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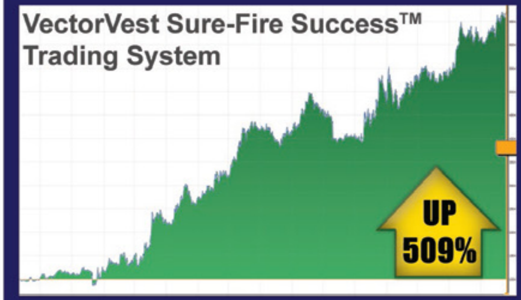

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To Trade or Not to Trade (or how I done it)

by JACK K. HUTSON

The format of sharing trading experiences is an easy way for Technical Analysis Group members, as well as others, to tell how they used chart work and technical analysis in the day to day trading of stocks or commodities.

One of my approaches to trading is as follows: This story begins around the first of the year, 1982. Pork Bellies had just made one of its abrupt ninety degree reversals which started a spectacular Bull market. At that time I was attracted to the chart because the reversal was so sharp — and the only side of the market to be on was the **long side**. On January 14th, I saw what looked like a good point to go long. Unfortunately I sat and watched. That trade would have taken me to the 5th of February for about 6 cents or $2200 net profit per contract.

For you new traders I would like to bring this sort of **short-term trade** into perspective. Commodity 'contracts' are bought and sold only on margin, much like securities may be bought. As with securities that are bought on margins, and a profit taken, it seems appropriate to compute a percent profit based on your out-of-pocket expense (i.e. your margin). At any rate the numbers sound much better when looked at from this point of view and this IS my story.

The current margin for one contract of Pork Bellies is $1500, or sometimes more based on an individual's finances. This fictitious trade would have returned about 146 2/3% on your margin money in 23 days or 1,461% annual interest rate COMPOUNDED DAILY! The only real problem with this, to be described, trading technique is that I had to wait 5? months for the same sort of conditions to present themselves again, at least in Pork Bellies.

This is just one of umpteen methods that may be used to give yourself a better chance of being on the right side of the market. I also use a number of other chart and numerical studies as well as some fundamental guess work. The purpose of the following dissertation is to relate to you just what steps I have gone through to make one trade. This I hope, will prove interesting and possibly useful in your own research. No justification nor documentation will be presented.

During February and March, Pork Bellies made three half-hearted attempts at making top. But each in its turn failed to follow-through. April and half of May was a strong Bull market for Pork Bellies, almost like a second wind. The second half of May exhibited what appeared to be another short-term short retracement or 'technical correction'. Over the long, and in Seattle hot, Memorial Day weekend I had ample time to review my position.

The previous week, Pork Bellies had shown chart signs of making a top (Re: Edwards & Magee, 'Technical Analysis of Stock Trends'). This told me that Bellies may be having trouble making a new high above the May high and therefore could be a hint of a real top forming. To verify that a short trade at this stage was practical I did the following:

1) Checked to see that the Relative Strength Index (Re: J. Welles Wilder, Jr., 'New Concepts in technical Trading Systems') was not already showing Bellies too short (i.e. below 20).

2) Checked a WEEKLY nearest futures chart to verify that what looked high, for Pork Bellies, was in truth the second HIGHEST in history. (A short at this time would feel better than a long.)

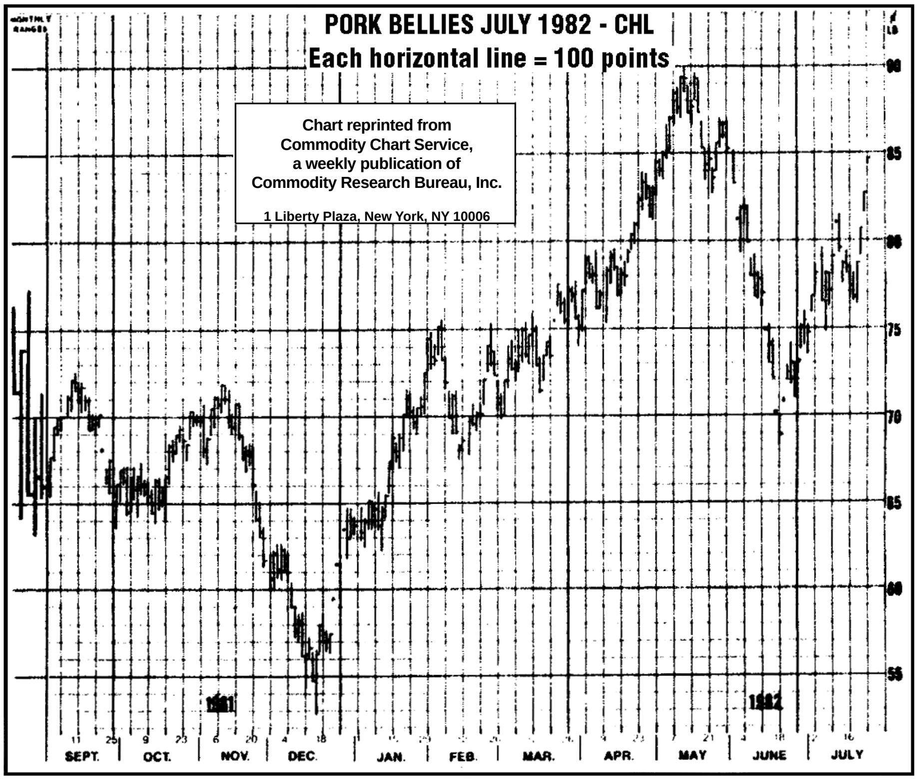
3) Checked a WEEKLY Stochastic chart to see if it too was showing a possible short in the making or in progress.

