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Hugh's

RULES

for churning

$1,000 into $100,000 in 1 year

Bread and Butter

Strategy

August, 2013

Impossible!

That’s what all your well meaning friends will say and try to talk you out of it. Ignore them. Better yet, send them to me. They may soon be trading along with you.

In fact, there is every reason making $100,000 out of minimal seed capital in one year is achievable using this incredible financial instrument. Why everyone doesn’t do it is somewhat of a mystery to me. But then, so are a lot of things, However, I promise not to get political.

This paper assumes you have a working knowledge of trading options and its amazing power of leverage. It also assumes you’ve read and understand the previous two publications, *Hugh’s Bread and Butter Strategy* and *Hugh’s Enhanced Bread and Butter Strategy*. Therefore, this release will further augment the approach with a set of rules. Follow these conventions to the letter and change your life beyond your wildest imagination.

Where Do We Start?

Attitude. A winning attitude will keep you focused and committed throughout the process. There will be stumbling blocks. Challenges will present themselves in ways unknowable at this point. But always staying the course, remaining positive and on track with the overall goal in mind, taking it one step, one day at a time, will allow this project to unfold naturally in the manner prescribed. When you trip, pull back a notch, analyze and learn from your mistakes. Then move forward.

I will present these rules in two parts, the second being the most important. I will present the first part only because I know you want to know the Strategy Rules first. At this point, understandably so, you may think this first part is the most important when in fact, it is the second part, Emotional Control, that will ensure your success. Much of the second part you can apply to other parts of your life as well.

Part One – Strategy Rules

This is the actual system we will use to execute trades. I will not execute a trade unless all indicators are lined up. I will not compromise or take unnecessary risks. I will be happy with the returns I get from my trades as planned. I will follow the rules knowing that if I break them, there will be costly consequences to pay. I will repeat this mantra a thousand times a day, if necessary, to hard wire it into my memory.

Part Two – Emotional Control

The psychology of trading seems to be the least taught yet most important aspect of trading: controlling our own emotions of fear, greed and ego. Master this and you’ll never have to worry about money again.

Part One - Strategy Rules

1) Plan, Plan, Plan

a) First, commit to a Trading Plan.

Trading Plan									
		Expected	5%		Actual				Notes
Date	Day	Starting Capital	Budgeted Gains	Ending Capital	Starting Capital	Gains to Day's End	Ending Capital	Actual ROI	
1/3	1	1,000	50	1,050	1000	60	1060	6.0%	
1/4	2	1,000	50	1,100	950	40	910	4.2%	
1/5	3	1,000	50	1,150					

I prepared mine in Excel as noted above. I have the date, day #, my expected opening capital, gains and ending capital, followed by actual results. I have also included a column for notes whereby I could record my thoughts and any details of the trade that would be useful for future reference. Was it the right trade with the right results? Wrong trade with the right results? Right trade with the wrong results or wrong trade with the wrong results? Did I make the cut because I was skillful or sheer luck? Did I lose because of some unforeseen circumstance or did I get spooked out?

By determining these things, you can identify mistakes in judgment. Even if you lucked out and made a profit, it could have been a big mistake. We don't want to rely on luck. You can isolate and deal with the 'wrong reasons' if you note what they are.

You will not be trading all day long. In fact, you will likely spend very little time actually with the mechanics of the trade so you will have ample time to reflect on the trade itself during and after the fact.

If you want a copy of this spreadsheet, let me know. The extended version of this particular plan calls for a reward after every 20 trades, so I will pay myself along the way as well as achieve my lofty goals.

A couple things to note: this plan has the dates on the left column. That is merely for reference and should not be construed as a pressure to have to trade every day. Sometimes, you could have 2 or more trades; that is certainly permissible, other days, none. This plan is also designed for myself. Your plan may be different and may have to account for circumstances such as the '3 trades in 5 days rule if you're under $25,000'. Never feel pressured to produce with the time. I am also assuming an average of 5% a trade gain. I have some greater profits and I also have some losses but my expectations of 5% is more than reasonable on average.

A Trading Plan keeps you on track, is measurable, time-bound and achievable. You can always adjust it along the way, easing the pressure should you feel the need. You will also be able to review the process and watch your personal growth while accumulating wealth.

b) Log your trades.

Again, below is a screenshot of part of my spreadsheet but you can make up your own.

