If there are order accumulations (buy stops) above the current price action, and those able to generate momentum are aware of the buy orders, if they buy heavily at the current lower prices, the market will usually go up. When it is time for them to liquidate, they will have

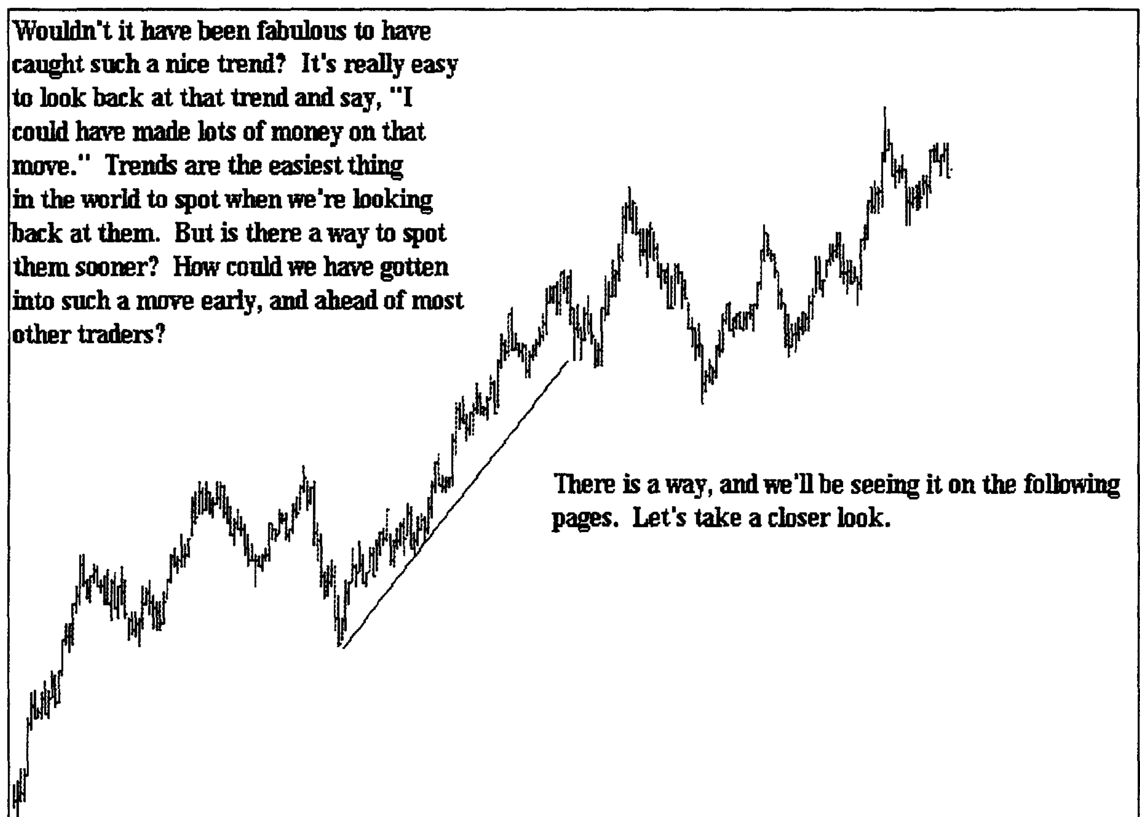
pushed prices to the level where all the buy stops are located. They will be selling, and they will have buy orders sitting there waiting to absorb their selling. Of course, the reverse is true when there are sell order accumulations below the current price action. The market movers know that if they sell at current price levels, they will cause prices to move down to where the sell orders are located, and when they are ready to liquidate their short positions by buying them back, they will have sellers waiting there to sell to them. We must be aware of such tactics and take advantage of them. One of our main jobs as traders is to realize when market movers are gunning for stops. If we can trade along with them, we will benefit from the momentum they generate as they manipulate prices towards those stops (order accumulations). To that end, we must learn to find out when a market is beginning to trend and also discover the market patterns that reveal to us what the market makers and movers are probably up to.

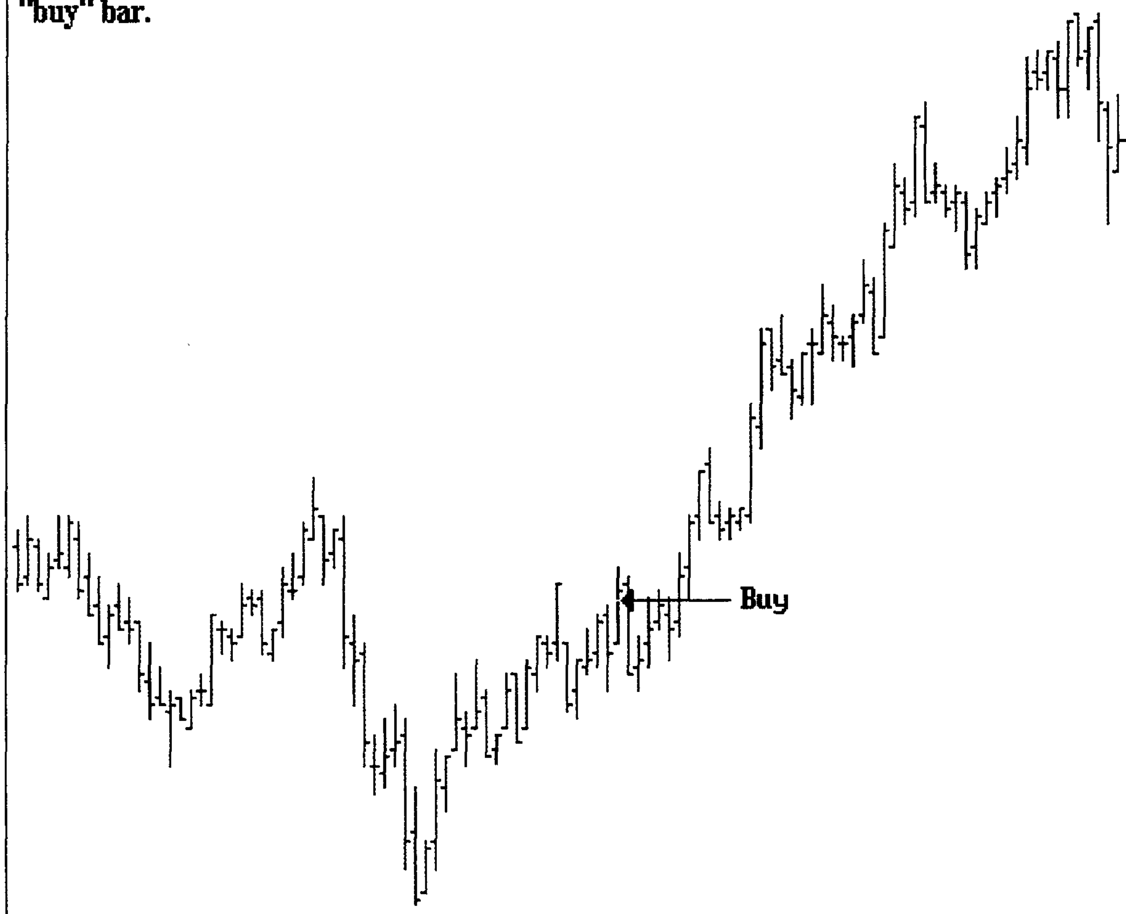
Chapter 27

TREND FINDING — 1

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

Take a good look at the chart on this page.

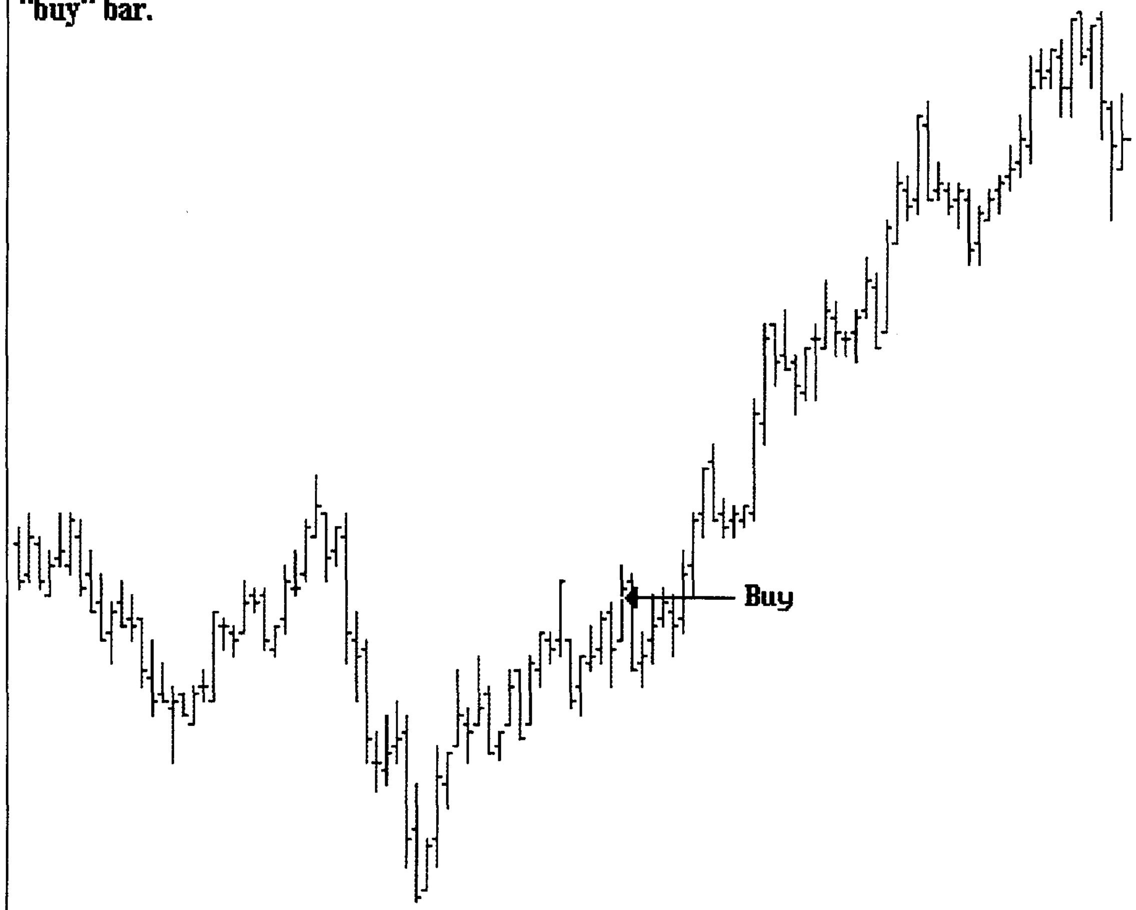




We'll begin with some very simple rules which will apply to an upmove. (For down moves, the same rules will apply in reverse.) We must see three bars in a row of higher highs. When we see them, WE WILL ATTEMPT TO BUY A BREAKOUT OF THE THIRD HIGH PROVIDED THE MARKET CORRECTS ONE OR MORE OF THE BARS BY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

As we see on the chart, our first attempt would have failed. The bar after the "buy" bar makes a lower low, and by virtue of our rules, we

must exit the trade as soon as we see that we have violated a low when prices are supposed to be moving up.



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

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

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

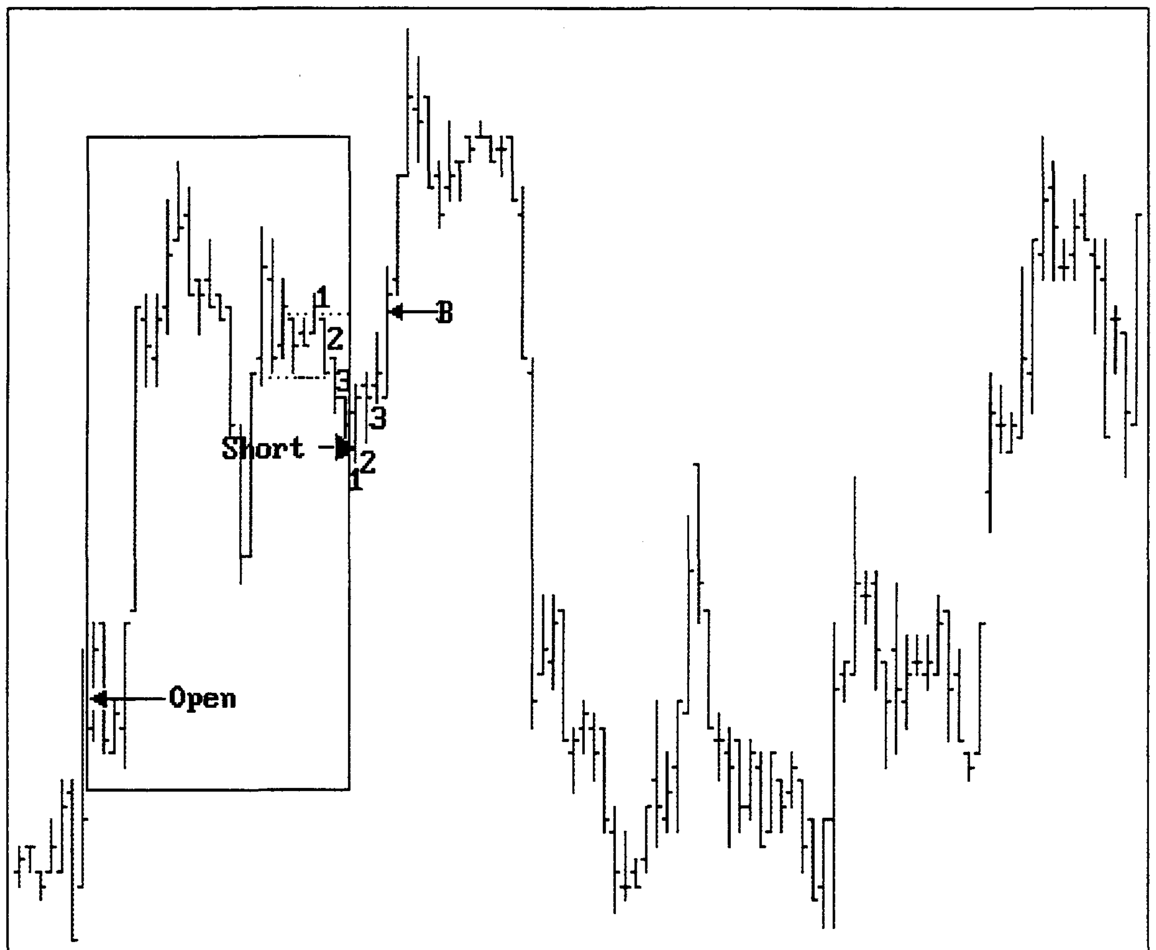
Notice that the trend continued long after any cost covering. Later, we will show two of the best ways to hang onto that trend once we are profitable.

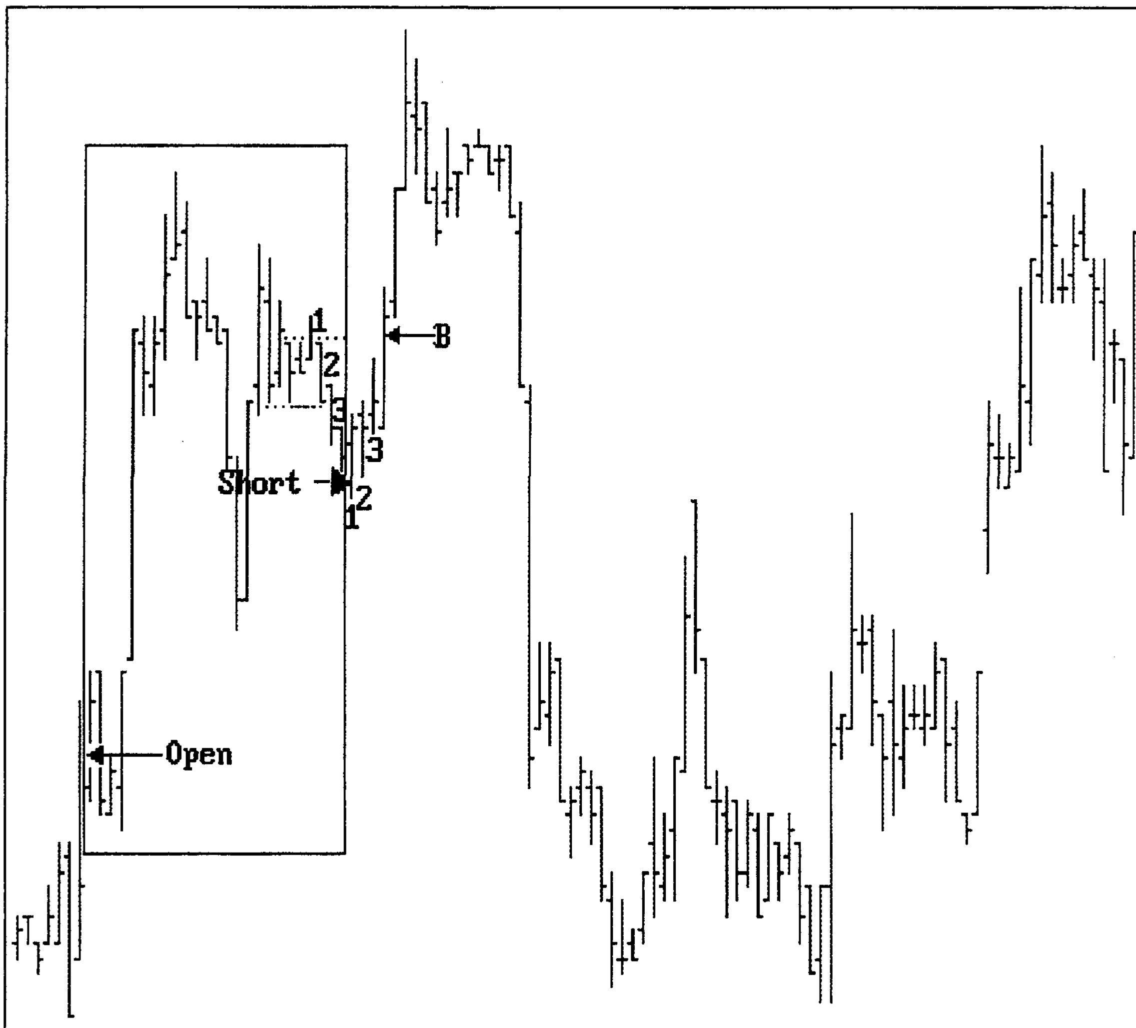
We want to point out that just because we would have to exit the trade on our first entry attempt, we do not walk away with our tail between our legs like some whipped dog. We "stayed in the water" until the trend developed to the point where we could make money. Losing money is part of trading. We have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

