TRADERS´

Your Personal Trading Coach

Issue 07, September 2010 | www.tradersonline-mag.com

MANAGING OVERNIGHT RISK

How to Set Up a Professional Trading Journal

Trade Like a Top Athlete

Technical Analysis vs. Trading Strategy

Multiple Signal Confirmation Is Key

Shooting for the Stars

Implementing a Basic Trading Approach

Insurance Buyer Beware!

Sometimes it's not exactly easy for the big corporations either. Imagine, for example, an insurance company. The majority of their investments are in bonds, eking out a relatively unprofitable existence. Of course, that may just be a case of "better safe than sorry". Or rather, there is no alternative to this since any insurance company is bound to be subject to various investment restrictions. So you cannot simply switch from bonds to stocks at the drop of a hat as many quantitative models may suggest.

Of course, insurance companies have been subject to all those investment constraints for quite some time and should by now be accustomed to settling for low if rock-solid yields. Or are they? What if performance keeps declining year after year, which is exactly what has been happening. Not only have, for example, government-bond yields been in steady decline, but inflation is inching up in some places at the same time. Too bad then that for the time being the central banks are not playing ball. Instead, they are more than happy to see slightly higher rates of inflation for a change since that is the only thing that can banish the spectre of deflation.

But what do low yields and well-nigh similarly high inflation rates add up to? Right – just about zero. That is the sort of result that you can achieve without any outside help. So don't you let anyone talk you into buying life insurance. You might as well put that money under your bed pillow. Or use it to trade with while managing your risks most conservatively. Why ever not?

Don't you let anyone talk you into buying life insurance.

Obviously, insurance companies have long been aware of the problem but the legal environment has been such that any possible solutions are very hard to implement. One alternative might, for example, be corporate or emerging-market bonds, which is where some extra basis points are still achievable at the moment. Stocks are considered to be too risky and volatile. However, given the government-bond bubble and against the risk-opportunity backdrop, the "risky" attribute applies more to bonds. Should you unexpectedly hear that insurance companies are raising their share quota big time, then that would be the long signal of the year.

But things haven't quite reached that stage yet. On the contrary, a lot of money has just recently been shifted away from stocks and – once again – invested in "safe" bonds. The upshot is that the latter's yields are falling to record lows although the risk of a government going broke has not exactly decreased lately. This is an aberration that ought to cause as massive a flight from bonds as any rational investor can possibly engage in. Or would you feel comfortable with an ever-rising stock of a company whose credit rating has become more and more dodgy of late? I'm sure you wouldn't.

Good Trading

Lothar Albert

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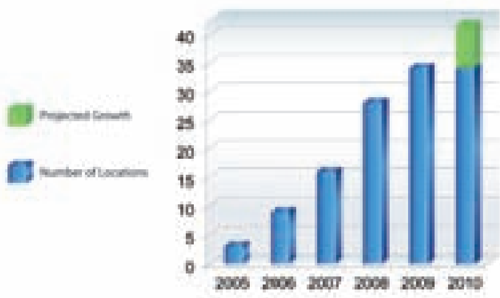

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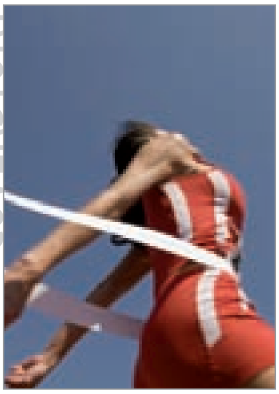

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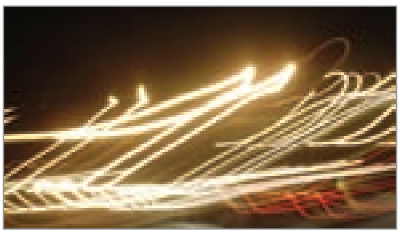

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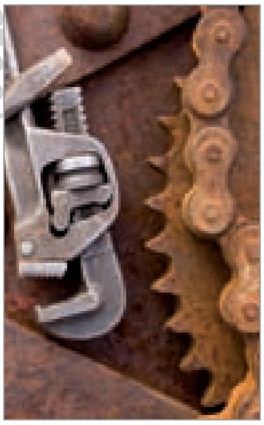

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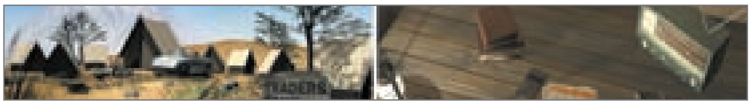
Strategies



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How to Set Up a Professional Trading Journal

Trade Like a Top Athlete

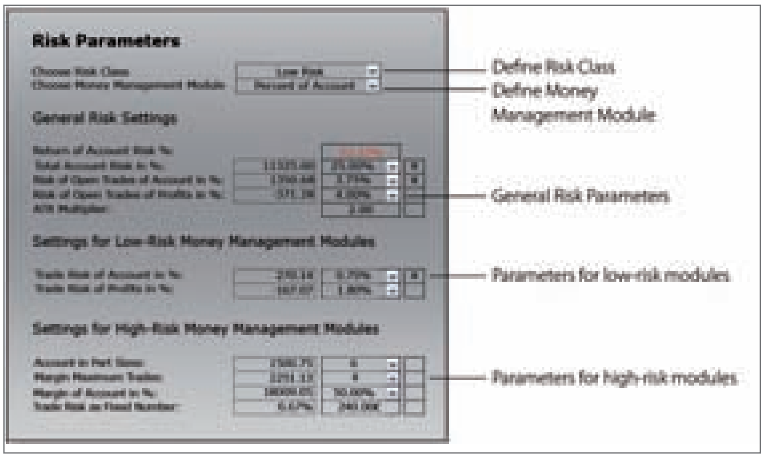
Trading successfully is hard work – especially hard personal work. Trading demands your undivided attention, draws on all your strengths and requires total dedication on your part at all times. That is why a trader can be compared to a highly competitive athlete who can only enjoy continued success if he constantly keeps developing. During this process keeping a top-notch trading journal can be of such help that it must not be underappreciated. To a trader, a good trading journal is like a mirror that he needs to look at time and again to find out where his current deficits lie.

What Is a Top-Notch Trading Journal?

Broadly speaking, most traders use a trading journal to track trade information such as entry price, initial stop, exit price, buy and sell date, fees, profit/loss and perhaps additional hand written notes. However, such a journal could actually offer a lot more. If equipped with the right tools, a trading journal might well be of invaluable help in almost all trading activities. So what does a trading journal need to have to be in the top league? To answer this question, I will be writing about how I got started in trading and about my first few encounters with this topic.

My trading began at the end of the nineties, in the middle of the Internet boom, with high profits. However, during the stock market crisis of 2000 to 2003 those profits

F1) The Risk Parameters



A finely adjustable risk management plan for the various money management modules is the foundation of successful trading.

Source: www.tradekom.com

turned into large losses within a very short period of time. After a large part of my portfolio was lost, I withdrew from the markets for a year to observe and analyse what mistakes I had made. That is when I realised that I had hardly any data to analyse.

The only information I had were the broker's data such as date, entry price, exit price and profit or loss as well as an additional field to record notes on the trade. I collected all this information in an Excel file serving as a journal. While this made it possible for me to determine my average profit or loss, I did not find any concrete clues as to at which point of my trading style there were unseen errors. After nearly two years of trading I had no opportunity whatsoever to evaluate this period of time and hundreds of trades. While I had gained experience during all this time, it was unfortunately impossible to translate that into direct analyses and statistics which could have led to direct action, for example, a change in strategy. To do that, additional data such as the strategy used, the kind of trade (day trade, scalping, trend following etc.) different entry dates, the trader's mental state, the type of order, the product, as well as some exit information would have been necessary in order to find out whether a strategy is profitable or loss-making, or whether profits or losses are more likely to be made at certain times of day, or if trading with certain products is profitable or not, or which entry or exit signal is profitable or not etc. But there were also other reasons for my losses that came to light:

- Lack of knowledge of portfolio and risk management
- No use of money management rules
- No feedback on trading behaviour
- No use of profitable strategies
- Use of products that do not fit the account
- Insufficient capital stock coupled with too high risk

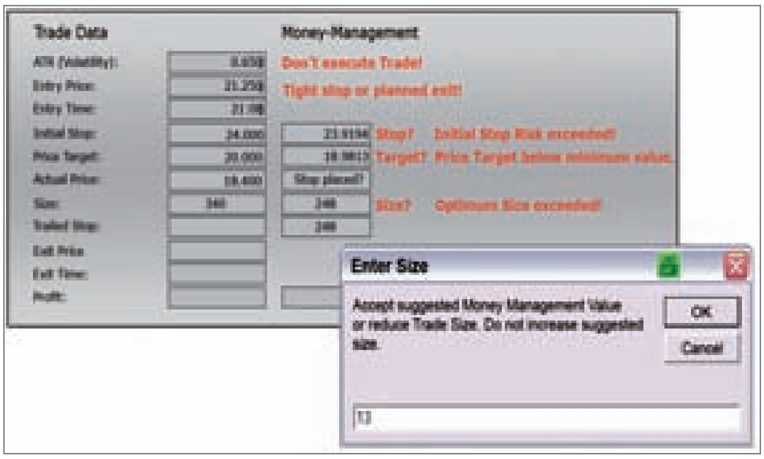
After many conversations with other traders I came to the conclusion that the above reasons and experiences may also be applicable to most other traders. While a trader may acquire knowledge of money management through books, reflecting on one's own trading style turns out to be extremely difficult.

As an athlete, I was used to making a plan for myself and implementing it through self-discipline. By collecting all the relevant data, such as date, exact time of training, physical condition prior to training (illness, indisposition, headache etc.), detailed diet plan, the amount and nature of training etc., you always get a complete picture of your degree of progress. If there is a setback, that detailed record allows you to uncover any mistakes made, to rectify them and thus to improve. Only by such reflection, by comparing all the data collected, is any future progress possible. This approach used by highly competitive athletes has been tried and tested and is highly functional. Why then should it not be possible to duplicate this in the world of trading?

However, in sports there are also other aspects of reflection such as competition, competitors, coaches, friends, training partners and measurable results (speed, stamina, strength). These external components provide the athlete with permanent feedback on his performance status, but these are precisely the ones that the trader totally lacks.

The only feedback he receives are his profits or losses, and unless he has an extensive database full of information about his trades he has, as a rule, no chance of any real further development. So, keep a trading journal and collect as much data as possible in order to have a complete record of your trading activities.

F2) Money Management



Active money management provides support to the trader by suggesting values and giving warnings when established risk levels have been exceeded.

Source:www.tradekom.com

The Trading Journal

The question now is what should such a trading journal look like and how it can support a trader's work. A good trading journal should include all the reasons initially

F3) The Inner Profile of the Trader

After completing a questionnaire the trader receives his inner profile. Those characteristics allow him to gain an insight into his strengths and weaknesses. As a next step, he receives direct instructions telling him how to improve his trading style.

Source: www.tradekom.com

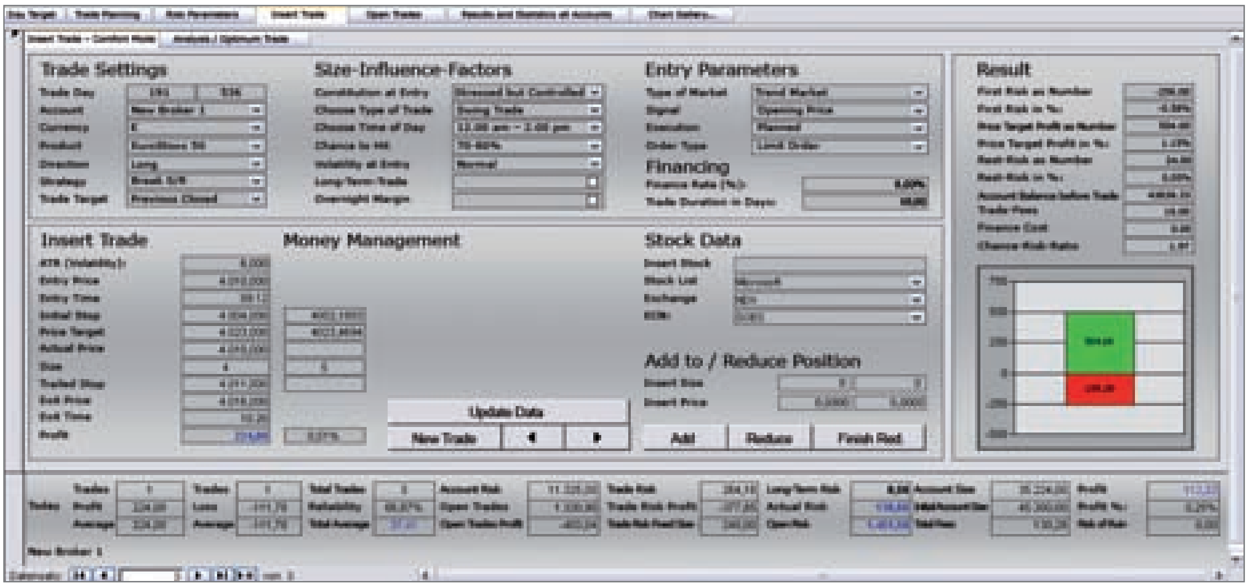
identified for any losses accrued and provide insight to the trader in each of these items.

Portfolio and Risk Management

With most brokers there is usually no opportunity to actively manage portfolios and risks. Account statements can be reviewed at the end of the month, although, that only provides information about the current balance and the profit and loss of trades.

However, active management of one's portfolio(s) would make more sense. This could be kept track of in a journal in which several portfolios are registered and administered to provide a quick survey of the portfolio(s) at all times. In addition, it should be possible for payment transactions to be copied. But the most important thing is risk management which has to be organised separately for each new portfolio. In risk management, risk parameters are determined for the portfolio, money management and trades. This includes, for example, the entire risk for the portfolio, for a series of trades (all open trades) and the individual trade. Furthermore, these parameters should be classified according to the trader's predetermined risk categories. If money management modules are offered, it should be possible for these to be defined by their individual risk parameters to enable suitable fine-tuning. Risk management serves to monitor trades and to control the risk taken. When entering a trade the risk parameters, suitably adjusted, should be checked and compared to the trade entered. Should the risk level in question be exceeded, this ought to be indicated and the trade not executed. In this way, unnecessarily high risks and losses can be avoided.

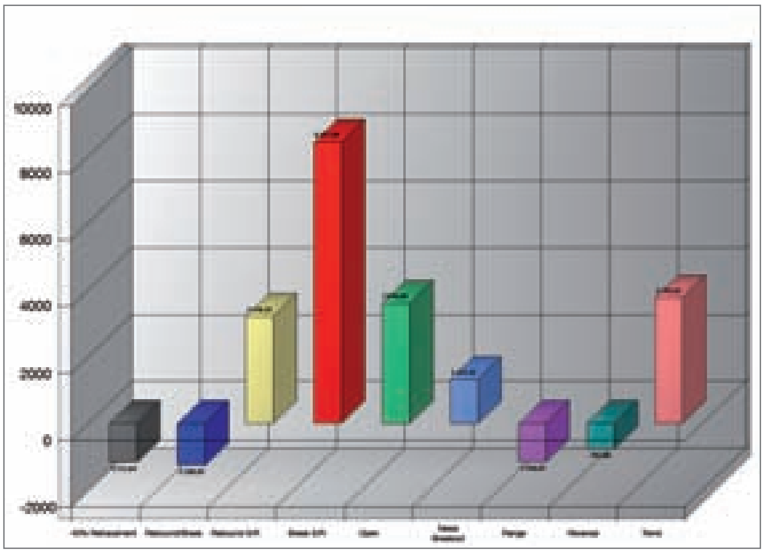
F4) Entry of the Data



Data entry should be facilitated by select lists. Only by filling in everything in a disciplined way and without leaving anything out, does the trader have the opportunity to conduct an extensive analysis with which to further develop his trading style.

Source: www.tradekom.com

F5) The Analysis: Strategy-Based Profit Distribution



Once the trader has executed a number of trades and collected all the data, the analyses and diagrams give him a complete picture of which parameters are profitable or not.

Source: www.tradekom.com

The Use of Money Management Rules

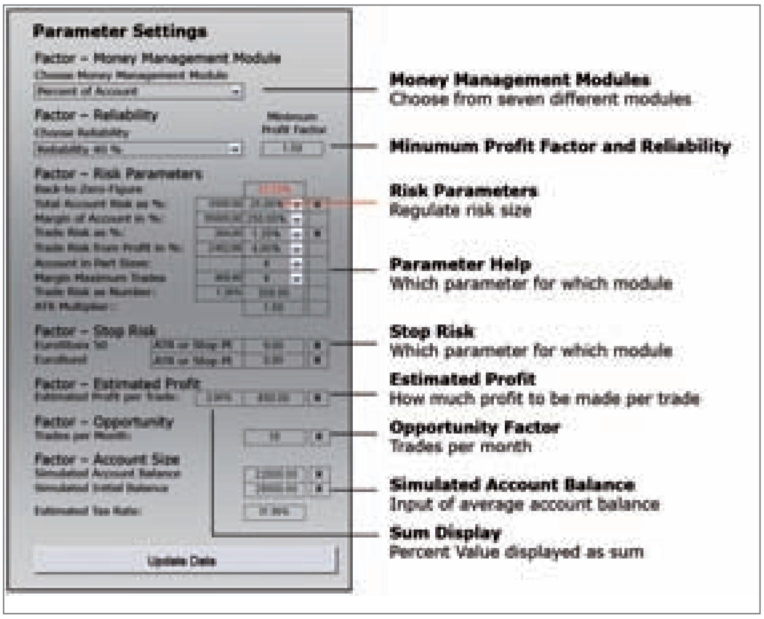
The use of money management has often been discussed in this magazine and is, unfortunately, still vastly underappreciated. Without the application of strict money management rules, it is not possible to make profits long term on the stock market.

If that's the case, then being supported by a trading journal is of paramount importance. While risk management defines the level of risk taken, money management determines how that risk is calculated. There are different money management approaches which should be included as modules in the trading journal. If a money management module is used by the trader, he would have to manually calculate the optimum number for each trade in accordance with the module used. When several trades are entered this approach becomes complicated and confusing.

The optimum approach would certainly be an automated function which would calculate the optimum number after entering the entry and the initial stop and present it to the trader as a suggestion.

Additionally, the minimum price target, depending on the hit rate, should be automatically determined and suggested because this is what generates the risk/return ratio, on the basis of which it is possible to determine whether the trade is worth entering in the first place. It makes sense for the risk/return ratio to be made dependent on the hit rate because only if this ratio is acceptable, can the portfolio turn any profit whatsoever. As well, warnings should appear whenever money management rules are broken.

F6) Simulation of Most Important Trade Parameters



Nearly all the important parameters can be simulated. This clearly shows the strong impact that the change of one individual parameter can have on the portfolio.

Source: www.tradekom.com

The Feedback on One's Own Trading Behaviour

Time and again, traders encounter psychological problems in their line of business.

Actions taken when entering a trade are no longer based on sound reasoning but are determined by emotions. This often means that established strategies and trading criteria are not adhered to, causing losses. At this point the trader usually finds himself in a kind of vicious circle that without help and support he is unable to break. Here are some of the core issues that typically confront the trader in the conduct of his craft:

- Fear of mistakes and losses
- Stubbornness and rigid adherence to a decision made
- Being blind to reality and only seeing what one wants to see

There are many more of these false behaviour patterns, but the important thing is for the trader to know his stumbling blocks. The most important step on the way to success, though, is … the look in the mirror.

The first prerequisite to learning and success is for us to be able to make ourselves aware of this behaviour. This includes a good deal of perception and the courage to look in the mirror.

Once you start doing that you'll discover something new. Sometimes something surprising every day. It would be a genuine asset to have a tool in the trading journal to allow the trader to determine his inner profile, presenting him with his personal characteristics and subsequently giving him reasonable directions with which to guide his actions. This tool could help the trader overcome his psychological barriers.

The Further Development of One's Own Trading Style

In further developing one's own trading style very many items of information are required, each of which have to be recorded when entering the trade.

The more data collected on the trade, the finer the adjustment can be made to the trading style. This makes it necessary for the recorded data to be divided into various categories in order to later provide differentiation.

1) **Basic Trade Settings:**
Day of trade, portfolio, currency, product, direction, strategy and trade target

2) **Further Factors of Influence:**
Mental state at beginning of trade (relaxed, fearful, tense etc.), type of trade (day trade, trend following etc), time of day, hit probability, volatility at beginning of trade

3) **Entry Parameters:**
Type of market (trend market, range market etc), entry signal (indicator, resistance etc), kind of execution (planned, unplanned, too early etc). Type of order (limit order, market order, stop order etc), financing rate, holding period

4) **Trade Entry:**
Average True Range (ATR), entry price, time of entry, initial stop, price target, current price, number, deferred stop, exit price, time of exit, profit/loss

5) **Additional Information on Stocks:**
Stock entry, list of shares, stock exchange, Electronic Communication Network (ECN)

6) **Exit Parameters:**
Type of execution (planned, unplanned, too early etc), exit signal (indicator, resistance etc), reason for exit (profit taking, safety exit etc), Type of order (limit order, market order, stop order etc), mental state at exit (relaxed, fearful, tense etc)

7) **Error Entry:**
Entry of standardised errors (entry criteria disregarded, stop criteria disregarded etc)

8) **Optimum Trade:**
Optimum entry, optimum stop, optimum exit, optimum profit, maximum move

9) **Note:**
Opportunity to record the trade in your own words

10) **Evaluation:**
Evaluation of preliminary planning, set-up, entry, exit, mental state and market conditions, all based on school marks

On the basis of this list you can see how complex the optimum recording of data ought to be. The trading journal should make it possible for all these data to be recorded relatively quickly and without complications. Except for the price data, all other parameters must be standardised. That means that these data are compiled in select lists, subsequently stay unchanged and may only be supplemented. Additionally, it should be possible for this data to be defined by traders themselves so that their own trading style can be reflected in the program.

Evaluation of the Collected Data

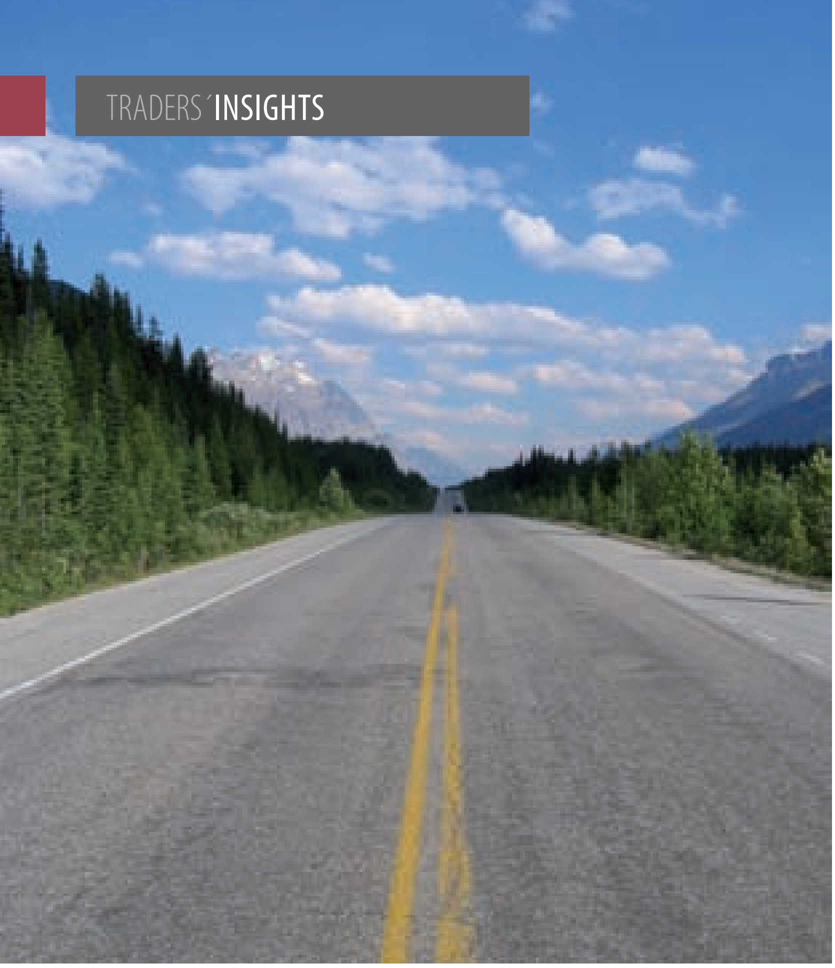
Once the trader has completely collected all the required data, the trading journal should offer him the opportunity to check the data for their profitability. To do so, he needs statistics, evaluations and above all, diagrams. Pivot diagrams may make it possible to display the collected data graphically causing anything abnormal to immediately stand out. What's more, the data could be filtered with one click of the mouse. This means that certain portfolios and quarters can be inserted or deleted.

Now What Can the Trader Derive for Himself from these Analyses?

Here is one example: In Figure 5 a trader has been trading for three months and executed 100 trades, using nine strategies. The result amounts to a profit of €16,060. According to the evaluation, there are five profitable and four loss-making strategies. If the trader were to stop using the loss-making strategy and exclusively concentrate on his profitable ones, his profit would amount to €20,518, representing an increase of approximately 22 percent. In that case, however, not only would his profit rise but his hit rate would increase considerably as well. The above example can also be used for each of the parameters entered at the trade entry whether it be the time of day, the entry signal, market volatility, product, mental state and all the others. Altogether, you would then have 21 to 25 possible starting points to effect changes. As you have seen in the example of Figure 5, the evaluation of one individual parameter may have a major impact on your performance. However, you would have more than 20 possible starting points according to the concept described. You can see from this how much fine-tuning you could apply to your trading style by using such a trading journal. ■

Thomas Wacker

Thomas Wacker has been making investments on European and American stock markets since 1998. The focus of his interest has been on trading futures along with stocks and foreign exchange. Since 2003 he has been working on the idea of a Trading Journal and has, together with Detlef Wormstall, developed a professional money management software application. He operates the www.tradekom.com portal, where the software as well as information on the structure of the trading journal is available.



