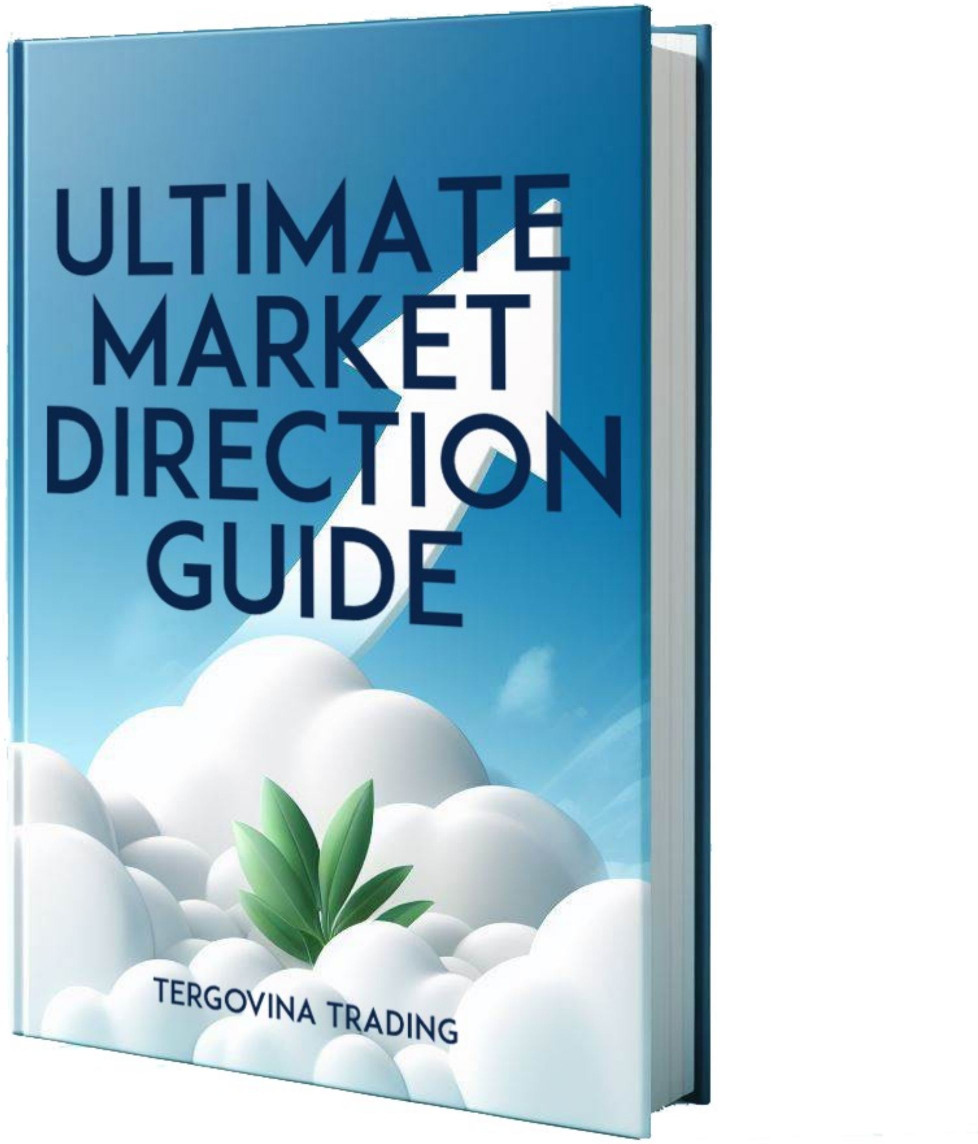

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Trading with a good strategy in a market condition that isn't right for the strategy is recipe for failure.

How can you know what direction the market is going? Let's look at the tools we have available that help indicate that.

Past performance doesn't guarantee future performance.

How you deal with risk will determine if you win or lose at trading. If you don't have it, you will be a loser.

Nobody knows the future. A lot of market behaviour is absolutely random, especially the shorter-term you get. That's why you must have risk management. Here's a couple ideas that can help limit risk:

- Never lose more than 1% of your money on a single trade.

You do this by what size position you take; by how many shares you buy. You do this by dividing the price to the stop loss by 1% of your money.

Here's an example:

You have $10,000. 1% of $10,000 is $100.