Chapter 28

TREND FINDING — 2

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



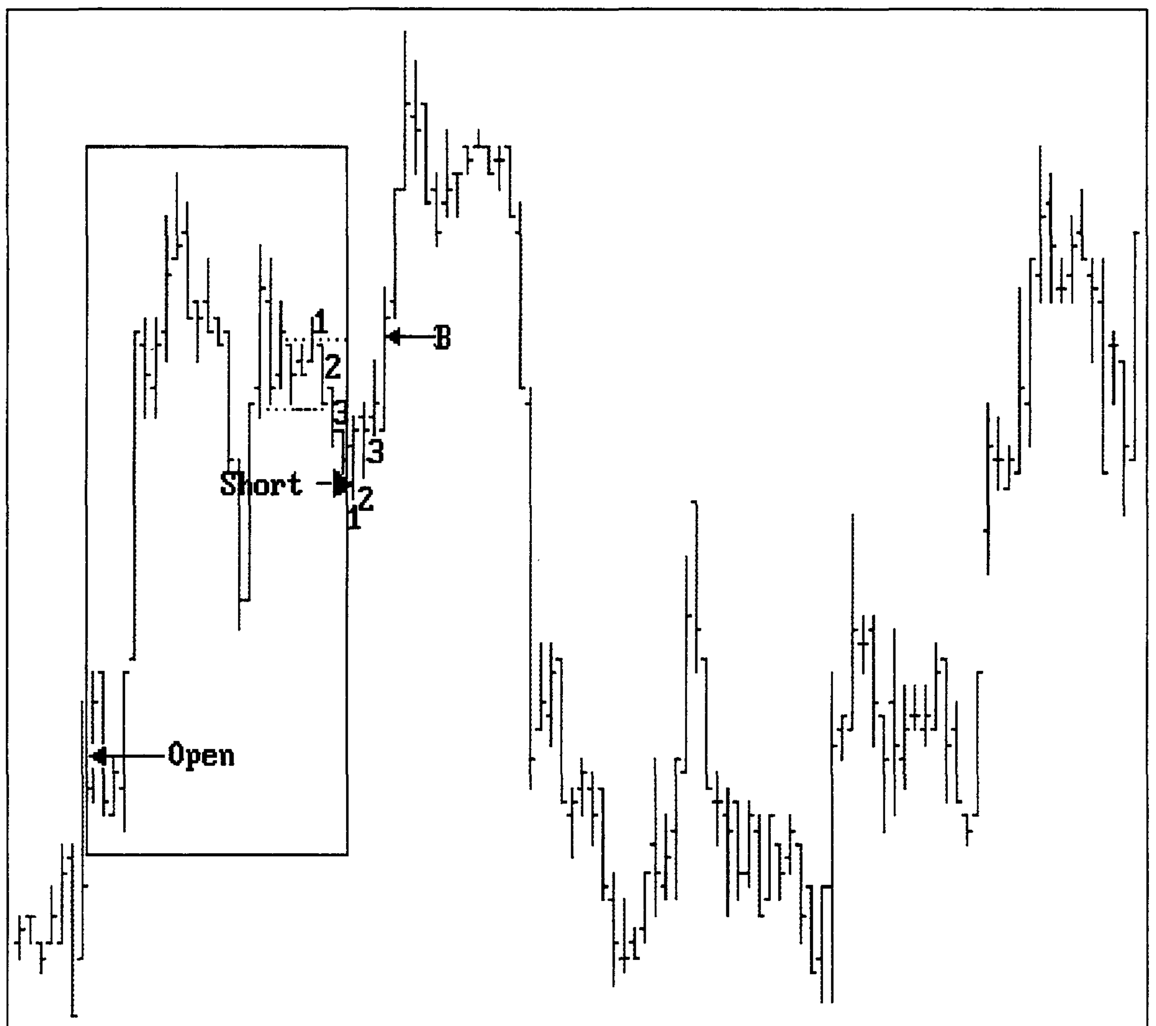


The first 15 minute bar is shown by the arrow at the lower left of the box. From that point until the bar at which we've shown the next arrow, we are never able to count three consecutive new highs, or three consecutive new lows. Therefore, there were no trades possible on that day.

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

We see that the bar at which we go short ends up a reversal bar (open lower, close higher). Prices go almost immediately against us closing one tick above the high of the previous bar. According to our

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



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

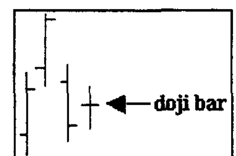
Our next trading opportunity comes when we get confirmation from the simple count in conjunction with a breakout of a 1-2-3 high formation, and are able to go short on the breakout of the #2 point of the 1-2-3 high. We've shown the simple count and the 1-2-3 count on the chart. The 1-2-3 is from TLOC,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

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

DOJI BARS

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

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



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

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

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

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

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

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

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

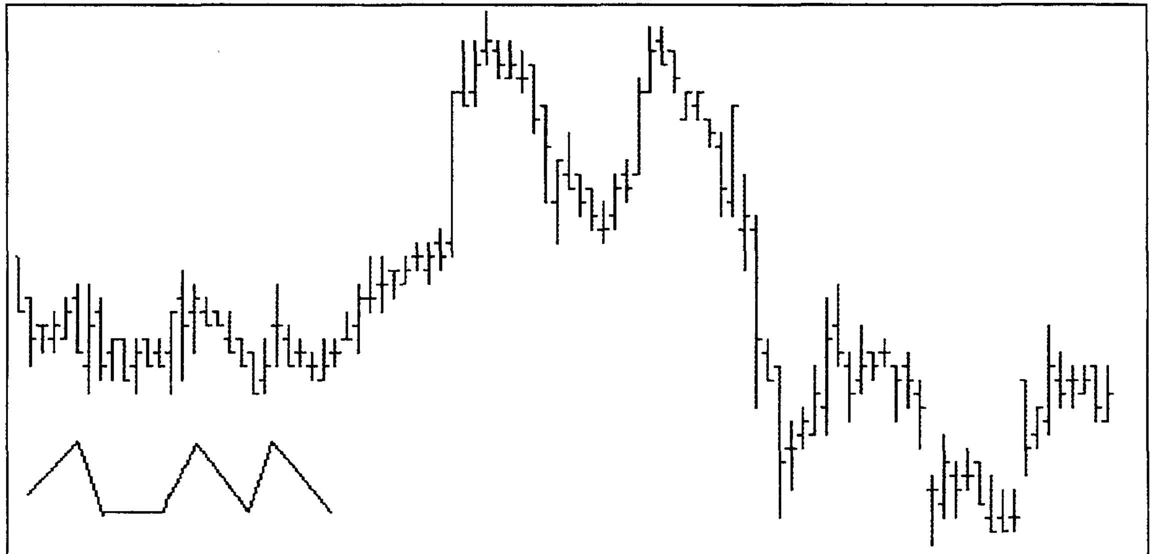
Chapter 29

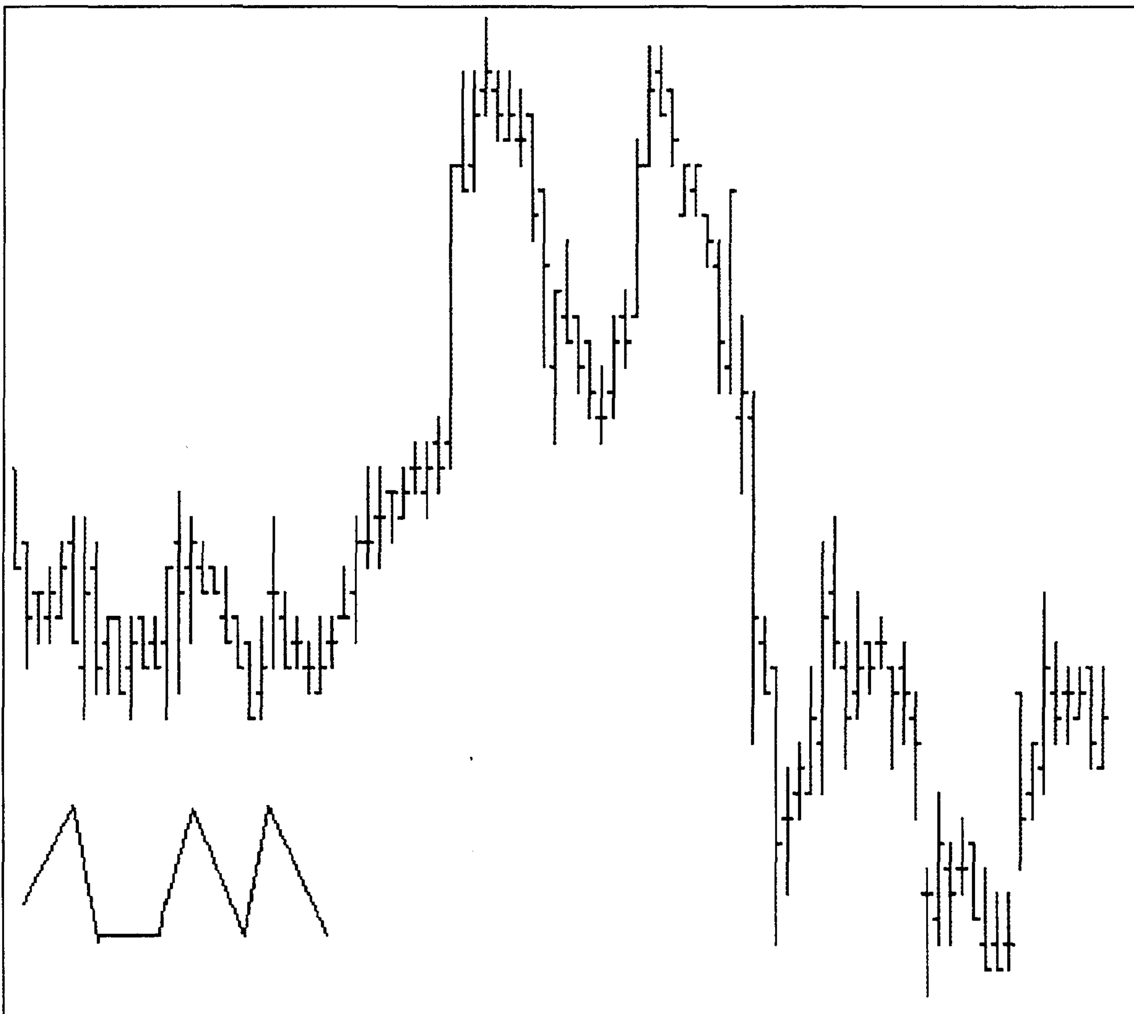
INTERESTING BARS AND FORMATIONS

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

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

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





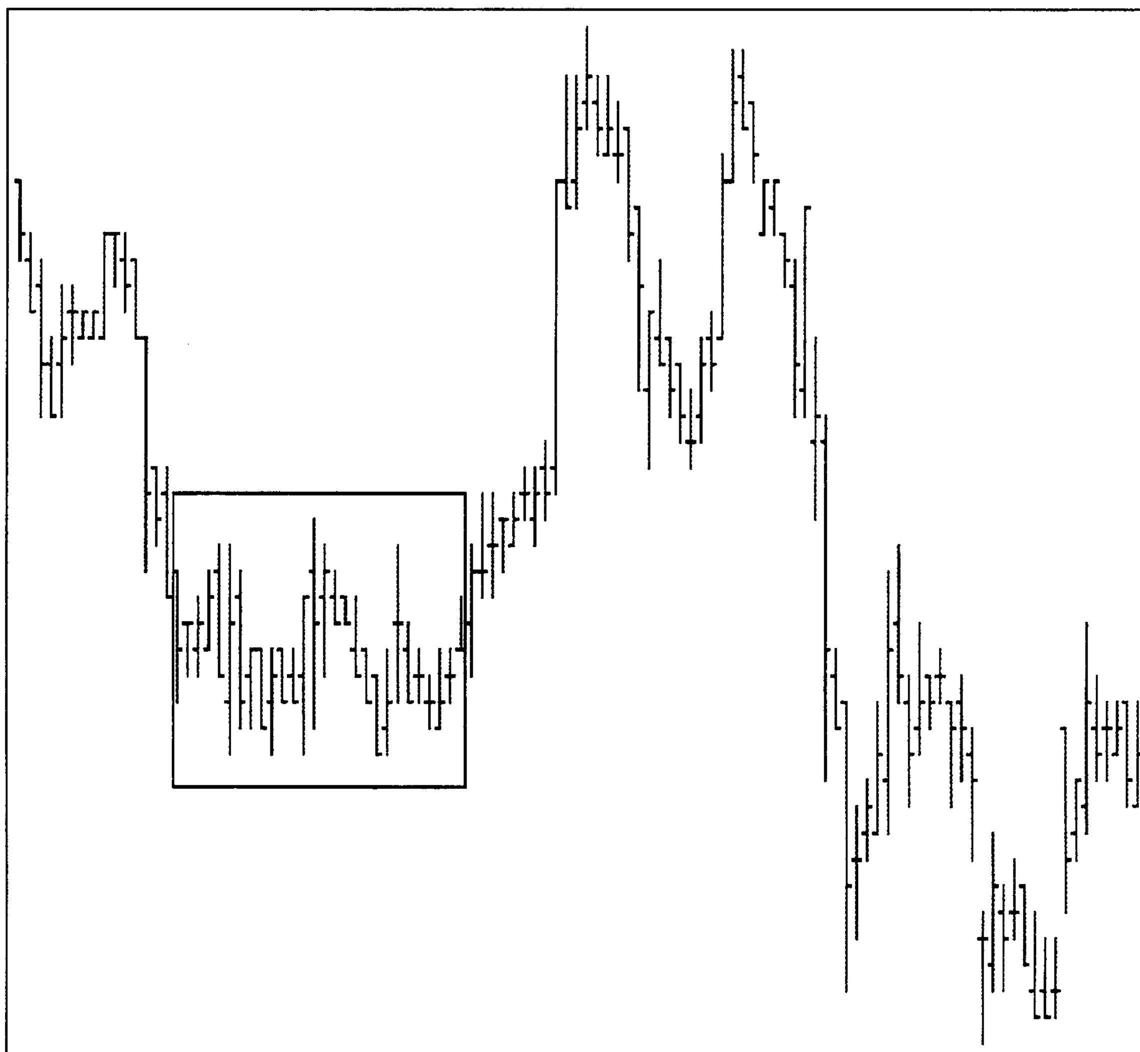
There are a number of ways, and this is a good time to point out at least two of them.

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

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

What we watch for looks like this:

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



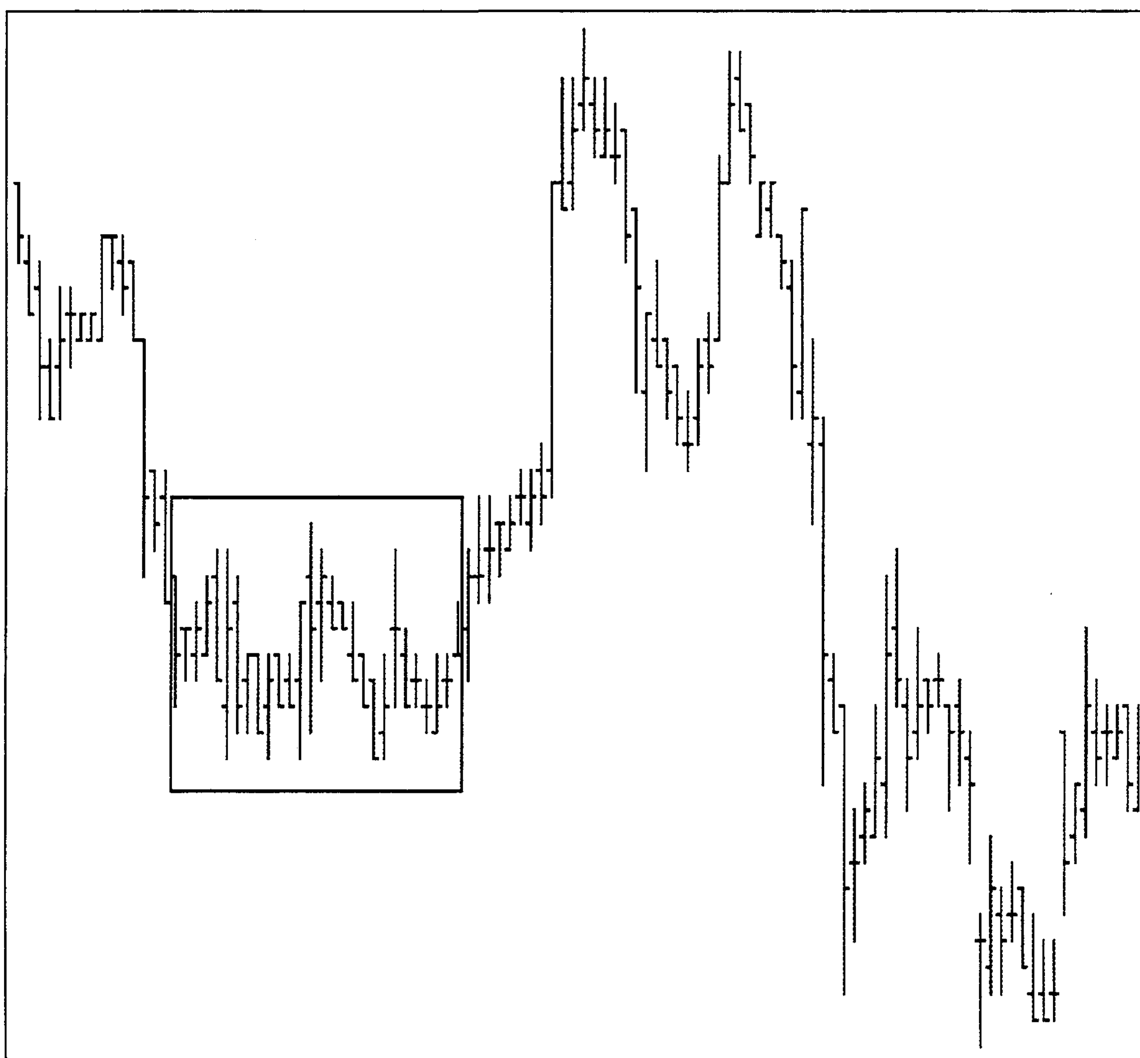
Notice the alternation of "open high-close low", "open low-close high" bars during the congestion period. Intermixed, but more often near either extreme of the congestion area, are dojis. The alternation of bars within a narrow range from top to bottom are a sure sign of congestion.