A Combination of Nature and Nurture

Resilience – The Backbone of Success

Resilience is a critical factor in becoming a successful trader. One of the most important factors in achieving success in any arena is being in that arena long enough to develop the skills, knowledge, understanding and experience to enable you to achieve your best levels of performance. Along the journey to success as a trader there will be many setbacks, periods of drawdown, times when you question your own motivations to start trading, and times when you will face yourself, and your own barriers. How well you get through these periods will depend largely on your levels of resilience.

Having worked with many traders at all stages in their career from fledgling enthusiastic novices to seasoned successful professionals I've seen first hand many times the importance of resilience in staying in the trading game long enough to get good at it, and then to make consistent profitable returns. A traders level of resilience will be a combination of nature and nurture, both in and out of trading. Resilience can be developed, and indeed a part of the armed forces training is designed to develop resilience, or toughness.

From my perspective it is interesting to think of resilience in two ways. Firstly in endurance terms i.e. the ability to continually perform at a high level in high pressure environments (the ups and downs of a trading career); and secondly in terms of 'turnaround/bounce-back-ability' i.e. the ability to overcome challenging events (overcoming setbacks, errors, losses, drawdown periods); there is also perhaps a third type of resilience, one which enables people to have the capacity to expose themselves to 'critical moments' (the big trading opportunities). So, how can you develop your resilience? Let's break down the components of trading resilience into:

- Psychological
- Physical
- Financial

Here are some strategies and approaches that you can use to improve your resilience.

Psychological Resilience

Motivation

Having strong motivation, commitment and a sense of purpose as a trader is important in keeping you 'fuelled'. If you started asking yourself 'Why am I doing this?', what would your answer be? Would it be strong enough to keep you going through even the toughest of periods? Strong motivation provides strong resilience!

Positive Attitude

I do not mean being overly optimistic, and denying the reality here folks! What I mean is accepting the situation as is, but maintaining your self-belief, focussing on what is going well, and actively working on areas that can be improved upon. Take an optimistic perspective in terms of seeing things as being temporary, and not taking them too personally. Focus on what you want to happen and how to create it, and not on what is happening and how to stay there!

Flexibility

Resilient traders accept that there will be dry periods in their trading. They realize that slumps happen and that market conditions change. This anticipation enables them to respond swiftly when their good ideas are no longer panning out. They reduce their risk, cut back on their trading, and wait to get a feel for things again.

Problem-Focused Coping

When they are losing, resilient traders delve deeper into themselves and deeper into the markets. They gain motivation to figure things out. Lesser traders become mired in discouragement and frustration, spinning their wheels by venting (or acting out) their emotions or by avoiding trading altogether.

Competitive/Fighting Spirit

The successful trader uses this drive to draw upon motivation during slumps. Many traders, surprisingly, are not competitive at all: they're drawn to trading because of a perceived easy lifestyle. These are among the least resilient traders. As soon as it becomes clear that trading out of a hole means real work, they lose motivation and interest.

Physical Resilience

Energy

The key factor in achieving physical resilience is having enough physical energy to literally 'soak-up' the stresses and pressures being encountered. When we feel physically energised, healthy and well, our ability to withstand stress and pressure is increased and our psychological/emotional responses are enhanced. Consider maintaining healthy rituals and habits for sleep, exercise, rest/recovery and diet to boost your physical energy and maintain/develop high levels of resilience.

Financial Resilience

Prevention and Preparation

I consistently find that traders who live on the edge financially – including those who ratchet up their lifestyle as they make money – are among the least resilient, and more fragile, traders. It is stressful enough to go through a trading slump; but to have to worry about making mortgage payments or supporting a family is too much pressure. The resilient traders prevent the pressures from becoming too great by maintaining healthy cash reserves for those dry periods and by perhaps having secondary sources of income wherever possible. Conversely, when the trading losses become a source of stress at home, this impairs resilience further.

Risk and Money Management

In line with the above, the trade-by-trade risk and money management strategy that you employ will have an impact on your resilience. Being hit by big losses, big losing days, big periods of drawdown etc are stressful. The amount of stress is correlated to a degree to the size of the loss, and therefore the amount of risk taken. Consider the risk you take in relation not just to the potential profit, but to the potential downside, and it's impact on your financial, psychological and physical components of resilience. ■

Steve Ward

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How to Manage the Triangle of Profits, Risks and Volatility

Movement – All that Matters

Initially, the most important thing for a trader is to find some kind of price movement, regardless of the market or the security he is trading. Leaving option writing aside, it is next to impossible to earn money without movement in the market, whether it be in futures, stocks, or in other securities that are traded. In order to remain profitable, a trader must use not only sound money and risk management methods, but also employ search routines to discover movement.

☐ Movement itself is not trivial and can be described in different forms. There are completely different kinds of movement and not every kind is compatible with the current condition of the trading account or the risk level the trader is willing to accept. For the trader it is very important to choose the right movement and to trade the right security. Therefore, the following article examines various kinds of movement, the search and discovery of the most important movement in the market and ways to utilise movement in a trading account.

What Does Movement Provide?

As trivial as it may seem, movement is the source of all profit. Profit can only result if available market movement is utilised by the trader. There are two basic forms of movement. One is the Passive Trade Movement (PTM); the other is the Active Trade Movement (ATM). PTM results when a security demonstrates real movement, and the trader is aware of the movement, but decides not to utilise it because he does not trade the security. In this case, movement is present but it is passive since it does not affect his trading account. Every trader experiences PTM on a daily basis because he will always see securities in the market that go through potentially profitable moves even when he chooses not to participate.

In contrast, a trader actively participates in ATM because he has taken the trade and opened a position in the security. This is an active component because the opened trade will result in a change in the trading account, unless of course the movement is sideways. Only this type of active participation in the market can be utilised by the trader for actual generation of profit.

Thus, in order to utilise movement the trader must participate in the market. Only when an account contains open positions is a trader capable of realising profits. Movement alone does not help. It must be correctly related to the number of opened positions held in the account. This point is very often underestimated because it seems so obvious and in the daily consideration of things it is practically never even considered by most traders.

It is clear that only ATM is physically profitable to the trader, nevertheless PTM also has its purpose. PTM empowers the trader to take a position in the selected security at a later point in time. Thus, it can be used in many trading circumstances. The trader has the choice at any time to transform PTM to ATM utilising the discovered movement for his account. Scanners programmed to recognise various movement patterns could improve your trading despite PTM because they make it possible for the trader to participate in the market at a defined point in time. They increase awareness of potential trades that would otherwise go unrecognised by the trader.

This point alone hints at why Technical Analysis (TA) seldom leads to consistent and lasting profitability. Indeed, TA recognises movement. However, it cannot relate it to a trader's account because there is no correlation between the account and TA. That is why it is of the utmost importance for the trader to apply various management methods in order to trade successfully. The trader must control his account and not be controlled by the market.

From the previous arguments we can see why trading in one security alone can be very restricting, robbing the trader of the opportunities presented by trading on a wider basis.

Finding Movement

There are several ways to find desired movement in the market. First, it must be decided if movement should be found in one or several securities. If a trader only trades the Bund Future for example, then he is interested in finding movement in this security alone. In contrast, traders looking for movement in the entire market increase their opportunities.

The following strategies can be ported to any desired stock market or any single security. Even the classic futures trader, who only trades one market and considers only one or at most two securities, can use these strategies.

We have already determined that movement is necessary to put the trader in a situation where he can realise lasting profits. It must also be said that movement alone will not lead to success if a thoroughly conceived system of risk and money management is not used. In order to find the desired movement, it is necessary to answer certain questions to optimise the selection of the markets and securities to be traded.

Question 1: Does the Traded Market Generally Move?

It is important for traders to know the market environment they are dealing with. Is it generally a dynamic environment? Does large movement occur during certain times of day make it volatile? Is the movement associated with high volume? If so, the market can be integrated in a trading system relatively easily.

However, if the market shows little movement, then possibly it is a static market with little volatility and little volume. Here, money management parameters must be adjusted in order to attain the same profits. Often the right adjustment in this type of situation is to increase position size. Again, this gives credibility to the claim that trade success is achieved through correct position size and not by determining the trade's entry point.

For example, the DAX or the Bund Future both have certain phases in which they demonstrate clearly enhanced movement patterns as compared to other times of the day. Both contracts tend to move well during the morning opening phases as well as again during the opening phases of the American markets in the afternoon. However, during European lunchtime phases the two markets are often at a standstill. The result is an up and down movement, with short, highly volatile peaks and long stretches of low volatility in which there is hardly any movement at all.

In my daily work with traders I often see trades that are entered during a volatile phase, and realise a quick profit, but they are ultimately unsuccessful during the following low volatile phase. The trades are held too long in the hope that the movement will continue producing more profit. In fact, these kinds of trades only produce opportunity costs.

Opportunity Costs

Opportunity costs result when capital is tied up in trades during periods when no additional profit can be generated, i.e. periods that show either very little movement or slightly negative movement for the position. These funds could be used more effectively at that time in a security showing a profitable move or at the very least, higher volatility than the currently held security. The trader loses the opportunity of attaining profit in another way.

Therefore, in this type of market it would be a greater advantage to make short, fast trades during the peak times that are increased in size as momentum increases profits and then closing them as soon as volatility decreases. In contrast, during subsequent long drawn out motionless phases, small positions can be entered that do not completely risk the previously gained profits and are only increased if and when they slowly turn profitable.

It is interesting to note that futures traders do not always take advantage of the opportunities offered by the markets. If I restrict myself to one contract, I restrict myself to one pattern of movement. Like all others, this pattern only generates profit if it moves. It does not do the trader any good during the periods it does not move. Limiting oneself to a single pattern automatically robs you of potential profits. The same thing happens for example if you are limited to speculating only on rising prices, because the exchange or the broker does not allow any other possibility. Here nearly 50 percent in potential profits become unavailable because falling prices occur almost as often as rising prices. In the example of a motionless market, it would be much simpler to look for an alternative security that is moving during this time.

Thus, it makes sense to trade a combination of futures and stocks whereby focusing on stocks alone is often just as good of a solution since there is enough variety of movement patterns available. Leverage also plays a role that is predetermined in the futures market, though with stocks it can be determined by the trader himself.

I often hear from students that they want to focus exclusively on just one futures contract whether it be the DAX Future, Bund Future or one of the American contracts. They do not want to deal with other markets under any circumstances. This choice is irrational in all but only a few situations because it cuts off other potential profit opportunities. The goal of every trader is to generate maximum profits on the account. That is why it is important for every trader to keep an open mind towards new ideas and not to view individual market alternatives as static sources of profit because that simply is not true. Markets change constantly and every trader is well advised to utilise his potential across the board. One good example of this was in the year 2000 when the American exchanges switched from fractional to decimal pricing. The minimum price spread before the change was 1/16 cent or 6.25 cents. After the change, it was only one cent. The switch meant that many market participants, whose strategies were based on larger spreads, were forced to change their approaches.

Question 2: When Does the Move Occur?

It can be observed in almost every market throughout the world that during each opening phase, high volatility comes with high volume. Accordingly, there are usually good movement patterns that can be traded during these times. Every trader must study the time points in each market that deliver the best movements. The European futures markets typically deliver two movement phases. One is the morning time period during the opening phases. The other is in the afternoon when the American markets open.

In contrast, the stock markets are somewhat different, because there is such a variety of opportunities and there are always securities that can be traded. Thus, movement occurs throughout the entire day. That is only true for individual stocks, which must be sifted out with the appropriate scanning tools, as the market for individual stocks can also be very reserved. However, there are many other ways to find and utilise movement.

Since stocks can be moved strongly by news releases, the use of a good news source is indispensable. Free access Internet news portals such as yahoo.com or cnnfn.com can be a good basis to build on. Subscription based services such as briefing.com or trendmove.com are usually a better choice because news is provided in a prepared format. Thus, the trader can determine the times of the day when the news flow is strongest. Here it is not surprising to note the huge number of news items during opening phases of the various markets that then slowly decrease as the day progresses. Other strong news flow times of the day include the lunch break and the last trading hour, but that is not the rule. Good news sources include www.yahoo.com, www.cnbc.com, www.cnnfn.com, www.briefing.com and www.tradethenews.com whereby the latter two choices are value added services.

Another important question is that of seasonality. Certain movement patterns based on seasonal influences occur often. For instance, the American Dollar usually increases against the Euro at year's end. Another pattern can be found in the large American retail stocks such as Wal Mart, Dillards or JC Penney. These equities are typically weak during the summer months but often increase substantially during the Christmas shopping season. Repeating patterns in securities can be a great help. A pattern that occurs repeatedly can be traded in a controlled manner. These types of patterns can especially be used as a starting point for strategies having to do with money management.

Question 3: What Movement Patterns Are There?

Not every movement in the markets is the same, which makes it necessary for the trader to pinpoint the kind of movement that is being detected. If the pattern of movement can be identified it is easier to choose the appropriate trading strategy to match.

It is essential for traders to develop various strategies prior to trading which can be utilised depending on the

F1) Push-Pull System Movement Pattern

Here you can see an example of a Push-Pull chart. This is during the market open when two or more strong opening moves occur before a security transfers into a relatively motionless sideways phase lasting to the close. Such a model is affected by strong movements. First the market price gets pushed into a direction. In this instance an upward movement until about 18:00 (MEZ), thus near lunch time (US-time). But afterwards the price begins to fall downwards the stairs and keeps this movement for the rest of the day – the pull part. So the stock first gets pushed up so it can get pulled down again.

Source: www.tradecision.com

market situation. This is the only way to ensure optimal utilisation of the situation at hand. If the trader only uses one strategy, then he is unable to take advantage of varied situations, and will not attain optimal profit results.

The Patterns

Patterns can be roughly categorised as dynamic and non-dynamic movement. The initial movements can be directed up or down and often end about one hour after the market open. The subsequent movement is often contrary to the first, taking prices back to where they started. This can occur very slowly and thus initially goes unnoticed by the trader. The push-pull system is a reverse system whereby the actual daily move is turned around (Figure 1). The trader must attempt to turn his initial position around sometime during the day in order to capture part of the other side of the move.

Another movement pattern that is often observed is the trending move. Potentially, the most successful form of this pattern is a trend in an entire market or sector. Here, the pattern typically continues during the trading day. Although the move is generally referred to as a trend, close attention must be given to the linearity of the movement. Trend patterns often emerge from quiet markets. The price can move in a stable manner up or down and the total change can often be several percent. However, prices that jump up or down are seldom the case, which is an advantage for the trader. This helps increase the hit rate because results can be anticipated. A nice example of this was delivered by the oil stocks at the beginning of August 2006 after the company BP announced that it must close its Alaskan oil field, the largest oil production field in the world, for repairs. The subsequent increase in oil prices resulted from the news announcement, which could easily be anticipated. Since the trend lasted for several days, it would have been possible to generate substantial profits with a sensible money management plan. Generally, trends increase the probability of success, which allows trade risk to be reduced leading to additional opportunities.

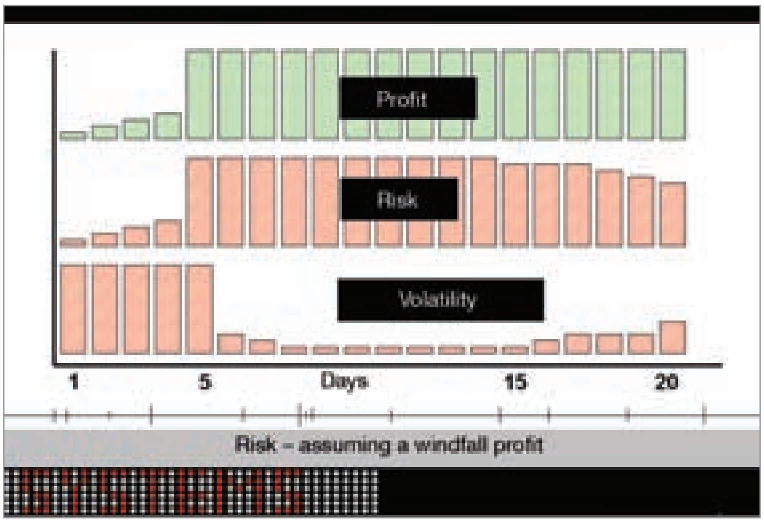
A third scenario that can be seen repeatedly is range building, i.e. the pure sideways movement of a sector or stock. Unfortunately, many of these range type scenarios are connected with high volatility. These phases are difficult to trade and one often ends up being long or short at the wrong spot.

This leads to repetitive losses that can quickly accumulate throughout the day. If a range has been identified, then trading in the security should cease immediately. Even if the trader successfully manages to trade the range, profits will be small and expenses comparatively high.

Therefore, the author feels that the only patterns worth pursuing are the push-pull system and the trend pattern. The sideways pattern involves too much effort to be profitable.

Note that the push-pull system requires that profits be secured quickly because prices can reverse in the other direction during the course of the day, while participation in the trend pattern should be extended as long as possible.

F2) Profit, Risk and Volatility



This chart shows the relation between profit, risk and volatility in a month.

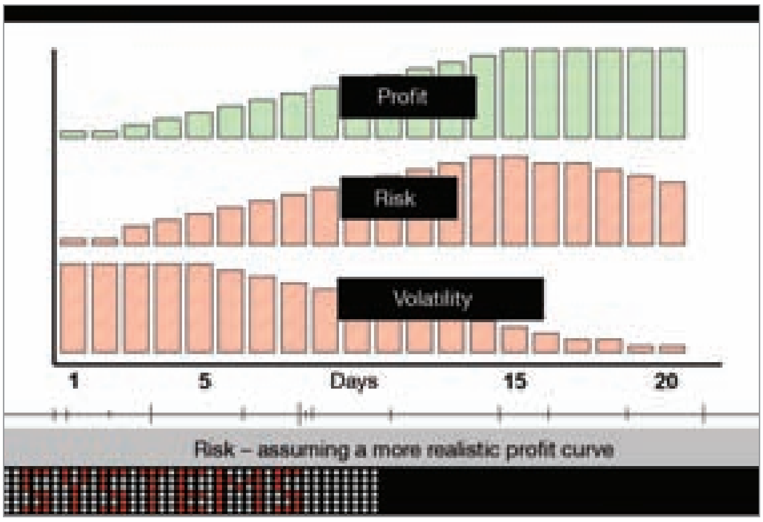
Source: www.tradenetconsulting.com

Question 4:
What Influence Does Movement Have on Risk?

Change in the price of a security always means change in incurred risk. Generally, it can be assumed that a narrow range of movement, i.e. low volatility, represents lower account risk, and naturally higher volatility produces higher account risk.

Therefore, it is essential that every trader purchase the right width of movement for the trading account whether it be increasing or decreasing in capital. It helps here to utilise the tools of various charting platforms. Every good platform features indicators such as the Average True Range (ATR), which can be used to measure the average daily range of a

F3) Reduction of Volatility



This shows the relations when assuming a more realistic increase of profits over time. As set goals are reached, volatility is reduced in order to limit the account risk.

Source: www.tradenetconsulting.com

security. If you trade the American markets beta can also be used. Beta compares the fluctuations of a security with the fluctuations of the market that houses that security. A beta of 1.0 indicates that a security has the same volatility as the total market. If the market moves one percent, the security can be expected to move about one percent as well. A beta of 1.3 would mean the security could move 30 percent more than the underlying market. Beta is a good indicator for selecting the right securities for an individual portfolio. Of course, beta is purely a theoretical value, but nevertheless, the trader can use it to adjust portfolio risk.

Time is also an important aspect of movement. It is important to take on movement in an account at the right time. For most people, a common financial interval is the month's end. People pay rent, receive salaries and pay the telephone bills usually at the end of the month. It also makes sense to review trading performance and account risk on a monthly basis.

Figure 2 shows the profit, the risk and the accompanying volatility over a period of one month. During the first four days, trading proceeded with regular small profits. However, on the fifth day, the trader gets lucky and a position moves strongly into profit. Since the position has produced a profit that is proportionally large for the account, the risk that some or all of these profits could be lost also increases. The figure shows how the trader can react to this increased risk. To create the proper relation of risk to profit, the only solution is to reduce volatility in order to preserve profit while attempting to increase it slowly. With less volatility and less inherent risk, the trader has essentially purchased the disadvantage of requiring more time for profit generation.

Figure 3 shows the relation for a realistic profit curve. As set goals are reached, volatility is reduced in order to limit the account risk. The same goes when losses are incurred, i.e. when the account immediately incurs a loss at the beginning without moving into positive territory at all. In that case, many traders try to compensate by trading larger positions. The correct procedure however is different. Volatility should be reduced and positions initiated with a smaller size. In that way, the trader recuperates the losses with the help of the element of time.

Question 5: What Role Does Money Management Play in Connection with Movement?

Money management is the art of determining the correct position size. The goal is to trade the right proportion of the total account. The trader's job is never to activate too much but also never too little of his total account. Money management is a difficult job and depends on a number of factors, among others of course from movement and specifically movement dynamic. Nevertheless money management should always be viewed in connection with movement and never separate from it. If for example on the previous day the trader traded a highly volatile market resulting in a loss, then today's trading volatility must be reduced in the effort to regain the loss. Simultaneously, selected position size must not be too big. The trader utilises time to get back into the profit zone. If a profit is generated then the number of shares traded should be increased, but with tight stops. In this way, the trader can recoup losses without allowing risk to get too high.

In contrast, a trader can use a high number of shares if movement is very quiet or the account is in the profit zone. Accordingly, movement dynamic strongly determines the choice of the correct position size and both in turn have a direct influence on the trade outcome and the amount of profit or loss.

Conclusion

Movement is indispensable for traders. Securities that do not move should not be held in an account for long. Nevertheless, it is not only enough to find movement. The movement must also fit the account and the profit or loss situation. Not every time of day offers the same movement. The selection of movement becomes even more important as the number of positions in an account increase. The more open positions are held the less volatile new additional positions should be unless the account is strongly in the profit zone. ■

Detlef Wormstall

After several years working in the stock market, Detlef Wormstall started to trade US stocks and futures in 1996. Since then, he has specialised in money and risk management.

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Bookmark

The Guts & Glory of Day Trading

True Stories of Day Traders Who Made (or Lost) $1,000,000

□ Very few day traders make money – let alone $1 million or more – in the daily stock-trading battle. Mark Ingebretsen's rediscovered classic 'The Guts & Glory of Day Trading' examines these few, otherwise ordinary, people in fascinating detail. Pulling back the curtain on twelve trading days never to be forgotten, it gives readers an intimate, memorable and above all valuable glimpse of the high-octane emotion and action involved in some of the most transformative trading days ever experienced. The book shares some of the most expensive lessons ever learned in the markets, making it a gripping and essential read for all traders.

The Online Trading Revolution

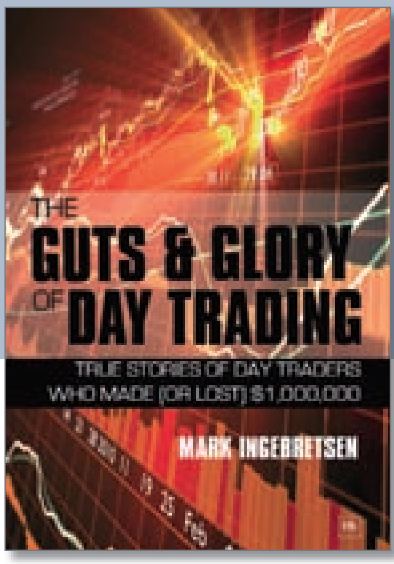
In the many years since the simple beginnings of the stock exchanges, technology has always radically streamlined the trading process. In the 1990s online trading became possible – probably the biggest revolution yet. As a result, millions of enthusiasts took up day trading. It was absorbing and fun, like gambling, and you could do it from the privacy of your own home, with the possibility that it might even make you rich.
This huge leap in technology meant that traders no longer needed to pay high commissions, or listen to what many saw as tainted advice from their brokers. Instead they could research stocks themselves, and then buy and sell these stocks with a single keystroke. Every day, thousands of day traders could take their positions in front of their computers and trade against the world's best, and most powerful, trading institutions. Of course, this led to some winners, and also some casualties.

Stories of Successful Traders

Mark Ingebretsen's book highlights the stories of traders who were skilled enough to make significant money, and also the gut-wrenching dramas of those who lost fortunes.

For instance, in Chapter Four, 'Those Who Forget The Past', Ingebretsen studies Terry Bruce, a trader who grew a $75,000 account into $575,000 – and then, a year later, lost it all as the account crashed to zero. To get back into the trading game, Terry gave up his job, took out a second mortgage and resolved never to make the same mistakes again.

Mark follows Terry's roller-coaster career from its beginnings in the mid-1990's when he was a photographer,



The Guts & Glory of Day Trading

Subtitle: True stories of day trader who made (or lost) $1,000,000
Author: Mark Ingebretsen
ISBN: 9781906659714
Price: £19.99
Publisher: Harriman House

right the way through to establishing that trading account worth over half a million dollars – and then what happened next. Mark recounts how Terry found his confidence began to grow and then, like a lot of traders, discovered the hard way that too much confidence is definitely not a good thing.

Taking bigger and bigger risks, buying more and more with each trade, Terry began to lose money, and instead of taking the losses, he held on to the tanking stocks – and watched as his account plummeted to zero. Ingebretsen's account of Terry's experience, here, gives human shape to some classic stock trading wisdom, as well as dramatic insight into the survival tactics needed to trade another day.