The stock you're buying has a price of $10. Based on price history and technical analysis of it, you might choose our stop loss price to be $8. If you buy 1 share and your stop loss is triggered, you will have lost $2.

Divide $100 by $2. The result is 50, or how many shares you should buy to limit your risk to losing only 1% of your account if the stop loss is triggered. Our position will be $500, or 50 shares. If the stop loss is hit, you will lose only $100.

- Avoid trading during big news events.

If you're trading currencies, avoid trading during big economic news reports like CPI, GDP, Treasury meetings, and the like. (Just search for "forex calendar" and avoid big red events.)

If you're day trading stocks, then avoid earnings reports and big announcements.

- Avoid market closing

Most relevant in day-trading, where small price movements can wipe out your stop loss. You don't want to wake up to a price gap that went the wrong direction overnight.

If you're trading a much higher timeframe, it's not as big of a deal as your stop loss distance is much less likely to be triggered.

- Establish a maximum loss per trading period

If you limit yourself to two or three losses in a row, not only will it keep you from revenge trading emotionally, but it will also help you sit out time periods in which your strategy doesn't make money. No strategy makes money in every market condition or period. And it can be hard to tell when it switches, especially early in the switch.

- Don't trade if the market is choppy

More for short-term traders: if the candlesticks don't look nice and smooth, easy to read, just walk away.

- Follow a written checklist before every trade

Make a plan and follow it. It'll help you stay away from markets you shouldn't be trading.

- Journal every trade

My suggestion is to record the following data:

- Date

- Time

- Screenshot of the chart, including entry and exit

- Security traded

- Profit and loss

- A line for miscellaneous notes. If a problem keeps coming up, you can see it and address it.

You can find where you're messing up, and where you excel. If you make most profit between 9-11 AM New York time, then you might want to focus on that time. If you keep losing money swing trading gold, then you better stop it!

- Mega nerds might learn options

Sometimes price gaps can jump your stop loss and make you lose way more than you wanted. Sometimes slippage makes you lose more than you wanted.

Options can tie the trade to a contract with an exact price, so you know exactly what you will lose if the price goes against you.

- Lower risk in a loss streak

Consider this:

Everytime you lose, reduce how much you are risking per trade. You might gradually dial back all the way to 0.1% risk. When you win, go back to your regular risk of 1%.

Your profit potential will decrease. But so will your losses.When the market is not favorable to your strategy, this will help you weather out a loss streak. And when the market direction and behavior is right for your strategy, you start making good profit.

Not losing your gains might make you more money than chasing big profit.

- Your default should be to do nothing

If you are excited or scared, doing nothing is probably the best choice so you don't get into a trade you shouldn't

If you stare at a chart too long, you might start seeing things that don't exist. Take a break.

19 out of 20 set-ups should be avoided. Just take the good 1.

If the chart is messy, do nothing. Turn off your computer and enjoy a walk in the sun.

- Always keep enough money to cover losses in your account

Or else the broker will make a margin call and force you to close your positions and you will feel like a broke clown. Because then you would be one.

- ALWAYS have a stop loss!

Cut losers quickly and keep losses small. You should place your stop loss with room for regular price movement, but where you get out as soon as your trade idea is no longer valid.

You might consider a trailing stop loss that moves up as price moves up, so you can lock in gains.

- Close positions yourself

If a trade idea is no longer valid (examples: price goes sideways when you're trying to trade a trend, or a company stops seeing growth you want), close the trade immediately.

- Do your own research

Relying on hot tips, news, or buzz can get you into trouble. Trade only what you know.

- Only trade high volume, big stocks

Avoid penny stocks and scammy cryptocurrencies. Price is easily manipulated with low float and low volume. Stops can have tremendous slippage.

On to our next bit:

What data should you use?

If you are trying to make gains from the growth of a company over a decade, it doesn't make sense to base a buy or sell decision off a tiny movement in a 5 minute candle.

In the same way, it doesn't make sense to make a 5 minute scalp by only looking at a business's quarterly report that was published a month ago.

Use data that is relevant to the time frame you are trading.

- For short term day trading

These trades can typically take from 15 minutes to 4 hours, but sometimes a few days if it's going well. Usually the trade is closed before the market closes at the end of the day.

Look at candle stick charting with technical analysis tools that look at price and volume. I'll cover those in a bit.