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

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

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

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



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

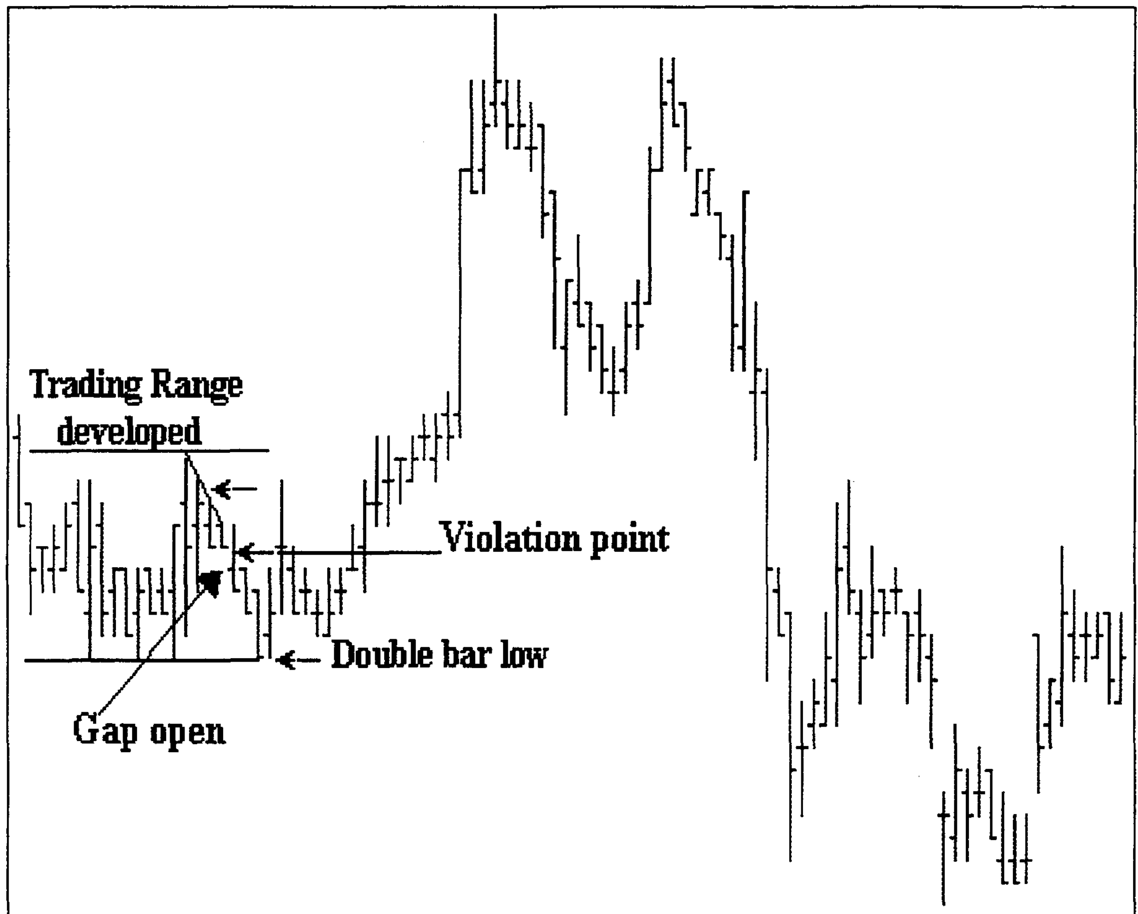
Markets speak. To those who chart, they speak a graphic language. We suggest making part of your life's work the ability to understand what the markets are telling you. By learning to understand the way a market speaks, you can better communicate and get in step with the market. You must learn to patiently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

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

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

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

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



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

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

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

It could also look like this. Even though a lower low was made, the buy would take place. Why? Because with the lower low, we have fulfilled the simple count method!

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

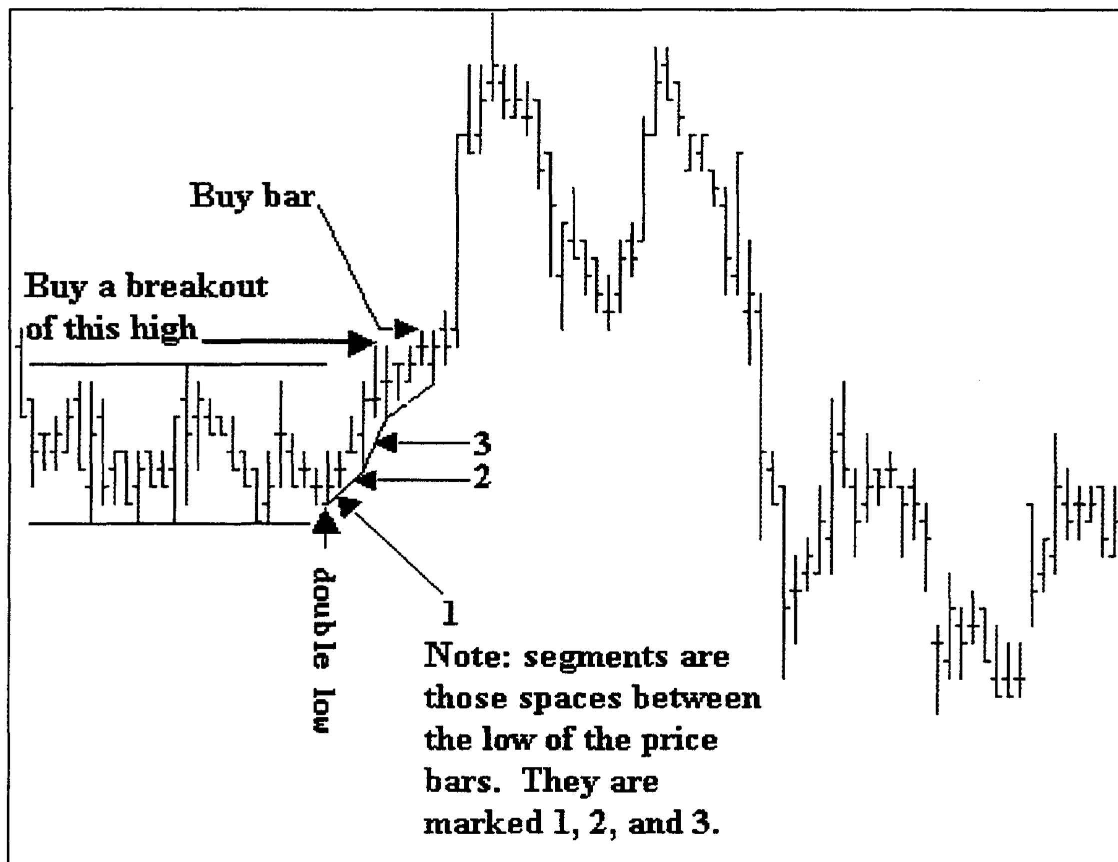
We need yet another technique, and it's called segment counting.

SEGMENT COUNTING

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

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

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



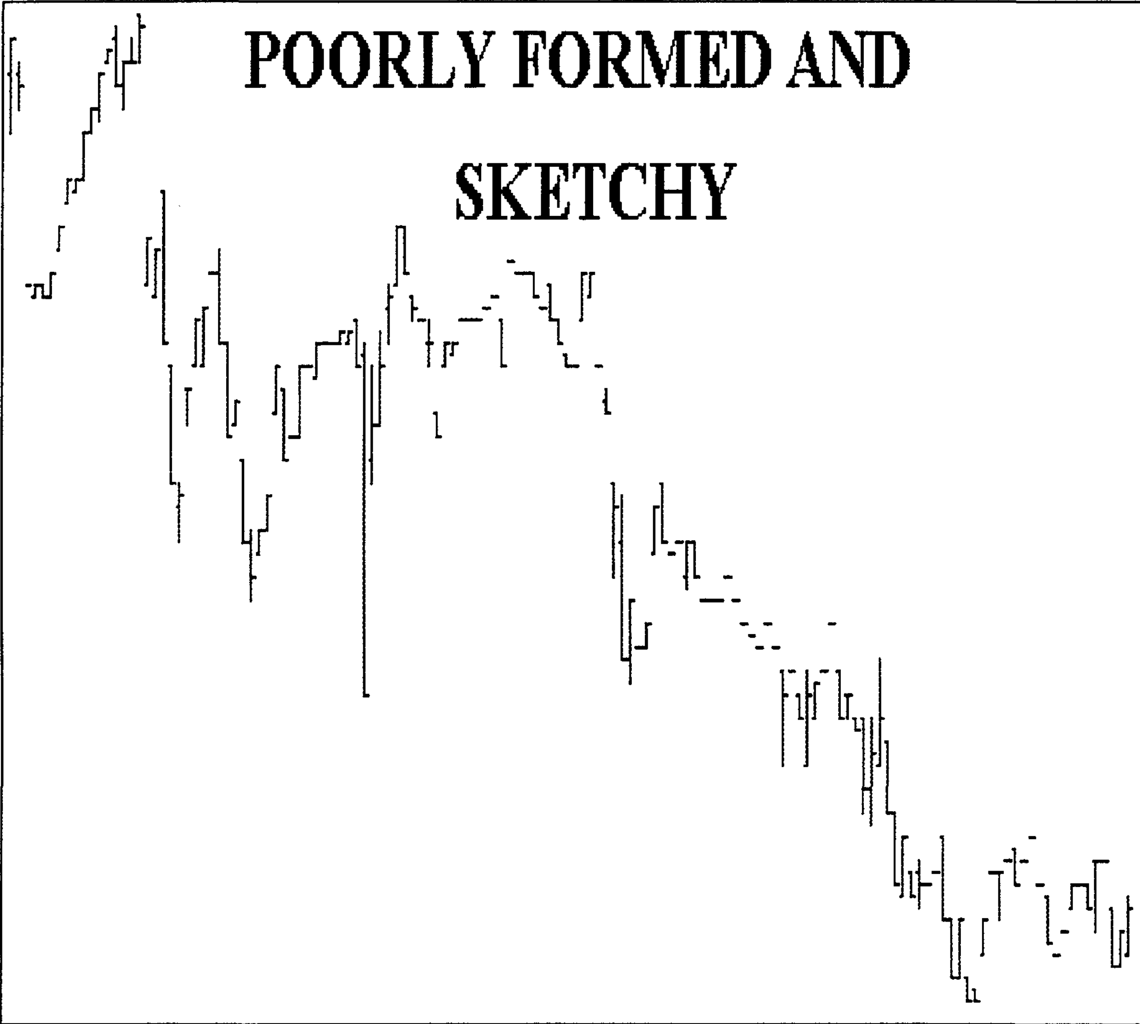
Take a close look at how we've connected the lows on the chart: THE NUMBERED SEGMENTS ARE POSITIONED BETWEEN THE LOWS.

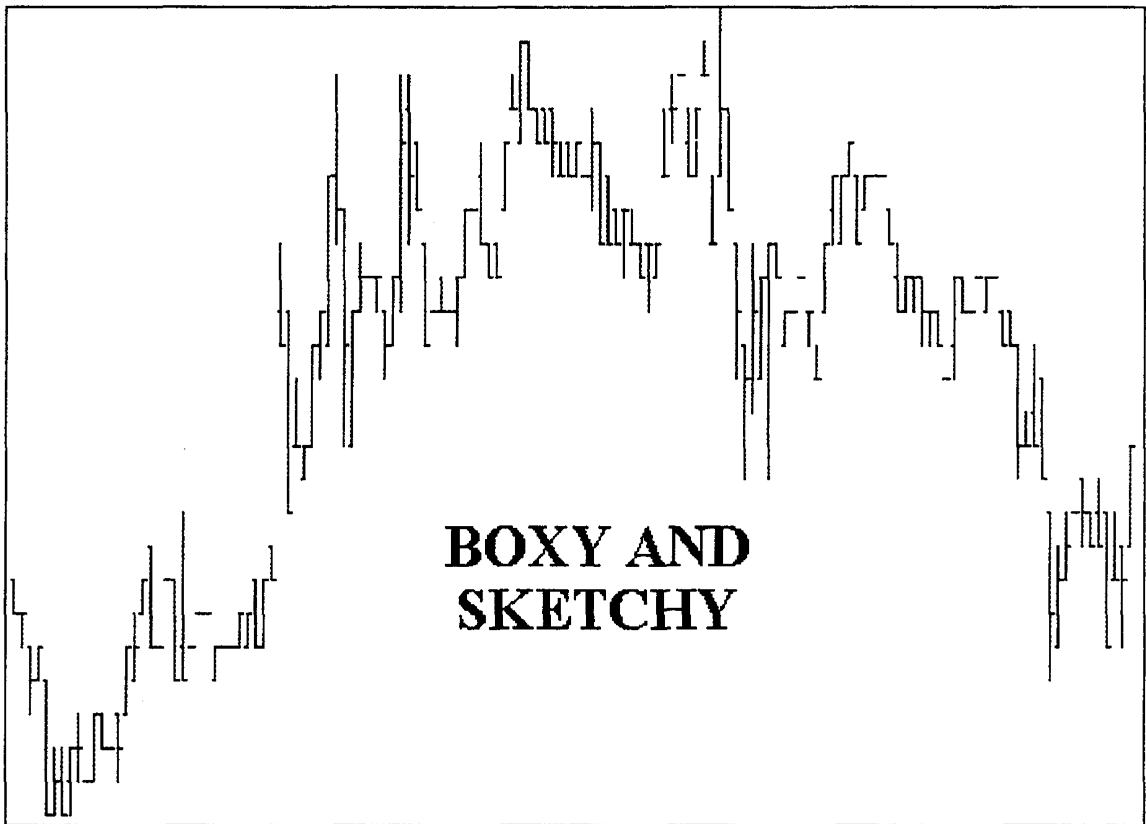
We've connected a low to a second low. We've connected the second low to a correction low, and the correction low to a double low.

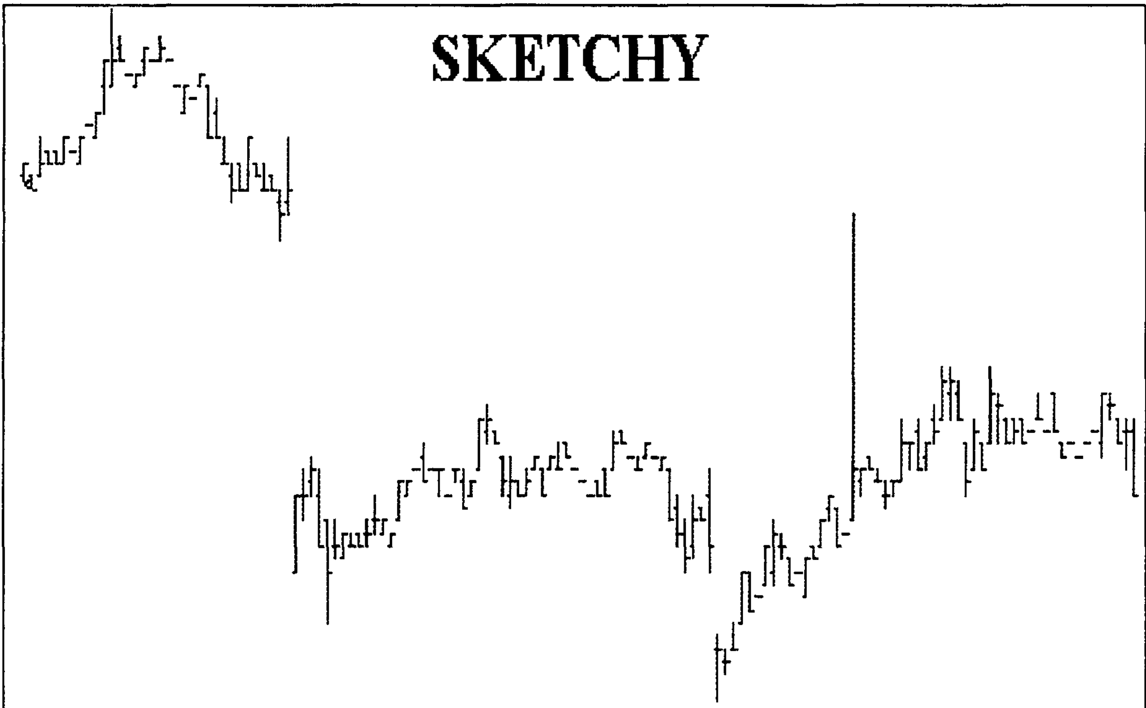
We will buy a breakout of the high of the bar whose low made the third segment.