Terry and the other eleven traders profiled in this book can be especially helpful to anyone thinking about becoming a better trader – or indeed to those thinking of starting – as we see in turn how each of the twelve developed their own strategy and approach to the markets. And then, of course, how that approach worked out in practice, in the white heat of the trading day.

Some traded relatively small amounts of money, others bet everything on expensive, highly volatile stocks, some held certain positions for months, years even, while some jumped in and out of the markets in a matter of seconds. And if there is one indelible truth that the book can teach us, it is that an averagely intelligent person can succeed at trading, and grow their portfolios substantially in a short amount of time. Regular people – classical pianists, photographers, and business consultants – have all achieved success on the markets. Some had to learn the hard way, others took a smoother path – and both kinds are detailed in 'Guts & Glory'.

A Master List of Trading Rules

Mark's final chapter 'A Master List of Trading Rules' pulls together the trading rules of the twelve traders and provides a definitive list of do's and don'ts, including 'Set rules, but know when to break them' and 'Back your winners, cut your losses'. It may sound obvious, but many day traders forget these rules once they're in the markets. They won't forget them after reading the stories in this book. The final rule is perhaps the most important rule of all – 'Devise a strategy that suits your personality'. Successful trading styles are the ones that take advantage of people's natural strengths; trading will test you to the limit, so make sure your style reflects your personality.

Conclusion

Over the years since this book was first written, a new, more adept generation of traders has emerged. This new breed is wise to the mistakes and successes of their earlier peers. Anyone who wishes to join their ranks would be well advised to read 'The Guts & Glory of Day Trading' in order to get up to speed as well. ■

A Whole New World

MetaTrader 5

In TRADERS´ 01/2010, we introduced the public Beta version of MetaTrader 5. June 1st 2010 time has finally come: MetaQuotes Software Corp. released its new trading platform MetaTrader 5. So we took a look at this software once again. Will the developers achieve even greater results, as well as enter new markets with MetaTrader5? We tested it for you.

MetaTrader 5 Is Born

MetaQuotes began the development of MetaTrader 5 three years ago. Obviously, the new platform was intended to exceed Meta Trader 4, which many consider one of the best software for Retail Forex. The developers explained their decision to develop a new platform, despite the fact that MetaTrader 4 already held a leading position on the market, by referring to competitive struggle.

„Five years after the release of MetaTrader 4, we hold a leading position in the software market for Retail Forex", admitted Renat Fatkhullin, the CEO of MetaQuotes Software Corp. It would appear a bit illogical, in this situation, to spend huge sums of money on the development of a new platform. However, Russian developers think otherwise.

MetaQuotes began to develop a new platform in 2007. The key differentiator of the new platform was an opportunity to go beyond Forex and begin working with other financial markets. The company wanted to create a platform, through which a trader could trade on Forex, as well as work with stocks on other markets, for example such as NYSE or any other stock exchange.

F1) All in One

Here you see all important features of MetaTrader 5 at a glance: the Market Watch with the current bid and ask prices, the Navigator, the symbol list and price charts of four different currencies.

Source: www.metaquotes.net

„Competition in the Forex retail market is very strong", says Alexander Saidullin, the head of trading platforms in MetaQuotes. "It is quite natural that brokers want to please traders and provide them with as much service as possible. Some brokers asked for the opportunity to simultaneously work on multiple markets. This is when we realized that this would be a good idea for our new MetaTrader 5." This is how the development of the MetaTrader 5 began. Now that the first version of MetaTrader 5 has been released, we can evaluate it.

The New Workplace of a Trader

MetaTrader 5 Client Terminal is a trader's workstation, from which he can analyze quotes and make trading operations. As stated before, the platform MetaTrader 5 was initially created for various financial markets. Thus MetaQuotes had to develop an entirely new trading system in the MetaTrader 5 platform, which would be compatible with multiple stock markets.

This turned out to be an unpopular decision: traders had to adapt to a new trading system and re-build their trading practices. The trading community raised a wave of indignation, due to the fact that there was no longer the possibility to display locks in MetaTrader 5. However, the boycott never took place, and traders began to get used to the new way of trading.

The analytical capabilities of the new terminal were broadened. In comparison to MetaTrader 4, the new platform has additional new technical indicators and analytical tools, a redesigned management system of graphical objects, and a number of different time frames. However, developers agree that the main innovation of the MetaTrader 5 terminal is the new development environment of Expert Advisors – MetaQuotes Language 5 (MQL5).

Secondly, the company has actively invested in the infrastructure surrounding MQL5. The new website MQL5.community was launched especially for the new development environment. It published the complete documentation of the language, a database of ready Expert Advisors and indicators, as well as many articles. In the near future, the company is planning to create a market of automated trading robots and development orders, as well as a service of monitoring Expert Advisors, on the MQL5.community base. Thirdly, MetaQuotes, supported by brokerage firms and our TRADERS´ magazine, holds annual Automated Trading Championships with a prize fund of $80,000. These competitions, which last three months, involve only automated trading robots. Informational coverage is at a very high level. The web site of the competition contains a lot of unique information which can be useful to regular traders, as well as to developers of Expert Advisors.

For mobile traders, developers promise to create a few terminals on popular platforms, such as iPhone, Android and Blackberry. "We will design mobile MetaTrader 5 terminals for them. But for Windows Mobile business is getting worse and worse. It is most likely that we will not support the Microsoft platform", says Renat Fatkhullin. The first mobile terminal is supposed to appear at the end of this or the beginning of next year, and it will be a terminal for iPhone.

The Most Important Enhancements at a Glance

Separation of Forex and CFDs:

One of the most important enhancements of MetaTrader 5 is the separation of Forex and CFDs. Using MetaTrader 4, it was only possible to trade foreign exchange and CFDs. Using MetaTrader 5 makes it possible in the future for shares, futures and options to be traded. This means that a whole new world is actually opened up to the MetaTrader user. For example, in the MetaTrader 4 model trading at a regular stock exchanges was not meant to be included. According to MetaQuotes, that was one of the reasons why MetaTrader 5 was fundamentally redeveloped.

F2) Analytics

Analytical abilities in MetaTrader 5 allow you to use almost any tools to get your signals.

Source: www.metaquotes.net

F3) New Order

Trading subsystem of MetaTrader 5 allows conducting almost all trading strategies.

Source: www.metaquotes.net

MQL5:
Another reason was the extension of the MQL programming language. MQL4 had purely been intended for structured programming, also referred to by developers as "spaghetti code". MQL5, though, at last makes the paradigm of object-oriented programming (OO programming) enter the MetaTrader world – a feature which had been on the wish list especially of advanced programmers for a long time.

With the help of MQL5-developers, there are plans to build a database of analytical tools and Expert Advisors (automated trading programs). MetaQuotes spares no effort or resources to achieve this. First there is the actual language of MQL5. Developers claim that it is very powerful, flexible, and productive.

The capabilities of the MQL5 language have significantly grown; with its help you can even create your own applications in MetaTrader 5. High performance allows you to create sophisticated trading robots with a large amount of computations. These types of trading robots are able to provide more detailed signals.

Market Depth Feature:
We already mentioned that the new platform also makes it possible for shares to be traded, which means that trading can be done on a regular stock exchange. Direct stock exchange trading is a novelty for MetaTrader users because it is well known that foreign exchange is traded OTC and CFDs are invariably traded directly with the broker who in this case plays the role of the market maker. In light of this, MetaTrader 5 also includes a market depth feature.

Orders and Fill Policy:
Another novelty is the new order types and execute statements. At first sight these are confusing although the changes made in this area are not difficult to understand. MetaTrader 5 knows the following eight types of order:

- Buy Market (buy order at market price).
- Sell Market (sell order at market price).
- Buy Limit (buy order at a maximum price typically below the current price).
- Buy Stop (buy order at a minimum price typically above the current price).
- Sell Limit (sell order at a price typically above the current price).
- Sell Stop (sell order at a price typically below the current price).
- Buy Stop Limit (combination of stop and limit order. If the price touches a stop level above the current price level, a limit order will be opened below).
- Sell Stop Limit (If the price touches a stop level below the current price level, a limit order will be opened above).

In MetaTrader 5 the fill policy provides for the following three order tags (if approved by the broker):

- All or None (also known as Fill or Kill – the order will only be executed if the volume requested by the trader is available at the current or better price, otherwise the order expires).
- Cancel Remains (If the order cannot be completely filled, the remaining request will expire).
- Return (If the order cannot be completely filled, a new order will be placed for the remaining request).

Charting and Indicators:
The new version makes it possible to have time frames with considerably more nuanced increments. Altogether you can choose from among 21 time frames. Those who cannot find an indicator among the 38 that are made available will certainly not have to wait for long. Moreover, there are new graphic objects along with the possibility of including graphics of one's own. Looking at the indicators that the resourceful developers have already developed in the old version, we can look forward to seeing more such exciting developments in the future.

Furthermore, the new MQL5 programming language offers some brand-new possibilities of control (so-called events). Combined with the new opportunities regarding graphic objects there are hardly any limits any more, and this applies not only to the development of indicators. For example, the new possibilities allow for a sophisticated individual graphic surface to be prepared.

Automated Trading:
The manufacturer promises that the new MQL5 language will increase the speed of execution by a factor of four to 20. That would indeed be a significant advance.

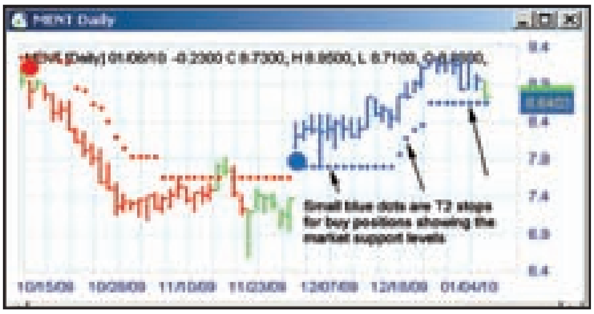
Conclusion

MetaTrader's strength is and remains automated trading. MetaTrader 5 offers users important and long-anticipated features: from now on not only foreign exchange and CFDs can be traded but also futures, shares, and options. Additional significant improvements are more likely to be found in details or below the surface. ■

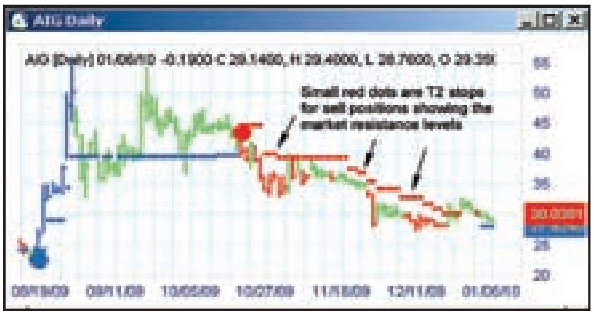
5 Interviews at www.ablesys.com

How Do I Know If The Market Has Changed Its Direction Or If It's Just A Temporary Pullback? AbleTrend T2 Stops Can Help

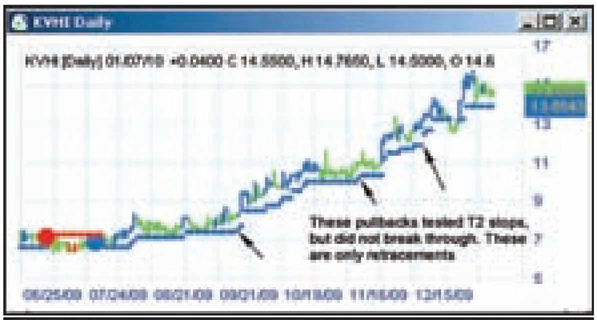
1. Small blue dots are T2 stops for buy positions showing the market support levels

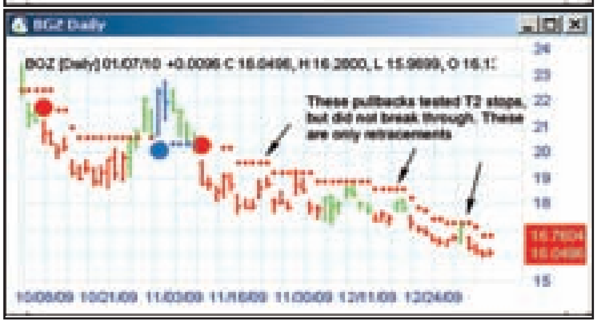


2. Small red dots are T2 stops for sell positions showing market resistance levels

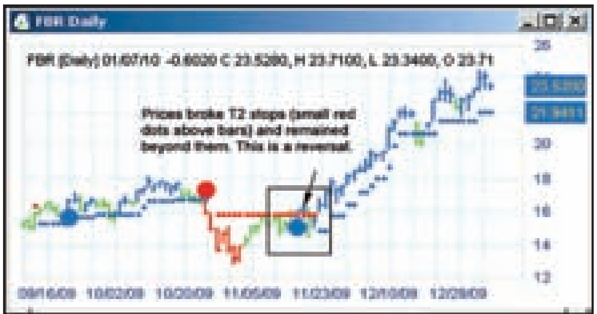


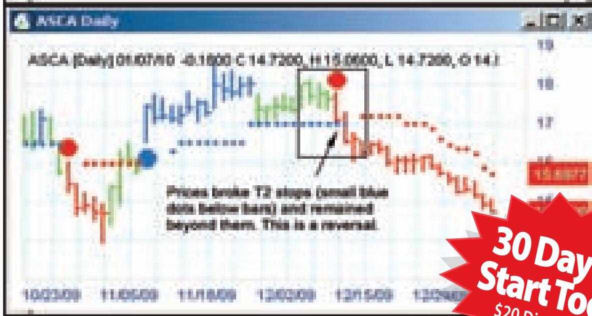
3. T2 stops helps to define the retracements





4. T2 stops helps to define the reversal





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AbleTrend T2 offers the following advantages:

1. T2 stops are defined by the market's own support and resistance levels and are therefore 100% objective.
2. The scientific calculations behind T2 stops are universal, not curve-fitted.
3. T2 stops can be back-tested to reveal the characteristics of individual markets.
4. T2 stops are updated with each new tick so there are no delays.
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6. Successful AbleTrend users around the world have relied on T2. Their common conclusion: "Never fight T2 stops."

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2. Exit the market when prices penetrate the T2 stops and close beyond that level, suggesting a reversal of the trend.
3. Boost your confidence, because "you have seen it happen hundreds of times" in both historical and real time. Without confidence, no matter how great your systems are, they are of no practical use.
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The market is always changing, but the way T2 works remains unchanged. Once you see it work time and time again, you will know that you can rely on it and utilize it. That's the value of the legendary T2 stops. The method is timeless. AbleTrend T2 stops can help you thrive in todays volatile markets.

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FX360.com – A Fount of Valuable Ideas for FX Traders

As its name suggests, the www.FX360.com website is aimed at active forex traders. It was founded by Kathy Lien and Boris Schlossberg who are responsible for currency research at GFT, making them real experts in the field of currency trading. GFT offers trading solutions and is one of the leading forex companies worldwide. According to its mission statement, FX360.com is designed to give its customers access to the latest painstaking research and professional market analyses and to always do so free of charge. We have been testing the forex platform for you.

F1) Start Page

Figure 1 shows the start page of www.FX360.com. The upper navigation bar will easily get you to the individual features of calendar, charts, videos, technical analysis, and commentaries.

Source: www.fx360.com

☐ Structure

FX360.com is structured in a clear and user-friendly manner (Figure 1). All its features are highlighted allowing the user to find his way on the website easily and quickly. At the very top you can see a window where the five most important news items and analyses of the current trading day rotate. On the left below, there are the market commentaries – in order of topicality – by Kathy Lien and Boris Schlossberg, the two forex specialists and founders of the website. Beyond that, FX360.com includes an economic calendar, a technical-analysis report by Roger A Stojsic and Bradley W Gareiss, the most current business news as well as a forum for traders. On the right-hand side you can see trading recommendations, the so-called Quote Board with real-time quotations, and the central banks'current interest rates. A totally new feature is the FX360 iPhone application allowing all the features to be used on the iPhone , effective immediately.

Always Up To Date

Economic news and indicators loom large for the Forex trader since they have a partly crucial impact on the currency markets. For this reason FX360.com every day makes available the most current economic calendar which includes all the significant events such as, for example, bank announcements, government reports or corporate data for the day in question (Figure 2).

To show the user at one glance which event exerts which influence on the individual currency pairs, FX360.com highlights each event by using the colour red, yellow, or blue. Red stands for a major influence, yellow for a moderate one, and blue for a slight one. Clicking on the event in question will open a window with further details on it. This way you will, for example, receive historical information and their source or learn how often these data are published. Beyond that, FX360.com provides, as mentioned previously, its users with real-time prices of currencies, gold, silver, oil, international shares and bond markets. Furthermore, real-time prices for the gold and oil markets can be retrieved and the latest business news can be viewed on videos. This way, the user will be given an overview of the current situation on the forex market, allowing him to make better trading decisions.

Interactive Charting

FX360.com includes an interactive charting tool enabling the user to conduct simple technical analyses (Figure 3). There are three different options he can choose from: First, he can have the chart indicated as a candlestick, line or bar chart. Secondly, he can select different time frames: 5 or 15 minutes, one hour, one day or one month.

And thirdly, he can add up to five indicators from the extensive list. Our example shows the EUR/USD 5-minute candlestick chart with the Ichimoku and the MACD. Beyond that, the user can plot lines, trend lines, Fibonacci retracements and the ABCD pattern. The latter is frequently used especially by those analysts who publish their own reports and commentaries on FX360.com.

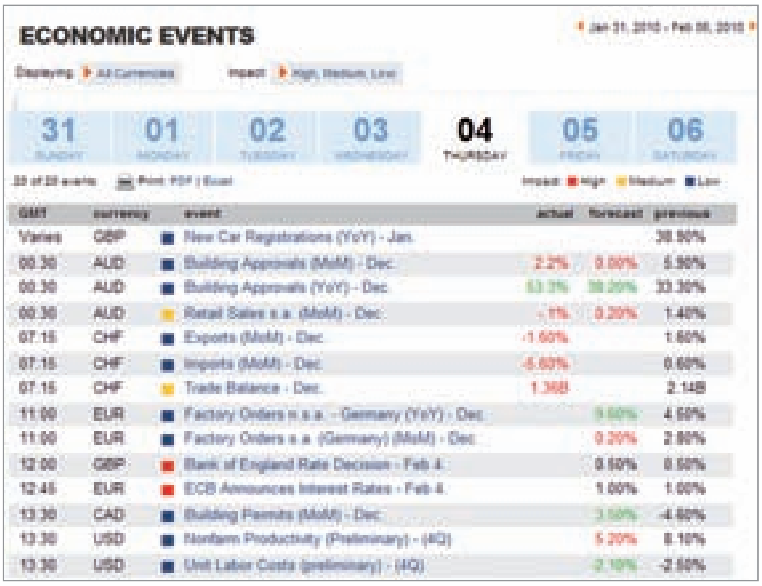
Training and Information

The Technical Analysis and Commentary Features include informative, instructive and insightful articles that are extremely valuable not only for forex traders but also for all those interested in technical analysis. For one, there are the intraday analysts who present their potential strategy for various currency pairs as well as the reason for this strategy. A similar format exists for swing trades or positions that are held for more than a day. For another, FX360.com offers chart pattern analyses where the analysts discuss the bullish and bearish Fibonacci patterns they use in their trades.

In addition, trading recommendations can be found for various currency pairs based on technical analysis. You will have access to the recommended, open, invalid, and closed trades, all of which will give you an insight into how these trades perform.

But always remember this: The trading recommendations are based on the analyses of the FX360.com team of analysts whose assessment you may not necessarily share. They are just designed to give you some inspiration and ideas to help you improve your own analyses and trading.

F2) Economic Calendar



ECONOMIC EVENTS

Jan 31, 2010 - Feb 06, 2010

31 | 01 | 02 | 03 | 04 THURSDAY | 05 | 06

GMT	currency	event	actual	forecast	previous
Varies	GBP	New Car Registrations (YoY) - Jan.			38.50%
00:30	AUD	Building Approvals (MoM) - Dec	2.2%	0.00%	5.90%
00:30	AUD	Building Approvals (YoY) - Dec	[illegible]	38.20%	33.30%
00:30	AUD	Retail Sales s.a. (MoM) - Dec	-1%	0.20%	1.40%
07:15	CHF	Exports (MoM) - Dec	-1.60%		1.60%
07:15	CHF	Imports (MoM) - Dec	-5.60%		0.60%
07:15	CHF	Trade Balance - Dec	1.36B		2.14B
11:00	EUR	Factory Orders n.s.a. - Germany (YoY) - Dec		[illegible]	4.50%
11:00	EUR	Factory Orders s.a. (Germany) (MoM) - Dec		0.20%	2.80%
12:00	GBP	Bank of England Rate Decision - Feb 4		0.50%	0.50%
12:45	EUR	ECB Announces Interest Rates - Feb 4		1.00%	1.00%
13:30	CAD	Building Permits (MoM) - Dec		[illegible]	-4.60%
13:30	USD	Nonfarm Productivity (Preliminary) - (4Q)		5.20%	8.10%
13:30	USD	Unit Labor Costs (preliminary) - (4Q)		[illegible]	-2.50%

Here you can see the current economic calendar that includes all the important events for the day in question. If an event is marked red, this has a major influence on the forex markets; if it is marked yellow or blue, it has only a moderate and slight influence respectively.

Source: www.fx360.com

Conclusion

FX360.com provides valuable and current information involving forex markets. Thanks to the economic calendar, business news, charting tool as well as professional market commentaries and technical analyses you will always be kept up to date and will also receive new and helpful ideas to assist you in improving your own trading. ■

F3) Interactive Charting Tool

Figure 3 shows the interactive charting tool allowing simple technical analyses to be carried out for important currency pairs. You have the option of choosing from among different types of chart, time frames and indicators and of, for example, plotting trend lines. Here you can see the EUR/USD 5-minute candlestick chart with the two indicators Ichimoku (plotted at the top of the chart) and MACD (graphic below).

Source: www.fx360.com

NEW PRODUCTS

Bollinger on Bollinger Bands

□ The **Bollinger on Bollinger Bands Website** (www.bollingeronbollingerbands.com) has finished a complete upgrade, including John Bollinger's latest work and some technical analysis tools unique to the website. Some of these tools are: BB Impulse, which measures price moves as a function of the width of the Bollinger Bands; Percent Bandwidth, which is a normalized and more intuitive view of BandWidth; Bandwidth Delta, which charts the rate of change in BandWidth. In addition, there are three indicators developed by Jim Alphier: Alphier Conviction, which is a divergence indicator that compares the count of plus and minus of days vs. actual gains; Alphier Execution, which is a supply-demand chart with specific buy and sell rules; Alphier Psychology, which is the central component of the Alphier Execution chart that is more sensitive and shorter-term in outlook. New chart overlays include: the Price Magnet, an overlay that plots a series of points in and around the price structure providing an indication which is a variation of Bollinger Bands which fucus on the extremes of price action. Bollinger Bands are centered on a moving average (usually of closing price), while Bollinger Envelopes are anchored by the extremes (highs and lows).

RTS Realtime Systems Group (RTS) now provides connectivity and low latency access to the Singapore Mercantile Exchange (SMX). The new pan-Asian commodity and currency derivatives exchange will launch using a state-of-the-art global futures and options trading platform for products which include precious metals, base metals, agricultural commodities, energy, currencies and commodity indices. Leveraging on its parent conglomerate Financial Technologies (India) Limited, who has designed and provided the end-to-end technology solution, the Exchange provides an application programming interface (API) to enable global independent software vendor (ISV) integration and thus facilitate a cross section of trading members, institutions and other financial market participants to trade on the Exchange. Members also have the option to write their own APIs for connectivity. Financial Technologies (India) Limited's highly robust and scalable trading technology gives SMX the agility and adaptability which ensures its edge in the financial markets. Additional details can be found at ***www.rtsgroup.net***.

Portfolio Maestro now is able to interface with eSignal Standard for price data. This allows traders to test their strategies on thousands of symbols at once. Its new Trade Charting Engine allows the flexibilty to view many different symbol charts also at the same time. For more information, please visit ***www.portfoliomaestro.com*** or ***www.rinatechnologies.com*.**

RTS

Portfolio Maestro

Interactive Brokers

Alpari

Interactive Brokers has updated its ScaleTrader algorithm to include pairs trading. Thus, their clients can trade the spread between any two securities. Investors typically buy the shares of one company and sell those in another when the distance between the two price moves towards an extreme value and away from an observed relationship. The Interactive Brokers ScaleTrader algorithm enables clients to create conditions under which a long position on one stock is built while simultaneously creating an offsetting short position in the other. The ScaleTrader is so named because investors can "scale-in" to market weakness by setting orders to buy as the market moves lower. Similarly, sell orders can be "scaled" into when a market is rising. The ScaleTrader algorithm can be programmed to buy the spread if the difference reaches predetermined levels set by the user. Orders can be entered using net share price differences or by using credit or debit ratios. Investors can set their own parameters to define the starting number of shares and maximum size of the position they wish to create, and must determine the distance between each increment buying price. Moreover, the user may vary the increment over time. The ScaleTrader Pair Trading algorithm is available to all Interactive Brokers customers trough its Trader Workstation trading software at no additional charge. For more details, please visit ***www.interactivebrokers.com***.