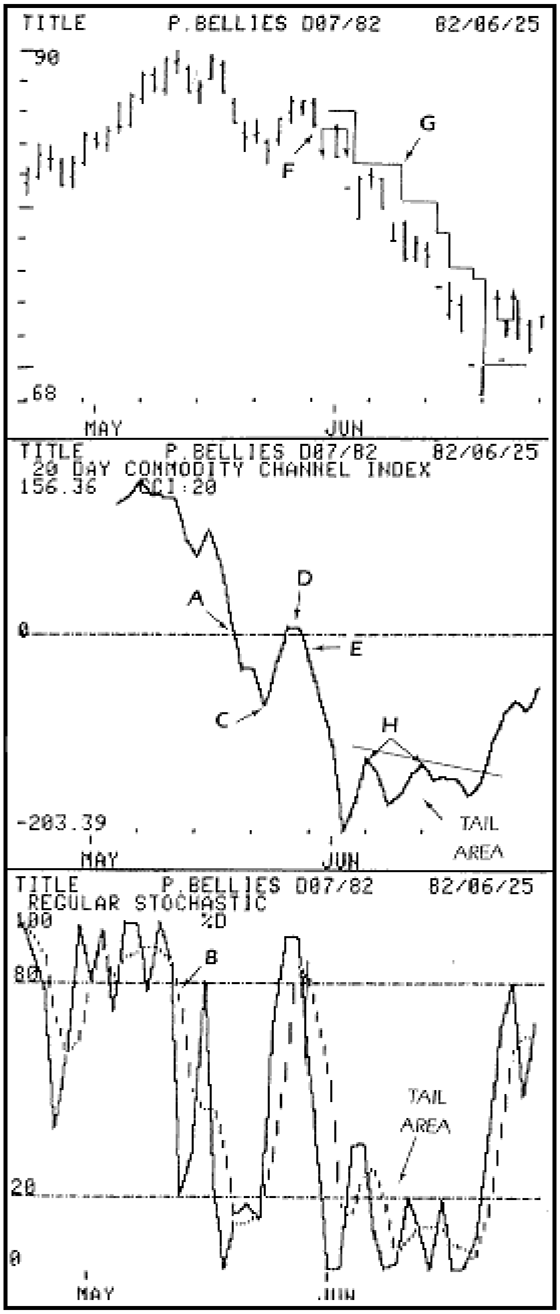
I expect that there are a dozen other things I could have looked at, but this story is supposed to relate what I really did, not 'should have done'. Based on the above confirmation I was encouraged to 'put on a position'; the question was: When and Where.

WHEN TO TRADE

For Pork Bellies I used a 20 day Commodity Channel Index (Re: Donald R. Lambert in COMMODITIES, Oct., 1980, pp. 40-41,, formula modified by Compu Trac Inc.) to get ready and signal a short as well as a Regular Stochastic for confirmation.

PORK BELLIES





The Commodity Channel Index (CCI) can be thought of as a breakout indicator. When a stock or commodity has been trending directionally in a channel, that is prices bouncing back and forth between fixed trendlines, there will eventually come a time when this channel will be penetrated. For nothing goes up, down or sideways forever, we trust. This penetration or break-out is marked on a chart of the CCI as the point were the line crosses the zero line from + to – for a short (SEE CHART POINTA) and – to + for a long. The market on the July 1982 contract of Pork Bellies on May 19, 1982, according to the above rule, had just broken downward.

For Pork Bellies, as well as a number of other 'issues', this is NOT much assurance that a long-term directional change has been made, but sometimes it can reflect an impending move. I had been looking for this breakout confirmation because of my observation of a Regular Stochastic chart collapse on May 14, 1982 (SEE POINT B). The Stochastic study has proven to be a good short-term entry as well as exit tool under a great number of conditions, this one included.

I am now waiting for the CCI to stop (POINT C), after crossing the zero line, and attempt to recross the zero line (POINT D). If, and when, this does NOT occur we have a probable signal that a true breakout or reversal has been established (POINT E). What has happened is that the CCI line ran out of steam when it tried to reestablish the channel. Prices could not continue in their OLD trend and appear to be changing the DIRECTION of trend . . .

