MTPredictor™
Find a Trade | Assess Risk/Reward | Determine Position Size | Manage the Trade

MTPredictor™ Trading/Training Course

[Part 1]

Steve Griffiths
MTPredictor Ltd
www.MTPredictor.com

Fourth Edition: July 2009

Web: www.MTPredictor.com
Email: Sales@MTPredictor.com

- First edition: November 2003
- Minor amendments: February 2004 and May 2004
- Second edition – including new chapters and amendments: August 2004
- Third edition – Parts 1 and 2: October 2004
- Minor amendments: February 2005
- Fourth edition (major re-write to align with MTPredictor v6.0): January 2009
- Minor amendments: July 2009
- Minor amendments: Dec 2009

Continued on the next page . . .

Risk Disclosure & Performance Disclaimer

Trade at your own risk. The information provided here is of the nature of a general comment only and neither purports nor intends to be, specific trading advice. It has been prepared without regard to any particular person's investment objectives, financial situation and particular needs. Information should not be considered as an offer or enticement to buy, sell or trade. You should seek appropriate advice from your broker, or licensed investment advisor, before taking any action. Past performance does not guarantee future results. Simulated performance results contain inherent limitations. Unlike actual performance records the results may under or over compensate for such factors such as lack of liquidity. No representation is being made that any account will or is likely to achieve profits or losses to those shown. By purchasing the MTPredictor program, you acknowledge and accept that all trading decisions are your own sole responsibility, and MTPredictor Ltd, MTPredictor.com or anybody associated with MTPredictor Ltd including S. E. Griffiths cannot be held responsible for any losses that are incurred as a result.

All trades shown in this Trading Course are hypothetical, they were not executed. There are shown for illustration and training purposes only.

U.S. Government Required Disclaimer - Commodity Futures Trading Commission Futures and Options trading has large potential rewards, but also large potential risk. You must be aware of the risks and be willing to accept them in order to invest in the futures and options markets. Don't trade with money you can't afford to lose. This is neither a solicitation nor an offer to Buy/Sell futures, stocks or options on the same. No representation is being made that any account will or is likely to achieve profits or losses similar to those discussed on this web site. The past performance of any trading system or methodology is not necessarily indicative of future results.
CFTC RULE 4.41 - HYPOTHETICAL OR SIMULATED PERFORMANCE RESULTS HAVE CERTAIN LIMITATIONS. UNLIKE AN ACTUAL PERFORMANCE RECORD, SIMULATED RESULTS DO NOT REPRESENT ACTUAL TRADING. ALSO, SINCE THE TRADES HAVE NOT BEEN EXECUTED, THE RESULTS MAY HAVE UNDER-OR-OVER COMPENSATED FOR THE IMPACT, IF ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFIT OR LOSSES SIMILAR TO THOSE SHOWN.NO REPRESENTATION IS BEING MADE THAT ANY ACCOUNT WILL, OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE DISCUSSED WITHIN THIS SITE, SUPPORT AND TEXTS. OUR COURSE(S), PRODUCTS AND SERVICES SHOULD BE USED AS LEARNING AIDS ONLY AND SHOULD NOT BE USED TO INVEST REAL MONEY. IF YOU DECIDE TO INVEST REAL MONEY, ALL TRADING DECISIONS SHOULD BE YOUR OWN

Information: For more information, please visit the website at www.MTPredictor.com

Continued on the next page . . .

Table of Contents (Part 1)

Chapter 1 - Introduction

Welcome to the MTPredictor Trading/Training Course. Although this course is primarily designed for users of the MTPredictor software program to teach them how to get the most out of the software, it is also supplied as a stand-alone teaching aid on the topic of Risk/Reward trading with Elliott wave using MTPredictor. So, if you are using this course to learn more about MTPredictor, it will give you a very good insight into my unique *Isolation Approach*™ to trading Elliott wave and how the automatic routines in the software work.

This course is split into two main parts, Part 1 and Part 2 - Part 1 covers practical Elliott wave theory and the automatic MTPredictor trade set-ups; Part 2 covers advanced analysis using the MTPredictor software program.

Part 1 is essential reading and should be read before starting to use the MTPredictor software. Part 2 takes you to more advanced levels.

Although much of this course and, therefore, much (but not all) of the MTPredictor program, is based on Elliott wave theory, please do not start with any preconceived opinions from other sources. I have a particular way of interpreting the Elliott wave theory, so I appreciate you taking a look at what I have to say in an unbiased manner. This is particularly important because Elliott wave theory has been taught in such a specific way for so many years that most believe there's only one Elliott approach to markets. As you'll see throughout this Course, I believe this is not true.

If you are new to Elliott wave theory, you will not fully appreciate the paragraph above. So, please also read some of the standard Elliott wave textbooks to see how this analysis technique is taught conventionally. You will then be able to understand my own view and why it is necessary to amend the way the Elliott wave theory is typically taught.

Part 1 starts by tackling the practical application of Elliott wave theory, in particular where the theory breaks down in the real world. Importantly, I will offer a unique solution, which allows a very practical use of Elliott wave in today's markets. This unique approach is then detailed, showing how it is the basis of the main, automatic trade set-ups within the MTPredictor software program. If you are new to the software, these automatic trade set-ups will be the main automatic routines to use on a daily basis.

Please note, although these routines are provided in the software and are capable of automatically finding and analysing specific trade set-ups, they should not be viewed as a *black box* trading system. They are only designed to *highlight* potential trade set-ups. They should be viewed as a *systematic* approach to the markets and not a system to be followed blindly, and as such it is recommended that you view the automatic setups in context of other factors, such as the larger degree trend.

Chapter 8 in this section is probably the single most important chapter in the whole Course because it discusses what goes into and, more importantly, what comes out of your trading account - in other words, profits and losses. There are too many software programs and training courses that are unwilling to tackle the topic of trading losses, so a full understanding of this chapter is vital.

Part 2 takes the software to the next level, and shows you how to perform additional manual analysis to uncover more advanced trade set-ups. Although it is very detailed, the concepts and trade set-ups covered are simple and straightforward. More importantly, once you have learnt these advanced techniques you will fully appreciate how easy they are to apply using the modules and tools in the MTPredictor software.

Thanks and good trading . . .

Steve Griffiths

Chapter 2– Introduction to Elliott wave theory

In this first section, I would like to take a look at the Elliott wave theory as the standard Elliott wave books, courses, and software programs teach it today. I will then move on to show where (in my opinion) this theory falls down when applied to actual market activity. I'll then show one unique solution developed from practical experience as a private trader during the last 20 years.

Even if you are an advanced or expert Elliott wave analyst, please do read this section, as it will cover my own personal view on the Elliott wave theory, in particular why I feel that the Elliott wave theory does not work as well in practice as it does in textbooks. I'll show how I use the Elliott wave theory, which is very different to the standard way taught in most Elliott wave textbooks. As such, please do read this whole section, as it will allow you to fully understand how I approach market analysis myself.

This is especially important, as it is the basis upon which the MTPredictor software is built and the reason why the software works very differently from some of the other Elliott wave programs on the market today. It is vital that you have a complete and full understanding of this before you can fully appreciate the MTPredictor program and its automatic routines.

If you are one of those who have tried Elliott wave analysis, and have now given up on it because you have found that it has not worked for you, then please do read this section carefully as I hope you will be pleasantly surprised at the solution I've developed.

If you are new to Elliott wave analysis, then please understand that this is a unique take on the way Elliott wave analysis is normally taught. Please understand that I am not saying in this chapter that the Elliott wave theory does not work - only that I have found it difficult to apply consistently as it is taught conventionally. This is not just because I am not good at applying the theory...it is a story I have heard time and time again from hundreds of Elliott wave traders during my last 20 years in the markets.

If you are new to Elliott wave analysis, I do suggest that you read some of the standard Elliott wave analysis textbooks yourself. You will then be able to fully appreciate the differences and exactly why the MTPredictor approach to Elliott wave analysis is unique.

Although I do not intend to go into great depth on the Elliott wave theory, mainly because there are numerous books and training courses written already on the subject, I feel I do need to give a brief introduction to those of you who are unfamiliar with it. For those of you who are familiar with it please read on as I would like to introduce my own view on the theory.

The Elliott wave theory was born from a set of articles written in the 1930s by R. N. Elliott, from his studies mainly on the Dow Jones Industrials index - the U.S. Stock Market. He noticed that the market tended to move in certain patterns. He then surmised that these patterns could be used to predict certain future price movements.

In essence, he noticed that most strong trends tended to unfold in 5 waves in the direction of the main trend, and which were connected by certain corrective patterns. He also noticed that when each pattern was complete, it then formed part of a larger-degree pattern. He also surmised that each pattern not only unfolded as part of a larger-degree pattern but also sub-divided into a minor pattern where the impulsive swings (the ones in the direction of the main trend) tended to unfold in 5 waves connected by corrective patterns (the simplest of which was the ABC).

He then surmised that *if* a market analyst pinpointed where in this pattern the market currently was, then he (or she) should be able to predict where the market would go from here. In essence, the Elliott wave theory allowed you to predict future market movements.

This is very different from many technical analysis techniques available today, where most of them are *lagging indicators* that show you when a market turn has unfolded in the past. Elliott wave theory is designed to be *predictive* in nature and as such should be considered a *leading indicator*, with the future movement of a market able to be anticipated, once the current position is established.

Continued on the next page . . .

If you look at the chart below, you can see how the decline on this US stock, SLB, unfolded in a perfect Elliott wave pattern, where each of the swings unfolded as either an *impulsive* 5 waves sequence, or a *corrective* ABC sequence. The larger-degree waves also sub-divided into a minor Elliott wave pattern, and the minor patterns made up a larger-degree Elliott wave pattern.

So, if you were able to determine accurately where in this current pattern you are, the Elliott wave theory should then be able to predict where the market should go in the future.

As you can see, knowing what a particular market is going to do in advance sounds great and should be the answer to every analyst's dream. However, as you may suspect, it is not as easy as this in reality, and the Elliott wave theory has received much bad press over the years - because so many of its *predictions* of where a market *should go* simply have not unfolded as anticipated.

This has sometimes given the Elliott wave theory a bad reputation, with many analysts not believing that it works, or that you can make money by trading it. This is where my own view on Elliott wave analysis comes in. Like many frustrated and fed up Elliott wave analysts, who have seen too many predictions fail, I also began to suspect the Elliott wave theory was no more than a very complicated way to show what *had* happened in the past, and was worthless for any predictive ability.

If you also fall into this category, please continue to read the next few chapters, as I hope to show you where I have found the wave theory has fallen down from my own experience, and also what parts of the wave theory I have found to be reliable.

Over the next few chapters, I will take a look at the Elliott wave theory as it's taught in the more *standard* Elliott wave sources and then move on to take a very detailed look at where (in my opinion) the Elliott wave theory falls down. In particular, I will look at what may be the greatest failing of the Elliott wave theory - it is so difficult to pinpoint exactly where you are in the current pattern, making any future prediction far less reliable than we would like.

Then, more importantly I will dissect the theory and take a look at what I have found to be a very reliable and simple pattern that, taken in isolation, provides a very good method for identifying a high probability, low-risk *trade set-up* that allows you to enter the market with a small initial risk, compared with the anticipated profit.

In essence, what I have done from my own research and experience over the last 20 years, is to take one part of the Elliott wave theory and, rather than use it for trying to predict the future, used it as a method for identifying a high probability, low-risk trade set-up - where the aim is simply to enter a trade with a small controlled risk. Over time, the result of these trades produces profits that are greater than the losses.

If you are an experienced trader already, then you will know that the single most important aspect of any successful long-term approach to the market is having a method that can consistently keep your losses small in relation to your profits.

Therefore, as you read the next few chapters, please bear in mind that this is a personal view of the Elliott wave theory, from my own experience as a private trader in the markets. Over the years, I have also heard a similar story from many traders who have also tried the Elliott wave theory, and have been less than impressed with the results.

Please understand, I am not saying that the Elliott wave theory does not work, or that some people cannot use it. There are a number of very good traders worldwide who use the Elliott wave theory very well indeed. But in my own experience I have found the Elliott wave theory to be less reliable than I liked, and also I have met many traders who have also had a similar bad experience with the theory, and found it difficult to apply on a consistent basis.

Even if you are an experienced Elliott wave analyst, and you like the Elliott wave theory, please bear with me, because I hope I can demonstrate that within the theory there is one simple pattern that is worth its weight in gold. But more importantly, that this simple pattern is far easier to identify and work with than trying to apply the whole of the Elliott wave theory all of the time with all of is complex patterns and alternate wave counts.

Chapter 3 – Basic Elliott wave theory

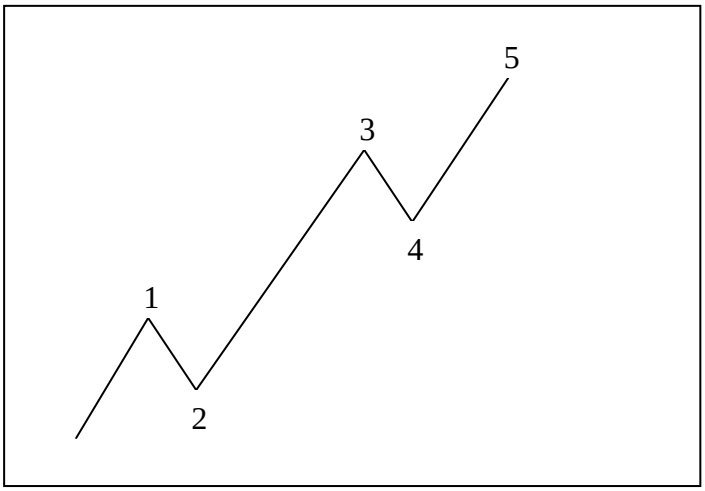
In this chapter I would like to look at the basic form of the Elliott wave patterns, and then look at some of the basic rules (or guidelines) that are currently used today by Elliott wave analysts. Although, at first sight, this chapter may seem very complicated, please read through the entire chapter, because it will lead on to why I suggest trading in the way I do later in the Book. It is vital to first understand Elliott wave theory in its conventional guise, to be able to see its shortfalls, to see how to use the parts that do work and why they work.

First I would like to give a General Overview of Elliott wave theory.

General Overview

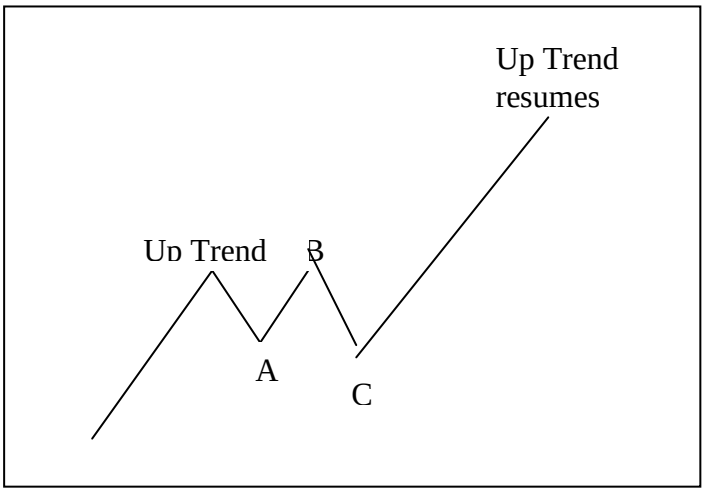
First there are two basic categories of waves: Impulsive (those that are *in the direction of* the main trend), and Corrective (those that are *against* the main trend).

An Impulsive Wave normally unfolds in 5 waves of lesser-degree, and normally unfolds in the direction of the main trend. Let's see what this looks like:



Here you can see the simple basic form of the Impulsive 5 wave swing, where you have 5 waves that unfold, in the direction of the main trend…in this example, up.

A Corrective wave is basically any form of wave that is not impulsive. The easiest to recognise and the most common is the simple ABC correction.

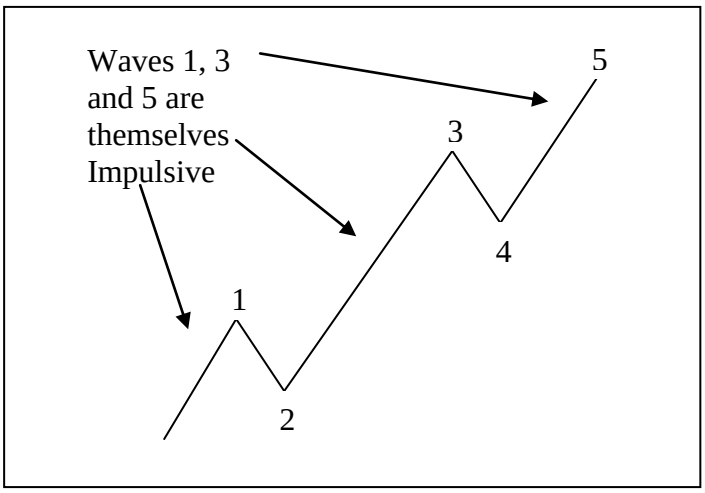


Here you can see the basic form of the simple ABC correction, where an up trend is followed by a correction that sub-divides into 3 swings, which are labelled A, B, and C. Then, once the correction is complete, the prior trend resumes.

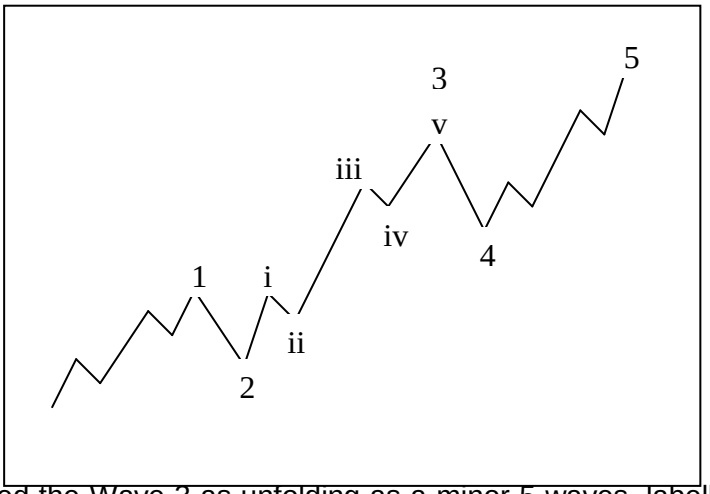
Now I would like to go into a little more detail on each category of Wave, starting with Impulsive waves.

Impulsive Waves – Basic form

The basic 5-wave pattern is made up of *lesser-degree* waves of which Waves 1, 3 and 5 are themselves impulsive 5-wave patterns.

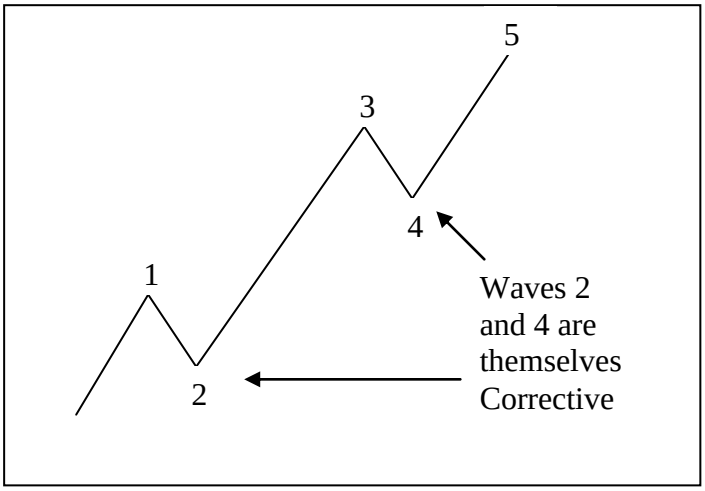


These impulsive waves (1, 3 and 5) should each sub-divide themselves into lesser-degree 5-wave patterns.



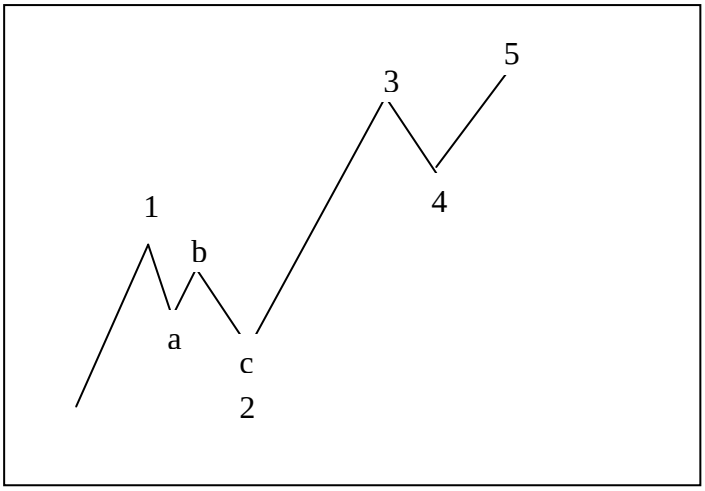
Here I have labelled the Wave 3 as unfolding as a minor 5 waves, labelled i, ii, iii, iv and v, but both Waves 1 and 5 should also sub-divide into a lesser-degree 5 wave pattern.