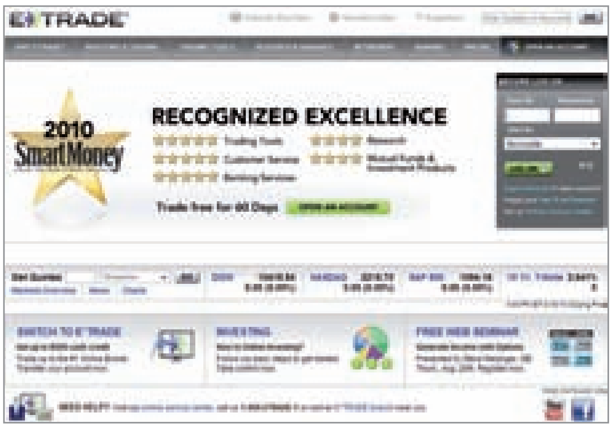
Market Technologies announced the release of VantagePoint 8.2. The enhancements of the new version improve overall speed and responsiveness of the program. Its new visual attributes improve the user's experience. ProfitCalc calculates and determines the potential profit or loss from a particular trade. IntelliScan replaces the Scan for Opportunities feature, making scanning for potential trades even more user-friendly. In VantagePoint 8.2, charts and reports open faster, custom trendlines are more user-friendly and intuitive, and the history report sports a new, more intuitive appearance. For further information, please visit ***www.tradertech.com***.

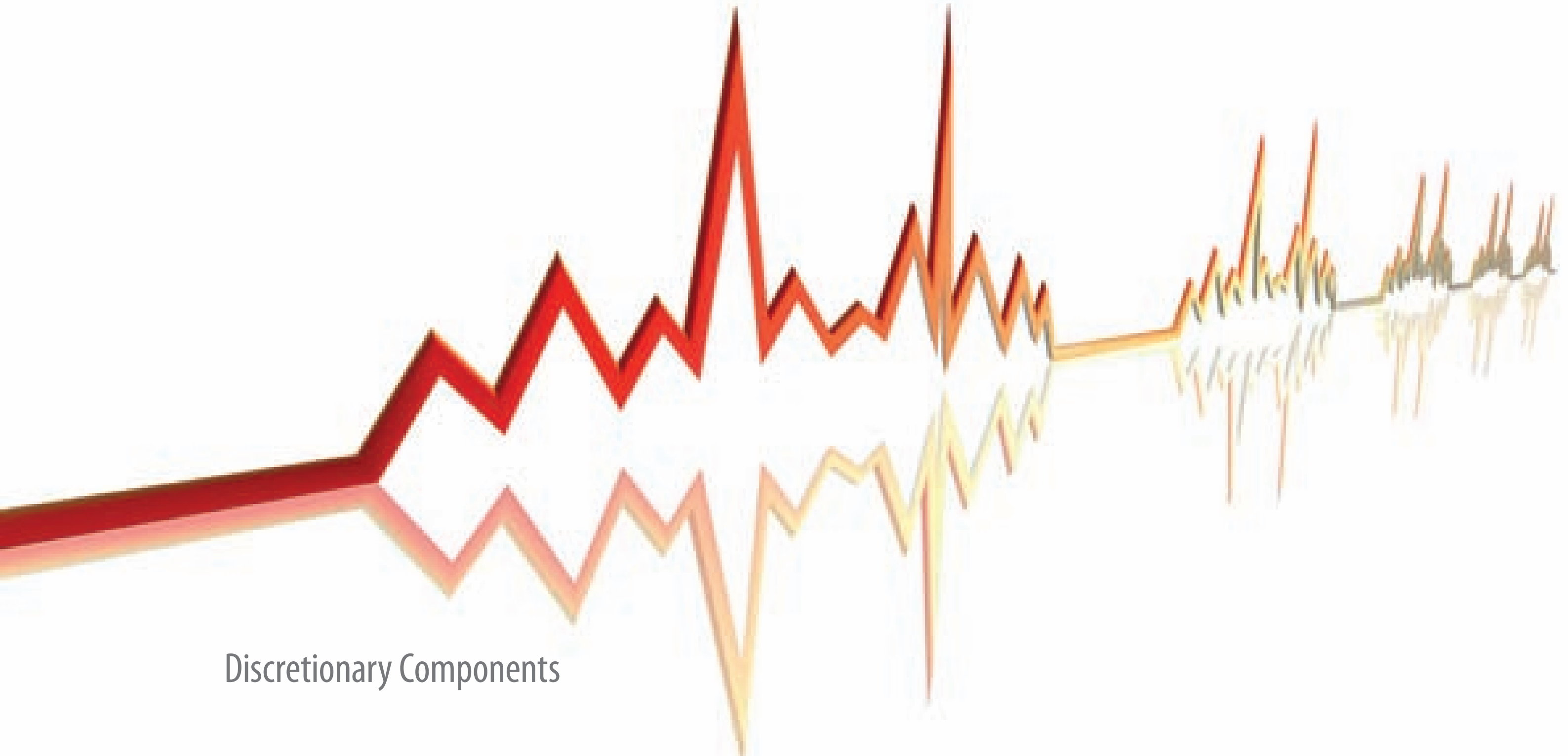
Alpari (US) has announced the launch of a free live audio market commentary service for its clients, launched in conjunction with Alpari (UK) and its subsidiaries. "Alpari Squawk" is a dedicated audio stream that covers major market-moving stories throughout the trading day, including coverage of economic news and figures as they are released, such as fixed-income, interest rates, equities, FX and commodities. First Call, a team of professional market analysts, manages the service. Alpari clients can access Squawk via the Alpari Website ***www.alpari.co.uk***.

E*TRADE Securities has launched an open application programming interface ("Open API") for third-party and independent software developers to integrate seamlessly with E*TRADE's investing platform. Through the new Open API, customers have access to technical information and documentation, reference guides, and other resources to help integrate external applications and programs with E* TRADE's investing platform. E*TRADE also announced plans to integrate with third-party vendors, including CoolTrade and AbleSys, offering investors seamless integration between E*TRADE's trading technology, and the market research and stock trading tool of external programs. For more information, please visit ***https://us.etrade.com/e/t/home***. ■

Market Technologies

E*TRADE Securities





Discretionary Components

Developing Swing Trading Strategies – Part 7

Part 7 of this series on developing professional swing-trading strategies will discuss existing and potential discrepancies between the simulation results presented in the previous article (TRADERS' 06/2010) and their implementation in practical trading. Besides the necessary and conceivable discretionary components, the following article, which will conclude this series, will also address typical problems that might arise over the composition of a portfolio, and discuss additional ideas for further studies.

Starting Point: The Rules Derived

Parts 1 to 6 of the series presented a large variety of different entry and exit criteria, several combinations of which produced promising results. For purely pragmatic reasons, a strategy was eventually followed whose criteria will again be summarised as follows:

Entry and exit rules for the buy side:

1) The current stock closing price is above two dollars: C > 2.
2) The 200-day rate of change is higher than zero: ROC(200) > 0.
3) Three-day RSI < 20: RSI(3) < 20.
4) If conditions 1 to 3 are met, buy the next day if the price is at least seven percent below today's closing price (seven percent buy limit).
5) Stop loss: ten per cent away from entry price.
6) Fixed profit target of six per cent (effective from the trading day following the entry).
7) If the closing price is above the previous day's closing price, sell the next day at the opening of the market – regardless of the fixed profit target and irrespective of whether the position is in plus territory or not.

The entry rules for the Short side apply as follows:

1) C > 2.
2) ROC(200) < 0.
3) RSI(3) > 95.
4) If conditions 1 to 3 are met, sell short the next day if the price is at least five per cent above today's closing price (five per cent short-sale limit).
5) Stop loss: ten per cent away from the entry price.
6) Fixed profit target of six per cent (effective from the trading day following entry).
7) If the closing price is below yesterday's close, smooth the position the next day at the opening of the market – regardless of the fixed profit target and irrespective of whether the position is in plus territory or not.

Multiple entries in a stock resulting in overlapping positions are allowed for both sides. For the simulation runs a marginable $100,000 stock account will be accessed, which makes it possible for all the shares contained in the portfolio to be borrowed against, allowing a leverage of up to 2:1. In addition, the position size will be fixed at 9.8 per cent, slippage at 0.1 per cent, and commissions at one cent per share per halfturn. The Russell 1000 Index as of 31st December 2008 will serve as a stock pool. Tests were carried out currently in Part 6 of the article over a period of six -and-a-half- years, i.e. from 1st July 2002 to 31st December 2008.

Discrepancies between Simulation Run Results and Their Practical Implementation

In the previous article, extending the period under consideration by the turbulent second half of the 2008 market year made it possible to demonstrate impressively that the swing-trading strategy rules (at least in the simulation run) are very robust and profitable. An annualised performance of 76.62 per cent at a maximum drawdown of -18.27 per cent, a Sharpe ratio of 2.87 (at a risk-free yield of zero per cent), an Ulcer Index of 1.59 and a profit factor of 2.17 (after allowing for commissions and slippage), represents an extraordinarily good result – when seen against the background of this result having been achieved over the period of 1st July 2002 to 31st December 2008, which included the most varied market phases.

As far as the swing trader is concerned, this raises the following three questions: Can such results be achieved in practical trading? Which conceivable pitfalls are there are in the practical implementation of the strategy? Could any resultant discrepancies between the simulation and practical trading even be inevitable?

Definitely Occurring Discrepancies Between Theory and Practice

a) Discrepancies in order execution

In any event, when executing limit orders there will be discrepancies between theory (simulation run) and practice.

The entry and exit criteria derived from Parts 1 to 6 also make use of limit orders. The advantage of this way of placing orders is that in the case of an order execution there will be no slippage, which means that the simulation at least reflects reality (in some cases there may even be better execution prices than are assumed by the simulation).

However, the disadvantage of limit orders is that even when a price is below the buy limit (in the case of the long side) or above the short-sale limit (for the short side), there may in practice only be partial executions or even none. This is a drawback that has to be put up with in simulation runs that – as in this case -are carried out on a daily basis. In a simulation run it is assumed that once a limit is reached, the order will be executed. At the same time, backtesting software does exist, which allows a setting by means of which a determination can be made by what percentage a limit must at least be exceeded before an execution order is assumed. Obviously, more realistic testing can be done using intraday data, which is what the ambitious trader is expressly recommended to do at this point. However, partial executions are also difficult to simulate realistically on an intraday basis.

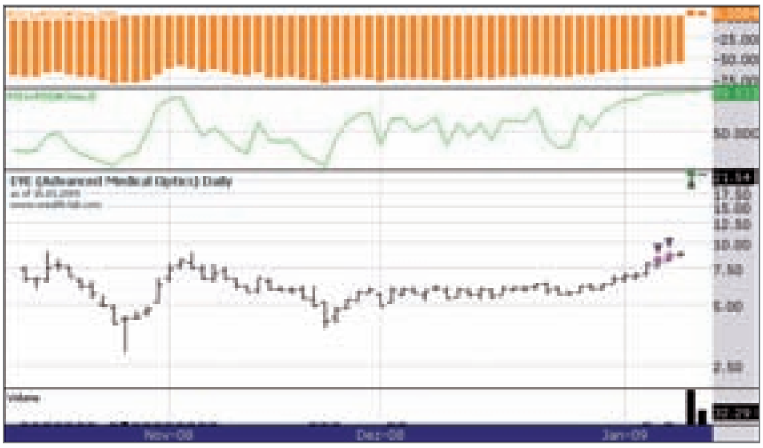
The above-described problems experienced when simulating limit orders can only be solved by accessing liquid stocks, i.e. highest-possible volume stocks. It is for that very reason that the Russell 1000 Index was chosen as a portfolio: It includes the largest and therefore most liquid stocks traded in America , at the same time offering a sufficiently large portfolio with its up to 1,000 shares.

When executing stop-loss orders and cancelling orders via a market order (see the above-mentioned exit rule number seven), there will also be discrepancies between the simulation runs and reality. However, against the background of the (in my experience) realistic average slippage of 0.1 per cent – and at an average execution price of $27 – that difference ought to tend towards zero over several hundred trades.

b) Discrepancies on days with maximum degree of investment

The studies carried out in this series of articles were conducted on a daily basis. On days when there were more than 20 executions and therefore the degree of investment within the portfolio reached maximum capacity, it is therefore impossible to say which trades would actually have entered the portfolio before maximum capacity was reached. Together with the above-described set of problems encountered when executing limit orders, this is where discrepancies between the simulated results and those actually

F1) Shorts in Advanced Medical Optics (Symbol: EYE)



This shows the two trades generated according to entry rules in January 2009, prior to the announcement of the EYE takeover by pharmaceutical giant Abbott Laboratories. As you can see it is possible to lose more than 100 percent in a short trade.

Source: www.ealth-lab.com

achieved in practice are bound to occur.
However, since the degree of investment only reached maximum capacity on less than 1.5 per cent of all trading days the discrepancies are expected to be minor.

T1) Comparison of the Long & Short and Long-Only Variants

	Period: 30.6.2002 until 31.12.2008	
	Long & Short	Long only
Net Profit	5399,84%	4239,98%
Annualized Gain	85,03%	78,42%
Exposure	22,38%	24,03%
Number of Trades	1816	1775
Avg. Profit/Loss	2,24%	2,17%
Avg. Bars Held	1,97	2,16
Winning Trades	72,91%	70,59%
Avg. Profit	5,26%	5,50%
Avg. Loss	-5,88%	-5,82%
Max. Drawdown	-13,86%	-16,84%
Profit Factor	2,27	2,15
Sharpe Ratio	2,58	2,46
Ulcer Index	1,08	1,32

Assumptions for all simulation runs: Weighting per position: 9.8 per cent; slippage 0.1 per cent, commissions one per cent a share per halfturn; criteria for buys: RSI(3) < 20, ROC(200) > 0, seven per cent buy limit; for shorts RSI(3) > 95, ROC(200) < 0, five per cent short limit; exit with six per cent fixed profit target and with the criterion of closing price being higher than previous day's close (for long side) and closing price being lower than previous day's close (for short side).

c) **Shorts are not always possible**
Not all stocks can be shorted. Depending on which broker or which bank handles the transactions, a stock will sometimes not be available for a short sale. What may also happen is that the regulating bodies will ban shorts in the case of certain shares, as happened to financial stocks in the second half of 2008.

d) **Discrepancies based on data quality**
Basically, simulation runs and practical trading will lead to different results whenever faulty data are accessed. Unfortunately, in my experience this is what happens quite regularly – regardless of the price offered by a data supplier. Typical data errors may include: Stock splits not executed (leading to a gap in the chart and hence, obviously, to false results), false entries by the data supplier for daily high, low, closing or opening prices and even time series with missing days (frequently going completely unnoticed by the user).

However, there is a second critical component that has to be mentioned at this point: the so-called survivorship bias of the portfolio in question. What is meant by survivorship bias is the phenomenon resulting from the fact that only shares are included in the retroactive calculation of a performance over several years that are still traded on the market at the time of the calculation, i.e. have "survived", while at the same time all those shares that have been delisted in the meantime are of no relevance to that calculation.

In the majority of cases, companies will only be delisted if they have either gone bankrupt or have been taken over. Only in exceptional cases have companies been returned to private investors and owners and have shares issued been bought back. In this article only the two cases mentioned first will be examined.

If a company is delisted owing to financial problems, this is almost always reflected in a steady several months-long downward trend of the stock price. For the swing-trading strategy presented, this means that on the buy side the survivorship bias will probably have very little or no impact due to the trend-following component implemented (see the above entry rule number three) which prevents entry signals from being generated in shares trending downwards. By the same token, this phenomenon even ought to benefit the short side which generates signals in such downward-trending shares whenever there is a short-term intermediate recovery. It's a different story though with companies that are taken over. Regardless of whether the trend of the stock points upwards or downwards, the price of the takeover candidate will explode upon the announcement of the takeover bid at the latest. Price gains of more than 100 per cent are certainly within the realm of possibility, as is shown by the drastic example given in Figure 1.

On Monday, 12th January 2009, the pharmaceutical company of Abbott Laboratories announced its intention to take over the Advanced Medical Optics company (symbol EYE) at a price of $22 a share. At the time of the takeover EYE was a Russell 1000 Index member and had already been in a downward trend several weeks prior to the takeover (see negative ROC indicator in Figure 1). In accordance with the above-mentioned entry rules for the short side, two trades were generated on 7th and 8th January 2009 which had not been smoothed again by 9th January. Following the announcement of the takeover the EYE stock opened with a gap of more than 140 per cent compared to Friday's close of 9th January 2009. According to strategy rule number five, the stop-loss order thereupon took effect for both positions resulting in losses of more than 150 per cent per position.

This example dramatically shows that shorts may lead to losses >100 per cent and accordingly even to a margin call for the trader's brokerage account!

This example may also serve to prove that the survivorship bias has to be regarded as critical for the realistic backtesting of the short side. In view of the fact that following the completion of the takeover the EYE stock will be delisted and subsequently disappear from the databases, which only include the shares currently listed, incalculable divergences in the simulation run can apparently be expected as far as the short side is concerned.

Consequently, the only way to eliminate the survivorship bias is to access a database containing shares that have meanwhile been delisted. However, such databases are quite expensive and only represent a genuine way of solving that problem for well-heeled professionals.

A considerably more pragmatic solution would be for the trader to completely forgo the short side under certain circumstances, which is a perfect segue to the next topic.

Looking at the Short Side

The drastic example shown in Figure 1 immediately raises the question to what extent disregarding the short side has any impact on the overall performance of the strategy.

Table 1 provides a comparison of both cases: The left-hand side shows the performance taking into account both sides, which had already been published in the earlier Part 6, while the right-hand part of the table indicates the result for the long only-setup (just buy signals) being taken into account.

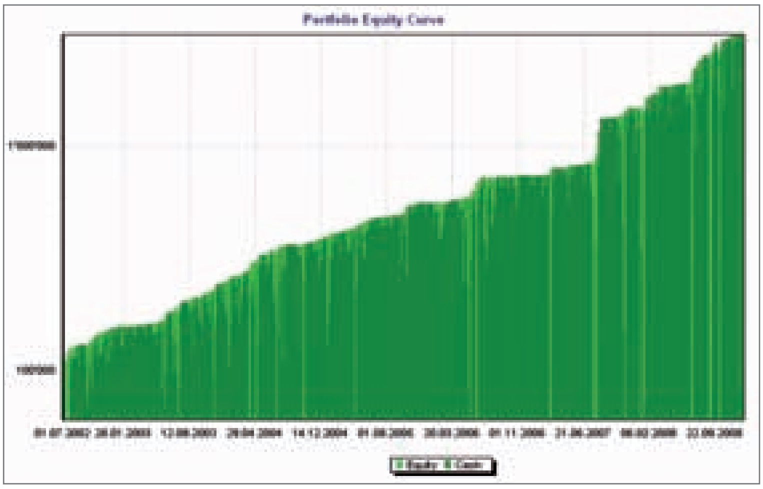
Figure 2 shows the portfolio development and Figure 3 the attendant drawdown of the long only setup. Even without taking into account the short side the result is impressive. Longer periods without any trades being made had to be endured but also offered the opportunity to pursue other strategies during these time periods.

Parenthetical remark: Forgoing the short side seems to be a very drastic step. Nevertheless, I strongly recommend seriously considering this approach. At the very least, though, every trader who is not a day trader and hence holds positions overnight, should be aware of the risks that they incur. Those who do wish to include the short side within the scope of the swing-trading strategy presented here, may want to consider the following steps and options:

1) Do not allow any overlapping positions which prevent multiple short position entries from being made.
2) Halve the weighting per position for the short side, for example from 9.8 to 4.9 per cent.
3) Use short signals only in fundamentally sound big caps that make no losses either (which rules out bank stocks of the past nine or twelve months); as a rule, these stocks are those that buy up another company. In addition, in cases where big caps were taken over price jumps turned out to be significantly more moderate than is shown in Figure 1.
4) Act on the short signals by trading options and buy put options, for example.
5) Avoid all the stocks of certain industries such as, for example, biotechnology.

Again, the last-mentioned item five provides a segue to the final observations of this article: the discretionary components in the swing-trading strategy presented.

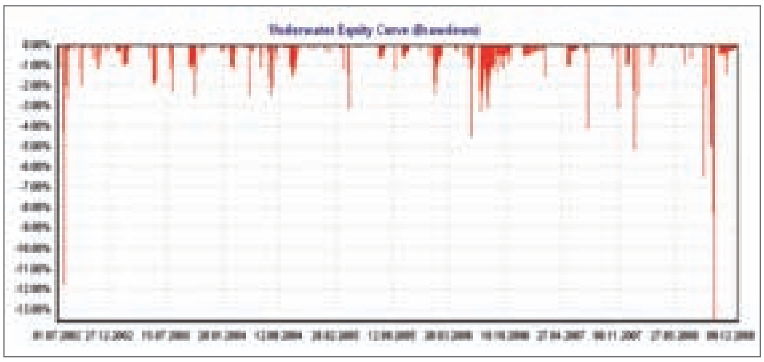
F2) Portfolio Development (Long Only)



You can see the overall performance of a $100,000 portfolio, calculated for the buy side only, using a ten percent stop loss, a fixed profit target of six per cent, and – if this is not reached – an exit at the next day's opening of the market if the closing price is higher than the previous day's close. The performance summary can be found in Table 1, right-hand column.

Source: www.ealth-lab.com

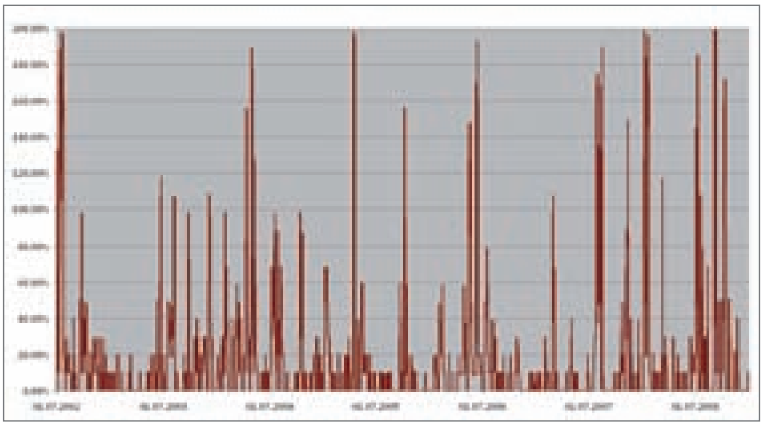
F3) Drawdown Chart on Portfolio Development (Long only)



The chart shows the drawdowns of the Figure 2 portfolio development calculated on a daily basis and indicated in percentage terms. The maximum drawdown of just under 14 per cent was suffered in October 2008.

Source: www.ealth-lab.com

F4) Investment Degree of Long-Only Variant



This represents the cash quota capacity over the period of 1st July 2002 to 31st December 2008. Each position is based on a 9.8 per cent weighting so that a maximum of 20 positions can be included in the marginable portfolio, which equals an investment degree of 200 per cent.

Source: www.ealth-lab.com

Discretionary Components

In the first part of this series of articles (TRADERS' 01/2010), the term "discretionary" was described as follows: "A trader acts in a discretionary manner if he uses his own judgment and feels compelled by a special situation to intervene in the clearly defined operations of a trading system. The discretionary part is understood to be that part of a trading system that cannot be backtested." This means that the remarks made and setups given on the subject of shorts in the previous part already fall in the "discretionary components" category. Obviously, there are additional items that the swing trader can and should include in his decision-making process in a discretionary manner. One of these then will be singled out at this point.

Portfolio Architecture

The most important discretionary components are the composition of the portfolio and the determination of the position size. Stocks regularly move in groups. This group or industry-specific behaviour may result in a large number of signals being triggered by stocks of a single group on certain days. In such a case an upper limit is needed which determines the maximum weighting of an industry. I work with industry weightings of 35 per cent of the portfolio volume at the most.

In addition, position weighting should also play a part. The simulation runs assumed a static position size of 9.8 per cent with a stop loss of ten per cent. This method produced very good results even in the second half of 2008. However, this raises the question what the results would have been if a more flexible position weighting had been chosen, which is made dependent, for example, on the volatility of the overall stock market (i.e. here the Russell 1000 Index). Table 1 as well as Figures 2 and 4 show the degree of investment for the long only setup.

What is striking is that time and again there are longer periods with investment degrees below 20 per cent. These periods always coincided with market phases of low volatility (not shown in the figure).

Measuring the volatility of the index could therefore be used, for example, to increase the position size in low-volatility periods, and to lower it in high-volatility market phases, as they occurred in the second half of 2008. Accordingly, the buy limits could also be adjusted for more signals to be received in low-volatility periods and thus for the degree of investment to be increased intelligently, as it were. Whichever way traders proceed in this field, closer examinations of such approaches should turn out to be well worth conducting.

Conclusion

There is a plethora of items that will lead to the indicated simulation results deviating from those actually achieved in practice. Besides the "certain divergences" mentioned above, these include discretionary components such as the portfolio architecture which loom large when it comes to any practical implementation. Now should this strategy be completely forgone due to the discrepancies between theory and practice that can be expected?

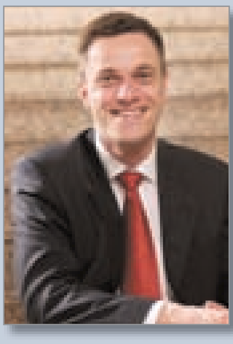
In my opinion, the answer is an unequivocal "no" since the divergences to be expected will probably not be dramatic enough for the criteria derived for entry and exit not to offer any benefits any more – at least not if only the long side is accessed.

For the short side, which – with the exception of the special situation shown in Figure 1 – incidentally worked very profitably up until 23 January 2009 and generated more than 40 signals in January 2009 alone, any implementation first requires further steps or a switch to other setups. These are presented in this article and are being used by me in just such a manner.

Final Remark

This seventh part concludes the series of articles on the development of swing-trading strategies with a discretionary component.