Knowing a little of fundamentals of the health of a stock can help, too. If you know if a company is going bankrupt or is growing, that can help you choose if you want to jump in or not.

- For medium term swing trading

A typical time frame could be a few days, or three months to two years.

You'll want to know the health of the business numbers which you get from financial reports. We'll conver this in a bit.

You can also use candlestick charting with technical analysis, too. It's particularly good for finding entry prices, and potential profit targets.

- For long term investing

Time frame for a typical investment can be years to decades.

Basically similar to swing trading with the tools you use, but you have the distant future in mind, and not the next business quarter.

Technical or Fundamental Analysis?

Which is better?

Technical analysis is reading candlestick charts and using indicators that assist in reading the candlesticks.

Fundamental analysis is looking at real data, like earning reports that businesses release quarterly.

Both are great.

They both tell a part of the story of where the price has been and why, and where it might go in the future.

A company that has been growing over the last 5 years will have earning reports that back it up.

The company's candlestick chart will also be going up over that time period as well, which indicates it's a growing company.

Seeing a sudden change in candlesticks might inform you to investigate what happened at a certain time, which you can then research.

On occasion, seeing a sudden illogical change in candlesticks can indicate insider trading before anything has been announced or reported.

Fundamental analysis might tell you a company is a good buy.

Technical analysis might help you get in at a better price.

Knowing both gives you a fuller picture of what's going on.

Okay, let's cover:

Finding market direction with charts (Technical Analysis)

Let's get into the gnitty-gritty of technical analysis, and how we can see trends with it.

Only use smooth charts

You know how trading examples show candlestick charts that are smooth and clear, and almost unreal? 9/10 times the chart doesn't look like that. So you know what you should do?

Don't trade 9/10 times. Only trade when it looks smooth and pretty, easy to read.

Time frame range

This is important but for some reason I've never seen it talked about. How many candles are you supposed to look at with a chart? (Ichimoku later will help a lot with this) Basically, for a very short term analysis, you consider the last 9 bars. For medium, 20 to 26 bars. And for longer term, 52 to 200 bars.

Higher Highs, higher lows

An uptrend will have waves of highs that keep getting higher, and lows that keep getting higher.

price moving up in your specified number of candles = price moving up

If your ending point has a higher price than your starting point, than your price has moved up. How is this useful? Let's check it out:

Let's say we are using daily chart, and we are looking at the last 200 candles. That's a business year. If the end point is higher than the start, and you see a steady climb of higher highs and higher lows, that's an indication that the company is growing.

Trend line

You draw a trend line on the lows. If the lows keep getting higher, it's an uptrend. If the price ignores the trend line and goes sideways through it, it's no longer an uptrend and it's going sideways (or ranging). If you get 2 higher lows on your trend line, it's a confirmed uptrend by definition.

Higher time frame

Go to a higher timeframe and see if your higher time frame is uptrending. If it is, that makes your child timeframe more likely to be uptrending as well. Another tip is to mark the support and resistance areas on your higher time frame as well so you can avoid going long into a major resistance area.

Parent time frames candlestick lengths could be as follows:

- 1 minute to 5 minute
- 5 minute candlesticks to 15 minute
- 15 or 30 minute to 1 hour
- 1 hour to 4 hour
- 4 hour to 1 day
- 1 day to 1 week

Let's keep going...

Support and Resistance

Short term price generally trades between support and resistance. Support is a bunch of buy orders in an area, and resistance is a bunch of sell orders in an area. If the area has been an area of support or resistance in the past, there's a chance they'll be again in the future. Higher time frames tend to have "stronger" support and resistance. Beware trying to trade through those levels. I find them useful for profit targets. If there's not enough room for a good profit, I won't touch it.

Often when a resistance is broken, it becomes the new support level.

Moving averages

A moving average basically shows you the average price for a certain time period. If your candlesticks stay above your moving average, then you are uptrending. If the moving average keeps passing through the price, then it's likely you are not in a trend.

One method is to adjust the moving average time period to show the price bouncing off of it. This is good if you want to see if the current momentum of the stock is continueing or not.

My preferred method is to pick a pre-defined time period.

For a super short period, pick 9.

For a medium period, pick 20 or 26.

For a longer period, pick 52 to 200.

You can use the price staying above the moving average as an indication that the price is uptrending. If the price passes through the moving average, you may no longer be in a trend.