Buy Date	Trade #	Contracts	Buy	Purchase	Sell	Proceeds	Profit	Sell Date	ROI for Trade	Option	Notes
Oct. 18	1	5	1.83	925.24	1.95	964.72	39.48	Sept. 20	4.3%	Oct107calls	

If you'd like a copy of the above, just ask. We also have an excellent log that one of our members has created and made available to the group… thanks Don for this invaluable tool.

c) Plan your trade and trade your plan.

This is not just a cool phrase you often hear in trading circles but a mantra you need to live by. Every trade needs to be planned. You should be able to mentally envision where the trade will go before you enter it. There should be no surprises. We will use only the pertinent indicators and not overload our screens with redundancy. Analysis Paralysis = No Trades.

Not planning your trade is akin to going to the casino with no plan… you end up playing until you lose it all. Professional traders know in advance their entry and exit positions… and they stick to them.

2) Trade Entry Rules

Trade entry starts long before the market opens. Make sure you're well rested and emotionally stable; don't enter the stock market if you just had a fight with your partner. I like to ask for divine guidance before trading as I brew my morning coffee. I also like to ensure my desk is cleared and that there will be no interruptions during my trading period. Of course it doesn't always work out that way but I do my best. If I treat my trading as the serious business that it is, it will pay as such. If I treat it as a hobby, it will pay as such as well. I like to make my money trading so my family and I can enjoy expensive hobbies.

Actual trade entry:

<u>Premarket</u> -
a) *Check the overnight news*, especially in Europe. We often follow what happens in overseas markets as they have 5 or more hours on us. The Asian markets are not as important but still not to be ignored. Currency reports from Asia tend to carry more weight. Subscribe to *MarketWatch*® for updates. It's free.

b) *Check forexfactory.com* for scheduled news for the day. 'No news' days generally see up trends. Depending on the news, there may be imminent bad news on the horizon; be ready for anything. Most news is released at 8:30 am and again around 10 am., ET. If Obama, Geithner or Bernanke are scheduled to speak, most often markets tank. Not always but…. they will move. Know when they're scheduled to speak. Assess the importance of news. Usually employment news sets the stage.. if it's better than expected, markets tend to rise; the reverse is also true. Also keep in mind that markets overreact to news.

If bad news is released and the markets drop, they often will rebound, usually the same day. Be aware of the news even though we're technical chart traders.

c) *Scan longer term charts*… hourly, daily, weekly and monthly charts to get a feel for where SPY is headed. Are we approaching a strong resistance level? Where are the macd's headed? Look for various and emerging chart patterns. Always keep an eye to the left, including extended hours. Charts have excellent memories and prices tend to gravitate to support and resistance.

d) *Lower time frame charts*… 30 minute and 5 minute charts… which way is the macd headed? Are they consistent with each other? Are they strong? Is the price bouncing off a support/resistance level? I watch for the pivot points on my 5 minute chart (same values on any chart but ensure you have prior day's data). If the macd's rising on the 30 and 5 minute charts with the price near the support, expect prices to rise.

<u>On opening bell</u> -
e) *Advance/decline line.* Check the 1 minute chart on opening bell to see the supply/demand activity. Is it strong (1,000+)? Is it staying high or receding right at open? Is it a doji with a reversal?

f) *Trigger off 1 minute chart*… using the fast line stochastics (tight at 5 & 6 settings) as it breaks through the 20/80 lines, preferably with the slow line in tow. Make sure the macd on the 1 minute chart concurs. Go in the direction of the longer term 5 and 30 minute trends.

If you do choose to buck the trend because of perhaps a strong movement to the opposite direction, always be ready for the imminent reversal which will happen the moment you step away to go to the bathroom. No breaks, no blinking when you're trading against the trend. If you do attempt such a trade, have a solid stop loss/trailing stop in place to cut your losses when the trade turns on you. The market has no loyalty to you; neither should you to it. Treat your stocks like employees. If they fail to perform, dump them. I don't advocate trading against this trend but know some people will so I bring this up for that reason alone. If I trade against the trend, I am keenly aware of the risk; but I don't support others doing it.

g) *Trade with the trend*. You really should be trading with the trend. The trend is your friend… until it's not. And it will turn against you. That's why I use longer term trends, to give myself a level of confidence that I just need to follow along for a short period of time. When that stochastics/macd line up on the 1 minute chart, do not hesitate… pull the trigger. Pay the ask price or the very least, the mark price (split between the bid and ask). Don't dicker for the price. If you come in low and wait, you'll likely get filled but only when the price is dropping. Is that what you want? Buy to the long side when the prices tank? If you want a stock, buy it. Buy at the limit price. Know what you'll be paying.