Waves 2 and 4 (which *link together* Waves 1, 3 and 5) are Corrective.



Continued on the next page. . .

Waves 2 and 4 normally sub-divide into either a simple ABC or one of the more complex corrective Elliott wave patterns, (more on this later).

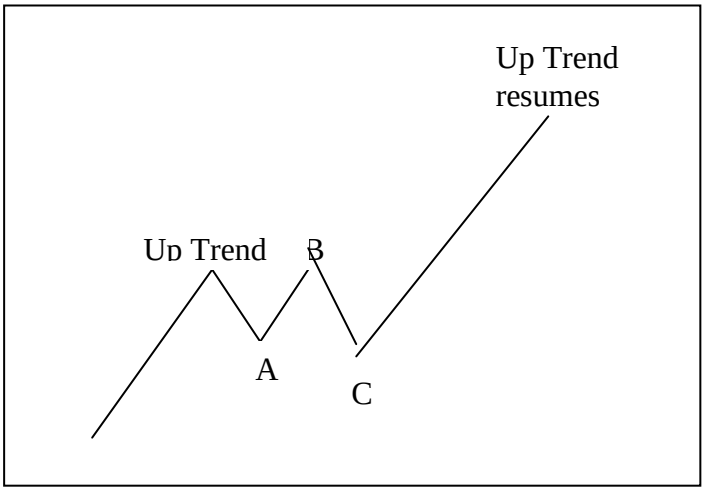


Here I have labelled the Wave 2 as unfolding as a minor 3 wave correction, labelled a, b and c, but wave 4 should also sub-divide into a minor corrective pattern.

Corrective Waves – Basic form

Although there is only one basic impulse wave (the 5 wave sequence) corrective patterns can unfold in many different forms. This (I believe) is one of the main reasons why Elliott wave analysis gets such a bad press, and why it is so difficult to apply consistently in practice, as many of these more *complex* corrections are what they sound - very complex, and are very often only visible after they are complete, which is useless for making an informed trading decision.

Elliott himself described in detail many of these complex corrections. However, because of their limited use, I believe it is best sticking to the easiest to recognize, most reliable and most common corrective pattern – the simple ABC correction.



CRACKED TRADING SOFTWARE

70+ DVD's FOR SALE & EXCHANGE

www.traders-software.com

www.forex-warez.com

www.trading-software-collection.com

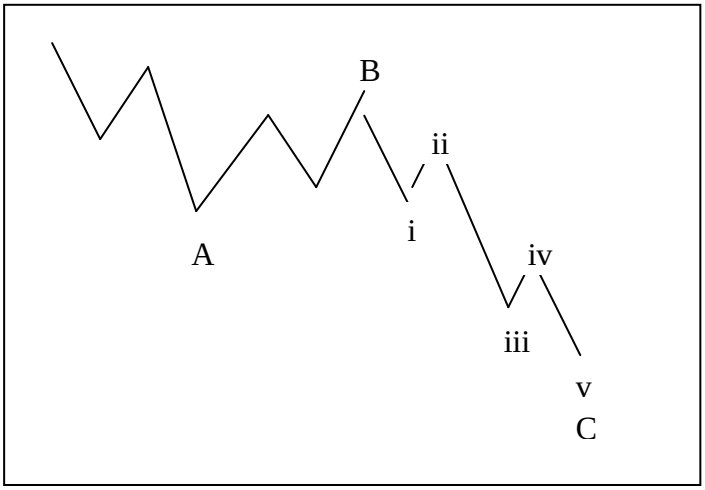
www.tradestation-download-free.com

Contacts

andreybbrv@gmail.com
andreybbrv@yandex.ru
Skype: andreybbrv

As you saw earlier, the simple ABC correction is a 3-swing pattern where the Wave C exceeds the price extreme of the Wave A.

Ideally Wave A of the ABC should sub-divide into a *lesser-degree* 3 (ABC) or 5 (12345) wave pattern, and the Wave B should sub-divide into a lesser-degree 3 (ABC) wave pattern and the Wave C should sub-divide into a lesser-degree 5 (12345) wave pattern. This is the only place where a 5 wave pattern would be viewed as part of a correction and therefore not *in the direction of* the main trend.



Here you can see the minor 5-wave sub-division of the Wave C into a lesser-degree i, ii, iii, iv and v waves.

At first sight this may seen complicated, but I assure you things will get a lot simpler and easier in the following chapters. Part of what I wish to convey in this chapter is how complex and involved Elliott wave analysis can be in theory. Once we get on to the practical application in the next chapter, things will start to get even worse. But, again rest assured, this is only a means to an end, because I need you to see and fully understand the complexities of the Elliott wave theory to be able to fully understand the simplicity of the MTPredictor approach later in the course.

As you may have guessed already, you will be seeing a lot more of this simple ABC pattern as we progress further in the course!

Okay, now I have outlined the basic form of the two main categories of Elliott waves, I can start to look at the rules (or guidelines) on how they should unfold.

Impulsive Wave – rules for a 5 wave sequence

There are three main rules that most standard Elliott wave analysts adhere to today:

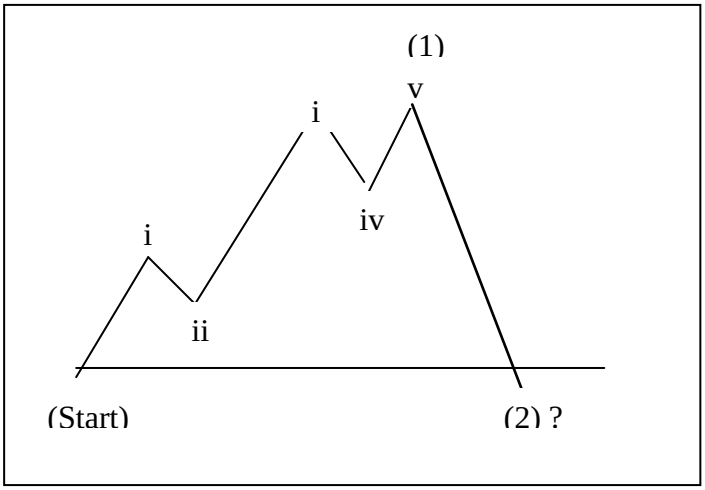
1. Wave 2 cannot retrace past the start of Wave 1
2. Wave 3 cannot be the shortest wave in a completed 5 wave sequence, and
3. Wave 4 cannot retrace into Wave 1

Although these are quoted as *rules,* Elliott himself (in his original writings) never referred to these as strict rules, he used phrases like *should* and *rarely* to describe them. As such, the label of *Elliott wave rules* was probably added in later years in an attempt to make the principle less ambiguous and more structured and exact. I will look at this in more detail in a later section.

For now I would like to look at each of these rules to demonstrate how to label a chart correctly.

Impulsive rule 1 – Wave 2 cannot retrace past the start of Wave 1

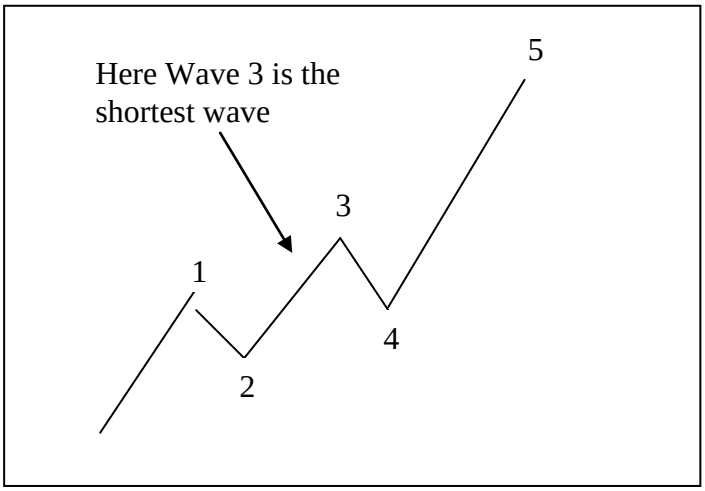
If Wave 2 retraces past the start of Wave 1, then it cannot be considered a Wave 2 and the current wave structure must be reconsidered.



This cannot be considered a valid wave count, because Wave (2) has traded below the start of Wave (1), so this wave count must be re-considered.

Impulsive rule 2 – Wave 3 cannot be the shortest wave

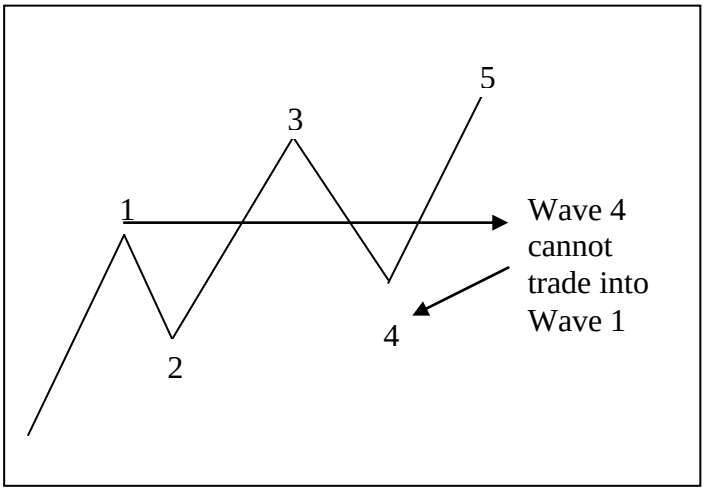
Wave 3 cannot be the shortest wave in a completed 5-wave structure.



Here Wave 3 is the shortest wave in this completed 5-wave sequence, which would be in breach of the second rule, so this wave count is incorrect and must be re-considered.

Impulsive rule 3 – Wave 4 cannot retrace into the area of Wave 1

If Wave 4 retraces into the area of Wave 1, then it cannot be considered a Wave 4, and the current wave structure must be reconsidered.



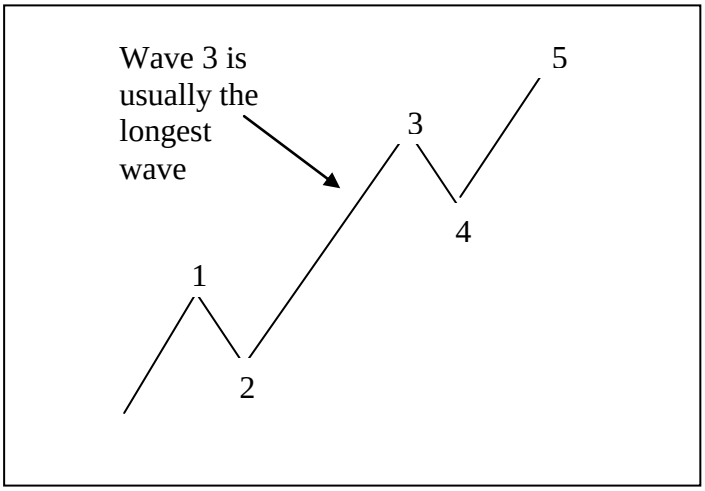
Here Wave 4 has retraced back below the high of Wave 1, which would be in breach of the third rule, so this wave count is incorrect and must be re-considered.

They are the three main Elliott wave rules that should be obeyed in all 5-wave sequences. Now I would like to look at some additional observations and general guidelines that can help in placing an Elliott wave count on a chart.

Corrections and corrective waves do not have a set of *rules* associated with them, so these general observations focus on the *ideal* 5 wave pattern.

General observation 1 – Wave 3 is usually the strongest Wave

Rule 2 stated that Wave 3 cannot be the shortest wave in a complete 5 wave sequence. In practice, Wave 3 is usually the strongest and longest wave.



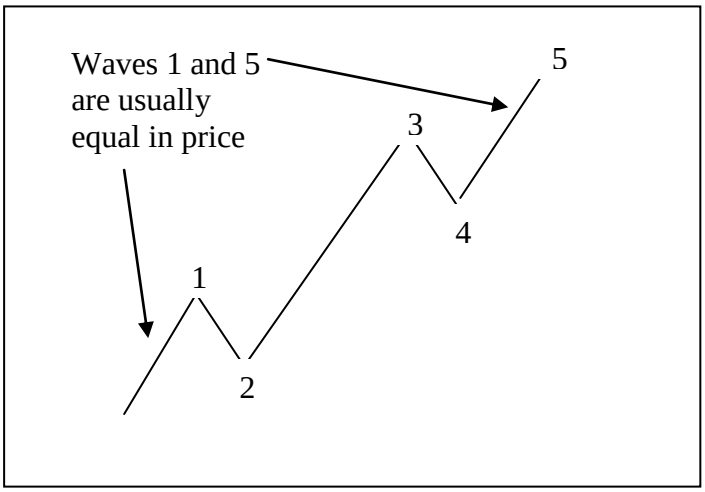
As wave 3 is usually the longest and strongest wave it normally carries the largest profit potential so (as you will see later) this is one of the best waves that you can trade.

Wave 3 very often is the *extended* wave, where this swing trades beyond what is considered normal in a completed 5-wave sequence. Again this makes this an ideal wave to trade, because of its large profit potential.

Continued on the next page . . .

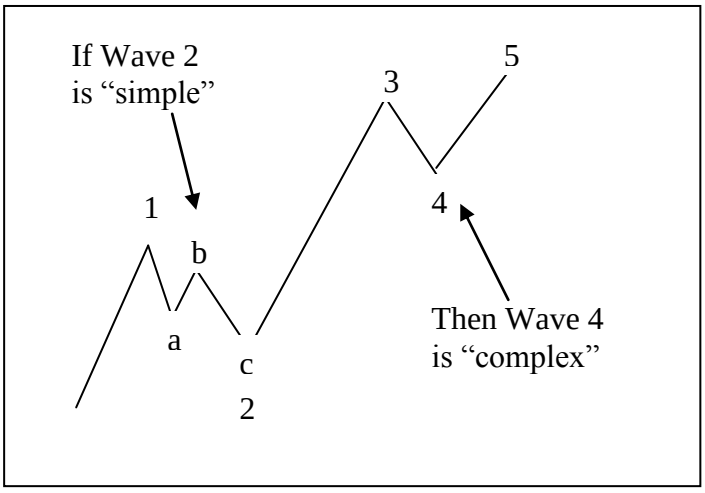
General observation 2 – Waves 1 and 5 are very often equal in price

If Wave 3 is the extended wave (i.e. it is the longest Wave) then very often Wave 1 and Wave 5 tend to be approximately equal in price.



As wave 5 is very often equal in price to Wave 1, once Wave 4 is complete, this allows an easy way to approximate where the Wave 5 will end.

General observation 3 – the rule of alternation

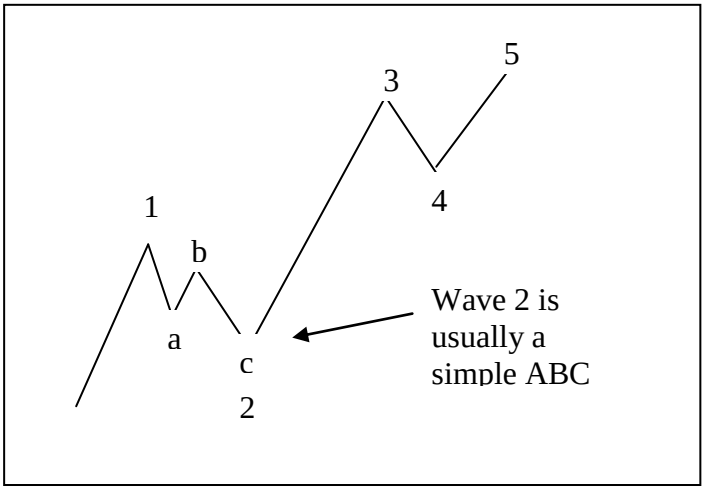


There is a general tendency for the pattern of the two corrective swings in a completed 5-wave sequence to alternate between a *simple* (very often an ABC) correction and one of the more complicated or "complex" Elliott corrections.

This is a very helpful observation, because if Wave 2 unfolds as a simple ABC correction then the probabilities will favour that Wave 4 will unfold as a more complex correction. And vice-versa, if Wave 2 is complex, then you should anticipate that wave 4 is likely to unfold as a simple ABC pattern.

General observation 4 – Wave 2 usually unfolds as a simple ABC correction

In most cases Wave 2 usually unfolds as a simple ABC correction. Or put another way, a simple ABC correction is found in a Wave 2 correction more often than in a Wave 4.

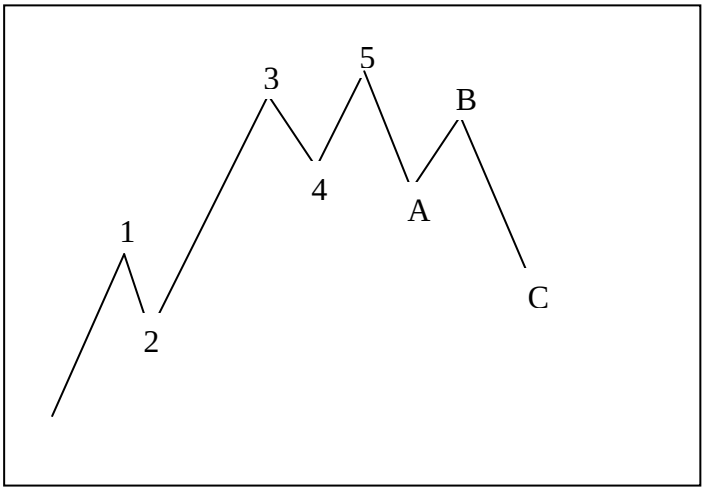


Again, this is a very useful piece of information, because once Wave 1 is complete, then the most likely pattern to unfold is a simple ABC correction.

And, because of the rule of alternation, this leads onto Wave 4 usually being the *complex* correction in a completed 5-wave sequence.

General observation 5 – Once a 5 wave sequence is complete, the whole sequence is corrected

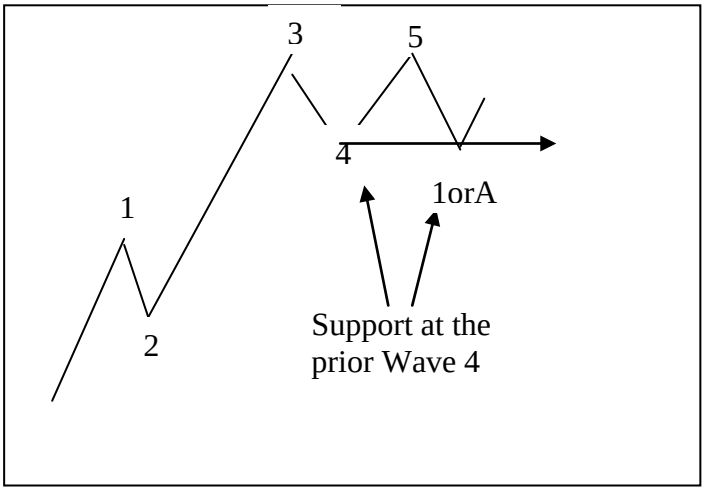
Once the Wave 5 of a completed 5-wave sequence is complete a correction will unfold that corrects the entire prior 5-wave sequence



What this means in practice is that once Wave 5 is complete a correction which is larger than any correction incurred during the prior 5-wave sequence should then unfold.

General observation 6 – The first leg of the move off a complete 5 wave sequence often finds support / resistance at the prior minor Wave 4

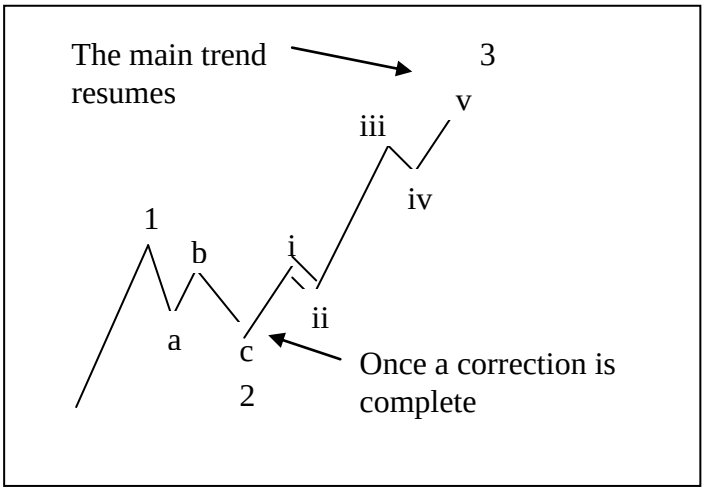
Again, this is a very useful observation as it gives you an approximate target for the first swing of the correction following the end of a completed 5-wave sequence. In Elliott wave terms this is the Wave 1 or A



Here you can see how the first swing off the Wave 5 high found support at the price level of the prior minor Wave 4.

General observation 7 – Once a correction is complete the main trend resumes

Once a correction is complete the main trend normally resumes.