I trust that my articles which were designed to explain the procedure used when developing short-term strategies and provide ideas for the readers' own further studies, have achieved their objective and I welcome any feedback and constructive criticism. ■



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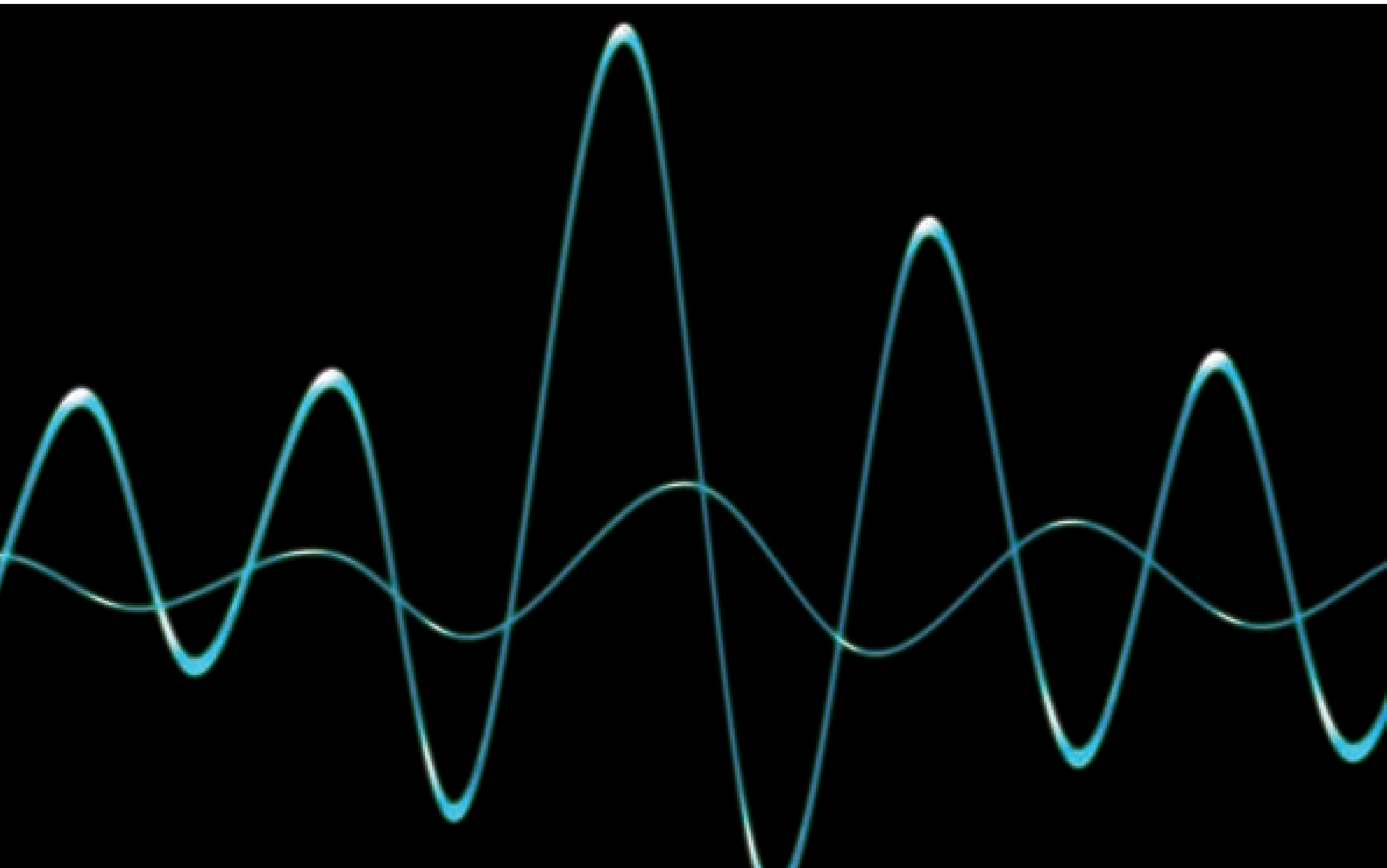
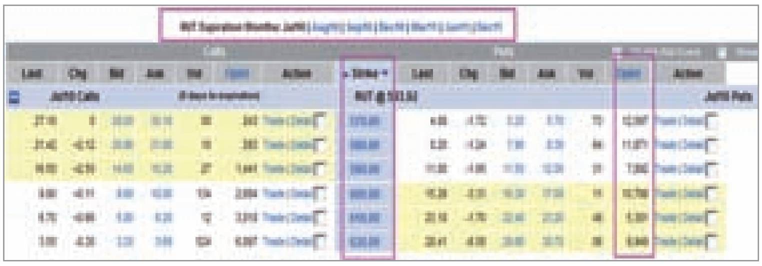


Playing Volatility on the Russell 2000 Index

Market Neutral Options Strategies

This article will discuss the advantages of using the Russell 2000 index (RUT) underlying for options market neutral strategies and how to use price and implied volatility action to define higher probability trades. Via some trade examples, the reader will discover the basics of working with three popular options strategies that benefit from market neutrality; i.e. sideways price moves and time decay.

F1) Strike Prices and Expiration Calendar



RUT is a very flexible and liquid options instrument for traders. RUT options chains are listed with $10 strike intervals. The index offers a large possibility of month expiration contracts to traders, from July 2010 to December 2011, as shown at the top of this table.

Source: www.optionsxpress.com

Russell 2000 (RUT) Overview

What does an options trader need to know before using this underlying? The Russell 2000 is designed to measure the performance of the bottom 2000 companies' universe of the 3000 largest stocks in the U.S. market index also known as the "small-cap index"; i.e. companies having a market capitalization below $3 billion. The index itself is considered to be the benchmark for all small cap mutual funds.

Exercise Style and Settlement

"European style", RUT options generally can only be exercised on the last business day before expiration and they are "cash settled"; i.e. all options positions going through expiration in-the-money are settled in cash and are not exercised to the owner. Besides, RUT settle value is based on the "RUT Flex Opening Exercise Settlement" index – the RSL – which is announced at the end of the Friday's trading session by the CBOE (Chicago Board of Options Trading). Its value can be found at www.cboe.com or at all options brokers on Friday at the close or Saturday morning. Usually the RSL may be slightly higher or lower than the proprietary RUT index value on the last Friday.

Options Trading with RUT and Market Neutral Strategies

The RUT options are largely applied to more conservative trading strategies by investors seeking regular income results. These strategies involve the combination of short and long, call and put options to reach a certain level of neutrality regardless of the price direction, i.e. they are expected to bring profits if the underlying price (RUT in this case) moves sideways or inside a certain price range during the lifetime of the trade).

These strategies have become very popular among retail traders because they allow passive income generation regardless of the market direction and by the same token avoiding overtrading every time the market changes its trend direction; which means lower expenses in broker commissions.

These strategies take advantage of the "time decay" of options prices by reducing them as long as time goes by. Trade management is also critical in producing expected profits.

Implied Volatility and Price Behavior: Two Key Building Blocks for Options Trading Decisions

In order to define the most appropriate choice of the options market neutral strategy to apply in conjunction with RUT, two aspects become the most relevant in this decision making process: its implied volatility situation compared to the historical data and its recent price patterns.

Due to the higher level of RUT's volatility compared to the overall market benchmark S&P 500, this has an impact on its options contract premimums; meaning, higher than S&P 500 options. For this reason, it is key to monitor the RUT implied volatility index (RVX) to define the most appropriate options strategy to be applied. In Figure 2, we can see the fluctuations of RVX (blue line) compared to the RUT index prices (black line). Like the VIX (volatility index of the S&P 500), the RVX moves in the opposite direction of RUT prices; and the spikes of RVX correspond with the important and rapid drops of the RUT index prices. Many options traders use the extreme readings of RVX, at historical higher or lower levels in trying to detect options trading opportunities, by selling expensive options or by buying cheaper ones.

A higher level of RVX indicates uncertainty and fear in the market, bringing unpredictable and turbulent RUT price movements which cause the options premiums in RUT to increase significantly. A lower level of RVX indicates investor complacency associated with orderly upward price movements, and by consequence, lower options premiums. These two opposite situations for RVX levels have

F2) Fluctuations of RVX Compared to the RUT Index Prices

This chart shows the weekly variation on RUT prices and its volatility index (RVX) from March 2007 to June 2010. On note that the sudden drop on RUT value from $750 to $400 level in October 2008 made the RVX rises from 25 to above 80 extreme levels. Note that RVX values fluctuated within ranges of approximately 20 to 35 during long period of time in 2007, 2008 and from April 2009 to April 2010.

Source: Thinkorswim

implications for different profitable trading opportunities which influence the choice of options strategies.

In addition to the importance of volatility on options premium definition, many traders look at the technical analysis of price patterns. A trader looking for market neutrality must look for the zones of price support and resistance.

From Figure 3, we can see that RUT has had periods of range bound price moves illustrated by the orange boxes, found commonly in recent periods since 2005.

Selecting the Options Trading Strategy in a Neutral Market Condition

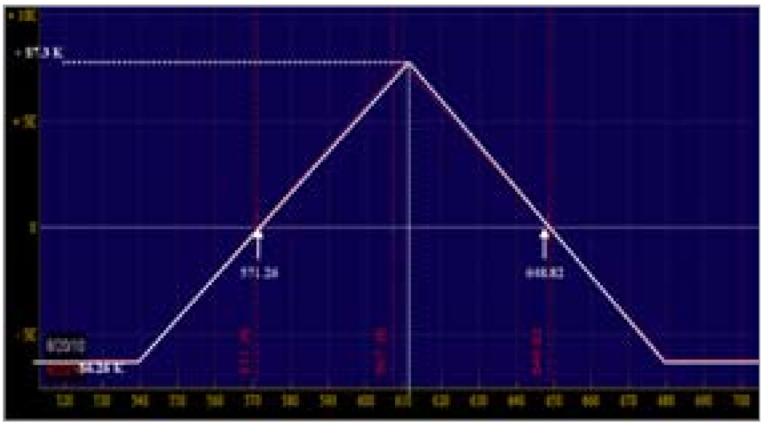
Using the combination of implied volatility (RVX) levels seen in Figure 2 and the price patterns from Figure 3 allows traders to identify future trading opportunities using options

F3) RUT Long-Term Chart

Figure 3 shows RUT weekly candlestick chart prices from 2005 up to June 2010.

Source: Thinkorswim

F4) Butterfly



This is the P&L chart of this trade: on X axis the RUT prices and in the Y axis the gains and losses in $. Maximum gain is equal to $7300 if RUT expires at 610 on August 20th 2010. Breakeven points are at 571.26 and 648.82 (at expiration). Maximum risk is $6260 (total cost of this position) – if RUT is above 680 or below 590 at expiration.

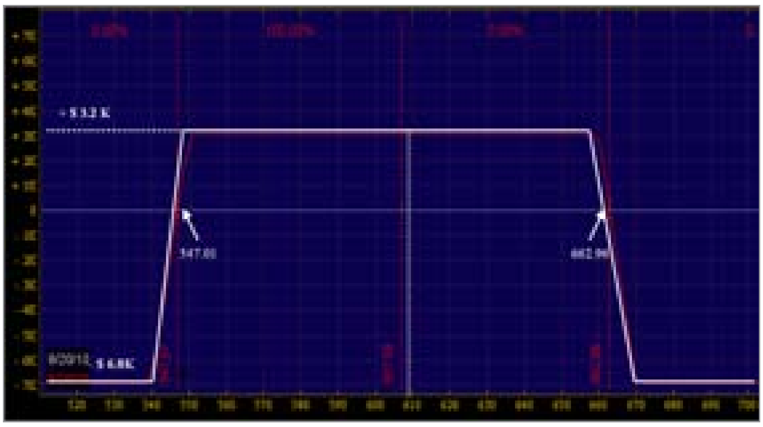
Source: Thinkorswim

strategies on RUT. Looking at Figure 2, when RVX stays in a range of 20 to 35, it usually indicates certain price stability for RUT, i.e. at these levels the price fluctuations remain inside the orange boxes highlighted in the Figure 3.

Depending on the RVX expectation – its increase or decrease on the following weeks – the trader can choose the most appropriate options neutral strategy that benefits from this change in RVX, and by consequence the strategy that provides the best probability of profits under this price and implied volatility expected scenario.

To illustrate this idea, we will assume that RUT is expected to trade within a range for the following weeks of August 2010 back inside the last orange box displayed in Figure 3 (extremes at 550 and 650). Three options neutral strategies examples will be implemented on 20 July 2010 when RUT price was fluctuating around 605, using approximately the same level of capital allocation (or risk level by trade).

F5) Iron Condor



Here you can see the P&L chart of this trade. Maximum gain is equal to $3200 if RUT expires at 610 on August 20th 2010. Breakeven points are at 546.01 and 662.96 (at expiration). Maximum risk is $6800 (total cost of this position) – if RUT is above 670 or below 540 at expiration.

Source: Thinkorswim

Scenario 1 – Implied Volatility (RVX) Expected to Decrease and RUT Prices Trend Sideways

RVX is at 37 points at this point in time which could be considered by many traders as a good opportunity to sell volatility (shorting vega positions).

High levels of implied volatility make options premiums (or prices) more expensive compared to their historical prices; a trader could assume this volatility reflects uncertainty that the market has reached an extreme and should reverse to its more recent mean.

Let's now investigate via two examples illustrating similar strategies that take advantage of time decay and decreasing volatility. A trader may prefer a Butterfly strategy if she thinks the underlying (RUT in our example) will stay in a narrower price range during the trade holding time; or, if the expectation is a price fluctuation inside a wider range, an Iron Condor. Please find the Options Glossary at the end of the article for detailed definitions of the technical terms.

Butterfly (Figure 4)

RUT is trading at 607.30. This trade example uses August 2010 expiration call options contracts: purchase of two ITM (in-the-money), sale of four ATM (at-the-money) and purchase of two OTM (out-of-the-money).

2 long contracts 540 Call strike
4 short contracts 610 Call strike
2 long contracts 680 Call strike

Debit of $31.30 per contract for a total cost of $6260
[= $31.30 x 2 contracts x 100]

Iron Condor (Figure 5)

RUT trading at 607.09. This example uses August 2010 expiration options.

10 long contracts 540 Put strike
10 short contracts 550 Put strike
10 short contracts 660 Call strike
10 long contracts 670 Call strike

Credit of $ 3.20 per contract for a total credit of $3200
[= $3.20 x 10 contracts x 100]

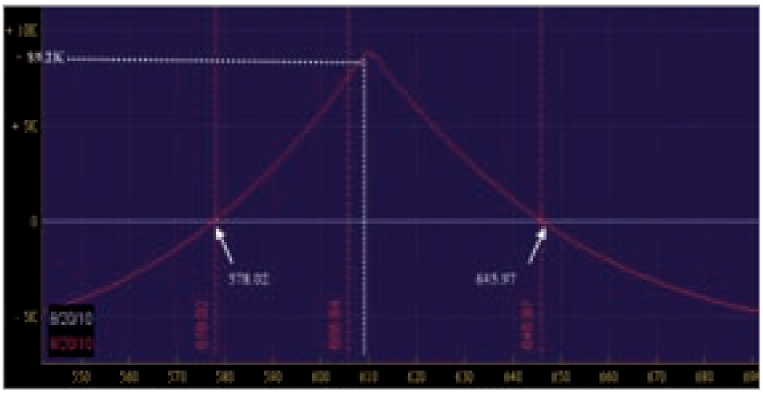
Maximum risk = capital allocation = $6800
[= # Contracts x 100 x difference of strike (Short - Long)]
- total credit = [10 x 100 x $10] - $3200

Comparing the Pofit&Loss chart of both strategies, it turns out that the wider breakeven points of the Iron Condor on RUT (547.07 and 662.96) would imply lower risk versus the Butterfly, in which the breakeven points are at 571.26 and 648.82. This means that the Iron Condor's risk is lower due to a larger range of price fluctuation in its profitable zone, but on the other hand this reduces the maximum gain to a limit of $3200 versus $7300 for the Butterfly. In short, the Iron Condor presents a lower risk/lower reward than the Butterfly strategy.

Scenario 2 – Implied Volatility (RVX) Expected to Increase and RUT Prices Trend Sideways

If the market expectation for the RUT implied volatility (RVX) is an increase from the present levels, traders may consider an options strategy such as a "calendar spread". Calendar spreads take advantage of the increase of volatility which causes options premiums to rise and hence, the gains as well. In addition, the time decay of options will favour sideways price movement of RUT within a certain range; for the example below, the 578 to 646 price range.

F6) Calendar Spread



Here is the P&L chart of this trade. Maximum gain is equal to $9200 if RUT expires at 610 on August 20th 2010. Breakeven points are at 578.02 and 645.97 (at expiration). Maximum risk is $6260 (total cost of this position)

Source: Thinkorswim

Calendar Spread (Figure 6)

RUT trading at 605.84.

7 short conctracts (August expiration)
7 long contracts (September expriation)

Debit spread with a cost of $9.00 per contract or a total cost of $ 6,300 [= $9.00 x 7 x 100]

The increase of RUT's implied volatility would expand the profit side of the P&L of this trade represented by the red "tent shaped" line; resulting in larger distance to the breakeven points. In short, these price extremes would move lower than 578 and higher than 646 by the implied volatility effect, which would provide wider leeway for the RUT prices to move until expiration (in August in this example) to make this trade profitable. Similarly to the butterfly strategy, this calendar spread will reach a maximum gain if RUT finishes at 610 on August expiration – or $9200 profits at this level of RVX. However, calendar spreads – in contrast to Butterflies and Iron Condors – can have a variable return depending on the final implied volatility of its underlying; for a fixed debit (or risk) when the trade was initiated ($6300 in this example).

A Final Word about RUT and Market Neutral Strategies

In summary, this article illustrated a few ideas with which a trader can explore the usage of RUT in conjunction with options market neutral strategies, analyzing the major role played by its implied volatility associated with the price range expectation over the expected profit and loss results.The RUT index, like a few other market indexes, provide options traders a good possibility to combine the frontiers of price – determined by the support and resistance price levels – with the breakeven points resulting from the options neutral strategy selected. This association can be seen as a real edge by many traders as it allows them to monitor the trade via the price action of RUT within specific limits. The breaking of these psychological price levels becomes useful information in making necessary trading decisions to limit the amount of losses. These price breaks may indicate a new change in market sentiment and a possible surge of a new price trend, therefore making a non-directional options strategy possibly not the best alternative to play under this new scenario. As with any other type of trading system, one requires a trading plan where the exit points for profits and losses are prepared in advance; and respected. "Planning the trade and trading the plan" is largely recognized by all successful traders as the most important aspect to succeed in trading. And it is never enough to repeat it again and again.

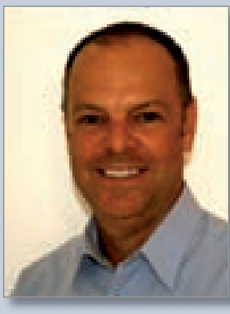
Options Glossary

(ATM) at-the-money: an option contract that has an exercise (strike) price that is equal to the current market price of the underlying security.

(ITM) in-the-money: an option with intrinsic value. For a call option, it is when the strike price is below the underlying current market price. For a put option, it is when the strike price is above.

(OTM) out-of-the-money: an option contract with no intrinsic value. For a call option, it is when the strike price is higher than the underlying security's current market price. For a put option, it is when the strike price is above.

Vega: the sensitivity of an option's theoretical value to a change in implied volatility. This means, the gain or loss of options from a one percent rise or fall in implied volatility.



Fabio DeCastro

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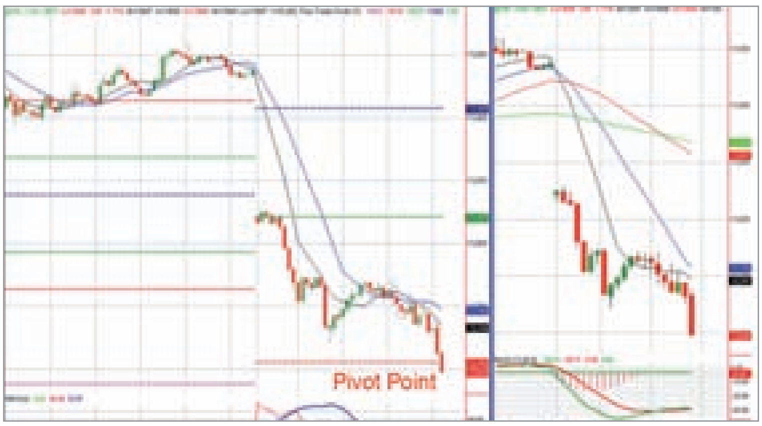
Multiple Signal Confirmation Is Key

Technical Analysis vs. Trading Strategy

What is the difference between technical analysis and a technical trading strategy? Many people do not recognise the difference. More than likely they are among the many technical traders out there struggling to find the right technical indicator that will work for them. They should stop looking as it does not exist. No one piece of Technical Analysis will be enough for a trader to achieve consistency through trading. Consistent profitability comes from consistent application of a trading strategy.

F1) Setup



1-Minute chart live entry with price touching daily pivot point (above center) plus bullish divergence on three indicators across two timeframes (below).

Source: www.tradestation.com

What is Technical Analysis?

Technical Analysis (TA) is the study of price action to forecast the probability of future price movements. When a certain TA tool triggers, there is more chance of the market going one way than the other. TA is grouped into many patterns and indicators with many names. Common chart patterns include double tops, double bottoms, triangles (both ascending and symmetrical), flags, channels and of course the infamous head & shoulders. Popular indicators among the hundreds of possibilities are the Moving Average Convergence Divergence (MACD), Stochastic, Relative Strength Index (RSI), volume, pivot points, Fibonacci & moving averages. The Japanese have given us names for many candle patterns consisting of hammers, shooting stars, doji’s and a hanging man – to name only a few. All of the above are considered forms of technical analysis.

The fact is that all of these names are completely irrelevant and unimportant. Taking a common form of technical analysis and applying a new name to it helps authors to sell many new books each year. Knowing the names of these patterns unfortunately does not help traders make money. Profitability requires more than a name, it requires an understanding of the technicals and then the skill and discipline to follow a proven & tested trading strategy through both good times and bad.

What Is Good about TA?

Each technical aspect, when used and understood correctly, puts the odds in your favour that price is more likely to move in the indicated direction, than the other. You have more chance of being right than wrong on a trade. This is assuming your use of the tool at hand and your entry point are close to perfect.

What Is Wrong with TA?

On its own, each TA tool puts the odds slightly in your favour and some TA is more powerful than others. Herein lies the problem. The odds of being correct are just slightly in your favour. 'Slightly' is not good enough. Not to mention that with a bad entry or a little bad money management, regardless of what the TA is telling you, your odds of winning have just completely reversed.

Many new traders begin by learning a variety of TA tools. This usually comes from a seminar, a book or a website. Excited, the trader thinks he understands head and shoulders patterns and has just unlocked the secret to infinite wealth. He starts trading the patterns but finds them a lot harder to interpret in real time then in hindsight. Where exactly should he enter & exit? Having lost money on these patterns he hears of another trader making money using the MACD indicator.

With renewed excitement he studies the MACD and starts trading but still loses. The frustration is now building and confidence is low. A trader he met recently said he was making money trading gold. Perhaps that is the secret… so he switches from trading stocks to trading gold yet still loses. A lady he met was using expensive charting software while he is still using free stuff. He purchases the fancy software, is more money down for doing so and still consistently losing in his trading. What could possibly be wrong? Perhaps the timeframe… he has heard that short-term traders make less than long-term traders, so he switches from one-hour charts to daily charts. Now the losses are larger and more drawn out over days and weeks. He understands the technicals but they are quite simply not working out.

This is a common problem and many traders could recognise themselves or others who have experienced a very similar situation. The solution lies not just in understanding these technicals, but by formulating TA into a precise trading strategy.

Technical Analysis vs. Trading Strategy

Think of technical analysis as ingredients. Trading strategy is the recipe. If you want to bake a chocolate cake and have sugar, flour, chocolate and milk but with no recipe, the ingredients will be virtually useless to you. The recipe is what enables you to get the end result, the chocolate cake. Similarly, each technical tool can have many uses, as does a

F2) Winning Trade

Winning Precision Scalp trade on Mini Dow. The established uptrend continued.

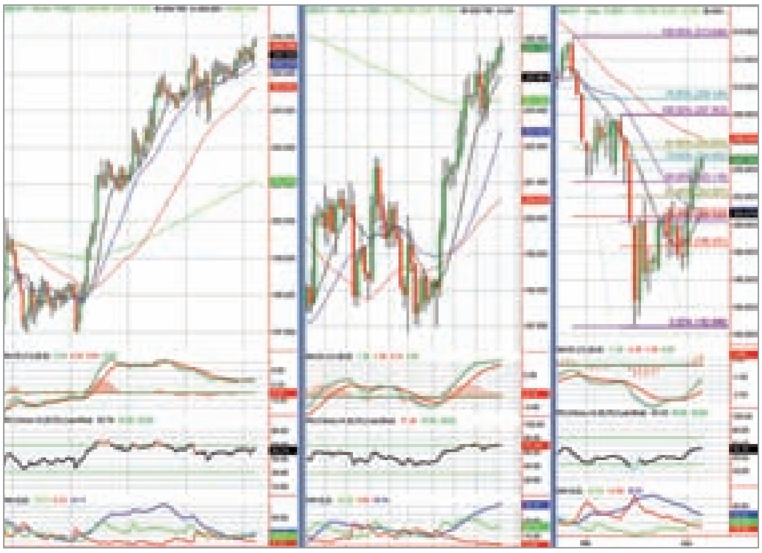
Source: www.tradestation.com

F3) GBP/JPY 15-Minute Chart

Beautiful cluster: MACD and RSI show bearish divergences and the price touches the pivot point .