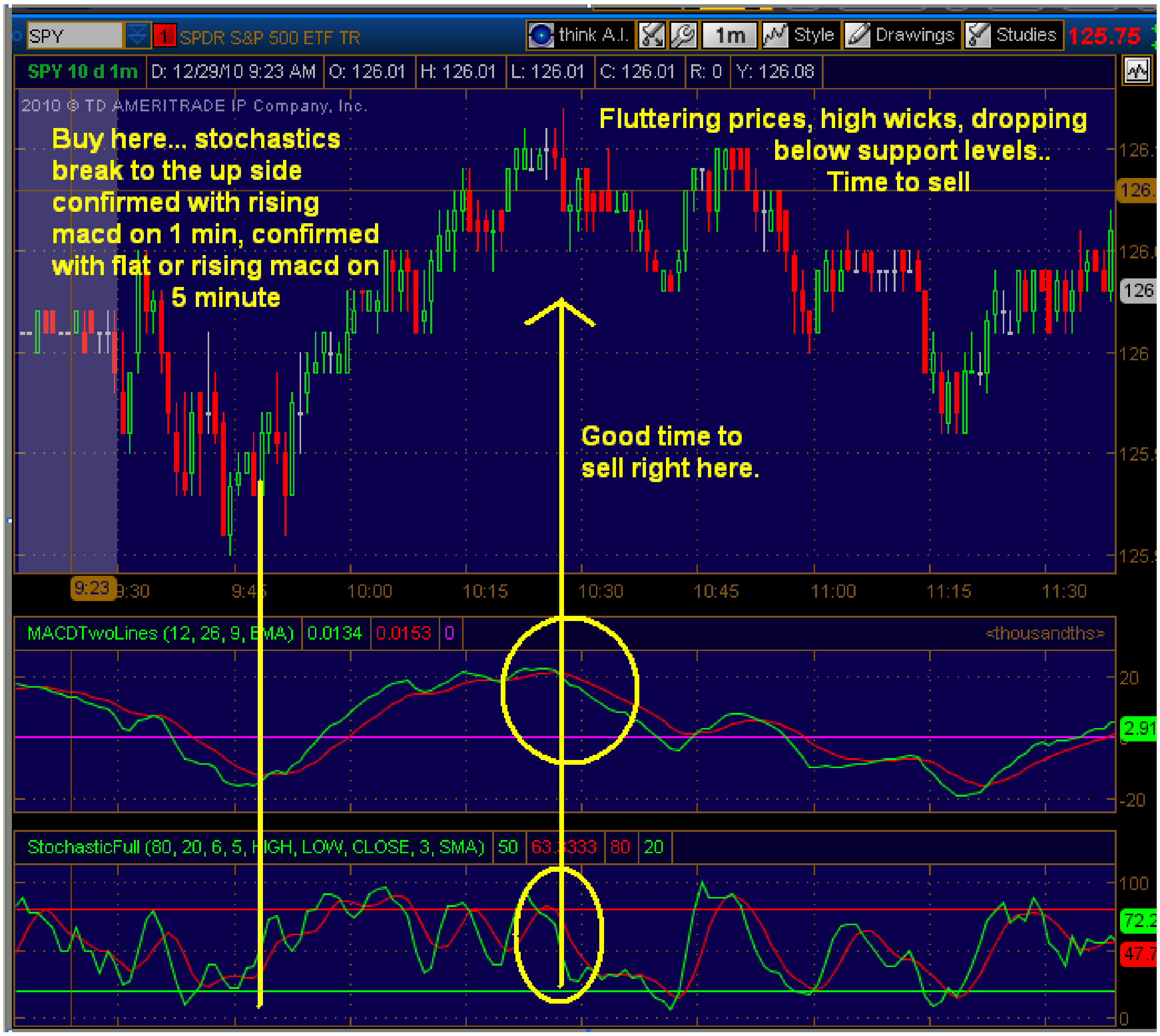
h) *Which option to buy*: This is a function of your propensity for risk. SPY has weekly series, the new weeks always released on Thursdays. The closer you are to expiration Friday, the greater the volatility, theta and risk… but also greater the movement. The surer I am in a trade, the more confident I feel to go with the front month/week. I like to trade the front week up to about Wednesday. Thursdays and Fridays I prefer the next week. Trading front week on Fridays is exciting but akin to gambling… I won't be doing that on this program. For safety, the monthly series will be the way to go but the returns will be less. Buy at the money. If the price is 124.45, I'd likely trade the 124 calls. If it's 124.68, I'll go with the 125 calls. I like to split it at the halfway point as to which strike price I would buy.