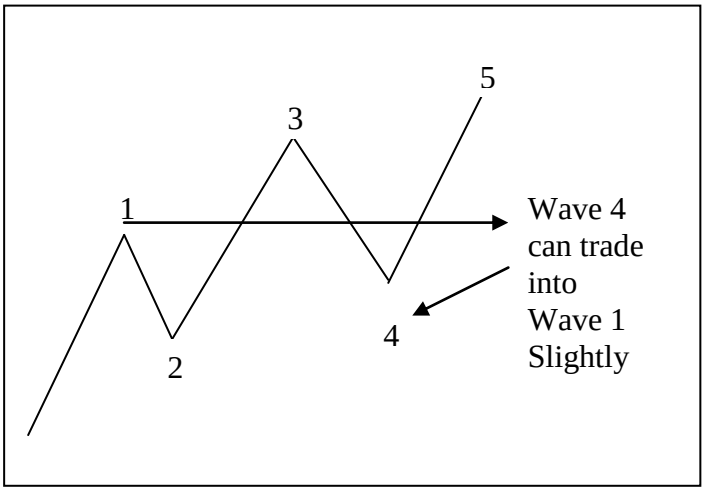


Again, this is a very important observation, because it allows you to anticipate that once a corrective sequence (ideally a simple ABC) is complete, it should be followed by a strong and impulsive move in the original trend direction.

I will be returning to this idea later in the Book.

General observation 8 – Wave 4 can retrace into the area of Wave 1 (slightly)

Rule number 3 states that Wave 4 cannot retrace into the area of Wave 1. However, in practice, particularly in the commodity markets, a small retracement into the area of Wave 1 often happens.



Here Wave 4 has retraced back *just* below the high of Wave 1, which normally would invalidate this as a potential 5-wave count. However, in practice you can allow Wave 4 to dip into the area of wave 1 slightly.

Actually, if the market in question immediately reverses and then moves out of the area of Wave 1, then this should be allowed as a valid 5 wave count. As you will see in a later chapter, although this minor breach of the Wave 1 extreme can be *allowed* it should not normally happen in a *perfect* 5-wave count.

As such, when this happens you should treat the wave count as *valid* but not perfect. More on this in Chapter 15 on advanced Elliott wave analysis.

Continued on the next page . . .

Okay, now I have finished a General Overview of Elliott wave and the specific Elliott rules and also some General Observations, you should be ready to apply these to some charts. So let's take a look at a few examples.

Firstly, here is a chart of a US stock, Schlumberger Ltd (SLB):

Can you see any Elliott wave patterns on this chart ?

Please try to label this chart for yourself before turning the page to see the answer.

Continued on the next page . . .

Here is the answer - a potential 5-wave decline:

This obeys all of the specific Elliott wave rules...

As well as obeying the basic Elliott wave *rules*, this 5-wave decline also reflects many of the Elliott guidelines that were outlined earlier in this chapter. Please see the chart on the next page.

Continued on the next page . . .

Here is a more detailed look at the Schlumberger chart:

Here you can see many of the general Elliott guidelines, in particular:

- Wave (3) is the strongest and longest of all the Waves.
- Waves (1), (3) and (5), being the 3 impulsive waves, clearly sub-divide into a minor 5 wave sequence.
- Wave (2) is corrective and sub-divides into a simple ABC correction.
- In this example Wave (4) also appears to sub-divide into a minor ABC, which disagrees with the rule of alternation and is regarded as rare.

When this Wave (5) low is complete, as outlined in guideline number 5, a rally greater in magnitude than any of the corrective rallies during this decline should unfold.

Let's see what unfolded after this Wave (5) low was complete. Please see the chart on the next page.

The result:

Exactly as anticipated, once the Wave (5) low was complete (on Oct 10 2002) then a rally stronger than any during the decline off the Feb 2002 high did indeed unfold.

As you can see, placing an Elliott wave count on a chart, and then anticipating where the market will move into the future is simply a matter of following the Elliott rules and guidelines.

Continued on the next page . . .

Let's look at another example:

Again, try to place an Elliott wave count on this chart before turning the page.

Continued on the next page . . .

Here is the answer:

And, as outlined in guideline number 7: Once a correction is complete, the prior main trend normally resumes. This is exactly what happened, with BOY (UK stock) continuing the prior rally to new highs...

The future appears to unfold exactly as anticipated by the Elliott wave theory!

These are just two examples but, at first sight, the Elliott wave theory appears to be perfect - all you have to do is place the appropriate wave count on the chart, by obeying a few simple rules and guidelines, and then you should be able to forecast where the market will go next. And as you have seen from these two examples, the profits should then just fall into your account.

Well, these were two carefully chosen examples, and this is where the problem normally occurs. Most textbooks and Elliott wave courses use specially selected examples that are tailored to *demonstrate* the technique.

However, as we will see in the next chapter things are very different once you enter the real world.

Chapter 4 – Enter the real world

Please understand that the comments in this course are only a personal observation from my own experience, but it is one that appears to reflect many Elliott wave analysts I have met during my 17 years involved in the markets. The normal sequence of events goes something like this…

Firstly, the budding Elliott wave analyst hears about Elliott waves on some chat room or from another trader, and then goes and purchases an Elliott wave book or trading course. They then spend months carefully studying all of the rules and guidelines with the aim of becoming fluent in Elliott wave analysis.

They then try to apply the rules and guidelines they have learnt to real and live market examples, normally with limited success. You can always spot a new Elliott wave analyst because they always have the most current bar ending some sort of complicated wave structure, with labels of varying degree all over their chart. They then make a forecast that *must be correct* because everything is perfect and all the rules have been obeyed on their chart.

However, the market usually goes the other way, resulting in a trading loss. They usually try this on a number of charts over a few weeks or months, with most of the charts moving in exactly the opposite direction to anticipated. Sometimes the Elliott student will have one great success, and call the exact day of a market turn, which normally makes them deny or carefully forget more of the not-so-good recent calls on other markets. But usually, at some point, the student admits that most of their calls are not working out as anticipated.

Not to be disheartened, the budding Elliott student puts this minor setback down to lack of knowledge and then returns to a greater and more in-depth study of the subject, putting their recent failures behind them and continuing to study.

After months (sometimes years) of further study, the Elliott wave analyst emerges and returns to the market confident in his (or her) new found and now complete knowledge of the Elliott wave theory. He (or she) has spent many long hours carefully applying the rules and guidelines to as many charts and past examples as they can find, to make themselves confident to be able to recognise and apply the rules perfectly to real and live examples.

However, a very similar outcome normally unfolds, with most of the market calls made by the Elliott analysts not turning out as anticipated.

To cut a long story short, at some point the Elliott wave student will come to the conclusion that Elliott wave analysis does not work and therefore cannot be used to profitably trade the markets.

Sometimes it can take years for Elliott wave analysts to come to this conclusion, but at some point they normally give up in a burst of fury claiming to anybody who will listen that Elliott wave theory is rubbish and useless.

So, depending on where you are along this time line, you will normally fall into one of three broad categories:

1. New to Elliott wave and still completely amazed at what it promises to do, or
2. Experienced but frustrated at your lack of success or consistency, or
3. Completely given up and angry and frustrated by the whole experience.

Although there are a few people who can (and do) use Elliott wave analysis in the markets successfully, they are few and far between. The vast majority of Elliott traders that I have met in the last 20 years fall into one of the three categories above. Can you relate to one of these categories?

To show you what I mean, and shed some light on the apparent lack of success by Elliott wave analysts in what appears to be a very simple and easy-to-apply approach, I will take a look at a number of examples during the rest of this chapter. So if you are one of the frustrated Elliott wave analysts, please read on and take heart in the following examples.

Continued on the next page . . .

Here is the first example:

Here is a Daily chart of AML, a UK stock. Okay, how would you label this chart, what swings can you see and what Wave count would you use? Remember, all I did in the last chapter was to apply the Elliott wave rules and guidelines and the rest was simple!

But I imagine you are still looking at the chart above, desperately trying to make a reasonable count *fit* onto it.

This is the first and biggest mistake an Elliott wave analyst can make – assuming that just because they have a chart in front of them, a wave count can or indeed should be applied. This is false, as the worst mistake you can make is to *force* a wave count. If a wave count is not *obvious* then admit that there is no count present and move onto the next chart.

However, this is against human nature and against most of the Elliott wave textbooks available today, mainly because they teach that Elliott waves are always on a chart. As such you should always be able to *know* where in a wave count you are, so you should always be able to know where the next move is likely to unfold. However, this is the single largest misrepresentation of how Elliott wave analysis works in the real world.

This apparent ambiguity has led to the theory of alternate counts. This is where two (or more) alternate counts can exist at the same time, so the market (by its own action) will either confirm or invalidate these counts to show the true and current count.

However, as you can imagine, trying to deal with (and trade with) such uncertainty is a nightmare - for the trader, more often than not, the wave count you are using will turn out to be the wrong one, and although the theory was correct in hindsight, you have lost money.

The same can be said for many Elliott wave software programs on the market today in that they change their wave counts as new market data arrives. In theory this is great, because the program can *adjust* to unfolding events. However, in practice I have heard too many horror stories where the trader was left with a loss after the software has re-labelled the chart, to be correct, but again this was after the trader had lost money.

Again this is a personal opinion from my own personal experience and other traders I have spoken with over the years.

I believe there is only one way to reasonably deal with a chart like the one on the prior page, and that is to forget it and move on to the next.

The idea that a valid wave count is not applicable on all charts all of the time is not new. However, it is not a common practice among the Elliott wave purists, who have developed a number of more complex and varied ways of counting wave structures to be able to cope with all eventualities. For those of you who have reached an advanced level of Elliott wave analysis, as well as alternate counts, you will have come across the *X* wave – an attempt to link together complex corrections to take account of irregular wave structures.

Again, I feel this creates more confusion than it dispels and should be re-named the *don't know* wave!

However, it is not just this particular wave formation that creates confusion, it is because there is a vast array of *complex* corrections that are categorised and defined and *could be* applied to a chart. Again, any corrective pattern that goes much beyond the simple ABC correction is too complex and as such should be avoided with the simple and easy to apply phrase "I don't know". But admitting that you *don't know* goes against human nature, so in a vain attempt to place an Elliott wave count on a chart, budding Elliott wave analysts often make more trouble for themselves by not admitting the count is beyond a simple and obvious one and moving onto the next chart.

I could go on to show a huge number of ever more complex variations that just do not work out in practice, but I leave it as read that if you encounter a corrective wave structure that goes much beyond a simple ABC, then it is best avoided.

Okay, another example...here you can see a Daily chart of Soybeans in the summer of 2008 (it does not matter what market this is, only that you have what appears to be an initial rally off prior major low). From the rules and guidelines covered in the last chapter, what should you anticipate unfolding from here?

Exactly…After a Wave (2) low is complete, you should anticipate that a Wave (3) rally will unfold that will take the market in question (Soybeans) to new highs, and this rally should be longer and stronger than Wave (1).

Continued on the next page . . .

As you can see from the chart above, this is exactly what unfolded. The Wave (3) was perfect in that is was much longer than the Wave (1) rally and also sub-divided into a lesser-degree 5 wave pattern.

So far, so good and the Elliott wave theory has done a great job of anticipated what should unfold next.

Okay, now a Wave (3) high is complete, what should you anticipate will happen next?

Continued on the next page . . .

Ideally, following a Wave (3) high the market should make a Wave (4) correction, which should be followed by another rally to new highs – the Wave (5). This should then complete the entire sequence.

So far the Waves (1), (2) and (3) appear to be perfect so you should anticipate that this will continue, and a Wave (4) corrective decline should now unfold before a rally, in a Wave (5), to new highs.

But, as you can see from the chart above, this did not happen. Instead Soybeans declined sharply, with no sign of the Wave (4) correction, or the Wave (5) rally.

This situation happens far more than most Elliott wave analysts would like to admit. After a period of working perfectly, with textbook waves unfolding, the whole pattern blows up and just stops working. This is a nightmare if you are in a trade, because all your carefully laid plans have to be thrown out of the window.

If you are honest, I am sure that the experienced Elliott wave analysts among you have all seen this happen again and again, and it is one of the most frustrating parts of the practical application of the theory - one day you are in perfect control and know exactly what is happening, then suddenly, for no reason, you are left without a clue about the pattern, or are even expecting a pattern that does not unfold.

So why should the theory break down so suddenly?

Sometimes the current Elliott wave pattern breaks down because of support or resistance on the large degree timeframe. For example, if we now look at a weekly chart of Soybeans we can see that as the daily Wave (3) high was coming in, it was finding resistance at the weekly DP zone:

This is not always the case, but sometimes a failure of an Elliott wave pattern on one timeframe, can be explained by looking at support or resistance levels on the larger degree timeframe, in this example moving from daily to a weekly chart.

However, sometimes the current Elliott wave pattern just seems to stop working. I do not have a good answer for this except that in the real world this just happens, and it does happen more often than most Elliott wave professionals would like to admit. As professional traders, rather than spending time and energy worrying about “why” this happens, it is much better to just accept that it does.

The only practical way round this is to accept that Elliott wave analysis only works about 50% of the time. In other words, an easy to recognise and obvious wave count only exists on half the charts you look at or will only work about half the time while you are looking at one market.

As we have seen in example 1, by taking this stance, if no easy-to-recognise and obvious Elliott wave pattern is present on the chart you are currently looking at, then move on to the next. This is an easy way to avoid being caught in a wave count that is just too complicated and, therefore, very unlikely to unfold as anticipated.

But, as we have seen in the second example, at some point during a perfect wave count the chart can slip into the *don't know* 50% and leave you in a very messy situation.

These examples were on different commodity markets; however the situation gets much worse once you enter the US stock market, where you can go chart after chart for hundreds of charts without finding any obvious Elliott wave structures.

Again, please do not take my word on this, I encourage you to perform your own research by looking at as many charts as you can on the markets you follow. However, all I ask is that you are honest with yourself when you look at the charts to see whether you can find any obvious Elliott wave counts. I hope that very quickly you will start to agree with me, in that it is very difficult to find an obvious and easy to spot Elliott wave sequence. In particular, it is extremely difficult to find a chart in which you can label *all of the price actio*n, obeying all of the Elliott wave rules and guidelines.

At this point, I hope I'm not depressing you too much, because all I want to do is to bring you back to earth, and demonstrate how Elliott wave analysis, as it is taught by the *standard* methods and sources, does not unfold as well as we would all like in practice.

Before you give up on Elliott wave analysis completely, please bear with me, as there is (I believe) a very good solution to this problem that I will move on to in the next chapter.

Continued on the next page . . .

Chapter 5 – The solution

In the last chapter I looked at the practical application of Elliott wave theory - how it is taught by many of the standard books, courses and software programs - and came to the conclusion that *in practice* the theory did not work for long enough periods to be a reliable technical analysis method. Having reached this conclusion, where can you go from here ?

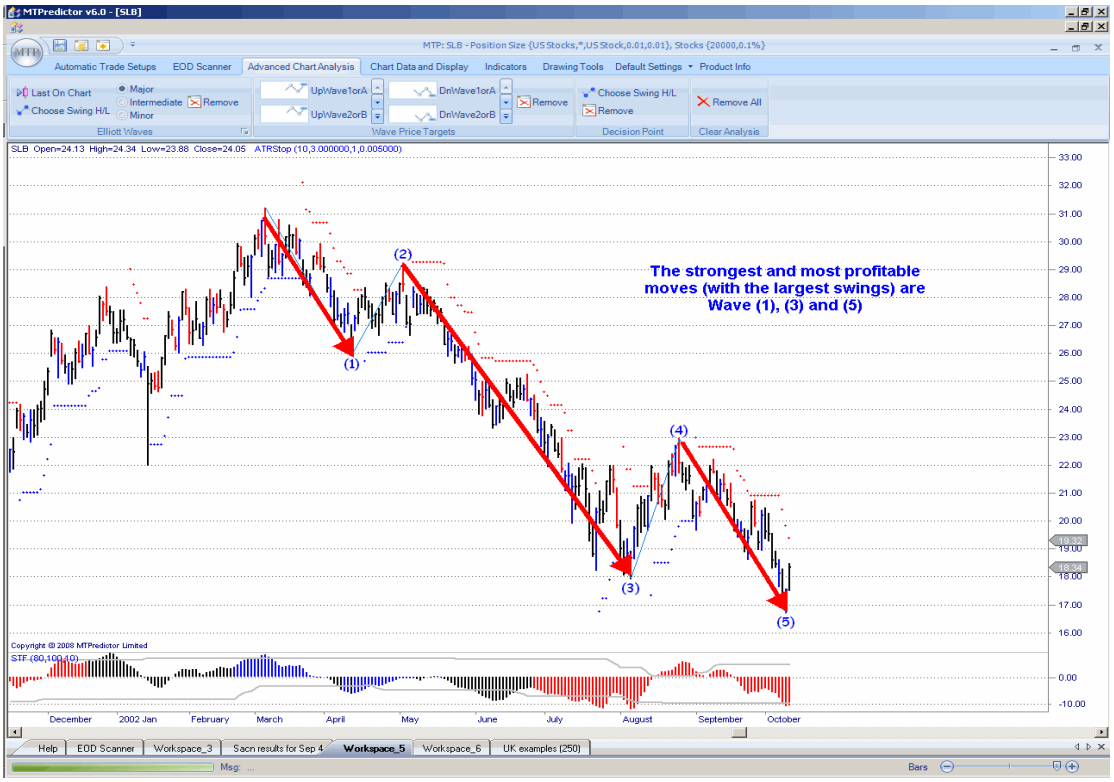
Rather than simply giving up and throwing the theory away, I spent years looking at what (if any) parts of the theory produced reliable and, more importantly, consistent results, and the solution was remarkably simple.

But before I reveal my findings I want to review what is required for a long-term profitable approach to trading the markets.

As outlined in Chapter 2, the two main criteria are that you have a method that keeps the losses small, and that (on average) keeps the profits larger than the losses. So in an ideal world, assuming that Elliott wave theory is perfect and works all of the time, where could you find such trades ?

From chapter 3, you know that the largest waves are the Impulsive waves and, as such, carry the largest profit potential but the corrective waves are by nature corrective, so they have limited profit potential. So it makes sense that the largest profit potential should be found in a study of the Impulsive waves.

Okay, let's take a more detailed look at an ideal 5-wave count.



Here you can see that the largest (and most profitable) swings are Waves (1), (3) and (5), which is no surprise because, as outlined in chapter 3, these are the three swings that are in the direction of the main trend.

So it seems obvious that the best (and most profitable) trades would come from being able to participate in these strong and impulsive moves. This would fulfil one of our primary objectives of having a trading strategy that (on average) makes trades that are larger than the losses.

You also require that a strategy that enters trades with a small controlled risk i.e. the other side of the statement in the last paragraph, in that you try to keep the losses small in comparison with the profits. At first sight this may not make sense, because if the profits are large, then by definition (on average) the losses must be small. But, as you will see later, the only way to control this equation is to focus on the losses, or initial risk. More on this later, for now I just want you to focus on this ideal Elliott wave pattern and seeing how our primary objective fits into an ideal 5-wave pattern.

Okay, if you are to keep the initial risk on any new trade as small as possible it makes sense that you need to enter the trade as early in the new trend as possible. This also has the benefit of increasing the potential profit, but for now the main advantage is that it reduces to a minimum the initial risk required to enter the new trade.

As you can see from the chart above, there are three points where the new impulsive trend starts or, looking at it another way, where the prior Wave (5) ends and where the new Waves (2) and (4) end – please see the chart on the next page.

Here are the ends of the prior swings, which also signal the beginning of the 3 new impulsive trends:

As such, your aim must be to try to enter a new trade as the prior Wave (5), then current wave (2) and the current wave (4) end - this will then place you in a new trade as the Waves (1), (3) and (5) are just beginning. As I have already outlined, this is the best you can do because this both maximises the potential profit and also reduces the initial risk on the trade.

The question now arises, how do you achieve this ?

Leaving the end of the prior Wave (5) aside for now, I would like to concentrate on the two corrective waves in this sequence - Waves (2) and (4), and in particular the Wave (2) because this leads into the strongest and longest of all the Elliott waves, the Wave (3). Therefore, being able to reliably identify the end of the Wave (2) to then be able to trade the entire Wave (3) would be the most profitable Elliott trade possible. So this is where I focused my main attention. This idea is not new – the legendary trader W.D. Gann stated that the safest place to enter a new trade is at the end of the first correction in a new trend. In Elliott wave terminology, this is the end of the Wave (2). It therefore appears that I was starting to look in the right place.

As outlined in chapter 3, the corrective Waves of an Elliott wave sequence can come in many forms, many of which are classified as *complex*. As their title suggests their complexity makes them hard to deal with. From a practical trading perspective, ideally, I was looking for a pattern that had a high reliability and could be identified easily, so looking at complex corrections appeared to being heading in the wrong direction. I then started to focus on the easiest and simplest correction in the Elliott theory.

As I outlined in chapter 3, the basic (and simplest) corrective Elliott pattern is the simple ABC correction. This is also the easiest to recognize and to work with. So I started to look at where these types of corrections unfolded.

And to my amazement, the most common pattern for the lesser-degree pattern within a Wave (2) correction was the simple ABC !

I cannot stress how important this is, because not only is the simple ABC correction the easiest recognise, but the end of the Wave C is the most reliable to identify as well. Combine this with the pattern occurring in the best place possible and the pieces were staring to fall into place, in that all a trader really needed to focus on was the identification of a simple ABC correction that unfolded as part of a Wave (2) correction.