Source: www.tradestation.com

F4) Cluster Constellation



The GBP/JPY 60-Minute chart (to the left) shows significant bearish divergence on MACD and RSI. Daily chart (to the rigth) pulled back into a cluster of Fibonacci levels.

Source: www.tradestation.com

cup of flour. It is just virtually useless on its own. Many traders are using each TA tool in isolation and moving from tool to tool trying to find the one that works. That is the equivalent of trying to bake a cake with a cup of sugar and when that does not work trying to bake it with a cup of flour. Just like a cook needs a recipe to achieve an end result, a trader needs a trading strategy. In this case the end result is a trade that has a higher probability of working out than not.

Technical Trading Strategy for Forex & Indices

Certain technical indicators are more powerful than others.

F5) Precision Scalp Winner (Continued from Figure 3)

Precision Scalp winner on GBP/JPY. The chart went down and the trading position became a winner.

Source: www.tradestation.com

For example, the MACD cross over buy/sell signal or entering a trade when one moving average crosses through another are two of the worst possible reasons for entering a trade. Unfortunately, they are also two of the most common entries that struggling traders look for.

One reason they are ineffective is that they are lagging indicators – that is, they only highlight ideal entry points in hindsight once the price has already moved. It is essential to use leading indicators. Two of the most powerful leading indicators at a trader's disposal are divergence and pivot points.

Technicals (Ingredients) for the 'Precision Scalp' Trade

To execute the Precision Scalp correctly you must use:

1. Divergence (between the price and indicators).
2. Pivot Points.

Information on these technical tools is widely available and the intention of this article is to teach you a trading strategy, not to regurgitate the same technicals taught by many. It is easy to get familiar with the technicals. However, these two reasons occurring in unison formulate the Precision Scalp strategy, which is enough reason for us to place the trade. For those with a full understanding of the technicals, you may also notice many reasons to think that this trade has more chance of rising from here than falling further, other than the two essentials listed above:

1. Price touching daily Support 2 (S2) pivot.
2. Bullish divergence on 1-minute RSI.
3. Bullish divergence on 2-minute RSI.
4. Bullish divergence on 2-minute MACD.
5. Tick at extreme oversold levels.
6. An unclosed gap on the chart which has a high chance of closing, the trade is in the direction of this gap.

Figure 2 shows the result achieved when the long trade was executed – a good winner with still a lot of potential to move higher and scale out of the position if the gap finally closes.

Precision Scalp Trade on Spot GBP/JPY

Figure 3 shows a 15-minute currency chart for Sterling vs. the Japanese Yen. Note that again price is touching a pivot point and as price breaks up to new highs, both the MACD and RSI fail to do so resulting in bearish divergence. The criteria to place a Precision Scalp short trade right now are met. Between the four timeframes there are multiple reasons to say that the price is about to fall.

1. Bearish divergence on 15-minute RSI.
2. Bearish divergence on 15-minute MACD.
3. Bearish candle pattern formed on 15-minute chart.
4. Bearish divergence is even more apparent on the one-hour chart, again on both the MACD and RSI (Figure 4).

5. Fibonacci – in addition to all of this, a huge bonus is that the daily chart has rallied into a cluster of Fibonacci levels (chart on the right in Figure 4). This is a sell area and the lower timeframe is simply providing the ideal entry point.

There are multiple reasons to short GBP/JPY in Figure 4 right now for a high probability trade. You will never know whether any particular trade will be a winner or a loser. Rather, you will understand that a trade has more chance of working out than not and when executed correctly, a good trading strategy will make you more over the long run than you lose. This particular trade has some support at 204.40 which becomes an ideal target. Finanlly, Figure 5 shows the price having reached this target for a profitable trade.

The Possibilities are Endless

There are thousands of possible combinations of how the charts may set up to give you a high probability entry point. The best trading strategies that you could ever create surrounding these possibilities are ones that you create yourself. Aim to understand the markets, the technical aspects and the likely direction. Forget trying to memorise the names of hundreds of chart and candle patterns, it is completely unnecessary. Once you have found the technicals that you like and understand the most, you should look for combinations of these tools all setting up at the same time – i.e. you have many reasons at a precise moment in time to believe that a price chart is more likely to move one way than another.

This is a trading strategy and is essential to set you on the path to trading success. Thereafter, you have to develop the trader mindset and the skills and discipline to stick to your strategies through all the ups and downs that the market will throw at you. No one said trading was going to be easy but the good news is that it is very possible for those with drive and patience. Get rich slowly!

Nick McDonald
website: www.tradewithprecision.com

Enhancing Performance by Variable Positions

Testing Pyramiding

The Pyramiding of positions is a frequently used trading instrument: A cautious entry to start with – and additional purchases in the event of profits. Or the other way round: a step-by-step reduction of profitable positions in a portfolio. However, to date its concrete impact on the performance of strategies has hardly been analysed.

Here we mean by "Pyramiding" what the term usually suggests, i.e. the successive increase or reduction of a position. Whether Pyramiding is part of Money Management, Risk Management or even Entry/Exit strategies remains a theoretical question which won't be discussed in this article. Rather, we will analyse and backtest practical examples to see what returns different concrete Pyramiding strategies would have achieved.

In this context the question arises as to how Pyramiding could be rated. An evaluation purely based on the profits achieved is, of course, not sufficient, as higher or lower capital investments generally come along with Pyramiding. Hence, for the purpose of standardisation we will mainly make use of the risk on capital, measured as the maximum drawdown of the equity curve.

The problem of increasing a winning position for instance, despite the corresponding drawdown reduction, is that the position is becoming more expensive – thus the strategy is less profitable than a strategy which enters a trade with a full position size. The opposite strategy, i.e. the averaging down of a losing position, may indeed increase the return, but it also increases the risk to an even higher extent. So the goal of a-well balanced Pyramiding strategy has to be to improve the profit/drawdown ratio.

Traders who have already worked with Pyramiding have certainly noticed that increasing or reducing positions does not always make sense nor is it equally successful with all trading approaches. Therefore, in the following sections we will present indicators which show whether or not the step-by-step increasing or reduction of positions may bring any benefits. Let's consider some classic entry strategies as basic systems test if and how they can be improved with the help of Pyramiding.

F1) Bund Future Countertrend Pyramid

The screenshot shows how a long position, that despite falling prices, ends in a profit, because the position has been averaged down. The horizontal lines show the stop limits of two, three and four percent, at which an additional contract was successively purchased.

Source: www.investox.de

System I: Bund RSI Countertrend

We start with the test of a classic and thus very simple countertrend strategy with the German Bund Future on the basis of end-of-day data.

Basic System:

- Enter Long when the 5-period RSI < 20.
- Enter Short when the 5-period RSI > 80.

The entry occurs at the opening of the next day and €24 slippage and commission are factored into the calculation. With a fixed contract per position the backtest results are as follows:

System Start:	13 December 1996
System End:	25 July 2008
Total Number of Trades:	58
Net Profit:	€-8012
Maximum Drawdown:	€-24,828
Profitable Trades:	56.90%
Average Trade Entry Efficiency:	41.13%
Average Trade Exit Efficiency:	71.49%

The results are typical for countertrend systems: despite a profitability of more than 50 percent, the strategy generates losses. The high exit efficiency of the trades is nevertheless remarkable. Entry and Exit efficiencies indicate how favourable the entry or the exit of the trade was.

The entry efficiency shows a rate of between zero and 100 percent, indicating how close the entry was to the low (or for short trades to the high) of the trade in comparison with the total price range of the trade. The exit efficiency indicates how close the exit was to the high (or for short trades to the low) of the trade in comparison with the total price range of the trade.

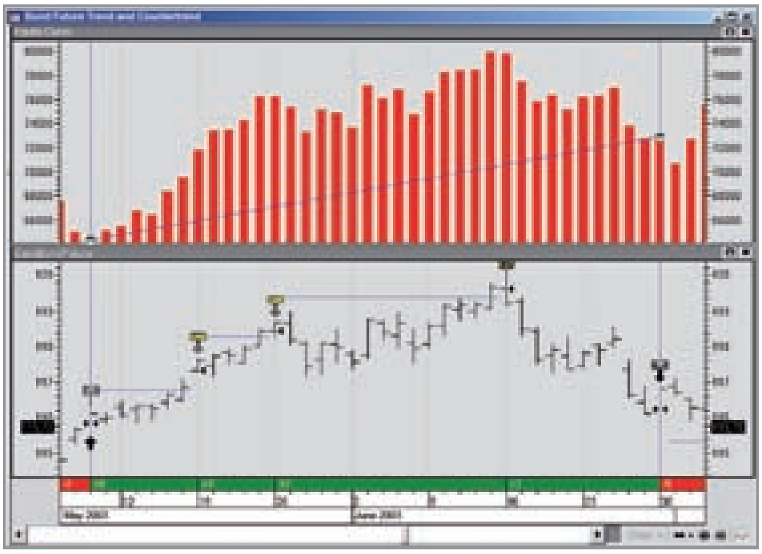
When, on the one hand, the entry efficiency is quite low and, on the other hand, the exit efficiency is quite high, it means that the entry of the trade was not optimal but also that the trade improved before the exit. This can be an indication that averaging down the position can be advantageous, as quite often a position which did not start so well finally improves. We will test this aspect with the following Pyramiding strategy:

- Buy successively one contract after a two, three and four percent loss.

The position is thus being increased up to a maximum of four contracts when the position's drawdown continually increases. The other parameters remaining unchanged, the results are as follows:

System Start:	13 December 1996
System End:	25 July 2008
Total Number of Trades:	58
Net Profit:	€55,080
Maximum Drawdown:	€-25,530
Profitable Trades:	75.86%

F2) Bund Future: Reduction of the Position Size in a Trend



Through reduction of the position size, the long position remains profitable despite falling prices.

Source: www.investox.com

With a slightly larger maximum drawdown, the same strategy consisting of averaging down losing positions generates considerable profits with profitability increasing as well. All entries, exits and additional purchases were calculated with end-of-day data, i.e. on the basis of closing prices with order execution at the opening of the next day.

System II: Bund RSI Trend

Let us consider a simple trend following system which is innately associated with a positive return assumption:

Basic System:

- Enter Long when the 14-period RSI > 60.
- Enter Short when the 14-period RSI < 40.

F3) FDAX Equity Curve Comparison

Here you can see the equity curve of the FDAX intraday basic system (upper blue line) compared to the equity curve of the Pyramiding strategy (upper red line).

Source: www.investox.com

F4) Trade Example FDAX

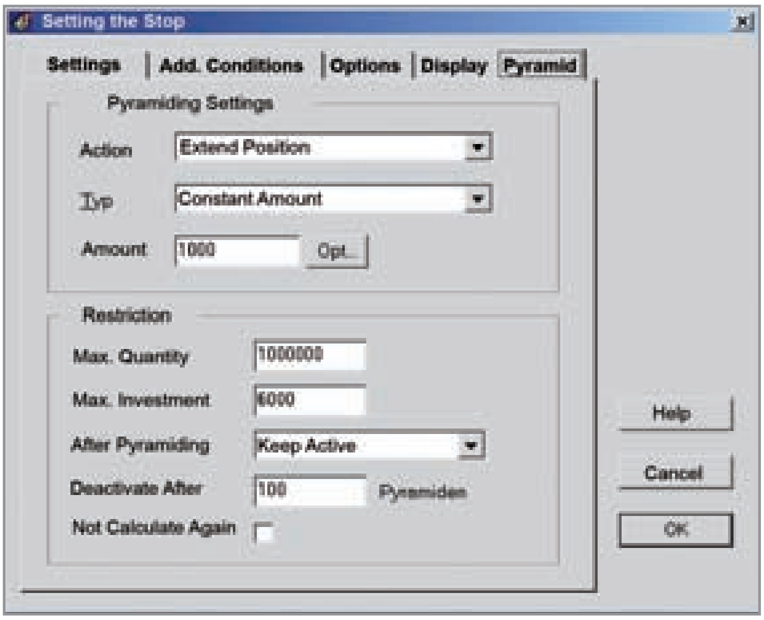
This figure shows live position management through Pyramiding over several trading days using the FDAX.

Source: www.investox.com

Here, too, we enter the trade at the next open, but we now trade five contracts from the beginning. The results are:

System Start:	13 December 1996
System End:	25 July 2008
Total Number of Trades:	65
Net Profit:	€60,100
Maximum drawdown:	€-48,330
Profitable trades:	43.08%
Average Trade Entry Efficiency:	61.10%
Average Trade Exit Efficiency:	25.53%

F5) Pyramid Setup



Pyramiding can be set up via stops with the help of Investox. Above: Pyramiding with a two percent profit target.

Source: www.investox.com

As expected, profitability is lower and drawdown higher than for the countertrend strategy. It is, however, remarkable that entry efficiency is better than exit efficiency. The entry into the trades is quite favourable, but the exit often is not. This may suggest that in comparison with the countertrend system, a reduction of the position could make sense. We will test this idea with the following Pyramiding:

- Sell one contract for every 0.8 percent profit, up to four partial sells, the last contract being held until a reversal of the position.

The key figures compared to the ones of the basic system are the following:

Net Profit:	€105,650
Maximum Drawdown:	€-30,546
Profitable Trades:	61.54%

With a halved maximum drawdown, the strategy with the partial sells of a winning position yields a profit that is nearly twice as high.

System III: FDAX Intraday Position Trading

The previous examples have clearly shown that it depends on the type of strategy whether a Pyramiding makes sense or not. Now we are going to present further examples of the application of pyramids.

Our basic system for the German DAX-Future (FDAX) adopts the well-known approach of daily long or short positioning, with a very simple setup (on the basis of 10-minute-bar data):

- Go long at 9:30 when the prices were in an uptrend over the last ten periods.
- Go short at 9:30 when the prices were in a downtrend over the last ten periods.

In order to protect the position, we place a 0.25 percent stop-loss, which is being tightened to 0.1 percent after one period (ten minutes). We open only one position per day and the position is being closed at the market close (no overnight positions). Due to the rather tight stops the strategy generates many losing trades. However, the overall return assumption is positive. Test result (one fixed contract, €29 costs per trade taken into account):

System Start:	02 January 1997
System End:	20 March 2008
Total Number of Trades:	2841
Periods with Trades:	28.0%
Net Profit:	€ 69,648
Maximum Drawdown:	€-34,045
Sum of all costs:	€ 82,389
Profitable Trades:	18.44%
Largest Winning Trade:	€ 8646
Largest Losing Trade:	€-1904

Test Result with Pyramiding:
As expected, the backtest (over more than eleven years of intraday data) shows a very low profitability with a slightly positive return assumption. To improve the result, we employ a Pyramiding strategy as follows:

- Buy a new contract for every 0.25 percent gain, up to a maximum of three contracts.
- As soon as an additional buy has been done: place a 0.7 percent trailing stop. Each time that level is reached, one contract is being sold.

Thus, the Pyramiding strategy combines additional buys with partial sells. The key figures of this backtest compared to the ones of the basic system are the following:

Net Profit:	€ 341,441
Maximum Drawdown:	€-38,254
Sum of all costs:	€ 131,921
Largest Winning Trade:	€ 22,834
Largest Realised Losing Trade:	€-7849

While the maximum drawdown remains nearly unchanged, the Pyramiding strategy delivers a roughly quintuple return. The high volatility of the equity must, however, be noted and is recognisable by the largest winning and losing trades. In this case the Pyramiding supports the trend following nature of the strategy: the position is either quickly stopped out or it more or less keeps pace with the trend. Profit can accordingly be increased through additional buys. On the basis of several tests it was quite clear that the increase of a position had to be effected relatively quickly

F6) Pyramid Portfolio for System IV

For every two percent gain, €1000 are added to the position. On the left-hand side the current signals of the stocks can be seen, at that very time they are all "Out".

Source: www.investox.com

F7) Portfolio Pyramid Compared to the DAX

Equity curve of the pyramiding momentum strategy with a DAX portfolio (green line) compared to the DAX as benchmark (blue line).

Source: www.investox.com

(the maximum position size was already achieved after a 0.5 percent profit in the example shown) before a stronger trend fully developed and its momentum already started to weaken.

System IV: DAX Portfolio

The examples of Pyramiding presented have so far shown the trading of individual contracts and drawdowns that can only be sustained in practice by large accounts. Can a Pyramiding strategy also have a positive effect on a stock portfolio? This is what we wanted to analyse in our last example. The basic system relies on a simple momentum strategy, consisting of the investment in five DAX stocks provided the index is in an uptrend:

- Redefine the positions at every new quarter.
- Buy only when the 10-day Simple Moving Average (SMA) of the DAX is above its 200-day SMA.
- Determine the ranking of the momentum of all the stock of the index, the momentum being defined as the 100-day momentum, smoothed over five days.
- Then invest then €3000 each in every five stocks ranked between position five and nine.
- Sell the stock (at every new quarter) when its rank is not between position five and nine any more, or any time at a 25 percent loss.

All the calculations were made with end-of-day data with an order execution at the opening of the next day. The results of the tests for the portfolio are as follows (0.7 percent costs per trade taken into account):

System Start:	17 July 1995
System End:	25 July 2008
Total Number of Trades:	131
Profitable Trades:	61.83%
Net Profit:	€ 29,538
Periods with Trades:	13.0%
Maximum Drawdown:	€-4633
Profit Factor:	2.73
Average Return:	€ 225
Largest Winning Trade:	€ 2714
Largest Losing Trade:	€-1041

Results Achieved with Pyramiding

The Pyramiding of the positions will be as follows: we start with investing only €1000 per stock (compared to €3000 in the basic system). For every two percent gain we add €1000 to the position, up to a maximum position size of €6000 (see Figure 5 for the setup). The key figures of this backtest compared to the ones of the basic system are the following:

Profitable Trades:	55.73%
Net Profit:	€ 41,649
Maximum Drawdown:	€-3911
Profit Factor:	3.59
Average Return:	€318
Largest Winning Trade:	€ 4579
Largest Losing Trade:	€-1279

Through the cautious entry and successive purchases there was a roughly 35 percent increase in the rate of return at a near-equal risk.

Conclusion

The examples have clearly shown that working with Pyramiding often produces good results – but also that it depends on the type of strategy whether or not it makes sense. The most important aspects in this context are to:

- Consider increasing or reducing positions, or a combination of both.
- Consider making positions cheaper or more expensive or a combination of both.
- Remember the pace at which the positions evolve.

The key figures that matter in strategies such as profitability and entry/exit efficiency can provide some clues about which Pyramiding strategy is appropriate. Before putting the strategy into practice, the impact of the different Pyramiding parameters should always be tested.

Miguel Mestanza

Miguel Mestanza has worked for different software producers in the scope of selling, training and supporting since 1994. Since 2002, he has guided users of Investox for Knöpfel Software development.

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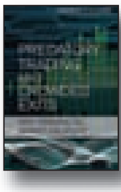

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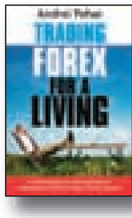

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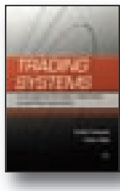

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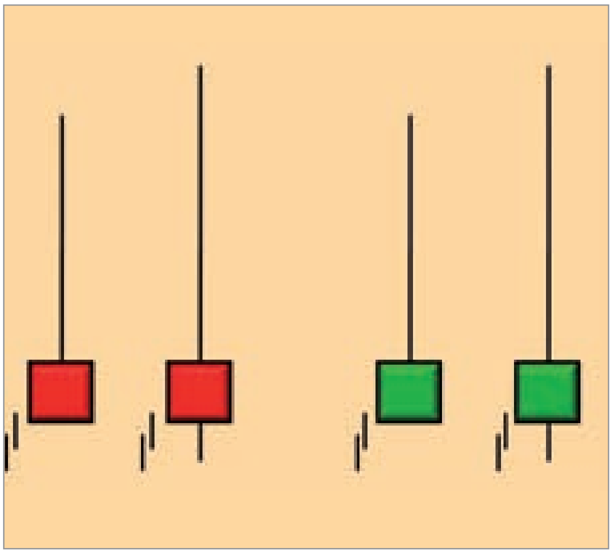
How to Implement a Candlestick Trading Strategy

Shooting for the Stars

Have you ever wanted to "Shoot for the Stars" in your trading? Every trader has wanted to hit the homerun in their trade, a big winning trade to boast about to their friends, or even a big winning trade that can make your week or even your month, swinging for the fences and hitting the trade out of the park. Unfortunately many traders that swing for the fences end up blowing out their account. The best traders know that becoming a consistently profitable trader comes from having a plan and having the discipline to stick with that plan. The kind of "Shooting for the Stars" trade that I am talking about is exactly that. I will show you exactly how to trade a specific pattern consistently with detailed rules in place. The only thing I will not give you is the discipline to actually follow the rules. You are responsible for that.

F1) Shooting Star



Here you can see several types of a Shooting Star candlestick formation.

The Pattern

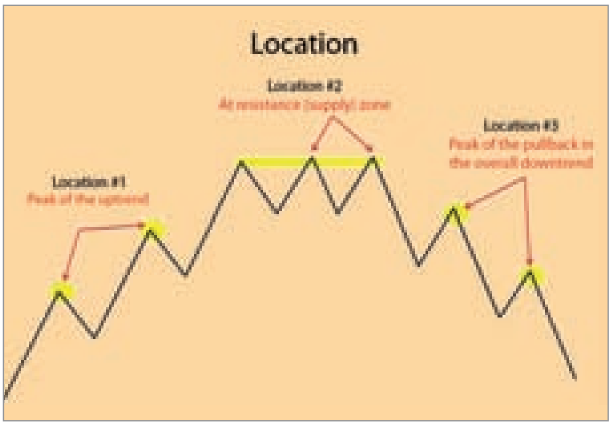
If you have been trading for even a short period of time you have heard about candlesticks, however most traders do not truly understand how to interpret them, much less trade them. In this article I will show you how to trade one of the most reliable patterns with the detail and accuracy that traders need to have – I will show you how to trade the Shooting Star candlestick pattern.

First we need to understand what a Shooting Star truly is and what it means to a trader. A shooting star is a candle shape that has a body that has opened and closed in the lower twenty percent of its range. The Shooting Star must also have a topping tail that is at minimum of two times greater than the body, but preferably three times larger than the body. The body of the candle can be red or green, but if it is red it does have a slight statistical advantage, though not enough to be concerned about (Figure 1).

The Two Most Important Questions

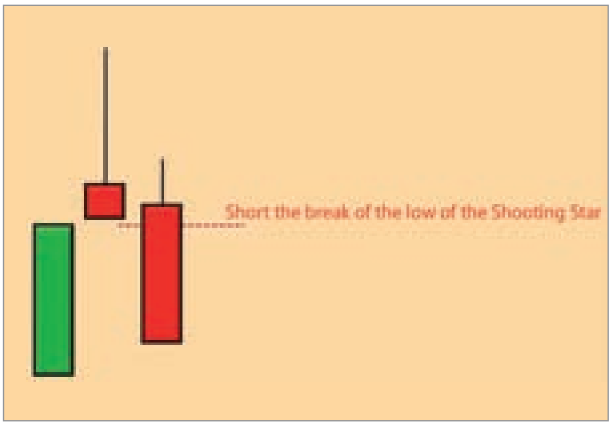
Now that you know what the candle looks like it is important to always ask two questions when it comes to any candlestick:

F2) Location



The three specific types of locations that a trader needs to know when trading Shooting Stars.

F3) Shooting Star Entry (with Inside Day Gap)



Traders can enter a Shooting Star trade when price opens inside the Shooting Star day.

- Is this candlestick bullish, bearish or neutral?
- Is this candle in a location that it must be at in the charts?

By understanding if this candlestick is bullish, bearish or neutral we have an answer as to how we will trade it. Bullish means go long, bearish means short it and neutral means wait for more information, but get ready to go long or short depending on the location.

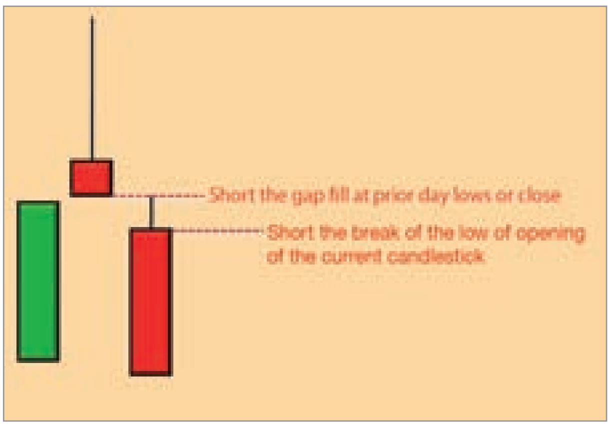
Now we add the location and we have just increased our odds of the trade working in our favor. As traders, we will see all types of candlesticks all over the place, so we always need to be very picky and selective when it comes to trading candlesticks. It is very important to only take the trades that have the best chance of success, the highest probability trades, and not just any candlestick that you read in a book and see on a chart. Go back and look at all of the Shooting Stars you can find on any time frame and you will see the best of the best happen in a great location.

Location, Location, Location

There are three specific types of locations that a trader needs to know when trading Shooting Stars (Figure 2). First is the peak of an uptrend. At the peak of an uptrend is where price turns down. There is good and bad about every strategy and this location has two big drawbacks. First, it is a counter trend trade and that means lower probability. Second, the profit potential is small because pullbacks are shorter lived in trends. It is still a tradable location, as long as you realize it is not the best location and you are quick to take profits.

The second location is very reliable and is found in areas of sideways price movement. The profit potential is normally high and the best thing about this location is that it is easy to define. All that needs to be done is look left on the chart for a prior pivot high and wait for price to enter that same price level. It's at this level that supply is greater than demand. Think about this, if you want to short a stock, you want the price to go lower right? So why wouldn't we short in an area where price has more supply than demand?