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

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

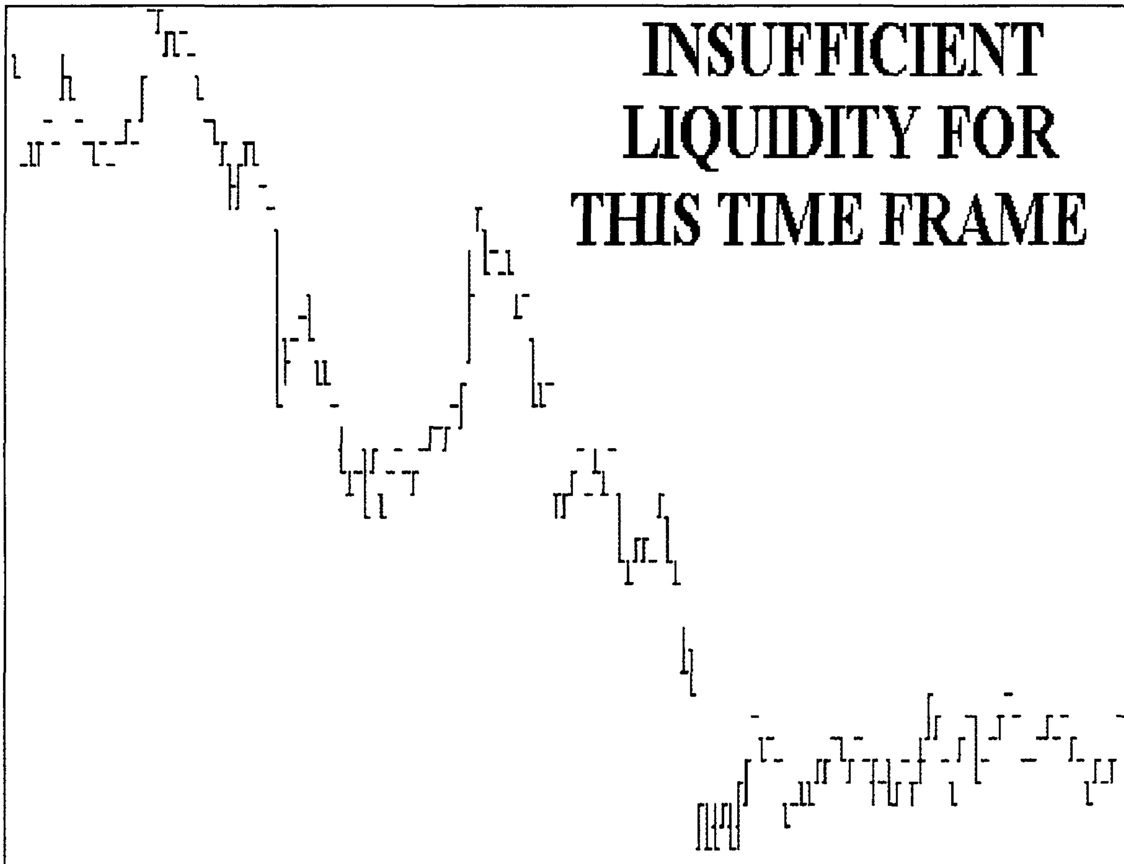

POORLY FORMED AND
SKETCHY


BOXY AND
SKETCHY

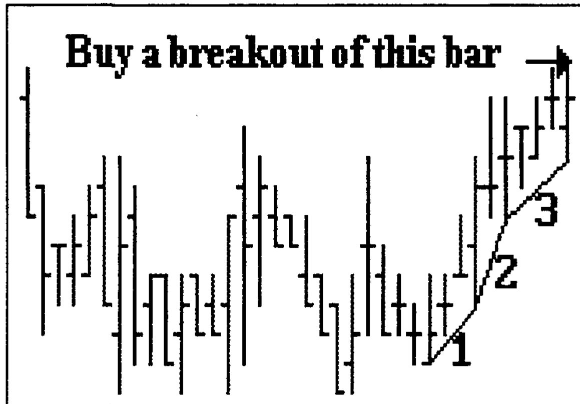

SKETCHY

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

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

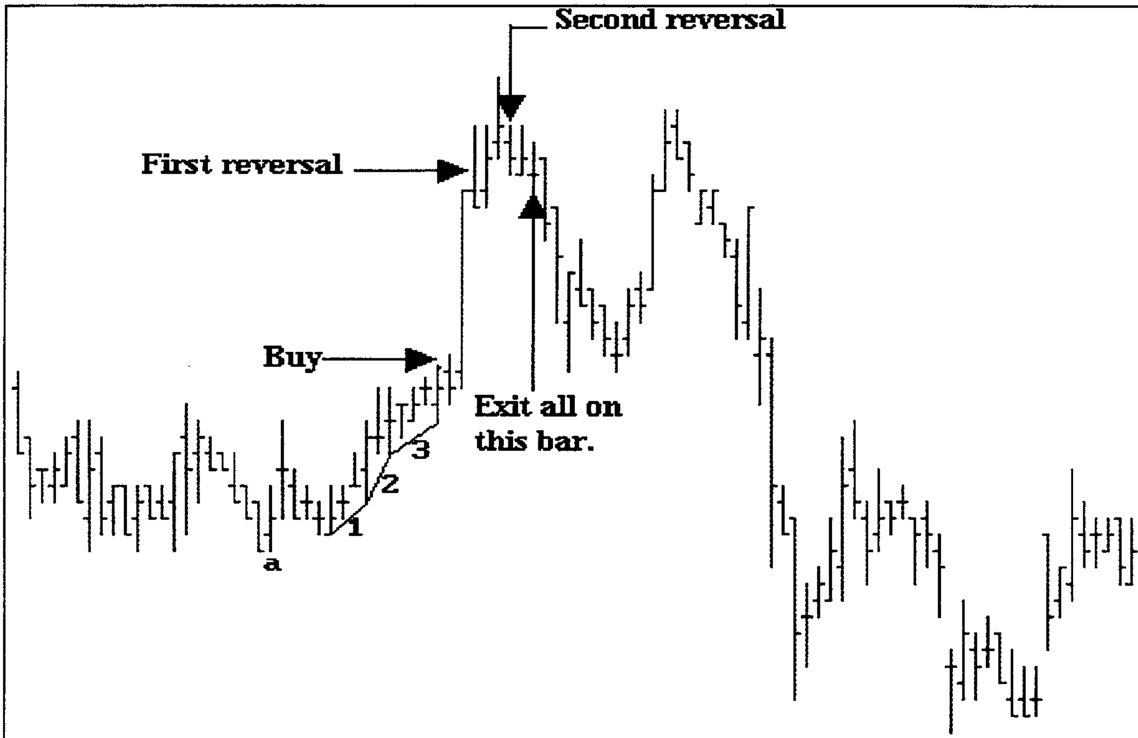


We can now resume our examination of a 30 minute chart. We left off where prices were about to breakout to the upside of a Trading Range. We had a brief look at numbering segments. Each time prices made a lower low than any previous bar since we began counting segments, we connect our last segment to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



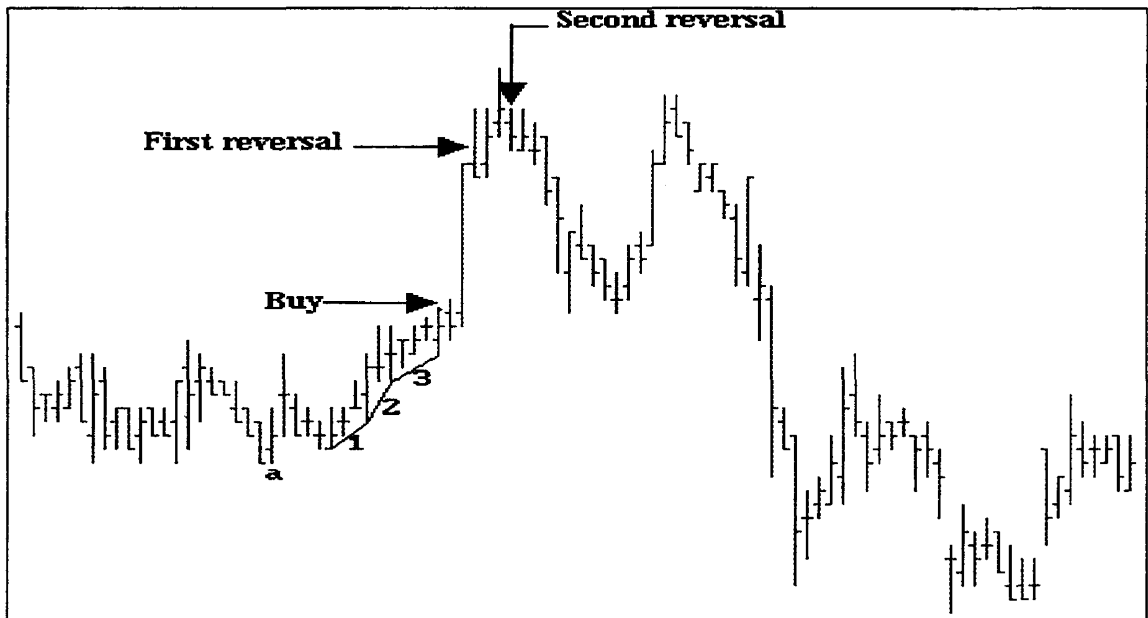
We want to get long based upon a breakout of the high of the price bar whose low completed the third segment drawn on the chart. The third segment was completed because of the correction low.

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



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

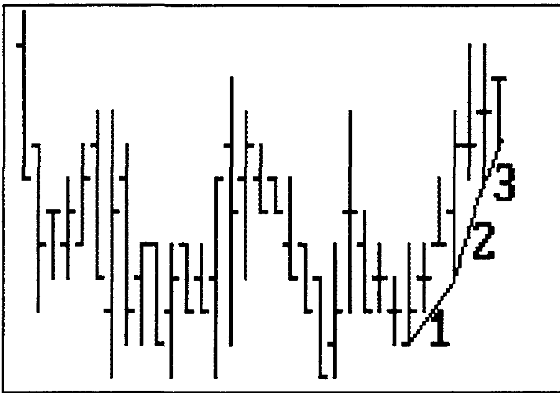
With the violation method you have a choice as to whether or not you would sell the entire position at the time of the violation, a violation being two reversal bars in any series of bars going in a single direction, or the making of a higher high in a down move or a lower low in an upmove.



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

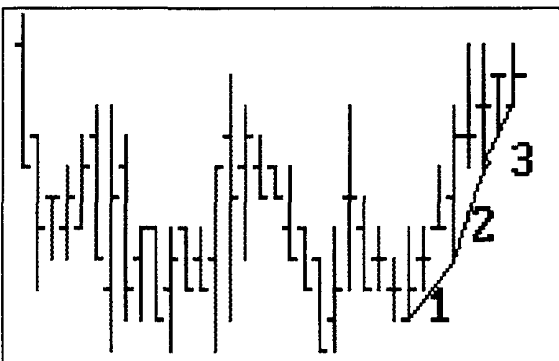
Why didn't we start the segment count a point "a?" The reason is that the market went into congestion by definition of the alternating bars that made the double low at "a," followed by a doji, a reversing bar and then two dojis.

Why didn't we enter a trade earlier, on the breakout of the doji bar that opened and closed at the high of the bar? The answer is that we could have. However, we felt it was better to wait until prices cleared the congestion. At that time the low of the doji bar occurred, the segment was connected to that bar as shown by the following chart.

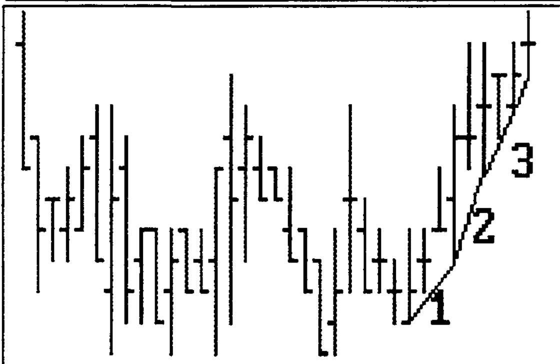


The last bar shown is the doji bar referred to on the previous page. A breakout of the high of the doji would have been a valid entry signal.

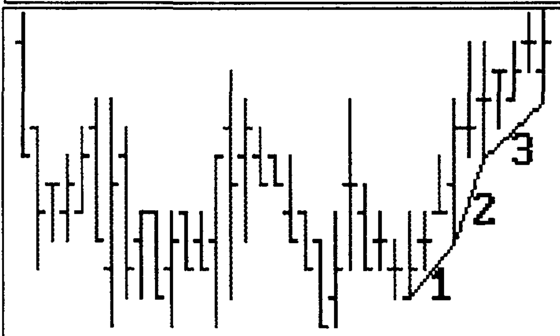
Let's understand. The segment line is drawn from bar to bar until we get a bar that makes a lower low than the previous bar. At that point, the segment line is moved from the previous bar that made a lower low to the current bar making a lower low. In the case of the chart we've been examining, the progression would have been as shown on the next three charts.



Notice that the segment line is moving along at the lows. We will not move away from hugging those lows with the segment line until we see a bar that makes a lower low than the previous bar. A breakout of the high of this last bar, or the high of the next bar, would also have been a valid entry signal.

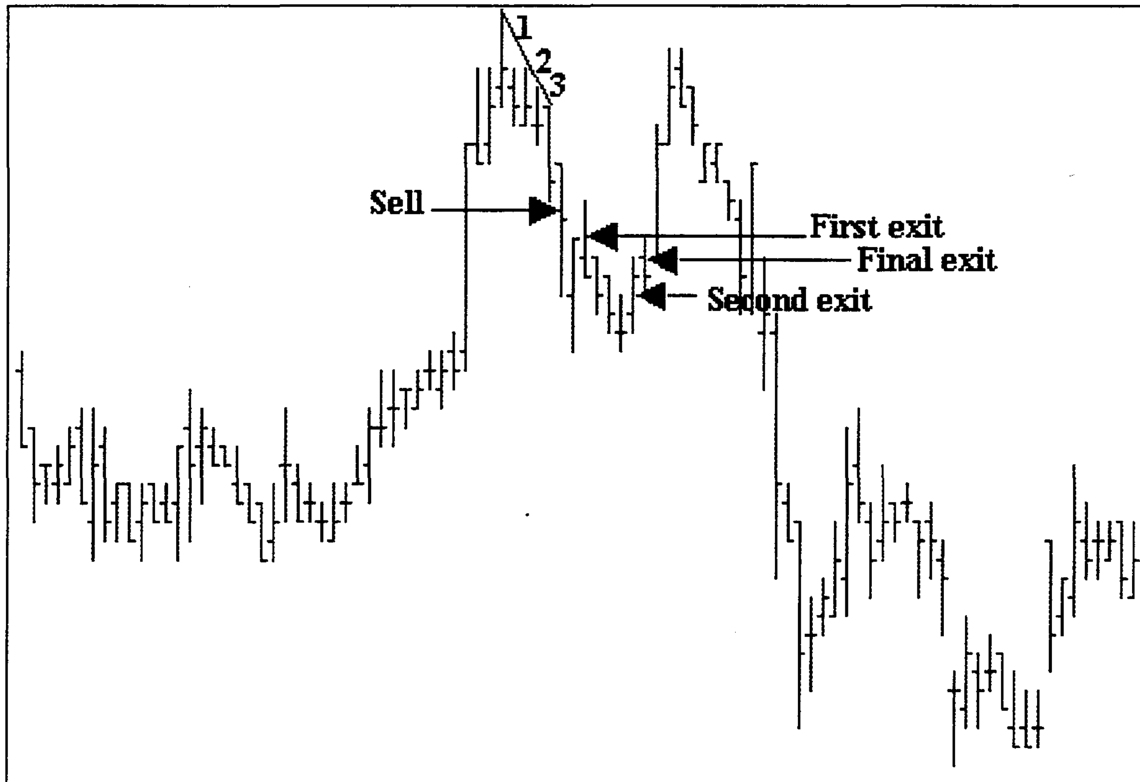


On the left was the last part of the segment prior to a bar making a lower low. Segment 3 will be finalized when we get a bar with a lower low.



The chart on the left shows how the segment line for segment 3 finally ended with a lower low.

As prices retreat from the 30 minute bar that made the high and also the close of the previous day, we begin to count and connect the diminishing highs.