Let's take another look at the current example:

As you can see, this is exactly what happened on this daily chart of Schlumberger Ltd. The Wave (2) sub-divided into a simple ABC correction. As such, being able to enter a trade as this ABC correction was ending would have placed you in the perfect position to take the maximum profit from the resulting Wave (3) decline, with the minimum initial risk.

I was starting to get excited now, as the pieces of what could be the ideal trade set-up started to come together. Although there is nothing new about this pattern, or indeed how it unfolds, up until now the significance and, more importantly, the simplicity of this potential trade set-up had been buried deep within the Elliott wave theory as a whole. So a number of Elliott traders had thrown this pattern out along with the whole wave theory because they had not realised that to be able to use this pattern they did not need to have to be an Elliott wave expert, or indeed become involved in the intricacies of the theory and, critically, they could avoid all the confusing and continually re-labelling patterns that tend to occur when the theory is applied in its entirety.

Let me explain what I mean.

What if all you were looking for was the occurrence of a simple ABC correction that unfolded as part of the *first correction* to the *initial move* off an *important high or low*?

There you have it, a simple ABC correction that unfolded as part of the corrective rally following the initial decline off an important high. No mention of Elliott wave or any in-depth analysis, just a very simple to recognise pattern.

As you can see, being able to enter a new short trade just as the ABC correction was ending would have put you in the perfect place to make the most profit from the large decline that followed.

But I hope you can see how, although this pattern is part of the Elliott wave theory, its identification can be made *in isolation*, and you do not need to be an Elliott wave expert. There are a number of other advantages that we will come onto later in the book.

This is where the MTPredictor automatic routines come in.

Continued on the next page . . .

As you can see, this ABC correction was found as one of our automatic (TS3) trade setups. I will come back to this later in the training course.

Yes, there was some slippage as the market gapped open on the day this trade would have been entered.

Here we can see that the potential profit at the maximum Wave 3 profit target would have been approximately 9x the initial risk required to take the trade. This is why this type of trade is so exciting, because it represents the ability to enter a trade with a very small controlled initial risk when compared to the potential profit that can unfold in strong Wave 3 type swings.

Continued on the next page . . .

Okay, now I have had a detailed look at how the minor pattern unfolds within a wave 2 correction, I would like to move on to the next corrective swing in the completed 5 wave sequence, which is the wave (4).

As you have already seen earlier in this section, the most common pattern within a wave 2 correction is the simple ABC correction and, as outlined in chapter 3, the rule of alternation would indicate that if a wave (2) correction unfolds as a simple ABC then you should anticipate that the wave (4) would unfold as one of the more complex of the Elliott wave patterns. As I have already detailed, the last thing you should get involved with is a complex correction. Because of the nature of a complex correction, they are very hard to deal with and it is almost impossible to identify their end as they are unfolding. So they are not ideal to work with when trying to identify an ideal trade set-up.

However, as I have also outlined in chapter 4, Elliott wave theory is not ideal and only tends to work about 50% of the time. So how does that affect you when you are trying to look at the minor pattern within wave 2 and then wave 4? The answer is simple - as I have already suggested, the best way to treat Elliott wave analysis is to treat the swings and waves *in isolation*. This then means that you can look at the sub-division of wave 4 in exactly the same way as you did with wave 2, in other words look for the occurrence of a simple ABC correction.

Okay, let's have a look at a few examples:

The chart on the prior page shows a classic Elliott wave sequence in which the wave 2 correction alternated with the wave 4 correction ...and it was the wave 4 correction that sub-divided as a simple ABC. As such being able to identify the end of the wave C of the ABC correction would have resulted in a great short trade to take full advantage of the wave 5 decline.

I hope you can see that all you needed to do to identify this new short trade was to identify the end of the wave C of the ABC correction, there was no detailed Elliott wave analysis or, indeed, any need to categorise this correction into any larger degree pattern or large degree trend. In essence all you had to do was look for the end of an ABC correction, exactly the same procedure as was used in the last section, for the end of the wave 2 correction.

Unlike an Elliott wave 2 correction where the correction unfolds as part of the first correction against the first move off a major high or low (as outlined before), a wave 4 correction unfolds during the main trend - in other words after the end of a wave 3.

Let's look at another example:

This is the same example that was used earlier where you saw how the wave (2) correction unfolded as a simple ABC. The theory of alternation would now suggest that wave (4) cannot be a simple ABC because it has to alternate with the ABC which unfolded as part of the wave (2). However, as you can clearly see on the chart above the wave (4) definitely unfolded as a simple ABC correction, so this seems to be in breach of the Elliott wave guidelines outlined in chapter 3. Does this matter?

If you are an armchair Elliott wave enthusiast whose main focus is on applying the theory correctly, then it would matter…however if you are a trader whose sole aim is to identify a high probability low-risk trade set-up then how you find the set-up is immaterial, whether it breaks a few of the Elliott wave guidelines or rules does not matter to you. The main thing you are after is a high probability low-risk trade set-up - it is as simple as that.

Coming back to the chart above, just as in the prior example, I hope you can see how the end of the wave C (of the ABC correction) did indeed identify both the end of the wave (4) and the start of the wave (5), so the ideal place to enter a new short trade.

I hope you are beginning to see where I am going with this? Although the Elliott wave theory is very good *in theory*, in practice all you need to be able to do is apply certain parts of it (in particular the ABC correction) consistently and reliably to be able to find high probability, low-risk trade set-ups.

So far I've been talking about a way to identify the end of the wave (2) and then a wave (4) correction in order to be able to trade the wave (3) and the wave (5), but that still leaves us with the wave 1.

As you have seen so far, both the wave (2) and the wave (4) are corrective patterns within the Elliott wave sequence, however the start of the wave (1) usually comes after the end of the prior trend. So to be able to identify the very start of wave (1), you have to able to identify the very end of the prior trend. In theory this sounds exactly the same as we've been doing so far with identifying the end of a wave (4) and a wave (2). But in practice there is a very big difference.

The main difference is in the word *trend* - a trend implies an impulsive move, which as you have seen in chapter 2 carries strength and momentum with it. Whereas waves (2) and wave (4) are corrective, implying they are weaker and less likely to overrun. This situation is very different with a strong impulsive trend, as they have a nasty habit of continuing on further than anticipated. What this means in practice is that it is normally very difficult to identify the end of a wave (5) or indeed the end of any impulsive swing.

As I have touched upon many times in the prior chapters, one of the main requirements for any trading strategy is that it can be applied reliably and consistently. The end of an ABC correction falls into this category, as it is one of the most reliable, consistent and easily recognisable Elliott wave patterns, however the end of an impulsive (5) wave swing does not fall into this category, as it has a nasty habit of overrunning. Therefore, in theory, while you should be able to identify the end of the prior impulsive trend, as such the start of a new wave (1), in practice this has a lower reliability than dealing with the end of a wave (2) and wave (4). So the question has to be asked: as a trader, would you prefer to deal with a simple and easy-to-use method that is reliable and consistent or a method that has a low reliability, low probability and more than likely would result in more losses than you are comfortable with?

Personally, I prefer to deal with patterns that have the highest reliability and are the easiest to use - this means the simple ABC correction.

Continued on the next page . . .

Up to now I have been dealing with perfect Elliott wave 5-wave sequences, in which I looked to trade the strongest impulsive moves, which were waves (1), (3), and (5). Out of these three waves, the ABC correction provided a simple and reliable method to identify and therefore trade in the wave (3) and wave (5). What if you are dealing with a pattern that cannot be categorised as a perfect 5-wave Elliott pattern? As you've seen in prior chapters, because only 50% of the time any given market is exhibiting a reliable Elliott wave pattern, this means that also 50% of the time the market is not exhibiting any pattern that can be categorised at all. Does that mean that you have to ignore half the markets, half of the time?

No, the answer is again simplicity in itself. As I have mentioned before, and will mention again, because I believe (personally) that the best way to deal with Elliott wave analysis is to treat the swings and waves *in isolation*, this means that you can look for a simple ABC correction by itself. If you think about it, all you are trying to do is use the unique characteristics of the ABC correction to identify a *trade set-up*, where the criteria of the trade set-up are to both keep the initial risk small and on average keep the profits larger than the losses.

Let's have a look at an example:

This is one of the examples I used in chapter 4 to demonstrate how often a market moved sideways in a very choppy and unpredictable pattern, in particular where it was almost impossible to try to label an Elliott wave count on the chart.

However, what if you did not try to place Elliott wave labels on the entire chart and only focused on small chunks of the chart, treating them *in isolation* ?

Let's roll time back in this example to May 16 2008 and focus our attention on just the last section of the chart:

So let's treat this pattern *in isolation* and see if you can identify a trade set-up? As you saw in chapter 3, once a simple ABC correction is complete the prior trend normally resumes.

This is the situation you have on the chart above - as of May 16, an ABC corrective rally appears to be ending. This means you should now consider a new short trade. But the most important point is that this potential sell set-up was identified *in isolation*, in other words it was not necessary to have any Elliott wave labels on any of the swings earlier in the chart. This is important, because this approach to Elliott wave analysis is very different from what is taught by most classical Elliott wave analysts.

Let's now move time forward and see how this particular market unfolded from this wave C high.

Continued on the next page . . .

Here is the chart a few weeks later:

As you can see, this share declined very nicely off the wave C high and resulted in a very profitable trade of +5.3R (I will talk more about *Rs* or risk units later in the course) at the DP support zone.

I hope you can all see the most important part of this example is how all that was needed was the identification of the end of the wave C of the ABC correction to be able to identify a potential trade set-up. There was no need for any complicated or in-depth Elliott wave analysis; in fact, you didn't even have to look at any pattern earlier in the chart prior to the set-up. This has a huge advantage over traditional Elliott wave analysis in that the trade set-up can be found *in isolation*.

Again, I would like to stress the difference between this approach and standard Elliott wave analysis because this is such an important point to understand fully.

In standard Elliott wave analysis you are required to have Elliott wave labels (or at least an alternate wave count) on all of the swings, on the entire chart, all of the time. Then, once you know where you are in the Elliott wave pattern, you should be able to predict reliably where the market will go. As you have seen in chapter 4, in the real world this is virtually impossible. This is trying to use Elliott wave to predict the future which, as you now know, is virtually impossible to do reliably...consistently...all of the time.

The approach I am looking at here is, rather than trying to predict the future, trying to identify a high probability, low risk *trade set-up*. Once your focus is on identifying trade set-ups and not trying to predict the future you are able to a look at the chart very differently. In other words, you are able to look at parts of the chart *in isolation* from what happened before or indeed may happen in the future. In essence, this releases you from the limitations of standard Elliott wave analysis.

Continued on the next page . . .

Summary

I started this chapter looking for a method that would allow you to participate in the strongest and longest moves in the completed five wave Elliott wave sequence - the wave (1), (3) and (5).

The primary concern was finding a method that would, firstly, maximise the profits and, secondly, keep the initial risk small on any new trade. The answer was the ABC correction. As you saw, this simple pattern could be used to both identify the end of a wave (2) and the end of a wave (4) to be able to participate in the wave (3) and wave (5) swings. Most importantly, the simple ABC correction was most likely to unfold as part of a wave (2), which meant that it positioned you exactly at the start of wave (3), which, as you have seen in chapter 3, is usually the strongest and longest of any wave in the completed 5-wave sequence. In essence the simple ABC correction could be used to identify the start of the most profitable trade in the book - combine that with being able to identify the start of a wave (5) (off the end of the prior Wave (4)) and you have what is starting to look like a winning trade set-up. The only wave where you were unable to find a reliable method to identify the start was a wave (1).

I then went on to show how the simple ABC correction could also be used to identify high probability low-risk set-ups even when the Elliott wave sequence was less than ideal.

At this point in my research I was getting very excited as this one simple pattern could be used in so many different locations and so many applications, all with the same aim of identifying an *ideal* trade set-up where the main criteria were that the set-up maximised profits and kept the initial risk small. To me, this seemed the ideal solution as this pattern was reliable and easy to identify, and, more importantly, was consistent to apply. To me this was more important than applying complicated or sophisticated technical analysis patterns.

The ABC correction had several more advantages, in particular when it is applied *in isolation*, in that the pattern and its end is relatively simple to identify, all of which leads to our primary goal of having a pattern that can identify a high probability and low risk trade set-up. To me, this is the single most important aspect to any successful trading plan.

In later chapters I will go on to look at the ABC correction in more detail and look at the maths behind the ABC correction that will enable you to predict *in advance* exactly where the ABC correction is likely to end.

The simple ABC correction forms the basis of the three main trade set-ups in the MTPredictor software program, more on this in later chapters.

Chapter 6 – Elliott wave summary

Over the last few chapters I have had a detailed look at the Elliott wave theory. In chapter 3 I looked at the rules and guidelines for labelling Elliott wave sequences on a chart. Chapter 4 took this one stage further and demonstrated how (from my own personal experience) I believe that Elliott wave patterns cannot be applied in practice as easily as they could be taught in theory. Chapter 5 then provided one unique solution, in which I took one of the Elliott wave corrective patterns, the simple ABC correction, and demonstrated how this could be used to identify trade set-ups *in isolation* rather than trying to predict the future with a complete Elliott wave count.

When the Elliott wave pattern was ideal, the simple ABC correction could be used to identify the end of a wave (2) as well as the end of wave (4), which allowed you to be able to trade two of the three impulsive swings in ideal Elliott 5-wave sequences (the Wave 3 and 5). This chapter also demonstrated how the simple ABC correction could be used to identify a trade set-up even when the Elliott wave pattern was less than ideal.

As I have already mentioned, the opinions of the author on Elliott waves and Elliott wave analysis are personal and derived from my own experience as a private trader. So many books, courses and software programs have tried to apply Elliott wave analysis to the markets with (what I believe to be) limited success. As I have mentioned, I do not believe this is the fault of the Elliott wave theory or indeed Elliott wave analysis in general. I just believe that the Elliott wave patterns simply do not exist on as many charts or as many markets enough of the time. This has led to me moving back to the simple ideas on the Elliott wave theory as suggested by R.N Elliott himself, in that markets *tend* to move in 5 waves in the direction of the main trend and *tend* to correct in 3 waves (ABCs) against the trend. I suspect that Elliott himself realised that the outcome of his analysis was only ever a matter of *probabilities* and, as such, did not work perfectly all of the time.

It is only human nature to require exact results from mathematical analysis of the markets. However the problem arises from the markets not being exact, as they tend to move with different rules governed by probabilities rather than exact mathematics. It is like being taught at school that 2 + 2 = 4 only 50% of the time. Most of us find this very hard to understand and deal with. However, if you wish to be a successful trader you must learn, understand and be totally comfortable with the theory of probabilities. For now, all you need to understand is that however good the Elliott wave theory is, it just cannot be applied consistently enough to the markets, enough of the time, to produce the accurate forecasting results that we all expected of it.

However, as you have seen, I personally believe that the Elliott wave theory can only reliably be placed on any single chart about 50% of the time. This then allows you to focus on just the best wave counts that do have a high reliability, avoiding the less obvious patterns. Once you fully realise that the Elliott wave theory can drift in and out of phase like this, then the whole process of labelling a chart becomes a lot less stressful, in that if a wave count is not *obvious* then it should not be used. It is as simple as that !

This piece of advice will allow you to only focus on the best and most obvious wave counts. It is my opinion that trying to *fit* a wave count onto a chart that is not obvious is one of the greatest mistakes any Elliott wave analyst can make, mainly because it will give you an opinion of where the markets will go that very often does not unfold as anticipated. This can be disastrous for your trading !

Leading on from this, if you only use Elliott wave patterns to identify the end of the current wave *in isolation* (the unique MTPredictor *isolation approach*), then this also allows you to accept that the current Elliott wave count could at anytime drift out of phase. Again this has the main advantage of not keeping you in an Elliott wave pattern that suddenly becomes unclear and, as such, can give you misleading results.

I hope you can see by now that this is the place where the Elliott wave theory falls down, in that if you label a chart in a particular way, then you are anticipating a particular outcome from this pattern. However, if the pattern you base your original analysis on is not the correct pattern, then the market in question will normally be heading in the wrong direction, relative to your forecast. This is what happens too many times to standard Elliott wave analysts and is normally why the Elliott wave theory gets such a bad press. However, I hope you can see that if you change your view on how to approach the Elliott wave theory as suggested in this section, then this will avoid these major problems experienced by most Elliott wave analysts.

As such, these chapters have allowed you to release yourself from the shortcomings of the Elliott wave theory and trying to *forecast* where some market may go at some point in the future, in favour of using the Elliott wave theory to be able to identify a high probability, low risk trade set-up in isolation.

You either have to learn to deal with the situation as it really is, or give up on the Elliott wave theory, or look for a different method to trade the markets.

I hope that you don't make the decision of many Elliott wave analysts to give up on the theory, as I hope I have demonstrated that buried within the theory is one particular pattern that is worth its weight in gold. However, to be able to use this in your own trading you have to adjust the way you look at the markets or, indeed, the way you look at Elliott wave theory as it is applied by some of the more traditional Elliott wave theorists.

In particular, the main difference in my approach is that I believe the best way to use this particular pattern, or any Elliott wave analysis, is to look at the wave patterns *in isolation* (The unique MTPredictor *isolation approach*). Although many will say this removes the predictive ability of Elliott wave analysis, I hope I have demonstrated that this is less reliable than we would all like. So I have made a trade-off, against a low reliability predictive analysis technique (Elliott wave analysis) in favour of a high reliability way of identifying an individual trade set-up. I'll talk more about this in future chapters.

This *isolation approach* to Elliott wave analysis and trade identification is unique to MTPredictor.

As such, my best advice is to stick to using the simple ABC correction to identify a trade set-up. It is as simple as that. This is the basis of four of the automatic set-ups in the MTPredictor software program: the simple ABC correction (TS3), and TS1 and TS2 and TS4 (larger degree ABC) trade set-ups.

However, I do realise that many of you would like to take Elliott wave analysis further and I will cover some more advanced techniques in Part 2 of this course. But for now, focus on the simple ABC correction with the simple aim of using it to identify a trade set-up, but not just any trade set-up - a trade set-up that has a high probability and, more importantly, a low initial risk. In this way you can use this set-up to maximise your profits and, critically, keep the losses small. If you can do this you will have the ingredients for a success long-term approach to trading the markets.

This is what the automatic MTPredictor trade set-ups are designed to do...more on this in the next chapter.

Continued on the next page.....

Chapter 7 – MTPredictor and the automatic set-ups

As you have seen over the last few chapters, I believe that the best way to use the Elliott wave theory is to look at each individual pattern *in isolation* (the unique MTPredictor *isolation approach*) and, in particular, use the simple ABC correction as a way to identify a high probability, low risk trade set-up. The MTPredictor software program uses this simple pattern in the four main set-ups that the software can automatically identify for you. These are:

1. **TS1 trade set-up** - Minor abc correction within a Wave (2orB) swing
2. **TS2 trade set-up** - Minor abc correction within a Wave (4) swing
3. **TS3 trade set-up** - The simple ABC correction by itself
4. **TS4 trade set-up** – Larger-degree ABC correction (uses fewer earlier swings)
5. In addition...**DP (Decision Point™)** trade set-up

In this chapter, I would like to introduce these four set-ups one-by-one in detail, starting with the simple ABC correction or TS3 set-up.

<u>The simple ABC trade set-up (automatic TS3)</u>

A simple ABC is where the market makes a correction that subdivides into a lesser-degree ABC, where the minor Wave C exceeds the price extreme of the minor Wave A.

This a very important set-up because once the ABC correction is complete, the market normally continues in the original trend direction. As such, the end of the simple ABC correction is a great place to look to enter a new trade, to take advantage as the main trend resumes.

MTPredictor identifies this as an automatic TS3 trade set-up.

Let's take a look at an example.

Continued on the next page . . .

Here is an example on a daily chart of the forex pair USDCAD:

You can see in this example on the USDCAD, the market was in a clear uptrend going into May 2008 highs. The market then made a correction, which unfolded as three separate swings, labelled A, B and C on the chart above. As can be seen, this ABC rally is against the main trend - which was clearly up – therefore, this ABC decline would be viewed as corrective.

The first question I hear you asking is: Okay, the market is falling from the May highs and this fall appears to be unfolding in three swings...but how do we know how far this drop will go before it ends? The simple answer is that you don't for sure, however the MTPredictor software program has routines that can project the *most likely* areas for all of the Elliott waves to end. In this example, as you are looking for the end of the wave C (of an ABC correction) you will be using the typical wave C WPT.

Continued on the next page . . .

As you can see from the chart above, in this example the market has now reached the area of the typical wave C WPT. This is the *most likely* area for the ABC correction to end.

As we'll see in later chapters the software can calculate and display this level for you automatically.

Now the market is in an area where the ABC correction is most likely to end, the next question I hear you ask is: how do we know the current ABC rally is ending?

For this, the software can automatically colour the bars on the chart red for a sell and blue for a buy.

As you can also see from the chart above, the last bar was painted blue. This means that the MTPredictor software program has identified this as a potential buy Reversal Bar.