Using the exponential moving average is fine, too. Whichever you prefer. Often I slap on the 200 EMA for a quick indication for trend direction.

A combination of the short, medium, and long term can be used together to show if the short and medium trend are in the same direction as the long term trend. More on this when I get to the Ichimoku system.

Breakouts

Price breaking out of a tight area can be an indication of the beginning or continuation of an uptrend.

Basically, if the price breaks a previous high, it's a breakout. Wait for the candle to close to confirm it, though. Many people wait for the price to come back down and test the level again before they call it a breakout.

A bonus tip is if you see a higher time frame breakout, you can go to a child time frame and look for trading opportunities there.

Increased high volume on a breakout can be an indication that it's not a false breakout.

My favorite indicator to show a breakout is the Donchian Channel set to 50. When the price breaks the Donchian channel up, you may have a breakout.

Uptrend in industry indexes

Markets can be correlated. If the S&P 500 index is in an uptrend, there's a high chance that almost the entire market of quality USA growth stocks could be as well.

If an index on tech is uptrending, then a quality tech company may be as well.

In forex, the Australian dollar might have similar movement to the New Zealand dollar.

A foreign country that supplies a large amount of oil to the world announcing that they aren't exporting can affect oil prices. Oil prices can affect oil company profits, causing their stocks price to go up.

Keep an eye out for correlated markets.

Now for my favorite tool...

Ichimoku Theory

Let's get rid of a misconception. Ichimoku cloud is not about forcasting the future. It shows where the market is now. If the price hits to cloud, then the market is probably not trending, but just going sideways. Let's dig in now.

Ichimoku is about a system for **observing** the market. It comes with 3 theories. Once you understand, you don't even need the indicator for looking at the market (although still useful).

Ichimoku is almost like using 3 moving averages for short, medium, and long term. (9, 26, and 52 bar.) Instead of using moving average which gives the average price of the last x number of bars, it uses the **middle price** of the chosen period. (In other words, it's like the middle price of a Donchian channel.)

Let me cover the different lines:

- Short term "conversion line" "Tenkan sen" (9 bars)

This represents your short-term trend.

- Medium term "base line" "Kijun sen" (26 bars)

This represents your medium term trend.

- Lagging span "chikou" (follows by 26 bars)

if the lagging span hits the price, it's a sign that you are not in a trend and the price is going sideways.

- "kumo" cloud consists of:

1. Leading span A "Senko span A" (The fast line, calculated as the average of the Tenkan sen and Kijun sen lines, pushed forward 26 bars)

2. Leading span B "Senko span B" (52 bars middle price, pushed forward 26 bars)

Span B represents your long term trend.

If the span A and price is above span B, that's an indication of an uptrend. If span B is moving up, that indicated your long term trend is moving up as well.

About the lines!

The different lines will help indicate what's going on in different time windows. When the system was developed, the length of each candlestick was 1 day, so the daily chart was used. Therefore, short term was about 1 trading week. Mid-term was just over a month. And long term was about 2.5 months. However, you can use Ichimoku on different time frames, too. My experience is that price can act much more sporatically at shorter time frames.

Let's dig into the 3 theories!

Wave theory

Basically, price moves in waves. Up and down. There are different shapes of the waves. The wave could be an "I" wave, or basically a line that goes like a straight line, like a "/". Or it could be a "V" wave, that zigs up, and then down. Or perhaps an "N" wave, with a zig-zag. There's also the "P" and "Y" waves, which are like a shrinking or expanding flag pattern.

Price moves in waves.

Time theory

Add onto the wave theory this: the market moves in waves at a certain rate, or cycle ("Kihon Suchi"). Sometimes it's not in exact or similar numbers at all. But on occasion, the market waves last for a similar amount of time that passes ("Taito Suchi"). For example, your waves might be 10 bars apart.

This can be used to anticipate how much longer the current wave cycle might last, based on previous waves. The end of a wave is described as a "day of change" ("Hen Kabi").

You can measure the distance by looking at the recent two lows and measuring the distance between them. Or you can measure a high to a high. Or even the recent high to recent low. If you find a pattern, the pattern might continue. I like using the cycle drawing tool in tradingview, and try and get the waves on my chart to fit in a pattern between my cycle lines. Then I hold shift and click, and it brings up a ruler to show how many candles are between the cycles.