How much should I buy? Trade your plan… start with approximately $1,000 for each of the first 20 days. Increase your purchase after a solid month's gains. Not only will you gain financially but you'll gain confidence and experience trading this method. Follow your plan and get in the habit of winning.

i) *Immediately put in your sell order*. There are actually several ways to do this, depending on your risk tolerance, expected returns, ability to watch the market, etc. Let's play this safe and place your order for a profit of 8%. Ideally, so you don't get spooked and sell prematurely, you should walk away and come back at the end of the day to pick up your money. Many of you will want to watch the trade unfold. There is no stop loss/trailing stop in this strategy. It could vacillate all day before you sell. 8% is quite safe, according to recent studies. Of course, there are never any guarantees. You're on your own.

Other exits….

> (i) pay attention to the macd on the 5 minute chart. Follow it up, closing when it loses steam. When the price starts to flutter on the 1 minute chart, be ready to sell. When the price starts dropping under a support level at that point, for sure sell. Never try to force a trade. Take what the market gives you. Sometimes you'll pick up 3%, other times 30%.



(ii) watch the pivot points. When the price moves past the mid point between pivot support and resistance levels with macd's in your favor, follow along, calculating where the option price should be if it reaches the next pivot level. Place your order for that price or slightly below to ensure you'll sell. As it enters that zone, pay close attention… are the macd's on the 1 and 5 minute still strong? If so, stay with the trade if it breaks through the pivot in a strong way… it's headed higher.

(iii) 5% plus 1 or 2 cents to cover commissions… about as close to a guarantee as you can get.

Don't get greedy here… watch any flattening out on the price and take your profits. Greed will be the killer. If it breaks through and runs up higher, just be glad you got what you did… the price is just too volatile at this point. As you can see in this view below, it dropped very quickly.

<u>Post trade</u> -
j) *Know your limit*. You were successful. Now stop.

You're deservedly emotionally charged after a respectable gain and not thinking with the clarity you need to plan your next trade. Experienced traders will likely enter another position perhaps but I used to surrender my profits in afternoon trades, so I stopped trading after lunch. Holding positions overnight is not much more than a gamble and can only ultimately end in severe losses. The world doesn't stop spinning because you're sleeping. Too much happens in those wee hours of the night… just check the next day gaps for proof.

k) *Celebrate your earnings*. Goodness knows, you rightfully earned them. Take a screen shot of your trade and send it to me for verification so I can post it on the web site. Rest assured, your privacy will be respected. You don't need to draw attention from ex-spouses, IRS, CRA, creditors, long lost friends and family, etc.   and by the way, congratulations on another great trade.

Incidentally, if you need a screen capture program, SnagIt® is good… it's a free download. All the screen shots you see here are from SnagIt®.

Part Two – Emotional Control

There will be a few key points to mentally be aware of at all times. As your account balance increases, your emotional control will become even more important.

I recall reading a story long ago about market analysts, schoolchildren and shots at a dart board picking winning trades. The winner was the dart board followed by the kids. The analysts came in a pitiful third place in picking winning stocks. It makes one wonder about the validity of all the technology and knowledge we have at our disposal.

Fact is, as underscored by numerous psychological studies, the more emotional involvement one has in stock trading, the worse their results. This is clearly evident in every study. Emotion belongs in your love life, not on the stock market. If you'd like to combine emotions with trading, take your significant other to one of the many romantic fine dining establishments near the NYSE.

Greed, Fear, Ego

These three little guys lay dormant until you put real money in a trade. That's why I have an issue with what they call 'paper trades'. They have their place, yes, but it's not the same as with real cash.