Let's take a moment and reflect on the current position, as of July 15. Firstly, the market (USDCAD) was making a three wave decline which is labelled as an ABC correction; secondly, the wave C (of this ABC correction) has now reached the most likely area (the typical wave C WPT) for the entire ABC correction to end; thirdly, the MTPredictor software program has coloured the last bar on the chart as a blue (buy) reversal bar.

As you can see, these three factors (the ABC correction, typical wave C WPT, and buy trade set up bar) have all combined on July 15, 2008. This is like the three sides of a triangle all coming together to signal harmony entering the market and, as such, this is the area where a turn in this market *could* unfold.

So, this would be considered an *ideal* buy trade set-up.

You can now consider entering a new long trade *if* the market trades above the high of the blue (buy) reversal bar:

At first sight, this may seem quite involved; however the MTPredictor software program automatically identifies these trade set-ups and automatically displays all the information on the chart for you.

Although you can never know for sure whether any trade set-up will turn out as anticipated, the one thing you can control is the initial risk (or the amount you would lose) when a trade goes wrong. As I have mentioned in the previous chapter, the single most important aspect to any successful trading plan is to keep the initial risk (and therefore your losses) as small as possible. This is where position sizing comes in, which will be discussed in greater detail later in this course.

However, what I would like to stress at this point is how three elements have all come together at the same time to signal a potential change in trend:

1. The market in question (USDCAD) was at a level where a low was anticipated to unfold. This was the typical wave C WPT support zone.
2. The market in question (USDCAD) made a blue (buy) Reversal Bar that unfolded right in the typical wave C WPT support zone.
3. The market in question (USDCAD) then rallied above the high of the blue (buy) Reversal Bar.

As you see, these three things meant that the USDCAD was not only at an area where a low was anticipated to unfold but also it had given an indication that a low was likely to unfold (with a blue buy Reversal Bar unfolding at the WPT support zone). Additionally, the USDCAD (by its own actions) confirmed that the low was complete by rallying above the high of the blue buy Reversal Bar.

Let's see how this turned out:

As you can see on the prior page, the market rallied nicely to be stopped out eventually for a profit of just over five times the initial risk (we call this +5*R*). But the most important point is that this profit was large in relation to the initial risk, which was kept small. This is what the MTPredictor trade set-ups are designed to do. Over time, I am sure you can understand that by keeping your profits large and your losses small, you will help build a solid foundation for a successful approach to trading.

Although this is was an example of a new long trade, exactly the same procedure is followed for a potential short trade, where the market makes a strong decline followed by a corrective rally that unfolds in 3 swings - a simple ABC correction.

Let's look at an example:

Here you can see an example on TALV, a stock in the UK FTSE 250 index. In this example, the market made a decline from the April high, followed by a 3-swing (ABC) correction. The wave C high also unfolded at WPT resistance - in this case, the minimum wave C WPT as shown by the orange box on the chart above. The last bar on the chart was also a red (sell) reversal bar.

This is exactly the same as the long trade in the prior example, where these three aspects - the ABC correction, wave C WPT and coloured (red for a sell here) Reversal Bar - have all come together on June 20, 2008...except it is for a potential sell set-up for a new short trade.

The very next day TALV declined, triggering a new short trade:

As you can see from the chart above, TALV declined sharply over the next month. Eventually the trade was stopped out for a +12R profit (or approximately 12 times greater than the initial risk) as the market reached the larger-degree Typical Wave (3) WPT. Again, hopefully you can see that having profits much larger than the initial risks will help build a solid trading strategy.

In both examples, all three aspects - the ABC correction, wave C WPT and coloured reversal bar - came together to signal the wave C swing was at an end and you should have been looking for a potential trade set-up.

Continued on the next page . . .

In each of these examples, the current profit has been far in excess of the initial risk required to take the trade. This is a very important point because not all trades will result in profits. Losses can and will happen, but the trick is keeping the losses small in relation to the profits. This is what the MTPredictor trade set-ups are designed to do.

However, for now, all you need to focus on is that for a simple ABC correction you need all three elements

- the ABC correction pattern
- Wave C WPT (support / resistance zones) and
- the correctly coloured Reversal Bar

These elements need to combine to signal the wave C swing is at an end, so you should be looking for a potential trade set-up.

The MTPredictor software program will find and identify automatically these set-ups for you as a TS3 automatic trade set-up.

Next, let's look at the TS1 trade set-up. This is where the abc pattern forms as part of the Wave (2orB) correction.

The TS1 automatic trade set-up

A TS1 trade set-up is where the abc correction forms as part of the *first correction* to the *first move* off an *important high or low*. In Elliott wave terms, this is off the end of a larger-degree Wave (2) or (B) correction.

Why is identifying this set-up so important ?

Because the next swing off a potential Wave (2) or (B) high or low has the *potential* to turn into a Wave (3) type swing. As Wave (3) is usually the strongest and longest of all the Elliott wave sequences, it carries the largest profit potential. Therefore, identifying the very end of a potential Wave (2) or (B) correction can be the best place to look to enter a new trade.

Legendary trader W.D. Gann believed *"the safest place to look for a new trade is at the end of the first correction to a new swing".* This is what the TS1 trade set-up is designed to identify.

Let's take a look at an example:

On this chart of Sugar futures, you can see exactly the same set-up as in the prior section, with the correction and folding as a 3-swing (ABC).

However, there is one important difference between the simple ABC described in the prior section and this ABC. It is to do with where the ABC correction unfolds in relation to the *larger-degree* trend. As you can see from the chart on the prior page, this ABC unfolded as part of the *initial correction* following the *initial rally* off an *important low*. In other words, a TS1 trade setup.

As far as the initial set-up is concerned there is very little difference between this ABC and the ABC in the prior section. The main difference comes with the trade management and, in particular, how the move off a TS1 trade set-up can be very strong sometimes. The reason for this is that if this correction turned out to be a wave (2) then you should anticipate a wave (3) swing to follow. As you have seen in chapter 3, a wave (3) is usually the strongest and longest in any of the Elliott wave sequences. As such, it carries the largest profit potential. Therefore, being able to identify the end of a Wave (2) correction can be one of the best trades you can have!

The initial trade entry is exactly the same as before, where (in this example) a new long position is taken *if* the high of the blue buy trade set up bar is exceeded.

As before, if the trade is triggered the initial protective sell stop (in this example) is placed just below the last minor swing low.

Here, this would have resulted in a new long position in Sugar at 12.40, with the initial protective sell stop at 12.11. This would have been an initial risk of US$324.80, 12.40 – 12.11 (29 ticks at $11.2 per tick) per contract (excluding slippage and commission).

I hope you see how similar this set-up is to the regular ABC, the only difference being that the ABC unfolds as the first correction against the first move off an important high or low.

Otherwise you have exactly the same position as before, in that all three elements

- the ABC correction
- Typical wave C WPT and
- coloured Reversal Bar

came together to signal the wave C swing was at an end, so you should be looking for a potential trade set-up...just as before.

Again, just as before, the MTPredictor software program identifies and displays automatically these set-ups on the chart for you.

Continued on the next page . . .

Let's see how this would have turned out:

Clearly the market (Sugar) rallied very strongly off this ABC correction and wave (2) low in a wave (3) type rally. In fact, the market went on to rally past the maximum wave (3) WPT resistance area, making a wide range *blow off day* (the last bar on the chart above). Again, I'll return to projected price targets and how to manage these trades in later chapters.

However, the key point here is that as this wide range blow off day unfolded, the open profit would have been approximately US$3,472.00, 15.50 – 12.40 (310 ticks at $11.2 per tick) per contract (excluding slippage and commission). Or, looking at it another way, this profit would have been approximately 10x larger than the initial risk This is what successful trading is all about - keeping the profits large in relation to the losses (or initial risks).

This is what these set-ups are designed to do. I will come back to this in a future chapter.

Before I continue, let's take a look at a situation that can occur sometimes. So far, I have described that when you get an ABC correction that unfolds as part of the *first correction* against the *first move*, off an important high or low, that it should be considered a TS1 trade set-up.

CRACKED TRADING SOFTWARE

70+ DVD's FOR SALE & EXCHANGE

www.traders-software.com

www.forex-warez.com

www.trading-software-collection.com

www.tradestation-download-free.com

Contacts

andreybbrv@gmail.com
andreybbrv@yandex.ru
Skype: andreybbrv

So what happens, when we get this situation but the software has labelled the trade setup as a TS3 rather than a TS1? See this example:

Here this TS3 sell setup unfolded where we would anticipate a TS1 sell. So what difference does this make? Well, this is where understanding the theory and concepts behind the automatic MTPredictor trade set-up is important. Computers can only do so much in the way they look at data and find automatic trade set-ups...the human brain is far more sophisticated and, as such, can look at the larger-degree picture much more easily. Therefore, when you have a situation like this, where the software has found a TS3 automatic set-up, however it has obviously unfolded as part of the first correction against the initial move of a major high or low, you should treat it (and manage it) as if it were a TS1.

We had the same situation in the example in the last section on TALV where, although the automatic set-up was found as a TS3, the ABC correction unfolded as part of the first correction against the initial swing of the major high, therefore (as I have outlined here) the trade should be treated as a TS1. And as we saw, the trade declined into the large-degree typical wave (3) WPT, which is what we normally anticipate off a TS1 trade set-up.

However, just because we normally anticipate that the rally off a TS3 trade set-up that has unfolded as part of the first correction against the initial move of an important high or low should unfold as a strong larger-degree Wave (3) type swing, it does not always happen as anticipated...

Here is an example on US stock AN:

We must always remember that the future is uncertain and how these trades unfold is always dictated by the laws of probability. Even though this TS3 trade setup did not reach the Typical Wave 3 WPT as we would normally expect, the profit at the minimum Wave C WPT was still almost +5R.

Remember, when we are trading we are dealing with probabilities not certainties and the probabilities normally point to a strong Wave 3 type rally off a TS1 (or TS3) where the ABC correction unfolds as part of the *first correction* against the initial *swing* off an *important high or low* - this is what *normally* unfolds.

I will come back to this trade set-up in more detail in Part 2 of the trading course because it is one of my favourite set-ups. The reason is simply that the wave 3 swing is the largest and strongest of all the Elliott Wave sequence and this particular set-up has the best profit potential to initial risk.

Next, let's move on to the TS2 trade set-up. This is where the abc pattern forms as part of the Wave (4) correction.

The TS2 automatic trade set-up

A TS2 trade set-up is where the ABC correction forms as part of a correction once the main trend is already well established. In Elliott wave terms, this is off the end of a Wave (4) correction.

This is also a very important set-up because once a Wave (4) correction is complete, the Wave (5) swing is the last impulsive move before the entire Elliott sequence ends. As such, the move off a completed Wave (4) correction also represents a good tradable opportunity.

Let's take a look at an example on US Stock EMN:

Here you can see exactly the same set-up as in the prior sections, with a simple ABC correction. However, the ABC correction has unfolded as part of a larger-degree Wave (4).

Continued on the next page . . .

Let's see how this would have turned out:

The market in question (EMA) declined very nicely off this ABC correction and wave (4) high in a wave (5) type decline. In fact, the market dropped into the typical wave (5) WPT support area, where a profit of approximately +4R was available (excluding slippage and commission).

Again, this profit was large in relation to the initial risk required to take the trade. This is what successful trading is all about, keeping the profits large in relation to the losses (or initial risks). This is what the MTPredictor set-ups are designed to do. I will come back to this in a future chapter, as this is vital and is one of the most misunderstood concepts of trading. This is why I believe that the vast majority of amateur traders (as high as 95%) fail in this business.

Continued on the next page . . .

The TS4 automatic trade set-up

The TS4 trade set-up is again based on a 3-swing (ABC) correction. In fact, it is very similar to a TS3 trade set-up as it uses the same degree of swing, however the TS4 trade set-up does not *look back* to see the prior swing. So it cannot judge whether it is *corrective* in relation to the prior swing.

The inability to see whether it is a corrective swing automatically would seem, on the surface, to be a risk…so why have I included it ?

A good question...well, given the way markets can unfold and the way the automatic swings on the charts are calculated, the standard TS3 set-up can miss some very good ABC patterns because of a minor *wiggle* in the prior trend. This confuses the standard TS3 logic, so I decided to construct the same ABC pattern as the TS3 but remove the *look back* so it can find trades where minor wiggles in the prior trend have occurred.

Let's take a look at an example on the forex pair USDJPY daily chart:

Here the minor *wiggle* would have invalidated this as an automatic TS3 trade set-up, when in reality the decline from the high has still unfolded in a 3-swing (ABC) pattern. This is the kind of set-up the automatic TS4 trade set-up is designed to find for you.

Okay, bearing this in mind, what additional checks must the advanced trader do to make sure that this 3-swing ABC is still a valid trade set-up?

The main one is that you must make sure the ABC pattern is still *corrective* in relation to the prior main swing:

For this, you must look at the Wave C swing low (TS4 label) and check that it falls above (for a long trade) the prior main low. Reverse for a short trade.

In this way the 3-swing (ABC) pattern is *correcting* the prior upswing because the whole correction ends *above* the start of the prior rally. This low is circled in the chart above. Can you see how the Wave C (TS4) set-up is above this main low?

Now you can move on to the standard check of WPT support/resistance and coloured reversal bar.

Because this is not as straightforward as the standard TS3, the TS4 should be considered an *advanced trade.*

Continued on the next page . . .

So, assuming the TS4 trade set-up is *corrective,* you now need to check also that the reversal is at one of our price support/resistance areas (WPTs or Wave Price Targets).

The long trade was entered as the high of the blue (buy) bar was exceeded. The initial protective stop was then placed 1 tick below the recent low.

The initial profit target is the DP (Decision Point) from the prior main swing high. This is because we assume that when the ABC correction is complete, we should get at least a move to new highs (in this long example).

Also, because this TS4 ABC correction is sometimes larger than the TS3 set-up, the STF is not as important as in the standard TS1, TS2 and TS3 trade set-ups. Again, this makes it more of an *advanced set-up.*

If you find any of this confusing or do not understand how and when to use the TS4 trade set-up, please do not use it.

Continued on the next page . . .

The DP automatic trade set-up

The DP automatic trade set-up is designed to catch the *end* of an impulsive move as the impulsive trend runs out of steam:

The basic ingredients here are that the market is making a strong *impulsive* swing, and then makes a *correction* to the *prior impulsive* swing, followed by *another impulsive* swing to new price extremes. However, this new price extreme is not supported by the STF oscillator as the STF peaks *diverge* from the price peaks on the main chart. This is standard bullish or bearish divergence as taught in general technical analysis books…

However, the important addition that we at MTPredictor have made is the price level - where this second price extreme is most likely to reverse. This is the DP (Decision Point) level – the higher light blue zone in the chart above. This allows us to enter a trade with a small controlled risk to take advantage as the market starts to move in the opposite direction (new trend).

So far so good, but because this is a trend termination setup, caution is advised. The reason is that you can get a few “false” attempts as the trend is ending. So my advice is that the DP setup is best used when you have added support / resistance from the higher time frame charts as well. These add weight to the setup.

The *initial* profit target for the DP set-up is the *opposing* DP level taken from the prior swing low:

This is the lower light blue zone in the chart above. As you can see, the Risk/Reward at this *initial* target was approximately 2.6x the initial risk (excluding slippage and commission). As you will know from earlier, we consider anything above 2:1 a good risk and worth considering.

Summary - DP automatic trade set-up

The important ingredients for a DP trade set-up are:

- the reversal is at the DP (Decision Point) support/resistance zone
- there is clear divergence on the STF oscillator
- the R/R is strong (above 2:1) at the first profit target (the opposing DP level)
- Use caution as this is a trend termination setup
- Always check the higher time frame for added confirmation that the current trend is indeed ending (DP and/or WPT levels on the higher time frame).

Continued on the next page . . .

MTPredictor automatic routines

At first sight, identifying these five specific trade set-ups can appear quite complicated especially when you have to worry about an Elliott wave pattern, a projected support or resistance area and coloured bars. However, this is where the MTPredictor software program excels, as it contains a special module that automatically identifies these trade set-ups for you.

As you can see, the software will automatically identify the TS1, TS2, TS3, TS4 and DP trade set-ups.

Continued on the next page . . .

The automatic routines do not stop there, because with a simple click of the mouse, you can also place the projected profit targets on the chart:

Not only that, but this module also automatically takes care of the position sizing for you (more detail on this in a future chapter). This is designed to keep your initial risks small in relation to your profits.

Continued on the next page . . .

Summary

This chapter has taken the simple ABC correction - which you found in earlier chapters was the most reliable and easiest-to-identify Elliott wave pattern - and used it within the MTPredictor software program to form the basis of our four automatic ABC correction set-ups in the software: the TS1, TS2, TS3 and TS4. We also have the automatic Decision Point (DP) trade set-up. As you have seen, MTPredictor is designed to find and then automatically identify these *ideal* trade set-ups for you.

In these examples, I have started to introduce the topic of Position Sizing and how this relates to the profit from trades. This is a vital topic and, as such, I will devote the whole of the next chapter to exploring in more detail how this is probably the single most important aspect of any successful trading plan.

The MTPredictor software program does most of the work for you in identifying these trade set-ups automatically. The Trade Scanner, in particular, makes it easy to scan numerous markets to find the few that are currently positioning for an ideal trade set-up. This is similar to going fishing - you have an ideal set-up and you only wish to focus on those few issues where the ideal set-up is unfolding. You are not interested in what the rest of the markets are doing. In essence, you cast your fishing line out into the thousands of issues each day and then focus your attention only on the few that the Trade Scanner brings back to you.

It is your job to view each chart individually to check the set-up. But the point is that the Trade Scanner has done most of the hard work for you in reducing the list of candidates from what could be thousands to just a few.

Although these are the most reliable trade set-ups, MTPredictor does not stop there. I will go on to cover how you can perform additional manual analysis, above and beyond these basic set-ups in future chapters. However, I hope you can all see how these automatic routines in the software make it easy to start to find ideal trade set-ups quickly without the need to perform lengthy or in-depth, complicated analysis. In fact, many MTPredictor customers prefer to stay with just the automatic set-ups.

This is very different from most other technical analysis approaches in the market, in that they are only interested in buy or sell signals. They do not focus on or even realise that simply buying or selling is not the best approach to profitable trading. What you need to focus on is taking only those trades that are off an *ideal* set-up and have a high probability of making a profit far in excess of the initial money risk. Position sizing is vital here because it is the final ingredient in a successful trading approach and it keeps your initial risks small and profits large.

Continued on the next page . . .

Chapter 8 – Position Sizing, the real "Holy Grail"

During the last chapter, I introduced the automatic MTPredictor trade set-ups. However, this is only the first stage - not only do you require a reliable pattern that gives you a good trade set-up, but also, when the set-up goes wrong (which it will do), you need an approach that will keep the losses small in relation to the profits.

There are very few books, courses or trading educators that will focus on losses. This is mainly because, as human beings, we associate losses with failure (please see the next chapter). And the one thing we all hate to do is fail. However, taking a loss, and more importantly a small loss, is the single most important thing you could ever do when trading. The reason for this is that normally a small loss (if not taken early) will turn into a larger loss later. As I am sure you understand, keeping the losses small and infrequent will help significantly your bottom-line profits.

This is so important that I will rephrase this. It is not by making large profits that money is made over time; it is by keeping the losses small.

However, most books, training courses and educators focus on the positives - how much profit you can make from any trade. If you stop and think about this, it is illogical. The main reason is that no one (despite what you may have been told) can predict the future. This means that no one can know *for sure* how much profit any single trade is likely to make. Yes, we may have an idea, by using various techniques to project future profit targets, but before the market gets there, this is all they are - a projection. It is like a *best guess* of where a market may go in the future, but what you must understand at this stage is that this is all it is - a *best guess*.

Now compare this with the initial risk. When the set-up appears, you know at what level to enter the new trade, you also know at what level the trade will have gone wrong and, therefore, where you should place your protective stop. As such, you can control the initial risk (or loss) from the initial set-up. Obviously a market can gap beyond any stop orders, and I will cover that in more detail in a future chapter. However, I just want to get you to focus on the difference between the initial risk, in which you can control the entry, and therefore the loss, (if it happens) and the future, with any potential profits that the trade may have, before it gets there.

What you need to focus on is what you have direct control over (the initial risk) and not what you do not have control over (any future profit). This may be a slightly new idea for you, so please take a few minutes to think about it and understand the implications.

Okay, now I hope you understand that the only thing you have direct control over at this stage is the initial risk. I can now look in more detail at how keeping this initial risk (and therefore any losses) small in comparison with the profits is so important to a successful long-term approach to trading markets.

Let's take a look at a couple of examples. First, assume you have a US$10,000 trading account and you are trading either on your own, or by some other mechanical system. Now I would like to look at the results of the few trades you have taken...the first trade you made banked a profit of $500. So far, so good...however the second trade was a loss of $2,000. Trades three and four also made losses of $1,500 and $2,500 respectively.