F4) Shooting Star Entry (with Outside Day Gap)

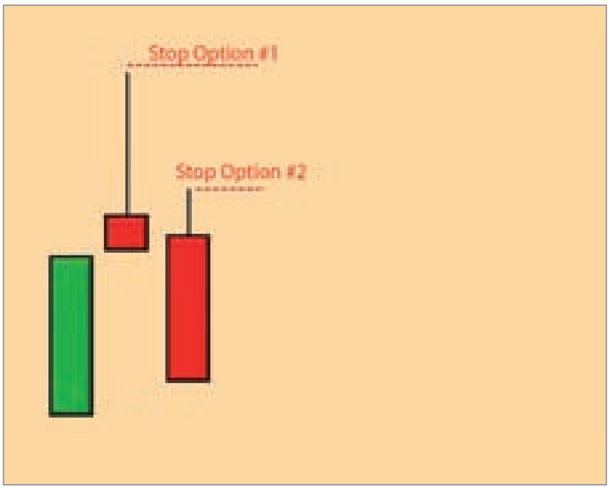


Traders can enter when the next periods opening price is below the close from the Shooting Star.

F5) Akamai Technologies (AKAM)

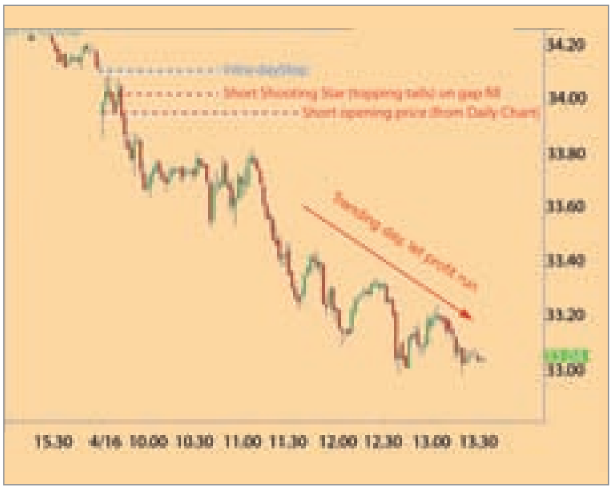
Here you can see a daily chart of AKAM showing a definite Shooting Star.

F6) Stop Placement



Stop placement is a penny above the current candlestick that was shorted or above the topping tail high.

F7) 2-Minute AKAM Chart



The 2-minute chart shows the entry and what happened on this strong reversal day.

The third type of Location that we need to have for our Shooting Star is at a pullback in the overall downtrend. For example, in a downtrend we know the primary move is down and the secondary or corrective move is up. It is these upward moves (pullbacks) in the overall downtrend that we look for Shooting Stars. This gives us a very reliable clue that the trend is likely to continue. The pullback in a downtrend has the highest probably as well as the highest profit potential because it is going with the trend.

The Details

Now that you have a basic understanding of the Shooting Star, let's look into how to actually trade it.

- Step 1: Identify the Shooting Star in the correct location.
- Step 2: Put stock on your daily bearish watch list.
- Step 3: Mark off the lows of the Shooting Star candle.
- Step 4: Mark off the high of the Shooting Star candle.
- Step 5: If price trades one penny (or tick for futures) below the low of your line from the low of the Shooting Star candle, short it!
- Step 6: Set your stop above the high of the line from the high of the Shooting Star.

Like in any good battle, we need a plan. Now you have one; however what if price does not happen exactly as we have it in our rules? Two options:

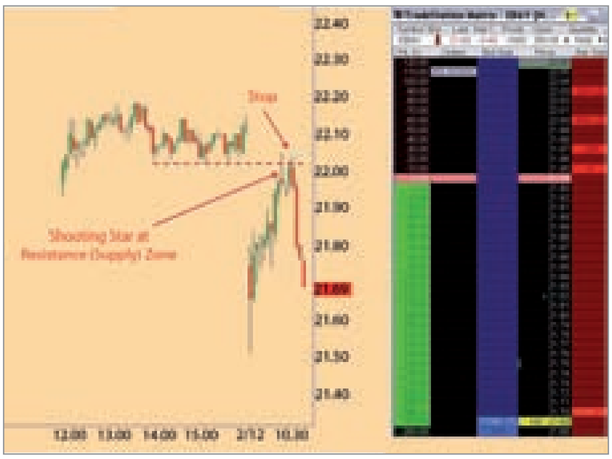
- Do not take the trade because it is not in your plan.
- Study and learn different scenarios to put in your plan so you do not miss a great Shooting Star move.

I have learned every battle must have a plan, yet be flexible based on what the market gives us. Now do not confuse "being flexible" as deviating from your plan. Traders simply

F8) Joy Global (JOYG)

The daily JOYG shows bearish divergence on the CCI and a strong pierce through the upper Bollinger Band. This is a good swing trade set up.

F9) Ebay (EBAY) 5-Minute Chart



This was an intraday trade on EBAY for a quick move.

learn the different set ups and adapt to it, learn from it, then put it in their plan to trade from.

Chart Examples

Now we have the basics down when it comes to candlesticks, so let's look at our Shooting Star in more detail. The shooting star is a bearish candlestick pattern and we need to see it in an area of quality location for the best results. This works on any timeframe; Daily charts, 15 minute charts, 5-minute charts, etc. Traders can enter a Shooting Star when price opens inside the Shooting Star day (see Figure 3) or enter when the next periods opening price is below the close from the Shooting Star (Figure 4).

Take a look at AKAM on a daily chart (Figure 5). You will notice a definite Shooting Star (bearish) and it is also in the location we want it (resistance from the weekly chart, not shown). This pattern has met our requirements for a trade set up so we now will put this on our "bearish" watch list for the next day. Now we are prepared for a potential short position. Being prepared is a lot of the game, but it comes down to detail entry, stop and exit management.

On the next day I was teaching a class of about 20 traders at Online Trading Academy's Milwaukee, Wisconsin location (www.tradingacademy.com) how to trade this pattern live that morning. We identified the Shooting Star and put it on our bearish watch list just like I did above. I continued to explain to the class exactly how we as a class will trade this set up.

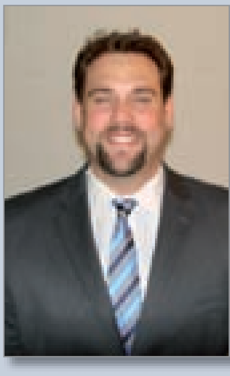
My Rules Were as Follows

Entry option number one: if price opens inside the Shooting Star wait for price to break below the low of the Shooting Star (Figure 3). Entry option number two: If price opens below the low of the Shooting Star, wait for a gap fill, or break below the opening price (Figure 4). Stop placement would be a penny above the current candlestick that was shorted or above the topping tail high (Figure 6). But what about the exit strategy? Because we were anticipating a big strong reversal day, we had our "let profits run" exit strategies in place (Figure 7). There are several ways of doing this that I explain in detail in my trading courses. Many of the traders had good days trading using this one simple set up.

JOYG was another stock we traded in class (Figure 8). JOYG had a bearish divergence on the CCI, as well as a strong pierce through the upper Bollinger Band: both very bearish signs and great probability enhancers. As traders, we can use this candlestick pattern as a swing trade or as a set up for an intraday trader. Lastly, EBAY (Figure 9) was an intraday day trade for a quick move. Price ran up into the prior days support (new resistance). I took the short on the Shooting Star and let profits run back down into the lows of the day for some fast cash flow.

Summary

Keep in mind there are over 100 candlestick names. You do not need to know all their names; I promise not to quiz you on them. Focus on high probability, low risk, high profit potential set ups in great locations and the Shooting Stars will perform well for you too. I hope this article has shed some light on how to trade the Shooting Star. ■



Ryan Watkins

Ryan Watkins has been a trader & active investor since 1999. He is also an instructor for Online Trading Academy (www.tradingacademy.com), as well as one of their Extended learning Track (XLT) instructors in which students can watch and learn from live trades and live trade lessons everyday in the market. Ryan has invented products for traders, been featured on many trader talk radio shows, webcasts, author of print and media articles on trading, as well as a mentor to his students. To trade with and learn more from Ryan, go to www.tradingacademy.com for more information.

Determining Trends the Easy Way

The Use of Trend Lines in Technical Analysis

Traders need market movements to be successful. There cannot be any profits unless there is movement. When markets move strongly to one direction or the other, this is referred to as a trend. If there is no trend and little or no movement of prices, it is more than difficult to trade successfully. It is therefore important to identify existing trends. So-called trend lines are one of the most fundamental concepts in technical analysis. On the one hand, they provide clues to where prices might be headed, and on the other hand they are a warning signal that appears whenever prices stray from the "right path". While they are mainly suitable for longer time frames (swing trading, for example) and less for shorter ones (day trading), one should be familiar with the principles of this theory since trend lines are relatively easy to use and frequently send reliable buy or sell signals.

Upward Trend Line

An upward trend line is obtained by connecting the first low point (the historically older price quotation) to another low point (the historically younger price quotation) of a price with the latter one having to be higher than the former. Rising trend lines are considered to be a support. The more points of support the marked trend line has, the more significant it is itself and the more support there is.

That is why trend lines with only two points of support should at least be confirmed by a third one in order to be considered by the trader as a possible future entry point. The upward trend will be intact as long as prices are quoted above the trend line. The upward trend will be broken once the price crosses the upward trend line downwards.

F1) Royal Dutch Shell, Daily Chart

This is a good example of an upward trend line. The line was confirmed several times, corresponding very well to the overall development of the chart. Eventually the break in the trend did occur.

Source: www.tradesignalonline.com

Downward Trend Line

The rules governing the upward trend line only need to be reversed accordingly. This means that a downward trend line is obtained by connecting the first high point to at least one other high point of a security with the latter one having to be lower than the former. Following a change in trend, falling trend lines function as resistance and imply continuing falling prices. As long as prices are quoted below the trend line, the downward trend is intact. However, it will be broken once the price crosses the downward trend upwards, leading in turn to a change in trend.

F2) BHP Biliton, Daily Chart

This chart shows a downward trend line which is also broken in its subsequent development. However, it had previously been confirmed by many contact points.

Source: www.tradesignalonline.com

F3) First Group, Daily Chart

This shows a trading range with a very slight upward trend. That trend has established itself in the First Group chart over a few months and remained intact.

Source: www.tradesignalonline.com

Sideways Trend Line

When prices do not reveal an upwards or downwards trend, they move sideways. Such sideways phases may also be described as a trend – sideways trends. For further price development they also contain a support or resistance function which the trader can utilise. These so-called trading ranges are of interest to traders because you can also buy or sell within this trading range since the price moves back and forth within it and is therefore "predictable". Most of the time there is a middle line within a trading range. If this is broken from the bottom to the top, a test of the upper resistance line is likely, but if it is broken from the top to the bottom a test of the support line is likely.

Trend Channels

Trend channels consist of two parallel trend lines. This means that they do not just indicate the approximate direction of the trend but also the price range to be expected, which may allow excellent entry and exit prices to be marked. An upward trend channel is obtained by a line running parallel to the upward trend line, and that line consists of the first high point combined with at least another high point of the price. The downward or sideways trend channel is determined analogously. Prices move back and forth between the upper and lower edge of the trend channel. If the latter is left upwards or downwards, then this is a sign of a change in trend and a new definition. If there is neither an upward nor a downward trend, we have a sideways trend. This trend is attractive as soon as it is left since there may well then be a movement that causes the price to move far away from the sideways trend, leading to attractive trading opportunities. However, price fluctuations may also be effectively utilised within the sideways trend.

Primary Trend, Secondary Trend, Tertiary Trend

Such trend lines and trend channels, while being more suitable for longer-term periods, may be created for any time frame. Depending on how you look at it, a distinction is made between different trends as a function of time frames. The long-term trend is described as a primary trend, which can then be subdivided into secondary trends, within which, in turn, further tertiary trends may appear. What can frequently be read is that such categorisation should be tied to periods of time relatively rigidly. A primary trend, for example, would then be a trend on a monthly basis, a secondary trend one on a weekly basis, and a tertiary trend one on a daily basis.

Conclusion

Trend lines are among the most important and effective instruments of chart-based technical analysis. For this reason they ought to be watched very closely, especially when broken by the price. Such trend change signals are often good buy or sell signals. However, no immediate action should be taken whenever there is a minor break and prices are only slightly below the trend lines since these might be short-lived. It is only a sustained break that forces the trader to act. ■

F4) Cable & Wireless, Daily Chart

This chart shows an upward trend channel which has been confirmed very frequently. When the price broke out from this channel, there was a correspondingly strong downward movement.

Source: www.tradesignalonline.com

May All Your Trades Be Green

How to Manage Overnight Risk

Many beginners and intermediate level traders are confused by limit orders. What good do they do in relation to risk management? Can you hold an overnight position on a stock bought at $21 (ordered, say, thirty seconds before the market closes) and set a stop loss of $20.90 on it so that if the stock gets a surprise downgrade the following morning, a horrendous loss can be avoided? Is this possible, using some type of Good Till Cancelled (GTC) scenario? Is there any way to competently "guess the market" in order to limit devastating losses? If not, then why not use market orders exclusively? The risk is the same, and more often than not, market orders are much cheaper.

One Question at a Time – Define Your Orders

Let's start with simple definitions. Limit orders specify a specific price (or better) and share size. Market orders are executed at the price the market is at – At Time of Execution – which may not be instantaneous, allowing the market to move somewhat. Limit orders do not suffer slippage, but run the risk of not being filled. Market orders are almost always filled, but you can get filled away from the price you had in mind.

Now, the question posed on controlling overnight risk has to do with Stop Loss Limit versus Stop Loss Market orders. The word Stop in the market means "trigger an order at." Stop Limit means "trigger a Limit order at $20.90 and sell for no less than $20.90." A Stop Market means: "trigger a Market order at $20.90 and sell at market".

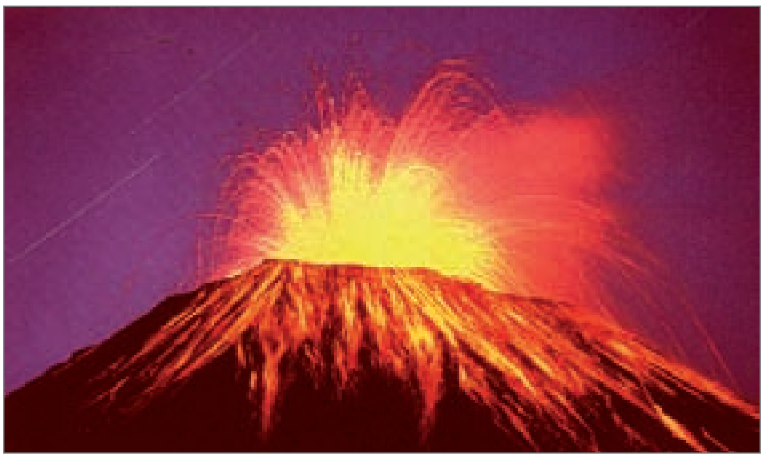
Scenarios – Stop and Non-Stop

In the above situation, there is a long position that will be held overnight. We had good reasons to do so, but an extraordinary event (volcanoes, earthquakes, oil leaks, geo-political unrest) causes it to gap down several points.

Scenario #1: The position was bought at $21 and had placed a Stop Loss Limit order of $20.90. The market gaps down to $18. The first trade was well below your Stop Loss Limit of $20.90. You do not get filled, thus, you are now holding a $3 dollar loser. You still have the position and we can work with this, but clearly, this is not the best scenario.

Scenario #2: The position is at $21 and has a Stop Loss Market order set at $20.90. The market gaps down to $18. The first trade was at $18. This "triggers" your Market Sell order. You will probably be filled on the next trade at the Inside Bid price (possibly $17.99, $18 or $18.01 in normal markets). You have been filled, thus, you have taken a $3 dollar loser. You are out of the trade, which is good, but you have suffered a significant draw down. I could be glib and say „Welcome to trading" but let's see what we could do. Again, this is not a good scenario.

F1) Iceland Volcano



This could be one of those extraordinary events causing your position to gap down against you overnight.

Source: www.mixxbuzzers.com

What Can We Do about It?

Scenario #1 protects you against normal wear and tear of price movement, although $0.10 is fairly tight for an overnight stop. Most traders are trying to maintain at least a 1:3 Risk to Reward ratio. That is to say, if you risk a dime, you expect 30 cents minimum. Overnights are high risk trades, as you cannot control events (assassinations, fraud, terrorism or just a good old earthquake – I live in California) and, therefore, should you take one home, you need to have very high probability that an excellent reward awaits you (high risk had better equal high reward). Extraordinary events do catch us. So a Stop Loss Limit actually protects you by giving you the opportunity to „work" the position rather than „eat" the big loser.

Scenario #3: In this case, it has gapped down against us. Almost always, there will be „gap filling" pressures. Gap fills take place in the first 45 minutes (sometimes an hour). Thus, instead of canceling your Stop Loss Limit and blowing out the position at Market, watch for the first hour. We are not trying to make a profit here, but rather, to manage and salvage our loss (you are not "hoping" for it to come back, you are calculating a better exit). If the gap fills only 38.2 per cent, sell the whole position. If the Gap fills 50 per cent, sell half of your position, and watch for any weakness. If weakness shows, blow out the balance. If the gap fills 61.8 per cent or higher, then hold on a little longer, because this higher percentage of gap fill shows this asset has some strength. Be prepared to dump the whole thing if there is any indication of weakness.

Again, we are trying to cut your loss, not make a profit on a loser. If you were fortunate to retrace to the 61.8 percent fill, you have saved about $2 of the loss. The percentages I mentioned here are Fibonacci Retracement numbers.

F2) Stop Loss Limit – $20.90

A Stop Loss Limit order will not be triggered if the market gaps below it.

F3) Stop Market – $20.90

A Stop Market Order will trigger your Market Sell Order if the price gaps below it.

Risk Management Starts with Understanding the Environment

So, we are at a decision point. First, should you take this stock home overnight? Never take home a loser. If you take a 'long' overnight, you want it closing on or near the high of the day with strong, increasing volume.

Next, what stop loss to use? First question for every good trader is, "How much am I willing to lose if I am wrong?" Whatever that amount is, multiply it by three, and then look to see if you can achieve that profit. If not, pass on the trade.

An Example of This to Consider

You say, "I can afford to lose $0.50/share on this trade." Therefore, you have calculated that you can make $1.50/share in potential profit. Now look at the reality of the environment. You are playing a $20 stock. For it to move $1.50 the next day, it will have to move 7.5 per cent or better. Is this realistic? If it is, then you must realize that you are playing with a fairly volatile stock (probably a Beta of 2.5+). Most stocks move a couple of per cent in a day. So, if the stock has been moving only three or four per cent in its recent history, you must decide on one or two possibilities. First decision, a $0.50 stop loss is too large to protect the risk/reward scenario with only a normal two to four percent move – trade or no trade? If the stock only moves five percent, then $1 is the profit target, thus, you should probably reduce your stop loss to only $0.33 (remember 1:3 ratio). Anything less in either case – too large a risk or too small a reward – no Trade.

The next thing to consider under "environment" is the aspect of "extraordinary events" – how do you factor them into your risk profile? Look at the over-all picture. Has the market been clearly trending or is it choppy? Are there good Economic and Market indications to support your decision to hold overnight? If you only expect to make $0.25 or $0.50 the next day, but could suffer a $2 to $3 loser, then why not buy it the next day. Sure, you may lose some profitability to gap ups or release of news, but the game is learning "how NOT to lose" and Capital Preservation. Remember, "Better money missed, than money lost!" So, in reality, it does not matter which Stop Loss you use – Limit or Market – but rather the risk/reward scenario, your own risk tolerance, the stock's characteristics and the possibility/probability of bad news. A trade plan (which includes a Stop Loss) is absolutely necessary.

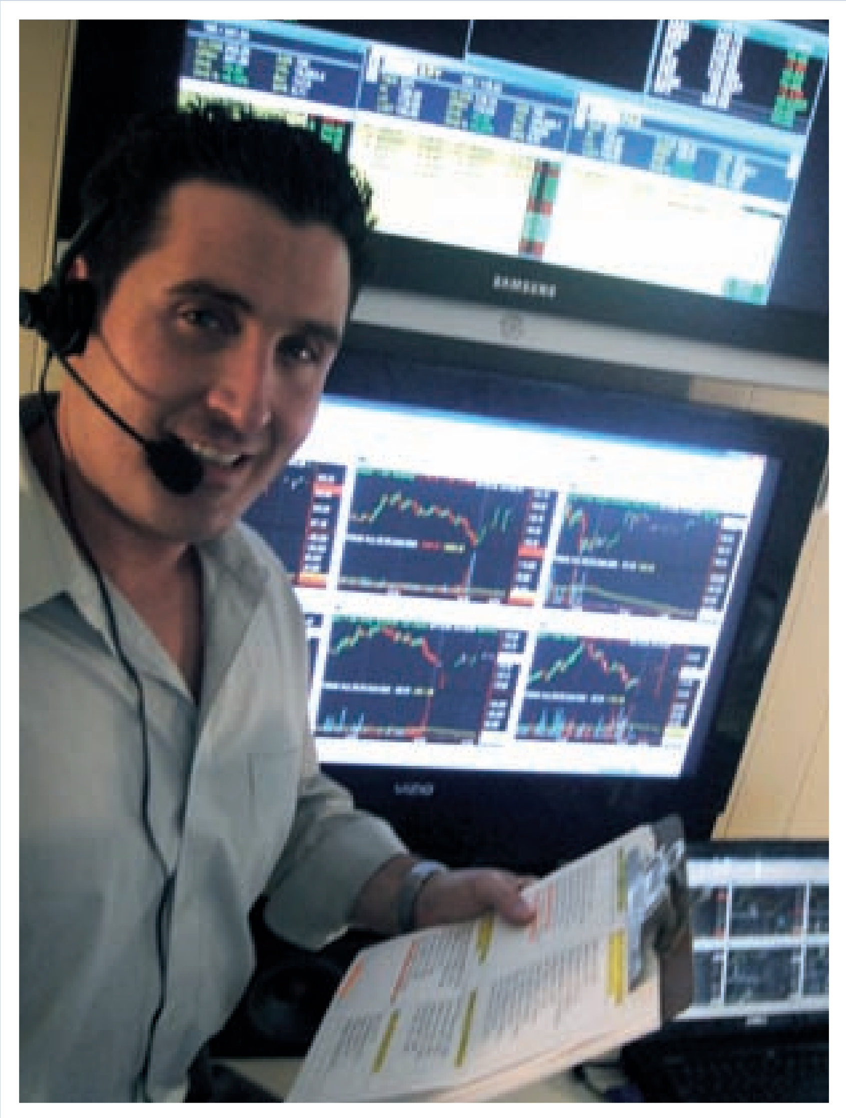
However, we all get caught occasionally – that is trading. But if you follow the "loss management" I proposed above considering gap filling, you can hold your account together to fight another day.

Last Comment

I mentioned that Market orders are much cheaper than Limit. First, check around with other Broker-dealers. If you are working with very cheap commissions, then you may be doing yourself a disservice. A $5 market order on 1000 shares costs about $25 with only a $0.02 slippage. A $15 limit order is $15, as there is no slippage. I have no idea who you are trading with, what prices you pay, but please consider what we call "the load" – which is slippage + commission + fees. You might be surprised what that "cheap" ticket is really costing you. Remember Kermit the Frog sang, "It's Hard to Be Green". May all your trades be green. ■

Mike McMahon

Passion and enthusiasm are the "watch" words of Mike Mc Mahon. He brings both to his trading and his teaching, with over 20 years of experience in the market, as an investor, a trader and a licensed Commodities broker. Graduated from UCLA with a Bachelor's Degree in Political Science, Mike brings a blend of academia and experience to the classroom. His ability to communicate this blend is the rare talent that allows an active trader to be a successful trainer. His students are always well-schooled – with passion and enthusiasm.



Josh DiPietro

TRADERS´ Interview

The Truth about Day Trading

Josh DiPietro discovered his passion for day trading twelve years ago. After harsh losses and a longer break, he decided to become a fulltime day trader – with big success. By now DiPietro operates his own website www.daytraderjosh.com. Moreover, he is the author of the book "The Truth about Day Trading Stocks". DiPietro's strategy is based on counter-trend trading. His goal is to take quick profits and to allow only small losses. A promising system when you look at his profit/loss ratio of over 90 per cent. We invited Josh DiPietro to an interview and talked with him, among other things, about his trouble-strone path to becoming a professional trader, the truth about day trading, and how to deal with fear and greed.

TRADERS´: How did you get in touch with the markets and become a professional trader?

DiPietro: My journey began in sunny San Diego back in 1998. I caught a free trading seminar and learned how easy it was to sit in your shorts and make tons of money when buying and selling stock online. I opened a traditional online day trading account, through a prominent pay-per-trade broker. I was paying about $14.99 per trade back then.

I quickly realized how easy it was to lose a lot of money very fast. I began searching for day trading academies and purchased every day trading book that I could find. I was desperate to learn how to profit consistently.

I found a 3-day day trading program here in California. It cost $6500, and no guarantees. The trader/instructor that sold me over the phone was very convincing. He promised I would be learning proprietary information that would transcend my day trading career to a whole new level.

After the 3-day program I came home to my trading station, which at the time was two laptops and a 36" monitor. I felt like a true professional trader. My confidence levels were through the roof.

To make a long story short, I lost so much money within one year I had to sell my house and I almost lost my fiancé. I was a mess!

TRADERS´: What happend next?