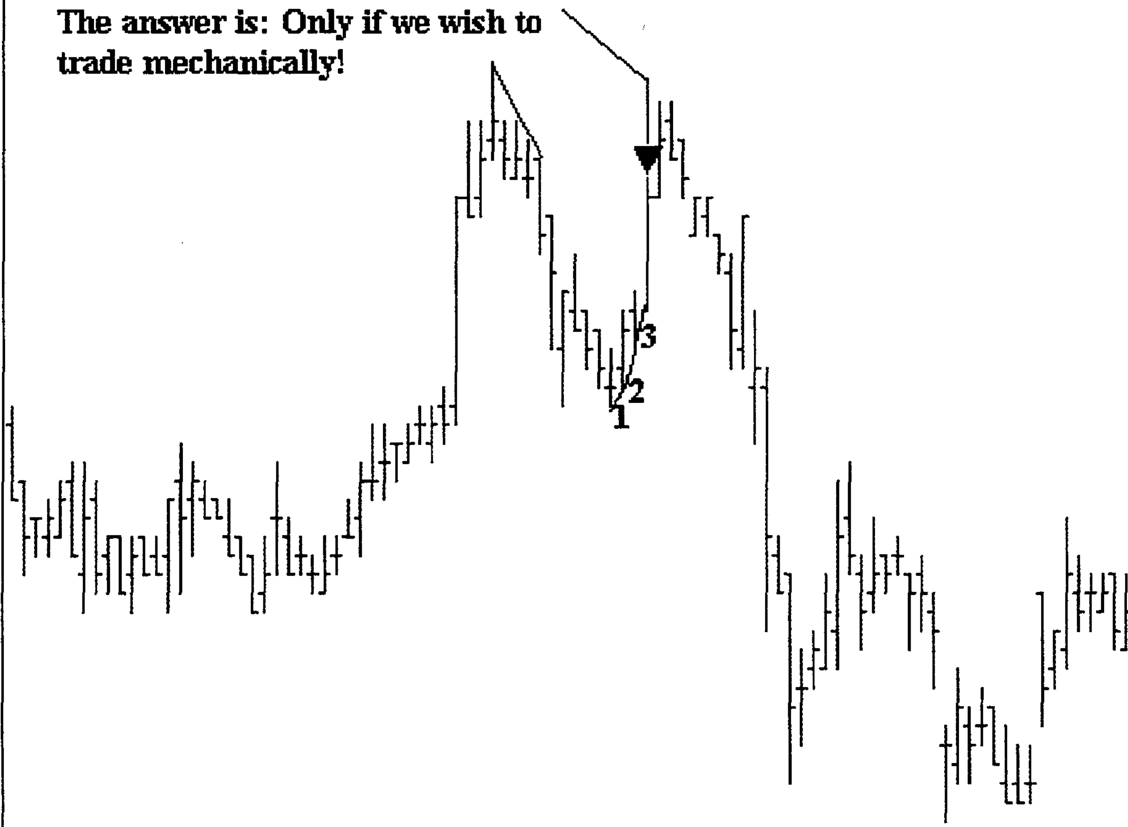


Depending upon the entry and exit prices, something, but not much would have been made on the first portion of the position. A bit more on the second portion, and a profit on any remaining shares. Of course we could choose to exit the entire position.

What we are seeing is the reality of intraday trading. The most important thing for us is to not lose money, and to be there as often as we are able when prices run.

Continuing with the 30 minute chart, we see the final exit (above chart).

The next day (next chart), prices shoot up in the first 30 minutes of trading. Let's look at that now.

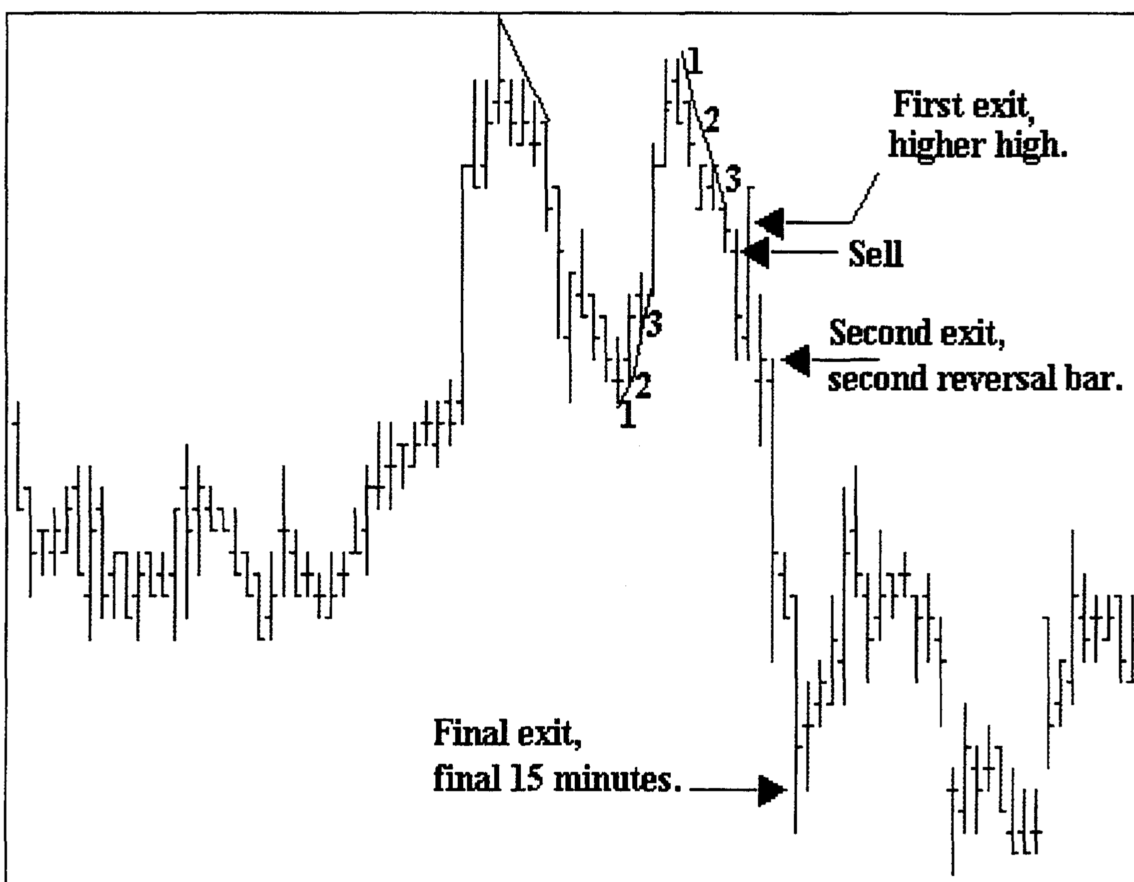


If we are determined to trade a mechanical system, then the trade must be entered. Note that our exit signal will keep us from disaster. We exit a portion of our shares as soon as we see a bar making a lower low than the previous bar, a portion when two reversal bars are in effect, and the rest on the second bar to make a lower low.

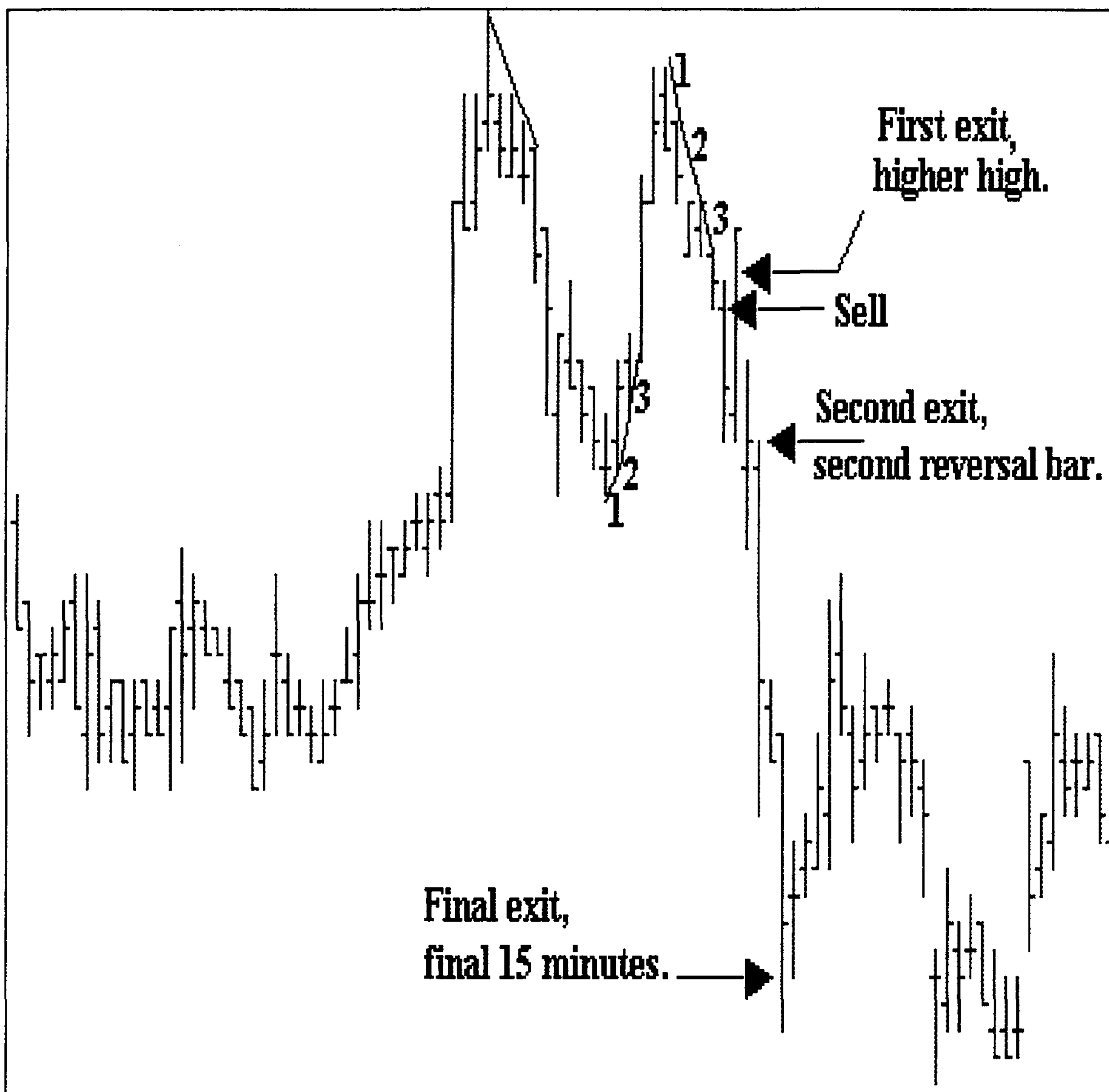
Taking it from the double top, the first bar after the double top makes a new low, liquidate one part of the shares. That same bar ends up being a reversal bar, exit a second part of the shares. The next bar gaps down, exit all shares, or exit all shares using the violation method shown earlier.

But should the trade have been entered at all? That's a tough decision and one that we each have to make on our own. There were no coordinating signals from TLOC. But then, neither were there any on the previous trade. There was a coordinating signal based on rising bottoms and another on simple counting. My opinion is that the trade was worth the attempt. We don't win on every trade. But we were able to keep any losses very small.

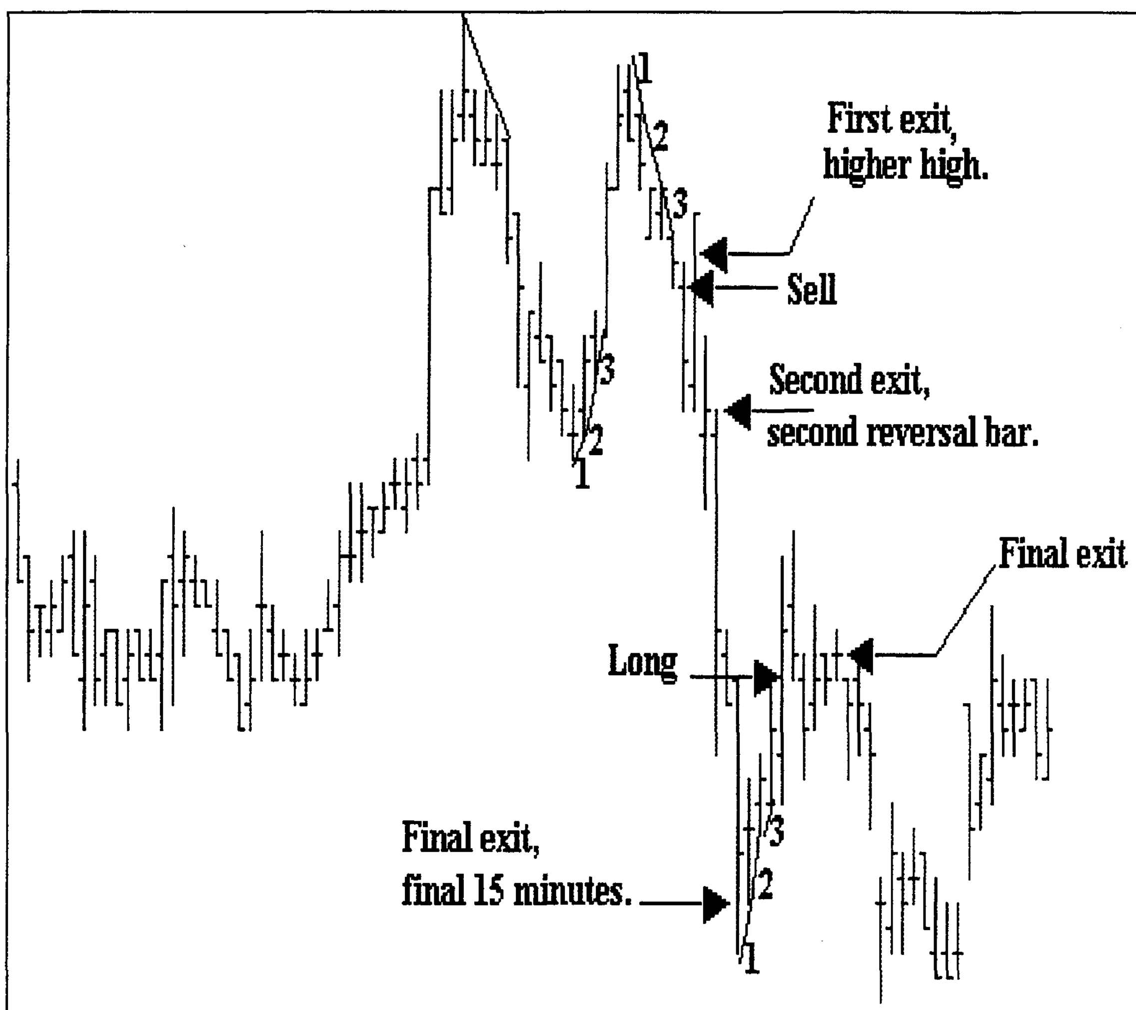
Let's continue with the next trade. It comes during the fourth hour of trading. Notice that even though we might still be long, we begin counting segments to the short side. In fact, the moment we have 3 segments to the short side, might be our clue to exit any remaining part of our original position.



By now, you should be getting the idea of the segment count. So why don't you try the next one. The day begins with the bar following the final exit bar. We'll reproduce the chart on the next page and give the answer on the page following that.



Your turn! Count the segments, and figure out the entry point and the three exits. Probably one-quarter of all the trades you make will have results similar to this one.



Well, how did you do? Our entry was on a violation of the high of the bar that gave us the third segment. Prices moved up to the local high. Our first exit is almost exactly where our entry was, and we couldn't fit another arrow in there, but it came as a result of the bar following the local high, making a new low. Our second exit was right at the open of the second bar following the local high, because the bar preceding it was a second reversal bar. Our final exit might have tricked you. We went out on the open of the doji bar, because the bar preceding it was a third reversal bar.

This was an early exit because we didn't like what we were seeing. If you picked the bar following the doji bar as your final exit, you made a good choice because it made a lower low that the preceding (doji) bar.

It would be very easy to load you up with nothing but examples of winning trades, but that is not the way actual trading really happens. All too many traders fool themselves when they study charts, they sit for hours looking for some magic way to trade that never shows a loss. In this course, we take the good with the bad — exactly the way it happens in real life.

Chapter 30

TURNING DAY TRADES INTO POSITION TRADES

A very important consideration in what you will learn in this course is the ability to turn a daytrade into a position trade.

Perhaps position trading is not for you. However, it is difficult for many traders to resist the temptation to turn some winning daytrades into position trades.

However, this chapter is not for the beginning trader. Please use this with caution. If you're not careful, it could have disastrous results. Be especially cautious around earnings releases and economic data releases.

For years the only way there was to trade was to position trade. There was no such thing as daytrading. It seems to some that strictly daytrading leaves too much money on the table.

If we have a winning position in a particular stock, why shouldn't we hold onto it overnight? Isn't one of the oldest rules of trading to "hold on to your winners?"

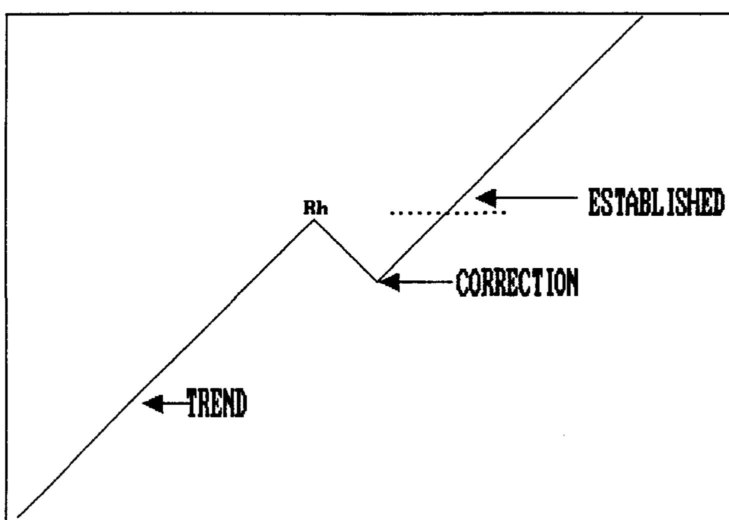
Over time we can develop an appreciation for which daytrades turn into the best position trades.

We can attempt to hold on to any daytrade entered as a result of one of our major entry signals. If we are in a daytrade when a major entry signal occurs, or enter one because of a major entry signal, we may attempt to hold that trade overnight. Our major entry signals are the breakout of a 1-2-3 high or low, the breakout of a Ledge, the breakout of a Trading Range, or the breakout of a Ross Hook.

There is one intermediate term signal that can also cause us to try to hang on to a trade and convert it into a position trade. That signal is the breakout of the lowest low or the highest high of the last three days. For purposes of conversion, that intermediate signal carries the same weight as a major entry signal.

Once the trade is converted, we can maintain it as a position trade. As much as possible, we monitor and keep an eye on the trade intraday, but we do not trade in and out of it on a daytrading basis. We try to stay in. Therefore, the only time we will try to hang on to a trade and convert it is if it meets one of the signals mentioned, <u>and is also</u> in a profitable position at the time we decide to hold.