So here you are, only 4 trades into your new system, and you have already lost nearly 50% of your trading fund. This may seem unlikely however I have heard many stories like this in the past where a significant chunk of trading capital has been lost to the market very quickly. A 50% loss may not seem totally devastating but what you must realise is that to even recover to your original $10,000 starting capital you now have to make a near-100% return on your $5,500. This is the problem with letting your account decrease in value by any significant amount - the percentage returns to get you even back to break-even become larger and larger and, therefore, even more unobtainable.

It is without doubt your number one priority to keep your trading capital intact. What this means is, keeping your losses small because without trading capital you simply cannot trade.

I hope this make sense to you?

Okay, let's look at another trading system (or approach). With this approach, the first trade also made $500, however the second trade only lost $250. Trade three was not taken (because the initial risk was too large) and trade four also lost $250.

As you see, the number of profits and losses was very similar to the first system, however because the losses were small (in relation to the profits), although the system made more losses than profits, you are actually break-even overall. What this means is, even after a bad string of trades, you still have your full $10,000 account intact.

I hope you can all see that this is a far better position to be in if you wish to continue trading.

So what are the main differences between approach one and approach two ? While initially the profits are the same, both at $500, it is the losses that are significantly different. With approach two the losses were limited to a maximum of $250. You even had to skip one trade because the initial risk was too large but that avoided a large loss. The most important point is that the losses (at $250) are small in comparison with the profits (at $500).

I hope you can begin to see how this will make a significant difference over time to your trading capital. If you can use a trading approach that keeps the losses small and the profits large, this will help your trading account grow. But more importantly, it will minimise the reduction in your trading capital when you hit a bad time - when a string of losing trades come through.

This may seem obvious but you might be horrified at how many times a trading approach, market tip sheet or software program gets people into trades where the initial risk (and therefore the inevitable losses) is excessive for their trading account. It is all too easy to focus on just the profits and think 'if I make that $5,000 trade that will increase my $10,000 trading account by 50%'. What traders often fail to consider is what would happen if, to get this $5,000 trade, they had to risk $5,000 or even $8,000. This is gambling mentality, where the only aim is to hit the one big winning trade.

Again, if you wish to become a profitable long-term trader you need to focus on keeping the losses small and not try to hit the one big winner.

Okay, if you now understand that keeping the initial risk on any new trade (and therefore minimising the losses) is vital, how can you achieve this? The easiest way is to only ever enter a new trade if the initial risk is below a certain percentage of your trading account. For example, a good *rule of thumb* is to never risk more than 2-3% of your trading fund (even less, nearer 0.1-0.5% for stocks). Therefore, in this example of a trader with $10,000 available, the initial risk should never be more than $200-300.

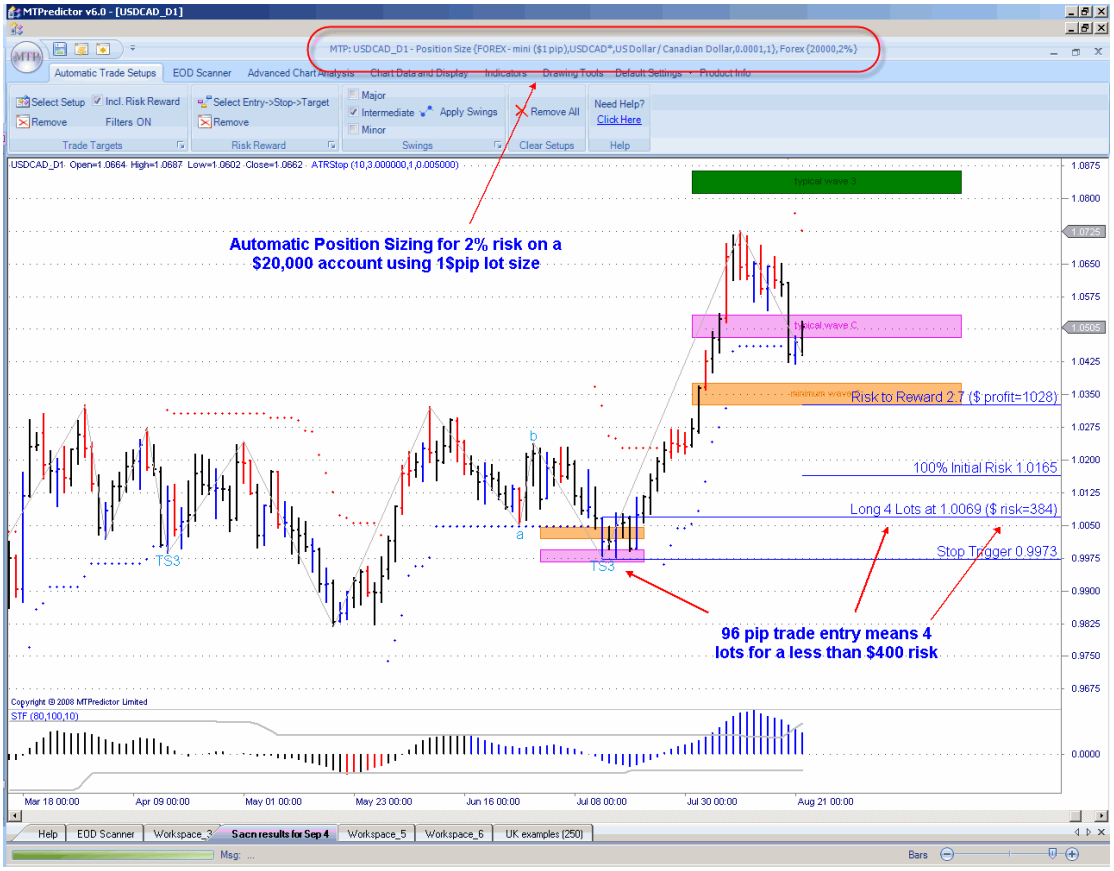
As you can see, this should instantly avoid any large losses in the region of $1,000-2,500 on your $10,000 account, as you saw in example one.

However, this does have one drawback. It does restrict the number of trades you are allowed to enter. I know a lot of traders find this very frustrating, particularly when the trade they decided not to enter (because the initial risk was too large) turned out to be a large winner. However, missing one large winning trade is far less important than keeping the large losses out of your trading account. Over time, there will be far more large losses than large profits. A large profit is normally a gift - it does not happen all the time - whereas large losses have a nasty habit of creeping up on you far more often than you would like.

Okay let's have a look at a couple of examples on the next few pages.

Continued on the next page . . .

Here is an example on the USDCAD Forex pair, a daily TS3 buy set-up:



Here I have used a sample $20,000 account risking 2% per trade. Also, I have assumed that the trader is using Forex minilots ($1per pip, as opposed to the standard $10per pip, or the microlot $0.1 per pip).

2% risk on a $20,000 account equals $400 so as outlined earlier; our aim is to only take a trade where we risk less than $400.

In this particular example, the trade entry was at 1.0069 and, if filled, the initial protective stop would have been placed at 0.9973, for an initial risk of 96 pips. With each pip worth $1, to keep the total initial risk under $400 you would have been allowed to trade 4 lots (4 x 96 = $384).

Note to Forex traders: this can get slightly more complicated when the base currency of the cross rate you are currently trading is not in USD. I will come back to trading non-US dollar-based Cross rates in Part 2 of the training course.

Let's take a look at the result:

As you can see from the chart above, the CAD did indeed rally over the next few weeks to be stopped out eventually (using the ATRstop), for a profit of +4.1R - the profit approximately 4 times greater than the initial risk.

To those of you who like more detailed mathematics, the profit of approximately $1,576, was 4.1 times greater than the initial risk required to take the trade of just $384 ($1,576 / $384 = 4.1). However, I hope you're starting to understand that the way you need to view profits is not just in pure dollars but in risk multiples, or *R* units as we like to call them. So why is this so important?

Well, because this profit was four times greater than the initial race, it now means that you can make three consecutive losing trades and still be in profit. This is what is so important about a successful trading approach...the profits are much larger than the losses so when you do (and inevitably *will*) get a string of losses, they are small enough to not wipe out your profit. This is what happens to most amateur traders and why most of them are never successful. They do not control the initial risks and when their losses come through their profits are blown completely.

It is vital, then, to become a successful professional trader by focussing on the initial risk and the losses that can result. It is so important to keep these large losses out of your trading account.

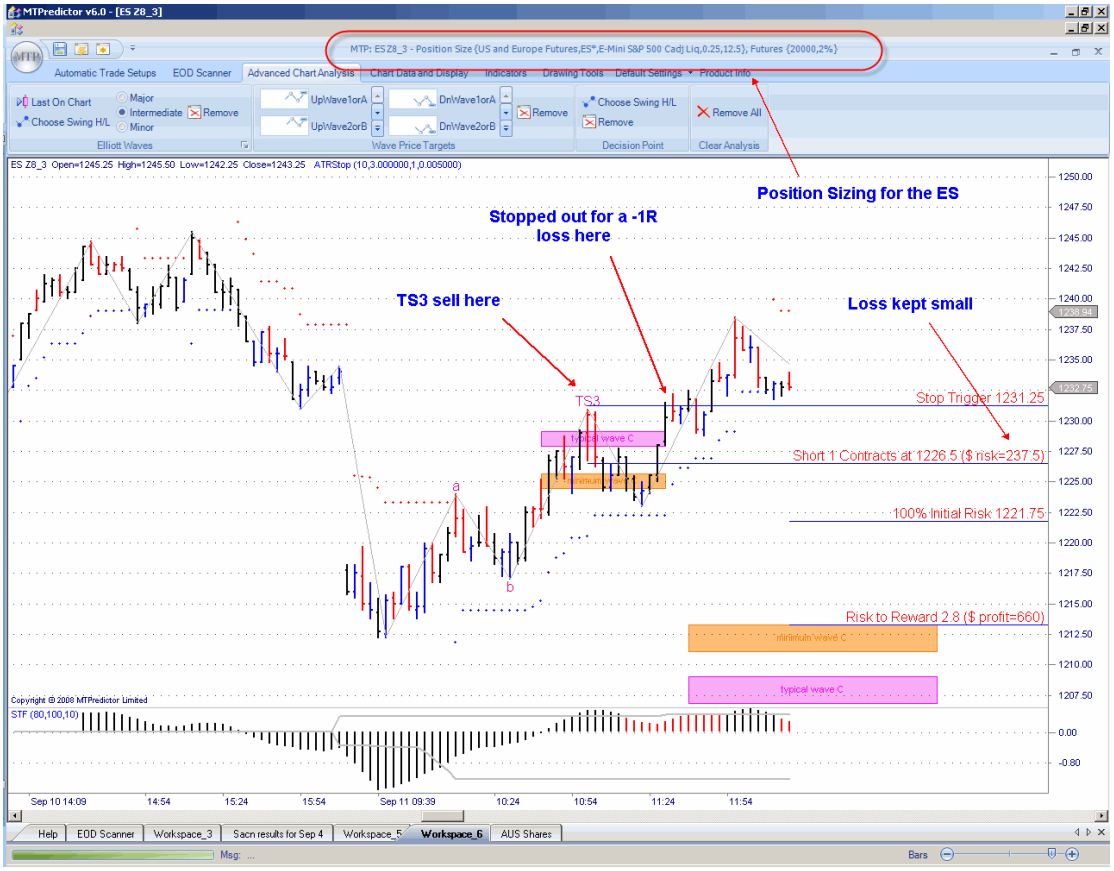
Let's take a look at another example, on Australian stock AAC:

In this example, I have used an A$10,000 account, risking 0.5% per trade. As you can see, the software has calculated that you can sell 416 shares off this particular set-up.

Note to stock traders: sometimes, due to less use of margin than futures, forex and so on, you are unable to physically trade the full number of shares based on your account size. If this happens, simply reduce the percentage risk per trade. This will have the result of lowering the number of shares traded per set-up.

As you can see, AAC declined nicely from the automatic DP sell set-up to reach the first projected profit target, where a profit of approximately +5.9R was available. Again, the important point is that this profit was large (5.9x) compared with the initial risk.

Will losses happen? Of course...and this is where the true strength of correct Position Sizing comes in. It keeps the losses small relative to the profits. It should be clear by now that this is the most important aspect to any successful trading approach - keeping the losses small (not avoiding them) in relation to the profits.



The next example is on a short-term, 3minute chart of the US S&P500 E-mini index future (symbol ES). Again, we have applied the same position sizing logic, only risking a maximum of 2% on this sample $20,000 account. In other words, we are keeping the losses to less than 2% of $20,000 - or less than $400 each.

Yes, this trade did result in a loss however it was kept small at just -1R, or 1 risk unit. Why is this so important ?

This loss is much smaller than the profits we have seen over the last few pages so you can have a series of consecutive losses (this *will* happen) and still be up overall. For example, the profit on the prior page was +5.9R, so you can have four consecutive -1R losses and still be in profit overall. 5 trades: 1 profit and 4 losses is only a 20% success rate, however overall this would have resulted in a +1.9R profit (+5.9 minus 4x-1R = +1.9R). This is the true power of position sizing in that it allows profits to be made overall even when losing trades come through.

How is this different from what most amateur traders do in their own trading account?

Let's take a look at another example:

Here the trader has gone back and performed some manual analysis on a daily chart of Gold futures and spotted that there was a great sell setup earlier in the year, that caught the sharp decline in gold. As you can see, this would have resulted in a massive +10R trade.

So the trader gets his calculator out and looks at what this trade *could have* made. It would have been short from 977.5, then taking profits at approximately 762.1 for 2154 ticks profit. At $10 per tick, this would have made just over $21,000. Considering a $20,000 account to start with, that means a doubling of money in one shot !

This is where greed takes over – the sole concern is with potential profits. So what happens when he gets an automatic DP buy setup, as of the last bar on the chart ?

Well, because greed has taken over and all he can think of is the massive profit he has just missed out on, he takes the trade with no respect for the initial risk.

Although this trade may, or may not, turn out to be a profit, let's assume that it does not turn out as anticipated and a loss occurs. What does this mean for our trader and his $20,000 account?

As you can see, the trade entry would have been at 770.6 with an initial stop at 739.7, all for an initial risk of 309 ticks. At $10 per tick, this would mean an initial risk of just over $3000.

So when this goes wrong (which it may well do) he has just lost $3000.

So how does this compare to some of the profits we were looking at earlier? Well, if you go back to the Canadian dollar example you will see that made just over $1500 profit. So do you all see where I'm going with this? If you have trades where the profits are (for example) only $1500, and you have trades where losses are in the region of $3000 or above, you are in a position where a number of good profitable trades could all be wiped out by just one big loser.

And this is what happens all too often for amateur traders. They are normally scared so they take profits early (small profits) and have no risk control whatsoever, often ending up in trades where their losses are far too big and, as such, these large losses tend to wipe out their account.

It has been said often enough by brokers that the average amateur trading account lasts for only 3 to 6 months before *bankruptcy* and some brokers have even admitted that up to 95-97% of amateur traders are bankrupt within the first year. When asked, the most common reason for bankruptcy is that the losses have spiralled out of control. Now compare this with the professional trader, who assesses and controls the initial risk even before considering placing the trade. In this way, the professional (not taking into account gap opens or slippage) will always keep his losses small and under control. He will always have money available to take the next trade. In other words, this keeps him in the game.

If you think about it, it is just looking at speculation from another angle - rather than looking at what your trade *may* make, you just look at what it may lose and decide whether the risk is worth taking. Once you understand and appreciate that nobody can control the future and how your trade will eventually unfold is uncertain – so the only aspect you can control is the initial risk - then this all starts to make sense. Successful speculation is all about risk control and trade management. It has very little to do with your profitable trades because if you do not keep your losses under control, they will wipe out your profitable trades all too quickly. The only way to come out in front is to make sure your profits are large in relation to your losses so just a few big losses do not wipe out all your profits. Then, and only then, your account can grow over time...

This is where correct position sizing helps because it not only calculates the number of lots/shares/contracts you should trade for each individual trade setup to keep your initial risk constant, but also prevents you from entering any silly trades where the risk is unnecessarily large.

Continued on the next page . . .

Summary

This chapter is the single most important chapter in the whole of this course…in fact, this may be the most important chapter you've ever read in any trading-related book. The reason for this is that it deals with what actually enters or leaves your trading account - in other words, trading profits and losses.

So far I have been looking at Elliott wave patterns, which led on to the automatic MTPredictor trade setups. However, in this chapter you have also seen how vital it is to keep trading losses to a minimum. The best way to do this is to take a trade set-up only where the initial risk was small…as a guideline I suggested never risking any more than 1-3% (typically 2%) of your trading account on any single trade, unless you are trading stocks...then we suggest a lower percentage, typically 0.1-0.5%, because stocks normally require more margin than futures, forex and so on. I then went on to discuss losses and how it is vital that when the losses come through (which they will) you must keep them small so they will not eat away at your trading capital.

Many other trading books, courses or tip sheets focus their attention on just analysing the market but, as you have seen so far, financial markets are an arena where the future is very uncertain most of the time. So what this chapter does is bring you back to earth to deal with the markets as they really are. The techniques described here are designed to preserve your capital as much as possible when the inevitable trading losses come through and also to allow you to focus on only the best trade set-up where the likelihood of a profit greater than the potential loss is high. Crucially, I hope it has taught you how to look at profits not simply in money terms, but in relation to initial risk – or what we call risk units (*R multiples*). A profit of +3R, for example, means the profit is 3 times greater than the initial risk.

The reason this is critical is that to be a successful long-term trader over time you need to make profits that are (on average) larger than your losses. So, it is not just how large profits are that makes you a success, it is how small your losses are relative to your profits.

This leads on to a very interesting question...whether you actually have to be right to make money? Do you need a high percentage of winning trades to be successful in this business? The answer will surprise many of you.

Chapter 9 – Do you have to be right to make money?

This is a very interesting question and one of the most misunderstood aspects to successful trading.

First, a little background, as human beings, we have grown up with the idea that we have to be *right* to get on in life. At school, 70% was always regarded as the typical A grade pass rate and a fail was typically set at 40%. So, from an early age we have been taught that the higher the success rate the better we are. However, in trading things are very, very different and we cannot apply what we have learnt in our life so far...

There is a side message here, which blocks most traders' progress. There are far too many software vendors and gurus preying on the amateur trader's desire to be right by selling software that they *claim* is designed to give the amateur what they want – a high success rate. But all is not what it seems on the surface.

Put bluntly again, trading is not about anticipating what is going to happen in the future. By definition, the future has not happened yet. So, no matter what many tell you it is IMPOSSIBLE to predict the future with any accuracy. If it were, 97% of amateur traders would not fail…but they do !

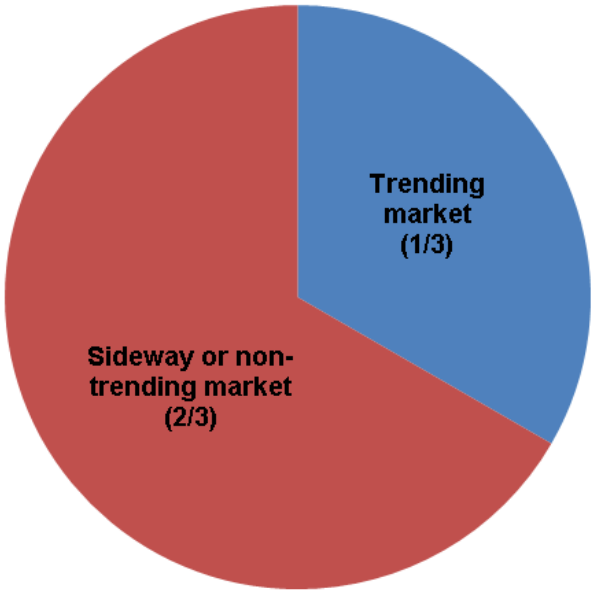
Basically there are two ways to design a system:

Firstly, look to take profits early. This has the effect of giving a higher % of winners because you are not trying to look too far into the future. However, most such systems have a major drawback - the profits are usually only small in relation to the losses. So, just a small upset in the system (such as bad fills) can send it into a loss. This is why most *back-tested* profitable systems fail in the real word…

Secondly, design a system that works *in tune* with how the markets really unfold. Typically markets can unfold in three basic ways: they can go up; they can go down; they can move sideways. Most of us are familiar with rising markets and falling markets but in reality a sideways market is far more common. Typically, markets will spend about 2/3 of their time moving sideways and about 1/3 of their time in a trend (moving either strongly up or down). Most trading strategies rely on a market actually moving, either in an uptrend or a downtrend - to make money. Therefore, typically, you should anticipate making profits only about 1/3 of the time

Continued on the next page.....

Let's see how this looks:



Let's take a look at an example on a recent daily chart of forex pair GBPUSD:

As you can see, throughout much of this chart the market was chopping sideways making short small swings. However, as you can see towards the end of the chart there was a big decline.

I hope you can all understand that the largest money profits are made when the markets actually make a big move, such as the sharp decline towards the end of the chart on the prior page. However, big moves tend to happen only about 1/3 of the time. This is the same in virtually any market or any timeframe you look at. So bearing this in mind, the best system (and the most profitable in the long run) should maximise its profits on the big moves - not look to come out early - and also look to cut losses early during the choppier periods. Basically, have *small losses and big profits*. To me, this is plain common sense ☺.