The 20 days I use seems to be satisfactory for the following:

Wheat

Soybeans

T-Bills

Copper (use 30 days)

Cotton

Soybean Meal

Silver

Corn

Soybean Oil

Pork Bellies

Sugar

Gold

But, as you can see by the fact that the CCI, for Bellies, did move a little above the zero line (POINT D), these numbers may need a little tweaking for each commodity. For instance, I have recorded an optimized number of days for T-bills to be about 22 (days). At any rate the number 20 is convenient when setting up a procedure that may be used on all the commodites I follow.

Thus I have established WHEN to get in as of May 28, 1982 (ie. Point E). A number of indicators have encouraged me to believe that the odds are in favor of a short position, but still I'm not sure (and probably will never be). The question is where do I sell Pork Bellies, at what price? What I am looking for is a price that allows me to place a stop (I could be wrong!) such that I both; limit my exposure, yet assure that I will not be taken out during the normal daily oscillations.

WHAT PRICE TO TRADE

Early in 1980 I met with a local author and commodity trader (Bruce Gould) to discuss commodities. I subsequently bought his 'Commodity Trading Manual' and some of his old newsletters. One technique I have used again and again is to place your order to buy or sell just out of the past trading day's (or week) trading range. I guess the idea is: if it's going your way just get in front of it and jump on as it goes by. This policy has saved me a number of times from taking a bad position.

On June 1, 1982 I went short the July 1982 contract of Pork Bellies at 84.90 (POINT F) with a defensive stop at 86.10. The stop was a little too close (should have been more like 87.10), but I only wanted to risk about $550 per contract (this includes commission).Also, Pork Bellies have a nasty habit of running past ones stops and I felt that if it got to 86.10 it could just jump over some other stop I might have picked.

June 2nd Pork Bellies went limit down thus implying that the next day could also go the limit as well, at least at the open. This sort of thinking is rationalized fundamentally because the only reason that the downward price motion stops during a limit day (maybe) is because of that artificial exchange limit. This causes the trader both an advantage to be taken and a dilemma. The advantage because one now has almost a precognitive ability to predict tomorrows open and take over 5 cents out of Pork Bellies in less than three days. The dilemma is that by taking the quick bird in the hand one also loses the opportunity to participate in a big move. At this point I briefly considered two things:

1) I am ahead at this juncture and can see that it would be difficult (but always possible!) to actually lose on this trade. This sort of thinking makes you forget about all the times you were on the other end of the stick.

2) I waited for over FIVE months for this trade to develop. The single trait in this business you must maintain is patience (is this wisdom?).

USED STOPS

To set my stop on subsequent days I looked at past daily highs in an effort to arrive at a probability for the next days high. As a side effect or benefit of developing an ARIMA model based on past daily highs, I was able to make a good estimate of the probability of a given high occuring (see another article in this issue about ARIMA). I chose to accept a 20% chance that if my stop was touched that I should have stayed with the position (i.e. A one out of five chance that my stop is too close). Based on the last 300 days of trading this turned out to be 1.47 cents above the most recent lowest high. The stops I set are shown on the price bar chart (SEE LINE G).

At least two points are shown on the CCI that were good pyramid resting places to add to my position. These show up as small bumps on June 8 & 14 (POINTS H) for indicating shorts on the following day. Stochastic can display these points as well.

On the 17th of June the Bellies again moved limit down. The tails of both the Regular Stochastic and Commodity Channel Index were narrowing as noted on their respective charts. This is often a sign of a 'technical correction' in the offing. I thought I would ask my broker for his advice. Should I get out before the correction or was I seeing the trees again and panicking. His comment was, "You got yourself into this, so you get yourself out." Great help. That day I set my stop at 70.52 and resolved to think about it that evening.

On the morrow I was on the phone to my broker with a predetermined 'get out' strategy. Based on the forgoing fundamental theory that the day after a limit move sometimes precipitates a following day opening of limit in the same direction. I resolved to wait for the opening trade or call and immediately place a buy stop at 68.35. Well at least I had a plan — The opening trade (and low for the day) was 68.30, which was .13 above limit down. Oh Well! He who hesitates, etc. After all that patience, it's tough to get out of low gear. Plus, again, I was not sure that the move was over.

I should note here that I used one other tool to forewarn myself that the end of the move may be near. I reviewed past Pork Bellies charts to get an idea of how far and long other market years had moved under similar conditions. (RE: This time I used COMMODITIES: A Chart Anthology by Edward D. Dobson)

My buy stop remained at 70.52 for the following two days limit up against me for a final exit on the opening June 22, 1982 at 72.85. Thus returning over a 12 cent profit on my original position (i.e. $4500 net per contract).

Again, I would like to encourage you to write about some of your experiences and/or observations. Again, I hope that this format of 'how I do it' will be of some help to others. I only wish that all my trades were as pleasant as this one. I have more than my share of disappointments.