DiPietro: Once I decided to take a break from full-time day trading, I began searching for some sort of small business. I had to pay the bills. I quit actively day trading for about three years and began pursuing a mobile detailing business. I did maintain my online brokerage account, and I did place several swing trades over the next few years. I never really made a lot of money, especially consistent money until I decided to get back in again, actively intra-day trading.

It was 2004, and I was currently finishing up my Bachelors degree in Business marketing from San Diego State University. The college experience helped me become a much smarter and resourceful person.

I came into some money so I decided to give full-time day trading another chance. I purchased a few current day trading books, and I decided to dish out another $5000 on my second professional trading program. It was a five-day intensive and professional trading program. I expected to learn a highly structured way of profiting consistently in trading equities. Once again I was let down. This time, I actually was disappointed because I knew more than I thought. The program did not teach me anything that I didn't already know. I felt completely ripped-off.

I continued day trading with my traditional pay-per-trade account until 2007. I was moderately successful while trading with a pay-per-trade broker and trading platform. During this period I was definitely learning how the stock market truly functions.

Just prior to 2007 I started getting labeled as a "pattern day trader". This means I am trading more then four round-trip-trades in any five day rolling period. Basically, the S.E.C requires all pattern day traders to have at least 25,000 in their brokerage accounts.

I had no problem with the 25,000 minimum requirement. My main problem was the pay-per-trade commission structure; it was killing me. I was placing over ten round trip trades per day. That's 20 executions per day. That translates to $200 in commission fees per day ($9.99 per trade). I needed to find a way to trade without getting charged so much per trade.

In 2007 I began seeking out pay-per-trade firms that had much cheaper per-trade commission cost. The lowest I ever found was $4.99 per trade. This was still too high. I then aggressively began my search for day trading firms in New York City. I started finding trading firms that offered pay-per-share commission structures. Pay-per-share firms were very foreign to me. But, the more I researched, the more I knew I had to move to New York City.

TRADERS´: Did you finally move to New York City?

DiPietro: So in late 2007 I sold virtually everything I owned and moved to Manhattan, so I could be near Wall Street, where most of the independent pay-per-share trading firms are located. Once I got to Manhattan I was blown away by the pay-per-share firms. They all had their own trading floors. The caliber of day trader experience made me feel like a complete amateur. The truth is, I was, compared to the veterans on the floor.

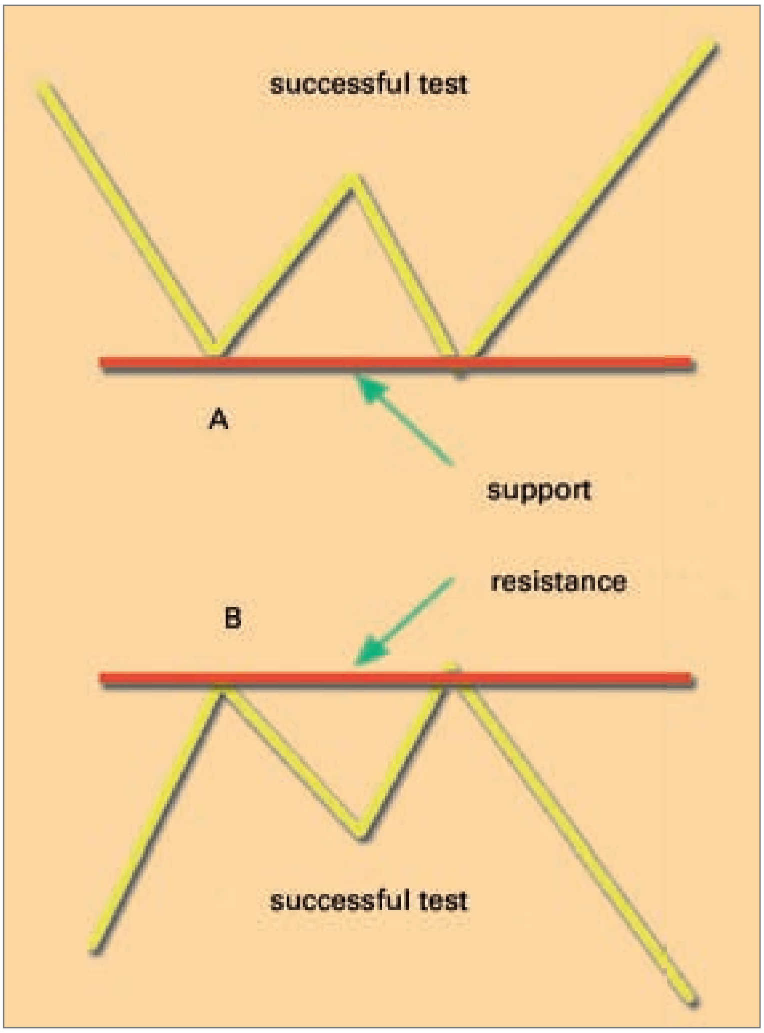
For an entire year I was exposed to real day trading firms, and real day traders. I learned more then I did in all nine years prior. Currently I am intra-day trading remotely from my home on Cape Cod, MA.

TRADERS´: You mentioned the pay-per-share firms and pay-per-trade firms. What is the difference?

DiPietro: Many beginners are unaware that there are critical differences between pay-per-trade and pay-per-share online brokers. If your commission fees are based on pay-per-trade, then you are usually paying $5 to $10 per trade. Most amateur day traders use pay-per-trade brokers because they do not know about the pay-per-share alternative. I sure wish I had been informed about pay-per-share when I started day-trading stocks.

Why use pay-per-share firms? On average, you only pay $0.003 to $0.005 per share. That translates to paying, on average, 40 cents per trade, when you are trading in 100-share blocks. On the other hand, if you place a trade of 100 shares with a pay-per-trade broker, you are usually charged a flat rate commission of $9.99. If you place over 50 trades per day with pay-per-trade, imagine how gouged you will get by fees. Most active professional day traders, like myself, place at least fifty trades per day (25 round-trip trades). If they use a pay-per-trade broker, that is roughly $500 per day in paid commission fees. Trading through a pay-per-share broker, however, placing 50 trades per day in 100 share blocks, costs you only $15-30 in fees. You can see just how crucial it is for a pro to use a pay-per-share broker.

F1) Support and Resistance



It is all about the successful testing of a previous high or low by counter trend trading at support and resistance levels. The price mostly turns when the support or resistance level was reached or broken slightly.

Source: TRADERS´ Graphik

TRADERS´: What kind of trader are you?

DiPietro: I am definitely an intra-day trader, similar to "scalp" trading. Scalping is a trading style specializing in taking profits on small price changes, generally soon after a trade has been entered and has become profitable. It requires a trader to have a strict exit strategy, because one large loss could eliminate the many small gains that the trader has worked to obtain.

TRADERS´: How would you describe your trading approach?

DiPietro: My trading approach is based on counter-trending (Figure 1). For instance, I wait for the price to rise above resistance (intra-day) and then I short. When the price falls below support I go long. I basically sit at my trade station for the entire duration of market hours (including pre-market and sometime after-market trading). I look for quick 15 to 25 cent moves. I exit quickly, either at a loss or a profit.

TRADERS´: How successful is your system?

DiPietro: I always start my trading positions in 100 share-blocks. On a productive day I will place about 100 executions (10,000 total shares traded per day), that is 50 round-trip-trades per day. My profit/loss ratio is about 90 percent in the green. This translates to me profiting on 45 of my 50 quick-trades and taking losses on about five trades per day. My system is very consistent. Again, I will either profit $15 to $25 on a quick trade or lose up to $50 on a Stop/Loss. My average profit on each trade is $20, and my average loss is $35.

On this productive day I will profit about $900 ($20 x 45 trades), and I will lose about $175 ($35 x 5 trades). My commissions are never a problem since I pay-per-share. I pay about $0.004 per share traded. So if I placed 50 round-trip-trades (100 executions) in 100 share-blocks, that translates to 10,000 shares traded for the day. I would owe roughly $40 in commissions for the day (10,000 x $0.004 per share). My total net profit on a productive day comes to roughly $685 ($900 - $175 - $40).

However, I do not always trade 50 round-trip trades per day. Some days I trade only 30 to 40 round-trip trades and net profit about $400. I am very satisfied If I make more then $400 per day.

TRADERS´: What does your exit strategy look like? Where do you place your stops and why?

DiPietro: I have a strict system of taking quick profits of 15 to 25 cents per trade, and of never allowing the price to move more then 50 cents against me:

- I never hold a position past my predetermined Profit exit point.
- I never hold a position past my predetermined Stop/Loss exit point.

I allow for a cushion of two 25 cent general market barriers for my trade to run against me, that translates to a 50 cent stop/loss exit. The stock price is more likely to retrace 15 to 25 cents after my intial entry, rather then continue to run an additional 50 cents.

TRADERS´: How many setups do you use?

DiPietro: I use intra-day support and resistance. These levels are constantly changing throughout the day. Once intra-day resistance breaks I look to short, once Support breaks I look to go long.

TRADERS´: Which time frames do you use?

DiPietro: I use the 1-minute candle sticks. I need at least five minutes (five candle sticks) to have a new intraday range formed. Some ranges can be five minutes and some ranges can take two hours, it depends on the volatility of the stock on any giving day. On average, there is usually a setup every 15 to 20 minutes on the stocks I trade.

TRADERS´: Do you trade other instruments beside stocks?

DiPietro: No, I trade only equities (stocks).

TRADERS´: Which indicators or oscillators do you use and why?

DiPietro: The 1-minute candlesticks determine my intra-day support and resistance levels. I combine them with volume bars. All other indicators only add noise and confusion. My system of entry is very crude but effective. My entry levels are based on price levels, intra-day price action.

TRADERS´: Would you show us some of your trades?

DiPietro: Of course. Let us look at a pre market trade first. Figure 2 shows the pre market high/low (shaded area). These levels are your first intra-day resistance/support, respectively. Once the market opens at 9:30am you wait for one of these levels to break. In this case the pre market high broke first, so I made a short trade off the resistance level. I wait two 25 cent barriers before entering (only off pre market). Remember the general market barriers of 25 cents? For instance, the 0.25, 0.50, 0.75, and 1.00. In this case, the pre market resistance was at 117.60, therefore, I need to break 117.75 and 118.00 before entering a short position (two 25 cent barriers). Also, the entry point must be on the initial breakout past these points. The price initially breaks 118.00 at 9:35. I entered a short 100 share position quickly at $118.03. Then I held for two minutes until I received my profit of $25, exiting at $117.78 at 9:37.

Notice how I exit before it breaks the 25 cents range: in this case the 25 cent barrier is at $117.75. I never try to get more then 25 cents on each trade. It is much easier to take 25 cent profits then say 50 cents. This is true because the 25 cent barriers are hard to break through. For instance, if I try to get 25+ cents on each trade that means I will have to break through a general market barrier of 25 cents. What typically happens at these levels the price retraces. So, your perfect 15 to 25 cent profits can quickly reverse back to breakeven or loss. Point: taking small 20 to 25 cents profits is more consistent.

The second trade of day usually comes after first trade off pre market H/L (Figure 3). In this case I placed a long position after the first intraday support developed. At 9:44 the first support forms. At this point the price dropped to a low of 117.03 and reversed. I now have my first intra-day support at this price level. I waited until 10:09 for it to retest and break. It breaks at 10:09, but doesn't go far enough into next 25 cent range. Since the support was so close to the 25 cent range (117.00) I want the entry price to be closer to 116.75. So, I waited for the next candle stick to enter. At 10:10 I entered a long position of 100 shares at 116.82.

I exited at 10:11 at 116.99, profit of $17. Remember, I always exit before the next 25 cent range. In this case, I wanted to get out before the 117.00 price level. Any profit between 15 to 25 cents is a great profit.

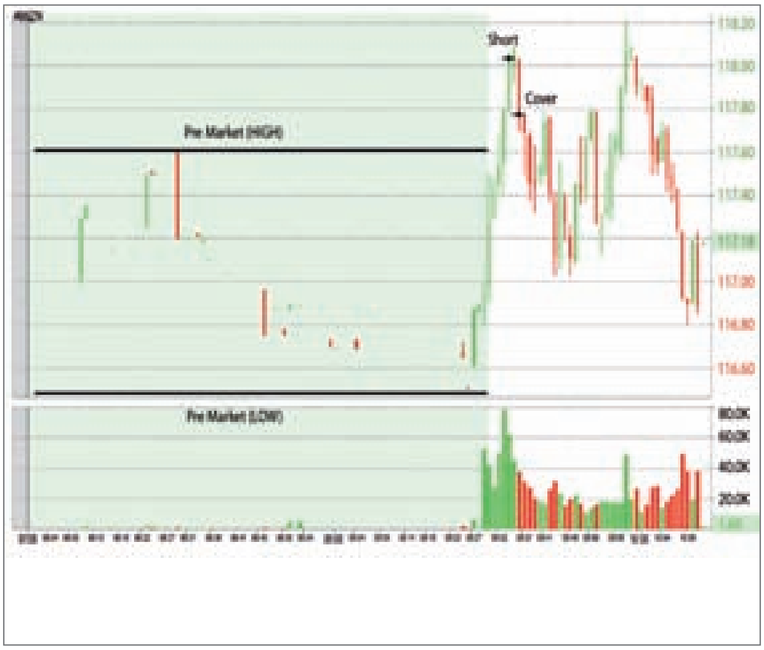
TRADERS´: Are you a systematic or a discretionary trader?

F2) Pre Market Trade

The pre market high/low is the first intraday resistance/support, respectively. At the market opening at 9:30am I wait for one of these levels to break. Here the pre market high broke first, so I made a short trade off the resistance level. I wait two 25 cent barriers before entering. The pre market resistance was at 117.60, therefore, I need to break 117.75 and 118.00 before entering a short position. The entry point followed on the initial breakout past these points. The price initially breaks 118.00 at 9:35. I entered a short 100 share position quickly at $118.03. At 9:37 I closed my position at $117.78 with a profit of $25.

Source: Lightspeed Trader

F3) Intraday Trade



Here I placed a long position after the first intra-day support developed at 9:44. At this point the price dropped to a low of 117.03 and reversed. I waited until 10:09 for it to retest and break. Since the support was so close to the 25 cent range (117.00), I placed the entry price closer to 116.75. At 10:10 I entered a long position of 100 shares at 116.82. I exited at 10:11 at 116.99, profit of $17.

Source: Lightspeed Trader

DiPietro: I never take my eyes off a trade, and I place all my trades manually using Fast-Key order execution. I do not let a system do that for me.

TRADERS´: What role do risk and money management play in your trading and why?

DiPietro: By trading in 100 share blocks consistently I am lowering my risk considerably. My strict stop/loss strategy is my entire risk strategy.

TRADERS´: What does your typical trading day look like?

DiPietro: I usually wake up around 7am. I have my coffee and begin my current market news observations. I like to browse websites like Bloomberg.com and the Yahoo Finance section. Once I have my trade station all lit-up I then click on the TV. I watch CNBC business channel. This channel is the best in my opinion for observing market moving headlines. Once I have digested the market news, I then focus my attention on my stock list. I begin filtering through each stock on my watch list. I usually have about 15 familiar stocks that I'm watching on any given day. I am looking for any news that can potentially hurt my particular stock. If I deem that the stock should be trading normal today then I add it to my today's trade list.

Once I have my selected stocks that I want to trade today, I then begin the chart analysis phase of my early morning preparations. I usually begin this process by simply taking yesterday's high, low, and closing prices and logging them on a sheet of paper. These levels will be my starting points of interest.

All my early morning preparations are leading into the opening of pre-market trading. I usually have an hour once I get up before the pre-market trading session opens at 8am. Most amateurs do not realize that you can execute orders (not just place) starting at 8am (Eastern Standard Time). This is just one more advantage of trading through a pay-per-share broker.

Pre-market is 8:00am to 9:30am, before the opening bell. At 8:00am the level 2 quote charts start to move and orders begin to fill. The charts start dancing across the screens. During this period I am watching for any abnormal activity in my stocks. I am also keeping track of any break-outs. Meaning, if the pre-market stock price breaks through yesterday's high and low price before the regular market opens at 9:30am.

When the bell rings at 9:30am, I am locked and loaded. I know exactly what price levels I am prepared to execute trades for each of my selected stocks. I usually place at least 25 to 30 round-trip trades in the first hour of trading. I like to be high energy and focused during the first hour of trading. My trades are quick and decisive.

I usually only take $15 to $25 profits on each trade. I mostly trade in 100 share blocks. In the morning, I trade one to ten stocks simultaneously. I like to give each stock an equal chance to win my trust and confidence early in the day. Once I quickly execute a trade I am then quickly looking to exit with a small profit, or a small loss. I never hold past my predetermined exit points. That's for both the limit price and stop-loss price. I always stick to my original exit/entry strategies. This scalping strategy makes for a great first hour of trading.

Around 10:30am, I have executed about thirty trades. I usually take a quick ten minute break after I have closed all positions out. Once I have taken my break I begin some research on my performance. I'm gauging which stocks I want to stop trading for the day and which stocks I plan on continuing trading. I choose the stocks that have been consistent in their volatility and price movements.

Around lunch time I wind down. I close all my positions and take my break, usually 45 minutes. I tend to stop trading around 1pm. I will begin again around 2pm. After lunch I usually decide to shorten my stock watch list. I try to trade only one to three stocks leading into the close. After trading and watching all my original stocks picks for the day I begin noticing fairly consistent trends in a few stocks. I tend to trade in 200 and 300 share blocks towards the end of the day in a few select stocks. The market usually picks up volume and volatility during the last hour of trading. After 3pm I am always on high alert, just as I was in pre-market. I save the last hour for my best performing stock all day. Which ever stock has been trading like clock work, I will stick with until the bell rings. The key to the last hour of trading is not holding any large positions. I do not have to worry about this because I never trade in more then 500 share-blocks. During the final hour I will limit my exposure even more by not trading more then 100 share blocks at any given time. This way when the bell rings at 4pm I will only need to close out a 100 share block position.

At 4:00 Eastern Standard Time the U.S. equities markets are closed. The work day is done. No it is not! I always sit at my trade station for at least another hour. I like to watch how my stocks trade in after hours. I like to watch how after-hour news affects the markets and other stocks. And, of course I like to gauge my profit/loss performance for the day. Sometimes I decide to trade in after-hours – but only if I know some major news is coming out, and this news will most likely make my stock trade like it would in normal market hours.

TRADERS´: What do you after finishing trading for the day?

DiPietro: Then I do my homework. After I am completely closed-out of all my positions for the day, then it's time to recap my performance. I start by focusing on the best and the worst trades of the day. I like to simplify the screening process by utilizing the following essentials:

- Stock symbol
- Amount of shares purchased on individual trades
- Total amount of shares
- Long/short position
- Time of entry
- Time of exit
- Profit/loss
- Number of total trades

Taking time to recap is crucial. It makes me slow down and think about my trading style. Trading styles have to be constantly updated, just like a computer. In order to be able to gauge your trading performance, you must go back and research what happened at the time you executed the order. These days I research my intra-day trades and focus on a few essentials. I primarily like to know this:

- What stock(s) was I trading the most, and why?
- What stock(s) did I profit the most from on that day, and why?
- What stock(s) did I lose the most on that day, and why?

Upon answering those three basic questions, I walk away feeling more in control of my trading style. Now I can relax and enjoy my evening, feeling better about my performance.

TRADERS´: You published the book "The Truth about Day Trading Stocks". What is the truth?

DiPietro: The truth is: Becoming consistently profitable in this profession CANNOT be fast-tracked. There is no "Golden Goose Strategy" to becoming rich overnight. My book is based on my own real-life experiences, it is a cautionary tale.

TRADERS´: One of the first topics you discuss in your book is controlling emotions. Why is it so important for a trader and how do you handle emotions?

DiPietro: This chapter is called: "The fear and greed factors and how to avoid them". The fear factor usually keeps you safe, but you make very little money. The greed factor usually gets you into big trouble, but you have the chance of making a lot of money.

The fear factor is your natural instincts taking over. You're hardwired from birth to avoid situations that are risky. On the other hand, your greed factor is what overrides your fear and causes you to do things that you wouldn't normally do.

In day trading the fear factor and greed factor need to be tamed. You can never totally suppress their inherent influences on your subconscious. But, you can train yourself to resist the overwhelming persuasions that fear and greed inevitably work to dictate your trading decisions.

TRADERS´: And what does this training look like?

DiPietro: The simplest way to avoid the fear factor manipulating your trading performance is to limit your exposure. This is why I stress that you only trade in 100 share-blocks. I can gurantee you that if you only trade in 100 share-blocks you will not feel as much fear when trying to wrestle with a large 1000 share-block trade. Suppose you are in a trade with 100 shares and the stock moves against you by a full dollar. You are only down $100, not so bad. But, what if you were holding 1000 shares. Then you would be down $1000. Basically, if you are experiencing fear while trading a position, then most likely you're trading more then 100 shares per trade.

Other ways to avoid fear include:

- Not holding a losing position all day.
- Not holding a losing position overnight.
- Not trading with your rent money.
- Not trading when you have been consistently losing for days (take a break).

Now let's go to the greed factor. If you find yourself not happy with making small profits all day then you can quickly run into deep waters when your greed kicks in. Methods to avoid greed:

- If you insist on trading more then 100 share-blocks per trade, then limit yourself to 500 shares per trade.
- Don't recklessly average-down a position, ever!
- Avoid breaking your consistency. If you have been trading a certain way all day, then do not start trading differently in the last hour of trading.

Besides, every day trader should be focused all day. That is the quintessential factor in his success rate.

TRADERS´: How can you do this?

DiPietro: Never take your eyes off your screens while in a trade. That means: no lunch breaks while in a trade, no long phone calls that can break your attention, no bathroom breaks. Basically, you must close your positions, hopefully at a profit, before engaging in any activity that inhibits you from watching your screens.

Also, do not try trading on a day that you have personal/family issues that most likely are going to cause you to trade on emotion. In addition, if you have a hang-over from the previous night, then you should wait until late afternoon to begin trading. You do not have to start trading early in the morning.

If there is a major national crisis occurring, and it is affecting the stock market, then you should take the day off. Generally speaking, drink coffee to stay alert, and/or exercise/stretch at the trade station. This is extremely effective, so you do not get fatigued and experience muscle aches.

TRADERS´: You struggled for a long time before you became a successful trader. What gave you the motivation not to give up?

DiPietro: I have invested blood, sweat, and of course cold-hard-cash into my struggle – why stop after I learned so much? My mistakes were very expensive, so I learned to capitalize on those lessons.

TRADERS´: Can anybody become a good day trader?

DiPietro: No, it takes a very determined and self-disciplined individual to succeed in this high-risk and high-stress profession. You really do have to live and breathe the stock market to have any chance at succeeding.

Emilio Tomasini

Emilio Tomasini is a full time professional trader. He trades both stocks discretionally and futures in a systematic way (commodities, stock and bond futures). He advises institutional players on quantitative trading. For more info www.emiliotomasini.com His email is tomasini@emiliotomasini.com.

Built to Last

This is a topic that often is neglected by traders but it is one of the most important aspects of trading success. Traders come from every walk of life: they are lawyers, managers, salesmen, etc. They usually come to trading because they are fed up with their current work and they believe that trading can overcome all the pitfalls that their current work has. Then they discover that trading is a long lasting endeavor, in which it takes time to learn how to make money and it takes time to make money. Look at the VIX in the recent weeks, it simply hasn't moved; even worse, it is going down. How do you make money in a market that is anything but volatile? So you have to wait: weeks, months, sometimes years. Good years are rare and average years are the norm. Even the worst years are rare, so that to find a good year, you need spend a lot of time waiting.

It is around this point that the average trader goes from the idea that trading is his only economic activity to the idea that it is better to find a secondary activity that protects him from the worst years and the average years. So we frequently see successful traders running bars, restaurants, and discotheques. It seems to be the perfect crime: by day you trade, by night you sell pizzas.

But it does not work like that: selling pizzas is a respectable job that deserves and requires much attention and energy. The same is so with trading. You cannot do both because you have to sleep, to rest. So eventually the lawyers, who gave up their legal practices to trade, will likewise sell their pizzerias to trade again.

Trading is a dedicated full time job that does not allow other activities. Economies of scale work in such a way that you can hold a seminar, write an article, maybe develop a system, all activities related to trading and sometimes really informative for the trader himself, but you cannot bake a pizza and expect to have economies of scale in futures trading.

One of the main problems for the lawyers that sold their practices and started to trade was the lack of proper trading capital. If there is not enough capital on hand then average years will wipe you out and you need to be able to wait for the good years with the hope that you avoid the worst years which can kill you. Everything is difficult.

Sometimes I stumble upon the case of someone who sold a business and started trading with too much capital. Having started with too much capital in the beginning when he was still learning how to trade led to huge losses which, once he had learned the craft and become successful, took years to recover. This in stark contrast to our lawyer friends.

The lesson is patience in trading is the same as in business. Just consider the time it takes to build a company, to launch a new product, to acquire a large and loyal clientele, to build brand recognition. Business takes time and so does trading. There are no shortcuts.

And as in many other businesses here the intelligence of the trader is to distinguish between what is a good year from a bad one. Many beginning traders stop trading because they are upset by poor performances that are in reality good performances. The problem is that they have little capital and their results are by consequence poor in absolute terms. Many beginning traders start trading during the worst years and they do not realise that they simply have to trod ahead and slug it out. Other beginners start trading during good years and they do not understand that this is about the biggest piece of luck one can have in a lifetime. In these cases they need to take the money and run, open a restaurant and leave trading forever.

There is a trader in Italy who did just that: during the bubble of 2000 he made a fortune, understood that he was mister nobody, and opened a pizzeria in Milan. A pizzeria that, by the way, makes a very tasty pizza. Congratulations to him: he is the best trader around, and pizza baker as well. ■

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