So why aren't more systems designed to be in tune with how markets really work and, as such, designed for maximum profit?

Well, because as I have said, because big moves tend to unfold only about 1/3 of the time in the real world, so your system may have only about 30-40% winners. This number depends on how you count the break-even trades (please see later in this chapter). Or put simply, a system may have less than 50% profitable trades (ignoring break-even)…

Because amateur traders do not like a low % of winners, many gurus and software vendors do not design systems like this because they do not sell well, they design systems that sell well (best for the vendor) and not that make the most money (best for the trader).

Put this alongside what most amateurs believe they need – incorrectly - and what many gurus teach – incorrectly - and you can see why 97% or so of amateur traders fail. They are going after the wrong goal, a high % of winners rather than a system that is designed to make the most money however the markets really unfold in real life…

This is not the fault of amateur traders individually - they have been misled by software and service sellers designing for what customers think they want (wrongly) and not what actually makes them the most money.

Yes, the trading business is a very strange customer-led business in that most new customers do not know what is required to be successful. Hence we have the bizarre situation of products on the markets designed not to maximise profits for the trader but simply to sell well for the vendors.

So, is there an answer ?

Yes, but first you must adjust your attitude and belief system from what you may think is required to be successful when trading. Sadly, most amateur traders cannot do this and fail as a result. But most successful professional traders can make the adjustment, accept that trading is different from the rest of life and that to be successful you must adjust to keep your losses small and maximise your profits. As a result, you may have less than 50% profitable trades (ignoring break-even). But that does not matter because the winners will be far greater than the losses and that is what makes you money over time. In reality this is the true *Holy Grail* most traders seek and now you can see why most of them fail to find it !

Successful trading is a relatively simple process. The difficult part is accepting what you (the trader) have to do to achieve it and, unlike most people's idea, this does not involve learning ever more complicated analysis techniques. What is needed is an adjustment in *your belief system* so you get *in tune* with how the market really unfolds in real life. You should accept trading as it really is and not how you, at the outset, thought it would be…

If you ask the vast majority of successful professional traders, they will tell you the same thing - their job to keep their initial risks and, as such, their losses small...to manage their winning trades to make money overall. The most important point is that they are in this business to make money, not to be right. The vast majority of successful professional traders, such as fund managers and professional speculators, will have a success rate of around 50% or slightly less. I cannot stress this enough - these are the *big guns* in the industry, who can make a fortune from trading and do this with less than 50% winners.

So, it still amazes me that amateur traders pursue this unrealistic goal of a high percentage of winning trades, when all they have to do is look at the most successful people in their own industry and learn from what they do...

This is where the MTPredictor set-ups are invaluable. They have been designed not to keep you happy but to keep the inevitable losses small when they happen - they will - and maximise the profits when the market makes a good move. There are very few systems designed to achieve these two goals at the same time. This is achieved by keeping your initial risk small and then having two different trade management strategies to maximise profits both in sideway markets and trending markets - something very few other system can do. You then use correct *position sizing* to make sure these profits relate to your losses and are truly large in relation to these losses.

So the whole idea of this section is to encourage you to understand that to be successful – making money over time - you do not have to have a high % of winning trades. True, some traders can achieve this over short periods but doing it consistently, year after year, is extremely hard. That is why it is easier to accept a slightly lower % of winners and use the MTPredictor techniques to keep your losses small and profits large. Over time, this is a far easier approach…

As I have shown, this is not only a far easier approach but it also keeps you in tune with how the markets actually unfold - which is far far more important.

If I were asked for one reason why most amateur traders never make it in this business, this would be the answer - they simply cannot make that transition from wanting to be right (and having a high percentage of winning trades) to accepting the way the markets really unfold and how most professional traders really make their money - by keeping their losses small and profits large over time. Yes, this will usually mean that they have fewer than 50% winning trades (ignoring break-even) - but it does not matter because their winners are far greater than their losses.

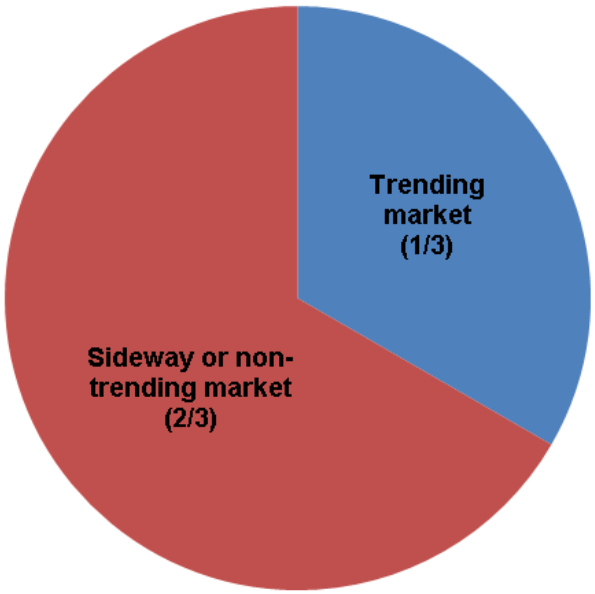
So you have a simple choice - either keep struggling in a vain attempt to be right all the time with your trades or accept the truth, making the transition to understanding how markets unfold and how professional traders work in the real world - the choice is yours !

So is that the end of the story, well not quite, because you need to understand how Profits and losses fit into how markets unfold in the real world and whether you do really have to accept less than 50% (ignoring break-even) winners or not.....

How Profits and Losses unfold in the real world...

Most amateur traders have simply no idea how the markets work in the real world and, therefore, have no idea how their profits and losses are anticipated to unfold. There are many software packages that allow you to develop and back-test a multitude of strategies, enabling you to generate trading reports. However, because these are just a simple statistical analysis of trading results, they can often be misleading - especially when you see them in the context of a bare analysis of just a set of numbers...without any understanding of how the markets really unfold.

As we have already seen, markets can unfold in three basic ways: they can go up; they can go down; they can move sideways. Therefore, typically, you should anticipate making profits only about 1/3 of the time.

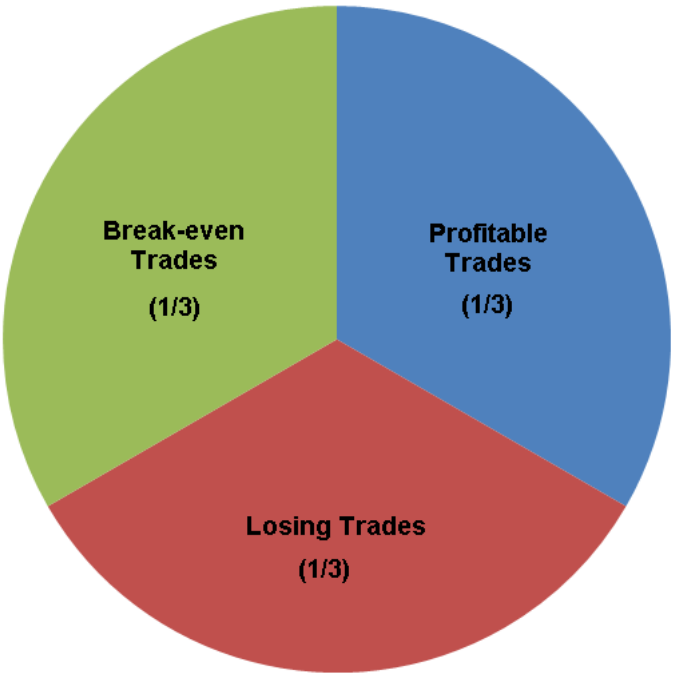


However, most trading strategies or statistics about profits and losses, do not take into account the observation that the markets are in a position where profits can be made only about 1/3 of the time. This makes profit and loss statistics very misleading, particularly when the amateur trader starts trading for real.

So what should you really anticipate as far as profits and losses are concerned?

Well, over the last 20 years that I have been involved in the markets and from seeing hundreds of different trading systems, I have seen that profits and losses and breakeven (no profit or loss) trades tend to unfold in approximately equal 1/3 segments. Put another way, about 1/3 of the time you will be making losses, about 1/3 of the time you will be making breakeven trades and about 1/3 of the time you will be making profits.

Let's take a look at this concept in a picture:

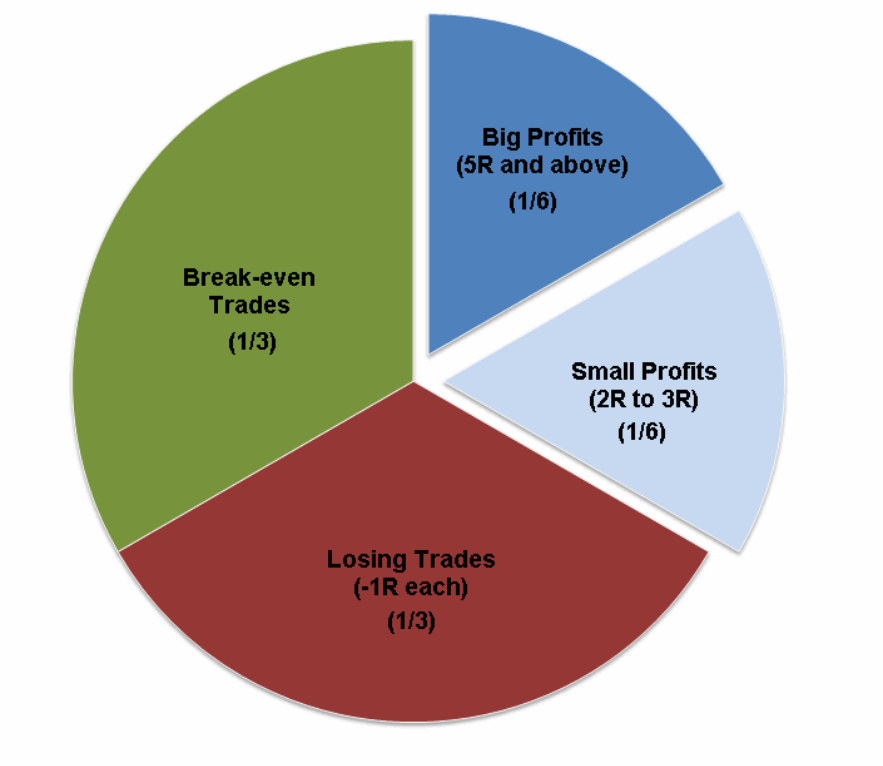


Hopefully, you can see that how you treat your breakeven trades has a huge effect on how you report the percentage of winners. For example, if the breakeven trades are counted as losing trades, you could have a system that is 66.6% losses and only 33.3% winners. In other words, your profitability could quite easily be reported as 30-40% winning trades. On the surface, this does not look good and will deter amateur traders.

However, if the breakeven trades are counted as winners (for example, if each breakeven trade was actually just a $1 winner), the system in the last paragraph is turned on its head. Suddenly, the system has 66.6% winners and 33.3% losers. Not surprisingly, this system is far more appealing to most traders...

As you see, this is where statistics can be very misleading - you need to look into them in far greater detail.

Again, trading typically seems to unfold in equal 1/3 segments where 1/3 of the time you will have losing trades, 1/3 of the time you will have breakeven trades and the remaining 1/3 will be profitable trades. But is that where the story ends? Well, not quite...because in reality the profitable 1/3 splits down often into 1/2 where your profitable trades are small profits (such as +2R or +3R) and 1/2 where your large profits (+5R and above) fall. What this actually means is that you tend to make your largest profits only about 1/6 (1/2 of your profitable 1/3) of the time! This is precisely where most amateur traders fall down.

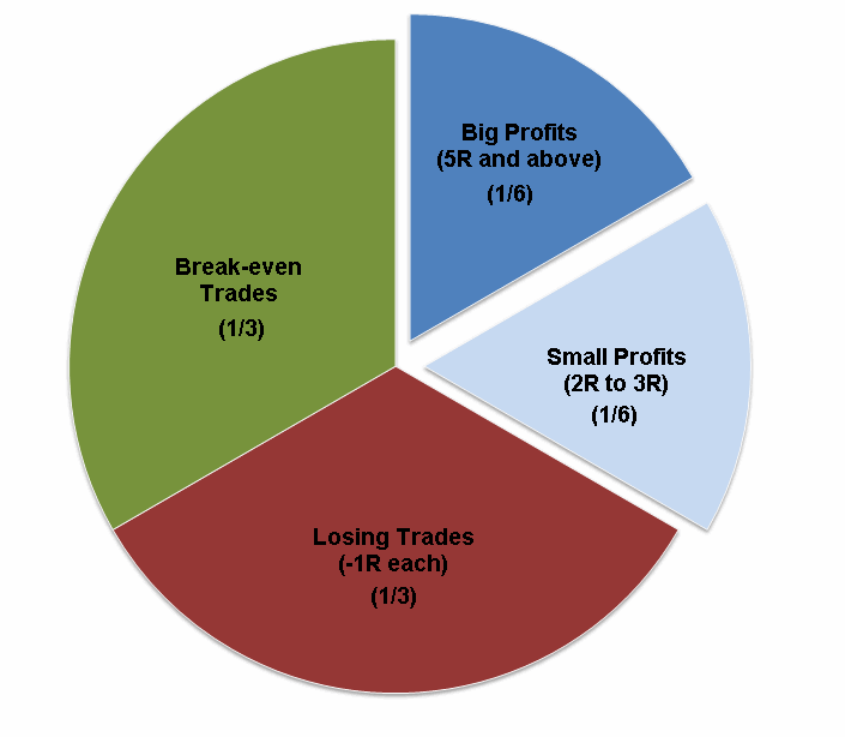


In reality, then, you will spend 2/3 of the time either making losses (albeit small) and breakeven trades and only about 1/6 of the time will you be making the big profits. Most amateur traders find it very difficult to deal with this psychologically because most amateur traders - this is basic human nature - want to be right all the time and have big profits all of the time. So, what happens in practice is that the amateur trader will have 2, 3 or 4 losing or breakeven trades... then, as soon as they get one winner, they will exit that winner too early. Buy not managing it correctly, they cut one of their big profitable winners into a small winner. This can have a devastating impact on their profitability because the big winners are necessary to make the money overall. I am sure that you can understand that by not allowing these big winners to develop, and banking profits too early, you miss out on the big winners.

It is quite strange that becoming a successful trader sometimes has more to do with dealing with yourself on a psychological level - mainly by allowing your winning trades to run further - rather than actually learning how to trade. I imagine this is why 97% of amateur traders end up losing and only 3% end up becoming successful, profitable professional traders.

This is why you need to understand how markets unfold in the real world...so you can understand why it is so important to let your big winners run. And also, to understand that to be a successful profitable trader actually means treading water (small losses and breakeven trades) most of the time, waiting for the few big winners to come through. In reality, you will not have that many big winners but they are vital to your overall success as a trader.

So let's summarise by looking at what a successful professional trader should anticipate in terms of profits and losses:



As you can see, typically you should anticipate about 1/3 of the time you will be making losses (but keeping them small at just -1R); 1/3 of the time making breakeven trades; the remaining 1/3 profitable, with the profitable 1/3 splitting into ½ of the time small profits and ½ the time large profits. You should anticipate having large profitable trades only about 1/6th (16-17%) of the time.

If you are going to become a successful professional trader, understanding this gives you a far better chance of being able to manage your trades and letting the big profitable trades run - which is vital for your overall trading success.

Amateur traders expect to be right all the time and make big money all the time. In real life nothing is further from the truth. As we have seen, on the surface you can have a 66% profitable system (profits and break-even trades), but in reality the big profits unfold only about 16-17% of the time.

Chapter 10 – Managing the standard trade set-ups

During the last few chapters I have looked at the automatic set-ups in MTPredictor - the simple ABC (TS3), TS1, TS2, TS4 and DP - and shown how the MTPredictor software program can automatically scan for and identify these set-ups for you. I also took a detailed look at Position Sizing and demonstrated how keeping the initial risk (which means the losses) small was vital in any successful trading plan.

Okay, now you have identified (or MTPredictor has identified for you) a low risk initial set-up, that set-up has been triggered and you are now in a new trade, the next question is: “how do I manage this trade” or “how do I adjust my protective stop loss as the trade moves in my favour”? This will be covered in this chapter.

There are two choices: firstly, using the projected profit targets (the WPTs, Wave Price Targets); secondly, looking to run your trade using the ATRStop. Let’s look at these two methods individually, showing the pros and cons of each method, before combining them by using the STF strength band towards the end of this chapter...

Let’s start with the projected profit targets, using the larger-degree WPTs.

Please note, these are only the basic guidelines. There are more advanced strategies and alternative trade management methods included in Part 2 of the Trading Course. However, by simply following and using these basic guidelines, you will have a good, solid foundation upon which to build your own, personal trade management system.

Continued on the next page . . .

Projected profit targets (larger-degree WPTs)

In this section, I will detail the basic guidelines suggested for advancing your projective stop loss off a TS1, TS2 or TS3, using the projected profit targets as a trade moves in your favour. The basic principle is the same for the TS1, TS2 and TS3 set-ups – the TS4 and DP are slightly different as they have only one projected profit target.

Please understand that having a protective stop in the market at all times is vital because this protective stop will take you out of a trade quickly when it goes wrong, therefore keeping your losses small. Not having a protective stop on any open position is plain foolish and not recommended!

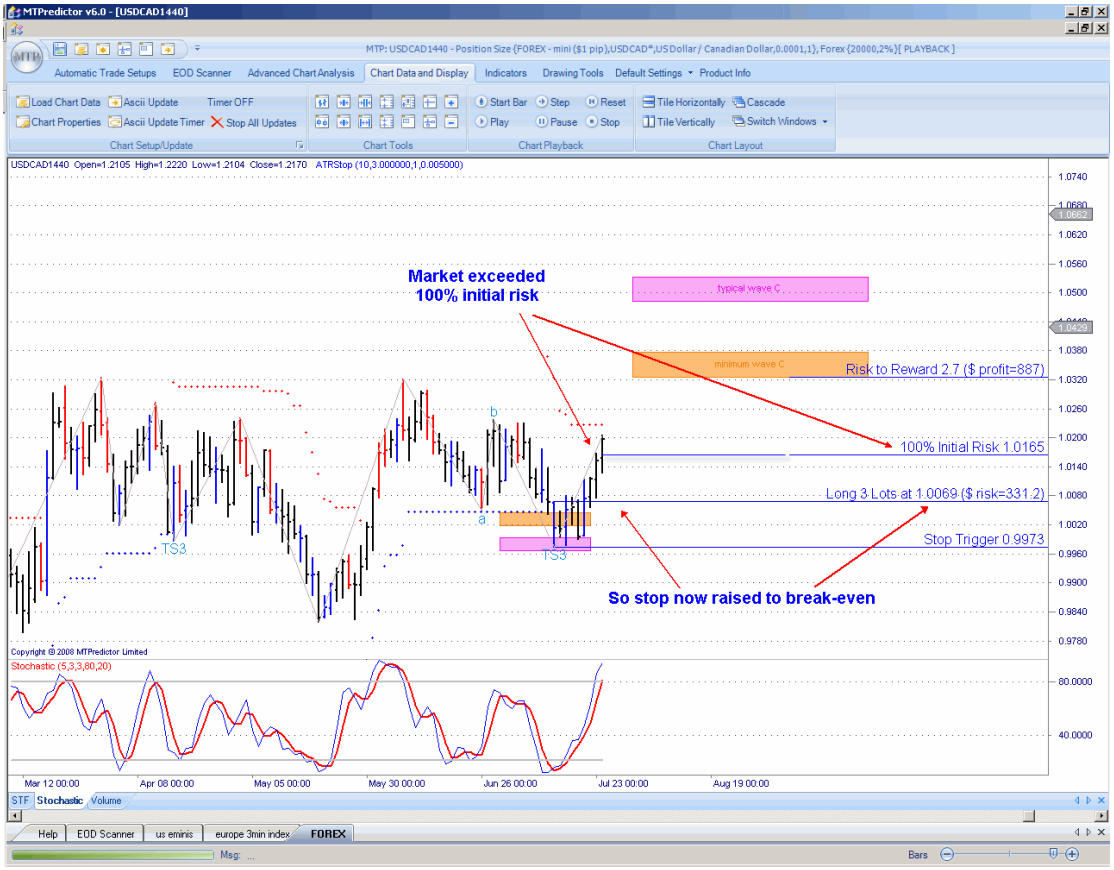
The basic idea is that you should advance your protective stop as the market in question reaches the next important *larger-degree* support or resistance area (WPT). Then if the market closes *beyond* one of these areas, you should anticipate that the current trend will continue into the next support or resistance area.

As an example, let's follow the progress of a TS3 long trade on the forex pair USDCAD, Daily chart, from the initial buy trade set-up off a TS3 low on July 15, 2008:

In the chart above, you can see that this long trade was filled on Jul 17. As soon as the long trade was filled you should then place your initial protective sell stop in the market, at 1 tick below the recent low.

The stop stays here until you are either stopped out for a small (-1R, or 1 risk unit) loss or the market moves past the 100% initial risk point.

A few days later the USDCAD has indeed rallied and has now exceeded the 100% initial risk level:



The 100% initial risk point is where your current profit would equal (be 100% of) the initial risk required to take the trade. Once this has happened you should raise your protective stop to break-even.