Most traders lose their money because of greed. They do well for a while, then think they're the alpha man, that they did well because of skill. Ego. Fact is, at some times, especially in market bubbles, even a monkey could do well. Do well in a rising market and you feel good. Get back in another trade and do well again… and again. This fuels your inner fire… you become invincible. Do no wrong, Mr. Wong.

Then it hits you suddenly like a ton of bricks, out of nowhere… the market drops 50 points in one fell swoop. You're toast. Instantly humbled. Then the 3 stages of grief…denial/disbelief, anger and finally, acceptance of the truth. I know this all too well. It happened to me… more than once.

Then you become afraid to trade… fear now takes over. You get back up, wipe the dust off and get back in the game… buy a few contracts.. then immediately sell when you're down a couple cents. You play until you lose. Can't make a dime to save your life. Sound familiar?

What's interesting is that we know this behavior all too well. A new crop of young, enthusiastic traders come along and repeat the same mistakes… over and over again. Nothing changes. It's human nature. How can intelligent people, some of the brightest individuals on the face of this planet, slide down this slippery slope repeatedly, never mastering these seemingly easy symptoms of human behavior?

Interestingly, we seem troubled by attacking these issues of greed, ego and fear. Truth is, they can be corralled and kept in abeyance while we trade, but it takes serious work and conditioning of the mind.

Understanding the need for this mental training is a good start.

Detachment:

You will need to completely detach yourself from the trade. Analyze the situation when you're emotionally cold, when it doesn't matter which way the trade will go, if at all. You can then rationally assess the direction and strength of the move. To detach oneself on a $1,000 move is the same as detaching oneself on a $100,000 move. Detachment is detachment. The numbers should not make any difference at all. When you're emotionally cold, you have no vested interest in the trade, therefore you will likely make the right decisions.

Tools:

Think of your capital as tools of the trade. Just as an auto mechanic has an arsenal of tools with which to work on your car, so should your capital be considered 'tools' with which you will make money. If you did your premarket analysis correctly, examined the likely direction of the trade and estimated the strength, you should feel confident in using the designated 'tools' to make your investment. The mechanic attaches the odd looking oil filter wrench to twist off an old filter with complete confidence knowing that is the tool required to do that particular job.

Hide the Buying Power:

One trader I know made over $1 million without knowing it. He was down to his last few thousand when he blanked out his Buying Power on his trading platform. By not knowing, he wasn't spooked out by what he had left. He kept trading up, buying more and more contracts with every trade. After several months, I persuaded him to 'unhide' that figure, which he discovered he had about $1.1 million in his account. He told me had he known, there's no way he would have been able to do it. He announced his earnings to his wife on a birthday cruise in the Caribbean. If you feel the pressure, block it out.

Envision the Trade:

After much study of one particular stock, SPY in this case, you will get to know and understand its behavior and nuances. Study charts as much as possible. 1, 5, 30 and 60 minute charts. Daily, weekly and monthly charts… every waking moment you can attach yourself to one of these charts, study it, see how it moves to certain events, how it peaks, its range of movement. How do the candlesticks relate to themselves, to each other… from one day to the next? Picture in your mind how the trade will unfold and follow along. Back test to see how it unfolded as you envisioned it in prior days.

Exercise Patience:

A cat will wait for hours, patiently watching for that mouse to surface out of a hole. When it does, the feline waits not a second to pounce on it. Become that cat… wait for the perfect setup you're looking for, then don't hesitate, just 'pull the trigger'. It's the setup you were waiting for. If this isn't the time, when is it? Sometimes you may want to jump the gun but remember that it's better to possibly give up a penny or two to ensure you're in the right trade than to get in too early and have it reverse on you. By waiting, you'll enter and exit at the most opportune moments, seizing maximum gains.

Be Critical/Skeptical:

You should have a valid reason for entering the trade. Simply trading for the sake of being in a trade is the wrong reason to be in a trade. 'Cash' is a position.. and a good one at that. Make sure you can identify and explain why you are placing that trade. It should be judged against very specific set of criteria, all of which meet your high standards required. Even if you lose on the trade, it's better to lose for the right reasons than to win for the wrong reasons. Make sure your trade is bulletproof, so that even should it turn on you, you can walk away knowing you did the right thing and would do it the same all over again.