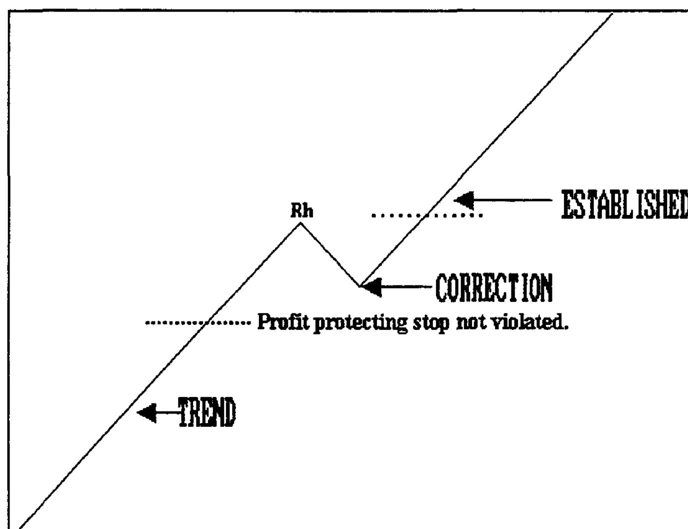
Although it's not necessary, it is best if the trade is in an established trend. Stocks trend upward on a daily or weekly basis because there is a real demand for them. They trend downward on a daily or weekly basis because no one wants them. Why should we have to fight our way in and out numerous times a day if a stock is trending and the underlying fundamentals, whatever they are, cause the stock's prices to behave in a trending manner?



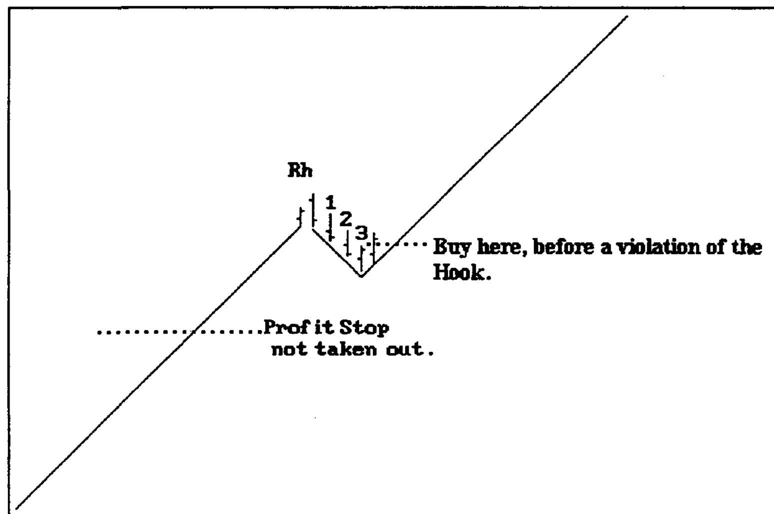
That means that it has had a leg up (or down), a correction, and then has taken out a Ross hook.

It's it even better when we are in a profitable position with a stop that has not been violated by the correction as shown in the diagram below.

We like it best when we're nursing a profitable position on the first leg and are able to add to our position during the correction prior to the hook's being taken out. RULE: A CORRECTION CAN LAST FOR A DURATION OF ONLY THREE PRICE BARS. THEN THE STOCK MUST BE SOLD.



The next chart will give us a glimpse of the beginnings of the Traders Trick entry.



If we're holding overnight in a stock, we place a stop in the market so as to protect any profits we have already earned in the trade. If we're not in a profitable position just prior to the close, there's no point in holding overnight even if the prices formed an entry signal that would cause us to want this to be a position trade.

Once conversion has been made to a position trade, we hang on to it as long as we possibly can by placing stops just below natural support points. A natural support point for a long position is that point where the correction stops moving lower and prices resume moving higher. The longer we're able to stay in the trade, the less we need to look at it intraday. If the trade lasts past the first correction on the daily chart, we quit monitoring it intraday.

Chapter 31

FULL CIRCLE

Position trading is something you can mix in with your daytrading. Here's how to do it, and it takes us right back to the earlier parts of this course.

Whenever a trade derives from one of the major entry signals, we then have a perfect candidate for a position trade.

For instance, when prices break out of a Trading Range or from a Ledge, when prices take out a 1-2-3 high or low, or a Ross Hook, we have an opportunity to do continuation trading or even to add shares to the trade. These additional shares will be held overnight along with any others that are still open. But clearly, the positioning in the trade is based upon the optimization we can get from the intraday entry which makes these position trades better and more profitable than they would be just trading them from a daily chart.

By optimization we mean that, because we're able to enter from a breakout of the intraday congestion that comes before the actual breakout point on the daily chart, we are usually in the trade earlier than we would have been using just a daily chart. That means that when the other traders enter on the breakout of these significant major entry points, they often give a boost to our already positioned shares, driving them further ahead in the direction in which we're trading.

By optimization, we mean not leaving any more money on the table than we have to.

It's rather like what some of the pros and floor traders do with moving averages. Some of them are mindful of where nine and eighteen day moving averages will cross, and position themselves in the market ahead of time in order to be there when the sheep who take these signals as gospel truth all dive into the market driving it to profits for the pros. Believe it, the pros will soon bail out, undermining the market and leaving the sheep to wonder what happened to the trade.

Other professionals watch other things they know will bring the "suckers" (their word — not ours) into the markets.

We'd like to take what's left of this volume to talk about some things in general — things we hope are of interest.

We have found it extremely profitable to subscribe to Investor's Business Daily and one or two good stock advisories and to consistently chart the stocks recommended there as "buys." We never buy just because the advisor says to. Instead, we employ the advisory's research to indicate which stocks we should be watching. Only when we see one of our entry signals on the daily chart do we attempt to buy or sell shares of a particular stock issue.

When you're trading, if you don't know what is going on, don't trade. This is a rule of trading you may have heard before. Yet we know that many ignore this rule. We can tell by what is said to us on the phone and in letters.

The reason for not knowing what is going on is an unwillingness to make the effort necessary to become a good trader.

Trading is hard work. It's not easy. We spend 85% of our time getting ready to trade and only 15% of our time trading.

That means doing analysis work <u>before</u> taking a trade. How else can you know what's going on? You can't usually judge from the news — it generally comes too late. You can't listen to the opinion of others. You have to analyze the markets and then trade from what you see.

Try to never trade what you think, only what you see. Your opinion is worthless, and what you think ***is*** your opinion and nothing more.

Here's how you might go about doing your analytical work.

First, go through all your charts to get an overview of the various stocks, especially those which are the most liquid. During that time, look for stocks that are trending. This action keeps you sharp in identifying the trend.

Next, go through all your charts again looking for against the grain moves — the intermediate trend that went against the longer term trend. This alerts you to markets that might soon resume trending.

Then go through all your charts looking for Ross Hooks. Take note of each Hook, even taking notes as to which to keep in mind. Try to select those stocks that appear to have the greatest potential, and write down order entry prices that are just above or below the Ross Hooks. These are sometimes entered as resting orders in the market.

How do you know which stocks have the greatest potential? The answer is simple. Select those stocks which have the strongest trend lines, or those which are recommended by one of the advisories.

What you want most are trending stocks that are making a retracement. Then you can attempt an entry as the market retraces, using the Trader's Trick. There are almost always shares that are trending.

Do your homework every day. There is no way to know when an important breakout, the beginning of a trend, will occur, unless you perform your daily analytical work.

Finally, be sure to set your work aside and take breaks. After a break, when your head has cleared a bit, look at your charts again. Then do your best to come up with a trading plan. Try to think through what you are going to do. Ask yourself many "what if's." Try to anticipate what might happen if you enter the trade. This type of action is quite different from what you do when daytrading. With daytrading, there is little time to plan and much of the time you are merely reacting to what you see.

Often, thinking about position trades will cause you to eliminate quite a few of them. Also, a second look at times results in "Why didn't I see this before?"

All this and more you should do <u>before</u> you enter a trade. But most traders do their analysis after the trade is made. Too often, they do it when the trade is already going against them.

Many times traders go into a trade, and then when they are in it, they say to themselves, "Oh no, why didn't I see that before?" How could they see it before if they hadn't looked, and looked again, and thought about it, and then perhaps looked one more time?

Also, many traders do their analysis after entering the trade, in search of a justification for having entered. "Now I'm in the trade, let's see if I can find a couple of good reasons as to why!"

If you want to continue as a successful trader, you have to be hard. Hard on yourself and hard on your brokerage firm. That doesn't mean you have to be a rat, or be impolite, or be contemptuous. You just have to be firm in all you do. You can't afford to be "Mickey Mouse" about the way you do things. This is a business. You must be businesslike in conducting your affairs.

As a business person, you must manage your business. One of the main functions of management is planning. You have to plan your trades. Other things to look for as you go through your charts are: One-two-three formations, matching congestions, reversal bars and dojis. These may all fit into your plan in some way.

You have to have good reason(s) for getting into a trade. But, too often others get into a trade, and then look around to see if there was a good reason for having done so. That way they justify to themselves that they did the right thing, when in fact they did the wrong thing.

Too many traders give more thought to choosing which flavor ice cream they will eat than they give to which stocks to trade and how and when to trade them.

By not taking the time for preparation, they end up not having enough time to weigh the pros and cons or really familiarize themselves with what they are getting into.

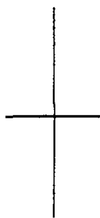
They don't have time to realize that prices have supported two ticks away from their entry about forty times in the past. They don't have time to see that they are trading right into overhead selling. They don't have time to notice that if prices break out of yesterday's high, they will also probably take out a Ross Hook. They don't have time to see where prices are in relation to a simple trend line. They don't have time to really grasp the overall trend, or the wave that is going counter trend. They don't have time to really consider where they will place their stop. They don't have time to read the market and to see what it might be telling them.

All these things could be anticipated, but those who have not done their homework will end up chasing markets in a desperate attempt to get into "the big move."

Once again, what we will say next is an important item to look for when you are in a trade. It's a piece of information you should hang onto. Amazingly, it is now coming into vogue via the Japanese candlestick charts. It has to do with what has always been called a "reversal bar."

Essentially, there are two forms of reversal bars. Singly, one is more important than the other; in combination, they are just about equally important.

The least important is what the Japanese call a "doji." We showed it before, but in case you forgot, it looks like this:



The main thing to notice about a doji is the fact that the open and the close are about the same. The open and close do not have to be exactly the same, just very near to each other.

Much of the time, when you see a doji and a market is trending, be alerted that the market is going to go the opposite way on the following price bar.

A more important reversal bar is seen when in a down market you get a close that is higher than the open, and in an up market you get a close that is lower than the open.

Reversal bar ->

<- Doji

An even stronger indication of an imminent major trend change comes when there is a combination of a doji and a reversal bar. The very best indicator of a trend change comes when there is a combination of two or even three successive reversal bars mixed in with one or two bars that fit the pattern of the trend.

Note: **DO NOT CONFUSE THE MIX OF BARS IN A TRENDING MARKET WITH THOSE IN A CONGESTION. A LOOK AT CONGESTION AREAS ON ALMOST ANY CHART WILL SHOW THAT THERE ARE USUALLY REVERSAL BARS ALMOST EVERY OTHER PRICE BAR.**

When we see a series of reversing bars, (open higher than close on one day, and close higher than open the next day), we get out of the market. We'd stay out until we see a breakout or come to the realization that prices are trending.

These reversal bar, doji combinations occur in a downtrend while we're still seeing lower highs and lower lows. Conversely, they occur in an uptrend while we're still seeing higher highs and higher lows. In other words, to the casual viewer, it still looks as though the trend is intact. But if a trader knows how to read a market, these reversal bars and dojis are powerful signals.

If we have a position when these combinations occur, it is time to really tighten up our stops. We get ready to bail out.

When a trader knows how to read a market, and has a pretty good idea of what it is going to do, then he is able to get in step with that market and go along for a ride.

Statistics show that as prices approach a trend line due to a correction, the odds become two to one in favor of a successful trade

if we enter in the direction of the trend. The best place to do so is when prices have changed direction back towards the trend direction.

We do not attempt to trade in sideways markets. It is in the sideways markets, called Trading Ranges, that we have the most trouble.

Trading Ranges are an area that is strictly for floor traders, specialists, market makers, and others who scalp at the exchanges. They are strictly for those traders who have the shortest term view of the market. This is true whether we're trading a daily chart or a five minute chart.

Do we have any advantages at all over the market makers, the market movers, and the specialists (exchange professionals)? You bet we do. We can go for the long pull, we can trade the trend!

The exchange professional who is a scalper (most are) is looking for a few ticks and then out. Quite often, after the scalpers get out, the market goes on to make a bundle of additional ticks. The scalper leaves those lying on the table for us to take.

How can we take advantage of that situation? When the scalpers start cashing their profits, the market will retrace somewhat. It is the liquidation by scalpers and short term exchange professionals that create minor retracements in markets. Great! We wait for the retracement. As soon as prices move back in the direction of the trend, we jump in.

The exchange professional can actually lose his shirt when a market makes a big, sudden move as did the stock market in 1987, 1989 and 1997. In these instances, the public and the funds took hold of the market.

There are some real horror stories that came out of the markets during those times.

Here's a quote from some material written by William F. Eng, a professional trader. We made a copy of this for our files. It's quite interesting.

"The quandary posed to the professional when the public takes hold of the market applies not only to bull markets, but also to downside markets. Horror stories abounded after the October 19, 1987, worldwide market crash. Friday, October 16, was the first day of the massive downdraft. Many professionals who were still in business on that day told me that they had substantial profits on Friday's close. They came into the markets Monday opening short and made embarrassingly huge amounts of money immediately at the opening bell. As one professional told me: 'I couldn't help myself. The market just handed me fistful's of money.' It was what happened during the rest of that Monday, October 19, that did these professionals in. The market opened much lower, rallied, and then sold off dramatically. On the opening, some pros covered shorts. As the market went lower, they started to go long at 15 points lower, then 20 points lower, then 30 points lower, then 40 points lower. It looked as if the lows of the century were going to be tested. At the bottom they sold all their positions."

Such was also the fate of the Fibonacci traders. Fibonacci traders buy at the .382, .50, and .618 retracement levels. They expect the market to reverse there. Imagine how badly they ate their shoes during the crashes of 1987, 1989, and 1997? When the market started down, they would have bought at those levels, expecting a reversal to be imminent. When they finally decided to sell their long positions, who would have been there to buy them? They would have eaten those positions big-time. Many of the ones we know received margin calls and went bankrupt. They simply couldn't sustain a loss like that.

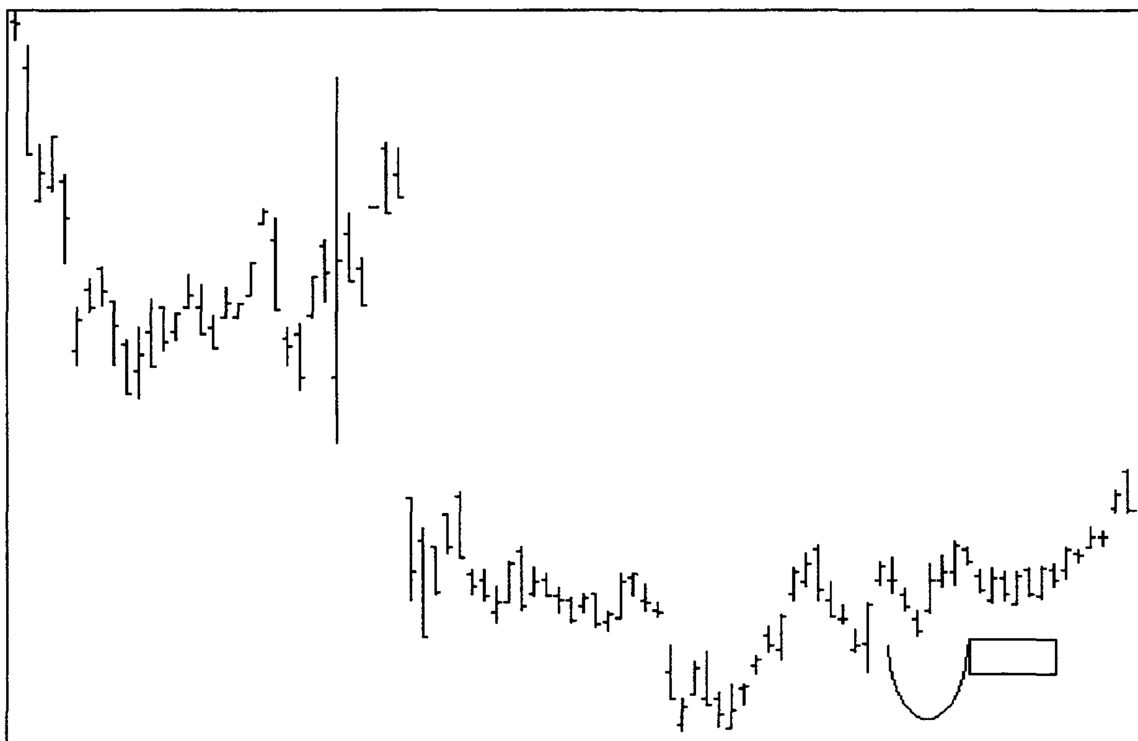
CUP WITH HANDLE

Several years ago, a subscription to Investor's Business Daily came with a free book written by William O'Neil. That may still be true.