Raising your protective stop to break-even as quickly as possible protects your trading capital. Keeping the losses as small as possible or, ideally, keeping them out of your account completely, protects your trading capital and builds the foundation for a solid long-term profitable approach to trading speculative markets, as outlined in the prior chapter.

However, you should only do this on Daily (or longer) charts. The reason is that short-tem (intraday) charts are more volatile and need more *room to wiggle* before the trade gets going. So use this 100% initial risk guideline only for daily charts or longer.

The next stop loss adjustment does not happen until the market in question has reached the first projected profit target. This is normally the *Minimum* Wave C WPT of *larger-degree*:

Once the market in question has reached this projected profit target, the protective stop should be trailed just below the bar lows (reverse for a short trade).

The idea here is that, at this stage, the current rally could still be either a Wave C or a Wave 3 of larger-degree. As such, you have to be prepared to close the current profitable trade *if* the current rally off the original trade set-up turns out to be only a Wave C of larger-degree.

However, *if* the market *closes* beyond the current projected profit target, you should assume the current swing will continue onto into the next profit target.

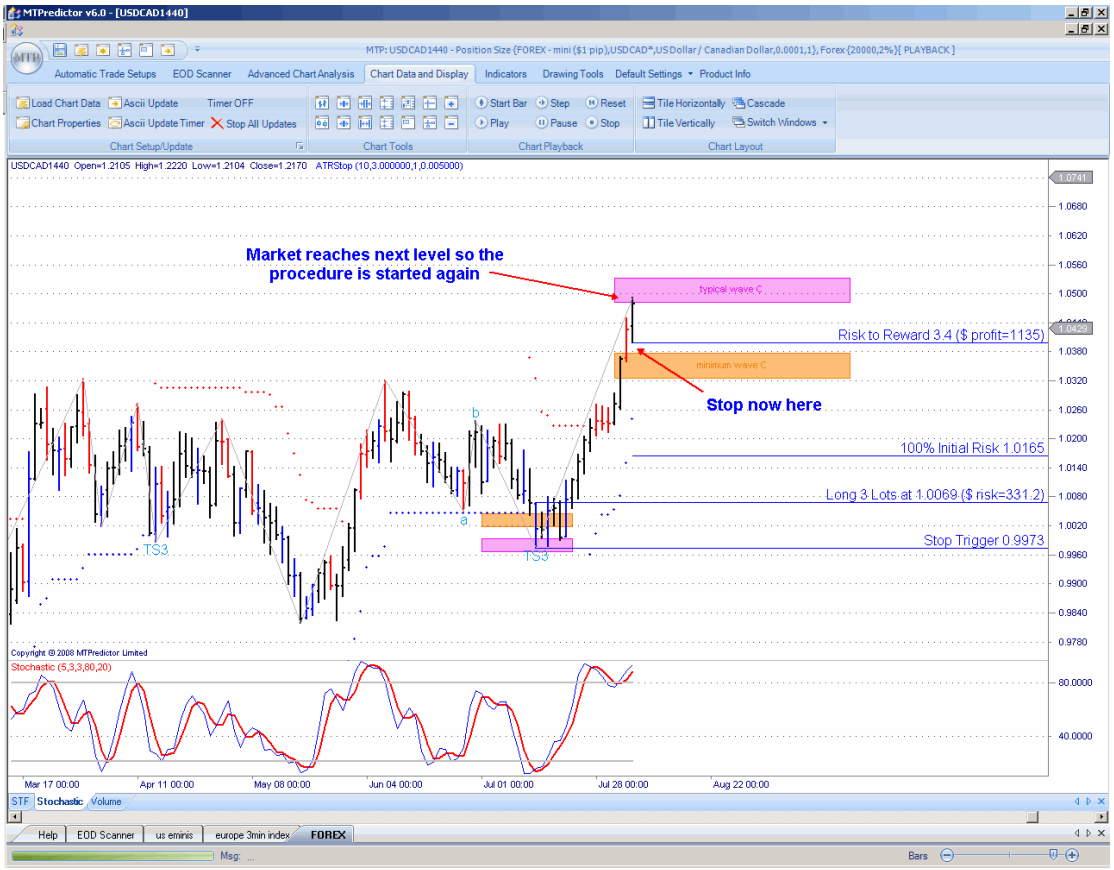
Continued on the next page . . .

So, if the market closes beyond the current profit target you should *fix* (or leave) the protective stop 1 tick below the low of the first bar that closes beyond the projected profit target, as in the example above (reverse for a short trade).

The protective stop stays there until you are either stopped out or the market in question reaches the next projected profit target.

Continued on the next page . . .

Here we can see that a few days later the USDCAD reaches the next projected profit target, so the process is repeated:



Just as before, as soon as the market enters the projected profit target, the stop is trailed 1 tick below the lows until you are stopped out or the market closes beyond the profit target...

Continued on the next page . . .

Which is what happens a few days later, as the USDCAD closes above the current projected profit target:

The stop is then fixed at this level until you are either stopped out or the next projected profit target is reached.

This process continues from one projected target to the next target until you are stopped out.

Continued on the next page . . .

A week later, the USDCAD declined back to the stop level set earlier and the long trade is stopped out for an excellent +4.7R Profit (excluding slippage and commission):

Projected profit target (WPT) trade management summary

1. As soon as the trade is entered, place an initial protective stop 1 tick beyond the recent high or low.
2. For Daily and longer-term charts, move your stop to break-even as soon as the 100% initial risk level is exceeded.
3. Trail stops 1 tick beyond bar high/low as projected target is reached.
4. Fix stop 1 tick beyond bar high/low of the first bar that closes beyond the target...stop stays there until stopped out or next target is reached.
5. Repeat steps 3 and 4 until stopped out.

Continued on the next page . . .

CRACKED TRADING SOFTWARE

70+ DVD's FOR SALE & EXCHANGE

www.traders-software.com

www.forex-warez.com

www.trading-software-collection.com

www.tradestation-download-free.com

Contacts

andreybbrv@gmail.com
andreybbrv@yandex.ru
Skype: andreybbrv

Okay, so far so good and, at first sight, this looks like the perfect trade management strategy because the protective stop advances with you as you move from one projected target to the next projected target. However, sometimes a minor wiggle can stop you out prematurely in what would otherwise have been a good move. So is there another way that will allow the trade to run while still giving the market enough *wiggle room* to not get stopped out too early ?

Yes there is - we call it the ATRStop.

The ATRStop is an adaptation of Wells Wilder's ATR, or Average True Range indicator. The indicator reacts to the volatility (or the *average true range*) of recent swings. It allows for minor wiggles while still allowing the trade to run.

Let's take a look at an example on US Stock AYE, daily chart:

As you can see, the ATRSTop held the short longer than using the projected profit targets alone.

At first sight, this seems the perfect solution, so why don't we just use the ATRStop to manage all our trades ?

Well, markets are not that simple. Normally markets have a good move only about 1/3 of the time - the other 2/3 of the time they are in a sideways choppy period. So, as the ATRStop is designed to let a trade run, it works best when a market makes a strong move. On the other hand, as we have seen earlier, the projected profit targets tend to get you out of a trade earlier, which works best in a sideways choppy market.

So we have two trade management strategies that work well in the two phases of a market, so the question is: how do you known which to use ?

For this, we have developed a *strength band* that we apply to the STF (Strong Trend Filter) indicator to give an early warning of whether the current move is strong or weak. This guides us as to which trade management strategy to use.

Let's take a look at what I mean:

In the chart above we have a DP buy set-up on the German Dax index future, 3minute timeframe. As you can see, the market has rallied well and reached the first projected profit target (for a TS4 and DP set-up there is one projected target only). The important point is that as the projected profit target is reached, the STF oscillator has exceeded its Strength Band. This indicates that the move is strong and is more than likely to continue past the profit target.

As such, you should look to run your trade further:

As you can see from the chart above, this is exactly what happened - the DAX continued higher. The ATRStop followed the long trade up to where it was eventually stopped out for a +9.7R profit (excluding slippage and commission).

The point is that when the STF exceeded its Strength Band the current move was strong (relative to past swings) and you should assume that it will continue in the current direction. So, when you are in a trade and the STF exceeds the Strength Band you should switch to the ATRStop and look to let your trade run further

Okay, so what happens when the STF is weak, or has not exceeded the Strength Band ?

Continued on the next page . . .

Here is an example on the US S&P500 E-mini index future (ES),3 minute chart:

Here we have a TS4 trade set-up in which the short trade has reached the projected profit target, but the STF has not yet reached the Strength Band. When this happens, it is the reverse of what I have been talking about over the last few pages, in that the current swing is assumed to be weak and therefore likely to reverse soon...so you should look to bank your profits earlier i.e. not looking to run the trade. For this, you use the projected profit targets.

Continued on the next page . . .

Here is the same chart a little later:

As you can see, the low came in right at the projected profit target and this was the best place to look to bank the largest profits.

<u>Summary of when to use the ATRStop (STF Strength Band)</u>

1. Use the projected profit targets when the STF is weak.
2. Swap to the ATRStop when the STF is strong i.e. has exceeded its Strength Band.

Continued on the next page . . .

In the example on the last page, profit was taken MIT (Market-if-Touched) at the project profit target, rather than looking to start to *trail* the stop just beyond the bar highs or lows. So which method is better ?

Here is another example where the profit at the profit target is approximately +5R (excluding slippage and commission).

Continued on the next page . . .

But, if you trail the stop the market moved lower:

As a result, the profit increased to just over +6R (excluding slippage and commission).

However, this is exactly the opposite to the example a few pages earlier5, where more profit was made coming out MIT *at* the project profit target, so which method is best ?

Well, you can use either as long as you choose one and stick with it - chopping and changing will only cause problems.

Continued on the next page . . .

Part 2 of the Trading Course will cover in more depth trade management and discuss more advanced trade management strategies, for example when to trade as a Wave (3) and when to use the DP from the minor Wave b swing to take profits earlier:

Here you can see how the low on this UK FTSE100 index future, 3minute short trade was made right at the DP (Decision Point) taken from the prior minor Wave b low and was, therefore, the perfect place to bank profits.

More detail on these as well as other advanced strategies will be covered in Part 2 of the Trading Course.

Continued on the next page . . .

Trade Management Summary

The standard trade management strategy is very simple, using the idea that if a market exceeds one projected target it is more likely to continue into the next support or resistance area. As such, your protective stop should be kept close to the market as the trade enters the projected target, until it closes beyond that target. Then you fix the protective stop where it is until the next projected target is reached, until you are either stopped out or the next projected target is reached. The process then starts again.

We then introduced the ATRStop as a way to try to run trades further and demonstrated how this should be used when the STF has exceeded its Strength Band.

The whole idea behind this is that you look to use the projected profit targets to exit a trade more quickly when the market is giving an indication that the current swing is weak. However, you then look to run the trade further, using the ATRStop if the market in question is strong i.e. has exceeded the STF Strength Band.

We know from experience that markets tend move sideways and or chop around about 2/3 of the time and make strong trending swings only about 1/3 of the time. This is what we are trying to capture with this dual trade management strategy. There is no single trade management strategy that works well in both sideways and trending markets, so we need two strategies and a way to swap between them. This is what the STF and its Strength Band offers us.

At this stage, I want you to be totally comfortable with the automatic trade set-ups and their trade management via the standard guidelines outlined in this chapter before you move on to some of the more advanced trade management strategies covered in Part 2 of the Trading Course.

Chapter 11 – Summary of Part 1

Hopefully you have enjoyed the journey through Part 1 of this Trading Course and appreciate the simplicity and ease with which MTPredictor approaches analysis and trade identification.

As you know, my own view on the way Elliott wave analysis should be applied is unique and different from the typical teachings. Some pure Elliott wave analysts will disagree with me (that is fine!). But I hope you can see that treating Elliott wave analysis *in isolation,* (the MTPredictor *Isolation Approach*™) - with the primary aim of identifying *ideal trade set-ups* and not trying to forecast any future outcome - releases you from many of the constraints and problems that arise with this form of analysis.

I cannot stress this difference enough. Therefore, when you look at the MTPredictor approach, please be fully aware of this difference.

In particular, I hope I have been able to demonstrate - and also that you have found from your own research - that when you use Elliott wave analysis in the standard way, it tends to come unstuck more often than not. This is not to say that Elliott wave analysis does not work, just that from my own experience (and from many traders I have spoken to over the years) there is an easier and simpler way to approach this analysis.

Again, taking one particular Elliott wave pattern (the simple ABC correction) and using this as the basis of the automatic trade set-ups in MTPredictor, makes trade identification and trade management simple and straightforward. There is so much information and so many techniques available today, that if you try to take it all in it will only lead to confusion. I have heard the phrases *information overload* and *paralysis of analysis* too many times over the years. It is far easier to focus on one particular method and then take the fishing approach to trading. In other words, you take your line and cast into the markets and reel in only the best and biggest fish. Although it may take some time waiting for the big fish to bite, it is normally better in the long-run.

This analogy highlights the MTPredictor approach - it is far better to have the patience and discipline to wait for and then trade only the *ideal* trade set-ups. Although this will mean you may not trade every day, over-trading is one of the worst mistakes any trader can make and should be avoided at all costs. Sticking to just the standard trade set-ups will help because it will enable you to create the self-discipline and patience that is required for a successful long-term approach to the markets.

Throughout my years as a private trader, whenever I incurred a period of losing trades, I thought the answer was to become more educated and look for more in-depth ways to understand the market. This personal journey took me through many different (an ever more complicated) ways to perform technical analysis. However, despite becoming an expert in many different forms of analysis, the bottom-line results did not reflect this new-found expertise. After many years of this, I suddenly stopped and looked back - and finally realised that the route to profitable trading does not come from unlocking the markets or discovering that one perfect method - the so-called "*Holy Grail"* does not exist.

In a way, the real "Holy Grail" is to make trades consistently over time, in which the profits are larger than the losses. It is as simple as that. And in reality, the real "Holy Grail" is within yourself and your ability to apply your own simple method consistently with, more importantly, the patience and discipline not to make silly and unnecessary trades.

This is where professional traders has a huge advantage over most new (and inexperienced) private traders. They fully understand that to make money over a period of a year does not mean making trades every day, or even every month. They fully understand that to make a profit at the end of a trading year needs the patience and discipline to wait for and trade only the best set-ups. This may mean participating in and taking full advantage of only one or two major moves during that year.

The statistics on the number of private amateur traders that fail in the markets every year are alarming; some say it is as high as 97%. One of the main reasons for this is over-trading and the belief that there is one "Holy Grail" or perfect market technique that can predict with complete accuracy any future market movement. If you stop and think about this for a while, this is a pure gambling mentality and complete nonsense. If there were one Holy Grail, some of the highly paid institutional traders would certainly have found it by now. If you look at most of the successful traders throughout history, one consistent theme links them all - the ability to keep their losses small in relation to their profits. Once you understand that this is the real Holy Grail and accept that you *will* make losses but the trick is keeping the losses small (and stop looking for that one method which avoids all losing trades) the sooner you will become a profitable long-term trader.

This is what the MTPredictor approach to the markets is designed to do - in particular, the five standard trade set-ups are designed not to predict or forecast any future market movement but to allow you to enter a new trade with a small, controlled risk. More importantly, to keep the inevitable losses small in relation to the profits over time. This is the key to a profitable long-term approach to the markets - the real Holy Grail.

However, MTPredictor does not stop there: Part 2 of the Trading Course takes you to new and more advanced levels.

For example, using the *Elliott Wave module* to identify additional Elliott wave patterns, such as the end of a Wave 5 swing:

Here the automatic routines nailed the exact high of the Oct 31, 2007 high in the US Nasdaq index.

Continued on the next page . . .

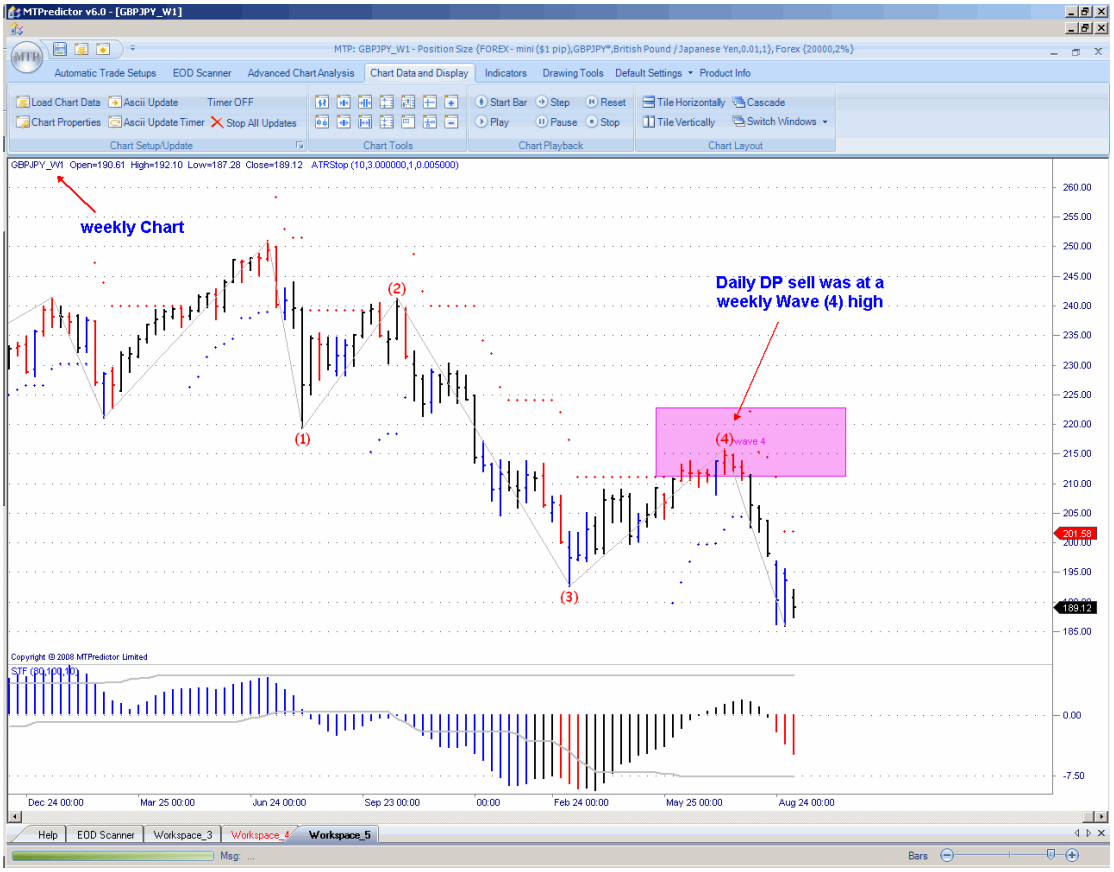
Part 2 of the Trading Course has far more detail on how to apply *manual analysis* to your charts. For example, the use of the Decision Point (DP) tool:

In this daily chart of the forex pair GBPJPY, you can see how we had STF divergence going into the July 23 high and, most importantly, this high unfolded at DP resistance. This was the trigger to signal a new short trade. The market declined nicely over the next month for a very healthy +8R profitable trade.

Manual use of the DP and oscillator divergence will be covered in greater detail in Part 2 of the Trading Course

Continued on the next page . . .

In Part 2 of the Trading Course, there is also detail on how to use multiple timeframe analysis. For example, the daily forex pair GBPJPY sell on the chart on the prior page also fell in line with the weekly chart:



Multiple timeframe analysis is particularly important if you are a day trader looking at the short-term 3 and 5minute charts. It is particularly important to orientate your short-term trades in the direction of the larger-degree 15 and 60minute charts.

Continued on the next page . . .

So far, you have seen examples on many different markets including US stocks, US futures, European futures, Forex, UK stocks, Australian stocks, on many different timeframes - including daily, weekly, intraday (from 3minute charts to 60 and 240minute charts). MTPredictor can be used on any market, on any timeframe as long as the chart in question has clear, clean and obvious swings and there is enough volume to trade easily. This is just common sense and would apply equally to any technical analysis strategy. We have customers in virtually every major trading country of the world, trading virtually all markets on all exchanges. This just goes to show that the methods outlined here are universal and can be applied in a manner wherever in the world you live or whatever markets you trade.

Also, because these methods are not optimised this means that they will not change over time. In fact, you can use the same routines on charts from last year or any time in the past, the same methods still apply. This is important because you must have confidence that your system can stand the test of time. Optimising a system to curve-fit the last few trades is like *moving the goalposts*; you never know where you are. This is why we do not do this at MTPredictor.

There is far more to MTPredictor than you have seen so far in Part 1 of the Trading Course. Part 1 is designed to build the foundation of a solid trading plan using the automatic trade set-ups. Once you become familiar with these, you can start to move up the Techniques Curve™ and make full use of all the more advanced routines and modules in the MTPredictor software program.

MTPredictor is not just a black box that spits out automatic trade set-ups. In the hands of an advanced trader MTPredictor becomes very powerful trading software that is capable of uncovering and then managing many additional trade opportunities.

Thanks and good trading

Steve Griffiths
MTPredictor Managing Director and Developer