Ignore the Noise:

Noise in the markets will spook you out every time if you let it. Lower time frame charts vacillate up and down continuously but if you follow each candlestick that strikes against you, it will whipsaw you out in no time and you'll be left scratching your head. When you identified the criteria by which you placed the trade, let it play out… let it come to you. Have the faith and confidence in yourself, your trade. Prices can fluctuate wildly, especially on news, but know that news causes swings that are often short lived so it will likely reverse back in your favor. Pay no attention to the market noise.

Ignore CNBC:

It's no wonder these news feeds are so highly rated: they hire the most beautiful women to bring us news shrouded in a high energy excitement that draws us in like steel to magnets, compelling us to feel like magnates for watching. Then the Wizard of Wall Street, Jim Cramer.. very exhilarating and entertaining to say the least. One great show after another, no question. I know of one chap who tapes *Fast Money* and even transcribes it for review later. Has he made even a nickel on this endeavor? Not yet that I know. To sum up in one word: distractions. That's all they are. Ignore it all.

Fundamental or Technical Traders?:

Know the difference. We are technical traders, pure and simple. This project focuses on only chart reading using a great deal of statistical analysis to back up our positions. The news and fundamentals of the economy, which is what the S&P 500 is, is reflected in the indicators. The reason this strategy works as well is because it is very short term and functions in any market. We don't care about earnings, company news, what CEO is having an affair, what the competition is doing, etc. All we care about is where is the economy going right at this moment in time.

Eliminate Analysis Paralysis:

Are there other indicators to use? I'm sure there are dozens. But by introducing new ones, you would unduly populate your screen, cloud your thinking and have the reverse effect you're after. More is not always better. If you can't trade off the proven indicators we have evaluated to work effectively and efficiently, then it's unlikely you'll improve with any others. If the mathematics were that good, the markets would be totally efficient and there would be no market. Knowing that should be convincing enough to forget the multitudes of other studies, indicators, drawings, etc. to clutter your charts.

Don't Predict but Do Prepare:

This sounds contradictory to what I've been preaching but there is a subtle difference. The indicators we use assess what is happening now. That's where we want to be, in the zone. We want to catch the wave and ride it briefly. Just as a train travels from NYC to LA, I only want to ride it from Buffalo to Chicago. I don't know or care what happens to it after I get off; it's no longer my train. But I do want to prepare for its arrival at the station because I know it won't stay stopped for long. I need to be on the deck ready to jump on the moment it stops. Of course, leaving Buffalo any way possible is always a good thing.

When the Facts Change, Change Your Mind:

Those indicators may show a position in the premarket but an event may be enough to change course rapidly. Agreed, the example below is highly unusual but sometimes, you need to assess if it's still prudent to be in your position when major events change the course of action.

Focus Only on the Facts:

Opinions don't generally count in trading SPY except if they're the opinions of the heads of the current Administration that cause markets to move. Opinions of analysts, money managers, media and others rarely makes any difference. Despite perhaps, your opinion that the market 'should be' dropping but is in fact rising, should not have a bearing on your opinion of the direction of the trend. If you see it rising, it is rising. Never mind where it 'should be' going. The market doesn't care about your opinion. Stay with just the facts. Believe what you see. Btw, ignore the opinion of your financial guru; he doesn't know either.

Remain Humble:

The markets have a unique way to bring you back to reality as soon as you cross the line. Especially as your wealth builds, you must always remain humble in knowing you can always lose it all. Always use the utmost care and diligence in assessing and executing your trades. Should something happen down the road and you lose $83,000, remember… you started with only $1,000 and that's all you really lost. Keep that in the back of your mind and you'll save your sanity. That is most important. You can always recover financially. Keep this project in perspective at all times. It's only money. Don't bet the rent.

It's Only Money:

If there's any way possible to keep this in perspective, do it. Some time ago, a trader friend of a friend of mine jumped off the Golden Gate Bridge. Apparently, this hedge fund manager was so enthralled in his clients' losses, it was his only way out. Another personal acquaintance, Dave, made $297,763.73 profit on an XOM trade several years ago… then rode it all back down, losing it on expiration Friday. I still have his spreadsheet. I ended up in an Orlando hospital last January over a huge loss when Obama declared war on the banks, tanking the markets. I was SPY long while on a flight to Florida… never again.

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