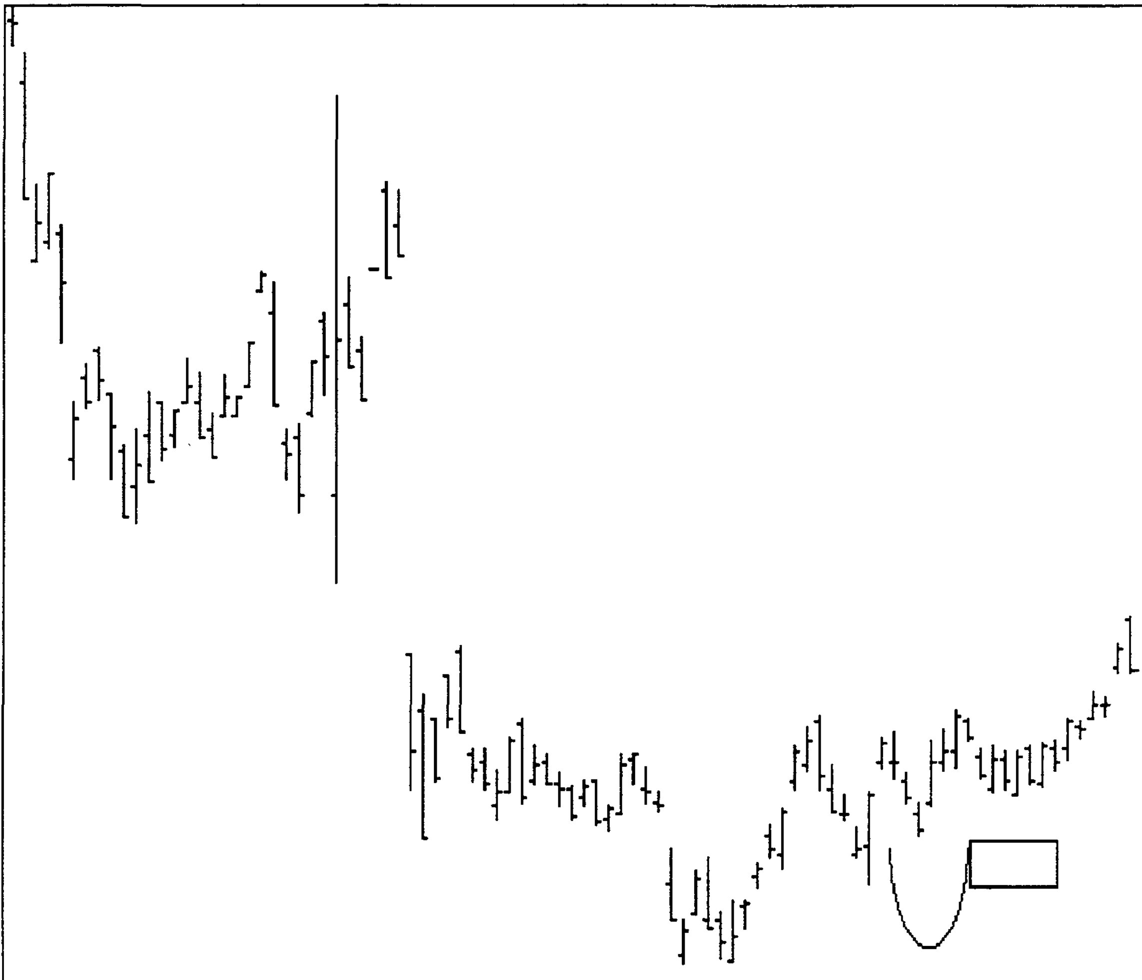
In the book was described a formation termed a "cup with handle." Picking up on that formation, has stood the test of time. We'll share that with you.

Below is a chart showing the cup with handle formation. It also turned out to be a matching congestion formation, just as can be seen on an intraday chart.

As we've noted before, matching congestions occur on intraday charts, daily charts, and on weekly charts as well.



The cup with handle formation is created by a dip in prices followed by a congestion that towards its end begins to have rising bottoms.

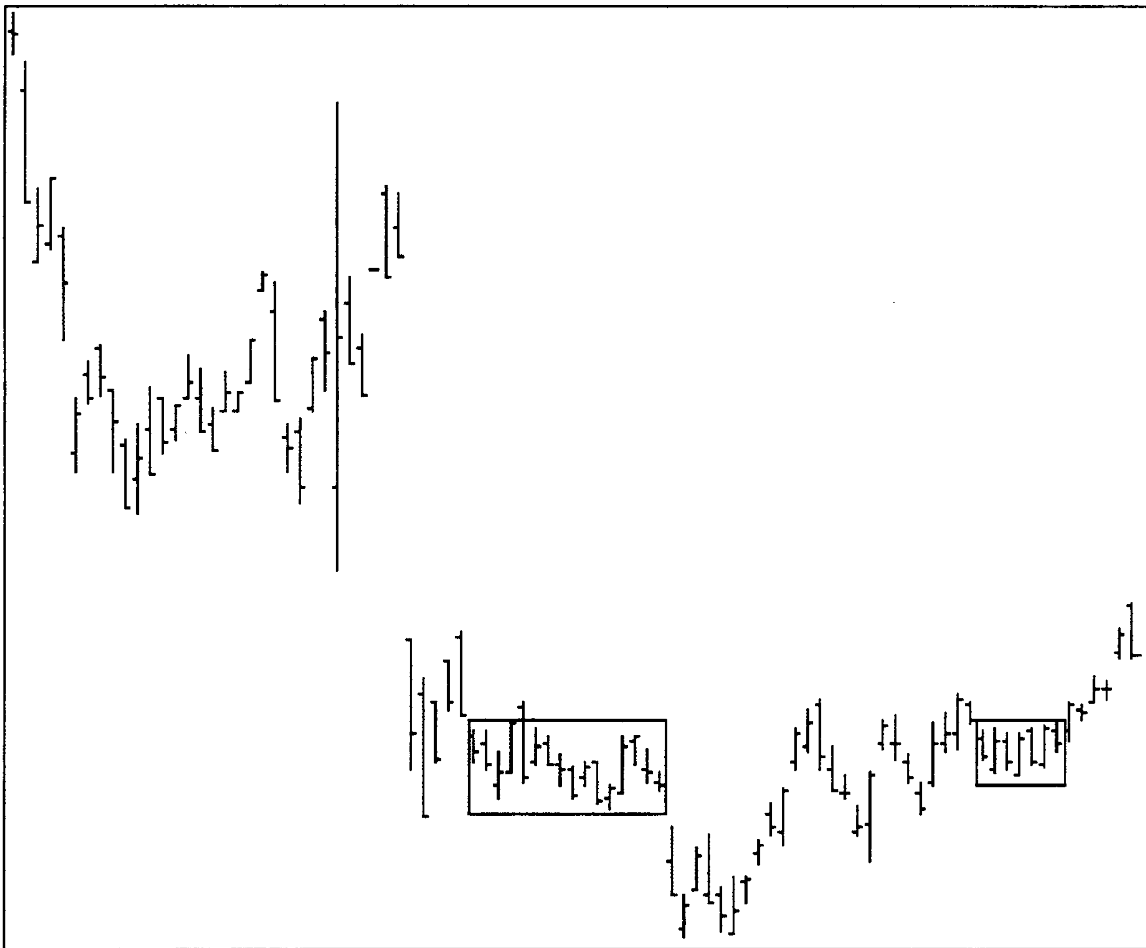


When position trading the cup with handle in the stock market, the anticipation is for the market to go up. When trading intraday, the anticipation is the same.

Notice carefully that whenever there is a tight congestion with rising bottoms, it will usually break and will have a strong move to the upside.

The reverse is also true. A tight congestion with falling tops will usually go down sharply, very soon.

On the next page, we can see the same chart depicted in a different manner — as matching congestions.



Matching congestion areas, once again, are an excellent way to enter a market. The upward bias of the rising bottoms gives a pretty good clue as to which way prices are going to break out.

PROTECTIVE STOPS

We are fully aware that in electronic daytrading it is difficult to place physical stops. But there is nothing to stop you from using mental stops. However, this course is about trading stocks, not only daytrading under the currently available electronic systems. If you use a broker, call your broker to put in stops.

Stop placement is where we separate the kids from the adults. Stop placement is the sole responsibility of us as traders and the managers of our trading businesses. It is one buck that cannot be passed. We are the end of the line when it comes to placing stops.

Let us understand why "we, and only "we" can decide where to place the stop. There are several considerations:

The size of our individual margin accounts: This has the greatest effect on stop placement. When we look at a trade and see where the stop should go, or where we would like it to go, we then have to look at the size of our margin account and determine whether or not we can even consider the trade.

Our comfort level: Although we may have sufficient margin to place the stop where we would like to, and although the stop is logical for the trade, we may not feel comfortable with the stop being so far away (or so close), and so we may decide not to take the trade with the stop far away, or move the stop back if it appears too close.

Volatility: We must take into account market volatility when placing a protective stop. If prices for an individual stock which normally ticks a minimum tick at a time suddenly begins to tick in multiples at a time, we must certainly take that into consideration. We may find out that we have to place our stop too far away for the size of our bank or our comfort level.

Other considerations are: The type of terminal from which we trade. Are we trading on the Internet? If so, is our Internet connection sufficiently fast? Are we trading based on viewing prices as they happen, or are we trading with electronic order entry, but delayed prices, or are we trading with up-to-the-second systems?

If we are using mental stops, and not trading from a live terminal, we need to time our orders. Find out how long it takes from the time the order is entered until confirmation of a fill is received. This procedure should be tested on several occasions in those markets in which we trade.

The number of trades we already have on in other stocks can have an effect upon where we place our stop. If we are already pretty well margined-up, we may not be able to financially, or comfortably, afford to put on another trade with the protective stop in the place we feel right in having it. In that event, it's best to pass this trade, or liquidate another trade so that we can comfortably enter the one we are

contemplating. Remember, overtrading in the sense of putting on too many trades may get us into trouble, and we may have to place our stops too close.

There are other considerations that may be involved in special situations which affect where we will place a protective stop, and whether or not we want to take the trade when we see where that stop needs to be.

The main point is, if we can't place the protective stop where it should be, we shouldn't enter the trade.

CAPITAL PRESERVATION

To operate one's trading as a business, sufficient capital with which to trade must be available. This capital will give control over the trading opportunities that present themselves. The more capital available for trading, the more opportunities there will be to make that capital go to work. In that way the trader can guide his career as a business-like trader.

When trading, there are a number of ways to control risk. Stop placement is one of them. There is, however, only one way to preserve capital — trades must be planned. A trader must learn to think them through, so that he can ascertain where in the trade the risk exists. The risk to capital lies somewhere within the life of the contemplated trade.

At ELECTRONIC TRADING 'TNT' — EXPLOSIVE TRADING STUFF seminars, we talk extensively about how so many traders have a wrong perception of the market. We also tear into traders for having a wrong anticipation of what a trade will bring. Typically, traders are always stepping up to the plate to try to hit a home run, instead of being satisfied with getting on base, which is the equivalent of taking home steady profits. The market, and only the market, can hand a trader home runs.

It is the very high level of intelligence traders possess that attracts them to highly mathematical concepts for trading markets. There is nothing mathematical about markets, and therefore trading them that

way dooms one to failure. *Yes, we know that so many of the ads say that markets are cyclical, astrological, mathematical, symmetrical, geometrical, and all kinds of other "ical's", but don't you believe them!* If you are interested in 'TNT' seminars please contact us using the information in the front of this manual.

Fibonacci trading is mathematical, and therefore appeals to the highly intellectual trader. In reality, as can be seen, it turns out to be another false god.

Suppose stock prices are seen by a trader to trend upward. He then sees them begin to falter. Prices then head down toward a Fibonacci support level. The first commonly accepted support level is composed of a .382 retracement of the previous move. A resting order to buy is placed at that retracement level.

Now the trader enters a trade long 200 shares. The trader anticipates a "magic" Fibonacci bounce. Nothing happens.

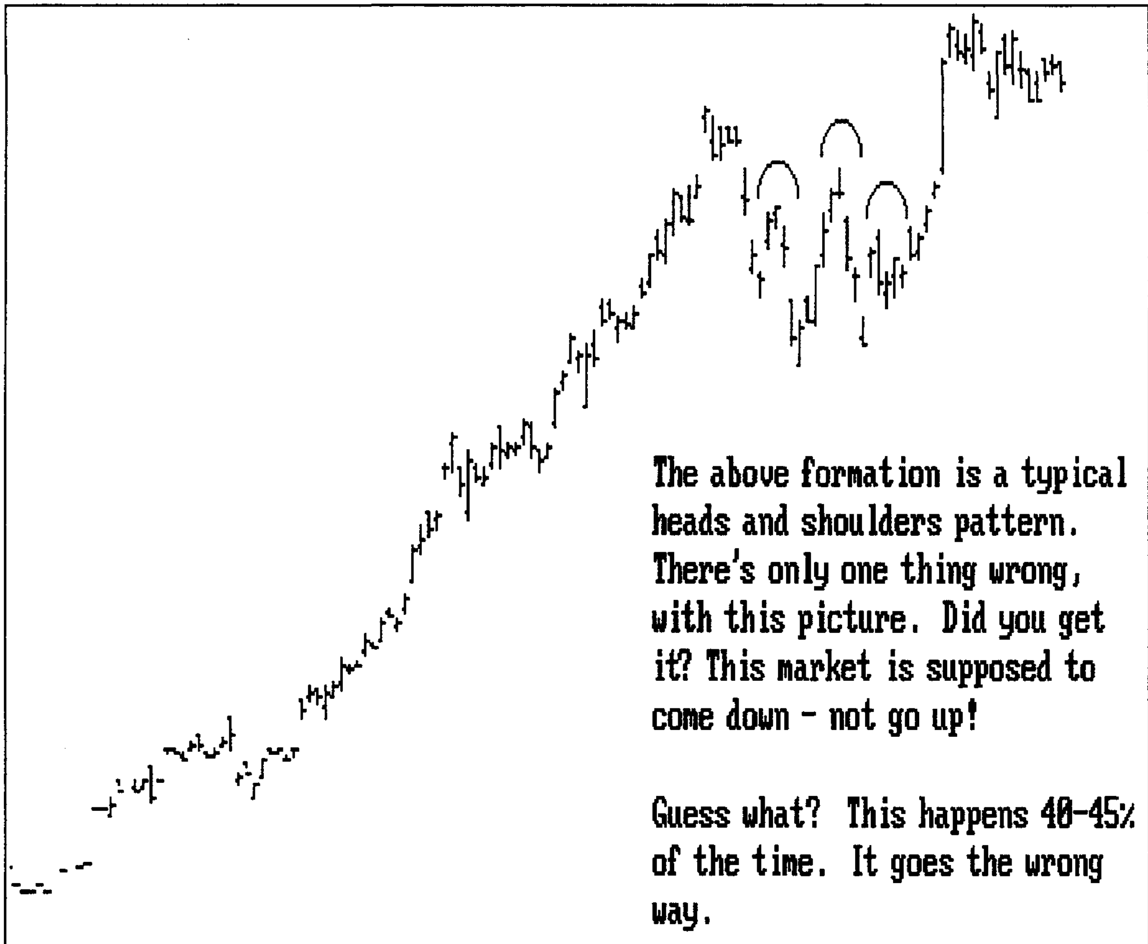
Now imagine the trader also has placed a resting order to buy 500 more shares at the .500 retracement level. Fifty percent is the so called "golden ratio." The trader and most of the other worshipers of this idol will have resting orders at the "golden ratio," and so there should be adequate support, sufficient to cause a bounce.

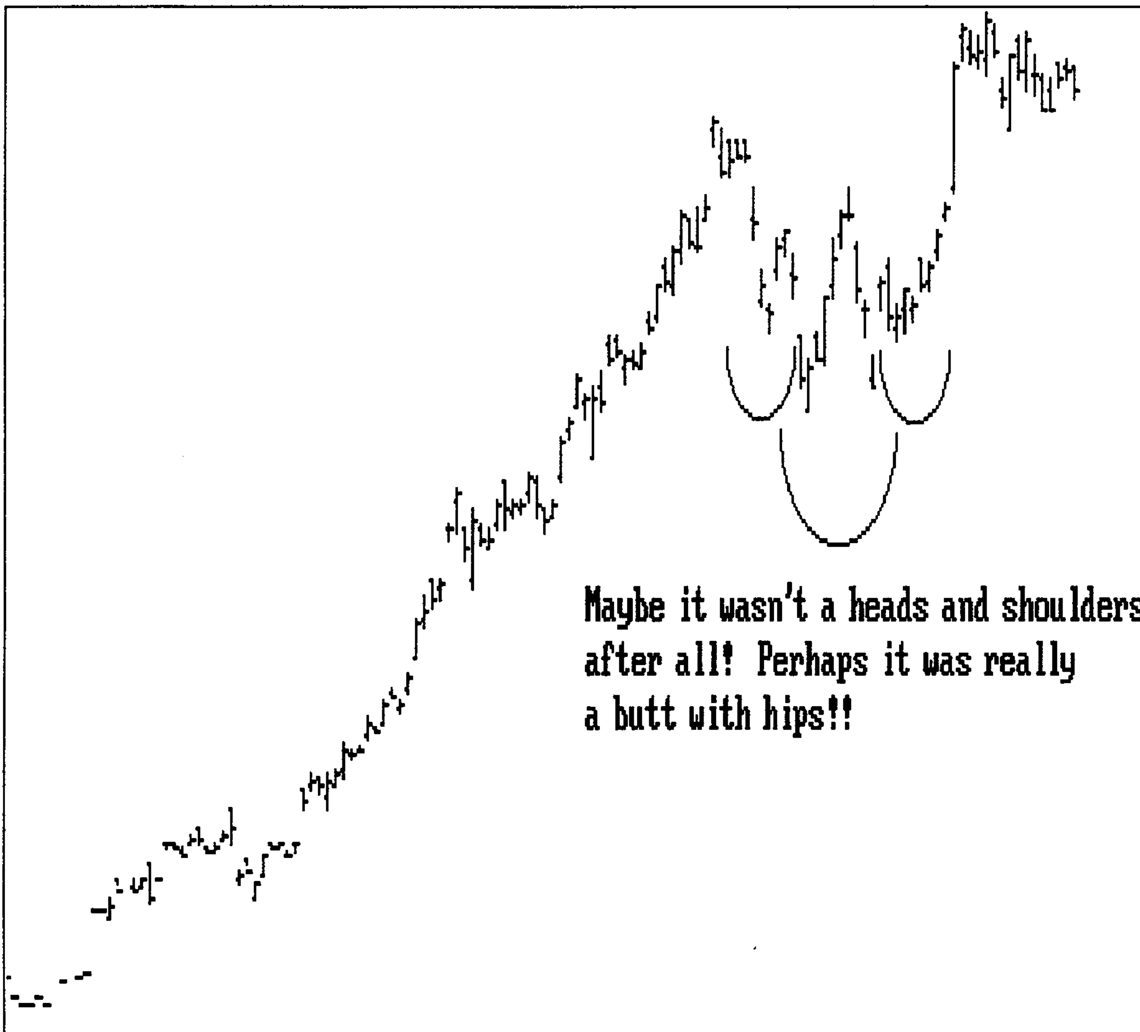
Of course, the exchange professionals, who also know about the "golden ratio," are there to help them fill their golden orders.