You can have gaps that sneak in between cycles, or have cycles that overlap eachother. ("Kagugi" and "Jugi") Once again, it's not an infallible predictor. Just an indicator.

Price theory

This is fairly simple. It's different ways to calculate price targets. (E, V, N, and NT, but I don't think knowing all these is particularly useful.) For example, you might take the height of the last price wave, and then predict the price might move a similar amount again. There's no gaurantee that your prediction means anything, though.

My prefered method is to assume the price may not push harder than it did in the last wave, but I'll also not assume it'll break through previous resistance as well. So my price target will generally be under the next resistance level, and also not a further distance than the last price push.

Reading the chart

This is what I love because you can see it all with a glance:

Price moves in waves. The default settings of 9, 26, and 52 are generally close to the waves that markets move in.

When the price hits the cloud, or the lagging span hits the price, the price is probably going sideways and not trending.

By definition, a confirmed trend is when price makes a higher high, and then breaks that new high. Ichimoku will usually show this:

In an uptrend, the price will stay above the cloud. Often the price will stay above the medium term line. And in a hot market, it might even stay above the short term price. In a strong trend, the short term line will be above the medium term line, which will be above the long-term cloud.

Now for the stellar technique of fundamental analysis...

Fundamental Analysis

Generally there are 2 styles of investment: growth and value. Growth looks to invest in companies that are seeing good growth, so you will see good returns. Value is about finding a stock that's underpriced, or "on sale". You gotta be careful and make sure an underpriced stock still has solid fundamentals and will keep growing. Otherwise your "sale" is just buying a trash stock that is worth less.

News

Direction changers VS. short term discounts

Sometimes you'll hear some buzz about a company that sounds bad.

- If it's really bad, the value of the company might drop and the price will be on the downward direction. Avoid this.

- If it's just bad PR that doesn't mean anything and won't really affect the business, then there's an opportunity to check the stock price. You may have found a short term discount you can take advantage of. You might profit from taking the risk on a low risk impact event.

- Beware: sometimes something you don't think is a big deal might be a big deal. In my mind, people generally have short memories and forget things in like 3 or 4 months. But I have underestimated the impact of a company insulting its customers. And I have underestimated the impact of a disease spread story hitting the news.

- Always use a stop loss that gets you out as soon as your trade idea is no longer valid.

Pricing and finding sales

If the price per share is under the typical valuation in the industry, and everything else checks out, you may have found a discount. Short term discounts can give a boost to your overall performance. You are looking at pricing relative to what's available in the industry. Whatever method you use for valuation of a company, it should be compared to about two dozen of their closest competitors.

Growth and value aren't necessarily at odds. Growth is also finding a good deal. Other investors also see it as a good deal, so the price might already have anticipated gains already added into the price.

Fundamentals

Let's look at how to start with fundamental analysis to help us determine market direction.

A company's value is subjective, and there are as many ways to value a business are there are investors. Pricing is a combination of

1. What individual investors think it is worth based on their own perceptions.
2. Emotions.
3. Anticipations.
4. Supply and demand.
5. Randomness (especially in the short term). The system isn't rigged and the fund manager doesn't care about your stop loss. It's just that nobody knows the future (except inside traders).

What you need is a method that takes a holistic view of a business's quarterly financial reports over time, and that compares it with competitors.

Here's what I like to do: open up the quarterly financial reports of a company, and go back five years. Compare it with about 20 competitors.

My business valuation is a combination of 6 things:

1. Earnings

How much money is a company making? Divide it by the number of outstanding shares, and you've got the amount of money a company earns per share (EPS).

Divide the price of the stock by the earnings per share, and you've got a popular and useful metric of "Price to Earnings Ratio", or P/E ratio. A higher P/E ratio can indicate a more "expensive" stock. While that might indicate an overbought stock, it might also just be taking into account anticipated stock growth. A low ratio might indicate a discount, but often it also might indicate a company that is going bust that you want to avoid. You have to dig deeper in the reports to see why.

You must compare P/E ratio with about two dozen close competitors in the same industry. Tech companies may have a much higher P/E ratio than home improvement companies, and that's okay. It's a different industry.

Past performance does not gaurantee future performance. However, I like graphing out earnings growth from the earnings per share (EPS) of a company over 5 years, and using recent performance to estimate where the price might be heading. You can take the percent growth of several periods, average them, and then use that to project where the company might be going. This can help you determine what YOU value the company to be at and going, and whether a higher P/E ratio is justified (Such as Apple or Microsoft stocks with high P/E).

I prefer to use track record and what is, and not projections and what-ifs and dreaming, so that's why I do the EPS growth calculations in the previous paragraph.

Keep in mind EPS can also be manipulated by various means. Some of the reasons could be splits, buybacks, depreciation of assets, debt interest rates, expenses and investments, liabilities, cuts in R&D, and more.

2. Assets

Assets are the value of everything the company owns. Real estate, widgets, machinery, servers, cash, and more. Everything.

3. Liabilities

Liabilities are all the debts a company owns. The book value of a company is all assets minus liabilities (and preferred shares). Divide that by outstanding shares and you have book value per share. That's the amount of assets each share owns. Bear in mind, if the company is liquidated, its assets will be sold at a fraction of what it's actually worth.

Basically you want to see that a company's asset to debt ratio is healthy and they aren't under a huge load of debt. You can compare this ratio to about 2 dozen competitors. Avoid companies under too much debt load.

4. Growth

You can calculate EPS growth like I did under the "Earnings" section above.

You can also look at share price growth as well.

A growing company is generally where you'll get the best returns. Growth companies are generally uptrending.

Be aware in times of stagnation in an economy, many traders switch to trying to find deals in value stocks intsead of growth in growth stocks.

5. Comparison to competition

Every industry has its own metrics and behaviours. You **must** compare to about two dozen close competitors. Even better if you compare more! You may stick with your choice, or you may pick a competitor. Or you may just do nothing, which is a good default thing to do.

Compare performance of other industries, too. You may find some great opportunities, and you have some diversification as well.

6. Use filters to find only the top performers

I love using stock screeners to find only the best. You can filter it down to about a dozen, and then you can dig into the metrics of each.

Congratulations!

Those are my main metrics I look at when observing a company to determine market direction and value. Let's look into some other interesting metrics.

Price-to-Book (P/B) Ratio

You can look at the ratio of the price of a share devided by the book value per share (assets minues liabilities and preferred shares). Make sure the company is healthy if you find the book value is above the price per share. Also remember that earnings are not calculated in book value.

Technical tool - average true range (ATR)

ATR will show the volatility a stock has over a time period. Many use a multiple of 2 or 3 for stop loss placement to avoid regular market movements hitting your stop loss.

Industry and Market condition

Overall industry and market conditions can affect a stock. Market correlations exist.

For example, price of oil can affect oil company profits. Interest rate hikes will affect all businesses.

Dividend rate/growth

Dividends are nice to see because it means the company is actually paying out money to its shareholders. Some people value a company based on its dividend. A healthy company usually has regular and growing dividend payments. That can be a sign of a healthy company. Some do not pay dividends. And that's okay, too. I do not obsess over dividends. I'll explain:

A company is like a jar. It's filled with gumballs which represent assets the company owns. When the company generates earnings, it's like adding more gumballs into the jar. A company that keeps those earnings and holds or reinvests them keeps all those gumballs in the jar. When the company pays a dividend, it's like taking gumballs out of the jar. The book value of the company goes down by the amount of the dividend.

If I wanted dividends, I could just take the gumballs out of the jar myself by selling shares of the company. I can pay my own dividend out of a growth company that doesn't pay dividends in this way.

Return on Assets

You can take the earnings of a business, and compare it to the value of the assets it holds to see how efficient the business is at making a profit per dollar invested. Different industries will have different metrics. A real estate company might only make 5% profit per dollar invested vs a tech company that can make multiples on each dollar.

P/E to Growth (PEG) ratio

P/E divided by expected earnings per share growth percentage. Lower is better.

Competency of management team and board members

Not as tangible as business numbers, but a good company needs a competent team!

Remember!

While you can raise the probability of putting your money where the market goes in your direction, nobody knows the future. You must use solid risk management.

Recommended Resources (all free!):

Charting:

trading view

thinkorswim

webull

Research:

nasdaq

marketwatch

yahoo finance

searching stock name on a browser

forexfactory.com/calendar for currency and macro economic news

searching "currency strength chart" or currencystrength.com/en for comparison of currencies and their strength

charles schwab research tools

Brokers:

fidelity

charles schwab

webull

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