As stated, with the trader's and others' entry into the market at that point, there may even be somewhat of a bounce, and the market may rally for a few ticks. However, if the fundamentals that are driving the market down remain in place, the rally will not last long, and so the market will re-cross the "golden ratio", and head south toward the next magic number. At that point, traders will be waiting with eager anticipation for the expected bounce at the .618 retracement. If they don't get it, may their "god" help them!

HEADS AND SHOULDERS

Another piece of mythology is the so called heads and shoulders formation. The formation itself is real, at least in the eye of the beholder. What is wrong is the expectation. Anyone who thinks he knows which way a heads and shoulders formation is going to break needs to have his own head (and maybe even his own shoulders) examined. To prove our point, we submit the following very common example.





Please pardon the pun, but sometimes this is the way we feel about some of these figments of the imagination that some people claim to trade from. Some of these formations are strictly in the eye of the beholder. Now, don't blame us for what we see. Joe Ross says, "Not only can't I do math, but I'm also dyslexic. Dyslexia may be the secret of my trading success. Perhaps I can write a book about how to become dyslexic.

"If I can trade from a chart seeing things all wrong, then our students should surely be able to do it seeing things straight side up."

TRADE WHAT YOU SEE

Here is something that comes up time and time again. We'll mention what it is. It's something we all have to learn to think about with all our might, and as often as we can. It's a good idea to write this one down. Place it where you will have to read it every day, and make sure you read it and think about it every day. The majority of traders will understand it academically, but not from the depth of soul to which you must eventually came. You need to come to the point where you really understand what we're about to say; the understanding must become deep. Here's the poster you can make for yourself.

NEVER TRADE WHAT YOU THINK, TRADE ONLY WHAT YOU SEE!

What you think is merely another opinion — yours. Most have learned that their own opinion is as good as anyone else's opinion. That is right, but it is also wrong. You have to come to see it as being that your opinion is as bad as anyone else's opinion.

It's the old viewpoint of the cup being half full or half empty. In the case of trading, the cup is half empty. Your opinion is bad, it stinks. As long as you try to trade based on what you think, you will be trading on opinion.

When prices break out on a gap up and you miss a trade, don't think that it is too late to get in now. The fact is that prices are going up.

When prices start coming back down, you might think that prices are not really going to go up. Again that is your opinion. The truth is that you don't and can't really know which way prices will go. Therefore, when you see prices begin to go up again, try to buy.

In a bull market, learn to buy every chance you get. Look for reasons to buy. Buy as soon as a downward retracement starts to go back up again. Buy ahead of when today's prices take out yesterday's high. Buy ahead of the breakout of the Ross Hook that was created when the retracement began. Buy, buy, buy. That is the only way to learn to make money in this business when prices are going up.

When you see prices going down, sell! When prices break out of congestion and move down, wait for a correction. As soon as prices are moving down again, sell ahead of a breakout of the low of the correction. In fact, try to be selling breakouts of the lows of the first three price bars in the correction. Once prices start moving down and the trend is established, sell every chance you get. Sell ahead of a breakout of yesterday's low, every day. Have resting sell orders ahead of every Ross Hook. Sell and sell some more. That's how to make money in bear markets.

Trade what you see. Trade with the trend. Buy bull markets. Sell bear markets. You can see when a trend is in force. A little child can see that. You don't need an oscillator to tell you which way the trend is going. You don't even need to draw a trend line on the chart. If the trend is up, buy. If the trend is down, sell. Trade what you see.

If you think the market can't go any higher, and the trend is up, buy. Trade what you see, not what you think. If you think that surely this is the bottom, and the trend is down, sell. What you think doesn't matter. It's what you see that counts.

In growing up, you have become so used to doing what you think that it is hard to divorce yourself from your own opinion. After all, you've lived by your wits most of your life. In the markets, relying on an opinion can kill a trader. Trading is simple, but it is difficult to separate what is seen from what is thought. Work hard at doing that. Let this concept sink deeply into your thoughts. It has to become a part of every fiber of your being. It will take a lot of effort on your part.

STRANGE DATA

A piece of data we've come across is that upon initial entry into a market, 80% of traders are on the right side of the trade. Yet they end up as net losers. Why? When first learning of this, it boggles the mind. How could such a thing be? Here is the answer: Apart from the flat-out gamblers who are in the markets, many, many traders have read and studied intently everything they could afford to buy or send off and receive for free. They have been diligent about getting their education in every aspect of trading but one — they haven't learned how to make money.

That's right! They have learned how to trade. Indeed, they know ***how*** to trade! What they don't know is ***how*** to make money. Believe it, there is a world of difference between the two. We've shown some of how to do it in this manual. The rest you will find in other volumes of this course. Knowing how to trade is a quite different from knowing how to make money from trading. Apart from this course, we've never seen or heard of such a manual. If there is one, we'd like to hear about it ....but only after you've read all of the volumes in this course.

Many of our readers know how to trade. They are actually pretty good at it. But when it comes time to reel in a profit, they don't seem to know how or when.

We would venture to say that many of the traders and would-be traders we teach are better and more astute at trading than we are. But they are consistent and/or overall net losers in the markets. ELECTRONIC TRADING 'TNT' II — HOW-TO-WIN TRADING STUFF addresses in detail the reasons for this and explicitly shows how to turn a profit in the markets.

We will end this part of the course with a piece of advice. **Don't overtrade!** Don't think you have to take every trade that comes along. Wait for the very best. Wait for the pre-breakout trading congestions that are small and tight, or long and skinny. Be selective in trading. Be patient. Be very cautious in getting into a market and very easily convinced to get out. Just because you've learned a new trick or two doesn't mean that you have to trade it every time you see it. Resolve to establish sound trading habits.

We welcome any and all comments and criticisms of this course. We want to learn and to grow as much as anyone else. When you write nice things, it encourages us to do more for you. When you point out our mistakes, we rush to correct them and it makes it better for the next person who takes the course. We'll see you next in ELECTRONIC TRADING 'TNT' II — HOW-TO-WIN TRADING STUFF.

Joe Ross **Mark Cherlin**

FOR YOU

In this course, consisting of the four manuals that make up the ELECTRONIC TRADING 'TNT' series: GORILLA TRADING STUFF, HOW-TO-WIN TRADING STUFF, TECHNICAL TRADING STUFF, and TIPS-TRICKS AND OTHER TRADING STUFF, we've revealed the way we trade and conduct a trading business. We've shown what we do day in and day out. We've described the tools we use, and how, where, when, and why we use them. We make our living as traders, not as authors.

Unlike most authors who secrete themselves behind a publisher's telephone number and address, we will gladly respond to any phone calls, faxes, E mail, or letters that we receive regarding the material presented in these manuals. For more information about other services, books, and seminars which we offer our readers, please continue reading.

SEMINARS

At times a manual is not enough. Some would like more help than we are able to present in a manual. For this reason, we hold seminars regularly for the purposes of tutoring those who want and can afford the additional help.

If you want to learn to run your trading as a profitable business, you will benefit from the two day seminars we give. We give these seminars almost every month. Enrollment is limited. A prerequisite for taking the seminar is that you must have read both ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF and ELECTRONIC TRADING 'TNT' II — HOW-TO-WIN TRADING STUFF.

At our seminars we attempt to answer any and all questions concerning the material in our books. We then go on to expand the material beyond what is contained in the books.

Once you have taken a seminar, you may attend it again for up to two years. There will be no charge other than what it costs you for travel, lodging and meals. The only requirement is that you let us know well in advance that you will be coming.

At the seminar, you will be shown a great many things that are impossible to get into a book. Here are some of the novel things you will be taught:

How to neutralize the advantages the insiders have over you.

Techniques for getting into a stock ahead of everyone else so that their entry pushes along your position.

Techniques for taking the risk out of a trade.

Techniques for buying more time for a trade without getting hurt.

How to safely hold overnight positions in volatile stocks.

How to figure the true risk in a trade.

How to make significant profits over costs from your trading.

And much, much more in the way of tips and tricks to help your trading. To book reservations, contact information is listed at the front of the manual.

Private Training Sessions

We offer three-day private training sessions, one for day traders and one for position traders. These are intensive sessions for a maximum of four persons at $10,000 each. The same sessions are also available on a one-on-one basis for $12,000.

Private Tutoring and Consulting

For those who want one-on-one private tutoring, we are available by appointment only. Fees are:

$400/hour by telephone

$500/hour in person

$4,000/day in person

$4,000/DAY (plus travel, lodging, meals, and expenses if travel on our part is involved.)

Private tutoring sessions involve any or all of the following: You doing the trading while being coached, offered suggestions, and being helped with proper organization; Answering your particular questions; Custom tailoring of the session time to precisely fit your needs; Anything else with which you might require assistance.

CATALOG

DON'T FORGET TO SEND FOR OUR FREE CATALOG. CONTACT NUMBERS ARE AT THE FRONT OF THIS MANUAL.

Appendix

MARKET MAKERS

ABSB	ALEX BROWN & SONS, INC.
AGIS	AEGIS CAPITAL CORP.
BEST	BEAR STEARNS & CO., INC.
BTSC	BT SECURITIES
CANT	CANTOR FITZGERALD & CO.
CHGO	CHICAGO CORP.
CJDB	J LAWRENCE DEUTSCHE BANK
COST	COASTAL SECURITIES
COWN	COWEN & CO.
DAIN	DAIN BOSWORTH, INC.
DEAN	DEAN WITTER
DLJP	DONALDSON LUFKIN JENRETTE
DOMS	DOMESTIC SECURITIES
EXPO	EXPONENTIAL CAPITAL MKTS.
FACT	FIRST ALBANY CORP.
FAHN	FAHNESTOCK & CO.
FBCO	FIRST BOSTON CORP.
FPKI	FOX-PITT, KELTON, INC.
GRUN	GRUNTAL & CO., INC.
GSCO	GOLDMAN SACHS & CO.
GVRC	GVR CO.
HMQT	HAMBRECHT & QUIST, INC.
HRZG	HERZOG, HEINE, GEDULD, INC.
JEFF	JEFFERIES CO., INC.
JPMS	J.P. MORGAN
KEMP	KEMPER SECURITIES, INC.
LEHM	LEHMAN BROTHERS
MADF	BERNARD MADOFF
MASH	MAYER & SCHWEITZER, INC.
MHMY	M.H. MEYERSON & CO., INC.
MLCO	MERRIL LYNCH
MONT	MONTGOMERY SECURITIES
MSCO	MORGAN STANLEY & CO.

MSWE	MIDWEST STOCK EXCHANGE
NAWE	NASH WEISS & CO.
NEED	NEDDHAM & CO.
NMRA	NOMURA SECURITIES INTL.
OLDE	OLDE DISCOUNT CORP.
OPCO	OPPENHEIMER & CO.
PERT	PERSHING TRADING CO.
PIPR	PIPER JAFFRAY
PRUS	PRUDENTIAL SECURITIES.
PUNK	PUNK ZIEGEL & KNOELL.
PWJC	PAINE WEBBER INC.
RAGN	RAGEN MCKENZIE INC.
RPSC	RAUSCHER PIERCE
RBSF	ROBERTSON STEPHENS & CO.
SALB	SALOMON BROTHERS
SBNY	SANDS BROTHERS & CO., LTD
SELZ	FURMAN SELZ INC.
SHWD	SHERWOOD SECURITIES CORP.
SNDV	SOUNDVIEW FINANCIAL
SWST	SOUTHWEST SECURITIES.
TSCO	TROSTER SINGER CORP.
TUCK	TUCKER ANTHONY, INC.
TVAN	TEEVAN & CO., INC.
UBSS	UBS SECURITIES
WARB	S.G. WARBURG & CO., INC
WEAT	WHEAT FIRST SECURITIES.
WEDB	WEDBRUSH MORGAN SEC.
WEED	WEEDEN & CO. LP
WERT	WORTHEIM,SCHRODER

THIS LIST IS A REPRESENTATION OF SOME CURRENT MARKET MAKERS. BE CAREFUL, IT CAN AND WILL CHANGE.

READING LIST:

BOOKS AND COURSES

ELECTRONIC TRADING 'TNT' I — GORILLA TRADING STUFF
Joe Ross and Mark Cherlin

ELECTRONIC TRADING 'TNT' II— HOW –TO-WIN TRADING STUFF
Joe Ross and Mark Cherlin

ELECTRONIC TRADING 'TNT' III — TECHNICAL TRADING STUFF
Joe Ross and Mark Cherlin

ELECTRONIC TRADING 'TNT' IV — TIPS –TRICKS AND OTHER TRADING STUFF
Joe Ross and Mark Cherlin

WHAT I LEARNED LOSING A MILLION DOLLARS
Jim Paul and Brendan Moynihan

REMINISCENCES OF A STOCK OPERATOR
Edwin Lefevre

MARKET WIZARDS - (Interviews with Top Traders)
Jack D. Schwager

HOW TO MAKE MONEY IN STOCKS
William J. O'Neil

THE DISIPLINED TRADER
Mark Douglas

THE INNER GAME OF TRADING
Robert Koppel and Howard Abell

THE WINNING EDGE
Adrienne Laris Toghraie

PRIVATE AND GROUP SEMINARS

ELECTRONIC TRADING 'TNT'— EXPLOSIVE TRADING STUFF
Joe Ross — Mark Cherlin

INSPIRATIONAL THOUGHTS

"THE TOUGHEST THING ABOUT SUCCESS IS THAT YOU'VE GOT TO KEEP ON BEING A SUCCESS." **IRVING BERLIN**

"A SHIP IS A SAFE HARBOR — BUT THAT'S NOT WHAT SHIPS ARE FOR." **JOHN A. SHEDD**

"THE QUALITY OF A PERSON'S LIFE IS IN DIRECT PROPORTION TO THEIR COMMITMENT TO EXCELLENCE." **VINCE LOMBARDI**

"OUR GREATEST GLORY IS NOT IN NEVER FALLING, BUT IN RISING EVERY TIME WE FALL." **CONFUCIOUS**

PERSISTENCE

NOTHING IN THE WORLD CAN TAKE THE PLACE OF PERSISTENCE.

TALENT WILL NOT, NOTHING IS MORE COMMON THAN UNSUCCESSFUL MEN WITH TALENT.

GENIUS WILL NOT, UNREWARDED GENIUS IS ALMOST A PROVERB.

EDUCATION WILL NOT, THE WORLD IS FULL OF EDUCATED DERELICTS.

PERSISTENCE AND DETERMINATION ALONE ARE OMNIPOTENT. **CALVIN COOLIDGE**

THE DROPOUT

HE DROPPED OUT OF GRADE SCHOOL.

HE RAN A COUNTRY STORE — WENT BROKE. HE TOOK 15 YEARS TO PAY OFF HIS BILLS.

HE TOOK A WIFE — UNHAPPY MARRIAGE.

HE RAN FOR THE HOUSE OF REPRESENTATIVES — LOST TWICE.

HE RAN FOR THE SENATE — LOST TWICE.

HE DELIVERED A SPEECH THAT BECAME A CLASSIC — AUDIENCE INDIFFERENT.

HE WAS ATTACKED DAILY BY THE PRESS AND DESPISED BY HALF THE COUNTRY.

DESPITE ALL THIS, IMAGINE HOW MANY PEOPLE ALL OVER THE WORLD HAVE BEEN INSPIRED BY THIS AWKWARD, RUMPLED, BROODING MAN WHO SIGNED HIS NAME SIMPLY, A. LINCOLN. **FROM A MESSAGE PUBLISHED IN THE WALL STREET JOURNAL BY UNITED TECHNOLOGIES CORPORATION.**

THE MAN IN THE GLASS

WHEN YOU GET WHAT YOU WANT IN YOUR STRUGGLE FOR SELF
AND THE WORLD MAKES YOU KING FOR A DAY,

JUST GO TO THE MIRROR AND LOOK AT YOURSELF
AND SEE WHAT THAT MAN HAS TO SAY.

FOR IT ISN'T YOUR FATHER OR MOTHER OR WIFE
WHOSE JUDGMENT UPON YOU MUST PASS,

THE FELLOW WHOSE VERDICT COUNTS MOST IN YOUR LIFE
IS THE ONE STARING BACK FROM THE GLASS.

YOU MAY BE LIKE JACK HORNER AND CHISEL A PLUM
AND THINK YOU'RE A WONDERFUL GUY,

BUT THE MAN IN THE GLASS SAYS YOU'RE ONLY A BUM
IF YOU CAN'T LOOK HIM STRAIGHT IN THE EYE.

HE'S THE FELLOW TO PLEASE — NEVER MIND ALL THE REST,
FOR HE'S WITH YOU CLEAR TO THE END,

AND YOU'VE PASSED YOUR MOST DANGEROUS, DIFFICULT TEST
IF THE MAN IN THE GLASS IS YOUR FRIEND.

YOU MAY FOOL THE WHOLE WORLD DOWN THE PATHWAY OF YEARS
AND GET PATS ON THE BACK AS YOU PASS,

BUT YOUR FINAL REWARD WILL BE HEARTACHE AND TEARS
IF YOU'VE CHEATED THE MAN IN THE GLASS.

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